**WORLD TRADE ORGANIZATION**

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# UNITED STATES – SUBSIDIES ON UPLAND COTTON

## *Report of the Panel*

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| *Chile – Price Band System* | Appellate Body Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002 |
| *EC – Bananas III* | Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591 |
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| *US – Corrosion-Resistant Steel Sunset Review* | Appellate Body Report, *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan*, WT/DS244/AB/R, adopted 9 January 2004 |
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| *US – Superfund* | GATT Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances*, adopted 17 June 1987, BISD 34S/136 |
| *US – Wool Shirts and Blouses* | Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323 |

## TABLE OF ABBREVIATIONS USED IN THIS REPORT

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|---|---|
| FACT Act of 1990 | Food, Agriculture, Conservation, and Trade Act of 1990 |
| FAIR Act of 1996 or 1996 Farm Act | Federal Agriculture Improvement and Reform Act of 1996 |
| ARP Act of 2000 | Agricultural Risk Protection Act of 2000 |
| FSRI Act of 2002 or 2002 Farm Act | Farm Security and Rural Investment Act of 2002 |
| AMS | Aggregate Measurement of Support |
| AWP | adjusted world price |
| CCC | U.S. Commodity Credit Corporation |
| CCP or CCP payment | counter-cyclical payment |
| CFR | Code of Federal Regulations |
| CIF | cost, insurance, and freight |
| DP or DP payment | Direct payment under the FSRI Act of 2002, Title I, Subtitle A |
| DSB | Dispute Settlement Body |
| EC | European Communities |
| ERS | Economic Research Service of the USDA |
| ETI Act of 2000 | FSC Repeal and Extraterritorial Income Act of 2000 |
| EU | European Union |
| FAPRI | Food and Agricultural Policy Research Institute |
| FCIC | Federal Crop Insurance Corporation |
| FSA | USA Farm Services Agency |
| FSC | Foreign Sales Corporation |
| FY | fiscal year |
| GSM 102 | General Sales Manager 102 |
| GSM 103 | General Sales Manager 103 |
| ICAC | International Cotton Advisory Committee |
| IMF | International Monetary Fund |
| LDP | loan deficiency payment |
| MLG | marketing loan gain |
| MT | metric ton (equals 2204 pounds) |
| MY | marketing year |
| NCC | National Cotton Council of America |
| OECD | Organisation for Economic Co-operation and Development |
| PFC payment | production flexibility contract payment |
| RMA | USDA Risk Management Agency |

| | |
|---|---|
| SCGP | Supplier Credit Guarantee Program |
| U.S.C. | United States Code |
| USDA | United States Department of Agriculture |

# I. INTRODUCTION

1.1 On 27 September 2002, the Government of Brazil requested consultations with the Government of the United States pursuant to Articles 4.1, 7.1 and 30 of the *Agreement on Subsidies and Countervailing Measures* ("*SCM Agreement*"), Article 19 of the *Agreement on Agriculture*, Article XXII of the *GATT 1994* and Article 4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("*DSU*") concerning certain subsidies provided to United States producers, users and exporters of upland cotton[2] as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies. The United States and Brazil held consultations on 3, 4 and 19 December 2002 and on 17 January 2003, but failed to settle the dispute.

1.2 On 6 February 2003, Brazil requested the establishment of a panel[3] pursuant to Article 6 of the *DSU*, Article XXIII:2 of the *GATT 1994*, Article 19 of the *Agreement on Agriculture* and Articles 4.4, 7.4 and 30 of the *SCM Agreement*. At its meeting on 18 March 2003, the Dispute Settlement Body (the "DSB") established a Panel in accordance with Article 6 of the *DSU* to examine the matter referred to the DSB by Brazil in document WT/DS267/7.[4] At that meeting, the parties to the dispute also agreed that the Panel should have standard terms of reference. The terms of reference are, therefore, the following:

> "To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

1.3 In its request for establishment of a panel, Brazil requested that the DSB initiate the procedures provided in Annex V of the *SCM Agreement* pursuant to paragraph 2 of that Annex. At its meetings on 18 and 31 March, 15 April and 19 May 2003, the DSB discussed this request.[5]

1.4 On 9 May 2003 [6], Brazil requested the Director-General to determine the composition of the Panel, pursuant to paragraph 7 of Article 8 of the *DSU*. This paragraph provides:

> "If there is no agreement on the panelists within 20 days after the date of the establishment of a Panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairman receives such a request".

1.5 On 19 May 2003, the Director-General accordingly composed the Panel as follows:

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[2] Footnote 1 of the request for consultations (WT/DS267/1, G/L/571, G/SCM/D49/1, G/AG/GEN/54), which directly follows the phrase "The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton" reads "[e]xcept with respect to export credit guarantee programs as explained below [in that same document]."

[3] WT/DS267/7.

[4] WT/DS267/15.

[5] See the minutes of those meetings in documents WT/DSB/M/145, item 2(a), M/146, item 1(a), M/147, item 6(a) and M/150, item 5(a).

[6] 52 days after the establishment of the Panel (i.e. 18 March).

Chairman: Mr. Dariusz Rosati

Members: Mr. Mario Matus
Mr. Daniel Moulis

1.6 Argentina, Australia, Benin, Canada, Chad, China, the European Communities, India, New Zealand, Pakistan, Paraguay, Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu (hereafter referred to as "Chinese Taipei") and Venezuela reserved their rights to participate in the Panel proceedings as third parties.

1.7 The Panel met with the parties on 22-24 July 2003, at a resumed session of the first substantive meeting on 7-9 October 2003 and at a second substantive meeting on 2, 3 December 2003. It met with the third parties on 24 July 2003 and 8 October 2003.[7]

1.8 The Panel submitted its interim report to the parties on 26 April 2004. The Panel submitted its final report to the parties on 18 June 2004.

## II. FACTUAL ASPECTS

2.1 This dispute concerns various United States domestic support measures and other United States measures which Brazil alleges are export subsidies. Brazil alleges that the measures are inconsistent with certain United States obligations under the *Agreement on Agriculture*, the *SCM Agreement* and the *GATT 1994*.

2.2 The measures as identified in Brazil's request for the establishment of a panel are alleged prohibited and actionable subsidies provided to United States producers, users and/or exporters of upland cotton[8], as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies (including export credit guarantees), grants, and any other assistance to United States producers, users and exporters of upland cotton. They include measures referred to as marketing loan programme payments (including marketing loan gains and loan deficiency payments (LDPs)), user marketing (step 2) payments, production flexibility contract payments, market loss assistance payments, direct payments, counter-cyclical payments, crop insurance payments, cottonseed payments and export credit guarantee programmes, which are described below.[9]

## III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

### A. BRAZIL

3.1 Brazil requests that the Panel make the following findings:

(i) concerning Article 13 of the *Agreement on Agriculture*:

- Article 13 of the *Agreement on Agriculture* is in the nature of an affirmative defence;

- Article 13(b)(ii) of the *Agreement on Agriculture* does not exempt US domestic support measures, including marketing loan/LDP payments, crop insurance payments, production flexibility contract payments, direct

[7] See, *infra*, Section VII:A of this report for procedural aspects of the Panel proceedings.

[8] Brazil's request for establishment of a panel contains the following footnote: "The term 'upland cotton' means raw upland cotton as well as the primary processed forms of such cotton including upland cotton lint and cottonseed. The focus of Brazil's claims relate to upland cotton with the exception of the US export credit guarantee programs as explained below [in that same document]."

[9] Description of these measures can be found in Section VII:C of the report.

payments, market loss assistance payments, counter-cyclical payments, cottonseed payments, and Step 2 payments made in MY 1999-2002 to upland cotton from actions based on Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994*;

- Article 13(c)(ii) of the *Agreement on Agriculture* does not exempt Step 2 "export" payments, GSM 102, GSM 103 and SCGP export credit guarantees and ETI Act subsidies from actions based on Article 3 of the *SCM Agreement* and Article XVI of the *GATT 1994*;

(ii) concerning Step 2 "export" payments:

- Section 1207(a) of the FSRI Act of 2002 mandates Step 2 export payments in violation of Articles 3.3 and 8 of the *Agreement on Agriculture*;

- Section 1207(a) of the FSRI Act of 2002 mandates Step 2 export payments in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*;

(iii) concerning export credit guarantee programmes:

- GSM 102, GSM 103 and SCGP constitute export subsidies within the meaning of the *Agreement on Agriculture* that violate Article 10.1 of the *Agreement on Agriculture* by circumventing and threatening to circumvent the US export subsidy commitments. The three programmes, therefore, also violate Article 8 of the *Agreement on Agriculture*;

- GSM 102, GSM 103 and SCGP are prohibited export subsidies within the meaning of item (j) of the Illustrative List of Export Subsidies, and within the meaning of Articles 3.1(a) and 3.2 of the *SCM Agreement*;

(iv) concerning the FSC Repeal and Extraterritorial Income Act of 2000 ("ETI Act"):

- the ETI Act is inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture*;

- the ETI Act is inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*;

(v) concerning Step 2 "domestic" payments:

- Section 1207(a) of the FSRI Act of 2002 mandates the payment of Step 2 "domestic" payments in violation of Articles 3.1(b) and 3.2 of the *SCM Agreement*;

- Section 1207(a) of the FSRI Act of 2002 mandates the payment of Step 2 "domestic" payments in violation of Article III:4 of the *GATT 1994*;

(vi) concerning present serious prejudice to the interests of Brazil:

- the US subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by suppressing upland cotton prices in the US, world and Brazilian markets for upland cotton in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*;

- the US subsidies provided during MY 1999-2001 caused and continue to cause serious prejudice to the interests of Brazil by increasing the US share of the upland cotton world market in violation of Articles 5(c) and 6.3(d) of the *SCM Agreement*;

- the US subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by resulting in the United States having a more than equitable share of world exports of upland cotton in violation of Articles XVI:1 and XVI:3 of the *GATT 1994*;

(vii) concerning threat of serious prejudice to the interests of Brazil:

- the US subsidies mandated to be provided in MY 2003-2007 threaten to cause serious prejudice to the interests of Brazil by suppressing upland cotton prices to an extent that is significant in the US, world and Brazilian markets in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*;

- the US subsidies mandated to be provided during MY 2002-2007 threaten to cause serious prejudice to the interests of Brazil by increasing the US share of the upland cotton world market in violation of Article 5(c) and 6.3(d) of the *SCM Agreement*;

- the US subsidies mandated to be provided during MY 2003-2007 to cause serious prejudice to the interests of Brazil by resulting in the United States having a more than equitable share of world exports of upland cotton in violation of Articles XVI:1 and 3 of the *GATT 1994*;

(viii) concerning selected provisions of the FSRI Act of 2002 and the ARP Act of 2000:

- the following sections of the FSRI Act of 2002 and the referenced regulations thereto violate, *as such*, Articles 5(c), 6.3(c), 6.3(d) of the *SCM Agreement* and Articles XVI: 1 and 3 of the *GATT 1994* to the extent that they relate to upland cotton:

- direct payments: section 1103(a)-(d)(1) and 7 CFR 1412.502;

- counter-cyclical payments: sections 1104(a)-(f)(1), and 7 CFR 1412.503;

- marketing loan payments: sections 1201(a)-(b), 1202(a)(6), 1202(b)(6), 1204(b), 1205(a)(1), 1205(b), 1205(c)(1), 1608, and 7 USC. 7286 (Section 166 of the FAIR Act of 1996 as amended), and 7 CFR 1427.22;

- Step 2 Payments: section 1207(a), and 7 CFR 1427.105(a), 7 CFR 1427.107, and 7 CFR 1427.108(d); and

- crop insurance payments: ARP Act of 2000: sections 508(a)(8), 508(b)(1), 508(b)(2)(A)(ii), 508(b)(3), 508(c)(1)(A), 508(e), 508(k) and 516.

3.2 Brazil requests that the Panel make the following recommendations in light of the above findings:

- recommend to the United States, pursuant to Article 4.7 of the *SCM Agreement*, to withdraw Step 2 "export" payments, GSM 102, GSM 103 and

SCGP export credit guarantees, and subsidies under the ETI Act without delay;

- recommend to the United States, pursuant to Article 4.7 of the *SCM Agreement*, that it withdraw Step 2 "domestic" payments without delay;

- recommend to the United States, pursuant to Article 19.1 of the *DSU*, that it bring the measures found by the Panel to be inconsistent with the *Agreement on Agriculture* or the *GATT 1994* into conformity with the *Agreement on Agriculture* and the *GATT 1994*;

- recommend to the United States pursuant to Article 7.8 of the *SCM Agreement* to remove the adverse effects caused to the interest of Brazil by virtue of the serious prejudice to the interests of Brazil or to withdraw the subsidies;

- recommend to the United States pursuant to Article 7.8 of the *SCM Agreement* to withdraw the subsidies threatening to cause serious prejudice to the interests of Brazil or remove the threat of serious prejudice to the interests of Brazil; and

- recommend to the United States pursuant to Article 19.1 of the *DSU* that it bring its measures providing subsidies to producers, users and exporters of upland cotton in conformity with Articles XVI:1 and 3 of the *GATT 1994*.

3.3 Brazil further asks the Panel to reject all of the United States' requests for preliminary rulings.

B. UNITED STATES

3.4 The United States requests that the Panel make the following preliminary rulings:

- export credit guarantee measures relating to eligible US agricultural commodities other than upland cotton were not the subject of consultations and are therefore not within the Panel's terms of reference;

- Brazil failed to provide a statement of available evidence with respect to export credit guarantees for commodities other than upland cotton as required by Articles 4.2 and 7.2 of the *SCM Agreement*;

- production flexibility contract payments and market loss assistance payments had terminated prior to Brazil's request for consultations and panel establishment, and are therefore not within the Panel's terms of reference;

- measures under the Agricultural Assistance Act of 2003, including cottonseed payments under that Act, did not exist at the time of Brazil's Panel request, and are therefore not within the Panel's terms of reference;

- cottonseed payments made for the 1999 and 2000 crops were not identified in Brazil's consultation or panel request, and are therefore not within the Panel's terms of reference; and

- Brazil's challenge to storage payments and interest subsidy were not included in Brazil's consultation or panel request, and are therefore not within the Panel's terms of reference.

3.5 The United States submits that:

- Article 13 of the *Agreement on Agriculture* (the "Peace Clause") is part of the balance of rights and obligations of Members and is not an affirmative defence;

- pursuant to Article 13(a)(ii) of the *Agreement on Agriculture*, direct payments under the FSRI Act of 2002 and expired production flexibility contract payments under the 1996 FAIR Act (to the extent within the Panel's terms of reference) "conform fully to the provisions of Annex 2 to [the Agriculture] Agreement" and are "exempt from actions based on Article XVI of the *GATT 1994* and Part III of the Subsidies Agreement";

- pursuant to Article 13(b)(ii) of the *Agreement on Agriculture*, US domestic support measures that conform fully to the provisions of Article 6 of the *Agreement on Agriculture*, including the marketing loan programme (including marketing loan gains and loan deficiency payments), user marketing (step 2) payments, direct payments, counter-cyclical payments, and crop insurance payments, for marketing year 2002, as well as payments made during each of marketing years 1999-2001, "do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" and are "exempt from actions based on paragraph 1 of Article XVI of GATT 1994 and Articles 5 and 6 of the Subsidies Agreement";

- Brazil may not bring or maintain any action against such measures "based on" the provisions specified in the respective Peace Clause provisions;

- Section 1207(a) of the FSRI Act of 2002 does not mandate Step 2 payments that are inconsistent with Articles 3.3 and 8 of the *Agreement on Agriculture*, Articles 3.1(a), 3.1(b), and 3.2 of the *SCM Agreement*, and Article III:4 of the *GATT 1994*;

- US export credit guarantee programmes (GSM 102, GSM 103 and SCGP) for upland cotton and the export credit guarantee programmes for all eligible agricultural commodities (to the extent within the Panel's terms of reference), are not export subsidies within the meaning of the *Agreement on Agriculture*, are not inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture*, and are not a prohibited export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies or within the meaning of Articles 3.1(a) and 3.2 of the *SCM Agreement*; and

- Brazil has failed to make a prima facie case that the ETI Act is inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.

3.6 The United States submits that, in the event the Panel were to find that Brazil has demonstrated that the US measures do not satisfy the conditions of Article 13 of the *Agreement on Agriculture*:

- crop insurance payments are not specific within the meaning of Article 2 of the *SCM Agreement* and are not subject to the provisions of Part III of the *SCM Agreement*;

- US direct payments, expired production flexibility contract payments, counter-cyclical payments, and expired market loss assistance payments are no more than minimally trade- or production-distorting and Brazil's claims under Articles 5(c) and 6.3 of the *SCM Agreement* and Article XVI of the *GATT 1994* fail; and

- with respect to measures properly within the Panel's terms of reference, those measures are fully consistent with the United States' WTO obligations.

## IV. ARGUMENTS OF THE PARTIES

4.1 The arguments of the parties as submitted, or as summarized in their executive summaries as submitted to the Panel, are attached as Annexes (see Table of Annexes, page ix *ff*).

4.2 The parties' answers to questions from the Panel, their comments on each other's answers, and other documents submitted at the request of each other are also attached as Annexes.

## V. ARGUMENTS OF THE THIRD PARTIES

5.1 The arguments of those third parties which have made submissions to the Panel are attached to this Report as Annexes. Third parties' responses to the Panel's questions are also attached as Annexes.

## VI. INTERIM REVIEW

6.1 On 26 April 2004, the Panel submitted its interim report to the parties. On 17 May 2004, Brazil and the United States submitted written requests for review of precise aspects of the interim report. On 3 June 2004, Brazil and the United States submitted written comments on each other's request for interim review.

6.2 The Panel has modified aspects of its findings in light of the parties' comments where it considered appropriate, as explained below.[10] Moreover, the Panel has made certain technical corrections and revisions as well as other modifications, as described in paragraph 6.59 below.

### A. CONFIDENTIALITY OF THE PANEL'S INTERIM REPORT

6.3 The **United States** requests that the Panel note in its final report that Brazil had breached the obligation of confidentiality of the Panel's interim report and to note any information that the Panel obtained with respect to those breaches.

6.4 **Brazil** replies that it "regrets the unfounded U.S. accusation that it has breached the confidentiality of the Panel's Interim Report" and provides certain details to support its view that certain press reports which ostensibly attributed content to, for example, "Brazilian diplomats" "speaking on condition of anonymity" could not have and, in fact, had not, obtained information from any Brazilian source. Brazil states that the ostensible sources cited in such press reports could just as easily have been United States officials or other persons not connected with Brazil.

6.5 The **Panel** notes that, when we transmitted our interim report to the parties, we clearly indicated that it was confidential. Indeed, pursuant to Article 18.2 of the *DSU*, all panel proceedings remain confidential until the Panel Report is circulated to WTO Members. Over and above the binding treaty obligation of confidentiality in the *DSU*, the confidentiality of our Panel proceedings

[10] Unless otherwise indicated, references to paragraph numbers and footnote numbers in this Section are those shown in the final report.

was reflected in our working procedures adopted pursuant to Article 12.1 of the *DSU*. Therefore, we are profoundly concerned to observe that the confidentiality has not been respected and that aspects of the Panel's interim report were disclosed, as evidenced in various press reports brought to our attention by the parties. We consider this lack of respect for confidentiality unacceptable.

B. SECTION VII:B - PRELIMINARY RULINGS

6.6 The **United States** requests review of paragraph 7.61 because, in its view, the mere fact that Brazil submitted written questions during consultations does not show that certain measures were the subject of actual consultations; and paragraph 7.179 because storage and interest may be waived in some instances but not all and because these waivers are not unique among covered commodities to upland cotton.

6.7 **Brazil** asks the Panel to reject both the United States' requests. With respect to paragraph 7.61 in its view, the fact that questions were posed proves that consultations were held, despite the fact that the United States refused to answer them. Otherwise, a Member could block dispute settlement procedures simply by refusing to engage during the consultation process. Paragraph 7.179 does not indicate that these waivers are unique, among covered commodities, to upland cotton.

6.8 The **Panel** declines to modify paragraph 7.61 in view of the considerations set out in paragraph 7.67. The Panel considered that paragraph 7.179 of the interim report was consistent with the United States' concerns on interim review but has modified it in the final report for the avoidance of doubt.

C. SECTION VII:C - PRELIMINARY ISSUES

6.9 The **United States** requests review of paragraph 7.202 to reflect the fact that some CCC programmes are not administered by the FSA; paragraph 7.209 so as not to imply that user marketing (Step 2) payments were made in 1990; footnote 294 to paragraph 7.213 so as not to suggest that the FACT Act of 1990 set a target price of "72.9 cents per pound"; paragraphs 7.215 and 7.222 so as to clarify further that planting flexibility limitations and exceptions only applied to acreage corresponding in amount to base acres; paragraph 7.216 to note the timing of the enactment of MLA payments each year; footnote 306 to paragraph 7.217 to add a reference to base acres and to alter the amount of MLA payments; paragraphs 7.218, 7.223 and 7.225 to clarify the definition of "producer"; paragraph 7.218 to clarify the coverage of peanuts; paragraph 7.225 to avoid mixing disparate rates calculated according to current and historical production; footnote 456 to paragraph 7.334 and paragraph 7.336 in relation to the mandatory/discretionary distinction; to strike a footnote to paragraph 7.227 which discussed the meaning of "exempt from actions" in relation to non-violation nullification and impairment claims, because it was unnecessary for the purposes of this dispute; paragraph 7.349 for clarity; and to make certain other technical revisions.

6.10 **Brazil** agrees with the United States' requests with respect to paragraph 7.202; footnote 306 to paragraph 7.217 to add a reference to base acres; and paragraph 7.218 and footnote 310 relating to peanuts. Brazil does not object to the United States' request with respect to former footnote 394 to paragraph 7.277 and paragraph 7.349. Brazil agrees that amendments could be made but suggests alternative language in paragraphs 7.209, 7.215, former footnote 303 to paragraph 7.219 (including cross-references to the factual findings in the Attachment to Section VII:D) and paragraph 7.225. Brazil asks the Panel to reject the United States' requests with respect to footnote 294 to paragraph 7.213 as it is factually correct; paragraph 7.216 as the change is unnecessary but, if it is amended, Brazil suggests alternative language that the timing of enactment of MLA payments did not diminish their impact on supporting production of upland cotton; footnote 306 to paragraph 7.217 because the amounts are correct; paragraphs 7.218 and 7.223 with respect to the definition of "producer" as that is the term used in the legislation and is already explained in the interim report but

Brazil also suggests alternative language in paragraph 7.218; paragraph 7.222 as, in its view, the amendment would only complicate the sentence without adding clarity; and paragraph 7.225, fifth sentence because CCP payments should not be seen in isolation and the loan rate is qualified by the words "where applicable".

6.11 The **Panel** takes note of the parties' comments and has modified paragraphs 7.202, 7.209, 7.215 (and added a footnote), 7.222, 7.225; modified footnote 294 to paragraph 7.213 for clarity; modified paragraphs 7.212 (and added a footnote), 7.213 (and modified a footnote), 7.218 (and modified one footnote and added another), 7.219 (deleted a footnote), 7.223 (and added a footnote) and 7.224 to clarify the meaning of "producer" by quoting the applicable definitions and then using the defined term, which is the approach followed in the relevant legislation, and to cross-reference the factual findings in the Attachment to Section VII:D; and modified paragraph 7.217 and footnote 306 to clarify and correct the MLA payment amounts. The Panel has deleted former footnote 394 from paragraph 7.277, having satisfied itself that nothing in Article 13(b)(iii) of the *Agreement on Agriculture* is inconsistent with its findings in that paragraph. The Panel takes note of the parties' comments and declines to modify paragraph 7.216 as it is sufficiently detailed. The Panel further takes note of the parties' comments on footnote 456 to paragraph 7.334 and paragraph 7.336 in relation to the mandatory/discretionary distinction. The Panel declines to modify footnote 456 as it is logically accurate, and has made certain modifications to paragraphs 7.335 and 7.336, including inserting footnotes for greater clarity. The Panel has also deleted a footnote from paragraph 7.211 and made certain other technical revisions as suggested by the parties, including footnote 453 to paragraph 7.331.

## D. SECTION VII:D - DOMESTIC SUPPORT MEASURES AND ARTICLE 13 OF THE *AGREEMENT ON AGRICULTURE*

### 1. General

6.12 **Brazil** requests review of footnote 469 to paragraph 7.345 to correct the date on which it submitted that the peace clause expired; paragraph 7.450 to correct a reference to the target price in the first line; paragraphs 7.453-7.456 for consistency with the inclusion of crop insurance payments in the peace clause tabulation; paragraphs 7.561-7.567 to cross-reference the calculation of CCP payments; paragraph 7.566 to clarify that the producers in question are upland cotton producers; and paragraph 7.594 for clarity. It also suggests technical revisions to paragraphs 7.640 and footnote 595.

6.13 In response, the **United States** agrees that paragraph 7.450 should be corrected but suggests an alternative term. The United States does not agree to refer in paragraph 7.566 to "'upland cotton' producers" because the evidence cited does not necessarily mean that any policy holders is a producer, and it suggests alternative language.

6.14 The **United States** requests review of paragraph 7.386 for consistency; paragraph 7.387 to be deleted since it is not necessary to resolve the matter before the Panel; paragraph 7.403 to reflect additional arguments presented by the United States; footnote 579 to paragraph 7.437 because the meaning of "crop year" or "crop" could vary depending on the context; paragraph 7.446 with regard to the role of the OBRA Act of 1990; paragraph 7.488 with respect to the relevance of the quotation; paragraph 7.517 to distinguish between types of covered losses and separate plans of insurance; paragraph 7.562 with respect to the authorizing statutes for MLA payments and the term "successor" programmes; paragraph 7.574 and footnote 740 to reflect Brazil's explanation of its 14/16ths methodology and for clarity; footnote 748 to paragraph 7.577 to correspond to the contents of the Attachment; paragraph 7.600 to treat A.R.P. and flex acres in the same way; and paragraphs 7.602 and 7.603 to reflect the way in which CCP payments are calculated; and certain technical revisions.

6.15 In response, **Brazil** agrees to the United States' requested amendment of paragraph 7.562 with respect to the authorizing statutes for MLA payments. Brazil does not object to the clarification of

former paragraph 7.490 or to the deletion of the footnote to Brazil's Annex IV methodologies, but suggests that the Panel make additional findings on those methodologies, including that Brazil's use of them was appropriate. Brazil agrees that amendments could be made but suggests alternative language in paragraphs 7.386, 7.446 and 7.513. Brazil strongly disagrees with the deletion of paragraph 7.387 as it may be of relevance on appeal. Brazil asks the Panel to reject the following United States' requests: with respect to paragraph 7.403 as the additional arguments contradict a USDA statement submitted by Brazil referred to in the preceding paragraph and because the lack of base updates during the term of the FSRI Act of 2002 is already mentioned; with respect to the footnote to paragraph 7.437 because the United States did not dispute that the upland cotton crop year and upland cotton marketing year are identical in response to a question from the Panel and both parties had used these terms interchangeably in submissions; with respect to paragraph 7.517 because the Panel's description is factually correct and the United States has not proved its assertion that these coverage for the relevant types of losses were ever offered to other crops; paragraph 7.562 because these programmes are "successors" in the ordinary sense of that word; and paragraph 7.574 because the reasoning for Brazil's 14/16ths methodology in its response to Panel Question No. 60 is narrowly limited. Brazil stated that it developed that methodology as a proxy amount and made the reasonable assumption that each acre of upland cotton planted would receive support equivalent to the support that an upland cotton base acre would receive since the United States had "misrepresented" the fact that it did not have data on the amount of contract payments made to current producers of upland cotton; footnote 740 to paragraph 7.574 because it is necessary to understand the relationship of the 14/16ths ratio to payments; paragraph 7.602 because deficiency payments were also calculated in respect of base acreage; paragraph 7.603 because, on the facts, it is accurate to state that upland cotton producers receive CCP payments and unnecessary to make the change requested by the United States. Brazil asks the Panel to reject the United States' request with respect to the A.R.P. in paragraph 7.600 but proposes a different amendment to reflect programme non-participation rates in order to show that the percentage of upland cotton acreage ineligible for support from the marketing loan programme was 11.8 per cent, which is much higher than the 7.5 per cent found by the Panel.

6.16 The **Panel** takes note of the parties' comments and has made modifications to footnote 469 to paragraph 7.345, as suggested by Brazil, to correct the date on which it submitted that the peace clause expired (i.e. 31 December 2003); paragraph 7.349; paragraphs 7.386, 7.403 (and added a footnote), footnote 579 to paragraph 7.437, paragraph 7.446, paragraph 7.450 consistently with the language of preceding paragraphs; paragraphs 7.453 (and modified, deleted and added footnotes), 7.456, 7.490 (former paragraph), 7.504, 7.513 (and added a footnote), 7.516, 7.561, 7.562, 7.574 (and added additional footnotes) and footnote 740; paragraph 7.579 by moving footnote 748 to the correct position; paragraph 7.584; paragraph 7.602, although the Panel declines to state that deficiency payments were calculated in respect of current production because they were also calculated in respect of base acreage; and paragraph 7.603 for greater clarity although the Panel uses the term "producer" which appears in the legislation and description of measures. The Panel has also amended paragraphs 7.593 and 7.594 to clarify the separate issues dealt with in each and to remove unnecessary references to "marketing" years. The Panel has also made certain technical revisions, as suggested by the parties, including revision to paragraph 7.380, footnote 508 to paragraph 7.384, footnote 522 to paragraph 7.395, footnote 595 to paragraph 7.447, footnote 664 to paragraph 7.512 and paragraph 7.642, as well as editing the terminology in paragraphs 7.385 to 7.387 and 7.413 for consistency and adding a footnote to paragraph 7.518 and editing footnote 515 to paragraph 7.386, paragraphs 7.399, 7.481, 7.498 and 7.559(ix), footnote 727 to paragraph 7.565 and paragraph 7.570 for clarity and accuracy. The Panel takes note of the parties' comments and declines to modify paragraph 7.387 since it refers to an argument raised by a third party and silence could be misconstrued as implying a view on that argument; paragraph 7.600 as requested by the United States for the reasons already given in footnote 779, eighth sentence, and paragraph 7.600 as requested by Brazil because, in order to be consistent with the United States' approach, decisions by producers on participation should not be taken into account and also because Brazil's proposed amendment is not strictly limited to responding to the United States' request for review as required by paragraph 16 of the Panel's Working Procedures.

## 2. Section VII:D.5(g) - Brazil's requests that the Panel draw adverse inferences

6.17 The **United States** requests that the Panel review paragraph 7.621 because the FSA does not track total expenditures on a farm-specific basis with respect to planted acres for payments calculated with respect to base acres; and paragraph 7.631(ii) because "the United States preliminarily advised Brazil and the Panel at the second meeting that the release of planted acreage information is confidential information that cannot be released under U.S. domestic law" and Brazil did not suggest substitute farm numbers in Exhibit BRA-369.

6.18 **Brazil** strongly opposes the United States' requests with respect to paragraphs 7.621 and 7.631(ii) as the Panel's analysis accurately reflects the United States' conduct in this dispute and its description reflects the actual sequence of events. Brazil agrees only that the reference to Exhibit BRA-369 should be deleted.

6.19 The **Panel** takes note of the parties' comments and has modified paragraph 7.621 for accuracy to state that the FSA tracks both total expenditures and planting information on a farm-specific basis. The Panel has modified paragraph 7.631(ii) (and modified and added additional footnotes) to remove the statement that substitute farm identifiers had been suggested by Brazil prior to the second substantive meeting and to set out the facts surrounding Brazil's approach to the format of data at the second substantive meeting, which the United States alleged was responsible for its later inability to provide the requested data.

## 3. Factual findings

6.20 The **United States** requests that the Panel delete its factual findings in paragraphs 7.583, the final sentence of paragraph 7.600 and paragraphs 7.634-7.647 because these findings are not necessary to resolve the matter before the Panel.

6.21 **Brazil** strongly disagrees with the United States' requests. In Brazil's view, these factual findings are important, or may be important. The United States has already indicated that it would appeal the Panel's report. In the event that the Appellate Body should modify the Panel's interpretation, these factual findings may be highly relevant for the Appellate Body to "complete the analysis". If so, then these findings may significantly assist the parties in resolving their dispute. Without them, the Appellate Body might be prevented from completing the analysis, which is immensely frustrating for complaining parties who have gone to great expense to develop the evidence necessary to establish their claims.

6.22 The **Panel** takes note of the parties' comments and declines to delete these factual findings. The Panel's function is to assist the DSB in discharging its responsibilities under the *DSU* and covered agreements including, specifically, to make an objective assessment of the facts of the case.[11] The Panel makes the factual findings in this report in order to carry out that function. Certain of these factual findings, notably in the Attachment to Section VII:D, provide support for findings in Section VII:G. The Panel has added a sentence to that effect in paragraph 7.6314. Certain other factual findings are not necessary to resolve the matter according to the Panel's legal interpretations, but we observe that the aim of the WTO dispute settlement system is to secure a positive solution *to a dispute*.[12] In this dispute, the Panel is the sole tribunal of fact[13] and these additional factual findings may ultimately be essential in order to secure a positive solution to it. In this regard, we note that the United States indicates in its request for review that it intends to appeal the Panel's final report.[14]

[11] Article 11 of the *DSU*.
[12] Article 3.7 of the *DSU*.
[13] Article 17.6 of the *DSU*.
[14] United States' request for interim review, paragraph 2.

## E. SECTION VII:E - EXPORT SUBSIDIES

### 1. Overview of parties' export subsidy claims and arguments under the *Agreement on Agriculture*, the *SCM Agreement* and the *GATT 1994*

6.23 The **Panel** has made the technical clarification suggested by Brazil in paragraph 7.651(iii).

### 2. Relationship between the export subsidy provisions of the *Agreement on Agriculture* and the *SCM Agreement* and the *GATT 1994*

6.24 The **United States** requests that the Panel modify paragraph 7.657 to clarify that Article 21.1 of the *Agreement on Agriculture* is not limited in its application only in the event of a conflict. **Brazil** opposes this request, asserting that the rights and obligations arising from Annex 1A apply cumulatively, unless there is a conflict. **The Panel** has modified paragraph 7.657 in light of the parties' comments, noting that the last sentence commences with the proposition "[i]n the event of a conflict...".

### 3. Section 1207(a) of the FSRI Act of 2002: user marketing (Step 2) payments to exporters

6.25 In connection with our treatment of the parties' comments on the mandatory/discretionary distinction, outlined above in paragraph 6.11, we have modified paragraphs 7.742, 7.746 and 7.747.

6.26 The Panel has made the technical corrections identified by the United States in footnotes 894 and 912, and has supplemented footnote 895 in light of paragraph 6.45 *infra*.

### 4. Export credit guarantee programmes

(a) Brazil

6.27 **Brazil** submits that, in paragraph 7.842, we should place quotation marks around the term "subsidy" - in the sentence beginning "[a]ccording to the United States government, a positive net present value means that the United States government is extending a subsidy..." - to clarify that the term is not used there within the meaning of Article 1.1 of the *SCM Agreement*, but rather in the sense of the United States Federal Credit Reform Act of 1990. The latter defines the term "subsidy" with reference to cost and relates to cost to the United States government. The **United States** expresses no view on this request. Noting that the surrounding paragraph deals with the United States net present value methodology under the FCR Act, and that the sentence begins with the phrase "according to the United States government", the **Panel** has inserted quotation marks around the term "subsidy" in the sentence concerned in paragraph 7.842 and has also inserted a footnote.

6.28 **Brazil** requests that we incorporate our finding in paragraph 7.843 about the consistently positive numbers in the United States budget guaranteed loan subsidy line into Section VII:E.5(d)(i)iii.g. relating to the structure, design and operation of the programmes. The **United States** does not agree with this suggestion. The United States submits that this did not coincide with the analytical approach or conclusions of the Panel. According to the United States, such incorporation would "conflate the conceptual distinction" which the Panel made between past performance of the programmes and structure operation and design of the programmes. The **Panel** has inserted footnote 1052. This does not conflate the conceptual distinction we have drawn in our analysis. Our examination of the past performance of the programme and our findings relating to the structure, operation and design of the measure are mutually reinforcing. As we have already indicated (for example, in paragraphs 7.808 and 7.867), our findings on the United States export credit guarantee programmes are based upon the evidence as a whole.

6.29 **Brazil** requests that we insert, in footnote 1011, a reference to the percentage of rescheduled guarantees (1992-2003) that remain outstanding.[15] The **United States** submits that it would be inappropriate to include the percentage share Brazil proposes as it is derived from figures not constituting part of the discussion in the footnote and accompanying text. In light of the record evidence indicating that approximately $1.6 billion of defaulted guarantees have been re-scheduled 1992-2003 (Column F of Exhibit US-147), and that approximately $1.5 billion in principal on rescheduled debt remained outstanding as of 30 November 2003, while $205 million in principal may have been collected on reschedulings (Column F of Exhibit US-148) and some interest has been collected on reschedulings (Column M in Exhibits US-128 and US-147), the **Panel** does not believe that it is necessary to make the additional percentage finding requested by Brazil.

6.30 **Brazil** requests, in respect of paragraph 7.858 and footnote 1033, that we note that CCC authority to extend export credit guarantees is not limited by the budget appropriations process. The **United States** believes that Brazil's suggestion would distort otherwise fuller and more precise statements of the Panel. The **Panel** has included a reference to 2 USC 661c(c)(2) in footnote 1033.

6.31 **Brazil** requests the Panel to make certain additional "factual" findings regarding the parties' evidence and argumentation relating to Brazil's allegation that the CCC export credit guarantee programmes at issue constitute prohibited export subsidies under the elements of Articles 1 and 3.1(a) of the *SCM Agreement*. Brazil asserts that, in the event one of the parties appeals and the Appellate Body reverses the Panel's conclusion on item (j), it might not have the necessary facts at its disposal to "complete the analysis" with respect to Brazil's claims under Articles 1 and 3.1(a) of the *SCM Agreement*. In the **United States**' view, the Panel has already made findings on the claims cited by Brazil, in paragraphs 7.946-7.948. According to the United States, Brazil improperly requests us to make unnecessary and unsupported additional factual findings with respect to its *SCM Agreement* claims, and to reverse the applicable burden of proof. The United States asserts that Article 10.3 of the *Agreement on Agriculture* applies only in respect of claims of export subsidies in excess of applicable reduction commitment levels under the *Agreement on Agriculture*, and does not apply to export subsidy claims or factual findings under the *SCM Agreement*. The **Panel** declines to make the additional findings requested by Brazil. We are of the view that Brazil's allegation invoking the elements of Articles 1 and 3.1(a) of the *SCM Agreement* is not a separate claim, but merely another argument, on a different factual basis, as to how the United States export credit guarantee programmes would meet the definition of an export subsidy in Article 3.1(a) of the *SCM Agreement*. Given our finding in paragraphs 7.946-7.948, we do not believe that it is necessary to address Brazil's additional arguments about how the Article 3.1(a) definitional elements would be fulfilled on another factual basis in order to resolve this dispute. For greater clarity, we have inserted footnote 1125.

6.32 **Brazil** requests that, in paragraph 7.875 and footnote 1056, we make reference to Exhibit BRA-298, which contains a list of all agricultural products that are eligible for CCC export credit guarantees. The **United States** submits that we should reject Brazil's request, noting that Brazil's own description of Exhibit BRA-298 is that it identifies "all agricultural products that are *eligible* for CCC export credit guarantees", and that eligibility is not the relevant test under the Panel's approach. The **Panel** declines to make the addition requested by Brazil. Our finding in the paragraph concerned relate to exports of upland cotton and other unscheduled agricultural products *supported* under the programme, and not to all products eligible for such support. We recall that we have already referred to Exhibit BRA-298 in footnote 851, in describing the products subject to Brazil's claim. In the interests of comprehensiveness, we have, however, also inserted a reference to Exhibit BRA-299 in footnote 851.

6.33 **Brazil** requests that the Panel review its statement, in paragraph 7.880, relating to the time period of the United States' actual circumvention of export subsidy commitments for rice. The

[15] Brazil refers to its 18 February 2004 comments on United States 11 February 2004 responses, para. 38.

**United States**' view is that we should reject Brazil's request. According to the United States, Brazil prepared and presented the data in Exhibit BRA-300 solely as a comment in response to a Panel question which was oriented to the issue of "threaten[ing] to lead to circumvention". Having satisfied ourselves of the record, including the United States' statement in footnote 150 of its further rebuttal submission that "[t]he only commodity with respect to which the United States did not provide ['uncontroverted' evidence that the respective quantities of exports under the export credit guarantee programmes did not exceed the applicable quantitative reduction commitment] is rice", the **Panel** has made certain modifications to paragraph 7.880 and footnote 1060 in light of these comments. We also refer to paragraph 6.34 in respect of our treatment of "threatening to lead to circumvention" in respect of rice and to unscheduled products supported under the programmes.

6.34 In respect of paragraphs 7.882-7.896, **Brazil** requests that the Panel address Brazil's "separate claims" that the CCC export credit guarantee programmes, with respect to rice and to unscheduled agricultural products supported under the programmes, threaten to lead to circumvention of the United States export subsidy commitments. The **United States**' view is that we should reject this request. The **Panel** declines to make any additional findings in this respect. We have, however, inserted footnote 1061 for greater clarity.

6.35 We have also made the clarifications and/or modifications suggested by the parties in paragraphs 7.793, 7.821, 7.895, 7.896, 7.940 and 7.1305 and footnotes 1028, 1047, 1067, and have inserted footnote 1080.

(b) United States

6.36 In light of the **United States**' request, with which **Brazil** does not disagree, the **Panel** has made modifications in paragraph 7.803 to more accurately reflect the United States' argument and to clarify that even if an export credit guarantee programme for agricultural products meets the elements of item (j) it would not be a "prohibited" export subsidy under the *SCM Agreement* as long as agricultural export subsidies during the implementation period were within reduction commitments.

6.37 The **United States** requests that we clarify that our reference in paragraph 7.875 (and paragraph 8.1(d)(ii)) to Exhibit BRA-73 as relevant record evidence refers to those unscheduled products that are within the scope of the *Agreement on Agriculture* and our terms of reference. **Brazil** requests us to conclude that GSM 102, GSM 103 and SCGP also constitute prohibited export subsidies within the meaning of item (j) and Article 3.1(a) of the *SCM Agreement*, for all products not covered by the *Agreement on Agriculture*. Recalling that: interim review is not the time to raise new arguments; our terms of reference include export credit guarantees to facilitate the export of United States upland cotton and other eligible *agricultural* commodities as addressed in document WT/DS267/7 (see also *supra*, paras. 7.69 and 7.103); Article 2 and Annex I of the *Agreement on Agriculture* set out the product coverage of that agreement; the core distinction between "scheduled" and "unscheduled" products is rooted in the scheduled commitments under the *Agreement on Agriculture*; and the scope of the products within our terms of reference does not materially affect the programme-wide analytical approach that we have taken, and the evidence we have considered, under item (j), the **Panel** has made the clarifications requested by the United States. This would, of course, affect the cross-reference in paragraph 8.1(d)(ii).

F. SECTION VII:F - IMPORT SUBSTITUTION SUBSIDY

6.38 The **United States** suggests that the Panel should omit paragraphs 7.1046-7.1052 as the parties agree that Article 13 of the *Agreement on Agriculture* would not be applicable to the import substitution subsidies at issue and the Panel need not reach further issues concerning the relationship between Article 13 of the *Agreement on Agriculture* and Article 3.1(b) of the *SCM Agreement*. **Brazil** disagrees with the United States' request. According to Brazil, although both parties agreed that Article 13 of the *Agreement on Agriculture* does not exempt actions under Article 3.1(b) of the *SCM*

*Agreement*, Articles 13(b) and (c) of the *Agreement on Agriculture* may still provide context for interpreting Article 3.1(b) of the *SCM Agreement* and Article 6.3 of the *Agreement on Agriculture*. Brazil submits that the Panel correctly explains the relevance of the omission of any reference to Article 3 of the *SCM Agreement* in Article 13(b)(ii) and the importance of its inclusion in paragraph 13(c)(ii) of the *Agreement on Agriculture*. The **Panel** declines to make the deletion requested by the United States. As we have noted, we endorse the shared view of the parties that Article 13 of the *Agreement on Agriculture* does not affect a claim under Article 3.1(b) of the *SCM Agreement*. We believe that our examination of the terms of Articles 13(b) and (c) of the *Agreement on Agriculture* provide relevant context and support for our examination.

6.39 The **United States** requests that we delete footnote 1217 to paragraph 7.1074, as the examples therein are not necessary to resolve the dispute. **Brazil** disagrees with the United States' request. The **Panel** declines to make the deletion requested by the United States. We believe that the considerations in this footnote support our examination.

6.40 The **United States** requests that the Panel strike the second sentence of paragraph 7.1085 as it was not aware of any record evidence relating to the "ease of use" of domestic cotton. **Brazil** submits that the second sentence is not necessary for the Panel's conclusions in the first and third sentences of paragraph 7.1085, but it provides a useful comparison. According to Brazil, evidence suggesting that United States upland cotton is easier to use than imported cotton is reflected in the extremely low import figures for upland cotton into the United States as shown in Exhibit BRA-4, and by the fact that there are far smaller freight and delivery charges for United States mill owners to use United States upland cotton, and because domestic users are paid under the user marketing (Step 2) subsidy. The **Panel** points out that the sentence actually addresses the issue of ease of meeting the conditions of eligibility for the subsidy, as opposed to ease of use of domestic cotton. The rationale behind the sentence is that use of domestically produced cotton does not merely improve the chances of obtaining the subsidy. Rather, as we note in the following sentence, use of such cotton is a pre-condition for receipt of the payments. The Panel therefore declines to make any modification.

6.41 With reference to the United States requests relating to the mandatory/discretionary distinction, the Panel has made certain modifications to paragraphs 7.1089, 7.1094 and 7.1096. The Panel has also made requested modifications to the description of the United States' argument in paragraph 7.1024, as well as modifications, in light of the parties' comments, in paragraphs 7.1148 and 7.1150. We have also made requested technical revisions in footnote 1234.

## G. SECTION VII:G - ACTIONABLE SUBSIDIES: CLAIMS OF "PRESENT" SERIOUS PREJUDICE

### (a) Brazil

6.42 **Brazil** requests modifications in respect of footnote 1323 concerning the participation of certain experts as members of its delegation, and suggested that we insert a reference in paragraph 7.1248 to certain expert testimony and statements. The **Panel** has made modifications to footnotes 1323 and 1343, and has inserted footnote 1361 to paragraph 7.1245.

6.43 **Brazil** requests that we refer to Exhibit BRA-302 in support of figures we cite in paragraph 7.1283 relating to United States' share of world exports, and include the level in MY 2002. Brazil also requests that we include figures relating to United States' share of world exports in footnote 1534 or in paragraph 7.1283 so that, in the event of an appeal, the Appellate Body could draw a legal conclusion on the existence of a "consistent trend" within the meaning of Article 6.3(d) of the *SCM Agreement* and could complete the analysis, if necessary. The **United States**' view is that such a finding would appear to be irrelevant in light of the Panel's interpretation of "world market share" in Article 6.3(d), and that the data in Exhibit BRA-302 has been revised as evidenced in Exhibits US-119 and -120 and thus Brazil's requested findings overstate the United States' share of world exports. In light of the parties' comments, our role as the sole tribunal of fact and the fact that

these additional factual findings may ultimately be essential in order to secure a positive solution to this dispute, the **Panel** has modified paragraph 7.1283, including through the insertion of footnote referencing Exhibit BRA-302 and other relevant record evidence. The Panel has inserted cross-references in footnote 1534. The Panel has made further consequent modifications in its report.

6.44 **Brazil** requests that we add references to Exhibits BRA-224, -275 and -276 in footnote 1400 as further USDA studies addressing the effect of the marketing loan programme. The **United States** submits that we should reject Brazil's request. Recalling that the footnote concerned includes the term "e.g." and is therefore not intended to be exhaustive of relevant record evidence, the **Panel** declines to insert the additional references requested by Brazil in footnote 1400. However, the Panel has ensured that these studies are referred to in footnote 1329. The considerations set out in paragraph 7.1215 therefore apply.

6.45 **Brazil** requests that we include, either in the main body of the text or in a footnote, the total amount of user marketing (Step 2) payments to domestic users and exporters. The **Panel** has supplemented footnote 895 and cross-referenced this in footnote 1408.

6.46 **Brazil** requests that we refer to specific evidence in support of our finding in paragraph 7.1313. The **United States** indicates that this is not necessary as, in its view, the Panel has indicated the evidence that it considered in making this finding. The **Panel** has inserted footnote 1428.

6.47 **Brazil** requests the insertion of further cross-references in Section VII.G.3(k). The **United States** does not believe this would add any clarity to the Panel's analysis. In light of the existing cross-references in Section VII.G.3(k), for example in footnotes 1455 and 1458, the **Panel** does not believe it is necessary to insert the further cross-references to Section VII:G.3(j)(iii)ii and iii.

6.48 **Brazil** submits that it would be useful and appropriate for the Panel to make specific findings, in paragraph 7.1415, that it has relied on evidence produced by Benin and Chad. The **United States** does not agree with Brazil that the Panel should alter its detailed analysis and conclusions relating to "other Members". Recalling paragraphs 7.54 and footnote 1323, and underlining the constructive role the participation of experts have played in these proceedings, the **Panel** does not find it necessary to add such a specific reference in the paragraph concerned.

(b) United States

6.49 We have made modifications in paragraphs 7.1148 and 7.1150 in light of the requests of the **United States**, and comments by **Brazil**. The **United States** requests that we delete footnote 1276 and modify paragraph 7.1150 concerning the specificity of crop insurance subsidies, particularly in respect of our discussion of livestock. **Brazil** opposes this request for deletion. In light of the parties' comments, the **Panel** has modified paragraphs 7.1138, 7.1148 and 7.1152 and footnote 1276 for clarity and accuracy.

6.50 The **United States** requests certain modifications to the first sentence of paragraph 7.1168 concerning our characterization of the aim of a countervailing duty investigation. **Brazil** has no objection to these changes. The **Panel** has made the requested changes.

6.51 The **Panel** has declined to modify the description of the A-Index in paragraph 7.1264 as suggested by the **United States**, and opposed by **Brazil**, but the Panel has added to footnote 1374 for accuracy.

6.52 The **United States** requests that we delete footnote 1374. **Brazil** requests that the Panel retain the footnote. The **Panel** has retained the footnote. The Panel derives contextual guidance from the now-lapsed Article 6.1(a) of the *SCM Agreement*. The last sentence of the footnote refers to our

view that while a rate of subsidization may, where available, constitute relevant evidence in a given case, in the particular facts and circumstances of this case, it is not necessary to establish with any precision a rate of subsidization in order to resolve the dispute.

6.53 The **United States** requests clarifications in the third sentence of paragraph 7.1360 relating to the United States share in world production and exports. **Brazil** suggests that we reject the United States request and make a technical modification. In light of the parties' comments, the **Panel** has made certain modifications in the paragraph concerned.

6.54 The **United States** requests that we delete the term "evidentiary" in paragraph 7.1415. Although the United States generally agrees that third party submissions can help provide additional context and support in panel proceedings, the United States submits that the term "evidentiary" could be read as going further than this to imply that third parties can help sustaining Brazil's burden of proof. **Brazil** asserts that the United States' argument that evidence provided by third parties cannot provide "evidentiary support" conflicts with Article 10 of the *DSU*. According to **Brazil**, while a third party cannot alleviate a complainant's burden to present a prima facie case of inconsistency of a measure, the evidence presented by a third party can nevertheless provide "evidentiary" support that can be relied upon by the Panel. The **Panel** has retained the term "evidentiary" in the paragraph concerned. Neither party suggests that evidence provided by a third party may alleviate the complainant's burden to establish a prima facie case. We agree entirely. Information supplied by third parties in support of their allegations may constitute evidence, in terms of additional context and support, that we may take into account in conducting an objective assessment of the matter before us.

6.55 The **United States** requests modifications and/or deletions of paragraphs 7.1425, 7.1451, 7.1452 and 7.1453. **Brazil** opposes these requested modifications, asserting that the United States is trying to introduce a new argument at the interim review stage. Having reviewed the record, the **Panel** has declined to make the precise deletions and modifications requested by the United States. The Panel has, however, made certain modifications, including to paragraphs 7.1425 (also added a footnote), 7.1451 and 7.1453 and has modified footnotes 1519 and 1527 in light of the parties' comments.

6.56 The Panel has also made certain technical and other revisions in respect of suggestions by Brazil in paragraphs 7.1107, 7.1229, 7.1305 (also added a footnote and made a related revision in paragraph 7.214) and footnotes 1185, 1327, 1336, 1375 and 1409, and certain suggestions by the United States in paragraphs 7.1305, 7.1307, 7.1447, 7.1449, 7.1501, footnote 1417 to paragraph 7.1305, footnote 1544 to paragraph 7.1477 and footnote 1561 to paragraph 7.1502. We have also made certain modifications in footnote 1410.

## H. SECTION VII:H - ACTIONABLE SUBSIDIES: CLAIMS OF "THREAT OF" SERIOUS PREJUDICE

6.57 The **Panel** has modified paragraph 7.1480 and footnote 1544 in light of the parties' comments.

## I. SECTION VIII - CONCLUSIONS AND RECOMMENDATIONS

6.58 **Brazil** suggested that the language of paragraph 8.3(c) mirror that of paragraph 8.3(b). The **United States** does not object to this, but also wishes to avoid any mistaken impression that the six month period referred to for withdrawal is "required by" Article 4.7. In light of the parties' comments, the **Panel** has modified paragraph 8.3(c). We have, however, retained certain language, as the measures subject to paragraph 8.3(b) are also subject to the recommendation in paragraph 8.3(a). This is not the case for the measure subject to the recommendation in paragraph 8.3(c).

J. OTHER

6.59 As stated in paragraph 6.2 above, the Panel has also made technical corrections and revisions, as well as other modifications, including the following: paragraphs 7.54 (bullet 5), 7.178, 7.260, 7.261, 7.274, 7.285, 7.330, 7.337(ix), 7.338, 7.340, 7.351, 7.357, 7.365-7.370, 7.375, 7.376, 7.379, 7.387, 7.388, 7.390, 7.392, 7.396, 7.397, 7.412, 7.413, 7.417, 7.418, 7.422, 7.424, 7.436, 7.443, 7.446, 7.447, 7.448, 7.460, 7.464, 7.476 (by adding a footnote), 7.479, 7.480, 7.481, 7.495 (by adding a footnote), 7.499 (by adding a footnote), 7.515, 7.520, 7.526 (by modifying the footnote), 7.528 (by deleting a footnote), 7.551, 7.554 (also added two footnotes), 7.559 (by inserting a new paragraph consistent with paragraph 7.286), 7.584, 7.586, 7.606 (for clarity with paragraph 7.607), 7.628(iii) and (iv) (by adding a footnote to each, respectively), 7.633 (by adding a footnote), 7.636 (also modified a footnote), 7.637, 7.646, 7.665, 7.689, 7.695, 7.704, 7.707, 7.708, 7.713 (by adding a footnote), 7.736, 7.754, 7.826, 7.864 (by quoting an excerpt from an Exhibit), 7.866 (by adding a footnote), 7.883, 7.947 (also added a footnote), 7.1004, 7.1007 (by inserting a new paragraph), 7.1011 (also added a footnote), 7.1014, 7.1037 (also added a footnote), 7.1039, 7.1097, 7.1140, 7.1142, 7.1155 (by moving the paragraph), 7.1161, 7.1165, 7.1192, 7.1200, 7.1213, 7.1222 (by deleting a footnote), 7.1281 (also added a footnote), 7.1282, 7.1284 (also modified a footnote and deleted another), 7.1285, 7.1307, 7.1311, 7.1314, 7.1332, 7.1351 (by adding a footnote to bullet 5), 7.1360, 7.1361, 7.1449, 7.1458, 7.1459 (by inserting a new paragraph and a footnote), 7.1460, 7.1469 (by inserting a new paragraph and five footnotes), 7.1478, 7.1484, 8.1 and footnotes 43, 44, 63, 197, 261, 383, 427, 442, 477, 522, 523, 850, 937, 999, 1011, 1056, 1060, 1076, 1215, 1234, 1294, 1330, 1334, 1337, 1338, 1401, 1456, 1414, 1465, 1496, 1510, 1534 and 1544.

## VII. FINDINGS

A. PROCEDURAL MATTERS

### 1. Organization of the Panel's Procedures

7.1 On 21 May 2003, prior to the Panel's adoption of its working procedures, the United States sent a communication to the Panel in which it "propose[d] that the Panel organize its procedures to deal with the threshold Peace Clause issue at the outset of this dispute". It stated, *inter alia*, as follows:

> "We would suggest that the Panel first receive written submissions from both parties on the applicability of the Peace Clause, to be followed by a meeting of the Panel with the parties on this issue, and then rebuttal submissions. The Panel would then make findings on whether any US measure is in breach of the Peace Clause. If the Panel agrees that Brazil has failed to establish that the US measures are inconsistent with the Peace Clause, then that would dispose of those claims. If the Panel finds that the US measures are inconsistent with the Peace Clause, then Brazil could have recourse to the Annex V procedures with respect to its Subsidies Agreement claims on these measures. In either event, briefing and meetings of the Panel with the parties could then proceed on any claims not disposed of by the Peace Clause findings.
>
> This procedure would satisfy the legal requirement that certain claims not be maintained while the Peace Clause is applicable and provide the Panel with a fair and orderly means of addressing the issues in this dispute. The United States notes that the Panel has broad discretion to determine its working procedures under Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), and, under DSU Article 12.2, the Panel is charged with establishing panel procedures with "sufficient flexibility so as to ensure high-quality panel reports." Because in this dispute Brazil has made claims under 17 different provisions of the WTO Multilateral Agreements with respect to numerous US programs under at least

> 12 US statutes, we believe the Panel's consideration of the critical Peace Clause issue would be aided by briefing and argumentation focused on this threshold issue."[16]

7.2 On 23 May 2003, after the Panel asked Brazil to communicate its views, if any, on the United States' letter[17], Brazil sent a communication opposing the United States' proposal. It stated, *inter alia*, as follows:

> "The United States has singled out AoA [Agreement on Agriculture] Article 13 as a "special" provision which allegedly requires special and unprecedented procedural treatment. Yet DSU Appendix 2, the closed list of "special and additional" rules and procedures that trump the normal rules of dispute settlement, does not include Article 13 or any other AoA provision, nor does it include the cross-references to the AoA in Articles 3.1 and 7.1 of the Agreement on Subsidies and Countervailing Measures (ASCM). There is no support in the DSU, in the Agreement on Agriculture, or elsewhere in the WTO Agreement for the proposition that a separate "mini-trial" on peace clause issues is required before any claim can be made against subsidies under the Agreement on Agriculture. Acceptance of this proposition would invent a substantial new obstacle to future claims by any government against agricultural subsidy programs, altering the rights of Brazil and many other Members, in contradiction to Article 3.2 of the DSU.
>
> The US notion that two rounds of submissions and a special meeting are required before the parties perform any further work on the case is unprecedented. As the Panel is aware, the concept of preliminary objections is not new. [ ... ]
>
> The threshold issues posed by AoA Article 13 are no more or less significant than other threshold issues in many WTO Agreements."[18]

7.3 On 28 May 2003, after having heard the views of the parties in the organizational meeting, the Panel adopted its timetable and working procedures in accordance with Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*").[19] At the same time, the Panel indicated that it intended to make a ruling on certain issues on 20 June 2003, prior to the submission by the parties of their first written submissions. The Panel requested the parties and invited third parties to address the issues related to the proposed ruling. More specifically, the communication relating to the proposed ruling stated as follows:

> "As indicated in the attached[20] timetable, prior to the submission by the parties of their first written submissions, the Panel requests the parties to address, in their initial briefs to the Panel (to be submitted on 5 June 2003), the following:
>
> - whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words 'exempt from actions' as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant

[16] Excerpt from the United States' letter dated 21 May 2003. See Annex K item 1 for full communication.
[17] Communication from the Panel dated 21 May 2003. (see Annex L-1 item 1).
[18] Excerpt from Brazil's letter dated 23 May 2003. See Annex K item 2 for full communication.
[19] See Annex M.
[20] Attachment omitted. See Annex M item 2 for the evolution of the timetable of this dispute.

> considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article13.
>
> As also indicated in the attached timetable, the Panel will invite the parties to submit any written comments on each other's comments on this issue (i.e. on 13 June 2003). The Panel intends to rule on these issues on 20 June 2003, prior to the parties' submission of their first written submissions.
>
> As has been indicated, the Panel recognizes that it may need to revisit certain aspects of its timetable and working procedures in light of developments during the course of the Panel procedures, including the nature of the Panel's ruling that is scheduled for 20 June 2003. In particular, in the event that the Panel were to rule that Article 13 precludes the Panel from considering certain claims raised by Brazil prior to a conclusion that certain conditions of Article 13 remain unfulfilled, we may decide to adjust the timetable to permit the parties to make further submission(s) after the second substantive meeting and to schedule further substantive meeting(s), as necessary, with the parties. Related amendments to the working procedures may also be made, if necessary.
>
> With respect to the participation of third parties in these Panel proceedings, we have carefully considered the parties' comments at this morning's organizational meeting. In exercise of our discretion to manage these Panel proceedings, we continue to believe that it would be appropriate in this case for the third parties to have access to the parties' initial written comments (and any written comments the parties may make on each others' comments) as well as to have the ability to submit any written comments they themselves may have on the issue that we have identified above. The Panel considers that such third party participation in this initial stage of the Panel proceedings is appropriate for the following reasons.
>
> The Panel is aware of the provisions of Article 10.3 of the *DSU*, which states that third parties shall receive the submissions of the parties to the dispute to the first meeting of the Panel. We would also observe that the factual circumstance that presents itself here is not itself specifically addressed by the *DSU*. In our view, the legal issue that the Panel has asked the parties to address in their initial briefs will necessarily have ramifications for the remainder of the Panel proceedings, including the scope of the first substantive meeting, at which third parties will participate.
>
> We therefore invite the parties to serve also on the third parties their initial briefs and any responding comments. The Panel will also invite third parties to submit any written comments they might have concerning the initial phase of these proceedings. The deadline for any third party comments is 10 June 2003. The parties' comments to be submitted on 13 June may, of course, also address comments made by third parties."[21]

7.4 On 5 June 2003, in line with the schedule set out in paragraph 7.3 *supra*, the parties submitted their initial briefs on this question.[22] On 10 June 2003, the following six third parties submitted initial

[21] Excerpt from the communication from the Panel dated 28 May 2003. (See Annex L-1 item 3 for the full communication). A corresponding communication was sent to the third parties. (See also Annex L-2 item 1.)

[22] See Annex A items 1 and 2.

briefs: Argentina, Australia, European Communities, India, New Zealand and Paraguay.[23] On 13 June 2003, the parties submitted further comments.[24]

7.5 On 20 June 2003, after carefully considering all these initial briefs, the Panel issued the following communication to the parties and third parties:

> "Article 13(a)(ii) of the *Agreement on Agriculture* states that domestic support measures that conform fully to the provisions of Annex 2 of the *Agreement on Agriculture* shall be exempt from actions based on Article XVI of *GATT 1994* and Part III of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*"). Article 13(b)(ii) of the *Agreement on Agriculture* states that domestic support measures that conform fully to certain conditions shall be "exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year." Articles 5 and 6 of the *SCM Agreement* are each qualified by the proviso that "[t]his Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture." Article 13(c)(ii) of the *Agreement on Agriculture* provides that export subsidies that conform fully to the provisions of Part V of that Agreement, as reflected in each Member's Schedule, shall be 'exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement'. Article 3.1 of the *SCM Agreement*, which prohibits export subsidies, is qualified by the proviso: "Except as provided in the *Agreement on Agriculture*...". These provisions of Article 13 afford a conditional exemption from certain obligations relating to certain actionable and prohibited subsidies under the provisions of the *SCM Agreement* and Article XVI of the *GATT 1994*. This conditionality requires, *inter alia*, a comparison of facts with the applicable exemption requirements.
>
> Briefly, Brazil asserts that the Panel can simultaneously consider all of the arguments and evidence on the substance of its claims under the *SCM* and *Agriculture Agreements*, while the United States asserts that the Panel is precluded from examining the SCM claims concerning prohibited and actionable subsidies in the absence of a prior ruling that the conditions of Article 13 of the *Agreement on Agriculture* are not satisfied, and, even if not, the Panel should exercise its discretion to order its proceedings in this way. All of the six third parties that made submissions support the view that the Panel is not precluded from simultaneously considering all of the arguments and evidence on the substance of Brazil's claims under the *SCM* and *Agriculture Agreements*, or, putting this another way, that conclusions on the applicability of the Article 13 exemptions do not have to be made before consideration of SCM claims in relation to the measures concerned.
>
> We are faced with two questions:
>
> - first, whether we are *required* to defer any examination of certain of Brazil's claims based on Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* until after making a ruling or expressing views on the issue of fulfilment of *Agreement on Agriculture* Article 13 conditions; and
>
> - second, if not, then *how* we should exercise our discretion to best structure our examination of the matter before us.

[23] See Annex A items 3-8.
[24] See Annex A items 9 and 10.

These questions concern the manner in which we should or must treat the claims of Brazil based on Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* having regard to the provisions of Article 13 of the *Agreement on Agriculture*.

We therefore look first to the dispute settlement procedures governing disputes under the *SCM Agreement*. Article 30 of the *SCM Agreement* states: "The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding shall apply to consultations and the settlement of disputes under this Agreement, except as otherwise specifically provided herein."

We thus turn next to the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*") and to the terms of the *SCM Agreement* itself (in order to see whether or not there is anything otherwise specifically provided therein). Article 1.1 of the *DSU* is entitled "Coverage and Application". It states that "[t]he rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the "covered agreements")."

As the Appellate Body has observed, "[a]rticle 1.1 of the DSU establishes an integrated dispute settlement system which applies to all of the agreements listed in Appendix 1 to the *DSU* (the "covered agreements"). The DSU is a coherent system of rules and procedures for dispute settlement which applies to "disputes brought pursuant to the consultation and dispute settlement provisions of" the covered agreements."[25] The *SCM Agreement* and the *GATT 1994* are Multilateral Agreements on Trade in Goods in Annex 1A of the *WTO Agreement* and are therefore "covered agreements" listed in Appendix 1 of the *DSU*. The general *DSU* rules and procedures do not set forth any specific distinct way to deal with claims under the *SCM Agreement* and the *GATT 1994* having regard to the provisions of Article 13 of the *Agreement on Agriculture*.

Article 1.2 of the *DSU* provides, in relevant part, that the rules and procedures of the *DSU* shall apply subject to such special or additional rules and procedures on dispute settlement contained in the covered agreements as are identified in Appendix 2 to the *DSU*.

We therefore examine whether Appendix 2 to the *DSU* identifies any special or additional dispute settlement rules or procedures relating to the *SCM Agreement* or to Article XVI of the *GATT 1994*.

Appendix 2 of the *DSU* does not identify Article XVI of the *GATT 1994* as a special or additional rule. It does identify Articles 4.2-4.12 and Articles 7.2-7.10 of the *SCM Agreement* as "special or additional rules and procedures". These provisions contain special procedures and remedies for disputes involving prohibited and actionable subsidies governed by the *SCM Agreement*. However, none of these provisions purports to confer any sort of precedence or priority for considering SCM remedies in a dispute involving claims under the *Agreement on Agriculture*. Furthermore, Article 7.1 of the *SCM Agreement*, which is not identified as a special or additional rule or procedure in Appendix 2 of the *DSU*, indicates that it applies: "Except as

[25] *Original footnote*: Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico* ("*Guatemala – Cement I*"), WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, 3767, para. 64.

provided in Article 13 of the Agreement on Agriculture...". This clearly indicates to us that this provision must be read in the light of the provisions of Article 13 of the *Agreement on Agriculture*. Moreover, as noted in para. 5 above, the substantive provisions to which these remedial articles are linked – Articles 3, 5 and 6 – stipulate either that they apply "except as provided in the Agreement on Agriculture" (Article 3 relating to prohibited subsidies), or that they do "not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture" (Articles 5 and 6.9 of the *SCM Agreement*, entitled "Adverse Effects" and "Serious Prejudice", respectively).

The cited provisions of the *SCM Agreement* refer, as just indicated, to the *Agreement on Agriculture*, and some specify more precisely Article 13 of the *Agreement on Agriculture*. We therefore examine the rules applicable to dispute settlement under the *Agreement on Agriculture*, which is also a Multilateral Agreement on Trade in Goods in Annex 1A of the *WTO Agreement* and is, therefore, a "covered agreement" listed in Appendix 1 of the *DSU*. Article 19 of the *Agreement on Agriculture* is entitled "Consultation and Dispute Settlement". It states that the provisions of Articles XXII and XXIII of *GATT 1994*, as elaborated and applied by the *DSU*, shall apply to consultations and the settlement of disputes under that Agreement.

Appendix 2 to the *DSU* does not identify any special or additional dispute settlement rules or procedures relating to Article 13 of the *Agreement on Agriculture.*

Consequently, consistent with our consideration of the relevant provisions, there is no special dispute settlement requirement foreseen in the covered agreements in respect of a panel's consideration of the fulfilment of Article 13 conditions. The issue of fulfilment of the conditions of Article 13 of the *Agreement on Agriculture* is to be resolved using generally applicable *DSU* rules and procedures. The fact that certain very specific provisions are included in Appendix 2 of the *DSU* as special or additional rules indicates that, when the drafters intended to make a particular provision applicable as a special or additional dispute settlement rule, they did so explicitly. Therefore, their failure to include a reference to any provision of the *Agreement on Agriculture* in the text of Appendix 2 demonstrates that they did not intend to make any provision of that Agreement a special or additional dispute settlement rule. It is not necessary for us to look for any further interpretive guidance on this issue.

We next turn to the issue of how we should structure our procedures to consider the matter before us. As we have concluded above, this issue is subject to the *DSU* but not otherwise affected by the covered agreements. In this regard, within the overall parameters set by the *DSU* of prompt and efficient dispute resolution[26], we must exercise our discretion as to how best to organize our procedures. Our discretion must be guided by the instructions given to us by the *DSU*. Pursuant to Article 12.1 of the *DSU*, "[p]anels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute". Moreover, Article 12.2 provides: "Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process."

[26] *Original footnote*: Article 3.3 of the *DSU* provides: "The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

Article 11 of the *DSU*, entitled "Function of Panels" provides that the function of panels is to assist the DSB in discharging its responsibilities under the *DSU* and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Article 11 contemplates that a panel must make an "objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements." It does not require that a panel must conduct its proceedings in any particular way, provided that its requirements are fulfilled. It is within our discretion to manage our procedures so as to best fulfil the requirements of Article 11.

Given the potential complexity of the claims before us, the conditional nature of certain of these claims and the volume of evidence which may be introduced by the parties in support of their claims and arguments, and in order to organize our proceedings in an orderly, effective and efficient manner which serves to facilitate an objective assessment of the matter before us, and optimizes use of our resources, we have adopted the following modifications to our procedures (as indicated in the attached[27] timetable):

- The Panel intends to express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, to the extent that it is able to do so, by 1 September 2003,[28] and will defer its consideration of claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as those provisions are referred to in Article 13 of the *Agreement on Agriculture* until after it has expressed those views. The Panel's views may be expressed in the form of rulings which could affect the Panel's further consideration of this dispute.

- In order that third parties may participate effectively at the first meeting at which the claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as referred to in Article 13 of the *Agreement on Agriculture* are examined (as necessary), the Panel intends to divide its first meeting into two sessions, each of which will include a third party session.

- Accordingly, for the purposes of the first session of the first substantive meeting on 22-24 July 2003, the Panel does not require the parties to address claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as referred to in Article 13 of the *Agreement on Agriculture*. Having said this, the Panel notes that this does not preclude the parties from addressing such matters in their first submissions.

- All other claims of Brazil in relation to measures which Brazil maintains do not involve a consideration of Article 13 of the *Agreement on Agriculture* should also be addressed in first submissions, in order for the other party and third parties to have an opportunity to express their views on any such claims.

[27] Attachment omitted. See Annex M item 2 for the evolution of the timetable of this dispute.

[28] This date was changed to 5 September by the communication from the Panel dated 30 July 2003. (See Annex L-1 item 6 and L-2 item 3 for full communication. See Annex M item 2 for the evolution of the timetable of this dispute.)

- For the purposes of allowing the Panel to express its views on the exemption conditions of Article 13 of the *Agreement on Agriculture* by 1 September 2003, in relation to those measures which may be affected by Article 13, full and complete submissions on factual and legal issues related to Article 13 in this dispute will need to be provided, at the latest, in the parties' rebuttal submissions (to be submitted on 22 August 2003).

We recognize that we may need to revisit certain aspects of our timetable and working procedures in light of developments during the course of the Panel procedures. Related amendments to the working procedures may also be made, if necessary. We have been mindful of due process considerations in revising our timetable and will continue to ensure that the parties have reasonable time to prepare for any subsequent stages of the dispute, as appropriate."[29]

7.6 On 27 August 2003, the United States sent a letter requesting that the Panel's views of 5 September be presented in an "interim form". It stated, *inter alia*, as follows:

"The United States notes that the Panel intends to express its views on the issue of the Peace Clause by September 5, 2003. No prior panel nor the Appellate Body has made findings on the Peace Clause. The submissions and material provided to the Panel to date have demonstrated that the issues involved in the Panel's findings on the Peace Clause are fact-intensive, complex and sensitive.

While prior panels have made preliminary rulings on procedural issues, no prior panel has been confronted with the situation presented in this dispute. Here, the Panel will be making substantive findings on key provisions of the covered agreements. In this connection, the United States takes note of the Panel's observation that the fairness of panel proceedings may require ensuring that the parties receive sufficient opportunity to comment on new material. The United States also takes note of the provisions of paragraph 2 of Article 15 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* in which Members have agreed that parties should have an opportunity to comment on a panel's findings before they are final.

In this dispute, the Panel's findings on the Peace Clause are presumably intended to be dispositive of substantive claims and arguments of the parties for the remainder of the panel proceedings. Because of the substantive nature of those findings, the Panel's findings on September 5 will need to provide the factual basis and basic rationale underlying the findings. Both parties have a significant interest in those findings, in terms not just of the ultimate conclusion reached, but also in terms of the factual findings, rationale underlying those findings, and an understanding of the scope of those findings. Accordingly, in keeping with Article 15.2 of the DSU, and in order to be fair to both parties, the United States respectfully requests that the Panel provide Brazil and the United States with the Panel's September 5 Peace Clause findings in an interim form and provide the parties an opportunity to comment on the Panel's findings. The United States suggests that, in keeping with the practice in other panel proceedings and this Panel's timetable for the interim review in this dispute, two weeks should be sufficient time to comment."[30]

[29] Excerpt from the 20 June 2003 communication from the Panel. (See Annex L-1 item 4 for full communication.)

[30] Excerpt from the United States' letter dated 27 August 2003, footnotes omitted. (See Annex K item 15 for full communication.)

7.7 On 28 August 2003, Brazil sent a letter opposing the United States' request. It argued, *inter alia*, as follows:

> "The US letter argues that the Panel must set forth its complete and full reasoning and factual findings in its 5 September decision. Brazil notes that paragraph 20 of the Panel's 20 June Decision stated that it would 'express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the Agreement on Agriculture' and would 'express its views in the form of ruling...'. Brazil does not and would not presume or suggest what form the Panel's "ruling" will or should take. However, it is within the Panel's discretion, as with many previous panels, to provide the basic rulings on the preliminary issue and then to further elaborate such rulings in the final determination.
>
> As the United States recognizes, there will be an opportunity for the parties to comment on the interim report that the Panel will issue following the second meeting of the Panel with the Parties. Brazil believes that its procedural rights will be fully protected by the existing procedural safeguards provided by the interim review process. The United States has provided no legitimate reasons why its rights would not also be protected. Both parties will have an equal opportunity to comment on any decision by the Panel regarding the peace clause at that time.
>
> In sum, Brazil requests that the Panel reject the United States request to establish an interim review process to the Panel's 5 September ruling."[31]

7.8 On 29 August 2003, the United States and Brazil each sent a further letter[32] reiterating their positions.

7.9 On 5 September 2003, in line with the established schedule, the Panel sent the following communication to the parties and third parties:

> "[ ... ]
>
> 4. The Panel takes note of the correspondence from the parties dated 27, 28 and 29 August 2003 and declines to make findings at this stage as to whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, for the reasons given in its communication dated 20 June 2003. The Panel's findings on that issue will be included in its interim report, on which the parties will have the right to comment in accordance with Article 15.2 of the *DSU*.
>
> 5. The Panel has now had the opportunity to consider the parties' and third parties' evidence and arguments to date. At this stage, the Panel cannot conclude its assessment of the matter before it on the basis that the measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*. The expression by the Panel of this view is without prejudice to the Panel's eventual findings, and is subject to paragraph 6 below. In this context, the Panel is of the view that consideration, as appropriate, of Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*, as those provisions are referred to in Article 13 of the *Agreement on Agriculture*, is warranted in order for the Panel properly to discharge its responsibilities under the *DSU* and the relevant covered agreements. Therefore, the Panel will consider those claims at a second session of the first substantive meeting.

[31] Excerpt from Brazil's letter dated 28 August 2003. (See Annex K item 16 for full communication.)
[32] See Annex K items 18 and 19.

6. The Panel also wishes to inform the parties that, on the basis of the evidence and arguments presented to date, it is unable to form any view on whether the ETI Act satisfies the relevant provisions of the *Agreement on Agriculture*.

7. Regarding the Panel's procedures:

(a) the Panel invites the parties to address in further submissions, due on 9 and 23 September respectively, the claims referred to in paragraph 5 above;

(b) the Panel also invites the parties to address further the issue whether the export credit guarantee programs at issue constitute export subsidies for the purposes of the Agreement on Agriculture;

(c) the Panel confirms that items (o), (p) and (q) of its timetable will be necessary, and confirms the following dates:

| | |
|---|---|
| Further submissions of the third parties: | 29 September 2003; |
| First substantive meeting with the parties (resumed second session): | 7, 8 and (as necessary) 9 October 2003; |
| Third party session: | 8 October 2003; |

(d) the Panel invites the third parties to address in their further submissions the claims referred to in paragraph 5 above;

(e) the Panel intends to postpone the second substantive meeting; and

(f) the Panel invites the parties to comment on the attached[33] draft further revised timetable. Such comments should be submitted no later than close of business on Tuesday, 9 September 2003."[34]

7.10 On 12 and 18 September 2003, after having received comments from the parties[35], the Panel issued further communications revising its timetable.[36]

**2. Rights of third parties in the proceedings**

7.11 On 31 July 2003, the European Communities sent a communication to the Panel[37] in which it requested: (a) to have sight of the oral statements of the main parties at the first substantive meeting, (b) that the Panel ask the parties to provide third parties with copies of their oral statements and responses to the Panel's questions, and (c) that the Panel confirm that it would make the 5 September 2003 views of the Panel available to the third parties.

[33] Attachment omitted. See Annex M item 2 for the evolution of the timetable of this dispute.
[34] Excerpt from the communication from the Panel dated 5 September 2003. Footnote omitted. (See Annex L-1 item 11 for full communication.)
[35] United States' letters dated 9, 11, 16 and 17 September 2003 (See Annex K items 20, 22, 24 and 26) and Brazil's letters dated 9, 10, 16 and 17 September 2003. (See Annex K items 19, 21, 23 and 25.)
[36] See Annex L-1 items 12 and 13. See Annex M item 2 for the evolution of the timetable.
[37] See Annex K item 6.

7.12 On 1 August 2003, Brazil and the United States each communicated their views on this issue[38] to the Panel, and the European Communities commented on these communications on 4 August 2003.[39]

7.13 On 5 August 2003, the Panel issued a communication to the parties and third parties in which:

(i) it informed them that it would communicate its 5 September 2003 views to third parties, as well as to the parties to the dispute, in order to enable them to participate, as necessary and appropriate, in any second session of the first substantive meeting in a full and meaningful fashion; and

(ii) it denied both the European Communities' requests for additional third party rights. Nonetheless, in view of the phased nature of the first meeting, the Panel directed the parties to the dispute to make best efforts to ensure that their submissions to any second session of the first meeting were understandable either on their own or in conjunction with the submissions to the first session of the meeting. In particular, such submissions should not refer to any document to which the third parties did not have access without, at the very least, a summary, explanation or description of the contents of that document (or a citation indicating where that document may be found on the public record).[40]

### 3. Results of econometric model(s) used by Brazil and related communications

7.14 On 9 September 2003, in its further submission, Brazil submitted a quantitative simulation in conjunction with its initial "serious prejudice" arguments under Articles 5(c) and 6.3 of the *SCM Agreement*.[41] On 7 October 2003, during the resumed session of the first substantive meeting, the United States requested Brazil to provide information relating to the underlying econometric model (the "FAPRI[42] model"), as well as any modifications made thereto by Dr. Sumner[43], for the purposes of this dispute. The United States asserted that:

> "[T]he report provided by Brazil as Annex I to its further submission does *not* provide the model itself, including detailed specifications of the equations used therein. As a result, Brazil is essentially asking the Panel and the United States to accept Dr. Sumner's results on faith alone. Dr. Glauber[44] has pointed out why Dr. Sumner's approach is inappropriate for a retrospective analysis of the effect of US subsidies. Even were Dr. Sumner's approach appropriate, however, Brazil has failed to this point to provide sufficient evidence to allow the Panel to fully understand and evaluate that model. Thus, quite apart from the flaws identified by Dr. Glauber, Brazil's reliance

[38] See Annex K items 7 and 8.
[39] See Annex K item 9.
[40] Communication from the Panel dated 5 August 2003. See Annex L-1 item 7.
[41] "A Quantitative Simulation Analysis of the Impacts of US Cotton Subsidies on Cotton Prices and Quantities" by Professor Daniel Sumner, reproduced in Annex I to Brazil's further submission of 9 September 2003.
[42] "FAPRI" is an acronym for the Food and Agricultural Policy Research Institute.
[43] Dr. Daniel Sumner is an expert economist with the Brazilian delegation. See also *infra*, Section VII:G, footnote 1323 , relating to the involvement of experts as members of party and third party delegations in these Panel proceedings
[44] Dr. Joseph Glauber is the Deputy Chief Economist, Office of the Chief Economist of the USDA. Dr. Glauber participated in the resumed session of the first substantive meeting and the second substantive meeting with the Panel as a member of the United States delegation. See also *infra*, Section VII:G, footnote 1323 , relating to the involvement of experts as members of party and third party delegations in these Panel proceedings

> on Dr. Sumner's inadequately explained results, evident throughout Brazil's latest submission, further demonstrates that Brazil has *not* established a *prima facie* case that US subsidies have the effects complained of."[45]

7.15 On 14 October 2003, in response to a request by Brazil to provide a precise description of the information sought, the United States identified the information it requested.[46]

7.16 On 5 November 2003[47], Brazil indicated that it would provide the written information requested by the United States "early in the week of 10 November", and that it understood that the "electronic version" of the model was available for use by the United States Government upon coordination with FAPRI staff. On 11 November 2003[48], the United States expressed disappointment that Brazil claimed not to be able to provide an electronic version of the model and indicated that the "the offer by FAPRI to run simulations at the United States request for a fee is not an acceptable substitute". The United States also requested an extension of the timetable in light of Brazil's delay in providing the requested written information. On 12 November 2003[49], Brazil submitted certain written information about the model[50] and asked the Panel to reject the request of the United States for an extension of the timetable. The United States sent a further letter, dated 13 November 2003[51], reiterating its position.

7.17 On 14 November 2003, the Panel issued the following communication to the parties:

> "The Panel takes note of the United States' written request of 14 October 2003 for certain information relating to the quantitative simulation model used by Dr. Sumner in his analysis presented in Annex I to Brazil's 9 September 2003 further written submission. The Panel also takes note of the parties' related communications dated 5, 11, 12 and 13 November 2003, and the submissions by Brazil on 12 and 13 November 2003.
>
> The Panel confirms the dates in its existing timetable, subject to the following.
>
> The Panel does not require the parties' 18 November further rebuttal submissions, nor their oral statements during the second Panel meeting, to address the methodology, equations or parameters underlying the quantitative modelling simulation in Annex I

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[45] United States' oral statement at the resumed session of the first substantive meeting, para. 56. (Emphasis in original)

[46] United States' letter dated 14 October 2003 (See Annex K item 31). The attachment to the letter reads as follows:

> "Please provide the following information relating to the model used by Dr. Sumner in his analysis presented in Annex I to Brazil's further submission:
>
> (a) Electronic copies of the actual models used for the baseline and each of the seven scenarios described in Annex I.
>
> (b) Printed copies of the exact equation specifications used for the baseline and for each of the seven scenarios described in Annex I, including all parameter estimates. (If no such printed copies currently exist, please develop and provide.)
>
> (c) Documentation of all adaptations to the original FAPRI modeling system made or used by Dr. Sumner for his analysis presented in Annex I. (If no such documentation currently exists, please develop and provide.)"

[47] See Annex K item 32.

[48] See Annex K item 33.

[49] See Annex K item 34.

[50] Exhibits BRA-313, -314.

[51] See Annex K item 35.

to Brazil's further written submission which are directly linked to the information requested by the United States on 14 October 2003 and the submissions by Brazil on 12-13 November 2003. Having said this, the parties are not precluded from doing so.

Mindful of the requirements of Article 12.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* and in keeping with its duty to conduct an objective assessment of the matter before it, the Panel invites the United States to submit, on 22 December, in conjunction with its responses to any questions following the second Panel meeting, any comments that it may have on Brazil's submissions of 12-13 November 2003. Brazil may submit any comments on any such US comments by 12 January 2004, and the United States may submit any further comments by 19 January 2004. If necessary, at the discretion of the Panel, a further Panel meeting with the parties may be held to address this specific material.

This decision is without prejudice to the relevance and significance which the Panel may ascribe to the quantitative simulation model and related evidence and argumentation in its report.

Finally, the Panel wishes to ask the United States to respond, by 22 December, to the following:

Is the Panel correct in understanding that the US government (including the United States Department of Agriculture) does not have a license or any other form of permission (standing or otherwise; free of charge or otherwise) to run, electronically, the FAPRI/CARD model and/or Professor Sumner's adaptations thereto?"[52]

7.18 On 8 December 2003, after having heard the views of both parties at the second substantive meeting, the Panel communicated the following to the parties:

"1. The Panel has been advised by Brazil that, to the best of Brazil's knowledge and belief, all of the information used by FAPRI to generate the various results presented in Brazil's submissions concerning the effects of the subsidies, and their removal, has been provided to the US in an electronic format. Conceptually speaking, the information is in two parts: (a) the model used as the basis for generating the results ('the FAPRI model'), and (b) adaptations to the model and other specific pieces of information which affect the calculations made by the model ('the Brazil information'). FAPRI has possession of the FAPRI model and the Brazil information. Brazil only has possession of the Brazil information. Brazil instructed FAPRI as to the use of the Brazil information that FAPRI then used to generate the various results presented by Brazil to the Panel.

2. We say that the US has all of the information (ie both the FAPRI model and Brazil's information) 'to the best of Brazil's knowledge and belief' because Brazil itself has never had access to all of the data comprising the FAPRI model, which is voluminous. FAPRI considers the model to be its own work product. At the request of Brazil, FAPRI has made all of the information available to the US. Why it has done this in the case of the US, but not Brazil, relates to the relationship (commercial or otherwise) between FAPRI (which receives US funding for its work) and the US Government. FAPRI has provided all of the information to the US on the express stipulation that the model not be provided to the Panel or Brazil ("the FAPRI stipulation").

[52] Communication from the Panel dated 14 November 2003, reproduced in full.

3. At para 74 of its Opening Statement at the Second Panel Meeting, the US asks this of the Panel:

> '[W]hether it intends the United States to comment on this new model, documentation, and results by the original 22 December deadline to file comments on the methodology underlying the Annex I model.'

4. During the Second Panel Meeting, Brazil advised the Panel that it had no objection, then, to the US looking at the information provided to it by FAPRI, notwithstanding the FAPRI stipulation.[53] The Panel acknowledges this, but also notes that it would be open to Brazil to reconsider its position depending on anything that the US may wish to present to the Panel about the FAPRI model.

5. The Panel's view in these circumstances is that the US should comment on the FAPRI model, if it believes that it needs to do so in the interests of presenting its case to the Panel, by **22 December**. The FAPRI stipulation does not, in the Panel's view, affect the Panel's ability to make an objective assessment of the matter before it in the terms of Article 11 of the DSU. The Panel will assess the reliability and relevance of the FAPRI model on the basis of the evidence presented to it by the parties.

6. Brazil will be given until **12 January 2004**, to comment on the above US comments."[54]

7.19 On 22 December 2003, in line with the above timetable, the United States submitted "Comments of the United States of America concerning Brazil's Econometric Model"[55]. On 20 January 2004[56], Brazil submitted "Brazil's Comments on the 22 December US Comments Concerning Brazil's Econometric Model".[57] On 28 January 2004, the United States submitted further views on this issue[58] as "Comments of the United States of America on Comments by Brazil on US Comments Concerning Brazil's Econometric Model".[59]

### 4. Requests for information under Article 13.1 of the DSU

7.20 In its further rebuttal submission submitted on 18 November 2003, Brazil, in response to the assertion of the United States that it had not provided precise calculations of the amount of contract payments to current producers of upland cotton, observed, after explaining Brazil's methodology, that the Panel had the discretion to request the United States, pursuant to Article 13.1 of the *DSU*, to

[53] The "FAPRI stipulation" refers to the fact that Dr. Babcock of FAPRI stated in his e-mail to Dr. Glauber of the USDA that: "I am sending you this material with the understanding that it is for use by the United States and should not be shared with Brazil or other parties." (Brazil submitted a copy of this e-mail in Exhibit BRA-346.)

[54] Second attachment to the communication from the Panel dated 8 December 2003. See Annex L-1 item 18 for full communication.

[55] See Annex I item 9.

[56] The original deadline of 12 January 2004 was extended, at the request of Brazil, to 20 January 2004 by the Panel's communication dated 24 December 2003. (See Annex L-1 item 20.)

[57] See Annex I item 12.

[58] The Panel's communication dated 8 December 2003 provided that "[t]he parties may submit any further comments on each other's comments by 19 January". This deadline was extended, at the request of Brazil, to 28 January 2004 by the Panel's communication dated 24 December 2003. (See Annex L-1 item 20 for full communication)

[59] See Annex I item 16.

produce information on contract payments made in respect of base acreage in the 1999-2002 marketing years.[60]

7.21 On 2 December 2003, during the second substantive meeting, Brazil requested that the United States submit information that would permit the calculation of the precise amount of these contract payments made to current producers of upland cotton.[61] More specifically, it requested farm-specific planting and base acreage data to determine the amount of upland cotton planted on contract base acreage during the 1999-2002 marketing years. Brazil took note of information that the United States Department of Agriculture's (USDA) Kansas City Administrative Office had provided under the Freedom of Information Act ("FOIA") to a private citizen assisting the Brazilian delegation concerning another programme crop, (i.e. rice)[62], and sought information in a similar format, according to standard USDA practice.[63]

7.22 On 8 December 2003, the Panel communicated to the parties that the United States would be given until 18 December to respond to Brazil's request and Brazil would be given until 12 January 2004 to comment on the United States' response.[64]

7.23 On 18 December 2003[65], the United States informed the Panel that the release of planted acreage information associated with a particular farm, county, and state number was confidential information that could not be released under United States domestic law, in particular the Privacy Act of 1974. This was consistent with the position of the United States in Freedom of Information Act appeals that had considered this issue.[66] Nevertheless, the United States provided, for all programme crops and for each marketing year: (1) planted acreage data aggregated for all cotton farms; and (2) farm-level planted acreage data without any fields that could identify the particular farm.[67] The United States further advised the Panel that the USDA had released the information concerning rice in error and asked that Brazil and its agents return all copies of the erroneous rice release.

7.24 On 22 December 2003, in its responses to the Panel's questions following the second substantive meeting, Brazil submitted that the United States had confirmed that it had collected complete planted acreage, contract base acreage, contract yields, and payment data that would allow it to calculate with relative precision the amount of direct and counter-cyclical payments made to current producers of upland cotton in the 2002 marketing year. Brazil also indicated that it could not calculate direct payment and counter-cyclical payment figures because the United States had refused to provide farm-specific identifying numbers, thus rendering any matching of farm-level information on contract payments with information on farm-specific plantings impossible.[68]

7.25 On 12 January 2004, the Panel made certain observations to the parties on the material submitted by the United States concerning the Privacy Act of 1974 and made the following request:

> "Pursuant to Article 13 of the DSU, the Panel requests the United States to provide the same data that it agreed to provide in its letters dated 18 and 22 December 2003

[60] Brazil's further rebuttal submission , para. 48.
[61] Exhibit BRA-369.
[62] Exhibit BRA-368.
[63] Brazil referred to documents in FOIA cases 03-117, 03-302, 03-103 and 03-082, attached to a statement by Mr. Christopher Campbell of the "Environmental Working Group" (EWG), reproduced in Exhibit BRA-316. See also *infra*, Section VII:G, footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings.
[64] See Annex L-1 item 18 for full communication.
[65] See Annex K item 37.
[66] The United States submitted Exhibits US-103 through US-107 in support of its arguments.
[67] The delivery was made, at the request of Brazil, to the Embassy of Brazil in Washington D.C. The CD-ROM with the data was delivered to the Panel on 23 December 2003.
[68] See Brazil's response to Panel Question No. 196. (See Annex I item 7.)

> but in a format which permits matching of farm-specific information on contract payments with farm-specific information on plantings. The Panel considers it both necessary and appropriate to seek this information in a suitable format in order to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements. Disclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years.
>
> The United States may again designate the data as confidential in accordance with paragraph 3 of the Panel's working procedures. Disclosure can be limited to Brazil's delegation, the Panel and Secretariat staff assisting the Panel. The United States may also protect the identity of individual producers by, for example, using substitute farm numbers which still permit data-matching.
>
> A refusal by the United States to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn.
>
> The Panel reminds Brazil that it may not disclose the above information outside its delegation in this proceeding if it is designated by the United States as confidential."[69]

7.26 The Panel also posed the following additional question to Brazil:

> "Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks."[70]

7.27 On 20 January 2004[71], the United States noted that it had previously provided data that permitted calculation of "total expenditures" for all decoupled payments made to "farms planting upland cotton" with respect to historical base acres (whether upland cotton base acres or otherwise). Thus, the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to "farms planting upland cotton". It also informed the Panel that it was not possible to protect the identity of individual producers while providing the requested data in a format that permitted data-matching because it had already provided, by farm number, farm-specific contract information. Even in the absence of farm numbers, disclosing the farm-specific plantings would allow each farm's confidential plantings to be connected to the USDA farm numbers through the farm-by-farm files previously provided. It submitted that it had provided the original data with Farm Service Agency (FSA) farm numbers as a result of Brazil's refusal to consider any alternative that would respect the privacy interests of United States' producers. The United States responded to certain of the Panel's observations on confidentiality under its domestic law and submitted that there was no basis for an 'inference' of any kind, adverse or otherwise, because the United States did not have the authority to provide the farm-specific planting information in the format requested and, further, it had provided both farm-specific and aggregated contract data that would permit the Panel to make the assessment it identified, i.e. an assessment of total expenditures of decoupled payments to farms planting upland cotton. The United States also recalled that panels must take care not to use the information gathered under this authority to relieve a complaining party from its burden of establishing a prima facie case of WTO inconsistency based on specific legal claims asserted by it, such that the Panel could not relieve Brazil of its burden of

[69] Excerpt from the communication from the Panel dated 12 January 2004. (See Annex L-1 item 21 for full text).

[70] Panel Question No. 258 posed in a communication from the Panel dated 12 January 2004. (See Annex L-1 item 21).

[71] See Annex K item 42.

advancing and establishing claims and arguments relating to the key issue in the serious prejudice claim of the value of decoupled payments benefiting upland cotton.

7.28 On 28 January 2004, Brazil submitted certain documents in accordance with the Panel's timetable for "any further comments on each other's comments". One of the documents submitted by Brazil was entitled "Brazil's Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled Data on 20 January 2004".[72]. In it, Brazil submitted that the United States had refused to provide the information concerning the amount of contract payments made to current producers of upland cotton, that there were no legitimate confidentiality concerns that would prevent the United States from producing the data and, even if there were, confidentiality procedures under Article 13.1 of the *DSU* and/or the Panel's working procedures could have addressed these concerns. Brazil asked the Panel to draw adverse inferences (listed in Section 6 of that document) and conclude that the withheld information would have been adverse to the United States' defence in this case. Furthermore, Brazil asked the Panel to use the best information available, including the adverse inferences, to find that the figures Brazil had estimated under its so-called 14/16$^{ths}$ methodology were supported by the evidence on the record.[73]

7.29 On 28 January 2004[74], the United States submitted revised data on a new CD-ROM[75] to correct for errors it had detected in the data submitted in December.[76]

7.30 On 30 January 2004, the United States requested that the Panel give it an opportunity to comment on Brazil's comments of 28 January 2004.[77] On 2 February 2004, Brazil replied, outlining the limits within which it deemed appropriate for the Panel to grant such opportunity.[78] On 3 February 2004, the United States replied, refuting Brazil's arguments.[79]

7.31 On 3 February 2004, after carefully reviewing these letters and the data, the Panel informed the parties as follows:

> "The Panel has noted the US letter dated 30 January, Brazil's response dated 2 February, and a further letter from the US dated 3 February 2004. Keeping in mind the dictates of due process and relevant provisions of the covered agreements -- including Article 12.2 of the DSU which requires Panel procedures to provide sufficient flexibility so as to ensure high-quality panel reports while not unduly delaying the panel process -- the Panel is of the view that the above revisions to the timetable [omitted] provide the United States and Brazil sufficient opportunity to comment on each other's comments. Accordingly, the US is free to submit its comments on Brazil's above mentioned submission by 11 February (but no later).
>
> This is without prejudice to any definitive view of the Panel on the characterization of any of the above communications by the parties and, in particular, of the document submitted by Brazil entitled 'Brazil's Comments and Requests Regarding Data

[72] See Annex I item 15.
[73] See paragraphs 107 and 108 of "Brazil's Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-scrambled data on 20 January 2004". (See Annex I item 15.)
[74] See Annex K item 43.
[75] The content of this CD-ROM is described in Exhibit US-145.
[76] See *supra*, footnote 67.
[77] See Annex K item 44.
[78] See Annex K item 45.
[79] See Annex K item 46.

> Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-scrambled Data on 20 January 2004'."[80]

7.32 In the same communication, the Panel also made a supplementary request pursuant to Article 13 of the *DSU* for the United States to provide:

> (i) such of the information requested on 12 January 2004 in the format requested, as regards payment recipients who did not have interests protected under the Privacy Act of 1974, if any; and
>
> (ii) planting information for farms enrolled in each of the PFC, MLA, DP and CCP payments programmes for each of the 1999, 2000, 2001 and 2002 marketing years, grouped into three broad categories, according to whether they had greater or less upland cotton base acreage than upland cotton planted acreage or upland cotton planted acreage but no upland cotton base acreage. The category for farms which overplanted their upland cotton base acres was divided into three sub-categories according to their base acreage for all covered commodities.[81]

7.33 Also in the same communication, the Panel advised the parties as follows:

> "The Panel considers it both necessary and appropriate to seek this information to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements. However, the Panel reserves its views as to the extent to which any methodology might be appropriate to determine support provided to upland cotton in the circumstances of this case.
>
> A refusal by the United States to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn."

7.34 Also in the same communication, the Panel posed additional questions to both parties, including several questions to the United States related to the Privacy Act of 1974.

7.35 On 11 February 2004, the United States responded to the Panel's questions[82], explaining *inter alia* that the USDA was obligated under United States domestic law to protect farm-specific planting data. It also submitted comments[83] on the comments of Brazil[84] to the United States' data submitted on 18 and 19 December 2003.

7.36 On 11 February 2004, the United States also requested a time extension to respond to the supplementary request for information due to its very extensive nature and sought specific clarification of item (b) of the Panel's request. [85] It also requested an opportunity to comment on any reply which the Panel might permit Brazil to file to the United States comments filed on that day.

7.37 On 13 February 2004, Brazil responded, asking the Panel to reject the requests of the United States.[86] On 16 February 2004, the United States reiterated its position.[87]

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[80] Excerpt from the communication from the Panel dated 3 February 2004 (See Annex L-1 item 22 for full communication.)

[81] The full text of the supplementary request is set out in Annex L-1 item 22.

[82] See Annex I item 18.

[83] See Annex I item 19.

[84] See *supra*, paragraph 7.28.

[85] This Panel's request is reproduced as (ii) in paragraph 7.32 *supra*.

[86] See Annex K item 48.

7.38 On 16 February 2004, the Panel provided clarification of its supplementary requests for information, as requested by the United States[88], and indicated that it would consider at a later stage the United States' request for an opportunity to comment.[89] It also granted the United States an extension of time until 3 March 2004 to submit all remaining data as requested.[90]

7.39 On 18 February 2004, Brazil submitted a communication entitled "Brazil's Comments on US 11 February 2004 Comments on Brazil's 28 January Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled data on 20 January 2004".[91] It provided extensive comments on the Privacy Act of 1974 and argued that WTO Members' domestic laws do not provide a basis for not complying with obligations to cooperate in a WTO dispute settlement proceeding and to provide, if requested by a Panel under Article 13 of the *DSU*, any information, if necessary using special confidentiality procedures.

7.40 On 3 March 2004, the United States submitted[92] the data requested by the Panel on 3 February 2004, as well as its comments[93] on Brazil's 18 February 2004 comments.

7.41 On 10 March 2004, Brazil submitted its comments to the data submitted by the United States on 3 March 2004.[94] In this comment, Brazil stated, *inter alia*, that the data provided by the United States on 3 March 2004 was the best information available before the Panel, and that Brazil no longer considered that relying on its "14/16$^{ths}$ methodology" would be appropriate.

7.42 On 15 March 2004, the United States submitted its comments on Brazil's comments, reiterating its criticism of the various calculation methodologies recently advanced by Brazil, and noting Brazil's statement in its last submission that it "no longer considers that relying on its 14/16$^{ths}$ methodology would be appropriate", observed that this meant that the only methodology that Brazil had brought forward from August 2003 until January 2004 to allegedly demonstrate a breach of the Peace Clause was irrelevant to this dispute.

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[87] See Annex K item 49.

[88] See *supra*, paragraph 7.36.

[89] The Panel, after reviewing Brazil's submission subsequently submitted on 18 February 2004, granted, by the communication dated 20 February 2004, the United States until 25 February 2004 to comment on this Brazil's submission. (See Annex L-1 item 24.) On 23 February, the United States sent a letter requesting an extension of this deadline, and on 24 February, the Panel issued a communication to inform parties that the deadline would be extended until 3 March 2004. (See Annex K item 50 for the letter and Annex L-1 item 25 for the communication from the Panel.)

[90] The Panel's communication dated 16 February 2004 is set out in Annex L-1 item 23 in full.

[91] See Annex I item 22.

[92] By a document entitled "Response of the United States of America to the Panel's February 3, 2004 Data Request, as Clarified on February 16, 2004" (See Annex I item 24), submitted together with a CD-ROM. The United States designated the data submitted as confidential pursuant to paragraph 3 of the Panel's working procedures. (Paragraph 31 of the document.)

[93] Entitled "Comments of the United States of America on the February 18, 2004, Comments of Brazil". (See Annex I item 23)

[94] Brazil requested (in a letter dated 13 February 2004) that in the event the Panel would allow the extension of the deadline for the United States to submit the data requested by the Panel, Brazil should be given the opportunity to comment on the data. The Panel granted this opportunity in its communication dated 4 March 2004. (See Annex K item 48 for Brazil's letter and Annex L-1 item 26 for the communication from the Panel.)

## 5. Other procedural issues

(a) Timing of the service of documents

7.43 On 14 July 2003, Brazil sent a letter[95] complaining about the late timing of delivery of documents by the United States. On 14 August 2003, Brazil sent another letter stating, *inter alia*, as follows:

> "As it had already done on two previous occasions, the US did not deliver its answers to the Panel's questions following the first substantive meeting with the parties by the time established in paragraphs 17(b) and (d) of the "Working Procedures". Brazil recalls that the deadline for submitting the parties' answers to the Panel was expressly confirmed by the Panel on its communication dated 30 July 2003 informing about the extension of the deadline for the submission of the parties' responses.
>
> As a matter of fact, the electronic version of the US answers, which was due on 11 August, 5:30 pm, was delivered around 11:30 pm, more than 6 hours after the deadline, more than 6 hours after Brazil delivered both its electronic version and hard copies to the Secretariat and the US. Brazil further notes that no hard copy of the US answers was made available either to the Secretariat or to Brazil by the deadline. [ ... ]
>
> Brazil respectfully asks the Panel to take note of this new delay and to encourage, again, the US to respect the deadlines, with a view to ensuring procedural fairness in these proceedings."[96]

7.44 On 19 August 2003, the Panel informed the parties as follows in its communication:

> "The Panel has received a communication from Brazil dated 14 August 2003 in which Brazil draws attention to the timing and format of service of the United States' responses to the Panel's questions, in light of paragraphs 17(b) and (d) of our Working Procedures, and in which it raises issues of procedural fairness.
>
> The Panel has taken note of the matters raised in the communication from Brazil and draws them to the United States' attention. The Panel recalls that, at its meeting with the parties on 22 July 2003, it also drew the attention of the United States to these issues as raised by Brazil in connection with the filing of the United States' first written submission and comments on Brazil's initial brief."[97]

7.45 On 2 October 2003, Brazil sent another letter[98] complaining about the timing of the United States' delivery of documents.[99] On 13 October 2003, after having heard the views of parties at the resumed session of the first substantive meeting, the Panel communicated the following to the parties:

> "The Panel takes note of Brazil's request in its letter dated 2 October 2003 regarding the late receipt of submissions, and the US response in its letter dated 6 October 2003. In accordance with paragraph 17(b) of the Panel's working procedures, the Panel sets the following time for the provision of submissions by the parties: 11:59 pm, Geneva time on the dates concerned. This time refers to *receipt* of submissions by the other

[95] See Annex K item 3.
[96] Excerpt from Brazil's letter dated 14 August 2003. (See Annex K item 10 for full communication.)
[97] Excerpt from the communication from the Panel dated 19 August 2003. (See Annex L-1 item 8 for full communication.)
[98] See Annex K item 29.
[99] The United States sent a letter on 6 October 2003 responding to Brazil's letter. (See Annex K item 30.)

> party and the Secretariat and not to commencement of transmission. For greater clarity, this time for receipt of submissions also refers to the time of completion of receipt of any Exhibits and service of all Exhibits (if necessary, electronically) to the other party and to the Secretariat as envisaged in paragraphs 17(a)-(d) of the Panel's working procedures. All other provisions of the Working Procedures remain unchanged. The Panel confirms the dates in the revised timetable, as revised in its communication of 18 September 2003.
>
> The Panel has set this time in light of the repeated service of submissions by the United States after 5.30 p.m. and in order to ensure due process and secure a balance between the two parties. The Panel stresses its expectation that the parties will respect all of the rules and procedures set out in the *DSU* and in the working procedures, including the new time set by the Panel above for the dates in question." [100] [101]

7.46 On 23 December 2003, Brazil sent another letter on this issue.[102]

(b) Other extensions of deadlines

7.47 On 29 July 2003, the United States sent a communication to the Panel requesting an extension of the deadline to respond to the questions posed by the Panel [103], citing the number and complexity of the questions. After reviewing Brazil's comment[104] on this request, the Panel notified, in its communication dated 30 July 2003 [105], certain modifications to its timetable.

7.48 On 14 August 2003, Brazil sent a written communication to the Panel requesting that it be provided additional time to comment on certain responses to the Panel's questions submitted by the United States on 11 August, on grounds that the United States did not provide complete answers or documentation that would have allowed Brazil the opportunity to comment and rebut in its rebuttal submission which was due on 22 August 2003.

7.49 In a communication dated 19 August 2003, the Panel notified the parties as follows:

> "[W]hen each party receives the other party's rebuttal submission, it is invited, without delay, to draw the Panel's attention to any specific material on which it has not had an opportunity to comment and to show cause why it needs such an opportunity. Upon a showing of good cause, the Panel will permit that party to comment in writing by 27 August 2003. The Panel is willing to grant such permission on Saturday, 23 August 2003, if necessary."[106]

[100] Excerpt from the communication from the Panel dated 13 October 2003. (See Annex L-1 item 15 for full communication.)

[101] The Panel notes that the United States' submissions due on 22 December 2003, 28 January 2004, 18 February 2004 and 3 March 2004 were received after the deadline of 23:59, regarding both the paper version and the electronic version.

[102] See Annex K item 40.

[103] Posed on 25 July 2003. This was the first of the series of questions subsequently posed by the Panel.

[104] Letter dated 29 July 2003. (See Annex K item 5.)

[105] See Annex L-1 item 6 and L-2 item 3.

[106] Excerpt from the communication from the Panel dated 19 August 2003. (See Annex L-1 item 8 for full communication.)

7.50 On 23 August 2003, in response to this communication by the Panel, Brazil identified specific issues on which it deemed that additional time for comment was necessary.[107] On the same day, the Panel permitted Brazil to comment on such new material by 27 August 2003.[108]

7.51 On 25 August 2003, the Panel received a communication from the United States in which it also identified specific issues on which it deemed additional time for comment necessary.[109] On the same day, in conjunction with transmitting additional question 67*bis*, the Panel permitted the United States to comment on new material by 27 August 2003.[110]

7.52 On 23 September 2003, the United States sent a letter to the Panel requesting extension of the deadline for submitting its further submissions as well as extension of other related deadlines. After hearing Brazil's views[111], the Panel, on 24 September 2003, notified the parties and third parties of certain modifications to its timetable.[112]

7.53 On 23 December 2003, in relation to additional questions posed by the Panel on 23 December[113], Brazil requested an extension of certain deadlines including the deadline for responses to the specific Panel's questions.[114] After reviewing the United States response[115] to this request, the Panel notified the parties of further modifications to its timetable.[116]

### 6. Least-developed country Members

7.54 Benin and Chad, two least-developed country Members, are involved in these proceedings as third parties. In accordance with Article 24.1 of the *DSU*, particular consideration was given to the special situation of these two Members. In this respect, the Panel notes:

- Benin provided a detailed written submission and presented an oral statement at the first session of the first meeting of the Panel. It provided written responses to the Panel's questions following that session;

- Benin and Chad made a detailed joint written submission, and presented separate oral statements, at the resumed session of the first meeting of the Panel. They provided joint written responses to the Panel's questions following that session[117];

- in their joint submission, Benin and Chad extensively explained the situation of the cotton sector in their respective countries;

- Benin, which has a permanent mission in Geneva, was represented by a delegation headed by its Ambassador, which included a research fellow[118] of the International

[107] See Annex K item 12.
[108] Panel's communication dated 23 August 2003. (See Annex L-1 item 9.)
[109] The United States sent a communication to the Panel on 20 August 2003 foreshadowing that it would make such request. Brazil sent a communication on 25 August 2003 requesting the Panel to reject the United States' request. (See Annex K items 11 and 14.)
[110] By the Panel's communication dated 25 August 2003. (See Annex L-1 item 10.)
[111] Letter dated 23 September 2003. (See Annex K item 28.)
[112] Communication from the Panel dated 24 September 2003. (See Annex L-1 item 14.)
[113] Communication from the Panel dated 23 December 2003. (See Annex L-1 item 19.)
[114] Letter dated 23 December 2003. (See Annex K item 40.)
[115] Letter dated 23 December 2003. (See Annex K item 41.)
[116] Communication from the Panel dated 24 December 2003. (See Annex L-1 item 20. )
[117] The further submission submitted on 3 October 2003, and responses to certain of the Panel's Questions, submitted on 27 October 2003. ( See Annex E item 4 and Annex J item 14.)
[118] Mr. Nicholas Minot. See also *infra*, Section VII:G, footnote 1501 and footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings.

Food Policy Research Institute, who presented the results of a study entitled "Effect of falling cotton prices on rural poverty in Benin"[119];

- Chad, which does not have a permanent mission in Geneva, was represented at the resumed session of the first substantive meeting by a delegation headed by its Brussels-based Ambassador, who presented a detailed statement by the Chairman of the *Société Cotonnière du Tchad ("Cotontchad")* and the *Association Cotonnière Africaine*, Mr. Ibrahim Malloum;

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

- the parties and other third parties referred to the special situation of Benin and Chad in various places [120]; and

- the Panel referred to the arguments of Benin and Chad at paragraphs 7.267, 7.990, 7.1211, 7.1233 and 7.1400 of this report.

## B. PRELIMINARY RULINGS

### 1. Export credit guarantees for agricultural commodities other than upland cotton

#### (a) Terms of reference

7.55 The **United States** requests the Panel to rule that export credit guarantee measures relating to eligible United States agricultural commodities (other than upland cotton) are not within its terms of reference because this "measure" was not the subject of Brazil's request for consultations.[121]

7.56 The Panel notes that the United States did not address export credit guarantee measures relating to agricultural commodities other than upland cotton in terms of substance in its first written submission.

7.57 **Brazil** asks the Panel to reject the United States' request, submitting that both its request for consultations and the accompanying statement of available evidence, as well as the questions it posed to the United States during consultations, revealed that they covered export credit guarantee measures relating to all eligible United States agricultural commodities.[122]

7.58 **New Zealand** also considers that the Panel should reject the United States' request because Brazil had had little choice but to look at a broader commodity coverage in relation to export credits as the information specific to upland cotton alone was not available.[123]

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[119] Brazil also submitted a report by Mr. Nicholas Minot and Ms. Lisa Daniels as Exhibit BRA–244.

[120] For example, Brazil has explained the situation in Benin and/or Chad in its further submission dated 9 September 2003 (executive summary included as Annex E item 1) at paragraph 1; in its answers dated 27 October 2003 to questions from the Panel at paragraphs 61, 121, 159 (see Annex I item 5); in Exhibit BRA-294, and in its further rebuttal submission dated 18 November 2003 (executive summary included as Annex G item 1) at paragraph 87. Numerous exhibits also pertain to the cotton sectors in Benin and/or Chad, in particular, Exhibit BRA-15, an OXFAM briefing paper, Exhibits BRA-264 through BRA-268 and BRA-294. The United States referred to the submission of Benin in its response dated 11 August 2003 to the Panel's Questions at paragraph 26 (see Annex I item 2).

[121] United States' first written submission, para. 206. For the record, we note that the United States raised this issue at both meetings of the DSB at which Brazil's request for establishment of a panel was considered. See the minutes of the DSB meetings in WT/DSB/M/143, para. 27 and WT/DSB/M/145, para. 24.

[122] Brazil's oral statement at the first session of the first substantive meeting, para. 94.

[123] New Zealand's written submission to the first session of the first substantive meeting, para. 5.02.

7.59 The Panel was established with standard terms of reference[124] that are set out in Brazil's request for establishment of a panel. That request states that "the measures that are the subject of this request" include:

> "Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton, and other eligible agricultural commodities as addressed herein, provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;"[125]

7.60 It is agreed that this document specifically mentions other eligible agricultural commodities. However, Article 6.2 of the *DSU* provides that a request for establishment of a panel:

> "… shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. …"

7.61 The United States accepts that consultations were held in respect of export credit guarantee measures for upland cotton, but contends that consultations were not held for other eligible agricultural commodities. The United States acknowledges that Brazil posed questions in consultations which extended beyond upland cotton.[126] The Panel notes that during the consultations Brazil submitted 21 questions in writing to the United States regarding export credit guarantee measures, seeking information on the total volume and value of exports of United States agricultural goods guaranteed by these programmes, the same information for exports of United States upland cotton only, the total costs of the programmes and the legal basis for the programmes, among other issues.[127] This shows that the *actual* consultations did include export credit guarantee measures relating to all eligible agricultural commodities.

7.62 The United States takes the view that the consultations could only cover upland cotton because the other products were not included in Brazil's request for consultations.[128] Assuming *arguendo* that the scope of the written request for consultations is determinative, rather than the scope of the actual consultations, the Panel notes that Brazil's request included the following paragraph:

> "The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton,[1] as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry")."

7.63 Footnote 1 to this paragraph read "Except with respect to export credit guarantee programs as explained below." This should have indicated to the careful reader that the subject of the request for consultations, with respect to export credit guarantee measures only, was different from those "provided to US producers, users and/or exporters of upland cotton". Looking below, there were two references to export credit guarantee measures, which read as follows:

> "Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the

[124] Document WT/DS267/15.
[125] Document WT/DS267/7.
[126] United States' first written submission, para. 198.
[127] Exhibit BRA-101. The United States confirmed that these questions were posed to it during consultations and that it immediately objected to them – see its response to Panel Question No. 8.
[128] United States' first written submission, para. 198.

> GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;" (on page 2); and
>
> "Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, Brazil is of the view that these programs, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement. Subsidies provided under these programs are also actionable subsidies for the purpose of Brazil's claims under Article 6.3 of the SCM Agreement." (on page 4).[129]

7.64 The second of these paragraphs referred to the three export credit guarantee programmes at issue "as applied and as such" and made no specific reference to upland cotton, yet almost every other substantive paragraph and *tiret* of the request made such a specific reference. Therefore, a plain reading of that paragraph includes all eligible agricultural commodities.[130] Any uncertainty on the part of the United States should have been dispelled by the questions which Brazil posed during the consultations.[131]

7.65 Therefore, the Panel concludes that export credit guarantee measures relating to all eligible agricultural commodities were included in Brazil's request for consultations, based on its reading of the text of the request itself. Accordingly, the Panel rejects the United States' contention that they were not so included and that export credit guarantee measures relating to eligible agricultural commodities other than upland cotton are not properly before the Panel.

7.66 The Panel asked the United States whether it had suffered any actual prejudice as a result of the alleged omission of products other than upland cotton from the request for consultations. The United States replied that the issue of prejudice was not relevant to the question whether a measure not consulted upon may be the subject of panel proceedings. Nevertheless, it submitted that it had suffered an inability to prepare, respond and consult with respect to allegations on measures never presented in accordance with the *DSU*. If export credit guarantees with respect to other eligible commodities were included in the dispute, it would suffer prejudice of having to prepare and defend its actions in a severely compressed time frame without the benefit of any consultations whatsoever.[132]

7.67 We note the fact that the United States declined to respond to the questions posed by Brazil during consultations concerning export credit guarantees relating to eligible commodities other than upland cotton. On a plain reading of the request for consultations, export credit guarantee measures were challenged by Brazil in relation to all eligible agricultural commodities. If a Member is uncertain as to the scope of the measures referred to by another Member in a request for consultations, and chooses not to seek clarification, it cannot rely on its own uncertainty as a jurisdictional bar to a Panel finding on the measures. Members have an obligation under Article 3.10 of the *DSU* to engage in WTO dispute settlement procedures in good faith in an effort to resolve the dispute.

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[129] Document WT/DS267/1.

[130] The United States does not disagree that the request for establishment of a panel can be understood to indicate that Brazil's claim related to products other than upland cotton, although it submits that Brazil was not entitled to add the words "other eligible agricultural commodities" to its request for establishment of a panel to broaden the scope of the challenged measures. See the United States' response to Panel Question No. 11.

[131] The title "United States – Subsidies on Upland Cotton" was added by the Secretariat when it circulated a copy of the request for consultations to Members. The title did not appear in the original communication sent from the Permanent Mission of Brazil to the Permanent Mission of the United States and is therefore not a legally relevant consideration here.

[132] United States' response to Panel Question No. 10.

7.68 Given the Panel's finding on the scope of the two requests, it is not strictly necessary to examine the relationship between them. However, the Panel takes note of the United States' concern that the request for establishment of a panel included the words "and other eligible agricultural commodities as addressed herein" which did not appear in the request for consultations. There is no requirement in the *DSU* that the language in the request for establishment of a panel should be a duplicate of the request for consultations. Rather, the difference in language between Article 4.4, which requires a request for consultations to identify the measures at issue, and Article 6.2, which requires a request for establishment of a panel to identify the "specific" measures at issue, suggests that the measures will be identified in sharper focus in the latter request.[133] Indeed, one of the purposes of consultations is that each party should gain a better understanding of the other's position, which may often lead to differences between the two requests.

7.69 Therefore, the Panel rules that export credit guarantees to facilitate the export of United States upland cotton, and other eligible agricultural commodities as addressed in document WT/DS267/7, are within its terms of reference.[134]

(b) Statement of available evidence

7.70 The **United States** also requests the Panel to rule that Brazil could not advance claims under either Article 4 or Article 7 of the *SCM Agreement* with respect to export credit guarantee measures on eligible agricultural commodities other than upland cotton because it did not include a statement of available evidence with respect to such export credit guarantees in accordance with Articles 4.2 and 7.2 of that Agreement.[135]

7.71 In its first written submission, the United States argued that the statement of evidence attached to Brazil's request for consultations provided further proof that the request for consultations did not extend beyond export credit guarantees for upland cotton.[136] After the Panel's 25 July 2003 communication relating to its intended ruling that export credit guarantee measures in respect of other eligible agricultural commodities were within its terms of reference, the United States foreshadowed a request for a preliminary ruling in its responses to Panel questions following the first session of the first Panel meeting.[137] The United States first clearly requested a ruling on the adequacy of Brazil's statement of available evidence with respect to export credit guarantees on eligible agricultural commodities other than upland cotton in its 30 September 2003 further submission.[138]

7.72 **Brazil** asks the Panel to reject the United States' request. Brazil asserts that the United States' request is not new and is untimely, groundless and "mooted by" the Panel's communication of 25 July 2003 indicating that the Panel intended to rule that export credit guarantees to facilitate the export of United States upland cotton and other eligible agricultural commodities are within the Panel's terms of reference.[139]

7.73 The Panel first recalls that the United States has made allegations of inadequacy in Brazil's statement of available evidence under *both* Articles 4.2 and 7.2 of the *SCM Agreement*.

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[133] We note that the Panel in *Canada – Wheat Exports and Grain Imports* was also of this view: see para. 15 of the preliminary ruling set out at para. 6.10 of that Panel Report (circulated to Members, currently on appeal).

[134] The Panel communicated to the parties and third parties in a letter dated 25 July 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their answers to questions and rebuttals.

[135] United States' further written submission, para. 9.

[136] United States' first written submission, para. 197.

[137] United States' response to Panel Question No. 3, footnote 3.

[138] United States' further written submission, paras. 9 *ff*.

[139] Brazil's oral statement at the resumed session of the first substantive meeting, paras. 73-78.

7.74 Article 4.2 of the *SCM Agreement*, in Part II of that Agreement, deals with requests for consultations relating to alleged *prohibited* subsidies. With respect to such alleged prohibited subsidies, it requires that: "A request for consultations ... shall include a statement of available evidence with regard to the existence and nature of the subsidy in question."

7.75 With respect to the United States' request pertaining to Article 4.2 of the *SCM Agreement*, during the course of the Panel proceedings, Brazil clarified that its export subsidy claims under Part II of the *SCM Agreement* included export credit guarantees under the GSM 102, GSM 103 and SCGP programmes as they relate to upland cotton and other eligible agricultural commodities. It is clear to us that our terms of reference include Brazil's prohibited subsidies claims under Article 3 of the *SCM Agreement* in relation to cotton and other eligible agricultural commodities.[140] It is therefore appropriate for us to address here the United States' allegations of inadequacy in Brazil's statement of available evidence under Article 4.2 of the *SCM Agreement*.

7.76 By contrast, Article 7.2 of the *SCM Agreement*, in Part III of that Agreement, deals with requests for consultations relating to alleged *actionable* subsidies. With respect to such alleged actionable subsidies, it requires that: "A request for consultations ... shall include a statement of available evidence with regard to *(a)* the existence and nature of the subsidy in question, and *(b)* the injury caused to the domestic industry, or the nullification or impairment, or serious prejudice caused to the interests of the Member requesting consultations." (footnote omitted)

7.77 In our 3 November 2003 communication, we indicated an intention to rule that Brazil had provided a statement of available evidence with respect to export credit guarantee measures relating to eligible United States agricultural commodities other than upland cotton under Article 7.2 of the *SCM Agreement*.[141] As we indicated there, our intention at that time was to assist the parties in deciding what evidence and argumentation to submit in the course of the Panel proceedings. In light of the particular circumstances of this dispute and, more specifically, the long-standing issue of the product scope of Brazil's claims pertaining to United States export credit guarantee measures, we made it clear that neither party should consider it was justified in withholding any relevant evidence from the Panel for any reason.

7.78 In relation to the United States' allegations of inadequacy under Article 7.2 of the *SCM Agreement*, it is now clear that Brazil's allegations of "serious prejudice" under Part III of the *SCM Agreement* are in respect of export credit guarantees under only one of the United States export credit guarantee programmes – GSM 102 – and *only* as that programme applies to upland cotton.[142] In light of Brazil's limitation of the product scope of its actionable subsidy claims to upland cotton, and of our exercise of judicial economy in respect of that claim[143], it is no longer necessary for us to make nor

[140] We recall our ruling *supra*, para. 7.69.

[141] See Annex L to this report.

[142] It is clear that Brazil's actionable subsidy claims relating to export credit guarantees under the GSM 102 programme do *not* relate to agricultural products other than upland cotton from, *inter alia*, Brazil's statement that "the only CCC export credit guarantee program that significantly contributed to the upland cotton-related serious prejudice suffered by Brazil was the GSM-102 program...". See Brazil's response to Panel Question No. 139(a), para. 77. Moreover, Brazil stated:

> "[e]ven if the United States were to make this request for a preliminary ruling and the Panel were to grant it, it would not affect Brazil's claims. Brazil's compliance with Article 7.2 of the *SCM Agreement* can have no effect on its claims under the Agreement on Agriculture, or on its prohibited subsidy claims under the SCM Agreement, or on its actionable subsidy claims with respect to upland cotton." See Brazil's 22 August comments on United States' response to Panel Question No. 3, para. 5.

[143] See *infra*, Section VII:G.

substantiate that intended ruling in respect of the adequacy of Brazil's statement of available evidence under Article 7.2 of the *SCM Agreement*.[144]

7.79 Accordingly, we limit our examination here to whether Brazil included a statement of available evidence with respect to export credit guarantees on other eligible agricultural products in accordance with the requirement pertaining to its *export* subsidy allegations in Article 4.2 of the *SCM Agreement*.

7.80 As we have already mentioned, in respect of claims concerning alleged prohibited subsidies, Article 4.2 of the *SCM Agreement* provides:

> "A request for consultations under paragraph 1 shall include a statement of available evidence with regard to the existence and nature of the subsidy in question."

7.81 Appendix 2 of the *DSU* identifies this provision as a "special or additional rule or procedure". In respect of such special or additional rules, Article 1.2 of the *DSU* provides:

> "The rules and procedures of this Understanding shall apply subject to such special or additional rules and procedures on dispute settlement contained in the covered agreements as are identified in Appendix 2 to this Understanding. To the extent that there is a difference between the rules and procedures of this Understanding and the special or additional rules and procedures set forth in Appendix 2, the special or additional rules and procedures in Appendix 2 shall prevail."

7.82 To the extent that there is a difference between the rules and procedures of the *DSU* and the special or additional rules, the latter will prevail. A request for consultations relating to prohibited subsidies must therefore satisfy the requirements in Article 4.2 of the *SCM Agreement* as well as the standard requirements set out in Article 4.4 of the *DSU*.[145]

7.83 Brazil's "statement of available evidence" annexed to its request for consultations contains multiple references to alleged United States prohibited (and actionable) subsidies to upland cotton. It also contains two points specifically referring to United States export credit guarantee programmes. These read*:*

> "US export credit guarantee programs have caused serious prejudice to Brazilian upland cotton producers by providing below-market financing benefits for the export of competing US upland cotton;
>
> US export credit guarantee programs, since their origin in 1980 and up the present, provide premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses [...]"

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[144] The evidence properly before the Panel is a separate issue from the adequacy of the statement of available evidence. Thus, this does not affect the evidence which we may take into account when examining Brazil's actionable subsidy claims relating to the export credit guarantee measures at issue.

[145] See for example, Appellate Body Report, *US – FSC*, paras. 159-161. Article 4.4 of the *DSU* provides:

> "All such requests for consultations shall be notified to the DSB and the relevant Councils and Committees by the Member which requests consultations. Any request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint."

7.84 The first of these paragraphs -- which refers to "serious prejudice" -- is textually limited to upland cotton. The second -- which refers to United States' export credit guarantee "programmes" and contains language reflecting certain elements set out in item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*[146] -- is not so limited. The United States contends that this non-limitation "does nothing to expand" the scope of the statement of available evidence.[147]

7.85 We disagree. Particularly when this paragraph is read in light of footnote 1[148] of the request for consultations, a careful reader should have been alerted to the fact that this paragraph referred to alleged subsidies arising from export credit guarantees under the challenged programmes, without any limitation to upland cotton or any other particular product or products. Brazil referred to the three export credit guarantee programmes by name – GSM 102, GSM 103 and SCGP – elsewhere in its consultation request, thereby clarifying the particular United States export credit guarantee programmes at issue.

7.86 We read Brazil's statement of available evidence, insofar as Brazil's export subsidy claims are concerned, to refer to each of the three challenged United States export subsidy programmes as they relate to upland cotton and other eligible agricultural products.

7.87 It is not entirely clear to us that the United States challenges the *adequacy* of the statement of available evidence in terms of evidence with respect to the "existence" or "nature" of these alleged subsidies with respect to any product other than upland cotton. However, to the extent that the United States makes this challenge, we see nothing in the text of Article 4.2 of the *SCM Agreement* that would *necessarily* require Brazil to identify specifically or explicitly the products for which the programmes were provided, the amounts provided, or indicate that they existed beyond upland cotton, as the United States contends.[149] This would have fallen within the scope of the export credit guarantee "programmes" already identified by Brazil.

7.88 Article 4.2, by its terms, requires that the complaining party include an expression in words of the facts available at the time of the consultation request concerning the "existence" and "nature" of the subsidy in question. It would be illogical to expect that this was meant to refer to the universe of all "available" evidence. Rather, this must be taken to refer to evidence available to the complaining

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[146] Brazil's statement of available evidence alleges that the US export credit guarantee programmes at issue "provide premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses." Item (j) similarly focuses on a comparison of premium rates of export credit guarantee programmes and long-term operating costs and losses in order to discern whether the former are inadequate to cover the latter. Item (j) reads as follows: "The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes." While it may not be appropriate to limit a statement of available evidence to the text of the relevant legal provisions, we note that Brazil refers elsewhere in its statement to evidence on which it relies. The similarity of the language used by Brazil in its statement of available evidence and the language in item (j) provides an insight into aspects of the alleged prohibited export subsidy forming the subject of Brazil's statement of available evidence.

[147] United States' further written submission, para. 11.

[148] As already indicated, Brazil's request for consultations states:

> "The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton,[1] as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton ('US upland cotton industry')."
>
> [1]Except with respect to export credit guarantee programs as explained below. [*original footnote*].

[149] United States' further written submission, para. 11.

Member. This evidence available to the complaining Member goes towards identifying the "existence" and "nature" of the subsidy in question, including available evidence of the character of the measure as a "subsidy".[150]

7.89 Brazil's statement of available evidence indicates Brazil's view that the character of the alleged subsidy lay in the provision of export credit guarantees under programmes "at premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses."

7.90 Brazil therefore had evidence available to it at that time which led it to conclude that the United States was providing a prohibited export subsidy of this nature and character under the three identified export subsidy programmes, without any limitation to a particular product or products.

7.91 In this context, we note that Brazil's "statement of available evidence" indicates that:

> "2. The evidence set out below is evidence available to Brazil at this time regarding the existence and nature of those subsidies, and the adverse effects caused by them to the interests of Brazil. It reflects the presently available evidence regarding the claims reflected in Brazil's request for consultations and is supported by documents that are described and set out in United States Department of Agriculture (USDA) and non-governmental internet locations set out in paragraph 4 below. Brazil reserves the right to supplement or alter this list in the future, as required."[151]

7.92 We further note that, among the various websites and documents that Brazil identifies in order to substantiate its statement that United States export credit guarantee programmes are run at "premium rates that are inadequate to cover the long-term operating costs and losses of the programmes" is a website maintained by the United States "Congressional Budget Office", concerning "Current Budget Projection". That website contains CBO projections for United States government mandatory and discretionary spending. In a table entitled "CBO's Baseline Projections of Mandatory Spending, Including Offsetting Receipts", there is an entry for the "Commodity Credit Corporation" – the entity administering the United States' export credit guarantee programmes – accompanied by certain data pertaining to spending and offsetting receipts.

7.93 Neither this entry, nor the related data, contain any indication of limitation of Brazil's allegations concerning the export credit guarantee programmes to any specific product, such as, for example, upland cotton. This budgetary projection evidence could reasonably be taken as evidence available to Brazil that led it to conclude that the United States' export credit guarantee programmes are run at "premium rates that are inadequate to cover the long-term operating costs and losses of the programmes."

7.94 The United States further contends that the statement did not contain *all* of the evidence available to Brazil at the time of the request for consultations, and that Brazil deliberately withheld certain evidence that was available to it.[152]

7.95 While objective confirmation by a panel of the totality of evidence available to Brazil at the time that it made its consultation request would be difficult, Brazil has submitted to us that its request for consultations and statement of available evidence submitted on 27 September 2002 "offer[ed] the quite limited information it knew at the time about the CCC export credit guarantee programs. It

[150] See Appellate Body Report, *US – FSC*, paras. 159-161.

[151] WT/DS267/1, p.5, para. 2. The electronic version of the document contains hyperlinks to the identified websites.

[152] United States' further written submission, paras. 11-12.

sought to use the consultation process to gather information that was readily available to the United States."[153]

7.96 It is clear to us that Article 4.2 of the *SCM Agreement* requires a complaining Member to include more information about its case in its request for consultations than is otherwise required under the *DSU*.

7.97 As we have already mentioned, by virtue of Article 1.2 of the *DSU*, to the extent that there is a difference between Article 4.2 of the *SCM Agreement* and the rules and procedures in the *DSU*, Article 4.2 would prevail.[154] Article 4.4 of the *DSU* requires that: "Any request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint." Thus, Article 4.4 of the *DSU* merely requires "identification" of the measures at issue and an "indication" of the legal basis for the complaint. This is a different requirement to that of Article 4.2 of the *SCM Agreement*.

7.98 This additional requirement in Article 4.2 of the *SCM Agreement* serves to provide a responding Member with a better understanding of the matter in dispute and serves as the basis for consultations. The statement of available evidence informs the responding Member of facts at the disposal of the complaining Member at the time it requests consultations about the prohibited subsidy it alleges is being granted or maintained.[155]

7.99 However, Article 4.2 does not require disclosure of *all* facts and evidence upon which the complaining Member will ultimately rely in the course of the dispute settlement proceedings.[156] Article 4.3 explicitly states that one of the purposes of consultations shall be to "clarify the facts of the situation". This implies that additional facts and evidence will be developed during the consultations.[157] This is consistent with the view that a central purpose of consultation in general, and of consultations under Article 4 of the *SCM Agreement* in particular, is to clarify and develop the facts of the situation.

7.100 The statement of available evidence directs attention to the measures concerned. It is the starting point for consultations, and for the emergence of more evidence concerning the measures by reason of the clarification of the "situation". If the dispute proceeds to the panel stage, additional evidence may well come to light by reason of the parties' participation in the panel procedures, including in response to the panel's questions and requests for information.

7.101 It is therefore credible that Brazil's statement of available evidence indicated the evidence that was available to Brazil at the time that led it to conclude that the United States was providing a prohibited subsidy. As we have observed in paragraph 7.92 above, at least one of the website links cited in the "statement of available evidence" contained evidence that would reasonably be relevant to substantiate such an allegation.[158]

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[153] Brazil's oral statement at the resumed session of the first substantive meeting, para. 78.

[154] See *supra*, paragraph 7.81.

[155] See Panel Report, *Australia – Automotive Leather II*, para. 9.29.

[156] We find support for this proposition in Panel Report, *Australia – Automotive Leather II*, paras. 9.27-9.29.

[157] Indeed, consultations may play a significant role in developing the facts in a dispute settlement proceeding. For example, the Appellate Body has observed that "[...] the claims that are made and the facts that are established during consultations do much to shape the substance and the scope of the subsequent panel proceedings." See Appellate Body Report, *India – Patents (US)*, para. 94.

[158] We refer to the particular circumstances of this case. We do not mean to imply that mere reference in a complaining Member's statement of available evidence to a list of websites would invariably be appropriate or sufficient for the purposes of Article 4.2 of the *SCM Agreement*. It is clear to us, however, that there is no

7.102 The United States has not demonstrated that Brazil actually had at its disposal any additional evidence that it failed to include in its statement of available evidence. Even if this had been established (and this might arguably not have been difficult, in light of the large volume of evidence that was subsequently submitted), it is not the Panel's view that the statement of available evidence must be absolutely comprehensive and exhaustive of the entire universe of all available evidence. To rule otherwise would go well beyond the purpose of consultations, to which such a statement is directed, and create a jurisdictional obstacle which would run counter to an underlying rationale of the procedural rules of WTO dispute settlement, which are designed to promote, not the development of litigation techniques, but the fair, prompt and effective resolution of trade disputes.[159]

7.103 For all of these reasons, assuming *arguendo* that the United States' request was timely[160], the Panel rules that Brazil provided a statement of available evidence with respect to export credit guarantee measures relating to upland cotton and eligible United States agricultural products other than upland cotton, as required by Article 4.2 of the *SCM Agreement*.[161]

**2. PFC and MLA payments**

(a) Expired programmes

7.104 The **United States** requests the Panel to rule that production flexibility contract ("PFC") payments and market loss assistance ("MLA") payments are not within its terms of reference because they expired prior to Brazil's request for consultations. Consultations under Article 4.2 of the *DSU* cannot cover expired measures, and measures not the subject of consultations cannot fall within a panel's terms of reference.[162] The United States did not address these payments in terms of substance in its first written submission.

7.105 **Brazil** asks the Panel to reject the United States' request, submitting that a panel is required to examine the effects flowing from expired measures in order to conduct an objective assessment of a serious prejudice claim. Otherwise, the actionable subsidies provisions of the *SCM Agreement* would be redundant, as a Member could easily tailor its measures in a fashion which effectively circumvented these disciplines.[163]

7.106 **New Zealand** considers that these measures should be within the scope of the Panel's consideration, particularly when the programmes in question in fact continue in a slightly different form, and given that serious prejudice claims may necessitate consideration of trends over a number of years.[164]

7.107 The parties agree that PFC and MLA payments were made under legislation that no longer exists. PFC payments constituted a programme under the FAIR Act of 1996 which no longer

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requirement under Article 4.2 of the *SCM Agreement* for a complaining Member to establish a *prima facie* case in its statement of available evidence.

[159] Article 3.10 of the *DSU*. See Appellate Body Report, *US – FSC*, para. 166.

[160] In light of our ruling, it is not necessary for us to address the issue of timeliness here.

[161] The Panel communicated to the parties on 3 November 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their further rebuttal submissions.

This ruling is, of course, without prejudice to the issue of whether or not a panel would be required to dismiss claims under Article 3 of the *SCM Agreement* because the complaining Member did not include a sufficient statement of available evidence in its request for consultations within the meaning of Article 4.2 of the *SCM Agreement*.

[162] United States' first written submission, para. 211.

[163] Brazil's oral statement at the first session of the first substantive meeting, para. 144; its response to Panel Question No. 15 and its closing statement at the first session of the first substantive meeting, para. 4.

[164] New Zealand's written submission to the first session of the first substantive meeting, para. 5.01.

authorizes payments.[165] MLA payments were made under four separate annual Acts in 1998, 1999, 2000 and 2001, discussed below. The authorizing legislation allocated these payments to a particular crop year (in the case of PFC payments) or fiscal year (in the case of MLA payments). All those measures and years of allocation expired prior to the date of Brazil's request for establishment of a panel. This is a different situation from that confronting some previous panels, where measures expired during their proceedings.

7.108 The Panel notes that Brazil pursues claims only in respect of the subsidies and domestic support provided under the expired programmes and authorizing legislation, in other words, the payments themselves.[166] Brazil does not seek any relief in respect of the PFC and MLA programmes or authorizing legislation "as such". Therefore, the Panel only considers whether the payments are within its terms of reference.

7.109 Brazil does not seek any recommendation that PFC and MLA payments be brought into conformity with the *Agreement on Agriculture* or the *GATT 1994* but only requests findings that those made during the 1999-2001 marketing years are not exempted from actions by Article 13 and that they caused and continue to cause serious prejudice to the interests of Brazil in violation of Articles 5(c) and 6.3(c) and (d) of the *SCM Agreement* and Articles XVI:1 and XVI:3 of the *GATT 1994*.[167]

7.110 PFC and MLA payments had already been made at the date of the establishment of the Panel. In that sense, they had not expired, but simply occurred in the past, which will be true of most subsidies challenged in a claim of actual serious prejudice. We agree with the following statement of the Panel in *Indonesia – Autos*:

> "We note that at any given moment in time some payments of subsidies have occurred in the past while others have yet to occur in the future. If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were "expired measures" while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice."[168]

7.111 However, to the extent that the payments constituted programmes "as applied", Brazil *is* challenging expired measures and the Panel will therefore consider the preliminary objection further.

7.112 The United States argues that for this reason these measures do not fall within the Panel's terms of reference. It cites Article 4.2 of the *DSU* which provides:

> "2. Each Member undertakes to accord sympathetic consideration to and afford adequate opportunity for consultation regarding any representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former."(footnote omitted)

7.113 The United States argues that measures that are no longer in effect at the time of consultations cannot be "affecting the operation of any covered agreement" at that time within the meaning of Article 4.2 of the *DSU* and therefore cannot be "measures at issue" within the meaning of Article 6.2 of the *DSU*.[169] Brazil argues that Article 4.2 has no temporal connotation.[170]

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[165] Nevertheless, the PFC programme was basically continued with modifications in the FSRI Act of 2002, as discussed in Section VII:D of this report.

[166] See Brazil's first written submission, para. 352 and Brazil's further written submission, para. 471.

[167] See Brazil's further written submission, para. 471 and its response to Panel Question No. 250.

[168] See the Panel Report, *Indonesia – Autos*, para. 14.206.

[169] See United States' response to Panel Question No. 15.

7.114 Article 4.2 of the *DSU* was applicable to Brazil's request for consultations in this dispute. The rules and procedures in the *DSU* are applicable to disputes under all the covered agreements, subject to any special rules and procedures listed in Appendix 2.[171] There are no special rules concerning requests for consultations that would prevail over Article 4.2 in this dispute.

7.115 Article 4.2 of the *DSU* contains the word "affecting" which, in the English and French versions, is a participle that refers not to the status of measures but rather to the way in which they relate to a covered agreement. This is consistent with the Spanish version which does not use a participle but rather a subjunctive verb in the phrase "*medidas que afecten*" which simply indicates measures of the type which may affect the operation of any covered agreement.

7.116 This is consistent with Article 3.3 of the *DSU* which states that:

> "The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

7.117 This provision is phrased in the present tense in all three authentic texts. It refers to situations in which a Member "considers" (present tense) that any benefits accruing to that Member under the covered agreements "are being impaired", (present continuous tense) by measures "taken" (past participle) by another Member. This provision focuses on the present nature of the alleged impairment of benefits but does not address whether or not measures themselves must still be in effect.

7.118 In light of the above, the Panel does not consider that Article 4.2 supports an interpretation that a request for consultations cannot concern measures that have expired, or payments made under programmes that are no longer in effect, where the Member requesting consultations represents that benefits accruing to it directly or indirectly under the covered agreements are being impaired by those measures.

7.119 Brazil's request for consultations alleges that the use of the measures specified in the request "causes adverse effects, i.e. serious prejudice" to its interests. We note the present tense of this allegation. The request concerns the way in which measures were affecting the operation of a covered agreement at the time of consultations, and it states that Brazil had reason to believe that these subsidies were resulting in serious prejudice at that time. As such, it satisfies the requirements of Article 4.2 of the *DSU*.

7.120 The United States also distinguishes between non-recurring subsidies and recurring subsidies and the period of time for which they are allocated to production, in support of an argument that recurring subsidies may not be actionable subsidies after they have expired.[172] Given our view that expired measures may be the subject of a request for consultations, it is not necessary for us to address this argument here. However, the Panel notes that the text of Part III of the *SCM Agreement* does not indicate that requests for consultations are to be governed in the way in which subsidies are expensed. Rather, the conformity of expired recurring subsidies to the provisions of Part III is an issue of substance and remedies and does not go to the scope of the terms of reference.

7.121 In any event, the Panel's terms of reference refer to Brazil's request for establishment of a panel, not its request for consultations. Article 6.2 of the *DSU* provides that a request for

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[170] Brazil's oral statement at the first session of the first substantive meeting, para. 142.
[171] Article 1.1 and 1.2 of the *DSU*.
[172] See United States' response to Panel Question No. 15.

establishment of a panel should identify the "specific measures at issue" and does not address the issue of the status of the measures at all.

7.122 For all of the above reasons, the Panel does not believe that Article 4.2, and hence Article 6.2, of the *DSU* excludes expired measures from the potential scope of a request for establishment of a panel.

(b) Identification as specific measures

7.123 The **United States** also notes that the request for establishment of a panel did not identify MLA payments by name and submits that it "raises concerns under Article 6.2 of the *DSU*".[173] The United States mentioned this in a footnote in its first written submission, and did not formally indicate that it was raising an objection. Objections should be clearly raised. However, for the record, the Panel wishes to explain its approach to this issue.

7.124 The request for establishment of a panel identified the pieces of legislation under which the MLA payments were authorized in the marketing years 1999-2001 in the following paragraph:

> "Subsidies provided under the Agricultural Assistance Act of 2003; Subsidies provided under the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2002 (November 2001), the Crop Year 2001 Agricultural Economic Assistance Act (August 2001), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001 (October 2000), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 (October 1999), and the Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1999 (October 1998);"[174]

7.125 Brazil submits that the four Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Acts in this list authorized MLA payments.[175] The United States indicated that these are the names and dates of the relevant legislation.[176] Elsewhere, the United States indicated that the last market loss assistance payment was authorized under Public Law 107-25, which is the third Act in the above list.[177] The Panel also notes that the Agricultural Risk Protection

[173] United States first written submission, para. 210, footnote 190. There is no dispute that the request for establishment of a panel identified PFC payments by name and by authorizing statute. It read, relevantly, as follows: "*Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to* marketing loans, loan deficiency payments, commodity certificates, *production flexibility contract payments*, conservation payments, Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other FAIR Act provisions providing direct or indirect support to the US upland cotton industry; [emphasis added]" (document WT/DS267/7, page 2).

[174] This paragraph also appeared in the request for consultations, minus the phrase "Subsidies provided under the Agricultural Assistance Act of 2003;".

[175] See Brazil's first written submission para. 60, footnote 129. The United States, in its first written submission, para. 209, footnote 188, agrees with the titles of the relevant legislation, and para. 210, footnote 190, it agrees that they were set out in the request for establishment of a panel. Compare Exhibit BRA-105, Annex 2, footnote16, which lists all five Acts in this paragraph besides the Agricultural Assistance Act of 2003.

[176] United States' first written submission, para. 209, footnote 188. In para. 210, footnote 190, the United States indicates that the MLA payments were authorized within these pieces of appropriations legislation.

[177] See section 1 of the law which is reproduced in Exhibit BRA-138. See United States' response to Panel Question No. 15. The title of this Public Law is discussed below in paragraph 7.142.

Act of 2000, which is cited elsewhere in the request for establishment of a panel, contained provisions relevant to MLA payments.[178]

7.126 The word "Agriculture" is missing from the title of the 1999 Act. This appears to have been a typographical error as it was correctly stated in the request for consultations and the rest of the title, which is lengthy, is correctly cited in the request for establishment of a panel and cannot refer to anything else. It therefore identifies the specific Act. The term "market loss assistance payments" does not appear.

7.127 In the Panel's view, this paragraph specifically identifies MLA payments in the marketing years 1999-2001 in accordance with Article 6.2 of the *DSU*. It specifically identifies the titles of the appropriating Acts and refers to the "subsidies" provided under them, one of which was in fact MLA payments. Brazil included the same paragraph (minus the 2003 Act) in its request for consultations and posed questions referring to "market loss assistance payments" by name during consultations[179] thereby confirming to the United States that the paragraph, when it was repeated in identical terms in all relevant respects in the request for establishment of a panel, referred to MLA payments, among other things. The United States has not alleged that the description in the request for establishment of a panel prejudiced the preparation of its defence.

7.128 Therefore, in light of our conclusion at paragraph 7.122, and the specific identification of MLA payments in the request for establishment of a panel, the Panel rules that PFC and MLA payments, as addressed in document WT/DS267/7, fall within its terms of reference.[180] This ruling is without prejudice to the relevance, if any, of PFC and MLA payments under the substantive provisions of Article 13(b) of the *Agreement on Agriculture*, Articles 5, 6 and 7 of the *SCM Agreement* and Article XVI of *GATT 1994*.

### 3. Payments with respect to non-upland cotton base acres[181]

7.129 The **United States** submits that payments made with respect to non-upland cotton "base acres" are not within the terms of reference of the Panel because neither the request for consultations nor the request for establishment of a panel referred to payments under programmes unrelated to upland cotton. It submits that Brazil has attempted to raise these payments at the very end of this proceeding which deprives the United States of fundamental rights of due process. The United States argues that the reference in Brazil's request for establishment of a panel to "payments ... providing direct or indirect support to the United States upland cotton industry" does not provide information that would allow identification of the specific measures at issue in accordance with Article 6.2 of the *DSU*. It argues that Brazil's own submissions to the Panel demonstrated that it did not consider payments with respect to non-upland cotton base acres within the terms of reference because it only referred to payments for upland cotton base acres or to measures with an upland cotton specific link in terms of historic, updated or present upland cotton acreage or present upland cotton production or prices.[182]

[178] See section 201 of the ARP Act, the table of contents of which is reproduced in Exhibit BRA-137.

[179] See questions 11.1 to 11.3 in Exhibit BRA-101. The United States confirms that these questions were posed during consultations: see its response to Panel Question No. 8.

[180] The Panel communicated to the parties and third parties in a letter dated 25 July 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their answers to questions and rebuttals.

[181] The term "base acres" is a feature of certain direct payments support programmes at issue, which is explained in the description of measures in Section VII:C below.

[182] See the United States' oral statement at the second substantive meeting, para. 31; its response to Panel Question No. 256; its 28 January 2004 comments on Brazil's response to Panel Question No. 204; its 11 February 2004 comments, paras. 48-50 and its 15 March 2004 comments, para. 4.

7.130 **Brazil** responds that the issue of the amount of these payments is part of the broader legal question of the amount of support to upland cotton under Article 13(b)(ii) of the *Agreement on Agriculture*. It also argues that its request for establishment of a panel fully complied with Article 6.2 of the *DSU* because it identified by name the specific laws providing the contract payments, the specific types of payments, the class of recipients and the specific time period when those payments were made. Brazil argues that there is no requirement to identify sub-categories of payments on non-upland cotton base acreage and on upland cotton base acreage. It submits that the United States' argument is untimely.[183]

7.131 The Panel notes that this issue relates to PFC, MLA, DP and CCP payments, which are described in Section VII:C of this report, and to the methodology for allocating those payments as support to specific commodities, which is discussed in Section VII:D of this report. The relevant paragraphs in Brazil's request for establishment of a panel read as follows:

> "The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton [original footnote omitted], as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies (including export credit guarantees), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry"). The measures include the following:
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> (...)
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> "Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans, loan deficiency payments (LDPs), commodity certificates, direct payments, counter-cyclical payments, conservation payments (to the extent they exceed the costs of complying with such programs), Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other provisions of FSRIA that provide direct or indirect support to the US upland cotton industry;"
>
> (...)
>
> "Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to marketing loans, loan deficiency payments, commodity certificates, production flexibility contract payments, conservation payments, Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other FAIR Act provisions providing direct or indirect support to the US upland cotton industry;"
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> (..)
>
> "Subsidies provided under the Agricultural Assistance Act of 2003; Subsidies provided under the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2002 (November 2001), the Crop Year 2001 Agricultural Economic Assistance Act (August 2001), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001 (October 2000), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 (October 1999),

[183] Brazil's 28 January 2004 comments, paras. 18 and 19; 18 February 2004 comments, paras. 80-82.

> and the Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1999 (October 1998);"

7.132 These paragraphs contain no reference to payments on upland cotton base acres and there is nothing that would imply such a limitation. They specifically identify the four types of payments at issue, three of them by name.[184] The chapeau refers to "subsidies provided to US producers, users and/or exporters of upland cotton" and, together with the paragraphs quoted above, clearly covers payments under these programmes to recipients with current United States upland cotton production, whether or not they hold upland cotton base acreage. Therefore, the Panel rules that PFC, MLA, DP and CCP payments to upland cotton producers with respect to non-upland cotton base acres are within the terms of reference of the Panel.

7.133 The United States also refers to Brazil's submissions to the Panel. These do not alter the Panel's terms of reference and, in any event, the passages to which the United States refers do not support the inference which it asks the Panel to draw concerning Brazil's own understanding of the scope of the terms of reference. Brazil's first written submission referred to USDA data showing the amount of payments, which showed how Brazil calculated the *amount* of payments, not which payments it considered were within the Panel's terms of reference. In fact, at that stage, neither Brazil nor the Panel knew that the USDA data tabulated all payments with respect to upland cotton base acres. Brazil's response to Panel question No. 41 expressly indicated that the measures at issue could include those with a link to present upland cotton acreage or production, and not merely upland cotton base acreage. Brazil's response to Panel question No. 44 included payments with a link to one of those parameters: present upland cotton prices. Brazil's request for relief referred to sections of the FSRI Act of 2002 relating to DP and CCP payments "to the extent that they relate to upland cotton". Sections of that Act authorizing DP and CCP payments to recipients with present upland cotton acreage or production, and not merely upland cotton base acreage, relate to upland cotton and are therefore within the terms of Brazil's request for relief.

7.134 The United States submits that these payments were raised at the very end of this proceeding which deprives it of fundamental rights of due process.[185] However, the extent to which PFC, MLA, DP and CCP payments are relevant support to upland cotton has been a central issue in this dispute since the parties' first written submissions in June and July 2003. Brazil's first written submission expressly presented the following argument:

> "Thus, the phrase "such measures ... grant support" requires identifying all such forms of support, and if need be, allocating the portion of support (by measures that are provided to more than one commodity) to the individual commodity under consideration."[186]

7.135 Brazil referred to the "portion of upland cotton (...) payments that actually benefits acres planted to upland cotton" on 11 August 2003 in its response to Panel question No. 67 after the first session of the first substantive meeting. The United States submitted that Brazil had failed to bring forward evidence that the recipients of these payments were upland cotton producers at the resumed session of the first substantive meeting on 7 October 2003. Both parties addressed payments on non-upland cotton base acreage in their responses to Panel question No. 125(8) on 27 October 2003. Brazil requested information on all programme crop base during the second substantive meeting on

[184] The Panel considers that this paragraph identifies MLA payments for the reasons given in paras. 7.124-7.128 above.

[185] See the United States' oral statement at the second substantive meeting, para. 31; its response to Panel Question No. 256; its 28 January 2004 comments on Brazil's response to Panel Question No. 204 and its 11 February 2004 comments, paras. 48-50.

[186] Brazil's first written submission, para. 135.

2 December 2003.[187] Since that meeting, the United States has addressed the issue of allocation of these payments on four occasions in its response to Panel question No. 256 on 22 December 2003, its comment on Brazil's response to Panel question No. 204 on 28 January 2004, its comment on Brazil's comments on United States data on 11 February 2004 and its comment on Brazil's comments on United States data on 15 March 2004.

7.136 These facts show that this matter was not raised at the very end of the proceedings and that the United States has in fact responded to it. Therefore, the Panel considers that the United States' rights of due process have been respected.

**4. Cottonseed payments**

(a) Public Laws 106-224 and 107-25

7.137 The **United States** submits that cottonseed payments for the 2000 crop of cottonseed are not within the Panel's terms of reference because they were not identified as measures at issue in the request for consultations or the request for establishment of a panel.[188]

7.138 **Brazil** argues that these measures were the subject of consultations and that they were identified in the request for establishment of a panel.[189]

7.139 The parties agree that cottonseed payments for the 2000 crop were made under Public Laws 106-224 and 107-25.[190] The Panel notes that Brazil's request for establishment defines "upland cotton" in the first footnote to include upland cotton cottonseed as follows:

> "The term 'upland cotton' means raw upland cotton as well as the primary processed forms of such cotton including upland cotton lint and cottonseed."[191]

7.140 The short title as enacted of Public Law 106-224 is the Agricultural Risk Protection Act of 2000.[192] Both the request for consultations and the request for establishment of a panel refer to:

> "Subsidies and domestic support provided under the Agricultural Risk Protection Act of 2000 and any other measures that provide subsidies relating to crop, disaster or other types of insurance to the US upland cotton industry;"

7.141 The short title as enacted of Public Law 107-25 is, according to the United States, the Emergency Agricultural Assistance Act, but the short title as introduced into the United States Congress was the Crop Year 2001 Agricultural Economic Assistance Act (August 2001).[193] Both the request for consultations and the request for establishment of a panel refer to:

> "Subsidies provided under … the Crop Year 2001 Agricultural Economic Assistance Act (August 2001) …;"

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[187] See Exhibit BRA-369, dated 2 December 2003 and revised 3 December 2003, submitted with Brazil's oral statement at the second substantive meeting.

[188] United States' rebuttal submission, para. 108 and further written submission, para. 8.

[189] Brazil's oral statement at the resumed session of the first substantive meeting, para. 79.

[190] Brazil's response to Panel Question No. 17 and United States' rebuttal submission, para. 107.

[191] Upland cotton accounts for approximately 97 per cent of United States cotton production: see USDA Economic Research Service, Briefing Room – Cotton, and background paper dated July 2001 reproduced in Exhibits BRA-13 and BRA-46, respectively. It does not include extra long staple ("ELS") cotton.

[192] Public Law 106-224 is reproduced in Exhibit BRA-137. The short title as enacted appears on the cover page and in the first margin.

[193] Public Law 107-25 is reproduced in Exhibit BRA-138. No short title appears in it. The United States indicated the short title in its response to Panel Question No. 17.

7.142 The short title as introduced of Public Law 107-25 is listed on the United States Library of Congress legislative database as a title of that Act, whilst the title indicated by the United States to the Panel is not. In response to a question posed by the Panel, the United States at first agreed that Public Law 107-25 "arguably may be found in Brazil's consultation and panel requests" because it identified the Crop Year 2001 Agricultural Economic Assistance Act (August 2001) as a title of that Act.[194] That title cannot refer to any other Act. In these circumstances, the short title as introduced is sufficiently precise and has in fact identified the measure to the respondent for the purposes of both Articles 4.4 and 6.2 of the *DSU*.

7.143 Further, the cottonseed payments authorized by Public Law 107-25 were provided under the Agricultural Risk Protection Act of 2000, which is named in Brazil's request for establishment of a panel. Section 6 of Public Law 107-25 provided as follows:

> "The Secretary shall use $84,700,000 of funds of the Commodity Credit Corporation to provide supplemental assistance under section 204(e) of the Agricultural Risk Protection Act of 2000 (Public Law 106-224; 7 U.S.C. 1421 note) to producers and first-handlers of the 2000 crop of cottonseed that previously received assistance under such section."[195]

7.144 Therefore, the Panel rules that the cottonseed payments under both Public Law 106-224 and Public Law 107-25 are within its terms of reference.[196]

(b) Public Law 106-113

7.145 The **United States** submits that the cottonseed payments for the 1999 crop are not within the Panel's terms of reference because they were not identified as measure at issue in the request for consultations or the request for establishment of a panel. It is agreed that cottonseed payments for the 1999 crop were made under Public Law 106-113.[197] Brazil admits that it did not explicitly identify this law in its request for establishment of a panel.[198] There are dozens of short titles of this law, which was a consolidated appropriations Act. Neither the request for consultations nor the request for establishment of a panel refer to this Public Law by any of these titles or its number.

7.146 **Brazil** initially submitted in error that payments for the 1999 crop were made under Public Law 106-224.[199] Later, it left open the possibility that some payments for the 1999 crop were made under this law, in addition to those under Public Law 106-113.[200] However, section 204(e) of Public Law 106-224, which Brazil cites as the relevant provision, only referred to the 2000 crop.[201] The text of the implementing regulations which Brazil provided indicated that that law only applied to the

[194] United States' response to Panel Question No. 17.

[195] Public Law 107-25 is reproduced in Exhibit BRA-138.

[196] The Panel communicated to the parties in a letter dated 3 November 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their further rebuttal submissions.

[197] Brazil's response to Panel Question No. 17 and United States' rebuttal submission, para. 107. Public Law 106-113 is reproduced in Exhibit BRA-136. Section 104 of Appendix E of that law granted the Secretary of Agriculture the discretion to make cottonseed payments for the 1999 crop from unused funds made available under section 802 of Title VIII of Public Law 106-78 (the short title of which was the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriations Act 2000) which is identified in both the request for consultations and the request for establishment of a panel, and section 1111 of Division A of Public Law 105-277, which was not identified in either. These two laws may have provided the source of funding but they did not provide the legal basis of the appropriation for the 1999 cottonseed payment program. They therefore did not identify the cottonseed payments for the 1999 crop as measures at issue.

[198] See Brazil's response to Panel Question No. 123.

[199] Brazil's first written submission, para. 106, footnote 274.

[200] See Brazil's response to Panel Question No. 123.

[201] Section 204 is reproduced in Exhibit BRA-137.

2000 crop.[202] There is no evidence before the Panel that any cottonseed payments for the 1999 crop were made under Public Law 106-224.

7.147 After the United States requested a preliminary ruling regarding Public Law 106-113, Brazil submitted that all forms of cottonseed payments from the marketing years 1999-2007 are covered by the following passages of its request for establishment of a panel:[203]

> "Domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2001;
>
> Domestic support subsidies that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;
>
> All subsidies or support measures benefiting upland cotton that have trade-distorting effects or effects on production by the US upland cotton industry,
>
> Export subsidies, domestic support, and other subsidies provided under regulations, administrative procedures, administrative practices and any other present measures or future measures implementing or amending any of the measures listed above, that provide for or facilitate the payment of domestic support, export subsidies, and other subsidies for the production, use and/or export of US upland cotton and upland cotton products."

7.148 We recall that Article 6.2 of the *DSU* provides that a request for establishment of a panel:

> "… shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. …"

7.149 None of the passages cited by Brazil specifically mentions cottonseed payments or any instrument under which cottonseed payments were authorized or made. These descriptions of subsidies and measures are so vague that they do not give notice to the respondent that any specific cottonseed measures are at issue. The cottonseed payments that are within the Panel's terms of reference were made under legislation which Brazil chose to name in its request for establishment of a panel. That legislation does not include the legislation authorizing the payments for the 1999 crop.

7.150 The last passage cited refers to "future measures implementing or amending any of the measures listed above" which included the two Public Laws appropriating funds for cottonseed payments for the 2000 crop, discussed above. Public Law 106-113 does not fall within this description because it was prior legislation. Nor can payments under Public Law 106-113 be considered part of a single programme identified by the references to Public Laws 106-224 and 107-25, for the reasons given in paragraphs 7.163 to 7.167 below. Therefore, the quoted passages do not satisfy the requirements of Article 6.2 in relation to cottonseed payments.

7.151 In fact, Brazil posed questions to the United States during consultations concerning support for cottonseed production and exports, and specifically raised a "Cottonseed Payment Program", a "Recourse Seed Cotton Loan Program" and "any export enhancement programmes to encourage the export of cottonseed products".[204] Brazil indicated that the United States provided answers

[202] The regulations are reproduced in Exhibit BRA-32

[203] Brazil's oral statement at the resumed session of the first substantive meeting, para. 79, quoting passages from its request for the establishment of a panel.

[204] See Exhibit BRA-101, questions 14.1-14.5. The United States confirmed that the document in which these questions were posed was sent to it during consultations – see its response to Panel Question No. 8.

concerning cottonseed payments in the marketing years 1999 and 2000.[205] The fact that Brazil then chose, in its request for establishment of a panel, only to name the Public Laws appropriating funds for cottonseed payments for the 2000 and 2002 crops, in the absence of a reference to "cottonseed payments", indicated, if anything, that it was *not* challenging the cottonseed payments for the 1999 crop.

7.152 For the above reasons, the Panel rules that the cottonseed payments under section 104 of Public Law 106-113 are not within its terms of reference.[206]

7.153 In the Panel's view, this is an issue which goes to its jurisdiction and which does not depend on whether a party requests a preliminary ruling in a timely manner. The Panel is not empowered to make a finding in relation to this measure. However, the Panel notes for the record that the United States respected the Panel's working procedures in raising its objection. These procedures provide relevantly as follows:

> "12. A party shall submit any request for preliminary ruling not later than its first submission to the Panel. … Exceptions to this procedure will be granted upon a showing of good cause."

7.154 The United States' request for this preliminary ruling was made later than its first submission to the Panel. Brazil mentioned cottonseed payments for the 1999 crop for the first time in these proceedings in its first written submission.[207] It mentioned Public Law 106-113 for the first time in its answers to the Panel's questions after the first session of the first substantive meeting, when it also provided a copy of the relevant section of the law.[208] The United States first raised this issue in its written answers to the Panel's questions at the same time, when it noted that the legislation authorizing cottonseed payments for the 1999 crop was not found in the request for consultations or the request for establishment of a panel.[209] The United States formally submitted that the payments did not form part of the Panel's terms of reference in its rebuttal submission. It explained that it became aware of this difficulty "in the course of preparing its answer to Question No. 17 from the Panel and reviewing Brazil's answers to Questions Nos. 17 and 19".[210] It reiterated its request in its further submission.[211] For these reasons, the Panel finds that the United States has shown good cause for not submitting its request for preliminary ruling earlier.

(c) Agricultural Assistance Act of 2003

7.155 The **United States** requests the Panel to rule that any measure under the Agricultural Assistance Act of 2003, including those portions of the Act that provide "a one-time cottonseed payment", is not within its terms of reference because the measure was not consulted upon and was not enacted until after Brazil presented its request for establishment of a panel.[212] The United States requested this preliminary ruling in its first written submission in accordance with paragraph 12 of the

[205] See Brazil's first written submission, para. 106, footnote 272.

[206] The Panel communicated to the parties in a letter dated 3 November 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their further rebuttal submissions. At that time, the Panel indicated that this was without prejudice to the relevance, if any, of the cottonseed payments for the 1999 crop to the conditions set out in Article 13(b) of the *Agreement on Agriculture*.

[207] Brazil's first written submission, para. 106. It had posed questions during consultations regarding cottonseed production and exports during the marketing years 1992-2002.

[208] See Brazil's response to Panel Question No. 17 and Exhibit BRA-136.

[209] See United States' response to Panel Question No. 17.

[210] See United States' rebuttal submission, para. 108.

[211] See United States' further written submission, para. 8.

[212] United States' first written submission, paras. 212-217, its rebuttal submission, para. 106 and its further written submission, para. 8.

Panel's working procedures. It did not address measures under this Act in terms of substance in its first written submission.

7.156 **Brazil** submits that the request should be rejected because the Agricultural Assistance Act of 2003 was enacted prior to the establishment of the Panel.[213]

7.157 The Panel notes that this piece of legislation has been raised in these proceedings only in relation to cottonseed payments of $50 million to assist producers and first handlers for the 2002 crop. The Agricultural Assistance Act of 2003 is the short title as enacted of Title II of Public Law 108-7.[214] The parties agree that it was not enacted until 20 February 2003.[215] Brazil submitted its request for establishment of a panel (document WT/DS267/7) on 6 February 2003, which was considered by the DSB for the first time on 19 February 2003[216] and on the basis of which the DSB established the Panel on 18 March 2003. On the date of establishment, the DSB decided that the Panel's terms of reference were the following:

> "To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".[217]

7.158 The "matter" referred to the DSB by Brazil in document WT/DS267/7 consisted of the measures and claims set out in that document[218] which was dated 6 February 2003. On that date, the Agricultural Assistance Act of 2003 did not exist, had never existed and might not subsequently have ever come into existence. Brazil anticipated adoption of that Act in its panel request and its claim in respect of that Act was entirely speculative. Therefore, Brazil could not refer it to the DSB at that time and it does not form part of the Panel's terms of reference.[219]

7.159 We believe that this is consistent with the principle set out in Article 3.3 of the *DSU* which provides that:

> "The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

7.160 In this case, the Agricultural Assistance Act of 2003 could not possibly have been impairing any benefits at the date of Brazil's referral of its complaint to the DSB because it did not yet exist.[220]

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[213] Brazil's oral statement at the first session of the first substantive meeting, para. 145.

[214] The Act is reproduced in Exhibit BRA-135.

[215] United States' first written submission, para. 212; Brazil's oral statement at the first session of the first substantive meeting, para. 148.

[216] See the minutes of the DSB meeting in document WT/DSB/M/143, paras. 22-25.

[217] Document WT/DS267/15; See the minutes of the DSB meeting in document WT/DSB/M/145, para. 22.

[218] See Appellate Body Report, *Guatemala – Cement I*, para. 72, and the Panel Report, *Australia – Automotive Leather II (Article 21.5 – US)*, para. 6.4.

[219] In our communication dated 25 July 2003, the Panel asked the parties not to exclude consideration of the Agricultural Assistance Act of 2003 in responding to the Panel's written questions and in rebuttal submissions.

[220] We note that the Panel in *Australia – Automotive Leather II (Article 21.5 – US)*, at paras. 6.4-6.5, declined to conclude that a measure specifically identified in the request for establishment was not within its

7.161 Brazil argues that the Agricultural Assistance Act of 2003 essentially continues a supposed "Cottonseed Payment Program that existed since at least MY 1999" by authorizing funding of $50 million for the 2002 crop. It argues that all aspects of the existing programme remained intact and that there was an "existing unfunded" programme at the time the Agricultural Assistance Act of 2003 was enacted. [221]

7.162 The Panel notes that the cottonseed payments for each year were *ad hoc* appropriations, each with a separate legal basis, which did not follow a single model.[222] The scope of each appropriation was distinct and limited to a single year's crop of cottonseed. The frequency of the appropriations was irregular, with one for each of the 1999 and 2002 crops, two for the 2000 crop and none for the 2001 crop. The value of the funds available to each programme varied widely: $79 million for the 1999 crop,[223] $100 million for the 2000 crop, a further $84.7 million for the 2000 crop and $50 million for the 2002 crop.

7.163 The Panel's terms of reference include Public Laws 106-224 and 107-25, which each appropriated a specific amount of money for the 2000 crop of cottonseed only. Under the regulation implementing the cottonseed payments appropriated by both those laws, payments were available to first handlers of cottonseed who had applied to participate in the "Cottonseed Payment Program" in accordance with section 204(e) of Public Law 106-224. Payments were made in accordance with regulations dated 2 November 2000. The payment rate (dollars per ton) was calculated by dividing the total available funds by the total payment quantity of 2000 crop cottonseed.[224] No cottonseed payments were made for the 2001 crop.

7.164 The Agricultural Assistance Act of 2003 contains a single provision regarding cottonseed, which reads, in its entirety, as follows:

> "Sec. 206. COTTONSEED
>
> The Secretary shall use $50,000,000 of funds of the Commodity Credit Corporation to provide assistance to producers and first-handlers of the 2002 crop of cottonseed."

7.165 Section 206 did not amend or modify any existing or previous programme. Unlike Public Law 107-25, it did not provide for assistance under an earlier law, it did not define the recipients as those who had previously received assistance and it was not implemented by an existing regulation.[225]

7.166 Section 206 was implemented by means of new regulations dated 25 April 2003,[226] the text of which was modelled on the regulations for the 1999 and 2000 crops.[227] Each set of regulations required the submission of fresh applications by first handlers, so that eligibility in one year did not

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terms of reference "in the absence of any compelling reason". We believe that the speculative inclusion of a something which had not yet been adopted is such a compelling reason.

[221] Brazil's oral statement at the first session of the first substantive meeting, paras. 146 and 148 and its response to Panel Question No. 17.

[222] The Agricultural Assistance Act of 2003 was a title within Public Law 108-7 which made consolidated appropriations for fiscal year 2002, most of them unrelated to agriculture. Cottonseed payments for the 2000 crop were made under Public Laws devoted solely to agriculture and the cottonseed payments for the 1999 crop were made under a consolidated appropriations Act, discussed above.

[223] United States' and Brazil's respective responses to Panel Question No. 17.

[224] See 7 CFR 1427.1100(a) and 1427.1109, reproduced in Exhibit BRA-32.

[225] See section 6 of Public Law 107-25, reproduced in Exhibit BRA-138.

[226] See the 2002 regulation from 68 FR 20331 *et seq.*, reproduced in Exhibits BRA-139 and US-14.

[227] See the 2000 regulation from 65 FR 65722 *et seq.*, reproduced in Exhibits BRA-32 and US-15. See the 1999 regulation from 65 FR 36563 *et seq.*, reproduced in Exhibit US-16. The background notes in the supplementary information published with the 2002 regulation expressly state that "This rule follows the model set by those preceding programs", i.e. for the 1999 and 2000 crops of cottonseed.

carry over to the next. The formula for calculating the payment rate was basically the same in each regulation, being the quotient of the funds available (which varied in each year) divided by the eligible quantity of cottonseed (which varied in each year). The administration had a discretion to adjust the payment rate in 1999 and 2002, but not in 2000. In contrast, Public Law 107-25, which appropriated a second payment for the 2000 crop, was expressed as supplemental assistance under Public Law 106-224.

7.167 This evidence discloses the existence of separate and legally distinct cottonseed payment programmes for crops in different years rather than a single cottonseed payment programme. There was not in fact any programme in effect at the time of Brazil's request for establishment of a panel. At that time, for the 2002 crop of cottonseed, there was no applicable statute, no applicable regulation, no eligible quantity of cottonseed nor any available funds. As a result, the payments under section 206 of the Agricultural Assistance Act of 2003 were entirely separate measures which Brazil could not refer to the DSB on 6 February 2003, a date prior to its adoption.

7.168 The Panel also notes that the Agricultural Assistance Act of 2003 was not specifically the subject of consultations, nor could it have been, since it did not yet exist at the time consultations were held. It was not named in Brazil's request for consultations. Brazil argues[228] that the authorization of funds for the "Cottonseed Payment Program", including under the Agricultural Assistance Act of 2003, was covered in its request for consultations by the following paragraph:

> "Export subsidies, domestic support, and other subsidies provided under regulations, administrative procedures, administrative practices and any other present measures, amendments thereto, or future measures implementing any of the measures listed above, that provide for or facilitate the payment of domestic support, export subsidies, and other subsidies for the production, use and/or export of US upland cotton and upland cotton products."

7.169 It highlights the following words in that paragraph:

> "… other subsidies provided under regulations … amendments thereto, of future measures implementing any of the measures listed above …"

7.170 However, for the reasons already given, the Panel does not consider that the Agricultural Assistance Act of 2003 is an amendment, or a measure implementing any of the measures within the Panel's terms of reference. It appropriated funds to a separate programme - "the 2002-Crop Cottonseed Payment Program"[229] - in respect of which the complainant did not request consultations and with regard to which the parties did not actually consult.

7.171 Therefore, for all of the above reasons, the Panel rules that the cottonseed payments under the Agricultural Assistance Act of 2003 are not within its terms of reference.[230] No ruling is required in relation to other provisions of that Act since none have been raised in the parties' substantive submissions to the Panel.

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[228] Brazil's oral statement at the first session of the first substantive meeting, para. 146.

[229] See title of Subpart F of 7 CFR 1427 published at 68 FR 20331 *et seq.* (25 April 2003), reproduced in Exhibit BRA-139.

[230] The Panel communicated to the parties in a letter dated 8 December 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their answers to questions. At that time, the Panel indicated that this was without prejudice to the relevance, if any, of the cottonseed payments for the 2002 crop to the conditions set out in Article 13(b) of the *Agreement on Agriculture*.

**5. Storage payments and interest subsidies**

7.172 The United States, in response to a question posed by the Panel at the first session of the first substantive meeting, prepared AMS calculations which included a line that read "Other payments", followed by a number and the source "USDA estimate of storage payments and interest subsidy".[231] Brazil then referred to these other payments in its comments on the United States' responses[232] and included them in its further submission.[233]

7.173 The **United States** requests the Panel to rule that "other payments", as referred to in Brazil's further submission, are not within its terms of reference because they did not appear in the request for consultations or the request for establishment of a panel.[234] The United States submits that these other payments are storage payments and interest subsidies estimated by the United States Department of Agriculture.

7.174 **Brazil** submits that these other payments are covered by the same passages of its request for establishment of a panel quoted in full at paragraph 7.147 of this report. Brazil submits that they encompass, but apparently are not limited to, storage payments and interest subsidies.[235]

7.175 The Panel notes that none of the passages in the request for establishment of a panel cited by Brazil specifically mention storage payments or interest subsidies or any measures under which such payments and subsidies were authorized or made. These descriptions of subsidies and measures are so vague that they do not give notice to the respondent that any specific storage payments or interest subsidies are at issue. They therefore do not satisfy the requirements of Article 6.2 of the *DSU*.

7.176 Brazil submits that these payments were covered by the reference in the questions posed during consultations to "any other support to or government funding for the US upland cotton industry."

7.177 The Panel notes that, even if this were correct, this would not bring them within the Panel's terms of reference if they were not covered by the request for establishment of a panel.

7.178 Brazil also submits that these other payments are part of the operation of the marketing loan programme.[236] The United States agrees that interest subsidies and storage payments are support provided in connection with the marketing loan programme.[237]

7.179 The Panel notes that the United States government's Commodity Credit Corporation pays storage charges and waives interest upon forfeit of warehouse-stored upland cotton under loan. It also wavies storage and interest charges on redemption of upland cotton under loan where the repayment amount is low enough in order to implement its obligation to permit producers to repay a marketing loan at the repayment rate.[238] Were these charges not borne by the United States government, they could reduce the guaranteed revenue to the producer below the loan rate.[239] The waiver of storage and

[231] United States' response to Panel Question No. 67, para. 129.
[232] Brazil's 22 August comments on United States' responses to Panel Questions Nos. 54, 57 and 60.
[233] Brazil's further written submission, para. 7.
[234] United States' further written submission, para. 7.
[235] Brazil's oral statement at the resumed session of the first substantive meeting, paras. 80-81.
[236] Brazil's oral statement at the resumed session of the first substantive meeting, para. 80.
[237] United States' 27 August 2003 comments, para. 13, and its response to Panel Question No. 192.
[238] FAIR Act of 1996, section 134(b) and FSRI Act of 2002, section 1204(b), reproduced in Exhibits BRA-28 and BRA-29, respectively.
[239] See United States' 27 August 2003 comments, para. 13; United States' response to Panel Question No. 192(b); USDA Fact Sheet: Upland Cotton, January 2003, page 2; and USDA Farm Services Agency "Background Information: Non-Recourse Marketing Assistance Loans and Loan Deficiency Payments", March 1998, reproduced in Exhibits BRA-4 and BRA-50, respectively.

interest charges is provided for in the marketing loan programme regulations.[240] Therefore, the waiver of these storage and interest charges formed part of the conditions of the marketing loan programme.

7.180 The request for establishment of a panel refers to:

> "Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to marketing loans …" and
>
> "Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans …".

7.181 The storage payments and interest subsidies fall squarely within the descriptions set out in these paragraphs of the request for establishment of the Panel. The reference to the specific name of the programme and the name of the statutes under which it existed and exists at all relevant times, provide the level of specificity that was required to notify the United States that Brazil put these payments in issue. The reference to the implementing regulations and administrative procedures under the FSRI Act of 2002 confirmed this. The request therefore satisfied the requirements of Article 6.2 of the *DSU* in relation to these storage payments and interest subsidies and the Panel rules that storage and interest payments that implement the marketing loan programme are within its terms of reference.[241]

### 6. Payments made after the establishment of the Panel

7.182 The **United States** submits that measures taken after the Panel was established cannot be within the Panel's terms of reference and, to the extent that Brazil challenges payments, as opposed to legal instruments "as such", those made after the date of establishment of the Panel are outside the Panel's terms of reference.[242] The United States raised this issue in passing in its response to a question from the Panel concerning the calculation of AMS, and later explained its views in response to questioning by the Panel.[243]

7.183 **Brazil** submits that these payments are identified in its request for establishment of a panel and are within the Panel's terms of reference.[244] It recalls that the panel in *Indonesia – Autos* did not find that only non-expired subsidies paid up until the date of establishment of the panel should be considered for the purposes of assessing serious prejudice. It notes that the statutes and regulations set out in the terms of reference have not changed and mandated payments both before and after the date of establishment of the Panel.[245]

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[240] 7 CFR 1427.13 and 1427.19, (1 January 2000 edition), first published at 61 FR 37601 on 18 July 1996, and (1 January 2003 edition), first published at 67 FR 64459 on 18 October 2002, reproduced in Exhibits US-117 and US-118, respectively.

[241] In our communications dated 3 November and 8 December 2003, the Panel asked the parties not to exclude consideration of these other payments in their further rebuttal submissions, to respond to its written questions relevant to these payments and not to exclude consideration of these payments in their answers to other questions.

[242] United States' responses to Panel Questions No. 67, paras. 129, and 194.

[243] United States' response to Panel Question No. 194.

[244] Brazil's response to Panel Question No. 194. Brazil has also argued that the cottonseed payments made in June 2003 is "before the Panel" because an objective assessment of support to upland cotton in the marketing year 2002 requires the tabulation of all support to upland cotton. See Brazil's oral statement at the first session of the first substantive meeting, para. 151 and its response to Panel Question No. 17.

[245] Brazil's 28 January 2004 comments on the United States' response to Panel Question No. 194.

7.184 The Panel was established on 18 March 2003, a date during the term of the FSRI Act of 2002, which provides authority for the marketing loan, user marketing (step 2), counter-cyclical payments and direct payments programmes during the 2002 through 2007 crop years.[246] Payments were authorized and continued to be authorized under these programmes, as well as the crop insurance and export credit guarantee programmes at issue, before and after the date of establishment of the Panel.

7.185 The date on which the Panel was established fell during the 2002 marketing year for upland cotton in the United States, which began on 1 August 2002 and ended on 31 July 2003.[247] Therefore, payments made during the complete 2002 marketing year include those made during the period of 4½ months immediately following the date of establishment of the Panel.[248]

7.186 Brazil's request for establishment of a panel specifically identifies these current domestic support and export credit guarantees in the following paragraphs:

> "Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans, loan deficiency payments (LDPs), commodity certificates, direct payments, counter-cyclical payments, conservation payments (to the extent they exceed the costs of complying with such programs), Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other provisions of FSRIA that provide direct or indirect support to the US upland cotton industry;
>
> Subsidies and domestic support provided under the Agricultural Risk Protection Act of 2000 and any other measures that provide subsidies relating to crop, disaster or other types of insurance to the US upland cotton industry;
>
> Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton, and other eligible agricultural commodities as addressed herein, provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;"

7.187 The programmes and legislation identified in these paragraphs include payments made before the date of establishment of the Panel, and those made subsequently. All such payments were and are made under the same legislative and regulatory provisions which entered into effect prior to the consultations and have remained in place throughout this Panel proceeding. Therefore, the Panel rules that payments under programmes and legislation within the Panel's terms of reference, made after the date on which the Panel was established, as addressed in document WT/DS267/7, are within its terms of reference.

7.188 Certain other considerations support this finding. Brazil's request for establishment of a panel specifically identifies the fact that some of the measures at issue were provided in the past, some in the current marketing year, and others will be provided in the future, in the paragraphs which immediately preceded those quoted above, as follows:

> "Domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2001 [original footnote omitted];

[246] Sections 1108, 1201(a)(1) and 1207(a)(1) of the FSRI Act of 2002, reproduced in Exhibit BRA-29. The crop year is the same as the marketing year.

[247] See the definition in 7 CFR 1412.103 (1 January 2003 edition), reproduced in Exhibit BRA-35.

[248] This does not include the cottonseed payments for the 2002 crop, which were not made until 5 June 2003: see Exhibit BRA-129, cited in the United States' rebuttal submission, para. 106, footnote 132. The Panel has ruled that these payments are not within its terms of reference in paragraph 7.171.

> Domestic support subsidies that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;
>
> Export subsidies provided to the US upland cotton industry during marketing years 1999-2001;
>
> Export subsides that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;
>
> Subsidies provided contingent upon the use of US over imported upland cotton in marketing years 1999-2001 and that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;"

7.189 The second, fourth and fifth of these paragraphs expressly put the respondent on notice that Brazil put subsequent payments in issue. Although these paragraphs are not sufficiently specific to identify subsequent payments under any programme or provision of legislation not itself specifically identified in accordance with Article 6.2 of the *DSU*, neither party has put any such payments in issue.

7.190 In each of the same paragraphs Brazil asserts that the alleged subsidies at issue provided during marketing years 2002-2007 were mandated to be provided as at the date of establishment of the Panel. Therefore, on its face, the request does not assert speculative claims.[249] The question whether the subsidies are indeed mandated to be provided is one of substance which the Panel will consider together with the claims.[250]

7.191 Furthermore, the claims in the present dispute raise the issue of serious prejudice to the interests of another Member, which includes a threat of serious prejudice.[251] Part III of the *SCM Agreement* and Article XVI of *GATT 1994* expressly provides Members with a right to take action against serious prejudice which may not yet have occurred. There is nothing in the text which indicates that this right is limited to a window of subsidies provided in the past but which cause serious prejudice in the future. The object and purpose of Part III of the *SCM Agreement*, which can be summed up in the basic obligation that "no Member should cause, through the use of any subsidy … adverse effects to the interests of other Members",[252] confirm this view. If a Member were unable to bring an action against subsidies until they were actually paid, this would undermine the object of preventing adverse effects to its interests. This approach is consistent with the approach of certain previous WTO and GATT panels.[253]

7.192 The evidence properly before the Panel is a separate issue from the measures within its terms of reference. It is agreed that the Panel may look at evidence subsequent to the date of its establishment.[254] Payments made after that date under legislative instruments that are within the Panel's terms of reference form an essential part of the facts of this case for two reasons.

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[249] The United States argues that payments after the date of establishment of the panel under the marketing loan, user marketing (step 2), counter-cyclical and direct payments programmes are not mandatory at least in the sense that recipients must comply with programme conditions and payment is subject to the availability of funds. The Secretary of Agriculture also has authority to adjust payments to comply with AMS commitments. See United States' responses to Panel Questions Nos. 253 and 254.

[250] The issue is discussed in later Sections of this report. This view is consistent with the view of the Appellate Body expressed in a different context, in Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 89.

[251] Article 5(c), footnote 13 of the *SCM Agreement* and the request for establishment of a panel, page 4.

[252] Article 5 of the *SCM Agreement*.

[253] See the following Panel Reports: *Indonesia – Autos*, para. 14.206, *Australia – Automotive Leather II*, paras. 9.37-9.42 and *US – Superfund*, paras. 5.2.1.-5.2.2.

[254] See United States' response to Panel Question No. 247.

7.193 First, the 2002 marketing year is the only complete marketing year that has elapsed to date in which counter-cyclical payments and direct payments have been authorized, and the only complete marketing year that has elapsed to date in which the marketing loan and user marketing (Step 2) programmes "as such" have been authorized under the FSRI Act of 2002. Evidence of payments throughout the 2002 marketing year is therefore essential to assess those programmes under Article 13(b)(ii) of the *Agreement on Agriculture*, which the parties agree calls for a marketing year-on-marketing year comparison with support decided during the 1992 marketing year. Second, Brazil makes claims under Article 5 of the *SCM Agreement* and Article XVI of the *GATT 1994* regarding subsidies which *threaten* serious prejudice, which necessarily involves a projection regarding events that lay in the future at the time of establishment of the Panel. Data relating to the most recent past is usually the best gauge of future events[255], and events which took place after the establishment of the Panel provide a more solid basis for projections about the future. Our duty to make an objective assessment of the matter before us under Article 11 of the *DSU* actually *requires* us to examine recent data, including that which relates to the period after the date of establishment of the Panel.[256]

## 7. Summary of preliminary rulings

7.194 The Panel rules that the following measures, as addressed in document WT/DS267/7, are within its terms of reference:

(i) export credit guarantees to facilitate the export of United States upland cotton, and other eligible agricultural commodities;

(ii) production flexibility contract payments and market loss assistance payments;

(iii) production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments to upland cotton producers with respect to non-upland cotton base acres;

(iv) cottonseed payments under both Public Law 106-224 and Public Law 107-25 (for the 2000 crop);

(v) storage payments and interest subsidies that implement the marketing loan programme; and

(vi) payments under programmes and provisions within the Panel's terms of reference made after the date on which the Panel was established.

7.195 The Panel rules that the following measures, as addressed in document WT/DS267/7, are *not* within its terms of reference:

(i) cottonseed payments under Public Law 106-113 (for the 1999 crop); and

(ii) cottonseed payments under the Agricultural Assistance Act of 2003 and implementing regulations (for the 2002 crop).

[255] See, for example, Appellate Body Report, *US – Lamb*, para. 137, in relation to a threat of serious injury analysis under the *Agreement on Safeguards*.

[256] We note that Brazil has argued that payments made under the Agricultural Assistance Act of 2003 are "before the Panel" because an objective assessment of support to upland cotton in marketing year 2002 requires the tabulation of all support to upland cotton. See Brazil's oral statement at the first session of the first substantive meeting, para. 151 and its response to Panel Question No. 17.

7.196 The Panel also rules that, in its request for consultations in document WT/DS267/1, Brazil provided a statement of available evidence with respect to export credit guarantees under the GSM 102, GSM 103 and SCGP programmes relating to upland cotton and eligible agricultural commodities other than upland cotton, as required by Article 4.2 of the *SCM Agreement*.

## C. PRELIMINARY ISSUES

### 1. Products at issue

7.197 This dispute principally concerns alleged United States subsidies in respect of "upland cotton"[257] (*Gossypium hirsutum*). This is defined in relevant United States legislation as:

> "Planted and stub cotton that is produced from other than pure strain varieties of the Barbadense species, any hybrid thereof, or any other variety of cotton in which one or more of these varieties predominate."[258]

7.198 In relation to Brazil's claims that United States export credit guarantee measures constitute export subsidies under the *Agreement on Agriculture* and the *SCM Agreement*, the dispute concerns upland cotton and other eligible agricultural products as well.[259]

7.199 Upland cotton, and the other agricultural products eligible under the export credit guarantee programmes at issue, are products covered by the *Agreement on Agriculture.*[260]

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[257] Brazil's request for the establishment of a panel (document WT/DS267/7) and the parties respective responses to Panel Question No. 1.

[258] Definition for marketing loan programme in 7 CFR 1427.3 (1 January 2003 edition), reproduced in Exhibit BRA-36 and also in 7 CFR 1413.3 (1 January 1993 edition), reproduced in Exhibit US-3. Upland cotton harvested from a field has cotton lint and cottonseed. Ginning involves separating cotton lint from cottonseed. See, for example, Exhibit BRA-12, USDA, ERS, "Cotton: Background for 1995 Farm Legislation", p. 1; and Exhibit BRA-32, 7 CFR 1427.1102 (1 January 2002 edition), pertaining to the cottonseed payment programme, discussed *infra*, paras. 7.233 *ff*. Certain of the United States measures at issue expressly require, as a condition of eligibility, that upland cotton be "baled" and/or "ginned" (see e.g. Exhibit BRA-36, 7 CFR 1427.5(b)(11) in respect of marketing loan programme and loan deficiency payments; and Exhibit BRA-37, 7 CFR 1427.103(b) in respect of user marketing (Step 2) payments, referring to "baled" upland cotton "lint"; "loose"; semi-processed and reginned (processed) motes). The definition of upland cotton for the PFC programme also included brown lint cotton in 7 CFR 1412.103 (1 January 2002 edition), reproduced in Exhibit BRA-31. Unless otherwise indicated, references in this report to "upland cotton" ordinarily refer to upland cotton lint.

Upland cotton accounts for approximately 97 per cent of United States cotton production: see USDA Economic Research Service, Briefing Room – Cotton, and background paper dated July 2001, reproduced in Exhibits BRA-13 and BRA-46, respectively. It does not include extra long staple ("ELS") cotton. The parties confirmed in response to Panel Question No. 1 that the information submitted -- at least up to that point -- related to upland cotton.

[259] See the preliminary rulings in Section VII:B *supra*. The three export subsidy programmes at issue are briefly described in this Section, *infra,* paras. 7.236 *ff*. Our export subsidy findings are contained *infra* in Section VII:E. In response to Panel Question No. 1, the United States indicated that the CCC does not maintain data to distinguish transactions involving different types of cotton, but indicated that "[...] the United States has no reason to believe that types of cotton other than upland cotton constitute a material percentage of such transactions".

[260] Article 2 and Annex 1 of the *Agreement on Agriculture*. In particular, the Panel notes that the Agreement covers products under Harmonized System Headings 52.01 to 52.03 (raw cotton, waste and cotton carded and combed). The other agricultural commodities eligible under the export credit guarantee programmes are considered in Section VII:E of this report.

## 2. Measures at issue

(a) General overview

7.200 The *Agricultural Act of 1949*[261] and the *Agricultural Adjustment Act of 1938*[262] make up the major part of what is known as the "permanent law" that provides for United States commodity price and farm income support. The United States Congress regularly enacts omnibus farm bills that expire after four, five or six years which amend and suspend many provisions of the *Agricultural Act of 1949* in order to effect temporary changes in the levels and design of commodity programmes. If temporary legislation were to expire before new legislation was enacted, the law would revert back to the provisions of the permanent law.[263]

7.201 The last three farms bills have been the Food, Agriculture, Conservation and Trade Act of 1990 (the "FACT Act of 1990"), the Federal Agricultural Improvement and Reform Act of 1996 (the "FAIR Act of 1996") and the Farm Security and Rural Investment Act of 2002 (the "FSRI Act of 2002").[264] The FAIR Act of 1996 repealed some provisions of the Agricultural Act of 1949, suspended the application of other provisions through 2002 and authorized payments under programmes for the 1996 through 2002 crops of specified agricultural commodities, including upland cotton. The FSRI Act of 2002, which entered into law on 13 May 2002, suspends the vast majority of the provisions of the permanent law and authorizes payments under programmes for the 2002 through 2007 crop years for specified agricultural commodities, including upland cotton. Additionally, Congress provides ad hoc emergency and supplementary assistance under separate legislation.[265]

7.202 The United States federal commodity programmes are administered by the Secretary of the United States Department of Agriculture (referred to in this report as the "Secretary" or the "USDA"). The *Commodity Credit Corporation Charter Act of 1948*, which also forms part of the permanent law, provides the Secretary with broad authority to implement commodity programmes to support prices through loans, purchases, payments and other operations.[266] The Commodity Credit Corporation ("CCC"), which has no staff, is essentially a financing institution for USDA's farm price and income support commodity programmes and support to agricultural exports.[267] It is authorized to buy, sell, lend, make payments and engage in other activities for the purpose of increasing production, stabilizing prices, assuring adequate supplies, and facilitating the efficient marketing of agricultural commodities. The majority of the programmes funded through CCC are administered by employees of the Farm Service Agency ("FSA").[268]

7.203 The *Federal Crop Insurance Act* is Title V of the *Agricultural Adjustment Act of 1938* which grants the Secretary authority to provide crop insurance and reinsurance.[269] Congress amends this title

[261] Public Law 81-439.

[262] Public Law 75-430.

[263] See USDA: "Provisions of the Agricultural Improvement and Reform Act of 1996, Appendix III: Major Agricultural and Trade Legislation 1933-1996" and Congressional Research Service: "Farm Commodity Programs: A Short Primer", reproduced in Exhibits BRA-24 and BRA-255, respectively.

[264] Public Laws 101-624, 104-127 and 107-171, respectively.

[265] See Congressional Research Service: "Farm Commodity Programs: A Short Primer", reproduced in Exhibit BRA-255.

[266] See Congressional Research Service: "Farm Commodity Programs: A Short Primer", reproduced in Exhibit BRA-255.

[267] See Congressional Research Service report for Congress "What is a Farm Bill?" dated 5 May 2001, an extract of which is reproduced in Exhibit BRA-416. The CCC is the entity responsible for providing the three types of export credit guarantee programmes at issue in this dispute – see 7 USC 5622, reproduced in Exhibit BRA-141.

[268] See Congressional Research Service: "Farm Commodity Programs: A Short Primer", reproduced in Exhibit BRA-255.

[269] See USDA: "Provisions of the Agricultural Improvement and Reform Act of 1996, Appendix III: Major Agricultural and Trade Legislation 1933-1996", reproduced in Exhibit BRA-24.

from time to time. Two major amendments have been the *Federal Crop Insurance Reform Act of 1994* and the *Agricultural Risk Protection Act of 2000* (the "ARP Act of 2000").[270] Federal crop insurance is administered by the Federal Crop Insurance Corporation ("FCIC"), which is an agency within the USDA, supervised by the Risk Management Agency, which is an independent office within the USDA.

(b) Marketing loan programme payments

7.204 Marketing loan programme payments for upland cotton began in 1986 and have continued under successive legislation, including the FAIR Act of 1996[271] and the FSRI Act of 2002.[272] The marketing loan programme is intended to minimize potential loan forfeitures by providing interim financing to eligible producers on their eligible production and facilitate the orderly distribution of eligible commodities throughout the year.[273] Accordingly, rather than selling the crop at harvest when prices tend to be at their lowest, the proceeds of the interim loan enable producers to pay off their expenses when they become due, while storing their pledged harvested crop as collateral and repaying the loan when market conditions are potentially more favourable.

7.205 Under the FAIR Act of 1996, marketing assistance loans for upland cotton were provided to producers for upland cotton harvested on a farm containing eligible cropland covered by a production flexibility contract (see below). The loans for upland cotton were made on conditions prescribed by the Secretary for a term of ten months. The legislation provided that the loan rate for upland cotton was determined by the Secretary for each year's crop at a rate that was no less than the smaller of 85 per cent of the five year Olympic average[274] of county spot market prices[275], or 90 per cent of the Northern Europe-based average price but which should be not less than 50 cents per pound and not more than 51.92 cents per pound.[276] The loan rates for the 1999, 2000, 2001 and 2002 crops of upland cotton were each determined at 51.92 cents per pound.[277] The loans were non-recourse, so a producer had the option to deliver to the CCC the quantity of a commodity pledged as collateral for the loan as payment in full when the loan was due to be repaid.

7.206 Under the FSRI Act of 2002, marketing assistance loans continue to be provided, but certain features of the programme have been changed. In particular, loans are provided to producers for any upland cotton produced on a farm, the term of a marketing assistance loan for upland cotton is now nine months and the loan rate for upland cotton is fixed by the Act itself at 52 cents per pound for the 2002 through 2007 crop years.

7.207 The repayment rate for marketing loans is the lower of the adjusted world market price[278] and the loan rate plus interest. When the adjusted world market price is lower than the loan rate, the producer repays at less than the loan rate and the difference is referred to as a "marketing loan gain".

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[270] Public Law 103-354, Title I, and Public Law 106-224, respectively.

[271] FAIR Act of 1996, Title I, Subtitle C (sections 131-135), reproduced in Exhibits BRA-28 and US-22.

[272] FSRI Act of 2002, Title I, Subtitle B (sections 1201-1205), reproduced in Exhibits BRA-29 and US-1, implemented under 7 CFR 1427, Subpart A, reproduced in Exhibit BRA-36.

[273] USDA Fact Sheet, June 2003, "Nonrecourse marketing assistance loan and loan deficiency payment program".

[274] An "Olympic average" is a 5-year average excluding the highest and lowest values. See USDA Economic Research Service side-by-side comparison of 1996 and 2002 farm bills' commodity programs, reproduced in Exhibit BRA-27.

[275] The price at which a physical commodity (e.g., upland cotton) for immediate delivery is selling at a given time and county.

[276] FAIR Act of 1996, section 132(c), reproduced in Exhibit BRA-28.

[277] Table 19 in *Agricultural Outlook*, published by USDA, May 2002, p. 50, (May 2002) reproduced in Exhibit BRA-142 and (November 2003), reproduced in Exhibit BRA-394.

[278] That is, adjusted to United States quality and location as determined by the Secretary.

Alternatively, a producer may forego a marketing loan and receive a "loan deficiency payment" in the amount of the difference between the lower adjusted world market price and the loan rate.[279] Additionally, in October 1999, the FAIR Act of 1996 was amended to include provisions for the issuance of "commodity certificates", available to producers, including upland cotton producers, to use in acquiring 1998 through 2002 crop collateral pledged to CCC for a commodity loan.[280] Marketing loan gains, loan deficiency payments and commodity certificate exchange gains are collectively referred to below as "marketing loan programme payments".

7.208 When loans are repaid, the CCC charges interest at a rate 1 per cent higher than the rate it pays the Treasury. The CCC forgives interest and pays storage charges for the loan period when upland cotton under loan is forfeited, and also on redemption of upland cotton under loan where the repayment amount is too low to satisfy the loan amount and those charges.[281]

(c) User marketing (Step 2) payments

7.209 The upland cotton user marketing certificate or "Step 2" programme is a special marketing loan provision for upland cotton. The programme has been authorized since 1990 under successive legislation, including the FAIR Act of 1996[282] and the FSRI Act of 2002.[283] It provides for the issuance of marketing certificates or cash payments (collectively referred to below as "user marketing (Step 2) payments")[284] to eligible domestic users and exporters of eligible upland cotton[285] when certain market conditions exist such that United States cotton pricing benchmarks are exceeded.

7.210 Under the FAIR Act of 1996, the Secretary issued user marketing (Step 2) payments to domestic users and exporters of upland cotton for documented purchases by domestic users and sales for export by exporters made in a week following a consecutive four-week period when the lowest price quotation for United States cotton delivered to Northern Europe exceeded the Northern Europe price quotation by more than 1.25 cents per pound, and the adjusted world price did not exceed 130 per cent of the marketing loan rate for upland cotton. Payments were made in certificates or cash to domestic users or exporters at a rate per pound equal to the difference between the two price quotations during the fourth week of the period, minus the 1.25 cents per pound threshold.[286]

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[279] All the eligibility requirements for Market Assistance loans for upland cotton apply to LDPs, except the cotton does not have to be ginned or stored in a warehouse and LDPs are paid after the cotton is ginned.

[280] See USDA Fact Sheet "Commodity Certificates" July 2000; and regulations at 7 CFR 1401 and 1427.22 (1 January 2003 edition), reproduced in Exhibits BRA-52, BRA-34 and BRA-36, respectively. Payment limitations under the marketing loan payment programme are explained in the Report of the Commission on the Application of Payment Limitations for Agriculture, August 2003, reproduced in Exhibit BRA-276.

[281] See 7 CFR 1427.13 and 7 CFR 1427.19(e), reproduced in Exhibit BRA-36. See also 7 CFR 1405, cited in the United States' response to Panel Question No. 192(b); and see USDA fact sheet: Upland Cotton (1 January 2003 edition), page 2, reproduced in Exhibit BRA-4.

[282] Section 136 of the FAIR Act of 1996, reproduced in Exhibits BRA-28 and US-22.

[283] Section 1207 of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1, implemented under 7 CFR 1427, Subpart C, reproduced in Exhibit BRA-37.

[284] For the purposes of this dispute, on the basis of the views of the parties, we make no distinction between user marketing (Step 2) cash payments and marketing certificates. See Brazil's and the United States' respective responses to Panel Question No. 110 (a).

[285] "Eligible upland cotton" is defined as: "domestically produced baled upland cotton which bale is opened by an eligible domestic user ... or exported by an eligible exporter" during a certain period. It can be "baled lint", loose, certain semi-processed motes and re-ginned (processed) motes. It cannot be cotton for which a user marketing (Step 2) payment has been made available; imported cotton; raw (unprocessed) motes or textile mill wastes. See 7 CFR 1427.103(a),(b) and (c), reproduced in Exhibit BRA-37.

[286] Section 136(a) of the FAIR Act of 1996 reproduced in Exhibits BRA-28 and US-22. Section 136(a)(5) limited total expenditures under this programme to $701 million, but was later repealed.

7.211 Under the FSRI Act of 2002, Step 2 payments continue to be paid, but certain features of the programme have been changed. In particular, application of the 1.25 cents per pound threshold has been delayed until 1 August 2006 (i.e. for the 2002 through 2005 marketing years). Consequently, Step 2 payments are issued following a consecutive four-week period when the lowest price quotation for United States cotton delivered to Northern Europe exceeded the Northern Europe price quotation by any amount and the adjusted world price did not exceed 134 per cent (not 130 per cent, as under the FAIR Act of 1996) of the marketing loan rate. Payments are made at a rate per pound equal to the difference between the two price quotations during the fourth week of the period, with no reduction for the threshold.[287]

(d) Production flexibility contract payments

7.212 Production flexibility contract ("PFC") payments were only made under the FAIR Act of 1996.[288] The last payment was made not later than 30 September 2002.[289] The programme provided support to producers (as defined)[290] based on historical acreage and yields for seven commodities, including upland cotton (referred to in this report as "covered commodities"[291]). Its stated purpose was to support farming certainty and flexibility while ensuring continued compliance with farm conservation and wetland protection requirements.[292]

7.213 An eligible producer could enter into a PFC for the 1996 through 2002 crops during a one-time enrolment period that ended on 1 August 1996.[293] Cropland was eligible for coverage under a PFC if at least a portion of it had been enrolled in the deficiency payments programme under the previous farm bill for at least one of the 1991 through 1995 crops.[294]

7.214 PFC payments did not depend on then-current prices of commodities. The FAIR Act of 1996 appropriated a budgetary amount to the programme for each fiscal year from 1996 through 2002 and allocated a certain percentage of that amount to each of the seven commodities.[295] The allocation for a commodity was distributed among the PFC contracts according to the acreage and yield for the particular commodity which each PFC contract covered. That acreage was not the amount of acres currently planted to that commodity (referred to in this report as "planted acres"). Rather, it was the average of the plantings of each commodity in the 1993 through 1995 marketing years according to

[287] Section 1207(a) of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1, and 7 CFR 1427.107 (1 January 2003 edition), reproduced in Exhibit BRA-37.

[288] FAIR Act of 1996, Title I, Subtitle B (sections 111-118), reproduced in Exhibits BRA-28 and US-22, and 7 CFR 1412.101-1412.501 (1 January 2002 edition), reproduced in Exhibit BRA-31.

[289] Section 112(d)(1) of the FAIR Act of 1996, reproduced in Exhibit BRA-28.

[290] "Producer" was defined as "an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop and is entitled to share in the crop available for marketing from the farm, or would have shared had the crop been produced." See section 102(12) of the FAIR Act of 1996 and 7 CFR 1412.202 (1 January 2002 edition), reproduced in Exhibits BRA-28 and US-22, and BRA-31, respectively.

[291] The FAIR Act of 1996 used the term "contract commodity".

[292] Section 101(b)(1) of the FAIR Act of 1996, reproduced in Exhibit BRA-28.

[293] Acreage returning from conservation reserve was allowed to enrol subsequently.

[294] Under the FACT Act of 1990, "deficiency payments" were direct payments made to producers who participated in an annual programme for certain commodities, including upland cotton. The crop-specific payment rate for a particular crop year was based on the difference between an established target price and the higher of the loan rate for that commodity or the national average market price for the commodity during a specified time period. During the marketing years 1990 to 1996, the target price for upland cotton was 72.9 cents per pound. Payment was conditional upon planting upland cotton for harvest – see the United States' rebuttal submission, para. 112, and USDA Economic Research Service: *Agricultural Outlook Supplement*, April 1996, "Glossary of Agriculture Policy Terms" at p. 5, reproduced in Exhibit BRA-25.

[295] The amount appropriated for each fiscal year ranged between $5.8 billion to $4.008 billion. The amount of this allocated to upland cotton in each fiscal year was 11.63 per cent; see section 113(a) and (b) of the FAIR Act of 1996, reproduced in Exhibit BRA-31.

the method of calculation that would have applied to the 1996 crop under the previous farm bill[296] (referred to in this report as "base acres"[297]). The payment rate for the 1999, 2000 and 2001 crops were set for each of the seven covered commodities. The payment rates for upland cotton were 7.88 cents, 7.33 cents and 5.99 cents, per pound, respectively.[298] PFC payments were made on 85 per cent of the base acreage for each commodity multiplied by the corresponding payment rate multiplied by the applicable payment yield, which was the yield established for the 1995 crop.[299]

7.215 Producers were permitted to plant any commodity or crop on base acres, subject to certain limitations and exceptions concerning the planting of fruits and vegetables.[300] PFC payments were either eliminated or reduced if producers planted fruits and vegetables on base acres, unless they satisfied a special eligibility criterion. Additionally, producers had to use the land for an agricultural or related activity and not for a non-agricultural commercial or industrial use and comply with certain conservation requirements.[301] Otherwise, PFC payments were not affected by what was planted on base acreage nor by whether anything was produced on it at all.[302]

(e) Market loss assistance payments

7.216 Market loss assistance ("MLA") payments were made under four separate pieces of legislation, one each for the years 1998 through 2001.[303] They were *ad hoc* emergency and supplementary assistance provided to producers in order to make up for losses sustained as a result of recent low commodity prices.[304]

7.217 The 1998 MLA payments were intended essentially as a 50 per cent additional PFC payment.[305] The 1998, 1999 and 2001 Acts each appropriated a dollar amount to assistance which was divided among PFC payment recipients proportionately to their respective previous PFC payment.[306] The 2000 Act provided for payments at the same contract payment rates as the 1999 Act.[307] MLA payments were only made to recipients enrolled in the PFC programmes.

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[296] Under the FACT Act of 1990, base acres were calculated according to a rolling average of the previous three crop years for upland cotton. See the United States' corrected response to Panel Question No. 216 in its 28 January 2004 comments on Brazil's responses.

[297] The FAIR Act of 1996 used the term "contract acreage".

[298] See USDA Economic Research Service *Agricultural Outlook* (online data as of November 2003) reproduced in Exhibit BRA-394, also May 2002 edition, p. 50, reproduced in Exhibit BRA-142, and USDA Farm Service Agency Fact Sheet *Upland Cotton – Summary of 2000 Commodity Loan and Payment Program* June 2001 edition, p.1, reproduced in Exhibit BRA-45.

[299] Section 114(d) of the FAIR Act of 1996, reproduced in Exhibit BRA-28.

[300] The limitations and exceptions are set out in detail in Section VII:D of this report.

[301] Section 111(a) of the FAIR Act of 1996. An agricultural use refers to cropland planted to a crop, used for haying or grazing, idled for weather-related reasons or natural disasters, or diverted from crop production to an approved cultural practice that prevents erosion or other degradation.

[302] The Panel makes certain factual findings on the relationship between farms with upland cotton base acres and upland cotton planted acres in the 1999 through 2002 marketing years in the Attachment to Section VII:D of this report.

[303] Market loss assistance payments were provided pursuant to the following Acts: the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 1999 for the 1998 crop; the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2000 for the 1999 crop; the Agriculture Risk Protection Act of 2000 for the 2000 crop; and the Crop Year 2001 Agriculture Economic Assistance Act for the 2001 crop, reproduced in Exhibit BRA-138, as discussed in Section VII:B of this report.

[304] See United States' rebuttal submission, para. 100 and USDA Economic Research Service: "Cotton: Background and Issues for Farm Legislation", July 2001 at page 9, reproduced in Exhibit BRA-46.

[305] See United States' rebuttal submission, para. 99.

[306] The budgetary outlays for MLA payments (in respect of wheat, feed grains, rice and upland cotton base acres) in 1998, 1999 and 2001 were $2.857 billion, $5.544 billion and $4.622 billion, respectively. See

(f) Direct payments

7.218 The direct payments ("DP") programme was established under the FSRI Act of 2002.[308] It provides support to producers (as defined)[309] based on historical acreage and yields for nine commodities, which are those that were covered by the PFC programme, including upland cotton, plus soybeans and other oilseeds (referred to in the legislation and this report as "covered commodities").[310] There are special provisions for peanuts (also referred to in this report as a "covered commodity").[311]

7.219 An eligible producer must enter into an annual agreement in order to receive payments for a crop year. DP payments are made to producers on farms for which payment yields and base acres are established for each of the 2002 through 2007 crop years of each covered commodity.

7.220 DP payments do not depend on current prices of commodities. The FSRI Act of 2002 sets fixed payment rates on a per unit basis for the 2002 through 2007 crop years. The payment rate for upland cotton is 6.67 cents per pound. Payments are not made in respect of planted acres. DP payments are made on 85 per cent of the base acreage for each commodity multiplied by the applicable payment yield, which was the yield established for the 1995 crop (if there was one). Under the implementing regulations, the amount of a PFC payment received for the 2002 crop was deducted from the DP payment made in the 2002 crop year.[312]

7.221 Owners had a one-time opportunity to elect the method for calculation of their base acreage. An owner could elect to have base acreage for all covered commodities calculated on the basis of the four-year average of planted acreage during the 1998 through 2001 crop years plus acreage the producers were prevented from planting by natural disasters during the same period. Failing such an election, an owner's base acreage in the DP programme is the same as under the PFC programme for the 2002 payment (i.e. the three year average of the 1993 through 1995 marketing years for upland cotton and rice), plus the four-year average of planted acreage for eligible oilseeds during the 1998 through 2001 crop years.[313]

7.222 Producers are permitted to plant any commodity or crop on base acres, subject to certain limitations concerning the planting of fruits and vegetables.[314] DP payments are either eliminated or reduced if producers plant these crops on base acres, unless they are destroyed before harvest, subject to certain exceptions. Additionally, producers must use the land for an agricultural or conserving use and not for a non-agricultural commercial or industrial use and abide by conservation compliance

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USDA Economic Research Service Features: *"The 2002 Farm Bill: Title I – Commodity Programs"*, printed 16 September 2002, page 2, reproduced in Exhibit BRA-27.

[307] The resulting budgetary outlay in 2000 was $5.465 billion.

[308] FSRI Act of 2002, Title I, Subtitle A, reproduced in Exhibits BRA-29 and US-1, implemented by 7 CFR 1412, reproduced in Exhibit BRA-35.

[309] "Producer" is defined as "an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop and is entitled to share in the crop available for marketing from the farm, or would have shared had the crop been produced." See section 1001(12) of the FSRI Act of 2002 and 7 CFR 1412.402 (1 January 2003 edition), reproduced in Exhibits BRA-29 and US-1, and BRA-35, respectively.

[310] The term "other oilseed" includes sunflower seed, rapeseed, canola, safflower, flaxseed, mustard seed, and any other oilseed designated by the United States Secretary of Agriculture. A direct payment of $36 per ton is available to peanut producers on eligible base period (1998-2001) peanut production: see section 1301 of the FSRI Act of 2002. The parties agree that the direct payments programme covers peanuts: see Brazil's first written submission, para. 49, footnote 110 and the United States' rebuttal submission, para. 57, footnote 46.

[311] FSRI Act of 2002, Title I, Subtitle C, reproduced in Exhibit US-1.

[312] See 7 CFR Chapter. XIV (1 January 2003 edition) 1412.502(f), reproduced in Exhibit BRA-35.

[313] Generally, oilseed base acres can not exceed the difference between total acreage for covered crops for the crop year and the sum of base acreage under the PFC programme for the 2002 payment.

[314] The limitations are set out in detail in Section VII:D of this report.

requirements.[315] Otherwise, DP payments are not affected by what is produced on base acreage nor by whether anything is produced on it at all.[316]

(g) Counter-cyclical payments

7.223 The counter-cyclical payments ("CCP") programme was also established by the FSRI Act of 2002.[317] It provides support to producers (as defined)[318] based on historical acreage and yields for the same commodities as DP payments, including upland cotton.

7.224 An eligible producer must enter into an annual agreement in order to receive payments for a crop year. The eligibility requirements and planting flexibility requirements are the same as for the DP programme. CCP payments, like DP payments, are made to producers on farms for which payment yields and base acres are established for each of the 2002 through 2007 crop years of each covered commodity.

7.225 CCP payments depend on the current prices of commodities. They are provided to producers with base acres and yields for a covered commodity for each of the 2002 through 2007 crop years whenever the effective price falls below the target price, which is fixed by the Act at 72.4 cents per pound for upland cotton.[319] The effective price for a commodity is the sum of the DP payment rate (see above), plus the higher of the national average farm price for the marketing year or the loan rate (see above). The difference between the effective price and the target price is the CCP payment rate. Consequently, the CCP payment rate, DP payment rate and, where applicable, the loan rate, are equal to the difference between the market price and 72.4 cents per pound.

7.226 CCP payments are made on 85 per cent of the base acreage for each commodity multiplied by the corresponding payment rate multiplied by the applicable payment yield.[320] An owner who elected to have his or her base acreage calculated on the basis of the four-year average of planted acreage during the 1998 through 2001 crops, had a one-time opportunity partially to "update" CCP payment *yields* for CCP payments for all covered commodities, using one of two methods which both included the farm's average yields for the 1998 through 2001 crop years.[321]

(h) Crop insurance payments

7.227 The United States government offers annual crop yield or revenue insurance coverage to producers of upland cotton and other crops for losses due to natural disasters and market fluctuations and offers reinsurance to providers of such insurance under the *Federal Crop Insurance Act*[322], as amended by other legislation, including the ARP Act of 2000. A stated objective of this legislation is

[315] Section 1105(a)(1) of the FSRI Act of 2002.

[316] The Panel makes certain factual findings on the relationship between farms with upland cotton base acres and upland cotton planted acres in the 1999 through 2002 marketing years in the Attachment to Section VII:D of this report.

[317] FSRI Act of 2002, Title I, Subtitle A, reproduced in Exhibits BRA-29 and US-1, implemented by 7 CFR 1412, reproduced in Exhibit BRA-35.

[318] See *supra*, footnote 309.

[319] Target prices are fixed for MY 2002-03 and then raised to fixed levels for MY 2004-07 except for soybeans, rice, upland cotton and peanuts, which remain at the MY 2002-03 levels throughout the term of the FSRI Act of 2002.

[320] Section 1104(e) of the FSRI Act of 2002.

[321] Section 1102(e) of the FSRI Act of 2002.

[322] Sections 501 through 522, and Section 523, of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, are reproduced in Exhibits BRA-30 and BRA-336, respectively.

to promote the national welfare by improving the economic stability of agriculture through a sound system of crop insurance.[323]

7.228 In general, the Federal Crop Insurance Corporation ("FCIC") may insure, or provide reinsurance for insurers of, producers of agricultural commodities grown in the United States under one or more plans of insurance determined to be adapted to the agricultural commodity concerned. To qualify for coverage under a plan of insurance, the losses of the insured commodity must be due to drought, flood, or other natural disaster as determined by the Secretary.[324] There are also "special provisions for cotton and rice" whereby, beginning with the 2001 crop, the FCIC "shall offer plans of insurance, including prevented planting coverage and replanting coverage, ... that cover losses of upland cotton ...resulting from failure of irrigation water supplies due to drought and saltwater intrusion".[325]

7.229 There are also specific provisions on catastrophic risk protection and additional coverage. In particular, FCIC crop insurance plans include both protection against losses resulting from low crop *yields* and protection against low *revenue*, whether it results from low yields or low crop prices. Coverage levels range from catastrophic risk coverage (50 per cent of yield, indemnified at 55 per cent of expected price for the 1999 and subsequent crop years) for which the producer pays none of the premium,[326] to additional or "buy-up" coverage, which provides a higher level of coverage (up to 75, or in some cases 85 per cent of expected yield or revenue) for which the producer pays a portion of the premium. The FCIC pays the balance of the premium.[327] It also reinsures the insurance provider, thereby covering underwriting costs, and defrays some of its administrative costs.

7.230 The *Federal Crop Insurance Act* defines the "agricultural commodities" to which it applies.[328] These are predominantly crops (as opposed to livestock). The legislation also provides for "livestock pilot programmes".[329] These pilot programmes, such as the Adjusted Gross Revenue programme[330] and the "AGR-Lite" programme[331] provide for payment by the FCIC of a percentage of premium and

[323] Section 502 of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced in Exhibits BRA-30. Federal crop insurance is explained in USDA: "U.S. Crop Insurance: Premiums, Subsidies and Participation" in *Agricultural Outlook*, December 2001, and USDA: "Briefing Room: Farm and Commodity Policy: Crop Yield and Revenue Insurance", reproduced in Exhibits BRA-58 and BRA-59, respectively.

[324] Section 508(a)(1) of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced in Exhibit BRA-30.

[325] Section 508(a)(8) of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced Exhibit BRA-30.

[326] Section 508(e)(2)(A) of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced Exhibit BRA-30. An administrative fee, up to a maximum of $100, is payable per crop per county, which can be waived for limited-resource farmers: see section 508(b)(5)A and E.

[327] The formula for the amount of such premium paid by the FCIC is set out in section 508(e)(2)(B)-(G) of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced Exhibit BRA-30.

[328] Section 518 of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced in Exhibit BRA-30.

[329] Exhibit BRA-336 contains section 523 of the *Federal Crop Insurance Act*. Entitled "Pilot Programs", this section envisages that pilot programs may provide insurance protection against losses involving, *inter alia*, livestock poisoning and disease. The livestock eligible for livestock pilot programmes are defined as including, but not being limited to, cattle, sheep, swine, goats and poultry (Section 523(b)).

[330] Exhibit BRA-272 contains a USDA fact sheet description of the AGR pilot programme for MY 2003. It indicates that AGR "complements other Federal crop insurance plans". When a producer purchases both AGR and other crop insurance plans, the AGR premium will be reduced. A producer must "earn no more than 35 per cent of expected allowable income from animals and animal products".

[331] This programme is described as "a streamlined whole-farm revenue protection package that can be used as a stand-alone coverage or in addition to other individual crop insurance policies (except A.G.R.)". Initially available in Pennsylvania, AGR-Lite has been expanded to 11 northeastern states: see USDA RMA fact sheets, Adjusted Gross Revenue – Lite (AGR-Lite), February 2003, reproduced in Exhibit BRA-338 and

administrative fee[332] in respect of certain policies for some types of livestock production in certain limited areas of the United States.

7.231 Producers generally apply for FCIC crop insurance policies prior to planting but usually pay their share of the premiums after harvest.[333] The policies are sold through government-approved private insurance providers.[334] The price paid by the producer is the total premium minus the amount paid by the FCIC. The portion of the premium paid by the FCIC depends on the level of coverage and the features of the relevant plan but is the same for all crops covered by a particular plan.[335] Emergency premium discounts additionally reduced producer costs of buy-up coverage, at rates of 30 per cent and 25 per cent in 1999 and 2000, respectively.[336] The ARP Act of 2000 increased the portion of the premium[337] paid by the FCIC commencing in the 2001 crop year.

7.232 Over 90 per cent of cotton area covered by federal crop insurance in the 2002 crop year is insured at coverage levels of 70 per cent or less of expected yield or revenue for which the FCIC pays a portion of the premium.[338]

(i) Cottonseed payments

7.233 Cottonseed payments are *ad hoc* emergency and supplementary assistance provided to first handlers[339] and producers of cottonseed.[340] The payments within the Panel's terms of reference were made under the ARP Act of 2000 in order to offset low commodity prices. Payments were available only for cottonseed produced and ginned in the United States.[341]

7.234 The ARP Act of 2000 and a later Act[342] each appropriated a specific amount of money for the 2000 crop of cottonseed.[343] The payment rate (dollars per ton) was calculated by dividing the total available funds by the total payment quantity of 2000 crop cottonseed of first handlers who applied to participate.[344]

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November 2003 available on the USDA Risk Management website: see also United States' response to Panel Question No. 133.

[332] These are to be determined by the amount of funds made available and the number of participants.

[333] USDA Economic Research Service: Briefing Room, farm and commodity policy – crop yield and revenue insurance, reproduced in Exhibit BRA-59.

[334] USDA Economic Research Service: Briefing Room, farm and commodity policy – crop yield and revenue insurance, reproduced in Exhibit BRA-59.

[335] USDA Economic Research Service: Briefing Room, farm and commodity policy – crop yield and revenue insurance, reproduced in Exhibit BRA-59.

[336] See Exhibit BRA-61.

[337] See Exhibits BRA-59 and BRA-61.

[338] See United States' oral statement at the resumed session of the first substantive meeting, para. 46, United States' response to Panel Question No. 136, and Exhibit BRA-61.

[339] A first-time handler of cottonseed is a gin, which means a person that removes cotton seed from cotton lint. See 7 CFR 1427.1102 (1 January 2002 edition), reproduced in Exhibit BRA-32.

[340] The implementing regulations of cottonseed payments define cottonseed as, "the seed from any variety of upland cotton and extra long staple cotton (ELS) produced in the United States." Approximately 97 per cent of the annual United States cotton crop is from upland cotton: see USDA Economic Research Service Briefing Room Cotton document, reproduced in Exhibit BRA-13.

[341] 7 CFR 1427.1100 (b) (1 January 2002 edition), reproduced in Exhibit BRA-32.

[342] The *Agricultural Risk Protection Act of 2000*, Public Law 106-224, section 204(e), reproduced in Exhibit BRA-137, and the *Crop Year 2001 Agricultural Economic Assistance Act*, Public Law 107-25, reproduced in Exhibit BRA-138.

[343] $100 million and $84.7 million, respectively.

[344] See 7 CFR 1427.1100(a) and 1427.1109, reproduced in Exhibit BRA-32.

7.235 Payments were made to first-time handlers because they usually retained proceeds from the sale of cottonseed. However, it was a condition that they shared any payment received with producers to the extent that the revenue from the sale of the cottonseed was shared with the producer.

(j) Export credit guarantee measures

*(i) Overview*

7.236 The USDA administers export credit guarantee programmes for commercial financing of United States agricultural commodities[345] through the CCC.[346] The CCC operates three export credit guarantee programmes: General Sales Manager 102 ("GSM 102"), General Sales Manager 103 ("GSM 103") and the Supplier Credit Guarantee Programme ("SCGP").[347]

7.237 According to the stated "purpose of the program", the CCC may use export credit guarantees authorized under the statute to "increase exports of agricultural commodities"; "to compete against foreign agricultural exports"; "to assist countries in meeting their food and fiber needs..."; and "for such other purposes as the Secretary determines appropriate ...".[348]

7.238 Pursuant to the statute, the CCC may: guarantee the repayment of credit made available to finance commercial export sales of agricultural commodities on credit terms that do not exceed three years (under the GSM 102 programme); issue guarantees for the repayment of credit made available for a period of not more than 180 days by a United States exporter to a buyer in another country (under the SCGP programme); and guarantee the repayment of credit made available by financial institutions in the United States to finance commercial export sales of agricultural commodities on credit terms of between 3 and 10 years (under the GSM 103 programme) "in a manner that will directly benefit United States agricultural producers." We examine additional details of each of the three programmes below.

7.239 The CCC "shall make available" for each relevant fiscal year "not less than $5,500,000,000 in credit guarantees" under the three export credit guarantee programmes.[349]

7.240 Export credit guarantees "shall contain such terms and conditions as the [CCC] determines to be necessary."[350]

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[345] We recall that our terms of reference include upland cotton and other eligible agricultural products under the three challenged export credit guarantee programmes. See *supra*, Section VII:B. According to Exhibits BRA-141, -366, 7 USC 5622(h), the CCC "shall finance or guarantee under this section only United States agricultural commodities". 7 USC 5622(k) sets out percentages of the total amount of export credit guarantees issued for certain fiscal years that promote the export of processed or high-value agricultural products, with the balance issued to promote the export of bulk or raw agricultural commodities. This percentage requirement applies to the extent that a reduction in the total amount of guarantees issued is not required to meet it.

Exhibit BRA-73 contains an excerpt from the USDA website (www.fas.usda.gov/excreds/...) which offers a summary of activity under the challenged export credit guarantee programmes, indicating the allocations and applications received by country and commodity, MY 1999-MY 2003.

[346] The CCC is a wholly owned government corporation within the USDA. The CCC has no employees and carries out the majority of its programmes through the personnel and facilities of the Farm Service Agency. See, for example, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002* (Exhibit BRA-158). Brazil's does not challenge the CCC Facility Guarantee programme in this dispute – see Brazil's 11 August responses to the questions posed by the Panel, footnote 206.

[347] These programmes were established by 7 USC 5622. Exhibits BRA-141 and BRA-366.

[348] 7 USC 5622(d), reproduced in Exhibits BRA-141, BRA-366.

[349] 7 USC 5641(b)(1), reproduced in Exhibit BRA-297. The CCC retains discretion as to allocation between short and intermediate terms.

[350] 7 USC 5622(g), reproduced in Exhibits BRA-141, BRA-366.

7.241 The statute also sets out certain restrictions on the use of credit guarantees. In general, "the CCC shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such sale."[351] All countries eligible for any of the CCC export credit guarantee programmes are categorized according to risk. A country's risk premium has no impact on the premiums payable under the programmes.[352]

*(ii) General Sales Manager 102 ("GSM 102")*

7.242 Under the GSM 102 export credit guarantee programme, the CCC is authorized to guarantee the repayment of credit made available to finance commercial export sales of agricultural commodities from privately owned stocks on credit terms between 90 days and three years. The CCC generally covers 98 per cent of the principal and a portion of the interest. The CCC selects agricultural commodities and products according to market potential. The CCC does not provide financing, but rather guarantees payments due from foreign banks. To secure such a payment guarantee, once a firm export sale exists, the United States exporter must apply prior to the date of exportation. The exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods. There is a statutory cap on the fee charged of 1 per cent of the guaranteed dollar value of the transaction.[353] In terms of financing, the CCC-approved foreign bank issues an irrevocable letter of credit in favour of the United States exporter, ordinarily advised or confirmed by the financial institution in the United States which agrees to extend credit to the foreign bank. If the foreign bank fails to make any payment as agreed, the exporter is required to submit a notice of default to the CCC. The CCC pays a valid claim for loss.[354]

*(iii) General Sales Manager 103 ("GSM 103")*

7.243 The GSM 103 programme operates in a similar fashion to GSM 102. The main differences between the two programmes include: export credit guarantees under GSM 103 are "intermediate term credit guarantees" issued for terms from three to 10 years[355]; there are additional statutory required determinations to be made when the CCC issues guarantees[356]; and there is no statutory cap on the origination fees that may be charged by the CCC in connection with an export credit guarantee transaction.

*(iv) Supplier Credit Guarantee Programme ("SCGP")*

7.244 Under the SCGP, the CCC is authorized to issue guarantees for the repayment of credit made available for a period not exceeding 180 days by a United States exporter to a purchaser of United States agricultural commodities in a foreign country. These direct credits must be secured by

[351] 7 USC 5622(f), reproduced in Exhibits BRA-141, BRA-366.

[352] See United States' response to Panel Question No. 86.

[353] See United States' response to Panel Question No. 84, where the United States indicates that section 211(b)(2) of the Agricultural Trade Act of 1978, 7 USC 5641(b)(2) limits the fee of transactions under the GSM 102 programme, except for those transactions under the CCC Facility Guarantee programme.

[354] FAS Online Fact Sheet: CCC Export Credit Guarantee Programmes, reproduced in Exhibit BRA-71.

[355] 7 USC 5641(b), reproduced in Exhibit BRA-141.

[356] 7 USC 5622(c), reproduced in Exhibits BRA-141, BRA-366, provides as follows: "The [CCC] shall not guarantee [...] the repayment of credit made available to finance an export sale unless the Secretary determines such sale will: (1) develop, expand or maintain the importing country as a foreign market, on a long-term basis, for the commercial sale and export of United States agricultural commodities, without displacing normal commercial sales; (2) improve the capability of the importing country to purchase and use, on a long-term basis, United States agricultural commodities; or (3) otherwise promote the export of United States agricultural commodities." ("The reference to ...'on a long-term basis' shall not apply in the case of determinations with respect to sales to the independent states of the former Soviet Union.") 7 USC 5622(f)(2) sets out additional criteria for determinations to be made relating to GSM 103.

promissory notes signed by the importers. The CCC does not provide financing, but rather guarantees payment due from the importer. Typically, the CCC guarantees a portion (65 per cent) of the value of the exports (principal only; the guarantee does not cover interest). The exporter negotiates terms of export credit sales with the importer. Once a firm export sale exists, the United States exporter must apply for a payment guarantee prior to the date of exportation. The exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales. There is a statutory cap on the fee charged of 1 per cent of the guaranteed dollar value of the transaction.[357] The importer must issue a dollar-denominated promissory note in favour of the United States exporter in the form specified in the applicable country or regional programme announcement. The United States exporter may negotiate an arrangement to be paid, in full or in part, by assigning the right to proceeds that may become payable under the CCC's guarantee to a United States financial institution. If the foreign bank fails to make any payment, the exporter or assignee is required to submit a notice of default to the CCC. The CCC pays a valid claim for loss.

(k) Export subsidies under the ETI Act of 2000

7.245 The request for establishment of the Panel includes export subsidies provided to exporters of United States upland cotton under the "*FSC Repeal and Extraterritorial Income Exclusion Act of 2000*" (referred to in this report as the "ETI Act of 2000").[358]

7.246 Brazil refers the Panel to the findings in the panel and Appellate Body reports in an earlier dispute[359] and to a page on the website of the European Commission.[360] Brazil asserts that the ETI Act of 2000 sets out conditions for the non-taxation of a portion of extraterritorial income that would otherwise be taxed. It outlines the reasoning of the panel and Appellate Body in that earlier dispute and recalls that the Appellate Body noted that in order to obtain a subsidy under the ETI Act of 2000, property produced in the United States must be sold, leased or rented for direct use, consumption or disposition "outside the United States".[361] Brazil also refers us to the panel's finding in that earlier dispute that the ETI Act of 2000 created a legal entitlement for recipients to receive export subsidies with respect to both scheduled and unscheduled agricultural products, as the United States must provide the tax exclusion upon fulfilment by the taxpayer of the conditions stipulated in the ETI Act of 2000.[362]

7.247 Brazil asserts that exporters in the United States exported United States upland cotton benefiting from the ETI tax breaks, but it is not in a position to quantify the amount of the subsidy provided to upland cotton, although it posed this question to the United States during consultations.[363]

7.248 Brazil requests this Panel to make factual findings regarding the ETI Act of 2000 based on this evidence.[364] It does not submit a copy of the ETI Act of 2000, or the relevant sections of it.

7.249 The panel report in that dispute, which established the facts in that dispute, cites the short title set out in our terms of reference[365] but the Appellate Body report sets out a short title that we cannot

[357] See United States' response to Panel Question No. 85, where the United States indicates that section 211(b)(2) of the Agricultural Trade Act of 1978, 7 USC 5641(b)(2) limits the fee of transactions to this level.

[358] Brazil's first written submission, para. 315, refers to the "*FSC Repeal and Extraterritorial Income Act of 2000* (the 'ETI Act')" and its response to Panel Question No. 19 refers to the "*FSC Repeal and Extraterritorial Exclusion Act of 2000* (Public Law 106-519)".

[359] Panel Report, *US – FSC (Article 21.5 – EC)*, WT/DS108/RW, as modified by the Appellate Body Report in *US – FSC (Article 21.5 – EC)*, WT/DS108/AB/RW.

[360] See Brazil's oral statement at the first session of the first substantive meeting , para. 137.

[361] Brazil's first written submission, para. 322.

[362] Brazil's first written submission, para. 325.

[363] Brazil's first written submission, para. 330.

[364] See Brazil's oral statement at the first session of the first substantive meeting, para. 139.

[365] Panel Report, *US – FSC (Article 21.5 – EC)*, para. 2.1, footnote 14.

identify.[366] However, the Public Law number in the second footnote of the Appellate Body report matches the one given to this Panel by Brazil.[367] Therefore, we are satisfied that the earlier dispute in fact concerned the same law at issue in the present dispute.

(l) Legislative and regulatory provisions

7.250 Brazil challenges certain legislation and regulations under which the above subsidies are currently provided. This challenge relates to this legislation and these regulations "as such". Specifically, the measures are:

*(i) Marketing loan/Loan deficiency provisions*

- Sections 1201(a)-(b), 1202(a)(6), 1202(b)(6), 1204(b), 1205(a)(1), 1205(b), 1205(c)(1), 1608 of the FSRI Act of 2002[368] and 7 USC 7286 (Section 166 of the FAIR Act of 1996 as amended) and 7 CFR 1427.22[369] to the extent that these provisions relate to upland cotton.

*(ii) User marketing (Step 2) provisions*

- Section 1207(a) of the FSRI Act of 2002[370] and 7 CFR 1427.103, 7 CFR 1427.104(a)(1) and (2), 7 CFR 1427.105(a) and 7 CFR 1427.108(d).[371]

*(iii) Direct payments provisions*

- Section 1103(a)-(d)(1) of the FSRI Act of 2002[372] and 7 CFR 1412.502.[373]

*(iv) Counter-cyclical payments provisions*

- Section 1104(a)-(f)(1) of the FSRI Act of 2002[374] and 7 CFR 1412.503.[375]

*(v) Crop insurance provisions*

- Sections 508(a)(8), 508(b)(1), 508(b)(2)(A)(ii), 508(b)(3), 508(e) and 508(k) and 516 of "the ARP Act of 2000".[376]

*(vi) Export credit guarantee provisions*

- 7 USC 5622,[377] in particular, 7 USC 5622(a)(1) and (b), and 7 CFR 1493[378] which established and maintain the GSM 102, GSM 103 and SCGP programmes.

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[366] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 1.
[367] See Brazil's response to Panel Question No. 19.
[368] The provisions of the FSRI Act of 2002 are reproduced in Exhibits BRA-29 and US-1.
[369] 7 CFR 1427.1-1427.25 (1 January 2003 edition) are reproduced in Exhibit BRA-36.
[370] Section 1207(a) of the FSRI Act of 2002 is reproduced in Exhibits BRA-29 and US-1.
[371] 7 CFR 1427.100-1427.108 (1 January 2003 edition) are reproduced in Exhibit BRA-37.
[372] Section 1103 of the FSRI Act of 2002 is reproduced in Exhibits BRA-29 and US-1.
[373] 7 CFR 1412 is reproduced in Exhibit BRA-35.
[374] Section 1103 of the FSRI Act of 2002 is reproduced in Exhibits BRA-29 and US-1.
[375] 7 CFR 1412 is reproduced in Exhibit BRA-35.
[376] The ARP Act of 2000 amended the *Federal Crop Insurance Act* which is reproduced in Exhibit BRA-30 as amended through Public Law 107-136, 24 January 2002. See Brazil's first written submission, footnotes 178 and 184.
[377] 7 USC 5622 is reproduced in Exhibit BRA-141.
[378] 7 CFR 1493 is reproduced in Exhibit BRA-38.

*(vii) ETI Act of 2000*

- ETI Act of 2000, in particular, Section 3, which Brazil asserts inserted new Sections 114, 941, 942 and 943 in the United States Internal Revenue Code.

**3. Claims**

7.251 **Brazil** claims that the measures at issue are inconsistent with the obligations of the United States under the following provisions:

- the export subsidy provisions of Articles 3.3, 8, 9.1 and 10.1 of the *Agreement on Agriculture*;
- the prohibited subsidies provisions of Articles 3.1(a) and (b) and 3.2 of the *SCM Agreement*;
- the actionable subsidies provisions of Articles 5(c) and 6.3(c) and (d) of the *SCM Agreement*;
- the subsidies provisions of paragraphs 1 and 3 of Article XVI of the *GATT 1994*; and
- the national treatment provision of Article III:4 of the *GATT 1994*.

7.252 Brazil submits that the domestic support measures and alleged export subsidies at issue are not exempt from actions based on Article 13(b)(ii) and 13(c)(ii), respectively, of the *Agreement on Agriculture*.

7.253 Brazil also claimed in its request for establishment of a panel that the measures were inconsistent with the obligations of the United States under the domestic support provisions of Article 7.1 of the *Agreement on Agriculture*; and with the obligations of the United States under the actionable subsidies provisions of Articles 5(a) and 6.3(b) of the *SCM Agreement.* Brazil did not pursue these claims in its submissions and the United States did not respond to them. The Panel considers these claims abandoned and makes no other findings in relation to them.

**4. Order of analysis**

7.254 The claims in this dispute are made under the *SCM Agreement*, the *Agreement on Agriculture* and the *GATT 1994*. The *SCM Agreement* prohibits certain subsidies and creates obligations with respect to so-called "actionable subsidies".[379] The *Agreement on Agriculture* contains domestic support and export subsidy disciplines for certain products at issue in this dispute. Article XVI of the *GATT 1994* also contains obligations with respect to subsidies, and Article III:4 of the *GATT 1994* contains obligations with respect to laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution and use of imported products.

7.255 An appropriate order of analysis of the claims requires careful consideration due to the interlocking nature of the *SCM Agreement* and the *Agreement on Agriculture*, the relationship between the *SCM Agreement* and Article XVI of the *GATT 1994*, and the relationship between the *SCM Agreement* and the *Agreement on Agriculture*, and Article III:4 of the *GATT 1994.* The respective texts of the covered agreements expressly provide for a general order of precedence among them. The general interpretative note to Annex 1A of the *WTO Agreement* provides that:

[379] Article 1.2 of the *SCM Agreement.*

> "In the event of conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A to the Agreement Establishing the World Trade Organization (referred to in the agreements in Annex 1A as the "WTO Agreement"), the provision of the other agreement shall prevail to the extent of the conflict."

7.256 This note only applies "[i]n the event of conflict". It does not exclude the *GATT 1994* from the scope of application of the agreements set out in Annex 1A, including the *SCM Agreement* and the *Agreement on Agriculture*, in any other circumstances. Similarly, Article 21.1 of the *Agreement on Agriculture* provides that:

> "1. The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement."

7.257 This paragraph expressly provides for the application of the *GATT 1994* and the *SCM Agreement*. It does not exclude their application, although it indicates that the *Agreement on Agriculture* takes precedence.

7.258 The specific provisions of the covered agreements raised in the claims contain consistent references to each other. With respect to prohibited subsidies, Article 3 of the *SCM Agreement* provides that certain subsidies are prohibited "[e]xcept as provided in the Agreement on Agriculture".

7.259 With respect to actionable subsidies, Articles 5 and 6.9 of the *SCM Agreement* both provide as follows:

> "This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture."

Article 7.1 of the *SCM Agreement* also begins with the phrase "[e]xcept as provided in Article 13 of the Agreement on Agriculture".

7.260 Article 13 of the *Agreement on Agriculture* applies, during the implementation period, "notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures". In the Panel's view, this refers to the provisions of Articles II and XVI of the *GATT 1994* and Parts II, III and V of the *SCM Agreement* that are specifically listed in the subparagraphs of Article 13.[380] It provides, *inter alia*, that domestic support measures and export subsidies for agricultural products that fulfil certain conditions shall be "exempt from actions" based on various provisions of Article XVI of the *GATT 1994* and the *SCM Agreement*[381], and based on non-violation nullification or impairment of the benefits accruing from tariff concessions, and it also limits their exposure to countervailing duties.[382] Most of the conditions are set out in the three paragraph chapeaux of Article 13 and cross-reference compliance with particular substantive provisions of the *Agreement on Agriculture* and commitments in Part IV of each Member's Schedule, although there is an additional condition in subparagraphs (b)(ii) and (b)(iii) that is not an obligation.

7.261 This web of cross-references discloses a scheme according to which an analysis of the same measures under the *Agreement on Agriculture*, the *SCM Agreement* and Article XVI of the *GATT 1994* concerning export subsidies for agricultural products and, at least during the implementation

[380] For the reasons given in paragraphs 7.315 to 7.319, the Panel does not consider that it also refers to Articles XXII and XXIII of the *GATT 1994*, as elaborated and applied by the DSU.

[381] Subparagraphs (a)(ii), (a)(iii), (b)(i), (b)(ii), (b)(iii) and (c)(ii) of Article 13.

[382] An additional cross-reference is found in Article 10 of the *SCM Agreement* which subjects countervailing duties investigations to the provisions of both the *SCM Agreement* and the *Agreement on Agriculture*.

period for the purposes of Article 13, allegedly actionable subsidies for agricultural products, should be examined first under the *Agreement on Agriculture.* The implementation period for the purposes of Article 13 had not yet expired on the date of establishment of the Panel.[383] Therefore, the Panel will follow this order of analysis with respect to the alleged export subsidies and actionable subsidies in issue.[384]

7.262 The Panel's approach is consistent with the following statement of the Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)*, which specifically addressed the order of analysis of the WTO-consistency of an export subsidy for agricultural products:

> "The relationship between the *Agreement on Agriculture* and the *SCM Agreement* is defined, in part, by Article 3.1 of the *SCM Agreement*, which states that certain subsidies are "prohibited" "[e]xcept as provided in the Agreement on Agriculture". This clause, therefore, indicates that the WTO-consistency of an export subsidy for agricultural products has to be examined, in the first place, under the *Agreement on Agriculture*."[385]

7.263 The Panel takes note that a previous panel and the Appellate Body did not follow this order of analysis in *US – FSC*, a dispute which did not primarily concern agricultural products.[386] Instead, that panel and the Appellate Body first examined the consistency of export subsidies with Article 3.1(a) of the *SCM Agreement*, and then proceeded to examine the consistency of subsidies under the same provisions for agricultural products with Article 3.3 and Part V of the *Agreement on Agriculture*. Nevertheless, for the reasons given above, the Panel chooses to follow the order of analysis explained in *Canada – Dairy (Article 21.5 – New Zealand and US)*.

7.264 The Panel's order of analysis does not preclude it from looking to the *SCM Agreement* for contextual guidance in its interpretation of the *Agreement on Agriculture*, for example, with respect to the meaning of the terms "subsidy" and "export subsidies".

## 5. Burden of proof

(a) Main arguments of the parties

7.265 **Brazil** requests that the Panel make a finding that Article 13 of the *Agreement on Agriculture* is in the nature of an affirmative defence. It submits that in light of the relevant WTO jurisprudence on the burden of proof, Article 13 of the *Agreement on Agriculture* is in the nature of an affirmative defence and, as such, the United States bears the burden of proving that its measures are in conformity with Article 13 for the following reasons: (1) Article 13 does not alter the scope of other provisions providing positive obligations for Members; (2) Article 13 provides no positive obligations in itself; and (3) Article 13 does not alter the legal nature of Members' measures, but simply allows Members to maintain those measures exempt from actions if they comply with the conditions that it sets out.[387]

7.266 The **United States** argues that Article 13 forms part of the balance of rights and obligations of Members and is not an affirmative defence but a threshold procedural hurdle that Brazil must overcome. The United States claims that the use of the word "notwithstanding" in the introductory paragraph of Article 13 means that conforming measures are exempt from action "in spite of and without regard to or prevention by" the obligations contained in the *GATT 1994* or the *SCM*

[383] For the reasons given in paragraphs 7.340 to 7.345.

[384] It does not affect the Panel's examination of measures under Article 3.1(b) of the *SCM Agreement*, for the reasons given in Section VII:F of this report.

[385] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 123.

[386] Appellate Body Report, *US – FSC*, sections V, VI and IX, applied in its Report in *US – FSC (Article 21.5 – EC)*, paras. 187-196.

[387] Brazil's first written submission, para. 117.

*Agreement*. The United States argues that Article 21.1 of the *Agreement on Agriculture* further clarifies that the obligations under the *SCM Agreement* and the *GATT 1994* only apply "subject to" the provisions of the *Agreement on Agriculture*, including Article 13.[388] The United States submits that the burden is on Brazil to show that the conditions exist that would allow it to bring its action, that is, that the United States measures do not conform to Article 13.[389] It also asserts that Brazil's approach would produce bizarre results.[390]

(b) Main arguments of the third parties

7.267 **Argentina**[391], **Australia**[392], **Benin**[393], **China**[394] and **India**[395] agree with Brazil that Article 13 is in the nature of an affirmative defence and that the United States bears the burden of proving that the measures at issue fully conform with the applicable conditions of Article 13 of the *Agreement on Agriculture*.

7.268 The **European Communities** agrees with the United States that Article 13 is not an affirmative defence and that Brazil bears the burden of proving that the measures at issue are not in conformity with the conditions set out in Article 13.[396]

7.269 **Chinese Taipei** submits that it is inappropriate to label Article 13 as an "affirmative defence" or "exception" purely in order to determine which of the two parties bears the burden of proof. Article 13 contains a right to exemption from actions conditional upon conformity with a positive obligation of full conformity with the *Agreement on Agriculture*. It is for Brazil to prove a breach of this positive obligation by demonstrating non-conformity.[397]

(c) Evaluation by the Panel

7.270 The Panel will apply the usual rule regarding the burden of proof in WTO proceedings, unless the text of the covered agreements indicates otherwise. Accordingly, the initial burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what it asserts is correct, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut that presumption.[398] In the Panel's view, asserting the affirmative of a claim requires the complainant first to show that a measure falls within the *scope* of a positive obligation, that is, that the obligation is applicable to the measure, and then to show that the measure is inconsistent with that obligation.[399]

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[388] United States' first written submission, paras. 38-39.

[389] United States' first written submission, para. 41.

[390] The United States provides an example of this with respect to Article 6 of the *Agreement on Agriculture*. According to the United States, Brazil would bear the burden of proof if it only claimed a violation under Article 6, which it emphasizes is also a requirement found in Article 13. Consequently, the United States submits that there is no basis for concluding that the burden of proving a violation of Article 6 would be reversed merely because a Member were to claim a violation of one of the provision of the *SCM Agreement* found in Article 13 in addition to Article 6. See the United States first written submission, para. 44.

[391] Argentina's written submission to the first session of the first substantive meeting, paras. 43-46.

[392] Australia's written submission to the first session of the first substantive meeting, paras. 5-15.

[393] Benin's written submission to the first session of the first substantive meeting, paras. 21-36.

[394] China's written submission to the first session of the first substantive meeting, paras. 3-9.

[395] India's oral statement at the first session of the first substantive meeting, para. 8.

[396] European Communities' written submission to the first session of the first substantive meeting, paras. 8-14.

[397] Chinese Taipei's written submission to the first session of the first substantive meeting, para. 8.

[398] See Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, quoted in Brazil's first written submission at para. 111.

[399] This was the approach of the Appellate Body in *Brazil – Aircraft*, paras. 139-141 and *US – FSC (Article 21.5 – EC)*, para. 128, and recalled in *EC – Tariff Preferences*, para. 88.

7.271 This situation is to be contrasted with at least one other example. As regards agricultural export subsidies, the text of Article 10.3 of the *Agreement on Agriculture* articulates a special rule that alters the usual rule on burden of proof in certain disputes under Articles 3, 8, 9, and 10 of the *Agreement on Agriculture*.[400]

7.272 We recall that, pursuant to Article 3 of the *Agreement on Agriculture*, a Member is entitled to grant export subsidies within the limits of the reduction commitment specified in its Schedule. Where a Member claims that another Member has acted inconsistently with Article 3.3 of the *Agreement on Agriculture* by granting export subsidies in excess of a quantity commitment level, there are two separate parts to the claim. First, the responding Member must have exported an agricultural product in quantities exceeding its quantity commitment level. If the quantities exported do not reach the quantity commitment level, there can be no violation of that commitment, under Article 3.3. However, merely exporting a product in quantities that exceed the quantity commitment level is not inconsistent with the commitment. The commitment is an undertaking to limit the quantity of exports that may be *subsidized* and not a commitment to restrict the volume or quantity of exports *as such*. The second part of the claim is, therefore, that the responding Member must have granted export subsidies with respect to quantities exceeding the quantity commitment level. There is, in other words, a *quantitative* aspect and an *export subsidization* aspect to the claim.

7.273 Article 10.3 of the *Agreement on Agriculture* allocates to different parties the burden of proof with respect to the two parts of such a claim. Where a Member exports an agricultural product in quantities that exceed its quantity commitment level, that Member will be treated as if it has granted WTO-inconsistent export subsidies, for the excess quantities, unless the Member presents adequate evidence to "establish" the contrary. This reversal of the usual rule obliges the responding Member to bear the consequences of any doubts concerning the evidence of export subsidization. With respect to the export subsidization part of the claim, the complaining Member, therefore, is relieved of its burden, under the usual rule, to establish a prima facie case of export subsidization of the excess quantity, provided that this Member has established the quantitative part of the claim.[401]

7.274 Turning to Article 13 of the *Agreement on Agriculture*, we note that its text does not contain any special rule on the burden of proof. Therefore, the usual rule applies. Article 13 contains positive obligations only to show due restraint in initiating countervailing duties investigations; these are not relevant in this dispute.[402] Otherwise, it sets out conditions according to which certain domestic support measures and export subsidies for agricultural products benefit from certain protection, including in relation to Article XVI of the *GATT 1994* and the *SCM Agreement*. Measures that do not satisfy those conditions are not necessarily inconsistent with Article XVI of the *GATT 1994* or the *SCM Agreement*. Members have a choice throughout the implementation period whether or not to satisfy the additional condition set forth in Article 13(b)(ii) and (iii) and benefit from the protection that it provides, or whether to comply with the obligations in Article XVI of the *GATT 1994* and the *SCM Agreement*, or both. The additional condition is not an obligation. Although the other

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[400] Article 10.3 provides:

> "Any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question."

We find support for our approach in the Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, paras. 69-71, 73-75. Contrary to the United States' assertion, in its further rebuttal submission at para. 191, we do not believe that our observation (in our 20 June 2003 communication, set out in Annex L) that no provisions of the *Agreement on Agriculture* are identified as special or additional rules and procedures in Appendix 2 to the *DSU*, is at variance with our articulation and application of this burden of proof, which flows from the text of Article 10.3 itself and related provisions.

[401] See Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, paras. 70-75.

[402] Subparagraphs (b)(i) and (c)(i) of Article 13.

conditions in Article 13 of the *Agreement on Agriculture* stipulate compliance with other provisions of that agreement, many of which set out positive obligations, they are only obligations for the purposes of claims under those other provisions of the *Agreement on Agriculture*. They do not arise as positive obligations under Article 13.

7.275 The obligation with respect to actionable subsidies is found in Articles 5 and 6 of the *SCM Agreement*, both of which provide, in identical terms, that:

> "This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture."[403]

7.276 This language shows that, during the implementation period for the purposes of Article 13, the obligation regarding actionable subsidies simply does not apply to subsidies for agricultural products that satisfy the conditions set forth in Article 13 of the *Agreement on Agriculture*. The obligation is not applicable and, hence, such subsidies are not actionable subsidies. Satisfaction of the conditions in Article 13 is therefore a question of the scope of the obligation and the initial burden is on the complainant to adduce evidence sufficient to raise a presumption that domestic support measures do not satisfy those conditions.

7.277 The obligations with respect to prohibited subsidies are found in Part II of the *SCM Agreement*. Article 3.1 provides that certain subsidies are prohibited "[e]xcept as provided in the Agreement on Agriculture". In the Panel's view, the mere use of the word "except" does not indicate that subsidies covered by this introductory phrase (i.e. export subsidies provided for in the *Agreement on Agriculture*) necessarily fall within the scope of the basic obligation in Article 3.1 of the *SCM Agreement* because, read in context, the introductory phrase of Article 3.1 forms part of the scheme referred to above in paragraph 7.261. The introductory phrase refers to the *Agreement on Agriculture* as a whole which includes Article 13(c). The parallel structure of paragraphs (b) and (c) of Article 13 indicates that the drafters intended them to operate in the same way. Accordingly, given that the conditions in Article 13(b) clearly affect the scope of obligations in Part III (Articles 5 and 6) of the *SCM Agreement*, it appears to us that those in Article 13(c) are also intended to affect the scope of relevant obligations in Article 3.1 of the *SCM Agreement*.

7.278 The Panel notes that the wording of the reference to the *Agreement on Agriculture* found in Article 3.1 of the *SCM Agreement* differs from those found in Articles 5 and 6.9. However, this difference appears to be due to the fact that both agreements contain export subsidy disciplines, but only the *SCM Agreement* contains actionable subsidies obligations.

7.279 The Panel also notes that Article 13 uses the words "notwithstanding" and "exempt". The ordinary meaning of "notwithstanding" is "in spite of, without regard to or prevention by".[404] The ordinary meaning of exempt is "[n]ot exposed or subject to something unpleasant or inconvenient; not liable to a charge, tax, etc. (Foll. by *from*)"[405] The mere use of these words does not indicate whether the measures provided for in that article fall within or without the scope of the relevant obligations in the listed provisions, any more than merely characterizing a provision as an exception.[406] Read in context, these words do not indicate that domestic support measures provided for in paragraph (b) fall within the scope of the obligations in Articles 5 and 6 of the *SCM Agreement* in light of the clear wording of the last sentence of Article 5 and Article 6.9. Therefore, there is no basis to conclude that

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[403] Article 5, last sentence, and Article 6.9 of the *SCM Agreement*.

[404] *The New Shorter Oxford English Dictionary*, (1993). This definition was also quoted by the Appellate Body in *EC – Tariff Preferences* at para. 90, in its interpretation of the Enabling Clause.

[405] *The New Shorter Oxford English Dictionary*, (1993). The meaning of "exempt" in the phrase "exempt from actions" is discussed in greater detail below.

[406] See the Appellate Body Reports in *EC – Hormones*, para. 104, and *EC – Sardines*, para. 275, which commented on this issue.

the use of those words indicates that export subsidies provided for in paragraph (c) fall within the scope of the obligations in Article 3.1 of the *SCM Agreement* either.

7.280 The position under Article XVI of the *GATT 1994* is no different. If the obligations found in Article XVI dealing with "Subsidies in General" (Part A - Article XVI:1) and "Export Subsidies" (Part B - Articles XVI:2-5) are now subsumed within, or elaborated and applied by, the *SCM Agreement* and the *Agreement on Agriculture*, and no longer have independent application, the limitation on the scope of the prohibited and actionable subsidies obligations in the *SCM Agreement* applies to the interpretation of Article XVI as well. Alternatively, if Article XVI continues to have independent application, the scope of such application during the implementation period is defined by the texts of Article XVI itself, the *SCM Agreement*, and the *Agriculture Agreement*, including the terms of Article 13 of the *Agreement on Agriculture*.[407]

7.281 This interpretation is supported by the content of Article 13 of the *Agreement on Agriculture*. The principal conditions that it sets forth are simply conformity with Article 6 and Part V of that same agreement. There is no dispute that a complainant bears the burden of proving claims of violation of domestic support commitments under Article 6 or violation or circumvention of export competition commitments under Part V (subject to the special provision in Article 10.3) irrespective of the Panel's order of analysis. In the Panel's view, the insertion of Article 13 was not intended to require a panel confronted with claims of serious prejudice as well as violations of the *Agreement on Agriculture* to assess twice the conformity of measures with Article 6 and Part V, allocating the burden of proof once to the complainant and once to the respondent according to whether it was assessing conformity for the purposes of the *Agreement on Agriculture* or the *SCM Agreement* and Article XVI of the *GATT 1994*. Rather, as part of a scheme, it was intended to ensure that if a complaint was ever filed during the implementation period, the Panel would first analyse the measures under the *Agreement on Agriculture*. If the measures satisfied the conditions set forth in Article 13, the Panel would not proceed to find any inconsistency with the *SCM Agreement* or Article XVI of the *GATT 1994*, as referred to in Article 13 of the *Agreement on Agriculture*.

7.282 The Panel notes that Brazil cites the Appellate Body report in *US – FSC (Article 21.5 - EC)*. In that case, the Appellate Body interpreted the fifth sentence of footnote 59 of the *SCM Agreement* as an affirmative defence because it did not alter the scope of an obligation and was therefore an exception.[408] This is precisely the approach that the Panel has adopted in its interpretation of Article 13 of the *Agreement on Agriculture*. Articles 3.1, 5 and 6.9 of the *SCM Agreement do* alter the scope of the prohibited and actionable subsidies obligations by reference to the conditions in Article 13. Consequently, neither those conditions nor Article 13 are an affirmative defence.

7.283 Similarly, Brazil cites the Appellate Body report in *Brazil – Aircraft.* In that case, the Appellate Body considered the provisions of Articles 3.1(a), 27.2(b) and 27.4 of the *SCM Agreement*. It upheld the Panel's finding that certain provisions in Article 27.4 were "positive obligations" and not an affirmative defence, because if a developing country Member complied with them during a transitional period, the export subsidy prohibition in Article 3.1(a) simply did not apply.[409] Whilst we do not consider that the conditions in Article 13 of the *Agreement on Agriculture* are positive obligations as such for the purposes of the claims pursued in this dispute, they do partly define the scope of positive obligations. If domestic support measures and export subsidies comply with these conditions during the implementation period, the obligations in Articles 3.1(a), 5 and 6 of the *SCM Agreement* simply do not apply. Therefore, in the Panel's view, those conditions as referred to in Article 13 are not an affirmative defence.

[407] We refer to our findings on Article XVI:3 of the *GATT 1994* in Section VII:E and on Article XVI:1 of the *GATT 1994* in Section VII:G of this report.

[408] See the Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 131 and 132.

[409] See the Appellate Body Report, *Brazil – Aircraft*, paras. 134 – 141.

7.284 Article 13 of the *Agreement on Agriculture* was drafted later than the basic obligations in Parts II and III of the *SCM Agreement*, which may contribute to a perception that it should also be analysed later and is somehow an affirmative defence. However, this is a matter of drafting chronology. The results of the Uruguay Round are a single undertaking simultaneously agreed in the Final Act, and the order in which a Panel should analyse them and allocate the burden of proof is dictated by a proper interpretation of the texts of the covered agreements and not by the order in which they were negotiated.

7.285 For these reasons, the Panel declines to make a finding that Article 13 is in the nature of an affirmative defence. Rather, the Panel finds that the conditions in Article 13, for a limited time, partly define the scope of the obligations in Article XVI of the *GATT 1994* and Articles 3, 5 and 6 of the *SCM Agreement*, among other things. According to the usual rule regarding the burden of proof, the complainant, Brazil, bears the initial burden to show that the measures at issue fall within the scope of the obligations with which it alleges that the measures are inconsistent. That includes the burden to show that they do not satisfy the conditions in Article 13 of the *Agreement on Agriculture*.

7.286 In the present dispute, the Panel is of the view that Brazil has succeeded in discharging the burden to show that certain measures at issue do not satisfy the conditions in Article 13[410], for the reasons given in Sections VII:D and E of this report.

**6. "Exempt from actions"**

(a) Main arguments of the parties

7.287 Immediately following the composition of the Panel, the United States submitted a letter dated 21 May 2003 in which it asserted that Brazil may not maintain its action based on its claims of adverse effects and serious prejudice under the *SCM Agreement* and Article XVI of the *GATT 1994* unless the Panel had found that United States support measures for upland cotton do not conform to Article 13 of the *Agreement on Agriculture*. Brazil replied in a letter dated 23 May 2003 in which it disagreed.[411]

7.288 The **United States** requested the Panel to organize its procedures to determine first whether Brazil was permitted to maintain any actions based on the provisions exempted by Article 13 of the *Agreement on Agriculture*. If the Panel allowed Brazil to proceed with its substantive claims under the *SCM Agreement* and the *GATT 1994*, and only concluded later that the measures at issue conformed to Article 13 of the *Agreement on Agriculture*, the measures at issue would already have been subject to actions based on those claims, which would contradict the ordinary meaning of "exempt from actions". It asserted that the normal rules of the *DSU* allow the Panel to first determine the conformity of United States measures with Article 13.[412]

7.289 **Brazil** asserted that the phrase "exempt from actions" means that a complainant cannot receive authorization from the DSB to obtain a remedy against another Member's measures that would otherwise be subject to the disciplines of certain provisions of the *SCM Agreement* and the *GATT 1994* if the measures comply with Article 13 of the *Agreement on Agriculture.* According to Brazil, a WTO panel is not a "court" where lawsuits are initiated by filing the appropriate papers. Rather, the word "action" means joint action by WTO Members. *DSU* panel proceedings only begin when Members take collective actions to establish a panel. Brazil argued that providing special proceedings

[410] With the exception of the ETI Act of 2000 and export subsidies granted under it, for the reasons given in Section VII:E of this report.

[411] These letters are contained in Annex K to this report.

[412] See United States' initial brief, para. 3, and its comments on initial briefs, para. 5.

for determining compliance with Article 13 would effectively add Article 13 to the closed list of special and additional rules and procedures in Appendix 2 to the *DSU*.[413]

(b) Main arguments of the third parties

7.290 **Argentina**[414], **Australia**[415], **India**[416], **New Zealand**[417] and **Paraguay**[418] generally agreed with Brazil that the Panel was not precluded from considering claims under the *SCM Agreement* and Article XVI of the *GATT 1994* until it first determined whether United States measures conformed with Article 13 of the *Agreement on Agriculture*.

7.291 The **European Communities** was of the view that the issue of whether a measure falls within Article 13 is a question which a panel must decide before it determines whether the measure potentially violates provisions of the *SCM Agreement* and the *GATT 1994*, but this does not imply that a panel is precluded from hearing evidence and arguments relating to provisions of the *SCM Agreement* and the *GATT 1994* until after it has decided on the applicability of Article 13 of the *Agreement on Agriculture*.[419]

(c) Evaluation by the Panel

7.292 The Panel is satisfied that it had authority to deal with the claims raised under the *SCM Agreement* and Article XVI of the *GATT 1994*.[420] It communicated to the parties on 20 June 2003 its views that it was not required to defer any examination of certain of Brazil's claims based on Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* until after making a ruling or expressing views on the issue of fulfilment of the conditions in Article 13 of the *Agreement on Agriculture*.[421] The Panel concluded at that time that there is no special dispute settlement requirement foreseen in the covered agreements in respect of a panel's consideration of the fulfilment of Article 13 conditions. The issue of fulfilment of the conditions of Article 13 of the *Agreement on Agriculture* is to be resolved using generally applicable *DSU* rules and procedures. It was not necessary for the Panel to look for any further interpretive guidance on this issue.

7.293 Further, in accordance with the Panel's ordering of its procedures, after the parties and third parties presented evidence and submissions focused on the conditions in Article 13 of the *Agreement on Agriculture*, but before they presented evidence and submissions focused on the claims under the *SCM Agreement* and Article XVI of the *GATT 1994*, the Panel issued a communication to the parties and third parties which stated, *inter alia*, as follows:

> "4. The Panel takes note of the correspondence from the parties dated 27, 28 and 29 August 2003 and declines to make findings at this stage as to whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, for the reasons given in its communication dated 20 June 2003. The Panel's findings on that issue will be included in its interim report, on which the parties will have the right to comment in accordance with Article 15.2 of the *DSU*.

[413] See Brazil's initial brief, para. 9, and its comments on initial briefs, paras. 2-4 and 18-19.
[414] See Argentina's initial brief, para. 16.
[415] See Australia's initial brief, para. 8.
[416] See India's initial brief, para. 8.
[417] See New Zealand's initial brief, p. 2.
[418] See Paraguay's initial brief, p. 1.
[419] See the European Communities' initial brief, para. 7
[420] A panel's duty to deal with such issues in order to satisfy itself that it has authority to proceed was discussed by the Appellate Body in *Mexico – Corn Syrup (21.5 – US)*, para. 36, *US – 1916 Act*, para. 54 and *US – Carbon Steel*, para. 123.
[421] The Panel's communication dated 20 June 2003 is set out in full in Section VII:A of this report.

> 5. The Panel has now had the opportunity to consider the parties' and third parties' evidence and arguments to date. At this stage, the Panel cannot conclude its assessment of the matter before it on the basis that the measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*. The expression by the Panel of this view is without prejudice to the Panel's eventual findings, and is subject to paragraph 6 below. In this context, the Panel is of the view that consideration, as appropriate, of Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*, as those provisions are referred to in Article 13 of the *Agreement on Agriculture*, is warranted in order for the Panel properly to discharge its responsibilities under the *DSU* and the relevant covered agreements. Therefore, the Panel will consider those claims at a second session of the first substantive meeting."

7.294 The United States submits that:

> "As a responding party cannot prevent panel establishment from occurring, it will inevitably be forced to argue to a panel that the panel's procedures should be structured so that the party's challenged measures are not subject, from that point on, to actions based on provisions specified in the Peace Clause. Thus, given the automaticity in DSU rules relating to consultations and panel establishment, the Panel's organization of its procedures provides the first opportunity to arrest Brazil's taking of 'legal steps to establish a claim' …"[422]

7.295 In the Panel's view, this argument implies that there was an oversight in the *DSU* rules and procedures, as a result of which a panel must organize its procedures to enforce the conditions in Article 13 as a second-best option. However, the absence of any reference to any applicable special dispute settlement rule in Appendix 2 to the *DSU* indicates that a panel is under no obligation to organize its procedures in this way, but is only prevented from making a finding that measures that comply with the conditions set out in Article 13 of the *Agreement on Agriculture* are inconsistent with the relevant provisions that it lists.

7.296 The United States' argument would also seemingly require a Panel to make a definitive finding on Article 13 before it could go on. This could mean that a separate panel on Article 13 would be necessary every time, before a Member could bring any action based on the listed provisions of the *SCM Agreement*, or at least require a panel to conduct basically two consecutive panel proceedings from first submissions to interim or even final report, where measures did not satisfy the conditions set out in Article 13. Nowhere is such a procedure required in the *DSU* or the relevant special rules and procedures. Rather, Article 12.1 and 12.2 provide that:

> "1. Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute.
>
> 2. Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process."

7.297 The United States requested a separate interim report devoted to Article 13 of the *Agreement on Agriculture*:

> "In this dispute, the Panel's findings on the Peace Clause are presumably intended to be dispositive of substantive claims and arguments of the parties for the remainder of the panel proceedings. Because of the substantive nature of those findings, the Panel's findings on September 5 will need to provide the factual basis and basic

[422] United States' comments on parties' initial briefs, para. 37.

> rationale underlying the findings. Both parties have a significant interest in those findings, in terms not just of the ultimate conclusion reached, but also in terms of the factual findings, rationale underlying those findings, and an understanding of the scope of those findings. Accordingly, in keeping with Article 15.2 of the DSU, and in order to be fair to both parties, the United States respectfully requests that the Panel provide Brazil and the United States with the Panel's September 5 Peace Clause findings in an interim form and provide the parties an opportunity to comment on the Panel's findings. The United States suggests that, in keeping with the practice in other panel proceedings and this Panel's timetable for the interim review in this dispute, two weeks should be sufficient time to comment."[423]

7.298 The Panel's expression of views on 5 September 2004 was not "dispositive of substantive claims and arguments", on which the United States' request was premised. In any event, Article 15.2 of the *DSU* only envisages one interim report in respect of the entire matter before a panel. It appears to us that this is because multiple interim report procedures would unduly delay the panel process without benefiting the quality of the final panel report. We therefore rejected this suggestion.

7.299 The Panel also notes for the record that the United States submitted detailed argument on interpretation and fulfilment of the conditions in Article 13 of the *Agreement on Agriculture* after the Panel's communication to the parties of 5 September 2003.[424]

7.300 In the present case, the Panel has, in fact, organized its proceedings to phase examination of different issues. This was due to the potential complexity of the claims, the conditional nature of certain of these claims and the volume of evidence which we expected would be introduced by the parties in support of their claims and arguments, and in order to organize our proceedings in an orderly, effective and efficient manner. This served to facilitate an objective assessment of the matter before us, and optimized use of our resources. The order of our procedures was not due to lack of jurisdiction or authority to hear all claims at once.

7.301 The conditionality of Article 13 was therefore one of the Panel's prime considerations. In that context, we now set out our views on the meaning and implications of the phrase "exempt from actions" as it is used in Article 13.

7.302 **Brazil** submits that the word "actions" refers to "multilateral actions taken collectively by Members" and that therefore:

> "The phrase 'exempt from actions' in Article 13 means that if all the conditions of Article 13(b)(ii) and 13(c)(ii) are fulfilled … a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the *SCM Agreement* or Article XVI of GATT 1994."[425]

7.303 The **United States** argues that the phrase "exempt from actions" means "not exposed or subject to" a "legal process or suit" or the "taking of the legal steps to establish a claim" such as a formal complaint or any formal proceedings, including an adjudication of the claim. It requests that the Panel find that measures that conform to Article 13 are exempt from any action, including

[423] Letter from the United States to the Panel dated 27 August 2003.

[424] See United States' 28 January 2004 comments on Brazil's response to Panel Question No. 258, its 11 February 2004 comments, its 3 March 2004 comments and its 15 March 2004 comments, concerning the interpretation of Article 13(b)(ii). The Panel takes note that para. 1 of the 3 March 2004 comments stated that it was odd to "advance new arguments concerning the applicability of the peace clause at this late stage in the proceedings, long after the time when the peace clause portion of the dispute was supposed to have been concluded."

[425] Brazil's initial brief, para. 2.

consultations and panel proceedings, based on the listed provisions of the *SCM Agreement* and Article XVI of the *GATT 1994*.[426]

7.304 The Panel disagrees with Brazil's interpretation of the word "actions" because it does not take account of the fact that individual Members can take certain actions based on the relevant provisions of Article XVI of the *GATT 1994* and the *SCM Agreement*, including requests for consultations and establishment of a panel, prior to a multilateral finding that the conditions of Article 13 are fulfilled. It is based on specific uses of the word "action" in the English and French versions of the *DSU*, without taking account of other uses of that word in those versions of the *DSU* which refer to an action by an individual Member.[427]

7.305 Further, "multilateral actions taken collectively by Members" include decisions by the DSB to establish panels, which are taken prior to any Panel assessment as to whether the conditions in Article 13 are fulfilled, and from which certain disputes could only be exempted with the consent of all Members in the DSB, including the complainant party. They also include decisions by the DSB to adopt reports in which panels conclude that certain measures are *not* inconsistent with the conditions in Article 13 of the *Agreement on Agriculture*, from which there is no exemption.

7.306 The Panel agrees with the United States' definition of the words "exempt from actions" but not with the conclusions that the United States requested the Panel to arrive at as a result of that definition. The Panel does not consider that the *possibility* earlier in the dispute that the measures at issue were "exempt from actions" by virtue of Article 13 of the *Agreement on Agriculture* has affected its authority to examine the claims raised under the *SCM Agreement* and Article XVI of the *GATT 1994* in these proceedings in accordance with its discretion to organize its own procedures.

7.307 Turning to the meaning of the phrase "exempt from actions", the adjective "exempt" can be defined as follows:

> "Not exposed or subject to something unpleasant or inconvenient; not liable to a charge, tax, etc. (Foll. by *from*)"[428]

7.308 The English and French versions of the text of Article 13(b)(ii) and (iii) use the word "actions". There are various definitions of the word "action", including the generic senses of:

> "The process or condition of acting or doing; the exertion of energy or influence; working, agency, operation; … A thing done, a deed, an act";

and the more specific judicial senses of:

> "1. The taking of legal steps to establish a claim or obtain remedy; the right to institute a legal process. b A legal process or suit".[429]

7.309 Article 13 uses the word in a judicial sense, because it qualifies the "actions" as those based on listed treaty provisions[430] and non-violation nullification or impairment of the benefits of tariff

[426] See United States' initial brief, paras. 2 and 12, and its comments on initial briefs, para. 5.
[427] See Brazil's comments on initial briefs, para. 15. See Articles 3.7, 3.8 and 4.5 of the *DSU*.
[428] *The New Shorter Oxford English Dictionary*, (1993).
[429] *The New Shorter Oxford English Dictionary,* (1993). See also the definition of "proceeding" in Article 17.10 of the DSU discussed by the Appellate Body in *Brazil – Aircraft*: "In a general sense, the form and manner of conducting juridical business before a court or judicial officer. Regular and orderly progress in form of law, *including all possible steps in an action from its commencement to the execution of judgment.*" See Appellate Body Report, *Brazil – Aircraft*, para. 121.
[430] Variously Article XVI of GATT 1994, paragraph 1 of Article XVI of GATT 1994, Part III of the *SCM Agreement*, Articles 5 and 6 of the *SCM Agreement* and Articles 3, 5 and 6 of the *SCM Agreement.*

concessions accruing to another Member under Article II of the *GATT 1994*, in the sense of paragraph 1(b) of Article XXIII of the *GATT 1994*, which is itself a "right to institute a legal process" (collectively referred to below as the "listed provisions"). The only difference between the two possible judicial senses is that the sum of the "legal steps" to establish a particular claim or obtain a particular remedy in a given case is "a legal process or suit", and both can be called an "action" in English or French.

7.310 The Spanish version of the text uses the word "*medidas*". This word is used in many places in the covered agreements where the English version uses the word "measures" and the French version uses the word "*mesures*". It refers to dispositions taken by a Member which, in the context of Article 13(b)(ii), are the legal steps to establish a particular claim or obtain a particular remedy. There seems to be no practical difference in this sense between the legal steps to establish a particular claim or obtain a particular remedy, in the plural, and a lawsuit.[431]

7.311 Accordingly, the ordinary meaning of the phrase "exempt from actions" is "not exposed or subject to the taking of steps to establish claims or obtain remedies" based on the listed provisions. However, the ordinary meaning of the terms used in the text must be read in context and in the light of the agreement's object and purpose.[432]

7.312 The context within Article 13 itself shows that the drafters did not use the term "exempt from actions" in every subparagraph of Article 13, notably, in subparagraph (a)(i), which uses the term "non-actionable subsidies". Yet all subparagraphs of Article 13 share the same purpose of setting out protection for certain agricultural measures from particular consequences outside the *Agreement on Agriculture*, which are generally actions of various kinds. The range of actions differs in each subparagraph of Article 13. The actions to which the term "non-actionable subsidies" normally applied were limited to those based on Parts III and V of the *SCM Agreement*[433], and subparagraph (a)(i) limits their scope even further to countervailing duties (i.e. Part V of the *SCM Agreement*). In contrast, the phrase "exempt from actions" itself is not limited to any particular actions. Subparagraphs (a)(ii), (a)(iii), (b)(ii), (b)(iii) and (c)(ii) apply it to provisions beyond those based on Parts III and V of the *SCM Agreement* to which the term "non-actionable subsidies" cannot apply. In these subparagraphs, the relevant actions include those based on provisions in Part III of the *SCM Agreement*, but also variously non-violation nullification or impairment of the benefits of tariff concessions, actions based on paragraphs of Article XVI of the *GATT 1994* and actions based on Article 3 of the *SCM Agreement* as well. This may explain why the different terms "non-actionable subsidies" and "exempt from actions" are used.

7.313 The class of "non-actionable subsidies", which were not exposed to certain types of actions, was governed by Part IV of the *SCM Agreement*, comprising Articles 8 and 9 of the *SCM Agreement*. These have now lapsed.[434] Part IV did not exclude any measures from multilateral evaluation but in fact provided a multilateral procedure to evaluate the consistency of a programme with the conditions and criteria to be considered non-actionable.[435] Failing a notification under that procedure, it was

[431] The Spanish version of Article 25.11 of the *SCM Agreement* also uses *"medidas"* where the English version uses "actions" and the French version uses *"decisions"* with respect to countervailing duties. The Spanish version of Article 4.5 of the DSU uses the word *"medidas"* where the English and French versions use "action" in the sense of legal steps, or a lawsuit, taken by a Member to establish a claim or obtain a remedy under the WTO dispute settlement procedures.

[432] In accordance with the general rule of interpretation in Article 31(1) of the Vienna Convention on the Law of Treaties.

[433] Footnote 35 to the *SCM Agreement*.

[434] By virtue of the operation of Article 31 of the *SCM Agreement*.

[435] Article 8.1 of the Agreement identified certain subsidies that "shall be considered non-actionable". Article 8.2 set out conditions and criteria identifying subsidies that "shall be non-actionable". Article 8.3 provided that a subsidy for which the provisions of paragraph 8.2 were invoked "shall be notified in advance" to the SCM Committee. Any such notification "shall be sufficiently precise to enable other Members to evaluate

expressly provided that Parts III or V of the *SCM Agreement* "may be invoked".[436] If Parts III or V were invoked, there was no requirement to reach preliminary findings on whether a measure satisfied the conditions and criteria to be considered non-actionable first, although that would naturally have been a question to be addressed by a panel or a Member's authorities in the course of their examination or investigation.

7.314 Measures that are "exempt from actions" by virtue of Article 13 are not exposed to certain types of actions based on particular provisions. However, unlike Part IV of the *SCM Agreement*, none of those provisions creates a special multilateral procedure for evaluation of whether the measures satisfy the conditions set out in Article 13. Rather, all of them are subject to the rules and procedures of the *DSU*, although some[437] are also subject to certain special and additional rules and procedures in Appendix 2 to the *DSU*. If any of these provisions are invoked, there is no requirement to reach preliminary findings on whether a measure satisfies the conditions set out in Article 13 first, although that is a question to be addressed by a panel in accordance with a proper order of analysis and in accordance with the organization of its own procedures.

7.315 Further relevant context is found in the procedures that apply to disputes arising under the *Agreement on Agriculture*. Article 19 provides that the applicable procedures are those set out in the *DSU*:

> "The provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding, shall apply to consultations and the settlement of disputes under this Agreement."

7.316 Neither this article, nor the *DSU*, contain any exception for consultations and disputes arising in relation to Article 13. The list of special and additional rules or procedures in Appendix 2 to the *DSU* does not include Article 13 or any other provision of the *Agreement on Agriculture*.

7.317 The first step in bringing an action under the *DSU* rules and procedures is a request for consultations, which is a unilateral step taken by an individual Member, as is a request for establishment of a panel. There is no multilateral mechanism to prevent a Member making these requests on the basis that the measures at issue do, in fact, satisfy the conditions in Article 13 of the *Agreement on Agriculture*. Once a request is received, the *DSU* rules and procedures apply. Nothing in the *DSU* or the relevant special and additional rules and procedures prevents a dispute proceeding in the usual way where a Member alleges non-compliance with the conditions in Article 13 of the *Agreement on Agriculture*. In fact, the only way to obtain a multilateral finding that measures do or do not satisfy the conditions in Article 13 and therefore are or are not exempt from actions is for the complainant to take further legal steps in an attempt to establish its claims and the right to relief. A panel can only make findings as to whether measures are consistent with the listed provisions of the

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the consistency of the programme with the conditions and criteria" in Article 8.2. Under Article 8.4, upon request of a Member, the Secretariat was to review the notification and could request additional information. It was to report its findings to the SCM Committee, and the Committee was to review such findings (or, absent a request for such findings, the notification itself) with a view to determining whether the conditions and criteria for "non-actionability" in Article 8.2 were met. Pursuant to Article 8.5, identified in Appendix 2 of the *DSU* as a special or additional rule or procedure, upon request of a Member, the determination by the Committee, or failure by the Committee to make a determination, as well as the violation of the conditions set out in a notified programme, "shall be submitted to binding arbitration." The SCM Committee adopted a format for notifications under Article 8.3 on 22 February 1995 (documents PC/IPL/11; G/SCM/14), and adopted a format for updates of Article 8.3 notifications on 23 October 1997 (document G/SCM/13). The SCM Committee also adopted procedures for arbitration under Article 8.5 on 2 June 1998 (document G/SCM/19). No Member availed itself of these notifications or procedures.

[436] Footnote 35 to the *SCM Agreement*.

[437] Those based on Articles 3, 5 and 6 or "Part III" of the *SCM Agreement*.

*SCM Agreement* and Article XVI of the *GATT 1994* where a complainant has taken certain actions based on those provisions.

7.318 The object and purpose of WTO dispute settlement procedures are to provide security and predictability to the multilateral trading system.[438] A cornerstone of the *DSU* is the prompt settlement of situations in which a Member considers that its benefits under the covered agreements are being impaired,[439] which is given effect *inter alia* through a Member's comprehensive right to bring dispute settlement actions.[440] This is not conditional upon whether the complaining Member is correct in its views. Therefore, the Panel would need a clear injunction in the treaty text to depart from the objective of prompt settlement by deferring jurisdiction to examine any claims pending a final conclusion on Article 13 and we see none.[441]

7.319 Further, the conditions in Article 13 help define the scope of substantive obligations and rights to relief, and most of the conditions themselves refer to compliance with substantive obligations under the *Agreement on Agriculture.* The *DSU* provides a multilateral procedure to settle disputes arising under the covered agreements and it is most unlikely that the negotiators intended to provide only for unilateral determinations by Members as to whether their own measures satisfy conditions such as those set forth in Article 13.

7.320 Accordingly, the Panel considers that the ordinary meaning of the terms read in their context and in light of the object and purpose of the treaty, indicates that "exempt from actions" means that dispute settlement actions based on the listed provisions shall not be invoked with respect to measures that satisfy the conditions in Article 13. However, that does not preclude multilateral dispute settlement based on the listed provisions where a Member considers that benefits accruing under covered agreements are being impaired by a measure taken by another Member that does *not* satisfy the relevant conditions set forth in Article 13. The issue of whether a measure satisfies the relevant conditions is an issue of substance in a dispute.

7.321 The meaning of the phrase "exempt from actions" as used in Article 13 is confirmed by the drafting history of the *Agreement on Agriculture*.[442] The basic form of what is now Article 13 emerged from the first US/EC Blair House Agreement of November 1992[443], which was inserted in

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[438] Article 3.2 of the DSU.

[439] Article 3.3 of the DSU.

[440] Articles 4.2 and 6.1 of the DSU. However, that right is subject to Articles 3.7, 3.10 and 24.1 of the DSU.

[441] This is consistent with the views of the Appellate Body in *US – Corrosion-Resistant Steel Sunset Review*, regarding allegedly mandatory measures, that:

> "[...] As long as a Member respects the principles set forth in Articles 3.7 and 3.10 of the DSU, namely, to exercise their 'judgement as to whether action under these procedures would be fruitful' and to engage in dispute settlement in good faith, then that Member is entitled to request a panel to examine measures that the Member considers nullify or impair its benefits. We do not think that panels are obliged, as a preliminary jurisdictional matter, to examine whether the challenged measure is mandatory. This issue is relevant, if at all, only as part of the panel's assessment of whether the measure is, as such, inconsistent with particular obligations. [...]" (para. 89)

Similarly, the Panel considers that it is not obliged, as a preliminary jurisdictional matter, to examine whether challenged measures satisfy the conditions set out in Article 13 of the *Agreement on Agriculture*. This issue is relevant as part of the Panel's assessment of whether those measures are inconsistent with the obligations in Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*.

[442] The Panel has recourse to supplementary means of interpretation in accordance with Article 32 of the Vienna Convention on the Law of Treaties in order to confirm the meaning resulting from the application of the general rule of treaty interpretation in Article 31 of that convention.

[443] See the draft article which formed part of the first US/EC Blair House agreement, dated 20 November 1992, reproduced in Exhibit EC-1.

the agriculture text of the draft Final Act of December 1991. It included the exemptions from actions, more or less in their current form. There is no explanation outside the text itself as to why those two Members' negotiators chose this form of words. The first footnote of the draft article, which became Article 13, provided that:

> "The provisions of this Article replace those in Article 7:3, Article 12 and Article 18:2 of the Text on Agriculture of this Draft Final Act."

7.322 Articles 7:3, 12 and 18:2 of the agriculture text of the draft Final Act[444] read as follows:

> "Article 7 – General Disciplines on Domestic Support
>
> 3. The domestic subsidies listed in Annex 2 to this Agreement shall be considered as non-actionable for the purposes of countervailing measures, but not otherwise, provided that such subsidies are in conformity with the general and specific criteria relating thereto as prescribed in that Annex."
>
> "Article 12 – Serious Prejudice
>
> Where reduction commitments on domestic support and export subsidies are being applied in conformity with the terms of this Agreement, the presumption will be that they do not cause serious prejudice in the sense of Article XVI:1 of the General Agreement."
>
> "Article 18 – Consultation and Conciliation
>
> 2. On the basis of the commitments undertaken in the framework of this Agreement, Members will exercise due restraint in the application of their rights under the General Agreement in relation to products included in the reform programme."

7.323 Draft Article 18:2 had been included in the list of special or additional rules and procedures in the draft DSU text, which became Appendix 2 to the *DSU*.[445] This reference was then placed in square brackets[446] and the final version of Appendix 2 of the *DSU* contains no reference to any provision of the *Agreement on Agriculture*. Given that draft Article 18:2 was the predecessor of parts of the final Article 13, this is an indication that the omission of Article 13 from the final list of special or additional rules or procedures was deliberate and that the negotiators did not intend it to operate as a special dispute settlement procedure.[447]

7.324 Draft Article 7:3 provided for an exclusion from certain types of actions, without using the phrase "exempt from actions". It provided that green box measures should be "non-actionable" for the purposes of countervailing measures, which was retained in paragraph (a)(i) of the final Article 13. At the same time as the drafters modified the content of draft Article 7:3, they replaced draft Article 12 with a raft of provisions, choosing the phrase "exempt from actions" in five of them. These were the predecessors of subparagraphs (a)(ii), (a)(iii), (b)(ii), (b)(iii) and (c)(ii) in the final Article 13. Whilst three of these provisions referred to provisions in Part III of the *SCM Agreement*, all five extended beyond these to actions based on other types of complaints and provisions as well, in particular, non-violation nullification or impairment of the benefits of tariff concessions, Article XVI

[444] Extracted from document MTN.TNC/W/FA, dated 20 December 1991, reproduced in Exhibits US-29 and EC-2.

[445] See the extract of the draft text of the DSU, dated 15 June 1992, reproduced in Exhibit BRA-1.

[446] See the extract of the draft text of the DSU, dated 15 November 1993, reproduced in Exhibit BRA-2.

[447] Draft Article 18:1 was later revised to become the final Article 19 in the *Agreement on Agriculture*.

of the *GATT 1994* or its paragraph 1, and Article 3 of the *SCM Agreement*. In these circumstances, the record discloses that the drafters chose a phrase with a meaning similar to "non-actionable" but which was not limited in its application to Part III or V of the *SCM Agreement*.[448]

7.325 Accordingly, the Panel considers that the drafting history confirms the ordinary meaning of the terms read in their context and in light of their object and purpose, as set out in paragraph 7.320 above.

7.326 The Panel has a mandate to examine the matter referred to the DSB by the complainant. The Panel has a duty under Article 11 of the *DSU* to make an objective assessment of the facts of the case and the applicability of and conformity of the measures at issue with the relevant covered agreements. The Panel makes that assessment in accordance with the dispute settlement rules and procedures of the *DSU*, subject to the applicable special or additional rules and procedures in the covered agreements listed in Appendix 2 to the *DSU*. In conducting its examination of the applicability of, and conformity with the provisions of Articles 3, 5 and 6 of the *SCM Agreement* and paragraphs 1 and 3 of Article XVI of the *GATT 1994*, the Panel's order of analysis is indicated by the relevant covered agreements, as discussed above. If the Panel were to conclude that measures did satisfy the conditions in Article 13, it could not find that they were inconsistent with the obligations set out in the listed provisions and need not continue its examination in order to provide a solution to the dispute.

7.327 This interpretation is confirmed in respect of actionable subsidies by the last sentence of Article 5 and Article 6.9 of the *SCM Agreement* which clarify that each of those articles "does not apply" to subsidies maintained on agricultural products as provided in Article 13. This clarifies that the conditions in Article 13 partially define the scope of those substantive obligations. Emphasis of that point may have been considered important due to the unusual nature of the exemption from actions in Article 13 and its key role in the successful conclusion of the Uruguay Round.[449]

7.328 Article 7.1 of the *SCM Agreement*, which is the first provision in the article on remedies for actionable subsidies, applies "[e]xcept as provided in Article 13 of the Agreement on Agriculture". In the Panel's view, this indicates that the remedies for actionable subsidies are not available for domestic support measures that conform to the conditions in paragraphs (a) and (b) of Article 13. Although that phrase is located in Article 7.1, which refers to requests for consultations only, it cannot refer only to that merely procedural step, for the above reasons. This is confirmed by the fact that Article 7.1 is singled out as the only part of that article not listed as a special and additional rule and procedure in Appendix 2 of the *DSU*, which indicates that the normal dispute settlement rules are intended to apply.

7.329 The Panel also notes that the Appellate Body paraphrased the English version of Article 13 in *EC – Bananas III* in terms of bringing (and preventing) dispute settlement actions.[450] However, in

[448] The drafters chose to use the phrase "exempt from the imposition of countervailing duties" in paragraph (b)(i) in a context in which neither the term "non-actionable" nor "exempt from actions" was appropriate. The obligation to show due restraint in initiating any countervailing duty investigations found in the final Article 13(b)(i) and (c)(i), and the title of the article, can be traced to draft Article 18:2. The final Article 13(b)(ii) and (c)(ii), as well as the last sentence of Article 5, and Article 6.9 of the *SCM Agreement*, can be contrasted with the "presumption" in draft Article 12.

[449] Note that the draft texts of Article 6 of the *SCM Agreement* did not include any reference to the predecessors of Article 13 of the Agreement on Agriculture: see draft texts reproduced in Exhibit BRA-372.

[450] The relevant passage in that report reads as follows:

> "[...] In addition, Article 13 of the *Agreement on Agriculture* provides that, during the implementation period for that agreement, Members may not bring dispute settlement actions under either Article XVI of the GATT 1994 or Part III of the *Agreement on Subsidies and Countervailing Measures* for domestic support measures or export subsidy measures that conform fully with the provisions of the *Agreement on Agriculture*. With these examples in mind, we believe it is significant that Article 13 of

doing so, the Appellate Body was not commenting on the manner in which a panel must go about deciding whether an action was prevented, and the fact that a panel can only decide whether measures satisfy the conditions in Article 13 after a proceeding has been brought.

### 7. Mandatory or discretionary distinction

7.330 A number of Brazil's claims relating to export subsidies under the *Agreement on Agriculture*, as well as the prohibited and actionable subsidy provisions of the *SCM Agreement* and Article XVI of the *GATT 1994*, rely on the allegedly "mandatory" nature of certain of the United States measures in dispute.[451]

7.331 In addition, the FSRI Act of 2002 contains a so-called "circuit-breaker" provision, in section 1601(e) which, the United States submits, could result in certain payments not being made.[452] That section provides that if:

> "the Secretary determines that expenditures under [subtitles A through E[453] of the FSRI Act of 2002] that are subject to the total allowable domestic support levels under the Uruguay Round Agreements ... will exceed such allowable levels for any applicable reporting period, the Secretary shall, to the maximum extent practicable, make adjustments in the amount of such expenditures during that period to ensure that such expenditures do not exceed such allowable levels."

7.332 Brazil's allegations of the mandatory nature of certain measures, as well as the United States' rebuttal of such allegations in respect of certain measures, are therefore relevant to our examination of numerous claims.

7.333 WTO panels have developed a relatively consistent approach to the so-called "mandatory/discretionary distinction" whereby a WTO Member's law *as such* can be challenged before a WTO panel if the law mandates WTO-inconsistent behaviour. WTO panels have generally found that a law is WTO-inconsistent if they find that it *mandates* WTO-inconsistent behaviour.[454] If, on the other hand, the law provides the executive branch of a Member's government with discretionary authority to act in a WTO-consistent manner, then WTO panels have generally found that the law is not WTO-inconsistent.[455]

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> the *Agreement on Agriculture* does not, by its terms, prevent dispute settlement actions relating to the consistency of market access concessions for agricultural products with Article XIII of the GATT 1994." (Appellate Body Report, *EC – Bananas III*, para. 157).

[451] We recall Brazil's claims as set out in its Panel request reproduced in Annex N of this report, our preliminary ruling concerning payments made after the date of establishment of the Panel in Section VII:B, our description of the measures at issue in Section VII:C, and Brazil's clarifications in its submissions described in subsequent Sections of this report . We have summarized these above in the descriptive part of this report.

[452] United States' oral statement at the second substantive meeting, para. 82.

[453] Under Title I of the FSRI Act of 2002, entitled "Commodity Programs", Subtitles A through E deal with direct and counter-cyclical payments for covered commodities, marketing assistance loans and loan deficiency payments for loan commodities and specific programme payments for peanuts, sugar and dairy.

[454] For example, the panel in *US – Section 301 Trade Act*, recognized the "classical test in the pre-existing jurisprudence that only legislation mandating a WTO inconsistency or precluding WTO consistency, could, as such, violate WTO provisions" (at para. 7.54 of that Panel Report). See also Panel Report, *US – Steel Plate* , para. 7.88.

[455] See, for example, Panel Report, *US – Export Restraints*, para. 8.131.

7.334 This test has been generally applied by GATT/WTO panels[456], although the Appellate Body has never pronounced generally upon the continuing relevance or significance of the mandatory/discretionary distinction nor specifically ruled that it was determinative in consideration of whether a legal instrument was inconsistent with relevant WTO obligations.[457] The Appellate Body has not, however, precluded the possibility that a Member could violate its WTO obligations by enacting legislation granting discretion to its authorities to act in violation of its WTO obligation[458], and sees no reason for concluding that, in principle, non-mandatory measures cannot be challenged "as such" in WTO dispute settlement.[459] Furthermore, panels are not obliged, as a preliminary jurisdictional matter, to examine whether a challenged measure is mandatory. This issue is relevant, if at all, only as part of the panel's assessment of whether the measure is, as such, inconsistent with particular obligations.[460]

7.335 Recalling that the import of the "mandatory/discretionary distinction" will vary from case to case, as well as from measure to measure, in our examination of the matter before us, we do not apply this analytical tool mechanistically.[461] It is our duty properly to characterize each of the measures challenged in these proceedings, as appropriate.[462]

7.336 In the course of our examination of each of the claims and measures concerned, we therefore make an objective assessment of the particular United States legal and regulatory provisions forming the basis of Brazil's claims, in the first instance, on the basis of the text of those provisions and, as appropriate, determine the extent to which they are of binding normative nature and operation. In this respect, we recall the reproach of the Appellate Body in *US – Corrosion-Resistant Steel Sunset Review* that the panel in that case "... did not consider the extent to which the specific provisions of the Sunset Policy Bulletin are normative in nature, nor the extent to which the USDOC itself treats these provisions as binding."[463]

## D. DOMESTIC SUPPORT MEASURES AND ARTICLE 13 OF THE *AGREEMENT ON AGRICULTURE*

### 1. Measures at issue

7.337 This section of our report deals with domestic support measures. These are the following measures, as described in Section VII:C of this report:

(i) marketing loan programme payments;

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[456] In application of this distinction, there were generally two issues to be considered in a case where a WTO Member's law was being challenged before a panel: first, whether the Member's law mandates a certain course of action; and second, whether that course of action is inconsistent with the WTO provision cited by the complainant. Previous WTO panels followed different sequences in approaching these two issues. However, the sequence in which these two issues are considered will not change the ultimate conclusion of the panel. (See, e.g. Panel Report, *US – Corrosion-Resistant Steel Sunset Review*) That is because whatever sequence a panel follows, in order to conclude that certain aspects of a WTO Member's law are inconsistent with the WTO provisions, the panel had to conclude that both elements were present.

[457] In *US – Corrosion-Resistant Steel Sunset Review*, the Appellate Body addresses the distinction, but also indicates its view that the Appellate Body had not, as yet, been required to pronounce generally upon the continuing relevance or significance of the mandatory/discretionary distinction. The Appellate Body then stated: "Nor do we consider that this appeal calls for us to undertake a comprehensive examination of this distinction." See Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 93.

[458] See Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, para. 159 and note 334.

[459] Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 88.

[460] Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 89.

[461] Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 93.

[462] We note that the United States has not contested, before us, that the relevant measures are measures.

[463] Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 99.

(ii) user marketing (Step 2) payments paid to domestic users[464];

(iii) production flexibility contract payments;

(iv) market loss assistance payments;

(v) direct payments;

(vi) counter-cyclical payments;

(vii) crop insurance payments;

(viii) cottonseed payments[465]; and

(ix) current legislative and regulatory provisions providing for the payment of measures (i), (ii), (v), (vi) and (vii), above.[466]

## 2. Applicability of Article 13 of the *Agreement on Agriculture*

7.338 **Brazil** requests a finding that Article 13(b)(ii) of the *Agreement on Agriculture* does not exempt these United States domestic support measures made in marketing years 1999-2002 to upland cotton from actions based on Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994*.[467]

7.339 The **United States** requests a finding that, pursuant to Article 13(b)(ii) of the *Agreement on Agriculture*, its domestic support measures are "exempt from actions based on paragraph 1 of Article XVI of the *GATT 1994* and Articles 5 and 6 of the Subsidies Agreement" and that Brazil may not bring or maintain any action against such measures "based on" those provisions.

7.340 The Panel will first consider whether Article 13 is applicable in this dispute.

7.341 Domestic support measures on agricultural products are the subject of paragraphs (a) and (b) of Article 13 and are considered here in Section VII:D of this report. Paragraph (c) of Article 13 only deals with export subsidies, which we will consider in Section VII:E.

7.342 Article 13 is a temporary provision applying only "[d]uring the implementation period". The implementation period is defined in Article 1(f) as follows:

> "(f) 'implementation period' means the six-year period commencing in the year 1995, except that, for the purposes of Article 13, it means the nine-year period commencing in 1995;"

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[464] In Section VII:E of this report, user marketing (Step 2) payments *to exporters* are found to be export subsidies. That being the case, the United States accepts that they no longer constitute domestic support and do not form part of an analysis under Article 13(b). See the United States' response to Panel Question No. 45.

[465] In Section VII:B of this report, cottonseed payments for the 2000 crop only were ruled within the Panel's terms of reference, and they therefore are the only cottonseed payments described in Section VII:C of this report. Nevertheless, cottonseed payments for the 1999 and 2002 crops are relevant to the assessment of whether domestic support measures satisfy the conditions in Article 13(b), for the reasons given in paragraphs 7.533 and following, and are considered in this Section VII:D as well.

[466] In this Section of our report, the Panel will consider the current programmes "as applied" and "as such" together. Therefore, references to marketing loan programme, user marketing (step 2), direct, counter-cyclical and crop insurance "payments" include the legislative and regulatory provisions authorizing those payments, unless otherwise indicated.

[467] Brazil does not pursue a claim that domestic support measures are inconsistent with the obligations of the United States under the *Agreement on Agriculture.*

7.343 Brazil requested consultations regarding this matter on 27 September 2002 and the Panel was established on 18 March 2003, which were clearly dates during the implementation period for the purposes of Article 13. The Panel's terms of reference are as follows:

> "To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."[468]

7.344 The Panel's function is explained in Article 11 of the *DSU*, which provides, relevantly, as follows:

> "The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and *the applicability of and conformity with the relevant covered agreements*, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Panels should consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution." (emphasis added)

7.345 In this dispute, the terms of the "relevant covered agreements" may have changed during the Panel proceeding, depending on whether Article 13 has expired.[469] However, it is not in dispute that the Panel's mandate in its terms of reference to examine the matter before it "in the light of the relevant provisions of the covered agreements" refers to the relevant provisions of the covered agreements as at the date on which those terms of reference were set, which was the date of its establishment.[470] The Panel's duty is to assess the applicability of and conformity with the relevant covered agreements as of that date. Brazil does not request us to do otherwise.[471] Article 13 is therefore applicable in this dispute.[472]

### 3. Structure of Article 13 of the *Agreement on Agriculture*

7.346 Article 13 sets out certain conditions in the chapeaux of paragraphs (a) and (b) and an additional condition in the proviso in subparagraphs (ii) and (iii) of paragraph (b).

7.347 Paragraph (a) covers domestic support measures that conform fully to the provisions of Annex 2 of the *Agreement on Agriculture*, that is, so-called "green box" measures, which are not subject to reduction commitments. Paragraph (b) covers domestic support measures that conform

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[468] See document WT/DS267/15.

[469] The parties do not agree as to whether the implementation period for the purposes of Article 13 expired during these proceedings. Brazil submits that the implementation period for Article 13 ended on 31 December 2003. The United States refers to the definition of "year" for the purposes of Article 1(f), which is found in Article 1(i), and submits that the end of the 2003 calendar year is not relevant to this dispute because US commitments with respect to cotton are specified by marketing year. The European Communities also refers to Article 1(f) and (i) and asserts that it is still an "open question" whether Article 13(b)(ii) and (c)(ii) will cease to apply by the end of the 2003 calendar year or at a subsequent date during 2004. For the reasons given in paragraph 7.345, the Panel does not need to form its own view as to whether Article 13 expired during these proceedings.

[470] See Brazil's and the United States' respective responses to Panel Question No. 124 and the responses of China, the European Communities and New Zealand to Panel third party Question No. 50. See also the United States' 3 March 2004 comments, footnote 1. The Panel takes note that Argentina and Australia did not agree with this view in their responses to that question.

[471] See Brazil's request for relief in the factual and arguments section of this report.

[472] This implies no view as to whether a panel may apply provisions in a covered agreement that were not in force as at the date of consultations.

fully to the provisions of Article 6, which covers domestic support subject to reduction commitments, and domestic support not subject to reduction commitments in terms of the criteria set out in that article. The chapeau of paragraph (b) confirms that these are so-called "amber box", "blue box", "*de minimis*" and "S&D box" domestic support measures.

7.348 Paragraph (b) does not cover domestic support measures not subject to reduction in terms of the criteria in Annex 2 and maintained in conformity therewith in accordance with Article 7.1.[473] These are measures that satisfy paragraph (a). The parties agree that these measures are excluded from paragraph (b).[474] We will therefore refer to measures covered by paragraph (b) as "non-green box measures".

7.349 Measures that do not conform fully to the provisions of Annex 2 of the *Agreement on Agriculture* do not satisfy paragraph (a). Therefore, they are subject to reduction commitments, unless they are exempt on the basis of other criteria set forth in Article 6. In either case, they must conform fully to the provisions of Article 6 and, hence, are subject to paragraph (b).

7.350 The conditions that apply to green box measures are set out in the chapeau of paragraph (a). The conditions that apply to non-green box measures are set out in the chapeau of paragraph (b), subject to an additional condition in the proviso in subparagraphs (ii) and (iii) that "such measures do not grant support to a specific commodity in excess of that decided in the 1992 marketing year". Each of these two groups of conditions provides exemptions from actions based on certain provisions, including paragraph 1 of Article XVI of the *GATT 1994* and Articles 5 and 6 of the *SCM Agreement*[475], under which Brazil has brought claims in the present dispute. Domestic support measures that satisfy *either* of the groups of conditions fall outside the scope of the obligations in these provisions of Article XVI of the *GATT 1994* and Part III of the *SCM Agreement*.[476]

7.351 Therefore, in order to succeed in its claims under the relevant provisions of those agreements, Brazil must first show that the domestic support measures that it challenges satisfy neither group of conditions. That is, it must first show that the measures are not green box, and that they do not satisfy at least one of the conditions in the chapeau of paragraph (b) or the additional condition in the proviso in subparagraph (b)(ii). If they do not satisfy the additional condition in the proviso in subparagraph (b)(ii), they are not exempt from actions, whether or not they satisfy the conditions in the chapeau of paragraph (b).

7.352 This is what Brazil sets out to show. It claims, firstly, that none of the domestic support measures satisfy the conditions set out in paragraph (a) and, secondly, that the sum of them does not satisfy the additional condition in the proviso in subparagraph (b)(ii). It does not claim that measures fail to satisfy the conditions in the chapeau of paragraph (b). The United States responds that certain of its domestic support measures satisfy the conditions set out in paragraph (a) and that the remainder satisfy the additional condition in the proviso in subparagraph (b)(ii).

7.353 Therefore, the logical order in which to consider conformity of the domestic support measures with Article 13 begins with paragraph (a), which will dictate which domestic support measures, if any, are excluded from the sum to be compared under subparagraph (b)(ii).

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[473] Article 6.1 of the *Agreement on Agriculture*.

[474] Brazil's first written submission, para. 129 and the United States' first written submission, para. 49.

[475] Those which satisfy the conditions in paragraph (a) fall outside the whole of Article XVI of the *GATT 1994* and Part III of the *SCM Agreement*.

[476] For the reasons given in Section VII:C of this report.

## 4. Paragraph (a) of Article 13

(a) Introduction

7.354 Paragraph (a) of Article 13 of the *Agreement on Agriculture* applies to domestic support measures that conform fully to the provisions of Annex 2 to that agreement.

7.355 **Brazil** claims that PFC payments and DP payments fail to satisfy these conditions[477] because:

(i) PFC payments and DP payments are inconsistent with paragraph 6(b) of Annex 2 because the amount of such payments is related to the type of production that is undertaken by United States upland cotton producers after the base period[478];

(ii) DP payments do not conform to the provisions of paragraph 6(a) and (b) of Annex 2 because of the updating of the base periods for the DP programme[479]; and

(iii) PFC and DP payments are inconsistent with the fundamental requirement in paragraph 1 of Annex 2 that they have no, or at most minimal, trade-distorting effects or effects on production.[480]

7.356 The **United States** responds that these measures fully conform to the provisions of Annex 2.[481] It agrees that marketing loan programme payments, user marketing (Step 2) payments to domestic users, market loss assistance ("MLA") payments, crop insurance payments and cottonseed payments are non-green box measures. It does not assert that counter-cyclical ("CCP") payments are green box because they are granted due to low prevailing market prices.[482] It has notified all these types of payments as non-green box domestic support to the WTO Committee on Agriculture (except CCP payments which began in the 2002 marketing year and have not yet been the subject of a notification).[483]

7.357 The parties therefore only disagree as to whether PFC and DP payments conform fully to the provisions of Annex 2 and, hence, satisfy the conditions in paragraph (a) of Article 13. The Panel will therefore turn to these measures, which have been described in Section VII:C of this report. The Panel will consider them in terms of the features which allegedly do not conform fully to the provisions of Annex 2: namely, planting flexibility requirements and updating of base periods, followed by the fundamental requirement in paragraph 1 of Annex 2.

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[477] Brazil claimed in its request for the establishment of a panel that United States domestic support measures were inconsistent with the United States' obligations under Article 7.1 of the *Agreement on Agriculture* but has not pursued that as a separate claim in these proceedings, as explained in paragraph 7.253 of this report. Therefore, the Panel only considers whether measures conform fully to the provisions of Annex 2 for the purposes of its assessment under Article 13 of the *Agreement on Agriculture*.

[478] See Brazil's first written submission, paras. 153 and 174 and its response to Panel Question No. 19.

[479] See Brazil's first written submission, para. 176.

[480] See Brazil's first written submission, paras. 163 and 183. Brazil agrees that these payments meet the first basic criterion in paragraph 1(a) of Annex 2 and does not allege that they are inconsistent with the second basic criterion in paragraph 1(b): see its response to Panel Question No. 30.

[481] See United States' first written submission, para. 55 (regarding DP payments) and rebuttal submission, para. 53 (regarding PFC payments).

[482] See United States' rebuttal submission, para. 102.

[483] See documents G/AG/N/USA/43 (MY 1999 notification) and G/AG/N/USA/51 (MY 2000 and MY 2001 notifications). The United States notified all user marketing (Step 2) payments as domestic support, but see *supra*,footnote 464.

(b) Planting flexibility limitations

*(i) Main arguments of the parties*

7.358 **Brazil** claims that PFC and DP payments and the provisions of the FSRI Act of 2002 and implementing regulations providing for the DP programme are inconsistent with paragraph 6(b) of Annex 2.[484] It submits that the PFC and DP programmes limited and limit the type of production that can receive payments and reduce and even eliminate all payments under those programmes if certain types of production, namely fruits, vegetables (and wild rice in the case of the DP programme), are produced on base acreage. It argues that the effect of the restriction is to funnel production on base acreage to particular types of crops.[485]

7.359 Brazil submits that the European Communities' argument (summarized below), in essence, is that trade distortions for products that traditionally have been subsidized should be permitted in order to prevent trade distortion in markets for non-subsidized products. In Brazil's view, this does not avoid distortions but maintains them, contrary to the object and purpose of the *Agreement on Agriculture*.[486]

7.360 The **United States** responds that PFC and DP payments are decoupled from production because there is no requirement that the farmer engage in any production to receive payment or that the base acreage be used for production.[487] It argues that, under Brazil's analysis, a requirement that a payment recipient produce nothing at all in the current year would be inconsistent with paragraph 6(b) even though it would ensure that such payments met the "fundamental requirement" of paragraph 1 of Annex 2.[488] It also argues that, under Brazil's analysis, the reduction or elimination of payments to producers of illegal crops, such as opium poppy, unapproved biotech varieties or environmentally damaging production, would be inconsistent with paragraph 6(b).

*(ii) Main arguments of the third parties*

7.361 **Argentina** agrees with Brazil.[489] **Australia** argues that the exclusion of fruits and vegetables (other than lentils, mung beans, and dry peas) from the planting flexibility otherwise available in respect of the contract acreage for which PFC payments could be made, related, or connected, PFC payments to the type of production undertaken by the producer in any year after the base period, contrary to the requirements of paragraph 6(a) of Annex 2. Fruits, vegetables (other than lentils, mung beans and dry peas) and wild rice are generally prohibited from being planted on base acreage on which DP payments are made unless the commodity, if planted, is destroyed before harvest except that trees and other perennial plants are prohibited. This relates, or connects, DP payments to the type of production undertaken by the producer, contrary to paragraph 6(a) of Annex 2.[490]

7.362 **Canada** argues that the amount of PFC payments and DP payments are based on the type of commodity produced after the base period. Canada submits that the United States has not addressed in its submission the evidence of implementing legislation and regulations regarding either measure. Its argument that payment recipients are not required to engage in any particular type or volume of production (or any current agricultural production at all) to receive payments fails to address the evidence indicating that the amount of the payment may change based on whether base acreage is used for current production of fruits, vegetables or wild rice. For both measures, the evidence

[484] Brazil's first written submission, para. 198.
[485] Brazil's oral statement at the first session of the first substantive meeting, para. 66.
[486] Brazil's rebuttal submission, paras. 8-9.
[487] United States' first written submission, paras. 55-57.
[488] United States' oral statement at the first session of the first substantive meeting, para. 19; United States' closing statement at the first session of the first substantive meeting, para. 20.
[489] Argentina's written submission to first session of the first substantive meeting, para. 56.
[490] Australia's written submission to the first session of the first substantive meeting, paras. 41, 44-45.

indicates that the amount of the payment is based on the type of production: payments are full, nil or some amount in between where base acres are used for current fruit, vegetable or wild rice production.[491]

7.363 The **European Communities** submits that an examination of the conformity of a decoupled scheme with the criteria set out in Annex 2 must involve an examination of the scheme as a whole. In that light, the European Communities is not convinced that where, as part of a scheme where no production is required to receive payments, and that the production of any type of crop is permitted, reducing payments where certain crops are produced can be such as to make the scheme, when taken as a whole, related to a type of production. Consequently, the reduction of payment linked to the production of fruit and vegetables must be seen as part of a scheme which permits a farmer to grow any type of crop, or even not to produce at all. Such a scheme, taken as a whole, meets the criteria that payments are not related to a type of production. To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition, in an historical perspective, and avoid those farmers receiving decoupled payments from enjoying both the decoupled payments and a privileged position vis-à-vis farmers who are not entitled to such payments. Moreover, the European Communities asserts that such a finding would require a Member to increase its subsidy programmes in order to prevent internal distortions of competition, running directly contrary to the process of reform instituted by the *Agreement on Agriculture*.[492]

*(iii) Evaluation by the Panel*

7.364 The Panel begins by noting that paragraph 6 of Annex 2 of the *Agreement on Agriculture* lists specific criteria according to which certain domestic support, which it describes as "[d]ecoupled income support", may qualify as green box support. It reads as follows:

> "Decoupled income support
>
> (a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.
>
> (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.
>
> (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.
>
> (d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.
>
> (e) No production shall be required in order to receive such payments."

7.365 Paragraph 6 is a list of five criteria that describe decoupled income support. The first four criteria, including paragraph 6(b), focus on the distinction between the base period and the time after the base period, providing that income support may be coupled to factors that occurred during the base period, but not after it.

[491] Canada's written submission to the first session of the first substantive meeting, para. 23.
[492] European Communities' response to Panel third party Question No. 5.

7.366 The text of paragraph 6(b) refers to the relationship between the amount of decoupled income support payments, on the one hand, and the type of production undertaken by the producer (among other things) after the base period on the other. The ordinary meaning of the word "related" is "[h]aving relation; having mutual relation; connected. (Foll. by *to, with*.)".[493] This is a very general notion. In the text, it can be contrasted with the words "based on". The ordinary meaning of "base" as used in this context is "found, build, or construct *(up)on* a given base, build up *around* a base (chiefly *fig*.)".[494] This is a more specific notion, which denotes that one element in some way precedes or shapes the other. In contrast, "related to" denotes a mere connection between the amount of such payments and the type of production after the base period. This word is not limited to a connection that is positive or negative, or absolute or partial. It appears to include all types of relationship between the amount of such payments and the type of production after the base period, whether the amount increases or decreases and whether the difference in the amount is proportional to the volume of production or not.

7.367 Read in context, we note that paragraph 6(a) mandates requirements, whilst paragraphs 6(b), (c) and (d) prohibit certain programme requirements relating to the years after the base period. Paragraphs 6(a), (c) and (d) do not distinguish between positive and negative programme requirements, in the sense of requirements concerning what the payment recipient must, or must not, do. In particular, they do not distinguish between requirements that channel income support toward, or away from, certain production in the years after the base period. This does not suggest that paragraph 6(b) should be interpreted to prohibit only positive requirements to produce, or to engage in certain types of production, but rather confirms the ordinary meaning of its terms, which also prohibit negative requirements not to engage in certain types of production.

7.368 Paragraph 6(e) does not concern a negative requirement. It only prohibits a positive requirement, i.e. a requirement of production. However, it must be presumed that each of the criteria in paragraph 6 has meaning and effect.[495] If paragraph 6(b) could be satisfied by ensuring that no production was required to receive payments, paragraph 6(e) would be redundant. The drafters would have had no reason to include it in the list of criteria.[496] This confirms that paragraph 6(b) must be interpreted to require more than that one prohibition.

7.369 There are certain similarities between paragraph 6 and the subsequent paragraphs of Annex 2, all of which set out criteria according to which certain domestic support measures may qualify as green box support. Paragraph 11(b) is in identical terms to paragraph 6(b) except for the addition of the phrase "other than as provided for under criterion (e) below". Criterion (e) in paragraph 11 provides as follows:

> "(e) The payments shall not mandate or in any way designate the agricultural products to be produced by the recipients except to require them not to produce a particular product."

7.370 Paragraph 11(b) therefore provides, in effect, that the amount of certain payments shall not be related to the type of production undertaken by the producer after the base period except that the payments may require recipients not to produce a particular product. Paragraph 6(b) does not set forth such an exception. There is nothing in the context that would explain why it was necessary to express the exception in paragraph 11(e) if it was already implicit in paragraph 11(b), which is otherwise

[493] *The New Shorter Oxford English Dictionary*, (1993).
[494] *The New Shorter Oxford English Dictionary*, (1993).
[495] This accords with the principle of effective treaty interpretation. See the discussion in the Appellate Body Report in *US – Gasoline*, page. 23.
[496] The context also includes paragraph 5 which provides that any existing or new type of direct payment other than those specified in paragraphs 6 through 13, shall conform to criteria (b) through (e) in paragraph 6 (in addition to the general criteria set out in paragraph 1), which emphasizes the importance of these four criteria in the scheme of Annex 2.

identical to paragraph 6(b). This confirms that, if the drafters of Annex 2 had intended to permit such a negative requirement in decoupled income support exempt from reduction commitments, they would have done so expressly.

7.371 The object and purpose of Annex 2 is to set out the terms on which certain domestic support measures can be exempt from reduction commitments. The first sentence of paragraph 1 provides that "domestic support measures for which exemption from the reduction commitment is claimed shall meet the fundamental requirement that they have no or at most minimal trade-distorting effects or effects on production". Brazil submits that the chapeau of paragraph 1 of Annex 2 forms part of the context for interpreting paragraph 6(b).[497] The United States submits that the purpose of the criteria in Annex 2 is to determine compliance with that fundamental requirement. Therefore, on either view, that fundamental requirement should be taken into account in interpreting the criterion in paragraph 6(b).

7.372 The United States argues that the interpretation of paragraph 6(b) should permit decoupled income support that requires recipients to engage in production of *no crops at all* "because such a measure necessarily can have no trade-distorting effects or effects on production".[498] In the Panel's view, paragraph 6(b) permits such a condition because it only prohibits the amount of payments being related to the type or volume of production undertaken by the "producer", which by definition excludes those who are required not to produce anything.[499]

7.373 The United States also argues that the interpretation of paragraph 6(b) should permit decoupled income support that prohibits recipients from producing illegal crops, such as opium poppy or unapproved biotech varieties, or engaging in environmentally damaging production.[500] This is not an issue before this Panel and it is not incumbent upon the Panel to decide it.

7.374 There are no other facts or arguments on the record of this dispute which require the Panel to consider its interpretation of paragraph 6(b) further. The Panel will therefore apply that criterion to PFC and DP payments in accordance with the ordinary meaning of the terms it uses, as explained above.

7.375 The parties agree that PFC and DP payment recipients had, and have, flexibility in what they choose to produce on their base acres and in whether they produce anything on their base acres at all. It is agreed that that flexibility was not, and is not, unlimited.[501] The parties disagree as to whether the limitations on that flexibility affect the conformity of the measures at issue to the provisions of Annex 2 of the *Agreement on Agriculture*.

7.376 The planting flexibility provisions applicable to PFC payments were found in section 118 of the FAIR Act of 1996, subsection (a) of which provided as follows:

> "Subject to subsection (b), any commodity or crop may be planted on contract acreage on a farm."

7.377 Subsection (b)(1) provided the following limitations:

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[497] Brazil's first written submission, para. 179.

[498] United States' rebuttal submission, para. 41.

[499] The Panel also notes that paragraphs 9 and 10 of Annex 2 deal with producer and resource retirement programmes.

[500] United States' rebuttal submission, para. 43.

[501] See Brazil's first written submission, paras. 159-161 and 174; the United States' oral statement at the first session of the first substantive meeting, para. 19. The Panel also notes the United States' correction to its response to Panel Question No. 26, that payments are made regardless of whether upland cotton is produced, but not regardless of what is currently produced.

> "The planting of fruits and vegetables (other than lentils, mung beans, and dry peas)[502] shall be prohibited on contract acreage."

7.378 Subsection (b)(2) provided exceptions to these limitations. The first related to regions with a history of double-cropping of contract commodities (such as upland cotton) with fruits or vegetables. In these regions, double-cropping was permitted. The other two exceptions related to farms with a history of planting fruits or vegetables on contract acreage and producers with an established planting history of a specific fruit or vegetable. It was provided that payments in respect of these farms and to these producers "shall be reduced by an acre for each acre planted to the fruit or vegetable".[503]

7.379 The planting flexibility provisions that form part of the DP programme, under which DP payments are made, are found in section 1106 of the FSRI Act of 2002, subsection (a) of which provides as follows:[504]

> "Subject to subsection (b), any commodity or crop may be planted on base acres on a farm."

7.380 Subsections (b)(1), (2) and (3) provide the following limitations:

> "(1) The planting of an agricultural commodity specified in paragraph (3) shall be prohibited on base acres unless the commodity, if planted, is destroyed before harvest.
>
> (2) The planting of an agricultural commodity specified in paragraph (3) that is produced on a tree or other perennial plant shall be prohibited on base acres.
>
> (3) Paragraphs (1) and (2) apply to the following agricultural commodities:
>
> (A) Fruits.
>
> (B) Vegetables (other than lentils, mung beans and dry peas).
>
> (C) Wild rice."

7.381 Subsection (c) provides exceptions to these limitations related to historical double-cropping in almost identical terms to those which applied to PFC payments. Subsection (d) created a special rule which allowed fruits, vegetables (other than lentils, mung beans and dry peas) and wild rice to be planted on excess base acres for the 2002 crop year only due to the overlap between PFC and DP payments that year, but provided that DP payments for the 2002 crop year "shall be reduced by an acre for each acre of the excess base acres planted to such an agricultural commodity."[505]

7.382 Regulations implemented and implement the planting flexibility provisions, providing *inter alia*, a non-exhaustive list of over 191 fruit and vegetable crops subject to the limitations.[506]

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[502] Wild rice was added to the list of restricted crops pursuant to the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 2000. [Footnote not in original]

[503] Section 118(b)(2)(B) and (C)(ii), reproduced in full in Exhibits BRA-28 and US-22; and 7 CFR 1412.206(e) (1 January 2002 edition), reproduced in Exhibit BRA-31 and explained in USDA Fact Sheet, reproduced in Exhibit BRA-4.

[504] These conditions also form part of the CCP programme.

[505] Section 1106 of the FSRI Act of 2002 is reproduced in full in Exhibits BRA-29 and US-1. 7 CFR 1412.407(d)(3)(ii) (1 January 2003 edition) is reproduced in Exhibit BRA-35.

[506] See 7 CFR 1412.206(f) (1 January 2002 edition) and 7 CFR 1412.407(h) (1 January 2003 edition), reproduced in Exhibits BRA-31 and BRA-35, respectively. There was a special rule for wild rice for PFC

Non-compliance with contract requirements results in termination of the contract and the recipient must refund payments with interest, but in cases of violations of the planting flexibility limitations which are not serious enough to warrant termination, payments may be made in an amount reduced by the sum of the "per-acre market value of the fruits, vegetables (and wild rice)" "times the number of acres in violation" plus the payments.[507] This is equivalent to a zero payment for those acres and a net refund of the market value of the fruits, vegetables and wild rice.

7.383 There is little doubt that *in general* the "amount" of PFC and DP payments is not "related to, or based on, the type or volume of production ... undertaken by the producer in any year after the base period". However, although there is no programme requirement to produce any particular product, where a producer in fact undertakes certain restricted types of production, such as fruits and vegetables, on some or all acres enrolled in the programme in a year after the base period, the amount of the payment which that producer receives may be reduced. Where the farm or the producer meets certain special eligibility criteria, which essentially depend on a history of planting fruits or vegetables, there is a reduction in the amount of the payment, unless the region satisfies the special eligibility criteria, in which case there is no reduction. Where neither the farm nor the producer meets the special eligibility criteria, and the producer undertakes certain restricted types of production, such as fruits and vegetables, on some or all acres enrolled in the programme in a year after the base period, payments are revoked or there is a reduction in the amount of the payment by way of a penalty. It is with respect to these requirements, under which payments are eliminated or reduced, that Brazil claims that PFC and DP payments are not in conformity with the criterion in paragraph 6(b) of Annex 2 of the *Agreement on Agriculture* because the amount of such payments in any given year is related to, or based on, the type and volume of production undertaken by the producer in a year after the base period, and that therefore PFC and DP payments do not qualify for exemption from reduction commitments as decoupled income support.

7.384 It is clear that the planting flexibility limitations at issue provide for the "amount" of PFC and DP "payments" to be reduced or eliminated by reference to the planting of fruit and vegetables (and wild rice) on base acres. Those producers who did not and do not plant fruit and vegetables (or wild rice) on their base acres did not and do not have the amount of their payments reduced. Those producers who did and do plant fruit and vegetables (and wild rice) on their base acres, whether in accordance with special eligibility criteria (with one exception)[508] or not, did and do have the amount of their payments reduced.

7.385 It is also clear that the harvesting of fruit, vegetables and wild rice are "types" of production. The *permitted* crops, which are a very large but not unlimited group, are also "types" of production. The planting flexibility limitations at issue, although they refer to "planting", do in fact apply to types of "production". In the case of PFC payments, they applied to planting, which necessarily included prohibited crops that were harvested and those that were destroyed before harvest. This is not in dispute. In the case of DP payments, the limitations apply to the harvesting of these crops, as those prohibited crops destroyed before harvest are specifically excluded from the limitations. In the case of both PFC and DP payments, the limitations refer to the planting of prohibited crops during the term of a contract, which is after the base period. Therefore, on a plain reading, the amount of all PFC and DP payments were and are related to the type of production undertaken by the producer after the base period.

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payments in fiscal years 1998 through 2002, according to which "for each contract acre on which a producer plants wild rice, 1 acre will not be used in determining the contract payment".

[507] See 7 CFR 1412.401 (1 January 2002 edition) and 7 CFR 1412.601 (1 January 2003 edition), reproduced in Exhibits BRA-31 and BRA-35, respectively.

[508] Other than the exception for *regions* with a history of double cropping: Section 118(b)(2)(A) of the FAIR Act of 1996 and Section 1106(c)(1) of the FSRI Act of 2002.

7.386 The Panel does not need to decide for the purposes of this dispute the extent to which the interpretation of paragraph 6(b) requires a consideration of the trade-distorting effects or effects on production of a measure, in light of the fundamental requirement in paragraph 1. Firstly, the Panel notes that the planting flexibility limitations provide a monetary incentive for payment recipients not to produce the prohibited crops. USDA data presented by Brazil shows that the planting flexibility limitations in this dispute cover a wide range of types of production[509] which represent approximately 22 per cent of farm income from crops in the seventeen states of the United States producing upland cotton, peaking at over 70 per cent in California, a major upland cotton producing state.[510] The United States has not suggested that these farms are covered by the special eligibility criterion which would permit them to plant fruits and vegetables without penalty. These limitations therefore significantly constrain production choices available to PFC and DP payment recipients and effectively eliminate a significant proportion of them. Whilst these programmes permit recipients to produce nothing, this alone does not remove the significant constraint that the planting flexibility limitations have in certain regions on the choices of those PFC and DP payment recipients who do produce something, which the evidence shows is the overwhelming majority.[511]

7.387 Secondly, the Panel asked the United States to indicate the reason for the planting flexibility limitations and to comment on the suggestion by the European Communities that these limitations are designed to avoid unfair competition.[512] The United States informed the Panel of when the limitations were introduced and in what connection but declined to indicate the reason for them or to comment on the European Communities' suggestion. Therefore, there is no evidence before this Panel that these particular planting flexibility limitations in these particular programmes actually promote fair competition or reduce production- or trade-distorting effects in the markets for fruits and vegetables, or the markets for the commodities covered by the programmes or any other market. This does not imply any view as to whether such evidence is relevant to the interpretation of paragraph 6(b).

7.388 For the above reasons, the Panel concludes that PFC payments, DP payments, and the legislative and regulatory provisions that provide for the planting flexibility limitations in the DP programme, do not fully conform with paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*.

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[509] The limitations cover over 191 crops: see 7 CFR 1412.206(f) (1 January 2002 edition) and 7 CFR 1412.407(h) (1 January 2003 edition), reproduced in Exhibits BRA-31 and BRA-35, respectively..

[510] This is a five year average 1997-2001. See USDA Economic Research Service "U.S. and state farm income database, farm cash receipts 1997-2001", reproduced in Exhibit BRA-107, and Brazil's oral statement at the first session of the first substantive meeting, para. 66. This average includes high proportions of farm income in Florida, New Mexico and Virginia which only account for a small amount of upland cotton production, as well as high proportions in Arizona, California and Georgia, which account for a large amount of upland cotton production. National statistics also show that the amount of acreage planted to crops prohibited under the PFC and DP programmes is large: see USDA Fruits and Tree Nuts Yearbook, October 2003, Table A-2, and USDA Vegetables and Melons Yearbook, July 2003, Table 3, reproduced in Exhibits BRA-422 and BRA-423.

[511] See USDA data supplied in December 2003 in Exhibits US-111 and US-112 and corrected in January 2004 as described in Exhibit US-145. See also the testimony before the United States House of Representatives Committee on Agriculture in 2001 by Mr. Robert McLendon, then Chairman of the National Cotton Council's Executive Committee that "I don't think we have a lot of farmers getting their payment and not working the land" set out in Exhibit BRA-41, at page 17; and the statement of Dr. Sumner at pages 11 and 12 in Exhibit BRA-342.

[512] The Panel asked the United States to comment on this suggestion by the European Communities. In its response, the United States informed the Panel that these limitations on planting flexibility came into play with the "flex acre" concept of the FACT Act of 1990 and have continued to apply only to base acres under the 1996 and 2002 legislation. See the United States' response to Panel Question No. 217.

(c) Updating of base acres

*(i) Main arguments of the parties*

7.389 **Brazil** claims that the DP payments and provisions of the FSRI Act of 2002 and implementing regulations that provide for the DP programme are inconsistent with paragraphs 6(a) and (b) of Annex 2 because they permitted updating of base acres from the PFC programme. It argues that successive decoupled income support programmes with the same structure, design and eligibility criteria must have a fixed and unchanging base period to be consistent with paragraph 6(a). It argues that the updating of base periods captures additional payment acreage for a particular crop and links increased recent volumes of production with the amount of current payments which is inconsistent with paragraph 6(b). It argues that the object and purpose of paragraph 6 is to ensure that Members do not permit payments to increase over time in a manner linked to increases in production over time.[513]

7.390 The **United States** responds that DP payments are made to persons on farms for which payment yields and base acres are established, which are "defined" in the Act and "fixed" for the duration of the legislation – that is, marketing years 2002-2007.[514] The United States does not agree that once a particular type of direct payment under Annex 2 has been made, all subsequent measures providing direct payments must be made with respect to the same base period. There is no textual requirement that all domestic support measures for which exemption from the reduction commitments is claimed utilize the same "defined and fixed period".[515] Although it is irrelevant, PFC and DP payments are not in fact essentially the same.[516]

*(ii) Main arguments of the third parties*

7.391 **Australia** agrees with Brazil.[517] **Canada** submits that the Panel should find that the applicable base period for DP and PFC payments is the same because the structure and payment parameters of the two programmes are essentially the same.[518] **New Zealand** submits that the DP programme is the successor to the PFC programme and to permit an updating of the fixed base period by changing the name of the programme would render the provisions of paragraphs 6(a) and (b) of Annex 2 a nullity.[519]

7.392 The **European Communities** takes note of the United States' explanation that the updating of the base period was necessary in order to bring support for oilseeds production into the DP scheme and saw nothing in paragraph 6 of Annex 2 that prevented different base periods where eligibility was based on previous eligibility for production distorting subsidies. However, the European Communities is concerned that continued updating of reference periods in respect of the same existing decoupled support, creating an expectation that production of certain crops would be rewarded with a greater entitlement to supposedly decoupled payments, tended to undermine the decoupled nature of such payments.[520]

[513] Brazil's first written submission, paras. 176-180 and response to Panel Question No. 19.
[514] United States' first written submission, para. 67; United States' response to Panel Question No. 24.
[515] United States' rebuttal submission, paras. 30-35.
[516] The United States does not assert that PFC and DP payments are anything but decoupled income support subject to all the requirements in paragraph 6.
[517] Australia's written submission to the first session of the first substantive meeting, paras. 46-48.
[518] Canada oral statement at the first session of the first substantive meeting, para. 5.
[519] New Zealand written submission to the first session of the first substantive meeting, para. 2.26.
[520] European Communities' oral statement at the first session of the first substantive meeting, para. 32.

*(iii) Evaluation by the Panel*

7.393 The Panel has already found that DP payments fail to conform to the provisions of paragraph 6 of Annex 2 due to the planting flexibility limitations. It is therefore unnecessary for the purposes of this dispute to make findings on their conformity with paragraph 6 due to the updating. Therefore, the Panel makes only the following factual findings which aid in understanding the comparison of support under Article 13(b) and later Sections of this report.

7.394 Under the DP programme, owners had to establish base acres and programme yields for all commodities covered by the programme before enrolling. "Base acres" are the quantity of acreage on which payments are calculated.[521] They are calculated as an average of plantings in certain previous years, not plantings in the years when payments are made. The alternative methods of calculating base acres for the DP programme are found in section 1101(a) of the FSRI Act of 2002, which gave owners a one-time opportunity to elect a method of calculation of base acres.

7.395 This provision essentially gave owners three options for calculation of base acres. One option was to choose base acres equal to those that would have been used to calculate the 2002 PFC payment for the commodities covered by both programmes. This was calculated for upland cotton from the three-year average of acreage planted during the 1993 through 1995 crop years.[522] Another was to add oilseeds to base acres used for the PFC payment, using one of three possible methods. The other option was to calculate base acres from the four-year average of acreage planted during the 1998 through 2001 crop years. The USDA described this option as "updating" all base acres.[523]

7.396 The majority of farms with upland cotton base acres did not choose to update all base acres. However, those which did update caused the total upland cotton base acreage to increase in the 2002 marketing year from 15,933,377.9 acres under the PFC programme to 18,558,304.2 acres under the DP programme, an increase of 16.4 per cent.[524] This increase was based on planting that occurred during 1998-2001, which was after the base period 1993-1995. The updating necessarily increased the total amount of payments on upland cotton base acreage over the previous year, because the DP payment rate for upland cotton is not lower than the PFC payment rate for the previous year (it is in fact slightly higher). At the same time, upland cotton planted acreage in the 2002 crop year declined over the 2001 crop year by 1.09 million acres.[525] Therefore, the overall updating of base acres was not linked to an overall increase in production of upland cotton. However, individual updating by certain recipients was linked to increases in plantings of upland cotton in 1998-2001 over 1993-1995. For those recipients, the amount of payments is related to the type or volume of production undertaken by the producer in 1998-2001.

[521] They were called "contract acreage" in the PFC programme. "Payment acres" are equal to 85 per cent of a recipient's base acres in both the PFC and DP programmes.

[522] Section 102(4) of the FAIR Act of 1996. See 7 CFR 1412.103 (1 January 2002 edition) for the definition of "eligible acreage" and 7 CFR 1413.7 (1 January 1993 edition) relating to deficiency payments, reproduced in Exhibit BRA-26. For covered commodities other than upland cotton and rice, base acreage was generally calculated as the average of acres planted during the previous five years.

[523] USDA side by side comparison of PFC and DP payments in Economic Research Service Features: *"The 2002 Farm Bill: Title I – Commodity Programs"*, printed 16 September 2002, reproduced in Exhibit BRA-27; USDA Agriculture Information Bulletin Number 778, Economic Research Service electronic report: *"The 2002 Farm Act – Provisions and Implications for Commodity Markets"* by Paul C. Westcott, C. Edwin Young and J. Michael Price, November 2002, at page 7; USDA Direct payment and CCP enrolment report dated 19 June 2003; USDA "Cotton Briefing room: Farm Commodity Policy, Updating Base Acres and Payment Yields", USDA Farm Services Agency Newsroom "Veneman reminds farmers to complete DCP sign-up by June 2" dated 29 May 2003; and extract from USDA *"2002 Direct and Counter-Cyclical Program Final Enrolment Report (DCP-01)"*, November 2002 titled "Upland cotton base and yield updating by state and region, marketing year 2002", reproduced in Exhibits BRA-27, BRA-42, BRA-44, BRA-110, BRA-321 and US-94, respectively.

[524] Exhibits US-111 and US-112 and United States' further rebuttal submission para. 82.

[525] Exhibits US-111 and US-112.

7.397 It is clear to the Panel that the DP programme is the successor to the PFC programme. The two programmes were established by successive farm bills, the latter of which provided that DP payments in the 2002 marketing year should be adjusted to take account of the PFC payments for the same fiscal year.[526] Base acreage used for the 2002 PFC payment can be used to calculate base acreage for the DP programme. This relationship is confirmed by the USDA Economic Research Service as follows:

> "While the 2002 Farm Act introduces some new policies to the array of agricultural commodity programs, in many ways, it extends provisions of the 1996 Farm Act and the ad hoc emergency spending bills of 1998-2001. For example, the 2002 Act continues marketing assistance loans, which existed under previous U.S. farm law; *direct payments replace production flexibility contract payments* of the 1996 Farm Act; and counter-cyclical payments are intended to institutionalize the market loss assistance payments of the past several years."[527] [emphasis added]

7.398 The fact that they are "successor" programmes does not tell us whether they are or are not the same income support programme for which the base period has been changed. The Panel notes that the PFC and DP programmes share certain structural elements:[528]

(i) eligible recipients are the same[529];

(ii) the payment formula is the same, namely 85 per cent of the recipient's base acres, multiplied by payment yields multiplied by the payment rate for each commodity[530];

(iii) payments are made by reference to historical acreage and historical yields, not current production[531];

(iv) base acres for the same commodities can be the same, at the owner's election[532];

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[526] Section 1107 of the FSRI Act of 2002. Adjustment to avoid double payments in itself may only indicate that the recipients are the same, and not that two programmes are structurally similar. For instance, there was a similar provision to adjust PFC payments in the 1996 marketing year to take account of deficiency payments for the same year, although deficiency payments allowed no planting flexibility – see section 114(e) of the FAIR Act of 1996.

[527] USDA Agriculture Information Bulletin Number 778, Economic Research Service electronic report: *"The 2002 Farm Act – Provisions and Implications for Commodity Markets"* by Paul C. Westcott, C. Edwin Young and J. Michael Price, November 2002, page iv, reproduced in Exhibit BRA-42. See also the description of direct payments at page 4.

[528] Brazil also drew attention to the USDA side by side comparison of PFC and DP payments: USDA Economic Research Service Features: *"The 2002 Farm Bill: Title I – Commodity Programs"*, printed 16 September 2002, reproduced in Exhibit BRA-27. The Panel considers that comparison useful in that its contents reveals the structural similarities between the programmes, not because of the choice of format.

[529] Section 102(12) of the FAIR Act of 1996, 7 CFR 718.2 (1 January 2002 edition) and Section 1001(12) of the FSRI Act of 2002 and 7 CFR 1412.202 and 1412.402, reproduced in Exhibits BRA-28, BRA-31, BRA-29 and BRA-35, respectively. The United States emphasized that "the 1996 Act and implementing regulations under both Acts contained identical language" – see its rebuttal submission para. 37.

[530] See 7 CFR 1412.103 (1 January 2002 edition) and 7 CFR 1412.502(e), reproduced in Exhibits BRA-31 and BRA-35, respectively.

[531] Section 114(a) of the FAIR Act of 1996 and Section 1103(b) of the FSRI Act of 2002.

[532] Section 1101(a)(B)(i) of the FSRI Act of 2002, which refers to the "contract acreage (as defined in Section 102 of the [FAIR Act of 1996] used by the Secretary to calculate the fiscal year 2002 payment authorized under section 114 of such Act for the covered commodities on the farm". See Exhibits BRA-29 and US-1.

(v) payment yields for commodities covered by both programmes are the same[533];

(vi) payment rates are fixed for each commodity and unaffected by current market prices[534];

(vii) land use requirements are basically the same[535];

(viii) planting flexibility and planting flexibility limitations are the same[536]; and

(ix) payment limitations are the same.[537]

7.399 The two programmes also have certain differences:

(i) commodity coverage differs. The DP programme includes all commodities covered by the PFC programme plus soybeans, other oilseeds and peanuts[538];

(ii) the method of calculating payment rates differs. The DP payment rates are set out in the legislation and fixed on a per unit basis for the entire life of the Act. PFC payment rates are derived from the share of funds allocated to each contract commodity according to percentages specified in the Act;

(iii) the term of contract differs. DP contracts are annual but PFC contracts ran for up to the entire life of the Act. Payments are annual under both; and

(iv) actual payment rates differ. DP payment rates for upland cotton are higher than PFC payment rates for 2001 and 2002, but lower than the average PFC rates throughout the life of the PFC programme.

7.400 The United States explained that the reason for allowing producers to calculate base acres for all covered commodities using the 1998-2001 average was due to the fact that oilseeds had not been covered by the PFC programme. Some mechanism was required to bring acreage previously devoted to oilseeds within the scope of the DP programme.[539]

7.401 The Panel observes that such a mechanism is found in section 1101(a)(1)(B), which permitted a recipient to calculate base acres by reference to the base period of the 1993 through 1995 crop years, adding acreage for oilseeds under one of three different options. Section 1101(a)(1)(A), on the other hand, permitted a recipient to update base acres for *all* covered commodities, and not just bring

[533] See 7 CFR 1412.103 (1 January 2002 edition) and 7 CFR 1412.301 and 1412.302 (1 January 2003 edition), reproduced in Exhibits BRA-31 and BRA-35, respectively.

[534] See 7 CFR 1412.103 (1 January 2002 edition); 7 CFR 1412.502(d) (1 January 2003 edition), and Table 19 of USDA *Agricultural Outlook* (November 2003), reproduced in Exhibits BRA-31, BRA-35 and BRA-394, respectively.

[535] Section 111(a) of the FAIR Act of 1996 and section 1105(a) of the FSRI Act of 2002.

[536] See 7 CFR 1412.206 (1 January 2002 edition) and 7 CFR 1412.407 (1 January 2003 edition), reproduced in Exhibits BRA-31 and BRA-35, respectively.

[537] There was and remains a limitation of $40,000 per person per crop year. The three entity rule has been retained according to which an individual can receive a full payment directly and up to a half payment from two additional entities: see section 115 of the FAIR Act of 1996 and section 1603 of the FSRI Act of 2002; see also the USDA side by side Comparison of PFC and DP payments at page 12, reproduced in Exhibit BRA-27.

[538] Section 102(5) of the FAIR Act of 1996 and sections 1001(4) and 1103 of the FSRI Act of 2002. Payments are calculated differently with respect to peanuts, as described in Section VII:C of this report.

[539] United States' first written submission, para. 60.

acreage previously devoted to oilseeds within the scope of the DP programme. The United States explained that compelling all recipients to use the 1998-2001 average would have penalized those who had chosen not to produce during the PFC programme.[540] However, this explanation assumes that it was appropriate to use the 1998-2001 average for all covered commodities, which is what is in dispute.[541] The United States could have chosen a separate means to provide support to oilseed producers, instead of incorporating them into this measure and permitting owners to update their base period, but it did not.

7.402 Brazil argues that the possibility of updating encourages producers to plant more acreage to commodities covered by a programme in the expectation that they would be able to update base acreage in the successor programme.[542] It submits that the option of updating base acres in 2002 for all covered commodities "will send a strong signal to producers to use their 'freedom to farm' to protect their 'future base' by at a minimum maintaining existing levels of production and if possible, increase production and yields of program crops."[543] It cites evidence from USDA economists that "[t]hese base acreage and payment yield updates may influence current production choices if farmers expect that future legislation will again allow them to update these program parameters for their farms."[544]

7.403 The United States responds to this argument in relation to its arguments that DP payments comply with the fundamental requirement in paragraph 1. It submits that Brazil's argument rests entirely on theoretical statements and that it does not evaluate the extent of any hypothesized production effect.[545] It submits that Brazil's argument ignores the opportunity costs of planting cotton instead of a crop with a more favourable expected return in the current year and notes that there is no statutory authority for any future base updating.[546]

7.404 The Panel notes that Brazil expresses its argument as a hypothetical: the effect on current production choices depends on "if" farmers expect future updating. However, since the time when base acres for deficiency payments were established by a rolling average of previous years' plantings under the FACT Act of 1990, there has been only one opportunity to update base acres. Brazil asserts that:

> "The 2002 update and individual deficiency payment updates during 1985-1995 established the principle that acreage and yield base updates are a part of the farm policy in the United States. Even though no updates are explicitly provided for during the lifespan of the 2002 FSRI Act, farmers may reasonably expect future

[540] United States' first written submission, para. 60.

[541] Brazil drew attention to the comments of an advisor to the Board of the United States National Cotton Council, that: "The new bill also provides the ability to update base acreage and payment yields based on recent history, specifically the years 1998-2001. This will bring a producer's payment production more in line with recent production patterns. The updating will be of particular benefit to growers in the southeast, where recent plantings have exceeded the base established under the 1996 Act." Robert McLendon: *"The Six Year World Outlook for Cotton and Peanuts: Implications for Production and Prices"*, presentation at the Fourth Annual Symposium on the Future of American Agriculture, University of Georgia College of Agricultural and Environmental Sciences, reproduced in Exhibit BRA-111.

[542] Brazil's first written submission, paras. 179 and 180.

[543] Brazil's first written submission, para. 185.

[544] USDA The 2002 Farm Act, Provisions and Implications for Commodity Markets reproduced in Exhibit BRA-42 at page 19, cited in Brazil's first written submission, paras. 186 and 187.

[545] United States' rebuttal submission, para. 62.

[546] United States' oral statement at the second substantive meeting, paras. 59-66 and response to Panel Question No. 216.

updates, either as a part of ad hoc legislation or as a part of the regularly scheduled new law in 2007."[547]

7.405 The Panel notes that updating was not permitted throughout the term of the FAIR Act of 1996, and is not permitted throughout the term of the FSRI Act of 2002. It has been permitted only once since 1996. There is no evidence before the Panel as to what the United States Congress intends to do in future farm bills. There is no evidence, only speculation, as to whether producers will expect to be able to update their base acres under future farm bills.

(d) The "fundamental requirement"

*(i) Main arguments of the parties*

7.406 **Brazil** claims that PFC and DP payments provided to upland cotton producers are inconsistent with "the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production" pursuant to paragraph 1 of Annex 2.[548] In Brazil's view, measures that do not comply with that fundamental requirement are actionable independently of any failure to comply with the basic or policy-specific criteria in Annex 2. An interpretation of the fundamental requirement as a policy objective that merely informs the rest of Annex 2 would detract from the unambiguous obligation that domestic support measures have no, or at most minimal, trade-distorting effects or effects on production.[549] Brazil presents economic evidence concerning the alleged production effects of these payments.

7.407 However, Brazil submits that any domestic support measures that do not comply with one of the basic or policy-specific criteria in Annex 2 are to be presumed to violate the fundamental requirement. It argues that this conclusion holds regardless of any finding on the character of the fundamental requirement as a stand-alone obligation.[550] Brazil does not challenge PFC and DP payments under either of the basic criteria in paragraphs 1(a) and (b) of Annex 2. It accepts that they comply with the basic criterion that they are provided through a publicly-funded government programme not involving transfers from consumers, and does not allege that they "have the effect of providing price support to producers."[551]

7.408 The **United States** responds that compliance with the fundamental requirement that domestic support measures for which exemption from reduction commitments is claimed have no, or at most minimal, trade-distorting effects or effects on production will be demonstrated by conforming to the basic and policy-specific criteria in Annex 2. Measures that conform to the two basic criteria in paragraph 1 plus the applicable policy-specific criteria and conditions in paragraphs 6 through 13 of Annex 2 will be deemed to meet the fundamental requirement.[552] In the United States' view, the fundamental requirement does not merely set out in hortatory terms the objective of Annex 2.[553] The United States argues that Brazil has not made a prima facie case with respect to the fundamental requirement because its evidence is hypothetical and does not address whether the production effects

[547] Brazil's response to Panel Question No. 216. It also cited an article by two ABARE economists "2002 U.S. Farm Bill: An Australian Perspective on its Impact", reproduced in Exhibit BRA-81.

[548] Brazil's first written submission, paras. 163-165.

[549] Brazil's response to Panel Question No. 27.

[550] Brazil's response to Panel Question No. 27.

[551] Brazil's response to Panel Question No. 30. The United States submits that the DP programme satisfies both basic criteria, relying on section 1103 of the FSRI Act of 2002 and the fact that DP payments are not made to support any "applied administered price" in the sense of paragraph 8 of Annex 3 of the *Agreement on Agriculture*. See the United States' first written submission, paras. 64-66.

[552] United States' first written submission, para. 50; United States' oral statement at the first session of the first substantive meeting, para. 16

[553] United States' response to Panel Question No. 29.

of these payments are more than minimal. It submits economic evidence in support of its view that these payments in fact do satisfy the fundamental requirement.[554]

*(ii) Main arguments of the third parties*

7.409 **Argentina**[555] and **Australia**[556] submit, in effect, that measures must satisfy the fundamental requirement in paragraph 1 in addition to the criteria in Annex 2 in order to be exempt from reduction commitments.

7.410 The **European Communities** submits that the first sentence of paragraph 1 of Annex 2 does not set out an independent obligation but simply signals the objective of Annex 2.[557]

7.411 **New Zealand** submits that the fundamental requirement and the other criteria in Annex 2 are to be strictly applied to measures in order to obtain exemption from reduction commitments.[558]

*(iii) Evaluation by the Panel*

7.412 The Panel does not decide whether the fundamental requirement in paragraph 1 of Annex 2 is a freestanding obligation or not. In Brazil's view, any domestic support measures that do not comply with one of the basic or policy-specific criteria in Annex 2 are to be presumed to violate the fundamental requirement. In the United States' view, a measure that does not satisfy the basic and policy-specific criteria in Annex 2 may not conform to the provisions of Annex 2 even if it satisfies the fundamental requirement. Therefore, in light of the Panel's finding that the measures do not satisfy a criterion in paragraph 6, it is unnecessary to continue for the purposes of paragraph (a) of Article 13. The Panel makes certain findings on the effects of these measures in Section VII:G of this report.

(e) Conclusion regarding paragraph (a) of Article 13

7.413 In light of the above findings, the Panel concludes that PFC payments, DP payments, and the legislative and regulatory provisions which establish and maintain the DP programme, do not fully conform with paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*. They are not green box measures.

7.414 Consequently, the Panel concludes that these measures do not comply with the condition in paragraph (a) of Article 13 of the *Agreement on Agriculture* and are therefore non-green box measures covered by paragraph (b) of Article 13.

**5. Paragraph (b) of Article 13**

(a) Condition at issue

7.415 **Brazil** asserts that the United States domestic support measures at issue do not satisfy the conditions in paragraph (b) of Article 13 of the *Agreement on Agriculture* for the single reason that they do not comply with the proviso in subparagraph (ii), i.e. because they "grant support to a specific

[554] United States' rebuttal submission, paras. 60-64. The United States also submits that, on Brazil's reading, if a measure does not conform to the criteria in Annex 2, it still could meet the fundamental requirement of paragraph 1. However, see Brazil's response to Panel Question No. 27 referred to *supra* at footnote 550.

[555] Argentina's response to Panel third party Question No. 9.

[556] Australia's written submission to the first session of the first substantive meeting, paras. 31-32.

[557] European Communities' written submission to the first session of the first substantive meeting, para. 15.

[558] New Zealand's response to Panel third party Question No. 11

commodity in excess of that decided in the 1992 marketing year". It does not pursue any claim that the domestic support measures do not comply with the conditions set out in the chapeau of paragraph (b).

7.416 The **United States** responds that its domestic support measures satisfy all the conditions in paragraph (b), including the proviso in subparagraph (ii).

7.417 The Panel begins by noting that Article 13(b)(ii) provides as follows:

> "During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures (referred to in this Article as the "Subsidies Agreement"):
>
> (…)
>
> (b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:
>
> (…)
>
> (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, *provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year*; …" [emphasis added]
>
> (…)

7.418 The task of the Panel is therefore to assess whether the United States domestic support measures grant support to a specific commodity in excess of that decided in the 1992 marketing year. This calls for a comparison. The two quantities to be compared are the extent to which "such measures (…) grant support to a specific commodity" and "that decided during the 1992 marketing year". We will refer to the first half of this comparison as "implementation period support" because the relevant time at which such measures grant support is contemporaneous with the applicability of Article 13.[559] Whether implementation period support is annual support, or some other period of support, is a matter we may consider later. We will refer to the second half of the comparison as the "MY 1992 benchmark".

7.419 The words "in excess of" link the two halves of the comparison grammatically. They indicate that a mathematical comparison has to be made. An excess of implementation period support over the MY 1992 benchmark will show that the domestic support measures at issue are inconsistent with the additional condition in Article 13(b)(ii). There is no requirement to quantify the excess, but the decisive question is whether there is any excess. Thus, it would not be strictly necessary for the Panel to make a precise calculation of the amount of the excess if it is clear that, on the basis of the proper evidentiary standard, there is an excess of some degree.

7.420 The notion of "support" links the two halves of the comparison semantically. Implementation period support refers to "support" to a specific commodity expressly and the MY 1992 benchmark refers to "'that' decided", which refers to "support to a specific commodity". Disciplines on "support"

[559] Discussed below in paragraph 7.529.

are one of the three pillars of the *Agreement on Agriculture*, which uses the word "support" interchangeably with "domestic support".[560] Neither are defined terms, although Articles 3.2, 6.1, 6.3, 7.1 and 7.2(a) clarify their meaning somewhat by referring to "support in favour of domestic producers" or "domestic support in favour of agricultural producers". The subject of the proviso in subparagraph (b)(ii) is "such measures" that conform fully to the provisions of Article 6.

7.421 Annex 3 sets out at great length a methodology for measuring the support granted by those measures which are calculated or can be calculated in an Aggregate Measurement of Support ("AMS"). Paragraph 1 of Annex 3 lists the following types of support:

> "market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment ('other non-exempt policies')"

7.422 The residual type of support in this list refers to any "other" subsidy and paragraph 2 refers to "subsidies" under paragraph 1. We can also note that the first two types of support in the list are price and income support, which are terms used in paragraph 1 of Article XVI of the *GATT 1994* to illustrate the word "subsidy".[561] It is clear from all these references that all relevant types of support for the purposes of the *Agreement on Agriculture* are subsidies.

7.423 An important feature of the *Agreement on Agriculture* is that it defines in detail the domestic support measures *exempt* from reduction commitments, rather than those which are *subject* to reduction commitments. It is therefore inappropriate to attempt to give an exhaustive definition of "support". It is also unnecessary to do so due to the detailed methodology for measuring support contained in the text. In any event, for the purposes of this dispute, the parties agree that all of the measures in issue provide "support" in some form.[562]

(b) MY 1992 benchmark

*(i) Interpretation*

i Main arguments of the parties

7.424 **Brazil** argues that the phrase "decided during the 1992 marketing year" refers to some sort of a decision made by a Member between 1 August 1992 and 31 July 1993, but not before and not after. Brazil is aware of no specific legislation or regulation enacted or decided by the United States during the 1992 marketing year with respect to upland cotton. The only decision that could be said to have been made during that year was to provide the appropriations and continued funding for upland cotton pursuant to the FACT Act of 1990.[563] It argues that the interpretation of Article 13(b)(ii) must permit an "apples-to-apples" or "support-to-support" comparison. The word "decided" is neutral, requires no particular type of decision, and must not detract from the meaning of the term "grant" which is the operative verb for implementation period support. The MY 1992 benchmark must include some aspect of "grant" because it is "that" decided in MY 1992, which refers back to "support" and which is connected to the verb "grant".[564]

7.425 The **United States** responds that the key term in this phrase is "decided" which stands in contrast to other provisions in the *Agreement on Agriculture* that use the term "provided". This suggests that the use of the term "decided" was deliberate so as to make the condition in

[560] See the preamble, the definitions of AMS, EMS and Total AMS in Article 1, the methods of calculation of AMS and EMS in Annexes 2 and 3 and Articles 3, 6, 7, 18 and 20.

[561] The text of Article XVI:1 of the *GATT 1994* is set out in Section VII:G of this report.

[562] However, they have sharply differing views on whether they grant "support to a specific commodity" within the meaning of Article 13(b)(ii).

[563] Brazil's first written submission, paras. 139 and 141.

[564] Brazil's oral statement at the first session of the first substantive meeting, para. 31.

Article 13(b)(ii) not dependent on the support actually provided during the 1992 marketing year.[565] United States domestic support measures did not decide on an outlay or expenditure amount in favour of upland cotton, but determined a level of income support. The United States government ensured that upland cotton farmers would receive 72.9 cents per pound of upland cotton.[566]

7.426 **Brazil** argues that a rate of support methodology would allow Members to make huge increases in payments when market prices are falling, as long as they comply with Total AMS reduction commitments. In any event, the 1990 deficiency payments programme rate of support of 72.9 cents per pound must be adjusted downwards for upland cotton not eligible to receive that support, the cost to producers of the requirement to idle part of their base acreage, and other programmes in effect in 1992.[567]

7.427 The **United States** responded that – even allowing for the adjustments proposed by Brazil – the product-specific support granted in marketing years 1999 through 2002 was lower than the rate of support decided in the 1992 marketing year. In any event, the fact that some upland cotton was not eligible to receive the rate of support was due to producer decisions not to participate in the programme, not a decision of the United States government. Land idling and flex acre requirements were decisions taken by the United States government but they affected eligibility and not the rate of support.[568] If these requirements were factored into the rate of support, it would produce a guaranteed producer revenue of 67.7625 cents per pound.[569]

ii Main arguments of the third parties

7.428 **Argentina** considers that the support "decided" refers to a legislative or administrative decision by a Member on the domestic support to be granted during the implementation period in terms of budgetary outlays. If no "decision" was taken in terms of budgetary outlays during the 1992 marketing year, the only support that can have been "decided" during that marketing year is the support granted during that year.[570]

7.429 **Australia** considers that "decided" means the level of non-green box domestic support by a Member in the course of the 1992 marketing year to be provided to the benefit of a specific agricultural commodity in the future. Australia clearly understood in the resumed Uruguay Round agriculture negotiations in 1993 that the words "decided during the 1992 marketing year" had been chosen to incorporate in the text of Article 13(b)(ii) and (iii) the sense of expectations of "conditions of price competition" as interpreted and applied in the *EEC – Oilseeds* dispute. Budgetary outlay figures put forward by Brazil and the rate of payment put forward by the United States would both properly form a part of that assessment, but not the whole.[571]

7.430 **China** does not agree with the United States' rate of support approach because it would prevent any measure involving year end accounting for the calculation of expenditures ever exceeding that decided during the 1992 marketing year. The drafters may have chosen "decided" rather than "granted" to exclude expenditures that cannot be precisely allocated to a specific marketing year or to include certain support payments granted by an administration in 1992 but which did not reach the

[565] United States' first written submission, paras. 82-87.
[566] United States' first written submission, para. 94.
[567] Brazil's oral statement at the first session of the first substantive meeting, paras. 33 and 36, and Exhibits BRA-103 and BRA-105.
[568] United States' rebuttal submission, paras. 121-124.
[569] United States' rebuttal submission, para. 126.
[570] Argentina's response to Panel third party Question No. 21.
[571] Australia's written submission to the first session of the first substantive meeting, paras. 24-26 and its oral statement at the first session of the first substantive meeting, paras. 6-13.

beneficiaries until later. However, the core intention was to choose the 1992 marketing year to establish a benchmark support level.[572]

7.431 The **European Communities** does not agree with Brazil's budgetary outlays approach because the word "decided" stands out in contrast to "grant" in the same sentence. This is intended to set a benchmark made up of an amount of support adopted by some form of decision (be it political, legislative or administrative) in which support for a specific product is decided and allocated for future years. This text was negotiated in November 1992 when the negotiators could not yet have known the support that would be granted in the whole 1992 marketing year. They used the term "decided" rather than "granted" to refer to decisions taken during 1992 in respect of support which Members intended to grant – not that actually granted. The Panel should use a level of support readily comparable with the support currently granted which may well be the support decided for a particular marketing year. It is not possible that a Member providing subsidies could not have made a relevant decision in the 1992 marketing year since, at the very least, it would have decided, on the basis of its subsidy programmes and the amount of eligible production and/or estimated production, to set aside a specific amount of budgetary appropriations for future years. However, if a Member decided not to provide support to a specific commodity, the level of support for purposes of the comparison would be zero.[573] AMS-like criteria should be used to measure the support decided because it takes into account the reference to AMS as the annual level of "support" yet would also measure the support "decided" rather than granted. AMS-like criteria could be used because it often is possible to establish, for certain measures, a gap between the applied administered price and the internal or external fixed reference price and establish, on the basis of information available to the decision makers, the amount of production which was eligible, or which was estimated. For other measures, it may also be possible to use appropriation or budgetary decisions.[574]

7.432 **New Zealand** does not agree with an approach that focuses solely on a guaranteed price per pound. The comparison must take into account the totality of payments to upland cotton producers in order to reflect the true nature of the support that is being granted, which the United States' rate of support approach ignores. A rate per pound alone ignores the actual levels of domestic support represented by budgetary outlays that must be granted in order to maintain those rates and the other payments received. The clear overarching intention of the negotiators of the *Agreement on Agriculture* was that such distortions would be reduced, consistent with the long term objective of correcting and preventing restrictions and distortions in world agriculture markets.[575]

iii Evaluation by the Panel

7.433 The Panel notes that the proviso in subparagraph (ii) of paragraph (b) reads as follows:

> "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year"

7.434 The MY 1992 benchmark is expressed as "that decided during the 1992 marketing year". The words "that decided" refer back to the phrase "support to a specific commodity" which is discussed in relation to implementation period support below.[576] The words "that decided" therefore mean "that [support to a specific commodity] decided". This occurrence of the verb "decided" with the direct object "support" is unique in the *WTO Agreement*. It is not defined and is a curious usage of the verb

[572] China's response to Panel third party Question No. 21.

[573] European Communities' oral statement at the first session of the first substantive meeting, paras. 16, 19-20 and its responses to Panel third party Questions Nos. 21 and 27.

[574] European Communities' response to Panel third party Question No. 22.

[575] New Zealand's written submission to the first session of the first substantive meeting, paras. 2.06-2.09 and its oral statement at the first session of the first substantive meeting, para. 6.

[576] See the Panel's findings in paragraphs 7.494 and following.

"decide" which rarely takes a direct object such as "support" without a preposition such as "on". The word "decide" can be defined as follows:

> "Come to a determination or resolution *that, to do, whether*."[577]

7.435 In its context, the use of the verb "decided" stands in contrast to the use of the verb "grant" in relation to the same noun "support" in the same proviso. Yet despite the contrast, the proviso calls for a comparison which necessarily requires the two halves of the comparison to be expressed in the same units of measurement.

7.436 A difference between the support that a government decides and the support that its measures grant is that one is expressed in terms of prior determinations of levels of support and the other in terms of subsequent support provided. (The word "grant" in the English version of the text also has connotations that "provided" does not). Decisions on support are often expressed in terms of appropriations of specific amounts of money, which may exceed the amount subsequently granted. Decisions on support can also be expressed in terms of payments of specific amounts, which are identical to the amount granted. Decisions on support are often expressed in terms of rates or methods to calculate payments, so that the amounts outlaid are not known until later. Decisions on price and income support also include eligibility criteria for production or producers, which are not captured separately in the notion of support granted. In the Panel's view, all of these decisions would delimit "that [support to a specific commodity] decided".

7.437 Another difference between the choice of the verbs "decided" and "grant" is that, where the benchmark is established by reference to a specific period of time, the relevant acts were the decisions on support, and not the grant of support, during that period of time. The text spells out that the relevant time for the establishment of the benchmark was "during the 1992 marketing year". This is one of only two domestic support benchmarks or base periods referred to in the *Agreement on Agriculture*. Both were periods during the negotiations, the other being "the years 1986 to 1988" for the purposes of calculation of the AMS.[578] Although the "marketing year" varies, it is a very specific period of time for a specific commodity and Member. The parties agree that the marketing year for upland cotton in the United States begins on 1 August, and that the 1992 marketing year ran from 1 August 1992 to 31 July 1993.[579]

7.438 The period "during the 1992 marketing year" is a very specific limitation on the establishment of the benchmark which the Panel is obliged to apply. The Panel must examine what decisions were made by the United States during the 1992 marketing year concerning support for upland cotton, and at no other time. The time at which support was granted as a result of those decisions is not addressed in the text. Decisions taken during the 1992 marketing year could have related to support granted in the same marketing year or in a later marketing year or in several marketing years. The text does not preclude any of these possibilities.

7.439 Brazil submitted that this portion of Article 13 first appeared in the Uruguay Round text following the second US/EC Blair House agreement of December 1993, and that it was drafted to provide a safe harbour for the European Community's Common Agricultural Policy ("CAP") reform

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[577] *The New Shorter Oxford English Dictionary* (1993). The parties agree that it means "determine". The United States adds that it can mean "pronounce".

[578] See paragraphs 9 and 11 of Annex 3.

[579] Brazil's first written submission, para. 139 and United States' response to Panel Question No. 69. See 7 CFR 1413.3 (1 January 1993 edition), reproduced in Exhibits BRA-26 and US-3, for the definition of "marketing year". USDA information provided in the Exhibits often refers to "crop year" for upland cotton which the United States delegation advised the Panel orally during the first session of the first substantive meeting was the same as the marketing year for upland cotton. The United States also used these terms interchangeably in its reponse to Panel Question No. 125(6).

"decided during the 1992 marketing year".[580] The United States is not aware of any written negotiating history that would shed light on why this proviso was added to Article 13(b)(ii).[581] The European Communities also submitted that Article 13(b) was negotiated in November 1992 and designed to protect support which Members had "decided during 1992" to grant[582] and submitted copies of two EC regulations reforming the CAP adopted during 1992 which lowered target prices for cereals commencing in the 1993/94 marketing year and offset loss of income through direct aid per hectare for arable farmers.[583]

7.440 The Panel notes that the text of subparagraph (ii) as it is currently drafted appeared in the Uruguay Round text following the first US/EC Blair House agreement of November 1992.[584] It was therefore negotiated during the 1992 marketing year itself, at which time some decisions may already have been taken by individual Members concerning support, and at which time they may not have known the value of the support that they would grant during that marketing year. This does not alter the Panel's interpretation in this dispute.

7.441 The proviso in subparagraph (ii) itself does not "protect support" but rather sets forth an additional condition besides those in the chapeau of paragraph (b) with which measures must comply in order to benefit from the exemptions from actions. However, within that additional condition, in choosing to define the benchmark as support "decided" rather than, say, "granted" during the 1992 marketing year, the drafters may well have intended to protect certain decisions which had already been taken or were proposed to be taken during that marketing year. However, that intention is not clear from the wording of the provision, nor the negotiating history provided to the Panel.

7.442 The two EC regulations submitted to the Panel show that they were both "done" on 30 June 1992. This appears to mean that the decisions to adopt those regulations were taken on that day, although they entered into force the following day. Both define the marketing year for the relevant products as beginning on 1 July and ending on 30 June of the following year[585] so that, for those products and the European Communities, the 1992 marketing year did not begin until 1 July 1992. Therefore, on their own terms, neither regulation appears to have been decided "during the 1992 marketing year" and, as such, they do not assist the Panel in its interpretation in this particular dispute.

7.443 The Panel also takes note of Australia's proposed interpretation of Article 13(b)(ii) and (iii) which reads elements of actions based on non-violation nullification and impairment into the conditions of Article 13. This interpretation is based on the premise that the additional condition in those subparagraphs should be capable of application in a non-violation complaint. In the Panel's view, that premise is false because Article 13 sets out conditions which provide exemption from certain types of actions and does not set out conditions which must be applied in the actions from which it provides exemption.

7.444 In any event, however the MY 1992 benchmark is defined, an essential feature of the additional condition in Article 13(b)(ii) and (iii) is that it sets forth the only condition in Article 13 of the *Agreement on Agriculture* as finally agreed that links the exemptions from actions for domestic support to specific commodities. It effectively replaced proposed product-specific and sector-wide

[580] See Brazil's first written submission, para. 140 citing Terence P. Stewart (editor): *The GATT Uruguay Round: A Negotiating History*, Vol. IV, pp.24-25, reproduced in Exhibit BRA-75.

[581] See United States' response to Panel Question No. 50.

[582] See European Communities' response to Panel third Party Question No. 21.

[583] See European Communities' response to Panel third party Question No. 24 and Exhibits EC-3 and EC-4.

[584] See the draft Article which formed part of that agreement in Exhibit EC-1.

[585] Council Regulation (EEC) No. 1765/92 establishing a support system for producers of certain arable crops, Article 1, and Council Regulation (EEC) No. 1766/92 on the common organization of the market in cereals, Article 2, reproduced in Exhibits EC-4 and EC-3, respectively.

AMS reduction commitments in the draft agriculture text as the benchmark for the purposes of this condition.[586]

*(ii) Relevant decisions*

i Main arguments of the parties

7.445 **Brazil** and the **United States** both submitted that a variety of decisions, mentioned below, was taken by the United States concerning its domestic support for upland cotton during the 1992 marketing year.[587] Both parties' arguments also referred to levels of support during the 1992 marketing year itself, although they measured such support differently.

ii Evaluation by the Panel

7.446 The Panel observes that no statute deciding domestic support for upland cotton was enacted by the United States during the 1992 marketing year. The legislative basis for the then-current marketing loan, deficiency payments and user marketing (Step 2) programmes was the FACT Act of 1990.[588] That Act provided a formula to calculate the marketing loan rate subject to a minimum of not less than 50 cents per pound.[589] The Act set a target price for deficiency payments for upland cotton of "not less than" 72.9 cents per pound and also set forth conditions for the user marketing (Step 2) payments.[590] The OBRA Act of 1990 played a role in establishing the elements which are incorporated into the FACT Act of 1990 provisions implemented by the United States.[591] The next major piece of legislation determining programme structures was the FAIR Act of 1996.[592] Brazil has drawn the Panel's attention to the OBRA Act of 1993[593], which was amending legislation, but this was enacted in August 1993, not during the 1992 marketing year for upland cotton and is therefore irrelevant.

7.447 Regulations relevant to domestic support for upland cotton were published during the 1992 marketing year. The United States relied on the Secretary of Agriculture's determination of the 1992 loan rate but this was decided during the 1991 marketing year and is therefore irrelevant.[594] The

[586] This section of the drafting history is discussed at paragraphs 7.495 and following. Total AMS commitments replaced the proposed product-specific and sector-wide commitments for the purposes of compliance with the domestic support disciplines of the *Agreement on Agriculture* and the chapeau of paragraph b) of Article 13.

[587] Brazil's and the United States' respective responses to Panel Question No. 54.

[588] Public Law 101-624, enacted on 28 November 1990 - see Section VII:C of this report.

[589] 7 USC 1444-2(a)(3), (1992 Supplement dated 4 January 1993), reproduced in Exhibit US-5, and explained in USDA Economic Research Service: "Cotton: Background for 1995 Farm Legislation", April 1995, reproduced in Exhibit BRA-12.

[590] 7 USC 1444-2(c)(1)(B)(ii) (1992 Supplement dated 4 January 1993), reproduced in Exhibit US-5.

[591] Omnibus Budget Reconciliation Act of 1990, Public Law 101-508 enacted on 5 November 1990 and explained in USDA Economic Research Service: "Cotton: Background for 1995 Farm Legislation", April 1995, pages 15-17, and "Provisions of the Agricultural Improvement and Reform Act of 1996, Appendix III: Major Agricultural and Trade Legislation, 1933-96", pages 133-134, reproduced in Exhibits BRA-12 and BRA-24.

[592] Federal Agriculture Improvement and Reform Act of 1996, Public Law 104-127. This Act amended the Agricultural Act of 1949. Title I, the Agricultural Market Transition Act, is reproduced in Exhibits BRA-28 and US-22.

[593] See the statement of Dr. Sumner, para. 7, in Exhibit BRA-105, referring to the Omnibus Budget Reconciliation Act of 1993, Public Law 103-66. The Bill for this Act was not passed by the House of Representatives until 5 August 1993 and was not signed by the President of the United States until 10 August 1993. This law amended the Agriculture Act of 1949 and the FACT Act of 1990, *inter alia*, replacing the deficiency payments 50/92 programme option with the 50/85 programme option.

[594] United States' first written submission, para. 101, citing 57 FR 14326 published on 20 April 1992 (during the 1991 marketing year), reproduced in Exhibit US-2. The loan rate had already been announced on

United States also mentioned regulations published on 24 March 1993, which determined the price support rate (i.e. the loan rate) with respect to the 1993 crop of upland cotton at 52.35 cents per pound and the Acreage Reduction Program percentage ("A.R.P."[595]) for the 1993 crop of upland cotton at 7.5 per cent (down from 10 per cent for the 1992 crop). It also provided that a Paid Land Diversion Program would not be implemented for the 1993 crop of upland cotton.[596] The final rates had been announced on 2 November 1992, after publication of a proposed rule on 29 September 1992. Therefore, these decisions on the marketing loan rate and A.R.P. for the 1993 crop of upland cotton were taken during the 1992 marketing year. The regulations classified the impact of these two decisions in monetary terms as follows:

> "This rule has been reviewed under USDA procedures established in accordance with Executive Order 12291 and provisions of Departmental Regulation 1512-1 and has been classified as "major". It has been determined that an annual effect on the economy of $100 million or more may result from implementing of the provisions of this final rule."[597]

7.448 Brazil drew the Panel's attention to a range of other operational decisions including implementation of the 50/92 programme option, decisions on the deficiency payment rate (20.3 cents per pound),[598] determination of the upland cotton acreage base, a weekly adjusted world price for the marketing loan programme, the weekly Step 2 payment rate and decisions on individual crop insurance policies.[599] These operational decisions affected payments but they only produced some of the parameters in payment calculations. Other essential parameters in those calculations, such as the loan rate and target price for the 1992 crop, were not decided during the 1992 marketing year but earlier, as required by legislation. Therefore, these operational decisions do not represent support decided during the 1992 marketing year. Two decisions on the loan rate and A.R.P. were taken during the 1992 marketing year but they related to the 1993 crop, as required by legislation. They did not affect any payments affected by the operational decisions taken during the 1992 marketing year . Therefore, taken together, these decisions do not add up to support decided.[600]

7.449 The Panel sees no evidence of any other policy decision that could be relevant to the MY 1992 benchmark. The United States Congress set the minimum target price and loan rates in 1990 for the 1991 through 1995 marketing years and delegated authority to the Secretary of Agriculture to set and announce the actual loan rate for each marketing year. The loan rate for the 1992 crop of upland cotton was published in regulations on 20 April 1992.[601] The final rate had been announced on 31 October 1991 following publication of a proposed rule on 13 September 1991.[602] That was not a decision taken during the 1992 marketing year.

7.450 The United States argues that the Secretary of Agriculture decided to maintain the target price and loan level during the 1992 marketing year for the 1992 crop and that these decisions were

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31 October 1991. The FACT Act mandated the Secretary to decide the marketing loan rate applicable for each of the 1991 to 1995 crops and the permanent law provided that the loan level for the 1992 crop of upland cotton be determined in accordance with a specific formula and announced not later than 1 November 1991.

[595] The A.R.P. is explained below at footnote 774. It has nothing to do with the ARP Act of 2000.

[596] Published at 58 Federal Register 15755 and reproduced in Exhibit US-146. See the United States' responses to Panel Questions No. 54 (at footnote 63) and 214.

[597] Exhibit US-146 see *supra*,footnote 596.

[598] Exhibit BRA-4.

[599] Brazil's response to Panel third party Question No. 54 and 22 August comments on the United States' response to Panel Question No. 54.

[600] This is so regardless of whether a rate of support is an appropriate measurement of support.

[601] The Regulation was published on 20 April 1992 at 57 Federal Register 14326 and is reproduced in Exhibit US-2. It established a loan rate of 52.35 cents per pound.

[602] See United States' response to Panel Question No. 54.

reflected in the 1992 Supplement to the United States Code,[603] the 1 January 1993 edition of the Code of Federal Regulations[604] and a USDA fact sheet published in September 1993.[605] However, the legislation prohibited any change to the loan rate during the 1992 marketing year after it was announced in the preceding calendar year.[606] It is less clear to what extent the Secretary had authority to change the target price but, in any event, the 1992 Supplement to the United States Code and the 1 January 1993 edition of the CFR published the target prices for all five years covered by the FACT Act of 1990, including the 1991 marketing year which had completely elapsed.[607] This indicates that no decision had been taken to change the target price in 1992 and suggests that these publications simply reprinted or reformatted the decision regarding the target price enacted in legislation in 1990. The USDA fact sheet simply reported what had already been decided. The United States argued that the Secretary did not exercise his discretion to alter the effective price in the 24 March 1993 regulations. That is an accurate statement. In fact, those regulations do not mention the target price, or deficiency payments, at all. Therefore, in the Panel's view, the evidence does not show that any decision was taken during the 1992 marketing year with respect to target prices, or with respect to the loan rate for the 1992 crop of upland cotton. There is no justification for interpreting the MY 1992 benchmark as the target price of 72.9 cents per pound.

7.451 In view of this evidence, the MY 1992 benchmark might be thought to be the loan rate of 52.35 cents per pound, subject to reduction of the A.R.P of 7.5 per cent. Neither of the parties submitted that the Panel should treat this as the MY 1992 benchmark. Although it is dictated by the apparently deliberate choice of an unusual word in this context, i.e. "decided" to contrast with "granted", rather than, say, "provided", it appears to lead to an absurd result. It reflects only the timing of certain discrete decisions but not the total level of support decided for upland cotton over time. This is all the more curious given that the final decisions on the loan rate and the A.R.P. were taken only three weeks before the wording of the condition in Article 13(b)(ii) was negotiated. Brazil suggested that the condition was negotiated with the European Communities' domestic support measures in mind, but it is unnecessary for the Panel to take a view on that suggestion for the purposes of this dispute.

7.452 The only other decisions on support for upland cotton in the United States during the 1992 marketing year were decisions to make particular payments under programmes to support upland cotton. Each of those was a "determination" of a recipient's entitlement to a payment, in a particular amount, according to the programme and payment conditions, and hence a "decision" on "support" taken "during the 1992 marketing year". Those determinations involved consideration by the United States government of its obligations or authority to make payments, and matters such as eligibility criteria, compliance with acreage conditions, relevant rates and prices, and volume of upland cotton harvested and used, as set out in the applicable laws and regulations. There is no evidence that payments determined by these decisions involved substantial delays from the time these decisions were taken such that they were made in a different marketing year from that in which the payments were made. The sum of these decisions represents an amount of support that can be compared meaningfully with implementation period support and which can be measured according to the same methodology. In the Panel's view, this is the correct measure of the MY 1992 benchmark in this dispute.

7.453 Brazil submits that there were four types of support to upland cotton in the 1992 marketing year: deficiency payments, marketing loan programme payments, user marketing (Step 2) payments

[603] Reproduced in Exhibit US-5.
[604] Reproduced in Exhibit US-3.
[605] Reproduced in Exhibit US-17.
[606] 7 USC §1444-2(a)(3) (1992 Supplement) (4 January 1993), reproduced in Exhibit US-5.
[607] 7 USC §1444-2(c)(1)(B)(ii) (1992 Supplement) (4 January 1993), reproduced in Exhibit US-5 and 7 CFR §1413.104(a), reproduced in Exhibit US-3.

and crop insurance payments.[608] The United States accepts that deficiency payments, marketing loan programme payments and user marketing (Step 2) payments are relevant for the purposes of the comparison under Article 13(b)(ii).[609] Its objection to the inclusion of crop insurance payments is that they are non-product-specific.[610] However, the evidence shows that upland cotton was an agricultural commodity for which the Federal Crop Insurance Corporation Act was authorized to offer crop insurance in that year.[611] All four types of payments granted support specifically to upland cotton.

7.454 The United States argues that this ignores how it decided support for upland cotton during the 1992 marketing year, which was in terms of a rate of support. No amount of outlays was "decided" during the 1992 marketing year since outlays or expenditures that are needed to provide this level of income support were neither known nor completed until after the marketing year ended and market prices reported.[612]

7.455 The Panel agrees that the United States did not adopt a discrete decision on the dollar amount of total outlays or expenditures that it would make for upland cotton during the 1992 marketing year. However, in the first place, the text of Article 13(b)(ii) *does not* require such a decision. The form of the decision or decisions by which support was decided is not addressed, which permits a comparison of a series of operational decisions (which are, relevantly, decisions) that determined the support; and secondly, the text of Article 13(b)(ii) *does* indicate that the relevant decision or decisions are those taken "during the 1992 marketing year". The target price for upland cotton was not such a decision, as it was taken during 1990, which prohibits the Panel from basing its comparison on that decision.

7.456 In summary, therefore, the Panel will include in the MY 1992 benchmark decisions made during the 1992 marketing year to make the following payments:

(i) deficiency payments;

(ii) marketing loan programme payments;

(iii) user marketing (Step 2) payments to domestic users[613]; and

(iv) crop insurance payments.

(c) Implementation period support

*(i) Interpretation*

i Main arguments of the parties

7.457 **Brazil** submits that the measures relevant to the implementation period support are all those which it has challenged. It submits that they in fact deliver support to upland cotton. These are the

[608] Brazil's first written submission, paras. 143-144.

[609] See the United States' first written submission, paras. 100-104, confirming that the first three types of payments constitute product-specific support to cotton. At para. 102 of that submission, the United States submits that deficiency payments ensured cotton farms would realize income support of 72.4 cents per pound through the following legislation: 7 CFR 1413 (1 January 1993 edition), 7 CFR 1413.6 (1991 edition) and 7 U.S.C. 1444-2 (1992 supplement), reproduced in Exhibits US-3, US-4 and US-5, respectively. See also the United States' rebuttal, paras. 110, 111 and table.

[610] See the United States' rebuttal submission, paras. 93-98.

[611] See FCIC "Crop Year Statistics" reproduced in Exhibit BRA-57.

[612] United States' first written submission, paras. 93-94; United States' oral statement at the first session of the first substantive meeting, paras. 10-11.

[613] A meaningful comparison requires the exclusion of user marketing (Step 2) payments to exporters from the MY 1992 benchmark support, as they are also excluded from the implementation period support.

marketing loan programme payments, user marketing (Step 2) payments to domestic users[614], PFC, MLA, DP and CCP payments, crop insurance payments and cottonseed payments.

7.458 Brazil submits that the ordinary meaning of Article 13(b)(ii) read in its context, requires the Panel to tabulate any non-green box domestic support payments that are linked in some manner to the production of upland cotton, and that there is nothing in the text of Article 13(b)(ii) limiting the support that must be tabulated to only that provided to a single commodity.[615]

7.459 The **United States** responds that the measures relevant to the implementation period support are only those which deliver product-specific support to upland cotton, namely benefits under the marketing loan programme, user marketing (Step 2) payments and, to the extent that they are within the Panel's terms of reference, cottonseed payments. It submits that "[t]he *measures* to be included in the calculation are identified by the phrase "support to a specific commodity".[616]

7.460 The United States argued that the phrase "grant support to a specific commodity" means "product-specific support", which it argued was defined as "support provided for an agricultural product in favour of the producers of the basic agricultural product", one of the components of the definition of AMS in Article 1(a) of the *Agreement on Agriculture*.[617]

7.461 **Brazil** disagreed with the United States' interpretation of "product-specific" in light of the components of the definition of AMS in Article 1(a) of the *Agreement on Agriculture*. It submitted that support provided "in favour of agricultural producers in general" was "non-product-specific" and that all other domestic support, including support provided for only a limited number of agricultural commodities, must be deemed "product-specific".[618]

7.462 The **United States** agreed that non-product-specific support is support in favour of agricultural producers in general but argued that the "precise definition" of product-specific support in Article 1(f) ensures that non-product-specific support is the residual category of support, covering those measures that do not fall within the phrase "support provided for an agricultural product in favour of the producers of the basic agricultural product" in Article 1(a). It also argued that recipients of decoupled payments *are* "producers in general" because they are free, with limited exceptions, to plant any commodity and are free, without exception, to undertake other agricultural activities.[619]

7.463 The United States argued that the allocation to one commodity of a share of any non-product-specific support has no basis in the *Agreement on Agriculture* and would erase the fundamental distinction between product-specific and non-product-specific support.[620] These categories are *sui generis* and may not be rendered inutile by the application of *SCM Agreement* concepts of subsidy, benefit and subsidized product which are not used in, nor directly applicable to, Article 13 of the *Agreement on Agriculture*. Brazil's approach treats a payment calculated with respect to base acreage historically planted to one crop as support to that crop and any other programme crop at the same time which is not support "to a specific commodity" but support to multiple commodities.[621] It factors in producer decisions about what to plant and how to spend decoupled payments, which would rob Members of their ability to comply with the conditions in Article 13(b).[622]

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[614] See *supra*, footnote 464.
[615] Brazil's rebuttal submission, para. 14.
[616] United States' 3 March 2004 comments, para. 14, second bullet.
[617] United States' first written submission, paras. 77-78 and its rebuttal submission, para. 73
[618] Brazil's rebuttal submission, para. 21 and its response to Panel Question No. 38.
[619] United States' rebuttal submission, para. 83, comments on Brazil's response to Panel Question No. 258 and its 11 February 2004 comments, paras. 7-14.
[620] United States' rebuttal submission, paras. 76 and 79.
[621] United States' comments on Brazil's response to Panel Question No. 258.
[622] United States' closing statement at second substantive meeting, para. 25.

ii Main arguments of the third parties

7.464 **Argentina** argues that the relevant support under Article 13(b)(ii) is made up of payments for a specific commodity (including the revenue foregone under Article 1(c) of the *Agreement on Agriculture)*, whether those payments are classified as product-specific or non-[product] specific, as well as other forms of domestic support in monetary terms as set forth in Annex 3.[623]

7.465 **Australia** agrees with Brazil that support "to a specific commodity" is support granted to an individual agricultural commodity covered by Annex 1 of the *Agreement on Agriculture*, such as upland cotton, whether through product specific or non-product-specific support. Had the negotiators intended that "support to a specific commodity" in the context of Article 13(b)(ii) and (iii) mean product-specific AMS only, they would have said so in the text. The portions of the direct payment and counter-cyclical payment programmes that benefit upland cotton should be included in the calculation of "support to a specific commodity" within the meaning of Article 13(b)(ii).[624]

7.466 **Canada** submits that "specific commodity" means a commodity that is clearly and explicitly defined. Article 13(b)(ii) requires an examination of all support that is not exempt under Annex 2 and that benefits a "precise", "exact" or "defined" commodity, which may be provided either through product-specific or non-product-specific support programmes. Deletion of the word "specific" would imply an examination of support benefiting a potentially broader product class, a result that is not supported by the text of Article 13(b)(ii).[625]

7.467 **China** argues that where support measures are generally available to a number of products including upland cotton, the term "specific commodity" requires breaking up and attributing general budgetary outlay to each specific product for comparison under the proviso. For the purpose of this case, only the portion of outlay that was used for upland cotton is relevant for that comparison. Outlays broken up for other products covered by the same programme is not at issue before this Panel.[626]

7.468 The **European Communities** agrees with the United States' approach that the correct comparison is between product-specific support decided in the 1992 marketing year and product-specific support currently granted. It argues that support which is provided to a number of crops cannot at the same time be considered "support to a specific commodity". Such support is support to several commodities or support to more than one commodity. There is no reason that the support granted should not be calculated on the basis of the AMS methodology set out in Annex 3. Indeed, Article 1(a) of the *Agreement on Agriculture* refers to AMS as the annual level of *support*.[627]

7.469 **New Zealand** disagrees with the United States' argument that "support granted to a specific commodity" should be read as meaning "product-specific support". Members listed in detail domestic support measures potentially exempt in the chapeau to Article 13(b) and they used the phrase "product-specific" at least five times elsewhere in the Agreement. Had they intended to exclude non-product-specific support or limit Article 13(b)(ii) to "product specific" support, they would have said so. There is no basis on which support to a specific commodity should be excluded simply because other commodities may receive similar support, since support provided through generally available programmes is still support received for the individual products. Brazil proposes an approach in relation to domestic support which is no more than what the United States has done in relation to export credit guarantees – where it allocates export credit administrative costs to the specific product

[623] Argentina's response to Panel third party Question No. 21.

[624] Australia's written submission to the first session of the first substantive meeting, para. 23 and its oral statement at the first session of the first substantive meeting, paras. 21-25.

[625] Canada's response to Panel third party Question No. 17.

[626] China's response to Panel third party Question No. 14.

[627] European Communities' oral statement at the first session of the first substantive meeting, paras. 21, 24 and its response to Panel third party Question No. 22.

of upland cotton. The same arguments can be made with respect to the payments under the crop insurance programmes.[628]

iii Evaluation by the Panel

7.470 The Panel begins its analysis by noting that the parties agree that the chapeau of paragraph (b) refers to all non-green box domestic support measures that comply with the obligations in the *Agreement on Agriculture*. The chapeau of paragraph (b) and subparagraph (ii) form part of a single sentence. The chapeau is incomprehensible without the subparagraphs, and subparagraph (ii) is incomprehensible without the chapeau. The words in subparagraph (ii) "exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement" are a predicate of the subject in the chapeau. The proviso "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" is a subordinate clause of the same sentence. It is not a stand-alone provision even though it creates an additional condition.

7.471 The subject of the proviso is "such measures", not "measures", which refers back to those measures which are the subject of paragraph (b), that is, all non-green box domestic support measures that conform fully to the provisions of Article 6 of the *Agreement on Agriculture*.[629] These are product-specific domestic support, non-product-specific domestic support, both including *de minimis* support, plus blue box and S&D box support. *All* such measures are relevant to the condition in the proviso and can potentially be taken into account in assessing implementation period support. An interpretation which excluded any of these categories of support from the assessment of implementation period support, would be inconsistent with the wording and grammar of the sentence in paragraph (b) of Article 13, including the proviso.[630]

7.472 The subject of the proviso "such measures" therefore indicates which *are* the relevant measures. The verb and object in the proviso refer to what those measures *do*: namely, grant support to a specific commodity. All of such measures must be included in the calculation of support for the purposes of the proviso to the extent that each one grants support to a specific commodity. This will exclude such measures that only grant support to *other* specific commodities not at issue as well as such measures that do not grant support to *any* specific commodity.

7.473 The Panel must interpret the phrase "grant support to a specific commodity" as it is used in subparagraph (ii). We begin by noting that the term "product-specific support" is not used.[631]

7.474 This use of the verb "grant" with "support" is unique in the English version of the *Agreement on Agriculture* which, except for this provision, only uses the verb "provide" with domestic support.[632] However, the same distinction is not made in the French and Spanish versions which generally use *"accorder"* and *"otorgar"*, respectively, with domestic support. The word "grant" can be defined as follows:

[628] New Zealand's written submission to the first session of the first substantive meeting, paras. 2.21-2.26.

[629] Brazil has not claimed that these measures do not conform fully to those provisions. The Panel makes no findings in respect of those provisions.

[630] But see footnote 629.

[631] That term does not, in fact, appear anywhere in the *Agreement on Agriculture*, although the term "product-specific domestic support" is used in Article 6.4(a)(i), and the term "product-specific" is used in paragraph 2(b) of Annex 2, paragraph 1 of Annex 3 and paragraphs 2 and 3 of Annex 4.

[632] The English version also uses "grant" in relation to export subsidies in Articles 9.2(ii) and 10.3.

> "To bestow or confer (a possession, right, etc.) by a formal act. Said of a sovereign or supreme authority, a court of justice, a representative assembly, etc. Also, in *Law*, to transfer (property) from oneself to another person, especially by deed."[633]

7.475 This definition was also cited by the Appellate Body in *Brazil – Aircraft* in a different context in relation to the phrase the "level of export subsidies granted" in a certain year in footnote 55 to Article 27.4 of the *SCM Agreement*. The Appellate Body interpreted "grant" to mean "something actually provided":

> "(…) To us, the word 'granted' used in this context means "something actually provided". Thus, to determine the amount of export subsidies 'granted' in a particular year, we believe that the actual amounts *provided* by a government, and not just those *authorized* or *appropriated* in its budget for that year, is the proper measure. A government does not always spend the entire amount appropriated in its annual budget for a designated purpose. Therefore, in this case, to determine the level of export subsidies for the purposes of Article 27.4, we believe that the proper reference is to actual expenditures by a government, and not to budgetary appropriations."[634]

7.476 This interpretation is consistent with our earlier observation that the word "decided" is contrasted with "granted" in Article 13(b)(ii) of the *Agreement on Agriculture*[635]. "Decided" refers to what the government determines, but "grant" refers to what its measures provide.

7.477 The direct object of the verb "grant" is "support", which we have discussed at paragraphs 7.420 to 7.423 above.

7.478 The indirect object of "grant" is "a specific commodity" which is not a defined term and is used nowhere else in the *Agreement on Agriculture*. This is significant because the same agreement does define the similar term "basic agricultural product" in Article 1(b) which it uses in the definitions of AMS, EMS and Total AMS in Article 1(a), (d) and (h), respectively, and in numerous places in the respective methodologies for calculation of AMS and EMS in Annexes 3 and 4, as well as in the provision on calculation of *de minimis* "product-specific domestic support" in Article 6.4(a)(i). It is especially significant since those provisions are all used in the calculation of support to determine whether domestic support measures conform fully to the provisions of Article 6, which is the principal condition set out in the chapeau of paragraph (b) of Article 13. In the Panel's view, the choice of a different term in all three authentic versions of the text in relation to the same measures in the proviso in subparagraph (b)(ii) indicates that it is not appropriate to calculate an AMS on a product-specific basis for the purposes of the additional condition in Article 13(b)(ii). Rather, a bespoke measurement is required.

7.479 The Panel will interpret the words "a specific commodity" in the usual way.[636] The ordinary meaning of a "commodity" can be defined as follows:

> "A thing of use or value; *spec.* a thing that is an object of trade, *esp.* a raw material or agricultural crop."[637]

7.480 The word "commodity" must be read in the context of Article 2 of the *Agreement on Agriculture* which provides that the agreement applies to the products listed in Annex 1 to the

[633] *The New Shorter Oxford English Dictionary*, (1993).
[634] Appellate Body Report, *Brazil – Aircraft*, para. 148.
[635] We noted this contrast at paragraph 7.435 of this report.
[636] The Panel will apply the general rule of interpretation set out in Article 31 of the Vienna Convention on the Law of Treaties and, if appropriate, have recourse to the supplementary means of interpretation set out in Article 32 .
[637] *The New Shorter Oxford English Dictionary*, (1993).

Agreement. The product coverage of the Agreement is narrower than this dictionary definition, because it covers only agricultural products and not all things of use or value nor all things that are the object of trade nor all raw materials. The product coverage of the Agreement is broader than an agricultural crop because it covers products such as livestock, meat, dairy products and wool. All products within the coverage of the Agreement are covered by the chapeau of paragraph (b) and there is no reason to assume that support to any of them is excluded from the scope of the condition in subparagraph (ii). Therefore, we will treat the word "commodity", in this context, as basically synonymous with one of the "agricultural products" defined in Article 2 and Annex 1 but it cannot be assumed that any provision which refers to "agricultural products", as defined, necessarily applies to a commodity within the meaning of Article 13(b)(ii).

7.481 The word "specific" qualifies "commodity". The ordinary meaning of "specific" in this context can be defined as "clearly or explicitly defined; precise, exact; definite".[638] It indicates that the commodity to which support is granted should be clearly or explicitly defined. The question is where? There is no reduction commitment per commodity nor any notification obligation under Article 13(b)(ii). In this dispute, the commodity at issue with respect to domestic support is "upland cotton" which is clearly and explicitly defined in the Panel's terms of reference. However, the place in which commodities will always be defined is in the measures themselves under which the support is granted. In the Panel's view, that is the place where a commodity must be specified for it to be relevant to the additional condition in Article 13(b)(ii). Therefore, the additional condition requires a comparison of support granted by all measures covered by paragraph (b) of Article 13, i.e. non-green box measures, that clearly or explicitly define a commodity as one to which they bestow or confer support.

7.482 Another definition of "specific" is "specially or peculiarly pertaining to a particular thing or person, or a class of these; peculiar (*to*)". This definition is appropriate in a different context, such as "job-specific" or "product-specific" where the word "specific" together with the other term such as "job" or "product" qualifies another noun. However, in the context of Article 13(b)(ii) it is inappropriate because here it alone qualifies "commodity".

7.483 There is no reason to assume that the relevant measures may specify only one commodity. The measures may clearly and explicitly define various commodities. The subject of the proviso is "such measures" which includes all non-green box measures, including any which specify more than one commodity. A key feature of the additional condition in subparagraphs (b)(ii) and (iii) is that it relates support to individual commodities, which distinguishes it notably from the reduction commitments expressed in terms of Total AMS that are cross-referenced in the chapeau of paragraph (b). There is no reason to identify measures that deliver support to only one commodity for the purpose of Article 13(b)(ii) or (iii). If a measure specifies more than one commodity, it would be appropriate to measure the amount of support granted to each of them in accordance with the terms of the measure itself.

7.484 Support granted in accordance with a volume of current production should be measured in that way. Measures which grant support in accordance with other parameters, such as volume of historical production, may not be subject to paragraph (b) of Article 13 at all. If they conform fully to the provisions of Annex 2, they are exempt from reduction commitments and are protected by paragraph (a) of Article 13. If they do not so conform, they are covered by paragraph (b) of Article 13. In the Panel's view, where these measures identify and allocate support based on an express linkage to specific commodities, they provide support to those commodities within the meaning of subparagraph (b)(ii), read in its context and in the light of its object and purpose. Where, for example, these measures specify commodities in the eligibility criteria and payment rates, they constitute support to the commodities specified in that way. This applies *a fortiori* where the payments are determined according to, or are related to, current market prices of the specific

[638] *The New Shorter Oxford English Dictionary*, (1993).

commodities. Support granted in this way should be measured in the same way as the actual payments are determined.

7.485 The United States argues that "support" in the phrase "support to a specific commodity" in Article 13(b)(ii) and in the term "product-specific support" in Article 1(a) refers to support to a crop, not a farmer, so that programmes that do not oblige a farmer to grow a particular crop cannot be "support" in this sense.[639]

7.486 The Panel notes that its interpretation refers to the domestic support measures which specify commodities to which support is provided. In any event, all "support" referred to in Article 6.1 and 6.3 and included in Article 1(a), is provided in favour of "producers".[640] Even support provided "for" an agricultural product is provided "in favour of" the producers of the basic agricultural product. All such support is covered by paragraph (b) of Article 13 and, hence, subparagraph (ii). It is clear that "support" in this context, although granted "to" a specific commodity, is also provided "in favour of" producers.

7.487 The Panel's interpretation enables WTO Members to ensure that their domestic support measures satisfy this additional condition, since the Members are responsible for what their measures clearly and explicitly define, and how much they grant. Were this not so, and the proviso focused on where support was spent due to reasons beyond the control of the government, such as producer decisions on what to produce within a programme, it would introduce a major element of unpredictability into Article 13, and render it extremely difficult to ensure compliance. It is not clear how Members providing support would ever be able to ensure that their domestic support measures satisfied this additional condition. The additional condition would become an impenetrable barrier for other Members who wished to challenge support provided by a Member who, unlike the United States, did not maintain detailed records about payment recipients. This would undermine the security and predictability of the multilateral trading system, which would be at odds with the function of the WTO dispute settlement system as set out in Article 3.2 of the *DSU*.

7.488 This consideration is manifest in the domestic support disciplines of the *Agreement on Agriculture*. Domestic support is often provided in a way dependent on market prices, either in the form of market price support or direct payments dependent on a price gap. Market prices of agricultural products are generally beyond the control of a government. The *Agreement on Agriculture* provides a methodology to measure domestic support which filters out the fluctuations in market prices, by using the gap between a fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price ("price gap methodology").[641] It does not filter out changes in the volume of eligible production. This confirms that a prime consideration of the drafters was to ensure that Members had some means of ensuring compliance with their commitments despite factors beyond their control.

7.489 The Panel also notes that in Canada – Dairy (Article 21.5 – New Zealand and US II), the Appellate Body considered that an examination of conformity with another provision of the Agreement on Agriculture should reflect the fact that the provision was an international obligation imposed on Members. It considered that the data on producers' actions that was relevant in that dispute should be treated in a way that could be used to assess a Member's compliance with that obligation. 642

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[639] United States' 3 March 2004 comments, para. 18.

[640] Articles 3.2 and 7.2(a) of the *Agreement on Agriculture* also refer to domestic support "in favour of domestic producers" and "in favour of agricultural producers" respectively.

[641] Paragraphs 8 and 10 of Annex 3 to the *Agreement on Agriculture*.

[642] Appellate Body report in *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 96, concerning Article 9.1(c) of the *Agreement on Agriculture*. We do not consider it material that the provision under consideration referred to "payments [...] financed by virtue of governmental action".

7.490 The United States submits that the phrase "do not grant support to a specific commodity" means "do not grant product-specific support" although it admits that "[i]t is not possible to determine exactly why the drafters of Article 13(b)(ii) did not use the term "product-specific support".[643] At the same time, the United States submits that the fact that the drafters did not use the term "AMS" when it was readily available and a key concept, indicates that they did not intend the Article 13(b)(ii) comparison to require the use of product-specific AMS.[644]

7.491 The Panel notes that its interpretation of "support to a specific commodity" bears some similarity to product-specific domestic support. However, the phrase "support to a specific commodity" is unique to Article 13(b). The phrase "product-specific domestic support" (not "product-specific support") appears in the *de minimis* provision in Article 6.4(a)(i) and the phrase "support … provided for an agricultural product in favour of the producers of the basic agricultural product" appears in the definition of AMS in Article 1(a). Both those concepts are relevant to Article 13(b) but the class of measures which is covered by paragraph (b) is broader than either of them. The choice of a different phrase in Article 13(b)(ii) and (iii) indicates that the other two are not pertinent to the additional condition in the proviso.[645]

7.492 The object and purpose of the additional condition in subparagraphs (ii) and (iii) are to provide an additional condition linking the domestic support commitments and disciplines of the *Agreement on Agriculture*, on the one hand, to the actionable subsidies obligation in Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994* and non-violation complaints arising from tariff concessions, on the other hand. Our interpretation of the phrase "support to a specific commodity" is consistent with that object and purpose. Nothing indicates that the purpose of the additional condition is to focus on product-specific domestic support.

7.493 The treatment of domestic support measures in paragraph (b) of Article 13 can be contrasted with that of export subsidies in paragraph (c). Both paragraphs (b) and (c) link commitments in the *Agreement on Agriculture* with the *SCM Agreement*, both set out conditions that are substantive obligations of the *Agreement on Agriculture*, yet paragraph (c) contains no additional condition applicable to export subsidies analogous to that applicable to domestic support measures under the proviso in subparagraphs (ii) and (iii) of paragraph (b). Export subsidies are subject to commitments in respect of individual products - there are specific commitments in respect of scheduled products and, effectively, zero commitments for unscheduled products. An additional condition in terms of individual products is therefore unnecessary in Article 13(c) since the substantive obligations themselves are expressed in terms of specific products and not in the aggregate.

7.494 The Panel therefore considers that the phrase "grant support to a specific commodity", as used in Article 13(b)(ii):

(i) means all non-green box support measures that clearly or explicitly define a commodity as one to which they bestow or confer support; and

(ii) does not mean "grant product-specific domestic support".

7.495 This interpretation is confirmed by the drafting history.[646] The text of subparagraphs (ii) and (iii) of paragraph (b) appeared in the Uruguay Round text following the first US/EC Blair House agreement of November 1992.[647] During 1990 and 1991 the agriculture negotiators considered

[643] See United States' response to Panel Question No. 37.
[644] United States' first written submission, paras. 86-87.
[645] The term "product-specific subsidy" is also used in paragraph 3 of Annex 4.
[646] The Panel has recourse to supplementary means of interpretation in accordance with Article 32 of the Vienna Convention on the Law of Treaties in order to confirm the meaning resulting from the application of the general rule of treaty interpretation in Article 31 of that convention.
[647] See the draft Article which formed part of that agreement in Exhibit EC-1.

expressing reduction commitments in terms of AMS "per product" or "per commodity" with a sector-wide AMS for non-product-specific support.[648] The agriculture text in the draft final Act of December 1991 had provided domestic support reduction commitments in just these terms. Draft Article 6.1 provided *in fine*:

> "These [domestic support] commitments are expressed in terms of Aggregate Measurements of Support and of equivalent commitments."

7.496 Draft Article 6:3 provided that:

> "A participant shall be considered to be in compliance with its domestic support reduction commitments in any year where the sector-wide and product-specific AMS values for support, or the equivalent commitments, do not exceed the corresponding annual commitment levels specified in the Schedule of domestic support commitments of the participant concerned."[649]

7.497 In contrast, the *Agreement on Agriculture* as finally agreed substituted Total AMS commitments for the product-specific commitments. It provides in Article 6.1 *in fine* and in Article 6.3 as follows:

> "The commitments are expressed in terms of Total Aggregate Measurement of Support and "Annual and Final Bound Commitment Levels."; and
>
> "A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule."

7.498 Draft Article 6:4 had provided for *de minimis* exclusions from domestic support commitments in the case of both "product-specific support" and the "sector-wide AMS".[650] Article 6.4 as finally agreed provides for *de minimis* exclusions from Current AMS, to be calculated according to whether support is "product-specific domestic support" or "non-product-specific domestic support".

7.499 Draft Article 12 had provided that:

> "Where reduction commitments on domestic support and export subsidies are being applied in conformity with the terms of this Agreement, the presumption will be that they do not cause serious prejudice in the sense of Article XVI:1 of the General Agreement."[651]

7.500 This was replaced by Article 13 in the *Agreement on Agriculture* as finally agreed. The presumption was replaced with the exemptions from actions, among other things, discussed above in Section VII:C. The conditions still include the reduction commitments – now expressed in terms of Total AMS – in the chapeau of paragraph (b), but they also include an additional condition regarding "support to a specific commodity" in subparagraphs (ii) and (iii).

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[648] See Negotiating Group on Agriculture documents "Framework Agreement on Agriculture Reform Programme", Draft Text by the Chairman, document MTN.GNG/NG5/W/170, dated 11 July 1990, para. 5, reproduced in Exhibit US-25; "Options in the Agriculture Negotiations", Note by the Chairman, document MTN.GNG/AG/W/1 dated 24 June 1991, para. 17, reproduced in Exhibit US-26; and an addendum in document MTN.GNG/AG/W/1/Add.1 dated 2 August 1991, reproduced in Exhibit US-27.

[649] Document MTN.TNC/W/FA, page L.7, reproduced in Exhibit US-29.

[650] Document MTN.TNC/W/FA, page L.7, reproduced in Exhibit US-29.

[651] Document MTN.TNC/W/FA, page L.9, reproduced in Exhibit US-29.

7.501 The drafting history shows three things: (1) the additional condition referring to "support to a specific commodity" ensures that there is still a domestic support condition (although not an obligation) in the *Agreement on Agriculture*[652] which is defined on an individual product basis despite the disappearance of per product domestic support commitments from the draft text; (2) the drafters had not limited the proposed presumption in serious prejudice cases to product-specific support but had envisaged that the presumption could apply to non-product-specific support depending on whether it complied with the proposed sector-wide reduction commitment, which was later removed; and (3) the drafters chose to retain the term "product-specific" when they revised draft Article 6:4, where it now appears in context with "non-product-specific", but they chose not to use it when they replaced draft Article 6:3 and inserted the additional condition in Article 13(b)(ii) and (iii). This supports the Panel's interpretation to the extent that the drafters did not intend to exclude from this condition any support that was granted to a specific commodity, irrespective of whether it was "product-specific" domestic support or not.

7.502 The Panel's interpretation maintains the distinction between green box and non-green box domestic support which is fundamental to Article 13. It also maintains the identity between the subject of the chapeau of paragraph (b) and subparagraph (b)(ii). It respects the wording of the proviso by comparing support that is granted to a specific commodity with the benchmark relevant to that specific commodity and excluding all other support, which either grants support to other specific commodities or does not grant support to any specific commodity. Brazil acknowledges this implicitly in that it does not challenge very widely available support, such as infrastructure and irrigation subsidies, some of which, presumably, deliver support to upland cotton either directly or indirectly.[653]

7.503 The Panel is not required to interpret the difference between the terms "product-specific domestic support" and "non-product-specific domestic support" used in Article 6.4(a) nor the difference between the phrases "support ... provided for an agricultural product in favour of the producers of the basic agricultural product" and "non-product-specific support provided in favour of agricultural producers in general" used in Article 1(a). Those differences are not relevant to the sole condition that Brazil alleges that the United States' non-green box domestic support measures do not satisfy. It suffices for us to observe that, to the extent that non-product-specific domestic support can specify commodities to which support is in some way delivered (a question which we do not decide), an interpretation of Article 13(b)(ii) that excluded all non-product-specific domestic support would create a novel and potentially large category of support which did not fall within Article 13(a), nor fully within Article 13(b), which would be subject to the chapeau of Article 13(b) but not the additional condition in the proviso. This would ignore the subject of the proviso which is "such measures" without any basis in the text or context nor any justification in the object and purpose of the provision. This would be some unknown kind of "pale amber", non-product-specific box which the drafters clearly did not intend to create.

7.504 The Panel notes that the four types of support with planting flexibility, namely PFC, MLA, DP and CCP payments, have, in turn, followed deficiency payments under the FACT Act of 1990. The parties agree that deficiency payments form part of the MY 1992 benchmark. The replacement of deficiency payments, which were product-specific, with these other types of support is the principal difference between the support delivered to upland cotton during the implementation period under the 1996 and 2002 farm bills, and the period immediately prior to that under the 1990 farm bill.[654] If implementation period support were limited to product-specific support, the comparison under Article 13(b)(ii) would primarily be a comparison of deficiency payments, which were tied to the production of specific commodities, and the later measures, which are principally tied to production

[652] Besides the *de minimis* provision in Article 6.4(a)(i) which is relevant to calculation of Current Total AMS.

[653] See Brazil's response to Panel Question No. 41 and the United States' rebuttal submission, para. 79.

[654] The United States agrees with this view: see its 11 February 2004 comments, paras. 15-16.

of those specific commodities in a base period. The text of Article 13 and the architecture of the *Agreement on Agriculture* make clear that such a shift should only be determinative where the change in method of delivery is a shift to green box support or to support that is not granted to a specific commodity. Therefore, the Panel's interpretation does not "rob" Members of their ability to shift to decoupled payments and still comply with the Article 13. Decoupled payments that conform fully to the provisions of Annex 2 automatically comply with the conditions in Article 13(a), and others that conform fully with Article 6 and the additional condition in Article 13(b)(ii), also comply with Article 13.

7.505 The Panel's interpretation does not "erase the distinction" between product-specific and non-product-specific support. That distinction remains essential to the calculation of Total AMS for the purposes of reduction commitments, which is germane to the chapeau of paragraph (b) of Article 13, but not the additional condition in subparagraph (ii). No reason has been advanced in these proceedings that would explain why the drafters would have distinguished between product-specific and non-product-specific domestic support when they determined the additional condition under which measures which could be exempt from certain types of actions. In fact, in a prior draft of the *Agreement on Agriculture* which did distinguish between the two methods of delivery, they expressly proposed parallel conditions under which both would be exempt from such actions.

7.506 The United States acknowledges the "simple fact" that non-product-specific support delivers support to various agricultural commodities.[655] Without accepting that these programmes are non-product-specific, from the Panel's perspective, the only question is how to include only the amount of support that the programmes at issue grant to any specific one of those agricultural commodities. Such an allocation is not required for the calculation of AMS or Total AMS because non-product-specific support is calculated separately from product-specific support. However, that is relevant only to the reduction commitments which are referred to in the chapeau of paragraph (b) of Article 13, not the additional condition in subparagraphs (ii) and (iii). There is no reason to assume that an allocation of support delivered by a single measure to more than one agricultural commodity cannot be called for under the *Agreement on Agriculture*. Indeed, allocation of the extent to which a measure delivers support to a particular product is not alien to the Agreement, since support measures directed at agricultural processors are included in measurements of support only to the extent that such measures benefit the producers of the basic agricultural product.[656]

*(ii) Relevant measures*

i Main arguments of the parties

7.507 **Brazil** claims that all of the measures at issue are relevant and should be included as measures which grant support to the specific commodity of upland cotton.

7.508 The **United States** accepts that marketing loan programme payments, user marketing (Step 2) payments and cottonseed payments are product-specific support. It does not accept that PFC, MLA, DP, CCP and crop insurance payments grant support to a specific commodity.

ii Evaluation by the Panel

7.509 The Panel recalls its finding at paragraph 7.494 and will examine each of the domestic support measures at issue in turn to determine whether they clearly and explicitly define upland cotton as a commodity to which they bestow or confer support.

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[655] United States' 3 March 2004 comments, para. 4.

[656] Paragraph 7 of Annex 3 and paragraph 4 of Annex 4 of the *Agreement on Agriculture*. The Panel agrees with the United States that this does not suggest any methodology that would allocate non-product-specific support as "support to a specific commodity" - see the United States' 3 March 2004 comments, para. 13.

7.510 Under the marketing loan programme, producers on a farm are eligible for a marketing assistance loan for any quantity of a "loan commodity" produced on the farm[657] and the Secretary may make loan deficiency payments ("LDPs") available to producers on a farm eligible to obtain a marketing assistance loan with respect to a "loan commodity".[658] Upland cotton is defined specifically as a "loan commodity".[659] The current legislation specifies a loan rate of "in the case of upland cotton, $0.52 per pound" and the former legislation specified a formula to establish "the loan rate for a marketing assistance loan (...) for upland cotton", which was published in a regulation annually.[660] There is a special provision in the repayment rate for upland cotton and rice[661] and a special provision on the adjustment of the prevailing world market price for upland cotton.[662]

7.511 User marketing (Step 2) payments are made under a provision titled "Special marketing loan provisions for upland cotton". They are available only to domestic users and exporters of "upland cotton" and are contingent upon certain price quotations for upland cotton.[663]

7.512 Cottonseed payments were made to assist producers and first handlers of the 2000 crop of "cottonseed".[664] Cottonseed is a part of harvested raw cotton. The evidence shows that approximately 97 per cent of the annual United States cotton crop is from upland cotton.[665]

7.513 PFC payments were made in respect of cropland covered by a contract. Eligible cropland had to satisfy very specific eligibility criteria, in that it had to be land that, for at least one of the 1991 through 1995 crops, was enrolled in the acreage reduction programme authorized for a crop of seven contract commodities or was considered planted or subject to a conservation reserve contract.[666] Upland cotton was specified as one of those contract commodities.[667] The legislation made allocations for specific commodities from the amounts appropriated to PFC contracts, including the following:

> "(b) ALLOCATION. - The amount made available for a fiscal year under subsection (a) shall be allocated as follows:
>
> (...)
>
> (6) for upland cotton, 11.63 per cent"[668]

7.514 The legislation provided a formula to determine the payment rate for upland cotton and each other contract commodity, which was published in regulations. The rate depended on the acreage enrolled as upland cotton base and the yield which was also specific to upland cotton.[669]

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[657] Sections 1201-1204 of the FSRI Act of 2002, and sections 131-134 of the FAIR Act, respectively.
[658] Section 1205 of the FSRI Act of 2002 and section 135 of the FAIR Act of 1996, respectively.
[659] Section 1001(8) of the FSRI Act of 2002 and section 102(5) and (10) of the FAIR Act of 1996, respectively.
[660] Section 1202 of the FSRI Act and section 132(c) of the FAIR Act of 1996, respectively.
[661] Section 1204(b) of the FSRI Act of 2002 and section 134(b) of the FAIR Act of 1996, respectively.
[662] Section 1204(e) of the FSRI Act of 2002 and section 134(e) of the FAIR Act of 1996, respectively.
[663] Section 1207 of the FSRI Act of 2002 and section 136 of the FAIR Act of 1996, respectively.
[664] Section 204(e) of the ARP Act of 2000, section 6 of Public Law 107-25, and 7 CFR 1427.1100 (1 January 2002 edition), reproduced in Exhibits BRA-137, BRA-138 and BRA-32, respectively.
[665] USDA Economic Research Service Briefing Room Cotton document, reproduced in Exhibit BRA-13.
[666] Section 111(d) of the FAIR Act of 1996.
[667] Section 102(5) of the FAIR Act of 1996.
[668] Section 113(b)(6) of the FAIR Act of 1996.
[669] Section 114 of the FAIR Act of 1996.

7.515 MLA payments were intended as additional PFC payments to respond to low prevailing prices of commodities, including upland cotton. They were paid proportionally in accordance with entitlements to PFC payments.[670]

7.516 DP and CCP payments are available in respect of acreage planted on a farm which has to satisfy very specific eligibility criteria, which begin with the criterion that it was planted to one of nine covered commodities for the 1998 through 2001 crop years.[671] Upland cotton is one of the covered commodities[672] The legislation provides for a DP payment rate as follows: "upland cotton, $0.0667 per pound".[673] The legislation provides that CCP payments are paid when the effective price for the covered commodity is less than the target price for the covered commodity[674] and provides for a target price in the 2002 and 2003 crop years, as well as subsequent crop years as follows: "upland cotton, $0.7240 per pound".[675]

7.517 With respect to crop insurance payments, the Federal Crop Insurance Corporation ("FCIC") is authorized to offer insurance or reinsurance for insurers of, producers of "agricultural commodities" grown in the United States under one or more plans determined by the FCIC to be adapted to the agricultural commodity concerned.[676] "Cotton" is specified as an "agricultural commodity".[677] The major plan type (actual production history) is available for approximately 100 agricultural commodities, and specifies upland cotton as one of them.[678] The other four plan types (group risk, crop revenue coverage, income protection and revenue assurance) are available only for a limited number of eight commodities or less and they each specify upland cotton as one of them. The proportion of the premium borne by the FCIC is set out in each plan. USDA maintains separate accounts for the amount of premium payments borne by the FCIC for each crop, including one that is specific to cotton.[679] Certain sample policy provisions specify cotton crops.[680] The legislation contains "Special Provisions for Cotton and Rice" which require the FCIC to offer plans of insurance that cover losses of upland cotton, ELS cotton and rice resulting from failure of irrigation water supplies due to drought or saltwater intrusion.[681]

7.518 In view of the above, the Panel finds that Brazil has made a prima facie case that each of these measures clearly and explicitly specifies upland cotton or, in the case of crop insurance

[670] See Brazil's first written submission, paras. 60-61, and its rebuttal submission, para. 29 and the United States' rebuttal submission, paras. 99-101 and its response to Panel Question No. 43.

[671] Section 1101 of the FSRI Act of 2002, which contains other eligibility criteria, notably with respect to oilseed acreage.

[672] Section 1001(4) of the FSRI Act of 2002.

[673] Section 1103(b)(6) of the FSRI Act of 2002.

[674] Section 1104(b) of the FSRI Act of 2002.

[675] Section 1104(c)(1)(F) and (2)(F) of the FSRI Act of 2002.

[676] Section 508 of the FCIC Act.

[677] Section 518 of the FCIC Act.

[678] See USDA Risk Management Agency lists of crops covered under the 2002 and 2003 crop years crop insurance programmes, reproduced in Exhibits BRA-62 and BRA-57, respectively; Brazil's rebuttal submission, para. 55, and United States' 27 August 2003 comments, footnote 48.

[679] Examples for the 1992 and 1999 through 2003 marketing years are reproduced in Exhibit BRA-57. See also Brazil's oral statement at the first session of the first substantive meeting, para. 63 and its rebuttal submission, paras. 50 and 53. The United States also supplied data presented by year and plan type showing the amount and percentage of upland cotton acreage coverage, premiums paid by upland cotton producers and insurance indemnity payments to upland cotton producers; see Exhibits US-65, US-66 and US-67, respectively.

[680] See "Income Protection – Cotton Crop Provisions" USDA FCIC, 2000-321 and "Cotton Crop Provisions" USDA FCIC, 99-021, reproduced in Exhibits BRA-174 and BRA-175.

[681] Section 508(a)(8) of the *Federal Crop Insurance Act*, 7 USC 1508(a)(8), inserted by section 162 of the *Agricultural Risk Protection Act of 2000* applicable since the 2001 crops.

payments and cottonseed payments, cotton[682], as a commodity to which they grant support within the meaning of Article 13(b)(ii).

7.519 The United States argues that the four types of support with planting flexibility do not grant support to upland cotton because they are not product-specific support and because they contain no requirement to produce.

7.520 The Panel does not consider that the United States has rebutted Brazil's case for two reasons: (1) the "product-specific" criterion is not based in the text of Article 13; and, therefore, (2) the result of the United States' argument would be that these types of support – which total several billion dollars for specific covered commodities – are not in fact support to any commodity.

*(iii) Payments under expired programmes*

i Main arguments of the parties

7.521 The parties agree that PFC and MLA payments, as well as cottonseed payments for the 2000 crop, were made under expired programmes.[683]

7.522 The **United States** argues that the present tense phrasing of "do not grant support" rather than the past tense ("did not grant") or the future tense ("will not grant"), indicates that determining whether measures currently in effect are exempt from actions depends upon the support which they currently grant.[684]

7.523 **Brazil** replies that the United States' interpretation would create a sweeping limitation on the right of WTO Members to challenge any domestic support payments not "currently" provided. It calls this a "statute of limitations" approach under which a subsidizing Member would be absolved of any responsibility for serious prejudice caused by domestic support provided during the prior marketing year, so long as the measures have not been challenged prior to the 1 August marketing year deadline for upland cotton. It argues that Article 13(b)(ii) does not address the time when domestic support measures can no longer be subject to challenge during the implementation period, just as Article 1.1 of the *SCM Agreement* does not address the time at which a "financial contribution" and/or "benefit" must be shown to exist.[685]

ii Main arguments of the third parties

7.524 **Argentina** emphasizes that in the Spanish text of Article 13(b)(ii) the present tense of the subjunctive mode is used, indicating the conditional or possible nature and expressing syntactic subordination. According to Argentina, the Spanish text coincides with the verbal tense used in the French version in which the present subjunctive is also used. Consequently, Argentina disagrees with the United States' contention that the present tense criterion in Article 13(b)(ii) implies that the only support the Panel may consider is current support.[686]

7.525 **China** argues that Article 13 (b) cannot be limited to a comparison only of measures currently in effect. Although China recognizes that it is indeed written in the present tense, the sentence is led by the key word "provided" in a strong limitation and demanding style. According to China, the

[682] Upland cotton accounts for approximately 97 per cent of United States cotton production: see USDA Economic Research Service, Briefing Room – Cotton, and background paper dated July 2001 reproduced in Exhibits BRA-13 and BRA-46, respectively. It does not include extra long staple ("ELS") cotton.

[683] See the preliminary ruling in this regard in Section VII:B of this report.

[684] United States' first written submission, paras. 79 and 90.

[685] Brazil's oral statement at the first session of the first substantive meeting, paras. 40-44, citing the Appellate Body Report , *US – Lead and Bismuth II*.

[686] Argentina's response to Panel third party Question No. 26.

intention of such tense is to ensure that support levels beyond those in 1992 are not to be protected by the Peace Clause.[687]

7.526 The **European Communities** considers that the present tense of the phrase "do not grant support" makes it clear that the comparison for the purpose of Article 13(b) must be between the level of support decided in the 1992 marketing year and that granted by virtue of the measures being challenged, which would typically mean the most recent marketing year.[688]

7.527 **Paraguay** submits that the Spanish text expresses the conditionality of Article 13(b)(ii) in even clearer terms than the English text through the words "*a condición de que no otorguen*". Although Paraguay considers that both texts indicate the present tense, the Spanish version of the sentence stresses conditionality, which must be given considerable weight in order to arrive at a correct interpretation. Paraguay is of the view that it is the Panel's task to consider the period it deems suitable for determining the effects of this type of measure on world trade.[689]

iii Evaluation by the Panel

7.528 The Panel considers the proper interpretation of the tense of this phrase to be quite straightforward. Article 13(b) is made up of two clauses. The principal clause is "domestic support measures … shall be exempt from actions based on (...)". The subordinate clause is "provided that such measures do not grant support in excess of that decided during the 1992 marketing year." The principal clause is in the future tense, and the subordinate is in the present simple tense to express an open condition which also relates to the future.[690] The future time (as of the time of its signature on 15 April 1994) to which the clauses relate is stated at the beginning of Article 13: "During the implementation period", i.e. the nine-year period commencing in 1995. The meaning of the present simple tense can be illustrated by the sentence: "The meeting will begin at 10 o'clock provided that the parties are not late." The verb "are", although in the present, does not refer to lateness at the time of speaking, but to lateness in the future, i.e. at 10 o'clock. It does not matter whether the parties are late *now*; it only matters if they are late at 10 o'clock. This is clearer in the Spanish version of Article 13(b) in which the principal clause is in the future indicative and the subordinate clause is in the present subjunctive which indicates that the verb "grant" expresses a condition. The French version also uses the future indicative and present subjunctive for the same reason.

7.529 Consequently, the tense of the proviso "provided that such measures do not grant …" does not limit the scope of Article 13(b) to measures which are currently in effect. It refers to any domestic support measures covered by paragraph (b) which are or have been in force during the implementation period of nine years commencing in 1995. Therefore, the Panel finds that these payments under expired measures can be taken into account in the examination of consistency of the United States domestic support measures with Article 13(b)(ii).

7.530 The Panel notes that Brazil's claims regarding expired programmes only concern payments made under them, in order to seek relief from their allegedly present effects under the *SCM*

[687] China's response to Panel third party Question No. 12.

[688] European Communities' oral statement at the first session of the first substantive meeting, para. 13. This is also relevant to the reference period, considered at para. 7.591 below. In response to a question from the Panel as to whether there was any difference in the Spanish text which might aid the Panel in interpreting these words, the European Communities noted only that "both the French and Spanish text also use the present tense". See European Communities' response to Panel third party Question No. 26.

[689] Paraguay's response to Panel third party Question No. 26.

[690] See John Eastwood: *Oxford Guide to English Grammar*, Oxford University Press, 1994, sections 77, 257 and 259.

*Agreement*. Brazil does not make claims regarding any expired legislation *per se* (unlike its claims regarding current measures).[691]

*(iv) Measures outside the Panel's terms of reference*

i Main arguments of the parties

7.531 **Brazil** submits that support outside the Panel's terms of reference should be included in the calculation of implementation period support if it was made in respect of the 2002 marketing year. Specifically, it refers to the cottonseed payments for the 2002 crop, which the Panel has ruled are not within its terms of reference.[692]

7.532 The **United States** maintains that cottonseed payments are not within the scope of this dispute.[693]

ii Evaluation by the Panel

7.533 Cottonseed payments for the 1999 and 2002 crops are outside the Panel's terms of reference, for the reasons given in Section VII:B of this report. The Panel notes that subparagraphs (b)(ii) and (iii) of Article 13 provide conditional exemptions from certain actions. Those actions involve recourse to dispute settlement procedures based on the listed provisions, as discussed in Section VII:C of this report. Measures outside a panel's terms of reference in those procedures may not be the subject of claims under Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994*, considered in Section VII:G of this report. However, measures outside the terms of reference may be relevant as evidence.

7.534 The purpose of the Panel's examination as to whether measures satisfy the conditions in Article 13 is not to determine whether or not they are consistent with obligations in the *SCM Agreement* or Article XVI of the *GATT 1994*. A finding that measures do or do not satisfy the conditions in Article 13 does not lead to any recommendation or relief. Rather, it determines whether or not measures benefit from particular exemptions from actions. This is a matter of evidence, not terms of reference.

7.535 The treaty text requires the Panel to include in the comparison under subparagraph (b)(ii) of Article 13 all those measures put in evidence which fall within the terms of the chapeau of paragraph (b) and which grant support to a specific commodity, in this case, upland cotton, either in the reference period or within the MY 1992 benchmark. That is the appropriate comparison. A complaining party is not required to request the establishment of a panel in respect of any and all domestic support measures other than those in respect of which it seeks relief.

7.536 In the present dispute, cottonseed payments for the 1999 and 2002 crops constitute non-green box domestic support granted specifically to upland cotton in the period under review. The Panel will therefore include them in the comparison of support under Article 13(b)(ii). Where the Panel finds that all such domestic support measures, including these cottonseed payments, do not satisfy the additional condition in that provision, then it must find that they are not exempt from actions. However, the Panel may only continue to examine those measures which are within its terms of reference for conformity with Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994*.

[691] Brazil's response to Panel Question No. 19.
[692] Brazil's response to Panel Question No. 17.
[693] United States' rebuttal submission, paras. 106-110.

*(v) Summary of implementation period support*

7.537 In summary, the Panel will include the following in its measurement of implementation period support:[694]

(i) marketing loan programme payments (including interest and storage payments where appropriate);

(ii) user marketing (Step 2) payments made to domestic users;[695]

(iii) PFC, MLA, DP and CCP payments;

(iv) crop insurance payments; and

(v) cottonseed payments for the 1999, 2000 and 2002 crops.

7.538 The Panel can only include payments made in the 1999 through 2002 marketing years because these are the only years for which the parties have provided evidence.

(d) Measurement of support

*(i) Methodology*

i Main arguments of the parties

7.539 **Brazil** tabulates both implementation period support and the MY 1992 benchmark in terms of actual expenditures for support to upland cotton in each marketing year.[696] At the Panel's request, it also presented this information on a per pound basis.[697] Brazil submits that budgetary expenditures are the most natural measure of support, which are straightforward to apply and allow a ready and accurate comparison.[698]

7.540 Brazil does not consider that an AMS calculation is appropriate because Article 13(b)(ii) does not use the term "AMS", "product-specific" or "non-product-specific". However, the best approach besides using actual expenditures is to apply an AMS-like methodology using rules in Annex 3 of the *Agreement on Agriculture* to all "support provided to a specific commodity" in the sense of Article 13(b)(ii). Price-gap methodology is appropriate only for deficiency payments whilst budgetary outlays are appropriate for all other support because that was the approach that the United States used to calculate its AMS reduction commitments and make its domestic support notifications with respect to upland cotton.[699] Any rate of support methodology should be based on budgetary expenditures.[700]

7.541 Brazil also drew attention to the United States' 1994 Statement of Administrative Action submitted to the United States Congress with the proposed Uruguay Round Agreements Act, which stated as follows:

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[694] This is without prejudice to their specificity within the meaning of Article 2 of the *SCM Agreement*, considered in Section VII:G of this report**.**

[695] The Panel excludes user marketing (Step 2) payments to exporters, as mentioned in *supra*,footnote 464.

[696] Brazil's first written submission, paras. 143 and 146.

[697] Brazil's response to Panel Question No. 60.

[698] Brazil's response to Panel Question No. 59.

[699] Brazil's rebuttal submission, para. 87 and its 27 August comments on United States' rebuttal submission, paras. 10-15.

[700] Brazil's rebuttal submission, para. 87.

> "Under Article 13(b)(ii) and (iii), governments may not initiate adverse effects, serious prejudice or non-violation nullification and impairment challenges in the WTO in respect of this type of domestic support measure unless the AMS for the particular commodity exceeds the level decided in the 1992 marketing year. (For example, direct payments decided upon in 1992 as part of the EU's Common Agricultural Policy would be covered by this exemption.) Accordingly, even though rules applying to reduction commitments do not require a WTO member to reduce support for any particular product and may even permit a government to increase support for a particular product, a WTO member will not be protected by the peace clause if its support for the product is above that decided during the 1992 marketing year."[701]

7.542 The **United States** compares implementation period support and the MY 1992 benchmark in terms of a rate of support. It submits that the rate of product-specific support for upland cotton decided during the 1992 marketing year (72.9 cents per pound) is greater than the rate of product-specific support that challenged United States non-green box measures currently grant to upland cotton (52 cents per pound).[702] The rate of support methodology permits an *ex ante* comparison of the support because the rate is known at the outset (or even in advance) of the relevant crop year in which payments are made and thereby permits a rapid challenge.[703]

7.543 The United States does not consider that Article 13(b)(ii) calls for an AMS calculation because "support" does not mean "AMS", which is one particular way of measuring support. Had Members intended the comparison to *require* the use of product-specific AMS, calculated in total monetary value terms, they could have used that term in Article 13(b)(ii).[704] Nor does it permit an *ex ante* calculation which means that a Member cannot know with certainty whether support exceeds that decided in the 1992 marketing year. However, within the context of an AMS calculation, it submits that a price gap calculation provides an appropriate methodology because it eliminates the effect of changes in prevailing market prices on the calculation of support and thereby reflects changes in the level of support decided by a Member.[705]

7.544 The United States does not consider that the *Agreement on Agriculture* permits measurement of support in terms of an AMS-like methodology using rules in Annex 3. Annex 3 specifically provides that non-product-specific support must be kept separate from product-specific support for purposes of AMS calculation, and therefore they must be kept separate for purposes of the Article 13 analysis.[706]

ii Main arguments of the third parties

7.545 **Argentina** considers that implementation period support must be linked to budgetary outlays.[707]

7.546 **Australia** considers that the term "support" in Article 13(b)(ii) was not intended to have the same meaning as "AMS". It does not agree that the interpretation of "grant support" should be limited to either budgetary outlays or a rate of support. The same proviso is used in subparagraph (iii) of

[701] Statement of Administrative Action, H.R. 5110, H.R. Doc. 316, Volume 1, 103d Congress, 2nd Session, 656 (1994), quoting from page 67, reproduced in Exhibit BRA-102. The SAA "represents an authoritative expression by the Administration concerning its views regarding the interpretation and application of the Uruguay Round agreements". (SAA, p. 656).

[702] United States' first written submission, para. 76.

[703] United States' response to Panel Question No. 33.

[704] United States' first written submission, para. 86.

[705] United States' rebuttal submission, paras. 116 to 118, and its 27 August 2003 comments, paras. 5-9.

[706] United States' comments on Brazil's response to Panel Question No. 258.

[707] Argentina's response to Panel third party Question No. 23.

Article 13(b) so it must be interpreted in a manner capable of application in a non-violation complaint, which requires the application of a conditions of price competition test.[708]

7.547 **China** considers that budgetary outlays as exemplified by the AMS calculation method is the approach adopted by the drafters.[709]

7.548 The **European Communities** considers that implementation period support should be calculated on the basis of the AMS methodology set out in Annex 3 to the *Agreement on Agriculture*, which is not necessarily in terms of budgetary outlays. The MY 1992 benchmark should be calculated using "AMS-like criteria" on the basis of information available to the decision makers, such as eligible production, production estimates or budgetary acts.[710]

7.549 **New Zealand** considers that there is nothing to suggest that budgetary outlays should not be a component of the calculation of "support" under Article 13(b)(ii).[711]

iii Evaluation by the Panel

7.550 The Panel observes that the *Agreement on Agriculture* does not state in Article 13(b)(ii) how to measure support. However, elsewhere the Agreement provides in great detail methodologies to measure support, namely the AMS and, where the calculation of a particular component of AMS is not practicable, the EMS. The AMS methodology has a striking degree of overlap with Article 13(b)(ii), notably: (1) the definition of AMS in Article 1(a) indicates that it measures "support" that is "provided", which is synonymous with the extent to which measures "grant" "support";[712] (2) the AMS measures support during the implementation period (and later); (3) the purpose of Total AMS is to measure support provided against a fixed benchmark level; (4) the AMS measures domestic support subject to reduction commitments, which is one of the relevant components of support covered by paragraph (b) of Article 13 and, therefore, "such measures" which are the subject of subparagraph (b)(ii); and (5) the AMS does not measure green box support, which is also excluded from paragraph (b) of Article 13.

7.551 However, there are two reasons dictated by the treaty text why an AMS *per se* cannot be an appropriate measurement under Article 13(b)(ii). These are: (1) Blue box support is excluded from a Current Total AMS calculation, *de minimis* support, although measured in terms of an AMS, may be excluded from Current Total AMS under Article 6.4, as may S&D box support under Article 6.2, yet all are covered by paragraph (b) of Article 13 and, hence, subject to subparagraph (b)(ii); and (2) Non-product-specific support is excluded from an AMS calculated on a product-specific basis for a basic agricultural product but it is covered by paragraph (b) of Article 13 and, hence, subject to subparagraph (b)(ii).

7.552 Nevertheless, the drafters of the *Agreement on Agriculture* evidently considered that the AMS reflected basic principles of the measurement of support. In the Panel's view, AMS methodology can be used to measure both the MY 1992 benchmark and implementation period support under Article 13(b)(ii), subject to two modifications dictated by the treaty text: (1) the AMS methodology should be applied to the corpus of implementation period support measures subject to Article 13(b), to the extent relevant, and not just to support subject to reduction commitments; and (2) it is not appropriate to calculate an AMS on a product-specific basis for a basic agricultural product and total non-product-specific support separately. Therefore, the Panel will apply the principles of AMS

[708] Australia's response to Panel third party Question No. 28. The Panel has dealt with this argument in paragraph 7.443 above.

[709] China's response to Panel third party Question Nos. 22 and 23.

[710] European Communities' response to Panel third party Question Nos. 22 and 23.

[711] New Zealand's response to Panel third party Question No. 22.

[712] The French and Spanish versions use the same term in Articles 1(a), 1(d) and 13(b)(ii) and (iii). We will simply refer to the AMS as it is not argued that the EMS is appropriate in the circumstances of this case.

methodology to measure the MY 1992 benchmark and implementation period support, subject to these two modifications, for the purposes of Article 13(b)(ii).

7.553 It is not disputed that all of the types of measures which the Panel includes in its measurement of support must be included in the calculation of Current Total AMS, except that the United States excludes PFC and DP payments as green box support and includes user marketing (Step 2) payments to exporters as domestic support. The Panel includes the former as non-green box and excludes the latter as export subsidies for the reasons set out in this Section VII:D, and Section VII:E, respectively.

7.554 The AMS expresses support in monetary terms.[713] It measures subsidies, including both budgetary outlays and revenue foregone by governments or their agents[714]. Non-exempt direct payments dependent on a price gap can be measured in terms of a "price gap methodology", which filters out the effect of fluctuations in market prices, or in terms of budgetary outlays.[715] Non-exempt direct payments based on factors other than price must be measured in terms of budgetary outlays.[716] Where calculation of the market price support and other components of AMS is not practicable, an EMS shall be calculated, which also involves multiplying prices by quantities of eligible production or budgetary outlays.[717] There is no reason why these basic principles of measurement of support under the *Agreement on Agriculture* would be inappropriate to measure implementation period support under Article 13(b)(ii).

7.555 Therefore, the AMS provides a choice between a methodology based on budgetary outlays only, or a price gap combined with budgetary outlays. Brazil submits that the Panel should use budgetary outlays, making an AMS-like calculation of all relevant support. The Panel notes that this methodology is consistent with the United States' notifications of all its domestic support for the purposes of its AMS reduction commitments, including all those measures at issue, with the exception of deficiency payments which were not granted during the reference period.[718] The United States submitted that, if the Panel made an AMS calculation, it should use a price gap methodology. Ultimately, this Panel does not need to decide if one of these methodologies is less appropriate than the other because, for the purposes of Article 13(b)(ii), it is only necessary to assess whether there is or is not an "excess" of support over that decided in the 1992 marketing year. It is not necessary to calculate the value of the excess and, in this dispute, both methodologies lead to the same result.

7.556 The United States argues that its budgetary outlays for domestic support are not known ahead of time which creates a problem for a Member who wishes to claim that implementation period support, measured in terms of budgetary outlays, is in excess of the MY 1992 benchmark. In contrast, rates of support are set out in United States domestic support legislation and regulations, which

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[713] Article 1(a) and paragraphs 1 and 6 of Annex 3 of the *Agreement on Agriculture*.
[714] Paragraph 2 of Annex 3 of the *Agreement on Agriculture*.
[715] Paragraph 10 of Annex 3 of the *Agreement on Agriculture* provides as follows:

> "10. Non-exempt direct payments: non-exempt direct payments which are dependent on a price gap shall be calculated either using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, or using budgetary outlays."

[716] Paragraph 12 of Annex 3 of the *Agreement on Agriculture*.
[717] There is no allegation that any of the measures at issue constitute market price support.
[718] In the supporting material relating to agricultural commitments in its Schedule, the United States calculated deficiency payments using price gap methodology and all other relevant support using budgetary outlays – see document G/AG/AGST/USA, reproduced in Exhibit BRA-191. In its notifications to the Committee on Agriculture, the United States notified only deficiency payments for the 1995 marketing year as "blue box" support using price gap methodology and all other support relevant to this dispute for the 1999-2001 marketing years using budgetary outlays – see document G/AG/N/USA/10 and G/AG/N/USA/43, reproduced in Exhibits BRA-150 and BRA-47, respectively and G/AG/N/USA/51 for the 2000 and 2001 marketing years.

permits a Member to mount a rapid challenge and perhaps obtain panel findings before a crop year is over.[719]

7.557 The Panel notes that this is precisely the situation that applies to the assessment of compliance with all domestic support commitments under the *Agreement on Agriculture* and, for that matter, actionable subsidies obligations and non-violation complaints based on tariff concessions. There is no reason to assume that the situation was intended to be different with respect to the additional condition under Article 13(b)(ii) and (iii), particularly given that the text indicates that implementation period support must be measured in terms of support that measures "grant", rather than what was budgeted or estimated.

7.558 The United States argues that support under Article 13(b)(ii) should be measured in terms of a rate of support expressed in cents per pound. This rate represents the level of support guaranteed by the government to producers. When market prices exceed the guaranteed rate, the government makes no payments. When market prices fall below the guaranteed rate, payments by the government increase to maintain the gap between the prices and the guaranteed rate.

7.559 The Panel makes the following observations on the United States' rate of support methodology:

(a) With respect to the MY 1992 benchmark:

(i) the target price for deficiency payments was not in fact decided during the 1992 marketing year, for the reasons given above.

(b) With respect to implementation period support:

(i) a rate of support does not appear to capture the actual amounts granted or provided by a government, rather than those authorized or appropriated in its budget for that year;

(ii) a rate of support expressed in cents per pound is not expressed in monetary terms, but in a combination of monetary and quantitative terms;

(iii) a rate of support is neither a budgetary outlay nor measured in terms of a price gap;

(iv) the rate of support for marketing loan programme payments does not include support provided under the other domestic support at issue, namely, user marketing (step 2) payments, PFC, MLA, DP and CCP payments and cottonseed payments;

(v) the rate of support for CCP payments takes into account DP payments, and is only applicable under the FSRI Act of 2002. There was no rate of support under the FAIR Act of 1996 for PFC and MLA payments. The rate of support methodology is therefore unworkable for the 1999 through 2001 marketing years;

(vi) a second rate of support can be used to measure user marketing (step 2) payments, but a comparison of the combination of two rates of support across different years to determine whether one combination is in excess of

[719] United States' response to Panel Question No. 33.

the other is only possible if they both trend in the same direction, or one remains constant; and

(vii) no rate of support includes cottonseed payments, or crop insurance payments, which can only be measured in terms of budgetary outlays, either in total monetary value terms or on a per unit of production basis.

7.560 Consequently, the rate of support approach proposed by the United States does not represent the MY 1992 benchmark and is incapable of measuring the implementation period support. It is therefore an inappropriate measurement methodology for the comparison under Article 13(b)(ii) in this dispute.

*(ii) Payments dependent on a price gap*

7.561 The AMS permits either the use of a price gap methodology or budgetary outlays for non-exempt direct payments dependent on a price gap.[720] Three types of support relevant to the comparison fall into this category: (1) marketing loan programme payments, which form part of both the MY 1992 benchmark and the implementation period support, are dependent on the difference between the loan rate and the adjusted world price; (2) deficiency payments, which form part of the MY 1992 benchmark only, were also dependent on a price gap; and (3) CCP payments, which form part of the implementation period support only, are dependent on a price gap but are also calculated in respect of base acreage Therefore, the amount of CCP payments is calculated below at paragraph 7.582.

7.562 Marketing loan programme payments form part of the measurement of support in the benchmark and every year under review. There is no practical impediment to using either price gap methodology or budgetary outlays to measure them. The difference is that the use of a price gap filters out the effect of changes in market prices up to the loan rate on the calculation of this one component of support. However, other components of support have changed since the MY 1992 benchmark and within the implementation period so that they effectively involve a comparison of payments under different programmes. Deficiency payments were followed by PFC and MLA payments under the 1996–2001 farm legislation and DP and CCP payments under the FSRI Act of 2002. Of these later programmes, only CCP payments are dependent on a price gap, but the parties have not suggested an appropriate methodology to calculate this support in terms of a price gap, so the Panel considers it appropriate to use a methodology based on budgetary outlays to measure them. As a result, the use of a price gap to measure deficiency payments, whilst possible, may not produce an appropriate comparison with later measures, all of which are measured in terms of budgetary outlays. The use of budgetary outlays for all but deficiency payments is also consistent with the United States' notifications of its support to the WTO Committee on Agriculture for the purpose of domestic support reduction commitments.[721] Therefore, the Panel for these reasons as well as those set out above, considers it appropriate to use a methodology based on budgetary outlays for these two payments which are dependent on a price gap. This does not imply any view as to whether price gap methodology is inappropriate.

7.563 The parties agree on the amount of budgetary outlays for both marketing loan programme payments[722] and deficiency payments,[723] although the United States does not accept that this is the

[720] Paragraph 10 of Annex 3 of the *Agreement on Agriculture*.

[721] The Panel notes that although the notifications were made with respect to reduction commitments, not Article 13(b)(ii), they also used AMS methodology. None of the adjustments to AMS methodology dictated by the text of Article 13(b)(ii) affect the appropriateness of using either price gap or budgetary outlays..

[722] Brazil's and the United States' respective responses to Panel Question No. 67, citing USDA and other sources including, Exhibits BRA-4, BRA-55 and BRA-76. Updated information on the 2002 marketing year is set out in the United States' response to Panel Question No. 196.

appropriate methodology. Marketing loan programme payments calculated using budgetary outlays include storage payments and interest subsidies, which the Panel ruled within its terms of reference in Section VII:B of this report. Accordingly, marketing loan programme payments were valued as follows: MY 1992: $866 million; MY 1999: $1,761 million; MY 2000: $636 million; MY 2001: $2,609 million; and MY 2002: $897.8 million. Deficiency payments for MY 1992 were valued at $1,017.4 million.

7.564 The parties agree on the amount of $867 million for deficiency payments calculated using price gap methodology consistent with the United States' notifications.[724] They include basic deficiency payments of approximately $832 million plus 50/92 payments of $35 million calculated as follows. The target price was 72.9 cents per pound and the fixed reference price for 1986-88 was 57.9 cents per pound, giving a price gap of 15 cents per pound. Production eligible for basic deficiency payments was 5,544 million pounds (9.226 million acres times the average programme yield of 601 pounds per acre). Production eligible for 50/92 payments was 254 million pounds (404 000 acres times the average programme yield of 50/92 programme participants of 628 pounds per acre).[725]

7.565 The United States calculated an amount for marketing loan programme payments using price gap methodology.[726] This does not include storage payments and interest subsidies, in accordance with paragraphs 8 and 10 of Annex 3. It entered a zero figure for all crop years under review but indicated that the price gap was always negative because the average adjusted world price for 1986-1988 was 53.65 cents per pound and thereby higher than the loan rate for each of the years in the reference period.[727]

7.566 Brazil objected to the use of price gap methodology for marketing loan programme payments on the grounds that the United States has used and notified marketing loan programme payments (to the WTO Committee on Agriculture) through a budgetary outlays methodology and that price gap methodology would transform millions of dollars of payments to negative values.[728]

7.567 For the reasons given below, it is unnecessary for the purposes of this dispute for the Panel to decide whether the price gap methodology is inappropriate.

*(iii) Measures directed at agricultural processors*

7.568 The AMS methodology provides that measures directed at agricultural processors shall be included only to the extent that such measures benefit the producers of the basic agricultural products.[729] Two types of support at issue in this dispute are directed wholly or partly at processors: user marketing (step 2) payments made to domestic users; and cottonseed payments which are made

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[723] USDA Fact Sheet for Upland Cotton, January 2003, reproduced in Exhibit BRA-4, referred to in Brazil's first written submission, para. 144. Up to date figures for the 2002 marketing year are found in the United States' response to Panel Question No. 196 and Exhibit BRA-373.

[724] Brazil's and the United States' respective responses to Panel Question No. 198. In its response, and its 27 August 2003 comments, the United States also suggested an alternative approach, but it is based on eligible "acreage", rather than eligible "production".

[725] See the United States' calculations including an adjustment factor as per its notification in the United States rebuttal submission, para. 115, footnote 144, revised in its 27 August 2003 comments at para. 8, footnote 14. See Exhibit US-39 entitled "USDA announces Final Compliance Figures for 1992 Acreage Reduction Programme".

[726] United States' rebuttal submission, para. 115 and footnotes 144 and 148.

[727] See the United States' rebuttal submission, para. 116, footnote148. The Panel has calculated that, using negative values, the marketing loan programme payments would be: MY 1992: $-84 million; MY 1999: $-133 million; MY 2000: $-136million; MY 2001: $-162million and MY 2002: $-130million.

[728] Brazil's 27 August comments, para. 10 and Brazil's 28 January 2004 comments on United States' response to Panel Question No. 208.

[729] Paragraph 7 of Annex 3.

to first handlers of the cottonseed crop, who are ginners, and are obliged to share the payments with producers to the extent that the revenue from the sale of the cottonseed was shared with the producer.

7.569 The United States agrees that user marketing (step 2) payments are support in favour of agricultural producers[730] and that cottonseed payments are "product-specific" support for cotton.[731] It is possible that some part of these payments does not actually benefit producers, but it is unnecessary for the purposes of this dispute to quantify the precise amounts since the values of these payments do not alter the potential for an excess over the MY 1992 benchmark, as explained below. The United States' included the full amount of user marketing (step 2) payments (together with user marketing (step 2) payments to exporters) and the full amount of cottonseed payments in its calculations.[732] This is also consistent with its notifications of the full amounts to the WTO Committee on Agriculture, for the purposes of its reduction commitments.[733]

7.570 The parties agree on the calculation of payments to user marketing (step 2) payments to domestic users.[734] The Panel notes that this data is gathered in terms of fiscal years, not marketing years, which differ by two months for upland cotton. Nothing indicates that this materially affects the result of the Panel's comparison. Accordingly, user marketing (Step 2) payments to domestic users are as follows: MY 1992: $102.7 million; MY 1999: $165.8 million; MY 2000: $260 million; MY 2001: $144.8 million; and MY 2002: $72.4 million.

7.571 The parties also agree on the calculation of cottonseed payments[735], although they do not agree on whether they are within the Panel's terms of reference nor on whether any outside the Panel's terms of reference should be included in the measurement of support.[736] Accordingly, cottonseed payments are as follows: MY 1999: $79 million; MY 2000: $184.7 million; and MY 2002: $50 million.

*(iv) Payments calculated in respect of base acreage*

7.572 PFC, MLA, DP and CCP payments are calculated with respect to a recipient's "base acres". The acreage actually planted to upland cotton or any other crop in the years in which payments are made is referred to as "planted acres".[737]

7.573 **Brazil** initially submitted that implementation period support included all payments under these four programmes as indicated in a USDA fact sheet summary of the 2002 Commodity Loan and

[730] United States' response to Panel Question No. 108.

[731] United States' response to Panel Question No. 67 and its rebuttal submission , para. 109.

[732] United States' response to Panel Question No. 67.

[733] See, for example, documents G/AG/N/USA/10 and 43, reproduced in Exhibits BRA-150 and BRA-47, respectively and G/AG/N/USA/51.

[734] United States' response to Panel Question No. 104 and Brazil's rebuttal submission, para. 73, footnote 172. The amounts of user marketing (Step 2) payments to exporters are also set out in the United States' response to Panel Question No. 104.

[735] The authorizing statutes are reproduced in Exhibits BRA-135, BRA-136, BRA-137 and BRA-138, respectively. All but the statute authorizing cottonseed payments for the 1999 crop appropriated a specific amount. The amount of payments for each crop, including the 1999 crop, is agreed: see Brazil's and the United States' respective responses to Panel Question No. 17. See also Brazil's first written submission, para. 106.

[736] The Panel ruled in Section VII:B that only those cottonseed payments for respect of the 2000 crop are within its terms of reference, and in paragraph 7.536 of this Section VII:D that all cottonseed payments for the 1999, 2000 and 2002 crops must be included in its measurement of support for the purposes of Article 13 of the *Agreement on Agriculture*. Without prejudice to whether they were relevant, the United States, as well as Brazil, included the cottonseed payments for each crop in the calculation of support granted in the same marketing year: see, for example, their respective responses to Panel Question No. 67. See also, United States' rebuttal submission, para. 106 and USDA News Release: "USDA issues $ 50 million in Payments for 2002 Crop Cottonseed Program", reproduced in Exhibit BRA-129,

[737] See the description of measures in Section VII:C of this report.

Payment Program. The payments listed in that fact sheet represent all payments on upland cotton base acreage.[738]

7.574 Brazil then adjusted these calculations by dividing the total annual upland cotton planted acreage by total upland cotton base acreage in each programme. It explained in notes to its calculations that this adjustment was necessary because only the portion of upland cotton payments under the programmes that actually benefits acres planted to upland cotton can be considered support to upland cotton.[739] It called this methodology the "14/16ths methodology".[740] It considered that this was a "reasonable proxy" since actual data collected by the United States concerning the amount of payments to upland cotton producers was not available and cited various factors to support an assumption that these revised figures were appropriate.[741] It set out a detailed summary of the evidence available at that time which, it argued, suggested that the amount of payments could best be calculated by finding that United States upland cotton producers received those payments using upland cotton base acreage.[742]

7.575 Brazil also cited data generated by the Environmental Working Group ("EWG") to support its assumption, which had matched recipients of marketing loan programme payments (who must harvest some quantity of upland cotton to be eligible for payment) to recipients of PFC, MLA, DP and CCP payments.[743] The EWG database is publicly available on the internet and shows dollar amounts of payments received by individuals and corporations calculated in respect of base acreage for each crop under these programmes.

7.576 The **United States** submits that it would be erroneous to attribute to upland cotton or upland cotton producers all payments calculated according to upland cotton base acreage due to the production flexibility which allows recipients not to produce upland cotton.[744] It disputes Brazil's 14/16ths methodology and submitted that Brazil had provided no evidence to support its assumptions that every acre of upland cotton was planted by a holder of upland cotton base acreage, and that no such base acreage holder planted more upland cotton than his or her base acres.[745] The United States declined to suggest an alternative approach to payments made in respect of base acreage because the issue of what payments may be attributed to upland cotton production was fundamentally part of Brazil's burden to present evidence substantiating the amount of the subsidy that it is challenging.[746] It also identified alleged shortcomings in the EWG data.[747]

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[738] Brazil's first written submission, para. 148, citing USDA fact sheet, reproduced in Exhibit BRA-4.

[739] Brazil's responses to Panel Question No. 60, notes 2-5 to table.

[740] This name reflects the fact that, according to data available to Brazil at that time, in the 2002 marketing year, total upland cotton planted acreage was over 14 million acres and total upland cotton base acreage was over 16 million acres. The actual proportions of planted acres to base acres are 88.7 per cent, 94.3 per cent, 95.1 per cent and 84.98 per cent in each of the 1999 through 2002 marketing years (under the PFC and MLA programmes), and 73 per cent in the 2002 marketing year (under the DP and CCP programmes). See Brazil's response to Panel Question No. 67, notes to table in para. 97 and footnote 58 to its further rebuttal submission.

[741] The factors included the geographical spread of crops and relative costs of production of different covered commodities: see Brazil's response to Panel Question No. 125(2)(a), (2)(c), (3) and (8).

[742] Brazil's closing statement at the resumed session of the first substantive meeting, para. 8, and Annex 1.

[743] Brazil's 28 January 2004 comment on United States' response to Panel Question No. 205. See also statement of Christopher Campbell of EWG and EWG Dtabae table of results, reproduced in Exhibits BRA-316 and BRA-317, respectively.

[744] United States' response to Panel Question No. 67*bis* and United States' further submission, para. 75

[745] United States' response to Panel Question No. 125(e).

[746] United States' response to Panel Question No. 125(e).

[747] United States' response to Panel Questions Nos. 195 and 205.

7.577 After obtaining the planting data by category, **Brazil** submitted that the Panel should apply Brazil's methodology to this data[748], and that it no longer relied on its 14/16ths methodology.[749] It also submitted calculations based on two versions of the methodology in Annex IV of the *SCM Agreement*.

7.578 After providing the planting data, the **United States** indicated that for the marketing years before 2002 the data was based on crop reports that were not generally required. The United States argued that Brazil's methodology is invented and lacks any basis in any WTO agreement or in economic logic. Brazil's methodology inappropriately conflates product-specific and non-product-specific support. *SCM Agreement* concepts of subsidy, benefit and subsidized product are not used in nor are directly applicable to Article 13. However, internal inconsistencies in the methodology have implications for both the serious prejudice claim and for the interpretation of Article 13 since, on Brazil's approach, it is necessary to identify the subsidy benefit in order to determine the "support to" upland cotton. There is no basis for attributing only part of a payment to some crops rather than across all production on a farm.[750] The United States submits that the Panel should not have to adopt a reasonable methodology to allocate support under Article 13 because the drafters would not have left the methodology undefined, and because Article 13 itself provides a methodology to calculate support to a specific commodity, namely product-specific support.[751] The United States rejected Brazil's calculations based on Annex IV of the *SCM Agreement* because, in its view, Brazil's version was inconsistent with Annex IV and Brazil's calculations of the Unites States' version did not reflect the United States' interpretation of Annex IV.[752]

7.579 The Panel recalls its finding that all non-green box support measures that clearly or explicitly define a commodity as one to which they bestow or confer support must be included in the calculation of implementation period support. In this case, the relevant commodity is upland cotton. The Panel's task is not to measure only product-specific support.

7.580 The Panel calculates these payments, like other support directed at producers, as specified in the domestic support measures themselves. The measures provide for payments to recipients who have enrolled cropland in the programme on the basis of upland cotton production, at a rate specific to upland cotton, according to a yield specific to upland cotton. This methodology is used by USDA and was the original approach submitted by Brazil. It includes all payments calculated with respect to upland cotton base acres.

7.581 The Panel will measure these payments in accordance with the principles of AMS methodology set out in Annex 3 to the *Agreement on Agriculture*. PFC, MLA and DP payments are non-exempt direct payments based on factors other than price. The Panel therefore uses budgetary outlays to measure them in accordance with paragraph 12 of Annex 3. For the reasons given in paragraph 7.562 above, the Panel will use budgetary outlays to measure CCP payments as well.

7.582 The parties agree on the total amount of payments calculated in respect of upland cotton base acreage, although they do not agree that all such payments are support to upland cotton.[753] The total amounts are as follows:

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[748] Set out in the Attachment at the end of this Section.

[749] Brazil's 10 March 2004 comments, para. 3.

[750] United States' comments on Brazil's response to Question No. 258, its 11 February 2004 comments on US data, generally and its 3 March 2004 comments, paras. 37-44.

[751] United States' 3 March 2004 comments, para. 14.

[752] United States' 15 March 2004 comments, paras. 30-36 and its 3 March 2004 comments, paras. 45-56.

[753] USDA Fact Sheet on Upland Cotton, reproduced in Exhibit BRA-4 and the United States' response to Panel Question No. 196 for the 2002 marketing year.

**Table 1: Payments calculated in respect of upland cotton base acreage**

| $ million | MY1999 | MY2000 | MY2001 | MY2002 |
|---|---|---|---|---|
| PFC payments | 616 | 574.9 | 473.5 | 436 |
| MLA payments | 613 | 612 | 654 | |
| DP payments | | | | 181 |
| CCP payments | | | | 1309 |

7.583 The Panel notes that the evidence in this dispute shows a strongly positive relationship between recipients who currently plant upland cotton and those whose payments are calculated with respect to upland cotton base acres and whose payments are therefore calculated at the upland cotton-specific payment rate.[754] The Panel makes certain factual findings with respect to that relationship and also with respect to Brazil's allocation of an amount of the total payments under these programmes to upland cotton in the Attachment to Section VII:D.

*(v) Payments calculated with respect to insurance*

7.584 Brazil submitted official Federal Crop Insurance Corporation ("FCIC") calculations of the amounts of crop insurance payments borne by the FCIC with respect to insurance offered relating to upland cotton.[755] The United States does not agree that they are relevant but does not contest their accuracy.[756] The Panel will therefore rely on the FCIC calculations. Accordingly, the amounts are as follows: MY 1992: $26.6 million; MY 1999: $169.6 million; MY 2000: $161.7 million; MY 2001: $262.9 million; and MY 2002: $194.1 million.

(e) Comparison of support

*(i) Reference period*

i Main arguments of the parties

7.585 **Brazil** challenges domestic support payments for the production and use of upland cotton, which were and continue to be made between the 1999 marketing year to the present and those scheduled to be made from the present through the 2007 marketing year pursuant to the statutes and regulations listed in its request for establishment of a panel. It also challenges legal instruments under which these payments are made "as such". [757]

7.586 Brazil submits that if measures fail to meet one of the relevant conditions in Article 13 in any year – be it the current year or an earlier year during the implementation period – those measures can no longer be considered to "fully conform" or to not "grant support" "in excess of" the MY 1992 benchmark. Consequently, those measures are not exempt from actions.[758]

7.587 The **United States** is of the view that failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) would only lift

[754] This does not imply any view on whether such an allocation of support is appropriate under the *Agreement on Agriculture*.

[755] See FCIC Summary of Business Report as of 16 June 2003, reproduced in Exhibit BRA-57 and referred to in Brazil's response to Panel Question No. 67, footnote 8, and with respect to the 2002 crop year, as of 8 December 2003, reproduced in Exhibit BRA-374.

[756] The United States does contest the value of crop insurance net indemnities with respect to upland cotton in the 2002 marketing year. See Brazil's response to Panel Question No. 196, footnote 13 and the United States' 28 January 2004 comments on Panel Question No. 196, para. 20, footnote 9.

[757] Brazil's response to Panel Question No. 19.

[758] Brazil's response to Panel Question No. 35.

the exemption from action for those measures for the year of that breach. Measures, i.e. subsidies, in a later year would remain exempt from action so long as those measures in the given year comply with the conditions in Article 13(b)(ii). Because the fundamental commitment under Article 6 is to limit domestic support as measured by the Current Total AMS to a Member's final bound commitment level, and that commitment is judged on a year-by-year basis, a Member may breach its commitments under Article 6 in one year and come back into compliance in the following year. Thus, conformity with this element of Article 13 must be judged on a year-by-year basis.[759]

7.588 The United States goes on to argue that if the Peace Clause is breached in any particular year, a Member could bring an action against such measure, i.e. subsidy, but only for the year of the breach. For example, where subsidies were provided on a yearly basis, a Member could breach the Peace Clause in one year in which the support such measures grant is in excess of that decided during the 1992 marketing year, but could be in conformity in the following year, if support were again within the 1992 marketing year level. Only the subsidies for the year in which the Peace Clause were breached would not be exempt from actions.[760]

ii Main arguments of the third parties

7.589 **Argentina** contends that excess support granted during any one of the years of the period of implementation suffices to cancel the protection provided by the Peace Clause. A year-on-year comparison cannot be inferred from Article 13 or from its context. Otherwise, at the beginning of each marketing year the Member that had exceeded the level of support in the previous year would be covered by the Peace Clause once again and their measures would be exempt from any claims.[761] In Argentina's view, the failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) results in the loss of the protection granted by the Peace Clause.[762]

7.590 **China** is of the view that a Member's failure to comply in a given year with the chapeau of Article 13(b) will not impact its entitlement to benefit in an earlier or a later year from exemption from actions. The chapeau requires that domestic support measures conform fully to provisions of Article 6. Articles 6.1 and 6.3 in turn provide that all non-green box domestic support measures of a Member are considered to be in compliance with Article 6 if the Member's "Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule". The word "exceed" requires a comparison. The words "current", "corresponding" and "annual" indicate that the comparison is to be made on an annual basis between the level of support actually provided in a given year and the annual bound commitment level in the same year as indicated in the Member's Schedule. A Member's actual level of support varies from year to year, so does a Member's annual bound commitment level. Therefore, a factual comparison between the two in a given year shall not have any bearing on a comparison of different support levels in an earlier or later year.[763]

7.591 The **European Communities** agrees with the United States that Brazil's argument that any breach of the 1992 level during the nine-year implementation period removes the protection of Article 13 is incorrect. The present tense of the phrase "do not grant support" makes this clear. The comparison for the purpose of Article 13(b) must be between the level of support decided in the 1992 marketing year and that granted by virtue of the measures being challenged. This would typically mean the most recent marketing year.[764] The European Communities considers that Article 13(b)

[759] United States' response to Panel Question No. 35.
[760] United States' response to Panel Question No. 35.
[761] Argentina's response to Panel third party Question No. 12.
[762] Argentina's response to Panel third party Question No. 13.
[763] China's response to Panel third party Question No. 13.
[764] European Communities' oral statement at the first session of the first substantive meeting, para. 13.

permits, but does not require, a year-on-year comparison, because support is generally expressed in annual amounts. In order to benefit from the protection of Article 13, a measure must conform to the provisions of Article 6 and must not "grant support" in excess of that decided in during the 1992 marketing year. The European Communities considers that the Panel has some discretion in choosing a specific period, although it is clear it must be as close as possible to the time of the dispute. However, since the Panel must consider the support granted it must choose a period for which data is complete. Given Article 1(i) of the *Agreement on Agriculture*, the period chosen may well be based on the calendar, financial or marketing year of the Member complained against.[765]

7.592 **New Zealand** argues that Article 13(b)(ii) and (iii) require a comparison with 1992 of any year in which injury, nullification or impairment or serious prejudice is alleged to have occurred.[766] New Zealand is of the view that the nature of non-compliance at issue may be such that it does impact on a Member's entitlement to benefit in an earlier or later year from the exemption from action provided by Article 13(b) on a case-by-case basis.[767]

iii Evaluation by the Panel

7.593 The Panel notes that there is nothing in the text of the *Agreement on Agriculture* or any other covered agreement that indicates the length of the reference period for the comparison under Article 13(b)(ii). However, in this dispute, the decisions on support taken during the 1992 marketing year related to one year only. Therefore, a meaningful comparison of the implementation period support requires it to be compared by year as well.

7.594 It is not necessary for the purposes of this dispute to decide how many years during the implementation period must show an excess over the MY 1992 benchmark for measures not to be exempt from actions because the comparison in each year for which there is evidence shows the same result. The Panel has already found that the chapeau of paragraph (b) and subparagraph (ii) share the same subject.[768] It suffices for the purposes of this dispute for the Panel to add that, in view of that finding, measures which grant support during the implementation period in excess of the MY 1992 benchmark fail to satisfy Article 13(b), and it is not simply that amount of support in excess of the MY 1992 benchmark which is exposed to actions under Articles 5 and 6 of the *SCM Agreement* and paragraph 1 of Article XVI of the *GATT 1994*. Neither party has suggested otherwise. This does not imply any view as to whether the grant of support in any one year in excess of the MY 1992 benchmark would result in that Member's implementation period support for other years failing to comply with Article 13(b).

7.595 In any case, the issue of which measures do or do not satisfy the conditions of Article 13 and which are or are not exempt from actions concerns the *actions*, not the substance of the allegations raised in connection with those actions. Therefore, if a measure is not exempt from actions based on Articles 5 and 6 of the *SCM Agreement* and paragraph 1 of Article XVI of the *GATT 1994*, there is no bar to a claim that the measure threatens to cause serious prejudice at some future time. It is not necessary to prove that the measures are not exempt at that future time.

*(ii) Table showing comparison*[769]

7.596 In light of the foregoing analysis and measurement of support for each of the 1992, 1999, 2000, 2001 and 2002 marketing years, the Panel tabulates the MY 1992 benchmark and implementation period support using budgetary outlays to permit a comparison as follows:

[765] European Communities' response to Panel third party Question No. 12.
[766] New Zealand's response to Panel third party Question No. 12.
[767] New Zealand's response to Panel third party Question No. 13.
[768] See paragraph 7.471 above.
[769] See Brazil's and the United States' respective responses to Panel Question No. 67.

**Table 2: Comparison of support in accordance with Article 13(b)(ii)**

| $ million | MY1992 | MY1999 | MY2000 | MY2001 | MY2002 |
|---|---|---|---|---|---|
| Marketing loan programme | 866 | 1761 | 636 | 2609 | 897.8 |
| User marketing (step 2) | 102.7 | 165.8 | 260 | 144.8 | 72.4 |
| Deficiency payments | 1017.4 | 0 | 0 | 0 | 0 |
| PFC payments | 0 | 616 | 574.9 | 473.5 | 436 |
| MLA payments | 0 | 613 | 612 | 654 | 0 |
| DP payments | 0 | 0 | 0 | 0 | 181 |
| CCP payments | 0 | 0 | 0 | 0 | 1309 |
| Crop insurance payments | 26.6 | 169.6 | 161.7 | 262.9 | 194.1 |
| Cottonseed payments | 0 | 79 | 184.7 | 0 | 50 |
| **TOTAL** | 2012.7 | 3404.4 | 2429.3 | 4144.2 | 3140.3 |

7.597 The comparison shows that implementation period support exceeds the MY 1992 benchmark in every year under review. Implementation period support also exceeds the MY 1992 benchmark in every year under review where (1) the marketing loan programme payments and deficiency payments are both calculated using a price gap; and (2) where the marketing loan programme payments are calculated using a price gap but deficiency payments are calculated using budgetary outlays in order to provide a more appropriate comparison with the measures which succeeded them. This is the case whether marketing loan programme payments: (a) are shown as zero; or (b) are calculated using negative values.[770]

7.598 Therefore, taking into account all the evidence above, the Panel considers that Brazil has discharged its burden to show that the United States domestic support measures at issue grant support to a specific commodity in excess of that decided during the 1992 marketing year.

*(iii) Rate of support*[771]

7.599 The Panel has observed that a rate of support methodology is unable to measure implementation period support.[772] The Panel has also found that the rate of support of 72.9 cents per pound was not in fact decided during the 1992 marketing year and therefore cannot constitute the MY 1992 benchmark.[773] The United States has not submitted that any other rate of support constituted the MY 1992 benchmark. Therefore, this methodology is inappropriate for the comparison under Article 13(b)(ii).

7.600 The only rate of support that appears to have been decided during the 1992 marketing year was the rate of 52.35 cents per pound for the marketing loan programme, subject to the Acreage Reduction Percentage ("A.R.P.") of 7.5 per cent.[774] Neither party submitted that this was an

[770] See calculations under the "measurement of support", above.
[771] United States' rebuttal submission, paras. 121-126.
[772] See paragraph 7.560 above.
[773] See paragraph 7.449 above.
[774] The A.R.P. programme obliged farmers to idle a set portion of their base acreage of upland cotton and other specific commodities as a condition of eligibility for marketing loans and deficiency payments. The goal was to reduce supplies, thereby raising market prices. It reduced the amount of production and hence the amount of support guaranteed to upland cotton producers by the loan rate, and reduced the amount of acres eligible for deficiency payments. A.R.P. can be contrasted with set-aside programmes which based reductions on current year plantings and did not require farmers to reduce their plantings of specific crops. The programme was not reauthorized in the FAIR Act of 1996. See USDA Economic Research Service "Commodity Program Entitlements: Deficiency Payments" (May 1993), reproduced in Exhibit BRA-417 and statement of Dr. Sumner, para. 8 in Exhibit BRA-105.

appropriate rate of support to measure the MY 1992 benchmark. However, in order to pursue the rate of support approach to its logical conclusion, the Panel finds that the loan rate in each of the 1999-2002 marketing years was 51.92 cents per pound[775], and under the FSRI Act of 2002 in the 2002 marketing year was 52 cents per pound[776] (and the target price for CCP payments in the 2002 marketing year was 72.4 cents per pound). None of these rates were subject to an A.R.P. or any other land idling requirements. Therefore, these rates of 51.92 and 52 cents per pound, free of reductions, granted support in excess of 52.35 cents per pound subject to an A.R.P. reduction of 7.5 per cent.

7.601 Further, the target price for deficiency payments of 72.9 cents per pound, which was not decided during the 1992 marketing year, did not represent "support decided" either. First, support guaranteed by this target price was subject to an A.R.P. of 10 per cent for the 1992 crop, which reduced the amount of acres eligible for payments, as well as "normal flex acres" conditions, according to which deficiency payments were not paid for 15 per cent of base acreage.[777] These were decisions by the United States government[778] creating mandatory conditions that reduced the guaranteed revenue to producers delivered by the target price. The target price adjusted for A.R.P. and normal flex acres, according to United States calculations, produces a rate of support decided of 67.7625 cents per pound.[779] Second, this adjusted target price does not capture user marketing (step 2) payments, which the United States accepts are part of the MY 1992 benchmark.[780] Prior to the 2002 marketing year, these payments were triggered when a certain quote exceeded another by

[775] The range of 50 cents to 51.92 cents per pound was established by s.132(c)(2) of the FAIR Act of 1996. See USDA *Agricultural Outlook*, November 2003, reproduced in BRA-394.

[776] Section 1202(a)(6) of the FSRI Act of 2002.

[777] The Omnibus Budget Reconciliation Act of 1990 "made 15 per cent of each program crop acreage base ineligible for deficiency payments. This change was intended to reduce program spending and to increase producers' planting flexibility." - see USDA Economic Research Service "Commodity Program Entitlements: Deficiency Payments" (May 1993), reproduced in Exhibit BRA-417. See also the statement of Dr. Sumner, paras. 10 and 12, in Exhibit BRA-105.

[778] There were also eligibility criteria that reduced the amount of upland cotton receiving the support which the United States argues should not be taken into account because they were decisions by producers, not the United States government. However, it also argues that the A.R.P. and normal flex acres should be disregarded because adjusting the rate of support for these would assume unrealistically that producers would have produced on 100 per cent of base acres. Paradoxically, those are decisions by producers not the United States government and, on the United States' approach, such decisions should not be taken into account in using the rate of support as the benchmark. See the United States' rebuttal submission, para. 126.

[779] Maximum deficiency payments rate (20.55 cents per pound) reduced by 10 per cent A.R.P. and 15 per cent normal flex acres, yields an adjusted maximum deficiency payment rate of 15.4125 cents per pound. This rate, plus the marketing loan rate of 52.35 cents per pound, gives guaranteed producer revenue of 67.7625 cents per pound. If the maximum deficiency payment rate were reduced by 10 per cent A.R.P. only, it would yield an adjusted maximum deficiency payment rate of 18.495 cents per pound. This rate, plus the marketing loan rate, gives guaranteed producer revenue of 70.845 cents per pound. See the United States' rebuttal submission, para. 126, and "Calculating the Per-Unit Rate of Support" by Dr. Glauber, reproduced in Exhibit US-24. The Panel takes note of Dr. Glauber's observation that in 1992 producers could plant other crops on their flex acres (Exhibit US-24, p.1). This did not affect the mandatory idling of ten per cent of programme base. Further, the extent to which producers chose to exercise that flexibility was not a decision of the United States government which, consistent with the United States' approach, should not be taken into account in calculating the rate of support decided for upland cotton producers. The Panel also takes note of Dr. Glauber's statement that "[i]f a significant proportion of the abandoned area were declared as idled acreage for program reporting purposes, this would imply that the amount of upland cotton eligible for marketing loans in 1992 was close to 100 per cent" (Exhibit US-24, p.2). This is speculation that, in the six to eight week period between survey estimates and programme reports, almost 2 million abandoned acres were reported as idled. There is no evidence before the Panel that this possibility was anything but remote.

[780] The United States submits that it also decided to provide support in the form of user marketing (Step 2) payments in 1992 under the FACT Act of 1990: see United States' first written submission, para. 104.

more than 1.25 cents per pound, and payments were made equal to the difference between the two quotes minus the 1.25 per cents per pound threshold.[781]

7.602 The corresponding rates of support during the implementation period exceed both the adjusted target price and the user marketing (step 2) support. No meaningful comparison with implementation period support is possible for the 1999, 2000 and 2001 marketing years because there was no target price in those years. However, in the 2002 marketing year, there was a target price for CCP payments of 72.4 cents per pound, but not subject to A.R.P. or any set aside requirements. This exceeds the adjusted target price for deficiency payments of 67.7625 cents per pound. In the 2002 marketing year, user marketing (step 2) payments conditions have remained basically constant but are not subject to the 1.25 cents per pound threshold. This exceeds support guaranteed under the user marketing (step 2) programme in the 1992 marketing year. Therefore, implementation period support in the 2002 marketing year exceeds the MY 1992 benchmark even on the approach proposed by the United States. In the alternative, to the extent that differences between the programmes in the 1992 and 2002 marketing years prevent a meaningful comparison, the approach proposed by the United States is unworkable in all years under review.

7.603 The United States commented that the CCP target price ceases to be paid when the farm price rises about 65.73 cents per pound.[782] It is true that CCP payments cease to be paid at that price because DP payments make up the difference to 72.4 cents per pound, but the guaranteed level of support to producers with upland cotton base acres remains 72.4 cents per pound, calculated with respect to base acres and yields.

7.604 Brazil argued that the rate of support in the MY 1992 benchmark should be adjusted for the limitation that deficiency payments were made only on 85 per cent of base acres. However, this is also a programme feature of PFC, MLA, DP and CCP payments, and does not affect the comparison in terms of a rate of support.[783]

7.605 Brazil argued that the Panel should also take into account changed eligibility requirements. Marketing loan programme payments in the 1996 to 2002 marketing years were only available to cropland enrolled in the PFC programme (estimated by Brazil at 97 per cent[784]) but that restriction was removed in the FSRI Act of 2002 so that from the 2002 marketing year 100 per cent of United States production of upland cotton was eligible to receive marketing loan benefits.[785] Brazil also argued that the Panel should take into account optional land idling features, including optional flex acres and the 50/92 option.[786] In light of our findings, it is not necessary to decide whether these decisions on participation by producers and exercise of options are properly part of the MY 1992 benchmark support.[787]

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[781] See the description of measures in Section VII:C of this report. The importance of this change is illustrated by the fact that during MY 2001, Step 2 payments were zero during 15 weeks but, after the abolition of the threshold, in MY 2002 they were zero during only five weeks. See the weekly step 2 certificate values in Exhibits BRA-350.

[782] United States' further rebuttal submission, para. 91.

[783] See statement of Dr. Sumner, para. 17, in Exhibit BRA-105.

[784] See Brazil's oral statement at the first session of the first substantive meeting, statement of Dr. Sumner, Annex 2, p.4.

[785] Section 1201(b) of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1.

[786] See 7 CFR 1427.4(a)(3) and 7 CFR 1413 (1992 edition), reproduced in Exhibit US-3. Brazil's estimate of eligible production is set out in Brazil's oral statement at the first session of the first substantive meeting, statement of Dr. Sumner, Annex 2, p.3.

[787] See statement of Dr. Sumner, pages 2-7, in Annex 2 to Exhibit BRA-105. See also Brazil's oral statement at the first session of the first substantive meeting, para. 36, in Exhibit BRA-103 and Brazil's 22 August comments on United States' response to Panel Question No. 57.

7.606 The United States argued that the adjusted rate of support approach would not allow it to know *ex ante* what its obligations are under Article 13(b)(ii). This may not be factually accurate as the United States support decided during the 1992 marketing year for upland cotton was decided and provided before the entry into force of the *Agreement on Agriculture*: the deficiency payments target price, marketing loan rate, user marketing (step 2) payments formula and mandatory land idling requirements for 1992 and 1993 were all decided before the end of the Uruguay Round. In any event, the drafters chose to require Members to schedule precise AMS reduction commitments but did not choose to specify the MY 1992 benchmark, either in Members' schedules, notifications to the WTO Committee on Agriculture or in any negotiating document which has been submitted to the Panel. There is no reason to find that they considered *ex ante* precision critical to the interpretation of the additional condition in Article 13(b)(ii). This is not at all unusual. Members have differing views about the interpretation of many obligations in the covered agreements which can be resolved through consultations and resort to the WTO dispute settlement system.

7.607 For these reasons, the Panel considers that, even accepting the United States' rate of support approach to the comparison under Article 13(b)(ii), United States domestic support measures grant support to a specific commodity in excess of that decided during the 1992 marketing year. In light of this, and the Panel's rejection of the United States' interpretation of Article 13(b)(ii), the United States has not presented sufficient evidence and arguments to show that its domestic support measures satisfy the conditions in Article 13(b). This is without prejudice to the Panel's view that Brazil bears the initial burden of proving that they do not satisfy those conditions, for the reasons set out in Section VII:C of this report.

(f) Conclusion regarding Article 13(b)

7.608 In light of the above findings, the Panel concludes that the United States domestic support measures listed in paragraph 7.1107 grant support to a specific commodity in excess of that decided during the 1992 marketing year and that, therefore, they are not exempt from actions based on paragraph 1 of Article XVI of the *GATT 1994* or Articles 5 and 6 of the *SCM Agreement*.

(g) Brazil's requests that the Panel draw adverse inferences

7.609 The procedural record of the Panel's requests for information pursuant to Article 13.1 of the *DSU* is set out in Section VII:A of this report. The Panel indicated in its request for information dated 12 January 2004 and again in its supplementary request dated 3 February 2004 that a refusal to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn. The United States provided the information requested in response to the supplementary request for information on 3 March 2004.

7.610 On 28 January 2004, **Brazil** requested the Panel to draw the following adverse inferences: (1) that its methodology[788] for allocating PFC, MLA, DP and CCP payments to current producers of upland cotton for the 1999 through 2002 marketing years using United States-controlled data would have resulted in higher payments than those estimated by Brazil's 14/16$^{th}$ methodology; (2) that the application of the United States methodology for allocating PFC, MLA, DP and CCP payments to current producers of upland cotton for the 1999 through 2002 marketing years using United States-controlled data would have resulted in higher payments than those estimated by Brazil's 14/16$^{th}$ methodology; and (3) that the information would have been detrimental to the United States

[788] See Brazil's response to Panel Question No. 258. See Brazil's earlier comments on this issue in its response to Panel Question, No. 125 (5) and further rebuttal submission, para. 49 and footnote 57.

arguments that PFC, MLA, DP and CCP payments are not support to cotton within the meaning of Article 13(b)(ii), or alternatively, "non-product-specific support".[789]

7.611 Brazil argues that in light of the Appellate Body's findings in *Canada – Aircraft* and *US – Wheat Gluten* regarding the legal basis for drawing adverse inferences, the following facts support the Panel drawing the three aforementioned adverse inferences: (1) the United States was aware of: (a) Brazil's latest estimates of its 14/16ths methodology[790]; (b) the results of the EWG database tabulations; and (c) it had access to all farm-specific data; (2) the United States was fully capable of calculating the amount of payments allocable to current United States producers of upland cotton; (3) the consistent misleading information provided by the United States concerning its possession of data regarding acreage and payment information for contract payments; and (4) the refusal of the United States to provide information regarding alleged "decoupled" contract payments paid to current upland cotton producers.[791] Brazil also approvingly cites *Argentina – Textiles and Apparel*, where it asserts that the Panel used the best information available when the complainant refused to provide documents within its exclusive control.[792] According to Brazil, applying these concepts to the allocation issues involved in the Peace Clause portion of this dispute indicates that the Panel has more than sufficient evidence in the record to support a reasonable estimate of the amount of contract payment support provided to upland cotton in the 1999-2002 marketing years.[793]

7.612 Brazil further submits that the Panel should bear in mind that if a Member can easily block a panel's request for information without any consequences, then it will effectively undermine and circumvent WTO disciplines. Brazil also argues that any adverse inferences drawn by the Panel become part of the evidence on which the Panel must make an objective assessment of the facts pursuant to Article 11 of the *DSU*.[794]

7.613 The **United States** responds that there is no basis for an "inference" of any kind, adverse or otherwise, regarding its non-disclosure of farm-specific planting information in the format requested by the Panel because the United States did not have authority to provide that data as requested and because it had provided data that would permit the Panel to assess "total" payments to farms planting upland cotton, which the United States interpreted to include payments in respect of non-upland cotton base acres as well.[795]

7.614 The United States submits that under Article 11 of the *DSU* the Panel cannot make claims for a party, nor develop evidence for a party. The Appellate Body explained in *Japan – Agricultural Products II* that it is for the complaining party to bring forward sufficient evidence and arguments to carry its burden of establishing a prima facie case.[796]

7.615 On 13 February 2004, **Brazil** submitted that if the United States provided the data requested in the Panel's supplementary request pursuant to Article 13.1 of the *DSU*, most of its comments on

[789] Brazil's 28 January 2004 comments and requests regarding data provided by the United States on 18/19 December 2003, paras. 57 and 108.

[790] Brazil stated after receiving the data submitted by the United States on 3 March 2004 that it would no longer be appropriate to rely on its 14/16ths methodology in view of that data. See Brazil's 10 March 2004 comments, para. 3.

[791] Brazil's 28 January 2004 comments and requests regarding data provided by the United States on 18/19 December 2003, paras. 58-64.

[792] Brazil's 28 January 2004 comments to the United States' response to Panel Question No. 256, para. 234.

[793] Brazil's 28 January 2004 comments to the United States' response to Panel Question No. 256, para. 235 and Brazil's 10 March 2004 comments, para. 34.

[794] Brazil's 28 January 2004 comments and requests regarding data provided by the United States on 18/19 December 2003, paras. 65-66.

[795] United States' letter to the Panel dated 20 January 2004, p.3.

[796] United States' response to Panel Question No. 256.

28 January 2004 would be rendered moot. The purpose of those comments was to demonstrate the inadequacy of the United States' data production, to request the drawing of adverse inferences and, in the absence of the actual data, to supply the inadequate summary data.[797]

7.616 On 3 March 2004, the **United States** provided data in response to the Panel's supplementary request.

7.617 On 10 March 2004, **Brazil** argued that the data produced by the United States was incomplete, for certain specific reasons. It requested the Panel to rely on the calculations which Brazil made based on that data, as any shortcoming in these results stemmed from the United States' refusal to produce farm-specific data as requested. The "refusal" of the United States to produce complete data would permit the Panel to draw the adverse inferences that this information would have shown even higher payments being allocated to upland cotton.[798]

7.618 The **United States** submits that the information which it provided was not incomplete but complied with the terms of the Panel's supplementary request for information, by including farms with no upland cotton planted acres and not including contract yield and payment units information and payments to producers (not farms) with upland cotton plantings.[799] It notes that Brazil considers the data which the United States provided as "the best information available before the Panel", and that Brazil had also stated that the United States had produced "complete summary base and complete summary planted data covering all crops for which data was requested by the Panel and all farms covered by the Panel's request". Therefore, according to the United States, Brazil has implicitly conceded that there is no basis to draw adverse inferences.[800]

7.619 The Panel recalls that after the first session of the first substantive meeting, we asked the United States in writing to state the annual amount granted by the United States government in each of the 1999 through 2002 marketing years to United States upland cotton producers under each of the PFC, MLA, DP and CCP programmes ("Question 67 *bis*").[801]

7.620 The United States stated that it consulted with the USDA, including personnel from the Farm Services Agency, in preparing its response to the Panel's question.[802] It provided a lengthy written response in which it stated that "[t]he United States does not maintain and cannot calculate this information".[803] The United States explained that it tracked total expenditures with respect to base acres but that it is not possible to derive from these payments whether the payment is being received by an upland cotton producer.[804]

7.621 The USDA Farm Services Agency maintains detailed information tracked by individual farms under these programmes, including payment, base acres and planting information. Planting information is not publicly available. The United States did not mention that the Farm Services Agency tracks planting information, as well as total expenditures, on a farm-specific basis. It did not mention that its earlier response was dependent upon a definition of "producer" that excludes a person who plants but does not harvest.

7.622 At the resumed session of the first substantive meeting, the Panel orally asked the United States whether it also had information available on production or planted acreage. The head of the United States delegation sought and received clarification that the Panel referred to how much of the

[797] Brazil's letter dated 13 February 2004, page 5.
[798] Brazil's 10 March 2004 comments, para. 10, footnote 14.
[799] United States' 15 March 2004 comments, paras. 17-20.
[800] United States' 15 March 2004 comments, para. 16.
[801] See the United States' response to Panel Question No. 67 *bis*.
[802] See the United States' response to Panel Question No. 195.
[803] Panel Question No. 67 *bis* and the United States' response.
[804] See the United States' response to Panel Question No. 67 *bis*.

payment was received by the recipient who also produces cotton. He then replied that this information was not available. The next day, the head of the United States delegation modified his response and informed the Panel orally that there was a mandatory reporting requirement under section 1105(c) of the FSRI Act of 2002, which generally requires recipients to report the uses of the cropland. He did not mention detailed planting information maintained in respect of previous years.

7.623 At the resumed session of the first substantive meeting, the Panel asked the United States in writing whether the acreage report requirement pursuant to the FSRI Act of 2002 indicates or assists in determining the number or proportion of acres of upland cotton planted on upland cotton base acres and whether a similar reporting requirement existed for upland cotton during the 1996 through 2002 marketing years.[805] The United States replied that the acreage reports filed under the FSRI Act of 2002 indicate what crops are planted on a farm but do not indicate the quantity of base acres on the farm because the acreage reports are filed after the planting season but before harvest and do not contain information on the quantity of production on each farm. The United States provided a statistic "based on a very preliminary review of a sampling of marketing year 2002 acreage reports" which showed that approximately 47 per cent of individual farms with upland cotton base had ceased to plant upland cotton.[806] It also indicated to the Panel that acreage reports for the period of the 1996 Act were incomplete.[807]

7.624 At the second substantive meeting, Brazil presented evidence that the USDA Farm Services Agency maintains detailed planting information tracked by individual farms. This information had been obtained in a Freedom of Information Act request by a private citizen assisting the Brazilian delegation from a USDA Farm Services Agency office in Kansas City.[808]

7.625 After the second substantive meeting, the Panel asked the United States whether it wished to modify its response to Question 67 *bis*.[809] The United States declined, saying that its original response remained accurate because Question 67 *bis* had inquired about annual amounts granted to upland cotton producers. It confirmed that the relevant payments are not tracked by whether the recipient produces upland cotton and indicated that the United States does not collect production data based on actual harvesting figures reported by farmers.[810]

7.626 Later, in January 2004, the Panel requested information pursuant to Article 13.1 of the *DSU* in order to permit an assessment of the total expenditures under the relevant programmes to upland cotton "producers". The United States noted that it had previously provided data that permits calculation of total expenditures to farms "planting" upland cotton.[811]

7.627 The Panel asked the United States how this reply could be reconciled with the United States' earlier view that requests for information on production did not relate to information on planting.[812] The United States replied that it maintained some planting information but it did not maintain information on individual farm production. Its answer to Question 67 *bis* had concerned production

[805] Panel Question No. 125(5).

[806] Data which the United States provided to the Panel later upon request showed that the volume of acreage on those farms was approximately 26 per cent: see table A-1 in the Attachment at the end of Section VII:D.

[807] Brazil submitted evidence of discussions with a USDA Farm Services Agency official that the vast majority of farms filed acreage reports under the FAIR Act of 1996: see Exhibit BRA-318. See also data on comprehensiveness of acreage reports for another covered commodity (rice) in Exhibit BRA-368.

[808] Annexed to Exhibit BRA-368. See also Exhibit BRA-369.

[809] Panel Question No. 195.

[810] United States' response to Panel Question No. 195.

[811] United States' letter to the Panel dated 20 January 2004.

[812] Panel Question No. 260.

whilst its statement in January 2004 concerned planting. The United States emphasized the distinction that must be made between planting information and production information.[813]

7.628 The Panel notes that the first occasion on which the United States explained the particular definition of the word "producer" that it had been using in responding to the Panel's questions was in December 2003. It was important to know this definition in view of the following:

(i) the relevant legislation does not define "producer" in this way, but rather defines it to include a person who plants but does not harvest (see the FAIR Act of 1996 and the FSRI Act of 2002 and regulations thereunder);[814]

(ii) the Panel prefaced its oral questions by referring to production information in terms of planting information so that it was quite clear that, if the response was predicated on a difference between the two terms, this should have been explicitly drawn to the Panel's attention;

(iii) the United States does not use its particular definition consistently in these proceedings, since it asserts that it provided information on total expenditures to "upland cotton producers" by providing information on total expenditures to "farms that plant upland cotton"[815]; and

(iv) abandonment rate information is available which could be applied to farm-specific planting information to derive average harvesting information.[816]

7.629 The United States submits that "it was the United States itself at the second session of the first panel meeting that brought to the Panel's and Brazil's attention the planting reporting requirement that was introduced by Section 1105 of [the FSRI Act of 2002]"[817]

7.630 The Panel takes note that the United States first informed the Panel of the existence of Section 1105(c) of the FSRI Act of 2002 in response to an oral question from the Panel which specifically asked whether it gathered any production *or planted* acreage information. The Panel takes note that the United States' initial response at the meeting was negative, that its corrected response the following day related to only one year under review and that it only mentioned planting information in respect of the 1999, 2000 and 2001 marketing years later when asked specifically in writing about those marketing years.[818]

7.631 The Panel's requests for information under Article 13.1 of the *DSU* and the surrounding circumstances are set out in Section VII:A of this report. The Panel makes the following factual findings:

(i) the United States provided much data in December 2003 (which it corrected in January 2004) in response to Brazil's request for information. Brazil sought this information to overcome the United States' objection that Brazil had provided no evidence to support its assumptions that every acre of upland cotton was planted by a holder of upland cotton base acreage, and

[813] United States' 28 January 2004 comments on Brazil's response to Panel Question No. 195 and United States' response to Panel Question No. 260.

[814] Exhibits US-22, US-1, BRA-28, BRA-29, BRA-31 and BRA-35.

[815] See also the United States' letter dated 20 January 2004 in which it refers to the privacy interests in planting information as privacy interests of United States "producers".

[816] See the United States' response to Panel Question No. 209.

[817] United States' 28 January 2004 comments on Brazil's response to Question No. 196, paras. 15-18, and the United States' 11 February 2004 comments, para. 66.

[818] Panel Question No. 125(5) and the United States' response.

that no such base acreage holder planted more upland cotton than his or her base acres.[819] The United States did not supply the part of the data that was within its exclusive control in a format that permitted Brazil to attempt to rebut the United States' objection;

(ii) the United States did not provide further data in January 2004 in response to the Panel's initial request pursuant to Article 13.1 of the *DSU* because it considered that this was not permitted under the Privacy Act of 1974. In its view, it was not possible to supply the data even with substitute farm identifiers because it could potentially be linked to the data it supplied in December 2003 with actual farm identifiers.[820]. The Panel notes that the deletion of farm identifiers had been discussed at the second substantive meeting prior to supply of all data when the United States raised possible confidentiality concerns. At that time, Brazil indicated orally that it did not understand what the possible confidentiality issues would be because the FSA had used actual farm identifiers when it released planting information for rice.[821] Brazil also indicated that if the United States found that there was some kind of confidentiality problem that it would let Brazil know. The United States only asserted that confidentiality concerns prevented it releasing planting data with FSA farm numbers, and that the rice release had been an error, at the time it supplied the other data with actual farm identifiers[822] shortly after which, Brazil indicated that the United States could have used substitute farm numbers[823]; and

(iii) the United States provided extensive and detailed data in response to the Panel's supplementary request for information pursuant to Article 13.1 of the *DSU*, which sought the same information in a format which would overcome aggregation problems and permit Brazil to attempt to rebut the United States' objection.

7.632 The Panel does not consider it necessary for the purposes of this dispute to rule on Brazil's request to draw adverse inferences, nor to express any view on the parties' respective interpretations of the Privacy Act of 1974, in light of the findings that the Panel has been able to make in this Section VII:D, including the Attachment.

7.633 The Panel wishes to point out that it has used its powers under Article 13 of the *DSU* to evaluate Brazil's arguments. The support delivered to upland cotton by these four types of payments is a central issue in this dispute. Brazil presented USDA data in its first written submission which measured support in accordance with payment formulae in the measures themselves. The Panel has relied on that data. Brazil later proposed a methodology using the then-available data which relied on a particular assumption. Data that could prove or disprove that assumption was in the control of the United States but not available to Brazil or to the Panel. Brazil had already explained the problems caused by the aggregation of data.[824] At the Panel's request, Brazil explained the methodology which it would apply to the unavailable data, which showed the Panel that it was both necessary and appropriate to use its powers under Article 13 of the *DSU* to access the data in a suitable format that would permit Brazil to run its methodology. At that stage, it was not clear to the Panel what the data

[819] See *supra* at paragraph 7.576.

[820] It added in a footnote that, moreover, this data might be separately obtained - see United States' letter dated 20 January 2004, footnote 5.

[821] Exhibits BRA-368 and BRA-369.

[822] United States' letter dated 18 December 2003.

[823] Brazil's response to Panel Question No. 196, dated 22 December 2003.

[824] See the second statement of Christopher Campbell of EWG, paras. 3 and 4, reproduced in Exhibit BRA-368.

would show, nor what the results of Brazil's methodology would be. This was an information-gathering exercise on the Panel's part, in order for it to carry out its function. Any suggestion that a panel "makes the complainant's case", when it merely exercises its powers under the *DSU*, is entirely inaccurate. The *DSU* contains extensive provisions about the effective way for panels to gather facts and information, and how to assess those facts (including by way of commissioning advisory reports)[825]. It is a central feature of any system of redress, be that judicial, arbitral or otherwise, that evidence be obtained and analysed, and that the parties have equal opportunities to present their cases by using or contradicting that evidence, including by presenting their own evidence.

## 6. Attachment to Section VII:D

7.634 The Panel has found in paragraph 7.580 and following that it is appropriate to include in its measurement of support all payments calculated with respect to upland cotton base acreage for the purposes of Article 13(b)(ii) of the *Agreement on Agriculture*. Without prejudice to those findings, in accordance with the Panel's function under Article 11 of the *DSU* to make an objective assessment of the facts of the case, the Panel sets out in this Attachment certain additional findings of fact concerning the relationship between base acreage and upland cotton plantings and Brazil's allocation of an amount of payments calculated with respect to base acreage to upland cotton.[826] Certain of these factual findings provide support for findings in Section VII:G of this report.

(a) Relationship between base acreage and upland cotton plantings

7.635 The PFC, MLA, DP and CCP programmes permit planting flexibility and do not require production.[827] Eligibility for these payments depends on production of specific covered commodities in a base period, not the year of the payment. Payments are calculated with respect to these "base acres", at a rate specific to each covered commodity, as described in Section VII:C of this report. Recipients who hold upland cotton base acres, in respect of which payments are calculated at the upland cotton rate, could have since ceased production of upland cotton. Recipients who hold other base acres, in respect of which payments are calculated at the rate for other specific covered commodities, could have since commenced production of upland cotton.

7.636 The evidence on the record shows where upland cotton production is taking place within the PFC, MLA, DP and CCP programmes. At the request of Brazil, and later at the request of the Panel under Article 13 of the *DSU*, the United States provided a large amount of data concerning the planting of upland cotton under these programmes. The data provided[828] shows that a very large proportion of farms with upland cotton base acres continue to plant[829] upland cotton in the year of payment. The data provided also shows that the overwhelming majority of farms enrolled in the programmes which plant upland cotton also hold upland cotton base. The total data, expressed in terms of acreage (which is the basis on which payments are calculated in respect of upland cotton) and percentages of total base acreage and total planted acreage, respectively, are as follows:

[825] Article 13.1 and 13.2 and Appendix 4 to the *DSU*.

[826] See paragraph 7.580 of this Section .

[827] The present tense includes the past tense in respect of the PFC and MLA programmes and payments.

[828] Calculated based on USDA data submitted by the United States on 28 January and 3 March 2004. Note that the 1999-2001 data is based on crop reports that were not mandatory, which may lead to some undercounting.

[829] The data refers to planting which necessarily includes those farms which harvest. See USDA data on total of planted and harvested upland cotton acres in the United States' response to Panel Question No. 209. See also the definition of "producer" in the FAIR Act of 1996 and the FSRI Act of 2002 which includes a person who plants but does not harvest.

**Table A-1: Upland cotton base acres**[830]

| | MY1999 | MY2000 | MY2001 | MY2002 |
|---|---|---|---|---|
| On farms with upland cotton planted acres | 12,581,725 | 12,625,169 | 12,386,499 | 13,818,215 |
| On farms without upland cotton planted acres | 3,835,298 | 3,684,411 | 3,860,809 | 4,740,089 |
| Total upland cotton base acres | 16,417,023 | 16,309,580 | 16,247,309 | 18,558,304 |
| % of upland cotton base acres on farms with upland cotton planted acres | 76.6% | 77.4% | 76.2% | 74.4% |

**Table A-2: Upland cotton planted acres**[831]

| | MY1999 | MY2000 | MY2001 | MY2002 |
|---|---|---|---|---|
| On farms with upland cotton base acres | 13540383 | 14170478 | 14118952 | 13022669 |
| On farms without upland cotton base acres | 1032581 | 1217550 | 1344982 | 518837 |
| Total upland cotton planted acres | 14572964 | 15388028 | 15463935 | 13541506 |
| % of upland cotton planted acres on farms with upland cotton base acres | 92.9% | 92.0% | 91.3% | 96.1% |

7.637 These figures show a strongly positive relationship between those recipients who hold upland cotton base acres and those who continue to plant upland cotton, despite their entitlement to plant other crops, which is indicative of the relationship between payments calculated with respect to upland cotton base acreage and recipients who plant upland cotton. These figures also show that upland cotton production within these four programmes is almost exclusively taking place on farms which hold upland cotton base acres.

(b) Brazil's allocation of payments calculated with respect to base acreage to upland cotton

7.638 **Brazil** recognizes that recipients who hold upland cotton base acres and continue to plant upland cotton (that is, they have not recently ceased or commenced production of upland cotton) may have increased or decreased their acreage planted to upland cotton since they established their base acres. In other words, they may have "overplanted" or "underplanted" their upland cotton base.[832] This means that there is not a one-to-one relationship between upland cotton base acres and upland cotton planted acres on individual farms shown in the top line of tables A-1 and A-2.

7.639 The data supplied to the Panel shows the following:

[830] Calculated based on USDA data supplied by the United States on 28 January 2004 at the request of Brazil, described in Exhibit US-145.

[831] Calculated based on USDA data supplied by the United States on 28 January 2004 at the request of Brazil, described in Exhibit US-145. This data shows all upland cotton planted acres within these programmes. The table shown on page 10 of Brazil's 10 March 2004 comments show base acreage that could be included in a proportion of total planted acreage, or a "cotton to cotton" calculation.

[832] These aggregation problems are explained in the second statement of Christopher Campbell of EWG, paras. 3 and 4, reproduced in Exhibit BRA-368.

**Table A-3: Upland cotton acreage of recipients who underplanted their upland cotton base**[833]

| Marketing year | Upland cotton base acreage | Upland cotton planted acreage | Difference |
|---|---|---|---|
| 1999 | 10,346,685 | 4,548,886 | 5,797,799 |
| 2000 | 9,919,461 | 4,386,073 | 5,533,388 |
| 2001 | 9,869,516 | 4,146,352 | 5,723,164 |
| 2002 | 13,135,588 | 5,997,438 | 7,138,150 |

**Table A-4: Upland cotton acreage of recipients who overplanted their upland cotton base**[834]

| Marketing year | Upland cotton base acreage | Upland cotton planted acreage | Excess |
|---|---|---|---|
| 1999 | 6,070,338 | 8,991,496 | 2,921,158 |
| 2000 | 6,390,118 | 9,784,405 | 3,394,287 |
| 2001 | 6,377,793 | 9,972,600 | 3,594,807 |
| 2002 | 5,422,716 | 13,135,588 | 7,712,872 |

7.640 Brazil proposes an allocation of payments calculated with respect to base acreage made to recipients who plant upland cotton. It allocates payments according to the shifts from base acres (in respect of which payments are calculated) to planted acres (in respect of which recipients produce covered commodities). It applies the following steps:

(i) it excludes payments calculated in respect of upland cotton base acreage on farms without upland cotton planted acres, which are shown on the second line of table A-1;

(ii) it reduces payments for those who underplant their upland cotton base proportional to the drop in upland cotton planted acreage to upland cotton base acreage, as shown in the final column of table A-3;

(iii) it increases payments for those who overplant their upland cotton base proportional to the increase in upland cotton planted acreage to upland cotton base acreage, as shown in the final column of table A-4, by allocating certain payments from other covered commodities for which they underplanted their base (not shown in the table);

(iv) it includes payments calculated in respect of other covered commodity base acreage on farms without upland cotton base acres, which are shown on the second line of table A-2.

7.641 Brazil first applied a methodology which it labelled "cotton to cotton" to the data provided by the United States. This methodology allocates for each planted acre of upland cotton, those payments associated with one upland cotton base acre – if available on the same farm. This includes the *lower* of upland cotton base acres and upland cotton planted acres on each farm. Brazil calculated payments with respect to the "cotton to cotton" acres using the upland cotton payment rate specified in the legislation and regulations and average yields. The results were as follows:

[833] Calculated based on USDA data supplied by the United States on 3 March 2004 at the request of the Panel.

[834] Calculated based on USDA data supplied by the United States on 3 March 2004 at the request of the Panel.

**Table A-5: Cotton to cotton methodology**[835]

| $ million | MY1999 | MY2000 | MY2001 | MY2002 |
|---|---|---|---|---|
| PFC payments | 434.9 | 411.7 | 329.5 | |
| MLA payments | 432.8 | 438.3 | 452.3 | |
| DP payments | | | | 391.8 |
| CCP payments | | | | 864.9 |

7.642 Brazil then made a calculation of "excess acres", which refers to the number of upland cotton planted acres in excess of upland cotton base acres on a farm. These acres are made up of the increase in paragraph (iii) over each farm's upland cotton base and all acres in paragraph (iv), where the farm had no upland cotton base. It pooled the payments for other contract commodities on each farm and allocated them according to their share of the total acres for each overplanted covered commodity. It added the results of its calculations of excess acres to the results of the cotton to cotton methodology. The results were as follows:

**Table A-6: Brazil's allocation of payments to upland cotton**[836]

| $ million | MY1999 | MY2000 | MY2001 | MY2002 |
|---|---|---|---|---|
| PFC payments | 501.4 | 478.9 | 385.7 | |
| MLA payments | 499.0 | 509.8 | 529.4 | |
| DP payments | | | | 421.3 |
| CCP payments | | | | 869.4 |

7.643 The **United States** objects to the allocation of support, particularly from other commodity base to upland cotton where the recipient has increased or begun production of upland cotton. It argues that the allocation of payments for base acres to planted acres is arbitrary, leading to situations in which a particular crop could be subsidized at different rates; that a particular crop could receive a greater subsidy than another crop that accounts for more acreage on the farm; and that a recipient may grow crops without base acreage and engage in other types of production. It also argues that Brazil's methodology unfairly allocates excess payments to upland cotton, which biases its results upwards.[837]

7.644 The Panel agrees with the United States that base acres are not physical acres, and that money is fungible and that under these programmes it can subsidize whatever the recipient chooses to produce.[838] Differences in the "rate of subsidization" of a particular crop on different acres on the same farm, or on different farms, do not arise under the cotton to cotton methodology. They arise notionally under Brazil's allocation methodology but are irrelevant because the methodology calculates a total amount of support for a particular crop, not a rate of subsidization. The methodology of calculating payment amounts according to rates per acres, at different rates for different crops, is set out in the programmes' own conditions. A particular crop could receive a larger payment than another crop that accounts for more acreage on the farm due to the difference among the

[835] See Brazil's 10 March 2004 comments, paras 12-15. Details of the calculations are reproduced in Exhibit Bra-433.

[836] See Brazil's 10 March 2004 comments, para. 19. Details of the calculations are reproduced in Exhibit Bra-433, and the methodology is discussed in Brazil's response to Panel Question No. 258.

[837] United States' comments on Brazil's response to Panel Question No. 258, its 11 February 2004 comments, paras. 37-43 and 3 March 2004 comments, paras. 37-44. The United States also argues that the allocation of payments calculated according to base acreage across planted acreage does not account for producers who have switched into or out of upland cotton from/to other programmes.

[838] United States' comments on Brazil's response to Panel Question No. 258.

payment rates in the programmes' own conditions. This result could occur even if the recipient's planted and base acres for each covered commodity were identical.[839]

7.645 The Panel notes that the inclusion of excess acres in the calculation of support is the corollary of excluding payments made on upland cotton base where the recipient decreased production of upland cotton, to which the United States has not objected. Both imply that switches in planting decisions by recipients alter the allocation of support per commodity. Brazil's allocation of payment rates for so-called "excess acres" is a formula for the allocation of payments to account for the fact that payment recipients, to a greater or lesser degree, have shifted plantings of crops since the base period. The result is simply a proportion in monetary terms of the total payment for each commodity which the recipient actually chooses to produce.

7.646 Therefore, as a factual matter, the Panel finds the above allocation of support delivered under these programmes to one covered commodity appropriate, because it combines elements of the way in which the payments are calculated with the volume of upland cotton which recipients plant. Adjustments to payments for those who underplanted their upland cotton base could be appropriate, to account for the fact that upland cotton has one of the highest payment rates in the programme, but no specific adjustments were proposed in this dispute. Adjustments to payments for some planted acres that were later abandoned could also be appropriate.[840]

7.647 The factual findings in this Attachment do not imply any view as to whether evidence as to how domestic support measures which specify commodities in terms of eligibility criteria and payment rates actually deliver support to a particular commodity is a relevant consideration under Article 13(b)(ii) and (iii) of the *Agreement on Agriculture.*

## E. EXPORT SUBSIDIES

### 1. Measures at issue

7.648 This Section of our report deals with alleged export subsidies. These are the following measures, as described in Section VII:C:

(i) Section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters;[841]

(ii) export credit guarantees under the GSM 102, GSM 103 and SCGP programmes; and

(iii) the ETI Act of 2000.

### 2. Overview of the parties' export subsidy claims and arguments under the *Agreement on Agriculture*, the *SCM Agreement* and the *GATT 1994*

7.649 Briefly, Brazil claims that the United States is in breach of its export subsidy obligations under the *Agreement on Agriculture* and the *SCM Agreement*, as follows:

[839] For instance, the PFC payment rates per acre for upland cotton and wheat in the 2001 crop year were $36.26 and $16.35, respectively. As a result, a recipient who planted 200 acres of wheat on wheat base received a smaller payment than a recipient who planted 100 acres of upland cotton on upland cotton base. This is the case in every year under review: see data in Exhibits BRA-142 and BRA-394. Conversion for wheat into pounds at the standard moisture content of 60 lbs per bushel.

[840] Average cotton yields calculated in pounds per planted acres 1997-2002 are set out in Exhibit BRA-323.

[841] We address user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 *infra*, Section VII:F.

(i) user marketing (Step 2) payments to exporters under Section 1207(a) of the FSRI Act of 2002 are *per se* export subsidies listed in Article 9.1(a) of the *Agreement on Agriculture*, or, alternatively, under Article 10, and are inconsistent with Articles 3.3 and/or 8 of the *Agreement on Agriculture*, as well as with Articles 3.1 and 3.2 of the *SCM Agreement*;

(ii) the GSM 102, GSM 103 and SCGP export credit guarantee programmes in respect of exports of eligible agricultural commodities are export subsidies inconsistent with Articles 8 and 10.1 of the *Agreement on Agriculture*, as well as with Articles 3.1 and 3.2 of the *SCM Agreement*; and

(iii) the ETI Act of 2000 is inconsistent with Articles 8 and 10.1 of the *Agreement on Agriculture*, as well as with Articles 3.1 and 3.2 of the *SCM Agreement*.

7.650 Brazil contends that none of the United States' alleged export subsidies are exempt from actions based on Article 3 of the *SCM Agreement*, within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*, because they do not conform fully to the export subsidy provisions in Part V of the *Agreement on Agriculture*.

7.651 Again briefly, the United States maintains that the challenged measures are consistent with its export subsidy obligations under the *Agreement on Agriculture* and the *SCM Agreement* as follows:

(i) user marketing (Step 2) payments under section 1207(a) of the FSRI Act of 2002 are not contingent upon export performance and thus do not constitute export subsidies for the purposes of the *Agreement on Agriculture* or Articles 3.1 and 3.2 of the *SCM Agreement* as they are available to exporters *and* domestic users;

(ii) Article 10.2 of the *Agreement on Agriculture* indicates that export credit guarantee programmes are outside the scope of the export subsidy disciplines of the *Agreement on Agriculture* (and the *SCM Agreement*), and, in any event, the United States export credit guarantee programmes at issue do not constitute export subsidies for the purposes of the *Agreement on Agriculture* (or the *SCM Agreement*);

(iii) Brazil has not established a prima facie case of inconsistency of the ETI Act of 2000 with Articles 8 and 10.1 of the *Agreement on Agriculture* (or Articles 3.1 and 3.2 of the *SCM Agreement*).

7.652 The United States submits that, as the measures described as (i) and (ii) in para. 7.648 conform fully to the provisions of Part V of the *Agreement on Agriculture*, they are exempt from actions based on Article 3 of the *SCM Agreement* within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*.

7.653 Brazil also makes claims with respect to certain of these measures under Articles XVI:1 and XVI:3 of the *GATT 1994*. The United States asks us to reject these claims.

### 3. Relationship between the export subsidy provisions in the *Agreement on Agriculture* and the *SCM Agreement* and the *GATT 1994*

7.654 We have set out, above, the order of analysis among the various agreements at issue that we will apply in our examination of Brazil's export subsidy claims in this dispute.[842] Now we briefly outline our understanding of the general relationship among the export subsidy provisions of the *Agreement on Agriculture*, the *SCM Agreement* and the *GATT 1994*.

7.655 We first look generally at the relevant obligations in the three agreements in question. The *Agreement on Agriculture* and the *SCM Agreement* are both multilateral agreements on trade in goods contained in Annex 1A of the *WTO Agreement.* The *Agreement on Agriculture* contains general rules and specific disciplines governing the provision by a Member of export subsidies in respect of agricultural products, including certain export subsidy reduction commitments specified in a limited number of Members' schedules.[843] Except as provided in the *Agreement on Agriculture*, the *SCM Agreement*[844] generally[845] prohibits granting or maintaining export subsidies in respect of any product. The respective texts of each of these agreements can, as necessary and appropriate, provide guidance in the interpretation of the provisions in that and the other agreements.

7.656 Article XVI of the *GATT 1994* also refers to certain types of subsidies which may affect exports of the subsidizing Member. Article XVI:1 of the *GATT 1994* appears in Section A of that Article, which is entitled "Subsidies in general". Article XVI:1 speaks to the situation where any Member "grants or maintains any subsidy ... which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory" and refers to "any case in which it is determined that serious prejudice to the interests of any other Member is caused or threatened by any such subsidization". Article XVI:3 of the *GATT 1994* appears in Section B of that Article, which is entitled "Additional provisions on export subsidies". It states that Members "should seek to avoid the use of subsidies on the export of primary products". If, however, a Member grants directly or indirectly "any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that Member having more than an equitable share of world export trade in the product [...]".

7.657 With respect to the general relationship between these export subsidy disciplines and obligations *inter alia* in these three covered agreements, Article 21.1 of the *Agreement on Agriculture* stipulates: "The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A of the WTO Agreement shall apply subject to the provisions of [the *Agreement on Agriculture*]." Accordingly, the provisions of the *SCM Agreement* and the *GATT 1994* apply subject to the provisions of the *Agreement on Agriculture*. In the event of a conflict between the provisions of the *Agreement on Agriculture* and a provision of the *GATT 1994* or another covered agreement pertaining to multilateral trade in goods in Annex 1A of the *WTO Agreement*, the rights and obligations in the *Agreement on Agriculture* would prevail to the extent of that conflict.

7.658 We therefore next turn, in more detail, to the export subsidy obligations contained in the *Agreement on Agriculture*. Article 8 of the *Agreement on Agriculture* provides:

> "Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule."

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[842] *Supra*, Section VII:C.

[843] 25 Members, counting EC-15 as one (TN/AG/S/8).

[844] The product coverage of the *Agreement on Agriculture* is limited to agricultural products (in accordance with Article 2 and Annex I of that agreement). The product coverage of the *SCM Agreement* is broader, encompassing all industrial and agricultural goods.

[845] Article 27 of the *SCM Agreement* contains certain special and differential treatment provisions.

7.659 The qualified prohibition in Article 8 of the *Agreement on Agriculture* is supported by the more specific prohibitions in respect of "scheduled" and "non-scheduled" products in Article 3.3 of the *Agreement on Agriculture*. This provides, in part:[846]

> "... a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule."

7.660 Part V of the *Agreement on Agriculture*, together with Article 3.3 thereof, provide the principal specific export subsidy obligations pertaining to agricultural products. For the purposes of this dispute, its key provisions consist of Article 8 ("Export Competition Commitments"); Article 9 ("Export Subsidy Commitments"); and Article 10 ("Prevention of Circumvention of Export Subsidy Commitments").[847]

7.661 Article 1(e) of the *Agreement on Agriculture* contains a definition of "export subsidies" for the purposes of the *Agreement on Agriculture*. It states:

> "'export subsidies' refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of [the *Agreement on Agriculture*]."

7.662 Article 9 of the *Agreement on Agriculture* is entitled "Export Subsidy Commitments". Article 9.1 lists specific types of export subsidies which are subject to reduction commitments under the *Agreement on Agriculture*. In most cases, such export subsidy reduction commitments include commitments in respect of both budgetary outlays and export quantities. These commitments are made an integral part of the *GATT 1994* under the provisions of Article 3.1 of the *Agreement on Agriculture* and are recorded in Section II of Part IV of a Member's schedule.

7.663 Article 10 of the *Agreement on Agriculture* is entitled "Prevention of circumvention of export subsidy commitments". Article 10.1 of the *Agreement on Agriculture* provides that "[e]xport subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments."

7.664 In general terms, these export subsidy provisions of the *Agreement on Agriculture* permit a limited number of Members to use export subsidies, as defined in that Agreement, within the limits of the budgetary outlay and/or quantitative commitments specified in Section II of Part IV of its Schedule and only with respect to the agricultural products described therein.

7.665 However, the provision of any export subsidy listed in Article 9.1 of the *Agreement on Agriculture* in respect of unscheduled products or in excess of scheduled reduction commitment levels is formally prohibited under Articles 3.3 and 8 of the *Agreement on Agriculture*. The use of other export subsidies in excess of commitment levels, in respect of scheduled or non-scheduled products, is subject to the anti-circumvention provisions of Article 10.1.

7.666 Upland cotton falls within the product coverage of the *Agreement on Agriculture*.[848] The United States has no "scheduled" commitment with respect to upland cotton.[849] Any export subsidy

[846] The provisions to which this prohibition is specifically subject comprised temporary exceptions that are no longer operative.

[847] Article 11 of the *Agreement on Agriculture* (entitled "Incorporated products" and relating to commitments on subsidies on agricultural products contingent upon their incorporation in exported products) was not directly invoked in this dispute.

[848] As provided in Article 2 of the *Agreement on Agriculture*, the product coverage of that Agreement appears in Annex I to that Agreement *supra*, Section VII:C.

listed in Article 9.1(a) of the *Agreement on Agriculture* in respect of upland cotton (or any other unscheduled product) is therefore prohibited.

7.667 If a particular product within the coverage of the Agreement is not the subject of a scheduled commitment, then, pursuant to Article 10.1 of the *Agreement on Agriculture*, export subsidies shall not be applied in respect of that product in a manner which results in, or which threatens to lead to, circumvention of a Member's commitment under Article 3.3 not to provide listed export subsidies in respect of such an unscheduled product.[850]

7.668 Of particular relevance in this dispute, Article 10.2 of the *Agreement on Agriculture* provides that:

> "Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith."

7.669 A question arises as to whether or not the United States export credit guarantee programmes at issue in this dispute are subject to the export subsidy disciplines of the *Agreement on Agriculture* (and the *SCM Agreement*) at all.[851]

7.670 The *SCM Agreement* also contains export subsidy disciplines pertaining to trade in goods. Article 1 of that agreement defines a "subsidy" for the purposes of that agreement. Export subsidy disciplines can be found in Articles 3 and 4 of the *SCM Agreement*. Subject to the provisions on special and differential treatment in Article 27 of the *SCM Agreement* (and related Annex VII), and to other considerations set out in the text of Article 3.1 of the *SCM Agreement* (which defers to the *Agreement on Agriculture*), the latter contains a prohibition on export subsidies, except as provided in the *Agreement on Agriculture*. Article 3.1(a) of the *SCM Agreement* provides:

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[849] The United States has scheduled export subsidy reduction commitments in respect of the following thirteen commodities: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, eggs. See "Schedule XX of the United States of America, Part IV, Section II, entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments", reproduced in Exhibit BRA-83 and Exhibit US-13, respectively.

[850] We note that, with regard to the circumvention of the Article 3.3 prohibition on the use of subsidies listed in Article 9.1 in respect of unscheduled products, the Appellate Body stated: "Members would certainly have 'found a way round', a way to 'evade', this prohibition if they could transfer, through tax exemptions, the very same economic resources that they are prohibited from providing in other forms under Articles 3.3 and 9.1. Thus, with respect to the *prohibition* against providing subsidies listed in Article 9.1 on *unscheduled* agricultural products, we believe that the FSC measure involves the application of export subsidies, *not* listed in Article 9.1, in a manner that, at the very least, '*threatens* to lead to circumvention' of that 'export subsidy commitment' in Article 3.3." Appellate Body Report, *US – FSC* , para. 150.

[851] We address this issue *infra*, in particular, in paras. 7.897 *ff*. We recall that our examination of Brazil's export subsidy claims related to export credit guarantees granted under the GSM 102, GSM 103 and SCGP programmes is not limited to upland cotton. "Export credit guarantees ... to facilitate the export of US upland cotton, and other eligible agricultural commodities" as addressed in Brazil's panel request, are within the Panel's terms of reference. Such "eligible agricultural commodities" under the United States programmes include both scheduled and unscheduled agricultural products. See our description of the measure in *supra*, Section VII:C. We also refer to our ruling on this issue *supra*, Section VII:B. Exhibit BRA-73 contains an excerpt from the USDA website (www.fas.usda.gov/excreds/...) which offers a summary of activity under the challenged export credit guarantee programmes, indicating the allocations and applications received by country and commodity, 1999-2003. See also Exhibits US-12 and US-41 and Exhibit BRA-299. Exhibit BRA-298 contains a FASonline Press Release dated 24 September 2002: "USDA Amends Commodity Eligibility Under Credit Guarantee Programs", listing eligible standard products and high value agricultural products for GSM 102 and SCGP, available at www.fas.usda.gov/.

> "3.1 *Except as provided in the Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I," (emphasis added, footnotes omitted)

7.671 Pursuant to Article 3.2 of the *SCM Agreement*: "A Member shall neither grant nor maintain subsidies referred to in paragraph 1 [of Article 3]."

7.672 The text of Article 3.1(a) of the *SCM Agreement* indicates that the obligation it contains (and consequently the related obligation in Article 3.2 of that agreement) applies except as provided in the *Agreement on Agriculture*.

7.673 As we have already indicated, we therefore believe that it is appropriate to examine an alleged export subsidy in respect of an agricultural product first under the *Agreement on Agriculture* before, if and as appropriate, turning to any examination of the same measure under the *SCM Agreement.* Furthermore, for the reasons already stated, we believe it is also appropriate to examine an alleged export subsidy in respect of an agricultural product first under the *Agreement on Agriculture* before, if and as appropriate, turning to any examination of the same measure under Article XVI of the *GATT 1994*.[852]

7.674 This approach is borne out by the provisions of Article 13(c)(ii) of the *Agreement on Agriculture.* We recall (once again) that this provision reads:

> "(c) export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be: ...
>
> (ii) exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement."

7.675 The conditions set out in the chapeau of Article 13(c) of the *Agreement on Agriculture* refer to compliance with particular substantive provisions in Part V of the *Agreement on Agriculture* (which includes Articles 8 through 11, as well as, by reference, Article 3.3, of that Agreement) and export subsidy reduction commitments in each Member's Schedule.

7.676 As these two issues – i.e. substantive compliance with the provisions of Part V and fulfilment of Article 13(c) of the *Agreement on Agriculture* – are squarely before us with respect to at least certain of Brazil's claims[853], we conduct a two-pronged enquiry in examining the merits of Brazil's export subsidy claims under the *Agreement on Agriculture*, before proceeding, as appropriate, to Brazil's claims under Articles 3.1(a) and 3.2 of the *SCM Agreement* and/or Article XVI of the *GATT 1994*.

7.677 Our examination of the export subsidy claims of Brazil under the *Agreement on Agriculture* will, in the first instance, determine the merits of Brazil's claims under the export subsidy provisions of the *Agreement on Agriculture*. Where substantive compliance with the provisions of Part V and fulfilment of Article 13(c) of the *Agreement on Agriculture* are both squarely before us, these findings will also be determinative for the purposes of the examination of consistency with Part V of the

[852] This applies *a fortiori* during the implementation period for reasons set out in *supra*, Section VII:C, "Order of analysis".

[853] That is, Brazil's claims relating to user marketing (Step 2) export payments and export credit guarantees under the GSM 102, GSM 103 and SCGP programmes.

*Agreement on Agriculture* called for under Article 13(c)(ii) of the *Agreement on Agriculture*.[854] Should we find a violation of the export subsidy provisions in Part V of the *Agreement on Agriculture,* we may then conduct an examination, as necessary and appropriate for the resolution of this dispute, under Articles 3.1(a) and 3.2 of the *SCM Agreement* and/or Article XVI of the *GATT 1994*.

**4. Section 1207(a) of the FSRI Act of 2002: user marketing (Step 2) payments to exporters**

(a) Main arguments of the parties

7.678 **Brazil** asserts that since the United States did not schedule any export subsidy commitments for upland cotton under the *Agreement on Agriculture*, it may not provide any export subsidies for upland cotton.

7.679 Brazil challenges section 1207(a) of the FSRI Act of 2002 mandating user marketing (Step 2) payments to exporters of upland cotton as a *per se* export subsidy listed in Article 9.1(a), and defined in Article 1(e), of the *Agreement on Agriculture*, which is in violation of Articles 3.3 and 8 of the *Agreement on Agriculture.*[855] In the alternative, Brazil claims that section 1207(a) of the FSRI Act of 2002 mandating payments to exporters is an export subsidy, not listed in Article 9.1, which is applied in such a manner as to circumvent (or threaten to circumvent) the United States' export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*.

7.680 According to Brazil, as section 1207(a) of the FSRI Act of 2002 mandating payments to exporters does not conform fully to the provisions of Part V of the *Agreement on Agriculture*, it is not exempt from actions based on Article 3 of the *SCM Agreement* within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*. For the same reasons as it constitutes an "export subsidy" "contingent upon export" within the meaning of the *Agreement on Agriculture*, the measure also constitutes a prohibited export subsidy in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement.*

7.681 Brazil states that user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are export-contingent because, when certain market conditions prevail, the United States Secretary of Agriculture must make such payments to eligible exporters upon proof of the export of United States upland cotton. The existence of another factual situation in which user marketing (Step 2) payments are available, to domestic users, does not dissolve this export contingency.

7.682 Brazil asserts that the Appellate Body has indicated that context for interpretation of an "export subsidy" under the *Agreement on Agriculture* is found in the *SCM Agreement*. Step 2 export payments involve a subsidy within the meaning of Article 1 of the *SCM Agreement.* Step 2 export payments are also export contingent within the meaning of Article 3.1(a) of the *SCM Agreement* because exporters are only eligible to receive Step 2 export payments if they produce evidence that they have exported an amount of United States upland cotton.[856] The United States' position is flawed because Members could avoid the disciplines of Articles 3.1(a) and (b) of the *SCM Agreement* by structuring a subsidy in such a way as to have both a "*de jure* export contingency" element and a "*de jure* local content contingency" element.[857]

7.683 Brazil further asserts that the text of section 1207(a) clearly indicates that the user marketing (Step 2) programme is mandatory in that it does not provide the United States Secretary of

[854] *Supra*, Section VII:C, "Exempt from actions" and Section VII:A and Panel communication of 20 June 2003.
[855] Brazil's first written submission, paras. 237-238.
[856] Executive summary of Brazil's first written submission, para. 32.
[857] Brazil's oral statement **at** the first session of the first substantive meeting, paras. 74-76.

Agriculture with the discretion to apply it in a WTO-consistent manner. The fact that payments are dependent upon market price conditions does not alter their mandatory nature.[858]

7.684 The **United States** does not contest that user marketing (Step 2) payments are "subsidies" in favour of United States agricultural producers.[859] However, the United States argues that section 1207(a) of the FSRI Act of 2002 – providing for payments to exporters *and* domestic users – is not an export subsidy listed in Article 9.1(a) of the *Agreement on Agriculture* and, in the alternative, not an export subsidy in circumvention of its obligation not to confer an export subsidy with respect to upland cotton contrary to Article 10.1. The United States submits that, in accordance with Article 1(e) of the *Agreement on Agriculture*, to constitute an "export subsidy" for the purposes of the Agreement, the subsidy must first be "contingent on export performance". The benefits of the user marketing (Step 2) programme under section 1207(a) of the FSRI Act of 2002 are not contingent on export performance as they are also available to domestic users. Looking at the programme as a whole, user marketing (Step 2) payments under section 1207(a) of the FSRI Act of 2002 may be obtained without exporting.

7.685 The United States asserts that user marketing (Step 2) payments are made to eligible users of upland cotton. The Secretary of Agriculture is authorized to issue marketing certificates or cash payments to domestic users and exporters of upland cotton for documented purchases by domestic users and sales for export by exporters. The programme is indifferent to whether recipients of the benefit of this programme are parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States or exporters. The United States stresses that *all* upland cotton produced in the United States is eligible for the Step 2 payment without regard to how such cotton is used, and all actual users of such cotton are eligible for the payment. Moreover, the form and rate of payment are identical. The only contingency is use. Eligible domestic users and exporters comprise the universe of eligible users. Parties in the cotton market who do not use cotton are the only parties not eligible for the payment. The United States reports the benefits conferred under the user marketing (Step 2) programme as product-specific amber box domestic support.[860]

7.686 According to the United States, subject to the availability of funds (that is, the availability of CCC[861] borrowing authority), user marketing (Step 2) payments must be made to all those who meet the conditions for eligibility.[862] The United States generally invokes the adjustment authority "circuitbreaker" provision in section 1601(e) in the FSRI Act of 2002, which authorizes the Secretary to adjust support to the maximum extent practicable to comply with the United States' Uruguay Round domestic support commitments.

7.687 The United States submits that, as the measure conforms fully to the provisions of Part V of the *Agreement on Agriculture*, it is exempt from actions based on Article 3 of the *SCM Agreement* within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*. For the same reasons as it does not constitute an "export subsidy" "contingent upon export" within the meaning of the *Agreement on Agriculture*, the measure also does not constitute a prohibited export subsidy in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement.*

(b) Main arguments of third parties

7.688 **Argentina** submits that user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are export subsidies in violation of the United States commitments under

[858] Brazil's response to Panel Question No. 257(b).

[859] United States' response to Panel Question No. 108. The United States, however, argues that user marketing (Step 2) payments to exporters and domestic users constitute domestic support for the purposes of the United States obligations under the domestic support provisions of the *Agreement on Agriculture*.

[860] Executive summary of the United States' first written submission, para. 25.

[861] "CCC" is the Commodity Credit Corporation. See description of the measure, *supra*, Section VII:C.

[862] United States' response to Panel Question No. 109.

Articles 3.3 and 8 of the *Agreement on Agriculture*, not exempt from actions based on Article 3 of the *SCM Agreement* within the meaning of Article 13(b)(ii) of the *SCM Agreement* and in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*. User marketing (Step 2) payments establish the right of exporters to receive a subsidy for shipments made in connection with foreign sale operations, while establishing an obligation upon the CCC to grant that subsidy once the particular requirements are satisfied.[863]

7.689 **Australia** observes that the United States has not specified any reduction commitments in its Schedule for upland cotton. Australia argues that user marketing (Step 2) payments to exporters under both the FAIR Act of 1996 and the FSRI Act of 2002 are export subsidies listed in Article 9.1(a) of the *Agreement on Agriculture* in violation of the United States commitments under Articles 3.3 and 8 of the *Agreement on Agriculture*, not exempt from actions based on Article 3 of the *SCM Agreement* within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture* and in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*. User marketing (Step 2) payments are available only to exporters (export payments) or to domestic users (domestic payments). Section 1207(a)(1) "identifies the two situations which must be different since the very same property cannot be" exported or used within a Member.[864] In each of the distinct factual situations of export or domestic use, such payments are contingent upon export performance or contingent upon the use of domestic over imported goods respectively.[865]

7.690 **New Zealand** agrees with Brazil that user marketing (Step 2) payments to exporters violate *per se* Articles 3.3 and 8 of the *Agreement on Agriculture*[866], as they are either within the description set out in Article 9.1(a) of the *Agreement on Agriculture*, or "at the very least", threaten circumvention of subsidy reduction commitments within the meaning of Article 10.1. The fact that payments may also be made to domestic users of upland cotton does not "dissolve" the export contingency of the payments that are made to exporters. Payments to eligible exporters of upland cotton are dependent on proof of export being provided and are therefore contingent on export performance.[867]

7.691 New Zealand also supports Brazil's conclusion that the Step 2 export payments meet the requirements of a "subsidy" under Article 1.1(a)(1)(i) and Article 1.1(a)2(ii) of the *SCM Agreement* and are contingent upon export within the meaning of Article 3.1(a) of the *SCM Agreement*. Accordingly if the Panel finds, as New Zealand believes it should, that Step 2 export payments constitute *per se* prohibited subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the programme without delay. New Zealand therefore supports Brazil's request that the Panel make such an express recommendation.[868]

(c) Evaluation by the Panel

*(i) Claims under the Agreement on Agriculture*

7.692 Brazil claims that section 1207(a) of the FSRI Act of 2002 mandating user marketing (Step 2) payments *to exporters* is a *per se* export subsidy within the meaning of Article 9.1(a) of the *Agreement on Agriculture*. The United States disagrees, asserting that section 1207(a) of the FSRI Act of 2002, as a whole, provides for payments to both exporters *and* domestic users.

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[863] Argentina's response to Panel third party Question No. 38.
[864] Australia's written submission to the first session of the first substantive meeting, paras. 52-54.
[865] Australia's response to Panel third party Question Nos. 38 and 39.
[866] New Zealand's written submission to the first session of the first substantive meeting, paras. 3.03-3.04.
[867] New Zealand's written submission to the first session of the first substantive meeting, paras. 3.05-3.08.
[868] New Zealand's written submission to the first session of the first substantive meeting, paras. 3.10-3.11.

7.693 We recall that Article 3.2 of the *DSU* recognizes that interpretative issues arising in WTO dispute settlement are to be resolved through the application of customary rules of interpretation of public international law. It is well settled that the principles codified in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*") are such customary rules.[869] Thus, the task of interpreting a treaty provision must begin with its specific terms.

7.694 We naturally begin our examination of Brazil's claim with the text of the relevant treaty provision. Article 9 of the *Agreement on Agriculture* is entitled "Export Subsidy Commitments". Article 9.1(a) reads:

> "1. The following export subsidies are subject to reduction commitments under this Agreement:
>
> (a) the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance; ..."

7.695 We do not understand the United States to disagree that section 1207(a) of the FSRI Act of 2002 -- the legislative provision governing the user marketing (Step 2) payments to exporters and domestic users -- provides for payments that constitute "the provision by governments ... of direct subsidies ... to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board ...".[870]

7.696 Nor, in our view, could the United States properly do so. User marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are granted by the CCC of the United States Department of Agriculture, which is a United States government agency. The payments take the form of cash grants (or commodity certificates)[871] for which no consideration is received by the government. The recipients of the export payments are expressly defined in the text of the implementing regulations of the measure as "eligible exporters", which includes "...a producer or a cooperative marketing association" (both terms which appear in the text of Article 9.1(a) of the *Agreement on Agriculture*).

7.697 Rather, the key issue before us is whether the measure provides for subsidies "contingent on export performance" within the meaning of Article 9.1(a) of the *Agreement on Agriculture*.

7.698 Article 1(e) of the *Agreement on Agriculture* states that the term "export subsidies" "refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement".

7.699 However, the *Agreement on Agriculture* does not contain any further textual or contextual elaboration of that term. The term "contingent upon export performance" also appears in Article 3.1(a) of the *SCM Agreement*. That provision reads:

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[869] Article 31(1) of the *Vienna Convention* provides in relevant part that: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

[870] The United States' submits that user marketing (Step 2) payments are support in favour of agricultural producers. See United States' response to Panel Question No. 108.

[871] The parties concur that there is no need to draw any distinction between cash payments and "commodity certificates" in terms of whether a "subsidy" exists. Brazil makes no material distinction in its allegations, while the United States' concurred with this proposition in its response to Panel Question No. 110. We therefore do not make any such distinction in our analysis.

> "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact[4], whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I[5] ..."
>
> ---
>
> [4] This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.
>
> [5] Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

7.700 We see no reason to read the term "contingent upon export performance" in the *Agreement on Agriculture* differently from the same term in the *SCM Agreement* for the purposes of this dispute. The two Agreements use precisely the same words to define "export subsidies". We therefore believe that it is appropriate for us to seek contextual guidance in that provision of the *SCM Agreement* for our interpretation of the term "contingent upon export performance" in the *Agreement on Agriculture* in the particular circumstances of this dispute.[872]

7.701 The meaning of "contingent" is "conditional" or "dependent for its existence upon".[873] The grant of the subsidy must be conditional or dependent upon export performance. Article 3.1(a) further provides that such export contingency may be the sole condition governing the grant of a prohibited subsidy or it may be "one of several other conditions".[874]

7.702 Brazil is making a claim of "*per se*" contingency, challenging section 1207(a) of the FSRI Act of 2002 "as such".[875] We understand Brazil's *per se* claim to be conceptually analogous to a claim of "*de jure"* export contingency within the meaning of Article 3.1(a) of the *SCM Agreement*. Such *de jure* export contingency is demonstrated on the basis of the words of the relevant legislation, regulation or other legal instrument.[876] A subsidy is also properly held to be *de jure* export contingent where the condition to export can be derived by necessary implication from the words actually used in the measure.[877]

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[872] See, for example, Appellate Body Report, *US – FSC*, para. 141: "We see no reason, and none has been pointed out to us, to read the requirement of 'contingent upon export performance' in the *Agreement on Agriculture* differently from the same requirement imposed by the *SCM Agreement*. The two Agreements use precisely the same words to define 'export subsidies'. Although there are differences between the export subsidy disciplines established under the two Agreements, those differences do not, in our view, affect the common substantive requirement relating to export contingency. Therefore, we think it appropriate to apply the interpretation of export contingency that we have adopted under the *SCM Agreement* to the interpretation of export contingency under the *Agreement on Agriculture*." See also *US – FSC (Article 21.5 – EC)*, para. 192. See also *infra*, note 917.

[873] Appellate Body Report, *Canada – Aircraft*, para. 166.

[874] See Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 111.

[875] See e.g., Brazil's first written submission, para. 245.

[876] Appellate Body Report, *Canada – Aircraft*, para. 167.

[877] Appellate Body Report, *Canada – Autos*, cited with approval in Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 112. This approach stands in contrast to a "*de facto*" inquiry, in which a panel would examine the "total configuration of the facts constituting and surrounding the grant of the subsidy."

7.703 We will therefore examine whether export contingency is apparent from the words of section 1207(a) of the FSRI Act of 2002 (and related legal and regulatory instruments)[878], or can be derived by necessary implication from the words actually used therein.

7.704 Section 1207(a) of the FSRI Act of 2002 governs user marketing (Step 2) payments. The text of section 1207(a) provides that during the period beginning on the date of the enactment of the FSRI Act of 2002 through 31 July 2008, "... the Secretary shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters for documented purchases by domestic users and sales for export by exporters..." where certain market conditions prevail.[879]

7.705 Implementing regulations "set forth the terms and conditions under which CCC shall make payments ... to eligible domestic users and exporters of upland cotton who entered into an Upland Cotton Domestic User/Exporter Agreement with CCC to participate in the upland cotton user marketing certificate program under Section 1207."[880] Eligible upland cotton is domestically produced baled upland cotton which bale is opened by an eligible domestic user or exported by an eligible exporter, between certain time periods and under certain market conditions.[881] "Eligible domestic users and exporters" are defined as follows:

> "(1) A person regularly engaged in the business of opening bales of eligible upland cotton for the purpose of manufacturing such cotton into cotton products in the United States (domestic user), who has entered into an agreement with CCC to participate in the upland cotton user marketing certificate program; or
>
> (2) A person, including a producer or a cooperative marketing association ... regularly engaged in selling eligible upland cotton for exportation from the United States (exporter), who has entered into an agreement with CCC to participate in the upland cotton user marketing certificate programme."[882]

7.706 Eligible upland cotton will be considered:

> "(1) Consumed by the domestic user on the date the bale is opened for consumption; and
>
> (2) Exported by the exporter on the date CCC determines is the date on which the cotton is shipped through 31 July 2008."[883]

7.707 Applications for payment[884] must contain the documentation required by the provisions of the Upland Cotton Domestic User/Exporter Agreement and the instructions that the CCC issues.

7.708 The United States asserts that the user marketing (Step 2) payment programme must be assessed globally, as the relevant United States law and regulations do not separate the programme into domestic users and exporters. The United States asserts that there is but one Step 2 statute and one Step 2 rule set out in the regulations for all upland cotton users. The statute and rule identify

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[878] Exhibit BRA-37 contains 7 CFR 1427.100 *et seq.*, which are the regulations setting forth the terms and conditions under which the CCC shall make user marketing (Step 2) payments under section 1207 of the FSRI Act of 2002.

[879] Section 1207(a) of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1, and 7 CFR 1427.100-1427.108 (1 January 2003 edition), reproduced in Exhibit BRA-37.

[880] See 7 CFR 1427.100(a), reproduced in Exhibit BRA-37.

[881] See 7 CFR 1427.103(a), reproduced in Exhibit BRA-37.

[882] See 7 CFR 1427.104(a), reproduced in Exhibit BRA-37.

[883] See 7 CFR 1427.108(c), reproduced in Exhibit BRA-37.

[884] There are separate reporting forms for exporters and domestic users. Eligible domestic users must submit form CCC-1045UP-1. Eligible exporters must submit form CCC-1045UP-2.

"domestic users" and "exporters" as the universe of *bona fide* users of upland cotton and thus potential recipients for Step 2 payments. According to the United States, the only distinction drawn between these recipients is the proof of use: domestic users are paid when they open a bale, and exporters are paid when they export. For the United States, as it is not necessary to export in order to receive a Step 2 payment, the Step 2 payments to exporters are not contingent upon exportation.

7.709 We agree that user marketing (Step 2) payments are governed by a single legislative provision: Section 1207(a) of the FSRI Act of 2002. We also agree that there is a single set of regulations pertaining to the Step 2 programme: 7 CFR. 1427.100 *ff*. We further agree that, pursuant to the legislation and regulations, the form[885] and rate of payment[886] to domestic users and exporters are identical; and the fund from which payments are made is a unified fund available to both eligible domestic users and exporters. We acknowledge that, as the United States argues, upland cotton does not have to be exported in order to trigger eligibility for a user marketing (Step 2) payment under section 1207(a) as domestic users are also eligible (i.e. for a payment to a *domestic user*).[887]

7.710 However, we disagree with the United States that this measure involves only one factual situation, which is use of upland cotton during a particular period of time.[888]

7.711 We recall that at least two prior WTO disputes have addressed claims under Article 3.1(a) of the *SCM Agreement* pertaining to alleged export subsidies involving a distinct set of circumstances and discrete segments of recipients: *Canada - Aircraft* and *US – FSC (Article 21.5 – EC)*. Brazil cites the Appellate Body reports in these disputes in support of its arguments that the user marketing (Step 2) payments to exporters are export-contingent. The United States contends that neither report is relevant as they speak to different factual situations. For its part, the United States invokes the panel report in *Canada – Dairy*, which concluded that where a subsidy was available either exclusively for the domestic market or in connection with exportation but also with the domestic market, "access to milk under such other classes is not 'contingent on export performance.'"

7.712 We recall the essence of these three prior reports cited by the parties to discern any relevance they may have for the instant dispute.

7.713 First, in its report in *US – FSC (Article 21.5 – EC)*, the Appellate Body stated:

> "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances. Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the

[885] In this respect, we refer to 7 CFR 1427.106, which makes no distinction between exporters and domestic users in terms of the form of payment: "Payments under this subpart shall be made available in the form of commodity certificates [...] or in cash, at the option of the program participant."

[886] 7 CFR 1427.107 outlines the payment rate for purposes of calculating payments, and does not differentiate between the rate applicable to domestic users and exporters. The Upland Cotton Domestic User/Exporter Agreement in Exhibit US-21, Section A-4 prescribes that the general payment rate shall be in accordance with the regulations found in 7 CFR 1427. While there are slight differences between the provisions governing the reporting for the purposes of payment rate to domestic users, on the one hand, and exporters, on the other, we understand that these do not affect the amount actually paid.

[887] United States' oral statement at the first session of the first substantive meeting, paras. 25-26.

[888] United States' response to Panel Question No. 99.

> second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."[889] (footnote omitted)

7.714 The facts and conditions relating to the grant of the subsidy before us are, to some extent, distinguishable from those addressed by the panel and Appellate Body in *US – FSC (Article 21.5 – EC)*. In that dispute, the subsidy programme dealt with products produced within and outside the United States. There, the export-contingency of the subsidy *vis-à-vis* products produced within the United States was not vitiated by the fact that the subsidy could also be obtained in a second set of circumstances, irrespective of whether the subsidy in this second set of circumstances (in respect of property produced outside the United States) was also export contingent. By contrast, here, the two "situations" in the user marketing (Step 2) programme *both* involve production within the United States, whether for domestic use or for export. That is, the eligible product (upland cotton) is the same *and* its locus of production (i.e. within the United States) is identical for all user marketing (Step 2) user payments under section 1207(a) of the FSRI Act of 2002.[890]

7.715 Second, in *Canada – Aircraft*, the Appellate Body stated that,

> "[T]he fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".[891]

7.716 The facts and conditions relating to the grant of the subsidy before us are, to some extent, distinguishable from those addressed by the panel and Appellate Body in *Canada - Aircraft*, in terms of the eligible product itself. In that dispute, the subsidy in question was available to multiple industry sectors. There, the export-contingency of the subsidy *vis-à-vis* regional aircraft was not vitiated by the fact that payments in some other industry sectors may not have been contingent upon export performance. By contrast, here, the subsidy programme under section 1207(a) deals with one eligible product – upland cotton – and not with any other product or industry sector. The eligible product is notionally *all* United States upland cotton, subject to its eligible "use".

7.717 Third, in *Canada – Dairy*, the panel stated:

> "The United States also makes claims under milk classes other than Classes 5(d) and (e). In this regard, we note that milk under such other classes is also available (often exclusively) to processors which produce for the domestic market. Accordingly, access to milk under such other classes is not "contingent on export performance". We therefore find that such other milk classes do not involve an export subsidy under Article 9.1(a)."[892]

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[889] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 119.

[890] We recall that 7 CFR 1427.103(a) and (c), reproduced in Exhibit BRA-37, provide that "[...] eligible upland cotton is *domestically produced* baled upland cotton" which "must *not* be" "imported cotton" (emphasis added).

[891] Appellate Body Report, *Canada – Aircraft*, para. 179.

[892] Panel Report, *Canada – Dairy*, para. 7.41. The Panel reached a similar view under Article 10.1 of the *Agreement on Agriculture*.

7.718 The facts and conditions relating to the grant of the subsidy before us are also distinguishable from those addressed by the panel in *Canada – Dairy*, in light of the express terms of the text of the measure. In that case, there was no explicit condition limiting a discrete segment of the payments of the subsidies concerned to exporters, nor was there a subsidy expressly combining the two contingency components before us: that is, use of domestic products and exportation.

7.719 We thus recognize that the facts and conditions surrounding the grant of the subsidy before us are, to some extent, distinguishable from those addressed in those previous disputes.

7.720 We nevertheless firmly believe that the legal principles in *US – FSC (Article 21.5 – EC)* and *Canada - Aircraft* are relevant and illuminating here. We understand these prior reports to stand for the proposition that export contingency in respect of a discrete segment of payments in one set of circumstances may not be vitiated by the existence of other discrete segments of payments which may not be conditioned upon exportation.

7.721 On this basis, even if we examine the legislative and regulatory framework governing user marketing (Step 2) payments globally, we cannot accept the United States' argument that we should treat all user marketing (Step 2) payments as a single situation and all recipients as a single class of eligible "users" who constitute the entire universe of potential purchasers of upland cotton from producers.[893]

7.722 Rather, we must discern the actual nature of the measure from its text. The text of the measure itself explicitly identifies, on its face, two distinct factual situations involving two distinct types of eligible recipients: one in which the payment is made to eligible exporters, and another in which the payment is made to eligible domestic users.

7.723 The universe of potential recipients of user marketing (Step 2) payments are "eligible domestic users" and "eligible exporters". Contrary to the United States' assertion, this is not a single class of eligible "users" who constitute the entire universe of potential purchasers of upland cotton from producers.

7.724 A bale of United States domestically produced upland cotton must *either* be exported to trigger receipt of a user marketing (Step 2) export payment, *or* purchased for domestic use to trigger receipt of a user marketing (Step 2) domestic payment. The two situations must be distinct as the same bale of cotton cannot be exported and also sold to a domestic user.[894]

7.725 We consider it determinative that the text of the single legal provision at issue explicitly identifies the two distinct situations in which user marketing (Step 2) payments are made. The text does not identify a single monolithic situation in which payments are made to a single class of recipients. On the contrary, the text of the measure itself compels us to examine separately the conditions pertaining to the grant of the subsidy in these two distinct factual situations addressed by the measure that involve two distinct sets, or discrete segments, of eligible recipients.[895] We do not

[893] United States' oral statement at the first session of the first substantive meeting, para. 25.

[894] We find support for this approach in Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 115. See also the text of the measure itself, reproduced in Exhibit BRA-37, 7 CFR 1427.103(c)(1), where the definition of eligible upland cotton indicates that it must not be, *inter alia*, "[c]otton for which a payment, under the provisions of this subpart, has been made available".

[895] Segregated data is available indicating the amount of payments going to domestic users and exporters under the programme and its FAIR Act predecessor. Brazil initially submitted such data by fiscal year and use (Exhibit BRA-69). In response to Panel Question No. 104, the United States subsequently submitted USDA data. The USDA data, which we have no reason to believe is not factually accurate, shows that in 1991-1993 and 1997-2001, domestic user payments were greater than export payments. Export payments exceeded domestic user payments in 1994-1996 and 2002. In 1996, there were no domestic payments: only export payments were made. The amounts indicated for export payments, on a fiscal year basis, are as follows: 1991:

see this as any kind of artificial bifurcation in our analysis of the measure before us. We see this as being at the heart of the *de jure* export contingency at issue.[896]

7.726 This textual distinction is not the only distinction between the two distinct factual situations, involving two distinct sets, or discrete segments, of eligible recipients.

7.727 We note further that a distinction is drawn in the measure itself between domestic users and exporters in terms of the proof needed to be eligible for the subsidy: domestic users are eligible upon proof of opening a bale, and exporters are eligible upon proof of export. Documentation to be submitted is also different. There are separate regulatory sub-sections and separate conditions pertaining to fulfilment of either of the two situations in which a user marketing (Step 2) subsidy can be granted.[897]

7.728 Furthermore, the relative proximity of the recipient of the user marketing (Step 2) payment to the producer may also differ depending upon whether the transaction involves exportation or domestic use.[898] The recipients of domestic payments are necessarily *not* producers; they are domestic *users*. By contrast, the recipients of export payments may include producers.[899]

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$17,259; 1992: $30,852,107; 1993: $89,095,640; 1994: $178,266,742; 1995: $75,200,203; 1996: $34,798,579; 1997: $2,875,936; 1998: $158,924,004; 1999: $113,521,476; 2000: $185,273,956; 2001: $90,903,021; 2002: $105,415,152. See United States' response to Panel Question No. 104. We also refer to Section VII:D *supra* in relation to data pertaining to user marketing (Step 2) payments to domestic users, as well as to unsegregated data available, for crop years 1991-2001, in Exhibit BRA-4, as follows ($ million): 1991: $140.3; 1992: $206.7; 1993: $198.9; 1994: $90.5; 1995: 34.1; 1996: 3.3; 1997: $390.2; 1998: $307.5; 1999: $421.6; 2000: $236.1; 2001: $196.3. For fiscal year 2002, the record indicates, in United States response to Panel Question 196, an amount of $415,379, 000; We note that we are conducting a *de jure* examination of the text of the measure, on its face, and that it is therefore not strictly necessary to consider actual conditions surrounding the operation of the measure. See, for example, *supra*, footnote 877. If, however, the Appellate Body were called upon to review this matter and disagreed with our export contingency analysis here under Article 9.1(a) and, in the alternative, Article 10.1 of the *Agreement on Agriculture*, then such data might be relevant for determination of the level of domestic support examined in Section VII:D, *supra*.

[896] Even if Brazil's claim was not solely one of *de jure* inconsistency, it seems to us that it would only be necessary for us to consider any *de facto* inconsistency where *de jure* inconsistency was not apparent on the face of the measure itself.

[897] Brazil's oral statement at the first session of the first substantive meeting, paras. 71-73.

[898] Export-contingent subsidies need not be made solely to producers of the product concerned. To the extent a subsidy made to a purchaser of the product enables that purchaser to obtain that product on more favourable terms than would otherwise be available in the marketplace, this will, at a minimum, represent a prima facie case that the payments confer a benefit on the *producers* of that product as well, as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products. The Panel in *Canada – Aircraft Credits and Guarantees* examined whether or not a benefit was conferred on the producer by virtue of a benefit being conferred on the customer purchasing the product (para. 7.229 and note 187 of that Panel Report), and endorsed the following statement by the *Brazil – Aircraft (Article 21.5—Canada II)* Panel: "We note that PROEX III payments are made in support of export credits extended to the *purchaser*, and not to the *producer*, of Brazilian regional aircraft. In our view, however, to the extent Canada can establish that PROEX III payments allow the purchasers of a product to obtain export credits on terms more favourable than those available to them in the market, this will, at a minimum, represent a *prima facie* case that the payments confer a benefit on the *producers* of that product as well, as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products." See Panel Report, *Brazil – Aircraft (Article 21.5 – Canada II)*, para. 5.28, footnote 42) (emphasis in original).

[899] In connection with Panel Question No. 249 observing that 7 CFR 1427.104(a)(2) includes "a producer" within the definition of "eligible exporter", the United States indicated that producers would only receive the payments in their capacity as manufacturers, that this would only occur with very large producers, if at all, and that such payments would be "highly isolated". See United States' 28 January 2004 comments on Brazil's response to Panel Question No. 249.

7.729 Moreover, an export sale transaction is sufficient for the purposes of section 1207(a). Thus, an eligible exporter having completed an export sale transaction (and having submitted proof of exportation) may receive a "user marketing (Step 2) payment". While the United States asserts that exportation is deemed to be a "use" for the purposes of the programme, an eligible exporter need not open a bale of upland cotton to trigger receipt of a payment. Thus, at the very least, an exporter is not a "user" in the same sense as a domestic "user".

7.730 By contrast, it is not true that *any* completed domestic transaction concerning the sale of upland cotton by a domestic cotton producer qualifies as a use.[900] The eligible domestic *user* criteria exclude all individuals or firms that do not purchase the bale to open it, such as domestic cotton brokers or resellers.[901] [902] This is a fundamental distinction made in the text of the measure itself and confirmed to us by the United States in these proceedings.[903] This fundamental distinction also aligns with the text of the two prohibitions in Article 3.1 of the *SCM Agreement* itself. Article 3.1(b) of the *SCM Agreement* refers to contingency upon the "use" of domestic over imported goods. Article 3.1(a) refers to contingency upon "export performance", which is not expressly referred to in the text of the treaty as any kind of "use".

7.731 The United States insists that because it is not necessary to export in order to receive a user marketing (Step 2) payment (i.e. because user marketing (Step 2) payments are also available to domestic users), the user marketing (Step 2) payments to eligible exporters cannot be export contingent.

7.732 However, this argument does not properly characterize the measure before us. We are not dealing here, for example, with a subsidy that is paid to a producer irrespective of whether the producer sells domestically or for export. Rather, this measure involves payment to two distinct sets of recipients (exporters or domestic users) in two distinct factual situations (export or domestic use).

7.733 As we have seen, these factual situations are distinct in terms of the identified recipients, the proximity of such recipients to the producer, the documentation required to trigger eligibility and the distinction between eligibility on the basis of any export transaction as opposed to the requirement of domestic *use* (not simply *any* domestic sale). Each of these two factual situations, in our view, falls squarely into each of the two prohibitions set out in Articles 3.1(a) and (b) of the *SCM Agreement*.[904]

7.734 It is undeniable that a condition of the receipt of user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 will always and inevitably be proof of exportation. The only way to receive such a payment is through exportation. Export performance is, therefore, a condition of receipt for this discrete segment of eligible recipients.

7.735 Every user marketing (Step 2) payment to an eligible exporter is contingent upon export.

7.736 Here, it is not the case that the subsidy is indiscriminately and generally available to all producers and/or processors of upland cotton, irrespective of whether a domestic or export transaction is involved. Nor does the measure generally target all upland cotton production or processing while

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[900] United States' response to Panel Question No. 96.

[901] United States' 28 January comments on Brazil's response to Panel Question No. 249. We also understand that a producer simply bundling a bale to break it, without involving a transaction with a domestic user, would not be eligible for the payment. We note that Exhibit US-21 (Upland Cotton Domestic User/Exporter Agreement, Section B1) indicates: in the event that the cotton is not used for the specified purpose (by a domestic user as a person regularly engaged in manufacturing eligible upland cotton into cotton products in the United States) "the payment received shall be returned immediately and with interest".

[902] Brazil's response to Panel Question No. 101.

[903] United States' response to Panel Question Nos. 96 and 105.

[904] We also refer to our finding in Section VII:F that the user marketing (Step 2) payment to domestic users is a prohibited Article 3.1(b) subsidy.

merely incidentally and randomly happening to benefit the occasional exporter.[905] Rather, the measure specifically and explicitly targets eligible exporters – persons who are "regularly engaged" in exporting upland cotton – as a defined class of recipient for a defined, discrete, segment of the payments for a single eligible product. No one else is eligible to receive such payments. The only way to receive such payments is to be an eligible exporter exporting eligible (i.e. domestically produced) upland cotton. This United States upland cotton must be exported outside the United States, traversing the United States border. The measure at issue is, therefore contingent, or conditional upon, exportation.

7.737 We recall again the United States' insistence that user marketing (Step 2) payments to eligible exporters cannot be export-contingent because user marketing (Step 2) payments to domestic users are also available.

7.738 We again observe that section 1207(a) grants user marketing (Step 2) payments, under certain market conditions, in two distinct factual situations: (a) where a bale of United States upland cotton is exported by an eligible exporter; and (b) where a bale of United States upland cotton is opened by an eligible domestic user. Our conclusion that the user marketing (Step 2) measure grants subsidies that are export-contingent in the first situation is not affected by the fact that the subsidy can also be obtained in the second situation, which we have also found to constitute a prohibited subsidy (albeit of a different kind, that is, contingent upon use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*).[906]

7.739 The fact that the subsidies granted in the second situation may not be export contingent does not dissolve the export contingency arising in the first situation. The subsidy granted to eligible exporters upon proof of exportation is export contingent, irrespective of the fact that the subsidy given to domestic users is not (although it is a prohibited subsidy of another kind).[907]

7.740 We do not view it as necessary for an entire subsidy programme to be export-contingent in order to find export contingency: we have found that, under section 1207(a), a distinct and explicitly identified and targeted segment of the subsidies will inevitably be export-contingent. Where a programme makes some payments contingent upon export of products, the fact that other, also prohibited, payments under the programme are made to domestic users contingent upon the use of domestic over imported goods cannot eliminate the export contingency of the programme.

7.741 Most importantly, here, we do not believe that it is possible for a Member to design two prohibited subsidy components – an export subsidy and an import substitution subsidy[908] – and, merely through joining them in a single legal provision, somehow render one, or both, of them

[905] Contrary to the United States' assertion (United States' 28 January 2004 comments on Brazil's response to Panel Question No. 249), this is not a situation analogous to the Ad Note to Article III of the *GATT 1994*, which basically describes when a measure imposed at a Member's border may be considered nevertheless an "internal" tax or charge. According to that provision: "Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in [Article III:1] which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in [Article III:1], and is accordingly subject to the provisions of Article III."

[906] Section 1207(a) envisages certain conditions that would exclude potential recipients that are common to both domestic user and exporter payments. For example, in the case of both domestic users and exporters, an "eligible" user cannot include individuals or firms that are not "regularly engaged in" opening bales of upland cotton for manufacturing upland cotton products in the United States or exporting upland cotton from the United States. The United States characterizes this provision as an anti-fraud provision.

[907] We find support for our interpretation in Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 119.

[908] We also refer to our finding *infra*, Section VII:F, that user marketing (Step 2) payments to domestic users are a prohibited import substitution subsidy within the meaning of Article 3.1(b) of the *SCM Agreement*.

"unprohibited". It is simply inconceivable to us that two prohibited subsidies could somehow become permitted because they are provided for in the same legal provision. Two wrongs cannot make a right.

7.742 Finally, we consider whether the measure is mandatory.[909]

7.743 Turning once more to the text of the relevant legal provision, pursuant to section 1207(a)(1) of the FSRI Act of 2002, "the Secretary *shall* issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters" (emphasis added).[910]

7.744 The United States does not disagree that, subject to the availability of funds (that is, the availability of CCC borrowing authority), user marketing (Step 2) payments must be made to all those who meet the conditions for eligibility.[911]

7.745 We are of the view that section 1207(a)(1) of the FSRI Act of 2002 mandates the granting of subsidies in that the United States authorities have no discretion not to allow it if exporters fulfil certain conditions. This is not a situation in which the United States executive enjoys a discretion to somehow grant user marketing (Step 2) payments to exporters in a WTO-consistent manner. Every user marketing (Step 2) payment to an exporter constitutes a prohibited export subsidy.

7.746 The fact that the actual payment of subsidies is triggered only if certain market conditions prevail does not impact upon our analysis of the normative nature and operation of the measure within the United States legal system. The operation of the world upland cotton market, and the underlying determinative prices for the level of user marketing (Step 2) payments to upland cotton, are not exclusively within the control of the United States government. When certain market conditions exist, the Secretary of Agriculture has no discretion: the payments are automatically triggered.

7.747 We recall that, pursuant to section 1601(e) of the FSRI Act of 2002, the United States Secretary of Agriculture is authorized to adjust support to the maximum extent practicable to comply with total allowable *domestic support* levels under the Uruguay Round Agreements. This authority applies to certain aspects of the user marketing (Step 2) programme.[912] However, this authority pertains exclusively to the *level* of United States *domestic support* commitments under the *Agreement on Agriculture*[913], an issue distinct from the constituent qualitative elements and conditionality of subsidies governed by the *SCM Agreement*, and from compliance with the agricultural export subsidy obligations in Part V of the *Agreement on Agriculture*. The level of domestic support is not legally relevant to whether or not the United States grants export-contingent subsidies. Therefore, this provision is not legally determinative for whether the measure is of binding normative nature and operation within the United States domestic legal system, and has no strict relevance to our finding that the user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are prohibited export subsidies within the meaning of Article 3.1(a) of the *SCM Agreement*, or export subsidies under Articles 9.1(a) and 1(e) of the *Agreement on Agriculture*.

[909] See *supra*, para. 7.336 of Section VII:C.
[910] Section 1207(a)(1) of the FSRI Act of 2002, reproduced in Exhibit BRA-29.
[911] United States' response to Panel Question No. 109.
[912] Section 1601(e) pertains to expenditures under subtitles A through E of the FSRI Act of 2002. Section 1207(a) is in Subtitle B of that Act. Levels of domestic support expenditures under section 1207(a) are therefore covered by the provision.
[913] United States' response to Panel Question No. 253. In response to Panel Question No. 253(b), the United States confirmed that "section 1601(e) applies to the Aggregate Measure of Support commitments under the Uruguay Round Agreement on Agriculture."

7.748 We therefore find that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters constitutes a subsidy "contingent on export performance" within the meaning of Article 9.1(a) of the *Agreement on Agriculture*.

7.749 As we have already stated, the United States has no scheduled export subsidy reduction commitments for upland cotton.[914] User marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are an export subsidy listed in Article 9.1 of the *Agreement on Agriculture*. In providing such subsidies, the United States has acted inconsistently with its obligation under Article 3.3 of the *Agreement on Agriculture* to "not provide subsidies in respect of any agricultural product not specified in ... its Schedule". The United States has furthermore acted inconsistently with its obligation in Article 8 of the *Agreement on Agriculture* "not to provide export subsidies otherwise than in conformity with [the *Agreement on Agriculture*] and with the commitments as specified in [its] Schedule".

7.750 In light of this finding, we do not examine Brazil's alternative claim of violation of Article 10.1 of the *Agreement on Agriculture.*

7.751 Having examined the WTO-consistency of the export subsidies for agricultural products, in the first place, under the *Agreement on Agriculture*, we observe that, as articulated in Article 13(c)(ii) of the *Agreement on Agriculture*, to the extent that the export subsidy at issue does not conform fully to the provisions of Part V of the *Agreement on Agriculture*, it is not exempt from actions based on Articles 3.1(a) and 3.2 of the *SCM Agreement*. We, therefore, now examine Brazil's claims based on Articles 3.1(a) and 3.2 of the *SCM Agreement*.

*(ii) Claims under Article 3.1(a) (and 3.2) of the SCM Agreement*

7.752 Pursuant to Article 3.1(a) of the *SCM Agreement*:

> "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I ..." (footnotes omitted)

7.753 The United States does not contest that user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are "subsidies" within the meaning of Article 1 of the *SCM Agreement.*[915] Nor, for the reasons we have already stated, could the United States properly do so.[916] The only question before the Panel is whether such payments are "contingent … upon export performance" within the meaning of Article 3.1(a) of the *SCM Agreement*.

7.754 We recall our earlier finding that user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 constitute a subsidy "contingent upon export performance" within the meaning of Article 9.1(a) of the *Agreement on Agriculture*. Although there are differences between the export subsidy disciplines established under the two Agreements, we do not believe that those differences affect our examination of the substantive requirement relating to export-contingency here.[917] We are not aware of any reason, and none has been brought to our attention in this dispute,

[914] *Supra*, para. 7.666.
[915] United States' response to Panel Question No.108.
[916] We recall our examination *supra*, para. 7.696
[917] We find support for our approach in Appellate Body Report, *US – FSC*. We are aware that the Appellate Body conducted an examination of export subsidies there under Article 10.1 of the *Agreement on Agriculture*. As the definition of "export subsidies" contained in Article 1(e) includes export subsidies listed in Article 9, we see a parallel, in the particular circumstances in this dispute, relating to the requirement of export

why it would not be appropriate to apply directly the interpretation of export contingency that we have adopted under Article 9.1(a) of the *Agreement on Agriculture* – which, in any event, referred for contextual guidance to the export contingency condition in the *SCM Agreement* – to the interpretation of export contingency under the *SCM Agreement* in this factual situation.

7.755 In so doing, we must, once again, underline the unreasonableness of the view of the WTO-consistency of the user marketing (Step 2) payments advocated by the United States in this dispute.

7.756 Acceptance of the United States' argument would be to accept the proposition that a government could elect to bestow export-contingent subsidies simply by combining them with other, equally egregious, but different, prohibited subsidies. Members could thereby avoid the disciplines of both Articles 3.1(a) *and* (b) of the *SCM Agreement* by structuring a subsidy in such a way to have both a "*de jure* export contingency" element and a "*de jure* local content contingency" element. This would reduce the fundamental prohibitions in Articles 3.1(a) and (b) of the *SCM Agreement* to "redundancy and inutility".[918]

7.757 As we have already stated[919], we do not believe that it is possible for a Member to design two prohibited subsidy components and, merely through joining them in a single legal provision, somehow render one, or both, of them "unprohibited". It is simply inconceivable to us that two prohibited subsidies could somehow become permitted because they are provided for in the same legal provision. Two wrongs cannot make a right.

7.758 Furthermore, the interpretation advanced by the United States would be irreconcilable with the object and purpose of the *SCM Agreement*, given that it would give a licence to Member governments to evade any effective disciplines on export subsidies by combining export-contingent subsidies with subsidies contingent on the use of domestic over imported goods in a single legislative provision and programme. This would subvert the most stringent subsidy disciplines in the *SCM Agreement*.[920]

7.759 We recall our earlier finding that the measure is mandatory in nature.[921] We see no reason why that finding, made in the context of our examination under Article 9.1(a) of the *Agreement on Agriculture*, cannot also be applicable to our analysis under Article 3.1(a) of the *SCM Agreement* in this factual situation.

7.760 For these reasons, we find that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters is inconsistent with Article 3.1(a) of the *SCM Agreement*.

7.761 Article 3.2 of the *SCM Agreement* provides: "A Member shall neither grant nor maintain subsidies referred to in paragraph 1" of Article 3. To the extent that section 1207(a) of the FSRI Act

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contingency in Article 9.1(a) of the *Agreement on Agriculture*. See also Appellate Body Report, *Canada – Aircraft*, paras. 162-180.

[918] It is well established that an interpreter is not free to adopt a reading that would reduce whole clauses of a treaty to redundancy or inutility. See, for example, Appellate Body Report, *Brazil – Aircraft*, para. 179 and footnote 110, and Panel Report, *US – FSC (Article 21.5 – EC)*.

[919] *Supra*, para. 7.741.

[920] See Panel Report, *US – FSC (Article 21.5 – EC)*. As that panel also observed, the panel in *Canada – Aircraft* noted that "[…] the object and purpose of the SCM Agreement could more appropriately be summarised as the establishment of multilateral disciplines on the premise that some forms of government intervention distort international trade, [or] have the potential to distort [international] trade." See Panel Report, *Canada – Aircraft*, para. 9.119. We also find support for our view of the object and purpose of the *SCM Agreement* in Appellate Body Report, *Canada – Aircraft*, para. 157, where the Appellate Body referred to "the trade-distorting potential of a 'financial contribution'".

[921] *Supra*, para. 7.748.

of 2002 providing for user marketing (Step 2) payments to exporters is inconsistent with Article 3.1(a), it is, consequently, also inconsistent with Article 3.2 of the *SCM Agreement*.

**5. Export credit guarantee programmes**

(a) Measures at issue

7.762 Brazil challenges export credit guarantees under three United States export credit guarantee programmes: GSM 102, GSM 103, and the Supplier Credit Guarantee Programme ("SCGP") under Articles 10.1 and 8 of the *Agreement on Agriculture*. These measures are described in Section VII:C, *supra*.

7.763 Brazil challenges these programmes both "as such" and "as applied". Because of the analytical approach we adopt below in our examination under the *Agreement on Agriculture*, for the reasons we indicate[922], based on the contextual guidance available under item (j) of the Illustrative List of Export Subsidies in Annex I to the *SCM Agreement*, we do not view this distinction as a determinative one here. Item (j) refers to the provision by governments of export credit guarantee "programmes". We adopt a programme-wide analysis under item (j) and examine whether or not the premiums charged under the export credit guarantee programmes at issue are inadequate to cover long-term operating costs and losses.[923] We then transpose this contextual guidance to make a finding, with respect to the scheduled and unscheduled products at issue, under Articles 10.1 (and 8) of the *Agreement on Agriculture*.[924]

7.764 We recall that our examination here is not limited to upland cotton as our terms of reference include "export credit guarantees ... to facilitate the export of US upland cotton, and other eligible agricultural commodities" as addressed in Brazil's panel request.[925]

(b) Main arguments of the parties

7.765 **Brazil** argues that three United States export credit guarantee programmes – GSM 102, GSM 103 and SCGP – violate Articles 10.1 and 8 of the *Agreement on Agriculture* and are therefore not exempt, under Article 13(c)(ii) of the *Agreement on Agriculture*, from actions based on Articles 3.1(a) and 3.2 of the *SCM Agreement*. Brazil alleges that the programmes also violate the latter provisions.

7.766 Brazil contends that GSM 102, GSM 103 and SCGP result in, or threaten to lead to, circumvention of the United States' export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*. According to Brazil, GSM 102, GSM 103 and SCGP, insofar as they are available for unscheduled products, violate Articles 10.1 and 8 of the *Agreement on*

[922] *Infra*, paras. 7.802 *ff*.
[923] *Infra*, paras. 7.804 *ff*.
[924] *Infra*, paras. 7.870 *ff*.
[925] *Supra*, Section VII:C. We recall that, in our 5 September 2003 communication, we, "invited the parties to address further the issue whether the export credit guarantee programs at issue constitute export subsidies for the purposes of the *Agreement on Agriculture*." We also indicated our intention to rule that the programmes as they relate to upland cotton, and all other eligible agricultural commodities, are within our terms of reference and that the Brazil's statement of available evidence is adequate in this respect. See s*upra*, Section VII:A and Annex L-1.11. Exhibit BRA-73 contains an excerpt from the USDA website (www.fas.usda.gov/excreds/...) which offers a summary of activity under the challenged export credit guarantee programmes, indicating the allocations and applications received by country and commodity, 1999-2003. Exhibit BRA-299 contains a summary of activity of GSM 102, GSM 103 and SCGP for FY 2003. Exhibit US-12 indicates eligible US commodities (and high-value commodities) under the GSM 102 and SCGP programmes. See also Exhibit US-41. Exhibit BRA-298 contains a FASonline Press Release dated 24 September 2002: "USDA Amends Commodity Eligibility Under Credit Guarantee Programs", listing eligible standard products and high value agricultural products for GSM 102 and SCGP, available at www.fas.usda.gov/.

*Agriculture* because they make export subsidies available for unscheduled products. With respect to scheduled products, GSM 102, GSM 103 and SCGP also threaten to lead to circumvention of the United States export subsidy reduction commitments.

7.767 Brazil asserts that item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* and Articles 1 and 3 of the *SCM Agreement* provide contextual guidance for the interpretation of the terms "export subsidies" under Article 10.1 of the *Agreement on Agriculture*. The United States export credit guarantee programmes are export subsidies within the meaning of Article 10 *Agreement on Agriculture* as they are provided at premium rates which are inadequate to cover the long term operating costs and losses of the programmes as set out in item (j) and are therefore export subsidies within the meaning of Article 3.1 of the *SCM Agreement*. According to Brazil, they also constitute financial contributions conferring a benefit, within the meaning of Article 1 of the *SCM Agreement*, as there are no commercially comparable instruments in the marketplace. They are contingent on export under Article 3.1(a) of the *SCM Agreement*.

7.768 Brazil disagrees with an *a contrario* interpretation of item (j): even if an export credit guarantee programme is not an export subsidy within the meaning of item (j) (with adequate premiums for the purposes of item (j)), it could still constitute an export subsidy by virtue of the definitional elements contained in Articles 1 and 3 of the *SCM Agreement*.

7.769 Brazil argues that Article 10.2 of the *Agreement on Agriculture* does not serve to exempt export credit guarantees from the provisions on prevention of circumvention of export subsidy disciplines in Article 10.1 of the *Agreement on Agriculture*, nor from the prohibition on export subsidies in Article 3.1(a) of the *SCM Agreement*. Brazil argues that Article 10.2 indicates Members' commitment to undertake the development of further disciplines on export credit guarantees, but does not imply that no disciplines currently exist.

7.770 For the **United States**, analysis of export credit guarantees under the *Agreement on Agriculture* "begins and ends" with Article 10.2 of the *Agreement on Agriculture*. The United States asserts that Article 10.2 of the *Agreement on Agriculture* "reflects the deferral of disciplines on export credit guarantee programs contemplated by WTO Members"[926] and that export credit guarantee programmes are not export subsidies under the *Agreement on Agriculture* and are not subject to the export subsidy disciplines of that Agreement. Invoking Article 21.1 of the *Agreement on Agriculture* and the introductory language in Article 3 of the *SCM Agreement*, the United States also asserts that Article 10.2 of the *Agreement on Agriculture* is an "explicit exception" from the subsidy disciplines under the *SCM Agreement*.[927]

7.771 While it does not concede that any WTO disciplines exist on agricultural export credit guarantees, it submits that even if the *SCM Agreement* were relevant to United States export credit guarantees, "the only appropriate mode of analysis" is an examination under item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*.[928] The United States also states, however, that Article 1 of the *SCM Agreement* would provide relevant context in determining whether a subsidy exists in order to determine the applicability of Article 10.1 to a particular measure not described in Article 9.1.[929]

7.772 The United States argues that its export credit guarantee programmes "do not run afoul of the criteria of item (j)" of Annex I of the *SCM Agreement* and that, therefore, "…they are not a prohibited export subsidy under Article 3.1(a) of the Subsidies Agreement."[930] The United States thus asks the

[926] United States' first written submission, para. 160.
[927] Executive summary of the United States' first written submission, paras. 35-37.
[928] United States' response to Panel Question No. 75.
[929] United States' response to Panel Question No. 74.
[930] United States' first written submission, para. 183.

Panel to interpret item (j) *a contrario*: to the extent premiums cover long-term operating costs and losses, then export credit guarantees are not export subsidies for purposes of item (j) and they must be automatically deemed not to confer export subsidies for the purposes of Article 10.1 of the *Agreement on Agriculture* or Article 3.1 of the *SCM Agreement*.

7.773 The United States argues that Articles 1 and 3 of the *SCM Agreement* are not relevant. Nevertheless, as an additional line of defence, the United States argues that, even if its export credit guarantee programmes are export contingent financial contributions within the meaning of Articles 1 and 3, they do not confer a "benefit" in the marketplace, as identical instruments are available in the form of "forfaiting" (and private "insurance").

7.774 The United States submits that it is not permitted to provide export subsidies in respect of unscheduled products, but that it is in compliance with its scheduled quantitative reduction commitments with respect to 12 out of the 13 scheduled commodities.[931] In the United States view, under a "mandatory/discretionary" analysis, the relevant question would be whether the provisions establishing the export credit guarantee programmes mandate a breach of any WTO obligation. In the United States view, they do not, in view of the various discretionary elements in the operation of the programmes that restrict the actual issuance of guarantees.

(c) Main arguments of the third parties

7.775 In **Argentina's** view, the United States' interpretation of Article 10.2 of the *Agreement on Agriculture* is entirely at odds with the context of that provision and the object and purpose of Article 10, since it would contribute to the circumvention of export subsidy commitments by excluding an entire category of export subsidies from the general disciplines in that area. Article 1(e) clearly defines export subsidies without excluding those that are not listed in Article 9.1 of the *Agreement on Agriculture*. At the same time, Article 13(c)(ii) stipulates that in order to be exempt from actions based on Article 3 of the *SCM Agreement*, export subsidies must conform fully to the provisions of Part V of the *Agreement on Agriculture*, and not to a particular article. Thus, the lack of disciplines specifically developed for export credit guarantees does not necessarily imply the absence or shortage of criteria that would make it possible to establish whether these instruments "conform fully to the provisions of Part V of this Agreement" as stipulated in the chapeau of Article 13(c).[932]

7.776 According to Argentina, the relevance of Articles 1 and 3 of the *SCM Agreement* is unquestionable when it comes to evaluating the consistency of the export credit guarantees with WTO rules.[933] Argentina does not agree with an *a contrario* interpretation, either with respect to the first paragraph of item (k) or item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*, because unlike the final sentence of the second paragraph of item (k), the text of item (j) does not explicitly recognize that the measure will not be an export subsidy. Argentina submits that an *a contrario* interpretation that circumvents the test of Article of 3.1(a) of the *SCM Agreement* is not possible.[934]

7.777 **Canada** asserts that the United States argument that Article 10.2 of the *Agreement on Agriculture* exempts export credit practices from subsidy disciplines under the Agreement is untenable. Article 10.2 sets out an intention on the part of Members to undertake further work regarding these measures – the simple fact of agreeing to do so, however, does not amount to a

[931] United States' rebuttal submission, para. 183 and data in footnote 220.

[932] Argentina's response to Panel third party Question No. 37 (b).

[933] Argentina's response to Panel third party Question No. 30. Argentina argues that the Appellate Body in *US – FSC* and *Canada – Dairy* has turned to the *SCM Agreement* for context since the *Agreement on Agriculture* does not contain its own definition of a subsidy. According to Argentina, the Appellate Body has also established (in *US – FSC*) that export subsidies under Article 3.1(a) of the *SCM Agreement* constitute export subsidies under the *Agreement on Agriculture*.

[934] Argentina's response to Panel third party Question No. 30.

permission to use those measures to confer export subsidies without consequence and without limit. The United States interpretation of Article 10.2 ignores the context provided by Article 10.1 and contradicts the stated object and purpose of Article 10 as a whole: "Prevention of Circumvention of Export Subsidy Commitments". For the United States to meet the requirements of Article 10.3, it must demonstrate the absence of subsidization as understood under Article 1(e) of the *Agreement on Agriculture.*[935]

7.778 Canada is of the view that United States export credit guarantee programmes may provide "subsidies contingent upon export performance" under Article 1(e) of the *Agreement* on *Agriculture* that are "not listed in paragraph 1 of Article 9", pursuant to Article 10.1. Because the United States has no export subsidy reduction commitments for upland cotton, it may have violated Article 10.1 by applying such subsidies in a manner that results in circumvention of its export subsidy commitments. The United States may have also therefore violated Article 8 of the *Agriculture Agreement* by providing export subsidies "otherwise than in conformity with this Agreement". Canada submits that the Panel should refer to both item (j) and Articles 1 and 3 of the *SCM Agreement* for contextual guidance in interpreting Article 10 of *Agreement on Agriculture*. Item (j) allows the Panel to determine whether the United States provides "export credit guarantee[…] programmes" such that "guaranteed export credit transactions guaranteed" under those programs are subsidized *per se* and Articles 1 and 3 of the *SCM Agreement* enables the Panel to determine whether given quantities of United States exports are subsidized on a transaction-by-transaction basis.[936]

7.779 Canada argues that the United States cannot deny that United States export credit guarantees involve a "financial contribution" in the form of a "potential direct transfer of funds" under Article 1.1(a)(1)(i) of the *SCM Agreement.* Nor can the United States deny that the "export guarantees" are contingent upon export performance under Article 3.1(a) of the Agreement. Canada therefore addresses only the "benefit" requirement of the subsidy definition under Article 1.1(b) of the *SCM Agreement.*[937]

7.780 According to Canada, item (j) of the Illustrative List may not be interpreted *a contrario* to deem United States export credit guarantee practices as not providing export subsidies under Article 10.1. Canada argues that whether an export subsidy exists under Articles 1 and 3 of the *SCM Agreement* is relevant in determining whether the United States programmes grant export subsidies within the meaning of Article 1(e) of the *Agreement on Agriculture*. Where United States programmes may not be deemed to provide export subsidies because they do not meet the requirements of item (j), Articles 10.1 and 10.3 of the *Agriculture Agreement* nevertheless require the United States to demonstrate that it has not granted export subsidies within the meaning of Articles 1 and 3 of the *SCM Agreement* in respect of the relevant quantity of exports.[938]

7.781 The **European Communities** submits that Article 10.2 of the *Agreement on Agriculture* cannot be seen as exempting export credit guarantees granted to agriculture products from WTO disciplines as this provision makes it clear that export credit guarantees are not one of the types of export subsidies listed in Article 9.1 which a Member is given a limited authorization to apply. Thus, export credit guarantees which qualify as export subsidies may be illegal under Article 10.1 when they might lead to circumvention of the export subsidy commitments. Article 10.2 is designed to develop disciplines of a broader nature than simply the regulation of export credits and export credit guarantees which operate as an export subsidy, since whether an export credit guarantee is an export subsidy depends on an analysis of the structure of that instrument.

[935] Executive summary of Canada's written submission to the first session of the first substantive meeting, paras. 14-15.
[936] Canada's response to Panel third party Question No. 31.
[937] Executive summary of Canada's written submission to the first session of the first substantive meeting, paras. 8-11 and Canada's response to Panel third party Question No. 32.
[938] Canada's response to Panel third party Question No. 30.

7.782 The European Communities argues that in the similar way the agreement to negotiate disciplines on harmonized rules of origin does not imply that Members are exempted from other WTO obligations on rules of origin, export credits or export credit guarantees which operate as export subsidies are subject to the export subsidy disciplines of the *Agreement on Agriculture* and the *SCM Agreement*.[939]

7.783 The European Communities disagrees with the United States' argument that there are no disciplines on export credit guarantees. The discipline applying to export credit guarantees, where they operate as export subsidies, is that they should not be provided in a manner inconsistent with Article 10.1. If they are provided inconsistently with Article 10.1 then they are not protected by Article 13 and are subject to the prohibition in Article 3 of the *SCM Agreement*.[940]

7.784 According to the European Communities, the relationship between the Illustrative List and Article 3.1(a) is addressed specifically by footnote 5 of the *SCM Agreement*. Item (j) describes circumstances in which, *inter alia*, export credit guarantee programmes may constitute export subsidies. In certain circumstances (e.g., where the government is the only provider), it may be that the requirement set out in item (j) – export credit guarantees must not be provided at premium rates which are inadequate to cover the long-term operating costs and losses of the programme – represents the appropriate benchmark for determining that an export subsidy does not exist.[941]

7.785 **New Zealand** finds no basis for the assertion by the United States that export credit guarantee programmes are not subject to the export subsidy disciplines of the *Agreement on Agriculture*. Nothing in Article 10.2 suggests that it provides an exception for export credit guarantee programmes from the disciplines of Article 10.1. According to New Zealand, the inclusion of reference to such programmes in the context of Article 10 supports the opposite conclusion - that Members were in fact concerned at the potential for such programmes to circumvent Members' export subsidy reduction commitments. According to New Zealand, while Article 10.1 currently provides the only discipline on the use of export credits, it is expected that the work envisaged in Article 10.2 will elaborate further and more specific disciplines that will presumably make identification of the extent to which such export credit programmes constitute export subsidies more straightforward.[942]

7.786 According to New Zealand, the Panel should refer to both item (j) and Articles 1 and 3 of the *SCM Agreement* for contextual guidance in the interpretation of Article 10 of *Agreement on Agriculture*. The *SCM Agreement* provides both a general definition of an "export subsidy" (specifically the definition of a "subsidy" in the terms of Article 1 and the requirement of contingency upon export in the terms of Article 3) and an Illustrative List containing specific examples of export subsidies. Therefore Articles 1 and 3 and item (j) of the Illustrative List provide contextual guidance for the interpretation of the terms in Article 10.[943]

[939] European Communities' oral statement at the first session of the first substantive meeting, paras. 42-43.

[940] European Communities' response to Panel third party Question No. 37 (b).

[941] European Communities' response to Panel third party Question No. 30.

[942] Executive summary of New Zealand's written submission to the first session of the first substantive meeting, para. 18.

[943] New Zealand's response to Panel third party Question No. 31.

(d) Evaluation by the Panel

*(i) Claims under the Agreement on Agriculture*

i. Overview of Panel's approach

7.787 The initial issue before us is whether the three United States export credit guarantee programmes at issue conform fully to the export subsidy provisions in Part V of the *Agreement on Agriculture*. Pursuant to the provisions governing the relationship between the *Agreement on Agriculture*, the *SCM Agreement* (and the *GATT 1994*), and as articulated in Article 13(c)(ii) of the *Agreement on Agriculture*, if they so conform, then our examination would end there. However, to the extent that they do not "conform fully to" the provisions of Part V of the *Agreement on Agriculture*, we may also conduct an examination under the prohibition on export subsidies in Articles 3.1(a) and 3.2 of the *SCM Agreement* (and Article XVI of the *GATT 1994*).[944]

7.788 The parties agree that export credit guarantees are not included in the non-exhaustive list of export subsidies in Article 9.1, and that Article 10 of the *Agreement on Agriculture* is the relevant provision. We adopt this shared view of the parties, without prejudice to any interpretation of Article 9 of the *Agreement on Agriculture.*

7.789 We structure our examination under Article 10 of the *Agreement on Agriculture* as follows. First, we consider whether United States agricultural export credit guarantee programmes constitute export subsidies for the purposes of Article 10.1 of the *Agreement on Agriculture*. This requires us to identify the definitional elements of an export subsidy under Article 10.1 of the *Agreement on Agriculture*, and to determine what, if any, are the relevant contextual elements provided in the *SCM Agreement* (i.e. item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* and/or Articles 1 and 3 of the *SCM Agreement*).

7.790 Second, we examine whether the agricultural export credit guarantee programmes constitute "export subsidies" which conform fully to the provisions of Articles 10.1 and 8 of the *Agreement on Agriculture*.

7.791 Third, we examine whether Article 10.2 of the *Agreement on Agriculture* provides an "exception" or "carve out" or "deferral of disciplines" for export credit guarantee programmes that constitute export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*.

7.792 Our examination requires us to take account of the burden of proof set forth in Article 10.3. As we have already mentioned[945], Article 10.3 provides a special rule for proof of export subsidies that applies in certain disputes under Articles 3, 8, 9, and 10 of the *Agreement on Agriculture*.[946] Article 10.3 provides:

> "Any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question."

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[944] We refer to our "exempt from actions" and "order of analysis" examinations in Section VII:C, as well as our overview of export subsidy obligations, *supra*, paras. 7.654 *ff.*

[945] We refer to our discussion of the burden of proof, *supra*, Section VII:C.

[946] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, paras. 69-71, 73-75. Contrary to the United States' assertion, in its further rebuttal submission, para. 191, we do not believe that our observation (in our 20 June communication contained in Section VII:A) that no provisions of the *Agreement on Agriculture* are identified as special or additional rules and procedures in Appendix 2 to the *DSU* is at variance with our application of this burden of proof, which flows from the text of Article 10.3 itself and related provisions.

7.793 As outlined above, the United States in effect claims or asserts in response to the primary claims made by Brazil that no export subsidies within the scope of Article 10.1 have been granted by virtue of the export credit programmes in question in excess of the commitment levels applicable to either scheduled or unscheduled products. In these circumstances, as a result of the special rule on burden of proof in Article 10.3, it is for Brazil as the complaining party to prove that the quantity of United States exports of a "scheduled"[947] agricultural product exceed the relevant quantity commitment level referred to in the first clause of Article 3.3 of the Agreement. The United States will then be treated as if it has granted WTO-inconsistent export subsidies in respect of the excess quantity, unless the United States presents adequate evidence to "establish" that no export subsidy has been granted through the United States export credit programmes in question in respect of this excess quantity of exports. With respect to upland cotton and other unscheduled products, the Panel considers that the United States' reduction commitment level, for the purposes of Article 10.3, is zero for each unscheduled product. By virtue of the second clause of Article 3.3, that is the level to which a Member must reduce any Article 9.1 export subsidies that were not in fact specifically made subject to "scheduled" reduction commitments. Accordingly, in the case of upland cotton and other unscheduled products the same sequence is to be followed, with Brazil as the complaining party first having to prove that United States' exports of unscheduled products exceed that "zero" level.[948]

ii. Do the United States agricultural export credit guarantee programmes at issue constitute export subsidies for the purposes of Article 10.1 of the *Agreement on Agriculture*?

7.794 The issue before us here is whether the United States export credit guarantee programmes at issue constitute "export subsidies" within the meaning of Article 10.1 of the *Agreement on Agriculture*.

7.795 Article 10.1 of the *Agreement on Agriculture* is entitled "Prevention of circumvention of export subsidy commitments". It states:

> "Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments."

7.796 Article 1(e) of the *Agreement on Agriculture* states that the term "export subsidies" "refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement". According to its own terms, and read in conjunction with Article 1(e) of the *Agreement on Agriculture*, Article 10.1 covers any subsidy contingent on export performance that is not listed in Article 9.1.

7.797 The *Agreement on Agriculture* does not contain any further textual or contextual elaboration of the terms "subsidies" "contingent upon export performance", beyond the list of export subsidies defined in Article 9.1. Nor does the *Agreement on Agriculture* contain any specific guidance on the

[947] The United States has scheduled export subsidy reduction commitments in respect of the following thirteen commodities: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, eggs. See Schedule XX of the United States of America, Part IV, Section II, entitled "Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments", reproduced in Exhibit BRA-83 and Exhibit US-13.

[948] In any event, even if there is *no* reduction commitment level in respect of unscheduled products, affecting the rules of burden of proof that apply to Brazil's claims pertaining to unscheduled products so as to remove the burden entirely from Brazil or to place the entire burden on Brazil to prove not only that exports have been made, but even that export subsidies have been provided in respect of such exported products, this would not materially affect our analysis, as we are of the view that Brazil has discharged this burden as well, and the United States has failed to discharge its burden in this respect.

criteria that may be applied to determine when export credit guarantee programmes, in particular, in respect of agricultural products may constitute "export subsidies".

7.798 However, as we have previously noted, Article 1 of the *SCM Agreement* defines a "subsidy" as a "financial contribution" that confers a "benefit". In addition, "subsidies", as defined in Article 1 of the *SCM Agreement*, that are "contingent upon export performance" are prohibited by Article 3.1(a) of the *SCM Agreement*. That provision reads:

> "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact[4], whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I[5] ..."

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[4] This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

[5] Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

7.799 We see no reason to consider that, in this factual situation, the concept of "export subsidy" in Article 10.1 of the *Agreement on Agriculture* differs from the same term in the *SCM Agreement*. The two Agreements use precisely the same words to define "export subsidies".[949] We therefore believe that it is appropriate to seek contextual guidance in the relevant provisions of the *SCM Agreement* for our interpretation of the term "export subsidies" in Article 10.1 of the *Agreement on Agriculture* in this factual situation.[950]

7.800 The text of Article 3.1(a) of the *SCM Agreement* prohibits subsidies contingent upon export performance "including those illustrated in Annex I". Annex I to the *SCM Agreement* comprises an "Illustrative List of Export Subsidies". One of the items of this Illustrative List – item (j) – contains a specific textual reference to "export credit guarantee ... programmes". Item (j) of the Illustrative List reads:

> "The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes."

7.801 Brazil asserts that both Articles 1 and 3 of the *SCM Agreement* and item (j) of the Illustrative List provide relevant contextual guidance for the determination of what might constitute an export

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[949] See, for example, Appellate Body Report, *US – FSC*.

[950] Our examination of the United States export credit guarantee programmes on this basis is therefore without prejudice to the interpretation of the term "export subsidies" in the *Agreement on Agriculture* based on the definition of "export subsidies" in Article 1(e) and the text of Article 10.1, and other provisions of the *Agreement on Agriculture*, in and of themselves, or on other available contextual guidance.

subsidy for the purposes of Article 10.1 of the *Agreement on Agriculture*. The United States asserts that an item (j) inquiry is, in the first instance, determinative.[951]

7.802 We look for guidance to the overall disciplines contained in the *SCM Agreement* governing export credit guarantees granted under a Member's export credit guarantee programmes. We see that the *SCM Agreement* contains, in item (j) of the Illustrative List of Export Subsidies in Annex I, an explicit indication as to when export credit guarantee programmes constitute *per se* export subsidies for the purposes of the *SCM Agreement*.

7.803 Subject to the United States' view of the role and effect of Article 10.2 of the *Agreement on Agriculture*, there is no disagreement between the parties to this dispute that, if an export credit guarantee programme meets the elements of item (j), it is a *per se* export subsidy. We therefore examine the United States export credit guarantee programmes in question under the context provided by item (j) in the Illustrative List of the *SCM Agreement*. Only if the result of our examination is that the item (j) test is not met will we proceed to a further contextual examination of the definitional elements contained in Articles 1 and 3 of the *SCM Agreement*.

iii. Are premium rates under the United States export credit guarantee programmes inadequate to cover long-term operating costs and losses pursuant to item (j)?

7.804 In general terms, the test for determining whether an export credit guarantee programme satisfies the terms of item (j) is the net cost to the government, as the service provider, of providing the service under the export credit guarantee programmes.[952] To discern this overall cost to government, item (j) calls for an examination of whether the premium rates of the export credit guarantee programme at issue are inadequate to cover the long-term operating costs and losses of the programmes. Beyond that, item (j) does not set forth, or require us to use, any one particular methodological approach nor accounting philosophy in conducting our examination. Nor are we required to quantify precisely the amount by which costs and losses exceeded premiums paid.

7.805 We understand that we are to look at premiums in relation to long-term operating costs and losses. In this dispute, in order objectively to assess premiums in relation to long-term operating costs and losses, we believe it is also appropriate for us to take into account aspects of the structure, design and operation of the measure before us. We are entitled to inquire whether the programme, including in terms of the premiums charged, was set up in such a way that the total of all premiums would be

[951] To the extent that the United States might contest the "export contingent nature" of its export credit guarantee programmes, we disagree that the United States could properly do so. We note that such programmes are, by their very nature, contingent upon exportation. Pursuant to 7 USC section 5622(a) and (b), reproduced in Exhibit BRA-141, the CCC may guarantee the repayment of credit made available to finance "commercial *export* sales of agricultural commodities" (emphasis added). Only United States agricultural commodities are eligible (see 7 USC 5622(h)), and such commodities must be exported. The programmes are conditional upon exportation. Under 7 CFR 1493.40 and 1493.430, reproduced in Exhibit BRA-38, Exhibit US-6, a firm export sale must exist before an exporter may submit an application for a payment guarantee. Such a firm export sale is a condition for seeking a guarantee under the three United States programmes at issue. We therefore consider that these programmes are export-contingent, in the sense of being conditional or dependent upon exportation within the meaning of Article 3.1(a) of the *SCM Agreement* and Articles 10.1 and 1(e) of the *Agreement on Agriculture*. In addition, we note that the stated purpose of the programme is to increase exports of United States agricultural commodities and to compete against foreign agricultural exports - see 7 USC 5622(h).

[952] We find support for this proposition in Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 93. We further note that item (l) in the Illustrative List refers to "any other charge on the public account constituting an export subsidy in the sense of Article XVI of GATT 1994". The reference to "other" in item (l) supports the view that the other items in the Illustrative List also involve an examination of "charges on the public account", or net cost to government. We are not, therefore, involved, in this part of our analysis, with trying to discern or calculate any benefit to the recipient. For this reason, we do not believe that the arguments of the United States relating to whether or not a benefit to the recipient exists, for example, in its first written submission, para. 177, are legally relevant to the issue before us.

likely to cover the total of all operating costs and losses under the programme. For example, where a programme does not provide for premium rates that are fully reflective of the risks of a particular transaction, this might be one indicator that the programme was set up in such a way that its long-term operating costs and losses have to be borne, in total or in part, by the government.[953]

7.806 We note that it was well-established in the WTO, and, prior to that, in the GATT, that export credit guarantees may generally constitute export subsidies. This possibility was identified in the Illustrative List of Export Subsidies incorporated in the *Tokyo Round Subsidies Code*[954], and had already been acknowledged by the 1960 Working Party.[955]

7.807 We recall that item (j) focuses on "The provision by governments (or special institutions controlled by governments)" of export credit guarantee programmes meeting certain conditions. There is no disagreement between the parties that the CCC, a United States government agency, is the agency responsible for administering the three export credit guarantee programmes at issue.[956] Our examination therefore focuses upon CCC's long-term operating costs and losses in administering these programmes, while recognizing that the CCC operates within the larger context of the United States Treasury and the United States government as a whole.

7.808 We must examine the totality of the relevant evidence on the Panel record, on its merits, and on the basis of the text of item (j), to come to an overall view of whether the United States government charges premiums that are inadequate to cover the long-term operating costs and losses of the three United States export credit guarantee programmes at issue: GSM 102, GSM 103 and SCGP.

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[953] We note the view expressed in GATT Panel Report, *EEC – Airbus*. Regarding the condition, "at premium rates, which are manifestly inadequate to cover the long-term operating costs and losses of the programmes" in item (j) of the *Tokyo Round SCM Code*, the panel considered that in assessing an exchange risk programme, what counted was not the particular premium rate applied to a particular transaction, but whether the scheme was set up in such a way that the total of all premiums would be likely to cover the total of all costs and losses under the programme. That GATT panel thus considered that item (j) was applicable to any exchange risk programme which involved a net cost to the government. A programme that did not contain premium rates and which was set up in such a way that its long-term operating costs and losses have to be borne, in total or in part, by the government would therefore fall under the provision of item (j). As with any unadopted report, we may find useful guidance to the extent we consider this relevant. See Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 14: "a panel could nevertheless find useful guidance in the reasoning of an unadopted panel report that it considered to be relevant."

[954] The text of item (j) of the Illustrative List of Export Subsidies annexed to the *Tokyo Round Subsidies Code* was identical to the current item (j), except that it contained the term "manifestly" modifying "inadequate to cover long term costs and losses of the programmes".

[955] "Subsidies: Provisions of Article XVI:4", Report adopted on 19 November 1960 (L/381). Article XVI:4 deals with exports of any product other than a primary product. That Working Party referred to a list of practices which certain contracting parties agreed, for certain purposes, "generally are to be considered as subsidies in the sense of Article XVI:4 [of the *GATT 1994*] or are covered by the Articles of Agreement of the International Monetary Fund." That list included: "In respect export credit guarantees, the charging of premiums at rates which are manifestly inadequate to cover the long-term operating costs and losses of the credit insurance institutions". See BISD, 9S/185, paras. 5-6.

[956] See Exhibit US-129 and Exhibit BRA-158. Established in 1933, the CCC is a wholly owned government corporation within the United States Department of Agriculture. It is the United States government's primary financing arm for a range of domestic and international agricultural programs, including extending export credit guarantees for commodity sales to other countries. The CCC has no employees. It carries out the majority of its programs through the personnel and facilities of the Farm Service Agency (FSA). A Board of Directors manages CCC, subject to the general supervision and direction of the Secretary of Agriculture, who is an *ex officio* director and chairperson of the Board. The Board consists of seven members, in addition to the Secretary, appointed by the President of the United States with the advice and consent of the Senate. The CCC has its own disbursing authority rather than issuing payments through the Treasury Department. It has a variety of funding mechanisms (Appendix B of Exhibit US-129 lists CCC accounts with the Treasury Department).

We underline that our approach is based on the evidence, taken as a whole, and that no one avenue of inquiry has, in isolation, been determinative for us.

7.809 We begin by examining the terms of the text of item (j).

a. "Export credit guarantee ... programmes"

7.810 Item (j) calls for an examination of export credit guarantee "programmes".[957] Brazil's claims identify three such "programmes", that is, GSM 102, GSM 103 and SCGP. Brazil asserts that an item (j) analysis must examine the export credit guarantee "programmes".

7.811 The United States does not disagree that GSM 102, GSM 103 and SCGP are "programmes". The United States contends, however, that merely tracking the activity of GSM 102, GSM 103 and SCGP on a net present value or cash basis by fiscal year would distort (overestimate) the costs of the programme. The United States distinguishes between activity on a fiscal year basis as opposed to cohort-based subsidy estimates and re-estimates that calculate net present value over the life of the programme. According to the United States, United States budget figures referred to in these proceedings are on a fiscal year basis and do not reflect re-estimates on a cohort basis. [958]

7.812 The United States therefore directs us to adopt a "cohort[959]-specific" approach in our item (j) evaluation.

7.813 The United States further argues that "[n]ot until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal government."[960] Because all cohorts disbursed since the inception of federal credit reform remain open, a logical extension of the United States argument would be that it is impossible for this Panel, at this point in time, to judge whether the CCC guarantee programmes satisfy the elements of item (j).

7.814 However, we have the mandate and duty, within the time period provided under the covered agreements, and respecting the terms of reference given to us by the DSB, to examine Brazil's claims concerning the United States export credit guarantee programmes. We are also not required to use the accounting or regulatory characterization of the Member concerned in our item (j) examination.[961] We are required to interpret a treaty provision in accordance with its specific terms, and in its context.

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[957] As much of the evidence and argumentation submitted relates to the CCC export credit guarantee activity collectively under the three programmes, we also consider that we may treat the programmes collectively to the extent that we have relevant evidence and argumentation before us. Keeping the applicable burden of proof in mind, and to the extent that the record permits, we also examine relevant aspects of the programmes individually.

[958] The United States insists that a fundamental tenet of credit reform accounting is the requirement that the performance of the credit be tracked over its lifetime, which is done by tracking each cohort of credit until the credit period has expired or lapsed. According to the United States, the only estimates and re-estimates that may be applied directly against each other are upward and downward re-estimates for the same "cohort". The United States nevertheless submitted a fiscal-year chart in Exhibit US-147 depicting performance of certain cohorts on a fiscal year/cash basis.

[959] "Executive Office of the President, Office of Management and Budget, June 2002: Circular No. A-11, Part 5: Federal Credit Programs", reproduced in Exhibit BRA-116, defines a "cohort" as all loan guarantees of a programme for which a subsidy appropriation is provided for a given fiscal year (except for modified pre-1992 loan guarantees). All guarantees issued during fiscal year 2002 comprise a distinct cohort. The Panel understands that all cohorts for the CCC export credit guarantee programmes under credit reform are still open, although cohorts for 1994 and 1995 should close this year. Although the formal administrative steps had not been taken to close the 1994 and 1995 cohorts, all financial transactions necessary to do so are complete. See United States' responses to Panel Questions 81(c) and 221(e).

[960] United States' response to Panel Question No. 81(c).

[961] See our more detailed discussion of this *infra*, footnote 993.

7.815 We see no explicit reference to the term "cohort" in the text of item (j). Nor do we read any caveat or condition in the text of item (j) which would require us to await the closure of any or all United States export credit guarantee cohorts before being able to conduct an objective assessment of the matter before us. Our task is not to calculate with precision any difference between premiums and operating costs and losses of certain cohorts on the basis of any specific accounting methodology. Rather, our task is to evaluate whether the premiums charged under the United States export credit guarantee programmes are inadequate to cover long-term operating costs and losses.

7.816 We nevertheless deem that our duty to conduct a thorough and objective assessment of the matter before us permits us also to take into account, to the extent relevant, the cohort-specific evidence before us.

b. "Premiums"

7.817 The ordinary meaning of the word "premiums" is "an amount to be paid for a contract of insurance".[962] There is no disagreement between the parties about the meaning of "premiums" for the purposes of item (j) in this dispute.

7.818 Under the GSM 102, GSM 103 and SCGP export credit guarantee programmes, such "premiums" are the fees paid by the applicant exporter constituting the consideration for the payment guarantee provided by the CCC.

7.819 Under the GSM 102 and GSM 103 programmes, the exporter must remit, with a written application, the full amount of the guarantee fee, and applications will not be approved until the guarantee fee has been received by CCC.[963] In return for this fee, the CCC agrees to pay the exporter (or assignee) an amount not to exceed the guaranteed value, plus eligible interest, in the event that the foreign bank fails to pay under the foreign bank letter of credit or the related obligation[964] in connection with the export sale to which CCC's guarantee coverage pertains.[965] The "guaranteed value" is the maximum amount, exclusive of interest that CCC agrees to pay the exporter (or assignee) under the payment guarantee.[966] The fee is computed by multiplying the guaranteed value by the guarantee fee rate.[967] Typically, 98 per cent of principal and a portion of interest (e.g. 55 per cent)[968] at an adjustable rate is covered.[969]

7.820 Under the GSM 102 and GSM 103 export credit guarantee programmes, the guarantee fee rates are based upon the length of the payment terms provided for in the export sale contract, the degree of risk the CCC assumes, as determined by the CCC, and any other factors which the CCC determines appropriate for consideration.[970] Fees vary by the guaranteed dollar value of the transaction, the repayment period, and the principal repayment interval (annual or semi-annual).[971]

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[962] *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

[963] 7 CFR 1493.70(c), reproduced in Exhibit BRA-38. Guarantee fee rates paid in connection with an approved application will ordinarily not be refundable.

[964] 7 CFR 1493.60, reproduced in Exhibit BRA-38.

[965] 7 CFR 1493.10(3), reproduced in Exhibit BRA-38.

[966] 7 CFR 1493.20(o), reproduced in Exhibit BRA-38.

[967] 7 CFR 1493.70 (b), reproduced in Exhibit BRA-38.

[968] See Exhibit BRA-84.

[969] See FAS Online: CCC Export Credit Guarantee Programs, reproduced in Exhibit BRA-71.

[970] 7 CFR 1493.70(a), reproduced in Exhibit BRA-38. We note, however, that the United States has acknowledged that the fees are not risk-based. See e.g. Exhibit US-150.

[971] United States' response to Panel Question No. 84. Exhibit BRA-98 contains a fee schedule for GSM 102 and GSM 103 announced by USDA on 4 September 2001, which replaced those in PR 1080-94 issued 26 September 1994 and PR 1085-94, issued 27 September 1994. This fee schedule was altered for GSM 102 to include fees for 30-day and 60-day coverage, effective 1 October 2002 (the fee rates and length of coverage for

7.821 Under the SCGP, the exporter must similarly remit, with a written application, the full amount of the guarantee fee.[972] In return for this fee, the CCC agrees to pay the exporter (or assignee) an amount not to exceed the guaranteed value, plus eligible interest, in the event that the importer fails to pay under the importer obligation[973] in connection with the export sale to which CCC's guarantee coverage pertains.[974] The fee is computed by multiplying the guaranteed value by the guarantee fee rate.[975] The guaranteed value is currently 65 per cent of the principal amount.[976]

7.822 According to uncontested information submitted to us, a total of roughly $246 million in premiums was collected on CCC guarantees under the GSM 102, GSM 103 and SCGP programmes over the period 1992-2003.[977] Pursuant to item (j), we examine whether premiums are inadequate to cover the long-term operating costs and losses of the programmes.

c. "Are inadequate to cover"

7.823 Item (j) requires us to examine whether premiums charged are "inadequate" "to cover" long-term operating costs and losses. "Inadequate" means: "not adequate; insufficient".[978] "Cover", in the sense that it is used in item (j), means: "...to be enough to defray (expenses, a bill, etc.)"[979]; "to be sufficient for, to counterbalance; as receipts that do not cover expenses...".[980]

7.824 We therefore understand that, under item (j), we are to assess whether or not premiums are sufficient to meet the long-term operating costs and losses of the export credit guarantee programmes.

7.825 We are not called upon to make a precise quantification of the amount by which premiums may or may not be sufficient. Rather, we are called upon to compare premiums charged against long-term operating costs and losses in order to assess the sufficiency of such premiums. In our view, such sufficiency cannot be met without at least some indication that premiums are charged with a view to covering long-term operating costs and losses.

7.826 Moreover, as we are looking into whether the government is incurring a net cost in running the programmes, we understand that it is premiums, rather than any other source of revenue from whatever source derived[981], that are to be the revenue that covers long-term operating costs and losses. Item (j) does not make any reference to any other source of revenue that must be examined in counterbalance with operating costs and losses. Rather, it explicitly identifies premiums. It then juxtaposes premiums against long-term operating costs and losses.

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GSM 103 remained unchanged). The revised fee rates are indicated in Exhibits US-20 and BRA-155. The fees are expressed in cents per $100 of coverage, based on guaranteed value, with annual and semi-annual principal repayment intervals, and with fees including a charge to provide adjustable per annum eligible interest.

[972] 7 CFR 1493.460(c), reproduced in Exhibit BRA-38. Guarantee fee rates paid in connection with an approved application will ordinarily not be refundable.

[973] 7 CFR 1493.440, reproduced in Exhibit BRA-38.

[974] 7 CFR 1493.400, reproduced in Exhibit BRA-38.

[975] 7 CFR 1493.460(b), reproduced in Exhibit BRA-38. See also Exhibits BRA-166-168, which indicate, *inter alia*, that the guarantee fees is $0.45 per $100 (up to 90 days) and $0.90 per $100 (90 to 180 days).

[976] This is according to record evidence. 7 CFR 1493.460, reproduced in Exhibit BRA-38, provides that current "guarantee fee rates" will be available by Programme Announcement. See *FAS Online: CCC Supplier Credit Guarantee Program*, reproduced in Exhibit BRA-72.

[977] Exhibit US-128.

[978] *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995); *Webster's Revised Unabridged Dictionary* (1996).

[979] *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

[980] *Webster's Revised Unabridged Dictionary* (1996).

[981] We refer to United States' response to Panel Question No. 77.

d. "Long-term"

7.827 Item (j) does not define the words "long-term" nor does it identify any conceptual or temporal benchmark, let alone a precise temporal period, which would constitute "long-term". Nor does it stipulate that the examination called for must necessarily be an historical or retrospective one.

7.828 The ordinary meaning of "long-term" is "occurring in or relating to a long period of time."[982] In its ordinary meaning, "long-term" does not necessarily pertain to any particular temporal period. Nor does it require that the "long-term" under consideration must be either in the future or in the past, or have any particular temporal or conceptual benchmark.

7.829 According to the United States, the item (j) analysis requires "a certain degree of retrospection..." to make the requisite comparison between premiums and net operating results of the programme. Brazil does not entirely agree, but nevertheless submits a considerable amount of evidence pertaining to past performance.[983]

7.830 The United States concedes that the programmes historically "admittedly incurred" "significant losses" with respect to Poland and Iraq[984] which are no longer reflected in accounts relating to cohorts since 1992. However, the United States asserts that to subject the programme to the "analytical yoke" of the unique circumstances of the Polish and Iraqi defaults over 10 years ago would effectively require elimination of the programme altogether.[985] While Brazil does not consider that an examination beyond 10 years is "inappropriate", Brazil nevertheless believes that it is adequate in this case to assess the performance of the CCC export credit guarantee programmes.[986]

7.831 The parties have submitted argumentation and evidence relating to the fiscal years since 1992, largely concerning the fiscal years from 1992-2002, and including, where possible, more recent data. Both parties agree that the period since 1992 is an adequately "long-term" period for the Panel to assess in its examination of Brazil's claims in this dispute.

7.832 We understand the reference to "long-term" in item (j) to refer to a period of sufficient duration as to ensure an objective examination which allows a thorough appraisal of the programme and which avoids attributing overdue significance to any unique or atypical experiences on a given day, month, trimester, half-year, year or other specific time period. The reference to "long-term" guides us to undertake an overall appraisal of the programme over a sufficiently long period of time in order to gain a full appreciation of the functioning of the programme and any relationship between premiums charged and operating costs and losses.

7.833 On the basis of the evidence and argumentation submitted to us, in our examination under item (j), we believe that it is reasonable to take into account specific developments over the period since 1992. We note that this period coincides with the entry into effect of the United States Federal Credit Reform Act of 1990, which introduced a reformed accounting methodology for the United States government to measure and reflect the performance of, *inter alia*, its export credit guarantee programmes, effective from fiscal year 1992. We also note that one of the programmes in issue, the SCGP was not in operation at the beginning of this period. We further note that a part of the period since 1992 – the years prior to 1995 – pre-date the entry into force of the *WTO Agreement*, and thus the entry into force of the current set of agricultural export subsidy disciplines. We nevertheless include this period in our examination, on the basis of the evidence and argumentation submitted.

[982] *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).
[983] Brazil's response to Panel Question No. 257(a)(1).
[984] United States' rebuttal submission, paras. 172-174.
[985] United States' response to Panel Question No. 221(i).
[986] e.g. Brazil's 28 January 2004 comments on United States' response to Panel Question No. 226.

7.834 We consider that we may, however, also consider, for contextual confirmation, developments prior to this period. Item (j) contains no textual limitation on how "long-term" our analysis may be.

7.835 Furthermore, as we have already indicated[987], we also believe that the item (j) analysis need not be a purely retrospective one. It also appropriately takes into account elements of the structure, design and operation of the measure which may affect the long-term operating costs and losses of the programmes, in terms of whether the programmes involve a net cost to government.

e. "Operating costs and losses"

7.836 Item (j) refers to "operating costs and losses". It does not identify what constitutes such "operating costs and losses". It provides no further precision or description of "operating costs and losses". It does not provide an illustrative nor exhaustive list of such operating costs and losses, nor does it supply any particular accounting methodology that must be followed in discerning such long-term operating costs and losses.

7.837 We begin our examination of "operating costs and losses" by recalling the ordinary meaning of these words. "Operating" or "operate" means to "manage, work, control; put or keep in a functional state."[988] "Cost" may be defined as "the price paid or to be paid ... "a ... sacrifice".[989] "Losses" means "a person, thing or amount lost"; "the act or an instance of losing"; "the detriment or disadvantage resulting from losing".[990] We observe that dictionaries are important guides to, not dispositive statements of, definitions of words appearing in agreements and legal documents.[991]

7.838 The context of item (j) indicates that the "operating costs and losses" relate to export credit guarantee programmes. We recognize that the terms "operating costs and losses" refer generally to an economic, financial or accounting concept. Operating costs and losses in that sense generally connote costs and losses in administering programmes.[992] It is not at all clear to us that these terms in item (j) have obtained a rigid or universally agreed definition. Even if such a definition had arisen, we do not see any indication that it has been included in item (j), or more broadly in the *SCM Agreement*, or in any other covered agreement, as a common understanding among WTO Members. Therefore, in our examination of the United States export credit guarantee programmes at issue under item (j), we decline to adopt one particular rigid definition of the terms "operating costs and losses", as those terms are used in item (j). Nor do we believe that the meaning of operating costs and losses, as referred to in item (j), are necessarily to be determined purely by reference to the domestic laws of the Member whose measures are subject to our examination, here, the United States.[993]

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[987] *Supra*, para. 7.805,

[988] *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

[989] *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

[990] *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

[991] We find support for this proposition in Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 248.

[992]For example, the term "operating cost" may mean "a term for prime or variable costs" (see, for example, *Dictionary of Economics* (The Economist Books, 1999)). To the extent the term "operating" in item (j) also refers to the term "losses", the term "operating loss" can mean a loss, before tax and interest, usually on the principal trading activities of the business, excluding extraordinary items (see, for example, *Dictionary of International Finance* (The Economist Books, 1999) or the accounting loss made by a business from its business activities in a given period (see, for example, Moles and Terry, *The Handbook of International Financial Terms* (Oxford University Press, 1999)).

[993]We observe that item (j) in Annex I to the *SCM Agreement* does not contain any statements analogous to the statement in footnote 6 to Article XIV of the *General Agreement on Trade in Services*, which reads: "Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure." See also, for example, Panel and Appellate Body Reports, *US – FSC (Article 21.5 – EC)*, paras. 8.93 and 140-141, respectively, interpreting certain terms in footnote 59 of the *SCM Agreement*.

7.839 We weigh the evidence before us as we deem relevant and appropriate, without prejudice to the validity of any one approach, in isolation, as a conclusive measurement for long-term operating costs and losses under item (j).

7.840 The parties agree that administrative expenses are among the "operating costs" that should be taken into account under item (j).[994] Nor is there a difference between the parties in the total amount of such administrative expenses for the CCC export credit guarantee programmes at issue: approximately $39 million ($3 million per year for the years 1992-1996 and approximately $4 million for the years 1997-2002).[995]

7.841 In our examination of "operating costs and losses" (in comparison with "premiums") under item (j), we will examine whether there is a net cost to the United States government in administering the three export credit guarantee programmes at issue. To discern any net cost to the United States government, we will first consider the past performance of the United States export credit guarantee programmes. Second, we will examine relevant elements pertaining to the structure, operation and design of the programmes.

f. Past performance of the United States export credit guarantee programmes

7.842 We first note that the United States government currently utilizes a "net present value" approach to budget accounting for its export credit guarantee programmes.[996] Net present value analysis basically calculates the value today of a future stream of income or cost. Under this approach, the United States government identifies an annual "cost"[997] in terms of the "net present

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According to the United States' response to Panel Question No. 229, CCC financial statements are prepared in accordance with generally accepted accounting principles (GAAP), based on accounting standards promulgated by the Federal Accounting Standards Advisory Board (FASAB).

[994]See e.g., United States' response to Panel Question No. 77; United States' response to Panel Question No. 221(c); Brazil's 28 January comments on the United States' response to Panel Question No. 221. US "Statement of Federal Financial Accounting Standards No. 2: Accounting for Direct Loans and Loan Guarantees", 23 August 1993, paragraph 38, reproduced in Exhibit US-127 reads: "Costs for administering credit activities, such as salaries, legal fees and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of direct loans and loan guarantees." See United States' response to Panel Question No. 221(d).

[995]See e.g. Exhibit BRA-133, setting out administrative expenses of the United States export credit guarantee programmes per fiscal year from line 00.09 of the United States budget. See also Exhibit US-128. Exhibit BRA-119, *Federal Credit Reform Act of 1990*, P.L. 101-508, 5 November 1990, Section 504(g); 2 USC 661(c) all funding for an agency's administration of a direct loan or loan guarantee programme shall be displayed as distinct and separately identified subaccounts within the same budget account as the program's cost. See Exhibit US-11, Exhibit BRA-117.

[996]Effective for fiscal year 1992, the *Federal Credit Reform Act of 1990* ("FCR Act of 1990") required the United States President's Budget to reflect the costs of direct loan and guarantee programs. Exhibit US-11, Exhibit BRA-119, *US Federal Credit Reform Act of 1990*, P.L. 101-508, 5 November 1990, Sec. 501 indicates that the purposes of that legislation include: "to measure more accurately the costs of federal credit programs".

[997]Section 502(5)(c) of the United States *Federal Credit Reform Act of 1990*, P.L. 101-508, 5 November 1990, reproduced in Exhibit BRA-119, indicates that the cost of a loan guarantee shall be the net present value, when a guaranteed loan is disbursed, of the cash flow from: (i) estimated payments by the Government to cover defaults and delinquencies, interest subsidies, or other payments; and (ii) payments to the Government including origination and other fees, penalties and recoveries. See also 2 USC 661(a)(5)(C), reproduced in Exhibit US-11 and Exhibit BRA-117, respectively; and Section 185.3(o) of *Executive Office of the President, Office of Management and Budget, June 2002: Circular No. A-11, Part 5: Federal Credit Programs*, reproduced in Exhibit BRA-116, defining "loan guarantee subsidy cost" and Section 185-2. See also, e.g. Treasury Financial Manual, Part 2-Chapter 4600, reproduced in Exhibit US-149, See also, e.g., "United States General Accounting Office, Report to the Director, Office of Management and Budget, Credit Reform: *Review of OMB's Credit Subsidy Model"*, August 1997, pp. 3-4, reproduced in Exhibit BRA-120. See also, e.g.

value"[998] associated with its export credit guarantee programmes. According to the United States government, a positive net present value means that the United States government is extending a "subsidy" to borrowers; a negative present value means that the programme generates a "profit" (excluding administrative costs) to the United States government.[999] The annual entries in the "guaranteed loan subsidy" line in the United States budget, 1992-2002 (plus 2003 and 2004 estimates) show us that, according to this formula, there has been a positive "guaranteed loan subsidy" every year.[1000] If administrative expenses[1001] are added thereto, the annual amount of cost to the United States government increases under this formula by approximately $39 million.

7.843 We realize that these amounts are *initial estimates* of the long-term costs to the United States government. They are not, however, mere random guesses as to the amount of possible, but highly unlikely, costs to the government. Nor, at the other extreme, are they historically verifiable real amounts that have been, or actually will be, disbursed by the United States government. Rather, this is a methodology used and relied upon by the United States government to assess the estimated long-term net cost to the United States government of export credit guarantees. Actual historical experience is a "primary factor" on which estimates are based.[1002] The consistently positive numbers in the United States budget guaranteed loan subsidy line indicate to us that the United States government believes, based upon its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without some net cost to government. In accordance with the FCR Act of 1990, such "estimates" are subject to certain re-estimations over the lifetime of the guarantees involved.[1003] [1004] Re-estimates "take into account all factors that may have

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Exhibit BRA-123, United States Congressional Budget Office, Budgeting for Administrative Costs under Credit Reform, January 1992. See Exhibit BRA-121, p. 6. See also, Exhibit US-42, OMB Circular No. A-11 (July 2003), sections 20.5(a); 20.5(f), pages 20-19, 20-22; Exhibit US-127, FASAB, Original Pronouncements, Statement of Federal Financial Accounting Standards No. 2: Accounting for Direct Loans and Loan Guarantees; Exhibit BRA-160, Office of the Chief Financial Officer, Credit, Travel and Accounting Policy Division, Agriculture Financial Standards Manual, Revised May 2003; Exhibit BRA-161, Federal Financial Accounting and Auditing, Technical Release 3, "Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act", 31 July 1999; Exhibit BRA-162, Government-wide Audited Financial Statements Task Force, Credit Reform, Issues Paper, "Model Credit Program Methods and Documentation for Estimating Subsidy Rates and the Model Information Store", Reference No. 96-CR-7, 1 May 1996; Exhibit BRA-163, "Introduction to Federal Credit Budgeting, OMB Annual Training, 24 June 2002"; Exhibit BRA-185, Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform", April 1991.

[998]2 USC 661a.(5)(E), reproduced in Exhibits BRA-117 and US-11, states that "in estimating net present values, the discount rate shall be the average interest rate on marketable Treasury securities of similar maturity to the cash flows of the loan guarantee for which the estimate is being made".

[999]See Section 185.2 and definition of "loan guarantee subsidy cost" in *Executive Office of the President, Office of Management and Budget, June 2002: Circular No. A-11, Part 5: Federal Credit Programs*, reproduced in Exhibit BRA-116. See also definition of "cost" in 2 USC section 661a(5)(C), reproduced in Exhibits BRA-117 and US-11. We note that the term "subsidy" in this sentence is used in the sense of subsidy cost within the meaning of the United States FCR Act of 1990, rather than strictly in the sense of Article 1 of the *SCM Agreement*.

[1000] Exhibit BRA-133.

[1001] See e.g., Exhibit BRA-133 and Exhibit US-128.

[1002]"Federal Accounting Standards Advisory Board, 'Statement of Federal Financial Accounting Standards, No. 19, Technical Amendments to accounting Standards for Direct Loans and Loan Guarantees' in Statement of Federal Financial Accounting Standards No. 2" (March 2001), p. 16, para. 36, reproduced in Exhibit BRA-118 states: "Actual historical experience of the performance of a risk category is a primary factor upon which an estimation of default cost is based".

[1003]See Section 185.2 of *Executive Office of the President, Office of Management and Budget, June 2002: Circular No. A-11, Part 5: Federal Credit Programs*, reproduced in Exhibit BRA-116, indicating that United States agencies concerned (including the CCC) are required to re-estimate the subsidy cost throughout the life of each cohort to account for differences between the original assumptions of cash flow and actual cash flow or revised assumptions about future cash flow. These re-estimates represent additional costs or savings to the Government and are recorded in the budget. An upward re-estimate indicates that insufficient funds had

affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries," to the extent that those factors have changed since the initial estimate was made for purposes of the budget year column of the budget.[1005]

7.844 Brazil has also placed on the record the following constructed "cost" formula, again based on United States budget data:

> (Premiums collected + Recovered principal and interest (Line 88.40) + Interest revenue (Line 88.25)) – (Administrative expenses (Line 00.09) + Default claims (Line 00.01) + Interest expense (Line 00.02)).

7.845 This formula indicates the following (including references to the specific United States budget lines involved):

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been paid to the financing account, so the increase (plus interest) is paid from the programme account to the financing account. Permanent indefinite budget authority exists for this. A downward re-estimate indicates that too much subsidy has been paid into the financing account. See e.g. FASAB "Amendments to Accounting Standards for Direct Loans and Loan Guarantees, Statement of Federal Financial Accounting Standards No.18", May 2000, reproduced in Exhibit BRA-122, and FASAB "Original Pronouncements, Statement of Federal Financial Accounting Standards No. 18: Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2", reproduced in Exhibit US-125.

[1004] There are two types of re-estimates: interest rate re-estimates and technical re-estimates. The latter adjust for revised assumptions about loan performance, such as differences between assumed and actual default rates or new projections of repayments. Exhibit US-31 shows US budget summary of GSM 102, GSM 103 and SCGP subsidy estimates and re-estimates by fiscal year, programme and financing accounts FY 1992-2004. Exhibit US-32 shows apportionments for the CCC export credit guarantee programs. It indicates that in FY 2001, in respect of cohorts 1992-1999, there was a total downward re-estimate of $1,969,422. In FY 2002, in respect of cohorts 1992 through 1999, there was a total upward re-estimate of $148,364,475. In FY 2003, in respect of cohorts 1999-2002, there was a net re-estimate of -$3,039,202. Exhibit BRA-192 shows upward and downward (technical and interest) re-estimates 1992-2003. Exhibits BRA-364 and BRA-365 show subsidy rates and re-estimates for the programmes from the FY 2002 and 2003 *Federal Credit Supplement*.

[1005] Section 185.3(x), of *Executive Office of the President, Office of Management and Budget, June 2002: Circular No. A-11, Part 5: Federal Credit Programs*, p. 185-12, reproduced in Exhibit BRA-116, states: "Re-estimates mean revisions of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and or estimated changes in future cash flows of the cohort." See also United States' response to Panel Question No. 221(f).

**Table 3: Results of Brazil's constructed "cost" formula**

| Fiscal year | Premiums collected (88.40) + Recovered principal and interest (88.40) + Interest revenue (88.25) | Admin. expenses (00.09) + Default claims (00.01) + Interest expense (00.02) |
|---|---|---|
| 1993 | $27,608,000 + $12,793,000 + $15,672,000 = $56,073,000 | $3.320,000 + $570,000,000+ $0 = $573,320,000 |
| 1994 | $20,893,000 + $458,954,000 + $0 = $479,847,000 | $3,381,000 + $422,363,000 + $0 = $425,744,000 |
| 1995 | $18,000,000 + $62,000,000 + $0 = $80,000,000 | $3,000,000 + $551,000,000 + $10,000,000 = $564,000,000 |
| 1996 | $20,000,000 + $68,000,000 + $26,000,000 = $114,000,000 | $3,000,000 + $202,000,000 + $61,000,000 = $266,000,000 |
| 1997 | $14,000,000 + $104,000,000 + $26,000,000 = $144,000,000 | $4,000,000 + $11,000,000 + $62,000,000 = $77,000,000 |
| 1998 | $17,000,000 + $81,000,000 + $54,000,000 = $152,000,000 | $4,000,000 + $72,000,000 + $62,000,000 = $138,000,000 |
| 1999 | $14,000,000 + $58,000,000 + $0 = $72,000,000 | $4,000,000 + $244,000,000 + $62,000,000 = $310,000,000 |
| 2000 | $16,000,000 + $100,000,000 + $99,000,000 = $215,000,000 | $4,000,000 + $208,000,000 + $62,000,000 = $274,000,000 |
| 2001 | $18,000,000 + $149,000,000 + $125,000,000 = $292,000,000 | $4,000,000 + $52,000,000 + $104,000,000 = $160,000,000 |
| 2002 | $21,000,000 + $155,000,000 + $61,000,000 = $237,000,000 | $4,000,000 + $40,000,000 + $93,000,000 = $137,000,000 |
| Total | $1,841,920,000 | $2,925,064,000 |
| **Total difference** | **1,083,144,000** | |

7.846 This data is taken from the "prior year" column of the United States government budget. It represents an additional informed appraisal, based on information generated by the United States government itself, of the performance of export credit guarantee programmes. Moreover, it takes into account the actual level of guarantees issued by the CCC in a given year, as opposed to an estimate of this level. We compare the result of this formula with[1006] fiscal year/cash basis evidence submitted by the United States[1007], which, the United States asserts, portrays "actual performance" of the programmes. This reflects that, according to the United States, total revenues exceed total expenses of the programmes by approximately $630 million. By this United States approach, rescheduled claims -- amounting to approximately $1.6 billion -- are not treated as "outstanding" claims.[1008] This

[1006] See Brazil's 28 January comments on United States' response to Panel Question No. 221, para. 129. We acknowledge that data relating to particular cohorts and fiscal year data may not directly correlate, and we are aware that United States budget data may not always reflect "actual performance" of the export credit guarantee programmes. We are further sensitive to the fact that attention must be paid to the particular time periods covered by the data in question. In our view, none of these considerations undermine the comparison made.

[1007] United States' response to Panel Question No. 264 (a).

[1008] Column F of the cohort-based chart in Exhibit US-128; column F in fiscal year/cash basis chart in Exhibit US-147. See e.g. Exhibit BRA-431. Exhibit US-147 shows certain additional revenue and expense figures for an additional amount of approximately $103.6 million. The additional information does not materially change the picture before us.

amount is of the same order of magnitude as the difference between the figures submitted by Brazil ($1.083 billion) and the United States ($630 million).

7.847 Thus, a major difference between the parties' approaches relates to the treatment of re-scheduled debt.

7.848 By way of brief background, when the CCC pays out a claim, it is subrogated and pursues repayment of the claim. Sometimes it is successful, in which case, the claim is deemed "recovered". Although there are disagreements on certain factual aspects of the record, there is no disagreement between the parties that, in principle, claims actually recovered may be treated as net revenue to (or at least not as a long-term loss by) the CCC. Sometimes, however, the CCC is not successful in recovering a paid-out claim. Then, as we understand it, one of two things may occur. First, the CCC may "write off" that debt.[1009] According to the record, no amounts have actually been determined uncollectible, written off or forgiven with respect to any post-1992 cohort.[1010]

7.849 Alternatively, the CCC will reschedule that debt, in which case it will conclude a rescheduling agreement providing for the capitalization of the principal and interest. This does not mean that the United States government *collects* an outstanding claim.[1011] In addition, reschedulings provide for repayment of principal (on a sliding scale or on equal payments) over terms such as 8, 10, 12, 14, 15 and 17 years, at various interest rates.[1012] It strikes us that given that the original terms of the export credit guarantees extended under the programmes are less than 3 years (GSM 102); 180 days (SCGP) and 3-10 years (GSM 103), these reschedulings are for terms generally far in excess of the original term of the guarantee.

7.850 Recalling our discussion of the "long-term" period relevant to our item (j) examination[1013], we observe that the only amounts written off during the period since 1992 concern 1992 and pre-1992 cohorts. The write-offs occurred in fiscal years 1995[1014] and 1999.[1015] These amounts have therefore not been recovered. Amounts of debt forgiveness have also not been recovered.[1016] The record also

[1009] Exhibit BRA-116, Section 185, p. 185-15. See also United States' response to Panel Question No. 221(f).

[1010] United States' response to Panel Questions Nos. 225, 265 and 273. See also Exhibit BRA-158.

[1011] Column F in Exhibit US-147 indicates that approximately $1.6 billion of defaulted guarantees have been re-scheduled, 1992-2003. In Column F of Exhibit US-148, the United States indicates $205 million in "principal collected on re-schedulings". The United States indicated to us that "a significant portion" of principal collected on reschedulings "has not been reflected" in United States budget line 88.40 which is a basis for the table in para. 7.845. This is apparently so despite the United States' acknowledgement to us that, "[a]s a theoretical matter, such recovered principal should be reflected in the budget line 88.40". The United States asserted before us: "Accounting research within the US Government suggests, however, that a significant portion of [the amount of $205 million of principal which the US states it has collected on reschedulings] has not in fact been reflected in that budget line." (See United States response to Panel Question No. 264 (b)). In any event, even if we accepted this assertion by the United States, it would not materially change our view.

[1012] See Exhibit US-153. According to the record, the principal outstanding (as of 30 November 2003) on re-scheduled amounts is $1,579,950,350.

[1013] *Supra*, paras. 7.827 *ff*.

[1014] United States' response to Panel Question Nos. 225 (Nigeria, $129,000) and 273.

[1015] United States' response to Panel Question Nos. 225 and 273 (Argentina, $48,000; Russia and Former Soviet Union, $13,000).

[1016] The United States submits the following uncontested data concerning debt forgiveness:

**Table 4: CCC Debt forgiveness**

| Cohort | Fiscal Year of forgiveness | Country | Amount (US dollars) |
|---|---|---|---|
| Pre-1992 | 1991, 1994 | Poland | 1,406,000,000 (approximate) |
| Pre-1992 | 1997 | Yemen | 1,686,000 |

indicates sizeable defaults and reschedulings concerning Iraq (approximately $2 billion)[1017] and Russia and the other former Soviet Union republics.[1018] We note that post-1991 defaults on pre-1992 CCC export credit guarantees are treated separately[1019] under the net present value methodology imposed by the FCR Act of 1990. At the very least, the existence of defaults on pre-1992 cohorts of a large order of magnitude[1020] indicates to us that the CCC did not enjoy a premium-based or market-generated equilibrium or surplus which it could carry forward from 1991, corresponding to the period forming the focus of our long-term analysis under item (j) and, coincidentally, the advent of the FCR Act of 1990, effective FY 1992.

7.851 The United States indicates that the standard accounting treatment of reschedulings by the CCC is to no longer treat them as an outstanding claim, but rather as a new direct loan.[1021] This is an instant reduction from the amount of claims outstanding in the year the terms of the rescheduling are

| | | | |
|---|---|---|---|
| Pre-1992 | 1999 | Honduras | 5,951,000 |
| Pre-1992 | 2002 | Former Yugoslavia | 3,343,000 |
| Pre-1992 | 2002 | Tanzania | 8,806,000 |

See United States' response to Panel Question No. 225. The United States clarifies that all of the debt in the table is associated with Paris Club (Poland, Former Yugoslavia) or Heavily Indebted Poor Country (HIPC) (Honduras Tanzania and Yemen).

Exhibit BRA-114 contains a United States Treasury, February 2000 "Public Report to Congress: US Debt Reduction Activity FY 1990 through FY 1999" outlining the Multilateral Paris Club and Heavily Indebted Poor Country (HIPC) Initiative (1996, enhanced in 2000).

See also USDA "Undersecretary A Schumacher, Statement before the United States Sub-Committee on General Farm Commodities, Hearing on the Asian Financial Crisis", 4 February 1998, pp. 10-11, reproduced in Exhibit BRA-87.

[1017] Exhibit BRA-87, pp. 10-11. See also, "United States General Accounting Office, Report to the Chairman, Task Force on Urgent Fiscal Issues, Committee on Budget, House of Representatives, International Trade: Iraq's participation in US Agricultural Export Programs", November 1990, p. 2, reproduced in Exhibit BRA-157. See also, "United States General Accounting Office, Status Report on GAO's Reviews of the Targeted Export Assistance Program, and the GSM-102/103 Export Credit Guarantee program, Statement of Allan I Mendelowitz, Trade Energy and Finance Issues, National Security and International Affairs Division before the Task Force on Urgent Fiscal Issues Committee on Budget, House of Representatives", 28 June 1990, p. 9, reproduced in Exhibit BRA-152.

[1018] See "United States General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*", GAO/GGD-95-60 (February 1995), pp. 50-52 and 56-67 and Table 2.6, reproduced in Exhibit BRA-181. The record indicates that, in 2002, Iraq no longer participated in the programme, and that FSU republics are no longer major beneficiaries. Congressional Research Service, "Agricultural Export and Food Aid Programs" (updated 14 June 2002), p. CRS-7, reproduced in Exhibit BRA-97,

[1019] Exhibit BRA-116. See also, e.g. Exhibit US-127 relating to the distinct treatment of pre-1992 loan guarantees.

[1020] We note the 1991 estimation by the United States GAO that "As of May 31, 1990, the Corporation had approximately $8.6 billion outstanding in credit guarantees and $2.6 billion in accounts receivable resulting from guarantee payments on delinquent loans. We estimate that the GSM 102 programs will cost the Corporation about $6.7 billion in the long run, or about 60 per cent of the $11.2 billion face value of the outstanding credits and receivables." See, United States GAO, Report to the Chairman, Subcommittee on Criminal Justice, Committee on the Judiciary, House of Representatives. "Loan Guarantees: Export Credit Guarantee Programs' Long-Run Costs are High", April 1991, reproduced in Exhibit BRA-115; See United States GAO, Report to Congressional Requesters, "Loan Guarantees: Export Credit Guarantee Program's Costs are High", December 1992, p. 3, reproduced in Exhibit BRA-159.

[1021] See United States' response to Panel Question No. 264(b). A "direct loan" is a disbursement of funds by the government to a non-federal borrower under a contract that requires the repayment of such funds within a certain time with or without interest. (Adapted from OMB Circular A-11), accessible on the FASAB website (www.fasab.gov) Original Pronouncements, Version 3 (01/2004). See Exhibit BRA-116, section 185.3, pp. 185-6.

finalized.[1022] Particularly given the magnitude in the amounts involved, we share Brazil's concerns that the United States' treatment of rescheduled debt before us understates the net cost to the United States government associated with the export credit guarantee programmes at issue.[1023] [1024]

7.852 Our view does not change in light of the evidence introduced by the United States ("Subsidy Estimates and Re-estimates by Cohort") reflecting cumulative re-estimates on a cohort-specific basis.[1025] These figures show a positive subsidy of approximately $230 million, which approximates a figure of $211 million submitted by Brazil.[1026] Neither figure includes administrative expenses of approximately $39 million.

7.853 We note that, over the lifetime of the cohorts issued in 1992 and since, the record indicates an overall lifetime downward re-estimate of $1.9 billion.[1027] With the exception of 2002, for which only very recent data is necessarily available, the United States directs the Panel to note that the trend for all cohorts is uniformly favourable as compared to the original subsidy amount. The United States submits that data for the 1992-1996 and 1999 "cohorts" indicate profitability. According to the United States, when data for the -- as yet uncompleted -- 2001 and 2002 cohorts are removed, the $230 million is almost entirely eliminated. While taking note that the process of estimates and re-estimates by cohort is necessarily a fluid one that cannot be definitively finalized or forensically analyzed until a cohort is "closed", we disagree with the United States that we should "eliminate" the

[1022] In charts provided to us in Exhibits US-128 and -147, the US defines "claims outstanding" as "claim payments" minus "claims recovered" minus "claims rescheduled". According to this treatment, a rescheduled claim no longer constitutes an outstanding claim.

[1023] We note that a 1991 report by the United States' General Accounting Office referred to "long-run costs" in terms of "the expenses the Corporation incurs over the long run, e.g. the next 18 years, because its guaranteed credits and accounts receivable will not be fully repaid." We consider it relevant that a United States government agency itself deems non-repaid accounts receivable to constitute "long-run costs". See "United States GAO, Report to the Chairman, Subcommittee on Criminal Justice, U.S. House of Representatives Committee on the Judiciary, 'Loan Guarantees: Export Credit Guarantee Programs' Long-Run Costs are High'", April 1991. p.1, footnote 1, reproduced in Exhibit BRA-115.

[1024] The record indicates different levels of reschedulings and outstanding claims for each of the three programmes separately. However, we do not consider this legally determinative given the other elements we have taken into account in our examination. In particular, we are not persuaded that any particular characteristic of the GSM 103 programme or the SCGP programme or their long-term operating costs and losses would serve to distinguish it for the purposes of item (j).

[1025] We recall our discussion of "programmes" for the purposes of our item (j) analysis *supra*, paras. 7.810 *ff*. The United States submitted a revised and corrected version of the table in response to Panel Question 221(a). The original version of the table appeared in paragraph 161 of the United States' rebuttal submission. However, as acknowledged by the United States' agreement (in footnotes 82 and 96 of its further written submission and footnote 160 of its further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August comments on the United States' rebuttal submission), the total figure net of re-estimates is $230,127,023, rather than the figure that originally appeared ($381,345,059). The United States acknowledged, however, that data discrepancies occur with respect to cohorts 1992-1996 when compared to evidence submitted by Brazil on "Net lifetime re-estimate" in Exhibit BRA-182. In the absence of internal documentation to corroborate the figures originally submitted to the Panel and unable to explain the relatively minor disparity in figures, the United States "necessarily accepts" the figures submitted by Brazil on "Net lifetime re-estimate" by cohort.

[1026] Exhibit BRA-193.

[1027] See United States revised and corrected version of the table in response to Panel Question 221(a), Exhibit BRA-193. The United States submits evidence, in Exhibit US-32, comprising internal United States government budgetary documents, concerning the reapportionment constituting a decrease of subsidy in the permanent indefinite authority for the GSM programme as provided under the FCRA Act of 1990. According to these documents, "[The] downward estimate of $1.9 billion is based on actual activity since the last reestimate was approved and apportioned [...]" OMB Circular No. A-11, Part 4, Instructions on Budget Execution (July 2003), reproduced in Exhibit US-43, describes the apportionment/reapportionment process.

data for certain, more recent, cohorts in our analysis. We have not been persuaded that cohort re-estimates over time, will necessarily not give rise to a net cost to the United States government.[1028]

7.854 We believe that it is relevant for our item (j) analysis that, netting re-estimates against original subsidy estimates on a cohort-specific basis yields a positive subsidy which reveals that over the long term the United States government anticipates that it may not break even with its export credit guarantee programmes.

7.855 Furthermore, we note that the CCC financial statements for the years 2002 and 2003 indicate a "credit guarantee liability" of $411 million and $22 million, respectively. The CCC defines the term "credit guarantee liability" as the estimated cash outflows of the guarantees on a net present value basis.[1029] "Liability" is defined as "...a probable future outflow or other sacrifice of resources as a result of past transactions or events."[1030] We observe that these amounts are not actual losses. They are but another indicator, used and relied upon by the United States government, to assess the estimated long-term cost to the United States government of export credit guarantees. They are consistently positive, indicating to us that the CCC believes, based upon its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without some net cost to government.[1031]

7.856 The above considerations relating to the past performance of the programmes support a view that the programmes are run at a net cost to the United States government. We next consider the structure, operation and design of the programmes.

g. Structure, design and operation of the programmes

[1028] See United States' response to Panel Question No. 221(a). For example, for a cohort that is on the verge of closing, the original subsidy cost estimate for 1994 was $123 million; thus, applying the downward re-estimate, the net cost of the programme to the United States Government is currently projected at $7 million. For that cohort, there is currently a net cost indicated in the United States figures. Furthermore, the 1997, 1998, 2000, 2001 and 2002 data do not indicate a current appraisal of that the CCC export credit programmes will be operated at no net cost to government. The $122 million positive figure for 1997 is a particularly large figure. We note the United States assertion that "it is reasonable to expect that, in the fullness of time, the data will … reflect further negative re-estimates for cohorts 2001 and 2002". While there may be a possibility (based on the experience of certain of other cohorts) that this figure may diminish over the lifetime of the cohort concerned, there is no assurance that this figure will necessarily evolve towards, and conclude as, zero or a negative figure.

[1029] Exhibit US-129. Notes, p. 4.

[1030] Exhibit US-130. Appendix E of the FASAB Statements of Federal Financial Accounting Concepts and Standards. This differs from the definition of "loss" ("Any expense or irrecoverable cost, often referred to as a nonrecurring charge, an expenditure from which no present or future benefit may be expected").

[1031] See Exhibits BRA-194 and BRA-196. In CCC Financial Statements for 1999-2001, on the basis of testing GSM 102 data, USDA indicates that by not using the current risk rating, they may have understated the losses associated with these guarantees by about $430 million. The CCC Financial Statements, Fiscal Year 2001 indicates that the CCC credit reform subsidy amount for direct credits and guarantees and noted substantially different credit reform accounting and reporting standards for the budget and financial statements for the CCC. It stated that they continued to find lack of quality assurance over CCC foreign loan accounting operations and preparations of its financial statements, and material weaknesses in the processes and procedures used by USDA's lending agencies to estimate and reestimate loan subsidy costs since 1994. The USDA Consolidated Financial Statement for Fiscal Year 1999 states: "We are unable for the sixth consecutive year to assess the reasonableness of USDA's credit program receivables and estimated losses on loan guarantees, stated at about $70.7 billion and $1.7 billion, respectively, as they relate to the subsidy costs. These same problems also materially impact the Department's budget submissions. Because we can provide no assurance on USDA's credit reform financial data, the Congress and other decision-makers do not know whether the costs of USDA's loan programs, estimated in excess of $27.3 billion as of 30 September 1999, can be relied upon."

7.857 In terms of the structure, design and operation of the export credit guarantee programmes before us, there are several elements which lead us to believe that the programmes are not designed to avoid a net cost to government.

7.858 We deem it relevant to our examination that the CCC borrows from the United States Treasury.[1032] When it does borrow, it incurs interest, which is recognized as an interest expense in the "Interest on debt to Treasury" row of the United States budget[1033] and in material submitted to us.[1034] If the CCC did not pay or record interest expense, it would not be permitted to borrow from Treasury. Access to Treasury borrowings facilitates the functioning of the CCC's export credit guarantee programmes. Moreover, for a creditor, it provides the backing of the full faith and credit of the United States government concerning its ability to pay a claim in the case of default by a borrower.

7.859 Moreover, the premiums are not geared toward ensuring adequacy to cover long-term operating costs and losses for the purposes of item (j). We are of this view for several reasons.

7.860 First, there is a statutory fee cap in connection with transactions under the GSM 102 and SCGP programmes, of no more than 1 per cent of the amount of credit to be guaranteed. This 1 per cent fee cap does not, however, apply to the GSM 103 programme.[1035]

7.861 Second, the premiums are not risk-based[1036], either with respect to country risk or the creditworthiness of the borrower in an individual transaction.[1037] All countries eligible for any of the CCC export credit guarantee programmes are categorized according to risk. CCC categorization of countries is based on a United States government internal risk classification system, which, according to the United States, "is administratively controlled and may not be released outside of the US Government".[1038] However, the United States has confirmed that "a country's risk classification has no impact on the premiums payable under the United States export credit guarantee programmes".[1039]

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[1032] FCRA Section 505, 2 USC Section 661d (c), reproduced in Exhibit US-11 and Exhibit BRA-117: "The Secretary of the Treasury shall borrow from, receive from, lend to, or pay to the financing accounts such amounts as may be appropriate."

[1033] The Panel notes Exhibit US-129. In its response to Panel Question No. 270(i), the United States assures us that references to the CCC "non-interest bearing" debt or repayments are unrelated to the export credit guarantee programmes at issue. In addition, in its response to Panel Question No. 270(ii), the United States asserts that "permanent indefinite borrowing authority from Treasury" is not available in respect of the programmes. We note that 2 USC 661c(c)(2), providing an "exemption for mandatory programs", exempts all CCC credit programs existing on 5 November 1990, from the "appropriations" requirement in 2 USC 661c(b) and from the "modifications" requirement in 2 USC 661c(e). In its response to Panel Question No. 271, the United States asserts that full reimbursement of the CCC for prior year net realized losses – as set out in Exhibit US-152– do *not* include any portion attributable or allocable to the export credit guarantee programs. In its response to Panel Question No. 271, the United States submits that Treasury reimbursements of CCC net realized losses "do not include any portion attributable or allocable to the export credit guarantee programs."

[1034] e.g. Exhibit US-128; Exhibit US-148.

[1035] See Exhibit BRA-300.

[1036] The United States government acknowledges this. See Exhibit US-150 and United States' response to Panel Question No. 86.

[1037] e.g. United States' response to Panel Question No. 85. The United States has confirmed to us that under the SCGP "CCC does not determine the creditworthiness of participating importers[...]". Rather, according to the United States, the risk sharing between the CCC and the exporter is intended to ensure that due diligence is performed.

[1038] United States' response to Panel Question No. 86. According to 7 USC 5622, the CCC shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such sale.

[1039] See e.g. Exhibit US-150 and United States' response to Panel Question No. 86. See also, "US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition and Forestry, US Senate, *Former Soviet Union, Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60", February 1995, pp. 135-136, reproduced in Exhibit BRA-181: "Although

Rather than the premiums, it is the United States government subsidy estimates and re-estimates for the export credit guarantee programmes that are determined in large part by the obligor's sovereign or non-sovereign country risk grade.[1040]

7.862 In this respect, the statute governing the CCC export credit guarantee programmes currently sets out certain restrictions on the United States use of export credit guarantees. In general, "the CCC shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such sale."[1041] The statute and the implementing regulations indicate that, in respect of GSM 102 and GSM 103, "Export credit guarantees ... shall not be used for foreign aid, foreign policy, or debt rescheduling purposes".[1042] Moreover, pursuant to the regulations, "criteria considered by CCC in reviewing proposals for country allocations under the GSM 102 or GSM 103 programs, will include, but not be limited to, the following: (a) Potential benefits that the extension of export credit guarantees would provide for the development of, expansion or maintenance of the market for particular United States agricultural commodities in the importing country; (b) Financial and economic ability of the importing country to adequately service CCC guaranteed debt; (c) Financial status of participating banks in the importing country as it would affect their ability to adequately service CCC guaranteed debt; (d) Political stability of the importing country as it would affect its ability to adequately service CCC guaranteed debt; and (e) Current status of debt either owed by the importing country to CCC or to lenders protected by CCC's guarantees."[1043] Additional considerations apply for GSM 103.[1044]

7.863 These criteria do not stipulate what might constitute an acceptable level of risk in evaluating whether countries can adequately service their debt. Nor does the statute impose any limitation on the amount of guarantees that can be provided annually to a high-risk country (in the aggregate or individually) or to high risks transactions. The CCC is, therefore, able to provide large amounts of guarantees to high-risk countries with a resulting high rate of default.

7.864 Finally, there are additional indications on the record that premiums are not the source of revenue that cover the long-term operating costs and losses of the programmes. In this connection, Brazil raises the issue of the adequacy of any review of premiums by the United States government to ensure that they are adequate to cover long-term operating costs and losses.[1045] The United States provides evidence of annual review of premiums pertaining to FY 2003 and FY 2004.[1046] However,

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GSM 102 recipient countries vary significantly from one another in terms of their risk of defaulting on GSM 102 loans, CCC does not adjust the fee that it charges for credit guarantees to take account of country risk. [...] CCC fees that included a risk-based component might not cover all of the country risk, but they could help to offset the cost of loan defaults." In Exhibit BRA-153**,** *Audit Report of CCC for FY 2000*, June 2001, USDA's Office of the Inspector General stated that fees for the GSM 102 and GSM 103 programs had not been changed in 7 years, and as a result "may not be reflecting current costs." Without accounting for country risk in the fees charged, the CCC foregoes an opportunity to cover the cost of loan defaults.

[1040] e.g. Exhibit US-150.

[1041] 7 USC 5622(f), reproduced in Exhibits BRA-141, BRA -366.

[1042] 7 USC 5622(e), reproduced in Exhibits BRA-141, BRA-366; 7 CFR 1493.3, reproduced in Exhibit BRA-38,

[1043] 7 CFR 1493.4, entitled "Criteria for country allocations", reproduced in Exhibit BRA-38. By virtue of 7 CFR 1493.400, these restrictions and criteria also apply to the SCGP. Furthermore, the SCGP operates in cases where credit is necessary to increase or maintain United States exports to a foreign market and where private United States exporters would be unwilling to provide financing without CCC's guarantee. The programme is targeted toward those countries where the guarantees are necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments. Also see 7 CFR 1493.400 (a)(3).

[1044] 7 USC 5622(f)(2), reproduced in Exhibits BRA-141, and BRA-366; 7 CFR 1493.6, reproduced in Exhibit BRA-38.

[1045] Brazil's first written submission, para. 277.

[1046] Exhibit US-150.

there is also evidence that even the United States government itself has recognized, in the audit report relating to FY 2001:

> "As reported, in [the] FY 1999 and 2000 financial statement audits, CCC has not yet conducted required annual reviews of fees associated with the General Sales Manager (GSM) guarantee program. As a result, the fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programs have not been changed for many years and may not be reflecting current costs."[1047]

Since then, fees have been changed, but not substantially.[1048]

7.865 More importantly, evidence submitted by the United States to substantiate its assertion that there is an annual review of fees for USDA credit programmes also indicates that fees that are collected *offset* subsidy costs[1049] and result in a reduced "ending subsidy".[1050] However, *they do not come close to covering* the "subsidy cost" of the programme. The United States government itself acknowledges that the fees do not cover the subsidy cost. Indeed, the United States government also provides a "Justification for not covering the subsidy cost of the program". In respect of FY 2004, this is as follows:

> "... cost information is an important basis in setting fees and re-imbursements. Pricing and costing, however, are two different concepts. Setting prices is a policy matter, sometimes governed by statutory provisions and regulations, and other times by managerial or public policies.
>
> The current fees for GSM 102, GSM 103 and SCGP are not risk-based. There are several reasons for this. First of all, Section 211(b)(2) of the Agricultural Trade Act of 1978, as amended, caps the current fees at 1 per cent for Short-Term Credit Guarantees, as described in Section 202(a), which includes GSM 102 and SCGP. If the fees were changed to a risk-based system, this would most likely exceed 1 per cent, which would require legislative amendment. There is no statutory fee cap for GSM 103.
>
> The US exporter currently pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different lengths of credit periods. The exporter therefore pays more for a longer term of coverage than for a shorter term. If all fees were increased to the 1 per cent maximum to offset a greater portion of the subsidy cost, all exporters would be paying the same for different coverage terms, which would favour exporters seeking longer guarantees.

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[1047] See USDA, Office of Inspector General, Great Plains Region, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC, February 2002, reproduced in Exhibit BRA-154; and "USDA, Office of Inspector General Financial and IT Operations Audit Report of the CCC Financial Statements for FY 2000, Audit Report No. 06401-14-FM", June 2001, p. 31, reproduced in Exhibit BRA-153. These audit reports indicate that the CCC had not conducted the review of fees associated with the GSM guarantee programme (under OMB Circular A-129)**.** In addition, in a similar vein to the audit report in respect of FY 2001 (Exhibit BRA-154), the audit report in respect of FY 2000 (Exhibit BRA-153) states: "We recommended in our prior audit that CCC conduct the required review of fees to assure the charges are set at levels that minimize the corporation's cost without unduly impairing these loan program's policy objectives, and ensure that these loan guarantee fees are reviewed annually in the future. In response to our recommendations, CCC stated that the Foreign Agricultural Service would work with the OCFO staff to develop a standard template for an annual review of fees."

[1048] Exhibit BRA-155 and Exhibit US-20.

[1049] We also refer to our general discussion of the *Federal Credit Reform Act* of 1990 and treatment of export credit guarantees thereunder.

[1050] See Exhibit US-150. CCC Export Credit Guarantee Programmes (FY 2004).

> Finally, the current fee schedules for GSM 102, GSM 103 and SCGP are subject to negotiations taking place under the World Trade Organization (WTO). Once an agreement is reached under these negotiations, it is likely that the FAS will need to revise the fee structure. Changing the fee structure at this time without knowing the final outcome of these negotiations would be premature. We have however begun a study of the historical default and claims rates that will be the basis for developing options."[1051]

7.866 These elements indicate to us that the premiums may serve to *offset* long-term operating costs and losses to a certain degree. However, the premiums are by no means proportionate to, reflective of, nor geared towards, *covering* long-term operating costs and losses. It is the United States' government's subsidy estimates and re-estimates, and ultimately, the availability of United States government funds to cover any cost to government – rather than the premiums charged – which effectively ensure coverage of the long-term operating costs and losses of the export credit guarantee programmes.[1052]

7.867 We have conducted a detailed examination of the relevant evidence and argumentation submitted by the parties. On the basis of the totality of the record evidence, including approaches regularly relied upon by the United States government itself, we find that Brazil has established that the United States CCC provides the GSM 102, GSM 103 and SCGP export credit guarantee programmes "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes" within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*. Our view is based on a careful consideration of the evidence, taken as a whole, and no one element, in isolation, is determinative.

7.868 Moreover, recalling the burden of proof articulated in Article 10.3 of the *Agreement on Agriculture*, the United States has not established that it does not provide these export credit guarantee programmes at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

7.869 We therefore find that the United States export credit guarantee programmes at issue – GSM 102, GSM 103 and SCGP – constitute a *per se* export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*.

iv. Are the United States export credit guarantee programmes applied in a manner which results in, or threatens to lead to, circumvention of export subsidy commitments?

7.870 Having made this finding on the basis of the contextual guidance provided by the *SCM Agreement* relating to export credit guarantees, we consider its relevance for our examination under Article 10.1 of the *Agreement on Agriculture*. That provision refers to "export subsidies" not listed in paragraph 1 of Article 9. Such export subsidies "shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments."

7.871 We recall our earlier observations concerning the burden of proof under Article 10.3 of the *Agreement on Agriculture*[1053] and briefly summarize the parties arguments in this respect.

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[1051] The corresponding justification for not covering the subsidy cost in FY 2003 is substantially similar. See Exhibit US-150.

[1052] Our examination of the past performance of the programme sustains this finding. As we stated *supra*, para. 7.866, the consistently positive numbers in the United States budget guaranteed loan subsidy line indicate to us "... that the United States government believes, based upon its own assessment, that it may not, even over the long-term, be able to operate the export credit guarantee programmes without some net cost to government."

[1053] *Supra*, paras. 7.271-7.273 of Section VII:C.

7.872 **Brazil** asserts that, in respect of upland cotton and other unscheduled products, it is sufficient for Brazil to establish that export credit guarantees constituting export subsidies were provided. In respect of scheduled products, once Brazil establishes that export credit guarantees constituting export subsidies were provided in excess of United States quantitative reduction commitments, the United States bears the burden of proof, by virtue of Article 10.3 to prove that those excess quantities of scheduled products did not receive "export subsidies" within the meaning of Article 10.1. Brazil alleges that the United States has provided export subsidies for scheduled agricultural commodities that exceeded its quantitative reduction commitments for most scheduled commodities and that it has shown actual circumvention for at least one scheduled product, rice.[1054] The relevant test is not whether the measure is mandatory or discretionary, but whether there is a mechanism in the measure for CCC to stem or otherwise control the flow of CCC export credit guarantees. According to Brazil, there is not.

7.873 The **United States** submits that it is not permitted to provide any export subsidies in respect of unscheduled products, but that it is in compliance with its scheduled quantitative reduction commitments with respect to 12 out of the 13 scheduled commodities.[1055] In the United States view, under a "mandatory/discretionary" analysis, the relevant question would be whether the provisions establishing the export credit guarantee programmes mandate a breach of any WTO obligation. In the United States view, they do not, in view of the various discretionary elements in the operation of the programme that restrict the actual issuance of guarantees.

7.874 The **Panel** first examines the implications of its finding with respect to upland cotton and other unscheduled commodities in respect of which the record evidence sustains that export credit guarantees are granted. We then examine the implications with respect to certain scheduled commodities. Finally, we examine the implications with respect to other scheduled and unscheduled commodities.

a. Exports of upland cotton and other unscheduled agricultural products supported under the export credit guarantee programmes

7.875 Recalling our discussion of the applicable burden of proof, we find that Brazil has shown that export credit guarantees – constituting export subsidies within the meaning of Article 10.1 (and therefore, necessarily, not listed in Article 9.1) – have been provided under the programmes in question during the period we have examined in respect of exports of upland cotton and certain other unscheduled agricultural products.[1056] The United States has not shown that no export subsidy has been granted in respect of such products. We therefore conclude that, in respect of upland cotton and other such *unscheduled* agricultural products on record, the United States applies export credit guarantees constituting export subsidies in a manner which results in circumvention of its export subsidy commitments inconsistently with Article 10.1 of the *Agreement on Agriculture*.

[1054] In Exhibit BRA-300, Brazil calculates the quantity of US rice exports benefiting from the 3 US export credit guarantees programmes at issue: FY 2003: 1,162, 700 metric tonnes; FY 2002: 1,236,700 metric tonnes; FY 2001: 1,180,500 metric tonnes.

[1055] United States' rebuttal submission, para. 183 and data in footnote 220

[1056] In its first written submission, para. 266, Brazil identifies upland cotton, soybeans, corn, and oilseed and oil products as unscheduled commodities in respect of which the United States has made export credit guarantees available under the challenged programmes. Brazil also refers to "all other non-scheduled commodities" and directs us to USDA "Summary of Export Credit Program Guarantee Activity", 1999-2003, reproduced in Exhibit BRA-73. See also Exhibits US-12, US-41 and BRA-299. To the extent that it identifies products within the product coverage of the *Agreement on Agriculture* that are within our terms of reference, we consider Exhibit BRA-73 to be the relevant record evidence of such products for the purposes of this dispute.

b. Exports of scheduled products supported under the programmes

7.876 Turning to United States *scheduled* agricultural products, we recall that the United States scheduled export subsidy reduction commitments are contained in Schedule XX of the United States of America, Part IV, Section II entitled "Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments".[1057]

7.877 In respect of *scheduled* products, Members are not subject to a general prohibition against providing export subsidies listed in Article 9.1; rather, there is a limited authorization for a limited group of Members[1058] to provide such subsidies up to the level of the reduction commitments specified in their Schedule. As regards scheduled products, when the specific reduction commitment levels have been reached, the limited authorization to provide export subsidies as listed in Article 9.1 is transformed, effectively, into a prohibition against the provision of the subsidies. Thus, where the United States exports an agricultural product in quantities that exceed its quantity commitment level, it will be treated for the purposes of Article 10.1 as if it has granted WTO-inconsistent export subsidies, for the excess quantities, unless it presents adequate evidence to "establish" the contrary.

7.878 Brazil initially alleged that the United States provided export subsidies for scheduled agricultural commodities that exceeded its quantitative reduction commitments for most scheduled commodities over a certain time period (July 2001-June 2002): wheat, coarse grains, rice, vegetable oils, butter, skim milk powder, cheese, other milk products, bovine meat, pig meat, poultry meat, live dairy cattle and eggs.

7.879 The United States submits that it is in compliance with its scheduled quantitative reduction commitments with respect to wheat, coarse grains, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, live dairy cattle and eggs[1059]; that this may also be true for vegetable oil and that, in fiscal year 2002 it would also be true for poultry meat. The United States asserts that it did not use the GSM 102 or GSM 103 programmes during 2001-2002 with respect to butter and butter oil, skim milk powder, cheese, other milk products, or eggs.

7.880 Brazil subsequently maintained that it has shown actual circumvention for at least one scheduled product: rice.[1060] It also asserts that it has established threat of circumvention for scheduled products stemming from the mandatory nature of the programmes and CCC's inability to stem or otherwise control the flow of CCC export credit guarantees.

7.881 We note that the United States has not specifically discharged its burden of establishing that it did not grant WTO-inconsistent export subsidies, for the excess quantities of rice exported.

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[1057] The United States has scheduled export subsidy reduction commitments in respect of the following thirteen commodities: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, eggs. See Schedule XX of the United States of America, Part IV, Section II, entitled "Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments", reproduced in Exhibit BRA-83 and Exhibit US-13.

[1058] See *supra*, footnote 843.

[1059] United States' rebuttal submission, para. 183 and, data in footnote 220.

[1060] This is the case for at least one year (July 2001-June 2002). The United States did not rebut Brazil's initial allegation in respect of this period. See, for example, footnote 150 of the United States further rebuttal submission, where the United States asserts that "[t]he only commodity with respect to which the United States did not provide ['uncontroverted' evidence that the respective quantities of exports under the export credit guarantee programmes did not exceed the applicable quantitative reduction commitment] is rice". Subsequently, in Exhibit BRA-300, Brazil calculated the quantity of United States rice exports benefiting from the three United States export credit guarantees programmes at issue: FY 2003: 1,162, 700 metric tonnes; FY 2002: 1,236,700 metric tonnes; FY 2001: 1,180,500 metric tonnes. The quantitative United States export subsidy reduction commitment (2000) for rice is 38,544 metric tonnes. See Exhibit BRA-83 and Exhibit US-13.

Therefore, we find that the United States has applied export credit guarantees constituting export subsidies within the meaning of Article 10.1 – and therefore, necessarily, not listed in Article 9.1 – in a manner which results in circumvention of export subsidy commitments in respect of this particular scheduled commodity. It has not been established, however, that such actual circumvention has resulted in respect of the twelve other United States scheduled commodities.

c. Scheduled products other than rice and unscheduled products not supported under the programmes

7.882 We next consider whether the United States export credit guarantee programmes require the provision of an "unlimited amount" of subsidies, so that scheduled commodities other than rice and unscheduled agricultural products not supported under the programmes, therefore, benefit from those subsidies when the reduction commitment levels specified in the United States' Schedule for those agricultural products have been reached. [1061]

7.883 If so, we would conclude that the export credit guarantee programmes constituting export subsidies within the meaning of Article 10.1 are applied in a manner that, at the very least, *threatens* to lead to circumvention of the export subsidy commitments made by the United States, under the first clause of Article 3.3 and/or Article 8, with respect to scheduled agricultural products other than rice and other unscheduled products (not supported under the programmes). However, if these programmes are not such as to necessarily create an unconditional legal entitlement to receive them, then there would not necessarily be such a threat. We therefore examine whether an unconditional statutory legal entitlement to an export credit guarantee exists in respect of such products.

7.884 The United States export credit guarantee programmes are classified as "mandatory" under the United States Budget Enforcement Act of 1990.[1062]

7.885 The designation of "mandatory" under United States law means basically that the spending is authorized by so-called "permanent law"[1063] rather than requiring annual appropriations.[1064] Brazil cites evidence that under mandatory credit programmes loans must be available to all eligible

[1061] We recall that Article 10.1 of the *Agreement on Agriculture* provides that export subsidies not listed in Article 9.1 "shall not be applied in a manner which results in, *or* which threatens to lead to, circumvention of export subsidy commitments ..." (emphasis added). With respect to rice and to unscheduled agricultural products supported under programmes, we have found, in paragraphs 7.875 and 7.881, that the United States applies export credit guarantee programmes constituting export subsidies in a manner which *results in* circumvention of its export subsidy commitments inconsistently with Article 10.1. We consider that the "or" in Article 10.1 indicates that either one (resulting in circumvention) or the other (threatening to lead to circumvention) or both in combination would be adequate to trigger the remedies associated with this provision. We also see "resulting in circumvention" as including and exceeding the concept of "threatening to lead to circumvention". In this respect, we refer to and incorporate, *mutatis mutandis*, our findings in paragraphs 7.1494-7.1497 concerning the concept of "threat" and its relationship to the actual existence of a substantive requirement. We therefore do not believe that it is necessary to conduct any additional examination here.

[1062] See Exhibit BRA-295 "2004 US Budget, Federal Credit Supplement, Introduction and Table 2", stating "[...] the program's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory"; and Table 2 (in which the classification "mandatory" is indicated).

[1063] *Supra*, Section VII:C.

[1064] 2 USC 661c.(c)(2), reproduced respectively in Exhibit US-11 and Exhibit BRA-117, indicates that all existing credit programmes of the CCC on 5 November 1990 are mandatory programs exempted from otherwise applicable statutory requirements of appropriations and/or modifications. Pursuant to 2 USC 661c.(e), "An outstanding direct loan guarantee (or commitment) shall not be modified in a manner that increases its costs unless budget authority for the additional cost has been provided in advance in an appropriations Act." Pursuant to 2 USC 661c.(f), "when the estimated cost for a group of direct loan guarantees for a given credit programme made in a single fiscal year is reestimated in a subsequent year, the difference between the reestimated cost and the previous cost estimate shall be displayed" separately in the budget. There is "hereby provided" permanent indefinite authority for these estimates.

borrowers.[1065] This evidence states that appropriations actions do not effectively control mandatory credit programmes.

7.886 This designation of "mandatory" under United States law is not, however, determinative for our examination of the nature of the measure in the context of the WTO covered agreements. Moreover, we do not believe that the "mandatory/discretionary" distinction is the sole legally determinative one for our examination of whether or not "threat" of circumvention of export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture* has been proven to the required standard . This view is based, *inter alia*, on the reference in that provision to the manner in which a measure is applied, rather than the actual measure itself. We view this reference as supporting an examination as to whether the measure is actually applied in such a manner as to threaten to lead to circumvention.

7.887 The statutory requirement that the CCC "shall make available ... not less than $5,500,000,000 in credit guarantees ..."[1066] does not mandate that the CCC actually *issue* any particular level of credit guarantees.[1067] This law requires that CCC "make available" certain guarantees. However, the actual issuance of guarantees is within the discretion of the CCC, which "may guarantee the repayment of credit made available to finance commercial export sales of [United States] agricultural commodities..." over certain time frames.[1068] The statute makes clear that "[e]xport credit guarantees *issued* pursuant to this section shall contain such terms and conditions as the Commodity Credit Corporation determines to be necessary."[1069] The statute sets out certain required determinations that the CCC must make in order to guarantee repayment, including that it must "develop, expand, or maintain the importing country as a foreign market, on a long-term basis, for the commercial sale and export of United States agricultural commodities, without displacing normal commercial sales....". [1070] It also sets out the purpose of the programme, to which end the CCC may use export credit guarantees authorized under the statute.[1071]

7.888 The statute also provides certain restrictions on the use of export credit guarantees, including that the CCC "...shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such sale."[1072] Brazil argues that the entitlement that qualified applicants have to CCC guarantees is not curtailed by this latter requirement and that it is not relevant to stemming or otherwise controlling the flow of CCC guarantees.[1073] While this does not curtail the amount of guarantees that may ultimately be made available, it does indicate to us that there exists a discretion (on the part of the Secretary) to determine situations in which guarantees cannot be made available.

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[1065]"Congressional Budget Office Staff Memorandum, *An Explanation of the Budgetary Changes under Credit Reform*", April 1991, p. 7, reproduced in Exhibit BRA-185,

[1066]7 USC 5641(b)(1), reproduced in Exhibit BRA-297.

[1067]The Panel notes that except for programme year 1992, CCC has not since issued $5.5 billion in guarantees in any year. Sales registrations have ranged from a low of $2.876 billion for programme year 1997 and have generally been approximately $3.0 billion-$3.2 billion. See United States' further rebuttal submission, para. 201; United States' further written submission, para. 148 and accompanying table entitled CCC Export Credit Guarantee Program Levels, Annual President's Budgets and Actual Sales Registrations, Fiscal Years 1992-2004. 7 USC 5622 note, reproduced in Exhibits BRA-141 and BRA-366, indicate that the CCC shall make available for fiscal years 1996 through 2002 not less than $1,000,000,000 of direct credits or export credit guarantees for exports to emerging markets.

[1068]7 USC 5622(a)(1)(b), reproduced in Exhibit BRA-141; see also *id.* 5622(k) (imposing requirement that certain percentages "of the total amount of credit guarantees *issued* for a fiscal year [be] *issued*," not merely made available, with respect to certain products) (emphasis added).

[1069] 7 USC 5622(g), reproduced in Exhibits BRA-141, BRA-366.

[1070] 7 USC 5622(c), reproduced in Exhibits BRA-141, BRA-366.

[1071] 7 USC 5622(d), reproduced in Exhibits BRA-141, BRA-366.

[1072] 7 USC 5622(f)(1), reproduced in Exhibits BRA-141, BRA-366.

[1073] Brazil 's comments (27 October) on Panel Question No. 142 posed to the United States, para. 91.

7.889 The statute sets out a limit on the total amount of guarantees issued in certain fiscal years with respect to "processed or high value" agricultural products, with the balance to be issued to promote the export of bulk or raw agricultural commodities (provided that this limit does not require a reduction in the total amount of credit guarantees issued for the fiscal year).[1074]

7.890 The regulations expand upon certain statutory provisions[1075], but nothing in the regulations indicates that the CCC is *required* to issue a particular guarantee. They set forth restrictions and criteria which the CCC will apply in the exercise of its discretion to determine whether credit guarantees will be issued, and guiding country allocations and commodity allocations. There are no quantitative requirements obligating the CCC to extend any particular type or amount of guarantees in respect of any particular commodity.[1076]

7.891 Brazil also asserts that the fact that the CCC can deny guarantees to individuals who do not meet eligibility criteria does not affect the conclusion that the CCC cannot stem or otherwise control the flow of export credit guarantees.[1077]

7.892 However, we are of the view that the actual issuance of a particular export credit guarantee remains within the discretion of, and is susceptible to limitation by, the CCC. Availability of export credit guarantees is governed by allocations in effect at any one time for specific commodities and specific destinations.[1078] The CCC may increase allocations, and has done so[1079], but there is no absolute legal *requirement* that it need necessarily do so. It has the ability to make commodity-specific allocations (although many allocations are specific as to country of destination).[1080] An exporter will not necessarily be entitled to an export credit guarantee in respect of exports of any product at a given time. It is the CCC which decides upon country and product allocations, which dictate the availability of guarantees to exporters. Allocations are made on a monetary basis, and do not dictate whether or not the United States may surpass its quantitative export reduction commitments in a given period (in respect of scheduled products), nor extend guarantees to other unscheduled products. The fact that they operate in conjunction with other export subsidies listed in Article 9.1 also does not necessarily lead to circumvention, at least in the case of scheduled products.

7.893 In order to pose a "threat" within the meaning of Article 10.1 of the *Agreement on Agriculture*, we do not believe that it is sufficient that an export credit guarantee programme might

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[1074] 7 USC 5622(k), reproduced in Exhibits BRA-141, BRA-366.

[1075] Exhibit US-6; Exhibit BRA-38.

[1076] Pursuant to 7 CFR 1493.5: "The criteria considered by CCC in reviewing proposals for specific U.S. commodity allocations within a specific country allocation will include, but not be limited to, the following: (a) Potential benefits that the extension of export credit guarantees would provide for the development, expansion or maintenance of the market in the importing country for the particular U.S. agricultural commodity under consideration; (b) The best use to be made of the export credit guarantees in assisting the importing country in meeting its particular needs for food and fiber...; (c) Evaluation, in terms of program purposes, of the relative benefits of providing payment guarantee coverage for sales of the U.S. agricultural commodity under consideration compared to providing coverage for sales of other U.S. agricultural commodities; and (d) Evaluation of the near and long-term potential for sales on a cash basis of the U.S. commodity under consideration." With respect to the SCGP, the United States agricultural commodity must be, *inter alia*, determined to be a high-value agricultural product. See Exhibit BRA-38.

[1077] Brazil 's comments (27 October) on Panel Question No. 142 posed to the United States, para. 90.

[1078] e.g., Exhibit US-12 shows examples of programme announcements issued in accordance with 7 CFR 1493.10(d). These programme announcements indicate that USDA authorizes a certain amount of credit guarantees for sales of particular commodities to particular estimations in a certain fiscal year. USDA also amends commodity eligibility.

[1079] See e.g. "USDA Announces $2.8 billion in Export Credit Guarantees", FAS Press Release, 30 September 2003, reproduced in Exhibit BRA-296

[1080] See e.g. USDA, "Summary of FY 2003 Export Credit Guarantee Programme Activity", reproduced in Exhibit BRA-299. See also Exhibit US-41.

possibly, or theoretically, be used in a manner which threatens to lead to circumvention of export subsidy commitments.

7.894 We note that we would be entitled to take into account historical practice under the measure in order to discern its nature in terms of whether or not a "threat" arises. However, we cannot accept that, just because an export subsidy has, historically, actually circumvented within the meaning of Article 10.1 with respect to certain unscheduled and scheduled products[1081], a "threat" of circumvention under Article 10.1 of the *Agreement on Agriculture* necessarily exists in respect of all other products absent a provision in the statutory and regulatory framework of a Member governing a certain measure that would *guarantee* that the measure would *always and inevitably* be used in a WTO-consistent manner (or *absolutely preclude the possibility* that the measure might *ever* be used to provide export subsidies that would contravene a Member's obligations under Article 10.1 of the *Agreement on Agriculture).*[1082]

7.895 We are of the view that the statutory and regulatory framework of the United States export credit guarantee programmes is such that the CCC would not necessarily be required to issue guarantees in respect of any other unscheduled agricultural product (not supported under the programmes), or in respect of scheduled agricultural products other than rice, in a manner which "threatens to lead to" circumvention of export subsidy commitments.

7.896 Keeping the applicable burden of proof in mind, we therefore decline to find that the export credit guarantee programmes at issue are generally applied to scheduled agricultural products other than rice and other unscheduled agricultural products (not supported under the programmes) in a manner which threatens to lead to circumvention of United States export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*.

v. Does Article 10.2 of the *Agreement on Agriculture* exempt export credit guarantees that are export subsidies from the anti-circumvention provision in Article 10.1 of the *Agreement on Agriculture*?

a. Text

7.897 We recall (again) that Article 3.2 of the *DSU* recognizes that interpretative issues arising in WTO dispute settlement are to be resolved through the application of customary rules of interpretation of public international law. It is well settled in WTO case law that the principles codified in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*") are such customary rules.[1083]

7.898 Thus, the task of interpreting a treaty provision must begin with its specific terms.

7.899 As always, we thus begin our examination with the specific terms of the text of the relevant treaty provision. Article 10.2 of the *Agreement on Agriculture* provides:

> "2. Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees

[1081] See our findings *supra*, paras. 7.875 and 7.881.

[1082] We thus believe that the export credit guarantee programmes we are examining are of a fundamentally different nature than the mandatory and essentially unlimited subsidy (in the form of revenue forgone that is otherwise due) examined in *US – FSC*. Our examination also shows that they are of a different nature than the mandatory user marketing (Step 2) measure that we examine in paras. 7.742-7.748 and 7.1089-7.1097..

[1083] Article 31(1) provides in relevant part that: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

> or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith."

7.900 The United States argues that the text of Article 10.2 of the *Agreement on Agriculture* reflects the deferral of disciplines on export credit guarantee programmes contemplated by Members. According to the United States, the structure and text of the *Agreement on Agriculture* reflect that Members came to no agreement with respect to substantive disciplines on export credit guarantee programmes.

7.901 We disagree with the United States view that "... the plain words of Article 10.2 ... indicate that the export credit guarantee programmes are not subject in any way to the export subsidy disciplines of that Agreement."[1084] Indeed, our reading of the text of Article 10.2 of the *Agreement on Agriculture*, in light of its context and the object and purpose of the Agreement, leads us to the opposite conclusion. For the reasons that follow, we view the text as clearly indicating that export credit guarantee programmes constituting export subsidies for the purposes of Article 10.1 must not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments.

7.902 The text of Article 10.2 indicates that Members have undertaken to work toward the "development of internationally agreed disciplines to govern the provision of .... export credit guarantees". It further indicates that, after agreement has been reached on such disciplines, WTO Members will be obliged to provide export credit guarantees only in conformity with such disciplines.

7.903 We recall that, in order to carve out or exempt particular categories of measures from general obligations such as the prevention of circumvention of export subsidy commitments in Article 10.1 of the *Agreement on Agriculture*, it would be reasonable to expect an explicit indication revealing such an intention in the text of the Agreement.[1085] Therefore, we examine the text of Article 10.2 of the *Agreement on Agriculture* in order to see whether there is a clear indication that the drafters intended to carve-out export credit guarantees in respect of agricultural products from the export subsidy disciplines in Article 10.1, or whether there is any provision that would do so.

7.904 However, we see no language in Article 10.2 which would modify the scope of application of the general export subsidy disciplines in Article 10.1 in the *Agreement on Agriculture* so as to carve out or exempt export credit guarantees from the export subsidy disciplines imposed by that Agreement. We find no textual support for the United States assertion that Article 10.2 serves to "defer disciplines" or to "except" export credit guarantee programmes from export subsidy disciplines.

7.905 The text tells us that WTO Members may not have been able to agree on new specific disciplines governing agricultural export subsidies. However, the text does *not* tell us that, in light of that, any other potentially relevant existing disciplines do not apply.

7.906 This contrasts starkly with the text of other provisions in the covered agreements, which clearly carve out or exempt certain products or measures from certain obligations that would otherwise apply pending the development of further multilateral disciplines.

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[1084]United States' first written submission, para. 164.

[1085]We find support for our reasoning in Appellate Body Reports, *US – Carbon Steel* and *US-Corrosion-Resistant Steel Sunset Review*, underlining the importance of the text and the role of cross-references and clear textual indications about the relationship between treaty provisions. Also, for example, Appellate Body Report, *EC-Sardines*, paras. 201-208; Appellate Body Report, *EC – Hormones*, para. 128, relating to the treatment of a large/significant group of measures and a fundamental treaty obligation.

7.907 For example, the text of Article 6.1(a) of the *SCM Agreement*[1086] specified that the presumption of serious prejudice flowing from the threshold total *ad valorem* subsidization of a product "[did] not apply to civil aircraft" since it "was anticipated that civil aircraft will be subject to specific multilateral rules. Similarly, the footnote to Article 8.2(a) of the *SCM Agreement*[1087] stipulates that: "Since it is anticipated that civil aircraft will be subject to specific multilateral rules, the provisions of this subparagraph *do not apply* to that product." (emphasis added) Likewise, Article XIII of the *General Agreement on Trade in Services*, entitled "Government Procurement" provides another example of a clear textual indication that certain existing disciplines *do not apply*, and that future negotiations are contemplated. That provision stipulates:

> "1. Articles II, XVI and XVII *shall not apply* to laws, regulations or requirements governing the procurement by governmental agencies of services purchased for governmental purposes and not with a view to commercial resale or with a view to use in the supply of services for commercial sale.
>
> 2. There shall be multilateral negotiations on government procurement in services under this Agreement within two years from the date of entry into force of the WTO Agreement. (emphasis added)"

7.908 These provisions in the covered agreements show us that the Uruguay Round drafters were well aware of how to take into account the prospect of development of international disciplines in certain areas following the completion of the Uruguay Round, and of how to specify in the text of the covered agreements that existing disciplines *did not apply* in a certain situation pending the negotiation of future disciplines that would then govern. Where the negotiators intended to carve out certain measures from the existing disciplines imposed by an agreement, including pending the development of further multilateral or internationally agreed disciplines, they demonstrated that they knew how to do so. They inserted clear textual guidance to this effect.[1088]

7.909 However, Article 10.2 contains no such explicit textual indication that the existing disciplines do not apply pending the negotiation of the internationally agreed disciplines to which Article 10.2

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[1086]We realize that this provision has now lapsed, by virtue of the operation of Article 31 of the *SCM Agreement*. Members took no action to extend the application of the provisions of this provision, nor of Articles 8 and 9 concerning non-actionable subsidies beyond the period of five years from the date of entry into force of the *WTO Agreement.* However, these provisions can nevertheless be instructive in understanding the overall architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address. We recall that the Decision by the Arbitrator in *US – FSC (Article 22.6 – US)*, footnote 66, expressed a similar view**.**

[1087]*Ibid.*

[1088]We find other examples in the covered agreements of explicit guidance as to the temporal application of obligations pending the development of additional rules in other covered agreements.

For example, Article 9 of the *Agreement on Rules of Origin*, in Part IV of that Agreement, provides: "With the objectives of harmonizing rules of origin and, *inter alia*, providing more certainty in the conduct of world trade, the Ministerial Conference shall undertake the work programme set out below in conjunction with the CCC, on the basis of the following principles:..". Part II of that Agreement is entitled "Disciplines to Govern the Application of Rules of Origin". It contains two provisions. Article 2 is entitled "Disciplines During the Transition Period". Article 3 is entitled "Disciplines after the Transition Period". This provides a clear textual indication of the disciplines that apply pending the development of further disciplines.

Similarly, in the *General Agreement on Trade in Services*, Article X:1 provides for "multilateral negotiations on the question of emergency safeguard measures based on the principle of non-discrimination. The results of such negotiations shall enter into effect on a date not later than three years from the date of entry into force of the WTO Agreement." Article X:2 provides guidance for the situation "in the period before the entry into effect of the results of the negotiations [...]". Article XV of the General *Agreement on Trade in Services* obliges Members to "enter into negotiations with a view to developing the necessary multilateral disciplines to avoid such trade distortive effects [...]". It does not, however, contain any explicit carve-out from any other potentially relevant and applicable subsidy disciplines.

refers. There is no footnote stating that the obligations in Article 10.1 "do not apply" pending development of future internationally agreed disciplines. Nor is there any type of introductory caveat to Article 10.2, such as "except as provided in Article 10.1..."; "notwithstanding the provisions of Article 10.1..."; or "Nothing in any other provision of the Article 10 shall mean that the existing disciplines governing agricultural export credit guarantees do not apply to export credit guarantees on agricultural products...".[1089]

7.910 There is not even any indication along the lines of the caveat in Articles 5 and 6.9 of the *SCM Agreement*, which both stipulate that they do "not apply to subsidies maintained on agricultural products as provided in Article 13 of the *Agreement on Agriculture*". In turn, Article 13(c)(ii) of the *Agreement on Agriculture* explicitly indicates that certain measures are "exempt from actions" based on certain provisions of the *SCM Agreement* and Article XVI of the *GATT 1994* upon fulfilment of certain conditions.[1090]

7.911 The absence in Article 10.2 of such an explicit stipulation supports our view that the general export subsidy anti-circumvention disciplines apply pending development of the "internationally agreed disciplines" referred to in Article 10.2 of the *Agreement on Agriculture*. While those internationally agreed disciplines are under negotiation, the general disciplines on export subsidies included in the *Agreement on Agriculture* (and, subject to the provisions of Article 13(c) and the terms of the *SCM Agreement*, the export subsidy prohibition in Article 3 of the *SCM Agreement*) apply. Members have agreed to undertake to work toward the development of internationally agreed disciplines. If Members *do* conclude an agreement on these specific disciplines, the second part of Article 10.2 would be triggered (or, more likely, would be taken into account and modified by the specific disciplines) following any appropriate action by WTO Members.

b. Context, object and purpose

7.912 Our interpretation of the text finds support in the immediate context of Article 10.2, as well as in the object and purpose. Article 10.2 is a sub-paragraph of Article 10, which is entitled "Prevention of Circumvention of Export Subsidy Commitments". Article 10.1 refers to export subsidies "applied in a manner which *results in*, or which *threatens to lead to*, *circumvention* of export subsidy commitments". (emphasis added) The verb "circumvent" means, *inter alia*, "find a way round, evade…".[1091] The title of Article 10, and the text of Article 10.1, indicates an intention to prevent Members from circumventing or "evading" their "export subsidy commitments".[1092] Under Article 10.1, it is not necessary to demonstrate *actual* "circumvention" of "export subsidy commitments". It suffices that "export subsidies" are "applied in a manner which … *threatens to lead to circumvention* of export subsidy commitments".

7.913 In response to questioning, the United States asserts that "export credit guarantees are not subsidies" within the meaning of Articles 9.1 or 10.1 of the *Agreement on Agriculture*, and that Article 13(c) therefore does not apply to them.[1093]

7.914 Again, we recall that, it is well-established in the WTO, and, prior to that, in the GATT, that export credit guarantees may generally constitute export subsidies. This possibility was already

[1089] Nor do other provisions of Article 10 contain such a carve out or exemption, such as "Nothing in this provision shall mean that export credit guarantees may constitute export subsidies ...".

[1090] See *supra*, para. 7.5 of Section VII:A, which reproduces an excerpt from the 20 June 2003 communication from the Panel.

[1091] *The New Shorter Oxford English Dictionary*, (1993).

[1092] Appellate Body Report, *US – FSC*, para. 148.

[1093] United States' response to Panel Question No. 88(c).

identified in the Illustrative List of Export Subsidies incorporated in the *Tokyo Round Subsidies Code*, and had already been acknowledged by the 1960 Working Party.[1094]

7.915 Moreover, the entirely unreasonable implications of the approach advocated by the United States before us can be demonstrated by the following proposition, which takes the United States argument to its logical extreme. If, by virtue of Article 10.2, there are currently no disciplines on agricultural export credit guarantees, a WTO Member may therefore extend agricultural export credit guarantee without charging *any* premium whatsoever, for an indefinite period, for an infinite amount, and with or without any other conditions that a Member may wish. In our view, Members would have found "a way round", a way to "evade", their commitments under Articles 3.3 and 9.1, if they could make available, in the form of export credit guarantees, export incentives that they are prohibited from providing through other methods under the first clause of Article 3.3 and under Article 9.1.[1095]

7.916 The Panel put this proposition to the United States, and asked how the United States view of Article 10.2 would reconcile with the title of Article 10 ("Prevention of Circumvention of Export Subsidy Commitments").[1096]

7.917 The United States submitted that Article 10.2 applies only to export credit guarantees "properly characterized as such", and then lists a number of characteristics which, in the United States view, compel characterization of the programmes as export credit guarantees benefiting from a deferral of any disciplines by virtue of Article 10.2: "export credit guarantees are offered pursuant to programs which charge premiums; impose limits on tenor; impose limits on exposure to individual bank obligations; impose limits on exposure to risk of default from different countries; define shipping periods; and issue allocations (value limitations) of potential guarantee availability for specific commodities to be exported to specific destinations" and guaranteeing only a relatively small portion of the interest. Consequently, the United States asserts, "participants remain exposed to a significant component of the overall risk of default". According to the United States, "[i]llegitimate attempts to characterize export subsidy programmes as export credit guarantee programmes would be subject to the anti-circumvention provisions of Article 10.1...".[1097]

7.918 However, we see no indication in the text of the provision that only certain types of export credit guarantees – those meeting certain criteria relating to premiums or tenor or limitation of risk exposure – may benefit from a deferral of disciplines, while certain other types – those not meeting such criteria – would not. The text of Article 10.1 refers to "export subsidies". The text of Article 10.2 refers to "export credit guarantees". No further details or specific definitional elements exist that would serve as a textual basis for the United States view. The only question to be asked is whether or not export credit guarantees constitute export subsidies for the purposes of Article 10.1, and not whether a Member's agricultural export credit guarantees may or may not be of a type that would benefit from a deferral of disciplines.

7.919 Further context for Article 10 is found in Article 9.1 of the *Agreement on Agriculture*. Article 9.1 of the *Agreement on Agriculture* lists a number of specifically identified export subsidies.

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[1094] See *supra*, para. 7.806.

[1095] We note that the text of Article 10.2 is not limited to export credit guarantees, but also refers to "export credits" and "export credit insurance programmes". Logically, the implications of any analysis of the meaning of Article 10.2 for export credit guarantees would also have to be tenable in the context of export credits. Under the United States' approach, a Member could provide an agricultural export credit at zero per cent interest for a term of, for example, 50 years. We do not view this as a reasonable interpretation of Article 10.2, particularly in light of the provisions of Article 10.1.

[1096] United States' response to Panel Question No. 88(b).

[1097] United States' response to Panel Question No. 88(b).

The terms "export credit guarantees" do not explicitly appear in the text listing such practices.[1098] The United States asserts: "Conspicuously absent in Article 9.1 is any provision addressing such practices, even though US export credit guarantee programmes had been in existence for nearly fifteen years preceding the inception of obligations under the WTO."[1099]

7.920 We acknowledge that Article 9.1 of the *Agreement on Agriculture* sets forth a list of six specific practices known to the drafters and deemed to constitute export subsidies under the *Agreement on Agriculture*. However, the existence of such a list does not negate the possibility that other forms of export subsidies might exist, apart from those that appear in the list. If this were not the case, there would have been no need for the drafters to have included Article 10, which deals with export subsidies "not listed in paragraph 1 of Article 9". Article 10 exists precisely to prevent circumvention of export subsidy commitments through the use of export subsidies not listed in Article 9.1. Furthermore, if Members had intended to defer export subsidy disciplines on export credit guarantees, they would have done so. In contrast to the United States argument that some sort of implicit permission was maintained with respect to export credit guarantees in the drafting history of Article 9.1, we find an express obligation in the final text of Article 10.1 of the *Agreement on Agriculture*.

7.921 Article 3.3 of the *Agreement on Agriculture* prohibits the use of export subsidies listed in Article 9.1: (i) in excess of reduction commitment levels in the case of scheduled products; and (ii) in respect of non-scheduled products. It does not cover other types of export subsidies. The parties to this dispute agree that Article 8 of the *Agreement on Agriculture*, pursuant to which Members undertake "not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule" serves to prohibit the use of *listed and non-listed* export subsidies in excess of reduction commitment levels in the case of scheduled products and to prohibit the use of export subsidies otherwise than in conformity with reduction commitments and the provisions of the Agreement.[1100]

7.922 The final clause of Article 10.1 reads: "nor shall non-commercial transactions be used to circumvent such commitments." The United States argues that instead of making any connection between "non-commercial transactions" and export credit guarantees (by, for example, providing guidance as to when export credit guarantees might be considered to be on "commercial" or "non-commercial terms"), the Members agreed in Article 10.2 to provide wholly distinct treatment to export credits, export credit guarantees and insurance.[1101] However, we understand the reference in this final clause of Article 10.1 to refer, *inter alia*, to international food aid. In this respect, Article 10.4[1102] provides additional guidance with respect to international food aid, setting out criteria,

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[1098] As we have noted, the parties to this dispute agree that Article 9.1 does not apply to export credit guarantees and that Article 10 is the relevant provision for our analysis. Our examination is therefore without prejudice to the interpretation of Article 9.

[1099] United States' response to Panel Question No. 74.

[1100] See Brazil's and the United States' respective responses to Panel Question No. 219.

[1101] United States' response to Panel Question No. 219.

[1102] Article 10.4 of the *Agreement on Agriculture* reads:

> "Members donors of international food aid shall ensure:
> (a) that the provision of international food aid is not tied directly or indirectly to commercial exports of agricultural products to recipient countries;
> (b) that international food aid transactions, including bilateral food aid which is monetized, shall be carried out in accordance with the FAO 'Principles of Surplus Disposal and Consultative Obligations', including, where appropriate, the system of Usual Marketing Requirements (UMRs); and

including references to certain internationally agreed disciplines, which might help to identify when international food aid might be considered to constitute an export subsidy for the purposes of the anti-circumvention disciplines of Article 10.1. We see no contradiction between this and an interpretation of Articles 10.1 and 10.2 whereby, in contrast to Article 10.4, Article 10.2 contains no additional substantive criteria, but nevertheless identifies the possibility that export credit guarantees may constitute export subsidies within the meaning of Article 10.1.

7.923 Still further context is found in item (j) of the Illustrative List of Export Subsidies, included in Annex I of the *SCM Agreement*. This item explicitly refers to export credit guarantee programmes, and offers criteria to assess whether such programmes constitute *per se* export subsidies. The United States asserts that this Illustrative List, including item (j), had previously formed part of the *Tokyo Round Subsidies Code*. For the United States, the fact that Members had agreed on item (j) and yet, in Article 10.2, agreed to "undertake to work toward *the development* of internationally agreed disciplines to govern the provision of export credits, export credit guarantees" and, once agreed, only to provide export credit guarantee programmes "in conformity with" such developed and agreed disciplines, suggests that item (j) does not impose disciplines on export credit guarantees for agricultural goods.

7.924 We do not agree. The existence of item (j) and its direct reference to, and disciplines upon, export credit guarantees does not support the United States view. In item (j), there is a recognition that export credit guarantee programmes may constitute export subsidies *per se*, and a test is provided to identify when they do so: when premiums are inadequate to cover long-term operating costs and losses. The inclusion of a reference to agricultural export credit guarantee programmes in the context of Article 10 supports the conclusion that Members were very well aware of the possibility that such export credit guarantees may constitute export subsidies *per se* and that Members were, in fact, concerned about the potential for such programmes to circumvent Members' export subsidy reduction commitments. Members therefore undertook to develop disciplines specific to agricultural export credit guarantees. They did not, however, carve out such export credit guarantees from otherwise applicable disciplines.

7.925 The existence of disciplines on export credit guarantee programmes would not render the internationally agreed disciplines envisioned by Article 10.2 unnecessary nor irrelevant. Rather, the purpose of any eventual disciplines could be further to facilitate the determination of when export credit guarantee programmes in respect of agricultural products constitute export subsidies *per se* by developing and refining existing disciplines. Pending the development of such disciplines, certain guidance already exists as to when export credit guarantees constitute export subsidies *per se*.[1103] Such a reading of Article 10.2, in the context of Article 10.1, allows both provisions to have full meaning and does not reduce either to inutility.

7.926 Article 10.2 sets out an intention on the part of Members to undertake to work toward the development of internationally agreed disciplines regarding agricultural export credit guarantees. The expression of this undertaking, however, does not amount to a fiat to use those measures to confer export subsidies without consequence and without limit. Admittedly, as the United States has argued, the provision does not explicitly indicate that the disciplines which Members have committed themselves to developing would apply *in addition to* disciplines which already exist.[1104] However, such an explicit indication is not necessary in light of the unqualified wording of the provision, and its

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(c) that such aid shall be provided to the extent possible in fully grant form or on terms no less concessional than those provided for in Article IV of the Food Aid Convention 1986."

[1103] We refer to our examination above concerning the contextual guidance available in the *SCM Agreement* (i.e. item (j) of the Illustrative List of the *SCM Agreement*), leading to the finding in para. 7.869.

[1104] See the United States' first written submission, para. 164.

context. While Article 10.1 currently provides the discipline in the *Agreement on Agriculture* on the use of export credit guarantee programmes, the work envisaged in Article 10.2 would presumably elaborate further and more specific disciplines that could facilitate identification of the extent to which such export credit guarantee programmes constitute export subsidies, or to what extent export credit guarantee programmes are not permitted. Such rules might, for example, provide more precise rules applicable to all export credit guarantees, irrespective of a Member's reduction commitments under the *Agreement on Agriculture*.

7.927 Our interpretation is not tantamount to saying that agricultural export credit guarantees will *always* constitute export subsidies. It simply means that when an agricultural export credit guarantee meets the definition of "export subsidy" for the purposes of Article 10.1, it will be subject to the anti-circumvention disciplines imposed by that provision.

c. Subsequent practice

7.928 The United States also invokes Article 31(3)(b) of the *Vienna Convention*[1105], arguing that "subsequent practice" supports the view that disciplines on agricultural export credit guarantees were deferred. According to the United States, such "subsequent practice" is evident in the years of negotiations to develop internationally agreed disciplines immediately following the conclusion of the WTO Agreement[1106] under the auspices of the Organization for Economic Co-operation and Development (OECD)[1107] and subsequently within the WTO itself under the mandate of the Doha Ministerial Declaration.[1108]

7.929 The record in these Panel proceedings does not suggest that there is a discernible pattern of acts or pronouncements implying an agreement among WTO Members on the United States' interpretation of Article 10.2.[1109] [1110]

7.930 However, even assuming that the United States has identified a "concordant, common and consistent" sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties to a treaty regarding its interpretation[1111], we understand that such practice would consist precisely of an implementation by Members of their undertaking in

[1105] Article 31.3(b) of the *Vienna Convention* provides: "There shall be taken into account, together with the context: [...] any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation".

[1106] United States' rebuttal submission, para. 135.

[1107] Exhibit US-7 contains document TD/CONSENSUS(2000)25/REV4, Arrangement on Officially Supported Export Credits: *The Chairman's Revised Proposal for a Sector Understanding on Export Credits for Agricultural Products*, dated 9 July 2002.

[1108] WT/MIN(01)/DEC/1. Exhibit US-8 contains a Cairns Group "Negotiating Proposal on Export Competition" submitted to the Informal Meeting of the Special Session of the Committee on Agriculture, 18-20 November 2002, containing proposals relating to, *inter alia*, export credit guarantees. Exhibit US-9 contains document TN/AG/W/1/Rev.1, "Negotiations on Agriculture, First Draft of Modalities for the Further Commitments", addressing, *inter alia*, export credit guarantees in the context of export competition and export subsidies. Exhibit US-10 contains document G/AG/NG/W/139-G/AG/W/50, "Export Credits for Agricultural Products", Proposal by MERCOSUR (Argentina, Brazil, Paraguay and Uruguay), Bolivia, Chile, Costa Rica, Guatemala, India and Malaysia).

[1109] We note that neither Brazil nor any of the third parties that expressed a view on this matter agree with the United States' arguments in these Panel proceedings.

[1110] We note that no revisions to, nor universally agreed interpretations of, the relevant provisions of the *Agreement on Agriculture* (including within the meaning of Article 10 of the *WTO Agreement*) have, as yet, resulted from the WTO negotiations launched on the basis of the Doha Ministerial Declaration. It is certainly not our task to prejudge, or to try to predict the scope and content of, any future results of those negotiations.

[1111] See Appellate Body Report, *Japan – Alcoholic Beverages II*, para. 107. See Appellate Body Report, *Chile – Price Band System*, para. 213.

Article 10.2 "to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes ...".

7.931 Subsequent practice, if any, clearly and indisputably demonstrates that Members are attempting to develop internationally agreed disciplines. It does not reflect any concession or agreement that there are no current rules in this area. We therefore disagree with the United States' argument that "subsequent practice" supports the proposition that there are presently no disciplines in place.

7.932 In brief, our examination of the text of Article 10.2 in light of its context and the object and purpose indicates that there is no justification for the United States' approach. Nowhere does the *Agreement on Agriculture* define "export credit guarantees", exempt export credit guarantees from the definition of export subsidies, nor enumerate characteristics which might serve to exempt certain export credit guarantees constituting export subsidies from the disciplines of Article 10.1. If the drafters had intended to ensure that agricultural export credit guarantees were *never* to be considered export subsidies, they would have clearly so indicated. However, they have not done so.

d. Drafting history

7.933 We believe that our examination of the text of Article 10.2 of the *Agreement on Agriculture*, in its context and in light of the object and purpose of that agreement leads to a clear interpretation of the text.[1112] However, as the United States has relied upon the drafting history of Article 10.2, and of related provisions, to support its argument that Article 10.2 defers any disciplines on agricultural export credit guarantees[1113] we consider that it is also appropriate for us to point out that nothing in the drafting history of the provision would compel us to reach a different conclusion. Indeed, it confirms our interpretation.

7.934 The drafting history included in the record of these Panel proceedings reflects that, in July 1990, the Framework Agreement on Agriculture Reform Programme ("DeZeeuw Text") was circulated. Paragraph 20(e) of that draft text contemplated that Members would provide "data on financial outlays or revenue forgone ... in respect of export credits provided by governments or their agencies on less than fully commercial terms." Under paragraph 22, that draft envisaged concurrent negotiations to govern the use of export assistance, including "disciplines on export credits". Beyond a general reference to "export credits", there was no express reference to export credit guarantees or export credit guarantee programmes.

7.935 In June 1991, a Chairman's Note on Options in the Agriculture Negotiations was circulated. In paragraph 48 of that Note, the Chairman identified "Other key issues on which at least in principle decisions are needed are whether subsidised export credits and related practices ... would be subject to

[1112] A treaty interpreter may take account of a treaty negotiating history in certain circumstances. Article 32 of the *Vienna Convention on the Law of Treaties* provides:

> "Article 32
> *Supplementary means of interpretation*
> Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
> (a) leaves the meaning ambiguous or obscure; or
> (b) leads to a result which is manifestly absurd or unreasonable."

[1113] See, e.g. United States' rebuttal submission, paras. 131 *ff*. At the second Panel meeting, we asked the United States to present its detailed argument orally concerning the drafting history, including Exhibits US-25-30.

reduction commitments." The Chairman requested decisions by the principals on "whether subsidized export credits and related practices ... would be subject to reduction commitments unless they meet appropriate criteria to be established in terms of the rules that would govern export competition."

7.936 Subsequently, in August 1991, the Chairman circulated a series of addenda on the Note on Options "aimed at exploring certain options in greater detail".[1114] Included among the addenda was Addendum 10 on "Export Competition: Export Subsidies to be subject to the terms of the Final Agreement".[1115] Section 3 of that Addendum, in paragraph 48, sets out a proposed "Illustrative List of Export Subsidy Practices." Item (h) refers explicitly to "Export credits provided by governments or their agencies on less than fully commercial terms." More relevantly, item (i) refers explicitly to: "Subsidized export credit guarantees or insurance programs."

7.937 In December 1991, the Chairman circulated for discussion a "Draft Text on Agriculture".[1116] Article 8.2 of that Draft Text lists "export subsidies" that "are subject to reduction commitments under this Agreement", somewhat resembling the current Article 9.1 of the *Agreement on Agriculture*.[1117] Article 9.1 of the Draft Text, similar to Article 10.1 of the current Agreement, provides that "Subsidies contingent on export performance that are not listed in Article 8.2...shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments." Paragraph 3 of Article 9 of that Draft Text states: "For the purposes of this Article, whether export credits, export credit guarantees or insurance programmes provided by governments or their agencies constitute export subsidies shall be determined on the basis of paragraphs (j) and (k) of Annex 1 to the [*SCM Agreement*]."

7.938 Shortly thereafter, the Chairman of the Trade Negotiations Committee issued the "Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations".[1118] The paragraph 3 of Article 9 that had appeared in the previous draft text was omitted. Article 10.2 of the Draft Final Act read as follows:

> "Participants undertake not to provide export credits, export credit guarantees or insurance programs otherwise than in conformity with internationally agreed disciplines."

7.939 This draft language was subsequently replaced by the current final text of Article 10.2. The revisions that occurred do not, in our view, establish that the drafters of the final text of Article 10.2 intended to defer the application of any and all disciplines on agricultural export credit guarantees.

7.940 Rather, the current text of Article 10.2 of the *Agreement on Agriculture* reflects that, while Members may not have agreed on any new specific disciplines for agricultural export credit guarantees, they nevertheless undertook to engage in the development of such internationally agreed disciplines. They did not, however, explicitly indicate any intention to carve out the application of other, existing disciplines. The omission of paragraph 3 of Article 9 of the December 1991 Draft Text is consistent with a decision that the words were mere surplusage, because export credits, export credit guarantees and insurance programmes were within the disciplines on export subsidies according to the terms of the agreement captured. The omission is much less consistent with a decision to exclude such programmes from the disciplines altogether, considering the clear textual ability of the

[1114] MTN.GNG/AG/W/1/Add.1 (2 August 1991), reproduced in Exhibit US-27.
[1115] MTN.GNG/AG/W/1/Add.10 (2 August 1991), reproduced in Exhibit US-27.
[1116] Exhibit US-28.
[1117] Exhibit US-28. Annex 7 of that draft text lists export subsidies that shall be subject to reduction commitments.
[1118] MTN.TNC/W/FA (20 December 1991), reproduced in Exhibit US-29, contains the draft text of the Draft Final Act pertaining to Agriculture.

disciplines to extend to such programmes and the lack of any attention to an explicit carve-out of such programmes from the disciplines.

7.941 The United States notes that, as part of the negotiations, Members had to prepare and submit schedules of quantities and budget outlays during a base period to derive the export subsidy reduction commitments ultimately reflected in the respective schedules of the Members. The United States argues that had Members' export credit guarantees been considered export subsidies for these purposes from the outset then the export credit guarantee activity during the relevant period would also have to have been added to the base figures from which each Member's export subsidy reduction commitments were calculated.[1119] According to the United States, the base period export subsidy quantity in Schedule XX of the United States for each commodity would have been much larger. The size of the quantities involved in the export credit guarantee programmes during the 1986-90 period indicate it obviously understood that export credit guarantees were not subject to export subsidy commitments. The amount of exports involved was obviously very significant and would have meant a significant difference in the level of export subsidy reduction commitments from which all Members would now be negotiating.[1120]

7.942 We cannot accept this view of one Member as representative of an agreed interpretation or understanding of all Members. As this dispute demonstrates, there is a difference of view between the United States and the other WTO Members that are parties and third parties concerned on this very point. As indicated in Article 3.2 of the *DSU*, a primary rationale of the dispute settlement system established by the *WTO Agreement* is to clarify the existing provisions of the covered agreements in accordance with customary rules of interpretation of public international law. Our analysis, applying those interpretative rules, indicates to us that the text of the *Agreement on Agriculture*, as finally negotiated, does not support the United States' view.

7.943 Having examined the WTO-consistency of the export subsidies for agricultural products, in the first place, under the *Agreement on Agriculture*, we observe that, in accordance with Article 13(c)(ii) of the *Agreement on Agriculture*, to the extent that the United States does not conform fully with its export subsidy commitments under Part V of the *Agreement on Agriculture*, it is susceptible to challenge under Articles 3.1(a) and 3.2 of the *SCM Agreement* and Article XVI of the *GATT 1994*.

7.944 In the alternative, if we were to accept the United States argument that export credit guarantees cannot constitute export subsidies for the purposes of the *Agreement on Agriculture* and that the export subsidy disciplines in Article 10.1 of the *Agreement on Agriculture* do not apply to export credit guarantees, then export credit guarantees cannot "conform fully to the provisions of Part V" of that Agreement within the meaning of Article 13(c)(ii) of the Agreement. That is, they are not "export subsidies" for the purposes of the Agreement, and it is, in any event, conceptually not possible to conform with non-existent disciplines and trigger the exemption from action provided for in Article 13(c).[1121] They would thus not be "exempt from actions" based on Article 3 of the *SCM Agreement* (and Article XVI of the *GATT 1994*) within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*.

7.945 Having made these findings, we will now examine Brazil's claims based upon the export subsidy provisions of the *SCM Agreement*.[1122]

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[1119] United States' rebuttal submission, paras. 147-148.

[1120] United States' rebuttal submission, para. 149.

[1121] We note that the panel in *Canada – Aircraft (Article 21.5 – Brazil)* was of the view that conformity with certain disciplines could only occur when those disciplines actually *applied* to the measure in question. See Panel Report, *Canada – Aircraft (Article 21.5 – Brazil)*, paras. 5.143-5.145.

[1122] See *supra*, Section VII:C, "Order of analysis", as well as this Section's overview of the relationship between these provisions.

*(ii) Claims under Article 3.1(a) (and 3.2) of the SCM Agreement*

7.946 We have conducted a "contextual" analysis under item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* for the purposes of determining whether or not an export subsidy exists within the meaning of Article 10.1 of the *Agreement on Agriculture*.[1123] We see no reason, and none has been pointed out to us in these Panel proceedings, why this analysis may not also be applied directly in an examination of the merits of Brazil's claims under item (j)/Article 3.1(a) of the *SCM Agreement* in respect of the export credit guarantee programmes in this factual situation.

7.947 We take into account the substantive relationship between the export subsidy provisions of the *Agreement on Agriculture* and the *SCM Agreement*[1124], including that Article 3.1(a) of the *SCM Agreement* applies "[e]xcept as provided in" the *Agreement on Agriculture*. To the extent that the United States export credit guarantee programmes at issue – GSM 102, GSM 103 and SCGP – do not conform fully to these provisions in Part V of the *Agreement on Agriculture* and do not benefit from the exemption from actions provided by Article 13(c)(ii) of the *Agreement on Agriculture*, they are also export subsidies prohibited by Article 3.1(a) for the reasons we have already given.[1125]

7.948 Article 3.2 of the *SCM Agreement* provides: "A Member shall neither grant nor maintain subsidies referred to in paragraph 1" of Article 3. To the extent that the three United States export credit guarantee programmes at issue are inconsistent with Article 3.1(a), they are, consequently, also inconsistent with Article 3.2 of the *SCM Agreement*.

## 6. FSC Repeal and Extraterritorial Income (ETI) Act of 2000

(a) Main arguments of the parties

7.949 **Brazil** reiterates the claims and arguments made by the European Communities under the *Agreement on Agriculture* and the *SCM Agreement* against the *FSC Repeal and Extraterritorial Income Act of 2000* (the "ETI Act of 2000") upheld by the panel and Appellate Body in the *US - FSC (Article 21.5 - EC*) dispute. In that dispute, both the panel and Appellate Body found that the ETI Act of 2000 violates Articles 8 and 10.1 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*. Brazil requests the Panel to apply the reasoning as developed by that panel, and as modified by the Appellate Body, in that case *mutatis mutandis*[1126], in order to find that the ETI Act of 2000 violates Articles 8 and 10.1 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.[1127]

7.950 Brazil submits that the ETI Act of 2000 provides an export subsidy to upland cotton. According to Brazil, this Act eliminates tax liabilities for exporters who sell products, including upland cotton, in foreign markets. The tax concessions provided under the ETI Act of 2000 constitute export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*. The ETI Act of 2000 threatens to circumvent the United States export subsidy commitments by providing an export subsidy to upland cotton despite the fact that the United States does not have any export subsidy reduction commitments for upland cotton in violation Articles 8 and 10.1. As the ETI Act of 2000 subsidies do not fully conform to Part V of the *Agreement on Agriculture*, there is no "peace clause"

[1123] This led to our finding *supra*, para. 7.869

[1124] See, for example, our discussion of that relationship, *supra*, paras. 7.654-7.677.

[1125] We recall that Article 3.1(a) of the *SCM Agreement* sets out a prohibition on subsidies contingent upon export performance, "including those illustrated in Annex I". Annex I - the Illustrative List of Export Subsidies - contains item (j). We have found that the challenged United States export credit guarantee programmes meet the definitional elements of a *per se* export subsidy in item (j). As they are among those "illustrated in Annex I" for the purposes of Article 3.1(a), they are included in the subsidies contingent upon export performance prohibited by Article 3.1(a) of the *SCM Agreement*.

[1126] Brazil's first written submission, para. 327.

[1127] Brazil's first written submission, para. 352.

exemption from actions under the *SCM Agreement*. The ETI Act of 2000 also constitutes a prohibited export subsidy within the meaning of Articles 3.1(a) and 3.2 of the *SCM Agreement*.[1128]

7.951 The **United States** asserted early in the proceedings that Brazil failed to make a prima facie case with respect to the ETI Act of 2000. Brazil's approach would put the Panel in the position of having to violate its obligation under Article 11 of the *DSU* to "make an *objective assessment of the matter* before it, including an *objective assessment of the facts* of the case and the *applicability of and conformity with* the relevant covered agreements" (emphasis added). As a result of Brazil's "*mutatis mutandis*" approach, the Panel is in no position to exercise its judgment to follow, or decline to follow, prior dispute settlement findings concerning the ETI Act of 2000, nor even in a position to make factual findings concerning the Act. In the absence of a prima facie case by Brazil, the United States submits that the Panel should reject Brazil's claims concerning the ETI Act of 2000.[1129]

7.952 The United States asserted that it was confident that the ETI Act of 2000 would be repealed in the reasonably near future.[1130]

(b) Main arguments of the third parties

7.953 With respect to the export subsidies granted to upland cotton under the ETI Act of 2000 which provide fiscal incentives in respect of United States exports, **Argentina** recalls that the ETI Act of 2000 was found to be inconsistent with Article 3.1(a) of the *SCM Agreement* and Articles 10.1 and 8 of the *Agreement on Agriculture*.[1131]

7.954 **China** submits that the panel and Appellate Body's reasoning and their conclusion in *US – FSC (Article 21.5 – EC)* concerning the very same ETI Act of 2000 are of "extraordinary value" to the Panel. Any substantive deviation from the reasoning and conclusions in the earlier case may disturb and offend Members' legitimate expectations[1132] created through the adopted dispute settlement reports and cast doubt on the DSB's authority and reputation. In addition, China submits that the DSB's authorization for the EC to impose countermeasures strengthens the weight of the panel and Appellate Body reports and that the benefits of efficiency far outweigh any need to repeat work already completed by the panel and Appellate Body. Too, the adopted reports reflect the collective will of Members and the requirement of prompt compliance with dispute settlement rulings means that adjudication in one case must benefit all Members. [1133]

7.955 The **European Communities** submits that, pursuant to Article 17.14 of the *DSU*, parties to a dispute must "unconditionally accept" adopted Appellate Body Reports as "a final resolution to that dispute." The United States must be assumed to have unconditionally accepted the findings of the Appellate Body in the *US – FSC (21.5)* dispute, which, by definition also included a finding that the United States was illegally providing export subsidies to unscheduled agricultural products such as upland cotton. The European Communities fails to see how the United States can argue that Brazil needs to establish a prima facie case. The European Communities is of the view that Brazil simply needs to assert a claim.[1134]

7.956 **New Zealand** supports the claims made by Brazil, based on the findings already made in *US – FSC (Article 21.5 – EC)*, that the tax incentives under the ETI Act of 2000 threaten to circumvent United States export subsidy commitments within the meaning of Article 10.1 of the *Agreement on*

[1128] Executive summary of Brazil's first written submission, para. 43.
[1129] Executive summary of the United States' first written submission, para. 44.
[1130] See United States' response to Panel Question No. 119 (of 11 August 2003).
[1131] Argentina's written submission to the first session of the first substantive meeting, para. 95.
[1132] China cites Appellate Body Report, *Japan – Alcoholic Beverages II* and Panel Report, *India – Patents* (EC), para. 7.30.
[1133] China's written submission to the first session of the first substantive meeting, paras 20-25.
[1134] European Communities' oral statement at the first session of the first substantive meeting, para. 45.

*Agriculture* and therefore cannot be exempt from actions under the *SCM Agreement* under Article 13(c)(ii) of the *Agreement on Agriculture*. In addition, the Appellate Body found that there was a prohibited subsidy under Article 3.1(a) of the *SCM Agreement*. Accordingly if the Panel finds, as New Zealand believes it should, that the tax cuts under the ETI Act of 2000 are prohibited subsidies under Article 3.1(a) of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the subsidies without delay.[1135]

(c) Evaluation by the Panel

7.957 In the *US – FSC (Article 21.5 – EC)* dispute, the panel and Appellate Body found that the United States ETI Act of 2000 and export subsidies provided thereunder were inconsistent with Articles 3.3, 8 and 10 of the *Agreement on Agriculture*, as well as Articles 3.1(a) and 3.2 of the *SCM Agreement*. We note, as a matter of fact, that the United States has not yet repealed the ETI Act of 2000.

7.958 In this dispute, Brazil submits that the same measure is at issue and asks us to refer to the claims and arguments made by the European Communities, and to apply the reasoning of the panel and Appellate Body in that case, in order to find violations of Articles 8 and 10 of the *Agreement on Agriculture*, as well as Articles 3.1(a) and 3.2 of the *SCM Agreement* in respect of upland cotton.

7.959 Brazil argues that its reference to the panel and Appellate Body reports is evidence reflecting the nature, function and WTO-inconsistency of the ETI Act of 2000. Brazil directs the Panel and the United States to a European Communities web-page where all of the European Communities' submissions can be viewed and downloaded.[1136] However, Brazil has not submitted any direct evidence to us. Brazil has not, for example, even submitted a direct quotation from the underlying legal instrument in question, nor has Brazil itself asserted its own specific claims or arguments on the matter dealt with in the previous dispute, beyond purporting to incorporate by reference the claims and arguments made by the European Communities, and the reasoning, findings and conclusions of the panel and Appellate Body in the previous dispute.[1137]

7.960 We understand that the panel and Appellate Body findings in the previous *US – FSC (Article 21.5 – EC)* dispute between the European Communities and the United States provide relevant guidance and we may – indeed must – take them into account.[1138] As with all adopted panel and Appellate Body reports[1139], they provide valuable guidance. They create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute.[1140] However, they are not legally binding, except with respect to resolving the particular dispute between the parties to that dispute.[1141]

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[1135] New Zealand's written submission to the first session of the first substantive meeting, paras. 3.18-3.19.

[1136] Brazil's oral statement at the first session of the first substantive meeting, para. 137, footnote 187.

[1137] See Brazil's response to Panel Question No. 121, where Brazil states that it is appropriate for us to "make similar findings of fact, conclusions of law, and recommendations as the panel and Appellate Body in *US – FSC (21.5)*".

[1138] Panel Report, *India – Patents (EC)*, para. 7.30.

[1139] In Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, the Appellate Body clarified that the same principle applies to Appellate Body reports.

[1140] The panel in *India – Patents (EC)* examined the relevance of prior GATT Panel cases dealing with the same measure. See Panel Report, *India – Patents (EC)*, paras. 7.26-7.29.

[1141] See Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 14. Footnote 106 of that report states: "It is worth noting that the Statute of the International Court of Justice has an explicit provision, Article 59, to the same effect. This has not inhibited the development by that Court (and its predecessor) of a body of case law in which considerable reliance on the value of previous decisions is readily discernible." See also Panel Report, *India – Patents (EC)*, para. 7.28 and footnote 106.

7.961 We understand Brazil to nevertheless seek a Panel process whereby we would simply apply the reasoning, and findings and conclusions of the panel, as modified by the Appellate Body, in the *US – FSC (Article 21.5 – EC)* dispute, without going through the ordinary procedural steps constituting panel proceedings set out in the *DSU*, including the examination of the legal claims against the measures constituting the matter before this Panel on the basis of direct evidence and argumentation submitted by the complaining and defending parties in this dispute. While Brazil has supplemented the evidence and argumentation in that dispute[1142], it has not purported directly to establish the elements comprising the basis of the findings and conclusions in that dispute.

7.962 We see no basis in the text of the *DSU* as it currently stands for such incorporation by reference of claims and arguments made in a previous dispute nor for a quasi-automatic application of findings, recommendations and rulings from a previous dispute. Nowhere is such a procedure required or envisaged in the *DSU* or the relevant special rules and procedures. Rather, Articles 12.1 and 12.2 provide that:

> "1. Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute.
>
> 2. Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process."

7.963 We are aware that, in terms of the resolution of a particular dispute between the parties to that dispute, Article 17.14 of the *DSU* provides:

> "*Adoption of Appellate Body Reports*
>
> An Appellate Body report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the Appellate Body report within 30 days following its circulation to the Members." (footnote omitted)

7.964 Brazil submits that Article 17.14 of the *DSU* requires that after the adoption of an Appellate Body report, the parties to the dispute are unconditionally bound by the results of that report.[1143]

7.965 We do not disagree with Brazil that panel and Appellate Body reports adopted by the DSB must be considered final resolutions to a particular dispute between the parties to that dispute.[1144] Appellate Body Reports that are adopted by the DSB are, "… unconditionally accepted by the parties to the dispute", and, therefore, must be treated by the parties to a particular dispute as a final resolution to that dispute.[1145] At a given point in time, disputes must be viewed as definitely *settled*

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[1142] For example, before us, Brazil has referred to the following elements that were not addressed in that dispute: Article 13(c) of the *Agreement on Agriculture* and evidence that Brazil made inquiries to the United States about the extent to which upland cotton benefited from the prohibited export subsidy addressed in that dispute.

[1143] Brazil's response to Panel Question No. 121.

[1144] We find support for this proposition in the Appellate Body Reports in *US – Shrimp (Article 21.5 – Malaysia)* and *EC – Bed Linen (Article 21.5 – India).*

[1145] Appellate Body Reports that are adopted by the DSB are, as Article 17.14 provides, "[...] unconditionally accepted by the parties to the dispute", and therefore, must be treated by the parties to a particular dispute as a final resolution to that dispute. See Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, paras. 96-97. The same principle [as that expressed in Article 17.14] applies to those aspects of the Panel's report that are not appealed and are thus not addressed by the Appellate Body. Thus, the portions of the original Report of the Panel that are not appealed, together with the Appellate Body report resolving the issues appealed must be considered as the final resolution of the dispute. See Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, paras. 90-96.

by the WTO dispute settlement system.[1146] Moreover, it is clear to us that panels in implementation proceedings are entitled to use Appellate Body findings in the same dispute as a tool for their own reasoning.[1147]

7.966 However, while the United States, as the defending party in the *US – FSC (Article 21.5 – EC)* dispute, is "unconditionally bound" to accept the adopted reports in that dispute, the bounds of that dispute are limited to the parties to that dispute.

7.967 We thus hasten to point out that we are not dealing here with the same *dispute* as *US – FSC (Article 21*.5 – *EC*). Our terms of reference in this dispute were set by the DSB upon the establishment of the Panel, and refer to Brazil's request for establishment of a panel.[1148] We are not an implementation panel constituted under Article 21.5 of the *DSU* charged with examining the existence or consistency with the covered agreements of measures taken to comply with recommendations and rulings in DS108. Although the defending Member is the same in both cases, Brazil was *not* a party to that dispute. Thus, the panel and Appellate Body reports in that dispute cannot be taken as providing a final resolution to the part of the matter before us concerning the ETI Act of 2000.[1149]

7.968 Nor was Brazil a third party in that previous dispute. We nevertheless note that a third party considering that a measure already the subject of panel proceeding nullifies or impairs benefits accruing to it under any covered agreement may have recourse to "normal dispute settlement procedures under [the *DSU*]".[1150] If "normal dispute settlement procedures under [the *DSU*]" apply to such a "follow-up" case brought by a third party then, *a fortiori* such normal dispute settlement procedures must apply *vis-à-vis* a Member which was *not* a third party in the dispute.

7.969 Moreover, we disagree with Brazil that there is a complete identity between the "measure" and the "claims" in this case and the *US – FSC (Article 21.5 – EC)* dispute and that it would therefore be appropriate for us to make similar findings of fact, conclusions of law, and recommendations as the panel and Appellate Body in *US – FSC (Article 21.5 – EC)*.[1151]

7.970 The ETI Act of 2000 examined in the *US – FSC (Article 21.5 – EC)* dispute applies in respect of a range of industrial and agricultural products. It therefore applies not only with respect to products falling within the product scope of the *Agreement on Agriculture*[1152], but also in respect of products outside that scope. By contrast, the measure subject to this particular claim by Brazil is the ETI Act of 2000 in respect of upland cotton *only*. As we have already noted, upland cotton falls within the product scope of the *Agreement on Agriculture*.[1153]

7.971 Moreover, in this case, we are adopting a different order of analysis than the one followed in the *US – FSC (Article 21.5 – EC)* dispute. In that dispute, the panel and Appellate Body first examined the complainant's claims under the *SCM Agreement*, before considering the claims under the *Agreement on Agriculture*. By contrast, we have decided to begin our analysis of Brazil's claims

[1146] Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, para. 98.
[1147] Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, paras. 107-109.
[1148] WT/DS267/7.
[1149] In its response to Panel Question No. 121, Brazil asserts that there is no precedent in the WTO or the GATT that would require the Panel to find that the United States *alone* is bound in this case. We do not rely on any "precedent" here, but rather on the text of the *DSU* as it currently stands.
[1150] Article 10.4 of the *DSU*. Such a dispute shall be referred to the original panel wherever possible.
[1151] Brazil's response to Panel Question No. 121.
[1152] Article 2 and Annex 1 of the *Agreement on Agriculture* indicate the product coverage of that Agreement.
[1153] Brazil's request for establishment expressly refers to an upland-cotton related claim ("Export subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ('ETI Act'))". Brazil's only claim in this dispute dealing with products other than upland cotton relates to the United States export credit guarantee programmes as export subsidies.

against the measure under the *Agreement on Agriculture*.[1154] This is but one example of a panel's mandate and authority to conduct an independent, thorough and objective assessment of the matter before it rather than merely adopting findings in another, previous, dispute. We note, however, the different order of analysis we have adopted would not necessarily compel a different conclusion in this case.

7.972 Furthermore, in contrast to the present case, there was no discussion of, or findings made on, issues arising under Article 13 of the *Agreement on Agriculture* in the prior dispute settlement proceeding. Brazil itself states that "[b]ecause the United States never raised the peace clause as a defence in [*US – FSC (Article 21.5 – EC)*] there were no findings by the panel or the Appellate Body regarding the peace clause...".[1155] While Brazil submitted arguments in the present Panel proceedings linking the Part V claims in the previous case to the terms of the peace clause in the present case, it is not clear to us that we may directly transpose findings of violation of the substantive obligations in Part V to a finding that the conditions of Article 13(c) of the *Agreement on Agriculture* are not fulfilled. The legal nature of Article 13 is distinct from the positive obligations contained in the legal provisions of Part V of the *Agreement on Agriculture*.[1156]

7.973 Nor are there any findings in the previous panel and Appellate Body report on whether, in respect of upland cotton specifically, the ETI Act of 2000 is an export subsidy which is in violation of the United States' legal obligations under Part V of the *Agreement on Agriculture*. That is, the prior dispute settlement proceeding would only give an answer to the intermediate question of whether an export subsidy exists in general under the ETI Act of 2000. It would not furnish a commodity-specific answer pertaining to upland cotton in particular.[1157] In order to complete our examination under Part V of the *Agreement on Agriculture* in this dispute, we would need to examine whether cotton was a commodity eligible to benefit from the fiscal incentives available under the ETI Act of 2000. Furthermore, if that was the case, we would have to go further and apply the Articles 10 and 8 reasoning specifically to upland cotton (i.e. we would have to apply and develop the panel and Appellate Body's reasoning in that case: as the United States has made no upland cotton-specific export subsidy reduction commitments, it is not entitled to have any export subsidy on upland cotton).[1158]

7.974 These inquiries would require us to be presented with, and to examine, evidence concerning these matters. We do not understand Brazil to be asking us to seek the evidence and construct the case on their behalf. However, that would be the effect of their request, if the Panel decided that it needed to pursue Brazil's claim to its logical end-point. Rather, we understand Brazil to simply be putting before us the proposition that the ETI Act has been found to grant prohibited subsidies and that therefore we should endorse that conclusion in this case as well. Viewed in this way, Brazil's use of the *US - FSC (Article 21.5 – EC)* dispute as part of its argumentation is no different from the use any party might make of an Appellate Body report which the party believes supports its case, *except that the facts and argumentation necessary to make out the claim before this Panel are entirely missing.*

7.975 In light of these distinctions between the evidence and argumentation presented in the *US – FSC (Article 21.5 – EC)* dispute and in this case, we are of the view that no direct transposition or

[1154] See *supra*, Section VII:C, "Order of analysis".
[1155] Brazil's response to Panel Question No. 120, para. 218.
[1156] See *supra*, Section VII:C.
[1157] Brazil indicated that, in the course of consultations, as well as in what it asserts were questions in the context of the SCM Annex V exercise, it asked the United States about the amount of ETI Act of 2000 subsidies that went to upland cotton, but never received a response. Brazil's first written submission, para. 330, footnote 581. See also Exhibits BRA-49 and BRA-101. In our view, this issue of specific data on cotton is not a legally relevant consideration here because the substance of the measure itself was never properly put in issue before us.
[1158] See *supra*, para. 7.666.

incorporation of the panel and Appellate Body findings and conclusions would, in any event, be appropriate on the basis of the evidence and argumentation submitted in this dispute.

7.976 Articles 3.2 and 3.3 of the *DSU* reflect the importance to the multilateral trading system of security, predictability and the prompt settlement of disputes.[1159] However, these essential elements must be balanced against fundamental concerns of due process and procedural fairness in WTO dispute settlement.

7.977 We are compelled by Article 11 of the *DSU* to carry out "an objective assessment of the matter" before us. We, as a panel, have extensive discretionary authority to request information from any source (including a Member that is a party to the dispute). Such authority is essential in order properly to discharge a panel's mandate and responsibility under the *DSU* and the other covered agreements.

7.978 The United States has not attempted to rebut the substance of Brazil's claims in respect of the ETI Act of 2000, and has indicated that it intends to implement the rulings and recommendations of the DSB *in the previous dispute*. In the Panel's view, that does not constitute an admission that relieves Brazil of its duty to make a prima facie case, as Brazil submits.[1160] Rather, as a respondent, the United States is entitled to expect Brazil to prove its own case in the present dispute.

7.979 Brazil has been on notice since the United States' first written submission that its duty to make a prima facie case was in issue. The United States submitted that Brazil had failed to make such a case by simply citing to and quoting from prior panel and Appellate Body reports and failing to offer a description of the ETI Act of 2000.[1161] Brazil has chosen not to offer its own arguments or description of the Act.

7.980 In its 5 September 2003 communication, the Panel indicated to the parties that, "on the basis of the evidence and arguments presented to date, it is unable to form any view on whether the ETI Act of 2000 satisfies the relevant provisions of the *Agreement on Agriculture*". We thereby put Brazil on notice that the evidence and arguments submitted up to that point in the Panel proceedings did not provide a sufficient basis for us to make a finding.

7.981 This communication was made in the context of the unique procedural and substantive circumstances of these Panel proceedings. It allowed Brazil an additional possibility to redress deficiencies in its case.

7.982 In its further submission of 9 September 2003, Brazil acknowledged the Panel's view, but nonetheless submitted no new evidence.[1162] Rather, Brazil expressed its belief that it had demonstrated that the ETI Act of 2000 violated the export subsidy provisions of the *Agreement on Agriculture* and the *SCM Agreement*, although it offered to submit any additional arguments and evidence on issues the Panel believed had not been addressed in sufficient detail.

7.983 Mindful of our extensive discretionary authority to put questions to the parties to clarify the factual and legal aspects of the matter before us, we considered whether we should specifically indicate any deficiencies we perceived in the case brought by Brazil in order to give Brazil an opportunity to remedy any such deficiencies at that stage of the proceedings.

7.984 We are well aware that the fact that it is for the party asserting the affirmative of a particular claim or defence to discharge the burden of proof does not mean that a panel is "frozen into

[1159] See, e.g., Panel Report *US – Section 301 Trade Act*, para. 7.75, with respect to Article 3.2 of the *DSU*.

[1160] Brazil's further written submission, para. 469.

[1161] United States' first written submission, paras 184-189.

[1162] Brazil's further written submission, para. 469.

inactivity".[1163] A panel's extensive authority to put questions to the parties in order to inform itself of the relevant facts of the dispute and the legal considerations applicable to such facts is not conditional in any way upon a party having established, on a prima facie basis, a claim or defence.[1164]

7.985 In considering the nature of any further questioning to the parties, we were, however, equally conscious that, in our assessment of the matter, we may not relieve Brazil, as complaining party, of its task of establishing the inconsistency of United States measures with the relevant provisions of the covered agreements. In particular, we were and remain mindful that, in our questions posed to the parties, we must not "overstep the bounds of legitimate management or guidance of the proceedings … in the interest of efficiency and dispatch."[1165] We are not permitted to make Brazil's case for Brazil.

7.986 For all of these reasons, on the basis of the evidence and arguments submitted, we are not in a position to conclude that Brazil has established a prima facie case that the ETI Act of 2000 and subsidies granted thereunder are inconsistent with Articles 8 and 10.1 of the *Agreement on Agriculture* in respect of upland cotton.

7.987 Having examined the WTO-consistency of the export subsidies for agricultural products, in the first place, under the *Agreement on Agriculture*, we observe that, in accordance with Article 13(c)(ii) of the *Agreement on Agriculture*, to the extent that Brazil has not demonstrated that the United States ETI Act of 2000 is not in conformity with the United States export subsidy commitments under Part V of the *Agreement on Agriculture* in respect of upland cotton, the United States is "exempt from actions based on" Articles 3.1(a) and 3.2 of the *SCM Agreement*. We therefore decline to examine Brazil's claims based on those provisions.[1166]

### 7. Claims under Article XVI:3 of the *GATT 1994*

(a) Main arguments of the parties

7.988 **Brazil** requests us to rule that the United States export and actionable subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by resulting in the United States having more than an equitable share of world exports of upland cotton in violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

7.989 The **United States** contends that that Brazil has failed to demonstrate a prima facie case of inconsistency with Article XVI:3 of the *GATT 1994*, which applies only in respect of export subsidies.

(b) Main arguments of the third parties

7.990 **New Zealand** agrees with Brazil that the subsidies of the United States have operated to increase United States' exports of upland cotton resulting in the United States having a "more than equitable share" of world export trade in upland cotton within the meaning of Article XVI:3 of the *GATT 1994* and thus have caused serious prejudice to the interests of Brazil within the meaning of Article XVI:1 of the *GATT 1994*.[1167] The **European Communities**, without stating whether it supports or opposes Brazil's claims on this issue, "put on record" its support on certain elements of

[1163] See, for example, Panel Report, *Thailand – H-Beams*, para. 7.50.
[1164] Appellate Body Report, *Canada – Aircraft*, para. 185.
[1165] Appellate Body Report, *Korea – Dairy*, para. 149.
[1166] See *supra*, Section VII:C "Order of Analysis" and Section VII:E, overview of the relationship between the export subsidy provisions of the *Agreement on Agriculture* and the *SCM Agreement*.
[1167] Paragraphs 2.35 and 2.36 of its further third party submission. See also its response to Panel Question No. 56.

interpretation advanced by the United States on Article XVI:3 of the *GATT 1994*.[1168] In response to the question from the Panel, the European Communities further notes that "[i]t is conceivable ... that one and the same measure may be at the same time an 'export subsidy' in the sense of Article XVI:3 and 'domestic support' within the meaning of the Agreement on Agriculture."[1169] **Australia, China** and **Chinese Taipei** have offered, in response the Panel's question, their views on the interpretation of Article XVI:3 of the *GATT 1994*.[1170] Specifically, Australia argues that it is unambiguous that agricultural domestic support programmes are challengeable under Article XVI:3 of the *GATT 1994*. Australia also sheds light on the relationship between Articles XVI:1 and XVI:3 of the *GATT 1994* in the context of the analysis of Article 13(b)(ii) of the *Agreement on Agriculture*.[1171] China and Chinese Taipei argue that agricultural domestic support programmes are not challengeable under this provision. **Benin** has also offered its views on certain aspects of this issue.[1172]

(c) Evaluation by the Panel

7.991 We understand that Brazil's claims under Article XVI:1 and XVI:3 of the *GATT 1994* envisage a joint application of these two provisions. That is, Brazil does not seem to make independent claims under paragraphs 1 and 3 of Article XVI, but rather requests us to rule that the United States subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by resulting in the United States having more than an equitable share of world exports of upland cotton in joint violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

7.992 For the reasons that follow, we do not believe that these provisions are susceptible to such joint application. We do not believe that Brazil may assert a "serious prejudice" claim under Article XVI:3. Rather, each provision – Article XVI:1 and Article XVI:3 -- requires application in accordance with its own terms in respect of measures that fall within its respective scope of application. We thus examine the terms of these two distinct treaty provisions separately. Our examination of Brazil's claim under Article XVI:1 of the *GATT 1994* is included in Section VII:G below, in conjunction with our actionable subsidies analysis.[1173]

7.993 We limit our examination here to Brazil's claims under Article XVI:3 of the *GATT 1994*.

7.994 We see the first issue before us as whether or not Article XVI:3 of the *GATT 1994* applies only to export subsidies, or whether it also applies to other types of subsidies that may cause serious prejudice within the meaning of Article XVI.1 of the *GATT 1994* (and Article 5(c) of the *SCM Agreement*).[1174]

7.995 **Brazil** disagrees with the **United States**' assertion that the only subsidies governed by Article XVI:3 are "export subsidies".

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[1168] The European Communities supports the interpretation of the term "more than equitable share" in Article XVI:3 of the GATT advanced by the United States. See paragraph 3 of its oral statement at the resumed session of the first substantive meeting.

[1169] See the European Communities' response to Panel third party Question No. 56.

[1170] See respective responses to Panel third party Question No. 56, which asked, *inter alia*, whether agricultural domestic support programmes are challengeable under this provision.

[1171] See paragraph 19 and 20 of its submission to the first session of the first substantive meeting.

[1172] See Benin's response to Panel third party Question No. 44, in which it argues that the Panel is required to take account of the effects of the US subsidies on the interest of Members other than the complaining Member.

[1173] See *infra*, Section VII:G.

[1174] By virtue of footnote 13 of the *SCM Agreement*.

7.996 The **Panel** begins its interpretation with the text of Article XVI:3 of the *GATT 1994*.[1175] Article XVI:3 appears in Section B of Article XVI. Entitled "Additional provisions on export subsidies", it reads:

> "Accordingly, contracting parties should seek to avoid the use of *subsidies on the export of primary products*. If, however, a contracting party grants directly or indirectly any form of *subsidy which operates to increase the export of any primary product* from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product." (emphasis added)

7.997 We believe that the text of Article XVI:3 of the *GATT 1994* itself indicates that the provision is limited to "export subsidies" and does not address rights and obligations of Members relating to other types of subsidies.

7.998 We see that Article XVI of the *GATT 1994* consists of two distinct "parts". Part A is entitled "Subsidies in General". Part B of Article XVI is entitled "Additional Provisions on Export Subsidies". Paragraph 3 of Article XVI is found in Part B entitled "Additional Provisions on Export Subsidies". It is not found in Part A of Article XVI, entitled "Subsidies in General".

7.999 The text of paragraph 3 of Article XVI of the *GATT 1994* refers to subsidies which "operate[..] to increase the export of any primary product".[1176] The first sentence of Article XVI:3 of the *GATT 1994* refers to "subsidies *on* the export of primary products".(emphasis added) These aspects of the text and context of paragraph 3 support an interpretation that it deals with export subsidies only, rather than domestic support subsidies.

7.1000 We take note that the second sentence of paragraph 3 reads:

> "If, however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory..."

7.1001 **Brazil** asserts that a reading of this part of Article XVI:3 of the *GATT 1994* as pertaining to "export subsidies" only would reduce this part of the treaty provision to redundancy or inutility, as this sentence speaks not only of subsidies contingent upon export, but also of subsidies that operate to increase the export of any primary product from a Member's territory.[1177]

7.1002 The **United States** submits that there is now a general prohibition of export subsidies in the *SCM Agreement* which moves away from this statement in Article XVI:3 of the *GATT 1994*.[1178]

7.1003 **We** are well aware of our duties as a treaty interpreter. It is clear to us that the provisions of the *Agreement on Agriculture*, the *SCM Agreement* and the *GATT 1994* must be read in conjunction

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[1175] We refer to our "order of analysis" examination in Section VII:C, as well as our examination of the relationship between the provisions of the other covered agreements and those of Article XVI of the *GATT 1994* in Sections VII:E and F. We note that, unlike Article XVI:4, which by its terms clearly applies to "the export of any product other than a primary product", Article XVI:3 applies to "subsidies on the export of primary products". It therefore also potentially relates to products within the product coverage of the *Agreement on Agriculture*.

[1176] The first sentence of Article XVI:3 commences with the word "Accordingly...". We believe that this indicates a conceptual *sequitur* to the recognition expressed in Article XVI:2 that "...subsidies *on the export* of primary products may have harmful effects for other Members..." (emphasis added).

[1177] Brazil's response to Panel Question No. 185 (a).

[1178] United States' response to Panel Question No. 186.

and that, unless explicitly indicated, provisions of the *Agreement on Agriculture* and/or the *SCM Agreement* cannot be taken to replace, subsume or exclude provisions of the *GATT 1994*. We are also well aware that WTO obligations generally apply "cumulatively" and that an appropriate reading of the "inseparable package of rights and disciplines" in these covered agreements must, accordingly, be a harmonious one that gives meaning to *all* the relevant provisions of these three equally binding agreements.[1179]

7.1004 As we have already seen, the term "export subsidy" – a subsidy contingent upon export performance – is now defined in the current *Agreement on Agriculture* and the *SCM Agreement*. Such a definition did not exist when Article XVI was originally drafted.

7.1005 Particularly in view of the rules pertaining to potential conflicts in Article 21.1 of the *Agreement on Agriculture* and the General Interpretative Note to Annex 1A of the *WTO Agreement* which would give precedence to the provisions of the *Agreement on Agriculture* and then the *SCM Agreement* over a provision of the *GATT 1994* to the extent of any conflict[1180], we do not believe that it is appropriate to apply a separate or different definition of "export subsidies" under Article XVI:3 than that which is now applicable for the purposes of Articles 3.3, 8, 9, 10 and 1(e) of the *Agreement on Agriculture* and Article 3.1(a) of the *SCM Agreement*. We see that the *Agreement on Agriculture* contains scheduled export reduction commitments on export subsidies listed in Article 9.1 and a general prohibition on export subsidies not listed in Article 9.1 which are applied in a manner which results in, or threatens to lead to, circumvention of these commitments (Article 10.1). Except as provided in the *Agreement on Agriculture*, the *SCM Agreement* contains a *general prohibition on export subsidies* in Article 3.1(a).

7.1006 This reading of the text of Article XVI:3 of the *GATT 1994*, in its context, supports a conclusion that Article XVI:3 applies only to "export subsidies" as that term is currently understood in the *WTO Agreement*.[1181] This reading finds support in the object and purpose of the agreement.[1182]

7.1007 While it is not necessary to resort to drafting history under these circumstances[1183], we nevertheless observe that such an interpretation finds confirmation in the drafting history. The relevant provisions of the *Tokyo Round Subsidies Code* clearly distinguished between export and other subsidies.

7.1008 Article 8 dealt with "subsidies in general", with Article 8.2 referring to "export subsidies" and Articles 8.3(c) and 8.4 dealing with "serious prejudice" in the sense of Article XVI:1. Article 9 dealt with "export subsidies on products other than certain primary products", with Article 9.1 providing:

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[1179] *See*, e.g. Appellate Body Report, *Argentina – Footwear (EC)*, paras. 81, 83-84; Panel Report, *Indonesia – Autos*, paras. 14.28 *ff*. In *Brazil – Dessicated Coconut*, the Appellate Body agreed with the panel that:

> "[...] the question for consideration is not whether the SCM Agreement supersedes Article VI of GATT 1994. Rather, it is whether Article VI creates rules which are separate and distinct from those of the SCM Agreement, and which can be applied without reference to that Agreement, or whether Article VI of GATT 1994 and the SCM Agreement represent an inseparable package of rights and disciplines that must be considered in conjunction." See Appellate Body Report, *Brazil – Dessicated Coconut*, p. 15.

[1180] See our other examination of these provisions above in Section VII:E, paras. 7.654 *ff*.

[1181] We do not mean to suggest that export subsidies may never be included in a serious prejudice analysis under Article XVI:1. Rather, we mean that subsidies other than export subsidies may not form the basis for an examination under Article XVI:3.

[1182] See e.g. *supra*, footnote 920.

[1183] See Articles 31 and 32 of the *Vienna Convention*, previously addressed *supra*, footnote 1112.

"Signatories shall not grant export subsidies on products other than certain primary products". Article 10 dealt with "export subsidies on certain primary products". Article 10 provided:

> "1. *In accordance with the provisions of Article XVI:3 of the General Agreement*, signatories agree not to grant directly or indirectly any export subsidy on certain primary products in a manner which results in the signatory granting such subsidy having more than an equitable share of world export trade in such product, account being taken of the shares of the signatories in trade in the product concerned during a previous representative period, and any special factors which may have affected or may be affecting trade in such product." (emphasis added)

7.1009 This suggests that the drafters of the *Tokyo Round Subsidies Code* considered that the export subsidies in Article 10 of the *Tokyo Round Subsidies Code* were those subject to Article XVI:3 of the *GATT 1994*.

7.1010 Article 11 of the *Tokyo Round Subsidies Code* addressed "subsidies other than export subsidies". Article 11.2 provided, in part:

> "Signatories recognize, however, that subsidies other than export subsidies ... may cause or threaten to cause injury to a domestic industry of another signatory or serious prejudice to the interests of another signatory or may nullify or impair benefits accruing to another signatory under the General Agreement, in particular where such subsidies would adversely affect the conditions of normal competition. Signatories shall therefore seek to avoid causing such effects through the use of subsidies."

7.1011 Read together with Article 10, this provision similarly suggests that the drafters of the *Tokyo Round Subsidies Code* distinguished between the export subsidies referred to in Article XVI:3 of the *GATT 1994* and other subsidies. The drafters indicated in Articles 9 and 10 that export subsidies were subject to certain disciplines, while subsidies *other than export subsidies* were subject to *other* disciplines and could form the main basis for a serious prejudice claim. This confirms our view of the distinction between export subsidies and other (actionable) subsidies maintained in the current text of the *SCM Agreement*.[1184]

7.1012 Returning to the current text of the treaty, we note that, other than the common reference to "export subsidies" found in all of the three relevant texts (i.e. (i) Article XVI:3; (ii) the export subsidies provisions of the *Agreement on Agriculture*; and (iii) Article 3.1(a) of the *SCM Agreement*) there is no further explicit textual linkage or cross-reference between any relevant provision of the *Agreement on Agriculture*, any provision of the *SCM Agreement* – including Articles 3, 5 and 6 (in

[1184] See *supra*, footnote 1181.

particular, Article 6.3(d))[1185] – and Article XVI:3 of the *GATT 1994* that would compel us to find any other scope of application for the obligation contained in Article XVI:3 of the *GATT 1994*.[1186]

7.1013 We look to Article 13 of the *Agreement on Agriculture* to discern whether there is any clear articulation of the relationship between the rights and obligations in the *Agreement on Agriculture* and the *SCM Agreement* and Article XVI:3 of the *GATT 1994* during the implementation period that would lead us to a different conclusion. We see that Article 13(b)(ii) of the *Agreement on Agriculture*, relating to domestic support, contains no reference to Article XVI:3 of the *GATT 1994*.[1187]

7.1014 We understand this omission, in Article 13(b)(ii) of the *Agreement on Agriculture*, of any reference to paragraph 3 of Article XVI of the *GATT 1994*, to indicate that the drafters of Article 13(b)(ii) of the *Agreement on Agriculture* did not believe that a domestic support measure could ever be subject to actions under the "export subsidy" provisions of Article XVI:3 (and there was thus no need to refer to that provision in Article 13(b)).

7.1015 In light of the extensive package of substantive rights and obligations on domestic and export subsidies resulting from the Uruguay Round in the *Agreement on Agriculture* and the *SCM Agreement*, and the focus in both agreements upon disciplines governing domestic support and export subsidies, we do not consider it plausible that the drafters of Article 13(b)(ii) of the *Agreement on Agriculture* simply overlooked the possibility that actions under Article XVI:3 might arise in respect of domestic support and that such actions were not covered by the "exemption from actions" provided by Article 13 of the *Agreement on Agriculture*. Indeed, we are not entitled to presume that this was the case. Had the drafters wished to refer to all of Article XVI in Article 13(b)(ii) they could have. However, they did not. They explicitly identified only paragraph 1 of the provision as potentially applicable to the domestic support measures in question.

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[1185] At first blush, there appear to be similarities between Article XVI:3 of the *GATT 1994* and Article 6.3(d) of the *SCM Agreement*. Both call for a comparison of a Member's quantitative share in a certain world phenomenon – "export trade" (Article XVI.3) or "market share" (Article 6.3(d)) – with a corresponding share during a previous period. The tests contained in Article 6.3(d) and Article XVI:3 may be similar, but they are certainly not textually or conceptually identical. For example, Article 6.3(d) does not contain the terms "equitable share" and "special factors". It also defines a "previous representative period" for comparison as three years. It also refers to "market share" rather than "export trade". We do not believe that the language of Articles 5(c)/6.3(d) of the *SCM Agreement* suggests an intention by the Uruguay Round negotiators directly to *develop and refine* the requirements of Article XVI:3 of the *GATT 1994* within the *SCM Agreement* insofar as export subsidies are concerned. At least, if there were such an intention, they have not clearly so indicated in the text of these two covered agreements.

[1186] There *is* an explicit textual linkage between Article 6.3(d) and Article 5(c) of the *SCM Agreement*: the chapeau of Article 6.3 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise where one of the following [including the elements in Article 6.3(d)] apply...". We discuss the cross-reference further *infra*., Section VII:G, in our examination of Brazil's claims under Article XVI:1.

[1187] We see that Article 13(a)(ii) of the *Agreement on Agriculture* provides that "Green Box" domestic support measures shall be "exempt from actions based on Article XVI of the GATT 1994 and Part III of the Subsidies Agreement...".

Article 13(b)(ii) of the *Agreement on Agriculture* provides that certain "domestic support measures" shall be "exempt from actions based on paragraph 1 of Article XVI of the GATT 1994 and Articles 5 and 6 of the Subsidies Agreement...". This provision refers only to paragraph 1 of Article XVI. It does *not* refer to Article XVI:3.

Article 13(c)(ii) of the *Agreement on Agriculture* stipulates that certain "export subsidies" shall be "exempt from actions based on Article XVI of the GATT 1994 and Articles 3, 5 and 6 of the *SCM Agreement*". In contrast to Article 13(b)(ii) which contains the limited reference to *paragraph 1* of Article XVI of the GATT 1994, Article 13(c)(ii) refers to Article XVI in its entirety, necessarily including both paragraphs 1 and 3, to the extent relevant and applicable.

7.1016 We therefore find that Article XVI:3 applies only to export subsidies as that term is now defined in the *Agreement on Agriculture* and the *SCM Agreement*.

7.1017 In any event, even if Article XVI:3 of the *GATT 1994* is still susceptible to independent application in respect of export subsidies, in light of our findings above that the challenged export subsidy measures concerned – that the user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 and export credit guarantees under the GSM 102, GSM 103 and SCGP programmes – constitute prohibited subsidies in violation of the United States' obligations under the export subsidy provisions (Articles 3.3, 8 and/or 10) of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement* – we do not believe that it is necessary to conduct an examination of challenged export subsidy measures also under Article XVI:3 of the *GATT 1994* for the purposes of resolving this dispute.

## F. IMPORT SUBSTITUTION SUBSIDY

### 1. Measure at issue

7.1018 This Section of our report deals with an alleged import substitution subsidy under Articles 3.1(b) and 3.2 of the *SCM Agreement*. Brazil's claim relates to section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users[1188], as described in Section VII:C.

### 2. Claim under Article 3.1(b) (and 3.2) of the *SCM Agreement*

(a) Main arguments of the parties

7.1019 **Brazil** challenges section 1207(a) of the FSRI Act of 2002 as a *per se* import substitution subsidy that is inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*. Brazil argues that user marketing (Step 2) payments to domestic users are "subsidies" as defined in Article 1 of the *SCM Agreement*. The subsidies are contingent on the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*: they are "conditional" on proof of consumption of domestically produced upland cotton. Article 3.2 of the *SCM Agreement* requires that such subsidies be neither granted nor maintained.

7.1020 According to Brazil, there is no inherent conflict between the prohibition on import substitution subsidies in Article 3.1(b) of the *SCM Agreement* and the provisions of the *Agreement on Agriculture*. Articles 1(a), 3.2 and paragraph 7 of Annex 3 of the *Agreement on Agriculture* deal with the calculation of a Member's AMS and envisage that measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products. However, according to Brazil, these provisions do not require, nor grant permission, for a Member to grant subsidies contingent upon import substitution.

7.1021 In Brazil's view, the introductory phrase to Article 3 of the *SCM Agreement* ("[e]xcept as provided in the *Agreement on Agriculture*"), in conjunction with Article 21.1 and other provisions of that Agreement, does not have the effect of carving agricultural domestic support out from the prohibition imposed by Article 3.1(b) of the *SCM Agreement*. Brazil submits that the absence of any conflict, coupled with the absence of any explicit exemption for import substitution subsidies in

[1188] See section 1207(a) of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1. The implementing regulations are found in 7 CFR 1427.100 *et seq*., reproduced in Exhibit BRA-37. The FAIR Act of 1996 provided for user marketing (Step 2) payments to domestic users in section 136, reproduced in Exhibits BRA-28 and US-22.

In this Section of our report, we limit our examination to Brazil's claim relating to user marketing (Step 2) payments to domestic users. We address user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 in Section VII:E.

Article 13(b) or anywhere else in the *Agreement on Agriculture*, supports the conclusion that import substitution subsidies related to agricultural goods violate Article 3.1(b) of the *SCM Agreement*.

7.1022 The **United States** acknowledges that user marketing (Step 2) payments are "subsidies"[1189] and that, to receive a payment under the Step 2 programme, a domestic user "must open a bale of domestically produced baled upland cotton".[1190]

7.1023 However, according to the United States, user marketing (Step 2) payments are included in measures which comply with "domestic support reduction commitments" under the *Agreement on Agriculture* within the meaning of Article 6.3 of the *Agreement on Agriculture*.

7.1024 The United States submits that the introductory language to Article 3 of the *SCM Agreement* ("[e]xcept as provided in the *Agreement on Agriculture*") renders that provision subject to the terms of the *Agreement on Agriculture*. Under Article 6.3 of the *Agreement on Agriculture*, if a Member is providing support within its domestic support reduction commitments, then such support may not be challenged under Article 3.1(b) of the *SCM Agreement*. This is because Article 3.1(b) of the *SCM Agreement* applies "except as provided in the Agreement on Agriculture". Paragraph 7 of Annex 3 of the *Agreement on Agriculture* recognizes that a Member has a right to provide subsidies contingent upon use of domestic products under the *Agreement on Agriculture*. Moreover, pursuant to Article 21 of the *Agreement on Agriculture*, all of the Annex 1A agreements (including the *SCM Agreement*) apply subject to the provisions of the *Agreement on Agriculture*. The United States asserts that, inasmuch as Article 3.1(b) does not apply, the operation of the user marketing (Step 2) programme also cannot violate Article 3.2 of the *SCM Agreement.*

(b) Main arguments of the third parties

7.1025 **Argentina** contends that there is no conflict between Article 3.1(b) and any provision of the *Agreement on Agriculture*. Paragraph 7 of Annex 3 of the *Agreement on Agriculture* does not refer to the "subsidies contingent […] upon the use of domestic over imported goods" mentioned in Article 3.1(b) of the *SCM Agreement*. Moreover, paragraph 7 of Annex 3 contains no mention of the *SCM Agreement*. If the intention had been to exempt these measures from the prohibition contained in Article 3.1(b) of the *SCM Agreement*, this would have been expressly stated.[1191]

7.1026 **Australia** asserts that user marketing (Step 2) payments to domestic users are contingent upon the use of domestic over imported goods.[1192] Australia does not consider that the phrase "provide support in favour of domestic producers" in Article 3.2 of the *Agreement on Agriculture* permits subsidies contingent upon the use of domestic goods. In Australia's view, the legal issue in question relates to the condition attached to the grant of a subsidy, not the grant of a subsidy *per se* or who might benefit from the subsidy. The fact that a measure may benefit an agricultural producer ("support in favour of domestic producers") does not serve to override measures otherwise prohibited. In the case of subsidies contingent upon the use of domestic goods, there is no conflict between either the *Agreement on Agriculture* and the *SCM Agreement* or the *GATT 1994*, which discipline or prohibit certain conditions attached to subsidies, including subsidies in favour of agricultural producers (subject only to the provisions of Article III:8(b) of the *GATT 1994*). There is no provision in the *Agreement on Agriculture* which provides for an exception to, or cover for, import substitution conditions attached to the grant of a subsidy.[1193] Australia emphasizes that Article 13(b)(ii) does not

[1189] United States' response to Panel Question No. 108.
[1190] United States' response to Panel Question No. 144.
[1191] Argentina's response to Panel third party Question No. 40.
[1192] Australia's response to Panel third party Question Nos. 38 and 39.
[1193] Australia's response to Panel third party Question No. 40.

exempt non-"green box" domestic support measures from actions based on Article 3 of the *SCM Agreement*.[1194]

7.1027 The **European Communities** agrees with the United States that subsidies contingent upon the use of domestic goods which are maintained consistently with the *Agreement on Agriculture* are not inconsistent with the *SCM Agreement*. The European Communities argues that subsidies contingent upon the use of domestic goods are consistent with Article 3.2 of the *Agreement on Agriculture*. The European Communities puts an emphasis on the phrase "in favour of", as not requiring that support be "to" domestic producers. The same term is used in Article 1(a) (the definition of AMS) and in Article 1(h) (definition of Total AMS). Paragraph 7 of Annex 3 recognizes that a Member has a right to provide subsidies contingent upon use of domestic products under the *Agreement on Agriculture*.[1195]

7.1028 According to the European Communities, Article 21.1 of the *Agreement on Agriculture* provides that the other goods agreements will apply "subject to" the provisions of the *Agreement on Agriculture*. A finding that a measure was an import substitution subsidy would mean that such a subsidy would be prohibited under Article 3.1(b) of the *SCM Agreement*. In such an event, the consequences of such a finding would have to be subordinated to the right to adopt such measures under the *Agreement on Agriculture* (provided reduction commitments are respected). Moreover, the chapeau of Article 3.1 of the *SCM Agreement* clearly exempts from the scope of that Article domestic content subsidies which are maintained consistently with the *Agreement on Agriculture*.[1196]

7.1029 **New Zealand** does not agree that a right to provide subsidies contingent upon the use of domestic products contrary to Article 3 of the *SCM Agreement* can be found in the requirement that subsidies "directed at agricultural producers […] to the extent that they benefit producers of the basic agricultural product" be included in the calculation of AMS. There is no basis for reading such a right into the *Agreement on Agriculture*. To do so would allow the possibility for exemption from action under the *SCM Agreement* to exist other than by virtue of Article 13 of the *Agreement on Agriculture*. Article 13 of the *Agreement on Agriculture* explicitly does not provide such exemption from action under Article 3 of the *SCM Agreement* when it quite clearly could have done so. In New Zealand's view that indicates that there was no intention on the part of the drafters that domestic support measures, whether they conform with Article 6 of the *Agreement on Agriculture* or not, should be so exempt.[1197]

## 3. Examination by the Panel

(a) Relationship between Article 3.1(b) of the *SCM Agreement* and the domestic support provisions of the *Agreement on Agriculture*

*(i) Overview*

7.1030 Article 3.1 of the *SCM Agreement* states:

> "3.1 *Except as provided in the Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited: ...

[1194] Australia's response to Panel third party Question No. 40.
[1195] European Communities' oral statement at the first session of the first substantive meeting, paras. 33-36.
[1196] European Communities' oral statement at the first session of the first substantive meeting, paras. 37-39.
[1197] New Zealand's response to Panel third party Question No. 40.

> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I; ...
>
> (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." (emphasis added, footnotes omitted)

7.1031 We recall once again that Article 3.2 of the *DSU* recognizes that interpretative issues arising in WTO dispute settlement are to be resolved through the application of customary rules of interpretation of public international law. It is well settled that the principles codified in Articles 31 and 32 of the *Vienna Convention* are such customary rules.[1198] The task of interpreting a treaty provision must begin with its specific terms.

7.1032 We thus look to the specific terms of the treaty text. The relationship between the *Agreement on Agriculture* and the *SCM Agreement* is defined, in part, by the text of Article 3.1 of the *SCM Agreement*. That provision contains an introductory clause: "[e]xcept as provided in the Agreement on Agriculture".

7.1033 In giving effect to this introductory phrase of Article 3.1 of the *SCM Agreement*, we have a duty to read all the provisions of WTO agreements as a whole[1199], in a manner which respects and gives effect to the text of all relevant provisions read in light of their context, object and purpose. Indeed, we have already noted the interlocking nature of the *SCM Agreement* and the *Agreement on Agriculture.*[1200] The respective texts of these agreements expressly provide for a general order of precedence among them, when certain conditions prevail.

7.1034 The introductory clause of Article 3.1 of the *SCM Agreement* ("[e]xcept as provided in the Agreement on Agriculture") indicates that any examination of the WTO-consistency of a subsidy for agricultural products under the *SCM Agreement* may depend upon the provisions of the *Agreement on Agriculture.*[1201]

7.1035 Article 21.1 of the *Agreement on Agriculture* states:

> "The provisions of GATT 1994 and of the other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement".

7.1036 This provision expressly acknowledges the application of the *GATT 1994* and the *SCM Agreement* to agricultural products, while indicating that the *Agreement on Agriculture* would take precedence in the event, and to the extent, of any conflict.[1202]

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[1198] We recall, once again, that Article 31(1) of the *Vienna Convention* provides in relevant part that: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

[1199] See Appellate Body Reports: *Korea – Dairy* and *Argentina – Footwear (EC).*

[1200] We recall our general discussion of "order of analysis" in Section VII:C.

[1201] As already mentioned in Section VII:C, we find support for our approach in the Appellate Body Report in *Canada – Dairy (Article 21.5 – New Zealand and US).*

[1202] Neither the introductory phrase in Article 3.1 of the *SCM Agreement*, nor Article 21.1 of the *Agreement on Agriculture* mean that the *Agreement on Agriculture* must *necessarily* contain a provision that would have the effect of carving out certain domestic support measures from the prohibition on import substitution subsidies in Article 3.1(b) of the *SCM Agreement* or rendering those disciplines inapplicable to agricultural domestic support. This view does not reduce the introductory phrase to inutility. For example, the

7.1037 We recall that the *WTO Agreement* is a "single undertaking". All of the "covered agreements"[1203] in Annexes 1, 2 and 3 are integral parts of the same *WTO Agreement*[1204], subject to the integrated dispute settlement system established by the *DSU*. Each covered agreement contains distinct obligations, which govern Members' conduct within the parameters of the substance and subject-matter of the particular provision and of the particular covered agreement. It is clear to us that the same measure can be subject to more than one WTO obligation or commitment, although the specific *aspects* of the measure that may be subject to an obligation or commitment may vary depending upon the particular agreement or legal provision in question.

7.1038 We understand that Article 21.1 of the *Agreement on Agriculture* could speak to a situation where, for example, the domestic support provisions of the *Agreement on Agriculture* would prevail in the event that an explicit carve-out or exemption from the disciplines in Article 3.1(b) of the *SCM Agreement* existed in the *text* of the *Agreement on Agriculture*. Another situation would be where it would be impossible for a Member to comply with its domestic support obligations under the *Agreement on Agriculture* and the Article 3.1(b) prohibition simultaneously. Another situation might be where there is an explicit authorization in the text of the *Agreement on Agriculture* that would authorize a measure that, in the absence of such an express authorization, would be prohibited by Article 3.1(b) of the *SCM Agreement*.

7.1039 For the purposes of resolving this dispute, it is not necessary for us to decide upon any single fixed meaning of a "conflict" or to identify a particular situation that might fall to be decided subject to the order of precedence set out in Articles 21.1 of the *Agreement on Agriculture* and the introductory clause to Article 3.1(b) of the *SCM Agreement*. This flows from our view that none of the situations just mentioned arise in this dispute from the relevant provisions in the *Agreement on Agriculture*.

7.1040 For the reasons that follow, we believe the domestic support provisions of the *Agreement on Agriculture*, on the one hand, and Article 3.1(b) of the *SCM Agreement*, on the other, do not present any conflict.[1205]

7.1041 We turn to the relevant provisions of the *Agreement on Agriculture* in order to discern whether, and/or to what extent, these provisions affect a claim concerning the prohibition on import substitution subsidies in Article 3.1(b) of the *SCM Agreement.* [1206]

*(ii) Article 13 of the Agreement on Agriculture*

7.1042 We first consider whether Article 13 of the *Agreement on Agriculture* articulates any clear expression that the drafters intended the domestic support provisions of the *Agreement on Agriculture* to affect a claim under Article 3.1(b) during the implementation period.

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introductory clause in Article 3.1 also relates to the export subsidy prohibition in Article 3.1(a), and our view is without prejudice to that relationship.

[1203] The "covered agreements" are listed in Appendix 1 to the *DSU*.

[1204] Article II:2 of the *WTO Agreement.*

[1205] We recall and find support in the approach of certain previous panels, which have referred to a presumption against conflict. Panel Report, *Indonesia – Autos*, para. 14.28; *Turkey – Textiles*, paras. 9.92-9.95.

[1206] We find support in Appellate Body Reports, *US – Carbon Steel* and *US - Corrosion-Resistant Steel Sunset Review*. These reports underline the importance of the text and the role of cross-references and clear textual indications about the relationship between and among treaty provisions. We also note that other Appellate Body reports – for example, Appellate Body Report, *EC – Sardines*, paras. 201-208 and Appellate Body Report, *EC – Hormones*, para. 128 – address relationships among certain treaty provisions, and, in particular, situations where large groups of measures are (or are not) exempted from disciplines. In *EC – Sardines*, para. 208, the Appellate Body stated: "[...] we must conclude that, if the negotiators had wanted to exempt the very large group of existing technical regulations from the disciplines of a provision as important as Article 2.4 of the *TBT Agreement*, they would have said so explicitly."

7.1043 Brazil argues that Article 13(b)(ii) of the *Agreement on Agriculture* does not exempt user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 from challenges under Article 3 of the *SCM Agreement*. Brazil therefore considers that it is entitled to assert a claim that user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 are subsidies contingent upon the use of domestic over imported goods, within the meaning of Article 3.1(b) of the *SCM Agreement*.

7.1044 The United States seemed to indicate in its initial brief[1207] that Article 3.1(b) claims are "exempt from action" by virtue of Article 13 of the *Agreement on Agriculture*. However, in responding to Panel questioning, the United States observes that Article 13(b) "does not reference ... Article 3" of the *SCM Agreement*, and that, on the United States' view, while Article 13(b) addresses domestic support measures, Article 13 "would not appear to be applicable" to domestic support measures constituting import substitution subsidies under Article 3.1(b) of the *SCM Agreement*.[1208]

7.1045 We therefore do not understand the parties to disagree that Article 13 of the *Agreement on Agriculture* does not affect claims under Article 3.1(b) of the *SCM Agreement*.

7.1046 In any event, our own analysis, based on the text of Article 13 of the *Agreement on Agriculture*, leads us to endorse what appears to be the shared view of the parties based on their submissions to the Panel.

7.1047 Article 3.1 of the *SCM Agreement* prohibits two types of subsidies: (i) those contingent on export performance (so-called "export subsidies") in paragraph (a); and (ii) those contingent on the use of domestic over imported goods (so-called "import substitution" subsidies) in paragraph (b).

7.1048 Article 13(b)(ii) of the *Agreement on Agriculture* exempts certain domestic support measures in respect of agricultural products from actions based on Articles 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*, but does not refer to Article 3 of the *SCM Agreement* at all.

7.1049 Article 13(c)(ii) of the *Agreement on Agriculture* states that "*export subsidies* that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement." (emphasis added) The negotiators were therefore fully aware of how to insert a reference to Article 3 of the *SCM Agreement* when they deemed it appropriate to do so (as they did in Article 13(c)). However, they inserted no such cross-reference when addressing obligations relevant to domestic support measures in Article 13(b).

7.1050 As noted, Article 13(c)(ii) of the *Agreement on Agriculture* explicitly and exclusively refers to "export subsidies", which are those dealt with in Article 3.1(a) of the *SCM Agreement*. Article 13(c) of the *Agreement on Agriculture* does not refer to import substitution subsidies, or, indeed, to any type of subsidy other than *export* subsidies. Therefore, claims relating to alleged import substitution subsidies, under Article 3.1(b), do not fall within the ambit of Article 13(c) of the *Agreement on Agriculture*.

7.1051 Had the drafters of Article 13 of the *Agreement on Agriculture* intended to exempt certain measures from actions based on Article 3.1(b) in Article 13(c), they would have so indicated, either by referring explicitly to "import substitution" subsidies in the chapeau of Article 13(c) or by using the more general reference to "subsidies" rather than qualifying the term "subsidies" by the term

[1207] In United States' initial brief, footnote 2, the United States included Article 3.1(b) of the *SCM Agreement* in the list of provisions in respect of which the United States asserted that "Brazil cannot maintain any action – and the United States cannot be required to defend any such action – based on provisions specified in the Peace Clause since the U.S. support measures for upland cotton conform to the Peace Clause." (footnote omitted)

[1208] United States' response to Panel Question No. 111.

"export" in the chapeau. Moreover, the provisions of the *Agreement on Agriculture* referred to in the chapeau of Article 13(c) refer to the provisions of "Part V" of the *Agreement on Agriculture*. That part contains export subsidy disciplines. They do not relate to domestic support.[1209]

7.1052 Thus, we believe that Article 13 of the *Agreement on Agriculture* does not affect our analysis of Brazil's claim under Article 3.1(b) of the *SCM Agreement*.

*(iii) Domestic support provisions in the Agreement on Agriculture*

7.1053 We next turn to the substantive provisions relating to domestic support in the *Agreement on Agriculture* to check whether they affect our examination of Brazil's claim under Article 3.1(b) of the *SCM Agreement*.

7.1054 Articles 6 and 7 of the *Agreement on Agriculture* and Members' schedules contain domestic support commitments. Article 6.3 of the *Agreement on Agriculture* provides that "[a] Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total [Aggregate Measurement of Support] does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule."[1210]

7.1055 Annex 3 of the *Agreement on Agriculture* is entitled "Domestic Support: Calculation of Aggregate Measurement of Support". Paragraph 7 of Annex 3 provides:

> "7. The AMS shall be calculated as close as practicable to the point of first sale of the basic agricultural product concerned. Measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products."

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[1209] That part of the *Agreement on Agriculture* consists of Article 8 ("Export Competition Commitments"); Article 9 ("Export Subsidy Commitments"); Article 10 ("Prevention of Circumvention of Export Subsidy Commitments") and Article 11 ("Incorporated Products"). Article 11 deals with incorporated agricultural primary products. It therefore addresses certain obligations relating to incorporated products, but does not deal with the concept of contingency upon import substitution in general. This gives further contextual support to our view that actions based on Article 3.1(b) of the *SCM Agreement* are not affected by Article 13 or the substantive domestic support provisions of the *Agreement on Agriculture*.

[1210] Article 1(a) of the *Agreement on Agriculture* reads, in part:

> "(a) 'Aggregate Measurement of Support' and 'AMS' mean the annual level of support, expressed in monetary terms, *provided for an agricultural product in favour of the producers of the basic agricultural product* or non-product-specific support provided in favour of agricultural producers in general, other than support provided under programmes that qualify as exempt from reduction under Annex 2 to this Agreement, which is: ...
>
> (i) with respect to support provided during any year of the implementation period and thereafter, calculated in accordance with the provisions of Annex 3 of this Agreement and taking into account the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule;"

Article 3.2 of the *Agreement on Agriculture* provides:

> "2. Subject to the provisions of Article 6, a Member shall not provide support *in favour of domestic producers* in excess of the commitment levels specified in Section I of Part IV of its Schedule." (emphasis added)

7.1056 The United States asserts that this provision requires the United States to include its user marketing (Step 2) payments in favour of domestic upland cotton producers, even though such payments are made to processors, within its calculation of its AMS. The United States asserts that if Members could not discriminate in favour of domestic producers when making subsidy payments through processors, there would be no reason for paragraph 7 of Annex 3.[1211] The United States thus contends that user marketing (Step 2) payments to upland cotton domestic users that provide support to domestic producers contingent on the use of domestic goods is consistent with the *Agreement on Agriculture*.

7.1057 We do not agree. Domestic support reduction commitments are adopted pursuant to the domestic support provisions contained in the *Agreement on Agriculture*, and the terms of Article 6.3 define the circumstances in which a Member shall be deemed to be in conformity with those commitments.

7.1058 However, Article 6.3 does *not* provide that compliance with such "domestic support reduction commitments" shall necessarily be considered to be in compliance with other applicable WTO obligations. Nor does it contain an explicit textual indication that otherwise prohibited measures are necessarily justified by virtue of compliance with the domestic support reduction commitments. The obligations are parallel, and the operation of Article 6.3 of the *Agreement on Agriculture* does not pre-empt or exclude the operation of the obligation under Article 3.1(b) of the *SCM Agreement*.

7.1059 We believe there is a clear distinction between a provision that requires a Member to include a certain type of payment (or part thereof) in its AMS calculation and a provision that requires inclusion in the AMS of subsidies contingent upon import substitution. The United States, in this dispute, would have us read such provisions synonymously. We decline to do so.

7.1060 Support "in favour of" domestic producers does not *require* or *authorize* contingency upon use of domestic over imported goods.

7.1061 The fact that the *Agreement on Agriculture* foresees that certain domestic support measures actually paid to other recipients may also "benefit" the producers of the basic agricultural products, and require inclusion in the AMS of an amount to the extent this is the case, does not permit a measure that is otherwise prohibited. Annex 3 provides guidance on the calculation of the AMS. Nowhere in the text is there recognition that a Member has a *right* to provide subsidies contingent upon use of domestic products under the *Agreement on Agriculture*. Support "in favour of" or that "benefits" domestic producers need not necessarily be support *conditional upon* the use of domestic over imported goods.

7.1062 The provision of funds to processors of the product concerned need not have the consequence of limiting access to such subsidies *exclusively* to domestic production, so as to ensure that it is only available upon use of domestic over imported goods.

7.1063 The specific reference to subsidies that benefit the producers of the basic agricultural products in paragraph 7 of Annex 3 does not *entitle* a Member to maintain subsidies contingent on the use of domestic over imported goods consistently with the *Agreement on Agriculture* and the *SCM Agreement*. The phrase "to the extent" in paragraph 7 of Annex 3 implies a requirement for Members to make an annual determination and allocation of support that *actually* benefits the "producers" of the subsidizing Member. All types of "domestic support in favour of agricultural producers" must be tabulated for the purposes of setting and enforcing a Member's domestic support reduction commitments. To the extent the subsidy benefits processors or other parties besides the domestic producers, then, pursuant to paragraph 7 of Annex 3, that portion of the funds would not be included

[1211] United States' response to Panel Question No. 116.

within AMS. The provision envisages that not all support paid to processors may benefit domestic producers, and provides guidance as to the calculation of AMS in this situation.

7.1064 Indeed, the reference in the text to "to the extent that" clearly indicates that there is a range of degrees to which a measure could be "in favour of" domestic producers. It is not possible to read this language as requiring or allowing conditionality upon the use of domestic products.

7.1065 We can conceive of domestic support measures provided to processors which provide support "in favour of domestic producers" and that are *not* contingent upon the use of domestic over imported goods (and that would therefore be consistent with Article 3.1(b) of the *SCM Agreement*).[1212]

7.1066 Article 3 of the *Agreement on Agriculture* is entitled *"Incorporation of Concessions and Commitments"*. Pursuant to Article 3.1,

> "1. The domestic support and export subsidy commitments in Part IV of each Member's Schedule constitute commitments limiting subsidization and are hereby made an integral part of GATT 1994."

7.1067 From this, we understand that the limitation of subsidization imposed by the domestic support reduction commitments in the *Agreement on Agriculture* relates to the object and purpose of imposing quantitative limitations at certain defined levels. It does not address all of the *qualitative* aspects of subsidization. That is, it sets permitted levels of support subject to reduction commitments and does not deal exhaustively with all of the other potential characteristics of the support measure itself. The issue of the grant of a subsidy *per se* or the general identification of potential recipients or beneficiaries of the subsidy is therefore not legally relevant to the particular *condition* we are currently examining that is attached to the grant of a subsidy, i.e. contingency upon the use of domestic over imported goods.[1213]

7.1068 The terms "domestic support reduction commitment", AMS and Total AMS are germane to the *Agreement on Agriculture* and, in fact, do not appear in Article 3 (or any other provision) of the *SCM Agreement*.

7.1069 By contrast, the definition of a subsidy for the purposes of the *SCM Agreement* is contained in Article 1 of that Agreement. The definitional elements of, and prohibition upon, an import substitution subsidy are set out in Article 3.1(b) of the *SCM Agreement*. Nowhere in the texts of these or any other provisions of the covered agreements do we find a statement that, should a measure satisfying the conception of a compliant domestic support measure in Article 6 of the *Agreement on Agriculture* also happen to meet the definitional criteria of an import substitution subsidy within the meaning of Article 3.1(b) of the *SCM Agreement*, the prohibition in that provision would not apply, or the subsidy would be effectively exempted from that prohibition.

7.1070 We find further support for our view in the absence we have already found of *any* reference to import substitution subsidies under Article 3.1(b) in Article 13 of the *Agreement on Agriculture*.[1214] Article 13 of the *Agreement on Agriculture* sets out certain specific rules concerning the relationship between the obligations in the *SCM Agreement* and the *Agreement on Agriculture* during the implementation period, when Members sought to provide a degree of clarity which might not

[1212] e.g., subsidies paid to processors regardless of the origin of the basic agricultural product.

[1213] In this regard, we also note that the preamble to the *Agreement on Agriculture* records the commitment of Members "to achiev[e] specific binding commitments in ... market access, domestic support; export competition...". This preambular statement cannot, of course, override any provision which gives primacy to the *Agreement on Agriculture* over a specific binding commitment in another covered agreement. However, it is useful context to assist us in our interpretation that obligations in the covered agreements are different in their nature and capable of applying in parallel.

[1214] *Supra*, paras. 7.1042-7.1052.

otherwise have been entirely evident from the other substantive provisions defining the relationship. The silence of Article 13 of the *Agreement on Agriculture* on Article 3.1(b) relating to import substitution subsidies can be taken as a further indication that Members did not believe that such subsidies were of such a nature as to merit the articulation of any particular treatment other than the treatment already indicated in the substantive obligations under the *SCM Agreement* and the *Agreement on Agriculture*.

7.1071 We do not see an inherent conflict between compliance with the domestic support reduction commitments in Article 6.3 of the *Agreement on Agriculture* and the prohibition of import substitution subsidies under Article 3.1(b) of the *SCM Agreement* so as to render the simultaneous application of the provisions untenable. Article 3.1(b) of the *SCM Agreement* can be read together with the *Agreement on Agriculture* provisions relating to domestic support in a coherent and consistent manner which gives full and effective meaning to all of their terms. There is, therefore, no necessity to apply the rules in Article 21.1 of the *Agreement on Agriculture* in order that the provisions of that agreement would prevail over a conflicting provision.

7.1072 We recall the introductory phrase of Article 3 of the *SCM Agreement* ("[e]xcept as provided in the *Agreement on Agriculture*"). We have concluded that the *Agreement on Agriculture* does not "provide" otherwise so as to affect the prohibition on import substitution subsidies in Article 3.1(b) of the *SCM Agreement*.

7.1073 We do not see the application of the Article 3.1(b) prohibition in respect of *both* industrial and agricultural products as being manifestly contrary to the object and purpose of the *Agreement on Agriculture* or the *SCM Agreement*. The fundamental prohibition in Article 3.1(b) is a cornerstone of the subsidy disciplines imposed by the *SCM Agreement* – and indeed, appears in Part II of that Agreement containing the most stringent SCM disciplines. It relates to the basic national treatment provision in Article III:4 of the *GATT 1994*, which is a cornerstone of the GATT/WTO multilateral trading system.[1215]

7.1074 As the drafters indicated in the preamble of the *Agreement on Agriculture*, the "long-term objective is to provide for substantial progressive reductions in agricultural support and protection". The drafters did not indicate there an intention to undermine the fundamental disciplines applicable to import substitution subsidies. Had they desired to do so, they would have so indicated.[1216] It is not our task to read in to the text such a caveat or exemption for subsidies that are contingent upon the use of domestic over imported goods and subject to the Article 3.1(b) prohibition.[1217]

(b) Is there a subsidy contingent upon import substitution within the meaning of Article 3.1(b)?

7.1075 We once again recall that Article 3.1 of the *SCM Agreement* states:

> "3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited: ...

[1215] See, for example, Appellate Body Report, *US – Section 211 Appropriations Act*, para. 241.

[1216] We are aware that, for example, scheduled agricultural products are subject to certain quantitative limits imposed by the export subsidy disciplines of the *Agreement on Agriculture*. These quantitative limits may be considered less stringent than the outright prohibition on export subsidies found in Article 3.1(a) of the *SCM Agreement*. However, these less stringent obligations are explicitly spelled out in the text of the Agreement, with further guidance provided in Articles 13 and 21 of the Agreement. We find no such guidance in the text of either agreement relating to subsidies governed by Article 3.1(b) of the *SCM Agreement*.

[1217] We can conceive of examples where issues of consistency with other provisions of the covered agreements might arise where a Member grants agricultural domestic support: e.g. domestic support funded by an internal tax collected only on imports might raise issues of consistency with a Member's obligations in the *SCM Agreement* or Article III of the *GATT 1994*; or a measure requiring the use of domestic over imported goods might raise issues of consistency with the *Agreement on Trade-Related Investment Measures.*

> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I ...
>
> (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." (footnote omitted)

7.1076 Article 3.1(b) of the *SCM Agreement* provides that subsidies "within the meaning of Article 1" which are "contingent…upon the use of domestic over imported goods" are prohibited. Consequently, in order for a measure to be an import substitution subsidy within the meaning of Article 3.1(b) of the *SCM Agreement*, it must be a "subsidy" within the meaning of Article 1 of that Agreement.

7.1077 There is no dispute between the parties that user marketing (Step 2) payments under section 1207(a) of the FSRI Act of 2002 constitute a "subsidy" for the purposes of Article 1 of the *SCM Agreement*.[1218] Our own analysis confirms that this is the case.[1219]

7.1078 We therefore turn to the issue of contingency "upon the use of domestic over imported goods" within the meaning of Article 3.1(b) of the *SCM Agreement*.

7.1079 We note that, under section 1207(a) of the FSRI Act of 2002, the condition of "use" of United States domestic upland cotton pertains to all user marketing (Step 2) payments (i.e. those to domestic users *and* exporters). Brazil has confirmed to us that its claim under Article 3.1(b) of the *SCM Agreement* relates only to user marketing (Step 2) payments to *domestic users* under section 1207(a) of the FSRI Act of 2002.[1220]

7.1080 We recall our earlier observation – in the context of our examination of section 1207(a) of the FSRI Act of 2002 under Article 9.1(a) of the *Agreement on Agriculture* and Article 3.1(a) of the *SCM Agreement* -- that the text of the single legal provision governing user marketing (Step 2) payments identifies two distinct situations in which user marketing (Step 2) payments are made:[1221] eligible exporters and eligible domestic users. The text of the measure itself therefore compels us to examine separately the conditions pertaining to the grant of the subsidy in these two distinct factual situations addressed by the measure that involve two distinct sets of eligible recipients.

7.1081 We further recall our earlier observation[1222] that the meaning of "contingent" in Article 3.1(a) of the *SCM Agreement* is "conditional" or "dependent for its existence upon", and that contingency "in law" may be demonstrated on the basis of the words of the relevant legal instrument. Such conditionality may also be derived by necessary implication from the words actually used in the measure. This legal standard applies not only to contingency under Article 3.1(a), but also to contingency under Article 3.1(b) of the *SCM Agreement*.[1223]

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[1218] See United States' response to Panel Question No. 108.

[1219] We refer to our findings, *supra* in Section VII:E, that a "subsidy" exists under section 1207(a) of the FSRI Act of 2002 in the context of our examination of user marketing (Step 2) payments to exporters. The measure makes no differentiation in the defining elements of a "subsidy" between payments to exporters and domestic users. Nor has the United States argued that such a differentiation exists.

[1220] Brazil's response to Panel Question No. 94.

[1221] See our findings *supra*, in Section VII:E.

[1222] See our findings *supra*, in Section VII:E.

[1223] Appellate Body Report, *Canada – Autos*, para. 123.

7.1082 The United States acknowledges that to receive a payment under the user marketing (Step 2) programme, a domestic user must open a bale of domestically produced baled upland cotton.[1224] We therefore understand the United States does not dispute that user marketing (Step 2) payments to domestic users constitute a subsidy conditional or dependent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*.[1225]

7.1083 In any event, our own analysis confirms this view. Section 1207(a) of the FSRI Act of 2002 provides that during the period beginning on the date of the enactment of the FSRI Act of 2002 through 31 July 2008, " .. the Secretary shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters for documented purchases by domestic users and sales for export by exporters..." made during a week following a period during which certain cotton price conditions are fulfilled. "Eligible upland cotton" is "*domestically produced* baled upland cotton..." (emphasis added).[1226] Eligible upland cotton "must not be imported cotton".[1227] "Eligible domestic users" are defined as follows:

> "(1) A person regularly engaged in the business of opening bales of eligible upland cotton for the purpose of manufacturing such cotton into cotton products in the United States (domestic user), who has entered into an agreement with CCC to participate in the upland cotton user marketing certificate program;"

7.1084 Moreover, "[p]ayments ... shall be made available upon application for payment and submission of supporting documentation, including *proof of purchase and consumption of eligible cotton by the domestic user* or proof of export of eligible cotton by the exporter, as required by the CCC-issued provisions of the Upland Cotton Domestic User/Exporter Agreement" (emphasis added).[1228]

7.1085 Therefore, user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 will not be made except upon proof of consumption of eligible upland cotton – which must be "domestically produced", and "not imported". It is not just that it will invariably be easier for domestic users to meet the conditions for user marketing (Step 2) payments to domestic users by using domestic -- rather than imported -- upland cotton. The text of the measure explicitly *requires* the use of domestically produced upland cotton as a pre-condition for receipt of the payments.

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[1224] United States' response to Panel Question No. 144. The United States also confirms, in response to Panel questioning concerning the relevance of Article III:8 of the *GATT 1994*, that the user marketing (Step 2) payment is not made exclusively to domestic producers. See also, United States' response to Panel Question No. 118.

[1225] See e.g., Appellate Body Report, *Canada – Autos*, para. 126.

[1226] As defined in 7 CFR 1427.103, reproduced in Exhibit BRA-37.

[1227] 7 CFR 1427.103(c)(2), reproduced in Exhibit BRA-37.

[1228] According to 7 CFR 1427.108, entitled "Payment", reproduced in Exhibit BRA-37, under the terms of the agreement, upland cotton eligible for payment is cotton consumed by the domestic user within the United States fulfilling certain conditions. In order to receive payments, domestic users of upland cotton must submit proof of consumption in the form of reports of weekly consumption of eligible upland cotton. Exhibit BRA-65 contains a sample cotton domestic user/exporter agreement, which the United States admitted "appeared to be accurate versions of old Step 2 program documents" - see United States' response to Panel Question No. 92. The United States submitted an updated version of the "Upland Cotton Domestic User/Exporter Agreement", reproduced in Exhibit US-21 and also indicated that the official documents for the upland cotton (step 2) program can be found at the FSA website (www.fsa.usda.gov/daco). Section B-1 of that Agreement indicates that in the event that the cotton is not used for the purpose (by a domestic user as a person regularly engaged in manufacturing eligible upland cotton into cotton products within the United States) "the payment received shall be returned immediately and with interest." Section B-5 of the Agreement indicates that failure to submit an application or the weekly reports will result in delays in payments until all delinquent application/ reports are received.

7.1086 The use of United States domestically produced upland cotton is a condition for obtaining the subsidy. User marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 are clearly conditional, or dependent upon, such use.

7.1087 As we have already found, the fact that the user marketing (Step 2) payments are also available in another factual situation explicitly identified in the text of the measure – i.e. exporters -- would not have the effect of dissolving such contingency in respect of domestic users, particularly in a situation where the other factual contingency (upon export performance) also gives rise to a prohibited subsidy. As we have previously noted, it would in our view be extremely odd, indeed, if a Member could make a subsidy dependent upon two alternative conditions, each of which would separately give rise to a prohibited subsidy and a violation, but which would somehow become "unprohibited" when combined.

7.1088 For these reasons, we find that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users is a subsidy contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*.[1229]

(c) Is the measure mandatory?

7.1089 Finally, we consider whether the measure is mandatory.[1230]

7.1090 Turning to the text of the relevant legal provision, pursuant to section 1207(a)(1) of the FSRI Act of 2002, "the Secretary *shall* issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters" (emphasis added).[1231] We recall our conclusion above that user marketing (Step 2) payments to exporters are mandatory. We are of the view that the same principles are brought to bear here.[1232]

7.1091 The United States does not disagree that, subject to the availability of funds (that is, the availability of CCC borrowing authority), user marketing (Step 2) payments must be made to all those who meet the conditions for eligibility.[1233]

7.1092 We are of the view that section 1207(a)(1) of the FSRI Act of 2002 mandates the granting of subsidies in that the United States authorities have no discretion not to allow it if domestic users fulfil certain conditions.

7.1093 This is not a situation where the executive branch of the United States government enjoys a discretion that may, or may not, be exercised in a WTO-consistent manner. *Any* grant of a user marketing (Step 2) payment to a domestic user under section 1207(a) of the FSRI Act of 2002 will inevitably be contingent upon the use of United States upland cotton and therefore constitute a prohibited import substitution subsidy.

7.1094 The fact that the actual payment of subsidies is triggered only if certain market conditions prevail does not impact upon our analysis of the normative nature and operation of the measure within the United States legal system. The prevailing world market conditions are not exclusively within the control of the United States government. Nor are the underlying determinative prices triggering the existence and magnitude of user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002. When certain market conditions exist, the Secretary of Agriculture has no discretion. The payments are automatically triggered.

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[1229] We note, in passing, the relatively low level of imports of upland cotton into the United States. See USDA Fact Sheet: Upland Cotton, January 2003, reproduced in Exhibit BRA-4.

[1230] See *supra*, Section VII:C, in particular, para. 7.336.

[1231] Exhibit BRA-29.

[1232] See *supra*, Section VII:E.

[1233] United States' response to Panel Question No. 109.

7.1095 We recall that, pursuant to section 1601(e) of the FSRI Act of 2002, the Secretary is authorized to adjust support to the maximum extent practicable to comply with total allowable domestic support levels under the Uruguay Round Agreements. This authority applies to certain aspects of the user marketing (Step 2) programme.[1234] However, this authority pertains exclusively to the *level* of United States domestic support commitments under the *Agreement on Agriculture*[1235], an issue distinct from the constituent qualitative elements and conditionality of subsidies governed by the *SCM Agreement*.[1236]

7.1096 As we have already observed, compliance with the domestic support reduction commitments does not *authorize* or *require* the provision of subsidies contingent upon the use of domestic over imported goods. Moreover, the level of domestic support is not legally relevant to whether or not that domestic support is conditional upon import substitution. Therefore, section 1601(e) of the FSRI Act of 2002 is not legally determinative of whether the measure is of binding normative nature and operation within the United States domestic legal system.

7.1097 For these reasons, we conclude that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users is inconsistent with Article 3.1(b) of the *SCM Agreement*.[1237]

7.1098 Article 3.2 of the *SCM Agreement* provides: "A Member shall neither grant nor maintain subsidies referred to in paragraph 1" of Article 3. To the extent that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users is inconsistent with Article 3.1(b), it is, consequently, also inconsistent with Article 3.2 of the *SCM Agreement*.

### 4. Claim under Article III:4 of the *GATT 1994*

(a) Main arguments of the parties

7.1099 **Brazil** claims that user marketing (Step 2) payments to domestic users violate Article III:4 of the *GATT 1994* and are not covered by Article III:8 (b) of the *GATT 1994*. Brazil argues that these payments are subject to the disciplines of Article III:4 of the *GATT 1994* because they are made to domestic *users* of United States upland cotton and therefore, they are not exclusively paid to domestic *producers* within the meaning of Article III:8(b) of the *GATT 1994*. Brazil, therefore, requests the Panel to find that the United States acts inconsistently with its obligations under Article III:4 of the *GATT 1994* by providing user marketing (Step 2) payments to domestic users of United States upland cotton.[1238]

7.1100 The **United States** submits that the user marketing (Step 2) programme provides benefits in favour of United States upland cotton producers within the meaning of the *Agreement on Agriculture*. According to the United States, Article 3.1 of the *Agreement on Agriculture* provides that the domestic support commitments in Part IV of each Member's Schedule are made an integral part of the *GATT 1994* and therefore, the domestic support commitments of the United States are integral part of

[1234] Section 1601(e) pertains to expenditures under subtitles A through E of the FSRI Act of 2002. Section 1207(a) is in Subtitle B of that Act. Levels of expenditures under section 1207(a) are therefore covered by the provision.

[1235] United States' response to Panel Question No. 253. In response to Panel Question No. 253(b), the United States confirmed that "section 1601(e) applies to the Aggregate Measure of Support commitments under the Uruguay Round Agreement on Agriculture."

[1236] We have discussed this in more detail *supra*, paras. 7.1053 *ff*.

[1237] This finding is specific to the text of Article 3.1(b) of the *SCM Agreement* and Article 6.3 and related domestic support provisions of the *Agreement on Agriculture*. It is without prejudice to issues arising under Articles 3.3, 8 and 21 of the *Agreement on Agriculture* and Article 3 of the *SCM Agreement* in relation to Members' rights and obligations with respect to export subsidies.

[1238] Brazil's first written submission, paras. 342-351.

the *GATT 1994* itself. The user marketing (Step 2) programme exists in favour of agricultural producers within Current Total AMS, and the text of the *Agreement on Agriculture* does not prohibit any particular form of delivery of such "amber box" domestic support. The United States notes that Brazil's submission focuses exclusively on GATT jurisprudence involving Article III:8(b), which predates the Uruguay Round Agreements. The *Agreement on Agriculture* imposed, for the first time, rigorous disciplines on agricultural support and the commitments of the United States constitute an integral part of the *GATT 1994*. [1239]

7.1101 The United States also asserts that paragraph 7 of Annex 3 of the *Agreement on Agriculture* specifically requires that "[m]easures directed at processors shall be included" in the calculation of AMS to subject these measures to the domestic support reduction commitments established for the first time in the *Agreement on Agriculture*. Therefore, according to the United States, it would be illogical to include such payments in the required calculations and subject them to reduction commitments if they were already prohibited under Article III:4 of the *GATT 1994*. The United States submits that a coherent reading of the *Agreement on Agriculture* with the *GATT 1994* indicates that the user marketing (Step 2) programme, in conformity with the *Agreement on Agriculture*, does not violate Article III:4 of the *GATT 1994*.[1240]

(b) Main arguments of the third parties

7.1102 **Argentina** submits, in response to the Panel's question, that Article III:4 of the *GATT 1994* prohibits discrimination against imported products, and so that provision is "also applicable" to the present case.[1241]

7.1103 The **European Communities** agrees with the United States that subsidies contingent upon the use of domestic goods, which are maintained consistently with the *Agreement on Agriculture*, are not inconsistent with either Article 3 of *SCM Agreement* or Article III:4 of the *GATT 1994*.[1242]

7.1104 **New Zealand** submits that Brazil has demonstrated that marketing (Step 2) payments are prohibited subsidies under Article 3.1(b) of the *SCM Agreement*, and that "on that basis, they also violate" Article III:4 of the *GATT 1994*.[1243]

(c) Evaluation by the Panel

7.1105 We recall that we need not examine all claims before us. Rather, we need only address those claims that must be addressed in order to resolve the matter in issue in the dispute[1244], provided that we address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member in order to ensure effective resolution of disputes to the benefit of all Members.[1245]

7.1106 In light of our findings above under Article 3.1(b) and Article 3.2 of the *SCM Agreement*, we do not believe that it is necessary to address Brazil's claim relating to the same measure – section

[1239] United States' first written submission, paras. 146-149.
[1240] United States' first written submission, para. 150.
[1241] Argentina's response to Panel third party Question No. 40.
[1242] European Communities' oral statement at the first session of the first substantive meeting, paras. 33-38. See also European Communities' response to Panel third party Question No. 40.
[1243] New Zealand's written submission to the first session of the first substantive meeting, para. 4.01. See also New Zealand's response to Panel third party Question No. 40.
[1244] Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19. See also e.g., Appellate Body Report, *Canada – Autos*, paras. 112-117, where the Appellate Body refers to and endorses that panel's exercise of the "discretion" implicit in the principle of judicial economy.
[1245] Appellate Body Report, *Australia – Salmon*, para. 223.

1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users – under Article III:4 of the *GATT 1994*.

## G. ACTIONABLE SUBSIDIES: CLAIMS OF "PRESENT" SERIOUS PREJUDICE

### 1. Measures at issue

7.1107 This Section of our report deals with alleged actionable subsidies, including certain alleged subsidies that are not "exempt from actions" based on Articles 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* within the meaning of Articles 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture* as a result of our findings in Sections VII:D, E and F of the Panel's report. These are the following measures[1246], as described in Section VII:C of this report:

(i) user marketing (Step 2) payments to domestic users and exporters;

(ii) marketing loan programme payments;

(iii) production flexibility contract payments;

(iv) market loss assistance payments;

(v) direct payments;

(vi) counter-cyclical payments;

(vii) crop insurance payments;

(viii) cottonseed payments for the 2000 crop; and

(ix) legislative and regulatory provisions currently providing for the payment of measures in (i), (ii), (v), (vi) and (vii) above.[1247]

### 2. Overview of Brazil's present serious prejudice claims under the *SCM Agreement* and the *GATT 1994*

7.1108 Brazil alleges present serious prejudice under Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*, and Articles XVI:1 and XVI:3 of the *GATT 1994*. Brazil claims that United States subsidies provided during MY 1999-2002 have caused, cause and continue to cause "serious prejudice" to Brazil's interests by:

(i) significantly suppressing upland cotton prices in the United States, world and Brazilian markets in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*;

(ii) increasing the United States share of the upland cotton world market in violation of Articles 5(c) and 6.3(d) of the *SCM Agreement*; and

[1246] With regard to Brazil's claims concerning United States' export credit guarantee programmes, Brazil clarified, in response to Panel Question Nos. 129 and 139, that Brazil's serious prejudice claims relating to export credit guarantee programmes involve only GSM 102. According to Brazil, this is because either no cotton allocations were made, or only negligible amounts of cotton were exported, under the GSM 103 and SCGP export credit guarantee programmes during the years in question. In light of our findings in Section VII:E, *supra*, we do not consider it necessary to include export credit guarantees under the GSM 102 programme in our analysis here. We therefore exercise judicial economy with respect to this claim of Brazil.

[1247] See also Brazil's *per se* actionable subsidy claims in Section VII:I.

(iii) resulting in the United States having more than an equitable share of world export trade in violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

## 3. Claims under Articles 6.3(c) and 5(c) of the *SCM Agreement*

(a) Introduction

7.1109 Part III of the *SCM Agreement* is entitled "Actionable Subsidies". It comprises Articles 5, 6 and 7. Article 5 of the *SCM Agreement* is entitled "Adverse Effects". According to its chapeau: "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e. ...". Article 5(c) identifies "serious prejudice to the interests of another Member" as one such adverse effect. Article 6.3(c) states that serious prejudice in the sense of Article 5(c) may arise where "the effect of the subsidy" is "significant price suppression" "in the same market". Article 7 deals with remedies.

7.1110 Article 5 of the *SCM Agreement* provides: "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members...". Therefore, to be an "actionable subsidy" for the purposes of Part III of the *SCM Agreement*, there must first be a specific subsidy within the meaning of Articles 1.1 and 1.2 of the *SCM Agreement*. We therefore now examine whether the measures at issue are such specific subsidies.

(b) Are the challenged measures "subsidies" for the purposes of an actionable subsidies analysis?

7.1111 Article 1 of the *SCM Agreement* provides, in part, that:

> "1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:
>
> (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:
>
> (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees); ...
>
> and
>
> (b) a benefit is thereby conferred."

7.1112 **Brazil** alleges that all of the challenged measures constitute "subsidies". According to Brazil, most of them – user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; production flexibility contract payments; market loss assistance payments; direct payments; counter-cyclical payments; crop insurance subsidies[1248]; and cottonseed payments – provide "financial contributions" in the form of "grants" to participating United States producers,

[1248] Brazil clarifies in response to Panel Question No. 130 that its claim pertains to "two different types of subsidies": the United States FCIC pays a portion of the premiums that farmers would otherwise have to pay for obtaining crop insurance. Exhibit BRA-30 (section 508(e) of the Federal Crop Insurance Act); Exhibit BRA-59 ("Briefing Room: Farm and Commodity Policy: Crop Yield and Revenue Insurance") Second, the FCIC covers losses under crop insurance policies that exceed the amount of premiums collected, thus "providing free reinsurance for private insurance companies offering crop insurance." Exhibit BRA-30 (section 508(k) of the Federal Crop Insurance Act). Reinsurance agreement standards are set out in 7 CFR 400.161 *et seq.*, reproduced in Exhibit BRA-39.

processors, users or exporters of upland cotton within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*.[1249]

7.1113 Moreover, Brazil alleges that all of the measures concerned confer a "benefit" within the meaning of Article 1.1(b) of the *SCM Agreement* upon United States upland cotton producers and/or users because the recipients of such payments were placed in a better, more advantageous, position than would have been secured on the market.[1250]

7.1114 The **Panel** does not understand the **United States** to dispute that many of the challenged measures – i.e. user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; crop insurance payments and cottonseed payments – constitute "subsidies" for the purposes of Article 1 of the *SCM Agreement*.[1251]

7.1115 Nor, in the Panel's view, could the United States properly do so in respect of any of these payments. User marketing (Step 2) payments to domestic users and exporters[1252]; marketing loan programme payments, crop insurance payments[1253] and cottonseed payments are financial contributions, essentially in the form of "grants" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*.

7.1116 These grants are made by a United States government agency (CCC or FCIC).[1254] Each of these United States government grants confers a benefit within the meaning of Article 1.1(b) of the *SCM Agreement* as they place the recipient in a better position than the recipient otherwise would have been in the marketplace.

7.1117 The United States, however, raises objections to Brazil's "subsidy" allegations concerning PFC, DP, MLA and CCP payments. The United States contends that Brazil has not established the "amount" or "portion" of the subsidy properly attributable to upland cotton producers pursuant to Article 1 of the *SCM Agreement*.[1255]

7.1118 We are of the view that PFC, DP, MLA and CCP payments constitute "financial contributions" in the form of "grants" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*. These grants are made by the CCC (which is a United States government agency).[1256] These United States government grants confer a benefit within the meaning of Article 1.1(b) of the *SCM Agreement* as they place the recipient in a better position than they otherwise would have been in the market.

7.1119 In our view, the argument of the United States relating to the "amount" or "portion" of the subsidy "properly attributable to upland cotton producers" is not germane to the inquiry that is to be conducted under Article 1 of the *SCM Agreement*. Here, we are asking whether a "financial contribution" exists, and whether a "benefit" is thereby conferred. We are not required precisely to establish, at this stage, the quantity of that benefit in respect of upland cotton. Although the United States questions whether Brazil has established the amount of the subsidy in respect of upland cotton, we do not understand the United States to assert that *no benefit whatsoever* is conferred in respect of

[1249] Brazil's further written submission, para. 32.
[1250] Brazil's further written submission, para. 33.
[1251] United States' responses to Panel Question Nos. 108 and 127.
[1252] We have already found *supra*, that user marketing (Step 2) payments to domestic users and exporters are "subsidies" within the meaning of Article 1 of the *SCM Agreement*. We refer to, and incorporate, these findings in Sections VII:E and F.
[1253] In the case of crop insurance payments, the FCIC pays a portion of the premium that a producer of upland cotton would otherwise have to pay.
[1254] See description of the measures in Section VII:C. See also Sections VII:E and F.
[1255] United States' response to Panel Question No. 129.
[1256] See description of the measures in Section VII:C. See also Sections VII:E and F.

upland cotton by these payments. In any event, we have found that these payments do, in fact, manifest a strongly positive relationship to upland cotton.[1257] We therefore do not change our view that these payments, too, constitute "subsidies" within the meaning of Article 1 of the *SCM Agreement*.

7.1120 In conclusion, the Panel finds that user marketing (Step 2) payments to domestic users and exporters[1258]; marketing loan programme payments; PFC payments; MLA payments; DP payments; CCP payments; crop insurance payments; and cottonseed payments constitute "subsidies" within the meaning of Articles 1.1(a) and (b) of the *SCM Agreement*.

(c) Are the challenged subsidies "specific" for the purposes of an actionable subsidies analysis?

*(i) Main arguments of the parties*

7.1121 **Brazil** claims that the United States subsidies at issue – i.e. user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; production flexibility contract payments; market loss assistance payments; direct payments; counter-cyclical payments; crop insurance subsidies; and cottonseed payments – are "specific" within the meaning of Article 2 of the *SCM Agreement.*

7.1122 Brazil alleges such specificity as each of the programmes is provided to "discrete segments" of the United States economy.[1259] None are widely available throughout the United States economy to a multitude of diverse industries. Eligibility for the domestic support and export subsidies at issue is either "explicitly" limited to the subset of the United States industry producing agricultural crops, to subgroups of industries producing *certain* agricultural *crops*, or to upland cotton *only*. None of the subsidies are generally available for all agriculture, much less any non-agricultural product.

7.1123 Brazil also alleges that user marketing (Step 2) payments to domestic users and exporters, are "deemed to be specific" within the meaning of Article 2.3 of the *SCM Agreement* as they are prohibited subsidies falling under the provisions of Article 3 of the *SCM Agreement.*[1260]

7.1124 The **United States** submits that, in principle, a subsidy that is limited to a small proportion of United States commodities would be limited and thus "specific". However, the *SCM Agreement* does not establish any quantitative standard for determining when a subsidy is so limited, and the determination must be made on a case-by-case basis.

7.1125 The United States does not expressly contest that user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; PFC payments; MLA payments; DP payments; CCP payments; and cottonseed payments are "specific" within the meaning of Article 2 of the *SCM Agreement*.

7.1126 However, the United States contends that Brazil has not established that crop insurance subsidies are specific within the meaning of Article 2 of the *SCM Agreement*. According to the United States, crop insurance subsidies are available to the whole United States agricultural sector and the United States contends that this is too broad and diverse to constitute a single "enterprise or industry or group of enterprises or industries".[1261]

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[1257] *Supra*, Section VII:D.

[1258] We again recall that we have already found *supra* that user marketing (Step 2) payments to domestic users and exporters are "subsidies" within the meaning of Article 1 of the *SCM Agreement*. *Supra*, Sections VII:E and F.

[1259] Brazil's further written submission, para. 42.

[1260] Brazil's further written submission, footnote 16.

[1261] United States' response to Panel Question No. 131(a).

*(ii) Main arguments of the third parties*

7.1127 **Argentina** stresses that the concept of "specificity" in Article 2 of the *SCM Agreement* is very broad, since it refers to the subsidies for an enterprise or an industry or group of enterprises or industries. According to Argentina, agricultural subsidies are specific within the meaning of Article 2, since they are not available for all products. Further, a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, *such as livestock*) is specific, as is a subsidy in respect of certain identified agricultural products specific to producers of certain agricultural products and a subsidy in respect of upland cotton, but not other products.[1262]

7.1128 **Canada** is of the view that, based on the ordinary meaning of the phrase "is specific to", read in context and in light of the object and purpose of Article 2 and of the *SCM Agreement*, the specificity test is concerned with the actual availability of a programme.

7.1129 Canada shares the view of the United States that, as a general matter, "all agriculture" is too broad to qualify as a "group of enterprises or industries" for specificity purposes. Whether a subsidy is specific in respect of all agricultural crops except other agricultural commodities, such as livestock depends on: (1) the facts of a given case, as a panel would have to consider, *inter alia*, the number of enterprises or industries (based on standard industrial classification) within the jurisdiction of the granting authority that are actually eligible to receive the subsidy, and the level of diversification of the "all agricultural crops" universe and (2) on the nature of the measure in question and whether it excludes enterprises or industries that might otherwise be reasonably or practically included.[1263]

7.1130 Canada further submits that where a programme appears *de jure* non-specific under Articles 2.1(a) and (b), predominant use of a programme by "certain enterprises" (a defined term in Article 2.1) would indicate, in the absence of any other reasonable explanation, that the availability of the subsidy is limited in fact to such enterprises or industries under Article 2.1(c) and 2.4. Likewise, where a programme appears *de jure* non-specific under Articles 2.1(a) and (b), the granting of disproportionately large amounts of subsidy to certain enterprises would indicate, in the absence of any other reasonable explanation, that the availability of the subsidy is limited in fact to such enterprises or industries under Article 2.1(c) and 2.4. In both cases, any predominance or disproportionality should be measured over an appropriate period of time and in relation to the value of production in question as compared to the total value of all agricultural production.[1264]

7.1131 **China** argues that "agricultural commodity" can be understood as equivalent to "agricultural product" under the *Agreement on Agriculture*. In light of the respective definitions of "industry" and "agriculture", the latter term meets the definition of the former as it is the "science and practice of using productive labour". China is of the view that: (1) any subsidy to agricultural commodities must be considered as specific for the purpose of Article 2 of the *SCM Agreement*; (2) agriculture producing all agricultural products is an industry and consists of "group of enterprises" by definition. In addition, "subsidies in respect of 'all agricultural crops'" "certain identified agricultural products" (i.e. but not to other agricultural commodities, such as livestock), "certain identified agricultural products" and "upland cotton, but not other products" should all be deemed specific since "group of enterprises" producing crops are targeted in all cases and the use of "a certain proportion of the value of total United States commodities" or "a certain proportion of United States farmland" will necessarily be equivalent to "an enterprise or industry or group of enterprises or industries" because the "proportion" has to be generated by adding up those data from specific "enterprise or industry or group of enterprises or industries".[1265]

[1262] Argentina's response to Panel third party Question No. 51.
[1263] Canada's response to Panel third party Question No. 51.
[1264] Canada's response to Panel third party Question No. 51.
[1265] China's response to Panel third party Question No. 51.

7.1132 **India** submits that the United States subsidies at issue are explicitly limited to certain enterprises or industries, as none of the subsidies at issue are widely available throughout the United States economy across industries. Eligibility for the domestic support and export subsidies is either "explicitly" limited to the subset of the United States industry producing agricultural crops, to subgroups of industries producing certain agricultural crops, or to only upland cotton. None of the subsidies are available for any non-agricultural product.[1266]

7.1133 The **European Communities** asserts that a subsidy granted to an economic operator which does not require any production of agricultural products, and in which the subsidy may be used for any purpose, does not appear, to the European Communities, to be specific in the sense of Article 2.1(a).[1267] With respect to crop insurance subsidies, the European Communities understands that different crop insurance policies apply to different agricultural products and if such differences had the consequence that some agricultural products will receive a benefit in circumstances where other products will receive no benefit, or only a smaller benefit, the difference would be clearly "specific".[1268]

7.1134 **New Zealand** submits that crop insurance subsidies to upland cotton producers enhances United States upland cotton production, as the payments act as a direct production stimulant by keeping marginal upland cotton land in production. According to New Zealand, Brazil has demonstrated that the crop insurance programme is limited to certain enterprises and thus is not generally available but is effectively available only in respect of crops.[1269]

7.1135 **Chinese Taipei** states that a further reason for excluding "non-specific subsidies" from being prohibited should be that the subsidies are generally available and no competitive advantage is provided to a particular sector or some specific sectors. If there is competitive advantage provided to one or more sectors with the effect of excluding other sectors from receiving the advantages, it should be considered as specific.[1270]

*(iii) Evaluation by the Panel*

7.1136 Pursuant to Article 1.2 of the *SCM Agreement*: "A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2." Therefore, in order to qualify as an "actionable subsidy" for the purposes of Part III of the *SCM Agreement*, a measure must be a "specific" subsidy, as defined in Article 2 of the *SCM Agreement*.

7.1137 Article 2 of the *SCM Agreement* provides:

[1266] India's oral statement at the resumed session of the first substantive meeting, p. 1.
[1267] European Communities' response to Panel third party Question No. 51.
[1268] European Communities' oral statement at the resumed session of the first substantive meeting, paras. 5-6.
[1269] New Zealand's oral statement at the resumed session of the first substantive meeting, paras. 12-13.
[1270] Chinese Taipei's response to Panel third party Question No. 51.

"Article 2

*Specificity*

2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:

(a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.

(b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions[2] governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.

(c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.[3] In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation.

2.2 A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific. It is understood that the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Agreement.

2.3 Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.

2.4 Any determination of specificity under the provisions of this Article shall be clearly substantiated on the basis of positive evidence."

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[2] Objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.

> [3] In this regard, in particular, information on the frequency with which applications for a subsidy are refused or approved and the reasons for such decisions shall be considered.

7.1138 Pursuant to this provision, subsidies that are, either in fact or in law, specifically granted to an "enterprise" or "industry" (or group of enterprises or industries) meet the "specificity" criteria in Article 2 of the *SCM Agreement*. Pursuant to Article 2.1(a) of the *SCM Agreement*, "[w]here the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific." Pursuant to Article 2(c), other factors (such as the use of a subsidy programme by a limited number of certain enterprises or predominant use by certain enterprises) may be considered where there is an appearance of non-specificity.

7.1139 According to the text of Article 2 of the *SCM Agreement*, a subsidy is "specific" if it is specific to an enterprise or industry or group of enterprises or industries (referred to in the *SCM Agreement* as "certain enterprises") within the jurisdiction of the granting authority. This is one way in which the *SCM Agreement* serves to define requirements as to the "recipients" of the benefit bestowed by a subsidy.[1271] Beyond setting out this rather general principle, Article 2 of the *SCM Agreement* does not speak with precision about when "specificity" may be found.

7.1140 Looking more closely at the textual terms used in the chapeau of Article 2 of the *SCM Agreement*, the term "industry" may be defined as "a particular form or branch of productive labour; a trade; a manufacture".[1272] "Specificity" extends to a group of industries because the words "certain enterprise" are defined broadly in the opening terms of Article 2.1, as an enterprise or industry or group of enterprises or industries.

7.1141 The provision does not offer any technical definition or additional, detailed indication about how broadly or narrowly we are to classify an "industry". Nor is it necessary for the purposes of this dispute to develop any fixed definition of the scope of an "industry" within the meaning of the chapeau of Article 2.

7.1142 We nevertheless believe that an industry, or group of "industries", may be generally referred to by the type of products they produce.[1273] To us, the concept of an "industry" relates to producers of certain products. The breadth of this concept of "industry" may depend on several factors in a given case. At some point that is not made precise in the text of the agreement, and which may modulate according to the particular circumstances of a given case, a subsidy would cease to be specific because it is sufficiently broadly available throughout an economy as not to benefit a particular limited group of producers of certain products. The plain words of Article 2.1 indicate that specificity is a general concept, and the breadth or narrowness of specificity is not susceptible to rigid quantitative definition. Whether a subsidy is specific can only be assessed on a case-by-case basis.

7.1143 We see merit in the shared view of the parties that the concept of "specificity" in Article 2 of the *SCM Agreement* serves to acknowledge that some subsidies are broadly available and widely used throughout an economy and are therefore not subject to the Agreement's subsidy disciplines. The footnote to Article 2.1 defines the nature of "objective criteria or conditions" which, if used to determine eligibility, would preclude an affirmative conclusion of specificity. Such criteria are "neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise."

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[1271] See e.g., Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, paras. 112-113.

[1272] *The New Shorter Oxford English Dictionary*, (1993).

[1273] See Panel Report, *US – Softwood Lumber IV*, para. 7.120.

7.1144 Furthermore, the concept of specificity in Article 2 of the *SCM Agreement* is germane to the disciplines imposed by the *SCM Agreement*. The *SCM Agreement* is an agreement on trade in goods, in Annex 1A of the *WTO Agreement*. By its own terms, subject to considerations reflected in the text of some of its provisions, it applies in respect of *all* goods. The concept of specificity must be considered within the legal framework and frame of reference of that agreement as a whole.[1274]

7.1145 We do not understand that there is a dispute between the parties that many of the challenged subsidies – i.e. user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; PFC payments; MLA payments; DP payments; CCP payments; and cottonseed payments – are "specific" within the meaning of Article 2 of the *SCM Agreement*.

7.1146 In any event, a textual analysis of "the legislation pursuant to which the granting authority operates", to discern whether or not it "explicitly limits access to a subsidy to certain enterprises" leads us to conclude that such subsidies are "specific" within the meaning of Article 2.1(a).

7.1147 Certain of the measures at issue were or are available specifically in respect of upland cotton: user marketing (Step 2) payments depend on the domestic use or export of upland cotton. Other products or industries are not eligible for the subsidy. Cottonseed payments went to first handlers, while also, to some extent, benefiting producers of upland cotton. We believe that a subsidy that is limited to a small proportion of industries, such as those producing one or two individual United States products would be limited and thus "specific" within the meaning of Article 2 of the *SCM Agreement*. These subsidies are "specific" as they are not even available in respect of a number of commodities.

7.1148 Other measures before us pertain to a restricted number of agricultural products, but are not widely or generally available in respect of all agricultural production, let alone the entire universe of United States production of goods. These measures include the marketing loan programme payments.[1275] They also include the measures available in respect of upland cotton as part of a restricted basket of agricultural commodities. These are the four types of domestic support which permit production flexibility (PFC, MLA, DP and CCP payments) that were or are provided in respect of certain agricultural production in a base period which satisfies certain eligibility criteria. These criteria have the effect of limiting eligibility to a subset of basic agricultural products, including upland cotton or certain other programme crops. We therefore find that these subsidies are "specific" within the meaning of Article 2. The fact that some of the subsidies go to farmers who may produce different commodities, or, in theory, may not produce a given commodity does not mean, by some process of reverse reasoning, that the specificity that is apparent from the face of the grant instrument no longer exists.

7.1149 The United States disagrees with Brazil's allegation that crop insurance subsidies are "specific".

7.1150 Crop insurance subsidies are, generally, available for most crops but they are not generally available in respect of the entire agricultural sector in all areas.[1276] Each insurance plan is available

[1274] There is no analogous concept of specificity in, for example, the *Agreement on Agriculture*.

[1275] Section 1202 of the FSRI Act of 2002 identifies 17 "loan commodities"; Section 131 of the FAIR Act of 1996 identified several commodities, including upland cotton. The statute and regulations implementing the marketing loan programme set out specific provisions regarding upland cotton. See *supra*, Section VII:D.

[1276] Exhibit BRA-30 (Section 518 of the Federal Crop Insurance Act) contains a list of the "agricultural commodities" covered by insurance policies that are subsidized under the Federal Crop Insurance Act. The text of this legislative instrument indicates that the term "agricultural commodity" includes, *inter alia*, cotton and other United States crops. Livestock (while not expressly enumerated) would fall under the blanket reference to "any other agricultural commodity". The fact that the definition expressly excludes "stored grain" supports this, in that here is no analogous exclusion for livestock). We note that, even assuming *arguendo* that the text of the granting instrument shows any appearance of non-specificity, record evidence indicates that there are pilot

for a defined list of crops to which the FCIC determines that it is adapted.[1277] The proportion of the premium borne by the FCIC is set out in each plan. The major plan type (actual production history) is available for approximately 100 agricultural commodities, and specifies upland cotton as one of them.[1278] The other four plan types (group risk, crop revenue coverage, income protection and revenue assurance) are available only for a limited number of eight commodities or less and they each specify upland cotton as one of them.[1279] Certain sample policy provisions specify "cotton".[1280] There are no subsidized crop insurance policies on the record available to all agricultural producers. They are therefore, in fact, not even generally available to the industry which can be categorized as the agricultural industry.

7.1151 In our view, the industry represented by a portion of United States agricultural production that is growing and producing certain agricultural crops (and certain livestock in certain regions under restricted conditions) is a sufficiently discrete segment of the United States economy in order to qualify as "specific" within the meaning of Article 2 of the *SCM Agreement*.

7.1152 As a factual matter, we have found that the crop insurance subsidy is not universally available for all agricultural production. Rather, it is generally limited to certain "crops", it differentiates among such crops and it is only available in certain regional "pilot programmes" in respect of livestock. The facts of this case therefore do not require us to address the United States argument that the crop insurance subsidy is generally available to the United States agricultural sector as a whole, and thus, according to the United States, would not be specific within the meaning of Article 2.

7.1153 Finally, we address the "specificity" of user marketing (Step 2) payments to domestic users and exporters under Article 2.3 of the *SCM Agreement*. Pursuant to Article 2.3 of the *SCM Agreement*: "Any subsidy falling under the provisions of Article 3 shall be deemed to be specific." By virtue of this provision, a subsidy falling within the provisions of Article 3 (i.e. a subsidy contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement* or a subsidy contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*) is "deemed to be specific" for the purposes of Part I of the *SCM Agreement*. We recall our findings that user marketing (Step 2) payments to domestic users and exporters under section 1207(a) of the FSRI Act of 2002 are prohibited subsidies under Articles 3.1(a) and (b) of the *SCM Agreement*.[1281] As we have found that user marketing (Step 2) payments to domestic users and exporters under section 1207(a) of the FSRI Act of 2002 "fall within the provisions of Article 3", we consequently find that these are "specific" subsidies within the meaning of Article 2.3 of the *SCM Agreement*. Furthermore, because of the substantial similarities between user marketing (Step 2) payments to domestic users and exporters under section 1207(a) of the FSRI Act of 2002 and under section 136 of the FAIR Act of 1996, we find that the latter are also specific within the meaning of Article 2.3 of the *SCM Agreement*.

7.1154 For these reasons, we conclude that all of the subsidies at issue – i.e. user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; PFC payments; MLA payments; DP payments; CCP payments; crop insurance payments and cottonseed payments – are "specific" within the meaning of Article(s) 2.1(a) and/or 2.3 of the *SCM Agreement*.

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programmes for livestock – AGR and "AGR-lite" in certain regions – but that these programmes are not universally available in respect of all livestock within the United States. See, for example, Exhibits BRA-174 through -176, -271 and -272.

[1277] See, for example, Exhibit BRA-175 concerning USDA FCIC "Cotton Crop Provisions".

[1278] See USDA Risk Management Agency lists of crops covered under the 2002 and 2003 crop years crop insurance programs, reproduced in Exhibits BRA-62 and BRA-57, respectively; Brazil's rebuttal submission, para. 55, and United States' 27 August comments, footnote 48.

[1279] See also *supra*, para. 7.517.

[1280] See "Income Protection – Cotton Crop Provisions" USDA FCIC, 2000-321 and "Cotton Crop Provisions" USDA FCIC, 99-021, reproduced in Exhibits BRA-174 and BRA-175.

[1281] Sections VII:E and F.

7.1155 Having found that the measures at issue constitute specific subsidies within the meaning of Articles 1.1 and 1.2 of the *SCM Agreement*, we continue our examination of Brazil's claims under Articles 5(c) and 6.3(c) in Part III of the *SCM Agreement*.

(d) Panel's approach to serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement*

*(i) Relevant legal provisions*

7.1156 Article 5 of the *SCM Agreement*, entitled "Adverse effects" states, in part:

> "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:
>
> (a) injury to the domestic industry of another Member[11];
>
> (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994[12];
>
> (c) serious prejudice to the interests of another Member.[13]"

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[11] The term "injury to the domestic industry" is used here in the same sense as it is used in Part V.

[12] The term "nullification or impairment" is used in this Agreement in the same sense as it is used in the relevant provisions of GATT 1994, and the existence of such nullification or impairment shall be established in accordance with the practice of application of these provisions.

[13] The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice.

7.1157 Article 6.3(c) of the *SCM Agreement* provides:

> "Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:
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> ...
>
> (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;"

7.1158 Brazil submits that the United States subsidies at issue have caused serious prejudice to its interests within the meaning of Article 5(c) in the form of "significant price suppression" under Article 6.3(c) of the *SCM Agreement*. The United States disagrees. Before examining specific elements of Brazil's claims, we outline our treatment of certain arguments put to us by the parties, as well as the considerations that will guide our analysis of these claims.

*(ii) Panel's treatment of certain arguments of the parties*

7.1159 We recall that the United States reproaches Brazil for not identifying the "subsidized product for each of the types of subsidies from which it claims serious prejudice".[1282]

7.1160 Specifically, the **United States** argues that Brazil has failed to properly take account of, or "expense", the duration of the "benefit" associated with certain annually recurring subsidies and has, furthermore, not demonstrated "how much" or "to what extent" United States cotton exports are subsidized.

7.1161 According to the United States, because payments which permit planting flexibility are not "tied to the production or sale" of upland cotton, as suggested by Annex IV of the *SCM Agreement*, they must be allocated by Brazil across the total value of production of each recipient.[1283] The United States asserts that Brazil has failed to demonstrate which product benefits from the subsidy. In order to perform the calculation, under the Annex IV guidelines, one must know what the subsidized product is. The United States asserts that, in the context of this dispute, a subsidy provided to a recipient who does not produce upland cotton cannot be said to provide a benefit to upland cotton and cannot be regarded as having one of the effects described in Article 6.3 insofar as upland cotton is concerned.[1284]

7.1162 The United States further argues that paragraph 7 of Annex IV of the *SCM Agreement* indicates that the drafters took it for granted that the benefits of certain subsidies should be allocated to future production. According to the United States, Brazil cannot have it both ways: it cannot expense the entire value of payment to a particular crop year for which the payment was received but also claim that the subsidy continues to exist in a later year in which new recurring subsidies are made.[1285]

7.1163 The United States submits that the Panel must utilize some methodology to determine the benefit to upland cotton from a subsidy not tied to production of upland cotton and considers that Annex IV continues to provide useful context for the necessary task of identifying the products that benefit from a subsidy not tied to the production or sale of a given product.[1286]

7.1164 **Brazil** states that the only legal basis for the alleged "allocation" requirement of "untied" subsidies cited by the United States is Annex IV of the *SCM Agreement* which, like Article 6.1(a), is now defunct.[1287] Brazil is of the view that the United States continues to try and transform this dispute into a countervailing duty investigation based on the now-defunct Annex IV of the *SCM Agreement*.

7.1165 Brazil emphasizes that 100 per cent of the four types of payments which permit planting flexibility (i.e., PFC, DP, MLA and CCP payments) are paid to the bank accounts of current upland cotton producers, conferring for each a “benefit” to upland cotton producers. Brazil further asserts that, under existing countervailing duty procedures, 100 per cent of the contract payments would be allocated across the production value of the producers because the total amount of benefits to the company producing the subsidized goods would first be calculated. According to Brazil, no deductions are made depending on how the subsidy is used by the recipients (i.e. to pay rents). Only

[1282] United States' oral statement at the resumed session of the first substantive meeting, para. 9.
[1283] United States' response to Panel Question No. 125 (9), para. 24.
[1284] United States' further rebuttal submission, paras. 13-14.
[1285] United States' oral statement at the second substantive meeting, para. 32.
[1286] United States' response to Panel Question No. 231.
[1287] Brazil's further rebuttal submission, paras. 103-104.

in case the subsidy is not *de facto* tied to the production of the subsidized product, is there in a second step an allocation of the benefit (100 per cent) over the total value of the company's production.[1288]

7.1166 The **Panel** sees a common thread in these arguments of the United States: the nature of the examination that we are to conduct in examining Brazil's claims under Part III of the *SCM Agreement*. In particular, certain of these arguments by the United States raise the question of the appropriateness of applying certain relatively precise quantitative and/or "countervailing duty" methodologies and concepts, found in Part V of (or elsewhere in) the *SCM Agreement*, when conducting a "serious prejudice" analysis under Part III of the *SCM Agreement*.

7.1167 On the basis of the text of Part III, and for the reasons that follow, we are of the view that, while they may provide contextual – and general conceptual – guidance, the more precise quantitative concepts and methodologies found in Part V of the *SCM Agreement* are not directly applicable in our examination of Brazil's actionable subsidy claims under Part III of the *SCM Agreement*.[1289]

7.1168 Governed by the provisions of Part V of the *SCM Agreement*, a unilateral countervailing duty investigation by a Member aims to establish whether imports of a subsidized product are causing material injury to a given Member's domestic industry and the level of any permissible countervailing duty. Accordingly, Articles 10-23 of the *SCM Agreement* set forth obligations relating to the imposition of countervailing duties. In particular, Article 10 of the *SCM Agreement* provides that:

> "Members shall take all necessary steps to ensure that the imposition of a countervailing duty [36] on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture." (footnotes omitted in part)
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>
> [36] The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994.

According to Article 32.1 of the *SCM Agreement*:

> "[n]o specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement." (footnote omitted)

Article VI:3 of the *GATT 1994* reads:

> "[n]o countervailing duty shall be levied on any product of the territory of a Member imported into the territory of another Member in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation… The term "countervailing duty" shall be understood to mean a special

[1288] Brazil's 28 January 2004 comments on United States' response to Panel Question No. 242, paras. 197-198.

[1289] By this, we do not mean to say that we entirely disagree that the general order of magnitude of a subsidy may be a relevant consideration in a serious prejudice analysis in a particular case (where such information is probative and readily available).

> duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export or any merchandise."

7.1169 By contrast, Article XVI of the *GATT 1994* contains certain rights and obligations concerning subsidies, as do Parts II and III of the *SCM Agreement*. Under the multilateral "actionable subsidies" disciplines in Part III of the *SCM Agreement*, a WTO panel established by the DSB assesses the extent to which a Member's subsidy causes "adverse effects" to the "interests" of other Members.[1290] Pursuant to Article 5(c), one form of adverse effects is "serious prejudice to the interests of another Member". Pursuant to Article 6.3(c), such serious prejudice may arise where the effect of the subsidy is significant price suppression in the same market.

7.1170 The remedies available in a Member's unilateral countervailing duty action under Part V of the *SCM Agreement* also contrast sharply with the remedies available for successful multilateral actions under Part III of the *SCM Agreement*.[1291] Footnote 35 of the *SCM Agreement* sets out rules pertaining to the relationship between these two sets of obligations and remedies. The role of the WTO dispute settlement system is different than the role of a national investigating authority imposing countervailing duties: where a claim under Part III prevails, the subsidizing Member concerned is obligated to take appropriate steps to remove the adverse effects or withdraw the subsidy.

7.1171 Other aspects of the current text of the provisions of Part III of the *SCM Agreement* further support the view that the focus of an "adverse effects"/"serious prejudice" analysis does not call for any precise quantification of the subsidy at issue.

7.1172 Articles 7.2-7.10 of the *SCM Agreement* are "special or additional rules and procedures" identified in Appendix 2 to the *DSU*. Entitled "Remedies", Article 7 sets out procedures and remedies

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[1290] Similarly, under the multilateral "prohibited subsidies" disciplines in Part II of the Agreement, a panel assesses whether or not a Member is granting or maintaining prohibited subsidies within the meaning of Article 3 of the Agreement.

[1291] In the unilateral trade remedy context, Article 19.1 provides:

> "If, after reasonable efforts have been made to complete consultations, a Member makes a final determination of the existence and amount of the subsidy and that, through the effects of the subsidy, the subsidized imports are causing injury, it may impose a countervailing duty in accordance with the provisions of this Article unless the subsidy or subsidies are withdrawn."

By contrast, Articles 7.8-7.10 outline the multilateral remedies where an actionable subsidies claim prevails:

> "7.8 Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy.
>
> 7.9 In the event the Member has not taken appropriate steps to remove the adverse effects of the subsidy or withdraw the subsidy within six months from the date when the DSB adopts the panel report or the Appellate Body report, and in the absence of agreement on compensation, the DSB shall grant authorization to the complaining Member to take countermeasures, commensurate with the degree and nature of the adverse effects determined to exist, unless the DSB decides by consensus to reject the request.
>
> 7.10 In the event that a party to the dispute requests arbitration under paragraph 6 of Article 22 of the DSU, the arbitrator shall determine whether the countermeasures are commensurate with the degree and nature of the adverse effects determined to exist."

pertaining to dispute settlement proceedings involving actionable subsidy claims. Article 7.2 requires that a request for consultations in an actionable subsidies dispute include a statement of available evidence with regard to (a) "the *existence* and *nature* of the subsidy in question; and (b) ...the serious prejudice caused to the interests of the member requesting consultations."[1292] (emphasis added)

7.1173 This provision does not explicitly refer to the "magnitude" or "amount" or "value" of the subsidy, let alone to any precise quantitative methodologies pertaining to its breakdown or allocation. Rather, while it may not preclude consideration of the general order of magnitude of a subsidy where this information may be relevant and readily available, we understand it to call for a qualitative and, to some extent, quantitative analysis of the existence and nature of the subsidy and the serious prejudice caused.[1293] Allocating absolutely precise proportions of the subsidy to the product concerned, or trying to trace with precision where each subsidy dollar may be spent by a recipient, is not a necessary exercise on the part of the Panel. Broader considerations are at play in a serious prejudice analysis than those involved in a countervailing duty sense.

7.1174 If a request for consultations in an actionable subsidies case must set out a statement of available evidence with regard to "the existence and nature of the subsidy in question", and need not focus on its amount or value (let alone any more precise quantitative concepts or methodologies) then the focus of the claims in an actionable subsidies dispute may also logically be the existence and nature of the subsidy in question.[1294]

7.1175 Pursuant to Article 7.3 of the *SCM Agreement*: "The purpose of the consultations shall be to *clarify the facts* of the situation and to arrive at a mutually agreed solution." (emphasis added) These facts would necessarily pertain to the subject of the request for consultations, including the statement of available evidence. They would thus logically pertain to the existence and nature of the subsidy.

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[1292] Footnote 19 to the *SCM Agreement* states:

> "In the event that the request relates to a subsidy deemed to result in serious prejudice in terms of paragraph 1 of Article 6, the available evidence of serious prejudice may be limited to the available evidence as to whether the conditions of paragraph 1 of Article 6 have been met or not."

Article 6.1 of the *SCM Agreement* is no longer applicable. It may nevertheless still provide relevant guidance for understanding the original architecture of the Agreement. The Panel is of the view that the Report of the Arbitrator, *US – FSC*, note 56 is relevant here. As that Arbitration noted, although Article 6.1 has lapsed, it is nevertheless "helpful ... in understanding the overall architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address". We have similarly referred to this treatment *supra*, Section VII:E. Article 6.1(a) stated that "Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of: (a) the total ad valorem subsidization of a product exceeding 5 per cent" (footnote omitted). The particular explicit reference to the special requirements in such a case, which dealt with calculating the total *ad valorem* subsidization of a product pursuant to the provisions of Annex IV, supports our view that in other cases, not involving Article 6.1(a), there is no requirement to quantify the amount or value of subsidization at this phase of the dispute settlement proceedings.

[1293] The same is true for the *SCM Agreement* multilateral disciplines on prohibited subsidies. Article 4.2 of the *SCM Agreement* similarly requires that a request for consultations in a prohibited subsidies dispute include a statement of available evidence with regard to the *existence* and *nature* of the subsidy (and not its magnitude or amount).

[1294] We note that Annex V of the *SCM Agreement* contains "Procedures for developing information concerning serious prejudice". Paragraph 2 of Annex V envisages that the DSB may "initiate the procedure to obtain such information from the government of the subsidizing Member as necessary to establish the existence and *amount* of subsidization...". We see this as in indication that information relating to the general order of magnitude of the subsidy could be relevant in a given case. We recall, however, that the Annex V procedures also related to the establishment of the presumption of serious prejudice in Article 6.1 and Annex IV (based upon an *ad valorem* rate of subsidization) during the period of application of that provision. See *supra*, footnote 1292.

We see no requirement in Article 7.3 that the consultations clarify the facts of the situation, including facts relating to the precise quantification of the amount of the subsidy.[1295]

7.1176 This contrasts with the text of Part V of the *SCM Agreement*, dealing with countervailing duty investigations. There, Article 19.4 provides that "no countervailing duty shall be levied on any import in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product." Therefore, the general rationale of a unilateral countervailing duty investigation is to determine whether or not a countervailable subsidy exists and, if so, to ensure that any countervailing duty levied on any import is not in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product. Logically, should a Member make an affirmative determination that a countervailable subsidy exists, these provisions in Part V necessitate calculation of the amount of the subsidy before a countervailing duty may be imposed. Moreover, they require the calculation of that amount to be performed in a certain way: "in terms of subsidization per unit of the subsidized and exported product".

7.1177 In view of the contrast in the text, context, legal nature and rationale of the provisions in Part III of the *SCM Agreement* relating to a multilateral assessment as to whether a Member is causing, through the use of any subsidy, "adverse effects" in the form of "serious prejudice to the interests of another Member" and Part V of the Agreement relating to obligations of a Member in conducting a unilateral countervailing duty investigations, we decline to transpose directly the quantitative focus and more detailed methodological obligations of Part V into the provisions of Part III of the *SCM Agreement*.[1296]

7.1178 We again recall the particular United States arguments we address here.

7.1179 First, the United States argues that we are under an obligation to precisely quantify the subsidies at issue in our serious prejudice analysis under Part III of the *SCM Agreement*. For the reasons we have given, we see no textual basis for this argument. If the text of Part III of the agreement imposes no such general requirement to quantify the overall amount of the subsidy, then it also, logically, cannot impose any more precise conceptual or methodological requirements. Thus, we find no textual support in the serious prejudice provisions in Part III for the United States argument that annually recurring subsidies must be "expensed" to one year alone, so that the "benefit" of the measure does not survive past that year. The concept of "benefit" is a definitional element of a subsidy pursuant to Article 1.1(a)(2) of the *SCM Agreement*.[1297] Inasmuch as we are not required to calculate an amount of "benefit", we cannot logically be required to conduct any sort of precise "expensing" of the "benefit".[1298] Moreover, we see no textual basis for reading the different terms –

[1295] See Appellate Body Reports: *US – Countervailing Measures on Certain EC Products* and *US – Corrosion-Resistant Steel Sunset Review*. The presence in the text of the same *SCM Agreement* of specific provisions requiring quantitative precision demonstrates to us that negotiators were well aware of how to craft such provisions, and to indicate that certain obligations apply in serious prejudice cases. They could, for example, have inserted clear introductory language or cross-references to Part V of the *SCM Agreement*, as they did, for example, in footnote 11 of the *SCM Agreement*, indicating that "The term 'injury to the domestic industry' is used [in Article 5(a)] in the same sense as it is used in Part V." However, they have not done so in Article 5(c) relating to serious prejudice. The lack of any explicit textual indication to this effect supports a conclusion that obligations such as those in Part V of the Agreement do not apply in a serious prejudice examination under Part III of the Agreement.

[1296] This does not mean, however, that the concept and definition of a "specific" "subsidy" – set out in Articles 1 and 2 of the *SCM Agreement* – differs under Part III and Part V. The provisions of Articles 1 and 2 define those subsidies that are susceptible to remedies under the other parts of the Agreement.

[1297] We are aware that provisions in Part V of the Agreement, e.g. Article 14, speak to the identification and quantification of the benefit in certain circumstances and that this guidance has been deemed relevant in understanding of benefit as that term is used in Article 1. See Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, paras. 108, 110.

[1298] This is not to say that we do not recognize that the "expensing" principle was devised as a "rule of thumb" and can be quite useful in certain circumstances in considering the effects of a subsidy. We do not

"benefit" and "adverse effects"/"serious prejudice" – synonymously. Were we to discern an identity between the concept of "benefit" to a recipient and the concept of "adverse effects" to another Member's interests, we would effectively reduce the provisions of Part III to redundancy. As a treaty interpreter, the Panel is precluded from doing so.[1299]

7.1180 Second, the United States argues that Brazil must establish the precise extent to which United States subsidies provided in respect of "upland cotton" production were actually "passed through" to the exporter, after having been processed and sold, before being traded.[1300] We have already cited the provisions governing the imposition of a countervailing duty in Part V of the *SCM Agreement*, and in Article VI of the *GATT 1994*. [1301] In addressing these provisions, the Appellate Body has recently observed:

> "... GATT/WTO dispute settlement practice is consistent with and confirms our interpretation that, where countervailing duties are used to offset subsidies granted to producers of input products, while the duties are to be imposed on *processed* products, and where input producers and downstream processors operate at *arm's length*, the investigating authority must establish that the benefit conferred by a financial contribution directly on input producers is passed through, at least in part, to producers of the processed product subject to the investigation. Therefore, we agree with the Panel that:
>
> > 'If it is not demonstrated that there has been such a pass-through of subsidies from the subsidy recipient to the producer or exporter of the product, then it cannot be said that subsidization in respect of that product, in the sense of Article 10, footnote 36, and Article VI:3 of GATT 1994, has been found.'" [1302] (footnote omitted)

7.1181 These principles apply in the context of a countervailing duty investigation governed by Part V of the Agreement. As they also relate to the definitional elements of a subsidy – i.e. a financial contribution conferring a benefit – in Article 1 of the Agreement, we consider that they are also of relevance to our examination, to the extent it concerns the "subsidized product" under Article 6.3(c). However, again, the textual distinctions between Parts III and V lead us to believe that while the countervailing "pass-through" principles may well be relevant, they are not directly applicable to our examination of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.

7.1182 Third, the United States argues that certain subsidies that are allegedly not directly tied to current production of upland cotton would need to be allocated over total production on a recipient's farm.

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disagree with the general proposition underlying such "expensing" rules, which we understand to be that, with the passage of time, a subsidy's effects may diminish. For example, a subsidy granted 9 or 10 years ago would indubitably be less likely to affect producers decisions now than it did 8 years ago. However, we see no basis for any particular precision concerning "expensing" in the text of Part III.

[1299] In order to find a violation of the actionable subsidies provisions in Part III of the *SCM Agreement*, it would suffice simply to establish the existence of a subsidy – i.e. a financial contribution conferring a benefit (and possibly that the subsidy was specific under Article 2) in order to establish that such a subsidy necessarily has adverse effects. This cannot be so. A fundamental tenet of the subsidy disciplines enshrined in the *SCM Agreement* is that Members are permitted to grant or maintain specific subsidies to the extent that they do not cause adverse effects within the meaning of Articles 5 and 6 of the *SCM Agreement*. Logically, there must be some specific subsidies that do not cause such adverse effects. Otherwise, there would be no need for the drafters to have crafted any of the criteria and conditions specified in Articles 5 and 6 of the *SCM Agreement*.

[1300] See also *infra*, our discussion of like product and subsidized product.

[1301] See *supra*, para. 7.1168, citing Articles 10 and 32.1 of the *SCM Agreement* and Article VI of the *GATT 1994*.

[1302] Appellate Body Report, *US – Softwood Lumber IV*, para. 146.

7.1183 We recall that Article 6.1(a) of the *SCM Agreement* stated:

> "6.1 Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of:
>
> (a) the total ad valorem subsidization[*] of a product exceeding 5 per cent; ..."
>
> _____
>
> [*] The total ad valorem subsidization shall be calculated in accordance with the provisions of Annex IV. (subsequent footnote omitted)

7.1184 Annex IV of the *SCM Agreement* was entitled "Calculation of the Total Ad Valorem Subsidization (paragraph 1(a) of Article 6)". Pursuant to its paragraph 1, "[a]ny calculation of the amount of a subsidy shall be done in terms of the cost to the granting government." Pursuant to its paragraph 2, in general, "[in] determining whether the overall rate of subsidization exceeds 5 per cent of the value of the product, the value of the product shall be calculated as the total value of the recipient firm's sales in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted." (footnotes omitted) Paragraph 3 stated:

> "3. Where the subsidy is tied to the production or sale of a given product, the value of the product shall be calculated as the total value of the recipient firm's sales of that product in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted."

7.1185 These provisions ceased to apply at the end of 1999.[1303] Neither party to this dispute seeks to apply them directly.

7.1186 We agree with the United States that these provisions may nevertheless provide relevant contextual guidance for interpreting "serious prejudice" within the meaning of Articles 5(c) and 6.3 of the *SCM Agreement*.[1304] While we certainly do not dispute the widely held premise that subsidies to producers relate generally to the products they make, there is nothing in the text of Part III of the *SCM Agreement* that requires any particular precise calculations or the application of any particular methodology concerning this element.[1305]

7.1187 The reference in Annex IV, paragraph 3, to "tied to the production or sale" existed in order to inform the calculation that would form the basis for the establishment of the presumption in Article 6.1(a) that a 5 per cent subsidization rate causes serious prejudice. The text of Article 6.1(a) clearly indicated that, in order for such a presumption to be established, a specific calculation had to

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[1303] As already noted in footnote 1292, the Panel is of the view that the Report of the Arbitrator, *US – FSC*, note 56 is relevant: As that Arbitration noted, although Articles 8 and 9 have lapsed, they are nevertheless "helpful ... in understanding the overall Architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address". The Appellate Body referred to the text of Annex IV and its reference to the "recipient firm" as one of multiple textual factors in the course of clarifying the meaning of "benefit" to the recipient for the purposes of a countervailing duty investigation without explicitly discussing the significance of it no longer applying. See Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, para. 112. We do not understand this reference by the Appellate Body as indicating that the text of Article IV may still have an equivalent legal value as the current text of the Agreement.

[1304] United States response to Panel Question No. 231. See *e.g.*, United States' oral statement at the resumed session of the first substantive meeting, para. 20.

[1305] As already mentioned (see *supra*, paras. 7.1169 *ff*), there is no textual analogue in Part III to the countervailing duty provisions in Part V of the Agreement, and, in particular, Article 10 and footnote 36 of the *SCM Agreement* or Article VI:3 of the *GATT 1994*, requiring any sort of precise allocation of subsidies. See Appellate Body Report and Panel Report, *US – Softwood Lumber IV*, addressing pass-through in the countervailing context.

be undertaken and special rules were designed to further inform the nature of the calculation that had to be undertaken.[1306] Negotiators indicated their awareness that the creation of such a presumption dependent upon the existence of a precise numerical benchmark would require guidance as to how the numerical benchmark would be established. Among the specifications that negotiators set out were those in Annex IV, paragraph 3 (i.e. where a "subsidy [is] tied to the production or sale of a given product," the amount of that subsidy would be compared only to the value of a firm's sales of that product). Those specifications are, however, no longer applicable.

7.1188 Looking to the text of Article 6.1(a), it is clear to us that one way in which the negotiators originally countenanced that a presumption of serious prejudice could be established was through the calculation of a total *ad valorem* subsidization of a product exceeding 5 per cent. Article 6.2 tells us that notwithstanding such a total *ad valorem* subsidization, serious prejudice shall not be found if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3.

7.1189 The text of this provision clearly distinguishes between the quantitative benchmark in Article 6.1(a) and the other, more qualitative, elements involved in discerning the effects of the subsidy spelled out in Article 6.3. This clear demarcation between, on the one hand, the quantitative benchmark of subsidization and, on the other, the effects that may or may not accompany a subsidy satisfying the quantitative level in Article 6.1(a), is at the crux of the analysis which takes place under Article 6.3. At the very least, it is distinct, and different, from a quantitative analysis intended to establish a percentage of total *ad valorem* subsidization. This confirms to us that it is not necessary to establish such a rate of subsidization under Article 6.3 (although we are not precluding the possibility that it might be relevant in a given case).

7.1190 The fact that Article 6.2 foresees that a subsidy with a certain total *ad valorem* subsidization percentage may nevertheless not cause "serious prejudice" is, to us, consistent with the view that, while the magnitude of a subsidy may be relevant in some cases where such information is probative and readily available, the magnitude of a subsidy may not, in and of itself, be determinative of the nature or extent of its effects. A massive ("inefficient") subsidy of a certain design may have relatively miniscule effects, whereas a smaller subsidy of a different nature may have relatively greater effects. Furthermore, the variable where the effects are manifest may differ.

*(iii) Considerations guiding the Panel's analysis*

7.1191 We consider it axiomatic that the nature of a given subsidy may play an important role in determining its effects. We are well aware that the subsidies before us are of differing natures, manners of operation and orders of magnitude. The effects flowing from certain of the subsidies

[1306] In this respect, footnote 62 of the *SCM Agreement* indicates: "An understanding among Members should be developed, as necessary, on matters which are not specified in this Annex or which need further clarification for the purposes of paragraph 1(a) of Article 6." We note that, at its regular meeting in June 1995, the SCM Committee established an "Informal Group of Experts" ("IGE") to examine matters which were not specified in Annex IV to the Agreement or which needed further clarification for the purposes of paragraph 1 of Article 6 and to report to the Committee such recommendations as the IGE considered could assist the Committee in the development of an understanding among Members, as necessary, regarding such matters. At the Committee's regular meeting in April 1998 (see G/SCM/M/16, paras. 68-82), the SCM Committee discussed and took note of the report of the IGE in document G/SCM/W/415/Rev.1, and asked the IGE to continue to try to resolve issues that remained unresolved. Subsequently, at its November 1999 meeting (see G/SCM/M/24, paras. 14-19), the Committee discussed and took note of the IGE's supplementary report, in document G/SCM/W/415/Rev. 2/Suppl. 1, on calculation issues related to Annex IV of the *SCM Agreement*. That report indicates that: "The Group reached consensus on a recommendation regarding ad hoc loan guarantees. The Group did not reach a consensus on any of the other issues discussed. The Group considers that there are no further issues on which consensus is likely to be reached, and therefore considers that it has completed its mandate from the Committee."

certainly might, in isolation, be of a different nature and degree than those flowing from certain others.

7.1192 We recall that the chapeau of Article 5 of the *SCM Agreement* states: "No Member should cause, *through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1*, adverse effects to the interests of other Members, i.e. ...".(emphasis added) Article 5 refers to the adverse effects caused through the use of any specific subsidy within the meaning of the *SCM Agreement*. Article 6.3(c) requires an examination of "the effect of the subsidy" through a price phenomenon ("significant price suppression") and refers to a "subsidized product". We do not see the Article 6.3(c) reference to "the effect of the subsidy" (in the singular, rather than the plural) as meaning that a serious prejudice analysis of price suppression must clinically isolate each individual subsidy and its effects.[1307] Rather, these textual references to "any subsidy", "the subsidy" and the "subsidized product" in Articles 5(c) and 6.3(c) suggest that while due attention must be paid to each subsidy at issue as it relates to the subsidized product, a serious prejudice analysis may be integrated to the extent appropriate in light of the facts and circumstances of a given case.[1308] In our view, these textual references to "any subsidy" and "the effect of the subsidy" permit an integrated examination of effects of any subsidies with a sufficient nexus with the subsidized product and the particular effects-related variable under examination. Thus, in our price suppression analysis under Article 6.3(c), we examine one effects-related variable – prices – and one subsidized product – upland cotton. To the extent a sufficient nexus with these exists among the subsidies at issue so that their effects manifest themselves collectively, we believe that we may legitimately treat them as a "subsidy" and group them and their effects together. We derive contextual support for this view from Article 6.1 and Annex IV[1309], which referred to the concept of total *ad valorem* subsidization and envisaged that, "[i]n determining the overall rate of subsidization in a given year, subsidies given under different programmes and by different authorities in the territory of a Member shall be aggregated".

7.1193 Finally, the fact that, in this dispute, certain of the subsidies before us[1310] are also prohibited subsidies does not lead us to change our view as to the nature of the serious prejudice analysis. We note that there are different remedies available in respect of prohibited and actionable subsidies under

[1307] Taken to an extreme, this could mean that separate dispute settlement proceedings, or at least separate claims, would need to be brought with respect to the serious prejudice caused by each and every individual subsidy, even where these subsidies exist contemporaneously and interact in concert in respect of a single subsidized product to produce a single result in the form of a price phenomenon.

[1308] We recall the approach of the panel in Panel Report, *Indonesia-Autos*, para. 14.206. In the context of deciding to examine subsidies under an expired measure, that panel observed that it had before it "... a variety of different subsidy measures provided pursuant to a single National Car programme". Under those circumstances, the panel determined,

> "...that it makes little sense to treat each one separately when analysing the existence of serious prejudice. Rather, we must assess the 'effect of the subsidies' on the interests of another Member to determine whether serious prejudice exists, not the effect of 'subsidy programmes.' "

That panel was dealing with a different basket of measures, under a single programme. It was also dealing with a different issue than the precise issue here before us (which involves questions not only of temporal, but also substantive, interrelationships among the subsidies at issue). Furthermore, it was dealing with different legal claims and arguments under Article 6.3(c) and 5(c) (relating to price undercutting, rather than price suppression). We do not understand that panel to suggest that the effects of *all* challenged subsidies in existence more or less contemporaneously and with any connection whatsoever with a subsidized product *must* be aggregated in a serious prejudice analysis. However, to the extent that it does suggest such an approach, our approach here is not identical and is tailored to the particular facts and circumstances of this dispute and of the measures before us.

[1309] As we have already stated, this provision has lapsed, but may still be relevant in indicating the original architecture of the Agreement. See *supra*, footnote 1292.

[1310] i.e. user marketing (Step 2) payments to domestic users and exporters.

Articles 4.7[1311] and 7.8[1312] of the *SCM Agreement*, respectively.[1313] There is no indication in the text of Article 5(c), or any other provision of the *SCM Agreement*, that a Member is precluded from bringing both prohibited and actionable subsidy claims against the same measure, nor that a panel is precluded from examining such claims or from making the recommendation foreseen in Article 4.7 and also making a finding that the same measure is causing adverse effects within the meaning of Article 5 of the *SCM Agreement*, thereby triggering the operation of the remedy in Article 7.8.[1314]

7.1194 Consonant with this textual and contextual guidance, we will therefore undertake an analysis focusing on the existence[1315] and nature of the subsidies in question by examining their structure, design and operation with a view to discerning their effects. In this case, we also have readily available to us information relating to the general order of magnitude of many of the subsidies at issue (i.e. we have already established, in another context, elements relevant to the order of magnitude of the subsidies)[1316] and we will take this into account as an element in determining whether or not "significant price suppression" and/or "serious prejudice" exist. To the extent a sufficient nexus exists between certain subsidies and any suppression of prices of the subsidized product, we aggregate these subsidies and their effects. These guiding considerations are relevant to several aspects of our analysis, including our examination of: "subsidized product"[1317]; the existence of "price suppression" in the same market[1318]; whether the price suppression is "significant";[1319] and the existence of a causal

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[1311] Article 4.7 of the *SCM Agreement* reads:

> "4.7 If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn."

[1312] Article 7.8 of the *SCM Agreement* reads:

> "7.8 Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy."

[1313] We recall our findings in Sections VII:E and F that the user marketing (Step 2) payments under section 1207(a) of the FSRI Act of 2002 constitute prohibited subsidies under Articles 3.1(a) and (b), and Article 3.2, of the *SCM Agreement*. As a consequence, in respect of these prohibited subsidies, we are bound by Article 4.7 of the *DSU* to "recommend that the subsidizing Member withdraw the subsidy without delay". See *infra*, Section VIII.

[1314] It is not unusual for a measure of a Member to be subject to multiple WTO obligations, which may result in multiple findings of inconsistency with the covered agreements. Depending upon how a Member opts to implement the rulings and recommendations of the DSB in a particular dispute, sufficient implementation may be achieved through one integrated act. That is, in a situation similar to the one before us, withdrawal of a prohibited subsidy within the meaning of Article 4.7 of the *SCM Agreement* may also be sufficient to remove its adverse effects within the meaning of Article 7.8 of the *SCM Agreement*. However, it may be, for example, that withdrawal of the prohibited contingency may not wholly achieve removal of adverse effects or that removal of the adverse effects may not equate with withdrawal of the prohibited subsidy. This would, of course, depend upon the particular facts and circumstances surrounding the implementation.

[1315] Which, in any event, the United States does not dispute.

[1316] See *supra*, Section VII:D and footnote 895. We underline that our view relating to the order of magnitude of a subsidy is specific to the circumstances we face in this particular case, and that our view might very well be different in another case where even this extent of information may either not be relevant or not be available. As we have already indicated, we see no requirement precisely to quantify the subsidy in a serious prejudice analysis under Part III of the *SCM Agreement.*

[1317] See *infra*, paras. 7.1216 *ff*, including footnote 1336.

[1318] See *infra*, paras. 7.1290 *ff*, in particular, para. 7.1303 concerning the price-contingent subsidies before us: marketing loan programme payments; user marketing (Step 2) payments; and MLAs and CCPs; and

link between certain of the subsidies and "significant price suppression".[1320] This approach ensures that we determine, as the text of the treaty requires, whether or not "the effect of the subsidy" is "significant price suppression" in the same market within the meaning of Article 6.3(c) which constitutes "serious prejudice" within the meaning of Article 5(c).

(e) Reference period

7.1195 Article 5(c) and Article 6.3(c) of the *SCM Agreement* do not refer to any specific time period within which we must conduct our evaluation.

7.1196 **Brazil** asserts that the Panel must select an appropriate period of time for analyzing Brazil's claims under Articles 5(c) and 6.3 of the *SCM Agreement* relating to the "present" effects of the United States measures at issue. According to Brazil, 1999-2002 is a reasonable period of time, since data for those years is essentially complete.

7.1197 The **United States** counters that the appropriate representative period for demonstrating present serious prejudice will depend on the nature of the subsidies at issue. Normally, the most recent period for which data are available will be the appropriate period. According to the United States, Brazil must demonstrate serious prejudice for MY 2002.

7.1198 The **Panel** concurs with the United States assertion that MY 2002 is a relevant year for our serious prejudice inquiry. It represents a recent period for which essentially complete data exists. The identification of "significant price suppression" flowing from "the effect of the subsidy" calls for an evaluation of this effects-based phenomenon that cannot be conducted in the abstract. Rather, discerning adverse effects of subsidies seems to us to require reference to a recent historical period. We believe, however, that it is important for the establishment of "current" serious prejudice that such prejudice would be established to exist up to, and including, a recent point in time.[1321]

7.1199 We also believe that subsidies granted prior to MY 2002 are relevant to our evaluation. Consideration of developments over a period longer than one year, while not necessarily required (at least in Articles 5(c) and 6.3(c)) provides a more robust basis for a serious prejudice evaluation than merely paying attention to developments in a single recent year. It may put such developments in a broader temporal context. In addition, having found that the subsidies exist and have been provided over a longer period of time than one year, it would be inappropriate to look at trends only in the last year to arrive at any conclusion on serious prejudice. It may, for example, be that the market may well already be distorted in a given year due to subsidies.

7.1200 In our examination, we are required to ensure that the "effect of the subsidy" is the situation in question (i.e. significant price suppression under Article 6.3(c)). These elements also address the concerns of the United States regarding alleged unusually high or low production or yields in a given crop year: in exercising our judgment about the causal link between the subsidies and any prejudice caused, we ensure that we are satisfied that such subsidies in respect of United States upland cotton has caused prejudice which can be said to be serious within the meaning of Article 5(c). If other causes have had effects which diminish the effects of the subsidies to a level which we conclude could not be serious, then we could not arrive at a proper serious prejudice finding under Article 5(c).

7.1201 The fact that the legal and regulatory provisions governing payment of many of the subsidies at issue – i.e. measures under the FAIR Act of 1996, *ad hoc* legislation providing for MLA payments

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para. 7.1307 concerning the non-price-contingent subsidies before us: PFC and DP payments and crop insurance payments.

[1319] See *infra*, paras. 7.1316 *ff*, in particular, para. 7.1332.

[1320] See *infra*, paras. 7.1349 and 7.1350.

[1321] We recall our findings in Section VII:D of our report pertaining to United States subsidies, MY 1999-2002.

and cottonseed payments for the 2000 crop – have expired is immaterial to our serious prejudice analysis. Subsidies granted under expired measures may have had adverse effects at the time they were in effect, and may still have lasting adverse effects.[1322]

(f) Role of econometric modelling results used by Brazil in this dispute

7.1202 Brazil initially submitted that the economist that it had retained to perform quantitative simulation modelling for this dispute, Dr. Sumner[1323], had found that *but for* the United States subsidies subject to that modelling exercise, United States production of upland cotton during the period of MY 1999 to MY 2002 would have been an average of 28.7 per cent lower than actual United States production and United States exports would have declined on average by 41.2 per cent during the period of MY 1999 to 2002. According to Brazil, Dr. Sumner found that *but for* the United States subsidies provided to the United States upland cotton industry, the A-Index would have been higher by an average of 12.6 per cent or 6.5 cents per pound during the period of MY 1999 to 2002.[1324] Dr. Sumner also presented the results of his analysis orally, in the course of the substantive Panel meetings.

7.1203 The parties disagree as to the accuracy and adequacy of the results of the econometric model submitted by Brazil, which focuses on a "but for" examination of the production, export and price effects of the United States subsidies. The United States criticizes the model for, *inter alia*, relying on an inappropriate baseline; failing to take into account "futures price" information available to producers; effects of the subsidies on production costs; the treatment of PFC payments and crop insurance payments in the model and a number of other modelling deficiencies. It also argues that the model is ineffective for use in retrospective analysis. The United States asserts that Brazil's analysis appears flawed in several respects and as a result, the conclusions drawn are biased and misleading.

7.1204 In response to a United States request, the Panel informed the parties that it did not require (nor preclude) the parties' further rebuttal submissions, nor their oral statements during the second Panel meeting, to address the methodology, equations or parameters underlying the simulation model used by Brazil. The Panel gave the parties an additional opportunity for a written exchange and

[1322] Panel Report, *Indonesia – Autos*, para. 14.206. See also ruling in Section VII:B.

[1323] We note that it is open for a Member to determine the composition of its own delegation for the purposes of WTO dispute settlement. Neither the *DSU* nor the *SCM Agreement* contains specific rules on any sort of qualification of experts. We would underline, that, in this dispute, we consider the participation of experts, as part of the submissions of the parties and third parties, contributed constructively to our duty to conduct an objective assessment of the matter before us.

Dr. Sumner participated in the first and resumed sessions of the first substantive meeting as well as in the second substantive meeting with the Panel. Exhibit BRA-104 contains Dr. Sumner's *curriculum vitae*. In addition to Dr. Sumner's contributions annexed to this report and to Brazil's submissions/statements, the record also includes the following material: Exhibits BRA-105, -275, -279, -280, -313 through -315, -325, -326, -342 through -346 and -396; Exhibit US-56. Dr. Sumner's modelling results involved the use of the so-called "FAPRI" model. In response to Panel Question No. 203, Brazil submitted evidence pertaining to FAPRI's status and credentials, in Exhibits BRA-376 through -380.

Without prejudice to any relevance to our serious prejudice examination, we also note that Brazil submitted expert opinion statements by Mr. Christopher Campbell of the Environmental Working Group, in his capacity as an expert in the design and use of computer software in USDA commodity subsidy database information (Exhibits BRA-316 and -368). As we note *infra*, in footnotes 1361/1375 and 1465, respectively, Mr. Andrew MacDonald and Mr. Christopher Ward also participated, and provided expert opinions, as part of Brazil's delegation in these Panel proceedings.

Dr. Glauber, a member of the United States delegation and government also contributed expert opinions and material in this capacity, and his work was cited by the parties. See, for example, Exhibit BRA-131; Exhibits US-76, -91.

Certain third party submissions/statements (e.g. of Benin and Chad) also involved the participation of experts, including Mr. Minot and Mr. Malloum. See e.g. *supra*, para. 7.54.

[1324] Brazil's further written submission, para. 183.

indicated that, if necessary, at the discretion of the Panel, a further Panel meeting with the parties would be held to address this specific material. The parties were advised that this was without prejudice to the relevance and significance which the Panel might ascribe to the quantitative simulation model and related evidence and argumentation in its report.[1325] Several further exchanges occurred between the parties in respect of this issue.[1326]

7.1205 We have taken note of the outcomes of the simulations submitted by Brazil[1327], and the parties' exchanges of views thereon. We have not relied upon the quantitative results of the modelling exercise – in terms of estimating any numerical value for the effects of the United States subsidies, nor, indirectly, in our examination of the causal link required under Articles 5 and 6.3(c) of the *SCM Agreement*.

7.1206 Without prejudice to the relevance or utility of such simulations generally to a serious prejudice analysis under Part III of the *SCM Agreement*, we would point out our particular concern here, in ensuring procedural fairness between the parties and the reliability of evidence, that the underlying model itself was not equally accessible to the parties and, as relevant, to the Panel in these proceedings. Brazil did not itself have access to the model. While Brazil instructed the organization which owned and operated the model (FAPRI) as to the modifications and adaptations that Brazil believed needed to be made in order to produce the econometric results presented to the Panel, Brazil could not itself autonomously check the use of those modifications and adaptations. When the United States asked to be able to analyse the model and its workings, FAPRI stipulated that neither Brazil nor the Panel could have similar access.

7.1207 However, we observe that the simulations were prepared by experts, and explained to the Panel by experts. The outcomes of the simulations are consistent with the general proposition that subsidies bestowed by Member governments have the potential to distort production and trade and the elimination of subsidies would tend to reduce "artificial" incentives for production in the subsidized Member. This is one of the underlying rationales for the establishment of the subsidy disciplines in the *SCM Agreement*.

7.1208 We further do not disagree with another basic assumption underlying the modelling used by Brazil in this dispute: that the effects of a subsidy may vary depending upon the nature of the subsidy. We also note that the United States would support this proposition. Again, we consider this to make common economic sense.

7.1209 In light of the nature of our examination of Brazil's claims under Part III of the *SCM Agreement*, based upon an interpretation of the text, in light of its context, object and purpose[1328], we have taken the analyses in question into account where relevant to our analysis of the existence and nature of the subsidies in question, and their effects, under the relevant provisions of the *SCM Agreement*, and have attributed to them the evidentiary weight we deemed appropriate.

(g) Role of studies by other organizations/academic institutions

7.1210 The parties have also brought to our attention a number of studies produced by the United States government, several international governmental and non-governmental organizations and

[1325] See *supra*, Section VII:A.
[1326] See *supra*, Section VII:A.
[1327] Dr. Sumner estimates that the cumulative effects of the subsidies, for MY 1999-2002, are (approximately): a 28 per cent increase in United States upland cotton acreage; a 29 per cent increase in United States production, a 41 per cent increase in United States exports and a 12.6 per cent decrease in world price (A-Index). In terms of relative magnitude, from subsidies with largest to smallest effect: 1. marketing loan/LDP; 2. user marketing (Step 2) payments; 3. crop insurance payments; 4. CCP payments; 5. DP payments.
[1328] See *supra*, paras. 7.1156 *ff*.

academic institutions. Brazil asserts that many of these studies have made findings that substantiate its arguments that United States subsidies have "caused" "significant" "price suppression".[1329]

7.1211 Certain third parties support Brazil's arguments concerning the relevance of these studies in this dispute.[1330]

7.1212 We consider it relevant that numerous studies find, for various reasons, that a removal of certain of the United States subsidies, over certain time periods, would lead to an alteration in United

[1329] The studies referred to include:

- Exhibit BRA-210: "Production and Trade Policies Affecting the Cotton Industry", ICAC, July 2002.
- Exhibit BRA-224: "Factors Affecting the United States Farm Price of Upland Cotton", Leslie Meyer (USDA 1998).
- Exhibit BRA-233: "Production and Trade Policies Affecting the Cotton Industry", ICAC, September 2001.
- Exhibit BRA-234: "Rethinking U.S. Agricultural Policy: Changing Course to Secure Farmer Livelihoods Worldwide", Daryll E. Ray, Daniel G. De La Torre Ugarte, Kelly J. Tiller, Agricultural Policy Analysis Center, The University of Tennessee.
- Exhibit BRA-235: "What is the Impact of Removing Agricultural Support", IMF World Economic Outlook 2002, Chapter II; IMF (2002), How Do Industrial Country Agricultural Policies Affect Developing Countries?
- Exhibit BRA-236: "Market Access for Developing Country Exports – Selected Issues", IMF and the World Bank, 26 September 2002.
- Exhibit BRA-237: "Rich Countries Should Show the Way to Trade: World Bank urges Action to Further Open Markets to Developing Countries", World Bank, press release 2003/094/S, 27 September 2002.
- Exhibit BRA-238: "Trade Distortions and Cotton Markets: Implications for Australian Cotton Producers", Cotton Research and Development Corporation, April 2001.
- Exhibit BRA-264: Goreux, "Prejudice Caused by Industrial Countries subsidies to cotton sectors in Western and Central Africa".
- Exhibit BRA-275: "U.S. Cotton Supply Response under the 2002 Farm Act", Paul C. Westcott and Leslie A. Meyer (USDA, 2003).
- Exhibit BRA-276: "Report of the Commission on the Application of Payment Limitations for Agriculture", Submitted in Response to Section 1605, FSRI Act of 2002 (USDA, 2003).
- Exhibit US-62: IMF Working Paper (2003) "Measuring the Impact of Distortion in Agricultural Trade in Partial and General Equilibrium".
- Exhibit BRA-222: Westcott and Price (USDA 2001) "Analysis of the United States Commodity Loan Programme with Marketing Loan Provisions".

Parties' critiques of certain of these "third party" studies are found in Exhibit US-91 and Exhibit BRA-275.

[1330] For example, **Argentina** considers that the number and quality of the empirical and econometric analyses presented by Brazil, which were carried out by both international organizations and various prestigious United States economic research institutions such as the USDA, provide irrefutable evidence of the *collective* and *individual* effects of each subsidy programme on the price of cotton. See Argentina's written submission to the resumed session of the first substantive meeting, para. 34. According to **Benin** and **Chad**, the Oxfam report – using data from the International Cotton Advisory Committee - estimates that in 2001 alone, sub-Saharan exporters lost $302 million as a direct consequence of United States cotton subsidies. The Report further notes that Benin's actual cotton export earnings in 2001/02 were $124 million. However, had United States subsidies been withdrawn, Benin's export earnings are estimated to have been $157 million. Therefore, the value lost to Benin as a result of United States subsidies was $33 million. Chad's cotton export earnings in 2001/02 were $63 million, although in the absence of United States subsidies, Chad would have earned $79 million, thus reflecting a loss of $16 million. For the period from 1999/2000 to 2001/2002, Oxfam estimates a total cumulative loss of export earnings of $61 million for Benin and $28 million for Chad. Benin and Chad agrees with Oxfam when it emphasizes, "the small size of several West African economies and their high levels of dependence on cotton inevitably magnify the adverse effects of United States subsidies. For several countries, US policy has generated what can only be described as a major economic shock." See Benin and Chad's written submission to the resumed session of the first substantive meeting, paras. 19-21.

States production and exportation and to a change in certain world or United States prices. This is consistent with the general proposition that subsidies bestowed by Member governments have the potential to distort production and trade flows and the elimination of subsidies would tend to reduce "artificial" incentives for production in the subsidizing Member. As we have already noted, this is one of the underlying rationales for the establishment of the subsidy disciplines in the *SCM Agreement*.

7.1213 However, none of these various studies address the precise legal issues arising under Part III of the *SCM Agreement*, based on the measures, period, facts, argumentation and evidence before us. For example, although some address possible movements in the A-Index, others, including certain studies of USDA, do not address the issue of world price movements at all, but rather focus on effects on United States prices. Furthermore, each of these studies is premised on certain econometric assumptions concerning *inter alia*, treatment of certain measures, selection of baseline, and supply and demand elasticities.

7.1214 They are, therefore, not only subject to the same considerations – in terms of the legal and factual analysis that we must conduct under the *SCM Agreement* – as we have already discussed in the context of the outcomes of the simulations used by Brazil 's quantitative simulation model(s)[1331], but also were not legally or factually tailored to the matter before us.

7.1215 In light of the nature of our examination of Brazil's claims under Part III of the *SCM Agreement*, based upon an interpretation of the text, in light of its context, object and purpose[1332], we have taken the analyses in question into account where relevant to our analysis of the existence and nature of the subsidies, and their effects. We have attributed to them the evidentiary weight we deemed appropriate.

(h) "Like product" and "subsidized product"

7.1216 The text of Article 6.3(c) refers to "like product"[1333] and "subsidized product". As the identification of the "subsidized product" may affect the conception of "like product", we address them together.

7.1217 Brazil asserts that upland cotton[1334] is the "subsidized product" for the purposes of its allegations of serious prejudice. According to Brazil, it has submitted evidence to establish that each of the subsidies at issue is a production- and export-enhancing subsidy in respect of upland cotton lint. According to Brazil, "it is the production, export and use of upland cotton lint that benefits from the United States subsidies challenged by Brazil".[1335]

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[1331] *Supra*, paras. 7.1202 *ff*.

[1332] *Supra*, Section VII:C.

[1333] There is a clear indication in the text of Article 6.3(c) of the *SCM Agreement* that an examination of price undercutting is to focus on whether there is "significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market" (emphasis added). However, the structure of the remaining text of the provision does not clearly indicate whether this requirement to establish a "subsidized product" and "like product" also necessarily applies to a price suppression analysis. In this regard, the text merely reads: "the effect of the subsidy is ... significant price suppression, depression or lost sales in the same market." It may therefore be asked whether or not the same requirement of a "subsidized product" and a "like product" also applies to a price suppression analysis under Article 6.3(c) of the *SCM Agreement*. We observe, however, that Article 6.3(c) calls for an examination of price suppression, and that price suppression necessarily involves the prices of certain products. Thus, our examination of "prices" in the world market necessarily relates to "prices" of certain "products". Accordingly, we address the concepts of "subsidized product" and "like product".

[1334] See *supra*, Section VII:C, including, in particular, footnote 258 where we discuss the product subject to this dispute.

[1335] See Brazil's further written submission, para. 79.

7.1218 The United States submits that Brazil needs to identify the "subsidized product" for each of the types of subsidies that Brazil alleges is causing the serious prejudice. According to the United States, Brazil has not established to whom certain payments go and whether certain payments may properly be attributed to exported upland cotton. The United States further asserts that account must be taken of the extent to which the subsidies are not tied to current upland cotton production.

7.1219 The Panel recalls that Article 6.3(c) of the *SCM Agreement* requires us to examine whether "the effect of the subsidy" is "significant price suppression".

7.1220 We understand the term "subsidized" "product", as used in Article 6.3(c), to refer to a "product" that is "subsidized", i.e. in respect of which a subsidy is directly or indirectly granted or maintained.[1336]

7.1221 To the extent that the United States argues that Brazil has not established that the "subsidized product" is upland cotton in the form traded on the world market, we recall Brazil's assertion in this dispute that it: "agreed with USDA's classification of upland cotton lint as a distinct agricultural product". This is the product traded in the world market. Thus, according to Brazil, the Brazilian product that is "like", i.e. identical to or which has characteristics closely resembling the subsidized United States product, is Brazilian upland cotton lint.[1337]

7.1222 The United States indicated that "[f]or purposes of this dispute, the United States is not arguing that all United States cotton is 'unlike' Brazilian cotton".[1338]

7.1223 We therefore do not understand there to be disagreement between the parties as to the core meaning of "like" product for the purposes of Article 6.3(c) of the *SCM Agreement* in this dispute.

7.1224 Furthermore, we do not understand the United States to have argued that United States production of upland cotton does not benefit from any subsidies. Rather, the United States asserts that at least certain of the subsidies at issue may not relate to upland cotton in the form that it is exported and traded in the world market.

7.1225 We note that the text of the United States legal or regulatory instruments governing the grant of a number of the subsidies before us explicitly or implicitly make the grant of the subsidy available in respect of upland cotton: (1) marketing loan programme payments[1339] and (2) user marketing

[1336] On the basis that Brazil has identified upland cotton lint as the "subsidized product" for the purposes of its serious prejudice claims, we do not believe that the structure, design and operation of the United States cottonseed payments within our terms of reference manifest a sufficiently close nexus with the subsidized product and the alleged price effects of the subsidy at issue so as to cause significant price suppression within the meaning of Article 6.3(c). As described *supra*, Section VII:C, these cottonseed payments were paid to first handlers of cottonseed for the 2000 crop of cottonseed, and were shared with producers to the extent that revenue from the sale of that product was shared with the producer. Brazil itself separates "cottonseed revenue received by farmers" from "cotton lint price received by farmers" in, for example, Brazil's response to Panel Question No. 125(c), Exhibits BRA-169, -287, as does the USDA Fact Sheet: Upland Cotton (January 2003), reproduced in Exhibit BRA-4. Cottonseed is an oilseed, used to make cottonseed oil and meal. For this reason, we do not include cottonseed payments in the remainder of our Article 6.3(c) analysis.

[1337] Brazil's further written submission, paras. 80-81. See also *supra*, footnote 258.

[1338] United States' response to Panel Question No. 126. In its response to Panel Question No. 154, the United States indicated its agreement that upland cotton is a "primary product or commodity" within the meaning of Article 6.3 (d) of the *SCM Agreement*.

[1339] 7 CFR 1427.5(b)(11), reproduced in Exhibit BRA-36, in respect of marketing loan refers to conditions "for a bale of cotton to be eligible" which include that it must be "ginned" by certain ginners. With respect to LDPs, the upland cotton need not be ginned for eligibility, but the LDP is disbursed after the upland cotton is ginned.

(Step 2) payments to exporters and domestic users.[1340] Other subsidies are also available in respect of upland cotton. Crop insurance subsidies are granted in respect of contracts to insure against losses arising in respect of "upland cotton".[1341]

7.1226 The four types of domestic support which permit production flexibility (PFC, MLA, DP and CCP payments) were or are provided in respect of a restricted list of products, including upland cotton, which satisfy certain specific eligibility criteria.[1342] We recall our earlier observation that we do not need to make any precise quantification for the purposes of our examination under Articles 5(c) and 6.3(c)[1343], nor do we need to ascertain the precise proportion of subsidies actually benefiting upland cotton. We nevertheless recall that we have established, as a matter of fact, that, in the case of these subsidies, there is a strongly positive relationship between recipients of these payments and current upland cotton production.[1344] The fact that some of the subsidies are paid to farmers who do not produce upland cotton presently (a small number), or that the subsidies or part of them in some cases are "captured" by landowners or others, does not alter the proposition that upland cotton production is, in fact, benefiting from the subsidies. We are, nevertheless, well aware that the particular structure, design and operation of the measures must be taken into account in discerning the effects of these subsidies in our examination of price suppression under Article 6.3(c).

7.1227 Finally, to the extent that the United States argues that it is the "subsidized product" – rather than the "effect of the subsidy" – which must cause "significant price suppression"[1345] within the meaning of Article 6.3(c) of the *SCM Agreement*, we disagree. The text of Articles 5 and 6 of the *SCM Agreement* support the conclusion that it is the effects of the United States subsidies – not the effects of the "subsidized product" – that are at issue in a claim of price suppression under Article 6.3(c). The chapeau of Article 5 states: "No Member should cause, through the use of any subsidy ... adverse effects to the interests of another Member." (emphasis added) Similarly, Article 6.3(c) provides: "Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where ... (c) the effect of the subsidy is ... significant price suppression ...". (emphasis added) These references in Articles 5(c) and 6.3(c) to the "effect of the subsidy" contrast with the language used in the countervailing duty provisions in Part V of the Agreement.[1346]

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[1340] 7 CFR 1427.103(b), reproduced in Exhibit BRA-37, in respect of user marketing (Step 2) payments, defines eligible upland cotton as "baled" upland cotton "lint"; "loose"; semi-processed and reginned (processed) motes. In the case of payments to exporters, the text of the measure indicates that an eligible exporter *includes* a producer. In the case of payments to domestic users, the United States has indicated that the Step 2 programme is also designed precisely to benefit the producer .

[1341] Some policies specify that the insured crop is upland cotton. See Exhibit BRA-174, USDA FCIC, Income Protection, Cotton Crop Provisions, section 7.

[1342] See *supra*, Section VII:D.

[1343] See *supra*, paras. 7.1177 and 7.1179

[1344] See *supra*, Section VII:D.

[1345] United States' oral statement at the resumed session of the first substantive meeting, para. 9.

[1346]For example, Article 15 of the *SCM Agreement* deals with the determination of injury in a countervailing duty investigation. Article 15.1 requires a determination of injury to be based "on positive evidence and involve an objective examination of both (a) the volume of the subsidized imports and the effect of the *subsidized imports* on prices in the domestic market for like products and (b) the *consequent impact of these imports* on the domestic producers of such products." (emphasis added, footnotes omitted). Article 15.2 states, in part: "... With regard to the *effect of the subsidized imports* on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or whether the *effect of such imports* is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, to a significant degree." (emphasis added) Similar additional references to the "effects of the imports"; "impact of the subsidized imports", "the effect of the subsidized imports" also exist in Article 15. Article 15.5 stipulates:

> "It must be demonstrated that the *subsidized imports are, through the effects of subsidies, causing injury* within the meaning of this Agreement. The demonstration of a causal

7.1228 There is no disagreement between the parties that an examination under Article 6.3(c) may precede any examination under Article 5(c). There is also no disagreement, in this part of this dispute, that an affirmative conclusion under Article 6.3(c) is a necessary[1347] element for an affirmative serious prejudice finding under Article 5(c). We will therefore first examine Brazil's claim under Article 6.3(c), which calls for an examination of "price suppression" "in the same market".

7.1229 An analysis of price suppression requires an analysis of prices. The "prices" we examine will necessarily depend upon the product and the particular market under examination. We therefore turn next to an examination of the textual condition of "in the same market" in Article 6.3(c) of the *SCM Agreement*.

(i) "In the same market"

*(i) Main arguments of the parties*

7.1230 **Brazil** asserts that the term "in the same market" in Article 6.3(c) can refer to either an individual country, regional or world market since Article 6.3(c) does not specify which geographic (or even product) markets are relevant for an analysis of price suppression.[1348] The "same market(s)" for the purposes of Brazil's price suppression claims under Article 6.3(c) are: (i) the world market for upland cotton; (ii) the Brazilian market; (iii) the United States market; and (iv) 40 third country markets where Brazil exports its cotton and where United States and Brazilian "like" upland cotton is found.[1349] Brazil submits evidence in support of its argument that global price effects in the world market – Cotlook "A-Index" and B-Index and New York futures prices and spot prices reflecting global supply and demand influences – are transmitted to the other markets.

7.1231 The **United States** argues that the later use of "in the same market" in Article 6.3(c) suggests that the significant price suppression or depression must occur when "the subsidized product" is found "in the same market" as "a like product of another Member." This phrase requires identification of a particular domestic market of a Member in which price effects are alleged to have occurred so as to allow a comparison in that market. The term "same market" in Article 6.3 (c) cannot be interpreted to include the world market because that would render redundant the word "same".[1350]

*(ii) Main arguments of the third parties*

7.1232 **Argentina** considers that Brazil has presented sufficient evidence with respect to the significant effect of subsidies on prices for each relevant geographical market, including the United States, Brazil, the African countries, other producer countries and Brazilian export markets. Argentina states that price movements of the United States, the Cotlook "A" Index and third country (e.g. Brazilian and Argentine) market prices are directly interconnected, and this is an unquestioned and irrefutable fact. Moreover, United States cotton forms part of Cotlook's "A" Index basket, so that

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relationship between the subsidized imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities." (emphasis added, footnotes omitted).

Other provisions in Part V of the *SCM Agreement* contain similar references to "through the effects of the subsidy, subsidized imports are causing injury..." e.g. Article 19.1.

[1347] There is, however, a disagreement between the parties as to whether this is not only a "necessary", but also a "sufficient" requirement. We address this issue *infra* paras. 7.1368 *ff*.

[1348] Brazil's further written submission, paras. 94-96.

[1349] Brazil's response to Panel Question No. 233.

[1350] United States' further written submission, para. 91.

the Panel cannot ignore the fact that the United States subsidies have a decisive impact on the price of cotton in the world market.[1351]

7.1233 **Benin** and **Chad** agree with Brazil that for the purposes of Article 6.3(c), the term "market" could encompass an individual country, a region, or the world market for cotton. In addition, in the view of Benin and Chad, Brazil has clearly established the causal link between United States subsidies and suppressed prices in the world market.[1352]

7.1234 The **European Communities** disagrees with the United States contention that the term "same market" in Article 6.3 (c) cannot be interpreted to include the world market because that would render redundant the word "same". In accordance with its ordinary meaning, the term "market" may refer to any geographical market, including not only national or regional markets but also the world market, provided that there is such a world market for the product under consideration. The European Communities' position is that there is no world market for the purposes of Article 6.3 (c) where the existence of trade barriers has the consequence that the conditions of competition, and in particular the price levels prevailing in one geographical area are significantly different from those prevailing in another geographical area. Unlike, for example, import duties, quotas or transport costs, subsidies do not, of themselves, insulate the prices in one geographical area from those in other areas and, therefore, do not lead to existence of separate geographical markets.[1353] The European Communities has not taken a position on the factual issue of whether, "in relation to cotton", there is a world market for the purposes of Article 6.3 (c).[1354]

*(iii) Evaluation by the Panel*

7.1235 The **Panel** naturally begins its examination with the text of the treaty. Article 6.3(c) of the *SCM Agreement* provides that serious prejudice within the meaning of Article 5(c) may arise in any case where the effect of the subsidy is "significant price suppression ... in the same market".

7.1236 We first examine the ordinary meaning of "market", which can be: "a place ... with a demand for a commodity or service"[1355]; "a geographical area of demand for commodities or services"; "the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices".[1356]

7.1237 In one of its ordinary meanings, therefore, the term "market" may refer to a (geographical) area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices. While we understand there to be a geographic implication to the term, we also see that there is no limitation or restriction on the scope of such a geographic area of economic activity. It could, for example, be a local, regional, national, continental or, even, global, geographical area, provided that the conditions of competition for sales of the product in question provides an appropriate foundation for a finding that a "market" exists within that area. The degree to which a market is limited by geography will depend on the product itself and its ability to be traded across distances. If barriers exist (such as distance), the interaction between buyers and sellers which allows one price to affect another may not be apparent.

7.1238 Returning to the text of the treaty, we see that Article 6.3(c) of the *SCM Agreement* also does not identify any particular "same market" where price suppression must be demonstrated. It does not specify that there must a particular "domestic" "same market". The ordinary meaning of the term is

[1351] Argentina's oral statement at the resumed session of the first substantive meeting, paras. 23-26.
[1352] Benin and Chad's written submission to the resumed session of the first substantive meeting, para. 6.
[1353] European Communities' response to Panel third party Question No. 47.
[1354] European Communities' response to Panel third party Question No. 45.
[1355] *The New Shorter Oxford English Dictionary*, (1993).
[1356] *Merriam-Webster Dictionary online.*

not constrained to a particular geographic area of economic activity. The text of the provision does not, therefore, exclude the possibility that the "world market" could be relevant to our inquiry into price suppression under Article 6.3(c).

7.1239 Furthermore, the text of Article 6.3(c) of the *SCM Agreement* does not refer either to "imports" into or "exports" out of any particular Member's market, or any particular market at all. It therefore leaves open the possible geographical frame of reference that might define a market as a "world market".

7.1240 The immediate context of the provision would also support the view that the term "market" refers to a geographical area, and, furthermore, that there is no geographical or conceptual limitation on the connotation of "market" in Article 6.3(c) of the *SCM Agreement*. Articles 6.3(a) and (b) of the *SCM Agreement* each identify a particular "market" and a particular trade flow. They refer, respectively to: "imports into" "the market of the subsidizing Member"; and "exports" from "a third country market". Had the drafters wished to identify or place a conceptual or geographical constraint on the particular market that must be examined for the purposes of Article 6.3(c), they could have. However, they did not. The absence of a similar reference to any particular trade flows "into" or "out of" (a) Member'(s') domestic market(s), would therefore support the view that the "market" for the purposes of an Article 6.3(c) examination of price suppression is an unspecified geographical area that could include a "world market".[1357]

7.1241 Further contextual guidance is present in other provisions of the *SCM Agreement*.

7.1242 For example, Article 15.2 of the *SCM Agreement*, dealing with a price suppression examination in the course of a countervailing duty investigation, states, in pertinent part:

> "... With regard to the effect of the subsidized imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or *whether the effect of such imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, to a significant degree*...".(emphasis added)

7.1243 That provision indicates clearly that the "market" frame of reference for the price suppression examination is the domestic market of the importing Member. The trade flow involved is "such imports", that is, the subsidized imports that are exported by the allegedly subsidizing Member into the market of the Member conducting the countervailing duty investigation Furthermore, the Agreement itself contemplates the compartmentalization of a Member's domestic market in certain situations where there may be a localized or targeted impact in a certain geographic area within the importing Member's market.[1358] The absence of any such (or analogous) explicit requirement (or

[1357] The existence of such a "world market" could depend on many factors. The nature of the "market" to be examined for the purposes of Article 6.3(c) may well differ from case to case depending upon the facts of the particular case, including the commodity or "subsidized product" at issue. Indeed, there may not always be a "world market" for any given product. In order to characterize a certain geographical area, whether it is the territory of one or more Members or the entire world, as a "market", the conditions of competition prevailing within that geographical area would need to manifest at least some degree of homogeneity. The conditions of competition for sales of the product in question would have to provide an appropriate foundation for a finding that a "market" exists within that area.

[1358] Article 16.4 of the *SCM Agreement* states:

> "In exceptional circumstances, the territory of a Member may, for the production in question, be divided into two or more competitive markets and the producers within each market may be regarded as a separate industry if *(a)* the producers within such market sell all or almost all of their production of the product in question in that market, and *(b)* the demand in that

permission) in Article 6.3(c) to constrain the meaning of "market" to any particular geographic area, or to focus particularly upon a particular trade flow (i.e. imports into, or exports from, a particular areas) supports the view that we are not precluded from reading the term "market" as including a geographical area which may embrace the entire world.

7.1244 This is consistent with the object and purpose of the Agreement, which is to reduce trade distortion through the grant of subsidies by Member governments.[1359] Trade distortion may occur in multiple possible geographical areas.

7.1245 Here, the product we are dealing with is upland cotton. It is a fungible commodity that does not rapidly spoil and is readily transportable, and that is, in fact, regularly traded in large quantities all over the world.[1360] Key participants in this upland cotton market are producers and consumers of upland cotton. As with any basic, fungible commodity, prices for upland cotton are determined by supply and demand. Market prices are affected by the perception and anticipation of market participants as to current and probable future movements of production and consumption as essential determinants of demand, supply, and, consequently, price.[1361]

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market is not to any substantial degree supplied by producers of the product in question located elsewhere in the territory. In such circumstances, injury may be found to exist even where a major portion of the total domestic industry is not injured, provided there is a concentration of subsidized imports into such an isolated market and provided further that the subsidized imports are causing injury to the producers of all or almost all of the production within such market."

[1359] See *supra*, Section VII:E, footnote 920.

[1360] For example, International Cotton Advisory Committee, *Cotton: World Statistics* (September 2002), reproduced in Exhibit BRA-9 and International Cotton Advisory Committee, *Cotton: World Statistics* (September 2003), reproduced in Exhibit BRA-208, indicate worldwide cotton supply and use, and cotton supply and use in 68 countries, and production, consumption imports and exports of cotton lint in recent years. See also Cotton Outlook; USDA ERS, Cotton and Wool Outlook (Exhibits BRA-10, -20, -189, -253, -328, and -382). We recall, as well, for example, Chad's oral statement at the resumed session of the first substantive meeting, paras. 7-11.

USDA ERS recognizes that "Trade is particularly important for cotton. Thirty per cent of the world's consumption of cotton fiber crosses international borders before processing, a larger share than for wheat, corn, soybeans, or rice...". See USDA ERS, Briefing room, Cotton: Background (from www.ers.usda.gov), reproduced in Exhibit BRA-13.

[1361] We recall the statement of Mr. Andrew MacDonald, retained by Brazil and a member of Brazil's delegation at the resumed session of the first substantive meeting and the second substantive meeting with the Panel. Annex II to Brazil's further written submission contains a notarized "declaration" of Mr. MacDonald dated 21 May 2003. Mr. MacDonald's statement is focused on upland cotton only, and references to "cotton" are to "upland cotton". A written version of Mr. MacDonald's oral statement at the resumed session of the first substantive meeting with the Panel is provided in Exhibit BRA-281. See, in particular, para. 4 of Exhibit BRA-281 and para. 11 of Annex II to Brazil's further written submission. See also *supra*, footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings, and *infra*, footnote 1375 on Mr. MacDonald's further involvement. The record indicates that, at the time of this Panel proceeding, Mr. MacDonald is the Vice President and "President-elect of the Liverpool Cotton Association and will take office as its President in 2004"; President of the Private Sector Advisory Panel of the International Cotton Advisory Committee; and Chairman of the Spinners' Committee of the International Textiles Manufactures Federation, and had worked for thirty years in the "cotton business", including purchasing and negotiating upland cotton from a variety of sources, trading cotton futures in the New York Futures market, reviewing "leading cotton trade journals" such as "Cotton Outlook" on a daily basis. Mr. MacDonald "never worked for producers of upland cotton". Mr. MacDonald indicated that his "experience is that of a businessman intimately familiar with the factors and mechanisms that are used to price and negotiate price for upland cotton in many individual countries, as well as the international market." Mr. MacDonald also provided expert opinion evidence on another issue in Exhibit BRA-401.

7.1246 While certain WTO Members and non-Members may produce, consume and/or export cotton relatively more or less upland cotton than others[1362], and world trade flows of upland cotton may vary in volume over different periods of time across various countries and regions of the world, we see no factual elements in the record before us that would lead us to conclude that there is a necessity geographically to compartmentalize our analysis or to superimpose any degree of regional/continental/national/sub-national isolation or to limit our analysis to particular isolated impacts in a particular geographical area. We would also point out that it is not our task to select an appropriate market: it is for the complaining Member to identify the market for the purposes of its claim. We then determine whether it is a "market" within the meaning of Article 6.3(c) and whether the effect of the subsidy is proven in that market.

7.1247 Our conclusion that such a world market, in fact, exists in this case, does not preclude the existence of other relevant markets for the purposes of our analysis. In saying that a "world market" may exist for upland cotton, we do not mean to construct a monolithic "world market" that reads out every other possible connotation of "market" under Article 6.3(c).

7.1248 Therefore, this does not mean that we cannot also conduct another inquiry into other geographical areas within the world market, which meet the definition of "same market" in the sense of Article 6.3(c). This would not, however, permit, for example, coupling an examination of Brazil's product under the conditions of competition prevailing in one Member's market with an examination of the United States' product under the conditions of competition prevailing in *another* Member's market. This would not meet the definition of "same market" because the frame of reference would necessarily have to be, at that level, either one or the other Member's market in which both Brazilian and United States upland cotton were present and competing for sales. Applying the frame of reference of a geographic region consisting of a particular Member's market, it could not be two different such "markets".

7.1249 We therefore disagree with the United States assertion[1363] that, if a complaining party could merely assert price suppression or depression in the world market, the word "same" in the phrase "the same market" would be rendered inutile because the subsidized and non-subsidized products could always be deemed to be in the same "world market". If there truly is a world market for a given commodity, which we believe there is in the present case, then our price suppression analysis in the context of that world market would occur within that frame of reference. The selection of the relevant market will then impact upon the concepts of effect (of the subsidy), significance (of the price suppression) and seriousness (of the prejudice) under the relevant articles.

7.1250 We believe that our interpretation allows the text of Article 6.3(c) to be read effectively in its context. Annex V of the *SCM Agreement* contains "Procedures for Developing Information Concerning Serious Prejudice." Paragraph 1 of Annex V requires that the parties to the dispute and any third-country Member concerned shall notify to the DSB, as soon as the provisions of Article 7.4 have been invoked, the organization responsible for administration of this provision within its territory and the procedures to be used to comply with requests for information. Article 6.6 of the *SCM Agreement* states that "[e]ach Member *in the market of which* serious prejudice is alleged to have arisen shall ... make available ... all relevant information ... as to the changes in market shares of the parties to the dispute as well as concerning *prices of the products involved*" (emphasis added).

7.1251 Furthermore, the information gathered during the information-gathering process "should include, *inter alia*, data concerning the amount of the subsidy in question (and, where appropriate, the value of total sales of the subsidized firms), *prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers to the market*, changes in the supply of the subsidized product *to the market in question* and changes in market shares." (emphasis added) Our

[1362] See, for example, Exhibits BRA-9 and BRA-209.
[1363] United States' response to Panel Question No. 159.

interpretation allows these provisions to be read also as applying to particular markets where competition exists between Brazilian and United States upland cotton.

7.1252 Similarly, we do not agree with the United States' proposition that the subsidized and other products could never be found in the same geographic market and still be considered to be in the same "world market". In our view, as we have already indicated, the world market *is* a geographic market. Where price suppression is demonstrated in that market, it may not be necessary to proceed to an examination of each and every other possible market where the products of both the complaining and defending Members are found.

(j) Is there price suppression in the same world market?

*(i) Main arguments of the parties*

7.1253 **Brazil** asserts that "price suppression" in Article 6.3(c) of the *SCM Agreement* refers to the situation where prices are prevented from rising (i.e. but for the subsidies, market prices would have been higher) or where prices actually declined.[1364] Brazil asserts that the effects of United States subsidies in MY 1999-2002 cause "significant price suppression" in the Brazilian, United States and world markets.

7.1254 Brazil states that "significant" price suppression is such as to meaningfully affect suppliers (i.e., Brazilian, African and other non-United States suppliers) competing with the subsidized product. Brazil further argues that "significance" may also be judged in appropriate situations based on the vulnerability of a Member and its affected industry to serious prejudice from even smaller amounts of price suppression.[1365]

7.1255 The **United States** submits that there has been no "price suppression" within the meaning of Article 6.3(c) of the *SCM Agreement*. The United States does not agree that a world market for upland cotton can exist, as Article 6.3(c) requires an examination of a Member's domestic market where both Brazilian and American upland cotton are competing for sales. The United States disagrees that Brazil has established price suppression in any "same market" within the meaning of Article 6.3(c).

7.1256 For the United States "significant" modifies "price suppression or depression" and therefore, it is the effect on prices that must be "significant" and not the direct effect on producers. Such price suppression must be demonstrated in respect of Brazilian products alone.[1366] The United States disagrees with Brazil that the meaning of "significance" may vary depending upon the complaining Member. The United States asserts that Brazil's developmental status is irrelevant for purposes of Article 6.3(c).[1367]

*(ii) Main arguments of the third parties*

7.1257 **Argentina** states that it does not understand how the United States can simply brush aside the Panel's findings in *Indonesia - Autos*, since this was the only dispute under the GATT-WTO that dealt with the interpretation of the term "significant". Argentina also fails to understand how the United States can claim that Brazil argued that it is the effect on producers that must be significant, and not on prices, when Brazil has submitted copious evidence, based on numerous empirical and econometric analyses, of the effects of the subsidies on prices. Argentina states that an increase in the world price of cotton would be significant, even if international price suppression or depression were

[1364] Brazil's further written submission, paras. 83-89.
[1365] Brazil's further written submission, paras. 94-97.
[1366] United States' further written submission, para. 86.
[1367] United States' further written submission, paras. 85-87.

to amount to only one per cent per pound, since such an increase would enable countries such as Brazil and Argentina to recover their competitive positions in the world cotton market. At no time does the United States seem to suggest that a suppression or depression effect of 12.6 per cent on international cotton prices is not "significant" within the meaning of Article 6.3(c).[1368]

7.1258 The **European Communities** takes issue with Brazil's interpretation that it is relevant to consider not only the impact on the producers concerned, but also the impact on the government of the complaining Member in assessing the "significance" of price depression or suppression for the purposes of Article 6.3 (c). The European Communities contends that Brazil's interpretation belies the correct approach it advances elsewhere that the existence of serious prejudice must be presumed whenever it is established that the effect of the subsidy is to cause, *inter alia*, significant price depression or suppression, without it being necessary to show, as an additional and separate requirement, that such price depression or suppression causes a serious prejudice to the interest of the Member concerned. The European Communities also rejects Brazil's suggestion that the threshold for establishing the existence of serious prejudice should be lower when the complaining party is a developing country Member, as Article 6.3 (c) is not special and differential treatment provision.[1369]

7.1259 **New Zealand** agrees with Brazil that even a very small level of price suppression may have a meaningful effect, for example where large volumes of a product may be traded. New Zealand asserts that the United States argument that the significance of the price suppressive effect of the subsidy can only be determined by reference to the effect on 'price' should be rejected since Articles 5 and 6 are concerned with the adverse effects of a subsidy and therefore, it is entirely appropriate under Article 6.3(c) to consider whether price suppression is "significant" by reference to the effect of the price suppression on the Member alleging adverse effects to its interests. According to New Zealand, what renders price suppression significant or insignificant is whether or not it causes adverse effects to the Member concerned, not whether or not an arbitrary level of numeric significance is achieved as implied by the United States.[1370] Such an approach is not inconsistent with the United States assertion that the drafters of Article 6.3(c) used the term "significant" to create a threshold to ensure that not just "any theoretical price effect" would suffice.[1371] For New Zealand, the phrase "in the same market" serves to locate the price suppressive effects rather than define their substance.[1372]

*(iii) Evaluation by the Panel*

i Is there a world market "price"?

7.1260 We begin our examination, as always, with the relevant text of the treaty. Article 6.3(c) of the *SCM Agreement* calls for an examination of whether "the effect of the subsidy is a ... significant price suppression, price depression or lost sales in the same market."

7.1261 "Price" suppression requires an examination of "prices". Before examining whether or not price suppression in the world market exists, we first discern which "price" we are to examine in the "world market".

[1368] Argentina's oral statement at the resumed session of the first substantive meeting, paras. 18-22.
[1369] European Communities' written submission to the resumed session of the first substantive meeting, paras. 5-9.
[1370] New Zealand's written submission to the resumed session of the first substantive meeting, paras. 2.21, 2.23 and 2.24.
[1371] New Zealand's written submission to the resumed session of the first substantive meeting, para. 2.25.
[1372] New Zealand's written submission to the resumed session of the first substantive meeting, paras. 2.26-2.27.

7.1262 The ordinary meaning of "price" is: "the amount of money or goods for which a thing is bought or sold"; "value or worth".[1373]

7.1263 Brazil focuses on the A-Index and the New York Futures price as the bases for its world market "price suppression" allegations. The United States, contends that while these price discovery mechanisms are "price quotes", neither constitutes an actual world market "price" which may be the subject of an analysis under Article 6.3(c) of the *SCM Agreement*.

7.1264 The "A-Index" is a composite of an average of the five lowest price quotes from a selection of the principal upland cottons traded in the world market obtained by Cotlook, a private UK-based organization.[1374] The New York Cotton futures index reflects an exchange of a standard futures contract (Cotton No. 2 futures contract). The issue before us is whether we may consider either or both of these as a "price" for the purposes of analysing whether or not "price suppression" has occurred in the same "world market" for the purposes of Article 6.3(c) of the *SCM Agreement*.

7.1265 We first consider the A-Index. There are four main reasons why we believe that we may consider it as a "price" for the purposes of analysing whether or not "price suppression" has occurred in the same "world market" for the purposes of Article 6.3(c) of the *SCM Agreement* in this dispute.

7.1266 First, in respect of the upland cottons comprising the constituent elements of the A-Index, both Brazilian Middling 1 3/32" and United States prices for Memphis and California/Arizona Middling 1 3/32" are among the constituent quotes.

7.1267 Second, we have before us credible evidence that the A-Index "summarizes price developments of the physical market [for upland cotton] in various countries around the world" and that the A-Index is perceived by key market participants – growers, consumer and traders – as reflecting the "world" market price for upland cotton.[1375]

7.1268 Third, we find consistent, supporting evidence in the fact that the International Cotton Advisory Council refers to the A-Index as expressing "world" or "international" "cotton prices".[1376]

7.1269 Fourth, and perhaps more relevantly for the purposes of this dispute, the USDA ERS has itself referred to the A-Index as the "world price"[1377] and as the "indicator of world price levels"[1378] and as a measurement of United States relative [upland] cotton competitiveness in the "world market".[1379]

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[1373] *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

[1374] "Cotton Outlook", April 5 2002, p. 2, reproduced in Exhibit BRA-11. See also http: www.cotlook.com. The prices are quoted c.i.f Northern Europe.

[1375] See contributions of Mr. Andrew MacDonald, retained by Brazil and a member of Brazil's delegation, in Annex II to Brazil's further written submission and Exhibit BRA-281. See also *supra*, footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings, and footnote 1361 on Mr. MacDonald in particular. Mr. MacDonald also states: "The A and B-Index reflects how interconnected the 'world' price for cotton is with the prices of cotton in the individual country markets that make up these indices".

[1376] Exhibit BRA-19.

[1377] The United States government has itself referred to the A-Index as the "world price", USDA ERS "Cotton and Wool Outlook", p. 3, Figure 2, reproduced in Exhibit BRA-20,: "World price rises 45 per cent during March 2002-March 2003", citing source: "Cotlook Limited". The accompanying text reads: "...the world price of cotton has risen 45 per cent from March 2002 to March 2003". The United States government has also referred to the A-Index as the "indicator of world price levels", USDA ERS "Background for 1995 Farm Legislation", p.12, reproduced in Exhibit BRA-12. It has also referred to the A-Index as a measurement of United States relative cotton competitiveness in the "world market". *Ibid*, p. 19, first column: Addressing developments in the A-Index during the period MY 1991-MY 1993: "Over 85 per cent of the time U.S. cotton was selling competitively on the 'world market' ". We further recall the Appellate Body's reference to "world

7.1270 Moreover, and perhaps most importantly, the United States government relies upon the A-Index as a "price" which is a key determinant for whether or not certain of its market condition-contingent subsidies will be paid.[1380] The United States "adjusted world price" is precisely an adjustment of the A-Index which, by necessary implication, would mean that the A-Index represents – at least in the estimation of the United States government for the purposes of its subsidies to upland cotton – the "world price" which is achievable in the market in which United States upland cotton competes.[1381]

7.1271 The United States "adjusted world price" is *based on* and *derived from* the A-Index. It is adjusted to United States base quality and average location.[1382] The USDA announces the "adjusted world price" and CCA each Thursday, when the USDA also announces consequent loan deficiency payment rates and user marketing (Step 2) certificate payment rates for upland cotton.[1383]

7.1272 Rather than reflecting "disparate price quotes from around the world" as the United States asserts, the considerations we have just mentioned rather lead us to conclude, as a matter of fact, on the basis of our assessment of the evidence before us, including the oral statements of various Members of the parties' delegations at the meetings of the Panel with the parties[1384], that the A-Index may serve as an indication of the "world price" – in terms of the "amount of money set for sale of upland cotton" or the "value or worth" of upland cotton – for the purposes of our analysis of whether or not price suppression has occurred in the same "world market" under Article 6.3(c) of the *SCM Agreement*.

7.1273 We next examine the New York Futures Exchange futures contract values. This value is a reflection of market forces of supply and demand at a futures market, based in New York, where daily trading is conducted, and contracts are entered into, on the basis of price levels that reflect the daily perception of the probable future direction of upland cotton prices.[1385] We believe that the A-Index

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market prices" as a benchmark in another context. See, for example, Appellate Body Report, *Canada – Dairy(Article.21.5, – New Zealand and US)*, paras. 86 *ff*.

[1378] USDA ERS "Background for 1995 Farm Legislation", p.19, reproduced in Exhibit BRA-12.

[1379] *Ibid*, p. 19, first column: Addressing developments in the A-Index during the period MY 1991-MY 1993: "Over 85 per cent of the time U.S. cotton was selling competitively on the 'world market' ".

[1380] i.e., concerning the marketing loan programme payments: Sections 1201(a)-(b), 1202(a)(6), 1202(b)(6), 1204(b), 1205(a)(1), 1205(b), 1205(c)(1), 1608 of the FSRI Act of 2002 and 7 USC 7286 (Section 166 of the FAIR Act as amended) and 7 CFR 1427.22; and concerning the user marketing (Step 2) payments, Section 1207(a) of the FSRI Act of 2002; 7 CFR 1427.107 and section 136 of the FAIR Act of 1996.

[1381] The United States government effectively acknowledges, in another context, that the name itself is indicative of its role: "In the case of upland cotton, the alternative repayment rate is the adjusted world price (AWP) and reflects, as the name indicates, an estimate of world prices, adjusted to the United States". See Exhibit BRA-50.

[1382] The adjusted world price for individual qualities is determined using the schedule of loan premiums and discounts and location differentials. A "coarse count adjustment" (CCA) may be applicable for cotton with a staple length of 1-1/32 inches or shorter and for certain lower grades with a staple length of 1-1/16 inches and longer.

[1383] See FSA, News Release: "USDA announces prevailing world market price, loan deficiency payment rate and user marketing certificate payment rate for upland cotton", reproduced in Exhibit US-72. This Exhibit also gives a indication as to how the AWP (and CCA) are determined.

[1384] Statement of Andrew MacDonald, Annex II to Brazil's further submission and Exhibit BRA-281. See *supra*, footnotes 1375 and 1323.

[1385] Statement of Mr. Andrew MacDonald, Annex II to Brazil's further written submission and Exhibit BRA-281: "The New York Cotton Exchange's futures market is the only important futures market for cotton in the world. Trading is conducted with price levels reflecting the daily perception of the market participants worldwide, on how prices will develop in the future, as well as in the near and medium-term[...]. It is the principle price and trend indicator for the whole worldwide cotton market, and as such the 'New York futures price' is a key mechanism used by the growers, trade and cotton consumers in determining the current market

and the New York Futures Index have different functions and rationale: one summarizes actual daily upland cotton price quotes under certain conditions; the other is, *inter alia*, an instrument for global price discovery for future delivery of cotton. While we do not understand the United States to disagree with the proposition that the New York futures values are prospectively indicative of market-based price expectations, we do not need to rely on these values as a current "world price" for the purposes of our examination under Article 6.3(c).

7.1274 We therefore find, as a factual matter, that the A-Index can be taken to reflect a world price in the world market for upland cotton that is sufficient to form the basis for our analysis as to whether there is price suppression in the same world market within the meaning of Article 6.3(c) for the purposes of this dispute.

ii Is there "price suppression"?

7.1275 The current text of Part III of the *SCM Agreement* does not provide a definition or any interpretative guidance concerning the meaning of "price suppression" or "depression" as those terms are used in Article 6.3(c) of the *SCM Agreement*.

7.1276 The ordinary meaning of "suppress" is "[p]revent or inhibit (an action or phenomenon)";[1386] "Depression" can be defined as: "the action of pressing down; the fact or condition of being pressed down"[1387]

7.1277 Thus, "price suppression" refers to the situation where "prices" – in terms of the "amount of money set for sale of upland cotton" or the "value or worth" of upland cotton – either are prevented or inhibited from rising (i.e. they do not increase when they otherwise would have) or they do actually increase, but the increase is less than it otherwise would have been. Price depression refers to the situation where "prices" are pressed down, or reduced.[1388]

7.1278 This reading of the textual terms "price suppression" and "depression" in Article 6.3(c) of the *SCM Agreement* finds general contextual support in Article 15.2 of the *SCM Agreement*, which, for a Member's countervailing duty investigation, requires an examination of "...whether the effect of [the subsidized] imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred ... ".

7.1279 The text of Article 6.3(c) of the *SCM Agreement*, in its context, indicates that we need to undertake an inquiry into whether upland cotton prices either were pressed down, prevented or inhibited from rising, or while they did actually increase the degree and magnitude of increase was less than it otherwise would have been.

7.1280 We next turn to the question of how we assess whether or not "price suppression" has occurred in the same "world market" which we have found to exist. We believe the following considerations are relevant to our examination: (a) the relative magnitude of the United States' production and exports in the world upland cotton market; (b) general price trends; and (c) the nature of the subsidies at issue, and in particular, whether or not the nature of these subsidies is such as to have discernible price suppressive effects. We examine each of these considerations in turn.

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values as well as the contract prices for forward deliveries, in both the international and domestic markets." See *supra*, footnotes 1375, 1384 and 1323.

[1386] *The New Shorter Oxford English Dictionary*, (1993).

[1387] *The New Shorter Oxford English Dictionary*, (1993).

[1388] In the remainder of our analysis, we use the term "price suppression" to refer both to an actual decline (which otherwise would not have declined, or would have done so to a lesser degree) and an increase in prices (which otherwise would have increased to a greater degree).

a. relative magnitude of United States' production and exports

7.1281 We begin with the relative magnitude of the United States' production and exports in the world upland cotton market in the marketing years 1999 to 2002.

7.1282 In the period under consideration, the United States was the world's second largest producer of upland cotton, accounting for approximately one-fifth of world production.[1389] In the marketing years 1999 to 2002, the respective shares of the United States in world production of upland cotton were approximately 19.2, 19.3, 20.6 and 19.6 per cent, respectively.

7.1283 Furthermore, the United States was the world's largest exporter of upland cotton during the marketing years 1999 to 2002. According to the record evidence, the United States share of world exports increased from approximately 23.5 per cent in MY 1999 to 24.5 per cent in MY 2000 to 37.3 per cent in MY 2001 to 39.9 per cent in MY 2002.[1390]

7.1284 In comparison, according to record evidence, Brazil's share of world production of upland cotton was approximately 3.8 to 5 per cent in the marketing years 1999 to 2002, while Brazil's share of world exports of upland cotton never exceeded 2.4 per cent in the same period.[1391]

7.1285 We believe that, due to the large relative proportion of the United States production and export of upland cotton, the United States exerted a substantial proportionate influence on prices in the world market for upland cotton.

b. general price trends

7.1286 In terms of general price trends, the United States acknowledges that market prices in recent years have been "extraordinarily low"[1392], and even that there was a "dramatic plunge" in prices.[1393]

7.1287 We asked the parties to provide us with a chart of the weekly United States adjusted world price, the A-Index, the nearby New York futures price, the average United States spot market price and prices received by United States producers from January 1996 to the present. Brazil's submission[1394], which does not materially differ from that of the United States[1395], is as follows:

[1389] We estimated the shares for upland cotton using the World Cotton Statistics of the International Cotton Advisory Committee (Exhibit BRA-208), by subtracting the data for production/exports of "extra-fine cotton" from production/exports of "cotton". We note that the United States share of word upland cotton production in MY 1998 was approximately 16 per cent.

[1390] According to data submitted by Brazil (Exhibit BRA-302), the United States share in world exports of upland cotton were 24.1 per cent, 24.7 per cent, 38.3 per cent and 41.6 per cent in the marketing years 1999 to 2002, respectively. The United States also submitted data pertaining to the United States share in world exports of upland cotton, in response to Panel Question No. 160, as well as in, for example, Exhibits US-119 and -120. They show an increase during the marketing years 1999 to 2002, as follows: 1999/2000: 24.1 per cent; 2000/01: 24.7 per cent; 2001/02: 38.2 per cent; 2002/03: 39.3 per cent. We note that while the absolute figures provided by the United States in response to Panel Question No. 160 differ slightly from those of Brazil, they are of the same general order of magnitude and direction. Our analysis is not materially affected by the slight differences in the figures submitted by the parties.

[1391] We estimated the shares for upland cotton using the World Cotton Statistics of the International Cotton Advisory Committee (Exhibit BRA-208), by subtracting the data for production/exports of "extra-fine cotton" from production/exports of "cotton".

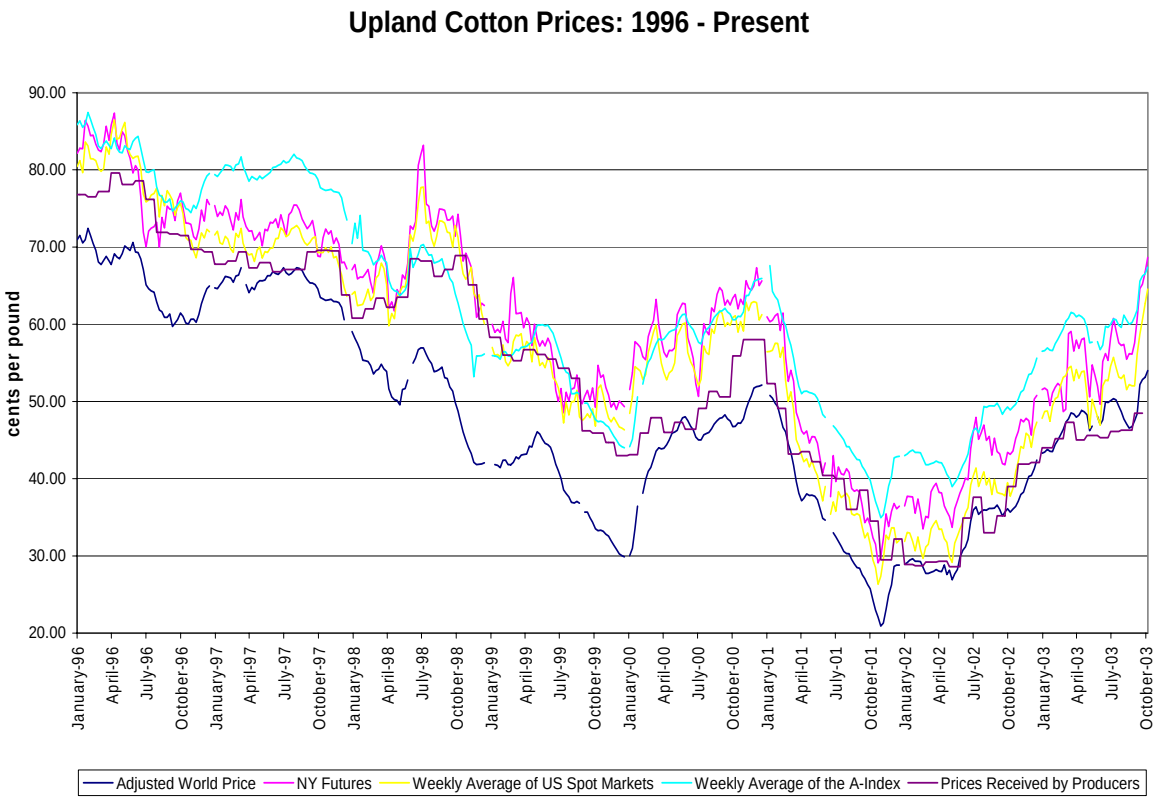
[1392] e.g. United States' oral statement at the resumed session of the first substantive meeting, para. 21.

[1393] United States' further written submission, para. 17.

[1394] Exhibit BRA-311, indicating that the data was obtained from the Cotton Outlook published by Cotlook, Ltd.

[1395] Exhibit US-73.

**Chart 1: Various upland cotton "prices" and "indicators"**




7.1288 This depicts a broad decline in the overall level of these price trends from 1996 through the beginning of calendar year 2002, with intermittent peaks and valleys. From 2002, there is a general upward trend. This chart also demonstrates that there is a broad similarity in many of the price trends depicted. The fact that prices dropped from 1996 through the beginning of 2002 is relevant. However, it is not, in and of itself, conclusive for a determination of price suppression. Nor is the increase from 2002 conclusive that a determination that any price suppression necessarily ceased at that point. We need to examine whether these prices were suppressed, that is, lower than they would have been without the United States subsidies in respect of upland cotton.

c. nature of the subsidies

7.1289 In this respect, we first recall that the existence of the United States subsidies challenged in this dispute is not in question. We consider that the *nature* of the United States subsidies at issue – in terms of their structure, design and operation – is relevant in assessing whether or not they have price suppressing effects. We see before us two general types of United States subsidies: those that are directly price-contingent, and those that are not. We consider that, in light of the guiding considerations we have already outlined[1396], this distinction is critical for the purposes of our price suppression analysis in terms of the nexus which the subsidies have to any price suppression and to the subsidized product at issue. We examine each of these two types of subsidies in turn.

[1396] *Supra*, paras. 7.1191-7.1194.

*(i) price-contingent subsidies*

7.1290 We consider it highly relevant that certain of the United States subsidies are directly linked to world market prices. Foremost among these are the marketing loan programme payments and the user marketing (Step 2) payments. MLA payments and CCP payments are also included in this category. We examine each in turn.

7.1291 First, under the marketing loan programme[1397], benefits to producers result when the United States adjusted world market price falls below the loan rate. The repayment rate for upland cotton is the lower of the two. When the adjusted world market price is lower than the loan rate, the producer repays at less than the loan rate. This difference is referred to as a "marketing loan gain". Alternatively, a producer may forego a marketing loan and receive a "loan deficiency payment" ("LDP") in the amount of the difference between the lower adjusted world market price and the loan rate. Where producers repay at less than the loan rate, there is patently a financial contribution supplementing the income of the producer. We have no doubt that the payments stimulate production and exports and result in lower world market prices than would prevail in their absence. Moreover, the text of the measure indicates that the payments are mandatory, where certain market conditions prevail.[1398]

7.1292 The magnitude of payments under the marketing loan programme was – and continues to be – countercyclical and dependent upon the adjusted world price, which is derived from the A-Index. The greater the difference between the adjusted world price and the marketing loan rate, the greater the subsidy payment.

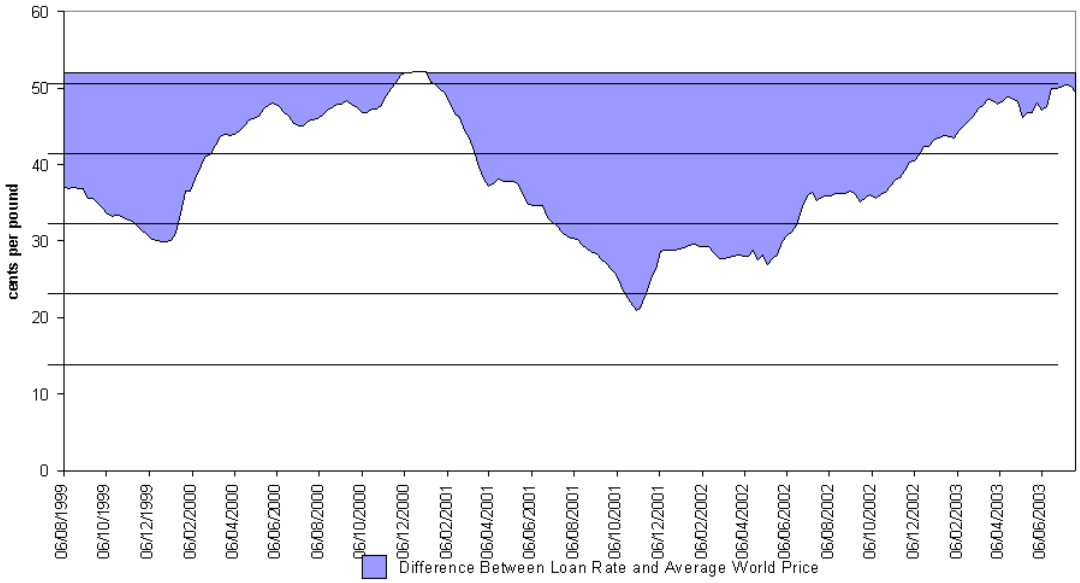
7.1293 The proposition that the per unit payment under the marketing loan programme increases when the gap between the adjusted world price and the loan rate widens is borne out by the following graph:[1399]

[1397] See our description of the measure s*upra*, Section VII:C.

[1398] Section 1201(a) of the 2002 FSRI Act provides that "... the Secretary shall make available to producers on a farm nonrecourse marketing assistance loans for loan commodities produced on the farm"; and "[t]he producers on a farm shall be eligible for a marketing assistance loan for any quantity of a loan commodity produced on the farm." Section 1202 sets out the loan rate for upland cotton. See Exhibit BRA-29. We refer to and incorporate our general discussion of the mandatory/discretionary distinction in Section VII:C. We also refer to and incorporate *mutatis mutandis* our findings in Sections VII:E and F that section 1601(e) of the FSRI Act of 2002, pertaining to expenditures under subtitles A through E of the FSRI Act of 2002, addresses levels of domestic support for the purpose of a Member's domestic support commitments under the *Agreement on Agriculture*. However, it does not deal with a Member's compliance with the serious prejudice provisions of the *SCM Agreement* and therefore is not legally relevant here.

[1399] Brazil's response to Panel Question No. 167, para. 150.

**Chart 2: Difference between loan rate and adjusted world price**




7.1294 This graph illustrates that except for a short period in MY 2000, the adjusted world price was *below* the marketing loan rate throughout virtually *the whole period from* MY 1999-2002. The shaded portion of the graph corresponds to the difference between the adjusted world price and the marketing loan rate of approximately 52 cents. The graph indicates that the marketing loan subsidy by the United States government, at certain points, was greater than the market value of the product itself. It accounted for *more than half* of the difference between the adjusted world price and the marketing loan rate (and thus of United States upland cotton producer revenue). The further the adjusted world price drops, the greater the extent to which United States upland cotton producers' revenue is insulated from the decline, numbing United States production decisions from world market signals.

7.1295 We concur with Brazil, who cited certain USDA economists[1400] in support, that the structure, design and operation of the marketing loan programme has enhanced production and trade-distorting effects.[1401] The payments stimulate production and exports and result in lower world market prices than would prevail in their absence. The counter-cyclical nature of the programme means that the lower the United States adjusted world price, the greater the magnitude of the subsidy received by United States upland cotton producers over a given time period.

7.1296 Over the period MY 1999-2002 shown in the chart above, when United States prices decreased, due to the marketing loan's impact on United States production of upland cotton, this did not have the effect of decreasing United States production or export. Rather, we see that United States production and exports essentially continued or increased over the period MY 1999-MY 2002, reflecting the enhanced competitiveness of United States producers in world trade.[1402] The structure of the measure, directly linked to the A-Index, affects the world market generally. In particular over the period MY 1999-MY 2002, the United States adjusted world price, that is, the determinative price for the availability and magnitude of the United States marketing loan programme payments and user

[1400] See e.g., Exhibits BRA-222 and -223.

[1401] The fact that theUnited States notifies the marketing loan programme as "amber box" support under the *Agreement on Agriculture* may not necessarily be determinative for the purpose of our "adverse effects" analysis under Part III of the *SCM Agreement*.

[1402] See e.g., Exhibit BRA-223.

marketing (Step 2) payments was almost always below – and at times well below – this marketing loan rate throughout this period.

7.1297 While we do not believe it is necessary to calculate the precise amount of the subsidies in question, we observe that we have this information readily available on the record.[1403] This is a very large amount.

7.1298 Turning next to user marketing (Step 2) payments[1404], we see that they contribute to artificially higher prices for United States upland cotton in the way of eliminating any positive difference between United States internal prices and international prices of upland cotton.[1405]

7.1299 *Ceteris paribus*, in the case of user marketing (Step 2) payments to exporters, the relatively lower prices that the foreign purchaser must pay have a positive impact on export demand for United States upland cotton. Similarly, payments to domestic users stimulate the demand for United States upland cotton by domestic users to the same degree that lower prices of United States upland cotton would stimulate such demand. User marketing (Step 2) payments tend to enhance the demand for United States upland cotton and raise the price received by upland cotton producers.[1406] The payments therefore stimulate production and exports and result in lower world market prices than would prevail in their absence.

7.1300 Furthermore, as the triggering, and magnitude, of user marketing (Step 2) payments are also linked to prices – indeed, they are contingent upon the relationship between the A-Index and the United States adjusted world price – the observations that we have made above in the context of the marketing loan programme payments are similarly applicable here.[1407] The structure of the measure, directly linked to the A-Index, affects the world market generally. While we do not believe it is necessary to calculate the precise amount of the subsidies in question, we observe that we have this information readily available on the record.[1408] This is a very large amount.

7.1301 Third, United States upland cotton producers were also receiving MLA payments and CCP payments, which are/were also expressly linked to market prices. The United States has acknowledged that MLA payments were paid in light of low commodity prices. The 1998 MLA payments were intended essentially as a 50 per cent additional PFC payment. The 1998, 1999 and 2001 Act each appropriated a dollar amount to assistance which was divided among PFC payment recipients proportionately to their respective previous PFC payment. The 2000 Act provided for payments at the same contract payment rates as the 1999 Act. CCP payments, established by the FSRI Act of 2002, are provided to producers of a covered commodity for each of the 2002 through

[1403] *Supra*, Section VII:D.

[1404] We have already addressed the United States statutory and regulatory provisions for the user marketing (Step 2) programme under the FSRI Act of 2002. See Section VII:C for a description of the measures. See also our findings in Section VII:E (concerning payments to exporters) and Section VII:F (payments to domestic users) under the *Agreement on Agriculture* and the *SCM Agreement*. We refer to, and incorporate, our findings concerning the mandatory nature of the measure.

[1405] The United States asserts: "The Step 2 program has been constructed and implemented in a manner to support the price paid to US upland cotton producers by purchasers of their product. [...] Step 2 payments are provided to merchandisers or manufacturers who use upland cotton, as they represent the first step in the marketing chain where these payments could be made and have the greatest impact on producer prices". See United States' oral statement at the first session of the first substantive meeting, para. 24.

[1406] We recall the basic economic proposition that the effect on the producer of a subsidy may be affected by the elasticities of supply and demand.

[1407] *Supra*, paras. 7.1293-7.1296.

[1408] *Supra*, Section VII:D and footnote 895.

2007 crop years whenever the effective price falls below the target price[1409], which is fixed by the Act at 72.4 cents per pound for upland cotton.

7.1302 We agree with the view of USDA economists that, due to their market-price contingency, CCPs may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations. In the price range from the loan rate up to the target price minus the DP payment rate, changes in producer revenues due to changes in market prices are partly offset by the countercyclical payments if the base acreage crop is planted, thereby reducing total revenue risk associated with price variability.[1410] We have confirmed a strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production.[1411] Moreover, the payments are mandatory, under certain market conditions.[1412]

7.1303 These three subsidies are provided for in the same legal measure: the FSRI Act of 2002.[1413] They are granted, to varying degrees, in respect of the production and sale and/or export of the subsidized product under examination: upland cotton. They are also price-contingent. In the particular facts and circumstances of this dispute, we consider that these three subsidies therefore have a nexus with the subsidized product and the single effects-related variable - world price - that we are called upon to examine in our price suppression analysis under Article 6.3(c). The effects of these three price-contingent subsidies are, in our view, manifest in the movements in upland cotton prices in the same world market during the reference period. We consider these to be the subsidies whose effects we are required to evaluate for the purposes of our Article 6.3(c) analysis.

7.1304 These subsidies were not, however, the only subsidies in respect of United States upland cotton during this period. Other types of subsidies, not directly tied to world market prices of upland cotton, were also granted. We turn to these subsidies below.

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[1409] The effective price is equal to the sum of (1) the higher of the national average farm price for the MY, or the loan rate for the commodity and (2) the DP rate for the commodity.

[1410] See USDA study in "The 2002 Farm Act, Provisions and Implications for Commodity Markets" (November 2002), reproduced in Exhibit BRA-42: The extent of the offset depends on how much of the acreage base is planted as well as the relationship between the producer's expected selling price and expected season average price. Furthermore, as they increase net producer revenue, they may affect agricultural production through wealth and investment effects. The effect of the additional income stabilization for farmers is to reduce the cost of capital for upland cotton producers and, thereby, to keep land in the production of upland cotton that otherwise would have been removed from producing upland cotton because of low cotton prices. The FSRI Act of 2002 provides, on an on-going basis, for payments under certain market conditions. This contrasts with the *ad hoc* nature of the MLA payments. Under the FSRI Act of 2002, United States producers are currently aware that such payments are available under certain conditions and that there is no need to be uncertain as to whether United States Congress may or may not decide to authorize such payments in a given year. This certain claim on future payments under certain conditions increases United States producers' economic stability. Also, e.g., "Farm Program Payments and the Economic Viability of Production Agriculture", reproduced in Exhibit BRA-130, contains a 2002 USDA ERS report to the United States Congress indicating its view that "such payments can affect production and, thus, market prices and export availability".

[1411] *Supra*, Section VII:D.

[1412] Section 1104(a) of the FSRI Act of 2002, reproduced in Exhibit BRA-29. We refer to and incorporate our general discussion of the mandatory/discretionary distinction in Section VII:C. We also refer to and incorporate *mutatis mutandis* our findings in Sections VII:E and F that section 1601(e) of the FSRI Act of 2002, pertaining to expenditures under subtitles A through E of the FSRI Act of 2002, addresses levels of domestic support for the purpose of a Member's domestic support commitments under the *Agreement on Agriculture*. However, it does not deal with a Member's compliance with the serious prejudice provisions of the *SCM Agreement* and therefore is not legally relevant here.

[1413] As we have noted, MLAs, which we also include in this group, were granted pursuant to legislation to supplement PFCs.

*(ii) subsidies not contingent upon price*

7.1305 First, the PFC and DP payments are/were granted. For PFC payments, the 1996 Act appropriated a budgetary amount to the programme for each fiscal year from 1996 through 2002 and allocated a certain percentage of that amount to each of the seven programme commodities.[1414] DPs, established by the FSRI Act of 2002, provide support to producers based on historical acreage and yields for nine commodities, including upland cotton, for each of the 2002 through 2007 crop years.[1415] We agree with the view of the USDA Economic Research Service[1416] that because DP payments do not expressly depend upon current production of upland cotton and are not directly tied to market prices, their price suppression effects are not as easily discernible as those of certain other subsidy programmes (the marketing loan programme and the user marketing (Step 2) programme and CCP payments). DP payments are tied to base acreage. They enhance producer wealth and investment potential, including lowering of risk aversion.[1417] We have confirmed a strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production.[1418] The text of the measure indicates that these payments are mandatory.[1419]

7.1306 Second, we recall the fact that the United States government pays a certain proportion of the insurance premium that would otherwise be payable by the United States upland cotton producer. This means reduced cost and heightened economic security to the United States upland cotton producer.[1420] Moreover, the insurance coverage affects United States upland cotton producers' risk considerations. Each of these will have positive ramifications for producer wealth and investment and economic stability. While we do not believe it is necessary to calculate the precise amount of the

[1414] The amount appropriated for each fiscal year ranged between $5.8 billion to $4.008 billion. The amount of this allocated to upland cotton in each fiscal year was 11.63 per cent. We incorporate our description of the measure, *supra*, Section VII:C.

[1415] We incorporate our description of the measure, *supra*, Section VII:C.

[1416] Exhibit BRA-42.

[1417] The United States acknowledges that these programmes may have some impact on production, albeit the United States says that the research concludes that the impact appears negligible. For the United States, it is "widely accepted" that these programs have whole farm impacts rather than crop-specific impacts. We observe that PFC payments and DP payments mean higher cash flow and higher wealth in terms of net worth for United States upland cotton producers. United States producers that enrol under the PFC and DP payment programmes obtain an entitlement to receive future payments which increases their net wealth. This will have various predictable effects, including enhanced investment prospects due to better access to loans (as the producers are perceived as having a lower risk of default); ability to pay existing loans and other debt; a lowered aversion to risk which may allow a producer to assume riskier planting strategies; and an income-stabilizing effect as a producer may make production decisions taking into account this government revenue stream of income. This is particularly the case when the PFC and DP payments are considered in conjunction with the market loss and its countercyclical component, respectively. We incorporate our description of the measure in Section VII:C, including the requirement to use the land for an agricultural or conserving use. These payments provide an incentive to maintain land in agricultural use. Moreover, while a producer has the ability to vary production among certain crops, the strongly positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production shows that they are, to a certain degree, an incentive for continuity. We also refer to and incorporate our findings on these measures in Section VII:D.

[1418] *Supra*, Section VII:D.

[1419] See description of the measure in Section VII:C. We refer to and incorporate our general discussion of the mandatory/discretionary distinction in Section VII:C. We also refer to and incorporate *mutatis mutandis* our findings in Sections VII:E and F that section 1601(e) of the FSRI Act of 2002, pertaining to expenditures under subtitles A through E of the FSRI Act of 2002, addresses levels of domestic support for the purpose of a Member's domestic support commitments under the *Agreement on Agriculture*. However, it does not deal with a Member's compliance with the serious prejudice provisions of the *SCM Agreement* and therefore is not legally relevant here.

[1420] See description *supra*, Section VII:C and Exhibits referenced therein, as well as, for example, Exhibit BRA-229.

subsidies in question, that information is readily available on the record.[1421] The text of the measure indicates that these payments are mandatory.[1422]

7.1307 With respect to this second group of subsidies we have identified, we note that none of them are price-contingent. The PFC and DP payments are provided in the same legal measure as the three price-contingent subsidies we have discussed above - the FAIR Act of 1996 and the FSRI Act of 2002, respectively - whereas crop insurance subsidies have a separate legal basis. PFC and DP payments and crop insurance subsidies, were/are granted, to varying degrees, in respect of the subsidized product under examination: upland cotton. However, in the particular facts and circumstances of this dispute, the combination of these elements indicates to us that these particular subsidies are more directed at income support. This combination attenuates the nexus between these subsidies with the subsidized product and the single effects-related variable - world price - that we are called upon to examine in our price suppression analysis under Article 6.3(c). These subsidies are of a different nature, and thus effect, than the other (price-contingent) subsidies we have examined above.[1423] Because they are of a different nature and effect, we decline to aggregate them and their effects with those of the mandatory price-contingent subsidies in our price suppression analysis here. Rather, we must consider them separately.

d. conclusion as to the existence of price suppression in the same world market

7.1308 As we have just indicated, several of the United States subsidies are directly linked to world prices for upland cotton, thereby numbing the response of United States producers to production adjustment decisions when prices are low. We have readily available information on the record showing us that the price-contingent subsidies in question involve very large amounts of United States government money benefiting United States upland cotton. In our view, the collective operation of these subsidies was akin to a very large, counter cyclical, deficiency payment laced with additional enhancements. We believe that the structure, design and operation, particularly of the price-contingent subsidies, constitutes strong evidence supporting a finding of price suppression.

7.1309 In this respect, we recall that the United States does not disagree with the proposition that increased production and supply which reaches world markets will have an effect on prices. This is the underlying logic for the United States' argument that China's sales of 11.6 million bales between MY 1999-2001 was a significant factor that depressed world prices.[1424] Neither party therefore disputes the proposition that suppressed world prices may follow from an increased supply being infused on the world market, over and above existing available world supply of fungible upland cotton.

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[1421] See *supra*, Section VII:D. Exhibit BRA-57 and Exhibit BRA-374 show the amount of "subsidy" and "premium discount" in recent years. We note the United States' argument that crop insurance subsidies are generally available for most crop producers and hence do not give a specific advantage to one crop or another. Our inquiry into any serious prejudice caused by the United States subsidies in this dispute under the provisions of Part III of the *SCM Agreement* is not limited to an inquiry of the effects of those subsidies on cotton *vis-à-vis* other crops. Rather, our inquiry focuses on the impact of the United States subsidies on upland cotton production and prices.

[1422] Sections 508(b)(1), 508(b)2)(A) and 508(b)(3) of the Federal Crop Insurance Act, reproduced in Exhibit BRA-30, provide that catastrophic risk protection and alternative risk protection shall be provided. Section 508(c)(1)(A) provides that additional coverage shall be provided. Section 508(e) of the legislation provides that the FCIC shall pay a part of the premium in respect of certain policies. We refer to and incorporate our general discussion of the mandatory/discretionary distinction in Section VII:C. We also refer to and incorporate *mutatis mutandis* our findings in Sections VII:E and F that section 1601(e) of the FSRI Act of 2002, pertaining to expenditures under subtitles A through E of the FSRI Act of 2002, addresses levels of domestic support for the purpose of a Member's domestic support commitments under the *Agreement on Agriculture*. However, it does not deal with a Member's compliance with the serious prejudice provisions of the *SCM Agreement* and therefore is not legally relevant here.

[1423] See, in particular *supra*, para. 7.1303.

[1424] United States' further written submission, paras. 41-43.

7.1310 We believe that this has occurred in the world market for upland cotton. Between MY 1998-2002, the A-Index fell on average approximately 30 per cent below its 1980-1998 average.

7.1311 Moreover, we have before us credible evidence that prices for upland cotton transactions throughout the world are influenced by reference to the New York futures market and largely determined by the A-Index price.[1425] Physical upland cotton is traded on spot markets in each country where upland cotton is produced, or under forward delivery contracts involving domestic or export sales. The levels reflected in the futures market may influence the levels of the prices for spot markets and forward delivery contracts. Moreover, the price movements in the A-Index, the New York futures, spot prices and the United States adjusted world price indicates that United States and world prices for upland cotton are closely linked, and that price movements and trends originating from the United States market are closely tracked by, and would also influence, prices on the world market.[1426] The link between the A-Index and the United States adjusted world price and the parallelism in the price movements confirms the link between prices in the United States and the world market. As we have already indicated, the United States exerts a substantial proportionate influence in this world market.[1427]

7.1312 On the basis of these considerations, we find that price suppression has occurred in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement*.

7.1313 We also find that developments in the world upland cotton price would inevitably affect prices in other markets where Brazil and the United States may compete, due to the nature of the world prices in question and the nature of the world upland cotton market, and the relative proportion of that market enjoyed by the United States and Brazil. All individual sales of upland cotton by Brazil and the United States in any domestic market in which both were present would occur against this backdrop.[1428]

7.1314 We recall the United States' argument that much of the evidence submitted by Brazil in the context of its Article 6.3(c) submissions indicates that it was the prices of Brazil's product that *undercut* the prices of the United States' product in certain markets. The United States argues that a finding of price suppression is not possible under these conditions. In this respect, we note that the text of Article 6.3(c) of the *SCM Agreement* refers to: "significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market *or* significant price suppression ... in the same market". We understand this conjunction "or", in this context, to indicate alternative independent conditions which may exist. It does *not* indicate any necessity to cumulate the conditions of price undercutting and price suppression in order to find price suppression amounting to serious prejudice. That is, price suppression under Article 6.3(c) exists independent of any finding of price undercutting. Nothing in the context or object and purpose of this provision indicates otherwise to us. We find confirmation for our view in the drafting history

[1425] Statement of Andrew MacDonald, Annex II to Brazil's further submission. See *supra*, footnotes 1375 and 1323. See the chart in Exhibit BRA-311; Exhibit US-73, cited *supra*, para. 7.1287. While the particular United States price quote for the purposes of the A-Index may not have been consistently among the lowest price quotes taken into account in the calculation of the A-Index, the United States adjusted world price – the determinative price for the marketing loan programme payments as well as user marketing (Step 2) payments – is derived from the A-Index.

[1426] *Supra*, paras. 7.1287-7.1288.

[1427] *Supra*, para. 7.1285.

[1428] We also find support for our view in the statements by Mr. McDonald, Annex II to Brazil's further written submission, in particular, para. 24 (see also *supra* footnote 1375) and Mr. Ward, Exhibit BRA-283, in particular, para. 11. We further note Chad's third party oral statement at the resumed session of the first substantive meeting with the Panel, e.g. para. 3. See also, generally, *supra*, footnote 1323, concerning the participation of experts as part of the parties' and third parties' delegations in these Panel proceedings.

of the provision.[1429] Moreover, the text makes it clear that the conditions set out in Article 6.5 of the *SCM Agreement* pertain to "price undercutting" for the purpose of paragraph 3(c) of Article 6. They do not refer to price suppression under Article 6.3(c) of the *SCM Agreement*.[1430]

7.1315 In light of this finding, we do not believe that it is necessary to proceed to any further examination of the parties' evidence and argumentation relating to alleged price suppression in individual country markets.[1431]

iii Is it "significant" price suppression?

7.1316 It may not simply be *any* price suppression which will necessarily fulfil the conditions of Article 6.3(c) of the *SCM Agreement*. Rather, the text of Article 6.3(c) stipulates that we must examine whether "the effect of the subsidy is a ... *significant* price suppression, price depression or lost sales in the same market." (emphasis added)

7.1317 The current text of the *SCM Agreement* does not define "significant" for the purposes of Article 6.3(c), nor does it expressly specify any elements or criteria that would inform how a panel would go about assessing whether or not any price suppression or depression is "significant" under this provision.[1432]

7.1318 The only prior WTO panel to have examined the meaning of this term in Article 6.3(c) of the *SCM Agreement* in the context of a price undercutting claim observed that:

> "Although the term "significant" is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully affect suppliers of the imported product whose price was being undercut are not considered to give rise to serious prejudice"[1433]

7.1319 That panel did not, therefore, attempt to develop a general definition or interpretation of the term "significant", but rather relied upon its apparent rationale as a mechanism to filter out effects of insignificant degree or magnitude.

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[1429] Articles 31 and 32 of the Vienna Convention. Exhibit BRA-372 indicates that an 18 July 1990 Report by the Chairman on the Negotiating Group on Subsidies and Countervailing Measures (MTN/GNG/NG10/W/38) shows what is now Article 6.3(c) referred to price suppression as a result of price undercutting as opposed to an independent ground ("There is a significant price undercutting by the subsidized products as compared with the price of a like product of another signatory in the same market resulting in price suppression..."). Following various proposals, a subsequent draft Chairman's text (MTN/GNG/NG19/W/38/Rev.2) inserts an "or" between "significant price undercutting by the subsidized products as compared with the price of a like product of another signatory in the same market" [or] "the subsidized imports result in price suppression, price depression or lost sales in the same market...". This "or" remained in the final text, rendering "price undercutting" independent from "significant price suppression".

[1430] We observe, in passing, evidence in Exhibit BRA-383 which indicates that, for MY 1999 - MY 2002, the average price (cents per pound) for exports of United States upland cotton was 45.33, while, for Brazil, it was 44.65. The A-Index was 51. 94.

[1431] For this reason, it is also not necessary for us to express any view with respect to the United States assertion that Brazil's statement of findings and recommendations requested is limited to the "Brazilian, United States and world markets", and that Brazil has not specifically requested us, in that portion of its submissions, to request a finding in respect of individual third country export markets.

[1432] Some contextual guidance as to how significance may have, at least originally, be conceived, may be derived from the provisions of the agreement. We recall that Article 6.1(a) of the agreement, which has now lapsed, indicated that serious prejudice "shall be deemed to exist" where the total *ad valorem* rate of subsidization exceeded 5 per cent. Thus, evidence as to the rate of subsidization may be relevant to this issue. We do not, however, consider it necessary to consider this element here.

[1433] Panel Report, *Indonesia – Autos*, para. 14.254.

7.1320 Primarily on the basis of this prior panel report, Brazil suggests that the level of price suppression meaningfully affects non-subsidized suppliers of the like product (i.e., Brazilian, African and other non-United States suppliers) competing with the subsidized product. For Brazil, the notion of "meaningfully affect" and "serious prejudice" are essentially equivalent for the purpose of Article 6.3(c) of the *SCM Agreement*.[1434] Brazil asks us to reject the "two-step approach" suggested by the United States under Article 6.3(c), whereby an affirmative conclusion on "significance" under Article 6.3(c), would be followed by an examination of whether or not such "significant price suppression" constitutes "serious prejudice" within the meaning of Article 5(c).[1435]

7.1321 For its part, the United States asserts that we should not ascribe much weight to the *Indonesia – Autos* panel's view, as that panel conducted no textual examination and also indicated it was making an assumption about the meaning of the term "significant".[1436] For the United States, it is the effect on *prices* (of the Brazilian product) that must be "significant". The existence of any direct effect on Brazilian producers is not relevant to an assessment of the significance of price suppression; rather, significant price suppression may or may not have any effect on producers.

7.1322 We realize that Article 6.3(c) is the only sub-paragraph of Article 6.3 that contains a qualifying adjective – "significant" – that modifies the particular effects-based situation under examination. We believe that the degree of "significance" of any price suppression found to exist in the course of the Article 6.3(c) examination would also ordinarily be a relevant consideration in assessing – under the chapeau of Article 6.3 – whether or not "serious prejudice" "may" exist within the meaning of Article 5(c) of the *SCM Agreement*. Indeed, we agree entirely with the United States that "...it is conceivable that the effect of the subsidy could be price suppression so significant that it alone rises to the level of serious prejudice to the interests of another Member."[1437]

7.1323 We do not, however, believe that this is an issue that can be resolved by an examination of the text of Article 6.3(c) in isolation. In our view, the question whether or not "significant" price suppression within the meaning of Article 6.3(c) will necessarily amount to "serious prejudice" within the meaning of Article 5(c) will also depend on the clarification of the remaining relevant text of the treaty provision in question, i.e. the chapeau of Article 6.3. We must remain cognizant of the terms of both the sub-paragraphs of Article 6.3 and the chapeau of that provision. We are precluded from reducing either one to redundancy.

7.1324 To us, it is therefore essential first to establish whether or not the conditions in Article 6.3(c) exist. If they do, then, due to the particular treaty text and structure of Article 6.3(c) and its chapeau, we would consider the textual terms of the chapeau of Article 6.3(c).

7.1325 As always, we turn first to the treaty text in question: "significant". The ordinary meaning of the term "significant" is "important; notable ... consequential".[1438] The term "significant" therefore connotes something that can be characterized as important, notable or consequential.

7.1326 In the text of Article 6.3(c), the term "significant" modifies the term "price suppression or depression". Therefore, under Article 6.3(c), the "something" that must be important, notable or consequential is the "price suppression or depression".

7.1327 We endorse the shared view of the parties that we can find relevant contextual support (although not direct methodological guidance) for this reading of "significant" "price suppression" in

[1434] Brazil's 28 January 2004 comments on United States' response to Panel Question No. 234.
[1435] See United States' response to Panel Question No. 234; and Brazil's 28 January 2004 comments on United States' response to Panel Question No. 234.
[1436] United States' further written submission, para. 82.
[1437] United States' response to Panel Question No. 234, para. 135.
[1438] *The New Shorter Oxford English Dictionary*, (1993).

Article 15.2 of the *SCM Agreement.*[1439] That provision reads, in pertinent part: "whether the effect of [the subsidized] imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, *to a significant degree*... ". (emphasis added)

7.1328 This reading of the text in its context confirms to us that it is the degree of price suppression or depression itself that must be "significant" (i.e. important, notable or consequential) under Article 6.3(c) of the *SCM Agreement*. In determining whether the price suppression is "significant", it may be relevant to look at the degree of the price suppression or depression in the context of the prices that have been affected – that is, at the *degree* of significance of suppression or depression.[1440]

7.1329 Such significance may be manifest in a number of ways. The "significance" of any degree of price suppression may vary from case to case, depending upon the factual circumstances, and may not solely depend upon a given level of numeric significance.[1441] Other considerations, including the nature of the "same market" and the product under consideration may also enter into such an assessment, as appropriate in a given case.

7.1330 We cannot believe that what may be significant in a market for upland cotton would necessarily also be applicable or relevant to a market for a very different product. We consider that, for a basic and widely traded commodity, such as upland cotton, a relatively small decrease or suppression of prices could be significant because, for example, profit margins may ordinarily be narrow, product homogeneity means that sales are price sensitive or because of the sheer size of the market in terms of the amount of revenue involved in large volumes traded on the markets experiencing the price suppression.

7.1331 The *SCM Agreement* contains certain provisions in Article 27 relating to substantive special and differential treatment for developing countries, including relating to certain aspects of actionable subsidies disciplines. However, we do not find any such explicit provision for substantive special and differential treatment for developing countries in Article 6.3(c) of the *SCM Agreement* relating to the assessment of "significance" of any price suppression.

7.1332 During the period under consideration, given the relative magnitude of United States production and exports[1442], the overall price trends we identified in the world market[1443], and the nature of the mandatory United States subsidies in question – in particular, the market-price contingent, countercyclical, nature of the marketing loan programme, the user marketing (Step 2) programme, MLA payments and CCP payments[1444] – and the readily available evidence of the order of magnitude of the subsidies[1445], we are certainly not, by any means, looking at an insignificant or unimportant world price phenomenon.[1446]

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[1439] See e.g., United States' response to Panel Question No. 148 and Brazil's further written submission, para. 88.

[1440] United States' response to Panel Question No. 148.

[1441] In any event, we note that no such numeric standard is provided in Part III of the Agreement. This contrasts, to a certain extent, with the provisions of Part V of the agreement, which contain, for example, indications of "amount" of the subsidy which are *de minimis* (less than 1 per cent *ad valorem*) and volumes of the "subsidized product" which are negligible. See e.g. Article 11.9 of the *SCM Agreement*

[1442] We refer to, and incorporate our examination *supra*, paras. 7.1281-7.1285.

[1443] *Supra*, paras. 7.1287-7.1288.

[1444] We refer to, and incorporate, our examination of the structure, design and operation of these measures, *supra*, paras. 7.1289-7.1303.

[1445] *Supra*, Section VII:D and footnote 895.

[1446] See also our discussion *infra*, para. 7.1395. As we deem this a sufficient basis for our determination of "significance", it is not necessary for us also to consider any impact on Brazilian producers here. We observe, however, that any such examination would only reinforce our finding.

7.1333 We therefore consider that the degree of price suppression we have found to exist in the same world market is "significant" within the meaning of Article 6.3(c) of the *SCM Agreement*.

(k) "The effect of the subsidy"

*(i) Main arguments of the parties*

7.1334 **Brazil** submits that the United States market generated excess supplies of upland cotton through the use of large subsidies which have greatly increased United States exports. In turn, this suppressed prices in the interconnected global commodity markets of upland cotton, a basic fungible commodity. According to Brazil, the evidence it submits, when considered independently, confirms the causal link between United States subsidies and significant price suppression, but, when taken as a whole, overwhelmingly shows the existence of a close and important link in MY 1999-2002.[1447] Brazil also asserts that each of the United States subsidies, individually, have resulted in "serious prejudice" within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*.

7.1335 Brazil does not disagree that the Panel can and should take "other factors" into account, to the extent they are relevant. For Brazil, even though some of these factors may have contributed to lower and suppressed prices during MY 1999-2002, the United States arguments and evidence do not refute Brazil's evidence that the impact of $12.9 billion in United States subsidies on United States acreage, production, exports and prices was significant.

7.1336 The **United States** submits that Brazil has not demonstrated causation.[1448] It was other factors, and not United States subsidies, that affected world cotton markets during the MY 1999-2002 and caused the dramatic plunge in cotton prices.[1449] The United States also alleges that the use of the years 1998 (due to drought) and 2001 (due to unusually high yields) are misleading. The United States also denies that any of the subsidies, individually, had the effects alleged by Brazil.

*(ii) Main arguments of the third parties*

7.1337 **Argentina** considers that the subsidies granted by the United States to its cotton sector over the MY 1999-2002 period have caused and still cause serious prejudice to the interests of other Members, including Argentina, in that they have a significant suppressing or depressing effect on international cotton prices, within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*.[1450]

7.1338 **Paraguay** submits that "cotton trade is affected by the United States measures" because cotton production has a considerable impact on its economy, and especially on its rural populations which depend on cotton for their livelihood. Thus, the impact on trade in countries like Paraguay is devastating and causes the migration of rural populations to the urban areas, further aggravating the economic situation of a country dependent on its agriculture.[1451]

*(iii) Evaluation by the Panel*

7.1339 Article 5(c) of the *SCM Agreement* provides that: "[n]o Member should *cause*, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.: ...serious prejudice to the interests of another Member". (emphasis added)

7.1340 Article 6.3(c) of the *SCM Agreement* provides that: "Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply: ... (c) *the*

[1447] Brazil's further written submission, paras. 104-105.
[1448] United States' further written submission, para. 17.
[1449] United States' further written submission, paras. 45-70.
[1450] Argentina's written submission to the resumed session of the first substantive meeting, para. 50.
[1451] Paraguay's written submission to the resumed session of the first substantive meeting, paras. 10-11.

*effect of the subsidy* is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market." (emphasis added)

7.1341 The text of the treaty requires the establishment of a causal link between the subsidy and the significant price suppression.

7.1342 In considering the nature of the causal link that must exist between the subsidy and the price suppression, we recall the general distinction we have drawn between the provisions of Part III and Part V of the *SCM Agreement*, and our general approach to this serious prejudice analysis.[1452]

7.1343 Articles 5 and 6.3 of the *SCM Agreement* do not contain the more elaborate and precise "causation" and non-attribution language which is contained in the trade remedy provisions of the *SCM Agreement*, as well as in the Anti-dumping and Safeguards Agreements.[1453] The absence of such detailed language, which exists elsewhere in the covered agreements, including in the immediate context of the same (SCM) agreement may be taken as a demonstration that the drafters knew how to craft a precise causation standard when they deemed it appropriate. However, they have not done so with as much precision here.[1454]

7.1344 While this may suggest that we need not necessarily separate, distinguish and attribute, to a precise degree, all of the different effects from the various factors, we believe, nevertheless, that the condition of a causal link requires us to ensure that the significant price suppression *is* "the effect of the subsidy" within the meaning of Article 6.3(c). This necessarily calls for an examination of United States subsidies, within the context of other possible causal factors, to ensure an appropriate attribution of causality.

7.1345 We therefore, first, examine whether or not "the effect of the subsidy" is the significant price suppression which we have found to exist in the same world market. As this examination is necessarily a fact-specific examination that will vary from case to case, we will conduct an examination of the arguments and evidence before us as a whole, and come to a conclusion on the basis of the evidence in its entirety.

7.1346 We then consider the role of other alleged causal factors in the record before us which may affect our analysis of the causal link between the United States subsidies and the significant price suppression.

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[1452] *Supra*, paras. 7.1156 *ff*.

[1453] For example, Article 15.5 of the *SCM Agreement* provides:

> "It must be demonstrated that the subsidized imports are, through the effects of subsidies, causing injury within the meaning of this Agreement. The demonstration of a causal relationship between the subsidized imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities. The authorities shall also examine any known factors other than the subsidized imports which at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the subsidized imports. Factors which may be relevant in this respect include, *inter alia*, the volumes and prices of non-subsidized imports of the product in question, contraction in demand or changes in the patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry." (footnote omitted)
>
> See also Article 4.2 of the *Safeguards Agreement* and Article 3.5 of the *Anti-dumping Agreement*.

[1454] Furthermore, Articles 6.4 and 6.5 of the *SCM Agreement* set forth certain detailed considerations to be taken into account when demonstrating the causation of the occurrence of the element in question under paragraphs 3(b) and 3(c) (concerning price undercutting).

i Is there a causal link?

7.1347 There are four main, cumulative, grounds why we believe that a causal link exists between certain of the challenged United States subsidies and the significant price suppression.

7.1348 First, as we have already indicated, we believe that the United States exerts a substantial proportionate influence in the world upland cotton market.[1455] This substantial proportionate influence flows, *inter alia*, from the magnitude of the United States production and export of upland cotton. We recall again that the United States does not disagree with the proposition that a Member's proportionate magnitude in world production and consumption of upland cotton might be a relevant consideration here.[1456] Nor does the United States disagree with the proposition that increased production and supply of upland cotton which reaches the world markets will have an effect on prices.[1457]

7.1349 Second, we recall our examination of the nature of the United States subsidies at issue. In particular, we recall that several of the United States subsidies – marketing loan programme payments, the user marketing (Step 2) payments, MLA payments and CCP payments – are directly linked to world prices for upland cotton, thereby insulating United States producers from low prices.[1458] We believe that the structure, design and operation of these three measures constitutes evidence supporting a causal link with the significant price suppression we have found to exist. Furthermore, while we do not believe that it is strictly necessarily to calculate precisely the amount of the subsidies in question, we observe that we have readily available information on the record showing us that the price-contingent subsidies in question involve very large amounts of United States government money benefiting United States upland cotton production. We agree with the United States that "the question is one of the nature of the subsidy examined and the degree of any predicted effect, which could range from significant to negligible."[1459] These price-contingent subsidies were, in our view, sufficient to cause the significant price suppression that we have found to exist in the same world market.

7.1350 It is true that PFC payments, DP payments and crop insurance payments were/are also granted contemporaneously with these price-contingent subsidies. However, in our view, Brazil has not established that, in light of their structure, design and operation, these measures – which are more concerned with income support than directly with world price effects – had a sufficient nexus with the marketing of the subsidized product and the price suppression effects as to render their inclusion or non-inclusion in our price suppression analysis legally determinative in respect of the significant price suppression that we have found in the same world market. We nevertheless observe that they did not have the effect of diminishing, or cancelling out, the significant price suppression. However, because of the different nature and effect of these subsidies, we decline to aggregate them and their effects with those of the price-contingent subsidies in our serious prejudice analysis. In our view, Brazil has not established that the significant price suppression we have found was "the effect of" these non-price-contingent subsidies within the meaning of Article 6.3(c).[1460]

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[1455] *Supra*, paras. 7.1281-7.1285.

[1456] e.g. United States' further rebuttal submission, para. 37. The United States was the second largest producer of upland cotton, accounting for approximately 20 per cent of the world's cotton production in the relevant years. See our findings, *supra*, para. 7.1282. China, the largest producer, had a slightly higher average share of world production in MY 1999-2002. See "Cotton: World Statistics," ICAC, September 2003, p. 4, reproduced in Exhibit BRA-208.

[1457] This is the underlying logic for the United States' argument that China's sales of 11.6 million bales during MY 1999-2001 was a significant factor that depressed world prices.

[1458] *Supra*, paras. 7.1289-7.1303.

[1459] United States' response to Panel Question No. 164.

[1460] We refer to, and incorporate, the considerations guiding our analysis, *supra*, paras. 7.1191-7.1194 and the citations indicated there.

7.1351 Third, there is a discernable temporal coincidence of suppressed world market prices and the price-contingent United States subsidies. Looking at the period, we see the following:

- United States production of upland cotton increased from MY 1998 to MY 2001 and, while production dropped in MY 2002, there was still an overall increase in MY 2002 compared to MY 1998;
- the United States' share of world upland cotton production increased to and remained at a level of approximately 20 per cent;[1461]
- United States prices received by United States upland cotton producers decreased by 34 per cent between MY 1998 and MY 2001;[1462]
- the A-Index in MY 1999 – MY 2002 was, on average, 29.5 per cent below its 1980-1998 average;[1463]
- United States exports increased by approximately 160 per cent from MY 1998 to MY 2001 and by an even greater percentage from MY 1998-MY 2002;
- United States share of world exports of upland cotton increased;[1464] and
- United States imports of upland cotton remained at comparatively low levels.

7.1352 These data reveal that, over the same period that the subsidies in question were being granted, the United States market generated large supplies of upland cotton. Over this same time period, market revenue of United States upland cotton producers decreased. So did world market prices. There was also a marked increase in United States exports, both absolute and in terms of relative share of world exports. Even taking into account that in 1998, production may have been driven downward by drought and high levels of crop abandonment and that, in 2001, production may have been driven upward by high yields, we see a strong temporal coincidence between the United States subsidies and the drop in United States prices, the drop in – and suppression of – world market prices, the increase in United States exports.

7.1353 Fourth, we find credible evidence on the record concerning the divergence between United States producers' total costs of production[1465] and revenue from sales of upland cotton since

[1461] See our findings *supra*, para. 7.1282.

[1462] USDA Fact Sheet: Upland Cotton (January 2003), p. 4-5, reproduced in Exhibit BRA-4.

[1463] The A-Index averaged 73.54 and 51.88 US-cents/lb in the periods of MY 1980-1998 and MY 1999-2002, respectively. Exhibit BRA-209.

[1464] See *supra*, para. 7.1283, pertaining to export data on the Panel record.

[1465] We believe that not only coverage of variable costs, but also of fixed costs, would be necessary, at least over the medium to longer term, in order for United States upland cotton producers rationally to opt to remain United States upland cotton producers. We find support for this proposition in Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 87, 88. Only an analysis of the total cost of production takes account of the economic resources the producer invests in the product. Fixed and variable costs are the total amount which the producer incurs in order to produce the product and the total amount it must recoup, in the long-term, to avoid making losses. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, or else the producer simply has to close down his business. We recall, for example, the statement of Mr. Christopher Ward, reproduced in Exhibit BRA-283. Mr. Christopher Ward, who is a Brazilian producer and exporter of upland cotton, also made a statement regarding the conditions of producing upland cotton in Brazil at the resumed session of the first substantive meeting with the Panel as a member of Brazil's delegation. See *supra*, footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings.

1997.[1466] This supports the proposition that United States upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the United States subsidies at issue[1467] and that the effect of the subsidies was to allow United States producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs.

7.1354 If market revenue alone is compared to United States upland cotton producers' total costs of production, the information before us reveals that United States upland cotton producers would on average have lost money for each planted acre in every year since MY 1998, and made a small profit in MY 1997.[1468] We do not believe the utility of the record data is fundamentally undermined by any of the criticisms levied by the United States for the purposes of this dispute, particularly as the data are calculated in accordance with a methodology which the USDA itself has deemed to be a sufficiently reliable reflection of United States upland cotton producers' costs and revenues.[1469] That the figures before us are cumulated to show a result over the six-year period from 1997-2002 also lends itself to an assessment of the medium- to longer- term examination of developments in the United States upland cotton industry.[1470] We believe that the existence of this gap between upland

[1466] See USDA "Characteristics and Production Costs of United States Cotton Farms" (October 2001), reproduced in Exhibit BRA-16, in which the USDA ERS indicates that, for 1997, producing a pound of upland cotton cost United States farmers 38 cents in operating costs and another 35 cents in overhead-costs (average total cost of production: 73 cents per pound). Brazil's arguments address the marketing years since 1997.

[1467] We note that the USDA has acknowledged that "Potential net revenue is the bottom line in a producer's decision to participate in government programs...". See Exhibit BRA-12, p. 20.

[1468] See e.g., Brazil's response to Panel Question No. 163, para. 136. See also "Costs and Returns of United States Upland Cotton Farmers MY 1997-2002", reproduced in Exhibit BRA-323. Exhibit BRA-206 shows the revenue gap for United States production of upland cotton lint. Exhibit BRA-353 depicts producers' cumulative loss without contract payments. See also United States' response to Panel Question No. 163, para. 100 and accompanying chart. See also Brazil's response to Panel Question No. 163, paras. 131-136. Depending upon which figures before us are taken into account, we see that United States upland cotton producers would have suffered cumulative losses during MY 1997-2002 of approximately $872 (or $748) per acre of upland cotton. As either of these indicates a gap, we need not select between them for the purposes of resolving this dispute. We also note that "operating costs" include the costs of "ginning". They also break down data pertaining to upland cotton and cottonseed. Due to the small relative magnitude of cottonseed returns data in relation to cotton lint returns, we do not consider that its inclusion in some of the data considered materially affects our findings here.

[1469] Brazil's further rebuttal submission, para. 72. The United States, in this dispute, takes issue with the methodology applied to calculate these figures, and the reliability of the figures as a reflection of the choices and expectations of United States upland cotton producers. However, the cost projections by the USDA cited by Brazil are updates of a 1997 USDA cost survey. As the United States has indicated, in every year subsequent to 1997, the USDA takes the results of the 1997 cost survey and updates it to reflect the general increase in prices according to the producer price index. We observe that, according to the USDA, the reliability of the USDA estimate may differ depending upon the amount of time that has elapsed since the USDA survey year. See USDA's website: www.ers.usda.gov/costs and returns/....

This approach may not fully reflect all of the technological and structural change since 1997 in United States upland cotton production. We nevertheless also understand that certain developments affecting costs and returns may be reflected to a certain extent through the USDA's updated estimation process (e.g., pest eradication bringing new (low cost) areas of the United States into production or the adoption of biotech cotton which requires fewer pesticide applications: the cost of production demonstrates that the cost for seed increased from $17.63 in MY 1997 to $47.99 in MY 2002). This increase may reflect developments such as the introduction of more expensive biotech cotton seed varieties. At the same time, costs for fertilizer and chemicals remained constant or fell. This is also consistent with the use of biotech crops.

We note that Exhibits BRA-14 and BRA-251 contain surveys of comparative costs of production of raw cotton in various countries. We are aware that such cross-country comparisons are affected by numerous considerations. We observe that this evidence reflects that the United States cost of production is higher than the cost of production in many other countries.

[1470] We disagree with the United States that an examination of United States upland cotton producers' "off farm income" may be a legally relevant consideration in the examination before us. We are considering

cotton producers' total production costs and market revenue, on the one hand, and the effect of the subsidies, on the other hand, was to sustain a higher level of output than would have occurred in the absence of the United States subsidies at issue.[1471]

7.1355 While there may well have been other factors affecting prices in the world market over this time period, on the basis of the above examination of these four factors, taken together, we find that a causal link exists between the mandatory United States price-contingent subsidies at issue – marketing loan programme payments, user marketing (Step 2) payments, MLA payments and CCP payments – and the significant price suppression that we have found to exist. However, no such causal link has been established in respect of the non-price contingent subsidies before us, that is, PFC and DP payments and crop insurance subsidies.

7.1356 We proceed to an examination of other causal factors in order to see whether any of these would have the effect of attenuating this causal link, or of rendering not "significant" the effect of the subsidy.

ii Other alleged causal factors

7.1357 We address each of the other causal factors alleged by the United States in turn.

7.1358 First, the United States asserts that prices have been historically low because of the weakness in world demand for cotton due to competing, low-priced synthetic fibres, and weak world economic growth. Brazil argues that data on world consumption do not support the United States claim of weak world demand. It seems to us that if the low prices acknowledged by both parties were caused by persistent weakness in the world demand for upland cotton, one would reasonably expect a reduction in production of upland cotton. However, United States upland cotton production increased over the period.[1472] Although we see an increase in world polyester production, we also see an increase in world cotton production up until 2001 and we do not see pronounced declines in world consumption of upland cotton.[1473] We do not find this United States argument compelling.

7.1359 Second, the United States argues that burgeoning United States textile imports, reflecting the strong United States dollar since the mid-1990's and declining United States competitiveness in textile and apparel production, have fundamentally shifted the disposition of United States cotton production from domestic mills to export markets. The United States asserts that the growing United States

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costs and market revenues in respect of upland cotton. Our examination is one of the upland cotton industry. We find support for this proposition in the references to "subsidized product" and "like product" in Article 6.3(c) of the *SCM Agreement*, and contextual support in such references in Article 15 of the *SCM Agreement*. We are inquiring into whether, in respect of upland cotton production, United States producers' revenues in respect of upland cotton were insufficient to sustain their total costs incurred. We are not looking into the possibility of cross-subsidization or cross-financing of insufficient market revenues for upland cotton that may have come from other United States industries. Indeed, the very fact that the United States relies on such cross-subsidization as a possible source of revenue would tend to support the proposition that upland cotton producers would have lost money over the longer term if they were involved in upland cotton production alone. If the infrastructure of United States upland cotton production supports the "off farm income" then the subsidies are supportive of that income as well. If the infrastructure of United States upland cotton production does not support "off farm income", the producer need not produce upland cotton. However, we have seen, as a factual matter, that United States producers continue to produce upland cotton, and still receive subsidies in relation to production.

[1471] Exhibit BRA-109, containing 2001 testimony of the then-Chairman of the National Cotton Council before the United States House Agriculture Committee would support this proposition: "during the past three years, many cotton farmers have avoided bankruptcy only because Congress has authorized emergency relief to supplement the FAIR Act's inadequate fixed payments". This tells us that United States upland cotton producers rely on United States government subsidies to cover their production costs.

[1472] USDA Fact Sheet: Upland Cotton (January 2003), p. 4, reproduced in Exhibit BRA-4.

[1473] "Cotton: World Statistics," ICAC, September 2003, p. 3-4, reproduced in Exhibit BRA-208.

cotton-equivalent trade deficit and growth in United States retail purchases of cotton fibres has supported world cotton prices. We see that exchange rate adjustments affect textile trade flows.[1474] We do not see how this United States assertion concerning support, rather than suppression, of world upland cotton prices is germane to our examination of other possible causal factors that might have suppressed world upland cotton prices.

7.1360 Third, the United States asserts that the strong United States dollar since the mid-1990's has had an inverse effect on the world price of cotton, as cotton is traded internationally in dollars.[1475] Brazil disagrees. We observe that the United States' share of world upland cotton production did not decline materially and its share of world upland cotton exports increased markedly at the same time the United States dollar appreciated during MY 1999-2001.[1476] While we acknowledge that exchange rates are indeed important for United States upland cotton production and exportation, and would affect market prices, such market prices are not guiding United States producer decisions (except to the extent that, when they are lower than the marketing loan rate, they dictate the magnitude of United States government subsidies to producers). United States producers' market revenue was effectively sheltered from such currency/price developments by virtue of the United States subsidies (mainly the marketing loan programme and the user marketing (Step 2) programme).[1477] We do not find this United States argument compelling.

7.1361 Fourth, the United States asserts that China subsidized the release of millions of bales of government stocks between 1999 and 2001, which was instrumental in pushing down upland cotton prices to very low levels. Brazil concurs that suppressed world prices would inevitably follow from millions of additional million bales being added to available world supply of upland cotton where demand is relatively inelastic. We endorse the shared view of the parties that an infusion of a large amount of supply onto the market would exert a downward pressure on prices. The fact that such additional supplies became available on the world market may well have affected world prices. However, it was smaller in magnitude than the United States exports over this period. In addition, it did not have a dampening effect upon United States production or exports, which both continued and/or increased over this period.

7.1362 Finally, the United States asserts that upland cotton planting decisions that are not limited only to benefits derived from United States subsidies, but rather are driven by other factors such as (1) the effect of technological factors of upland cotton production, which includes boll weevil eradication and genetically modified upland cotton (2) the relative movement of upland cotton prices *vis-à-vis* prices of competing crops, which affect upland cotton producers' planting decisions and (3) the expected prices for the upcoming crop year.[1478] Even assuming that the effect of the two cited technological factors reduced the cost of production for some United States upland cotton farmers, which may not be fully reflected in USDA cost-revenue estimate updates, the record still shows that the total cost of production for United States producers increased over the period in question, while world market prices were suppressed. Furthermore, during MY 1999-2002, we have found a strongly positive relationship between upland cotton base acres and continued production of upland cotton.[1479]

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[1474] See for example, Exhibit BRA-100.

[1475] United States' further written submission, paras. 35-36.

[1476] See, e.g. our findings *supra*, paragraphs 7.1281-7.1285.

[1477] See *supra*, Chart 2, para. 7.1293. The USDA effectively recognizes this, at least with respect to the marketing loan programme. Exhibit BRA-100 contains a USDA ERS discussion of "US Cotton and the Appreciation of the Dollar". Addressing the maintenance of "relatively steady" US cotton production despite the fall in the dollar-denominated world price for cotton, it states: "Finally, cotton producers benefit from the marketing loan programme, which helps producers maintain revenues while permitting large adjustments in market prices." Also see, for example, Exhibit BRA-214. In Exhibit BRA-213, the National Cotton Council indicated, in 2001 that "without the presence of US cotton's Step 2 program to offset some of the impact of a strong dollar, US raw cotton exports would likely have experiences a far larger decline" (since 1996).

[1478] United States' further written submission, paras. 45-70.

[1479] *Supra*, Section VII:D.

Thus, it is reasonable to conclude that United States producers continued to grow upland cotton due to United States subsidies rather than market prices or expected market revenue.

7.1363 Although some of these factors may have contributed to lower, and even suppressed, world upland cotton prices during MY 1999-2002, they do not attenuate the genuine and substantial causal link that we have found between the United States mandatory price-contingent subsidies at issue and the significant price suppression. Nor do they reduce the effect of the mandatory price-contingent subsidies to a level which cannot be considered "significant".

(l) The chapeau of Article 6.3 of the *SCM Agreement* and "serious prejudice"

*(i) Main arguments of the parties*

7.1364 **Brazil** contends that an examination under Article 6.3(c) of the *SCM Agreement* is determinative of "serious prejudice" for the purposes of Article 5(c) of the *SCM Agreement*, and that no further showing is necessary.[1480] However, even if it were, Brazil submits that it has discharged this burden as well.

7.1365 The **United States** is of the view that the use of "may" in the introductory sentence of Article 6.3 of the *SCM Agreement* indicates that serious prejudice need not arise even if one or more of the circumstances listed in Article 6.3 are found. If Brazil demonstrates one or more of the criteria in Article 6.3 is met, Brazil must then demonstrate "serious prejudice" – that is, that the "prejudice" caused by the effects of the subsidy were "serious."[1481]

*(ii) Main arguments of the third parties*

7.1366 **India** is of the view that nothing more than the demonstration that one of the effects enumerated in Article 6.3 exists is necessary to arrive at a finding of "serious prejudice". The effects listed in Article 6.3 themselves equate to serious prejudice. Subsidies listed under Article 6.1 are *deemed* to cause serious prejudice, hence such a presumption is rebuttable under Article 6.2 if the subsidy does not result in any of the effects enumerated in Article 6.3. No such rebuttal is envisaged under Article 6.3.[1482]

7.1367 **New Zealand** submits that there is no basis for drawing from a comparison of language used in Articles 6.1 and 6.3 the conclusion that there is some other standard, independent of Article 6, that must be demonstrated in order to show "serious prejudice". New Zealand states that a comparison of both the language *and substance* of Articles 6.1 and 6.3, in the context of Articles 5 and 6 of the *SCM Agreement*, supports the contrary conclusion – that if a complainant has demonstrated the existence of one or more of the effects enumerated in Article 6.3 there is "serious prejudice" that is an adverse effect of the subsidy within the meaning of Article 5. Both must be seen in the context of concern in this part of the *SCM Agreement* with the effects of subsidies on other Members.[1483]

*(iii) Evaluation by the Panel*

i "Serious" prejudice

7.1368 Article 5(c) of the *SCM Agreement* sets out the concept of "serious prejudice" to the interests of another Member as one of three forms of "adverse effects" in Article 5 of the *SCM Agreement*. The chapeau of Article 6.3 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 *may*

[1480] Brazil's response to Panel Question No. 229.
[1481] United States' further written submission, paras. 77-79.
[1482] India's oral statement at the resumed session of the first substantive meeting, p. 2.
[1483] New Zealand's written submission to the resumed session of the first substantive meeting, para. 211.

arise in any case where one or several of the following apply."(emphasis added) Article 6.3(c) defines one circumstance in which such "serious prejudice" "may" arise.

7.1369 The parties disagree as to whether the establishment of all of the requisite elements in Article 6.3(c) is *sufficient*, in and of itself, to also establish the existence of serious prejudice within the meaning of Article 5(c). Brazil believes that it is, but, even if not, it submits evidence to substantiate that "serious prejudice" exists.[1484] The United States, however, argues that even if Brazil establishes that the conditions in Article 6.3(c) are met, the use of the term "may" in the chapeau of Article 6.3 signifies that Brazil must still demonstrate that the "prejudice" caused by the effects of the subsidy is "serious" within the meaning of Article 5(c) of the *SCM Agreement*.

7.1370 The ordinary meaning of the word "may" in the chapeau of Article 6.3 of the *SCM Agreement* may express "possibility" or "permission".[1485] We agree with the United States that the use of the word "may" in the chapeau of Article 6.3(c) may, at least, play such a permissive role. In this sense, the ordinary meaning of the chapeau of Article 6.3 would be that there is a "possibility" or "opportunity" for serious prejudice in the sense of Article 5(c) to arise where one or more of the effects-based situations listed in Article 6.3 is found. A panel would be permitted to find serious prejudice upon finding that one of these listed effects-based situations exists.

7.1371 There is an explicit and bald textual linkage between Article 6.3(c) and Article 5(c) through the cross-reference in the chapeau of Article 6.3 of the *SCM Agreement*. This textual linkage contains no additional express criteria to establish serious prejudice within the meaning of Article 5(c).

7.1372 Moreover, nowhere else in Articles 5 and 6 of the *SCM Agreement* are any additional criteria explicitly or specifically identified that would inform a panel's examination as to when serious prejudice would or would not arise within the meaning of Article 5(c) once the conditions in one or more of the paragraphs of Article 6.3 are fulfilled.

7.1373 The absence of any reference in Articles 5 and 6 of the *SCM Agreement* to any such additional criteria that would inform a panel's examination as to when serious prejudice would or would not arise within the meaning of Article 5(c) once the conditions in one or more of the paragraphs of Article 6.3 are fulfilled differs from the level of detailed affirmative guidance provided in respect of the price and volume effects, in Article 6.4, that would go to the establishment of displacement or impediment of exports for the purpose of Article 6.3(b); and, in Article 6.5, with respect to the establishment of price undercutting for the purposes of Article 6.3(c) of the *SCM Agreement*.

7.1374 In contrast, the text of the chapeau of Article 6.3 of the *SCM Agreement* is silent as to any factors which would guide an examination under its term "may". We do not believe that, in light of this relatively detailed express guidance that is available on certain aspects relevant to the Article 6.3 examination, there is *another* set of entirely *undefined* requirements or conditions that must also guide our examination and that must also be demonstrated in order to find serious prejudice within the meaning of Article 5(c). Indeed, we believe that the use of "may" in the chapeau of Article 6.3 could be seen as an implicit cross-reference to these other, more specific, requirements spelled out in the other paragraphs of Article 6 relating to price and volume effects of subsidies that are generally referred to in Article 6.3.[1486]

7.1375 The indication in the chapeau of Article 6.3 that serious prejudice may arise when "one or several" of the effects-based situations in the sub-paragraphs exist(s) does not change our view. In

[1484] Brazil's further written submission, paras. 437 *ff*.
[1485] *Concise Oxford English Dictionary* (Oxford, Clarendon Press, 1995).
[1486] We note, however, that no such detailed guidance is available, e.g. in respect of price suppression under Article 6.3(c).

using this phrase, the drafters indicated their awareness that at least one of the effects-based phenomena in the various sub-paragraphs of Article 6.3 must exist, but that it was conceptually possible that several might co-exist or overlap in a serious prejudice analysis. The simultaneous co-existence of situations identified in several of the sub-paragraphs would bolster, rather than negate, a finding of serious prejudice. We thus do not understand their reference to "one or several" to require any sort of cumulative application of the sub-paragraphs of Article 6.3, so as to obliterate the possibility that the establishment of one of the effects-based situations identified in a single sub-paragraph would be sufficient to ground a finding of serious prejudice in the sense of Article 5(c).

7.1376 This interpretation – that a demonstration of the existence of one or more of the effects-based situations enumerated in Article 6.3 is sufficient to ground a finding of "serious prejudice" within the meaning of Article 5(c) – finds support in the context of the provision.

7.1377 The language in Article 6.3 ("may") contrasts with the contextual language in Article 6.1 ("shall").[1487] At first blush, it could be concluded that the "may" in Article 6.3 could then only be permissive and *conditional*, rather than permissive in all circumstances. Following this reasoning, had the drafters intended Article 6.3 to be determinative in all circumstances for "serious prejudice" under Article 5(c), they presumably could and would have used "shall".

7.1378 This contrast is not, in itself, dispositive, because of the different substantive focuses of the two provisions. Under Article 6.1, "serious prejudice" was given meaning by reference to qualitative and quantitative criteria pertaining to the particular types and characteristics of the subsidies themselves. Serious prejudice was "deemed" to exist upon identification of subsidies with such characteristics or qualities. As the titles of Articles 5 ("Adverse Effects") and 6 ("Serious Prejudice") of the *SCM Agreement* indicate, the underlying rationale for these provisions is to focus upon subsidies with adverse effects. Thus, the subsidies of the nature enumerated in the sub-paragraphs of Article 6.1 were deemed to have such *effects*.

7.1379 However, it is critical to also take note of the text of Article 6.2, which states:

> "Notwithstanding the provisions of paragraph 1, serious prejudice shall not be found if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3."

7.1380 Thus, under Article 6.2, it was open to a subsidizing Member to rebut the presumption of serious prejudice by showing that, despite its nature, in fact, the subsidy did not actually cause any *effect* tantamount to serious prejudice. That is, that the subsidy had not caused any of the *effects* enumerated in Article 6.3. In our view, Article 6.2 serves to clarify that a prerequisite for a finding of serious prejudice is that at least one of the four effects-based situations in Article 6.3 must be demonstrated. It indicates to us that demonstration that at least one of the four effects-based situations in Article 6.3 exists is a necessary basis to conclude that serious prejudice exists.

7.1381 A symmetrical reading of the text of Article 6.2 could be that it identifies, by implication, the situations listed in Article 6.3 as, in and of themselves, constituting or giving rise to, serious prejudice. That is, the elements in Article 6.3 may be not only necessary, but also sufficient, conditions, to support a serious prejudice finding under Article 5(c) of the *SCM Agreement*.

7.1382 Another reading of the text could result in an asymmetry, whereby demonstration that none of the effects-based situations enumerated in Article 6.3 existed would mean that serious prejudice did not exist, but demonstration that one or more of the effects enumerated in Article 6.3 existed would

[1487] We are aware that this provision has lapsed, through the operation of Article 31. Nevertheless, we find it may provide relevant guidance as to the original architecture of the *SCM Agreement*. See *supra*, footnote 1292.

not be sufficient to find serious prejudice. If there were other elements above and beyond those in Article 6.3 that had to be demonstrated to show serious prejudice, we might wonder why Article 6.2 would not also require a subsidizing Member to show that those elements were not present in order to avoid the presumption of serious prejudice in Article 6.1 of the *SCM Agreement*?

7.1383 The qualitative and quantitative focus upon the types and characteristics of certain subsidies in Article 6.1 contrasts with the effects-based focus of Article 6.3. For the purposes of an Article 6.3 examination, there is thus no need to "deem" certain effects to arise from subsidies of a certain nature, as there was in Article 6.1. Rather, Article 6.3 does not attempt to define any qualitative or quantitative aspects of the subsidy: its effects-based focus embraces a subsidy of any nature that has the adverse effects enumerated and is therefore "actionable".

7.1384 Moreover, we find further contextual guidance in other provisions of the *SCM Agreement*. Article 27.8 of the *SCM Agreement* stipulates:

> "There shall be no presumption in terms of paragraph 1 of Article 6 that a subsidy granted by a developing country Member results in serious prejudice, as defined in this Agreement. Such serious prejudice, where applicable under the terms of paragraph 9, shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6."

7.1385 This provision makes it clear that "serious prejudice" "shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6". Thus, the considerations spelled out in Articles 6.3-6.8 are considered to be *determinative* in terms of establishing serious prejudice. This provision makes no reference to any other, super-added requirements to establish "serious prejudice" after having established that the effects-based situations in one of the paragraphs of Article 6.3 exist. We consider that the rationale underlying this explicit, contextual guidance informs the meaning of the references in Article 6.4 of the *SCM Agreement* to "for the purpose of paragraph 3(b)", and in Article 6.5 to "for the purpose of Article 3(c)".

7.1386 The United States argues that these references serve to establish displacement or impediment or price undercutting for the purposes of Article 6.3 of the *SCM Agreement*, but do not explicitly indicate that such phenomena necessarily constitute, or result in, serious prejudice for the purposes of Article 5(c). According to the United States, had Members intended that a finding under Article 6.3 would necessarily suffice to demonstrate serious prejudice, one also would have expected Articles 6.4 and 6.5 to mandate a finding of serious prejudice where a finding of one of the effects under Article 6.3 is mandated.[1488]

7.1387 We disagree with this argument of the United States, particularly in light of the references in Article 6.7 ("Displacement or impediment *resulting in serious prejudice* shall not arise under paragraph 3..."), and in Article 6.8 ("In the absence of circumstances referred to in paragraph 7, the existence of *serious prejudice* should be determined ...). These references indicate that the examination called for under Article 6.3 of the *SCM Agreement*, as informed by the more detailed guidance in Articles 6.4-6.8, could equally serve to establish whether or not serious prejudice exists, for the purposes of Article 5(c) of the *SCM Agreement*.

7.1388 An interpretation that the term "may" in the chapeau of Article 6.3 does not require the establishment of any additional elements to those established under one of the paragraphs of Article 6.3 would also be consistent with the object and purpose of the agreement. It would also find

[1488] United States' response to Panel Question No. 149.

support in the drafting history of the provision.[1489] In this respect, we understand that the term "may" was, at least originally, intended to demonstrate that the list in Article 6.3 is illustrative and not exhaustive. Pursuant to the footnote 13 attached to Article 5(c), the concept of "serious prejudice" is used in the same sense as in Article XVI.1, which includes *inter alia* the threat of serious prejudice. Therefore, it was appropriate to state that serious prejudice in the sense of paragraph (c) of Article 5 *may* arise where any of the listed effects exists because there may be other circumstances in which serious prejudice could be demonstrated, including, for example, where there is a threat of serious prejudice. The use of the word "shall" could have been taken to mean that Article 6.3 provides the exhaustive enumeration of situations in which serious prejudice can ever arise. As we are dealing with one of the listed items in Article 6.3, it is not necessary for us, here, to decide on whether or not there may exist situations – other than those enumerated in Article 6.3 – in which serious prejudice could be established.

7.1389 We would therefore be permitted to find that serious prejudice has arisen upon fulfilment of the elements in one or more of the paragraphs of Article 6.3(c). In this connection, we note the presence of the qualifying term "significant", which modifies the term "price suppression" in Article 6.3(c). The presence of this qualifying term, which permits consideration of the *degree* or *intensity* of the effects caused, stands in sharp contrast to the absence of any such (or analogous) term in the other paragraphs of Article 6.3.[1490] Nevertheless, we fail to see how the absence of any element of degree in paragraphs 3(a), 3(b) and 3(d) of Article 6 would result in the complaining Member being separately required to prove that any prejudice is indeed "serious" even after having established that one of the listed effects-based situations exists. If the drafters had intended that the complaining

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[1489] The *Tokyo Round Subsidies Code*, where the word "may" appeared in this context for the first time, contained a basic rule on serious prejudice (Article 8.3), which was conceptually similar to Article 5 of the current *SCM Agreement*. It provided:

> "2. Signatories [...] agree that they shall seek to avoid causing, through the use of any subsidy:
> (a) injury to the domestic industry of another signatory, [footnote omitted]
> (b) nullification or impairment of benefits accruing directly or indirectly to another signatory under the General Agreement, [footnote omitted] or
> (c) serious prejudice to the interests of another signatory.[25]
>
> [25] Serious prejudice to the interests of another signatory is used in this Agreement in the same sense as it is used in Article XVI:1 of the General Agreement and includes threat of serious prejudice."

Article 8.4 of the Code stated:

> "4. The adverse effects to the interests of another signatory required to demonstrate nullification or impairment or serious prejudice *may arise* through
> (a) the effects of the subsidized imports in the domestic market of the importing signatory,
> (b) the effects of the subsidy in displacing or impeding the imports of like products into the market of the subsidizing country, or
> (c) the effects of the subsidized exports in displacing the exports of like products of another signatory from a third country market." (emphasis added, footnotes omitted)

The term "may arise" in the chapeau of Article 8.4 seems to suggest that the items enumerated in (a) through (c) are simply intended to be examples of possible ways in which serious prejudice (and/or nullification or impairment) could show itself. That is, this list in the *Tokyo Round Subsidies Code* seems to be an illustrative, non-exhaustive list of situations constituting serious prejudice, with the "may" leaving open the possibility that other situations as well might lead to or constitute serious prejudice. It appears that the drafting of the terms "serious prejudice may arise" was directly carried over from the *Tokyo Round Subsidies Code* into Article 6.3 of the *SCM Agreement*. This phrase appears unchanged in the chapeau of versions of the negotiating text of what is now Article 6.3 of the *SCM Agreement* (i.e., MTN/GNG/NG10/W/38 and Revisions).

[1490] We discuss this term in more detail below.

Member should separately establish that the prejudice caused by the effects of the subsidy was "serious", they would have defined the requirements for this purpose.[1491]

7.1390 We therefore do not believe that, once we have concluded that the conditions in Article 6.3(c) are fulfilled, and thus that serious prejudice "in the sense of paragraph (c) of Article 5""may" arise, a separate examination of the existence of "serious prejudice" under the chapeau of Article 6.3 or Article 5(c) is necessary.[1492] Our examination of the text, in its context, indicates to us that the Article 6.3(c) examination is determinative also for a finding of serious prejudice under Article 5(c). That is, an affirmative conclusion that the effects-based situation in Article 6.3(c) exists is a sufficient basis for an affirmative conclusion that "serious prejudice" exists for the purposes of Article 5(c) of the *SCM Agreement*.

7.1391 In any event, even assuming *arguendo* that any sort of additional demonstration is necessary to establish that the "significant price suppression" we have found to exist in the same world market constitutes prejudice amounting to "serious prejudice" within the meaning of Article 5(c), we believe that Brazil has also fulfilled that burden**.**

7.1392 For the purposes of this dispute, we do not believe that it is necessary to develop a fixed interpretation of the outer parameters of what may constitute "serious prejudice" to the interests of another Member within the meaning of Article 5(c) of the *SCM Agreement*. At the very least, given the subject matter covered by the *SCM Agreement* – government subsidies in respect of goods – the effects-based situations identified in the sub-paragraphs of Article 6.3, and the reference in the chapeau of Article 6.3 to serious prejudice "in the sense of" Article 5(c), we believe that such "serious prejudice" may involve the effects of subsidies on the complaining Member's trade in a given product. That is, it addresses the volumes and prices and flows of such trade, which may, by logical extension, affect a producing Member's domestic production of that product. We therefore consider that a

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[1491] While we can conceive of a theoretical situation where a panel would not be compelled to deem even the most *de minimis* effects of a subsidy inevitably to give rise to, or constitute, serious prejudice, the facts of the case before us do not envisage such a situation.

[1492] We find support for this proposition in previous WTO and GATT panel reports. The only other WTO panel to have examined these provisions (including "may"), the *Indonesia-Autos* panel, did not conduct such an additional examination, but apparently considered that it was sufficient to establish serious prejudice through the fulfilment of the conditions in Articles 6.3(a) through (d).

This approach was essentially consistent with the approach of three GATT 1947 panels. Two of these disputes were based exclusively on Article XVI of GATT 1947, as they occurred prior to the entry into force of the Tokyo Round *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade*. At that time, the term "serious prejudice" in Article XVI:1 – without any further textual elaboration – was the only reference to this concept in the GATT rules governing subsidies. In *EC – Sugar Exports (Australia)*, the panel noted that the European Communities scheme in question and its application "had contributed to depress world sugar prices in recent years and that thereby serious prejudice had been caused indirectly to Australia, although it was not possible to quantify the prejudice in exact terms" (i.e. effectively, that price depression constituted serious prejudice). See Panel Report, *EC – Sugar Exports (Australia)*, Section V, conclusion (g). In *EC – Sugar Exports (Brazil)* the panel similarly found that the European Communities scheme in question "[...] had been applied in a manner which in the particular market situation prevailing in 1978 and 1979, contributed to depress sugar prices, and that this constitutes a serious prejudice to Brazilian interests in terms of Article XVI:1". See Panel Report, *EC – Sugar Exports (Brazil)*, Section V, conclusion (f).

The panel in *EEC – Wheat Flour Subsidies*, which occurred after the entry into force of the *Tokyo Round Subsidies Code*, framed its examination in terms of whether the subsidies in question had led to market displacement or price undercutting, and conducted no further, separate, inquiry concerning serious prejudice.

These dispute settlement reports indicate that serious prejudice involved the effects of subsidies on a Member's trade in a given product as such, i.e., the volumes and prices and flows of such trade, rather any further effects on a Member's domestic industry, or other issues such as the significance of the particular industry producing the product in question to the overall "interests" of the complaining Member.

detrimental impact on a complaining Member's production of, and/or trade in, the product concerned may fall within the concept of "prejudice" in Article 5(c) of the *SCM Agreement*.[1493]

7.1393 Moreover, the prejudice involved must be "serious". In one of its ordinary meanings, "serious" means "important" and "not slight or negligible".[1494] Thus, the prejudice in terms of the effect on Brazil's production of, and/or trade in, upland cotton must be such as to affect Brazil's production of upland cotton, to a degree that is "important", "not slight or negligible", or meaningful.

7.1394 We recall our conclusion that the price suppression is "significant".[1495] We note, moreover, Brazil has submitted evidence to substantiate its assertions that there is a close relationship between movements of Brazilian prices and movements in the A-Index and that Brazilian producers have suffered from the suppressed price trends in the Brazilian market and in Brazilian export markets, including in terms of Brazilian producers having reduced production and investment.[1496]

7.1395 In the particular facts and circumstances of this case, whether or not we consider the impact and magnitude of the price suppression or the materiality of effect upon Brazilian producers of upland cotton in terms of the "significance" of the price suppression or in terms of the question as to whether or not such "significant" price suppression amounts to "serious prejudice" under the chapeau of Article 6.3, we arrive at the same conclusion: such "significant price suppression" amounts to "serious prejudice" within the meaning of Article 5(c) of the *SCM Agreement*.

ii Serious prejudice to the interests of "another Member"

7.1396 **Brazil** also asserts that other WTO Members, in particular African cotton-producing Members, have suffered serious prejudice as a result of the United States subsidies. The **United** States asserts that the only Member's interests at issue under Article 5(c)/Article 6.3(c) examination are those of Brazil, as the complaining party in this dispute.

7.1397 In terms of third parties, whereas the **European Communities** agrees with the United States that, for the purposes of Article 6.3(c), only the price effects on the "products" of Brazil are relevant[1497], **New Zealand** asserts that just because Brazil is the "other party" in the context of

[1493] In contrast to a trade remedy investigation, in the context of a serious prejudice analysis under Article 5(c), we are not considering a "domestic industry" test where there may be a need to show that a domestic industry is being materially or seriously injured.

[1494] *Concise Oxford English Dictionary* (Oxford, Clarendon Press, 1995).

[1495] *Supra*, para. 7.1333.

[1496] Annex III to Brazil's further submission contains notarized statements by 27 Brazilian "cotton" producers – some in English, some in Portuguese – generally attesting to the nature of cotton production in Brazil, lower cotton price trends in recent years and/or the effects of these price trends on their production and investment decisions. For example, Mr. Christopher Ward (see *supra*, footnote 1465) states that, "[o]ver the past three years I have experienced lower prices for both my domestic Brazilian and export sales". Another producer states that "I initiated my cotton planting in the 1998/99 crop year" and "was very encouraged with the prospect of getting a good profit margin", doubling his acreage in crop year 1999/2000. This producer was "forced to sell" at low prices, subsequently reduced his planted area in crop year 2000/2001 by more than half and then "decided to abandon cotton planting". A further producer indicates that he decided to reduce, as of the 2003/2004 crop year, his planted area by 50 per cent, and would only change his decision if "there is a further substantial rise in current prices". A different producer indicates that he is no longer planting cotton and the last time he planted was in 2000/2001, with an area of 100 hectares. According to him, "[t]he lack of adequate price and elevated costs when compared to other cultures led me to stop producing cotton." Yet another producer indicates that he reduced his cotton plated area "during this last crop-year due to last crop's prices, which left us quite dispirited".

[1497] European Communities' response to Panel third party Question No. 55.

Article 5(c), this does not mean that other Members too cannot be suffering the serious prejudice through the use of the subsidies at issue by the United States.[1498]

7.1398 Certain third parties have also argued that the concept of "another Member" in Article 6.3(c) would include Members other than the complaining Member in a particular dispute.[1499]

7.1399 For example, **Argentina** submits that, despite the fact that Brazil is the complainant, the concept of "another Member" within the meaning of Article 6.3(c) includes Argentina, which submitted allegations relating to the price effect of United States subsidies and has also suffered serious prejudice.[1500]

7.1400 **Benin** and **Chad** also submit that the Panel is required to take account of the effects of the United States subsidies on the interests of Members other than the complaining Member in assessing the WTO-consistency of the United States subsidies[1501], for the following reasons: (1) the drafters of Article 5 of the *SCM Agreement* referred to "Members" in the plural, connoting an obligation on behalf of the subsidizing Member not to cause adverse effects to the interests of all WTO Members – not just the complaining Member; (2) when the drafters of the *SCM Agreement* intended to refer only to the "complaining Member", they used this term specifically, such as in Article 6.7, or in paragraph 2 of Annex V; (3) it is consistent with Article 3.8 of the *DSU*, which refers to the "adverse impact" on "other Members" in the plural, referring to all WTO Members despite the fact that the *SCM Agreement* provides special and additional rules for dispute settlement; (4) by contrast to Article 10.2 of the *DSU*, Article 10.1 is not limited to providing third parties with the right to present views, as it mandates that the "interests" of the third parties shall be "fully taken into account"; (5) if Article 24.1 of the *DSU* has any meaning, this "special situation" of Benin and Chad must be given full, substantive consideration by the Panel; and (6) the fact that Brazil has specifically addressed the serious prejudice caused to Benin and Chad's economies provides addition support for the position that the serious prejudice to Benin and Chad needs to be examined by the Panel.

7.1401 **China** asserts that "another Member" under Article 6.3 of the *SCM Agreement* includes any Member, the prices of whose like product, as supplied in the same market, at the same level of trade and at comparable times, is capable of being compared to the prices of the subsidized product for the purpose of determining whether "significant price undercutting" exists under Article 6.3(c).[1502]

7.1402 The **Panel** recalls that, Article 7 of the *SCM Agreement*, entitled "Remedies", sets forth the steps to be taken by a Member that believes that it has suffered adverse effects within the meaning of Part III of the *SCM Agreement*. Article 7.2 of the *SCM Agreement*, a special and additional rule or procedure identified in Appendix 2 to the *DSU*, provides that:

> "A request for consultations under paragraph 1 shall include a statement of available evidence with regard to *(a)* the existence and nature of the subsidy in question, and *(b)* the injury caused to the domestic industry, or the nullification or impairment, or serious prejudice [footnote omitted] *caused to the interests of the Member requesting consultations*." (emphasis added)

7.1403 The text of Article 7.2 of the *SCM Agreement* makes it clear that the dispute settlement procedures set forth in Article 7 of the *SCM Agreement* may only be invoked by a Member where that

[1498] New Zealand 's response to Panel third party Question No. 55.

[1499] Chinese Taipei does not claim that it is an "another Member" in the sense of Article 6.3(c) of the *SCM Agreement.* See Chinese Taipei's response to Panel third party Question No. 55.

[1500] Argentina's response to Panel third party Question No. 55.

[1501] Benin and Chad's response to Panel third party Question Nos. 44 and 55. We also recall that the delegation of Benin at the resumed session of the first substantive meeting included Mr. Nicholas Minot. See *supra*, Section VII:A, para. 7.54 and footnote 118.

[1502] China's response to Panel third party Question No. 55.

Member believes that it has itself suffered serious prejudice as a result of subsidization. From this, the only logical inference is that the serious prejudice under examination by a WTO panel is the serious prejudice experienced by the complaining Member.

7.1404 Our view of the nature of the dispute settlement process under Article 7 of the *SCM Agreement* is bolstered by the substantive provisions of Articles 5 and 6 of the *SCM Agreement*. The chapeau of Article 5 of the *SCM Agreement* reads:

> "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e. ..."

7.1405 This general introductory statement refers to "other Members" in the plural, and could be taken to refer to Members other than exclusively the complaining Member. However, the more precise text of Article 5(c) refers to "serious prejudice to the interests of *another Member*" (emphasis added). The related footnote 13 of the *SCM Agreement* specifies: "The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice."[1503]

7.1406 The entirety of Articles 7.2-7.10 of the *SCM Agreement* are special and additional rules or procedures identified in Appendix 2 to the *DSU*. However, none of these provisions contains any special rules or procedures pertaining to other WTO Members or to third parties to a dispute governed by these provisions (in conjunction with the provisions of the *DSU*). As Article 7 of the *SCM Agreement* makes no mention of third parties, the customary rights and obligations governing third party participation in panel proceedings in Article 10 of the *DSU* pertain.

7.1407 Pursuant to Article 10.1 of the *DSU*,

> "The interests of the parties to a dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process."

7.1408 We are bound to take the interests of the parties and those of other Members under the *SCM Agreement* into account during the Panel process.[1504]

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[1503] The focus on the trade effects of subsidization in Article XVI:1 of the *GATT 1994* on any other Member is carried over into Part III of the *SCM Agreement*. As we have already seen, Article 6.3 of the *SCM Agreement* provides that serious prejudice may arise where one or several of four listed situations exist, and Article 6.3(c) addresses price suppression. Article 6.7 allows a subsidizing Member to raise a defence to a displacement/impedance claim where "imports from the complaining Member" or "exports from the complaining Member" are affected by such factors as export prohibitions or restrictions, natural disasters, and arrangements limiting exports. These provisions of Article 6.7 assume that the products subject to a claim of serious prejudice arising from displacement or impedance originate in the complaining Member.

[1504] We further note the provisions of Article 3.8 of the *DSU*:

> "In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules *has an adverse impact on other Members parties to that covered agreement*, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge." (emphasis added)

This phrase also recognizes the particular nature of the rights and obligations of the covered agreements.

7.1409 We recall that two least-developed country WTO Members – Benin and Chad – have reserved third party rights in these Panel proceedings. We take note of the provisions of Article 24 of the *DSU*, entitled "Special Procedures Involving Least-Developed Country Members". Article 24.1 states:

> "1. At all stages of the determination of the causes of a dispute and of dispute settlement procedures involving a least-developed country Member, particular consideration shall be given to the special situation of least-developed country Members. In this regard, Members shall exercise due restraint in raising matters under these procedures involving a least-developed country Member. If nullification or impairment is found to result from a measure taken by a least-developed country Member, complaining parties shall exercise due restraint in asking for compensation or seeking authorization to suspend the application of concessions or other obligations pursuant to these procedures."

7.1410 While this provision seems to us primarily to address a situation where a least-developed country Member would be the Member complained against in a particular WTO dispute settlement proceeding, the first sentence of the provision is sufficiently generally worded to encompass the situation where least-developed country Members are involved as third parties in a Panel proceeding. This requires that at all stages of the dispute settlement procedures, which includes this Panel process, particular consideration shall be given to the situation of least-developed countries.[1505] We understand this direction, contained in the *DSU*, to address the procedural aspects of the dispute settlement process, rather than our substantive examination under the covered agreements. We recall our references, in Section VII:A, *supra*.

7.1411 As we have already observed, by the terms of Article 10.1 of the *DSU*, we are already bound to take the interest of *all* WTO Members – naturally including least-developed country Members – *fully* into account in our substantive examination under Part III of the *SCM Agreement*. In taking such full account of all Members' interests, we do not view it as conceptually or practically possible to take certain Members' interests *more fully* into account than those of other Members.

7.1412 Nor, in the course of our substantive examination of the merits of Brazil's claims in this dispute, do we believe that this full "taking into account" of *all* Members' interests would entitle us to alter the terms of the treaty text which determines the substantive rights and obligations of Members. In this respect, we note that the substantive subsidy disciplines in the *SCM Agreement* envisage, in Article 27, certain *substantive* special and differential treatment for developing and least-developed countries. Of certain relevance to this dispute are the substantive special and differential treatment provisions relating to the obligations of developing countries in terms of Part III of the *SCM Agreement*.[1506]

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[1505] See *supra*, Section VII:A, where we identify elements germane to the participation of Benin and Chad, as least-developed country Members in these Panel proceedings.

[1506] Articles 27.8 and 27.9 of the *SCM Agreement* provide:

> "27.8 There shall be no presumption in terms of paragraph 1 of Article 6 that a subsidy granted by a developing country Member results in serious prejudice, as defined in this Agreement. Such serious prejudice, where applicable under the terms of paragraph 9, shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6.
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> 27.9 Regarding actionable subsidies granted or maintained by a developing country Member other than those referred to in paragraph 1 of Article 6, action may not be authorized or taken under Article 7 unless nullification or impairment of tariff concessions or other obligations under GATT 1994 is found to exist as a result of such a subsidy, in such a way as to displace or impede imports of a like product of another Member into the market of the

7.1413 However, we do not see, in the text of Article 6.3(c) of the *SCM Agreement*, any specific provision concerning *substantive* special or differential treatment in the situation dealt with under these particular Panel proceedings.

7.1414 For these reasons, in examining Brazil's allegations under Part III of the *SCM Agreement* that it has suffered serious prejudice to its interests within the meaning of Article 5(c), we take full account of the interest of *all* Members – including those of least-developed Members – in these dispute settlement proceedings in accordance with the rights and obligations provided for in Part III of the *SCM Agreement*. Pursuant to Article 3.2 of the *DSU*, we are called upon to clarify the rights and obligations in this covered agreement through application of customary principles of interpretation of public international law.

7.1415 Therefore, we have taken into account serious prejudice allegations of other Members to the extent these constitute evidentiary support of the effect of the subsidy borne by Brazil as a Member whose producers are involved in the production and trade in upland cotton in the world market. However, we have not based our decision on any alleged serious prejudice caused to them.

7.1416 In conclusion, in light of all of these considerations, we find that the effect of the mandatory, price contingent United States subsidies at issue – that is, marketing loan programme payments, user marketing (Step 2) payments and MLA payments and CCP payments – is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Articles 6.3(c) and 5(c) of the *SCM Agreement*.

## 4. Claims under Articles 6.3(d) and 5(c) of the *SCM Agreement*

### (a) Introduction

7.1417 As we have already mentioned, Part III of the *SCM Agreement* is entitled "Actionable Subsidies". Article 5 of the *SCM Agreement* is entitled "Adverse Effects". According to its chapeau: "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e. ...". Article 5(c) identifies "serious prejudice to the interests of another Member" as one such adverse effect. Article 6.3(d) of the *SCM Agreement* provides:

> "Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply ...
>
> (d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity[17] as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted."
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>
> [17]Unless other multilaterally agreed specific rules apply to the trade in the product or commodity in question.

7.1418 We recall that, pursuant to the chapeau of Article 5 of the *SCM Agreement*, to be an "actionable subsidy" for the purposes of Part III of the *SCM Agreement*, there must first be a specific

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subsidizing developing country Member or unless injury to a domestic industry in the market of an importing Member occurs."

subsidy within the meaning of Articles 1.1 and 1.2 of the *SCM Agreement*. We refer to, and incorporate, our earlier findings that the subsidies at issue – user marketing (Step 2) payments to domestic users and exporters[1507]; marketing loan programme payments; PFC payments; MLA payments; DP payments; CCP payments; crop insurance payments; and cottonseed payments constitute "subsidies" within the meaning of Articles 1.1(a) and (b) of the *SCM Agreement* that are "specific" within the meaning of Articles 1.2 and 2 of the *SCM Agreement*.

7.1419 Having established that these subsidies may be actionable for the purposes of Article 5, we observe that there is no disagreement between the parties that an examination under Article 6.3(d) may precede any examination under Article 5(c) of the *SCM Agreement*. There is also no disagreement, in this part of this dispute, that an affirmative conclusion under Article 6.3(d) is a necessary element for an affirmative serious prejudice finding under Article 5(c). We therefore first examine the elements of Brazil's claim under Article 6.3(d) of the *SCM Agreement*.

7.1420 The text of Article 6.3(d) of the *SCM Agreement* consists of at least the following six definitional elements: (i) the effect of the subsidy; (ii) is an increase in the world market share; (iii) of the subsidizing Member; (iv) in a particular subsidized primary product or commodity; (v) as compared to the average over the preceding period of three years; and (vi) this increase "follows a consistent trend over a period when subsidies have been granted."

7.1421 There is no disagreement between the parties that the United States is the [alleged] "subsidizing Member", nor that upland cotton is the "particular subsidized primary product or commodity" in question.[1508]

7.1422 However, the parties disagree on the meaning of "world market share". Due to the evidence each party marshals in line with its own understanding of these terms, the answer to the question of whether or not an "increase" exists following a period manifesting a consistent trend within the meaning of Article 6.3(d) would differ.

7.1423 We thus now examine the meaning of "world market share" in the text of this treaty provision.

(b) "World market share"

7.1424 **Brazil** argues that the phrase "world market share" as used in Article 6.3(d) of the *SCM Agreement* means a Member's share of the world market for exports.[1509]

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[1507] We again recall that we have already found *supra* that user marketing (Step 2) payments to domestic users and exporters are "subsidies" within the meaning of Article 1 of the *SCM Agreement*. *Supra*, Sections VII:E and F.

[1508] United States' response to Panel Question No. 154; Brazil's further written submission, para. 262. Footnote 17 of the *SCM Agreement*, linked to Article 6.3(d), states that the provision applies to a particular subsidized primary product or commodity "[u]nless other multilaterally agreed specific rules apply to the trade in the product or commodity in question." In this dispute, the parties are in agreement that footnote 17 does not affect a claim under this provision concerning upland cotton. See, e.g. Brazil's further written submission, para. 275; United States' response to Panel Question No. 156: (Brazil notes that footnote 17 does not carve out upland cotton from the scope of Article 6.3(d), as there are no multilateral agreed "specific" rules that apply to the trade of upland cotton. Brazil further submits examples of what it conceives would be covered by footnote 17, in the form of: *The International Agreement on Olive Oil and Table Olives*, EC OJ L214, 4 August 1987, reproduced in Exhibit BRA-246; *The International Sugar Agreement of 1977*, 9 *Australian Treaty Series* (1978), reproduced in Exhibit BRA-248; and a list of further "International Commodity Agreements" from the website: europa.eu.int/eur-lex/en/..., reproduced in Exhibit BRA-247. The United States asserts that it is not aware of any other multilaterally agreed specific rules that apply to upland cotton within the meaning of footnote 17.) Given this agreed view of the parties, we wish to emphasize that our reasoning is without prejudice to the interpretation of footnote 17.

7.1425 The **United States** is of the view that the reference to "world market share" in Article 6.3(d) of the *SCM Agreement* "encompasses all consumption of upland cotton, including consumption by a country of its own cotton production" and that "US cotton's share of total world consumption" is "US exports plus domestic US consumption divided by total world consumption".[1510] In response to a Panel question, the United States asserted: "The United States has proposed that the US share of the world market for upland cotton must be measured by that portion of world consumption of upland cotton satisfied by United States upland cotton."[1511]

7.1426 As third parties, **Argentina** and **New Zealand** argue that the United States errs in its interpretation of the expression "world market share" in Article 6.3(d) by trying to identify it with "share in world consumption". However, the **European Communities** supports the United States' arguments: the ordinary meaning of "world market" is the sum of all the geographical markets for the product concerned, including the domestic market of the subsidizing Member.[1512] **Paraguay** generally requests the Panel to find that the measures applied by the United States are inconsistent with the obligations laid down in various provisions of the GATT 1994 and the *SCM Agreement*, and to take account of the arguments put forward by Brazil.[1513]

7.1427 **We** must therefore interpret the phrase "world market share" in order to decide whether it refers to the world *export* market (as Brazil argues), or whether it encompasses all consumption of upland cotton, including consumption by a country of its own cotton production (as the United States argues), or whether it refers to something else.

7.1428 We recall our examination of the term "market" in the context of our Article 6.3(c) analysis.[1514] We see no reason, and none has been pointed out to us, why a similar approach to this terms cannot be taken here in the circumstances of this dispute.

7.1429 As we have already observed, the term "market" can be defined as: "a place ... with a demand for a commodity or service"[1515]; "a geographical area of demand for commodities or services"; "the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices".[1516] In one of its ordinary meanings, therefore, "market" may refer to a geographical area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices, that is, a locus of competition for sales of a particular commodity.

7.1430 As we have already noted[1517], the meaning of a the term "market" may vary depending upon the geographical context in which the term is used. That is, if the frame of reference is a market within a sub-federal unit within a Member, a Member's domestic market, or a continental or regional market, the meaning would be different than, for example, a "world market" in the context in which the term is used in Article 6.3(d) of the *WTO Agreement.*

7.1431 The ordinary meaning of "world market" is the global geographical area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices.

7.1432 We see no foundation in the plain meaning of these terms to find that "world market" as used in Article 6.3(d) would necessarily *not* include the domestic market of the subsidizing Member.

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[1509] Brazil's further written submission, para. 265.
[1510] United States' further written submission, paras. 97 and 99 and footnote 52.
[1511] United States response to Panel question No. 239(b), para. 148.
[1512] European Communities' written submission to the resumed session of the first substantive meeting paras. 14-16.
[1513] Paraguay's written submission to the resumed session of the first substantive meeting, para. 15.
[1514] *Supra*, paras. 7.1235-7.1252
[1515] *The New Shorter Oxford English Dictionary*, (1993).
[1516] *Merriam-Webster Dictionary Online*.
[1517] See *supra*, paras. 7.1246-7.1247.

Rather, we see that this may be a geographic term inclusive of all national "markets", to the extent that such inclusion would be germane to the inquiry envisaged by the provision.

7.1433 The text of Article 6.3(d) also refers to a particular "share" of this world market. The ordinary meaning of the word "share" is "a: a portion belonging to, due to, or contributed by an individual or group; b: one's full or fair portion".[1518]

7.1434 According to Article 6.3(d), it is the "share of the subsidizing Member" that must be examined. Thus, we need to examine the portion of the world market that is satisfied by the subsidizing Member's producers. We are of the view that a plain reading of the combined terms "share of the subsidizing Member" and "world market" in Article 6.3(d) calls for an examination of the portion of the world's supply that is satisfied by the subsidizing Member's producers.

7.1435 Therefore, we disagree with Brazil's argument that a Member's share of the world market would necessarily consist solely of the Member's exports as a proportion of the world export market, and would not embrace relevant developments within the domestic market of the Member. Like Brazil, we believe that a Member's exports are relevant to an examination under this provision. However, unlike Brazil, we also believe that a Member's supply (which may not ultimately be exported) is also a relevant consideration for the purposes of this provision.

7.1436 Furthermore, we agree with the United States that certain developments within the subsidizing Member's domestic market may be relevant. However, we disagree with the United States argument that a Member's share of the world market within the meaning of Article 6.3(d) would necessarily include a Member's own *consumption*.[1519]

7.1437 We derive support for this interpretation of the text of Article 6.3(d) from the immediate context of Article 6.3(d), that is, other paragraphs in the same Article: Article 6.3(a) refers to "imports" and Article 6.3(b) refers to "exports". Both of these provisions contain market-specific references. Article 6.3(a) indicates that a Member's domestic market (as a potential destination for the exports of other Members) may indeed be relevant to a serious prejudice analysis. Article 6.3(b) indicates that the market of a third country Member to which the subsidizing and complaining Member exports may also be relevant. Article 6.3(c) does not refer specifically to the domestic market of any Member. It refers to "the same market", which we have found may refer to a geographical area, including the world.[1520]

7.1438 Other provisions of the covered agreements provide additional contextual guidance. Article XVI:3 of the *GATT 1994* explicitly refers to "world export trade". Article 27.6 of the *SCM Agreement*, dealing with achievement by developing country Members of export competitiveness explicitly refers to the situation where "a developing country Member's exports of [a] product have reached a share of at least 3.25 per cent in world trade of that product".

7.1439 Brazil would have us read the terms "world market share" in Article 6.3(d) to be synonymous with the phrases "world export trade" or the share of a Member's exports in world trade in these other contextual provisions. The United States asserts that, had Members intended that "world export trade" be the relevant concept to apply in Article 6.3(d), one would have expected use of that phrase.

7.1440 We agree entirely with the United States on this point. The use of the phrase "world export trade" in Article XVI:3 of the *GATT 1994* demonstrates to us that the drafters were well aware of how

[1518] *Merriam-Webster Dictionary Online*.

[1519] We note that the United States at times refers to an approach which seems to resemble the one we adopt (see, for example, United States response to Panel Question No. 239(b), para. 148, cited *supra*, **at** para. 7.1425). However, the United States' arguments focus on the term "consumption" and, as we have noted, *infra*, at footnote 1527, the United States' data includes imports, which is not reflective of our approach.

[1520] *Supra*, 7.1235-7.1252.

to insert this concept when they so intended. Indeed, the fact that this particular phraseology had existed since the inception of the *GATT 1947* means that the Uruguay Round negotiators could very well have simply transposed those terms from the text of Article XVI:3 of the *GATT 1947* into Article 6.3(d) of the *SCM Agreement*.[1521] However, they did not do so.

*7.1441* Similarly, the use of the terms "a developing country Member's exports of [a] product have reached a share of at least 3.25 per cent in world trade of that product" in Article 27.6 of the *SCM Agreement* demonstrates to us that negotiators were well aware of how to include a reference to a Member's share of world export trade in the product concerned in the same *SCM Agreement*. However, again, they did not do so.

7.1442 Rather, the Uruguay Round negotiators used different words in Article 6.3(d) of the *SCM Agreement*. We attribute meaning to the fact that the negotiators used such different words. It is not our task to read into the text obligations which do not exist or concepts which are not there. We therefore cannot read the terms "world market share" in Article 6.3(d) as referring to a Member's share of "world export trade".

7.1443 Brazil has submitted evidence to us that the interpretation of the phrase "world market share" as referring to the share of a member's exports in world export trade in Article 6.3(d) is consistent with the USDA's[1522] own use of the term "world market share", as well as with the use of that term by other Members – e.g. and the European Communities[1523] and Canada.[1524]

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[1521] The Tokyo Round negotiators had done just this, maintaining the Article XVI:3 reference to "more than an equitable share of world export trade" in Articles 10.1 and 10.2 of the *Tokyo Round Subsidies Code*.

[1522] Exhibit BRA-277 (USDA, *Cotton: World Markets and Trade*, January 2000, "Francophone West African Cotton Exports Reach 14 Percent of *World Market Share*", also stating such "exports are 14 per cent of world trade"); Exhibit BRA-277 (USDA, *Oilseeds: World Markets and Trade*, Circular Series FOP 11-01, November 2001, p. 1,"Growth in World Soybean Trade Benefits Brazil", states: "As the demand for soybeans has surged in recent years, Brazil has been able to increase exports both relative to their competitors, as well as in absolute terms. Brazil's exports have grown from 8.9 million tons three years ago to an estimated 17.5 million tons in the coming October-September year. This growth represents a rise in Brazil's *world market share* from 23.1 per cent three years ago, to 30.5 per cent expected this coming year.") (emphasis added); Exhibit BRA-277 (Paul C. Westcott and Linwood A. Hoffman, Market and Trade Economics Division, Economic Research Service, USDA, "Price Determination for Corn and Wheat: The Role of Market Factors and Government Programs," Technical Bulletin N° 1878, July 1999, p. 7, under the sub-heading "Exports" states: "Although the United States is the world's largest exporter of wheat, it has a smaller *world market share* than for corn, averaging slightly over 30 per cent of global wheat trade in 1990-96."); Exhibit BRA-277 ("World Coarse Grains Situation and Outlook," FASOnline, p. 1, states: "Global corn trade is forecast up marginally to a five year high. Increased exports from China and Argentina are expected to encroach into US *world market share*, reducing expected exports 2.9 million tons from 1998/99.") (emphasis added); Exhibit BRA-277 (USDA, "World Beef, Pork, and Broiler Trade Forecast to Reach Record High in 2002; Competition for Market Share Stiffens," Livestock and Poultry: World Markets and Trade, Circular Series DL&P 1-02, March 2002 states: "World beef, pork, and poultry exports for 2002 are forecast to rise to new records. For beef and pork, the United States will be facing stiff competition in key markets, especially Japan. For poultry, US exports are projected to continue growing, although Brazil is making gains in their *world market share*.") (emphasis added); Exhibit BRA-277 ("U.S. Agricultural Market Share Holds Its Own," FASOnline, October 1998, p. 1, states: "Exports fell ... and are projected to fall ... Despite the decline, it's important to remember that the United States has managed to retain its share of the global agricultural trade pie: the U.S. *world market share* is forecast to remain at 19.5 per cent in 1999.") (emphasis added).

[1523] EUROPA, Trade Issues, Sectoral Issues, "Trade in Agricultural Goods and Fishery Products," Press Release, Brussels, 11 July 2002, p. 3, reproduced in Exhibit BRA-277 states: "The same factors also help to explain why an obverse picture is seen in *exports*. The EU exports far less to developing countries than the U.S., and is in fact losing *world market share* in farm commodity products (due to restraint in use of export measures and supply-side limiting measures.") (emphasis added).

[1524] Agriculture and Agri-Food Canada, "Challenges and Implications Arising from the Achievement of CAMC's 2005 Agri-food Export Target," June 1998, p. 9, reproduced in Exhibit BRA-277 states: "For most

7.1444 This evidence indicates that some WTO Members, including the United States itself, sometimes utilize the phrase "world market share" when referring, in the context of world agricultural trade, including world trade of upland cotton, to the proportional share of a Member's exports in relation to world exports.

7.1445 However, we do not view this evidence as determinative for the interpretation of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement*. It is not a formal interpretative tool within the meaning of Articles 31 or 32 of the *Vienna Convention*, much less a universally agreed interpretation among WTO Members within the meaning of the *WTO Agreement*.

7.1446 Our interpretation of the text, in its context, also finds support in the object and purpose of the subsidy disciplines in the *SCM Agreement*. As we have already mentioned, Part III of the *SCM Agreement*, containing Articles 5-7, is entitled "Actionable Subsidies". Article 5 of the *SCM Agreement* is entitled "Adverse Effects"; Article 6 is entitled "Serious Prejudice".

7.1447 From even this rudimentary outline, it is evident to us that Part III of the *SCM Agreement* focuses on the effects of subsidies in respect of products produced by a Member's producers, in order to discern, for example, whether and to what extent such subsidies increase their production (and export) of the product concerned in a manner that causes adverse effects. Why is this so? Because such increase in the production and export of the product concerned from the subsidizing Member – which does not flow from the operation of market forces but rather reflects governmental interference through the bestowal of subsidies – may adversely affect other Members' production and export of the product concerned.

7.1448 If we held the view that the actionable subsidies provisions in Part III of the *SCM Agreement* were limited to export subsidies[1525] – which we most definitely do not – then we would perhaps be more sympathetic to the view that "world market share" in Article 6.3(d) referred to "world export trade". This would dovetail with the hypothetical scope of application of that provision in such a scenario.

7.1449 However, we hasten to underline that actionable subsidies governed by the provisions of Part III of the *SCM Agreement* are *not* limited to export subsidies, or even to subsidies which may necessarily affect a subsidizing Member's exportation. Rather, Part III of the *SCM Agreement* relates generally to adverse effects, including those that may be the effect of subsidies that affect production. This includes not only those subsidies that, while not contingent upon export performance within the meaning of Article 3.1(a), may still incidentally facilitate or promote exportation. It also embraces subsidies that promote production itself, whether or not exportation of such production necessarily results.[1526]

7.1450 In order to dovetail with the actual scope of application of Article 6.3(d), and with the overall architecture of the subsidies disciplines in the agreement, we believe that it is not only entirely reasonable, but also necessary, to read the phrase "world market share" in a manner which takes into account both production and exports. This supports our interpretation of that provision as referring to the share of the world market supplied by the subsidizing Member.

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bulk commodities, Canada may significantly increase export volume but have relatively little impact on world prices because of its small *share of the world market*." (emphasis added).

[1525] Article 3.1(a) in Part II of the *SCM Agreement* addresses, and indeed prohibits, subsidies contingent upon exportation. An interpretation that actionable subsidies included only export subsidies would render the distinction between the prohibited subsidy disciplines in Part II of the *SCM Agreement* and the actionable subsidies disciplines in Part III of the *SCM Agreement* a nullity. We, as a treaty interpreter, are not permitted to do so.

[1526] For example, Article 6.3(a) focuses on effects within the domestic market of the subsidizing Member.

7.1451 By contrast, a focus on a Member's consumption share, plus exports, in world consumption in Article 6.3(d) would run counter to the underlying object and purpose of the subsidy disciplines in the agreement. We do not find tenable the proposition that the expression "world market share" in Article 6.3(d) includes the increase in consumption of the Member granting the subsidy.[1527] It is simply unfathomable to us why an agreement that focuses on subsidies in respect of products would contain a provision effectively limiting an increase in a Member's *consumption* of a product, including of their own product.

7.1452 Indeed, increased consumption of a product would potentially lead to enhanced demand, which might then be satisfied either by the subsidizing Member's own production, or from imports. To the extent imports increased due to enhanced consumption, this would be more likely to benefit, rather than adversely effect, the interests of other WTO Members. Such a situation would most definitely not fall within the "adverse effects" paradigm envisaged in Part III of the *SCM Agreement*.

7.1453 The aim of Articles 5 and 6 is to address the adverse effects of subsidies on the interests of other Members. Specifically, it is concerned with adverse effects to other Members caused when one Member uses subsidies in order to increase its share of the world market for a particular product. To construe "world market share" as including a reference to the consumption of a Member as a share of world consumption of a product would subvert the underlying rationale of Article 6.3(d).

7.1454 We thus understand the terms "world market share" in the text of Article 6.3(d) to refer to the share of the world market supplied by the subsidizing Member.

7.1455 We consider that this interpretation of the text, in its context, and in light of the object and purpose of the subsidy disciplines in the *SCM Agreement* is clear and unambiguous. We would therefore be entitled to stop our interpretive examination here.[1528] However, we note that recourse to the drafting history of the provision only serves to confirm this interpretation.

7.1456 As we have already mentioned, Article XVI of the *GATT 1947* contained two "parts". Part A was entitled "Subsidies in General". Part B was entitled "Additional Provisions on Export Subsidies". Article XVI:3 of the *GATT 1947*, in Part B, read:

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[1527] To the extent that the United States could be understood to have argued that the United States share of total world consumption is: (United States consumption + United States exports)/ total world consumption. (United States response to Panel Question 197 and Exhibit US-47.), we would note that calculation of the converse figure (Non-United States consumption + non-United States-exports)/total world consumption (presuming that other WTO Members would also apply the same methodology) results in a total world market share that exceeds 100 per cent. (See Brazil's 28 January comments on United States' response to Panel Question No. 236). Furthermore, the United States data and methodology double count exports as part of the "world market share" of the exporting country and part of the consumption of the importing country that contributes to total world consumption. (See United States' response to Panel Question No. 197 and footnote 24). There, the United States indicates that the figure for United States consumption includes imports. Exhibit US-120 contains USDA, Economic Research Service, *Fibres Yearbook*, Appendix Table 2, "Upland Cotton Supply and Use". For the years MY 1965-2003, it shows a consistently very low ratio of imports to United States production of upland cotton (for example, MY 2001, the ratio was 5:19,603 bales; the ratio was at its highest in 1998, at 427:13,426). Although the United States asserts that "United States cotton imports are often zero and, even when positive, have accounted for less than one per cent of consumption over the past decade", this United States-specific analysis would not be susceptible of universal application to all WTO Members, particularly in the case of a Member whose imports accounted for a larger proportion of domestic consumption. To the extent that the United States could be understood to have argued in these Panel proceedings that the United States share of total world consumption is: (United States consumption *of US cotton* + United States exports)/ total world consumption, as in , for example, United States' response to Panel Question No. 238(b), footnote 15, the above observations on the reference to "consumption" and the "consumption" data submitted to us would still hold. See also *supra*, footnote 1519.

[1528] *Supra*, footnote 636.

> "3. Accordingly, contracting parties should seek to avoid the use of subsidies on the export of primary products. If, however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having *more than an equitable share of world export trade* in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product." (emphasis added)

7.1457 As we have already observed, the *Tokyo Round Subsidies Code* contained four main substantive provisions on subsidies:[1529] Article 8 ("Subsidies – General Provisions"), Article 9 ("Export subsidies on products other than certain primary products"); Article 10 ("Export subsidies on certain primary products"); and Article 11 ("Subsidies other than export subsidies").

7.1458 Article 9.1 stipulated that: "[S]ignatories shall not grant export subsidies on products other than certain primary products". Article 10.1 of the *Tokyo Round Subsidies Code* read:

> "1. In accordance with the provisions of Article XVI:3 of the General Agreement, signatories agree not to grant directly or indirectly any export subsidy on certain primary products in a manner which results in the signatory granting such subsidy having *more than an equitable share of world export trade* in such product, account being taken of the shares of the signatories in trade in the product concerned during a previous representative period, and any special factors which may have affected or may be affecting trade in such product." (emphasis added, footnotes omitted)

7.1459 This suggests that the drafters of the *Tokyo Round Subsidies Code* considered that the export subsidies in Article 10 of the *Tokyo Round Subsidies Code* were subject to Article XVI:3 of the *GATT 1994*. Read in context, the drafters indicated that those export subsidies on certain primary products were subject to certain disciplines, other export subsidies were subject to certain other disciplines and subsidies *other than export subsidies* were subject to still *other* disciplines and could form the main basis for a serious prejudice claim.[1530]

7.1460 The text of Article 6.3(d)[1531] of the current *SCM Agreement* is cited above, as are the export subsidy provisions of the current *Agreement on Agriculture* and the *SCM Agreement*.[1532]

7.1461 At first blush, there appear to be overarching similarities between Article XVI:3 and Article 6.3(d). For example, both call for a comparison of a Member's quantitative share in a certain world phenomenon with a corresponding share during a previous period. While the tests contained in Article 6.3(d) and Article XVI:3 may be similar, they are certainly not textually or conceptually identical. For example, Article 6.3(d) does not contain the terms "equitable share" and "special factors"; and it defines a "previous representative period" for comparison as three years. It also refers to "world market share" rather than "world export trade". It also refers to "a particular subsidized product or commodity" rather than "certain primary products".

7.1462 As we have already indicated[1533], we believe that the text of Article XVI:3 refers only to export subsidies which are now also governed by the prohibition in Article 3.1(a) of the

[1529] See *supra*, paras. 7.1007 *ff*. Also see *supra*, footnote 1492 for a discussion, in another context, of the GATT panel reports which occurred prior and subsequent to the entry into force of the *Tokyo Round Subsidies Code*.

[1530] *Supra*, paras. 7.999 *ff* of Section VII:E.

[1531] *Supra*, para. 7.1417.

[1532] e.g. s*upra*, paras. 7.654 *ff*.

[1533] *Supra*, paras. 7.999 *ff* of Section VII:E.

*SCM Agreement* (except as provided in the *Agreement on Agriculture*). It does not address actionable subsidies governed by the provisions of Part III of the *SCM Agreement*. By extension, we do not believe that the language of Articles 5(c)/6.3(d) of the *SCM Agreement* suggests an intention by the Uruguay Round negotiators directly to *develop and refine* the requirements of Article XVI:3 of the *GATT 1994* within the actionable subsidy provisions of the *SCM Agreement*. At least, if there was such an intention, they have not clearly so indicated in the text of these two covered agreements.

7.1463 Rather, the Uruguay Round negotiators indicated in the text their intention to devise a new test pertaining to Members' "not-necessarily-export-contingent-subsidies" in respect of primary products and commodities, and which would take into account considerations germane to worldwide trade in such products and commodities, including trends in production and export that would be affected by Members' bestowal of subsidies.

7.1464 We therefore find that the phrase "world market share" of the subsidizing Member in Article 6.3(d) of the *SCM Agreement* refers to share of the world market supplied by the subsidizing Member of the product concerned.

7.1465 As Brazil's evidence and argumentation in this dispute focused exclusively upon a different, and in our view erroneous, legal interpretation of the phrase "world market share" in Article 6.3(d), we find that Brazil has not established a prima facie case of violation of Article 6.3(d) or Article 5(c) of the *SCM Agreement*.[1534]

## 5. Claim under Article XVI:1 of the *GATT 1994*

(a) Main arguments of the parties

7.1466 **Brazil** requests us to rule that the United States subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by resulting in the United States having more than an equitable share of world exports of upland cotton in violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

7.1467 Brazil clarifies, in responding to a Panel question, that it does not seek relief under Article XVI in respect of "expired measures", by which Brazil understands the Panel to mean the legal instruments consisting of the FAIR Act of 1996 as well as the various emergency appropriation Acts in 1998-2001 providing, *inter alia*, for MLA payments.[1535]

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[1534] In accordance with the Panel's duty to make an objective assessment of the matter before it pursuant to Article 11 of the *DSU* concerning the interpretation of the term "world market share" in Article 6.3(d) of the *SCM Agreement*, we nevertheless observe that data pertaining to the share of United States *exports* as a proportion of world *exports* – i.e. corresponding to the legal interpretation proposed by Brazil in these proceedings – can be found in Exhibits BRA-206 and BRA-302 and in United States response' to Panel Question No. 160. See also our findings *supra*, para. 7.1283.

Data pertaining to the share of United States consumption as a proportion of world *consumption* – i.e. corresponding to the legal interpretation proposed by the United States in these proceedings – can be found in Exhibits US-47, US-70 and US-71. United States figures (MY 1995-1998 data from USDA/FAS, *Cotton, World Markets and Trade*; and otherwise from Production, Supply and Demand Estimates (www.fas.usda.gov/psd) and USDA, *World Agricultural Supply and Demand Estimates Report* (December (2003)) show the following for "US consumption and exports as a share of world consumption": MY 1995/96 – 21.3 per cent; MY 1996/97 – 20.4 per cent; MY 1997/98 – 21.6 per cent; MY 1998/9 – 17.4 per cent; MY 1999/2000 – 18.6 per cent; MY 2000/01 16.9 per cent; MY 2001/2 – 19.8 per cent; MY 2002/3 – 19.6 per cent. (2002/03 is considered an estimate).

We also recall our findings *supra*, relating to the United States share of world upland cotton production, para. 7.1282.

[1535] Brazil's response to Panel Question No. 250, para. 184.

7.1468 The **United States** contends that Brazil's joint claim under Articles XVI:1 and XVI:3 of the *GATT 1994* has no legal basis. According to the United States, Article XVI:3 pertains only to export subsidies and Brazil has failed to demonstrate a prima facie case of inconsistency with Article XVI:3.

(b) Main arguments of the third parties

7.1469 **Argentina**[1536], **China**[1537], **Chinese Taipei**[1538], the **European Communities**[1539] and **New Zealand**[1540] are generally of the view that a finding of serious prejudice under Article 5(c) of the *SCM Agreement* would be determinative for a finding under Article XVI:1 of the *GATT 1994.*

(c) Evaluation by the Panel

7.1470 We understand that Brazil's claims under Article XVI:1 and XVI:3 of the *GATT 1994* envisage a joint application of these two provisions. That is, Brazil does not make independent claims under paragraphs 1 and 3 of Article XVI, but rather requests us to rule that the United States subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by resulting in the United States having more than an equitable share of world exports of upland cotton in joint violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

7.1471 As we have already indicated[1541], we do not believe that these provisions are susceptible to such joint application. Rather, each requires application in accordance with its own terms. We therefore examine the terms of these two distinct treaty provisions separately.

7.1472 Article XVI:1 of the *GATT 1994*, is found in Part A of that article, entitled "Subsidies in General". It states:

> "If any [Member] grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify ... in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, ..., the possibility of limiting the subsidization."

7.1473 There is an explicit textual linkage between Article 6.3(d) and Article 5(c) of the *SCM Agreement*: the chapeau of Article 6.3 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise where one of the following [including the elements in Article 6.3(d)] apply...".

7.1474 Following that cross-reference to Article 5(c), we see that footnote 13 to Article 5(c) explicitly refers to Article XVI:1 of the *GATT 1994*. It states: "The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice."

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[1536] Argentina's response to Panel third party Question No. 53.
[1537] China's response to Panel third party Question No. 53.
[1538] Chinese Taipei's response to Panel third party Question No. 53.
[1539] European Communities response to Panel third party Question No. 53.
[1540] New Zealand's response to Panel third party Question No. 53.
[1541] See Section VII:E.

7.1475 As the term "serious prejudice" in both provisions of the two agreements is used "in the same sense", our findings of "serious prejudice" under Articles 5(c)/6.3(c) of the *SCM Agreement* would also be conclusive for a finding of "serious prejudice" under Article XVI:1 of the *GATT 1994*. That is, if the terms "serious prejudice" are used "in the same sense" in the two provisions, a finding of "serious prejudice" under Article 5(c) must necessarily also constitute a finding of "serious prejudice" also for the purposes of Article XVI:1. In addition, the remedies available under Part III of the *SCM Agreement* are at least as effective as those that would be available under Article 19.1 of the *DSU* in respect of an infringement of Article XVI:1 of the *GATT 1994*.

7.1476 In light of our findings of inconsistency with Articles 5(c) and 6.3(c) of the *SCM Agreement*[1542], and for these reasons, we see no need for an additional examination of "serious prejudice" for the purposes of Article XVI:1 of the *GATT 1994*.[1543]

## H. ACTIONABLE SUBSIDIES: CLAIMS OF "THREAT OF" SERIOUS PREJUDICE

### 1. Measures at issue

7.1477 This Section of our report deals with alleged actionable subsidies from MY 2003-MY 2007.[1544] These are the following measures, as described in Section VII:C of this report:

(i) export credit guarantees under the GSM 102 programme[1545];

(ii) user marketing (Step 2) payments to exporters and domestic users[1546];

(iii) marketing loan programme payments;

(iv) direct payments;

[1542] *Supra*, para. 7.1416.

[1543] To the extent that Brazil's argument under Article XVI:1 also focuses upon the attainment of an "inequitable share of world export trade" within the meaning of Article XVI:3 of the *GATT 1994*, we have addressed this *supra*, in Section VII:E.

[1544] As regards the "implementation period" – during which Article 13 of the *Agreement on Agriculture* applies – the United States is of the view that the end of the 2003 *calendar* year is not relevant to this dispute because US commitments with respect to cotton are specified by *marketing* year. See United States' response to Panel Question No. 124. To the extent that there is any issue as to precisely when in "2003" the implementation period for purposes of Article 13 expires, we recall our findings in *supra*, Section VII:D relating to claims of threat of serious prejudice. In particular, we recall our statement in paragraph 7.595. Given those findings, we are of the view that the United States cannot, in any event, benefit from the conditional protection of Article 13 of the *Agreement on Agriculture* during MY 2003 or subsequently in relation to claims of threat of serious prejudice.

[1545] We recall that, in Section VII:E, we have found that export credit guarantees under the three export credit guarantee programmes before us constitute export subsidies in violation of Article 10.1 and 8 of the *Agreement on Agriculture* and prohibited export subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*. We note that Brazil's references to GSM 102 in its claims of threat of serious prejudice are somewhat inconsistent. While it does not refer to GSM 102 as one of the five "mandatory" subsidies in question, it nevertheless refers to the GSM 102 programme in various places in its threat analysis. In any event, Brazil clarified, in response to Panel Question No. 139, that Brazil's serious prejudice claims relating to export credit guarantee programmes refer only to one of the three United States export credit guarantee programmes, GSM102. According to Brazil, this is because either no upland cotton allocations were made or only negligible amounts of cotton were exported under the GSM 103 and SCGP programs during the years in question.

[1546] We recall that, in Section VII:E, we have found that the aspect of the measure providing for payments to exporters constitutes an export subsidy in violation of the Articles 3.3 and 8 of the *Agreement on Agriculture* and a prohibited export subsidy under Articles 3.1(a) and 3.2 of the *SCM Agreement;* in Section VII:F, we have found that the aspect of the measure providing for payments to domestic users is an import substitution subsidy within the meaning of Articles 3.1(b) and 3.2 of the *SCM Agreement*.

(v) counter-cyclical payments;

(vi) crop insurance payments; and

(vii) legislative and regulatory provisions providing for the payment of measures (i)-(vi) above.

## 2. Overview of Brazil's claims of threat of serious prejudice under the *SCM Agreement* and the *GATT 1994*

7.1478 Brazil alleges "threat of serious prejudice" under Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*, and Articles XVI:1 and XVI:3 of the *GATT 1994*. Brazil claims that United States subsidies to be granted during MY 2003-MY 2007 threaten to cause serious prejudice to Brazil's interests as follows:

(i) threat of significantly suppressing upland cotton prices in the United States, world and Brazilian markets in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*;

(ii) threat of increasing the United States share of the upland cotton world market in violation of Articles 5(c) and 6.3(d) of the *SCM Agreement*; and

(iii) threat of the United States continuing to have more than an equitable share of world export trade in violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

## 3. Claim of threat of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*

(a) Main arguments of the parties

7.1479 **Brazil** submits that the appropriate test for "threat"[1547] of serious prejudice for the purposes of Articles 5(c) and 6.3(c)/(d) of the *SCM Agreement* is whether the payments are mandated by legal mechanisms and whether there are any effective limits on the volume of production, volume of exports or the budgetary expenditures related to upland cotton. Brazil also asserts an alternative test: the same elements necessary to demonstrate present serious prejudice focusing on the likely effects of the subsidies in suppressing world prices and increasing and maintaining a high level of world export market share.

7.1480 According to Brazil, the United States subsidies at issue threaten to cause serious prejudice within the meaning of Article 5(c) of the *SCM Agreement* because, under either test:

- five types of subsidies (user marketing (Step 2) payments; marketing loan programme payments; DP payments; CCP payments; and crop insurance payments) are "mandatory" payments to eligible recipients, with unlimited budgetary expenditures and on an unlimited amount of upland cotton production.

- existing "present" serious prejudice in MY 1999-2002 is proof that a "threat" exists in MY 2003-MY 2007 given the substantial similarity between the measures in question and the increase of subsidies under the FSRI Act of 2002;

[1547] Brazil refers, in support, to past GATT Panel Reports in *EC – Sugar Exports (Australia)* and *EC – Sugar Exports (Brazil)* and the WTO Appellate Body Report in *US – FSC*.

- the nature of the United States subsidies and their likely trade effects are evidence of "threat";

- given continuing high costs of production, the United States producers' cost-revenue gap will remain significant and United States producers will remain dependent on all United States subsidies to maintain current levels of production throughout MY 2003-MY 2007;

- the significant production, export and price-suppressing effects of the mandated United States subsidies will exist between MY 2003-MY 2007 even as world prices fluctuate (as DP payments, crop insurance and export credit guarantees are not impacted by market price fluctuations);

- current and projected price levels indicate that marketing loan programme payments and CCP payments will be made during MY 2003-MY 2007;

- USDA's projected upland cotton acreage, United States Senators' statements and research by independent or other experts all support a finding of threat of serious prejudice between MY 2003-MY 2007;

- the increasing reliance of United States producers on export sales will enhance the price suppressing effects of the subsidies (particularly the user marketing (Step 2) payments and the export credit guarantees).

7.1481 The **United States** asserts that Brazil's test for "threat" of serious prejudice is incorrect as it would produce a threat determination wherever subsidies by a large exporter have no effective production or export limitations. According to the United States, the appropriate test for "threat" is whether there is a clearly foreseen and imminent likelihood of future serious prejudice in light of future market conditions, world prices and other factors.[1548]

7.1482 The United States argues that Brazil has not demonstrated a clearly foreseen and imminent likelihood of future serious prejudice, mainly because: no "present" serious prejudice exists and thus no threat can be presumed[1549]; and certain of the allegedly "mandatory" measures (marketing loan programme payments, user marketing (Step 2) payments and CCP payments) depend upon price conditions which may or may not be fulfilled in the future. Indeed, according to the United States, futures prices indicate that prices may be close to the average that existed in the era before Brazil alleged serious prejudice.

(b) Main arguments of the third parties

7.1483 **Argentina** agrees with Brazil that the threat of serious prejudice is clearly foreseeable and imminent because of the effects of the even larger subsidies provided under United States' legislation for the MY 2003-MY 2007 period. Argentina contends that the guaranteed flow of subsidies will lead to a higher level of United States' cotton production and exports, and result in price suppression and depression as well as an increasing and inequitable world market share for cotton, thus creating a source of permanent uncertainty that confirms the threat of serious prejudice generated by the subsidies. According to Argentina, future subsidies will continue to be necessary to bridge the gap

[1548] The United States cites, in support, the "threat" of injury standard applicable in a countervailing duty investigation, articulated in Article 15.7 of the *SCM Agreement*.

[1549] As the Panel has found "present" serious prejudice within the meaning of Articles 6.3(c) and 5(c), this argument of the United States – that no "present" serious prejudice exists and thus no threat can be presumed – is no longer valid.

between market prices and the total production costs of the upland cotton producers of the United States, especially considering that the USDA forecasts an increase in total production costs.[1550]

7.1484 The **European Communities** asserts that subsidies without any "pre-established limitations" in terms of value and volume are not in and of themselves dispositive of the existence of threat of serious prejudice. It argues that other factors, including in particular factors analogous to those listed in Article 15.7 (ii)-(v) of the *SCM Agreement*, may also be relevant and should be examined as well. The European Communities considers that in light of Article 15.7 of the *SCM Agreement* a determination of threat of serious prejudice, like a determination of injury, must "be based on facts and not merely on allegation, conjecture or remote possibility". Also, the relevant "changes in circumstances" must be "clearly foreseen and imminent".[1551]

7.1485 **New Zealand** supports Brazil's arguments and asserts that Brazil has brought evidence to show that the United States subsidies threaten to cause serious prejudice to Brazil's interests in the future. It agrees with Brazil that the very same factors creating present serious prejudice also create a threat of serious prejudice in the future. It cites to the fact that United States' subsidies are mandated to continue until MY 2007, that they are effectively unlimited, and that they have already caused serious prejudice to Brazil's interests. New Zealand further asserts that the continued operation of the subsidies for a further four years cannot but be considered to threaten further serious prejudice to Brazil's interests.[1552]

(c) Evaluation by the Panel

7.1486 Article 5 of the *SCM Agreement* states:

> "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:
>
> (a) injury to the domestic industry of another Member[11];
>
> (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994[12];
>
> (c) serious prejudice to the interests of another Member."[13]

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[11] The term "injury to the domestic industry" is used here in the same sense as it is used in Part V.

[12] The term "nullification or impairment" is used in this Agreement in the same sense as it is used in the relevant provisions of GATT 1994, and the existence of such nullification or impairment shall be established in accordance with the practice of application of these provisions.

[13] The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice.

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[1550] Argentina's written submission to the resumed session of the first substantive meeting, paras. 44-49.

[1551] European Communities' written submission to the resumed session of the first substantive meeting, paras. 17-26.

[1552] New Zealand's written submission to the resumed session of the first substantive meeting, paras. 3.01- 3.06.

7.1487 Footnote 13 to Article 5(c) of the *SCM Agreement* makes it clear that: "The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and *includes threat of serious prejudice*." (emphasis added)

7.1488 As we have already noted, Article XVI:1 of the *GATT 1994*, in Section A of that Article, is entitled "Subsidies in General". It states:

> "If any [Member] grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify ... in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. *In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened* by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, ..., the possibility of limiting the subsidization." (emphasis added)

7.1489 Article XVI:1 of the *GATT 1994* refers to the situation where "... serious prejudice to the interests of any other Member is caused *or* threatened by any such subsidization" (emphasis added).

7.1490 There is an explicit textual linkage between Article 5(c) of the *SCM Agreement* and the chapeau of Article 6.3 of the *SCM Agreement*. The chapeau of Article 6.3 states: "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise where one of the following apply...". Article 6.3(c) then sets out the condition that "the effect of the subsidy" is "significant price suppression" "in the same market".

7.1491 We consider it significant that the text of Article 5(c) of the *SCM Agreement* indicates that the term "serious prejudice to the interests of another Member" is used in the *SCM Agreement* "in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, *and includes* threat of serious prejudice" (emphasis added).[1553]

7.1492 We believe that this phrase gives rise to two initial issues:

- first, what guidance do we find in the indication that "serious prejudice" "includes threat of serious prejudice" in footnote 13 of the *SCM Agreement*?*;* and

- secondly, what guidance do we find in the phrase "... serious prejudice to the interests of any other Member is caused *or* threatened by any such subsidization" in Article XVI:1 of the *GATT 1994*?

7.1493 With respect to the first question, the cited legal provisions make it clear that, whatever the overall scope of the concept of serious prejudice may be, that scope includes the concept of "threat" of serious prejudice. The ordinary meaning of the verb "include" is: "comprise or reckon in as part of a whole."[1554] Thus, serious prejudice *includes* a threat of serious prejudice.[1555]

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[1553] By virtue of footnote 13 of the *SCM Agreement*.

[1554] *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

[1555] The converse would not necessarily hold. That is, a finding of *threat* of serious prejudice would not necessarily include present serious prejudice.

7.1494 With respect to the second question, we consider the meaning of the phrase "... serious prejudice to the interests of any other Member is caused *or* threatened by any such subsidization" (emphasis added) in Article XVI:1 of the *GATT 1994*. The main question is whether to read the "or" inclusively, or exclusively. That is, are we to read this phrase in the sense of either *one* ("caused") *or the other* ("threatened"), *but not both* would be adequate to trigger the remedies in Article 7 of the *SCM Agreement*?[1556] Or should we read this phrase rather as "caused or threatened " in the sense of *either one or the other, or both in combination* ("caused or threatened [to be caused]") would be adequate ?

7.1495 We believe that "threat" of serious prejudice refers to something distinct from serious prejudice. However, in terms of the rising continuum of seriously prejudicing another Member's interests, that ascends from a "threat" of serious prejudice" up to "serious prejudice", we see "serious prejudice" as necessarily *including* the concept of a "threat" and *exceeding* the presence of a "threat" for purposes of answering the relevant inquiry.[1557] This is confirmed by the text of footnote 13 of the *SCM Agreement*, which indicates that serious prejudice "includes" threat of serious prejudice.

7.1496 In this respect, we observe that present serious prejudice would more often be *preceded in time* by a prejudice that threatens to become serious, and serious prejudice would be the realization of a threat of serious prejudice.[1558]

7.1497 The text of the cited legal provisions leads us to conclude that either serious prejudice, or threat of serious prejudice, or both in combination, may trigger the remedies available in Article 7 of the *SCM Agreement*. The existence of either one, or the other, is both a necessary and sufficient condition, in and of itself, to achieve this.

7.1498 Turning to the particular factual situation before us, there are two main measures providing for payment of the United States subsidies in question:

- the FSRI Act of 2002 and implementing regulations (relating to MY 2002 – MY 2007)[1559]; and

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[1556] As, pursuant to footnote 13, "serious prejudice" in Article 5(c) is used in this same sense.

[1557] We do not mean to imply that the concept of serious prejudice to another Member's interests within the meaning of Article 5(c) of the SCM Agreement can be identified with the concept of "material injury" or "serious injury" to a Member's domestic industry as those terms are used in the trade remedy provisions of the *SCM Agreement*, the *Anti-dumping Agreement* or the *Agreement on Safeguards*. We nevertheless recall the view of the Appellate Body in addressing a similarly worded requirement in Article 2.1 of the *Agreement on Safeguards* in *US – Line Pipe*, paras. 170-171:

> "The question at issue is whether the right [to apply a safeguard measure] exists in this particular case. And, as the right exists if there is a finding by the competent authorities of a 'threat of serious injury' or - something *beyond* - 'serious injury', then it seems to us that it is irrelevant, *in determining whether the right exists*, if there is 'serious injury' or only 'threat of serious injury' - so long as there is a determination that there is *at least* a 'threat'. In terms of the rising continuum of an injurious condition of a domestic industry that ascends from a 'threat of serious injury' up to 'serious injury', we see 'serious injury'- because it is something *beyond* a 'threat' - as necessarily *including* the concept of a 'threat' and *exceeding* the presence of a 'threat' for purposes of answering the relevant inquiry: is there a right to apply a safeguard measure?"

[1558] *Ibid.* In the only previous WTO Panel Report on "serious prejudice" (*Indonesia – Autos*) the "threat" claims were made in the alternative to the "present" serious prejudice claims. Having found present serious prejudice, the Panel declined to examine the alternative "threat" claims. See Panel Report, *Indonesia – Autos*, para. 14.257.

[1559] Certain transition rules apply, e.g. section 1106(d) entitled "special rule for 2002 crop year" relating to direct payments and counter-cyclical payments.

- legislation providing for crop insurance subsidies prior to and since MY 2002.

7.1499 Brazil's "present" "serious prejudice" claims pertain to measures in force and subsidies granted from MY 1999-MY 2002. Our finding of "present" serious prejudice thus pertain also to measures in force and subsidies paid in MY 2002, the first year of the FSRI Act of 2002.

7.1500 Brazil's "threat" claims pertain to subsidies granted (or yet to be granted) under measures in force from MY 2003-MY 2007. This is the remaining period of application of the FSRI Act of 2002. It is clear that the existing subsidy programmes are currently envisaged to remain in effect between MY 2003-MY 2007.

7.1501 Because the Panel's "present" serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted thereunder in MY 2002, the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our "present" serious prejudice finding. We recall that, pursuant to Article 7.8 of the *SCM Agreement*, the United States is under an obligation to "take appropriate steps to remove the adverse effects or ... withdraw the subsidy".[1560]

7.1502 Furthermore, we have found that certain of the measures challenged in the "threat" context are *prohibited* subsidies which must be withdrawn "without delay" pursuant to Article 4.7 of the *SCM Agreement* – i.e. user marketing (Step 2) payments to exporters and domestic users; and export credit guarantees in respect of certain products under the GSM 102, GSM 103 and SCGP programmes.[1561] Required withdrawal of these prohibited subsidies within the time frame we set below would, we believe, have real, practical implications for the scope of the measures subject to the threat analysis (i.e. the basket of measures that is the subject of the threat analysis that pertains to MY 2003-MY 2007 would include measures that the United States must, in any event, withdraw without delay).

7.1503 We consider that, upon required implementation by the United States of this Panel's prohibited subsidy findings and present serious prejudice findings, the basket of measures in question may be so significantly transformed or manifestly different from the measures that are currently in question that it is not necessary or appropriate to address Brazil's claims of threat of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.[1562]

### 4. Claim of threat of serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement*

7.1504 We recall our finding above[1563] that Brazil's evidence and argumentation in this dispute focused exclusively upon a legally erroneous interpretation of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement*. As Brazil has also relied upon this same interpretation in its "threat" evidence and argumentation, we similarly find that Brazil has not established a prima facie case of violation of Article 6.3(d) (nor of Article 5(c)) here.

### 5. Claims under Articles XVI:1 and XVI:3 of the *GATT 1994*

7.1505 We recall the Panel's finding above that, in light of the Panel's finding under Article 5(c) of the *SCM Agreement*, it is not necessary to make findings also under Article XVI:1 of the *GATT 1994*.[1564] We further recall our finding above that Article XVI:3 of the *GATT 1994* pertains only to export subsidies as those are currently defined in the *Agreement on Agriculture* and the

[1560] See Section VII:G and Section VIII.
[1561] See Sections VII:E , F and Section VIII.
[1562] See e.g. Panel Report, *US – FSC.*
[1563] *Supra*, Section VII:G.
[1564] *Supra*, Section VII:G.

*SCM Agreement.*[1565] On this basis, it is not necessary for us to address these claims of Brazil in order to resolve this dispute.

## I. CLAIMS OF *PER SE* INCONSISTENCY

### 1. Measures at issue

7.1506 This Section of our report deals with alleged actionable subsidies, including certain alleged subsidies that are not "exempt from actions" based on Articles 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* within the meaning of Articles 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture* as a result of our findings in Sections VII:D, E and F of our report. These are the following measures, as described in Section VII:C of this report:

(i) Allegedly mandatory legislative provisions and implementing regulations providing for the payment of the following subsidies:

- user marketing (Step 2) payments to domestic users and exporters;[1566]
- marketing loan programme payments;[1567]
- direct payments;[1568]
- counter-cyclical payments;[1569] and
- crop insurance payments.[1570]

### 2. Main arguments of the parties

7.1507 **Brazil** alleges that the legislative and regulatory provisions governing these five United States subsidies constitute "*per se*" violations of Articles 5(c) and 6.3(c) and (d) of the *SCM Agreement* and Articles XVI:1 and XVI:3 of the *GATT 1994* for the period MY 2002-MY 2007. According to Brazil, they are "mandatory in nature" and fall into two general categories: certain payments vary depending upon prevailing market conditions (i.e. marketing loan, counter-cyclical payments and require payment (with no budgetary or quantitative limitations), others (i.e. crop insurance payments and direct payments) do not; while user marketing (Step 2) payments are "somewhat of a hybrid". The five subsidies necessarily threaten to cause serious prejudice where market conditions require their joint payment. In addition, they cause threat of serious prejudice even when market conditions are such that only crop insurance and direct payments are made.

7.1508 The **United States** argues that even if the measures concerned do not permit the United States government discretion to grant the subsidies in certain market conditions, it is not clear that such

[1565] *Supra*, Section VII:E.

[1566] Section 1207(a) of the FSRI Act of 2002, reproduced in Exhibit BRA-29 and 7 CFR 1427.103, 7 CFR 1427.104(a)(1) and (2), 7 CFR 1427.105(a) and 7 CFR 1427.108(d), reproduced in Exhibit BRA-37.

[1567] Sections 1201(a)-(b), 1202(a)(6), 1202(b)(6), 1204(b), 1205(a)(1), 1205(b), 1205(c)(1), 1608 of the FSRI Act of 2002, reproduced in Exhibit BRA-29 ; 7 USC 7286 (Section 166 of the FAIR Act as amended); and 7 CFR 1427.22, reproduced in Exhibit BRA-36.

[1568] Section 1103(a)-(d)(1) of the FSRI Act of 2002, reproduced in Exhibit BRA-29 and 7 CFR 1412.502, reproduced in Exhibit BRA-35.

[1569] Sections 1104(a)-(f)1 1608 of the FSRI Act of 2002, reproduced in Exhibit BRA-29 and 7 CFR 1412.503, reproduced in Exhibit BRA-35.

[1570] Section 508(a)(8), Section 508(b)(1), Section 508(b)(2)(A)(ii), 508(b)(3), 508(e) and 508(k) and 516 of "the ARP Act of 2000". The ARP Act of 2000 amended the *Federal Crop Insurance Act* which is reproduced in Exhibit BRA-30 as amended through Public Law 107-136, 24 January 2002. See Brazil's first written submission, footnotes 178 and 184.

market conditions will arise. The United States asserts that both it and Brazil agree that, given certain conditions such as price levels, these challenged measures would be "mandatory" in the sense that the United States could not arbitrarily decline to provide them. However, for purposes of a mandatory/discretionary analysis, no WTO-inconsistency is mandated by those measures because serious prejudice does not necessarily result, even where there is no discretion not to provide payment.[1571]

### 3. Main arguments of the third parties

7.1509 The **European Communities** claims that the Panel should reject Brazil's *per se* claim. First, it claims that Brazil's argument that a Member can challenge measures of another Member on a *per se* basis when those measures mandate a violation of its WTO obligations would have absurd and unacceptable results when applied to WTO provisions which, like Article 5(c) of the *SCM Agreement*, incorporate a "trade effects" test. It also claims that the "mandatory" standard invoked by Brazil would result in the creation of third category of prohibited adverse effects in addition to actual and threatened serious prejudice, which is nowhere mentioned in Article 5(c): the mere possibility of threat of serious prejudice in certain circumstances. Furthermore, in light of the European Communities argument that threat of serious prejudice must be *imminent* and *foreseeable*, it further argues that under Brazil's interpretation, it would be sufficient to establish a *per se* violation if a complaining party demonstrated that the legislation at issue mandates action that threatens serious prejudice in certain circumstances, no matter how remote the likelihood that such circumstances will ever materialise.[1572]

### 4. Evaluation by the Panel

7.1510 The Panel recalls that it need not examine all legal claims before it. Rather, we need only address those claims that must be addressed in order to resolve the matter in issue in the dispute.[1573] This is the case provided that we address those claims on which a finding is necessary to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member in order to ensure effective resolution of disputes to the benefit of all Members.[1574]

7.1511 In light of our findings above in Sections VII:E, F, G and H, we do not believe that it is necessary to address Brazil's *per se* claims relating to these measures under Articles 5(c) and 6.3(c) and (d) of the *SCM Agreement* and Articles XVI:1 and XVI:3 of the *GATT 1994*.

## VIII. CONCLUSIONS AND RECOMMENDATIONS

8.1 In light of the findings above, we conclude as follows:

(a) Article 13 of the *Agreement on Agriculture* is not in the nature of an affirmative defence;

(b) PFC payments, DP payments, and the legislative and regulatory provisions which establish and maintain the DP programme, do not satisfy the condition in paragraph (a) of Article 13 of the *Agreement on Agriculture*;

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[1571] United States' 28 January 2004 comments on Brazil's response to Panel Question No. 257 (a) (ii), para. 192.

[1572] European Communities' written submission to the resumed session of the first substantive meeting, paras. 27-36.

[1573] Appellate Body Report, *US – Wool Shirts and Blouses*, page 19. See also e.g. Appellate Body Report, *Canada – Autos*, paras. 112-117, where the Appellate Body refers to and endorses that panel's exercise of the "discretion" implicit in the principle of judicial economy.

[1574] Appellate Body Report, *Australia – Salmon*, para. 223.

(c) United States domestic support measures considered in Section VII:D of this report grant support to a specific commodity in excess of that decided during the 1992 marketing year and, therefore, do not satisfy the conditions in paragraph (b) of Article 13 of the *Agreement on Agriculture* and, therefore, are not exempt from actions based on paragraph 1 of Article XVI of the *GATT 1994* or Articles 5 and 6 of the *SCM Agreement*;

(d) concerning United States export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes:

(i) in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes[1575], and in respect of one scheduled product (rice):

- United States export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes are export subsidies applied in a manner which results in circumvention of United States' export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture* and they are therefore inconsistent with Article 8 of the *Agreement on Agriculture*;

- as they do not conform fully to the provisions of Part V of the Agreement on Agriculture, they do not satisfy the condition in paragraph (c) of Article 13 of the *Agreement on Agriculture* and, therefore, are not exempt from actions based on Article XVI of the *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement*;

- United States export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes are provided by the United States government at premium rates which are inadequate to cover long-term operating costs and losses of the programmes within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*, and therefore constitute *per se* export subsidies prohibited by Articles 3.1(a) and 3.2 of the *SCM Agreement*.

(ii) however, in respect of exports of unscheduled agricultural products not supported under the programmes[1576] and other scheduled agricultural products:

- the United States has established that export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes have not been applied in manner which either results in, or which threatens to lead to, circumvention of United States export subsidy commitments within the meaning of Article 10.1 and that they therefore are not inconsistent with Article 8 of the *Agreement on Agriculture*;

[1575] As indicated *supra*, Section VII:E, paragraph 7.875, referring to Exhibit BRA-73, to the extent they are within our terms of reference and within the product scope of the *Agreement on Agriculture*.

[1576] i.e. unscheduled agricultural products, to the extent they are within our terms of reference and within the product scope of the *Agreement on Agriculture*, other than those indicated *supra*, Section VII:E, paragraph 7.875.

- in these circumstances, and as Brazil has also not made a prima facie case before this Panel that the programmes do not conform fully to the provisions of Part V of the *Agreement on Agriculture*, this Panel must treat them as if they are exempt from actions based on Article XVI of the *GATT 1994* and Article 3 of the *SCM Agreement* in this dispute.

(e) concerning section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton:

(i) section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton is an export subsidy, listed in Article 9.1(a) of the *Agreement on Agriculture*, provided in respect of upland cotton, an unscheduled product. It is, therefore, inconsistent with the United States' obligations under Articles 3.3 and 8 of the *Agreement on Agriculture;*

(ii) as it does not conform fully to the provisions of Part V of the *Agreement on Agriculture*, it does not satisfy the condition in paragraph (c) of Article 13 of the *Agreement on Agriculture* and, therefore, is not exempt from actions based on Article XVI of the *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement;*

(iii) section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton is an export subsidy prohibited by Articles 3.1(a) and 3.2 of the *SCM Agreement*.

(f) concerning section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users of upland cotton: it is an import substitution subsidy prohibited by Articles 3.1(b) and 3.2 of the *SCM Agreement*;

(g) concerning serious prejudice to the interests of Brazil:

(i) the effect of the mandatory price-contingent United States subsidy measures – marketing loan programme payments, user marketing (Step 2) payments, MLA payments and CCP payments -- is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*;

(ii) however, Brazil has not established that:

- the effect of PFC payments, DP payments and crop insurance payments is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*; or

- the effect of the United States subsidy measures listed in paragraph 7.1107 of Section VII:G of this report is an increase in the United States' world market share within the meaning of

Article 6.3(d) of the *SCM Agreement* constituting serious prejudice within the meaning of Article 5(c) of the *SCM Agreement*.

(h) concerning the ETI Act of 2000:

(i) Brazil has not made a prima facie case before this Panel that the ETI Act of 2000 and alleged export subsidies provided thereunder are inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture* in respect of upland cotton;

(ii) with respect to the condition in Article 13(c)(ii) of the *Agreement on Agriculture*, as Brazil has also not made a prima facie case before this Panel that they do not conform fully to the provisions of Part V of the *Agreement on Agriculture* in respect of upland cotton, this Panel must treat them as if they are exempt from actions based on Article XVI of the *GATT 1994* and Article 3 of the *SCM Agreement* in this dispute.

8.2 Under Article 3.8 of the *DSU*, in cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered prima facie to constitute a case of nullification or impairment. We conclude that, to the extent that the United States has acted inconsistently with the covered agreements, it has nullified or impaired benefits accruing to Brazil under these agreements.

8.3 In light of these conclusions:

(a) we recommend pursuant to Article 19.1 of the *DSU* that the United States bring its measures listed in paragraphs 8.1(d)(i) and 8.1(e) above into conformity with the *Agreement on Agriculture*;

(b) as required by Article 4.7 of the *SCM Agreement*, we recommend that the United States withdraw the prohibited subsidies in paragraphs 8.1(d)(i) and 8.1(e) above without delay. The time-period we specify must be consistent with the requirement that the subsidy be withdrawn "without delay". In any event, this is at the latest within six months of the date of adoption of the Panel report by the Dispute Settlement Body or 1 July 2005 (whichever is earlier);

(c) pursuant to Article 4.7 of the *SCM Agreement*, we recommend that the United States withdraw the prohibited subsidy in paragraph 8.1(f) above without delay and, in any event, at the latest within six months of the date of adoption of the Panel report by the Dispute Settlement Body or 1 July 2005 (whichever is earlier); and

(d) we recall that, in respect of the subsidies subject to our conclusion in paragraph 8.1(g)(i) above, pursuant to Article 7.8 of the *SCM Agreement*:

> "7.8 Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy."

Accordingly, upon adoption of this report, the United States is under an obligation to "take appropriate steps to remove the adverse effects or ... withdraw the subsidy".

**WORLD TRADE ORGANIZATION**

**WT/DS267/R/Add.1**
8 September 2004

(04-3414)

Original: English

# UNITED STATES – SUBSIDIES ON UPLAND COTTON

## *Report of the Panel*

Addendum

This addendum contains the annexes A-H to the Report of the Panel to be found in document WT/DS267/R. Annex I can be found in Add.2 and Annexes J-O can be found in Add.3.

# ANNEX A

## INITIAL BRIEFS OF PARTIES AND THIRD PARTIES

# ANNEX A-1

## BRAZIL'S BRIEF ON PRELIMINARY ISSUE REGARDING THE "PEACE CLAUSE" OF THE AGREEMENT ON AGRICULTURE

5 June 2003

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## I. INTRODUCTION AND SUMMARY

1. Brazil responds to the Panel's 28 May 2003 request for a briefing on the following issue:

> *Whether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled.*[1]

[1] The Panel also "invites the parties to explain their interpretation of the words 'exempt from actions' as used in Article 13 of the Agreement on Agriculture, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue."

2. The short answer to this question is "no". There is no procedural rule or legal requirement for a panel to make such a preliminary finding. The phrase "exempt from actions" in Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture (AoA) means that *if all* the conditions of Article 13(b)(ii) and 13(c)(ii) are fulfilled (*i.e.*, there is peace clause protection), a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the Agreement on Subsidies and Countervailing Measures (ASCM or SCM Agreement) or Article XVI of GATT 1994. But neither the phrase "exempt from actions" nor AoA Article 13 compel the Panel to *first* make a peace clause finding before considering the substance of Brazil's ASCM and GATT Article XVI claims.

3. Article 13 of the Agreement on Agriculture is not a "special and additional" rule set out in Appendix 2 to the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). Article 19 of the AoA makes all DSU provisions applicable to the AoA. Pursuant to DSU Article 11, a panel must make an "objective assessment of the facts of the case". Assessing and weighing all relevant facts – including rebuttal facts – obtained during the normal two meeting panel process is essential to resolve properly fact-intensive issues relating to the peace clause. This Panel should follow the lead of previous panels that made similar complex threshold findings in final panel reports.

4. Brazil will be prejudiced by delays in the process because a number of Brazil's claims are not dependent on any resolution of the "peace clause". Much of the proof required for demonstrating that the US has no peace clause protection under Articles 13(b)(ii) and 13(c)(ii) is the same evidence demonstrating US violations under the SCM Agreement. Requiring separate briefings, hearing, presentation of factual evidence and legal argument for such inter-connected "peace clause" issues would seriously disrupt Brazil's presentation of its evidence, lead to duplication of its efforts, delay the proceeding, and increase Brazil's financial and human resource costs.

## II. ANALYSIS OF THE PHRASE "EXEMPT FROM ACTIONS"

1. The Panel has requested that Brazil address the meaning of the phrase "exempt from actions" in AoA Article 13. In the view of Brazil, this phrase means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that otherwise would be subject to the disciplines of certain ASCM and GATT 1994 provisions if those measures are in compliance with the various peace clause provisions. It does not mean that a Panel may not hear evidence or consider Brazil's ASCM or GATT 1994 claims while it decides whether all the peace clause conditions have been fulfilled. In sum, this phrase in no way suggests that a panel must make a finding that the peace clause provisions are unfulfilled before proceeding with the other claims.

2. The phrase "exempt from actions" is used, as relevant to this dispute, in AoA Articles 13(a), 13(b)(ii), and 13(c)(ii). The dictionary definition of "actions" is "the taking of legal steps to establish a claim or obtain a remedy."[2] In a multilateral system such as the WTO (like GATT 1947[3] before it), "actions" are taken collectively by Members. DSU Article 2.1 (last sentence) emphasizes this notion

[2] New Shorter Oxford Dictionary, Volume 1 (1993 Edition), at 22.

[3] Article XXV of GATT 1994 provides for "joint action" by the contracting parties to "further the objectives of this Agreement". The decision by the contracting parties to approve the Tokyo Round results in 1979 was entitled "Action by the CONTRACTING PARTIES on the Multilateral Trade Negotiations". BISD 26S/201.

in stating that "only those Members that are parties to that Agreement may participate in decisions or *actions* taken by the DSB with respect to that dispute." (emphasis added) "Actions" include decisions made by the Dispute Settlement Body (DSB) to adopt rulings and recommendations of panels and the Appellate Body. Article XVI:1 of GATT 1994 also provides for another action, a decision by the relevant WTO body to hold consultations with a subsidizing Member to discuss what steps that Member will take to remove the serious prejudice or threat caused by its subsidies.[4] And "actions" also include the enforcement of remedies authorized by the DSB pursuant to DSU Article 22. In sum, "actions" are multilaterally agreed decisions of WTO bodies including the DSB.

3. The ordinary meaning of the word "exempt" is "grant immunity or freedom from liability to which others are subject".[5] The chapeau of Article 13 states that the period of exemption is "during the implementation period", *i.e.*, until 1 January 2004.

4. Combining these definitions of "actions" and "exempt," the term "exempt from action" in Article 13(b)(ii) means that before 1 January 2004, a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic support measures that otherwise would be subject to the disciplines of Article XVI:1 and ASCM Articles 5 and 6. And "exempt from action" in the context of Article XVI:1 would mean that the WTO could not take a decision to require a Member to consult with the WTO on how the Member will eliminate serious prejudice or the threat of serious prejudice caused by that subsidy. However, the immediate context of the phrase "exempt from actions" in Articles 13(a), 13 (b)(ii) and 13(c)(ii) make clear that the "exemption" is not *absolute* but rather subject to a number of conditions:

- Article 13(a) only permits green box domestic subsidies to be exempt from the types of determinations listed in Article 13(a) (i), (ii) or (iii) if they "conform fully to the provisions of Annex 2" of the AoA. If a domestic support measure does not comply with one of a number of requirements of the "green box" provisions of Annex 2, then such domestic support would be evaluated under the peace clause provisions of Article 13(b) and could be subject to a remedy determination by the DSB and/or the WTO.

- Under the provisions of peace clause Article 13(b)(ii), "amber" and "blue" box domestic support measures provided during any marketing year between 1995-2003 are only exempt from determinations by the DSB and/or the WTO relating to paragraph 1 of Article XVI of GATT 1994 (not Article XVI, paragraph 3) and Articles 5 and 6 (not Article 3) of the SCM Agreement "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year". If the quantity of amber and/or blue box support granted in any marketing year from the 1995-2003 period is greater than that decided during marketing year 1992, then the subsidy programme is not "exempt" from such determinations.

- Export subsidies under the peace clause provisions of AoA Article 13(c)(ii) are only exempt from determinations by the DSB and/or the WTO relating to Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement *if* they "conform fully to the provisions of Part V of [the AoA]". Thus, if export subsidy measures are inconsistent with the provisions of AoA Articles 8, 9 or 10, then they are no longer exempt from such determinations.

[4] *See, e.g.*, Report of the Working Party on Article XVI:1 discussions on *EC- Refunds on Exports of Sugar*, BISD 28S/80.

[5] New Shorter Oxford Dictionary, Volume 1 (1993 Edition), at 878.

5. In sum, "exempt from actions" means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are "peace clause" protected. Yet, as described below, the phrase "exempt from actions" when viewed in the broader context of DSU provisions *does not require* the Panel to *first* make a peace clause compliance finding before hearing or considering any of the evidence or arguments relating to the various ASCM or GATT 1994 claims.

## III. THE CONTEXT OF ARTICLE 13 DEMONSTRATES THAT THERE IS NO LEGAL REQUIREMENT FOR THE PANEL TO FIRST MAKE A FINDING ON THE PEACE CLAUSE BEFORE PERMITTING BRAZIL TO SET OUT ITS ARGUMENT AND CLAIMS REGARDING US VIOLATIONS OF THE SCM AGREEMENT

1. There is nothing in the text of Article 13 or other provisions of the AoA, the SCM Agreement, or any other WTO Agreement *requiring* the Panel to make a preliminary factual and legal finding on the applicability of the peace clause before examining Brazil's evidence and argument regarding US violations of the SCM Agreement or GATT 1994.

2. First, and most importantly, Annex 2 of the DSU Agreement is the closed list of "special and additional" rules and procedures that trump the normal rules of dispute settlement. This list does not include Article 13 or any other AoA provisions. Thus, resolution of the "peace clause" issues, like other issues raised by Brazil's request for establishment of a panel, must be resolved using normal DSU rules and procedures.

3. Second, AoA Article 13 does not exclude AoA Article 19 which states that the "provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding, shall apply to consultations and *the settlement of disputes under this Agreement*" (emphasis added). Among the DSU procedures applicable to AoA Article 13 is DSU Article 11 which provides, in part:

> [a] panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements.

4. Article 11 contemplates that a panel must make an "objective assessment of the facts of the case". It does not state that a panel must conduct such an assessment by first examining *part* of the facts of a case before it then examines *other* facts. Further, Article 11 contemplates that the parties will have the full opportunity to search for and present rebuttal facts. This is accomplished through the normal two meeting panel process – not in a single truncated meeting. It is also accomplished through the exchange of rebuttal submissions.

5. Review by a panel of all the facts including rebuttal facts is necessary *before* deciding whether the peace clause is applicable or not. This follows from the inter-related nature of the proof necessary to demonstrate the peace clause and ASCM actionable and prohibited export subsidy claims. As the Panel will discover shortly upon reviewing Brazil's First Submission, the facts relevant to the application of the "peace clause" largely overlap with facts relevant to determining whether the programmes at issue are "actionable" or "prohibited export subsidies". Consider the following:

- Each of the domestic support subsidies at issue in Brazil's actionable subsidy claims are also at issue in Brazil's proof regarding the absence of US peace clause protection for marketing years 1999-2002. For the purposes of AoA Article 13(b)(ii) the "amber" box subsidies include marketing loan/loan deficiency payments; crop insurance payments; Step-2 payments; production flexibility contract payments; direct payments; marketing loss assistance payments; counter-cyclical payments, and cottonseed payments. Proof of both peace clause and actionable subsidies require the same detailed descriptions of the type, nature, extent, and history of each of these US domestic support programmes.

- Brazil has made claims under the AoA and the ASCM regarding prohibited export subsidies under the US Step-2 programme and US export credit guarantee programmes. Brazil will demonstrate that these two export subsidies do not "conform fully to the provisions of Part V of this Agreement" in the sense of AoA Article 13(c); obviously, Brazil's evidence and argument regarding the lack of conformity of these two measures with Part V of the AoA largely overlaps with the evidence and argument necessary to demonstrate a violation of ASCM Articles 3.1(a) and (b).

6. This close overlap of proof for both peace clause and actionable and prohibited subsidy claims highlights the need for the Panel to examine all the "facts of the case" together – including rebuttal facts presented by Brazil to contest US assertions. Such a determination can only be made after collecting information in an iterative process.

7. DSU Article 11 also requires a panel to consider the "applicability" of the "relevant covered agreements". This includes deciding whether actions are exempt from the *covered* agreements. But Article 11 contains no requirement for a special briefing, meeting or determination by a panel to resolve such applicability or exemption.

8. Of course, when fulfilling its obligations under DSU Article 11, the Panel may well need to organize its assessment of the facts in its final determination by first examining and deciding issues related to the peace clause. The Appellate Body in *Brazil Aircraft* held that this is what the panel should have done in deciding the very similar peace-clause-like issues under ASCM Articles 27.2(b) and 27.4.[6] But there is nothing in DSU Article 11 or any other WTO provision mandating that Brazil present its evidence relating to the peace clause alone, divorced from factual evidence and argument relating to the SCM Agreement. As described below, such a requirement would be inconsistent with the previous practice of panels and prejudicial to Brazil's efforts to make a coherent and unified presentation of its case.

## IV. RESOLUTION OF THRESHOLD ISSUES PRIOR TO PROVIDING PARTIES THE OPPORTUNITY TO PRESENT ALL OF ITS EVIDENCE IS CONTRARY TO THE PRACTICE OF EARLIER PANELS

1. Many panels have faced preliminary threshold issues under DSU Article 6.2 and other WTO Agreements. These preliminary issues have involved whether panels have the jurisdiction to resolve and make recommendations concerning certain claims and measures. Many of these preliminary issues involved far less complex facts than are presented by the peace clause in this dispute. Despite this, many panels waited to resolve these threshold jurisdictional issues until the final determination

[6] Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R (adopted 2 August 1999), paras. 143-44.

after reviewing all the evidence and arguments.[7] Other panels have decided these threshold issues after the first meeting of the panel with the parties where the complaining party had an opportunity to present its evidence.[8]

2. The closest case to the peace clause issue presented here was addressed in *Brazil – Export Financing Programme for Aircraft*.[9] That dispute involved Articles 27.2(b) and 27.4 of the SCM Agreement, which exempts certain developing country Members from obligations under ASCM Article 3.1(a) provided that such a Member has complied with certain stated condiditons.[10] The Appellate Body discussed the application of this peace-clause-like provision in *Brazil Aircraft.*[11]

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[7] WTO Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R (adopted 20 August 1999), para. 9.15 (Panel rejected request for preliminary ruling based claims under DSU Article 6.2 and decided issues in final report); WTO Panel Report, *Egypt – Definitive Anti-Dumping Measures on Steel Rebar from Turkey*, WT/DS211/R (adopted 1 October 2002), para. 7.27-7.31 (Panel determined in final report that certain claims were not within its terms of reference); WTO Panel Report, *India – Measures Affecting the Automotive Sector*, WT/DS146/R and WT/DS/175/R (adopted 5 April 2002), paras. 7.44-7.103 (Panel rejected India's threshold *res judicata* claims in final panel report); WTO Panel Report, *United States – Anti-Dumping Duty and Dynamic Random Access Semiconductors (DRAMS) of One Megabit or more From Korea*, WT/DS99/R (adopted 19 March 1999), para. 6.17 (Panel ruled in final report granting US's preliminary objections that certain AD measures predated the WTO and could therefore not be subject to challenge); WTO Panel Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/R, WT/DS10/R and WT/DS11/R (adopted 1 November 1996), para. 6.5 (Final report determined that a claim was outside of the Panel's terms of reference); WTO Panel Report *United States – Definitive Safeguard Measures on Circular Welded Carbon Quality Line Pipe from Korea*, WT/DS202/R (adopted 8 March 2002), para. 7.121-7.126 (Panel rejected a Korean claim as beyond its terms of reference in the final panel report); WTO Panel Report, *United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan*, WT/DS184/R (adopted 23 August 2001), para. 7.22 (final report determined that the "adverse facts available" claim was beyond its terms of reference).

[8] WTO Panel Report, *European Communities – Anti-Dumping Duties on Malleable Cast Iron Tube or Pipe Fittings from Brazil*, WT/DS219/R (not yet adopted), para. 7.14 (preliminary finding made following first meeting with the parties that certain claims were not within its terms of reference); WTO Panel Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WTDS213/R (adopted 19 December 2002), para 8.1 –8.2 and footnote 224 (Panel decided at end of first meeting that two claims were outside its terms of reference and provided reasoning in final Panel report); WTO Panel Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/R (adopted 10 January 2001), para. 6.11 (Panel issued preliminary ruling regarding scope of measures within its terms of reference at the end of the second meeting with the parties); WTO Panel Report, *United States – Safeguard Measures on Imports of Certain Fresh, Chilled and Frozen Lamb from New Zealand and Australia*, WT/DS177/R and WT/DS178/R (adopted 16 May 2001), para. 5.15 (Panel ruled during first meeting that panel request was sufficient in covering all the claims brought by Australia and New Zealand).

[9] WTO Panel Report, WT/DS46/AB/R (adopted 2 August 1999).

[10] These provisions provide as follows:

> 27.2: The prohibition of paragraph 1(a) of Article 3 [prohibited export subsidies] shall not apply to:
> ** ** ** **
> (b) other developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, subject to compliance with the provisions in paragraph 4.
>
> 27.4: Any developing country Member referred to in paragraph 2(b) shall phase out its export subsidies within the eight-year period, preferably in a progressive manner. However, a developing country Member shall not increase the level of its export subsidies, and shall eliminate them within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs. . .

[11] Appellate Body Report, WT/DS46/AB/R (adopted 2 August 1999).

> In our view, too, paragraph 4 of Article 27 provides certain obligations that developing country Members must fulfill if they are to benefit from this special and differential treatment during the transitional period. . . . If a developing country Member complies with the obligations in Article 27.4, the prohibition on export subsidies in Article 3.1(a) simply does not apply. . . . If [. . .] non-compliance is demonstrated, then, and only then, does the prohibition of Article 3.1(a) *apply* to that developing country Member.[12] (*emphasis added)*

3. The Appellate Body found that the panel should have considered first the threshold issue of whether Brazil was in compliance with Article 27.4 before deciding whether Brazil was in violation of ASCM Article 3.1(a).[13] Yet, there was never a suggestion or finding that the Panel erred by not conducting a special briefing and special determination *before* even accepting arguments of Brazil and Canada regarding the ASCM Article 3.1(a) issue. A finding on the threshold issue in that case, as here, was conditioned upon other crucial determinations such as: the definition of subsidy; the moment when a subsidy was granted; the relevant level, etc. In that case, the threshold issue was decided by the Panel in the final report only after the parties had a chance to discuss all the related issues during the full course of the Panel proceedings.

4. There are a number of other threshold issues in WTO Agreements. No claim may be brought against a measure under the General Agreement on Trade in Services (GATS) unless the measure falls within the scope of the General Agreement on Trade in Services as defined in GATS Article I. No claim may be brought under Article 2 of the Agreement on Technical Barriers to Trade except in respect of a measure that is a "technical regulation" as defined by that agreement. Claims under the Agreement on Government Procurement may only be brought concerning procurement of an entity covered by Annex I of that agreement. While the language of these provisions differs, the effect is the same as the operation of the AoA Article 13 and ASCM Articles 27.2(b) and 27.4 – if the threshold objections are granted, the Panel cannot make a finding that the defending Member has acted contrary to the covered agreements. Yet none of these provisions have special and additional rules to provide for extraordinary preliminary briefings, meetings, and determinations prior to a panel hearing all of the claims presented.

## V. BRAZIL WILL BE PREJUDICED BY SEPARATE HEARINGS AND BRIEFINGS ON THE PEACE CLAUSE ISSUE

1. Brazil has previously described in its letter of 23 May 2003 to the Panel the prejudice that will occur if special meetings and briefings are imposed to resolve peace clause issues. Such prejudice includes requiring Brazil to present the *same* evidence three – not two times – and in having to bring its legal and economic experts to Geneva for an extra meeting.

2. In addition, Brazil would note that such special proceedings would cause it prejudice because there would be significantly delays in the resolution of its claims – many of which do not implicate the peace clause. These non-peace clause claims include the following:

1. Article XVI:3 of GATT 1994 involving all domestic and export subsidies challenged by Brazil;
2. Article III:4 of GATT 1994 regarding Step-2 domestic payments;

[12] Appellate Body Report, WT/DS46/AB/R, paras. 140-41 .
[13] Appellate Body Report, WT/DS46/AB/R, paras. 143-44.

1. Articles 3.1(b) and 3.2 of SCM Agreement regarding prohibited local content Step-2 domestic payments;
2. Articles 3.3 and 9.1(a) of the AoA regarding export subsidies including Step-2 export payments;
3. Articles 8 and 10.1 of the AoA regarding the GSM 102, GSM 103, and SCGP export credit guarantee programmes;
1. Articles 8 and 10.1 of the AoA regarding ETI measure (FSC replacement measure).

3. Moreover, Brazil's proof of these claims involves evidence overlapping with that relevant to Brazil's peace clause claims, as well as with its actionable and prohibited export subsidy claims. Given this overlap, a special proceeding on only the peace clause would negatively impact on Brazil's ability to present a coherent and unified presentation of its case.

## VI. CONCLUSION

1. For the reasons set forth above, Brazil requests that this Panel find that it is not precluded from hearing evidence and considering Brazil's claims under the ASCM or Article XVI of GATT 1994 without first concluding that the peace clause conditions of AoA Article 13(b)(ii) and 13(c)(ii) remain unfulfilled.

# ANNEX A-2

## INITIAL BRIEF OF THE UNITED STATES ON THE QUESTION POSED BY THE PANEL

5 June 2003

### A. INTRODUCTION

1. The United States thanks the Panel for this opportunity to comment on the question concerning Article 13 of the *Agreement on Agriculture* ("Agriculture Agreement") posed by the Panel in its fax of 28 May 2003. The Panel asked the parties to address:

> [W]hether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions in Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue.

2. Article 13 (the "Peace Clause") precludes the Panel from considering Brazil's claims under Article XVI of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") and the *Agreement on Subsidies and Countervailing Measures* ("Subsidies Agreement") since the US support measures at issue conform with the Peace Clause. The Peace Clause "exempt[s]" conforming support measures "from actions based on" the corresponding provisions of the Subsidies Agreement and the GATT 1994.[1] Read in accordance with the customary rules of interpretation of public international law, the phrase "exempt from actions" means "not exposed or subject to" a "legal process or suit" or the "taking of legal steps to establish a claim". Therefore, Brazil cannot maintain any action – and the United States cannot be required to defend any such action – based on provisions specified in the Peace Clause[2] since the US support measures for upland cotton conform to the Peace Clause. In light of the correct interpretation of the Peace Clause, the United States respectfully requests the Panel to organize its procedures to first determine whether Brazil may maintain any action based on provisions exempted by the Peace Clause.

3. Consider the alternative approach proposed by Brazil in its 23 May letter – that is, requiring the United States to defend the substantive claims at the same time as arguing the Peace Clause issues. If the Panel were to allow Brazil to proceed with its substantive claims under the Subsidies Agreement and GATT 1994 now, and only conclude later (for example, at the time of the issuance of its report) that the US measures at issue conform to the Peace Clause based on the facts of this dispute, US measures would already have been subject to Brazil's action based on those claims. As the United States will explain, this would contradict the ordinary meaning of the phrase "exempt from actions" in Article 13, read in its context, and in light of the object and purpose of the Agriculture

[1] For example, Article XVI of the GATT 1994 and Part III of the Subsidies Agreement correspond to Article 13(a)(ii) of the Agriculture Agreement, GATT 1994 Article XVI:1 and Articles 5 and 6 of the Subsidies Agreement correspond to Article 13(b)(ii) of the Agriculture Agreement, and GATT 1994 Article XVI and Articles 3, 5, and 6 of the Subsidies Agreement correspond to Article 13(c)(ii) of the Agriculture Agreement..

[2] *See* WT/DS267/7, at 3 (asserting claims based on Subsidies Agreement Articles 3.1(a), 3.1(b), 3.2, 5(a), 5(c), 6.3(b), 6.3(c), and 6.3(d) and GATT 1994 Articles XVI:1 and Article XVI:3).

Agreement. Consequently, to allow Brazil to proceed with any action against these US measures that are exempt from actions based on such claims would contravene the Peace Clause and upset the balance of rights and obligations of WTO Members.

B. LEGAL INTERPRETATION OF THE PEACE CLAUSE

4. The Peace Clause, Article 13 of the Agriculture Agreement[3], governs the treatment during the implementation period of the Agreement of certain domestic support measures and export subsidies "notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures".[4] For purposes of the Panel 's question, there would appear to be two interpretive issues. The first is straightforward and apparently not in dispute: whether the Peace Clause is in effect for the measures at issue. The second is what is the nature of the treatment under the Peace Clause of conforming measures – i.e., what does it mean to say that conforming measures are "exempt from actions".

[3] The Peace Clause reads:

During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures (referred to in this Article as the "Subsidies Agreement"):

(a) domestic support measures that conform fully to the provisions of Annex 2 to this Agreement shall be:
  (i) non-actionable subsidies for purposes of countervailing duties;
  (ii) exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement; and
  (iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994;

(b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:
  (i) exempt from the imposition of countervailing duties unless a determination of injury or threat thereof is made in accordance with Article VI of GATT 1994 and Part V of the Subsidies Agreement, and due restraint shall be shown in initiating any countervailing duty investigations;
  (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and
  (iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year;

(c) export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be:
  (i) subject to countervailing duties only upon a determination of injury or threat thereof based on volume, effect on prices, or consequent impact in accordance with Article VI of GATT 1994 and Part V of the Subsidies Agreement, and due restraint shall be shown in initiating any countervailing duty investigations; and
  (ii) exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement.

Agriculture Agreement, Article 13 (footnote omitted).

[4] Agriculture Agreement, Article 13 (chapeau). Article 21.1 of the Agriculture Agreement also makes it clear that the Subsidies Agreement and GATT 1994 only apply "subject to" the provisions of the Agriculture Agreement, including Article 13 (the Peace Clause).

### 1. Duration of the Peace Clause: The "Implementation Period"

5. The Peace Clause is in force at present. The first words of the Peace Clause ("During the implementation period") establish the duration of the treatment afforded by this provision. Article 1(f) of the Agriculture Agreement defines "implementation period" as "the six-year period commencing in the year 1995" but goes on to specify that "for purposes of Article 13, it means the nine-year period commencing in 1995". That is, Members determined that exempting certain measures from certain actions based on otherwise applicable WTO provisions was desirable for a time period *longer* than the period for the phase-in of all other commitments under the Agriculture Agreement. Thus, the Peace Clause currently continues to exempt conforming measures – whether US, Brazilian, or of any other Member – from actions under the corresponding provisions of the GATT 1994 and the Subsidies Agreement.

### 2. Effect of the Peace Clause: "Exempt from Actions"

6. For purposes of this dispute, all of the relevant provisions of the Peace Clause utilize the same language and construction: conforming measures "shall be . . . exempt from actions based on" specified provisions of the WTO agreements. The critical phrase "exempt from actions" is not defined in the Agriculture Agreement. According to the customary rules of interpretation of public international law[5], these terms should be interpreted according to their ordinary meaning in their context, in light of the object and purpose of the Agreement.[6]

7. The ordinary meaning of the word "exempt" is "[n]ot exposed or subject to something unpleasant or inconvenient; not liable to a charge, tax, etc. (Foll. by *from, of*.)".[7] The ordinary meaning of the word "action" is "[t]he taking of legal steps to establish a claim or obtain remedy; the right to institute a legal process" and "[a] legal process or suit".[8] A legal dictionary provides further explanation of the term "action":

> Term in its *usual legal sense* means *a lawsuit* brought in a court; a *formal complaint* within the jurisdiction of a court of law. . . . . The *legal or formal demand of one's right* from another person or party made and insisted on in a court of justice. An *ordinary proceeding in a court* of justice by which one party prosecutes another for the enforcement or protection of a right, the redress or prevention of a wrong, or the punishment of a public offence. It includes *all the formal proceedings* in a court of justice attendant upon the demand of a right made by one person of another in such court, *including an adjudication* upon the right and its enforcement or denial by the court.[9]

Thus, according to the ordinary meaning of the terms, "exempt from action" means "not exposed or subject to" the "taking of legal steps to establish a claim", such as a "formal complaint" or any "formal proceedings", including an "adjudication" of the claim. An even simpler formulation would be "not liable to" a "legal process or suit".

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[5] *See Understanding on Rules and Procedures Governing the Settlement of Disputes*, Article 3.2 (The dispute settlement system "serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law.").

[6] The customary rules of interpretation of public international law are reflected in part in Article 31(1) of the Vienna Convention, which reads: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

[7] *The New Shorter Oxford English Dictionary*, vol. 1, at 878 (first definition as adjective & noun) (italics in original).

[8] *The New Shorter Oxford English Dictionary*, vol. 1, at 22 (first and second definitions).

[9] *Black's Law Dictionary* at 28 (6th ed. 1990) (emphasis added).

8. Relevant context for the phrase "exempt from actions" includes the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), which applies to "disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the 'covered agreements')". The covered agreements, of course, include the Agriculture Agreement and the Subsidies Agreement. Article 3.7 of the DSU states: "*Before bringing a case*, a Member shall exercise its judgement as to whether *action* under these procedures would be fruitful" (emphasis added). Similarly, Article 4.5 of the DSU states: "*In the course of consultations* in accordance with the provisions of a covered agreement, before resorting to *further action* under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter" (emphasis added). Thus, these provisions suggest that "action" based on the relevant provisions would include all stages of a dispute, including the "bringing [of] a case", consultations, and panel proceedings.[10]

9. In addition, Article 7, which forms part of Part III of the Subsidies Agreement (entitled "Actionable Subsidies"), serves as context for the term "exempt from actions." Article 7 provides procedures (including consultations, panel proceedings, and remedies) to enforce the legal rights contained in Article 5 (on "adverse effects") and Article 6 (on "serious prejudice"). Article 7 states in its introductory phrase that its procedures apply "[e]xcept as provided in Article 13 of the Agreement on Agriculture".[11] Thus, these provisions also support reading "exempt from actions" in Article 13 to mean "not subject to" the "taking of legal steps to establish a claim". Footnote 35 of the Subsidies Agreement provides additional context that may help explain that "exempt from action" includes not resorting to dispute settlement. Footnote 35, which deals with "non-actionable"[12] subsidies, states that "[t]he provisions of Parts III [on actionable subsidies] and V [on countervailing measures] *shall not be invoked* regarding measures considered non-actionable in accordance with the provisions of Part IV".[13] As otherwise relevant provisions cannot be "invoked" for non-actionable subsidies, footnote 35 supports reading " exempt from action" as not resorting to dispute settlement by asserting legal claims.

10. This interpretation of "exempt from actions" meshes with the object and purpose of the Agriculture Agreement. The Agreement represents the outcome of long and difficult negotiations to move towards the "long-term objective . . . to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets".[14] Members therefore agreed to the Peace Clause, recognizing that agricultural subsidies could not be eliminated immediately and needed, under certain conditions, to be exempted from the Subsidies Agreement and GATT 1994 subsidies disciplines.

## C. CONCLUSION: BRAZIL MAY NOT BRING, AND THE PANEL MAY NOT ADJUDICATE, A SUBSIDIES AGREEMENT OR GATT 1994 ARTICLE XVI ACTION AGAINST US MEASURES CONFORMING TO THE PEACE CLAUSE

11. Brazil's approach – that both the applicability of the Peace Clause and Brazil's Subsidies Agreement and GATT 1994 Article XVI claims be considered at the same time – would contravene the plain meaning of the Peace Clause by subjecting US measures to the "taking of legal steps to establish a claim". Under Brazil's approach, the US measures would be subject to an action based on the

[10] As further support for the fact that "action" includes dispute settlement, DSU Article 3.10 provides that: "It is understood that requests for conciliation and the use of the dispute settlement procedures should not be intended or considered as contentious *acts* . . ." (emphasis added).

[11] Subsidies Agreement, Article 7.1.

[12] The ordinary meaning of the term "actionable" is "[a]ffording ground for an action at law". *The New Shorter Oxford English Dictionary*, vol. 1, at 22.

[13] Subsidies Agreement, Article 10 fn. 35 (emphasis added).

[14] Agriculture Agreement, preamble (third paragraph).

corresponding provisions of the Subsidies Agreement and GATT 1994 at the same time that the Panel would be reviewing the applicability of the Peace Clause. Brazil's approach would ignore the plain meaning of the provisions of the Peace Clause exempting these measures from actions.

12. Accordingly, the United States respectfully requests the Panel to find that measures that conform to the Peace Clause are exempt from any action, including action under the DSU, based on the corresponding provisions of the Subsidies Agreement and the GATT 1994. As a result, the United States is not required to defend those measures in any action based on Brazilian claims exempted by the Peace Clause.

# ANNEX A-3

## ARGENTINA'S THIRD PARTY INITIAL BRIEF

10 June 2003

1. Argentina would like to thank the Panel for the opportunity to submit, as third party to the dispute, written comments concerning whether Article 13 of the Agreement on Agriculture (AoA) precludes the Panel from considering Brazil´s claims under the Agreement on Subsidies and Countervailing Measures (SCM Agreement) in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. To that respect, Argentina states the following:

2. The text of Article 13 of the AoA does not require the Panel to make a preliminary finding on the applicability of the peace clause before examining Brazil´s claims under the SCM Agreement or GATT 1994. If the negotiators had considered such preliminary finding was necessary, they would have set it forth.

3. Indeed, a textual analysis of Article 13 of the AoA reveals that *"actions"*, and not the analysis of claims under Article XVI of GATT 1994 or Articles 3, 5 or 6 of the SCM Agreement, can only be precluded if all conditions established in paragraphs b) (ii) or c) (ii) of the referred Article 13 are met.

4. To that regard, the Appellate Body has established:

> *"The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the Vienna Convention. But these principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended."*[1]

- **The terms *"exempt from actions"* as stated in Article 13 of the Agreement on Agriculture:**

5. From Argentina´s point of view, in the context of Article 13 of the AoA the words *"exempt from actions"* do not amount to an impossibility to request a panel procedure. *"Exempt from actions"* means that a finding of inconsistency with Articles XVI of GATT 1994 or Articles 3, 5 and 6 of SCM Agreement will not be possible if the legal requirements for the exemption are fulfilled. The immediate context of the terms "*exempt from actions"* -i.e., paragraphs b) and c)- confirms this interpretation since that exemption require a particular threshold, i.e., that domestic support measures and export subsidies "conform fully" (to different provisions of the AoA).

6. Nevertheless, it is precisely through the panel procedures that the fulfilment of those legal requirements will be determined. Argentina agrees with Brazil´s statement in paragraph 6 of its Brief that the word "actions" in the context of Article 13 of the AoA refers to decisions of WTO competent bodies, such as the DSB when it discharges its duties by establishing a panel. A different interpretation would imply giving the measures allegedly covered by the Peace Clause a character of absolute immunity, independent of whether the legal requirements established in Article 13 are fulfilled or not. This would contradict the principle of *in dubio mitius*, constituting a more onerous interpretation of the treaty provisions

[1] Appellate Body Report, *India-Patents*, adopted 16 January 1998, WT/DS50/AB/R, para. 45. (Emphasis added).

7. Therefore, the words *"exempt from actions"* do not preclude a Panel from considering a claim under the SCM Agreement or GATT 1994 while it decides whether the Peace Clause conditions have been fulfilled.

8. Argentina considers that there is no doubt that "the Peace Clause currently continues to exempt conforming measures from actions under the corresponding provisions of the GATT 1994 and the Subsidies Agreement".[2] Indeed, the key words in Article 13 b) (ii) and c) (ii) of the AoA are "*that conform fully*" and "*provided that"* and "*that conform fully*", respectively. These words imply that the exception is not absolute, but rather subject to the fulfilment of certain conditions. When considering the interpretative issues for purposes of the Panel's question at paragraph 4 of its Brief, the US seems to omit this issue by stating that what appears to be in dispute is the nature of the treatment of conforming measures under the Peace Clause. However, from Argentina's point of view, what is important here is to determine at this stage of the proceedings the treatment under the Peace Clause of measures that are supposed not to be in conformity with the legal requirements needed to be exempted from actions.

9. In addition, the fulfilment of the legal conditions set forth under Article 13 is a matter of fact that necessarily requires to be elucidated during panel procedures. If not, how can this issue be elucidated where, as in the present case, the US did not state which was its 1992 domestic support level and did not answer the specific questions during the consultations? Only through panel proceedings could those issues be elucidated.

10. On the other hand, as Brazil stated in paragraph 17 of its Brief[3], there is no WTO provision obliging a Member to present evidence relating to the Peace Clause in a manner that is divorced from factual evidence and allegations under the SCM Agreement and/or GATT 1994. As stated by Brazil in paragraphs 13 and 14 of its Brief, according to Article 11 of the DSU a panel must make an objective assessment of the facts of the case and not of part of them before examining others, specially when, as in the case at hand, there is an overlap between the evidence related to the requirements of Art. 13 of the AoA and the evidence related to the actionable and prohibited subsidy claims.

11. Argentina considers that the text of Article 13 of the AoA does not ban a Panel from considering altogether a defence invoked under the Peace Clause and the allegations of inconsistency under GATT 1994 or the SCM Agreement. If a preliminary ruling on the applicability of the Peace Clause were necessary before being able to examine Brazil´s claims under the SCM Agreement or GATT 1994, the terms "*exempt from actions"* would have too broad a sense. It would amount to the creation of a new obligations for Members clearly not envisaged in the text of Art. 13.

12. Finally , the same reasoning could apply to other preliminary issues, such us the objections to the consistency of a Panel´s terms of reference with Article 6.2 of the DSU or the general exceptions under Article XX of GATT 1994. However, different Panels and the Appellate Body have made their findings on those issues altogether with their findings regarding substantive claims.

- **Other relevant provisions of the covered agreements:**

13. The SCM Agreement is applicable both for agricultural and non-agricultural products. It is true that Article 7 of the SCM Agreement states that the request of consultations is subject to Article 13 of the AoA. However, in the case at hand the US did not put it forward neither during

[2] US Initial Brief on Question Posed by Panel, 5 June 2003.

[3] Brazil´s Brief on Preliminary Issue Regarding the "Peace Clause" of the Agreement on Agriculture, 5 June 2003.

consultations nor during the meetings where the establishment of the Panel was requested, thus engaging itself in such procedures.

- **Other considerations that should guide the assessment of this issue :**

14. Argentina considers that the provisions contained in Article 13 of the AoA have an exceptional nature. This would imply that the Member who alleges to be protected by the Peace Clause has the burden of proving the fulfilment of its legal requirements. As long as the US does not demonstrates *prima facie* that it fulfils all the conditions that would allow a protection against a claim by virtue of Article 13 of the AoA, the Panel should consider as appropriate the claims under Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement.

15. Finally, as stated by Brazil in paragraphs 13 and 14 of its Brief, according to DSU Article 11 a panel must make an objective assessment of the facts of the case and not of part of them before examining others, specially when, as in the case at hand, there is a need to clarify closely related issues of fact that relate both to the fulfilment of the conditions set forth by the Peace Clause and to the substantive claims regarding actionable and prohibited subsidies.

**Conclusion**

16. According to the above statements, Argentina considers that Article 13 of the AoA does not preclude the Panel from hearing evidence and considering Brazil´s claims under the SCM Agreement or GATT 1994 while it decides whether the Peace Clause conditions of Article 13 have or have not been met.

# ANNEX A-4

## AUSTRALIA'S WRITTEN COMMENTS

10 June 2003

1. I refer to your faxed letter of 28 May 2003 in which you invited third parties to the dispute to submit any written comments they may have in relation to the following:

> whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invite the parties to explain their interpretation of the words "exempt from action" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article 13.

2. Please note that, for the purposes of Australia's comments in relation to the issues identified in the previous paragraph, references to "Article 13" refer to Article 13(a)(ii), 13(b)(ii) and 13(c)(ii). There is nothing in Article 13 of the *Agreement on Agriculture* – nor indeed in the *Dispute Settlement Understanding ("the DSU")* – that would preclude the Panel from considering claims under the *Agreement on Subsidies and Countervailing Measures* in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled.

3. Article 13 of the *Agreement on Agriculture* provides a limited, conditional and time-limited exemption from actions based on Article XVI of GATT 1994 and certain provisions of the *Agreement on Subsidies and Countervailing Measures* ("the specified provisions") in respect of measures which conform fully to the respective provisions of the *Agreement on Agriculture* and to Article 13 itself. Article 13 does not preclude *per se* claims based on the specified provisions, that is, Article 13 does not prevent the specified provisions being invoked. Rather, Article 13 is in the nature of an "affirmative defence" for measures which are inconsistent with the specified provisions.[1]

4. Viewing Article 13 of the *Agreement on Agriculture* as an affirmative defence gives proper meaning to that provision, as well as to Article 21 of the *Agreement on Agriculture* and Articles 3.1, 6.9 and 7.1 of the *Agreement on Subsidies and Countervailing Measures*. This view would also be consistent with the interpretive principle of effectiveness, which the Appellate Body has found should guide the interpretation of the WTO Agreement.[2]

5. In assessing an affirmative defence based on Article 13 of the *Agreement on Agriculture*, the proper application of that provision would require the Panel to consider the conditions listed in Article 13 ("the prescribed conditions"), that is:

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[1] See, for example, *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, page 16.

[2] *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/AB/R, WT/DS234/AB/R, paragraph 271.

- as appropriate, whether the measure at issue constitutes a domestic support measure or an export subsidy within the meaning of Annex 2 to, or Articles 6 or 1(e) of, the *Agreement on Agriculture*; and, if so,

- as appropriate, whether the measure at issue conforms fully to the provisions of Annex 2 to, or Article 6 or Part V of, the *Agreement on Agriculture*; and

- as appropriate, whether measures falling within the provisions of Article 6 of the *Agreement on Agriculture* grant support to a specific commodity not in excess of that decided during the 1992 marketing year.

6. Only if the Panel determines that Article 13 of the *Agreement on Agriculture* is relevant because the prescribed conditions are met would it need to consider whether the measures at issue are "exempt from actions based on" the specified provisions. In that event, the Panel would need to consider whether the measures at issue are "free or released from a duty or liability to which others are held"[3] in relation to a proceeding "found[ed], buil[t] or construct[ed] on"[4] the specified provisions. In other words, if the prescribed conditions are met, a Member will be immune from liability for a measure's inconsistency with the specified provisions for the period for which Article 13 applies.

7. In this dispute, there is disagreement between the parties to the dispute whether the measures at issue conform fully to the respective provisions of the *Agreement on Agriculture*. However, disagreement between the parties to the dispute does not serve to limit the Panel's mandate. There is no provision in the covered agreements that a disagreement between the parties to the dispute about conformity would serve as a barrier to a Panel's legal mandate to examine claims in accordance with the provisions of Article 3.2 and 11 of the DSU. There is, therefore, no requirement that the Panel reach a conclusion that certain conditions of Article 13 of the *Agreement on Agriculture* remain unfulfilled before considering claims under the *Agreement on Subsidies and Countervailing Measures*.

[3] *Black's Law Dictionary*, Seventh Edition, Bryan A Garner, Editor in Chief, West Group, St Paul, Minn., 1999, page 593.

[4] *The New Shorter Oxford English Dictionary*, Ed. Lesley Brown, Volume 1, Clarendon Press, Oxford, 1993, page 187.

# ANNEX A-5

## COMMENTS BY THE EUROPEAN COMMUNITIES ON CERTAIN ISSUES RAISED ON AN INITIAL BASIS BY THE PANEL

10 June 2002

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## I. INTRODUCTION

1. The Panel has asked the Parties to this dispute, together with the third parties, to comment on the following question:

> [W]hether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions in Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue.

2. The European Communities understands the positions of the two parties as follows. The United States is arguing for a multi stage procedure – first the Panel should deal with this initial issue, second, it should examine whether the US measures at issue fall under Article 13 of the *Agreement on Agriculture*, and finally, and only if the measures do not fall under Article 13 of the *Agreement on Agriculture*, should the Panel examine whether these measures are consistent with the *Agreement on*

*Subsidies and Countervailing Duties* (*SCM Agreement*).[1] On the other hand, Brazil considers that the Panel should, after settling this initial issue, examine Brazil's claims under Article 13 of the *Agreement on Agriculture* and the *SCM Agreement* simultaneously, treating Brazil's claims under Article 13 of the *Agreement on Agriculture* as a threshold issue.[2] Neither party appears to suggest that this issue is anything other than a substantive issue. [3]

3. The parties submissions concern the manner in which the Panel should organise its procedures. In other words, should it hear arguments and evidence on Brazil's claims under Article XVI GATT and the *SCM Agreement* before it has decided whether the United States can avail itself of Article 13 of the *Agreement on Agriculture*. The European Communities considers that this issue falls within the Panel's discretion as to the organization of its procedures. Such discretion is, nevertheless, not without its limits. The European Communities considers that there are a number of factors which require the Panel to exercise its discretion so as to examine the evidence and arguments presented by the parties with respect to both Article 13 of the *Agreement on Agriculture* and Article XVI GATT and the *SCM Agreement* at the same time. The European Communities sets out its arguments on these issues in more detail in the sections below.

## II. THE QUESTION AT ISSUE FALLS WITHIN THE PANEL'S DISCRETION AS TO THE ORGANISATION OF ITS OWN PROCEDURES

4. Both parties seem to consider that the Panel is required to rule, as a matter of substance, on whether the US measures fall under Article 13 of the *Agreement on Agriculture*, and if not, whether they are consistent with Article XVI GATT and the *SCM Agreement*. Brazil's contention that the US measures are inconsistent with Article XVI GATT and the *SCM Agreement*, because they are not covered by Article 13 of the *Agreement on Agriculture* requires the Panel to determine whether Article 13 is applicable. Similarly, the United States' claim that Article 13 of the *Agreement on Agriculture* prevents the Panel from ruling on Brazil's other claims requires adjudication of the issue of the applicability of Article 13.

5. The European Communities finds support for its view that the choice between a single and multistage procedure is a matter for the Panel's discretion in the fact that Article 13 of the *Agreement on Agriculture* is not set up as a specific rule which can be distinguished from the normal DSU procedures. Thus, for instance, Article 13 is not mentioned in Annex 2 of the DSU listing special or additional rules and procedures contained in the covered agreements. Moreover, Article 19 of the *Agreement on Agriculture* states that the provisions of Article XXII and XXIII GATT, as elaborated in the DSU, apply to the *Agreement on Agriculture*. Consequently, there are no special rules foreseen in respect of Article 13 in the event that a Member requests dispute settlement in which it may be raised as an issue.

6. In order further to demonstrate that this is a matter for the Panel's discretion, it is instructive to consider the United States' arguments on the meaning of exempt from action". The United States argues that the meaning of the term "exempt from action" is that no formal proceedings can be

[1] In para. 2 of its initial brief, the US argues

> "[t]he United States respectfully requests the Panel to organize its procedures to first determine whether Brazil may maintain any action based on provisions exempted by the Peace Clause."

[2] Brazil concludes its initial brief as follows:

> "[ ..] Brazil requests that this Panel find that it is not precluded from hearing evidence and considering Brazil's claims under the ASCM or Article XVI of GATT 1994 without first concluding that the peace clause conditions of AoA Article 13(b)(ii) and 13(c)(ii) remain unfulfilled."

[3] For instance, that the arguments on Article XVI GATT and the SCM Agreement are not within the terms of reference of the Panel.

launched with respect to the matter exempt from action, and that in the WTO, this would mean that a Member could not request consultations and later request the establishment of a panel.[4] The implications of this are unclear however. The logical conclusion would appear to be that the United States is suggesting that Brazil should first bring a panel arguing that Article 13 of the *Agreement on Agriculture* is not applicable, and then (if it is successful) bring a second panel to adjudicate its claims under Article XVI GATT and the *SCM Agreement*? This notion seems implausible for a number of reasons. First, in considering whether Article 13 of the *Agreement on Agriculture* is applicable, the first Panel would not be adjudicating a dispute but would be requested to issue a declaratory judgement. Second, a Member is not under an obligation to act consistently with Article 13 of the *Agreement on Agriculture* – failing to respect Article 13 implies that a Member no longer enjoys the protection thereof. Consequently, and third, Article 13 of the *Agreement on Agriculture* can only be seen as a defence against a claim brought under other aspects of the WTO Agreements which regulate the provision of subsidies. It would seem bizarre if, before Brazil could bring a claim with respect to subsidies which it considered did not respect the US's WTO obligations, Brazil had first to establish that potential US defences did not apply.

7. The European Communities notes that, although this situation is the logical continuation of the US interpretation of the term "exempt from action", the United States does not suggest that Brazil should have launched two successive WTO panels. Rather it maintains that the Panel's hearing argument and evidence on Article XVI GATT and the *SCM Agreement* would amount to an "action" which cannot be brought against it until it is determined that the US measures do not conform to Article 13 of the *Agreement on Agriculture*. Why the United States considers that hearing evidence would amount to such a prohibited "action", while requesting consultations or the establishment of a panel does not amount to maintaining an "action" is unclear. Indeed, the European Communities would presume that the United States would agree that Article 13 of the *Agreement on Agriculture* has the ultimate effect of not requiring any subsidy maintained consistently with Article 13 of the *Agreement on Agriculture* and otherwise inconsistent with the *SCM Agreement* to be brought into conformity with the provisions of the *SCM Agreement* (typically through its withdrawal). For the European Communities, therefore, the issue of whether a measure falls under Article 13 is necessarily a question which a Panel must decide before it decides whether the measure might violate Article XVI GATT or the *SCM Agreement.* However, the mere fact that the Article 13 issues must be decided before the other claims are decided does not imply that a panel, when it is examining evidence and considering arguments with respect to Article 13 of the *Agreement on Agriculture*, is precluded from hearing the evidence and arguments relating to Article XVI GATT or the *SCM Agreement* until after it has decided on the applicability of Article 13 of the *Agreement on Agriculture*.

8. In conclusion, the Panel has substantial discretion in deciding how it will manage these issues. Article 12.1 DSU makes it quite clear that the Working Procedures set out in Appendix 3 of the DSU may be departed from if the Panel decides this is appropriate. Therefore, it is a matter for the Panel's discretion whether to arrange a multistage procedure as proposed by the United States or a single stage procedure as proposed by Brazil.

9. The European Communities considers that the normal procedure proposed by Brazil should be followed by the Panel for the reasons set out in the next section.

[4] See paras. 7 and 8 of the US initial Submission.

## III. SEVERAL FACTORS MILITATE IN FAVOUR OF EXAMINING THE EVIDENCE AND ARGUMENTS PRESENTED IN RESPECT OF ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE AT THE SAME TIME AS THE OTHER CLAIMS

10. The European Communities submits that the Panel should consider evidence and argument relating to both the applicability of Article 13 of the *Agreement on Agriculture*, and the other provisions which Brazil has alleged the United States has acted inconsistently with.

### A. THE APPLICATION OF ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE IS DEPENDENT ON THE EXAMINATION OF QUESTIOnS OF SUBSTANCE

11. As the United States and Brazil appear to have recognised, the question of the applicability of Article 13 of the *Agreement on Agriculture* is dependent on the assessment of substantive issues, notably the conformity of the measures in question with other provisions of the *Agreement on Agriculture*. In order for the Panel to establish whether Article 13 applies, the Panel will have to consider detailed arguments and evidence. For that reason, the applicability of Article 13 should be subjected to the normally applicable procedures by which Panel deal with complex issues of fact and law and not adjudicated in some form of preliminary procedure. The European Communities note, for instance, that this was the approach taken by the panel in the *United States – Export Restraints* dispute, which refused to rule on a number of preliminary objections brought by the United States (as the defendant) which went to the substance of the matter.[5]

### B. ASSESSING THE APPLICABILITY OF ARTICLE 13 AS A PRELIMINARY MEASURE MAY DELAY THE ISSUANCE OF THE REPORT

12. In the same vein, it can be noted that hearing evidence and considering arguments on the applicability of Article 13 would inevitably require a considerable amount of time, as will hearing and assessing the arguments and evidence on the other issues which could only be considered after the preliminary decision on Article 13 was taken. Given the substantial number of claims brought, their complex nature, and the substantial interest in this dispute from third parties, the Panel may, if it splits up the dispute into three stages, have problems issuing its report within nine months, as it is required to do under the Article 12.9 DSU.

13. The European Communities also has some sympathy for the concerns set out by Brazil, in section V of its Initial Submission, as to the effect of splitting the procedure on Brazil's ability to present its case.

### C. THIRD PARTY DUE PROCESS RIGHTS MAY BE INFRINGED BY A DECISION TO SPLIT THE PROCEDURE INTO THREE STAGES

14. As the Panel is aware, Article 10.3 DSU provides that third parties are entitled to receive the submissions of the parties to the first meeting with the Panel. If the first panel meeting is limited to considering the applicability of Article 13 of the *Agreement on Agriculture* and thus parties submissions are limited to that question, the third parties will not have an opportunity to be heard on issues other than Article 13 of the *Agreement on Agriculture*. If the Panel decides to adopt a three stage procedure, in order to avoid such a situation arising, the European Communities respectfully submits that the Panel should make provision to ensure that third parties have adequate access, and the opportunity to be heard on all matters (that is, also in the third stage of procedures). Inevitably,

[5] Panel report, *United States – Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001, para. 8.2.

however, setting up such a procedure will involve additional work for both the Panel and the Secretariat.

## IV. CONCLUSION

15. In conclusion, the European Communities respectfully submits that, while the Panel is obliged to decide on the applicability of Article 13 of the *Agreement on Agriculture* before it may take a decision with respect to Brazil's claims under Article XVI GATT and the *SCM Agreement* it is not precluded from considering evidence or argument on these claims until after it has decided on the applicability of Article 13 of the *Agreement on Agriculture*. As the European Communities has explained above, there are several reasons militating in favour of the Panel considering all arguments and evidence simultaneously.

# ANNEX A-6

## INDIA'S COMMENTS ON PRELIMINARY ISSUE REGARDING THE PEACE CLAUSE OF THE AGREEMENT ON AGRICULTURE

10 June 2003

1. India thanks the panel for being provided an opportunity to comment on the submissions of Brazil and the United States on the following question concerning Article 13 of the Agreement on Agriculture posed by the Panel:

> *Whether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled.*[1]

2. India notes that both Brazil and the United States evidently agree that "exempt from actions" means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are in compliance with various provisions of the Peace Clause. In other words, a measure must be in conformity with: (a) provisions of Annex 2 of the Agreement on Agriculture in respect of green box domestic support measures; (b) provisions of Article 6 of the Agreement on Agriculture in respect of amber and blue box support measures; and (c) Part V of the Agreement on Agriculture as reflected in each member's Schedule in respect of export subsidies to attract the exemption from obtaining a remedy under the Peace Clause.

3. However the United States seems to argue in various paragraphs of its submission, including in paragraphs 7, 9 and 12, that this exemption extends to "any action, including action under the DSU, based on the corresponding provisions of the Subsidies Agreement and GATT 1994". The United States thereby suggests that resort cannot be had to the dispute settlement proceedings by asserting legal claims in respect of measures claimed by a Member to be Peace Clause protected.

4. Thus, on the question posed by the Panel, the United States is of the view that the Panel should organize its procedures to first determine whether Brazil may maintain any "action" based on provisions exempted by the Peace Clause. On the other hand, Brazil has asserted that the phrase "exempt from actions" in Article 13 of the Agreement on Agriculture does not compel the Panel to *first* make a Peace Clause finding before considering the substance of Brazil's other claims.

5. The United States seeks to interpret "action" to "include all stages of a dispute, including the "bringing [of] a case," consultations, and panel proceedings." Subsequently, the United States suggests a reading of "exempt from actions" in Article 13 to mean "not subject to" the "taking of legal steps to establish a claim" or "not resorting to dispute settlement by asserting legal claims".

6. In India's view, if the interpretation of "exempt from actions" under Article 13 of the Agreement on Agriculture, as sought by the United States, extends to exemption from "any action"

[1] The Panel also "invites the parties to explain their interpretation of the words 'exempt from actions' as used in Article 13 of the Agreement on Agriculture, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue."

such that resorting to dispute settlement by asserting legal claims is precluded in respect of Peace Clause protected measures, then consequences follow that have systemic implications. This interpretation would result in countries being precluded from even resorting to the dispute settlement process in respect of measures claimed by the country to be complained against to be conforming to the Peace Clause unless there is a prior finding on the lack of conformity of the measure with the Peace Clause. This interpretation of "exempt from actions" taken to its logical end would imply that even consultations under the DSU cannot be sought in respect of such a measure, unless there is a prior finding on non-conformity of the measure with the Peace Clause. A complaining country would therefore have to resort to the dispute settlement process twice in respect of the same measure; first, for obtaining a finding whether the measure is in conformity with the Peace Clause and, if not, then whether the measure is in conformity with obligations under various WTO Agreements. In India's view this result is neither desirable nor envisaged under the DSU or any other covered agreements.

7. India believes that neither the phrase "exempt from actions" nor Article 13 of the Agreement on Agriculture compel the Panel to *first* make a peace clause finding before considering the substance of Brazil's claims in various issues in this dispute. India is of the view that Article 13 of the Agreement on Agriculture is not a "special and additional" rule set out in Appendix 2 to the DSU. Article 19 of the Agreement on Agriculture makes all DSU provisions applicable to the Agreement on Agriculture. Thus there is no legal basis under the DSU or any of the covered agreements that would support the two stage approach suggested by the United States in this dispute whereby the Panel would first make a Peace Clause finding before considering claims on other agreements.

8. In conclusion, India believes that the phrase "exempt from actions" when viewed in the context of DSU provisions *does not require* the Panel to *first* make a Peace Clause non-compliance finding before hearing or considering any of the evidence or arguments relating to the various claims under other agreements.

# ANNEX A-7

## THIRD PARTY COMMENTS BY NEW ZEALAND ON PRELIMINARY ISSUE REGARDING ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE ("THE PEACE CLAUSE")

10 June 2003

New Zealand welcomes the opportunity to comment on the preliminary issue addressed in the Panel's 28 May 2003 request:

> "Whether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion of the Panel that certain conditions of Article 13 remain unfulfilled …"

In New Zealand's view, a Panel is not required to make any prior conclusion concerning the applicability of Article 13 (the "Peace Clause") before proceeding to hear evidence and submissions relating to substance of legal claims brought under the Agreement on Subsidies and Countervailing Measures (ASCM) and GATT Article XVI. New Zealand notes in this regard that the overlapping nature of the evidence required to establish both the applicability of the Peace Clause as well as actionable and prohibited subsidies claims would make a separation of submissions and hearings on each aspect artificial.

In relation to the Panel's request for views on the term "exempt from actions" in Article 13(b)(ii) and 13(c)(ii), New Zealand considers that these words simply mean that a Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are otherwise protected by the "Peace Clause". New Zealand does not consider that this phrase should be interpreted so as to suggest that substantive claims under the ASCM and GATT Article XVI can only be addressed in written or oral submissions after a Panel has made a ruling that the Peace Clause apply.

In summary, New Zealand considers that the Panel is not precluded from hearing evidence and considering claims under the Agreement on Subsidies and Countervailing Measures or Article XVI of the GATT without first concluding that Peace Clause conditions remain unfulfilled.

# ANNEX A-8

## SUBMISSION OF PARAGUAY
## COMMENTS ON THE "PEACE CLAUSE"

10 June 2003

Paraguay does not see how, under the provisions of the Dispute Settlement Understanding (DSU), the Panel can establish that a matter calls for a "preliminary and special ruling" when the DSU does not provide for such a procedure.

If this were so, many complaints would be subject to the prior demonstration of the existence of the conditions for bringing the action, when in fact, what needs to be resolved is the main subject of the dispute and the effects caused by the failure to comply with the rules and regulations of world trade.

Paraguay considers that to set a precedent of this kind would be to undermine the DSU's purpose of providing a flexible and prompt dispute settlement procedure, since countries would be faced with an unnecessary delay in the process involving costs and time beyond their "predictions".

Since there is no established procedural rule in this respect, the Panel must proceed to the analysis of the substantive issue, and permit the parties, in this case especially Brazil as complainant – and by extension Paraguay – to demonstrate that the subsidies and support measures benefiting upland cotton have effects on trade and production by the cotton industry in the world.

Paraguay has a supreme interest in ensuring the application of strict justice with respect to this complaint, since cotton production is the sustenance of the poorest segments of its population. Indeed, 70 per cent of the country's small farmers depend on cotton production for their living.

As already stated in the past, of Paraguay's population of approximately 5,300,000, some 150,000 families work in cotton production, and the damage caused by the kinds of subsidies and support measures at issue in this case have caused an exodus of this rural population to urban areas with no relief or solution in sight, further aggravating the country's economic situation.

In view of the above, Paraguay considers that since Article XIII is not a rule forming part of the procedural system established by the DSU, a preliminary ruling by the Panel on the "Peace Clause" would be inappropriate.

# ANNEX A-9

BRAZIL'S COMMENTS ON THE BRIEFS BY THE UNITED STATES AND THE THIRD PARTIES ON CERTAIN PRELIMINARY ISSUES REGARDING THE "PEACE CLAUSE" OF THE AGREEMENT ON AGRICULTURE

13 June 2003

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## I. INTRODUCTION

1. Brazil welcomes the opportunity to provide its comments regarding the third party submissions of Argentina, Australia, the European Communities, India, New Zealand, and Paraguay filed on 10 June 2003, and to respond to the *Initial Brief of the United States of America on the Questions Posed by the Panel (US Initial Brief),* filed on 5 June 2003.

## II. THE US TEXTUAL AND CONTEXTUAL ARGUMENTS CONCERNING "EXEMPT FROM ACTIONS" ARE INCONSISTENT WITH THE MULTILATERAL NATURE OF "ACTIONS" UNDER THE DSU AND WITH US CONDUCT IN THIS DISPUTE

2. The customary rules of interpretation of public international law do not support the United States' reading of Article 13 of the Agreement on Agriculture (AoA). The United States relies on a legal dictionary for a definition of "action" and then concludes incorrectly that "action" means any "proceeding in a court of justice" including any "legal steps to establish a claim".[1] This interpretation misreads Article 13 because it starts from fundamentally mistaken premises.

3. A WTO panel is not a "court" because the WTO panel process is founded on, and guided by, *collective* action by the Members. A lawsuit in a US or Brazilian court of law starts automatically when a plaintiff takes the "action" of filing papers that are in the proper form. But a DSU panel proceeding commences only when the Members of the WTO take *collective* "action" to establish the panel. The DSU rules "elaborate and apply"[2] the rules in GATT Article XXIII:2, which speak of an investigation by the CONTRACTING PARTIES – which under GATT Article XXV:1 are all the contracting parties "acting jointly". Whereas a US or Brazilian judge has broad powers conferred on him or her constitutionally, a WTO panel is a body of limited jurisdiction acting only with powers delegated to it by the DSB. For example, defending parties challenge claims as going beyond the terms of reference under DSU 6.2, because the terms of reference define the limits of the powers delegated to the panel by the DSB through the DSB's action to establish the panel.

4. The "negative consensus" provisions in DSU Article 16.4 further support Brazil's position that "action" in AoA Article 13 must be interpreted as *joint* action by WTO Members. Decisions of a court are directly and immediately binding on the parties to the litigation, but such is not the case for decisions of a panel or the Appellate Body. Instead, the drafters of the DSU decided that the Members acting jointly would retain ultimate control of whether a panel or Appellate Body report has any binding effect. Similarly, the recommendations and rulings referred to in DSU Articles 21 and 22 are not recommendations and rulings of a panel or the Appellate Body, but are recommendations and rulings of the DSB. Accordingly, DSU 21.7 refers to *further* actions that the DSB must consider when a matter (not an "action") has been raised by a developing country.

5. The United States misinterprets DSU Article 3.7.[3] In this provision ("Before bringing a case, a Member shall exercise its judgment as to whether action under these procedures would be fruitful"), "actions" could and should be read in a *collective* context, as referring to the DSB's *action* to adopt a panel report and (if need be) to authorize suspension of concessions. DSU Article 3.7 transposed a provision in the 1979 Understanding Regarding Notification, Dispute Settlement and Surveillance[4]

[1] US Initial Brief, para. 7.

[2] AoA Article 19: provides that "The provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding, shall apply to consultations and the settlement of disputes under this Agreement."

[3] US Initial Brief, para. 8.

[4] Adopted on 28 November 1979; BISD 26S/210. The full text is set out in the GATT Analytical Index (6th Ed., 1995) at page 632. DSU Article 3.7 transposes paragraph 4 of the Agreed Description of the

which refers to "action under Article XXIII:2." As discussed in Brazil's Initial Brief, such "action" has always meant *joint* action by the CONTRACTING PARTIES, not individual action by a particular contracting party. Article 3.7 simply restates the common-sense advice that litigants must consider in advance whether the persuasive effect of a collective determination of rule violation and a collective authorization of suspension of concessions would be useful in eliminating the concrete problem. It cannot be read to suggest that any Member should be able to pressure another into dropping a valid legal claim by arguing that enforcing rights through litigation is not "fruitful."

6. The United States also misinterprets DSU Article 4.5 ("before resorting to further action under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter.").[5] Read correctly, DSU Article 4.5 simply refers to the "action" of the DSB to grant a request for establishment of a panel.[6] Thus, Article 4.5 urges a Member to attempt to obtain satisfactory adjustment of the "matter" (not the "action") before it requests the DSB to take action to establish a panel.

7. The United States also cites footnote 35 of the SCM Agreement ("The provisions of Parts III and V *shall not be invoked* regarding measures considered non-actionable in accordance with the provisions of Part IV.").[7] Yet "shall not be invoked" is a different legal standard that goes substantially farther than "shall be . . . exempt from actions." Under footnote 35, no DSB authorization could be obtained to establish a panel against a non-actionable subsidy granted by another Member. By contrast, AoA Article 13 exempts certain agricultural subsidies from actions by the DSB adopting a panel or Appellate Body report or authorizing suspension of concessions, but only *under certain conditions*. The DSB can only take "actions" against such subsidies if it decides that those conditions are unfulfilled (based on the recommendations in the report of the panel and/or Appellate Body). But this *conditionality* means that a panel must address the conditions of the peace clause if they are invoked by the Member providing the domestic support – as the United States appears to have indicated it will do in this dispute. If the drafters had intended to protect agricultural subsidies against even an *invocation* of Part II and III of the SCM Agreement, they would have said so, and they did not.

8. The United States argues in paragraph 9 that its subsidies are even "exempt" from consultations under the DSU. Paragraph 9 highlights the logical challenges presented by the US argument—particularly in light of the fact, discussed below, that Article 13 does not create *any* exception to the normal rules of WTO dispute settlement.

9. Moreover, the United States' own conduct in this dispute is at odds with paragraph 9 of the US brief. Brazil's consultation request dated 3 October 2002 clearly stated that "the United States has no basis to assert a defence under Article 13(b)(ii) . . . [and] Article 13(c)(ii) of the Agreement on Agriculture . . ".[8] Yet, the United States said nothing during three rounds of consultations about any requirement for a separate panel proceeding regarding the peace clause. Brazil's panel request also referred to the lack of any basis for the United States to assert a peace clause "defence".[9] The DSB minutes reflect that the United States did not mention the peace clause at all in the meetings of the

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Customary Practice of the GATT in the Field of Dispute Settlement (Article XXIII:2) annexed to the 1979 Understanding; paragraph 4 appears on page 635.

[5] US Initial Brief, para. 8.

[6] DSU Article 4.5 was a transposition of paragraph 4 in the Agreed Description of the Customary Practice of the GATT in the Field of Dispute Settlement annexed to the (Tokyo Round) Understanding Regarding Notification (BISD 26S/210; The full text is set out in the GATT Analytical Index on page 635). That provision refers to "action under Article XXIII:2." As discussed by Brazil, such "actions" are multilateral actions by the CONTRACTING PARTIES, not individual action by a particular contracting party.

[7] US Initial Brief, para. 9.

[8] WT/DS267/1 at 3.

[9] WT/DS267/7.

DSB that considered the panel request.[10] The first official US assertion regarding special procedural requirements relating to the peace clause did not come until a meeting in the office of the Director of the Legal Services Division, on 25 March 2003, one week after the Panel was established on 18 March 2003.

10. In considering the US request for a special "peace clause" proceeding, the Panel should take note that the panel and Appellate Body in the *US - FSC* dispute rejected US procedural claims of an allegedly defective EC consultation request. In that dispute the United States engaged in three rounds of consultations without mentioning the problem once and then attempted to raise the defect consultations request as a preliminary objection to the panel. The panel and the Appellate Body both rejected the objection. As the Appellate Body found:

> It seems to us that, by engaging in consultations on three separate occasions, and not even raising its objections in the two DSB meetings at which the request for establishment of a panel was on the agenda, the United States acted as if it had accepted the establishment of the Panel in this dispute, as well as the consultations preceding such establishment. In these circumstances, the United States cannot now, in our view, assert that the European Communities' claims under Article 3 of the *SCM Agreement* should have been dismissed and that the Panel's findings on these issues should be reversed.[11]

11. In this dispute, the United States sat mute on the subject of peace clause procedures through three rounds of consultations and two DSB meetings. Had the United States raised this particular procedural issue on a timely basis, other WTO Members may have reserved their rights under DSU Article 10. To permit such an issue to be raised on such an untimely basis also denies those other Members their rights under the DSU.

## III. THE NARROW INTERPRETATION OF THE WORD "ACTION" SUGGESTED BY THE UNITED STATES IS NOT SUPPORTED BY ALL THREE AUTHENTIC VERSIONS OF THE AOA

12. As argued in Brazil's Initial Brief of 5 June , Brazil believes that the word action refers to collective actions of the WTO Members, and not to actions by individual Members. Brazil further submits that the meaning the United States tries to impute to the word "action" is too narrow and inadequate.

13. Brazil recalls that the three versions of the WTO Agreements are authentic. The US interprets the word "action" in the English version as "legal process or suit". Brazil agrees that this is a possible meaning of the word, but so is "the process or condition of acting or doing"; or "a thing done, a deed, an act...; habitual or ordinary deeds".[12] Therefore, the word action in the English language could mean either a legal process or a simple act or deed.

14. The French version uses the word "action" which also allows both connotations. It could have the ordinary connotation of: "ce que fait qqn et par quoi il réalise une intention ou un impulsion;" "exercice de la faculté d'agir;" but it could also have the more specific meaning of the "exercice d'un droit en justice".[13]

[10] WT/DSB/M/143, WT/DSB/M/145.
[11] WT/DS108/AB/R, "United States – Tax Treatment for "Foreign Sales Corporations", para. 165.
[12] The New Shorter Oxford English Dictionary, 1993 edition.
[13] Le Petit Robert, Nouvelle édition ... 1982.

15. The Spanish version however does not allow such interpretative flexibility. The word used in Article 13 is not the word "acción", which would allow the arguable double meaning of the English and French versions: "resultado de hacer" or "*[e]n sentido procesal*, derecho a acudir a un juez o tribunal ..."[14] (emphasis added). The word used in Article 13 of the Spanish version is "medidas." While "medidas" could mean "disposición, prevención ... tomar, adoptar medidas"[15], it could not possibly have the connotation of a legal action. Again, while the dictionary meanings of the word "acción" do include the possibility of a judicial measure, the same is not true for the word "medidas".

16. Therefore, the Panel must avoid an interpretation of Article 13 that is possible in only two of the authentic versions, while there is another plausible – and in fact more adequate – interpretation that is equally possible in all three authentic versions. The Panel must accordingly reject the narrow interpretation suggested by the United States for the word "action".

## IV. THE OVERLY-BROAD US DEFINITION OF "EXEMPT FROM ACTION" IMPROPERLY CREATES NEW OBLIGATIONS AND PROCEDURES NOT CONTEMPLATED IN THE AOA OR THE DSU

17. The United States argues that the word "action" means "all stages of the dispute, including the 'bringing [of] a case,' consultations, and panel proceedings".[16] Brazil agrees with the arguments advanced by Argentina[17], the European Communities[18] and India[19] that this broad US interpretation would exempt measures allegedly covered by the "peace clause" exemption from any aspect of the DSU, including consultations. As India and the European Communities correctly point out, the result would logically lead to two separate panel proceedings – an initial proceeding deciding the peace clause issues, and after the issuance of a decision, the initiation of a second proceeding beginning with consultations to challenge the measures under the ASCM.[20] Yet, as these and other third parties highlight, there is no textual requirement or provision in the AoA, the DSU, or any other WTO provision for such a two-panel or two-stage process to resolve peace clause issues.

## V. THE US PROPOSAL FOR A SEPARATE PROCEEDING FOR PEACE CLAUSE ISSUES WOULD EFFECTIVELY ADD AOA ARTICLE 13 TO THE CLOSED LIST OF SPECIAL AND ADDITIONAL PROVISIONS IN DSU APPENDIX 2 AND GIVE AOA ARTICLE 13 A SCOPE THAT WAS NOT INTENDED BY AOA DRAFTERS

18. The United States' initial brief makes no reference to DSU Appendix 2, even though this provision was a key issue raised in Brazil's 23 May letter to the Panel. Brazil repeats that Appendix 2 provides a closed list of all the "special and additional" provisions that trump the normal rules of dispute settlement under the DSU. Article 13 does not appear in Appendix 2. Set forth below are two additional reasons in support of this argument.

19. First, providing a special proceeding for determining peace clause defences would effectively add Article 13 to DSU Appendix 2. In the first dispute settlement proceeding on *Guatemala Cement*, the panel found that Article 17 of the *Anti-Dumping Agreement* (ADA) replaced the DSU system as a whole because ADA Articles 17.4-17.7 were listed as special and additional provisions in Appendix 2

[14] Diccionario de la Lengua Española (Real Academia Española), vigésima segunda edición, 2001.
[15] *Id.*
[16] US Initial Brief para. 8.
[17] Argentina's Third Party Initial Brief, para. 6;
[18] Initial Submission by the European Communities, paras. 6-7;
[19] India's comments on preliminary issue regarding the Peace Clause of the Agreement on Agriculture, para. 6.
[20] Initial Submission by the European Communities, paras. 6-7; India's comments on preliminary issue regarding the Peace Clause of the Agreement on Agriculture, para. 6.

even though ADA Articles 17.1-17.3 were not included.[21] The Appellate Body reversed the panel's implied determination to treat ADA Articles 17.1-17.3 as special and additional rules when it found that DSU provisions generally do not apply to disputes brought pursuant to the ADA:

> Article 17.3 of the *Anti-Dumping Agreement* is not listed in Appendix 2 of the DSU as a special or additional rule and procedure. It is not listed precisely because it provides the legal basis for consultations to be requested by a complaining Member under the *Anti-Dumping Agreement.*[22]
>
> The special or additional provisions listed in Appendix 2 of the DSU are designed to deal with the particularities of dispute settlement relating to obligations arising under a specific covered agreement, while Article 1 of the DSU seeks to establish an integrated and comprehensive dispute settlement system for all of the covered agreements of the *WTO Agreements* as a whole. . . [23]

20. The effect of the United States argument and interpretation of "action" in this case would be to include AoA Article 13 as a special and additional rule in Appendix 2. Were the Panel to agree with the United States, it would create a precedent for applying a special procedure whenever a peace clause defence might be invoked. However, this is precisely what the Appellate Body rejected in *Guatemala Cement,* emphasizing that the WTO's dispute settlement system is a *unified* system, not one fragmented according to topic.[24]

21. Second, the negotiating history confirms that AoA Article 13 was not intended to alter normal dispute settlement procedures. The concept of "due restraint" first appeared in Article 18.2 of the Agriculture text in the Dunkel Draft of December 1991, which provided:

> On the basis of the commitments undertaken in the framework of this Agreement, Members will exercise due restraint in the application of their rights under the General Agreement in relation to products included in the reform programme.[25]

The concept of special and additional provisions and Appendix 2 then emerged during the work of the Legal Drafting Group on dispute settlement in Spring 1992. The final Legal Drafting Group DSU text dated 15 June 1992 included AoA Article 18.2 in its Appendix 2, as a special and additional provision.[26]

22. The United States and the EC then reached the Blair House Agreements in November 1992, providing *inter alia* for the Dunkel Draft text of Article 18.2 to be deleted, and for the insertion in the AoA of a text corresponding to the present Article 13. In the fall of 1993, the Institutions Group discussed both institutions and dispute settlement; the DSU text resulting from its work, as circulated on 15 November 1993, placed AoA Article 18.2 in brackets.[27]

23. During this period, further discussions also took place on the AoA. After a US-EU settlement in early December 1993 adjusting the Blair House deal, the Blair House changes as adjusted were

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[21] *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/R,
[22] WT/DS60/AB/R, para. 64.
[23] *Id.*, para. 66.
[24] *Id.*, para. 67.
[25] MTN/TNC/W/FA, 20 December 1991, page L.11.
[26] Brazil Exhibit 1 (hereinafter Brazil will refer to its exhibits as "Exhibit Bra-1, 2 , 3 etc.") Excerpt of *Draft Understanding on Rules and Procedures Governing the Settlement of Disputes*, Job No. 968, 15 June 1992.
[27] Exhibit Bra-2. Excerpt of *Draft Understanding on Rules and Procedures Governing the Settlement of Disputes*, 15 November 1993.

made to the AoA. In the December 15, 1993 Final Act, the text of the AoA reflected those changes [28], and Appendix 2 of the DSU[29] included no reference to the AoA. The negotiating record thus confirms that if negotiators had intended to include the peace clause in Appendix 2, they had ample opportunity to do so. The changes in the "peace clause" component of the Blair House agreements involved deleting former Article 18.2, which *was* a dispute settlement provision listed in Appendix 2, and substituting Article 13. However, although Article 13 limits the ultimate "action" that the DSB may take, as a drafting matter it is *not* placed together with the dispute settlement provisions of the AoA, it is not labeled as a dispute settlement provision, and it is not included in Appendix 2 of the DSU. Reading Article 13 as the United States requests would be inconsistent with DSU Article 3.2 by impermissibly altering the balance of rights and obligations in the WTO and its dispute settlement procedures.

24. Furthermore, AoA Article 13 deliberately makes no reference to any provisions relating to dispute settlement under the Agreement on Agriculture itself (Article 19) or other relevant WTO Agreements (ASCM Articles 4 and 7; DSU or GATT 1994 Articles XXII and XXIII). The AoA Article 13 drafting denotes that Uruguay Round negotiators were concerned about the relationship between substantive provisions of the SCM Agreement (Articles 3, 5 and 6) and GATT 1994 (Article XVI) and the substantive provisions on domestic support and export subsidies under the AoA. In short, what Article 13 does is to protect Members that comply with Article 13 conditions from actions derived from a violation of the substantive provisions cited therein, namely ASCM Articles 3, 5 and 6 and GATT 1994 Article XVI. What Article 13 does not, given the way it was drafted, is to shield Members from the dispute settlement procedures which would be necessary to identify or to confirm the substantive violation of those Articles.

25. Had the AoA drafters intended to carve domestic support and/or export subsidy measures out of the WTO dispute settlement mechanism they would have done it expressly, but they did not. This is further confirmed by the example of Article 6 of the TRIPS Agreement, which clearly states that the issue of the exhaustion of intellectual property rights cannot be addressed through dispute settlement.[30] Unlike AoA Article 13, TRIPS Article 6 expressly prohibits a Member from resorting to the WTO dispute settlement mechanism to challenge certain matters. Against all these evident facts, the only argument the US has to read a prohibition to resort to dispute settlement into Article 13 is based on a groundless definition of "action", as shown above.

## VI. A SPECIAL PEACE CLAUSE PROCEDURE WOULD AMOUNT TO HAVING THE PANEL ISSUE A DECLARATORY JUDGMENT FOR THE US AFFIRMATIVE DEFENCE

26. Brazil's request for the establishment of a panel (as well as its consultation request) stated that the "United States has no basis to assert a defence under Article 13(b)(ii) . . . and Article 13(c)(ii) of the Agreement on Agriculture . . .".[31] The third-party statements of the European Communities, Australia, and Argentina agree with Brazil's description of the peace clause as a "defence". Each of these third parties agree that the United States is required to assert and prove that all the peace clause conditions apply. For example, the European Communities stated that AoA Article 13

> can only be seen as a defence against a claim brought under other aspects of the WTO Agreements which regulate the provision of subsidies. It would seem bizarre if,

[28] MTN/FA II/A1A-3, Arts. 13, 19.

[29] MTN/FA II/A2, Appendix 2.

[30] TRIPs Article 6 reads: "*For the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.*"

[31] WT/DS267/7

> before Brazil could bring a claim with respect to subsidies which it considered did not respect the US's WTO obligations, Brazil had first to establish that potential US defences did not apply.[32]

27. In addition, Australia argues that "Article 13 is in the nature of an 'affirmative defence' for measures which are inconsistent with the specified provisions". [33] Argentina also takes the view that this provision is in the nature of an affirmative defence, stating that "the Member who alleges to be protected by the Peace Clause has the burden of proving the fulfillment of its legal requirement".[34]

28. The United States' Initial Brief alleges in paragraph 2 that "the US support measures at issue conform with the Peace Clause". Based on this allegation, the United States concludes that "Brazil cannot maintain any action – and the United States cannot be required to defend any such action. . ."[35] The United States has not labeled this as a defence, or an "affirmative defence". However, this assertion by the United States suggests its intent to invoke such a defence as part of its First Submission that it will file on 11 July 2003.[36]

29. Brazil agrees with the European Communities, Australia and Argentina that the peace clause is a defence requiring the United States – not Brazil – to demonstrate that it has met all of its conditions. Brazil also agrees with the European Communities that it would be bizarre if Brazil were required to establish that potential US defences did not apply before it could bring its own claims. And Brazil further agrees with the European Communities that what the United States is requesting in this dispute is effectively a "declaratory judgment" that the United States defences of the peace clause do or do not apply.

30. Brazil will present evidence in its First Submission that the US measures do not meet the conditions of the various peace clause provisions. Brazil will do this because the United States is on record before this Panel in asserting that its support measures are fully in compliance with the peace clause. However, Brazil is not required to present any evidence on the peace clause to assert its actionable and prohibited subsidy claims under the ASCM. Rather, this is the US burden defending against Brazil's various claims. The time and place for the Panel to hear and consider any evidence proffered by the US in any such defence is during the normal panel process, as Brazil has argued in this Comments, in its Initial Brief and in its letter dated 23 May 2003. There is no basis for the United States to demand, or for the Panel to grant, a declaratory judgment that the US peace clause defences are legitimate or not.

## VII. CONCLUSION

31. For the reasons set forth above, Brazil's Initial Brief and its letter dated 23 May 2003, Brazil requests that this Panel find that it is not precluded from hearing evidence and considering Brazil's claims under the ASCM or Article XVI of GATT 1994 without first concluding that the peace clause conditions of AoA Article 13(b)(ii) and 13(c)(ii) remain unfulfilled.

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[32] EC Initial Submisson, para. 6.
[33] Australia Initial Submission paras. 4-7.
[34] Argentina Initial Submission, para. 14.
[35] US Initial Brief, para. 2.
[36] By contrast, the United States did *not* invoke the peace clause defence in *US - FSC* even though the EC request for the establishment of a panel included claims under ASCM Article 3.1(a) with respect to export subsidies for agricultural products. AoA Article 13(c) conditionally exempts those claims from "actions."

# ANNEX A-10

## COMMENTS OF THE UNITED STATES ON THE COMMENTS BY BRAZIL AND THE THIRD PARTIES ON THE QUESTION POSED BY THE PANEL

13 June 2003

## I. OVERVIEW

1. The United States thanks the Panel for this opportunity to provide its views on the comments by Brazil and the third parties on the question concerning Article 13 of the *Agreement on Agriculture* ("Agriculture Agreement") posed by the Panel in its fax of 28 May 2003.[1] The interpretation of Article 13 (the "Peace Clause") advanced by Brazil and endorsed by some of the third parties is deeply flawed. Simply put, Brazil fails to read the Peace Clause according to the customary rules of interpretation of public international law. Its interpretation does not read the terms of the Peace Clause according to their ordinary meaning, ignores relevant context, and would lead to an absurd result.

2. Brazil reads the Peace Clause phrase "exempt from actions" to mean only that "a complaining Member cannot receive authorization from the DSB [Dispute Settlement Body] *to obtain a remedy* against another Member's domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the Agreement on Subsidies and Countervailing Measures . . . or Article XVI of GATT 1994'".[2] However, Brazil's reading simply ignores parts of the definition of "actions" that it quotes: "The dictionary definition of 'actions' is 'the *taking of legal steps* to *establish a claim* or obtain a remedy".[3] Thus, while the United States would agree that the phrase "exempt from actions" precludes "the taking of legal steps to . . . obtain a remedy", Brazil provides no explanation of why the term "exempt from actions" would not, based on its ordinary meaning, also preclude "the taking of legal steps to establish a claim".[4]

3. Brazil also bases its reading in part on the assertion that "[i]n a multilateral system such as the WTO (like GATT 1947 before it), 'actions' are taken collectively by Members".[5] Brazil cannot explain, however, why "actions" should be limited to *only* those actions taken collectively. Read in the context of provisions in the WTO agreements in which the term "action" does not refer to collective action by Members, "action" in the Peace Clause refers broadly to the "taking of legal steps to establish a claim or obtain a remedy".

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[1] The Panel asked the parties to address: "[W]hether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions in Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the Agreement on Agriculture, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue."

[2] Brazil's Brief on Preliminary Issue Regarding the "Peace Clause" of the Agreement on Agriculture, para. 2 (5 June 2003) ("Brazil's Initial Brief") (emphasis added).

[3] Brazil's Initial Brief, para. 6 (emphasis added).

[4] *See infra* part II.A.

[5] Brazil's Initial Brief, para. 6 (footnote omitted).

4. In addition, Brazil's suggested reading of the Peace Clause would lead to an absurd result. If the phrase "exempt from actions" means nothing more than that "a complaining Member cannot receive authorization from the DSB to obtain a remedy", then a panel would be perfectly free to make findings that a measure that conforms to the Peace Clause is inconsistent with the relevant provisions of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") or the *Agreement on Subsidies and Countervailing Measures* ("Subsidies Agreement"). Under the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), the DSB would be unable to avoid adopting the panel findings of inconsistency with the Subsidies Agreement or GATT 1994 or recommendations to bring the measure into conformity, thus depriving the Peace Clause of any meaning.

5. The remainder of Brazil's arguments do not go to a proper interpretation of the Peace Clause under the customary rules of interpretation of public international law and so do not assist in answering the question posed by the Panel concerning the Peace Clause. Nonetheless, the United States addresses various of these misplaced concerns. For example, Brazil argues that the Peace Clause is not a special or additional rule set out in Appendix 2 of the DSU; however, the Peace Clause need not be a special or additional rule because the Panel may properly deal with the Peace Clause issue under normal DSU rules. Brazil also tries to cite to unrelated issues in completely distinct disputes, arguing that some of these other panels have delayed making "complex threshold findings" until final panel reports. None of these panels is relevant since none of them has been presented with the issues presented by the Peace Clause. Brazil also asserts that consideration of alleged administrative burdens should override the plain meaning of the text of the Agriculture Agreement – an obviously erroneous approach.

6. As the United States explained in its initial brief on the Panel's question[6], the phrase "exempt from actions" (read in accordance with the customary rules of interpretation of public international law) means "not exposed or subject to" a "legal process or suit" or the "taking of legal steps to establish a claim". Therefore, Brazil cannot maintain any action – and the United States cannot be required to defend any such action – based on provisions specified in the Peace Clause since the US support measures for upland cotton conform to the Peace Clause.

7. In light of the correct interpretation of the Peace Clause, the United States affirms that it respectfully requests the Panel to organize its procedures to first determine whether Brazil may maintain any action based on provisions exempted by the Peace Clause. Bifurcation of the legal issues in this proceeding is not only required under the Peace Clause but, as an exercise of the Panel's discretion to organize its procedures, would assist the Panel in resolving the complex issues involved in this dispute in a logical and orderly fashion.

## II. BRAZIL'S INITIAL BRIEF DOES NOT READ THE PEACE CLAUSE ACCORDING TO THE CUSTOMARY RULES OF INTERPRETATION OF PUBLIC INTERNATIONAL LAW AND LEADS TO ABSURD RESULTS

### A. THE ORDINARY MEANING OF "EXEMPT FROM ACTIONS" DOES NOT SUPPORT BRAZIL'S READING

8. According to the customary rules of interpretation of public international law[7], the terms of the Peace Clause should be interpreted according to their ordinary meaning in their context, in light of

[6] Initial Brief of the United States of America on the Question Posed by the Panel, paras. 6-10 (5 June 2003) ("US Initial Brief").

[7] *See* DSU Article 3.2 (The dispute settlement system "serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law.").

the object and purpose of the Agriculture Agreement.[8] The United States agrees completely with Brazil in terms of the dictionary definition of "actions". Under that definition, "action" means "the *taking of legal steps to establish a claim* or obtain a remedy".[9] As the Panel's question has highlighted, one of the key issues in this dispute is whether the Peace Clause permits Brazil to "take legal steps" so Brazil can "establish" its Subsidies Agreement "claims".

9. Yet, as soon as Brazil provides the correct definition of "action", Brazil urges an approach that would ignore it. Combining this definition with that for the word "exempt"[10], Brazil reads the term "exempt from actions" to mean "that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are 'peace clause' protected".[11] Strikingly, neither Brazil nor any of the third parties who share this interpretation[12] provides any basis in the text of the Peace Clause for ignoring that portion of the definition of "actions" that refers to "the *taking of legal steps* to *establish a claim*".[13]

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[8] The customary rules of interpretation of public international law are reflected in part in Article 31(1) of the Vienna Convention, which reads: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

[9] Brazil's Initial Brief, para. 6 (emphasis added).

[10] Brazil has quoted the definition of the word "exempt" when used as a verb. *See The New Shorter Oxford English Dictionary*, vol. 1, at 878 (1993 ed.) (first definition as transitive verb: "Grant immunity or freedom from or *from* a liability to which others are subject") (italics in original). However, if used as a verb in the Peace Clause, the correct form of "exempt" would be "shall be *exempted* from actions." *See id.*, vol. 1, at 878 (examples for first definition of "exempt" as verb: "J. A. FROUDE Clergy who committed felony were no longer *exempted* from the penalties of their crimes. R. D. LAING I was *exempted* from military service because of asthma.") (italics added). As used in the Peace Clause in the construction "shall be . . . *exempt* from actions," "exempt" is an adjective. *See id.*, vol. 1, at 878 (examples of "exempt" as used in first definition as adjective: "R.C. TRENCH They whom Christ loves are no more *exempt* than others *from* their share of earthly trouble and anguish. J. BERGER He is *exempt* on medical grounds *from* military service.") (italics added). Therefore, the correct definition of "exempt" as used in the Peace Clause is "[n]ot exposed or subject to something unpleasant or inconvenient; not liable to a charge, tax, etc. (Foll. by *from, of*.)." *Id.*, vol. 1, at 878 (first definition as adjective) (italics in original).

[11] Brazil's Initial Brief, para. 9; *see id.*, para. 8.

[12] Regrettably, *none* of the third parties (save Australia) even attempts to read the Peace Clause – and in particular the phrase "exempt from actions" – according to the customary rules of interpretation of public international law. Australia does offer an interpretation of "exempt from actions based on" purportedly using the ordinary meaning of the terms, but it appears that Australia has interpreted "exempt from actions" merely by quoting a definition for " exempt." *Compare* Comments of Australia on Question Posed by Panel, para. 7 & n. 3, *with Black's Law Dictionary* at 593 (7th ed. 1999) (definition of "exempt" as adjective: "Free or released from a duty or liability to which others are held."). That is, Australia's interpretation ascribes no meaning to the words "from actions," reducing them to inutility. In addition to failing to provide any definition for "actions," Australia also fails to examine any context for that term in the DSU and the Subsidies Agreement. *See* US Initial Brief, paras. 7-10.

[13] Argentina reads "exempt from actions" as meaning that "a finding of inconsistency with Articles XVI of GATT 1994 or Articles 3, 5 and 6 of SCM Agreement will not be possible if the legal requirements for the exemption are fulfilled." Comments by Argentina on Question Posed by Panel, para. 5. However, in making this assertion, Argentina neither provides nor attempts to distinguish the ordinary meaning of "action" as the "taking of legal steps to establish a claim or obtain a remedy." Nor does Argentina explain why, if Members only meant to preclude "a finding of inconsistency" with specified provisions, they did not simply use the word "finding" – for example, "measures . . . shall be . . . exempt from findings based on" certain specified provisions – when the term "finding" is used at least 12 times in the DSU. *See, e.g.*, DSU Article 7.1 (standard panel terms of reference include "mak[ing] such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/those agreement(s)"); DSU Article 11 (panel should make an objective assessment of matter before it, including "such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements"); DSU

10. As the United States has demonstrated, the ordinary meaning of "action" encompasses not only the "taking of legal steps to . . . obtain a remedy" but also the "taking of legal steps to establish a claim". Other dictionary definitions of "action" – such as "the right to institute a legal process", "[a] legal process or suit", "a lawsuit brought in court", "a formal complaint", "a legal or formal demand of one's right", and "all the formal proceedings in a court of justice attendant upon the demand of a right made by one person of another in such court"[14] – provide additional support for this reading. Thus, while the United States agrees that the phrase "exempt from actions" would also preclude "the taking of legal steps to . . . obtain a remedy"[15], the United States disagrees with Brazil that one may ignore that "exempt from actions" also precludes "the taking of legal steps to establish a claim." Nothing in the text of the Peace Clause authorizes departing from the ordinary meaning of the Peace Clause phrase "exempt from actions" to narrow this text to refer *solely* to "obtaining a remedy".[16]

B. THE CONTEXT FOR "EXEMPT FROM ACTIONS" DOES NOT SUPPORT BRAZIL'S READING

11. In its analysis of the phrase "exempt from actions", Brazil quickly moves beyond the ordinary meaning of the term "action" it quotes (which encompasses "the taking of legal steps to establish a claim") to examine what it deems relevant context for the term. Brazil asserts that "[i]n a multilateral system such as the WTO (like GATT 1947 before it), 'actions' are taken collectively by Members"[17], citing DSU Article 2.1 (last sentence), GATT 1994 Article XVI:1, and DSU Article 22[18], and concludes: "In sum, 'actions' are multilaterally agreed decisions of WTO bodies including the DSB."[19] Brazil's argument overlooks the fact that there are numerous instances in various WTO agreements in which the term "action " is used to refer to action by an individual Member, not just collective action by Members.

12. Brazil notes that the term "actions" is sometimes used in the DSU to refer to collective "decisions or actions" by the DSB.[20] This observation is accurate, but the conclusion that Brazil draws from it is a *non sequitur*. The fact that the term "action" can mean "collective decision or action by the DSB" does not imply that the term "action" can mean *only* "collective decision or action by the DSB".

13. Brazil has moreover failed to consider those instances in which the term "action" is used to refer to individual action by Members.[21] For example, Article 3.7 of the DSU, which states that "[b]efore bringing a case, a Member shall exercise its judgement as to whether action under these

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Article 12.7 (panel "shall submit its findings in the form of a written report to the DSB"). There is no basis in the text or context of the Peace Clause to read "actions" to be limited to "panel findings".

[14] US Initial Brief, para. 7.

[15] Indeed, this necessarily follows from the fact that, if a party cannot take legal steps to establish a claim, it will also be precluded from obtaining a remedy.

[16] We also note that Brazil's approach of interpreting "exempt from actions" as "cannot receive authorization . . . to obtain a remedy" appears to overlook the "taking of legal steps" component of even the "remedy" portion of the definition of " action".

[17] Brazil's Initial Brief, para. 6 (footnote omitted).

[18] Brazil also asserts that "'[a]ctions' include decisions made by the Dispute Settlement Body (DSB) to adopt rulings and recommendations of panels and the Appellate Body" but provides no reference to a provision of the DSU to support the assertion. Neither DSU Article 16.4 (on adoption of panel reports) nor DSU Article 17.14 (on adoption of Appellate Body reports) uses the term "action" to describe a DSB decision to adopt panel and Appellate Body rulings and recommendations.

[19] Brazil's Initial Brief, para. 6.

[20] For example, Brazil quotes DSU Article 2.1, which states that "[w]here the DSB administers the dispute settlement provisions of a Plurilateral Trade Agreement, only those Members that are parties to that Agreement may participate in decisions or actions taken by the DSB with respect to that dispute."

[21] *See* US Initial Brief, paras. 8-9.

procedures would be fruitful," does not by its terms refer to "multilaterally agreed decisions of WTO bodies including the DSB". Similarly, Article 4.5 of the DSU states: "*In the course of consultations* in accordance with the provisions of a covered agreement, before resorting to *further action* under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter" (emphasis added). In the Subsidies Agreement, subsidies are divided into prohibited, actionable, and non-actionable categories, and a Member may impose countervailing duties against prohibited and "actionable" subsidies without first obtaining authorization through a "multilaterally agreed decision[] of WTO bodies including the DSB".[22] Brazil's interpretation is at odds with all of these provisions – for example, since during consultations the DSB will not have taken *any* action with respect to a dispute, how could a Member attempt to settle a matter before resorting to *further* action? These provisions make clear that, read in the context of the DSU and the Subsidies Agreement, "actions" has a broader scope than Brazil would like: as indicated by its ordinary meaning, "actions " refers to "the taking of legal steps to establish a claim or obtain a remedy," encompassing all stages of a dispute – obtaining DSB authorization for retaliation would only constitute one, final step.[23]

14. Indeed, had Members intended the scope of the Peace Clause to be limited solely to collective decisions taken by the DSB, they could have used in the Peace Clause the same construction as used in DSU Article 2.1 – for example, "measures . . . shall be . . . exempt from actions taken by the DSB based on" specified provisions. Members did not do so, however.

15. Finally, the United States notes that Brazil has asserted that GATT 1994 Article XVI:1 and DSU Article 22 provide relevant context for the term "actions". However, neither of these provisions uses the term "action" at all[24], and they do not support Brazil's assertion that "actions" in the Peace Clause must be read to refer solely to "multilaterally agreed decisions of WTO bodies including the DSB." Similarly, Brazil refers to GATT 1994 Article XXV, entitled "Joint Action by the Contracting Parties." The fact that the drafters referred to this one kind of "action" as *joint* action only reinforces that the term "action" by itself is not intended to be limited to *only* "joint" or "collective" action. The phrase "contracting parties acting jointly" in Article XXV would be unnecessary if Brazil's interpretation of "action" were correct.[25]

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[22] Members are obligated to "take all necessary steps to ensure that the imposition of a countervailing duty on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement." Subsidies Agreement, Article 10 (footnote omitted). *See also* GATT 1994 Article VI:6 (requiring multilateral approval of certain exceptional anti-dumping and countervailing duties).

[23] We note that Argentina implicitly concedes that relevant context in the Subsidies Agreement for the phrase "exempt from actions" suggests that the term is not limited to decisions or actions taken by the DSB. Argentina recognizes that "[i]t is true that Article 7 of the SCM Agreement states that the request of consultations is subject to Article 13 of the AoA". Argentina's Third Party Initial Brief, para. 13. This would appear to contradict its reading of "the word 'actions' in the context of Article 13 of the AoA [as] refer[ring] to decisions of WTO competent bodies, such as the DSB when it discharges its duties by establishing a panel," *id.*, para. 6. That is, if the Peace Clause precludes a request for consultations by a Member under Article 7 of the Subsidies Agreement, the term "actions" in the Peace Clause cannot solely refer to "decisions of WTO competent bodies".

[24] *See, e.g.*, GATT 1994 Article XVI:1 ("In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or contracting parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization."); DSU Article 22.6 ("When the situation described in paragraph 2 occurs, the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request.").

[25] *See* GATT 1994 Article XXV ("Wherever reference is made in this Agreement to the contracting parties acting jointly they are designated as the CONTRACTING PARTIES. ").

C. BRAZIL'S INTERPRETATION OF THE PEACE CLAUSE WOULD LEAD TO ABSURD RESULTS

16. Brazil's suggested reading of the Peace Clause would rob this provision of any real meaning. Brazil would expose measures that conform to the Peace Clause to finding of inconsistency with the relevant GATT 1994 and Subsidies Agreement provisions and would expose them to retaliation *unless* the complaining party were to agree *not* to adopt the findings or authorize retaliation.

17. Under Brazil's interpretation, the phrase "exempt from actions" means only that "a complaining Member cannot receive authorization from the DSB to obtain a remedy" – that is, the Peace Clause would exempt conforming measures from actions taken by the DSB to authorize remedies but not from findings by the Panel. A panel would therefore be perfectly free to make findings in its final report that a challenged measure that conforms to the Peace Clause is inconsistent with, *inter alia*, the Subsidies Agreement. Under the DSU, the DSB would be unable to avoid adopting the panel findings of inconsistency with the relevant GATT 1994 or Subsidies Agreement provisions or recommendations to bring the measure into conformity.[26] Panel reports are adopted automatically by the DSB under the "negative consensus" rule[27] and authorization to retaliate is also automatically given unless the DSB decides by consensus against this.[28] As a result, the DSB could not decline to adopt the report or authorize remedies unless the complaining party agreed. Thus, under Brazil's reading, the phrase "measures . . . shall be . . . exempt from actions" in the Peace Clause would exempt conforming measures from DSB authorization to retaliate, but *only if* the complaining Member itself agreed not to authorize a remedy. This would be a strange and strained interpretation of the Peace Clause indeed and would effectively render it inutile, contrary to customary rules of treaty interpretation.

18. This absurd result would also conflict with the object and purpose of the Peace Clause and the Agriculture Agreement: namely, to exempt agricultural subsidies, under certain conditions, from the subsidies disciplines of the Subsidies Agreement and GATT 1994 while Members continue negotiations to move towards the "long-term objective . . . to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time".[29] Brazil also has not explained why, on its reading, Members would have chosen to allow actions, with all of their attendant burden on Members' (and the WTO's) resources, up to but not including authorization for retaliation.

[26] Under DSU Article 19, "[w]here a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement." DSU Article 19 (emphasis added) (footnote omitted).

[27] Under DSU Article 16, a panel report "shall be adopted at a DSB meeting unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report". DSU Article 16.4 (footnote omitted).

[28] When a Member "fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings" and compensation cannot be agreed, the complaining party Member may request authorization from the DSB to suspend concessions, DSU Article 22.2, and "the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request", DSU Article 22.6.

[29] Agriculture Agreement, preamble (third paragraph).

## III. BRAZIL'S INITIAL BRIEF RAISES A NUMBER OF MISGUIDED CONCERNS WHICH CANNOT UPSET THE BALANCE OF RIGHTS AND OBLIGATIONS OF MEMBERS UNDER THE PEACE CLAUSE AND DO NOT SUPPORT CONSIDERING BOTH THE APPLICABILITY OF THE PEACE CLAUSE AND BRAZIL'S SUBSTANTIVE CLAIMS TOGETHER

19. Brazil has advanced a number of other arguments, which relate neither to the ordinary meaning and context of the phrase "exempt from actions" nor to the object and purpose of the Peace Clause and the *Agreement on Agriculture*. These arguments are thus not relevant to the Panel's task of clarifying the meaning of the Peace Clause in accordance with customary rules of interpretation of public international law. Nonetheless, an examination of each of Brazil's arguments reveals that none of these concerns is well-founded.

### A. THE PANEL MAY EXAMINE THE APPLICABILITY OF THE PEACE CLAUSE UNDER NORMAL DSU RULES

20. Brazil argues that because Article 13 is not a special or additional rule set out in Appendix 2 of the DSU, Peace Clause issues must be resolved using normal DSU rules and procedures, which Brazil believes would prohibit reaching the Peace Clause issue first. Brazil errs on two counts. There was no need to designate Article 13 of the Agriculture Agreement as a special or additional rule *precisely because* the Panel may properly deal with the Peace Clause issue using the flexibility inherent in the normal DSU rules. The DSU, in Articles 12.1 and 12.2, provides the Panel with all the authority it needs to organize its working procedures as it considers best to resolve the matter in dispute.[30] Under DSU Article 12.1, the Panel is given the authority to determine its own working procedures "after consulting the parties to the dispute".[31] Under DSU Article 12.2, moreover, the Panel is charged with establishing panel procedures with "sufficient flexibility so as to ensure high-quality panel reports".[32]

21. Brazil itself has conceded the Panel's broad authority to establish its procedures in its letter of 23 May 2003, when it wrote of objections relating to the scope of a panel request under DSU Article 6.2: "The decision on how to handle such preliminary objections procedurally *is a matter of panel discretion*".[33] Thus, Brazil implicitly recognizes that the Panel already has the flexibility and the authority under normal DSU rules to organize its procedures to consider and dispose of the Peace Clause issue first. There is no need for the Peace Clause to be listed as a "special or additional rule and procedure" in DSU Appendix 2 because under normal DSU rules the Panel may bifurcate the proceedings in order to respect the balance of rights and obligations of Members under the Peace Clause and the Agriculture Agreement – that is, to ensure that conforming US measures are "exempt from actions based on" provisions specified in the Peace Clause.

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[30] *See* Comments by the European Communities on certain issues raised on an initial basis by the Panel, para. 8 ("In conclusion, the Panel has substantial discretion in deciding how it will manage these issues. Article 12.1 DSU makes it quite clear that the Working Procedures set out in Appendix 3 of the DSU may be departed from if the Panel decides this is appropriate.").

[31] DSU Article 12.1 ("Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting with the parties to the dispute. ").

[32] DSU Article 12.2 ("Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process.").

[33] Letter from Ambassador Luiz Felipe de Seixas Corrêa, Permanent Mission of Brazil, to Mr. Dariusz Rosati, Chairman of Panel, at 3 (23 May 2003) (emphasis added). The carry-over paragraph continues: "Where preliminary objections have been resolved in advance of other claims, normally they have been resolved in the panel's first meeting, on the basis of the first round of submissions and oral statements."

22. The United States notes that the Appellate Body has urged panels to adopt working procedures providing for preliminary rulings to deal with threshold jurisdictional issues[34], even though there are no "special and additional rules" in the DSU providing for these. In addition, we note that Article 10.3 of the Agriculture Agreement (the same agreement at issue here) is not listed as a "special and additional rule," but panels and the Appellate Body have made clear that this provision nonetheless governs dispute settlement proceedings by shifting the burden of proof to the responding party.[35]

23. Finally, Brazil relies on Article 11 of the DSU – pursuant to which a panel "should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements" – to support its position. Brazil's reliance on Article 11 is misplaced as shown by a simple examination of the text of Article 11. Article 11 provides the standard of review for panels; it does not guide the procedure used by panels. According to Brazil, DSU Article 11 somehow mandates that a panel review "all the facts including rebuttal facts," hold two panel meetings, and allow for the exchange of rebuttal submissions.[36] Brazil's argument is untenable; it would read Article 11 to *mandate* a particular series of meetings and submissions when Article 11 does *not* set out *any* particular procedural steps through which a panel "should make an objective assessment of the matter before it." At the same time, Brazil argues that the Panel *may not*, consistent with Article 11, consider the applicability of the Peace Clause first because "Article 11 contains no requirement for a special briefing, meeting or determination by a panel to resolve such applicability or exemption."[37] Of course, there is nothing in the text of Article 11 that supports reading this provision to preclude the Panel's bifurcating the proceeding to respect the balance of rights and obligations in the Peace Clause. However, to be consistent with its own argument, Brazil should also read Article 11 not to mandate any particular number or sequence of procedural steps (such as those set out in DSU Appendix 3) that are not required under its terms.

B. NO PREVIOUS PANEL REPORT HAS EXAMINED THE PEACE CLAUSE, AND OTHER PROCEDURAL PROVISIONS CITED BY BRAZIL DO NOT CONTAIN THE PHRASE "SHALL BE . . . EXEMPT FROM ACTIONS"

24. Brazil suggests that deciding the issue of the applicability of the Peace Clause in advance of Brazil's substantive Subsidies Agreement and GATT 1994 claims is "contrary to the practice of earlier panels".[38] Of course, there is no such practice since this is the first dispute to face this issue.

25. Brazil also argues that there are "a number of other threshold issues in WTO Agreements" but that "none of these provisions have special and additional rules to provide for extraordinary preliminary briefings, meetings, and determinations prior to a panel hearing on all of the claims presented".[39] Brazil's invocation of previous panel proceedings is inapt. Brazil has not asserted that any of the "threshold" provisions in other WTO agreements that it cites or that have been interpreted by previous panels contain the same language as the Peace Clause (that is, "shall be . . . exempt from

[34] *See* Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, para. 144.

[35] *See* Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/RW2, WT/DS113/AB/RW2, paras. 67-75 (second recourse to DSU Article 21.5).

[36] *See* Brazil's Initial Brief, paras. 11-16.

[37] Brazil's Initial Brief, para. 16; *see id.*, para. 11 ("Thus, resolution of the 'peace clause' issues . . . must be resolved using normal DSU rules and procedures.").

[38] Brazil's Initial Brief at 7 (heading IV).

[39] Brazil's Initial Brief, para. 21.

actions").[40] Indeed, it is striking that Brazil studiously avoids comparing the text of any of these provisions with the text of the Peace Clause.[41]

26. Given the fact that *none* of the other provisions cited by Brazil contains Peace Clause-like language, these provisions have little relevance for the Panel's interpretation of the Peace Clause. At most, the relevance of these provisions lies in the fact that such " threshold" provisions do *not* use language that certain measures "shall be . . . exempt from actions." This suggests that the distinct language of the Peace Clause was intended to provide a distinct right, and one that differs from rights provided by these other WTO provisions.

27. We also note Brazil's argument that in the "closest case to the peace clause issue presented here" – that is, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R – there was "never a suggestion or finding that the panel erred by not conducting a special briefing and special determination" on the "threshold issue whether Brazil was in compliance with Article 27.4" of the Subsidies Agreement. From the Appellate Body report, it would appear that the Appellate Body did not address it because no party suggested that this threshold issue had to be taken up as a first stage of the proceeding. Nonetheless, the Appellate Body found that the panel erred in not considering the threshold Article 27.4 issue first. The Peace Clause language ("measures . . . shall be . . . exempt from actions") is different and even stronger in requiring that the Peace Clause be taken up first and separately, with findings, prior to any consideration of the relevant GATT 1994 and Subsidies Agreement provisions.

## C. BRAZIL WILL NOT BE PREJUDICED BY SEPARATE HEARINGS AND BRIEFINGS ON THE PEACE CLAUSE ISSUE

28. Brazil, referring to its 23 May letter, argues that it will be prejudiced if the Panel considers separately the issue of the applicability of the Peace Clause from Brazil's substantive claims as this will disrupt "Brazil's efforts to make a coherent and unified presentation of its case"[42] and result in greater expense to Brazil "in having to bring its legal and economic experts to Geneva for an extra meeting."[43] Of course, any concerns that Brazil's presentation of its case may be affected cannot supersede the rights and obligations of Members as set out in the covered agreements – including the Peace Clause. In fact, the Peace Clause resolves any issue of how to account for burdens on parties since it provides that the responding party's measures are exempt from any action based on the relevant GATT 1994 and Subsidies Agreement provisions – it exempts the responding party from the burden of having to respond to the complaining party's claims. Brazil ignores this aspect of the Peace Clause. In any event, we note that bifurcating this proceeding to ensure that these conforming US measures are exempt from action based on Peace Clause-specified provisions will *reduce*, rather than increase, the amount of work involved for *both* parties. Here, dealing with the Peace Clause issue first will resolve that part of the dispute, saving both parties further work, since the US measures conform to the Peace Clause. And in general, such an approach simply means that a panel would deal

[40] For example, arguments that a particular claim is not within a panel's terms of reference under DSU Article 6.2 do not involve any textual mandate that measures "shall be . . . exempt from actions." What Brazil calls the "closest case to the peace clause issue presented here" involved Articles 27.2(b) and 27.4 of the Subsidies Agreement, neither of which says that measures "shall be . . . exempt from actions based on" specified provisions. *See* Brazil's Initial Brief, para. 19 (quoting Appellate Body discussion of Subsidies Agreement Articles 27.2(b) and 27.4 in *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R; Subsidies Agreement Article 27.2 states that the "prohibition of paragraph 1(a) of Article 3 shall not apply to" developing country Members in compliance with Article 27.4). Other provisions cited by Brazil (Article 1 of the *General Agreement on Trade in Services*, Article 2 of the *Agreement on Technical Barriers to Trade*, and Annex I of the *Agreement on Government Procurement*) similarly do not provide a legal right not to be subject to actions.

[41] *See* Brazil's Initial Brief, paras. 18-21.

[42] *See* Brazil's Initial Brief, paras. 17.

[43] Brazil's Initial Brief, para. 22.

in sequence with the issues it would otherwise have to confront in a dispute. Because no additional issues would be covered (and needless work on certain claims might be avoided), it would not appear that additional effort on the part of a panel or the parties would be required.

29. We also note in any event that Brazil's concerns about duplication of its factual presentation and increased expense seem overstated. Even if this were a dispute where the relevant measures did not conform to the Peace Clause, Brazil misunderstands the process. The fact that some of the same evidence might be relevant to Peace Clause as well as Subsidies Agreement claims does *not* mean that the evidence would have to be introduced twice. Once Brazil's factual evidence were introduced, if it were relevant to later stages of the proceeding, it could of course be used for that purpose.[44] Thus, there should be no duplication of its factual presentation and no additional burden to Brazil on that count. Similarly, with respect to concerns about the additional expenditure of resources should the Panel bifurcate this proceeding, the full-time presence of Brazil's private-sector counsel in Geneva should alleviate some of the expense that extra meetings (which there is no reason to assume would be needed since the US measures conform to the Peace Clause) might entail. In any event, however, the United States finds it difficult to believe that Brazil would bring an action with claims under 17 different provisions of the WTO agreements with respect to programs under at least 12 US statutes and not expect that the resulting dispute would involve additional complications and all the accompanying demands for time and resources.

30. Finally, the United States notes that Brazil has raised the issue that separate hearings and briefing on the Peace Clause issue "would cause it prejudice because there would be significant[] delays in the resolution of its claims – many of which do not implicate the peace clause".[45]. While, on its face, Brazil's list of "non-peace clause claims" appears to include claims based on provisions specified in the Peace Clause[46], Brazil's point is not raised by the Panel's question. If the Panel requests the parties to give their views on the question of what should happen with any claims in this action based on provisions not specified by the Peace Clause, the United States would be pleased to do so.

## IV. WERE THE PANEL TO CONSIDER THAT THE PEACE CLAUSE DOES NOT REQUIRE THAT THE PANEL DETERMINE WHETHER US MEASURES ARE EXEMPT FROM ACTIONS BEFORE CONSIDERING BRAZIL'S SUBSIDIES AGREEMENT AND GATT 1994 ARTICLE XVI ACTION, THE PANEL SHOULD EXERCISE ITS DISCRETION TO BIFURCATE THE PROCEEDING

31. Putting aside the arguments related to prejudice and expense which have been discussed above, the United States notes that, in the course of allegedly discussing the "context" for the Peace Clause, Brazil makes an argument that speaks not to any relevant context but to the Panel's exercise of its discretion to organize its procedures. Brazil argues that the "close overlap of proof for both peace clause and actionable and prohibited subsidy claims highlights the need for the Panel to examine all the 'facts of the case' together".[47] First, in this context, the United States has noted, and Brazil and the European Communities apparently agree, that the Panel enjoys significant discretion under DSU Articles 12.1 and 12.2 to organize its working procedures as it considers best to resolve the matter in dispute.

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[44] To put it simply, "Brazil exhibit 419" (for example) would remain "Brazil exhibit 419" – it would not change simply because it was now being cited in a different argument.

[45] Brazil's Initial Brief, para. 23.

[46] Brazil argues that its "non-peace clause claims include . . . Article XVI:3 of GATT 1994 involving all domestic and export subsidies challenged by Brazil." Brazil's Initial Brief, para. 23. However, the Peace Clause explicitly states that conforming "export subsidies . . . shall be . . . exempt from actions based on Article XVI of GATT 1994." Agriculture Agreement, Article 13(c)(ii).

[47] Brazil's Initial Brief, para. 15.

32. However, even were the Panel to conclude that Article 13 does not require the Panel to determine whether US measures are in breach of the Peace Clause and no longer "exempt from actions based on" specified provisions, the significance and wording of the Peace Clause in this dispute would mean that the Panel should exercise its discretion to bifurcate this proceeding. The Peace Clause would remain a significant, decisive issue. As noted above, bifurcating the proceedings would save both parties as well as the Panel significant time and work since it will render it unnecessary to address the relevant GATT 1994 and Subsidies Agreement claims.

33. Furthermore, given that Brazil has signalled that its Peace Clause arguments alone will involve "the presentation of considerable factual evidence and expert econometric testimony"[48], it would appear that to hear Brazil's substantive claims at the same time would significantly complicate the Panel's work. The apparent complexity of Brazil's Peace Clause evidence also calls into significant question the likelihood that the timetable requested by Brazil is realistic with respect to the legitimate interests of the United States to defend its position. Finally, we note that, by seeking to have the Panel consider both the Peace Clause issue and Brazil's substantive claims at the same time, Brazil may be attempting to prejudice the US rights of defence – particularly since, even on Brazil's mis-reading of the Peace Clause, the US measures are "exempt from actions", Brazil is not entitled to obtain any remedy from the DSB.[49]

34. The United States also disagrees in any event that the "close overlap of proof for both peace clause and actionable and prohibited subsidy claims highlights the need for the Panel to examine all the 'facts of the case' together". For example, to establish its "serious prejudice" claims, Brazil must present evidence showing that the United States has caused "adverse effects" through "the use of any subsidy" (Subsidies Agreement, Article 5(c)) and evidence on "the effect of the subsidy" (Subsidies Agreement, Article 6.3(b), (c), (d)). Neither of these showings is relevant to the issue of whether US measures have breached the Peace Clause.

35. Frankly, if Brazil's Peace Clause arguments will involve extensive factual and econometric evidence, it is difficult to understand why the Panel would be *better* served by considering this "considerable" evidence and testimony at the same time that it receives even *more* evidence and testimony on other, unrelated issues. Thus, even if one hypothesized that the Peace Clause does not require the Panel to consider the issue of its applicability prior to examining Brazil's substantive claims and that the Panel solely needed to consider how to take the Peace Clause issue into account in exercising its discretion to organize its procedures, the United States submits that the Panel's work would be facilitated by focusing on the legally and logically distinct Peace Clause issue first.[50]

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[48] Letter from Ambassador Luiz Felipe de Seixas Corrêa, Permanent Mission of Brazil, to Mr. Dariusz Rosati, Chairman of Panel, at 4.

[49] *See* Brazil's Initial Brief, para. 9 ("In sum, 'exempt from actions' means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are 'peace clause' protected.").

[50] *See* Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, paras. 142-44 (finding that panel should have considered threshold Article 27.4 issue before examining whether export subsidy had been provided under Subsidies Agreement Article 3.1(a)); *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, para. 144 (noting that panels would be better served by adopting working procedures providing for preliminary rulings to deal with threshold jurisdictional issues).

## V. OTHER ARGUMENTS BY THIRD PARTIES

### A. GIVEN DSU RULES, THE PANEL'S ORGANIZATION OF ITS PROCEDURES REPRESENTS THE FIRST OPPORTUNITY TO ARREST BRAZIL' S ACTION

36. India and the European Communities have suggested that, taken to its logical extreme, reading "actions" as the "taking of legal steps to establish a claim" would require a complaining party to bring two actions: first, an action to establish that the Peace Clause does not apply to certain measures, and second, if a panel were to find the Peace Clause inapplicable, an action challenging the measures based on the provisions specified in the Peace Clause. While this issue is not pertinent to the Panel's question concerning Article 13, the United States notes that it has not advanced such an interpretation by, for example, asking the Panel to find that it could not be established.[51] Thus, this issue is not before the Panel, and India's and the EC's arguments are irrelevant. Rather, we have requested more modestly that the Panel, consistent with the Peace Clause, structure its procedures so that US measures will in fact be exempted from Brazil's action based on provisions specified in the Peace Clause at the earliest possible juncture under the DSU.

37. As these third parties apparently fail to appreciate, prior to this moment, DSU rules provided for the dispute to proceed through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause. Although the United States has maintained at each and every stage that the challenged measures conform to the Peace Clause, the United States could not have stopped Brazil from asking for consultations[52], nor could it reasonably have been expected to refuse an entire request for consultations because it contains a request contrary to the Peace Clause, nor could the United States have prevented the establishment of this Panel. As a responding party cannot prevent panel establishment from occurring, it will inevitably be forced to argue to a panel that the panel's procedures should be structured so that the party' s challenged measures are not subject, from that point on, to actions based on provisions specified in the Peace Clause. Thus, given the automaticity in DSU rules relating to consultations and panel establishment, the Panel's organization of its procedures provides the first opportunity to arrest Brazil's "taking of legal steps to establish a claim", and this is all the United States has asked the Panel to do.

### B. CONTRARY TO THE SUGGESTION BY SEVERAL THIRD PARTIES, THE PEACE CLAUSE IS NOT AN AFFIRMATIVE DEFENCE

38. Australia and the European Communities have each asserted that the Peace Clause is an affirmative defence.[53] The United States believes that they are in error. However, this issue is not

[51] We also note that this potential question relating to whether a panel could have been established given the applicability of the Peace Clause could arise even under Brazil's interpretation of "exempt from actions". Brazil states that "actions are multilaterally agreed decisions of WTO bodies including the DSB". However, "exempt from actions" would then seem to reach DSU Article 6.1, under which the DSB takes a "multilaterally agreed decision" to establish a panel to consider a matter. Thus, under Brazil's own logic, "exempt from actions" in the Peace Clause should also preclude a decision by the DSB to establish a panel and not just a decision to authorize remedies. Argentina implicitly concedes the point when it states that it "agrees with Brazil's statement in paragraph 6 of its Brief that the word 'actions' in the context of Article 13 of the AoA refers to decisions of WTO competent bodies, *such as the DSB when it discharges its duties by establishing a panel*". Argentina's Third Party Initial Brief, para. 6 (emphasis added).

[52] However, the United States notes that Argentina (in paragraph 13 of its "Third Party Initial Brief") accepts that under Article 7 of the Subsidies Agreement, a Member is not to request consultations on measures conforming to the Peace Clause.

[53] *See* Comments by Australia, para. 4 (10 June 2003); Comments by the European Communities on certain issues raised on an initial basis by the Panel, para. 6 (dated 10 June "2002" on first page, 2003 in the heading).

raised by the Panel's question concerning Article 13, and there is no need to discuss it further at this time.

## VI. CONCLUSION: BRAZIL MAY NOT BRING, AND THE PANEL MAY NOT ADJUDICATE, A SUBSIDIES AGREEMENT OR GATT 1994 ARTICLE XVI ACTION AGAINST US MEASURES CONFORMING TO THE PEACE CLAUSE

39. For the reasons set out above and in its initial brief on the Panel's question concerning the Peace Clause, the United States respectfully requests the Panel to find that measures that conform to the Peace Clause are exempt from any action, including action under the DSU, based on the corresponding provisions of the Subsidies Agreement and the GATT 1994. As a result, the United States is not required to defend those measures in any action based on Brazilian claims exempted by the Peace Clause.

# ANNEX B

## SUBMISSION OF PARTIES AND THIRD PARTIES FOR THE FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING

# ANNEX B-1

## EXECUTIVE SUMMARY OF BRAZIL'S FIRST SUBMISSION TO THE PANEL REGARDING THE "PEACE CLAUSE" AND NON-PEACE CLAUSE RELATED CLAIMS

### Introduction

1. Brazil's first submission initially addresses issues relating to the substantive interpretation of Article 13 of the Agreement on Agriculture (AoA), known as the "peace clause," and details the evidence demonstrating that the United States has no basis to assert a peace clause defence regarding Brazil's actionable and prohibited subsidy claims. The second part of Brazil's first submission sets forth the evidence and arguments concerning claims involving the following US measures: Step 2 export payments, the US export credit guarantee programmes (GSM 102, GSM 103 and SCGP) and the ETI Act subsidies. These three subsidies do not fully conform to the provisions of Part V of the Agreement on Agriculture and, thus, the United States has no peace clause protection from claims under the SCM Agreement. Step 2 export payments, the three export credit guarantee programmes and the ETI Act subsidies also violate ASCM Article 3.1(a) and 3.2. Finally, Brazil demonstrates that Step 2 domestic payments violate ASCM Article 3.1(b) and GATT Article III:4.

### Issues Regarding the Peace Clause in AoA Article 13

2. The peace clause of AoA Article 13 is in the nature of an affirmative defence. The United States has indicated that it will invoke a peace clause defence. To do so, the United States bears the burden of proof that US domestic support and export subsidies to upland cotton are provided in conformity with the requirements of the peace clause. Based on public international law and Appellate Body jurisprudence on the allocation of the burden of proof, AoA Article 13 is an affirmative defence because it provides an exception to a legal regime otherwise applying to agricultural support measures. It does not alter the scope of other provisions providing positive obligations on Members, and is not itself a positive obligation. It simply allows Members to maintain measures otherwise inconsistent with their WTO obligations exempt from actions, provided that the measures meet the conditions specified in AoA Article 13.

3. In accordance with Article 31 of the *Vienna Convention*, the appropriate interpretation of AoA Article 13(b)(ii) is the following: Members may assert a peace clause defence under AoA Article 13(b)(ii) *only* if the total quantity of support granted through all non-"green box" domestic support measures (*i.e.*, measures that do not fully comply with the provisions of AoA Annex 2) to a specific commodity in any marketing year from 1995-2003 does not exceed the quantity of non-"green box" domestic support decided to be granted in MY 1992. The only "decision" made by the United States "during" MY 1992 was to grant (i.e., make actual expenditures) of $1.994 billion in non-"green box" support to upland cotton pursuant to the terms of the 1990 FACT Act.

4. The evidence regarding the amount of non-"green box" US support to upland cotton granted in MY 1999-2002 is based largely on USDA documents, which show that US non-"green box" domestic support decided to be authorized and paid to upland cotton increased to $3,445 million in MY 1999, was $2,311 million in MY 2000, and increased to a new record high of $4,093 million in MY 2001 (for a crop valued at $3,312 million). Brazil estimates that US non-"green box" domestic support for MY 2002 (which will end on 31 July 2003) is $3,113 million. This estimate is based on the last available data and the requirements set out in the 2002 FSRI Act.

5. Thus, the evidence reveals that the amount of non-"green box" support granted in MY 1999-2002 exceeds the level of support "decided" by the United States in MY 1992. Therefore, the United States does not enjoy peace clause exemption from actions based on ASCM Article 5 and 6 and Article XVI:1 of GATT 1994 involving non-"green box" domestic support to upland cotton.

6. Brazil's calculation of the MY 1999-2002 reflects the appropriate set of non-"green box" domestic support measures granted to upland cotton. The United States notified to the WTO Committee on Agriculture that the following programmes are "amber box" support for MY 1999: Step 2 payments, loan deficiency payments, marketing loan gains, crop insurance payments, cottonseed payments, and market loss assistance payments. The structure of the first five of these domestic support programmes is substantially the same in MY 2000-2001 and under the 2002 FSRI Act as it was in MY 1999. There is also no indication that these five programmes should not continue to be treated as non-"green box" domestic support to upland cotton for the purposes of MY 2002. Therefore, the support under these five programmes, as well as market loss assistance payments, are non-"green box" support to upland cotton and are properly included in the set of domestic support measures for purposes of assessing possible US peace clause exemption from action.

7. With respect to production flexibility contract payments (PFC), direct payments (DP) and counter-cyclical payments (CCP), the evidence demonstrates that these payments are also non-"green box" support granted to upland cotton. The basis of this conclusion is summarized below.

8. *Production Flexibility Contract Payments (PFC)*: There are two reasons why PFC payments are not properly "green box" support. First, PFC payments are inconsistent with AoA Annex 2 paragraph 6(b), because Section 118(b) of the 1996 FAIR Act and the regulations implementing the PFC programme eliminates or reduces payments if producers grow certain products – fruits, vegetables and wild rice – on contract acreage.

9. AoA Annex 2 paragraph 6(b) requires that the "amount" of payments "shall not be related to or based on, the type of production…" The object and purpose of paragraph 6(b), based on its text and context, is to ensure that decoupled "green box" payments are not focused or channelled for a single product or a particular sub-set of products. It covers only *completely* decoupled domestic support measures. Paragraph 6(b) seeks to guarantee that a producer who receives such payments can produce any product covered by the Agreement on Agriculture.

10. Section 118(b) of the 1996 FAIR Act and its regulations make it clear that the *amount* of PFC payments in any given marketing year between 1996 and 2001 was related to or was based on the *type* of production undertaken by a producer who entered into a PFC contract. The general rule is that "planting fruits and vegetables (except lentils, mung beans, and dry peas) shall be prohibited on contract acreage". If fruits and vegetables are grown on contract acreage, then the regulations provide that "the Deputy Administrator shall terminate the contract with respect to the producer on each farm in which the producer has an interest". The regulations also provide that in less serious cases of violation, the penalty may be a reduction of contract payments equal to the market value of the fruits and vegetables or the contract payment for each acre used for fruits and vegetables. Thus, the PFC payments are not "decoupled income support" as set out in AoA Annex 2 paragraph 6(b) and therefore, are not "green box" support.

11. The second reason that PFC payments provided to upland cotton producers are not properly "green box" support is that they are inconsistent with the "fundamental" requirement in AoA Annex 2 paragraph 1 that they have "no, or at most minimal, trade distorting effects or effects on production". The quantity or level of production or trade distorting effects need only be very minimal to trigger denial of "green box" status under AoA Annex 2. This follows from the text of AoA Annex 2 paragraph 1, which contains the phrases "no," "at most," and "fundamental".

12. The record in this case demonstrates that PFC payments have had more than "at most" a "minimal" effect on production of US upland cotton during MY 1999-2002. Almost all upland cotton producers participated in the PFC programme. Furthermore, domestic US upland cotton producers view PFC payments as an important component of payments provided to upland cotton farmers. The percentage of subsidization by PFC payments relative to the market value measured by the price received by US upland cotton producers represents between 14 and 17 per cent for period MY 1999-2001. This provides US producers with a significant advantage in export competition with producers in the rest of the world who do not receive such a level of (or any) subsidies.

13. The PFC payments also have production effects because of the very high cost of production for upland cotton in the United States. Given the high US costs, without 14-17 per cent subsidies some higher-cost US producers would likely stop producing upland cotton. This would have resulted in lower levels of US upland cotton production. USDA economists have acknowledged the production-enhancing effects of PFC payments. They have also identified likely patterns of production effects.

14. Because the *quantity* or *level* or trade distorting effects need only be very minimal to trigger denial of "green box" status under AoA Annex 2, the evidence of the production enhancing effects of PFC payments necessitates the conclusion that PFC payments are not properly included within the AoA Annex 2 "green box". They are, thus, properly included within the domestic support measures to be used for the calculation of the amount of domestic support to upland cotton for MY 1999, 2000 and 2001.

15. *Direct payments (DP)*: with the passage of the new FSRI Act in May 2002, PFC payments were discontinued and replaced with DP. These began to be paid in MY 2002 and will be paid until the end of MY 2007. USDA has identified the DP programme as the direct successor to the PFC programme under the 1996 FAIR Act.

16. There are three reasons why DP are not properly within AoA Annex 2. First, as with PFC payments, the amount of DP are related to or based on the type of production undertaken in any year after the base period in violation of AoA Annex 2 paragraph 6(b). The 2002 FSRI Act and its implementing regulations eliminate or limit the amount of DP if base acreage is used for the production of certain crops, i.e., fruits, vegetables and wild rice.

17. Second, the DP provisions of the 2002 FSRI Act violate AoA Annex 2, paragraph 6(a) and (b) because producers were permitted to "update" their base acreage using MY 1998-2001 production totals. This is inconsistent with Annex 2, paragraph 6(a), which requires a *single, fixed* base period for a programme of support. The object and purpose of AoA Annex 2 paragraph 6(a) and (b) is to ensure that Members do not permit payments to increase over time in a manner linked to increases in production over time. This also follows from the AoA Annex 2 paragraph 1 requirement that "green box" support measures have no or at most minimal production effects. That can only occur if the base (i.e., the base for increased payments) does not adapt to recent changes in the production of a farmer.

18. The major structural elements of the PFC programme and the DP programme are the same for both programmes in terms of the basic types of crops covered, the producer's obligations to receive payments, prohibited plantings of certain crops, and freedom to receive payments for one crop and farm another crop. The change from the PFC programme to the DP programme is not "de-coupling" but rather "re-coupling" of MY 2002 and future DP with MY 1998-2001 production.

19. One third of farms receiving PFC payments between MY 1996-2001 updated their acreage for the DP programme using MY 1998-2001 production data. Thus, interpreting AoA Annex 2 paragraph 6(a) and (b) to permit an updating of the "fixed" base period by essentially changing the name of the "PFC payment" programme to DP programme would render these provisions a nullity.

20. Third, DP also have more than "at most minimal" production and trade-distorting effects contrary to the chapeau of AoA Annex 2 paragraph 1. DP, like PFC payments, can increase production of upland cotton through (1) a direct wealth effect through risk aversion reduction, (2) a wealth facilitated increased investment reflecting reduced credit constraints, and (3) a secondary wealth effect resulting from the increase in investment. In addition, the updating of base acres in the 2002 FSRI Act created an ongoing production-enhancing effect because farmers will expect future updates and continue to maintain high levels and even increase production between MY 2002 - 2007. Continued low cotton prices will increase the need of producers to protect their base as a hedge against low prices. In addition, US upland cotton producers are among the world's highest cost producers. That means that the amount of DP (and CCP) is critical to the economic survival of many US upland cotton producers. Thus, there will be a very strong incentive to maintain and increase upland cotton base in anticipation of future base updates in future farm legislation to offset potentially lower world prices.

21. In sum, DP are properly included within the set of domestic support measures to be used for calculating the amount of domestic support to upland cotton for MY 2002.

22. *Counter-Cyclical Payments (CCP)*: are non-"green box" domestic support because they are inconsistent with AoA Annex 2 paragraphs 6(a), 6(b) and 6(c). First, like PFC and DP, CCP are inconsistent with Annex 2 paragraph 6(b) because the CCP programme eliminates or limits the amount of payments for *those* producers who grow fruits, vegetables and wild rice on base acres.

23. Second, CCP also violate AoA Annex 2 paragraph 6(c) because the amount of payments is based on current market prices. The ordinary meaning of AoA Annex 2 paragraph 6(c) is that any direct income support to a producer of agricultural products must not be linked to an international or domestic price established after the base period, *i.e.*, to a current price. CCP are not based on the prices of upland cotton production that took place in a prior base period but rather on prices of present production. As the current upland cotton prices received by US farmers fluctuate between $0.52 and $0.6573 per pound, the amount of payments for each year between MY 2002-2007 changes. This is inconsistent with AoA Annex 2 paragraph 6(c), which requires that payments cannot be based on "the prices…applying to any production undertaken in any period after the base period". But the CCP programme has no fixed "base period" for the purposes of setting "prices". It uses current prices, *i.e.*, prices that apply to current production and, thus, to a "production undertaken in a period after the base period".

24. Third, like PFC and DP, CCP have production and trade distorting effects in violation of AoA Annex 2 paragraph 1. The new CCP programme for upland cotton is one of the main sources of increased payments for US cotton producers between the 1996 FAIR Act and the 2002 FSRI Act. The payments to US upland cotton farmers in MY 2002 will exceed $1 billion and represent over 32 per cent of the market value of US upland cotton. USDA economists have acknowledged that CCP have identifiable and measurable production effects.

25. In sum, CCP are non-"green box" domestic support properly included within the set of domestic support measures to be used for calculating the amount of domestic support to upland cotton for MY 2002.

26. *DP and CCP are support to upland cotton*: DP and CCP made in MY 2002 are support to upland cotton within the meaning of AoA Article 13(b)(ii). The great majority of upland cotton producers are enrolled in the programmes and will receive the full amount of these payments in MY 2002. Most of the producers of upland cotton in MY 2002 used upland cotton base acres to produce upland cotton. US farms growing the bulk of upland cotton tend to grow upland cotton year after year because of considerable investments in cotton-specific equipment and the lack of alternative crops. Thus, most farmers with cotton "base acreage" generally do not use that base acreage to grow other

crops. In addition, CCP create incentives to maintain upland cotton production at the level of the base period in order to minimize the risk of low revenues.

27. In sum, the United States cannot successfully invoke peace clause protection against Brazil's actionable subsidy claims under ASCM Articles 5 and 6 or Brazil's claims under GATT Article XVI:1.

28. *Export Subsidy Peace Clause Issues Under AoA Article 13 (c):* The United States also has no peace clause protection under AoA Article 13(c) for claims against export subsidies under the SCM Agreement regarding Step 2 export payments, the export credit guarantees and subsidies provided under the ETI Act. AoA Article 13(c) can only be invoked by a WTO Member as an affirmative defence if that WTO Member can demonstrate that its export subsidies "conform fully to the provisions of Part V" of the AoA. Part V of the AoA consists of Articles 8 to 11. A Member violates Part V of the AoA if it provides export subsidies for products for which it has not undertaken any export subsidy reduction commitments; or second, if it has export subsidy reduction commitments for the product under consideration, but exceeds the maximum amount of export subsidies to or the maximum value of the product that it has scheduled to be exported with the assistance of export subsidies. The United States does not enjoy peace clause protection for the agricultural export subsidies challenged by Brazil under the SCM Agreement because – as Brazil demonstrates – each of the subsidies at issue does not fully conform to Part V of the AoA.

**Brazil's Claims Regarding Prohibited US Export and Local Content Subsidies**

29. The United States maintains three types of export subsidies related to US upland cotton and other commodities. These subsidies violate AoA Articles 3.3, 8 and 10.1 and are prohibited under ASCM Articles 3.1(a) and 3.2. Brazil challenges all three measures to the extent they provide subsidies to upland cotton. In addition, it challenges the export credit guarantee programmes for all products covered.

30. The first measure, the Step 2 export programme, relates solely to exports of US upland cotton and provides grants to exporters. The second group of measures are three export credit guarantee programmes – the General Sales Manager 102 ("GSM 102"), the General Sales Manager 103 ("GSM 103") and the Supplier Credit Guarantee Programme ("SCGP") – provided by the United States in connection with the export of agricultural goods in general. The third measure providing export subsidies is the FSC Repeal and Extraterritorial Income (ETI) Act of 2000, by which the United States provides tax breaks for exporters of US products, including agricultural products such as upland cotton.

31. *Step 2 Export Payments:* Section 1207(a) of the 2002 FSRI Act mandates Step 2 export payments contingent on the export of US upland cotton lint. Section 1207(a) of the 2002 FSRI Act requires USDA to pay US exporters the difference between higher priced US upland cotton and the average of the five lowest price quotes for exports of upland cotton worldwide (Cotlook's A-Index). The size of this subsidy averaged 8 per cent of the price received by US producers between MY 1999-2001 and an estimated 9.9 per cent in MY 2002.

32. Step 2 export payments constitute export subsidies within the meaning of the AoA. The Appellate Body has indicated that context for interpretation of an "export subsidy" under the AoA is found in the ASCM. Step 2 export payments involve grants within the meaning of ASCM Article 1.1(a)(1)(i), as the US Government pays money to US exporters. Such grants are direct transfers of economic *resources* for which the US Government receives no consideration. Step 2 export payments constitute "free money" for which exporters incur no corresponding obligations and, thus are made for "less than full consideration". They, therefore, confer a benefit within the meaning of ASCM Article 1.1(b). Finally, Step 2 payments are also export contingent within the meaning of ASCM

Article 3.1(a) because exporters are only eligible to receive Step 2 export payments if they produce evidence that they have exported an amount of US upland cotton.

33. Section 1207(a) of the 2002 FSRI Act requires the US Secretary of Agriculture to make Step 2 export payments to eligible exporters upon proof of the export of US cotton. Therefore, Section 1207(a) of the 2002 FSRI Act is inconsistent with AoA Articles 3.3 and 8, because it requires payments of export subsidies to upland cotton without the United States having undertaken any export subsidy reduction commitments under the AoA. Thus, the United States has no peace clause protection against claims made under the ASCM for Step 2 export payments. In addition, for the same reasons the Step 2 export payments violate AoA Articles 3.3 and 8, Section 1207(a) of the 2002 FSRI Act also mandates payment of export subsidies in violation of ASCM Articles 3.1(a) and 3.2.

34. *Export Credit Guarantee Programmes:* The United States, through the US Commodity Credit Corporation (CCC), operates three export credit guarantee programmes – General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103) and the Supplier Credit Guarantee Programme (SCGP). The programmes guarantee the repayment of loans granted to foreign importers of all US agricultural commodities and are not limited to upland cotton. Brazil's also challenges the whole programmes, not just as they relate to upland cotton.

35. USDA export data demonstrates that US exports of most scheduled commodities exceed the respective US quantitative export subsidy reduction commitment. For unscheduled commitments, there is no such commitment, which means *that* every export of these commodities is in excess of the United States' commitments. In *Canada – Dairy Article 21.5 (II)*, the Appellate Body characterized export subsidy claims under the AoA as involving both a "quantitative aspect" and an "export subsidization aspect". It held that AoA Article 10.3 allocates the burden of proof for the export subsidization part to the defending Member – in this case the United States – if the complaining Member – in this case Brazil – establishes that the level of exports in exceeds of the export subsidy reduction commitments. Therefore, the United States bears the burden to prove that its excess exports did not benefit from export subsidies, including export credit guarantees

36. Nevertheless, Brazil also provides evidence that the three export credit guarantee programmes are export subsidies within the meaning of the AoA. The Appellate Body in *US – FSC* held that export subsidies within the meaning of the SCM Agreement are also export subsidies for the purposes of the AoA. Brazil demonstrates in two distinct ways that GSM 102, GSM 103 and SCGP are "export subsidies". First, context for determining whether the US programmes are export subsidies under the AoA is provided by reference to ASCM Annex I, Item (j) of the Illustrative List of Export Subsidies. Item (j) provides that export credit guarantee programmes are export subsidies if they are operated "at premium rates which are inadequate to cover the long-term operating costs and losses of the programme". Second, export credit guarantees also constitute export subsidies under the AoA and in light of the Appelllate Body decisions in *US- FSC* and *Canada – Dairy*, if they involve "financial contributions" that confer "benefits" and are contingent upon export performance within the meaning of ASCM Articles 1.1 and 3.1(a).

37. US documents demonstrate that GSM 102, GSM 103 and SCGP are export subsidies because they are operated at premium rates which are far below the level necessary to cover the programmes operating costs and losses. The programmes are, thus, export subsidies as defined in item (j) of the Illustrative List of Export Subsidies. Under Appellate Body and panel jurisprudence, export subsidies defined in the ASCM Agreement are relevant context for a finding of export subsidies under the AoA. Therefore these three programmes constitute export subsidies within the meaning of the AoA.

38. In addition, GSM 102, GSM 103 and SCGP are export subsidies within the meaning of the AoA because they are financial contributions consistent with ASCM Article 1.1(a)(1)(i), and confer benefits within the meaning of ASCM Article 1.1(b). The United States itself, in its budget, treats them as subsidies. In addition, no such guarantees are commercially available in the marketplace.

GSM 102, GSM 103 and SCGP are, furthermore, contingent upon export performance within the meaning of ASCM Article 3.1(a). Thus, the programme constitutes export subsidies within the meaning of both the SCM Agreement and the AoA.

39. The export subsidies GSM 102, GSM 103 and SCGP result in, or threaten to lead to, circumvention of the United States' export subsidy commitments within the meaning of AoA Article 10.1. GSM 102, GSM 103 and SCGP, in so far as they are available for unscheduled products, violate AoA Articles 10.1 and 8 because they make export subsidies available for unscheduled products. The Appellate Body has held that for unscheduled products, it is inconsistent with AoA Article 3.3 to provide export subsidies listed in AoA Article 9.1, and that it is inconsistent with AoA Articles 10.1 and 8 to provide any other export subsidy. GSM 102, GSM 103 and SCGP provide export subsidies to unscheduled products, and thus violate AoA Article 10.1 and 8.

40. With respect to scheduled products, GSM 102, GSM 103 and SCGP as such also threaten to lead to circumvention of the US export subsidy reduction commitments. The United States provides monetary allocations for export credit guarantees to individual third countries either on a commodity specific basis or on a non-commodity specific basis. This common feature of the three export credit guarantee programmes creates a threat that the United States will exceed its quantitative export subsidy reduction commitment for scheduled products in violation of AoA Articles 10.1 and 8.

41. In sum, the export credit guarantee programmes GSM 102, GSM 103 and SCGP are inconsistent with AoA Articles 10.1 and 8. As they do not fully conform to AoA Part V, they do not enjoy peace clause protection under AoA Article 13(c)(ii).

42. Brazil has already established that GSM 102, GSM 103 and SCGP are export subsidies within the meaning of item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement, and within the meaning of ASCM Article 3.1(a). It follows that GSM 102, GSM 103 and SCGP are prohibited export subsidies within the meaning of ASCM Articles 3.1(a) and 3.2.

43. *ETI Act Export Subsidies*: The third export subsidy provided by the United States to upland cotton consists of tax cuts under the FSC Repeal and Extraterritorial Income Act of 2000. This Act eliminates tax liabilities for exporters, *inter alia*, of upland cotton. A WTO panel and the Appellate Body have previously found that the ETI Act violates AoA Articles 10.1 and 8 and ASCM Articles 3.1(a) and 3.2. The tax breaks provided for under the ETI Act constitute export subsidies within the meaning of AoA Article 10.1. The ETI Act threatens to circumvent the US export subsidy commitments by providing an export subsidy to upland cotton while the United States does not have any export subsidy reduction commitments for upland cotton in violation of AoA Articles 10.1 and 8. As the ETI Act subsidies do not fully conform to AoA Part V, there is no peace clause exemption from actions under the SCM Agreement. Consequently, the ETI Act *also* constitutes a prohibited export subsidy within the meaning of ASCM Article 3.1(a) and 3.2.

44. *Step 2* Domestic *Payments*: Section 1207(a) of the 2002 FSRI Act mandates the payment of the Step 2 domestic payments. Step 2 domestic payments are subsidies within the meaning of the ASCM Article 1.1. They involve grants because the US Government pays domestic users of US upland cotton the difference between higher priced US upland cotton and the average of the five lowest upland cotton price quotes for exports (A-Index) without receiving any consideration in return. These grants are direct transfers of funds and constitute a financial contribution by a Government within the meaning of ASCM Article 1.1(a)(1)(i). They confer a "benefit" within the meaning of ASCM Article 1.1(b) because the domestic user of US upland cotton receives the financial contribution on terms more favorable than those available in the market. Step 2 domestic payments constitute "free money" for which domestic users of US upland cotton incur no corresponding obligations. Finally, Step 2 domestic payments are contingent on the use of domestic over imported goods. Domestic users of US cotton can only receive payments upon proof of opening a bale of domestic US upland cotton. In sum, Section 1207(a) of the 2002 FSRI Act mandating Step 2 domestic

payments violates ASCM Articles 3.1(b) and 3.2 by requiring the provision of subsidies contingent upon the use of domestic over imported goods.

45. The Step 2 domestic payment programme also constitutes a violation of GATT Article III:4. Section 1207(a) requires the US Secretary of Agriculture to treat upland cotton of non-US source less favorable than like US upland cotton. Only upland cotton that "is domestically produced baled upland cotton" is eligible for the Step 2 domestic payment programme. Paying a subsidy to like domestic upland cotton while denying such payments to imported like cotton negatively affects the competitiveness of imported cotton by making it less attractive to US purchasers. The Step 2 domestic payment programme therefore extends "less favorable treatment" to imported goods within the meaning of GATT Article III:4.

**Conclusion**

46. In Brazil's further submission (scheduled for 4 September 2003 following the Panels expression of its views on AoA Article 13 on 1 September 2003) Brazil will present its arguments concerning its claims under ASCM Articles 5(c), 6.3(b), 6.3(c) and 6.3(d), as well as under GATT Article XVI.

# ANNEX B-2

## EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF THE UNITED STATES

1. In this submission, the United States principally focuses on the issues involving the Peace Clause. However, three sets of measures identified by Brazil – (1) export credit guarantee measures relating to eligible US agricultural commodities other than US upland cotton; (2) production flexibility contract payments and market loss assistance payments; and (3) cottonseed payments – were, respectively, not the subject of consultations, had expired before consultations were requested, or had not yet been adopted at the time of the consultation and panel requests. With respect to these measures, the United States requests that the Panel make preliminary rulings that they are not within the Panel's terms of reference.

2. **General Interpretation of the Peace Clause and "Exempt from Actions"**: As set out in more previous submissions, read in accordance with the customary rules of interpretation of public international law, the key Peace Clause phrase "exempt from actions" means "not exposed or subject to" a "legal process or suit" or the "taking of legal steps to establish a claim or obtain a remedy". Relevant context in DSU Article 3.7 and 4.5 and Subsidies Agreement Article 7 supports this reading. For example, contrary to Brazil's suggestion that "action" only refers to "collective action" by the Dispute Settlement Body, DSU Article 4.5 uses the phrase "further" action. Since no "action" will have been taken by the DSB "in the course of consultations," the phrase "further action" suggests that requesting consultations is part of the action brought by a complaining party. Thus, these provisions suggest that "action" based on the relevant provisions would include all stages of a dispute, including the "bringing [of] a case", consultations, and panel proceedings and would support reading "exempt from actions" in Article 13 to mean "not subject to" the "taking of legal steps to establish a claim".

3. Prior to this point in the process, DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause. As a responding party cannot prevent panel establishment from occurring, it will inevitably be forced to argue to a panel that its procedures should be structured so that the party's challenged measures are not subject, from that point on, to actions based on provisions specified in the Peace Clause. Thus, the Panel's organization of its procedures provided the first opportunity to arrest Brazil's "taking of legal steps to establish a claim".

4. **The Peace Clause Is Not an Affirmative Defence**: The Peace Clause applies *"[n]otwithstanding* the provisions of GATT 1994" and the Subsidies Agreement – that is, *in spite of* and *without regard to or prevention by* the subsidies obligations contained in those agreements. Article 21.1 of the Agriculture Agreement further clarifies that the obligations of Members under the Subsidies Agreement and GATT 1994 *only* apply "*subject to*" the provisions of the Agriculture Agreement, including the Peace Clause. There is no need to determine if a measure is inconsistent with WTO subsidies disciplines before applying the Peace Clause as would be the case if the Peace Clause were an affirmative defence to those obligations.

5. As in *United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, in which the Appellate Body explained that a provision that was described as an "exception" was not an affirmative defence and in fact was "an integral part" of the arrangement under the *Agreement on Textiles and Clothing* that "reflects an equally carefully drawn balance of rights and obligations of Members", here, too, the Peace Clause is part and parcel of the balance of rights and

obligations with the subsidies disciplines of GATT 1994 and the Subsidies Agreement and explains which measures are subject to actions based on those disciplines.

6. Article 13(a)(i) establishes that green box measures are "non-actionable subsidies for purposes of countervailing duties". This obligation is not contingent on whether a Member asserts an "affirmative defence" that a particular measure is "green box"; that is, one Member is not free to impose a countervailing duty until another establishes a Peace Clause "affirmative defence". There is no textual basis to interpret the Peace Clause to be an affirmative defence under one provision (Article 13(b)(ii)) but not another. In fact, rather than a defence, the Peace Clause could be used on the *offense* (as a cause of action) if, for example, a Member imposed a countervailing duty on a "green box" measure while the Peace Clause was in force.

7. Brazil has erroneously asserted that the Peace Clause "provides no positive obligations itself". Brazil overlooks the text of, for example, Article 13(a)(ii) and (b)(ii), which incorporates positive obligations of Annex 2 and Article 6 by reference. The Peace Clause also differs from the fifth sentence of footnote 59 to item (e) and under the second paragraph of item (k) of the Illustrative List, under which it appears that a measure otherwise prohibited under Article 3 of the Subsidies Agreement would nonetheless be permitted given the existence of circumstances detailed in those provisions. However, under the Peace Clause, conforming measures are not even exposed or subject to the taking of legal steps to establish a claim or obtain a remedy based on Peace Clause-specified provisions. Further, Subsidies Agreement Articles 3, 5, and 6 recognize that measures conforming to the Peace Clause are not subject to those disciplines by expressly excluding such measures from the scope of those obligations.

8. Brazil asserted in both its panel and consultation requests that the Peace Clause does not exempt the challenged US measures from action. Brazil implicitly recognized in these documents that it must surmount the Peace Clause hurdle to bring this action against US agricultural support measures. Even were the United States to present no arguments on the applicability of the Peace Clause, Article 13 would bar Brazil's claims unless Brazil made a *prima facie* case that the US measures breach the Peace Clause.

9. **US Direct Payments Meet and Conform to the Criteria in Article 13(a)**: Pursuant to Agriculture Agreement Article 13(a)(ii) domestic support measures that "conform fully to the provisions of Annex 2 to this Agreement" are "exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement". The 2002 Act establishes several types of measures that qualify for green box protection, including one, direct payments, that is challenged by Brazil.

10. Direct payments under the 2002 Act conform fully to the basic criteria in paragraph 1, Annex 2, as well as the five "policy-specific criteria and conditions" in paragraph 6, Annex 2, for "decoupled income support". Consistent with paragraph 1, direct payments are provided by a publicly-funded government programme and do not provide price support. Consistent with paragraph 6, direct payments establish eligibility by reference to the clearly-defined criteria of factor use or production level in a defined and fixed base period. Payments are not related to production or prices or the factors of production employed in any year after the base period, and no production is required in order to receive such payments.

11. In short, direct payments do not provide support for upland cotton because they are not linked to current cotton production. These payments are made with respect to farm acreage that was devoted to agricultural production in the past, including previous upland cotton production. Direct payments, however, are made regardless of whether cotton is currently produced on those acres or whether anything is produced at all. Because all of the criteria in paragraphs 1, 5, and 6 are met, direct payments conform to the requirements of Annex 2 and are "exempt from actions" based on Part III of the Subsidies Agreement and GATT 1994 Article XVI.

12. **Applicability of Agriculture Agreement Article 13(b)(ii):** Pursuant to Agriculture Agreement Article 13(b)(ii), "domestic support measures that conform fully to the provisions of Article 6" are "exempt from actions" based on GATT 1994 Article XVI:1 and Subsidies Agreement Articles 5 and 6. Brazil does not contest that US non-green box domestic support measures conform fully to the requirements of Article 6. Thus, the only question is whether US non-green box domestic support measures do or do not "grant support to a specific commodity in excess of that decided during the 1992 marketing year."

13. The phrase "grant support to a specific commodity" is not explicitly defined. Read according to its ordinary meaning, this phrase means to "give" or "confer" formally a "subsidy" ("assistance, backing") "specially . . . pertaining to a particular" "agricultural crop". Read in the context of, *inter alia*, the definition of "Aggregate Measurement of Support" in Article 1(a), "support to a specific commodity" refers to support "provided for an agricultural product in favour of the producers of the basic agricultural product" or "product-specific support".

14. The product-specific support granted by such Article 6 measures must be compared to "that decided during the 1992 marketing year". According to its ordinary meaning, this phrase would mean the product-specific support that was "determined" or "pronounced" during the 1992 marketing year. With reference to support or subsidies, the term "decided" is not used elsewhere in the Agriculture Agreement nor in the Subsidies Agreement. Various provisions that define the overall domestic support in favour of agricultural producers that has been, is being, and may be provided by a Member use the phrase "support *provided*" in favour of an agricultural product or agricultural producers no fewer than 13 times. Context thus suggests that the use of the term "*decided"* in Article 13(b) was deliberate so as to make the availability of the Peace Clause not dependent upon the support – for example, as measured through budgetary outlays – actually "provided" during the 1992 marketing year. This interpretation is further supported by Members' decision not to use the term "Aggregate Measurement of Support" in this part of Article 13(b)(ii). That is, Members did not choose to make the applicability of the Peace Clause contingent on comparison of a Member's product-specific Aggregate Measurement of Support.

15. The Peace Clause thus exempts from certain actions a Member's non-green box domestic support measures that conform to that Member's overall reduction commitments under Article 6, provided that such measures do not currently "give" or "confer" "product-specific support" in excess of that "determined" or "pronounced" during the 1992 marketing year. The relevant test for the applicability of Article 13(b)(ii) is to compare the product-specific support as it was decided in 1992 versus the product-specific support that existing measures currently grant.

16. **US Measures Conform to the Criteria in Article 13(b) and Are Exempt from Actions**: US domestic support measures under the 2002 Act were written to grant support for upland cotton within the 1992 marketing year level so that such measures would conform to the Peace Clause criteria. In particular, the 2002 Act shifts support away from the product-specific support that prevailed in 1992 to reduce support linked to the production of upland cotton.

17. **The Product-Specific Support for Upland Cotton Decided During 1992 Was To Ensure Income of 72.9 Cents per Pound**: The product-specific support in favour of upland cotton decided during the 1992 marketing year was to ensure a level of income ($0.729) for upland cotton farmers for each pound of upland cotton production. That is, US domestic support measures set a *rate* of support, rather than deciding *ex ante* a level of budgetary outlay or expenditures. This support was granted by the 1990 Act through two programmes: marketing loans (including marketing loan gains and loan deficiency payments) and deficiency payments.

18. Through marketing loans, the United States in effect guaranteed that cotton producers would realize income equivalent to at least 52.35 cents per pound of upland cotton produced. The United States further ensured cotton farmers would realize income equivalent to 72.9 cents per pound

of upland cotton produced by making "deficiency payments". By the terms of the 1990 Act and all subsequent implementing regulations, the support "decided" (that is, " determined" or "pronounced") in favour of upland cotton was *not* expressed in terms of outlays or appropriations but rather as a *rate*: that is, through both marketing loans and deficiency payments, producer income of 72.9 cents per pound of upland cotton. Thus, budgetary outlays, which reflect the difference between the rates set out in US legislation and regulations (which *were* decided by the US Government) and market prices (which obviously were *not*), do not represent the product-specific support "decided" during the 1992 marketing year.

19. **US Domestic Support Measures Currently Grant Product-Specific Support to Upland Cotton to Ensure Producer Income of 52 Cents per Pound**: Under the 2002 Act, product-specific support is again granted to upland cotton through the marketing loan programme and through user marketing (step 2) payments. Despite a small adjustment in the user marketing (step 2) payment formula, US measures currently in effect grant product-specific support to upland cotton far lower than that decided in the 1992 marketing year. Through the marketing loan programme, the US Government has in effect guaranteed that cotton producers will realize income equivalent to at least 52 cents ($0.52) per pound (the "2002 loan rate") of upland cotton produced. Marketing loans and loan deficiency payments are contingent on a farm's actual production of upland cotton in the current marketing year.

20. Product-specific support decided during the 1992 marketing year for upland cotton was to ensure producer income of 72.9 cents per pound; US domestic support measures currently grant product-specific support only at the rate of 52 cents per pound of production. Even taking into account the minor differences in payment rates for user marketing payments, this comparison indicates that US measures do not grant product-specific support to upland cotton in excess of that decided during the 1992 marketing year; in fact, current US measures grant product-specific support at a rate more than 20 cents per pound *less* than that decided during 1992.

21. **US Payments That Brazil Has Mischaracterized As Providing Support to a Specific Commodity Do Not Form Part of the Peace Clause Comparison**: Direct payments, counter-cyclical payments, and crop insurance are not product-specific support for upland cotton and are therefore irrelevant to the 1992 to 2002 Peace Clause comparison. Direct payments are green box support because they conform to the applicable general and policy-specific criteria under Annex 2 of the Agriculture Agreement. As green box measures, direct payments are not part of the comparison of "product-specific" support under Article 13(b)(ii). Because direct payments are based on quantities of acreage that historically produced certain commodities, including upland cotton, and there is no requirement to produce upland cotton to receive these payments, however, direct payments are non-product-specific.

22. With respect to counter-cyclical payments, the United States notes that these measures do not grant product-specific support to upland cotton. Product-specific support is " provided for an agricultural product" for the benefit of "the *producers* of the basic agricultural product". The payment formula for counter-cyclical payments demonstrates that these payments are not "provided for an agricultural product" because it is not current production of upland cotton that qualifies a recipient to receive payment. In addition, it is not "the producers of the basic agricultural product" – that is, current upland cotton growers – that are entitled to receive the counter-cyclical payments but rather persons (farmers and landowners) on farm acres with *past histories* of producing covered commodities, including upland cotton. Because counter-cyclical payments are not product-specific support for upland cotton, such payments are not properly part of the Peace Clause comparison under Article 13(b)(ii).

23. Neither does crop insurance grant product-specific support to upland cotton. A variety of insurance plans are now subsidized and reinsured by the United States. The basic programme provisions for crop insurance are generic, not commodity-specific. For example, the US Government

provides an incentive to participate in the crop insurance programme by subsidizing the premium paid by the farmer. This premium subsidy is available to a broad array of commodities around the country and does not vary by commodity. Thus, while the United States notifies crop insurance as "amber box" domestic support subject to US reduction commitments, crop insurance is "non-product-specific support in favour of agricultural producers in general".

24. **Conclusion: US Non-Green Box Domestic Support Measures Are Exempt from Brazil's Subsidies Agreement and GATT 1994 Article XVI Action**: Brazil has asserted that US domestic support measures breach the Peace Clause by comparing US budgetary outlays for the 1992 marketing year to US budgetary outlays for marketing years 1999-2001 and its "reasonable" estimates of US outlays for the 2002 marketing year. As noted above, Brazil's interpretation of the Peace Clause and resulting analysis is fundamentally in error. Because the level of income support granted to upland cotton producers is far lower now than the support decided in marketing year 1992, Brazil may not maintain this action and advance claims under GATT 1994 Article XVI:1 or Subsidies Agreement Articles 5 and 6 with respect to US non-green box domestic support measures – marketing loan programme payments, user marketing (step 2) certificates, counter-cyclical payments, and crop insurance subsidies.

25. **US Step 2 Payments Are Not an Export Subsidy for Upland Cotton**: User marketing (Step 2) payments are made to users of upland cotton. Under section 1207 of the 2002 Act, the Secretary of Agriculture is authorized to issue marketing certificates or cash payments *to domestic users and exporters* of upland cotton *for documented purchases by domestic users and sales for export by exporters*. The programme is indifferent to whether recipients of the benefit of this programme are parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States or exporters. Accordingly, the United States reports the benefits conferred under the Step 2 programme as product-specific amber box domestic support.

26. The Step 2 programme is not an export subsidy under Agriculture Agreement Article 9.1 and not an export subsidy in circumvention of the US obligation not to confer an export subsidy with respect to cotton, contrary to Article 10.1. Article 1(e) of the Agriculture Agreement states that "'export subsidies' refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement". Consequently, to constitute an "export subsidy" for any purposes of the Agreement, the subsidy must first be "contingent on export performance". The benefits of the Step 2 programme are not contingent on export performance.

27. A WTO dispute settlement panel has already determined that such facts do not involve an export subsidy for purposes of both Articles 9 and 10 of the Agriculture Agreement, because the subsidy is not "contingent on export performance". The panel in *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products* concluded that where a subsidy was available in connection with the exported product but also to processors producing for the domestic market, "access to milk under such other classes is not 'contingent on export performance.' We therefore find that such other milk classes do not involve an export subsidy under Article 9.1(a)". For precisely the same reasons, the panel also found that "these other milk classes do not involve an export subsidy in the sense of Article 10.1". Similarly, the Step 2 programme is not an export subsidy inconsistent with Articles 9 and 10 of because the subsidy is not contingent on export performance and therefore is not an export subsidy.

28. **Brazil Bears the Burden of Proof to Demonstrate the Existence of an Export Subsidy for Upland Cotton**: Brazil as complainant bears the burden of proof with respect to any export subsidy claim relating to upland cotton. Brazil cites Agriculture Agreement Article 10.3 to assert that the United States bears this burden. However, the burden-shift set forth in Article 10.3 is only applicable with respect to exports in excess of a *reduction* commitment level. As Brazil correctly points out, the United States does not have such a *reduction* commitment level with respect to upland cotton. Article 10.3 therefore does not apply with respect to US cotton exports. With respect to products for

which a Member has no scheduled export subsidy reduction commitments, the burden of proof remains with the complainant.

29. **US Step 2 Payments Are Not a Prohibited Subsidy Under Article 3 of the Subsidies Agreement**: With respect to domestic support, the negotiators of the Agriculture Agreement devised the novel concept of "Aggregate Measurement of Support" (AMS), defined in Article 1(a). As the definition provides, all annual domestic support provided for an agricultural product, like cotton, in favour of the producers of that product that is not otherwise exempt under the "green box" (Annex 2) from reduction commitments, or as otherwise provided in Articles 6.4 and 6.5 of the Agreement, is included in the AMS. The definition further contemplates that support provided during any one year is to be calculated in accordance with the provisions of Annex 3. Paragraph 7 of Annex 3 requires that "measures directed at agricultural processors shall be included [in the AMS] to the extent such measures benefit the producers of the basic agricultural products".

30. Accordingly, Step 2 user payments, directed at upland cotton processors and other users but intended to benefit US producers of upland cotton, are included in the annual AMS calculation of the United States. As a result, such payments are subject to reduction commitments applicable to the United States. Agriculture Agreement Article 6.3 provides that "a Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule". Where a particular programme exists in favour of agricultural producers within such Current Total AMS, the Agriculture Agreement is entirely agnostic as to the method of delivery of such support.

31. The United States is in compliance with its domestic support reduction commitments, of which support in the form of the Step 2 programme is a constituent part, as provided in the Agriculture Agreement. Articles 3.1(a) and 3.1(b) of the Subsidies Agreement apply "except as provided in the Agreement on Agriculture". The conformity of the Step 2 programmes with the terms, object and purpose of the Agriculture Agreement – and in particular the domestic support reduction commitments – constitute precisely the kind of exception contemplated in the introductory words of Article 3. Inasmuch as Articles 3.1(a) and (b) do not apply to Step 2 payments, the Step 2 programme also cannot violate Subsidies Agreement Article 3.2.

32. **US Step 2 Payments Are Not Inconsistent with GATT 1994 Article III:4**: As contemplated by the terms of the Step 2 programme itself, as well as Annex 3 of the Agriculture Agreement, the Step 2 programme provides benefits in favour of US upland cotton producers. As noted above, the Step 2 programme is in conformity with Agriculture Agreement Article 6. In addition, Agriculture Agreement Article 3.1 provides that the domestic support commitments in Part IV of each Member's Schedule are made an integral part of GATT 1994. The domestic support commitments of the United States are therefore an integral part of GATT 1994 itself, and Agriculture Agreement Article 21.1 expressly states that "the provisions of GATT 1994 . . . shall apply subject to the provisions of this Agreement".

33. Pursuant to Article 6.3 of the Agriculture Agreement, "a Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule". Annex 3, paragraph 7, specifically requires that "[m]easures directed at processors shall be included" in the calculation of AMS to subject these measures to the domestic support reduction commitments established for the first time in the Agriculture Agreement. The Step 2 programme exists in favour of agricultural producers within such Current Total AMS, and the text of the Agriculture Agreement does not prohibit any particular form of delivery of such amber box domestic support.

34. The Agriculture Agreement imposed for the first time rigorous disciplines on agricultural support. The domestic support reduction commitments of the United States constitute an integral part of GATT 1994. A coherent reading of the Agriculture Agreement with the GATT 1994 indicates that the Step 2 programme does not violate GATT 1994 Article III:4.

35. **The Commodity Credit Corporation Export Credit Guarantee Programmes are Not Export Subsidies**: During the Uruguay Round, negotiators did not reach agreement on disciplines on all areas that had been the subject of negotiations, in several cases agreeing to continue negotiating after the close of the Round and the entry into force of the WTO Agreement. The simple fact is that during the Uruguay Round WTO Members did not agree on disciplines to be applicable to export credits, export credit guarantees, and insurance programmes. Unable to reach agreement on such disciplines within the Uruguay Round, Members opted to continue discussions in an appropriate forum, deferring the imposition of substantive disciplines until a consensus was achieved.

36. Following the entry into force of the WTO Agreement, numerous WTO Members commenced negotiations under the auspices of the OECD to achieve such internationally agreed disciplines. When such negotiations failed to achieve an agreement, negotiations on disciplines for export credits and export credit guarantees have subsequently continued both under the reform process contemplated under Article 20 of the Agriculture Agreement and the mandate of the Doha Ministerial Declaration.

37. The scope and detail of the current agriculture negotiations as reflected in the Harbinson text demonstrate that the Members are currently engaged in active negotiations on disciplines for export credits and credit guarantees. Among the areas under active discussion include disciplines on the relationship between premiums, term, and long-term operating costs and losses. These discussions would be unnecessary if existing disciplines applied to such programmes in agriculture. The Panel should not pre-empt such negotiations.

38. The text of Article 10.2 of the Agriculture Agreement reflects the deferral of disciplines on export credit guarantee programmes contemplated by WTO Members. As simply reflected in the structure and text of the Agriculture Agreement, Members came to no agreement with respect to substantive disciplines on export credit guarantee programmes. Article 10.2 stands in stark contrast to Article 9.1. Article 9.1 sets forth a list of six very specific practices known to the drafters and deemed to constitute export subsidies under the Agriculture Agreement. Significantly, the Illustrative List of Export Subsidies in the Subsidies Agreement explicitly addresses export credit and credit guarantee practices in its item (j). Conspicuously absent in Article 9.1 is any provision addressing such practices, even though US export credit guarantee programmes had been in existence for nearly fifteen years preceding the inception of obligations under the WTO.

39. To include US export credit guarantee programmes within the ambit of Article 10.1 or within the definition of export subsidy under Article 1(e) of the Agreement would render the work programme envisioned by Article 10.2 unnecessary. Further, to adhere to the approach that Brazil advocates would allow for the utter irrelevance of Article 10.2. Indeed, Brazil unabashedly makes not one reference to Article 10.2 in its initial submission.

40. **CCC Export Credit Guarantees are Not Prohibited Export Subsidies Under the Subsidies Agreement**: Brazil has alleged that the CCC export credit guarantee programmes are prohibited subsidies under Article 3.1(a) of the Subsidies Agreement. The very first words of Article 3.1 of the Subsidies Agreement, however, are: "Except as provided in the Agreement on Agriculture." Article 10.2 of the Agriculture Agreement, as noted above, provides for the deferral of disciplines unless and until internationally agreed disciplines are in fact achieved. Brazil has conveniently ignored both Article 10.2 and the explicit introductory words of the Subsidies Agreement Article 3.1 in its first submission. However, Brazil concedes that the export credit guarantees are "exempt from action under ASCM Article 3.1(a) if they fully conform to the provisions of [Agreement

on Agriculture] Part V". These programmes are in conformity with Article 10.2, which is within such Part V. In addition, Article 21.1 explicitly provides that the Multilateral Trade Agreements in Annex 1A to the WTO Agreement, which include the Subsidies Agreement, shall apply *subject* to the Agriculture Agreement.

41. Brazil alleges that the export credit guarantee programmes constitute an export subsidy for purposes of the Subsidies Agreement because such programmes fall within item (j) of the Illustrative List of Export Subsidies. Brazil alleges the United States provides export credit guarantees for cotton "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes" and that a ten-fiscal-year period "fulfils the criterion of being 'long-term' within the meaning of item (j)". Quite simply, with respect to cotton, for the last 10 fiscal years for which complete data is available, premiums paid exceed claims paid. As with any other insurance-type programme, moreover, a proper analysis of "losses" should involve the calculation of the net result of premiums collected, plus claims amounts repaid or rescheduled, minus claims paid. Such calculation would properly reflect the net position of the programme.

42. For the 10-year period from fiscal year 1993 through fiscal year 2002, premiums collected total $16,026,202 and losses incurred via claims total $4,768,096. Consequently, even *before* any post-default recoveries, premiums exceeded claims paid. Of claims incurred, $1,015,365 were subsequently directly recovered, and an additional $8,175,570 have been rescheduled. Brazil argues that the United States "must at the very least recover their operating costs by virtue of fees or premiums collected". Without conceding that this is the applicable test by which the conformity of export credit guarantee programmes with WTO obligations should be assessed, nevertheless, the US programmes for cotton satisfy this Brazilian suggestion.

43. Brazil, like any complainant, bears the burden of establishing that export credit programmes fall within the terms of item (j). Brazil, the United States, and the Appellate Body would apparently agree, however, that *a contrario*, to the extent a WTO Member provides, as the United States has already demonstrated with respect to cotton, export credit guarantees at premium rates which *do* cover long-term operating costs and losses of the programmes, then it is *not* an export subsidy within the meaning of item (j) and the Subsidies Agreement. Premiums collected for US export credit guarantees in connection with cotton transactions over the last 10 fiscal years exceed long-term operating costs and losses. Under the criteria of item (j) alone, these programmes do not constitute a prohibited export subsidy within the meaning of the Subsidies Agreement and are not prohibited under Article 3.1(a) nor inconsistent with Article 3.2.

44. **Brazil Has Failed to Make a Prima Facie Case Regarding the FSC Repeal and Extraterritorial Income Exclusion Act of 2000**: With respect to its claims concerning the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ("ETI Act"), in its first submission Brazil has not presented any evidence regarding the ETI Act itself and does nothing more than "reiterate[] the claims brought by the European Communities under the [Agriculture Agreement] and the Subsidies Agreement in *US – FSC (21.5)*, and ask[] the Panel to apply the reasoning as developed by the panel and as modified by the Appellate Body in that case *mutatis mutandis*". In so doing, Brazil has failed to make a *prima facie* case with respect to the ETI Act. Brazil's approach would put the Panel in the position of having to violate its obligation under DSU Article 11 to "make an *objective assessment of the matter* before it, including an *objective assessment of the facts* of the case and the *applicability of and conformity with* the relevant covered agreements". As a result of Brazil's approach, the Panel is in no position to exercise its judgment to follow, or decline to follow, prior reports concerning the ETI Act, nor even in a position to make factual findings concerning the Act. In the absence of a *prima facie* case by Brazil, the Panel should reject Brazil's claims concerning the ETI Act.

# ANNEX B-3

THIRD-PARTY SUBMISSION BY ARGENTINA

15 July 2003

**TABLE OF CONTENTS**

## I. INTRODUCTION

1. Argentina thanks the Panel for this opportunity to present its views as a third party to these proceedings and will address Brazil's claims[1] of inconsistency of the subsidy programmes provided by the United States to US producers, users and exporters of upland cotton, as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies.

In addition, Argentina will discuss the export credit guarantee programmes provided by the United States for exports of cotton and other commodities that are also exported by Argentina.

2. Given the little time available between the receipt on 11 July of the responding party submission of the United States and the date fixed for this third-party submission, Argentina will comment on the US submission at the meeting of the Panel with the parties and third parties scheduled on 24 July.

3. Firstly, Argentina proposes to argue the absence of US protection under Article 13(b)(ii) and (c)(ii) of the Agreement on Agriculture (hereinafter "AoA"), since the United States does not fulfil the legal requirements for protection against claims under Article XVI of the GATT 1994 and Articles 3, 5 and 6 of the Agreement on Subsidies and Countervailing Measures (hereinafter "SCM Agreement").

4. Secondly, Argentina will argue that the domestic support measures challenged by Brazil are inconsistent with Articles 5 and 6 of the SCM Agreement to the extent that they cause adverse effects to the interests of other Members, including Argentina. It will also argue that the United States grants export subsidies that are prohibited under Article 3(a) and (b) of the SCM Agreement.

5. Nevertheless, Argentina has taken note of the Panel's decision of 20 June to express its views, by 1 September next, on whether the measures at issue satisfy the conditions in Article 13 of the AoA and to differ its consideration of the claims under Article XVI of the GATT 1994 and Articles 3, 5 and 6 of the SCM Agreement as those provisions are referred to in Article 13 of the AoA.

6. Argentina will therefore address the inconsistency of the US subsidies with Articles 5 and 6 of the SCM Agreement in the submission of 22 September next, providing evidence that the US may not invoke protection under Article 13 of the AoA since it does not fulfil the conditions for protection under that provision.

7. Lastly, Argentina maintains that US cotton export subsidies are inconsistent with Articles 3.3, 8 and 10.1 of the AoA, since the Peace Clause cannot be used as a defence in respect of such claims.

## II. WORLD COTTON MARKET SITUATION AND IMPACT OF THE US SUBSIDIES IN ARGENTINA

### II.1. WORLD COTTON MARKET SITUATION

8. According to data from the Statement of the 61st Plenary Meeting of the International Cotton Advisory Committee (ICAC), held in Cairo, Egypt, from 20 to 25 October 2002[2], world cotton

[1] "Brazil´s First Submission to the Panel regarding the 'Peace Clause' and Non-Peace Clause Related Claims", 24 June 2003. (Hereinafter "Brazil's Submission").

[2] Representatives of 38 governments and eight international organizations took part in the meeting. MEMBER GOVERNMENTS: Argentina, Australia, Belgium, Brazil, Burkina Faso, Cameroon, Chad, Chinese Taipei, Colombia, Côte d'Ivoire, Egypt, Finland, France, Germany, Greece, India, Iran, Israel, Italy, Japan, Republic of Korea, Mali, Netherlands, Nigeria, Pakistan, Paraguay, Philippines, Poland, Russia, South Africa,

production reached a record 21.5 million tons in marketing year 2001/2002, exceeding global consumption by 1.3 millions tons.

9. Over the same period, world cotton exports increased by 10 per cent to an unprecedented 6.5 million tons, while international cotton prices fell to the lowest average level in 30 years of US$0.418 per pound (according to Cotlook Index A).

10. The value of world production declined by US$5 billion from the previous season, affecting the incomes of millions of growers, input suppliers and service providers in unsubsidized countries.

11. Since the mid-1990s, the world cotton economy has been marked by chronic price depression. Average international cotton prices, adjusted for inflation, are at their lowest since the Great Depression of 1930, having remained below US$0.60 per pound for the last four consecutive years (1998/1999 to 2001/2002) against an average of US$0.725 per pound over the past 25 years.

12. According to the ICAC, at 1 July 2003 the average international cotton price in marketing year 2002/2003 was estimated at US$0.56 per pound, still well below the average of the last 30 years. Under such conditions, even the most efficient producers find themselves operating at a loss, unable to cover even their production costs. ICAC projections suggest that prices will remain chronically depressed for the foreseeable future. Forecasts point to a modest recovery in 2003/2004, but prices will stay within the US$0.50-0.60/lb range until 2015.

## II.2. COTTON SITUATION IN THE UNITED STATES

13. As a rule, when prices slump production undergoes a similar downturn. However, while world cotton prices have fallen by 54 per cent since the mid-1990s, the United States has increased its output and exports.

14. Since 1998, US cotton production has experienced 42 per cent growth from 14 million metric tons to a record 20.3 million metric tons in 2001.

15. Likewise, at a time of dramatically declining international cotton prices the volume of US exports has expanded to unprecedented levels, from 946,000 tons in 1998 to 2,395,000 tons in 2002.[3]

16. In addition, US cotton production costs are among the highest in the world. According to a recent ICAC study[4], the cost of production in the United States was US$0.81 per pound of cotton in marketing year 1999,[5] while US producers market prices fell from US$0.60 to US$0.30 per pound.

17. The only possible explanation how the United States bridged the widening gap between production costs and market prices is subsidies, for without them many US producers would have been compelled to cease production.

18. Hence the factor underlying the world cotton market crisis is the US subsidies. As Brazil points out at paragraph 2 of its Submission, it was the subsidies that enabled the United States to

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Spain, Sudan, Switzerland, Syria, Tanzania, Togo, Turkey, Uganda, United Kingdom, United States, Uzbekistan and Zimbabwe.

[3] According to data from "*Cultivating Poverty: The Impact of U.S. Cotton Subsidies on Africa*", Oxfam Briefing Paper 30, 27 September 2002 (See Exhibit Bra-15) and ICAC Secretariat.

[4] "Cotton: World Statistics". Bulletin of the International Cotton Advisory Committee, September 2002. (Exhibit Bra-9).

[5] As stated by Brazil at paragraph 32 of its Submission, the cost of production in Argentina averaged 59 cents/lb of cotton, according to the ICAC study (See Exhibit Bra-9).

increase production and exports while market prices remained far below the cost of production over marketing years 1999 to 2002.

19. The total value of US cotton subsidies during this period – as stated at paragraph 3 of Brazil's Submission – amounted to almost US$13 billion and the average cotton subsidization rate was 95 per cent.[6]

20. While there are a great many cotton producing countries, four of them (China, the United States, India and Pakistan, in descending order) alone account for two thirds of world cotton production. Most of the cotton is used in the producing country itself. The great exception to this rule is the United States, which exports over half of the cotton it produces[7] and is the world's leading exporter. This is why the level of subsidization in the United States is so important as far as the world cotton market is concerned.

## II.3. COTTON SITUATION IN ARGENTINA

21. Argentina's cotton sector is a substantial source of employment and income for many of the country's provinces. The Argentine cotton sector has been contracting since 1998, as a result of declining international prices. In 2001/2002, cultivated area and production plummeted to historic low levels. Cultivated area has shrunk by 76 per cent since 1998, with 174,000 hectares planted to cotton, and production has fallen by 63 per cent compared to 1998, with an estimated 73,000 tons of cotton fibre produced.[8]

22. According to the Argentine Ministry of Agriculture, Livestock, Fisheries and Food, provisional estimates as at 13 June 2003 for marketing year 2002/2003 were 157,930 hectares of cultivated area and 60,000 tons of cotton produced.

23. The decline is even more significant when considered in terms of a 10-year annual average, record prices in 1994/1995 (US$0.9275/lb Cotlook A Index) having led to record figures for both cultivated area and production (1,010,000 hectares and 437,000 tons of cotton fibre in 1995/1996).

24. The contraction of the cotton sector started in 1997/1998. Since then, steadily falling prices and increased US government support have gradually driven raw cotton[9] producer prices down to their lowest level (US$192/ton) since 1991/1992, which in turn has entailed constant reductions in cultivated area and production.

25. Although domestic consumption is dwindling, Argentine exports of cotton fibre set another historic low record of 18,366 tons in 2001/2002. Data updated at 31 May 2003 show even worse results, since exports for marketing year 2002/2003 barely reached 2,000 metric tons.

### *(a) Impact of low international prices on Argentine production*

26. Over the last three years, low international prices – because of the huge US subsidies – have impacted heavily on producers' decisions, with only 309,287 cultivated hectares, representing a 58 per cent reduction from a 10-year annual average (1989/1990 to 1998/1999). This has led to sharp reductions in cotton fibre production. Over that same three-year period (1999/2000 to 2001/2002), production averaged 122,883 tons – a 62 per cent fall from the annual average of 327,360 tons

[6] USDA Fact Sheet: Upland Cotton (January 2003). (See Exhibit Bra-4).

[7] As indicated at paragraph 10 of Brazil's Submission, domestic cotton consumption in the United States is dwindling steadily.

[8] "Argentina: Economic Injury to the Cotton Sector as a Result of Low Prices", Working Group on Government Measures of the International Cotton Advisory Committee, 2002.

[9] Seed cotton; unginned.

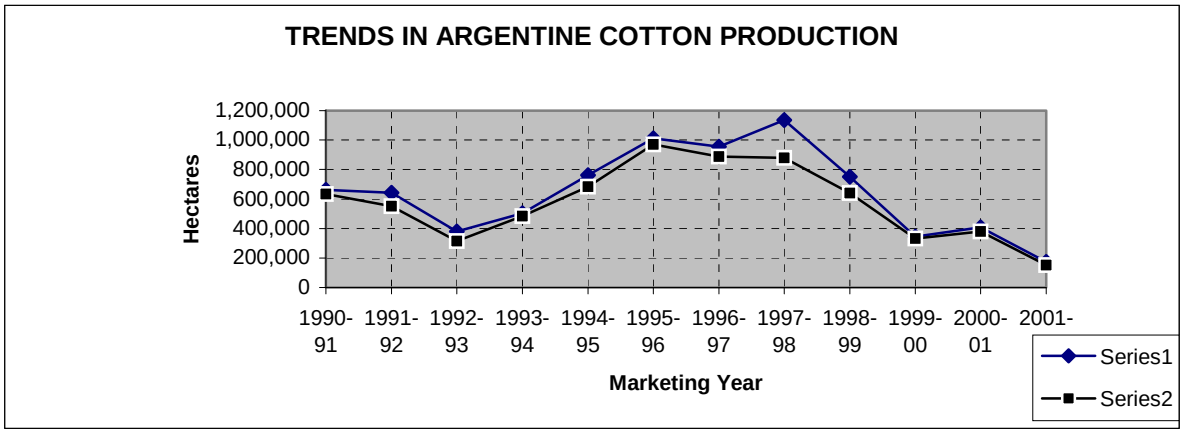
between 1994/1995 and 1998/1999. Worse still, production in 2001/2002 was estimated at 69,810 tons and in 2002/2003 at 60,000 tons, against 163,000 tons in 2000/2001.

27. This collapse of the Argentine cotton sector is reflected in the high level of indebtedness of producers estimated at US$600 million and equivalent to twice the size of agricultural GDP of Argentina's largest cotton producing province.

28. The table below shows the direct relationship between the area of cultivated and harvested cotton and fibre production in Argentina, and trends in world cotton prices according to Cotlook A Index.

| **Season** | **Cotton area (hectares)** | | **Fibre production** | **World price A Index** |
|---|---|---|---|---|
| | ***Cultivated*** | ***Harvested*** | ***(Metric tons)*** | ***(US cents/lb)*** |
| **1995/96** | **1,010,000** | **969,400** | **437,000** | **85.60** |
| 1996/97 | 955,600 | 887,140 | 338,000 | 78.55 |
| 1997/98 | 1,133,500 | 877,900 | 311,000 | 72.20 |
| 1998/99 | 751,000 | 639,700 | 200,000 | 58.90 |
| 1999/00 | 345,950 | 332,100 | 134,000 | 52.80 |
| 2000/01 | 407,980 | 384,850 | 165,000 | 57.20 |
| 2001/02 | 173,930 | 170,000 | 73,000 | 41.80 |
| **2002/03*** | **157,930** | **147,410** | **60,000** | **55.30** |

* Estimate




*(b) Impact of low international prices on employment*

29. Total employment in raw cotton production in Argentina amounts to 93,470 workers; this figure includes 32,060 cotton producers and is based on an average harvested area of 810,828 hectares. The ginning sector employs 3,946 workers and the marketing and input supply chain represents 12,550 additional jobs.

30. Between 1999/2000 and 2001/2002, employment in the cotton sector decreased to an average of 70,400 workers, i.e. a **reduction in employment of 64 per cent**. These figures were obtained from the official employment records of registered workers but they are probably underestimated. According to private estimates, there are 50,000 non-registered workers, which would increase labour loss to 102,000 jobs.

31. Argentina's cotton production is concentrated in 11 provinces and, according to a 1999 World Bank study, 56.6 per cent of the population in these provinces live under the poverty line and 18.2 per cent below the indigence line. The same study shows that 36.1 per cent of Argentina's population live

under the poverty line and 8.6 per cent below the indigence line, which reflects the higher level of poverty in the cotton producing provinces.[10]

*(c) Impact of low international prices on income*

32. Between 1999/2000 and 2001/2002, average raw cotton production[11] was 652,872 tons lower than the 1994/1995 to 1998/1999 average. Using an average price received by producers of US$358/ton[12] between 1994/1995 and 1998/1999, annual gross revenue has dropped by US$255 million over the past three years.

*(d) Impact of low international prices on the value and volume of Argentine exports*

33. In marketing year 2002/2003, planted area shrank to a mere 157,930 hectares, its lowest level in the last 66 years, and production will not even succeed in meeting domestic demand. Even in circumstances like these, it might have been possible to generate sufficient export supply had international prices not been artificially depressed.

34. It should be emphasized that in 1996 Argentina exported 70 per cent of its production, ranking that year as the world's fourth largest exporter.

35. The table below shows the trends in Argentine cotton exports.

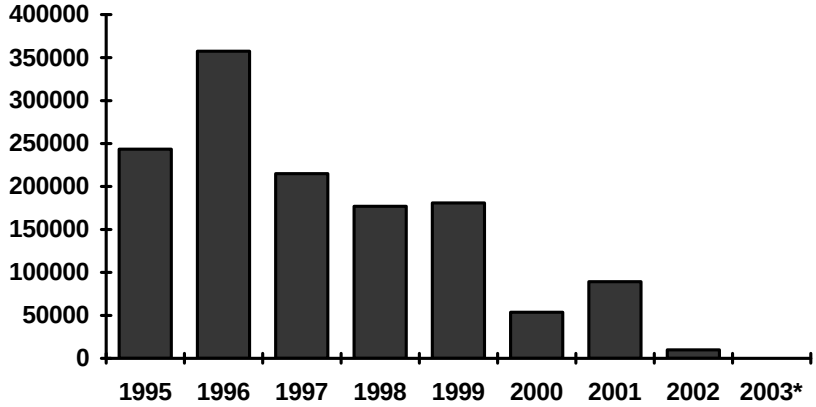
**TRENDS IN ARGENTINE COTTON EXPORTS**

| Years | Volume (tons) | FOB value (US$ millions) | Argentina's per cent share of world exports |
|---|---|---|---|
| **1995** | 243,474 | 432.8 | 4% |
| **1996** | 357,447 | 497.0 | 6% |
| **1997** | 214,904 | 332.3 | 3.6% |
| **1998** | 177,025 | 224.3 | 3.2% |
| **1999** | 180,897 | 177.9 | 3% |
| **2000** | 53,637 | 53.2 | 0.9% |
| **2001** | 89,262 | 72.8 | 1.5% |
| **2002** | 18,366 | 11.9 | 0.1% |
| **2003*** | **1,985** | **1.6** | -- |

*****(Estimate at 31 May 2003)

[10] *Id.*
[11] Seed cotton; unginned.
[12] For a quality equal to a C-1/2 grade.

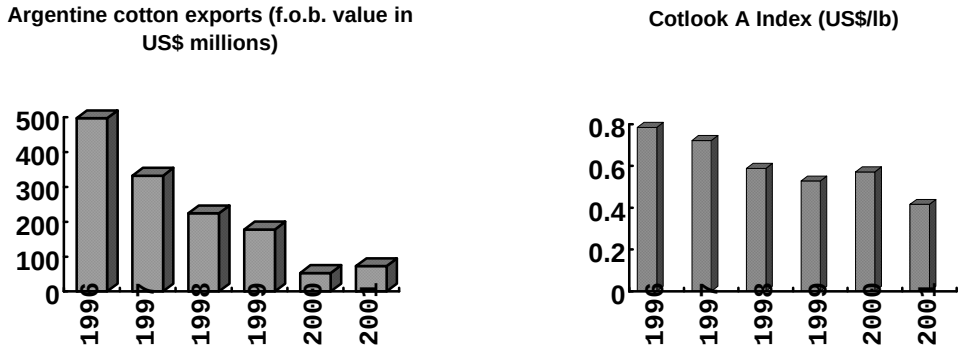
36. In chart form, Argentine cotton exports (tons) since 1995 show the following trends:




37. This chart shows – as does the table below – a direct relationship between the decline in international cotton prices, which began in 1996/1997, along with the implementation of the 1996 US Farm Act, and the collapse of the Argentine cotton economy.

| **Years** | **Argentine cotton exports (FOB value in US$ millions)** | **Cotlook A Index (US$/lb)** |
|---|---|---|
| **1996** | 497.0 | 0.7855 |
| **1997** | 332.3 | 0.7220 |
| **1998** | 224.3 | 0.5890 |
| **1999** | 177.9 | 0.5280 |
| **2000** | 53.2 | 0.5720 |
| **2001** | 72.8 | 0.4180 |
| **2002** | 11.9 | 0.5530 |
| **2003*** | 1.6 | --- |

38. The following chart clearly illustrates the direct relationship (except for the year 2000) between Argentine exports and international cotton prices.




## III. LOSS OF PROTECTION UNDER THE PEACE CLAUSE: ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE (AOA)

39. As stated in paragraph 6 above, Argentina will address the inconsistency of the United States subsidies with Articles 5 and 6 of the SCM Agreement in the 22 September submission. On that occasion, Argentina will explain why the United States cannot seek the protection of Article 13 of the AoA because of non-compliance with the legal requirements for protection under that provision.

PEACE CLAUSE DEFENCE SUBJECT TO CONDITIONS

40. The "Peace Clause" – Article 13 of the AoA – precludes actions against a Member's agricultural subsidies up to 1 January 2004 if such measures comply with certain legal requirements.

41. As stated by Argentina in its Third Party Initial Brief:

> "… a textual analysis of Article 13 of the AoA reveals that *"actions"*… can only be precluded if all conditions established in paragraphs (b) (ii) or (c) (ii) of the referred Article 13 are met".[13] (Emphasis added).
>
> …
>
> " … *'Exempt from actions'* means that a finding of inconsistency with Article XV1 of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement will not be possible if the legal requirements for the exemption are fulfilled. The immediate context of the term *'exempt from actions'* – i.e., paragraphs (b) and (c) – confirms this interpretation since that exemption requires a particular threshold, i.e. that domestic support measures and export subsidies 'conform fully' (to different provisions of the AoA)".[14]
>
> …
>
> " … A different interpretation would imply giving the measures allegedly covered by the Peace Clause a character of absolute immunity, independent of whether the legal requirements established in Article 13 are fulfilled or not. This would contradict the principle of *in dubio mitius*, constituting a more onerous interpretation of the treaty provisions".[15]
>
> …
>
> " … Indeed, the key words in Article 13 (b) (ii) and (c) (ii) of the AoA are *"that conform fully"* and *"provided that"* and *"that conform fully"*, respectively. These words imply that the exception is not absolute, but rather subject to the fulfilment of certain conditions … ".[16]

BURDEN OF PROOF WITH RESPECT TO THE CONDITIONS FOR THE PEACE CLAUSE DEFENCE

42. As Argentina stated in its Third Party Initial Brief, the defence under Article 13 of the AoA is in the nature of an exception (affirmative defence).

43. It follows that in accordance with the WTO rules on the burden of proof (laid down by the Appellate Body in (*United States – Shirts and Blouses from India)*, the burden is on the party invoking the exception to show that its use is justified. In the present case, it is clearly for the party invoking the protection of Article 13 of the AoA to show that the conditions stipulated in that Article are satisfied.

44. Accordingly, for the United States domestic support measures to be exempt from actions based on Article XVI.1 of GATT 1994 or Articles 5 and 6 of the SCM Agreement, the United States must show that:

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[13] See Argentina's Third Party Initial Brief of 10 June 2003, paragraph 3.
[14] *Ibidem* paragraph 5.
[15] *Ibidem*, paragraph 6.
[16] *Ibidem*, paragraph 8.

- The domestic support measures for cotton conform fully to the provisions of Annex 2 to the AoA (or belong in the "green box", at the risk of being included in the Current Total AMS in accordance with Article 7.2 (a) of the AoA), or that

- the domestic support measures that do not belong in the "green box" and grant support to cotton do not exceed the support decided during the 1992 marketing year.

45. Likewise in order for the export subsidies granted by the United States to be exempt from actions based on Article XVI of GATT 1994 and Articles 3, 5 and 6 of the SCM Agreement the United States must show that these export subsidies conform fully to Articles 8 to 11 of the AoA (Part V).

III.1 LOSS OF PEACE CLAUSE PROTECTION IN RELATION TO DOMESTIC SUPPORT MEASURES: ARTICLE 13 (B) (II) OF THE AoA

46. In particular, in relation to domestic support measures, Article 13 (b) (ii) of the AoA states that:

> *"During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies … :*
>
> *… domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within de minimis levels and in conformity with paragraph 2 of Article 6, shall be:*
>
> …
>
> *exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; …" (emphasis added).*

47. In Argentina's opinion, in the present case, for lack of a specific WTO notification or known US laws or regulations, the support *"decided during the 1992 marketing year"* by the United States should be considered to be the non-"green box" domestic support granted by that country to cotton during the 1992 marketing year.

48. Argentina agrees with Brazil that the level of subsidies granted by the United States to its cotton sector during marketing years 1999 to 2002 exceeded that of 1992, thereby depriving the United States of Peace Clause protection, for non-compliance with the legal requirements of Article 13 (b) (ii) of the AoA.

49. In this respect, the Oxfam Briefing Paper ("*Cultivating Poverty*: The impact of USCotton Subsidies on Africa")[17] states that:

> *"The US has lost this protection (the Peace Clause protection) by virtue of the fact that* ***the level of subsidies it provided in 2001 was double that provided in 1992****".*
>
> …

[17] See Exhibit Bra – 15.

*"Every acre of cotton farmland in the US attracts a subsidy of $230, or around five times the transfer for cereals.* ***In 2001/02 farmers reaped a bumper harvest of subsidies amounting to $3.9bn – double the level in 1992.*** *This increase in subsidies is a breach of the "Peace Clause" in the WTO Agreement on Agriculture …"*

…

*"The United States accounts for approximately one-half of the world's production subsidies for cotton.* ***In 2001/02 the value of US cotton production amounted to $3bn at world market prices. In the same year, the value of outlays in the form of subsidies to cotton farmers by the USDA's Commodity Credit Corporation (CCC) was $3.9bn.*** *In other words, cotton was being produced at a net cost to the American economy".*

50. The domestic support measures which, in Argentina's view, do not enjoy Peace Clause protection under Article 13 (b) (ii) are the following programmes established in the United States legislation as described by Brazil in its First Submission: Deficiency Payments[18], Loan Deficiency Payments[19], Production Flexibility Contract Payments[20], Direct Payments[21], Market Loss Assistance[22], Counter-Cyclical Payments[23], Marketing Loan Gains[24], Crop Insurance Subsidies[25], Step 2 Domestic Payments[26], and Cottonseed Payments[27].

51. It should be pointed out that in the consultations held on 3, 4 and 19 December 2002 – in which Argentina was joined – in relation to the above-mentioned programmes Argentina requested the United States for information on the amount of support granted to cotton producers in the years 1999, 2000 and 2001, considering that the last domestic support notification had been for the year 1998[28].

52. In this connection, the United States confined itself to pointing out that various answers to the Argentine questions could be found in US domestic support notifications in the process of being submitted to the Committee on Agriculture, without specifying what these answers were or when these notifications would be made.

*The programmes Production Flexibility Contract (PFC), Direct Payment (DP) and Counter-Cyclical Payment (CCP) are non-"green box"*

53. As Brazil shows in its Submission, the PFC, DP and CCP programmes are not subsidies that can be classified as "domestic support measures that conform fully to the provisions of Annex 2" of the AoA.

54. Accordingly, the amounts granted to cotton producers under these programmes must be treated as domestic support in calculating total support under Article 13(b)(ii).

55. These three programmes are inconsistent with Annex 2 of the AoA, *inter alia*, because they are not in accordance with the provisions of paragraph 6 (b) of that Annex in as much as the amount of

[18] Submission by Brazil, paragraphs 45 to 47.
[19] *Ibidem*, paragraphs 70 to 78 and Exhibits Bra – 28, Bra – 29 and Bra – 36.
[20] *Ibidem*, Sections 2.6.1 and 3.2.6.
[21] *Ibidem*, Sections 2.6.2 and 3.2.7.
[22] *Ibidem*, Section 2.6.3.
[23] *Ibidem*, Sections 2.6.4 and 3.2.8.
[24] *Ibidem*, Section 2.6.5.
[25] *Ibidem*, Section 2.6.6
[26] *Ibidem*, Section 2.6.8
[27] *Ibidem*, Section 2.6.10.
[28] It should be noted that after the consultations the United States notified the Committee on Agriculture of the amount of domestic support for the year 1999 (G/AG/N/USA/43; Exhibit Bra – 47).

payments is related with the type of production undertaken by the producer in years after the base period.

56. In this respect, Argentina agrees with Brazil that the term "type … of production …" means the type of crop planted and not the production method employed.

*Failure of the United States to comply with its notification obligations*

57. Considering (i) that the last domestic support notification available is that for the year 1999[29] and (ii) the delay of more than three years, since the end of that year, in submitting a notification, Argentina wishes to make the following points:

58. Argentina considers that the United States has failed to fulfil its notification obligations under Article 18.2 of the AoA, the Decision on Notification Procedures adopted on 15 December 1993 and the Notification Requirements and Formats (G/AG/2) adopted by the Committee on Agriculture on 8 June 1995.

59. This failure to comply with notification obligations makes it very difficult to verify the domestic support provided from 2000 onwards as regards compliance with the commitments under Article 3.2 of the AoA, that is to say, whether or not the United States' non-"green box" subsidy programmes remain within the limits to which it is committed in its Schedule. The lack of notification also makes it difficult to verify whether the domestic support measures "conform fully to Article 6" of the AoA.

60. It is also difficult to review the implementation of the AoA by the United States under Article 18.2 in relation to the categorization of its subsidies, in particular whether some of them are "green box" or not.

61. The seriousness of failure to comply with the obligation to inform Members is such that paragraph 7 of Annex V to the SCM Agreement actually sanctions instances of non-cooperation by requiring the Panel to draw adverse inferences.

62. Argentina considers that this failure should be taken into account in deciding whether the United States' domestic support is consistent with Article 3.2 of the AoA and whether that domestic support should be included among the subsidies of Annex II to the Agreement.

THE US LEVELS OF DOMESTIC SUPPORT FOR COTTON EXCEED THE 1992 LEVEL

63. Argentina agrees with Brazil's figures in paragraphs 144, 148 and 149 of its First Submission showing that the United States budgetary outlays for domestic support for the cotton sector have been as follows (in millions of dollars), on the basis of information supplied by the USDA itself[30]:

[29] G/AG/N/USA/43 (Exhibit Bra-47).
[30] See Exhibits Bra-6, Bra-76, Bra-4, Bra-57, Bra-55, Bra-47, and footnotes 301 and 321.

| Domestic Support | Marketing Year 1992 | Marketing Year 1999 | Marketing Year 2000 | Marketing Year 2001 | Marketing Year 2002* |
|---|---|---|---|---|---|
| **Loan Deficiency Payments** | 268 | 685 | 152 | 743 | 206[31] |
| **Marketing Loan Gains** | 476 | 860 | 390 | 1.763 | 602[32] |
| **(Total Marketing Loan Payments)** | --- | --- | --- | --- | 952[33] |
| **Deficiency Payments** | 1,017 | --- | --- | --- | --- |
| **Production Flexibility Contract Payments[34]** | --- | 616 | 575 | 474 | --- |
| **Direct Payments[35]** | --- | --- | --- | --- | 523 |
| **Step 2 Payments** | 207 | 422 | 236 | 196 | 317 |
| **Crop Insurance Payments** | 26.5 | 170 | 161 | 263 | 194 |
| **Market Loss Assistance Payments** | --- | 613 | 612 | 654 | --- |
| **Counter-Cyclical Payments[36]** | --- | --- | --- | --- | 1,077 |
| **Cottonseed Payments** | --- | 79 | 185 | --- | 50 |
| **TOTAL** | **1,994.5** | **3,445** | **2,311** | **4,093** | **3,113** |

* The information relating to United States support for cotton during marketing year 2002 is not yet complete as the marketing year does not end until 31 July 2003. Nevertheless, Argentina has used the best available evidence provided by Brazil in paragraph 149 of its Submission using partial USDA data and estimates based on criteria and provisions of support under the 1996 FAIR Act.

64. Thus, the subsidy levels for cotton in 1999, 2000, 2001 and 2002 are considerably in excess of the level for 1992 and, as already pointed out, the United States therefore lacks a basis for its claim,

[31] See Exhibit Bra-55.
[32] See Exhibit Bra-55.
[33] See footnote 338 of Brazil's Submission.
[34] According to paragraph 45 of Brazil's Submission, PFC payments replaced the Deficiency Payment Programme that had existed for years and had been renewed in the 1990 FACT Act.
[35] As indicated by Brazil in paragraph 49 of its Submission, direct payments began to be paid in marketing year 2002 with the passage of the new Farm Act in May 2002 (2002 FSRI Act) and will be paid until the end of marketing year 2007, in place of the Production Flexibility Contract payments.
[36] As indicated by Brazil in paragraph 63 of its Submission, the 2002 Farm Act (2002 FSRI Act) institutionalized the market loss assistance payments that the United States enacted in marketing years 1998- 2001 with a new programme of counter-cyclical payments up to the end of marketing year 2007.

under Article 13(b)(ii) of the AoA, that its domestic support measures for cotton are exempt from actions based on Article XVI.1 of GATT 1994 or Articles 5 and 6 of the SCM Agreement.

III.2 LOSS OF PEACE CLAUSE PROTECTION IN RELATION TO EXPORT SUBSIDIES: ARTICLE 13(c)(ii) OF THE AoA

65. With respect to export subsidies, Article 13(c)(ii) of the AoA states that:

> *"During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies … :*
>
> …
>
> *export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be:*
>
> …
>
> *exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement".* (Emphasis added).

66. In relation to export subsidies, the Peace Clause could only be invoked by the United States if its export subsidies conformed fully to the provisions of Part V of the AoA, that is, Articles 8-11 of the AoA.

67. According to Article 8 of the AoA, "Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule".

68. Thus, as Brazil asserts in paragraph 222 of its Submission, the United States can provide export subsidies for agricultural products if it satisfies two conditions: (i) has a reduction commitment for the product in question and (ii) the amount of export subsidies provided does not exceed this reduction commitment.

69. In this case, the measures that Argentina considers to be inconsistent with WTO rules are:

I. the export subsidies for US (upland) cotton established in the United States legislation under the Step 2 Export Program[37];

II. the export credit guarantee programmes for cotton and other products, General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103), and Supplied Credit Guarantee Programme (SCGP), as described by Brazil in its First Submission[38]; and

III. the cotton export subsidies granted under the FSC Repeal and Extraterritorial Income Act of 2000(ETI Act).

[37] CFR 1427.103 to 1427.107.
[38] Submission by Brazil, sections 2.6.7, 4.1 and 4.1.1 and 2.6.9.

*Inconsistency with the provisions of Part V (Articles 8 to 11) of the AoA*

70. Article 3.3 of the AoA prohibits the granting of export subsidies in respect of agricultural products not specified in Section II of Part IV of a Member's Schedule[39]. This provision forms part of the reference to "unconformity with this Agreement and with the commitments as specified in that Member's Schedule" in Article 8 of the AoA.[40]

71. In fact, Schedule XX of the United States, Part IV (Agricultural Products: Commitments Limiting Subsidization), Section II (Export Subsidies: Budgetary Outlay and Quantity Reduction Commitments)[41], **does not specify cotton among the products subject to commitments**.

72. Consequently, because its export subsidies are not in conformity with the provisions of Part V of the AoA, the United States has no basis for invoking, under Article 13 (c) (ii) of the AoA, the exception to the effect that its cotton export subsidies are exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement.

73. Moreover, as described in Section IV of this submission, neither the US (upland) cotton export subsidies established in the United States legislation under the Step 2 Export programme, nor the export credit guarantee programmes for cotton and other products General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103) and Supplied Guarantee Programme (SCG), nor the subsidies granted to cotton exports under the FSC Repeal and Extraterritorial Income Act of 2000 (ETI Act) are in conformity with Part V of the AoA since they are inconsistent with Articles 3.3, 8 and 10.1 of the AoA.

## IV. INCONSISTENCY WITH ARTICLES 3.3, 8 AND 10.1 OF THE AoA AND ARTICLE 3 OF THE SCM AGREEMENT

74. In accordance with paragraph 7 above, Argentina maintains that the United States cotton export subsidies are inconsistent with Articles 3.3, 8 and 10.1 of the AoA.

75. As already pointed out, Schedule XX of the United States, Part IV (Agricultural Products: Commitments Limiting Subsidization), Section II (Export Subsidies: Budgetary Outlay and Quantity Reduction Commitments)[42], **does not specify cotton among the products subject to commitments**.

76. Consequently, as noted by Brazil in paragraph 237 of its Submission, any export subsidy provided by the United States to its cotton industry will be inconsistent with Articles 3.3 and 8 of the AoA. In other words, as it has not specified cotton as a product subject to subsidy reduction commitments, the United States has no right to grant this type of support for the product in question, any support granted or proposed constituting a breach of the provisions of Articles 3.3 and 8 of the AoA:

[39] Article 3.3 of the AoA reads as follows: *"…a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule"*. (Emphasis added).

[40] Article 8 of the AoA reads as follows:

*"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule"*.

[41] See Exhibit Bra-83.

[42] See Exhibit Bra-83.

ARTICLE 10.3 OF THE AoA

77. Argentina wishes to point out that, in accordance with Article 10.3 of the AoA and the Appellate Body's interpretation in "*Canada - Dairy Products: Article 21.5 DSU (II)*[43]", it is for the United States to show that quantities exported in excess of the export subsidy reduction commitment level have not been subsidized.

78. Figures 18 and 19 in paragraphs 265 and 266 of Brazil's submission clearly indicate that in the case of both cotton and other agricultural commodities exports of which qualify for the export credit guarantee programmes GSM 102, GSM 103 and SCGP United States exports during the year 2001 were well in excess of the reduction commitments in its Schedule.

79. Consequently, the United States bears the burden of proving that both for cotton and for other products that benefit from export credit guarantee programmes the export segment in excess of the scheduled reduction commitment has not received any export subsidy.

THE INDIVIDUAL EXPORT SUBSIDY PROGRAMMES

- *Step 2 Export Programme*

80. Referring to Brazil's observations in paragraphs 244 and 245 of its Submission, Argentina agrees that Section 1207(a) of the Farm Act of 2002 (*2002 FSRI Act*)[44] – establishing the *Step 2 Export Programme* – constitutes a *per se* violation of AoA Articles 3.3 and 8 as it is a mandatory provision, in the same way that the *Step 2 Export Programme* also constitutes a *per se* violation of those provisions because of its mandatory nature.

81. Both the corresponding section of the 2002 FSRI Act and the provisions of Section 1427.100 ff. of the *Code of Federal Regulations* clearly establish that the *Commodity Credit Corporation* (CCC) *must* issue marketing certificates or cash payments to exporters and/or users of US (upland) cotton.

82. The purpose of the programme is to provide a direct incentive for US cotton exports and consists of a direct payment to exporters based on the difference between the US domestic cotton price and the world market price. There can be no doubt that whenever the former is higher than the latter an export subsidy is present in as much as the existence of these payments enables the US product to compete artificially with the lower-cost products of more efficient producers. All these aspects are dealt with *in extenso* by Brazil in its Submission dated 24 June 2003[45], and Argentina therefore considers it unnecessary to dwell on a description of the operational details of the programme itself.

83. What Argentina wishes to make clear is the fact – to which attention has already been drawn by Brazil – that the programme known as *Step 2* establishes the right of exporters to receive a subsidy for shipments made in connection with foreign sale operations, while establishing an obligation upon the CCC to grant that subsidy once the particular requirements are satisfied.

84. In "*US EXPORT CREDITS: Denials and Double Standards*"[46], published by Oxfam America, it is noted that:

> *"In the case of cotton, developing countries are clearly losing out because of the unfair competitive advantage given to US cotton exports. For the marketing year*

[43] WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted17 January 2003.
[44] See Exhibit Bra-29.
[45] Submission by Brazil, Sections 4.1, 4.1.1, 4.1.2, 4.2 ff.
[46] Oxfam American Briefing Note, March 2003.

> *2001/2002, US subsidies to cotton amounted to $4 billion, including, among other programs, export credits. In the 2001/2002 marketing year, the transfer linked with Step 2 cotton subsidies ranged from 0-7 cents per pound, or up to 18 per cent of the world market price. Total export subsidization under this heading was around $197 million in 2001".*

85. Insofar as the United States does not specify Upland Cotton in its Schedule of Commitments (see paragraphs 72 and 75 above) and this type of subsidy is granted to cotton under the *Step 2* programme, any provision in the legal texts with respect to the granting of such a subsidy makes those texts inconsistent *per se* with Articles 3.3 and 8 of the AoA, while for the same reason any sum distributed, budgeted or provided for under this programme constitutes a prohibited subsidy within the meaning of Article 3 of the SCM Agreement, which expressly establishes a reservation in respect of the Agreement on Agriculture.

- *The programmes GSM 102, GSM 103 and SCGP:*

86. In its submission of 24 June, Brazil establishes unequivocally that the US export credit guarantee programmes constitute export subsidies. For this purpose Brazil carries out a combined analysis of the provisions of the AoA and the SCM Agreement, while also basing its arguments on the relevant WTO case-law[47].

87. Argentina agrees with the Brazilian analysis and therefore considers it unnecessary to repeat the description of the operational programmes or the analysis of their legal coverage under the Agreement on Agriculture and the SCM Agreement. Suffice it to note that Argentina also considers that these programmes constitute export subsidies under item (j) of the Illustrative List in Annex I to the SCM Agreement – in as much as the export credit guarantees are granted "*at premium rates which are inadequate to cover the long term operating costs and losses of the programmes*" – thereby resulting in a violation of the provisions of Article 10.1 of the AoA.

88. At the same time, Argentina wishes to emphasize the impact and distorting effect on trade of these export credit guarantees.

89. The export credit guarantee programmes provide incentives for exports for United States agricultural products, in this case cotton and other agricultural products, and the credits are granted on terms more favourable than those available on the market. This situation is clearly reflected in paragraphs 275 to 286 of Brazil's First Written Submission and further illustrated by the Oxfam study "*US EXPORT CREDITS: Denials and Double Standards*"[48] which on page 3 states:

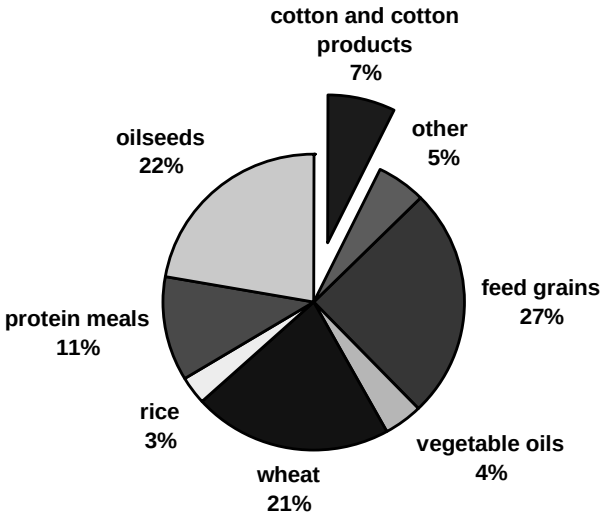
> *" … those favourable conditions include lower interest rates, a longer loan repayment period, a smaller down payment, less frequent payments per year and/or the virtual waiver of a fee or premium designed to provide the US government with adequate protection against potential defaults".*

90. Likewise, a study carried out by the OECD in 2000, in which the effects of export subsidies granted by various countries are evaluated, indicates that the United States credit guarantee programmes are the most trade-distorting of all those analyzed, in as much as the premiums paid by the beneficiaries are too low to cover the high level of the guarantees granted for long term credits.[49]

[47] Submission by Brazil, Section 4.2.1.4.2.
[48] Oxfam America Briefing Note, March 2003.
[49] "An analysis of officially supported export credits in agriculture", OECD, 2000.

91. According to the "*Summary of FY 2002 Export Credit Guarantee Programme Activity*", published on the Federal Agricultural Service (FAS) Website[50], the percent shares of export credit guarantee applications, by commodity, for fiscal year 2002 were as follows:

**Applications for export credit guarantees, by commodity,**
**Fiscal year 2002, Percent share**




92. Thus, as the United States does not have export subsidy reduction commitments specified in its Schedule for cotton and other products such as soya, maize (corn) and oilseeds and given the existence of United States export subsidies for cotton and other products, the United States is in violation of Articles 3.3, 8 and 10.1 of the Agreement on Agriculture.

93. Finally, it should be noted that the GSM 102, GSM 103 and SCGP programmes can be granted both to products for which reduction commitments exist and to those for which no such commitments exist[51]. With the respect to the products for which there are reduction commitments, the amounts exported by the United States are well in excess of the levels of those commitments.[52] Accordingly, Argentina considers – as indicated by Brazil[53]- that the burden lies with the United States to prove that its excess exports did not benefit from export subsidies, including export credit guarantees.

94. Moreover, since the GSM 102, GSM 103 and SCGP programmes are intended to promote exports of cotton, confirmation of their export subsidy component would imply the presence of a subsidy prohibited within the meaning of Article 3.1 (a) of the SCM Agreement and a violation of Article 10.1 of the AoA –

[50] "US EXPORT CREDITS: Denials and Double Standards", Oxfam America Briefing Note, March 2003.
[51] See Exhibit Bra-84, pages 9, 12 and 17, and Exhibit Bra-73.
[52] Submission by Brazil, paragraphs 265 and 266.
[53] Submission by Brazil, paragraph 268.

- *ETI ACT*

95. With respect to the export subsidies granted to cotton under the ETI Act, which provides tax exemptions for US exporters who sell products outside the United States, Argentina refers to the fact that this Act was declared inconsistent with Article 3.1 (a) of the SCM Agreement and Articles 10.1 and 8 of the AoA in the "*United States - FSC*[54]" dispute.

## V. CONCLUSION

96. For the above reasons Argentina considers that both the domestic support measures and the export subsidies granted by the United States to its cotton sector and called into question in these proceedings do not qualify for the protection provided under Article 13, paragraphs (b) (ii) and (c) (ii) of the Agreement on Agriculture.

97. Furthermore, the export subsidies for cotton and other products provided for in the United States legislation in the form of export credit guarantees (GSM 102, GSM 103, and SCGP) are likewise not protected by Article 13 (c) (ii).

98. Argentina also maintains that the subsidies for cotton exports provided for in the United States legislation are inconsistent with Articles 3.3, 8 and 10.1 of the Agreement on Agriculture.

[54] WT/DS108/AB/R adopted on 20 March 2000.

# ANNEX B-4

## AUSTRALIA'S THIRD PARTY SUBMISSION

### TABLE OF CONTENTS

## I. INTRODUCTION

1. Australia welcomes the opportunity to present its views in this proceeding on US subsidies for upland cotton.

2. Australia notes that this dispute is the first to involve the interpretation and application of Article 13 of the *Agreement on Agriculture* (AA), the so-called "peace clause". As such, this dispute has particular systemic as well as commercial significance.

3. In this third party Submission, Australia addresses:

I. the nature of AA Article 13 as an affirmative defence, and the meaning of Article 13(b)(ii);

II. whether "production flexibility contract payments" and their successor "direct payments" may be claimed as "green box" support within the meaning of AA Annex 2;

III. whether s.1207(a) of the Farm Security and Rural Investment Act of 2002 ("the FSRI Act") mandating payments to exporters of US cotton ("Step 2" export payments) is inconsistent with AA Articles 3.3 and 8 and thus is also inconsistent with Article 3 of the *Agreement on Subsidies and Countervailing Measures* (the *SCM Agreement*); and

IV. whether s.1207(a) of the FSRI Act mandating payments to domestic users of US cotton ("Step 2" domestic payments) is inconsistent with Article 3 of the *SCM Agreement*.

4. Because of the very limited time that has been available to consider the First Written Submission of the United States, Australia will address issues raised in that Submission in its oral statement before the Panel.

## II. ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE

### A. AA ARTICLE 13 IS IN THE NATURE OF AN AFFIRMATIVE DEFENCE AND THE UNITED STATES HAS THE BURDEN OF PROOF

5. Australia agrees with Brazil that AA Article 13 is in the nature of an affirmative defence and that the United States has the burden of proof on the question of whether the measures at issue fully conform with the applicable conditions of Article 13.

6. Like Article XX of the *General Agreement on Tariffs and Trade* ("GATT"), AA Article 13 "does not establish any 'positive obligations' relevant to determining the proper scope of the obligations under *[the specified provisions of GATT 1994 and the SCM Agreement]*. Instead, it sets out circumstances in which Members are entitled to 'adopt or maintain' measures that are inconsistent with the obligations imposed under other provisions of *[the GATT 1994 and the SCM Agreement]*".[1]

7. AA Article 13 does not of itself impose any obligation on a Member granting domestic support measures falling within Annex 2 or Article 6 or granting export subsidies falling within Part V of the *Agreement on Agriculture*.

[1] *United States – Tax Treatment for "Foreign Sales Corporations"*, Recourse to Article 21.5 of the DSU by the European Communities, Report of the Appellate Body, WT/DS108/AB/RW, paragraph 127.

8. Instead, AA Article 13 sets out the circumstances in which Members will be immune, either wholly or partially, from the consequences of granting domestic support measures or export subsidies that otherwise constitute grounds for a claim of infringement of the obligations contained in the provisions of GATT 1994 and the *SCM Agreement* specified in that Article. Thus, for example, under AA Article 13(b)(ii), "domestic support measures that conform fully to the provisions of Article 6 of *[the Agreement on Agriculture]* … shall be: … exempt from actions based on" the specified provisions of GATT 1994 and the *SCM Agreement*, "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year".

9. The nature of AA Article 13 as an affirmative defence is confirmed by an examination of the protection afforded by Article 13.

10. Under AA Article 13(a)(i), domestic support measures that conform fully to the provisions of AA Annex 2 "shall be non-actionable subsidies for purposes of countervailing duties". Under AA Article 13(b)(i), domestic support measures that conform fully to AA Article 6 shall be "exempt from the imposition of countervailing duties unless …". Under AA Article 13(c)(i), export subsidies that conform fully to the provisions of AA Part V shall be "subject to countervailing duties only upon a determination of …".

11. Under the other provisions of AA Article 13, domestic support measures or export subsidies that conform fully with the prescribed conditions "shall be exempt from actions based on …" the specified provisions of GATT 1994 and the *SCM Agreement*. If domestic support measures or export subsidies infringe the relevant provisions specified in Article 13, they are nevertheless "free or released from a duty or liability to which others are held"[2] in relation to a proceeding[3] "found[ed], buil[t] or construct[ed] on"[4] those provisions, as long as the measures meet the relevant conditions specified in Article 13.

12. Thus, the protection afforded by AA Article 13 becomes available only in circumstances where the domestic support measures or export subsidies at issue have been found:

V. to be actionable subsidies, or to be otherwise countervailable, under Article 13(a)(i), 13(b)(i) or 13(c)(i); or

VI. in all other cases, to be inconsistent with the relevant specified provisions of GATT 1994 and/or the *SCM Agreement*;

and if the applicable conditions for the availability of that protection as specified in Article 13 are met.

13. Further, had the negotiators of the *Agreement on Agriculture* intended that AA Article 13 should mean that a Member would not be liable to a legal process of dispute, it is reasonable to assume that they would have said so. For example, the negotiators could have provided that the specified provisions of GATT and the *SCM Agreement* could not be "invoked", as they did in footnote 35 to Article 10 of the *SCM Agreement* in relation to non-actionable subsidy measures.

[2] *Black's Law Dictionary*, Seventh Edition, Bryan A Garner, Editor in Chief, West Group, St Paul, Minn., 1999, page 593.

[3] *Black's Law Dictionary*, page 593, defines "action" as "1. The process of doing something; conduct of behaviour. 2. A thing done; act. 3. A civil or criminal judicial proceeding."

[4] *The New Shorter Oxford English Dictionary*, Ed. Lesley Brown, Volume 1, Clarendon Press, Oxford, 1993, page 187.

14. The Appellate Body has previously clarified that "the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence"[5], and that "[i]t is only reasonable that the burden of establishing *[an affirmative defence]* should rest on the party asserting it".[6]

15. Thus, in order to qualify for the protection afforded by AA Article 13, the United States must prove that the measures at issue conform fully to the applicable provisions of the *Agreement on Agriculture*. Further, in the case of the protection potentially afforded by Article 13(b)(ii), as well as by Article 13(b)(iii), the United States must prove that it has not granted, and does not grant, support to a specific commodity in excess of that decided during the 1992 marketing year.

## B. THE MEANING OF AA ARTICLE 13(B)(II)[7]

16. In its First Written Submission, Brazil correctly highlights that there are a number of interpretative issues raised by the text of AA Article 13(b)(ii).[8]

### (i) "Implementation period"

17. Under AA Article 1(f) and 1(i) read together, the "implementation period" is, for the purposes of Article 13, defined as the nine-year period commencing in 1995 according to the calendar, financial or marketing year specified in the Schedule relating to that Member.

### (ii) "Domestic support measures that conform fully to the provisions of *[AA]* Article 6"

18. Australia supports Brazil's interpretation that the chapeau of AA Article 13(b) includes all non-"green box" domestic support measures, including product specific and non-product specific, *de minimis* and production-limiting domestic support, as well as investment subsidies and "diversification" support in developing countries.[9]

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[5] *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, Report of the Appellate Body, WT/DS33/AB/R, page 14.

[6] *United States – Woven Wool Shirts and Blouses* , WT/DS33/AB/R, page 16.

[7] Article 13(b)(ii) of the *Agreement on Agriculture* provides as follows:

> During the implementation period, notwithstanding the provisions of GATT 1994 and *[the SCM Agreement]*:
>
> …
>
> (b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:
>
> …
>
> (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the *[SCM Agreement]*, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and
>
> …

[8] First Submission of Brazil, paragraph 127.

[9] First Submission of Brazil, paragraph 133.

(iii) "Exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the *[SCM Agreement]*"

19. As noted in Section II.A above, if domestic support measures within the scope of the chapeau of AA Article 13(b) infringe the specified provisions, they are nevertheless "free or released from a duty or liability to which others are held"[10] in relation to a proceeding[11] "found[ed], buil[t] or construct[ed] on"[12] those provisions as long as the conditions specified in Article 13 are met. Again, had the negotiators of the *Agreement on Agriculture* intended that a Member would not be liable to a legal process of dispute, it is reasonable to assume that they would have said so, for example, by providing that the specified provisions may not be "invoked" as in footnote 35 to Article 10 of the SCM Agreement in relation to non-actionable subsidy measures.

20. Australia notes, however, that only actions based on paragraph 1 of GATT Article XVI and Articles 5 and 6 of the SCM Agreement are covered under AA Article 13(b)(ii). Thus, for example, any actions based on paragraph 3 of GATT Article XVI or on SCM Article 3 would not benefit from the protection afforded by AA Article 13(b)(ii). In Australia's view, the limitation of protection under Article 13(b)(ii) to actions based on GATT Article XVI:1 and on SCM Articles 5 and 6 is consistent with the object and purpose of the *Agreement on Agriculture* as expressed in the preamble to the Agreement, including to "[prevent] … distortions in world agricultural markets" and "to [achieve] specific binding commitments in … export competition". The attainment of those objectives would be too easily subverted if commitments in regard to export subsidies could be circumvented through the provision of domestic support.

(iv) "Such measures"

21. In Australia's view, the phrase "such measures" in AA Article 13(b)(ii) refers to the universe of non-"green box" measures covered by the chapeau of Article 13(b), consistent with the ordinary meaning of "such" as "of the kind, degree, or category previously specified or implied contextually".[13]

(v) "Grant support"

22. In Australia's view, having regard to the ordinary meaning of the words in their context and in light of the object and purpose of the *Agreement on Agriculture*, "support" means the actual support, other than legitimate "green box" support, provided to an agricultural product. Thus, to "grant support" is to "agree to", "promise", "bestow", "allow", "give", "confer" or "transfer"[14] non-"green box" domestic support of the type referred to in the chapeau of AA Article 13(b), which calculation must include that portion of non-product specific support that benefits the specific commodity at issue.

(vi) "To a specific commodity"

23. Australia agrees with Brazil's interpretation[15] that the ordinary meaning of this phrase, read in its context and in light of the object and purpose of the *Agreement on Agriculture*, is support granted

[10] *Black's Law Dictionary*, page 593.
[11] *Black's Law Dictionary*, page 28, defines "action" as "1. The process of doing something; conduct of behaviour. 2. A thing done; act. 3. A civil or criminal judicial proceeding."
[12] *The New Shorter Oxford English Dictionary*, Volume 1, page 187.
[13] *The New Shorter Oxford English Dictionary*. Volume II, page 3129.
[14] *The New Shorter Oxford English Dictionary*. Volume I, page 1131.
[15] First Submission of Brazil, paragraph 136.

to an individual agricultural commodity covered by AA Annex 1, such as upland cotton, whether through product specific, or non-product specific, support.

(vii) "That decided during the 1992 marketing year"

24. In Australia's view, this phrase, read in its context and in light of the object and purpose of the *Agreement on Agriculture*, means the level of non-"green box" domestic support, including support provided through non-product specific non-"green box" domestic support measures, "decided" by a Member in the course of the 1992 marketing year to be provided to the benefit of a specific agricultural commodity in the future.

25. The use of the word "decided" in this context was deliberate.

26. Australia notes that the other operative provision of the *Agreement on Agriculture* in which the word "decided" is used is Article 13(b)(iii), which relates to non-violation nullification or impairment actions. Australia notes too that Article 13(b)(iii) contains precisely the same language – "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" – as used in Article 13(b)(ii). Thus, the meaning of the word "decided" in the context of Article 13(b)(ii) must be capable of having that same meaning in the context of non-violation nullification and impairment actions under Article 13(b)(iii).

(viii) Summary of the meaning of AA Article 13(b)(ii)

27. During the nine calendar, financial or marketing year period specified in a Member's Schedule period commencing in 1995, all non-"green box" domestic support measures that conform fully to the provisions of AA Article 6 are immune from the consequences of infringing GATT Article XVI:1 or Part V of the SCM Agreement, provided that the level of support to an individual commodity does not exceed the level of support for that commodity that was decided by the Member to be made available during the relevant 1992 marketing year.

## III. "PRODUCTION FLEXIBILITY CONTRACT PAYMENTS" AND "DIRECT PAYMENTS" MAY NOT BE CLAIMED AS "GREEN BOX" MEASURES UNDER ANNEX 2 TO THE AGREEMENT ON AGRICULTURE

28. The United States has previously notified "Production Flexibility Contract (PFC) Payments"[16] as AA Annex 2 "green box" measures.[17] The United States has not made a domestic support notification since PFC payments were replaced by "Direct Payments" (DP)[18] under the 2002 FSRI Act. Like Brazil[19], Australia considers that neither of these payments programs may be claimed as "green box" measures for the reasons outlined below.

### A. THE RELEVANT REQUIREMENTS OF PARAGRAPHS 1 AND 6(B) OF AA ANNEX 2

29. AA Annex 2.1 provides that "[d]omestic support measures for which exemption from reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production".

[16] "Production Flexibility Contract Payments" are described at Section 2.6.1 of the First Submission of Brazil.

[17] See, for example, WTO document G/AG/N/USA/43 of 5 February 2003, page 8, Exhibit Bra-47.

[18] "Direct Payments" are described at Section 2.6.2 of the First Submission of Brazil.

[19] First Submission of Brazil, Sections 3.2.6 and 3.2.7.

30. In addition, in relation to decoupled income support, AA Annex 2.6(b) provides that "[t]he amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period".

(i) "No, or at most minimal, trade-distorting effects or effects on production"

31. In requiring that domestic support measures "shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production", AA Annex 2.1 imposes a stringent standard. Annex 2.1 requires that such measures must, as a primary or essential condition, not "bias" or "unnaturally alter"[20] trade or production. Alternatively, Annex 2.1 requires that, at most, such measures must have "extremely small; of a minimum amount, quantity or degree; very slight, negligible"[21] effects on trade or production.

32. In Australia's view, this standard cannot be met if the domestic support measure at issue directly and specifically stimulates production and/or trade of a particular commodity, or if that support measure directly retards or halts the transfer of economic resources to other forms of economic activity, other than as specifically provided for under paragraphs 2-13 of AA Annex 2. If a domestic support measure results in a level of production and/or trade in a particular product or group of products higher than would otherwise be the case except as specifically provided for in Annex 2, the support measure cannot meet the standard established in Annex 2.1. Thus, if the direct effect of a support measure is that farmers keep producing, or keep producing a particular product, in circumstances that would be uneconomic but for the support measure, that measure cannot meet the requirements of Annex 2.1.

(ii) "The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period"

33. Paragraph 6 of AA Annex 2 is headed "decoupled income support". Paragraph 6(a) provides that "[e]ligibility for *[decoupled income support]* payments shall be determined by clearly defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period". Thus, consistent with the customary rules of interpretation codified at Article 31 of the *Vienna Convention on the Law of Treaties*, "after the base period" in paragraph 6(b) means after the base period defined and fixed pursuant to paragraph 6(a).

34. Accordingly, the meaning of paragraph 6(b) of AA Annex 2 is clear. Once a base period has been defined and fixed pursuant to paragraph 6(a), decoupled income support payments may not be "connected"[22] to or "found[ed], buil[t] or construct[ed] on"[23] the type of production or the volume of production undertaken by a producer in a later period.

[20] *The New Shorter Oxford English Dictionary*. Volume I, page 707.
[21] *The New Shorter Oxford English Dictionary*. Volume I, page 1781.
[22] *The New Shorter Oxford English Dictionary*. Volume II, page 2534.
[23] *The New Shorter Oxford English Dictionary*, Volume 1, page 187.

B. "PRODUCTION FLEXIBILITY CONTRACT (PFC) PAYMENTS" COULD NOT BE CLAIMED AS "GREEN BOX" PAYMENTS

(i) PFC payments had more than a negligible trade-distorting effect or effect on production, contrary to paragraph 1 of AA Annex 2$

35. Like Brazil, Australia considers that PFC payments directly stimulated, and stimulated by more than a negligible amount, US production of, and trade in, upland cotton and Australia endorses Brazil's arguments in this respect.[24]

36. Further, the value of PFC payments rates as a proportion of the marketing year average farm price received by US upland cotton growers can be seen from data published by the United States Department of Agriculture (USDA) and included in Table 1 below.

*Table 1: The value of PFC payments as a percentage proportion of the marketing year average farm price received by US upland cotton growers*

| *Marketing or Crop Year* | *Production flexibility contract (PFC) payment rates US¢/lb.*[25] | *Average farm price US¢/lb.*[26] | *PFC payment rates as a proportion of the marketing year average farm price %* |
|---|---|---|---|
| 1996/97 | 8.882 | 69.3 | 12.82 |
| 1997/98 | 7.625 | 65.2 | 11.69 |
| 1998/99 | 8.173 | 60.2 | 13.58 |
| 1999/2000 | 7.990 | 45.0 | 17.76 |
| 2000/01 | 7.330 | 49.8 | 14.72 |
| 2001/02 | 5.990 | 29.8 | 20.10 |

37. In addition, data published by the USDA for this period show that PFC payments constituted 26.37%, 36.5% and 22.90% of government payments by crop year for the 1999, 2000 and 2001 years respectively.[27]

38. PFC payments constituting such high proportions of the marketing year average farm prices and of domestic support measures must have a production and trade-distorting effect.

39. But this view is further confirmed when the marketing year average farm prices as shown in Table 1 are considered against the fact that in 1997 the average of total economic costs for all US cotton farms was approximately 73 cents per pound and operating costs averaged 38 cents per pound[28]. In such circumstances, economically rational producers should have begun to transfer resources to other forms of economic activity. This did not happen. USDA data shows that the area planted to cotton in the United States over this period increased, from 13.1 million acres in 1998 to 15.5 million acres in 2001.[29] It is clear that many US producers of upland cotton could only have

[24] First Submission of Brazil, Section 3.2.6.2.

[25] Figures extracted from *Agricultural Outlook*, USDA, May 2000 and May 2002, Table 19, available at http://www.ers.usda.gov/publications/agoutlook/may2000/ao271k.pdf and http://www.ers.usda.gov/publications/agoutlook/May2002/ao291j.pdf respectively.

[26] . *Fact Sheet: Upland Cotton: Summary of 2002 Commodity Loan and Payment Program*, USDA, January 2003, page 5, Exhibit Bra-4.

[27] *Fact Sheet: Upland Cotton*, page 6, Exhibit Bra-4.

[28] *Cotton: Background and Issues for Farm Legislation*, USDA, July 2001, page 6, Exhibit Bra-46.

[29] *Fact Sheet: Upland Cotton*, page 4, Exhibit Bra-4.

remained viable over this period through subsidisation. Further, US exports of upland cotton increased from 4.1 million bales in 1998 to 10.6 million bales in 2001.[30]

40. In Australia's view, PFC payments during this period contributed directly to increased production and export levels and that they did so contrary to the express requirement of AA Annex 2.1 that the domestic support measures at issue not, or only negligibly, bias or unnaturally alter trade or production.

(ii) PFC payments were related to the type of production undertaken by the producer, contrary to paragraph 6(b) of AA Annex 2

41. By excluding fruits and vegetables (other than lentils, mung beans, and dry peas) from the planting flexibility otherwise available in respect of the contract acreage for which PFC payments could be made, s.118 of the Federal Agriculture Improvement and Reform Act of 1996 (the FAIR Act) related, or connected, PFC payments to the type of production undertaken by the producer in any year after the base period, contrary to the requirements of AA Annex 2.6(a).

C. "DIRECT PAYMENTS" FOR UPLAND COTTON MAY NOT BE CLAIMED AS "GREEN BOX" PAYMENTS

(i) Direct payments are likely to have more than a negligible trade-distorting effect or effect on production, contrary to paragraph 1 of AA Annex 2

42. Australia considers that direct payments for upland cotton are likely to stimulate, by more than a negligible amount, US production of, and trade in, upland cotton. The 2002 FSRI Act has established a direct payment rate for upland cotton of 6.67 cents per pound for each of the 2002 through 2007 crop years.

43. In addition to the arguments put forward by Brazil[31], which Australia endorses, Australia considers that, so long as there is a reasonable possibility of continuing and significant longer-term volatility in the gross returns to producers (as measured by the marketing year average farm price), the assured availability of a direct payment for upland cotton at the rate of 6.67 cents per pound must be presumed to influence directly and specifically the decisions of growers to continue producing upland cotton, notwithstanding significant peaks and troughs in their income, rather than to transfer resources to other forms of economic activity.

(ii) Direct payments are related to the type of production undertaken by the producer, contrary to paragraph 6(b) of Annex 2 of the Agreement on Agriculture

44. Under s.1106(b) of the 2002 FSRI Act, fruits, vegetables (other than lentils, mung beans and dry peas) and wild rice are generally prohibited from being planted on base acreage unless the commodity, if planted, is destroyed before harvest except that trees and other perennial plants are prohibited. The implementing regulations make clear that, where it is determined that a producer made a good faith effort to comply with the "planting flexibility" provisions of s.1106 of the FSRI Act but that that producer's acreage report of fruits, vegetables or wild rice planted on a farm's base acreage is inaccurate and exceeds the allowed tolerance levels, the producer "shall accept a reduction in the direct and counter-cyclical payments for the farm …".[32]

[30] *Fact Sheet: Upland Cotton*, page 5, Exhibit Bra-4.
[31] First Submission of Brazil, at Section 3.2.7.3.
[32] 7 CFR 1412.602(a)(2), Exhibit Bra-35.

45. Thus, direct payments are related, or connected, to the type of production undertaken by the producer, contrary to paragraph 6(a) of AA Annex 2.

(iii) Direct payments are related to, or based on, the type or volume of production undertaken by the producer in a year after the base period, contrary to paragraph 6(b) of Annex 2 of the Agreement on Agriculture

46. Sections 1101 and 1102 of the 2002 FSRI Act allow producers to update their base acres and payment yields respectively for the purposes of receiving direct payments. As set out in Section III.A.ii above, only one base period is possible for the purposes of paragraph 6 of AA Annex 2. Once the base period has been defined and fixed, no further updating of either the type or volume of production is permissible if a support program is to comply with the conditions of paragraph 6 of Annex 2.

47. Under the 2002 FSRI Act, direct payments replaced PFC payments.[33] Since the United States has claimed PFC payments as "green box" decoupled income support[34], Australia considers that the United States has selected the base period that it used to determine base acres and payment yields under the 1996 FAIR Act as its defined and fixed base period for the purposes of paragraph 6 of AA Annex 2.

48. By providing for base acres and payment yields to be updated under the 2002 FSRI Act, the United States has related the amount of direct payments to, or based the amount of direct payments on, the type and volume of production undertaken by a producer in any year after the base period, contrary to paragraph 6(b) of AA Annex 2.

## IV. "STEP 2" PAYMENTS ARE PROHIBITED SUBSIDIES CONTRARY TO ARTICLES 3.3 AND 8 OF THE AGREEMENT ON AGRICULTURE AND/OR ARTICLE 3 OF THE SCM AGREEMENT

49. Section 1207(a)(1) of the 2002 FSRI Act provides: "… the Secretary shall issue marketing certificates or cash payments … to domestic users and exporters for documented purchases by domestic users and sales for export by exporters …". Section 136 of the 1996 FAIR Act provided similarly that "… the Secretary shall issue marketing certificates or cash payments to domestic users and exporters …".

50. The regulations to implement s.1207(a)(1) of the FSRI Act provide:

> Eligible upland cotton must not be: … (2) imported cotton …[35]
>
> Payments … shall be made available to eligible domestic users and exporters who have entered into an Upland Cotton Domestic User/Export Agreement with CCC and who have complied with the terms and conditions in this subpart, the Upland Cotton Domestic User/Exporter Agreement and instructions issued by CCC.[36]

51. The standard Upland Cotton Domestic User/Export Agreement[37] provides *inter alia*:

[33] *Fact Sheet: Upland Cotton*, Exhibit Bra-4.
[34] WTO document G/AG/N/USA/43, page 8, Exhibit Bra-47.
[35] 7 CFR 1427.103(c), Exhibit Bra-37.
[36] 7 CFR 1427.105(a), Exhibit Bra-37.
[37] Exhibit Bra-65.

> Upland cotton eligible for payment is cotton consumed by the Domestic User in the United States … (Section B-2)
>
> Eligible upland cotton will be considered consumed by the Domestic User on the date the bagging and ties are removed from the bale in the normal opening area, immediately prior to use, … (Section B-3(b))
>
> Upland cotton eligible for payment is cotton which is shipped by an eligible Exporter … (Section C-2)
>
> Eligible upland cotton will be considered exported based on the on-board-vessel-date as shown on the bill of lading. (Section C-3)

52. A "Step 2" payment is unquestionably a subsidy within the meaning of the *Agreement on Agriculture* and the *SCM Agreement*. A "Step 2" payment involves a direct transfer of economic resources (cash or the equivalent value in ownership of goods) to a domestic user or exporter of US upland cotton.

53. The Article 21.5 stage of *United States – Tax Treatment for "Foreign Sales Corporations" (US – FSC (21.5))* involved provisions under which more favourable tax treatment was available in either of two, mutually exclusive, situations. The availability of the favourable tax treatment was found to be a prohibited export subsidy in one of those situations notwithstanding that the favourable tax treatment was freely available in both situations, subject to the prescribed conditions for entitlement being met. The Appellate Body said:

> In our view, it is … necessary, under Article 3.1(a) of the *SCM Agreement*, to examine separately the conditions pertaining to the grant of the subsidy in the two different situations addressed by the measure. We find it difficult to accept the United States' arguments that such examination involves an 'artificial bifurcation" of the measure. The measure itself identifies the two situations which must be different since the very same property cannot be produced both within and outside the United States.[38]

54. The availability of "Step 2" payments under s.1207(a)(1) is analogous to the situation examined in *US – FSC (21.5)*. "Step 2" payments are available only to exporters ("Step 2" export payments) or to domestic users ("Step 2" domestic payments). Section 1207(a)(1) "identifies the two situations which must be different since the very same property cannot be" exported or used within the United States.

A. "STEP 2" EXPORT PAYMENTS ARE PROHIBITED EXPORT SUBSIDIES CONTRARY TO ARTICLES 3.3 AND 8 OF THE AGREEMENT ON AGRICULTURE AND ARTICLE 3.1(A) AND 3.2 OF THE SCM AGREEMENT

(i) "Step 2" export payments are subsidies contingent upon export performance

55. For "Step 2" export payments, the export contingency is expressly provided for in s.1207(a)(1), which provides "… the Secretary shall issue marketing certificates or cash payments … to exporters for … sales for export by exporters …" and in the implementing regulations.

[38] *United States – Tax Treatment of "Foreign Sales Corporations"*, Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/AB/RW, paragraph 115.

56 "Step 2" export payments are only payable once US-produced upland cotton has been placed aboard a vessel: they are "conditional" upon the cotton actually being exported. Thus, "Step 2" export payments are contingent upon export performance.

(ii) "Step 2" export payments are export subsidies contrary to Articles 3.3 and 8 of the Agreement on Agriculture

57. "Step 2" export payments are a type of export subsidy expressly foreseen by AA Article 9.1(a) and subject to budgetary outlay and quantity reduction commitments thereunder. They are a direct subsidy, including through payment-in-kind, to an industry, to producers of an agricultural product, or to a cooperative or other association of such producers, contingent on export performance.

58. The United States has not specified any reduction commitments in its Schedule for upland cotton.

59. Consequently, by providing "Step 2" export payments under both the 1996 FAIR Act and the 2002 FSI Act, the United States has provided export subsidies contrary to its obligations:

VII. pursuant to AA Article 3.3 not to provide export subsidies in respect of any agricultural product not specified in Section II of Part IV of its Schedule; and

VIII. pursuant to its obligation pursuant to Article 8 not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in its Schedule.

(iii) "Step 2" export payments are prohibited export subsidies contrary to SCM Article 3

60. Because "Step 2" export payments are export subsidies that do not conform fully to the provisions of Part V of the *Agreement on Agriculture*, Article 13(c)(ii) of that Agreement is not applicable and the payments are not protected from the operation of SCM Article 3.

61. A "Step 2" export payment is a subsidy within the meaning of SCM Article 1.1(a)(1)(i) for the purposes of SCM Article 3.1: it involves a direct transfer of economic resources to a domestic user or exporter of US upland cotton, and confers a benefit on the recipient by making US upland cotton commercially competitive.

62. Further, a "Step 2" export payment is contingent upon export performance: it is only payable once the upland cotton has been placed aboard a vessel for export. The Appellate Body has said:

> We see no reason, and none has been pointed out to us, to read the requirement of "contingent upon export performance" in the *Agreement on Agriculture* differently from the same requirement imposed by the *SCM Agreement*.[39]

63. As a consequence, because "Step 2" export payments mandated by s.1207(a)(1) of the FSRI Act are export subsidies that are not being made "as provided in the *Agreement on Agriculture*", they are prohibited export subsidies pursuant to SCM Article 3.1(a), and the United States is acting contrary to its obligations under SCM Article 3.2 by granting or maintaining such subsidies pursuant to s.1207(a)(1) of the FSRI Act. Consistent with the provisions of SCM Article 4.7, Australia

[39] *United States – Tax Treatment for "Foreign Sales Corporations"*, Report of the Appellate Body, WT/DS108/AB/R, paragraph 141.

endorses Brazil's request[40] that the Panel recommend that the United States withdraw the "Step 2" export payments without delay.

B. "STEP 2" DOMESTIC PAYMENTS ARE LOCAL CONTENT SUBSIDIES CONTRARY TO ARTICLE 3 OF THE SCM AGREEMENT

64. For "Step 2" domestic payments, the local content requirement is expressly provided for in s.1207(a)(1), which provides "… the Secretary shall issue marketing certificates or cash payments … to domestic users … for documented purchases by domestic users …" and in the implementing regulations, which provide that "eligible cotton must not be … imported cotton".

65. "Step 2" domestic payments are only payable once US-produced upland cotton is consumed by a domestic user. "Step 2" domestic payments are contingent upon the use of domestic over imported goods.

66. Thus, s.1207(a)(1) of the FSRI Act mandates the payment of subsidies which are prohibited pursuant to SCM Article 3.1(b), and the United States is acting contrary to its obligations under SCM Article 3.2 by granting or maintaining such subsidies. Consistent with the provisions of SCM Article 4.7, Australia endorses Brazil's request[41] that the Panel recommend that the United States withdraw the "Step 2" domestic payments without delay.

C. THE UNITED STATES CANNOT AVOID ITS OBLIGATIONS RELATING TO PROHIBITED SUBSIDIES BY DESIGNING A MEASURE UNDER WHICH ENTITLEMENTS ARE OSTENSIBLY AVAILABLE IN MULTIPLE CIRCUMSTANCES

67. In Australia's view, the United States cannot avoid its obligations relating to prohibited subsidies under the *Agreement on Agriculture* and the *SCM Agreement* by designing a measure under which entitlements are ostensibly available in multiple circumstances. As the Appellate Body concluded in *US – FSC (21.5)*:

> Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.[42]

68. Moreover, in the circumstances of the present case, it would be a manifestly inequitable outcome if a WTO Member was able to avoid its obligations relating to prohibited subsidies under the *Agreement on Agriculture* and the *SCM Agreement* on the basis that there is a second set of circumstances in which a subsidy can be paid, when the second set of circumstances is itself a prohibited subsidy.

69. Australia considers that, through the "Step 2" payments mandated by s.1207(a)(1) of the FSRI Act, the United States is paying: (1) export subsidies contrary to its obligations pursuant to AA Articles 3.3 and 8 and SCM Article 3.1(a) and 3.2; and (2) local content subsidies contrary to its obligations pursuant to SCM Article 3.1(b) and 3.2.

[40] First Submission of Brazil, paragraph 251.
[41] First Submission of Brazil, paragraph 341.
[42] *United States – Tax Treatment for "Foreign Sales Corporations"*, Recourse to Article 21.5 of the DSU by the European Communities, Report of the Appellate Body, WT/DS108/AB/RW, paragraph 119

## V. CONCLUSION

70. This dispute raises fundamental issues concerning the object and purpose of the *Agreement on Agriculture*, and the balance of rights and obligations accepted by all Members under the *Marrakesh Agreement Establishing the World Trade Organization*. The outcome of this dispute will determine whether, in fact, Members accepted any meaningful obligations in relation to domestic support measures pursuant to the *Agreement on Agriculture*.

71. In Australia's view, Brazil has provided *prima facie* evidence that the United States has not acted consistently with its obligations in relation to domestic support measures and export subsidies provided to upland cotton under the *Agreement on Agriculture*. Further, Australia considers that the "Step 2" payments for domestic users and exporters of upland cotton are clearly subsidies prohibited by the *SCM Agreement*, and endorses Brazil's request that these be withdrawn without delay.

# ANNEX B-5

## THIRD PARTY SUBMISSION OF BENIN

15 July 2003

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## I. INTRODUCTION

1. The issue in this dispute is of critical importance for Benin, West Africa, and many developing countries: whether WTO Members must respect agreed disciplines for the provision of agricultural subsidies.

2. The right to grant agricultural subsidies is by no means absolute. During the Uruguay Round, the drafters of the *Agreement on Agriculture* and the SCM Agreement established a number of preconditions for the provision of WTO-consistent subsidies. These preconditions, including those embodied in Article 13 of the *Agreement on Agriculture* - the so-called "peace clause" - were part of the overall balance of rights and obligations accepted by the United States and other participants at the conclusion of the Round.

3. Benin, upon its accession to the WTO in 1996, accepted the Uruguay Round package. In doing so, it expected that the subsidies provided by its trading partners, including the United States, would remain within these agreed parameters.

4. However, contrary to its WTO obligations, the United States has provided huge subsidies for the production, use and export of US cotton. These WTO-inconsistent subsidies have been highly damaging to Benin.

5. Benin supports the positions advanced by Brazil in this dispute, particularly those set out in Brazil's first submission of June 24. Benin welcomes the opportunity to provide its views to the Panel, divided into two headings:

(a) Benin and US cotton subsidies, which provides appropriate additional context to the issues facing the Panel; and

(b) WTO legal issues.

## II. BENIN AND US COTTON SUBSIDIES

6. Benin is a least-developed country, with a GNP per capita of US $380. Of the 175 countries listed in the 2003 Human Development Index of the United Nations Development Programme, Benin is ranked 159th.[1]

7. Cotton plays a crucial role in the development of Benin. It is the most important cash crop in the national economy. Cotton accounts for 90 per cent of agricultural exports, and has provided around 75 per cent of the country's export earnings over the past four years. Benin is the 12th largest exporter of cotton in the world.

8. Cotton generates 25 per cent of the country's revenues. A third of all households in Benin depend on the cultivation of cotton, and a fifth of wage-earning workers are employed in the cotton sector. Overall, about a million people in Benin – out of a population of six million – are dependant on cotton, or cotton-related activities.

9. The cotton sector in Benin, which is mainly in the rural regions, has suffered considerable hardship. As the International Monetary Fund noted in a report earlier this year, "poverty is prevalent in cotton-producing areas".[2] Cotton growers are concentrated in the north of the country, a more arid region where the potential for any agricultural diversification is lower, and where opportunities for non-farm employment are scare.[3]

10. Despite these problems of persistent poverty, the cotton sector in Benin and the region remains highly competitive by world standards. The cost of producing cotton in West Africa is 50 per cent lower than comparable costs in the United States.[4]

11. As recent report noted: "West Africa is one of the world's most efficient cotton producing regions. The IMF estimates that the sector can operate profitably at world price levels of around 50 cents/lb. Few producers in the US could compete at this price. Indeed, the USDA estimates average production costs at 75 cents/lb."[5]

12. Moreover, the sector has also undergone major structural reforms in recent years to increase efficiency. The IMF reported that: "Benin has moved away from the integrated monopoly that characterized the organization of cotton production and marketing of seed cotton in western and central Africa. Benin's reform process is among the most advanced in the region."[6]

13. Unfortunately, the benefits of such reforms have been completely negated by massive US subsidies. As noted by Brazil in its First Submission, total upland cotton subsidies amounted to

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[1] *Human Development Report 2003*, United Nations Development Programme, http://www.undp.org/hdr2003.

[2] According to the IMF, "The cotton zone in central Benin (the Zou and Borgou) presents one of the highest incidences of poverty, while the deepest poverty (as measured by the poverty gap index) can be found in the north (cotton-producing area in northern Borgou). International Monetary Fund, Country Report No. 03/120. *Benin: Fourth Review Under the Poverty Reduction and Growth Facility – Staff Report*. April 2003. Page 28.

[3] *Impact of Global Cotton Markets on Rural Poverty in Benin*. Nicholas Minot and Lisa Daniels. International Food Policy Research Institute, Washington, D.C. November 2002. Page 19.

[4] See Louis Goreux, *"Préjudices causés par les subventions aux filières cotonnières de l'AOC."* March 2003. Cited in TN/AG/GEN/4, 16 May 2003.

[5] *Northern Agricultural Policies and World Poverty: Will the Doha 'Development Round' Make a Difference?* Kevin Watkins, Head of Research, Oxfam Great Britain. Paper presented to the Annual World Bank Conference of Development Economics. 15-16 May, 2003. Page 65.

[6] IMF Country Report, *Op. Cit.*, page 23

US$12.9 billion during the 1999-2002 marketing years.[7] The International Cotton Advisory Cotton estimates that US subsidies are equivalent to 24 cents per pound of cotton produced.[8]

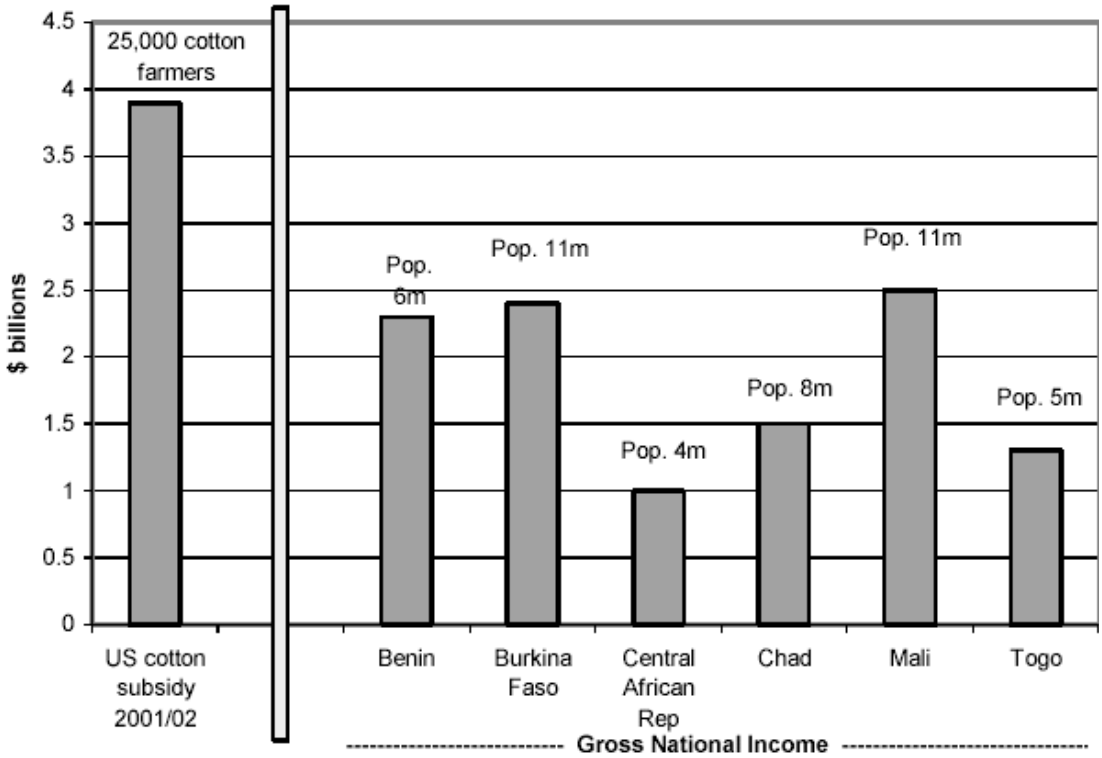
14. Subsidies of this magnitude have sharply increased supplies on the international market, thereby producing a collapse in global cotton prices. From January, 2001 to May, 2002, world cotton prices fell by nearly 40 per cent, from 64 cents to about 39 cents per pound, the lowest level since the 1930s. Although prices have improved since last year, the world market for cotton remains characterized by oversupply as a result of US subsidies. This has extremely serious consequences for Benin and other West African countries.

15. Benin is highly vulnerable to changes in the world price of this cash crop. The International Food Policy Research Institute has estimated that a 40 per cent reduction in farm-level prices of cotton results in an increase in rural poverty in Benin of 8 per cent in the short term, and 6-7 per cent in the long term. An increase of 8 per cent is equivalent to pushing an additional 334,000 people below the poverty line.[9] This, in turn, has produced a deterioration in the social conditions of many rural communities, including conditions pertaining to housing, schooling, sanitation, nutrition and other basic needs.

16. The overwhelming magnitude of US cotton subsidies, and the impossibility of Benin competing with them, are well illustrated in the table below.[10] As the table indicates, the subsidies paid by the United States to 25,000 US cotton farmers exceeds the gross national income of Benin. These subsidies also exceed the gross national income of Burkina Faso, the Central African Republic, Chad, Mali and Togo.

[7] First Submission of Brazil, paragraph 3.
[8] Minot and Daniels, *op. cit*, page 1.
[9] Minot and Daniels, *op cit*., page 50.
[10] This table is from *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa.* Oxfam Briefing Paper 30. 27 September 2002. Brazil has filed the full Oxfam report as exhibit Bra–15.

**Figure 3: US cotton subsidy and the gross national incomes for selected West African countries in 2000 ($billions)**




*Source: World Development Indicators, World Bank, 2002, and US Department of Agriculture*

17. Thus, when cotton from Benin enters world markets, it must compete against such massively subsidized US cotton.

18. Oxfam has estimated that US subsidies have caused Benin to lose US $33 million in foreign exchange earnings, equivalent to 9 per cent of the country's export earnings.[11]

19. Indeed, the shock of such subsidies, and their attendant effect on prices, threatens the very existence of the cotton sector in Benin. It has created a genuine economic crisis in the sector, and it is possible that the cotton sector in Benin could simply disappear during the 2003/04 marketing year. This would have catastrophic effects both for the national economy, and for the social cohesion of the country in regions where cotton production predominates. This also poses a significant threat to Benin's efforts at poverty alleviation in economically precarious rural areas.

20. With these preliminary comments as additional context, Benin now comments briefly on some of the legal issues raised in Brazil's submission.

## III. WTO LEGAL ISSUES

21. Benin agrees with Brazil that the United States cannot successfully invoke the peace clause to bar the actionable subsidy claims that have been advanced in this dispute.

[11] *Ibid*., page 17.

22. The peace clause is an affirmative defence. The United States, not Brazil, must bear of burden of demonstrating that US domestic support and export subsidies comply with the requirements of Article 13.

23. Affirmative defences, as the Appellate Body made clear in *United States – Wool Shirts and* Blouses, are "limited exceptions from obligations under certain other provisions", not "positive rules establishing obligations in themselves". In the view of the Appellate Body, "[i]t is only reasonable that the burden of establishing such a defence should rest on the party asserting it".

24. The language in Article 13 shows the clear intent of the drafters that the Member seeking to invoke the peace clause must bear the burden of demonstrating full compliance with all of the preconditions set out in this provision.

25. In addition to the arguments advanced by Brazil, Benin would note that the use of the proviso "provided that" in Article 13(b)(ii) and (iii) also shows the intent of the drafters to shift the burden to the Member seeking to invoke this exception. In both subsections, the exemption from actions has been qualified by the addition of this proviso:

(b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:

(ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and

(iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year…" [emphasis added]

26. A similar proviso can be found in GATT Article XVIII:11, dealing with the elimination of restrictions imposed for balance of payments purposes:

> "[T] he contracting party concerned… shall progressively relax any restrictions applied under this Section as conditions improve, maintaining them only to the extent necessary under the terms of paragraph 9 of this Article and shall eliminate them when conditions no longer justify such maintenance; Provided that no contracting party shall be required to withdraw or modify restrictions on the ground that a change in its development policy would render unnecessary the restrictions which it is applying under this Section." [emphasis added]

27. In construing GATT Article XVIII:11, the Appellate Body made clear in the *Quantitative Restrictions* case that the burden of proof lay clearly on the responding party – in that case, India – seeking to invoke the proviso:

> "The proviso precludes a Member, which is challenging the consistency of balance-of payments restrictions, from arguing that such restrictions would be unnecessary if the developing country Member maintaining them were to change its development policy. In effect, the proviso places an obligation on Members not to require a developing country Member imposing balance-of payments restrictions to change its development policy….

> [W]e do not exclude the possibility that a situation might arise in which an assertion regarding development policy does involve a burden of proof issue. Assuming that the complaining party has successfully established a *prima facie* case of inconsistency with Article XVIII:11 and the Ad Note, the responding party may, in its defence, either rebut the evidence adduced in support of the inconsistency or invoke the proviso. In the latter case, it would have to demonstrate that the complaining party violated its obligation not to require the responding party to change its development policy. This is an assertion with respect to which the responding party must bear the burden of proof. We, therefore, agree with the Panel that the burden of proof with respect to the proviso is on India."[12]

28. Although the use of the proviso "provided that" is not determinative, it does provide strong textual support for the proposition that the drafters of Article 13 of the *Agreement on Agriculture*, like the drafters of GATT Article XVIII:11, intended the burden of proof to shift to the party seeking to invoke the proviso.

29. Indeed, the situation in the Cotton dispute is very similar to that examined by the Appellate Body in the *Quantitative Restrictions* case. The United States is seeking to invoke the "provided that" proviso set out in Article 13. This is, as the Appellate Body reasoned, "an assertion with respect to which the responding party must bear the burden of proof". Therefore, as with India in *Quantitative Restrictions*, the burden of proof with respect to the proviso is on the United States.

30. Article 13, construed as a whole, also supports the position that if the United States seeks entry into the "safe harbour", it bears the burden of demonstrating that it has met the preconditions necessary to justify entry.

31. For example, the chapeau to paragraphs (a), (b) and (c) all provide that the measures or subsidies "must conform fully" with the applicable disciplines. Domestic support measures or export subsidies that do not "conform fully" to the specified provisions cannot benefit from the peace clause. Since the United States claims that it "conforms fully" to the relevant provisions of the *Agreement on Agriculture*, the SCM Agreement, and the GATT 1994, and it is up to the United States to provide sufficient evidence in support of this defence.

32. Thus, as argued above, the burden falls on the United States if it wishes successfully to invoke the affirmative defence of Article 13.

33. However, even if the burden rested on Brazil – which it does not – Brazil has amply demonstrated in its First Submission that the United States is providing domestic support and export subsidies far in excess of WTO commitments.

34. For example, as Brazil demonstrated in its submission, US non-"green box" domestic support to upland cotton in the 1992 marketing year was $1,994.4 million. By 2001, US non-"green box" domestic support increased to $4,093 million. Thus, the defence that may have been conditionally available to the United States – had it "conformed fully" to the requirements of Article 13 – is unavailable.

35. Brazil presents compelling evidence on the WTO-inconsistency of all of the impugned US measures, encompassing both domestic support payments and export payments. Benin agrees with Brazil that the US measures violate the *Agreement on Agriculture*, the SCM Agreement, and the GATT 1994.

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[12] Appellate Body Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile an Industrial Products*, WT/DS90/AB/R, paragraph 134 and 136.

36. The United States, in its submission of July 11, has done nothing to rebut the presumption of WTO-inconsistency established by Brazil.

## IV. CONCLUSIONS

37. As noted above, US cotton subsidies exceed the Gross National Income of Benin. Benin has few options available to it to respond to subsidies of such magnitude. The resulting impact on the economy of the country has been devastating.

38. Benin is not seeking any special and differential treatment in this dispute. It simply asks the Panel to ensure that the relevant provisions of the WTO Agreements, including Article 13 of the *Agreement on Agriculture*, are interpreted and applied as negotiated. The United States must respect the disciplines that it, and other WTO Members, agreed to at the end of the Uruguay Round.

39. Benin is grateful for the opportunity to present its views to the Panel in this extremely important dispute. Benin notes that further submissions are intended, and reserves the right to provide additional views to the Panel (including in response to the US First Written Submission of 11 July) as necessary and appropriate, at a later stage.

# ANNEX B-6

## THIRD PARTY SUBMISSION OF CANADA

15 July 2003

TABLE OF CONTENTS

## I. INTRODUCTION

1. Canada has a systemic interest in the correct interpretation of Annex 2 of the *Agreement on Agriculture* (*Agriculture Agreement*), as well as the export subsidy provisions of both the *Agriculture Agreement* and the *Agreement on Subsidies and Countervailing Measures* (*SCM Agreement*).

2. In its first written submission, Brazil makes a number of claims. Canada's comments relate to the claims of Brazil in respect of the following:

IX. Whether US production flexibility contract payments (PFC payments) made under the Federal Agriculture Improvement and Reform Act of 1996 and US direct payments made under the US Farm Security and Rural Investment Act of 2002 (2002 FSRI Act) satisfy the policy-specific criteria for decoupled income support in Annex 2, paragraph 6(b) of the *Agriculture Agreement*; and

X. Whether US GSM-102, GSM-103, and the SCG export credit guarantee programmes provide export subsidies in violation of Articles 8 and 10.1 of the *Agriculture Agreement*.

## II. CLAIMS REGARDING US DOMESTIC AGRICULTURAL SUPPORT MEASURES

3. Among the claims brought by Brazil against the United States in this dispute are those concerning the conformity of US domestic subsidies with US obligations under Part III of the *SCM Agreement* and Article XVI of the *General Agreement on Tariffs and Trade 1994* (*GATT 1994*).

4. On 20 June 2003, the Panel preliminarily ruled that it would defer consideration of Brazil's claims under Part III of the *SCM Agreement* and Article XVI of *GATT 1994* until after it had expressed views on whether the US measures satisfy the conditions of Article 13 of the *Agriculture Agreement* (the so-called "Peace Clause"). Accordingly, Brazil argues in its first written submission that PFC payments and direct payments (US measures involving direct payments to US agricultural producers) are not exempt from action under the Peace Clause because they do not conform fully to the criteria in Annex 2 of the *Agriculture Agreement*.[1] The United States argues in response that PFC payments are not within the Panel's terms of reference because they were no longer in effect at the time of the consultation or panel requests.[2] Regarding direct payments, the United States argues that these measures are exempt from action because they conform fully to the provisions of Annex 2 and are therefore covered by Article 13(a)(ii) of the *Agriculture Agreement*.[3]

5. Canada provides views in this submission on the conformity of PFC payments and direct payments with criteria in Annex 2 of the *Agriculture Agreement*.

### A. PFC PAYMENTS AND DIRECT PAYMENTS DO NOT QUALIFY AS EXEMPT DECOUPLED INCOME SUPPORT UNDER THE *AGRICULTURE AGREEMENT*

6. It is Canada's view that PFC payments and direct payments do not fully conform to the provisions of paragraph 6(b) of Annex 2 of the *Agriculture Agreement* for the reasons set out below.

[1] First Written Submission of Brazil, 24 June 2003 , at paras. 153 and 173 [hereinafter Brazil First Written Submission].

[2] First Written Submission of the United States, 11 July 2003, at paras. 190 and 207-211 [hereinafter "US First Written Submission"].

[3] US First Written Submission, paras. 64-68.

**1. Decoupled income support under Annex 2 of the *Agriculture Agreement* is exempt from action under the *SCM Agreement* and *GATT 1994***

7. Annex 2 of the *Agriculture Agreement* is relevant to actionable subsidy cases under the *SCM Agreement* and *GATT 1994* because the *Agriculture Agreement* provides for certain conditional exemptions. In this section, Canada sets out the relationship between these three agreements in this respect.

8. Action under Part III of the *SCM Agreement* and Article XVI of *GATT 1994* depends on a determination of the existence of a "subsidy".[4] Article 1.1 of the *SCM Agreement* sets out the definition of a subsidy:

**1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:**

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member…

or

(a)(2) here is any form of income or price support in the sense of Article XVI of GATT 1994;

and

(b) a benefit is thereby conferred.

9. Article 1.2 provides that a subsidy is actionable under Part III of the Agreement if it is "specific" in accordance with the provisions of Article 2.

10. Article 5 begins Part III of the *SCM Agreement* on actionable subsidies by providing that "[n]o Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members...". Articles 5 and 6 describe "adverse effects" and set out the basis for determining whether they exist. Article 7 sets out the available remedies where adverse effects do exist. All of these provisions are subject to Article 13 of the *Agriculture Agreement*.[5]

11. Article 13 of the *Agriculture Agreement* conditionally exempts domestic support measures from actionable subsidy complaints. It provides in relevant part:

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[4] See *United States – Tax Treatment for "Foreign Sales Corporations"*, Report of the Appellate Body, WT/DS108/AB/R, adopted March 20, 2000 at para. 93 [hereinafter *US FSC* AB Report]:

> Article 1.1 sets forth the general definition of the term "subsidy" which applies "for the purpose of this Agreement". This definition, therefore, applies wherever the word "subsidy" occurs throughout the *SCM Agreement* and conditions the application of the provisions of that Agreement regarding *prohibited* subsidies in Part II, *actionable* subsidies in Part III, *non-actionable* subsidies in Part IV and countervailing measures in Part V [emphasis in original].

[5] Article 5 ends with: "This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture". Article 6.9 contains identical language. Article 7.1 begins: "Except as provided in Article 13 of the Agreement on Agriculture, …".

> Regarding action under Article XVI of *GATT 1994*, in addition to the provisions in Article 13 of the *Agriculture Agreement*, Article 21.1 states: "The provisions of GATT 1994… shall apply subject to the provisions of this Agreement."

> During the implementation period, notwithstanding the provisions of *GATT 1994* and the SCM Agreement on Subsidies and Countervailing Measures (referred to in this Article as the "Subsidies Agreement"):
>
> (a) domestic support measures that conform fully to the provisions of Annex 2 to this Agreement shall be:
>
> …
>
> (ii) exempt from actions based on Article XVI of *GATT 1994* and Part III of the Subsidies Agreement;
>
> …
>
> (b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:
>
> …
>
> (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year…

12. Accordingly, domestic subsidies are exempt from application of the provisions in Part III of the *Subsidies Agreement* and of Article XVI of *GATT 1994* if they conform to Annex 2 of the *Agriculture Agreement*. Domestic subsidies that do not conform to Annex 2 are exempt if such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

**2. Decoupled income support must not be linked to the type of commodity produced in any year after the base period**

13. To determine whether a measure is exempt under Article 13(a) of the *Agriculture Agreement*, it must be assessed under the criteria of Annex 2. Canada sets out the relevant Annex 2 provisions.

14. Annex 2 is the basis for the conditional exemption of domestic subsidies, under Article 13(a) of the *Agriculture Agreement*, from the application of Part III of the *SCM Agreement* and Article XVI of *GATT 1994*. Annex 2 also conditionally (and principally) exempts domestic support measures from reduction commitments pursuant to exceptions under Articles 3.2, 6 and 7 of the Agreement. Paragraph 1 of Annex 2 reads as follows:

> 1. Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:
>
> (a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,
>
> (b) the support in question shall not have the effect of providing price support to producers;
>
> plus policy-specific criteria and conditions as set out below.

15. The policy-specific criteria are for each of the following measures: general services (paragraph 2); public stockholding (paragraph 3); domestic food aid (paragraph 4); and direct payments to producers (paragraphs 5-13).

16. Paragraph 5 of Annex 2 provides that direct payments to producers are exempt only if they meet the basic criteria in paragraph 1 of Annex 2 and the "specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13…". Paragraph 5 further specifies that, to be exempt, any measure that does *not* constitute a type of direct payment covered by paragraphs 6-13 must conform to the criteria in paragraph 6(b) through (e) as well as the basic criteria listed in paragraph 1.

17. Paragraph 6 of Annex 2 reads:

> 6. Decoupled income support
>
> (a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.
>
> (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.
>
> (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.
>
> (d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.
>
> (e) No production shall be required in order to receive such payments.

18. For direct payments to qualify as decoupled income support, paragraph 6(b) requires that the amount of the payments not be "related to, or based on, the type… of production… undertaken by the producer in any year after the base period." The ordinary meaning of "production" is "something which is produced by an action, process, etc.; a product".[6] Nothing in the context or in the object and purpose of this subparagraph, of Annex 2, or of the *Agriculture Agreement* as a whole detracts from this ordinary meaning. Accordingly, under paragraph 6(b), the amount of the payment must not be linked to the kind of product that is produced.

### 3. PFC payments and direct payments do not conform to Annex 2 of the *Agriculture Agreement* because the amount of these payments is linked to the type of commodity produced after the base period

19. Based on the evidence and arguments presented in the submissions of the disputing parties at this stage of the proceedings, it is Canada's assessment that the amount of PFC payments and direct payments are based on the type of commodity produced after the base period. Were the Panel to accept the evidence submitted by Brazil, it would find that PFC payments and direct payments are inconsistent with paragraph 6(b) of Annex 2 of the *Agriculture Agreement*.

[6] *The New Shorter Oxford English Dictionary*, p. 2367 [Exhibit CDA-1.].

20. Brazil asserts that under US law implementing PFC payments, the amount of such payments "could fluctuate from 100 percent of the PFC payments if [a producer] did not grow any fruits and vegetables, to zero percent in case such prohibited products are grown" or "[to] a reduced and pro-rated decrease based on acreage and/or value of the fruit or vegetable crop grown on PFC contract acres."[7] According to Brazil, US implementing law also provides that "PFC payments are reduced for each acre of wild rice that is produced." [8] Regarding direct payments, Brazil argues that under US implementing law, current fruit, vegetable, or wild rice production affects the amount of the direct payment in the same manner as such production affects the amount of the PFC payment. [9]

21. The United States describes direct payments under the 2002 FSRI Act as direct payments "to persons (farmers and landowners) with farm acres that formerly produced any of a series of commodities during the base period."[10] The United States claims that these payments constitute "decoupled income support" under Annex 2 of the *Agriculture Agreement* because they: (1) are provided through a publicly-funded government programme not involving transfers from consumers; (2) do not have the effect of providing price support to producers; and (3) conform to the five policy-specific criteria and conditions set out in paragraph 6.[11] The United States claims in particular that the direct payments are "decoupled from production" because the amount of the payments is not based on the type of production undertaken after the base period, in conformity with paragraph 6(b). In this respect, the United States argues:

> Not only is there no requirement that a direct payment recipient engage in any *particular* type or volume of production, a recipient need not engage in *any* current agricultural production in order to receive the direct payment.[12] [emphasis in original]

22. The United States does not describe or assess PFC payments, given its request for a preliminary ruling by the Panel that such payments are not within its terms of reference.[13]

23. Canada's assessment of the facts and arguments presented so far in this case is that the United States has incorrectly classified PFC payments as decoupled income support,[14] and that US direct payments do not qualify as such support.[15] Nowhere in its submission does the United States address the evidence of implementing legislation and regulations regarding either measure. Its argument that direct payment recipients are not required to engage in any particular type or volume of production (or any current agricultural production at all) to receive direct payments fails to address the evidence indicating that the amount of the payment may change based on whether base acreage is used for current production of fruits, vegetables, or wild rice. For both measures, the evidence indicates that the amount of the payment is based on the type of production: payments are full, nil, or some amount in between where base acres are used for current fruit, vegetable or wild rice production.

[7] Brazil First Written Submission, para. 160.
[8] *Ibid*., para. 161.
[9] Brazil First Written Submission, para 174.
[10] US First Written Submission, para. 57.
[11] *Ibid*., paras. 64-68.
[12] *Ibid*., para. 67.
[13] *Ibid*., para. 211.
[14] Brazil First Written Submission, para. 153.
[15] *Ibid*., paras. 175 and 198.

## III. CLAIMS REGARDING US EXPORT CREDIT GUARANTEE PROGRAMMES

24. Brazil asserts that the US GSM-102, GSM-103, and SCG programmes provide export subsidies with respect to upland cotton and other agricultural commodities in violation of Articles 8 and 10.1 of the *Agriculture Agreement*.[16] According to Brazil, the United States violates Articles 8 and 10.1 of the *Agriculture Agreement* because these programmes:

XI. provide export subsidies under item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement;*[17] and

XII. provide "subsidies" that are "contingent upon export performance" under Articles 1.1 and 3.1(a) of that Agreement.[18]

25. As a result, Brazil argues, these measures do not fully conform to the provisions of Part V of the *Agriculture Agreement* and the Peace Clause, therefore, does not exempt them from actions based on Article 3 of the *SCM Agreement.*[19] Brazil also argues that these programmes provide prohibited export subsidies within the meaning of Article 3.1(a) of the *SCM Agreement* and requests the Panel to recommend to the DSB that the measures be withdrawn without delay under Article 4.7.[20]

26. The United States argues in response that its export credit guarantee programmes are not export subsidies subject to Article 10.1 of the *Agriculture Agreement* because Article 10.2 permits export credit guarantee practices "to continue, unaffected by export subsidy disciplines otherwise negotiated and reflected in the text of the Agreement".[21] The United States asserts that these programmes do not provide prohibited export subsidies under Article 3.1(a) of the *SCM Agreement* because export credit guarantees are carved out from export subsidy commitments by virtue of Article 10.2 of the *Agriculture Agreement* and any application of Article 3 of the *SCM Agreement* is subject to the provisions of the *Agriculture Agreement*.[22] Finally, according to the United States, its measures do not satisfy the standard in item (j) of Annex I of the *SCM Agreement* and are not, for that reason alone, export subsidies under Article 3.1(a).[23]

27. The United States also requests the Panel to rule preliminarily that Brazil's arguments in connection with all commodities other than upland cotton are not properly before the Panel, and limits its arguments to upland cotton accordingly.[24]

28. In this submission, Canada limits its views to whether the United States has violated Articles 8 and 10.1 of the *Agriculture Agreement* by providing export subsidies in the form of export credit guarantees resulting in the circumvention of US export subsidy commitments with respect to upland cotton. Canada notes that this aspect of Brazil's claim is both independent and determinative of the applicability in this dispute of the Peace Clause under Article 13(c)(ii) of the *Agriculture Agreement*. That is, a violation of Articles 8 and 10.1 in this case would itself form the basis for both a recommendation by the DSB to the United States to bring its measures into conformity and would also form the basis for continued action by Brazil under Article 3 of the *SCM Agreement.*

[16] *Ibid*., para. 304.
[17] *Ibid*., paras. 272-286.
[18] *Ibid*., paras. 287-294.
[19] *Ibid*., para. 306.
[20] *Ibid*., para. 306.
[21] US First Written Submission, para. 160.
[22] *Ibid*., para. 167.
[23] *Ibid*., paras. 171 to 183.
[24] US First Written Submission, paras. 171 and 218.

A. EXPORT CREDIT GUARANTEES MAY PROVIDE "EXPORT SUBSIDIES" UNDER THE *AGRICULTURE AGREEMENT*

29. Under the *SCM Agreement*, export subsidies are prohibited. Under the *Agriculture Agreement*, certain export subsidies are allowed up to certain limits. The export subsidy disciplines of the *SCM Agreement* apply subject to the export subsidy disciplines of the *Agriculture Agreement*.[25] The Appellate Body confirmed in its first *Canada - Dairy* implementation report that "the WTO-consistency of an export subsidy for agricultural products has to be examined, in the first place, under the *Agreement on Agriculture*."[26] Canada sets out the relevant provisions of both Agreements in this section.

30. Article 1(e) of the *Agriculture Agreement* defines "export subsidies" as "subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement". Article 3.3 sets out the obligation of Members not to provide export subsidies listed in Article 9 in excess of scheduled commitment levels:

> Subject to the provisions of paragraphs 2(b) and 4 of Article 9, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule.

31. Article 8 of the *Agriculture Agreement* confirms the fundamental obligations of Members with respect to the provision of export subsidies:

> Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule.

32. Article 9 of the *Agriculture Agreement* lists and describes certain export subsidies that are subject to reduction commitments. All other export subsidies fall within the scope of Article 10.1, which reads:

> Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments.

33. The *Agriculture Agreement* does not define the term "subsidy" in the definition of "export subsidy" in Article 1(e) of the Agreement. The Appellate Body drew upon the definition of a "subsidy" in Article 1.1 of the *SCM Agreement* as context to the term "subsidy" in Article 1(e) of the *Agriculture Agreement* in both its original *Canada – Dairy* report and its original and implementation

[25] See Article 3.1 of the *SCM Agreement* and Articles 13(c)(ii) and 21.1 of the *Agriculture Agreement*.

[26] *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products: Recourse to Article 21.5 of the DSU by New Zealand and the United States*, Report of the Appellate Body, WT/DS103/AB/RW, WT/DS113/AB/RW, adopted 18 December 2001, paras. 123-124.

reports in *US - FSC*.[27] The Appellate Body also held in *US - FSC* that the "contingent upon export performance" requirements in the *Agriculture Agreement* and the *SCM Agreement* are the same.[28]

34. Article 1.1 of the *SCM Agreement* sets out the definition of a subsidy, which reads in relevant part:

> 1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:
>
> (a)(1) there is a financial contribution by a government or any public body within the territory of a Member…, i.e. where:
>
> (i) a government practice involves… potential direct transfers of funds or liabilities (e.g. loan guarantees); …
>
> and
>
> (b) a benefit is thereby conferred.

35. Article 3.1(a) of the *SCM Agreement* describes export subsidies as follows:

> 3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I…

36. Annex I of the *SCM Agreement* includes in particular item (j), which reads:

> The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

37. Canada provides views only on key elements of Articles 1 and 3.1(a) of the *SCM Agreement* that are applicable to a determination of whether the US programmes provide "export subsidies" under Article 1(e) of the *Agriculture Agreement.* If they do, then they are subject to US obligations under Articles 8 and 10.1 of the *Agriculture Agreement*.

## B. US EXPORT CREDIT GUARANTEES MAY GRANT EXPORT SUBSIDIES UNDER ARTICLE 1(E) OF THE *AGRICULTURE AGREEMENT* AND ARTICLE 3.1(A) OF THE *SCM AGREEMENT*

38. Based on the evidence and arguments presented by the disputing parties at this stage in the proceedings, it is Canada's assessment that US export credit guarantee programmes may provide "subsidies contingent upon export performance" under Article 1(e) of the *Agriculture Agreement* that

[27] See *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, Report of the Appellate Body, WT/DS103/AB/R, WT/DS113/R, adopted 27 October 1999, para. 87; *US – FSC* AB Report, paras. 136-137; *United States – Tax Treatment for "Foreign Sales Corporations: Recourse to Article 21.5 of the DSU by the European Communities*, Report of the Appellate Body, WT/DS108/AB/RW, adopted 29 January 2002, para. 194 [hereinafter *US – FSC* Article 21.5 AB Report].

[28] *US – FSC* AB Report, paras. 141-142; *US – FSC* Article 21.5 AB Report, para. 192.

are "not listed in paragraph 1 of Article 9", pursuant to Article 10.1. Because the United States has no export subsidy reduction commitments for upland cotton, it may have violated Article 10.1 by applying such subsidies in a manner that results in circumvention of its export subsidy commitments. The United States may have also therefore violated Article 8 by providing export subsidies "otherwise than in conformity with this Agreement".

39. Evidence submitted by Brazil indicates that the United States has exceeded its quantitative export subsidy reduction commitment level for various agricultural commodities, including upland cotton.[29] Accordingly, were the Panel to accept such evidence, the United States would bear the burden of establishing that no export subsidies have been granted in respect of the quantity of exports in question pursuant to Article 10.3 of the *Agriculture Agreement*.[30]

40. The United States cannot deny that US export credit guarantees involve a "financial contribution" in the form of a "potential direct transfer of funds" under Article 1.1(a)(1)(i) of the *SCM Agreement*. Export credit guarantees are loan guarantees. Nor can the United States deny that the export guarantees are contingent upon export performance under Article 3.1(a) of the Agreement. Canada therefore addresses only the "benefit" requirement of the subsidy definition under Article 1.1(b) of the *SCM Agreement*.

41. The determination of a "benefit" in transactions involving agricultural commodities is necessarily factual. However, any assessment of the facts in this dispute must be undertaken within an appropriate legal framework. The applicable framework in this dispute is based on well-established WTO case law.

42. In *Canada – Aircraft*, the panel found that:

> … a financial contribution will only confer a "benefit", *i.e.*, an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market.[31]

43. The Appellate Body upheld this finding:

> We ... believe that the word "benefit", as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market.[32]

44. Based on this reasoning, the question is whether there is a difference between the amount that the firm receiving the guarantee pays on credit guaranteed under the US programmes and the amount that the firm would pay on a comparable commercial loan absent that guarantee. The benefit is the

[29] Brazil First Written Submission, paras. 265-266.

[30] See *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products: Second Recourse to Article 21.5 of the DSU by New Zealand and the United States*, Report of the Appellate Body, WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted 17 January 2003, para. 73.

[31] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Panel, WT/DS70/R, adopted 20 August 1999, para. 9.112.

[32] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted August 20, 1999 at para. 157.

difference between these two amounts adjusted for any differences in fees. The useful context provided by Article 14(c) of the *SCM Agreement* supports such a standard. Article 14(c) reads:

> [A] loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees[.]

45. The panel in *Canada - Aircraft II* established a similar standard in respect of equity guarantees provided through a Canadian provincial government financing institution called *Investissement Québec* (IQ).[33] The panel reasoned as follows:

> Consistent with the findings of the panel and Appellate Body in *Canada – Aircraft*, we consider that *IQ* equity guarantees will confer a "benefit" to the extent that they are made available to Bombardier customers on terms more favourable than those on which such Bombardier customers could obtain comparable equity guarantees in the market. We note that the parties appear to agree that this standard can be applied by reviewing the fees, if any, charged by *IQ* for providing its equity guarantees. We agree that the "benefit" standard could be applied to *IQ* equity guarantees in this manner. Thus, to the extent that *IQ*'s fees are more favourable than fees that would be charged by guarantors with Québec's credit rating in the market for comparable transactions, *IQ*'s equity guarantees may be deemed to confer a "benefit".[34]

46. The panel went on to find that:

> … a "benefit" could arise if there is a difference between the cost of equity with and without an *IQ* equity guarantee, to the extent that such difference is not covered by the fees charged by *IQ* for providing the equity guarantee. In our opinion, it is safe to assume that such cost difference would not be covered by *IQ*'s fees if it is established that *IQ*'s fees are not market-based.[35]

47. Regarding IQ loan guarantees, the panel applied the same reasoning:

> In considering precisely what Brazil must show in order to demonstrate the existence of a "benefit", we note the findings of the panel and Appellate Body in *Canada – Aircraft*. We therefore consider that *IQ* loan guarantees will confer a "benefit" to the extent that they are made available to Bombardier customers on terms more favourable that those on which such Bombardier customers could obtain comparable loan guarantees in the market. In applying this standard, we are guided by Article 14(c) of the SCM Agreement, which provides contextual guidance for interpreting the term "benefit" in the context of loan guarantees.
>
> (…)
>
> In our view, and taking into account the contextual guidance afforded by Article 14(c), we consider that an *IQ* loan guarantee will confer a "benefit" when

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[33] *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Report of the Panel, WT/DS222/R, adopted 19 February 2002, para. 7.397 [hereinafter *Canada – Export Credits*, Panel Report].

[34] *Canada – Export* Credits, Panel Report, para. 7.344.

[35] *Canada – Export* Credits, Panel Report, para. 7.345.

> "there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by [*IQ*] and the amount that the firm would pay on a comparable commercial loan absent the [*IQ*] guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees". In other words, there will be a "benefit" when the cost-saving for a Bombardier customer for securing a loan with an *IQ* loan guarantee is not offset by *IQ*'s fees. In our opinion, it is safe to assume that this will be the case if it is established that *IQ*'s fees are not market-based.[36]

48. The same standard applies in the current dispute.

49. The United States avoids addressing the standard under Article 1.1(b) and argues simply that its export credit guarantee programmes "do not run afoul of the criteria of item (j)" of Annex I of the *SCM Agreement* and that, therefore, "…they are not a prohibited export subsidy under Article 3.1(a) of the Subsidies Agreement."[37] The United States asks the panel to interpret item (j) *a contrario*, meaning that if its measures meet the description of the programmes in the provisions but do not meet the standard for being considered a subsidy *per se*, the measures must be deemed not to confer export subsidies. However, item (j) does not create a "safe haven" for export credit guarantees where "premium rates… are [adequate] to cover the long-term operating costs and losses of the [programme]." To the contrary, item (j) "sets out the circumstances in which the grant of loan guarantees is *per se* deemed to be an export subsidy."[38] It simply "illustrates" deemed export subsidy practices. Nothing in the context or object and purpose of the *SCM Agreement* supports the US interpretation.

50. The issue of whether the premium rates under the US programmes are adequate under item (j) of Annex I of the *SCM Agreement* is necessarily factual. However, even if the US programmes charge adequate fees under the item (j) standard, the United States must nevertheless demonstrate that no export subsidies have been granted in respect of the quantity of exports in question in accordance with Articles 10.1 and 10.3 of the *Agriculture Agreement*. In other words, it must demonstrate the absence of subsidization on a transaction-by-transaction basis under Articles 1 and 3.1(a) of the *SCM Agreement*.

51. The United States also argues at length that Article 10.2 of the *Agriculture Agreement* exempts export credit practices from subsidy disciplines under the Agreement. This argument is untenable.

52. Article 10.2 of the Agreement on Agriculture reads:

> Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

53. Article 10.2 refers to "disciplines to govern the provision of export credits, export credit guarantees or insurance programmes" and not to "disciplines to govern the provision of *export subsidies in the form of* export credits, export credit guarantees or insurance programmes". This provision sets out an intention on the part of Members to undertake further work regarding these measures – the simple fact of agreeing to do so, however, does not amount to a permission to use those measures to confer export subsidies without consequence and without limit. The US

[36] *Canada – Export Credits*, Panel Report, paras. 7.397 and 7.398.
[37] US First Written Submission, para. 183.
[38] *Canada – Export Credits*, Panel Report, para. 7.395.

interpretation of Article 10.2 ignores the important context provided by Article 10.1. It also directly contradicts the stated object and purpose of Article 10 as a whole: "Prevention of Circumvention of Export Subsidy Commitments".[39]

54. Article 10.2 of the *Agriculture Agreement* does not exempt the United States from its obligation to demonstrate, under Article 10.3, that no export subsidies have been granted in respect of the quantity of exports in question in this dispute contrary to Article 10.1. For the United States to meet the requirements of Article 10.3, it must demonstrate the absence of subsidization as understood under Article 1(e) of the *Agriculture Agreement*. Indeed, the United States does not address Articles 1(e) or 10.1, or any prior panel and Appellate Body findings thereon.

## IV. CONCLUSION

55. At this stage of the proceedings, it is Canada's view that if the panel accepts the evidence presented by Brazil in its first written submission, it would find that PFC payments and direct payments do not satisfy the policy-specific criteria in paragraph 6(b) of Annex 2 of the *Agriculture Agreement*. Contrary to those requirements, the amount of these payments would be found to vary based on current production of certain fruit, vegetables and wild rice.

56. Regarding the US export credit guarantee programmes, in Canada's view, were the Panel to find that these programs provide export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement*, then it would also find that the United States has violated Articles 8 and 10.1 at the very least in respect of exports of upland cotton.

[39] See also "Export Credits and Related Facilities", Background Paper by the Secretariat, G/AG/NG/S/13, 26 June 2000 [Exhibit CDA-2.] at para. 44:

> [A]s matters currently stand the only rules and disciplines on agricultural export credits are those of the Agreement on Agriculture but only to the extent that such measures constitute export subsidies for the purposes of the Agreement on Agriculture. Where exports of an agricultural product are considered to be subsidised through export credits or related facilities, ascertaining the exported quantities benefitting [sic] from such measures for the purposes of determining conformity with export quantity reduction commitments would be reasonably straight forward. Quantifying related budgetary outlays and revenue foregone for the annual commitment level in question, using market-related premium or interest rate benchmarks for example (it is not clear what, if any, role there might be for export credit "subsidy equivalents" in this context), may be less straight forward but not necessarily problematic.

# ANNEX B-7

## THIRD PARTY SUBMISSION OF CHINA

15 July 2003

TABLE OF CONTENTS

## 1. INTRODUCTION

1. China is appreciative of this opportunity to present its views to the Panel in this proceeding on various domestic supports and export subsidies granted by the United States (the "US") for the production, use and export of US upland cotton.

2. In line with this Panel's decision dated 20 June 2003, China will focus its submission to issues relating to

(1) the burden of proof under Article 13 of the *Agreement on Agriculture* (the "Peace Clause");

(2) proper categorization of direct payments under the US. Farm Security and Rural Investment Act of 2002 ("FSRI"); and

(3) treatment of a non-complying measure by this Panel.

In China's opinion, these three issues, amongst others, call for close attention and analysis by the Panel.

## 2. ARGUMENTS

### 2.1. The Burden Of Proof Under The Peace Clause

3. China agrees with Brazil that "the [P]eace [C]lause is in the nature of an affirmative defense, and that the burden of proof that US domestic support and export subsidies to upland cotton are provided in conformity with the requirements of the [P]eace [C]lause lies with the United States and not with Brazil as the complainant"[1].

4. The burden of proof issue has been squarely dealt with by the Appellate Body in the *US – Shirts and Blouses* Case[2]. It stated that a complaining party asserting a claim under a positive rule, establishing obligations in themselves, first has the burden of proof to establish a prima facie case of an infringement of obligations by the responding Member, then the burden shift to the responding Member to adduces sufficient evidence to rebut the presumption[3]. However, with respect to rules providing "limited exceptions from obligations under certain other provisions of the GATT 1994", the Appellate Body is of the view that they are "in the nature of affirmative defense, thus it is only reasonable that the burden of establishing such a defense should rest on the party asserting it"[4].

5. The parties to this dispute disagree on the nature of the Peace Clause. The US does not see the Peace Clause as an affirmative defense; it argues that portions of the Peace Clause impose positive obligations. It cites Articles 13(a)(i), 13(a)(ii) and 13(b)(ii) of the Peace Clause to prove that by incorporating obligations under Article 6 and Annex 2 within the "conform fully to" requirement, the Peace Clause contains positive obligations on members[5].

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[1] Para. 107, Page 50, *First Submission of Brazil*, 24 June 2003.

[2] Section IV, Appellate Body Report, *US - Shirts and Blouses, WT/DS33/AB/R*.

[3] Page13-14, Section IV Burden of Proof, Appellate Body Report, *US - Shirts and Blouses, WT/DS33/AB/R*.

[4] Page 15-16, Section IV and Text at Note 23, Appellate Body Report, *US - Shirts and Blouses, WT/DS33/AB/R* .

[5] Paras. 43 and 45, *US First Written Submission*, 11 July 2003.

6. China has a different opinion. When stand-alone, Article 6 in and Annex 2 to the *Agreement on Agriculture* and may contain positive obligations on Members. However, when cross-referred to by Articles 13(a)(ii) and 13(b)(ii) respectively, they are brought under the Peace Clause to form part and parcel of pre-conditions to its application. Generic components of the relevant Peace Clause provisions[6] are (i) domestic support measures or export subsidies; (ii) that fully conform to Annex 2 and/or Article 6 of the *Agreement on Agriculture*; (iii) are exempt from actions; (iv) provided that…[7] The thrust of the relevant provisions of the Peace Clause lies in its exemption of measures from certain actions. To qualify under the exemption, a measure under item (i) above must first meet the requirements under items (ii) and (iv) above. The moment either Annex 2 or Article 6 are brought into "fully conform to" formula under item (ii) above, it ranks *pari passu* with the other requirement under item (iv) above to form conditions precedent to a successful exemption.

7. China believes the US errs on seeing no distinction between "obligation" and "condition". The Peace Clause requirement for full conformity to Article 6 and Annex 2 does not create new obligations because Members have to comply with Article 6 and Annex 2 whether Article 13 exists or not. Within the Peace Clause, these requirements do not stand to impose obligations on Members, but to set conditions precedent for a Members intending to invoke Peace Clause protection. Positive obligations to comply with Article 6 and Annex 2, lie under where they are, i.e. under Article 6 and Annex 2, but not under the Peace Clause.

8. China does not see any "absurdity" as described by the United States in its written submission[8]. No such "absurdity" would be instilled into the process if at the first stage, the party alleging protection of Peace Clause for its measures is required to discharge its burden to prove that such measures do conform to the relevant Peace Clause conditions; if it cannot so prove, the measures would lose Peace Clause protection. A second stage will follow for the party claiming against the measures to establish its substantive case, without the Peace Clause shield.

9. China hopes the above two-step approach will help both this Panel and the parties to move the procedures on towards resolution of the case.

### 2.2 Proper Categorization Of US FSRI 2002 Direct Payments

10. The United States in its first written submission argues that direct payments ("DP") under FSRI conforms fully to Annex 2 of the *Agreement on Agriculture*[9] and are therefore "Green Box" in nature. Brazil argues that DP programme is inconsistent with Paras. 1, 6(a) and (b) of Annex 2 to the *Agreement on Agriculture*, as

(1) it conditions the type of production undertaken by the producer[10];

(2) it sanctions base period updating[11]; and

(3) it has production and trade-distorting effects[12].

11. Para. 6(a) of Annex 2 to the *Agreement on Agriculture* provides to the effect that eligibility for "Green Box" direct payment support measures "shall be determined by clearly-defined criteria"

[6] Articles 13(b)(ii), 13(b)(iii) and 13(c)(ii), the *Agreement on Agriculture*.
[7] Note that Article 13(c)(ii) of the Peace Clause has no such proviso.
[8] Para. 36, *US First Written Submission*, 11 July 2003.
[9] Paras. 54 through to 68, *US First Written Submission*, 11 July 2003.
[10] Para. 174, *First Submission of Brazil*, 24 June 2003.
[11] Paras. 176 through to 182, *First Submission of Brazil*, 24 June 2003.
[12] Paras. 183 through to 191, *First Submission of Brazil*, 24 June 2003.

"*in* a defined and fixed base period." The word "in" requires a link between the "criteria" and the "defined and fixed base period". In other words, to qualify for "Green Box" direct payment measure under Para. 6(a), a criterion adopted by a Member must be tied, in a chronological sense, to a starting time frame that cannot be moved up on the calendar.

12. As the United States concedes, production acreage is a criterion for making FSRI DP[13]. However, under FSRI, production acreage for the purpose of DP is not tied to a defined and fixed base period. It moves progressively along the calendar.

13. Under the FSRI DP scheme, payment acreage, being one factor in calculating payment[14], is 85% of a person's base acreage. Base acreage, in turn, are either (i) "a four year average (1998-2001) of plantings of covered commodities (including upland cotton)", or (ii) the total of production flexibility contract ("PFC") acreage under the US 1996 Federal Agricultural Reform Improvement and Reform Act ("FAIR") and the four-year average (1998-2001) of plantings of eligible oilseeds[15]. With respect to base acreage calculation method (i) above, the United States explains, FSRI DP allowed landowners to retain PFC base acres and "add 1998-2001 acres of eligible oilseeds or simply declare base acreage for all covered commodities" (including upland cotton)[16]. With respect to base acreage calculation method (ii) above, the United States explains that while a landowner may elect to simply utilize acres devoted to covered commodities during the 1998-2001 period for purpose of DP, a landowner need not do so; base acres may remain those under FAIR, implying no cotton production need have occurred since the 1993-1995 period for a landowner to have "cotton base acres". The United States then concludes that "[t]hese … base acres are defined in the 2002 [FSRI] Act and fixed for the duration of the legislation (that it, from marketing year 2002-2007)"[17]. Such a conclusion ignores the fact that during the progression from PFC to DP, the requisite link between the programme acreage as a criterion and the "defined and fixed" starting time frame is broken. The change of legislation from FAIR to FSRI and the replacement of PFC with DP were utilized for producers to leap from their previous coverage acreage, which should have been tied to the base period, to a new updated acreage in 2002.

14. Enticement certainly exists for a producer to obtain more payments by leaping over the calendar and updating production acreage. The fundamental requirement that "no, or at most minimal trade distorting effects or effects on production" as required by Article 1 of Annex 2 to the *Agreement on Agriculture* is therefore not met.

15. In China's opinion, without dwelling upon the burden of proof issue, the preponderance of evidence as produced by the parties indicates that the US DP under FSRI fails to meet the "tie" requirement under Para. 6(a) of Annex 2 of the *Agreement on Agriculture* and shall be properly categorized as non-"Green Box" measures.

### 2.3 Panel Treatment Of Measures Found By Earlier Proceedings To Be In Violation

16. Brazil also brought claims against export subsidy support granted for upland cotton export sales by US "Foreign Sales Corporations" ("FSCs") under the "FSC Repeal and Extraterritorial Income Act of 2000" ("ETI Act") [18].

[13] Paras. 56 and 67, *US. First Written Submission*, July 11, 2003.,
[14] Para. 58, *Ibid.*
[15] Para. 59, *Ibid.*
[16] Para. 60, *Ibid.*
[17] Subpara. 67(1), *Ibid.*
[18] Paras. 315 through to 330, *First Submission of Brazil*.

17. The US ETI Act has previously been found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by both the panel[19] and the Appellate Body[20] in *US – FSC (21.5)*. On 29 January 2002, the WTO Dispute Settlement Body (the "DSB") adopted the panel and Appellate Body reports, declaring that the ETI Act violates Articles 3.1(a) and 4.7 of the *Subsidies Agreement*, Articles 8 and 10.1 of the *Agreement on Agriculture* and Article III:4 of *GATT 1994*.

18. As the United States had failed to implement the DSB recommendations and rulings within the prescribed time framework, on 25 April 2003, the European Communities (the "EC") requested the DSB authorization to take appropriate countermeasures and to suspend concessions pursuant to Article 4.10 of the *Subsidies Agreement* and Article 22.7 of the *DSU*[21]. On 7 May 2003, the DSB authorized the EC to impose countermeasures against the US.

19. Brazil quoted main EC arguments and portions of the panel's and the Appellate Body's reasoning from *their* respective reports in *US – FSC (21.5)*, all to persuade this Panel into taking the same reasoning and conclusion[22].

20. China believes that the panel and the Appellate Body's reasoning and their conclusion in *US – FSC (21.5)* are of extraordinary value to the current Panel.

21. First, "[a]dopted panel reports are an important part of the GATT *acquis*. They are often considered by subsequent panels. They create *legitimate expectations* among WTO members, and, therefore, *should be taken into account where they are relevant to any dispute*. [emphasis added]." [23] Export subsidy support provided to upland cotton export sales by US "Foreign Sales Corporations" under the ETI Act as challenged by Brazil in this case, is exactly the very same one challenged by the EC and found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by the panel[24] and the Appellate Body[25] in *US – FSC (21.5)*. The panel and the Appellate Body's decisions, as well as DSB's adoption of same in *US – FSC (21.5)*, have already created "legitimate expectations" among WTO members. Should this Panel re-consider the arguments, analysis and conclusions in respect of the same measure adopted by the same Member in dispute, and re-decide with even the slightest difference, the WTO Members' legitimate expectations will be seriously disturbed and offended. Unless the current Panel finds the FSC export subsidies under the ETI Act challenged by Brazil in this case different from the FSC export subsidies under the ETI Act challenged by the EC in the *US – FSC (21.5)*, relevancy is fulfilled to the maximum extent possible. The very same export subsidies shall be governed by the same juridical analysis, rule and conclusion. Substantive deviation from that the reasoning and conclusion of the earlier case on the same measure may well cast misgivings on the established DSB authority and reputation.

22. The United States in its *First Written Submission* argues that:

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[19] Panel Report, *US - FSC (21.5)*, WT/DS108/RW, adopted on 29 January, 2002.

[20] Appellate Body Report in *US - FSC (21.5)*, AB-2002-1, WT/DS108/AB/RW,adopted on 29 January, 2002.

[21] Recourse by the European Communities to Article 4.10 of the *Subsidies Agreement* and Article 22.7 of the *DSU*, WT/DS/108/26, circulated on April 25, 2003.

[22] Paras. 315 through to 327, *First Submission of Brazil*.

[23] Para. E, Report of the Appellate Body, *Japan - Taxes on Alcoholic Beverages*, AB-1996-2, adopted on 1 November 1996).

[24] Paras.8.30, 8.46, 8.48, 8.50, 8.74, 8.75, and 9.1(a.), Panel Report, *US - FSC (21.5)*, WT/DS108/RW, adopted on 29 January 2002.

[25] Paras.111, 116 through to 120, 122, 194, 196, and 256(d), Appellate Body Report, *US - FSC (21.5)*, AB-2002-1, WT/DS108/AB/RW, adopted on 29 January 2002.

> It also is well-established that even though panels may take into account prior panel and Appellate Body reports, "panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same."[26]

China notes that US had omitted the immediate subsequent paragraph, in which the panel states:

> However, in the course of "normal dispute settlement procedures" required under Article 10.4 of the DSU, we *will take into account the conclusions and reasoning* in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we *should give significant weight to both Article 3.2 of the DSU,* which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, *and to the need to avoid inconsistent rulings* (which concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the DSU.[27] [emphasis added]

China believes that second sentence following the US quote from the panel's report could not be more relevant to the US ETI Act before this Panel.

23. Secondly, the DSB has already, upon request by the EC, authorized the EC to impose countermeasures against the US, for its failure to implement the DSB recommendations and rulings within the prescribed time framework. DSB's authorization to counteract

(1) further strengthens the weight of the panel and the Appellate Body's decisions in *US – FSC (21.5).* Authorization by the DSB for countermeasures against the very same measures is a collective reflection that the measures shall have been withdrawn, and;

(2) brings up the need for efficiency. Given the DSB's heavy caseload, as well as workload of this Panel, benefits of efficiency far overweighs whatever need for repeating the work that had been completely accomplished by a previous panel and the Appellate Body.

24. Thirdly, in light of difficulties encountered by the DSB in encouraging compliance subsequent to the *US – FSC (21.5)* proceedings, a different finding by this Panel in relation to ETI in the current dispute will frustrate WTO's effectiveness as reflected in the DSB mechanism. The essence of "[p]rompt compliance with recommendations or rulings of the DSB" "to ensure effective resolution of disputes to the benefit of all Members" called for under Article 21.1of the *DSU* will evaporate.

25. Being a multilateral system, the WTO cannot afford to permit non-compliance by any Member in its face. One dispute settled will definitively involve several legal issues having been clarified and practices of certain members adjudicated. Such clarification and adjudication in one case must serve to benefit all members in the multilateral system. As Article 3.2 of the *DSU* tries to impress, the dispute settlement system of the WTO is a pivotal element in providing uniform security and predictability to the multilateral trading system and to avoid multiplication of the same practices being disputed in separate but non-distinct cases. To compel panels in later instances to re-visit the

[26] Para. 185, *First Written Submission of the US,* 11 July 2003, quoting in quotation marks Para. 7.30, Panel Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS79/R, adopted 22 September 1998.

[27] Para. 7.30, Panel Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Product*, WT/DS79/R, adopted 22 September 1998.

same legal issue and re-adjudicate the same practices the DSB recommends against on a second or even indefinite analytical journey would relegate WTO dispute settlement regime into disrepute.

26. The concern is not unfounded. The fact that Brazil had to resort to the WTO dispute settlement system and bring the ETI Act before this Panel is distinctly telling. This current Panel must put an end to that concern by ruling that the panel and the Appellate Body's reasoning *and* their conclusion in *US – FSC (21.5)* be taken by this Panel, unless by the time the current Panel makes it decision, such measures will have already been withdrawn by the US.

## 3. CONCLUSION

27. To sum up, China is of the following opinion:

(1) The Peace Clause is an affirmative defense in nature, and a party seeking its protection bears the burden of proof;

(2) The US DP, which removes production acreage from its required nexus with a defined and fixed based period by allowing acreage updating, is not "Green Box" measure within the meaning of Para. 6(a) of Annex 2 to the *Agreement on Agriculture*; and

(3) The US ETI Act has been found by a prior panel and the Appellate Body to violate the *Agreement on Agriculture* and the *Subsidies Agreement*. In addition, the DSB has authorized the complaining party in the prior proceeding to take countermeasures. In light of coherency and efficiency of the WTO dispute settlement mechanism, this Panel shall take the reasoning and conclusion of the Appellate Body in the earlier case.

28. China thanks this Panel for granting this opportunity to present its views on issues related to this proceeding, and hopes that this Panel will finds the above points helpful.

# ANNEX B-8

## FIRST THIRD PARTY SUBMISSION BY THE EUROPEAN COMMUNITIES

15 July 2003

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## I. INTRODUCTION

1. This dispute raises a number of complex yet important questions in respect of the applicable WTO regime for trade in agricultural goods. In this First Third Party Submission, the European Communities has submitted arguments on a number of questions raised by Brazil's First Written Submission.[1] However, the present submission should not be seen as exhaustive. Given the very short period between the deadline for the US First Written Submission and the deadline for submissions from third parties, the European Communities has not been able to incorporate in this submission a response to all of the arguments brought in the US First Written Submission which might merit a comment. Consequently, the European Communities reserves its right to submit argument on other questions (or to further develop the arguments set out here) at the First Session of the First Substantive Meeting with the Parties.

2. Following the Panel's invitation of 20 June 2003, the European Communities has essentially limited itself to questions related to the interpretation of Article 13 of the *Agreement on Agriculture*, and some of the "non-peace clause" related claims brought by Brazil. The European Communities will therefore argue that :

- As a preliminary matter, Brazil is incorrect to consider that only legislation which mandates a particular action can be found inconsistent with the WTO Agreements;

- Article 13 *Agreement on Agriculture* is not an affirmative defence;

- The first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* does not create a free-standing obligation, separate from the basic criteria set out in the second sentence of paragraph 1; and,

- Article 10.2 of the *Agreement on Agriculture* does not exempt export credits and export credit guarantees from the disciplines of the *Agreement on Agriculture*.

3. The European Communities does not express an opinion on the application of the relevant legal interpretations to the facts of this dispute.

## II. PRELIMINARY ISSUE - BRAZIL'S REFERENCE TO A "MANDATORY / DISCRETIONARY DOCTRINE" IS UNFOUNDED

4. Before turning to the substantive questions of interpretation the European Communities would like to touch briefly upon one systemic issue raised in Brazil's submission. Brazil states in its First Written Submission that:

> "It is established under WTO law that a Member can only challenge measures of another Member *per se* if such measures mandate a violation of the WTO Agreement."[2]

5. Brazil cites as authority for this position para. 88 of the Appellate Body's Report in *United States – 1916 Act*. However, the Appellate Body did not "establish" that measures can only be

[1] Brazil's First Submission to the Panel regarding the "Peace Clause" and Non-Peace Clause Related Claims, 24 June 2003 ("Brazil's First Written Submission").

[2] Brazil's First Written Submission, para. 244. See, in the same sense, paras. 250 and 341.

challenged if they mandate a violation of the WTO Agreements. In that case, the Appellate Body upheld the panel's finding that the legislation in question was not discretionary and thus;

> "[did] not find it necessary to consider [..] whether Article 18.4, or any other provision of the *Anti-Dumping Agreement*, has supplanted or modified the distinction between mandatory and discretionary legislation".[3]

6. Panels have taken different approaches to this issue. The panel in *United States – Section 301* found that discretionary legislation may violate certain WTO obligations.[4] This approach can be contrasted with that of the panel in *United States – Export Restraints*.[5] More recently, the Appellate Body in considering an EC claim against US legislation noted that;

> "[it did not] preclud[e] the possibility that a Member could violate its WTO obligations by enacting legislation granting discretion to its authorities to act in violation of its WTO obligations. We [the Appellate Body] make no finding in this respect".[6]

7. Consequently, it is far from established that only mandatory legislation can be found *per se* inconsistent with the WTO Agreements. The European Communities, for one, is convinced that discretionary legislation may, in certain circumstances, be found to be inconsistent with WTO obligations. However, further discussion of this issue does not appear necessary at present, since Brazil claims that the legislation in question permits of no discretion and the United States does not appear to dispute this point.[7] Consequently, the European Communities will not develop its arguments on this issue further in this submission.

## III. ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE CANNOT BE CONSIDERED AN AFFIRMATIVE DEFENCE

8. Brazil argues that Article 13 of the *Agreement on Agriculture* should be understood as an affirmative defence and thus that the United States bears the burden of proof.[8] The United States has indicated that it disagrees with this characterisation, and considers that Article 13 is not an affirmative defence.[9]

9. The European Communities shares the view of the United States that there are compelling reasons to consider that Article 13 is not an affirmative defence.[10] Article 13 cannot be considered an

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[3] Appellate Body Report, *United States – Anti-Dumping Act of 1916 ("United States – 1916 Act")*, WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, para. 99

[4] Panel Report, *United States – Sections 301-310 of the Trade Act of 1974 ("United States – Section 301")*, WT/DS152/R, adopted 27 January 2000, footnote 23, paras. 7.53-7.54. Note that the Appellate Body in *United States – 1916 Act* mentioned this finding, without suggesting that it was incorrect (see footnote 59 of the Appellate Body Report).

[5] Panel report, *United States – Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001, paras. 8.8 and 8.9.

[6] Footnote 334, Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 8 January 2003.

[7] Brazil's First Written Submission, para. 245.

[8] Brazil's First Written Submission, paras. 110 to 121.

[9] Para. 38, Comments of the United States of America on the Comments by Brazil and the Third Parties on the Question Posed by the Panel,.13 June 2003. See also First Written Submission of the United States of America, 11 July 2003 ("US First Written Submission"), paras. 38 to 47.

[10] The European Communities is aware of the fact that it used the term "defence" in its Initial Submission to the Panel of 10 June 2003 (Para. 6 , Comments by the European Communities on certain issues raised on an initial basis by the Panel, 10 June 2003). It did so, however, in the context of a discussion of what

affirmative defence which will excuse a violation of another provision of the WTO Agreements. Rather, it seems to the European Communities, Article 13 is a form of "gateway" or "threshold" provision, which regulates the use of certain mechanisms (countervailing duties, serious prejudice claims, non-violation complaints) in respect of certain types of subsidies. Conformity with the conditions of Article 13 has the effect of providing an exemption from action under Article XVI GATT 1994 and the *SCM Agreement*. Consequently, once a panel has determined whether or not agricultural subsides conform to the conditions of Article 13, it need not, indeed cannot, rule on whether those agricultural subsidies are consistent with Article XVI GATT 1994 and the *SCM Agreement*. For that reason, it cannot be equated to a defence to a violation of a provision of a WTO Agreement, in the way, for instance, Article XX may be considered a defence to a violation of Article I or III GATT 1994.

10. Even assuming, *arguendo*, Brazil's contention that Article 13 of the *Agreement on Agriculture* is an exception to the otherwise applicable disciplines[11], the Appellate Body has pointed out in *EC-Hormones* that merely characterising a provision as an "exception" and consequently an affirmative defence is insufficient to shift the burden of proof in dispute settlement proceedings.[12] Any finding reversing the ordinary rule that the complaining party bears the burden of proof to establish a *prima facie* case must be derived from an application of the normal rules of treaty interpretation. The ordinary rules of treaty interpretation do not lead to such a conclusion in this case.

11. First, as noted above, the Panel is not asked to examine a general rule – exception situation with respect to Article 13. Article 13 is more akin to a threshold permitting further action if that threshold is not complied with.

12. Second, Article 13 is an integral part of the *Agreement on Agriculture*. In that sense, it is comparable to Article 6 of the *Agreement on Textiles and Clothing*, Article 3.3 of the *Sanitary and Phytosanitary Agreement* and the second sentence of Article 2.4 of the *Agreement on Technical Barriers to Trade* which were found not to be affirmative defences by the Appellate Body.[13] Article 13 incorporates the obligations which a WTO Member assumes under the *Agreement on Agriculture* should it decide to provide agricultural subsidies to its producers, and regulates the status of such subsidies with respect to potential dispute settlement and the application of countervailing duties. In a similar fashion, Article 6 of the *Agreement on Textiles and Clothing* provides certain obligations which a WTO Member assumes if it decides to dis-apply the disciplines of the ATC in the form of a "transitional safeguard measure". Likewise, Article 3.3 of the *Sanitary and Phytosanitary*

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appeared to be the extreme logical conclusion of the arguments which the United States made, in order to refute the proposition that the issue of conformity with Article 13 could only be dealt with in a separate panel proceeding, divorced from a panel proceeding which dealt with the claims conditional upon Article 13 not being applicable. The term "defence" was used in a general sense to connote an argument which could be invoked in reaction to another argument. Moreover, the European Communities did not use the term "affirmative defence" and did not use the term "defence" in the sense of a "defence […] to a claim of violation of a GATT obligation" or as a "limited exception from certain other provisions of the [WTO Agreements]" (Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India* ("United States – Shirts and Blouses"), WT/DS33/AB/R, adopted 23 May 1997, page 15-16). Finally, the European Communities was addressing only the question posed by the Panel and not the question of the burden of proof applicable to Article 13.

[11] Brazil's First Written Submission, para. 120.

[12] Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 104.

[13] Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India* ("United States – Shirts and Blouses"), WT/DS33/AB/R, adopted 23 May 1997, page 16. *European Communities – Hormones* Para. 104, Appellate Body Report, *European Communities — Trade Description of Sardines (European Communities – Sardines)*, WT/DS231/AB/R, adopted 23 October 2002. Paras. 274-275.

*Agreement* sets out obligations on a Member wishing to maintain a higher level of sanitary or phytosanitary protection than provided for in international standards. These provisions, like Article 13 of the *Agreement on Agriculture* provide certain rights to WTO Members, but cannot be seen as exceptions.

13. Third, as pointed out by the United States, considering Article 13 as an affirmative defence leads to perverse effects.[14] If a complaining Member makes a claim that a Member has acted inconsistently with the *Agreement on Agriculture*, the complaining Member will bear the burden of proof to establish a breach of the Agreement. However, if Article 13 is considered an affirmative defence, where a complaining Member brings a claim arguing breach of both the *Agreement on Agriculture* and the *SCM Agreement* the complaining Member would bear the burden of establishing a breach of the *Agreement on Agriculture*, the responding Member would bear the burden of proving that it was in compliance with the same provisions of the *Agreement on Agriculture* in order to apply Article 13, and the complaining Member would bear the burden of proof under the *SCM Agreement*. This cannot be what WTO Members intended when they negotiated Article 13. Indeed, the negotiators were aware of the issue of burden of proof and explicitly reversed the burden of proof in Article 10.3 *Agreement on Agriculture* with respect to potential circumvention of export subsidy commitments. That they did not agree on similar language with respect to Article 13 suggests that they intended the ordinary rules of burden of proof to apply.

14. Consequently, the European Communities respectfully requests that the Panel find that Article 13 is not an affirmative defence.

## IV. THE INTERPRETATION OF ANNEX 2 OF THE AGREEMENT ON AGRICULTURE

### A. THE RELEVANCE OF THE FIRST SENTENCE OF PARAGRAPH 1 OF ANNEX 2

15. Brazil argues in several instances that the first sentence of paragraph 1 of Annex 2 of the *Agreement on Agriculture* is an independent obligation which must be satisfied in addition to the basic criteria set out in paragraph 1 and the policy-specific criteria set out in paragraphs 2 to 13 of Annex 2.[15] The European Communities considers that this interpretation is incorrect. The first sentence does not set out an independent obligation. It simply signals the objective of Annex 2.

16. Paragraph 1 of Annex 2 reads as follows:

> 1. Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:
>
> (a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,
>
> (b) the support in question shall not have the effect of providing price support to producers;
>
> plus policy-specific criteria and conditions as set out below.

[14] US First Written Submission, para. 44
[15] See, e.g. Brazil's First Written Submission, paras. 163-172, 183-191 and 199-201.

17. The European Communities will set out its understanding of the first sentence below. While some ambiguity as to the effect of the first sentence might arise when considering its ordinary meaning in isolation, as Brazil does, it is quite clear that, when seen in context, the first sentence should not be considered to be a free-standing obligation. This result also follows from a consideration of the objective of Annex 2.

18. It should be recalled that the provision of domestic subsidies for industrial products (i.e. non-export contingent subsidies) is not prohibited as such under the *SCM Agreement* or other *WTO Agreements*.[16] Such subsidies will only be actionable if they meet the requirements of Articles 1 and 2 of the *SCM Agreement*, and cause adverse effects to the interests of another Member in the sense of Article 5 of the *SCM Agreement*.

19. The *Agreement on Agriculture* initiated a process of reform for domestic support for agricultural products.[17] Negotiators recognised that domestic support for agricultural products required discipline and binding limits on the amount of domestic support. However, given that the provision of domestic subsidies to industrial products can be unlimited, provided there is no infringement of Article 5 of the *SCM Agreement*, it would have been inequitable to subject all types of domestic support to the strict discipline and limitations of the *Agreement on Agriculture* when the economic effects of different types of measures are not comparable. Consequently, it was necessary for the negotiators to differentiate between those types of support measures whose economic effect was deemed significant[18], and those types of measures whose economic effects were deemed less significant. This differentiation was achieved, not by defining those measures deemed to have a significant effect, but rather those deemed to have a less significant effect. The result was Annex 2 to the *Agreement on Agriculture*.

20. The first sentence of paragraph 1 announces the differentiation which is achieved by the criteria set out in Annex 2.[19] It sets out the logic for distinguishing between the types of domestic support which come under Annex 2 and are exempt from reduction commitments and other domestic support measures. That the first sentence does not set out an independent obligation can be seen from the next sentence of Paragraph 1 which starts with the word "accordingly". "Accordingly" means "in accordance with the logical premises; correspondingly".[20] "Accordingly" consequently links the "fundamental requirement" in the first sentence with the "basic criteria" in the second sentence making it clear that in order to be considered to have "no, or at most minimal, trade-distorting effects or effects on production" the measure must meet the basic criteria in the second sentence of paragraph 1 together with the policy-specific criteria set out in paragraphs 2 to 13.

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[16] Provided the subsidisation is not contingent upon the use of domestic over imported goods, in the sense of Article 3.1(b) of the *SCM Agreement*.

[17] See the Preamble to the *Agreement on Agriculture*.

[18] Without analysing whether the effects would, in the absence of the *Agreement on Agriculture* and assuming the *SCM Agreement* to be applicable to agricultural goods, lead, in a particular case, for a particular product, to a finding of inconsistency with the *SCM Agreement*.

[19] It can be noted that one commentator, who has undertaken one of the most comprehensive reviews of the *Agreement on Agriculture*, notes that the requirement in the first sentence of paragraph 1 is:

> "[t]oo vague to translate into concrete and enforceable obligations. As an appreciation of this fact, the Agreement on Agriculture has gone to great lengths to provide a detailed and comprehensive [..] list of measures along with the general and specific criteria they have to satisfy before they are exempted from the reduction commitments."

P. 420-421, M. G. Desta, *The Law of International Trade in Agricultural Products* (Kluwer Law International 2002).

[20] The New Shorter Oxford English Dictionary, 1993.

21. Contextual support for this position can be found in Annex 2 itself and in Articles 6 and 7 of the *Agreement on Agriculture*.

22. Paragraph 5 of Annex 2 states that support provided through direct payments which are to be exempted from reduction commitments "shall meet the basic criteria set out in paragraph 1 above, plus specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13." It is quite clear that the "basic criteria" referred to here is the "basic criteria" referred to in the second sentence of paragraph 1 of Annex 1. There is no reference to the fundamental requirement and thus that the measures should have "no or at least minimal trade distorting effects or effects on production". Consequently, this fundamental requirement cannot be an additional criteria for a domestic measure to be exempted from reduction commitments under Annex 2.

23. Further support for this view is found in the *Agreement on Agriculture*. Article 6.1 applies to domestic support measures other than those "which are not subject to reduction in terms of the criteria set out in this Article and in Annex 2" (emphasis added). Article 7.1 obliges Members to ensure that domestic support measures "not subject to reduction commitments because they qualify under the criteria set out in Annex 2 to this Agreement are maintained in conformity therewith" (emphasis added). Article 7.2(a) goes on to state that "any measure that is subsequently introduced that cannot be shown to satisfy the criteria in Annex 2 to this Agreement […] shall be included in the Member's calculation of its Current Total AMS" (emphasis added). Annex 2 itself clearly distinguishes between the "fundamental requirement" of the first sentence of paragraph 1 and the "basic criteria" of the second sentence of paragraph 1 and the "policy-specific criteria" set out in paragraphs 1 to 13. The use of the word "criteria" in Articles 6 and 7, and its use in Annex 2 make it quite clear that in order to be exempted from reduction commitments by virtue of inclusion in the green box a domestic support measure must meet the criteria. It is obvious that the negotiators developed the criteria in order to determine whether a policy could be deemed to meet the "fundamental requirement" set out in paragraph 1 of Annex 2 and did not intend the first sentence to set out an independent obligation.

24. This interpretation is also supported by the objective behind Annex 2 and the *Agreement on Agriculture* more generally. In the administration of its agricultural policy, in order to ensure respect for their reduction commitments, a WTO Member must know how to classify its support measures. It is thus vital, for reasons of legal security and predictability, that a Member can determine the classification of its measures. The clear and specific criteria set out in Annex 2 provides WTO Members with guidance on how to approach this task. Assuming Brazil's argument to be correct, a Member would also have to determine whether a particular measure to be taken might have a more than minimal trade distorting effect or effect on production. This is inevitably a difficult exercise, based on a subjective appreciation of a particular situation, which often may only be performed on an *ex post facto* basis. This is not a reasonable basis for advancing reform of trade in agriculture, and promoting the predictability of the system. Moreover, it can be noted that there is no such "effects" text in respect of other exempted domestic support measures *viz.* "de minimis payments" under Article 6.4 of the *Agreement on Agriculture* and "blue box payments" under Article 6.5 of the *Agreement on Agriculture*.

25. On the basis of the above, the European Communities respectfully requests the Panel to conclude that the first sentence of Paragraph 1 of Annex 2 of the *Agreement on Agriculture* does not impose an obligation independent of the basic and policy-specific criteria set out in Annex 2.

B. INTERPRETATION OF PARAGRAPH 6 OF ANNEX 2

26. Brazil's first written submission raises a number of questions as to the correct interpretation of paragraph 6 of Annex 2. The European Communities attaches the utmost importance to the correct interpretation of these provisions. While the European Communities is still analysing the Brazilian

and US arguments, it already takes note of the fact that the US does not claim that its counter-cyclical payments qualify as exempt under the green box.[21]

## V. INTERPRETATION OF ARTICLES 10.1 AND 10.2 OF THE AGREEMENT ON AGRICULTURE (EXPORT CREDIT GUARANTEES)

27. Brazil argues that the US export credit guarantee schemes violate the *Agreement on Agriculture* and the *SCM Agreement*.[22] The European Communities can concur with this argument to the extent it can be confirmed that the export credit guarantees in question are to be considered export subsidies.

28. The European Communities points out, in this regard, that Article 10.2 of the *Agreement on Agriculture* cannot be considered to exempt export credit guarantees from the disciplines of Article 10.1 of the *Agreement on Agriculture*.[23] Article 10.2 states:

> Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

29. Article 10.2 makes it clear that the provision of export credit guarantees is not one of the types of export subsidies listed in Article 9.1 which a Member is given a limited authorisation to apply. Article 10.1 provides that non-listed export subsidies may not be applied in order to circumvent export subsidy commitments. Since export credit guarantees may be "export subsidies not listed in paragraph 1 of Article 9" they may be applied in a manner which "results in or threatens to lead to, circumvention of export subsidy commitments" and thus may be prohibited by Article 10.1. For unscheduled products, since the listed export subsidies cannot be provided, the Appellate Body has found that the transfer of economic resources in the form of non-listed export subsidies (e.g. export credit guarantees) threatens to circumvent the prohibition on giving listed export subsidies to such products.[24] Thus, export credit guarantees which qualify as export subsidies may be illegal under Article 10.1 where they might lead to circumvention of the export subsidy commitments.

30. Such a conclusion does not render Article 10.2 devoid of meaning. Article 10.2 is designed to develop disciplines of a broader nature than simply the regulation of export credits and export credit guarantees which operate as an export subsidy, since whether an export credit guarantee is an export subsidy depends on an analysis of the structure of that instrument. One reason why Article 10.2 was necessary is that export credits and export credit guarantees for agricultural commodities are not covered by the OECD Arrangement on Guidelines for Officially Supported Export Credits (see Article 3d).[25] Export credits which conform to this arrangement are considered not to be prohibited export subsidies.[26] Consequently, Article 10.2 sets up an obligation to develop disciplines for export credits and export credit guarantees irrespective of the question whether such instruments operate as

[21] US First Written Submission, para 5, para. 118.

[22] Brazil's First Written Submission, paras. 252-314.

[23] The European Communities notes that the US has made this argument in paras. 154-166 of its First Written Submission.

[24] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" ("United States – FSC")*, WT/DS108/AB/R, adopted 20 March 2000, para. 150.

[25] OECD Arrangement on Guidelines for Officially Supported Export Credits of 15 October 2002 available at www.oecd.org/dataoecd/52/3/2763846.pdf.

[26] See Item K of the Illustrative List of Export Subsidies, Annex 1 to the *SCM Agreement*.

export subsidies. It does not permit any differentiation in treatment between export credits, export credit guarantees or insurance programmes and other non-listed export subsidies.[27]

31. The European Communities submits, therefore, that Article 10.2 cannot be seen as exempting export credit guarantees granted to agriculture products from WTO disciplines.

## VI. CONCLUSION

32. By way of conclusion, the European Communities respectfully requests the Panel to find that:

- Article 13 *Agreement on Agriculture* should not be considered an affirmative defence;
- The first sentence of the first paragraph of Annex 2 to the *Agreement on Agriculture* should not be interpreted as a free-standing obligation; and,
- Article 10.2 of the *Agreement on Agriculture* does not exempt export credits and export credit guarantees, which are export subsidies, from the disciplines of the *Agreement on Agriculture*.

33. The European Communities reserves its right to address new arguments, and further develop the arguments set out herein, in its oral statement to the first session of the first substantive meeting.

[27] Note that Desta arrives at a similar conclusion:

> "To the extent that no such agreement [on the provision of export credits etc] has been reached, this provision simply remains to be an agreement to maintain good faith for a planned future negotiation devoid of any substantive additional obligation for some time to come. Until then, there seems to exist no legal distinction in the treatment of these three practices and the other forms of export subsidies not listed under Article 9.1."
>
> See Desta, p. 234 op cit. footnote 19.

# ANNEX B-9

## THIRD PARTY SUBMISSION OF NEW ZEALAND

15 July 2003

CONTENTS

## I. INTRODUCTION

1.01 The present dispute between Brazil and the United States regarding United States subsidies to upland cotton, as well as being important in respect of addressing the rights and obligations of the parties concerned, is also timely. New Zealand hopes this dispute will give greater clarity to the proper interpretation of important WTO disciplines applicable to agricultural trade. Although New Zealand is not a producer or exporter of cotton, New Zealand has a systemic interest in ensuring the continued integrity of these disciplines and has therefore joined this dispute as a third party.

1.02 New Zealand also acknowledges the importance of the cotton sector for a number of developing countries. In this regard New Zealand recalls the recent joint proposal made in the context of the Doha Development Agenda negotiations by Benin, Burkina Faso, Chad, Mali entitled 'Poverty Reduction: Sectoral initiative in favour of cotton'.[1] The joint proposal calls for recognition of the strategic nature of cotton for development and poverty reduction in many least developed countries and for the complete phasing out of support measures for the production and export of cotton. As the paper points out, the efforts of cotton producers in West and Central African countries towards liberalisation and competitiveness are virtually nullified by the fact that certain WTO Members continue to apply support measures to cotton that distort global markets.

1.03 The joint proposal outlines the damage caused by the very high levels of support given to cotton producers in certain WTO Member countries, including artificially increasing supply in international markets and bringing down export prices. This is the very same damage that Brazil is attempting to address through this dispute.

1.04 With respect to WTO disciplines, one of the biggest achievements of the Uruguay Round was the recognition that domestic support policies were instrumental in determining the overall nature of international agricultural trade. For the first time specific disciplines were placed on the ability of Members to use domestic support programmes in an unfettered manner. Trade-distorting or production-distorting domestic support measures became subject to reduction commitments.

1.05 New Zealand is concerned to ensure trade-distorting or "amber box" measures cannot be used contrary to the "peace clause" in a manner that negatively affects other Members.

1.06 At the same time as addressing trade-distorting support, Members recognized that some forms of domestic support were less trade-distorting than others and that certain types of programmes should continue to play a role in Members' policy "tool box". Accordingly the "green box", as set out in Annex 2 of the *Agreement on Agriculture*, was designed to allow Members to pursue agricultural objectives such as the provision of general services, disaster relief, food security and structural adjustment assistance and to support incomes as long as that was done in a way totally "decoupled" from production. The "green box" therefore allows WTO Members to meet legitimate non-trade objectives in a non-trade distorting way.

1.07 Strict eligibility criteria have been set down in Articles 6 and 7 and Annex 2 of the *Agreement on Agriculture* to ensure that only genuine non-trade distorting measures escape reduction commitments, including explicit inclusion of the "fundamental requirement" that such measures "have no, or at most minimal, trade-distorting effects or effects on production".[2]

1.08 The fact that basic and policy-specific criteria were included in the *Agreement on Agriculture* shows Members recognised the potential for the "green box" to be abused and domestic support commitments circumvented. In New Zealand's view it is critical that the integrity of the disciplines

[1] TN/AG/GEN/4
[2] *Agreement on Agriculture* Annex 2, paragraph 1.

on "green box" measures are not weakened or their legitimate purpose undermined through the inclusion of measures that fail to meet the strict requirements of Annex 2, including the fundamental criterion that such measures are non-trade or production distorting. Accordingly one of New Zealand's key objectives in joining this dispute as a third party is to ensure that the "green box" cannot be used to circumvent commitments on trade-distorting measures.

1.09 Under the Uruguay Round Members also agreed to a "peace clause" (Article 13 of the *Agreement on Agriculture*). Of particular relevance to this dispute is Members' agreement that provided non-"green box" measures meet the requirements of the *Agreement on Agriculture* and the levels of support did not exceed 1992 levels, such measures would be exempt during the implementation period of the *Agreement* from certain actions that would otherwise be available to Members under the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*") and *General Agreement on Tariffs and Trade 1994* (the "*GATT 1994"*). "Peace clause" protection was also extended to export subsidies conforming with the requirements of the *Agreement on Agriculture*.

1.10 Accordingly, New Zealand is also concerned to ensure that Members are able to utilise their rights under the *SCM Agreement* and *GATT 1994* to take action in respect of domestic support measures and export subsidies where the requirements of the "peace clause" have not been respected.

1.11 New Zealand believes that the arguments put forward by Brazil[3] show that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years ("MY") 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the *GATT 1994* and the *SCM Agreement*.

1.12 This submission, as requested by the Panel[4], primarily addresses issues raised in the submissions of Brazil and the United States relating to the substantive interpretation of Article 13 of the *Agreement on Agriculture*. As further elaborated in this submission New Zealand supports the claims made by Brazil. New Zealand has had only limited time to consider the First Written Submission of the United States[5] and therefore addresses only some of the issues raised therein. In particular New Zealand addresses, at the end of this submission,[6] the request by the United States for a Preliminary Ruling on certain matters.[7] New Zealand looks forward to the next phase of the case which will examine Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*.

## II. DOMESTIC SUPPORT MEASURES

### A. THE UNITED STATES HAS NO "PEACE CLAUSE" PROTECTION AGAINST ACTIONABLE SUBSIDY CLAIMS RELATED TO SUPPORT PROVIDED TO UPLAND COTTON IN MARKETING YEARS 1999, 2000, 2001 AND 2002

2.01 New Zealand agrees with Brazil that Members may assert a "peace clause" defence under *Agreement on Agriculture* Article 13(b)(ii) only if the total quantity of support granted through all

[3] Brazil's First Submission to the Panel Regarding the "Peace Clause" and Non-"Peace Clause" Related Claims, 24 June 2003 ("First Written Submission of Brazil").

[4] Panel communication to the Parties, 20 June 2003.

[5] First Written Submission of the United States of America, July 11 2003 ("First Written Submission of the United States").

[6] Para 5.01-5.02.

[7] First Written Submission of the United States, Pt V.

non-"green box" domestic support measures to a specific commodity does not exceed the quantity of non-green box domestic support decided to be granted in MY 1992.

2.02 New Zealand endorses the process outlined by Brazil[8] for determining whether the United States can claim peace clause protection against serious prejudice claims under *SCM Agreement* Articles 5(c) and 6.3 and *GATT 1994* Article XVI.1.

2.03 Specifically New Zealand agrees that the first step is to identify and quantify all the United States non-"green box" support for the production of upland cotton in MY 1992. The second step is to identify and quantify all non-"green box" United States payments that grant support to upland cotton in MY 1999, 2000, 2001 and to provide estimates for MY 2002. The final step is to determine whether United States support to upland cotton in MY 1999-2002 exceeded its 1992 support to upland cotton.

2.04 The information provided by Brazil[9] demonstrates that the level of domestic support for upland cotton in each of those marketing years did in fact exceed the level decided during the 1992 marketing year and therefore such domestic support measures may be subject to claims based on *GATT 1994* Article XVI or *SCM Agreement* Articles 5 and 6.

2.05 New Zealand notes that the United States argues that the relevant concept for the comparison required by Article 13(b)(ii) is only the 'per pound' rate of support set by the relevant domestic support measures.[10] Using this concept the United States argues that the support currently granted to upland cotton ($0.52 per pound) does not exceed that granted to upland cotton in the 1992 marketing year ($0.729 per pound).[11]

2.06 New Zealand agrees that the measures concerned (the loan rate) contribute to the effect of guaranteeing a producer price at a specified rate per pound of production and that the per pound rate of guaranteed price for producers is one of the relevant factors in making the comparison required by Article 13(b)(ii). However New Zealand does not agree that the use of the word "decided" in Article 13(b)(ii) was intended to be, or should be, construed to mean that the per pound rate of guaranteed price to producers of a commodity is the only factor to be considered in determining the amount of support granted. Indeed, New Zealand sees no support for such an approach in either the specific wording of Article 13(b)(ii) or in its object and purpose.

2.07 New Zealand considers that the comparison must take into account the totality of payments to upland cotton producers in order to reflect the true nature of the support that is being granted to a producer – the United States approach ignores this objective. For example, in relation to support granted to United States producers of upland cotton, Step 2 payments and crop insurance payments are also factors which affect farmers production decisions as is, of course, the "counter-cyclical" payments programme that effectively guarantees a price of $0.724 per pound. Therefore even under the United States assumption that the use of a "rate" is key, the story is very different from that claimed by the United States.

2.08 Further, New Zealand considers that an evaluation of budgetary payments is also essential in order to see the real effects of the support programmes. Focussing solely on a rate per pound ignores the actual levels of domestic support represented by budgetary outlays that must be granted in order to maintain those rates and the other payments received.

[8] First Written Submission of Brazil, para 123.
[9] *Ibid*, para 124.
[10] First Written Submission of the United States, paras 94 and 105.
[11] *Ibid*, para 125.

2.09 In this respect New Zealand recalls that the rationale behind the proviso in Article 13(b)(ii) that such measures not grant support to a specific commodity in excess of that decided during the 1992 marketing year is to create an upper limit in the level of trade or production distortion caused by such measures. The clear overarching intention of WTO Members in the negotiation of the *Agreement on Agriculture* was that henceforth such distortions would be reduced, consistent with the long term objective of "correcting and preventing restrictions and distortions in world agriculture markets".[12] Accordingly it would be inconsistent with the object and purpose of the *Agreement*, and Article 13(b)(ii) specifically, to adopt an interpretation that artificially limits consideration of the scope of support granted to that of a 'per pound rate' of guaranteed price to a producer rather than the totality of the support granted that creates the trade and production distortions.

2.10 In that respect the fact that United States budgetary outlays have increased from their 1992 levels is not coincidental. Such increases are due, at least in part, to the production and market distorting effects of the United States measures that have lead to higher export levels of upland cotton from the United States that have in turn pushed world market prices for cotton down. In essence, the level of trade distortion has increased as the gap between the price farmers expect to receive and the world price has increased. Looking at it the other way around, had the United States maintained the 1992 level of support its producers would be far more aware of the realities of the world market for cotton and have less incentive to add further to the trade distortion.

**1. Step 2 payments, loan deficiency payments, marketing loan gains and cottonseed payments**

2.11 These payments are clearly non-"green box" support, as implied by the notification by the United States to the WTO Committee on Agriculture for MY 1999.[13] As Brazil points out, the structure of most of these programmes is substantially the same in MY 2000-2001 and under the Farm Security and Rural Investment Act of 2002 (the "2002 FSRI Act")[14] as it was in MY 1999. New Zealand considers that these payments should continue to be treated as non-"green box" support to upland cotton and must therefore be used in calculating the total quantity of support granted to upland cotton in MY 1999-2002.

**2. Marketing loss payments, counter-cyclical payments and crop insurance payments**

2.12 The United States has notified crop insurance payments and marketing loss assistance payments as "amber box" domestic support.[15] Brazil notes that the 2002 FSRI Act institutionalised marketing loss assistance payments with a new program of "counter-cyclical" payments ("CCP").[16]

2.13 New Zealand notes that Brazil argues that CCP subsidies do not meet the criteria set out in *Agreement on Agriculture* Annex 2, specifically paragraphs 6(b) and (c), and fail to meet the fundamental requirement that "green box" measures "have no, or at most minimal, trade-distorting effects or effects on production".

2.14 Brazil argues that the CCP programme is not a "green box" measure because payments are not based on prices of upland cotton that took place in a prior base period but are linked to present prices for the product concerned, contrary to the requirements of Annex 2 paragraph 6(c).[17]

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[12] Preambular paragraph 3 of the *Agreement on Agriculture*.
[13] G/AG/N/USA/43, Exhibit BRA-47.
[14] Exhibit BRA-29.
[15] G/AG/N/USA/43 page 37. Exhibit BRA-47.
[16] First Written Submission of Brazil, para 62.
[17] *Ibid*, para 197.

2.15 Paragraph 6(c) of Annex 2 makes it clear that the amount of decoupled income support payments "shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period." As Brazil notes, the amount of the payment under the CCP programme varies with fluctuations in the national average market price, that is, it is linked to a current price. Accordingly, in New Zealand's view this is sufficient to support a finding by the Panel that the CCP programme involves payments that are not "green box" support measures in accordance with Annex 2 of the *Agreement on Agriculture* and must therefore be used in calculating the total quantity of domestic support granted to upland cotton for MY 2002. Indeed, the United States endorses this approach.[18]

2.16 New Zealand notes, however, that the United States has argued that the term "support to a specific commodity" used in Article 13(b)(ii) should be interpreted to mean "product-specific support".[19] On this basis the United States argues that the CCP programme and crop insurance programme should be excluded from the scope of support granted to upland cotton for the purposes of Article 13(b)(ii). [20]

2.17 While New Zealand notes that the United States has notified marketing loss assistance and crop insurance (and presumably will notify CCP payments) as non-product specific domestic support,[21] it is clear from discussion in the WTO Committee on Agriculture that Members, including New Zealand, have questioned whether that is appropriate.[22]

2.18 The United States asserts that CCP payments are non-product specific because they are not coupled to current production of any specific commodity but rather are based on historical fixed base acreage and yields.[23] However in New Zealand's view Brazil has brought forward significant evidence of a strong linkage between the CCP payments and production of upland cotton, such that farmers with upland cotton base acreage are likely to continue to produce upland cotton.

2.19 In particular Brazil points out that most cotton farmers have made considerable investments in cotton-specific equipment, or farm in locations where cotton is the most productive crop, and are therefore more likely to continue to produce cotton.[24] The linkage between the receipt of CCP payments and production of cotton is further reinforced by the CCP payments being explicitly calculated on the basis of current cotton prices.

2.20 Brazil also points out that CCP payments create incentives for farmers with upland cotton base acreage to maintain upland cotton production.[25] In fact under the CCP programme the only way a farmer can guarantee a particular outcome is to continue to grow the same crop, otherwise the farmer runs the risk of missing out. For example, if he or she chooses to produce wheat and cotton prices are high enough that no CCP payment is made but wheat prices fall, the farmer will make a loss they would not have made had they stayed with cotton production.

2.21 Irrespective of whether or not these payments are notified as product-specific or not, they must still be considered "support granted to a specific commodity" for the purposes of Article 13(b)(ii). There is no foundation for the assertion by the United States that "support granted to a specific commodity" should be read as meaning "product-specific support". Given the detailed listing

[18] First Written Submission of the United States, para 118.
[19] *Ibid*, para 78.
[20] *Ibid*, para 122.
[21] G/AG/N/USA/43, Exhibit BRA-47.
[22] See for example, G/AG/R/34 'Summary report of the meeting held on 27 March 2003' at page 32.
[23] First Written Submission of the United States, para 115.
[24] First Written Submission of Brazil, para 207.
[25] *Ibid*, para 211.

of domestic support measures potentially exempt in the chapeau to Article 13(b)(ii) itself, had Members intended to exclude non-product specific support they would surely have said so. Further, had they meant that "support granted to a specific commodity" was to be read as "product specific" support they would have said so – the phrase was used at least five times elsewhere in the *Agreement*.

2.22 Rather, the reference to support to a "specific commodity" in Article 13(b)(ii) was used to distinguish the nature of the "peace clause" from the domestic support commitments more generally which are on a "Total" (i.e. over all agriculture) Aggregate Measurement of Support ("AMS") basis. Only if support increases for a particular product can it be open to challenge under the *SCM Agreement*. Without such clarification "peace clause" protection could potentially be lost for any agricultural product if Total AMS increases, even though support to that specific product had not increased. This would have unpredictable results for individual products and cannot have been the intended effect of the "peace clause".

2.23 Nothing in Article 6 suggests that treating product-specific and non-product specific support separately under Article 13 is warranted. New Zealand sees no basis on which to suggest that support to a specific commodity should be excluded simply because other commodities may receive similar support. Support provided through generally available programmes (which, New Zealand notes, the marketing loss assistance programme and now the CCP programme are not) is still support received for the individual products. Taking the United States argument to its logical extreme would effectively render all agricultural support non-product specific so long as the same kind of support was being provided to more than one product.

2.24 Accordingly, New Zealand considers that the United States incorrectly categorises CCP payments as non-product specific support. But whether they are product-specific or non-product specific is, in fact, irrelevant for the purposes of Article 13(b)(ii) as there is no basis upon which to read such a limitation on the kinds of domestic support to be considered within the meaning of that provision. Instead, the portion of any non-product specific support granted to a specific commodity, in this case to upland cotton, must be included in the comparative analysis required by Article 13(b)(ii). In this respect New Zealand notes that what Brazil is proposing is no more than what the United States has done in relation to export credits in its First Written Submission where it has allocated export credit administrative costs to the specific product of upland cotton.[26]

2.25 The same arguments can be made with respect to the payments under the crop insurance programmes.

## 3. Production Flexibility Contract Payments, Direct Payments

2.26 In New Zealand's view one important aspect of the "Direct Payments" ("DP") programme rules out inclusion of those payments in the "green box", specifically the ability of farmers to update the base acreage used for calculation of DP payments.[27] As outlined by Brazil, the DP programme is the successor to the Production Flexibility Contract Payments ("PFC") programme and to permit an updating of the 'fixed' base period by changing the name of the PFC programme to a DP program would render the provisions of paragraph 6(a) and (b) of *Agreement on Agriculture* Annex 2 a nullity.[28]

2.27 The option for farmers to update base acreage under the 2002 FSRI Act directly violates the requirement under Annex 2 paragraph 6 that decoupled income support be determined in relation to a

[26] First Written Submission of the United States, para 175.
[27] First Written Submission of Brazil, para 52; Exhibit BRA-35.
[28] *Ibid*, para 182.

"defined and fixed base period". New Zealand agrees with Brazil's interpretation that paragraph 6(a) and (b) contemplates only one base period that is fixed and unchanging.

2.28 As Brazil points out, permitting the updating of the base period to capture additional payment acreage (as one third of all United States farms with eligible acreage opted to do)[29] would link increased recent volumes of production with the amount of current payments.[30] Brazil is also correct to state that this is contrary to the object and purpose of "de-coupled income support", which is to break the link between production and the amount of support and thereby ensure that such measures "have no, or at most minimal" effects on production. As the evidence brought forward by Brazil shows, an expectation of being able to update base acreage and payment yields influences production in a number of ways,[31] particularly as, having had one opportunity to update their base acreage, farmers could reasonably expect further opportunities to do so in the future.

2.29 In New Zealand's view the updating of base acreage for the DP programme alone is sufficient to exclude it from the scope of permitted "green box" measures as set out in Annex 2. Instead such payments are "amber box" measures that, in accordance with Article 6 of the *Agreement on Agriculture*, are domestic support to upland cotton in MY 2002.

2.30 Brazil has also argued that the PFC and DP programmes have more than a minimal effect on production and trade and therefore fail to meet the "fundamental requirement" of "green box" domestic support measures.

2.31 New Zealand agrees with Brazil's interpretation that the "fundamental requirement" that "green box" domestic support measures "have no, or at most minimal, trade-distorting effects or effects on production" means that the quantity or level of production or trade distorting effects need only be very small to trigger denial of "green box" status under Annex 2 of the *Agreement on Agriculture*.[32] The language of paragraph 1 of Annex 2 makes it clear that this fundamental requirement and the other criteria set out in Annex 2 are to be strictly applied to any measures in order to obtain exemption from reduction commitments.

2.32 The trade-distorting effects or effects on production of any domestic support measure must be determined on a case-by-case basis, looking at the specific circumstances and characteristics of each particular measure. Brazil has provided comprehensive information regarding the effects of the PFC and DP programmes to enable the Panel to determine whether those payments have even very minimal production or trade distorting effects and thus fail to meet the "fundamental requirement" for "green box" measures as provided in *Agreement on Agriculture* Annex 2.

2.33 New Zealand notes that the United States provides no response to any of Brazil's arguments regarding the PFC/DP programme and the level of production distortion it causes other than to claim that changing the name of the programme indemnifies it from consideration. Accordingly Brazil's arguments should stand.

[29] *Ibid*, para 181.
[30] *Ibid*, para 179.
[31] *Ibid*, paras 185 – 190.
[32] *Ibid*, para 165.

## III. PROHIBITED EXPORT SUBSIDIES

### A. THE UNITED STATES HAS NO "PEACE CLAUSE" PROTECTION AGAINST PROHIBITED AND ACTIONABLE SUBSIDY CLAIMS RELATED TO EXPORT SUBSIDIES

3.01 New Zealand supports the arguments made by Brazil that the three types of export subsidies applied to upland cotton and other commodities by the United States (the Step 2 Export Programme, the Export Credit Guarantee Programme, and the FSC Replacement Programme) violate Articles 3.3, 8 and 10.1 of the *Agreement on Agriculture* and therefore fail to meet the requirement of conformity with Part V of the *Agreement*, with the result that such subsidies are not exempt from claims by Brazil based on Article XVI of *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement*.

### B. THE UNITED STATES EXPORT SUBSIDIES VIOLATE THE AGREEMENT ON AGRICULTURE AND THE SCM AGREEMENT

#### 1. Step 2 Export Payments

(a) Per se violation of Articles 3.3 and 8 of the *Agreement on Agriculture*

3.02 As outlined by Brazil,[33] Step 2 export payments clearly fall within the description of an export subsidy set out in Article 9.1(a) of the *Agreement on Agriculture* in that it is a direct subsidy provided by the United States government to exporters of upland cotton contingent upon export.

3.03 Even if the Panel were to find that Step 2 export payments did not fall within the description set out in Article 9.1(a) of the *Agreement on Agriculture*, the Appellate Body has determined, as Brazil notes, that the effect of Article 10.1 is that a Member can only provide export subsidies in conformity with the *Agreement on Agriculture* if it has scheduled export subsidy reduction commitment levels for the agricultural product concerned.[34] The use of any other type of export subsidy will "at the very least" threaten circumvention of subsidy reduction commitments within the meaning of Article 10.1.

3.04 Accordingly New Zealand agrees with Brazil that the Step 2 export payments violate *per se* Articles 3.3 and 8 of the *Agreement on Agriculture*

3.05 New Zealand notes that the United States has argued that Step 2 export payments are not export subsidies as defined by Article 9.1(a) and 10 of the *Agreement on Agriculture* (and Article 3.1(a) of the *SCM Agreement*) because the Step 2 payments are available to domestic users as well as exporters of upland cotton.[35] As the Appellate Body in *US-FSC Recourse to Article 21.5*[36] recognised, the fact that a scheme allows for payments to be made otherwise than contingently on export does not diminish the export contingency of those that are.

3.06 In *US-FSC Recourse to Article 21.5* the United States argued that a measure that provided tax exclusion for exported products, but also allowed tax exclusion to be obtained without exportation, could not be considered to be 'contingent upon export performance'. The Appellate Body disagreed.

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[33] *Ibid*, paras 238-243.

[34] Report of the Appellate Body, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R ("*US-FSC*"), para 150-152; First Written Submission of Brazil, para 237.

[35] First Written Submission of the United States, para 132.

[36] Report of the Appellate Body, *United States – Tax Treatment for "Foreign Sales Corporations" Recourse to Article 21.5 of the Dispute Settlement Understanding by the European Communities*, WT/DS108/AB/RW ("*US-FSC Recourse to Article 21.5"*).

3.07 The Appellate Body said that the measure "contemplates two different factual situations"; where property is produced within the United States and held for use outside the United States, and where property is produced outside the United States and held for use outside the United States. The Appellate Body said that "the fact that the subsidies granted in the second set of circumstances might not be export contingent does not dissolve the export contingency arising in the first set of circumstances".[37]

3.08 New Zealand considers that the fact that payments are also able to be made to domestic users of upland cotton does not 'dissolve' the export contingency of the payments that are made to exporters. Payments to eligible exporters of upland cotton are dependent on proof of export being provided and are therefore contingent on export performance.

3.09 Accordingly Step 2 export payments breach the obligation of the United States under Article 3.3 not to provide such subsidies in respect of any agricultural product that it has not specified in Section II of Part IV of its Schedule and therefore violates *per se* the undertaking by the United States in Article 8 not to provide export subsidies otherwise than in conformity with the *Agreement on Agriculture*.

(b) Violation of Article 3.1(a) and 3.2 of the *SCM Agreement*

3.10 New Zealand supports Brazil's conclusion that the Step 2 export payments meet the requirements of a subsidy under Article 1.1(a)(1)(i) and Article 1.1(a)(2) of the *SCM Agreement* and are contingent upon export within the meaning of Article 3.1(a) of the *SCM Agreement*.

3.11 Accordingly if the Panel finds, as New Zealand believes it should, that Step 2 export payments constitute *per se* prohibited subsidies under Article 3.1(a) and 3.2 of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the programme without delay. New Zealand therefore supports Brazil's request that the Panel expressly make such a recommendation.

**2. Export Credit Guarantee Programme**

(a) Violation of Articles 8 and 10.1 of the *Agreement on Agriculture*

3.12 New Zealand supports Brazil's arguments that the export credit guarantee programme provides export subsidies that can lead to, or threaten to lead to, circumvention of export subsidy commitments under Article 10.1. As established by the Appellate Body in *US-FSC*,[38] Article 10.1 of the *Agreement on Agriculture* is violated where an export subsidy is available for unscheduled agricultural products for which no reduction commitments have been made, as, "at the very least", this threatens to lead to circumvention of export subsidy commitments.

3.13 It is evident that Members considered that export credit programmes could provide export subsidies through the specific reference to such programmes in *Agreement on Agriculture* Article 10.2. While not all government export credit programmes necessarily provide export subsidies, it is clear that the United States programme does so in both of the ways demonstrated by Brazil (ie because it clearly falls within Item j of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*[39] or is otherwise an export subsidy as defined in Articles 1.1 and 3.1(a) of the

[37] *Ibid*, para 119.
[38] Report of the Appellate Body, *US-FSC*, para 150-152.
[39] First Written Submission of Brazil, paras 272-286.

*SCM Agreement*).[40] The export credit scheme is therefore a subsidy contingent on export in the context of Article 10.1 of the *Agreement on Agriculture*.

3.14 New Zealand notes that the United States has argued that "the plain words of Article 10.2 (of the *Agreement on Agriculture*) indicate that the export credit guarantee programs are not subject in any way to the export subsidy disciplines of that *Agreement*."[41] New Zealand disagrees with this assertion. The heading of Article 10 is 'Prevention of circumvention of export subsidy commitments' and the inclusion of reference to export credits under that Article clearly reflects Members' concern that export credits can provide export subsidies.

3.15 Nor does Article 10.2 in any way suggest that it provides an exception from the disciplines of Article 10.1. New Zealand agrees with the United States that Article 10.2 does not say "in addition to the export subsidy commitments" of the *Agreement*.[42] That is because it did not have to, coming as it does directly after the general prohibition against circumvention in Article 10.1. While Article 10.1 currently provides the only discipline on the use of export credits, it is expected that the work envisaged in Article 10.2 will elaborate further and more specific disciplines that will presumably make identification of the extent to which such export credit programmes constitute export subsidies more straightforward. However it is incorrect to assume that there is a vacuum in the meantime. Item j of the Illustrative List of the *SCM Agreement* clearly already provides guidance on when export credit guarantee or insurance programmes are to be considered to be 'export subsidies' and beyond this the general definition in Articles 1.1 and 3.1(a) of the *SCM Agreement* also applies. While the provisions of Item j do not apply to agricultural products *mutatis mutandis* there is no reason to believe that the guidance there and elsewhere in the *SCM Agreement* is not appropriate for analyses under the *Agreement on Agriculture*.

3.16 Nor should the application of the disciplines in the *Agreement on Agriculture* in the meantime obviate the need for continued negotiations as envisaged by Article 10.2, as New Zealand hopes that those negotiations will result in clearer and more specific rules. Indeed it may even be that the result of the negotiations is that an export credit programme that is considered to be an export subsidy under the current, more generally applicable rules, will be deemed not to be an export subsidy in the future. However in that respect New Zealand notes, for example, that the United States Intermediate Export Credit Guarantee Program (GSM-103) provides for a repayment term of between 3 and 10 years[43], terms clearly well outside the scope of disciplines to govern the use of export credit guarantee programmes currently being considered in the negotiations.

(b) Violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*

3.17 As export credits are not in conformity with Part V of the *Agreement on Agriculture* and thus do not benefit from protection under the "peace clause", they can equally be examined under the *SCM Agreement*. If the Panel finds, as New Zealand believes it should, that export credit guarantee payments are prohibited subsidies under Article 3.1(a) of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the payments without delay. New Zealand therefore supports Brazil's request that the Panel expressly make such a recommendation.

[40] *Ibid*, paras 287-293.
[41] First Written Submission of the United States, para 164.
[42] *Ibid.*
[43] *Ibid*, para 151.

### 3. FSC Replacement Measure

3.18 New Zealand supports the claims made by Brazil,[44] based on the findings already made by the Appellate Body in *US-FSC Recourse to Article 21.5*, that the tax cuts under the FSC Repeal and Extraterritorial Income Act of 2000 threaten to circumvent United States export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture* and therefore cannot be exempt from actions under the *SCM Agreement* under Article 13(c)(ii) of the *Agreement on Agriculture*. In addition the Appellate Body found that there was a prohibited subsidy under Article 3.1(a) of the *SCM Agreement*.

3.19 Accordingly if the Panel finds, as New Zealand believes it should, that the tax cuts under the FSC Repeal and Extraterritorial Income Act of 2000 are prohibited subsidies under Article 3.1(a) of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the subsidies without delay. New Zealand therefore supports Brazil's request that the Panel expressly make such a recommendation.

## IV. PROHIBITED SUBSIDIES

### A. STEP 2 DOMESTIC PAYMENTS VIOLATE THE SCM AGREEMENT AND GATT ARTICLE III:4

4.01 New Zealand supports Brazil's argument that the "peace clause" provides no immunity for "amber box" subsidies from prohibited subsidy claims under Article 3.1(b) of the *SCM Agreement.*[45] New Zealand believes that Brazil has demonstrated that Step 2 domestic payments are a prohibited subsidy under Article 3.1(b) in that the payments are contingent on the use of domestic over imported upland cotton. On that basis they also violate Article III.4 of *GATT 1994*.

4.02 Accordingly if the Panel finds, as New Zealand believes it should, that Step 2 domestic payments violate per se Article 3.2 of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the payments without delay. New Zealand therefore supports Brazil's request that the Panel expressly make such a recommendation.

## V. UNITED STATES REQUEST FOR A PRELIMINARY RULING ON CERTAIN MATTERS

5.01 New Zealand rejects the arguments of the United States that measures no longer in effect are not within the Panel's terms of reference.[46] Such measures should be within the scope of the Panel's consideration, particularly when the programmes in question have effectively only been renamed and in fact continue in a slightly different form. In addition, the nature of serious prejudice claims may necessitate consideration of data beyond a single year and may in fact require a Panel to consider trends over a number of years. Accordingly New Zealand rejects the United States claim that market loss assistance payments and PFC payments should be excluded from the Panel's consideration of Brazil's claims.

5.02 New Zealand also considers that the Panel should reject the United States request that that Panel rule that export credit guarantee measures relating to eligible United States agricultural commodities (other than upland cotton) are not within its terms of reference.[47] While New Zealand did not participate in the consultations, in New Zealand's view Brazil had little choice but to look at a broader commodity coverage in relation to export credits because the information specific to upland

[44] First Written Submission of Brazil, paras 315-330.
[45] First Written Submission of Brazil, para 332.
[46] First Written Submission of the United States, paras 207-211.
[47] *Ibid*, paras 191-206.

cotton alone was not available. To prevent Brazil from doing so would unjustly allow a lack of transparency to preclude scrutiny of measures by Members taking disputes, especially where the information at a higher level of aggregation showed there was clearly a case to answer in respect of a particular measure, in this instance export credits. While more time is needed to analyse the information brought forward by the United States (which does not appear to be sourced from publicly available documents), at this stage of the Panel's consideration of Brazil's claims, New Zealand considers that the Panel should not make the ruling requested by the United States.

## VI. CONCLUSION

6.01 In conclusion, New Zealand believes that Brazil had demonstrated that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the *GATT 1994* and the *SCM Agreement*. New Zealand looks forward to the next phase of the case which will examine Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*.

# ANNEX B-10

THIRD PARTY SUBMISSION BY PARAGUAY

## INTRODUCTION

1. Paraguay is grateful for the opportunity to express its views on the matter at issue in this dispute.

2. Because Paraguay is a firm believer in a fair system of international trade, it feels that it should explain its position on this issue which is of particular interest to its economy.

### Applicable rules

3. In the Marrakesh Ministerial Declaration of April 1994 itself, Ministers affirmed that the establishment of the WTO ushered in a new era of global economic cooperation, reflecting the widespread desire to operate in a fairer and more open multilateral trading system for the benefit and welfare of their peoples, and expressed their determination to resist protectionist pressures of all kinds as well as their belief that the strengthened rules achieved in the Uruguay Round would lead to a progressively more open world trading environment.

4. Moreover, in October 2002, on the occasion of the meeting of the International Cotton Advisory Committee, governments observed the critical situation that the world cotton industry was going through and its link to subsidies, suggesting the establishment of a schedule for the elimination of measures that distorted world production and trade in cotton, and stressing the need to submit complaints before the WTO for violation of the applicable rules.

5. Paraguay considers that the subsidies and support granted by the United States to its cotton production are inconsistent with the Agreement on Subsidies and Countervailing Measures, the Agreement on Agriculture and the rules and principles of the GATT 1994, and that for the purposes of this dispute it is therefore essential to take account of WTO legislation, which was carefully drafted to avoid causing distortions in international trade and prejudice to developing countries such as Paraguay.

6. WTO jurisprudence and the principles of interpretation of international law applied to the various cases suggests that the applicable rules should be read cumulatively, taking account of all elements applied to the case in order to support the system as an integrated whole.

7. Paraguay considers Brazil's complaint and the legal justifications invoked with respect to the inconsistency of the United States' laws, regulations and administrative procedures with the applicable WTO rules to be fully consistent with the law.

## PEACE CLAUSE

8. With respect to the applicability of Article 13(b)(ii) concerning domestic support measures that conform fully to the provisions of Article 6 of the Agreement including direct payments that conform to the requirements to paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, Paraguay considers they shall be exempt from actions based on paragraph 1 of Article XVI of GATT

1994 or Articles 5 and 6 of Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

9. This implies that it is not limited or confined to specific products. Thus, it can be concluded that the United States does not enjoy protection from actions relating to subsidies using 1999, 2001 and 2002 as a basis, as Brazil duly proved.

10. In interpreting the Peace Clause, account must be taken of the serious prejudice that Member economies could suffer, and an assessment made of the overall significance of all of the agreements relating to the case.

11. Paraguay does not grant subsidies, either under the Subsidies Agreement or under the Agreement on Agriculture. Paraguay did notify the Committee on Agriculture, on 22 July 2002, of its domestic support commitments for 2000 and 2001 (G/AG/N/PRY/10, supporting table DS.1 and related supporting tables) as required under the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures.

12. Consequently, as long as discriminatory support not provided for under WTO Agreement on Agriculture or the WTO Agreement on Subsidies on Countervailing Measures continues to be granted, Paraguay will have no choice but to file complaints with the relevant bodies.

**Inconsistency with the Agreement on Agriculture**

13. The Step 2 programme introduced by the United States to stimulate exports and the competitiveness of its products on the international market is inconsistent with Articles 3.3 and 8 of the Agreement on Agriculture.

14. Article 3 of the Agreement on Agriculture refers to the incorporation of concessions and commitments. Paragraph 3 thereof stipulates that:

> *Subject to the provisions of paragraphs 2(b) and 4 of Article 9 of this Agreement, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule.*

15. The above paragraph enables Members to provide the subsidies listed in Article 9.1 of the Agreement on Agriculture subject to fulfilment of the commitments assumed.

16. Similarly, Article 8 of the said Agreement regulates export competition commitments, stipulating that:

> *Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and the commitments as specified in that Member's Schedule.*

17. For the above reasons, and because it does not consider the provisions of the Agreement on Agriculture to have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

**Inconsistency with the Agreement on Subsidies and Countervailing Measures**

18. The agricultural subsidies cause "serious prejudice" to the domestic industry of other Members under Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures.

19. The introductory paragraph of part III, Article 5 of the said Agreement provides that no Member should cause, through the use of any subsidy – specific and not exempted under the Agreement – adverse effects to the interests of other Members, more specifically, as categorically stated in the indents that follow, (a) injury to the domestic industry of another Member and (c) serious prejudice to the interests of another Member.

20. Article 6 specifically refers to cases in which "serious prejudice" is deemed to exist in the sense of paragraph (c) of Article 5.

**Effects of agricultural subsidies**

21. Agricultural subsidies have effects on world trade, and measures such as those applied by the United States have a significant impact on developing countries like Paraguay.

22. Indeed, Paraguay is all the more affected by the said measures in that it is precisely cotton production that provides sustenance for the most needy segments of the population.

23. Paraguay has a total population of approximately 5,300,000, of which more than 500,000 are linked to cotton production. If we add the related industries and activities, the figure reaches an estimated 1,500,000, or approximately 30 per cent of the country's total population.

24. Any slump in the cotton trade causes an exodus of rural population towards the urban areas which do not offer any relief or solution, and this further undermines the economic situation of a country that depends on its agriculture.

25. As regards exports, in 1991, the foreign exchange revenue generated by sales of cotton and byproducts thereof reached US$318,912,000, approximately 43 per cent of the total for the country's exports that year. At the time, a total of 299,259 farms, 190,000 were cultivating cotton.

26. By 2001, the figures had changed considerably. Export revenue had fallen to US$90,505,000, a 72 per cent drop in the value of exports. The number of farms producing cotton decreased to about 90,000, representing a 52 per cent decrease in farms, employment and small farmer income. In other words, the impoverishment was real.

27. Regarding international cotton fibre prices, in 1991, the price per ton of Paraguayan type fibre was quoted on the New York Exchange at US$1,624, while in 2001, it was quoted at US$934.

28. In Paraguay, some 60 per cent of cotton is produced on farms of less than 10 hectares, making it the main or only source of income for small farmers and the main source of employment for the rural workforce in the most disadvantaged segment of society where access to capital and technology is more restricted and the leading socio-economic welfare indicators are lower than anywhere else.

**CONCLUSION**

29. Paraguay is a small economy. It is a land-locked country that has no oil, gas, gold or other natural resources of a kind that could make it of particular interest to the developed countries. The Paraguayan economy is essentially based on agricultural production, including the production and sale of cotton.

30. Paraguay therefore considers that the measures adopted by the United States cause serious prejudice to world trade, affecting Paraguay in particular, and that the necessary steps should be taken to eliminate the adverse effects and seek to achieve a balance in world trade.

31. Paraguay respectfully requests the Panel to conclude that the measure applied by the United States is inconsistent with its WTO obligations under the various provisions of the Agreement on Agriculture, the GATT 1994 and the Agreement on Subsidies and Countervailing Measures.

# ANNEX B-11

## THIRD PARTY SUBMISSION OF THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU.

15 July 2003

1. In its fax of 28 May 2003 to the parties to this dispute, the Panel poses questions regarding the correct interpretation of Article 13 of the Agreement on Agriculture and the on the issue of preliminary rulings. As the Panel's questions raise an important point of law and the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu has a systemic interest in the proper interpretation and operation of these and other relevant provisions involved in the procedures, we would like to submit our views on the following aspects:

**I. THE BURDEN OF PROOF REQUIRED BY ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE (THE "PEACE CLAUSE"), AND**

**II. THE QUESTION OF PRELIMINARY RULINGS.**

### I. BURDEN OF PROOF IN THE "PEACE CLAUSE"

2. In attempting to arrive at a proper interpretation of the burden of proof as provided in Article 13 of the Agreement on Agriculture, we suggest comparing different types of exemptions, defences, or carving-out under different agreements.

3. It could happen that a matter is brought under an agreement not covered by the DSU. Since Article 1 of the DSU provides that the DSU shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to the DSU and the WTO Agreement, it follows that consultation or dispute arising from or in connection with any non-covered agreement would not be within the scope of the dispute settlement procedures under the DSU. Thus, if a Member brings a complaint alleging a breach of certain international environmental treaties, for example, the complaining party would bear the burden to prove that the issue in dispute falls within the purview of the DSB.

4. It could also be that a matter is specifically excluded from the dispute settlement procedures by certain relevant agreements. A typical example of this would be the provision in Article 6 of the TRIPS agreement, which provides that "for the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights". It is apparent that as long as it is an "issue of the exhaustion of intellectual property rights," the dispute settlement procedure shall not be used. There is no threshold or prerequisite for applying such provision. The Member applying this provision would be able to prevent such dispute settlement procedures unless the complaining party asserts and proves that the measure concerned is not such an "exhaustion issue".

5. It could also happen that exceptions or exemptions are granted under relevant agreements providing specific obligations. There are different ways of providing exceptions for specific activities or measures. Examples include paragraph 2 of Article XI of the GATT stating "...shall not extend to the following"; Articles XX and XXI of the GATT stating "nothing in this Agreement shall be

construed to..." These are in the nature of an affirmative defence. Here, the burden of proof rests on the party invoking the exception.

6. It is clear that Article 13 of the Agreement on Agriculture is not a "matter under an agreement not covered under the DSU". Neither is it a matter specifically excluded from the dispute settlement procedures as provided in Article 6 of the TRIPS Agreement. It is also not typical of the type of exception as contained in Articles XI, XX or XXI of the GATT. In our view, Article 13 falls between the type of exception in Article 6 of the TRIPS and that in Article XI, XX or XXI of the GATT. Thus the procedures for applying the provision should be interpreted differently.

7. In its First Written Submission, Brazil asserted that, "Article 13 is in the nature of an affirmative defense, because it provides an exception to a legal regime otherwise applying to agricultural support measures. It does not alter the scope of other provisions providing positive obligations on Members, and is not itself a positive obligation" and as a consequence, in this proceeding the United States has the burden of proof on the question of whether its subsidies "are in conformity with the AOA Article 13"[1].

8. In our view, the very nature of Article 13 is such that it is not appropriate for any particular description or "label" such as an "affirmative defence", or "exception", to be ascribed to it, simply for the convenience of resolving the question of burden of proof.[2] We consider that Article 13 in itself contains both rights and obligations of Members. The right conferred by Article 13, i.e. entitlement to "exempt from actions" is conditional; conditional upon a positive obligation of full conformity to the requirements as set out in the relevant provisions of the Agreement on Agriculture. We agree with the view put forward by the United States at paragraph 43 of its First Written Submission which purports to identify such positive obligations. If the contention that Article 13 confers a right as well as imposes a positive obligation, is accepted, then, as a complainant, it is for Brazil to prove a breach of this positive obligation by demonstrating non-conformity rather than for the United States to bear the burden of proving conformity. We consider that the above contention is the only logical conclusion in giving effect to Article 13. Since there is no scheme for a Member under Article 13 to prevent the initiation and the establishment of a panel, suppose Article 13 is interpreted in such a way as to still require the United States to bear the burden of proving the conformity of relevant provisions of the Agreement of Agriculture, it would mean Article 13 having less than its originally intended effect.

9. In addition to the above, drafters' intent should be taken into account when interpreting this Article. Domestic support measures are expressly allowed under this Article with the intention of giving Members some flexibility on domestic support measures to help the progressive liberalization of their agriculture. Requiring the respondent to bear the burden to prove that the subsidy measure in question is consistent with this Agreement will, to a certain degree, offset the respondent's right to claim for the exceptions provided by this Provision, which is contrary to the drafters' intention.

10. To impose the burden of proof on the respondent has another negative implication. In the case before us, if Brazil's argument stands, it would render the words "exempt from actions" pointless as the result would inevitably be a full-blown dispute settlement proceeding with Brazil submitting evidence to substantiate its complaints and the US filing its defence by invoking Article 13 and submitting proof of conformity thereto.

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[1] Brazil first Written Submission, paragraph 23.

[2] In *EC-Hormones*, the Appellate Body is of the view that the particular description of "exception" did not discharge the burden of the complaining party in establishing a prima facie case. At para 104, the Appellate Body stated: the general rule in a dispute settlement proceeding requiring a complaining party to establish a prima facie case of inconsistency of a provision…before the burden of showing consistency with that provision is taken by the defending party is not avoided by simply describing the same provision as an exception."

## II. THE QUESTION OF PRELIMINARY RULINGS

11. Although on the evidence of past dispute settlement cases the normal practice of the Panel tends to be that it hears preliminary issues, provides indicative rulings and consolidates detailed reasoning only in the final Panel report, the questions associated with the correct interpretation of Article 13 are such that they merit the Panel's consideration and disposition at the earliest opportunity.

12. We consider that the preliminary issues raised in this dispute determine the manner in which the parties to this proceeding prepare their case. If the question of the correct interpretation of the words "exempt from actions" is not resolved along with the question of the allocation of burden of proof, considerable resources will be wasted both by complaining and defending claims. Needless to say, due process will not be properly served in such a case. Accordingly, we respectfully urge this Panel to adopt a special procedure to deal with this preliminary issue at the earliest opportunity so that parties to this dispute will not be prejudiced.[3]

[3] This Panel may recall that the Appellant Body in *EC-Banana* indicated its opinion that "…this kind of issue could be decided early in panel proceedings, without causing prejudice and unfairness to any party or third party,.." WT/DS27/AB/R, at para. 144.

# ANNEX C

## ORAL STATEMENTS OF PARTIES AND THIRD PARTIES AT THE FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING

# ANNEX C-1

## EXECUTIVE SUMMARY OF THE ORAL STATEMENT OF BRAZIL AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

### I. INTRODUCTION

1. Brazil addresses first various peace clause issues, followed by Step 2 export and domestic payments, export credit guarantees and the ETI Act subsidies. Finally, Brazil addresses the "preliminary issues" raised by the United States.

### II. PEACE CLAUSE ISSUES

**The Peace Clause is an Affirmative Defence**

2. The peace clause is in the nature of an affirmative defence and it is, thus, the US burden to prove that Brazil's claims under the SCM Agreement are "exempt from actions". An affirmative defence is a provision that does not set out any positive obligations but enables Members to maintain measures that are otherwise inconsistent with its WTO obligations. The peace clause does not in itself set out any positive obligations for Members, but simply provides a conditional shelter against certain actionable and prohibited export subsidy claims under the SCM Agreement. The peace clause meets the criteria set forth by the Appellate Body for an affirmative defence in *US – FSC* and in the *Aircraft* disputes, by being an exception to a legal regime otherwise applicable. Given the extraordinary protection it provides, it is not "bizarre", as the United States argues, that the peace clause requires the defending Member to prove that its domestic and export subsidies meet the conditions for peace clause protection.

**"such measures do not grant support to a specific commodity"**

3. This phrase in AoA Article 13(b)(ii) means that in calculating the amount of support for any marketing year between 1995-2003, all non-"green box" support provided to a specific commodity must be tabulated, regardless of whether the *type* or *form* of the support is "product-specific", "non-product specific", *de minimis*, or "blue box". This is certainly evidenced by the decision of negotiators *not* to use the phrases "product-specific" and "AMS" in Article 13(b)(ii) to qualify the type of support to a specific commodity. The US attempt to read "product-specific" into Article 13(b)(ii) is inconsistent not only with the text but also the context of the phrase "such measures" in Article 13(b)(ii). The US interpretation of "product-specific support" is further incompatible with the object and purpose of the Agreement on Agriculture. It would create a new category of non-actionable trade-distorting non-"green box" subsidies and sanction huge increases in spending for "amber box" and, therefore trade-distorting, domestic support as long as it took the form of support for *multiple* commodities. This is contrary to the presumption of trade and production-distorting effects for individual products from non-"green box" domestic support, which flows from a domestic measure being inconsistent with the "green box" requirements of AoA Annex 2.

**"that decided during the 1992 marketing year"**

4. This word "decided" does not require any particular *type* of "decision". As a neutral term, the meaning of "decided" must be interpreted in a way that does justice to the ordinary meaning of other terms in Article 13(b)(ii) that are *not* neutral. Most importantly, the term "decided" must be interpreted in a manner that permits a comparison between a "*grant*" of non-"green box" "*support*" to a specific commodity for individual marketing years between 1995-2003, and a "decision" regarding such support in MY 1992. A textual interpretation reveals that the term "that" refers back to "support" and that support is accompanied by the term "granted".

5. The Appellate Body agreed with the panel in *Brazil – Aircraft* that the phrase "the *level* of export subsidies *granted*" meant "something actually provided", which means actual budgetary expenditures. Thus, the neutral term "decision" (for MY 1992) can only be read harmoniously with the term "grant support" (for MY 1995-2003) where the "decision" is to fund non-"green box" support to a specific commodity for marketing year 1992.

6. In addition, even if Article 13 would refer to a *level* of (income) support, as the United States alleges, the Appellate Body has held in *Brazil – Aircraft* that the "level" of export subsidies refers to actual expenditures.

7. The US interpretation of a "level of support" is furthermore inconsistent with its own interpretation of Article 13(b)(ii) in its Statement of Administrative Action (SAA). In the SAA, it stated that governments would have peace clause protection from adverse effects and serious prejudice challenges in the WTO "*unless the AMS for the particular* commodity exceeds the level decided in the 1992 marketing year". Brazil strongly disagrees with the notion of "AMS" as the relevant standard for the peace clause, *but* this official US interpretation of the peace clause in 1995 is nevertheless compelling evidence of the United States view of the "decision" it had taken during MY 1992. The calculation of the AMS for a particular commodity requires the calculation of the support provided in monetary terms. AoA Annex 3 offers two options for the calculation of AMS: budgetary outlays or the price gap formula detailed on paragraphs 10 and 11. Under either option, the AMS represents a measurement of support in monetary terms.

8. In sum, Brazil is of the firm view that the text of Article 13(b)(ii) requires comparing MY 1992 support with MY 1995-2003 support by comparing actual expenditures. This methodology produces an "amount" of support – not a "rate". Thus, any decision under Article 13(b)(ii), by definition, must relate in some way to an "amount" of expenditures. Only this methodology allows a clear comparison between the two time periods, regardless of the *type* of support.

9. However, even if the Panel were to decide that the relevant standard is a "rate of support" standard, Brazil has provided the testimony of Professor Daniel Sumner indicating that – following the US approach to measuring "support to upland cotton" – the "rate of support" to upland cotton in MY 1999-2002 was much higher than the "rate of support" to upland cotton in MY 1992. Based on the evidence and analysis presented by Professor Sumner, Brazil also asserts that even under the US "rate of support" methodology, the United States has failed to demonstrate that its MY 1999-2002 support does not exceed its support to upland cotton decided in MY 1992.

**US "statute of limitations" interpretation of the peace clause**

10. There is no express or implied "statute of limitations" in the peace clause. Subsidizing Members such as the United States are offered conditional protection under the peace clause during a 9-year period. But the rights of Members injured by subsidies provided in excess of 1992 marketing year levels are preserved throughout the implementation period as well. This is the balance struck by the peace clause.

11. The US "statute of limitations" argument in this case is very similar to one rejected by the Appellate Body in *US – Lead Bars*. This argument is further inconsistent with the views of the *Indonesia – Automobiles* panel, which held that measures applied in the past must be examined to assess present serious prejudice. The US interpretation would cut off a Member's right to challenge such measures because it missed an imaginary deadline. This US interpretation is inconsistent with the object and purpose of the AoA because it would permit Members to provide huge "non-green" box support one year without peace clause protection, and then claim absolution as soon as the next marketing year began.

**"Support to Upland Cotton"**

12. Brazil has produced extensive evidence providing the factual basis for the Panel to find that CCP, DP, market loss, and PFC payments are "support to" upland cotton within the meaning of the peace clause. USDA categorizes the PFC and market loss payments as part of "total payments" to upland cotton. US National Cotton Council officials repeatedly testified and produced documents revealing that their producer members requested, received, and depended on all four of these subsidies. Crop insurance is also support to cotton as evidenced by specific upland cotton crop insurance policies and groups of policies for upland cotton. Moreover, USDA specifically identifies and tabulates crop insurance subsidies for upland cotton. In addition, all five domestic support measures fail to meet the requirements of AoA Annex 2. Therefore, they constitute non-"green box" support that is presumed to be production and trade distorting. Such distortions can, however, only occur with respect to the production of or the trade in a particular commodity. Because, PFC, market loss assistance, direct and counter-cyclical payments as well as crop insurance subsidies are available to producers of upland cotton, these production and trade-distorting subsidies affect the production of and trade in upland cotton. The Panel should, therefore, find that all five of these programmes granted support to upland cotton in MY 1999-2002.

**Restrictions on Plantings of Fruits and Vegetables under the PFC and DP Programmes**

13. Brazil presents evidence that PFC and direct payments are not "decoupled" domestic support. These payments are dependent on the requirement that a farmer does not produce fruits, vegetables, nuts or wild rice on the contract acreage. This restrictions has the effect of channelling production on contract acreage into production of programme crops, including upland cotton, and is of particular importance for upland cotton base acreage located in regions of the United States where production of fruits and vegetables is a viable alternative to the production of upland cotton.

## III. STEP 2 EXPORT AND DOMESTIC PAYMENTS

14. The US Step 2 export payments clearly constitute subsidies contingent upon proof of export of US upland cotton. Step 2 export payments are export subsidies that violate AoA Articles 3.3 and 8 and that are prohibited by ASCM Articles 3.1(a) and 3.2.

15. Similarly, US Step 2 domestic payments are prohibited local content subsidies in violation of ASCM Article 3.1(b). There is no explicit derogation of ASCM Article 3.1(b) built into the Agriculture Agreement. In fact, the opposite is true, since AoA Article 13(b)(ii) provides a conditional exemption only for claims under ASCM Articles 5 and 6, but not for claims under ASCM Article 3. There is also no conflict between ASCM Article 3.1(b) and AoA Article 6 or Annex 3, paragraph 7, because there are two types of domestic support, including domestic support to processors of agricultural commodities – those that comply with Article 3.1(b) of the SCM Agreement and those that do not.

## IV. EXPORT CREDIT GUARANTEES

16. With respect to the consultations regarding the US export credit guarantee programmes, there is no doubt that the United States and Brazil consulted on three occasions about the GSM 102, GSM 103, and SCGP programmes as they relate to all eligible products. Thus, these measures are properly within the Panel's terms of reference and the Panel should reject the US request for a preliminary ruling.

17. With respect to Brazil's claims regarding the GSM 102, GSM 103 and SCGP export credit guarantee programmes, the United States interpretation of AoA Article 10.2 should be rejected. AoA Article 10.2 does not carve out export credit guarantees from the disciplines on export subsidies under the AoA. Nowhere does the provision exempt export credit guarantees from the disciplines on export subsidies, while exemption need to be made explicit in the text of an agreement following the Appellate Body reports in *EC – Hormones* and *EC – Sardines*. Similarly the context of AoA Article 10 as well as its object and purpose do not support the US view of AoA Article 10.2 as enabling Members to grant export credit support at zero percent interest and for unlimited terms – all for *free* – until Members complete negotiations on specific disciplines for export credits.

18. Concerning the substance of Brazil's claims against export credit guarantees, the United States has not even addressed Brazil's claim that since there is no commercial market for export credit guarantees on terms such as those provided by the CCC programmes, those programmes confer benefits *per se*. Brazil furthermore demonstrates that under the US formula accounting for the budgetary costs of contingent liabilities of CCC export credit guarantees, operating costs and losses for GSM 102, GSM 103 and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992. These figures represent *actual* costs and losses of the US export credit guarantee programmes.

19. Thus, the programmes constitute export subsidies within the meaning of ASCM Articles 1.1 and 3.1(a), item (j) of the Illustrative List, and AoA Articles 10.1, 1(e) and 8. They "at the very least" threaten to circumvent US export subsidy commitments, in violation of Articles 10.1 and 8 and are prohibited under ASCM Articles 3.1(a) and 3.2.

## V. ETI ACT

20. Lastly, the United States argues that Brazil has failed to meet is burden of proof that ETI Act subsidies constitute export subsidies violating the AoA and prohibited by the SCM Agreement. Brazil has adopted and reiterated all of the successful arguments of the EC in the *US – FSC (21.5)* dispute. Brazil asks the Panel to follow the panel in *India – Patents (EC)* and to give "significant weight" to the rulings in the *US – FSC (21.5)* dispute and to avoid "inconsistent rulings", while recognizing that the Panel is not formally bound by that decision.

## VI. PRELIMINARY ISSUES

21. Brazil has addressed the US request for a preliminary ruling on export credit guarantees above.

22. Concerning the US request for a preliminary ruling on the MY 2002 cottonseed payments, the record indicates that Brazil's consultation request covered "future" measures related to existing measures; it indicates further that Brazil and the United States consulted about the "Cottonseed Payment Programme", and that the Agricultural Assistance Act of 2003 provided funding for the existing administrative structure of the Cottonseed Payment Programme. Therefore, following the Appellate Body decision in *Chile – Agricultural Products (Price Band)*, the Agricultural Assistance Act of 2003 is properly within the Panel's terms of reference. In any event, the $50 million in

cottonseed payments are properly treated as "support to cotton" for the purposes of the peace clause calculation of the amount of support granted in MY 2002.

23. Regarding the US arguments that PFC and market loss assistance payments are outside the Panels terms of reference, as they constitute expired measures, Brazil asks the Panel to reject this third US request for a preliminary ruling. Brazil has properly included PFC and market loss assistance payments as part of its claims relating to *present* serious prejudice. Consultations under DSU Article 4.2 may be held concerning measures affecting the operation of a covered agreement. ASCM Article 5 requires a Member to avoid causing adverse effects, which may be the effects of current or previous, expired subsidies. As in the *Indonesia – Automobiles* dispute, expired measures are eminently within the Panel's terms of reference. Denying Members the possibility to challenge expired measures would yield the result that a Member could enact "one-time" subsidy measures that could never be challenged and the provisions of ASCM Articles 5 and 6 would thereby be rendered a nullity.

## VI. CONCLUSION

24. Brazil requests the Panel to reject all three US requests for preliminary rulings and to rule that AoA Article 13 does not exempt US domestic support and export subsidies from actions under the SCM Agreement.

# ANNEX C-2

## EXECUTIVE SUMMARY OF THE CLOSING STATEMENT OF BRAZIL AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

### I. INTRODUCTION

1. Brazil addresses first the "preliminary issues" raised by the United States, and then the various peace clause issues. Finally, Brazil addresses the Step 2, ETI Act and export credit guarantee measures.

### II. PRELIMINARY ISSUES

2. With respect to the consultations regarding the US export credit guarantee programmes, there is no doubt that the United States and Brazil consulted on three occasions about the GSM 102, GSM 103, and SCGP programmes as they relate to all eligible products. Thus, these measures are properly within the Panel's terms of reference.

3. Regarding the MY 2002 cottonseed payments, the record indicates that Brazil's consultation request covered "future" measures related to existing measures; it indicates further that Brazil and the United States consulted about the "Cottonseed Payment Programme", and that the Agricultural Assistance Act of 2003 provided funding for the existing administrative structure of the Cottonseed Payment Programme. Therefore, the Agricultural Assistance Act of 2003 is properly within the Panel's terms of reference. In any event, the $50 million in cottonseed payments are properly treated as "support to cotton" for the purposes of the peace clause calculation of the amount of support granted in MY 2002.

4. Regarding the US arguments that PFC and market loss assistance payments are outside the Panels terms of reference, as they constitute expired measures, Brazil asks the Panel to reject this third US request for a preliminary ruling. Brazil has properly included PFC and market loss assistance payments as part of its claims relating to *present* serious prejudice. ASCM Article 5 requires a Member to avoid causing adverse effects, which may be the effects of current or previous, expired subsidies. Adverse present effects caused by both types of measures are eminently within the Panel's terms of reference. As a factual matter, the Panel must decide on the question whether a particular expired subsidy has an actual causal connection with currently existing adverse effects. Yet, by granting the US request for a preliminary ruling the Panel would effectively dismiss Brazil's claim. Therefore, the fact that a subsidy measure has expired cannot be the basis for *a priori* excluding it from the Panel's terms of reference.

5. Furthermore, DSU Article 4.2 and 6.2 – invoked by the United States – must be applied in the context of the remedies provided for actionable subsidies under ASCM Articles 7.2-7.10. Under DSU Article 19 a panel can only recommend that the Member bring a wrongful measure into conformity with the covered agreement(s) at issue. However, for disputes concerning ASCM Articles 5 and 6, ASCM Article 7.8 contemplates two different remedies: removal of the adverse effects or withdrawal of the subsidy. While a Member cannot bring an expired measure into conformity with the covered agreements, both of the ASCM Article 7.8 remedies are valid options even for remedying the effects of a subsidy measure no longer in effect (as in the *Australia – Leather* dispute). As ASCM Articles 7.2-7.10 are "special and additional rules and procedures" under DSU Article 1.2 and DSU Appendix 2, they must prevail to the extent there is a difference between them and DSU Articles 4

and 6. This means that contrary to disputes involving other covered agreements, the Panel is required to address the adverse effects of expired subsidy measures.

6. Further, ASCM Articles 5 and 6.3 make no distinction between subsidies that are now being paid and subsidies that are no longer being paid but have a causal relationship to continuing adverse effects, as evidenced by the Panel report in *Indonesia – Automobiles*, which found serious prejudice arising, *inter alia*, from expired subsidy measures that had been provided for one year and – like the market loss assistance payments – been terminated.

## III. PEACE CLAUSE ISSUES

**"such measures do not grant support to a specific commodity"**

7. This phrase in Article 13(b)(ii) means that in calculating the amount of support for any marketing year between 1995-2003, all non-"green box" support provided to a specific commodity must be tabulated, regardless of whether the *type* or *form* of the support is "product-specific," "non-product specific", *de minimis*, or "blue box". This is certainly evidenced by the decision of negotiators *not* to use the phrases "product-specific" and "AMS" in Article 13(b)(ii) to qualify the type of support to a specific commodity. The US attempt to read "product-specific" into Article 13(b)(ii) is inconsistent not only with the text but also the context of the phrase "such measures" in Article 13(b)(ii). The US interpretation is further incompatible with the object and purpose of the Agreement on Agriculture. It would create a new category of non-actionable trade-distorting non-"green box" subsidies and sanction huge increases in spending for "amber box" and, therefore trade-distorting, domestic support as long as it took the form of support for *multiple* commodities. This is contrary to the presumption of trade and production-distorting effects for individual products from non-"green box" domestic support, which flows from a domestic measure being inconsistent with the "green box" requirements of Annex 2 of the Agriculture Agreement.

**"that decided during the 1992 marketing year"**

8. This word "decided" does not require any particular *type* of "decision". As a neutral term, the meaning of "decided" must be interpreted in a way that does justice to the ordinary meaning of other terms in Article 13(b)(ii) that are *not* neutral. Most importantly, the term "decided" must be interpreted in a manner that permits a comparison between a "*grant*" of non-"green box" "*support*" to a specific commodity for individual marketing years between 1995-2003, and a "decision" regarding such support in MY 1992. The Appellate Body agreed with the panel in *Brazil – Aircraft* that the phrase "the *level* of export subsidies *granted*" meant "something actually provided", which means actual budgetary expenditures. Thus, the neutral term "decision" (for MY 1992) can only be read harmoniously with the term "grant support" (for MY 1995-2003) where the "decision" is to fund non-"green box" support to a specific commodity for marketing year 1992.

9. The US argument that the only decision it took during MY 1992 was a "fixed rate of support" for MY 1992 is totally inconsistent with the US Statement of Administrative Action (SAA), in which the United States provided its official interpretation of the peace clause. In the SAA, the United States stated that governments would have peace clause protection from adverse effects and serious prejudice challenges in the WTO "*unless the AMS for the particular* commodity exceeds the level decided in the 1992 marketing year." Brazil strongly disagrees with the notion of "AMS" as the relevant standard for the peace clause, and draws the attention of the Panel to the fact that the United States now admits that "AMS" is nowhere found in the text of Article 13(b)(ii). *But* this official US interpretation of the peace clause in 1995 is nevertheless compelling evidence of the United States view of the "decision" it had taken during MY 1992. And this interpretation did not reflect a decision regarding only a rate of support. Instead, the only two "decision" options were set out in the AoA Annex 3, where "AMS" is calculated. This calculation is based on either budgetary

outlays, or a calculated *amount* based on the difference between a fixed reference price and the applied administered price multiplied by the amount of production eligible to receive the administered price. Under either option, the United States' interpretation indicates that an "amount" (not a "rate of support") is the measure of support under the peace clause.

10. The SAA statement is also strong evidence that the alleged US "decision" to continue the 1990 FACT Act level of support at 72.9 cents per pound is simply *post hoc* rationalization. Brazil presents evidence that prior to this dispute, the United States had not made up its mind on what would constitute the relevant decision for peace clause purposes. A series of questions asked by Brazil in the Committee on Agriculture and answers provided by the United States reveals that as of 28 June 2002, the United States had not yet made a "decision" regarding which year the United States was using with respect to Article 13(b)(ii). These questions provided the United States with every opportunity to announce the decision that it had allegedly taken 10 years before. Yet, it said nothing about a "rate of support".

11. In sum, Brazil is of the firm view that the text of Article 13(b)(ii) requires comparing MY 1992 support with MY 1995-2003 support by comparing actual expenditures. This methodology produces an "amount" of support – not a "rate". Thus, any decision under Article 13(b)(ii), by definition, must relate in some way to an "amount" of expenditures. Only such methodology allows a clear comparison between the two time periods, regardless of the *type* of support.

12. However, even if the Panel were to decide that the relevant standard is a "rate of support" standard, Brazil has provided the testimony of Professor Daniel Sumner indicating that the "rate of support" to upland cotton in MY 1999-2002 was much higher than the "rate of support" to upland cotton in MY 1992. Based on the evidence and analysis presented by Professor Sumner, Brazil also asserts that even under the US "rate of support" methodology, the United States has failed to demonstrate that its MY 1999-2002 support does not exceed its support to upland cotton decided in MY 1992.

**US "statute of limitations" interpretation of the peace clause**

13. There is no express or implied "statute of limitations" in the peace clause. Subsidizing Members such as the United States are offered conditional protection under the peace clause during a 9-year period. But the rights of Members injured by subsidies provided in excess of 1992 marketing year levels are preserved throughout the implementation period as well. This is the balance struck by the peace clause.

14. The US "statute of limitations" argument in this case is very similar to one rejected by the Appellate Body in *US – Lead Bars*. This argument is further inconsistent with the views of the *Indonesia – Automobiles* panel, which held that measures applied in the past must be examined to assess present serious prejudice. The US interpretation would cut off a Member's right to challenge such measures because it missed an imaginary deadline. This US interpretation is inconsistent with the object and purpose of the AoA because it would permit Members to provide huge "non-green" box support one year without peace clause protection, and then claim absolution as soon as the next marketing year began.

**"Support to Upland Cotton"**

15. Brazil has produced extensive evidence providing the factual basis for the Panel to find that CCP, DP, market loss, and PFC payments are "support to" upland cotton within the meaning of the peace clause. USDA categorizes the PFC and market loss payments as part of "total payments" to upland cotton. US National Cotton Council officials repeatedly testified and produced documents revealing that their producer members requested, received, and depended on all four of these subsidies. Crop insurance is also support to cotton as evidenced by specific upland cotton crop insurance policies and groups of policies for upland cotton. Moreover, USDA specifically identifies and tabulates crop insurance subsidies for upland cotton. Thus, the Panel should find that all five of these programmes granted support to upland cotton in MY 1999-2002.

## IV. STEP 2 PAYMENTS

16. The US Step 2 export subsidies clearly constitute export subsidies that violate Articles 3.3 and 8 of the Agriculture Agreement and that are prohibited by Articles 3.1(a) and 3.2 of the SCM Agreement because they are contingent upon proof of export of US upland cotton.

17. Similarly, US domestic Step 2 subsidies are prohibited local content subsidies in violation of Article 3.1(b) of the SCM Agreement. There is no explicit derogation of Article 3.1(b) built into the Agriculture Agreement. In fact, the opposite is true, since Article 13(b)(ii) provides a conditional exemption only for claims under Articles 5 and 6 of the SCM Agreement, but not for claims under Article 3 of the SCM Agreement. There is also no conflict between Article 3.1(b) of the SCM Agreement and Agriculture Agreement Article 6 or Annex 3, paragraph 7, because there are two types of domestic subsidies – those that comply with Article 3.1(b) of the SCM Agreement and those that do not.

## V. EXPORT CREDIT GUARANTEES

18. With respect to Brazil's claims regarding the GSM 102, GSM 103 and SCGP export guarantee programmes, the United States interpretation of AoA Article 10.2 should be rejected. Under the US view of Article 10.2, it can grant export credit support at zero percent interest and for unlimited terms – all for *free* – at least until Members complete negotiations on specific disciplines for export credits. This interpretation is not supported by a Vienna Convention analysis.

19. The United States has not even addressed Brazil's claim that since there is no commercial market for export credit guarantees on terms such as those provided by the CCC programmes, those programmes confer benefits *per se*. And Brazil has demonstrated that under the cost formula used by the White House, the US Congress, US government accountants and the CCC itself, operating costs and losses for GSM 102, GSM 103 and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992. These figures represent *actual* costs and losses of the US export credit guarantee programmes. The programmes therefore constitute export subsidies within the meaning of ASCM Articles 1.1 and 3.1(a), item (j) of the Illustrative List, and AoA Articles 10.1, 1(e) and 8. They "at the very least" threaten to circumvent US export subsidy commitments, in violation of Articles 10.1 and 8 and are prohibited under ASCM Articles 3.1(a) and 3.2.

## VI. CONCLUSION

20. Brazil requests the Panel to reject the numerous attempts by the United States to delay the initiation of Brazil's serious prejudice claims. Brazilian upland cotton producers are experiencing present serious prejudice from continued huge amounts of US subsidies to upland cotton. Applying

either methodology of calculating the support for peace clause purposes, the United States has no basis to claim peace clause protection.

# ANNEX C-3

## EXECUTIVE SUMMARY OF THE OPENING STATEMENT OF THE UNITED STATES AT THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. The United States has stayed within the disciplines and acted consistently with its WTO obligations negotiated and agreed in the Uruguay Round. We share many of Brazil's objectives with respect to reform of measures that affect agricultural trade, but we obviously do not endorse the means by which Brazil is attempting to obtain changes to WTO-consistent US support measures for upland cotton. Brazil seeks to impose disciplines and achieve results through this litigation that were not agreed in the Uruguay Round through negotiation.

2. Brazil suggests that whether a Member's measures are in breach of the Peace Clause should be judged by comparing the *aggregate outlays* that may be *attributed* to a commodity to the aggregate outlays that were made during the 1992 marketing year that, again, may be attributed to that commodity. Brazil's erroneous analysis stems from three interpretive missteps.

3. First, with respect to measures currently in effect, Brazil mistakenly suggests that support under previous measures in past years is relevant to the Peace Clause comparison. The proviso, however, is written in the present tense and thus, with respect to measures *currently* in effect, calls for a determination of the support that challenged measures *currently* grant. Brazil *nowhere* explains how the support in any previous years is relevant to the present-tense criterion that Peace Clause-exempted measures "do not grant support" in excess of a certain level. In fact, Brazil's analysis of the ordinary meaning and context of the phrase "grant support" assigns no meaning to Members' choice of verb tense.

4. Second, Brazil misunderstands the support that is relevant to the Peace Clause comparison because it misreads the phrase "support to a specific commodity". Brazil and New Zealand have asserted that, had Members intended for the phrase "support to a specific commodity" to mean "product-specific support", they would have used the latter phrase. With respect, this pushes the general interpretive aid of reading different word choices to carry different meanings too far. It ignores the relevant task for an interpreter, which is to read the text according to its ordinary meaning, in context, and in light of the object and purpose of the agreement. The ordinary meaning of the phrase "support to a specific commodity," in the context of the Agriculture Agreement, is "product-specific support".

5. We note that the Agriculture Agreement suggests that domestic support consists, in part, of product-specific and non-product-specific support. Brazil's interpretation of "support to a specific commodity," however, would apparently also capture "non-product-specific support". Absent a clear indication that such a contrary-to-logic result was intended, the interpreter should read "support to a specific commodity" to exclude "non-product-specific support". We note that the Agriculture Agreement suggests that domestic support consists, in part, of product-specific support and non-product-specific support. Brazil's interpretation of "support to a specific commodity", however, would apparently also capture "non-product-specific support". Absent a clear indication that such a contrary-to-logic result was intended, the interpreter should read "support to a specific commodity" to exclude "non-product-specific support".

6. Third, Brazil ignores the way in which the United States "decided" (that is, "determined" or "pronounced") the product-specific support for upland cotton during the 1992 marketing year. As

Brazil explained in its first submission, the Peace Clause text resulted from the EC's desire to protect from challenge measures "decided" in 1992 for purposes of CAP reform, rather than support "provided" during marketing year 1992. That is precisely the approach the United States suggests: examine the product-specific support "decided" during marketing year 1992 and compare it to the product-specific support that measures currently in effect grant. Brazil fails to explain to the Panel how US measures *actually* decided support during the 1992 marketing year in favour of Brazil's pre-baked conclusion that the "term 'decided during the 1992 marketing year' requires an examination of the *amount or quantity of support* . . . for a specific commodity that a WTO Member 'decided' to provide during the 1992 marketing year". In fact, US measures "decided" support in the 1992 marketing year by ensuring upland cotton producer income at a rate of 72.9 cents per pound. Brazil nowhere explains how US domestic support measures could have "decided" the amount of outlays since those outlays resulted from the difference between the income support level and world prices during Marketing Year 1992 beyond the US Government's control.

7. Brazil has argued that the US approach would create an annual "statute of limitations" for the applicability of the Peace Clause and that the problem with this approach is budgetary outlays are not known until after a given marketing year is completed. This comment, rather, points out the difficulties of *Brazil's* approach that *only* budgetary outlays may be examined under the Peace Clause. That is, Brazil effectively concedes that under *its* approach there would be no certainty for Members whether measures are exempt from actions. For example, it would be difficult to know whether budgetary outlays under the 2002 Act exceeded 1992 outlays as of Brazil's panel request in February 2003.

8. With respect to US direct payments, which the United States believes are "green box" measures, Brazil argues that these payments do not satisfy the "fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production" under the first sentence of paragraph 1 of Annex 2. However, the text of Annex 2 indicates that "domestic support measures" shall be deemed to have met this "fundamental requirement" if the measures "conform to the . . . basic criteria" of the second sentence, plus any applicable policy-specific criteria, by beginning the second sentence with "accordingly". This interpretation is supported by relevant context in the Agreement; as the European Communities notes in its third party submission, Articles 6.1, 7.1, and 7.2 refer to the measures "which are not subject to reduction commitments because they qualify under the *criteria* set out in Annex 2".

9. In addition to the basic criteria in paragraph 1, US direct payments must also conform to the five "policy-specific criteria and conditions" set out in paragraph 6 of Annex 2. Brazil brings forward two arguments that direct payments do not satisfy the criterion under paragraph 6(b) of Annex 2 that the amount of payments not be related to, or based on, production undertaken in any year after the base period. First, Brazil argues that by eliminating or reducing payments if recipients harvest certain fruits or vegetables, payments are related to production in a year after the base period. However, no particular type of production is required in order to receive such payments – indeed, no production is necessary at all. Brazil's argument, moreover, proves too much. Under Brazil's analysis, *any* limitation on a producer's choices in a year after the base period that would alter the amount of payment would be inconsistent with paragraph 6(b). However, a requirement that a recipient of direct payments produce *nothing at all* (or see the payment reduced or eliminated) *would* link the amount of payment to the type or volume of production in the current year. Such a requirement would also *ensure* that such payments meet the "fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production" because there would be no production at all. Thus, under Brazil's analysis, paragraph 6(b) would *prevent* a payment that would demonstrably achieve the "fundamental requirement" of Annex 2. This result is not required by the text of paragraph 6(b) and should be avoided.

10. Second, Brazil argues that direct payments are based on production in a year after the base period because once one type of direct payment to producers under Annex 2 has been made, *all*

subsequent measures providing direct payments must be made with respect to the same base period. The Annex 2 text does not support such a reading, however. Annex 2 says that "[d]omestic support measures for which exemption from the reduction commitments is claimed" shall meet the fundamental requirement of the first sentence through the relevant basic and policy-specific criteria of the second sentence. For example, in the case of decoupled income support, the particular "domestic support measure" must meet "policy-specific criteria and conditions as set out" in paragraph 6. Paragraph 6(a), (b), (c), and (d) relate "such payments" to "a defined and fixed base period". Thus, payments with respect to a given "domestic support measure for which exemption from the reduction commitments is claimed" must satisfy conditions relating to "*a* defined and fixed base period". There is no textual requirement that *all* domestic support measures for which exemption from the reduction commitments is claimed utilize the *same* "defined and fixed base period". Brazil also reads paragraph 6 as though the text were "*the* defined and fixed base period". However, this is not what the text says nor what the negotiators agreed.

11. Brazil and the rest of the Cairns Group seek to address this very issue by proposing in the ongoing agriculture negotiations that Annex 2, paragraph 6, be amended to change the reference from "a defined and fixed base period" to "a defined, fixed *and unchanging historical* base period". The revised Harbinson text, in Attachment 8, incorporates this Cairns Group proposal by proposing adding to paragraphs 5, 6, 11, and 13 of Annex 2 the text: "Payments shall be based on activities in a fixed and *unchanging historical* base period." Again, Brazil is seeking to gain through litigation what it has not yet gained through negotiation.

12. The Step 2 programme has been constructed and implemented in a manner to support the price paid to US upland cotton producers by purchasers of their product. Step 2 is a single programme that provides for payments on all sales of all upland cotton produced in the United States in a given marketing year – whether those sales are for export or for domestic consumption. Step 2 payments are provided to merchandisers or manufacturers who use upland cotton as they represent the first step in the marketing chain where these payments could be made and have the greatest impact on producer prices.

13. The authorizing statute plainly does not state that the Step 2 payment is contingent upon export. The statute provides for Step 2 payments to a class of eligible users who constitute the entire universe of potential purchasers of upland cotton from producers. Payment occurs upon demonstration of the requisite use of the cotton. Unlike the facts of *United States - FSC (Recourse to Article 21.5)* , the Step 2 subsidy involves a universally available subsidy on sales of one agricultural product produced entirely in the United States, not tied to exportation or foreign commerce. Stated most simply, US upland cotton does *not* have to be exported to receive the payment. Assuming the conditions in the payment formula are met, all US upland cotton is sold with an entitlement to the Step 2 subsidy, whether it leaves the United States or is consumed there.

14. For nearly 15 years before the inception of obligations under the Agreement on Agriculture, as well as since that time, the core features of the two main agricultural export credit guarantee programmes of the United States (GSM-102 and GSM-103) have remained substantially the same. They are well-known and well-established export credit guarantee programmes, specifically discussed by negotiators during the Uruguay Round, as well as in the OECD and in the current Doha Round.

15. Article 9.1 of the Agriculture Agreement identifies and lists specific export subsidy programmes, also well-known to the negotiators, who wanted to assure that such specific practices were embraced within the definition of an export subsidy for purposes of the Agreement on Agriculture. Other export subsidies are captured within the anti-circumvention provision of Article 10.1. In contrast, export credit guarantees were not included in either Article 9.1 or 10.1. Instead, as part of the balance struck in the Uruguay Round, negotiators opted to extend the negotiations on this subject but determined to hold Members to a commitment that if and when internationally agreed disciplines emerged, the United States, like all other WTO Members, could

only grant export credit guarantees in conformity with such disciplines. To do otherwise would at that time constitute a violation of the Member's obligations under the Agreement on Agriculture.

16. Article 10.2 expresses the two commitments of the Members in this regard: (1) to engage in such negotiations notwithstanding the conclusion of the Uruguay Round and (2) upon development of internationally agreed disciplines to render them WTO commitments through the portal of Article 10.2. Article 10.2 does not state that export credit guarantees shall be subject to such future negotiated disciplines *in addition to* the anti-circumvention provisions of Article 10.1. To the contrary, Article 10.2 and the reference to export credit guarantees is juxtaposed to Article 10.1 to reflect the intention of the drafters to distinguish export credit guarantee programmes from other programmes that otherwise would be export subsidies subject to Article 10.1.

17. For the foregoing reasons and those set out in our first written submission, the United States believes that US non-green box measures are exempt from actions pursuant to Agriculture Agreement Article 13(b)(ii); US direct payments are exempt from actions pursuant to Agriculture Agreement Article 13(a)(ii); and US export credit guarantee programmes for upland cotton and Step 2 payments are consistent with our WTO obligations.

# ANNEX C-4

## EXECUTIVE SUMMARY OF THE CLOSING STATEMENT OF THE UNITED STATES AT THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. On the US requests for preliminary rulings, the Panel expressed some interest in the question of what prejudice would result to the United States if we were forced to defend export credit guarantees with respect to commodities other than upland cotton. First and foremost, the United States would have lost the benefit of consultations on these measures. Consultations serve a number of important functions, including helping the parties to understand each others' concerns and aiding in efforts to resolve the dispute. The DSU affirms the importance of consultations and requires that a Member cannot proceed to a panel unless the Member has consulted on that measure.

2. Moreover, to require the United States to address Brazil's allegations on these measures would impose additional burdens on the United States and detract from the time and resources available to respond for those measures that *are* within the terms of reference. The United States has export subsidy reduction commitments with respect to 12 commodities. Each such commodity is therefore subject to individual Peace Clause analysis under Article 13(c). In addition, under Brazil's approach, the type of analysis the United States has offered for upland cotton concerning item (j) of the Subsidies Agreement would be appropriate for all commodities subject to the coverage of the Agriculture Agreement. This would necessitate a commodity-by-commodity analysis of the export credit guarantee programmes, as applied, concerning premiums and long-term operating costs and losses (if any).

3. But in the end, the issue of prejudice to the United States does not figure in the question of whether a measure is within the Panel's terms of reference. It is *that* question that underlies the United States' preliminary ruling requests.

4. First, the United States has requested that the Panel find that export credit guarantee measures relating to other eligible agricultural commodities are not within the Panel's terms of reference. While Brazil's *panel* request *did* refer to "export credit guarantees . . . to facilitate the export of US upland cotton and other eligible agricultural commodities," its *consultation* request did not. That consultation request nowhere included the "other eligible agricultural commodities" language, nor did Brazil include these measures in its statement of available evidence. Thus, those measures on other eligible agricultural commodities were not part of the "measures at issue" that Brazil identified in its consultation request as it is required to do under DSU Article 4.4. Contrary to Brazil's statement a few moments ago, the United States and Brazil never consulted on export credit guarantees on commodities other than cotton – not once and certainly not three times. Brazil said as much on the first day of the first panel meeting when it acknowledged that the United States told Brazil at the first consultation that its questions were beyond the scope of the consultations.

5. On the question whether the export credit guarantee programmes were one measure or multiple measures: There is no reason why export guarantees for multiple products cannot be multiple measures. Under DSU Article 4.4, it is incumbent upon Brazil to identify in its consultation request "the measures at issue." Here, Brazil identified the measure as the "export credit guarantees . . . to facilitate the export of US upland cotton," and the United States may, and did, rely on that consultation request (including the attached statement of evidence) for notice.

6. For example, if a Member banned imports of all animal products for a stated health reason, and another Member filed a consultation request on the ban solely with respect to imports of beef, that complaining Member could not then expand the scope of the dispute through its written consultation questions or its panel request to challenge that ban with respect to other affected agricultural commodities. This is, however, what Brazil is attempting to do here.

7. Brazil also relies on footnote 1 of its consultation request, which refers to an explanation "below". Such an explanation expanding the scope of the request to include "other eligible agricultural commodities" is *not* found in the consultation request. DSU Article 4.4 requires Brazil to provide "an identification of the measures at issue," not a cryptic reference that is not explained further. Despite notice from the United States and despite ample opportunity to submit a new consultation request, Brazil never did so. Therefore, export credit guarantee measures relating to eligible US agricultural commodities other than US upland cotton were not the subject of consultations and pursuant to DSU Articles 4.4, 4.7, and 6.2 do not form part of the Panel's terms of reference.

8. With respect to production flexibility contract payments and market loss assistance payments, we have explained that these payments were completed, the programmes terminated, and the statutory instruments providing them were superseded before Brazil's consultation request was filed. The measures that Brazil challenges are subsidies or payments provided by these programmes. The laws authorizing these payments designated that each such payment was *allocated* to a particular crop or fiscal year. Thus, pursuant to the 1996 Act, the last production flexibility contract payment for fiscal year 2002 was made no later than the end of fiscal year 2002. As Brazil states in its first submission, "[w]ith the passage of the new FSRI Act in May 2002, PFC payments were discontinued". The last market loss assistance payment was made with respect to the 2001 marketing year (1 August 2001-31 July 2002) pursuant to legislation enacted on 13 August 2001. Because the relevant fiscal year and the relevant marketing year, respectively, had been completed by the time of Brazil's consultation and/or panel requests, these measures cannot have been consulted upon within the meaning of DSU Article 4.2 *nor* have been "measures at issue" within the meaning of DSU Article 6.2. They therefore do not fall within the Panel's terms of reference. Brazil's suggestion that Articles 7.2 to 7.10 of the Subsidies Agreement should supersede the DSU provisions concerning this Panel's terms of reference is novel. Preliminarily, we note that Article 7.4 does mention the Panel's terms of reference, but only in the context of setting a 15-day deadline for establishing them, as opposed to the time line under DSU Article 7.1.

9. Finally, with respect to subsidies provided under the Agricultural Assistance Act of 2003 – the cottonseed payment – these are measures that were not even in existence at the time of Brazil's panel request. As the cottonseed payment had not been made (implementing regulations were not even issued until 25 April 2003) and the legislation authorizing the payments had not been enacted at the time of Brazil's panel request, this subsidy or measure was not consulted upon and could not have been a measure at issue between the parties. Therefore, the United States requests that the Panel make preliminary rulings that these three sets of measures are not within its terms of reference.

10. To summarize briefly where our discussions on the Peace Clause have brought us: Brazil suggests in *this* dispute that the word " actions" in the phrase "exempt from actions" only refers to "collective action" by the DSB. However, we note that Brazil's interpretation runs directly contrary to the view it expressed in its consultation request in the dispute *European Communities – Export Subsidies on Sugar* (WT/DS266/1). With respect to Article 13(c)(ii), which uses the same phrase "exempt from actions" at issue in this dispute, Brazil wrote: "In respect of the claims based on Article 3 of the SCM Agreement, because the export subsidies provided by the EC on sugar do not conform fully to the provisions of Part V of the Agreement on Agriculture, those export subsidies are not *exempt from challenge* by virtue of Article 13(c)(ii) of the Agreement on Agriculture." That is, in that WTO document Brazil does *not* read the phrase "exempt from actions" to mean "exempt from remedies" or "exempt from collective action by the DSB" but rather "exempt from *challenge*".

Brazil's interpretation in that WTO consultation request could only result if "exempt from action" in the Peace Clause means "not subject to" the "taking of legal steps to establish a claim" – as the United States has been contending in this dispute. We submit that *this* interpretation by Brazil is correct.

11. The Peace Clause – in Brazil's words – "exempt[s] from challenge" certain measures. It follows that the Peace Clause is not an affirmative defence but rather a threshold issue for Brazil in this dispute. As Brazil implicitly recognized in both its panel and consultation requests, to even reach the point where it will, as the complaining party, be allowed to pursue its substantive claims, Brazil must first demonstrate that the Peace Clause does not exempt US measures from action – that is "from challenge".

12. On US direct payments, which the United States believes are "green box" measures because they satisfy the criteria set out in Annex 2: As a question from the Chair to Brazil suggested, assessing the conformity of a claimed green box measure against the "fundamental requirement" of the first sentence of paragraph 1 would be a difficult, if not impossible task, for a Panel. Members foresaw the problem and therefore provided guidance on how a measure would fulfill that fundamental requirement – that is, if the measures "conform to the . . . basic criteria" of the second sentence plus any applicable policy-specific criteria, they shall be deemed to have met the fundamental requirement.

13. With respect to the criterion in paragraph 6(b) that the amount of decoupled income support payments not be based on, or linked to, production undertaken in any year after the base period, this provision need not and should not be read as Brazil suggests. The text supports a reading that a Member may not base or link payments to production requirements. The EC endorsed this view this morning. US direct payments require no particular type of production – indeed, no production is necessary at all. As we have suggested, Brazil's reading of paragraph 6(b) would prevent a Member from prohibiting a recipient from producing crops – that is, would prevent a measure that bases or links payments to a type or volume of production: none at all. If there is no production at all as a result of the measure, such a measure necessarily can have no "trade-distorting effects or effects on production". Thus, Brazil's reading of paragraph 6(b) would *preclude* a Member from establishing a measure that meets the "fundamental requirement" of Annex 2. Paragraph 6(b) need not and should not be read in opposition to that fundamental requirement. In the context provided by the first sentence of Annex 2, then, paragraph 6(b) should be read as establishing that a Member may not base or link payments to requirements to produce any crop in particular – again, US direct payments require no upland cotton production and do not require any production at all.

14. Brazil has repeatedly raised the spectre of unchecked US domestic subsidies should the Panel agree with the US interpretation of the Peace Clause. Brazil's fears are groundless. Of course the United States may not provide subsidies without any limit. US subsidies are disciplined in several ways, and the US has deliberately kept itself within those limits. There are two main disciplines that apply. The first is the US final bound commitment level under the Current Total Aggregate Measurement of Support. The second, as we have discussed at length, is the Peace Clause itself and its effective limitation to a level of producer support of 72.9 cents per pound. The United States has stayed within the boundaries of those limits despite, as outlined in Brazil's filings, pressure to do otherwise. We are entitled to the benefit of that compliance.

15. We can understand that Brazil might feel that these limits are not enough. New limits may be negotiated in the ongoing agriculture negotiations, in which the United States shares many of the same goals as Brazil. Until that happens, however, Brazil may not seek to overturn the balance of rights and obligations negotiated and agreed by Members in the Uruguay Round. Brazil's Peace Clause interpretation would do violence to the text of the Agriculture Agreement and would penalize the United States for deciding support to upland cotton producers within the limits set by the Agreement. We therefore ask the Panel to find that Brazil has not established that US domestic

support measures breach the Peace Clause and that such measures are therefore exempt from Brazil's action at this time.

# ANNEX C-5

## ORAL THIRD PARTY COMMUNICATION BY THE ARGENTINE REPUBLIC

24 July 2003

## I. INTRODUCTION

1. The Argentine Republic thanks the Panel for the opportunity to present its views as a third party to these proceedings and, in pursuant to its Submission dated 15 July[1], will comment on the claims contained in the First Written Submission of the United States, dated 11 July.

2. In this connection, Argentina will comment more particularly on:

(a) The US interpretation of the provisions of the Peace Clause, particularly in Article 13(b)(ii);

(b) the US interpretations regarding Annex 2 of the Agreement on Agriculture and, lastly;

(c) the US interpretation whereby Article 10.2 of the Agreement on Agriculture excludes export credit guarantees from the general export subsidy disciplines in the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures.

## II. UNITED STATES CLAIMS

(a) Interpretation of the Peace Clause

3. Argentina will discuss what it regards as a mistaken US interpretation of the terms of the Peace Clause, particularly in Article 13(b) of the Agreement on Agriculture[2], whereby it draws the conclusion – equally mistaken – that its domestic support measures are exempt from the measures based on Article XVI.I of the GATT 1994 or Articles 5 and 6 of the Agreement on Subsidies (ASCM).

*(i) Grant support to a specific commodity*

4. First, the United States mistakenly interprets the phrase "grant support to a specific commodity".

5. In paragraph 71 of its Submission, the United States says that counter-cyclical payments and crop insurance payments do not constitute "support to a specific commodity" because they are not linked to specific commodity but are based on *historical* acreage and payment yields.[3]

6. The United States contends that "support to a specific commodity", in Article 13(b)(ii), means "product-specific support". Its argument is thus based on trying to incorporate the phrase "product-

[1] "Third party Submission by Argentina", paragraph 2.
[2] First Written Submission of the United States of America, 11 July 2003, Section III.D.
[3] *Ibid.*, paragraph 115.

specific support" into Article 13(b)(ii) when the phrase is not to be found in the wording of the article.[4]

7. If the negotiators had meant to say that "product-specific support" was exempt, they would have introduced that phrase into the wording of the article, but they did not do so.[5] Hence, AA Article 13(b)(ii) refers to a Member's non-Green Box domestic support measures, including domestic support measures granted only to individual specific products and also those relating to several specific products.

8. In other words, "support to a specific commodity", in Article 13(b)(ii), includes any non-Green Box domestic support measure providing identifiable support to an individual commodity, regardless of whether the measure can provide support to a larger number of commodities.[6]

9. In its argument, the US ignores the most relevant context of Article 13(b)(ii), namely the chapeau, which refers not to "product-specific support" but to "domestic support measures" in general. This means that the measures which, under Article 13(b)(ii) are relevant in determining whether a Member has granted support to a specific commodity in excess of that decided during the 1992 marketing year necessarily includes non-product-specific domestic support.

10. The US interpretation would mean no claim could be made against any Amber Box domestic support measure granted to more than one commodity. The US argument would thus allow Members to make enormous increases in domestic support to a relatively small number of commodities (such as the ten crops covered by the counter-cyclical payments programme), something which is inconsistent with the object and purpose of the AA, namely, cutting down the level of domestic support, as is apparent from the Preamble.[7]

11. Argentina considers that "support to a specific commodity", in Article 13(b)(ii), indicates that, in calculating the domestic support granted by a Member, the support must relate to a particular or precise commodity, regardless of whether the support is product-specific or specific to more than one product.[8]

12. Contrary to the US suggestion, the phrase "support to a specific commodity" does not mean "support exclusively or only" to a specific commodity. The fact that, through the same domestic

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[4] According to the Appellate Body in the *India-Patents Case* (WT/DS50/AB/R, adopted 16 January 1998, paragraph 45):

"*The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the Vienna Convention. But these principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended".* (Emphasis added)

[5] "*… had Members intended to exclude non-product specific support they would surely have said so", "Third Party Submission of New Zealand*", 14 July 2003, paragraph 2.21.

[6] In this respect, Argentina agrees with New Zealand: "*… New Zealand sees no basis on which to suggest that support to a specific commodity should be excluded simply because other commodities may receive similar support*". Third-party submission of New Zealand, 15 July 2003, paragraph 2.23.

[7] *"... the above-mentioned long-term objective is to provide substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets"* (Agreement on Agriculture, third preambular paragraph).

[8] Australia's Third Party Submission to the Panel, 15 July 2003, paragraph 23: "*... the ordinary meaning of this phrase* ("To a specific commodity"), *read in its context and in light of the object and purpose of the Agreement on Agriculture, is support granted to an individual agricultural commodity covered by AA Annex 1, such as upland cotton, whether through product specific, or non-product specific, support*".

support measures, the United States grants support to different products does not cancel out the fact that part of the support is granted to one specific product.

*(ii) Support "decided during the 1992 marketing year"*

13. After analysing the phrase "*that decided during the 1992 marketing year*", the United States reaches the conclusion that the phrase does not relate to support actually provided to a specific product during that year[9], but to support *determined* during the 1992 marketing year and that it consisted in "deciding" or "determining" a level of income support for cotton producers of US$0.72 per pound.

14. With this interpretation, the United States can get around the need to respond to Brazil's contention[10] - supported by Argentina[11] - that the US budgetary outlays on domestic support for the cotton sector for the 1999, 2000, 2001 and 2002 marketing years were far in excess of the US$1,994 million granted in 1992.

15. Argentina considers that, under Article 13(b)(ii), the word "decided" means a decision to make payments. The US argument ignores the fact that the text first uses the term "grant support" with reference to the support granted or provided to a specific commodity during the period of implementation (1995-2003). The phrase "grant support", however, is necessarily tied in with the support "decided during the 1992 marketing year"; otherwise, there would be no basis for comparison if one case involved the support granted and the other involved only the support scheduled.

16. In this connection, Argentina contends that the word "decided", in Article 13(b)(ii), should not be interpreted in such a way that the per pound guaranteed price for commodity producers (scheduled support) is the factor to be taken into consideration in determining the amount of support granted. If the criterion advanced by the United States were accepted, it would mean that an unlimited amount of domestic support could be granted to each product provided the total AMS is not exceeded.

17. In other words, the comparison required in Article 13(b)(ii) necessarily entails comparing the same type of support in each of the periods in question (period of implementation versus 1992 marketing year), in other words "comparing the comparable". The "support granted" in each marketing year during the period of implementation must necessarily be tied in with the budgetary outlays in those years.

18. In this respect, the definition of "granted" formulated by the Appellate Body in the "Brazil-Aircraft" case is relevant, namely that it is "*something actually provided*" and, thus, "*to determine the amount of export subsidies "granted" in a particular year, we believe that the actual amounts provided by a government, and not just those authorized or appropriated in its budget for that year, is the proper measure … Therefore, … we believe that the proper reference is to actual expenditures by a government …*".

19. Similarly, Argentina considers that, under AA Article 13(b)(ii), the definition of the term "support granted" must refer to a government's actual expenditures and not to a scheduled level of costs or a rate of support per unit of production.

20. Accordingly, Argentina takes the view that the support "decided during the 1992 marketing year" refers to payments actually made during that marketing year.

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[9] First Written Submission of the United States of America, paragraph 94: "… *no amount of outlays was 'decided' … during the 1992 marketing year …*".

[10] First Written Submission by Brazil, paragraphs 144-149.

[11] Third Party Submission by Argentina, paragraphs 64-65.

*(iii) The time dimension of Peace Clause protection*

21. In contrast to the US interpretation, Argentina contends that the domestic support measures granted in any of the marketing years in the period from 1995 to 2003 are relevant in determining compliance with Article 13(b)(ii). In this connection, we consider that any injurious effects of the subsidies are extended time-wise.

22. An interpretation like the one postulated by the United States would seriously restrict the possibility of questioning whether such subsidies are consistent with ASCM Articles 5 and 6, while effects causing injury, nullification or impairment or serious prejudice can be linked to domestic support measures granted in previous marketing years.

(b) Annex II of the Agreement on Agriculture

*(i) Interpretation of paragraph 1*

23. The United States claims that its direct payments programme is in conformity with AA Annex II[12] and, therefore, is exempt from measures under the protection afforded by Article 13(a). In reaching this conclusion, however, the United States makes a mistaken interpretation of paragraph 1 of AA Annex II.

24. The United States maintains that the structure of this provision, where the second sentence starts with the word "Accordingly", suggests that measures that conform to the two basic criteria set out in paragraph 1(a) and (b), plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex II are designed to meet the "fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production"[13].

25. Argentina considers this interpretation to be erroneous, since the text of the first sentence establishes a clear obligation that the domestic support measures to be exempted from the reduction commitments "… *shall meet the fundamental requirement that they have no … trade-distorting effect or effects on production …*". In Argentina's opinion, the language of this first sentence establishes a general requirement governing the application of all Green Box measures.

26. The structure of paragraph 1 of AA Annex 2 thus creates four types of obligation:

(i) The fundamental requirement of no, or at least minimal, trade-distorting effects or effects on production;

(ii) the support given in a government-financed programme does not entail transfers from consumers;

(iii) the support does not have the effect of providing producers with price support; and

(iv) the policy-specific criteria and conditions set out in paragraphs 2 to 13 of Annex 2 are also taken into account.

27. In this connection, Argentina believes that Green Box measures must respect the guiding principle of avoiding trade-distorting or production effects or at most minimal effects. A measure that meets the two basic criteria set out in paragraph 1(a) and (b), plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2 could also be at variance with the general

[12] First Written Submission by the United States of America, paragraph 53.
[13] *Ibid.,* paragraph 50.

principle. The opposite interpretation would render meaningless the first sentence of paragraph 1 of Annex 2, which the text describes as a "fundamental requirement".

28. Therefore, it is Argentina's view that, however much the United States claims that its direct payments programme conforms to the requirement established in the second sentence of paragraph 1 of Annex 2[14], since it does not meet the fundamental requirement established in the first sentence it cannot be viewed as a Green Box programme.

29. In this respect, Argentina concurs with Australia and New Zealand that the first sentence of Annex 2 paragraph 1, imposes a stringent standard by requiring that the measures to be exempted from reduction commitments must, as a primary or essential condition, not artificially alter trade or production.[15]

30. Consequently, if a domestic support measure leads to a higher level of production of trade in a particular product or group of products, the measure does not meet the standard established in Annex 2, Article 1.

31. It should be emphasized that the US has in no sense answered the statements by Brazil in paragraphs 183 to 191 of its Submission concerning the trade-distorting and production effects of the direct payments programme, according to studies made by the US Department of Agriculture's own economists.

32. In other words, because the direct payments programme does have trade-distorting and production effects, it cannot be included among the domestic support measures exempted from reduction commitments.

*(ii) Interpretation of paragraph 6(b)*

33. The United States maintains that the Production Flexibility Contract Payments (PFC) and Direct Payments programmes are not tied in with production and, therefore, are not Green Box domestic support.

34. Argentina considers that the alleged "flexibility" of producers to plant different crops is in fact seriously restrictive. The amount of payments made depends on the type of production. Indeed, particular crops (fruits, vegetables, etc.) are excluded from these programmes. The effect of this is to channel production to the remaining crops, which do benefit from the programmes. This shows that the amount of the payments made is linked to the type of product sown, as Argentina pointed out in its Third Party Submission[16] and, therefore, the payments are not in conformity with AA Annex 2 paragraph 6(b).

(c) Article 10.2 of the Agreement on Agriculture does not exclude export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture and the Agreement on Subsidies.

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[14] *Ibid.*, paragraphs 64-68.

[15] Australia's Third Party Submission to the Panel, 15 July 2003, paragraph 31: "… *AA Annex 2.1 imposes a stringent standard. Annex 2.1 requires that such measures must, as a primary or essential condition, not "bias" or "unnaturally alter trade or production …*"; Third Party Submission of New Zealand, 15 July 2003, paragraph 1.08: " … *In New Zealand's view it is critical that the integrity of the disciplines on "Green Box" measures are not weakened or their legitimate purpose undermined through the inclusion of measures that fail to meet the strict requirements of Annex 2, including the fundamental criterion that such measures are non-trade or production distorting …*".

[16] Third Party Submission by Argentina, 15 July 2003, paragraphs 54-57.

35. The United States asserts that the text of Article 10.2 of the Agreement on Agriculture permits Members to continue export credit guarantee programmes unaffected by export subsidy disciplines,[17] since the text reflects the fact of that, during the Uruguay Round, Members came to no agreement on the substantive disciplines applicable. In other words, the United States contends that the actual text of Article 10.2 of the Agreement on Agriculture indicates that the export credit guarantee programmes are not subject in any way to the Agreement's export subsidy disciplines.[18]

36. In this regard, Argentina would point out that the fact that WTO Members are negotiating disciplines in order to implement Article 10.2 does not in any way support the US reading to the effect that Article 10.2 excludes export credit guarantees from the general disciplines on export subsidies.[19] A commitment "to work towards the development" of specific international disciplines on the granting export credits, export guarantees or insurance programmes is not the same as excluding them from the general disciplines on export subsidies. If that had been the intention, then the negotiators would have expressly said so.

37. Contrary to the US contention, Argentina does not find any indication of this type in the wording of Article 10.2. The fact that the negotiators did not include an express reference to the effect that export credit guarantees are not included in the definition of export subsidies or are not subject to the disciplines established in AA Articles 3.3, 8 or 10.1 means that such disciplines apply to export credit support measures.

38. In other words, in conformity with the wording of AA Article 10.2, export credit guarantees are not exempt from the general disciplines of the Agreement on Agriculture, and where the measures are not in conformity with that Agreement, from the disciplines of the Agreement on Subsidies.

39. This interpretation is reinforced by the immediate context and the object and purpose of AA Article 10.2. Paragraph 2 forms part of Article 10, which is entitled *"Prevention of Circumvention of Export Subsidy Commitments"*. Paragraph 1 of Article 10 establishes that export subsidies not listed in paragraph 1 of Article 9 *"… shall not be applied in a manner which results in … circumvention of export subsidy commitments …"*. This provision imposes disciplines on export credit guarantees, just as it imposes disciplines on the whole universe of export subsidies not covered by Article 9.1.

40. In turn, the object and purpose of AA Article 10 is to prevent any form of circumvention of export subsidy commitments.[20] Consequently, the US interpretation of Article 10.2 is completely at variance on the context of the provision and the object and purpose of AA Article 10, since it contributes to circumvention of the export subsidy commitment by excluding an entire category of export subsidies from the general disciplines.

41. Lastly, contrary to what the US maintains,[21] the fact that an export subsidy is not included in AA Article 9.1 does not mean that it is not an export subsidy, for Article 9.1 is not an exhaustive list,

[17] First Written Submission of the United States of America, paragraph 160.

[18] *Ibid.*, paragraph 164.

[19] Third Party Submission of Canada, 15 July 2003, paragraph 53: "*This provision (*Article 10.2) *sets out an intention on the part of Members to undertake further work regarding these measures – the simple fact of agreeing to do so, however, does not amount to a permission to use those measures to confer export subsidies without consequence and without limit. The US interpretation of Article 10.2 ignores the important context provided by Article 10.1. It also directly contradicts the stated object and purpose of Article 10 as a whole …"*. Similarly, in its Third Party Submission, New Zealand states: "*Nor does Article 10.2 in any way suggest that it provides an exception from the disciplines of Article 10.1…*", paragraph 3.15.

[20] Article 10.3 reverses the burden of proof in cases of export subsidies under the Agreement on Agriculture where exports are in excess of the reduction commitment level. Article 10.4 establishes disciplines on international food aid.

[21] First Written Submission of the United States of America, paragraphs 161-162.

as is evidenced by the wording of Article 10.1.[22] Nor does it mean that such an export subsidy is not subject to the export subsidy disciplines of the Agreement on Agriculture.

42. Argentina agrees with the European Committees[23] that Article 10.2 makes it clear export credit guarantees are not one of the types of export subsidy listed in Article 9.1 and, in that connection, Article 10.1 establishes that non-listed export subsidy must not be applied in a manner which results in circumvention of export subsidy commitments.

43. Hence, as the European Communities contend, wherever export credit guarantees are export subsidies not listed in Article 9.1, those guarantees could be applied in a manner which would result in circumvention of commitments and, therefore, would be prohibited under Article 10.1.

## III. CONCLUSION

44. In accordance with the foregoing, Argentina considers that the United States has mistakenly interpreted the provisions of the Peace Clause, in particular in Article 13(b)(ii), has failed to bear the burden of proving that the domestic support measures it granted to cotton during the 1999, 2000, 2001 and 2002 marketing years were not in excess of the support "decided during the 1992 marketing year".

45. Second, Argentina considers that the US interpretations regarding Annex 2 of the Agreement on Agriculture are mistaken and that, therefore, the Direct Payments and PFC programmes do not fall under the protection of Article 13(a) of the Agreement on Agriculture for Green Box measures.

46. Third, Argentina considers that the United States export credit guarantee schemes (GSM 102, 103 and SGCP) constitute export subsidies subject to the general export subsidy disciplines of the Agreement on Agriculture (Articles 3.3, 8 and 10.1) and the Agreement on Subsidies and Countervailing Measures (Article 3.1(a) and 3.2).

[22] Third Party Submission of Canada, 15 July 2003, paragraph 32; *"Article 9 of the Agriculture Agreement lists and describes certain export subsidies that are subject to reduction commitments. All other export subsidies fall within the scope of Article 10-1…*".

[23] First Third Party Submission by the European Communities, 15 July 2003, Section V.

# ANNEX C-6

## ORAL STATEMENT BY AUSTRALIA

24 July 2003

Mr Chairman, Members of the Panel,

1. I appreciate this further opportunity to present Australia's views on matters at issue in this dispute.

2. In this statement, I will provide some elaboration of Australia's views on the meaning of Article 13(b)(ii) of the *Agreement on Agriculture*. I will also address some of the matters raised in the First Written Submission of the United States and in the First Third Party Submission of the European Communities.

Mr Chairman, Members of the Panel,

3. I will begin with matters relating to the meaning of Article 13(b)(ii) of the *Agreement on Agriculture*.

4. As Australia noted in its Written Submission[1], the word "decided" appears twice in the operative provisions of the *Agreement on Agriculture* – in subparagraphs (ii) and (iii) of Article 13(b). Further, the immediate context for the word "decided" is exactly the same in each case: "provided that such measures do not grant support to a specific commodity in excess of that *decided* during the 1992 marketing year". Yet Article 13(b)(iii) deals with a completely different type of action: one based on non-violation or impairment under GATT Article XXIII:1(b).

5. Thus, Australia believes that it will be necessary for the Panel to consider two key threshold questions.

6. Firstly, is the meaning of the phrase "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" the same in each of Article 13(b)(ii) and (iii)?

7. Australia recalls that the phrase, as well as draft text for what became Article 13, first appeared in the "Blair House Accord". Also included in the Accord were provisions concerning the *EEC – Oilseeds* dispute.[2]

8. In Australia's view, that dispute is crucially relevant to the interpretation of Article 13(b)(ii) and (iii).

9. Australia recalls that it clearly understood in the resumed Uruguay Round agriculture negotiations in 1993 that the words "decided during the 1992 marketing year" had been chosen to

[1] Third Party Submission of Australia, paragraph 26.

[2] *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins ("EEC – Oilseeds")*, Report of the Panel, adopted 25 January 1990, BISD 37S/86, and *Follow-Up on the Panel Report "European Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, DS28/R, BISD 39S/91.

incorporate into the text of Article 13(b)(ii) and (iii) the sense of expectations of "conditions of price competition" as this had been interpreted and applied in the *EEC – Oilseeds* dispute.

10. The panel in *EEC – Oilseeds* described the purpose of GATT Article XXIII:1(b) in the following terms:

> … The panel noted that these provisions, as conceived by the drafters and applied by the contracting parties, serve mainly to protect the value of tariff concessions.[…] The idea underlying them is that the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. …[3]

11. That Panel went on to say:

> … The Panel considered that the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset. …[4]

12. In any case, having regard to the customary principles of interpretation, Australia considers that the phrase "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" must have the same meaning in both Article 13(b)(ii) and (iii).

13. Thus, there is a second threshold question that the Panel needs to consider. That question is: could conditions of price competition for the purposes of a non-violation nullification or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole.

Mr Chairman, Members of the Panel,

14. I would now like to comment on some matters raised in the First Written Submission of the United States.

15. Firstly, Australia disagrees with the United States' approach to interpreting the "peace clause" and the meaning of "exempt from action based on".[5]

16. If the United States' interpretation is correct and the WTO Agreement negotiators intended the interpretation offered by the United States, surely the negotiators would have included provisions clarifying how such situations should be resolved? At the very least, surely Article 13 of the *Agreement on Agriculture* would have been listed in the Special or Additional Rules and Procedures Contained in the Covered Agreements at Appendix 2 to the *Dispute Settlement Understanding*? Yet the negotiators did neither of these things.

17. The United States argues as well that its interpretation is supported by the fact that the peace clause applies "[n]otwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and

[3] *EEC – Oilseeds*, paragraph 144.
[4] *EEC – Oilseeds*, paragraph 148.
[5] First Written Submission of the United States, paragraph 33.

Countervailing Measures".[6] However, the United States ignores that, for its argument to be valid, the peace clause would also have to apply "notwithstanding the provisions of the *Dispute Settlement Understanding*".

18. The United States argues too that Brazil is in error by asserting that the peace clause itself "provides no positive obligations".[7] In Australia's view, however, this argument confuses obligations and conditions: the United States is equating a binding requirement to act in a certain way with a prerequisite for the availability of a right or privilege. Article 13 of the *Agreement on Agriculture* does not of itself establish any binding requirements with which WTO Members are required to comply.

19. That confusion between rights and obligations continues when the United States argues that "Brazil's approach would produce bizarre results".[8] Indeed, the United States' arguments could be considered to confirm the nature of Article 13 as an affirmative defence. Had Brazil alleged a breach of the United States' obligations under Article 6, Brazil would have had the initial burden of making a *prima facie* case of inconsistency. Article 13, however, is a right or privilege available to the United States, provided that its measures fully conform to the relevant conditions. Thus, it is for the United States to demonstrate that it is entitled to invoke that right or privilege.

20. Secondly, the United States argues that "support to a specific commodity" is equivalent to "product-specific support".[9]

21. The United States asserts that the definition of Aggregate Measurement of Support – or AMS – at Article 1(a), and Article 6 concerning Domestic Support Commitments, provide relevant context. The United States asserts that because the calculation of AMS, and exemptions from Current Total AMS, differentiate between product specific and non-product specific domestic support, "support" in the context of Article 13(b)(ii) and (iii) means product-specific AMS.

22. Australia does not agree. AMS is defined by Article 1(a) to mean "the annual level of support … provided for an agricultural product in favour of the producers of the basic agricultural product". However, Article 13(b)(ii) and (iii) refer to "support to a specific commodity".

23. Had the negotiators intended that "support to a specific commodity" in the context of Article 13(b)(ii) and (iii) mean product-specific AMS only, they would have said so in the text. They did not. Further, the United States' argument ignores that a Member's reduction commitments include both product specific and non-product specific domestic support measures unless they are exempt from inclusion.

24. Thus, in Australia's view, "support to a specific commodity" means: all non-"green box" support that benefits a specific commodity, whether that support be through product specific, or non-product specific, programmes. Indeed, Australia believes that "support to a specific commodity" in the context of Article 13(b)(ii) and (iii) can include forms of support additional to those captured in an AMS calculation.

25. It follows, of course, that Australia considers – in the context of this dispute – that the portions of the direct payment and counter-cyclical payment programmes that benefit upland cotton should be included in the calculation of "support to a specific commodity" within the meaning of Article 13(b)(ii). Moreover, Australia notes that the counter-cyclical payment programme provides a

[6] First Written Submission of the United States, paragraph 39.
[7] First Written Submission of the United States, Paragraph 43.
[8] First Written Submission of the United States, paragraph 44.
[9] First Written Submission of the United States, paragraph 78.

target price of 72.4 cents per pound for upland cotton,[10] and that entitlements to "Step 2" payments and some other domestic support programmes are additional to the target price, as they were to the 1992 target price of 72.9 cents per pound.

26. Thirdly, the United States argues that direct payments under the 2002 Farm Act meet the criteria of Annex 2 Decoupled Income Support payments. Australia has already addressed the issue of planting restrictions on fruit and vegetables and wild rice in its Written Submission.

27. The United States argues that "eligibility for direct payments is defined by clearly defined criteria … in a defined and fixed base period" and that "payment yields and base acres are defined in the 2002 Act and fixed for the duration of the legislation".[11] The United States' interpretation means that a WTO Member could re-define and re-fix a base period every time it introduced new domestic support legislation. This cannot be a correct interpretation of the provisions of paragraph 6 of Annex 2 to the *Agreement on Agriculture*.

28. Fourthly, the United States argues that "a Member may choose to provide 'amber box' support in any … manner so long as that Member's Current Total AMS does not exceed … *[its]* commitment level".[12]

29. Australia disagrees. The United States' argument ignores that Article 13(b)(ii) does not exempt non-"green box" domestic support measures from actions based on Article 3 of the *SCM Agreement*. It also ignores the provisions of Article 21.1 of the *Agreement on Agriculture*. In an analogous situation in the *EC – Bananas* dispute, the Appellate Body said: "… the provisions of the GATT 1994 … apply … except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter".[13] The Appellate Body went on to say in that dispute:

> … [T]he negotiators of the *Agreement on Agriculture* did not hesitate to specify … limitations elsewhere in that agreement; had they intended to do so with respect to Article XIII of the GATT 1994, they could, and presumably would, have done so. …[14]

30. The Appellate Body's statement is equally applicable in the context of this dispute. Had the negotiators of the *Agreement on Agriculture* intended that non-"green box" domestic support measures be "exempt from actions based on" Article 3 of the *SCM Agreement*, they would have said so. The negotiators did expressly exempt export subsidies from actions based on SCM Article 3 to the extent that such export subsidies conformed fully to the provisions of Part V of the *Agreement on Agriculture*. In Australia's view, therefore, the omission from Article 13(b)(ii) of the *Agreement on Agriculture* of an express exemption from actions based on SCM Article 3 for local content subsidies has meaning.

31. Fifthly, the United States has requested that the Panel issue a preliminary ruling that Production Flexibility Contract and Market Loss Assistance payments are not within the Panel's terms of reference because these programmes have expired. The fact that a measure has expired cannot be sufficient to remove it from the Panel's purview. If the Panel were to grant the United States' request solely on that basis, it would mean that any Member could authorise WTO-inconsistent domestic support programmes through short-lived measures and avoid the consequences of such actions.

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[10] Section 1104, 2002 FSRI Act, Exhibit Bra-29.

[11] First Written Submission of the United States, paragraph 67.

[12] First Written Submission of the United States, paragraph 144.

[13] *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R, paragraph 155.

[14] *EC – Bananas*, paragraph 157.

Mr Chairman, Members of the Panel,

32. The final matter on which I will comment today concerns the Third Party Submission of the European Communities and its arguments in relation to the interpretation of the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture*. The European Communities argues that the first sentence "simply signals the objective of Annex 2" and does not set out an independent obligation.[15]

33. That argument ignores the plain meaning of the text and renders the first sentence of paragraph 1 inutile, which of course a treaty interpreter may not do. If an exemption from reduction commitments is being claimed for any domestic support measures, the first sentence says they "shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production". As explained in Australia's written submission,[16] a fundamental requirement is a primary or essential condition. To interpret a "fundamental requirement" other than as a separate and independent obligation would be contrary to the plain meaning of the words and thus to the normal rules of treaty interpretation. The use of the words "shall meet" establishes an express obligation to comply with the specified condition that such measures not, or only minimally, bias or unnaturally alter trade or production.[17]

34. The European Communities argues that the word "accordingly" at the beginning of the second sentence of paragraph 1 links the 'fundamental requirement' in the first sentence with the 'basic criteria' in the second sentence" and thus makes clear that the fundamental requirement is complied with if the basic criteria in the second sentence and the policy-specific criteria set out in paragraphs 2 to 13 are met.[18]

35. However, the meanings for "accordingly" cited by the European Communities – "in accordance with the logical premises" and "correspondingly" – do not compel the interpretation it has offered. Moreover, there are other, equally valid meanings of the word "accordingly", provided by the same dictionary, such as "harmoniously" and "agreeably".[19]

36. It is possible to interpret the whole of paragraph 1 to Annex 2 so as to give effect to all of its provisions:

- domestic support measures for which exemption from the reduction commitments is claimed shall not, or shall only minimally, distort trade or production; and

- to the extent that measures of the type described in paragraphs 2 to 13 of the Annex are consistent and harmonious with that fundamental requirement and conform to the basic and policy-specific criteria as set out in the second sentence, they are exempt from reduction commitments.

37. Thus, notwithstanding that they may meet the basic and policy-specific criteria set out in paragraphs 1 and 6 of the Annex, a Member may not claim Decoupled Income Support payments as "green box" where those payments do not meet the fundamental requirement that they shall not, or shall only minimally, distort trade or production. Such could be the case, for example, where the level of Decoupled Income Support payments are sufficient to affect directly producer decisions concerning the allocation of economic resources to production of a particular commodity.

[15] First Third Party Submission by the European Communities, paragraph 15.
[16] Australia's Third Party Submission to the Panel, paragraph 31.
[17] Australia's Third Party Submission to the Panel, paragraphs 31-32.
[18] First Third Party Submission by the European Communities, paragraph 20.
[19] *The New Shorter Oxford English Dictionary*, Volume I, Ed. Lesley Brown, Clarendon Press, Oxford, 1993, page 15.

Mr Chairman, Members of the Panel,

38. Should you have questions on any matters concerning Australia's Written Submission and Oral Statement, I would be pleased to take these on notice and arrange for written answers to be provided.

Thank you, Mr Chairman, Members of the Panel.

# ANNEX C-7

## THIRD PARTY ORAL STATEMENT OF BENIN

24 July 2003

Mr. Chairman, members of the Panel,

It is my honour to represent Benin at this Third Party session today. The other two members of our delegation are Mr. Eloi Laourou of the Permanent Mission of Benin, and Mr. Brendan McGivern of White & Case, our legal adviser.

Although Benin acceded to the WTO back in 1996, this marks our first entry into WTO dispute settlement. We have been led to take this unprecedented step by the magnitude of the threat posed by US cotton subsidies, and the highly damaging effect that such subsidies have on the exports and economy of our country.

In our third party submission, we sought to provide to the Panel, at the earliest possible stage, information on the impact of the WTO-inconsistent US subsidies on Benin. In our view, this provides essential additional context to the issues facing the panel.

I do not intend to repeat what was in our submission, but it is worth highlighting some key facts.

The importance of the cotton sector to Benin can hardly be overstated. As noted in our submission, it accounts for 90 per cent of our agricultural exports, and three-quarters of our export earnings over the past four years. It generates 25 per cent of national revenues. In total, about a million people in Benin – out of a total population of six million – depend on cotton or cotton-related activities. Cotton plays a particularly important role in rural areas, where national poverty reaches its highest levels.

Mr. Chairman, Members of the Panel: the results of US cotton subsidies are readily apparent in West Africa. The United States provides huge, and WTO-inconsistent, subsidies for cotton. This leads to an oversupply of cotton on the world market, and a consequent decline in prices. Moreover, when cotton from Benin enters world markets, it must compete against massively-subsidized US cotton.

The dollar value of these subsidies dwarfs all other economy activity in Benin. As indicated in our submission, the subsidies paid by the United States to its 25,000 cotton farmers exceed the entire gross national income of Benin – and indeed the other countries in the region as well.

This demonstrates, rather dramatically, the impossibility of Benin ever competing with such subsidies. It is inconceivable that any developing country – let alone a least-developed country in West Africa – could ever match the virtually limitless resources of the United States.

Therefore, for us, the solution to this problem lies in the WTO. We ask simply that the United States respect its WTO obligations regarding subsidies.

Mr. Chairman, we agree with Brazil that the United States cannot invoke the peace clause to bar the claims that have been advanced in this dispute. We agree that the peace clause constitutes an

affirmative defence, and that the burden lies on the United States to demonstrate that has met all the conditions for the successful invocation of this affirmative defence. This it has failed to do.

In any event, whether the peace clause constitutes an affirmative defence, as we believe, or is part of the "balance of rights and obligations of Members", as the United States argues, the result is the same. Brazil's First Submission has established, clearly and unambiguously, that the United States is in breach of its WTO obligations. The US First Submission has provided no convincing rebuttal of Brazil's claims.

Mr. Chairman, Members of the Panel:

In its submission of July 11, the United States argued that the phrase "support to a specific commodity" should be understood to mean "product-specific support". However, the term "product-specific" does not appear in Article 13(b)(ii). If the drafters of the Agreement on Agriculture had wanted to use this term in Article 13(b)(ii), they obviously could have done so, as they did elsewhere in Agreement, such as in Article 6(4), or in Annex 3. Moreover, if the US interpretation were accepted, measures providing support to more than one commodity could not be challenged under Article 13(b)(ii). This elevates form over substance, and is contrary to both the language and the object and purpose of this provision.

Finally, the United States asks this Panel to exclude from its terms of reference certain measures that it argues were not the subject of consultations. We were not part of the consultations, and will not delve into the facts of this disagreement. However, Benin would recall the statement of the Appellate Body in *Brazil Aircraft* (DS46):

> "We do not believe….that Articles 4 and 6 of the DSU, or paragraphs 1 to 4 of the SCM Agreement, require a <u>precise and exact identity</u> between the specific measures that were the subject of consultations and the specific measures identified in the request for the establishment of a panel. As stated by the Panel, '[o]ne purpose of consultations, as set forth in Article 4.3 of the SCM Agreement, is to 'clarify the facts of the situation', and it can be expected that information obtained during the course of consultations may enable the complainant to focus the scope of the matter with respect to which it seeks establishment of a panel." [emphasis added]

Indeed, Benin notes that the United States itself took a similar approach in the recent *Japan – Apples* case. In the US replies to the Panel on October 16, 2002, USTR stated that:

> "[T]here is no requirement in the DSU to consult on a particular claim in order to include that claim in a panel request and to have such a claim form part of the panel's terms of reference. The purpose of consultations is to provide a better understanding of the facts and circumstances of a dispute; logically, then, a party may identify new claims in the course of consultations."

Although this US reply dealt with claims rather than measures, it is consistent with the ruling of the Appellate Body in *Brazil Aircraft* that panels should not require a "precise and exact identity" between the measures that were the subject of consultations and the measures identified in the panel request.

Mr. Chairman, Members of the Panel:

For Benin, this dispute is of critical national importance. As we stated in our Third Party submission, we are not seeking any special and differential treatment in the present case. We are simply asking that the United States abide by the disciplines that it agreed to at the end of the Uruguay Round.

Thank you for allowing Benin to present its views to the Panel. We would be pleased to reply to any questions you may have.

# ANNEX C-8

## THIRD PARTY ORAL STATEMENT OF CANADA

24 July 2003

### I. INTRODUCTION

1. Mr. Chairman, members of the Panel, on behalf of my Government, I thank you for your consideration of Canada's views in this dispute.

2. Canada's statement today conveys our systemic interest in the interpretation of certain provisions of the Agriculture Agreement and the SCM Agreement regarding certain aspects of Brazil's claims. The first two points we address relate to US domestic support measures and the applicability of the Peace Clause. In this respect, we set out why:

- first, the updating of the base period for US direct payments renders these payments inconsistent with paragraphs 6(a) and (b) of Annex 2 of the Agriculture Agreement; and

- second, US counter-cyclical payments to producers of upland cotton must be counted as "support to a specific commodity" under Article 13(b)(ii) of the Agriculture Agreement.

3. The last point we address is whether there is any exemption for US export credit guarantee programmes from US export subsidy commitments under the Agriculture Agreement. Here, we set out why:

- first, item (j) of the SCM Agreement may not be interpreted a contrario to deem export credit guarantee practices as not providing export subsidies under Article 10.1 of the Agriculture Agreement; and

- second, Article 10.2 of the Agriculture Agreement does not exempt export subsidies granted under export credit guarantee programmes from US export subsidy commitments in the Agriculture Agreement.

### II. US DOMESTIC AGRICULTURAL SUPPORT MEASURES

#### A. TO BE EXEMPT UNDER ANNEX 2, DIRECT PAYMENTS MUST HAVE THE SAME BASE PERIOD AS PFC PAYMENTS

4. We turn first to US direct payments. The United States defends these measures by asserting, among other things, that the 2002 FSRI Act redefines and fixes the base period for the duration of the legislation.[1] According to the United States, direct payments therefore fully conform to Annex 2 of the Agriculture Agreement.

5. This, in Canada's view, raises form over substance. In addition to the views we provided in our written third party submission, Canada observes that US direct payments also do not conform to the base period requirement in paragraphs 6(a) and (b) of Annex 2. The structure of the PFC payment

[1] US First Written Submission, para. 67.

and direct payment programmes are essentially the same[2], so are the payment parameters.[3] The applicable base period therefore is that for PFC payments. However, the United States allows base acreage determining the receipt and the amount of direct payments to be updated.[4] The base period is therefore not "fixed", contrary to subparagraph (a). The amount of the payments may also be increased based on the volume of production undertaken by a producer in a year after the applicable base period, contrary to subparagraph (b).

6. The United States itself demonstrates the linkage between PFC payments and direct payments; they are closely related and successor programmes.[5] Yet, the United States takes the position that because the payments are continued under a separate piece of legislation and new regulations, an updating of the base period does not affect their exempt status.[6] In Canada's view, such formalistic arguments cannot prevail.

B. COUNTER-CYCLICAL PAYMENTS ARE "SUPPORT TO A SPECIFIC COMMODITY"

7. Mr. Chairman and members of the Panel, the formalism of US arguments does not stop there. In an effort to avoid the logical conclusion that counter-cyclical payments "grant support to a specific commodity" within the meaning of Article 13 of the Agriculture Agreement, the United States cites varied meanings of the term "specific" and inappropriately incorporates into Article 13 concepts relating to the calculation of the AMS. These arguments are an attempt to detract from the plain text of Article 13 and its straight-forward application to the facts of this case.

8. In Canada's view, counter-cyclical payments "grant support to a specific commodity" under Article 13(b)(ii) of the Agriculture Agreement.[7] It is hard to see how a measure that grants support that is specific to a "specific commodity" would not be included in the assessment under Article 13(b). It is uncontested that the US measure provides payments in an amount determined by target prices that are specific to certain covered products.[8] The setting of commodity-specific target prices necessarily leads to different levels of support for different products. The cotton-specific support granted in this respect must be taken into account for the purposes of Article 13(b).

## III. US EXPORT CREDIT GUARANTEE PROGRAMMES

9. I now turn to US export credit guarantee programmes.

10. In Canada's written third party submission we set out the applicable standard for determining whether transactions under these programmes are subsidized within the meaning of Articles 1(e) and 10.1 of the Agriculture Agreement. Canada takes no position on the facts in this respect, but notes that USDA's own description of its guarantee programmes implies that a benefit is conferred. I quote: "The programmes encourage exports to buyers in countries where credit is necessary to maintain or increase US sales, but where financing may not be available without CCC guarantees."[9] The Panel should assess CCC premiums in the light of this admitted reality.

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[2] See Brazil First Written Submission, para. 182; Third Party Submission of New Zealand, para. 2.26; Third Party Submission of Australia, paras. 47-48.

[3] US First Written Submission, paras. 58-63.

[4] US First Written Submission, para. 59.

[5] US First Written Submission, fn. 47.

[6] US First Written Submission, para. 67.

[7] See also Exhibit Br-27 ("Title I - *Commodity Programmes*"; "Counter-cyclical payments *for* wheat, feed grains, upland cotton, rice, and oilseeds" (emphasis added)).

[8] See US First Written Submission, para. 117.

[9] USDA, "Export Credit Guarantee Programmes", FAS Online at http://www.fas.usda.gov/excredits/exp-cred-guar.html, (second sentence) [Exhibit CDA-3].

11. Today, Canada addresses the two exemptions alleged by the United States in support of its assertion that the US programmes do not grant export subsidies in violation of US export subsidy commitments under Articles 8 and 10.1 the Agriculture Agreement. The claimed exemptions are the following:

- First, item (j) of the SCM Agreement sanctions any US export subsidy provided through CCC-guaranteed credit transactions because the programmes come within the scope of item (j) yet do not meet the standard it establishes. According to the United States, item (j) may be interpreted a contrario to allow subsidized export credit transactions. It follows for the United States that its programmes do not confer export subsidies within the meaning of Article 3.1(a) of the SCM Agreement and Article 1(e) of the Agriculture Agreement;

- Second, Article 10.2 of the Agriculture Agreement exempts outright any subsidized export credit transactions from US export subsidy commitments.

12. The panel in Brazil – Aircraft considered the first type of alleged exemption at length in its first implementation report. The United States was a third party in that case, and argued for an a contrario interpretation of the first paragraph of item (k) of the Illustrative List.[10] The panel rejected all arguments in this respect and concluded that the provision could not be used to establish that a prohibited export subsidy under the SCM Agreement is otherwise permitted.

13. The panel's reasoning in that case applies with equal force here. Briefly, the panel found that:

- First, Annex I is purely "illustrative" and does not purport to exhaustively list all export subsidy practices[11],

- Second, a measure that falls within the scope of Annex I is deemed to be a prohibited export subsidy such that where a Member demonstrates that the measure meets the standard in any of the listed items, it does not also have to demonstrate that the measure comes within the scope of Articles 1 and 3.1(a) of the SCM Agreement[12], and

- Third, footnote 5 of the SCM Agreement provides that practices described in Annex I may be properly considered not to constitute an export subsidy only in two situations. The first situation is where an affirmative statement in the Agreement provides that the measure in question is not an export subsidy; the second is where an affirmative statement in the Agreement provides that measures satisfying the conditions of an item in Annex I are not prohibited.[13] Footnote 5 reads "Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement".

14. In its second implementation report in Brazil – Aircraft, the panel applied the same reasoning.[14] Applying this reasoning to the case at hand, footnote 5 to the SCM Agreement precludes reliance on an a contrario interpretation of item (j) as an implied exclusion to any finding of subsidized transactions under the US programmes.

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[10] *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, adopted 4 August 2000, paras. 6.24-6.67 [*Brazil – Aircraft, First Recourse*].

[11] *Ibid.*, para. 6.30.

[12] *Ibid.*, para. 6.31.

[13] *Ibid.*, paras. 6.37.

[14] *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW2, adopted 23 August 2001 at paras. 5.274 and 5.275.

15. Regarding Article 10.2 of the Agriculture Agreement, Canada's view is that the words of that provision speak for themselves. Members have undertaken to work towards internationally agreed disciplines to govern the provision of export credit guarantees. Nothing in that provision states that the export subsidy obligations in Article 10.1 of the Agreement do not apply to US export credit guarantee practices. Where Members have wanted to exempt measures from export subsidy obligations, they have been clear– such as in the second paragraph of item (k) of the SCM Agreement.[15]

16. In addition, the US interpretation of this provision does not accord with its object and purpose. Canada shares the views of other third party participants in this dispute that the ongoing work under Article 10.2 is expected to further elaborate on current disciplines regarding export credit practices and to perhaps more clearly identify when such practices shall or shall not be deemed to confer export subsidies within the meaning of Article 1(e) of the Agriculture Agreement.[16] The obvious precedent in this respect is the second paragraph of item (k) of the SCM Agreement.

## IV. CONCLUSION

17. In conclusion, Mr. Chairman and members of the Panel, the Panel should find that the United States rendered direct payments inconsistent with Annex 2 of the Agriculture Agreement by allowing the base period to be updated. This finding would be in addition to a finding that PFC payments and direct payments do not conform to Annex 2 because the amount of the payment is linked to the type of production after the base period. Regarding counter-cyclical payments, the Panel should find that this support to US producers of upland cotton must be counted as "support to a specific commodity" under Article 13(b)(ii) of the Agreement. Finally, regarding US export credit guarantee programmes, the Panel should confirm that neither the Agriculture Agreement nor the SCM Agreement contain an exemption for any US export credit guarantee subsidy found in this case. Were the Panel to find that such subsidies exist – which in Canada's view is the most likely outcome to the Panel's assessment of the facts – then the Panel must conclude that the United States grants export subsidies in violation of its export subsidy commitments under Articles 8 and 10.1 the Agriculture Agreement and that Article 13(c)(ii) therefore does not apply.

[15] See also *Brazil – Aircraft, First Recourse*, para. 6.36.

[16] See First Third Party Submission by the European Communities, para. 30 and Third Party Submission of New Zealand, paras. 3.15-3.16.

# ANNEX C-9

## ORAL STATEMENT OF CHINA AT THE THIRD PARTY SESSION

24 July 2003

1. Thank you, Mr. Chairman, and members of the Panel. China is appreciative of this opportunity to present its views on the issues raised in this Panel proceeding. In its third party written submission of 15 July, China explained its views in relation to three issues. In this statement, I will summarize China's major points.

2. The first issue that China would like to have this Panel's attention is about the burden of proof issue under the Peace Clause.

3. China agrees with Brazil's argument that the Peace Clause is an affirmative defence in nature. If the United States claims that defence, the burden of proof is on the United States.

4. Contrary to what the United States see, China believes that the Peace Clause does not impose positive obligations. Stand-alone, Annex 2 and Article 6 of the *Agreement on Agriculture* may have positive obligations; but when they are cross-referred to by the Peace Clause, they become part and parcel of conditions that must be met before a Member can move under its safety.

5. China believes the US errs on seeing no distinction between "obligation" and "condition". The Peace Clause requirement for full conformity with Article 6 and Annex 2 does not create new obligations because Members have to comply with Article 6 and Annex 2 whether Article 13 exists or not. Within the Peace Clause, these requirements do not stand to impose obligations on Members, but to set conditions precedent for a Members intending to invoke Peace Clause protection. Positive obligations to comply with these requirements, if there is any, lie under where they are, i.e. under Article 6 and Annex 2, but not under the Peace Clause.

6. China does not see any "absurdity" as described by the United States in its written submission. No such "absurdity" would be instilled into the process if at the first stage, the party alleging protection of Peace Clause for its measures is required to discharge its burden to prove that such measures do conform to the relevant Peace Clause conditions; if it cannot so prove, the measures would lose Peace Clause protection. A second stage will follow for the party claiming against the measures to establish its substantive case, without the Peace Clause shield.

7. With respect, China submits that the burden of proof issue must be resolved first. China also hopes that the above two-step approach will help this Panel and the parties to move the procedures on towards resolution of the case.

8. The second point that China made in its written submission relates to proper categorization of US Direct Payments (shortened as "DP") under the US Fair Security and Rural Investment Act of 2002 (shortened as "FSRI"). Allow me to shorten that act to FSRI. Without repeating the issue of burden of proof, preponderance of evidence suggests that such Direct Payments are not "Green Box" in nature.

9. One of the requirements for "Green Box" Direct Payment support measures lies under Para. 6(a) of Annex 2 to the *Agreement on Agriculture*. The paragraph provides to the effect that eligibility shall be determined by "clearly-defined criteria" "in a defined and fixed base period".

10. The word "in" requires a link between the "criteria" and the "defined and fixed base period". In other words, to qualify for "Green Box" direct payment measure under Para. 6(a), a criterion adopted by a Member must be tied, in a chronological sense, to a starting time frame that cannot be moved up on the calendar.

11. As the United States has explained, 2002 FSRI DP allowed landowners to retain PFC base acreage under the 1996 Federal Agriculture Improvement and Reform Act (shortened as "FAIR") and "add 1998-2001 acres of eligible oilseeds or simply declare base acreage for all covered commodities" (including upland cotton). In addition, while a landowner may elect to simply utilize acres devoted to covered commodities during the 1998-2001 period for purpose of DP, a landowner need not do so; base acres may remain those under FAIR of 1996, implying no cotton production need have occurred since the 1993-1995 period for a landowner to have "cotton base acres" Consideration the progression from PFC to DP, one can see that contrary to the US argument that "base acres are defined in the 2002 [FSRI] Act and fixed for the duration of the legislation", the requisite link between the programme acreage as a criterion and the starting time frame under the DP is broken. The change of legislation from FAIR to FSRI and the replacement of PFC with DP were utilized to for producers to leap from their previous coverage acreage, which should have been tied to the base period, to a new updated acreage in 2002.

12. Therefore, in China's opinion, preponderance of evidence proves that the US direct payments under the FSRI shall be properly categorized as non-"Green Box" measures.

13. The last issue that China considers important is about export subsidy support granted by US "Foreign Sales Corporations" for upland cotton export sales under the "FSC Repeal and Extraterritorial Income Act of 2000". Its short name is ETI Act.

14. The ETI Act has previously been found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by both the panel and the Appellate Body in *US – FSC (21.5)* case. On 29 January 2002, the DSB adopted the panel and Appellate Body reports. Following US failure to withdraw such export subsidy support, on 7 May 2003, the DSB authorized the EC to impose countermeasures against the US.

15. China believes that the panel and the Appellate Body's reasoning and their conclusion in *US – FSC (21.5)* should be considered and taken by this Panel.

16. The measures challenged by Brazil in the current proceeding are exactly the same challenged by the EC in *US – FSC (21.5)*. Reasoning and conclusion by the earlier panel and the Appellate Body are more than relevant to the current case. Their reports, once adopted by DSB not only create legitimate expectations, but also reflect the collective will of the WTO membership.

17. In that respect, allow me to quote the panel in *India – Patent Protection for Pharmaceutical and* Agricultural *Chemical Products*, for this Panel:

> [I]n the course of "normal dispute settlement procedures" required under Article 10.4 of the DSU, we *will take into account the conclusions and reasoning* in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we *should give significant weight to both Article 3.2 of the DSU*, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, *and to the need to avoid inconsistent rulings* (which

concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the DSU.

18. This concludes my oral presentation. China welcomes questions from the Panel regarding these issues.

# ANNEX C-10

## ORAL STATEMENT BY THE EUROPEAN COMMUNITIES

24 July 2003

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## I. INTRODUCTION

1. Mr. Chairman, Distinguished Members of the Panel, the European Communities is grateful for the opportunity to express its views in this third party session.

2. We would first like to welcome the involvement of Benin in this procedure. The European Communities is of the view that the involvement of least developed countries in dispute settlement is highly desirable. We hope that other least developed countries follow Benin's lead.[1]

3. This is a complex case which raises many difficult and important interpretative issues. Those responsible for drafting Article 13 of the *Agreement on Agriculture* have left you with some difficult questions. Despite those difficulties, Article 13 in particular, and the *Agreement on Agriculture* more generally, represent a finely balanced and much fought over package of rights and obligations assumed by WTO Members. The European Communities is confident that this Panel will undertake a careful examination of these very precise terms and preserve the delicate balance of rights and obligations which has been negotiated.

4. This dispute raises a large number of issues. In our interventions, we have concentrated on those issues of principle which we consider are of systemic concern. Today, we will largely address issues which were not addressed in our written submission. At the same time, we also consider it necessary to revisit some issues which we have already addressed in order to rebut some of the arguments raised by other parties.

5. The European Communities starts by setting out its conception of the role of the peace clause (section II). We will then address several questions of interpretation relating to the peace clause (section III). We then turn to consider the interpretation of Annex 2 of the *Agreement on Agriculture* (the Green Box) (Section IV) before considering the status of domestic content subsidies and export credits under the *Agreement on Agriculture* (Section V). We conclude with some comments on one of the requests for preliminary rulings raised by the United States (Section VI).

## II. THE ROLE OF THE PEACE CLAUSE

6. We turn first to consider the role of the Peace Clause (Article 13).

7. The European Communities views Article 13 as one element regulating the interface between the *Agreement on Agriculture* and the *SCM Agreement*. It defines, in some cases, how subsidies granted pursuant to the *Agreement on Agriculture* should be treated for the purposes of countervailing duty investigations, and in other cases exempts such subsidies from actions under the *SCM Agreement*. The European Communities disagrees with both Brazil and the United States as to how the term "exempt from action" should be understood. However, while we disagree with the United States' logic, we do not disagree with the practical result of the application of its logic.

8. The term "exempt from action" cannot mean, as Brazil claims, that, even if the peace clause is applicable, the Panel must examine Brazil's claims under the *SCM Agreement*, and that if the Panel finds that the United States has acted inconsistently with the *SCM Agreement*, the DSB should somehow "refrain" from recommending the United States to bring itself into conformity with the *SCM Agreement*. The European Communities finds it difficult to imagine how the DSB, operating under the negative consensus rule, could refrain from recommending the United States bring itself into conformity should the Panel find that the United States had acted inconsistently with the *SCM Agreement*. Moreover, the United States can reasonably argue that it is not required to bring itself

[1] This text was not in the written statement circulated at the third party session, but reflects unscripted comments made during that session.

into conformity with the *SCM Agreement* by withdrawing measures which it is perfectly entitled to maintain under the *Agreement on Agriculture*, pursuant to both Article 13 and Article 21. The only answer to this question is that if the United States is entitled to peace clause protection, the Panel cannot find in favour of Brazil's *SCM Agreement* claims.

9. The European Communities does not agree with the United States that Article 13 prevents a Member from requesting consultations or the establishment of a panel with respect to a measure which might be entitled to Article 13 protection. It is not, as the US argues, the mere fact that the defendant Member is unable to block a request for consultations, or for establishment of a panel, that the applicability of the peace clause has come before this Panel. The need for the Panel to adjudicate this issue flows from the fundamental principle underlying the WTO Agreement that every question of interpretation of the WTO Agreements which "affects the operation of any covered agreement" must be subject to the DSU.[2] However, as we have noted, if the Panel determines that the US measures in question are protected by Article 13, it cannot find in favour of Brazil's claims under the *SCM Agreement*.

## III. INTERPRETATION OF THE PEACE CLAUSE

10. The Panel has a number of challenging questions before it on the interpretation of various aspects of Article 13(b). The European Communities turns now to set out its position on some of the issues before the Panel.

### A ARTICLE 13 IS NOT AN AFFIRMATIVE DEFENCE

11. The European Communities will only briefly touch upon the issue of the burden of proof for Article 13. The European Communities has yet to hear a credible response to the argument that putting the burden of proof on the defendant has perverse effects. As the European Communities and the United States have pointed out, when a complainant brings a case only under the *Agreement on Agriculture* (for instance alleging breach of Article 6) it will bear the burden of proof. However, if Article 13 is considered an affirmative defence, when a complainant brings a dispute under Articles 5 and 6 of the *SCM Agreement* and, for instance, Article 6 of the *Agreement on Agriculture*, the complainant would be required to prove a breach of Article 6 while at the same time the defendant would also be required to prove that it had not infringed Article 6 of the Agreement. The burden of proof cannot switch between parties simply on the basis of whether the complainant cites the *SCM Agreement* or not, but this would be the result of interpreting Article 13 as an affirmative defence.

12. Further confirmation that Article 13 is not an affirmative defence can be drawn from the fact that Article 13 also regulates the application of countervailing duties on agricultural subsidies. In this context, a determination that the subsidy in question is not protected by Article 13 must be taken by an investigating authority before it may impose countervailing duties. Article 13 is consequently a pre-condition for an individual Member in taking action against subsidised exports. It cannot, in that context, be considered as a defence for exporters co-operating in an investigation and may, as the United States have pointed out, be used as the foundation for a claim in a WTO dispute by the exporting Member that countervailing duties have been illegally imposed. There is no reason why that conception of Article 13 should change simply because the issue arises in WTO dispute settlement.

[2] Article 4.2 DSU.

B. RELEVANT COMPARISON FOR THE PURPOSES OF ARTICLE 13

13. Brazil has argued that any breach of the 1992 level during the 9 year implementation period removes the protection of Article 13.[3] The European Communities agrees with the United States that this is incorrect.[4] The present tense of the phrase "do not grant support" makes this clear. The comparison for the purpose of Article 13(b) must be between the level of support decided in the 1992 marketing year and that granted by virtue of the measures being challenged. This would typically mean the most recent marketing year.

C. THE MEANING OF "DECIDED DURING THE 1992 MARKETING YEAR"

14. We now turn to consider the meaning of the phrase "decided during the 1992 marketing year". Brazil argues that the term "decided" refers to a decision to budget a specific amount of domestic support over a number of years.[5] Brazil then goes on to suggest that because the United States did not make a "decision" during marketing year 1992 with respect to upland cotton, the only decision which the United States can be said to have made during marketing year 1992 was the continued funding of its programmes for upland cotton. Brazil then calculates the US' budgetary outlays in respect of upland cotton in 1992; in other words, Brazil looks at the support actually granted.[6]

15. The European Communities is concerned that Brazil appears to consider that the support "decided" in the sense of Article 13 can be equated with the support granted as Brazil has done in its use of US budgetary outlays. Such an interpretation ignores the meaning of the word "decided". That the use of the word "decided" cannot be equated with the term "granted" is illustrated by the following.

16. First, the use of the word "decided" itself is notable. It is, however, notable primarily for what it is not. WTO Members did not use the word "granted" which is the word which one would expect to be used had this phrase been intended to refer only to the domestic support actually used during the 1992 marketing year. The use of the word "decided" stands out particularly when it is compared to the use of the word "grant" in the very same sentence. The United States has made the same point with respect to the decision not to use the word "provided".[7] If WTO Members had intended that the support granted in the most recent period was to be compared to that granted in marketing year 1992 the word "decided" would not have been used. For this reason, Brazil's use of US budgetary outlays for marketing year 1992 is clearly flawed.

17. Second, the word "decided", meaning "settled, certain",[8] also implies a one-off decision. It would be odd to talk of an administration "deciding" countless applications for support under a particular programme. However, this is what Brazil's use of US budgetary outlays implies.

18. Finally, the use of the word "during" confirms that WTO Members intended that the decision need not be of application only in marketing year 1992 but may also cover future periods. The use of the word "during" (meaning "in the course of"[9]) implies a one-off decision, and does not suggest that the period of application of the decision must be limited to marketing year 1992. Had WTO Members intended a limitation to the support provided or granted in 1992 the word "for" would have been used

[3] Brazil's First Written Submission, paras.142 and 146-150.
[4] US First Written Submission, para. 79 and 90.
[5] Brazil's First Written Submission, paras. 139 and 140.
[6] Brazil's First Written Submission, paras. 141-145.
[7] US First Written Submission, paras.83-84.
[8] The New Shorter Oxford English Dictionary, 1993.
[9] The New Shorter Oxford English Dictionary, 1993.

in place of "during". This further confirms that Brazil's use of US budgetary outlays cannot be considered correct.

19. Consequently, Article 13(b)(ii) and (iii) are intended to set up as a benchmark an amount of support adopted by some form of decision (be it political, legislative or administrative) in which support for a specific product is decided and allocated for future years. It is clearly not intended to set up a comparison between domestic support granted in 1992 and domestic support granted in a more recent period. The European Communities respectfully requests the Panel not to follow Brazil's equation of the term decided with the term granted.

20. For the European Communities, the question of what decision was adopted during 1992 by the United States is a question of fact which we do not take a position on, especially as we are not fully aware of all the elements which might be relevant.

### D. THE MEANING OF THE TERM "SUPPORT TO A SPECIFIC COMMODITY"

21. The United States has argued that the term "support to a specific commodity" is synonymous with the term "product-specific support".[10] Brazil had, in its First Written Submission, taken all support which was specific to cotton, and added to it a proportion of generally available support intended to represent the amount of such support which could be attributed to cotton.[11]

22. The European Communities shares the approach of the United States. Quite simply, support which is provided to a number of crops cannot at the same time be considered "support to a specific commodity". Such support is "support to several commodities" or "support to more than one commodity".

23. With respect, Brazil and New Zealand are wrong to suggest that the word "specific" was added to make clear that the applicable benchmark under Article 13 was not the overall level of subsidies decided but rather was to be undertaken on a product-by-product basis.[12] A brief glance at the *SCM Agreement* finds it replete with references to "a product" or "a subsidised product".[13] Consequently, it could make no sense to interpret Article 13 as being based on overall support. The word "specific" was not, therefore, inserted to differentiate the use of Article 13 in respect of specific products to the application of Article 6 to overall agricultural support, but rather as a qualifier to the word "support".

24. Consequently, the Panel should conclude that the correct comparison is between product specific support decided in 1992 and product specific support currently provided.

## IV. THE INTERPRETATION OF ANNEX 2 OF THE *AGREEMENT ON AGRICULTURE* (THE "GREEN BOX")

### A. FIRST SENTENCE OF THE FIRST PARAGRAPH OF ANNEX 2[14]

25. Australia has argued in its comments today that the European Communities is incorrect to consider that the first sentence of the first paragraph of Annex 2 does not impose a separate obligation. The European Communities notes, however, that Australia does not comment and does not

[10] US First Written Submission, paras. 77-78.
[11] Brazil's First Written Submission, para. 143.
[12] Brazil's First Written Submission, para. 136; New Zealand Third Party Submission Para. 2.22.
[13] See, in particular, Article 6.3.
[14] This section was not in the written statement circulated at the third party session, but reflects unscripted comments made during that session.

attempt to rebut the compelling contextual arguments that the European Communities has made in its written submission.[15] The European Communities pointed out that in several instances that the *Agreement on Agriculture* refers to the "criteria" for inclusion in the green box, specifically in Articles 6 and 7, and most importantly, in paragraph 5 of Annex 2. There is no such reference to the "fundamental requirements". The European Communities recalls that a panel is obliged to follow the accepted canons of interpretation of international law, and therefore, to view the ordinary meaning of the words concerned in light of their context and objective. Consequently, it is clear that the first sentence of paragraph 1 of Annex 2 is not, in and of itself, an independent obligation. This does not render it inutile, as Australia charges. The first sentence sets out an objective and indicates the type of effects which respect for the criteria in the green box is deemed to create. The European Communities urges the Panel to reject Australia's unsubstantiated arguments.

B. TYPE OF PRODUCTION

26. Brazil has argued that the fact payments are reduced where fruits and vegetables, and certain other crops are grown on contract acreage for the purposes of PFC and direct payments means that the "amount of such payments [is] related to or based on, the type or volume of production [ ..] in any year after the base period" (Paragraph 6(b) of Annex 2). However, Brazil also appears to recognise that farmers claiming the benefit of direct payments may plant crops other than the programme crops, and may even not produce any crops.[16] The United States asserts that no current agricultural production is required in order to benefit from direct payments.[17]

27. Assuming the US' assertion to be correct (as seems to be acknowledged by Brazil) the Panel is faced with a dilemma. Is the amount of funding provided by a programme, from which a farmer can benefit without producing anything, to be considered to be "based on or linked to a certain type of production", when payments under that programme can be reduced by growing certain crops? Brazil and some third parties simply assume that where payments can be reduced by growing certain crops, the programme is based on or linked to a certain type of production. Such a view does not, however, take account of the complexity of the situation.

28. In the view of the European Communities, reducing payments under a programme, where a farmer grows fruit or vegetables does not mean that the amount of the payment is linked to type of production. This is because the farmer is free to produce a whole range of other crops, or even not to produce at all and receive the full payment.

29. What Brazil and other third parties fail to realise is that the reduction in payment for fruits and vegetables, if the European Communities understands correctly, is in fact designed to avoid unfair competition within the subsidising Member. Brazil and the other third parties have not challenged the right of a subsidising Member to decide decoupled payments based on past production of, or acreage utilised for, certain crops. Indeed, this is permitted in paragraph 6(a) of Annex 2. However, in the case where, for instance, upland cotton production enjoyed support, while fruit and vegetable production did not, decoupled payments based on past cotton production would allow subsidised former cotton farmers to grow fruit and vegetables, and thus unfairly compete with pre-existing fruit and vegetable producers who could not benefit from the decoupled payments because they had not produced cotton or other supported products in the base period. Thus, the reduction in payments is a necessary element in ensuring that the equilibrium established by the market for the production of fruit and vegetables is not artificially disturbed by the introduction of decoupled support.

[15] EC's First Third Party Submission, paras. 15-25 and in particular paras. 22 and 23.
[16] Brazil's First Written Submission, para. 49.
[17] US First Written Submission, para. 68.

30. Furthermore, finding that Brazil and the other third parties are correct would have perverse effects. The whole *Agreement on Agriculture* is geared at gradually reducing certain types of domestic support. However, if a Member could not reduce decoupled payments when certain types of products which had previously not enjoyed any support are grown, the net effect would be that WTO Members wishing to provide decoupled support would have to increase overall support, and provide producers previously excluded with support which they had not previously enjoyed. This is clearly not an effect which the negotiators of the *Agreement on Agriculture* intended.

31. In this light, this potential reduction of payment is very different from the prohibition set down in paragraph 6(b) of Annex 2. Paragraph 6(b) is intended to prevent an artificial pressure to produce certain crops in order to obtain decoupled payments. Reducing payments where fruit and vegetables are produced does not act to pressure farmers into growing a particular type of crop. Rather, it prevents internal unfair competition. At the same time, as we understand the US measure, it does not oblige a farmer to produce any particular type of crop, in fact requires no production, and therefore should not be considered inconsistent with paragraph 6(b).

### C. A DEFINED AND FIXED BASE PERIOD

32. The European Communities would also like to comment briefly on the arguments raised by Brazil and some of the third parties with respect to the updating of the base periods in the 2002 FRSI Act. We take note of the US statement that the updating of the base period was necessary in order to bring support for oilseeds production under the direct payments scheme.[18] In order to ensure the progressive movement of production distorting subsidies to decoupled subsidies we consider that it must be possible to have different reference periods where eligibility is based on previous eligibility for production distorting subsidies. We see nothing in paragraph 6 of Annex 2 which might prevent this. At the same time, however, the European Communities is concerned that continued updating of reference periods in respect of the same already decoupled support, creating an expectation that production of certain crops will be rewarded with a greater entitlement to supposedly decoupled payments, tends to undermine the decoupled nature of such payments.

## V. INTERPRETATION OF THE *AGREEMENT ON AGRICULTURE* /RELATIONSHIP WITH THE *SCM AGREEMENT* AND GATT 1994

### A. ARE DOMESTIC CONTENT SUBSIDIES EXPRESSLY PERMITTED BY THE AGREEMENT ON AGRICULTURE ?

33. Brazil has argued that US Step 2 payments, which it alleges are conditional upon use of domestic goods, are inconsistent with Article 3 of the *SCM Agreement* and Article III.4 GATT 1994. New Zealand supports this claim. However, as with other claims, their analysis does not take fully into account the complexities of the situation. The European Communities agrees with the United States that subsidies contingent upon the use of domestic goods, which are maintained consistently with the *Agreement on Agriculture* are not inconsistent with either the *SCM Agreement* or GATT 1994.

34. The first question is whether subsidies contingent upon the use of domestic goods are consistent with the *Agreement on Agriculture*. The answer is a clear yes. Article 3.2 of the *Agreement on Agriculture* requires Members not to:

> "…provide support <u>in favour of</u> domestic producers in excess of the commitment levels specified in Section I of Part IV of its Schedule." (emphasis added).

[18] US First Written Submission, para. 60.

35. We have emphasised the phrase "in favour of". This is significant because it does not require that support be "to" domestic producers. The same term is used in Article 1(a) (the definition of AMS) and in Article 1(h) (definition of Total AMS). Moreover, it is established with respect to Article 1 of the *SCM Agreement* that a financial contribution and benefit need not be bestowed on the same person.[19] Consequently, it is simply logical that support may be provided in favour of domestic producers through the provision of funds to processors of the product concerned, and consequently that access to such subsidies be limited to domestic produce, in order to ensure that it is domestic producers who benefit from this subsidy. Indeed, WTO Members, in their wisdom, recognised precisely this possibility in Annex 3 to the *Agreement on Agriculture* where they explained how the AMS was to be calculated. Paragraph 7 thereof explicitly contemplates that:

> "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products."

36. Consequently, it is clear that a Member has a right to provide subsidies contingent upon use of domestic products under the *Agreement on Agriculture*. On this, the US and the European Communities agree.

37. The second question for the Panel is how does that right relate to the prohibition in Article 3 of the *SCM Agreement* and the national treatment obligation in Article III.4 of GATT. Here, again, we agree with the United States.

38. Article 21.1 of the *Agreement on Agriculture* provides that the other goods agreements will apply "subject to" the provisions of the *Agreement on Agriculture*. That is, the other Annex 1A Agreements will be subordinated to the *Agreement on Agriculture*.[20] A finding that a measure was a domestic content subsidy would mean that such a subsidy would be prohibited under Article 3.1(b) of the *SCM Agreement* and would (in all likelihood) be inconsistent with Article III.4 GATT. In such an event, the consequences of such a finding would have to be subordinated to the right to adopt such measures under the *Agreement on Agriculture* (provided reduction commitments are respected). Moreover, the chapeau of Article 3.1 of the *SCM Agreement* clearly exempts from the scope of that Article domestic content subsidies which are maintained consistently with the *Agreement on Agriculture* and Article III.8 may be relevant to any claim under Article III.4. GATT.

39. Consequently, Brazil's claims that domestic content subsidies maintained consistently with the *Agreement on Agriculture* can be found to be inconsistent with the *SCM Agreement* and Article III.4 GATT should be dismissed.

## B. EXPORT CREDIT GUARANTEES WHICH OPERATE AS EXPORT SUBSIDIES ARE SUBJECT TO AGREEMENT ON AGRICULTURE OBLIGATIONS ON EXPORT SUBSIDIES

40. The United States maintains, in its first written submission, that Article 10.2 of the *Agreement on Agriculture* operates so as to exclude export subsidies in the form of export credits or export credit guarantees. This is not borne out by the text of Article 10.2. Article 10.2 provides for disciplines to be negotiated on the provision of export credits and export credit guarantees; it does not provide an exemption to the export subsidy obligations of the *Agreement on Agriculture*.

41. The United States provides numerous examples of instances in which the WTO has foreseen further negotiations. However, none of these examples support the United States argument that there are no disciplines for export credit guarantees which operate as export subsidies.

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[19] See, Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 8 January 2003, para. 110.

[20] The New Shorter Oxford English Dictionary, 1993.

42. The best example to illustrate this point is the agreement to negotiate disciplines on harmonised rules of origin. The fact that it was agreed to have negotiations on rules of origin simply means that there is no requirement for a WTO Member to apply an as yet un-finalised set of harmonised rules of origin. However, this does not imply that a WTO Member is exempted from other WTO obligations when it comes to apply rules of origin. A WTO Member must, for instance, in applying its rules of origin, respect the most-favoured nation principle set out in Article 1 GATT. Similarly, while there may not be disciplines on the provision of export credits and export credit guarantees, clearly export credits or export credit guarantees which operate as export subsidies are subject to the export subsidy disciplines of the *Agreement on Agriculture* and the *SCM Agreement*.

43. Other examples are equally illustrative. The US cites provisions in the GATS providing for negotiations on government procurement, emergency safeguards and subsidies on trade in services. However, it does not point out the fact that these subjects are clearly not subject to GATS disciplines, and thus negotiations are required to develop even minimal disciplines. Government procurement in services is the best example – GATS disciplines are explicitly excluded by Article XIII GATS. In contrast, there is no clear exclusion of export credits or export credit guarantees which operate as export subsidies from the *Agreement on Agriculture*.

44. Finally, contrary to the US suggestions, such an interpretation does not render Article 10.2 meaningless. Article 10.2 is not intended to regulate export credits and export credit guarantees as export subsidies but rather to provide for a general set of disciplines comparable to the OECD guidelines for export credits for industrial goods. That the Harbinson text (which of course has yet to be agreed) contains provisions on export credit and export credit guarantees is a recognition that disciplines must be negotiated and that clarification must be provided as to which export credits or export credits guarantees are, in the case of agricultural products, to be considered export subsidies, but is not a recognition that such support which operates as an export subsidy are not currently subject to the obligations of the *Agreement on Agriculture*.

## VI. MEASURES BEFORE THE PANEL (FSC REPLACEMENT SCHEME)

45. The United States has argued that Brazil has failed to make a prima facie case of the inconsistency of the FSC Replacement scheme (the ETI) with the covered agreements. The European Communities must admit to being surprised that the United States considers that Brazil has to present a prima facie case of inconsistency. According to Article 17.14 of the DSU parties to a dispute must "unconditionally accept" adopted Appellate Body Reports as "a final resolution to that dispute."[21] Given that the United States must be assumed to have unconditionally accepted the findings of the Appellate Body in the FSC 21.5 dispute, which, by definition also included a finding that the United States was illegally providing export subsidies to unscheduled agricultural products such as upland cotton, the European Communities fails to see how the United States can argue that Brazil needs to establish a prima facie case. On the contrary, Brazil simply needs to assert a claim.

## VII. CONCLUSION

46. This brings us to the end of our statement today. Thank you for bearing with us through a statement which was inevitably long, given the complexity of the issues, and the very short time we had to prepare our written submission.

47. There are a few central points which we would like to leave you with:

- The peace clause is not an affirmative defence;

[21] Appellate Body Report US- Shrimp (21.5 – Malaysia) para. 97.

- The term "decided" cannot be equated with "granted";

- Reducing payments where certain crops are grown for reasons of internal competition does not amount to basing payments on a certain type of production;

- Domestic content subsidies in favour of domestic producers are permitted under the *Agreement on Agriculture*, and can be maintained irrespective of other provisions; and,

- Export credit guarantees which operate as export subsidies are subject to the *Agreement on Agriculture*.

48. Thank you for your attention. We are, of course, happy to answer your questions, here or in writing.

# ANNEX C-11

## INDIA'S ORAL STATEMENT

Mr. Chairman and Members of the Panel,

I thank you for the opportunity to present India's views in this third party session. India has a few short comments to make on the issues in the dispute.

1. Brazil has challenged the US Subsidy programme relating to cotton. The main schemes challenged are

(i) Step 2 export payments
(ii) US export credit guarantee programmes, and
(iii) Extra Territorial Income (ETI) Act export subsidies.

2. These schemes do not conform to the provisions of Part V of the Agreement on Agriculture and thus have no "peace clause" protection from claims under the Subsidies Agreement. These schemes also violate Article 3.1(a) & 3.2 of the Subsidies Agreement.

3. The scheme relating to Step 2 export payments constitutes an export subsidy within the meaning of the Agreement on Agriculture. It also violates the Subsidies Agreement as

(i) It involves grants within the meaning of the Subsidies Agreement as the US Government pays money to its exporters
(ii) These grants involve direct transfer of economic resources for which the US Government receives no consideration
(iii) The scheme confers a benefit within the meaning of Article 1.1(b) of the Subsidies Agreement as they constitute "free money" for which exporters incur no corresponding obligations and they are made for " less than full consideration" and
(iv) The Scheme is also export contingent within the meaning of Article 3.1(a) of the Subsidies Agreement because exporters are only eligible for payments if they produce evidence that they have exported an amount of US upland cotton.

4. The three Export Credit Guarantee Programmes (GSM 102, GSM 103 & SCGP) are export subsidies within the meaning of the Agreement on Agriculture (AOA) as

(i) They are operated " at premium rates which are inadequate to cover the long term operating costs and losses of the program" as per item (j) of the illustrative list of export subsidies in ASCM.
(ii) They involve financial contributions that confer "benefits" and are contingent upon export performance within the meaning of Article 1.1 & 3.1(a) of the Subsidies Agreement. The US itself treats them as subsidies in its budget.

5. The ETI Act constitutes export subsidies within the meaning of Article 10.1 of the Agreement on Agriculture. This Act operates to circumvent the US export subsidy commitments by providing an export subsidy to upland cotton while the US does not have any export subsidy reduction commitments for cotton in violation of Articles 10.1 & 8 of the AOA.

6. The Step 2 Domestic Payment Scheme grants are direct transfers of funds and constitute a financial contribution by a Government within the meaning of Article 1.1(a)(1)(i) of the Subsidies Agreement. They also confer a "benefit" within the meaning of Article 1.1(h) of the Subsidies Agreement because the domestic user of US upland cotton receives the financial contribution on terms more favourable than those available in the market. Moreover these payment are contingent upon the use of domestic over imported goods.

Mr. Chairman, Members of the Panel,

7. Brazil has provided the legal arguments as to why the US has no basis to assert a "peace clause" defence against Brazil's claims on actionable/prohibited subsidies being given by the US.

8. According to Brazil, the "peace clause" of AOA Article 13 is in the nature of an affirmative defence. The US has indicated that it will invoke a "peace clause" defence in the matter. This means that the burden of proof will be on US to show that the US domestic support and export subsidies to upland cotton are provided in conformity with the requirements of the "peace clause".

9. Brazil has argued that US has no "peace clause" protection under AOA Article 13(c) as the US while invoking an affirmative defence must demonstrate that its export subsidies confirm fully to the provisions of Part V of the AOA. Part V of the AOA consists of Articles 8 to 11. A member violates Part V of the AOA if it provides export subsidies for products for which it has not undertaken any export subsidy reduction commitments.

10. Issues relating to affirmative defence and peace clause defence are mainly legal in nature and should be subject to interpretation under the Vienna Convention on the Law of Treaties and the WTO jurisprudence as seen through Appellate Body findings.

11. As regards subsidies contingent upon export performance, export credit guarantees and premiums, and use of domestic over imported inputs, Mr. Chairman, India believes that they all fall in the category of prohibited subsidies and are actionable under the ASCM.

Thank you for your kind attention.

# ANNEX C-12

## NEW ZEALAND'S ORAL STATEMENT

24 July 2003

1. Mr Chairman, Members of the Panel, New Zealand's views on the issues of concern in this dispute are set out in our Third Party Submission of 15 July and in the time available today it is clearly not possible to canvass all of those views. Accordingly, and as suggested by you in your opening remarks Mr Chairman, I will focus only on some key points.

**(i) New Zealand's systemic interest in the dispute**

2. First, as outlined in our Third Party Submission, New Zealand has joined this dispute because of our systemic interest in ensuring the continued integrity of WTO disciplines applicable to agricultural trade. In particular we are concerned to ensure that trade-distorting or "amber box" measures cannot be used contrary to the "peace clause" in a manner that negatively affects other Members.

3. It is equally important that where the requirements of the "peace clause" have not been respected Members are able to utilise their rights under the *SCM Agreement* and *GATT 1994* to take action in respect of domestic support measures and export subsidies.

**(ii) Brazil's demonstration that the United States cannot claim "peace clause" protection for domestic support provided in marketing years 1999, 2000, 2001 and 2002**

4. Second, Brazil has demonstrated that the level of domestic support for upland cotton granted by the United States in each of the marketing years in question did in fact exceed the level decided during the 1992 marketing year and that there is therefore no "peace clause" protection for those support measures.

5. The United States argues that this is not the case, on the basis that the comparison required by the "peace clause" should be between the 'per pound' rates of support set by the relevant domestic support measures and that certain domestic support measures should be excluded from the comparison.

6. Turning first to the United States claim that the relevant comparison should be between 'per pound' rates of support, in New Zealand's view such an interpretation would be inconsistent with the object and purpose of Article 13(b)(ii). Instead, Article 13(b)(ii) requires a comparison that takes into account the totality of payments to upland cotton producers in order to reflect the true nature of the support that is being granted, including for example, total budgetary outlays. This is especially so when those budgetary outlays have been increasing because of falling world market prices. And those prices are falling due, at least in part, to the fact that United States producers are shielded from true price signals by the guaranteed 'per pound' rates.

7. Furthermore, New Zealand sees no basis for excluding certain domestic support measures from the calculation required by the "peace clause" as requested by the United States.

8. The "counter-cyclical" payments are plainly not "green box" support measures in accordance with Annex 2 of the *Agreement on Agriculture*, as the amount of the payment is linked to current prices for upland cotton, in direct contravention of Annex 2 paragraph 6(c).

9. Nor is the scope of support to be measured under Article 13(b)(ii) limited to "product-specific" support in the sense proposed by the United States. There is no basis for such an interpretation in either the wording or the intent of Article 13(b)(ii). [Just to depart from the prepared statement for a moment, the EC has reminded us this morning of the importance of taking context into account when interpreting WTO Agreements. We would note that it is also important to consider the ordinary and natural meaning of the actual words appearing in the Agreements. Here the words used are "support to a specific commodity" – the text does not say "product-specific support". If the drafters had intended to mean "product-specific support", they surely would have said so. After all, the phrase "product-specific support" is used at least five times elsewhere in the *Agreement on Agriculture*. Returning now to the prepared text,] even if such an interpretation as suggested by the US, could be supported, "counter-cyclical" payments are in any event product-specific support because, as Brazil has demonstrated, there is a strong linkage between those payments and production of upland cotton.

10. New Zealand also considers that there is no basis for excluding the Production Flexibility Contract payments or Direct Payments from the required calculation. The ability of farmers to update the base acreage used for calculation of Direct Payments rules out inclusion of those payments in the "green box", which contemplates only one base period that is fixed and unchanging. To permit a Member to avoid this limitation by simply changing the names of its domestic support programmes would seriously undermine the requirement that there be no link between production and the amount of support.

**(iii) Brazil's demonstration that the United States cannot claim "peace clause" protection in respect of export subsidies;**

11. Looking now at export subsidies, New Zealand agrees with Brazil that the three types of export subsidies applied to upland cotton and other commodities by the United States (the Step 2 Export Programme, the Export Credit Guarantee Programme, and the FSC Replacement Programme) violate Articles 3.3, 8 and 10.1 of the *Agreement on Agriculture*.

12. New Zealand rejects the argument made by the United States that Step 2 export payments are not export subsidies because payments are available to domestic users as well as exporters of upland cotton. The Appellate Body (in *US-FSC Recourse to Article 21.5*) has made it clear that the fact that payments are also able to be made to domestic users of upland cotton does not 'dissolve' the export contingency of the payments that are made to exporters.

13. New Zealand also finds no basis for the assertion by the United States that export credit guarantee programmes are not subject in any way to the export subsidy disciplines of the *Agreement on Agriculture*. In fact the inclusion of reference to such programmes in the context of Article 10 supports the opposite conclusion and demonstrates that Members were in fact concerned at the potential for such programmes to circumvent Members' export subsidy reduction commitments.

14. In summary Brazil has demonstrated that the export subsidies to upland cotton do not have "peace clause" protection, and also that they are prohibited subsidies under Article 3.1(a) and 3.2 of the *SCM Agreement*.

**(iv) The request by the United States for a Preliminary Ruling**

15. Finally Mr Chairman, New Zealand does not consider that the Panel should grant the preliminary ruling requested by the United States.

16. First, New Zealand believes that measures no longer in effect are not outside the scope of the Panel's consideration, particularly where the programmes in question, while renamed, in fact continue in a slightly different form. Furthermore, the nature of serious prejudice claims means that Panels may need to consider data beyond a single year and consider trends over a number of years.

17. Second, New Zealand considers that export credit guarantee measures relating to eligible United States agricultural commodities (other than upland cotton) are within the Panel's terms of reference. To determine otherwise would be to allow a lack of transparency in the operation of particular measures to shield them from scrutiny by Members taking disputes.

**Conclusion**

18. In conclusion, Mr Chairman, New Zealand believes that Brazil has demonstrated that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the *GATT 1994* and the *SCM Agreement*. New Zealand looks forward to the next phase of the case which will examine those claims.

# ANNEX C-13

## ORAL SUBMISSION BY PARAGUAY

24 July 2003

Mr Chairman, members of the Panel:

1. Paraguay is grateful for the opportunity to participate in these proceedings and to present its views on the matter at issue in this dispute.

2. Because Paraguay is a firm believer in a fair system of multilateral trade, it feels that it should explain its position on this issue as a third party because it is an issue of particular interest to its economy.

3. Paraguay considers that the subsidies and support granted by the United States to its cotton production are inconsistent with the Agreement on Subsidies and Countervailing Measures, the Agreement on Agriculture and the rules and principles of the GATT 1994, and that for the purposes of this dispute it is therefore essential to take account of WTO legislation, which was carefully drafted to avoid causing distortions in international trade and prejudice to developing countries such as Paraguay.

4. WTO jurisprudence and the principles of interpretation of international law applied to the various cases suggests that the applicable rules should be read cumulatively, taking account of all elements applied to the case in order to support the system as an integrated whole.

5. With respect to the applicability of Article 13(b)(ii) concerning domestic support measures that conform fully to the provisions of Article 6 of the Agreement including direct payments that conform to the requirements to paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, Paraguay considers they shall be exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

6. This implies that it is not limited or confined to specific products. Thus, it can be concluded that the United States does not enjoy protection from actions relating to subsidies using 1999, 2001 and 2002 as a basis, as Brazil duly proved.

7. In interpreting the Peace Clause, account must be taken of the serious prejudice that Member economies could suffer, and an assessment made of the overall significance of all of the agreements relating to the case.

8. Regarding inconsistency with the Agreement on Agriculture, the Step 2 programme introduced by the United States to stimulate exports and the competitiveness of its products on the international market is inconsistent with Articles 3.3 and 8 of the Agreement on Agriculture.

9. Article 3 of the Agreement on Agriculture refers to the incorporation of concessions and commitments. Paragraph 3 thereof stipulates that:

> *3.3 "Subject to the provisions of paragraphs 2(b) and 4 of Article 9 of this Agreement, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule."*

10. The above paragraph enables Members to provide the subsidies listed in Article 9.1 of the Agreement on Agriculture subject to fulfilment of the commitments assumed.

11. Similarly, Article 8 of the said Agreement regulates export competition commitments, stipulating that:

> *"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and the commitments as specified in that Member's Schedule."*

12. For the above reasons, and because it does not consider the provisions of the Agreement on Agriculture to have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

13. The agricultural subsidies cause "serious prejudice" to the domestic industry of other Members under Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures.

14. The introductory paragraph of part III, Article 5 of the said Agreement provides that no Member should cause, through the use of any subsidy – specific and not exempted under the Agreement – adverse effects to the interests of other Members, more specifically, as categorically stated in the indents that follow, (a) injury to the domestic industry of another Member and (c) serious prejudice to the interests of another Member.

15. Article 6 specifically refers to cases in which "serious prejudice" is deemed to exist in the sense of paragraph (c) of Article 5.

16. Agricultural subsidies have effects on world trade, and measures such as those applied by the United States have a significant impact on developing countries like Paraguay.

17. Paraguay has a total population of approximately 5,300,000, of which more than 500,000 are linked to cotton production. If we add the related industries and activities, the figure reaches an estimated 1,500,000, or approximately 30 per cent of the country's total population.

18. Any slump in the cotton trade causes an exodus of rural population towards the urban areas which do not offer any relief or solution, and this further undermines the economic situation of a country that depends on its agriculture.

19. As regards exports, in 1991, the foreign exchange revenue generated by sales of cotton and byproducts thereof reached US$318,912,000, approximately 43 per cent of the total for the country's exports that year. At the time, of a total of 299,259 farms, 190,000 were cultivating cotton.

20. By 2001, the figures had changed considerably. Export revenue had fallen to US$90,505,000, a 72 per cent drop in the value of exports. The number of farms producing cotton decreased to about 90,000, representing a 52 per cent decrease in farms, employment and small farmer income. In other words, the impoverishment was real.

21. Regarding international cotton fibre prices, in 1991, the price per ton of Paraguayan type fibre was quoted on the New York Exchange at US$1,624, while in 2001, it was quoted at US$934.

22. In Paraguay, some 60 per cent of cotton is produced on farms of less than 10 hectares, making it the main or only source of income for small farmers and the main source of employment for the rural workforce in the most disadvantaged segment of society where access to capital and technology is more restricted and the leading socio-economic welfare indicators are lower than anywhere else.

23. In spite of its marked decline, cotton continues to be an important cash crop for the "capitalized" farms, and the main – if not only – cash crop of the farms that are on the decline.

24. The agricultural sector is fundamental to the Paraguayan economy, accounting for 90 per cent of exports, 35 per cent of employment and 25 per cent of GDP, in addition to which it supports an agro-industry that accounts for 11 per cent of GDP and 10 per cent of total employment.

Mr Chairman, members of the Panel:

25. The importance of cotton for Paraguay, both in social and economic terms, is such that an increase in international cotton fibre prices as a result of the elimination of significant market distortions such as subsidization of production would not only bring about a general improvement in the standard of living of the country's inhabitants, in a very fragile sector in particular, but it would also lead to an improvement in macroeconomic conditions, balance-of-payments, monetary reserves, etc. that would enable Paraguay to be more reliable in meeting its international financial commitments.

26. For the above reasons, and because it does not consider that the provisions of the Agreement on Agriculture have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

27. Paraguay therefore considers that the measures adopted by the United States cause serious prejudice to world trade, affecting Paraguay in particular, and that the necessary steps should be taken to eliminate the adverse effects and seek to achieve a balance in world trade.

28. Finally, Paraguay respectfully requests the Panel to conclude that the measure applied by the United States is inconsistent with its WTO obligations under various provisions of the Agreement on Agriculture, the GATT 1994 and the Agreement on Subsidies and Countervailing Measures.

# ANNEX C-14

## ORAL STATEMENT BY THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU AS A THIRD PARTY ON THE CASE OF THE UNITED STATES SUBSIDIES ON UPLAND COTTON

The Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu is pleased to be here as a third party in this case. We have a systemic interest in the particular question of the burden of proof required by Article 13 of the AOA, and would like to focus on this issue in our remarks. We have previously submitted our views in writing accordingly.

**The Burden of Proof (the "Peace Clause")**

In the case in point, Brazil asserts in its first written submission that Article 13 is by nature an "affirmative defence" or "exception" and "not itself a positive obligation", therefore the United States carries the burden of proof on whether its subsidies are in conformity with Article 13.

Our view, in summary, is that it is inappropriate to label Article 13 as an "affirmative defence" or "exception". Indeed this would mean the Article having much less than its originally intended effect. Article 13 in itself confers rights and imposes positive obligations on Members. It is not there simply for the convenience of resolving the question of the burden of proof. The right that it confers of entitlement to being "exempt from actions", for example, would be rendered pointless if the burden of proof were on the respondent. It is surely for Brazil, therefore, as a complainant, to prove a breach of a positive obligation by demonstrating non-conformity, rather than for the United States to bear the burden of proof.

In our written submission, we suggest that in arriving at a proper interpretation of the burden of proof in Article 13, it might also be helpful to make some comparisons with the different types of exceptions, exemptions and defences that exist in other Articles of WTO Agreements.

We mention, for example, disputes arising in connection with agreements not covered by the DSU, where the complaining party would bear the burden to prove that the issue in dispute falls within the purview of the DSB.

Also, where a matter is specifically excluded from the dispute settlement procedures by certain relevant agreements – such as Article 6 of the TRIPS agreement - the provision concerned allows the Member applying it to prevent dispute settlement procedures and the burden of proof falls on the complaining party.

And by way of further comparison, we refer to other cases where exceptions or exemptions are granted under relevant agreements providing specific obligations.

While Article 13 of the AOA is clearly in this case not dealing with a matter under a non-covered agreement or a matter that is specifically excluded from the dispute settlement procedures as in Article 6 of TRIPS, it is also not typical of the type of exception contained in a number of the GATT Articles. By its singular nature, Article 13, in our view, falls between these examples, therefore the procedures for applying its provision should be interpreted separately and differently.

And finally, as far as the burden of proof is concerned, we submit that requiring the respondent to prove that the subsidy measure in question is in conformity with the Agreement on Agriculture will, to a certain extent, offset the respondent's right to claim for the exceptions provided by the Article 13 provisions, which is surely contrary to the drafters' intent.

# ANNEX D

## REBUTTAL SUBMISSIONS OF PARTIES

# ANNEX D-1

## BRAZIL'S REBUTTAL SUBMISSION TO THE PANEL REGARDING THE "PEACE CLAUSE" AND NON-PEACE CLAUSE RELATED CLAIMS EXECUTIVE SUMMARY

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## 1. The United States Has No Peace Clause Protection for Non-Green Box Domestic Support Measures to Upland Cotton for MY 1999-2002

### 1.1. Production Flexibility Contracts and Direct Payments Are Non-Green Box Domestic Support

#### 1.1.1. The Amounts of PFC and Direct Payments Depend on the "Type" of Production

1. PFC payments and direct payments are non-green box support because both limit the "amount" of payment based on the "type" of production inconsistent with the requirements of Annex 2, paragraph 6(b) of the Agreement on Agriculture. The relevant text of paragraph 6(b) prohibits any linkage of the "amount of payments" to any "type of production" of an agricultural product. The "amount" of payments under the PFC and direct payment programmes *falls* when base acres are used to produce fruits, vegetables and wild rice. Thus, the undisputed evidence demonstrates that PFC and direct payments do not meet the policy-specific criteria for "de-coupled income support" in Annex 2, paragraph 6(b).

2. Prohibiting payments if *certain* types of crops are produced while at the same time permitting payments if *other* types of crops are produced violates Annex 2, paragraph 6(b). Contrary to the US argument, requiring no production, *i.e.*, prohibiting production, does not relate the amount of payments to the "type" of production, as no individual "type" of production would be eligible to payments. The notion of "type of production" in paragraph 6(b) is necessarily linked to the amount of payment to some "type" of commodity that is "produced" and not to a production requirement itself.

3. In addition, Brazil also presented evidence that the US restrictions on fruits, vegetables and wild rice prevent producers with PFC and direct payment base acreage from growing these alternative crops. This restriction, therefore, channels production into particular "types of production" by prohibiting *other* "types of production" and, therefore, violates Annex 2, paragraph 6(b).

#### 1.1.2. Direct Payments Are Not Green-Box Because the Base Periods for Determining Eligibility Have Been Updated in the 2002 FSRI Act

4. Direct payments are also not properly in the green box because the amount of payments are based on an updated "base period" and not on a "fixed" base period as required by Annex 2, paragraphs 6(a) and (b). Paragraphs 6(a) and (b) require a fixed and, therefore, unchanging base period for de-coupled domestic support measures with the same structure, design, and eligibility criteria. The evidence demonstrates that there are no significant changes in the payment eligibility criteria between the PFC programme and its direct successor, the direct payment program. Indeed, PFC payments made during 2002 were deducted from the amount of direct payments due in 2002.

5. Further, the updating permitted under the 2002 FSRI Act for direct payments was significant – one-third of eligible farms updated their PFC base acreage as of June 2003 in order to *increase* the base acreage – and payments – under the direct payment programme. This updating creates production-distorting effects because it creates expectations of future updates and will incite farmers to produce more of the programme crops that qualify for support.

6. The United States interprets the word "fixed" in Annex 2, paragraph 6(a) and (b) as being "fixed" only for the life of a particular legal measure. A Member could change a measure every year, update the "base period" to reflect the prior year's acreage, increase current payments to reflect the updated (and increased) "historical" acreage, and label it differently under a new law. Thus, the US interpretation would permit payments to be completely "coupled" to production, just with a one-year time lag. It would render any disciplines reflected in the use of the term "a" and "fixed" "base

period" in Annex 2, paragraph 6(a) a nullity. This is contrary not only to the ordinary meaning of the term "fixed" but also to the object and purpose of Annex 2, paragraph 6(a) to not permit Members to increase payments over time in a manner linked to increases in production over time. The re-linkage of payments to production is also inconsistent with the "fundamental requirement" in Annex 2, paragraph 1.

### 1.2. PFC, Market Loss Assistance, Direct and Counter-Cyclical Payments (CCP) and Crop Insurance Subsidies Are "Support To" Upland Cotton

7. The narrow US specificity test of "tied to production" seeks to impose a "form" of specificity on the text of Article 13(b)(ii) that is not there. It further contradicts the only analogous criteria to Article 13(b)(ii) for calculating annual levels of support – the AMS calculation criteria of Annex 3. In addition, it contradicts the broad definition of "in favour of" in defining AMS in Article 1(a) of the Agreement on Agriculture, and the "in general" language of the same provision. The "substance" the United States seeks to avoid with this unjustified interpretation is the $12.9 billion dollars in payments for the production of upland cotton from MY 1999-present.

8. Applying its narrow specificity criteria, the United States argues that PFC, market loss assistance, direct and counter-cyclical payments as well as crop insurance subsidies are not "support to" upland cotton. Brazil presents evidence that all five domestic support measures provide "support to" the production of upland cotton between MY 1999-2002.

#### 1.2.1. Production Flexibility Contract Payments

9. Brazil has presented considerable evidence demonstrating that PFC payments to holders of upland cotton base acreage in MY 1999-2001 are support to upland cotton. The 1996 FAIR Act established a specific payment formula permitting those upland cotton farmers who had traditionally farmed upland cotton to continue to receive payments following the elimination of the deficiency payment program. The 1996 FAIR Act singled out upland cotton and only six other crops for such PFC payments. Recipients were "producers" who "shared in the risk of producing a crop", and who farmed one of the seven crops in the three immediate years prior to the 1996 FAIR Act (MY 1993-95). Only a small minority of the producers of crops in the United States received PFC (and market loss assistance) payments. Brazil has demonstrated that between MY 1999-2001, the seven types of programme crops receiving PFC represented on average between MY 1999-2001 only 14.19 per cent of total US farm revenue. In addition, the total acreage of the seven PFC and market loss assistance crops in MY 2001 represented only 22 per cent of total US farmland. Thus, PFC payments were not provided to US producers *in general*.

10. The best available evidence demonstrates that upland cotton producers during MY 1999-2001 received PFC (and market loss assistance) payments. USDA reported that 97 per cent of farms producing upland cotton representing 99 per cent of upland cotton acreage from MY 1993-95 signed up to receive upland cotton PFC payments for MY 1996-2001. Upland cotton base acreage under the PFC (and market loss assistance) programme was 16.2 million acres. Between MY 1999-2001, the average acreage planted to upland cotton was 15.24 million acres. In addition, USDA reported that 95.7 per cent of the 16.2 million US upland cotton base acreage was planted to PFC programme crops in MY 2001 – a higher percentage than for any of the other 6 types of PFC programme crops. Thus, the evidence suggests that upland cotton producers in MY 1999-2001 were receiving PFC (and market loss assistance) payments.

11. Brazil has presented evidence demonstrating that PFC payments have production and trade distorting effects that arise from the prohibition on planting fruits, vegetables, and wild rice, as well as from the various "wealth effects" that result from the size of the subsidy averaging more than 15 per cent of the market value of upland cotton between MY 1999-2001. These effects provide further

confirming evidence that the selected, targeted PFC (and market loss assistance) payments are support to upland cotton.

### 1.2.2. Market Loss Assistance Payments

12. The evidence provided by Brazil with respect to PFC payments is also relevant to market loss assistance payments because these payments were made only to farmers with PFC contracts for the seven PFC crops, and additionally to soybeans. Thus, historic upland cotton producers (producing upland cotton in MY 1993-1995) received "upland cotton-specific" market loss assistance payments in MY 1998-2001. Even with the addition of soybeans, these 8 crops only represented on average 20.75 per cent of total US farm revenue in MY 1999-2001. PFC crop base acreage and soybean acreage in MY 2001 represented only 29 per cent of total US farmland. Thus, as with PFC payments, market loss assistance payments were not paid to US agricultural producers *in general* but rather to only a select group of US producers.

13. The evidence presented by Brazil indicates that while producers holding PFC/market loss assistance base acreage had the legal "freedom to farm" different crops, if they produced upland cotton, they would suffer adverse financial consequences *unless* they produced upland cotton on *upland cotton*, *corn* or *rice* base acres. The evidence highlights the practical impossibility of growing upland cotton without any type of PFC and market loss assistance payment in MY 2001. This evidence confirms NCC statements and supports a conclusion that any upland cotton produced in MY 1999-2001 – as a matter of economic reality and viability – needed and received PFC and market loss assistance payments to meet the high cost of production.

14. Further evidence that market loss assistance payments are support to upland cotton stems from the fact that the United States notified these subsidies as trade and production distorting amber box support. The evidence demonstrates that the targeted market loss assistance payments triggered by market price declines have even more trade and production-distorting effects than PFC payments. Further, as with PFC payments, production and trade distortions occurred because of the prohibition or restriction on receiving such payments based on growing fruits, vegetables, or wild rice. The production and trade-distorting effects on upland cotton are further confirmed by the fact that market loss assistance payments represented on average 17.87 per cent of the market value of upland cotton between MY 1999-2001. Thus, even though upland cotton producers were not *required* to produce upland cotton to receive market loss assistance payments, the record demonstrates that they continued to produce upland cotton between MY 1999-2001, and they continued to benefit from the 17.87 per cent subsidies represented by these payments.

### 1.2.3. Direct Payments

15. Direct payments are targeted support to "producers" farming, *inter alia*, on upland cotton base acreage. The eligible upland cotton producers who grew upland cotton in MY 1998-2001 (or in MY 1993-95) – together with eligible producers of only nine other crops – are a select group, who grew crops representing only 23.49 per cent of total farm cash receipts and 30 per cent of total US farm acreage. Thus, direct payments are *not* available to the great majority of US producers of agricultural commodities, *i.e.*, they are not provided to US agricultural producers *in general.*

16. The United States argues that direct payments and CCP payments are not "support to upland cotton" because there is no *legal requirement* under the 2002 FSRI Act for holders of upland cotton base acreage to grow upland cotton. However, Brazil has demonstrated that the theoretical legal *planting flexibility* in the 2002 FSRI Act is not reflected in the *economic* reality of growing high-cost crops like upland cotton. Farmers who did plant the 14.2 million acres of upland cotton for MY 2002 could only have covered their costs by receiving *upland cotton*, *rice* or *peanut* direct payments and counter-cyclical payments. This evidence strongly confirms what the NCC officials have stated

repeatedly, that their members need, rely on, and *receive* direct payment and counter-cyclical payment support. And this evidence refutes the United States argument that the *legal* flexibility to grow other crops – or not produce at all – is the single relevant fact justifying a finding that direct payments and CCP payments did not support upland cotton in MY 2002.

17. Further evidence that direct payments are support to upland cotton is derived from the effects on upland cotton production caused by the updating of the base acreage between the PFC and the direct payment programmes. Brazil has presented evidence indicating that this updating creates a re-linkage between production and the direct (and counter-cyclical) payments. Production effects are also caused by channeling the payments into crops other than fruits, vegetables, and wild rice. Further, the size of the subsidy (over 15 per cent of the current upland cotton market value) also contributes to wealth creation that has production effects. These production effects demonstrate that the direct payments (and CCP payments) are not de-linked from production – as argued by the United States – and support a conclusion that they are support to upland cotton.

### 1.2.5. Counter-Cyclical Payments

18. The United States argues that because producers receiving CCP payments are not required to produce upland cotton to receive payments, these payments cannot, as a matter of law, be considered support to upland cotton within the meaning of Article 13(b)(ii). Nevertheless, the evidence provided by Brazil demonstrates that CCP funds in MY 2002 paid to "historic" (i.e., 1998-2001 or 1993-1995) upland cotton producers are paid to a tiny fraction of total US producers of agricultural commodities and not to US producers of agricultural products "in general". Further, the evidence supports the conclusion that the recipients of these payments in MY 2002 needed these payments to continue producing upland cotton. They constitute "support to upland cotton".

19. Moreover, CCP payments create additional production effects due to the "base-update" permitted under the 2002 FSRI Act for both base yields and base acreage compared to market loss assistance payments. Further, the fruits, vegetables, and wild rice prohibitions or restrictions channel production into upland cotton. This evidence collectively supports a conclusion that CCP payments are "support to upland cotton".

### 1.2.6. Crop Insurance Payments

20. Brazil has demonstrated that upland cotton farmer benefit from specialized and specific crop insurance policies provided under the 2000 Agricultural Risk protection Act. Premium subsidies are directly tied to the amount of acreage planted by an upland cotton farmer. Also the participation rate, the share of policies at higher buy-up levels and the crop insurance loss ratio are higher for upland cotton than for other crops. This is confirmed by USDA's own economists, who have found that crop insurance subsidies cause much higher production and export effects for upland cotton than for other crops. In sum, crop insurance subsidies tied directly to the production of upland cotton are "support to a specific commodity" for the purposes of Article 13(b)(ii).

## 1.3. The US Support to Upland Cotton in MY 1999-2002 Exceeded the Support Decided in MY 1992

21. The United States has raised a number of *post hoc* arguments related to a supposed "rate of support" decision it alleges to have made during MY 1992. In the SAA, the United States stated that Members would have peace clause protection from adverse effects and serious prejudice challenges in the WTO "*unless the AMS for the particular* commodity exceeds the level decided in the 1992 marketing year". The phrase "AMS for the particular commodity" is an explicit recognition by the United States of the test in Annex 3, paragraph 6 which states: "For each basic agricultural product, a specific AMS shall be established *expressed in total monetary terms.*" The US "rate of support"

methodology is not an expression in "total monetary terms," nor does it permit such a calculation. There are only two types of methodologies that would allow an expression in monetary terms of a decision (or decisions) taken by the United States in MY 1992 regarding its level of support to upland cotton: "using budgetary outlays" or the "gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price".

22. Brazil disagrees with the United States' assertion that it did not "decide" on budgetary outlays. The alleged US decision to provide a rate of support must necessarily be accompanied by a decision to authorize whatever budgetary outlays would be necessary to meet the rate of support. The United States took specific administrative decisions which meant that the United States decided on the payment rates that resulted from the "rate of support" and, therefore, on the amount of budgetary outlays it would use from its unlimited spending authority. For the United States to argue, *post hoc,* that these decisions did not also include expenditures is inconsistent with its SAA interpretation of the peace clause that the 1992 decision must be expressed in "total monetary terms."

23. Brazil has demonstrated that expenditures for MY 1992 are lower than they are for any of the marketing years from 1999-2002. Therefore, under this methodology, the United States has no peace clause exemption for MY 1999-2002. While Brazil does not believe that calculating the upland cotton AMS based on the AMS methodology in Annex 3 is the appropriate methodology – based on the absence of the terms "AMS", "product-specific" and "non-product-specific" in Article 13(b)(ii) – Brazil has provided evidence that by using this methodology the United States support to the basic agricultural commodity "upland cotton" exceeded the support decided during the 1992 marketing year in all marketing years from 1999-2002.

24. In the event the Panel decides not to use a "total monetary value" methodology, then there are two "rate of support" methodologies: (1) budgetary outlays per pound of support, and (2) the expected guaranteed income rate of support set out in Professor Sumner's analysis. Brazil has provided extensive analysis of each of these two methodologies. However, Brazil does not endorse either methodology.

25. Brazil has demonstrated that the preferable methodology would be to rely on budgetary outlays per pound of upland cotton production. Professor Sumner's approach should be used only as an alternative to the simplistic US "72.9 methodology" because it is much more accurate than the United States approach accounting for eligibility criteria, effective programme limitations and costs that the US ignores. In any event, Brazil has demonstrated that also under both rate of support methodologies the US support in MY 1999-2002 exceeds the support decided during MY 1992

26. Any methodology that does not account for eligibility and effective participation criteria is inconsistent with Article 13(b)(ii). It is also inconsistent with the context of Article 13(b)(ii) which includes Annex 3, paragraphs 8 and 10 requiring calculation of the monetary value of support by factoring in "*production eligible to receive the administered price*." And it is also inconsistent with object and purpose of the Agreement on Agriculture, which is – after all – "correcting and preventing restrictions and distortions in world agricultural markets."

### 1.4. Challenges to Actionable Subsidies under Article 5 and 6 of the SCM Agreement and Article XVI of GATT 1994 Are Not Limited to the Marketing Year in which a WTO Panel Is Established

27. The United States argues that the Panel may only count *current* US non-green box support in determining whether the United States enjoys peace clause exemption under Article 13(b). Applying a strict "statute of limitations" approach, the United States argues that Brazil (1) cannot challenge any US trade and production-distorting agricultural support for MY 2001 (or MY 2000, or MY 1999) because it did not ensure that the Panel was established during MY 2001 (or MY 2000, or MY 1999), and (2) it cannot challenge *all* of the trade and production-distorting support for all of MY 2002 because it did not ensure that the Panel was established by 31 July 2003 – the last day of the 2002 marketing year. The United States goes so far as to argue that the Panel may only compare MY 1992 support decided with *partial* MY 2002 data through 18 March 2003 – the date the Panel was established. According to the US theory, the only date the Panel could have been established to ensure comparison with full MY 2002 data would have been 31 July 2003 – the last day of MY 2002.

28. Brazil has demonstrated that the United States has constructed an irrational interpretation of Article 13(b)(ii). It is bizarre to interpret Article 13(b)(ii) in a way that requires Members to carefully "time" a request for establishment of a panel to maximize the amount of support to be counted for the "current" marketing year. Nothing in the "present tense" of Article 13(b)(ii) compels this result. The Panel must interpret Article 13(b)(ii) according to its ordinary meaning and with regard to its context. The relevant context is Articles 1(h)(ii) and 6.3 of the Agreement on Agriculture. The *Korea – Beef* dispute exemplifies that a Member can challenge violations of "Current Total AMS" at any time after a marketing year ends. The ability of challenging Current Total AMS violations in later years by analogy suggests that non-conformity with the peace clause requirements in much the same way leads to lifting the peace clause exemption also for marketing years other than the current marketing year. Thus, the proper interpretation of Article 13(b)(ii) permits actionable subsidy challenges under the SCM Agreement and GATT Article XVI:1 for any marketing year for which peace clause exemption does not exist – under either its chapeau (Current Total AMS) or the proviso of Article 13(b)(ii).

### 2. The GSM 102, GSM 103 and SCGP Export Credit Guarantee Programmes Constitute Export Subsidies in Violation of Articles 10.1 and 8 of the Agreement on Agriculture, and Item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement

29. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP export credit guarantee programmes administered by the CCC constitute export subsidies within the meaning of Articles 10.1, 1(e) and 8 of the Agreement on Agriculture, Article 3.1(a) of the SCM Agreement, and item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement. Brazil also demonstrated that those export subsidies circumvent, or threaten to circumvent, the United States' export subsidy reduction commitments, in violation of Articles 10.1 and 8 of the Agreement on Agriculture. Additionally, because they violate the Agreement on Agriculture, these programmes are not exempt from actions by Article 13(c)(ii) of the Agreement on Agriculture, and constitute prohibited export subsidies within the meaning of item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement.

30. Article 10.2 does not, as the United States asserts, carve out export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture, including the anti-circumvention provisions of Article 10.1. The Appellate Body concluded that exemptions and carve-outs from general obligations must be provided for explicitly in the text of an agreement. Article 10.2 includes no such explicit carve-out or exemption. Rather, Article 10.2 announces Members' intent to work toward negotiations on specific disciplines for export credits. In the meantime, the general disciplines on export subsidies included in the Agreement on Agriculture apply to export credits.

### 2.1. CCC Export Credit Guarantees Constitute Export Subsidies under Articles 1 and 3.1(a) of the SCM Agreement

31. Brazil notes that CCC export credit guarantees are "financial contributions" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. Since CCC export credit guarantees are unique financing vehicles for agricultural commodity transactions that are not available on the commercial market, let alone on terms consistent with the market, they confer "benefits" within the meaning of Article 1.1(b) of the SCM Agreement. Brazil presents the affidavit of Marcelo Pinheiro Franco from the Brazilian Export Credit Insurance Agency who confirms that no

> comparable market-based export credit guarantees or financing instruments for international transactions involving agricultural commodities [exist] that provide these same terms [as the GSM and SCGP programmes].

32. Further, the United States compares agricultural export credit guarantees to export credit insurance for agricultural commodities, which it asserts is available on the private commercial market. However, it acknowledges that insurance coverage is structured altogether differently from guarantee coverage. Thus, even if the United States had proven its assertion with evidence, it acknowledges that the market for private insurance cannot serve as a benchmark against which to determine whether CCC guarantees confer "benefits".

33. Finally, CCC guarantees are contingent in law on export performance and therefore constitute prohibited export subsidies under Article 3.1(a) of the SCM Agreement.

34. Lastly, Brazil recalls that since the United States surpassed its quantity commitment levels, Article 10.3 of the Agreement on Agriculture allocates the burden to the United States to prove that its excess exports did not benefit from export subsidies, including export credit guarantees.

### 2.2. The CCC Export Credit Guarantee Programmes Constitute Export Subsidies under Item (j) of the Illustrative List of Export Subsidies

35. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes also constitute export subsidies because they charge premium rates that are inadequate to cover the long-term operating costs and losses of the programmes, within the meaning of item (j) of the Illustrative List. Item (j) does not require the Panel to endorse any particular methodology or formula for determining whether the CCC programmes cover their long-term operating costs and losses, or to decide by precisely how much those costs and losses exceed premiums collected. Rather, Brazil has provided the Panel with numerous alternatives, each of which demonstrates that long-term operating costs and losses for the GSM 102, GSM 103 and SCGP programmes outpace premiums collected, including data under the FCRA, Brazil' constructed formula, data from CCC's 2002 financial statements reporting large uncollectible amounts on post-1991 and pre-1992 guarantees, among others.

36. The United States criticizes the FCRA cost formula as inappropriate because it allegedly relies on "estimated" rather than "actual" data about the costs of the programmes. It is not true that the FCRA cost formula reflects only "an *estimate* of the long-term costs to the Government". A significant portion of the inputs into the FCRA cost formula reflect actual historical experience with borrowers, and actual contract terms such as interest rates, maturity, fees and grace periods.

37. Moreover, the results of the FCRA cost formula are modified throughout the lifetime of a cohort, pursuant to the "reestimation" process. The results of the reestimate process demonstrate that CCC has "los[t] money" during the period 1992-2002. When these total lifetime reestimates for all

cohorts of guarantees disbursed since 1992 are netted against the total *original* subsidy estimates adopted each budget year during the period 1992-2002, *the resulting loss is nearly $1.75 billion*.

38. The implication of the United States' position concerning "estimated data" is that it is impossible to judge whether premiums for the GSM 102, GSM 103 and SCGP programmes have covered operating costs and losses until all guarantee cohorts for a period constituting the "long term" are closed, so that purely "actual" rather than partial "estimate" data are available. Because all cohorts disbursed since the inception of federal credit reform remain open, the United States effectively argues that it is impossible for this Panel to judge whether the CCC guarantee programmes satisfy the elements of item (j). Brazil notes however that the US Congress and the President have endorsed the use of the FCRA cost formula as the principal way to "measure more accurately the costs of Federal credit programmes", *even in the budget year column of the US budget*, let alone several years out, when cohorts have been subject to successive rounds of reestimates.

39. In closing, Brazil reminds the Panel that the US criticism regarding the use of "estimated" data does not address the many other bases apart from the FCRA formula on which Brazil has demonstrated that the long-term operating costs and losses of the GSM 102, GSM 103 and SCGP programmes exceed premiums paid.

### 2.3. The CCC Export Credit Guarantee Programmes Threaten to Circumvent US Export Subsidy Reduction Commitments

40. At paragraphs 295-305 of its First Submission, Brazil demonstrated that with respect to both unscheduled and scheduled commodities, the GSM 102, GSM 103 and SCGP export subsidy programmes result in, or threaten to lead to, circumvention of the United States' export subsidy commitments, in violation of Article 10.1 of the Agreement on Agriculture. For the same reason, the United States violates Article 8, which requires a Member not to provide export subsidies otherwise than in conformity with the Agreement on Agriculture and with its scheduled commitments. The threat of circumvention for scheduled commodities is further enhanced by the fact that CCC is exempt from the requirement in the FCRA that a programme receive new Congressional budget authority before it undertakes new loan guarantee commitments. Mandatory programmes like the CCC export credit guarantee programmes must be available to all eligible borrowers, without regard to appropriations limits. In an important sense, this resembles the United States' FSC regime, which the Appellate Body found is available without limit. The Appellate Body considered that the unlimited nature of the regime posed a significant threat, under Article 10.1, that the United States would surpass its agricultural export subsidy reduction commitments.

### 2.4. The GSM 102, GSM 103 and SCGP Export Credit Guarantee Programmes Constitute Export Subsidies in Violation of Item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement

41. Since the CCC export credit guarantee programmes violate Articles 10.1 and 8 of the Agreement on Agriculture, the United States is not entitled to the "peace clause" exemption. Therefore, GSM 102, GSM 103 and SCGP programmes constitute prohibited export subsidies, in violation of item (j) of the Illustrative List of Export Subsidies, and of Articles 3.1(a) of the SCM Agreement.

## 3. The Step 2 Export and Domestic Subsidies Are Prohibited Subsidies in Violation of Articles 3.1(a) and 3.1(b) of the SCM Agreement

42. The United States asserts that all US upland cotton is eligible to receive Step 2 payments and that this removes the export and local content contingency. Brazil refutes the US assertion both as a

matter of law as well as fact. The Step 2 export provisions are not, as the United States now argues, simply domestic support payments made to US producers of upland cotton. Brazil again emphasizes that the *US – FSC* and *Canada – Aircraft* Appellate Body decisions are relevant jurisprudence and apply to the facts of the two situations set out in the regulations to Section 1207(a) of the 2002 FSRI Act. Thus, even if all US production since 1990 or even during MY 1999-2002 received Step 2 payments – which the United States has failed to document with any data – it would not remove the export and local content contingencies mandated by those regulations that violate SCM Agreement Articles 3.1(a) and (b).

43. US domestic Step 2 subsidies are prohibited local content subsidies in violation of Article 3.1(b) of the SCM Agreement. There is no explicit derogation of Article 3.1(b) built into the Agreement on Agriculture. The United States argues that there is an inherent conflict between Annex 3, paragraph 7 and Article 6.3 of the Agreement on Agriculture with Article 3.1(b) of the SCM Agreement because in the view of the United States, there can be no payments to processors of agricultural products included within AMS that do *not* violate Article 3.1(b) of the SCM Agreement. Brazil demonstrates that this is not true and that there are subsidies to agricultural processors that do not violate Article 3.1(b) and presents various examples to that respect.

44. Finally, Brazil notes the EC argument that applying Article 3.1(b) of the SCM Agreement "would lead to stricter disciplines being applied to domestic subsidies than are applicable for industrial goods". Local content subsidies – whether for agricultural and industrial products – are prohibited by Article 3.1(b). As "prohibited" subsidies, they are subject to the ultimate discipline – they cannot legally exist. The two packages of disciplines for agricultural and industrial products have both been negotiated during the Uruguay Round. The resulting rules have to be interpreted according to the customary rules of treaty interpretation as contained in the *Vienna Convention*. This interpretation results in agricultural local content subsidies being prohibited. Whether that results in there being more or less strict disciplines than would be applicable to industrial subsidies is not a relevant consideration for the interpretation of the disciplines.

### 4. The ETI Act Subsidies Violate Articles 10.1 and 8 of the Agreement on Agriculture and Are Prohibited by Articles 3.1(a) and 3.2 of the SCM Agreement

45. Brazil has made a *prima facie case* with respect to its claims against the ETI Act. Brazil challenges exactly the same measure based on the same claims asserted by the EC that the panel and the Appellate Body in *US – FSC (21.5)* held to violate the Agreement on Agriculture and the SCM Agreement. The sole difference is that Brazil limits its claims to ETI Act subsidies benefiting the export of upland cotton only.

# ANNEX D-2

## EXECUTIVE SUMMARY OF THE REBUTTAL SUBMISSION OF THE UNITED STATES

### Introduction and Overview

1. The comparison under the Peace Clause proviso in Article 13(b)(ii) must be made with respect to the support as "decided" by those measures. In the case of the challenged US measures, the support was decided in terms of a rate, not an amount of budgetary outlay. The rate of support decided during marketing year 1992 was ***72.9 cents*** per pound of upland cotton; the rate of support granted for the 1999-2001 crops was only ***51.92 cents*** per pound; and the rate of support that measures grant for the 2002 crop is only ***52 cents*** per pound. Thus, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.[1]

2. Brazil has claimed that additional "decisions" by the United States during the 1992 marketing year to impose a 10 per cent acreage reduction programme and 15 per cent "normal flex acres" reduced the level of support below 72.9 cents per pound. However, the 72.9 cents per pound rate of support most accurately expresses the revenue ensured by the United States to upland cotton producers. Even on the unrealistic assumption that these programme elements reduced the level of support by 10 and 15 per cent, respectively (that is, the maximum theoretical effect these programme elements could have had), the 1992 rate of support would still be ***67.625*** cents per pound, well above the levels for marketing years 1999-2001 and 2002.

3. Although such a comparison would not conform to the text, the result of the Peace Clause comparison is no different if one compares the support via an Aggregate Measurement of Support calculation. Using the price gap methodology (as provided under Annex 3 of the Agriculture Agreement) for US price-based deficiency payments and marketing loan payments, the upland cotton Aggregate Measurement of Support (in US $, millions) for these years is MY1992: 1,079; MY1999: 717; MY2000: 484; MY2001: 264; MY2002: 205. Again, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

4. Finally, the analysis presented by Brazil's expert at the first panel meeting actually supports the United States, not Brazil. Removing the non-product-specific support that Brazil erroneously tries to pass off as support to upland cotton, Brazil's own expert calculates the total support per unit

[1] Brazil has asserted that the United States' approach does not provide any way of taking Step 2 payments into account. Because the availability of Step 2 payments is contingent on certain price conditions existing during the marketing year, the level of support decided must relate to the payment parameters. These have remained the same for Step 2, with the exception of the suspension, through 2006, of the 1.25 cent price difference threshold and payment availability at slightly higher market prices. However, because Step 2 merely provides an alternative avenue of providing support (through processors rather than directly to producers), these minor adjustments do not alter the revenue ensured for producers by the marketing loan rate of 52 cents per pound. In addition, these minor adjustments cannot overcome the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002. Similarly, and without prejudice to whether these measures are within the Panel's terms of reference, we note that cottonseed payments in 1999, 2000, and 2002 ranged in value between 0.6 to 2.3 cents per pound (factoring expenditures over production); thus, they too do not materially affect the comparison between marketing year 1992 and any other year.

(cents/lb.) as MY1992: 60.05; MY1999: 53.79; MY2000: 55.09; MY2001: 52.82; MY2002: 56.32. Again, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

5. Thus, whether gauged via the rate of support decided by US measures (whether or not adjusted for the acreage reduction programme and normal flex acres), *or* via the AMS for upland cotton (calculated through a price gap methodology), *or* via the calculations of Brazil's expert (limited to product-specific support), the result is exactly the same: in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

**US Green Box Measures are "Exempt from Actions" Pursuant to Article 13(a)(ii)**

6. A measure shall be deemed to meet the "fundamental requirement" of the first sentence of Annex 2 if it meets the basic criteria of the second sentence plus any applicable policy-specific criteria. As suggested by the use of the word "fundamental" ("from which others are derived") and the structure of Annex 2 (that is, beginning the second sentence with the word "accordingly"), compliance with the requirement ("something called for or demanded") of the first sentence will be demonstrated by conforming to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6 through 13.

7. ***Direct Payments:*** Eligibility for direct payments under the 2002 Act is based on criteria in a "defined and fixed base period " (paragraph 6(a)) in the ordinary meaning of those terms: a base period that is "definite" (set out in the 2002 Act) and "stationary or unchanging in a relative position" (does not change in relative position for the six-year duration of the 2002 Act).

8. Paragraph 6(a) establishes that eligibility for payments under a decoupled income support measure shall be determined by clearly-defined criteria in "*a* defined and fixed base period," not "*the* base period" (as in paragraph 9 of Annex 3, which is defined in that same paragraph as "the years 1986 to 1988"). Brazil's reading of "a defined and fixed base period" would read into that text the term "unchanging", language Brazil has proposed in the ongoing WTO negotiations but is not currently found in the Agreement.

9. Annex 2, by its terms, sets out the fundamental requirement and basic and (if applicable) policy-specific criteria to which green box "*domestic support measures*" must conform. Other provisions in the Agreement similarly establish that the criteria set out in Annex 2 apply to "domestic support measures". Thus, with respect to a given decoupled income support measure, eligibility for payments must be determined by criteria in a "defined and fixed base period".

10. Brazil argues that a *new* decoupled income support measure must be based on the same base period as a previous measure if the new measure "is essentially the same" or "[i]f the structure, design, and eligibility criteria have not significantly changed." There is no provision in Annex 2 or the Agreement on Agriculture that supports Brazil's approach. It is thus irrelevant whether two decoupled income support measures are "essentially the same".

11. Brazil would read paragraph 6(b) as requiring a Member to make support available for *any* type of production; a Member could not preclude a recipient from producing certain crops.[2] While direct payments are reduced if certain crops are produced, a recipient need not produce any "type of"

[2] Brazil's reading would also seemingly require a Member to make payments even if the recipient's production was illegal – for example, the production of narcotic crops such as opium poppy or the production of unapproved biotech varieties or environmentally damaging production (for example, planting on converted rain forest or wetlands) – because, under Brazil's approach, by reducing or eliminating payments for any of these production activities, a decoupled income support measure could be understood to base or relate the amount of payment to the "type" of production undertaken.

crop in particular in order to receive the full payment for which a farm is eligible; the recipient need merely refrain from producing the forbidden fruit or vegetable. Thus, it is not any "type . . . of production . . . undertaken by the producer" that results in the full direct payment but rather production *not* undertaken by the producer – that is, *ceasing* certain production.

12. ***Production Flexibility Contract Payments:*** Production flexibility contract payments (now expired) were made with respect to farm acreage that was devoted to agricultural production in the past, including acreage previously devoted to upland cotton production. The payments, however, were made regardless of whether upland cotton was produced on those acres or whether anything was produced at all. As with direct payments, because production flexibility contract payments were decoupled from production, they met the five policy-specific criteria set out in paragraph 6 for decoupled income support measures.

13. Brazil has failed to make a *prima facie* case that US green box measures do not satisfy the fundamental requirement of Annex 2.[3] In fact, Brazil's "evidence" consists simply of selectively quoting and emphasizing conceptual and theoretical statements from the economic literature. *None of the papers Brazil cites concludes that these payments in particular, or decoupled income support measures in general, have more than "minimal[] trade-distorting effects or effects on production."*

14. The Agreement on Agriculture does not define a numerical threshold on what degree of effects will be considered "minimal[] trade-distorting effects or effects on production". However, given that *no study has found that these payments have effects on production of more than one per cent*, it would appear that direct payments have and production flexibility contract payments had no more than "minimal[] trade-distorting effects or effects on production". Thus, not only has Brazil failed to present a *prima facie* case, but the United States has affirmatively shown that these payments satisfy the fundamental requirement of the first sentence of Annex 2.

**US Non-Green Box Domestic Support Measures are not in Breach of Article 13(b)(ii)**

15. **: Peace Clause Proviso – Support was "Decided" During Marketing Year 1992 Using a Rate, Not a Budgetary Outlay**: The Peace Clause proviso requires a comparison to the product-specific support "decided" during the 1992 marketing year. A Member cannot "decide" world market prices or actual production or any other element outside a government's control. Yet Brazil would read the Peace Clause as though Members were omnipotent and could "decide" every factor influencing support.

16. Brazil lists nine different "decisions taken by the United States in relation to MY 1992 upland cotton support programmes". At least three of these "decisions" relate to the rate of support and *not a single decision relating to budgetary outlays or market prices.* Thus, Brazil's own answer confirms that the proper analysis of the support "decided" by US measures is to look to the terms of the US measures, which set a rate of support.

17. The use of the term "grant" in the Peace Clause proviso with respect to challenged measures does not compel an examination of budgetary outlays. The ordinary meaning of "grant" is to "bestow as a favour" or "give or confer (a possession, a right, etc.) formally". Thus, the use of the term "grant" would permit an evaluation of the rate of support that challenged measures "give or confer . . . formally". Members did not choose to use the word "granted" in place of "decided," and a valid

[3] If, as Brazil has argued, the first sentence is "fundamental" and has independent force, then presumably if a measure meets that "fundamental requirement", it will be deemed to be green box, irrespective of whether it meets the subordinate basic and policy-specific criteria. Thus, on Brazil's reading, if a measure does not conform to the criteria in Annex 2, it still could meet the "fundamental requirement", and the complaining party would bear the burden of proof to demonstrate a measure's inconsistency with that provision.

interpretation must make sense of that choice rather than reading it out of the Agreement. In addition, had Members intended the Peace Clause comparison to be made *solely* on the basis of budgetary outlays, they could have used that term, which is a defined term in Article 1(c) and used frequently in the Agreement.

18. **Peace Clause Proviso – "Support to a Specific Commodity" Means Product-Specific Support**: The phrase "support to a specific commodity" means "product-specific support". That the Peace Clause does not use the phrase "product-specific support" is neither surprising nor telling. The basic definition of product-specific support is given in Article 1(a), as "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product." Article 1(h) also refers to the concept but does not use the exact phrase "product-specific support"; in fact, the language this provision uses ("support for basic agricultural products") is strikingly similar to the Peace Clause proviso ("support to a specific commodity"). Neither Article 1(a) nor 1(h) *even uses the term "specific"* whereas the Peace Clause *contains all three elements of that phrase* (product, specific, and support).

**19. Brazil Simply Ignores the Definition of Product-Specific Support in the Agreement on Agriculture**: Brazil argues that certain challenged US measures are *not* "non-product-specific" and therefore must be "support to a specific commodity." Brazil focuses on the definition of "non-product-specific" support in Article 1(a) but simply fails to interpret that definition in light of the definition of product-specific support that immediately precedes it. The universe of domestic support measures under Article 1(a) consists of product-specific support and non-product-specific support; these two parts must be read together and in harmony.

20. The definition of product-specific support consists of two elements: First, the support must be provided "*for an agricultural product*," that is, the subsidy is given "in favour of" a product and not in respect of criteria not related to the product or in respect of multiple products. Second, such support is "in favour of the *producers of the basic agricultural product*", which suggests that subsidy benefits those who produce the product – that is, production is necessary for the support to be received. *Both* of these elements must be present for support to be product-specific since, should either be missing, the definition would not be satisfied.

21. The second category of support in Article 1(a) is defined as "non-product-specific support provided in favour of agricultural producers in general." The ordinary meaning of "in general" is "in general terms, generally". Non-product-specific support *cannot* be interpreted as support provided "for *an* agricultural product in favour of the *producers* of the basic agricultural product" because to do so would reduce the first half of the Article 1(a) definition to redundancy or inutility. Thus, non-product-specific support is support in favour of agricultural producers "generally" – that is, a residual category of support covering those measures that do not fall within the more detailed criteria set out in the definition of product-specific support.

22. **Counter-Cyclical Payments are Non-Product-Specific Support:** Counter-cyclical payments are non-product-specific support. The payment formula for counter-cyclical payments demonstrates that these payments are not "provided for an agricultural product" because a recipient need not currently produce upland cotton (or any other crop) to receive payment. In addition, it is not "the producers of the basic agricultural product" – that is, current upland cotton growers – that are entitled to receive the counter-cyclical payments but rather persons (farmers and landowners) on farm acres with *past histories* of producing covered commodities, including upland cotton, during the base period. Thus, counter-cyclical payments satisfy neither element of the definition of product-specific support and do not form part of the Peace Clause comparison.

23. Despite Brazil's attempts to mischaracterize the two as similar, counter-cyclical payments and deficiency payments differ in crucial respects. To receive a deficiency payment, a producer was

*required* to plant upland cotton for harvest and would be paid on the *acres planted to upland cotton for harvest* up to the maximum payment acreage. Thus, deficiency payments were support for an agricultural product (upland cotton) in favour of the *producers* of the product. By contrast, to receive the counter-cyclical payment a person with "upland cotton base acres" *need not plant for harvest or produce upland cotton* (nor any other crop nor any crop at all). Thus, counter-cyclical payments do not provide support for "an agricultural product" in favour of " the producers" of the basic agricultural product and do not form part of the Peace Clause comparison under the proviso in Article 13(b)(ii).

24. **Crop Insurance Payments Provide Non-Product-Specific Support**: Crop insurance is not support "provided for *an* agricultural product". For marketing year 2002, crop insurance payments are available to approximately 100 agricultural commodities, representing approximately 80 per cent of US area planted and greater than 85 per cent of the value of all US crops. Support which is provided to a number of crops is not "support to a specific commodity"; it is ' support to several commodities' or 'support to more than one commodity' and does not form part of the Peace Clause comparison. The United States notifies crop insurance as non-product-specific "amber box" domestic support subject to US reduction commitments. *No WTO Member has notified crop insurance programmes as product-specific*; in fact, Hungary, Canada, the EC, and Japan have notified crop insurance programmes as non-product-specific support. The United States is not aware of any other Member's crop insurance programme that has as broad product coverage as the US programme.

25. **Market Loss Assistance Payments are Non-Product-Specific Support**: As indicated in the US 1999 WTO domestic support notification (G/AG/N/USA/43), the expired market loss assistance payments were non-product-specific support. As with production flexibility contract payments, market loss assistance payments were made to persons with farm acres that previously had been devoted to production of certain crops, including upland cotton, during an historical base period. A recipient was not required to produce upland cotton or any other crop in order to receive payment, and no production was required at all. Thus, these payments are not product-specific support and would not form part of the Peace Clause proviso comparison.

26. **Direct Payments**: Were the Panel to conclude that direct payments do not conform fully to the provisions of Annex 2, direct payments would be non-product-specific support. As with counter-cyclical payments, direct payments are based on quantities of acreage that historically produced cotton, and there is no requirement to produce upland cotton (or any other crop) to receive these payments. Thus, direct payments would not be product-specific support.

27. **Production Flexibility Contract Payments**: Were the Panel to consider that these payments are within its terms of reference, the United States has explained that they would be green box support. Were the Panel to conclude further that production flexibility contract payments do not conform fully to the provisions of Annex 2, these payments would also be non-product-specific support for the reasons given with respect to direct payments. As such, they would not form part of the Peace Clause proviso comparison.

28. **Cottonseed Payments**: The Agricultural Assistance Act of 2003 and the cottonseed payment made pursuant to it is not within the Panel's terms of reference because the legislation authorizing the payments had not even been enacted at the time of Brazil's panel request, much less its consultation request. The "legal instruments" pursuant to which prior cottonseed payments were made, moreover, do not appear in Brazil's consultation or panel requests. Thus, it would appear that cottonseed payments for the 1999 and 2000 crops of cottonseed also do not form part of the Panel's terms of reference.

29. **Peace Clause Comparison – The Product-Specific AMS for Upland Cotton Also Demonstrates That Challenged US Measures Do Not Breach the Peace Clause**: The United States believes the Peace Clause compels comparing the rate of support decided by US

measures, whether or not adjusted for the acreage reduction programme and normal flex acres, with the current rate of support. Were the Panel to determine to use an Aggregate Measurement of Support calculation, however, the price gap methodology is the only appropriate one for Peace Clause purposes.

30. The price gap methodology eliminates the effect of prevailing market prices on the calculation of support. Instead, paragraphs 10 and 11 of Annex 3 designate that the support be calculated by multiplying the quantity of eligible production by the gap between the applied administered price (for example, the marketing loan rate) and the *fixed reference price* (that is, the actual price for determining payment rates for the years 1986 to 1988). Thus, by holding the reference price "fixed", support measured using a price gap calculation shows the effect of changes in the level of support (applied administered price) decided by a Member, rather than changes in outlays that result from movements in market prices that a Member does *not* control. In fact, the United States has calculated an AMS for upland cotton using the price gap methodology for both deficiency payments and marketing loan payments (marketing loan gains, certificate exchange gains, and loan deficiency payments) and using budgetary outlays for all other payments. The result is exactly the same as a rate of support comparison: in no marketing year from 1999 through 2002 is the support US measures grant in excess of the 1992 marketing year level.

**US Export Credit Guarantee Programme**

31. **The Negotiating History of Article 10.2 Reveals that the Negotiators Explicitly Deferred the Application of All Export Subsidy Disciplines on Export Credit Guarantees**: The GATT/WTO negotiating history regarding export credits and export credit guarantees in agriculture supports the US interpretation of Article 10.2. On 24 June 1991, Chairman Dunkel circulated a Note on Options in the Agriculture Negotiations requesting decisions by the principals on "whether subsidized export credits and related practices . . . would be subject to reduction commitments". Subsequently, on 2 August 1991, he circulated a proposed "Illustrative List of Export Subsidy Practices." Item (h) is explicitly "Export Credits provided by governments or their agencies on less than fully commercial terms." Similarly, item (i) is "Subsidized export credit guarantees or insurance programmes."

32. On 20 December 1991, the "Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations" was issued. Article 10.2 of the Draft Final Act states: "Participants undertake *not* to provide export credits, export credit guarantees or insurance programmes *otherwise than in conformity with* internationally agreed disciplines" (emphasis added). This draft text would clearly prohibit the use of export credit guarantees *except* in conformity with agreed disciplines. Such internationally agreed disciplines would include those contemplated by the SCM Agreement. This would be precisely the language necessary to support Brazil's reading.

33. Ironically, Brazil's interpretation would require export credit guarantees in agriculture to be subject to *greater* disciplines than any other practice addressed in the Agreement on Agriculture. Under Brazil's view, not only would export credit guarantees constitute export subsidies and be subject to *all* of the export subsidy disciplines, but Members would also be specifically obligated to work toward and then apply *additional* disciplines.

34. **Brazil's approach would result in gross injustice**: As part of the negotiations, the parties had to prepare and submit schedules of quantities and budget outlays during a base period to derive the export subsidy reduction commitments ultimately reflected in the respective schedules of the Members. Had Members' export credit guarantees been considered export subsidies for these purposes from the outset, then the export credit guarantee activity during the base period would also have to have been added to the base figures from which each Member's export subsidy reduction commitments were calculated. For example, the United States has no export subsidy reduction

commitment with respect to corn, yet during the 1986-1990 base period an average of over *5.5 million tons* of corn were exported *each year* under the GSM-102 and GSM-103 programmes. The United States would have reduction commitments for many more products than currently and would have had significantly increased commitments for the 13 products that are scheduled. However, Brazil would have the Panel impose the disciplines now but deny Members the corresponding changes in reduction commitments. Brazil's approach would be grossly inequitable and the Panel should reject it.

35. **The Application of Government-Wide Accounting Rules Indicates that the Export Credit Guarantee Programmes are Covering Long-Term Operating Costs and Losses:** The application of the Federal Credit Reform Act of 1990 ("FCRA") over time to the export credit guarantee programmes as a whole currently indicates that the net result of all activity associated with export credit guarantees issued in fiscal years 1994 and 1995 is a total net receipt to the United States of $29 million. The experience of 1994 and 1995 is viewed as representative, and the United States expects that the net results for other years will be similar to the experience for 1994 and 1995. Re-estimates thus far have resulted in a net reduction in the estimated costs of these programmes of over $1.9 *billion* since the inception of credit reform budgeting in fiscal year 1992. Based on those results, the Brazilian claim that "operating costs and losses for GSM 102, GSM 103, and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992" is not supportable.

36. The United States has gathered cumulative reestimates on a cohort basis: For example, for cohort 1992 (not yet closed) the current data reflects an estimate of a *profit* to the United States of approximately $124 million; for 1993 (not yet closed), the corresponding current figure is a *profit* of approximately $56 million; and, as indicated, cohorts 1994 and 1995 together project a *profit* of $29 million. With the exception of 2002, for which only very recent data is necessarily available, the Panel will note that the trend for all cohorts is uniformly favourable as compared to the original subsidy estimate.

37. Brazil asserts that "historically, the majority of GSM support that is rescheduled is 'in arrears'" and that this increases costs. Brazil largely relies, however, on a 1990 government report that is dated and precedes FCRA itself. No rescheduling applicable to export credit guarantees issued in fiscal year 1992 or later is in arrears.

38. **Brazil's Suggestion to Use Estimated Data to Determine Long-Term Costs and Losses Supports the View that the Export Credit Guarantees Do Not Provide Export Subsidies**: The United States notes Brazil's statement that "a certain degree of estimated data would be perfectly acceptable in an analysis of the costs and losses of guarantee programmes under item(j)" for two reasons. First, the re-estimate process for fiscal years 1994, 1995, and virtually every other year since fiscal year 1992 indicates a very strong net positive trend with respect to the programmes and that therefore current premium rates do cover long-term operating costs and losses. Second, it is relevant with respect to Brazil's reliance on the significant losses that the United States admittedly incurred with respect to Poland and Iraq. Presumably, to attempt to recover such losses in any practical time frame would require such a prohibitive fee increase that few, if any, exporters would take advantage of the program. Consequently, the United States would be whipsawed by a prohibition on the export credit guarantee as currently constituted because of the large losses incurred between 10 and 20 years ago, and the inability to create a conforming programme because the fee structure necessary to compensate for such historical losses would foreclose use of the programme. Item (j) cannot be reasonably interpreted to require an examination of all activity since the beginning of a programme, no matter how old it may be. The data provided with respect to fiscal years 1994 and 1995 and for the programmes as a whole indicates that current premium rates are presently adequate to cover long-term operating costs and losses as currently projected. The United States is also in a net positive position with respect to cotton transactions in the ten years commencing with fiscal year 1993.

39. **The Export Credit Guarantee Programmes Are Not Applied in a Manner which Results in or which Threatens to Lead to, Circumvention of Export Subsidy Commitments**: Brazil has challenged the export credit guarantee programmes, GSM 102, GSM 103, and SCGP, as such. Brazil has failed, however, to demonstrate that these programmes as such mandate a violation of US WTO obligations. It is well established under GATT and WTO jurisprudence that legislation of a Member violates that Member's WTO obligations only if the legislation *mandates* action that is inconsistent with those obligations or precludes action that is consistent with those obligations. If the legislation provides discretion to administrative authorities to act in a WTO-consistent manner, the legislation, as such, does not violate a Member's WTO obligations. This distinction has continued under the WTO system.

40. The Commodity Credit Corporation ("CCC") has complete statutory and regulatory discretion at any time not to issue guarantees with respect to any individual application for an export credit guarantee or to suspend the issuance of export credit guarantees under any particular allocation. This is in marked contrast to the situation in *US- FSC*, in which the Appellate Body found a threat of circumvention because the FSC legislation created a legal entitlement to the payment. There is no statutory legal entitlement to an export credit guarantee. Furthermore, even if an application and fee are received, the applicant is not necessarily entitled to receive the guarantee. Issuance is discretionary.

41. Finally, Brazil has alleged that the United States has exceeded its quantitative export subsidy reduction commitments during the period July 2001-June 2002. Even if the export credit guarantee programmes were deemed export subsidies, the United States would be in compliance with the quantitative reduction commitments for that period with respect to wheat, coarse grains, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, live dairy cattle, and eggs. This may also be true with respect to vegetable oil. In fiscal year 2002, it would also be true for poultry meat. The United States did not use the GSM-102 or GSM-103 programmes during 2001-2002 with respect to butter and butter oil, skim milk powder, cheese, other milk products, or eggs.

42. **Financial Arrangements Analogous to the CCC Export Credit Guarantee Programmes are Available in the Marketplace**: In light of Article 10.2, it is neither appropriate nor necessary to analyze the export credit guarantees with respect to Article 1.1(b) of the SCM Agreement. However, we note that financing is available in the marketplace that is analogous to export credit guarantees. A prominent example in the commercial market would be "forfaiting." It would appear, then, that a competitive marketplace exists for trade financing even in emerging markets where more conventional financing is not available. The United States is not privy to the precise terms at any time available in forfaiting transactions because those terms can vary by country, commodity, bank risk, size of transaction and numerous other factors. In addition, like most private financial activity, that information is ordinarily held confidentially by the parties.

**The Step 2 Programme is not Contingent on Export Performance**

43. Brazil apparently does not contest that all uses of upland cotton are eligible for the Step 2 subsidy. Instead, Brazil suggests, erroneously, that not the entire universe of users of upland cotton is eligible for the subsidy. First, the requirement that a recipient must be "regularly engaged" in the use of cotton is simply an anti-fraud provision to preclude an attempt to receive a payment with respect to cotton on which a payment has already been made. Brazil also correctly notes that "the eligible domestic user criteria exclude all firms that are domestic cotton brokers or simple resellers". These parties are not using the cotton and are therefore ineligible. Brazil suggests a third category of persons who are users but are not eligible to receive the payment: "firms that have not entered into CCC contracts" as either manufacturers or exporters. It is true that CCC cannot pay parties that

choose to remain unknown to it, but this requires an assumption of economic irrationality and does not diminish the point that all who use cotton have it entirely within their power to receive the subsidy.

# ANNEX D-3

## BRAZIL'S COMMENTS ON US REBUTTAL SUBMISSION

27August 2003

1. Pursuant to the Panel's ruling of 23 August 2003, Brazil presents the following comments on the paragraphs listed below relating to the Rebuttal Submission of the United States of America. In addition, Brazil offers comments on Question 67a posed to the United States by the Panel's Communication of 25 August 2003.

**Paragraph 43**

2. In paragraph 43 of its Rebuttal Submission, the United States argues that "Brazil's reading would seemingly require a Member to make payments even if the recipient's production was illegal, for example the production of narcotic crops such as opium poppy or the production of unapproved biotech varieties or environmentally damaging production." The United States claims this would have "potentially far reaching results." This new argument has no merit.

3. The two examples provided by the United States involving the growing of illegal plants/crops are, by definition, situations in which a national (or state/regional) domestic criminal (or civil) law would prohibit or regulate the growing of such plants/crops. The criminal (or civil) law would operate separately from any de-coupled direct payment to prohibit or regulate all forms of such production. There would be no reason in that situation to have a further statute limiting the payment if such illegal plants (or illegal production methods) – the activity would already be illegal. That is exactly the case with the 1996 FAIR Act and the 2002 FSRI Act regarding PFC and direct payments respectively. Neither limits the amount of payments for the growing of plants that would be illegal under US law. There is no need to because US federal and/or State law already prohibits such activity.

4. In addition, the US example in paragraph 43 about a restriction on "environmentally damaging production" is not relevant because such a restriction does not relate to the "type" of production (*i.e.*, the type of crop) but rather the "manner" of production.[4] Therefore, Annex 2, paragraph 6(b), which focuses on the "type" of production related to the "amount" of payment, it does not address the manner in which production is conducted. The context of Annex 2, paragraph 6(b) includes Annex 2, paragraph 12 ("Payments under environmental programmes") which permits Members to impose specific conditions on the growing of crops in order to receive environmentally related direct payments.

5. Thus, the "potentially far-reaching results" [5] from Brazil's text-based approach to the ordinary meaning of "the amount of such payments" related to or based on the "type of production " do not and

[4] *See* First Submission of Brazil, para. 157 in which Brazil makes the distinction between Paragraph 6(b) in which the word "type" relating to the type of crop produced contrasted with Paragraph 6(d) which is concerned with the type of production process. The United States has never contested this distinction.

[5] The United States reference to "potentially far-reaching results" appears also to include its additional new argument in paragraph 43 relating to the EC's possible CAP reform imposing, *inter alia*, fruits and vegetable restrictions. That potential "reform" is obviously not at issue in this case. The EC will have to make a decision how to notify any such measure when it is required to do so under Article 18 of the Agreement on Agriculture. It goes without saying that an improperly categorized green box measure of one Member cannot be justified by relying on a possible future improperly categorized green box measure of another Member.

will not exist. Brazil further notes that in the extraordinary situation in which one Member could theoretically seek to challenge a de-coupled direct payment limiting payments for growing plants such as opium poppy as an actionable subsidy, the Member restricting the "type" of production of such plants could, for instance, assert defences under Article XX(b) or (d) of GATT 1994.[6]

**Paragraphs 96-98**

6. The United States raises the new argument that "no other WTO Member has notified crop insurance programmes as product-specific."[7] At the outset, Brazil notes that it is the US crop insurance programmes and the detailed record of the product-specific nature of the US crop insurance programmes that is at issue in this dispute – not those of other WTO Members.

7. None of the WTO notifications of the EC, Canada, or Japan cited by the United States reflect the existence of the type of special product-specific policies or special treatment for certain crops within a broader insurance programme. In particular, there is no indication that these Members provide any specific crop insurance provisions for a specific crop, such as the insurance programmes provided by the United States for upland cotton.[8] For example, while Canada appears to have a similar programme for "crops" as the United States, there is no indication that Canada provides special polices or groups of policies within its broader programme for individual crops. Thus, in contrast to the evidence of other Member's insurance policies, the *nature, type, value,* and *participation rate* of the crop insurance policies provided by the United States differs widely among commodities. As Brazil has explained, it is simply not a "one size fits all" programme. The EC agrees. It has argued before the Committee on Agriculture that the US crop insurance programme is product-specific support.[9]

8. The United States further argues that it "is not aware of any crop insurance programme maintained by any other Member" that covers as many commodities as the United States.[10] However, the Article 13(b)(ii) test is whether a specific commodity receives support from a domestic measure identified in the *chapeau* and whether there is some sort of a link between the support measure and the specific commodity. Evidence of such a link in the case of crop insurance exists, as with the US crop insurance programme, when particular commodities are provided special policies, coverage, or additional subsidies compared to other commodities covered by the crop insurance programme. There is no such evidence reflected in the notifications of Mexico whose notification states that "insurance premium subsidy [is] available for all producers."[11] Japan's "Agricultural Insurance Scheme" also includes subsidies for policies covering all crops (except vegetables), all livestock (except poultry) and sericulture.[12] By contrast, the US insurance programmes challenged by Brazil do not provide subsidies for any insurance for livestock or many other commodities. Indeed, the commodities *not* covered by the US 2000 ARP Act and relevant regulations represent more than half of the value of US farm cash receipts.[13]

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[6] These same exceptions would be available in the unlikely event a Member challenged a direct de-coupled payment for any of the three scenarios posed by the United States in paragraph 43.

[7] Rebuttal Submission of the United States, para. 96-98.

[8] *See* Rebuttal Submission of Brazil, paras 54 (special irrigation-related policies for upland cotton), para. 55 (upland cotton producers have much larger pool of insurance subsidies than other types of crops), para. 56 (specific upland cotton income protection policies and catastrophic risk protection), para 57 (much greater use of insurance subsidies than other crops), para. 58 (reinsurance payments for upland cotton).

[9] Exhibit Bra-144 (G/AG/R/31, para. 31).

[10] Rebuttal Submission of the United States, para. 98.

[11] G/AG/N/MEX/7, p. 4.

[12] Rebuttal Submission of the United States, para. 98.

[13] Rebuttal Submission of Brazil, para. 59 (Excluded agricultural commodities from US insurance programme represent 52 per cent of the value of all US farm cash receipts).

9. Finally, as the United States recognizes, more than half of the notifications (which include part of Japan's) cited by the United States refer to insurance programmes as green box support.[14] Members so notifying are not obliged to make a determination under Article 6 of the Agreement on Agriculture whether such support is product-specific or not because it is exempt from any reduction commitments. The United States has not provided evidence suggesting these green box categorizations are incorrect. For these reasons, these notifications are also irrelevant.

**Paragraphs 114-117**

10. The United States argues for the first time in paragraphs 114-117 of its Rebuttal Submission that using the "price-gap" methodology is the appropriate way to calculate the portion of upland cotton AMS that stems from marketing loan gains, certificate exchange gains, and loan deficiency payments (collectively known as "marketing loan payments"). The effect of applying the price gap methodology would be to transform the $2.5 billion in budgetary expenditures for marketing loan payments in MY 2001 into a "negative" amount for purposes of total current AMS.[15] The United States bases its new argument on an alleged statement by Brazil and "agrees" that "Brazil is correct when it states that a non-exempt direct payment dependent on a price gap may be calculated using a price gap methodology, rather than budgetary outlays. . .."[16]

11. The United States refers to Brazil's 11 August Answer to Question 67, paragraph 130, as the basis for its assertion. Brazil's statement cited by the United States reads as follows:

> Brazil notes that the United States has notified the deficiency payments using the price gap methodology provided for in Annex 3. [footnote citing Exhibit Bra-150 (G/AG//N/USA/10)] Brazil considers it appropriate to follow the US decision and will therefore, calculate the amount of support to upland cotton provided by the deficiency payment programme by using the "price gap" approach detailed in Annex 3 paragraph 10 and 11.

Contrary to the US interpretation of this statement, Brazil's point was that any calculation of AMS for deficiency payments (and for the other programmes that require such calculation) must be consistent with the actual choice of methodology originally made by the United States for calculating its domestic support reduction commitments as well as its yearly current AMS notifications. Indeed, the United States' entire argument in paragraphs 114-117 of its Rebuttal Submission is based on the alleged obligation for Brazil "to be consistent."[17] As demonstrated below, it is Brazil's AMS calculation, not that of the United States, that is "consistent."

12. Members are required to notify annually their current total AMS to provide other Members the opportunity to review the consistency with their domestic support reduction commitments pursuant to Article 6.3 of the Agreement on Agriculture.[18] The total AMS reduction commitments were negotiated during the Uruguay Round based on a calculation of "total AMS" provided in marketing years 1986-1988. The initial AMS calculation used for the purposes of the reduction commitments was performed pursuant to Annex 3 of the Agreement on Agriculture with Members choosing either budgetary expenditures or a "price-gap" methodology expressed in total monetary terms. Like Article 13(b)(ii), the comparison between *current* total AMS and the AMS ceiling, *i.e.*,

[14] Rebuttal Submission of the United States, para. 97.

[15] The United States even claims credit for being conservative by not netting the negative support by the marketing loan benefits against the positive support provided by the other domestic support programmes, Rebuttal Submission of the United States, para. 116 and note 148.

[16] Rebuttal Submission of the United States, para. 114.

[17] Rebuttal Submission of the United States, para 114 (last sentence).

[18] *See* Article 18.2 of the Agreement on Agriculture and various US notifications cited herein.

the reduction commitment, must allow for an "apples to apples" annual comparison in accounting for the same measures. It follows that once a Member uses a budgetary approach for one measure to establish the AMS ceiling, it cannot use a price gap approach for that same measure in calculating total *current* AMS. Instead, a Member is required to report *current* total AMS consistently with the choice it made for that particular type of support in its *original* total AMS calculation.

13. This interpretation of Annex 3 and Article 6.3 of the Agreement on Agriculture is consistent with its context and object and purpose. Opting for a methodology that would permit Members to change their original methodology (*i.e.*, from budgetary to price-gap) could sanction what the United States proposes – the covering up of billions of dollars of marketing loan payments (originally calculated on a budgetary basis) and turns them into "negative support" by using a "price-gap" formula. This would be inconsistent with the entire reason for the reduction commitments of Article 6 of the Agreement on Agriculture.

14. Brazil's calculation of AMS for, *inter alia*, marketing loan payments followed the actual decision of the United States during the Uruguay Round[19] as reflected in its notifications.[20] During the Uruguay Round, the United States calculated the upland cotton portion of what would eventually become its domestic support reduction commitment by using the following methodologies: it used the price gap formula for upland cotton deficiency payments[21] and used budgetary outlays for all other domestic support measures.[22] In its MY 1995 notification to the Committee on Agriculture the United States similarly notified deficiency payments using the price-gap formula and using budgetary outlays for all other domestic support measures subject to reduction commitments[23] consistent with its AMS calculation during the Uruguay Round. After the termination of the deficiency payment programme in 1996, all later domestic support (current total AMS) notifications of the United States for upland cotton only use budgetary outlays. Thus, Brazil's approach to calculating upland cotton AMS for MY 1992 and 1999-2002 is entirely consistent with the US approach as evidenced in its domestic support notifications[24] and with the US obligations under the Agreement on Agriculture.

15. The United States accounted for the marketing loan payments in the same manner as in its notifications when it answered Question 67 in its 11 August submission.[25] This is, furthermore, the methodology the Panel indicated the United States should use – referring to the US notification of MY 1999 domestic support in G/AG/N/USA/43, in which the United States – in line with its obligation – used budgetary outlays.[26]

16. In sum, like many other US arguments in this phase of the dispute, this US argument is designed to cover-up expenditures and support to upland cotton that increased significantly since the US Uruguay Round commitments came into effect. Therefore, the Panel should reject it.

[19] Exhibit Bra-191 (G/AG/AGST/USA, p. 20)
[20] Exhibit Bra-150 (G/AG/N/USA/10, p. 18)
[21] Exhibit Bra-191 (G/AG/AGST/USA, p. 20 and supporting tables on p. 21-22).
[22] Exhibit Bra-191 (G/AG/AGST/USA, p. 20).
[23] Exhibit Bra-150 (G/AG/N/USA/10, p. 18).
[24] The United States entire argument in paragraphs 114-117 is premised on the alleged need for Brazil "to be consistent" as stated in the last sentence in paragraph 114. As noted, it is Brazil who has been consistent in using actual US notifications and the US calculation method during the Uruguay Round, not the United States who now seeks to ignore them.
[25] US 11 August Answer to Question 67, para. 128-134.
[26] Exhibit Bra-47 (G/AG/N/USA/43, p. 20).

**Paragraphs 124-127 and Exhibit US-24**

17. The United States presents an additional critique of Professor Sumner's analysis in Exhibit US-24 prepared by Dr. Joseph W. Glauber, the Deputy Chief Economists of USDA, as well as in paragraphs 124-127 of its Rebuttal Submission.

Marketing Loan Benefits

18. Dr. Glauber notes that the analysis of Professor Sumner did not include in the upland cotton acres eligible for marketing loans 447,164 acres of upland cotton planted on Flex acres from other programme crops.[27] Dr. Glauber is correct that any such acreage would be eligible for receiving marketing loan payments and therefore should be included in the calculation.[28] Dr. Glauber refers to "Acreage Reduction compliance reports" as his source of this number. Dr. Glauber does not provide a citation for these compliance reports and the United States has not made them available to Brazil. Therefore, Brazil cannot confirm the actual number of acres. Brazil also notes that the number listed is planted acres not harvested acres.[29]

19. Dr. Glauber further rests his finding that 100 per cent of US upland cotton production in MY 1992 benefited from marketing loan payments on his statement that upland cotton farmers "often" report land that had been planted and abandoned as land left idle and therefore never planted. No citation, authority or reference is provided for this assertion. The assumption in this assertion is that farmers report one thing to the US Federal Government, yet actually do something else. Thus, Dr. Glauber's presumption appears to be that farmers engage in what would appear to be widespread misrepresentation. Brazil does not know if such assumed large-scale misrepresentations were legal under the 1992 US programme, but it certainly contradicts "programme" expectations.

20. Professor Sumner concluded that 1.99 million acres used to produce upland cotton in MY 1992 were not eligible for the marketing loan payments because they did not participate in the deficiency programme. Dr. Glauber confirms Professor Sumner's general approach on non-participating acreage in footnote 1 on page 2 where he acknowledges that "some base building occurred during the early 1990's." What this means is that a substantial amount of upland cotton must have been planted outside the programme to accommodate expansion of upland cotton base by 200,000 acres in 1993, as identified by Dr. Glauber. This acknowledgement supports Professor Sumner's analysis that a significant amount of upland cotton must have been grown *outside* the deficiency programme. The basis for this analysis is as follows:

21. Under the rules existing in MY 1992, in order to "build" base a farm was required to plant all of its upland cotton outside the programme.[30] The expansion of upland cotton base is equal to one-

[27] Exhibit US-24, p. 1.

[28] Neither Brazil nor Professor Sumner were aware of any flex acres from other programme crops planted to upland cotton or of data concerning any such plantings.

[29] Dr. Glauber raises in the first sentence of paragraph 2 what he called "statistical problems in comparing planted acres to programme acres." He points out that "planted acres" information was collected and reported by NASS, while "programme acres" are reported by the Farm Service Agency. (In 1992 this part of USDA was known as the Agricultural Stabilization and Conservation Service.) Dr. Glauber goes on to explain that a significant amount of cotton acreage is planted and abandoned each year. But the relevance of this information in critiquing Professor Sumner's analysis remains unclear. Brazil notes that contrary to Dr. Glauber's assumption, Professor Sumner's calculations do *not* rely on data published by NASS, but instead on published information in the Farm Service Agency's "Fact Sheet: Upland Cotton" (Exhibit Bra-4). This Farm Service Agency source provides data on planted acres, the abandonment rate as well as harvested acres of upland cotton for MY 1992.

[30] Exhibit US-3 (7 CFR 1413.7(c)). ("[T]he crop acreage base shall be equal to the average of the acreage planted and considered planted to such crop for harvest on the farm in each of the 3 crop years

third of the amount of additional cotton acres planted in each of the previous three years. An acre of base is added if an additional acre of cotton is planted for three consecutive years.[31] In order to plant more than the current base, a farm was required to leave the programme *altogether* so that current base acres would also be planted outside the programme. For example, assume a farm had 1000 acres of upland cotton base and wanted to add – over the two-year period 1991-1992 – 200 acres of base by 1993. That farm would withdraw from the programme for those two years and plant 1300 acres of cotton (300 acres more than the previous base) in 1991 and 1992. The 1993 upland cotton base would than be calculated as follows: (1000 acres + 1300 acres + 1300 acres) / 3 equalling 1200 acres, thus 200 acres more than previously. Therefore, to add the 200,000 acres of base in 1993 (which Dr. Glauber stated were actually added) a much larger amount of upland cotton would have been required to be planted *outside* the programme in 1992. In addition to building of additional base, farmers planted upland cotton outside the programme because they did not comply with payment limit rules and for some more idiosyncratic reasons.

22. In summary, the evidence of an expanding base is consistent with the assessment of Professor Sumner that a substantial amount of acreage was planted to upland cotton outside the programme. This evidence is not consistent with Dr. Glauber's undocumented or unsubstantiated claim that *all* upland cotton harvested was eligible for marketing loans.

23. To summarize, if the Panel were to accept the undocumented assertion by Dr. Glauber that 447,164 acres of cotton were planted on flex acres from other programme crop base acreage, then there would be 1.54 million acres (1.99 million acres – 0.45 million acres) that were planted to upland cotton but were not eligible for marketing loan payments. This 1.54 million represents 12 per cent of planted acreage.[32] Thus, adjusting 52.35 cents per pound by 0.88 results in a support from the marketing loan programme of 46.1 cents per pound. This is an increase of 1.76 cents over the marketing loan level of support set forth in Appendix Table 1 to Professor Sumner's 22 July 2003 Statement.

Deficiency Payments

24. Brazil has already rebutted the US argument that it is inappropriate to adjust the support provided by the deficiency payment programme by non-participation and the resulting non-eligibility to receive payments.[33]

25. The various "decisions" in MY 1992 with respect to the deficiency payment programme were calculated to establish rules that encouraged some producers to forego eligibility of the programme. Furthermore, the record establishes that US policy makers had relatively precise prior knowledge of how many acres would remain out of the programme based on their policy choices on required land idling and loan rates.[34]

26. Dr. Glauber criticizes Professor Sumner for relying on a programme yield of 531 pounds per acre to calculate the ratio of payment yield to expected yield and states that the true programme yield

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preceding such crop year"). For a farmer within the programme the acreage could never change, as all the acreage was planted (or if idled or – in case of flex acreage – if planted to other crop, it was "considered" planted to upland cotton). Thus, an increase of acreage could only take place, if a farmer withdrew from the programme and exceeded the planting limits imposed by the programme. Thus, MY 1992 base acreage is constitutes the 3-year average of acreage planted and considered planted in MY 1989-1991.

[31] Or of 3 additional acres are planted in the previous year, among other possible constellations.

[32] *Compare* Annex 2 to Exhibit Bra-105, p. 3.

[33] Brazil's 22 August Comment on Question 66, para. 81.

[34] Brazil's 22 August Comment on Question 66, para. 81.

in MY 1992 was 602 pounds per acre.[35] Dr. Glauber references a USDA press release that is not available to those outside the US government as his source of the payment yield information.[36] Assuming that the figure of 602 pounds per acre used by Dr. Glauber is correct, he incorrectly continues to rely on Professor Sumner's calculation of the expected yield by stating that the "expected yield based on an average of the upland cotton yields over the five preceding crop years is 601 pounds per acre." Professor Sumner estimated the payment yield based on actual yields per *planted* acre, whereas the payment yields that Dr. Glauber cites appears to be the approximate average yields per *harvested* acre. To achieve an apples-to-apples comparison, Brazil has re-calculated the expected yield for MY 1992 as the average yield per *harvested* acre during the 1990 to 1994 based on USDA's "Fact Sheet: Upland Cotton" (656.4 pounds per acre).[37] Thus, the relevant adjustment factor is not 1.002 as suggested by Dr. Glauber, but 0.917 (603 / 656.4).

27. Dr. Glauber offers no critique of Professor Sumner's analysis of the mandatory land idling cost component in the calculation of deficiency payment support. However, Dr. Glauber neglected to include these costs associated with the participation in the programme. As Professor Sumner explained, such costs are properly subtracted from the gross benefits of the cotton deficiency payment programme.

28. Brazil provides a revised calculation below, taking account of the revised yield adjustment factor of 0.917 – reflecting the deficiency payment yield as provided by Dr. Glauber's and the expected comparable yield for MY 1992 that Dr. Glauber erroneously did not correct. In addition, Brazil continues to deduct the cost figure calculated by Professor Sumner from the deficiency payment programme. The revised formula is as follows:

> Deficiency payment support = 20.55 cents per pound * 0.75 * 0.917 – 0.84 cents per pound = 13.29 cents per pound

Using the new payment yield and the new expected yield that is comparable to it, results in a 0.04 cents per pound upward adjustment to the 13.25 cents per pound presented by Professor Sumner in his 22 July Statement.

Other Payments

29. Brazil has already responded at length to Dr. Glauber's claims endorsing the arguments of the United States that PFC, market loss assistance, direct and CCP payments, as well as crop insurance payments are not "support to" upland cotton. Dr. Glauber's statement simply restates assertions in the legal briefs of the United States and offers no economic analysis to support his assertions.

30. Dr. Glauber asserts that it is relevant that Step 2 payments are not paid directly to producers.[38] As Brazil explains in its 11 August Answer to Question 18, a basic principle is that the effect of a subsidy is independent of who initially receives the subsidy.[39] That is the economic common sense behind the United States notifying Step 2 payments as product-specific support to upland cotton. And it is the basis for including such payments as "support to a specific commodity" "decided" by a

[35] Exhibit US-24, p. 3.

[36] The United States has not made this document available and thus we are unable to evaluate its applicability to the current situation. Professor Sumner had relied on the best information available to him and Brazil, which was the average upland cotton yield per planted acre during the reference period of MY 1981-1985.

[37] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[38] Exhibit US-24, p. 3.

[39] Exhibit Bra-140 (Pindyck, Robert S. and Rubinfeld, Daniel L. , *Microeconomics*, 5th edition (2002), Prentice Hall, New Jersey, p. 313-317).

Member with respect to MY 1992. The text of Article 13(b)(ii) requires, under any methodology, the calculation of a level of support *to upland cotton*, not *to producers* of upland cotton.

31. Dr. Glauber's assertions about "double counting" are also incorrect. All the support programmes Dr. Glauber discusses (marketing loan payments, CCP payments and deficiency payments) have production and trade effects largely independent of Step 2 payments. But the purpose of calculating a rate of support under Article 13(b)(ii) is not to assess the *amount* of production, export, and price effects of the simultaneous application of all measures of support. Brazil will present an equilibrium analysis of the full economic effects of these support programmes simultaneously for Brazil's "Further Submission." Such an analysis is, however, not required for the purposes of calculating the rate of support under Article 13(b)(ii). The fact that the United States notified Step 2 as "product-specific" support indicates its position that the Step 2 programme provides additional support to upland cotton. This has certainly been the strongly held view of the US National Cotton Council.[40] Thus, it was appropriate for Professor Sumner to include this production and trade-distorting subsidy in the total rate of support.

32. Brazil notes that Dr. Glauber does not criticize any other calculation made by Professor Sumner. For the convenience of the Panel, Brazil reproduces the chart containing Professor Sumner's calculation as amended following the detailed US critique of Professor Sumner's methodology. As the Panel will note, the results do not materially change. The support granted by the United States in MY 1999-2002 exceeds the support decided in MY 1992. Thus, even under this methodology, the United States does not enjoy peace clause exemption from actions based on Articles 5 and 6 of the SCM Agreement or Article XVI:1 of GATT 1994.

| Year | 1992 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| | (Cents per pound) | | | | |
| **1. Marketing Loan** | 46.10 | 50.36 | 50.36 | 50.36 | 52.00 |
| **2. Deficiency Payments** | 13.29 | na | na | na | na |
| **3. Step 2** | 2.46 | 2.46 | 2.46 | 2.46 | 3.71 |
| **4. Crop Insurance** | 0.36 | 2.00 | 2.00 | 2.62 | 2.62 |
| **5. PFC Payments** | na | 6.13 | 5.70 | 4.65 | na |
| **6. Market Loss** | na | 6.10 | 6.07 | 6.42 | na |
| **7. Direct Payments** | na | na | na | na | 5.31 |
| **8. CCP Payments** | na | na | na | na | 10.65 |
| **9. Cottonseed Payments** | 0.00 | 0.97 | 2.27 | 0.00 | 0.61 |
| **10. Total Support** | **62.21** | **68.03** | **68.87** | **66.51** | **74.91** |

**Paragraphs 135-146, and Exhibits US-25 through US-29**

33. Brazil has demonstrated that under the ordinary meaning of Article 10.2 of the Agreement on Agriculture, in its context and according to the object and purpose of Article 10 and the Agreement on Agriculture overall, export credit guarantees are subject to the general export subsidy disciplines contained in that Agreement.[41] Article 10.2 announces Members' intent to work toward negotiations

[40] Brazil Rebuttal Submission, para. 127.

[41] *See* Brazil Statement at the First Panel Meeting, paras. 100-115; Brazil 11 August Responses to Panel Questions 70 (para. 138); Brazil 22 August Rebuttal Submission, paras. 99-100; Brazil 22 August Comments on Answers to Panel Questions 74 (paras. 89-90), 80 (para. 98), 88(b) (paras. 117-119).

on specific disciplines for export credits. In the meantime, the general disciplines on export subsidies included in the Agreement on Agriculture apply to export credits, if those export credits constitute export subsidies.[42]

34. The United States asserts that Article 10.2 carves out export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture, including the anti-circumvention provisions of Article 10.1. The Appellate Body has, however, concluded that to exempt or carve-out particular categories of measures from general obligations such as the export subsidy obligations in the Agreement on Agriculture, the exemption or carve-out must be *explicit* in the text of an agreement.[43] Article 10.2 includes no such explicit carve-out or exemption. The negotiators knew how to make such an exemption or carve-out explicit, as evidenced by, for example, Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.[44]

35. In support of its interpretation, the United States appeals to "subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation," within the meaning of Article 31(3)(b) of the *Vienna Convention*.[45] According to the United States, negotiations on agricultural export credit issues that have taken place in the OECD subsequent to the effective date of the WTO Agreement, and a statement by the OECD Secretariat, constitute "subsequent practice" establishing the agreement of WTO Members that Article 10.2 of the Agreement on Agriculture exempts export credits from any and all disciplines.

36. The United States is wrong. The United States has not established "a 'concordant, common and consistent' sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties [to a treaty] regarding its interpretation," which is the standard adopted by the Appellate Body to establish "subsequent practice" under Article 31(3)(b) of the *Vienna Convention*.[46] It is evident from the positions taken by Canada, the European Communities and New Zealand in this dispute that *not even those WTO Members that participated in the OECD negotiations* agree with the United States' interpretation of Article 10.2.[47] Nor is there any evidence of "subsequent practice" signifying agreement on the United States' interpretation amongst the 136 WTO Members that did not participate in the OECD negotiations.

37. Brazil notes, moreover, that the WTO Secretariat, which is in a better position to address interpretations of the covered agreements than is the OECD Secretariat, does not appear to agree that

[42] Export credit guarantees are not *per se* subject to these disciplines, as they would be if they were included in Article 9.1 of the Agreement on Agriculture (*See e.g.*: Brazil's 22 August Comment, para. 97, New Zealand's Answer to Third Party Question 35, EC's Answers to Third Party Questions 35, para. 70). Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes constitute export subsidies under Articles 1(e) and 10.1 of the Agreement on Agriculture, under Articles 1.1 and 3.1(a) of the SCM Agreement, and under item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement.

[43] Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128. *See* discussion at paragraphs 107-108 of the Oral Statement of Brazil.

[44] Oral Statement of Brazil, paras. 105-106.

[45] Rebuttal Submission of the United States, para. 135.

[46] Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 213; Appellate Body Report, *Japan – Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 107.

[47] *See* Third Party Submission of Canada (paras. 51-54); Third Party Submission of the European Communities (paras. 28-31); Third Party Submission of New Zealand (paras. 3.13-3.16).

agricultural export credits are exempt from the general export subsidy disciplines of the Agreement on Agriculture by virtue of Article 10.2.[48]

38. The United States also argues that the negotiating history of Articles 9.1 and 10.2 of the Agreement on Agriculture supports its argument that export credit guarantees are exempt from the general export subsidy disciplines of the Agreement on Agriculture. The United States raises three arguments in this regard.

39. *First*, the United States addresses the negotiating history of Article 9.1.[49]

40. In the DeZeeuw framework agreement, the United States points to paragraph 20(e), which contemplated Members providing "data on financial outlays or revenue foregone . . . in respect of export credits provided by governments or their agencies on less than fully commercial terms."[50] The United States apparently considers that since paragraph 20(e) was not carried over into the Agreement on Agriculture, export credits are not subject to the export subsidy disciplines in the Agreement.

41. Brazil notes, however, that paragraph 20(g) addressed "export performance-related taxation concessions or incentives." This provision was also not carried over into the Agreement on Agriculture. Nonetheless, panels and the Appellate Body have ruled that export performance-related taxation concessions or incentives like the United States' FSC and ETI measures are subject to the general export subsidy disciplines of the Agreement on Agriculture, including Article 10.1.

42. Similarly, the United States points to Addendum 10 of Chairman Dunkel's Note on Options, which includes an illustrative list of export subsidy practices.[51] A number of the items on that illustrative list were eventually included, with modifications, in Article 9.1 of the Agreement on Agriculture.[52] Others were not, including item (h), which refers to "[e]xport credits provided by governments or their agencies on less than fully commercial terms," and item (i), which refers to "[s]ubsidized export credit guarantees or insurance programmes." The United States apparently considers that since items (h) and (i) were not carried over into the Agreement on Agriculture, export credits, including export credit guarantees and insurance programmes, are not subject to the export subsidy disciplines in the Agreement.

43. Brazil notes, however, that item (g) of Chairman Dunkel's illustrative list refers to "[e]xport performance-related taxation concessions or incentives other than the remission of indirect taxes." This provision was also not carried over in Article 9.1 of the Agreement on Agriculture. Nonetheless, as Brazil has already noted, panels and the Appellate Body have ruled that export performance-related taxation concessions or incentives like the United States' FSC and ETI measures are subject to the general export subsidy disciplines of the Agreement on Agriculture, including Article 10.1.

44. Brazil assumes that the United States simply overlooked paragraph 20(g) of the DeZeeuw framework agreement and item (g) from Chairman Dunkel's illustrative list when it states, in paragraph 143 of its Rebuttal Submission, that

[48] G/AG/NG/S/13 (26 June 2000), para. 44 ("[A]s matters currently stand the only rules and disciplines on agricultural export credits are those of the Agreement on Agriculture but only to the extent that such measures constitute export subsidies for the purposes of the Agreement on Agriculture.").

[49] Rebuttal Submission of the United States, paras. 136-138.

[50] *See* Exhibit US-25.

[51] Exhibit US-27.

[52] Paragraph 48(a) corresponds to Article 9.1(a), paragraph 48(e) to Article 9.1(e), paragraph 48(f) to Article 9.1(d), paragraph 48(j) to Article 9.1(f), paragraph 48(k) to Article 9.1(c).

> the negotiating history reveals that the Members very early specifically included export credits and export credit guarantees as a subject for negotiation and specifically elected *not* to include such practices among export subsidies. In contrast, the negotiating history reveals no comparable discussion involving FSC.

45. In light of these facts, it is evident that the negotiating history of Article 9.1 does not offer support for the United States' argument that export credit guarantees are exempt from the general export subsidy disciplines of the Agreement on Agriculture.

46. *Second*, the United States argues that changes introduced to the text of Article 10.2 between the Draft Final Act and the final version of the Agreement on Agriculture mean that export credits are not subject to the export subsidy disciplines included in the Agreement.[53]

47. The version of Article 10.2 included by negotiators in the Draft Final Act read as follows:

> Participants undertake not to provide export credits, export credit guarantees or insurance programmes otherwise than in conformity with internationally agreed disciplines.

The United States argues that this version of Article 10.2 "would clearly prohibit the use of export credit guarantees except in conformity with [internationally] agreed disciplines," which it asserts "would include those contemplated by the SCM Agreement."[54]

48. The version of Article 10.2 included in the Agreement on Agriculture reads as follows:

> Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

The United States argues that having changed the draft, "[t]he Members clearly subsequently decided *not* to condition the use of export credit guarantees on conformity with the export subsidy disciplines of the Agreement on Agriculture or the SCM Agreement."[55]

49. The United States' interpretation of the negotiating history requires the Panel to accept that the version of Article 10.2 included in the Draft Final Act would have imposed a *greater burden* on Members than does the version of Article 10.2 ultimately included in the Agreement on Agriculture. In fact, however, Article 10.2 of the Draft Final Act was amended to make it clear that negotiators expected Members actually *to pursue* negotiations on specific disciplines. Whereas the version of Article 10.2 included in the Draft Final Act did not include an undertaking to pursue those negotiations, the final version of Article 10.2 does include such an undertaking. The amendment did not *relieve* the Members of any burden, but instead *increased* the burden.

50. At least some Members understood this to be the case, since soon after the conclusion of the Uruguay Round, they launched negotiations in the OECD on specific export credit disciplines.[56] The

[53] Rebuttal Submission of the United States, paras. 140-142.
[54] Rebuttal Submission of the United States, para. 140.
[55] Rebuttal Submission of the United States, para. 141.
[56] The United States' assertion that the phrase "internationally agreed disciplines" in Article 10.2 of the Draft Final Act referred to those disciplines "contemplated by the SCM Agreement of the Draft Final Act" is not credible. Where negotiators meant to refer to pending WTO agreements outside of the draft Agreement on

United States implies that Brazil's "admission" that those negotiations have not yet resulted in agreement on specific disciplines for export credits is fatal to its claims. Brazil has demonstrated elsewhere, however, that while those negotiations are pending, nothing in Article 10.2 (or Article 1(e)) exempts export credits from the general disciplines on export subsidies included in, for example, Article 10.1 of the Agreement on Agriculture. If export credits constitute export subsidies, they are subject to those disciplines. As noted above, the Appellate Body has concluded that to exempt particular categories of measures from general obligations such as Article 10.1, the exemption must be explicit.[57] The negotiators knew how to make exemptions explicit, but did not do so in the case of export credits.[58]

51. *Third*, the United States argues that "Brazil's interpretation would require export credit guarantees in agriculture to be subject to more disciplines than any other practice addressed in the Agreement on Agriculture," since "not only would export credit guarantees constitute export subsidies and be subject to all of the export subsidy disciplines, but Member's [sic] would also be specifically obligated to work toward and then apply *additional* disciplines."[59] This statement is incorrect for several reasons:

- As clarified by Brazil, New Zealand and the European Communities, since export credits are not included in Article 9.1, they do not necessarily "constitute export subsidies."[60] They only constitute export subsidies if they are financial contributions that confer benefits and are contingent on export, or if they satisfy the elements of one of the items on the Illustrative List of Export Subsidies annexed to the SCM Agreement.

- Export credits are only "subject to all of the export subsidy disciplines" of the Agreement on Agriculture if they lead to circumvention of a Member's export subsidy reduction commitments.

- It is not clear that any specific disciplines resulting from negotiations undertaken pursuant to Article 10.2 will be "additional" to those already included in the Agreement on Agriculture or the SCM Agreement. Those negotiations are not yet completed. Depending on the agreement negotiated, it is presumably possible that the resulting text could replace the disciplines included in the Agreement on Agriculture.

52. Therefore, the United States' argument is inaccurate, and does not support its assertion that export credit guarantees are exempt from the general export subsidy disciplines in the Agreement on Agriculture, even if they meet the definition of "export subsidy."

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Agriculture, they cited those WTO agreements by name. For example, Article 5.8 of the Draft Final Act (regarding special agricultural safeguards) refers specifically to the GATT and the Safeguards Agreement. Similarly, the final version of Article 13 of the Agreement on Agriculture includes numerous specific citations to the SCM Agreement.

[57] Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128. *See* discussion at paragraphs 107-108 of the Oral Statement of Brazil.

[58] *See, e.g.*, Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.

[59] Rebuttal Submission of the United States, para. 142.

[60] *See e.g.*: Brazil's 22 August Comment, para. 97, New Zealand's Answer to Third Party Question 35, EC's Answers to Third Party Questions 35, para. 70.

**Paragraphs 147-152**

53. The United States argues that it did not include the quantities exported under the CCC programmes in its calculation of average export subsidies during 1986-1990 (the base period from which export subsidy reduction commitments were calculated during the Uruguay Round)[61] because it did not consider that CCC export credit guarantees are export subsidies subject to reduction commitments.[62] According to the United States, subjecting export credit guarantee programmes to export subsidy reduction commitments in the Agreement on Agriculture would therefore lead to "gross injustice."[63]

54. This is not the logical conclusion to be drawn, however. It appears that during the Uruguay Round negotiations the United States took the same position as it has taken in this dispute – that CCC export credit guarantee programmes do not constitute export subsidies within the meaning of item (j) and Articles 1.1 and 3.1(a) of the SCM Agreement and that CCC export credit guarantees are, therefore, not subject to the general export subsidy disciplines included in the Agreement on Agriculture.[64] The United States did not feel compelled to include the CCC export credit guarantees in its calculation of export subsidy reduction commitments because it did not consider that they constituted export subsidies under those provisions. Brazil agrees that not all export credit guarantees are export subsidies and that, therefore, not all export credit guarantees are subject to export subsidy reduction commitments. However, if those guarantees meet the criteria of item (j) or constitute subsidies contingent upon export performance under Articles 1.1 and 3.1(a) of the SCM Agreement, they are export subsidies.[65] (Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes are export subsidies. It follows that GSM 102, GSM 103 and SCGP are subject to reduction commitments and, in fact, circumvent or threaten to circumvent the US export subsidy commitments.)

**Paragraphs 156-157, 160-162 and Exhibits US-31 and US-32**

55. The United States argues that it would not give an accurate picture to compare the reestimates made in any given year (and recorded in the US budget) with the cohort-specific subsidy estimates for guarantees disbursed in that year. Specifically, the United States argues that "upward reestimates and downward reestimates reflected in a single budget cannot necessarily be applied against each other for a notional 'net reestimate.'"[66] Brazil has never argued otherwise. In the chart included in paragraph 115 of its 22 August Rebuttal Submission, Brazil compares *cohort-specific* original subsidy estimates to *cohort-specific* reestimates, cumulated over the period 1992-2002, to give a picture of the long-term operating costs and losses of the "programmes," as required by item (j) (rather than costs and losses for a particular cohort). The United States itself uses this same method (albeit with different data) in paragraph 161 of its 22 August Rebuttal Submission.

56. With respect to FCRA-related data, it would in fact only be inappropriate to attempt to tie a cohort-specific subsidy estimate for one year to fiscal year, non-cohort-specific reestimates recorded in the budget for any one year. Brazil has never made this comparison. As the United States notes,

[61] Rebuttal Submission of the Untied States, para. 148.
[62] Rebuttal Submission of the United States, para. 149.
[63] Rebuttal Submission of the United States, paras. 147-153, *see* the heading to that section.
[64] Rebuttal Submission of the United States, para. 151. The arguments of the United States in this case demonstrate that it continues to be of the view that its programmes do not constitute export subsidies within the meaning of Articles 1.1 and 3.1(a), including item (j) of the SCM Agreement, nor within the meaning of Articles 1(e), 10.1 and 8 of the Agreement on Agriculture.
[65] Brazil's 22 August Comment on Question 80, para. 98. *See* also EC's 11 August Answer to Third Party Question 30, para. 65. New Zealand's 11 August Answer to Third Party Question 35.
[66] Rebuttal Submission of the United States, para. 160.

this would be inappropriate because reestimates recorded in the budget as made in a year do not necessarily relate to subsidy estimates for guarantees disbursed in that year. If the data is presented cumulatively over a period constituting the long term, however, and does not purport to *tie* cohort-specific subsidy estimates to fiscal year, non-cohort-specific reestimates recorded in the budget for any one year, a comparison is perfectly acceptable. Specifically, comparing the cumulative subsidy estimates to the cumulative reestimates shows whether the "programme" is loss-making or profit-generating over the long term. Making a comparison of the cumulative figures does not require that the estimates and reestimates recorded in the budget for any year correspond.

57. For example, this approach can be applied to the data included in Exhibit US-31 to the United States' 22 August Rebuttal Submission. The "subsidy" column included in Exhibit US-31 lists the subsidy estimate from the "prior year" column of the US budget for each cohort during the period 1992-2003. Subtracting cumulative annual downward reestimates from and adding cumulative annual upward reestimates to the cumulative original subsidy amount *yields a positive subsidy of $500 million*.[67] Adding administrative expenses over the period 1992-2003 increases this amount by a further $43 million.[68] Taking the data provided by the United States in Exhibit US-31 at face value demonstrates that the CCC guarantee programmes are losing money. This result is not tainted by the "apples-to-oranges" criticism levied in paragraph 160 of the United States' 22 August Rebuttal Submission.

58. Nor does Brazil's treatment of the data included in the chart at paragraph 165 of its 11 August Answers to Questions suffer from an "apples-to-oranges comparison" between fiscal year and cohort-specific data, as the United States alleges at paragraph 160 of its 22 August Rebuttal Submission. The chart at paragraph 165 is wholly unrelated to the FCRA cost formula. It tracks the results of a formula Brazil has constructed to verify, by alternative means, that long-term operating costs and losses for the CCC export guarantee programmes outpace premiums collected. The data in that chart are not FCRA-related subsidy estimates that are recorded on a cohort basis or that are subject to reestimates mandated by the FCRA. Instead, the left-hand column of that chart records revenue collected on a fiscal year (not a cohort-specific) basis, and the right-hand column of that chart records costs incurred on a fiscal year (not a cohort-specific) basis. Over the period 1993-2002, total revenue in the left-hand column is significantly less than total costs in the right-hand column. This entails no "apples-to-oranges comparison," and demonstrates that the CCC export guarantee programmes constitute export subsidies under item (j) of the Illustrative List of Export Subsidies.

59. In the chart included at paragraph 161 of its 22 August Rebuttal Submission, the United States nets cumulative reestimates on a cohort basis against the original, cohort-specific subsidy estimate from the US budget. There are some factual problems with the US data.[69]

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[67] (2,737 – 297) – (2,629 + 870) + (1,262 + 297) = 500. Since no reestimates have yet been made for 2004, Brazil has reduced the original subsidy amount included in Exhibit US-31 by the $297 million estimate included in the 2004 budget. Had the United States subtracted downward reestimates from and added upward reestimates to the *original* subsidy estimate included in the "budget year" column of the "guaranteed loan subsidy" line of the annual US budget, it would have yielded a positive subsidy, and thus a loss, of $2.038 billion. *See* Exhibit Bra-192.

[68] *See* paragraph 132 of Brazil's 22 July Statement at the First Panel Meeting, and accompanying citations.

[69] First, the United States has offered no documentation verifying the accuracy of the reestimate figures provided in the chart for the period 1993-2000. In contrast, the chart included in paragraph 115 of Brazil's 22 August Rebuttal Submission provides cumulative reestimates on a cohort basis that are taken directly from Table 8 of the Federal Credit Supplement included with the 2004 US budget. *See* Exhibit Bra-182. Second, although the United States asserts that it has netted cumulative reestimates against the "*original* subsidy estimate," it has in fact netted cumulative reestimates against the "guaranteed loan subsidy" figure included in the "*prior year*" column of the US budget, which yields a lower number. Using, subsidy data from the US budget for "prior year," the chart included at paragraph 115 of Brazil's 22 August Rebuttal Submission would

Resolving these problems is not particularly important, however, since the chart included at paragraph 161 of the United States' 22 August Rebuttal Submission itself shows a cumulative positive subsidy for the programmes of over $381 million for the period 1992-2002.[70] This positive subsidy is consistent with CCC's 2002 financial statements, which provide a cumulative, running tally of the subsidy figure for all post-1991 CCC export credit guarantees in the amount of $411 million.[71] The CCC export guarantee programmes have lost money over the period 1992-2002.

60. The United States' point seems to be that because subsidy reestimates are generally downward, the CCC programmes generate profits over the long term. However, all this means is that CCC's original estimates were too high.[72] The real test is the result when cohort-specific reestimates are netted against the original subsidy estimates for each cohort and cumulated over a period constituting the long term, so that the long-term costs and losses of the programmes can be determined, as required by item (j). Netting reestimates against original subsidy estimates on a cohort-specific basis yields a positive subsidy, revealing that over the long term, the CCC is losing money with its export guarantee programmes. This result is obtained whether the Panel accepts the chart at paragraph 161 of the United States' 22 August Rebuttal Submission, the chart at paragraph 115 of Brazil's 22 August Rebuttal Submission,[73] or the cumulative subsidy figure included in CCC's 2002 financial statements.[74]

61. The United States may be suggesting that reestimates will always, eventually, result in negative subsidies and profits. The data shows that this is not the case, however. Netting reestimates against original subsidy estimates does not consistently yield a negative subsidy, or profits, on a cohort basis. The charts included at paragraph 161 of the United States' 22 August Rebuttal Submission and at paragraph 115 of Brazil's 22 August Rebuttal Submission demonstrate this. Nor is it even relevant to focus on the results of individual cohorts, since item (j) require an analysis of the "long-term" costs and losses of export guarantee "programmes," rather than cohorts. That is why Brazil, and presumably the United States, has calculated cumulative results for the charts included at

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still yield a positive subsidy of $211 million, to which the $43 million in administrative expenses should be added, for a total loss of $254 million over the period 1992-2002. *See* Exhibit Bra-193. Third, the United States has not included administrative expenses for the CCC export guarantee programmes, which amount to $43 million for the period 1992-2003.

[70] Even accepting the validity of the data entered in the US chart, Brazil notes that summing up those figures yields a result different from the $381.35 million total provided by the United States. Using the US data, Brazil reaches a subsidy figure net of reestimates of $230,127,023.

[71] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

[72] Brazil notes that according to USDA's Inspector General, CCC estimates are in fact *understated*. In audit reports for fiscal years 1999, 2000 and 2001, CCC's estimates and reestimates were found to have "understated" costs and losses by amounts ranging from to $11 million to $430 million. Exhibit Bra-194 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC, February 2002, p. 11); Exhibit Bra-195 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, Audit Report No. 06401-14-FM, Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, June 2001, p. 9); Exhibit Bra-196 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, US Department of Agriculture Consolidated Financial Statements for Fiscal Year 1999, Report No. 50401-35-FM, February 2000, p. 9).

[73] Again, using "prior year" subsidy figures for this chart results in a positive subsidy of $211 million over the period 1992-2002. *See* Exhibit Bra-193 (Net Lifetime Reestimates of Guaranteed Loan Subsidy by Cohort)

[74] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

paragraph 161 of the United States' 22 August Rebuttal Submission and at paragraph 115 of Brazil's 22 August Rebuttal Submission.

62. In any event, if CCC considered that it would eventually make money on its guarantees on a cohort basis, why does it continue to offer original estimates that are so high? While some factors included in the estimation process are dictated by the FCRA and the US Office of Management and Budget, the original subsidy estimate is primarily driven by CCC's historical experience with its guarantees. Brazil has elsewhere noted that according to the US Federal Accounting Standards Advisory Board, the Government-Wide Audited Financial Statements Task Force on Credit Reform, the Office of Management and Budget and the Department of Agriculture itself, "[m]ethods of estimating future cash flows for existing credit programmes need to take account of past experience,"[75] "[a]ctual historical experience of the performance of a risk category is a *primary factor* upon which an estimation of default cost is based,"[76] and technical assumptions underlying subsidy calculations reflect "historical cash reports and loan performance."[77] If historical experience dictated that CCC would consistently make profits, CCC would reflect that historical experience in its subsidy estimates. Actual historical experience is, after all, a "primary factor" on which those estimates are based. That CCC continues to provide significant positive original subsidy estimates demonstrates that its actual historical experience does *not* suggest that it will make money on its loan guarantees. Since those estimates are calculated and recorded on a *net present value basis*, CCC apparently continues to consider that it will incur significant net costs at the time the cohorts are closed.

63. CCC's apparent views regarding its historical experience with the export guarantee programmes are justified. Evidence regarding CCC's actual historical experience confirms that the long-term operating costs and losses for the CCC guarantee programmes outpace premiums collected. At paragraph 109 of its 22 August Rebuttal Submission, Brazil summarizes this evidence.[78] Although, the United States implies at paragraph 172 of its 22 August Rebuttal Submission that Brazil's evidence is all "between 10 and 20 years" old, a cursory review of the evidence, which includes data from the 2004 US budget and CCC's 2002 financial statements proves otherwise. Therefore, even if the Panel agrees with the United States' conclusion, at paragraph 162 of its 22 August Rebuttal Submission, that the FCRA cost formula is not an ideal way to determine the costs of the CCC export guarantee programmes, Brazil has established by alternative means that CCC premiums fail to meet the long-term operating costs and losses of the programmes.

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[75] Exhibit Bra-162 (Government-Wide Audited Financial Statements Task Force on Credit Reform, ISSUE PAPER, *Model Credit Programme methods and Documentation for Estimating Subsidy Rates and the Model Information Store*, 96-CR-7 (1 May 1996), p. 2).

[76] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36)). *See also* Exhibit Bra-160 (US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2003), p. 120 ("In estimating default costs, the following risk factors are considered: (1) loan performance experience; . . .")).

[77] Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002, p. 9).

[78] Contrary to the United States' assertion at paragraph 170 of its Rebuttal Submission, Brazil has not misread Note 5 to CCC's 2002 financial statements. The amounts in the "subsidy allowance" column are in fact the amounts of receivables associated with post-1991 CCC guarantees that CCC considers uncollectible. The Panel will recall that under the FCRA, the subsidy allowance is recorded on a net present value basis, which means that it represents the cost CCC considers it will incur on a guarantee cohort at the time that cohorts is closed. The $770 million listed in the "subsidy allowance" column in the receivables table for post-1991 guarantees is therefore as uncollectible as the $ 2,567 billion listed in the "uncollectible" column of the pre-1992 CCC guarantee receivables table (*See* Notes to Financial Statements contained in Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2002, Audit Report N° 06401-15-FM (December 2002) p. 14).

**Paragraph 169 and Exhibit US-33**

64. The United States has asserted that there are no "arrearages" with respect to debt reschedulings.[79] Brazil has two comments. First, the United States does not state the source of the data it included at Exhibit US-33. Second, Brazil maintains that it is not appropriate to treat rescheduled debt as recoveries.[80] The US assumption that there will be no arrearages not only ignores the cost of rescheduling but also the fact that there may be further defaults on rescheduled debt.[81] Although rescheduled debt is treated as a receivable, CCC acknowledges in its financial statements that not all receivables are deemed collectible.[82] Moreover, Brazil presumes that rescheduled debt is subject to the FCRA estimation or reestimation process, which involves calculations of net present value of what the CCC expects to lose (or gain) on the rescheduled debt. The CCC does not assume that all rescheduled debt will be collected.

**Paragraphs 172, 174-175**

65. The United States has argued that Brazil improperly relies on CCC losses incurred *via* Iraqi and Polish defaults. The United States implies that these defaults occurred between 10 and 20 years ago.[83] This is incorrect. The US General Accounting Office ("GAO") reports that the losses in Iraq occurred over the period 1990-1997.[84] (The United States makes no specific challenge to the $2 billion in Polish defaults.) Thus, defaults and losses did not occur as long ago as the United States suggests.

66. Moreover, the United States argues that the Panel should only look into the question whether "*current*" premium rates are adequate to cover the long-term operating costs and losses of the programmes.[85] The United States relies on a "present tense" argument to exclude major defaults in Iraq and Poland that occurred in the recent past. Even if the Panel only looks to "current" premiums, item (j) calls for an analysis of "long-term" operating costs and losses.[86] The United States apparently agrees, since it looks to the performance of the CCC programmes in such years as 1994 and 1995 (a time period even longer ago than part of the defaults in Iraq[87]) to claim that premium rates charged were adequate to meet costs,[88]

67. If the United States believes that it is only appropriate to look at *current* premiums, given the present tense of the term "are" in item (j), then the FCRA cost formula is useful. The FCRA cost formula measures the *net present value* "of the following cash flows: (i) payments by the Government

[79] Rebuttal Submission of the United States, para 169.
[80] Oral Statement of Brazil, para. 122.
[81] Oral Statement of Brazil, para. 122. Brazil's 11 August Answer to Question 77, para. 162.
[82] *See* Brazil's 22 August Comments, para. 99. Exhibit Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14).
[83] Rebuttal Submission of the United States, para. 172.
[84] Bra-157 (US General Accounting Office, REPORT TO THE CHAIRMAN, TASK FORCE ON URGENT FISCAL ISSUES, COMMITTEE ON THE BUDGET, HOUSE OF REPRESENTATIVES, *International Trade: Iraq's Participation in US Agricultural Export Programmes*, GAO/NSIAD-91-76 (November 1990), p. 27 (Table IV.2)).
[85] Rebuttal Submission of the United States, para. 174.
[86] The United States has elsewhere endorsed a 10-year period (First Submission of the United States, para. 173; Rebuttal Submission of the Untied States, para. 161).
[87] *Compare* Rebuttal Submission of the United States, para. 172 and 175.
[88] Rebuttal Submission of the United States, para. 175.

. . . and (ii) payments to the Government" of guarantees at the time they are disbursed.[89] In other words, it measures the amount CCC expects today to lose (or gain) on a guarantee cohort at the time the cohort is closed tomorrow. Even if this involves some estimates, the United States has noted that those estimates are acceptable.[90] In fact, the US budget for fiscal year 2004 demonstrates that current premiums paid for guarantees disbursed in fiscal years 2002-2004 will generate losses worth hundreds of million of dollars.[91] Thus, current premiums are inadequate to cover the long-term operating costs and losses of the CCC export credit guarantee programmes. These programmes constitute export subsidies.

**Paragraphs 186-191 and Exhibits US-34 through US-37**

68. Brazil has argued that since CCC export credit guarantees from the GSM 102, GSM 103 and SCGP programmes are unique financial instruments for agricultural commodity transactions that are not available on the commercial market – certainly not for terms longer than the marketing cycles of the eligible commodities – they confer "benefits" within the meaning of Article 1.1(b) of the SCM Agreement.[92] The United States asserts that "financing is available in the marketplace that is analogous to the export credit guarantee programmes" – namely, forfaiting.[93]

69. The United States' assertion should be rejected. As discussed below, the two instruments are not "analogous," and are, in fact, different.

70. Brazil begins with a very rough sketch of the role a forfait can play in a typical transaction involving agricultural commodities. In a typical transaction, an importer will issue a promissory note to an exporter for the agreed price. The exporter will generally demand that the note be backed by a guarantee (or an aval) from the importer's bank and/or, as the United States points out in paragraph 187 of its 22 August Rebuttal Submission, by a guarantee from the importer's government export credit agency.

71. A forfait comes into play because, while both the exporter and the importer want the transaction to occur, they have different interests. The exporter wants to get paid immediately on a cash basis, and the importer wants credit that it can repay on a deferred basis. Even with a guarantee from the importer's bank or a government export credit agency, the exporter bears responsibility for collecting the receivables (in the absence of default). A forfaiter (which could be the exporter's own bank) will step in and purchase the promissory note at a discount to face value, without recourse to the exporter.[94] The exporter will receive payment immediately from the forfaiter. The forfait essentially enables the exporter to convert a credit sale into a cash sale.

72. A forfaiter will generally demand that the importer's obligation is backed by a guarantee from a bank or the importer's government export credit agency.[95] Rather than *substituting* for a guarantee,

[89] Exhibit Bra-117 (2 U.S.C. 661a(5)(C)).

[90] Rebuttal Submission of the United States, para. 171.

[91] *See* chart at paragraph 161 of the Rebuttal Submission of the United States. *See* also Exhibit Bra-127 (US budget for FY 2004, p. 107) referencing guaranteed loan subsidy amounts of $97 million, $294 million and $297 million respectively. Brazil notes that the figure for FY 2002 has been reestimated to $137,008,586 since the publication of the FY 2004 budget (*See* Rebuttal Submission of the United States, chart at para. 161).

[92] First Submission Brazil, para. 289; Oral Statement of Brazil, para. 116; Brazil 11 August Comment and Answer to Questions 71(a) (para. 139), 75 (para. 156); Rebuttal Submission of Brazil, para. 103.

[93] Rebuttal Submission of the United States, para. 186.

[94] *See* Exhibit Bra-197 (http://www.nedcor.co.uk/forfait-website/forfaiting.htm).

[95] United Rebuttal Submission of the United States, para. 187. *See also* Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 258 (Spring 2001) ("In most cases, the forfaiter requires the obligation of the importer to be guaranteed by a bank in the importer's country because of the impossibility of evaluating the credit risk of every importer in

therefore, guarantees and forfaiting are *complementary* instruments. For this reason alone, the US assertion that the two instruments are analogous is incorrect.

73. There are other differences between the two instruments. The importer realizes a tangible and extremely valuable benefit from a CCC guarantee; namely, the bank prices financing to the importer based on the credit rating of the United States, rather than the credit rating of the importer itself. Importantly, the CCC guarantee allows the importer to secure financing in the first place. As the regulations for the GSM and SCGP programmes state, the programmes operate in cases where banks "would be unwilling to provide financing without CCC's guarantee."[96] Forfaiting helps an exporter accept deferred payment terms for the importer, but does not otherwise beneficially affect the price for the financing secured by the importer. Nor would a bank require that forfaiting be involved in a transaction as a prerequisite for it to provide financing to the importer.

74. As a further distinction between the two instruments, while there is a secondary forfaiting market,[97] there is no secondary market for CCC guarantees.[98] Purchasers in the secondary market for forfaiting instruments assume that forfaited promissory notes will yield more at maturity than the purchaser paid for them in the secondary market.[99] Since no secondary market exists for CCC guarantees, apparently no such assumption can be made with respect to CCC guarantees (which itself reveals much about the quality of those guarantees).

75. Most importantly, the pricing for forfaiting instruments is substantially different than pricing for CCC guarantees. As noted above, a forfaiter purchases an exporter's trade receivables at a discount to face value. The discount rate and associated commitment fees are driven by the risks involved – country risk, political risk, currency risk, entity risk (essentially, the risk of the guarantor), etc., and by the length of the underlying credit.[100]

76. Brazil has attached as Exhibit Bra-199 a list of indicative forfaiting rates that vary greatly from market to market.[101] In contrast, the United States has confirmed that country risk "has no impact on the premiums payable" under the GSM 102, GSM 103 and SCGP programmes.[102] Brazil provided the Panel with evidence documenting that GSM and SCGP fees were the same whether guarantees were for transactions with the Dominican Republic, Ghana, Japan, South Korea or Vietnam (among others).[103]

77. Moreover, the *very lowest rate* in the forfaiting rate list included in Exhibit Bra-199 is 1.6638 per cent (6-month tenor). The rates for GSM 102 and GSM 103 guarantees are prohibited by law from being greater than 1 per cent,[104] and are currently (as they have been at least since 1994)[105]

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every country, particularly when medium or small sized companies are involved."). *See also Id*., p. 259 ("[I]f a bank guarantee is required, it must be unconditional, irrevocable and freely transferable.").

[96] Exhibit Bra-38 (7 CFR 1493.10(a)(2); 7 CFR 1493.400(a)(2)). *See* Brazil 11 August Response to Question 82(a) (paras. 183-184).

[97] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 251-252 (Spring 2001)).

[98] *See* US 11 August Answer to Question 86 (para. 184).

[99] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 251-252 (Spring 2001)).

[100] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 256 (Spring 2001)).

[101] Exhibit Bra-199 (Trade and Forfaiting Review, "Argentina Trade Finance to the Rescue," Volume 6, Issue 9, July/August 2003)

[102] United States 11 August Response to Question 86 (para. 184).

[103] *See* Brazil 11 August Comments to Questions 84 (para. 192) and 85 (para. 195).

[104] United States 11 August Responses to Question 84 (para. 179).

[105] Brazil 11 August Comment to Question 84 (para. 193).

no greater than 0.663 per cent for GSM 102 (36-month tenor)[106] and 0.05 per cent for GSM 103 (120-month tenor).[107]

78. Furthermore, although the United States' assertion that the tenor of forfaiting instruments can range from six months to 10 years is accurate, forfaiting instruments *for agricultural commodities* will not exceed tenors of 360 days, or in other words will not exceed a tenor "matching the typical period of consumption of most commodities."[108] This is consistent with Brazil's statement that commercial financing for exports of agricultural goods that exceeds the marketing cycles of the agricultural good is not available on the marketplace.[109]

79. Under Article 10.3 of the Agreement on Agriculture, the United States bears the burden of demonstrating that no export subsidies have been granted in respect of quantities of agricultural commodities exported in excess of its reduction commitments.[110] Although it is not its burden to do so, Brazil has demonstrated that CCC export credit guarantees are financial contributions that confer benefits and are contingent on export, within the meaning of Articles 1.1 and 3.1(a) of the SCM Agreement. With respect to "benefit," CCC regulations concerning the GSM and SCGP programmes demonstrate that the programmes grant better-than-market terms *per se*.[111] Brazil has also demonstrated that CCC export credit guarantees confer benefits *per se* since they are unique financial instruments for agricultural commodity transactions that are not available on the commercial market – and certainly not for terms longer than the marketing cycles of the eligible commodities.

80. The United States has not established that forfaiting is analogous to CCC export credit guarantees. Even if it had done so, and the market terms for forfaiting instruments could theoretically serve as a benchmark against which to judge whether CCC export credit guarantees confer "benefits," the United States has not: (i) established the terms on which forfaiting is provided on the market; or, (ii) demonstrated that CCC export credit guarantees do not provide terms better than those provided for forfaiting instruments. The United States acknowledges, at paragraph 191 of its 22 August Rebuttal Submission, that it has not provided market terms for forfaiting instruments that could serve as a benchmark. Thus, the United States has not met its burden under Article 10.3 of the Agreement on Agriculture.

**Brazil's Comment on Question 67a posed by Panel to the United States**

81. While Brazil obviously does not know how the United States will ultimately respond, Brazil offers the following information supporting Brazil's calculations of the amounts provided to these four crops as "support to upland cotton."

82. First, to the extent that the United States criticizes Brazil's calculations made to determine the different per acre payments for direct payment and CCP crops in paragraph 42 of its Rebuttal Submission, Brazil notes that these calculations are confirmed by the Food Agricultural Policy Research Institute at the University of Missouri (FAPRI).[112] As Brazil further notes that the FAPRI

[106] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, "Notice to GSM-102 and GSM-103 Programme Participants," 24 September 2002).

[107] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, "Notice to GSM-102 and GSM-103 Programme Participants," 24 September 2002).

[108] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 254 (Spring 2001)).

[109] Oral Statement of Brazil, para. 116.

[110] *See* First Submission of Brazil, paras. 263-268.

[111] *See* Brazil's 11 August Answer to Question 82, paras. 182-189.

[112] http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf. The information on CCP and direct payment per acre payments in US dollars for each of the programme crops is found in the last two lines of pages 55 (wheat), 57 (rice), 59 (corn), 61 (sorghum), 63 (barley), 65 (oats), 69

baseline itself and FAPRI analysis has often been influential in US policy formation process, including in analysis of the FSRI Act of 2002, for which FAPRI won the USDA's highest honour.[113]

83. Second, FAPRI's 2003 US Baseline is a long-run scenario projecting what would happen to various elements of US agriculture under the 2002 FSRI Act. In this analysis, FAPRI includes all of the different types of support provided by the 2002 FSRI Act into its projections of, *inter alia*, upland cotton planted acreage, production, exports, prices, revenue, costs, etc. In doing so, the FAPRI economists assume that, *inter alia*, upland cotton producers were holding upland cotton base acreage and receiving upland cotton CCP and direct payments.[114] These CCP payments and direct payments are reflected in their analysis of "Gross Market Revenue" to upland cotton producers on page 79 of their report, which constitutes the sum of LDP (marketing loan), CCP revenue, and direct payments.[115]

84. In addition, FAPRI states that "US cotton producers do not benefit from the projected price increases. Higher prices are offset by lower payments from the loan programme and the CCP programme."[116] This reflects the FAPRI economists' assumption that upland cotton producers receive upland cotton direct and CCP payments.

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(soybeans), 75 (peanuts) and 79 (upland cotton). Brazil notes that its figures for soybeans and peanuts differ slightly. The underlying reason for this difference is that Brazil had to base its figures on its estimates about the payments yields and it appears that FAPRI's figures for payment yields are slightly different from Brazil's.

[113] See for example, "Analysis of the grain, oilseed and cotton provision of the, 'Agriculture, Conservation, and Rural Enhancement Act of 2001 – S.1731.'" FAPRI-UMC Report #18-01 November 2001. http://www.fapri.missouri.edu/FAPRI_Publications.htm. Also see http://www.card.iastate.edu/about_card/news/press_releases/Highest_Honor.html

[114] FAPRI's 2003 US Baseline, http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf, p. 78.

[115] FAPRI's 2003 US Baseline, http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf, p. 79.

[116] FAPRI's 2003 US Baseline, http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf, p. 78.

**List of Exhibits**

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|---|---|
| G/AG/AGST/USA | Exhibit Bra- 191 |
| Reestimated Guaranteed Loan Subsidy based on Original Budget Year Estimate. | Exhibit Bra- 192 |
| Net Lifetime Reestimates of Guaranteed Loan Subsidy by Cohort. | Exhibit Bra- 193 |
| US Department of Agriculture Office of Inspector General Great Plains Region Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report N° 06401-4-KC, February 2002 | Exhibit Bra- 194 |
| US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, Audit Report N° 06401-14-FM, Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, June 2001 | Exhibit Bra- 195 |
| US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, US Department of Agriculture Consolidated Financial Statements for Fiscal Year 1999, Report N° 50401-35-FM, February 2000 | Exhibit Bra- 196 |
| http://www.nedcor.co.uk/forfait-website/forfaiting.htm | Exhibit Bra- 197 |
| Vincent Whittaker, "The Quick Buck, International Finance and Forfaiting," 23 *Thomas Jefferson Law Review* (Spring 2001) | Exhibit Bra- 198 |
| Trade and Forfaiting Review, *"Argentina Trade Finance to the Rescue"* Volume 6, Issue 9 July/August 2003 | Exhibit Bra- 199 |

# ANNEX D-4

## COMMENTS OF THE UNITED STATES ON NEW MATERIAL IN BRAZIL'S REBUTTAL FILINGS AND ANSWER OF THE UNITED STATES TO THE ADDITIONAL QUESTION FROM THE PANEL

27 August 2003

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## I. Introduction

1. The United States thanks the Panel for its prompt reply to the US request of 25 August 2003, granting an opportunity to comment on new material in Brazil's rebuttal submission and Brazil's comments on the US responses to questions. We also thank the Panel for its additional question. We present both the US comments on new material in Brazil's submissions and our answer to that additional question below.

2. As the United States notes in these comments and answer, Brazil's Peace Clause argument depends on three issues:

- First, Brazil relies on budgetary outlays that reflect prevailing market prices that could not have been "decided" by the United States. Brazil ignores the fact that "support" does not mean "budgetary outlays"; in fact, Annex 3 recognizes that an "Aggregate Measurement of

Support" for price-based support either shall[117] or can[118] be calculated using a price gap methodology, which does not rely on budgetary outlays.

- Second, Brazil conflates "non-product-specific support" with "support to a specific commodity" by attempting to allocate certain payments to upland cotton. To do so, however, Brazil relies on a reading of the definition of "non-product-specific support" in Article 1(a) that ignores the most relevant context for this term – that is, the (immediately preceding) definition of product-specific support in that same article. Indeed, Brazil's approach would appear to render the concept of "non-product specific support" so narrow that it becomes almost, if not completely, meaningless.

- Third, Brazil mischaracterizes US direct payments and production flexibility contract payments as non-green box support. Brazil has not established that these measures fail to conform to the policy-specific criteria in Annex 2. In fact, Brazil has not even established – pursuant to Brazil's own reading of the first sentence of Annex 2, paragraph 1, as a stand-alone obligation – that these payments have more than "minimal[] trade-distorting effects or effects on production."[119]

3. The weakness of Brazil's interpretation that "support" in the Peace Clause means "budgetary outlays" can be seen in this example. Even if US measures were *exactly* the same in *every year* of the implementation period as they were in the 1992 marketing year (that is, the same deficiency target price, same marketing loan rate, same acreage reduction percentage, same normal flex acres with planting flexibility[120], etc.), under Brazil's interpretation, US measures would have breached the Peace Clause in each and every year in which outlays increased due to external factors, for example, whenever market prices dipped below the 1992 level.

- Would 1999-2002 US measures *identical in every respect* to those in 1992 "grant support in excess of that decided during the 1992 marketing year"?

- In other words, if a Member had decided its support during 1992 for the period through 2004 and never changed its decision, could the Member be deemed to grant support in excess of the

[117] In the case of market price support. In fact, Annex 3, paragraph 8, states: "Budgetary outlays made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS."

[118] In the case of non-exempt direct payments dependent on a price gap. *See* Agreement on Agriculture, Annex 3, paragraph 10.

[119] Of course, the US view is that the "fundamental requirement" of the first sentence is met by a measure that conforms to the basic criteria and any applicable policy-specific criteria. In this regard, Brazil errs in claiming that the United States has "acknowledged that such effects can be presumed if the specific criteria in paragraph 6 of Annex 2 are not complied with." Brazil's Rebuttal Submission, para. 8 fn. 13. In fact, we believe the opposite. Meeting the basic and policy-specific criteria of Annex 2 establishes that a measure meets the "fundamental requirement" of paragraph 1. However, the converse is not necessarily true. So, according to Brazil's approach, Brazil would bear the burden of establishing that a measure that did not comply with the basic and policy-specific criteria in Annex 2 failed to meet the "fundamental requirement" of paragraph 1 of Annex 2.

[120] Recall that "under 1992 programme provisions, producers of non-cotton programme crops (i.e., wheat, corn, barley, grain sorghum, oats, and rice) could plant up to 25 per cent of their [non-cotton] crop programme base to cotton as Normal Flex Acres or Optional Flex Acres. Acreage Reduction Programme compliance reports indicate that, in 1992, 447,164 acres of cotton were planted on a much larger quantity of available Normal Flex Acres and Option Flex Acres of non-cotton programme base.") Exhibit US-24 (Report by Dr. Joseph Glauber, Deputy Chief Economist, US Department of Agriculture). In 1992, there were 153.9 million acres of non-cotton "complying base" and 197.2 million acres of non-cotton "effective base." *See* Exhibit US-39. Thus, the marketing loan was effectively available with respect to all upland cotton production.

> level decided during 1992 just because outlays increased, for example, because market prices changed?[121]

We believe the answer must be "No" because market prices are not "decided" by a Member (as paragraphs 8 and 10 of Annex 3 recognize). And yet, the situation in this dispute is analogous: the United States has changed its measures to *reduce* the product-specific level of support (by eliminating deficiency payments) since 1992, and yet Brazil claims that the Peace Clause has been breached simply because lower market prices resulted in increased price-based outlays.

4. Market prices are beyond the control of the United States, and therefore the United States cannot "decide" them. Removing the effect of market prices beyond the control of the United States from the measure of support demonstrates that US measures do not and did not grant support in excess of that decided during the 1992 marketing year. In fact, whether gauged (as the United States believes is compelled by the Peace Clause) via the rate of support expressed by US measures[122], *or* via the AMS for upland cotton (calculated through a price gap methodology), *or* via the erroneous calculations of Brazil's expert (but limited to product-specific support), the result is exactly the same: in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

## II. Brazil's AMS Calculation Is Flawed and, Had It Consistently Reflected a Price Gap Calculation, Would Demonstrate No Peace Clause Breach

5. We recall that Brazil has argued that budgetary outlays are the only measurement of "support" for purposes of the Peace Clause proviso comparison, without any foundation in the Peace Clause text and despite the context provided by Annex 3, which explicitly indicates that Members have agreed "support" *can* be measured without using budgetary outlays. Brazil itself concedes that US measures do not decide support on the basis of budgetary outlays:

> Brazil acknowledges that *the United States could not possibl[y] determine its expenditures* as they would depend to a certain extent on *market prices* that were also influenced by factors *outside the control of the US Government*.[123]

The United States agrees with this statement by Brazil and believes that this statement demonstrates that Brazil's approach to the Peace Clause comparison is not based on the text nor is it realistic. Instead, in order to hope to succeed, Brazil's claims *require* Brazil to use budgetary outlays and so to take into account low prevailing market prices. An Aggregate Measurement of Support calculation using a price gap methodology – that is, that eliminates the effect of market prices and reflects instead the eligible production and applied administered price decided by a Member – reveals that in no year from 1999-2002 have US measures breached the Peace Clause.

6. Brazil has argued that "there are only two types of methodologies that would allow an expression in monetary terms of a decision (or decisions) taken by the United States in MY 1992 regarding its level of support to upland cotton. The first is budgetary expenditures. The second is the calculation of AMS for a particular commodity."[124] In both its table of expenditures[125] and its AMS

[121] Other factors beyond a Member's control could also influence outlays, such as whether some additional producers chose to begin participating in the support programmes.

[122] Even taking into account the maximum theoretical effect on the deficiency payment effective price of the 1992 acreage reduction percentage (10 per cent) and normal flex acres (15 per cent) for the 1992 marketing year. Since the acreage reduction percentage was lower for 1993 marketing year (7.5 per cent versus 10 per cent) support, which was also decided during the 1992 marketing year, the adjusted level of support (68.27625 cents per pound) was even higher for the 1993 marketing year.

[123] Brazil's Comments on US Answers, para. 66 fn. 49.

[124] Brazil's Rebuttal Submission, para. 71.

table[126], Brazil has attempted to allocate non-product-specific support to a specific commodity. There is no basis in Annex 3 to do so. Annex 3, paragraph 1, explicitly requires an AMS to be calculated "on a product-specific basis for each basic agricultural product" and separately requires that non-product-specific support be calculated and "totalled into one non-product-specific AMS in total monetary terms." The point bears emphasis: "for each basic agricultural product," Annex 3 states that an AMS "shall be calculated on a product-specific basis." Similarly, were "support to a specific commodity" (upland cotton) to be calculated using an Aggregate Measurement of Support, it *must* be calculated "on a product-specific basis."

7. As a result, both Brazil's expenditure table and its AMS table run counter to the terms of Annex 3. Were the Panel to calculate an AMS for upland cotton for marketing years 1992 and 1999-2002, the United States has set forth a calculation consistent with Annex 3 in its rebuttal submission.[127] By using a price-gap methodology for both deficiency payments and marketing loan payments[128], the upland cotton AMS in 1992 is far higher than in any marketing year from 1999 to 2002, reflecting the US decision to move away from the high support levels of product-specific deficiency payments.

8. In fact, we note that the AMS data presented in paragraph 115 of the US rebuttal submission understates the AMS for marketing year 1992. For example, the United States reduced the price gap calculation for 1992 basic deficiency payments by an adjustment factor (approximately .875) to replicate the calculation used in G/AG/AGST/USA, p. 18. Without the adjustment, which is not called for by paragraphs 10 and 11 of Annex 3, the 1992 deficiency payment calculation would have been $858 million, rather than $755 million as reported in paragraph 115.[129] (In case of interest, we also present below the deficiency payment calculation in more detail, reflecting more accurate data, which would increase the deficiency payment calculation slightly, to $867 million.)[130] This

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[125] Brazil's Rebuttal Submission, para. 73.

[126] Brazil's Rebuttal Submission, para. 76.

[127] US Rebuttal Submission, paras. 114-118.

[128] Brazil has stated (with respect to deficiency payments) that "the formula approach under Annex 3, paragraphs 10-11 of the Agreement on Agriculture [is] warranted for upland cotton AMS calculations." Brazil's Rebuttal Submission, para. 73 fn. 172. Because the Peace Clause proviso comparison must compare the support that challenged measures grant to "that decided during the 1992 marketing year," the price gap methodology is the only AMS approach that reflects only the United States' decisions and not market prices beyond the United States' control. For the same reason, it is equally appropriate to use the price gap methodology for marketing loan payments.

[129] Total deficiency payments calculated via the price gap methodology equal unadjusted basic deficiency payments ($724 million / 0.875) + 50/92 deficiency payments ($30 million) – that is, $858 million. *See* US Rebuttal Submission, para. 115 fn. 144.

[130] To calculate the deficiency payment support using the price gap methodology and consistent with the 1995 US WTO notification and G/AG/AGST/USA, we made the following calculations.

Total deficiency payments are equal to basic deficiency payments plus 50/92 payments. Basic deficiency payments are equal to eligible production times a price gap measured as the difference between the target price and a fixed reference price. Eligible production is measured as eligible base acreage times average programme yield. Eligible base acreage is equal to participating base acreage minus Acreage Conservation Reserve acres minus Normal Flex Acres minus acres enrolled in the 50/92 programme. The fixed reference price is the1986-88 average of the higher of the market price or loan rate for each year.

Payments for the 50/92 programme were calculated in a similar fashion by multiplying base acres in the 50/92 programme times the average programme yield times 92 per cent of the price gap.

In 1992, the target price was 72.9 cents per pound and the fixed reference price for 1986-88 was 57.9 cents per pound. This gives a price gap of 15.0 cents per pound. Eligible production for basic deficiency payments in 1992 was equal to 5,544 million pounds (9.226 million acres times the average programme yield of 601 pounds per acre). Multiplying the price gap times eligible production gives basic deficiency payments equal to $832 million.

The same formula is used to calculate deficiency payments under the 50/92 programme. For 1992, the price gap is the same as that calculated for the basic deficiency payments (15 cents per pound). Eligible

calculation, moreover, uses the actual payment acreage (that is, acres planted for harvest or participating in the 50/92 programme on which payment was received) to calculate the "eligible production." Using instead the base acreage minus the 10 per cent acreage reduction figure and the 15 per cent normal flex acres (14.9 million effective base acres[131] *x* .75 = 11.175 million acres) and multiplying by the programme yield (602 pounds per acre), the "quantity of production eligible to receive the administered price"[132] is 6,727 million pounds, yielding a price gap deficiency payment calculation of $1,009 million. Thus, the figure in paragraph 115 of the US rebuttal reflected a conservative approach that understated the support resulting from a price gap calculation.

9. In this regard, the United States notes Brazil's argument with respect to the 1995 Statement of Administrative Action, which explained that Peace Clause protection would apply "unless the AMS for the particular commodity exceeds the level decided in the 1992 marketing year."[133] We agree with Brazil that this reference to "AMS" is "non-textual[]" because the Peace Clause uses the term "support decided" and not "AMS."[134] However, to the extent that the Panel were to examine "the AMS for the particular commodity" – that is, the upland cotton AMS – the United States has demonstrated that in no year from 1999-2002 does that AMS exceed the 1992 level.

## III. The US Level of Support Argument Does Take Into Account All Product-Specific Support That Challenged US Measures Grant

10. Brazil has argued that "the United States '72.9 methodology' does not – and cannot account for cottonseed payments, Step 2 payments, storage payments and interest rate subsidies," which the United States has identified as product-specific support.[135] Brazil then alleges that the US methodology "would sanction the cover-up of hundreds of millions – if not billions – of dollars of expenditures."[136] Over-heated rhetoric aside, Brazil's argument is simply erroneous.

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production under the 50/92 programme was 254 million pounds (404 thousand acres times the average programme yield of 50/92 participants of 628 pounds per acre). Deficiency payments under the 50/92 programme were thus equal to $35 million (0.92 times 254 million times $0.15).

Total deficiency payments under the price gap methodology were thus equal to $867 million ($832 million plus $35 million). *Sources:* US Department of Agriculture, Compliance Report for 1992 Acreage Reduction Programme (1993) (Exhibit US-39); Commodity Credit Corporation Commodity Estimates Book for the FY 1995 President's Budget (February 1994); G/AG/AGST/USA, p. 18.

[131] *See* Exhibit Bra-105, Annex 2 (1st source document: US Department of Agriculture, *Provisions of the Federal Agricultural Improvement and Reform Act of 1996*, at 142) (giving 1992 effective base acreage of 14.9 million acres); *id.*, Annex 2 (2nd source document: Daniel A. Sumner, *Farm Programmes and Related Policy in the United States*, at 4) (same).

[132] Agreement on Agriculture, Annex 3, para. 10.

[133] We also note that Brazil never quotes that passage in full since the first half reflects the US view throughout this dispute that "exempt from actions" means not liable to a legal process or suit. *See* 1995 Statement, at 68 ( "Under Article 13(b)(ii) and (iii), governments *may not initiate* adverse effects, serious prejudice or non-violation nullification and impairment *challenges* in the WTO . . . .") (emphasis added). There are numerous other statements in the 1995 Statement that Brazil similarly does not draw to the Panel's attention. *See id.* at 67 ("Article 13, commonly referred to as the peace clause, reflects *an agreement among WTO countries to refrain from challenging* certain of each other's agricultural subsidy programmes . . . *through WTO dispute settlement procedures* . . . .") (emphasis added); *id.* ("*Article 13(b) addresses possible challenges* to domestic support measures falling outside the green box in circumstances in which the WTO member providing the subsidy is meeting its total AMS commitments.") (emphasis added).

[134] Brazil's Opening Statement, para. 35; Brazil's Rebuttal Submission, para. 75; *see also* 1995 Statement of Administrative Action, at 68 (subsequently in same paragraph quoted by Brazil stating "a WTO Member will not be protected by the Peace Clause if its support for the product is above that decided during the 1992 marketing year.") (emphasis added).

[135] Brazil's General Comment on US Answers to Questions 47-69 from the Panel (para. 55).

[136] Brazil's General Comment on US Answers to Questions 47-69 from the Panel (para. 56).

11. Brazil argues that the United States has not accounted for Step 2 payments. The United States directs the Panel's attention to the US rebuttal submission, paragraphs 111 and 113, and the US first written submission, paragraph 111. The United States has noted that, because the availability of Step 2 payments is contingent on certain price conditions existing during the marketing year, the level of support decided must relate to the payment parameters. While these have changed slightly with the 2002 Act, these minor adjustments do not alter the revenue ensured for producers by the marketing loan rate of 52 cents per pound because Step 2 merely provides an alternative avenue of providing support (through processors rather than directly to producers). In addition, these minor adjustments cannot overcome the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002.

12. Brazil argues that the United States has not accounted for cottonseed payments. The United States directs the Panel's attention to the US rebuttal submission, paragraph 111 fn. 136, 137 and paragraph 113. While the United States maintains that these measures are not within the Panel's terms of reference[137], we note that cottonseed payments for the 1999, 2000, and 2002 crops ranged in value between 0.6 to 2.3 cents per pound (factoring expenditures – the way these measures were decided – over production). Thus, given the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002, cottonseed payments too do not materially affect the comparison between marketing year 1992 and any other year.

13. With respect to storage payments and interest rate subsidies, we note that these are US Government estimates of support provided through activities relating to operating the upland cotton marketing loan programme.[138] This support is already captured, however, in the level of support expressed by the marketing loan rate. Were these costs not borne by the United States, the costs to the producer would reduce the guaranteed revenue below the loan rate. In fact, Annex 3 of the Agreement on Agriculture explains that, for purposes of market price support calculated using a price gap, "[b]udgetary payments made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS." Similarly, where the support provided by marketing loans is measured using a price gap methodology (the only appropriate AMS calculation for purposes of the Peace Clause)[139], "payments made to maintain this gap," such as storage payments and interest rate subsidies, should not be counted separately.

## IV. Brazil's New Green Box Arguments Are in Error

14. In its rebuttal submission and comments on US answers to questions from the Panel, Brazil advances two novel arguments. First, Brazil for the first time responds to the US argument that Brazil's interpretation of paragraph 6(b) would create an inconsistency between that provision and the fundamental requirement of the first sentence of Annex 2, paragraph 1.[140] Second, Brazil argues that the US interpretation of Annex 2, paragraph 6(b), would render paragraph 6(e) of that Annex a nullity. Neither of these arguments withstands scrutiny.

15. First, Brazil misunderstands the US argument that Brazil's reading of paragraph 6(b) creates an inconsistency between that paragraph and the fundamental requirement of the first sentence of Annex 2, paragraph 1, and therefore its arguments go astray. The United States has noted that if payments under a decoupled income support measure were reduced or eliminated if a recipient were to produce any commodity, then the amount of payments would be (on Brazil's reading) linked to the type of production and therefore inconsistent with paragraph 6(b), even though such a measure would

[137] *See* US Rebuttal Submission, paras. 106-09.
[138] For example, for storage payments we estimate expenses incurred with respect to upland cotton put under loan and pledged as collateral.
[139] *See* US Rebuttal Submission, paras. 114-17.
[140] Brazil's Rebuttal Submission, paras. 4-9.

meet the fundamental requirement of Annex 2. Brazil does not contest that such a measure would meet that fundamental requirement but instead argues that "requiring no production, *i.e.*, on all base acres is not a 'type of production'" because "[t]he notion of 'type of production' in paragraph 6(b) is necessarily linked to the amount of payment to some 'type' of commodity that is 'produced' and not to a production requirement itself."[141]

16. With respect, if one were to credit this argument, then Brazil would appear to have misunderstood its own objection to US direct payments and production flexibility contract payments. That is, in the US example, payments are reduced or eliminated if a recipient produces *any type* of commodity. Similarly, Brazil's objection to US green box payments is that payments are reduced or eliminated if a recipient produces *certain types* of commodities. Thus, in the former example, the amount of payment is "based on" (in the sense of being reduced by) "the type" of production undertaken by the producer – for example, production of upland cotton, fruits, vegetables, or wild rice – just as in Brazil's argument on US green box payments, the amount of payment is "based on" (in the sense of being reduced by) "the type" of production undertaken by the producer – that is, fruit, vegetable, or wild rice production. Brazil's objection to US green box payments under paragraph 6(b) would therefore apply with equal force to the US example,[142] again, posing an inconsistency between Brazil's interpretation of paragraph 6(b) and the fundamental requirement of Annex 2.[143]

17. Brazil also argues that the US interpretation of paragraph 6(b) "would render Annex 2, paragraph 6(e)[,] a nullity" because the "US interpretation of paragraph 6(b) as not requiring the production of 'certain crops' is the same as 6(e)'s prohibition on not requiring production of 'any crops.'"[144] Brazil's own re-phrasing of the US argument, however, points to the distinction between the obligations contained in these two provisions. Paragraph 6(e) establishes that under a green box measure: "No production shall be required in order to receive such payments." Thus, there can be no production requirement "in order to receive such payments," but the provision is silent with respect to the *amount* of such payments at any particular time and any links to the "type or volume of production." That is, were paragraph 6(e) alone part of Annex 2, a Member could arguably link the amount of payments to requirements on the "type or volume of production" so long as payment eligibility were not contingent on production.

18. Paragraph 6(b) forecloses that option by prohibiting a green box measure from linking the "amount of such payments in any given year" to "the type or volume of production." That is, not only may a green box measure not require production, but the measure may not require a particular "type or volume of production" in order to obtain a payment amount. As the United States has noted, both direct payments and production flexibility contract payments meet that test because no "type or volume of production" is required to receive payments. For example, with respect to the fruits, vegetables, and wild rice planting flexibility issue, a payment recipient need not undertake any "type or volume of production" in order to receive the full "amount of payments" to which the farm's base acres are entitled. Rather, the recipient need only *desist* from planting certain commodities. Thus, Brazil's objection is nothing more than a statement that, under US green box measures, the amount of payments is linked to production *not* undertaken by the producer.

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[141] Brazil's Rebuttal Submission, para. 6. Brazil concludes the thought: "Otherwise, it logically could not be a 'type' of production. It would be nothing at all."

[142] *See* Brazil's Rebuttal Submission, para. 4 ("The relevant text of paragraph 6(b) prohibits any linkage of the 'amount of payments' to *any* 'type of production' of an agricultural product.") (emphasis added).

[143] Brazil's reference to paragraph 6(e) does not answer this objection. Brazil argues that "negotiators addressed any possible misunderstanding in this regard by including the very concept of prohibiting the requirement to produce in paragraph 6(e)." Brazil's Rebuttal Submission, para. 6. However, as Brazil immediately points out, conformity with paragraph 6(e) "does not exempt . . . payments from conforming to the requirement of paragraph 6(b)."

[144] Brazil's Comment on US Answer to Question 32 from the Panel (para. 44).

19. Finally, we note that Brazil's reading of paragraph 6(b) could prevent Members from imposing on decoupled income support payment recipients any conditions relating to the type of production – for example, the planting of illegal crops or production of unapproved biotech varieties or environmentally damaging production. As a practical matter, no Member could accept not being able to impose any such conditions on payment recipients. The result of Brazil's reading, then, would be to read decoupled income support out of Annex 2. This may be a favourable result from the Brazilian perspective, but the Panel should not adopt an interpretation of paragraph 6(b) not required by the text, not consistent with its context (in particular, the fundamental requirement of Annex 2), and with such potentially far-reaching results.

## V. Answer to Additional Question 67*bis* from the Panel

**67*bis*. Please state the annual amount granted by the US government in each of the 1999, 2000, 2001 and 2002 marketing years (as applicable) to US upland cotton producers, per pound and in total expenditures, under each of the following programmes: production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments.**

20. The Panel's question would require ascertaining for each programme the amount of upland cotton produced by recipients of payments under the programme. However, the United States does not maintain and cannot calculate this information – that is, it does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers. This is because the payments do not relate to, and do not depend on, what crop, if any, is actually produced. Instead, each of these programmes makes payments with respect to *past* production on base *acreage* in a fixed and defined base period, not with respect to whether one is currently a producer.

21. Thus, the United States did track total expenditures with respect to base acres of wheat, corn, barley, grain sorghum, oats, upland cotton, and rice under the expired production flexibility contract payments and market loss assistance payments and does track total expenditure with respect to base acres of wheat, corn, barley, grain sorghum, oats, upland cotton, rice, peanuts, soybeans, sunflower seed, canola, rapeseed, safflower, flaxseed, mustard seed, crambe, and sesame seed under the direct payments and counter-cyclical payments.[145] However, the fact that a recipient at one time produced one of these crops says nothing about what crops the recipient is currently producing, if any. In other words, payments made on the basis of past production of upland cotton do not tell anything about whether the recipient is currently producing cotton, corn, livestock, hay, or any other crop or is not producing at all. As a result, it is not possible to derive from these payments whether the payment is being received by an upland cotton producer.

22. The Panel's question points to a fundamental difficulty with Brazil's approach. Brazil would have the Panel allocate "support to a specific commodity" – upland cotton – on the basis that certain of these measures determine payment amounts (for base acres) based on current or recent market prices for that commodity. However, how could the payment be "support to a specific commodity" (support "provided for an agricultural product in favour of the producer of the basic agricultural product") if there need be no production of upland cotton in order to receive payment?

23. Brazil attempts to avoid this result by arguing that various US payments (direct, counter-cyclical, production flexibility contract, and market loss assistance payments) are *not* non-product-specific support because they are not payments to "producers in general." The United States has addressed this erroneous interpretation in detail in its rebuttal submission. In short, Brazil's reading requires ignoring the definition of product-specific support in Article 1(a) (that is "support . . .

[145] *See* US First Written Submission, para. 57 fn. 46.

provided for an agricultural product in favour of the producers of the basic agricultural product"), which Brazil has not interpreted, in over 450 pages of submissions and statements, even once.[146] In fact, Brazil's reading of the definition of non-product-specific support ("support provided in favour of agricultural producers in general") reads the phrase "in general" as meaning "in a body; universally; without exception." However, this dictionary definition is considered "obsolete"[147] and so would hardly be the "ordinary meaning" of the term.

24. As Brazil has conceded, moreover, payments made with respect to upland cotton base acres are not necessarily in favor of upland cotton producers since those acres may not be planted to upland cotton – indeed, may not be planted at all. We note that Brazil has adjusted its entire AMS calculation to reflect its belated realization that, under its own theory, "only the portion of . . . payments [on "upland cotton" base acres] that actually benefits acres planted to upland cotton can be considered support to upland cotton."[148] But Brazil's adjustment is not enough. Brazil simply takes the ratio of actual upland cotton acreage to "upland cotton" base acreage under a given programme. However, there is no reason why upland cotton acreage need be planted on "upland cotton" base acreage. Consider this example:

- One farm could have 100 base acres of upland cotton and currently plant those 100 acres to corn; direct and counter-cyclical payments would be made on those 100 "upland cotton" base acres that actually are planted to corn.

- Another farm could have 100 base acres of corn and currently plant those 100 acres to upland cotton; direct and counter-cyclical payments would be made on those 100 "corn" base acres that actually are planted to upland cotton.

- Brazil's approach (dividing upland cotton planted by upland cotton base acres) would simply say that *all* of the direct and counter-cyclical payments on "upland cotton" base acres are "support to upland cotton" because there are 100 "upland cotton" base acres on which payments were made and 100 acres currently planted to upland cotton, even though these are found on completely separate farms.

Thus, Brazil's ratio does not identify, *even on Brazil's own terms*, the alleged support to upland cotton (that is, "payments that actually benefit[] acres planted to upland cotton") under these programmes.[149]

25. Brazil's own approach would require Brazil to match up payments for upland cotton base acres with the amount of upland cotton production on those base acres, but Brazil has not done so.[150]

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[146] *See, e.g.*, Brazil's Rebuttal Submission, para. 19 (again misquoting the definition of product-specific support in Article 1(a) by eliminating the phrase support provided "for an agricultural product" and failing to interpret that definition according to the customary rules of interpretation of public international law); Brazil's Comments on US Answer to Question 43 from the Panel (paras. 58-60) (criticizing US interpretation of product-specific support but failing to interpret that definition according to the customary rules of interpretation of public international law); Brazil's Comments on US Answer to Question 38 from the Panel (paras. 48-49) (same).

[147] *See The New Shorter Oxford English Dictionary*, vol. 1, at 1073 (first definition of "in general": "† (*a*) in a body; universally; without exception"); *id.*, vol. 1, at xv (sec. 4.5.2: Status symbols) ("The dagger [†] indicates that a word, sense, form, or construction is obsolete. It is placed before the relevant word(s) or relevant sense number.").

[148] *See, e.g.*, Brazil's Answer to Question 67 from the Panel (table, fn. 2, 3, 4, 5).

[149] We also would reiterate that such payments would not be "support to a specific commodity" as explained in Article 1(a) and reflected in Annex 3.

[150] For example, Brazil admits that "this acknowledged legal flexibility to grow other crops does not answer the question of whether the producers planting 14.2 million aces of upland cotton in MY 2002 received direct and counter-cyclical payments. Nor does it answer the question of whether the 14.2 million acres planted

At best, Brazil speculates as to the *likelihood* of a person with cotton base acres actually producing upland cotton on those base acres, and even that speculation is flawed.[151] However, such an approach amounts to little more than speculation and, even if Brazil's erroneous interpretation were used, does not meet Brazil's burden of establishing a *prima facie* case.

26. In addition, under Brazil's own approach, the payments made in relation to corn base acres would be support for *corn* even if planted to upland cotton. However, Brazil's approach would appear to result in double counting the support – the same payment would be support to corn (because it was related to corn base acres) and support to upland cotton (because cotton was produced on base acres eligible for payments). In other words, Brazil is trying to have it both ways:

- First, Brazil argues that payments made based on production on base acres during a base period is support to the crop that was produced during that base period, regardless of what is actually produced currently (that is, payments made for upland cotton base acreage is support to upland cotton even if the producer is now growing corn on that acreage).

- Second, Brazil argues that payments made under these programmes are support to the crop that is currently being produced, even if the crop being produced is different from the base crop (that is, payments made for corn base acreage is support to upland cotton if upland cotton is being produced on the corn base).

27. Furthermore, because payments under the cited programmes are made with respect to historic acres and yields during a base period, it is not possible to calculate the "annual amount granted by the US government . . . to US upland cotton producers, per pound." Counter-cyclical payments, for example, determine the payment rate for base period production as the difference between a target price and the sum of the direct payment rate plus the higher of the market price or the loan rate. However, the per pound payment rate for upland cotton base acres applies only for base period production (base acres *x* payment yields), not current production. Thus, to express these payments per pound begs the question: "Per pound of what?" Any production figure used – whether base period production or production in any year from 1999 through 2002 – results in a highly artificial per pound

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to upland cotton in MY 2002 were planted on *upland cotton* base acreage." Brazil's Rebuttal Submission, para. 38 (emphasis in original). The United States agrees completely, and while Brazil's approach would require that these questions be answered, Brazil has not answered them, even though under Brazil's approach, Brazil would have the burden of proof in this regard. Rather, Brazil tries to construct a series of assumption based on what Brazil considers "likely" or "maybe" or "probably."

[151] *See* Brazil's Rebuttal Submission, paras. 24-50. Brazil makes a lengthy presentation of new data and calculations, including some with respect to crops other than upland cotton, to assert that these four payments are support for upland cotton because without them upland cotton farmers could not cover their costs. However, Brazil's approach is flawed in terms of its facts and the premises on which it relies. In the time available we have not been able to identify and describe all the flaws and inaccuracies in Brazil's presentation of the data. Simply by way of example, however, we note that (1) Brazil includes a figure for cottonseed payments in its graph purporting to show MY 2001 market revenue and government support (Rebuttal Submission, paragraph 30), but Brazil's own table at paragraph 84 of its rebuttal submission reflects that there were no cottonseed payments for the 2001 marketing year; (2) Brazil's theory would appear to be that cotton production on cotton base acres are "necessary" because without government payments costs of production would not be covered, but Brazil presents information only with respect to one year, marketing year 2001, with record low prices - Brazil does not explain its theory or present any data with respect to other years with more typical prices; (3) Brazil asserts that upland cotton production "is produced only in particular regions . . . and producers tend to specialize and not readily switch to other crops" – whereas cotton is produced in 17 of the 50 United States and, for all US cotton farms, average cotton area is approximately 38 per cent of a farm's acres (469 of 1,222 acres) (US Department of Agriculture, Characteristics and Production Costs of US Cotton Farms (October 2001).)

rate since (as noted above) these payments will be or were (as the case may be) received by a recipient regardless of whether he or she produced any upland cotton production.

28. We are able to provide to the Panel the total outlays under the cited programmes with respect to upland cotton base acreage:

| **Total Outlays Under Certain Programmes with respect to Upland Cotton Base Acres (millions US$)** | | | | |
|---|---|---|---|---|
| Payments[152] | MY1999 | MY2000 | MY2001 | MY2002 |
| Production flexibility contract | 614 | 575 | 474 | 452 |
| Market loss assistance | 613 | 612 | 524 | NA |
| Direct | NA | NA | NA | not yet available[153] |
| Counter-cyclical | NA | NA | NA | not yet available[154] |

## VI. Payments With Respect to Base Period Production of Certain Commodities But Not Others Are Not Inherently Product-Specific Support

29. Brazil has argued that production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments are product-specific support. The United States had addressed some infirmities in Brazil's approach in response to Additional Question 67*bis* from the Panel and in previous submissions.[155] The United States now briefly addresses two arguments presented by Brazil.

30. First, Brazil argues that each of these payments is product-specific because base acreage is defined as acreage on which only some commodities were historically produced during a defined and fixed base period. This argument, again, rests on an "obsolete" definition of "in general" (in the definition of non-product-specific support) as "universal" or "without exception" and a determined refusal to quote accurately and interpret the definition of product-specific support in Article 1(a).[156]

[152] *See* Exhibit US-38 (http://www.fsa.usda.gov/dam/BUD/bud1.htm) (for crop years 1999, 2000, and 2001).

[153] The US Department of Agriculture estimates that direct payments for the 2002 marketing year with respect to upland cotton base acres will total $173 million. Exhibit US-18 (www.fsa.usda.gov/dam/BUD/estimatesbook.htm).

[154] The US Department of Agriculture estimates that counter-cyclical payments for the 2002 marketing year with respect to upland cotton base acres will total $873 million. Exhibit US-18 (www.fsa.usda.gov/dam/BUD/estimatesbook.htm).

[155] *See, e.g.*, US Rebuttal Submission, paras. 79-92, 99-105.

[156] We note that, once again, Brazil has misquoted the definition of product-specific support in Article 1(a). Brazil quotes that definition as follows: "For support not provided to agricultural producers *in general*, the test is whether the support is 'provided in favour of the producers of the basic agricultural product.'" Brazil's Rebuttal Submission, para. 19. The actual text of Article 1(a), in pertinent part, reads:

That these payments are made with respect to base acreage for only some commodities is not relevant to the question whether they are support "provided for an agricultural product in favour of the producers of the basic agricultural product."[157] None of these payments satisfies either part of this definition: they are neither provided "for an agricultural product" (rather, they are made with respect to historic production of several products) nor "in favour of the producers of the basic agricultural product" (no production is necessary for payments to be made).

31. Brazil also appears to now argue that the requirement under paragraph 6(a) of Annex 2 that eligibility for payments under a decoupled income support measure "shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period" requires that these payments be made to *all* producers for *all* commodities. This approach would seriously limit the ability of Members to move to decoupled income support. It is not clear that any Member would be willing to switch to decoupled income support if it required expanding support to whole new classes of producers or commodities. We can find no basis for this approach in the text of paragraph 6(a). This definition does not require comprehensive coverage of all or nearly all production in "a defined and fixed base period"; it merely requires "clearly-defined criteria." Thus, under Brazil's reading, a measure could satisfy the requirement of Annex 2, paragraph 6(a), and yet qualify as product-specific support under Article 1(a).

32. Second, Brazil again selectively quotes the statutory definition of "producers" to suggest that recipients of these payments had to be growers who "shared in the risk of producing a crop."[158] As the United States has previously noted, the statute defines "producers" (those eligible in the first instance to receive payment) as persons who "would have shared had the crop been produced."[159] Thus, both the 2002 and 1996 Acts make clear that a payment recipient need not produce any crop (including upland cotton) to receive payment. It is thus a serious error to imply that a payment recipient is necessarily a "producer" in the Agreement on Agriculture rather than a "producer" (meaning "recipient") in the statutory sense.

33. Nowhere in Brazil's submission is there any suggestion of how its approach can be found in the Agreement on Agriculture. It does not make sense of the definitions of product-specific support and non-product-specific support in Article 1(a), which Brazil has recognized guide the interpretation of the phrase "support to a specific commodity" in the Peace Clause. In sum, Brazil's argument

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"support . . . provided *for an agricultural product* in favour of the producers of the basic agricultural product" (emphasis added). What Brazil describes as "the narrow US Article 13(b)(ii) specificity standard" in fact flows from an interpretation of Article 13 that makes sense of the *entire* text of Article 1(a) and not just selected parts of it.

[157] Indeed, Brazil's argument in paragraph 36 of its rebuttal submission rests on a *non sequitur*. Brazil's statement is that: "Thus, direct payments are *not* available to the great majority of US producers of agricultural commodities, *i.e.*, they are not provided to US agricultural producers *in general*." (Emphasis in original.) The illogic in Brazil's statement is that, by removing the requirement to produce any particular crop or any crop at all in order to receive these payments, the United States does in fact make the payments available to producers in general. Recipients are free to produce a broad range of commodities, and so are producers of agricultural commodities "in general." Brazil appears to acknowledge that the payments are not in fact tied to current production when, in paragraph 50, Brazil concedes that the payments are made to "upland cotton base acreage holders" rather than to upland cotton *producers*.

[158] *See* Brazil's Rebuttal Submission, paras. 24 (quoting first half of definition), 29 ("Thus, as with PFC payments, market loss assistance payments were not paid to agricultural producers *in general* but rather to only a select group of US producers), 36 ("Direct payments are targeted support to "producers" farming, *inter alia*, on upland cotton base acreage."), 48 ("But the evidence demonstrates that CCP funds in MY 2002 paid to "historic" (i.e., 1998-2001 or 1993-1995) upland cotton producers are paid to a tiny fraction of total US producers of agricultural commodities.").

[159] US Rebuttal Submission, paras. 36-38.

provides ample evidence that the phrase "support to a specific commodity" in the Peace Clause must be interpreted in the context provided by the Agreement on Agriculture. To divorce it from that context may result in an unworkable and illogical interpretation along the lines suggested by Brazil.

## VII. Brazil's New Arguments Relating to Crop Insurance Do Not Demonstrate that Crop Insurance Payments Are Product-Specific Support

34. Brazil presents a number of arguments claiming that crop insurance payments are "support to a specific commodity." In part, this argument relies on the notion that such payments are not support provided to agricultural producers "in general" and, hence, not non-product-specific support. We note, however, that in making these arguments Brazil avoids any reference to the definition of product-specific support in Article 1(a). This is a fundamental interpretive error: Brazil cannot claim that payments are not support to "agricultural producers in general" under Article 1(a) without providing an interpretation of the other component of support in Article 1(a), namely, product-specific support (support "provided for an agricultural product in favour of the producers of the basic agricultural product"). In fact, given that crop insurance support is available to approximately 100 agricultural commodities, representing approximately 80 per cent of US area planted and greater than 85 per cent of the value of all US crops, crop insurance payments are not support "provided for *an* agricultural product."[160] The support to these approximately 100 commodities is the same: that is, the crop insurance premium subsidies do not vary by commodity or plan of insurance.

35. Brazil's specific arguments fail to address the definition of product-specific support in Article 1(a); thus, each fails to demonstrate that crop insurance payments are "support to a specific commodity" rather than "support to several commodities."

36. First, Brazil argues that certain policies (and accompanying premiums) on irrigation failures are available only to upland cotton and a few other commodities. The United States has previously addressed this argument and directs the Panel's attention to that argument.[161]

37. Second, Brazil argues that a larger pool of types of insurance policies are offered to upland cotton than most other crops. Brazil has not explained how the types of crop insurance policies offered by private companies[162] can affect whether US crop insurance payments (premium subsidies that do not vary by commodity or insurance plan) are product-specific or not. Brazil's "facts" are also misleading in some instances and erroneous in others. For example, Brazil suggests that "in many instances, the policies available for cotton enterprises are not available for other crops."[163] However, we note that commodities other than upland cotton can be insured under the same types of policies as upland cotton.[164]

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[160] US Rebuttal Submission, paras. 93-98.

[161] *See* US Rebuttal Submission, para. 54.

[162] Under the Agricultural Risk Protection Act, new insurance products must be developed by the private sector and approved by the Board of Directors of the Federal Crop Insurance Corporation. The US Department of Agriculture is expressly prohibited from conducting research and development on new products. Thus, the variety and availability of insurance products reflects the fact that private companies, not the US Government, have developed and offered these products.

[163] Brazil's Rebuttal Submission, para. 55.

[164] Upland cotton producers can insure their crops under the following types of policies: Actual Production History, Group Risk Plan, Income Protection, Crop Revenue Coverage, and Revenue Assurance. Other crops that are eligible for the policies include:

for Actual Production History – Alfalfa seed, all other grapefruit, almonds, apples, avocados, barley, blueberries, cabbage, canola, cigar binder tobacco, cigar filler tobacco, cigar wrapper tobacco, corn, cotton, ELS cotton, crambe, cranberries, cultivated wild rice, dry beans, dry peas, early and midseason oranges, figs, flax, forage production, fresh apricots, fresh freestone peaches, fresh market tomatoes, fresh nectarines, grain sorghum, grapefruit, grapes, green peas, late oranges, lemons, macadamia nuts, mandarins, Maryland tobacco,

38. Third, Brazil argues that are there specific upland cotton provisions in certain policies.[165] This is true – an insurance product offered by a private company must be tailored for the situation and desires of the insurance purchasers – but also irrelevant as the policies are generally similar in underwriting rules and share the same subsidy schedule.

39. Fourth, Brazil argues that upland cotton producer participation rates in the crop insurance programme "is much higher that for other crops."[166] We first note that Brazil neglects to mention that participation rates for the major field crops are generally quite high (over 75 per cent of insurable acres). Any producer who received disaster assistance was required to purchase federal crop insurance in the following year; cotton participation may be slightly higher because of droughts that have hit cotton regions in recent years. More importantly, that cotton producers may choose to take up crop insurance more than producers of other commodities might is irrelevant to whether the payments are provided "for an agricultural product." Again, the crop insurance premium subsidy is identical for all commodities and for each plan of insurance.

40. Fifth, Brazil argues that tracking the cost of reinsurance provided to private companies is "further evidence that USDA treats crop insurance for upland cotton separately from crop insurance provided to other crops."[167] Of course, the way the US Department of Agriculture "tracks cost[s]" is irrelevant to the analysis of whether crop insurance payments provide support "for an agricultural product." Brazil also misinterprets the Standard Reinsurance Agreement between the US Government and private insurers. Under that Agreement, net underwriting gains and losses for each insurer are calculated *at the state level* over *all crops*, not separately for individual crops (such as upland cotton).[168] Thus, Brazil errs when it claims that reinsurance provides evidence that crop insurance for upland cotton is treated separately from crop insurance provided to other crops.

41. Sixth, Brazil claims that "the 2000 ARP Act denies subsidies to producers of other agricultural products."[169] It is true that there are certain products for which policies have not been developed. However, development of new policies is ongoing; for example, provisions of the Agricultural Risk Protection Act of 2000 allow for the development of livestock insurance products. A number of livestock products are currently available on a pilot basis, including price insurance for hogs and feeder cattle and gross margin insurance. We also note that producers may currently insure livestock and dairy revenue as part of whole farm insurance offered through the Adjusted Gross Revenue Insurance.[170] Finally, Brazil's argument here again reads domestic producers "in general' to mean "universally" or "without exception"; as noted above, that definition is now considered obsolete.

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millet, Minneola tangelos, mint, mustard, navel oranges, oats, onions, Orlando tangelos, peaches, peanuts, pears, plums, popcorn, potatoes, processing apricots, processing beans, processing cling peaches, processing freestone, prunes, rice, Rio Red and Star Ruby grapefruit, Ruby Red grapefruit, rye, safflower, soybeans, sugar beets, sugarcane, sunflowers, sweet corn, sweet oranges, sweet potatoes, table grapes, tomatoes, Valencia oranges, walnuts, wheat;

for Group Risk – corn, cotton, forage production, grain sorghum, rangeland, soybeans, wheat;

for Income Protection – barley, corn, cotton, grain sorghum, soybeans, wheat; and

` for Revenue Assurance – barley, canola, cotton, grain sorghum, rice, soybeans, sunflowers, wheat.

*See* http://www3.rma.usda.gov/apps/sob/current_week/crop2003.pdf.

[165] Brazil's Rebuttal Submission, para. 55.

[166] Brazil's Rebuttal Submission, para. 57.

[167] Brazil's Rebuttal Submission, para. 58.

[168] The provisions of the Standard Reinsurance Agreement are available on the Risk Management Agency website at: http://www.rma.usda.gov/pubs/ra/98SRA.pdf.

[169] Brazil's Rebuttal Submission, para. 59.

[170] More information on Adjusted Gross Revenue Insurance can be found on the Risk Management Agency website at: http://www.rma.usda.gov/pubs/2003/PAN-1667-06rev.pdf.

42. Finally, with respect to Brazil's references to the literature on the effects of crop insurance on production,[171] the findings are (contrary to what Brazil has claimed) mixed. While several studies (such as those cited by Brazil) have suggested crop insurance payments may have a slight effect on acreage, the effects on *production* are less clear.[172] If crop insurance encourages moral hazard problems (as claimed by Brazil), crop yields will be adversely affected as producers attempt to increase crop insurance indemnities. If moral hazard and adverse selection problems are severe, crop insurance support could potentially have a *negative* effect on production.[173] The potential production effects of crop insurance payments, moreover, goes to whether such payments are "amber box" support but does not figure in the question whether such payments (which are offered at the same rate across commodities and policies) can be support "for an agricultural product."

## VIII. Brazil May Not Act Unilaterally on Procedural Matters

43. The United States takes note of Brazil's statement in its 25 August 2003 letter to the Panel[174] that, concerning paragraph 20 of the Panel's determination of 20 June 2003, "Brazil interpreted this ruling as permitting it to provide no later than 22 August all of its evidence and argument that had not already been provided in its earlier submissions. This is the manner in which it treated the new evidence and arguments presented by the United States in its Rebuttal Submissions." The United States is unable to reconcile Brazil's position concerning its own ability to provide evidence and arguments at any time up through August 22 with Brazil's repeated assertions that the United States "should have" provided particular material in its replies to the Panel's questions.[175] There is of course no basis for Brazil's assertions that particular material "should have been" provided in replies to questions rather than in a rebuttal submission. There is no basis for Brazil to dictate to another Member what it may or may not include in its rebuttal submission. Brazil is fabricating an obligation and attempting to impose it on the United States at the same time that it exempts itself from this obligation. In this, Brazil's approach is similar to its repeated attempts in this dispute to add to the obligations in the Agreement on Agriculture and the Subsidies Agreement.

[171] Brazil's Rebuttal Submission, paras. 60-67.

[172] The US Department of Agriculture, Economic Research Service, studies cited by Brazil only examine the effects of crop insurance subsidies on acreage. They do not consider effects on crop yields.

[173] Recent studies by Smith and Goodwin (1996), Babcock and Hennessy (1996) and Goodwin and Smith (2003) suggest that farms with more insurance tend to use less inputs like fertilizer and pesticides and vice versa. This demonstrates a potential moral hazard problem with crop insurance that suggests that crop insurance participation may have a negative effect on yields. *See* Babcock, B. and D. Hennessy. "Input Demand Under Yield and Revenue Insurance" *American Journal of Agricultural Economics* 78(1996):416-27; Goodwin, B. and V. Smith. "An Ex Post Evaluation of the Conservation Reserve, Federal Crop Insurance, and other Government Programmes: Programme Participation and Soil Erosion." *Journal of Agriculture and Resource Economics* 28(2003):201-216; Smith, V. and B. Goodwin. "Crop Insurance, Moral Hazard and Agricultural Chemical Use." *American Journal of Agricultural Economics* 78(1996):428-38.

[174] The United States also notes that the Panel's communication of 19 August 2003 had not indicated that the parties would have an opportunity to comment on each other's requests to comment. Had there been such an opportunity, the United States would have been happy to comment on Brazil's request of 23 August 2003. Perhaps Brazil could reconsider whether it has a basis to assert a right to decide that it may unilaterally provide comments to the Panel while denying the United States the same procedural rights. Under Brazil's approach, it would not have needed to request permission from the Panel to file comments on Wednesday, August 27, but could have simply provided those comments, unsolicited, while denying equal access for the United States. The United States is grateful that the Panel's extremely prompt reply to the US request obviated any need to respond to Brazil's unauthorized and out of order comments on that request.

[175] *See* Brazil's 23 August 2003 letter to the Panel.

## IX. Conclusion

44. The United States has demonstrated that using any measurement that reflects the support "decided" by the United States rather than factors (such as market prices) beyond the United States' control, US support to upland cotton in marketing years 1999-2002 has not exceeded the 1992 marketing year level. The question then is whether the Panel will find that the United States has breached the Peace Clause simply because market prices were lower in some recent years than they were in 1992.

45. The United States submits that the Peace Clause must be interpreted in a way that permits Members to comply in good faith – that is, Members must be able to tell if they will breach the Peace Clause or not. Brazil's budgetary outlays approach does not do that. Brazil's approach would mean that Members could not know if they had complied with the Peace Clause until it was too late to do anything about it. The best way to interpret the Peace Clause in a way that allows Members to comply is to use the "support" as "decided" by a Member during the 1992 marketing year as the basis for comparison. Recognizing, as the United States believes is required by the Peace Clause text, that "decided" and "grant" cover only those parameters over which Members exercise control would also be consistent with this approach of allowing "good faith" compliance since it would permit Members to control whether their measures conformed to their obligations.

46. The United States has disciplined itself to grant support not in excess of that decided during the 1992 marketing year. Therefore, we are entitled to the protection of the Peace Clause, and we respectfully request the Panel to find that Brazil may not maintain this action challenging these conforming US measures.

## List of Exhibits

1. US Department of Agriculture, Fiscal Year Actual Budgetary Expenditures by Crop Year (http://www.fsa.usda.gov/dam/BUD/bud1.htm)

2. US Department of Agriculture, Compliance Report for 1992 Acreage Reduction Programme

# ANNEX E

## SUBMISSIONS OF PARTIES AND THIRD PARTIES FOR THE RESUMED SESSION OF THE FIRST SUBSTANTIVE MEETING ("FURTHER SUBMISSIONS")

# ANNEX E-1

## BRAZIL'S FURTHER SUBMISSION TO THE PANEL

### EXECUTIVE SUMMARY

#### Summary Of The Argument Regarding Brazil's Further Claims

1. Brazil demonstrates in its Further Submission that US subsidies from MY 1999-2007 supporting the production, use and export of US upland cotton cause or threaten to cause serious prejudice to the interests of Brazil within the meaning of Article 5(c), 6.3(c) and 6.3(d) of the SCM Agreement as well as violate GATT Article XVI.

2. The measures challenged by Brazil comprise domestic support subsidies including the marketing loan programme[1], crop insurance subsidies, market loss assistance payments and their successor counter-cyclical payments, production flexibility contract payments and their successor direct payments, cottonseed payments and "other payments".[2] The measures also include prohibited export and local content subsidies including Step 2 export and domestic payments, and the subsidies provided by the US GSM 102 export credit guarantee programme. These collective subsidies are referred to as "the US subsidies".

3. Table 1 summarizes the amounts of US subsidies in terms of US dollar and as a percentage of subsidization in terms of the market value of US upland cotton:

[1] Brazil uses the phrase "marketing loan programme" or "marketing loan payment" to encompass marketing loan gains, loan deficiency payment (or "LDP's") and certificate exchange gains. *See* US 11 August Answer to Question 67, para. 133.

[2] The United States qualified "other payments" as product-specific support to upland cotton. *See* US 11 August Answer to Question 67, para. 130-133.

| Programme | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| | Amount of Payment | Amount of Payment | Amount of Payment | Amount of Payment |
| | Rate of Subsidization | Rate of Subsidization | Rate of Subsidization | Rate of Subsidization |
| Marketing Loan Gains and LDP's | $1,545 million | $573 million | $2,541 million | $918 million |
| | 43.71per cent | 14.06 per cent | 82.5 per cent | 28.23 per cent |
| Crop Insurance | $169.6 million | $161.7 million | $262.9 million | $194.1 million |
| | 4.79 per cent | 3.97 per cent | 8.53 per cent | 5.97 per cent |
| Step 2 | $422 million | $236 million | $196 million | $217 million |
| | 11.94 per cent | 5.79 per cent | 6.36 per cent | 6.67 per cent |
| PFC Payments/ Direct Payments | $547.8 million | $541.3 million | $453.0 million | $485.1 million |
| | 15.5 per cent | 13.28 per cent | 14.7 per cent | 14.92 per cent |
| Market Loss Assistance/ Counter-Cyclical Payments | $545.1 million | $576.2 million | $625.7 million | $998.6 million |
| | 15.42 per cent | 14.14 per cent | 20.31 per cent | 30.71 per cent |
| Cottonseed Payments | $79 million | $185 million | No payments | $50 million |
| | 2.23 per cent | 4.54 per cent | No payments | 1.54 per cent |
| Other Payments | $216 million | $63 million | $68 million | $65 million |
| | 6.11 per cent | 1.54 per cent | 2.20 per cent | 1.99 per cent |
| **Total Payments** | **$3,524.5** | **$2,336.2** | **$4,146.6** | **$2,927.8** |
| **All programmes** | **97.69 per cent** | **57.32 per cent** | **134.6 per cent** | **90.03 per cent** |
| **Value of US Production** | $3,534 million | $4,073 million | $3,080 million | $3,252 million |
| **Average Rate of Subsidization** | **94.91 per cent** | | | |

Table 1[3]

4. Brazil's actionable subsidy claims fall into two basic temporal and legal categories: first, claims of *present* serious prejudice resulting from subsidies provided in MY 1999-2002; second, claims of *threat* of serious prejudice from subsidies that are required to be paid by USDA to the US upland cotton industry during MY 2003-2007 under the Farm Security and Rural Investment Act of 2002 (2002 FSRI Act) and the Agricultural Risk Protection Act of 2000 (2000 ARP Act).

5. Because Brazil's claims involve the adverse effects of "subsidies", Brazil first establishes that each of the US domestic and export programmes is a "subsidy" within the meaning of Article 1.1 of the SCM Agreement. As Table 1 above indicates, each provides a "financial contribution" which confers a "benefit".

[3] The amount of payments reflects the amount presented by Brazil in its 22 August Rebuttal Submission, para. 173. The value of the US upland cotton production has been taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p.5). The value of the US production in MY 2002 has been calculated by multiplying the amount of US production as reported in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p.4) (16.73 million bales * 480 pounds per bale) with the average price received by US farmers of 40.50 cents per pound (*see* Exhibit Bra-202 (Agricultural Outlook Tables, USDA, August 2003, Table 5). Differences between the sum of individual rates of subsidization and the total rate of subsidization are due to rounding effects.

6. Each of the subsidies is "specific" within the meaning of Article 2.1(a) and/or (c) of the SCM Agreement. The United States and Brazil agree that the specificity test of Article 2.1 was not intended to function as a loophole through which narrowly focused subsidies provided to or used by discrete segments of an economy could escape review. The four direct subsidies – the PFC, direct payment, market loss assistance, and CCP payments are *de jure* specific because the 1996 FAIR Act and the 2002 FSRI Act explicitly limit access of payments to holders of upland cotton base acreage. The per acre upland cotton base acreage payments of the four programmes are single specific subsidies because the payments are based on individual cotton-based criteria and are significantly higher than payments to most other base acres in each program. Alternatively, even if the total payments to all base acres for each of the four direct subsidies are treated as single subsidies, they are specific because the payments are excluded from the significant majority of US farmland and the value of the crops produced with such payments is less than one-quarter the value of total US commodities.

7. Crop insurance subsidies are specific because there are specific policies and groups of policies available only for upland cotton (or a few other crops) and not for the majority of crops in the programme. Alternatively, crop insurance is not specific because the 2000 ARP Act denies benefits to commodities representing more than half of the value of US agriculture. Further, US crops represent only 0.8 per cent of total US GDP.

8. Within each of the *present* serious prejudice and *threat* of serious prejudice claims, Brazil has asserted three different claims regarding the application of these actionable subsidies.

9. **Present Significant Price Suppression – Article 6.3(c) of the SCM Agreement:** The US subsidies provided during MY 1999-2002 cause present significant price suppression in the world and Brazilian market, as well as in markets where Brazilian producers export. Brazil first establishes that Brazilian upland cotton is "like" US upland cotton based on common tariff classification, USDA's designation of upland cotton as a separate commodity, and the interchangeability and treatment by the markets of US and Brazilian cotton as like products.

10. The bulk of Brazil's price suppression analysis involves establishing the causal link between the US subsidies and suppressed prices in the US, world, Brazilian, and other markets. Most of this evidence is also relevant for Brazil's other present and threat of serious prejudice claims. The enormous size of the MY 1999-2002 US subsidies in terms of amount ($12.9 billion) and percentage as market value (95 per cent) coupled with the dominating US world market share of 41.6 per cent of a fungible commodity create a *de facto* presumption of production, export, and price-suppressing effects. The effects of the subsidies are also seen in the significant increase of US production, exports, and world market share in MY 1999-2002 while US, A-Index, and Brazilian prices fell to record lows and remained suppressed. The causal link is further confirmed by the fact the average total US upland cotton costs of production was 77 per cent higher than market prices received by US farmers in MY 1999-2001, at the same time that US production and exports increased remained at high levels. Another demonstration of the causal link is the 15 per cent increase in the value of the US dollar between MY 1999-2001 at the same time that US export market share increased 68 per cent and A-Index prices declined by 21 per cent.

11. The link between US subsidies and suppressed A-Index, Brazilian, and other third country upland cotton market prices is further confirmed by the fact that the nature, size and global impact of the US market permits it to drive and suppress world prices. The large size of the US world market share of 41.6 per cent that is generated and sustained by the US subsidies suppresses world market prices. Production and export developments in the US market are widely publicized and impact the New York Cotton Exchange's futures market, which in turn directly influence and impact A-Index and Brazilian prices.

12. The link between the US subsidies and significant price suppression is also confirmed by USDA and other economists' findings of the individual production, export and price-suppressing effects of each of the US subsidies have . USDA and other economists have identified the US marketing loan payments as having the greatest production, exports and A-Index price-suppressing effects. Crop insurance subsidies, like marketing loan payments, are directly tied to production, and have been found to create similar types of effects by USDA and other economists, as they eliminate risk and induce farmers to put marginal land into production. CCP payments (and to a lesser extent market loss assistance, PFC and direct payments) have production impacts as a result of additional income and wealth effects that keep land in production and maintain base acres in production in anticipation of future base updating like that permitted under the 2002 FSRI Act. Step 2 export payments directly stimulate US exports and permit US exporters to export high-cost US upland cotton with the effect of suppressing A-Index prices. The GSM-102 export credit guarantee programme facilitated the export of more than $1 billion worth of US upland cotton between FY 1999 and the present, thereby increasing US exports and suppressing world prices.

13. A number of econometric studies found that the US subsidies collectively have the effect of increasing US production, exports and suppressing world prices. The ICAC found that world prices would increase by 11 cents per pound price from the removal of US subsidies in MY 2001 and 6 cents in MY 2000. The University of Tennessee found an average 11.4 per cent price suppressive effects from removing US subsidies during MY 2003-2007. The IMF estimated world prices would increase by 4 per cent based on removing $1 billion of US subsidies in MY 1998. The World Bank/IMF found a 25-30 per cent increase in world prices from elimination of US upland cotton subsidies in MY 2003-2007. The Centre for International Economics found an increase of world price by 13.4 per cent by eliminating US and Chinese subsidies in MY 1998. Professor Daniel Sumner determined that removing the US subsidies in MY 1999-2002 results in an average increase in the A-Index price of 12.6 per cent.

14. Further, Brazilian prices for domestic Brazilian sales as well as Brazilian export sales are suppressed by the effects of the US subsidies. The small size of the Brazilian market and low applied tariffs mean that Brazilian producers are price takers, not price makers. Negotiations to determine Brazilian domestic and export prices are heavily influenced by New York Cotton Exchange's futures prices and A-Index prices. The movements in prices between the Brazilian prices and prices in these international markets are closely tied. Prices in other third country markets also show a close linkage with Brazilian, New York futures, US spot, US A-Index and other prices included in the A-Index calculation.

15. Finally, the amount of price suppression between MY 1999-2002 as reflected in various econometric studies of world prices varies from 6 cents per pound to 11 cents per pound. Professor Sumner found the A-Index price suppression to be 6.5 cents per pound between MY 1999-2002. This estimated worldwide price suppression is "significant" because it materially affects producers in Brazil and throughout the world. Total income loss from the price suppression is $3.587 billion and Brazilian producers lost an estimated $478 million from suppressed prices.

16. **Increasing World Market Share in MY 2001 – Article 6.3(d) of the SCM Agreement:** The US subsidies for upland cotton contributed significantly to the production and export of large quantities of upland cotton in violation of Article 6.3(d) of the SCM Agreement. The three-year average US world market share in MY 1998-2000 was 22.3 per cent. In MY 2001, the subsidy-enhanced US world market share increased to 38.3 per cent. This MY 2001 increase follows a consistent trend since the 1996 FAIR Act was enacted with US world market share increasing from 25 per cent to 38.1 per cent. The evidence linking US subsidies and increasing production and exports in the price suppression analysis is also relevant for the Article 6.3(d) claim. Professor

Sumner finds that *but for* the US subsidies, US exports between MY 1999-2001 would have declined on average by 39 per cent.

17. **Inequitable World Export Share - 1999-2002: Articles XVI:1 and 3 of GATT 1994:** US subsidies provided from MY 1999-2002 contributed significantly to the United States having more than an equitable share of world export trade within the meaning of GATT Article XVI:3. The US share of world exports increased from 17.93 per cent in MY 1998 to 38.3 per cent in MY 2001 and increased further to 41.6 per cent in MY 2002. The causal link between the US subsidies and the increased US export market share is based on the evidence of production and export effects of US subsidies set out in the price suppression analysis. Professor Sumner concluded that *but for* the US subsidies US exports would be 41.2 per cent lower and US production would decline by 28.7 per cent on average between MY 1999-2002. The current US share of world exports of upland cotton is not "equitable" because producers from countries competing with the United States do not receive any or at most only small amounts of subsidies and have costs of productions are far lower than the United States. *But for* the effects of the US subsidies, these producers, including producers in Brazil, would have increased their share of the world export trade.

18. **Threat of Serious Prejudice:** Brazil's second set of adverse effects claims involves the demonstration of a *threat* of serious prejudice under Article 5(c), 6.3(c), and 6.3(d) of the SCM Agreement and GATT Articles XVI:1 and 3. The record shows that five US subsidies – marketing loan payments, crop insurance subsidies, Step 2, CCP and direct payments – have no production or expenditure limitations and either no or at best no practical payment limitations. These unlimited subsides are required to be paid by USDA and eligible US producers, users and exporters. These eligible recipients have an enforceable entitlement to receive the payments – regardless of the effect of US subsidies on the world upland cotton market. Based on the *EC – Sugar Exports* GATT panel decisions and the *US – FSC* Appellate Body decision, these facts support a finding of a threat of serious prejudice in the form of significant price suppression, increases in US world market share, and inequitable share of world export trade.

19. A threat of serious prejudice is confirmed by fact that the level of US subsidies has increased by up to 10 cents per pound between MY 2001 and 2002 with the passage of the 2002 FSRI Act. Having established *present* price suppression, increased world market share and inequitable share of world export trade, this evidence also confirms the existence of a *threat* of serious prejudice for MY 2003-2007. A University of Tennessee study predicts removal of the US subsidies will increase US prices by 11.4 per cent between 2003-2007. The IMF predicts that removal of US subsidies would increase world market prices by 25-30 per cent in the short term. Professor Sumner predicts that removal of US subsidies would increase world A-Index prices by 5.9 cents per pound, decrease US production by 4.5 million bales, and decrease exports by 4.4 million bales.

20. A threat of serious prejudice also exists because the US costs of production will increase between MY 2003-2007 with USDA and FAPRI not expecting the large cost-market revenue gap to decline significantly. The most recent FAPRI baseline suggests that marketing loan and CCP payments will be made throughout MY 2003-2007. Additional evidence of a threat of serious prejudice exists from USDA and FAPRI baselines (reflecting mandatory payments under the 2002 FSRI Act) that project that US acreage, production, and exports will continue at existing high levels given the existence of the US subsidies. The increasing export orientation of US production, as US domestic textile production declines, also increases the threat of significant price suppression, increased world market shares, and inequitable shares of world export trade.

21. The evidence demonstrates that the threat of an increased US world market share in MY 2002 has already materialized, as the US world market share continued to increase in MY 2002 to 41.6 per cent, well above the MY 1999-2001 three-year average of 29.1 per cent. The threat also exists for MY 2003 as recent USDA projections of US exports indicate that the likely US share will be 38.8 per

cent in MY 2003 – an increase over the three-year (MY 2000-2002) average of 34.9 per cent. This evidence further supports the finding of a threat that the US share of world export trade will continue to be inequitable for MY 2003-2007.

22. **Per Se Challenges to 2002 FSRI Act and 2000 ARP Act:** Brazil also challenges certain provisions of the 2002 FSRI Act and the 2000 ARP Act – in as far as they relate to upland cotton – as *per se* violations of Articles 5(c), 6.3(c), 6.3(d) of the SCM Agreement and GATT Article XVI:3. In particular, Brazil challenges the mandatory provisions requiring the executive branch of the US Government to make marketing loan, Step 2 domestic and export, crop insurance, direct and counter-cyclical payments to eligible upland cotton producers, users and exporters. There is no statutory mechanism in any of the challenged statutes or regulations to limit the guaranteed payments when these payments cause serious prejudice or a threat of serious prejudice. The absence of any statutory upland cotton circuit breaker threatens to cause serious prejudice, including price suppression, increased US export and an inequitable US share of world upland cotton exports.

# ANNEX E-2

## EXECUTIVE SUMMARY OF THE FURTHER SUBMISSION OF THE UNITED STATES

1. **Brazil Has Failed to Demonstrate that Crop Insurance Payments Are "Specific".** The United States reiterates that the subsidy to any agricultural producer is the premium subsidy paid by the US Government, which is common to all commodities at a chosen coverage level. Thus, Brazil's repetition that certain policies are not available to all commodities is in part true but wholly irrelevant: the particular *policies* offered to growers of different commodities are issued by private insurers but the *subsidy* by the US Government on the premiums remains the same. Crop insurance subsidies are available to the US agricultural sector as a whole. It is the position of the United States (reflected in domestic law) that such a widely available subsidy does not satisfy the specificity requirement of Article 2. Thus, pursuant to Article 1.2 of the Subsidies Agreement, US crop insurance payments are not "subject to the provisions of . . . Part III" of the Subsidies Agreement, including Articles 5 and 6 on serious prejudice.

**2. Brazil Has Failed to Demonstrate that Challenged US Measures Caused the Decline in World Upland Cotton Prices Because It Simply Ignores Key Factors Behind Those Price Movements.** Brazil has failed to make a *prima facie* case on its claims on the basis of the mere assertion that large US outlays during marketing years with low prevailing upland cotton prices necessarily establishes causation. Brazil has failed to explain to the Panel key factors that affected world cotton markets during the marketing year 1999 - marketing year 2002 period. These factors and not US subsidies were the causes of the dramatic plunge in cotton prices experienced in recent years.

3. – **Persistent weakness in world demand for cotton due to competing, low-priced synthetic fibres and weak world economic growth.** The production of competing, synthetic fibres exploded during the 1990's, putting downward pressure on world cotton prices. Asian countries added more polyester production capacity between 1991 and 2001 than existed in the entire world in 1990. Asian polyester prices remained below world cotton prices from 1990 to 2001. By 2002, cotton lost the position as the world's dominant fibre and slipped below polyester's market share. Consumer purchases outside the United States added over 40 million bales to textile fibre consumption since 1990 but virtually the entire amount was claimed by polyester. Consumers outside the United States buy no more cotton today than they did in 1990.

4. In addition to the price pressure from synthetic production, the world economy grew more slowly since 1997 than any time for many years. Clothing is a semi-durable good, and when income growth slows consumers cut back on current purchases, and postpone replacing clothing until incomes rise more rapidly. Cotton consumption can decline even while income growth remains positive. The 2001-2002 decline in world income occurred just as world cotton production was increasing because of good weather, severely pressuring world prices.

5. – **Burgeoning US textile imports, reflecting the strong US dollar and declining US competitiveness in textile and apparel production, have fundamentally shifted the disposition of US cotton production from domestic mills to export markets.** The United States has supported world cotton prices through its huge demand for cotton textiles and apparel. Imported textile and apparel products continue to displace US mill use of cotton fibre. From 1997 to 2002, US mill use of cotton dropped 32 per cent. For 2002, US cotton textile and apparel imports rose for the 14th consecutive year, while exports remained essentially unchanged for the fifth straight year. This huge

trade deficit in textiles and clothing has fundamentally changed the pattern of how US-grown cotton is used. As domestic mill use has fallen drastically, more US cotton has been available for use by foreign mills, which then comes back to the US in the form of cotton products.

6. – **China, the world's largest cotton producer and consumer, released 14 million bales of government stocks between 1999 and 2002, equalling as much as 7 per cent of world consumption in crop year 2000/01.** China's policies were strongly correlated to world cotton price movements through the late 1990's and early 2000's. Through the mid-1990's the Chinese Government was concerned with maintaining farmers' income and directed the state marketing organization to maintain cotton procurement prices at high levels, causing stocks to grow rapidly. At the beginning of the 1999/2000 marketing year, China announced a policy of auctioning cotton from these stockpiles, with the central government accepting the financial loss. China auctioned 11.6 million bales over August 1999 to July 2002 (3 million bales in 1999/2000, 6.5 million in 2000/01, and 2.1 million in 2001/02). Over the entire marketing year in 2000/01, China's auctions equalled 7 per cent of world consumption that year.

7. – **Factors Affecting US Cotton Production.** Cotton planting decisions are driven by numerous factors, including the expected price of cotton, prices of competing crops, farm programme benefits, technological factors and input costs. Contrary to Brazil's claims, US cotton producers have been responsive to world price movements and are not insulated from the world market. Changes in production technology can affect both the risk and the expected returns from cotton production. In recent years, the boll weevil eradication programmes and the introduction and adoption of genetically modified varieties of cotton have lowered production costs, increased yields, and increased net returns for US cotton production.[1]

8. Since 1994 there have only been 2 years when US harvested acres changed from one year to the next in a different fashion than growers in the rest of the world. Those 2 years, 1998 and 1999, are specific to severe drought in the United States. In 1998, US harvested area fell, largely due to disastrous conditions across much of Texas; in 1999, weather was more normal and US harvested acres increased by almost exactly the acres lost in the previous year.

9. In early calendar year 2000, the futures price for cotton had fallen from the previous year's level while corn and soybean prices had risen on the year. US and world cotton growers reduced harvested acreage from the level in 1999 by virtually identical proportions. While cotton harvest futures prices again declined on the year from 2000 to 2001, soybean and corn harvest futures prices fell by a greater per cent. As a result, US and world cotton growers saw an increase in cotton harvested acres in 2001. In considering planting in 2002, growers saw soybean and corn harvest futures prices showing greater percentage increases than cotton. Thus, both US growers and growers in the rest of the world saw harvested acres of cotton decline from the previous year's level.

10. **Brazil Has Not Established a *Prima Facie* Case With Respect to US Decoupled Income Support Measures Because These Measures Have No More than Minimal Effects.** With respect to US green box measures, namely direct payments under the 2002 Act and expired production flexibility contract payments under the 1996 Act, Annex 2 of the Agriculture Agreement makes clear that these payments have no, or at most minimal, trade-distorting effects or effects on production. Under Article 21.1 of the Agriculture Agreement, the Subsidies Agreement applies "subject to" the Agriculture Agreement. Accordingly, Annex 2 makes it clear that US green box measures do not

[1] Studies indicate that the boll weevil eradication program has lowered the costs of producing cotton and has made cotton a more attractive cropping alternative. US producers have also rapidly expanded plantings of biotech cotton, rising from 25 per cent of plantings during the 1997 crop year, to an estimated 73 per cent of plantings in 2003. Studies suggest that biotech cotton has increased yields and net returns while decreasing pesticide use.

cause serious prejudice. Income payments that vary in amount with market prices, such as counter-cyclical payments under the 2002 Act and expired market loss assistance payments, are also decoupled in the sense of not being linked to current production. Because (according to the economic literature on decoupled payments) the effect on production is negligible, these payments can have no "effect" for purposes of Subsidies Agreement Article 6.3 nor operate to increase exports under GATT 1994 Article XVI:3.

11. Finally, because no production of upland cotton (or any other crop) is necessary to receive these payments, it would be erroneous to attribute to "upland cotton" or "upland cotton producers" all decoupled payments made with respect to upland cotton base acreage. Those acres may be planted to alternative crops or may be growing no crops at all. Accordingly, there is no basis to include those payments in an analysis of whether "subsidies provided to US producers, users and/or exporters of upland cotton" have caused serious prejudice.

12. **Brazil Has Failed to Demonstrate that Challenged US Measures Have Caused Serious Prejudice to Brazil's Interests Within the Meaning of Article 5(c) and 6.3(c). – "Serious Prejudice . . . May Arise":** The introductory sentence of Article 6.3 establishes that serious prejudice "may arise" if "one or more" of four specific circumstances is found, indicating that serious prejudice need not arise even if they are found. As serious prejudice "may" arise if one or more of the four conditions under Article 6.3 are satisfied, Brazil must first show that *at least one* of those conditions is met. Second, if Brazil demonstrates one or more of the criteria in Article 6.3 is met, Brazil must then demonstrate "serious prejudice." In this dispute, Brazil has not established that any prong of Article 6.3 is met.

13. – **The "Effect of the Subsidy":** Brazil has not made a *prima facie* case that "the effect of the subsidy" was significant price suppression or depression. Brazil's argument on causation fails because Brazil has simply not demonstrated the causal connection between the US measures and the price effects. Brazil has not even shown there is a necessary correlation between the measures and the effects it claims, let alone that there is a genuine and substantial link between the US measures and the effects claimed. Brazil has failed to separate and distinguish all the different effects from the various factors at play during the marketing year 1999 - marketing year 2002 period and has erroneously attributed to the US measures the effects of these other causes.

14. – **"Significant price suppression".** The Agreement does not define "significant". The ordinary meaning of significant is "important, notable; consequential," which suggests that the price suppression must reach a level at which it is important, notable, and consequential in order to be inconsistent with Article 6.3(c). The United States further notes that the term "significant" modifies "price suppression or depression"; therefore, it is the effect on *prices* that must be "significant" and not the direct effect on *producers,* as Brazil argues.

15. Under Brazil's interpretation price suppression would be significant at a level of even 1 cent per pound because this could still "meaningfully affect" producers. Brazil's interpretation, however, collapses the concept of "significant price suppression or depression" with the concept of "serious prejudice". It would also greatly expand the effect of Article 6.3(c), which falls under Part III of the Subsidies Agreement on "Actionable Subsidies" rather than Part II on "Prohibited Subsidies", to encompass *any* subsidy with any production and therefore price effect. Members agreed, however, that any theoretical price effect would not suffice to satisfy Article 6.3(c); they accomplished this by stating that the price suppression or depression had to be "significant" in order to create a situation in which serious prejudice may arise.

16. Brazil's theory would also create two sets of subsidy rules: one for widely traded products, such as most agricultural products, and another for more differentiated products. The more widely traded a product is, the more *any* price effect could be deemed to "meaningfully affect" producers.

There is no basis in the text of the Agreement for creating such a distinction. Where Members intended a particular rule to apply to a particular type of product – such as a "subsidized primary product or commodity" (Article 6.3(d)) – they said so explicitly.

17. **– "In the Same Market":** Article 6.3(c) requires that the "significant price suppression [or] depression" that is the "effect of the subsidy" occur "in the same market". The use of the same "in the same market" phrase as in the price undercutting portion of this Article suggests that the significant price suppression or depression must occur when "the subsidized product" is found "in the same market" as "a like product of another Member". That is, "in the same market" is meant to require identification of a particular market in which price effects are alleged to have occurred so as to allow a comparison in that market. If a complaining party could merely assert price suppression or depression in the world market, the word "same" in the phrase "the same market" would be rendered inutile because the subsidized and non-subsidized products could always be deemed to be in the same "world market".

18. **– Time Period for Demonstrating Causal Effects:** The "appropriate representative period" for demonstrating present serious prejudice will depend on the nature of the challenged subsidies. Normally, the most recent period for which data are available will be the appropriate period. In the case of recurring subsidies such as those under the 1996 Act and the 2002 Act, moreover, a past subsidy no longer exists as of the time a new subsidy payment in respect of current production is made and can have no "effect" within the meaning of Article 6.3. As a result, the period for which Brazil must demonstrate present serious prejudice is marketing year 2002. None of the provisions cited by Brazil, moreover, say that the effect of a subsidy 1, 2, or 3 years ago is presently being felt. Thus, at a minimum, the effect of the subsidy must be demonstrated in each year and for each year in which Brazil has alleged effects.

19. **Brazil Has Failed to Demonstrate that Challenged US Measures Have Caused Serious Prejudice to Brazil's Interests Within the Meaning of Article 5(c) and 6.3(d) – "World Market Share":** Contrary to Brazil's interpretation, Article 6.3(d) does not use the phrase "world market for exports"; it uses the phrase "world market share . . . in a particular subsidized primary product or commodity". This broad term would appear to encompass all consumption of upland cotton, including consumption by a country of its own cotton production. Context supports reading "world market share" as distinct from "world export share". In fact, GATT 1994 Article XVI:3 uses the phrase "world export trade", and Brazil interprets Article 6.3(d) and GATT 1994 Article XVI:3 both as applying to "world export trade". Had Members intended that "world export trade" be the relevant concept to apply in Article 6.3(d), one would have expected use of that phrase. Because Brazil has misinterpreted "world market share", and all of Brazil's evidence goes to a comparison of the "world export share" of the United States, Brazil has failed to make a *prima facie* case.

20. **– Appropriate Time Period for Showing Present Serious Prejudice:** Brazil has limited its claim under Article 6.3(d) to "the increased US world market share for MY 2001". Thus, there can be no finding that subsidies under the 2002 Act or marketing year 2002 subsidies presently cause serious prejudice. As the United States has previously noted, to demonstrate the "effect of the subsidy" it would normally be appropriate to look to the subsidy provided in the most recent year. Brazil has not explained why it challenges marketing year 2002 subsidies (in addition to 1999-2001) under Article 6.3(c) but only marketing year 2001 under Article 6.3(d). Brazil has stated that the 1996 Act introduced a new subsidy scheme; at a minimum, Brazil should demonstrate that in fact there is a "consistent trend" over a period when subsidies have been granted (1996-2001).

21. **– Causation: "The Effect of the Subsidy":** Brazil has simply not demonstrated the causal connection between the US measures and the effects on world market share. As explained above, Brazil has failed to separate and distinguish other factors that drove prevailing upland cotton prices to historically low levels.

22. **Brazil Has Failed to Demonstrate any Inconsistency with GATT 1994 Article XVI:3 – "More than Equitable Share:** Brazil argues that in determining what is an "equitable" share, the Panel must look at what the US share of world export trade would have been in the absence of subsidies. Brazil cites to no textual basis for its approach, nor could it since the text does not contain one. There is nothing in Article XVI:3 that says that a Member is banned from using any subsidies, let alone that a Member is denied the ability to have any share in world markets if the Member employs subsidies. Any consideration of what is an "equitable" share needs to take into account the fact that Members are generally permitted to provide subsidies. However, any subsidy that has a production effect may increase exports; if so, according to Brazil, the resulting export share would be "inequitable". This interpretation would turn Article XVI:3 into a prohibition on subsidies that potentially could increase exports. Rather than imposing a prohibition, Article XVI:3 states only that Members "should seek to avoid" export subsidies on primary products, with additional conditions if inequitable shares result.

23. In considering the difficulties inherent in applying the "more than equitable world market share" language, the United States recalls the discussion of the Tokyo Round Subsidies Code panel on *Wheat Flour* on the "more than equitable world market share" language. The panel's enumeration of difficulties associated with this concept are the types of considerations that led to the negotiation of the Subsidies Agreement. Brazil now would have the Panel believe that these negotiations were unnecessary, that the disciplines it seeks were all in the language of Article XVI:3 all along. Brazil's approach is in error and should be rejected.

24. **– "Any Special Factors":** Brazil considers that one "special factor[]" that may be affecting trade or that may have affected trade is the low level or even absence of domestic support in other supplying countries. Again, Brazil's proposed rule would suggest that where no other Member were subsidizing (each because of its own sovereign choice not to use resources in that way), a Member would be prevented from subsidizing in any amount that results in increased exports. However, Article XVI does not contemplate a prohibition on agricultural subsidies, even on export subsidies: under Article XVI:3, Members "should seek to avoid" use of export subsidies on primary products. Therefore, "any special factors" should not be interpreted in a way that introduces a meaning that the provision itself avoids.

25. **Brazil Has Failed to Demonstrate a Threat of Serious Prejudice:** Brazil argues that there is no explicit standard for threat of serious prejudice in the Subsidies Agreement nor guidance in WTO reports. The United States considers that the first standard articulated by Brazil is incorrect. Brazil's proposed rule would seemingly transform Articles 5(c) and 6 from actionable subsidy provisions into prohibited subsidy provisions. That is, Brazil's approach would produce a threat determination wherever "subsidies by a large exporter have no effective production or export limitations". There is no such *per se* threat rule in the Subsidies Agreement, however; a finding of serious prejudice requires a fact-intensive demonstration.[2]

[2] The United States also considers that this proposed standard has not been met by Brazil. First, as explained above, Brazil has not established a *prima facie* case of present serious prejudice, and therefore one cannot presume that there is a threat such prejudice will continue. Second, the Appellate Body report in *United States – FSC* cited by Brazil involved export subsidies under the Agriculture Agreement and a completely separate standard. Under the serious prejudice provision of the Subsidies Agreement, the question is the much more complicated issue of what is the clearly foreseen and imminent effect of measures on a Member's interests, which may depend on future market conditions, world prices, and other factors. Third, Brazil has not demonstrated that the challenged measures are mandatory in the sense that they must be given if an application is made. Even though the Department of Agriculture has the obligation to make such payments available, the obligation only attaches when certain market conditions prevail. Thus, to show that the threat of serious prejudice is (in Brazil's words) "real, clear, and imminent," Brazil would have to show predicted prices over the future period complained of (marketing years 2003-07) and the likelihood of that occurring.

26. The United States believes the second standard proposed by Brazil is correct. To demonstrate a threat of serious prejudice a complaining party must show a clearly foreseen and imminent likelihood of future serious prejudice. The use of the elements of serious prejudice set out in Article 6.3 ensures that a complaining party come forward with sufficient credible evidence.[3]

27. **– Threat of Serious Prejudice Via Price Suppression:** In addition to the reasons just given, the United States notes that price developments over the past several months and expected price movements do not support a conclusion of a clearly foreseen and imminent likelihood of future serious prejudice. Brazil claims that "[b]ase[d] on MY 2002 prices, current prices in August 2003 and price levels projected by FAPRI's baseline, it is likely that marketing loan and CCP payments will be made during MY2003-2007". However, current market and futures prices (not reflected in Brazil's submission) already indicate that the baseline projection of low prices is wrong.[4] Thus, current prices and futures prices do not suggest any clearly foreseen and imminent likelihood of future serious prejudice.

28. **Threat of Serious Prejudice Via Price Suppression:** Brazil again reads "world market share" in Article 6.3(d) as the equivalent of "world export share". Thus, Brazil 's threat analysis is wrong for the same reason as its serious prejudice analysis, and Brazil has not established a *prima facie* case of threat of serious prejudice under Article 6.3(d).

29. **GATT 1994 Articles XVI:1 and XVI:3.** Brazil asserts that the 2002 Act and 2000 Agricultural Risk Protection Act threaten a high and inequitable share of world exports between MY2003-07. Brazil nowhere cites the text of GATT 1994 Article XVI:3 (or of the Subsidies Agreement) that would support the notion that there is a valid cause of action for "threat" of a "more than equitable share of world export trade". In the absence of any text relating to Article XVI:3, Brazil's claim of a "threat" of a "more than equitable share" must be rejected.

30. **Brazil Has Failed to Demonstrate that Challenged US Measures Are *Per Se* Inconsistent with US WTO Obligations.** Brazil argues that the marketing loan, counter-cyclical, direct, and step 2 payments as well as the crop insurance subsidies are *per se* inconsistent with US WTO obligations because they threaten to cause serious prejudice at price levels that require the payment of marketing loan and CCP payments (that is, below 52 cents per pound). For all the reasons set out with respect to Brazil's present serious prejudice claims and its threat of serious prejudice claims, Brazil's argument is in error.

31. Brazil also argues that even at high price levels where only direct payments and crop insurance payments would be made, there is necessarily a threat of serious prejudice because these payments necessarily will keep marginal land in production because producers face no down-side revenue risk. Brazil has presented no evidence on the extent of any alleged effect of these two subsidies in keeping marginal production on-line at a time of high prices (as the market currently expects). Second, that some marginal lands may be kept in production cannot alone suffice to

[3] A similar concern is addressed for purposes of threat of material injury in countervailing duty investigations by Subsidies Agreement Article 15.7; under this article, "[t]he change in circumstances which would create a situation in which the subsidy would cause injury must be clearly foreseen and imminent." We note the relationship between threat of serious prejudice and threat of material injury, both of which make up part of adverse effects under Article 5.

[4] Instead of continued low prices, the A-Index *average* for September 2003 has risen to 64.06 cents per pound. New York Cotton Exchange futures prices demonstrate that market participants expect cotton prices to climb even further through the 2003 marketing year, strengthening beyond their 20-year average of 67.86 cents per pound (1983-2002) within the current 2003 marketing year. In fact, if cotton prices reach the levels (over 70 cents per pound) indicated by the futures market, prices would be very close to what Brazil calculates as the A-index average (74 cents per pound) for the period *before* Brazil alleges serious prejudice.

demonstrate a *per se* threat of serious prejudice. Otherwise, any subsidy with any production effect would be found to pose a threat, transforming actionable subsidies into prohibited subsidies. Thus, Brazil has not demonstrated that these subsidies *per se* present a real, clear, and imminent threat of serious prejudice.

32. **Export Credit Guarantees – The Negotiating History of Article 10.2 Reveals that the Negotiators Explicitly Deferred the Application of All Export Subsidy Disciplines on Export Credit Guarantees:** The negotiating history of Article 10.2 of the Agreement on Agriculture reveals the explicit deferral by the drafters of the application of export subsidy disciplines on export credit guarantees. In particular, the plain difference between the language of the Draft Final Act and that of Article 10.2 shows that the negotiators specifically opted not to impose the disciplines that Brazil now seeks to impose through litigation. The earlier version was an unambiguous prohibition, unless permitted under internationally agreed disciplines. The latter – and current – version imposes no such prohibition. It only requires Members to work toward the development of yet-to-be-agreed disciplines, and only upon agreement on such disciplines are export credit guarantee programmes required to adhere to them.

33. Brazil's interpretation of Article 10.2 would require export credit guarantees in agriculture to be subject to more disciplines than any other practice addressed in the Agreement on Agriculture. Under Brazil's view, not only would export credit guarantees constitute export subsidies and be subject to all of the export subsidy disciplines, but Members would *also* be specifically obligated to work toward and then apply additional disciplines. Brazil's argument would require an interpretation that the negotiators viewed export credits, credit guarantees, and insurance programmes as more malign than the recognized export subsidies themselves. This implausible conclusion is nowhere manifest in the text of the negotiating history.

34. To the contrary, the text indicates that export credits, credit guarantees, and insurance programmes were not considered export subsidies, because they were explicitly excluded from Article 9.1 of the Agreement on Agriculture, despite their inclusion in negotiating documents culminating in the current text. Brazil argues that the same is true of "[e]xport performance-related taxation concessions or incentives other than the remission of indirect taxes", and yet the Appellate Body has ruled the FSC and ETI measures are subject to the export subsidy disciplines of the Agreement on Agriculture. With respect to those measures, however, no provision like Article 10.2 exists. Export credits, credit guarantees, and insurance programmes were not only removed from the illustrative list evident in Article 9.1 but received the explicit commitment to negotiate disciplines set forth in Article 10.2.

35. **– The Application of Government-Wide Accounting Rules under the Federal Credit Reform Act Indicates that the Export Credit Guarantee Programmes are Covering Long-Term Operating Costs and Losses:** The United States has demonstrated that over time, as indicated by the government-wide accounting rules mandated under the Credit Reform Act, with respect to those years for which nearly complete experiential data is available, programme revenues exceed operating costs and losses. In those years for which the accounting books are nearest to closing (1994 and 1995), the operation of the programme shows a profit. Similarly, current data for 1992, 1993, 1996, and 1999 also indicate a profit. All of this data is on a cohort-specific basis, a methodology with which Brazil agrees.[5]

[5] Brazil misapplies the cohort-specific accounting methodology, however, to erroneously argue that "when [the] total lifetime reestimates for all cohorts of guarantees disbursed since 1992 are netted against the total *original* subsidy estimates adopted each budget year during the period 1992-2002, *the resulting loss is nearly $1.75 billion*". To arrive at this fanciful figure Brazil begins not with the estimates based on the "actual" level of guarantees issued, but rather with the original subsidy estimate in the budget year, well before virtually any activity in the programmes has occurred in that fiscal year. The "actual" figure is simply a reflection of the

36. The United States has repeatedly noted that CCC has complete discretion at any time not to issue guarantees with respect to any individual application for an export credit guarantee or to suspend the issuance of export credit guarantees under any particular allocation. In addition, the authorizing statute prohibits CCC from making credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary of Agriculture determines cannot adequately service the debt associated with such sale. Third, availability of export credit guarantees is governed by allocations in effect at any one time for specific commodities and specific destinations. Fourth, the ability of CCC to issue guarantees is constrained by the apportionment process of the President's Office of Management and Budget.

37. **– Forfaiting is Analogous to the CCC Export Credit Guarantee Programmes:** Brazil's argument that forfaiting transactions and CCC export credit guarantee transactions are dissimilar illustrates the comparability of the financing available in these transactions. As Brazil points out, in both cases "the exporter wants to get paid immediately on a cash basis, and the importer wants credit that it can repay on a deferred basis". From the importer's perspective, the export credit guarantee transactions are *less* favourable than forfaiting, because although the importer's bank can repay its obligation over time, the CCC has no control over the terms of the arrangement between the importer and its bank, which may not extend the deferred payment terms to the importer. In forfaiting, the importer "can repay on a deferred basis". In both cases, the transaction (in Brazil's words) "enables the exporter to convert a credit sale into a cash sale." Brazil recognizes that as the complaining party it carries the burden of demonstrating that a "benefit" is conferred with respect to the GSM-102 programme. Brazil has failed to carry this burden.

38. **The Step 2 Programme Does Not Violate Article 3.1(b) of the Subsidies Agreement or Article III:4 of GATT 1994:** Brazil has rotundly stated: "There are no circumstances in which a 'local content subsidy' would comply with Article 3.1(b)". In effect, Brazil's argument would delete the application of the introductory clause of Article 3 to Article 3.1(b) entirely. But the phrase "except as provided in the Agreement on Agriculture" by its terms applies to both export subsidies under Article 3.1(a) and local content subsidies under Article 3.1(b).

39. Brazil would require the Step 2 programme to permit payments for the use of all cotton, whether domestic or imported, but only payments for domestic cotton would be included in the AMS. Such a programme would no longer be in favour of domestic producers. The Step 2 programme provides a benefit to producers because it serves to maintain the price competitiveness of US cotton vis-a-vis foreign cotton through a payment to capture some differential between prevailing foreign and domestic cotton prices. Brazil's hypothetical programme would cause the benefit to US producers to evaporate. Rather than a subsidy "in favour of agricultural producers", the programme would become a simple input subsidy in favour of textile manufacturers outside the coverage of the Agreement on Agriculture altogether. Brazil's interpretation would render Paragraph 3 of Annex 7 of the Agreement on Agriculture inutile.

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actual level of guarantees issued in the particular fiscal year. The original subsidy estimate, in contrast, begins with what is an historically overly optimistic projection of actual use of the programme and then is required to use the government-wide estimation rules without regard to the actual experience specific to the CCC export credit guarantee programmes.

Actual guarantee issuance can first be reflected only in the budget two fiscal years after the original subsidy estimate. Once the actual use of the program is determined all subsequent reestimates are based on that figure, not on the original subsidy estimate. Other than with respect to interest (because of independent market forces), a downward reestimate never occurs based on the original subsidy estimate. It only occurs subsequent to establishment of the actual program use. Consequently, it is wholly inappropriate to calculate net reestimates based on the original subsidy estimate for a particular cohort, as Brazil has done. For these reasons, the United States' calculation indicating increasing profitability within the program is accurate, and the Brazilian calculation is not.

40. Brazil argues that since the Peace Clause provisions for domestic subsidies do not reference Article 3, the Agreement on Agriculture envisioned that local content subsidies would be prohibited. Brazil's conclusion does not necessarily follow from the structure of the text. Indeed, a contrary conclusion is more appropriate. Article 13(b) does not refer to Subsidies Agreement Article 3 because the substantive obligation of Article 3.1(b) does not apply in the case of domestic content subsidies in favour of agricultural producers. Article 13(b) applies to "domestic support measures that conform fully to the provisions of Article 6 of this Agreement". The character of the domestic subsidy is not relevant to the disciplines. The Agriculture Agreement never defines "domestic support", which is permitted in any form so long as the Member adheres to its reduction commitments.

# ANNEX E-3

## SECOND WRITTEN THIRD-PARTY SUBMISSION BY ARGENTINA

3 October 2003

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## I. INTRODUCTION

1. Argentina thanks the Panel for the renewed opportunity to present its views as a third party to these proceedings.

2. Argentina reaffirms the arguments put forward in its written Third-Party Submission and at the meeting of the Panel with the third parties, of 15 and 24 July respectively. It accordingly reiterates its position that the United States has no basis for claiming protection under Article 13 of the Agreement on Agriculture (AoA) and that the US subsidies are therefore actionable under Article XVI of the GATT 1994 and Articles 3, 5 and 6 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). Argentina further reiterates that the US cotton export subsidies are inconsistent with Articles 3.3, 8 and 10.1 of the AoA and constitute prohibited subsidies within the meaning of Article 3.1(a) and (b) and 3.2 of the SCM Agreement.

3. Argentina will now address the claims put forward by Brazil in its recent Further Submission dated 9 September, regarding the inconsistency of the US cotton subsidies[1] with Articles 5(c) and 6.3(c) and (d) of the SCM Agreement to the extent that, in the case of the subsidies provided in marketing years (MY) 1999-2002, they cause serious prejudice to the interests of other Members, including Argentina. Argentina further proposes to argue that such subsidies threaten to cause serious prejudice[2] in MY 2003-2007.

[1] The US subsidies the consistency of which is being challenged include both the domestic support measures and the prohibited subsidies and export credit guarantee programme cited at paragraph 7 of Brazil's Further Submission to the Panel of 9 September 2003.

[2] Within the meaning footnote 13 of the SCM Agreement.

4. Given the little time available between the receipt on 30 September of the responding party submission of the United States and the date fixed for this third-party submission, Argentina will comment on the US submission at the meeting of the Panel with the parties and third parties scheduled on 8 October next.

## II. IMPACT OF THE US SUBSIDIES ON THE WORLD COTTON MARKET SITUATION

5. In the first line of the Introduction to its Further Submission of 9 September, Brazil points out that this is a case involving basic economic principles of supply and demand. Indeed, according to the basic principles of a market economy, in an open market prices would follow the costs of the more efficient producers. Thus, higher-cost (i.e. less efficient) producers are gradually compelled to reduce production. In the world cotton market, however, these principles are turned on their head: many highly efficient global producers have been cutting production, while the less efficient US producers are insulated from changes in market prices. Worse still, there is an inverse relationship between the world price of cotton and US production.

6. In the words of US Senator Fred Thompson,

> "*These policies defy logic and they defy the most basic laws of economics. The result is that farmers know that they are guaranteed to receive a certain price regardless of market conditions, so they ignore market signals and overproduce. The overproduction further depresses commodity prices, leading to the need for ever increasing government subsidies*".[3]

7. Argentina already emphasized this point in the consultations held in December of last year when it addressed the following questions, *inter alia*, to the United States:

> *Could the US explain the reasons behind the fact that in 2001 -fifth year of falling prices- US cotton producers did obtain a record harvest of 20.3 million tons -an increase of 42 per cent compared to 1998- and that the cotton planted area did increase by 6 per cent during the same period?*
>
> *Why does the USDA estimate a 10 per cent drop in the world production for 2002 -reflecting the impact of world prices in investment-, and at the same time estimates for this year another record harvest in the U.S. -the fourth biggest ever recorded-?*
>
> *Could the US please explain the reasons for the increase in the volume of US exports from 946,000 tons in 1998 to 1.8 million tons in 2001, while there is a drop in the international prices?*
>
> *According to international standards, the US is not a low-cost producer*[4]*. Additionally, US productivity levels are lower than those of other exporting countries*[5]*. However, while international prices fell about 54 per cent since the mid-1990s, the US did expand its cotton area and did increase the production: Could the*

[3] Exhibit Bra-200 (Congressional Record 107th Congress, Senate) S3990; Brazil's Further Submission, 9 September 2003, Section 4.9.

[4] The USDA estimates the average production cost in the USA at about US$0.73 per pound. Nevertheless, one third of its production has higher production costs. On the other hand, the average production cost in Burkina Faso, for instance, is US$0.21 per pound (Data from *International Cotton Advisory Committee, "Survey of the Cost of Production of Raw Cotton", 2001*).

[5] About 20 per cent lower than in Brazil or China, for instance.

*US please explain the lack of correlation between world price for cotton and US production?*

8. At the time, the United States' only response to Argentina's questions was that production was affected by a multiplicity of factors, including the development of fibres, biotechnology, demand, quality, technical progress, the price of inputs, and so forth, without in any way explaining how it could achieve such expansion amidst such a spectacular fall in international cotton prices and high domestic production costs.

9. In this respect, Argentina has already extensively discussed the impact of the decline in international cotton prices on its own cotton economy. As already mentioned, since 1997/98 slumping international prices and increased US government support have consistently driven cotton producer prices down, which in turn has entailed ongoing reductions in cultivated acreage and production.[6]

10. As Argentina stated at the 61st Plenary Meeting of the International Cotton Advisory Committee[7] (ICAC), planted and harvested acreage in MY 2001/02 plummeted to its lowest level since MY 1933/34 – that is, the lowest in the past 68 years – as a result of the continuing fall in international prices.

11. Argentina believes that without the subsidies granted by the United States to its cotton sector, U.S. cultivated acreage and production would diminish, as would US exports, and that there would be an ensuing rise in international prices.

12. Argentina further believes that if the United States – being one of the world's leading suppliers – had not increased its world market share as a result of the subsidies, the international price of cotton would have been higher, and hence third-country producers, including in Argentina, would not have been so adversely affected by artificially depressed prices.

13. The following table shows the steady increase in US cotton exports since 1995, whereas Argentina's cotton exports have been shrinking in a general context of declining world cotton prices, as discussed in paragraphs 23 to 25 below.

[6] Since 1997/98, cultivated acreage has in fact shrunk by 76 per cent, with 174,000 hectares planted to cotton, and production by 63 per cent, with an estimated 73,000 tons of fibre produced. *Argentina: Economic Injury to the Cotton Sector as a Result of Low Prices*, Working Group on Government Measures of the International Cotton Advisory Committee, 2002.

[7] Held in Cairo, Egypt, from 20 to 25 October 2002.

| Marketing Year | US Exports (in 1,000 metric tons) | Argentine Exports (in 1,000 metric tons) |
|---|---|---|
| 1995/96 | 1,671 | 274 |
| 1996/97 | 1,495 | 269 |
| 1997/98 | 1,633 | 202 |
| 1998/99 | 946 | 213 |
| 1999/00 | 1,481 | 70 |
| 2000/01 | 1,467 | 97 |
| 2001/02 | 2,395 | 51 |
| 2002/03* | 2,351 | 6 |

* Estimate.
Source: ICAC and *Instituto Nacional de Estadística y Censos* (INDEC) (National Institute of Statistics and Censuses).

## III. INCONSISTENCY WITH ARTICLES 5(C) AND 6.3(C) AND (D) OF THE SCM AGREEMENT

### III.1 ARTICLE 5(C) OF THE SCM AGREEMENT

14. Argentina contends that the United States has failed to meet its obligations under Article 5(c) of the SCM Agreement, which stipulates that "[*n*]*o Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.: ... serious prejudice to the interests of another Member...*".

15. In fact Argentina contends that through the granting of subsidies – understood in the sense of paragraphs 1 and 2 of Article 1 of the SCM Agreement[8] – the United States has caused and is threatening to cause serious prejudice to the interests of other Members, including Argentina.

### III.2 ARTICLE 6.3(C) OF THE SCM AGREEMENT

16. Article 6.3(c) establishes that "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where... the effect of the subsidy is a significant... price suppression, price depression...".

17. Thus, the existence and threat of serious prejudice to the interests of other Members – including Argentina – is based on the fact that, as established in Article 6.3(c) of the SCM Agreement, the effect of the subsidies provided by the United States to its cotton sector is and will be significant suppression and depression of international cotton prices.

18. Argentina fully concurs with Brazil that the sheer magnitude and percentage of U.S. cotton subsidization suggests a *de facto* presumption that the cotton subsidies are the decisive factor for the high levels of US production and exports as well as the low international cotton prices.[9] Argentina emphasizes that such was precisely the presumption implicit in its questions to the United States during the consultations. (See paragraphs 7 and 8 above.)

[8] As Brazil demonstrates in Section 3.2 of its Further Submission of 9 September 2003.
[9] On the basis of information in the USDA's *Fact Sheet: Upland Cotton*, January 2003, Exhibit Bra-4, Brazil points out that the total amount of US cotton subsidies was nearly US$13 billion, with an average subsidization rate of 95 per cent. Brazil's Further Submission, 9 September 2003, Section 3.3.4.1.

19. Argentina also agrees that there is a strong temporal link between the increase in the US subsidies over the MY 1999-2002 period and the significant suppression and depression of international cotton prices during that period.[10]

20. Argentina believes that but for the US subsidies international cotton prices would have been higher in MY 1999-2002. By stimulating US cotton production[11] and exports, the subsidies drove international prices down through excess, low-priced US supply – not in fact generated by efficient low-cost production but precisely thanks to the distorting effect of the subsidies.

21. It should be noted in this respect that Argentina (like or perhaps to an even greater extent than Brazil) is a "price-taker" in the world cotton market, which is heavily influenced by the enormous US subsidies that generate a growing world supply.

22. It should also be emphasized that the price movements of US, Cotlook "A" Index and third country (e.g. Brazilian and Argentine) market prices are directly interconnected. US – as indeed Brazilian – cotton forms part of Cotlook's "A" Index "basket". Likewise, US – as indeed Brazilian and Argentine – cotton forms part of Cotlook's "B" Index "basket".[12] Moreover, US, Brazilian and Argentine cotton are varieties of the same species, namely *Gossypium hirsutum*.

23. As in the Brazilian market, domestic price quotes for cotton have suffered a significant downturn.

24. The table below shows the direct relationship between the decline in the "A" Index world price of cotton and the drop in the domestic price quotes for cotton issued by the *Cámara Algodonera Argentina* (CAA) for the MY 1995/96-2001/02 period (in US cents/lb):

| **Marketing Year** | **"A" Index World Price*** | **CAA Price Quote**** |
|---|---|---|
| 1995/96 | 0.86 | 0.72 |
| 1996/97 | 0.79 | 0.69 |
| 1997/98 | 0.72 | 0.65 |
| 1998/99 | 0.59 | 0.55 |
| 1999/00 | 0.53 | 0.54 |
| 2000/01 | 0.57 | 0.49 |
| 2001/02 | 0.42 | 0.37 |

*** CIF Northern European ports**
****** FREE MILL, grade C 1/2

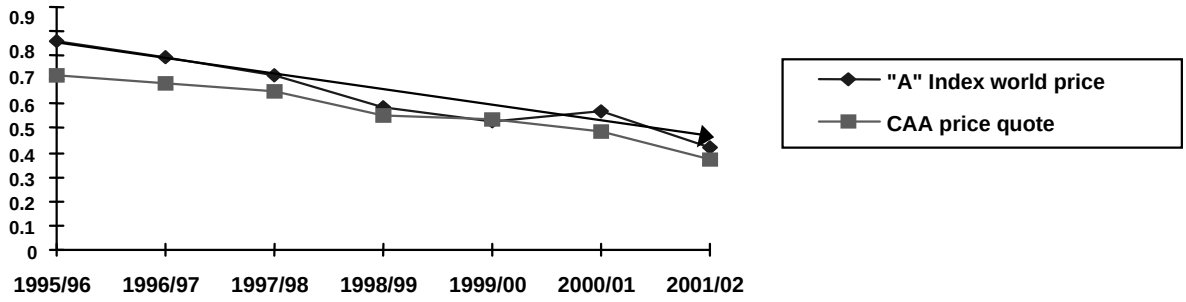
25. The following chart clearly shows the trends in the "A" Index world price of cotton and the domestic price quotes for cotton in recent years:

[10] Brazil's Further Submission, 9 September 2003, Section 3.3.4.2.

[11] Argentina agrees with Brazil (Section 3.3.4.7.7) that without the additional income provided by the subsidies granted by the US to its cotton farmers, acreage devoted to cotton would have been, and would be, much smaller, since US cotton production costs are among the highest in the world. (See Third-Party Submission by Argentina, 15 July 2003, para. 17.)

[12] In addition, the average values of national standards for the technical characteristics of Argentine cotton fibre show that the length, strength and micronaire value of the fibre are considered in the median range at international level.

26. The similarity in the trends in world prices and domestic price quotes for cotton further




supports Brazil's point[13] that the US subsidies have a suppressing and depressing effect on international cotton prices. In other words, in the absence of US subsidies that generate excess global supply, international cotton prices would have been higher, as would the domestic price quotes for cotton in Argentina, which are entirely influenced by the former.

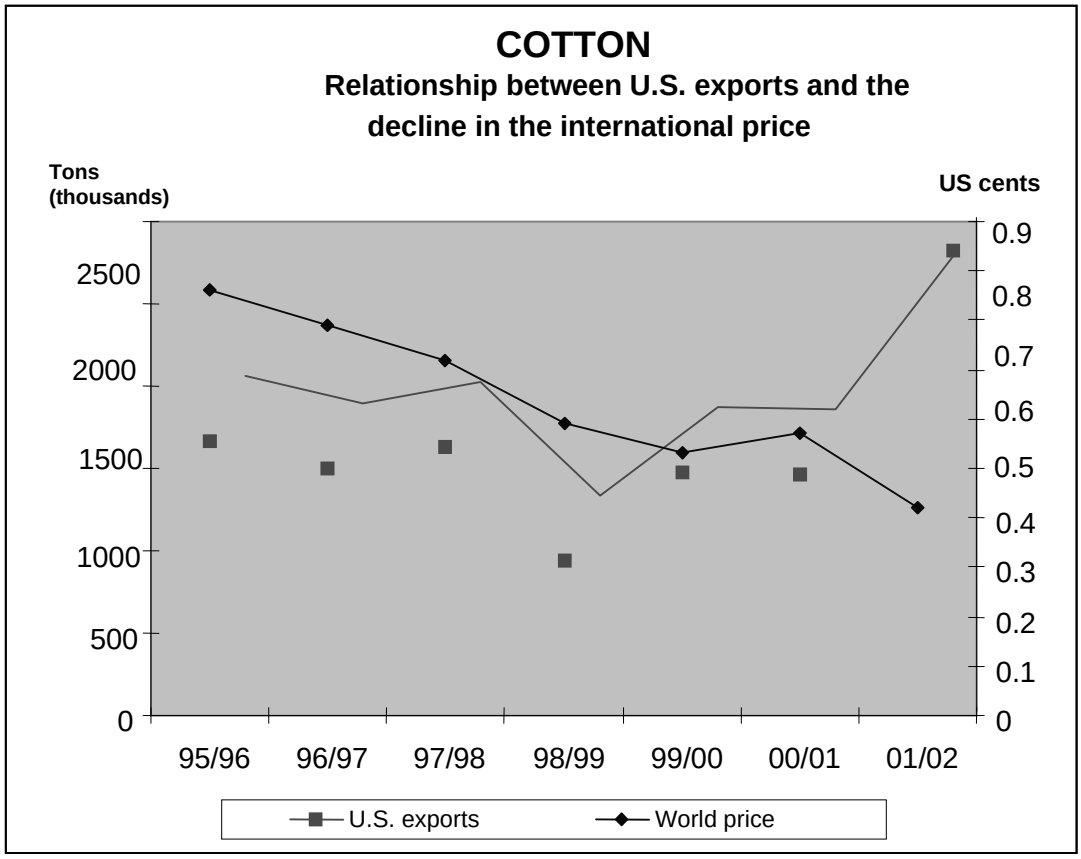
27. To an even greater extent than Brazil because of the smaller scale of its cotton economy, Argentina is basically a "price-taker" in the international cotton market, unlike the United States, which, given the size and global impact of the US cotton market and its 41.6 per cent world market share, is the international market "price-setter" *par excellence.*

28. In concrete terms, the amount of the US cotton subsidies and the scale of US production and exports are decisive when it comes to determining the extent to which the subsidies impact the fixing of both international and third market prices.

29. As economic theory would suggest and Brazil points out, increased supplies of US cotton in the world market tend to lower international prices since demand remains relatively inelastic.[14]

30. The chart below illustrates the relationship between US cotton exports and the international price of cotton:

[13] Brazil's Further Submission, 9 September 2003, Section 3.3.4.2.
[14] Brazil's Further Submission, 9 September 2003, Section 3.3.4.6; Exhibit Bra-I, para.22.




31. According to a study carried out by the Brazilian National Cotton Exporters' Association (ANEA),[15] the impact of the US subsidies is one of the reasons why cotton production in Argentina has dropped by more than 60 per cent.

32. The study reinforces Brazil's view that an increase in the world price of cotton would enable least-developed and developing countries such as Argentina, Brazil, Benin, Burkina Faso and Chad, *inter alia*, to recover the historically competitive position they enjoyed in the international market.

33. As Argentina indicated previously, the present collapse of the Argentine cotton sector is reflected in the extremely high level of indebtedness of producers, estimated at US$600 million and equivalent to twice the size of agricultural GDP of Chaco Province, the country's largest cotton producing region, which accounts for between 60 and 65 per cent of domestic cotton production.[16]

34. As regards the effects of the US subsidies on the international price of cotton, Argentina considers that the number and quality of the empirical and econometric analyses presented by Brazil, which were carried out by both international organizations and various prestigious US economic research institutions such as the USDA, provide irrefutable evidence of the *collective* and *individual* effects of each subsidy programme on the price of cotton.

[15] *Características del Mercado Mundial de Algodón* (Features of the World Cotton Market), ANEA, 15 February 2002.

[16] Third-Party Submission by Argentina, 15 July 2003, para. 28.

35. Argentina agrees with the conclusions reached by various studies presented by Brazil in its *Further Submission*[17] and repeats that an increase in the world price of cotton would enable countries such as Brazil and Argentina to recover their competitive position in the world cotton market.

36. Over and above any endorsement that may be given to the conclusions of any one of those studies (and each study's estimate of the price effect of the subsidies), Argentina emphasizes Brazil's point[18] that the suppressing and depressing effect on international cotton prices is significant, even if international prices were to decrease by only 1 cent per pound, for even such a level of decline implies highly prejudicial consequences for the cotton economies of many countries, including Argentina.

III.3 ARTICLE 6.3(D) OF THE SCM AGREEMENT

37. The existence and threat of serious prejudice to the interests of other Members, including Argentina, is also based on the following provision of the SCM Agreement:

> Article 6.3 "*Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:*
>
> ...
>
> *(d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.*"

38. As regards the serious prejudice claim, Argentina proposes on the one hand to refer to the U.S. levels of domestic support for cotton, as detailed at paragraph 64 of Argentina's first Third-Party Submission of 15 July 2003. Thus, the US budgetary outlays for support for the cotton sector in marketing years 1999 to 2002 were US$3.445 million, 2.311 million, 4.093 million and 3.113 million respectively, according to data supplied by the USDA.[19]

39. Such being the US levels of domestic support for cotton, Argentina will now give the US level of cotton exports over that same period, in order to demonstrate that the effect of the subsidies has been to increase the US world export market share for cotton.

40. The US level of cotton exports in recent years – according to data drawn from a USDA report other than the documents on which Brazil based its Article 6.3(d) claim[20] – is as follows:

[17] Brazil's Further Submission, 9 September 2003, Section 3.3.4.8.1.

[18] Brazil's Further Submission, 9 September 2003, Section 3.3.5.

[19] See Exhibits Bra-6, Bra-76, Bra-4, Bra-57, Bra-55, Bra-47, and footnotes 301 and 321. The budgetary outlays for US cotton export credits and credit guarantees have not been taken into account.

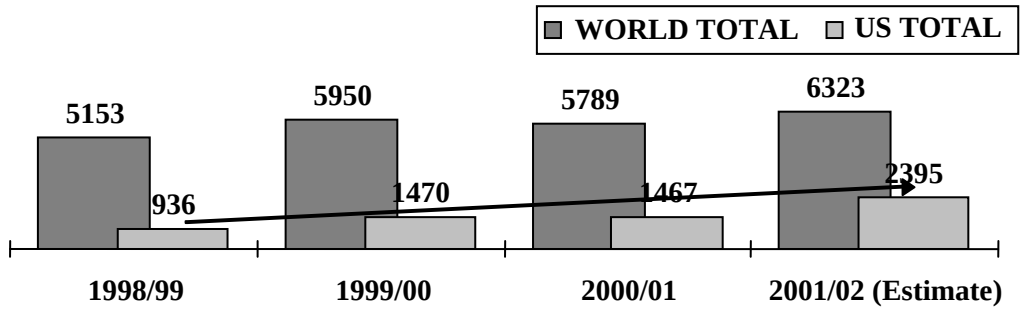
[20] *Cotton: World Markets and Trade*, USDA, March 2003, Table 1 (http://www.fas.usda.gov/export-sales/esrd1.html).

**COTTON EXPORTS**
**(in 1,000 metric tons)**

| | 1998/99 | 1999/00 | 2000/01 | 2001/02 (Estimate) |
|---|---|---|---|---|
| **WORLD TOTAL** | 5,153 | 5,950 | 5,789 | 6,323 |
| **US TOTAL** | 936 | 1,470 | 1,467 | 2,395 |
| **US WORLD SHARE (percentage)** | **18.16** | **24.70** | **25.34** | **37.87** |

41. In chart form, the US share of world cotton exports is as follows:

**WORLD AND US COTTON EXPORTS**
**(in 1,000 metric tons)**




42. Argentina thus contends that there has been an increase in the world market share of the United States as compared to the average share it had during the previous period of three years and that this increase has followed a consistent trend over a period when the subsidies have been granted, since the average world market share of the United States was 22.73 per cent between 1998/99 and 2000/01 and 37.87 per cent in MY 2001/02, recording **a more than 15 percentage point increase** over the average share during the immediately preceding three-year period.

43. In conclusion, Argentina asserts that, in the absence of subsidies, US cotton production would naturally have been lower than that actually recorded and consequently the volume of US exports and ultimately the impact of the US world market share would also have been smaller.

III.4 THREAT OF SERIOUS PREJUDICE: ARTICLE 6.3(C) AND (D)

44. Having established the existing serious prejudice caused by the US cotton subsidies, Argentina agrees with Brazil that the threat of serious prejudice is clearly foreseeable and imminent because of the effects of the even larger subsidies provided under US legislation for the MY 2003 2007 period.

45. As discussed in detail by Brazil,[21] the *marketing loan payments, crop insurance subsidies, CCP, direct payments* and *Step 2 Payments* programmes are mandatory in terms of the US budget for the MY 2003-2007 period, with no limitations on the volume of production and exports or on budgetary expenditure for cotton.

46. By way of example that confirms the above, and subsequently to Brazil's Further Submission, the USDA announced on 17 September 2003 that it would begin issuing counter-cyclical payments for final 2002-crop cotton.[22] The counter-cyclical payment rate for cotton is U$S303.09/ton. This is the amount by which the *target price* (U$S1,596.1/ton[23]) exceeds the *effective price* (the national average market price producers received or the *loan rate* – whichever is higher).

As can be seen from the table below, these payments represent a major portion of the price.

| | **Current price (US$/t)** | **Counter-cyclical payment rate (US$/t)** | **Percentage (counter-cyclical payments)** |
|---|---|---|---|
| **Cotton** | 1,235 | 303.09 | 24.54% |

47. Counter-cyclical payments for 2002-crop cotton are at their maximum levels because of this season's low market prices. In other words, the reason why counter-cyclical payments are so high is because this MY's prices are very low. The fact that the target price is maintained regardless of market price fluctuations confirms Argentina's point that US producers are insulated from such changes in market prices (see paragraph 5 above).

48. Argentina contends that this guaranteed flow of subsidies will undoubtedly lead to a higher level of US cotton production and exports. This will inevitably result in price suppression and depression as well as an increasing and inequitable US world market share for cotton, thus creating a source of permanent uncertainty that confirms the threat of serious prejudice generated by the subsidies.

49. Moreover, Argentina also agrees with Brazil[24] that the link between the US cotton subsidies and the threat of significant price suppression and depression and of an increase in the US world market share for cotton stems from the fact that that the future subsidies will be as necessary as the current ones for U.S. producers to bridge the gap between market prices and their total production costs. This will enable U.S. producers to continue competing with more efficient third-country producers, especially considering that the USDA forecasts an increase in total production costs.[25]

## II. CONCLUSION

50. In view of the foregoing, Argentina considers that the subsidies granted by the United States to the US cotton sector over the MY 1999-2002 period have caused and still cause serious prejudice to the interests of other Members, including Argentina, in that:

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[21] Brazil's Further Submission, 9 September 2003, Section 4.2.

[22] USDA Release: *USDA ISSUES FINAL 2002-CROP UPLAND COTTON, RICE AND PEANUT COUNTER-CYCLICAL PAYMENTS.*

[23] *Monitoring and Evaluation 2003*, OECD.

[24] Brazil's Further Submission, 9 September 2003, Section 4.5.

[25] See Exhibits Bra-7 (ERS Data: Commodity Costs and Returns); Bra-257 (*Cost of Farm Production Up in 2003*, USDA, 6 May 2003) and Bra-82 (*USDA Agricultural Baseline Projections until 2012*, USDA, February 2003, p.48).

- They have a significant suppressing or depressing effect on international cotton prices, within the meaning of Articles 5(c) and 6.3(c) of the SCM Agreement; and

- they have the effect of increasing the U.S. world market share for cotton, within the meaning of Articles 5(c) and 6.3(d) of the SCM Agreement.

51. Furthermore, Argentina considers that the subsidies provided under US legislation for the MY 2003-2007 period threaten to cause serious prejudice to the interests of other Members, including Argentina, insofar as:

- they will have a significant suppressing or depressing effect on international cotton prices, within the meaning of Article 5(c), its footnote 13, and Article 6.3(c) of the SCM Agreement; and

- they will have the effect of increasing the US world market share for cotton, within the meaning of Article 5(c), its footnote 13 and Article 6.3(d) of the SCM Agreement.

52. Argentina accordingly requests the Panel to find that the aforementioned subsidies granted by the United States to the US cotton sector are inconsistent with Articles 5(c) and 6.3(c) and (d) of the SCM Agreement.

# ANNEX E-4

## FURTHER THIRD PARTY SUBMISSION OF BENIN
## THIRD PARTY SUBMISSION OF CHAD

3 October 2003

TABLE OF CONTENTS

## I. INTRODUCTION

1. This dispute marks the first time that either Benin or Chad – two least-developed, sub-Saharan African countries – have participated in a WTO dispute. Benin and Chad have taken this unprecedented step in response to the serious threat posed to their economic and social stability by massive, WTO-inconsistent US subsidies on upland cotton.

2. As indicated below, subsidies provided by the United States to its relatively small and prosperous group of cotton farmers exceed the gross national income of Benin, Chad, and every other country in the West African region.

3. Cotton plays a critical role in the economic development of West Africa. The cotton farmers of the region are highly vulnerable to changes in the world price of cotton. These small, subsistence farmers have no ability to influence the international cotton market – they are "price takers", not "price makers".

4. When US subsidies cause or contribute to a dramatic fall in world prices, the consequences for Africa are severe: hundreds of thousands of people are pushed from basic subsistence living to stark poverty.

## II. SERIOUS PREJUDICE UNDER THE SCM AGREEMENT

5. US subsidies have caused, and are causing, adverse effects to the interests of Benin and Chad within the meaning of Article 5(c) and 6.3 of the SCM Agreement. The United States has caused, and is causing, serious prejudice to the interests of Benin and Chad through the use of WTO-inconsistent subsidies on upland cotton. The serious prejudice to the interests of Benin and Chad arises because the effect of the US subsidies has been the significant price suppression and/or price depression for cotton in the same market, within the meaning of Article 6.3(c).[1]

6. Benin and Chad agree with Brazil that for the purposes of Article 6.3(c), the term "market" could encompass an individual country, a region, or the world market for cotton.[2] In addition, in the view of Benin and Chad, the Further Submission of Brazil has clearly established the causal link between US subsidies and suppressed prices in the world market.

7. Therefore, for the purposes of this Third Party submission, Benin and Chad accept that the causal link has been established by Brazil, and will focus instead on the impact of such suppressed prices on the economies and cotton sectors of Benin and Chad.

## III. THE COTTON SECTOR IN BENIN

8. Benin's Third Party Submission of 15 July 2003, provided the basic facts about its cotton sector. While Benin does not wish to repeat all of this information, it would recall that:

- cotton is the most important cash crop in the national economy, accounting for about 90 per cent of agricultural exports;

[1] As a threshold matter, upland cotton from Benin and Chad is clearly "like" US upland cotton within the meaning of Article 6.3. Benin and Chad agree with the analysis set out by Brazil in Part 3.3.2 of its Further Submission. Applying the tests set out in previous GATT and WTO cases, the Panel should have little difficulty in concluding that these are "like products".

[2] Further Submission of Brazil, paragraph 98.

- cotton has provided 75 per cent of the country's export earnings over the past four years;

- cotton generates a quarter of the country's revenues;

- a third of all households depend on the cultivation of cotton, and a fifth of wage-earning workers are employed in the cotton sector; and

- overall, about a million people in Benin – out of a population of six million – are dependent on cotton, or cotton-related activities.

## IV. THE COTTON SECTOR IN CHAD

9. Since Chad did not file an earlier submission, it takes this opportunity to provide the Panel with brief essential information about the national economy of Chad, and the cotton sector.

10. Chad, like Benin, is one of the poorest countries in the world. Of the 175 countries listed in the 2003 United Nations *Human Development Index*, Chad is ranked 165th.[3] It is estimated that 80 per cent of the population of Chad lives on less than US $1 per day. Average life expectancy is 48 years. Nearly a third of all children in Chad under the age of five suffer from chronic malnutrition.[4]

11. The cotton-producing region of Chad is located in the southern part of the country, in an area covering about 127,000 square kilometres. Cotton is generally grown on small farms, usually no more than one or two hectares. Farmers have to rely on rain for irrigation and animals for traction when working the cotton fields during the sowing season.

12. Cotton production in Chad affects approximately 1.5 million people, out of a total population of about 8.1 million.[5] Cotton exports account for 5.1 per cent of GDP in Chad, and represents 25 per cent of all exports.[6] Cotton is therefore one of Chad's main sources of income, and sustains the livelihood of a large portion of its population.

13. A recent World Bank report on the cotton sector in Chad stated that:

> "*Revenue from cotton constitutes the only source of community development for villages in the cotton-producing area to meet their needs and improve their quality of life* [original emphasis]....[C]otton payments are received in two ways: as individual lump sums and as rebates/ balances (restourne), *depending on the realized level of prices internationally* [emphasis added]. Rebates constitute the only source farmers have to invest in village-level public goods such as schools, health centres, credit

[3] *Human Development Report 2003*, United Nations Development Programme, http://undp.org/hdr2003.

[4] *Chad at a Glance*, World Bank Group, 20 August 2003.

[5] According to the World Bank, there are roughly 400,000 farm households in the cotton-producing areas of Chad, of which about 60 per cent grow cotton. An average farm household has 5 to 6 people. World Bank, *Chad Cotton Sector Reform: A Case Study on Poverty and Social Impact Analysis*. Document available at http://poverty.worldbank.org/files/13138_chadcottonreform.pdf

[6] P. Fortucci, *The Contributions of Cotton to Economy and Food Security in Developing Countries*. Food and Agriculture Organization of the United Nations. July 2002.

> institutions, storage facilities, clean water pumps and wells, *radiers* to limit village isolation during rainy season, and so forth."[7]

14. Rather more succinctly, the World Bank observed that: "Cotton was introduced in Chad during the colonial period and has dominated the economy since then."[8]

## V. US COTTON SUBSIDIES – SERIOUS PREJUDICE TO BENIN AND CHAD

15. Brazil's Further Submission of 9 September 2003 provides compelling evidence of the serious prejudice Brazil has sustained as a result of massive, WTO-inconsistent cotton subsidies. Yet the serious prejudice to the countries of West Africa, including Benin and Chad, has been far worse.[9]

16. The subsidies paid by the United States to its relatively prosperous 25,000 cotton farmers dwarf the economies of West Africa. As indicated in Benin's Third Party submission of 15 July US cotton subsidies exceed the gross national income of Benin (population 6 million), as well as Chad (population 8 million).

17. US cotton subsidies also exceed the gross national income of Burkina Faso (11 million), Mali (11 million), Togo (5 million) and the Central African Republic (4 million). As the respected international NGO Oxfam noted, "no region is more seriously affected by unfair competition in world cotton markets than sub-Saharan Africa".[10]

18. The Oxfam report notes that:

> "Central and West African countries have suffered far graver injury than any other developing region….The crop…occupies a pivotal position in the macro-economy of many countries….[Cotton] exports are a vital source of foreign exchange, financing essential imports such as food, fuel, and new technologies. They also underpin government revenues, providing the funds needed to invest in health and education….
>
> High levels of poverty and limited government provision of basic services make Central and West Africa acutely vulnerable to adverse trends in world prices. Falling world prices mean that farmers have less to spend on health, education, and investment. Wages for agricultural labour also decline, as does the government's capacity to provide basic social services.
>
> Prospects for economic growth – a key requirement for poverty reduction – have also been damaged."[11]

19. The Oxfam report – using data from the International Cotton Advisory Committee - estimates that in 2001 alone, sub-Saharan exporters lost $302 million as a direct consequence of US cotton subsidies. It notes that Benin's actual cotton export earnings in 2001/02 were $124 million.

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[7] World Bank Report on Poverty and Social Impact Analysis – Chad Cotton Sector Reform – Ex-Ante Qualitative Analysis – First Phase. Document available at http://poverty.worldbank.org/files.

[8] *Id*.

[9] Benin and Chad also welcome, and endorse, the arguments set out in Part 7 of Brazil's Further Submission, "Serious Prejudice to the Interests of African Countries by Reason of the US Subsidies on Upland Cotton."

[10] *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*. Oxfam Briefing Paper 30. 27 September 2002. Brazil has filed the full Oxfam report as exhibit Bra-15.

[11] *Id*., pages 8-9.

However, had US subsidies been withdrawn, Benin's export earnings are estimated to have been $157 million. Therefore, the value lost to Benin as a result of US subsidies was $33 million.[12]

20. Chad's cotton export earnings in 2001/02 were $63 million, although in the absence of US subsidies, Chad would have earned $79 million, thus reflecting a loss of $16 million.[13]

21. For the period from 1999/2000 to 2001/2002, Oxfam estimates a total cumulative loss of export earnings of $61 million for Benin and $28 million for Chad.[14] As Oxfam rightly emphasizes, "the small size of several West African economies and their high levels of dependence on cotton inevitably magnify the adverse effects of US subsidies. For several countries, US policy has generated what can only be described as a major economic shock".[15]

22. Indeed, for the subsistence cotton farmers of Benin and Chad, already highly vulnerable to fluctuations in the world price of cotton, the price suppression caused by US subsidies can and does have a highly destabilizing effect. According to the empirical data analyzed by two US economists, Nicholas Minot of the International Food Policy Research Institute and Lisa Daniels of Washington College:

> "*A 40 per cent reduction in farm-level prices of cotton is likely to result in a reduction in rural per capita income of 7 per cent in the short-run and 5-6 per cent in the long-run. Furthermore, poverty rises 8 percentage points in the short-run, equivalent to an increase of 334 thousand in the number of individuals in families below the poverty line*. In the long run, as households adjust to the new prices, the poverty rate settles down somewhat, remaining 6-7 percentage points higher than originally….
>
> Overall, the results in this paper challenge the stereotype of the rural poor in developing countries as consisting of subsistence farmers that are relatively unconnected to, and thus unaffected, by swings in world commodity markets. At least in the case of Benin, *to the extent that fluctuations in world cotton prices are transmitted to farmers, they will have a significant effect on rural incomes and poverty.*"[16] [emphasis added]

23. Thus, as the Minot/Daniels paper indicates, a drop in world cotton prices of 40 per cent pushes an additional 334,000 people below the poverty line in Benin. Moreover, the Minot/Daniels study adopted a *relative* poverty line, equivalent to US$123 per person per year, far below the US$1 per day used by the World Bank. [17]

24. The Minot/Daniels paper describes what this means in human terms. The detailed household surveys carried out in Benin describe the living conditions for cotton farmers:

- 85 per cent of the cotton farmers in Benin have houses with mud or mud-brick walls.
- 62 per cent live in houses with a dirt floor.

[12] *Id*., page 17-18.
[13] *Id*., page 17-18.
[14] *Id*., page 32.
[15] *Id*., pages 17 and 32.
[16] Nicholas Minot and Lisa Daniels, *Effect of Falling Cotton Prices on Rural Poverty in Benin*. Exhibit BEN-CHA 1, paragraphs 36 and 38.
[17] *Id*., paragraph 13.

- 72 per cent have corrugated metal roofs and 28 per cent have straw roofs.
- 53 per cent of the cotton farmer households get drinking water from a public well, while another 18 per cent use water from a river or lake.
- Less than 2 per cent have electric lights, and 98 per cent use oil or kerosene lamps.
- On average, the nearest source of potable water is 430 m away, and the nearest paved road is 36 km away.
- About 34 per cent of the cotton farmers do not own a chair, 38 per cent do not own a table, and 34 per cent do not own a bed.[18]

25. Needless to say, farmers living in such conditions are "price takers", not "price makers" in the global cotton market.

26. While comparable household surveys have not been conducted in Chad, conditions in Chad are, if anything, worse than in Benin. Moreover, as in Benin, the cotton farmers of Chad are highly vulnerable to changes in the international price of cotton.

27. Yet despite this situation of poverty, cotton farmers in both Benin and Chad are, and remain, efficient producers. As noted in Benin's submission of 15 July the cost of producing cotton in West Africa is 50 per cent lower than comparable costs in the United States. Indeed, a recent World Bank Policy Research Working Paper found that West African countries were among the world's lowest cost producers of cotton.[19]

28. Moreover, as Benin noted in its Submission of 15 July the IMF reported that Benin's reform process in the cotton sector is among the most advanced in the region. However, to re-iterate a key point of Benin's earlier submission, these economic efficiencies have been vitiated by the plunge in world cotton prices caused in no small part by US subsidies.

29. Similarly, since 1999, Chad has undertaken major reforms in its cotton production system. The aim of these reforms has been to improve production and productivity with a view to generating supplementary income, which could then be used to reduce widespread poverty in cotton-growing areas, and indeed in the country as a whole. The method for achieving this goal is a progressive liberalization of the cotton industry, similar to methods employed in other African cotton-producing countries.

30. However, as in Benin, the reforms in Chad are being seriously undermined by huge US subsidies. As stated by the World Bank:

> This analysis[20] appears to be all the more urgent today, given the current situation on the international market and the low price of cotton deriving from the recently-introduced US subsidies. These can have the effect of thwarting the reform and of having a considerable social and poverty impact. *Unless the international situation*

[18] *Id*., paragraph 23.

[19] *Cotton Sector Strategies in West and Central Africa*. World Bank Policy Research Paper 2867, July 2002, page 9. Brazil has filed this Working Paper as exhibit Bra-265.

[20] The report's analysis was: "the findings … suggest that privatisation and liberalization will not automatically lead to price competition nor will they automatically solve some of the structural problems that plague the current cotton system in Chad".

> *changes and the US subsidies are removed, any liberalization and privatization of the cotton sector is unlikely to be successful.* [original emphasis].[21]

31. The World Bank Policy Paper adds that:

> "…subsidies to cotton farmers in major cotton producing countries increase artificially the supply in international markets and depress export prices for WCA [West and Central Africa] countries. Downward pressures on export prices have been exacerbated by generous (and in the case of the United States, rapidly increasing) subsidies for cotton production in the United States, China and the European Union."[22]

32. The Policy Paper ultimately concluded that:

> "Removal of these subsidies would benefit WCA countries, and allow them to better exploit their comparative advantage in cotton production for growth and poverty reduction."[23]

## VI. CONCLUSION

33. On 10 June 2003, the President of Burkina Faso, H.E. Blaise Compaoré, presented the joint proposal on cotton to the Trade Negotiations Committee on behalf of Benin, Burkina Faso, Chad and Mali.[24] In presenting the proposal, President Compaoré remarked that:

> "More than ten millions of people in West and Central Africa directly depend on cotton production, and several other millions of people are indirectly affected by the distortion of world market prices due to production and export subsidies to this agricultural product….
>
> While cotton accounts for only a small portion of economic activity in industrialized countries, in all our States, it represents a determining and critical factor for poverty reduction policies as well as for political and social stability. Through induced effects on infrastructure development, education and basic health services, cotton production acts as an essential link within our countries' development strategies….
>
> Arguments in favour of sector-based modalities for cotton are straightforward: *our countries are not asking for charity, neither are we requesting preferential treatment or additional aid. We solely demand that, in conformity with WTO basic principles, the free market rule be applied. Our producers are ready to face competition on the world cotton market – under the condition that it is not distorted by subsidies.*"[25] [emphasis added]

34. Similar remarks were made following the Cancun Ministerial by Dr. Kipkorir Aly Azad Rana, a Deputy Director-General of the WTO. Speaking to the Second East African Business Summit in Kenya (18-21 September 2003), he stated that:

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[21] World Bank Report on *Poverty and Social Impact Analysis – Chad Cotton Sector Reform – Ex-Ante Qualitative Analysis – First Phase*. *Op cit*., page 35.

[22] *Cotton Sector Strategies in West and Central Africa*. World Bank Policy Research Paper 2867, July 2002.

[23] *Id*.

[24] *Poverty Reduction: Sectoral Initiative in Favour of Cotton*. WT/MIN(03)/W/2.

[25] WTO News: Address by President Blaise Compaoré to the Trade Negotiations Committee, 10 June 2003. www.wto.org.

> "A strong call for action in addressing subsidy issues in cotton was made earlier this year by Benin, Burkina Faso, Mali and Chad….West African negotiators put the spotlight, before and at Cancún, on cotton subsidies leading to overproduction by less efficient farmers in rich countries and depressing global market prices….The countries who brought this issue to the table do not have a broad range of export possibilities to choose from, but in cotton, they produce high quality merchandise at competitive prices. In recognition of the benefits of export-led growth for development, they have turned, at the highest level, to the WTO. *They do not ask for aid, which is the World Bank's remit, nor do they make political appeals that belong to the United Nations. They have just asked that WTO rules and disciplines apply also in sectors of interest to the poor - that a fair and market-oriented system be established in agriculture and that rich countries' wasteful export and production subsidies be abolished and cease to undermine their comparative advantage*." [26] [emphasis added]

35. Both President Compaoré and Deputy Director General Rana were speaking about WTO negotiations, not dispute settlement. Yet their messages are equally valid for the purposes of this Panel proceeding. In this dispute, Benin and Chad are not seeking charity or preferential treatment. Similarly, Benin and Chad do not wish to make political appeals.

36. In the context of this proceeding, Benin and Chad ask the Panel simply to find that the United States must adhere to the WTO rules and disciplines on subsidies that it accepted at the conclusion of the Uruguay Round. This includes the clear prohibition in Part III of the SCM Agreement against causing serious prejudice to the interests of other Members. US subsidies on upland cotton have demonstrably caused serious prejudice to the interests of Benin and Chad by suppressing world prices for upland cotton. The results have been devastating for West Africa.

37. Benin and Chad therefore respectfully request the Panel to grant the relief requested by Brazil in Part 9 of its Further Submission.

[26] WTO News: Address by Dr. Kipkorir Aly Azad Rana, Deputy Director-General to the Second East African Business Summit, "The Multilateral Trading System: Why East Africa Must Remain Engaged." 18-21 September 2003. www.wto.org.

**Exhibit Ben-Cha 1**

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# Effect of falling cotton prices on rural poverty in Benin

**Summary**

This paper combines farm survey data from Benin with assumptions about the decline in farm-level prices to estimate the direct and indirect effects of cotton price reductions on rural income and poverty in Benin. The results indicate that there is a strong link between cotton prices and rural welfare in Benin. A 40 per cent reduction in farm-level prices of cotton results in an increase in rural poverty of 8 percentage points in the short-run and 6-7 percentage points in the long run. The short-run impact is equivalent to an increase of 334 thousand in the number of individuals in families below the poverty line.

The results in this paper challenge the stereotype of the rural poor in developing countries as consisting of subsistence farmers that are relatively unconnected to, and thus unaffected, by swings in world commodity markets. At least in the case of Benin, to the extent that fluctuations in world cotton prices are transmitted to farmers, they will have a significant effect on rural incomes and poverty.

**Introduction**

1. From January 2001 to May 2002, world cotton prices fell almost 40 per cent, from 64 cents per pound to 39 cents/pound[1]. Since then, prices have rebounded to about 60 cents/pound, but cotton prices still show a long-term downward trend from the mid-1990s when cotton prices were over 80 cents/pound (see Figure 1). One reason for the long-term decline is that world demand for cotton has been stagnant at 20 million tons since the mid-1990s, in part due to competition with synthetic fibers. Short-term fluctuations in cotton prices are often driven by shifts in the net trade of China, the largest cotton producer and consumer in the world.

2. In addition to these two effects, cotton prices are pushed below what they otherwise would be by government support to cotton growers. The International Cotton Advisory Committee (ICAC) estimates that world-wide direct assistance to cotton growers was US$ 4.9 billion in 2001/02. Of this amount, the United States accounted for US$ 2.3 billion, equivalent to 24 cents per pound of cotton produced. Other sources, using a broader definition of assistance, estimate that the government provides US$ 3.9 billion to the cotton sector (Oxfam, 2002). Until 2002, US cotton policy consisted of various programs[2], including two (the marketing loan program and loan deficiency payments) that ensure that farmers receive at least 52 cents/pound. This has the effect of insulating US farmers from the falling world prices. In 2001, in spite of low world prices, the US posted record cotton production and near-record export volumes. Furthermore, US subsidies to cotton have increased since these studies were carried out. The 2002 Farm Bill introduced target prices for the major commodities and programs that effectively pay farmers most of the difference between market prices and the target price. For upland cotton, the target price is 72 cents/pound. In addition, by allowing farmers to update their "base acreage", the new policy provides incentives for farmers to expand production[3].

3. Several recent studies have attempted to assess the impact of subsidies on world prices. The Centre for International Economics in Canberra uses a five-region world model of fibre, textile, and garment markets in 2000-01 to simulate the impact of US and European subsidies on cotton production and export. They find that removing US and European subsidies to cotton growers would raise the world cotton price by 6 cents/pound or 11 per cent. Another study, carried out by ICAC, estimates that removing US production subsidies would have increased the world price by 11 cents/pound in 2001/02 (ICAC, 2002). And most recently, Sumner (2003) estimates that, in the

[1] These prices are based on the A-Index cotton price, calculated as the average of the five lowest prices for US cotton in Northern European markets based on a grade of middling 1-3/32 inch fibre length.

[2] The 1996 Farm Bill introduced production flexibility contract (PFC) payments, which were related to historical (not current) production and would decline over time as part of an effort to phase out farm subsidies. PFC payments to cotton farmers fell steadily from US$ 700 million in 1996 to US$ 474 million in 2002. Loan deficiency payments and marketing loan gains are, on the other hand, tied to current output and market prices. Low commodity prices over the last 3-4 years have sharply increased the cost of these programs. Payments to cotton growers were negligible in 1997, but rose to US$ 1.5 billion in 1999 and almost US$ 2.5 billion in 2002. In addition, Congress has authorized ad hoc market loss assistance (MLA) payments almost annually. MLA payments to cotton farmers were US$ 600 million in 1999 and US$ 650 million in 2002. Cotton exporters and US mills also receive roughly US$ 200 million per year in "Step 2" payments, designed to keep US cotton exports competitive (USDA, 2002b and Oxfam, 2002).

[3] The 2002 Farm Bill introduces two new commodity programs: direct fixed payments and counter-cyclical payments. In the case of upland cotton, the fixed direct payment is set at 6.7 cents/pound and is paid on the basis of 85 per cent of the "base acreage". The counter-cyclical payments involve payments of up to 13 cents/pound on 85 per cent of the base acreage depending on the gap between the market price (or the loan rate, whichever is higher) and the target price. These programs replace the production flexibility contract system and (supposedly) eliminate the need for the market loss assistance. The marketing loan and loan deficiency payments continue under the new Farm Bill with the same loan rate: 52 cents/pound for upland cotton. In addition, farmers are allowed to update their base acreage, providing them incentive to maintain or increase acreage in the event future opportunities to update acreage (USDA, 2002c).

absence of US subsidies, the world cotton price would have been 12.6 percent higher over 1999-2002. This estimate is probably the most authoritative because it takes into account the 2002 Farm Bill, it incorporates a detailed treatment of various US subsidy programs, and it uses a standard modelling framework and parameter estimates.

4. The World Bank estimates that removing US cotton subsidies would generate US$250 million per year in additional revenues for West African cotton farmers (Badiane et al, 2002). An Oxfam report calculates the losses to three West African nations at 1-2 per cent of gross domestic product. It points out that, in Mali and Benin, losses in export revenue associated with US cotton subsidies are greater than US development assistance to those countries (Oxfam, 2002).

5. The adverse impact of lower cotton prices on export revenue and GDP in cotton exporting nations is clear, but does this translate into higher incidence of rural poverty? If cotton is grown mainly by larger farmers with relatively high incomes, then the effect of changes in cotton prices on rural poverty may be modest. Even if cotton is grown primarily by small farmers, the magnitude of the effect on rural poverty will be small if few farmers grow cotton or if it accounts for a small share of rural income. Assessing the direct impact of changes in cotton prices on rural poverty requires detailed household-survey data on incomes and expenditures.

6. This paper examines the impact of changes in cotton prices on rural poverty in Benin. In particular, it has two objectives:

- to describe the living conditions and level of poverty for cotton growers and other farmers in Benin; and

- to estimate the short- and long-run impact of lower cotton prices on the income of cotton growers and on the incidence of poverty in rural Benin.

**Background**

7. The Republic of Benin is a small West African nation of about 6.0 million inhabitants, 59 per cent of whom live in rural areas. Its rural economy is based on maize, sorghum, millet, yams, cotton, and livestock production. The per capita gross national product is US$ 380, placing Benin among the poorest 20 per cent of countries. The per capita income of Benin is lower than the average for sub-Saharan Africa (World Bank, 2000).

8. In 1989, Benin entered a period of economic and political reform. Elections were held in which the military government was voted out of office, and Benin entered into the first of several structural adjustment programs with the International Monetary Fund and the World Bank. In the agricultural sector, state farms and cooperatives were disbanded, food crop prices and marketing were liberalized, and many state-owned enterprises, including agro-processing enterprises, were privatized or closed (République du Benin, 1997). In January 1994, the CFA franc (FCFA) was devalued by 50 per cent, effectively doubling the price of imports and the returns to exports. Although this imposed hardship on manufacturing firms and consumers that had become accustomed to cheap imports, it stimulated the local production of cotton, rice, and other tradable goods.

9. Although the cotton sector benefited from the 1994 devaluation, structural reform in cotton marketing was limited. The cotton sector in Benin remained under the control of the state-owned *Societé Nationale pour la Promotion Agricole* (SONAPRA). In the past two years, Benin has begun to implement reforms to reduce the role of SONAPRA and introduce competition in the distribution of inputs and the marketing of cotton. The fall in world cotton prices has led to political pressure for the government to support the domestic price or even to re-assume control of the sector to protect

farmer interests. According to ICAC (2002), the government provides modest support for the cotton price, equivalent to 5 cents/pound. Currently, cotton represents 90 percent of agricultural exports and 60-70 per cent of its total exports (excluding re-exports[4]).

10. The economic reforms carried out in the 1990s and the growth in cotton production during this period resulted in concrete benefits for rural households. The 1994-95 *Enquête sur les Conditions de Vie en Milieu Rural* (Survey on Living Conditions in Rural Areas) estimated the poverty rate at 33 per cent (UNDP-MDR, 1996: 13). Adopting a similar definition of expenditure and the same poverty line (adjusted for inflation), the poverty rate in the 1998 survey had fallen to 21 per cent. Qualitative questions in the latter survey appear to support the view that rural conditions improved in the 1990s. According to the IFPRI-LARES survey, 52 percent of the households reported that they were better off at the time of the survey (1998) than in 1992 and only 28 per cent reported being worse off . Furthermore, those reporting improvement tended to attribute these gains to economic factors such as crop prices and off-farm income opportunities, while those reporting worsening conditions tended to cite health and weather factors. Cotton farmers, those in the north of the country, and poor households were more likely to report improved conditions than others. (IFPRI, 2001)

11. These results suggest that there is a strong link between market-oriented policies and cotton expansion on the one hand and the living conditions of farmers in Benin on the other hand. The analysis presented in this paper will further examine this link, focusing on the impact of changes in cotton prices on rural income and poverty.

**Methods**

12. The data used in this paper come from the *Enquête des Petits Agriculteurs* (EPP) or Small Farmer Survey, carried out in 1998 by the International Food Policy Research Institute (IFPRI) and the *Laboratoire d'Analyse Régionale et d'Expertise Sociale* (LARES). The survey used a 24-page questionnaire, divided into 16 sections[5]. The households were selected using a two-stage stratified random sample procedure based on the 1997 Pre-Census of Agriculture. In each of the six departments[6], villages were randomly selected, with the number of villages proportional to the volume of agricultural production, subject to a minimum of 10 villages per department. In total, one hundred villages were selected. In each village, nine households were randomly selected using household lists prepared for the pre-Census of Agriculture. The survey was carried out from August to November 1998. In a few villages, the number of interviewed households was eight or ten, resulting in a final sample size of 899 agricultural households. Sampling weights are used in calculating the results presented here (see IFPRI, 2001 for more detail).

13. In this study, we adopt a *relative* poverty line, set at the 40$^{th}$ percentile of per capita consumption expenditure. Per capita expenditure is calculated as cash expenditure on consumption goods, the imputed value of home-produced food, and the rental equivalent of owner-occupied housing. The resulting poverty line is equivalent to US$ 123 per person per year. It is worth noting that this poverty line is far below the US$ 1 per day frequently used by the World Bank.

[4] Re-exports of manufactured goods to Nigeria and other countries accounts for a large share of total exports.

[5] The 16 sections are household characteristics, housing characteristics, land, agricultural production, labour use, input use, changes regarding input use, credit, crop marketing, storage, sources of information, food and non-food consumption, allocation of time, asset ownership, sources of income, and perceptions of farmers.

[6] Since this study was carried out, an administrative reorganization has resulted in an increase in the number of departments from 6 to 12. The analysis in this report retains the old definitions of departments because this was the basis for the sampling design of the survey.

14. We simulate the impact of various percentage reductions in cotton prices on the incomes of rural households. In the short run (before the household responds to lower prices), the change in income of each household is simply the change in the value of cotton production, assuming the farmer grows the same amount of cotton. This can be calculated as follows:

$$y_{1i} - y_{0i} = (Q_{ci}\Delta P_c)/H_i \quad (1)$$

where $y_{1i}$ is per capita income[7] of household i after the shock, $y_{0i}$ is per capita income before the shock, $Q_c$ is the quantity of cotton produced by household i, $\Delta P_c$ is the change in the price of cotton, and $H_i$ is the number of members in household i.

15. In the long run, lower cotton prices will lead farmers to substitute away from cotton and reduce input use, so the long-run direct impact is smaller than the short-run direct impact of the change in cotton prices. In this analysis, we use the concept of producer surplus to measure the welfare impact of the change in cotton price. This is calculated using the following equation:

$$y_{1i} - y_{0i} = (Q_{ci}\Delta P_c)/H_i + \left(\frac{1}{2}(\Delta P_c)^2 \varepsilon_c \frac{Q_{ci}}{P_c}\right)/H_i \quad (2)$$

where $\varepsilon_c$ is the general equilibrium supply elasticity of cotton and Pc is the price of cotton[8].

16. In the absence of estimated elasticities of supply for cotton in Benin, we use a range of plausible elasticities to calculate the range of plausible welfare impacts[9]. The elasticities used are 0.5, 1.0, and 1.5. As in the analysis of the short-run effect, we simulate the impact of these changes on the income of each household in the sample (micro-simulation) in order to estimate the impact on different types of households in terms of income and poverty.

17. The simulations are run with farm-level reductions in cotton price ($\Delta P_c$) of 10%, 20%, 30%, and 40%. The other variables ($y_{oi}$ and $Q_{ci}$ ) are all defined at the household level, allowing the changes in per capita income to be calculated for each household in the sample. This "micro-simulation" approach allows us to estimate the change in income for any sub-group in rural areas, defined by income, farm-size, or other variables.

18. The impact of price changes on poverty is measured using the Foster-Greer-Thorbecke measures of poverty[10], the most widely used of which are known as $P_0$, $P_1$, and $P_2$. $P_0$ is just the

[7] As mentioned above, we use per capita expenditure as a proxy for per capita income

[8] This expression is more accurate for small changes in price than large ones. These are third-order effects in that they would be captured by the third term in a Taylor-series expansion. It will be shown later that the results are not very sensitive even to second-order effects (alternative assumptions about supply elasticities).

[9] Two studies have estimated the supply elasticity of cotton in Tanzania. Dercon (1993) estimated an elasticity of 0.63, while Delgado and Minot (2000), using more recent data, obtained an estimate of 1.0.

[10] The Foster-Greer-Thorbecke measures of poverty are calculated as

$$P_\alpha = \frac{1}{N}\sum_i \left[\frac{\mu - y_i}{\mu}\right]^\alpha$$

where $P_a$ is the poverty measure, N is the number of households, $\mu$ is the poverty line, and $y_i$ is the income or expenditure of poor household i (the summation occurs only over poor households). When $\alpha$=0, the poverty measure, $P_0$, is the incidence of poverty, that is, the proportion of households whose income is below the poverty line. When $\alpha$=1, the poverty measure, $P_1$, is the poverty-gap measure. The poverty gap is equal to the incidence of poverty multiplied by the average gap between the poverty line and the income of a poor household, expressed as a percentage of the poverty line. Thus, it takes into account the depth of poverty as

proportion of the population below the poverty line. $P_1$, sometimes called the poverty gap measure, takes into account how far below the poverty line the poor are, on average. And P2, sometimes called the poverty gap squared, takes into account the degree of inequality among poor households, giving greater weight to extreme poverty.

**Characteristics of Cotton Farmers in Benin**

19. Before estimating the impact of changing cotton prices on rural households, it is useful to describe the role of cotton in the rural economy and the characteristics of cotton growers. According to the IFPRI-LARES Small Farmer Survey, cotton is grown by roughly one third of the farm households. Cotton accounts for about 18 per cent of the area planted by farm households and 22 per cent of the gross value of crop production. In value terms, cotton is the second most important crop, after maize. Among cotton farmers, the average area planted with cotton is 2.3 hectares, producing 2.7 tons of seed cotton[11]. The value of this output is US$ 901 per cotton farm[12].

20. Another measure of the importance of cotton in the rural economy is its contribution to cash income. Farmers in Benin are quite market oriented, selling over half the output of cowpeas, groundnuts, manioc, and sweet potatoes, and selling almost half of the output of the "staple" foodcrop, maize. Nonetheless, cotton accounts for about one-third of the value of crop sales carried out by farm households in Benin (IFPRI, 2002).

21. Who are the cotton growers in Benin and how do they differ from other farmers? As mentioned earlier, cotton production is concentrated in the north and center of Benin. About two-thirds of the farmers in the large northern department of Borgou grow cotton, as do 37 per cent of those in nearby Atacora and 64 per cent of those in the central department of Zou. By contrast, in the three departments in the south (Atlantique, Mono, and Ouémé), the percentage ranges from zero to 25 per cent. If we divide the farm households into quintiles, the proportion of farmers growing cotton does not seem to vary consistently across quintiles. If anything, the proportion of cotton growers is lower (28 per cent) in the richest quintile (see Table 1).

22. Cotton growers tend to have farms that are, on average, twice as large as those of non-growers (5.3 hectares compared to 2.3 hectares). Nonetheless, cotton growers are similar to other farmers in terms of various measures of well-being. The incidence of poverty rate is slightly lower among cotton farmers (37 per cent) than among other farmers (42 percent), but the per capita expenditure of cotton growers is about 8 per cent lower than that of others, and the budget share allocated to food is almost identical to that of non-growers (see Table 2). The reason that the larger farms do not translate into a higher standard of living is that cotton growers are concentrated in the more arid north, where the agricultural potential is lower and where there are fewer opportunities for non-farm employment.

23. To give a more concrete idea of the living standards of cotton growers, it is useful to describe some indicators of living conditions, according to the farm surveys:

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well as the percentage of the households that are poor. If $\alpha=2$, then the poverty measure, $P_2$, takes into account the degree of inequality among poor households, as well as the depth of poverty and the number of poor households. $P_2$, sometimes called the poverty-gap squared, will be referred to as a measure of the severity of poverty (see Foster, Greer, and Thorbecke, 1984).

[11] It is worth noting that the average yield is calculated at the household level and aggregated, so it is not necessarily equal to the average quantity divided by the average area. A similar qualification applies to production, price, and value of output.

[12] When the Small Farmer Survey was carried out, the exchange rate was around 630 FCFA/US$, so that the value of cotton production was US$ 901 per cotton farm.

- 85% of the cotton farmers in Benin have houses with mud or mud-brick walls,
- 62% live in houses with a dirt floor,
- 72% have corrugated metal roofs and 28% have straw roofs,
- 53% of the cotton farmer households get drinking water from a public well, while another 18% use water from a river or lake,
- Less than 2 percent have electric lights,
- On average, the nearest source of potable water is 430 m away, and the nearest paved road is 36 km away,
- About 34% of the cotton farmers do not own a chair, 38% do not own a table, and 34% do not own a bed.

These figures are fairly typical of farmers in Benin. Thus, it is not that cotton farmers are poorer than average, but rather that almost all farmers in Benin, including cotton farmers, are quite poor.

**Effect of lower cotton prices**

24. In this section, we use the data from the IFPRI-LARES Small Farmer Survey to estimate the impact of lower cotton prices in Benin. First, we examine the impact of lower prices on the income and poverty of cotton farmers in the short-run, before they have an opportunity to respond to the lower prices. Next, we estimate the impact on cotton farmers in the longer run, after they have responded to the shock of reduced prices.

**Short-term direct effects of lower cotton prices**

25. As described earlier, we estimate the short-term change in income associated with lower cotton prices using household-level information on per capita expenditures and the volume of cotton production, combined with different assumptions about the reduction in cotton price. A 40 per cent reduction in the farm-gate price of cotton reduces the income of cotton growers 21 per cent. Taking into account the incomes of non-growers, which do not change in this simulation, the average income falls 7 per cent. Smaller reductions in the cotton price cause roughly proportionate changes in income (see Table 3).

26. With a 40 per cent fall in the cotton price, the average incidence of poverty, including both cotton growers and other farmers rises 8 percentage points, from 40 per cent to 48 per cent (see Table **3**). In absolute terms, this implies that about 334 thousand people would fall below the poverty line as a result of a 40 per cent reduction in cotton prices.[13] A 40 per cent decrease in the price of cotton results in a 40% increase in the poverty gap for all farm households in Benin, while the poverty gap squared ($P_2$) or severity of poverty increases 61 per cent.

27. This analysis can be broken down by department to evaluate regional differences in the impact of falling cotton prices[14] (see Table 3). In Atlantique and Ouémé, the reduction in cotton prices has negligible effects on income and poverty because there are virtually no cotton farmers in these departments. On the other hand, the impact on the departments of Borgou and Zou are large. In Zou, a 40 per cent reduction in cotton prices results a 15 percent fall in per capita income and a 17 percentage point increase in the incidence of poverty. In Borgou, the same decrease in cotton

[13] This estimate is obtained by multiplying the percentage point increase in poverty (.08), the number of farm households in Benin based on the sum of the sampling weights (474,964), and the average household size of farms in Benin according to the survey (8.8).

[14] As mentioned earlier, since the survey was carried out, the number of departments has increased from 6 to 12. The sample size of the survey is too small to allow disaggregation of results by the newly defined departments.

prices causes an 18 per cent reduction in per capita income and a 18 percentage point increase in the incidence of poverty. In fact, the department of Borgou moves from having an "average" poverty rate (greater than in two departments and less than in two others) to having the highest incidence of poverty, 62 per cent. Similarly, the poverty-gap ($P_1$) in Borgou increases by a factor of three and the severity of poverty ($P_2$) doubles as a result of the 40 percent reduction in cotton prices.

28. Finally, we look at the effect of falling cotton prices on the cumulative distribution of income per capita (see Figure 2). Among other things, it gives us information about the sensitivity of the results to alternative poverty lines, an important consideration given that our poverty lines is relative (set at the 40$^{th}$ percentile in the base distribution). The point where the cumulative distribution cross the poverty line is the poverty rate (note that the base distribution cross the poverty line at the 40$^{th}$ percentile). It is clear from the graph that similar results would have been obtained for higher and lower poverty lines.

**Long-term direct effect of lower cotton prices**

29. Because of uncertainty regarding the supply elasticity of cotton, we carry out this analysis using three elasticities: 0.5, 1.0, and 1.5. In order to simplify the discussion, we present only the impact of a 40 percent reduction in cotton prices. These results are presented with the base levels and with the short-run impact. Since the assumption behind the short-run impact is that the supply elasticity is zero ($\varepsilon$=0)., they are labelled as such.

30. As described earlier, the short-run impact of the lower cotton price is to reduce average per capita income by 7 per cent. If the general equilibrium supply elasticity of cotton is 0.5, the average income after the price reduction falls 6 percent from the base. At the other extreme, if the supply elasticity is 1.5, then the average income falls 5 per cent from the base (see Table 4 ).

31. In the long run, a reduction of 40 percent in the price of cotton is associated with a 6-7 percentage point increase in the overall rural poverty rate, depending on the assumption regarding the supply elasticity. The poverty gap measure ($P_1$) rises from 0.10 to 0.12 - 0.13, again depending on the elasticity assumption. And the poverty gap squared ($P_2$) increases from 0.036 to 0.047 - 0.058 (see Table 4). As expected, the long-run impact of the 40 per cent reduction in cotton prices is somewhat less adverse than the short-run impact. It is notable, however, that the results are not very sensitive to the elasticity assumption.

32. The long-run effects on each department are given in Table 4. For example, in Borgou, per capita income falls 18 percent in the short-run, but rebounds 4 percentage points if the supply elasticity is 1.0 and 7 percentage points if the elasticity is 1.5. Similarly, the per capita income in Zou falls 15 per cent in the short-run, but rebounds 3 percentage points in the long-run if the elasticity is 1.0.

33. The poverty rates in each department follow the same pattern in reverse. In the short-run, they rise as a result of the 40 percent fall in cotton prices, but in the long-run they fall back down part of the way. In Borgou, the poverty rate rises from 44 per cent to 62 per cent in the short run, falling back to 58-60 per cent in the long run, depending on which elasticity assumption is used. Similarly, the incidence of poverty in Zou increases from 33 per cent to 50 per cent in the short run, then falls to 47-49 per cent in the long run. As described above, there is little or no change in poverty in the three southern departments (Atlantique, Mono, and Ouémé) because there are very few cotton growers in these departments.

34. In Figure 3, we show the cumulative distribution of income in the base scenario, with a 40 per cent reduction in cotton prices in the short run ($\varepsilon$=0), and with a 40 per cent reduction in cotton prices in the long run ($\varepsilon$=1.5). Although the long-run supply elasticity used in this figure is at the upper end

of what we believe is plausible, the difference between the short-run and long-run results is not very large. In other words, the long-term results are not very sensitive to the assumption regarding the supply elasticity of cotton. Even with a relatively elastic supply ($\varepsilon$=1.5), the response of farmers only offsets about one-third of the initial negative short-run impact.

**Conclusions**

35. This paper analyzes the impact of changes in world cotton prices on farmers in Benin. Both quantitative measures of per capita expenditure from household surveys and qualitative responses to a nationally representative survey suggest that rural living conditions improved over the 1990s. Furthermore, farmers tend to attribute this improvement in rural living conditions to economic factors such as crop prices, availability of food, and access to non-farm employment. Although the causal link is difficult to establish with certainty, it appears the economic reforms of the 1990s (including the 1994 devaluation) and the growth of cotton production during this period contributed to a noticeable improvement in rural standards of living.

36. The link between cotton markets and rural living conditions can, however, work against farmers as well. The analysis in this paper is motivated by the 39 percent decline in the world price of cotton between January 2001 and May 2002. We combine farm survey data from 1998 with assumptions about the decline in farm-level prices to estimate the short- and long-term direct effects of cotton price reductions on rural income and various measures of poverty. We also use the survey data to study two types of indirect effects: the impact of lower cotton production on the demand for agricultural labour by cotton growers and the impact of lower cotton prices on other households through the multiplier effect.

37. The results indicate that there is a strong link between cotton prices and rural welfare in Benin. A 40 per cent reduction in farm-level prices of cotton is likely to result in a reduction in rural per capita income of 7 per cent in the short-run and 5-6 per cent in the long-run. Furthermore, poverty rises 8 percentage points in the short-run, equivalent to an increase of 334 thousand in the number of individuals in families below the poverty line. In the long run, as households adjust to the new prices, the poverty rate settles down somewhat, remaining 6-7 percentage points higher than originally.

38. Furthermore, these estimates may well underestimate the actual effect of lower cotton prices on rural poverty in Benin. First, in an economy with unemployed resources and excess capacity, an external shock affecting income (such as a change in cotton prices) has a multiplier effect. Changes in cotton farmer income result in changes in demand for goods and services produced by their non-cotton-growing neighbours, which in turn influences the demand for goods and services these neighbours consume. Estimates for four countries in sub-Saharan Africa suggest that the multiplier is in the range of 1.7 to 2.2, meaning that the total effect on income (positive or negative) is 1.7 to 2.2 times greater than the direct impact. Second, we assume that farm prices change by the same proportion as world prices. In competitive markets with a fixed marketing margin, the percentage change in farm prices will be greater than the percentage change in world prices[15]. Third, our estimates do not take into account other indirect effects associated with declining cotton production. An earlier analysis of the Small Farmer Survey data from Benin indicated that cotton farmers are three times more likely to apply fertilizer to their maize crops compared to non-cotton farmers (see Minot et al, 2001). This is because growing cotton gives farmers access to fertilizer on credit, some of which they "divert" to their maize fields. The implication is that lower cotton prices will indirectly reduce the yields of food crops.

[15] Until recently, the effect of changes in world prices on farm-level prices in Benin was muted by government regulation of the market which stablized prices. Under market reforms being carried out in Benin and elsehwere in West Africa, markets are becoming more competitive and changes in farm prices will closely match changes in world prices.

39. Overall, the results in this paper challenge the stereotype of the rural poor in developing countries as consisting of subsistence farmers that are relatively unconnected to, and thus unaffected, by swings in world commodity markets. At least in the case of Benin, to the extent that fluctuations in world cotton prices are transmitted to farmers, they will have a significant effect on rural incomes and poverty. The broader implication is that policies that subsidize cotton production in the United States and elsewhere, dampening world prices, have an adverse impact on rural poverty in Benin and (by extension) other poor cotton-exporting countries.

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- **Table 1. Proportion of farm households**
- **growing maize and cotton**

| | Maize | Cotton |
|---|---|---|
| Department | | |
| Atacora | 76 | 37 |
| Atlantique | 100 | 0 |
| Borgou | 96 | 68 |
| Mono | 83 | 25 |
| Ouémé | 91 | 4 |
| Zou | 95 | 64 |
| Quintile | | |
| Poorest | 91 | 35 |
| $2^{nd}$ | 93 | 30 |
| $3^{rd}$ | 90 | 44 |
| $4^{th}$ | 88 | 38 |
| Richest | 90 | 28 |
| Benin | 89 | 34 |

Source: IFPRI-LARES Small Farmer Survey.

**Table 2. Characteristics of cotton growers and other farmers**

| | Cotton growers | Other farmers | Total |
|---|---|---|---|
| Household size | 10.1 | 8.1 | 8.8 |
| Dependency ratio | 49 | 48 | 48 |
| Sown area (ha) | 6.5 | 3.2 | 4.4 |
| Farm size (ha) | 5.3 | 2.3 | 3.3 |
| Expenditure (FCFA/person/year) | 99,437 | 108,315 | 105,203 |
| Food share | 57 | 56 | 57 |
| Home production share | 35 | 24 | 28 |
| Percent growing cotton | 100 | 0 | 35 |
| Cotton area (ha) | 2.3 | 0 | 0.8 |
| Cotton output (kg) | 2,559 | 0 | 897 |
| Cotton yield (kg/ha) | 1,084 | | 1,084 |
| Cotton sales (FCFA) | 505,584 | 0 | 177,217 |
| Poverty measures | | | |
| $P_0$ | 0.37 | 0.42 | 0.40 |
| $P_1$ | 0.095 | 0.103 | 0.100 |
| $P_2$ | 0.033 | 0.037 | 0.036 |

Source: IFPRI-LARES Small Farmer Survey.

**Table 3. Short-run direct impact of reductions in cotton prices by department**

| | Atacora | Atlantique | Borgou | Mono | Ouémé | Zou | Total |
|---|---|---|---|---|---|---|---|
| Per capita expenditure | | | | | | | |
| Base | 84,672 | 139,290 | 94,803 | 88,034 | 116,479 | 110,108 | 105,203 |
| 10% reduction | 83,559 | 139,290 | 90,455 | 87,547 | 116,414 | 106,115 | 103,388 |
| 20% reduction | 82,446 | 139,290 | 86,106 | 87,060 | 116,349 | 102,123 | 101,574 |
| 30% reduction | 81,333 | 139,290 | 81,758 | 86,573 | 116,284 | 98,130 | 99,759 |
| 40% reduction | 80,219 | 139,290 | 77,409 | 86,086 | 116,219 | 94,137 | 97,944 |
| Incidence of poverty (P0) | | | | | | | |
| Base | 0.54 | 0.14 | 0.44 | 0.50 | 0.44 | 0.33 | 0.40 |
| 10% reduction | 0.55 | 0.14 | 0.46 | 0.50 | 0.44 | 0.37 | 0.42 |
| 20% reduction | 0.56 | 0.14 | 0.53 | 0.50 | 0.44 | 0.43 | 0.44 |
| 30% reduction | 0.56 | 0.14 | 0.58 | 0.52 | 0.44 | 0.47 | 0.46 |
| 40% reduction | 0.57 | 0.14 | 0.62 | 0.53 | 0.44 | 0.50 | 0.48 |
| Poverty gap (P1) | | | | | | | |
| Base | 0.161 | 0.034 | 0.098 | 0.131 | 0.110 | 0.071 | 0.100 |
| 10% reduction | 0.166 | 0.034 | 0.114 | 0.134 | 0.110 | 0.081 | 0.106 |
| 20% reduction | 0.172 | 0.034 | 0.137 | 0.137 | 0.111 | 0.097 | 0.115 |
| 30% reduction | 0.178 | 0.034 | 0.167 | 0.140 | 0.111 | 0.118 | 0.126 |
| 40% reduction | 0.185 | 0.034 | 0.202 | 0.143 | 0.111 | 0.144 | 0.138 |
| Severity of poverty (P2) | | | | | | | |
| Base | 0.065 | 0.012 | 0.031 | 0.046 | 0.042 | 0.022 | 0.036 |
| 10% reduction | 0.068 | 0.012 | 0.039 | 0.048 | 0.042 | 0.025 | 0.038 |
| 20% reduction | 0.070 | 0.012 | 0.052 | 0.050 | 0.042 | 0.031 | 0.042 |
| 30% reduction | 0.074 | 0.012 | 0.071 | 0.052 | 0.042 | 0.041 | 0.049 |
| 40% reduction | 0.078 | 0.012 | 0.100 | 0.055 | 0.042 | 0.057 | 0.058 |

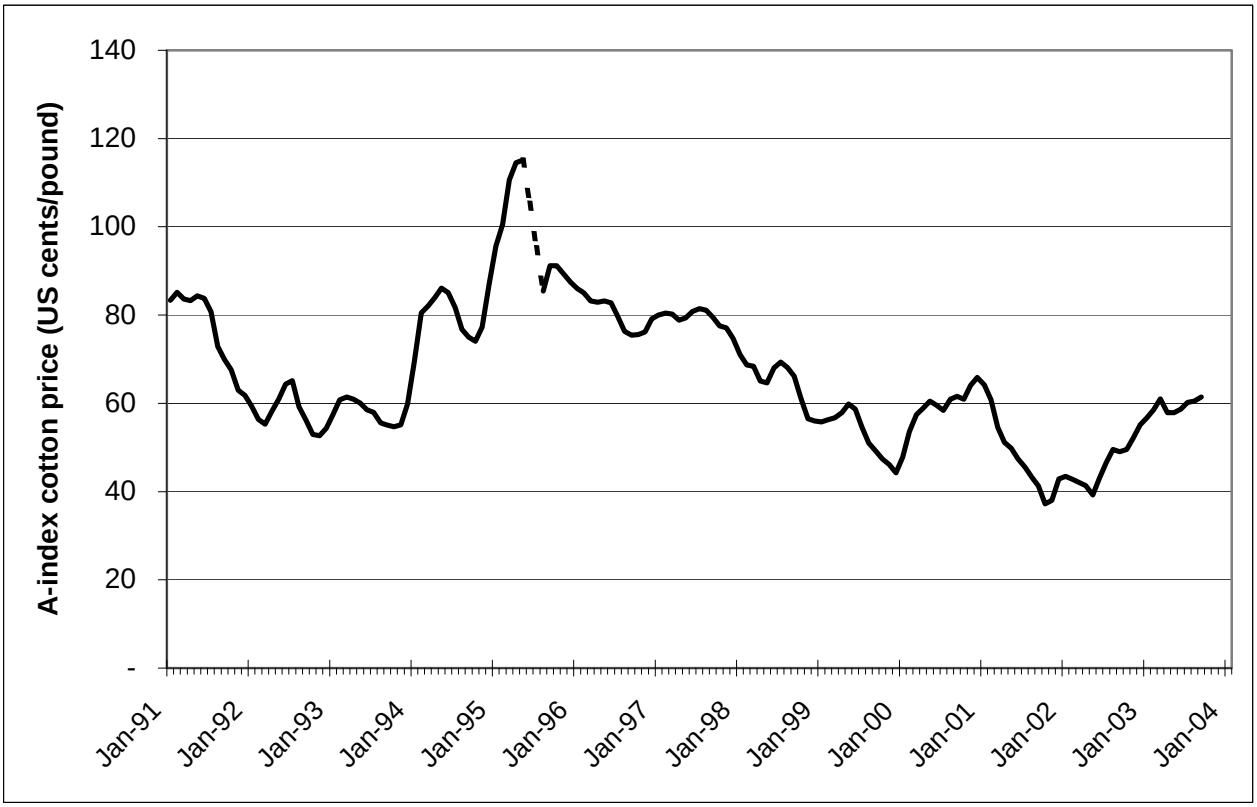
Source: IFPRI-LARES Small Farmer Survey.

**Table 4. Long-run direct impact of a 40% reduction in cotton price by department**

| | Atacora | Atlantique | Borgou | Mono | Ouémé | Zou | Total |
|---|---|---|---|---|---|---|---|
| Per capita expenditure | | | | | | | |
| Base | 84,672 | 139,290 | 94,803 | 88,034 | 116,479 | 110,108 | 105,203 |
| ε = 0 | 80,219 | 139,290 | 77,409 | 86,086 | 116,219 | 94,137 | 97,944 |
| ε = 0.5 | 80,665 | 139,290 | 79,149 | 86,280 | 116,245 | 95,734 | 98,670 |
| ε = 1.0 | 81,110 | 139.290 | 80,888 | 86,475 | 116,271 | 97,331 | 99,396 |
| ε = 1.5 | 81,555 | 139,290 | 82,627 | 86,670 | 116,297 | 98,928 | 100,122 |
| Incidence of poverty (P0) | | | | | | | |
| Base | 0.54 | 0.14 | 0.44 | 0.50 | 0.44 | 0.33 | 0.40 |
| ε = 0 | 0.57 | 0.14 | 0.62 | 0.53 | 0.44 | 0.50 | 0.48 |
| ε = 0.5 | 0.57 | 0.14 | 0.60 | 0.53 | 0.44 | 0.49 | 0.47 |
| ε = 1.0 | 0.57 | 0.14 | 0.59 | 0.52 | 0.44 | 0.48 | 0.47 |
| ε = 1.5 | 0.56 | 0.14 | 0.58 | 0.52 | 0.44 | 0.47 | 0.46 |
| Poverty gap (P1) | | | | | | | |
| Base | 0.161 | 0.034 | 0.098 | 0.131 | 0.110 | 0.071 | 0.100 |
| ε = 0 | 0.185 | 0.034 | 0.202 | 0.143 | 0.111 | 0.144 | 0.138 |
| ε = 0.5 | 0.182 | 0.034 | 0.188 | 0.142 | 0.111 | 0.133 | 0.133 |
| ε = 1.0 | 0.179 | 0.034 | 0.174 | 0.140 | 0.111 | 0.123 | 0.128 |
| ε = 1.5 | 0.177 | 0.034 | 0.161 | 0.139 | 0.111 | 0.113 | 0.123 |
| Severity of poverty (P2) | | | | | | | |
| Base | 0.065 | 0.012 | 0.031 | 0.046 | 0.042 | 0.022 | 0.036 |
| ε = 0 | 0.078 | 0.012 | 0.100 | 0.055 | 0.042 | 0.057 | 0.058 |
| ε = 0.5 | 0.077 | 0.012 | 0.088 | 0.054 | 0.042 | 0.050 | 0.054 |
| ε = 1.0 | 0.075 | 0.012 | 0.076 | 0.053 | 0.042 | 0.044 | 0.050 |
| ε = 1.5 | 0.073 | 0.012 | 0.067 | 0.052 | 0.042 | 0.039 | 0.047 |

Source: IFPRI-LARES Small Farmer Survey.

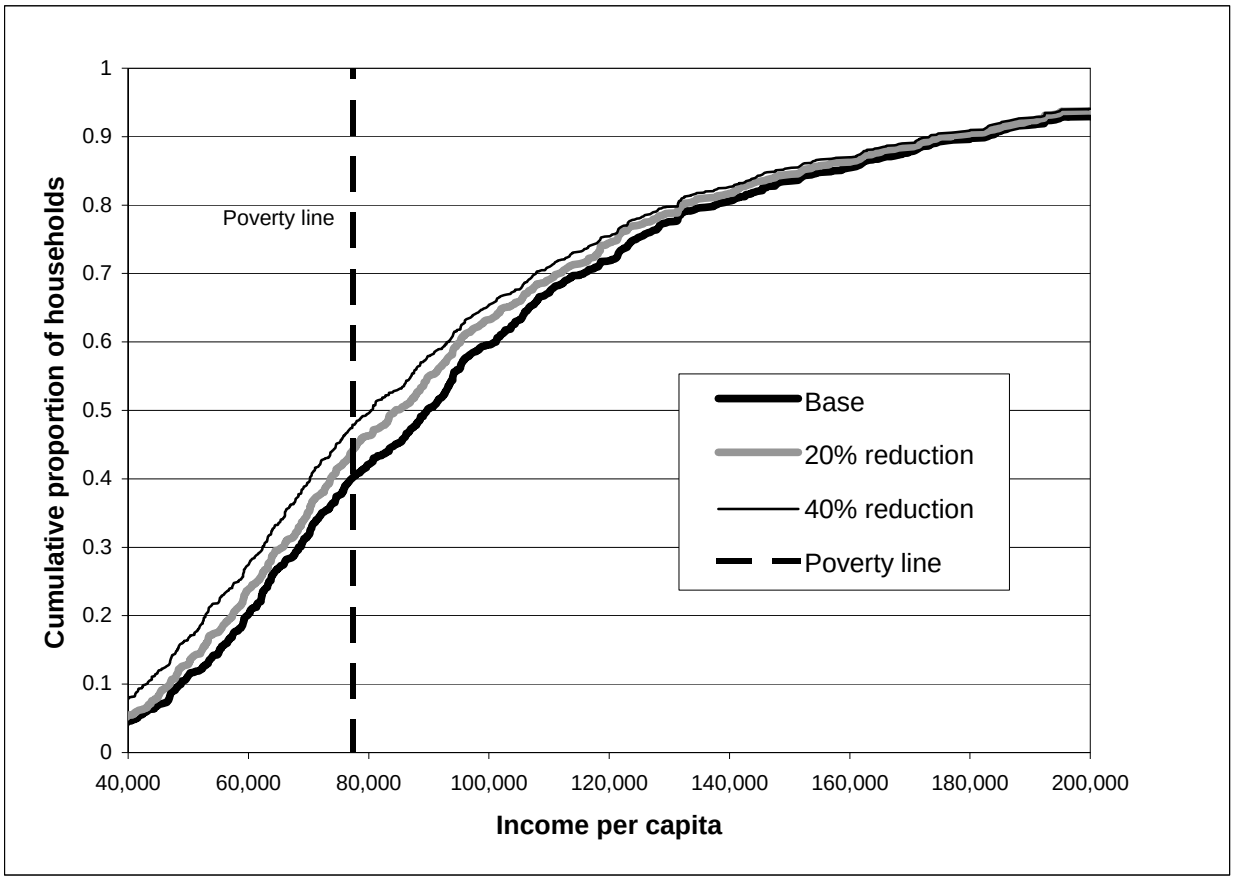
- **Figure 1. Cotton prices in Northern Europe (A-Index)**



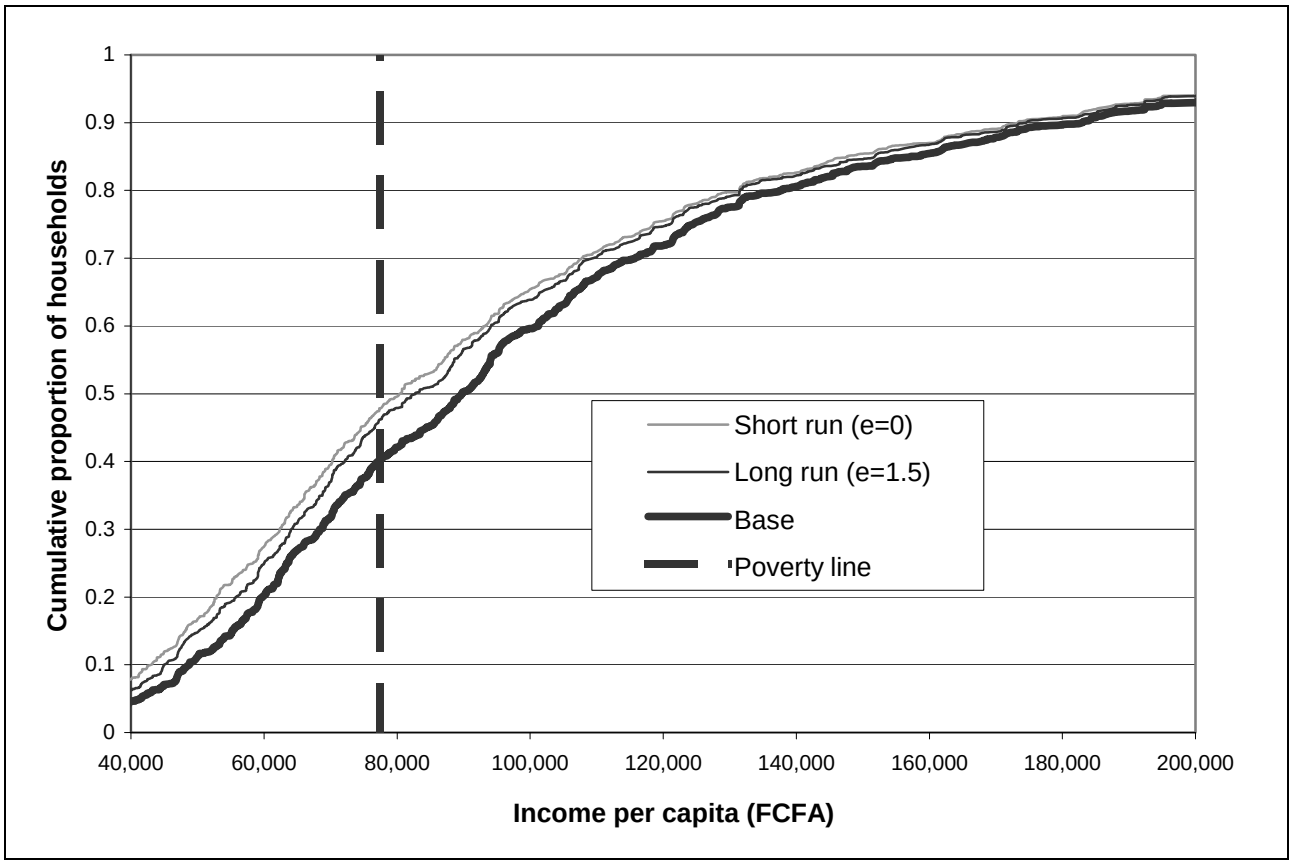

Source: USDA, 2002; USDA, 2001.

- Note: The A-Index is the average of the five lowest prices of cotton in Northern European markets for middling 1 3/32 inch fiber length**.** For June and July 1995, there was no A-Index quotation; the dotted line represents a simple linear interpolation.

• **Figure 2. Short-run impact of lower cotton prices on the cumulative distribution of income**



- **Figure 3. Long-run impact of a 40% reduction in cotton prices on the cumulative distribution of income**



# ANNEX E-5

## CANADA'S FURTHER THIRD PARTY SUBMISSION

3 October 2003

Canada's systemic interest in this case lies in the interpretation of the provisions of Article 13 and Annex 2 of the *Agreement on Agriculture*, as they related to certain US domestic support measures. It also lies in the interpretation of the export subsidy provisions of both the *Agreement on Agriculture* and the *SCM Agreement*, as they related to US export credit guarantee programmes.

Regarding US domestic support measures, were the Panel to accept the evidence presented by Brazil, it would find that US PFC payments and direct payments do not satisfy the policy-specific criteria in paragraph 6 of Annex 2 of the *Agreement on Agriculture*. The Panel should also count US counter-cyclical payments going to US producers of upland cotton as "support to a specific commodity" under Article 13(b)(ii) of the Agreement.

Regarding US export credit guarantees, were the Panel to find that the programs provide export subsidies within the meaning of Article 1(e) of the *Agreement on Agriculture*, then it would also find that the United States has violated Articles 8 and 10.1 at the very least in respect of exports of upland cotton. In this respect, the Panel should confirm that neither the *Agreement on Agriculture* nor the *SCM Agreement* contain an exemption for any US export credit guarantee subsidy found to exist in this case.

Canada has no further views to provide to the Panel at this point in the proceedings.

# ANNEX E-6

## FURTHER THIRD PARTY SUBMISSION OF THE EUROPEAN COMMUNITIES

3 October 2003

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## 1. Introduction

1. The European Communities (the "EC") makes this submission because of its systemic interest in the correct interpretation of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*"), the *Agreement on Agriculture* (the "AA") and the *General Agreement on Tariffs and Trade 1994* (the "GATT").

2. This submission provides the views of the EC with respect to Brazil's further submission of 9 September 2003. Due to the short deadline imparted to third parties, this submission does not address the further submission made by United States on 30 September 2003. The EC intends to provide its comments on the US submission at the meeting with the Panel.

3. Many of the issues raised in Brazil's further submission concern factual matters on which the EC is not in a position to comment. Accordingly, the EC will limit itself to provide its views with respect to a number of issues of legal interpretation to which it attaches particular importance. More specifically, the EC will argue in this submission that:

- in assessing the "significance" of price depression or suppression for the purposes of Article 6.3 (c) of the *SCM Agreement*, only their impact on the producers concerned is relevant;
- Brazil cannot complain about the continuing effects of recurring subsidies while expensing the full amount of such subsidies to the year in which they were granted;
- the phrase "world market share" in Article 6.3(d) of the *SCM Agreement* includes also the market of the subsidising Member;
- the mere fact that a subsidy is not subject to "pre-established limitations" is not sufficient for a finding of "threat of serious prejudice";
- Articles 5 and 6 of the *SCM Agreement* do not prohibit *per se* legislation that mandates subsidies that threaten serious prejudice "in certain circumstances".

4. The EC reserves the right to address other issues raised by Brazil's further submission at the meeting with the Panel.

## 2. The meaning of "significant" in Article 6.3 (c) of the SCM Agreement

5. Brazil argues that, in assessing the "significance" of price depression or suppression for the purposes of Article 6.3 (c), it is relevant to consider not only their impact on the producers concerned, but also on the Government of the complaining Member. Specifically, Brazil contends that

> A developing country Government facing foreign reserve or fiscal problems may find the loss of foreign exchange or tax revenue from its producers to be significant even if the level of price suppression is relatively small. In this regard, the amount of actual and potential revenue losses suffered by a complaining Member as a result of price suppression may be evidence of the significance of the price suppression.[1]

[1] Brazil's submission, para. 96.

6. The EC takes issue with this interpretation. As rightly argued by Brazil elsewhere in its submission[2], the existence of serious prejudice must be presumed whenever it is established that the effect of the subsidy is to cause *inter alia* significant price depression or suppression, without it being necessary to show, as an additional and separate requirement, that such price depression or suppression causes a serious prejudice to the interest of the Member concerned. Brazil's interpretation, however, amounts to reading such a separate requirement into the term "significant".

7. In *Indonesia – Autos*, which is cited with approval by Brazil, the panel held that

> Although the term 'significant' is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully affect suppliers of the imported product whose price was undercut are not considered to rise to serious prejudice …[3]

8. The above interpretation takes into account only the effects of price undercutting on the performance of the domestic producers of the complaining party, to the exclusion of any indirect effects on Government revenue. By the same token, where serious prejudice takes the form of price suppression or price depression, its significance should be evaluated only with respect to the producers concerned.

9. In any event, the EC rejects Brazil's suggestion that the threshold for establishing the existence of serious prejudice should be lower when the complaining party is a developing country Member. Article 6.3 (c) is not a provision on Special and Differential Treatment. There is no basis for giving different meanings to the term "significant" depending on the identity of the parties to a dispute.

### 3. Continuing effects of recurring subsidies

10. Brazil alleges that the effects of the subsidies paid during Marketing Years ("MY") 1999-2002 continue after they have been provided. More precisely, according to Brazil, by providing farmers with a significant source of income, these payments result in increased investment and production.

11. The EC finds it difficult to understand what point, if any, Brazil is trying to make. Brazil does not seem to be arguing that part of the benefit conferred by the subsidies granted during MY 1999-2002 should be allocated to subsequent years. That position would depart from the usual practice of most countervailing duty authorities, which is to consider that recurring subsidies must, in principle, be deemed "expensed" during the time period in which they are made. Similarly, the report of the Informal Group of Experts concerning Article 6.1(a) of the *SCM Agreement* recommended that subsidies should be expensed rather than allocated unless: (1) the purpose of the subsidy is linked to the purchase of fixed assets; (2) the subsidy is non-recurring or large; (3) the subsidy is oriented towards future production; (4) the subsidy consists of equity; or (5) is carried forward in the recipient's accounting records.[4]

12. Elsewhere in its submission Brazil appears to have expensed the full amount of the subsidies paid during each marketing year to that marketing year, rather than allocate it over a number of marketing years. Brazil cannot have it both ways. If it considers that part of the benefit should be allocated to subsequent marketing years, it should justify that position in light of the criteria outlined

[2] Ibid., paras 437-443.
[3] Panel report, *Indonesia – Automobiles*, WT/DS54/R, para. 14.254.
[4] Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures, 25 July 1997, G/SCM/W/415, paras. 5-12.

above and provide the Panel with a detailed allocation. Moreover, Brazil should deduct the amounts allocated to subsequent years from the yearly amounts for the period 1999-2001, so as to avoid any "double counting" of benefits. Needless to say, this could make more difficult for Brazil to establish that the subsidies paid during MY 1999 – 2001 have caused serious prejudice during that period.

13. In any event, while Brazil claims that the subsidies continue to have effects after MY 1999-2001, the alleged continuing effects (increased investments and production) do not of themselves amount to "serious prejudice" within the meaning of Article 5. Brazil has not explained, let alone proved, how those effects translated into one of the categories of "serious prejudice" described under Article 6.3 after 2001.

**4. World Market Share in Article 6.3(d)**

14. Brazil contends that the phrase "world market share" in Article 6.3(d) of the *SCM Agreement* means the "share of world market for exports".[5] The EC sees no basis for this proposition. The ordinary meaning of "world market" is the sum of all the geographical markets for the product concerned, including also the domestic market of the subsidising Member.

15. This reading is supported by the context. As evidenced by paragraph (a) of Article 6.3, the notion of "serious prejudice" may include also the prejudice suffered in the market of the subsidising Member. There is no reason, therefore, why the effects of a subsidy in that market should be excluded from the analysis under paragraph (d).

16. The phrase "world market share" may be contrasted with the phrase "share of world export trade", which is used in Article XVI:3 of the GATT. Surely, if the drafters of Article 6.3(d) had meant the "share of world market for exports", as argued by Brazil, they would have used the same terms as in Article XVI:3. Moreover, in the context of Article XVI:3, it makes perfect sense to use as a benchmark the "share of the world market for exports" because that provision is concerned exclusively with export subsidies, which have no direct effect on the domestic market of the subsidising Member. In contrast, the disciplines on "serious prejudice" contained in Articles 5 and 6 of the *SCM Agreement* apply equally to both export and domestic subsidies and, in practice, are meant to address primarily the effects of the latter, since export subsides are prohibited by Article 3 (except where provided in conformity with the *Agreement on Agriculture* or Article 27 of the *SCM Agreement*).

**5. Threat of injury**

17. Brazil sets forth two legal standards in order to analyse the existence of threat of serious prejudice. According to the first standard, there is threat of serious prejudice whenever "the legislation and practice of granting subsidies has no effective limits in terms of the volume of exports or domestic subsidies production eligible to receive subsidies".[6] Brazil contends that this standard can be "distilled" from the two GATT panel reports in *EC – Sugar* and from the Appellate Body report in *US – FSC*.[7]

18. For the reasons explained below, the EC considers that, while the fact that a subsidy is not subject to any "pre-established limitations" is certainly a relevant factor in considering the existence of threat of serious prejudice, it is not necessarily dispositive.

[5] Brazil's submission, para. 265.
[6] Brazil's submission, para. 301.
[7] Ibid.

19. The two GATT reports in *EC – Sugar* are of questionable authority on this point. Neither of the panels made any attempt to provide a generally applicable interpretation of the notion of "threat of serious prejudice". The findings cited by Brazil are just bare assertions, without any supporting reasoning. Furthermore, other passages of the reports indicate that both panels took the view that the unlimited availability of subsidies could not be, of itself, a cause of serious prejudice. Thus, the panel in *EC – Sugar (Australia)* noted that

> The Panel felt that since the Community sugar exporters were leading the world market for white sugar, traditionally covering more than half of the world market for refined sugar, the availability of exportable Community surpluses of sugar combined with the possibility of non-limited amounts available to cover export refunds, may well have had a depressing effect on world market prices for both white and raw sugar.[8]

Similarly, the panel in *EC – Sugar (Brazil)* observed that

> The Panel concluded that in view of the Community sugar made available for export with maximum refunds and the non-limited funds available to finance export refunds, the Community system of granting export refunds on sugar had been applied in a manner which in the particular situation prevailing in 1978 and 1979contributed to depress sugar prices in the world market, and that this constitutes a serious prejudice to Brazilian interests, in terms of Article XVI:1.[9]

20. The above passages suggest that both panels considered that the unlimited availability of the EC subsides was a cause of serious prejudice only because, in conjunction with the availability of supplies of sugar in the EC and with the "particular situation" prevailing during the years 1978 and 1979, it had a depressing effect on prices. It follows that, unless the same or similar circumstances were also present or imminent in this case, the mere availability of subsidies could not be considered to pose, as such, a threat of serious prejudice.

21. Brazil's arguments based on *US – FSC* are also without merit. Unlike Articles 5 and 6 of the S*CM Agreement*, Article 10.1 of the *Agreement on Agriculture* is not subject to a "trade effects" test. It prohibits any export subsidies not covered by Article 9, which exceed, or threaten to exceed, a Member's reduction commitments (in terms of budgetary outlays or exported volumes), regardless of the trade effects of the subsidy. In contrast, Articles 5 and 6 do not stipulate any limitations on the volume or value of subsidies. Rather, they prohibit the granting of subsidies in so far as they have certain "adverse effects" for the interests of another Member. Whether or not a subsidy has such effects will depend not only on the amount of the subsidy or the volume of subsided goods but also on other circumstances. For that reason, the mere fact that a subsidy is not subject to "pre-established limitations" is not a sufficient reason to conclude that it threatens to cause serious prejudice.

22. Brazil appears to agree with the view that the elements of a threat of serious prejudice injury are the same as those of a serious prejudice case, the only difference between the two being that "in a serious prejudice case, all the elements already exist, whereas in a threat of serious prejudice case, all of the elements need not have come to pass."[10] Yet that view cannot be reconciled with Brazil's first standard. Article 6 of the *SCM Agreement* makes it clear that the existence of "serious prejudice" cannot be established by looking only at the value of the subsidy (with the exception of the no-longer operational presumption in Article 6.1 (a)) or to the absolute volume of subsidised goods (as opposed

[8] Panel report, *European Communities – Refunds on Exports of Sugar (Australia)*, BISD 26S/290, para. 4.31

[9] Panel report, *European Communities –Refunds on Exports of Sugar (Brazil)*, BISD 27S/69, V(f).

[10] Brazil's submission, para. 304.

to their market share). Therefore, a determination of threat of serious prejudice cannot be based on those factors alone either.

23. The EC considers that Article 15.7 of the *SCM Agreement* provides relevant context for the interpretation of the notion of "threat of serious prejudice". Both "injury to the domestic industry" and "serious prejudice" are "adverse effects" within the meaning of Article 5. There is no good reason why the threshold for establishing the existence of "threat of injury" should be higher than the threshold for establishing the existence of "threat of serious prejudice". The EC is of the view, therefore, that the requirements set out in Article 15.7 of the *SCM Agreement* must be deemed implicit in the notion of "threat of serious prejudice". Accordingly, a determination of threat of serious prejudice, like a determination of injury, must "be based on facts and not merely on allegation, conjecture or remote possibility". Also, the relevant "changes in circumstances" must be "clearly foreseen and imminent".

24. As recalled by Brazil, Article 15.7(i) of the *SCM Agreement* provides that the "nature of the subsidy or subsidies in question and the trade effects likely to arise therefrom" is one of the factors that should be considered for the purposes of a threat of injury determination.[11] The EC agrees that this is also one of the factors that should be considered for the purposes of a determination of threat of serious prejudice. But it is not the only relevant factor. Brazil glosses over the last sentence of Article 15.7, which provides that no one of the factors listed in that provision "can necessarily give guidance". Rather, "the totality of the factors considered must lead to the conclusion that further subsidised exports are imminent and that, unless protective action is taken, material injury would occur". This confirms that, while the absence of "pre-established limitations" is a relevant factor, it is not necessarily dispositive.

25. Brazil further asserts that the other factors listed in Article 15.7 "are not directly relevant to a threat of serious prejudice case because they address the situation of imports that would harm the domestic industry in the country of importation."[12] This is, of course, correct. Nonetheless, Article 15.7 suggests that analogous factors may be relevant for a determination of serious prejudice. For example, the following factors could be relevant for establishing the existence of serious prejudice in an export market:

- a significant rate of increase of subsidised exports to the export market;
- sufficiently freely disposable, or an imminent, substantial increase in, capacity of the exporter indicating the likelihood of substantially increased subsidised exports, taking into account the availability of other export markets to absorb any additional exports;
- whether subsidised exports are entering into the export market at prices that will have a significant depressing or suppressing effect in prices, and would likely increase demand for further imports; and
- inventories of the product investigated.

26. In sum, the EC is of the view that, while the fact that a subsidy is not subject to any "pre-established limitations" as regards the value of the subsidies or the volume of subsidised goods is a relevant factor in order to establish the existence of threat of serious prejudice, it is not necessarily dispositive. Other factors, including in particular factors analogous to those listed in Article 15.7 (ii)-(v) of the *SCM Agreement*, may also be relevant and should be examined as well.

[11] Ibid., para. 302.
[12] Ibid., para. 303.

### *6.* ***Per se* claims**

27. Brazil claims that the US legislation conferring the subsidies at issue in this case is inconsistent *per se* with Article 5(c) of the *SCM Agreement* and Article XVI:3 of the GATT because it *mandates* the payment of subsidies that will necessarily threaten serious prejudice *in certain circumstances*. This claim is based on the assumption that

> It is established under WTO law that a Member can challenge measures of another Member on a per se basis when those measures mandate, in certain circumstances, a violation of its WTO obligations.[13]

28. The above proposition, however, is nowhere stated in the WTO Agreement and, as noted already in its first submission[14], the EC disputes its validity. True, some panels have asserted this position on the basis of an erroneous interpretation of the panel report in *US - Superfund*. Other panels, however, have taken a contrary, or at least more qualified view.[15] In particular, the panel in *US – Section 301* observed that

> we believe that resolving the dispute as to which type of legislation, *in abstract*, is capable of violating WTO obligations is not germane to the resolution of the type of claims before us. In our view the appropriate method in cases such as this is to examine with care the nature of the WTO obligation at issue and to evaluate the Measure in question in the light of such examination. The question is then whether, on the correct interpretation of the specific WTO obligation at issue, only mandatory or also discretionary national laws are prohibited. We do not accept the legal logic that there has to be one fast and hard rule covering all domestic legislation. After all, is it so implausible that the framers of the WTO Agreement, in their wisdom, would have crafted some obligations which would render illegal even discretionary legislation and crafted other obligations prohibiting only mandatory legislation? Whether or not Section 304 violates Article 23 depends, thus, first and foremost on the precise obligations contained in Article 23.[16]

29. The Appellate Body has not pronounced itself yet clearly on this issue. Thus, in *US – 1916 Act*, which is sometimes cited erroneously as an endorsement of the principle invoked by Brazil, the Appellate Body noted that

> … the 1916 Act is clearly not discretionary legislation, as that term has been understood for purposes of distinguishing between mandatory and discretionary legislation. Therefore, we do not find it necessary to consider, in these cases, whether

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[13] Brazil's submission, para. 417.

[14] EC's First Third Party Submission, paras. 4-7.

[15] See e.g. the Panel report on *United States – Countervailing Measures Concerning Certain products from the European Communities*, WT/DS212/R, para. 7.123:

> While only legislation that mandates a violation of WTO obligations can be WTO-inconsistent, we are of the view that the existence of some form of executive discretion alone is not enough for a law to be prima facie WTO - consistent, what is important is whether the government has an effective discretion to interpret and apply its legislation in a WTO-inconsistent manner.

[16] Panel report, *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, para. 7.53. [footnotes omitted]

> Article 18.4, or any other provision of the Anti-Dumping Agreement, has supplanted or modified the distinction between mandatory and discretionary legislation.[17]

30. The Appellate Body was even more cautious in a subsequent case, *US – Lead and Bismuth II*, where it noted that

> We are not, by implication, precluding the possibility that a Member could violate its WTO obligations by enacting legislation granting discretion to its authorities to act in violation of its WTO obligation. We make no finding in this respect.[18]

31. The EC agrees with the panel in *US – Section 301* that whether or not *discretionary* legislation may be subject to challenge depends on the specific obligations imposed by each provision of the WTO Agreement. Thus, for example, it is arguable that Article XI:1 of the GATT prohibits not only mandatory legislation, but also legislation which authorises expressly the executive branch to apply an import restriction under well specified circumstances, because such authorisation, of itself, may have a chilling effect on imports.

32. For the same reasons, it would be mistaken to assume, as Brazil does, that legislation which mandates action that would result in a violation of a WTO provision *in certain circumstances* is necessarily inconsistent with that provision. As illustrated by the present case, this notion would have absurd and unacceptable results when applied to WTO provisions which, like Article 5(c) of the *SCM Agreement* and Article XVI:3 of the GATT, incorporate a "trade effects" test. The EC considers that, once again, whether or not legislation that mandates a violation *in certain circumstances* can be challenged *per se* will depend on the specific obligations impose by the WTO provision at issue.

33. It is often overlooked that in *US– Superfund* the panel justified its finding that the tax legislation at issue could be challenged, even though it had not entered into effect, by reasoning that Article III of the GATT is not concerned with trade volumes, but rather with competitive opportunities[19]:

> The Panel noted that the United States objected to an examination of this tax because it did not go into effect before 1 January 1989, and - having no immediate effect on trade and therefore not causing nullification or impairment – fell outside the framework of Article XXIII. […]
>
> […] The general prohibition of quantitative restrictions under Article XI, which the Panel on Japanese Measures on Imports of Leather examined, and the national treatment obligation of Article III … have essentially the same rationale, namely to protect expectations of the contracting parties as to the competitive relationship between their products and those of the other contracting parties. Both articles are not only to protect current trade but also to cerate the predictability needed to plan future trade. That objective could not be attained if contracting parties could not challenge existing legislation mandating actions at variance with the General Agreement until the administrative acts implementing it had actually been applied to their trade. Just as the very existence if a regulation providing for a quota, without it restricting particular imports, has been recognized to constitute a violation of Article XI;1, the

[17] Appellate Body report, *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, WT/DS162/AB/R, para. 99.

[18] Appellate Body report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, footnote 334.

[19] Panel report, *United States – Taxes on Petroleum and Certain Imported Products*, BISD 34/136, 160, paras.5.2.1-5.2.2.

> very existence of mandatory legislation providing for an internal tax, without it being applied to a particular imported product, should be regarded as falling within the scope of Article III:2, first sentence. …

34. It is also a common mistake to assume that, like Articles III or IX of the GATT, all other WTO provisions are concerned also with competitive opportunities. Some WTO provisions, however, are not concerned with competitive opportunities, but instead with trade effects. Article 5(c) of the *SCM Agreement* and Article XVI:3 of the GATT fall within that category. They prohibit the granting of subsidies only to the extent that the subsidies cause "adverse effects" in the form of "serious prejudice". Such effects must be actual or threatened, not just theoretical.

35. The "mandatory" standard invoked upon by Brazil would result in the creation of third category of prohibited adverse effects in addition to actual and threatened serious prejudice, which is nowhere mentioned in Article 5(c): the mere possibility of threat of serious prejudice *in certain circumstances*. Furthermore, as a result, Brazil's interpretation would render redundant the two categories of effects which are mentioned in Article 5(c). As explained above, threat of serious prejudice must be *imminent* and *foreseeable*. Yet, on Brazil's interpretation, it would be sufficient, in order to establish a *per se* violation, to show that the legislation at issue mandates action that threatens serious prejudice *in certain circumstances*, no matter how remote the likelihood that such circumstances will ever materialise. For example, on Brazil's interpretation, it would be enough to show that the legislation mandates the payment of subsidies that will threaten serious prejudice in a purely hypothetical situation where world prices fall to an extremely low level, even if the chances that prices may actually fall to such level are negligible in practice.

36. In sum, Brazil's *per se* claim is an ingenious but misguided attempt to avoid the requirements of Article 5(c) of the *SCM Agreement*, which should be rejected by the Panel.

# ANNEX E-7

## FURTHER THIRD PARTY SUBMISSION OF NEW ZEALAND

3 October 2003

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## I. INTRODUCTION

1.01 Although New Zealand is not a producer or exporter of cotton, New Zealand has a systemic interest in ensuring the continued integrity of important WTO disciplines applicable to agricultural trade and has therefore joined this dispute as a third party. As outlined in New Zealand's First Submission to the Panel[1], New Zealand is concerned to ensure that Members are able to utilise their rights under the *Agreement on Subsidies and Countervailing Measures* (the *SCM Agreement*) and GATT 1994 to take action in respect of domestic support measures and export subsidies where the requirements of the "peace clause" have not been respected.

1.02 New Zealand believes that Brazil has demonstrated that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years ("MY") 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the GATT 1994 and the *SCM Agreement*.

1.03 In its Further Submission to the Panel,[2] Brazil has provided the legal and factual basis upon which the Panel should conclude that the United States subsidies cause or threaten to cause serious prejudice to the interests of Brazil within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement* and violate GATT Article XVI. New Zealand therefore considers that the Panel should make the findings and recommendations requested by Brazil.

1.04 This submission addresses issues raised in the Further Submissions of Brazil and the United States[3] and should be read in conjunction with New Zealand's First Submission. As recognised by the Panel in its communication of 24 September 2003, New Zealand has had only limited time to consider the Further Submission of the United States and therefore reserves the right present arguments in addition to those set out in this written submission in its oral statement to the Panel on 8 October 2003.

## II. PRESENT SERIOUS PREJUDICE

2.01 Brazil has demonstrated that the United States subsidies[4] cause serious prejudice to the interests of Brazil within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement* and violate GATT Article XVI.

2.02 Brazil has demonstrated that the United States subsidies during marketing year (MY) 1999-2002:

- cause present significant price suppression[5] in the world and Brazilian markets, as well as in markets where Brazilian producers export, within the meaning of Article 6.3(c) of the *SCM Agreement*;

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[1] *United States – Subsidies on Upland Cotton*, Third Party Submission of New Zealand, 15 July 2003 ("New Zealand's First Submission").

[2] *United States – Subsidies on Upland Cotton*, Brazil's Further Submission to the Panel, 9 September 2003 ("Further Submission of Brazil").

[3] *United States – Subsidies on Upland Cotton*, Further Submission of the United States of America, 30 September 2003 ("Further Submission of the US").

[4] New Zealand uses that term as it is used by Brazil in its Further Submission (para 7). Details of these programmes were provided by Brazil in its First Submission to the Panel Regarding the "Peace Clause" and Non-"Peace Clause" Related Claims, 24 June 2003 ("First Written Submission of Brazil"), paras 45 – 106.

[5] New Zealand uses the term as it is used by Brazil in its Further Submission to also encompass circumstances showing price depression characteristics.

- had the effect of increasing the United States share of the world upland cotton market within the meaning of Article 6.3(d) of the *SCM Agreement*, and

- contributed significantly to the United States having more than an equitable share of world export trade within the meaning of GATT Article XVI:3.

New Zealand will focus in particular on Brazil's claim that the United States subsidies cause "significant price suppression".

**1. The effect of the United States subsidies is significant price suppression**

2.03 Brazil has demonstrated that the United States subsidies during marketing year (MY) 1999-2002 cause present significant price suppression in the Brazilian and world markets, including in markets where Brazilian and United States producers export, within the meaning of Article 6.3(c) of the *SCM Agreement* and thus cause serious prejudice. Brazil has demonstrated that the United States subsidies suppressed A-index prices by an average of 12.6% over MY 1999-2002.[6] That translates into a total amount of lost revenue for Brazilian producers of $478 million[7] and suppressed revenue worldwide of $3.587 billion.[8]

2.04 With subsidisation at levels of 95 per cent on average[9], subsidies are the greater part of farmers' incomes and have a major impact on farmers' production decisions. Producers of upland cotton in the United States are thereby largely insulated from the effects of the market. Thus, when prices for upland cotton were falling[10], and the value of the United States dollar[11] and costs of production were rising[12], production of upland cotton and United States exports of upland cotton significantly increased.[13] United States farmers planted 13.5 per cent more acres with upland cotton.[14] United States production hit a record high.[15] United States exports and the United States share of the world market increased.[16]

2.05 Professor Sumner estimates that if all United States government support to upland cotton were eliminated, United States exports would have been 41 per cent less in MY 1999-2002.[17] By contrast, *with* the subsidies the United States world market share in fact more than doubled over that period.[18]

2.06 This subsidy-fuelled production and export growth resulted in significant price suppression within the meaning of Article 6.3(c). Prices were suppressed by the increased world supply of upland cotton and increased competition from United States upland cotton in world markets. Brazil has also outlined the influence that the United States has on world prices for upland cotton[19] - the sheer size of

[6] Further Submission of Brazil, para 229.
[7] *Ibid*, para 446.
[8] *Ibid*, para 256.
[9] *Ibid*, para 105.
[10] *Ibid*, part 3.3.4.2.
[11] *Ibid*, part 3.3.4.4.
[12] *Ibid*, Part 3.3.4.3. Brazil has demonstrated that by the end of MY 2001 the cost-revenue gap had increased to 39 cents per pound (para 121).
[13] See *Ibid*, para 105. Between 1998 and 2001 production increased by 45.5 per cent and exports by 161 per cent.
[14] *Ibid*, para 130.
[15] In MY 2001 United States production reached 19.603 million bales (*Ibid*, para 131).
[16] *Ibid*, para 132.
[17] *Ibid*, para 288.
[18] *Ibid*, para 283.
[19] *Ibid*, para 3.3.4.6.

the United States share of total world production[20] and of world exports magnifies the trade distorting effects of the United States subsidies. Any doubt about the impact that United States subsidies have on the world market for upland cotton should be quickly dispelled by the graphic demonstration of United States dominance of the world market illustrated by Brazil in Figure 26.

2.07 New Zealand agrees with Brazil that the absolute size and average subsidisation level of the United States subsidies creates a strong *de facto* presumption of production, export and price effects.[21] However Brazil has not simply relied on such a presumption. Brazil has produced econometric analysis demonstrating that the United States subsidies caused significant price suppression, as actual market prices throughout MY 1999-2002 would have been higher but for the effects of the United States subsidies.[22]

2.08 At no point in its submission does the United States dispute the accuracy of this econometric analysis. Instead, in response to Brazil's claims, the United States seeks to argue that Brazil's case "suffers from a failure of factual proof"[23] and that Brazil has failed to make a *prima facie* case of serious prejudice or more than equitable market share because Brazil has done no more than assert that causation is established because there were large United States outlays during marketing years with low prevailing upland cotton prices.[24] According to the United States, factors other than United States subsidies "were the causes of the dramatic plunge in cotton prices experienced in recent years,"[25] namely: competition from low price polyester; flat retail consumption of cotton outside of the United States; slow world economic growth; burgeoning United States textile imports leading to more United States cotton exports; a stronger United States dollar leading to weakened commodity prices and China's trade position.

2.09 However Brazil's argument is not that declining cotton prices were due solely to the impact of the United States subsidies. Nor does Article 6.3(c) require that to be the case. It is Brazil's contention, backed up by sound econometric analysis, that the United States subsidies have a significant price-suppressing effect. And that effect exists regardless of whether cotton prices are rising or falling.[26] Nor did Brazil's analysis fail to take into account the impact of other adverse factors affecting upland cotton prices as alleged by the United States.[27] The econometric models used by Brazil, in particular FAPRI, hold other relevant factors affecting the price of cotton constant while cotton subsidies are removed, thereby isolating the effect of those subsidies. Therefore Brazil's analysis did not attribute to cotton subsidies the effects of other factors affecting cotton prices. As noted above, at no point in its submission does the United States question the integrity of the models referred to by Brazil and upon which the estimated impacts of the removal of United States cotton subsidies is based.

*(i) Interpretation of Article 6.3(c)*

2.10 New Zealand disagrees with the United States interpretation of Article 6.3. Essentially the United States reached the wrong conclusion from its comparison of the language of Article 6.1 with that of Article 6.3. The United States concluded that because Article 6.3 used the phrase "*may* arise in

[20] 19.5 per cent in MY 2002 (*Ibid*, para 135).
[21] *Ibid*, paras 106 and 107.
[22] Evidence adduced by Brazil, specifically the Quantitative Simulation Analysis by Professor Daniel Sumner, shows that but for the United States subsidies A-Index prices between MY 1999-2002 would have been, on average, 12.6 per cent higher.
[23] Further Submission of the US, para 16.
[24] *Ibid*, para 17.
[25] *Ibid*.
[26] Further Submission of Brazil, para 231.
[27] Further Submission of the US, para 80.

any case where one or several of the following apply", whereas Article 6.1 states "serious prejudice *shall be deemed to exist* in the case of …", that this means that serious prejudice "need not arise even under Article 6.3 even where one of the listed effects is found".[28] The United States goes on to infer from this difference in language that a complainant, in addition to demonstrating the existence of one of the listed effects, must also meet a separate "serious prejudice" standard – the content of which is undefined by the *SCM Agreement*. The United States states that a complainant must show that the "prejudice" suffered is "serious".[29]

2.11 First, the example given by the United States in footnote 43 seems to be covered by the terms of Article 6.4. Second, and more importantly, there is no basis for drawing from a comparison of language used in Articles 6.1 and 6.3 the conclusion that there is some other standard, independent of Article 6, that must be demonstrated in order to show "serious prejudice". In fact, as New Zealand will show, a comparison of both the language *and substance* of Articles 6.1 and 6.3, in the context of Articles 5 and 6 of the *SCM Agreement*, supports the contrary conclusion – that if a complainant has demonstrated the existence of one or more of the effects enumerated in Article 6.3 there is "serious prejudice" that is an adverse effect of the subsidy within the meaning of Article 5.

2.12 That is because the difference in language simply reflects the different way in which both Article 6.1 and Article 6.3 give meaning to the term "serious prejudice". Both must be seen in the context of concern in this part of the *SCM Agreement* with the effects of subsidies on other Members. In relation to Article 6.1, "serious prejudice" was given meaning by reference to specific types of subsidies or qualities of a subsidy that were "deemed" to have effects that were adverse to the interests of other Members. However, it was open to a subsidising Member under Article 6.2 to overturn that presumption by showing that in fact the subsidy did not cause serious prejudice – i.e. that the subsidy *had not resulted in any of the effects enumerated in Article 6.3*.

2.13 The terms of Article 6.2 make it clear that the effects enumerated in Article 6.3 equate to "serious prejudice" and that nothing more than demonstration that one of those effects exists is necessary to find serious prejudice.

2.14 Further, by contrast with Article 6.1, Article 6.3 looks more broadly at the effects of the subsidy, rather than its specific characteristics. There is thus no need to "deem" certain effects to arise from certain types or characteristics of a subsidy as there was in Article 6.1. Instead Article 6.3 is more broadly cast to take an effects-based approach – in essence it is designed to encompass any kind of subsidy that has the adverse effects enumerated and is therefore "actionable". However there is no basis to draw from this difference in approach, and therefore in language, the conclusion that more is required under Article 6.3 than simply demonstrating that one or more of the prescribed effects exists in order show that there is serious prejudice. Such an interpretation undermines the careful structure of Article 6 and the clear intent of Article 5 and must be rejected.

2.15 Nor does the use of the word "may" in Article 6.3 lead to any other conclusion. In that respect it is important to note that Article 5(c) incorporates, as specified in Footnote 13 to the *Agreement*, GATT Article XVI.1 which includes *inter alia* the threat of serious prejudice. Therefore it was appropriate to state that serious prejudice in the sense of paragraph (c) of Article 5 *may* arise where any of the listed effects exists because there may be other circumstances in which serious prejudice can be demonstrated, including, for example, where there is a threat of serious prejudice. If the word "shall" had been used this would have been taken to mean that Article 6.3 provides the definitive set of circumstances in which serious prejudice can arise. By virtue of Footnote 13 that is not the case.

[28] *Ibid*, para 77.
[29] *Ibid*, para 79.

2.16 Consideration of Article 6.3 in the context of the rest of Article 6 provides further support for the interpretation outlined above. First, it makes little sense to have gone to such detail in Article 6.4 to describe what is required to meet the requirements of Article 6.3(b) if there is another set of undefined requirements that must also be demonstrated in order to find serious prejudice.

2.17 Second, in terms of Article 6.2, if there were other elements outside those in Article 6.3 that had to be demonstrated to show serious prejudice, why would a subsidising Member not also have had to show that those elements were not present in order to avoid the presumption in Article 6.1?

2.18 Third, Article 27.8 (although now defunct because Article 6.1 is no longer in effect), also provides that serious prejudice arising from subsidies by developing country Members "shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6". This makes it clear that serious prejudice need only be determined by reference to Articles 6.3–6.8 of the *SCM Agreement*.

2.19 Finally, Article 6.8 provides that "in the absence of circumstances referred to in paragraph 7, the existence of serious prejudice should be determined on the basis of the information submitted in accordance with the provisions of Annex V". This confirms that paragraph 7 of Article 6 outlines the only set of circumstances in which it is not possible to make a determination as to the existence of serious prejudice when one of the situations in Article 6.3 is demonstrated to exist. The direction in Article 6.8 to determine the "existence" of serious prejudice on the basis of the record would be deprived of meaning if a determination of serious prejudice also had to be made by reference to additional criteria not specified by the *SCM Agreement* that could lead to a materially different outcome as a matter of fact and law.

2.20 Serious prejudice is not the abstract concept the United States attempts to portray it as. Serious prejudice refers to the concrete adverse effects of a subsidy on the interests of another Member that are clearly elaborated in Article 6.3. However, even if the United States is right and a complainant, having demonstrated the existence of significant price suppression within the meaning of Article 6.3(c), must also meet a separate test of "serious prejudice" under Article 5(c), Brazil has demonstrated that serious prejudice exists by providing the Panel with additional information outlining the harm caused to its upland cotton producers as well as to the Brazilian economy.[30]

(a) "Significant"

2.21 Article 6.3(c) of the *SCM Agreement* requires that the level of price suppression caused by the United States subsidies must be "significant", that is, it may not be so small as to have no meaningful effect on other producers or suppliers of the same product.[31] Logically, price suppression that is so small as to have no meaningful effect could not give rise to serious prejudice. However, such an interpretation does not mean that a very small level of price suppression may not have a meaningful effect, for example where large volumes of a product may be traded.[32] As Brazil demonstrates, even a 1 cent per pound price-suppressing effect can reduce worldwide export revenue by $552 million. Average price declines of 12.6 per cent for upland cotton clearly have a meaningful affect on

[30] Further Submission of Brazil, Part 6.

[31] Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted 23 July 1998 ("*Indonesia – Automobiles*"). The Panel considered (at para 254) the meaning of "significant" in the context of Article 6.3(c) and concluded:

> Although the term "significant" is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully effect suppliers of the imported product whose price was being undercut are not considered to give rise to serious prejudice.

[32] Further Submission of Brazil, para 95and para 256.

Brazilian producers of upland cotton. New Zealand fully agrees with Brazil that such price suppression is thus "far beyond any legitimate threshold of 'significance'".[33]

2.22 The United States argues that Brazil's interpretation of "significant" collapses the concept of "significant price suppression or depression" with the concept of "serious prejudice" because Brazil's assessment of the significance of the price suppression has wrongly focussed on the effect of the subsidy on producers rather than on prices. As outlined in paragraphs 2.10–2.20 above, in New Zealand's view the construction of Articles 5 and 6 makes it clear that "significant price suppression or depression" is simply a form or manifestation of "serious prejudice" and therefore it is artificial to make into two separate inquiries what is clearly meant to be only one.

2.23 In any event the United States argument that the significance of the price suppressive effect of the subsidy can only be determined by reference to the effect on 'price' should be rejected. Articles 5 and 6 are concerned with the *adverse effects* of a subsidy – Article 5 states that "no Member should cause, through the use of any subsidy … *adverse effects* to the interests of other Members." Therefore it is entirely appropriate under Article 6.3(c) to consider whether price suppression is "significant" by reference to the effect of the price suppression on the Member alleging adverse effects to its interests. In other words, what renders price suppression significant or insignificant is whether or not it causes adverse effects to the Member concerned, not whether or not an arbitrary level of numeric significance is achieved as implied by the United States. Under the United States approach, a numerically small suppressive effect on prices could be disregarded, even though it may have significant adverse effects on the complainant Member. Thus, using the example given by Brazil, price suppression by only 1 cent per pound may not be "significant" enough under the United States standard and therefore could not give rise to serious prejudice, even though that level of price suppression would reduce worldwide export revenue by $552 million.[34]

2.24 Nor does the United States explain how 'significance' is to be determined under its proposed approach. That is because such an approach would require Panels to apply some kind of arbitrary standard of significance – would 5 per cent be significant? Would 10 per cent or 20 per cent? Would the level of required significance vary from case to case, and if so how is a Panel to determine what that level should be?

2.25 By contrast, the approach taken by Brazil of interpreting "significant" as requiring the level of price suppression to be "meaningful" in its effect, reflecting the Panel's reasoning in *Indonesia – Automobiles*, provides a more logical and consistent basis upon which to determine whether the price suppression is "significant". It is also consistent with the objective of Articles 5 and 6 which is to address subsidies that have an adverse effect on the interests of other WTO members. Nor is such an approach inconsistent with the United States assertion that the drafters of Article 6.3(c) used the term "significant" to create a threshold to ensure that not just "any theoretical price effect"[35] would suffice. In fact the Panel in *Indonesia – Automobiles* appears to have made the same assessment of the intention of the drafters when it stated that

> the inclusion of this qualifier (ie "significant") in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not

[33] *Ibid*, para 95.

[34] This example is of course based on the effect of subsidies on "like products", which, as Brazil has demonstrated (Further Submission of Brazil, part 3.3.2), United States upland cotton and Brazilian upland cotton are.

[35] Further Submission of the US, para 84.

> meaningfully affect suppliers of the imported product whose price was being undercut are not considered to give rise to serious prejudice.[36]

2.26 Nor does the United States argument find support in the reference to the price suppression being "in the same market" in Article 6.3(c). The United States argues this means that the price suppression must be significant in "market terms" and therefore the question is the effect of the price suppression on the market and not on the Member concerned.[37] While New Zealand agrees that the effect of the price suppression on the market may be relevant to considering whether that price suppression is "significant", New Zealand notes that the phrase "in the same market" simply serves to locate the price suppressive effects rather than define their substance. In fact the United States acknowledges as much further on it in its submission.[38] Further, the United States has not attempted to claim that its exports are not to the same market as exports from Brazil. And of course it cannot, because, as Brazil has demonstrated, Brazilian upland cotton and United States upland cotton are like products and are treated by upland cotton traders as interchangeable and substitutable.[39]

2.27 Finally, New Zealand notes that the United States arguments do not seek to suggest that the level of price suppression found to exist in the present case - 12.6 per cent - is not "significant" within the meaning of Article 6.3(c). Therefore the Panel should find that "significant price suppression" exists as a result of the United States subsidies and that therefore the United States subsidies cause serious prejudice to the interests of Brazil.

(b) Time Period for Demonstrating Causal Effects

2.28 The United States argues that "a past subsidy no longer exists as of the time a new subsidy payment in respect of current production is made".[40] Therefore, argues the United States, subsidies prior to the most recent period, MY 2002, can have no "effect" within the meaning of Article 6.3 and the "effect of the subsidy must be demonstrated in each year and for each year that Brazil has challenged".[41]

2.29 By the United States reasoning a complainant may only take a serious prejudice case in the year in which the serious prejudice is caused. To say that a "past subsidy no longer exists" once a further payment is made under the same subsidy scheme is entirely artificial. Leaving aside the practical difficulties the United States approach would pose given the nature of the evidence that is required and the timelines for WTO dispute settlement – which would effectively preclude any Members from ever taking serious prejudice cases – this approach ignores that fact that the subsidy programmes are in existence for a period of years and have effects on the decisions of producers beyond simply the year in which they have been paid.[42] Producers expectations of continued subsidies are integral to planting decisions and it is clear that United States producers expect ongoing subsidies as these have been legislatively mandated until MY 2007.

2.30 Similarly the serious prejudice caused to a WTO Member over the lifetime of a subsidy programme is not easily compartmentalised into a particular year and such an artificial constraint on the appropriate time period for consideration by a Panel would seem to undermine the object and

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[36] Panel Report, *Indonesia – Automobiles*, para 14.254.
[37] Further Submission of the US, para 87.
[38] *Ibid*, para 90.
[39] Further Submission of Brazil, para 80.
[40] Further Submission of the US, para 94.
[41] *Ibid*, para 95.
[42] Brazil has demonstrated that the effects of the United States subsidies continue after they have been provided because, for example, they have "wealth" and "investment" effects (Further Submission of Brazil, part 3.3.4.7.7).

purpose of the disciplines on actionable subsidies in the Agreement. New Zealand therefore agrees with Brazil that MY 1999-2002 is a reasonable period for the Panel to use for the present serious prejudice claims.

**2. The effect of the United States subsidies is an increase in the United States world market share**

2.31 Brazil has demonstrated that the United States subsidies resulted in an increase in the United States world market share for upland cotton in MY 2001 within the meaning of Article 6.3(d). The data provided by Brazil shows that the United States world market share in MY 2001 of 38.3 per cent is considerably higher than the previous three-year average,[43] and that this was due to the effect of the United States subsidies.[44]

2.32 The United States argues that the term "world market share" refers to "all consumption" of upland cotton and thus would include "consumption by a country of its own cotton production". The United States appears to suggest that Article 6.3(d) is thus concerned with the effect of the subsidy on world consumption of cotton.

2.33 It is true that GATT Article XVI:3 uses the phrase "world export trade". However it is quite a leap of logic to then conclude that because Article 6.3(d) uses the term "world market share" then it must refer to a Member's share of world consumption. The United States makes this leap on the basis that the relevant context for determining what "world market share" means is GATT Article XVI:3. However the first point of reference should in fact be Article 6.3 itself, and Article 5 to which it is so integrally related. Thus the appropriate context in which to give meaning to "world market share" is the aim of Articles 5 and 6, ie to address the adverse effects of subsidies on the interests of other Members.

2.34 Subsidies are the concern of WTO members to the extent that they distort trade – hence the differentiation in treatment of trade-distorting and non-trade distorting subsidies. Therefore the adverse effects with which Article 6.3 is concerned is the effect of subsidies on trade in the world market. Specifically, it is concerned with adverse effects to other Members caused when one Member uses subsidies in order to increase its share of the world market for a particular product. To construe "world market share" as referring to a Member's share of world consumption of a product would therefore completely subvert the underlying rationale of Article 6.3(d).

**3. The United States has a "more than equitable share" of world export trade in upland cotton**

2.35 Brazil has demonstrated that the United States subsidies have operated to increase United States exports of upland cotton resulting in the United States having a "more than equitable share" of world export trade in upland cotton within the meaning of GATT Article XVI:3 and has thus caused serious prejudice to the interests of Brazil within the meaning of GATT Article XVI:1.[45]

2.36 The United States seeks to dismiss the relevance of GATT Article XVI:3 by reference to pre-Uruguay Round comment by the Panel on Wheat Flour[46], addressing the Tokyo Round Subsidies Code, in an unadopted report, that there are "difficulties inherent in the concept of 'more than equitable share'."[47] The United States also seeks to assert that "Members are generally permitted to

[43] Further Submission of Brazil, para 267 and Figure 24.
[44] *Ibid*, paras 271 – 272.
[45] Further Submission of Brazil, part 3.5.
[46] GATT Panel Report, *EEC – Subsidies on Export of Wheat Flour*, SCM/42, (unadopted).
[47] Further Submission of the US, paras 108 and 109.

provide subsidies."[48] That is true up to the point at which those subsidies cause serious prejudice to the interests of the other Members. And in this context the Panel should consider whether, as the world's largest exporter of upland cotton with average levels of subsidisation of 95 per cent, the United States has a "more than equitable" share of world export trade. New Zealand submits that Brazil has demonstrated that the United States does.

**4. Issues relating to particular United States subsidies**

2.37 Brazil sets out arguments relating to the full complement of United States subsidies and the serious prejudice they cause both individually and collectively. New Zealand will comment only on marketing loan payments, Step 2 payments and market loss assistance/counter-cyclical payments.

*(i) Marketing Loan Payments*

2.38 Brazil has highlighted that these payments are considered by the USDA and by other economists as having the greatest production and export enhancing effects and thus the greatest A-Index price suppressing effects of all the United States subsidies.[49] Brazil has described how the effect of the marketing loan programme is to increase production, increase exports of upland cotton, and suppress upland cotton prices (on average by 5.75% in MY 1999-2002).[50] The marketing loan programme is thus responsible for almost half of the estimated average price suppressing effects of the United States subsidies.

*(ii) Step 2 Payments*

2.39 The availability of Step 2 payments increases production in the United States, displaces imports of lower priced foreign upland cotton and enables additional United States exports of upland cotton. The Step 2 payment programme is specifically designed to stimulate export demand for United States upland cotton. Brazil has shown that the trade distorting effect of the Step 2 payments is widely acknowledged.[51] Professor Sumner estimates that Step 2 payments suppressed world prices between MY 1999-2002 by 3.04 per cent.[52]

2.40 Brazil has demonstrated that Step 2 domestic payments are a prohibited subsidy under Article 3.1(b) of the *SCM Agreement* in that the payments are contingent on the use of domestic over imported upland cotton and thus also violate Article III.4 of GATT 1994.

*(iii) Market loss assistance/Counter-cyclical payments*

2.41 The United States continues to argue that market loss assistance payments and counter-cyclical payments (CCP) are not linked to production and accordingly cannot have "effects" for the purposes of Article 6.3(c) nor operate to increase exports as required by GATT Article XVI:3.[53] The United States implies that their production effects are less than one percent.[54] However Professor Sumner's analysis shows that although their production effects were less than one percent in 1999, since then they have been significantly higher and are projected to increase in the future.[55] He

[48] *Ibid*, para 105.
[49] Further Submission of Brazil, para 17.
[50] *Ibid*, para 157.
[51] *Ibid*, para 287.
[52] *Ibid*, Table 12.
[53] Further Submission of the US, para 74.
[54] *Ibid*, paras 73 and 74.
[55] Further Submission of Brazil, Annex 1, Table I.4.

concluded that these payments have a production impact because their effect is to keep land in the production of upland cotton that would not be otherwise because of low prices.[56]

2.42 As outlined by New Zealand in its First Written Submission to the Panel, the CCP payments create incentives for farmers with upland cotton base acreage to maintain upland cotton production.[57] New Zealand pointed out that in fact under the CCP programme the only way a farmer can guarantee a particular income is to continue to grow the same crop, otherwise the farmer runs the risk of missing out. For example, if he or she chooses to produce wheat and cotton prices are high enough that no CCP payment is made but wheat prices fall, the farmer will make a loss they would not have made had they stayed with cotton production. This, combined with other factors set out by Brazil,[58] for example the investment by farmers in cotton-specific machinery, virtually guarantees farmers will continue to produce cotton. The CCP payments are thus far from "de-coupled" in effect.

2.43 In fact Professor Sumner concluded that the CCP payments (as the institutionalised marketing loss assistance payments are now known under the Farm Security and Rural Investment Act 2002[59]) create *more* production incentive than the market loss payments, through base and yield updating and the increased per pound amount of support.[60] Professor Sumner determined that the market loss assistance payments and the CCP payments stimulated production by an average of 1.34% during MY 1999-2002.[61] And, as noted by Brazil, the full effects of the greater production incentives inherent in the CCP programme will only be realised in MY 2003.

## III. THREAT OF SERIOUS PREJUDICE

3.01 Brazil has brought evidence to show that the United States subsidies are not only causing serious prejudice to Brazil's interests today, but also threaten to cause serious prejudice to Brazil's interests in the future. Brazil has demonstrated that the United States subsidies cause a threat of serious prejudice to Brazil's interests within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*, as well as GATT Article XVI:3 in the period MY 2003-2007 because of the continued operation of the Farm Security and Rural Investment Act 2002 and the Agricultural Risk Protection Act 2000.

3.02 Brazil has demonstrated that the very same factors creating present serious prejudice also create a threat of serious prejudice in the future. The United States subsidies are mandated to continue until MY 2007. They are effectively unlimited. Brazil has demonstrated that they have already caused serious prejudice to Brazil's interests. Their continued operation for a further four years cannot but be considered to threaten further serious prejudice to Brazil's interests.

3.03 The United States argues that the two standards proposed by Brazil are incorrect and that Brazil has, in any event, met neither of them.

3.04 To take Brazil's first proposed legal standard, Brazil argues, drawing on the findings of the GATT Panel in *EC – Sugar Exports I*[62] and *EC – Sugar Exports II*[63] and the Appellate Body in *US* –

[56] *Ibid*, para 169.
[57] New Zealand's First Submission, para 2.20.
[58] Further Submission of Brazil, para 207.
[59] *Ibid*, para 62.
[60] *Ibid*, para 171.
[61] *Ibid*, para 172.
[62] GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Australia)*, L4833 – 26S/290, adopted 6 November 1979.
[63] GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Brazil)*, L5011 – 27S/69, adopted 10 November 1980.

*FSC*,[64] that where there is effectively no limit on the provision of a subsidy a permanent source of uncertainty exists that threatens serious prejudice to other WTO Members. In such circumstances there is no check on the provision of a subsidy that would prevent it from causing adverse effects to the interests of other Members.

3.05 That is the precise situation in the present case. United States legislation requires the provision of the subsidies irrespective of whether or not those subsidies have adverse effects on other Members. In that respect it is important to bear in mind that the present case involves a level of subsidisation of, on average, 95 per cent, with a dollar value of US$12.9 billion, being provided by a country that currently has a 41.6 per cent share of the world market for upland cotton. The possibility that United States subsidies will continue to cause serious prejudice to the interests of Brazil in the future, is a real one – it is well removed from the realm of "allegations, conjecture or remote possibility" alluded to by the United States.[65]

3.06 In that respect Brazil's second proposed legal standard for determining whether such a threat exists is highly relevant. As Brazil has demonstrated, all of the factors that currently exist that mean that the United States subsidies cause serious prejudice to their interests will continue to exist in the future. Furthermore, United States producers of upland cotton will act in the expectation of future subsidy payments and will make their planting decisions accordingly. Therefore the fact that the legislation creating those subsidies will continue until 2007, and United States producers know that those subsidy programmes will continue until 2007, creates a very strong *prima facie* case that those subsidies will continue to cause serious prejudice to Brazil for the full term of their existence.

3.07 Finally New Zealand supports Brazil's request that if the Panel makes a finding of present serious prejudice, it should not feel constrained in making a further finding that the subsidies also create a threat of serious prejudice in the future.[66] Firstly, even though the present effects of the subsidies are already being felt, their future effects have not yet eventuated and therefore necessarily remain a threat. Secondly, the purpose of dispute settlement is to assist Members in the resolution of disputes – in this case a finding by the Panel on the threat of future serious prejudice is important to resolve this dispute.

## IV. EXPORT CREDIT GUARANTEE PROGRAMMES

4.01 New Zealand notes that the United States raises further arguments in relation to the negotiating history and appropriate interpretation of Article 10.2 of the *Agreement on Agriculture* in order to support its claim that there are currently no export subsidy disciplines on the use of export credit guarantee programmes.

4.02 However the United States does not address the applicability of Article 10.1. As outlined by New Zealand in its First Submission, Article 10.2 does not in any way suggest that it provides an exception from the disciplines of Article 10.1. While Article 10.1 currently provides the only discipline on the use of export credits, it is expected that the work envisaged in Article 10.2 will elaborate further and more specific disciplines that will presumably make identification of the extent to which such export credit programmes constitute export subsidies more straightforward. However it is incorrect to assume that there is a vacuum in the meantime. Item j of the Illustrative List of the *SCM Agreement* clearly already provides guidance on when export credit guarantee or insurance programmes are to be considered to be 'export subsidies' and beyond this the general definition in Articles 1.1 and 3.1(a) of the *SCM Agreement* also applies.

[64] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000.

[65] Further Submission of the US, para 115.

[66] Further Submission of Brazil, para 291.

## V. CONCLUSION

5.01 In conclusion, New Zealand considers that Brazil has provided the legal and factual basis upon which the Panel should conclude that the United States subsidies cause or threaten to cause serious prejudice to the interests of Brazil within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement* and violate GATT Article XVI. New Zealand therefore requests the Panel to make the findings and recommendations requested by Brazil.

# ANNEX E-8

## SECOND WRITTEN SUBMISSION OF PARAGUAY (THIRD PARTY)

3 October 2003

1. Paraguay is grateful for the opportunity to express its views in this dispute.

2. As already stated, Paraguay maintains that the subsidies and support granted to cotton production of the type at issue are inconsistent with the Agreement on Subsidies and Countervailing Measures and other WTO rules.

3. The agricultural subsidies cause serious prejudice to the domestic industries of many WTO Members, in violation of Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures. Indeed, these measures involve a financial contribution which, by conferring a benefit, could adversely affect the determination of the world price of the product.

4. Article 5(c) stipulates that "no Member should cause, through the use of any subsidy [-specific and not exempted under the Agreement –] adverse effects to the interests of other Members, i.e.: … (c) serious prejudice to the interests of another Member."

5. The threat of serious prejudice takes the form of price undercutting and unfairness in international trade, particularly as regards developing countries like Paraguay, which is highly dependent on its cotton production.

6. Article 6, which concerns serious prejudice, states that serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems; and direct forgiveness of debt, i.e. forgiveness of government-held debt, and grants to cover debt repayment.

7. Paraguay submits that the measures adopted by the United States do not fit these descriptions and cause injury to its economy, Paraguay being a predominantly agricultural country.

8. Because of the amounts involved, the subsidies granted to the cotton industry have a significant impact on the world market as reflected in increased production and export and price variations on the global market.

9. In the International Cotton Advisory Committee (ICAC) as in other forums, governments have remarked on the critical situation that the world cotton industry is going through and its link to subsidies, stressing the need to submit complaints before the WTO for violation of the applicable rules. The Committee considers that without the subsidization, the average world cotton price would undergo a reasonable increase.

10. Paraguay's cotton trade is affected by such measures because cotton production has a considerable impact on its economy, and especially on its rural populations which depend on cotton for their livelihood. In the sectors involved, such as transport and related industries, the impact is considerable, with approximately 30 per cent of the population affected.

11. Thus, the impact on trade in countries like Paraguay is devastating and causes the migration of rural populations to the urban areas, further aggravating the economic situation of a country dependent on its agriculture.

12. As shown in the attached table, cotton fibre exports to the United States was 518 tons, for a value of US$898,000.

13. The effect is clear: in 2001, the volume of exports to the same market practically doubled, reaching 924 tons, and yet the price decreased in equal proportions, with exports generating US$830,000. The world cotton trade figures reflect the same trend.

**CONCLUSION**

14. There is sufficient evidence to prove that the subsidies are causing problems to the international marketing of cotton and that the American subsidies are further aggravating the situation of cotton exports from Paraguay.

15. We respectfully request the Panel to find that the measure applied by the United States is inconsistent with the obligations laid down by the WTO in various provisions of the GATT 1994 and the Agreement on Subsidies on Countervailing Measures, and to take account of the arguments put forward by Brazil.

## *PARAGUAYAN COTTON EXPORTS BY DESTINATION*

*(Tons / ThUS$)*

| | 1997 | | 1998 | | 1999 | | 2000 | | 2001 | | 2002 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE |
| GERMANY | 0 | 0 | 0 | 0 | 193 | 179 | 1,215 | 1,229 | 6,029 | 4,594 | 2,877 | 1,981 |
| ARGENTINA | 150 | 46 | 4,623 | 6,594 | 649 | 759 | 1,250 | 1,460 | 250 | 231 | 5,001 | 4,132 |
| BANGLADESH | 0 | 0 | 0 | 0 | 0 | 0 | 461 | 532 | 630 | 568 | 155 | 119 |
| BELGIUM | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 266 | 215 | 149 | 128 |
| BERMUDA | 473 | 757 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| BOLIVIA | 0 | 0 | 0 | 0 | 0 | 0 | 1,200 | 1,084 | 0 | 0 | 0 | 0 |
| BRAZIL | 39,898 | 64,492 | 47,267 | 64,914 | 47,115 | 55,933 | 56,726 | 61,113 | 31,063 | 29,465 | 29,599 | 22,877 |
| COLOMBIA | 0 | 0 | 0 | 0 | 0 | 0 | 1,660 | 1,556 | 200 | 224 | 0 | 0 |
| SOUTH KOREA | 0 | 0 | 79 | 102 | 0 | 0 | 0 | 0 | 98 | 92 | 0 | 0 |
| NORTH KOREA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 605 | 557 | 0 | 0 |
| CHILE | 845 | 1,509 | 624 | 938 | 1,107 | 1,208 | 1,183 | 1,309 | 424 | 404 | 1,675 | 1,262 |
| NATIONALIST CHINA (TAIWAN) | 0 | 0 | 191 | 219 | 0 | 0 | 0 | 0 | 2,126 | 1,865 | 579 | 450 |
| CHINA, PEOPLE'S REPUBLIC OF | 0 | 0 | 0 | 0 | 0 | 0 | 698 | 769 | 1,310 | 1,230 | 0 | 0 |
| DENMARK | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 128 | 102 |
| SLOVAKIA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 100 | 76 | 0 | 0 |
| SPAIN | | | | | | | 313 | 364 | 18 | 19 | 0 | 0 |
| UNITED STATES | 518 | 898 | 0 | 0 | 0 | 0 | 60 | 67 | 924 | 830 | 0 | 0 |
| PHILIPPINES | 0 | 0 | 0 | 0 | 102 | 119 | 33 | 39 | 569 | 616 | 155 | 132 |
| FRANCE | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 231 | 187 | 104 | 83 |
| HONG KONG | 0 | 0 | 0 | 0 | 0 | 0 | 1,116 | 1,188 | 148 | 111 | 185 | 123 |
| NETHERLANDS | 0 | 0 | 0 | 0 | 500 | 606 | 0 | 0 | 62 | 41 | 0 | 0 |
| INDIA | 0 | 0 | 0 | 0 | 0 | 0 | 526 | 408 | 33,463 | 28,267 | 3,088 | 2,738 |
| INDONESIA | 0 | 0 | 0 | 0 | 0 | 0 | 120 | 116 | 2,461 | 2,295 | 582 | 453 |
| ITALY | 0 | 0 | 462 | 550 | 0 | 0 | 25 | 23 | 360 | 345 | 363 | 271 |
| MALAYSIA | 0 | 0 | 0 | 0 | 0 | 0 | 500 | 449 | 130 | 109 | 0 | 0 |
| NIGERIA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 241 | 229 | 0 | 0 |
| PAKISTAN | 0 | 0 | 0 | 0 | 0 | 0 | 68 | 65 | 1,006 | 790 | 0 | 0 |
| PANAMA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 48 | 29 |

| | 1997 | | 1998 | | 1999 | | 2000 | | 2001 | | 2002 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE |
| PORTUGAL | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 989 | 702 | 200 | 133 |
| UNITED KINGDOM | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 2 | 1 | 0 | 0 |
| SWITZERLAND | 0 | 0 | 0 | 0 | 0 | 0 | 200 | 216 | 592 | 551 | 251 | 169 |
| THAILAND | 0 | 0 | 0 | 0 | 0 | 0 | 397 | 403 | 2,298 | 1,959 | 294 | 198 |
| TURKEY | 0 | 0 | 0 | 0 | 0 | 0 | 819 | 886 | 2,244 | 2,431 | 0 | 0 |
| URUGUAY | 2,684 | 3,927 | 1,165 | 1,453 | 501 | 601 | 475 | 529 | 198 | 200 | 65 | 53 |
| VENEZUELA | 720 | 1,227 | 459 | 649 | 1,942 | 2,140 | 4,403 | 4,687 | 4,035 | 3,731 | 632 | 528 |
| VIETNAM | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 602 | 533 | 0 | 0 |
| **TOTAL** | **45,288** | **72,856** | **54,870** | **75,419** | **52,109** | **61,545** | **73,448** | **78,492** | **93,674** | **83,468** | **46,130** | **35,961** |

Prepared by the Paraguayan Directorate of Foreign Trade.
*Source:* Central Bank of Paraguay.

# ANNEX F

## ORAL STATEMENTS OF PARTIES AND THIRD PARTIES AT THE RESUMED SESSION OF THE FIRST SUBSTANTIVE MEETING

# ANNEX F-1

## EXECUTIVE SUMMARY
## STATEMENT OF BRAZIL AT THE
## RESUMED FIRST SUBSTANTIVE MEETING
## OF THE PANEL WITH THE PARTIES

### 1. Brazil's Claims of Present Serious Prejudice Relating to Subsidies Provided in MY 1999-2002

1. Brazil's *present* serious prejudice claims relate to US subsidies provided for the production, export and use of US upland cotton during the period MY 1999-2002. This period covers the measures challenged by Brazil and represents the relevant period of investigation to examine *present* serious prejudice caused by the US subsidies under Articles 5(c) and 6.3 of the SCM Agreement. This four-year period is long enough to allow the Panel to make a determination (in the words of the Appellate Body in the recent *EC – Pipe Fittings* decision) "that is less likely to be subject to market fluctuations or other vagaries that may distort a proper evaluation."

### 2. Brazil Has Established That the US Subsidies between MY 1999-2002 Caused Significant Price Suppression within the Meaning of Article 6.3(c) of the SCM Agreement

2. Brazil has shown in its Further Submission the amount and the subsidization rate of the US subsidies which cause serious prejudice to Brazil as well as demonstrated that all of the US subsidies are specific within the meaning of Article 2 of the SCM Agreement. The United States asserts that crop insurance subsidies provided to upland cotton producers by the 2000 Agricultural Risk Protection ("ARP") Act are not specific. In seeking to rebut Brazil's evidence that more than 50 per cent of the value of US agricultural commodities did not benefit from crop insurance benefits, the United States now argues that livestock is covered in "pilot programmes". Yet, a close examination of the "pilot" programmes indicates that the great majority of livestock production was *not* covered by the crop insurance programmes during the period of investigation. Therefore, the crop insurance programme is specific.

3. Contrary to the US arguments, the Panel is required by Article 5 of the SCM Agreement to examine the collective and interactive effects of *all* US subsidies. While different economists have estimated varying degrees of acreage, production, export and price effects of the US subsidies, no economist has ever found or suggested that removing all of the US subsidies would have only minimal effects.

4. The conditions of competition in the upland cotton market that existed during MY 1999-2002 (and that exist today) explain why: **First**, upland cotton is a basic fungible commodity that is widely traded throughout the world; **Second**, demand for upland cotton is relatively price-inelastic and consumption increased steadily during MY 1999-2002**,** whether upland cotton prices rose or fell; **Third**, world market prices for upland cotton as reflected in the New York futures price and the A-Index are sensitive to changes in supply – prices tend to rise when world supply decreases and fall when world supply increases; **Fourth**, US producers in MY 2002 supplied 41.6 per cent of world export market demand – the next largest exporter (Uzbekistan) had only 13 per cent of the world market share. **Fifth**, US producers of upland cotton are among the world's highest cost producers and total average costs between MY 1999-2002 were 77 per cent higher than market revenue received for

upland cotton lint; and **Sixth,** US upland cotton subsidies covered the cost-revenue gap with subsidies averaging 95 per cent which are 19 times greater than the five per cent subsidization rate formerly deemed to create a presumption of serious prejudice under Article 6.1(a) of the SCM Agreement.

5. US subsidies are a key element of the conditions of competition in the world market for upland cotton. The US subsidies create a situation in which USDA's Chief Economist has acknowledged that many US upland cotton producers are immune from market forces. This is readily illustrated by the extensive record provided by Brazil.

6. The United States now argues that US upland cotton farmers are sensitive to changes in market prices. Yet, US planted acreage *increased* as prices *declined* between MY 1999-2001. There can be little doubt that without the US subsidies, many US upland cotton producers would have to switch to crops providing a higher market return or take marginal land out of production. This means that without subsidies, US acreage and production would fall considerably. In addition to falling US production, the removal of US subsidies would also result in significant reductions in US exports contributing to increased world prices. Professor Sumner found that, *but for* the US subsidies between MY 1999-2002, US exports would fall from the annual *actual* average exports of 8.62 million bales by 41.2 per cent to 5.07 million bales. This reduction of 3.55 million bales represents 13.4 per cent of the total average world export market between MY 1999-2002. Given the relatively inelastic demand for upland cotton, it would be remarkable if world prices did not increase with a 13.4 per cent decrease in the supply of upland cotton to the world export market.

7. Brazil has examined some of the non-subsidy market factors that the United States apparently now claims account for *all* of the fall in prices in MY 1998-2002. Even though some of these factors may have contributed to lower and suppressed prices during MY 1999-2002, the US arguments and evidence do not refute Brazil's evidence that the impact of $12.9 billion in US subsidies on US acreage, production, exports and prices was significant. Moreover, Brazil does not dispute that there were other factors causing world prices to fluctuate throughout MY 1999-2002. And these same types of factors are causing prices to fluctuate today – and they will do so tomorrow. Changes in weather, exchange rates, economic growth, and financial conditions, among other factors, will always play a role in price discovery in world commodity markets. But it is simply not credible for the United States to argue now that $12.9 billion in subsidies to US producers faced with an average 24.3 cents per pound cost-revenue gap, who nevertheless increased their world market share to 41.6 per cent at times of record low prices, had no impact on production or world prices.

8. Having established that US production and exports would fall significantly if US upland cotton subsidies were eliminated, Brazil also demonstrated that the effects of lower US exports would result in world upland cotton prices being higher by an amount that is "significant". Brazil presents additional evidence on the price-suppressing effect of the US subsidies from the Report of the Commission on the Application of Payment Limitations for Agriculture. At the request of the Commission, USDA economists Westcott and Price examined the effects of eliminating marketing loan benefits for MY 2000 and MY 2001 finding significant acreage and price effects representing 33.6 per cent of the average prices received by US farmers in MY 2001. The record contains the results of a number of different simulations of price suppression effects caused by all or some of the US subsidies. All of these results reveal "significant" price suppression within the meaning of Article 6.3(c). They are "significant" because these results of price suppression are far from *de minimis*.

9. Finally, Brazil has demonstrated the close link between world A-Index prices, Brazilian internal prices and prices received by Brazilian producers in the export markets.

10. Andrew Macdonald has provided his expert testimony and described the importance of US market factors in influencing the perception of traders in the New York futures market and in shaping the perceptions of price movements by traders in international transactions as reflected in the A-Index price development. Mr. Macdonald has also provided evidence of the close relationship between these two sets of prices and the determination of prices in the Brazilian market. This evidence fully supports the pricing data reflecting the close connection between US domestic prices, US export prices, A-Index prices, Brazilian prices, and the prices received by Brazilian and third country exporters.

11. The United States has asserted that the term world market share in Article 6.3(d) "would appear to encompass all consumption of upland cotton, including consumption by a country of its own production". This is incorrect. The ordinary meaning of the term "world market share" in Article 6.3(d) of the SCM Agreement is not "world production share" or "world consumption share". Rather, it is the share of the world market for exports. This interpretation is consistent with USDA's and the EC's use of the term "world market share". In addition, footnote 17 to Article 6.3(d) states: "Unless other multilaterally agreed specific rules apply to the *trade* in the product or commodity in question." This provision refers explicitly to "trade" referring to international commercial sales and purchases in export markets, not global consumption or production.

**3. Threat of Serious Prejudice**

12. By guaranteeing a level of support of approximately 75 cents per pound, the US Subsidies create a continuing threat of excess US acreage, production, and exports, and continued suppressed world prices. This threat is a seamless continuation of the *present* serious prejudice that Brazil has already demonstrated. The threat exists today and will exist throughout the lifetime of the 2002 US Farm Act – until the end of MY 2007. A key initial issue for the Panel to decide is the time period for assessing data regarding the existence of a threat of serious prejudice. The Appellate Body has noted that a threat analysis requires examination of "facts" not "conjecture" and requires the "use of facts from the present and the past to justify the conclusion about the future". The Appellate Body also has held it is important to examine data for the entire period of investigation "to allow the investigating authority to make a . . . determination that is less likely to be subject to market fluctuations or other vagaries that may distort a proper evaluation".

13. A threat of serious prejudice exists for the following reasons: The mandatory US subsidies in the 2002 US Farm Act create a guaranteed revenue stream for US producers of 75 cents per pound. This revenue cannot be stopped between MY 2003-2007 regardless of how *low* US and world prices may fall, regardless of how much US production of upland cotton *increases*¸ and regardless of the amount of US exports. As found by the *EC – Sugar Exports* panels, and the Appellate Body in *US – FSC,* the absence of any legal mechanism to limit the quantity of subsidies is a critical factor to assess in determining the existence of threat.

14. Brazil has demonstrated the existence of *present* price suppression, increases in world market share and an inequitable share of world export trade based on actual data and market conditions for MY 1999-2002. This four-year period of serious prejudice is the best guide for the Panel to assess whether during the remaining five years of the 2002 US Farm Act there is a significant threat that serious prejudice will occur *again.* In making this assessment, the Panel should also consider the fact that the US National Cotton Council estimated that the 2002 US Farm Act *increased* the revenue stream to US producers by 10 cents a pound over that provided in MY 1999-2001.

15. US planted acreage during MY 2003-2007 will remain at significant levels – around 14 million acres (slightly less than the average for MY 1999-2002). USDA and FAPRI both estimate that there will be *no* significant reduction in US acreage or production between MY 2003-2007. The

guaranteed high US acreage between MY 2003-2007 means high levels of production and exports. It also means suppressed world prices.

16. USDA estimates that US producers' cost of production will increase during MY 2003-2007 and remain high relative to market revenue. The most recent data shows that US producers' cost of production in MY 2002 was 83.59 cents per pound. At these cost levels, many US upland cotton producers will not be able to meet total costs of production without receiving all of the US subsidies. This fact demonstrates the clear causal connection between US subsidies and continuously high acreage, production, and exports along with significantly suppressed prices throughout MY 2003-2007.

17. With respect to Brazils threat claim under Article 6.3(d), Brazil notes that the threat of an increased US world market share in MY 2002 has already materialized, as the US world market share continued to increase in MY 2002 to 41.6 per cent, well above the MY 1999-2001 three-year average of 29.1 per cent. Brazil also notes that there is a real and clear threat of an Article 6.3(d) violation for MY 2003 as recent USDA projections for MY 2003 US exports indicate that the likely US share will be 38.8 per cent in MY 2003 – an increase over the three-year (MY 2000-2002) average of 34.9 per cent. This evidence further supports the finding of a threat that the US share of world export trade will continue to be inequitable for MY 2003-2007.

18. Finally, Brazil has established that GATT Articles XVI:1 and 3 allow for threat claims to be based on this provision. Brazil has also demonstrated that a threat of the United States to have a more than equitable share of world export trade exists.

**5. Export Credit Guarantees**

19. Contrary to the US allegation, Brazil has demonstrated that the CCC export credit guarantee programmes are "mandatory" programmes. Moreover, the CCC export credit guarantee programmes are expressly exempt from the requirement that a programme receive new Congressional budget authority before it undertakes new loan guarantee commitments. The Appellate Body considered that the unlimited nature of the FSC regime posed a significant threat, under Article 10.1 of the Agriculture Agreement, that the United States would surpass its agricultural export subsidy reduction commitments. In addition, Brazil again notes that for guarantees, the United States, through the Federal Credit Reform Act, has concluded that costs and losses are best measured and recorded on a net present value basis, rather than on a cash basis, at the time the guarantees are issued.

**6. New US Requests for Preliminary Rulings**

20. The United States' "new" request for a preliminary ruling addresses Brazil's failure to provide a statement of available evidence with respect to export credit guarantees for commodities other than upland cotton. This request is in fact not "new".

21. The US request for a preliminary ruling that Brazil should have included more information in its statement of available evidence has no merit. Brazil has already addressed this issue. Brazil was required to file a statement of the evidence available to it at the time.

22. Second, the United States claims that cottonseed payments for 1999 and 2000, and 2002 are not within the terms of reference of the Panel because the measures allegedly were not identified within Brazil's consultation or panel request, and because Brazil and the United States allegedly did not consult regarding these measures. Both of these claims are false. Brazil and the United States did consult about "any programme providing support to the US upland cotton industry for the production, processing, use, sale, promotion or export of cottonseed or products derived from cottonseed."

Similarly, Brazil's Panel request specifically identified in four different places "measures" that would encompass all forms of cottonseed payments from MY 1999-2007.

23. Finally, the United States argues that the "other payments" such as "storage payments" and "interest subsidies" allegedly were not included in Brazil's consultation or panel request, that Brazil and the United States did not consult about such payments, and that these payments are not properly within the Panel's terms of reference. These assertions are also false. Both the consultation and panel requests identify in four different paragraphs as "measures" payments which encompass "other payments" and "storage" and "interest subsidy" payments. Further, Brazil understands that "storage payment" and "interest subsidy" are part of the operation of the marketing loan programme, which Brazil specifically identified in both the consultation and panel requests, as well as in its questions to the United States during the consultations. The record demonstrates that Brazil and the United States consulted about all marketing loan and loan deficiency payments, as well as "any other support to or government funding for the US upland cotton industry". Therefore, it is properly before the Panel.

# ANNEX F-2

## EXECUTIVE SUMMARY
## CLOSING STATEMENT OF BRAZIL AT THE RESUMED FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

### 1. Introduction

1. In its Closing Statement, Brazil reiterates that at the core of this case are $12.9 billion of US subsidies for upland cotton for MY 1999-2002. These subsidies increase and maintain the production of high-cost US upland cotton, increase US upland cotton exports, suppress US, world and Brazilian prices and lead to the United States having a more than equitable share of world export trade. In short, these US subsidies cause and will continue to cause serious prejudice to the interests of Brazil.

### 2. Direct, CCP, PFC, and Market Loss Assistance payments were received by producers of upland cotton

2. In its Oral Statement of 7 October, the United States alleged that Brazil has not substantiated the amount of PFC, market loss assistance, direct and counter-cyclical payments to US upland cotton producers. Brazil requested this information from the United States more than a year ago in the consultation phase of this dispute but never received any information. Yesterday, the United States indicated to the Panel that it did not collect or have this information. In similar circumstances, WTO panels have held that "[i]n situations where direct evidence is not available, relying on inferences drawn from relevant facts . . . to determine whether applicable and unrebutted inferences are sufficient for satisfying the burden of proof". In lieu of this non-existent *direct* proof, Brazil presented extensive *circumstantial* evidence that all or nearly all of these producers of upland cotton in MY 1999-2002 received PFC, market loss assistance, direct and counter-cyclical payments.

3. Brazil previously set forth this circumstantial evidence in a number of different Submissions between 24 June and 9 September 2003. To assist the Panel, Brazil has collected this evidence in Annex I to its Closing Statement.

4. A summary of the evidence set out in the Annex is the following: It demonstrates very high production levels of cotton relative to total upland cotton base acreage throughout MY 1999-2002. It shows near universal participation of eligible upland cotton producers in the 1996 PFC programme and 95.7 per cent participation of upland cotton base acreage planted to programme crops in MY 2001. By June 2003, nearly all eligible farms producing, upland cotton in MY 1993-95 or MY 1998-2001 signed up for the direct and counter-cyclical payments. USDA recognized that cotton farmers benefited from PFC and market loss assistance payments and even treated such payments as part of "Government Payments by Crop Year" to upland cotton. Additional evidence shows relatively small fluctuation of cotton planted acreage between MY 1999-2002 and the strong cotton equipment and geographic forces maintaining historic cotton producers in current cotton production. Numerous statements by the National Cotton Council establish that their members received PFC and market loss assistance payments, and would (and do) receive direct and counter-cyclical payments.

5. In addition, the 2002 FSRI Act provides much higher per acre payments for upland cotton than other programme crops (except rice and peanuts). The 1996 FAIR Act similarly provided higher per acre payments for upland cotton (except rice). The only possible rationale for the much higher

upland cotton per acre payments for PFC, market loss assistance, direct and counter-cyclical payment base acreage than other programme crops was the expectation that historical producers of upland cotton needed the higher per-acre income to continue to produce high-cost upland cotton on base acreage. This conclusion is further supported by the fact that given their high costs of production, US upland cotton producers would have lost 10 cents per pound in MY 2002 if they had planted on corn (or six other programme crops) direct and counter-cyclical payment base acreage in MY 2002. Similar losses would also have been experienced in MY 1999-2001 if upland cotton were grown on most other programme crop base acreage.

6. The evidence in Annex I supports Brazil's methodology to calculate the amount of PFC, market loss assistance, direct and counter-cyclical payments by using the ratio of actual US upland cotton production and the amount of upland cotton base acres for programme payments. For example, total planted upland cotton acreage in MY 2002 was 14.1 million acres. The total amount of upland cotton base acreage in MY 2002 was 16.2 million acres. The ratio of these two amounts is 0.87. Brazil used this ratio to adjust the amount of total upland cotton direct and counter-cyclical payments for the marketing year to obtain the amount of subsidies received by upland cotton producers. Out of the 16.2 million upland cotton base acres, 2.1 million acres were not planted to upland cotton in MY 2002. Thus, holders of these 2.1 million cotton base acres either did not plant any crops or planted other crops. Consequently, Brazil has not included direct and counter-cyclical payments on these 2.1 million acres in its calculation of payments to upland cotton producers.

7. The total amount of upland cotton base acreage for direct payments in MY 2002 (which include the portion of PFC payments that were deemed to be direct payments) was $558 million. USDA paid out the maximum amount of upland cotton CCP payments in MY 2002 – $1.148 billion. Multiplying those figures by 0.87 results in $485 million in direct payments and $998 million in counter-cyclical payments to US upland cotton producers.

8. The United States refuses to offer a methodology for calculating the amount of direct and counter-cyclical (or PFC and market loss assistance) payments made to upland cotton farmers. Brazil's suggested methodology is based on the conclusion that all upland cotton producers received these payments. In particular, the evidence suggests that the amount of payments can be best calculated by finding that US upland cotton producers received those payments using upland cotton base acreage. This follows from the evidence listed in Annex I to Brazil's Closing Statement.

9. The United States asserts that "Brazil has presented no evidence that the recipients of these decoupled payments on upland cotton base acres are, in fact, upland cotton producers". Apparently what the United States had in mind in making this statement is that Brazil must produce data detailing the amount of each direct payment received by every single upland cotton farmer between MY 1999-2002. This is data the United States admits does not exist. But such a burden would require the Panel to disregard all the circumstantial evidence provided by Brazil. DSU Article 11 requires the Panel to "make an objective assessment of the facts of the case". In the absence of any alternative methodology proposed by the United States, the "facts of the case" are those presented by Brazil.

10. Therefore, what the United States suggests is that the Panel ignores $1.7 billion in PFC and direct payments simply because the United States does not collect data that could ascertain the precise figure – which will be very small – of upland cotton farmers that did not receive those payments. Such an approach would permit WTO Members to write off large amounts of subsidies by simply refusing to collect data. The Panel must not allow this position to prevail.

### 3. Brazil's Article 6.3(c) Price Suppression Claims and the Econometric Studies

11. Brazil has offered considerable evidence in the form of documents and witness statements demonstrating the existence and payment of subsidies, as well as the causal link between the subsidies

and significant price suppression. In addition, Brazil presented the Panel with evidence of a number of different studies that show significant price suppressing effects. Notably among these are the two Westcott/Meyer USDA studies (referred to and commissioned by the Payment Limitation Commission) showing 10 per cent price suppression for MY 2000 and an estimated 33.6 per cent price suppression in MY 2001 from *only* the effects of removing the marketing loan subsidies. By contrast, Professor Sumner found that US prices were suppressed by 32.7 per cent by the effects of *all* US subsidies that applied during MY 2001. In light of the lower level of price effects found by Professor Sumner, the United States claim that Professor Sumner's analysis is not "conservative" is curious. Other studies by the ICAC – of which the United States and Brazil are both Members – show increases in world prices from the removal of some US subsidies of 10.5 per cent for MY 2000 and 26.3 per cent for MY 2001. Professor Sumner found that the effects of a removal of *all* US subsidies that applied during MY 2000 and MY 2001 would have resulted in world price increases of 7.74 per cent and 17.7 per cent respectively. Brazil has presented many other studies as evidence. They all show significant price suppression.

12. What has been the US reaction to every one of these studies? As they indicated over the past two days, they have found many initial problems with all of them. But they reserved the broad scale attack for Professor Sumner's FAPRI model that has been repeatedly relied on by the US Congress and USDA. The United States even identified flaws in the results of the Westcott/Meyer 2000 and 2001 marketing loan studies. And the United States promises they will be busy for the next six weeks in critiquing all the studies cited by Brazil.

13. But the Panel must ask whether *all* these economists, including some of USDA's own leading economists, could be wrong although their results support USDA's own Chief Economist's views that US producers are insulated from market forces by these subsidies? Could these economists be wrong because they made the mistake of applying the fundamental notion that large production subsidies create larger supplies, and larger supplies result in significantly lower prices?

14. In the final analysis, these econometric studies are useful tools to confirm what common sense already tells us. That $12.9 billion in subsidies provided between MY 1999-2002 have production effects. That the National Cotton Council was correct when it argued that US upland cotton farmers could not exist without all of the cotton-specific subsidies. That many US producers needed subsidies to bridge the huge gap between their total costs and market revenue. That US acreage did not decrease as prices plummeted to record lows between MY 1999-2001 – rather planted US acreage increased. That US producers planted 14.1 million acres of upland cotton when prices were at record lows in the spring of 2002. That US exports did not decrease as prices plunged and the US dollar appreciated, rather they increased. And that the effects of US subsidies on suppressed prices are transmitted to the world and individual country markets, including Brazil.

**4. Brazil has established a claim under Article 6.3(d)**

15. With respect to Brazil's claim under Article 6.3(d), Brazil demonstrated that the ordinary meaning of the term "world market share" is the world market share of exports. USDA, the EC and Canada all use this term to refer to export market share, not share of world consumption. This interpretation is consistent with the use of the term "trade" in footnote 17 of the SCM Agreement which means the "sale and distribution of goods and services across international borders". It is also consistent with the object and purpose of Article 6.3(d) which is to prevent a Member from using its subsidies to *increase* its share of the world market for a particular product.

16. Undisputed facts show that the US share of world trade increased considerably from MY 1998 to MY 2002, and is projected to remain at very high levels in MY 2003. This increase follows a consistent trend from MY 1996. The "consistent trend" need not be an unbroken line of increases during the trend period examined, as the United States appears to argue. Because of severe

weather problems, such as occurred in the United States in MY 1998, export market share in agricultural problems will always susceptible to some annual variations not caused by subsidies. Rather the trend must reflect an overall increase and not reflect a number of wide swings within the period examined. The trend for US world market share of upland cotton from MY 1996, and particularly the period from MY 1998 onward, shows a sustained and significant increase in the US world market share. And the undisputed facts show that the record US world market share reached in MY 2001 and 2002 occurred at the same time as record high levels of US subsidies.

**5. Brazil has established that the US share of world export trade is not equitable**

17. The notion of "equitable share of world export trade" necessarily depends on the facts of each case. The fact-intensive nature of each case is reflected in the text of Article XVI:3, which requires the Panel to examine "special factors". Brazil suggests that examining whether there were any subsidy-induced *increases* in market share is one factor to consider. Another factor is the relative cost of production of the Members competing for world market share. The undisputed facts show (based on September 2003 ICAC data) that the US share of world exports of cotton more than *doubled* between MY 1998-2002 – from 18.7 to 39.3 per cent. At the same time, the African producers' collective share of world exports *decreased* from 10.2 to 8.1 per cent of world trade. Figure 26 shows these trends. If a picture is worth a thousand words, it is this one.

18. Brazil submits it is not equitable for a heavily subsidized WTO Member to more than double its share of competitive world markets for upland cotton in only five years reflecting a significant contribution of subsidies. And it is not equitable for that Member to do so when its costs of production were double those of the poorest and neediest producers in the world. Yet, when faced with these facts, the United States' only response is that the definition of "inequitable" is hopelessly vague. Brazil does not believe the inequity in this case is so difficult to determine.

# ANNEX F-3

## EXECUTIVE SUMMARY OF THE OPENING STATEMENT OF THE UNITED STATES AT THE SECOND SESSION OF THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. **Brazil's Analysis Fails to Establish to Whom Certain Payments Go and Whether Certain Payments May Properly Be Attributed to Exported Upland Cotton**. One of the fundamental elements of Brazil's claims is that Brazil needs to identify the "subsidized product" that is causing the serious prejudice that Brazil claims its interests are suffering.[1] Brazil has not even explained, however, what is the "subsidized product" for each of the types of subsidies from which it claims serious prejudice. Brazil appears to assume that the "subsidized product" is upland cotton in the form traded on the world market. Yet many of the subsidies at issue are paid to producers of cotton. Cotton is processed and sold before being traded. Brazil has made no showing of how the subsidy to the producer can be assumed to pass through to the exporter.

2. Brazil's panel request identifies the challenged measures as "subsidies provided to US producers, users, and/or exporters of upland cotton". However, it is for Brazil as the complaining party to establish who are the recipients of the subsidies and that the subsidies are properly attributed to upland cotton. Brazil's failure to do so means that it has not carried its burden in demonstrating that cotton is subsidized for purposes of considering adverse effects.

3. In the Peace Clause portion of this dispute, the United States has discussed at length certain decoupled payments that are not linked to production of upland cotton. With respect to these decoupled payments, Brazil has failed to demonstrate who the recipients of these payments are in connection with any exported upland cotton. Brazil simply presumes that every upland cotton producer is an upland cotton base acreage holder and receives a decoupled payment. Brazil has brought forward no facts to demonstrate that this is the case.

4. Even if Brazil had brought forward evidence that the recipients of these payments were upland cotton producers, that would not be enough. Brazil would still need to allocate these payments, which Brazil concedes are not linked to current production of upland cotton, over total production on a recipient's farm.[2]

[1] For example, for purposes of a claim under Article 6.3(c) of the Subsidies Agreement, the "effect of the subsidy" must be "significant price undercutting" or "significant price suppression, price depression, or lost sales" caused by "the subsidized product." Similarly, under Article 6.3(d) "the effect of the subsidy" must be an increase in world market share "in a particular *subsidized primary product or commodity*."

[2] Subsidies Agreement, Annex IV, paras. 1-3 (We note the context provided by Annex IV of the Subsidies Agreement, which explained the calculation of the ad valorem subsidization of a product under the now-defunct Article 6.1(a) of the Subsidies Agreement. This Annex provided that (among other conditions), unless "the subsidy is tied to the production or sale of a given product," the overall rate of subsidization of a "product" is found by taking the amount of the subsidy over the "total value of the recipient firm's sales in the most recent 12-month period".).

5. Thus, Brazil assumes that the subsidies[3] at issue are received by someone currently producing cotton, based simply on the fact that the subsidy is based on past production of cotton. Brazil has not explained how this makes upland cotton currently for sale on the export market the "subsidized product" with respect to these payments. Brazil has failed to demonstrate that the recipients of the subsidies are involved in current cotton production, nor has it demonstrated how much of the subsidy, even under Brazil's approach, should be allocated to other products produced by the recipient, such as corn or soybeans.

6. **Brazil Has Not Established that US Subsidies Have Suppressed or Depressed Prices in the Same Market**. As noted above, Brazil has in fact not even demonstrated the subsidized product for each of the subsidies it challenges or the size of the subsidies to exported upland cotton. However, without relieving Brazil of its burden on these issues, we note that even Brazil's overly simplified approach does not suffice to demonstrate causation. US subsidies largely resulted from low market prices, not the other way around.

7. This is nowhere more evident than in marketing year 2001, a year with historically low market prices. Brazil has failed to explain that market signals (futures prices) at the time when planting decisions were taken by US producers suggested prices would remain high. Thus, the large marketing loan payments ultimately made in marketing year 2001 do not demonstrate that marketing year 2001 payments had the effect of increasing US production. Brazil's expert acknowledges this very point, but Brazil has not presented in its further submission *any* information on "the expectations about production incentives that growers hold at the time they make their planting decisions", information on which its own expert has stated "cotton plantings depend". Thus, Brazil's simple explanation of the conditions in marketing years 1999 through 2002 ignores "the basic economic principles" its own expert says are relevant in this case.

8. **The Sumner Model Presented by Brazil Is Inadequately Explained, Inappropriately Applied for a Retrospective Analysis, and Apparently Uses Faulty Assumptions and Estimations.** In presenting this reaction to Brazil's expert's analysis, the United States notes that the use of a simulation model to explore the counter-factual of removal of US subsidies cannot be made without answers to previous questions on the subsidized product and size of the subsidies. That is, the use of a simulation model cannot relieve Brazil of its burden of arguing the elements necessary to establish its claims. This critique of Dr. Sumner's analysis is made to show that Brazil's approach is fundamentally flawed in all aspects.

9. Since Brazil has not provided access to the model itself, one cannot say with certainty how the modelling affects the results.[4] Nonetheless, based on what has been presented in Annex I, Brazil's analysis appears flawed in several respects and as a result, the conclusions drawn are biased and misleading. While the modelling approach used is well accepted for forward-looking projections, using a baseline model to simulate counterfactual outcomes over the historical period 1999-2002 is

[3] Brazil purports to include export credit guarantees under the GSM-102 programme within its actionable subsidy claims. However, Brazil has merely alleged the quantities of export credit guarantees benefitting cotton and the value of exports. Brazil has nowhere presented evidence on any alleged subsidy rate resulting from this programme nor the amount of the subsidy. Therefore, Brazil again has not provided any evidence with respect to the amount of the subsidy alleged to be provided by US export credit guarantees.

[4] The report provided by Brazil as Annex I to its further submission does not provide the model itself, including detailed specifications of the equations used therein. As a result, Brazil is essentially asking the Panel and the United States to accept Dr. Sumner's results on faith alone. The United States points out why Brazil's expert's approach is inappropriate for a retrospective analysis of the effect of US subsidies. Even were Brazil's expert's approach appropriate, however, Brazil has failed to provide sufficient evidence to allow the Panel to fully understand and evaluate that model. Thus, quite apart from flaws identified by the United States, Brazil's reliance on Dr. Sumner's inadequately explained results, evident throughout Brazil's latest submission, further demonstrates that Brazil has not established a *prima facie* case that US subsidies have the effects complained of.

problematic because of the implicit assumption of perfect foresight by producers of actual conditions in the historical year. This potentially overstates the effects of the programme because the model assumes outcomes that were unanticipated by producers when they made their planting decisions. Also, it is not clear to what extent actual observed data enter into the solution process. The difference is not merely conceptual: the choice of values can potentially affect the reported results.

10. Brazil's use of lagged prices as a proxy for expected prices is also problematic. Recent studies have criticized the use of lagged variables as substitutes for expectations, and numerous papers use the futures price for next year's crop as the best proxy for expected price. The use of futures prices in a multi-commodity modelling framework for extended time projection is cumbersome. Nonetheless, the use of lagged prices as a modelling convenience does not preclude the possibility of bias. In those years where there are large shocks, lagged prices are poor predictors of expected price. Futures prices, by contrast, are more efficient because they are based on more current information.[5]

11. Brazil's expert's estimates of US programme impacts after marketing year 2001 are further inflated by his choice of a low-price baseline for the counter-factual comparison.[6] The low-price baseline exaggerates the 2003-07 results and ensures projections of significant marketing loan payments throughout 2003-07.

12. The economic literature on decoupled payments acknowledges the programmes may have some impact on production, and that those impacts depend in part on farmer' s expectations. However, the research concludes that the impact appears negligible. Brazil's expert, on the other hand, uses a stylized logic to come up with the estimates for the impact of production flexibility contract (PFC) payments that have neither empirical nor theoretical grounding. It is widely accepted that these programmes have whole farm impacts rather than crop specific impacts. Furthermore, the impact is much smaller than Brazil has estimated; the whole farm impact is, at its upper estimate, perhaps one-quarter to one-fifth the impact Brazil's expert cites for cotton alone.

13. Brazil argues that market loss assistance (MLA) payments have a larger effect on area than do PFC payments, despite the fact that MLA payments were paid on the identical payment base as the PFC payments. Supplemental legislation authorizing each of these MLA payments was passed several months after planting for the crop year in question had occurred. Brazil asserts that producers had expectations about MLA payments at the time of planting. However, if producers had expectations of payment, then they also knew that they would be eligible to receive such a payment whether or not they planted cotton. Indeed, they could choose not to plant any crop at all and still be eligible for the payment.

14. Brazil argues that counter-cyclical payments "clearly provide more production incentive than the market loss or the direct payments," yet offers no empirical evidence to justify such a claim. The claim, as well as Brazil's expert's treatment of decoupled payments in general, is particularly puzzling

[5] Consider as an example the 2002 crop year. In Brazil's analysis, area response to the removal of the cotton loan programme results in a 36-per cent reduction in US planted area–the largest single effect for any of the years considered in his analysis. Based on lagged prices, price expectations for 2002 were 29.8 cents per pound, a 40 per cent reduction from 2001 levels. Yet, the futures market data suggests a far smaller reduction in expected price. December futures prices taken as an average in February 2002 averaged 42.18 cents per pound, a 28 per cent drop from year earlier levels. Based on Brazil's range of supply response elasticities of 0.36 to 0.47, a decline of this magnitude would suggest a drop in acreage of 10 to 13 per cent from the preceding year. In fact, actual US cotton acreage dropped 12 per cent (from 15.5 million acres in 2001 to 13.7 million acres in 2002) suggesting acreage levels entirely consistent with world market conditions and price expectations.

[6] Brazil's expert's estimate for the 2002 A-Index is 51 cents, compared with 54 cents in FAPRI' s March 2003 baseline, and an actual price of 56 cents. For 2003, Brazil's expert's A-Index is estimated again at 51 cents, whereas FAPRI's baseline has a 58.4 cent forecast; as of 15 September 2003, the A-Index is at 65.5 cents.

given a recent paper by Brazil's expert in which he concludes that the 2002 farm bill would have a minimal effect on cotton area and world prices. Brazil's expert also remarked that: "The impacts of the FSRIA will be hard to isolate amid the normal flux of world markets".[7] We agree with Dr. Sumner's previously *published* conclusions on these points.

15. Crop insurance subsidies are generally available for most crop producers and hence do not give a specific advantage to one crop over another. Thus, their effects are not commodity specific, and have no or minimal impacts on cotton markets. Moreover, crop insurance purchases by cotton growers have generally been at lower coverage levels than for other row crops. Over 2002-03, roughly 90 per cent of cotton acreage insured was at coverage levels at 70 per cent or less, consistent with the criterion under paragraph 8(a) of Annex 2 of the Agreement on Agriculture. This suggests that even if one were to consider cotton crop insurance subsidies as crop specific, over 90 per cent of insured cotton area would be exempt as having no or minimal trade-distorting effects.

16. Lastly, while some studies like the ones cited by Brazil have suggested crop insurance subsidies may have a slight effect on acreage, the effects on production are less clear. Recent studies suggest that farms with more insurance tend to use less inputs like fertilizer and pesticides and vice versa. This demonstrates a potential moral hazard problem with crop insurance: a negative effect on yields, which may well offset any marginal effects on crop area.

17. The size of Step 2 payments under Brazil's baseline appears to be biased upwards, in part, due to the low-price baseline discussed earlier. Brazil's results are inconsistent with other analyses of Step 2.[8] Thus, contrary to the results of Brazil's expert's model, the benefits of Step 2 payments would appear to largely accrue to the producer, with only negligible effects on world markets. While Brazil's model documentation is lacking, one explanation for the difference may be a more price responsive acreage equation by Brazil.

18. While Brazil has presented a modelling framework that is conventional, much of how Brazil's expert has modelled US farm payments can be considered "unconventional". Thus, the analysis presented by Brazil in Annex I is not "conservative", but rather produces results that are inconsistent with a wider body of academic research.

19. **Additional Legal Arguments**. With respect to price suppression or depression under Article 6.3(c) of the Subsidies Agreement, Brazil believes that it is the effect on the producers of the complaining Member that must be "significant". We find it implausible that the Subsidies Agreement was intended to create multiple standards for panels to apply: that is, what may be "significant" to one Member's producers may be "insignificant" to another's. Context for rejecting Brazil's approach can be found in Article 15.2 of the Subsidies Agreement, which sets out for countervailing duty purposes the same effects found in Article 6.3. This text makes it even more clear that the analysis is whether the level of price suppression or depression itself is "significant".[9] Brazil has not suggested that the analysis under Articles 15.2 and 6.3(c) should be different.

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[7] Sumner, D.A. "Implications of the US Farm Bill of 2002 for Agricultural Trade Negotiations." Australian Journal of Agricultural and Resource Economics. 47(2003): 99-123, at 114. (See Exhibit US-56)

[8] In Brazil's baseline, Step 2 payments average 5.6 cents per pound over the 2003-07 period, elimination of Step 2 payments raises world prices by an average of 1.6 cents, while farm prices fall by 2.5 cents per pound. These alleged effects are higher than those found by others. For example, in 1999, when Congress was debating whether to reauthorize Step 2 subsidies, the FAPRI analyzed the effects of reauthorization for the Senate Committee on Agriculture, Nutrition and Forestry. Their analysis estimated an average Step 2 payment of 5.3 cents per pound, resulting in an increase of the US spot price by 4 cents and a fall in the world cotton price of less than 0.5 cents.

[9] Subsidies Agreement, Article 15.2 ("With regard to the effect of subsidized imports on prices, the investigating authorities shall consider whether . . . the effect of such imports is otherwise to depress prices *to a*

20. With respect to GATT 1994 Article XVI:3, Brazil appears to assume that it may advance a claim under this provision on all challenged US subsidies. However, Article XVI:3 only applies to export subsidies. Therefore, as Brazil has predicated its claim under Article XVI:3 on evidence relating to all challenged US subsidies and not only those subsidies it alleges are export subsidies, Brazil has failed to establish a *prima facie* case on its claims.

21. Finally, with respect to Brazil's claims of a threat of serious prejudice, the United States notes Brazil's failure to present recent market and futures price data, which belie the notion that there is a clearly demonstrated and imminent likelihood of future serious prejudice. In fact, prices are currently above the level at which the marketing loan programme confers any benefit on US upland cotton producers and are expected to remain so. If there is not a "clearly demonstrated and imminent likelihood" of serious prejudice in marketing year 2003, it follows that there cannot be a threat of serious prejudice for marketing years 2004-07, either.

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*significant degree* or to prevent price increases, which otherwise would have occurred, *to a significant degree*.").

# ANNEX F-4

## EXECUTIVE SUMMARY OF THE CLOSING STATEMENT OF THE UNITED STATES AT THE SECOND SESSION OF THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. The US comments speak briefly to Brazil's allegations regarding "the effect" of US subsidies. Brazil has not shown causation between the US subsidies and the effects Brazil attributes to those subsidies. The United States has pointed out the failure of Brazil to separate and distinguish evidence on the effect of other factors from the alleged effect of the challenged US subsidies. Ultimately, this issue goes to the quality of the evidence before the Panel and whether Brazil has established a *prima facie* case on its claims.

2. There are three main elements of Brazil's argument. First is the "temporal proximity" argument – that is, that low world prices correspond in time with high US subsidies.[1] Mr. Chairman, there are subsidies and there are subsidies. For example, there is a difference if I give you a $10 subsidy to produce versus $10 whether you produce or not. Depending on the nature of the payment, one would estimate different effects. Therefore, one cannot merely aggregate the value of all US payments and claim that those subsidies have had "an effect" on production and prices.

3. In this part of its argument, Brazil misuses the data on production by making comparisons using marketing years 1998 and 2001. In 1998, production was driven downward by drought and record crop abandonment. In 2001, production was driven upward by record yields. To use 1998 and 2001 as the beginning and end of a comparison therefore distorts a proper analysis.

4. Brazil stated yesterday that the increase in US production in marketing year 2001 was not solely due to record yields but also to an increase in acreage. That is true – there was some increase in acreage in 2001, but Brazil has failed to make the proper comparison to put that information in context. Brazil should have compared the US acreage increase between marketing years 2000 and 2001 with that in the rest of the world. The United States invites the Panel's attention to Exhibit US-63 circulated today. This exhibit reflects, for marketing years 1996-2002, the percentage change in harvested acreage over the previous marketing year in the United States and the rest of the world.

5. In marketing year 1996, when the programmes challenged by Brazil were introduced, you see a large decrease in US acreage compared to the rest of the world. The United States draws your attention to marketing year 1998, in which there is a large decline in US harvested acreage due to drought, followed by a large increase in marketing year 1999, which largely cancel each other out. In marketing year 2001, we see that the increase in acreage in the United States corresponds to the increase in acreage for the rest of the world. In marketing year 2002, the percent decline in harvested acreage in the United States is *greater* than that observed in the rest of the world. Thus, the data do not support Brazil's contention that US producers are insulated from market forces. In fact, US harvested acreage largely increases and decreases in line with the rest of the world.

6. (Yesterday Mr. Moulis asked about the data in the upland cotton fact sheet. The data in Exhibit US-63 does not come from that fact sheet but from the most recent US Department of Agriculture data base – the specific source is indicated on the second page of the exhibit. Brazil has used this same source for numerous exhibits in its submissions.)

[1] The United States has addressed the disconnect between low world prices and the level of subsidy in Exhibit US-44.

7. The second element of Brazil's arguments that the United States would like to address is its reliance on Mr. Sumner's model. We first would like to comment on something Mr. Sumner said today in his statement to the effect that the United States does not object to the use of the FAPRI baseline model. In fact, as reflected in the portion of the US opening statement delivered by Dr. Glauber, we do criticize as inappropriate the use of a baseline simulation model for retrospective analysis, a type of analysis for which it is not designed and is poorly suited.

8. Mr. Sumner's analysis also uses an inappropriately low baseline for his prospective analysis of future years. I noted with interest Mr. Sumner's statement that he used the November 2002 preliminary FAPRI baseline because this was available when he ran his model and that the results would have been even more extreme had he used FAPRI's published 2002 baseline "released the previous winter". The United States realizes it would have been inconvenient for Mr. Sumner to re-run his model, but FAPRI released a more recent baseline in January 2003 (published in March 2003[2]), many months before Brazil submitted the results of its model to the Panel and the United States. We believe this more recent FAPRI baseline would have been a more appropriate baseline with which to do calculations, but Brazil has chosen not to do so, instead presenting to the Panel results based on more out-of-date and inaccurate data. We wonder what would arise from a prospective analysis using such more recent data.

9. The third issue concerns the allegations of high US costs, an issue we have touched on only briefly in this hearing and will return to in more detail in our submissions. Brazil asks: without subsidies how could high-cost US producers have stayed in business? It is important first to point out that all of the cost projections by the US Department of Agriculture cited by Brazil are merely updates of a 1997 cost survey. In every year subsequent to 1997, the Department simply takes the results of the 1997 cost survey and updates it to reflect the general increase in prices according to the producer price index.

10. This approach assumes that the mix of inputs remains the same in 1997 as in subsequent years. However, this causes a presentation of inaccurate data on what costs are now. Brazil has several times in this hearing stated that it is not denying that factors reducing costs have occurred – for example, pest eradication bringing new, low-cost areas of the United States into production or the adoption of biotech cotton which requires fewer pesticide applications. Brazil, however, has not updated the cost information it presents to the Panel to account for such new developments and information.

11. The United States also notes Brazil's repeated references to a so-called cost/revenue gap. In fact, Brazil presents another such comparison for marketing year 2002 at page 5 to the annex to its Closing Statement. However, Brazil's so-called "gap" is the difference between an inaccurate average total cost per pound and the average marketing year farm price. Mr. Chairman, this is a faulty comparison. Total costs are relevant over the long-term, but Brazil uses this (inaccurate) number to compare to revenue in the short term – that is, the market price for one year. Such a comparison tells you nothing and does not establish that it is only the effect of US subsidies to keep US cotton farmers in business.

12. In fact, Brazil has apparently not listened to the testimony of its own farmer witness, Mr. Christopher Ward. In his statement during the first day of this hearing, he said the following (and I quote from paragraph 6 of his statement):

> But even with these high yields and the excellent quality of our land, *we were not able to fully recover all of our variable costs of production during the 2000/01* ***and***

[2] Exhibit US-52.

> *2001/02 seasons*. These variable costs included depreciation and maintenance of equipment, seed and fertilizer, labor, insurance, and fuel. ***Nor were we able to meet our total costs*** *which include the additional fixed costs*.[3]

That is, Mr. Ward says he has not been able to cover *either* his variable costs *or* his total costs for a period of two marketing years, and yet he continues producing. Under Brazil's analysis, he should be out of the business of producing cotton. He is not, and Brazil claims he is not subsidized, so how can Brazil claim that it is "the effect of the subsidy" to keep US farmers in business when they allegedly were not able to cover their total costs in marketing year 2002? What's true for Brazil should also be true for the United States.

13. Mr. Chairman, members of the Panel, on the basis of these arguments and the evidence presented to date, the United States does not believe that Brazil has established a *prima facie* case that the challenged US subsidies have caused the effects complained of. We will continue to develop and provide our response to the voluminous submissions of Brazil in our answers to your questions and in our rebuttal submission. Thank you.

[3] Statement of Mr. Christopher Ward at the Second Session of the First Panel Meeting, para. 6 (emphasis added). Mr. Ward goes on to state: "Based on my discussions with many producers relating to Mato Grosso cotton production and revenue, *I know that most other producers in State of Mato Grosso were in the same situation as we were during the 1999-2002 period*." *Id.* (emphasis added).

# ANNEX F-5

## ORAL STATEMENT OF ARGENTINA

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### I. INTRODUCTION

1. Argentina would like thank the Panel for this renewed opportunity to submit its views as a third party in these proceedings, and as stated in its submission of 3 October[1], it will be commenting on some of the claims made by the United States in its written submission of 30 September.[2]

### II. CLAIMS OF THE UNITED STATES

#### II.1 Causal relationship and other factors which affected and still affect the world cotton economy

2. In paragraph 5 of its submission, the United States asserts with respect to marketing loan payments and step 2 payments that Brazil seeks to ascribe extraordinarily low cotton market prices in recent years to US subsidy payments without presenting or explaining to the Panel the factors that led to this low market price level that in turn resulted in larger US subsidies.

3. Similarly, in paragraph 80 of its submission, the United States claims that Brazil's argument rests largely on the assertion that large US outlays under the challenged measures necessarily demonstrate that US measures caused those price declines.[3]

[1] Second Written Third-Party Submission of Argentina, 3 October 2003, paragraph 4.
[2] Further Submission of United States, 30 September 2003.
[3] Further Submission of the United States, paragraph 80.

4. The United States claims that Brazil has not been able to demonstrate the causal connection between the US measures and their effects, nor has it considered other factors which affected and still affect the world cotton economy.

5. Argentina believes that Brazil, in its First Written Submission, provided a precise and comprehensive description of the world cotton market situation, backing the facts with considerable evidence and documentation.[4] Similarly, in its Further Submission, Brazil took account of other factors which also contributed to demonstrating the suppressing or depressing effect on prices of the US subsidies.[5]

6. Argentina would further like to point out that despite the existence of factors other than the US subsidies that could also have had a depressing effect on international prices (such as the development of synthetic fibres, Chinese trade polices and other factors raised by the United States in its further submission[6], some of which will be considered by Argentina further on), Article 6.3 of the SCM Agreement[7] clearly states that "*serious prejudice … may arise in **any case** where … the effect of the subsidy...*".

7. In other words, Argentina considers that Brazil has demonstrated the causal relationship between the subsidies that the United States has granted and continues to grant to its cotton sector and the fall in international cotton prices.

8. That is, Argentina considers that under the SCM Agreement **it is not necessary for a subsidy to be the only factor** in the decline in international prices in order to be able to establish a causal relationship between that subsidy and the serious prejudice.[8] Rather, the subsidy must be a determining factor or, according to the text of Article 6.3(c), its effect must be a "**significant**" price suppression or price depression, and this was demonstrated by Brazil.

9. Argentina recalls that the United States, given the size and global impact of its cotton market – with a 41.6 per cent share of the world market – is the international market "price-setter" *par excellence.*

10. Thus, without the US subsidies which generate a world market surplus, international cotton prices would have been higher or would not have fallen as much. Similarly, if the US share in the world market had not increased as a result of the subsidies, the international price of cotton would have been higher or would have not fallen as much, and as a result, third-country producers, including Argentina, would not have suffered as much prejudice as a result of artificially depressed prices.[9]

11. Argentina does not agree with the US statement that Brazil has not established a *prima facie* case because it has failed to provide sufficient evidence of the causal relationship between the enormous budgetary outlays and the low international cotton prices.[10]

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[4] Brazil's First Submission to the Panel, 24 June 2003.
[5] Brazil's Further Submission to the Panel, 9 September 2003, Section 3.3.4.4.
[6] Further Submission of the United States, Section IV.B and C.
[7] Agreement on Subsidies and Countervailing Measures.
[8] "*Further Third Party Submission of New Zealand"* (3 October 2003), *para. 2.09: "Brazil's argument is not that declining cotton prices were due solely to the impact of the United States subsidies. Nor does Article 6.3(c) require that to be the case … ".*
[9] Second Written Third-Party Submission of Argentina, 3 October 2003, paragraphs 21, 26 and 27.
[10] Further Submission of the United States, paragraphs 17 and 80.

12. Brazil has not based its claims on a mere assertion, but rather, as we have already stated[11], the number and quality of the empirical and econometric analyses presented by Brazil in its Further Submission[12], which were carried out both by international organizations and by various prestigious US institutions, not to mention the USDA itself, provide irrefutable evidence of the *collective* and *individual* effects of each subsidy programme on the price of cotton.

13. It is therefore difficult for Argentina to understand how the United States can claim that other factors, and not its subsidies, were the cause of the dramatic fall in cotton prices over the past few years. Nor does Argentina understand how the United States can disregard the evidence provided by Brazil[13] to the effect that during the marketing years 1999 to 2002, the total value of US cotton subsidies amounted to almost US$13 billion while the average cotton subsidization rate was 95 per cent.[14]

14. In the paragraphs that follow, Argentina will refute some of the arguments put forward by the United States concerning other factors that may have influenced the fall in international cotton prices:

15. FIRST: the United States claims that the explosion in the production of synthetic fibres played a considerable part in causing cotton prices to fall. Argentina submits that the contrary appears to be true.

16. Indeed, the "Fibre Prices" Table in paragraph 23 of the US Further Submission shows that polyester prices have always been lower than cotton prices (see: "US mill" as compared to "US spot" and "Asia poly") and, moreover, they appear to follow cotton prices (see 1995, when cotton prices reached their record level for the series and polyester happened to follow the same trend).

17. The fact that polyester had to adapt to cotton prices, and not the reverse as the United States claims, is confirmed by the very close correlation between cotton and polyester prices. On the other hand, the last few years do not show any correlation between the price per barrel of oil and the price of polyester fibres.

18. SECOND: Argentina does not understand how the United States can claim that without the increase in US retail consumption, international cotton prices would currently be lower[15] (which is not being questioned), while disregarding the role that its enormous subsidies have played and still play in the fall of international cotton prices.

19. As we have already pointed out[16], price movements of the US Cotlook "A" Index and third country (e.g. Brazilian and Argentine) market prices are directly interconnected, and this is an unquestioned and irrefutable fact. This being the case, the amount of the US subsidies granted to the cotton sector added to the scale of US production and exports are decisive when it comes to determining the extent to which the subsidies affect the fixing of both international and third market prices.[17]

20. THIRD: The United States correctly points out that since the world's cotton trade is managed in US dollars, an appreciation of the dollar will lead to a fall in the price of cotton both in the

[11] Second Written Third-Party Submission by Argentina, paragraphs 34-36.
[12] Further Submission of Brazil, Section 3.3.4.8.1.
[13] USDA's "Fact Sheet: Upland Cotton" (January 2003). (See Annex BRA-4).
[14] Written Third-Party Submission by Argentina, 15 July 2003, paragraph 20.
[15] Further Submission of the United States, paragraph 26.
[16] Second Written Third-Party Submission by Argentina, paragraph 22.
[17] *Idem*, paragraph 28.

United States and in third markets.[18] What the United States does not explain in connection with this fact is why this appreciation of the dollar by some 37 per cent between 1995 and 2002[19] did not also result in a fall in production, and consequently, in US cotton exports. The National Cotton Council (NCC) gives us the answer, pointing out that without its subsidies, the United States' share in the world cotton market would have declined.

21. FOURTH: Regarding the United States argument that China is the giant of the world cotton industry, and hence the impact of its trade policies and stocks, we note that neither Brazil nor third parties, such as Argentina, overlooked this fact. We repeat, Argentina has already pointed out[20] that while there were a great many cotton producing countries, four of them (China, the United States, India and Pakistan, in descending order) alone account for two thirds of world cotton production.

22. However, Argentina also pointed out that most of the cotton was used in the producing country itself, and that the great exception to that rule was the United States, which exported over a half of the cotton it produced and was the world's leading exporter. This was why the level of subsidization in the United States was the main factor in determining the world cotton market price. In other words, while China may be the giant in the world cotton **industry**, the United States is the giant in world cotton **trade**.

23. FIFTH: The United States claims that the decisions of farmers are based on expected cotton prices for the upcoming crop year and not prices from the previous crop year as cited by Brazil, and that US cotton producers are not insulated from international price movements.[21] We can only repeat some of the questions that we addressed to the United States during the consultations[22], namely:

24. If this is so, how does the United States explain the fact that in 2001 – the fifth year of falling prices – US cotton producers achieved a record harvest of 20.3 million tons, an increase of 42 per cent compared to 1998, and that the cotton planted area increased by 6 per cent during the same period? Why does the USDA estimate a 10 per cent drop in the world production for 2002 – reflecting the impact of world prices on investment – and at the same time estimate for this year another record harvest in the US – the fourth biggest ever recorded? How does the US explain the reasons for the increase in the volume of its cotton exports from 946,000 tons in 1998 to 1.8 million tons in 2001, while there was a drop in international prices?

25. Besides, the United States is not a low-cost producer[23] (despite its claim that pest eradication programmes and the adoption of genetically modified varieties of cotton have lowered its production costs[24]), and its productivity levels are lower than those of other exporting countries. Nevertheless, while international prices have fallen by some 54 per cent since the middle of the 1990s, the United States has expanded the area under cotton and increased its production. How does the United States explain the lack of correlation between the world cotton price and US cotton production?

26. Brazil has given answers to all of these questions. Argentina has also pointed out that if the United States did not grant subsidies to its cotton sector, the US cultivated acreage and production

[18] Further Submission of the United States, paragraph 35.
[19] *Idem*, paragraph 32.
[20] Written Third-Party Submission by Argentina, 15 July 2003, paragraph 21.
[21] Further Submission of the United States, paragraph 45.
[22] Second Written Third-Party Submission by Argentina, 3 October 2003, paragraph 7.
[23] International Cotton Advisory Committee, "Survey of the Cost of Production of Raw Cotton", 2001.
[24] Further submission of the United States, paragraph 46.

would diminish. US exports would also diminish and, the US being the world's leading supplier of cotton, international prices would be higher or would not have decreased as much.[25]

27. Argentina considers that the evidence submitted with respect to the increase in US production and exports which took place entirely independently or in isolation from the fall in the international price clearly demonstrates that US cotton producers are immune to changes in the market prices for cotton.[26]

28. SIXTH: The United States claims that the eradication of pests and the adoption of genetically modified varieties of cotton have lowered production costs.[27] We stress that even so, there continues to be a widening gap between those costs and market prices.

29. We repeat what has already been stated by Brazil and Argentina[28], namely that while US cotton production costs are among the highest in the world, US producers' market prices have fallen from US$0.60 to US$0.30 per pound.[29] The only possible explanation of how the United States has been and continues to be able to bridge the widening gap between production costs and market prices is subsidies, since without them many US producers would have been or would be compelled to cease cotton production.

30. SEVENTH: Argentina does not understand how the United States can claim that US cotton producers are highly sensitive to price changes when in spite of a 54 per cent fall in international prices since the middle of 1990s, the area under cotton and the production of cotton in the United States expanded considerably. In other words, contrary to what the United States has claimed, the area under cotton has responded to the fall in international prices by increasing steadily. The only way to achieve such a result is to grant enormous subsidies, since without them the cultivated area, and hence production, would have decreased.

31. EIGHTH: Argentina does not understand how the United States can state that its cotton producers show greater sensitivity to price changes than is demonstrated by third markets when, for example in Argentina – which is basically a "price-taker" in the international cotton market – the cultivated area shrank by 76 per cent during the marketing year 2001/2002, while production fell by 63 per cent compared to 1998.[30]

### II.2 Exclusion of measures

32. Regarding the US argument that some of its domestic support measures should not be included in the analysis[31], Argentina considers that the Panel should examine the collective effects of all of the support measures that are not green box measures. Argentina does not agree with the US statement that direct payments and counter-cyclical payments should be excluded from the analysis simply because their individual effects may not be that significant.

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[25] Second Written Third-Party Submission by Argentina, 3 October 2003, paragraphs 11 and 12.

[26] *Idem*, paragraph 5.

[27] Further Submission of the United States, 30 September 2003, paragraph 46.

[28] Written Third-Party Submission by Argentina, 15 July 2003, paragraphs 17 and 18.

[29] According to a recent ICAC study, the cost of production in the United States was US$0.81 per pound of cotton in the marketing year 1999. In contrast, as pointed out by Brazil in paragraph 32 of its submission, Argentina's production costs averaged 59 cents per pound of cotton. "Cotton: World Statistics", Bulletin of the International Cotton Advisory Committee, September 2002 (Annex BRA-9).

[30] "Argentina: Economic Injury to the Cotton Sector as a Result of Low Prices", Working Group on government Measures of the International Cotton Advisory Committee, 2002. Written Third-Party Submission by Argentina, 15 July 2003, paragraph 22.

[31] Further submission of the United States, 30 September 2003, paragraphs 71 to 75.

33. It is the collective impact of all of the US subsidies that has effects on the cultivated area, production, exports and prices.

## II.3. Interpretation of Article 6.3(c)

### II.3.1 Effect of the subsidy

34. Argentina considers that Brazil has made a proper *prima facie* case with respect to its claim of inconsistency with Article 6.3(c) of the SCM Agreement, conclusively demonstrating the significant price suppression or depression effect.

35. Firstly, Argentina does not understand how the United States can simply brush aside the Panel's findings in *Indonesia-Automobiles*[32], since this was the only dispute under the GATT-WTO which dealt with the interpretation of the term "significant".

36. Secondly, Argentina fails to understand how the United States can claim that Brazil argued that it is the effect on producers that must be significant, and not on prices, when Brazil has submitted copious evidence, based on numerous empirical and econometric analyses, of the effects of the subsidies on prices.

37. It is remarkable that the United States should completely disregard these analyses, especially considering they were conducted by international organizations and by different prestigious US institutions, not to mention the USDA itself[33], in an attempt to distort Brazil's evidence.

38. Argentina repeats that over and above any endorsement that may be given to the conclusions of any one of these studies (and each study's estimate of the price effect of the subsidies), an increase in the world price of cotton would be significant, even if international price suppression or depression were to amount to only one per cent per pound, since such an increase would enable countries such as Brazil and Argentina to recover their competitive positions in the world cotton market.[34]

39. Finally, at no time does the United States seem to suggest that a suppression or depression effect of 12.6 per cent on international cotton prices is not "significant" within the meaning of Article 6.3(c). The Panel should therefore find that the subsidies in question have caused and still cause significant depression of cotton prices in the world market resulting in serious prejudice to Brazil's interests.

### II.3.2 "In the same market"

40. Contrary to what the United States has claimed[35], Argentina considers that Brazil has presented sufficient evidence with respect to the significant effect of subsidies on prices for each relevant geographical market, including the United States, Brazil, the African Countries, other producer countries and Brazilian export markets.

41. The United States provides no legitimate reason why the Panel should not consider the world market. As stated earlier[36], price movements of the United States, of the Cotlook "A" Index and third

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[32] *Idem*,paragraph 82.

[33] Further Submission of Brazil, 9 September 2002, Section 3.3.4.8.1.

[34] Second Written Third-Party Submission by Argentina, 3 October 2003, paragraph 34 to 36. See also Further Third-Party Submission of New Zealand (3 October 2003), paragraph 2.21: "*...As Brazil demonstrates even a 1 cent per pound price-suppressing effect can reduce world wide export revenue by 552 million dollars"*.

[35] Further Submission of the United States, paragraphs 90 to 92.

[36] See paragraph 17 above.

country (e.g. Brazilian and Argentine) market prices are directly interconnected, and this is an unquestioned and irrefutable fact.

42. Moreover, US cotton forms part of Cotlook's "A" Index basket, so that the Panel cannot ignore the fact that the US subsidies have a decisive impact on the price of cotton in the world market.

43. Indeed, this being the case, the amount of US subsidies granted to the cotton sector added to the scale of US production and exports is decisive when it comes to determining the extent to which the subsidies affect the fixing of both third market and world market prices.

II.3.3 Time period to be considered

44. Regarding the US argument that subsidies that have ceased to exist can have no "effect"[37], Argentina would like to recall the Panel's remarks in the *Indonesia-Automobiles* concerning the irrelevance of serious prejudice having been caused by programmes that are no longer in force. Upon examining whether the subsidies caused serious prejudice to the interests of the complainants, the Panel in the said case rejected the argument that the effects of an expired subsidy programme could not be considered.[38]

45. Moreover, Argentina considers that it is necessary to consider a sufficiently extensive period to reflect market trends, and a period of one year as suggested by the United States is not sufficient.[39]

**II.4 Interpretation of article 6.3(d)**

II.4.1 World market share

46. The United States errs in its interpretation of the expression "world market share" by trying to identify it with "share in world consumption".[40] If, as the United States contends, the expression "world market share" in Article 6.3(d) refers to the increase in consumption of the country granting the subsidy, it would be contrary to the object and purpose of Articles 5 and 6 of the SCM Agreement, namely to avoid adverse effects of subsidies to the interests of other Members.

47. Indeed, if there were an increase in the share in world consumption of the product subsidized by the Member granting the subsidy, this would very probably lead to an increase in the international price of the product in question, and hence, there would be no adverse effects for other Members. In other words, to identify "world market share" with "share of world consumption" would completely subvert the underlying rationale of Article 6.3(d).[41]

[37] Further Submission of the United States, paragraph 94.

[38] The Panel stated that: *"[W]e must assess the 'effect of the subsidies' on the interests of another Member to determine whether serious prejudice exists, not the effect of 'subsidy programmes'. We note that at any given moment in time some payments of subsidies have occurred in the past while others have yet to occur in the future. If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were 'expired measures' while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice.*" Panel Report on *Indonesia – Automobiles*, paragraph 14.206.

[39] See WT/DS219/AB/R, paragraph 80: *" … we understand a POI to provide data collected over a sustained period of time, which period can allow the investigating authority to make a dumping determination that is less likely to be subject to market fluctuations or other vagaries that may distort a proper evaluation"*.

[40] Further Submission of the United States, paragraph 97.

[41] See also Further Third-Party Submission of New Zealand, paragraph 2.34.

48. Moreover, if we take account of the immediate context of Article 6.3(d), i.e. footnote 17, which states *"unless other … rules apply* ***to trade*** *… "*, we have a clear indication that the expression "world market share" can only refer to the share in world exports.

II.4.2 Time period to be considered

49. Contrary to the US claim that the trend in the period considered is not consistent because it includes years in which the United States world market share decreased rather than increasing[42], the fact is that there will always be peaks and troughs in agricultural production and export for climatic and other reasons. This does not mean that a trend over the years cannot be "consistent".

50. In other words, the word "consistent" cannot be interpreted in such a way as to allow a decrease in world market share during a given year to invalidate a trend over several years. On the contrary, the word "consistent" should be interpreted in the context of the investigation period, disregarding the market variations.

### II.5 Threat of serious injury

51. Argentina considers that since Brazil has established the existence of serious prejudice caused by the US subsidies, the threat of serious prejudice is clearly foreseeable and imminent as a result of the even higher subsidies planned under mandatory US legislation for the marketing years 2003-2007. Consequently, Argentina maintains that Brazil has established a prima facie case that these subsidies threaten to cause serious prejudice to Brazil.

52. Argentina contends that this guaranteed flow of subsidies will unquestionably lead to a higher level of US cotton production and exports. This will inevitably result in price suppression and depression as well as an increasing and inequitable US market share for cotton, thus creating a source of permanent uncertainty that confirms the threat of serious prejudice generated by the subsidies.

53. Argentina further considers that the link between US cotton subsidies and the threat of significant price suppression and depression and of an increase in the US world market share for cotton stems from the fact that the future subsidies will be as necessary as the current ones for US producers to bridge the gap between market prices and their total production costs. This will enable US producers to continue competing with more efficient third country producers, especially considering that the USDA itself forecasts an increase in total production costs.[43]

## III. EXPORT CREDIT GUARANTEES

54. In its Further Submission, the United States reverts to its argument in connection with the negotiating history for the interpretation of Article 10.2 of the Agreement on Agriculture, maintaining that there are no disciplines regulating the use of export credit guarantees.

55. Argentina repeats what it stated in its oral submission of 24 July 2003, namely that Article 10.2 in no way provides an exception to the general disciplines on export subsidies, and in particular, to the applicability to Article 10.1. As Argentina has pointed out, *"if that had been the intention, then the negotiators would have expressly said so."*[44]

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[42] *Idem*, paragraph 101.

[43] See Annexes BRA-7 (ERS Data: Commodity Costs and Returns); BRA-257 ("Cost of Farm Production Up in 2003", USDA, 6 May 2003) and BRA-82 (USDA Agricultural Baseline Projections until 2012, USDA, February 2003, p.48).

[44] See Oral Third-Party Submission by Argentina, paragraphs 35 to 43.

## IV. CONCLUSION

56. For the reasons set forth both in this statement and in previous submissions, Argentina requests the Panel to issue the findings and recommendations requested by Brazil throughout these proceedings.

# ANNEX F-6

## ORAL STATEMENT OF BENIN

8 October 2003

Mr. Chairman, members of the Panel,

1. My name is Eloi Laourou from the Mission of Benin. I am joined by Mr. Nicholas Minot of the International Food Policy Research Institute in Washington, D.C., the co-author of the study that has been annexed to our Third Party submission, "Effect of Falling Cotton Prices on Rural Poverty in Benin". I will ask Mr. Minot to speak to you in a moment. The other members of our delegation are our legal advisers, Mr. Brendan McGivern and Mr. Stefan Ramel, both from White & Case.

2. As noted in our Third Party submission, this is the first time that Benin has participated in a WTO dispute. We have not taken the decision to participate lightly. Indeed, it was only the serious threat posed to the economic and social stability of our country by massive, WTO-inconsistent US subsidies on cotton that has led us to take this unprecedented step.

3. The cotton farmers of Benin are efficient producers. The World Bank has estimated that the cost of producing cotton in West Africa is about 50 per cent of the cost of production in the United States. Moreover, the cotton sectors of both countries have undergone considerable structural reforms.

4. Yet the economic efficiencies of our producers, and the painful reforms they have accepted, have in the end proved to be almost completely irrelevant. US subsidies have had a ruinous effect on the world price of cotton, which in turn has had devastating effects on the economies of West Africa.

5. US cotton subsidies do not just dwarf the cotton sectors of West Africa. They dwarf all economic activity in the region. As noted in our submission, the subsidies paid by the United States to its prosperous 25,000 cotton farmers exceed the gross national income of Benin, Chad, Burkina Faso, Mali, Togo and the Central African Republic.

6. Oxfam estimates that for the period from 1999/2000 to 2001/2002, Benin suffered a total cumulative loss of $61 million in export earnings. Mr. Chairman, this is not an abstract, anodyne statistic. This translates into genuine suffering on the ground, as hundreds of thousands of people, deprived of export earnings, are pushed from bare subsistence to absolute poverty. Indeed, Dr. Minot estimates that a 40 per cent reduction in farm-level prices of cotton has the effect of pushing an additional 334,000 thousand people below the poverty line in Benin.

7. This is an important point, one that should be considered carefully by the panel as it assesses the meaning of "serious prejudice" to one of the poorest countries in the world.

8. With your permission, I would now ask Mr. Minot to summarize briefly the results of his study on how depressed world prices for cotton translate into poverty in Benin.

Dr Minot:

9. Thank you for the opportunity to present the results of a study that I hope will be relevant to the dispute. Before I begin, I would like to provide some background. I am a Research Fellow at the International Food Policy Research Institute, a Washington-based international organization whose mandate is to generate information to address problems of hunger and poverty in developing countries. I received my Ph.D. in agricultural economics from Michigan State University and have worked on issues of agriculture in developing countries for more than 15 years, including four years living in sub-Saharan Africa.

10. From 1998 to 2000, I led a German-funded study of the impact of agricultural reforms on farmers in Benin. In collaboration with a local research firm, we carried out four surveys in Benin: surveys of farmers, traders, market managers, and village cooperatives. In 2002, I was contracted by the World Bank to use these survey data to examine the impact of falling world cotton prices on poverty in Benin. My co-author, Lisa Daniels, and I finished the report later that year and a version of it was distributed as an IFPRI working paper in November.

11. Cotton prices are affected by competition with synthetic fibres, weather-related supply shocks, the rate of growth in the global economy, and government policies, among other factors. Cotton prices are pushed below what they otherwise would be by government support to cotton growers. The International Cotton Advisory Committee estimates that worldwide direct assistance to cotton growers was US$ 4.9 billion in 2001/02. Of this amount, the United States accounted for US$2.3 billion, equivalent to 24 cents per pound of cotton produced. Other sources, using a broader definition of assistance, estimate that the government provides US$ 3.9 billion to the cotton sector.

12. Until 2002, US cotton policy consisted of various programs, including two (the marketing loan program and loan deficiency payments) that ensured that farmers receive at least 52 cents/pound. This has the effect of insulating US farmers from falling world prices. In 2001, in spite of low world prices, the US posted record cotton production and near-record export volumes. Furthermore, US subsidies to cotton have increased since these studies were carried out. The 2002 Farm Bill introduced target prices for the major commodities and programs that effectively pay US farmers most of the difference between market prices and the target price. For upland cotton, the target price is 72 cents/pound. In addition, by allowing farmers to update their "base acreage", the new policy provides incentives for farmers to expand production.

13. Several recent studies have attempted to assess the impact of subsidies on world prices. The Centre for International Economics in Canberra uses a five-region world model of fibre, textile, and garment markets in 2000-01 to simulate the impact of US and European subsidies on cotton production and export. They find that removing US and European subsidies to cotton growers would raise the world cotton price by 6 cents/pound or 11 per cent. Another study, carried out by ICAC, estimates that removing US production subsidies would have increased the world price by 11 cents/pound in 2001/02. And most recently, Sumner estimates that, in the absence of US subsidies, the world cotton price would have been 12.6 per cent higher over 1999-2002.

14. The adverse impact of lower cotton prices on export revenue and GDP in cotton exporting ations is clear, but does this translate into higher incidence of rural poverty? If cotton is grown mainly by larger farmers with relatively high incomes, then the effect of changes in cotton prices on rural poverty may be modest. Even if cotton is grown primarily by small farmers, the magnitude of the effect on rural poverty will be small if few farmers grow cotton or if it accounts for a small share of rural income. Assessing the direct impact of changes in cotton prices on rural poverty requires detailed household-survey data on incomes and expenditures.

15. The paper examined the impact of changes in cotton prices on rural poverty in Benin. In particular, it had two objectives:

- to describe the living conditions and level of poverty for cotton growers and other farmers in Benin; and

- to estimate the short and long-run impact of lower cotton prices on the income of cotton growers and on the incidence of poverty in rural Benin.

16. The Republic of Benin has a population of about six million, 59 per cent of whom live in rural areas. Its rural economy is based on maize, sorghum, millet, yams, cotton, and livestock production. The per capita gross national product is US$380, placing Benin among the poorest countries in the world. Indeed, the per capita income of Benin is lower than the average for sub-Saharan Africa.

17. In 1989, Benin entered a period of economic and political reform. It made a peaceful transition from a military government to a constitutional multi-party democracy. It also began to move from a quasi-socialist economy to a free-market economy. In the agricultural sector, state farms and cooperatives were disbanded, food crop prices and marketing were liberalized, and many state-owned enterprises were privatized or closed. In January 1994, the CFA franc was devalued by 50 per cent, effectively doubling the price of imports and the returns to exports. Although this imposed hardship on manufacturing firms and urban consumers, it stimulated the local production of cotton, rice, and other tradable goods.

18. In the past two years, Benin has greatly reduced the role of the state cotton marketing board, introducing competition in the distribution of inputs and the marketing of cotton. The fall in world cotton prices has led to political pressure for the government to support the domestic price or even to re-assume control of the sector to protect farmer interests. Cotton represents 90 per cent of agricultural exports and around 70 per cent of its total exports (excluding re-exports).

19. Because the reliability of the results depends heavily on the quality of the survey data, it is worth briefly describing the survey methods. The survey, called the *Enquête des Petits Agriculteurs* (EPP) or Small Farmer Survey, was carried out in 1998 by the IFPRI and a local research firm, the *Laboratoire d'Analyse Régionale et d'Expertise Sociale* (LARES). The survey used a 24-page questionnaire covering 16 topics. The households were selected using a two-stage stratified random sample procedure based on the 1997 Pre-Census of Agriculture. In total, one hundred villages were selected. In each village, nine households were randomly selected using household lists prepared for the pre-Census of Agriculture. Due to some variation in the number of households interviewed in each village, the final sample was 899 rural households. The interviews were carried out in local languages by two teams of Benin interviewers, supervised by staff from LARES and IFPRI.

20. In order to study poverty, we need to define it. In this analysis, the poor are defined as those living in households whose per capita expenditure is below the $40^{th}$ percentile in rural areas. Expenditure is used instead of income because it is more reliably measured and is a better measure of household well-being. It includes cash spending on consumption goods, the value of home-produced food, and the rental equivalent of owner-occupied housing. The resulting poverty line is equivalent to US$123 per person per year. It is worth noting that this is a low poverty line, far below the US$1 per day frequently used by the World Bank.

21. We simulated the impact of various percentage reductions in cotton prices on the incomes of rural households using the concept of producer surplus. The details of the calculation are shown in the paper, but these are standard formulas used in economic analysis. In the short run (before households respond to lower prices), the change in income of each household is simply the percentage

change in the value of cotton production multiplied by the quantity produced. In the long run, lower cotton prices will cause farmers to substitute away from cotton, so the impact is smaller. We simulated the impact of these cotton price changes in the short and long run on each of the 899 household in the sample to generate estimates of the impact on rural income and poverty.

22. Before turning to the simulation results, I will describe the role of cotton in the rural economy and the characteristics of cotton growers. According to the IFPRI-LARES survey, cotton is grown by roughly one-third of the farm households. Cotton accounts for about 18 per cent of the area planted by farm households and 22 per cent of the gross value of crop production. In value terms, cotton is the second most important crop, after maize. Among cotton farmers, the average area planted with cotton is 2.3 hectares, producing 2.7 tons of seed cotton. The value of this output is US$ 901 per cotton farm. Cotton accounts for about one-third of the value of crop sales (these figures are shown in Table 2 of our paper).

23. Cotton growers tend to have farms that are larger than other farmers, but they are similar to other farmers in terms of the poverty rate and average per capita expenditure. The larger farms do not translate into a higher standard of living because cotton production is concentrated in the north, which is more arid and has fewer opportunities for non-farm employment. It is not that cotton farmers are poorer than average, but rather that almost all farmers in Benin, including cotton farmers, are quite poor.

24. Turning to the simulations, the short-term impact of a 40 per cent reduction in the farm-gate price of cotton reduces the income of cotton growers 21 per cent. Taking into account the incomes of non-growers, which do not change in this simulation, the average income of rural households falls 7 per cent. Smaller reductions in the cotton price cause roughly proportional changes in income, as shown in Table 3 of our paper.

25. With a 40 per cent fall in the cotton price, the average incidence of poverty, including both cotton growers and other farmers rises 8 percentage points, from 40 per cent to 48 per cent. In absolute terms, this implies that about 334 thousand people would fall below the poverty line. A 40 per cent decrease in the price of cotton results in a 40 per cent increase in the depth of poverty ($P_1$) and a 61 per cent increase in the severity of poverty ($P_2$).

26. Does it matter what poverty line we use? By looking at the cumulative distribution of income with and without the price change, we can evaluate the sensitivity of the results to alternative poverty lines. As shown in Figure 2 in our paper, similar results would have been obtained for higher and lower poverty lines. The results are not very sensitive to the elasticity assumption.

27. In summary, our paper analyzed the impact of changes in world cotton prices on farmers in Benin. Both quantitative measures of per capita expenditure from household surveys and qualitative responses to our 1998 survey suggest that rural living conditions improved over the 1990s. Furthermore, farmers tended to attribute this improvement in rural living conditions to economic factors such as crop prices, availability of food, and access to non-farm employment. Although the causal link is difficult to establish with certainty, it appears the economic reforms of the 1990s (including the 1994 devaluation) and the growth of cotton production during this period contributed to a noticeable improvement in rural standards of living.

28. The link between world cotton markets and rural living conditions can, however, work gainst farmers as well. The analysis in this paper is based on the 39 per cent decline in the world price of cotton between January 2001 and May 2002. We combined farm survey data from 1998 with assumptions about the decline in farm-level prices to estimate the short- and long-term direct effects of cotton price reductions on rural income and various measures of poverty.

29. The results indicated that there is a strong link between cotton prices and rural welfare in Benin. A 40 per cent reduction in farm-level prices of cotton is likely to result in a reduction in rural per capita income of 7 per cent in the short-run and 5-6 per cent in the long-run. Furthermore, poverty rises 8 percentage points in the short-run, equivalent to an increase of 334 thousand in the number of people below the poverty line. In the long run, as household adjust to the new prices, the poverty rate settles down somewhat, remaining 6-7 percentage points higher than it was originally.

30. Furthermore, these estimates may well underestimate the actual effect of lower cotton prices on rural poverty in Benin. First, in an economy with unemployed resources and excess capacity, an external shock affecting income (such as a change in cotton prices) has a multiplier effect. Changes in cotton farmer income result in changes in demand for goods and services produced by their non-cotton-growing neighbours, which in turn influences their income and their demand for goods and services. Estimates for four countries in sub-Saharan Africa suggest that the multiplier is in the range of 1.7 to 2.2, meaning that the total effect on income (positive or negative) is 1.7 to 2.2 times greater than the direct impact.

31. Second, we assume that farm prices change by the same proportion as world prices. In competitive markets with a fixed marketing margin, the percentage change in farm prices will be greater than the percentage change in world prices. Until recently, the effect of changes in world prices on farm-level prices in Benin was muted by government regulation of the market which stabilized prices. Under market reforms being carried out in Benin and elsewhere in West Africa, markets are becoming more competitive and changes in farm prices will closely match changes in world prices.

32. Third, our estimates do not take into account other indirect effects associated with declining cotton production. An earlier analysis of the Small Farmer Survey data from Benin indicated that cotton farmers are three times more likely to apply fertilizer to their maize crops compared to non-cotton farmers. This is because growing cotton gives farmers access to fertilizer on credit, some of which they "divert" to their maize fields. The implication is that lower cotton prices will indirectly reduce the yields of food crops.

33. Overall, the results in this paper challenge the stereotype of the rural poor in developing countries as consisting of subsistence farmers that are relatively unconnected to, and thus unaffected, by swings in world commodity markets. At least in the case of Benin, to the extent that fluctuations in world cotton prices are transmitted to farmers, they will have a significant effect on rural incomes and poverty. The broader implication is that policies that subsidize cotton production in the United States and elsewhere, dampening world prices, have an adverse impact on rural poverty in Benin and (by extension) other poor cotton-exporting countries. Thank you, Mr. Chairman and members of the Panel.

Mr. Laourou:

34. Thank you for allowing Dr. Minot to present his paper, and for allow Benin to present its views.

35. This concludes our oral statement. We respectfully ask this Panel to find that the United States is in breach of its WTO obligations, including by causing serious prejudice to the interests of Benin and other Members. We would be pleased to answer any questions that you may have.

# ANNEX F-7

## ORAL STATEMENT OF CHAD

8 October 2003

Mr. Chairman, members of the Panel,

I am Abderahim Yacoub N'Diaye, the Ambassador of Chad to the WTO. The other members of my delegation are Mr. Mouata Nanrabaye, as well as our legal advisers, Mr. Brendan McGivern and Mr. Stefan Ramel, both from White & Case.

Chad stands by its written Third Party submission of 3 October 2003. In addition, I wanted to supplement this by reading to the Panel a recent statement by Mr. Ibrahim Malloum, who is both the President of the Société Cotonnière du Tchad, as well as the President of the African Cotton Association. Given his unique qualifications, I asked him to prepare a statement for this third party session. Unfortunately, however, he could not attend the hearing, since he had to be in Chad this week. However, his statement is of direct relevance to the issues facing the Panel, and so with your permission, Mr. Chairman, I would like to read it to you.

"Statement by Mr Ibrahim Malloum

**Introduction**

1. My name is Ibrahim Malloum. I am the President of the Société Cotonnière du Tchad, commonly known as Cotontchad. Cotontchad is a public/private organization that controls the production and marketing of cotton in Chad. Cotontchad is responsible for supplying farmers with inputs on credit, purchasing and collecting the harvested seed-cotton, ginning the crop into upland cotton lint, as traded internationally, and finally selling the finished product. Cotontchad is required to purchase all cotton produced by Chad cotton farmers. In addition, Cotontchad is responsible for selling and marketing the cotton produced by more than 2.5 million people in Chad involved in the production of cotton.

2. I am also currently President of the African Cotton Association (ACA). The ACA was formally created during a summit meeting of African cotton producers in Cotonou, Benin, in September 2002. It includes all the West, Central and East African producers, ginners and merchants. Many international merchants, shipping companies, and banks are also members of this Association. The ACA's goals are to defend and promote African cotton in the world market and to encourage knowledge sharing among African cotton producers.

3. I have been involved with selling and marketing cotton for more than 18 years for Cotontchad, during which time I have been involved in all the cotton activities:

- I was in Memphis Cotton School in 1985.
- From the end of 1997 to 1999 I was the General Manager of Cotontchad.
- When I was General Manager I was in charge of supplying the farmers with fertilizers, and pesticides; we buy all the production from farmers, we gin the cotton, we classify and export the cotton.

- Today I am in charge of marketing all Chad cotton production around the world. I am thus selling in more than 30 countries (Europe, Far East, Africa and South America.).

- Our selling prices are based on the international prices driven by the New York Cotton Futures Market and the Liverpool "A" Index.

**Cotton in Chad**

4. Cotton is essential to the livelihood of more than 2.5 million people in Chad. It has been the major cash crop and driver of Chad's economy dating back to the 1920s and continues to be today. Cotton represents 25 per cent of Chad's export earnings and 5.1 per cent of its GDP.

5. Chad has about 8.1 million inhabitants of which over 2.5 million are in one way or the other involved in the production of cotton. Cotton is typically produced on small family farms that lack mechanization and modern equipment, and electricity. Irrigation is completely reliant on rain and all harvesting is done by hand. Many farms are not even accessible by road. Despite these handicaps, production costs are approximately between 54 and 58 cents per pound. This is approximately one-half of the costs of producing cotton in the United States.

6. In order to streamline the production of cotton, farmers are organized into roughly 5,000 Village Associations (Associations Villageoises), each comprising about 100 households of both cotton and non-cotton producers. These Associations Villageoises also provide some basic social structure for about 80 per cent of Chad's eight million people who live in rural areas and that depend on subsistence farming. Normally cotton production in each Association Villageoise is a group effort with everyone in the community contributing to the production process. The cotton harvest and the amount produced is a source of both pride and prestige in each Association Villageoise.

**The Role of Prices for Chadian Cotton**

7. As already mentioned, Cotontchad plays a central role in the production of cotton in Chad. The production cycle of cotton in Chad starts when each Association Villageoise requests input supplies from Cotontchad's field agents or "interface", based on their planned land cultivation. Cotontchad then allocates inputs to each Association Villageoise on credit using future cotton harvests as collateral. The amount of inputs acquired and distributed is influenced directly by the prices that are able to be obtained by Cotontchad in its international sales. When prices are low, as they were during 2001-2002, Cotontchad cannot afford to provide all of the imports demanded by the Associations Villageoises. This in turn reduces the amount of cotton produced by each Association Villageoise and in Chad in general. When prices increase, more inputs are purchased which are then provided to each of the Association Villageoise and causes cotton production – and incomes generated by those Associations – to increase. Thus, higher prices obtained in international markets directly impacts the amount of present and future income received by cotton producers in Chad.

8. Cotontchad purchases upland cotton from each Association Villageoise at its 2,500 nation-wide weigh stations. The price received by the producers is a countrywide uniform price that is set each year by a committee representing both farmers and Cotontchad. The price determined by the committee is a function of the price received by Cotontchad in its physical sales of cotton. Cotontchad can only offer a price to the farmers that is consistent with the international market price.

9. Cotontchad then transports the upland cotton to its nine ginning stations to be sorted, ginned and commercialized. Finally Cotontchad sells the finished cotton in physical markets on the spot and forward market. Cotontchad markets its cotton on both an immediate (spot) and on a forward contract

basis. I am the principal negotiator for sales of Chad cotton. In marketing cotton, I provide information to a number of purchasers concerning the availability of Chad cotton. In some countries (Europe, Japan, and partially India) Cotontchad uses the agent channels to sell directly to the spinning mills. In other countries, we sell directly to the international merchants. We fix prices in relation with New York Future prices, Liverpool "A" index and also in relation to the competition prices offered in the market. Everyday we inform our agents and merchants of the available quantities and the prices of the different qualities we are offering.

10. In negotiations for the spot market or immediate shipment of cotton, the price negotiation involves reference to the current N.Y. futures contract price as well as the A and B-index prices. I will always make reference to the N.Y. futures price if prices are increasing and the N.Y. futures price is higher than the A-index price.

11. The New York Cotton futures market is the main cotton market place in the world. It goes without saying that the cotton price is dictated by New York. All the business men can forecast the index "A" by looking to what New York did the night before.

12. The vast majority of cotton produced in Chad is exported (about 95 per cent). Cotton produced in Chad is in direct competition with other regional and foreign exporters of cotton. The extremely small world market share of Chadian cotton exports (about 1 per cent) invariably makes Chad a price taker.

**The United States and Its Influence on World Cotton Prices**

13. The United States' production of upland cotton has a large influence on the world market price for cotton. All traders of upland cotton keep a close watch on developments in the United States. As the largest exporter of cotton, the United States supplies more than 40 per cent of cotton sold in international sales. The United States is by far the largest exporter of upland cotton. Because of the large size of the US production and exports, when stocks of US cotton for sale decrease because of weather problems in the United States, then the world price of upland cotton invariably increases. This is normally first reflected in increased N.Y. futures prices and then later by increases in prices in the A-Index. On the other hand, when US production of upland cotton increases because of increased land planted to cotton or because of favourable weather conditions, then the increased stocks of US upland cotton in the world markets press world prices lower. I have seen this process repeatedly over the years that I have been trading upland cotton on world markets. In my view, it is obvious that if the US producers did not have access to very large subsidies, they would plant less cotton and world upland cotton prices would increase. There is no doubt in my mind that the large US subsidies keep world prices lower. This includes prices received by Chad cotton.

14. To give the Panel some idea of the impact of the large US exports, I frequently encounter during negotiations purchasers who indicate that they can purchase US cotton at a price lower than what I am seeking to obtain in negotiations. These purchasers frequently tell me that US upland cotton is available to them at a lower price because of the US Step 2 payments. These payments are well known in the industry and are reported in trade publications. The Step 2 payments for US cotton allows exporters selling US cotton to underbid my bids when I am in direct competition for sales. This has happened to me on a number of occasions. Again, the result is lower prices for cotton that I am able to negotiate for Cotontchad.

**Suppressed Cotton Prices and Their Effect on Chad**

15. I would tell you that the low prices received by Chad producers contributes to poverty in Chad. The description of what happened in Benin is the same as what has been happening in Chad. Cotton for most Associations Villageoises in Chad is the only source of outside income. Therefore Chadian schools, hospitals and local governments rely directly on money received from cotton sales. The cotton industry in Chad is still trying to recover from record low prices from 2001-2002. While prices are now increasing, prices will have to increase considerably more to make up for the unprecedented crisis caused by extremely low prices last year. In my view, the continuing high levels of US production are still depressing world prices. I look forward to the day when I do not have to compete with US upland cotton for every sale. Increased prices will allow Chad producers and Chad communities to obtain additional income and improve the life of our very poor people".

Thank you for your attention. I would be happy to answer any questions you may have.

# ANNEX F-8

## ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

8 October 2003

### 1. Introduction

1. The European Communities (the "EC") welcomes this opportunity to submit orally its views to the Panel.

2. The EC has already submitted in writing its views with respect to Brazil's further submission of 9 September 2003. Today, the EC will provide its comments on the further submission of the United States of 30 September 2003. Many of the issues raised in the US submission concern factual matters. The EC will limit itself to address three of questions of legal interpretation. Specifically, the EC will argue in this Statement that:

III. the crop insurance payments made by the United States would be "specific" in so far as it can be established that different insurance policies result in different benefits being conferred with respect to different products;

IV. the issue of whether green box payments can cause "serious prejudice" within the meaning of Article 5(c) of the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement") does not arise in this dispute;

V. the term *same market* in Article 6.3 (c) may refer to any geographical market, including also the world market, provided that there is such a world market for the product under consideration.

3. Before addressing these issues, the EC would like to put on record its agreement with the United States with respect to a number of questions on which it does not consider it necessary to submit additional arguments:

VI. the EC agrees with the US interpretation of the term "world market share" in Article 6.3(d) of the *SCM Agreement*;

VII. the EC endorses the U.S. interpretation of the term "more than equitable share" in Article XVI:3 of the GATT;

VIII. the EC also agrees with the US position that Brazil's first standard to establish the existence of "threat of serious prejudice" for the purposes of Article 5(c) of the *SCM Agreement* is incorrect;

IX. finally, the EC agrees with the United States that the *Agreement on Agriculture* (the "AA") excludes the application of Article III:4 of the GATT and of Article 3.1 (b) of the *SCM Agreement* to subsidies "in favour of agricultural producers" which are paid to the processors.

4. On the other hand, the EC would like to restate its disagreement with the US position that Article 10.1 of the AA does not apply to export credits and guarantees.

**2. Specificity of crop insurance payments**

5. The United States contests Brazil's claim that the subsidies allegedly provided in the form of crop insurance payments are specific. The United States argues that crop insurance is not "specific" because it is available, in one way or another, with respect to all agricultural products.[1]

6. The EC understands, however, that different crop insurance policies apply to different agricultural products.[2] If such differences had the consequence that some agricultural products will receive a benefit in circumstances where other products will receive no benefit, or only a smaller benefit, the difference would be clearly "specific".

**3. Green Box subsidies**

7. The United States argues that Brazil has failed to make a prima facie case that the payments for which it claims green box status cause serious prejudice. The United States recalls that paragraph 1 of Annex 2 of the AA makes clear that green box payments have no, or at most minimal, trade-distorting effects and that, under Article 21.1 of the AA, the *SCM Agreement* applies "subject to" the AA.[3]

8. This is correct. But this argument does not appear to be relevant in the context of this dispute. If the payments at issue meet all the criteria of Annex 2, they would be exempted from action under the *SCM Agreement* in accordance with Article 13 (a)(i) AA. If not, the United States could not invoke their conformity with Annex 2 and Article 21.1 in order to argue that they have no or minimal trade-distorting effects. Logically, the issue raised by the United States could arise only in the absence of the peace clause, or if the peace clause had expired at the initiation of this dispute.

**4. The meaning of "same market" in Article 6.3 (c)**

9. The United States contends that the term "same market" in Article 6.3 (c) cannot be interpreted to include the world market, because that would render redundant the word "same".[4] The EC disagrees. In accordance with its ordinary meaning, the term "market" may refer to any geographical market, including not only national or regional markets but also the world market, provided that there is such a world market for the product under consideration.

10. The US argument is based on the assumption that there will always be a world market for any given product. That assumption is incorrect. In order to characterise a certain geographical area, whether it is the territory of one or more Members or the entire world, as a "market" it must be shown that the conditions of competition prevailing within that geographical area are sufficiently homogenous. If there are significant trade barriers between Members, or between groups of Members, with the consequence that conditions of competition are significantly different within each Member or group of Members, it will not be possible to consider that there is a world market for the purposes of Article 6.3(c), but only national or regional markets.

[1] US further submission, para. 14.
[2] Ibid., para. 15.
[3] Ibid., para. 72.
[4] Ibid., paras. 90-92.

# ANNEX F-9

## ORAL STATEMENT OF INDIA

8 October 2003

1. We thank you for giving us the opportunity to present India's views in this third party session. India is the third largest producer of cotton in the world and has the highest area under cotton cultivation in the world. India has a substantial trade interest as well as systemic interest in this dispute. In the first part of this session on 24 July 2003, we had presented some views on the three US subsidy programmes that we consider as violative of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). Today we wish to present our views on the term 'serious prejudice' used in Article 6.3 of the Agreement.

2. The measures challenged by Brazil in its claims of *present* serious prejudice include the payment of subsidies through various programmes which include marketing loan payments, counter-cyclical payments, direct payments, production flexibility contract payments, market loss assistance payments, crop insurance subsidies, Step 2 payments, and GSM 102 export credit guarantees. The legal instruments providing these subsidies include the 1996 FAIR Act, the 2002 FSRI Act and the 2000 ARP Act as well as various appropriations bills for Marketing Years (MY) 1999-2002.

3. The subsidies given by US at issue are explicitly limited to certain enterprises or industries. None of the subsidies at issue are widely available throughout the US economy across industries. Eligibility for the domestic support and export subsidies at issue in this dispute is either "explicitly" limited to the subset of the US industry producing *agricultural crops*, to subgroups of industries producing *certain* agricultural crops, or to *only* upland cotton. None of the subsidies are available for any non-agricultural product. Thus the subsidies given by US to cotton are "specific" as understood under the SCM Agreement.

Mr. Chairman, Members of the Panel,

4. For establishing serious prejudice caused by the subsidies given by the US to cotton, Brazil has provided numerous facts that independently as well as collectively demonstrate the causal link between these subsidies and significant price suppression in upland cotton markets in MY 1999-2002.

5. It has been demonstrated, *inter-alia* through the analysis of Professor Daniel Sumner, details of which are available in Section 3.3.4.8.2 of Brazil's Further Submission to the Panel, that in terms of significant price suppression, removal of the subsidies given by the US would increase the A-index prices by an average of 12.6 per cetn or 6.5 cents per pound between MY 1999 and 2002. Brazil has demonstrated that the subsidies given by the US during MY 1999-2002 cause *present* significant price suppression within the meaning of Article 6.3(c) of the SCM Agreement in the Brazilian and world markets, including in markets where both Brazilian and United States producers export, and thus cause serious prejudice.

6. The average rate of subsidisation of cotton in the US during MY 1999-2002 as revealed in the Table at page 4 of Brazil's Further Submission was as high as 95 per cent. These subsidies, therefore, almost entirely constitute the farmers' incomes and have a major impact on farmers' production decisions. Producers of upland cotton in the United States are thereby largely insulated from the effects of the market. Thus, even when prices for upland cotton were falling, and the value of the United States dollar and costs of production were rising, production and exports of upland cotton by

the United States increased significantly. Similarly, the acreage under upland cotton in the US increased by 13.5 per cent between MY 1998 and MY 2001. Thus, in our view, Brazil has made a prima facie case of having suffered "serious prejudice" on account of the subsidies given by the US to cotton.

7. In its Further Submission, the United States has argued that after Brazil demonstrates that one or more of the effects of the subsidy mentioned in Article 6.3 is applicable, Brazil must then further demonstrate that the "prejudice" caused by the effects of the subsidy were "serious" enough to constitute "serious prejudice" within the meaning of the term in that Article. The argument of the United States appears to be based on the use of the words "may arise" in Article 6.3 as against the use of the words "shall be deemed to exist" in Article 6.1. The US seems to conclude that serious prejudice need not arise even if one or more of the effects of the subsidy listed in Article 6.3 is found. The United States goes on to infer from this difference in language that a complainant, in addition to demonstrating the existence of one of the listed effects, must also meet a separate "serious prejudice" standard – the content of which is undefined by the SCM Agreement.

8. In India's view nothing more than the demonstration that one of the effects enumerated in Article 6.3 exists is necessary to arrive at a finding of "serious prejudice". Subsidies listed under Article 6.1 are *deemed* to cause serious prejudice, hence such a presumption is rebuttable under Article 6.2 if the subsidy does not result in any of the effects enumerated in Article 6.3. No such rebuttal is envisaged under Article 6.3. There is, thus, no obligation under the SCM Agreement to demonstrate serious prejudice separately after establishing that one of the effects of a subsidy listed under Article 6.3 applies, as the effects listed in Article 6.3 themselves equate to serious prejudice. This interpretation is also confirmed by a reading of Article 6.2, which equates serious prejudice to effects listed under Article 6.3. India disagrees with the US interpretation of Article 6.3.

9. In conclusion, Mr. Chairman and Members of the Panel, India holds the view that the subsidies given by the US on upland cotton are specific, causal link exists between these subsidies and the significant price depression, and these subsidies given by the US have caused serious prejudice within the meaning of the term in Article 6.3 of the SCM Agreement.

# ANNEX F-10

## NEW ZEALAND'S ORAL STATEMENT

8 October 2003

1. Mr Chairman, Members of the Panel, New Zealand's Further Submission to the Panel of 3 October outlines New Zealand's support for the claims made by Brazil and its views on the issues raised in the Further Submission of the United States. The evidence brought by Brazil in support of its claims is overwhelming and conclusive.

2. New Zealand's submission, and our statement today, focuses in particular on Brazil's demonstration that the United States subsidies cause significant price suppression within the meaning of Article 6.3(c) of the *Agreement on Subsidies and Countervailing Measures* (or the *SCM Agreement*). Evidence brought by Brazil shows that the United States subsidies suppressed A-index prices by an average of 12.6 per cent over MY 1999-2002. That means a total amount of lost revenue for Brazilian producers of $478 million and suppressed revenue worldwide of $3.587 billion.

3. The United States has produced no evidence or argument to rebut this claim. Instead the United States points to a number of factors that it says caused prices for upland cotton to fall. However, those factors are entirely irrelevant to the issue of whether the United States subsidies cause significant price suppression. Nothing in the *SCM Agreement* requires a complainant to show that the subsidies at issue are the sole or major cause of prices falling in order to demonstrate serious prejudice.

4. In fact, the *SCM Agreement* does not even require prices to fall for there to be price suppression. As demonstrated by Brazil, price suppression can occur even when prices are rising. All a complainant is required to show to satisfy Article 6.3(c) is that significant price suppression is caused by the subsidies at issue. Brazil has done that, and the econometric models Brazil has used have not been challenged by the United States. Furthermore, those models isolate the effects of the subsidy from other factors, and thereby ensure that the effects of other factors affecting cotton prices are not attributed to cotton subsidies.

5. By contrast, the United States advocates an interpretation of Articles 5 and 6 that would completely undermine their objective, which is of course to allow WTO Members to act when adversely affected by other Members' use of subsidies.

6. In particular the United States draws the wrong conclusion from a comparison of Article 6.1 and Article 6.3, namely that it is not sufficient for a complainant to show that one of the effects set out in Article 6.3 exists for there to be serious prejudice. A closer look at the substance and nature of those provisions in the broader context of Articles 5 and 6 makes it clear that once a Member has demonstrated the existence of significant price suppression within the meaning of Article 6.3, there is serious prejudice. We note that the EC agrees with this interpretation in its Further Third Party Submission. New Zealand has described in detail in its Further Submission why the United States interpretation of Article 6 should be rejected.

7. The United States takes a similar approach to interpretation of the phrase "significant" in Article 6.3(c). The United States approach would require "significant price suppression" to be demonstrable solely by reference to some arbitrary level of numeric significance. Yet the United States does not suggest what level of significance would be appropriate in the present case, nor

does the United States go so far as to suggest that 12.6 per cent is not "significant". The United States offers no explanation at all of how "significance" is to be determined under its proposed approach. This is perhaps because such an approach is unworkable in practice.

8. Whether or not price suppression is significant within the meaning of Article 6.3(c) will depend on the circumstances of the case. And such a determination must be anchored in the overall context of consideration of the adverse effects of the subsidy if the *Agreement* is to operate as Members intended it to. Thus Brazil's approach of considering whether the level of price suppression is "meaningful" in its effect is entirely appropriate and workable, and offers the best means of ensuring that Article 6.3(c) is effectively and consistently applied.

9. These are but two examples of attempts by the United States to read into the *SCM Agreement* additional requirements that are simply not there and distort the requirements that are there. If accepted, such interpretations would make it virtually impossible for Members to show the existence of serious prejudice. Such an erosion of the rights negotiated by Members under the *SCM Agreement* cannot be permitted.

**Threat of Serious Prejudice**

10. New Zealand's Further Third Party Submission also outlines why the Panel should find that the United States subsidies create a threat of serious prejudice to the interests of Brazil in the future. The fact that Brazil's interests are already suffering serious prejudice as a result of the United States subsidies leads to a strong presumption that they will continue to do so. United States legislation requires the continued provision of the subsidies irrespective of whether or not they have adverse effects on other Members. The present case involves a level of subsidisation of, on average, 95 per cent, with a dollar value of US$12.9 billion, being provided by a country that currently has a 41.6 per cent share of the world market for upland cotton The threat of future serious prejudice is therefore a real one.

11. In addition to the points addressed in New Zealand's Further Submission, New Zealand takes this opportunity to record its views on two further issues raised by the United States.

**Crop Insurance**

12. The first is the United States argument that crop insurance payments fail to meet the requirement for specificity in Article 2 of the *SCM Agreement*. As demonstrated by Brazil, the crop insurance subsidies to upland cotton producers enhanced United States upland cotton production. The payments act as a direct production stimulant by keeping marginal upland cotton land in production. Professor Sumner's analysis concludes that in the period MY 1999-2002 United States crop insurance subsidies resulted in suppression of world prices by 1.2 per cent.

13. Brazil has demonstrated that the crop insurance programme is limited to certain enterprises and thus is not generally available but is effectively available only in respect of crops. The crop insurance programme is therefore specific within the meaning of Article 2 of the *SCM Agreement*.

**Step 2 domestic payments**

14. Second, New Zealand wishes to elaborate its view in support of Brazil's claim that the Step 2 domestic payments are prohibited subsidies under Article 3.1(b) of the *SCM Agreement* and GATT Article III.4. There is no basis upon which to claim that the *Agreement on Agriculture* gives Members a right to use whatever domestic support they wish with complete impunity from action under other WTO Agreements. The *Agreement on Agriculture* is silent on the issue of local content subsidies. Such silence cannot be taken as creating an "entitlement".

15. Nor does New Zealand accept that Members could have so encroached on the fundamental GATT principle of national treatment any way other than explicitly and expressly. The United States has been unable to demonstrate that Members intended, through the *Agreement on Agriculture*, to effectively waive their rights under GATT Article III in respect of agricultural products. Nor is there any evidence that Members traded those rights in return for reduction commitments on domestic support. Where there was a trade-off was between the application of Articles 5 and 6 of the *SCM Agreement* (for a limited period of time) and reduction commitments, as set out explicitly in the peace clause. There is no such trade-off in the peace clause for Article 3.1(b) of the *SCM Agreement*.

16. Paragraph 7 of Annex 3 of the *Agreement on Agriculture*, relied upon by the United States and EC as evidence that the *Agreement* authorises the use of local content subsidies, provides no basis for such a conclusion. All paragraph 7 does is recognise that it is possible for measures directed at agricultural processors to benefit the producers of basic agricultural products. For example, a government may pay a subsidy to a processor which it is required to pass on to the domestic producers. This can occur without affecting the competitive relationship between imports and domestic production. The measure would be consistent with Article 3.1(b) of the *SCM Agreement* and GATT Article III, and the support rightly counted against the Member's AMS. Nothing in paragraph 7 suggests that it should be interpreted as referring to domestic content subsidies, let alone that it authorises them in contravention of Article 3.1(b) of the *SCM Agreement* or GATT Article III.

**Conclusion**

17. In conclusion, New Zealand considers that Brazil has presented the factual evidence necessary to substantiate its claims under the *SCM Agreement*. Brazil has also demonstrated that the United States cannot avail itself of protection under the peace clause. The interpretation advanced by the United States of the provisions of the *SCM Agreement* would render actionable subsidies inactionable, thereby undermining the carefully negotiated balance of rights and obligations in the *SCM Agreement* and the *Agreement on Agriculture*. New Zealand therefore requests the Panel to make the findings and recommendations requested by Brazil.

# ANNEX G

## FURTHER REBUTTAL SUBMISSIONS OF PARTIES

# ANNEX G-1

## EXECUTIVE SUMMARY OF BRAZIL'S FURTHER REBUTTAL SUBMISSION

1. Brazil responds in its Further Rebuttal Submission to various arguments raised and evidence presented by the United States in earlier stages of this proceeding.

2. Brazil presents new evidence in rebuttal of US assertions that it has failed to demonstrate that contact payments were paid to current producers of upland cotton in MY 1999-2002. This evidence is in the form of USDA payment data obtained and analyzed by the Environmental Working Group (EWG) concerning, *inter alia*, upland cotton and other crop base contract payments between MY 2000-2002, as well as upland cotton marketing loan payments. The EWG database matches the upland cotton recipients and farms receiving each type of payment. It shows that the great majority of upland cotton producers grew upland cotton on upland cotton base acreage. It also shows that upland cotton producers received approximately three-quarters of all upland cotton contract payments between MY 2000-2002. Additional contract payments supporting upland cotton are found by attributing contract payments on non-cotton base acreage. While the EWG data underestimates the amount of contract payments in support of upland cotton, it nevertheless corroborates and supports Brazil's "14/16" methodology. Moreover, this data is also consistent with the large body of evidence demonstrating that upland cotton producers receive, rely on, and need upland cotton contract payments to make "ends meet."

3. Better evidence of the amount of contract payments in support of upland cotton would come from an examination of the amount of upland cotton currently planted on upland cotton (or other) contract acreage. This evidence is collected and exclusively in the control of the United States. Brazil rebuts the US assertions that it does not collect or maintain information permitting it to respond to the Panel's Question 67bis or to Brazil's repeated requests for information regarding the amount of contract payments received by current producers of upland cotton. In fact, the United States has access to all of the farm-specific and commodity specific commodity acreage and payment data from both current upland cotton producers as well as holders of crop base under contract payment programmes that would permit it to (1) provide a close approximation of the PFC and market loss assistance payments to current upland cotton producers in MY 1999-2001, and (2) provide the precise amount of direct and counter-cyclical payments to current upland cotton producers in MY 2002. Brazil requests the Panel to ask the United States, for the third time, to produce this information.

4. In the absence of information within the exclusive control of the United States, the information on marketing loan and contract payments in the EWG database, together with the considerable other evidence presented by Brazil, is the best information available to assist the Panel in making the determination concerning the amount of "support to upland cotton" for the purposes of the peace clause.

5. Regarding Brazil's price suppression and increase in world market share claims under Articles 6.3(c) and 6.3(d) of the SCM Agreement, Brazil first responds to US arguments that only variable costs are relevant to any cost of production analysis. This is the wrong legal as well as economic benchmark. Brazil notes the Appellate Body's decisions in the *Canada – Dairy (21.5)* disputes held that a cost of production analysis should focus on *total*, not *variable*, costs. That is, only an analysis of the total cost of production takes account of the economic resources the producer

invests in the product. The Appellate Body's jurisprudence on this issue reflects the economic reality that, over the long term, producers have to recover *all* their costs and make profits to stay in business. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source.

6. USDA cost data shows that US producers would have lost $871 per acre if they had grown upland cotton without subsidies between MY 1997-2002. With subsidies, these upland cotton producers made a per-acre "profit" of $120 over the six-year period. Further, most of the fixed costs of US producers must be covered over a long-term six-year period, or upland cotton producers would be forced to halt production. This evidence supports the close causal link between US subsidies and continued high levels of US upland cotton production and exports, as well as suppressed prices. These facts demonstrate the veracity of the National Cotton Council's Chairman's statement that US upland cotton producers "can't exist without subsidies".

7. The United States' argument that a cost of production analysis may be limited to variable costs defies all economic logic. This is particularly true in light of the items that the United States counts towards fixed costs, including hired labour, opportunity cost of unpaid labour, capital recovery of machinery and equipment, opportunity cost of land, taxes and insurance, and general farm overhead. These facts confirm the common sense notion that without the US subsidies, a significant portion of the US upland cotton production would not be economically viable and would not be produced.

8. Brazil rebuts US arguments that US subsidies had no price-suppressing effects by demonstrating the close relationship between increases or decreases in world cotton stocks and A-Index prices. USDA's own economists estimate that US subsidies increased US upland cotton world supply by 1.9 million bales in MY 2000 and 4.3 million bales in MY 2001. Because the United States has admitted that the injection of 11.6 million bales of Chinese government stocks into world supply between MY 1999-2001 depressed prices, it is not surprising that USDA economists, as well as Professor Sumner, found that the addition of similar quantities of US subsidy-generated upland cotton had similar price-suppressing effects. Moreover, if Chinese Government sales of stocks significantly depressed prices, as the US claims, then withdrawing a similar amount of US upland cotton during the same period certainly would significantly increase prices.

9. In addition, market experts predict that a 14 million bale US crop in MY 2004 (resulting from a potential crop failure) would have a significant impact in MY 2004 on increasing the New York futures price – and the world (and Brazilian) price of cotton. Brazil demonstrated the interconnected nature of world upland cotton market and the direct relationship between large US subsidies in sustaining US production and in lowering world and Brazilian prices.

10. Brazil rebuts US arguments that the appreciation of the US dollar does not demonstrate any causal link between US subsidies and increased US world market share and suppressed prices. Using data from Exhibit US-69, Brazil demonstrates that there has been a dramatic increase in the appreciation of the US dollar against a cotton-trade weighted basket of currencies of other world cotton producers by 154 per cent between the period 1996-2003. US exports – instead of falling as predicted by USDA economists – almost doubled.

11. The impact of the subsidies on international cotton trade is best assessed by analyzing the cotton trade-weighted exchange rate for cotton-exporting countries in general. This where the competition exists and where the impact of exchange rate movements on the competitiveness of countries should be found. With their currencies depreciating dramatically against the US dollar, US competitors should have been able to increase their market share and their exports compared to high-priced and high-cost US exports of the same commodity product. But since these competitors do not

have access to subsidies averaging 95 per cent of the value of their production, as a result, these competitors saw their exports and world market share reduced.

12. Brazil responds to US arguments that US producers are responsive to changes in futures prices at the time of planting. Brazil demonstrates that average January-March futures prices *declined* between MY 1998-2002, while US planted acreage *increased.* This is exactly opposite of what would be expected without the effect of US subsidies (that *increased* significantly during the same period). All of the analysis presented by Brazil is consistent with Congressional testimony by USDA's Chief Economist Keith Collins that there is little supply (i.e., planted acreage) response from US upland cotton farmers because of the subsidies they receive.

13. Further, the 72.4 cents target price support level available to US upland cotton producers in MY 2002 meant that US producers could not expect to receive higher revenue even if prices increased throughout MY 2002. In fact, US planted acreage declined in MY 2002 because some US upland cotton producers had suffered significant losses even with US subsidies, as they could not recover their cost of production.

14. Brazil responds to US legal arguments seeking to impose countervailing duty concepts in adverse effects claims by demonstrating that there is no textual basis in either Article 1 or Part III (adverse effects) of the SCM Agreement for the imposition of "pass-through," "value of subsidy**",** "subsidized product" or "tied-untied" methodologies. Unlike a countervailing duty investigation, it is the cumulative effects of the US subsidies that are the focus of price suppression and increase in world market share claims under Articles 6.3(c ) and (d) of the SCM Agreement. The current US position is directly contrary to its arguments in Indonesia – Automobiles, where the United States rejected Indonesian efforts to have the Panel examine each subsidy of the National Car Programme" individually.

15. The focus of Articles 5 and 6 of the SCM Agreement is on the effect of the subsidies in suppressing prices or increasing world market share. These cumulative effects of a variety of US subsidies caused price suppression and an increase in the US world market share between MY 1999-2002, and will continue to do so through the end of MY 2007.

16. Contrary to the US argument to sustain its serious prejudice claims, Brazil does not have to prove "that the 'prejudice' caused by the effects of the subsidies were 'serious'". Brazil's interpretation of the chapeau of Article 6.3 of the SCM Agreement does not read "may" to mean "shall". Rather, the term "may" refers to various situations in which the four enumerated types of serious prejudice exist but are not actionable.

17. Brazil highlights the collective effects of the US subsidies by noting that numerous econometric studies that Brazil has presented to the Panel, all conclude that US subsidies significantly increase US production and suppress US and world prices. Moreover, no study has ever found that the US subsidies to upland cotton would not have a significant production and export-enhancing as well as a price-suppressing effect.

18. Furthermore, Brazil rebuts US arguments that Professor Sumner's results, using the November 2002 FAPRI baseline misrepresent the real effects. Brazil demonstrates that using the most recent January 2003 FAPRI baseline, Professor Sumner's results also show significant production and export-enhancing and price-suppressing effects. Brazil further argues that a USDA study and an IMF study that the United States claims show that Professor Sumner's analysis was inflated are, in fact, consistent with Professor Sumner's findings.

19. Therefore, the US assertion that Professor Sumner's results are grossly overstated due to the use of a baseline projecting artificially low upland cotton prices is false. Whether the results of the modified or the original model and whether the November 2002 or the January 2003 baseline are used, continue to fully support that the US subsidies cause significant price suppression and an increase in the US world market share, as well as that those subsidies caused the United States to have more than an equitable share of world export trade.

20. Brazil further demonstrates the causal link between US subsidies and price suppression and increased exports by showing that the individual effects of the various US subsidies increase US production and exports, and result in suppressed prices. USDA and other economists are unanimous in finding that marketing loan payments to upland cotton created significant production- and export-enhancing and price-suppressing effects during the period of investigation. The effect of this subsidy alone caused serious prejudice to the interests of Brazil in MY 1999-2002.

21. Furthermore, USDA economists also found that crop insurance subsidies for upland cotton have far more production-enhancing effects than for other crops.

22. The National Cotton Council and cotton market experts have repeatedly emphasized the importance of the Step 2 subsidy in stimulating US production and exports. Brazil has provided compelling evidence that the Step 2 subsidies are trade- distorting and have caused increased US upland cotton exports and suppressed world prices.

23. Lastly, Brazil rebuts the United States so-called "literature review" for contract payment subsidies by pointing out that none of the studies addresses the specific situation of upland cotton during the period of investigation, none focuses on the impact of the restrictions on planting fruits and vegetables, none examine the impact of the updating of the base acreage and yield in 2002, and none focuses on the production effects caused when CCP payments are triggered by lower prices, or the production effects of more than $1 billion paid to producers of upland cotton in MY 2002. Finally, the studies do not explain the much higher per acre cotton payments than other base acres or the fact that US average upland cotton producers could not have covered their total costs without contract payments during MY 2000-2002.

24. Therefore, the evidence submitted to the Panel demonstrates that the decoupled payments have production-enhancing effects. While these effects are smaller than the effects of the marketing loan payments, they are an important part of the collective effects of the US subsidies in creating price suppression and increased and inequitable world market share.

25. Brazil demonstrates that crop insurance subsidies are specific within the meaning of Article 2 of the SCM Agreement. There are different crop insurance policies that are available for only limited products, as well as groups of policies available for certain crops. Therefore, the US crop insurance system is simply not the "one size fits all" programme as argued by the United States. Furthermore, Brazil rebuts US arguments concerning the specificity of crop insurance subsidies by showing that there are no crop insurance policies available for livestock, with the exception of four pilot programmes. Even these pilot programmes are very limited in terms of recipients, and have only a total budget of $20 million, a tiny fraction of the crop insurance subsidies paid for crops.

26. Additionally, the *US – Softwood Lumber CVD* panel report endorsed a finding by USDOC that subsidies paid to only a handful of industries in an economically diverse economy are "limited" (and therefore "specific") within the meaning of Article 2.1 of the SCM Agreement. The record continues to demonstrate that agricultural products representing approximately 50 per cent of the value of US agricultural commodities are not covered by crop insurance subsidies. This, together with the evidence submitted of specific policies and groups of coverage that are provided to only

selected crops such as upland cotton, highlight the fact that only certain enterprises receive the benefits of these subsidies.

27. Regarding Brazil's Article 6.3(d) claim, the United States is incorrect in claiming that Brazil's claims relate only to MY 2001. As discussed in Section 3.9, those claims also include claims for MY 2002, 2003 and the period from 2004-2007.

28. Furthermore, the United States argues that the term "world market share" in Article 6.3(d) of the SCM Agreement means "world consumption share". Contrary to the US arguments, the "world market share" does not refer to "all the markets in the entire 'world', including the market of the subsidizing Member. Brazil has demonstrated that the ordinary meaning of "world market share" refers to the share of a Member in the world export trade.

29. This interpretation is further supported by the context of Article 6.3(d), which includes the reference to the word "trade" in footnote 17. Additional context can also be found in the close similarity between the concepts used in Article 6.3(d) and Article XVI:3, second sentence (both involve primary products, increase in exports, representative periods, effects of any subsidy). Given the similarities between these provisions, the use of the terms "world market share" and "share of world export trade" does not state that both provisions deal with separate situations, as the United States argues. Instead, both terms refer to a share of export transactions in the world market. Therefore, the phrase "world market share" means the world market share of exports, not consumption.

30. In sum, Brazil has demonstrated that the US subsidies caused serious prejudice and threat thereof to the interests of Brazil, because for each marketing year between 2001-2003 the US world market share in upland cotton increased over its previous three-year average. These increases followed a consistent trend, within the meaning of Article 6.3(d) of the SCM Agreement.

31. Brazil rebuts US arguments that GATT Article XVI:3 only applies to export subsidies and, thus, has been superseded by Article 3.1(a) of the SCM Agreement. GATT Article XVI:3 is an actionable subsidy provision that applies to all subsidies having the effect of increasing exports. The phrase "which operates to increase the export" is quite different from the phrase "subsidy on the export". Furthermore, the phrase "operates to increase the export" does not contain any export contingency requirement. Therefore, read in the context of the SCM Agreement and GATT 1994, Article XVI:3, second sentence refers to export-related subsidies, which is a far broader notion than subsidies that are "contingent upon export performance".

32. In sum, GATT Article XVI:3 is not superseded by the export subsidy provisions of the Agreement of Agriculture and the SCM Agreement. Instead, it provides obligations concerning any form of subsidy, independent of the obligations set forth in Article 3 of the SCM Agreement.

33. Brazil also conclusively demonstrates that US upland cotton subsidies violate GATT Article XVI:3 by causing the United States to have a more than equitable share of world export trade in upland cotton.

34. With respect to Brazil's threat serious prejudice claims, Brazil argues that the appropriate standard for serious prejudice claims is not the "imminent threat" standard argued by the United States, but rather whether the unlimited and mandatory US subsidies create a structural and permanent source of uncertainty in suppressing prices, increasing world market share, and securing an inequitable share of world trade.

35. Brazil has demonstrated that it is appropriate for the Panel to rely on the standard proposed by the GATT *EC-Sugar Exports* panels to determine whether the mandatory and unlimited US subsidies on upland cotton create a permanent source of uncertainty in the world upland cotton market. The facts of this dispute meet that standard. The United States has admitted that the US subsidies are both mandatory and unlimited. Given the large US world market share and share of total world production, the US subsidies will have the effect of locking in large amounts of US production, of creating an ongoing significant threat of suppressed prices, and of securing an increasing and inequitable US world market share throughout MY 2003-2007.

36. The "imminent threat" standard is not found in the text of Part III of the SCM Agreement, and is only applicable to investigations by investigating authorities in countervailing duty, anti-dumping, or safeguard contexts. It is inconsistent with the remedies provided for in Article 7.8 of the SCM Agreement, which are imposed well after the period of investigation examined by a Panel.

37. Therefore, the collective effects of the mandated and unlimited US subsidies in MY 2003-2007 threaten to maintain a large US upland cotton production, to increase and maintain US exports, and to significantly suppress world upland cotton prices during MY 2003-2007, in violation of Articles 5(c), 6.3(c), and (d), and GATT Articles XVI:1 and 3.

38. In sum, the mandatory and unlimited US upland cotton subsidies cause threat of serious prejudice to the interests of Brazil. They constitute a structural and permanent source of uncertainty in the world upland cotton market, in which the United States enjoys a dominant position. This conclusion is further supported by the trade-distorting nature of the US subsidies, their effects in causing present serious prejudice in MY 1999-2002.

39. Finally, with respect to export credit guarantees, Brazil offers the Panel a recounting of its evidence and argument in support of its claims against the CCC export credit guarantee programmes, along with footnote citations to all of the places in its various submissions in which it makes those arguments and offers that evidence. Brazil also responds to particular points raised by the United States that Brazil has not yet addressed. The GSM 102, GSM 103 and SCGP export credit guarantee programmes constitute export subsidies that circumvent, or threaten to circumvent, the US export subsidy reduction commitment, within the meaning of Articles 10.1 and 8 of the Agreement on Agriculture. They also constitute prohibited export subsidies within the meaning of Articles 3.1(a) and 3.2 of the SCM Agreement and item (j) of the Illustrative List of Export Subsidies.

# ANNEX G-2

## EXECUTIVE SUMMARY OF THE UNITED STATES FURTHER REBUTTAL SUBMISSION

### 1. Brazil has failed to establish all of the elements necessary to establish its subsidies claims

1. For the Panel to make the findings Brazil requests, Brazil must adduce evidence and arguments sufficient for the Panel to identify the product(s) that a particular subsidy benefits. This requirement of identification can come up in a variety of ways, but the two most frequently encountered questions are: Which product(s) benefits from the subsidy? and Should the benefits of a subsidy be allocated to future production and sales of the product in question, or should such benefits be "expensed" – that is, allocated only to current production and sales during the time period in which the subsidy is received? Brazil has not provided a basis for a clear and unambiguous explanation on its conclusions for each of these points in order for the Panel to fulfil
its obligations under Article 12.7 of the DSU.

2. With respect to the first question – which product(s) benefits from the subsidy? – Annex IV to the Subsidies Agreement provides guidance. Annex IV provides guidelines for calculating total *ad valorem* subsidization for purposes of the now-expired Article 6.1(a). A subsidy not "tied to the production or sale of" cotton ("a given product") cannot be regarded as subsidizing merely "that product"; rather, the subsidy benefits all of the "recipient firm's sales". In the Negotiating Group on Rules, Brazil has proposed that Members adopt a "guideline" on calculating the amount of the subsidy precisely along these lines.

3. Implicit in both paragraphs 2 and 3 of Annex IV is the principle that a subsidy provides a benefit with respect to products that the recipient produces. A corollary of this principle is that a subsidy does not provide a benefit with respect to products that the recipient does *not* produce. Thus, a subsidy provided to a recipient who does not produce upland cotton cannot be said to provide a benefit to upland cotton. Such a subsidy cannot be regarded as having one of the effects described in Article 6.3 insofar as upland cotton is concerned.

4. The foregoing analysis suggests that, for each challenged subsidy, Brazil must identify (as would the Panel in its report) the product that benefits. In the case of product-specific support – that is, a payment that is linked to production of a specific product – such as the marketing loan payments and Step 2 payments, the issue is not difficult. In the case of a payment in which the subsidy is not "tied to the production or sale of a given product", the product subsidized by that payment is all the products produced by the recipient. To determine the portion of a payment not tied to the production or sale of a given product that benefits upland cotton, the value of the payment must be allocated over the "total value of the recipient firm' s sales".

5. With respect to the second question – how should subsidies be allocated over time? – Annex IV also provides guidance. Paragraph 7 provides that: "Subsidies granted prior to the date of entry into force of the WTO Agreement, *the benefits of which are allocated to future production*, shall be included in the overall rate of subsidization" (emphasis added). A corollary of this principle – that the benefits of certain subsidies should be allocated to future production – is that if subsidy benefits are *not* allocated to future production, they must be expensed – that is, allocated to production in the time period during which the subsidy is received. Thus, in the context of this dispute, a subsidy the benefits of which are expensed to production/sales in 2001 cannot be said to be causing serious prejudice in 2002 because the subsidy has ceased to exist. The "benefit" – one of the constituent

elements of a "subsidy" under Article 1 – was used up in 2001. Once the benefit was exhausted, the subsidy ceased to exist.

6. The Subsidies Agreement does not expressly identify those subsidies "the benefits of which are allocated to future production". However, guidance is available on this question, and it suggests that subsidies that are "non-recurring" should be allocated over time, while subsidies that are "recurring" should be expensed to the year of receipt.[1] For example, the Informal Group of Experts recommended to the Subsidies Committee that, as a general proposition, recurring subsidies be expensed and non-recurring subsidies be allocated. The Group also specifically recommended that price support payments generally be expensed. In making these recommendations, the Group follows the logic noted above: where there are *not* reasons to allocate subsidy benefits to future production, the subsidy must be expensed, and once the benefit was exhausted in the time period during which the subsidy is received, the subsidy ceased to exist. The analysis presented above and the conclusions and recommendations of the Group are not controversial. The domestic countervailing duty regulations of various Members, including those of Brazil and the European Communities, reflect this very approach.

7. Thus, it is appropriate for the Panel to expense the value of these payments – that is, allocate them to production in the time period during which the subsidy is received. No payment at issue is made for the acquisition of fixed assets. Rather, the challenged payments are recurring. Brazil's own arguments endorse the notion of expensing these payments. That is, for purposes of its Peace Clause arguments, *Brazil expenses these payments* by allocating the total value of each of these payments to the marketing year for which the payment is received. For purposes of Brazil's actionable subsidies claims, *Brazil adopts the identical approach and expenses these payments to the marketing year for which the payment is received*. Thus, despite Brazil's silence on the issue of expensing recurring subsidies, its actions and arguments reveal that it accepts and applies the concept to the challenged US subsidies.

8. The United States has explained, and Brazil tacitly accepts, that the payments challenged in this dispute are recurring subsidies that 0are expensed – that is, allocated to production in the time period during which the subsidy is received. It follows that a recurring subsidy provided in marketing years 1999, 2000, or 2001, respectively, cannot be said to be causing serious prejudice in marketing year 2002. Because the payments in each of those prior years was allocated to production in those years, no "benefit" exists after each of those years – a benefit could only exist in a subsequent year if the payment had been allocated to future production and not expensed.

9. Because the recurring subsidies provided in each of marketing years 1999, 2000, and 2001 ceased to exist when the benefit was used up for production in those years, the effect of those subsidies cannot be the subject of subsidies claims in marketing year 2002. Under Article 5(c) and 6.3, Brazil must demonstrate what "the effect of the subsidy *is*". Similarly, under GATT 1994 Article XVI:3, Brazil must demonstrate that the United States grants or maintains export subsidies "which operate[] to increase the export of any primary product," resulting in a more than equitable

[1] First, Article 2.2.1.1 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* ("Anti-Dumping Agreement"), which deals with the calculation of cost of production, singles out "*non-recurring* items of cost which benefit *future and/or current* production" (emphasis added). Second, the Appellate Body has acknowledged that non-recurring subsidies may be allocated over time. In *US - Lead Bar II*, the Appellate Body found that it was permissible for an investigating authority in a countervailing duty proceeding to rely on a rebuttable presumption "that a 'benefit' continues to flow from an untied, *non-recurring* 'financial contribution'" (emphasis added). Third, the *Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures*, G/SCM/W/415/Rev.2 (15 May 1998), recommends that certain subsidies be expensed to the year of receipt and that the benefits from other subsidies be allocated over time.

share of world export trade. Subsidies that were expensed and benefited historical production in marketing years 1999, 2000, and 2001cannot also benefit current production. Thus, these past payments would not form part of Brazil's subsidies claims nor the Panel's analysis. Serious prejudice has to be based on findings for the 2002 marketing year.

## 2. Brazil's legal interpretive errors also demonstrate that it has failed to make a *prima facie case on its subsidies claims*

10. As complainant Brazil must identify properly the measures within the Panel's terms of reference – that is, "subsidies provided to US producers, users and/or exporters of upland cotton" in respect of upland cotton, the subsidized product. The challenged measures are subsidies, or payments, and in order to assess their effect, one needs to know, *inter alia*, how large the subsidy is. Brazil has not properly identified the size of each challenged subsidy.[2]

11. **Brazil Misinterprets Article 6.3(c) on Price Suppression or Depression**. Brazil has not alleged any facts to establish that US and Brazilian cotton are found "in the same market" pursuant to Article 6.3(c) – that is, in each of the markets identified by Brazil (at various times, the United States, Brazil, Argentina, Bolivia, India, Indonesia, Italy, Paraguay, Philippines, and Portugal). Brazil has not identified the extent of subsidization of the US cotton in each market (the subsidized volume) – that is, which exports benefit from which challenged subsidy. Brazil has also not shown a price-suppressing effect by those US imports in each market. Brazil simply asserts that prices in those markets are correlated to the NY futures and A-index prices. This allegation of a generalized price effect cannot satisfy Brazil's burden of showing a price effect by the subsidized product of a like product of another Member "in the same market".

12. Brazilian price quotes in fact consistently undercut US price quotes for delivery CIF Northern Europe. It is also the case that in most of the markets identified by Brazil (Argentina, Bolivia, India, Indonesia, Italy, Paraguay, Philippines, and Portugal), Brazilian prices have been consistently lower than US prices. Thus, rather than US upland cotton suppressing Brazilian prices, the data suggests that it is Brazilian cotton that is undercutting US prices.

13. Article 6.3(c) does *not* establish that serious prejudice may arise if the effect of the subsidy is *any* price suppression or depression. Indeed, were the term "significant" omitted from Article 6.3(c), it would be the case that any production subsidy that was granted on a per-unit basis could be deemed to result in serious prejudice: any increase in production resulting from the subsidy would theoretically lead to some price effect. The use of the term "significant" prevents such theoretical or minor effects from rising to the level of serious prejudice.

14. Because "significant" modifies "price suppression" or "depression", it is the level of price suppression or depression itself that must be significant. One way of examining whether any alleged price suppression is significant would be to examine that degree or level in light of the price of the product itself. Another analytical tool that suggests itself is to look at the nature of the product's price. Strong or frequent fluctuations in price would themselves tend to cut against a finding that any alleged suppression or depression is "significant", especially if the variability frequently brings the

[2] For example, Brazil includes payments made to recipients that do not produce upland cotton and fails to allocate non-product-specific payments across the total value of the recipient firm's sales. Brazil has not reduced the value of decoupled income support payments to account for the capture by landowners of those payments made to farms on which cotton cropland is rented (65 per cent of total cotton cropland). Further, Brazil has Brazil has not identified the value of the cotton export credit guarantees under the GSM-102 programme, conceding that it "is not in a position to quantify the benefit to the recipients that has arisen from the application of the GSM 102 export credit guarantee programme to exports of US upland cotton between MY 1999-2002".

price of the product to a level at which the alleged suppression or depression (judged in light of that price) would not be significant. The United States notes that the price of upland cotton is highly variable, with frequent swings of substantial degree. Thus, this evidence relating to the price variability of upland cotton must be taken into account in any analysis of whether alleged price suppression or depression is "significant".

15. **Brazil Misinterprets Article 6.3(d) on an Increase in World Market Share**. Brazil misinterprets the phrase "world market share" in Article 6.3(d) as the share of world export trade. The plain meaning of the phrase "world market share" is not limited to export trade in products but includes all worldwide consumption – that is, the aggregate of all markets that make up the world. The United States is a "market" for upland cotton and part of the "world"; therefore, its domestic consumption forms part of the "world market" for upland cotton.

16. Context supports this reading of "world market share". For example, Article 6.3(a) identifies the "market of the subsidizing Member" as a relevant market from which a complaining Member's exports can be displaced or impeded. Logically, then, the market of the subsidizing Member should also be relevant for determining the "world market share". Various provisions also provide context for *not* reading "world market share" as relating to "world export trade".[3] Given repeated examples of the use of the terms "trade," "world trade," and "world export trade" in the covered agreements, the choice of the phrase "world market share" must be given meaning in accordance with the plain meaning of those terms.

17. The challenged US payments were only introduced in marketing year 2002; therefore, there can be no "trend" in US world market share with respect to those payments. Nonetheless, were the Panel to examine US world market share using data under the 1996 Act (consumption data, not the export data presented by Brazil), the criteria of Article 6.3(d) are not met.[4]

18. **Brazil Has Not Demonstrated a Clear and Imminent Likelihood of Future Serious Prejudice**. Although Brazil has presented evidence after the date of panel establishment (indeed, after conclusion of its three-year period of investigation), it advises the Panel to consider more probative, for purposes of explaining price developments in marketing year 2003, the conditions *in marketing year 1999* than the actual price developments *in marketing year 2003*. Brazil's approach carries with it a high potential for erroneous findings by the Panel. Given current high market prices and the expectations embodied in futures prices that such high prices will remain through the course of the 2003 marketing year, it would appear that US price-related payments (marketing loan payments and counter-cyclical payments) will decline dramatically, contrary to Brazil's assertions. In such a circumstance, it is difficult to see how challenged US payments would pose a clearly foreseen and imminent likelihood of future serious prejudice.

[3] First, footnote 17 to Article 6.3(d) provides an exception to the provision where "[o]ther multilaterally agreed specific rules apply to the trade in the product or commodity in question". This exception applies only to "trade" because "multilaterally agreed specific rules" would be unlikely to apply exclusively to domestic consumption; however, the use of the world "trade" in the *footnote* to Article 6.3(d) but *not* in the text of the Article itself suggests that "world market share" does not merely encompass shares in world "trade". Second, Article 27.6 speaks of a developing country Member reaching export competitiveness when its "share . . . in world trade of that product" reaches a certain level. This use of "world trade" stands in contrast to the phrase "world market share" in Article 6.3(d). Third, GATT 1994 Article XVI:3 uses the phrase "world export trade", which also stands in contrast to the phrase "world market share".

[4] While US share of world consumption in MY2002 was projected to be higher than the preceding three-year average, that increase has not followed "a consistent trend over a period when subsidies have been granted" – in this case, for purposes of argument, since the 1996 Act came into effect. Reversing direction every year since marketing year 1996 cannot constitute "a consistent trend".

19. **Brazil Has Misinterpreted GATT 1994 Article XVI:3**. Contrary to Brazil's arguments in this dispute, Brazil has previously agreed in a GATT plurilateral setting that GATT 1994 Article XVI:3 is limited in scope to export subsidies. Both the United States and Brazil were signatories to the Tokyo Round *Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade*, commonly known as the Subsidies Code. Article 10 of the Subsidies Code is entitled "Export subsidies on certain primary products" and states (in paragraph 1): "*In accordance with the provisions of Article XVI:3* of the General Agreement, signatories agree not to grant directly or indirectly *any export subsidy on certain primary products* in a manner which results in the signatory granting such subsidy having more than an equitable share of world export trade in such product . . . ." Thus, Article 10.1 of the Subsidies Code makes clear the understanding of both the United States and Brazil that GATT 1994 Article XVI:3 applies only to "export subsid[ies] on certain primary products". Therefore, Brazil has not made a *prima facie* case under Article XVI:3 on the basis of its arguments relating to *all* challenged US payments.

20. **Brazil Errs in Asserting that Threat of Serious Prejudice Includes "More than an Equitable Share" under GATT 1994 Article XVI:3**. There is no textual basis to assert that a claim of "threat of serious prejudice" under GATT 1994 Article XVI:1 may be founded on the "more than equitable share" language of GATT 1994 Article XVI:3. Neither Brazil nor the *EC – Sugar Exports* GATT panel report on which it relies cites any and that panel report does not appear to explain the basis for its decision to read the standard of Article XVI:3 into Article XVI:1. By way of contrast, footnote 13 to Article 5(c) of the Subsidies Agreement states that "[t]he term serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI:1 of GATT 1994, and includes threat of serious prejudice". This footnote does not reference Article XVI:3, and as there is no "more than equitable share" prong to Article 6.3, there would not appear to be any basis to advance a threat of serious prejudice claim using that standard under Article 5(c) of the Subsidies Agreement. Footnote 13 states that "serious prejudice" in the Subsidies Agreement and GATT 1994 Article XVI:1 should be read "in the same sense". Therefore, footnote 13 provides a further textual basis for finding that a threat of serious prejudice claim under GATT 1994 Article XVI:1 may not be based on the "more than equitable share" language of Article XVI:3.

### 3. Brazil has failed to demonstrate the challenged US subsidies caused the effects complained of

21. **The "Temporal Proximity" of US Payments and Low Cotton Prices Fails to Demonstrate that US Subsidies Caused Low Prices**. Brazil has failed to make a *prima facie* case based on the assertion that large US outlays during marketing years with low prevailing upland cotton prices necessarily establishes causation. Brazil makes selective use of data to present a number of erroneous claims about US production or exports during a period of low and declining cotton prices. Brazil repeatedly begins the period of comparison with marketing year 1998 or ends it with marketing year 2001. Such comparisons are inappropriate for several reasons and can produce misleading results.[5] The fact that high US payments were made when cotton prices were low does not establish causation.

[5] First, to use either marketing years 1998 or 2001 as one end of a period for comparison contradicts Brazil's own argument that the "period of investigation" should be marketing years 1999-2002. Second, marketing year 1998 was a year in which US harvested acreage and production were severely impacted by weather conditions, in particular, drought. The record shows record abandonment during that year (that is, the difference between planted acres and harvested acres). Thus, to begin a comparison of harvested acreage or production with marketing year 1998 will overstate any resulting increase. Third, marketing year 2001 was a year in which US production increased, primarily because of record yields (as Brazil has acknowledged). That is, while planted acreage increased over marketing year 2000 in large part due to the decline in expected returns from competing crops, production increased by a much greater percentage because of uncommonly favourable

22. **Brazil Erroneously Alleges Production Effects from Decoupled Payments, Contrary to the Economic Literature**. A fundamental error made by Brazil throughout its submissions and statements is to assert that decoupled payments are production-distorting. Brazil's conclusion that decoupled payments have had a large effect on cotton prices appears to be a direct consequence of Dr. Sumner's faulty analysis – one that is inconsistent with the empirical and theoretical literature on such payments. Economic theory suggests that, if producers are seeking to maximize profits, the decision of which crop to plant is based on expected returns offered by the market or government payments above operating (variable) costs. Decoupled income support payments do not figure in this decision because such payments will be paid to the producer regardless of the programme crop that is planted or whether any crop is planted at all.[6]

23. The main impact of decoupled payments is likely on land values. In well-functioning markets, asset prices reflect expectations about the future returns from their ownership. The direct link between base acres for decoupled payments and the known programme benefits allowed the future stream of payments to be efficiently capitalized into land values. Thus, much of the increase in wealth from farm payments accrues to non-operator landlords (Burfisher and Hopkins, 2003). Thus, the effects of increased wealth largely accrue to non-operators, and any theoretical production effects are further minimized. In fact, land values set by sales and rental markets have diverged from commodity prices, suggesting that land markets have additionally capitalized the present and expected future value of government payments.

24. Data also indicate that decoupled payments, by increasing income and wealth, have allowed households to increase their leisure and reduce their work hours. If the downturn in labour comes from agricultural activities, the effect of such payments could be to *decrease* the household's agricultural production, which would support world commodity prices. Data indicate that farm households that received decoupled payments in 2001 consumed more than farm households with similar incomes not participating in the programme. Thus, these data suggest that decoupled payments allow recipients to consume more out of income and may allow them to draw down savings that they typically carry as a precaution against income shortfalls.

25. Empirical studies have generally concluded that the effects of decoupled payments are minimal. For example, using an intertemporal Computable General Equilibrium model, Burfisher et al. (2003) estimate that production flexibility contract payments had "no effects on agricultural production in either the short run or the long run". These and other results are fully consistent with the fundamental requirement of Annex 2 of the Agreement on Agriculture that green box decoupled income support have no or at most minimal trade or production effects.

26. The available data also show large shifts in cotton acreage. Based on a preliminary review of a sampling of marketing year 2002 acreage reports, the United States estimates that nearly half (47 per cent) of farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage in fact planted no cotton at all. Preliminary estimates from the Farm Services Agency indicates that cotton producers enrolled upwards of 2 million acres for the 2002 Direct and Counter-Cyclical Programme that had not been enrolled under the 2002 Production Flexibility Contract programme. Marketing year 1999 planted acreage deviated substantially from base acreage, both by region and by

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weather conditions. Thus, to end any comparison of production with marketing year 2001 will overstate any resulting increase.

[6] Brazil has alleged that increased income can induce producers to take riskier choices, thus potentially increasing production and distorting markets. The economic literature suggests any such effects are empirically trivial. Recipients of decoupled payments use many market mechanisms to reduce their risk exposure in their farm operation. These strategies to manage risk reduce the extent to which changes in risk attitude due to decoupled payments, if any, will be evidenced in their production levels or demand for inputs.

State.[7] Thus, the data indicate that recipients of "upland cotton base acreage" decoupled payments plant alternative crops or no crops at all, and other farmers who do not hold upland cotton base acres choose to produce upland cotton.

27. **Third-Party Economic Studies Have Not Properly Modeled Cotton Production Decisions and Therefore Cannot Assist in Determining the Effect of US Subsidies on Cotton Production**. Brazil has pointed to various third-party economic studies which find price effects from US payments. Upon review, the United States concludes that they do not present relevant results because they generally suffer from two conceptual flaws. These fundamental flaws establish that these papers do not provide a basis to find a causal link between US payments and the effects of which Brazil complains.

28. First, several of these studies do not model the marketing loan programme appropriately.[8] Simply put, if Dr. Sumner and FAPRI's understanding of producer decisions is correct, then Brazil would have to agree that these papers do not properly model farmers' production decisions and any potential impact of marketing loans on those decisions. As a result, these models do not provide insight into the question this Panel has been asked to examine.

29. Second, most of these studies do not distinguish between payments linked to production and payments decoupled from any requirement to produce, instead treating them as having equal impacts on production. Again, Brazil's own expert recognizes that decoupled payments do *not* have the same impact as, for example, product-specific marketing loan payments. Thus, Dr. Sumner's own modelling of the impact of decoupled payments (with which the United States disagrees as contrary to the economic literature in ascribing *any* impact on production to these payments) indicates that these papers treat decoupled payments inappropriately.

30. **Brazil's "Total Costs of Production / Revenue Gap" is Meaningless and Cannot Establish Causation**. Brazil's so-called "gap" between the average total cost of production per pound of cotton for US cotton producers and the revenue such producers received from the market is an economically meaningless measure and is based on a simplistic calculation that misstates both the revenue and cost sides of the calculation. Brazil's revenue calculation is based on an erroneous representation of government support, especially crop insurance, decoupled payments, and Step 2 payments, and of market revenue.[9] More fundamentally, the existence of a "gap" does not establish

[7] Comparing marketing year 1999 planted acreage to base acreage, the ratio of planted to enrolled acreage, by region, in 1999 ranged from only 51% in the West to 141.25% in the Southeast. In the Southeastern United States (Alabama, Florida, Georgia, North Carolina, South Carolina and Virginia), for example, upland cotton planted acreage *exceeded* base acreage *by over 1 million acres*. In each of the other three regions, planted acreage was between 879,000 and 1 million acres *less than* base acreage. The variations by State are even more extreme.

[8] (a) Specifically, several of these papers simply remove the full outlay of the marketing loan program. This implies that farmers at the time of planting knew what actual prices would be at harvest time. Brazil's own expert recognizes that it is producers' expectations of harvest season prices that drive planting decisions. Thus, using the full outlays will overstate the influence of the marketing loan programme on the planting/production decision when actual prices turn out to be below the expected prices at the time of the planting/production decision.

[9] In three different submissions, Brazil presents three different per pound revenue figures derived from market revenue and US support programmes, and purports to represent this figure as average revenue received by upland cotton farmers in that year for every pound of cotton produced. This combined per pound figure in no way represents what a cotton farmer would have received – or even could have expected to receive – in the specific year in the way of government support. In addition, Brazil's measure of revenue for upland cotton producers – revenue from sales of cotton lint and cottonseed – is incomplete. Revenue from all sources – commodity sales, contracts in futures markets, off-farm employment, investment income – are needed to put the costs into perspective.

that US production would necessarily decline without the US payments Brazil has decided to challenge. For example, Brazil concedes that a substantial amount of US upland cotton in recent years was grown on non-upland cotton base acreage, at the same time that government payments were allegedly "necessary" for US producers to remain in business. Brazil fails to explain how it accounts for these inconvenient facts that do not support its cost-revenue gap theory.

31. On the cost side, Brazil's use of average total cost of production for US cotton to make its revenue gap argument is the wrong figure to measure costs – it is operating costs, not total costs, that figure in production decisions. Brazil also has made no effort to update cost data that is based on a 1997 survey and so does not take into account any technological or structural changes that have occurred in the interim. Since 1997, significant technological changes have occurred in US cotton production, changes which are not reflected in the estimated costs of production, such as increased production in low-cost regions and the introduction and adoption of genetically modified varieties of cotton with significantly increased yields while reducing pest control costs.

32. Finally, Brazil has used data from the International Cotton Advisory Committee (ICAC) to compare costs of production across countries arguing that the United States is a higher-cost producer than many other countries. Even when good survey data are available for one country, using cost of production data to draw valid economic conclusions is fraught with difficulties. The comparison of costs across countries poses greater difficulties, rendering such comparisons invalid. The ICAC itself notes that the cost data it presents is not appropriate for making these kinds of cross-country comparisons.

33. **Brazil Has Failed to Make A Proper Analysis of Conditions Actually Faced by Producers in Making Production Decisions Using Futures Prices, Which Reveals No Expected Impact from Marketing Loans Except for MY2002**. An analysis of the effect of marketing loan payments must begin with an understanding of farmers' planting decisions. The United States agrees with Mr. MacDonald, Brazil's expert on cotton markets, that the New York futures price provides the principal indicator of how market participants expect cotton prices to develop in the future. Unfortunately, Brazil's other expert, Dr. Sumner, has ignored Mr. MacDonald's testimony in modelling producers' expectations of harvest season market prices by using "lagged prices" instead of futures prices. Had Dr. Sumner conferred with Mr. MacDonald, Dr. Sumner would have learned that "[t]he ' New York futures price' is a key mechanism *used by cotton growers . . . in determining the current market values as well as the contract prices for forward deliveries*."

34. Comparing the planting-time (February) New York futures price for the following harvest season (December delivery) to the marketing loan rate for upland cotton for each marketing year reveals that in every year but marketing year 2002, *the planting time futures price was above the marketing loan rate*. That is, New York futures prices indicated to producers that in every year but marketing year 2002 the return from the market would *exceed* the marketing loan rate. Thus, the marketing loan programme in marketing years 1999-2001 would not be expected to have had an effect on the decision to plant.

35. Only in marketing year 1999 does Dr. Sumner's "lagged price" approach result in a value for producers' expectations that equals or exceeds the futures price. In every other marketing year, *the "lagged price" method significantly understates the harvest season price expected by producers* and thus would distort an analysis of the effect of US subsidies. In fact, the use of "lagged prices" would lead to the erroneous conclusion that expected prices in every year but marketing year 1999 were *below* the applicable marketing loan rate. However, market price expectations actually were *above* the loan rate in every year but marketing year 2002. Thus, the use of "lagged prices" instead of futures prices to gauge producers' price expectations at the time of planting in the specific years in which Brazil has alleged effects from US subsidies would seriously overstate the expected impact of

US marketing loans. To the extent Brazil relies on Dr. Sumner's analysis, which uses lagged prices rather than futures prices, Brazil's analysis is fundamentally flawed.

36. The futures price data and "lagged price" data above also reveal that, despite declining market prices over the course of marketing years 1999-2002, *market participants persisted in expecting prices to recover.*[10] Thus, Brazil's reliance on actual market year prices to claim that US cotton plantings should have been declining ignores the fact that harvest season cotton futures prices at the time of planting were fairly stable from marketing year 1999 through marketing year 2001, even as futures for other competing crops fell in value.

37. In marketing year 2002, harvest season futures prices at the time of planting had fallen below the loan rate. In this marketing year, there is a least the possibility that producers were planting for the loan rate and not for the harvest season expected price. However, the decline in US planted cotton acreage was within the range of expected values given the decline in the harvest season futures price from the previous year. Had US producers been planting for the 52 cents per pound marketing loan rate, one would have expected to see only one-tenth of the decline in planted acreage that actually occurred from marketing year 2001 to 2002.

38. Moreover, the per cent decline from marketing year 2001 to 2002 in US harvested acreage was very similar to (but larger than) the change in harvested acreage in the rest of the world. Despite the *theoretical* possibility that the marketing loan rate could have had some impact on planting decisions in marketing year 2002, the *actual* decline in US planted and harvested acreage suggests that US acreage levels were entirely consistent with price expectations and world market conditions. Thus, even in marketing year 2002, there is no evidence on this record that the marketing loan rate serves to insulate US producers' planting decisions from market price movements. To the contrary, the evidence suggests that US producers do respond to changes in expected prices (for cotton and for other competing crops) and are as responsive if not more so than producers in other countries.

[10] The marketing year 2000 harvest season futures price at planting time was 61.31 cents per pound, suggesting that the market expected prices in marketing year 2000 to recover from the previous year's levels. For marketing year 2001, the harvest season futures price at planting time was 58.63 cents per pound (nearly the same as futures in marketing years 1999 and 2000), once again indicting that market participants expected prices in marketing year 2001 to recover from their marketing year 2000 levels. It is only in marketing year 2002 that persistent lower-than-expected farm prices translated into a lower harvest season futures price at planting. For marketing year 2002, the February average futures price for December delivery fell to 42.18 cents per pound. However, even in marketing year 2002, market participants expected prices to recover and run higher than the "lagged price" of 29.80 cents per pound suggested.

# ANNEX H

## ORAL STATEMENTS OF PARTIES AT THE SECOND SUBSTANTIVE MEETING

# ANNEX H-1

## EXECUTIVE SUMMARY
## STATEMENT OF BRAZIL AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

**The United States Has Invented Threshold Burdens for Serious Prejudice Challenges that Do Not Exist in the Text of Articles 5 and 6.3 of the SCM Agreement**

1. The United States' has raised a number of threshold burdens that an Article 6.3 complainant allegedly must meet to establish a claim which are not based in the text of the serious prejudice provisions of the SCM Agreement.

2. First, the United States incorrectly asserts that under Article 6.3, Brazil must show an *ad valorem* subsidy rate and the amount for each of the challenged US subsidies. The only textual basis the United States provides is Annex IV of the SCM Agreement, which has expired with the text of Article 6.1(a) that contained the now-expired presumption of serious prejudice from a 5 per cent *ad valorem* subsidization. The United States further relies on *countervailing duty* measure procedures and interpretations of Brazil and the EC. But these allocation methodologies are irrelevant to Article 6.3 claims because unlike the expired Article 6.1(a) or Part V of the SCM Agreement, the focus of Articles 5(c) and 6.3 is on an examination of the *effects* of subsidies that are provided either directly or indirectly to producers of a product, such as cotton. In any event, Brazil has demonstrated a collective subsidization rate averaging 95 per cent and subsidies in the amount of $12.9 billion.

3. Second, the United States makes the sweeping argument that there is a legal prohibition on bringing adverse effects claims against subsidies that it alleges cannot be "expensed" or allocated to future years. The United States argues that all subsidies to cotton are "recurring" and therefore, as a matter of law, "cannot be said to be causing serious prejudice" except in the year in which they are provided. In fact, there is *no* textual basis in Part III or Article 6.3 of the SCM Agreement (or Article XVI:3 of GATT 1994) for distinguishing between the adverse effects of "recurring or non-recurring" subsidies. Nor is there any basis for "expensing" subsidies in one year or another year, as is often done in a countervailing duty investigation. Because Article 5 requires Members to *prevent effects*, a breach of Article 5 does not necessarily arise when a subsidy is granted, but only when actionable adverse effects occur.

4. The US argument is also inconsistent with the object and purpose of the SCM Agreement which is to protect Members from *any* subsidy causing serious prejudice. Under the US interpretation, a Member can permanently avoid any liability under Article 6.3 simply by carefully constructing the form of the payment as a recurring annual subsidy. Brazil has also presented evidence of continuing effects from subsidies provided in MY 1999-2002.

**Brazil Has Established the Existence of Price Suppression in the US, World, Brazilian, and Other Markets Where Brazilian Producers Export**

5. The United States now asserts that even though there may be evidence that New York futures market and A-Index prices as well as prices in other countries are suppressed by a "generalized effect," the "in the same market" language in Article 6.3(c) requires that US exports be present in the same geographical markets in which Brazilian cotton is present.

6. Brazil has established, consistent with the requirements of Article 6.3(c), that the effects of the US subsidies were to suppress prices in the "same market" in which Brazilian producers marketed their "like" cotton – i.e., in the world's, Brazil and in third countries. First, Brazil demonstrated the impact of US overproduction on the US and the "world market" prices (A-Index and New York futures market prices). Brazil then demonstrated that prices in Brazil and the countries to which Brazilian exporters shipped their cotton between MY 1999-2002 were suppressed and heavily influenced by US subsidies. The effects of those subsidies are communicated world-wide via a global price discovery mechanism. The parties agree that US, Brazilian and other countries' cotton are "like products". Throughout the world, prices for this fungible, price-sensitive commodity are determined by reference to the New York futures market and A-Index prices. Thus, Brazil established that the effect of the US subsidies is significant price suppression in the United States and Brazil, and in countries to which Brazilian producers exported their cotton. Further, the evidence shows that US subsidized cotton was present and contributed to the suppression of prices in 37 of the countries in which Brazilian producers marketed their cotton.

**Brazil Has Established the Causal Link between the US Subsidies and Significant Price Suppression, Increased US World Market Shares, and the Inequitable US Share of World Trade**

7. Brazil has properly analyzed both US revenues and costs using USDA's own data and conclusively demonstrated that the US industry producing cotton is heavily dependent on all US subsidies to cover total costs over the short and long run. This finding provides a key economic rationale for the large production-enhancing effects from the US cotton subsidies found by USDA, as well as by US and international economists.

8. Over the long term, even the United States agrees that producers must recover all of their costs and make a profit to stay in business. USDA's own cost and planted acreage data shows that US producers' long-term costs from MY 1997-2002 were $12.5 billion greater than their market revenue received. The United States argues that off-farm income should have been included in Brazil's revenue calculations. This US approach is conceptually as well as legally wrong. The relevant question is whether the "US cotton industry" is profitable from market revenue, not whether this industry is kept alive by cross-financing from other (non-subsidy) sources, such as social security payments.

9. US cotton producers would have suffered a cumulative loss of $332.79 per acre of cotton during MY 1997-2002 if they did not receive contract payments. But USDA's own data in the Environmental Working Group database demonstrates that almost all US producers of cotton did receive contract payments. And as a result, they made cumulative 6-year "profit" of $106 per acre by MY 2002, allowing them to plant significant acreage to cotton in MY 2002 and 2003.

10. Finally, the United States criticizes Brazil's comparison of costs of production among various countries. While Brazil agrees that the ICAC "data must be used carefully", the problems with ICAC's data do not render them unusable. Comparing ICAC "Variable Cash Costs" – which the United States does not challenge – demonstrates that it is much cheaper to produce a kilogram of cotton in Brazil than the United States.

11. The United States has argued that "in no year from marketing year 1999-2001 would the marketing loan rate be expected to have much of an impact, if any, on producer planting decisions," and that it did not affect producer decisions in MY 2002. This new US argument contradicts numerous USDA studies. In assessing the credibility of the new US argument that marketing loans provided no production incentives, the Panel should consider that USDA's own economists Westcott and Price found considerable effects of the marketing loan programme on US cotton production. The results of the Westcott and Price study are neither unique nor unexpected. Numerous other

economists have found similar results. Looking at futures prices also reveals that US producers are unresponsive to price changes at planting time.

12. Moreover, the basic US assumption is that if the *futures* price (minus five cents) is above the marketing loan rate of 52 cents per pound, then "economic logic" demands that the marketing loan can have no impact on planting decisions.

13. The United States' analysis of the marketing loan programme is based on a completely irrelevant comparison between the "expected cash price" and the marketing loan rate. Cotton marketing loan payments are based on the difference between the loan rate (52 cents) and the adjusted world price ("AWP") not the price received by US farmers. The AWP is typically far lower than the price received by U.S. farmers. The average spread between the December contract futures price during the period January-March and the adjusted world price of the following marketing year was 18.5 cents per pound. Thus, even using the US "futures price" methodology at planting time, for every year between MY 1999-2002, there was the expectation at planting time that significant marketing loan payments would be made.

14. Even if the expected AWP is above the loan rate, this does not mean that farmers expect a zero marketing loan payment. If the expected AWP lies above the loan rate, farmers would still expect, with a certain likelihood, that the actual AWP could be below the loan rate because the expectations about the AWP is a probability distribution. Thus, they would still expect a positive marketing loan payment.

15. Brazil emphasizes that the US futures price approach suffers from several significant shortcomings. Both farmers' decisions about planting and marketing of cotton are more complex. Planting decisions take place between January-March and the marketing of cotton takes place during the whole marketing year. Thus, just the February quote of the December futures contract does not properly address the complexity of farmers decisions.

16. The evidence is that the US cotton industry is sceptical of relying too heavily on present futures market prices as an accurate guide to future prices. Farmers have seen such volatility in the past as well as today. Therefore, any cotton farmer planting in the MY 1996-2002 period who actually relied on futures prices would know that the futures market is far from constituting a perfect predictor of future prices. Thus, as Professor Sumner correctly stated, "it is impossible to know what precisely individual farmers expect;" price expectations are "fundamentally unobservable".

17. The record supports a finding by the Panel that more than $4 billion in contract payments were provided to *current* producers of cotton in MY 1999-2002. Brazil has demonstrated that the publications listed in the US review literature were largely irrelevant because they are not cotton-specific, as they do not address the re-coupling of production due to the base acreage updating for direct and CCP payments, or the huge target price CCP payments provided to cotton producers. Brazil has also shown that the US subsidies do not meet the criteria of paragraph 6 of Annex 2 of the Agreement on Agriculture, and are therefore not "decoupled".

18. The record supports a finding by the Panel that the "other effects" apart from increased rental costs include significant production effects tied to upland cotton. First, the large majority of current cotton producers receive much higher per-acre payments for cotton than for other programme crops. The Panel must ask why much higher per acre direct and CCP payments are made to cotton base acreage *if* these payments are totally de-connected from current production? If that were the intention, as the United States argues and USDA presumes, then all contract payments in the same state or county would provide the same per acre benefit. The reason for the higher payments, of course, is that cotton is a high-cost crop and that cotton farmers insisted they were not receiving enough payments during MY 1999-2001 "to make ends meet".

19. Second, the United States has now admitted that two million additional cotton base acres were added to the total contract "base" acreage. This means that in MY 2002, an additional $227 million in payments were made to farmers producing cotton during MY 1998-2001. This is not "decoupling" payments from production, but re-coupling to reward farmers for increasing their recent production. And the prospect of future updates will keep many farmers planting cotton in order to protect and even increase future bases. Even USDA economists agree that this creates a link to current production.

20. Third, the 72.4 cent target price triggers CCP payments when *cotton* prices are lower – not corn, or soybeans prices – but *cotton*. Why is that? Because the NCC argued and Congress agreed that given the high costs of producing cotton in the United States, *current* and *future* cotton farmers will need high payments when prices decline. There would be no reason to set a "target price" to protect against low cotton prices if Congress expected that most farmers with upland cotton base acreage would start planting apple trees.

21. Fourth, Brazil presented the Panel with information from USDA's own electronic payment data showing that during MY 2000-2002 at least 71.3 to 76.9 per cent of total so-called "de-coupled" cotton base acreage payments were paid to producers of cotton. The data further shows that, in MY 2002, these producers of cotton received 85 per cent of their contract payments from cotton base acreage.

**The US Subsidies Increase Exports, in Violation of Article 6.3(d) of the SCM Agreement**

22. Brazil has demonstrated that, in violation of Article 6.3(d) of the SCM Agreement, the effect of the US subsidies played a significant role in the increase of the US world market share in MY 2001-2003 over its previous three-year average, following a consistent trend since MY 1996.

23. The US argues that "[u]nder Brazil's reading, a Member would be free to provide subsidies that increased the share of its own domestic consumption that its producers supplied without any disciplines under Article 6.3(d)". But this argument ignores the fact that Article 6.3(a) disciplines subsidies that increase domestic production in the market of the subsidizing Member. Further, Article 6.3(b) addresses any export displacement or impedance effects of subsidies in third country markets.

24. Second, the United States now argues explicitly that Article 6.3 has superseded Article XVI:3, second sentence. Assuming *arguendo* that the United States is correct, the effect of the US interpretation of "world market share" as meaning "world market share of consumption" would be to eliminate any WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports. As Brazil has pointed out, this would be contrary to the fact that the language and scope of both Article XVI:3, second sentence and the text of Article 6.3(d) are very closely related.

25. Finally, the entire concept of a "world market share of consumption" is flawed for the purposes of Article 6.3(d) as it results in double counting. The United States argues that "the US share of the world market for upland cotton should be defined as US consumption plus US exports over world consumption". However, the ordinary meaning in a trade remedy context of "domestic consumption" is total domestic "shipments" (i.e., net use from production or stocks) plus imports *minus* exports. Total "world consumption" is the sum of each country's domestic shipments plus imports minus exports. But the US methodology addresses as "consumption" both imports and exports and thus, double counts.

**CCC Export Credit Guarantee Programmes**

26. The United States considers that Article 10.2 exempts export credit guarantees from the disciplines included in Article 10.1. In Article 10.2, the negotiators reached a good faith agreement to work toward specific disciplines on export credits. That need for a good faith commitment to negotiate explains the difference between the Draft Final Act and the final version of Article 10.2. Given the "magnitude" of those programmes, the United States argues that no Member could possibly have intended for its agricultural export credit programmes to be subject to Article 10.1. But, among others, the EC and Canada, both massive users of export credits, have told the Panel that they consider export credits to be subject to Article 10.1 if they meet the definition of an "export subsidy". The United States did not think it needed to account for the CCC programmes in its reduction commitments, since it did not consider them to be export subsidies.

27. The United States says that it has offered "uncontroverted evidence" that for 12 of 13 scheduled products, US exports under the CCC export credit guarantee programmes did not exceed the United States' reduction commitment levels. The correct question, however, is whether *total* US exports of a scheduled product exceed the quantitative reduction commitments, which Brazil has demonstrated. It is for the United States, under Article 10.3, to prove that those excess quantities did not receive export subsidies.

28. Whomever bears the burden, Brazil has demonstrated that the CCC export credit guarantee programmes confer "benefits" *per se*, and also constitute export subsidies within the meaning of item (j). The United States argues that even if the CCC programmes constitute export subsidies, because "the quantities were within the applicable US export subsidy reduction commitments[,] they would conform fully to the provisions of Part V of the Agreement on Agriculture". The United States is in error.

29. With respect to *unscheduled* products, Brazil has established both actual circumvention and the threat of circumvention. Brazil's Exhibits 73 and 299 and Exhibit US-41list the billions of dollars of CCC guarantee support that have been provided for exports of unscheduled products during fiscal years 1992-2003, thereby circumventing the US commitment not to provide export subsidies. The mere availability of CCC guarantees for unscheduled products threatens circumvention, since Article 10.1 prohibits *any* export subsidy for such products.

30. With respect to s*cheduled* products, Brazil has demonstrated actual circumvention for US rice exports benefiting from CCC guarantees that have exceeded the US quantitative export subsidy reduction commitment. In its 18 November submission, the United States argues that because CCC has not disbursed the minimum amounts (at least $5.5 billion in guarantees each year, plus an additional annual amount of at least $1 billion in direct credits or guarantees for exports to "emerging markets") there is no threat of circumvention. The United States misunderstands the test set out by the Appellate Body in US – FSC. The lack of a legal mechanism that stems, or otherwise controls, the flow of CCC guarantees threatens circumvention. There is no limit on the amount of CCC guarantees and CCC's is exempt from the standard requirement of new Congressional budget authority for new guarantees.

# ANNEX H-2

## EXECUTIVE SUMMARY
## CLOSING STATEMENT OF BRAZIL AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

### 1. The United States enjoys No Peace Clause Protection

1. The record demonstrates that the United States enjoys no peace clause immunity for its upland cotton subsidies. Under any of three methodologies – a "budgetary outlay/expenditure", an "aggregate measure of support", or a "rate of support" methodology – the level of support provided in MY 1999-2002 exceeds the level of support decided in MY 1992. The United States has acknowledged that all challenged US subsidies, except PFC and direct payments, are non-green box (trade and production-distorting) subsidies. Brazil and all third parties agree that direct payments under the 2002 FSRI Act are non-green box because of the updating of a fixed base period contrary to Annex 2, paragraphs 6(a) and (b) of the Agreement on Agriculture. Further, PFC and direct payments are non-green box support because of the prohibition on fruits and vegetables contrary to Annex 2, paragraph 6(b). Moreover, payments for cotton base acreage are higher than those for other crop base acreage. The weight of evidence shows that all the challenged US subsidies are "support to" upland cotton within the meaning of Article 13(b)(ii) because they were received by current producers or by users and exporters of US upland cotton. Brazil's "14/16ths" methodology for estimating the amount of the four contract payments is reasonable and supported by the EWG database and considerable circumstantial evidence.

### 2. Brazil has established the Elements to Support its Significant Price Suppression Claims under Article 6.3(c)

2. Upland cotton is a basic, widely-traded commodity. Both Brazil and the United States agree that Brazilian upland cotton and other upland cottons are "like" subsidized US upland cotton. Because of this widespread interchangeability among world cottons, increases in world cotton supply by major cotton-producing countries have a major impact on discovery or establishment of world prices reflected in the A-Index and the New York cotton futures exchange.

3. The United States has made a great deal about what it terms some "fundamental" issues about the nature and amount of subsidies. Brazil has demonstrated the absence of any textual basis for incorporating various countervailing duty principles from Part V of the SCM Agreement into Part III and resurrecting Annex IV from the dead. However, Brazil used USDA's own data to show both the amount and rate of subsidization for each of the subsidies. To make up for US acreage and yield information the US has hidden from Brazil and the Panel for 16 months, Brazil has demonstrated through the EWG database and other circumstantial evidence that its "14/16th" methodology is reasonable. This methodology allocates payments only to current producers of upland cotton and does not "double count" payments provided to other producers of crops. And since the peace clause phase of this proceeding, Brazil has demonstrated that all the US subsidies are "tied" to the production of upland cotton and are "support to" upland cotton.

4. The US government has poured $12.9 billion over the past four years into a number of subsidy programmes specifically targeted at US upland cotton. No other US commodity has a Step 2 programme and no other US commodity received subsidies as high as 136 per cent *ad valorem*. Even

the so-called decoupled contract payments for "historical" cotton base acreage are much higher than for any other crop except rice. The subsidies provide a specific "target price support" of 72.4 cents per pound for upland cotton – not for other crops. And Congress insisted that USDA has no discretion to limit any of the required payments, all of which are mandatory and place no limit on the amount of upland cotton that could be produced with the support of these subsidy programmes.

5. The United States has agreed that all of the challenged US subsidies are "specific" except crop insurance. But USDA's own evidence showed that this programme is also specific since it is targeted at the industry growing crops, not livestock and thus covers only half of the value of US agricultural commodities and 38 per cent of farmland.

6. While Brazil continues to wait for farm-specific acreage and yield information from the United States, the incomplete Environmental Working Group data based on USDA farm-specific data show almost $3 billion in contract payments paid to upland cotton producers in MY 2000-2002 alone. And the great bulk of the other evidence shows that US upland cotton farmers are dependent upon, need and, in fact, receive such payments to "make ends meet" and "to survive".

7. Having established the fungible nature of the product and the existence and specificity of the subsidies, Brazil must link the effects of the subsidies to significant price suppression. The first important fact is that the United States is by far the world's largest exporter, with a world market share of 41.6 per cent, and the second largest producer of upland cotton in the world, with a 20 per cent share. The US subsidization rate of 95 per cent provided by the second largest producer and largest exporter creates the potential of causing serious prejudice to the interests of other Members, including Brazil. It is useful to recall the size of these subsidies compared to the 5 per cent *ad valorem* rate establishing a presumption of serious prejudice under Article 6.1(a) and compared to the amount, if any, of subsidies received by US competitors.

8. But what was the impact of the large US subsidies on production and world supplies of cotton? One answer to this question is found in the difference between market revenue and the US producers' total costs. While claiming that only variable costs are important in the short term, the United States admits that in the long-term, US producers have to make a profit to stay in business. Using only USDA's data for the period MY 1997-2002, the *average* US upland cotton producer received market revenue that was $872 dollars *per acre less* than its total costs. This means the cost/revenue gap for all upland cotton farmers between MY 1997-2002 was $12.5 billion.

9. The United States has attempted to leave you with the impression that its upland cotton producers do not rely or need any subsidies between MY 1997-2002 to make up this $12.5 billion gap. In assessing the credibility of these claims, consider that during this same 6-year period, US cotton producers received $16 billion in US subsidies and ended up with a 6-year "profit" of $127 per acre. The US claims that the PFC, market loss assistance, direct payment and CCP payments were not support to cotton. But without those 4 payments, US cotton producers would have lost $333 per acre between MY 1997-2002. The US further claims that the marketing loan payments in MY 1999-2002 made no difference to producers' planting decisions. But this argument ignores the impact of the subsidies in those producers' costs. By MY 2002, the average US producer would have been faced with a 3-year loss of $372 per acre if they had *not* received marketing loan payments during MY 1999-2001. This evidence confirms the conclusion of the Chief USDA economist that by making marketing loan payments "*you don't get cutbacks in production*". Clearly, the marketing loan programme kept many producers from reducing their planted acreage between MY 1999-2002.

10. Indeed, US producers planted between 14.2 – 15.5 million acres of upland cotton between MY 1999-2002 as prices fell to record lows. The combined revenue from *all* the US subsidies and market prices allowed producers to earn a long-term "profit" of $17.67 per year over the 6-year period. What is most amazing is that after having received record low prices for their cotton in MY

2001 and with futures prices at the time of planting suggesting market prices would remain at record low levels, US producers still planted 14.2 million acres of upland cotton – a similar amount of acreage that was planted when prices were much higher in MY 1996-1998. However, even 135 per cent *ad valorem* subsidies in MY 2001 were not sufficient to provide a profit to the highest-cost and lowest-yield US producers. This explains why US planted acreage declined to 1996-98 levels in MY 2002.

11. Having established that the US subsidies prevented production cutbacks, the Panel has to estimate how much of a cutback would have been made without US subsidies. USDA economists Westcott and Price estimate a 20 per cent cutback in MY 2001 from only the marketing loan programme. Professor Sumner estimates an average production cutback of 28.7 per cent or a total of 19.8 million bales between MY 1999-2002 from eliminating all subsidies.

12. The Panel then must estimate the effect of these estimated US production cutbacks on world prices. First, Brazil demonstrated the impact of US overproduction on the US and the "world market" prices (A-Index and New York futures market prices). Brazil then demonstrated that prices in Brazil and the countries to which Brazilian exporters shipped their cotton between MY 1999-2002 were also suppressed and heavily influenced by US subsidies. The effects of those subsidies are communicated world-wide *via* a global price discovery mechanism. Throughout the world, prices for this fungible, price-sensitive commodity are determined by reference to the New York futures market and A-Index prices. There is a world market for upland cotton. Subsidized US cotton and Brazilian cotton compete in this world market, i.e., "in the same market", as used in Article 6.3(c) of the SCM Agreement. Brazil established that the effect of the US subsidies is significant price suppression in that world market.

13. There are numerous studies from a number of economists finding clear and identifiable amounts of price suppression ranging from 10-33 per cent for the US price and 10-26 per cent of the world A-Index price. Professor Sumner responded to the US critiques of these studies by showing that they are not biased and correcting for some shortcomings are consistent with his results. The United States also claims these studies are useless for this dispute because they did not use "futures prices", but then admits that USDA and FAPRI models also use "lagged prices" because it is not possible to use futures prices in models to judge farmers' revenue expectations. Brazil also demonstrated that, using the US futures methodology, farmers expected significant revenue from marketing loan programmes in MY 1999-2002.

14. Finally, the Panel should judge the "significance" of the price suppression by the extent of the impact on Brazilian producers. But even judged in relation to objective levels, any of the price suppression estimated in the various econometric studies is sufficient to establish "significance".

### 3. Claims under Article 6.3(d) of the SCM Agreement

15. The facts strongly support Brazil's claims that US subsidies contributed to an increased US world market share of exports. USDA's data show that US exports increased in MY 2001, MY 2002, and are projected to increase in MY 2003 to levels well above the previous 3-year averages as required by Article 6.3(d).

16. The US domestic subsidies played a major role in the increased US exports by maintaining high-cost US production. Similarly, the Step 2 subsidy was paid in 188 out of 208 weeks and more than $1.6 billion worth of US upland cotton exports received GSM 102 export credit guarantee financing. The NCC confirmed that both subsidies played a major role in the significant expansion of US exports, in particular against the background of a rapidly appreciating US dollar. Professor Sumner's analysis estimates that on average, US exports would be 41.2 per cent lower without any of the US subsidies between MY 1999-2002. US world export market share expanded

rapidly from MY 1999 even as prices plunged to record lows. After reaching 41.6 per cent in MY 2002, the US market share is projected to remain very high at 39 per cent in MY 2003.

17. The United States response to this evidence is to argue that the term "world market share" means "world market share of consumption". But USDA, Canada, and the EC agricultural experts, among others, use and interpret the phrase as "world market share of exports". This is the correct meaning as confirmed by the use of the word "trade" in the footnote qualifying Article 6.3(d), and by the close similarity between the scope and text of Article 6.3(d) and Article XVI:3, second sentence, which also deals with world market share of exports. Further, as we demonstrated yesterday, the US "consumption" interpretation is unworkable and illogical because US consumption is total domestic "shipments" (i.e. net use from production or stocks) plus imports *minus* exports. To count US exports as consumption means double counting other countries' imports as consumption.

**4. Claims under GATT Article XVI:1 and 3**

18. The facts strongly support a finding that the US share of world export trade is inequitable. While world market prices plunged and the US dollar appreciated rapidly, the huge US subsidies allowed US exporters to purchase a record high share of 41.6 per cent. At the same time, the share of much lower cost and non-subsidized producers declined between MY 1999-2002. The text of Article XVI:3, second sentence, covers any type of subsidy that "operates to increase the export" of a primary product such as upland cotton. Contrary to the US arguments, nothing in the text of the WTO or GATT 1994 suggests that Article XVI:3, second sentence, has been superseded by Article 6.3.

**5. Claims of Threat of Serious Prejudice**

19. Brazil has also established that there is a present threat of serious prejudice during the lifespan of the 2002 FSRI Act. This threat covers the threat of significant price suppression, threat of a further increased US world market share and the threat that the United States continues to have a more than equitable share of world export trade. The mandatory and unlimited nature of the production and trade-distorting US upland cotton subsidies and the absence of a legal mechanism that stems, or otherwise controls, the flow of these subsidies constitutes the actionable threat of serious prejudice to the interests of Brazil. The timing and nature of actionable subsidy cases, as well as the remedies available under the SCM Agreement compel that such a threat need not be "imminent", but instead "present" to be actionable.

20. Brazil has demonstrated that there is a present threat of serious prejudice from the existence of the US subsidies. There is no dispute between the United States and Brazil that the US marketing loan, Step 2, crop insurance and contract payments are mandatory subsidies. There is no limit on the amount of upland cotton that can be produced, used and exported from farmers receiving these payments. Brazil has also demonstrated that all of these subsidies are production and trade-distorting and have caused present serious prejudice between MY 1999-2002.

21. The most recent USDA and FAPRI baselines project continued high levels of US planting and continued high costs that will not be covered by market revenue. Therefore, the US subsidies will continue to have large production and export-enhancing and price-suppressing effects. In particular, until MY 2007, the US subsidies threaten to cause significant price suppression in the US, world, Brazilian and in third-country markets to which Brazil exports its upland cotton.

22. Finally, the US subsidies mandated until the end of MY 2007 will cause serious prejudice under any market conditions. Thus, the provisions mandating marketing loan, Step 2, crop insurance and direct and counter-cyclical payments constitute per se violations of Articles 5 and 6.3(c) and (d) of the SCM Agreement.

## 6. Brazil's Claims regarding Step 2 Export and Domestic Payments under Article 3.1(a) and (b) of the SCM Agreement

23. The Step 2 export and Step 2 domestic subsidies are prohibited subsidies under Article 3.1(a) and (b) of the SCM Agreement. The Step 2 export subsidies violate Article 3.1(b) because they are subsidies expressly contingent upon proof of export of US upland cotton and are paid only to eligible exporters. The NCC describes the Step 2 programme as "export assistance" and the USDA acknowledges it makes U.S. exports of upland cotton more "competitive".

24. The United States acknowledges that Step 2 domestic subsidies are local content subsidies within the meaning of Article 3.1(b) of the SCM Agreement. Local content subsidies to processors of agricultural commodities are not expressly exempted from the disciplines in the SCM Agreement by either Agreement on Agriculture or by the chapeau of Article 3.1. In particular, Annex 3, paragraph 7 and Article 6.3 of the Agreement on Agriculture do not create rights and obligations that by necessity conflict with Article 3.1(b). Brazil has demonstrated the absence of any inherent conflict because it is possible to provide domestic support to processors of agricultural products without violating Article 3.1(b). Further, Article 13(b)(ii) is properly read as meaning that even if a local content domestic support measure may conform to Article 6.3 of the Agreement on Agriculture, it is not exempted from claims under Article 3 of the SCM Agreement. If the drafters had intended to exempt agricultural local content subsidies from Article 3 claims, they would have included Article 3 in Article 13(b)(ii), the same way that they included Article 3 of the SCM Agreement in Article 13(c)(ii) for purposes of exempted export subsidies for scheduled products.

## 7. Brazil's Claims regarding the CCC Export Credit Guarantees

25. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP export credit guarantee programmes administered by the CCC constitute export subsidies within the meaning of Articles 10.1, 1(e) and 8 of the Agreement on Agriculture, Articles 1.1 and 3.1(a) of the SCM Agreement, and item (j) of the Illustrative List of Export Subsidies. Brazil has also demonstrated that those export subsidies circumvent, or threaten to circumvent, the United States' export subsidy reduction commitments, in violation of Articles 10.1 and 8 of the Agreement on Agriculture. Additionally, because they violate the Agreement on Agriculture, these programmes are not exempt from actions by Article 13(c)(ii) of the Agreement on Agriculture, and constitute prohibited export subsidies within the meaning of item (j) and Articles 1.1, 3.1(a) and 3.2 of the SCM Agreement.

## 8. Brazil's Claims regarding the ETI Act Subsidies

26. With respect to the ETI Act, Brazil and the United States agree that the Panel should follow the precedent of the panel in *India – Patents (EC)*. Indeed, the United States has effectively admitted the inconsistency of the ETI Act by repeatedly stressing to the Panel that it intends to implement the rulings and recommendations of the Dispute Settlement Body to bring the ETI Act into conformity with the Articles 10.1 and 8 of the Agreement on Agriculture and Articles 3.1(a) and 3.2 of the SCM Agreement.

# ANNEX H-3

## EXECUTIVE SUMMARY
## OPENING STATEMENT OF THE UNITED STATES AT THE SECOND MEETING OF THE PANEL WITH THE PARTIES

### I. THE EFFECT OF US SUBSIDIES IS NOT SIGNIFICANT PRICE SUPPRESSION

1. Brazil's theory of its case is that subsidies result in greater production, increased exports, and suppressed world prices for upland cotton. Brazil does not, because it cannot, refute the fact that US producers have increased and decreased acreage commensurately with producers in the rest of the world. Thus, there is no evidence that US producers are insulated from market forces in making production decisions.

2. In every year but one in which Brazil has alleged price suppression, and in marketing year 2003 in which it alleges a threat of price suppression, expected harvest season prices at the time of planting have been *above* the US marketing loan rate. In marketing year 2002, the only year in which expected harvest season price was below that rate, US harvested acres fell by a slightly *larger* percentage than the rest of the world. In fact, US planted acres fell by the amount expected from the decline in expected harvest season prices from marketing year 2001 to 2002 and by *far more* than would have been expected had producers been planting for the marketing loan rate. Therefore, rather than supporting Brazil's argument – that the effect of US payments is to make US producers unresponsive to market price changes – the evidence contradicts it.[1]

3. Brazil's allegation that the effect of US subsidies is price suppression is dispelled by the fact that Brazilian cotton undercuts the US price in various third-country markets.[2] Aggregated data on average US and Brazilian upland cotton prices to various markets identified by Brazil unambiguously show that Brazilian cotton undercuts the US price in these third-country markets. Thus, these data demonstrate that it is not US upland cotton that has suppressed Brazilian upland cotton prices, but Brazilian cotton prices that have undercut US prices.

### II. THE EFFECT OF US SUBSIDIES IS NOT AN INCREASE IN WORLD MARKET SHARE

4. The facts do not demonstrate any increase in US world market share. While US world market share in marketing year 2002 was projected to be higher than the average of the preceding three-year period, the 2002 subsidies are different from the subsidies for prior marketing years, and 2002 payments were only introduced with the 2002 Act. It is the effect of the 2002 subsidies that Brazil must demonstrate under Article 6.3(d) of the SCM Agreement establishes an increase that follows a

[1] We also recall that Brazil failed to properly analyze marketing loan payments through its use of "lagged prices" instead of futures prices. During marketing years 2000-2003, lagged prices significantly understate the harvest season prices expected by producers, thereby inflating the expected effect of the marketing loan rate.

[2] Brazil's evidence under Article 6.3(c) must establish the volume of subsidized US upland cotton that is "in the same market" as Brazilian upland cotton, the extent of subsidization, and the prices of those respective products sufficient to establish its claim of "significant price suppression". Brazil has not even shown that for each foreign market, there have been *any* US exports of upland cotton.

"consistent trend." One year does not make a "consistent trend". Thus, there can be no "consistent trend over a period when subsidies have been granted".[3]

## III. THE EFFECT OF US SUBSIDIES IS NOT A THREAT OF SERIOUS PREJUDICE

5. The facts do not support a finding of threat of serious prejudice. We submit that Brazil seeks to have the Panel reject the "imminent threat" standard, even though it was Brazil itself that previously suggested this standard to the Panel, because market prices have recovered to the point that *no marketing loan payments have been made since 18 September 2003*, and counter-cyclical payments are expected to be well below their statutory maximum for marketing year 2003.[4]

6. Brazil concedes that "market prices [may] increase to the point where the present effects of the subsidies are minimal". Given current and expected prices for marketing year 2003, even Brazil might have to concede that the present effects of US subsidies could be "minimal". However, Brazil seeks to prevent the Panel from basing its threat of serious prejudice analysis on that same marketing year 2003 data. If Brazil cannot demonstrate an imminent threat of serious prejudice in marketing year 2003, logically, neither can it demonstrate a threat of serious prejudice in farther off years, given that (in Brazil's words) "market[] prices move up and down," and "[n]o Member . . . can predict the course of future prices".

## IV. BRAZIL HAS FAILED TO SHOW THE ELEMENTS NECESSARY TO ESTABLISH ITS SUBSIDIES CLAIMS

7. Brazil has argued that no concepts or analysis drawn from other parts of the SCM Agreement or provisions from other agreements may be applied to claims under Part III of the Subsidies Agreement. This position is untenable. The United States is not suggesting some radical methodology dreamt up for purposes of this dispute but instead is proposing methods based on principles set forth in the SCM Agreement and accepted and applied by other WTO Members, including Brazil, for purposes of their countervailing duty practice.

8. Brazil says there is no need for it to quantify the subsidy benefit attributable to the product at issue nor the rate of subsidization but does not explain how to evaluate the effect of the subsidy without identifying the amount or rate of support. Further, Brazil has repeatedly alleged a subsidy amount and subsidization rate for the marketing year 1999-2002 period. Presumably, then, the value of the subsidy and the subsidization rate of exported US upland cotton would be highly relevant to the Panel's analysis of the effect of the challenged subsidies; Brazil's position would deprive the Panel of that crucial element.

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[3] Even if one were to look to the period since the 1996 Act when different subsidies were in place, there is no consistent trend over a period when those subsidies have been granted. The facts demonstrate that since marketing year 1996, US world market share has increased and decreased in alternating years, and US world market share in marketing year 2002 is lower than in marketing years 1996-1997. These data cannot support a finding of a consistent trend. Brazil seeks to evade these facts by ignoring the change in subsidies over the years and by interpreting "world market share" contrary to the ordinary meaning of those terms.

[4] The effect of such higher market prices is vividly suggested by Brazil's use of the January 2003 FAPRI baseline versus the November 2002 preliminary FAPRI baseline in Dr. Sumner's new model. We, of course, strongly disagree with what we understand to have been the way in which Dr. Sumner has most recently modeled all of the US payments at issue, but we note that a mere change in baselines that increased the baseline A-index price by an average of *4.24 cents per pound* per year over MY 2003-2007 *reduced* the estimated impact of removal of all US subsidies on A-index prices by *nearly one-third*. Price movements since January 2003 would suggest that Dr. Sumner's estimated impacts using more current data would be smaller still. For example, the January 2003 FAPRI baseline projected a 2003 marketing year A-index price of 58.40 cents per pound while the year-to-date A-index price has been *68.73 cents per pound*, an increase of more than 10 cents per pound over the January baseline.

9. Brazil errs in asserting that it need not identify the "subsidized product", ignoring or selectively quoting various provisions – Subsidies Agreement Articles 6.1(a), 6.3(c), 6.3(d), 6.4, and 6.5 – that expressly mention the "subsidized product". Subsidies to products other than upland cotton would not be within the Panel's terms of reference nor relevant to the Panel's analysis of the effect of the challenged subsidies. Again, Brazil's position would deprive the Panel of a crucial element in determining, for example, whether and to what extent the US product in the same market as the Brazilian product was a subsidized product.

10. Brazil also errs in arguing that it need not attribute payments not tied to production across the recipient's total value of production. The methodology of attributing subsidies not tied to production across the value of a recipient 's production is spelled out in Annex IV to Part III of the Subsidies Agreement. Attributing such non-tied payments across the total value of the recipient's production is necessary to avoid double-counting of the subsidy.

11. The United States does not see how decoupled payments made with respect to non-upland cotton base acres would be within the scope of this dispute. Given Brazil's own explanation of the measures it has challenged[5], it cannot be possible that one set of measures was within the scope of the dispute at one point but that Brazil has the sole discretion to change the scope of that dispute by changing its legal position as to what it is challenging as support to upland cotton.

12. Finally, Brazil says effects of subsidies can linger, even if allocated to a particular year for countervailing duty purposes. It is clear in Annex IV, paragraph 7, that Members took it for granted that some subsidies are allocated to future production and others are not. Brazil, however, does violence to this principle by essentially asserting that all subsidies – including so-called "recurring" subsidies that most experts and national authorities (including its own) would expense to current production – should be allocated to future production. Brazil has now conceded that the subsidies at issue in this dispute are "recurring".[6] Brazil cannot have it both ways: it cannot expense the entire value of a payment to a particular crop year but also claim that the subsidy continues to exist in a later year in which new recurring subsidies are made.

## III. BRAZIL'S HAS FAILED TO SHOW THE EFFECT OF THE CHALLENGED SUBSIDIES

13. **Decoupled Payments**. Brazil has fundamentally erred in its explanation and modelling of decoupled payments by ascribing a production effect to them that is based on little more than conjecture. This assertion contradicts basic economic theory, the economic literature on such payments, and the available data showing large shifts in cotton acreage as recipients of decoupled payments plant alternative crops or no crops at all and other farmers who do not hold upland cotton base acres choose to produce upland cotton.[7] Thus, there is no basis to ascribe production-distorting

[5] For example, Brazil has repeatedly argued that the challenged US subsidies provided $12.9 billion in support over marketing years 1999-2002; this figure was based on payments made under specific programmes, including decoupled income support with respect to upland cotton base acres only. Brazil also has argued that decoupled payments for upland cotton base acres (net of base acres not "planted to cotton") are all support to upland cotton irrespective of what is planted on the land now.

[6] *See* Brazil's Further Rebuttal Submission, para. 208 n. 344 ("Brazil agrees that the recurring subsidies at issue would be allocated to the year in which they are paid for purposes of a CVD analysis . . . .").

[7] For example, the marketing year 2002 base acreage increase means that, on average over marketing years 1998-2001, 2.6 million acres of upland cotton were planted on farms without upland cotton base acreage or in excess of those farms' upland cotton base acreage, suggesting that Brazil's theory that upland cotton must be planted on upland cotton base acreage is not supported by the facts.

effects to decoupled payments. In fact, most empirical studies have concluded that the effects of decoupled payments are minimal.[8]

14. **Third-Party Papers**. Brazil cannot cite to results from papers that employ an approach fundamentally at odds with its own. These third-party economic studies do not provide insight into the question this Panel has been asked to examine because they generally suffer from two crucial conceptual flaws. First, most of the cited studies do not distinguish between payments linked to production of upland cotton and payments decoupled from any requirement to produce, instead treating them as having equal production impacts. Second, most of the third party studies do not model the marketing loan programme appropriately, simply removing revenue from the producer without focusing on the producer's expected harvest season price at the time of planting. Thus, Brazil would have to agree that these third party papers do not properly model farmers' production decisions.

## IV. BRAZIL HAS ADVANCED ERRONEOUS LEGAL STANDARDS UNDER ITS CLAIM IN THIS DISPUTE

15. **Threat of Serious Prejudice/Article XVI:3**. Brazil may not advance a claim of threat of serious prejudice using the "more than equitable share of world export trade" standard from GATT 1994 Article XVI:3. Nothing in the text of GATT 1994 Article XVI indicates that a threat claim under paragraph 1 may utilize the more than equitable share standard under paragraph 3. Neither is there any analysis in the *EC – Sugar Exports* GATT panel report that provides a textual basis to import that standard. Further, Brazil's interpretation would also introduce a contradiction between GATT 1994 Article XVI:1 and SCM Agreement Articles 5 and 6 even though the term "serious prejudice" is used "in the same sense" in these provisions.[9]

16. **Threat of Serious Prejudice and *Per Se* Serious Prejudice Standard**. Brazil's argument is that "[c]onsistent with prior precedent [the GATT *EC – Sugar Export Subsidies* panel report], the threat of serious prejudice is caused by the absence of any legal mechanism that stems or otherwise controls the flow of mandatory and unlimited US subsidies". The GATT *Sugar Export Subsidies* panel report, however, provided no basis for selecting that standard, and neither we nor Brazil find any basis for that standard in the text of the Subsidies Agreement or GATT 1994 Article XVI:1.

17. Brazil is simply wrong that US payments are "mandatory" and "unlimited".[10] More fundamentally, however, Brazil's argument that "the availability of a mandatory subsidy for an unlimited amount of production and exports will inevitably create a threat and support a finding of a per se violation" proves too much. Brazil's standard means that only way a Member could act consistently with its WTO obligations would be to have a cap on expenditures with respect to a

[8] A recent study concluded that production flexibility payments had "no effects on agricultural production in either the short run or the long run". USDA, ERS, Decoupled Payments: Household Income Transfers in Contemporary US Agriculture, M.E. Burfisher and J. Hopkins, Eds. (February 2003), at 23. (See Exhibit US-53). Other studies cited in Exhibit US-23 and discussed in the US rebuttal and further rebuttal submissions suggest that the effects of decoupled payments on planted area are less than 0.5 per cent.

[9] Under Articles 5 and 6 a Member cannot claim threat of serious prejudice using the "more than equitable share" standard because that standard is not enumerated in SCM Agreement Article 6.3(c). Therefore, under Brazil's interpretation, a Member could show a threat of "serious prejudice" (under GATT 1994 Article XVI:1) by showing a threat of something that is not "serious prejudice" within the meaning of Articles 5 and 6.

[10] The payments Brazil identifies as "mandatory" are "mandatory" only if price conditions are fulfilled. Thus, the *likelihood* that price conditions will be satisfied must be taken into account. The payments Brazil identifies are also not "unlimited". For decoupled payments, the payments are set by multiplying fixed base acres times fixed base yields times the fixed or statutory maximum payment rate. The challenged payments are also not unlimited because a "circuit breaker" in the 2002 Act could result in these "mandatory" payments not being made.

particular product. It is not at all clear at what level such a cap would have to be set. But Members rejected product-specific expenditure caps in the Uruguay Round, instead agreeing on a commitment across *all* commodities (the Total and Final Aggregate Measurement of Support).

## V. BRAZIL'S SUBSIDIES AND PEACE CLAUSE ARGUMENTS MUST BE CONSISTENT

18. Brazil's arguments in this dispute must be consistent. First, it is evident that Brazil has conceded that various payments it previously claimed were product-specific – namely, decoupled income support and crop insurance – are, in fact, non-product-specific support. That is, these subsidies are provided to "agricultural producers in general", either because they do not specify any production that must occur for receipt of payment or because they are provided to producers of a wide range of products.[11] As non-product-specific support, they should not be included in the comparison under Article 13(b)(ii) of the Agreement on Agriculture. This contradicts the Brazilian approach, and is consistent with the US approach, to the Peace Clause.

19. Second, Brazil not only recognizes that support to upland cotton *may* be measured in terms of a rate but also that this is the only way to gauge the support decided by the United States for future years; therefore, Brazil relies on the rate of support concept for its threat and *per se* claims.[12] By advancing such arguments, Brazil has effectively conceded the basis for the US Peace Clause analysis – that is, that the only way for Members to know whether US measures for any given year will comply with Peace Clause requirements is to examine the way in which they "decide" support: that is, the rate of support. If Brazil makes arguments under its subsidy claims based on the rate of support, it cannot credibly assert that the rate of support is inapt in the context of the Peace Clause. As demonstrated during the Peace Clause phase, the United States disciplined itself to remain within those limits by deliberately moving away from production-linked deficiency payments with a high target price to decoupled income support.

[11] For example, if a recipient of decoupled income support can choose to produce cotton, something else, or nothing at all, the payment is not tied to production of a particular product. There is nothing in the Agreement on Agriculture to suggest that support may be at one and the same time "product-specific support" and "non-product-specific support". Thus, in attributing part of the decoupled payments on upland cotton base acres to producers and part to non-producers, Brazil concedes that such payments are non-product-specific support.

[12] Brazil's Further Submission, para. 432 ("When US upland cotton farmers plant their crop in spring, farmers expect a certain price level. But, by no means is it ensured that this price level will be accomplished. However, given the US subsidies, that is irrelevant. . . . . *The single fact that these programmes exist ensures a guaranteed revenue amount from the production of upland cotton.*") (italics added).

# ANNEX H-4

## EXECUTIVE SUMMARY
## CLOSING STATEMENT OF THE UNITED STATES AT THE SECOND MEETING OF THE PANEL WITH THE PARTIES

### I. CCC EXPORT CREDIT GUARANTEE PROGRAMMES ISSUES

#### A. BRAZIL WRONGLY MINIMIZES THE SIGNIFICANCE OF ARTICLE 10.2 OF THE AGREEMENT ON AGRICULTURE

1. Brazil's assertions in its opening oral statement regarding the CCC export credit guarantee programmes invite a brief response.

2. First, as discussed with the Panel during this meeting, Brazil asserts that Article 10.2 of the Agreement on Agriculture reflects merely a banal compromise to accommodate potential "additional obligations regarding notification, consultation, and information exchange". Brazil implausibly asserts that the obvious transition between the language of the Draft Final Act that would have imposed significant substantive disciplines on export credit guarantees and the absence of such language in the Article 10.2 ultimately adopted can be fully explained as reflecting merely an agreement to work on such pedestrian disciplines as information exchange.

3. Brazil asserts that the Members had agreed on the applicability of export subsidy disciplines to export credit guarantees and that Article 10.2 was an apparently insignificant "good faith agreement". However, Article 10.2 did not arise only because "other participants were not willing to offer more than general disciplines included in Article 10.1". It arose because part of the grand compromise of the Agreement on Agriculture was that export credit guarantees were excluded from the export subsidy disciplines.

4. Ironically, however, Brazil's statement further serves to illustrate that export credit guarantees were *not* considered export subsidies under the Agreement on Agriculture. In December 1994, the Preparatory Committee for the World Trade Organization issued *Notification Requirements and Formats Under the WTO Agreement on Agriculture*.[1] These notification requirements remain in effect. Elaborate reporting requirements are set forth for Members with respect to numerous aspects of the disciplines of the agreement, including with respect to export subsidies.[2] However, no reporting requirement is indicated for export credit guarantees. This is consistent with treatment of such programmes as outside export subsidy disciplines. Had the parties agreed that all were "willing to offer" at least "the general disciplines included in Article 10.1", as Brazil asserts, then it would have been logical to include reporting requirements for such purposes. It is hard to imagine parties willing to make such an offer in the absence of the United States, among the largest providers of export credit guarantees. In fact, the United States never offered to include export credit guarantees in Article 10.1, and the Members never so agreed. Indeed, the agreement reflected in Article 10.2 is expressly to the contrary.

5. Article 10.2, furthermore, would be unnecessary for mere "notification, consultation, and information exchange". Had export credit guarantees been subject to export subsidy disciplines,

[1] PC/IPL/12, circulated 2 December 1994 (exhibit US-99).
[2] See, e.g., Exhibit US-99, paras. 1(c), 1(e), 1(i), 2; Table ES:1 and Supporting Tables ES:1 and ES:2.

Article 18 of the Agreement on Agriculture, to review the progress in the implementation of commitments negotiated under the Uruguay Round reform programme, and the Notification Requirements, which are still in effect, could amply accommodate any "notification, consultation, and information exchange".[3]

B. BRAZIL INVENTS A STANDARD NOT REQUIRED UNDER ARTICLE 10.3 OF THE AGREEMENT ON AGRICULTURE

6. Second, with respect to Article 10.3 of the Agreement on Agriculture, Brazil asserts that the only way for the United States to satisfy any burden applicable under that provision is "to demonstrate the absence of subsidization on a transaction-by-transaction basis". Such a standard would obviously be impossible to satisfy. Perhaps more importantly, Article 10.3 requires no such demonstration. Brazil simply invents this. The only authority it offers for this novel proposition is a Third Party Submission of Canada, which itself offers no authority for the assertion.

7. Article 10.3 applies only to export subsidy *reduction* commitments. We believe that Brazil agrees at least with that. Brazil has alleged that the United States has exceeded only its quantitative export subsidy reduction commitments and only during the period July 2001-June 2002. The United States has demonstrated that with respect to 12 of the 13 commodities for which the United States has reduction commitments the respective exports during that period under the export credit guarantee programme did not exceed applicable quantitative reduction commitments. Other than the Dairy Export Incentive Programme applicable to cheese and skim milk powder, with respect to which the United States previously noted in a prior submission the issuance of export subsidies, the United States provided no export subsidies for the other scheduled commodities. To avoid any further ambiguity the United States submits a copy of its notification concerning export subsidy commitments for fiscal year 2001, which reflects no export subsidies provided by the United States other than for cheese and skim milk powder.[4]

C. BRAZIL'S RECENT STATEMENTS CONCERNING THE CORRECT ANALYSIS UNDER ITEM(J) ARE INCONSISTENT AND INCORRECT

8. Third, with respect to item (j) Brazil directly acknowledges its view that the relevant period of time for examination is 10 years.[5] Yet Brazil disingenuously urges the Panel to examine allegedly "uncollectible amounts" on pre-1992 guarantees, and defaults of Iraq and Poland, which commenced in 1990 and the 1980's, respectively.[6]

9. Brazil also mysteriously alleges that "according to CCC's 2002 financial statements, CCC has been relieved of what the United States argues are onerous government-wide accounting rules that 'compel' projection of enormous losses". CCC, however, has never been so "relieved". It remains compelled to adhere to the requirements of the federal Credit Reform Act of 1990, and relevant provisions of the Office of Management and Budget Circular A-11, implementing that legislation. CCC remains subject to government-wide requirements for subsidy estimates and the risk categories mandated by OMB with respect to exposure to debt from different countries. The government-wide rules continue to dictate the methodology for calculation of estimates, and reestimates, and as the United States has previously noted, a principal reason for overly high initial estimates is continuously overly optimistic projections of programme use. Also, as the United States has previously noted, the result of the estimate (and reestimate) process is simply carried forward to the CCC financial statements; Brazil continues to misrepresent the $411 million figure in the 2002 financial statement

[3] See, e.g., Article 18.5, 18.6, and 18.7.
[4] *Notification*, G/AG/N/USA/47, circulated 6 June 2003 (exhibit US-100).
[5] Statement of Brazil - Second Panel Meeting (2 December 2003), para. 81.
[6] Statement of Brazil - Second Panel Meeting (2 December 2003), para. 84.

as well as to mistakenly assert the inclusion of "enormous uncollectible amounts . . . on post-1991 guarantees".

D. BRAZIL CONTINUES TO WRONGLY ASSERT THAT THE ISSUANCE OF CCC EXPORT CREDIT GUARANTEES IS UNBOUNDED

10. Fourth, with respect to Brazil's circumvention arguments, Brazil continues to insist that notwithstanding the myriad programmatic impediments to issuance of guarantees the export credit guarantee programmes are a runaway train, beyond the ability of CCC to "stem or otherwise control the flow of" CCC export credit guarantees. With respect, this is simply not so.

11. Similarly, in its oral statement, Brazil has increased the supposed annual mandatory minimum dollar amount of guarantees to $6.5 billion from $5.5 billion.[7] As the United States has previously observed, CCC has never remotely approached issuing any such fancifully large amount of export credit guarantees.[8]

## II. ACTIONABLE SUBSIDY ISSUES

12. The United States has reviewed Brazil's evidence and arguments underlying Brazil's actionable subsidy claims and found them lacking. We will not repeat our criticisms of fundamental errors in Brazil's legal interpretations. We do note that the evidence on the record does not demonstrate that US producers are unresponsive to market price signals, does not demonstrate significant price suppression in any "same market", does not demonstrate an increase in world market share, and does not demonstrate a threat of serious prejudice. Our comments today go principally to the consistency, or lack thereof, in Brazil's arguments.

A. BRAZIL HAS FAILED TO ESTABLISH ALL OF THE ELEMENTS NECESSARY TO ESTABLISH ITS SUBSIDIES CLAIMS

13. Consider the fundamental issue of identifying the subsidized product and the subsidy.

### 1. Brazil has not identified which products benefit from the subsidy

14. If Brazil cannot distinguish the benefit to cotton provided by a subsidy from the benefit to other products – that is, attribute the subsidy to the recipient's production – then it will lead to double-counting of the subsidy benefit. Recall the example the United States provided in the opening statement with respect to soybeans and cotton. If a producer grows both soybeans and cotton and receives a $1 payment not tied to the production of any crop, according to Brazil's approach, the *entire* $1 payment is attributed to and support for upland cotton. However, were Brazil to bring a dispute settlement proceeding against US support for soybeans (as was reported almost occurred roughly two years ago), under Brazil's approach, the entire $1 payment would *also* be support for soybeans. The same $1 payment cannot provide both $1 in benefit to cotton and $1 in benefit to soybeans – that's double-counting. Therefore, the payment must be attributed across the value of the recipient's production. As noted in the US further rebuttal submission, Brazil *would* attribute the value of the payment across all of a recipient's production for countervailing duty purposes.

[7] *Compare* Statement of Brazil - Second Panel Meeting (2 December 2003), para. 91, *with* Answer of Brazil to Panel Question 142 (October 27, 1993) paras. 95, 100.

[8] US Further Rebuttal Submission (18 November 2003), para. 201.

**2. Brazil has not quantified the subsidy benefit attributable to upland cotton**

15. If Brazil cannot properly quantify the amount of subsidy benefit to upland cotton producers, how can the Panel analyze the effect of the subsidy? Brazil cannot both claim that it need not quantify the benefit and at the same time argue that the subsidies provide $12.9 billion in aggregate support.

16. Similarly, if Brazil cannot properly identify the level of subsidization of the exported product, the Panel's analysis will be impacted. Again, Brazil cannot claim that it need not identify the subsidization rate and at the same time claim a 95 per cent subsidization rate over the 1999-2002 marketing year period.

**3. Brazil has not expensed the recurring payments at issue, contrary to its countervailing duty practice and inconsistent with its arguments in this dispute**

17. Finally, Brazil cannot both expense the *entire* amount of these subsidies it admits are "recurring" to the year for which the payment was received (for example, marketing year 1999) and *also* claim that the subsidy continues to exist in a later year in which new recurring subsidies are made (for example, marketing year 2002). That is, if the subsidy continues to exist in a later year, it *must* have been allocated to future production. Indeed, Brazil would expense these recurring payments for purposes of countervailing duties.

18. The Panel must demand consistency from Brazil. It is not enough for Brazil to say that those concepts are for countervailing duty purposes, not for serious prejudice purposes. We were not aware that the concept and definition of "subsidy" as used in Part III and Part V of the Subsidies Agreement were intended to have different meanings. In fact, there is nothing in the Subsidies Agreement to suggest that they should mean different things.

19. Brazil not only rejects the Subsidies Agreement Annex IV methodology with respect to these issues, and not only rejects its own countervailing duty methodology, but does not provide any rational method of approaching these issues. Brazil's approach results in dramatically inflated quantities of support and dramatically inflated levels of subsidization. The Panel should reject Brazil's unprincipled approach to subsidy identification issues.

B. BRAZIL'S APPROACH TO ITS SERIOUS PREJUDICE CLAIMS AND THE PEACE CLAUSE MUST BE CONSISTENT

20. Similarly, as indicated in the US opening statement, the Panel must demand consistency from Brazil between its arguments for purposes of serious prejudice and the Peace Clause. First, Brazil cannot rely on the *rate* of support in US. law and regulations for purposes of its threat and *per se* claims and *deny* their relevancy to the Panel's Peace Clause analysis.

21. Second, with respect to decoupled payments (such as direct payments), Brazil cannot attribute part of a decoupled payment to upland cotton producers and part to non-producers, and *simultaneously* claim that such decoupled payments are not non-product-specific support. They are non-product-specific support because they are (in the language of Article 1(a) of the Agreement on Agriculture) "support provided to agricultural producers in general" and because they are not (in the language of Article 1(a)) "support provided *for an agricultural product* in favour of the producers of an agricultural product". That is, Brazil has acknowledged that some recipients of, for example, direct payments are not producers of upland cotton; they are, rather, "producers in general". Under the Agreement on Agriculture, support (such as direct payments) cannot at the same time be both product-specific support and non-product-specific support. Thus, these payments would not form part of the Peace Clause (Article 13(b)(ii)) analysis.

22. Finally, it is clear that, under Brazil's approach, there can be *no* non-product-specific support for purposes of the Peace Clause. This results because a subsidy payment can always be traced to a final recipient and then can always be attributed to whatever products he or she produces. One problem with this result is that a Member can then have no certainty that it will be in compliance with the Peace Clause in any given year.

23. Consider a hypothetical: under Brazil's outlay approach to the Peace Clause, if a Member gave only decoupled support to producers, but in a given year all the recipients of the payment decided *only* to produce one commodity, the support (outlays) attributed to that commodity in that year could exceed the 1992 support level. But that would purely be a function of the recipients' decisions, not the decision of the United States. Brazil's approach therefore would rob Members of the ability to decide their support in a way to ensure conformity with Peace Clause requirements, and it must be rejected.

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**WORLD TRADE ORGANIZATION**

**WT/DS267/R/Add.2**
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# UNITED STATES – SUBSIDIES ON UPLAND COTTON

## *Report of the Panel*

Addendum

This addendum contains the Annex I to the Report of the Panel to be found in document WT/DS267/R. Annexes A-H can be found in Add.1 and Annexes J-O can be found in Add.3.

# ANNEX I

## ANSWERS OF PARTIES TO THE PANEL'S QUESTIONS AND OTHER COMMENTS AND DOCUMENTS RECEIVED FROM PARTIES

# ANNEX I-1

## ANSWERS OF BRAZIL TO QUESTIONS POSED BY THE PANEL FOLLOWING THE FIRST SUBSTANTIVE MEETING OF THE PANEL

11 August 2003

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| *US – FSC (21.5)* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation". Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002. |
| *EC – Bed Linen (21.5)* | Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton – Type Bed Linen from India. Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003 |
| *Chile – Agricultural Products (Price Band)* | Appellate Body, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002. |
| *Canada – Aircraft II* | Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, adopted 19 February 2002. |

**LIST OF EXHIBITS**

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| Agricultural Assistance Act of 2003, in P.L. 108-7 | Exhibit Bra-135 |
| P.L. 106-113 | Exhibit Bra-136 |
| P.L. 106-224 | Exhibit Bra-137 |
| P.L. 107-25 | Exhibit Bra-138 |
| 68 Federal Register 20331, 20331-20332 | Exhibit Bra-139 |
| Pindyck, Robert S. and Rubinfeld, Daniel L., Microeconomics, 5 Edition (2002), Prentice hall, New Jersey. | Exhibit Bra-140 |
| 7 U.S.C. 5622 | Exhibit Bra-141 |
| Agricultural Outlook, USDA, May 2002 | Exhibit Bra-142 |
| Agricultural Statistics 2003, USDA | Exhibit Bra-143 |
| G/AG/R/31 | Exhibit Bra-144 |
| US and State Farm Income Data, (United States and States 1997-2001), USDA | Exhibit Bra-145 |
| Acreage, NASS, 28 June 2002 | Exhibit Bra-146 |
| Estimate of Support Granted by Commodity via Counter-Cyclical Payments. Agricultural Prices | Exhibit Bra-147 |
| Statement of Administrative Action | Exhibit Bra-148 |
| Agricultural Outlook, USDA, August 2002 | Exhibit Bra-149 |
| G/AG/N/USA/10 | Exhibit Bra-150 |
| "US Export Credit Guarantee Programs: What Every Importer Should Know About the GSM-102 and GSM-103 Programs", USDA, November 1996. | Exhibit Bra-151 |
| GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, "Status Report on GAO's Reviews of the Targeted Export Assistance Program, the Export Enhancement Program, and the GSM 102/103 Export Credit Guarantee Programs," GAO/T-NSIAD-90-53, 28 June 1990. | Exhibit Bra-152 |

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| US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report N° 06401-14-FM, June 2001 | Exhibit Bra-153 |
| US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report N° 06401-4-KC, February 2002. | Exhibit Bra-154 |
| US Department of Agriculture Foreign Agricultural Service, "Notice to GSM – 102 and GSM – 103 Programme Participants", 24 September 2002 | Exhibit Bra-155 |
| US Export-Import Bank, "Comparison of Major Features of Programs Offered by Ex-Im Bank and Commodity Credit Corporation for Support of Bulk Agricultural Commodities" | Exhibit Bra-156 |
| US General Accounting Office, Report to the Chairman, Task Force on Urgent Fiscal Issues, Committee on the Budget, House of Representatives, "International Trade: Iraq's Participation in US Agricultural Export Programs", GAO/NSIAD-91-76, November 1990 | Exhibit Bra-157 |
| US Department of Agriculture, Office of Inspector General, Financial and IT Operations Audit Report, "Commodity Credit Corporation's Financial Statement for Fiscal Year 2002", Audit Report N° 06401-15-FM, December 2002 | Exhibit Bra-158 |
| US General Accounting Office, Report to Congressional Requesters, "Loan Guarantees: Export Credit Guarantees Programs' Costs are High", GAO/GGD-93-45, December 1992 | Exhibit Bra-159 |
| US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, "Agriculture Financial Standards Manual (May 2003) | Exhibit Bra-160 |
| US Federal Accounting Standards Advisory Board, Federal Financial Accounting and Auditing Technical Release 3, "Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act", 31 July 1999. | Exhibit Bra-161 |
| Government – Wide Audited Financial Statements Task Force on Credit Reform, "Issue Paper, Model Credit Programme Methods and Documentation for Estimating Subsidy Rates and the Model Information Store", 96-CR-7, 1 May 1996 | Exhibit Bra-162 |
| Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002 | Exhibit Bra-163 |
| US Department of Agriculture, Foreign Agricultural Service, "Revised FY 2001 and FY 2002 Annual Performance Plan". | Exhibit Bra-164 |

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| US Department of Agriculture, Foreign Agricultural Service, "Revised FY 2000 and FY 2001 Annual Performance Plan". | Exhibit Bra-165 |
| US Department of Agriculture Foreign Agricultural Service, News Releases regarding extension of GSM 102 and GSM 103 guarantees to Dominican Republic, Morocco, Ghana, South Korea, Vietnam and Algeria | Exhibit Bra-166 |
| 12 Steps to Participating in the USDA Supplier Credit Guarantee Program, Step 5. | Exhibit Bra-167 |
| US Department of Agriculture Foreign Agricultural Service, News Releases regarding extension of SCGP guarantees to Tunisia, Azerbaijan, Vietnam, South Korea, Japan and Nigeria | Exhibit Bra-168 |

A. UPLAND COTTON

**1. Please confirm that all information and data that you have provided to the Panel relating to "cotton" in fact relates to upland cotton only. BRA, USA**

Brazil's answer:

1. Brazil can confirm that, except as explicitly stated otherwise, all the data and references made by Brazil to "cotton" relate and will relate to "upland cotton" only.

B. PRELIMINARY ISSUES

*Note to parties: As indicated in the cover note, the Panel has expressed its views in respect of the three United States requests for preliminary rulings. The Panel's questions reflected in this compilation relating to the requested preliminary rulings on which the Panel has expressed its views are those that were posed in the course of the first session of the first Panel meeting. This is to give an opportunity for the parties to transpose into writing their oral responses.*

**1. Product scope of Panel's terms of reference relating to Brazil's export credit guarantee claims**

**2. Is Brazil's claim in relation to export credit guarantees against the measures said to constitute the GSM-102, GSM-103 and SCGP programmes in their entire application, or against the measures said to constitute the GSM-102, GSM-103 and SCGP programmes in their application to upland cotton, or both? BRA**

Brazil's answer:

2. Brazil confirms that its claims against GSM 102, GSM 103 and SCGP concern the programmes in their entirety and are *not* limited to their application to upland cotton.

**3. If the request for consultations in this dispute omitted certain products in relation to export credit guarantees, on what basis is it argued that it failed to identify the measures at issue in accordance with Article 4.4 of the DSU? USA**

**4. Is it argued that the export credit guarantee programmes concerning upland cotton are each a separate or independent measure, in that they operate independently? USA**

**5. Is there a specification in any legislation or regulation (or any other official government document) which limit or restrict the export credit guarantee programmes at issue exclusively to upland cotton? USA**

**6. For the purposes of the Panel's examination of Brazil's claims relating to GSM-102, GSM-103 and SCGP under the Agreement on Agriculture and the SCM Agreement, is accurate data and information available with respect to these export credit guarantee programmes concerning upland cotton alone (e.g. with respect to "long-term operating costs and losses")? In this respect, the Panel also directs the parties' attention to the specific questions below relating to the programmes. USA**

**7. Are commitments with respect to export subsidies under the Agreement on Agriculture commodity-specific? How, if at all, is this relevant? BRA, USA**

Brazil's answer:

3. Under Articles 3.3 and 8 of the Agreement on Agriculture, a Member can only grant export subsidies for agricultural products if that Member has an export subsidy reduction commitment for the agricultural product in question. The commodity specific aspect becomes relevant in Step 2 and ETI export subsidies because the United States scheduled no reduction commitments for upland cotton. In the case of the export credit guarantee programs challenged by Brazil, the commodity specific aspect becomes relevant only after the Panel has found that export credit guarantees are export subsidies within the meaning of the Agreement on Agriculture. At that stage, the Panel needs to examine whether (a) for the group of *unscheduled* commodities, which includes upland cotton, and (b) for each of *scheduled* commodities, there is a threat of circumvention of the US export subsidy reduction commitments. Brazil has set forth its arguments that GSM 102, GSM 103 and SCGP violate Article 10.1 of the Agreement on Agriculture for both scheduled and unscheduled commodities in paragraphs 295-305 of its First Submission.

4. The commodity-specific nature of export subsidy reduction commitments is, however, irrelevant for determining whether GSM 102, GSM 103 and SCGP in their application to all eligible products are within the Panel's terms of reference.

**8. Does the United States confirm that the questions referred to by Brazil in paragraph 92 of Brazil's oral statement were posed to the United States in the consultations? USA**

**9. How does the United States respond to paragraph 94 of Brazil's oral statement? USA**

**10. What actual prejudice, if any, has the United States suffered as a result of the alleged omission of products other than upland cotton from the request for consultations? USA**

**11. Does the United States agree that Brazil's request for establishment of the Panel can be understood to indicate that Brazil's export credit guarantee claims relatesto products other than upland cotton? How, if at all, is this relevant? USA**

**12. Please address issues and submit evidence regarding the three export credit guarantee programmes concerned relating to upland cotton and other eligible agricultural commodities in your answers to questions and rebuttal submissions. BRA, USA**

Brazil's answer:

5. Brazil has presented its arguments and evidence concerning the three export credit guarantee programmes always with respect to all eligible agricultural commodities[1] and will continue to do so in its answers to these questions and in future submissions to the Panel.

**13. Please include any argumentation and evidence to support your statement during the Panel meeting that the inclusion of such other eligible agricultural commodities would create additional "work" for the Panel with respect to each of these commodities under Article 13 of the Agreement on Agriculture. USA**

[1] *See* paragraphs 252-314 of the First Submission of Brazil and paragraphs 116-133 of the Oral Statement of Brazil.

**2. Expired measures**

**14. Please submit evidence regarding the programmes under the 1996 FAIR Act, in particular, production flexibility contract payments and market loss assistance payments, to the extent that they would be relevant to the Panel's determination under Article 13 of the Agreement on Agriculture in your answers to questions and rebuttal submission. USA**

**15. Do the parties agree that it is beyond a Panel's power to recommend a remedy for an expired measure? Could the Panel could be required to examine "expired measures" in order to conduct its assessment of the matter before it? How, if at all, is Article 7.8 of the SCM Agreement relevant to these matters? BRA, USA**

Brazil's answer:

6. The Panel must examine any continuing effects of subsidies provided by expired measures, and it can recommend a remedy for any such continuing effects. Brazil has set forth its arguments in that respect in paragraphs 4-7 of its Closing Statement at the First Substantive Meeting of the Panel with the Parties, as well as in paragraphs 141-144 of its Oral Statement at the same meeting. Subsidies provided under expired subsidy measures can be the source of present adverse effects. Preventing a panel from examining expired measures in its assessment of the matter before it would render the adverse effects provisions of the SCM Agreement a nullity, as a Member would be freed from any responsibility for the effects of its subsidies by, for example, simply letting the legislation expire and renewing it every year (or in even shorter periods). The Panel is, thus, required to analyze the effects of subsidies provided by production flexibility contract ("PFC") payments and market loss assistance payments in its assessment of Brazil's adverse effects claims. Disregarding those payments would not enable the Panel to conduct "an objective assessment of the matter before it", as it would disregard a source of present adverse effects.[2]

7. Article 7.8 of the SCM Agreement offers the Panel the possibility to recommend a remedy for the adverse effects from subsidies provided by expired measures. Under Article 7.8, a Panel can recommend that a Member withdraw the adverse effects of the expired measures. By virtue of DSU Appendix 2, Article 7.8, not DSU Article 19, provides the basis for remedies involving claims under Articles 5 and 6 of the SCM Agreement. In making recommendations under such claims, the Panel is not limited to a recommendation that a Member bring its measures into conformity with a covered agreement. Rather, a Panel finding adverse effects caused by a Member's actionable subsidies must recommend that the Member withdraw the subsidy or remove the adverse effects.

8. In sum, the Panel is required to objectively assess the present effects of PFC and market loss assistance payments on US production, US exports and prices of upland cotton. If it finds that these subsidies cause adverse effects within the meaning of Articles 5 and 6 of the SCM Agreement – as Brazil believes the Panel will find based on the arguments and evidence to be presented by Brazil on 9 September 2003 – the Panel should recommend that the United States remove the adverse effects pursuant to ASCM Article 7.8.

**3. Agricultural Assistance Act of 2003**

**16. What, if any, prejudice in terms of the presentation of its case does the United States allege, should the Panel proceed to consider the measures constituting the cottonseed payments under the Agricultural Assistance Act of 2003? USA**

[2] The analysis in this paragraph is relevant to the first paragraph of Brazil's Answer to Panel Question 19.

**17. (a) What is the relationship of the Agricultural Assistance Act of 2003 to other legislation in the request for establishment of the Panel? BRA, USA**

**(b) Do the legal instruments follow directly one after another, or are there temporal gaps? Are payments authorized under a broad legislative authority or are they specific to each legal instrument? BRA, USA**

**(c) Please provide any implementing regulations. Do these implementing regulations resemble those relating to previous programmes or payments? Are payments made retrospectively? How if at all is this relevant? BRA, USA**

Brazil's answer:

9. Cottonseed payments for MY 2002, as with the previous cottonseed payments in MY 1999 and 2000, were authorized by annual appropriations acts involving a variety of other legislative provisions that do not relate to cottonseed payments.[3] Public Law 106-113, inter alia, appropriated funds otherwise unused for assistance to producers or first-handlers of the MY 1999 crop of cottonseed.[4] The United States indicated in consultations that $79 million had in fact been used for that purpose. Public Law 106-224, inter alia, appropriates $100 million for assistance to producers and first-handlers of the MY 2000 crop of cottonseed.[5] Public Law 107-25, inter alia, added an appropriation of $84.7 million for assistance to producers and first-handlers of the same MY 2000 crop of cottonseed.[6] No cottonseed payments were authorized for MY 2001. The Agricultural Assistance Act of 2003, inter alia, appropriated cottonseed payments for the 2002 crop in the amount of $50 million.[7]

10. None of these statutory provisions contains any guidance on how USDA was to implement the cottonseed payments. Eligibility, administration, application and payment rates and details are all provided for in regulations. Brazil has provided in Exhibit Bra-32 the regulations applicable to the MY 2000 crop of cottonseed. Regulations governing payments for the MY 2002 crop of cottonseed were issued on 25 April 2003 and are set forth in Exhibit Bra-139. Comparing these regulations with the regulations that implement 2002 cottonseed payments[8] demonstrates that both regulations are almost identical. In fact, the preamble to the 2002-crop regulations provides that "[p]revious 1999-crop and 2000-crop cottonseed programs were codified in 7 CFR part 1427. This rule follows the model set by those preceding programs."[9] Additionally the preamble to the regulations states:

> Presumably, Congress expected the old programme to serve as the model for the new programme provided for in the new legislation as no dissatisfaction was expressed.[10]

11. This evidence demonstrates that the Cottonseed Payment Programme in MY 2002 was a continuation of the Cottonseed Payment Programme with respect to MY 1999 and 2000. The Agricultural Assistance Act of 2003 appropriated new funds for the MY 2002 crop to the existing programme (after no such appropriations took place for MY 2001). The 2002 cottonseed payments provided for in the Agricultural Assistance Act of 2003 are "future measures implementing"[11] the

[3] Exhibit Bra-135 (Agricultural Assistance Act of 2003, in P.L. 108-7), Exhibit Bra-136 (P.L. 106-113), Exhibit Bra-137 (P.L. 106-224) and P.L. Exhibit Bra-138 (107-25).
[4] Exhibit Bra-136 (Section 104 of P.L. 106-113).
[5] Exhibit Bra-137 (Section 204(e) of P.L. 106-224).
[6] Exhibit Bra-138 (Section 6 of P.L. 107-25).
[7] Exhibit Bra-135 (Section 206 of P.L. 108-7).
[8] Exhibit Bra-139 (68 Federal Register 20331).
[9] Exhibit Bra-139 (68 Federal Register 20331, p. 20331).
[10] Exhibit Bra-139 (68 Federal Register 20331, p. 20332).
[11] Brazil's Request For the Establishment of a Panel, WT/DS267/7, p. 2. *See* Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, paras. 135-136 and 144.

existing (but unfunded) Cottonseed Payment Program, which formed part of the request for consultations and which has been consulted upon. The MY 2002 cottonseed payments are therefore within the terms of reference of this Panel and Brazil is entitled to challenge the adverse effects caused by these payments.

12. Finally, the Agricultural Assistance Act of 2003 appropriated $50 million in cottonseed payments expressly for the MY 2002 crop. Payments will be made after the United States has received all applications and has calculated the payment rate.[12] Since, payments are made after the 2002 crop has been harvested, payments can be considered to be made retrospectively. Yet, irrespectively of when the payments are made and irrespective of the Panel's decision whether they form part of the Panel's terms of reference, they are made in respect of MY 2002[13] and, therefore, these payments should be included in the calculation of the MY 2002 support to upland cotton for purposes of the test under Article 13(b)(ii) of the Agreement on Agriculture.

**18. If the Panel is correct in understanding that cottonseed payments are divided between processors and producers, how is this reflected in Brazil's calculations? BRA**

Brazil's answer:

13. Brazil has included the full amount of cottonseed payments in its peace clause calculations for MY 1999, 2000 and 2002 because cottonseed payments constitute support to upland cotton. This approach is consistent with the United States' notifications of these payments as product-specific support to upland cotton in its notification of domestic support for MY 1999.[14]

14. Brazil furthermore notes that the full amount of cottonseed payments is available to stimulate production and distort trade. Including the full amount of cottonseed payments is also consistent with basic principles of microeconomics that the incidence of a tax or subsidy does not depend on where in the processing chain the tax or subsidy is applied. The production or consumption effects of a tax or subsidy depends on supply and demand elasticities and market conditions, but these market impacts do not depend on whether government checks are written in the name of farmers or initial processors.[15]

C. MEASURES AT ISSUE

**19. The Panel notes that Brazil's panel request refers, inter alia, to alleged "subsidies" and "domestic support" "provided" in various contexts. Please specify the measures, in particular, the legislative and regulatory provisions, by number and letter, in respect of which Brazil seeks relief and indicate where each is referred to in the panel request. BRA**

Brazil's answer:

15. Brazil's Request for Establishment of a Panel ("Panel Request") challenges two types of domestic support "measures" provided to upland cotton and various different types of export subsidy measures. The first type of domestic support "measure" is the payment of subsidies for the production and use of upland cotton. These payments were and continue to be made between MY 1999 to the present (and will be made through MY 2007) through the various statutory and regulatory instruments listed on pages 2-3 of Brazil's Panel Request. Brazil referred to these payments at pages 2-3 of the Panel Request as "subsidies and domestic support provided under" or "mandated to

[12] Exhibit Bra-139 (7 CFR 1427.1107-1110 as provided in 68 Federal Register 20331, p. 20333).
[13] *See* Brazil's answer to Question 34.
[14] *See* Exhibit Bra-47 (G/AG/N/USA/43, p. 20).
[15] Exhibit Bra-140 (Pindyck, Robert S. and Rubinfeld, Daniel L. , *Microeconomics*, 5th edition (2002), Prentice Hall, New Jersey, p. 313-317).

be provided" under the various listed statutory and regulatory instruments. Brazil has tabulated the different types of payments (i.e., the measures) made under these legal instruments in paragraphs 146-149 of its First Submission. Brazil's "Further Submission" on 9 September 2003 will provide considerable detail concerning the effects of the subsidies provided and mandated to be provided by the United States. It is these effects in respect of which Brazil seeks relief with respect to the first type of domestic support measures.

16. A second type of domestic support "measure" challenged by Brazil are legal instruments as such. The "legislative and regulatory provisions, by number and letter, in respect of which Brazil seeks relief" are those involving the 2002 FSRI Act and the 2000 Agricultural Risk Protection Act and in particular the following:[16]

- **Marketing loan/loan deficiency payments:** Sections 1201(a)-(b), 1202(a)(6), 1202(b)(6), 1204(b), 1205(a)(1), 1205(b), 1205(c)(1), 1608 of the 2002 FSRI Act and 7 U.S.C. 7286 (Section 166 of the 1996 FAIR Act as amended) and 7 CFR 1427.22 to the extent that these provisions require the provision of marketing loan and loan deficiency payments for all production of upland cotton.

- **Counter-cyclical payments:** Section 1104(a)-(f)(1) of the 2002 FSRI Act and 7 CFR 1412.503.

- **Direct payments:** Section 1103(a)-(d)(1) of the 2002 FSRI Act and 7 CFR 1412.502.

- **Step 2 Domestic Payments:** Section 1207(a) of the 2002 FRSI Act and 7 CFR 1427.103, 7 CFR 1427.104(a)(1), 7 CFR 1427.105(a), 7 CFR 1427.108(d) requiring cotton user marketing certificate ("Step 2") payments to be made to domestic users of US upland cotton.

- **Crop Insurance payments:** Section 508(a)(8), 508(b)(1), 508(b)(2)(A)(ii), 508(b)(3), 508(e) and 508(k) of the 2000 ARP Act[17] mandating the provision or crop insurance policies to farmers, premium subsidies to farmers and reinsurance to insurance providers to the extent that these provisions apply to upland cotton. Section 516 providing for unlimited funding of the crop insurance programme to the extent that these funds are available to upland cotton producers

17. Finally, Brazil challenges three types of export subsidies provided by the United States. Regarding Step 2 export subsidies, the measure Brazil challenges is Section 1207(a) of the FSRI Act, and 7 CFR 1427.103, 7 CFR 1427.104(a)(2), 7 CFR 1427.105(a), and 7 CFR 1427.108(d) requiring cotton user marketing certificate ("Step 2") payments to be made to exporters of US upland cotton.[18] Brazil also challenges as a "measure" subsidies provided by Step 2 export programme as actionable subsidies.

18. Regarding Brazil's ETI Act claim, the measure challenged by Brazil is the FSC Repeal and Extraterritorial Exclusion Act of 2000, Public Law 106-519, 114 Stat. 2423 (2000), and in particular, Section 3 (entitled "Treatment of Extraterritorial Income"), which amends the US Internal Revenue

[16] These Acts are referenced on page 2 of Brazil's Panel Request (WT/DS267/7), and Brazil's *per se* claim regarding these Acts and the regulations is referenced at page 4 of Brazil's Panel Request.

[17] Page 2 of Brazil's Panel Request (WT/DS267/7) identifies the Agricultural Risk Protection Act of 2000.

[18] Page 2 of Brazil's Panel Request (WT/DS267/7) identifies the 2002 FSRI and the regulations in relation to Step 2 payments.

Code (IRC) by inserting into it a new Section 114, as well as a new Subpart E, which is in turn composed of new IRC Sections 941, 942 and 943.[19]

19. With respect to Brazil's export credit guarantee claims, the measures challenged by Brazil are the GSM 102, GSM 103 and SCGP programs as established and maintained by 7 U.S.C. 5622[20] and 7 CFR 1493.[21] Brazil challenges 7 U.S.C. 5622(a)(1) and (b),[22] which provide for the extension of export credit guarantees on terms better than those available on the marketplace. Furthermore, Brazil challenges the maintenance of the GSM 102, GSM 103 and SCGP programs at premium rates that are inadequate to cover the long-term operating costs and losses of the programs. Additionally, Brazil challenges the failure of 7 U.S.C. 5622 and 7 CFR 1493 to prevent circumvention (or the threat of circumvention) of the US export subsidy commitments under the Agreement on Agriculture. Brazil also challenges as a "measure" GSM 102, GSM 103 and SCGP export credit guarantees facilitating the production and export of US upland cotton as actionable subsidies and thereby causing adverse effects to the interests of Brazil.

D. ARTICLE 13(B): DOMESTIC SUPPORT MEASURES

**1. "exempt from actions"**

**20. In paragraph 8 of its initial brief (dated 5 June, 2003), the United States argued that the word "actions" as used in the phrase "exempt from actions" in Article 13 of the Agreement on Agriculture includes the "bringing of a case" and consultations. In paragraph 36 of its first written submission (dated 11 July, 2003), the United States stated as follows:**

> **"[P]rior to this point in the process, the DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause."**

**Is it the United States' understanding that the drafters used the phrase "exempt from actions" knowing that under the DSU it would not be possible fully to exempt "actions", as the United States interprets that term? USA**

**21. In US - FSC and US - FSC (21.5) the Appellate Body made findings under the SCM Agreement relating to export subsidies in respect of agricultural products without making a finding in respect of Article 13 of the Agreement on Agriculture. How is this relevant to the United States' interpretation of the phrase "exempt from actions" as used in Article 13? USA**

**2. "such measures" and Annex 2 of the Agreement on Agriculture**

**22. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture. BRA, USA**

[19] Page 2 of Brazil's Panel Request (WT/DS267/7) identifies the ETI Act.

[20] Exhibit Bra-141 (7 U.S.C. 5622) codifies the relevant provisions of the 1978 Agricultural Trade Act as amended, identified on page 2 of Brazil's Panel Request (WT/DS267/7).

[21] *See* Exhibit Bra-38 (7 CFR 1493). Pages 2 and 5 of Brazil's Panel Request (WT/DS267/7) identifies GSM 102, GSM 103, and SCGP programs.

[22] Exhibit Bra-141 (7 U.S.C. 5622) codifies the relevant provisions of the 1978 Agricultural Trade Act as amended, identified on page 2 of Brazil's Panel Request (WT/DS267/7).

Brazil's answer:

20. The meaning of the term "defined" in relation to "base period" is the period of time used to define the parameters ("indicate the extent"[23]) of the base period. The word "period" is defined as "a course or extent of time".[24] For example, the "defined" "base period" to determine the amount of upland cotton base acreage for the PFC (and market loss assistance) payments was the average planted and considered planted acreage during MY 1993-95.[25] The term "fixed" in relation to "base period" means that the "defined" base period cannot change or be updated. This is confirmed by the dictionary meaning of the term "fixed," which is "definitely and permanently placed or assigned; stationary or unchanging in relative position; definite, permanent, lasting."[26] In sum, a base period is first "defined" in terms of a period of time, and then that period remains definitely and permanently assigned.

**23. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. BRA, USA**

Brazil's answer:

21. Paragraph 6(a) requires Members to establish clearly defined eligibility criteria for a de-coupled direct payment measure. These eligibility criteria must be taken from "a" defined and fixed base period of time. Paragraph 5 of Annex 2 makes it clear that all of the subparagraphs of paragraph 6 apply to the same type of de-coupled income support. Thus, a de-coupled income support measure with "a" "fixed base period" must also comply with Annex 2, paragraphs 6(b), (c) and (d). These sub-paragraphs use the phrase "after the base period." Because Article 6(a) establishes that there can only be "a" (single) "fixed" base period for a particular de-coupled domestic support measure, the use of the term "the" in 6(b)-(d) refers back to "a" "fixed" base period established in Article 6(a). Thus, a de-coupled income support measure can have only one "fixed" base period.

22. The Panel is faced with the question whether a Member can make minor adjustments to a decoupled support measure, label it a new decoupled support measure and then update the base period. Guidance for this question is provided by the first part of Annex 2, paragraph 6(a), which sets out a transparency requirement that eligibility criteria for decoupled support measures be determined by "clearly-defined criteria". In assessing whether one decoupled income support measure is essentially the same as a replacement decoupled income support measure, the Panel could examine the eligibility criteria for each set of measures. If the structure, design, and eligibility criteria have not significantly changed between the original measure (containing the "fixed base period") and its replacement, then there is no basis for any updating of the "fixed base period".

23. The factual question the Panel must address in this case is whether the "direct payment" programme in the 2002 FSRI Act contains similar design, structure, and eligibility criteria as the "production-flexibility contract payments" for upland cotton in the 1996 FAIR Act. The clearest evidence that the direct payment programme is the direct successor to production flexibility contracts is found in Section 1107(b) of the 2002 FSRI Act. It provides as follows:

> If a producer receives all or any portion of the payment authorized for fiscal year 2002 under a production flexibility contract, the Secretary shall reduce the amount of

[23] The New Shorter Oxford English Dictionary, 1993 edition, p. 618 (definition of "define").
[24] The New Shorter Oxford English Dictionary, 1993 edition, p. 2163.
[25] *See* First Submission of Brazil, para. 46. *See* also Exhibit Bra-31 (7 CFR 1412.103) in connection with Exhibit US-3 (7 CFR 1413.7(c)).
[26] The New Shorter Oxford English Dictionary, 1993 edition, p. 962.

> the direct payment otherwise due the producer for the 2002 crop year under section 1103 by the amount of fiscal year 2002 payment received by the producer under the production flexibility contract.[27]

24. Trading PFC dollars for direct payment dollars makes perfect sense given the very close similarities in the eligibility criteria between PFC and direct payments reflected in the statutes and regulations governing each. This is best illustrated in the following table:

**Similarities of Production Flexibility Contract and Direct Payments**

| Eligibility Criteria | **Production Flexibility Contracts** | Direct Payments |
|---|---|---|
| **Payment contract** | Annual fiscal payment based on 7 year contract[28] | Annual payment based on annual contract[29] |
| **Eligible Recipients** | "Producers" who assume all or part of the risk of producing a crop[30] | Same[31] |
| **Contract Acreage (Base Acreage)** | MY 1993-95[32] | MY 1993-95 or MY 1998-2001[33] |
| **Programme crops** | 7 Crops[34] | Same plus soybeans, other oilseeds, and peanuts[35] |
| **Planting Flexibility and Restrictions** | Limitations on fruits and vegetables (wild rice added in 2000).[36] | Same.[37] |
| **Payment Yield** | Base yield same as deficiency payment base average MY 1981-85[38] | Same.[39] |
| **Cotton Payment** | Payment on 85% of base acres times base yield times 7.07 cents per pound[40] on average between 1999-2001 for upland cotton[41] | Payment on 85% of base acres times base yield times 6.67 cents per pound for upland cotton[42] |
| **Compliance conditions** | Abide by conservation compliance requirements[43] | Same. [44] |

[27] Exhibit Bra-29 (Section 1107(b) of the 2002 FSRI Act).
[28] Exhibit Bra-31 (7 CFR 1412.101 and 1412.103)
[29] Exhibit Bra-35 (7 CFR 1412.401)
[30] Exhibit Bra-31 (7 CFR 1412.202)
[31] Exhibit Bra-35 (7 CFR 1412.402)
[32] Exhibit Bra-31 (7 CFR 1412.103)
[33] Exhibit Bra-35 (7 CFR 1412.201)
[34] Exhibit Bra-31 (7 CFR 1412)
[35] Exhibit Bra-35 (7 CFR 1412.103)
[36] Exhibit Bra-31 (7 CFR 1412.206)
[37] Exhibit Bra-35 (7 CFR 1412.407)
[38] Exhibit Bra-31 (7 CFR 1412.103)
[39] Exhibit Bra-35 (7 CFR 1412.301 and 1412.302)
[40] Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50). Brazil notes that these payment rates were not statutory rates but resulted from the allocation of a fixed amount of budgetary outlays to holders of upland cotton base under the PFC programme in MY 1999-2001.
[41] Exhibit Bra-31 (7 CFR 1412.103)
[42] Exhibit Bra-35 (7 CFR 1412.502(e))
[43] Exhibit Bra-31 (7 CFR 1410.20)

25. For an upland cotton producer with upland cotton base in MY 2001 and MY 2002, the direct payments available in MY 2002 were based on the following four elements: (1) yield (the average of the farm for MY 1981-85), (2) base acreage for the farm (resulting from either MY 1993-95 or MY 1998-2001 production), (3) only 85 percent of base acres could receive payment, and (4) the payment rate of $0.0677 cents per pound (applied to base acreage x yield x .85). The production flexibility contract payment for that same upland cotton farmer in MY 2001 would have been based on (1) yield (the average for MY 1981-85), (2) base acreage resulting from MY 1993-95 production, (3) only 85 percent of base acres could receive payment, and (4) 5.99 cents per pound.[45] Thus, with the exception of the per pound payment rate – which increased under the 2002 FSRI Act – and the ability in 2002 to update base acreage, the payment formula was the same under both programmes.

26. In addition to these payment formula similarities, the eligibility criteria for an upland cotton producer in MY 2001 and MY 2002 are either identical or very similar under both programmes. For example, eligible recipients under both programmes are "producers," defined in each programme as "an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop".[46] The "producer" under each programme could not plant fruits, vegetables, tree nuts or wild rice without either a forfeiture of all payments or a reduction of payments.[47] And each "producer" under both programmes had to maintain the land in agricultural use and adhere to conservation requirements.[48]

27. In addition to the possibility to update the base acreage, another difference between the PFC and direct payment is the addition of three additional programme crops for purposes of the direct payment programme – soybeans, other oilseeds, and peanuts.[49] Further, instead of a single seven-year contract, annual contacts are entered into between USDA and "producers" who must demonstrate that they are eligible for payments based, *inter alia,* on demonstrating that they "share in the risk of producing a crop and are entitled to share in the crop available for marketing from the farm".[50] The final difference was to set fixed amounts of payments per pound that did not decrease over the six-year term of the 2002 FSRI Act. The 1996 FAIR Act based the payment rate on annual budgeted amounts and as the budgeted amounts declined, the payment rate declined.

28. None of these changes to the direct payment programme in any way changed the eligibility criteria, the design, or the structure of the production flexibility programme as it applied to upland cotton producers. For the typical upland cotton producer farming on upland cotton base acreage, the only thing that changed was that the producer received the option to *increase* payments by updating base acreage and obtained an *increased* payment rate. Given the identical nature of most aspects of the production flexibility contract payments and direct payments, there was no basis to change the "fixed base period" of marketing years 1993-1995 for the calculation of these direct payments.

29. In light of this evidence, the Panel is not faced in this case with the situation where a Member significantly changes the structure, design, and eligibility criteria of an older measure. For example, if a Member replaces an amber box domestic support measure with a green box measure, the structure

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[44] Exhibit Bra-35 (7 CFR 1412.203)

[45] Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50). Brazil notes that this payment rate was not a statutory rate but resulted from the allocation of a fixed amount of budgetary outlays to holders of upland cotton base under the PFC programme in MY 2001.

[46] Exhibit Bra-29 (7 CFR 1001(1) of the 2002 FSRI Act), Exhibit Bra-28 (Section 102(12) of the 1996 FAIR Act)

[47] Exhibit Bra-28 (Section 118 b(1) of the 1996 FAIR Act), Exhibit Bra-29 (Section 1106 b(3) of the 2002 FSRI Act).

[48] Exhibit Bra-31 (7 CFR 1410.20) and Exhibit Bra-35 (7 CFR 1412.203)

[49] Exhibit Bra-29 (Section 1101-1103 of the 2002 FSRI Act), Exhibit Bra-27 ("Side by Side Comparison of the 1996 and 2002 Farm Act, USDA).

[50] Exhibit Bra-29 (Section 1001(1) of the 2002 FSRI Act).

and eligibility criteria is likely to be sufficiently different to permit the establishment of a new "fixed" base period for the new measure. But replacing an older green box measure with a new alleged green box measure, which basically only updates the base period and thereby results in increased payments, violates the requirement of "a" "fixed" base period in Article 6(a).[51]

30. Finally, Brazil believes that Annex 3, paragraphs 9 and 11 provide contextual support for the requirement that "a" "fixed" base period for essentially the same measure should not be changed. For the purposes of calculating total AMS, Annex 3 establishes "a" "fixed" base period – 1986-1988 – for determining the reference price that serves as a basis for the formula approach to calculating AMS for price support measures. This base period could not be changed without eliminating the basis for calculating the total AMS and the required reductions in domestic support. Similarly, paragraphs 6(a) and 6(b) of Annex 2 require a fixed base period and prevent an updating of a base period for "green box" domestic support measures that remain essentially the same programme.

**24. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture? BRA, USA**

Brazil's answer:

31. As set out in Brazil's Answer to Panel Question 23, the answer is *never* if the replacement de-coupled direct payment measure has a comparable structure, design and eligibility criteria as the older de-coupled direct payment measure.

**25. Does the United States consider that there is any ambiguity in the term "type of production" as used in paragraph 6(b) of Annex 2 of the Agreement on Agriculture? USA**

**26. Can the United States confirm Brazil's assertions in paragraph 174 of its first written submission that the implementing regulations for direct payments prohibit or limit payments if base acreage is used for the production of certain crops? If so, can the United States clarify the statement in paragraph 56 of its first written submission that direct payments are made regardless of what is currently produced on those acres? Can the United States confirm the same point in relation to production flexibility contracts? USA**

**27. Does Brazil argue that any United States measure that does not comply with the fundamental requirement of paragraph 1 of Annex 2 of the Agreement on Agriculture is actionable independently of any failure of that measure to comply with the basic or policy-specific criteria in Annex 2? BRA**

Brazil's Answer:

32. Yes. A domestic support measure that does not meet the "fundamental requirement" of the first sentence of Annex 2, paragraph 1, cannot be considered to be properly in the "green box". In addition to the arguments at paragraphs 163-172 of Brazil's First Submission, Brazil provides additional rationale for this argument below.

33. The use of the words "fundamental requirement" in the first sentence of paragraph 1, Annex 2, demonstrates that the obligation contained in the sentence is separate and distinct from the obligation to meet the basic and policy-specific requirements set forth in Annex 2. The ordinary meaning of those words, in that context and in light of the object and purpose of the Agreement in Agriculture, support this interpretation.

[51] *See* First Submission of Brazil, paras. 177-181.

34. The ordinary meaning of "requirement" is "a thing required or needed, a want, a need; something called for or demanded; a conditions which must be complied with".[52] Interpreted in the context of paragraph 1, Annex 2, it means that having no, or at most minimal, trade-distorting effects or effects on production is a condition for a domestic support measure, which must be complied with, for exempting this domestic support measure from the reduction commitments.

35. The word "fundamental" qualifies the word "requirement". The ordinary meaning of the term "fundamental" is "going to the root of the matter; serving as the base or foundation; essential or indispensable".[53] The use of this adjective emphasizes and underscores that the requirement that a measure does not have trade-distorting effects or effects on production is *essential and indispensable* for a domestic support measure to be exempted from reduction commitments.

36. In sum, the ordinary meaning of a "fundamental requirement" is an "essential and indispensable condition that must be complied with". It follows that the fundamental requirement in the first sentence of Annex 2, paragraph 1 must be read as a stand-alone obligation and that it is untenable to relegate the obligation in the first sentence of Annex 2, paragraph 1 to a policy objective role that merely informs the rest of the Annex. Instead, it is a condition of central importance that all domestic support measures must meet in order to be exempted from reduction commitments. Its importance is such that it serves as the premise on which the basic and policy-specific criteria are predicated.

37. The principle of effective interpretation (*l'effet utile*), recognized by panels and the Appellate Body, requires that a treaty be interpreted to give meaning and effect to all the terms of the treaty. The first sentence of Annex 2, paragraph 1 of the Agreement on Agriculture, which imposes an obligation in clear and unequivocal terms, has to be accorded full meaning. Nothing suggests that recognizing the fundamental requirement as a stand-alone obligation would undermine or render inutile the obligation to conform to the basic and policy-specific criteria. To interpret the fundamental requirement as a policy objective that merely informs the rest of Annex 2 would detract from the unambiguous obligation that domestic support measures have no, or at most minimal, trade-distorting effects or effects on production.

38. The obligation to meet the fundamental requirement set forth in Annex 2, paragraph 1 is the overriding principle that determines whether a measure can be exempt from reduction commitments. The purpose of the disciplines on domestic support in the Agreement on Agriculture, made effective in part through the reduction commitments, is to eliminate trade and production-distorting effects of domestic support measures or permit these measures to only have at most minimal trade or production-distorting effects. Where a measure does not create trade-distorting effects or effects on production, the rationale for limiting the use of that support measure disappears. Conversely, where a measure *does* have trade-distorting effects or effects on production, it must be subject to reduction commitments, regardless of whether it complies with certain other basic or policy-specific criteria. To exempt a measure because a Member alleges that it is classified as a green box measure, despite having trade-distorting effects or effects on production, would be to accept a circular reasoning and would undoubtedly undermine the disciplines on domestic support measures.

39. Brazil has set forth the evidence demonstrating that production flexibility contracts and direct payments have more than a minimal effect on production and thus are inconsistent with the fundamental requirement of the first sentence of Annex 2, paragraph 1.[54] These production effects are not surprising given the fact that both PFC and direct payments limit payments based on the *type* of

[52] The New Shorter Oxford English Dictionary, 1993 edition, p. 2557.
[53] The New Shorter Oxford English Dictionary, 1993 edition, p. 1042.
[54] First Submission of Brazil, paras. 163-172; 183-191; First Oral Statement of Brazil, paras 50-54, 57-61; Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel 22 July 2003, paras. 20-28).

production. Further, the updating of the base acreage for the direct payment programme (which one third of all eligible US farms took advantage of to increase their base acres eligible to receive direct payments), created further production enhancing effects today (as well as in the future) as detailed by Professor Sumner in paragraphs 20-29 of his Statement at the First Meeting of the Panel on 22 July 2003.[55]

40. Brazil finally notes that if follows from the first sentence of Annex 2, paragraph 1 that any domestic support measures not complying with one of the basic or policy-specific criteria in Annex 2 is to be presumed to violate the fundamental requirement that it have no, or at most minimal, trade-distorting effects or effects on production. This conclusion holds regardless of the finding of the Panel on the character of the first sentence of Annex 2, paragraph 1 as a stand-alone obligation.[56]

**28. Please explain the meaning of the word "criteria" in Articles 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the Agreement on Agriculture have on the meaning of the preceding sentence? BRA**

Brazil's Answer:

41. Articles 6.1 and 7.1 reference "criteria" in general, without a specific mention of "basic criteria", or "policy-specific" criteria. To give meaning to the "fundamental requirement" of Annex 2, paragraph 1, the use of the word "criteria" must encompass all the rules, standards, or requirements established by Annex 2 as conditions for determining whether a domestic support measure can be exempted from reduction commitments. There is no basis, therefore, on which to exclude the fundamental requirement in Annex 2, paragraph 1 from the criteria that a domestic support measure must meet to be exempted from the reduction commitments.

42. Brazil further notes that, while Article 6.1 refers to "criteria set out in this Article", nowhere in the subsequent sub-paragraphs of Article 6 can the word "criteria" be found. This suggests that the term "criteria" as used in the Agreement on Agriculture cannot be interpreted in such a way as to limit its coverage to "basic criteria" or "policy-specific criteria" in Annex 2. The word "criterion" means "a principle, standard or test by which a thing is judged, assessed or identified".[57] It follows that the term "criteria" encompasses all standards and tests set up by the provisions in the Agreement on Agriculture and its Annexes to which Article 6.1 and 7.1 refer. This standards and tests include the fundamental requirement in the first sentence of Annex 2, paragraph 1.

43. The word "accordingly" does not (and cannot be read to) emasculate a "fundamental requirement". It introduces the related but distinct obligation to conform to the basic and policy-specific criteria. "Accordingly" is defined as "in accordance with the logical premise". It is also defined as "harmoniously, agreeably," or "in natural sequence,"[58] or "appropriate, fitting".[59] The word "accordingly" indicates that the "basic criteria" are derivative of the more fundamental obligation in the first sentence of that same paragraph. "Accordingly" simply explains that because it is a fundamental requirement that domestic support measures have no, or at most minimal, trade-distorting effects or effects on production, it is necessary that the measures also meet certain basic criteria. Thus, the "fundamental requirement" is a premise, and the "basic criteria" in the second sentence of Annex 2, paragraph 1 are in accordance – *i.e.*, not contrary – to that fundamental requirement. Because the first is a premise of the second, it is incorrect, indeed illogical, to say that the second sentence takes precedence, subsumes or subordinates the first more fundamental obligation.

[55] *See* Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).
[56] *See* First Oral Statement of Brazil, para. 21.
[57] The New Shorter Oxford English Dictionary, 1993 edition, p. 551.
[58] The New Shorter Oxford English Dictionary, 1993 edition, p. 15.
[59] The New Shorter Oxford English Dictionary, 1993 edition, p. 15.

**29. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the Agreement on Agriculture. USA**

**30. Do the parties consider that direct payments and production flexibility contract payments meet or met the basic criteria referred to in paragraph 1 of Annex 2 of the Agreement on Agriculture? BRA, USA**

Brazil's Answer**:**

44. The direct payments and production flexibility contract payments meet the first basic criteria in paragraph 1(a) of Annex 2. With respect to the second basic criteria, Brazil is not alleging that either of these two types of payments "have the effect of providing price support to producers".

**31. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? BRA, USA**

Brazil's Answer:

45. Yes. As explained in answer to Question 27 above, any domestic support measures that do not comply with the basic or policy-specific criteria in Annex 2 shall be presumed to violate the fundamental requirement in the first sentence of paragraph 1 of Annex 2 and must, therefore, be considered non green-box domestic support measures. This is true regardless whether the Panel concludes that the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation.

**32. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. USA**

**3. "do not grant support to a specific commodity"**

**33. According to the United States' interpretation of the word "grant", when can a Member claim that a measure is not exempt from action under Article 13(b)? What if the measure is enacted annually? Can the Member obtain a remedy in respect of that measure under the DSU? USA**

**(34) Does Brazil interpret the word "grant" as used in Article 13(b)(ii) of the Agreement on Agriculture to mean payment made in a specific year or payment made in respect of a specific year? BRA**

Brazil's Answer:

46. Brazil interprets the word "grant" to mean "payment made in respect of a specific year".[60]

**35. Does a failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? BRA, USA**

[60] *See* First Oral Statement of Brazil, para. 31 ("Thus, the neutral term 'decision' must be read consistently with 'grant.' In sum, a harmonious interpretation of 'decided' exists where the 'decision' is to fund marketing year 1992 non-'green-box' expenditures for a specific commodity.").

Brazil's Answer:

47. Yes. A failure of a Member's measures to meet in any given year the conditions of the peace clause lifts the entitlement to peace clause protection for the whole implementation period for all measures found to fail meeting the conditions of the peace clause. This conclusion applies to domestic support measures as well as export subsidies.

48. At the outset, Brazil would like to recall that the peace clause provides Members only limited protection from actionable and prohibited subsidy claims under the SCM Agreement and GATT Article XVI. Domestic support measures are only exempt from action under Articles 5 and 6 of the SCM Agreement and under GATT Article XVI:1, if the domestic support measures do not violate the Total AMS reduction commitments of a Member and if they do not grant support to a specific commodity in excess of that decided during the 1992 marketing year. Export subsidies are only exempt from actions under Articles 3, 5 and 6 of the SCM Agreement and GATT Article XVI, if they conform fully to the provisions of Part V of the Agreement on Agriculture.

49. The peace clause does not impose any positive obligations and can, thus, not be violated. It constitutes a right and defence of a Member that this Member may or may invoke. The *US – FSC* and *US – FSC (21.5)* dispute are examples of disputes, in which a Member has chosen not to invoke the peace clause defence. Brazil has demonstrated before, that the peace clause is in the nature of an affirmative defence.[61] Accordingly, a complaining party does not bear the burden of proof that the measures at issue do not meet the conditions of the peace clause.

50. Nothing in the text of Article 13 suggests that a Member, which foregoes its peace clause exemption for particular measures in one year during the implementations period, shall be entitled to claim peace clause exemption for those measures for other – earlier or later – years. Article 13 offers peace clause exemption for measures that "fully conform" to Article 6 and that do not "grant support" "in excess of" that decided during the 1992 marketing year, as well as for measures that "fully conform" to Part V of the Agreement on Agriculture. If measures fail to meet one of the relevant conditions in any year – be it the current year or an earlier year during the implementation period – those measures can no longer be considered to "fully conform" or to not "grant support" "in excess of". Consequently, those measures are not exempt from action.

51. Finally, Brazil notes that the Panel need not decide this issue due to the circumstances of the present case. Brazil has demonstrated that the United States' domestic support measures at issue in this dispute do not meet the conditions of the peace clause in any marketing year from MY 1999 to the present and that the US export subsidies also do not conform fully to Part V of the Agreement on Agriculture. Thus, none of the subsidies at issue in this dispute is entitled to exemption from actions pursuant to the peace clause.

**36. Does a failure by a Member to comply with Article 13(b) in respect of a specific commodity impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? BRA, USA**

Brazil's Answer:

52. No. In fact, this is one of the purposes of the word "specific" in Article 13(b)(ii) – to differentiate a specific commodity whose amount of support was greater than the amount of support in marketing year 1992 from other specific commodities whose support may not have exceeded the 1992 marketing year level.

[61] *See* First Submission of Brazil, para. 110-121, and First Oral Statement of Brazil, para. 5-11.

**37. In the United States' view, why did the drafters not use the exact term "product-specific" in Article 13(b)(ii)? USA**

**38. Given the fact that subsidies available for more than one product could have various effects on production, how does the United States demarcate between product-specific support and non-product specific support ? USA**

**39. If "such measures" in Article 13(b)(ii) refers to all those in the chapeau of Article 13(b), why are they not all included in the potential comparisons with 1992? In what circumstances can measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994? USA**

**40. In relation to which other provisions in the Agreement on Agriculture is it relevant to disaggregate non-product specific support in terms of specific commodities? BRA**

Brazil's Answer:

53. The Panel's question uses the phrase "non-product specific support", which is not defined explicitly in the Agreement on Agriculture. Therefore, before responding to this question, Brazil will set forth its understanding of what this term means and which measures at issue in this dispute fall within that definition.

54. "Aggregate Measurement of Support" and "AMS" are defined in Article 1(a) as the "annual level of support, expressed in monetary terms" (a) "in favour of the producers of the basic agricultural product" or (b) "non-product-specific support provided in favour of agricultural producers in general . . ." (emphasis added). Brazil notes that the ordinary meaning of the word "general" is "including, involving, or affecting all or nearly all the parts of a (specified or implied) whole."[62] The "whole" in the case of Article 1(a) of the Agriculture Agreement refers to agricultural producers of all or nearly all basic agricultural products covered by the Agreement on Agriculture. Because the universe of domestic support measures includes either "product-specific" or "non-product-specific" domestic support measures, it follows that any domestic support that is not provided "in favour of agricultural producers in general" is deemed to be "in favour of the producers of the basic agricultural product". Accordingly, the test for determining whether a domestic support measure is "non-product specific" for the purpose of calculating AMS is whether, as a factual matter, the measure provides support to "agricultural producers in general".

55. The United States has argued that Article 1(a) is useful context for interpreting the meaning of "support to a specific commodity".[63] However, the United States latches on to only the first part of Article 1(a), and ignores the "in general" qualification in the second part, which provides the essential meaning as to the scope of what is and is not "product-specific". Brazil notes that none of the measures it used to calculate the levels of support for purposes of Article 13(b)(ii) for MY 1992 or MY 1999-2002 could properly be deemed to be "non-product-specific" support as defined in Article 1(a) of the Agreement on Agriculture. And, as Brazil has previously argued, all of these measures are "support to" upland cotton within the meaning of Article 13(b)(ii).

56. With that introduction, the answer to the Panel's question is that Brazil is not aware of any provision of the Agreement on Agriculture requiring the dis-aggregation of support that is "provided in favour of agricultural producers in general", as discussed above. However, Brazil notes that Article 13(b)(ii) is a sui generis provision of the Agreement on Agriculture that does not use the phrases "AMS", "non-product specific" or "product-specific" support. Contrary to all of the other

[62] The New Shorter Oxford English Dictionary, 1993 edition, p. 1073.

[63] First Submission of the United States, para. 78; *See* also Closing Statement of the United States, para. 18 (ignoring "in general" language).

provisions of the Agreement on Agriculture, Article 13(b)(ii) alone addresses the process for disciplining domestic support provided to a specific commodity under Articles 5 and 6 of the SCM Agreement and Article XVI:1 of GATT 1994.

**41. What is the position of Brazil with regard to certain other domestic support measures not cited by Brazil that were notified by the United States as non-product-specific (e.g. G/AG/N/USA/43), some of which presumably deliver support to upland cotton (e.g. state credit programmes, irrigation subsidies etc). Why have budgetary outlays for such measures related to upland cotton not been included in the comparison of support with 1992? BRA**

Brazil's Answer:

57. Brazil did not include any other types of domestic support measures for MY 1992 or MY 1999-2002 in calculating peace clause amounts because no other measures appeared to meet the test of being non-green box "support to" upland cotton in Article 13(b)(ii). Similarly, these measures appear to meet the test of being provided "in favour of agricultural producers in general". None, of these other measures notified by the United States as non-product specific had any upland cotton specific link in terms of historic, updated, or present upland cotton acreage, present upland cotton production or prices, or upland cotton groups of insurance policies or any other specific upland cotton provisions. Further, the United States has not indicated in any documents that these state credit programmes, irrigation subsidies, etc. were not made available "in favour of agricultural producers in general". If the United States is able to provide such information, then it would be appropriate for the Panel to allocate such support to, inter alia, upland cotton. As detailed in Brazil's answer to Question 40, the United States was obligated to notify to the Committee on Agriculture and to allocate as "product-specific support" to upland cotton any domestic measure that did not provide support "in favour of agricultural producers in general. . .".

58. The only US domestic support measures that Brazil is aware of that would meet the test of being "support to upland cotton" are those that it listed for purposes of calculating the level of peace clause support in its First Written Submission.[64] In the view of Brazil, these non-green box domestic support measures are the measures that constitute "support to" upland cotton for the purpose of Article 13(b).

**42. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? BRA**

Brazil's Answer:

59. Brazil believes that the meaning would change. The deletion of the word "specific" would create some ambiguity. The ordinary meaning of the phrase "a commodity" is "a thing that is an object of trade, esp. a raw material or agricultural crop". Therefore, the meaning of a commodity is rather broad and could for instance refer to "grains".[65] While the term "grains" may refer to "a commodity," it cannot connate "a specific commodity". Specific commodities that make up the commodity "grains" would be wheat, barley, oats, rice etc. Thus, the use of the term "specific commodity" clarifies that the subject of Article 13(b)(ii) is support to specific, i.e., individual, commodities and that this provisions does not deal with groups of individual commodities such as grains.

[64] First Submission of Brazil , paras. 144, 148, 149.

[65] Also Annex 1 of the Agreement on Agriculture refers to some broad commodity categories such as "animal hair" and "essential oils." These would cover several specific commodities such as specific types of animal hair, or specific essential oils like jasmin oil or peppermint oil.

60. Further, the phrase "a specific commodity" also makes it clearer that the "commodity" at issue is equivalent to the "like product" as defined, inter alia, in the SCM Agreement. This parallel construction of the term "specific commodity" and "like product" is consistent with the fact that the peace clause provides a conditional exemption from Articles 5 and 6 of the SCM Agreement and Article XVI:1 of GATT 1994 – which require the examination of effects of subsidies on products "like" those receiving the subsidies.

**43. What are the precise differences between deficiency payments and counter-cyclical payments that lead you to classify the former as product-specific and the latter as non-product specific? How do you classify market loss assistance payments? USA**

**44. Do you allege that counter-cyclical payments could be considered product-specific? BRA**

Brazil's Answer:

61. Brazil notes its discussion of "non-product specific" and "product-specific" support in its Answers to Questions 40-41. For the purpose of calculating AMS, counter-cyclical payments (CCP) are "product-specific" support for two main reasons: (i) they are not "support provided in favour of agricultural producers in general", and (ii) they are directly linked to upland cotton-specific parameters (current prices and historical acreage and yield). Indeed, when the US 2002 FSRI Act was examined by the WTO Committee on Agriculture, the European Communities agreed with Brazil that CCP payments could not be considered "non-product-specific" support.[66] New Zealand has taken a similar view in its Third Party Submission in this dispute.[67]

62. Brazil has provided extensive facts that upland cotton producers receive CCP payments as support to upland cotton and that such payments are support to upland cotton for the purposes of Article 13(b)(ii). These facts also support a finding that CCP payments are "product-specific" support. Further, Brazil notes the following facts demonstrating that counter-cyclical payments (and direct payments) are not provided "in favour of agricultural producers in general", but are instead provided to only a fraction of US agricultural production:

- CCP payments are made to holders of upland cotton base acreage when US upland cotton prices fall below 65.73 cents per pound. Producers/holders of all other farm acreage in the United States do not receive CCP payments when US upland cotton prices received by US producers fall. In MY 2001, (non-updated) upland cotton base acreage represented 1.7 percent of total US farmland.[68]

- CCP payments for upland cotton (and direct payments) are received by holders of upland cotton base acreage, i.e. for land that grew upland cotton between 1998-2001 or between

[66] Exhibit Bra-144 (G/AG/R/31, para. 30) ("Brazil would not accept [CCP] classification as 'non-product-specific payment'."); para 31 ("The EC also shared Brazil's analysis on how the counter-cyclical payments should be classified and pointed to US insurance programmes as not being properly classified at present").

[67] Third Party Submission of New Zealand, para. 2.24 ("Accordingly, New Zealand considers that the United States incorrectly categorizes CCP payments as non-product specific support.").

[68] In MY 2001, total US farmland was 959.163 million acres (*See* Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6). Average US upland cotton base acreage for MY 1997-2001 was 16.3 million acres (*See* Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, Table 19). Brazil has requested the United States to provide information on updated base acreage for the CCP and direct payment programme in questions during consultations and in the Annex V proceedings. Brazil has not received that information and, therefore, uses 16.3 million acreage as a proxy for the direct payment base acreage noting that USDA reports that more than 99 percent of eligible acreage signed up for the CCP and direct payment programme (Exhibit Bra-44 ("Direct Payment and CCP Enrollment Report," USDA, 19 June 2003).

1993-1995. USDA reported in 2001 that the 1997 census showed there were 31,500 upland cotton farms. Assuming no increase in the number of US upland cotton farms since 1997, this represents 1.46 percent of all farms in the United States.[69]

- Upland cotton cash receipts as a percentage of total cash receipts from all agricultural commodities was 2.5 percent in MY 1999, 2.35 percent in MY 2000, and 3.05 percent in MY 2001.[70]

- The 10 "programme" crops in the CCP (and direct payment) programme represented only 23.49 per cent of total farm cash receipts from all agricultural commodities on average between MY 1997-2001.[71]

- The base acreage of the 10 "programme" crops in the CCP (and direct payment) programme represented only 30 percent of total US farm acreage in MY 2001.[72]

- In MY 2002, CCP payments to holders of upland cotton base acreage represented approximately 80 percent – or $1.143 billion – of total CCP payments ($1.420 billion) for the ten eligible programme crops.[73]

- In MY 2002, no CCP payments were made to holders of 8 of the 10 eligible crops. In particular, holders of base acreage for barley, corn, grain sorghum, oats, soybeans, other oilseeds, and wheat received no CCP payments.[74]

- CCP base acreage receiving CCP payments in MY 2002 (upland cotton and rice base acreage) represented only 2.2 percent of total US farmland.[75]

- 90 percent of US acreage eligible to receive upland cotton CCP payments for upland cotton is located in only 10 out of 50 US states, with the top 5 US States accounting for 66 percent of US upland cotton production.[76] Thus, upland cotton CCP payments are focused on farms in a limited number of US States (i.e., the "cotton belt").

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[69] Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9-9). There were 2.155 million farms in the United States in 2001. USDA reported that in 1997, there were 31,500 farms that grew cotton. Exhibit Bra-46 ("Cotton: Background and Issues for Farm Legislation," USDA, July 2001, p. 2).

[70] Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 59). The calculations cited above were derived from comparing upland cotton cash receipts compared to total commodity cash receipts net of government payments.

[71] Exhibit Bra-145 (US and State Farm Income Data (United States and States 1997-2001), USDA, Table 5).

[72] Brazil does not have access to actual CCP base acreage figures. Therefore, Brazil has used MY 2001 figures as a proxy and relies on MY 2001 PFC base acreage for the 7 crops covered by PFC payments (Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 50) and has added MY 2001 soybean, peanut and other oilseed acreage (Exhibit Bra-146 (Acreage, NASS, 28 June 2002, p. 14, 15 and 17) (286.8 million acres). Total US farmland in 2001 was 959,163,331 million acres (Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6).

[73] Exhibit Bra-147 ("Estimate of Support Granted by Commodity via Counter-Cyclical Payments").

[74] Exhibit Bra-147 ("Estimate of Support Granted by Commodity via Counter-Cyclical Payments").

[75] Upland cotton and rice PFC base acreage represented 16.2 and 4.1 million acres (Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 50)). Brazil does not have any information on the effects of the base acreage update and, therefore, uses the PFC base acreage as a proxy for CCP base acreage. Total US farmland in 2001 was 959,163,331 million acres (Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6).

[76] Exhibit Bra-107 ("US and State Farm Income Data, Farm Cash Receipts," ERS, USDA, June 2003).

63. This evidence demonstrates that CCP (and direct payments) are provided to only a fraction of the producers of agricultural commodities in the United States and that payments are focused to producers of a limited number agricultural products. In view of these facts – particularly that upland cotton has its own "target price" of 72.4 cents per pound and accounted for 80 percent of all CCP payments in MY 2002 – it is appropriate for the Panel to consider only upland cotton statistics to conclude that these payments are "support to cotton" and are also "product-specific".

64. But even if the Panel relies on data regarding all 10 CCP programme crops, the evidence still demonstrates that CCP and direct payments are "support to cotton" and "product-specific" support because they are not provided to producers of US agricultural commodities "in general". Only around 30 percent of the farm acreage in the United States is farmed by producers with the possibility of receiving CCP payments.[77] In MY 2002, only 2.2 percent of total US farmland was eligible to receive CCP payments.[78] In light of these facts, it is not surprising that the EC correctly recognized in June 2002 that the US CCP programme does not represent a domestic support programme "provided in favour of agricultural producers in general".[79]

**45. If the Panel considered that Step 2 payments paid to exporters were an export subsidy, would the United States count them as domestic support measures for the purposes of Article 13(b)? Please verify Brazil's separate data for Step 2 export payments and Step 2 domestic payments in Exhibit BRA-69 or provide separate data. BRA, USA**

Brazil's Answer:

65. Brazil can verify that the Step 2 information its representatives received and that is tabulated in Exhibit Bra-69 was obtained from Wayne Bjorlie (wayne_bjorlie@wdc.usda.gov) in the Kansas City Commodity Office (KCCO) upon request for such data in December 2002.

**46. What is the relevance, if any, of the concept of "specificity" in Article 2 of the SCM Agreement and references to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture? BRA, USA**

Brazil's Answer:

66. The concept of "specificity" in Article 2 of the SCM Agreement is useful context in interpreting the meaning of "support to a specific commodity" in Article 13(b)(ii). As the United States recognized at the First Meeting of the Panel with the parties, the word "support" as used in the Agreement on Agriculture is a synonym for "subsidy".[80] The term "support to a specific commodity" has a similar meaning as "subsidized product," as used in, inter alia, Article 6.3(c) of the

[77] Brazil does not have access to actual CCP base acreage figures. Therefore, Brazil has used MY 2001 figures as a proxy and relies on MY 2001 PFC base acreage for the 7 crops covered by PFC payments (Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 50) and has added MY 2001 soybean, peanut and other oilseed acreage (Exhibit Bra-146 (Acreage, NASS, 28 June 2002, p. 14, 15 and 17) (286.8 million acres). Total US farmland in 2001 was 959,163,331 million acres (Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6).

[78] Upland cotton and rice PFC base acreage represented 16.2 and 4.1 million acres (Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 50)). Brazil does not have any information on the effects of the base acreage update and, therefore, uses the PFC base acreage as a proxy for CCP base acreage. Total US farmland in 2001 was 959,163,331 million acres (Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6).

[79] Exhibit Bra-144 (G/AG/R/31, paras. 30-31).

[80] Brazil does not mean to imply that in the second phase of this proceeding it will not have the burden of demonstrating that each of the domestic support programs are "subsidies" within the meaning of the SCM Agreement.

SCM Agreement. Given the textual similarities between "subsidized product" and "support to a specific commodity", assessment of whether "support to a specific product" exists could be examined with at least some reference to the specificity criteria of Article 2 of the SCM Agreement. Article 2 of the SCM Agreement provides, in relevant part:

> 2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:
>
> (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.. . .
>
> (c) If, notwithstanding any appearances of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of the subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionally large amounts of subsidy to certain enterprises . . .
>
> 2.2 A subsidy which is limited to certain enterprises within a designated geographical region within the jurisdiction of the granting authority shall be specific.

67. The US Statement of Administrative Action ("SAA") describes in some detail how the United States intends to administer the specificity provisions, suggesting that the US Department of Commerce applies a low threshold for finding both "de jure" and "de facto" specificity:

> The Administration intends to apply the specificity test in light of its original purpose, which is to function as an initial screening mechanism to winnow out only those foreign subsidies which truly are broadly available and widely used throughout an economy.[81]

Brazil agrees with this statement that the "original purpose" of the specificity criterion is to make subsidies non-specific only when they are broadly available and widely used throughout an economy.

68. The ordinary meaning of the plural term "certain enterprises," as set out in the chapeau to ASCM Article 2.1, underscores that a subsidy can be specific even if it applies to a "group of . . . industries." The term "industry" is defined as "a particular form or branch of productive labour; a trade, a manufacture".[82] Thus, the text of the chapeau supports the notion that for a subsidy to be specific under the SCM Agreement it must be limited to a certain number of industries that may be involved in different trades or manufacturing processes.

69. The object and purpose of the specificity requirement in Article 2.1(a) of the SCM Agreement is consistent with a broad scope for specificity. One key purpose for the specificity requirement is to avoid the countervailability of those subsidies widely available in an economy, while at the same time ensuring that those subsidies that benefit some groups of industries or enterprises more than others are covered. As the United States noted in the SAA:

> The specificity test was intended to function as a rule of reason and to avoid the imposition of countervailing duties in situations where, because of the widespread

[81] *See* Exhibit Bra-148 ("Statement of Administrative Action," p. 929) (emphasis added).
[82] The New Shorter Oxford English Dictionary, 1993 edition, p. 1356.

> availability and use of a subsidy, the benefit of the subsidy is spread throughout an economy. Conversely, the specificity test was not intended to function as a loophole through which narrowly focused subsidies provided to or used by discrete segments of an economy could escape the purview of the CVD law.[83]

70. Therefore, the ordinary meaning, context and object and purpose of Article 2.1(a) of the SCM Agreement confirm that subsidies that are available to discrete segments of an economy or to only particular industries are specific. Under these standards, each of the subsidies challenged by Brazil in this dispute (and listed as support for the purposes of the peace clause analysis) are provided to "discrete segments" of the US economy. Indeed, they are provided to discrete segments of the sub-section of the US economy known as "agriculture". Thus, if the Panel were to apply the specificity standard set out in Article 2 of the SCM Agreement to Article 13(b)(ii) of the Agreement on Agriculture, the identified domestic support subsidies would be considered "specific".

71. Brazil notes that further support for the use of specificity concepts from the SCM Agreement in interpreting Article 13(b)(ii) of the Agriculture Agreement is found in the definition of "AMS" in Article 1(a) of the Agriculture Agreement. The definition of "non-product specific" support ("support provided in favour of agricultural producers in general") illustrates that the concept of specificity in the context of the SCM Agreement and of AMS in the Agreement on Agriculture are similar. Both would require a finding of specificity unless support is provided to an economy generally, in the case of the SCM Agreement, or to "producers" of agricultural commodities "in general," in the case of AMS under the Agriculture Agreement.

72. In contrast, the United States seeks to apply an extremely restricted concept of specificity to the peace clause that begins and ends with the question whether production of a specific commodity is required to receive the payment. This is one of the "policy-specific" criteria of a "green box" test in Annex 2, paragraph 6, but not the test of "support to a specific commodity" required by Article 13(b)(ii). Further, as demonstrated above, this narrow US interpretation finds no support in the provisions of the SCM Agreement and the Agreement on Agriculture that speak to specificity.

**4. "in excess of that decided during the 1992 marketing year"**

**47. Where does Article 13(b)(ii) require a year-on-year comparison? BRA, USA**

Brazil's Answer:

73. The text of Article 13(b)(ii) sets up a comparison between the "support" "grant[ed]" during the implementation period with support "decided" during the 1992 marketing year. Brazil cannot conceive of a methodology in which all support granted during the entire implementation period could be compared with the support decided during marketing year 1992. In order to generate an "apples to apples" ("support to support") comparison, it is necessary to compare the support granted in any marketing year during the implementation period with the support decided during marketing year 1992. No other reading of Article 13(b)(ii) would permit the required comparison.

74. Additionally, Brazil notes that the second condition for domestic support measures to be exempted from actions under the SCM Agreement is that a Member's domestic support measures conform fully to Article 6, and, thus, grant support within the limits of that Member's Total AMS reduction commitments. These Total AMS reduction commitments are made on a yearly basis. The nature of the reduction commitment and the manner, in which compliance with Article 6 is determined, demonstrates that Article 13(b)(ii) – read in accordance with its chapeau and the reference to Article 6 therein – requires a year-by-year comparison. The context of the chapeau provides support for Brazil's argument made above that the relevant comparison for Article 13(b)(ii)

[83] Exhibit Bra-148 (Statement of Administrative Action, p. 930).

involves a comparison of support granted in any of the marketing years during the implementation period with support decided in MY 1992.

75. Similarly, Article 13(c) provides further context to support the conclusion that Article 13(b)(ii) requires a year-by-year comparison. Brazil notes in its answer to Question 7, that export subsidy reduction commitments under the Agreement on Agriculture are made on a commodity-specific basis. Brazil has also pointed out in its answer to Question 79 that a violation of Part V of the Agreement on Agriculture, and the resulting loss of peace clause exemption, must also be assessed on a yearly basis.

**48. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made? BRA, USA**

Brazil's Answer:

76. The answer to the first question is yes, the text of Article 13(b)(ii) requires a comparison between the "support granted" for marketing years between 1995-2003 with the "support decided" in marketing year 1992. Brazil has explained in detail in its First Oral Statement the basis for this legal conclusion.[84]

77. The second question asks how the comparison must be made. Brazil is of the view that a harmonious interpretation of "support decided" with "support granted" requires an examination of the expenditures incurred for all of the support related to the 1992 marketing year and each of the marketing years during the implementation period ending 1 January 2004. This expenditure approach permits an objective, easily verifiable approach to compare the support for each of the two time periods. That is particularly important when, as in this case, there are a wide variety of programmes that do not provide support on a "cents per pound" basis to all production. Brazil does not consider that a comparison based on a "rate of support" approach as suggested by the United States allows the same objective and easily verifiable comparison. Professor Sumner explained the difficulty of comparing, on a "cents per pound" basis, deficiency payments, Step 2, marketing loans, and crop insurance provided in marketing year 1992 with the marketing year 1999-2002 measures that replaced or changed the 1992 measures.[85] Nevertheless, Professor Sumner was able, through a relatively complex methodology, to calculate and compare a level of support on a per pound basis between marketing year 1992 and marketing years 1999-2002.

78. Another methodology is the rate of support taking into account expenditures, as detailed in Brazil's answer to Question 60 infra. Brazil would note that a last methodology that would have been possible, had the text of Article 13(b)(ii) included the term "AMS," would be to calculate support based on the criteria set forth in Annex 3 of the Agriculture Agreement. The results of this calculation are set forth in Brazil's answer to Question 67 *infra*.

**49. Brazil claims that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? BRA**

[84] First Oral Statement of Brazil, para. 31.
[85] Exhibit Bra-105 (Statement of Professor Sumner at the First Meeting of the Panel).

Brazil's Answer:

79. Brazil set forth its interpretation of the terms "grant" and "decided" in its First Oral Statement.[86] Brazil concluded that the text, context, and object and purpose of Article 13(b)(ii) meant that the MY 1992 "decision" must be related to "support granted" in order to make possible the comparison between MY 1992 and marketing years during the implementation period. Yet, Brazil does not believe that the "decision" in marketing year 1992 means that all of the support had to be "granted" (i.e., paid) during the 12-month period of that single marketing year. Rather, the decision had to authorize payment in respect of a specific marketing year, including MY 1992.[87] However, a Member could have decided during the 1992 marketing year to budget a certain amount of support to specific commodities for the next several marketing years, including MY 1995 et seq. In that case, the relevant peace clause comparison would involve comparing the support granted to a specific commodity in any marketing year during the implementation period to what was decided during the 1992 marketing year to be provided for that later marketing year.

80. Brazil has cited the negotiating history of Article 13(b)(ii), which indicates that the EC insisted on the use of the word "decided" to obtain a safe harbour for the total quantity of its domestic support subsidies that it had already budgeted in marketing year 1992 for marketing year 1995 and thereafter.[88] Brazil will comment further, as required, on the intentions of the "drafters" following receipt of the answers of the European Communities and the United States.

**50. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) and, in particular, why both words "grant" and "decided" were used. USA**

**51. Could the United States please comment on the interpretation advanced by the EC, in paragraphs 16 and 18 of its oral statement, of the words "decided during the 1992 marketing year"? USA**

**52. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". BRA, USA**

Brazil's Answer:

81. Brazil agrees that in its proper context, the term "decided during" in Article 13(b)(ii) is synonymous with the words "authorized during". Brazil has set forth the reasoning and citations supporting this conclusion in its Answers to Question 49 supra and Question 58 infra, as well as in its First Oral Statement at paragraph 31.

**53. Assume, for arguments sake, that the only "decision" made in the United States in 1992 was the target price. How would Brazil make the comparison vis-à-vis, for example, the year 2001? BRA**

Brazil's Answer:

82. Brazil maintains that the relevant comparison under Article 13(b)(ii) is to compare expenditures incurred relating to MY 1992 with expenditures incurred relating to marketing years during the implementation period. Only this methodology allows for a comparison irrespective of the nature and characteristics of the domestic support measures provided and does not suffer from the

[86] First Oral Statement of Brazil, paras. 27-34

[87] Brazil and the United States appear to agree that MY 1992 is the relevant marketing year for purposes of this dispute.

[88] First Submission of Brazil, para. 140.

shortcomings of other approaches, on which Brazil will comment below. In particular only an expenditure incurred approach allows for an effective comparison in the following situation: Assume, a Member introduces a payment that is made at a fixed rate per pound and is paid for each pound of actual upland cotton production. In this situation, it would be difficult to compare this domestic support measure, which is completely unrelated to market prices to a domestic support measure decided by a Member in MY 1992 and which sets a target price and provides price support.

83. With this qualification in mind, Brazil's understanding of this question is that the assumed single "decision" was the establishment of a target price of 72.9 cents per pound for eligible US upland cotton production during MY 1992. The assumed single "decision" on a target price of 72.9 cents per pound comprised of many other sub-decisions on the mandatory acreage reduction programme, on the operation of the 50/92-programme option, and on optional flex acres, among others.[89] Professor Sumner has analyzed in detail the process through which such a target price of support could be compared to the support provided in MY 1999-2002.[90] For MY 1992, he found that the estimated per unit support rates for all programs was 60.41 cents per pound. For MY 2001, he found the per unit support rates for all programmes was 66.51 cents per pound. Brazil refers to Professor Sumner's detailed description of the methodology he used to make these calculations.[91]

84. The irrationality of the simplistic "72.9 is greater than 51.92" approach by the United States is revealed by comparing it with the results of Professor Sumner taking into account in the calculation of the "rate of support" eligibility criteria and the costs imposed by participation in the US upland cotton support programs. It is also demonstrated by comparing the expenditures in MY 1992 ($1.9 billion) with the expenditures in MY 2001 ($4 billion).

**54. Please identify all United States legal and regulatory and administrative instruments decided during the marketing year 1992, with the respective dates of decision, that decided support for upland cotton. BRA, USA**

Brazil's Answer:

85. Brazil will comment further upon receipt of the answer provided by the United States to this question. The United States obviously has access to records related to all the decisions taken by the United States concerning its support programs for MY 1992. However, Brazil notes that given its understanding of the operation of the US support programmes, the United States took a number of decisions with respect to the upland cotton support programmes for MY 1992.

86. Many of the US support programmes for MY 1992 were decided by Title V of the Food, Agriculture, Conservation and Trade (FACT) Act of 1990 (P.L. 101-624), which established US farm policy for the 5 crop years 1991/92-1995/96, and by the Omnibus Budget Reconciliation Act (OBRA) of 1990 (P.L. 101-508), which established several programme provisions in order to reduce programme costs. Brazil considers that among the decisions taken by the United States in relation to MY 1992 upland cotton support programmes were the following:

- Continuation of the upland cotton target price under the deficiency payment programme at the 1990 level of 72.9 cents per pound set by the 1990 FACT Act. The OBRA limited the maximum payment acreage at 85 percent of the crop acreage minus the acreage reduction programme requirement, which was set annually. Therefore, the United States had to take a decision with respect to the MY 1992 percentage of deficiency programme

[89] For a more thorough discussion of the decisions Brazil understands the United States has taken with respect to MY 1992, *see* Brazil's answer to Question 54.

[90] *See* Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).

[91] Annex 2 to Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).

base acreage that would be required to be set aside under the acreage reduction programme.

- In connection with the former, the United States also took a decision allowing producers to plant up to 25 percent of upland cotton acreage base, the so-called "flex acreage," to any commodity except fruits and vegetables and mung beans.

- Furthermore, the United States had to decide on how to implement the 50/92-programme option under the deficiency payment program.

- The United States also needed to determine the upland cotton acreage base for purposes of the deficiency payment programme, which for MY 1992 represents the previous three-year average of planted and considered planted upland cotton acreage.

- Concerning the deficiency payment program, the United States finally had to decide on the payment rate for upland cotton.

- Concerning the marketing loan programme, the United States had to take a decision setting the marketing loan rate for upland cotton.

- Furthermore, the United States had to establish a weekly "adjusted world price" and, thus, the repayment rate for marketing loans determining the rate of marketing loan gains or loan deficiency payments.

- Furthermore, the United States took a weekly decision in MY 1992 with respect to the Step 2 payment rate applicable for that week.

- Regarding crop insurance, the Federal Crop Insurance Act of 1980 was the authorizing legislation, but it was necessary to adopt decisions concerning individual insurance policies that would apply to upland cotton and to set the respective rates of premium subsidies.

87. While Brazil does not consider this list to be exhaustive, it gives the Panel an overview on the variety of decisions the United States had to take to make the support programme to upland cotton operational. Brazil looks forward to the answer provided by the United States and reserves its right to comment as appropriate.

**55. Please provide a copy of the instrument in which the rate of support for upland cotton during the marketing year 1992 was decided, indicating the date of the decision. USA**

**56. Could the United States please explain how support granted under legislation that dates back to 1990 can have been support "decided during the marketing year 1992"? USA**

**57. If the United States decided on a rate of support for MY1992, does that not mean that it decided on whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at that time? USA**

**58. Please comment on the argument advanced by the EC, in paragraph 17 of its oral statement that: "Had WTO Members intended a limitation to the support provided or granted in 1992 the word 'for' would have been used in place of 'during'." BRA**

Brazil's Answer:

88. Brazil agrees with the EC that the word "during" does not mean that all of the support need be provided or granted within the 12-month period of marketing year 1992. Rather, the decision must have been related to the amount of support to be granted in respect of marketing year 1992. This interpretation is consistent with an expenditure methodology that compares expenditures for upland cotton in respect of MY 1992 with expenditures for upland cotton in MY 1995-2003, and thereby permits a comparison of 1992 levels of support with levels of support in marketing years 1995-2003.

89. The negotiating history cited by Brazil in its First Submission indicates that the EC is in a special situation vis-à-vis the peace clause.[92] It apparently made the decision in marketing year 1992 to budget an amount of support for commodities for marketing years 1995-2000 in its CAP reform. Brazil agrees with the EC that Article 13(b)(ii) was "intended to set up as a benchmark an amount of support adopted by some form of decision (be it political, legislative or administrative) in which support for a specific product is decided . . ." But the EC qualifies this assertion with the notion that that decision can only be "allocated for future years."[93] This qualification would appear to be compelled by the EC's particular situation. But that situation does not justify the EC's conclusion that its "future years" concept means that Article 13(b)(ii) "clearly is not intended to set up a comparison between domestic support granted in 1992 and domestic support granted in a more recent period."

90. The notion of a "decision" suggests that individual Members each made some sort of a decision with respect to the peace clause. The United States and Brazil agree that the decision made by the United States – whatever it may have been – related to the level of support provided to upland cotton in MY 1992. Brazil's argument with the United States concerns the type of decision and the methodology that can be used to account for the level of support decided during MY 1992.

**59. Should the rate of support as indicated in Article 13(b)(ii) include the market price? If so, why is it appropriate to include it in the comparison under Article 13(b)(ii)? BRA, USA**

Brazil's Answer:

91. The most natural measure of support is budgetary expenditures, and these implicitly include market price in the sense that, for several US upland cotton programs, higher market prices lead to lower budgetary outlays. The US Government payments under the marketing loan, deficiency and counter-cyclical programs all decline with increasing market prices, as they cover the difference between the loan rate or the target price and the market price. Step 2 payments are also related to market prices in that they cover the difference between the A-Index and the lowest-priced US quote for upland cotton and, therefore, vary with market prices.[94] Incorporating the different degrees to which the market price influences the support provided by the US Government to its upland cotton farmers is best achieved by looking at the results in terms of budgetary outlays for the programs. This measure of support is straightforward to apply and allows a ready and accurate comparison between 1992 and subsequent marketing years.

92. Under the US approach and Professor Sumner's adaptation of the US approach, market prices enter the calculation of the "rate of support" in the sense that the expected rate of support from the loan rate and the target price per eligible unit of production includes revenue expected to be received from the market (expected market price) and revenue expected from the US Government (subsidies). The market price enters inversely in the sense that the outlay is inversely related to the market price, as for instance the loan rate benefits make up the difference between the loan rate and the adjusted

[92] First Submission of Brazil, para. 140.
[93] Oral Statement of the European Communities, 24 July, para. 18.
[94] Brazil notes, however, that the relationship between market price and level of Step 2 payments by the US Government is not as straightforward and positively correlated as for the other price-based programmes.

world price for the eligible share of production.[95] The higher the market price, the higher the resulting budgetary outlays.

93. Additionally, there is one further important reason why the notion of support in Article 13(b)(ii) should include the market price. Without reference to the market price, it is impossible to say what the rate of support means to farmers. It may be that the support is completely irrelevant, because market prices are much higher than the loan rate or the target prices set by the US Government. For instance, the loan rate was irrelevant for US upland cotton producers in MY 1994-1996,[96] because market prices were so high that no payments occurred. However, under essentially the same program, market loan benefits amounted to 26.6 cents per pound in MY 2001.[97] Thus, without taking market prices into account, it is impossible to translate a "rate of support" into actual support provided and to give meaning to the term "support."

**60. Can you provide information on support decided in 1992 and the years with which you believe it should be compared, on a per support programme / per unit of production / per annum basis? If possible, please specify how, if at all, budget outlays may be transposed into units of production, and which units of production are best to use. BRA, USA**

Brazil's Answer:

94. Brazil maintains that the appropriate measure of support decided during MY 1992 is total actual expenditures resulting from any decisions regarding support to upland cotton. This must then be compared to total actual expenditures for support to upland cotton for MY 1999, 2000, 2001 and 2002. Presenting expenditures as a "rate of support" per pound of upland cotton disguises the fact that US expenditures for upland cotton have increased considerably since MY 1992. This is due to the fact that the increased US expenditures are now spread over an also increased US production. Therefore, a "rate of support" based on budgetary outlays or expenditure understates the real increase in US support to upland cotton. However, even disregarding the underestimation of the amount spent for upland cotton by presenting the budgetary outlays in the form of support per pound of actual upland cotton production, the data presented below show that also this measurement demonstrates that the US support in MY 1999-2002 is higher in each year than it was in MY 1992.

95. In answering this question, and responding to the Panel's requests, Brazil presents the support provided by the various US support programmes for a given marketing year on a per pound of actual upland cotton production basis. This approach takes into account market prices. Thus, the "support level" from deficiency payments, from the marketing loan programme and from counter-cyclical and Step 2 payments no longer reflects the "target price" approach favoured by the United States, but reflects actual payments made per unit of actual production.

96. Brazil believes that the unit of production that should be used is a pound of upland cotton actually produced in the United States for that marketing year in question. US support programmes provide support based on actual production (marketing loan programme, Step 2 and cottonseed payments), actual acres planted (crop insurance), updated historical production and current prices (deficiency payments and counter-cyclical payments), historical production (PFC, market loss assistance), and finally, updated historical production (direct payments). The most natural comparison on a per unit basis is to use actual production. The US National Cotton Council also calculates the support provided by all of these programmes to its upland cotton producer members in "cents per pound" of actual production.[98] This reflects the reality that an upland cotton farmer

[95] Brazil notes that budgetary outlays have not been part of Professor Sumner's calculation of the rate of support provided by the marketing loan, deficiency payment and CCP payment program.

[96] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5-6).

[97] *See* Brazil's answer to question 60.

[98] Exhibit Bra-109; Exhibit Bra-111; Exhibit Bra-112.

seeking to remain in business must calculate whether the amount of government support plus market revenue compensates for the cost of production incurred by producing a pound of upland cotton.

97. Brazil arrives at the figures presented in the following table by dividing the total annual amount of budgetary outlays to upland cotton from a US support programme by the total amount of production of upland cotton in the relevant marketing year.

**Support Per Pound Of Upland Cotton By Year And Support Programme**

| Year<br>Programme | 1992 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| | ----- cents/pound ----- | | | | |
| Deficiency Payments[1] | 13.49 | none | none | none | none |
| PFC Payments[2] | none | 7.00 | 6.71 | 4.81 | none |
| Market Loss Assistance Payments[3] | none | 6.97 | 7.15 | 6.65 | none |
| Direct Payments[4] | none | none | none | none | 6.04 |
| Counter-cyclical Payments[5] | none | none | none | none | 12.43 |
| Marketing loan (Loan gains and LDP)[6] | 9.86 | 19.75 | 6.72 | 26.63 | 11.85 |
| Step 2 Payment[7] | 2.74 | 5.39 | 2.93 | 2.09 | 3.95 |
| Crop Insurance[8] | 0.35 | 2.17 | 2.00 | 2.79 | 2.42 |
| Cottonseed Payment[9] | none | 1.01 | 2.29 | none | 0.62 |
| **Total** | **26.44** | **42.29** | **27.8** | **42.97** | **37.31** |

Notes

[1] Deficiency payment per pound of actual production = deficiency payment expenditure / (total production [bales] * 480 [pounds/per bale]). Total deficiency payments in MY 1992 were $1.0174 billion, while total production was 15,71 million bales (Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4-6)). One bale equals 480 pound of upland cotton.

[2] PFC payment per pound of actual production = PFC payment expenditure for upland cotton base * (actual upland cotton acreage / PFC upland cotton base acreage) / (total production [bales] * 480 [pounds/per bale]). Total PFC payments to upland cotton are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). This amount has been adjusted by the ratio of upland cotton acres actually planted (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4)) to upland cotton base acres in the PFC programme (Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). This adjustment is necessary because only the portion of upland cotton PFC payments that actually benefits acres planted to upland cotton can be considered support to upland cotton. Because the latter figure is higher than the former, this leads to a reduction in the payment rate reflecting actual production in each year. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[3] Market loss assistance payment per pound of actual production = Market loss assistance expenditure for upland cotton base * (actual upland cotton acreage / PFC upland cotton base acreage) / (total production [bales] * 480 [pounds/per bale]). Total market loss assistance payments to upland cotton are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). This amount has been adjusted by the ratio of upland cotton acres actually planted (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4)) to upland cotton base acres in the PFC programme (Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton. Because the latter figure is higher than the former, this leads to a reduction in the payment rate. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[4] Direct payments per pound actually produced = total direct payment expenditure for upland cotton base * (actual upland cotton acreage/direct payment upland cotton base acreage) / (total production [bales] * 480 [pounds/per bale]). Total direct payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 59. The new figure is based on the statutory payment rate of 6.67 cents per pound of upland cotton base multiplied by the direct payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)) multiplied by the direct payment yield of 604 pounds per acre (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). Payments are made on 85 percent of base acres. This translates into a total of $558.17 million. This amount has been adjusted by the ratio of upland cotton acres actually planted Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) to upland cotton base acres in the direct payment program. Because the latter figure is higher than the former, this leads to a reduction in the direct payment rate. This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[5] Counter-cyclical payments per pound actually produced = total counter-cyclical payment expenditure for upland cotton base * (actual upland cotton acreage / counter-cyclical payment upland cotton base acreage) / (total production [bales] * 480 [pounds/per bale]). Total counter-cyclical payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 69. The new figure is based on the MY 2002 payment rate of 13.73 cents per pound of upland cotton base multiplied by the counter-cyclical payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)) multiplied by the counter-cyclical payment yield of 604 pounds per acre (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50) Brazil notes that this underestimates the payments, as it disregards the yield update for purposes of the counter-cyclical payments). Payments are made on 85 percent of base acres. This translates into a total of $1,148.98 million. This amount has been adjusted by the ratio of upland cotton acres actually planted Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) to upland cotton base acres in the counter-cyclical payment programme. Because the latter figure is higher than the former, this leads to a reduction in the direct payment rate. This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[6] Marketing loan benefit per pound of actual production = total marketing loan expenditures / (total production [bales] * 480 [pounds/per bale]). Total marketing loan payments (marketing loan gains plus loan deficiency payments) are taken para. 144, 148-149 of the First Submission of Brazil. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[7] Step 2 payments per pound of actual production = total Step 2 expenditures/(total production [bales] * 480 [pounds/per bale]). Total Step 2 payments are contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Brazil has estimated the MY 2002 amount at note 335 in its First Submission to be $317 million. The amount of production has been taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4). Brazil notes that the difference between 3.95 cents per pound resulting from this calculation and 4 cents per pound – which was the basis for Brazil to calculate the total Step 2 payment for MY 2002 – is due to rounding effects.

[8] Crop insurance payments per pound of actual production = total crop insurance expenditures / (total production [bales] * 480 [pounds/per bale]). Total crop insurance payments are taken from Exhibit Bra-57 ("Crop Year Statistics", Federal Crop Insurance Corporation). Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[9] Cottonseed payment per pound of actual upland cotton production = total cottonseed expenditures/(total production [bales] * 480 [pounds/per bale]). Total cottonseed payments are listed in Brazil's answer to question 17 (see para. 9). Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

98. Brazil notes that also under this approach, the total US support to upland cotton in MY 1999-2002 surpasses the support decided by the United States in MY 1992. Brazil furthermore notes that even considering the support programs (and their respective replacements)[99] individually, nearly all of them provide higher support in MY 1999-2002 than they (or their predecessors) did in MY 1992 (with the exception of Step 2 and PFC / market loss assistance in MY 2001).

**61. Does the United States consider that Article 13(b)(ii) permits a comparison on any basis other than a per pound basis? USA**

**62. According to Prof. Sumner's calculation, the per pound support increased by approximately 24 % from 1992 to 2002. On the other hand, the Panel understands that the**

[99] The deficiency payments were replaced by PFC and market loss assistance payments in MY 1999-2001 and by direct and counter-cyclical payments in MY 2002.

**total budget outlay, according to Brazil, increased more than that. What, in Brazil's view, is the reason for this difference in the rate of increase? BRA**

Brazil's Answer:

99. US budgetary outlays for upland cotton are a function of the level of price, income and other support provided by the US support programmes. Everything being equal, an increase in the "rate of support" as interpreted by the United States would translate one-to-one into an increase of expenditure. However, the "rate of support" is not the only determinant of budgetary outlays, as two important qualifications apply. First, the most important US subsidy programmes for upland cotton are price-based.[100] For instance the marketing loan payment in MY 2002 guarantees a return of 52 cents per pound. With lower market prices, the gap between the adjusted world price and the loan rate, i.e., the basis for the calculation of the marketing loan benefit, widens and payments per pound increase. During the period MY 1992-2001, prices for upland cotton fell drastically.[101] For example, average upland cotton prices received by farmers in the United States were 53.7 cents per pound in MY 1992 and dropped to a low of 29.8 cents per pound in MY 2001.[102] Therefore, even for an identical set of programs providing an identical "rate of support," budgetary outlays would have vastly increased due to the drop in prices.

100. Second, the United States increased the production of upland cotton between MY 1992 and MY 1999-2002 from 15.7 million bales in MY 1992 to 16.3 million bales in MY 1999, 16.8 million bales in MY 2000, 19.6 million bales in MY 2001 and 16.7 million bales in MY 2002.[103] Thus, the increased "rate of support" was applicable to an increased production of upland cotton.

101. In sum, budgetary outlays for upland cotton increased between MY 1992 and MY 2002 for three main reasons: first, the United States increased its "rate of support", second, lower upland cotton prices led to higher budgetary outlays per pound of upland cotton produced; and third, at times of falling market prices, the United States expanded its upland cotton production so that more upland cotton was eligible to receive the increased rate of support. All of this resulted in an increase of budgetary outlays for upland cotton that is relatively bigger than the increase in the US "rate of support".

102. Lastly, Brazil notes that none of the figures presented by Professor Sumner[104] represent actual payments or actual rates of support. Rather, those figures represent average or expected rates of support in any given marketing year. They are not based on actual production or prices,[105] but solely on expected production and prices. Therefore, they cannot easily be compared to actual payments made by the United States in support of upland cotton. Professor Sumner chose the expected support approach in order to match the approach suggested by the United States as closely as possible, while correcting for its simplistic reliance on the target price that disregarded the eligibility criteria and other features of the programmes.

**63. In relation to Prof. Sumner's presentation at the first session of the first substantive meeting, please elaborate on the reasons behind the increase in the figures (from 1992 to 2002) concerning Loan Support and Step 2 payments. BRA**

[100] These include the marketing loan program, the deficiency payment program, the counter-cyclical payment programme and the Step 2 programs.

[101] *See* First Submission of Brazil, para. 28.

[102] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5).

[103] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[104] *See* Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).

[105] Which would only be important for the rate of Step 2 payments, as only this programme depends on actual prices for purposes of a rate of support. The other programs reduce Government payments with increasing prices, so that the total rate of support remains basically the same, or are not price-related.

Brazil's Answer:

103. The support rate from the marketing loan programme calculated by Professor Sumner represents the expected support rate from the marketing loan programme. Concerning the marketing loan programme, Brazil notes that the statutory loan rate, indeed, fell from 52.35 cents per pound in MY 1992 to 51.92 cents per pound in MY 1999-2001[106] before being slightly increased in MY 2002 to 52 cents per pound.[107] However, the somewhat higher loan rate in MY 1992 was accompanied by strict eligibility criteria.[108] In MY 1992, only production on farmland that participated in the upland cotton deficiency payment programme was eligible for marketing loan benefits, which restricted eligibility to 84.7 percent of production.[109] In MY 1999-2001, only upland cotton produced on farmland that participated in the PFC programme was eligible. Professor Sumner has conservatively used 97 percent of upland cotton production in MY 1999-2001 as the participation rate of upland cotton.[110] Finally, in MY 2002, all US production of upland cotton was eligible to receive marketing loan benefits.[111] Thus, taking into account the eligibility criteria for benefiting from the marketing loan programme, the slightly higher loan rate in MY 1992 provided less support to total expected US upland cotton production than the slightly lower loan rates in later years.

104. Concerning the difference between the expected Step 2 rate of support in MY 1992-2001 and MY 2002, this difference stems from the fact that the United States eliminated the 1.25 cents per pound threshold for Step 2 payments in the 2002 FSRI Act. Before MY 2002, Step 2 payments were made in the amount of the difference between the A-Index and the lowest priced US quote for upland cotton minus a 1.25 cents per pound threshold. Section 1207(a)(4) of the 2002 FSRI Act postpones the application of this threshold until 1 August 2006.[112] Thus, expected Step 2 payments for MY 2002 (and through MY 2005) will be 1.25 cents per pound higher than under the 1990 and 1996 Farm Acts, which both applied the threshold.[113]

**64. Do the figures cited in Prof. Sumner's presentation at the first session of the first substantive meeting indicate amount available or amount spent? Can the Panel derive amount spent from these figures? If Article 13(b)(ii) requires a rate of support comparison, is the rate of support the "rate" of support available or the "rate" at which the support was spent? BRA**

Brazil's Answer:

105. The figures in Professor Sumner's calculation do not indicate amounts spent, but were an attempt to approximate the expected rate of support for an expected pound of upland cotton production under the specific rules in place for each support programme in that year. The figures attempt to represent the normal result that would have been expected by policy makers and farmers as a result of the programme decisions taken by the United States. They do not represent actual expenditures per unit for any programme in any year because, in every year, the actual programme payments per pound of actual production deviates from the expected or normal payments, because the actual production will not exactly equal the expected production.

[106] Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 5).
[107] Exhibit Bra-29 (Section 1202(a)(6) and 1202(b)(6) of the 2002 FSRI Act).
[108] *See* Exhibit US-3 (7 CFR 1427.4(a)(3) and 7 CFR 1413 (1992 edition)).
[109] Annex 2 to Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel, p. 3).
[110] Annex 2 to Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel, p. 4).
[111] Exhibit Bra-29 (Section 1201(b) of the 2002 FSRI Act).
[112] Exhibit Bra-29 (Section 1207(a)(4) of the 2002 FSRI Act).
[113] *See* Exhibit Bra-12 ("Cotton: Background for 1995 Farm Legislation", USDA, April 1995, p. 16) and Exhibit Bra-46 ("Cotton: Background and Issues for Farm Legislation," USDA, July 2001, p. 9).

106. For some of the US support programs, the support indicated can be considered – within certain limits – as support available per pound. However, there is not a complete identity between the "expected rate of support" and the "support available to a pound of actual upland cotton production," because – as noted above – expected and actual production will vary from each other.

107. For marketing loan benefits, the loan rate can be considered the maximum support available to eligible production in case the market price would fall to zero. Similarly, for deficiency and counter-cyclical payments, the difference between the loan rate and the target price can be considered the maximum support available, albeit again only for the eligible production. The expected support differs from that, as it takes into account that not all of the expected production will benefit from those subsidies. The actual support differs again, as expected and actual production may not be identical. Finally, actual US Government payments depend on market prices.

108. For PFC, market loss assistance, direct and cottonseed payments and crop insurance subsidies, the "expected rates of support" represent expected expenditures per unit of expected production. This has been calculated by using average budget expenditures over an appropriate period as expected support, and by using average production as the expected production. Thus, these payments are not maximum available "rates of support". For example, under the crop insurance programme the US Government pays premium subsidies. Higher per unit support would have been available had all farms joined the programme at the maximum subsidized rates. However, this was not an expected or normal occurrence. Especially in MY 1992, when subsidy rates were relatively low, many upland cotton farms were expected to forgo participation in the programme. Both maximum available crop insurance subsidies as well as expected or normal crop insurance subsidies increased for MY 1999 through 2002, as premium subsidies rose and more cotton acreage found the programme attractive. For crop insurance, but also for PFC and direct payments as well as market loss assistance, the actual support per pound of upland cotton production will vary with the actual production undertaken and actual yields achieved.

109. The actual "rate of support" from the Step 2 payments depends on the actual price differential between the A-Index and the lowest-prices US quote. While it varies from the expected "rate of support" with the actual realization of the price gap, it is not expected to be systematically correlated to the actual level of prices.

110. In sum, it is not possible to derive the amount spent from the "expected rate of support" calculated by Professor Sumner without adding additional information on the level of market prices and the actual US upland cotton acreage, yield and production, among other variables. Following the US approach, Professor Sumner has calculated an expected rate of support that could be characterized as an expected guaranteed revenue. This approach is distinct from an approach looking into actual expenditures, as favoured and advocated by Brazil. In fact, Professor Sumner applied the US approach to a rate of support that would abstract in as far as possible from actual expenditures.

111. Brazil refers the Panel to its answers to questions 60 and 67 for actual expenditures by year, by programme – both per pounds of upland cotton production and as total expenditures for upland cotton.

112. Should the Panel decide that the required test under Article 13(b)(ii) is a "rate of support", Brazil submits that the relevant rate of support is "expenditures per pound of production", and thus the "'rate' at which support was spent", as discussed in Brazil's answer to Question 60.

**65. Does Brazil consider that adjustment for inflation is relevant in the context of the comparison under Article 13 (b)(ii) ? BRA**

Brazil's Answer:

113. Brazil does not believe that an adjustment for inflation is relevant in the context of the comparison under Article 13(b)(ii). First, there is nothing in the text of Article 13(b)(ii) that provides for such an adjustment. Second, the only provision of the Agreement on Agriculture addressing inflation is Article 18.4, which provides: "In the review process Members should give due consideration to the influence of excessive rates of inflation on the ability of any Member to abide by its domestic support commitments." The "review process" is the review by the Committee on Agriculture of the progress of implementation of commitments as set out in Article 18 of the Agreement on Agriculture. The fact that negotiators explicitly opened the possibility of "giving due consideration to the influence of excessive rates of inflation" in the review process, but not for purposes of Article 13(b)(ii), is evidence that this omission was intentional.

114. Furthermore, at no time during the review process has the United States ever stated or made any notifications that "excessive rates of inflation" in the US economy have negatively impacted "the ability of [the United States] to abide by its domestic support commitments". Even, if it had, Article 18.4 has no relevance for the purposes of the comparison required by Article 13(b)(ii), as it refers to the review process only, and not to the peace clause. Accordingly, there is no basis for the Panel to apply any adjustment to the US level of support to upland cotton in marketing year 1992.

115. Nevertheless, if the Panel should decide to use such an adjustment, Brazil submits that the appropriate index to be used is the applicable US agricultural price index. Three alternative indexes could be used. The first and most direct is the index of prices received for cotton. Other indexes that may be considered are the index of prices received for crops and the index of prices received for all farm products.

| | **2000** | **2001** | **2002** |
|---|---|---|---|
| Index of prices received for cotton | 82 | 65 | 49 |
| Index of prices received for all crops | 96 | 99 | 103 |
| Index of prices received for all farm products | 96 | 102 | 99 |

1990 to 1992 average = 100[114]

116. Thus, under none of the applicable indices is there any significant inflation to be taken into account. To the contrary, the cotton price index fell by 51 percent, while price indices for crops and all farm products have been stable if compared to the 1990-1992 base used by USDA.

**66. Could you please comment on the relative merits of each of the following calculation methods for the purposes of the comparison of support to upland cotton with 1992, irrespective of whether a particular measure should be included or excluded:**

**(a) Total budgetary outlays (Brazil's approach). USA**

**(b) Budgetary outlays per unit of upland cotton: Could you please calculate and provide an estimate for the marketing years 1992 and 1999-2002, respectively, and draw attention to any factors/qualifications that the Panel would need to be aware of. BRA, USA**

[114] Exhibit Bra-149 (Agricultural Outlook, August 2002, p. 38)

Brazil's Answer:

117. Brazil has presented figures for budgetary outlays by unit of actual production in its answer to Question 60. However, Brazil would like to add some further considerations on the shortcomings of this approach.

118. A significant issue in using these per unit figures to represent support rather than total budgetary outlays is that a per-unit approach discounts the fact that some of the change in production is itself caused by changes in the rate of support or subsidy. If support is calculated by dividing budgetary outlays by total production, the result neglects this effect. As support rises in the numerator, production rises in the denominator and the ratio or per unit of an increased support rate rises by less than total support (and may even decline).

119. The perverse effect is that the more production is stimulated by the US domestic support programmes and, thus, the more those programmes distort trade, the smaller the per unit measure effect of the increased subsidy. For this reason, a subsidy rate per unit of actual production should be avoided or used with extreme caution.

**(c) Per unit rate of support (United States approach): How should changes in acreage, eligibility and payment limitations per farm(s) (commodity certificate programmes) be factored into this approach? BRA**

Brazil's Answer:

120. The approach of the United States was simply to assert that the target price represented the rate of support per unit in MY 1992 and the loan rate alone represented the rate of support per unit in MY 2002. This approach rests on several fundamental errors.

121. First, the approach left out major support programs in each year. For 1992, the approach left out the Step 2 programme and crop insurance, both of which provided support to upland cotton in that year. For 2002, the approach of the United States left out support provided by the direct payment programme, the counter-cyclical payment programme and the cottonseed payment programme as well as the Step 2 and crop insurance programmes.

122. Second, the United States did not account for any factors that limited eligibility for support or imposed costs of participation as a mandatory condition of receiving support from the US support programmes. The failure to account for these factors in each year completely ignores the true nature of the US support programmes for upland cotton and seriously distorts the rate of support.

123. Lastly, these two per pound numbers cannot simply be added together because the eligibility criteria differ between them and, in particular, the support from the upland cotton deficiency payment programme was expected to apply to an even smaller share of actual production than the support from the marketing loan programme.

124. Professor Sumner's calculation attempted to correct the US presentation for these serious flaws in the implementation of the US approach. Professor Sumner added back the programmes that provide support to upland cotton, but that have been left out by the United States. He also corrected the rate of support for eligibility restrictions and the cost of participation, and presented the rate of support on the basis of expected production in order to be able to sum up the various "rates of support." At the same time, Professor Sumner has attempted to remain true to the approach of the United States by avoiding the use of actual production or actual payments, and instead relying on expected programme support per unit and expected or normal production to arrive at per unit support. Professor Sumner's approach also deals in detail with the question of how to account for eligibility

restrictions and costs of participation. Brazil refers the Panel to Annex 2 to Exhibit Bra-105 for the details of Professor Sumner's methodology.

125. In addition to eligibility, the Panel's question refers specifically to payment limits. Payment limits are applied on the basis of persons, including corporations, partnerships, producers and other persons actively engaged in agriculture.[115] Typically, for larger farms, there is more than one person actively engaged in agriculture, including spouses, and landlords on a share rental basis. In addition, there is typically more than one legal entity per farm and under the three entity rule, a person may receive programme payments from three entities and up to double the payment limit for that person for one entity.[116]

126. Payment limits for deficiency payments in MY 1992 were $50,000.[117] Payment limits for PFC (in MY 1999-2001)[118] were $40,000,[119] as is the case for direct payments (in MY 2002).[120] Payment limits for counter-cyclical payments are $65,000 (in MY 2002).[121] For the marketing loan programme, a payment limitation of $75,000 per person applied in MY 1992. In the 1996 FAIR Act, the payment limits for the marketing loan programme was also $75,000, but was increased to $150,000 for MY 1999-2001 by supplemental legislation.[122] The 2002 FSRI Act limits the amount of marketing loan gains and loan deficiency payments to a total of $75,000 for each producer.[123] However, the key change between MY 1992 and MY 1999-2002 was the establishment of the certificate programme in MY 1999,[124] which effectively eliminated any payment limit for the marketing loan programme.[125]

127. Brazil has no data that would allow it to factor payment limitations into the calculation of an expected rate of support. However, Brazil notes that with the inception of the commodity certificate programme in MY 1999, the limitations imposed by payment limits have – if anything – been relaxed. Additionally, Brazil notes that its approach to Article 13(b)(ii), by comparing total budgetary outlays, takes the budgetary effects of payment limitations into account. For farmers that have reached their payment limit, the US Government incurs no further expenditures, and consequently, the amount of expenditures is lower than it would be absent the payment limit. In that sense, actual expenditures reflect the effects of payment limits.

128. Finally, Brazil notes that Professor Sumner's calculations also do not account for the increase in production or acreage devoted to upland cotton between MY 1992 and MY 2002. Taking this into account by indexing the "expected rate of support" to the level of MY 1992 production – as one

[115] Exhibit Bra-33 (7 CFR 1400.1 et seq.).
[116] Exhibit Bra-33 (7 CFR 1400.1 et seq.).
[117] Exhibit Bra-12 ("Cotton: Background for 1995 Farm Legislation," USDA, April 1995, p. 14).
[118] Additional market loss assistance payments were made that did not count towards the PFC payment limit.
[119] Professor Sumner has stated in his statement at the first meeting of the Panel that a typical cotton farm with 3000 acres received about $300,000 in PFC payments per year (*see* Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel, p. 22). This amount results both from the fact that several persons on a farm may be eligible for payment and from the fact that the three-entity rule doubled the payment limit amount a single person could legally receive (for an explanation on the three-entity rule *see* paragraphs 74-76 of the First Submission of Brazil).
[120] Exhibit Bra-27 (Side by Side Comparison of the 1996 and 2002 Farm Act, USDA, p. 12).
[121] Exhibit Bra-27 (Side by Side Comparison of the 1996 and 2002 Farm Act, USDA, p. 12).
[122] Exhibit Bra-27 (Side by Side Comparison of the 1996 and 2002 Farm Act, USDA, p. 12).
[123] Exhibit Bra-42 (The 2002 Farm Act, Provisions and Implications for Commodity Markets," USDA, November 2002, p. 7).
[124] Exhibit Bra-42 (The 2002 Farm Act, Provisions and Implications for Commodity Markets," USDA, November 2002, p. 8); Exhibit Bra-29 (Section 1603 of the 2002 FSRI Act).
[125] The certificate programme is described in detail in paragraphs 75-76 of the First Submission of Brazil.

possible approach to account for the increase in production – would increase the "expected rate of support" for later marketing years, as the amount of US production of upland cotton increased.[126] The result of the comparison of MY 1992 and MY 1999-2002 support will, however, be the same: The United States' support to upland cotton in MY 1999-2002 exceeded the support to upland cotton decided in MY 1992 and the US domestic support measures fail to meet the condition in Article 13(b)(ii) for exemption from actions under Articles 5 and 6 of the SCM Agreement and GATT Article XVI:1.

**(d) Per unit rate of support for upland cotton (Prof. Sumner's approach at the first session of the first substantive meeting ). USA**

**(67) The Panel requests the parties to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002. For this purpose the parties are each requested to submit AMS calculations for upland cotton (using the budgetary-outlay/non-price gap methodology employed by the United States in respect of cotton in its DS Notifications (e.g., G/AG/N/USA/43) and using the formats and supporting tables in document G/AG/2) on the same basis as would be the case in calculating a product specific AMS for the purposes of the calculation of the "Total Current AMS" in any year in accordance with the relevant provisions, including as appropriate Article 1(a), (b) and (h), Article 6 and Annex 3 to the Agreement. BRA, USA**

Brazil's Answer:

129. Brazil sets forth the following table that summarizes the AMS calculation for upland cotton for marketing years 1992 and 1999-2002. Using the definition of non-product specific support detailed in Brazil's answer to the Panel's Question 40, all of the programmes listed constitute non-exempt direct payments, within the meaning of G/AG/2, providing product-specific support to upland cotton. The table includes all support programs that should have been included in "Supporting Table DS:6", within the meaning of G/AG/2. To the best of Brazil's knowledge, no other "product-specific" support to upland cotton has been provided by the US Government.

130. Brazil notes that the United States has notified the deficiency payments using the price gap methodology provided for in Annex 3.[127] Brazil considers it appropriate to follow the US decision and will, therefore, calculate the amount of support to upland cotton provided by the deficiency payment programme by using the "price gap" approach detailed in Annex 3, paragraph 10 and 11. Brazil notes that US budgetary expenditures for MY 1992 for the deficiency programme were $1,017.4 million.[128]

[126] Exhibit Bra-4 ("Fact Sheet, Upland Cotton," USDA, January 2003, p. 4)
[127] Exhibit Bra-150 (G/AG/N/USA/10)
[128] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6).

**AMS For Upland Cotton By Year And Support Programme**

| Year<br>Programme | 1992<br>----- $ million ----- | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| Deficiency Payments[1] | 812.1 | none | none | none | none |
| PFC Payments[2] | none | 547.8 | 541.3 | 453 | none |
| Market Loss Assistance Payments[3] | none | 545.1 | 576.2 | 625.7 | none |
| Direct Payments[4] | none | none | none | none | 485.1 |
| Counter-cyclical Payments[5] | none | none | none | none | 998.6 |
| Marketing loan (Loan gains and LDP)[6] | 743.8 | 1,545 | 542 | 2,506 | 952 |
| Step 2 Payment[7] | 206.7 | 421.6 | 236.1 | 196.3 | 317 |
| Crop Insurance[8] | 26.6 | 169.6 | 161.7 | 262.9 | 194.1 |
| Cottonseed Payment[9] | none | 79 | 184.7 | none | 50 |
| **Total** | **1,789.2** | **3,308.1** | **2,242.0** | **4,043.9** | **2,996.8** |

Notes

[1] This calculation is based on the price gap formula set forth in para. 10 and 11 of AoA Annex 3. In its notification of marketing year 1995 support (Exhibit Bra-150 (G/AG/N/USA/10, p. 18), the United States that the applied administered price for upland cotton under the deficiency payment programme is $1,607.169 per ton. The applied administered price (or target price) has been the same in MY 1992 and MY 1995 (Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 5). Therefore, Brazil uses that figure. The external reference price has been notified by the United States to be $1,275.741 per ton. Paragraph 11 of AoA Annex 3 specifies that the external reference price is based on 1986-1988 averages that have not changed between MY 1992 and MY 1995. Thus, Brazil bases the price-related direct payments from the deficiency payment programme in MY 1992 on the difference between $1,607.169 per ton and $1,275.741 per ton ($331.428 per ton) multiplied by the eligible production, which results from multiplying the eligible upland cotton base acreage and the payment yield. Professor Sumner has calculated the eligible upland cotton base acreage for MY 1992 to be 10.17 million acres, while the payment yield is 531 pounds per acres (Exhibit Bra-105 (Annex 2 to Statement of Professor Daniel Sumner at the First Meeting of the Panel, p. 5-6). Thus, the eligible production is 5,400,270,000 pounds or 2,450,213 metric tons (2204 pounds equal one metric ton). Thus, the amount of deficiency payments in that enters the calculation of total AMS for MY 1992 is 2,450,213 metric tons * $331.428 per ton = $812.069 million.

[2] PFC payment expenditure for upland cotton = total PFC payment expenditure for upland cotton base * (actual upland cotton acreage / PFC upland cotton base acreage). Total PFC payment expenditure for upland cotton is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). This amount has been adjusted by the ratio of upland cotton acres actually planted (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4)) to upland cotton base acres in the PFC programme (Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). This adjustment is necessary because only the portion of upland cotton PFC payments that actually benefits acres planted to upland cotton can be considered support to upland cotton.

[3] Market loss assistance expenditure for upland cotton = total market loss assistance expenditure for upland cotton base * (actual upland cotton acreage / market loss assistance (i.e., PFC) upland cotton base acreage). Total market loss assistance expenditures for upland cotton is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). This amount has been adjusted by the ratio of upland cotton acres actually planted (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4)) to upland cotton base acres in the market loss assistance (i.e., PFC) programme (Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton.

[4] Direct payments = total direct payment expenditure for upland cotton base * (actual upland cotton acreage / direct payment upland cotton base acreage). Total direct payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 59. The new figure is based on the statutory payment rate of 6.67 cents per pound of upland

cotton base multiplied by the direct payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)) multiplied by the direct payment yield of 604 pounds per acre (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). Payments are made on 85 percent of base acres. This translates into a total of $558.17 million. This amount has been adjusted by the ratio of upland cotton acres actually planted Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) to upland cotton base acres in the direct payment program. This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton.

[5] Counter-cyclical payments = total counter-cyclical payment expenditure for upland cotton base * (actual upland cotton acreage / counter-cyclical payment upland cotton base acreage). Total counter-cyclical payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 69. The new figure is based on the MY 2002 payment rate of 13.73 cents per pound of upland cotton base multiplied by the counter-cyclical payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)) multiplied by the counter-cyclical payment yield of 604 pounds per acre (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50) Brazil notes that this underestimates the payments, as it disregards the yield update for purposes of the counter-cyclical payments). Payments are made on 85 percent of base acres. This translates into a total of $1148.98 million. This amount has been adjusted by the ratio of upland cotton acres actually planted Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) to upland cotton base acres in the counter-cyclical payment program. This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton.

[6] Total marketing loan payments (marketing loan gains plus loan deficiency payments) are taken para. 144, 148-149 of the First Submission of Brazil.

[7] Total Step 2 payments are contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). Brazil has estimated the MY 2002 amount at note 335 in its First Submission to be $317 million.

[8] Total crop insurance payments are taken from Exhibit Bra-57 ("Crop Year Statistics," Federal Crop Insurance Corporation).

[9] Total cottonseed payments are listed in Brazil's answer to question 17 (see para. 9).

131. The figures presented above indicate that, using the AMS approach, the US level of support for MY 1992 is lower than in each of the marketing years between 1999 and 2002.

132. Brazil also notes that – as explained in the notes on the sources and methodology for arriving at the reported figures – the AMS figures for MY 1999-2002 reflect revised amounts of budgetary expenditures that should replace those listed in Brazil's First Submission at paragraphs 148-149.[129] These revised (and somewhat smaller) expenditures reflect new information collected by Brazil and more accurately tabulate support to upland cotton in MY 1999-2002. Brazil notes that none of these revisions results in any significant change to the total support to upland cotton, and that expenditures decided in MY 1992 are still well below expenditures related to MY 1999-2002.

**68. Could you please clarify the result of the calculations of, and the meaning of the title, in Appendix Table 1 "Estimated per unit Subsidy Rates by Programme and Year" in Annex 2 to Exhibit BRA-105, page 12. Why are the numbers calculated for marketing loans considered to be subsidies? Could the Panel, for example, read the "total level of support" (bottom line of the table) as the effective support price for upland cotton or the maximum rate of support for upland cotton? BRA, USA**

Brazil's Answer:

133. The Appendix Table 1 in Annex 2 to Exhibit Bra-105 should have been titled, "Estimated per unit Support Rates by Programme and Year". Brazil apologizes for any confusion caused by mis-titling this table.

134. The marketing loan programme support listed in Table 1 of Annex 2 to Exhibit Bra-105 is a "support rate" and not an actual loan deficiency payment or marketing loan gain. It does not represent a subsidy amount. The loan deficiency payment or marketing loan gain is calculated as the difference between the loan rate and the adjusted world price (AWP). When the AWP falls, the loan benefit per

[129] No such revision is necessary for MY 1992.

unit of eligible production rises to offset the fall in the AWP. In the US "rate of support" methodology, because the AWP is expected to be positively related to the price received by individual farmers in the United States, the loan rate of 52.35 cents per pound in MY 1992 can be considered an approximate rate of support per unit of eligible production.

135. The deficiency payment rate of support is similar to the marketing loan rate of support and represents the maximum rate of support per eligible unit, where eligibility is measured by the rules applicable in 1992. By contrast, actual support payments under Brazil's expenditure methodology are calculated as the difference between the higher of the average price received by farmers and the loan rate.

136. The other programmes listed in Table 1 provide support per unit of eligible production to upland cotton in addition to the loan rate and deficiency payment target price. These other programmes are calculated as the estimated expected support rates. These rates are not maximum rates of support but rather normal or expected rates of support. The other domestic support measures are not equivalent in overall effect to a price support, but they are calculated on a per unit basis and are added across programmes to give a total support rate.

137. The production and trade distorting effects of these subsidies are each different and are also different from a support price.[130] Brazil will discuss the adverse effects caused by each of those subsidies in its Further Submission, scheduled for 9 September 2003. The variety of the support programmes employed by the United States precludes interpreting the sum of the various support contributions as a "support price." However, their sum can be read as an expected guaranteed income that results from market revenue and US Government payments. Marketing loan benefits, deficiency payments and counter-cyclical payments will increase with falling market prices. Other support programs are relatively decoupled from market prices, and provide an expected rate of support, that can be added to the loan rate and target price established by the marketing loan, the deficiency and counter-cyclical payments.

**69. Can the United States confirm that the "marketing year" for upland cotton is 1 August to 31 July ? Can the United States confirm the Panel's understanding that USDA data for the "crop year" corresponds to the "marketing year"? USA**

E. EXPORT CREDIT GUARANTEE PROGRAMMES

**70. How does Brazil respond to the United States' assertion that Brazil is trying to realize through litigation what it could not achieve in past negotiations? BRA**

Brazil's Answer:

138. In WTO dispute settlement, there is only one way to determine what was achieved in past negotiations – to interpret those provisions actually concluded according to the customary rules of interpretation included in the Vienna Convention. In paragraphs 100-115 of Brazil's Statement at the First Panel Meeting, Brazil demonstrated that it is not in fact attempting "to realize through litigation what it could not achieve in past negotiations." In those paragraphs, Brazil demonstrated that under the ordinary meaning of Article 10.2 of the Agreement on Agriculture, in its context and according to the object and purpose of Article 10 and the Agreement on Agriculture overall, export credit guarantees are subject to the general export subsidy disciplines in the Agreement on Agriculture. Brazil will not repeat those arguments here, but simply notes that by ignoring an interpretation of Article 10.2 according to the Vienna Convention rules, it is the United States that is trying to escape what was in fact achieved in the Uruguay Round negotiations. Other participants in those

[130] *See* Exhibit Bra-105 (Statement by Professor Daniel Sumner at the First Meeting of the Panel, paras 20-39) for a summary of the economic impacts of these various support programs.

negotiations who are third parties in this dispute and who in fact use export credits – Canada, the European Communities and New Zealand – agree with Brazil.

**71. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? Does it confer a benefit within the meaning of Article 1.1(b)? Why or why not? If so, to whom? USA**

Brazil's Comment:

139. In paragraphs 287-289 of its First Submission, and again at paragraph 116 of its Statement at the First Panel Meeting, Brazil demonstrated that CCC export credit guarantees are expressly included as "financial contributions" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. Although export credit guarantees do not automatically confer benefits, CCC export credit guarantees confer "benefits" within the meaning of Article 1.1(b) because they are extended at premium rates and on repayment terms that are not available and in fact do not exist on the market. In its comments and answers to Questions 75 and 82 below, Brazil discusses passages from the GSM 102, GSM 103 and SCGP regulations and materials from USDA's Foreign Agricultural Service (FAS) concerning the programmes, which demonstrate that GSM 102, GSM 103 and SCGP confer "benefits".

140. Brazil notes that a number of agents benefit from the subsidy provided by the guarantees. The US financial institutions and the foreign bank enter into lucrative contracts they would not otherwise have, the importer also gets financing that would not otherwise have be available in the market, but the US Government ultimately designed the programs to provide a benefit to US farmers and exporters. On the FAS website "What Every Exporter Should Know About The GSM-102 and GSM-103 Programmes" it stated that the "USDA will consider announcing, for a specific country or region, the availability of guarantees for any US commercial commodity, if the market for US exports will be expanded or maintained as a result" (emphasis added).[131] Brazil also notes that it is the US exporter who applies for the guarantee and who triggers the process of obtaining coverage for each particular transaction.

**(b) How, if at all, would these elements be relevant to the claims of Brazil, and the United States response thereto? BRA, USA**

Brazil's Answer:

141. Brazil notes that because CCC export credit guarantees constitute subsidies *per se*, and because they are, further, de jure contingent on export, the GSM 102, GSM 103 and SCGP programmes constitute export subsidies within the meaning of Article 3.1(a) of the SCM Agreement. According to the reasoning of the Appellate Body in US – FSC,[132] this means that those programs are also export subsidies within the meaning of the Agreement on Agriculture. In paragraphs 295-304 of its First Submission, Brazil then demonstrated that those programs threaten to lead to circumvention of the United States' export subsidy commitments (both with respect to scheduled and unscheduled commodities), in violation of Article 10.1 of the Agreement on Agriculture and, as a consequence, of Article 8 of that Agreement. Having established a violation of Part V of the Agriculture Agreement, Brazil's claims under Article 3.1(a) of the SCM Agreement against the CCC export credit guarantee programmes are not exempt from action by Article 13(c)(ii) of the Agreement on Agriculture.

[131] Exhibit Bra-151 ("US Export Credit Guarantee Programs: What Every Exporter Should Know About The GSM-102 and GSM-103 Programmes", USDA, November 1996).

[132] Appellate Body Report, *US – FSC*, WT/DS108/AB/R. para. 139-141.

142. Articles 1.1(a)(1)(i) and 1.1(b) of the SCM Agreement are relevant for a number of reasons, including for the purposes of Article 10.3 of the Agreement on Agriculture. As demonstrated in paragraphs 263-268 of Brazil's First Submission, the United States has surpassed its export quantity commitment levels for commodities eligible for GSM 102, GSM 103 and SCGP support. Under Article 10.3, the burden now lies with the United States to prove that its exports in excess of these commitments did not benefit from export subsidies, including export credit guarantees. United States will, inter alia, have to prove that those programs do not grant "benefits" within the meaning of Article 1.1(b) of the SCM Agreement.[133]

**72. Could Brazil expand on why, as indicated in paragraph 118 of its oral statement, it does "not agree" with the United States arguments relating to the viability of an a contrario interpretation of item (j) of the Illustrative List of Export Subsidies in Annex 1 of the SCM Agreement? BRA**

Brazil's Answer**:**

143. As the Panel is aware, Brazil was earlier involved in a dispute (Brazil – Aircraft) that addressed the question whether certain items in the Illustrative List of Export Subsidies admit of an a contrario defense. Although, as the United States notes, Brazil argued in that dispute that a contrario interpretations of certain items included in the Illustrative List (in particular the first paragraph of item (k)) are enabled by footnote 5 to the SCM Agreement, the panel disagreed.

144. Footnote 5 provides that "Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." The first Article 21.5 panel in Brazil – Aircraft concluded as follows with respect to footnote 5:[134]

> 6.36 In its ordinary meaning, footnote 5 relates to situations where a measure is referred to as not constituting an export subsidy. Thus, one example of a measure that clearly falls within the scope of footnote 5 involves export credit practices that are in conformity with the interest rate provisions of the Arrangement on Guidelines for Officially Supported Export Credits ("Arrangement"). The second paragraph of item (k) provides that such measures "shall not be considered an export subsidy prohibited by this Agreement". Arguably, footnote 5 in its ordinary meaning could extend more broadly to cover cases where the Illustrative List contains some other form of affirmative statement that a measure is not subject to the Article 3.1(a) prohibition, that it is not prohibited, or that it is allowed, such as, for example, the first and last sentences of footnote 59[34] and the proviso clauses of items (h)[35] and (i)[36] of the Illustrative List.[37]
>
> 6.37 The first paragraph of item (k), however, does not contain any affirmative statement that a measure is not an export subsidy nor that measures not satisfying the conditions of that item are not prohibited. To the contrary, the first paragraph of item (k) on its face simply identifies measures that are prohibited export subsidies. Thus, the first paragraph of item (k) on its face does not in our view fall within the scope of footnote 5 read in conformity with its ordinary meaning.

[34] The first sentence of footnote 59 provides that "Members recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected." The last sentence states that "[p]aragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member."

[133] The United States will also have to prove that the programmes are not inconsistent with item (j) of the Illustrative List of export subsidies.

[134] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, paras. 6.36-6.37.

[35] ". . . provided, however, that prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products sold for domestic consumption, if the prior stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product . . . ." (emphasis added).

[36] ". . . provided, however, that in particular cases a firm may use a quantity of home market inputs equal to, and having the same quality and characteristics as, the imported inputs as a substitute for them . . . ."

[37] In any event, such measures may well fall within the scope of footnote 1, and thus not represent subsidies at all, whether prohibited or otherwise.

145. Reflecting on footnote 5, the panel recalled and rejected the US argument that "'[t]he Illustrative List does not deal with all possible financial contributions, but for those it does deal with, it establishes, by virtue of footnote 5, a dispositive legal standard insofar as prohibited subsidies are concerned'".[135] While the panel agreed that "an illustrative list could in principle operate in such a manner", it concluded that because of footnote 5, the Illustrative List of Export Subsidies annexed to the SCM Agreement did not operate in that manner.[136] According to the panel, "if the drafters had intended the meaning which the United States attributes to footnote 5, they could certainly have found appropriate language to do so".[137]

146. The panel noted that the first paragraph of item (k) has effect even if it does not admit of an a contrario interpretation. The panel likened the Illustrative List to "a list of per se violations".[138] According to the panel, even if a measure does not fulfill the elements of one of the items in the Illustrative List and therefore does not constitute a per se violation, it could still be deemed prohibited if the complaining party demonstrates that it fulfills the elements of Articles 1 and 3 of the SCM Agreement.[139]

147. In dicta, the Appellate Body suggested that the first paragraph of item (k) may indeed admit of an a contrario interpretation.[140] In Brazil's view, however, this suggestion is limited to the first paragraph of item (k), and at least does not extend to item (j). Although the Appellate Body emphasized in the initial appeal in Brazil – Aircraft that the term "material advantage" in item (k) had to be given meaning independent of the term "benefit" in Article 1.1(b)[141], it found that the difference between the two terms is the qualification in item (k) that the advantage conferred relative to the market must additionally be "material".[142] In other words, proving "material advantage" includes a showing that a "benefit" is conferred, but also requires something more. While disproving the existence of a "material advantage" may mean that, in some narrow circumstances, a benefit may nevertheless still exist, the first paragraph of item (k) at least still relies on an analysis whether a "material advantage" is conferred to the recipient, as compared to some market benchmark. This "to the recipient" standard does not undercut and in fact complements the market benchmark "to the recipient" standard included in Article 1.1(b). An a contrario reading of item (k), therefore, does not read out the market benchmark "to the recipient" standard from the test applicable to export credits, but simply gives it a particular meaning in the context of export credits.

[135] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, paras. 6.32, 6.38.
[136] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, para. 6.38.
[137] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, para. 6.38.
[138] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, para. 6.42.
[139] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, para. 6.42.
[140] Appellate Body Report, *Brazil – Aircraft (21.5)*, WT/DS46/AB/RW (adopted 4 August 2000), para. 80 ("If Brazil had demonstrated that the payments made under the revised PROEX were not 'used to secure a material advantage in the field of export credit terms', and that such payments were 'payments' by Brazil of 'all or part of the costs incurred by exporters or financial institutions in obtaining credits', then we would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List.").
[141] Appellate Body Report, *Brazil – Aircraft*, WT/DS46/AB/R, para. 179.
[142] Appellate Body Report, *Brazil – Aircraft*, WT/DS46/AB/R, para. 177.

148. In contrast, the evidence required to meet the elements of item (j) are completely unrelated to the evidence necessary to establish that a guarantee programme confers a benefit "to the recipient" of a loan guarantee. Whether the premia collected under an export credit guarantee programme meet the long-term operating costs and losses of the programme is completely irrelevant to the question whether a benefit "to the recipient" of the export credit guarantee is conferred. Consequently, allowing an a contrario reading of item (j) that provides, as the United States argues, "a dispositive legal standard"[143] for determining whether guarantees are prohibited, would suggest that the "to the recipient" market benchmark standard does not apply to guarantees. This cannot be true, since guarantees are expressly included in Article 1.1 (and Article 14(c)) as "financial contributions" that can confer "benefits" to a recipient relative to a market benchmark.

149. The conclusion that item (j) does not admit of an a contrario defense is relevant for a number of reasons, including for the purposes of Article 10.3 of the Agreement on Agriculture. As demonstrated in paragraphs 263-268 of Brazil's First Submission, the United States has surpassed its export quantity commitment levels for commodities eligible for GSM 102, GSM 103 and SCGP support. Under Article 10.3, the burden now lies with the United States to prove that its exports in excess of these commitments did not benefit from export subsidies, including export credit guarantees. Even if the United States is able to demonstrate that premia for the GSM 102, GSM 103 and SCGP programs meet long-term operating costs and losses, it will also have to prove that those programs do not grant "benefits" within the meaning of Article 1.1(b) of the SCM Agreement. Since item (j) does not admit of an a contrario interpretation, disproving the elements of item (j) will not be sufficient to remove the programs from the definition of "export subsidy."

**73. The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The United States has yet to submit any evidence or argumentation on this point, either as potential context for interpretation of the terms in Article 10 of the Agreement on Agriculture or in relation to Brazil's claims under the SCM Agreement. The Panel would therefore appreciate United States views in respect of this situation, and invites the United States to submit relevant argumentation and evidence. USA**

**74. If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 of the Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both? BRA, USA**

Brazil's Answer:

150. In determining what constitutes an export subsidy within the meaning of Article 10.1 of the Agreement on Agriculture, Brazil considers that the Panel should refer to contextual guidance included in Articles 1 and 3 of the SCM Agreement, and in item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement. As discussed in paragraphs 258-261 of Brazil's First Submission, this is consistent with the Appellate Body's decisions in US – FSC[144] and Canada – Dairy.[145] As a factual matter, Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes constitute export subsidies under Articles 1.1 and 3.1(a) of the SCM Agreement, and under item (j) of the Illustrative List (as well as under Articles 1(e) and 10.1 of the Agreement on Agriculture.

**75. The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see e.g. written third party submission of Canada) and to the panel report in DS 222 Canada- Export Credits and Loan Guarantees. How and to what extent are Article 14(c) of the SCM**

[143] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, para. 6.32
[144] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 136-140.
[145] Appellate Body Report, *Canada – Dairy*, WT/DS103/AB/R and WT/DS113/AB/R, para. 87-90.

**Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would be the appropriate market benchmark to use for any comparison? Please cite any other relevant material. BRA, USA**

Brazil's Answer:

151. As one way of demonstrating that the GSM 102, GSM 103 and SCGP programs constitute export subsidies within the meaning of Article 10.1 of the Agreement on Agriculture, Brazil has demonstrated that those programmes constitute financial contributions that confer benefits and that are contingent on export, within the meaning of Articles 1.1 and 3.1(a) of the SCM Agreement. Brazil recalls that as discussed above in response to Question 72, Article 10.3 of the Agreement on Agriculture in fact places the burden on the United States to prove that export quantities in excess of its export commitments have not benefited from export subsidies.

152. In any event, Brazil has demonstrated that the CCC guarantee programs confer "benefits" within the meaning of Article 1.1(b) because they are extended at premium rates and on repayment terms that are not available on the market. In fact, the CCC programmes are unique financing vehicles for agricultural commodity transactions that are not available on the commercial market.

153. Brazil notes that the United States has argued in Canada – Aircraft II that where there is no comparable financial product on the market, a programme confers benefits per se. It stated:

> If the commercial market does not offer a particular borrower the exact terms offered by a government, then the government is providing a benefit to the recipient whenever those terms are more favorable than the terms that are available in the market. A government entity "operating on commercial principles" is still a government entity. It is not the commercial market.[146]

154. Brazil agrees with the United States. This interpretation is, in fact, consistent with the benchmark established by Article 14(c) of the SCM Agreement. In relevant part, Article 14 provides as follows:

> For the purposes of Part V, any method used by the investigating authority to calculate the benefit to the recipient … shall be transparent and adequately explained. Furthermore, any such method shall be consistent with the following guidelines:
>
> …
>
> > (c) a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees.

155. Brazil first draws the Panel's attention to the fact that Article 14 was specifically conceived for the purposes of Part V of the SCM Agreement only. It should be referred to exclusively as context to determine whether a benefit exists when a particular transaction is backed by a government export credit guarantee. Secondly, Brazil observes that subparagraph (c) of Article 14 is simply a

[146] Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2 (para. 7).

"guideline", not the sole method of calculating the benefit to the recipient. Other methods may be applied as long as they are "consistent" with the guideline set out in subparagraph (c).

156. There is no market benchmark in the case of the GSM 102, GSM 103 and SCGP programmes, since there are no financial products available on the market on the terms provided by the programmes. As discussed in response to Question 82, the regulations regarding the GSM 102 and GSM 103 programmes, as well as regarding the SCGP programme note that "[t]he programs operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee".[147] Moreover, the regulations state that "[t]he programs are targeted towards those countries where the guarantee is necessary to secure financing of the export but which have sufficient financial strength so that foreign exchange will be available for scheduled payments."[148] These passages prove that without a CCC guarantee, a borrower would not be able to secure financing at all – not just financing on less attractive terms than could be secured with the CCC guarantee (or on terms that would constitute a benefit under Article 14(c) of the SCM Agreement) – but no financing at all. The regulations also emphasize that the CCC guarantee is necessary – a commercial guarantee would not be sufficient.

157. Moreover, as the FAS website explains, "[t]he reduction of risk to financial institutions in the United States … may make possible financing that would otherwise be unavailable".[149] The FAS further clarifies that "a CCC guarantee can encourage extension of credit in cases where financial institutions might otherwise be unwilling to finance export on credit terms".[150] In addition, the FAS points out that such guarantees would "facilitate credit to foreign banks in larger amounts and on more favorable commercial terms than would otherwise be available".[151] Whatever the meaning of Article 14(c), the provision by CCC of guarantees that do not exist on the market entails the provision of a benefit per se. The benefit to the recipient, under the benchmark established by Article 14(c), would be the total amount of the loan backed by the guarantee, since there would be no "comparable commercial loan absent the government guarantee".

**76. How does the United States respond to Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders"? USA**

**77. How does the United States interpretation of "long term operating costs and losses" in item (j) as claims paid give meaning to both "costs" and "losses"? Do claims paid represent "losses" or "costs" or both? If claims paid is represented by "losses", what would go into the "cost" element of item (j)? Could the United States expand on why it disagrees with the items which Brazil identifies for inclusion in the examination to be conducted under item (j)? USA**

Brazil's Comment:

158. Brazil may wish to comment in its rebuttal submission on the response the United States ultimately provides to this question. In the meantime, however, Brazil would like to comment on US criticisms of the initial formula Brazil constructed to determine whether the GSM 102, GSM 103 and SCGP programmes fail to meet their long-term operating costs and losses, within the meaning of

[147] Exhibit Bra-38 (7 CFR 1493.10(a)(2)) and Exhibit Bra-38 (7 CFR 1493.400(a)(2)).
[148] Exhibit Bra-38 (7 CFR 1493.10(a)(2)) and Exhibit Bra-38 (7 CFR 1493.400(a)(2)).
[149] Exhibit Bra-151 ("US Export Credit Guarantee Programs: What Every Exporter Should Know About The GSM-102 and GSM-103 Programs," USDA, November 1996).
[150] Exhibit Bra-151 ("US Export Credit Guarantee Programs: What Every Exporter Should Know About The GSM-102 and GSM-103 Programs," USDA, November 1996).
[151] Exhibit Bra-151 ("US Export Credit Guarantee Programs: What Every Exporter Should Know About The GSM-102 and GSM-103 Programs," USDA, November 1996).

item (j). The Panel will recall that Brazil's initial formula, which was included in paragraph 281 and Figure 20 of its First Submission, can be stated as follows:

Premiums collected – (Administrative expenses + Default claims + Interest expenses)

159. Where this formula yields a negative number over a period constituting the "long term", Brazil argued that loan guarantees are provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programme", within the meaning of item (j).[152] Applying this formula to data for the period 1994-2003, Brazil demonstrated that premiums collected for the CCC guarantee programmes were indeed inadequate to cover operating costs and losses for the programmes.

160. To correct for alleged errors in Brazil's initial constructed formula, which was included in paragraph 281 and Figure 20 of its First Submission, the United States adopted its own alternative formula, in paragraph 173 of its First Submission, which can be stated as follows:

(Fees + Claims recovered + Claims rescheduled) – Claims paid

161. Where this formula yields a positive number over a period constituting the "long term," the United States asserts that loan guarantees are provided at premium rates that are adequate to cover the long-term operating costs and losses of the program, within the meaning of item (j).

162. Brazil made several criticisms of the US formula. In paragraph 123 of its Statement at the First Panel Meeting, Brazil demonstrated that the failure to account for interest paid by the CCC to the Treasury Department leads to artificially low accounting of operating costs. In paragraph 122, Brazil additionally demonstrated that it is incorrect to treat rescheduled debt as a recovery of a default claim. Brazil notes that rescheduling can in fact have the effect of increasing the costs incurred by the government, rather than reducing those costs. In its budget documents, the US Government treats Paris Club rescheduling of imminent defaults as "work-outs."[153] According to the US Office of Management and Budget ("OMB"), work-outs can either have a negative or a positive effect on cash flow.[154] The U. General Accounting Office ("GAO") has in fact stated that historically, the majority of GSM support that is rescheduled is "in arrears."[155] If anything, this increases CCC's cost.

[152] Revenue for "premiums collected" is recorded in the "Financing Account" section of the CCC budget, in the row titled "Loan origination fee" (line 88.40). *See* the US budget documents included as Exhibits Bra-88 to Bra-95. "Administrative expenses" are recorded in the "Programme Account" section of the CCC budget, in the row titled "Administrative expenses" (line 00.09). *See* the US budget documents included as Exhibits Bra-88 to Bra-95. Expenses for "default claims" are recorded in the "Financing Account" section of the CCC budget, in the row titled "Default claims" (line 00.01). *See* the US budget documents included as Exhibits Bra-88 to Bra-95. "Interest expenses" are recorded in the "Financing Account" section of the CCC budget, in the row titled "Interest on debt to Treasury" (line 00.02). *See* the US budget documents included as Exhibits Bra-88 to Bra-95.

[153] Exhibit Bra-121 (US General Accounting Office ("GAO"), Report to Congressional Committees, *Credit Reform: US Needs Better Method for Estimating Cost of Foreign Loans and Guarantees*, GAO/NSIAD/GGD-95-31, December 1994, p. 63) ("GAO/NSIAD/GGD-95-31").

[154] Exhibit Bra-116 (Executive Office of the President, Office of Management and Budget, Circular No. A-11, Part 5, *Federal Credit Programs* (June 2002), p. 185-13) ("OMB Circular A-11")).

[155] Exhibit Bra-152 (GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National Security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, *Status Report on GAO's Reviews of the Targeted Export Assistance Program, the Export Enhancement Programme, and the GSM-102/103 Export Credit Guarantee Programmes*, GAO/T-NSIAD-90-53, 28 June 1990, p. 14).

163. The United States' formula did correct for one shortcoming of Brazil's initial constructed formula, however. The United States is correct that Brazil's formula did not include recoveries.[156] Brazil therefore introduces a revised constructed formula that accounts for recoveries and interest on those recoveries, as recorded in the "Principal collections" and "Interest collections" rows[157] of the US budget. It also accounts for the interest accruing to the CCC on balances maintained in its so-called "financing account" for the purposes of potential claims,[158] as recorded in the "Interest on uninvested funds" row of the US budget documents.[159] Brazil's revised constructed formula can be stated as follows (including references to the specific budget lines involved):

(Premiums collected + Recovered principal and interest (Line 88.40) + Interest revenue (Line 88.25)) – (Administrative expenses (Line 00.09) + Default claims (Line 00.01) + Interest expense (Line 00.02))

164. Brazil emphasizes that it does not intend for this revised constructed formula to replace the formula used by the US government itself to track the costs of the CCC guarantee programs, pursuant to the US Federal Credit Reform Act ("FCRA"). In paragraphs 124-133 of its Statement at the First Panel Meeting, Brazil discussed the FCRA cost formula in considerable detail. The chart included at paragraph 132 of Brazil's Statement demonstrates that under the FCRA cost formula, CCC's export credit guarantee programs are offered at premium rates that are inadequate to cover their long-term operating costs and losses. Brazil believes that the FCRA cost formula is one very useful way to determine the performance of the CCC guarantee programs relative to the elements of item (j). However, if the Panel would like to confirm the results of the FCRA cost formula, or refer to an alternative formula, Brazil offers its revised constructed formula for these purposes.

165. Where Brazil's revised constructed formula indicates a net cost over a period constituting the "long term", export credit guarantees are provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programme", within the meaning of item (j). The following chart demonstrates that during the ten-year period FY 1993-2002, premiums for GSM 102, GSM 103 and SCGP export credit guarantees have been inadequate to cover long-term operating costs and losses. Net costs for the programmes during this period total more than $1 billion as set forth below:

| Fiscal year | Premiums collected (88.40) + Recovered principal and interest (88.40) + Interest revenue (88.25) | Admin. expenses (00.09) + Default claims (00.01) + Interest expense (00.02) |
|---|---|---|
| 1993 | $27,608,000 + $12,793,000 + $15,672,000[160] = $56,073,000 | $3.320,000[161] + $570,000,000[162]+ $0[163] = $573,320,000 |
| 1994 | $20,893,000 + $458,954,000 + $0[164] = $479,847,000 | $3,381,000[165] + $422,363,000[166] + $0[167] = $425,744,000 |

[156] First Submission of the United States, para. 173.

[157] In combination with loan origination fees, these rows are collectively recorded as line 88.40 in the US budget documents.

[158] Exhibit Bra-116 (OMB Circular A-11, p. 185-51). *See* also Exhibit Bra-118 (Federal Accounting Standards Advisory Board, *Statement of Federal Financial Accounting Standards No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in* STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 2, March 2001, p. 16 (para. 37)).

[159] This row is recorded as line 88.25 in the US budget documents. The payment of interest to an agency for uninvested balances in financing accounts is addressed in Exhibit Bra-117 (2 U.S.C. § 661d(c)).

[160] Exhibit Bra-126 (US budget for FY 1995, p. 156).

[161] Exhibit Bra-126 (US budget for FY 1995, p. 156).

[162] Exhibit Bra-126 (US budget for FY 1995, p. 156).

[163] No budget line Exhibit Bra-126 (US budget for FY 1995, p. 156).

[164] Exhibit Bra-95 (US budget for FY 1996, p. 162).

[165] Exhibit Bra-95 (US budget for FY 1996, p. 161).

[166] Exhibit Bra-95 (US budget for FY 1996, p. 162).

| | | |
|---|---|---|
| 1995 | $18,000,000 + $62,000,000 + $0[168] = $80,000,000 | $3,000,000 + $551,000,000 + $10,000,000[169] = $564,000,000 |
| 1996 | $20,000,000 + $68,000,000 + $26,000,000[170] = $114,000,000 | $3,000,000[171] + $202,000,000[172] + $61,000,000[173] = $266,000,000 |
| 1997 | $14,000,000 + $104,000,000 + $26,000,000[174] = $144,000,000 | $4,000,000[175] + $11,000,000[176] + $62,000,000[177] = $77,000,000 |
| 1998 | $17,000,000 + $81,000,000 + $54,000,000[178] = $152,000,000 | $4,000,000[179] + $72,000,000[180] + $62,000,000[181] = $138,000,000 |
| 1999 | $14,000,000 + $58,000,000 + $0[182] = $72,000,000 | $4,000,000[183] + $244,000,000 + $62,000,000[184] = $310,000,000 |
| 2000 | $16,000,000 + $100,000,000 + $99,000,000[185] = $215,000,000 | $4,000,000[186] + $208,000,000[187] + $62,000,000[188] = $274,000,000 |
| 2001 | $18,000,000 + $149,000,000 + $125,000,000[189] = $292,000,000 | $4,000,000[190] + $52,000,000[191] + $104,000,000[192] = $160,000,000 |
| 2002 | $21,000,000 + $155,000,000 + $61,000,000[193] = $237,000,000 | $4,000,000[194] + $40,000,000[195] + $93,000,000[196] = $137,000,000 |
| Total | $1,841,920,000 | $2,925,064,000 |
| **Long-term Net Cost** | **$1,083,144,000** | |

166. To arrive at this result, Brazil notes that it did not rely on "estimates" of the programmes' costs.[197] The annual US budget documents upon which Brazil relied track CCC data for three consecutive years – the prior year, the current year and the budget year. The 2004 budget, for example, which is completed in 2003, includes data for 2002, 2003 and 2004. Budget year data is

[167] Exhibit Bra-95 (US budget for FY 1996, p. 162).
[168] Exhibit Bra-94 (US budget for FY 1997, p. 176).
[169] Exhibit Bra-94 (US budget for FY 1997, p. 175).
[170] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[171] Exhibit Bra-93 (US budget for FY 1998, p. 174).
[172] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[173] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[174] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[175] Exhibit Bra-92 (US budget for FY 1999, p. 105).
[176] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[177] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[178] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[179] Exhibit Bra-91 (US budget for FY 2000, p. 111).
[180] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[181] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[182] Exhibit Bra-90 (US budget for FY 2001, p. 112).
[183] Exhibit Bra-90 (US budget for FY 2001, p. 110).
[184] Exhibit Bra-90 (US budget for FY 2001, p. 111).
[185] Exhibit Bra-89 (US budget for FY 2002, p. 118).
[186] Exhibit Bra-89 (US budget for FY 2002, p. 116).
[187] Exhibit Bra-89 (US budget for FY 2002, p. 117).
[188] Exhibit Bra-89 (US budget for FY 2002, p. 117).
[189] Exhibit Bra-88 (US budget for FY 2003, p. 120).
[190] Exhibit Bra-88 (US budget for FY 2003, p. 118).
[191] Exhibit Bra-88 (US budget for FY 2003, p. 119).
[192] Exhibit Bra-88 (US budget for FY 2003, p. 120).
[193] Exhibit Bra-127 (US budget for FY 2004, p. 109).
[194] Exhibit Bra-127 (US budget for FY 2004, p. 107).
[195] Exhibit Bra-127 (US budget for FY 2004, p. 108).
[196] Exhibit Bra-127 (US budget for FY 2004, p. 108).
[197] First Submission of the United States, paras. 175-178.

indeed based on estimates. Current year data is revised to account for any change to the cost or revenue item at issue. Since the current year is not yet complete when the budget is issued, however, current year data remains, at least in part, based on estimates. Prior year data, however, is based on actual costs and revenues. In applying its formula, Brazil used the data in the prior year column, and therefore used actual costs and revenues, rather than estimates.[198]

167. Several other factors corroborate the fact that the CCC export guarantee programmes do not charge premia that allow them to meet their long-term operating costs and losses.

- First, in audit reports of the CCC's fiscal year 2000 and 2001 financial statements, the US Department of Agriculture's Office of the Inspector General noted that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programs have not been changed in 7 years and may not be reflecting current costs."[199] While Brazil does not have fee schedules for the entire period 1993-2002, it provides for the Panel's review fee schedules for GSM 102 and GSM 103 from November 1994, 4 September 2001 and 24 September 2002.[200] According to CCC's website, the latter is the fee schedule that is currently in force. The Panel will note that between November 1994 and 23 September 2002, CCC made only one change in its fee schedule for GSM 102: while the fee for a 12-month guarantee with semi-annual repayment intervals was $0.209 per $100 of coverage in November 1994, by 4 September 2001 it had changed to $0.229 per $100 of coverage. On 24 September 2002, one additional change was made: borrowers were offered the additional option of 30 and 60 day guarantees, at the same fee charged for 90-day and 4-, 6- and 7-month guarantees.

- Second, US Department of Agriculture Under Secretary August Schumacher testified to Congress in 1998 that the GSM 102 programme suffered nearly $2 billion in losses as a result of Iraqi defaults, and an additional nearly $2 billion resulting from Polish defaults.[201] GAO stated that liabilities on the Iraqi debt accrued over the period 1990-1997, as the guaranteed Iraqi borrowings came due.[202] As noted by Brazil in paragraph 284 of its First Submission, however, the maximum in GSM 102 premiums the United States could have generated from all export credit guarantees provided during the lifetime of the programmes up to 1998 – had it applied the highest possible

[198] Of the 1994-2003 period tracked in Figure 20 to Brazil's First Submission, the only figures that reflected estimates were those for the year 2003, since actual data is not yet available for that year. To correct this, and to ensure that the data is still sufficient to reveal whether the CCC export credit guarantee programmes incur "long term" operating costs and losses, the chart above tracks CCC guarantees for the period 1993-2002.

[199] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31). *See also* Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed for many years and may not be reflecting current costs.").

[200] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 and GSM-103 Programme Participants*, 24 September 2002); Exhibit Bra-98 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 & GSM-103 Programme Participants*, 4 September 2001); Exhibit Bra-156 (US Export-Import Bank, *Comparison of Major Features of Programmes Offered by Ex-Im Bank and Commodity Credit Corporation for Support of Bulk Agricultural Commodities*, available at http://www.exim.gov/pub/ins/pdf/eib99-13.pdf). Brazil was unable to locate from public sources other fee schedules from the period 1993-2002.

[201] Exhibit Bra-87 ("Testimony of August Schumacher Jr., Under Secretary, Farm and Foreign Agricultural Service, USDA, before the Subcommittee on General Farm Commodities, Hearing on the Asian Financial Crisis, 4 February 1998", p. 10-11).

[202] Exhibit Bra-157 (US General Accounting Office, REPORT TO THE CHAIRMAN, TASK FORCE ON URGENT FISCAL ISSUES, COMMITTEE ON THE BUDGET, HOUSE OF REPRESENTATIVES, *International Trade: Iraq's Participation in US Agricultural Export Programs*, GAO/NSIAD-91-76 (November 1990), p. 27 (Table IV.2)).

premium rate to all guarantees – is $358.54 million.[203] The total amount of received applications for GSM 102 export credit guarantees for the period 1999-2002 was $11.77 billion, resulting in a theoretical additional maximum premium of $78.08 million for that period.[204] Thus, the highest amount of premiums the United States could have generated under this programme from its inception through 2002 would amount to $436.62 million.[205] This does not come close to covering the programme's losses from the Iraqi and Polish defaults alone.

- Third, CCC financial statements for fiscal year 2002 report that uncollectible amounts on post-1991 CCC guarantees total $770 million.[206] As noted in the chart above at paragraph 165, CCC collected premiums of $222.641 million for GSM 102, GSM 103 and SCGP during the period 1992-2002.[207] Thus, even without accounting for other operating costs, or for receivables that CCC hopes to collect but may not, losses for the CCC export credit guarantee programmes outpace premiums during the period 1992-2002 by nearly $550 million.

- Fourth, CCC's 2002 financials also report uncollectible amounts on pre-1992 CCC guarantees of $2.567 billion.[208] While actual data concerning premiums during the period 1981-1991 (from the first year GSM 102 was available until the last year before credit reform was introduced with the Federal Credit Reform Act) is not publicly available, Brazil has applied a proxy based on the average annual fees collected during the period 1992-2002 ($20.24 million). Multiplying $20.24 million by the 11 years included in the 1981-1991 period results in total fees of $222.64 million. Thus, even without accounting for other operating costs, or for receivables that CCC hopes to collect but does not, losses for the CCC export credit guarantee programs outpace premiums during the period 1981-1991 by more than $2.3 billion.

- Finally, the US General Accounting Office ("GAO") estimated in 1992 that if GSM 102 and GSM 103 continued until 2007, costs for the programs would reach $7.6 billion.[209] Premium fees

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[203] *See* Exhibit Bra-73 ("Summary of Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003) for the total amounts of allocations. These have been multiplied by 0.663 percent to obtain the theoretical maximum premium.

[204] Exhibit Bra-73 ("Summary of Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003).

[205] This amount is a substantial overstatement, as premiums for periods of coverage shorter than 3 years will yield substantially lower premiums of as low as 15.3 cents per $100 as compared to 66.3 cents for a 3-year coverage. Exhibit Bra-98 ("Guarantee Fee Rate Schedule Under GSM 102 and GSM 103").

[206] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14). This figure theoretically includes not only uncollectible amounts for the GSM 102, GSM 103 and SCGP programs, but also uncollectible amounts for CCC's Facility Guarantee Programme ("FGP"). Brazil has not challenged the FGP in this dispute. Brazil notes, however, that in fiscal years 1999-2003 (for which programme activity data is available on CCC's website, at http://www.fas.usda.gov/excredits/Monthly/ecg.html), exporter applications were only received for a total of $4.8 million in coverage under the FGP. Thus, defaults on FGP guarantees, if any, would contribute only negligibly to the $770 million figure discussed above.

[207] The chart in paragraph 165 does not include premiums for 1992. Those premiums totalled $36.14 million. *See* Exhibit Bra-125 (US budget for FY 1994, p. 383). According to US budget documents, premiums for the FGP are included in the budget line item for fees on the GSM and SCGP programs.

[208] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14). The FGP did not exist during this period, and thus is not a factor.

[209] Exhibit Bra-159 (US General Accounting Office, REPORT TO CONGRESSIONAL REQUESTERS, *Loan Guarantees: Export Credit Guarantee Programmes' Costs are High*, GAO/GGD-93-45 (December 1992), p.4). *See also* Exhibit Bra-115 (US General Accounting Office, Report to the Chairman, Subcommittee on Criminal Justice, US House of Representatives Committee on the Judiciary, "Loan Guarantees: Export Credit Guarantee Programmes' Long Run Costs are High," GAO/NSIAD-91-180, 19 April 1991, p. 2-3) ("We estimate that the

for the period 1992-2007 (assuming current rates) would only reach $323.84,[210] demonstrating that fees for the programme do not meet costs.

In sum, CCC financials state that during the period 1981-2002, costs and losses for CCC export credit guarantee programmes exceeded premiums collected.

**78. Can the United States provide supporting documentation for data used relating to "costs and losses" in paragraph 173? Could the United States confirm that the figures cited in paragraph 173 of its first written submission relate to the SCGP? Why did the United States cite these figures after stating that it is not possible to make any assessment of the long-term operating costs and losses of this programme? USA**

**79. In respect of what time periods does Article 13(c) require an assessment of conformity with Part V of the Agreement on Agriculture? How does this affect, if at all, your interpretation of Article 13(b)? BRA, USA**

Brazil's Answer:

168. Part V of the Agreement on Agriculture requires that Members grant export subsidies in conformity with that agreement and with that Member's export subsidy reduction commitments. These commitments are made on a commodity specific basis.[211] The relevant section of the US Schedule of Concessions (Part IV, Section II) clarifies that the US export subsidy commitments are to be assessed on a US fiscal year basis.[212] A Member's export subsidy reduction commitments cover annual budgetary outlays and quantitative reduction commitments – in the US case on a fiscal year basis.[213] It follows that the US compliance with its export subsidy reduction commitments must be assessed on the basis of specific agricultural products and fiscal years.

169. Thus, similar to domestic support measures, the conformity of a Member's export subsidies with Part V of the Agreement on Agriculture must be assessed by comparing the amounts actually granted (both in term of budgetary outlays as well as in terms of quantities of specific agricultural products benefiting from export subsidies) with a benchmark, i.e., with a Member's export subsidy reduction commitments.

170. According to Article 3.3 of the Agreement on Agriculture, for agricultural products not included in Part IV, Section II of a Member's Schedule (i.e. unscheduled products) any export subsidy granted leads to a violation of Part V of the Agreement on Agriculture. Brazil's claims against Step 2 export subsidies and against ETI Act subsidies benefiting upland cotton fall in this category, as the United States does not have an export subsidy reduction commitment for upland cotton.[214] Furthermore, Brazil's claims concerning export credit guarantee programs fall in this category, in as far as export credit guarantees are available for unscheduled agricultural products.

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GSM programmes will cost the Corporation about $6.7 billion in the long run . . . This estimate assumes that the outstanding loans and guarantees remain at the same level for about 16 years and that their average risk remains unchanged as new guarantees replace old ones).

[210] This has been calculated based on actual fees for 1992-2002 and using average 1992-2002 fees as expected fees for the remainder of the time period (2003-2007).

[211] *See* Brazil's answer to Question 7.

[212] Exhibit Bra-83 (Schedule XX of the United States of America, Part IV, Section II entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments).

[213] Exhibit Bra-83 (Schedule XX of the United States of America, Part IV, Section II entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments).

[214] Exhibit Bra-83 (Schedule XX of the United States of America, Part IV, Section II entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments).

171. For scheduled agricultural products, the Panel needs to determine whether the export subsidies for a particular scheduled agricultural product are in excess of the export subsidy reduction commitment levels for that agricultural product in the year in question, or whether the application of the export subsidies threatens to lead to circumvention of the export subsidy reduction commitments. More specifically, in this dispute, the Panel needs to assess whether the CCC export credit guarantee programmes threaten to circumvent the export subsidy reduction commitments of the United States for scheduled agricultural products.

**80. In Brazil's view, why did the drafters of the Agreement on Agriculture not include export credit guarantees in Article 9.1? BRA**

Brazil's Answer:

172. The negotiating history of the Agreement on Agriculture does not reveal why the drafters did not include export credits guarantees in Article 9.1, just as it does not reveal why the drafters did not include well-known and widely-used export subsidies like the United States' FSC regime in Article 9.1. Yet, the Appellate Body concluded that the FSC regime constitutes an export subsidy and is subject to the general export subsidy disciplines in the Agreement on Agriculture, including Article 10.1 thereto. As Brazil has previously noted, Article 1(e) defines export subsidies as "including" those listed in Article 9.1 of the Agreement on Agriculture, and Article 10.1 refers to a universe of export subsidies "not listed in" Article 9.1. As the Appellate Body's report in US – FSC illustrates, if a measure meets the definition of "export subsidy", it is subject to Article 10.1, even though it is not included in Article 9.1.

173. Under the Vienna Convention rules, Articles 9.1 and 10.1, as well as Article 10.2 of the Agreement on Agriculture, are to be interpreted according to their ordinary meaning, in their context, and according to the object and purpose of the Agreement on Agriculture. Brazil has demonstrated that the CCC export credit guarantee programs fulfill the definition of "export subsidy" in the Agreement on Agriculture and the SCM Agreement, and that export credit guarantees are not, under a Vienna Convention interpretation of Article 10.2, excluded from the general export subsidy disciplines in Article 10.1.

**81. How does the United States respond to the following in Brazil's oral statement: USA**

**(a) paragraph 122 (rescheduled guarantees)**
**(b) paragraph 123 (interest on debt to Treasury)**
**(c) paragraphs 125 ff. (guaranteed loan subsidy)**
**(d) paragraphs 127-129 (re-estimates, etc.)**
**(e) Exhibits BRA-125-127**
**(f) the chart on page 53 of Brazil's oral statement at the first session of the first Panel meeting relating to "Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programs GSM-102 GSM 103 and SCGP"?**
**(g) In respect of (a)-(f) above, how and to what extent do the information and data presented for the export guarantee programmes concerning "program" and "financing", "summary of loan levels", "subsidy budget authority", "outlay levels", etc., in particular in Exhibits BRA-125-127, reflect "actual costs and losses" of the GSM-102, GSM-102 and SCGP export credit guarantee programmes(see e.g. Brazil's closing oral statement at the first session of the first substantive meeting, paragraph 24)? USA**

Brazil's Comment on Question 81(g):

174. Brazil may wish to comment in its rebuttal submission on the response the United States ultimately provides to this and the other sub-parts of question 81. In the meantime, however, Brazil would like to comment on the distinction between actual and estimated costs and losses.

175. As noted above in comments on Question 77, Brazil has used data from the prior year column of the US budget. This column is titled "actual," since it reflects reconciled data for a full fiscal year. Data reported in the prior year column of the "guaranteed loan subsidy" row of the US budget is "actual" in this sense. Brazil explained in paragraph 127 of its Statement at the First Panel Meeting that the FCRA calls for the CCC to make annual "reestimates" to the cost calculation and thus to the "guaranteed loan subsidy" line in the budget. Reestimates "take into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries,"[215] to the extent that those factors have changed since the initial estimate was made for purposes of the budget year column of the budget.

176. The results of the reestimate process are captured in the US budget and in CCC's financial statements.[216] Reestimates made in a given fiscal year are netted and recorded in the "reestimates of subsidy" (line 00.07) and "interest on reestimate" (line 00.08) lines of the US budget. In the 2002 column of the 2004 budget, for example, "reestimates of subsidy" were recorded in the amount of $118 million, and "interest on reestimate" was recorded as $8 million.[217] In the 2002 column of the 2004 budget, the United States in fact aggregates these two amounts with the "guaranteed loan subsidy" amount of $97 million and the "administrative expenses" of $4 million to arrive at a total subsidy of $227 million (which is in turn deducted from the budgetary resources available to the CCC in line 23.95 of the budget).[218] While Brazil could have followed this same convention to accentuate the amount by which the CCC guarantee programmes' costs and losses outstrip revenue by even more than that listed in the chart included in paragraph 132 of Brazil's Statement to the First Panel Meeting, it chose to be conservative and did not do so.

177. The results of the reestimate process are also captured in a cumulative, "running tally" of the FCRA subsidy figure included in CCC's annual financial statements. CCC's fiscal year 2002 financial statements track the "credit guarantee liability" for post-1991 guarantees disbursed under the CCC export guarantee programmes. "Credit guarantee liability" is defined in the CCC financials as representing "the estimated net cash outflows (loss) of the guarantees on a net present value basis."[219] The Panel will recall that the "guaranteed loan subsidy" line in the US budget similarly tracks the net present value of payments to and from the government for CCC export guarantees, although only with respect to guarantees disbursed in one particular year. The 2002 financial statement provides a cumulative subsidy figure for all post-1991 guarantees under the CCC programmes. The analysis included in the 2002 financial statement begins with the credit guarantee liability included in the 2001

[215] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, "Statement of Federal Financial Accounting Standards No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees" in STATEMENT OF FEDERAL FINANCING ACCOUNTING STANDARDS NO. 2, March 2001, p. 15 (para. 32)). *See also* Exhibit Bra-160 (US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2003), p. 80, 117, 199); Exhibit Bra-161 (US Federal Accounting Standards Advisory Board, FEDERAL FINANCIAL ACCOUNTING AND AUDITING TECHNICAL RELEASE 3, *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* (31 July 1999), p. 17-21).

[216] According to OMB, reestimates are to be recorded in the budget. Exhibit Bra-116 (OMB Circular A-11, p. 185-4).

[217] Exhibit Bra-127 (US budget for FY 2004, p. 107).

[218] Exhibit Bra-127 (US budget for FY 2004, p. 107).

[219] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 4).

financial statement, makes adjustments for defaults, fees and reestimates undertaken in fiscal year 2002 with respect to all post-1991 guarantees, and results in a new subsidy figure of $411 million for those post-1991 guarantees.[220] This positive net present value means that CCC has "los[t] money" during the period 1992-2002.[221]

178. While Brazil has demonstrated that the reestimation process applied to the FCRA formula does in fact track actual data and does in fact account for actual performance of CCC export credit guarantees, Brazil notes that a certain degree of estimated data would be perfectly acceptable in an analysis of the costs and losses of guarantee programs under item (j). The purpose of the FCRA and its cost formula was, after all, "to measure more accurately the costs of Federal credit programmes," including contingent liabilities like export credit guarantees.[222] As the United States evidently agrees, accounting for the costs of contingent liabilities like guarantees on a cash basis is not appropriate, since it masks the real costs of those guarantees. Even if the FCRA cost formula does entail the use of some estimated data, the US Congress and the President consider that that formula is the most accurate way of tracking costs.

179. Brazil notes, finally, that it is not entirely accurate to call the data used to arrive at initial estimates of the "guaranteed loan subsidy" figure "estimated" data. The US Federal Accounting Standards Advisory Board, the Government-Wide Audited Financial Statements Task Force on Credit Reform, the Office of Management and Budget and the Department of Agriculture itself have emphasized that "[m]ethods of estimating future cash flows for existing credit programs need to take account of past experience,"[223] that "[a]ctual historical experience of the performance of a risk category is a primary factor upon which an estimation of default cost is based",[224] and that the technical assumptions underlying subsidy calculations reflect "historical cash reports and loan performance".[225] This demonstrates that "estimates" of the subsidy cost of CCC guarantees are informed by actual historical experience with borrowers.

180. Brazil also notes that a number of factors involved in setting the FCRA subsidy cost are "explicit" and not "forecast". The Office of Management and Budget identifies contract terms such as maturity, borrower's interest rate, fees and grace periods as "explicit," and therefore not "estimated".[226] Moreover, as the Panel is well aware, none of the "reestimates" at issue is Brazil's. They are all estimates by official agencies of the United States.

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[220] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19). As noted above in Brazil's comments on Question 77, while this figure theoretically includes CCC's Facility Guarantee Programme ("FGP"), activity under that programme is virtually non-existent.

[221] Exhibit Bra-121 (US General Accounting Office ("GAO"), Report to Congressional Committees, "Credit Reform: US Needs Better Method for Estimating Cost of Foreign Loans and Guarantees," GAO/NSIAD/GGD-95-31, December 1994, p. 20).

[222] Exhibit Bra-117 (2 U.S.C. § 661(1)).

[223] Exhibit Bra-162 (Government-Wide Audited Financial Statements Task Force on Credit Reform, ISSUE PAPER, *Model Credit Programme methods and Documentation for Estimating Subsidy Rates and the Model Information Store*, 96-CR-7 (1 May 1996), p. 2).

[224] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36)). *See also* Exhibit Bra-160 (US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2003), p. 120 ("In estimating default costs, the following risk factors are considered: (1) loan performance experience; . . .")).

[225] Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002, p. 9).

[226] Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002, p. 9).

**82. Please explain each of the following statements and any possible significance it may have in respect of Brazil's claims about GSM-102 and GSM-103 (7 CFR 1493.10(a)(2), Exhibit BRA-38): BRA, USA**

Brazil's Answer:

181. As discussed below, these passages corroborate evidence provided by Brazil to demonstrate that the CCC guarantee programmes constitute export subsidies within the meaning of Articles 1.1 and 3.1(a) of the SCM Agriculture, and thus within the meaning of Articles 1(e), 10.1 and 8 of the Agreement on Agriculture.

> **(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Brazil's Answer:

182. The passage cited by the Panel provides corroborating evidence that CCC guarantees provide "benefits", within the meaning of Article 1.1(b) of the SCM Agreement. Specifically, the passage states that the CCC programmes "operate in cases . . . where US financial institutions would be unwilling to provide financing without CCC's guarantee". This demonstrates at least two things. First, it establishes that the CCC guarantee programs are used in situations where, without a CCC guarantee, a borrower could not secure financing at all – not just financing on less attractive terms than could be secured with the CCC guarantee (or on terms that would constitute a benefit under Article 14(c) of the SCM Agreement), but no financing at all. Second, it establishes that financing could not be secured without a CCC guarantee – a commercial guarantee would not do. This corroborates Brazil's assertion that CCC provides something that has no equivalent on the commercial market.

183. Brazil notes that the regulations for the SCGP programme contain an identical provision, in 7 CFR 1493.400(a)(2). That section states that "[t]he SCGP operates in cases where credit is necessary to increase or maintain US exports to a foreign market and where private US exporters would be unwilling to provide financing without CCC's guarantee".[227]

184. Moreover, in its Annual Performance Plans for fiscal years 2000, 2001 and 2002, the US Department of Agriculture's Foreign Agricultural Service similarly stated that the SCGP programme "was created to expand high-value product exports by facilitating credit for such purchases in foreign markets lacking sufficient liquidity to purchase openly on the commercial market".[228] This demonstrates that the SCGP programme extends "benefits," since it facilitates credit for the purchase of US agricultural commodities in circumstances where credit would not otherwise be available at all.

> **(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programs are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

[227] Exhibit Bra-38 (7 CFR 1493.400 *et seq*.).

[228] Exhibit Bra-164 (US Department of Agriculture, Foreign Agricultural Service, *Revised FY 2001 and FY 2002 Annual Performance Plan*, p. 11); Exhibit Bra-165 (US Department of Agriculture, Foreign Agricultural Service, *Revised FY 2000 and FY 2001 Annual Performance Plan*, p. 17).

Brazil's Answer:

185. This passage also demonstrates that CCC guarantees confer "benefits". Specifically, the passage states that "[t]he programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports . . .". Like the passage included in 82(a), this passage establishes at least two things. First, that without a CCC guarantee, a borrower would not be able to secure financing at all – not just financing on less attractive terms than could be secured with the CCC guarantee (or on terms that would constitute a benefit under Article 14(c) of the SCM Agreement), but no financing at all. Second, that the CCC guarantee is necessary – a commercial guarantee would not be sufficient.

186. Brazil notes that the regulations for the SCGP programme contain an identical provision, in 7 CFR 1493.400(a)(2). That section states that "The programme is operated in a manner intended not to interfere with markets for cash sales. The programme is targeted toward those countries where the guarantees are necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments."[229]

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

*Brazil's Answer:*

187. This passage demonstrates that the CCC guarantee programmes are contingent on export, within the meaning of Article 3.1(a) of the SCM Agreement. Specifically, the passage establishes that the CCC guarantee programs are for use by "US agricultural exporters". It also confirms that the programmes operate to the benefit of US exporters, who with the help of the programmes are able to expand their market share.

188. Brazil notes that the regulations for the SCGP programme contain an identical provision, in 7 CFR 1493.400(a)(2). That section states that "[i]n providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities."[230]

**83. Could Brazil explain how the procedure in Annex V of the SCM Agreement would be relevant to its claims concerning agricultural export subsidies, prohibited subsidies and agricultural domestic support? (e.g. note 301 in Brazil's first submission and paragraph 4 of Brazil's oral statement at the first session of the first substantive meeting). BRA**

Brazil's Answer:

189. The United States failed to respond to Brazil's questions and document requests during the Annex V procedures. Indeed, the United States refused to participate in any way in the Annex V procedures mandated by Brazil's invocation of Annex V in its request for establishment of this Panel. This refusal to participate has consequences under the express terms of Annex V. The list of Annex V questions provided to the United States by Brazil is included in Exhibit Bra-49. As directed by paragraph 6 of Annex V, given the United States' failure to cooperate in the Annex V information-gathering process, Brazil has and will present its case regarding peace clause issues and serious prejudice claims based on evidence available to it. If there are gaps in the evidence provided to the Panel by Brazil in support of its prima facie case, and those gaps are due to the United States' failure

[229] Exhibit Bra-38 (7 CFR 1493.400 *et seq.*).
[230] Exhibit Bra-38 (7 CFR 1493.400 *et seq.*).

to cooperate with and participate in the Annex V process, Annex V, paragraph 6 provides that "the panel may complete the record as necessary relying on best information otherwise available".

190. As a final note, Brazil's Annex V questions to the United States included questions concerning US agricultural export subsidies and domestic content subsidies because these are also "actionable" subsidies that cause serious prejudice to Brazil's interests.

**84. Is the Panel correct in understanding that, under the GSM-102 and GSM-103 programmes, the exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? USA**

Brazil's Comment:

191. The Panel is correct in stating that fees for GSM 102 and GSM 103 guarantees vary only according to the dollar value of the transaction and the length of the guarantee. GSM 102 and GSM 103 fees do not otherwise vary and are charged according to a fee schedule that does not account for the country risk involved or the credit rating of the borrower. Brazil attaches news releases from the US Department of Agriculture's Foreign Agricultural Service announcing GSM 102 and GSM 103 guarantees to Dominican Republic, Morocco, Ghana, South Korea, Vietnam and Algeria.[231] The Panel will note that the fees do not vary, and are based on the standard GSM 102 and GSM 103 fee schedule included as Exhibit Bra-155.[232]

192. As noted above in Brazil's comment on Question 77, the US Department of Agriculture's Office of the Inspector General has noted in June 2001 that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs".[233] It repeated this statement in February 2002.[234] Thus, GSM 102 and GSM 103 fees remained virtually unchanged from at least 1994 until February 2002. The current fee schedule demonstrates that this trend continues to the present.[235]

193. In reviewing the historical fee schedules available from public sources,[236] Brazil notes that from at least 1994 until the present, CCC made two changes in its fee schedule for GSM 102. First, it

[231] Exhibit Bra-166 (US Department of Agriculture Foreign Agricultural Service, News Releases regarding extension of GSM 102 and GSM 103 guarantees to Dominican Republic, Morocco, Ghana, South Korea, Vietnam and Algeria).

[232] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 and GSM-103 Programme Participants*, 24 September 2002).

[233] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31).

[234] Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed for many years and may not be reflecting current costs.").

[235] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 and GSM-103 Programme Participants*, 24 September 2002).

[236] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 and GSM-103 Programme Participants*, 24 September 2002); Exhibit Bra-98 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 and GSM-103 Programme Participants*, 4 September 2001); Exhibit Bra-156 (US Export-Import Bank, *Comparison of Major Features of Programmes Offered by Ex-Im Bank and Commodity Credit Corporation for Support of Bulk Agricultural Commodities*, available at http://www.exim.gov/pub/ins/pdf/eib99-13.pdf). Brazil was unable to locate from public sources other fee schedules from the period 1993-2002.

changed the fee for a 12-month guarantee with semi-annual repayment intervals from $0.209 per $100 of coverage to $0.229 per $100 of coverage. Second, it decided to offer borrowers the additional option of 30- and 60-day guarantees, at the same fee charged for 90-day and 4-, 6- and 7-month guarantees.

**85. Is the Panel correct in understanding that, under the SCGP, the exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? Please explain any "risk" assessment involved in the programme. USA**

Brazil's Comment:

194. The Panel is correct in stating that fees for SCGP guarantees vary only according to the dollar value of the transaction and the length of the guarantee. SCGP fees do not otherwise vary and are charged according to a fee schedule that does not account for the country risk involved or the credit rating of the borrower. For SCGP guarantees of up to 90 days, the fee is $0.45 per $100 of coverage, and for SCGP guarantees from 90-180 days, the fee is $0.90 per $100 of coverage.[237] Brazil attaches news releases from the US Department of Agriculture's Foreign Agricultural Service announcing SCGP guarantees to Tunisia, Azerbaijan, Vietnam, South Korea, Japan and Nigeria.[238] The Panel will note that the fees do not vary.

**86. Is there a risk categorization in relation to three export credit guarantee programmes (GSM-102, GSM-103 and SCGP)? Does this have any impact on premiums payable and the ability of the CCC to on-sell the guarantees ? USA**

Brazil's Comment:

195. Fees for GSM 102, GSM 103 and SCGP guarantees do not vary depending upon the credit rating of the borrower. As noted in Brazil's comments on Questions 84 and 85, guarantee fees for these three programs vary only according to the dollar value of the transaction and the length of the guarantee. Fees do not otherwise vary and are charged according to a fee schedule that does not account for the country risk involved or the credit rating of the borrower.

196. In calculating the "subsidy cost" for the purposes of the Federal Credit Reform Act, agencies like the CCC account for country risk. According to the narrative description included in the US budget,

> [t]he subsidy estimates for the GSM-102 and GSM-103 programs are determined in large part by the obligor's sovereign or non-sovereign country risk grade. These grades are developed annually by the International Credit Risk Assessment System Committee (ICRAS). . . . The default estimates for GSM guarantees are determined in large part by the risk premia assigned for each risk grade.[239]

197. According to the GAO, "OMB requires executive branch agencies to calculate the costs of foreign loans and guarantees using annually updated ICRAS ratings and . . . country risk interest premiums when foreign loans or guarantees are budgeted, authorized, disbursed, or modified. . . ."[240]

[237] Exhibit Bra-167 (12 Steps to Participating in the USDA Supplier Credit Guarantee Programme, Step 5).

[238] Exhibit Bra-168 (US Department of Agriculture Foreign Agricultural Service, News Releases regarding extension of SCGP guarantees to Tunisia, Azerbaijan, Vietnam, South Korea, Japan and Nigeria).

[239] Exhibit Bra-127 (US budget for FY 2004, p. 108).

[240] Exhibit Bra-121 (GAO/NSIAD/GGD-95-31, p. 7).

198. Thus, while CCC fees for GSM 102, GSM 103 and SCGP fees do not account for country risk or the credit risk of the borrower, the "guaranteed loan subsidy" line in the US budget and the subsidy figures in the CCC's financial statements do take account of country risk.

**87. What proportion of CCC (export-related and total) long term operating costs and losses are represented by GSM-102, GSM-103 and SCGP programmes? USA**

**88. (a) Is the Panel correct in understanding that the United States' argument is that, at present, by virtue of Article 10.2 of the Agreement on Agriculture, there are no disciplines on agricultural export credit guarantees under the Agreement on Agriculture (or the SCM Agreement)? USA**

**(b) Does the United States agree with the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the Agreement on Agriculture? Please cite any relevant material, including any past WTO dispute settlement cases. How would this reconcile with the United States' own statement, at paragraph 21 of its closing oral statement that "of course, the United States may not provide subsidies without any limit". USA**

**(c) If, as the United States argues, there are no disciplines on export credit guarantees in the Agreement on Agriculture, how could export credit guarantees "conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity when there are allegedly no disciplines against which such an assessment could occur)? USA**

Brazil's Comment:

199. As the Panel's question suggests, if the Panel determines that export credit guarantees are not subject to the export subsidy disciplines in the Agreement on Agriculture, the United States is nevertheless not entitled to the protection afforded by Article 13(c). Article 13(c) provides an exemption from action for those export subsidies that "conform fully to the provisions of Part V" of the Agriculture Agreement. If, as the United States argues, export credit guarantees are not subject to Part V, then they cannot "conform fully to the provisions of Part V," and are not entitled to the safe haven in Article 13(c).

200. The panel in Canada – Aircraft (21.5) took a similar approach with respect to the safe haven included in the second paragraph of item (k) to the Illustrative List of Export Subsidies appended to the SCM Agreement.[241] The second paragraph of item (k) provides as follows:

> Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

[241] Panel Report, *Canada – Aircraft (21.5)*, para. 5.143-5.145.

The "international undertaking on official export credits" cited in this provision is the Organization for Economic Co-operation and Development's Arrangement on Guidelines for Officially Supported Export Credits ("OECD Arrangement").[242]

201. To determine whether a particular Canadian measure could benefit from the safe haven in the second paragraph of item (k), the Panel first reviewed which types of "export credit practices" could potentially be "in conformity with" the "interest rates provisions" of the OECD Arrangement. According to the Panel, it could only "determine the conformity of a given export credit practice with those interest rate provisions . . . [if] it is of the type that conceptually could be subject to, and thus in conformity with, those provisions".[243] Similarly, if the United States is correct that CCC export credit guarantees are not subject to the disciplines in Part V of the Agriculture Agreement, then CCC guarantees cannot logically "conform fully to the provisions of Part V" and trigger the exemption from action provided for in Article 13(c).

**(d) Is the United States advocating the view that its own export credit guarantee programmes, which pre-dated the Uruguay Round, are effectively "grandfathered" so as to benefit from some sort of exemption from the export subsidy disciplines of the Agreement on Agriculture? How, if at all, is it relevant that the SCGP did not, according to the United States, become relevant for upland cotton until the late 1990's (i.e. after the entry into force of the WTO Agreement)? USA**

F. STEP 2 PAYMENTS

**89. Does the United States confirm Brazil's statement in paragraph 331 of its first submission that "The conditions and requirements for Step 2 domestic payments remain unchanged with the passage of the 2002 FSRI Act"? What is the relevance of this, if any, to this dispute? USA**

**90. Does the United States confirm Brazil's statement in paragraph 235 of its first submission that the changes concerning Step 2 export payments from the 1996 FAIR Act to the 2002 FSRI Act are: increase in the amount of the subsidy by 1.25 cents per pound and the removal of any budgetary limits that applied under the 1996 FAIR Act? What is the relevance of this, if any, to this dispute? USA**

**91. What is the significance of the elimination of the 1.25 cent threshold payment in the 2002 FSRI Act pertaining to Step 2 payments? USA**

**92. Does the United States confirm that Exhibit BRA-65 represents a sample contract for exporters of eligible upland cotton to conclude with the CCC under the FSRI 2002, and that an application form (Exhibit BRA-66) needs to be filled out with data on weekly exports and submitted to the USDA FAS. Is Exhibit BRA-66 - Form CCC 1045-2 – also a valid example? If not, please identify any differences or distinctions. USA**

[242] Available at http://www.oecd.org/dataoecd/52/3/2763846.pdf.

[243] WT/DS70/RW, para. 5.93. The Panel concluded that "the only forms of export credit practices" subject to the interest rate provisions of the *OECD Arrangement* are "direct credits/financing, refinancing and interest rate support," since only those forms of official financing support are subject to the *Arrangement*'s commercial interest reference rates ("CIRR") – "the only *existing* systems of minimum interest rates under the *Arrangement*." *Id*., paras. 5.98, 5.101 (emphasis in original). Since the CIRR are only expressed as fixed rates, the Panel concluded that they could only be applied to fixed (and not floating) interest rate transactions. *Id*., para. 5.102. Nor could the CIRR be applied to official support with a shorter maturity than two years (the minimum term expressly listed in the *OECD Arrangement*), or to guarantees or insurance. *Id*., para. 5.106.

Brazil's Comment:

202. Brazil includes a new version of the current "Upland Cotton Domestic User/Exporter Agreement" (Revision 7, in effect as of 1 August 2003 and issued on 17 June 2003), which replaces Revision 6 that Brazil has included as Exhibit Bra-65 to its First Submission.

**93. Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment? USA**

**94. Is the Panel correct in understanding that Brazil alleges an inconsistency with Article 3.1(b) of the SCM Agreement only with respect to Step 2 domestic payments? BRA**

Brazil's Answer:

203. Yes.

**95. Do the criteria in 7 CFR 1427.103(c)(2) (Exhibit BRA-37) that Step 2 "eligible upland cotton" must be "not imported cotton" apply to both domestic and export payments? USA**

**96. Is a domestic sale a "use" for the purposes of Step 2 payments? Is a sale for export, or export, considered a "use"? USA**

**97. How does the United States respond to Brazil's assertion, at paragraph 70 of Brazil's oral statement at the first session of the first substantive meeting, that "It is obvious that a single bale of cotton cannot be both exported and used domestically." Is this a relevant consideration? USA**

**98. How many Step 2 payments are received if a bale of upland cotton is exported, and then opened by a domestic user in the United States, or vice versa? USA**

**99. How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's oral statement at the first session of the first Panel meeting concerning the relevance of the Appellate Body Report in US-FSC (21.5). USA**

**100. How does Brazil respond to the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in Canada-Dairy and the findings of the Appellate Body in US-FSC (21.5)[244], do any other dispute settlement reports offer guidance on this issue? For example, how, if at all is the Appellate Body's report in Canada-Aircraft relevant here?[245] BRA**

[244] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.[244] Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use

Brazil's Answer:

204. The applicable regulations (7 CFR 1427.104)[246] define eligible domestic users and exporters of upland cotton.[247] To receive a Step 2 export payment, a person (including a cotton producer or a cooperative) must be "regularly engaged in selling eligible [US] upland cotton for export".[248] To receive a domestic payment, a person must be "regularly engaged in the business of opening bales of eligible [US] upland cotton to manufacture US upland cotton into cotton products in the United States".[249] The only actor who can be indifferent whether they export or use cotton domestically is a hypothetical domestic US cotton product manufacturer regularly engaged in opening US bales for domestic US manufacture that also regularly engages in exporting US cotton. In that situation, if a bale of cotton is opened by mistake instead of being exported, the exporter who is also the US cotton product manufacturer will receive a Step 2 domestic payment for that bale if the company has already entered into a contract with CCC for Step 2 payments, and subject to proof that bale is in fact used for manufacturing cotton products in the United States. But even if that hypothetical situation were to occur, then the payment would be contingent upon the domestic use of only US upland cotton (prohibited by Article 3.1(b) of the SCM Agreement). And if the bale were exported, the US exporter would receive the Step 2 payments subject to proof of export of US (not foreign) upland cotton (prohibited by Article 3.1(a) of the SCM Agreement).

205. It follows that the "two distinct factual situations" resulting in the payment of Step 2 subsidies are (1) the domestic "use" of eligible US upland cotton by a manufacturer of cotton products regularly engaged in opening bales; and (2) the "export" of eligible US cotton by exporters regularly engaged in selling US upland cotton. The United States argues that this case is distinguishable from US – FSC (21.5) because in that case one situation involved property produced within the United States and held for use outside the United States, and the other situation involved property produced outside the United States and held for use outside the United States.[250] This is irrelevant.

206. The point of the distinction by the Appellate Body in US – FSC (21.5) was not the geographic location of the property at issue, but rather whether one portion of payment under a programME was export contingent. In fact, in US – FSC (21.5), the products found to be subject to the export contingency were those produced within the United States and held for use outside the United States. This is exactly the situation with Step 2 export payments. Upland cotton produced in the United States receives Step 2 payment upon proof of export ("held for use outside the United States") outside the United States. As in US – FSC (21.5), the fact that subsidies available under the programme are also granted in a second situation, i.e., when upland cotton produced within the United States is used within the United States "does not dissolve the export contingency arising in the first set of circumstances".[251]

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outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

[245] There, the Appellate Body stated that,

"the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".

[246] Exhibit Bra-37 (7 CFR 1427.104).

[247] First Submission of Brazil, paras 92, 98.

[248] Exhibit Bra-37 (7 CFR 1427.104(a)(2)).

[249] Exhibit Bra-37 (7 CFR 1427.104(a)(1)).

[250] First Oral Statement of the United States, paras. 21-22.

[251] Appellate Body Report, *US – FSC (21.5)*, para. 119.

207. Concerning other relevant dispute settlement reports, Brazil believes that the Canada – Aircraft decision is useful precedent. In that case, Canada argued that Technology Partnership Canada (TPC) was a funding mechanism providing "support to a broad base of sectors and technologies" "that result in a high technology product or process for sale in domestic and export markets".[252] Canada claimed that "Brazil has not adduced any evidence to show that TPC contributions are contingent on export performance, in the sense that the contributions would not be paid unless exports took place, that there would be rewards if exports took place. . .".[253] The Appellate Body affirmed the panel's finding of export contingency, noting that "it is enough to show that one or some of TPC's contributions do constitute subsidies 'contingent . . . in fact . . . upon export performance.'"[254] This finding is consistent with the Appellate Body's later decision in US – FSC (21.5). It stands for the proposition that where a programme makes some payments contingent upon export of products, the fact that other payments under the programme are made for domestic use does not eliminate the export contingency of the programmes.

**101. How does Brazil respond to the United States' assertion at paragraph 22 of its oral statement that the programme involves "eligible users" who constitute the "entire universe" of potential purchasers of upland cotton? BRA**

Brazil's Answer:

208. Brazil considers that the United States' statement is not correct. As noted in the previous answer, an "eligible" user cannot include firms that are not "regularly engaged in" opening bales of upland cotton for manufacturing upland cotton products in the United States or exporting upland cotton from the United States.[255] The eligible domestic user criteria exclude all firms that are domestic cotton brokers or simple resellers. Nor would "eligible domestic users" include firms that have not entered into CCC contracts or who open bales but do not use them in the manufacture of upland cotton products or who only occasionally open bales of upland cotton for manufacture of upland cotton products. Similarly, the regulations for eligible "exporters" do not include persons who occasionally export and who are, thus, not considered to be persons "regularly engaged" in exporting upland cotton.[256] Furthermore, the regulations do not cover exporters who have not entered into a CCC contract as exporters eligible for payment.[257]

**102. How does Brazil respond to the United States' assertion at paragraph 129 of its first written submission, that "[t]he programme is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States." BRA**

Brazil's Answer:

209. Brazil notes that the same "programme indifference" argument could have been made by the United States in the US – FSC (21.5) case (tax deferred whether products produced within or outside the United States) or by Canada in the Canada – Aircraft case (TPC payments made whether products consumed or used domestically or exported). These two Appellate Body decisions clarify that what matters is whether one segment of the programme is contingent upon export. This is consistent with the Article 3.1(a) text that the export contingency be "solely or as one of several other conditions". Step 2 export payments are clearly contingent upon proof of export of US upland cotton by eligible exporters. The fact that another class of persons in a different situation (domestic users) also may

[252] WT/DS70/R, paras. 6.231, 6.235
[253] WT/DS70/R, para. 6.248.
[254] *Canada – Aircraft*, WT/DS70/AB/R, para. 179.
[255] Exhibit Bra-37 (7 CFR 1427.104(a)(1)).
[256] Exhibit Bra-37 (7 CFR 1427.104(a)(2) and (b)).
[257] Exhibit Bra-37 (7 CFR 1427.104(a)(2) and (b)).

receive the payment does not remove this export contingency. Additionally, Brazil notes that Step 2 domestic payments violate Article 3.1(b).

**103. Is the Step 2 programme fund a unified fund that is available for either domestic users or exporters, without a specific amount earmarked for either domestic users or exporters? Please substantiate your response, including by reference to any applicable statutory or regulatory provisions. USA**

**104. How does the United States respond to the data presented in Exhibit BRA-69? Is it accurate? Please substantiate. USA**

**105. Why is the Step 2 programme separated into "domestic users" and "exporters"? Apart from differentiating between exporters and domestic users, with consequential differentiation as to the forms that must be filled out and certain other conditions that must be fulfilled, are the eligibility criteria for Step 2 payments identical? Are the form and rate of payment, as well as the actual payment made, identical? USA**

**106. With respect to paragraph 139 of the United States' first written submission, are Step 2 export payments included in the annual reduction commitments of the United States? If so, why? USA**

**107. Please comment on any relevance, to Brazil's de jure claims of inconsistency with the provisions of the Agreement on Agriculture, of Exhibit BRA-69, which shows Step 2 payments made to (i) domestic users and (ii) exporters. This Exhibit shows that, from FY 91/92 through 02, the Step 2 payments for exporters exceeded those for domestic users in FY 94; FY 95; FY 96 (in fact there were no domestic payments in FY 96); and FY 02. In the other years, the domestic payments are greater than export payments. BRA, USA**

Brazil's Answer:

210. This document is not relevant for either Brazil's Article 3.1(a) or Article 3.1(b) claims under the SCM Agreement. Even if the Step 2 export payments were zero in certain years (which they have never been), it would not remove the export contingency. Similarly, the fact that Step 2 domestic payments were not made in one time period does not resolve their contingency upon use of domestic over imported upland cotton. Brazil's claims are that whenever a Step 2 payment for exported or domestically used upland cotton takes place, this payment is required to be made in a manner inconsistent with Articles 3.1(a) or 3.1(b) of the SCM Agreement and with Articles 3.3 and 8 of the Agreement on Agriculture in the case of Step 2 export payments.

**108. At paragraph 135 of its first written submission, the United States states : "[T]he subsidy is not contingent upon export performance..." (emphasis added). Again, in the course of the first Panel meeting, the United States admitted that the Step 2 payments were "subsidies". Does the United States thus concede that Step 2 payments constitute a "subsidy" within the meaning of the WTO Agreement? USA**

**109. How does the United States respond to Brazil's arguments concerning a mandatory/discretionary distinction and the allegation that certain United States measures (including s.1207(a) of the 2002 FSRI Act) are mandatory? (This is referred to, for example, in paragraph 28 of Brazil's first written submission). Does the United States agree with the assertion that (subject to the availability of funds) the payment by the Secretary of Step 2 payments is mandatory under section 1207(a) FSRI upon fulfilment by a domestic user or exporter of the conditions set out in the legislation and regulations? If not, then why not? To what extent is this relevant here? What determines the "availability of funds"? Please cite any**

**other relevant measures or provisions which you consider should guide the Panel in respect of this issue. USA**

**110. Section 1207(a) of the 2002 FSRI Act provides that during the period beginning on the date of the enactment of the FSRI Act through July 31 2008, " .. the Secretary shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters for documented purchases by domestic users and sales for export by exporters...". The Panel notes that Brazil does not appear to distinguish between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists. The United States refers to "benefits" and "payments" and "program" in asserting that Step 2 is not export contingent (paragraphs 127-135 of the United States' first written submission).**

**(a) Do the parties thus agree that there is no need to draw any distinction between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists for the purposes of the Agreement on Agriculture? BRA, USA**

Brazil's Answer:

211. Brazil agrees there is no need to draw any distinction between cash payments and "commodity certificates". The Step 2 regulations indicate that Step 2 payments "shall be made available in the form of commodity certificates issued under part 1401 of this Chapter, or in cash, at the option of the programme participants".[258] Part 1401 of the regulations indicated that commodity certificates may be exchanged for cash.[259]

**(b) Why would a domestic user or an exporter select to receive a marketing certificate over a cash payment? What is the proportion of cash payments vs. marketing certificates granted under the programme? USA**

**111. Does the United States maintain its argument that actions based on Article 3.1(b) of the SCM Agreement are conditionally "exempt from actions" due to the operation of Article 13 of the Agreement on Agriculture? USA**

**112. In the event that the Panel finds that Article 6.3 of the Agreement on Agriculture does not preclude an examination of Brazil's claims under Article 3.1 of the SCM Agreement and Article III:4 of GATT 1994, how does the United States respond to the merits of Brazil's claims relating to Step 2 payments under those provisions? USA**

**113. Is it necessary for measures directed at agricultural processors included in AMS to discriminate on the basis of the origin of goods? USA**

**114. With respect to the last sentence of paragraph 22 of Brazil's closing oral statement, could Brazil elaborate on the circumstances in which a local content subsidy would comply with Article 3.1(b) of the SCM Agreement? BRA**

Brazil's Answer:

212. Brazil believes the Panel is referring to paragraph 21 of the final "as delivered" version of Brazil's Closing Statement on 24 July 2003. The text of this sentence reads as follows: "There is also no conflict between Article 3.1(b) of the SCM Agreement and Agriculture Agreement Article 6 or

[258] Exhibit Bra-37 (7 CFR 1427.106).
[259] Exhibit Bra-34 (7 CFR 1401.4(a)).

Annex 3, paragraph 7, because there are two types of domestic subsidies – those that comply with Article 3.1(b) of the SCM Agreement and those that do not." Paragraph 85 of Brazil's First Oral Statement of 22 July 2003 was more precise in focusing on the relevant type of support, i.e., support provided to processors of agricultural products, stating that "[t]here are two types of 'non-green box' support to processors that could benefit producers of agricultural goods: support that violates ASCM Article 3.1(b) and GATT Article III:4 and support that does not."

213. There are no circumstances in which a "local content subsidy" would comply with Article 3.1(b) of the SCM Agreement.

**115. What is the meaning and relevance (if any) to Brazil's claims under Article 3 of the SCM Agreement and Article III:4 of GATT 1994 of the phrase "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products" in the Agreement on Agriculture? BRA, USA**

Brazil's Answer:

214. The phrase from Annex 3, paragraph 7 of the Agriculture Agreement cited by the Panel requires Members to tabulate and include as part of AMS to individual products an amount of benefit provided to producers of basic agricultural products resulting from "measures directed at agricultural processors. . . ". The obligations of Members to comply with reduction commitments tied to AMS, and the obligations of Members under SCM Article 3 and GATT Article III, all apply cumulatively and simultaneously. This phrase recognizes that subsidies to processors of agricultural products may benefit producers of the basic agricultural product and, thus, must be included within total AMS. However, as Brazil has argued, this phrase does not provide an exemption from the SCM Agreement or GATT Article III for such subsidies, and no such exemption can be interpolated into the text.[260] The cumulative nature of the obligations incurred under the WTO Agreement results in the prohibition of certain "measures directed at agricultural processors" that otherwise would be included in the AMS calculation, namely those that are contingent upon the use of domestic over imported agricultural products contrary to Article 3.1(b) of the SCM Agreement.

**116. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the Agreement on Agriculture? Does the phrase "provide support in favour of domestic producers" in Article 3.2 of the Agreement on Agriculture refer to, and/or permit such subsidies? BRA, USA**

Brazil's Answer:

215. Brazil agrees with the EC that Articles 1(a), 3.2, 6.3 of the Agreement on Agriculture include the phrase "domestic support in favour of agricultural producers". And Brazil further recognizes that all types of "domestic support in favour of agricultural producers" must be tabulated for the purposes of setting and enforcing a Member's domestic support reduction commitments (Total AMS). But Brazil notes that neither the EC nor the United States can point to any inherent conflict between these provisions and the prohibition of local content subsidies under Article 3.1(b) of the SCM Agreement for the reasons set forth in Brazil's First Oral Statement and in Brazil's answer to the Panel's Question 114.[261]

216. The EC and the United States fail to acknowledge that there can be subsidies/domestic support measures provided to processors of the basic agricultural product that can be consistent with Article 3.1(b) of the SCM Agreement and that also "provide support in favour of domestic producers". The EC appears to assume that all support to processors of a basic agricultural

[260] First Oral Statement of Brazil, paras. 81-86.
[261] First Oral Statement of Brazil, paras. 81-86.

commodity violates Article 3.1(b) of the SCM Agreement. That is simply not correct. Yet, without this assumption, there is no inherent conflict between the SCM Agreement and the Agreement on Agriculture. The absence of any conflict coupled with the absence of any explicit exemption for local content subsidies in Article 13(b) or anywhere else in the Agreement on Agriculture supports the conclusion that local content subsidies related to agricultural goods violate Article 3.1(b) of the SCM Agreement.

**117. What is the relationship between Step 2 payments to exporters and the marketing loan payments, both of which appear to compensate for the price differences relative to the Liverpool A-Index? For example, is there double compensation? Or is one of the explanations that these export-related price compensatory payments are paid to different operators (namely, the producer, on the one hand under the marketing loan arrangements, and the processor/users (Step 2 programme) arrangements on the other? USA**

**118. Can the United States confirm that it does not rely on Article III:8 of GATT 1994? USA**

G. ETI ACT

**119. How does the United States respond to Brazil's reference to the panel report in India - Patents (EC) (at paragraph 138 of its oral statement at the first session of the first substantive meeting)?[262] How, if at all, should the Panel take this report into account in considering the issues raised by Brazil's claims relating to the ETI Act? USA**

**120. Concerning its claims on the ETI Act, Brazil relies on the US – FSC case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the United States appear to invoke Article 6 of the Agreement on Agriculture. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Could you direct the Panel to any relevant findings or conclusions by the panel or Appellate Body in that case? BRA**

Brazil's Answer:

217. Brazil is not aware that there are any differences between the US position regarding the peace clause in the US – FSC case and the present case. There is no reference in the entire record of that dispute that the United States ever asserted that the EC's claims regarding the ETI Act were exempt by the peace clause. Also in this dispute, Brazil is not aware that the United States has ever asserted that Brazil's claims regarding the ETI Act were exempted by the peace clause. In this regard, the United States has taken a consistent approach in the present case and in US – FSC.

218. Because the United States never raised the peace clause as a defense in US – FSC, there were no findings by the panel or the Appellate Body regarding the peace clause. And neither the panel nor the Appellate Body held that the EC was required to demonstrate that the United States was not entitled to peace clause protection before proceeding to the substance of the EC's claims against the ETI Act. In any event, the United States has been unable to establish that the ETI Act is consistent

[262] That panel stated: "It can thus be concluded that panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same. In examining dispute WT/DS79 we are not legally bound by the conclusions of the Panel in dispute WT/DS50 as modified by the Appellate Body report. However, in the course of "normal dispute settlement procedures" required under Article 10.4 of the *DSU*, we will take into account the conclusions and reasoning in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we should give significant weight to both Article 3.2 of the *DSU*, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, and to the need to avoid inconsistent rulings (which concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the *DSU*." (footnote omitted)

with Part V of the Agreement on Agriculture. Therefore, the United States does not enjoy peace clause exemption under Article 13(c) of the Agreement on Agriculture.

**121. How do you respond to the reference in paragraph 43 of EC third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to that dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. USA, BRA**

Brazil's Answer:

219. Brazil is of the view that DSU Article 17.14 requires that following the adoption of an Appellate Body report, the parties to the dispute, i.e., the defending and complaining Member, are unconditionally bound by the results of that report. This interpretation is consistent with the Appellate Body decisions in US – Shrimps (21.5)[263] and EC – Bed Linen (21.5),[264] both confirming that panel and Appellate Body reports adopted by the Dispute Settlement Body must be considered final resolutions to a dispute between the parties to that dispute. There is no precedent in the WTO or GATT that would require the Panel to find that the United States alone is bound in this case. It is difficult to imagine, however, how the United States could take a different position in defending against Brazil's ETI claims in this case, in light of the adoption by the DSB of the Appellate Body and panel reports in US – FSC (21.5), and the recommendation by the DSB that the United States bring the ETI Act into conformity with the Agreement on Agriculture and the SCM Agreement.

220. In this case, Brazil challenges exactly the same measure as that found by the panel and the Appellate Body in US – FSC (21.5) to violate the Agreement on Agriculture and the SCM Agreement. There have been no changes to the ETI Act since the adoption of the panel and Appellate Body reports by the WTO Dispute Settlement Body.[265] Brazil challenges the ETI Act with exactly the same rationale as the EC. Thus, there is a complete identity between the "measure" and the "claims" in this case and the US – FSC (21.5) dispute (noting that upland cotton is a sub-set of all the products covered by the ETI Act). Under these circumstances, it is appropriate for the Panel to make similar findings of fact, conclusions of law, and recommendations as the panel and Appellate Body in US – FSC (21.5).[266]

221. Brazil does not consider any of the other provisions cited by the Panel to be relevant to this particular question. Should the Panel wish Brazil to elaborate on any of provisions more specifically, Brazil will be pleased to do so.

[263] Appellate Body Report, *US – Shrimps (21.5)*, para. 97.
[264] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 90-96.
[265] The United States has indicated in its First Submission (para. 189) that both branches of Congress are considering legislative proposals that would repeal the ETI Act. However, Brazil notes that it has been over 18 months since 29 January 2002, the date on which the panel and Appellate Body reports on the ETI Act were adopted by the DSB.
[266] First Oral Statement of Brazil, paras. 138-39.

# ANNEX I-2

## ANSWERS OF THE UNITED STATES TO THE QUESTIONS FROM THE PANEL TO THE PARTIES FOLLOWING THE FIRST SESSION OF THE FIRST SUBSTANTIVE PANEL MEETING

(11 August 2003)

*UPLAND COTTON*

**1. Please confirm that all information and data that you have provided to the Panel relating to "cotton" in fact relates to upland cotton only. BRA, USA**

1. The United States can confirm that, with the exception of export credit guarantees, all of the information and data we have provided to-date relates to upland cotton only. With respect to export credit guarantees, the Commodity Credit Corporation does not maintain data to distinguish transactions involving different types of cotton (for example, upland cotton versus extra-long staple (ELS) cotton). However, the United States has no reason to believe that types of cotton other than upland cotton constitute a material percentage of such transactions.

*PRELIMINARY ISSUES*

*Product scope of Panel's terms of reference relating to Brazil's export credit guarantee claims*

**3. If the request for consultations in this dispute omitted certain products in relation to export credit guarantees, on what basis is it argued that it failed to identify the measures at issue in accordance with Article 4.4 of the DSU? USA**

2. The only export credit guarantee measures identified in the Brazilian consultation request were those in respect of upland cotton. The request for consultations did not identify export credit guarantee measures for any other agricultural commodities.

3. The request for consultations identified the measures subject to consultations in a single sentence:[1]

> The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton[1], as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry").

[1] Except with respect to export credit guarantee programmes as explained below.

Another sentence followed this one, setting out (in a page and a half) a listing of measures that were included within the identification in the first sentence.

4. Apart from the footnote, the first two lines of the sentence quoted in the previous paragraph address "subsidies provided to US producers, users and/or exporters of upland cotton"; thus, apart

[1]WT/DS267/1, at 1.

from the footnote, it is clear that subsidies provided to US producers of, say, soybeans are not included within the scope of the request. Equally, apart from the footnote, it is clear that subsidies provided to, say, banks that finance US cotton exports (but do not produce, use or export cotton) are not included within the scope of the request. To give an example from another part of the request, Brazil's consultation request identified "[e]xport subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000" as a challenged measure. Having identified that measure at issue for purposes of DSU Article 4.4 as subsidies provided to upland cotton exporters under that legislation, Brazil could not then have included in its panel request such subsidies provided to exporters of all agricultural commodities or all industrial goods.

5. Brazil, however, contends that "[t]he footnote clarifies that Brazil's request with respect to export credit guarantees is *not* limited to upland cotton."[2] Brazil's contention is incorrect. The footnote does nothing more than direct the reader of the consultation request to look "below" for an explanation. The footnote by itself does not contain any "identification of [a] measure at issue" as required by DSU Article 4.4, and therefore cannot itself bring any additional measures within the scope of the consultation request. Any such additional measures would have to be found -- if anywhere -- in an explanation "below."

6. However, as described in the first US submission, no such explanation or identification of additional measures ever appears. In fact, though Brazil devoted several paragraphs to this issue in its oral statement, it has never pointed to any explanation of any kind -- or any other identification of additional measures -- "below."

7. In addition, the statement of evidence attached to Brazil's consultation request did not include any evidence related to measures other than those for upland cotton. For Brazil to now argue that its consultation request was broader than its statement of evidence is for Brazil to admit that its consultation request was in breach of Article 7.2 of the Subsidies Agreement. Brazil cannot have it both ways.[3]

8. In summary, while Brazil's consultation request did identify measures at issue for purposes of DSU Article 4.4, the measures it actually identified did not include export credit guarantees for agricultural commodities other than cotton. Thus, the latter measures were not within the scope of consultations, were not consulted upon, and could not have been included in Brazil's panel request.

**4. Is it argued that the export credit guarantee programmes concerning upland cotton are each a separate or independent measure, in that they operate independently? USA**

9. The CCC export credit guarantee programme (GSM-102), the CCC intermediate export credit guarantee programme (GSM-103), and the Supplier Credit Guarantee Programme (SCGP) each constitute separate programmes. The distinct operation of the programmes themselves is manifested in both the terms of the particular programmes as well as in the nature of the obligation guaranteed. The GSM-102 and GSM-103 programmes guarantee obligations of banks. SCGP extends exclusively to obligations of importers. Obligations guaranteed under the GSM-102 programme may not extend beyond three years. SCGP guarantees a far lower percentage of principal (65 per cent).

10. Within each programme, allocations are made by country, by commodity, and by amount.[4] Thus, discrete programming decisions are made in connection with each such country, commodity,

[2]Brazil's Opening Oral Statement, para. 90.

[3]In light of the Panel's intended finding on the scope of Brazil's consultation request with respect to export credit guarantees, the United States will be making a request for a preliminary ruling on this point.

[4]*See* 7 C.F.R. §§ 1493.4, 1493.5 (setting forth allocation criteria). These criteria also apply to SCGP. 7 C.F.R. § 1493.400.

programme, and amounts (in terms of a guarantee value).[5] As a result, for the last 10 fiscal years, for example, as described in the First Written Submission of the United States, no cotton transactions occurred under the GSM-103 programme.

11. Furthermore, each export credit guarantee issued is a separate measure. Under DSU Article 4.4, it is incumbent upon Brazil to identify in its consultation request "the measures at issue." Here, Brazil identified the measure as "export credit guarantees . . . to facilitate the export of US upland cotton," and the United States may, and did, rely on that consultation request (including the attached statement of evidence) for notice.

**5. Is there a specification in any legislation or regulation (or any other official government document) which limit or restrict the export credit guarantee programmes at issue exclusively to upland cotton? USA**

12. Programme announcements issued pursuant to applicable programme regulations (7 C.F.R. §§ 1493.10(d), 1493.400(d)) serve to limit the availability of CCC export credit guarantees. These limitations are expressed in terms of one or more of the following criteria: commodities, total guarantee value for individual commodities, destination, and time within which export must occur. Examples of such programme announcements are included as Exhibit US-12. Thus, export credit guarantee offerings through programme announcements may be limited to cotton, pursuant to the authority of programme regulations.

**6. For the purposes of the Panel's examination of Brazil's claims relating to GSM-102, GSM-103 and SCGP under the Agreement on Agriculture and the SCM Agreement, is accurate data and information available with respect to these export credit guarantee programmes concerning upland cotton alone (e.g. with respect to "long-term operating costs and losses")? In this respect, the Panel also directs the parties' attention to the specific questions below relating to the programmes. USA**

13. The United States endeavoured to provide precisely such data with respect to cotton alone in paragraph 173, and associated tables, in its First Written Submission.

**7. Are commitments with respect to export subsidies under the Agreement on Agriculture commodity-specific? How, if at all, is this relevant? BRA, USA**

14. Export subsidy commitments under the Agriculture Agreement are, indeed, commodity specific. Each Member may have a schedule of reduction commitments with respect to specified commodities. To illustrate, the export subsidy reduction commitment schedule of the United States is attached as Exhibit US-13. As reflected in that schedule, for each of the 12 scheduled commodities, the United States has a reduction commitment with respect to both budget outlays and subsidized quantities. Other Members have similar schedules involving different commodities and reduction commitments. In all cases, however, the budgetary and quantitative commitments are unique to each commodity on each Member's respective schedule of export subsidy reduction commitments.

15. An individual Member, therefore, could apply an export subsidy programme with respect to all commodities for which it has undertaken reduction commitments. By operation of such an export subsidy programme, however, a Member may be in conformity with none, some, or all of its commodity-specific reduction commitments. So long as a Member applies such export programme in a given year in accordance with the commodity-specific reduction commitment for each year, such export subsidy programme is permitted with respect to each commodity and conforms fully with respect to Part V of the Agreement on Agriculture. The fact that commitments are taken on a product-

[5] *See* Exhibit US-12.

specific basis confirms that alleged export subsidy measures can be defined on a product-specific basis – and that is exactly what Brazil did here.

16. In contrast, for those specific commodities for which such Member does not have a reduction commitment, then such Member may not provide export subsidies at all in connection with such specific commodities. As a result, the same programme that, as applied, may be entirely in conformity with that Member's reduction commitment vis-à-vis one commodity may be a prohibited subsidy with respect to another commodity.

**8. Does the United States confirm that the questions referred to by Brazil in paragraph 92 of Brazil's oral statement were posed to the United States in the consultations? USA**

17. Yes. When Brazil posed them during the consultations, the United States immediately objected to questions about commodities other than cotton as being outside the scope of the consultations (as paragraph 94 of Brazil's oral statement acknowledges).

**9. How does the United States respond to paragraph 94 of Brazil's oral statement? USA**

18. It is incumbent on the complaining party to identify the specific measure at issue, and it should not fall to the responding party to intuit that measures not specified in the request for consultations are considered included by the complaining party. This deprives the responding party of an opportunity to understand the measures that are at issue and to enjoy the benefit of appropriate consultations. In the final analysis, Brazil essentially argues that its consultation questions and statement at consultations could expand the scope of the measures at issue as identified in its consultation request beyond "export credit guarantees . . . to facilitate the export of US upland cotton." This is not the case. (For further information, please refer to the US answer to Question 3.)

**10. What actual prejudice, if any, has the United States suffered as a result of the alleged omission of products other than upland cotton from the request for consultations? USA**

19. The issue of prejudice is not relevant to the question of whether a measure not consulted upon may be the subject of panel proceedings. The requirement of consultations at the beginning of a dispute is a central characteristic of the dispute settlement system, and is reflected throughout DSU Article 4. Consultations serve a number of important functions, including helping the parties to understand each others' concerns and aiding in efforts to resolve the dispute. The DSU affirms the importance of consultations and *requires* that a Member cannot proceed to a panel unless the Member has consulted on that measure.

20. Article 4.4 delimits the scope of the consultations through its requirement that the complaining Member identify the measures at issue. In light of the jurisdictional nature of the consultation requirement, Article 4.4's explicit requirement that the measures be identified serves the useful role of establishing a bright line as to the matters which are within the scope of the consultations and the dispute. Any resort to an analysis of what topics were actually discussed at the consultations – beyond conflicting with the DSU Article 4.6 requirement that consultations "shall be confidential," designed to facilitate the resolution of the dispute – would invite litigation over the unverifiable recollections of each party.

21. The United States notes that in past disputes in which the scope of the dispute was at issue, it was accepted as a given that the consultation request defined the scope of the consultations. For example, in the *US – Import Measures* dispute, the European Communities did not assert that US actions taken on 19 April 1999 were the subject of consultations even though consultations took place two days later, on 21 April 1999. Instead, accepting that its 4 March 1999, consultation request delimited the scope of the consultations, and could not have covered measures taken after that time,

the EC argued (unsuccessfully) that the April 19 actions were the same measure as that identified in the 4 March consultation request.[6]

22. Brazil's consultation request identified export credit guarantees on upland cotton as the sole export credit guarantee measures within the scope of the consultations and, hence, the dispute. Had it wished to include export credit guarantees with respect to other products within the scope of the consultations, Brazil could have re-filed its consultation request to include these guarantees, much as other Members have re-filed consultation requests when they have wished to expand the scope of the dispute.[7] Brazil chose not to, instead apparently hoping to be relieved of the procedural requirements of the DSU, requirements enforced with respect to, and taken seriously by, other Members.[8]

23. While prejudice is not relevant to whether the scope of this dispute includes export credit guarantees for products other than upland cotton, the United States observes that, not only *has* it suffered prejudice as a result of Brazil's omission of allegations concerning products other than upland cotton, but more importantly, the United States *will* suffer even further prejudice if it is compelled to respond to allegations that Brazil never properly included in its request for consultations. The United States has suffered an inability to prepare, respond, and consult with respect to allegations on measures never presented to the United States in accordance with the DSU. The United States was entitled to rely on the measures identified by Brazil in its request for consultations and also rely on that which Brazil declined to put at issue by its failure to so state in its request. This justifiable reliance is furthered by Brazil's failure to amend its request for consultations after ample notice from the United States of its reasonable understanding of Brazil's request.

24. Consequently, the US has not had proper opportunity to consult with respect to the application of the three separate export credit guarantee programmes and their specific application to the myriad of commodities exported in connection with these programmes nor with respect to the conformity of the WTO obligations of the United States with the application of such programmes to such commodities. If export credit guarantees with respect to other eligible commodities were now included in this dispute, the United States will suffer the prejudice of having to prepare and defend its actions in a severely compressed time frame without the benefit of any consultations whatsoever.

**11. Does the United States agree that Brazil's request for establishment of the Panel can be understood to indicate that Brazil's export credit guarantee claims relates to products other than upland cotton? How, if at all, is this relevant? USA**

25. Brazil's panel request changed the language relating to export credit guarantees to include the words "other eligible agricultural commodities." However, Brazil may not unilaterally alter the scope of the "measures at issue" in its panel request simply by adding measures not previously identified. Thus, while Brazil would have been free to add additional *claims* in its panel request, it was not free to broaden the scope of the challenged *measures*.

26. Indeed, Brazil and at least one third party have argued that in two SPS disputes between the United States and Japan panels found that a complaining party may introduce new claims in its panel

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[6] Appellate Body report, *United States - Import Measures on Certain Products of the European Communities*, WT/DS165/AB/R, adopted 10 January 2001, para.70.

[7] *See, e.g.*, WT/DS204/1& WT/DS204/1/Add.1 (consultation request supplemented to add measures); WT/DS174/1 & WT/DS174/1/Add.1 (consultation request to add consultations under additional covered agreement).

[8] The United States refers the Panel to the preliminary ruling of the panel in the *Canada Wheat Board* dispute, WT/DS276/12, which necessitated the refiling of the US panel request and establishment of a second panel. Likewise, the United States refers the panel to India's refiling of its panel request in the *US Rules of Origin* dispute (WT/DS243/5/Rev.1) when made aware of deficiencies in that request at the DSB meeting at which the request was considered. *See also* WT/DS210/2 & WT/DS210/2/Rev.1.

request that were not included in its consultation request. In both of these cases, Japan argued that the United States could not introduce new claims (cite to new legal provisions) not in its consultation request. The United States argued, and both panels agreed, that every legal claim need not be included in the consultation request. However, these disputes are not relevant here because they did not involve identifying a new *measure* in the panel request. As noted in the 3d party oral statement of Benin, "claims" and "measures" are distinct concepts; indeed, the distinction between "claims" and "measures" is fundamental.[9]

**12. Please address issues and submit evidence regarding the three export credit guarantee programmes concerned relating to upland cotton and other eligible agricultural commodities in your answers to questions and rebuttal submissions. BRA, USA**

27. In light of the Panel's preliminary ruling and without prejudice to the US position that these measures are not within the scope of this dispute, the United States will respond to Brazil's arguments in the US submissions.

**13. Please include any argumentation and evidence to support your statement during the Panel meeting that the inclusion of such other eligible agricultural commodities would create additional "work" for the Panel with respect to each of these commodities under Article 13 of the Agreement on Agriculture. USA**

28. Article 10.2 defers disciplines on, *inter alia*, export credit guarantees until such time as internationally agreed disciplines are reached – as Members hope to do in the Doha Development Round. Therefore, export credit guarantees are not export subsidies within the meaning of the Agriculture Agreement, and Article 13(c) does not apply. However, for purposes of argument, we note that Article 13(c)(ii) of the Agreement on Agriculture provides that:

> (c) export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's schedule, shall be:
>
> * * * * *
>
> (ii) exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5, and 6 of the Subsidies Agreement.

Pursuant to Article 13(c)(ii), to the extent a Member *is* providing export subsidies in conformity with its reduction commitments under Part V of the Agreement on Agriculture, such export subsidies are exempt from action under Article XVI of the GATT and Articles 3, 5, and 6 of the SCM Agreement.

29. Article 13(c) is not relevant with respect to export subsidies granted in connection with commodities not subject to reduction commitments in the applicable schedule of the Member. For example, the United States does not have a reduction commitment with respect to upland cotton. Therefore, the United States may not provide any export subsidy for upland cotton. The Peace Clause protection of Article 13(c) therefore cannot apply to any theoretical export subsidy of the United States for upland cotton.

30. In contrast, however, the United States has reduction commitments for 12 commodities. (Please refer to the response of the United States to Question 7 for a description of how the export subsidy reduction commitments – and therefore export subsidy obligations – of the United States and all other members are, therefore, commodity specific.) Because such commitments are commodity specific, the extent to which Article 13(c)(ii) may apply to export subsidy measures of the United

[9]*See, e.g.*, Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted 25 November 1998, para. 72.

States is also commodity specific. Conformity with WTO obligations and the application of Article 13(c)(ii) to export credit guarantees with respect to those twelve commodities could only be evaluated by an examination of *each* commodity subject to reduction commitments.

*Expired measures*

**14. Please submit evidence regarding the programmes under the 1996 FAIR Act, in particular, production flexibility contract payments and market loss assistance payments, to the extent that they would be relevant to the Panel's determination under Article 13 of the Agreement on Agriculture in your answers to questions and rebuttal submission. USA**

31. The United States will present evidence and arguments regarding payments under the 1996 Act as may be relevant to the Panel's Peace Clause analysis with respect to those measures.

**15. Do the parties agree that it is beyond a Panel's power to recommend a remedy for an expired measure? Could the Panel could be required to examine "expired measures" in order to conduct its assessment of the matter before it? How, if at all, is Article 7.8 of the SCM Agreement relevant to these matters? BRA, USA**

32. The United States agrees that it is beyond a panel's power to recommend that a Member bring into conformity a measure that no longer exists.[10] However, more fundamentally, the issue is whether the expired measures in this dispute could have been measures affecting the operation of any covered agreement within the meaning of DSU Article 4.2 or "measures at issue" within the meaning of DSU Article 6.2. Because the production flexibility contract payments and market loss assistance payments were completed, the programmes terminated, and the statutory instruments providing them superseded before Brazil's consultation and/or panel requests were filed, they could not have been "measures at issue," and they could not properly have been consulted upon or brought within the terms of reference of the Panel. This is a broader concern than whether the Panel may recommend a remedy since findings cannot be made with respect to such expired measures.

33. To determine whether past subsidies may currently be challenged, it is useful to distinguish between recurring and non-recurring subsidies. A non-recurring subsidy is a measure that continues in existence for the duration of the allocation of the subsidy to production.[11] For example, a subsidy to acquire capital stock to be used in future production would be non-recurring and allocated over the useful life of the stock. Where a subsidy is non-recurring and is allocated to future production[12], the measure (subsidy) may continue to be actionable even if the authorizing programme or legislation has expired. For example, in the *Indonesia – Autos* dispute, where a non-recurring subsidy was provided, the panel deemed the measure to continue even though the subsidy programme had allegedly been terminated (and it is worth noting that the termination allegedly occurred well after the panel and consultation requests– in fact, after the second panel meeting).

34. In contrast, a recurring subsidy is typically provided year-after-year and is made in respect of current rather than future production. Once production has occurred and the measure been replaced or

[10]Appellate Body Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R, adopted 10 January 2001, para. 81.

[11]*See, e.g.*, Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures, G/SCM/W/415, para. 12 (25 July 1997) ("Whether a subsidy is oriented towards production in future periods, consists of equity, or is carried forward in the recipient's accounts were viewed as related to the question whether its benefits persist beyond a single period, and hence whether it should be allocated to future periods.").

[12]Subsidies Agreement, Annex IV, para. 7 (referring to "[s]ubsidies . . . the benefits of which are allocated to future production).

superseded, there would no longer be any measure in existence to challenge. Accordingly, a Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures suggested that recurring subsidies – such as grants for purposes other than the purchase of fixed assets and price support payments – should be expensed, or attributed to a single year, rather than allocated over some multi-year period.[13]

35. In the case of production flexibility contract payments and market loss assistance payments, these measures were subsidies allocated to a particular crop or fiscal year by the respective authorizing legislation. Pursuant to the 1996 Act, the last production flexibility contract payment was made for fiscal year 2002 (1 October 2001 – 30 September 2002) "not later than" 30 September 2002.[14] Pursuant to legislation enacted on 13 August 2001, the last market loss assistance payment was for the 2001 marketing year (1 August 2001 – 31 July 2002), that is, for market conditions prevailing in that year.[15] Once the relevant fiscal year and marketing year, respectively, had been completed, these measures would no longer exist. Thus, by the time of Brazil's consultation and/or panel requests, there were no measures to consult upon nor to be at issue under the DSU; production flexibility contracts and market loss assistance payments therefore do not fall within the Panel's terms of reference.

*Agricultural Assistance Act of 2003*

**16. What, if any, prejudice in terms of the presentation of its case does the United States allege, should the Panel proceed to consider the measures constituting the cottonseed payments under the Agricultural Assistance Act of 2003? USA**

36. It has been a fundamental characteristic of both the GATT 1947 and the WTO dispute settlement systems that proposed measures may not be the subject of dispute settlement. This has meant that dispute settlement proceedings, including consultations, could not begin until the measure at issue actually came into existence. In seeking to bring into the scope of this dispute the Agricultural Assistance Act of 2003, Brazil is seeking to fundamentally expand and change the nature of WTO dispute settlement. This issue goes well beyond the question of whether a particular responding party is prejudiced in a particular dispute and cannot be resolved on the basis of whether such prejudice has occurred. The reasons that the United States would be prejudiced if the Panel considered any measure under the Agricultural Assistance Act of 2003, including a cottonseed payment under that Act, are the reasons that the dispute settlement system has been organized to only allow proceedings on actual, not proposed, measures. First, the responding party would have lost the benefit of consultations on these measures. Consultations serve a number of important functions, including helping the parties to understand each others' concerns and aiding in efforts to resolve the dispute. The DSU affirms the importance of consultations and *requires* that a Member cannot proceed to a panel unless the Member has consulted on that measure. Likewise, the DSU requires that the "measures at issue" be identified in the panel request, and non-existent measures quite simply are not measures at all.

37. Apart from reflecting the importance Members have placed on consultations, the DSU's requirement that a measure exist before it can be the subject of dispute settlement proceedings avoids a waste of resources since anticipated measures may never come into effect, or may, when enacted, be in substantially changed form. Further, allowing challenges to measures not yet in existence would

[13]G/SCM/W/415, paras. 1-12; *id.*, Recommendation 1, at 26-27.

[14]Federal Agriculture Improvement and Reform Act of 1996, § 112(d)(1), Public Law No. 104-127 (4 April 1996); 7 US Code § 7212(d)(1).

[15]Public Law No. 107-25, § 1(a) (23 Aug. 2001) ("The Secretary of Agriculture . . . shall, to the maximum extent practicable, use $4,622,240,000 of funds of the Commodity Credit Corporation to make a market loss assistance payment to owners and producers on a farm that are eligible for a final payment for fiscal year 2001 under a production flexibility contract for the farm under the Agriculture Market Transition Act.").

effectively authorize panels to issue advisory opinions. Should Members desire to expand the scope of the dispute settlement system in this manner, they may do so – indeed could only do so – through amendment of the DSU. The DSU now requires the existence of a measure before consultations may be requested or a panel established.

38. Finally, were the issue of the specific prejudice to the United States relevant in deciding whether a panel's terms of reference could include a measure not in existence at the time of consultations or the panel request, the United States notes that this dispute is already complex, with multiple measures at issue involving multiple claims. To require the United States to address Brazil's allegations on the Agricultural Assistance Act of 2003 would detract from the time and resources available to respond to questions and make arguments relating to those measures that *are* properly within the terms of reference.

**17. (a) What is the relationship of the Agricultural Assistance Act of 2003 to other legislation in the request for establishment of the Panel? BRA, USA**

**(b) Do the legal instruments follow directly one after another, or are there temporal gaps? Are payments authorized under a broad legislative authority or are they specific to each legal instrument? BRA, USA**

**(c) Please provide any implementing regulations. Do these implementing regulations resemble those relating to previous programmes or payments? Are payments made retrospectively? How if at all is this relevant? BRA, USA**

39. (a) The Agricultural Assistance Act of 2003[16] was part of a large piece of legislation covering a diverse range of topics. The Act had several disaster provisions including some relief for sugar interests and more generalized relief for persons who lost other crops. One of the provisions provided for a cottonseed payment to be applied to the 2002 cotton crop (the crop that was harvested in that calendar year):

> Sec. 206. COTTONSEED. The Secretary shall use $50,000,000 of funds of the Commodity Credit Corporation to provide assistance to producers and first-handlers of the 2002 crop of cottonseed.

No law compelled or authorized the cottonseed payment for the 2002 crop except for the 2003 Act, which bears no relation to other legislation cited by Brazil.

40. There was no cottonseed payment authorized in either 2002 or 2001 for the 2001 crop. Cottonseed payments were made for the 1999 and 2000 crops. Of the three pieces of legislation authorizing cottonseed payments for the 1999 and 2000 crops, only one arguably may be found in Brazil's consultation and panel requests. Brazil identifies the "Crop Year 2001 Agricultural Economic Assistance Act (August 2001)" as a challenged measure. The Emergency Agricultural Assistance Act, Public Law No. 107-25 (13 August 2001), authorized a cottonseed payment of $85 million. In addition, Section 204(e) of Public Law No. 106-224, enacted 20 June 2000, directed the Secretary to use $100 million of Commodity Credit Corporation (CCC) funds to provide assistance to producers and first handlers of the 2000 crop of cottonseed. Finally, the cottonseed payment for the 1999 crop was authorized by section 104(a) of Public Law No. 106-113, enacted 19 Nov. 1999; $79 million in residual funds were used for the 1999 crop programme.

41. (b) The temporal gaps between the various cottonseed payments are indicated in the answer to (a), above. That is, no cottonseed payments were made in 2001 or 2002 for the 2001 crop (nor

[16]Public Law No. 108-7 (Feb. 23, 2003).

prior to 1999). This gap serves to emphasize that these payments are *ad hoc*, and there was no legislative guarantee that there would be a payment for any of the years involved until the payment was actually authorized. Thus, what Brazil has termed the "cottonseed programme" is readily distinguished from those programmes under the 2002 Act that recur for each crop harvested from 2002 through 2007.[17] In contrast, the legal authority for each cottonseed payment was separate and distinct; no underlying piece of legislation mandated that cottonseed payments be made.

42. (c) We note that each time a cottonseed payment is authorized, new rules must be issued to disburse the funds because there is no ongoing cottonseed "programme"; thus, when new rules are issued, the old rules are either removed at the same time or had been removed previously. That is, there is no publication that included rules for all three programmes.

43. The cottonseed payment under the 2003 Agricultural Assistance Act is not related to the other cottonseed payments except by subject matter. As indicated at the panel hearing, the text in the Agricultural Assistance Act (quoted above) is broad and simple, leaving much to the Department of Agriculture. Because of the discretion vested in the Secretary to disburse the 2002 crop cottonseed payment, and for reasons of administrative convenience, the 2003 regulations borrow from the regulations that implemented the cottonseed payments for the 2000 crop and for the 1999 crop. On 25 April 2003, the Department published regulations at 68 Federal Register 20331 to disburse funds in respect of the 2002 crop.[18] The regulations to disburse the 2000 crop cottonseed payment were published at 65 Federal Register 65718 (2 November 2000).[19] The regulations to disburse the 1999 crop cottonseed payment were published on 8 June 2000 at 65 Federal Register 36550.[20]

*ARTICLE 13(B): DOMESTIC SUPPORT MEASURES*

*"exempt from actions"*

**20. In paragraph 8 of its initial brief (dated 5 June, 2003), the United States argued that the word "actions" as used in the phrase "exempt from actions" in Article 13 of the Agreement on Agriculture includes the "bringing of a case" and consultations. In paragraph 36 of its first written submission (dated 11 July, 2003), the United States stated as follows:**

**"[P]rior to this point in the process, the DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause."**

**Is it the United States' understanding that the drafters used the phrase "exempt from actions" knowing that under the DSU it would not be possible fully to exempt "actions", as the United States interprets that term? USA**

44. There is a difference between a commitment to exempt from action and the mechanism to enforce that commitment, just as there is a difference between rights and obligations under the WTO and the mechanism to enforce those rights and obligations. For example, where one Member

[17]Farm Bills are initiated by Agricultural Committees of the US Congress and recur every 5 or 6 years. Programmes provided for in a Farm Bill are generally not tied to finite amounts of money but rather make use of the funds of the Commodity Credit Corporation (CCC), which has borrowing authority in the US Treasury. *See* 15 US Code § 713 a-11 *et seq.* As a result, no appropriation is needed. By contrast, cottonseed payments (similar to other disaster payments) are *ad hoc* with targeted monies.

[18]Exhibit US-14.

[19]Exhibit US-15.

[20]Exhibit US-16.

breaches a tariff binding, another Member will need to resort to dispute settlement in order to resolve the issue. This does not mean that it is not possible to fully obligate the Member to observe its tariff bindings. The similar situation arises with respect to procedural obligations as well.

45. When responding Members have been confronted by situations in which they considered that complaining parties did not meet requirements for invoking dispute settlement procedures, those responding Members can voice their objections at consultations and the DSB meetings at which panel establishment has been considered, but then must accept that the issue will ultimately be decided by the panel. For example, notwithstanding that the DSU requires consultations on a measure before a panel may be established, there is no mechanism available to address a complaining party's failure to consult absent resolution by a panel.

46. Responding Members have allowed jurisdictional issues to go to the panel for resolution as a practical way forward that offers sufficient protection for their interests while also protecting the integrity of the dispute settlement system. This does not mean that responding Members in any way lost their rights, for example, to consult on the measures at issue before being subject to panel proceedings; it has simply been practical to allow the issue to be decided by panels.

47. Likewise, in this dispute, the fact that Brazil has attempted improperly to invoke dispute settlement procedures notwithstanding the Peace Clause – and the fact that the United States has accepted that the issue should be resolved by the Panel – does not and cannot diminish the right of the United States to be exempt from Brazil's action. The fact that Members may disregard their obligations, or act based on a misunderstanding of the facts or obligations, does not affect those obligations. In this case, Brazil considers that the Peace Clause is inapplicable. As our argumentation to date indicates, we disagree and consider that, based on a correct reading of the law and facts, the Peace Clause is applicable, and Brazil was obliged not to bring this dispute. Upon making a finding on this issue in our favour, the Panel would effectively be concluding that Brazil's invocation of dispute settlement was improper – even if undertaken in good faith – just as panels have in the past concluded that complaining parties have improperly included measures that were not consulted upon in their panel requests or claims that were not within the panel's terms of reference in their argumentation.

**21. In US - FSC and US - FSC (21.5) the Appellate Body made findings under the SCM Agreement relating to export subsidies in respect of agricultural products without making a finding in respect of Article 13 of the Agreement on Agriculture. How is this relevant to the United States' interpretation of the phrase "exempt from actions" as used in Article 13? USA**

48. The FSC findings are not relevant since they do not address the Peace Clause issue. The issue was not raised by either party, and so neither the panel nor the Appellate Body made any finding with respect to Article 13, nor did they offer any reasoning on this issue. Indeed, in the absence of any party raising or arguing this issue, it would be difficult to see how the panel or Appellate Body could have made any findings concerning Article 13. Those DSB recommendations and rulings thus provide no guidance for purposes of this dispute.

*"such measures" and Annex 2 of the Agreement on Agriculture*

**22. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture. BRA, USA**

49. These terms should be interpreted according to the customary rules of interpretation of public international law. The ordinary meaning of "defined" is "clearly marked, definite" and "set out

precisely."[21] "Fixed" means "stationary or unchanging in relative position."[22] Thus, as used in paragraph 6(a), a "defined and fixed base period" means a base period that is "set out precisely" and "stationary or unchanging in relative position." That is, the "definite" base period must not be "changing in relative position"; for example, the "base period" for purposes of determining "base acres" for the deficiency payments under the 1990 Act was a farm's average acreage over the three most recent years[23], and so, was not a "fixed" base period but a moving one. On the other hand, US direct payments satisfy this criterion because eligibility is determined by historical production of any of a number of crops (including upland cotton) in a base period that is "definite" (set out in the 2002 Act) and "stationary or unchanging in a relative position" (does not change in relative position for the duration of the 2002 Act).

**23. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. BRA, USA**

50. Paragraph 6(a) establishes that eligibility for payments under a decoupled income support measure shall be determined by clearly-defined criteria in "*a* defined and fixed base period." That is, paragraph 6(a) does not mandate that any particular base period be used for a decoupled income support measure and does not mandate that the same base period be used for all decoupled income support measures. This contrasts with the use of the phrase "*the* base period" in paragraph 9 of Annex 3, which is defined in that same paragraph as "the years 1986 to 1988."[24]

51. Paragraphs 6(b), (c), and (d) use the term "*the* base period." As these subparagraphs all follow paragraph 6(a), in which eligibility is set in "a" defined and fixed base period, the later references to "the base period" should be read to refer to the base period used for eligibility under paragraph 6(a). Again, because paragraph 6(a) does not mandate that any particular base period be used (as opposed to paragraph 9 of Annex 3), "the base period" for paragraphs 6(b), (c), and (d) will be the "defined and fixed base period" used for purposes of eligibility under the decoupled income support measure. The definite article "the" is commonly used to refer back to a member of a indefinite set identified by the indefinite article "a." For example, it would be common grammatically to say: "A Member may take action if the Member makes the appropriate notification to the WTO."

**24. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture? BRA, USA**

52. Paragraph 6 establishes policy-specific criteria applying to a decoupled income support measure. Under paragraph 6(a), eligibility for payments under such a measure shall be determined by criteria "in a defined and fixed base period." Other policy-specific criteria under paragraph 6 establish that the amount of payments under a decoupled income support measure shall not be related to or based on the type or volume of production, the prices, or the factors of production employed in any year after the base period used for purposes of determining eligibility under paragraph 6(a).

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[21]*The New Shorter Oxford English Dictionary*, vol. 1, at 618 (1993 ed.).

[22]*The New Shorter Oxford English Dictionary*, vol. 1, at 962 (1993 ed.).

[23]*See* US First Written Submission, para. 101 n. 92.

[24]Agriculture Agreement, Annex 3, paragraph 9 ("The fixed external reference price *shall be based on the years 1986 to 1988* and shall generally be the average f.o.b. unit value for the basic agricultural product concerned in a net exporting country and the average c.i.f. unit value for the basic agricultural product concerned in a net importing country *in the base period*.") (emphasis added). *See also id.*, Annex 3, paragraph 5 ("The AMS calculated as outlined below for *the* base period shall constitute the base level for the implementation of the reduction commitment on domestic support.") (emphasis added). Appellate Body Report, *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef* , WT/DS161/AB/R - WT/DS169/AB/R, adopted 10 January 2001, paras. 115-16.

Thus, with respect to a decoupled income support measure, the base period used must be "defined and fixed."

53. There is no requirement in paragraph 6 that a *particular* base period be used for a decoupled income support measure nor that the *same* base period be used for purposes of every decoupled income support measure. Thus, so long as the base period for a particular measure is "defined and fixed," this element of the policy-specific criteria in paragraph 6 will be met.

54. For purposes of this dispute, the base period for US direct payments under the 2002 Act is defined by the 2002 Act and fixed for the duration of the 2002 Act – that is, for marketing years 2002-2007. Thus, one "defined and fixed base period" applies for payments under the US direct payment programme for the six-year period to which the 2002 Act applies.

**25. Does the United States consider that there is any ambiguity in the term "type of production" as used in paragraph 6(b) of Annex 2 of the Agreement on Agriculture? USA**

55. When read according to the customary rules of interpretation of public international law, the United States does not consider that the meaning of the term "type . . . of production" as used in paragraph 6(b) is ambiguous or obscure. This paragraph establishes that the amount of decoupled income support payments may not be "based on, or linked to, the type or volume of production . . . undertaken in any year after the base period." Interpreted according to the ordinary meaning of the terms, in context, and in light of the object and purpose of the Agriculture Agreement, this provision means that a decoupled income support measure may not base or link payments to production requirements, whether by type or volume.

**26. Can the United States confirm Brazil's assertions in paragraph 174 of its first written submission that the implementing regulations for direct payments prohibit or limit payments if base acreage is used for the production of certain crops? If so, can the United States clarify the statement in paragraph 56 of its first written submission that direct payments are made regardless of what is currently produced on those acres? Can the United States confirm the same point in relation to production flexibility contracts? USA**

56. The 2002 Act allows any commodity or crop to be planted on base acres on a farm for which direct payments are made with limitations regarding certain commodities. Those commodities are fruits, vegetables (other than lentils, mung beans, and dry peas), and wild rice. Planting of those commodities on base acres is prohibited, except: (1) in a region with a history of double-cropping those commodities with those crops the historical production of which makes acres eligible for direct payments, double-cropping is permitted; (2) on a farm with a history of planting those commodities, planting is permitted, and direct payments would be reduced for every acre so planted; and (3) for a producer with a history of planting those commodities, planting is permitted, and direct payments would be reduced for every acre so planted.[25]

57. To be more precise, the third sentence of paragraph 56 of the US first submission should have used the phrase "whether upland cotton" in place of "what." As the United States has previously indicated,[26] direct payments are not "related to, or based on, the type or volume" of current production

[25]Farm Security and Rural Investment Act of 2002, § 1106 ("2002 Act") (Ex. US-1).

[26]US First Submission, para. 22 ("These [direct] payments are made with respect to farm acreage that was devoted to agricultural production in the past; the payments, however, are made regardless of whether upland cotton is currently produced on those acres or whether anything is produced at all."); *id.*, para. 24 ("As stated, no current production of upland cotton (or any other crop) is required to receive payment – or, put another way, the payment is the same regardless of how much, or any, upland cotton is produced."); *id.*, para. 67 ("Not only is there no requirement that a direct payment recipient engage in any particular type or volume of

because there is *no requirement* that a recipient produce upland cotton or any other crop in order to receive these payments. Direct payments are made with respect to farm acreage that was devoted to agricultural production in the past. In its rebuttal submission, the United States will describe production flexibility contract payments, which would share these characteristics but not others with direct payments, and explain why production flexibility contract payments are "green box" measures.

**29. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the Agreement on Agriculture. USA**

58. "Fundamental" means "[s]erving as the base or foundation" and "primary, original; from which others are derived."[27] A "requirement" is "[s]omething called for or demanded."[28] Thus, the "fundamental requirement" that measures for which exemption from reduction commitments under Article 6 is claimed must have "no, or at most minimal, trade-distorting effects or effects on production" is "something called for or demanded" "from which others are derived."

59. The United States, perhaps in distinction from the European Communities, does not view this "requirement" ("something called for or demanded") as merely setting out in hortatory terms the objective of Annex 2. However, as suggested by the use of the word "fundamental" ("from which others are derived") and the structure of Annex 2 (that is, beginning the second sentence with the word "accordingly"), compliance with the fundamental requirement of the first sentence will be demonstrated by conforming to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraph 6 through 13. Relevant context supports this interpretation: Articles 6.1, 7.1, and 7.2 refer to measures which are not subject to reduction commitments because they qualify under "*the criteria* set out in Annex 2." Article 18.3 requires a Member to notify "details of the new or modified measure and its conformity with the *agreed criteria* as set out either in Article 6 or in Annex 2." Annex 2 itself, in describing the policy-specific criteria that must be met under paragraphs 2 and 5, emphasizes that measures must meet the "*basic criteria* set out in paragraph 1" rather than the "fundamental requirement" of that paragraph.

60. The text and context of paragraph 1 is also confirmed by the object and purpose of the Agriculture Agreement. Members need to be able to design green box measures with certainty that these measures will be exempt from reduction commitments so that they can meet their binding commitments on domestic support in furtherance of the goal of "substantial progressive reductions in agricultural support . . . sustained over an agreed period of time."[29] Assessing the conformity of a claimed green box measure against the "fundamental requirement" of the first sentence in isolation would be a difficult, if not impossible task, for a Panel. Members foresaw the problem and therefore provided guidance on how a measure would fulfill that fundamental requirement – that is, if the measures "conform to the . . . basic criteria" of the second sentence plus any applicable policy-specific criteria, they shall be deemed to have met the fundamental requirement of the first sentence of Annex 2.

**30. Do the parties consider that direct payments and production flexibility contract payments meet or met the basic criteria referred to in paragraph 1 of Annex 2 of the Agreement on Agriculture? BRA, USA**

61. The "basic criteria" referred to in paragraph 1 of Annex 2 are: (a) the support in question shall be provided through a publicly-funded government programme (including government revenue

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production, a recipient need not engage in any current agricultural production in order to receive the direct payment."); US Opening Statement at the First Panel Meeting, para. 18 ("The payments, however, are made regardless of whether cotton is currently produced on those acres or whether anything is produced at all.").

[27]*The New Shorter Oxford English Dictionary*, vol. 1, at 1042 (1993 ed.)

[28]*The New Shorter Oxford English Dictionary*, vol. 2, at 2557 (1993 ed.)

[29]Agriculture Agreement, preamble.

foregone) not involving transfers from consumers and (b) the support in question shall not have the effect of providing price support to producers. Direct payments under the 2002 Act meet these basic criteria, and the expired production flexibility contract payments under the 1996 Act met these criteria as well.

62. As noted in the US first written submission, direct payments under the 2002 Act are support provided through a publicly-funded government programme not involving transfers from consumers. Under Section 1103 of the 2002 Act, the Secretary of Agriculture "shall make direct payments to producers on farms [including landowners where no production occurs] for which payment yields and base acres are established," and, under Section 1601 of the Act, the Secretary "shall use the funds, facilities, and authorities of the Commodity Credit Corporation to carry out this title." Thus, no transfers from consumers are involved.[30]

63. Direct payments under the 2002 Act also do not have the effect of providing price support to producers. Direct payments augment the income of persons on farms based on historic acres and yields. They are not made to support any "applied administered price" for upland cotton (or that for any other commodity), for example, by increasing upland cotton demand or reducing upland cotton supply.[31] To-date, Brazil has not contested that US direct payments satisfy both "basic criteria" under paragraph 1.

64. As set out in the US answer to Question 15 from the Panel, the expired production flexibility contract payments are not within the Panel's terms of reference. Nonetheless, as we shall explain in more detail in our rebuttal submission, these payments too satisfy the "basic criteria" referred to in paragraph 1 of Annex 2. Production flexibility contract payments provide support through a publicly-funded government programme not involving transfers from consumers.[32] In addition, production flexibility contract payments did not have the effect of providing price support to producers; these payments augmented the income of persons on farms based on historic acres and yields but were not made to support any "applied administered price" for upland cotton (or that for any other commodity). Again, Brazil has not contested that US production flexibility contract payments satisfy both "basic criteria" under paragraph 1.

**31. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? BRA, USA**

65. As set out in the US answer to Question 29 from the Panel, the United States views the first sentence of paragraph 1 as an obligation in that it establishes a "fundamental requirement" for green box measures under Annex 2. This obligation is met when measures conform to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6 through 13. If a new measure does not conform to the basic and applicable policy-specific criteria in Annex 2, it will not have the benefit of the presumption that it meets the fundamental requirement of the first sentence.

**32. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. USA**

[30]*See* US First Written Submission, para. 65.

[31]*See* US First Written Submission, para. 66.

[32]Federal Agricultural Improvement Act of 1996, Title I, § 161(a) ("Use of Commodity Credit Corporation. — The Secretary shall carry out this title through the Commodity Credit Corporation."); *id.*, Title I, § 111 (providing for production flexibility contract payments).

66. As set out in the US answer to Question 29 from the Panel, the United States does not view the first sentence of paragraph 1 as merely setting out a general principle; according to its term, it establishes a "fundamental requirement" for green box measures under Annex 2. However, Annex 2 also indicates that measures that conform to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6 through 13 comply with that fundamental requirement. Thus, the first sentence of paragraph 1 provides important context for the interpretation of other provisions of Annex 2.

67. US direct payments satisfy the criteria set out in Annex 2 and therefore comply with the fundamental requirement of the first sentence of paragraph 1. As explained in the US answer to Question 30, US direct payments satisfy the two basic criteria under the second sentence of paragraph 1. In addition, as set out in the US first written submission,[33] direct payments satisfy the five policy-specific criteria set out in paragraph 6 of Annex 2 for decoupled income support.

68. The context provided by the first sentence of paragraph 1 indicates that Brazil's argument that direct payments do not satisfy paragraph 6(b) because payments are eliminated or reduced if payment recipients harvest certain fruits or vegetables is wrong.[34] Brazil's argument essentially is that paragraph 6(b) precludes a Member from requiring a recipient *not* to produce certain crops, rather than precluding a Member from requiring a recipient *to* produce certain crops. As indicated above, however, Brazil's interpretation leads to a conflict between paragraph 6(b) and the fundamental requirement of the first sentence. That is, a measure that demonstrably meets that fundamental requirement (there are no trade-distorting effects or effects on production because production of no crop is allowed) would be inconsistent with paragraph 6(b) (the amount of payment would be based on the type of production – production of no crops – in a year after the base period). In the context of the first sentence of paragraph 1, then, paragraph 6(b) should be read to prevent a Member from requiring a recipient *to produce* certain crops. US direct payments do not require a recipient to produce upland cotton or any other crop in order to receive payment.

*"do not grant support to a specific commodity"*

**33. According to the United States' interpretation of the word "grant", when can a Member claim that a measure is not exempt from action under Article 13(b)? What if the measure is enacted annually? Can the Member obtain a remedy in respect of that measure under the DSU? USA**

69. The United States has interpreted the word "grant" according to its ordinary meaning: to "bestow as a favour" or "give or confer (a possession, a right, etc.) formally."[35] Because the phrase "such measures do not grant support to a specific commodity" is expressed in the present tense, we have explained that this criterion indicates that whether measures currently in effect are exempt from actions depends upon the support they currently grant.[36] For example, whether payments under the 2002 Act can be challenged in the WTO at this time requires an examination of the product-specific support such measures currently grant (understood to be as of the date of the panel request or panel establishment), not the support measures granted 1, 2, or 3 years ago. A finding of a Peace Clause breach by current measures would allow a Member to proceed with an action based on Peace Clause-specified provisions and potentially obtain remedies with respect to those current subsidies.

70. A Member can make the claim that a measure is not exempt from action under Article 13(b) when the Member believes the measures at issue fail to conform to the Peace Clause, including that the Member believes the measure provides support in excess of that decided in 1992. It would not

[33]US First Written Submission, para. 67.
[34]*See also* US Answer to Question 25 from the Panel.
[35]*The New Shorter Oxford English Dictionary*, vol. 1, at 1131 (fourth & fifth definitions).
[36]US First Written Submission, paras. 79-81.

matter whether the measure were enacted annually. If there were a finding of a breach of the Peace Clause, then the complaining party could obtain a remedy in the form of a recommendation to bring the measure into conformity with the WTO agreements.

71. The issue of when a Member can claim that a measure is not exempt from action highlights the difficulty in adopting Brazil's interpretation that *only* budgetary outlays are relevant to the Peace Clause comparison. In the case of US domestic support measures, budgetary outlays are not known ahead of time. Accordingly, Brazil could only provide *estimates* of marketing year 2002 budgetary outlays in its first submission, explaining that "the evidence to tabulate the support granted to upland cotton during MY 2002 is not yet complete as the marketing year does not end until 31 July 2003."[37] Brazil has not demonstrated that US product-specific budgetary outlays for upland cotton exceeded marketing year 1992 outlays as of the time of its panel request, as of the time of panel establishment, nor, indeed, as of today.[38]

72. This problem is not presented when one looks at the support *as decided by* US domestic support measures. Because those measures, both in 1992 and today, set a rate of support (72.9 cents per pound during marketing year 1992; 52 cents per pound during marketing year 2002), the level of support is known at the outset (or even in advance) of the relevant crop year in which payments are made, permitting a rapid challenge and perhaps panel findings before a given crop year is over. Thus, a Member *would* be able to claim that a current measure is not exempt from action under Article 13(b) and *would* be able to obtain a remedy under the DSU.

**35. Does a failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? BRA, USA**

73. A failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) would only lift the exemption from action for those measures for the year of that breach. Measures (subsidies) in a later year would remain exempt from action so long as those measures in the given year comply with the conditions in Article 13(b)(ii).

74. This conclusion flows from the text of the Peace Clause as well as the nature of the subsidies challenged by Brazil. The universe of measures exempt from actions under Article 13(b)(ii) is "domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6." Because the fundamental commitment under Article 6 is to limit domestic support as measured by the Current Total Aggregate Measurement of Support to a Member's final bound commitment level, and that commitment is judged on a year-by-year basis[39], a Member may breach its commitments under Article 6 in one year and come back into compliance in the following year. Thus, conformity with this element of Article 13 must be judged on a year-by-year basis.

75. The proviso to Article 13 states that such measures shall be exempt from actions "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year." Thus, with respect to past subsidies (and putting aside the issue of whether there is a measure that can be challenged under the DSU), the Peace Clause proviso would require an

[37]Brazil's First Written Submission, para. 149.

[38]*See* US Answer to Question 67 from the Panel.

[39]Agriculture Agreement, Article 6.3 ("A Member shall be considered to be in compliance with its domestic support reduction commitments *in any year* in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule.") (emphasis added).

examination of the support those measures were granting as of the time such measures were in existence. Were the Peace Clause breached in any particular year, a Member could bring an action against such measure (subsidy), but only for the year of the breach. For example, where subsidies were provided on a yearly basis, a Member could breach the Peace Clause in one year in which the support such measures grant is in excess of that decided during the 1992 marketing year but could be in conformity in the following year if support were again within the 1992 marketing year level. Only the subsidies for the year in which the Peace Clause were breached would not be exempt from actions.

76. Finally, we note that payments under the 2002 Act are recurring subsidies, expensed in the crop year to which they apply and superseded by new payments in the following crop year.[40] (So too were past payments under the expired 1996 Act.) Thus, whether such measures conform fully to Article 6 and do not grant support in excess of that decided during the 1992 marketing year – that is, whether such measures are exempt from action under Article 13(b) – must be judged on a year-by-year basis. A breach of the Peace Clause in any particular year would allow a Member to bring an action against such measures, but only for the year of the breach.

**36. Does a failure by a Member to comply with Article 13(b) in respect of a specific commodity impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? BRA, USA**

77. No. For example, were the Panel to find a breach of the Peace Clause because the product-specific support US measures grant for upland cotton is in excess of that decided during the 1992 marketing year, this would not remove Peace Clause protection for support for soybeans (or any other commodity). In any subsequent action, a complaining Member would have to demonstrate that the challenged measures breach the Peace Clause with respect to that commodity and support.

**37. In the United States' view, why did the drafters not use the exact term "product-specific" in Article 13(b)(ii)? USA**

78. It is not possible to determine exactly why the drafters of Article 13(b)(ii) did not use the term "product-specific support" in place of "support to a specific commodity." Nonetheless, the phrase "support to a specific commodity" must be interpreted according to its ordinary meaning, in context, and in light of the object and purpose of the Agreement. As the United States has explained, this phrase means "product-specific support."[41] We note that while it is no doubt a good *drafting* rule to use one and only one term for any given concept in an agreement, the drafters' failure to follow that rule does not alter a treaty *interpreter's* obligation to interpret under the customary rules of public international law the words that actually are in the treaty.

79. Further, it is not surprising that this exact phrase is not used in the Peace Clause. The phrase "product-specific support" is not a defined term to be found in Agriculture Agreement Article 1. Not surprisingly, then, in different provisions the Agriculture Agreement uses different words to describe the concept of product-specific support. For example, in Article 1(a), the basic definition of product-specific support (although not identified as such) is given as "support . . . provided *for* an agricultural product in favour of the *producers* of the basic agricultural product." In Article 1(h), the Agreement again refers to product-specific support not by using that term but by using the words "support for basic agricultural products."[42] None of these references to "product-specific support" even uses the term "specific" whereas the phrase "support to a specific commodity" contains all three elements of that phrase (that is, product, specific, and support), using "commodity" in place of

[40]*See* US Answer to Question 15 from the Panel.

[41]US First Written Submission, paras. 77-78.

[42]Similarly, in Annex 3, paragraph 6, the Agreement refers to a "product-specific" AMS not by using those words but by using the phrase "for each basic agricultural product, a specific AMS shall be established."

"support."[43] The use of the phrase "support to a specific commodity" in the Peace Clause to refer to "product-specific support" is not remarkable in light of these multiple examples of different words in the Agreement that describe the same concept.[44]

**38. Given the fact that subsidies available for more than one product could have various effects on production, how does the United States demarcate between product-specific support and non-product specific support ? USA**

80. The phrase "support to a specific commodity" in the Peace Clause proviso, read according to its ordinary meaning, in context, and in light of the object and purpose of the Agreement, means "product-specific support." The United States finds the demarcation between product-specific and non-product-specific support in the Agriculture Agreement. Specifically, Article 1(a) defines the universe of support making up the Aggregate Measurement of Support as follows:

> "Aggregate Measurement of Support" and "AMS" mean the annual level of *support,* expressed in monetary terms, *provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general,* other than support provided under programmes that qualify as exempt from reduction under Annex 2 to this Agreement . . . (italics added).

Article 1(h), which defines the "Total Aggregate Measurement of Support,"[45] and paragraph 1 of Annex 3, explaining the calculation of the Aggregate Measurement of Support[46], also distinguish between product-specific and non-product-specific support, without providing additional detail to that found in Article 1(a).

81. Article 1(a), therefore, provides the basic demarcation between product-specific and non-product-specific support; as mentioned at the first panel meeting, Brazil has not contested this point. Product-specific support, then, is "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product." This definition contains two elements. First, the support must be provided "*for an agricultural product*," which suggests that the subsidy is given "in favour of"[47] a product and not in respect of criteria not related to the product or in respect of multiple products. Second, such support is "in favour of the *producers of the basic agricultural product*,"

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[43]Again, the use of the term "commodity" in place of "product" may result from the unique negotiating history of the Peace Clause. While the term "product" is used exclusively elsewhere in the Agreement, in the course of the Uruguay Round agriculture negotiations, the term "commodity" had been commonly used. *See, e.g.*, Framework Agreement on Agriculture Reform Programme, Draft Text by the Chairman, MTN.GNG/NG5/W/170, paras. 3, 5, 6, Annex I (11 July 1990). Despite the fact that the Peace Clause uses "commodity" in place of "product," Brazil has not suggested that "commodity" should be interpreted as anything other than agricultural "products" subject to the Agreement.

[44]The United States also notes that under paragraph 1 of Annex 3, non-product-specific support is to be aggregated into one separate AMS, which supports the notion that non-product-specific support is *not* to be allocated to specific products, contrary to what Brazil urges the Panel to do here.

[45]Agriculture Agreement, Article 1(h) ("'Total Aggregate Measurement of Support' and 'Total AMS' mean the sum of all domestic support provided in favour of agricultural producers, calculated as the sum of all aggregate measurements of *support for basic agricultural products*, all *non-product-specific aggregate measurements of support* and all equivalent measurements of support for agricultural products . . . .").

[46]Agriculture Agreement, Annex 3, paragraph 1 ("Subject to the provisions of Article 6, an Aggregate Measurement of Support (AMS) shall be calculated *on a product-specific basis for each basic agricultural product* receiving market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment ('other non-exempt policies'). *Support which is non-product specific shall be totalled into one non-product-specific AMS* in total monetary terms." (emphasis added)).

[47]*The New Shorter Oxford English Dictionary*, vol. 1, at 996 (1993 ed.) (definition of "for": "in favour of"; "[w]ith the purpose or result of benefitting").

which suggests that subsidy benefits those who produce the product – that is, production is necessary for the support to be received.

82. Article 1(a) explains non-product-specific support as "support provided in favour of agricultural producers in general." That is, non-product-specific support is not support provided "for *an* agricultural product" and is not support in favour of "the *producers* of the basic agricultural product" but rather is support in favour of agricultural producers "generally."[48] Thus, read according to its ordinary meaning and in the context of Article 1(a), non-product-specific support is a residual category of support covering those measures that do not fall within the more detailed criteria set out in the definition of product-specific support.

83. Finally, we note Brazil's argument that "[t]he term 'product-specific' that the United States seeks to read into Article 13(b)(ii) has a very technical and particular meaning as set out in Article 6(4), and Annex 3 to the Agreement on Agriculture."[49] As explained above, while both of these provisions use the term "product-specific" as well as "non-product-specific," the Panel will search these provisions in vain for a "technical and particular meaning" of either of these terms. Brazil fails to direct the Panel's attention to the only explanation of the meaning of those terms, Article 1(a), perhaps because this explanation of the "technical and particular meaning" of product-specific support suggests that several of the measures challenged by Brazil provide non-product-specific support and are not part of the comparison under the Peace Clause proviso.

**39. If "such measures" in Article 13(b)(ii) refers to all those in the chapeau of Article 13(b), why are they not all included in the potential comparisons with 1992? In what circumstances can measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994? USA**

84. The introductory phrase of Article 13(b) establishes the full universe of measures that are potentially exempt from actions under this provision – that is, domestic support measures "that conform fully to the provisions of Article 6." The phrase "such measures" in Article 13(b)(ii) occurs in the proviso, and the use of the word "such" refers back to those measures identified in the introductory phrase. However, the type of support that must be compared pursuant to the proviso is set out by the *text* of the proviso: the comparison is not between the *total* (product-specific and non-product-specific) support provided by all measures that existed in 1992 versus those that exist currently; rather, the proviso comparison is between the "support to a specific commodity" that challenged measures grant versus that decided during the 1992 marketing year.

85. With respect to Article 13(b), then, the Peace Clause has two tiers of analysis and effect. First, non-green box domestic support measures collectively lose Peace Clause protection if they do not conform fully to the provision of Article 6 – that is, if they exceed a Member's domestic support commitment level. Second, even if a Member's Current Total Aggregate Measurement of Support is within the reduction commitment, the support to a specific commodity can still lose its Peace Clause protection if it exceeds the level decided during marketing year 1992. This second tier was intended to prevent a Member from increasing its non-green box support to a specific commodity while staying within the domestic support commitment level. When a Member *has* disciplined its product-specific support, however, by staying within the level decided during the 1992 marketing year (as the United States has done), it is entitled to the benefit of observing that commitment.

86. Finally, we note that Brazil's interpretation of the proviso calls for allocating support from all non-green box measures to an agricultural product regardless of whether that support is product-

[48] "In general" means "in general terms, generally" and "as a rule, usually." *The New Shorter Oxford English Dictionary*, vol. 1 , at 1073 (1993 ed.).

[49] Brazil's Opening Oral Statement at the First Panel Meeting, para. 16.

specific or non-product-specific. This analysis has no foundation in the Agriculture Agreement. In fact, Brazil has not followed its own approach through to its logical conclusion: as alluded to by Question 41 from the Panel, presumably Brazil could have taken *all* non-product-specific support provided by the United States and allocated some portion of that support to upland cotton producers. Brazil has not done so, but there is no basis in the Agreement to distinguish the non-product-specific support Brazil excluded from the non-product-specific support Brazil *included* for purposes of its Peace Clause analysis (for example, counter-cyclical payments and crop insurance). The only basis to distinguish whether a measure provides "support to a specific commodity" that is found in the Agriculture Agreement is to rely on the distinction between product-specific and non-product-specific support as explained in Article 1(a).

**43. What are the precise differences between deficiency payments and counter-cyclical payments that lead you to classify the former as product-specific and the latter as non-product specific? How do you classify market loss assistance payments? USA**

87. As indicated in the US answer to Question 38 from the Panel, Article 1(a) of the Agriculture Agreement provides the demarcation between product-specific and non-product-specific support. The definition of product-specific support contains two elements. First, the support must be provided "*for an agricultural product*," which suggests that the subsidy is given in respect of a product and not in respect of criteria not related to the product or in respect of multiple products. Second, such support is "in favour of the *producers of the basic agricultural product*," which suggests that subsidy recipients are those who produce the product – that is, production is necessary for the support to be received. Non-product-specific support is a residual category of "support provided in favour of agricultural producers in general" – that is, "generally."

88. In light of these definitions, it follows that deficiency payments under the 1990 Act were product-specific support whereas counter-cyclical payments are non-product-specific. The relevant differences may be summarized as follows:

| **Deficiency Payments** | **Counter-Cyclical Payments** |
|---|---|
| Farmer must plant upland cotton to receive payment | No requirement to plant upland cotton (or any crop) |
| Payment based on acres "planted for harvest" to upland cotton in that crop year | Payment based on historical "base acres" irrespective of acres currently planted to upland cotton |

In short, deficiency payments required production of upland cotton whereas counter-cyclical payments do not. Thus, deficiency payments were support *for* upland cotton in favour of *the producers* of upland cotton.

89. In order to receive a deficiency payment, a producer was *required* to plant upland cotton for harvest. The "farm programme payment acreage" for an individual farm – that is, the acres on the farm for which the producer would receive a deficiency payment in a given crop year – was defined as "the smaller of the maximum payment acreage or *the acreage planted to the crop on the farm for harvest* within the permitted acreage of the crop of the farm."[50] That is, a farmer would be paid on the acres planted to upland cotton for harvest up to the maximum payment acreage. Under the programme regulations, "crop acreage planted for harvest" was generally defined as "[t]he acreage

[50]7 Code of Federal Regulations § 1413.108(d) (1 Jan. 1993) (emphasis added) (Exhibit US-3); 7 US Code § 1444-2(c)(1)(B)(i) (1992 Supp.) (4 January 1993) (Exhibit US-5).

harvested."[51] Thus, in a given crop year, production was required to receive a deficiency payment, and the amount of the deficiency payment was based on the acreage on which upland cotton was harvested. Thus, both elements of the definition of product-specific support in Article 1(a) are satisfied. The deficiency payment was support for an agricultural product in favour of the producers of the product because recipients had to have planted upland cotton for harvest to receive payment in a given crop year.

90. On the other hand, counter-cyclical payments are decoupled from production requirements. Counter-cyclical payments are made to persons with farm acres that were devoted to production of any of a number of crops, including upland cotton, during an historical base period. That base period was defined in the 2002 Act and is fixed for the life of the legislation (that is, for marketing years 2002-2007).[52] However, a person with "upland cotton base acres" need not produce upland cotton (nor any other particular crop) to receive the counter-cyclical payment. A person with "upland cotton base acres" also need not produce any crop at all. Thus, counter-cyclical payments do not satisfy the definition of product-specific support: they are not payments *for* an agricultural product in favour of *the producers* of the product since *no production of any product, including upland cotton, need occur for payment*.

91. As indicated in our 1999 WTO domestic support notification (G/AG/N/USA/43), the United States believes that market loss assistance payments are non-product-specific amber box support. As with production flexibility contract payments, market loss assistance payments were made to persons with farm acres that previously had been devoted to production of certain crops, including upland cotton, during an historical base period. No production of upland cotton or of any other crop was required to receive payment, and no production was required at all. Thus, these payments do not meet the definition of product-specific support in Annex 1(a).

92. However, the United States did notify these payments as amber box because they were made in response to low prevailing commodity prices. As such, the United States does not consider that they conform to the criterion in paragraph 6(c) of Annex 2 that the amount of decoupled income support payments "in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period". We note that while Brazil has included market loss assistance payments in its Peace Clause comparison, it has not contested the US position (as evidenced by G/AG/N/USA/43) that these payments are non-product-specific amber box support.[53]

**45. If the Panel considered that Step 2 payments paid to exporters were an export subsidy, would the United States count them as domestic support measures for the purposes of Article 13(b)? Please verify Brazil's separate data for Step 2 export payments and Step 2 domestic payments in Exhibit BRA-69 or provide separate data. BRA, USA**

[51]7 Code of Federal Regulations § 1413.4(b) (1 Jan. 1993) (Exhibit US-3). Under the 1990 Act, there were so-called 50-92 provisions, under which a producer could devote part of the maximum payment acreage (that is, 85 per cent of the established crop acreage base less any acreage under an acreage reduction programme) to conserving uses and still receive deficiency payments on the acreage. To take advantage of that provision, the producer was still required to plant upland cotton for harvest on *at least* 50 per cent of the maximum payment acreage. 7 US Code § 1444-2(c)(1)(D)(ii) (1992 Supp.) (4 Jan. 1993) ("To be eligible for payments . . . the producers on a farm must actually plant upland cotton for harvest on at least 50 per cent of the maximum payment acres for cotton for the farm.") (Exhibit US-5).

[52]By way of contrast, under the deficiency payment program, "base acres" were determined by a farmer's yearly upland cotton planting decisions. Base acres were defined as "the average of the acreages planted and considered planted to such crop for harvest on the farm in each of the 3 crop years preceding such crop year." 7 Code of Federal Regulations § 1413.7(c) (1 Jan. 1993) (Exhibit US-3).

[53]*See* Brazil's First Written Submission, paras. 60-62.

93. If the Panel were to conclude that the Step 2 programme and payments made thereunder could be separated in to domestic and export components, and the export component were deemed to be an export subsidy, logically, that component would no longer constitute domestic support. Therefore, that measure would not form part of an analysis under Article 13(b), but rather would fall under Article 13(c). For data relating to Step 2 payment by fiscal year and use, please see the US answer to Question 104 from the Panel.

**46. What is the relevance, if any, of the concept of "specificity" in Article 2 of the SCM Agreement and references to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture? BRA, USA**

94. The concept of specificity in Article 2 of the Subsidies Agreement is entirely unrelated to the meaning of "support to a specific commodity" in Article 13(b)(ii) of the Agreement on Agriculture. Generally, under Article 2 of the Subsidies Agreement, a subsidy is specific if it is limited, in law or in fact, to "an enterprise or industry or group of enterprises or industries." The relevant context for "support to a specific commodity" is found in Articles 1(a), 1(h), 6.4, and Annex 3 of the Agriculture Agreement.

*"in excess of that decided during the 1992 marketing year"*

**47. Where does Article 13(b)(ii) require a year-on-year comparison? BRA, USA**

95. Please see the US answer to Question 35 from the Panel for a reply to this question.

**48. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made? BRA, USA**

96. The proviso to Article 13(b)(ii) requires a comparison of the product-specific support that challenged measures grant (in this case, for upland cotton) to the product-specific support decided during the 1992 marketing year. The United States agrees with Brazil that the Peace Clause proviso requires an apples-to-apples comparison. However, while Brazil's proposed comparison (the budgetary outlays that may be allocated to a commodity, whether product-specific or non-product-specific) has no grounding in the text or context of the Peace Clause, the United States believes the basis for this comparison is established by the use of the word "decided."

97. The term "decided" is not explicitly defined in the Agreement and is not used elsewhere in the Agriculture Agreement nor in the Subsidies Agreement to refer to support or subsidies. Members' unique choice of words must be given meaning. "Decide" means to "[d]etermine on as a settlement, pronounce in judgement" and "[c]ome to a determination or resolution *that, to do, whether*."[54] Thus, the basis for the comparison under the Peace Clause proviso is the product-specific support that was "determined" or "pronounced" during the 1992 marketing year. US measures "decided" product-specific support for upland cotton in terms of a rate of 72.9 cents per pound through the combination of marketing loans and deficiency payments. Thus, to make an apples-to-apples comparison, this rate of support must be compared to the rate of support that challenged measures "grant."

98. Contrary to Brazil's assertion, the use of the term "grant" does not compel an examination of budgetary outlays. The ordinary meaning of "grant" is to "bestow as a favour" or "give or confer (a possession, a right, etc.) formally".[55] Thus, the use of the term "grant" would permit an evaluation of the rate of support that challenged measures "give or confer . . . formally". Brazil's reference to

[54]*The New Shorter Oxford English Dictionary*, vol. 1, at 607 (first and third definitions) (italics in original).

[55]*The New Shorter Oxford English Dictionary*, vol. 1, at 1131 (fourth & fifth definitions).

footnote 55 of the Subsidies Agreement[56] is not pertinent as this is one of several Subsidies Agreement references to a *Member* granting a *subsidy*,[57] which differs from the Peace Clause phrase, "such *measures* do not grant support". More importantly, Members did not choose to use the word "granted" in place of "decided", and a valid interpretation must make sense of that choice rather than reading it out of the Agreement. In addition, had Members intended the Peace Clause comparison to be made *solely* on the basis of budgetary outlays, they could have used that term. After all, "budgetary outlays" is a defined term in Article 1(c) and repeatedly referred to in the Agreement.[58]

99. Thus, the comparison of the product-specific support "decided" during the 1992 marketing year to the support challenged measures "grant" must be made on the terms established by US measures themselves. The United States decided to ensure producer support at a rate of 72.9 cents per pound of upland cotton during the 1992 marketing year. In this case, the comparison presents no difficulty because the challenged measures also grant a rate of support (52 cents per pound). Because the latter is not in excess of the former, challenged US domestic support measures are exempt from actions pursuant to Article 13(b)(ii).

**50. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) and, in particular, why both words "grant" and "decided" were used. USA**

100. The United States is not aware of any written drafting history on this point.

**51. Could the United States please comment on the interpretation advanced by the EC, in paragraphs 16 and 18 of its oral statement, of the words "decided during the 1992 marketing year"? USA**

101. The United States agrees with parts of the interpretation advanced by the EC. The Communities too see the use of the term "decided" in the Peace Clause as notable and suggest that it compels an examination of "an amount of support adopted by some form of decision". The Communities argues that a Member cannot be deemed to have "decided" all of the "applications for support under a particular programme" (as is implied by an examination of budgetary outlays) and that the term "decided" cannot "set up a comparison between domestic support [actually] granted in 1992 and domestic support granted in a more recent period". The United States agrees with these statements.

102. The Communities also advance argumentation that may not flow from the ordinary meaning of the term "decided." For example, the Communities suggests that the term "implies a one-off decision", without further explanation. It would appear that the support "decided" during a marketing

[56]*See* Subsidies Agreement, fn. 55 ("For a developing country Member not granting export subsidies as of the date of entry into force of the WTO Agreement, this paragraph shall apply on the basis of the level of export subsidies granted in 1986.").

[57]*See, e.g.*, Subsidies Agreement, Article 2.1(c) ("Such factors are: . . . the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy"); *id.*, Article 3.2 ("A Member shall neither grant nor maintain [prohibited] subsidies referred to in paragraph 1."); *id.*, Article 4.1 ("Whenever a Member has reason to believe that a prohibited subsidy is being granted or maintained by another Member, such Member may request consultations with such other Member."); *id.*, Article 7.1 ("Except as provided in Article 13 of the Agreement on Agriculture, whenever a Member has reason to believe that any subsidy referred to in Article 1, granted or maintained by another Member, results in injury to its domestic industry, nullification or impairment or serious prejudice, such Member may request consultations with such other Member."); *id.*, Article 9.2 ("Upon request for consultations under paragraph 1, the Member granting or maintaining the subsidy programme in question shall enter into such consultations as quickly as possible."); *id.*, Article 25.2 ("Members shall notify any subsidy as defined in paragraph 1 of Article 1, which is specific within the meaning of Article 2, granted or maintained within their territories.").

[58]*See* Agriculture Agreement, Articles 3.3, 9.2; *id.*, Annex 3, paras. 2, 10, 12, 13; *id.*, Annex 4, para. 2.

year could be made through more than one decision, however. In addition, the Communities suggests that this decision is one "in which support for a specific product is decided and allocated for future years." While it may be that a Member decided support for a future year during the 1992 marketing year, forming the benchmark for the comparison under the Peace Clause proviso, it would also appear likely that a Member decided on a level of support for the marketing year during that marketing year. Thus, the support decided during the 1992 marketing year would not appear to be necessarily limited to support for future years.

**52. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". BRA, USA**

103. The ordinary meaning of the words "decided during" would be "determined or pronounced during" or "having come to a determination or resolution that or to do during." The United States understands that the term "decided during" was intended to capture not just a decision during 1992 for 1992, but also, as the EC indicates, a decision in 1992 of the support to be granted in a future year, in particular the EC's decision during 1992 for future years. The term "authorized during" would not appear to capture all of these dimensions of the term "decided during". In fact, a measure could be "authorized" during 1992 based on a "decision" during an earlier year so the two terms are not synonymous.

**54. Please identify all United States legal and regulatory and administrative instruments decided during the marketing year 1992, with the respective dates of decision, that decided support for upland cotton. BRA, USA**

104. The level of support decided during marketing year 1992 was to ensure a rate of return to producers of 72.9 cents per pound. Numerous legal, regulatory, and administrative instruments "determined" or "pronounced" this support. This level of support was first determined or pronounced by the 1990 Act, which covered the 1991-1995 marketing years. This legislation stated that "[t]he established price for upland cotton shall not be less than $0.729 per pound" for deficiency payments[59] and promised to make up the difference between that price and the higher of the (1) marketing loan rate or (2) market price. The 1990 Act was enacted on 28 November 1990. We note that the established price was set at "not less than" 72.9 cents per pound; that is, the Secretary of Agriculture was given some discretion to set the effective price so long as this did not fall below 72.9 cents. The Secretary, in fact, did not decide to alter this effective price prior to, during, or after the 1992 marketing year.

105. The Secretary decided on the marketing loan rate applicable for the 1992 crop via a series of regulations. A proposed rule was published on 13 September 1991, at 56 Federal Register 46574. The final decision on a loan rate of 52.35 cents per pound was announced on 31 October 1991, published on 20 April 1992, at 57 Federal Register 14326.[60] Those determinations applied to all marketings during marketing year 1992.

106. The United States decided to maintain the effective price for deficiency payments and loan rate for marketing loans at those levels during the 1992 marketing year as reflected in several published documents. The 1 January 1993, Code of Federal Regulations (Exhibit US-3) codified these levels of support.[61] The 1992 Supplement to the US Code also codified the legislated effective price of "not less than" 72.9 cents per pound. In addition, the Department of Agriculture published an upland cotton fact sheet in September 1992 announcing that "[t]he 1992 target price [for deficiency payments] is 72.9 cents per pound" and the "1992 loan rate . . . is 52.35 cents per pound".[62]

[59]7 US Code § 1444-2(c)(1)(B)(ii) (1992 Supp.) (4 Jan. 1993) (Exhibit US-5).
[60]Exhibit US-2.
[61]7 Code of Federal Regulations § 1413.104(a) (1 Jan. 1993) (Exhibit US-3).
[62]US Department of Agriculture, Upland Cotton Fact Sheet, at 2 (September 1992) (Exhibit US-17).

107. Finally, we note that in anticipation of the 1993 crop year the Department of Agriculture also initially pronounced the level of support for the 1993 crop year during the 1992 marketing year. On 24 March 1993, regulations were published at 58 Federal Register 15755 setting the marketing loan rate at 52.35 cents per pound and leaving undisturbed the effective price for deficiency payments at 72.9 cents per pound.[63] Thus, the support decided for the 1993 crop was the same as that decided for the 1992 crop: to ensure producer support of 72.9 cents per pound of upland cotton.[64]

**55. Please provide a copy of the instrument in which the rate of support for upland cotton during the marketing year 1992 was decided, indicating the date of the decision. USA**

108. As indicated in the US answer to Question 54 from the Panel, the United States has provided copies of multiple legal, regulatory, and administrative instruments and publications reflecting the rate of support decided during marketing year 1992. These multiple decisions stem from the fact that an effective price and marketing loan rate were first published in advance of the 1992 marketing year in order to allow producers to become familiar with the programmes; subsequently, the Secretary of Agriculture decided not to change either the effective price (72.9 cents per pound) or the marketing loan rate (52.35 cents per pound), despite having the authority to do so.

**56. Could the United States please explain how support granted under legislation that dates back to 1990 can have been support "decided during the marketing year 1992"? USA**

109. Payments during the 1992 marketing year were made pursuant to the 1990 Act, which directed the Secretary of Agriculture to make marketing loan payments and deficiency payments (as well as Step 2 payments). The 1990 Act, however, was only the first decision on the level of support. The Act provided that the marketing loan rate could "not be reduced below 50 cents per pound".[65] The 1990 Act also stated that the "established price for upland cotton shall not be less than $0.729 per pound".[66] Thus, the Secretary had discretion to alter those rates of support.

110. The Secretary decided to set the marketing loan rate at 52.35 cents per pound in April 1992 but also decided not to change the implementing regulations establishing the effective price for deficiency payments. Similarly, during the 1992 marketing year, the Secretary had the discretion *to raise* the deficiency payment target price above 72.9 cents per pound and *to raise* the marketing loan rate above 52.35 cents per pound but decided not to. Documents published during 1992 evidence this decision: the 1992 supplement to the United States Code published in January 1993 reflects the decision not to alter the statutory provisions relating to upland cotton rates. The 1993 Code of Federal Regulations was published in January 1993 and also reflects the decision not to alter the regulatory rate provisions. Finally, when the upland cotton fact sheet was published in September 1992, the effective price and marketing loan rate were left unchanged, reflecting the Secretary's decision not to change the level of support.

111. In this case, the support determined or pronounced by US measures during the 1992 marketing year was also the support determined or pronounced for the 1992 marketing year. This result is entirely consistent with the Peace Clause text; in fact, it provides certainty to both Members seeking to provide support within Peace Clause limits and Members seeking to understand whether the Peace Clause has been breached.

[63]A proposed rule for the 1993 crop was published on 29 September 1992. The 1993 rates were announced on 2 November 1992, and published in the 24 March Notice.

[64]We note that one distinction made by the 24 March 2003 regulations between the 1993 crop and the 1992 crop was that the acreage reduction program percentage was lowered from 10 per cent in 1992 to 7.5 per cent in 1993.

[65]7 U.S.C. 1444-2(a)(1), (2)(A) (1992 Supp.) (Jan. 4, 1993) (Exhibit US-5).

[66]7 U.S.C. 1444-2(c)(1)(B)(ii) (1992 Supp.) (Jan. 4, 1993) (Exhibit US-5).

112. Thus, the 1990 Act initially established a level of support applicable to the 1991-95 crops. The US Congress could have changed the 72.9 cents per pound level at any time during MY 1992, but it decided not to. The Secretary of Agriculture also had discretion to alter the level of support (that is, to raise it) but also decided not to. Thus, 72.9 cents per pound was decided and remained decided as the level of support for each day of the 1992 marketing year.

**57. If the United States decided on a rate of support for MY1992, does that not mean that it decided on whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at that time? USA**

113. The Peace Clause proviso establishes the benchmark for comparison: the support "decided" during the 1992 marketing year. To say that the United States "determined" or "pronounced" an indefinite amount of budgetary outlays would not fit those meanings of the term. The United States could also not have come to a "determination or resolution" to make any budgetary outlay since that outlay would be determined by market prices during the year, *not* by the US Government. To read support "decided" as encompassing not only the explicit rate of support set out in US measures but also "whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at the time," would also appear to make the Peace Clause comparison impossible. That is, because both during the 1992 marketing year and under the 2002 Act the support decided would be "whatever budgetary outlay was required to meet that rate of support," both budgetary outlay "decisions" by the United States would appear to be unlimited, and one could not be in excess of the other. Alternatively, one could reason that a decision to provide whatever budgetary outlays would be necessary implies that the 1992 decided level would be higher because, even if prices fell to zero, the higher nominal level in 1992 would mean higher budgetary outlays.

114. The only support "decided" by the United States was the 72.9 cents per pound level of support. In effect, the United States provided a revenue floor for producers by guaranteeing a rate of income for plantings. The United States has never exceeded that level of incentive "for the commodity." Brazil's approach, which would ascribe to the United States a decision to make budgetary outlays resulting from differences between market prices and the level of support, is an effort to impose something akin to an AMS limit on US support for upland cotton. (We note, however, that Brazil cannot simply argue for calculating an AMS for upland cotton because that would exclude non-product-specific support, which Brazil wishes to include in the Peace Clause comparison, and would not require that support be measured through budgetary outlays.) Members considered and rejected any product-specific AMS limits in the Uruguay Round, however, and such a concept may not be overlaid onto the Article 13 language. The United States has introduced payments decoupled from production precisely to lower the incentive to produce the marginal pound of cotton and avoid exceeding the product-specific level of support of 72.9 cents per pound.

**59. Should the rate of support as indicated in Article 13(b)(ii) include the market price? If so, why is it appropriate to include it in the comparison under Article 13(b)(ii)? BRA, USA**

115. No, the market price is not relevant for purposes of the Peace Clause comparison. As indicated in the US answers to Questions 48 and 57 from the Panel, the benchmark for that comparison is the support "decided" during the 1992 marketing year. That support was decided by the United States as a rate of support: 72.9 cents per pound. The actual amount of expenditures necessary to provide that support depended on the market prices during the marketing year. However, these prices were not "determined" or "pronounced" by the United States and therefore cannot have been (or be) part of any US decision.

**60. Can you provide information on support decided in 1992 and the years with which you believe it should be compared, on a per support programme / per unit of production/per**

**annum basis? If possible, please specify how, if at all, budget outlays may be transposed into units of production, and which units of production are best to use. BRA, USA**

116. The United States has explained that the product-specific support decided during the 1992 marketing year for upland cotton was 72.9 cents per pound through the combined effect of the target price for deficiency payments and the loan rate for marketing loans. This rate was the only support "decided" by the United States as evidenced by the relevant legislation, regulations, and programme announcements. By comparison, the product-specific support that upland cotton support measures currently grant is only 52 cents per pound through the loan rate for the marketing loan programme.

117. The United States believes that any analysis that takes budgetary outlays into account necessarily will not reflect the support "decided" by the United States. Because US domestic support measures are largely dependent on a price-gap, budgetary outlays will reflect prevailing market prices during the applicable marketing year, prices the United States cannot decide. Budgetary outlays will also reflect, for the product-specific support that marketing loans grant, various *producer* decisions on programme participation, timing of receipt of payments, and production levels. Again, these factors cannot be decided by the United States. Thus, given the way in which the challenged US measures decide the level of support, the Peace Clause comparison may only be made on the basis of rates of support, not budgetary outlays.

**61. Does the United States consider that Article 13(b)(ii) permits a comparison on any basis other than a per pound basis? USA**

118. Article 13(b)(ii) requires that the benchmark for comparison be the support "decided" during the 1992 marketing year. The United States decided on an a rate of support of 72.9 cents per pound during the 1992 marketing year. Therefore, the evaluation must be whether challenged measures grant product-specific support in excess of that decided during the 1992 marketing year – that is, in excess of the 1992 rate of support. Were the relevant US domestic support measures structured differently, the term "decided" might imply a different comparison.

**66. Could you please comment on the relative merits of each of the following calculation methods for the purposes of the comparison of support to upland cotton with 1992, irrespective of whether a particular measure should be included or excluded:**

**(a) Total budgetary outlays (Brazil's approach). USA**

119. As stated in the US answer to Question 60 from the Panel, the United States believes that any analysis that takes budgetary outlays into account necessarily will not reflect the support "decided" by the United States. Because some US domestic support measures are dependent on a price-gap (for example, marketing loans), budgetary outlays will reflect prevailing market prices during the applicable marketing year, prices the United States cannot decide. Budgetary outlays will also reflect, for the product-specific support that marketing loans grant, various *producer* decisions on programme participation, timing of receipt of payments, and production levels. Again, these factors cannot be decided by the United States. Thus, given the way in which the challenged US measures decide the level of support, the Peace Clause comparison may only be made with respect to these measures on the basis of rates of support, not budgetary outlays.

**(b) Budgetary outlays per unit of upland cotton: Could you please calculate and provide an estimate for the marketing years 1992 and 1999-2002, respectively, and draw attention to any factors/qualifications that the Panel would need to be aware of. BRA, USA**

120. For the reasons stated in response to Question 66(a), any analysis involving budgetary outlays necessarily will not reflect the support "decided" by the United States. A budgetary outlays per unit

of upland cotton approach thus would not only be based on a faulty premise, but to calculate outlays per unit might also necessitate an *ex post* or retrospective analysis. Again, this cannot reflect the support "decided" by the United States.

**(d) Per unit rate of support for upland cotton (Prof. Sumner's approach at the first session of the first substantive meeting ). USA**

121. The United States continues to examine Mr. Sumner's approach to calculating a per-unit subsidy rate. We will present a detailed critique of Mr. Sumner's analysis in our rebuttal submission. Here, we limit our comments to two points.

122. First, as with the budgetary outlays approach favoured by Brazil, this per unit rate of support analysis ascribes to the United States choices made by producers themselves. For example, the first line of Sumner's analysis of the deficiency payment programme stated: "The following qualifications and adjustments must [] be made to the level of support provided by the deficiency payment programme: (1) payments were made *only if a farm chose to participate* in the deficiency payment programme; in 1992, farms representing 11 per cent (1.64 million acres) of the total 'effective' upland cotton acreage base (14.9 million acres) *did not agree to participate in the programme* and hence cotton production on this land could not receive support."[67] Sumner makes a similar argument and adjustment for the 1992 loan rate.[68]

123. Attempting to adjust the per unit rate of support to take account of producers that chose not to participate in the programme is a serious conceptual error. In economic terms, a farmer that participated in the upland cotton programme received full programme benefits; a farmer who chose not to participate did not. Averaging these numbers produces a "per unit rate of support" that no cotton farmer ever could have expected to receive.

124. Nor could a Member have "decided" such a level of support. In legal terms, an individual producer's choices on programme participation do not reflect any decision by the US Government. Thus, estimated rates of support that reflect these producer decisions are not relevant to the Peace Clause analysis under Article 13(b)(ii). We will discuss other conceptual errors in Sumner's approach in our rebuttal submission.

125. In reviewing Sumner's analysis, the United States was particularly struck by another point. The Panel may recall Brazil commenting at the first panel meeting that Sumner's calculations were not entirely unfavourable to the US position. A look at Appendix Table 1 to Sumner's statement (Exhibit BRA-105) reveals why.

126. Even using Sumner's flawed calculations, if one excludes the non-product-specific support that Brazil is attempting to "allocate" to upland cotton from the table, Sumner's analysis supports the United States, not Brazil. That is, Sumner's estimated per unit rate of support was *lower* in every year from marketing year 1999 through marketing year 2002 than the level of support during marketing year 1992:

[67]Exhibit BRA-105 (Statement of Mr. Daniel Sumner, para. 10) (emphasis added).
[68]Exhibit BRA-105 (Statement of Mr. Daniel Sumner, para. 12).

| Product-Specific Support in Sumner's per Unit Subsidy Rates (Cents per Pound) by Programme and Year | | | | | |
|---|---|---|---|---|---|
| | **MY1992** | **MY1999** | **MY2000** | **MY2001** | **MY2001** |
| Marketing Loan | 44.34 | 50.36 | 50.36 | 50.36 | 52.00 |
| Deficiency | 13.25 | na | na | na | na |
| Step 2 | 2.46 | 2.46 | 2.46 | 2.46 | 3.71 |
| Cottonseed | na | 0.97 | 2.27 | na | 0.61[69] |
| ***Total*** | **60.05** | **53.79** | **55.09** | **52.82** | **56.32** |

127. Thus, even were one to accept for purposes of argument Sumner's approach, comparing the product-specific support the challenged measures grant to the product-specific support decided during marketing year 1992 reveals that *in no marketing year from 1999 through 2002 did the level of support exceed the marketing year 1992 level*. Under Article 13(b)(ii), then, Sumner's own analysis reveals that US domestic support measures that conform fully to the provisions of Article 6 are exempt from actions based on Peace Clause-specified WTO subsidies provisions.

**67. The Panel requests the parties to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002. For this purpose the parties are each requested to submit AMS calculations for upland cotton (using the budgetary-outlay/non-price gap methodology employed by the United States in respect of cotton in its DS Notifications (e.g., G/AG/N/USA/43) and using the formats and supporting tables in document G/AG/2) on the same basis as would be the case in calculating a product specific AMS for the purposes of the calculation of the "Total Current AMS" in any year in accordance with the relevant provisions, including as appropriate Article 1(a), (b) and (h), Article 6 and Annex 3 to the Agreement. BRA, USA**

128. The United States has calculated a product-specific Aggregate Measurement of Support for upland cotton for marketing years 1992, 1999, 2000, 2001, and 2002, as explained below. This table summarizes the results of those calculations, and the following paragraphs provide additional detail:

| US Upland Cotton Aggregate Measurement of Support | |
|---|---|
| **Marketing Year** | **AMS (US $, millions)** |
| 1992 | 2,085 |
| 1999 | 2,262 |
| 2000 | 1,057 |
| 2001 | 2,804 |
| | |

[69]The United States includes the cottonseed amount from the table without prejudice to our preliminary ruling request that the Panel find the 2003 cottonseed payment not to be within the scope of this dispute.

| US Upland Cotton Aggregate Measurement of Support | |
|---|---|
| 2002[70] | 970 |

129. For marketing year 1992, the United States has used official data on budgetary outlays[71] to calculate the upland cotton Aggregate Measurement of Support, except for other product-specific support in the form of storage payments and interest subsidies. The latter payment amounts are based on estimates by the US Department of Agriculture. The calculations, in millions of US dollars, are as follows:

| **Crop year 1992 (estimate)** | **Payments** | **Source** |
|---|---|---|
| Deficiency payments | 1,017 | US Department of Agriculture (USDA), Upland Cotton Fact Sheet (Ex. Bra-4) |
| Marketing loan gains / Certificate exchange gains | 476 | USDA budget data (Ex. Bra-6) |
| Loan deficiency payments | 268 | USDA budget data (Ex. Bra-76) |
| User marketing certificates | 207 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| Commodity loan forfeit | (5) | USDA estimate |
| Other payments | 122 | USDA estimate of storage payments & interest subsidy |
| *Product-Specific AMS* | 2,085 | |

130. To calculate the upland cotton Aggregate Measurement of Support for marketing year 1999, the United States has used official budgetary outlays data for loan deficiency payments, marketing loan gains, certificate exchange gains, user marketing certificates, and the 1999 crop year cottonseed payment. For storage payments and interest subsidies, we have used estimates by the US Department of Agriculture as notified to the WTO. The calculations, in millions of US dollars, are as follows:

[70]As explained further below, the United States has calculated the 2002 Aggregate Measurement of Support for upland cotton as of the date of panel establishment, 18 March 2003.

[71]In light of the question from the Panel, we have used budgetary outlays to estimate payments.

| Crop year 1999 | Payments | Source |
|---|---|---|
| Marketing loan gains/ Certificate exchange gains | 860 | USDA budget data (Ex. Bra-55) |
| Loan deficiency payments | 685 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| User marketing certificates | 422 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| Cottonseed payments | 79 | G/AG/N/USA/43 |
| Other payments | 216 | USDA estimate of storage payments & interest subsidy (G/AG/N/USA/43) |
| *Product-Specific AMS* | 2,262 | |

131. To calculate the upland cotton Aggregate Measurement of Support for marketing year 2000, the United States has again used official budgetary outlays data for loan deficiency payments, marketing loan gains, certificate exchange gains, and user marketing certificates; the amounts set by legislation for the 2000 crop year cottonseed payments; and estimates by the US Department of Agriculture for storage payments and interest subsidies. The calculations are as follows:

| Crop year 2000 (estimate) | Payments | Source |
|---|---|---|
| Marketing loan gains | 61 | USDA budget data (www.fsa.usda.gov/dam/ BUD/estimatesbook.htm)[72] |
| Loan deficiency payments | 152 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| User marketing certificates | 236 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| Cottonseed payments | 185 | Public Law 106-224, § 204(e) (20 June 2000); Public Law 107-25, § 6 (13 Aug. 2001) |
| Certificate exchange gains | 360 | USDA budget data (www.fsa.usda.gov/dam/ BUD/estimatesbook.htm) |
| Other payments | 63 | USDA estimate of storage payments & interest subsidy |
| *Product-Specific AMS* | 1,057 | |

132. For marketing year 2001, the United States has used estimates by the US Department of Agriculture for storage payments and interest subsidies and official data on budgetary outlays for all other payments to calculate the upland cotton Aggregate Measurement of Support. The calculations, in millions of US dollars, are as follows:

[72]Exhibit US-18.

| Crop year 2001 (estimate) | Payments | Source |
|---|---|---|
| Marketing loan gains | 47 | USDA budget data (www.fsa.usda.gov/dam/BUD/estimatesbook.htm) |
| Loan deficiency payments | 744 | USDA budget data (Ex. Bra-76) |
| User marketing certificates | 196 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| Certificate exchange gains | 1,750 | USDA budget data (www.fsa.usda.gov/dam/BUD/estimatesbook.htm) |
| Other payments | 68 | USDA estimate of storage payments & interest subsidy |
| *Product-Specific AMS* | 2,805 | |

133. For crop year 2002, the United States has provided unofficial data on budgetary outlays as of 18 March 2003, the date of establishment of the Panel, for marketing loan gains, certificate exchange gains, loan deficiency payments, and user marketing certificates. Because the crop year has just ended (as of 31 July 2003), official budgetary outlay data is not yet available. For the 2002 crop year cottonseed payment, the United States has used the amount set by legislation ($50 million). We use a crop-year's-end estimate by the US Department of Agriculture for storage payments and interest subsidies. The calculation, in millions of US dollars, is as follows:

| Crop year 2002 (estimate as of panel establishment) | Payments | Source |
|---|---|---|
| Marketing loan gains/ Certificate exchange gains | 563 | USDA unofficial data (www.fsa.usda.gov/pscad/answer82rnat.asp (18 March 2003))[73] |
| Loan deficiency payments | 202 | USDA unofficial data (www.fsa.usda.gov/pscad/answer82rnat.asp (18 March 2003)) |
| User marketing certificates | 137 | USDA unofficial data |
| Other payments | 68 | USDA estimate of storage payments & interest subsidy |
| *Product-Specific AMS* | 970 | |

134. We note that it would not be appropriate for the Panel to examine payments made after the date of panel establishment, on which the Panel's terms of reference were set. Measures taken after the Panel was established cannot be within the Panel's terms of reference. However, for the Panel's convenience, we have also estimated an Aggregate Measurement of Support for the entire crop year 2002, using US Department of Agriculture projections of all payments with respect to the 2002 crop

[73]*See* Exhibit US-19 (Marketing Year 2002 Loan Deficiency Payment and Price Support Cumulative Activity As of 3/12/2003). Upland cotton data is shown in the row marked "UP." The loan deficiency payment amount is shown in the third column, and the marketing loan gain and certificate exchange gain amounts are shown in the eighth column (second from left). This Report, the PSL-82R, provides weekly, unofficial data. Brazil provided the same report as Bra-55 but chose to present the report with data as of 13 June 2003.

year. These projections show no dramatic change from the unofficial budgetary outlays as of 18 March. The full-year 2002 crop year estimate, in millions of US dollars, is as follows:

| Crop year 2002 (full-year estimate) | Payments | Source |
|---|---|---|
| Marketing loan gains | 11 | USDA estimate (www.fsa.usda.gov/dam/BUD/estimatesbook.htm)[74] |
| Loan deficiency payments | 206 | USDA estimate (www.fsa.usda.gov/dam/BUD/estimatesbook.htm) |
| User marketing certificates | 217 | USDA estimate (www.fsa.usda.gov/dam/ BUD/estimatesbook.htm) |
| Cottonseed payments | 50 | Public Law 108-7, § 206 (24 Feb. 2003) |
| Certificate exchange gains | 701 | USDA estimate (www.fsa.usda.gov/dam/BUD/estimatesbook.htm) |
| Other payments | 65 | USDA estimate of storage payments & interest subsidy |
| *Product-Specific AMS* | 1,250 | |

**68. Could you please clarify the result of the calculations of, and the meaning of the title, in Appendix Table 1 "Estimated per unit Subsidy Rates by Programme and Year" in Annex 2 to Exhibit BRA-105, page 12. Why are the numbers calculated for marketing loans considered to be subsidies? Could the Panel, for example, read the "total level of support" (bottom line of the table) as the effective support price for upland cotton or the maximum rate of support for upland cotton? BRA, USA**

135. The United States looks forward to reviewing Brazil's explanation of its Appendix Table 1 to Annex 2 to Exhibit BRA-105.

**69. Can the United States confirm that the "marketing year" for upland cotton is 1 August to 31 July ? Can the United States confirm the Panel's understanding that USDA data for the "crop year" corresponds to the "marketing year"? USA**

136. The United States confirms that the "marketing year" for upland cotton is 1 August to 31 July.[75] In response to a question from the Panel at the first meeting, we also communicate that payments listed in the Upland Cotton Fact Sheet (Ex. Bra-4) are for monies spent with respect to cotton harvested in a particular crop year, not necessarily for payments made during the marketing year.

*EXPORT CREDIT GUARANTEE PROGRAMMES*

**71. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? Does it confer a benefit within the meaning of Article 1.1(b)? Why or why not? If so, to whom? USA**

[74]Exhibit US-19.
[75]7 Code of Federal Regulations 1412.103.

**(b) How, if at all, would these elements be relevant to the claims of Brazil, and the United States response thereto? BRA, USA**

137. (a) For the reasons stated in its first written submission[76] and in response to Question 71(b), the United States does not believe that the appropriate analysis of the US export credit guarantee programme should begin with the Subsidies Agreement, much less Article 1of that Agreement. The text of Article 10.2 defers WTO obligations for export credit guarantees until disciplines are internationally agreed, such as within the OECD or WTO. Under the Agriculture Agreement, the provisions of the Subsidies Agreement "apply subject to the provisions of this Agreement,"[77] and the export subsidy disciplines of Article 3.1(a) of the Subsidies Agreement expressly apply "[e]xcept as provided in the Agreement on Agriculture."[78] Thus, the appropriate analysis would begin and end with Agriculture Agreement Article 10.2.

138. Even were the Subsidies Agreement relevant to US export credit guarantees, given that export credit guarantees are covered by item (j) of the Illustrative List of Export Subsidies, the appropriate mode of analysis under the Subsidies Agreement is to examine whether the programme is covering its long-term operating costs and losses.

139. (b) Article 3 of the SCM Agreement specifically states that Article 3.1(a), prohibiting export subsidies, applies "[e]xcept as provided in the Agreement on Agriculture". Article 21.1 of the Agriculture Agreement states that "[t]he provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement". Under Article 10.2 of the Agreement on Agriculture, the negotiators specifically deferred the application of export subsidy disciplines on agricultural export credit guarantee programmes like those of the United States. Any incidental "benefit" of any such measures is therefore irrelevant. Similarly, even if a particular (non-export credit) measure comprised a contribution and conferred a benefit for purposes of the Subsidies Agreement, to the extent the resulting subsidy was contingent on export performance, such export subsidy might nevertheless be permitted under the Agreement on Agriculture if within a Member's applicable reduction commitment.

**73. The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The United States has yet to submit any evidence or argumentation on this point, either as potential context for interpretation of the terms in Article 10 of the Agreement on Agriculture or in relation to Brazil's claims under the SCM Agreement. The Panel would therefore appreciate United States views in respect of this situation, and invites the United States to submit relevant argumentation and evidence. USA**

140. The United States does not believe that Brazil has submitted evidence and argumentation that would establish a *prima facie* case in favour of Brazil's claims, in particular in light of Article 10.2 of the Agriculture Agreement. However, the United States will review Brazil's submissions, including its responses to these questions, and provide any further response in the US submission.

**74. If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 of the Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both? BRA, USA**

[76]US First Written Submission, paras. 167-170.
[77]Agriculture Agreement, Article 21.1.
[78]Subsidies Agreement, Article 3.1.

141. As the United States has argued, the first point of analysis is Article 10.2 of the Agreement on Agriculture, in which Members agreed that they would only provide export credit guarantees in conformity with internationally agreed disciplines, which they undertook to develop. That is, Article 10.2 indicates that no "internationally agreed disciplines" currently exist. The obligation with respect to export credit guarantees is, in effect, a work programme to establish a future discipline. Brazil has not contested that challenged US export credit guarantee programmes are within the scope of Article 10.2. Therefore, neither item (j) nor Articles 1 and 3 of the Subsidies Agreement are relevant to the Panel's analysis of Article 10.2. We do note, however, that item (j) of the Illustrative List of Export Subsidies was agreed in the Uruguay Round, and, in fact, had previously formed part of the Illustrative List under the Tokyo Round Subsidies Code. Thus, the fact that Members had agreed on item (j) and yet, in Article 10.2, agreed to "undertake to work toward *the development* of internationally agreed disciplines to govern the provision of export credits, export credit guarantees" and, once agreed, only to provide export credit guarantee programmes "in conformity with" such developed and agreed disciplines, suggests that item (j) does *not* impose disciplines on export credit guarantees for agricultural goods.

142. Context for Article 10 is found in Article 9.1 of the Agreement on Agriculture, which describes specific practices that constitute export subsidies for purposes of the Agreement on Agriculture. Export credit guarantees were not listed among such practices. As to the practices described in Article 9.1, no recourse is necessary to Articles 1 and 3 of the SCM Agreement to determine whether a particular practice is an export subsidy. Article 1(e) of the Agreement on Agriculture defines an export subsidy only as a subsidy contingent on export performance. To determine the applicability of Article 10.1 to a particular measure not described in Article 9.1 first requires a determination whether a subsidy exists. In this regard, Article 1of the SCM Agreement would provide relevant context.

**75. The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see e.g. written third party submission of Canada) and to the panel report in DS 222 Canada-Export Credits and Loan Guarantees. How and to what extent are Article 14(c) of the SCM Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would be the appropriate market benchmark to use for any comparison? Please cite any other relevant material. BRA, USA**

143. For reasons set out in more detail in the US answer to Question 71(b) and Question 71(c) from the Panel, the United States does not believe that Article 14(c) is relevant to the Panel's analysis. An appropriate analysis of the US export credit guarantee programme begins and ends with Article 10.2 of the Agreement on Agriculture. Even were the Subsidies Agreement relevant to US export credit guarantees, the only appropriate mode of analysis under the Subsidies Agreement is to examine whether US export credit guarantee programmes are covering their long-term operating costs and losses under item (j) of the Illustrative List of Export Subsidies.

**76. How does the United States respond to Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders."? USA**

144. Brazil is incorrect. Commercial insurers do offer export credit insurance covering agricultural commodities. According to a background paper on export credits prepared by the WTO Secretariat, "While guarantees could be unconditional, they usually have conditions attached to them, so that in practice there is little distinction between credits which are guaranteed and credits which are subject to insurance."[79] However, for the sake of completeness we wish to note that such private insurance is structured differently than CCC credit guarantees. Most commonly, private insurers offer portfolio

[79]*See Export Credits and Related Facilities*, G/AG/NG/S/13 (26 June 2000).

coverage, covering multiple customers and transactions for a particular exporter. Because the coverage is not based on individual transactions (like CCC's coverage), it may be difficult or impossible to discern which particular transactions involve agricultural commodities.

**77. How does the United States interpretation of "long term operating costs and losses" in item (j) as claims paid give meaning to both "costs" and "losses"? Do claims paid represent "losses" or "costs" or both? If claims paid is represented by "losses", what would go into the "cost" element of item (j)? Could the United States expand on why it disagrees with the items which Brazil identifies for inclusion in the examination to be conducted under item (j)? USA**

145. Item (j) applies to three different types of programmes: export credits, export credit guarantees, and insurance. In the case of the latter two types of programmes, the provider will necessarily incur claims from time to time. In the case of direct export credits (the first type of programme), the provider will experience defaults on occasion. To the extent such claims or defaults exceed revenue from whatever source it may be derived, the net result would be a loss arising from operations. In an accounting sense such result would constitute an "operating loss."

146. In addition, it is appropriate to identify and allocate costs necessary to operate such programmes. For example, the United States agrees that certain administrative expenses should be allocated to the operation of the export credit guarantee programmes, and an annual figure is attributed as administrative expense in the budget of the United States. Other costs necessary for the operation of a programme would constitute "operating costs" of such programme.

147. Were item (j) to be relevant in this dispute, therefore, that item compels an examination of losses derived from the operation of the programme plus the costs necessarily allocable to the programme for its operation. In the case of US export credit guarantee programmes, as reflected in paragraph 173 and accompanying tables of the US first written submission, the Commodity Credit Corporation (CCC) charges and receives premiums from applicants. In addition, CCC receives post-claim revenue through late payments and rescheduling. As reflected in the tables, with respect to cotton, such revenue exceeds the relevant claims experience. The United States has, therefore, not incurred an operating loss.

148. It is appropriate to allocate operating costs of the programme in the final analysis within the meaning of item (j). The United States disagrees, however, with the allegation of Brazil concerning interest allocation and the manner in which it attempts to ascribe figures from the US budget to operating costs for purposes of item (j). These items are addressed specifically in the US response to Question 81 from the Panel.

**78. Can the United States provide supporting documentation for data used relating to "costs and losses" in paragraph 173? Could the United States confirm that the figures cited in paragraph 173 of its first written submission relate to the SCGP? Why did the United States cite these figures after stating that it is not possible to make any assessment of the long-term operating costs and losses of this programme? USA**

149. The United States maintains a comprehensive electronic data base of export credit guarantee programme activity. The data base is updated on a regular basis and is the source of the data shown in paragraph 173 and accompanying table. Data is recorded in the system at the time of each transaction. These include such items as claim payments, recoveries, rescheduling agreements, and fees received.

150. As indicated in the tables accompanying paragraph 173, the figures shown in paragraph 173 relate to GSM-102 in the first table and SCGP in the second table. During the ten fiscal years reflected in the tables, no GSM-103 export credit guarantees were issued with respect to cotton.

**79. In respect of what time periods does Article 13(c) require an assessment of conformity with Part V of the Agreement on Agriculture? How does this affect, if at all, your interpretation of Article 13(b)? BRA, USA**

151. Article 13(c) applies to "export subsidies that conform fully to the provisions of Part V of th[e Agriculture] Agreement, as reflected in each Member's Schedule." Part V of the Agreement, and in particular Article 8, establishes that "Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule." Those export subsidy reduction commitments, which are expressed in both export quantity and budgetary outlay terms, apply on a yearly basis.[80] Accordingly, a Member may be in conformity one year and not in conformity in another with regard to any particular commodity subject to reduction commitments.

152. If a Member has provided export subsidies to a particular commodity in any one year in excess of the applicable reduction commitments, then export subsidies for that commodity during such year would not "conform fully to the provisions of Part V", and those subsidies would not have Peace Clause protection. In a subsequent year, a Member may again comply with its export subsidy commitments. Its export subsidies would then conform fully to Part V of the Agreement and would again receive Peace Clause protection.

153. Similarly, a failure by a Member to comply in a given year with the criteria in Article 13(b) would lift the exemption from action for those domestic support measures only for the year of the breach. Measures (subsidies) in a later year would remain exempt from action so long as those measures in the given year comply with the conditions in Article 13(b)(ii). This conclusion flows from the text of the Peace Clause (measures must conform to Article 6, and Members' final bound commitment levels are expressed in yearly terms) as well as the nature of the subsidies challenged by Brazil (recurring subsidies that are provided yearly and expensed in the year given). For further explanation of the US interpretation of Article 13(b), please see the US answers to Questions 33 and 35 from the Panel.

**81. How does the United States respond to the following in Brazil's oral statement: USA**

**(a) paragraph 122 (rescheduled guarantees)**

154. Brazil is correct to assert "debt rescheduling does not involve any reduction in the value of outstanding debt". A rescheduling does not involve debt forgiveness. As reflected in the terms of the various rescheduling agreements, outstanding interest is capitalized, and interest accrues on such capitalized interest as well as on outstanding principal. Further, the United States expects to recover in full pursuant to such rescheduling.

155. Therefore, from an accounting perspective, rescheduled amounts are counted as *receivables*, not losses, and are reflected as such in paragraph 173 of the US First Written Submission. Contrary to the assertion of Brazil, the United States does in fact collect on the rescheduling. The history of rescheduled Commodity Credit Corporation (CCC) export credit guarantee claims over the long-term (the 10-year period 1993-2002) confirms this position. All rescheduled claims are currently performing. In other words, all payments due up to this point under these agreements have been received.

[80]With the exception of Agriculture Agreement Article 9.2(b), which is no longer applicable.

**(c) paragraphs 125 ff. (guaranteed loan subsidy)**[81]

156. The Credit Reform Act of 1990 establishes the procedures and parameters for US credit and credit guarantee programmes. In accordance with the provisions of that Act, the budgeting and accounting for US credit programmes, including the CCC export credit guarantee programmes, are based on the estimated lifetime costs to the Federal Government of making the credit available. In the case of credit guarantees, those costs are based on estimated payments by the Government to cover defaults and delinquencies, interest subsidies, and other requirements, and payments to the Government, including origination and other fees, penalties, and recoveries.

157. In presenting the annual budget, the subsidy costs of the programme reflect an *estimate* of the long-term costs to the Government. This estimate reflects various assumptions regarding credit risk, interest costs, and other factors that will apply over the lifetime period of the credit. At the time the budget is prepared, these costs are presented as estimates as of the date the budget is prepared – that is, they are a snapshot of the estimated costs. In fact, Brazil acknowledges in paragraph 125 of its oral statement that the "guaranteed loan subsidy" entry in the annual US budget is an estimate of the cost of the guarantees projected to be issued.

158. A fundamental tenet of credit reform accounting is the requirement that the performance of the credit be tracked over its lifetime. This is accomplished by tracking each cohort of credit until the credit period has expired or lapsed. A cohort consists of all transactions associated with each type of guarantee issued during a particular year – for example, all guarantees issued during fiscal year 2002 comprise a distinct cohort.

159. Activity (disbursement, repayment, claims, etc.) occurs within a given cohort over the life of all guarantees that were disbursed against that cohort. To view the data and activity strictly on an annual basis and not by cohort limits the utility of the data and distorts the costs of the programme. Not until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government.

160. All cohorts for the CCC export credit guarantee programmes under credit reform are still open although cohorts for 1994 and 1995 should close this year. At present, the 1994 cohort has a total net downward subsidy re-estimate of $116 million. The original subsidy cost estimate for the 1994 programme was $123 million; thus, applying the downward re-estimate, the net cost of the programme to the US Government is currently projected at $7 million. The 1995 cohort has a total net downward subsidy re-estimate of $149 million, versus an original subsidy estimate of $113 million. Thus, the net cost of the 1995 programme is a receipt of $36 million to the US Government. For 1994 and 1995 together, the total net receipt to the US Government is $29 million.

161. The experience of 1994 and 1995 is viewed as representative of the costs of the CCC export credit programmes generally, and it is expected that, once the cohorts for other years of credit activity are closed, they will follow closely the experience of the 1994 and 1995 programmes.

**(d) paragraphs 127-129 (re-estimates, etc.)**

162. As discussed in response to Question 81(c), it is necessary to understand the difference between activity that occurs on a fiscal year basis as opposed to the estimates and re-estimates of subsidy that calculate net present value over the life of the programme. Although estimates and re-estimates are made annually for each cohort, these include both actual data to date and estimates of future activity for the remainder of the life of the cohort.

[81]The US answer to Question 81(b) follows the answer 81(d), which discusses budget re-estimates.

163. With the exception of 2002, all cohorts for annual export credit programming since the inception of credit reform accounting in 1992, have a cumulative downward re-estimate. The net total for all cohorts for guarantees issued since 1992 currently stands at a downward re-estimate of $1.9 billion. This experience with re-estimates indicates that performance under the programme has been better than originally projected and that the original cost estimates for those programming years as presented in the annual US budget were too high. This experience also demonstrates that the assertion by Brazil at paragraph 129 of its oral statement that the original estimate of "guaranteed loan subsidy" line in the budget is an "ideal basis" for determining the costs of the programme is in error. Those estimates will be re-estimated on an annual basis until each cohort is closed and, as demonstrated above, to date the re-estimates for each cohort on a net basis have been almost exclusively downward.

**(b) paragraph 123 (interest on debt to Treasury)**

164. Under the guidelines for credit reform budgeting as established in the Credit Reform Act of 1990, there are two kinds of interest calculations that affect the CCC export guarantee programmes. These calculations are "snapshots" in time and will change annually for a cohort until the cohort has closed. Therefore, any one number shown in the budget for a given year is an estimate. The actual cost of the programme can be determined only when all financial activity for the cohort is completed.

165. An interest rate re-estimate is a component of the annual re-estimates of a cohort, which are made for as long as the guarantees are outstanding. The interest rate re-estimate calculates the difference between the estimated interest at the time the guarantee programme was budgeted and the actual interest at the time the guarantee is disbursed. If the actual interest is higher, the additional cost is shown in the programme account as a re-estimate. It should be noted that this cost would change with subsequent re-estimates in future years depending on the timing of the guarantee disbursement.

166. Interest on borrowings occurs in the financing account only if additional funds beyond those budgeted for a cohort is needed to pay claims. Again, these costs will vary from year to year as borrowings with a particular cohort change and the interest rate varies.

167. It is important to understand that should any interest on borrowings occur, they would be fully reflected in the costs attributed to the individual cohort. Thus, as the costs of the cohort are adjusted during the period it is active, any costs associated with the interest on borrowings are fully reflected in the programme costs. It is, therefore, incorrect to state as Brazil asserts in paragraph 123 that those payments are not fully reflected in the operating costs of the CCC export credit guarantee programmes.

**(e) Exhibits BRA-125-127**

168. Exhibits BRA-125-127 are pages from the Budget Estimates for the United States Government for fiscal years 1994, 1995, and 2004. These particular pages show one aspect of the budgeting for the CCC export credit guarantee programmes, the Export Loans Programme Account. In and of themselves, they do not reflect all aspects of the budgeting and financing transactions for the programmes. For example, Exhibit 127 for the fiscal year 2004 budget estimates excludes the Export Guarantee Financing Account, which appears on the following page. The data presented in the financing account is important because it presents information on both downward and upward re-estimates for the programme.

**(f) the chart on page 53 of Brazil's oral statement at the first session of the first Panel meeting relating to "Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM-102 GSM 103 and SCGP"?**

169. The table on page 53 of Brazil's oral statement at the first panel meeting presents information on budget estimates for the CCC export credit programmes for fiscal years 1992 through 2004. The data presented in the table are correct. However, as discussed previously in the answers to questions 81(c) and 81(d) above, the "guaranteed loan subsidy" is a snapshot estimate of the lifetime costs of the guarantees issued during the course of a given fiscal year. As the cohorts for those guarantees are reviewed annually over their lifetime, those estimates will change and, until the cohorts are closed out, the estimated costs of the programmes are simply that, estimates. Accordingly, Brazil is incorrect in asserting in paragraph 132 of its oral statement that, because the guaranteed loan subsidy line of the annual budget has always reflected a positive net present value, that fact indicates the programmes are "extending a subsidy to borrowers". That statement misinterprets and misrepresents the information presented in the budget.

170. In addition, Brazil makes a statement in paragraph 131 of its oral presentation with regard to the table on page 53 that likewise is incorrect. Brazil asserts that the column heading in the budget for the last completed fiscal year represents "actual" costs for the programme for that particular year. In fact, the numbers appearing in that column simply represent the latest, revised *estimate* of the costs of the programme for the fiscal year just completed. The estimate of those costs will change over the lifetime of the credit as the cohort for that year is tracked. The term "actual" is used in the column because the revised estimate is based on an actual level of guarantees issued by CCC during the year just completed.

171. Frequently, the level of guarantees issued by CCC in any given year is less than the level projected in the original budget for that year. In the case of the 2002 budget that was released in February 2001, it projected that $3.9 billion of guarantees would be issued by CCC during that year. However, only $3.4 billion of guarantees were actually issued. Thus, the estimate of programme costs in 2002 column of the 2004 budget has been revised to reflect that actual level of activity. Nevertheless, the cost presented in the column remains an estimate, and the estimate will continue to be revised as long as the cohort for 2002 remains active.

172. With respect to the "administrative expenses" that are displayed in the table on page 53 of Brazil's oral statement, the United States has noted elsewhere that those are imputed costs ascribed to the operation of the CCC export credit programmes as a whole.

**(g) In respect of (a)-(f) above, how and to what extent do the information and data presented for the export guarantee programmes concerning "programme" and "financing", "summary of loan levels", "subsidy budget authority", "outlay levels", etc., in particular in Exhibits BRA-125-127, reflect "actual costs and losses" of the GSM-102, GSM-102 and SCGP export credit guarantee programmes (see e.g. Brazil's closing oral statement at the first session of the first substantive meeting, paragraph 24)? USA**

173. The closing oral statement of Brazil at the first session of the first substantive meeting of the Panel, and paragraph 24 in particular, display a fundamental misunderstanding of the budget and accounting for the CCC export credit programmes. Contrary to what is asserted in that paragraph, the information presented in the annual budget of the United States does in fact represent estimates of the lifetime costs of the programmes. Those estimates are being revised annually to reflect actual performance and, until the cohorts for the annual programmes have been closed out, the actual costs cannot be determined definitively. However, as demonstrated in response to Question 81(d), the

re-estimates thus far have resulted in a net reduction in the estimated costs of these programmes of over $1.9 billion since the inception of credit reform budgeting in fiscal year 1992.

174. Further, as discussed in response to Question 81(c), the combined net costs of the cohorts associated with the 1994 and 1995 guarantee programmes, which are expected to close this year, are a receipt of $29 million to the Federal Government. Based on those results, the Brazilian claim in paragraph 24 that "operating costs and losses for GSM 102, GSM 103, and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992" is not supportable.

**82. Please explain each of the following statements and any possible significance it may have in respect of Brazil's claims about GSM-102 and GSM-103 (7 CFR 1493.10(a)(2), Exhibit BRA-38): BRA, USA**

**(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2), Exhibit BRA-38)**

175. The export credit guarantee programmes are generally made available in connection with middle-tier economies in which liquidity is constricted. In such cases, cash sales for all suppliers are not occurring readily. US financial institutions may face requirements regarding loan-loss reserves that impede their ability to lend.

**(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

176. The export credit guarantee programmes are intended to operate and indeed are applied in a manner not to displace cash sales. As liquidity improves in certain countries, the use of the programme recedes. This explains, in part, the dramatic reduction in US export credit guarantees since the years immediately preceding the inception of the WTO Agreement.

177. The following table shows the dollar value of guarantees provided by the United States in US fiscal years 1992-1994, along with the average value of guarantees for fiscal years 1995 - 2002:

| Fiscal Year(s) | Guarantee Value (Millions of USD) |
|---|---|
| 1992 | $5,671.8 |
| 1993 | $3,853.7 |
| 1994 | $3,177.4 |
| 1995 - 2002 | $3,061.9 |

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market**

**development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

178. Although the goal of the export credit guarantee programmes is to expand market opportunities, such goal alone has no bearing on the proper characterization of the programmes, the measures in dispute, or the conformity of the application of such programmes with the WTO obligations of the United States. Moreover, the United States is statutorily compelled to be mindful not to provide any such guarantees in connection with any country that the Secretary of Agriculture determines cannot adequately service the debt associated with such sales, nor does the United States provide guarantees in connection with any foreign bank that it has not approved and with respect to which it has not established an exposure limit.

**84. Is the Panel correct in understanding that, under the GSM-102 and GSM-103 programmes, the exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? USA**

179. Fees paid by an exporter participating in either the GSM-102 or GSM-103 programme vary by the guaranteed dollar value of the transaction, the repayment period, and the principal repayment interval (annual or semi-annual). A schedule of current fees is attached as Exhibit US-20. Section 211(b)(2) of the Agricultural Trade Act of 1978, 7 U.S.C. 5641(b)(2), limits the origination fee in connection with transactions under the GSM-102 programme, except for those transactions under the CCC Facility Guarantee Programme, to no more than 1 per cent of the amount of credit to be guaranteed. There is no other legislation or regulation addressing the specific fee rates.

180. Other than the legislative restriction noted above, the CCC sets and changes the fee rates as it deems appropriate. Fee rates are changed via a press announcement to the public. The most recent change in guarantee fee rates occurred on 1 October 2002, at which time the fee schedule was modified to include rates for transactions with 30- and 60-day repayment periods. Previously, the fee schedule had been adjusted to accommodate variable interest rates as opposed to fixed rates. Legislative amendment is not required to change the fee rates unless the rates for the GSM-102 programme are to exceed 1 per cent of the guaranteed dollar value of a transaction. Neither is it necessary to amend the programme regulations in order to change the fee rates.

**85. Is the Panel correct in understanding that, under the SCGP, the exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? Please explain any "risk" assessment involved in the programme. USA**

181. Under the SCGP, the exporter pays a fee to CCC based on the guaranteed dollar value of the export transaction and the repayment period. The current guarantee fee rates are $0.45 per $100 of coverage for credit terms up to 90 days, and $0.90 per $100 of coverage for credit terms up to 180 days. Section 211(b)(2) of the Agricultural Trade Act of 1978, 7 U.S.C. 5641(b)(2), limits the origination fee in connection with transactions under the SCGP to no more than 1 per cent of the amount of credit to be guaranteed. There is no other legislation or regulation addressing the specific fee rates.

182. Other than the legislative restriction noted above, the CCC sets and changes the fee rates as it deems appropriate. For example, fee rates for the SCGP were changed in US fiscal year 2000 (beginning 1 October 1999) and set at their current level. Prior to that time, the fee rate was $0.95 per

$100 of coverage regardless of the repayment period. The fee rates were changed to give exporters and importers an incentive to negotiate repayment terms of less than 180 days. Legislative amendment is not required to change the fee rates unless the rates for the SCGP are to exceed 1 per cent of the guaranteed dollar value of a transaction. It is not necessary to amend the programme regulations in order to change the fee rates.

183. CCC carries out a country risk assessment for each country prior to announcing its eligibility for SCGP participation. Country risk assessment entails a review of the economic and political situation in each country to ensure there is a reasonable expectation that the country's importers will be able to repay debts incurred under the programme. CCC does not determine the creditworthiness of importers participating in the SCGP. CCC provides a guarantee covering 65 per cent of the export transactions under the programme; the exporter or his assignee (US bank) must accept the remaining 35 per cent of the transaction's risk. This "risk sharing" between CCC and the exporter/assignee is intended to ensure that due diligence is performed in assessing an importer's creditworthiness before undertaking a transaction with that importer.

**86. Is there a risk categorization in relation to three export credit guarantee programmes (GSM-102, GSM-103 and SCGP)? Does this have any impact on premiums payable and the ability of the CCC to on-sell the guarantees ? USA**

184. All countries eligible for any of the CCC export credit guarantee programmes are categorized according to risk. CCC categorization of countries is based on a US government internal risk classification system. This system is administratively controlled and may not be released outside of the US Government. A country's risk classification has no impact on the premiums payable under the US export credit guarantee programmes. There is no secondary market for CCC guarantees; therefore, CCC does not "on-sell" the guarantees.

**87. What proportion of CCC (export-related and total) long term operating costs and losses are represented by GSM-102, GSM-103 and SCGP programmes? USA**

185. With the advent of the Credit Reform Act, the export guarantee programmes are not financed out of the Commodity Credit Corporation. While the programmes continue to be run through the authorities and facilities of the CCC, all budget authority (funding) for the guarantee programmes is provided directly to accounts for those programmes from the US Treasury.

**88. (a) Is the Panel correct in understanding that the United States' argument is that, at present, by virtue of Article 10.2 of the Agreement on Agriculture, there are no disciplines on agricultural export credit guarantees under the Agreement on Agriculture (or the SCM Agreement)? USA**

186. Article 10.2 provides: "Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines to provide export credits, export credit guarantees or insurance programmes only in conformity therewith." Article 10.2 imposes an obligation on Members to work toward "internationally agreed disciplines" and, upon agreement on such disciplines, to provide export credit guarantees only in conformity with such disciplines. This was the purpose of the negotiations in the OECD that followed the Uruguay Round, and which now are occurring under the aegis of the WTO. If and when such disciplines are agreed upon, they are WTO obligations under the Agreement on Agriculture.[82]

[82]This is similar to other work programs that continued beyond the close of the Uruguay Round. *See* US First Written Submission, paras. 154-66.

187. Brazil's argument is that such "internationally agreed disciplines" already apply. If export credit guarantee programmes were already subject to export subsidy disciplines, then Article 10.2 would be unnecessary. That is, Members would *already* have "to provide . . . export credit guarantees . . . only in conformity" with the internationally agreed disciplines of the WTO. In Brazil's oral statement, Brazil attempts to avoid this implication of its reading by repeatedly attempting to insert the word "specific" into the text of Article 10.2 – that is, "undertake to work toward the development of *specific* internationally agreed disciplines ."[83] That word is not there, however. The United States' interpretation of Article 10.2 gives meaning to the text of Article 10.2 as drafted and agreed by Members whereas Brazil's reading would effectively read it out of the Agreement on Agriculture.

**(b) Does the United States agree with the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the Agreement on Agriculture? Please cite any relevant material, including any past WTO dispute settlement cases. How would this reconcile with the United States' own statement, at paragraph 21 of its closing oral statement that "of course, the United States may not provide subsidies without any limit". USA**

188. Article 10.2 applies only to export credit guarantees (and export credits and insurance programmes) properly characterized as such. In the case of the United States, export credit guarantees are offered pursuant to programmes which charge premiums; impose limits on tenor; impose limits on exposure to individual bank obligations; impose limits on exposure to risk of default from different countries; define shipping periods; and issue allocations (value limitations) of potential guarantee availability for specific commodities to be exported to specific destinations. The United States also guarantees only a relatively small portion of interest. Consequently, participants remain exposed to a significant component of the over-all risk of default.

189. The United States submits that the deferral of disciplines under Article 10.2 properly applies to export credit guarantees offered pursuant to a programme with such characteristics; indeed, Brazil has not contested that US export credit guarantee programmes are encompassed by the terms of Article 10.2. Illegitimate attempts to characterize export subsidy programmes as export credit guarantee programmes would be subject to the anti-circumvention provisions of Article 10.1 and the other commitments of the Agreement on Agriculture.[84]

190. The US interpretation of Article 10.2 presents no conflict with the title of Article 10, which provides relevant context in interpreting the provisions of Article 10. Article 10 is entitled "Prevention of Circumvention on Export Subsidy Commitments." Article 10.2 contributes to the prevention of circumvention of export subsidy commitments by imposing two obligations on Members: first, they must undertake to work toward the development of internally agreed disciplines

[83]*See, e.g.*, Brazil's Oral Statement, para. 100 ("Article 10.2 instead announces Members' intent to work toward negotiations on *specific* disciplines for export credits.") (italics in original); *id.* ("In the meantime, while those *specific* disciplines are being discussed . . .") (emphasis added); *id.*, para. 102 ("Under the first part of Article 10.2, therefore, WTO Members have pledged to work toward the development of *specific* disciplines . . . .") (emphasis added); *id.*, para. 103 ("If Members do conclude an agreement on these *specific* disciplines . . . .") (emphasis added); *id.* (Brazil and the United States agree that there has been no agreement on any such *specific* disciplines . . . .") (emphasis added).

[84]For example, the United States could not simply change the name of the FSC Repeal and Extraterritorial Income Exclusion Act to the "FSC Repeal and Extraterritorial Income Exclusion Export Credit Guarantee Program" and successfully assert that the deferral of disciplines contemplated by Article 10.2 applies to such re-named program.

on export credit guarantees; second, "after agreement on such disciplines," they must provide export credit guarantees "only in conformity therewith". Thus, Members agreed that those internationally agreed disciplines would constrain the provision of export credit guarantees, which in turn would contribute to the goal of Article 10, to prevent the circumvention of export subsidy commitments.

191. Although the language quoted from paragraph 21 of the United States' closing oral statement was intended to address concerns involving domestic support for upland cotton,[85] it also applies in the case of export subsidies. The United States also cannot provide export subsidies without limit. It has a schedule of export subsidy reduction commitments for 12 commodities. For these commodities, export subsidies can only be provided in accordance with such schedule. For the remainder of agricultural commodities, the United States cannot provide export subsidies at all.

192. Although internationally agreed disciplines on export credit guarantee programmes have yet to be agreed, the characteristics of such programmes and the discipline inherent in the risk-sharing aspects of such programmes impose an internal constraint on their use. Indeed, the use of US export credit guarantee programmes has *declined* since the period before the inception of Uruguay Round commitments. As shown in the US answer to Question 82(b), the dollar value of guarantees provided by the United States in US fiscal year 1992 was $5,671.8 million, in fiscal year 1993 was $3,853.7 million, and in fiscal year 1994 was $3,177.4 million. In contrast, the average value of guarantees for fiscal years 1995 - 2002 was only $3,061.9 million. Any concerns about unchecked use of export credit guarantee programmes, then, are not supported by the post-Uruguay Round experience.

**(c) If, as the United States argues, there are no disciplines on export credit guarantees in the Agreement on Agriculture, how could export credit guarantees "conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity when there are allegedly no disciplines against which such an assessment could occur)? USA**

193. US export credit guarantee programmes provide "export credit guarantees" within the meaning of Article 10.2 and therefore will be subject to disciplines only as contemplated by that Article. Because no such disciplines currently exist, these programmes cannot be out of compliance with Part V of the Agriculture Agreement. Moreover, export credit guarantees are not export subsidies within the meaning of either Article 9.1 or 10.1, and since they are not export subsidies, Article 13(c) does not apply to them.

**(d) Is the United States advocating the view that its own export credit guarantee programmes, which pre-dated the Uruguay Round, are effectively "grandfathered" so as to benefit from some sort of exemption from the export subsidy disciplines of the Agreement on Agriculture? How, if at all, is it relevant that the SCGP did not, according to the United States, become relevant for upland cotton until the late 1990's (i.e. after the entry into force of the WTO Agreement)? USA**

194. It is not entirely clear what is meant by the term "grandfathering" in this connection. Agriculture Agreement Article 10.2 defers the imposition of disciplines on export credits, export

[85]The statement itself was intended to note that the United States is subject to the limit set forth in its domestic support reduction commitments for the Current Total Aggregate Measurement of Support. This amount, across all US commodities, is $19.1 billion. In addition, a very specific limit applies with respect to domestic support for upland cotton under the Peace Clause. It may not exceed the rate of 72.9 cents per pound, as decided in 1992, without removing the Peace Clause protection of Article 13 of the Agreement of Agriculture.

credit guarantees, and insurance programmes until internationally agreed disciplines are reached, and in that sense the export subsidy disciplines of the Agreement do not apply to the export credit guarantee programmes at issue in this dispute.

195. The SCGP began in 1996, and no transactions occurred under this programme in connection with cotton until fiscal year 1998, which began in September 1997. Although the negotiators obviously could not have considered the application of this specific programme, it is substantially similar in its operation to other US export credit guarantee programmes. Again, Brazil has not contested that SCGP provides export credit guarantees within the meaning of Article 10.2. Thus, the deferral of disciplines under Article 10.2 similarly applies.

*STEP 2 PAYMENTS*

**89. Does the United States confirm Brazil's statement in paragraph 331 of its first submission that "The conditions and requirements for Step 2 domestic payments remain unchanged with the passage of the 2002 FSRI Act"? What is the relevance of this, if any, to this dispute? USA**

196. While the Step 2 programme under the 2002 Act is largely consistent with the programme under the 1996 Act, there have been some modifications since the inception of the programme, relating to the precise nature of the price differential formula and the price ceiling for the Step 2 payments. The 2002 programme was unchanged from the 1996 Act programme, as amended, except for suspending the 1.25 cent differential. In the end, this is inconsequential because it does not materially affect the levels of support decided in marketing year 1992 (72.9 cents per pound) or that measures currently grant (52 cents per pound).

**90. Does the United States confirm Brazil's statement in paragraph 235 of its first submission that the changes concerning Step 2 export payments from the 1996 FAIR Act to the 2002 FSRI Act are: increase in the amount of the subsidy by 1.25 cents per pound and the removal of any budgetary limits that applied under the 1996 FAIR Act? What is the relevance of this, if any, to this dispute? USA**

197. As noted in the US answer to Question 89, the 2002 Act suspended the 1.25 cents differential, but the United States disagrees with the assertion of increased budgetary exposure for the programme. First, we note that Step 2 for the 1992 crop and marketing years was covered by the provisions of the 1990 Act, which had no limit on the amount of expense that could be undertaken in Step 2. For the 1996 Act, which covered the 1996-2002 crops until supplanted by the 2002 Act, there was a limit of $701 million for the six-year duration of the Act, and in fact that money did run out in December 1998. However, the Congress removed the budgetary limit of the 1996 Act as of October 1999 (Public Law No. 106-78, 22 Oct. 1999). Therefore, neither the 2002 Act, nor the 1996 Act (as of October 1999), nor the 1990 Act had budgetary limits on Step 2 expenditures.

198. While the potential step 2 payment (when price conditions in the statute are met) is higher in the 2002 Act than under the 1996 Act by as much as (but not more than) 1.25 cents per pound, step 2 merely changes the vehicle of support.

**91. What is the significance of the elimination of the 1.25 cent threshold payment in the 2002 FSRI Act pertaining to Step 2 payments? USA**

199. Please see the US answers to Question 89, 90, and 117.

**92. Does the United States confirm that Exhibit BRA-65 represents a sample contract for exporters of eligible upland cotton to conclude with the CCC under the FSRI 2002, and that an application form (Exhibit BRA-66) needs to be filled out with data on weekly**

**exports and submitted to the USDA FAS. Is Exhibit BRA-66 - Form CCC 1045-2 - also a valid example? If not, please identify any differences or distinctions. USA**

200. The Brazilian exhibits appear to be accurate versions of old Step 2 programme documents. Some of the documents in the exhibit are for domestic handlers and involved programme payment assignments. We also note that, in making an export claim, other documentation like bills of lading may be needed.

201. The official documents for the upland cotton step 2 programme can be found at the Farm Services Agency website (www.fsa.usda.gov/daco, click on "cotton" and on "upland cotton user marketing certificate programme".) There is a common contract that exists for both domestic users and exports under the Step 2 programme, CCC Form CCC-1045UP. Because of the different nature of uses and therefore applications, there are separate reporting forms: CCC-1045UP-1 for domestic users and CCC-1045UP-2 for Exporter Users. Recently updated documents used for this programme are attached as Exhibit US-21.

**93. Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment? USA**

202. As the United States has indicated, all upland cotton produced in the United States is eligible for the benefit of the Step 2 cotton subsidy. If the statutory price condition applies, all US upland cotton used during the applicable period of time will received the subsidy. "Use" in domestic manufacture or export constitutes the universe of potential use of US upland cotton. The United States submits that when the entirety of production of a good in a country is eligible to receive a subsidy, no contingency on export exists. The Step 2 subsidy is entirely distinct in this regard from a hypothetical situation in which a subsidy is theoretically available for domestic use, but in reality is exclusively or nearly exclusively available in connection with exports.

**95. Do the criteria in 7 CFR 1427.103(c)(2) (Exhibit BRA-37) that Step 2 "eligible upland cotton" must be "not imported cotton" apply to both domestic and export payments? USA**

203. Only domestic cotton is eligible for Step 2 payment, which is made if the statutory price conditions are met and requisite proof of use is submitted.

**96. Is a domestic sale a "use" for the purposes of Step 2 payments? Is a sale for export, or export, considered a "use"? USA**

204. A sale is not a use for purposes of the Step 2 subsidy. For domestic manufacture, opening the cotton bale constitutes use. For exports, similarly, the sale alone does not itself constitute use; the exporter must demonstrate actual exportation.[86]

**97. How does the United States respond to Brazil's assertion, at paragraph 70 of Brazil's oral statement at the first session of the first substantive meeting, that "It is obvious that a single bale of cotton cannot be both exported and used domestically." Is this a relevant consideration? USA**

205. It is unclear what Brazil's assertion is intended to demonstrate. The Step 2 programme makes payments to documented users of US upland cotton. If a bale cannot be both opened domestically and exported (although it is not clear why that would be so), that amounts to arguing that a single bale

[86]7 Code of Federal Regulations 1427.103(a).

cannot be "used" twice. The fact remains that *either* opening the bale domestically *or* exporting it – that is, the universe of activities resulting in use of US upland cotton – is entitled (given certain market conditions) to a Step 2 payment.

206. The United States notes, moreover, that it may actually be possible (economic realities aside) that the same bale could be exported and then brought back into the country and opened for domestic use. (Please see the US answer to Question 98 for more detail.) The US Department of Agriculture's position would be that the payment should be made on the bale once only. The purpose of the programme is to provide support to upland cotton farmers. Once the bale has been purchased by an upland cotton user, there would be no additional support for upland cotton farmers from providing Step 2 payments on additional "uses" of the same bale.

**98. How many Step 2 payments are received if a bale of upland cotton is exported, and then opened by a domestic user in the United States, or vice versa? USA**

207. If a bale were exported and then imported and opened up (or vice versa) it would be the US position that only one payment would be made. It does not appear that this situation has ever arisen in fact, but we note that the Step 2 regulations specifically provide that "imported" cotton is not eligible for payment. Such cotton may include any cotton that was imported, even if it had been produced in the United States.

**99. How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's oral statement at the first session of the first Panel meeting concerning the relevance of the Appellate Body Report in US-FSC (21.5). USA**

208. In contrast to the facts of the *United States – FSC (21.5)* dispute, in this dispute all of the product is produced in the United States; all of the product is eligible to receive the benefit of the subsidy; and all of the potential uses of the product are similarly eligible. If the statutory formula of price conditions applies, all US upland cotton used during that time – regardless of how such use is manifested – will receive the subsidy. This case involves only one factual situation: use of cotton during a particular period of time. The only factual distinction applicable here is whether the applicable price conditions are on or off. Brazil's emphasis on the "different instructions" in the programme regulations is misplaced. Such instructions are simply to demonstrate the requisite use and to assure payment is made to the proper party. If upland cotton could be used in a third or fourth way, this would not change the eligibility for subsidy but would necessitate a parallel third or fourth set of instructions to demonstrate that form of use as well.

**103. Is the Step 2 programme fund a unified fund that is available for either domestic users or exporters, without a specific amount earmarked for either domestic users or exporters? Please substantiate your response, including by reference to any applicable statutory or regulatory provisions. USA**

209. The upland cotton user marketing certificate programme (Step 2) makes no differentiation between funds for payments to exporters and domestic handlers – it is all one programme. The first paragraph of the Step 2 rule states:

> These regulations set forth the terms and conditions under which CCC shall make payments, in the form of commodity certificates or cash, to eligible domestic users and exporters of upland cotton who entered into an Upland Cotton Domestic User/Exporter Agreement with CCC to participate in the upland cotton user marketing certificate

The Step 2 rule was published on 18 October 2002, at 67 Federal Register 64454, and is codified at 7 Code of Federal Regulations 1427.100-.108.

210. As with other US domestic support measures, Step 2 payments are funded through the Commodity Credit Corporation, which has a borrowing authority in the Treasury and as such does not rely on appropriations. This is provided for in Sections 1207 and 1601(a) of the 2002 Act and codified at 7 US Code 7937 and 7991.

**104. How does the United States respond to the data presented in Exhibit BRA-69? Is it accurate? Please substantiate. USA**

211. The data in Exhibit BRA-69 is not official US Government data, and Brazil has not indicated the source of the information. Thus, we cannot confirm its reliability. The United States has tried in any event to obtain information in the format of Bra-69, which is not maintained and published by the US Government in that manner. The following data has been collected by the US Department of Agriculture and attempts to designate (as in Bra-69) Step 2 payments by fiscal year[87] and use.

| User Marketing Certificate (Step 2) Payments, by Fiscal Year and Use | | |
|---|---|---|
| **Fiscal Year** | **Mill Use (US $)** | **Export Use (US $)** |
| 1991 | 4,311,991 | 17,259 |
| 1992 | 102,769,543 | 30,852,107 |
| 1993 | 113,401,813 | 89,095,640 |
| 1994 | 28,251,613 | 178,266,742 |
| 1995 | 17,571,224 | 75,200,203 |
| 1996 | 0 | 34,798,579 |
| 1997 | 6,201,540 | 2,875,936 |
| 1998 | 255,502,154 | 158,924,004 |
| 1999 | 165,831,362 | 113,521,476 |
| 2000 | 260,075,318 | 185,273,956 |
| 2001 | 144,849,807 | 90,903,021 |
| 2002 | 72,425,112 | 105,415,152 |

A comparison with Exhibit BRA-69 suggests that the Brazilian data is inaccurate.

212. During the first panel meeting, the Panel asked about the figures shown for fiscal year 1996, which showed a zero payment for mill use and a positive number for export use. We suggested that perhaps appropriated amounts had suddenly run out, but our suggestion was not accurate. Rather, the odd numbers for fiscal year 1996 resulted because, at the time, payments for export use accrued when the contract for export was made. However, such payments were not paid until the export actually took place, at which time the exporter would be paid based on the Step 2 rates that applied when the

[87]The US fiscal year runs from October 1 - September 30, such that the 2002 fiscal year would run from 1 October 2001, through 30 September 2002.

contract was made. As the Panel is aware, Step 2 payments can be made only when there is a difference between world and US prices for cotton for a certain time period. In the case of fiscal year 1996, these prices did not satisfy the Step 2 conditions, but there were some payments that were made during that fiscal year because they had accrued by an export contract made in the previous fiscal year. That rule is now changed[88] so that the rate that applies for export use is the rate that is in effect when the export is made not when the contract for export was made.

**105. Why is the Step 2 programme separated into "domestic users" and "exporters"? Apart from differentiating between exporters and domestic users, with consequential differentiation as to the forms that must be filled out and certain other conditions that must be fulfilled, are the eligibility criteria for Step 2 payments identical? Are the form and rate of payment, as well as the actual payment made, identical? USA**

213. US law does not separate the Step 2 programme into domestic users and exporters. There is but one Step 2 statute – codified at 7 US Code 7937 – and but one Step 2 rule for all users – found at 7 Code of Federal Regulations 1427.100-.108. The statute and rule do identify "domestic users" and "exporters" as the universe of *bona fide* users of upland cotton and thus potential recipients for Step 2 payments. Therefore, the only distinction drawn between these recipients is the proof of use: domestic handlers are paid when they open a bale, and exporters are paid when they export. The form and rate of payment are identical.

**106. With respect to paragraph 139 of the United States' first written submission, are Step 2 export payments included in the annual reduction commitments of the United States? If so, why? USA**

214. The United States does not distinguish between the uses of US upland cotton for purposes of reporting the subsidy because the subsidy is not contingent on export performance. *All* Step 2 payments are reported as product-specific domestic support for upland cotton and are included within the Total Aggregate Measurement of Support calculation for purposes of *domestic support* reduction commitments.

**107. Please comment on any relevance, to Brazil's de jure claims of inconsistency with the provisions of the Agreement on Agriculture, of Exhibit BRA-69, which shows Step 2 payments made to (i) domestic users and (ii) exporters. This Exhibit shows that, from FY 91/92 through 02, the Step 2 payments for exporters exceeded those for domestic users in FY 94; FY 95; FY 96 (in fact there were no domestic payments in FY 96); and FY 02. In the other years, the domestic payments are greater than export payments. BRA, USA**

215. Without commenting on the accuracy of the specific numbers set forth in Exhibit BRA-69, it is entirely possible that in certain years one type of user happened to receive a larger share of payments than another type of user. This would entirely be a function of market conditions and relative demand for manufacture or for export. That is, differences in amounts paid to exporters and domestic users during any time period are happenstance based on actual use of US upland cotton.

216. The United States notes that payments to exporters were previously made based on when exporters finalized the sale contract, not on when the cotton was actually exported. In the specific case of fiscal year 1996, it appears that payments for exported upland cotton *accrued* during a period when Step 2 payments were allowed by the statute, but that the payments were actually made at a time when market conditions no longer met the statutory criteria for payment. The rule has been changed,[89] and that situation can no longer recur.

[88] *See* 61 Federal Register 37544, 37548 (18 July 1996).
[89] *See* 61 Federal Register 37544, 37548 (July 18, 1996).

**108. At paragraph 135 of its first written submission, the United States states : "[T]he subsidy is not contingent upon export performance..." (emphasis added). Again, in the course of the first Panel meeting, the United States admitted that the Step 2 payments were "subsidies". Does the United States thus concede that Step 2 payments constitute a "subsidy" within the meaning of the WTO Agreement? USA**

217. The United States has always maintained that Step 2 payments are subsidies that provide domestic support in favour of US agricultural producers.

**109. How does the United States respond to Brazil's arguments concerning a mandatory/discretionary distinction and the allegation that certain United States measures (including s.1207(a) of the 2002 FSRI Act) are mandatory? (This is referred to, for example, in paragraph 28 of Brazil's first written submission). Does the United States agree with the assertion that (subject to the availability of funds) the payment by the Secretary of Step 2 payments is mandatory under section 1207(a) FSRI upon fulfilment by a domestic user or exporter of the conditions set out in the legislation and regulations? If not, then why not? To what extent is this relevant here? What determines the "availability of funds"? Please cite any other relevant measures or provisions which you consider should guide the Panel in respect of this issue. USA**

218. The United States does not disagree that, subject to the availability of funds (that is, the availability of CCC borrowing authority), Step 2 payments must be made to all those who meet the conditions for eligibility. With respect to the well-accepted mandatory/discretionary distinction reflected in GATT 1947 and WTO panel and Appellate Body reports, the United States notes that the distinction is the natural consequence of the fact that there can be no presumption of bad faith in WTO dispute settlement, a fact that numerous Members, including the European Communities, have emphasized.[90] Thus, to the extent that a Member retains discretion under a measure to act in accordance with a WTO obligation, it may not be presumed that the Member will violate that obligation, or to conclude that the measure itself – separately from the measure's application in a specific instance – may be found inconsistent with that obligation.

**110. Section 1207(a) of the 2002 FSRI Act provides that during the period beginning on the date of the enactment of the FSRI Act through July 31 2008, " .. the Secretary shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters for documented purchases by domestic users and sales for export by exporters...". The Panel notes that Brazil does not appear to distinguish between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists. The United States refers to "benefits" and "payments" and "programme" in asserting that Step 2 is not export contingent (paragraphs 127-135 of the United States' first written submission).**

**(a) Do the parties thus agree that there is no need to draw any distinction between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists for the purposes of the Agreement on Agriculture? BRA, USA**

219. The United States agrees that there is no need to draw a distinction between cash payments and marketing certificates in terms of whether a subsidy exists for purposes of the Agreement on Agriculture.

[90] *See* Appellate Body Report, *United States - Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R, adopted 1 February 2002, para. 259.

**(b) Why would a domestic user or an exporter select to receive a marketing certificate over a cash payment? What is the proportion of cash payments vs. marketing certificates granted under the programme? USA**

220. A user of upland cotton that elects to receive payment in the form of a marketing certificate is entitled to redeem that certificate for an equivalent amount of upland cotton held by the Commodity Credit Corporation (CCC). Although authorized by statute, no Step 2 payments have been made in recent times in the form of certificates. Marketing certificates in lieu of cash payments for Step 2 were last used heavily in the early to mid-1990s. The CCC does not currently maintain high upland cotton inventories from which such certificates if issued could be redeemed.

**111. Does the United States maintain its argument that actions based on Article 3.1(b) of the SCM Agreement are conditionally "exempt from actions" due to the operation of Article 13 of the Agreement on Agriculture? USA**

221. Article 13(c) provides that "export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be . . . exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement." Article 13(b), which applies to domestic support measures, does not reference Subsidies Agreement Article 3. Brazil has advanced claims under Article 3.1(b) of the Subsidies Agreement only with respect to Step 2 payments, which are domestic support measures and not export subsidies. Thus, on the US view the Peace Clause would not appear to be applicable; however, to the extent Brazil asserts that Step 2 payments (or some part thereof) are export subsidies, Article 13(c) would be relevant.

222. We also note that paragraph 7 of Annex 3 requires that support in favour of domestic agricultural producers that is provided through payment to processors shall be included in the AMS of the Member. If payments are made in connection with both domestic and foreign product then such payments are not support in favour of domestic agricultural producers. Consequently, the Agriculture Agreement necessarily contemplates that support paid to processors may be paid solely with respect to domestic production. Under Article 6.3 of the Agriculture Agreement, if a Member is providing support within its domestic support reduction commitments, then such support may not be challenged under Article 3.1(b) because that Article applies "[e]xcept as provided in the Agreement on Agriculture". If a Member exceeds its domestic support reduction commitments, on the other hand, then such support paid to processors would be actionable under Article 3.1(b).

**112. In the event that the Panel finds that Article 6.3 of the Agreement on Agriculture does not preclude an examination of Brazil's claims under Article 3.1 of the SCM Agreement and Article III:4 of GATT 1994, how does the United States respond to the merits of Brazil's claims relating to Step 2 payments under those provisions? USA**

223. As indicated in the US answer to Question 111 from the Panel, and as the European Communities has noted in its third party submission, inasmuch as paragraph 7 of Annex 3 of the Agreement on Agriculture requires support in favour of agricultural producers that is paid to processors to be included in the Member's Aggregate Measurement of Support, then the Agreement on Agriculture necessarily contemplates that such payments to processors may apply solely with respect to domestic product. Otherwise, as in the case of Step 2 payments, domestic cotton producers would not receive the relative price benefit conferred by the payment. Consequently, such discrimination in favour of domestic production is permitted under the Agreement on Agriculture and, under Article 21.1 of that Agreement, the provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement are expressly "subject to the provisions of [the Agriculture] Agreement." For that reason, neither Article 3.1(b) of the Subsidies Agreement nor GATT 1994 Article III:4 precludes such payments to users of US upland cotton, unless the United States exceeds its domestic support reduction commitments.

**113. Is it necessary for measures directed at agricultural processors included in AMS to discriminate on the basis of the origin of goods? USA**

224. The United States does not express an opinion whether it is necessary in all circumstances for all Members with respect to all commodities. However, paragraph 7 of Annex 3 of the Agreement on Agriculture certainly contemplates that support in favour of domestic producers provided by payments to processors is included in the Aggregate Measurement of Support. In the case of Step 2 payments on upland cotton, if payments were provided in favour of all upland cotton, whether domestic or foreign, used by domestics mills or exporters, the price benefit for US producers would not be achieved. Without such a benefit to US producers, these payments would not need to be included in the Aggregate Measurement of Support. The Agreement on Agriculture does not preclude payments that solely benefit domestic producers; indeed, paragraph 7 contemplates such discriminatory subsidy payments. Accordingly, the United States reports all Step 2 payments as domestic support in favour of US producers of upland cotton.

**115. What is the meaning and relevance (if any) to Brazil's claims under Article 3 of the SCM Agreement and Article III:4 of GATT 1994 of the phrase "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products" in the Agreement on Agriculture? BRA, USA**

225. The United States directs the Panel's attention to the US answers to Questions 111, 112, and 113 from the Panel.

**116. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the Agreement on Agriculture? Does the phrase "provide support in favour of domestic producers" in Article 3.2 of the Agreement on Agriculture refer to, and/or permit such subsidies? BRA, USA**

226. Subsidies contingent on the use of domestic goods may be consistent with the Agreement on Agriculture. Paragraph 7 of Annex 3 of the Agreement requires the United States to include its Step 2 payments in favour of domestic upland cotton producers, even though such payments are made to processors, within its calculation of its Aggregate Measurement of Support. The United States has complied with its domestic support reduction commitments. Therefore, Step 2 payments to upland cotton users that provide support to domestic producers contingent on the use of domestic goods is consistent with the Agreement on Agriculture. If Members could not discriminate in favour of domestic producers when making subsidy payments through processors, there would be no reason for paragraph 7 of Annex 3. Such payments that are not limited to domestic products would not be in favour of domestic producers because the relative economic benefit of the subsidy vis-à-vis foreign production would not exist.

**117. What is the relationship between Step 2 payments to exporters and the marketing loan payments, both of which appear to compensate for the price differences relative to the Liverpool A-Index? For example, is there double compensation? Or is one of the explanations that these export-related price compensatory payments are paid to different operators (namely, the producer, on the one hand under the marketing loan arrangements, and the processor/users (Step 2 programme) arrangements on the other? USA**

227. Both marketing loan payments and Step 2 payments are domestic support for upland cotton, but the marketing loan payment is made directly to the producer whereas the Step 2 payment is made to users of the cotton. The marketing loan repayment formula, in section 1204 of the 2002 Act, and the Step 2 payment formula in section 1207 of the 2002 Act, differ by their terms and are simply

different forms of support, the latter (Step 2) being a form of support that can facilitate higher market prices for US cotton. We will address this more fully in our rebuttal submission.

**118. Can the United States confirm that it does not rely on Article III:8 of GATT 1994? USA**

228. The United States can confirm that the Step 2 payment is not made exclusively to domestic producers.

*ETI ACT*

**119. How does the United States respond to Brazil's reference to the panel report in India - Patents (EC) (at paragraph 138 of its oral statement at the first session of the first substantive meeting)? How, if at all, should the Panel take this report into account in considering the issues raised by Brazil's claims relating to the ETI Act? USA**

229. We agree with the passage quoted from the *India – Patents* dispute and consider it relevant to the extent that: Brazil has identified the challenged measure; Brazil has argued why the reasoning of the panels and Appellate Body are relevant in determining that the measure is inconsistent; and the Panel finds the reasoning in *FSC/ETI* persuasive. Our argument in the first written submission went to whether Brazil had carried its burden of bringing a *prima facie* case, in order to assist the Panel to fulfill its obligation under DSU Article 11 to make an objective assessment of the matter before it. Brazil may consider that it should not have to meet this burden, but under DSU rules as currently agreed, it must.[91] Finally, we note our statement in the first submission that "[w]hile the United States cannot specify the precise date on which this will occur, the United States is confident that the ETI Act will be repealed in the reasonably near future."[92]

**121. How do you respond to the reference in paragraph 43 of EC third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to that dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. USA, BRA**

230. The United States considers the EC's references to be irrelevant to the resolution of this dispute. As noted in the US first written submission, the United States intends to implement the DSB's recommendations and rulings in the *FSC/ETI* dispute. Further, the issues raised in the US first written submission related solely to whether Brazil had met its burden of argumentation in this dispute and not to the substantive correctness and applicability, or lack thereof, of the adopted findings in *FSC/ETI*. Nor did the US arguments relate to the breadth of the US obligation to implement the DSB's rulings and recommendations in that dispute. The United States considers that Brazil's burden in this dispute requires, at a minimum, that it identify those aspects of the measure which are WTO-consistent and explain why that is the case.

[91]*See* TN/DS/W/45 (Brazilian proposal in ongoing DSU review: "Brazil understands that one of the drawbacks of the current dispute settlement mechanism is the necessity for a Member to litigate a case *de novo* through all the established phases even if the same measure nullifying or impairing benefits of this Member has already been found WTO inconsistent in previous panel or appeal proceedings initiated by another Member.").

[92]US First Written Submission, para. 189.

# ANNEX I-3

## COMMENTS OF BRAZIL TO ANSWERS TO QUESTIONS POSED BY THE PANEL FOLLOWING THE FIRST SUBSTANTIVE MEETING OF THE PANEL

22 August 2003

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| US – Shirts and Blouses | Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB, adopted 23 May 1997 |
| Brazil - Aircraft | Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 20 August 1999 |
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| US - DRAMS | Panel Report, *United States – Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMS) of One Megabit or Above from Korea*, WT/DS99/R, adopted 19 March 1999 |
| Canada – Dairy | Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R and WT/DS113/AB/R, adopted 27 October 1999. |
| US - FSC | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
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| Chile – Price Band | Appellate Body Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002 |
| US – Byrd Amendment | Appellate Body Report, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/AB/R and WT/DS234/AB/R, adopted 27 January 2003 |
| Canada – Aircraft II | Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, adopted 19 February 2002. |
| EC - Sardines | Appellate Body Report, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002. |

**List of Exhibits**

| | |
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| O.A. Cleveland Newsletter, 25 April 2003; O.A. Cleveland Newsletter, 8 August 2003 | *Exhibit Bra- 187* |
| Testimony of James Echols, Chairman of the National Cotton Council before the Committee on Agriculture, Nutrition and Forestry of the US Senate, 17 July 2001 | *Exhibit Bra- 188* |
| Cotton and Wool Outlook, USDA, 13 August 2003 | *Exhibit Bra- 189* |
| Affidavit of Marcelo Pinheiro Franco | *Exhibit Bra- 190* |

## I. PRELIMINARY ISSUES

**(3) If the request for consultations in this dispute omitted certain products in relation to export credit guarantees, on what basis is it argued that it failed to identify the measures at issue in accordance with Article 4.4 of the DSU?**

**Brazil's Comment on US Answer:**

1. In paragraphs 5-6 of its 11 August Answer to Question 3, the United States argues that footnote 1 to Brazil's request for consultations does not expand the scope of the request, with regard to the US export credit guarantee programmes, beyond upland cotton. This is inaccurate. The footnote number falls *immediately after the words "upland cotton"* in the first sentence of the first paragraph of the request. With reference to "upland cotton", the footnote reads, "[e]xcept with respect to export credit guarantee programmes as explained below".[1] Although the United States claims that there is no explanation "below", there is indeed such an explanation. In particular, Brazil described its potential claim as follows, on page 4 of the request:

> Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as GSM-102, GSM-103, and SCGP programmes, Brazil is of the view that these programmes, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included in Annex I to the SCM Agreement.[2]

The Panel will note that there is no limitation in this sentence to any particular commodity or commodities.

2. At paragraph 7 of its 11 August Answer, the United States asserts that "the statement of evidence attached to Brazil's consultation request did not include any evidence related to measures other than those for upland cotton." This too is inaccurate. The United States conveniently leaves the word "available" out of the term "statement of available evidence" used in Articles 4.2 and 7.2 of the SCM Agreement. Brazil was required to provide a statement of the evidence available to it at the time. It was not required to attach exhibits with the evidence; nor was it required to provide a statement regarding all of the evidence that it would eventually present to this Panel. In paragraph 3 of its statement of available evidence, Brazil addressed what it knew at that point about the US export credit guarantee programmes:

> US export credit guarantee programmes, since their origin in 1980 and up [to] the present, provide premium rates that are inadequate to cover the long-term operating costs and losses of the programmes; in particular there were losses caused by large-scale defaults totaling billions of dollars that have not been reflected in increased premiums to cover such losses.

3. This sentence speaks not just to the existence of the US export credit guarantee programmes, but also to the way in which they constitute export subsidies, given the explicit use of the language included in item (j) of the Illustrative List of Export Subsidies. The statement fulfils the requirement in Articles 4.2 and 7.2 of the SCM Agreement. The Panel will also note that there is no limitation in this sentence to any particular commodity or commodities.

4. In footnote 3 to its response, the United States states that it "will be making a request for a preliminary ruling" that Brazil's consultation request was broader than its statement of evidence, in

[1] WT/DS/267/1, p. 1.
[2] WT/DS/267/1, p. 4.

violation of Article 7.2.[3] As demonstrated above, Brazil's request, and the accompanying statement of available evidence, do not support the United States' assertion. Both the request and the statement of available evidence address the US export credit guarantee programmes without limitation to any particular commodity or commodities.

5. Moreover, even if the United States were to make this request for a preliminary ruling and the Panel were to grant it, it would not affect Brazil's claims. Brazil's compliance with Article 7.2 of the SCM Agreement can have no effect on its claims under the Agreement on Agriculture, or on its prohibited subsidy claims under the SCM Agreement, or on its actionable subsidy claims with respect to upland cotton.

6. Finally, according to the Panel's Working Procedures, requests for preliminary rulings by a party were to have been made "not later than its first submission to the Panel".[4] Thus, the US request would not be timely. Brazil submits this information at this stage in the hope of avoiding another lengthy procedural objection by the United States.

**(4) Is it argued that the export credit guarantee programmes concerning upland cotton are each a separate or independent measure, in that they operate independently?**

**Brazil's Comment on US Answer:**

7. In paragraph 11 of its 11 August Answer to Question 4, the United States argues that "each export credit guarantee issued is a separate measure". It is not for the United States to define the measures that are the subject of Brazil's challenge. Brazil's requests for consultations and establishment identify the measures at issue as the GSM 102, GSM 103 and SCGP programs, both as such and as applied. In its submissions, Brazil has demonstrated that the programmes constitute export subsidies under Articles 1.1 and 3.1(a) of the SCM Agreement, since they are unique financing vehicles that are not available on the market for agricultural commodity transactions and as such provide something better than is available on the market. Brazil has also demonstrated that the long-term operating costs and losses for the programs outpace premiums collected, under item (j) of the Illustrative List (item (j) speaks to the long-term operating costs and losses of "programmes," and not individual guarantees).

**(8) Does the United States confirm that the questions referred to by Brazil in paragraph 92 of Brazil's oral statement were posed to the United States in the consultations?**

**Brazil's Comment on US Answer:**

8. In paragraph 17 of its 11 August Answer, the United States concedes that Brazil posed the questions included at Exhibit Bra-101. The Panel will note that many of the questions included in Section 9 of Brazil's list of questions cover export credit guarantees for all commodities. The United States therefore concedes that Brazil consulted with it on the matters raised in those questions. As Brazil discussed in paragraphs 95-98 of its Statement at the First Meeting of the Panel, panels and the Appellate Body have concluded that for a matter to be properly within the scope of a request for establishment, actual consultations must have been held. That has also been the United States' position in a number of other disputes, including *US – DRAMS* and *Japan – Agricultural Products*.[5]

9. The refusal of the United States to answer Brazil's questions cannot hinder Brazil's ability to pursue its claims against the CCC export guarantee programmes without any limitation to a particular

[3] US 11 August Answer to Question 3, para. 7 and footnote 3 to that paragraph.
[4] Working Procedures of the Panel, 27 May 2003, para. 12.
[5] Oral Statement of Brazil, para. 96-97.

commodity or commodities. If it did, responding Members would have every incentive to refuse to answer any questions during consultations, thereby halting dispute settlement proceedings altogether.

**(10) What actual prejudice, if any, has the United States suffered as a result of the alleged omission of products other than upland cotton from the request for consultations?**

**Brazil's Comment on US Answer:**

10. Brazil agrees that "a Member cannot proceed to a panel unless the Member has consulted on that measure", as the United States argues in paragraph 19 of its response. Brazil's request for consultations included the CCC export guarantee programmes in connection with all commodities, however, and the United States concedes, in paragraph 17 of its answer to Question 8, that it consulted with Brazil via the list of questions included in Exhibit Bra-101.

11. Brazil does not agree with the United States' assertion, at paragraph 20 of its 11 August Answer, that the consultation request is of a "jurisdictional nature". While the Appellate Body has concluded that a complaining Member's request for *establishment* is jurisdictional in nature, and strictly delimits a panel's terms of reference[6], it has not made this statement with respect to a request for *consultations*. In fact, in *Brazil – Aircraft*, the Appellate Body concluded that there is no requirement for a "*precise and exact identity*" between a request for consultations and a request for establishment, which suggests that a request for consultations is *not* jurisdictional in nature.[7]

12. In paragraph 23 of its 11 August Answer, the United States argues, without any proof, that it "has suffered an inability to prepare, respond, and consult with respect to allegations on measures never presented to the United States in accordance with the DSU". As noted above, Brazil's request for consultations specifically addressed potential claims against the US export credit guarantee programs in connection with all commodities, and not just upland cotton. Moreover, the United States acknowledges that Brazil posed questions to it regarding those programmes in connection with all commodities. The questions were provided to the United States in writing on 22 November, in advance of the consultations session.[8] In paragraph 92 of its Oral Statement at the First Meeting of the Panel, Brazil offered extracts from those questions, which clarify that consultations regarding the US export credit guarantee programs were not limited to upland cotton.

13. The United States, therefore, was aware, both from Brazil's request for consultations and from Brazil's extensive list of questions, that the consultations included US export credit guarantee programs with respect to all commodities, and not just upland cotton. That the United States refused to respond to Brazil's questions does not mean that it had an "*inability*" to prepare, respond, and consult with Brazil – it means that the United States made a strategic decision not to do so. The United States had more than seven months from receipt of Brazil's questions until it filed its First Submission to "prepare and respond" to Brazil's claims. This demonstrates that no due process rights were violated nor any prejudice caused. The United States alone bears responsibility for any alleged "prejudice" it has suffered as a result of its own strategic decision.

14. In paragraph 24 of its 11 August Answer, the United States argues that it "has not had [sic] proper opportunity to consult" with Brazil on the US export credit guarantee programs with respect to all commodities. In paragraph 17 of its 11 August Answer to Question 8, however, the United States concedes that Brazil did pose questions on the US export credit guarantee programmes with respect to all commodities. Consultations did, therefore, occur with respect to export credit guarantees covering all eligible agricultural products. The United States refused during meetings on 3-4 December, 19 December 2002 and 17 January 2003 to provide answers to Brazil's questions. With its

[6] Appellate Body Report, *EC – Bananas III*, WT/DS27/AB/R, para. 142.
[7] Appellate Body Report, *Brazil – Aircraft*, WT/DS46/AB/R, para. 132.
[8] Exhibit Bra-101 (Brazil's Questions for the Purposes of Consulations, 22 November 2002).

consultations request and its extensive list of questions, however, Brazil fulfilled the requirement to consult with the United States on the full scope of the programmes.

**(11) Does the United States agree that Brazil's request for establishment of the Panel can be understood to indicate that Brazil's export credit guarantee claims relates to products other than upland cotton? How, if at all, is this relevant?**

**Brazil's Comment on US Answer:**

15. At paragraphs 96-97 of its Statement at the First Panel Meeting, Brazil noted that in other disputes, the US position has been that "'a Member should be permitted to refer a claim to a panel if it was actually raised during consultations, even though it may not have been included in the written request for consultations.'"[9] In its 11 August Answer to Question 11, the United States now suggests that its position is different with respect to measures than it is with respect to claims. According to the United States, while a Member can add *claims* not present in its consultations request to its panel request, it cannot add *measures*.[10]

16. Brazil repeats that its request for consultations does in fact address the US measures (the GSM 102, GSM 103 and SCGP programs) in connection with all commodities. Every measure included in its request for establishment was similarly included in its request for consultations. The US argument is therefore irrelevant.

17. In any event, the US reliance on the Appellate Body's decision in *Guatemala – Cement (I)* is misplaced.[11] In that case, the Appellate Body explained that the text of Article 6 of the DSU and Article 17.4 of the Anti-Dumping Agreement required a distinction between measures and claims. The United States has, however, failed to explain the textual reason why the distinction between measures and claims is relevant *for the purpose of comparing a request for consultations with a request for establishment*. In fact, the Appellate Body has specifically held that Articles 4 and 6 of the DSU do not "require a *precise and exact identity* between the specific measures that were the subject of consultations and the specific measures identified in the request for the establishment of a panel".[12] Nor has the United States offered any logical reason why a Member should be allowed to add claims not covered by its consultations request to its request for establishment, but not measures. If anything, a defending Member would seem to suffer greater prejudice by the addition of claims than by the addition of measures, since the Member is likely more familiar with its *own* measures than it would be with *another Member's* claims.

**(16) What, if any, prejudice in terms of presentation of its case does the United States allege, should the Panel proceed to consider the measures constituting the cottonseed payments under the Agriculture Assistance Act of 2003?**

**Brazil's Comment on US Answer:**

18. There have been many disputes in which Panel found that measures, which were replacement measures to measures originally consulted on, were included in the panel's terms of reference, *Korea – Beef*[13] *and Chile- Agricultural Products (Price Band)*[14], to name a few. The Agricultural Assistance Act of 2003 is in the nature of a revised measure, as Brazil has argued in paragraphs 145-150 of its

[9] Panel Report, *US – DRAMS*, WT/DS99/R, para. 6.8.
[10] US 11 August Answer to Question 11, para. 25.
[11] US 11 August Answer to Question 11, para. 26 note 9
[12] Appellate Body Report, *Brazil – Aircraft*, WT/DS46/AB/R, para. 132.
[13] Panel Report, *Korea – Beef*, WT/DS161/R and WT/DS169/R, para. 563-564.
[14] Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 143-144.

Oral Statement. Brazil also notes that the United States has identified no prejudice to its ability to defend this measure in this dispute.

**(17) (a) What is the relationship of the Agricultural Assistance Act of 2003 to other legislation in the request for establishment of the Panel?**

**(b) Do the legal instruments follow directly one after another, or are there temporal gaps? Are payments authorized under a broad legislative authority or are they specific to each legal instrument?**

**(c) Please provide any implementing regulations. Do these implementing regulations resemble those relating to previous programmes or payments? Are payments made retrospectively? How if at all is this relevant?**

**Brazil's Comment on US Answer**

19. The United States argues that the four legislative acts that authorize cottonseed payments for the MY 1999, 2000 and 2002 crop are completely unrelated measures and that – while the regulations implementing these payments are very similar – this is immaterial to the question of whether such payments are part of a single programme.[15]

20. If a Member like Brazil would be prevented from challenging yearly renewed measures that provide support under the very same mechanism – and in fact under nearly identical regulations[16] – than another Member like the United States could continue to enact yearly measures and limit the challenge by WTO Members to old measures without a prevailing challenge having any effect on its current and future identical measures. The result would put a complaining Member in the impossible situation of having to challenge identical measures year after year, just because they are based on legislation that "bears no relation"[17] to preceding *identical* legislation *on the same matter*.

21. The Panel in *Argentina – Footwear* rejected similar arguments to those made by the United States:

Moreover, it appears that an interpretation whereby these subsequent Resolutions are considered to be measures separate and independent from the definitive safeguard measure, and thus outside our terms of reference, could be contrary to Article 3.3 of the DSU. Such an interpretation could allow a situation where a matter brought to the DSB for prompt settlement is not *resolved when the defendant changes the legal form of the measure through a separate but closely related instrument, while the measure in dispute remains essentially the same in substance*. In this way, Members could always keep one step ahead of any WTO dispute settlement proceeding because in such a situation, the complaining Member would indeed, challenge a "moving target", and panel and Appellate Body's findings could already be overtaken by events when they are rendered and adopted by the DSB.[18]

22. Brazil maintains that the Agricultural Assistance Act of 2003 constitutes a subsequent, separate but closely related instrument, that is essentially the same as the legal instruments authorizing the MY 1999 and MY 2000 cottonseed payments and that is, therefore, within the Panel's terms of reference.

[15] US 11 August Answer to Question 17, para. 39-43.
[16] *Compare* Exhibit US14-US16.
[17] US 11 August Answer to Question 17, para. 39.
[18] Panel Report, *Argentina – Footwear*, WT/DS121/R, para. 8.41 (emphasis added).

## II. ARTICLE 13(B): DOMESTIC SUPPORT MEASURES

### A. "EXEMPT FROM ACTIONS"

**(20) In paragraph 8 of its initial brief (dated 5 June, 2003), the United States argued that the word "actions" as used in the phrase "exempt from actions" in Article 13 of the Agreement on Agriculture includes the "bringing of a case" and consultations. In paragraph 36 of its first written submission (dated 11 July, 2003), the United States stated as follows:**

**"[P]rior to this point in the process, the DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause."**
**Is it the United States' understanding that the drafters used the phrase "exempt from actions" knowing that under the DSU it would not be possible fully to exempt "actions", as the United States interprets that term?**

**(21) In US - FSC and US - FSC (21.5) the Appellate Body made findings under the SCM Agreement relating to export subsidies in respect of agricultural products without making a finding in respect of Article 13 of the Agreement on Agriculture. How is this relevant to the United States' interpretation of the phrase "exempt from actions" as used in Article 13? USA**

**Brazil's Comment on US Answers:**

23. The United States and the European Communities maintain that the complaining party has the burden of proof under Article 13 of the Agreement on Agriculture. More specifically, they claim that Article 13 is not in the nature of an affirmative defence. Brazil's comment will again show that their position is untenable.

24. In its 11 August Answer to Question 20 of the Panel, the United States asserts, under the "exempt from action" argument, that "Brazil has attempted to improperly invoke dispute settlement procedures notwithstanding the Peace Clause."[19] According to the United States, a dispute settlement procedure could only be initiated after a determination of non-compliance with Article 13 has been made. In its 11 August Answer to Question 21, the United States then dismisses the findings in *US – FSC* by simply stating that they do not address the peace clause and that the issue was not raised by either party in that case.[20] Therefore, those rulings and recommendations "provide no guidance for purposes of this dispute".

25. The EC maintains that "Article 13 is more akin to a threshold permitting further action if the threshold is not complied with."[21] The EC affirms that Article 13 "is an integral part of the *Agreement on Agriculture*".[22] In that sense it would be comparable to Article 6 of the ATC, Article 3.3 of the SPS Agreement, and Article 2.4 of the TBT Agreement, which were found not to be affirmative defences by the Appellate Body.[23] According to the EC, those provisions, like Article 13 of the Agreement on Agriculture, "provide certain rights to WTO Members, but cannot be seen as exceptions".[24]

[19] US 11 August Answer to Question 20, para. 47.
[20] US 11 August Answer to Question 21, para. 48.
[21] Third Party Submission of the EC, para. 11.
[22] Third Party Submission of the EC, para. 12.
[23] Third Party Submission of the EC, para. 12.
[24] Third Party Submission of the EC, para. 12.

26. Brazil disagrees. The Appellate Body addressed the issue of burden of proof on numerous occasions. In *US – Shirts and Blouses*, the Appellate Body made a general finding stating that

... the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.
In the context of the GATT 1994 and the WTO Agreement, precisely how much and precisely what kind of evidence will be required to establish such a presumption will necessarily vary from measure to measure, provision to provision, and case to case.[25]

27. When examining Article 6 of the ATC, Article 3.3 of the SPS Agreement, and Article 2.4 of the TBT Agreement, the Appellate Body did not stray from this principle. In fact, it was the cornerstone of all determinations concerning the above-cited provisions. Paragraph 275 of the Appellate Body report in *EC – Sardines* reads:

> In EC – Hormones, we found that a "general rule-exception" relationship between Articles 3.1 and 3.3 of the SPS Agreement does not exist, with the consequence that *the complainant had to establish a case of inconsistency with both Articles 3.1 and 3.3*.[196] We reached this conclusion as a consequence of our finding there that "Article 3.1 of the SPS Agreement simply excludes from its scope of application the kinds of situations covered by Article 3.3 of that Agreement".[197] Similarly, the circumstances envisaged in the second part of Article 2.4 are excluded from the scope of application of the first part of Article 2.4. Accordingly, as with Articles 3.1 and 3.3 of the SPS Agreement, there is no "general rule-exception" relationship between the first and the second parts of Article 2.4. Hence, in this case, it is for Peru – *as the complaining Member seeking a ruling on the inconsistency with Article 2.4 of the TBT Agreement* of the measure applied by the European Communities – to bear the burden of proving its claim. (emphasis added) (footnotes omitted)[26]

28. With regard to Article 6 of the ATC, the Appellate Body found that provision to be a fundamental part of the rights and obligations of WTO Members concerning non-integrated textile and clothing products covered by the ATC during the transition period. Consequently a party claiming a violation of a provision of the WTO Agreement by another Member must assert and prove its claim. In this case, *India claimed a violation by the United States of Article 6 of the ATC.* We agree with the Panel that it, therefore, was up to India to put forward evidence and legal argument sufficient to demonstrate that the transitional safeguard action by the United States was inconsistent with the obligations assumed by the United States under Articles 2 and 6 of the ATC. (emphasis added)[27]

29. Unlike the EC, Brazil believes that these Appellate Body findings underscore the striking differences between Article 13 of the Agreement on Agriculture and the other provisions cited by the EC and which the Appellate Body found not to be in the nature of an affirmative defence.

30. First, Brazil notes that in all Appellate Body findings, the complaining party claimed a violation of the provision at issue. The complaining party tried to impute the burden of proof on the respondent by alleging that those provisions also contained language that provided an opportunity for an affirmative defence under an “exception” to the general rule.

[25] Appellate Body Report, *US – Shirts and Blouses*, p. 14.
[26] Appellate Body Report, *EC – Sardines*, para. 275.
[27] Appellate Body Report, *US – Shirts and Blouses*, p. 16.

31. Article 13 of the Agreement on Agriculture is entirely different. The peace clause imposes no obligations on WTO Members. As the EC rightfully stated in paragraph 6 of its Initial Submission of 10 June 2003:

> a Member is not under an obligation to act consistently with Article 13 of the *Agreement on Agriculture* – failing to respect Article 13 implies that a Member no longer enjoys protection thereof. Consequently ... Article 13 of the *Agreement on Agriculture* can only be seen as a defence against a claim brought under other aspects of the WTO Agreements which regulate the provision of subsidies. It would seem bizarre if before Brazil could bring a claim with respect to subsidies which it considered did not respect the US's obligations, Brazil had first to establish that potential defences did not apply. (italics in original) (underlining added)[28]

32. Brazil entirely agrees with the characterization of Article 13 as a potential defence against claims brought before the WTO. In fact, as the Panel is well aware, in Brazil's request for the establishment of the Panel, Brazil does not claim that the United States violated Article 13. Such violation is indeed impossible, since Article 13 of the Agreement on Agriculture imposes no obligations whatsoever on WTO Members. Article 13 simply provides shelter to Members that invoke its exemption from actions based on certain other provisions of the WTO Agreements. Again, as the Appellate Body stressed every single time it addressed the issue, "the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence."[29]

33. Second, Brazil's interpretation is entirely compatible with the findings of the panel and the Appellate Body in *US – FSC*. Brazil, unlike the United States, considers these finding to be very relevant to this dispute. In *US – FSC*, the United States decided not to invoke Article 13 of the Agreement on Agriculture as a possible defence against the challenges brought by the EC. The panel and the Appellate Body did not need to address Article 13 simply because it was not used as a defence by the respondent. This situation is not necessarily unusual. For example, a respondent that knows, in advance, that it is not complying with the requirements of Article 13, may well choose to directly rebut the prima facie case of the complainant by providing rebuttal arguments and evidence without attempting to use the Article 13 shelter.

34. Indeed, interpreting Article 13 of the Agreement on Agriculture as a "threshold"[30] provision is at odds with the Appellate Body's findings in *US – FSC*, *US– FSC* (21.5), *Mexico – HFCS* (21.5) and *US – Byrd Amendment*. In Mexico – HFCS (21.5), the Appellate Body held that

> We believe that a panel comes under a duty to address issues in at least two instances. First, as a matter of due process, and the proper exercise of the judicial function, panels are required to address issues that are put before them by the parties to a dispute. Second, *panels have to address and dispose of certain issues of a fundamental nature, even if the parties to the dispute remain silent on those issues*. In this regard, we have previously observed that '[t]he vesting of jurisdiction in a panel is a fundamental prerequisite for the lawful panel proceeding.' For this reason, panels cannot simply ignore issues which go to the root of their jurisdiction – that is, to their authority to deal with and dispose of matters. Rather, *panels must deal with such issues – if necessary, on their own motion – in order to satisfy themselves that they have authority to proceed*. (emphasis added) (footnote omitted)[31]

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[28] Initial Third Party Submission of the EC, para. 6.
[29] Appellate Body Report, *US – Shirts and Blouses*, p. 14.
[30] Third Party Submission of the EC, para. 11.
[31] Appellate Body Report, *Mexico – HFCS (21.5)*, WT/DS132/AB/RW, para. 36.

35. The Appellate Body applied this reasoning to itself in *US – Byrd Amendment*. In that case, the Appellate Body examined an issue related to the Panels jurisdiction, although it was not addressed before the Panel or, indeed mentioned in the notice of appeal.[32] If Article 13 of the Agreement on Agriculture were a threshold provision affecting the jurisdiction of a panel or the Appellate Body, both the panels and the Appellate Body in *US – FSC* and *US – FSC* (21.5) would have had to address the issue of peace clause exemption of the claims brought by the EC. The fact that none of them did is further evidence that Article 13 is not a "threshold" or jurisdictional provision. As Brazil maintains, Article 13 of the Agreement on Agriculture is an affirmative defence.

36. Further, Brazil does not claim that Article 13 is an "exception". Brazil does not claim that the United States "violated" Article 13 and, therefore, Brazil does not bear the burden of proving any such assertion. Actually, Brazil simply does not believe that Article 13 is at all relevant to claims raised under the SCM Agreement or GATT Article XVI until the respondent claims that it is exempt by the provisions of the peace clause. The respondent claiming such exemption has the burden of proving that it is entitled to it.[33] If the respondent does not claim such protection, Article 13 is moot, as demonstrated by the *US – FSC* case.

37. In paragraph 11 of its Oral Statement of 24 July, the EC points out that no "credible response" was given to the argument it put forward suggesting that Brazil's approach "has perverse effects".[34] The EC claimed that

> if Article 13 is considered an affirmative defence, when a complainant brings a dispute under Articles 5 and 6 of the SCM Agreement and, for instance, Article 6 of the *Agreement on Agriculture*, the complainant would be required to prove a breach of Article 6 while at the same time the defendant would also be required to prove that it had not infringed Article 6 of the Agreement. The burden of proof cannot switch between parties simply on the basis of whether the complainant cites the *SCM Agreement* or not ..." (italics on the original)[35]

38. Brazil fails to see the conundrum that seems to puzzle the EC. If the complainant cites the SCM Agreement or, better still, alleges a violation of the SCM Agreement together with a violation of Article 6 of the *Agreement on Agriculture*, the burden of proving both assertions rests on the complainant irrespective of the fact that the respondent may invoke Article 13. If the complainant fails to establish the violation of Article 6 of the *Agreement on Agriculture*, then the task of the respondent to invoke the Article 13 shelter against a possible violation of the SCM Agreement is made that much easier. In fact, the burden of proof concerning the violation of Article 6 of the *Agreement on Agriculture* will simply *start* with the complainant. As the Appellate Body noted in *US – Shirts and Blouses*, if the complainant "adduces evidence sufficient to raise a presumption that what is claimed is true, the burden shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption". Therefore, the burden of proof may well switch between parties, but not "on the basis of whether the complainant cites the *SCM Agreement*", as the EC suggested in its Oral Statement.

39. In sum, Brazil reemphasizes that the peace clause is in the nature of an affirmative defence.

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[32] Appellate Body Report, *US – Byrd Amendment*, WT/DS217/AB/R and WT/DS234/AB/R, para. 206-208.

[33] Appellate Body Report, *US – Shirts and Blouses*, p. 14.

[34] Oral Statement of the EC, para. 11

[35] Oral Statement of the EC, para. 11.

B. "SUCH MEASURES" AND ANNEX 2 OF THE AGREEMENT ON AGRICULTURE

**(22) Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture.**

**Brazil's Comment on US Answer:**

40. The United States 11 August Answer to Question 22 renders the meaning of the word "fixed" meaningless by isolating the phrase "relative position" from the full dictionary definition.[36] The complete definition includes the phrase "definite, permanent, and lasting".[37] There is nothing "permanent" about the US interpretation of the meaning of "fixed base period" for the PFC and direct payment programmes. For further comments on the issue, Brazil refers the Panel to paragraphs 10-12 of its Rebuttal Submission.

**(24) How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture?**

**Brazil's Comment on US Answer:**

41. Brazil agrees with the United States' statement that there is "no requirement in paragraph 6 that a particular base period be used for a decoupled income support measure nor that the same base period be used for purposes of every decoupled income support measure."[38] But this misses the point. The legal and factual question is whether a measure for which a new base period is "*fixed*" has the same structure, design, and eligibility criteria as an older replaced measure which had a *different* base period. The evidence demonstrates that PFC payments and direct payments have a similar structure, design, and eligibility criteria.[39]

**(29) Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the Agreement on Agriculture.**

**Brazil's Comment on US Answer:**

42. The United States argues in response to this question that "compliance with the fundamental requirement of the first sentence will be demonstrated by conforming to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6-13."[40] Brazil disagrees that compliance with the basic and policy-specific criteria is a sufficient condition for compliance with the fundamental requirement. For example, the volume of direct payments that conform to the criteria in paragraph 6 is not limited. However, the amount of support a Member provides may be so large that the payments create significant production and trade-distorting effects. Therefore, even if direct payments conform to the basic and policy-specific criteria in Annex 2, they may still have considerable production and trade-distorting effects. Brazil refers to its arguments in support of the "stand-alone" nature of the fundamental requirement.[41]

[36] Brazil 11 August Answer to Question 22, para. 20.
[37] The New Shorter Oxford English Dictionary, 1993 edition, p. 962.
[38] US 11 August Answer to Question 24.
[39] *See* Rebuttal Submission of Brazil, para. 10.
[40] US 11 August Answer to Question 29, para. 59.
[41] First Submission of Brazil, para. 163-165; Brazil's 11 August Answer to Questions 27-28, para. 32-43.

**(32) If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2.**

**Brazil's Comment on US Answer:**

43. Contrary to the US argument at paragraph 68 of its 11 August Answers, there is no conflict between the Brazil's position regarding the fruits, vegetables and wild rice prohibition and Annex 2, paragraph 1 "fundamental requirement". The undisputed facts show that this prohibition on the production of certain crops channels production to other crops that are permitted to be produced to receive the payment.[42] This channeling of payments creates production and trade distorting effects inconsistent with Annex 2, paragraph 1.

44. Further, the United States engages in a wishful interpretation when it states in paragraph 68 of its 11 August Answer that "paragraph 6(b) should be read to prevent a Member from requiring a recipient *to produce* certain crops". This interpretation would render Annex 2, paragraph 6(e) a nullity. Paragraph 6(e) provides that "no production shall be required in order to receive such payments". The US interpretation of paragraph 6(b) as not requiring the production of "certain crops" is the same as 6(e)'s prohibition on not requiring production of "any crops".

45. Paragraph 6(b) is distinct from paragraph 6(e) because it provides a clear test that *the amount* of payment cannot be related to the type of production. There is no factual dispute among the parties that the amount of PFC and direct payments *falls* when base acres are used to produce fruits, vegetables, tree nuts, and wild rice. There is no factual dispute that the 1996 FAIR Act and the 2002 FSRI Act *require* the prohibition or reduction in payments if these crops are produced on base acreage. Given these two undisputed facts and the clear text of Annex 2, paragraph 6(b), the only conclusion is that PFC and direct payments do not meet the policy specific criteria of Annex 2.

C. "DO NOT GRANT SUPPORT TO A SPECIFIC COMMODITY"

**(33) According to the United States' interpretation of the word "grant", when can a Member claim that a measure is not exempt from action under Article 13(b)? what if the measures is enacted annually? Can the Member obtain a remedy in respect of that measure under the DSU?**

**Brazil Comment to US Answer:**

46. Brazil's addresses in detail the US "statute of limitations" argument at paragraphs 88-96 of its Rebuttal Submission, as well as at paragraphs 40-47 of its Oral Statement.

**(37) In the United States' view, why did the drafters not use the exact term "product-specific" in Article 13(b)(ii)?**

**Brazil Comment on US Answer:**

47. The United States' 11 August Answer once again reveals that it equates the term "support to a specific commodity" with "product-specific". Brazil notes again that neither the phrase "product-specific" nor "AMS" is found in the text of Article 13(b). Given the use of such terms in the Agreement on Agriculture, the Drafters must be presumed to have used the term "support to a specific commodity" for a reason. The US answer ignores the likely reason which is that "support to a specific commodity" is qualified by the term "such measures" which includes the universe of non-

[42] *See* Rebuttal Submission of Brazil, para. 7.

green box support measures in the *chapeau* to Article 13(b). This universe of measures from which such support may be found is not limited to simply "product-specific" measures.

**(38) Given the fact that subsidies available for more than one product could have various effects on production, how does the United States demarcate between product-specific support and non-product specific support?**

**Brazil's Comment on US Answer:**

48. The United States demarcation line does not take into account the definition of "non-product specific" in Article 1(a) which is "provided in favour of agricultural producers *in general*". This "in general" language shows where the line between product-specific and non-product specific must be drawn. Any support that is *not* provided to producers "*in general*" cannot, by definition, be non-product specific support. It must instead fall into the category of "product-specific support". The United States fails to recognize that the term "in general" is directly related to and qualifies the phrase "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product".

49. The "demarcation" line drawn by the United States between "product-specific" and "non-product specific" support is necessary to justify the narrow US specificity test for Article 13(b)(ii). The United States argues that support could only be "product-specific" if "production is necessary for the support to be received."[43] Yet, the Article 1(a) notion of "support" "provided for an agricultural product in favour of the producers of the basic agricultural product" is very broad. It could include any *type* of support, regardless of whether production was required or not. For example, if the facts demonstrate that $1 billion of support were received by the "producers of a basic agricultural product" (such as in the case of CCP payments to upland cotton producers in MY 2002), the language of Article 1(a) would support the finding that this support is "product-specific". The only restraint on such a conclusion is if it could be shown that all, or most of the producers of agricultural products received the same type of support. However, none of the five domestic support payments at issue in this dispute comes even close to such an "in general" finding. The inclusion of such subsidies as "support to a specific commodity" is confirmed by the context of Article 13(b)(ii) which includes Annex 3 of the Agreement on Agriculture as discussed in paragraphs 17-22 of Brazil's Rebuttal Submission.

50. Further, the United States never addresses the premise of the Panel's question, i.e, that subsidies for more than one product could have various effects on production. This is exactly the situation with PFC, market loss, direct payments, CCP payments, and crop insurance subsidies. The evidence (which consists in large part of the statements of present or former USDA economists) shows the production enhancing effects of each of these subsidies.

51. The US 11 August Answer highlights the narrowness of its Article 13(b)(ii) specificity test. Trade and production-distorting amber box support from each of these five subsidies increases US production and sustains high levels of US exports of upland cotton. Yet, under the US specificity test, it could never be deemed "support to" upland cotton because no production of upland cotton is legally required. The Panel should reject this approach and find that these programmes provide support to upland cotton.

**(39) If "such measures" in Article 13(b)(ii) refers to all those in the chapeau of Article 13(b), why are they not included in the potential comparisons with 1992? In what circumstances can measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994?**

[43] US 11 August Answer to Question 38, para. 81.

**Brazil Comment to US Answer:**

52. The United States 11 August Answer does not address the second of the Panel's questions directly. But based on the argument in the "answer," the direct answer to the question would have been "*there are no circumstances in which measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994*." The arguments presented by the United States in its answer confirms that its interpretation creates a broad new category of "exempt" non-green box support – those presumptively trade and production-distorting measures it labels "non-product specific". The US constructs this new exempt category by improperly interpreting the phrase "product-specific" to include only non-green box support legally requiring the production of upland cotton. This incorrect definition is inconsistent with the fact that in analogous situations involving calculation of AMS, paragraphs 12-13 of Annex 3 of the Agreement on Agriculture require all types of non-green box support providing support to the producers of an agricultural commodity be included in the amount tabulated. These points are further discussed in paragraphs 13-67 of Brazil's Rebuttal Submission.

53. The US 11 August Answer to the first question in paragraph 84 indicates that it interprets the phrase "such measures" as only including "product-specific" support. Even apart from the incorrect US definition, such an interpretation renders a nullity the reference to most of the "measures" referred to in the "such measures" phrase of Article 13(b)(ii). If the drafters had intended to limit the universe of non-green box support in the manner suggested by the United States, they would have used the phrase "product-specific" instead of "such measures". The better interpretation that does not render the *chapeau* a nullity is that suggested by Brazil: any type of support listed in the chapeau which provides "support to a specific commodity" must be included within the support to be counted for the purpose of the required 13(b)(ii) comparison.

D. "IN EXCESS OF THAT DECIDED DURING THE 1992 MARKETING YEAR"

**General Comment by Brazil on the US Answers to Questions 47-69**

54. Brazil notes that the United States has not fully answered many of the questions posed by the Panel. The United States further announced in various questions that it would provide its views on certain questions posed by the Panel in its rebuttal submission. In the answers provided, the United States has continued to pursue its overly simplistic view of an alleged "decision" to provide a rate of support of 72.9 cents per pound in MY 1992. Brazil has pointed out that this rate of support does not accurately reflect the operation of the US support system to upland cotton and that it ignores restrictions on the availability of support and costs associated with the participation in the support programmes.[44] Professor Sumner has attempted to correct the overly simplistic US approach and has presented data to that respect.[45]

55. A fundamental flaw exposed by the US 11 August Answers is the inability of the US "72.9 methodology" to account for a number of different types of "support to upland cotton". In its 11 August Answer to Question 67, the United States provides a calculation of upland cotton AMS that lists as "product-specific" support Step 2 payments (user marketing certificates), cottonseed payments, storage payments, and interest subsidies, in addition to deficiency payments, and marketing loan payments. Yet, the United States "72.9 methodology" does not – and cannot – account for cottonseed payments, Step 2 payments, storage payments and interest rate subsidies. The United States takes no account of these subsidies – no matter how large the expenditures may be – because they do not fit within the US methodology. So they simply disappear.

[44] Oral Statement of Brazil, para. 36; Brazil's 11 August Answer to Question 66(c), para. 120-128.
[45] *See* Exhibit Bra-105 (Statement of Professor Sumner at the First Meeting of the Panel).

56. Any methodology that cannot account for *all* of the support "decided" and "granted" in MY 1992 and during the implementation period cannot be legitimate. A methodology that would sanction the cover-up of hundreds of millions – if not billions – of dollars of expenditures cannot be justified by the object and purpose of Agreement on Agriculture or by any reasonable reading of the text of Article 13(b)(ii).

57. With these general points in mind, Brazil comments on the answers provided by the United States.

**(43) What are the precise differences between deficiency payments and counter-cyclical payments that lead you to classify the former as product-specific and the latter as non-product specific? How do you classify market loss assistance payments?**

**Brazil's Comment on US Answer:**

58. The US 11 August Answer at paragraph 87-90 reveals its erroneous interpretation of the phrase "product-specific" in Article 1(a) of the Agreement on Agriculture. The United States ignores the phrase "in general" and assumes that "non-product specific" support is a huge residual category of support that includes everything *except* support which *requires* production of a specific product. Further, the United States' answer ignores the fact that all types of support in favour of domestic producers of a basic commodity are included in the analogous AMS calculation of Annex 3 – including "product-specific" support where the recipient is *not* required to produce a specific commodity. Brazil outlines the erroneous US interpretation in paragraphs 13-23 of its Rebuttal Submission.

59. The improper narrow US interpretation of "product-specific" is highlighted in its discussion of counter-cyclical payments where the only relevant fact is that a producer receiving CCP payments need not plant any crop at all. Brazil addresses in detail the evidence demonstrating that CCP payments are "support to" upland cotton in paragraphs 48-52 of its Rebuttal Submission.

60. With respect to market loss assistance payments, Brazil notes that it provides a detailed analysis of how such payments are "support to upland cotton" in paragraphs 29-35 of its Rebuttal Submission, as well as in paragraphs 50-54 of its Oral Statement. Contrary to the US statement in paragraph 92 of its 11 August Answers, Brazil has always asserted that market loss assistance payments are "support to a specific commodity", i.e., to upland cotton.

**(46) What is the relevance, if any, of the concept of "specificity" in Article 2 of the SCM Agreement and reference to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture?**

**Brazil's comment to US Answer:**

61. For the reasons set forth in Brazil's 11 August Answer to this question, Brazil believes that Article 2 of the SCM Agreement provides useful context in interpreting the concept of specificity in Article 13(b)(ii). Brazil notes that the very narrow US notion of specificity (only support *requiring* recipients to produce the commodity in question) for Article 13(b)(ii) is quite different than the very broad concept of specificity applying to all commodities (including agricultural commodities) as set out in the US SAA referred to in Brazil's answer. The United States has not provided any reasons why there should be such a radically different concept of specificity involving non-green box domestic support measures under Article 13(b)(ii) and all types of products (including agricultural goods) under the SCM Agreement. Brazil sees no basis for such a significant difference.

**(48) Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?**

**Brazil's Comment on US Answer:**

62. Brazil comments on the US 11 August Answer to Question 48 in the context of its Rebuttal Submission at paragraphs 68-96.

**(54) Please identify all United States legal and regulatory and administrative instruments decided during the marketing year 1992, with the respective dates of decision, that decided support for upland cotton.**

**Brazil's Comment on US Answer:**

63. As Brazil has noted in its general comment at paragraphs 54-57 above, the United States focuses solely on the alleged target price decision of 72.9 cents per pound. This simplistic approach does not accurately reflect the actual operation of the US support programmes to upland cotton. As detailed by Professor Sumner in his Statement at the First Meeting, the United States took a number of decisions concerning support for the 1992 marketing year.[46]

64. Professor Sumner – who actually participated in the decision making process concerning the MY 1992 acreage reduction programme decision – explained during the First Meeting of the Panel that the decision on the percentage of upland cotton base that farmers participating in the deficiency payment programme had to leave idle was a conscious decision based on, *inter alia*, budgetary considerations. Given expectations about production and prices in the upcoming marketing year, the decision on the acreage reduction programme was also a decision on expected participation. The United States could base expected participation on historical experience about participation in the deficiency payment program. Professor Sumner indicated that USDA was able to fairly accurately predict actual participation. The decision on the amount of mandatory acreage reduction is, thus, a decision on the level of participation.

65. Professor Sumner's testimony is supported by the Chief and Deputy Chief Economist of USDA who have explained that the aim of the acreage reduction programme was "to balance supply and demand"[47], i.e., to influence prices and thereby US budgetary outlays. They furthermore report that the United States implemented the acreage reduction programme with a view of reducing costly government stocks, and that the United States – with further budget considerations in mind – reduced target prices.[48]

66. Furthermore, the United States ignores various required additional administrative decisions that were necessary to make its domestic support programmes operative. These decisions include decisions on the deficiency payment rate, on weekly Step 2 payment rates and on a weekly-determined adjusted world price setting the amounts of marketing loan benefits available for that week. By taking all of these decisions, the United States directly influenced the expenditures related to the MY 1992 crop.[49] In addition, as the United States now reflects in its AMS data, the

[46] Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting, para. 7-8).

[47] Exhibit Bra-180 ("Will Policy Changes Usher in a New Era of Increased Agricultural Market Variability?," Keith J. Collins, Joseph W. Glauber, Choices, Second Quarter 1998, p. 27).

[48] Exhibit Bra-180 ("Will Policy Changes Usher in a New Era of Increased Agricultural Market Variability?," Keith J. Collins, Joseph W. Glauber, Choices, Second Quarter 1998, p. 27).

[49] Brazil acknowledges that the United States could not possible determine its expenditures as they would depend to a certain extent on market prices that were also influenced by factors outside the control of the US Government.

United States considers storage payments and interest subsidies[50] as product-specific support to upland cotton. Consequently, under the US approach, these product-specific domestic support measures need to be taken into account for purposes of the Article 13(b)(ii) decision. Yet, the United States fails to account for these programmes in its list of decisions taken concerning support to upland cotton, just as it failed to account for various decisions relating to the deficiency payment, marketing loan and Step 2 programmes.

67. Brazil also notes that the United States failed to answer Question 54 that asked the United States to identify "all" instruments that decided support for upland cotton. This would also cover instruments other than product-specific instruments. However, the United States has only followed its simplistic view of what kind of decision it took and has not provided information on other decisions. This appears to be an attempt to avoid the conclusion under all other approaches: that the United States provided support in MY 1999-2002 in excess of that decided during the 1992 marketing year.

**(55) Please provide a copy of the instruments in which the rate of support for upland cotton during the marketing year 1992 was decided, indicating the date of the decision.**

**Brazil's Comment on US Answer:**

68. As noted in Brazil's Comment to the previous question, the United States failed to identify a list of decisions taken with respect to support for upland cotton in MY 1992. As a consequence, the United States also failed to provide copies of those instruments.[51]

**(57) If the United States decided on a rate of support for MY1992, does that not mean that it decided on whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at that time?**

**Brazil's Comment on US Answer:**

69. At the outset, Brazil refers the Panel to the general comment made in respect of the set of questions referring to the term "decision" in Article 13(b)(ii) of the Agreement on Agriculture. Also this answer suffers from the simplistic picture the United States draws of its MY 1992 support programmes to upland cotton.

70. Brazil disagrees with the United States that it could not be said that the United States decided on budgetary outlays. Indeed, for *all* of the US programmes, there was a decision to authorize whatever budgetary outlays would be necessary to meet the rate of support.[52] In addition, the United States ignores that it has admitted that there were other programmes that meet its definition of "product-specific" and that do not provide a rate of support: Step 2, cottonseed, storage payments and interest subsidies. The United States accounted for those subsidies by providing budgetary outlays in its upland cotton AMS calculation, but it does not provide any information on the decision taken with respect to those domestic support measures and the rate of support provided by them. In addition, the United States took specific administrative decisions on the deficiency payment rate for MY 1992 (20.3 cents per pound[53]), weekly Step 2 payment rates as well as weekly decision on the adjusted world price and, thus, the rate of marketing loan benefits. By taking these decisions, the United States decided on the payment rates that resulted from the "rate of support" and, therefore, on the amount of budgetary outlays it would use from its unlimited spending authority.

[50] Brazil notes that the United States nowhere provides any information concerning the type and conditions of payments that are covered by these terms.

[51] *See* paras. 63-67 *supra*.

[52] First Submission of Brazil, para. 141.

[53] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5).

71. Brazil further disagrees with the US assertion at paragraph 113 of its 11 August Answers that the programs decided by the United States required an unlimited budgetary authority in both MY 1992 and in later marketing years.[54] Even at prices of zero cents per pound, the amount of US expenditure for the deficiency payment and the marketing loan programme in MY 1992 was, in fact, limited by decisions restricting the participation in the programs to farmers that historically had grown upland cotton, who were eligible, and who decided to participate based on the eligibility criteria. By contrast, participation in the MY 2002 marketing loan programme, the crop insurance programme, and the Step 2 programme, for instance, is no longer limited and now has an unlimited budgetary authority coupled with mandatory payment provisions. In particular, the marketing loan programme is now unlimited whereas in MY 1992, eligibility to marketing loan benefits was restricted to upland cotton grown on acreage that was enrolled in the deficiency payment programme.

72. In sum, the United States not only "decided on whatever outlay was required to meet that rate of support", it also took various administrative decisions that implemented the rate of support and transposed it into specific payment rates that resulted in identifiable budgetary outlays. The United States took those decisions with respect to all of the programmes including crop insurance and Step 2, as well as with respect to storage payments and interest subsidies.[55] Thus, the collective effect of these multiple decisions was to decide on the amount of expenditures for MY 1992. The only way to express this multitude of decisions and conduct the required comparison with MY 1999-2002 is to use total monetary amounts of budgetary expenditures.

**(60) Can you provide information on the support decided in 1992 and the years with which you believe it should be compared, on a per support programme / per unit of production basis / per annum basis? If possible, please specify how, if at all, budget outlays may be transposed into units of production, and which units of production are best to use.**

**Brazil's Comment on US Answer:**

73. Brazil notes that the United States has not provided, as requested, any per support measure, per unit figures of support that it decided in 1992 and support it granted in other years. Nor did the United States provide any information whatsoever on how to account for Step 2 payments, cottonseed payments, storage payments and interest subsidies because there is no way such measures could be measured using the simplistic US rate of support only approach.

74. In addition, the United States does not respond to the Panel's request to transpose this rate of support into budgetary outlays per pound of production. Brazil refers the Panel to paragraphs 84-85 of its Rebuttal Submission, where it provides a new chart reflecting new information provided by the United States for various programmes.[56]

**(61) Does the United States consider that Article 13(b)(ii) permits a comparison on any other than a per pound basis?**

**Brazil's Comment on US Answer:**

75. The United States admits that Article 13(b)(ii), and in particular the term "decided", permit a comparison different from comparing a rate of support, *had the US domestic support measures been structured* (*i.e.* decided) *differently* than characterized by the United States.[57] This admission is significant, because, in fact, the US measures *were structured quite differently* from what the

[54] US 11 August Answer to Question 57, para. 113.
[55] US 11 August Answer to Question 67.
[56] US 11 August Answer to Question 67, para. 129-134.
[57] US 11 August Answer to Question 61, para. 118.

United States asserts. Professor Sumner[58] established that the US support programmes in MY 1992 did *not* provide a rate of support of 72.9 cents per pound to each pound of upland cotton produced in the United States. Numerous restrictions on the availability of the support by the deficiency payment programme and the marketing loan programme existed. In addition, participation in both programmes was costly to farmers, as farmers were mandated to set aside a certain percentage of acreage every year. USDA Chief Economist Keith J. Collins and USDA Deputy Chief Economist Joseph W. Glauber explain that

> [s]everal programme changes beginning with the 1985 Farm Act reduced the ability of deficiency payments to stabilize incomes by fixing programme payment yields, reducing the amount of acreage eligible for payments, and tightening payment limits. In addition, many producers elected not to participate in farm programs, making a large portion of production not covered by payments and a large portion of producers ineligible for them by the early 1990s.[59]

76. This statement confirms the existence of severe restrictions on the availability of deficiency payments and the cost of participating in the programmes. Were there no cost associated with the programme, no rational farmer would opt to not take the "free money", *i.e.*, nearly everybody would participate. These conscious decisions by USDA and other US Government agencies must, therefore, be reflected in the claimed rate of support provided by the various non-green box domestic support measures during MY 1992.

77. Brazil agrees with the European Communities that such a mélange of domestic support measures decided in MY 1992 must be accounted for "in monetary terms".[60] While the European Communities advocates using an AMS-like approach for the support decided in MY 1992,[61] Brazil considers that an expenditure approach more accurately reflects the text of Article 13(b)(ii), which does not refer to AMS or "product-specific". Brazil emphasizes that the domestic support measures that need to be included in this approach are all those domestic support measures that provide support to upland cotton.

78. Furthermore, the US "72.9 methodology" is inconsistent with the object and purpose of Article 13(b)(ii) and of the Agreement on Agriculture to correct and prevent restrictions and distortions in world agricultural markets.

79. Accepting the US interpretation that eligibility criteria and participation costs of a programme are irrelevant would enable Members like the United States to avoid the disciplines of the SCM Agreement on trade-distortive subsidies. For example, the United States in MY 1992 decided and applied restrictive support programmes that required costly land set aside programs, low payment yields, restricted payments to 85 per cent of eligible acres, tied benefits from the marketing loan programme to participation in the costly deficiency payment programs, and applied payment limitations, among others. The US interpretations would allow it in MY 2002 to lift all of these restrictions and maintain the rate of support without affecting its entitlement to peace clause exemption. The approach taken to its extreme would allow a Member that decided a rate of support of 72.9 cents per pound for 0.0001 per cent of its production in MY 1992, to provide a rate of support of 72.9 cents per pound to 100 per cent of its production in MY 2002 without affecting its entitlement to peace clause exemption. Every legitimate comparison must take account of economic realities of support regimes in MY 1992 and in later marketing years during the implementation period. And these realities show that the support increased massively.

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[58] Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).

[59] Exhibit Bra-180 ("Will Policy Changes Usher in a New Era of Increased Agricultural Market Variability?," Keith J. Collins, Joseph W. Glauber, Choices, Second Quarter 1998, p. 28).

[60] EC Answer to Third Party Question 22, para. 47 and 49.

[61] EC Answer to Third Party Question 22, para. 49.

**(66) Could you please comment on the relative merits of each of the following calculation methods for purposes of the comparison of support to upland cotton with 1992, irrespective of whether a particular measure should be included or excluded:**

**(a) Total budgetary outlays (Brazil's approach)**

**(b) Budgetary outlays per unit of upland cotton: Could you please calculate and provide an estimate for the marketing years 1992 and 1999-2002, respectively, and draw the Panel's attention to any factors / qualifications that the Panel would need to be aware of.**

**Brazil's Comment on US Answers:**

80. Brazil comments jointly on both of the 11 August Answers provided by the United States. In essence, the United States rejects any approach based on budgetary outlays as *ex post* or retrospective and as does not reflecting its alleged single decision taken during MY 1992.[62] Based on the same argument, the United States also declines the Panel's request for information on how to calculate budgetary outlays per unit of upland cotton.[63] Therefore, Brazil refers the Panel to its own 11 August Answer to Question 60 and 66(b) for the only evidence in that respect as well as to Brazil's reservations concerning this approach.[64]

81. The United States maintains that because its support programmes depend on a price-gap, only a rate of support approach can reflect the US decision.[65] It further maintains, that any budgetary approach would automatically reflect also producers' planting and participation decisions and market prices, factors that the United States alleges, it could not have decided.[66] However, Brazil has demonstrated that the anticipated participation in the deficiency payment and marketing loan programme was an important aspect of the decision on the acreage reduction programme. Professor Sumner has indicated that, based on historical participation data and projections about other programme parameters, the United States in MY 1992 had a very good idea of the participation rate that would result from the setting of a 10-per cent acreage reduction rate under the deficiency payment programme.

82. Further, Brazil has demonstrated above that the range of programme decisions the United States has taken, including decisions on deficiency payment rates, adjusted world prices and Step 2 payment rates in connection with decisions on other programme parameters, impacted the amount of budgetary outlays. Thus, while the United States certainly did not decide on market prices, it took a number of decisions that translated these market prices into actual expenditures for MY 1992.

83. The European Communities and other third parties to this dispute agree with Brazil that the appropriate basis for a comparison of the support decided in MY 1992 with support granted in later marketing years during the implementation period is a approach based "on monetary terms".[67] Given the special situation of the EC with respect to the peace clause decision, it may be appropriate to use an *ex ante* AMS-like approach to its decision during MY 1992 compared to the actual AMS for later marketing years.[68] But even that decision would be expressed in "monetary terms".

[62] US 11 August Answer to Question 66, para. 119-120.
[63] US 11 August Answer to Question 66, para. 120.
[64] *See* Brazil's 11 August Answer to Question 60, para. 94-98 and Brazil's Answer to Question 66(b), para. 117-119.
[65] US 11 August Answer to Question 66, para. 119.
[66] US 11 August Answer to Question 66, para. 119.
[67] EC Answer to Third Party Question 22, para. 47.
[68] EC Answer to Third Party Question 22, para. 47-49.

84. Total expenditures for MY 1992 and total expenditures for marketing years during the implementation period are the only legitimate bases for the comparison required by Article 13(b)(ii) of the Agreement on Agriculture. All other calculation methods are either not supported by a *Vienna Convention* analysis of Article 13(b)(ii) (US rate of support approach; US rate of support approach as modified by Professor Sumner), or have major shortcomings that should lead them to be used them with extreme caution (budgetary outlays per unit). Brazil notes that its expenditure approach and the analogous AMS calculation yield identical results, if one were to account for deficiency payments in terms of expenditures rather than by using the formula approach offered by Annex 3, paragraph 10-11 of the Agreement on Agriculture.[69]

*(d) Per unit rate of support for upland cotton (Prof. Sumner's approach at the first session of the first substantive meeting).*

**Brazil's Preliminary Comment on US Answer:**

85. Brazil will further comment on any answer pursuant to the US promise to provide "a detailed critique of Mr. Sumner's analysis."[70] As for the 11 August US comments, Brazil has earlier in its 22 August Comments to Questions 66(a) and (b) argued that Professor Sumner properly accounted for all US decisions.[71] Concerning the inclusion of crop insurance subsidies, PFC and market loss assistance payments, as well as direct and counter-cyclical payments, Brazil has demonstrated in its Rebuttal Submission[72] and in comments to Questions 38 and 43 that these domestic support measures constitute support to upland cotton as well as product-specific support. Thus, there is no basis to exclude these payments from any US calculation of upland cotton AMS.

**(67) The Panel requests the parties to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002. For this purpose the parties are each requested to submit AMS calculations for upland cotton (using the budgetary-outlay/non-price gap methodology employed by the United States in respect of cotton in its DS Notifications (e.g., G/AG/N/USA/43) and using the formats and supporting tables in document G/AG/2) on the same basis as would be the case in calculating a product specific AMS for the purposes of the calculation of the "Total Current AMS" in any year in accordance with the relevant provisions, including as appropriate Article 1(a), (b) and (h), Article 6 and Annex 3 to the Agreement.**

**Brazil's Comment on US Answers:**

86. The United States' calculation of upland cotton AMS is incomplete because it does not account for the product-specific support provided to upland cotton from PFC and market loss assistance payment, direct and counter-cyclical payments and crop insurance subsidies. Brazil has discussed the nature of these programs as product-specific (and as constituting "support to upland cotton") and the incorrect US interpretation of "product-specific" elsewhere.[73] Brazil further notes that the United States has included in its calculation of upland cotton AMS storage payments and interest subsidies – product-specific support measures that the United States has not mentioned so far during this dispute.[74] Based on this and other new data supplied by the United States, Brazil provides an update of its AMS calculation and of its analysis of total budgetary outlays.[75]

[69] Brazil's 11 August Answer to Question 60, para. 97, and to Question 67, para. 130.
[70] US 11 August Answer to Question 66, para. 121.
[71] *See* para. 81-85 *supra*.
[72] Rebuttal Submission of Brazil, paras. 24-67.
[73] Rebuttal Submission of Brazil, para. 13-67.
[74] Brazil notes that it has asked the United States in consultations for information on any other domestic support measures the provides support to upland cotton and that the United States did not mention these

## III. EXPORT CREDIT GUARANTEES

**71 (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? Does it confer a benefit within the meaning of Article 1.1(b)? Why or why not? If so, to whom?**

**(b) How, if at all, would these elements be relevant to the claims of Brazil, and the United States response thereto?**

87. In responding to this Question, the United States relies solely on Article 10.2 of the Agreement on Agriculture and – alternatively – restricts the use of context from the SCM Agreement to item (j) only.[76] Brazil addresses the United States' arguments regarding Article 10.2 of the Agreement on Agriculture at paragraphs 99-100 of its Rebuttal Submission. In determining what constitutes an export subsidy within the meaning of Article 10.1 of the Agreement on Agriculture, Brazil considers that the Panel should refer to Articles 1(e) and 10.1 of the Agreement on Agriculture itself, as well as to contextual guidance included in Articles 1 and 3 of the SCM Agreement, and in item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement. This is consistent with the Appellate Body's decisions in *US – FSC*[77] and *Canada – Dairy*.[78]

**(73) The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The United States has yet to submit any evidence or argumentation on this point, either as potential context for interpretation of the terms in Article 10 of the Agreement on Agriculture or in relation to Brazil's claims under the SCM Agreement. The Panel would therefore appreciate United States views in respect of this situation, and invites the United States to submit relevant argumentation and evidence.**

**Brazil's Comment on US Answer:**

88. The United States argues that it does not need to address Articles 1 and 3 of the SCM Agreement because it "does not believe that Brazil has submitted evidence and argumentation that would establish a *prima facie* case in favour of Brazil's claims . . ."[79] Since the United States has surpassed its quantitative export quantity reduction commitment levels, Article 10.3 of the Agreement on Agriculture allocates the burden to the United States to prove that its excess exports did not benefit from export subsidies, including export credit guarantees.[80] Therefore, it is not Brazil, but the United States, that is faced with satisfying the elements of a *prima facie* case in favour of its defence.

**(74) If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 of the Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both?**

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programs during consultations. *See* Exhibit Bra-101 (Brazil's Questions for the Purposes of the Consultations, 22 November 2002, Questions 15.1-15.6).

[75] Rebuttal Submission of Brazil, paras. 73-74.

[76] US 11 August Answer to Question 71, para. 137-139.

[77] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 136-140.

[78] Appellate Body Report, *Canada – Dairy*, WT/DS103/AB/R and WT/DS113/AB/R, para. 87-90.

[79] US 11 August Answer to Question 73, para. 140.

[80] *See* First Submission of Brazil, paras. 263-268.

**Brazil's Comment on US Answer:**

89. In paragraph 141 of its 11 August Answer to Question 74 (and again in paragraphs 189 and 195 of its 11 August Answers to Questions 88(b) and (d), respectively), the United States asserts that "Brazil has not contested that challenged US export credit guarantee programs are within the scope of Article 10.2." The United States is incorrect. While it is possible that GSM 102, GSM 103 and SCGP export credit guarantees might be included in any international agreement that Members might some day reach in negotiations pursuant to Article 10.2 of the Agreement on Agriculture, no one knows at this stage what the scope of that agreement, if any, will be. The agreement might only cover export credits other than guarantees, like the OECD Arrangement on Guidelines for Officially Supported Export Credits, which does not cover export credit guarantees.

90. In any event, the relevant question is not whether export credit guarantees are "covered" by Article 10.2, but whether they are "exempted" by Article 10.2 from the general export subsidy disciplines of the Agreement on Agriculture. Brazil's position is that Article 10.2 does not exempt export credits like export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture, including Article 10.1 thereof. If those export credit guarantees constitute export subsidies, then they are subject to those disciplines. (In paragraph 142 of its 11 August Answer, the United States appears to concede this point, when it acknowledges that "[t]o determine the applicability of Article 10.1 to a particular measure not described in Article 9.1 first requires a determination whether a subsidy exists.")

**(75) (identical to Third Party Question 32)**

**The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see third party submission of Canada) and to the panel report in DS 222 Canada- Export Credits and Loan Guarantees. How and to what extent are Article 14(c) of the SCM Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material.**

**(Third Party Question 33)**

**What is the relevant (if any) of Brazil's statement that: " … export credit guarantees for exports of agricultural products [sic] are not available on the marketplace by commercial lenders."**

**Brazil's Comment on EC Answers on Third Party Question 32 (identical to Question 75) and 33 and on US Answer to Question 75:**

91. The United States argues that item (j) alone is relevant context for a determination whether CCC export credit guarantee programmes are export subsidies.[81] The European Communities argues that the fact that a particular financing instrument offered by a government (such as CCC guarantees) is not available on the marketplace does not mean that such financing confers a benefit *per se* within the meaning of Article 1.1(b) of the SCM Agreement.[82] The European Communities maintain that in circumstances in which a comparable type of financing is not available on the marketplace, an "alternative" benchmark such as item (j) has to be used for determining whether a benefit exists.[83] While Brazil agrees with the European Communities that item (j) is an *alternative* test for the existence of an export subsidy, Brazil strongly disagrees that Article 1.1 of the SCM Agreement is – as the European Communities effectively and the United States explicitly argues – inapplicable in

[81] US 11 August Answer to Question 75, para. 143.
[82] EC's Answers to Third Party Questions, para. 68.
[83] EC's Answer to Third Party 35, para. 67.

such situations. Article 1.1 defines the existence of a subsidy for the purposes of the SCM Agreement and provides relevant context for the interpretation of the term "export subsidy" under the Agreement on Agriculture. Article 1.1(b) requires a comparison between what the recipient of a financial contribution received from the government and what the recipient could have received on the marketplace.[84] The Appellate Body clarified that the standard under Article 1.1(b) is not the cost incurred by the government (as under item (j)).[85] The relevant standard is the "benefit to the recipient" standard.

92. This definition of a subsidy cannot simply be read out of the SCM Agreement in a situation where there is no comparable commercial financing available. Nothing suggests that Article 1.1(b) is inapplicable in such a situation. The United States and the European Communities would certainly agree that a direct transfer of funds without consideration is not commercially available. In these circumstances, a benefit within the meaning of Article 1.1(b) of the SCM Agreement is conferred. A similar situation exists with respect to CCC guarantees. A recipient of CCC guarantees cannot receive a similar financial contribution on commercial terms, as no such financing is available on the marketplace.[86] Thus, the CCC export credit guarantee programmes confer benefits. Brazil notes that the United States agreed, in its third party submission in *Canada – Aircraft II*, that where there is no comparable financial product on the market, a programme confers benefits *per se*.[87]

**(76) How does the United States respond to Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders."?**

**Brazil's Comment on US Answer:**

93. The United States asserts that export credit insurance may be a comparable commercial product to CCC export credit guarantees.[88] As noted in paragraph 103-104 of Brazil's Rebuttal Submission, the United States acknowledges that there are distinctions between insurance coverage and guarantees. Thus, the terms of insurance coverage by private, market-based financial institutions cannot serve as a benchmark against which to determine whether the CCC guarantee programmes confer "benefits," within the meaning of Article 1.1(b) of the SCM Agreement. As the United States has elsewhere noted, "[i]f the commercial market does not offer a particular borrower the *exact terms* offered by a government, then the government is providing a benefit to the recipient whenever those terms are more favourable than the terms that are available in the market."[89] Moreover, the United States has not provided actual terms for insurance coverage by private, market-based financial institutions. Brazil understands that private, market-based insurance coverage for agricultural products is not available for periods extending nearly as long as periods provided by CCC guarantees.

**(77) How does the United States interpretation of "long term operating costs and losses" in item (j) as claims paid give meaning to both "costs" and "losses"? Do claims paid represent "losses" or "costs" or both? If claims paid is represented by "losses", what would go into the "cost" element of item (j)? Could the United States expand on why it disagrees with the items which Brazil identifies for inclusion in the examination to be conducted under item (j)?**

[84] Appellate Body, *Canada – Aircraft*, WT/DS70/AB/R, para. 157.
[85] Appellate Body, *Canada – Aircraft*, WT/DS70/AB/R, para. 160.
[86] *See* also Rebuttal Submission of Brazil, paras. 103-105.
[87] Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2 (para. 7). *See* also Answers to Questions by Brazil, para. 151.
[88] US 11 August Answer to Question 76, para. 144.
[89] Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2 (para. 7).

**Brazil's Comment on US Answer:**

94. In paragraph 145 of its response, the United States suggests that claims and defaults must exceed "revenue from whatever source it may be derived" to meet the elements of item (j), despite the fact that item (j) limits the revenue to be used to offset operating costs and losses to "premium rates". On the other hand, the United States maintains that it is only legitimate to account for claims and defaults in the context of item (j), and not for other operating costs and losses such as interest on debt to Treasury[90], even though those sorts of other costs and losses are covered by the ordinary meaning of the terms included in item (j).[91] This is incongruous, and not supported by the text of item (j).

95. Further, Brazil refers the Panel to its Rebuttal Submission and to its 22 August Comments to the US Answers to Question 81 below for a more detailed discussion on the elements that are to be included in an item (j) analysis.

**(78) Can the United States provide supporting documentation for data used relating to "costs and losses" in paragraph 173? Could the United States confirm that the figures cited in paragraph 173 of its first written submission relate to the SCGP? Why did the United States cite these figures after stating that it is not possible to make any assessment of the long-term operating costs and losses of this programme?**

**Brazil's Comment on US Answer:**

96. The United States has failed to provide the supporting documentation requested by the Panel. The data mentioned in paragraph 149 of the United States' 11 August Answer could have been provided for review and analysis by the Panel and Brazil. As a result, Brazil requests that the Panel reject the United States' assertions in paragraph 173 of the US First Submission.

**(80) (identical to Third Party Question 35)**

**Did the drafters of the Agreement on Agriculture include export credit guarantees in Article 9.1 of the Agreement on Agriculture? Why of why not?**

**Brazil's Comment on EC Answer:**

97. Brazil agrees with the European Communities that "Article 9.1 represents a list of export subsidies … that are subject to reduction commitments."[92] Export credit guarantees are not included, as they do not constitute *per se* export subsidies subject to reduction commitments. Only if export credit guarantees confer a benefit within the meaning of Article 1.1(b) and/or Article 14(c) of the SCM Agreement, or if they are provided at premium rates that are inadequate to cover the long-term operating costs and losses of the export credit guarantee programme, do they constitute export subsidies to be assessed against the export subsidy reduction commitments of a Member. In these circumstances, export credit guarantees must not be provided in a manner inconsistent with Article 10.1 of the Agreement on Agriculture.

98. Because export credit guarantees are not – under a *Vienna Convention* interpretation of Article 10.2 of the Agreement on Agriculture – excluded from the general export subsidy disciplines in AoA Article 10.1, their provision counts towards the export subsidy reduction commitments of a Member. Article 10.2 states that after agreement on disciplines governing the provision of export credits is reached, these credits can only be provided in conformity therewith. Brazil does not want to speculate on whether the internationally-agreed disciplines will subject export credit guarantees to

[90] First Submission of the United States, para. 178.
[91] *See* Oral Statement of Brazil, para. 123.
[92] EC's Answers to Third Party Questions 35, para. 70.

reduction commitments. In any event, under the current regime governing the provision of export credit guarantees, they are subject to the anti-circumvention disciplines in Article 10.1 of the Agreement on Agriculture and count towards a Member's export subsidy reduction commitments, if they constitute export subsidies within the meaning of the Agreement on Agriculture (and, by context, the SCM Agreement).

**(81) How does the United States respond to the following in Brazil's oral statement**

**(a) paragraph 122 (rescheduled guarantees)**

**Brazil's Comment on US Answer:**

99. Although "rescheduled amounts are counted as *receivables*, not losses," that does not mean that rescheduled amounts are actually collected, or even expected to be collected. CCC's 2002 financial statements demonstrate that many of CCC receivables are classified as "uncollectible" – in fact, $3.34 billion of total receivables of $6.93 billion are classified as "uncollectible."[93] Moreover, as noted in Brazil's 11 August Comment on Question 77 (at paragraph 162), the US General Accounting Office has stated that historically, the majority of GSM support that is rescheduled is "in arrears".[94] Based on this evidence, it is simply not accurate for the United States to argue, in paragraph 155 of its 11 August Answer, that "[t]he history of rescheduled Commodity Credit Corporation (CCC) export credit guarantee claims over the long-term (the 10-year period 1993-2002) confirms" that "the United States does in fact collect on the rescheduling."

100. Brazil also notes that the United States has not provided any documentary evidence that would support its assertion.

**(c) paragraphs 125 ff. (guaranteed loan subsidy)**

**Brazil's Comment on US Answer:**

101. In paragraphs 108-110 of its Rebuttal Submission, Brazil summarizes the several bases on which the Panel can rest a finding that the GSM 102, GSM 103 and SCGP programmes constitute export subsidies under item (j). The United States criticizes one of those bases – the FCRA cost formula – as inappropriate because it allegedly relies on "estimated" rather than "actual" data about the costs of the programmes.[95] This appears to be the United States' sole defence, which Brazil again notes applies only to the FCRA cost formula and not the other evidence and bases summarized by Brazil in paragraphs 108-110 of its Rebuttal Submission. In any event, Brazil rebuts the US arguments concerning "estimated" versus "actual" data in paragraphs 111-119 of its Rebuttal Submission, and asks the Panel to refer to Brazil's arguments therein.

[93] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14).

[94] Exhibit Bra-152 (GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National Security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, *Status Report on GAO's Reviews of the Targeted Export Assistance Programme, the Export Enhancement Programem, and the GSM-102/103 Export Credit Guarantee Programmes*, GAO/T-NSIAD-90-53, 28 June 1990, p. 14). *See also* Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 (demonstrating that most of the rescheduled Russian and Former Soviet Union GSM claims have been in arrears)).

[95] *See* US 11 August Answers to Questions, paras. 157-161, 162-163, 169-172, 173.

102. Brazil notes that the United States has offered no documentation and data to support the figures included in paragraph 160 of its 11 August Answer. The Panel should not accept these unsupported assertions by the United States.

103. At paragraphs 122-123 of its 11 August Answer to Question 81(c), the United States asserts that "[a] cohort consists of all transactions associated with each type of guarantee issued during a particular year", and that "[n]ot until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government". Brazil notes that a "cohort" is not necessarily composed of *all* guarantees issued in a particular year. As the US Office of Management and Budget notes, cohorts may also be divided according to risk categories, with annual reestimates calculated according to those risk category-based cohorts.[96] The United States in fact acknowledges at paragraph 148 of its 11 August Answer to Question 86 that "[a]ll countries eligible for any of the CCC export credit guarantee programmes are categorized according to risk".

**(d) paragraphs 127-129 (re-estimates, etc.)**

**Brazil's Comment on US Answer:**

104. In paragraph 163 of its 11 August Answer, the United States asserts that the "net total for all cohorts for guarantees issued since 1992 currently stands at a downward re-estimate of $1.9 billion", suggesting that by the time a cohort is closed and final data becomes available, the cohort becomes profitable. Although the United States offers no citation, the $1.9 billion lifetime reestimate figure appears to be taken from the Federal Credit Supplement attached to the 2004 US budget. As discussed further in paragraphs 115-117 of Brazil's Rebuttal Submission, however, the United States fails to note that when these total lifetime reestimates for all cohorts of guarantees disbursed since 1992 are netted against the total *original* subsidy estimates adopted each budget year during the period 1992-2002, *the resulting loss is nearly $1.75 billion.*

**(b) paragraph 123 (interest on debt to Treasury)**

**Brazil's Comment on US Answer:**

105. The United States' 11 August Answer addresses interest rate reestimates under the FCRA cost formula. Paragraph 123 of Brazil's Statement at the First Panel Meeting, however, to which the Panel's question refers, does not address the treatment of interest paid by the CCC to the Treasury Department under the FCRA cost formula. Rather, in paragraph 123 of its Oral Statement at the First Meeting of the Panel, Brazil was responding to the US assertion that *Brazil's constructed formula* for determining whether the CCC guarantee programmes' operating costs and losses outpaced premiums collected should not have included interest paid by the CCC to the Treasury Department. In paragraph 123 of its Oral Statement, Brazil argued that under the ordinary meaning of the term "operating costs", interest paid by the CCC to the Treasury Department should be included in an assessment of the programmes under item (j). Brazil's arguments have nothing to do with interest rate reestimates under the FCRA cost formula. The United States' answer is, therefore, only relevant in so far as the United States now seems to acknowledge that, for the purposes of Brazil's revised constructed formula, interest payments to Treasury are properly included.[97]

[96] Exhibit Bra-116 (OMB Circular A-11, p. 185-16 – 185-17).
[97] US 11 August Answer to Question 81(b), para. 167.

**(e) Exhibits BRA-125-127**

**Brazil's Comment on US Answer:**

106. The United States' 11 August Answer is incorrect. Reestimates are recorded in the "programme account" segment of the CCC guarantee programme budget, in line item 00.07 (interest on reestimates is recorded in line 00.08).[98] Furthermore, Brazil has consistently also included the financing account in its exhibits, including – contrary to the US allegation[99] – in Exhibit Bra-127.

**(f) the chart on page 53 of Brazil's oral statement at the first session of the first Panel meeting relating to "Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM-102 GSM 103 and SCGP"?**

**Brazil's Comment on US Answer:**

107. Brazil refers the Panel to paragraphs 111-119 of Brazil's Rebuttal Submission for discussion of the US arguments concerning "estimated" versus "actual" data.

**(g) In respect of (a)-(f) above, how and to what extent do the information and data presented for the export guarantee programmes concerning "programme" and "financing", "summary of loan levels", "subsidy budget authority", "outlay levels", etc., in particular in Exhibits BRA-125-127, reflect "actual costs and losses" of the GSM-102, GSM-102 and SCGP export credit guarantee programmes(see e.g. Brazil's closing oral statement at the first session of the first substantive meeting, paragraph 24)?**

**Brazil's Comment on US Answer:**

108. Brazil refers the Panel to paragraphs 111-119 of Brazil's Rebuttal Submission for discussion of the US arguments concerning "estimated" versus "actual" data.

**(84) Is the Panel correct in understanding that, under the GSM-102 and GSM-103 programmes, the exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates?**

**Brazil's Comment on US Answer:**

109. As noted in Brazil's 11 August Comment on Question 84 (at paragraphs 192-194), GSM 102 and GSM 103 fees are charged according to a fee schedule that does not account for the country risk involved or the credit rating of the borrower. The US Department of Agriculture's Office of the Inspector General noted in June 2001 that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs".[100] It repeated this statement in February 2002.[101]

[98] *See* Exhibits Bra-88 to Bra-95 (US budgets for the years 1996-2003); Exhibits Bra-125 to Bra-127 (US budgets for the years 1994, 1995 and 2004). *See also* Exhibit Bra-184 (US budget for fiscal year 1993); Exhibit Bra-183 (US budget for fiscal year 1992).

[99] US 11 August Answer to Question 81(e), para. 168.

[100] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31).

110. Moreover, the US General Accounting Office ("GAO") analyzed CCC's failure to charge guarantee fees that take account of country risk or the creditworthiness of individual borrowers. Brazil quotes at length from the GAO study, since it provides further corroborating evidence that beneficiaries of CCC guarantees receive terms better than available on the market, and that CCC guarantee fees do not cover the costs of the CCC guarantee programmes:

> Although GSM-102 recipient countries vary significantly from one another in terms of their risk of defaulting on GSM-102 loans, CCC does not adjust the fee that it charges for credit guarantees to take account of country risk. CCC fees are based upon the length of the credit period and the number of principal payments to be made. For example, for a 3-year GSM-102 loan with semiannual principal payments, CCC charges a fee of 55.6 cents per $100, or 0.56 per cent of the covered amount. For 3-year loans with annual principal payments, the fee is 66.3 cents per $100.[ ] CCC fees that included a risk-based component might not cover all of the country risk, but they could help to offset the cost of loan defaults.
>
> USDA officials told us that including a fee for country risk could reduce the competitiveness of GSM-102 exports. However, they said they did not have recent or current data to support their claim.
>
> The US Export-Import Bank, which provides credit guarantees to promote a variety of US exports, uses risk-based fees to defray the cost of defaults on its portfolio. Under its system, each borrower/guarantor is rated in one of eight country risk categories. Exposure fees vary based on both the level of assessed risk and the length of time provided for repayment. For example, in the case of repayment over 3 years, a country rated in the lowest risk category is charged a fee of 75 cents per $100, whereas a country in the highest risk category is charged a fee of $5.70 per $100 of coverage. Thus, the bank's fee structure includes a substantial added charge for high country risk. According to the bank, its system is designed to remain as competitive as possible with fees charged by official export credit agencies of other countries.
>
> Under section 211(b)(1)(b) of the 1990 Farm Bill, CCC is currently restricted from charging an origination fee for any GSM-102 credit guarantee in excess of an amount equal to 1 per cent of the amount of credit extended under the transaction.[102] This restriction was initially enacted in 1985 following proposed administration legislation to charge a 5-per cent user fee for exports backed with credit guarantees. Some Members of Congress were concerned that such a fee would adversely affect the competitiveness of GSM-102 exports. Under the 1-per cent restriction, CCC would be considerably limited in the size of the fee that it could charge to take account of country risk should it decide to do so. For example, as previously noted, CCC charges 0.56 per cent for a loan payable in 3 years and with principal payments due annually. The most it could increase the fee would be 0.44 per cent. In contrast, the Export-Import Bank currently charges fees as high as 5.7 per cent for 3-year loans.[103]

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[101] Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programs have not been changed for many years and may not be reflecting current costs.").

[102] The United States confirmed in paragraphs 179-180 of its 11 August Answer that this remains the case.

[103] Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 135-136). Although government support from the Export-Import Bank does not constitute a market benchmark for the purposes of

111. Brazil notes that CCC fees for GSM 102 have not changed materially since the GAO published its report in 1995.[104] Moreover, the United States confirmed in its 11 August Answer to Question 84 (at paragraph 180) that US law prohibits CCC from charging fees in excess of one per cent of the guaranteed dollar value of the transaction.

**(85) Is the Panel correct in understanding that, under the SCGP, the exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? Please explain any "risk" assessment involved in the programme**.

**Brazil's Comment on US Answer:**

112. As noted in Brazil's 11 August Comment on Question 85 (at paragraph 195), SCGP fees do not vary according to the country risk involved or the credit rating of the borrower. With or without the "risk sharing" described in paragraph 183 of the United States' 11 August Answer, Brazil notes the United States' acknowledgement that "CCC does not determine the creditworthiness of importers participating in the SCGP."[105] This presents further corroborating evidence that beneficiaries of CCC guarantees receive terms better than available on the market, and that CCC guarantee fees do not cover the costs of the CCC guarantee programmes.

**(86) Is there a risk categorization in relation to three export credit guarantee programmes (GSM-102, GSM-103 and SCGP)? Does this have any impact on premiums payable and the ability of the CCC to on-sell the guarantees ?**

**Brazil's Comment on US Answer:**

113. Brazil notes the United States' acknowledgement that "[a] country's risk classification has no impact on the premiums payable under the US export credit guarantee programmes". CCC's failure to account for country risk provides further corroborating evidence that beneficiaries of CCC guarantees receive terms better than available on the market, and that CCC guarantee fees do not cover the costs of the CCC guarantee programmes.

**(87) What proportion of CCC (export-related and total) long term operating costs and losses are represented by GSM-102, GSM-103 and SCGP programmes?**

**Brazil's Comment on US Answer:**

114. The United States asserts that funding for the CCC export guarantee programs is provided from the US Treasury, and is not "financed out of" the CCC. This suggests that the CCC export guarantee programs are not self-sustaining. This suggests in turn that the CCC export guarantee programmes meet the elements of item (j) and, thus, constitute export subsidies.

**(88a) Is the Panel correct in understanding that the United States' argument is that, at present, by virtue of Article 10.2 of the Agreement on Agriculture, there are no disciplines on agricultural export credit guarantees under the Agreement on Agriculture (or the SCM Agreement)?**

---

Article 1.1(b) of the SCM Agreement, Brazil offers this example to demonstrate that the CCC guarantee programs do not even meet *non-market* benchmarks.

[104] Brazil's 11 August Answer to Question 77 and 84, para. 167, 193-194.

[105] US 11 August Answer to Question 85, para. 138.

**Brazil's Comment on US Answer:**

115. The United States incorrectly argues, in paragraph 187 of its 11 August Answer, that "[i]f export credit guarantee programmes were already subject to export subsidy disciplines, then Article 10.2 would be unnecessary." The negotiators may have considered it useful to negotiate additional disciplines for export credit guarantees one day, but that does not mean that they intended for export credits to be exempted from the general disciplines of the Agreement on Agriculture while those negotiations were pending.

116. The United States also argues in paragraph 187 that Brazil's use of the term "specific" disciplines somehow defeats Brazil's interpretation of Article 10.2. Brazil uses the term "specific" disciplines merely as a way of distinguishing between one actual and one potential category of export subsidy disciplines under the Agreement on Agriculture: (i) those "general" disciplines that apply to export credit guarantees today; and (ii) those "specific" disciplines that would additionally apply to export credits upon the completion of the negotiations called for by Article 10.2.

> **(b) Does the United States agree with the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the Agreement on Agriculture? Please cite any relevant material, including any past WTO dispute settlement cases. How would this reconcile with the United States' own statement, at paragraph 21 of its closing oral statement that "of course, the United States may not provide subsidies without any limit".**

**Brazil's Comment on US Answer:**

117. Please see Brazil's 22 August Comment on the United States' 11 August Answer to Question 74 for observations on the United States' assertion, in paragraph 189, that "Brazil has not contested that US export credit guarantee programmes are encompassed by the terms of Article 10.2."

118. The United States argues that an interpretation of Article 10.2 of the Agreement on Agriculture that exempts export credits from the general export subsidy disciplines of that agreement is consistent with the title of Article 10 – "Prevention of Circumvention of Export Subsidy Commitments."[106] The United States' argument is absurd. Since negotiations on specific disciplines pursuant to Article 10.2 have not been concluded, the United States' interpretation of Article 10.2 would leave export credit support completely undisciplined, and open to the abuse outlined in the text of the Panel's question. In this way, the United States' interpretation of Article 10.2 *facilitates*, rather than *prevents*, circumvention of its export subsidy commitments.

119. The United States also argues that the portion of Article 10.2 calling for Members to work toward the negotiation of specific disciplines on export credits also contributes to the prevention of circumvention. As the ordinary meaning of the first portion of Article 10.2 demonstrates, however[107], Members are not even required to actually negotiate specific disciplines for export credits, let alone to reach actual agreement on those specific disciplines. All Members have agreed to do is to work toward the development of those specific disciplines, which does not in itself prevent circumvention.

> **(c) If, as the United States argues, there are no disciplines on export credit guarantees in the Agreement on Agriculture, how could export credit guarantees**

[106] US 11 August Answer to Question 88(b), para. 190.
[107] *See* Oral Statement of Brazil, para. 102.

**"conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity when there are allegedly no disciplines against which such an assessment could occur)?**

**Brazil's Comment on US Answer:**

120. The United States argues that since export credit guarantees are not subject to export subsidy disciplines in the Agreement on Agriculture, they "cannot be out of compliance with Part V" of the that agreement. The pertinent question is whether export credit guarantees can, under the terms of Article 13(c), "conform fully to the provisions of Part V" of the Agreement on Agriculture. In this regard, the United States ignores the conclusions of the panel in *Canada – Aircraft (21.5)*.[108] As noted in Brazil's 11 August Comment on Question 88(c) (paragraphs 200-202), if the United States is correct that CCC export credit guarantees are not subject to the disciplines in Part V of the Agreement on Agriculture, then CCC guarantees cannot logically "conform fully to the provisions of Part V" and trigger the exemption from action provided for in Article 13(c).

121. Alternatively, the United States suggests that Article 13(c) does not apply to export credit guarantees because "export credit guarantees are not export subsidies within the meaning of either Article 9.1 or 10.1" of the Agreement on Agriculture. This assertion is not supported by the United States with any reference to the tools of interpretation included in the *Vienna Convention*, and is fundamentally incorrect. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP export credit guarantee programs administered by the CCC constitute export subsidies within the meaning of Articles 10.1, 1(e) and 8 of the Agriculture Agreement, Article 3.1(a) of the SCM Agreement, and item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement.[109]

**(d) Is the United States advocating the view that its own export credit guarantee programmes, which pre-dated the Uruguay Round, are effectively "grandfathered" so as to benefit from some sort of exemption from the export subsidy disciplines of the Agreement on Agriculture? How, if at all, is it relevant that the SCGP did not, according to the United States, become relevant for upland cotton until the late 1990's (i.e. after the entry into force of the WTO Agreement)?**

**Brazil's Comment on US Answer:**

122. Please see Brazil's comment on the United States' 11 August Answer to Question 74 for observations on the US assertion in paragraph 189 that "Brazil has not contested that SCGP provides export credit guarantees within the meaning of Article 10.2."

## IV. STEP 2 PAYMENTS

**(92) Does the United States confirm that Exhibit Bra.65 represents a sample contract for exporters of eligible upland cotton to conclude with the CCC under the FSRI 2002, and that an application form (Exhibit Bra-66) needs to be filled out with data on weekly exports and submitted to the USDA FAS. Is Exhibit Bra-66- Form CCC 1045-2 also a valid example? If not, please identify any differences or distinctions.**

**(96) Is a domestic sale a "use" for the purposes of Step 2 payments? Is a sale for export, or export, considered a "use"?**

[108] Panel Report, *Canada – Aircraft (21.5)*, WT/DS70/RW, para. 5.143-5.145.

[109] First Submission of Brazil, para. 271-294; Oral Statement of Brazil, para. 116-133; Brazil's 11 August Answers to Quetions, para. 139-168, 175-189 and 192-199.

**Brazil's Comments to the US Answers:**

123. Brazil notes that the Step 2 regulations make a clear distinction between "domestic *users*" and "exporters".[110] "Domestic *users*" may only receive payment upon "proof of purchase and *consumption of eligible cotton by the domestic user*. . .".[111] The agreement for domestic users provides that a domestic user is a person regularly engaged in manufacturing eligible upland cotton into cotton products in the United States and that "in the event that the cotton is not used for that purpose, the payment received shall be returned immediately and with interest".[112] There is no requirement that "exporters" prove, prior to receiving payment, that exported US upland cotton be "used" for anything upon export. Rather, the payment is a function of "proof of export of eligible cotton by the exporter".[113] Thus, the structure of the Step 2 programme clearly differentiates between "export" and "use". Article 3.1(b) applies the phrase "contingent upon *use*." Article 3.1(a) uses the phrase "contingent . . . upon export performance".

124. In relation to Exhibit US-21, Brazil agrees with the United States that the two different forms that have to be annexed to the User/Exporter Agreement have different objectives depending on the final destination of upland cotton. That is, if the upland cotton is *used* domestically, then the CCC-1045UP-1 form has to be completed and annexed to the User/Exporter Agreement. If the cotton is exported, then the CCC-1045UP-2 form has to be used. However, contrary to the US statement at paragraph 201 of its 11 August Answer to Question 92, the latter makes no reference whatsoever to an "Exporter User." Indeed, the term "exporter user" is not contained either in the Step 2 regulations nor in the form that has to be annexed to the User/Exporter Agreement if the upland cotton will be exported. This is consistent with the fact that an exporter is not a "user" under the Step 2 programme and the act of exporting is unlikely a final "use" of upland cotton. In sum, Step 2 export payments are not made contingent upon "use," but contingent upon "*export*".

**(93) Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment?**

**(99) How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's Oral Statement at the first session of the first panel meeting concerning the relevance of the Appellate body Report in US- FSC(21.5)**

**Brazil's Comment on US Answers:**

125. The United States in its 11 August Answer to Question 93 states at paragraph 202 that "all upland cotton produced in the United States is eligible for the benefit of the Step 2 cotton subsidy".[114] Furthermore, it submits that "when the entirety of production of a good in a country is eligible to receive a subsidy, no contingency on export exists".[115]

126. Brazil provides a detailed comment to these assertions in its Rebuttal Submission.[116] In fact, Step 2 payments are not made to every pound of upland cotton that is "used". Rather, Step 2 payments are made on every pound of upland cotton that is *exported by <u>eligible</u> <u>exporters</u>* or that is

[110] Exhibit Bra-37 (7 CFR 1427.104)
[111] Exhibit Bra-37 (7 CFR 1427.108(d)).
[112] Exhibit US-21 (Upland Cotton Domestic User / Exporter Agreement, Section, Section B1)
[113] Exhibit Bra-37 (7 CFR 1427.108(d))
[114] US 11 August Answer to Question 93, para. 202.
[115] US 11 August Answer to Question 93, para. 202.
[116] *See* Rebuttal Submission of Brazil, paras. 129-130.

*used by eligible domestic users*. No Step 2 payment is made for upland cotton exported or used by ineligible persons, or for upland cotton that is neither used domestically nor exported, but that is for instance stored, stolen or incidentally destroyed by for example fire.

127. Furthermore, the criterion whether Step 2 payments are available to all upland cotton produced in the United States is entirely irrelevant for Brazil's claims under Article 3 of the SCM Agreement. That provision prohibits the payment of subsidies that are contingent upon export or contingent upon the use of domestic over imported goods. It follows that a subsidy is prohibited if its payment is conditional on the existence of one of the two situations: export or use of local content.

**(107) At paragraph 135 of its first written submission, the United States states: "The subsidy is not contingent upon export performance…"(emphasis added). Again, in the course of the first Panel meeting, the United States admitted that the Step 2 payments were "subsidies". Does the United States thus concede that Step2 payments constitute a "subsidy" within the meaning of the WTO Agreement?**

**Brazil's Comment on US Answer:**

128. The arguments provided by the United States are not responsive to the question posed by the Panel. Brazil reiterates that Exhibit Bra-69 is not relevant for its *de jure* claims. Whenever a Step 2 payment for exported or domestically used upland cotton takes place, the payment is made inconsistently with Articles 3.1(a) or 3.1(b) of the SCM Agreement and with Articles 3.3 and 8 of the Agreement of Agriculture in the case of Step 2 export payments. Step 2 export payments are contingent upon export performance and Step 2 domestic payments are contingent upon use of domestic over imported upland cotton. Neither the respective share of Step 2 export and domestic payments nor the share of eligible US upland cotton production materially affects this conclusion.

**(111) Does the United States maintain its argument that actions based on Article 3.1(b) of the SCM Agreement are conditionally « exempt from actions » due to the operation of Article 13 of the Agreement on Agriculture?**

**(112) In the event that the Panel finds that Article 6.3 of the Agreement on Agriculture does not preclude an examination of Brazil's claims under Article 3.1 of the SCM Agreement and Article III:4 of GATT 1994, how does the United States respond to the merits of Brazil's claims relating to Step 2 payments under those provisions?**

**(113) Is it necessary for measures directed at agricultural processors included in AMS to discriminate on the basis of the origin of goods?**

**(115) What is the meaning and relevance (if any) to Brazil's claims under Article 3 of the SCM Agreement and Article III:4 of GATT 1994 of the phrase "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products" in the Agreement on Agriculture?**

**(116) With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the Agreement on Agriculture? Does the phrase "provide support in favour of domestic producers" in Article 3.2 of the Agreement on Agriculture refer to, and/or permit such subsidies?**

**Brazil's Comment to the US Answers:**

129. Brazil addresses the US 11 August Answers to the questions listed above in its Rebuttal Submission at paragraphs 131-144. Brazil further refers the Panel to paragraphs 78-86 of its Oral Statement and to its 11 August Answers to Questions 100-102 and 115-116.

# ANNEX I-4

Please refer to Section V. of Annex D-4.

# ANNEX I-5

## ANSWERS OF BRAZIL TO QUESTIONS POSED BY THE PANEL FOLLOWING THE RESUMED FIRST SUBSTANTIVE MEETING OF THE PANEL

27 October 2003

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| *EEC – Wheat Flour* | GATT Panel Report, *European Economic Community – Subsidies on Export of Wheat Flour,* SCM/42, circulated 21 March 1983. |
| *EC - Hormones* | Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones),* WT/DS26/AB/R, adopted 13 February 1998. |
| *EC- Bananas* | Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas,* WT/DS27/AB/R, adopted 25 September 1997. |
| *Argentina – Textiles and Apparel* | Panel Report, *Argentina – Measures affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/R, adopted 22 April 1998. |
| *Canada - Aircraft* | Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft,* WT/DS70/AB/R, adopted 20 August 1999. |
| *India – Quantitative Restrictions* | Panel Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WT/DS90/R, adopted 22 September 1999. |
| *Korea – Dairy Safeguards* | Appellate Body Report, *Korea* – Definitive Safeguard Measure on Imports of Certain Dairy Products, WT/DS98/AB/R, adopted 12 January 2000. |
| *US - FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
| *US – FSC (21.5)* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation."* Recourse to Article 21.5 of the DSU by the European Communities. WT/DS108/AB/R, adopted 29 January 2002. |
| *Argentina – Footwear Safeguards* | Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear,* WT/DS121/AB/R, adopted 12 January 2000. |
| *US – Section 301* | Panel Report, *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, adopted 27 January 2000. |
| *EC - Sardines* | Appellate Body Report, *European Communities – Trade Descriptions of Sardines*, WT/DS231/AB/R, adopted 23 October 2002. |

## List of Exhibits

| | |
|---|---|
| "Production and Trade Policies Affecting the Cotton Industry," ICAC, September 2003 | Exhibit Bra- 284 |
| "Agriculture Fact Book 2001-2002," Chapter 3 – American Farms. | Exhibit Bra- 285 |
| Direct and Counter-Cyclical Programme Contract, Form CCC-509, USDA, Commodity Credit Corporation | Exhibit Bra- 286 |
| Market Revenue and US Government Payments to US Upland Cotton Producers. | Exhibit Bra- 287 |
| "NASS to Update Acreage If Necessary," National Agricultural Statistics Service, USDA, 29 September 2003. | Exhibit Bra- 288 |
| 7 CFR 1412.606; 7 CFR 718.102, 2003 Edition | Exhibit Bra- 289 |
| "Farmers Must File Acreage to Receive 2002 Payments," Kansan Online Ag Briefs; AFBIS Inc. Crop Watch, June 2003 | Exhibit Bra- 290 |
| "Direct and Counter-Cyclical Payment Programme", Farm Service Agency, USDA, April 2003. | Exhibit Bra- 291 |
| 7 CFR 718.102, 2002 Edition | Exhibit Bra- 292 |
| Data for Acreage Chart | Exhibit Bra- 293 |
| "The World Fact Book – Benin," CIA. | Exhibit Bra- 294 |
| 2004 US Budget, Federal Credit Supplement, Introduction and Table 2 | Exhibit Bra- 295 |
| "USDA Announces $2.8 Billion in Export Credit Guarantees," FAS Press Release, 30 September 2003 | Exhibit Bra- 296 |
| 7 U.S.C § 5641(b)(1); 7 U.S.C. § 5622(a), (b) | Exhibit Bra- 297 |
| "USDA Amends Commodity Eligibility under Credit Guarantee Programmes", FAS Press Release, 24 September 2002. | Exhibit Bra- 298 |
| "Summary of FY 2003 Export Credit Guarantee Programme Activity", USDA, Covering GSM-102, GSM 103 and SCGP | Exhibit Bra- 299 |
| Calculation on US Rice Exports Benefiting from GSM-102, GSM-103 and SCGP. | Exhibit Bra- 300 |
| Additional Results from Professor Sumner's Model. | Exhibit Bra- 301 |
| Revised and Extended Data on Article 6.3(d) Claim. | Exhibit Bra- 302 |

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| John C. Beghin and Holger Matthey. "Modelling World Peanut Product Markets: A Tool for Agricultural Trade Policy Analysis". Center for Agricultural and Rural Development (CARD), May 2003. | Exhibit Bra- 303 |
| John C. Beghin, Barbara El Osta, Jay R. Cherlow, and Samarendu Mohanty. "The Cost of the US Sugar Programme Revisited", Centre for Agricultural and Rural Development (CARD), March 2001. | Exhibit Bra- 304 |
| Larry Salathe, J. Michael Price and David Banker. "An Analysis of the Farmer Owned Reserve Programme 1977-82. American Journal of Agricultural Economics, February 1984. | Exhibit Bra- 305 |
| "Supply Response under the 1996 Farm Act and Implications for the US Field Crops Sector," Lin et al., USDA, July 2000. | Exhibit Bra- 306 |
| Change in US and World Exports in Per cent. | Exhibit Bra- 307 |
| "Decoupled Payments: Household Income Transfers in Contemporary US Agriculture," ERS, Agriculture Economic Report N° 822. | Exhibit Bra- 308 |
| Barnard C., Nehring, R., Ryan, J., Collender, R. "Higher Cropland Values from Farm Programme Payments: Who Gains?" Economic Research Service. USDA, Agricultural Outlook November 2001. | Exhibit Bra- 309 |
| "The Incidence of Government Payments on Agricultural Land Rents: The Challenges of Identification," Roberts, Kirwan and Hopkins, August 2003, American Journal of Agricultural Economics. | Exhibit Bra- 310 |
| Side by Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average US Spot Market Price and Prices Received by US Producers from January 1996 to the present. | Exhibit Bra- 311 |
| Cotton Outlook Reports dated 7 June 2002, 27 September 2002 and 4 October 2002. | Exhibit Bra- 312 |

A. REQUEST FOR PRELIMINARY RULINGS

**122. Does Brazil allege that cottonseed payments, interest subsidies and storage payments are included in the subsidies that cause serious prejudice? Do they appear in the economic calculations? BRA**

Brazil's Answer:

1. Cottonseed payments, interest subsidies and storage payments are included in the set of subsidies that Brazil alleges cause serious prejudice to its interests within the meaning of Articles 5(c) and 6.3 of the SCM Agreement and Article XVI of GATT 1994. The amounts of cottonseed payments and interest subsidies/storage payments range from $50 million to $216 million per year.[1] To appreciate the size of these subsidies, the annual amount of each of them separately far exceeds the total amount of Brazilian assistance to its upland cotton farmers of $10 million in MY 2001 by a factor of 4 to 21.[2] Indeed, the annual, individual amount of US cottonseed payments, interest subsidies and storage payments also by far exceeds the amounts of subsidies paid by most other cotton-producing countries.

2. The United States has notified cottonseed payments as trade-distorting amber box subsidies to the WTO.[3] Thus, these payments are presumed to be trade-distortive. Interest subsidies and storage payments appear to be part of the operation of the marketing loan programme that has also been notified to the WTO as a trade-distortive amber box subsidy, and is therefore presumed to be trade-distortive. The United States has not notified them separately to the WTO.[4]

3. The economic calculations provided by Brazil on the effect of US subsidies in filling the cost revenue gap include cottonseed payments and interest subsidies/storage payments.[5] They are also included as part of the overall level of US subsidization provided. However, they are not part of the econometric model developed by Professor Daniel Sumner.[6]

**123. Does Brazil's request for the establishment of the Panel name the statute authorizing cottonseed payments for the 1999 crop? BRA**

Brazil's Answer:

4. To the extent that cottonseed payments for the MY 1999 crop were authorized by Section 204(e) of the Agricultural Risk Protection Act of 2000, Brazil's request for the establishment of the Panel names the statute authorizing these payments.[7] This act authorized the payment of $100 million in cottonseed payments. However, Brazil did not explicitly identify in its request for establishment P.L. 106-113, which serves as the legal basis for a further $79 million in cottonseed payments for the MY 1999 cottonseed payments.

[1] Brazil's 9 September Further Submission, Table 1, p. 4.

[2] Exhibit Bra-284 ("Production and Trade Policies Affecting the Cotton Industry," ICAC, September 2003, p. 6).

[3] Exhibit Bra-47 (G/AG/N/USA/43, p. 20).

[4] Exhibit Bra-47 (G/AG/N/USA/43, p. 20).

[5] Brazil's 22 August Rebuttal Submission, para. 30 and 40.

[6] To the extent that interest subsidies and storage payments operate to compensate for any cost incurred by US upland cotton producers from the participation in the marketing loan program (for instance, for the storage cost resulting from storing physical upland cotton as collateral for the marketing loan), these subsidies have been considered in Professor Sumner's model. However, those costs do not occur, if a producer decides to opt for a loan deficiency payment rather then taking out a marketing loan.

[7] WT/DS267/7, p. 2.

5. Brazil emphasizes that it is not challenging the underlying statutes authorizing the payment of cottonseed payments in MY 1999, 2000 and 2002, *i.e.*, Brazil does not challenge those payments *per se*. Brazil challenges as "measures" the payments of those subsidies as causing adverse effects to its interests. The United States and Brazil have consulted about those payments.[8] Brazil properly included reference to all "payments" for upland cotton in its request for the establishment of the Panel.[9] This is sufficient to properly identify cottonseed payments as measures for the purposes of Brazil's request for the establishment of the Panel.

B. EXEMPTION FROM ACTIONS

**6. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*? BRA, US**

Brazil's Answer:

6. No. Brazil's claims relate to prohibited and actionable subsidies provided during MY 1999-2002 when the United States had no peace clause protection. Brazil's threat of serious prejudice claims relate to the present threat of serious prejudice caused by subsidies provided during MY 1999-2002, as well as the threat caused by subsidies that are required to be provided through the end of MY 2007 by the 2002 FSRI Act and the 2000 ARP Act. The fact that the Panel will issue its determination regarding these subsidies after the termination of the "peace clause" in 2004 has no impact on the analysis of these claims.

C. IDENTIFICATION OF THE SUBSIDIZED PRODUCT

**125.**

**(2) Brazil has submitted that "The record suggests that *historic* producers are *current* producers." It points to factors including the specialization of upland cotton producers, the need to recoup expensive investments in cotton-specific equipment, and the geographic focus and climatic requirements of upland cotton production in the "cotton belt". (Brazil's rebuttal submission, footnote 98, on page 24)**

**(a) Regarding the specialization of upland cotton producers and the geographic focus of upland cotton production, how does Brazil take account of the fact that cotton is produced in 17 of the 50 states of the United States and that average cotton area is approximately 38% of a cotton farm's acres? (This information is taken from the US's response to question 67*bis*, footnote 35). BRA**

[8] Exhibit Bra-101 (Questions for the Purposes of the Consultations, Questions 14.1 *et seq.*, p. 13).

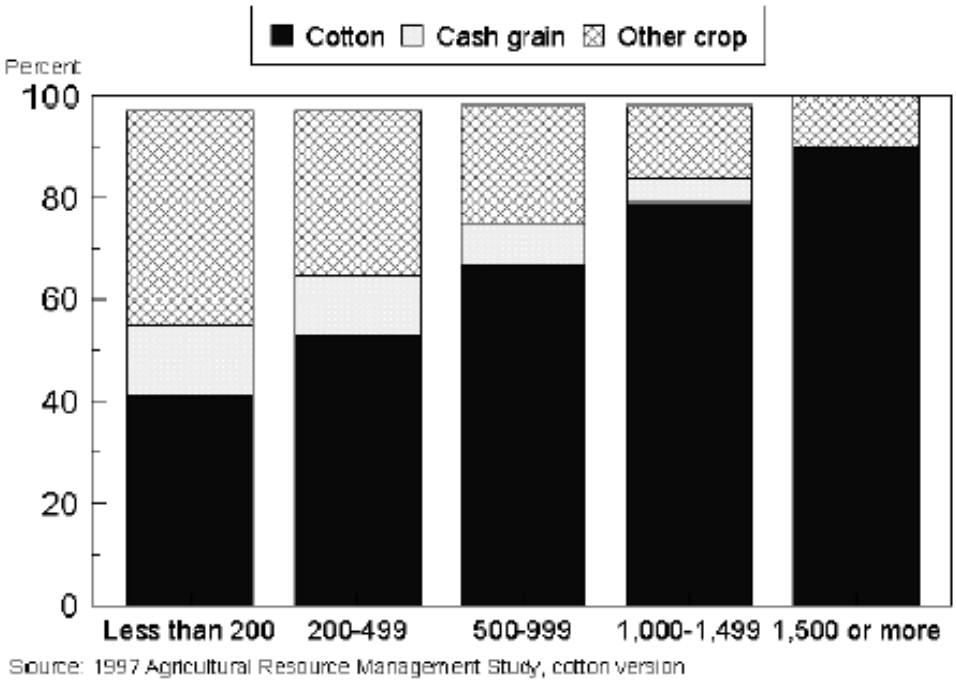
[9] The "measures" identified include (1) "domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2001", (2) "domestic support subsidies that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007", (3) "all subsidies benefiting upland cotton that have trade distorting effects or effects on production by the US upland cotton industry", (4) "domestic support, and all other subsidies provided under regulations, administrative procedures . . . for the production, use and/or export of US upland cotton and upland cotton products". WT/DS267/7, pages 1, 2, 3.

Brazil's Answer:

7. In contrast to the information cited in the Panel's question, more relevant information concerning specialization of cotton producers in cotton farms is set out in Exhibit Bra-16, which is a 2001 USDA report on the cost of production of cotton farms. That report contains the following figure:[10]

**Figure 3 Specialization of cotton farms**

Ninety percent of farms with 1,500 or more cotton acres specialized in cotto while roughly 40 percent of farms with less than 200 cotton acres specialized in either cotton or other crops.




Source: 1997 Agricultural Resource Management Study, cotton version

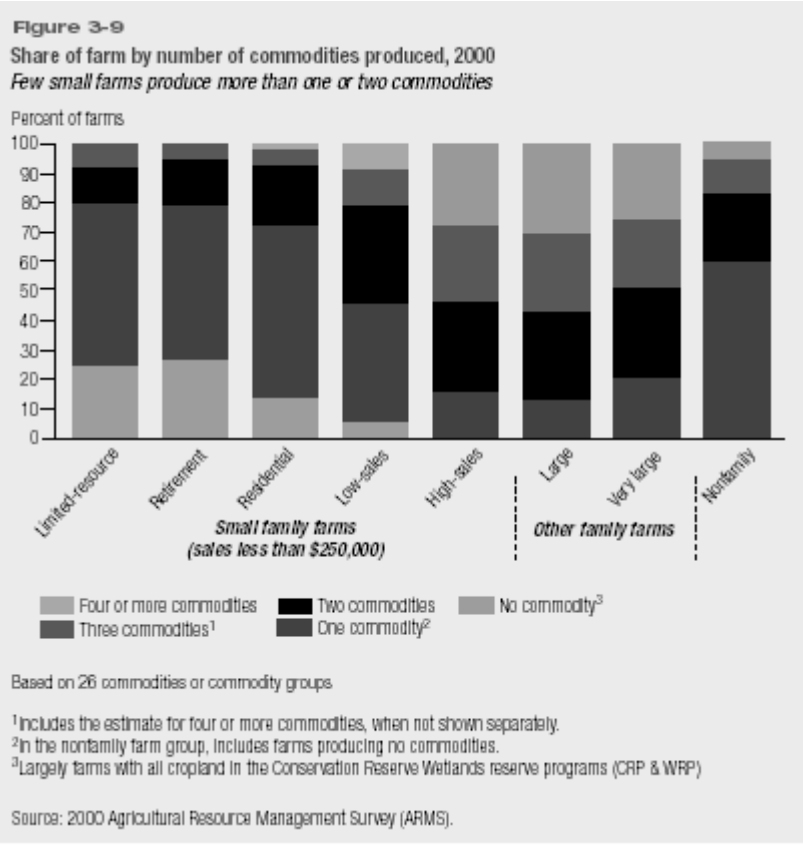
8. This evidence shows that farms with 500 or more acres of upland cotton are heavily specialized in the production of cotton. While these farms represented 33 per cent of US farms producing upland cotton, they produced 75 per cent of total US upland cotton in MY 1997.[11] Thus, the great majority of US production of upland cotton takes place on farms that largely specialize in the production of upland cotton.

9. Other data regarding specialization is found in a 1998 USDA report indicating that most smaller farms – defined as farms with income below $250,000 and which account for 92 per cent of all US farms – tend to produce only one or at most two crops.[12] This is illustrated in the chart below:

[10] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms", USDA, October 2001, p. 9).

[11] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms". USDA, October 2001, p. 7).

[12] Exhibit Bra-285 ("Agriculture Fact Book 2001-2002", Chapter 3 - American Farms, p. 32).




10. Approximately 55 per cent of upland cotton is produced on such smaller farms.[13] Thus, even for those smaller farms producing upland cotton, the evidence suggests that over 50 per cent produce mainly upland cotton and the rest produce at most one additional crop. This evidence is consistent with Brazil's argument concerning cotton specialization.

11. With respect to the Panel's question, the 38 per cent figure cited by the United States refers to "planted cotton acreage" as a percentage of "total acreage operated".[14] The United States provides no information on what "total acreage *operated*" means. Nor does the United States provide the Panel with the amount of "planted cotton acreage" as a percentage of "total PFC/DP base acreage". It may be that the cotton acreage accounts for most of a farm's "base acreage". Thus, the "total acreage operated" is not the appropriate basis to calculate a percentage of base acreage for farms producing upland cotton. The best evidence of specialization is the actual payments made to upland cotton producers discussed in Brazil's Answer to Question 125 (5). The next best evidence is the USDA data on specialization of cotton farms cited above.

12. Moreover, Brazil's arguments are not dependent on proof that the majority of cotton farms produce *only* upland cotton. The evidence suggests that larger farms tend to grow at least some other crops and, therefore, may have more than one type of PFC/market loss assistance or direct and counter-cyclical payment "base acreage".[15] As Christopher Ward testified, farmers rotate the production of several different crops, planting one crop on a certain portion of the farmland, and then

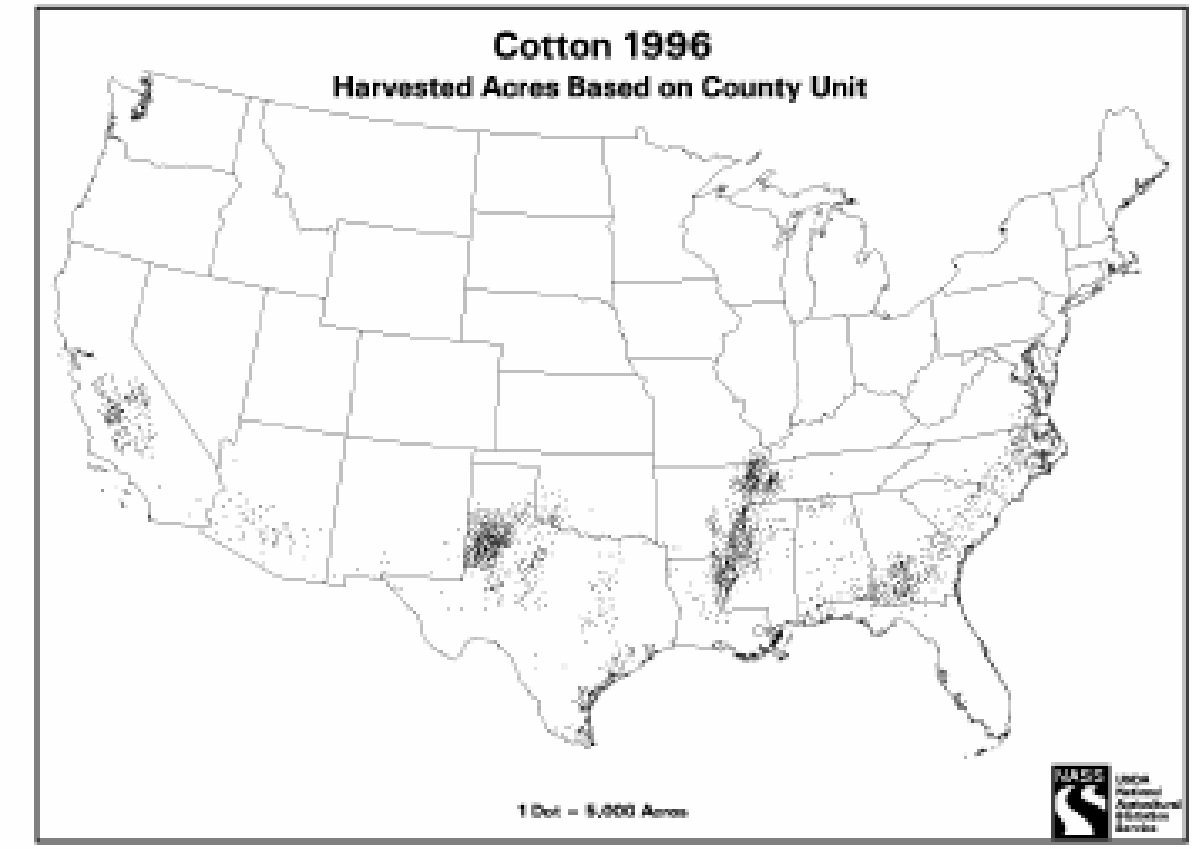
[13] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms," USDA, October 2001, Table 7) tabulating farms with value of production less than $250,000.

[14] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms," USDA, October 2001, Table 3).

[15] This is also demonstrated by Exhibit Bra-286 (Direct and Counter-cyclical Program Contract, Form CCC-509, USDA, Commodity Credit Corporation), which provides for the possibility to establish base acres for different crops.

moving the production of that same crop to another portion of the farmland.[16] But the fact that crops are rotated or that some farmers have multiple types of "base acres" and produce more than one crop on their farm does not mean that farmers do not continue to plant upland cotton and use cotton-specific machinery and ginning facilities. This is confirmed by the fact that between MY 1999-2002, there were no wide swings in planted upland cotton acreage.[17]

13. Finally, while the United States is correct in stating that upland cotton is produced in 17 states, 66 per cent of upland cotton is produced in only 5 states, and 90 per cent is produced in only 10 out of the 50 US states.[18] In addition, even within each of these 10 states, upland cotton tends to be grown in relatively distinct geographical regions. This is shown in the graph below:[19]




**(c) Regarding the high cost of upland cotton production, can Brazil show that farms who planted upland cotton could only have covered their costs by receiving upland cotton, rice or peanut payments in every year from 1999 through 2002? BRA**

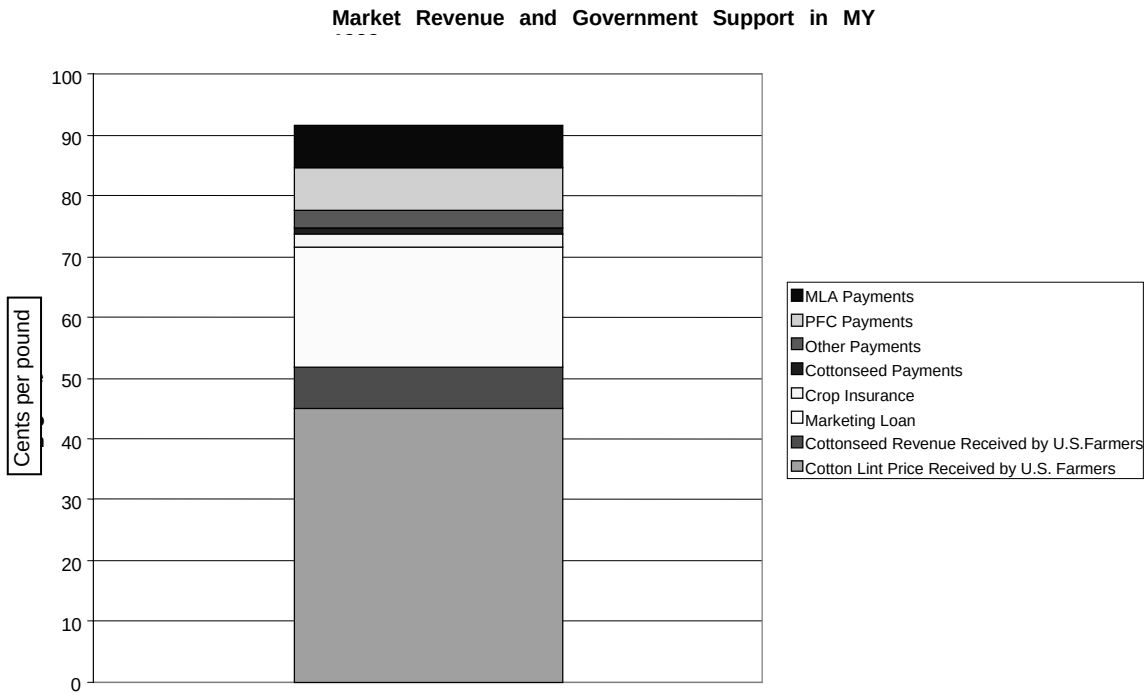
Brazil's Answer:

14. Between MY 2000-2002, US upland cotton producers could not make a profit, unless they grew upland cotton on upland cotton or rice (or peanut in MY 2002) base acreage. Brazil provides data below for each of the four marketing years covering the period of investigation (MY 1999-2002). This evidence is consistent with a conclusion that the great majority of upland cotton was produced on upland cotton base acreage. In responding to this question from the Panel, Brazil took into account

[16] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 2)
[17] *See* Brazil's Answer to Question 125(6).
[18] Exhibit Bra-107 (US and State Farm Income Data, Farm Cash Receipts, ERS, USDA, June 2003).
[19] http://usda.mannlib.cornell.edu/reports/nassr/field/planting/uph97.pdf , Usual Planting and Harvesting Dates for US Field Crops, National Agricultural Statistics Service, USDA, December 1997, p. 7.

Dr. Glauber's comment that Step 2 payments are not received by US upland cotton producers but rather by exporters and domestic users.[20] Brazil generally agrees with this statement. Therefore, Brazil has excluded Step 2 payments from the pool of revenue received by US upland cotton producers.[21] It presents data on the total amount of market revenue for upland cotton lint and seed, marketing loan benefits, crop insurance payments, cottonseed payments, so-called "other payments"[22] and PFC, market loss assistance, direct and counter-cyclical payments.

15. The following chart shows revenues of upland cotton producers in MY 1999:[23]




16. The chart shows that US upland cotton producers received total revenue of 91.54 cents per pound of upland cotton produced. At the same time, the average cost of production was 82.03 cents per pound in MY 1999[24] and prices received by producers were 45 cents per pound.[25] It follows that US producers could not produce upland cotton without the financial assistance of the US Government in the form of large amounts of subsidies. US producers needed 4.46 cents per pound from the total combined upland cotton PFC and market loss assistance payment of 13.97 cents per pound to recover their costs.[26]

[20] Exhibit US-24, p. 3 fifth and sixth paragraph.

[21] This does not affect Brazil's view that Step 2 payments are properly included in the peace clause analysis under Article 13(b)(ii) of the Agreement on Agriculture as "support to upland cotton". While Step 2 payments may not directly benefit domestic producers of upland cotton, they do so indirectly. As they increase demand for US upland cotton, they increase prices received by US producers and are, therefore, properly described as "support to upland cotton".

[22] Interest subsidies and storage payments.

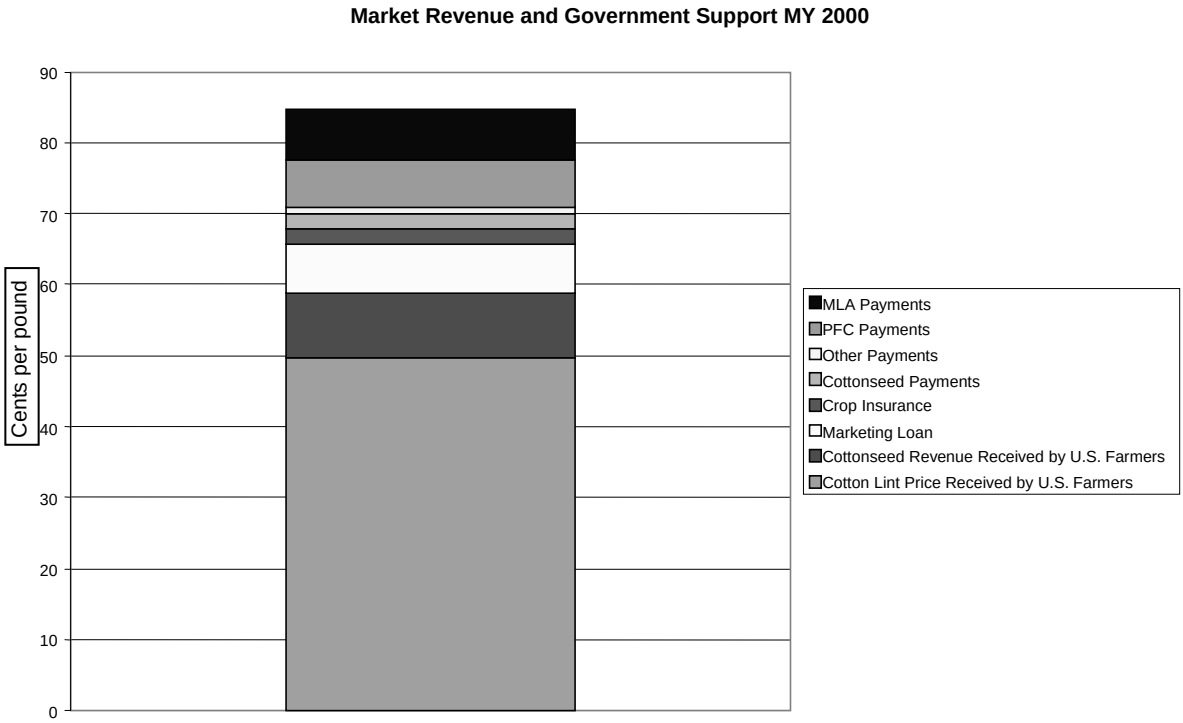
[23] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

[24] Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers).

[25] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5).

[26] Thus, they could have produced upland cotton on wheat, corn, grain sorghum, cotton and rice base acreage without suffering a loss.

17. In MY 2000, the financial situation of US upland cotton producers worsened. While the price they received for upland cotton lint increased to 49.8 cents per pound[27], their total revenue fell to 84.74 cents per pound[28], only slightly above their average cost of production of 82.69 cents per pound.




18. Again, large amounts of US subsidies were instrumental in closing the gap between the US cost of production and the market returns of producers. For MY 2000, the 13.86 cents per pound in upland cotton PFC and market loss assistance payments as well as all other subsidies were needed to close the gap between the cost of production and the market returns.[29] Average US upland cotton producers could also have covered their total costs had they planted upland cotton on rice base acres. But they would have suffered a marginal loss on corn or other crop base acres.

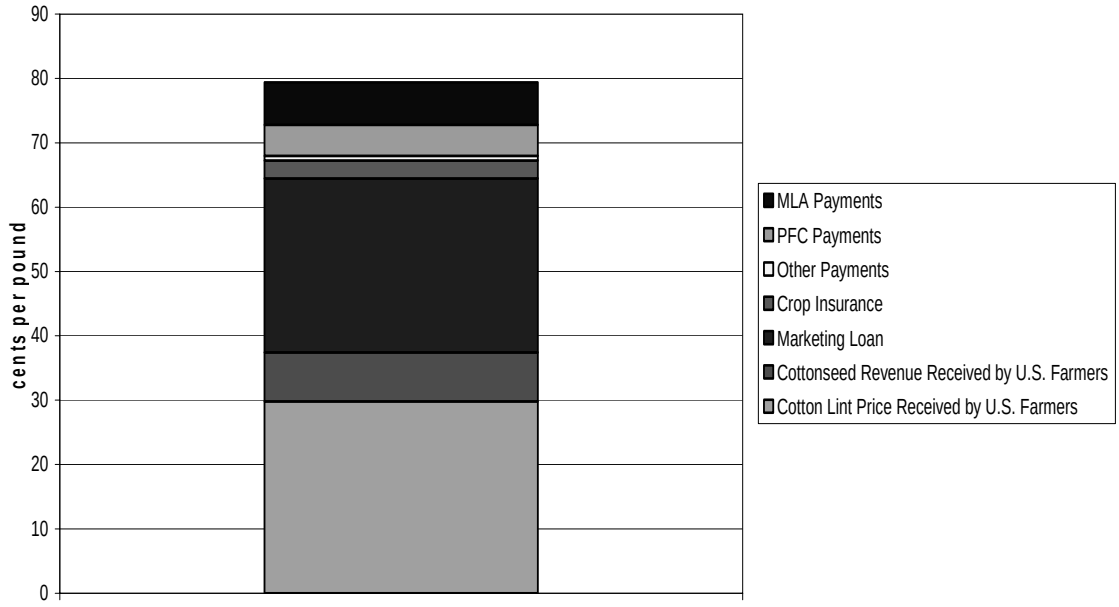
19. The results for MY 2001 show a similar result:

[27] Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 5).

[28] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

[29] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

**Market Revenue and Government Support in MY 2001**




20. US producers received a total revenue of 79.41 cents per pound,[30] only 29.8 cents per pound of which was market revenue for upland cotton lint. At the same time, they faced an average cost of production of 76.44 cents per pound.[31] Thus, the average US producer of upland cotton needed an upland cotton or rice PFC and market loss assistance payment to break even, while upland cotton production on corn or any other crop base acreage would have generated a loss.

21. For MY 2002, average US producers even suffered a loss from upland cotton production on upland cotton base acres[32], let alone corn or other crop base acres, except for rice and peanuts.[33] The average US upland cotton producer received total revenues of 82.96 cents per pound[34], while their average total cost for MY 2002 was 83.59 cents per pound.[35]

[30] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

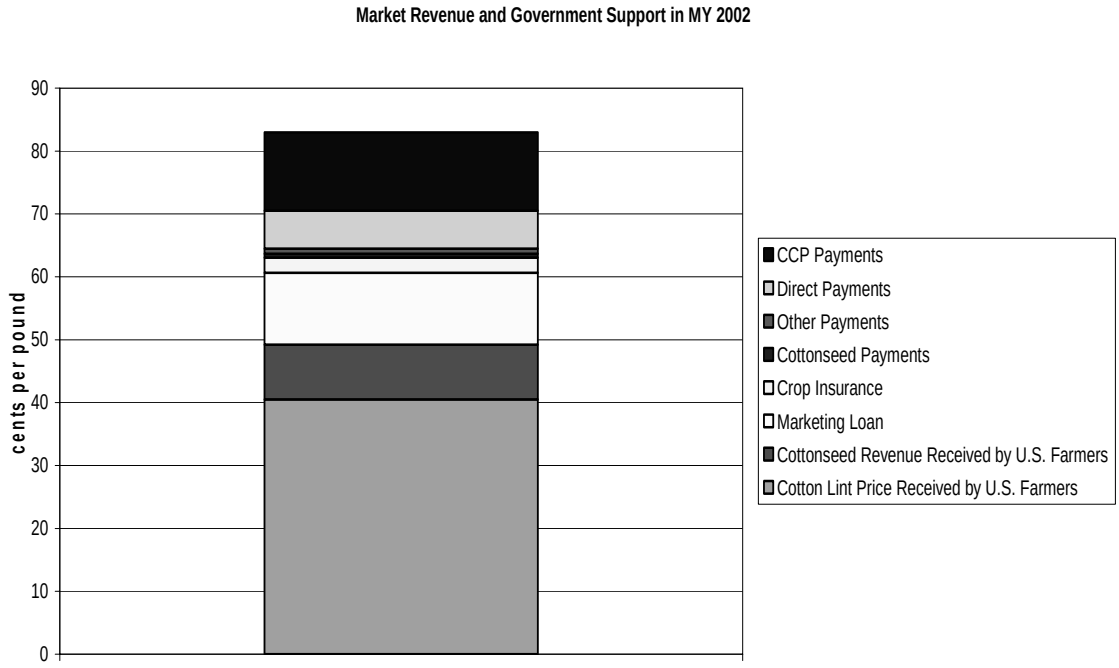
[31] Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers).

[32] Brazil notes that it is not in a position to quantify the effect of the yield update for purposes of the counter-cyclical payments and, thus, likely underestimated the amount of those payments (*See* Brazil's Answer to Questions 125 (8)). With slightly higher counter-cyclical payments than assumed by Brazil, US producers of upland cotton might have made a small profit in MY 2002.

[33] Brazil notes that while evidently some former corn producers had shifted to upland cotton production, the fact that they were allowed to update their base acres to upland cotton base acres meant that they could now receive upland cotton payments (*See* Brazil's Answer to Question 125 (7)).

[34] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

[35] Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers).




22. The overall conclusion of this analysis is that, on average over the period of investigation, US upland cotton producers needed and received upland cotton or rice programme payments to cover (or almost cover) their total cost of production. At the same time, as total revenue decreased relative to the cost of production, US upland cotton acreage increased between MY 1999-2001.[36] Because upland cotton producers with non-upland cotton or rice base acreage would have lost money (even with the subsidies), they would have been forced to switch out of upland cotton production. This means that the only producers that could remain were those with upland cotton or rice base. The fact that upland cotton acreage increased through MY 2001 suggests that only a small portion of upland cotton in the United States could have been grown on non-upland cotton base acres.

23. Similarly, in MY 2002, the option to update the base acreage (and yield for the CCP payment programme) allowed those producers that produced on non-upland cotton base acres in MY 1998-2001 to receive the considerably higher upland cotton payments under the 2002 FSRI Act. Because it is not economically sustainable to grow upland cotton on non-upland cotton (-rice or -peanut) base, the ability to update suggests that by MY 2002 nearly all US producers grew on upland cotton base.

24. Moreover, the data above indicates that even with subsidies, the average US producers did not earn any or, at most, a small profit during MY 1999-2002. As Christopher Ward testified, there is a strong need to generate profits to stay in the upland cotton business.[37] These profits pay for investments in new machinery and technologies, as well as for losses incurred in years with low prices. But even with large subsidies, US producers only met their costs. Without subsidies, they were not even able to meet their variable cost in MY 2001.

25. In sum, during most of the period of investigation, US producers of upland cotton needed the high upland cotton payments from the PFC, market loss assistance, direct and counter-cyclical payment programmes to generate sustainable returns (MY 1999), simply break even (MY 2000-

[36] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4). *See* also Brazil's Answer to Question 125 (6).

[37] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 10).

2001), or almost meet their total costs (MY 2002). It is, therefore, reasonable to assume that the great majority of US upland cotton was grown on upland cotton base acres.

**(3) In calculating the amount of PFC, MLA, direct and counter-cyclical payments that went on upland cotton, Brazil made an adjustment for the ratio of current acreage to base acreage (see its answer to question 67, footnotes 2, 3, 4 and 5). Is this an appropriate adjustment for the particular factors referred to above? Why or why not? BRA, US**

Brazil's Answer:

26. Brazil refers the Panel to its answers to Question 125 (8), Question 125(2)(a), and to Question 125(2)(c) for Brazil's arguments why its methodology is reasonable to use in the absence of direct evidence collected and controlled exclusively by the United States concerning the amount of those payments to upland cotton producers.[38] In the absence of such direct evidence, Brazil has set forth[39] extensive circumstantial evidence that US producers of upland cotton received such payments.[40]

**(4) Dr. Glauber has alleged that there are statistical problems in comparing planted acres to programme acres because of abandonment of crops and also because planted acres are only survey estimates, not reported figures (See Exhibit US-24, the first full paragraph in P2). Would it be more appropriate to divide harvested acreage by base acreage? What margin of error is there between the survey estimates and reported figures? BRA, US**

Brazil's Answer:

27. The appropriate figures to use for farmers' decisions on upland cotton acreage are the official USDA figures for acres planted to upland cotton. Dr. Glauber discussed certain programme and statistical issues that may have applied in the early 1990s, but which – with the termination of the deficiency payment programme from MY 1996 on – are no longer relevant.[41]

28. The planted acre figures used by Brazil are the only official USDA data for planted acres of crops. These data are reported by the Farm Service Agency (FSA) in its Fact Sheet on Upland Cotton.[42] Planted acres reflect the choice by farmers to commit land to upland cotton production by cultivating, fertilizing, seeding and applying other inputs during the pre-planting and planting period. In some parts of the United States, variable weather and other conditions mean that some land that has been planted to upland cotton, or to some other crops, is not harvested. But, there is no question that this land was committed at the time of planting to upland cotton production. Further, once the planting takes place, that decision generally precludes further upland cotton production (or other crops) for that marketing year.

29. According to USDA's National Agricultural Statistics Service (NASS), the procedure for measuring and reporting planted acres for upland cotton and other crops starts with a June survey of planted acres for each crop, which is well after planting commitments for upland cotton have been made early in spring. The June planted acre figures are updated in NASS files each month as additional data becomes available. Revisions in the figures on planted acres are determined in December and reported in the Crop Production report each year. These data include revisions based

[38] *See* also Brazil's 9 October Closing Statement, para. 2.

[39] Inferences drawn from this evidence satisfy Brazil's burden of proof in the absence of direct evidence. *See* Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.39.

[40] *See* Brazil's 9 October Closing Statement, Annex I for a summary of the evidence and further references.

[41] Brazil notes that Dr. Glauber's assertions were made in the context of the acreage reduction and set aside requirements under the US deficiency payment programme.

[42] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

on FSA's certified acreage information. As Exhibit Bra-288 makes clear, NASS reported the 2003 revisions using FSA information in the October Crop Production report, rather than waiting until December.[43]

**(5) Do the acreage reports under section 1105(c) of the FSRI Act of 2002 indicate or assist in determining the number or proportion of acres of upland cotton planted on upland cotton base acres? Was there an acreage reporting requirement for upland cotton during MY1996 through 2002? BRA, US**

Brazil's Answer:

30. The short answer to both of the Panel's questions is "yes". Regrettably, the United States has refused to provide Brazil or the Panel with the number or proportion of acres of upland cotton planted on upland cotton base acres for MY 1999-2002, despite Brazil's repeated efforts to obtain this information over the past year and despite the Panel's Question 67bis, in which the United States claimed incorrectly that it did not have access to this information.[44]

31. As implemented, Section 1105(c) of the 2002 FSRI Act requires any recipient of direct and counter-cyclical payments to submit, as a condition of eligibility of receiving the payments, "annual acreage reports with respect to all cropland on the farm".[45] This means that the precise acreage for each crop grown on the farm must be tabulated and identified in an annual report. Depending on the state and the county, these acreage reports are generally due by the middle of each calendar year.[46]

32. In addition to the annual acreage reports, the 2002 FSRI Act required all farms eligible for direct and counter-cyclical payments to file application forms establishing and proving their historic production of the 10 programme crops.[47] The required information includes the types, amount, and yields of all direct and counter-cyclical payment base acreages during the period 1998-2001 or reference to the earlier PFC base acreage. All of these applications were due no later than 1 June each year.[48] USDA reported in July 2003 that 99.6 per cent of eligible farms had completed the required applications and signed up for the direct and counter-cyclical programme.[49] Farms submitting both the annual programme acreage reports and the historic base-acreage application form were required to provide a specific farm identification number. This farm "ID" would appear to permit USDA to determine for each reporting farm the annual *acreage* mix of crops and the amount of direct and counter-cyclical base acreage for each one of those crops.

33. With respect to the period 1996-2001, the regulations under the 1996 FAIR Act required any recipient of PFC payments and marketing loans (or loan deficiency payment) to submit annual acreage reports for each of the commodities planted for harvest on a farm enrolled in such a programme.[50] This reporting requirement was a mandatory condition to receive payment. It would

[43] Exhibit Bra-288 ("NASS To Update Acreage If Necessary," National Agricultural Statistics Service, USDA, 29 September 2003).

[44] *See* US 27 August Comments on Brazil's Rebuttal Submission and Answer to Question 67bis, para. 21 (The United States admitted that it "tracked total expenditures," but denied that it collected or could derive the information requested by the Panel).

[45] Exhibit Bra-29 (Section 1105 of the 2002 FSRI Act) and Exhibit Bra-289 (7 CFR 1412.606) and Exhibit Bra-289 (7 CFR 718.102, 2003 edition).

[46] Exhibit Bra-290 ("Farmers must file acreage to receive 2002 payments," Kansan Online Ag Briefs, second paragraph); Exhibit Bra-290 (AFBIS Inc. Crop Watch, June 2003).

[47] Exhibit Bra-286 (Direct and Counter-cyclical Program Contract, Form CCC-509, USDA, Commodity Credit Corporation)

[48] Exhibit Bra-291 ("Direct and Counter-Cyclical Payment Program," Farm Service Agency, USDA, April 2003).

[49] Annex 2 to Exhibit Bra-105 (National Enrollment Report, USDA, 17 July 2003, last attachment).

[50] Exhibit Bra-292 (7 CFR 718.102, 2002 edition)

appear that the United States has collected precise acreage and payment information on (1) farms with PFC cotton base acreage, and (2) farms that produced upland cotton and received PFC and marketing loan payments. Combined with the specific farm identification number, this information would clearly permit the matching of information on a farm's crop base acreage and current planting and, thus, the collection of the amount and type of PFC (and market loss assistance) payments made to producers of upland cotton between MY 1999-2001.

34. In sum, the United States has exclusive control of the information that would provide the *amount* and *type* of PFC, market loss assistance, direct and counter-cyclical payments made by the US Government to US cotton producers during MY 1999-2002. The United States also has not provided information regarding the amount of updated upland cotton direct and counter-cyclical payment base acreage, the average yields applying to that (updated) base acreage, or the total amount of direct and counter-cyclical payment funds paid to holders of upland base acreage for MY 2002. All of this information is exclusively in the control of the United States and was first requested by Brazil over a year ago.[51] The Panel first requested this information in August 2003.[52] If the United States continues to refuse to provide this information, then Brazil submits that the Panel must either (1) draw adverse inferences that the information retained by the United States reflects greater payments than those estimated by Brazil,[53] or alternatively, (2) rely on Brazil's estimate that the payments equal total upland cotton base acreage payments times the ratio of upland cotton planted acreage to upland cotton base acreage.

**(6) Please prepare a chart showing upland cotton base acreage, planted acreage and harvested acreage for MY1996 through 2002. Does the planted acreage fluctuate within a broad band? If not, does this indicate any stability in decisions to plant the same acres to upland cotton? BRA, US**

Brazil's Answer:

35. Brazil has prepared the requested chart showing the developments of upland cotton base acreage, planted acreage and harvested acreage between MY 1996-2002.[54] The chart below shows that planted acreage does *not* fluctuate within a *broad* band. Instead, planted acreage fluctuates between a low of 13.1 million acres in MY 1998 and a high of 15.5 million acres in MY 2001.[55]

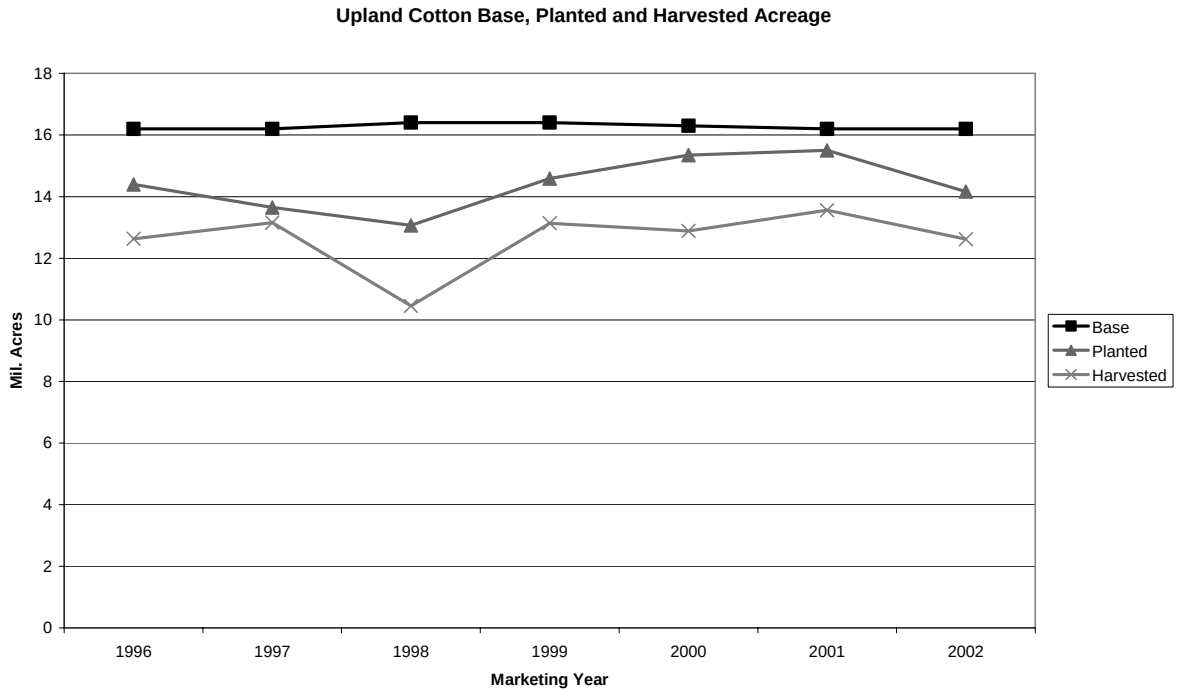
[51] Exhibit Bra-49 (Brazil's Questions for the Purposes of Annex V Procedure, March 2003) and Exhibit Bra-101 (Brazil's Questions for the Purposes of the Consultations, 22 November 2002)

[52] Question 67bis.

[53] The Appellate Body in *Canada – Aircraft* addressed the issue of drawing adverse inferences from a party's refusal to provide information requested by a panel. It stated that "a panel has the legal authority and the discretion to draw inferences from the facts before it." Moreover, it stated that a panel should examine very closely whether the full *ensemble* of the facts on the record reasonably permits the inference urged by one of the parties to be drawn, because a party's refusal to collaborate has the potential to undermine the functioning of the dispute settlement system. Furthermore, the Appellate Body noted that if it had been "deciding the issue that confronted the Panel, we might well have concluded that the facts of record did warrant the inference that the information Canada withheld . . . included information prejudicial to Canada's denial that the EDC had conferred a benefit and granted a prohibited export subsidy." (Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 205).

[54] Brazil again notes that it is not in a position to provide the updated MY 2002 base acreage, but uses the upland cotton PFC base acreage for that year.

[55] Exhibit Bra-293 (Data for Acreage Chart).




36. Indeed, aggregate producers' decisions to plant upland cotton are fairly stable. Despite drastic changes in upland cotton prices, the amount of planted acres only varies within a narrow range, confirming that US producers are largely isolated from upland cotton market price incentives. The data shown in this chart is also consistent with Brazil's argument that most upland cotton was planted on upland cotton base acreage. The amount of acreage planted to upland cotton always remains *below* the amount of upland cotton base acreage – a fact that supports Brazil's assumption that upland cotton producers receive payments related to upland cotton base.[56]

**(7) Brazil states that one third of all US farms with eligible acreage decided to update their base acreage under the direct payments and counter-cyclical payments programmes using their MY1998-2001 acreage. What is the proportion of the current base acreage for upland cotton resulting from such updating? Is the observed updating of base acreage consistent with Brazil's argument that it is only profitable to grow upland cotton on base acreage (and peanut and rice base acreage)? BRA**

Brazil's Answer:

37. Regarding the first question, Brazil does not know the proportion of current base acreage for upland cotton resulting from the 2002 updating of the base acreage. This information is exclusively collected and maintained by the United States. As indicated in answer to Question 125(5), USDA required all eligible farms to file applications by 1 June 2002 establishing and updating their base acreage. Brazil notes that the United States was quickly able to report that *overall* 99.6 per cent of eligible farms enrolled in the programme. This suggests that the United States is in possession of farm-specific information regarding the percentage of (1) the total amount of upland cotton direct and counter-cyclical payment base acreage, and (2) the number of farms growing upland cotton that chose to update their base acreage. Brazil reiterates its request to the United States for this information.[57]

[56] Brazil has discussed the validity of this assumption in its answers to Questions 125 (3) and (8).

[57] Exhibit Bra-49 (Brazil's Questions for the Purposes of Annex V Procedure, March 2003) and Exhibit Bra-101 (Brazil's Questions for the Purposes of the Consultations, 22 November 2002)

38. The answer to the second question is yes. As indicated in Brazil's Answer to Question 125(2)(c), upland cotton producers would lose money in MY 2000-2001 (even with the subsidies) if they grew upland cotton on anything other than upland cotton or rice base acreage. The record indicates that PFC per acre payments were $30.84 for upland cotton and $23.48 per acre for corn in MY 2001.[58] There were no PFC or market loss payments for peanut base under the 1996 FAIR Act.[59] Testimony from NCC representatives indicated that a number of producers in the south-eastern part of the United States grew upland cotton on corn base acreage during MY 1999-2001.[60] NCC representatives argued that it would only be "fair" for producers with corn base acreage that had switched into upland cotton production to be able to update their base acreage to receive *upland cotton* direct and counter-cyclical payments.[61] NCC's efforts were successful, as reflected in the fact that under the 2002 FSRI Act, maximum total direct and counter-cyclical per acre payments for upland cotton base acreage is $109.50, while for corn it is $54.10 per acre. This large increase in per acre payment for cotton relative to corn in the 2002 FSRI Act reflects the much higher cost of producing upland cotton – and the expectation that historic cotton producers receiving such high payments will continue to grow high-cost upland cotton.

39. Given the much higher per acre payments in MY 2002 for upland cotton base acreage, any producer who could gain more upland cotton base acreage would certainly take advantage of the chance to update. Thus, any increases in the updated upland cotton base in MY 2002 reflect the economic incentive to obtain significantly greater additional revenue by switching to upland cotton acreage than in staying with historical corn, wheat, oats, barley sorghum and barley acreage. Finally, the higher per acre payments for upland cotton also reflect the squeeze in profits for those cotton producers that grew upland cotton in MY 1999-2001 on corn base acreage, as testified to by NCC representatives, discussed above.

**(8) How could one take account of upland cotton producers who receive PFC, MLA, direct and counter-cyclical payments for other covered commodity base acreage? BRA, US**

Brazil's Answer:

40. The best information to use would be the actual data collected by the United States concerning the amount of PFC, MLA, DP, and CCP payments to US upland cotton producers. In the absence of this information, Brazil's methodology assumes that US producers of upland cotton grew upland cotton on upland cotton base acreage. This is a reasonable proxy, because there will be some upland cotton that is grown on rice (and peanut) base receiving higher payments, and some upland cotton that is grown on, *e.g.*, corn base receiving somewhat lower payments. On average, Brazil's approach would roughly cancel out the *over*-counting of rice and peanut payments and the *under*-counting of corn and any other lower-paying programme crop payments.

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[58] Brazil's 9 October Closing Statement, Annex 1, para. 31, *citing* Brazil's 22 August Rebuttal Submission, paras 32-34.

[59] Brazil's 24 June First Submission, para. 45; Brazil's 22 August Rebuttal Submission, para. 24

[60] *See* NCC testimony quoted in Brazil's 24 June 2003 First Submission, para. 53 *citing* Exhibit Bra-41 (Congressional Hearing, "The Future of Federal Farm Commodity Programs (Cotton)," House of Representatives, 15 February 2001, p.32).

[61] "[W]hat has happened is, under Freedom to Farm . . . in the Southeast we moved from corn, like I have done, to cotton. *So the last few years we have increased our cotton acreage in Georgia, for instance, to about a million and a half acres; we are getting [PFC] payments on about 900,000 acres*. [W]e have a tremendous production in the Southeast that is not getting a [Market Loss] payment or a regular [PFC] payment. So we are recommending . . . to this committee that a farmer have a choice with remaining with his existing acreage and yield, *or he has an option to move to a modified acreage and yield on his farm or acreage on his farm, and this would make this, we think, fair*. . . And this happened . . . outside the Southeast, but it is been more pronounced in the Southeast than any other section of the Country." (emphasis added) Exhibit Bra-41 ("The Future of Federal Farm Commodity Programs (Cotton)," Hearing before the House of Representatives Committee on Agriculture, 15 February 2001, p. 32). Brazil's 24 June First Submission, para. 53.

F. PROHIBITED SUBSIDIES

**128. Could the US respond to Brazil's assertions relating to the meaning and effect of the introductory phrase of Article 3 ("Except as provided in the *Agreement on Agriculture*....")? Would the meaning/effect change if Article 13 of the *Agreement on Agriculture* did not exist? BRA, US**

Brazil's Answer:

41. In commenting on the first question directed to the United States, Brazil notes that the United States argues that the phrase "except as provided in the Agreement on Agriculture" necessarily means that negotiators intended to carve out both domestic local content and export subsidies for agricultural products from the disciplines of Article 3 of SCM Agreement.[62] But the United States' argument twists the meaning of the phrase "*except* as provided". The word "except" does not imply that there *must* be something in the Agreement on Agriculture that carves out the disciplines on local content subsidies in the SCM Agreement. The phrase only means that *if* the Agreement on Agriculture clearly and unambiguously (i) exempts such agricultural subsidies from the SCM Agreement, or (ii) changes the obligations contained in the SCM Agreement, then the provisions of the Agreement on Agriculture that conflict with those of the SCM Agreement will prevail. The Appellate Body's jurisprudence teaches that it is only where the text clearly and unambiguously provides for modified obligations does the "except as provided" language become operational.[63]

42. In essence, what the United States seeks from the Panel is an interpretation that the prohibition on local content subsidies does not apply to agricultural goods. Yet, nothing in the Agreement on Agriculture or the SCM Agreement provides the carve-out the United States now seeks.

43. Brazil agrees that the Agreement on Agriculture constitutes *lex specialis* as opposed to the *lex generalis* of the SCM Agreement. The Agreement on Agriculture applies to a subset of goods covered by the SCM Agreement and, in case of conflicting provisions, the rights and obligations contained therein should prevail over those of the SCM Agreement. Brazil agrees that the introductory phrase of Article 3 of the SCM Agreement makes explicit the *lex specialis* nature of the Agreement on Agriculture.

44. However, the US argument goes further than the principle of *lex specialis derogat generalis* as it is normally applied. The United States wants the Panel to apply this principle in a way that effectively derogates explicit and specific provisions of the SCM Agreement whenever the Agreement on Agriculture is silent about such provisions. This is an absurd application of the *lex specialis* principle. The *lex specialis* is to be read together with the *lex generalis*. In fact, every effort must be made to read the two provisions in a harmonious manner. The derogation of the *lex generalis* is called for only in situations when an irreconcilable conflict between the two texts arises. It is a fundamental tenet of law that absolute contradictions between laws cannot be presumed; they must be established by a systematic analysis of the texts involved to identify any unequivocal incompatibility. Such conflict or incompatibility does not exist with regard to Article 3.1(b) of the SCM Agreement. The Agreement on Agriculture specifies no right or obligation that would, *by necessity*, derogate the obligation contained in Article 3.1(b) of the SCM Agreement. The Appellate Body and panels have

[62] US 30 September Further Submission, para. 171.

[63] Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128; Appellate Body Report, *EC – Bananas*, WT/DS27/AB/R, paras. 157-158; Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, paras. 201, 208.

rightly cautioned against interpretations that would exempt disciplines from entire sections of WTO agreements in the absence of a clear and unambiguous carve-out of rights and obligations.[64]

45. Furthermore, the United States' interpretation, which would (permanently) carve out all agricultural products from the prohibition of Article 3.1(b), is contrary to the object and purpose of Article 3 of the SCM Agreement. Negotiators expressed their intent that local content subsidies are a special class of trade-distorting subsidies. Because of their particularly trade-distortive nature, negotiators dispensed with the requirement of showing any adverse effects and made them prohibited subsidies. Given the special prohibited nature of such subsidies – coupled with the ability of negotiators to carve such subsidies out explicitly from the operation of the SCM Agreement – it would be expected that any exception from the disciplines would be clear and unambiguous.

46. The answer to the second question is "no". As Brazil's earlier submissions have articulated, Article 13(b) is not the only basis for Brazil's argument that the Agreement on Agriculture does not carve out agricultural local content subsidies from the Article 3.1(b) prohibition of local content subsidies.[65] As Brazil has argued, there is no inherent conflict between requiring the notification and scheduling of payments to processors of agricultural goods benefiting domestic producers under Annex 3, paragraph 7 of the Agreement on Agriculture and the prohibition on payments to processors of agricultural goods that are contingent upon the use of domestic over imported goods.[66] Nevertheless, the absence of any reference to Article 3 of the SCM Agreement in Article 13(b) of the Agreement on Agriculture (while a similar reference exists for export subsidies) is consistent with Brazil's other arguments that local content subsidies for agricultural goods are prohibited subsidies.

47. The US interpretation eliminating any prohibitions on agricultural local content subsidies creates a sharp distinction in the way that the other group of normally prohibited subsidies – subsidies contingent upon export – are treated under the Agreement on Agriculture. The Agreement on Agriculture provides many instances in which export subsidies for an individual agricultural product may be challenged as prohibited subsidies under the Agreement on Agriculture. These include prohibitions on export subsidies for unscheduled products, prohibitions on subsidies given to products where support is beyond the scheduled reduction commitments, and prohibitions on subsidies that lead to circumvention of export subsidy reduction commitments. By contrast, under the US interpretation of local content subsidies, there will never be an instance in which local content subsidies for an individual agricultural product would ever be prohibited.

48. It would be expected that such radically different treatment of local content subsidies would be spelled out clearly in the Agreement on Agriculture. Yet, the only link the United States can find to justify its total exclusion of local content prohibited subsidies is the provision in Annex 3, paragraph 7 to include local content subsidies – along with the multitude of other types of domestic subsidies that are *not* prohibited subsidies – in the support to be counted for total AMS. All that Annex 3, paragraph 7 stipulates is that AMS calculations shall include measures that "benefit the producers of the basic agricultural products". Such language contains nothing that conflicts with the obligation established in Article 3.1(b) of the SCM Agreement. Brazil notes that measures that "benefit the producers of the basic agricultural products" may or may not be "contingent upon the use of domestic over imported good". In both situations these subsidies must be included in AMS calculations. However, when challenged under the DSU, those subsidies that require local content

[64] Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128; Appellate Body Report, *EC – Bananas*, WT/DS27/AB/R, paras. 157-158; Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, paras. 201, 208; Panel Report, *India – Quantitative Restrictions*, WT/DS90/R, para. 5.103.

[65] Brazil's 22 July Oral Statement, paras. 84-86; Brazil's 11 August Answers to Questions, paras. 215-217; Brazil's 22 August Rebuttal Submission, paras. 131-144.

[66] Brazil's 22 August Rebuttal Submission, paras. 137-140 (setting out examples where no such conflict would exist).

will be found to violate Article 3.1(b) of the SCM Agreement, and the subsidizing Member will be urged to withdraw such measures.

G. SPECIFICITY/CROP INSURANCE

**129. In the event that the Panel does not consider that the alleged prohibited subsidies fall within the provisions of Article 3 and are therefore, pursuant to Article 2.3, "deemed to be specific", are there any other grounds on which Brazil would rely in order to support the view that such measures are "specific" within the meaning of Article 2 of the *SCM Agreement* (see, for example, fn 16 of Brazil's further submission)? BRA**

Brazil's Answer:

49. Brazil brought prohibited subsidy claims against the Step 2 export and domestic payments, as well as against the CCC export credit guarantee programmes GSM 102, GSM 103 and SCGP. Concerning the latter, only GSM 102 is relevant for Brazil's serious prejudice claims and, thus, the questions of specificity within the meaning of Article 2 of the SCM Agreement only needs to be addressed for that subsidy.

50. Step 2 export and domestic payments are *de jure* specific subsidies because they are only available for exporters and domestic users of upland cotton.[67] Exporters or domestic users of extra-long staple cotton, any other crop or any other product are not eligible to receive Step 2 payments. Consequently, the United States has notified Step 2 payments as cotton-specific non-green box domestic support.[68] Thus, Step 2 payments are specific within the meaning of Article 2.1 of the SCM Agreement in much the same way as marketing loan payments or cottonseed payments.

51. Brazil notes that the Panel's question raises a hypothetical situation that is highly unlikely given the clear export contingency of the GSM 102 export credit guarantee programme. Unlike the crop insurance programme, GSM 102 export credit guarantees are available for exports of most US agricultural commodities.[69] However, GSM 102 support is provided only to enterprises exporting agricultural products and, thus, for the reasons set forth in Brazil's answer to Question 131(a), these subsidies are both *de jure* and *de facto* specific. [70]

**130. Does Brazil agree that the US insurance premium subsidy is available in respect of all agricultural products? Please cite relevant portions of the record. BRA**

Brazil's Answer:

52. Brazil does not agree that the US crop insurance premium subsidy is available in respect of all agricultural products. At the outset, Brazil would like to clarify that the US crop insurance programme encompasses two different types of subsidies. First, the US Federal Crop Insurance Corporation pays *farmers* a portion of the premiums that they have to pay for obtaining crop insurance.[71] Second, the Federal Crop Insurance Corporation covers losses under crop insurance

[67] Exhibit Bra-29 (Section 1207(a) of the 2002 FSRI Act) and Exhibit Bra-28 (Section 136(a) of the 1996 FAIR Act).

[68] *See e.g.* Exhibit Bra-47 (G/AG/N/USA/43, p. 20). Brazil disagrees with the classification of Step 2 export payments as "domestic support." Brazil also considers Step 2 domestic payments to be prohibited local content subsidies within the meaning of Article 3.1(b) of the SCM Agreement and Article III:4 of GATT 1994.

[69] *See* Brazil's Comment to Question 142.

[70] *See* Brazil's Answer to Question 131.

[71] Exhibit Bra-30 (Section 508(e) and Section 508(h)(5)(A) of the Federal Crop Insurance Act). Exhibit Bra-59 ("Briefing Room: Farm and Commodity Policy: Crop Yield and Revenue Insurance").

policies that exceed the amount of premiums collected, thus providing free *reinsurance for private insurance companies* offering crop insurance.[72]

53. Brazil has demonstrated that crop insurance policies that are eligible for subsidy payments – both premium and reinsurance subsidies – are not available in respect of all agricultural products. The United States claims that crop insurance subsidies are and will in the future be available to livestock and dairy producers.[73] This assertion is incorrect. First, it is entirely irrelevant if crop insurance will be available to livestock and dairy producers in the future. The question that faces the Panel is whether the US crop insurance subsidies in MY 1999-2002 are specific, not whether they may at some point in the future become less specific. Brazil demonstrated that except for a very narrow pilot programme that began in MY 2002, there were no livestock "crop" insurance policies during MY 1999-2002.

54. Second, Brazil has demonstrated that crop insurance is currently – in MY 2003 – only available to livestock producers in a limited number of US states and counties.[74] The Adjusted Gross Revenue policy cited by the United States[75] covers only "incidental amounts of income from animals and animal products and aquaculture reared in a controlled environment," which must not exceed "35 per cent of expected allowable income".[76] In addition, this policy is only available for producers in a limited number of counties in 18 US states.[77] Even making the entirely unrealistic assumption that *all* US livestock in those pilot counties would be eligible for adjusted gross revenue coverage, that production[78] would only represent 7.58 per cent of the value of total US livestock production.[79] In addition, Brazil has demonstrated that the total value of US livestock and dairy production represents 52 per cent of the value of total US agriculture.[80] Thus, even taking into account the pilot counties for the adjusted gross revenue coverage, at least 48 per cent of the value of US agriculture is excluded from crop insurance subsidy benefits.

55. Third, the 2000 ARP Act itself explicitly limits its application to, *inter alia*, US crops, and does not cover insurance for the production of dairy, beef, poultry, pork and other livestock.[81]

56. In sum, the US crop insurance subsidies are not available to all US agricultural production.

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[72] Exhibit Bra-30 (Section 508(k) of the Federal Crop Insurance Act). For the reinsurance agreement standards *see* Exhibit Bra-39 (7 CFR 400.161 et seq.).

[73] US 30 September Further Submission, para. 15.

[74] Brazil's 7 October Oral Statement, para. 7.

[75] Brazil notes that this policy is the only one that is cited by the United States in support of its allegation that crop insurance would be available to all US agricultural products. Brazil is not aware of any other policy that would enable and in particular enabled US dairy or livestock producers during MY 1999-2002 to benefit from crop insurance subsidies.

[76] Exhibit Bra-272 ("Fact Sheet: Adjusted Gross Revenue," Risk Management Agency, USDA, February 2003, p. 1).

[77] Exhibit Bra-272 ("Fact Sheet: Adjusted Gross Revenue," Risk Management Agency, USDA, February 2003, p. 1,3).

[78] The record shows that most farms are small, and that many small farms specialize in beef production. *See* Bra-285 ("Agriculture Fact Book 2001-2002, Chapter 3 – American Farms, Figures 3.1 and 3.8). Therefore, these farms could not be eligible under the pilot programme because more than 35 per cent of their revenue is generated from the production of livestock. This suggests that even the figure of 7.58 per cent of total US livestock production is a significant overestimate.

[79] Exhibit Bra-271 (Analysis of the Market Value of Livestock in Adjusted Gross Revenue Insurance Pilot States and Counties).

[80] Brazil's 22 August Rebuttal Submission, para. 59 and Exhibit Bra-177 ("ERS Briefing Room: Farm Income and Costs: Farm Income Forecasts").

[81] Exhibit Bra-30 (Section 518 of the Federal Crop Insurance Act) contains a list of the "agricultural commodities" covered by insurance policies that are subsidized under the Federal Crop Insurance Act.

**131. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*: BRA, US**

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

**(c) is a subsidy in respect of certain identified agricultural products specific?**

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

Brazil's Answer:

57. The short answer to Questions 131(a) – (f) is "yes."

58. Brazil's Further Submission sets forth a detailed analysis of the legal requirements for *de facto* and *de jure* specificity (paras. 34-40), demonstrating the broad agreement between the official US interpretation of Article 2 of the SCM Agreement in the Statement of Administrative Action ("SAA") and the position of Brazil. Brazil also provided a detailed application of those requirements for each of the relevant subsidies (paras. 41-70). Brazil offers the following additional comments below:

59. With respect to Question 131(a), a US subsidy that is made available to all enterprises in the industry producing agricultural commodities is specific. As Brazil and the United States agree, the purpose of the specificity requirements is to "function as an initial screening mechanism to winnow out only those foreign *subsidies which truly are broadly available and widely used throughout an economy*".[82] The United States' SAA notes that "all governments, including the United States, intervene in their economies to one extent or another, and to regard all such interventions as countervailable would produce absurd results". Among such "absurd results" would be countervailing "public highways and bridges, as well as a tax credit for expenditures on capital investment even if available to all industries and sectors".[83] After providing these examples, the SAA states that "the specificity test was not intended to function as a loophole through which narrowly focused subsidies provided to or used by discrete segments of an economy could escape the purview of the CVD law".[84]

60. The US subsidies at issue in this case – including crop insurance – are *de jure* limited under Article 2.1(a) because they "explicitly limit access to a subsidy to certain enterprises", *i.e.*, those producing, using, or exporting either crops, certain crops, or one crop.[85] The US subsidies are also *de facto* specific under Article 2.1(c) because they are used by a limited number of enterprises in relation to all enterprises and industries making up the US economy. Only the group of enterprises

[82] Exhibit Bra-148 ("Statement of Administrative Action," p. 929).
[83] Exhibit Bra-148 ("Statement of Administrative Action," p. 929-30).
[84] Exhibit Bra-148 ("Statement of Administrative Action," p. 930).
[85] Brazil's 9 September Further Submission, paras. 34-70.

producing agricultural crops is entitled to receive or actually use these subsidies. All other enterprises and all other industries are excluded from the right to receive and, in fact, do not use such subsidies.

61. The broad diversification of the US economy is a relevant fact for the Panel to consider for *de facto* specificity under Article 2.1(c) ("account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority".). The US SAA indicates that the US Department of Commerce should take "account of the number of industries in the economy in question" in "determining whether the number of industries using a subsidy is small or large".[86] The US industry growing and producing agricultural products, or even the sub-industry of US producers who grow crops, are in the words of the US SAA, "a discrete segment" of the US economy. The value of all US agricultural production of all commodities is only 0.8 per cent of total US GDP.[87] Article 2.1(c) requires a Panel to undertake a "case by case" approach to diversification, and Brazil believes the approach presented here and endorsed by the US SAA is an appropriate application of the provision. In the case of the United States, there is a multitude of US industries that do not use the US subsidies at issue in this case. By contrast, in the case of Benin, the agricultural industry represents 38 per cent of its GDP.[88] For a country like Benin, subsidies to the entire agriculture sector would most likely not be considered to be specific because they are widely available to a large portion of the producers within the economy. No such facts exist for the cotton subsidies at issue in this dispute.

62. Brazil sees no basis in the text of Article 2 of the SCM Agreement for a different specificity test to be applied to subsidies for the purpose of Part V (countervailing measures) and Part III (actionable subsidies) of the SCM Agreement. Nor does Brazil see any basis to apply a different test of specificity for agricultural and other types of goods and industries – no such distinction exists in Article 2 of the SCM Agreement. For example, would a subsidy provided only to the US automotive parts industry (which includes thousands of enterprises) be specific while a subsidy provided to thousands of enterprises producing agricultural crops *not* be specific? There cannot be much doubt that the US automotive parts industry is a discrete segment of the US economy, and a discrete "industry". Brazil (and the US SAA) is of the view that in both these instances, the subsidy would be specific. All of the US subsidies challenged by Brazil are narrowly focused on, at most, a *portion* of the industry producing agricultural products.

63. With respect to Question 131(b), a subsidy that is provided to enterprises producing all agricultural *crops* is specific. Because the applicable industry is the one producing all agricultural commodities, a subsidy to only enterprises producing crops but not to enterprises producing *other* agricultural commodities is specific. Brazil notes the entirely different approach the United States now asserts in this case, regarding crop insurance, and the official interpretation offered in the SAA.[89] While the Panel, of course, is not bound by the unilateral interpretation of the United States in the SAA, Brazil believes that the SAA, in this instance, correctly described the intent of the drafters regarding specificity. The producers of US crops are discrete enterprises within a US industry. None of these subsidies is provided to enterprises producing other types of agricultural products that make up approximately 50 per cent of the value of the US agricultural commodities.[90] In the case of crop insurance, it is useful to recall that many of the small US farming enterprises – representing 92 per cent of US farms – produce livestock, including beef.[91]

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[86] Exhibit Bra-148 ("Statement of Administrative Action," p. 931).

[87] Exhibit Bra-269 ("Gross Domestic Product by Industry for MY 1999-2001," Robert J. McCahill and Brian C. Moyer, November 2002, p. 36).

[88] Exhibit Bra-294 ("The World Fact Book – Benin," CIA, p.6)

[89] The "SAA thus contains the view of the Administration, submitted by the President to Congress and receiving its imprimatur, concerning both interpretation and application and containing commitments, to be followed by future Administration, on which domestic as well as international actors can rely." Panel Report, *US – Section 301*, WT/DS152/R, para. 7.111.

[90] *See* Brazil's Answer to Question 130.

[91] Exhibit Bra-285 (Agriculture Fact Book 2001-2002, Chapter 3 – American Farms, Figures 3.1 and 3.8).

64. In deciding the question, the Panel should also take into account the significant implications of accepting the US arguments that any subsidy provided to all agricultural producers of all agricultural commodities would be non-specific. This interpretation would create a new class of trade-distorting agricultural subsidies that are non-actionable. The United States has always notified its crop insurance subsidies as amber box subsidies, *i.e.*, presumptively trade distorting. And USDA economists have found that even lower subsidies provided by the pre-2000 ARP Act increased US upland cotton acreage by 1.2 per cent and US upland cotton exports by 2 per cent.[92] Professor Sumner found that the higher subsidies provided by the 2002 ARP Act increased US upland cotton acreage by 3.3 per cent, US exports by 3.8 per cent, and decreased world A-Index prices by 1.3 per cent on average for each year between MY 2000-2002.[93]

65. The US specificity interpretation would permit, for example, a Member to provide a revenue guarantee to every enterprise producing any agricultural commodity to pay for the total cost of production plus a reasonable profit margin of 10 per cent. The US interpretation would permit Members to make direct payments to every farming enterprise that are tied to a constructed average price index for all agricultural products (not individual prices such as the CCP) and a farmer's current total production. A Member could also provide free inputs for the production of all agricultural commodities to every enterprise producing any agricultural product without that subsidy being actionable under Articles 5 and 6 of the SCM Agreement. In short, if the criteria is, as the United States argues, that the subsidy only need be provided to all farming enterprises, then *any* type of trade distorting non-green box domestic subsidy meeting that universal application criteria would escape discipline under the SCM Agreement.

66. The USinterpretation would create a gaping hole in the disciplines of the Agreement on Agriculture and the SCM Agreement. Such an interpretation is clearly inconsistent with the object and purpose of the Agreement on Agriculture, which is to "correct[] and prevent[] restrictions and distortions in world agricultural markets". It is inconsistent with the SCM Agreement's object and purpose of disciplining trade-distorting actionable subsidies. And it is completely inconsistent with the interpretation including in the United States' SAA.

67. With respect to Questions 131(c) and (d), for the reasons set forth above and in Brazil's earlier submissions, a subsidy that is mandated to be provided to only certain enterprises in respect of a handful of identified agricultural products (such as the 10 "programme" crops of the direct and counter-cyclical payment programme) but not provided to most other enterprises within the agricultural industry producing crops or agricultural commodities, is specific under Article 2.1(a) of the SCM Agreement. Similarly, there is *de facto* specificity because these same subsidies covered by the Panel's questions (c) and (d) are only used by certain enterprises of the overall industry producing agricultural commodities (which is the case for all the US subsidies except crop insurance and GSM 102).[94]

68. Regarding Question 131(e), if a subsidy is paid only to enterprises that produce or manufacture products representing a certain *portion* of the value of the products of a single industry (such as the US industry producing agricultural commodities), then the subsidy would be specific. Evaluating specificity based on the "value" of products produced by a single industry is a useful tool for measuring the extent to which the subsidy is provided to discrete enterprises within an industry, or within an economy. When many enterprises in the most highly revenue generating segments of an industry do not receive a subsidy – such as the absence of crop insurance for livestock including beef, poultry and pork, among others – then the subsidy is specific because it is only used by a certain number of enterprises within the industry.

[92] Brazil's 22 August Rebuttal Submission, paras. 63-64.
[93] Brazil's 9 September Further Submission, Annex I, Table 1.5d.
[94] Brazil's 9 September Further Submission, paras. 41-61.

69. Finally, with respect to Question 131(f), another tool for evaluating the specificity of a subsidy is the amount of total US farmland that receives the subsidy. The use of "farmland" is a rough proxy for the number of enterprises producing agricultural products within the meaning of Article 2.1. For example, only 38 per cent of US farmland is used for the growing of crops (including hay) that are eligible for the payment of crop insurance.[95] By contrast, 62 per cent of US farmland is used for the production of livestock that, with only a few exceptions, is not covered by US crop insurance. When used in conjunction with the "value" data discussed in Question 131(e) above, this acreage data confirms the fact that a number of enterprises within the industry producing agricultural commodities do *not* receive the crop insurance subsidy. Brazil notes that the United States has not contested the use of similar acreage data to demonstrate the specificity of other US subsidies.[96]

H. EXPORT CREDIT GUARANTEES

**137. Please elaborate the meaning of "net losses" as is used in paragraph 70 of Brazil's 7 October oral statement. BRA**

Brazil's Answer:

70. The term "net losses" was, in the context of an oral statement, merely a shorthand reference to the elements of item (j) – the provision of the CCC guarantee programmes at "premium rates which are inadequate to cover the long-term operating costs and losses of the programmes".

71. To prove that the CCC guarantee programmes suffered "net losses" (or in other words meet the elements of item (j)), Brazil referred, in paragraph 70, to the comparison of cohort-specific subsidy figures from the "guaranteed loan subsidy" line of the US budget with cohort-specific reestimates from Table 8 of the Federal Credit Supplement[97], summed over the period 1992-2002 to determine the performance of the CCC programmes over the long term.

72. Whether starting with the cohort-specific subsidy figure from the budget year column of the US budget or with the cohort-specific subsidy figure from the prior year column of the US budget, the result of this exercise is a positive subsidy number.[98] The CCC arrives at the very same result in its 2002 financial statements. Specifically, the 2002 financial statements provide a cumulative subsidy figure for *all* post-1991 CCC guarantees, taking account of all adjustments for defaults, fees and reestimates undertaken for all cohorts in all years through 2002. This exercise results in a cumulative

[95] Exhibit Bra-143 (Agricultural Statistics 2003, National Agricultural Statistics Service, USDA. Table IX-6; *See also* Summary of Business Application, Risk Management Agency. USDA. Accessed 21/10/03, http://www3.rma.usda.gov/apps/sob/ Based on the 1997 census (the most recent year), the total land in farms is 968,338,000 acres; the total cropland used for crops was 348,701,000 acres; idle cropland and grassland pasture was 580,165,000 acres; the number of acres insured on rangeland, forage seed, forage production, alfalfa seed (*i.e.*, crops that could be grown on grassland pasture) was 12,575,000 acres. If cropland not used for crops was included, then the total amount of acreage not producing insured commodities would be 58.61 per cent and the total amount of acreage used to produce insured (or potentially insured) commodities under the 2002 ARP Act would be 41.39 per cent. Brazil notes that this does not include any reference to the recent pilot programs discussed elsewhere. However, the percentages would not change to any great extent if such acreage were included, given the 35 per cent limit on livestock imposed by the crop insurance program.

[96] *See* Brazil's 9 September Further Submission, paras. 43-61 (discussion of specificity regarding PFC, MLA, DP, and CCP subsidies).

[97] Table 8 of the 2004 Federal Credit Supplement is included at Exhibit Bra-182.

[98] Brazil has offered calculations using the cohort-specific subsidy estimate from the budget year column of the US budget (para. 115 of Brazil's 22 August Rebuttal Submission), and using the cohort-specific subsidy estimate from the prior year column of the US budget (Exhibit Bra-193).

positive subsidy figure of $411 million for the period 1992-2002.[99] The Panel will recall that under the Federal Credit Reform Act, when "payments from" the government exceed "payments to" the government on a net present value basis, a positive subsidy results, meaning that CCC is "los[ing] money".[100]

73. Brazil has explained that the FCRA cost formula is one way to determine the performance of the CCC export credit guarantee programmes relative to the elements of item (j). Application of the formula demonstrates that over the period 1992-2002, CCC guarantees under the GSM 102, GSM 103 and SCGP programmes were provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes."

74. The United States objects to the appropriateness of the FCRA formula as a proxy for the analysis required by item (j).[101] The United States' objection is based on the fact that re-estimates are still being undertaken for all CCC guarantee cohorts during the period 1992-2002. Brazil has therefore also offered a number of other methods to confirm that operating costs and losses for the CCC guarantee programmes outpace premiums collected during the period 1992-2002[102], or in other words, that the CCC guarantee programmes suffered "net losses" over that long-term period.

**138. Please comment on Brazil's views stated in paragraph 70 of its 7 October oral statement. US**

Brazil's Comment:

75. Brazil notes an inadvertent error in paragraph 70 of its 7 October Oral Statement. Exhibit Bra-193 does indeed compare cohort-specific reestimates to cohort-specific subsidy figures from the prior year column of the US budget. However, the comparison of cohort-specific reestimates to cohort-specific subsidy figures from the budget year column of the US budget is reflected in the table at paragraph 115 of Brazil's 22 August Rebuttal Submission, rather than in Exhibit Bra-192.

76. In Exhibit Bra-192, Brazil subtracted downward reestimates from and added upward reestimates to the original subsidy figure included in the budget year column of the "guaranteed loan subsidy" line of the annual US budget.

**139. In the context of export credit guarantees, is the Panel correct in understanding that Brazil's claims of inconsistency with the *Agriculture Agreement* involve GSM 102, GSM 103 and SCGP, but that it limits its "serious prejudice" allegations in respect of export credit guarantee programmes to the GSM 102 programme, and does not challenge GSM 103 and SCGP in this respect? If so,**

**(a) could Brazil please explain why it did so, and confirm that all the data relied upon in its further submissions (e.g. in Table 13) relate to the GSM 102 programme rather than to GSM 102, GSM 103 and SCGP (and, if the data needs to be adjusted to take account of a narrower "serious prejudice" focus, supply GSM-102-relevant data)? BRA**

[99] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, "Commodity Credit Corporation's Financial Statements for Fiscal Year 2002", Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

[100] Exhibit Bra-121 (US General Accounting Office, Report to Congressional Committees, "Credit Reform: US Needs Better Method for Estimating Cost of Foreign Loans and Guarantees," GAO/NSIAD/GGD-95-31, December 1994, p. 20)). For the FCRA formula, *see* Exhibit Bra-117 (2 U.S.C. § 661a(5)(c)).

[101] US 22 August Rebuttal Submission, para. 162.

[102] Brazil's 11 August Answers to Panel Questions, paras. 163-168; Brazil's 22 August Rebuttal Submission, para. 109.

77. The Panel is correct in understanding that Brazil's serious prejudice claims involve only GSM 102. All tables and figures that make reference to export credit guarantees in the context of Brazil's serious prejudice claims represent data on GSM 102 only. The reason that Brazil's serious prejudice claims do not cover GSM 103 and SCGP is that either no cotton allocations were made under the programme (GSM 103 for most of the marketing years covered by the period of investigation) or that only negligible amounts of cotton were exported under the programme (SCGP and – if exports took place – GSM 103).[103] Almost all US upland cotton exports that benefited from a CCC export credit guarantee were covered by the GSM 102 programme. Thus, the only CCC export credit guarantee programme that significantly contributed to the upland cotton-related serious prejudice suffered by Brazil was the GSM 102 programme. Consequently, Brazil has excluded GSM 103 and SCGP from its serious prejudice claims.

78. However, Brazil has included GSM 102, GSM 103 and SCGP in its export subsidy claims under the Agreement on Agriculture and the SCM Agreement. All three CCC export credit guarantee programmes constitute export subsidies within the meaning of Articles 10.1, 8 and 1(e) of the Agreement on Agriculture and Articles 1 and 3.1(a) of the SCM Agreement, and fulfil the criteria of item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement.

**(b) for the purposes of Article 13(c)(ii) of the *Agreement on Agriculture*, is it necessary for the Panel to examine only GSM 102 or should the Panel's examination include also GSM 103 and SCGP? Why or why not? BRA**

79. The Panel needs to examine all three programmes under Article 13(c)(ii) of the Agreement on Agriculture. This provision exempts export subsidies from actions based on Article XVI of GATT 1994 and Articles 3, 5 and 6 of the SCM Agreement. Brazil has brought claims under Article XVI of GATT and Articles 5 and 6 of the SCM Agreement against CCC's GSM 102 export credit guarantee programme. Thus, to properly address these claims, the Panel needs to determine whether the GSM 102 programme fully conforms to the provisions of Part V of the Agreement on Agriculture, within the meaning of Article 13(c)(ii) of that Agreement.

80. In addition, Brazil has brought claims under Article 3.1(a) of the SCM Agreement against CCC's GSM 102, GSM 103 and SCGP export credit guarantee programmes. To properly address these claims, the Panel needs to determine whether the GSM 102, GSM 103 and SCGP programmes fully conform to the provisions of Part V of the Agreement on Agriculture, within the meaning of Article 13(c)(ii) of that agreement.

81. To demonstrate that CCC's GSM 102, GSM 103 and SCGP programmes do not fully conform to the provisions of Part V of the Agreement on Agriculture, Brazil has established that GSM 102, GSM 103 and SCGP constitute export subsidies and violate Articles 10.1 and 8 of the Agreement on Agriculture by circumventing or threatening to circumvent US export subsidy reduction commitments. The programmes, thus, do not conform fully to the provisions of Part V of the Agreement on Agriculture.

**140. Could Brazil explain how, if at all, it has treated export credit guarantees for the purpose of Table 1 of its further submission? BRA**

82. Brazil has not included GSM 102 for the purpose of Table 1 of its Further Submission. While Brazil has demonstrated that GSM 102 export credit guarantees constitute export subsidies within the meaning of the Agreement on Agriculture and the SCM Agreement[104], Brazil is not in a position to quantify the benefit to the recipients that has arisen from the application of the GSM 102 export credit

[103] Exhibit Bra-73 (Summary of Export Credit Guarantee Programs FY 1999-2003).
[104] Brazil's 22 August Rebuttal Submission, para. 102-110

guarantee programme to exports of US upland cotton between MY 1999-2002. Brazil has no data – nor has the United States provided any – that would enable it to calculate the benefit involved in the GSM 102 transactions.[105]

83. However, the National Cotton Council, which represents the industry benefiting from the GSM 102 programme, has provided what appears to be a reasonable estimate of the benefits to US upland cotton producers, users and exporters. These benefits are significant enough to generate an additional 500,000 bales of US upland cotton exports per year and to raise domestic US prices by 3 cents per pound.[106]

84. Having proven the export subsidy character of the GSM 102 programme, as well as having proven the production and export-enhancing as well as A-Index-suppressing effects of the programme[107], Brazil has met its burden of proof under Articles 5 and 6.3 of the SCM Agreement and GATT Article XVI to establish that the GSM 102 programme causes serious prejudice to the interests of Brazil.

**141. The Panel notes the US argument, *inter alia* in its further submission, that the export credit guarantee programmes are "self-sustaining". Recalling that item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* refers to "premium rates", could the US expand upon how it takes into account the premium rates for the export credit guarantee programmes in its analysis. US**

Brazil's Comment:

85. As Brazil has argued elsewhere, the United States cannot make a showing that the CCC guarantee programmes do not constitute export subsidies by appealing to an *a contrario* interpretation of item (j), since item (j) does not admit of an *a contrario* defense.[108]

86. Even if item (j) does admit of an *a contrario* defense, proving that the CCC programmes are "self-sustaining" is not enough. Were an *a contrario* defense possible, it would require the United States to demonstrate that over a period constituting the long term, "premium rates" are adequate to cover operating costs and losses, which include but are not limited to "claims or defaults". In contrast, the United States has argued that it is sufficient to show that "claims or defaults" do not exceed "revenue from whatever source it may be derived".[109] "Revenue from whatever source it may be derived" gives credit to the United States for revenue that is not recognized as relevant for the purposes of item (j), and "claims or defaults" ignores "operating costs and losses" that are relevant for the purposes of item (j).[110]

87. As a factual matter, Brazil quite evidently does not agree that the premium rates for the CCC programmes meet their long-term operating costs and losses. Brazil has presented voluminous quantitative data demonstrating that long-term operating costs and losses incurred by the CCC programmes outpace premiums collected. Brazil has also provided statements from the USDA Inspector General[111] and the US General Accounting Office[112] establishing that CCC's failure to

[105] However, Brazil has established that GSM 102 guarantees confer benefits *per se*, since there is no comparable commercial instrument available in the marketplace.

[106] *See* also Brazil's Answer to Question 143.

[107] Brazil's 9 September Further Submission, paras. 184-192.

[108] Brazil's 11 August Answers to Panel Questions, paras. 143-149.

[109] US 11 August Answers to Panel Questions, para. 145.

[110] *See* Brazil's 11 August Answers to Panel Questions, para. 162; Brazil's 22 July Oral Statement, paras. 122-123.

[111] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31 ("[T]he fees CCC charges for its GSM-102 and GSM-103

account for country risk or the credit rating of the borrower in setting guarantee fees means that CCC is charging "premium rates" that do not allow it to cover its operating costs and losses over the long-term.

**142. The US has pointed out that there are many limitations on granting export credit guarantees and that there is no requirement to issue any particular guarantee (US further submission, paras 153-156). Can the Commodity Credit Corporation decline to grant an export credit guarantee even in cases where the programme conditions are met? US**

Brazil's Comment:

88. No, the CCC cannot decline to grant an export credit guarantee even in cases where the programme conditions are met. The CCC cannot "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[113] The CCC export credit guarantee programmes therefore threaten to lead to (and in fact have led to) circumvention of the United States' export subsidy reduction commitments, within the meaning of Article 10.1 of the Agreement on Agriculture.

89. Under the Budget Enforcement Act of 1990, the US Office of Management and Budget classifies the CCC export credit guarantee programmes as "mandatory".[114] Mandatory programmes like the CCC export credit guarantee programmes are exempt from the requirement in US law that a programme receive new Congressional budget authority before it undertakes new loan guarantee commitments.[115] As the Congressional Budget Office has noted, support *via* mandatory programmes like the CCC export credit guarantee programmes "must be available to all eligible borrowers", without regard to appropriations limits.[116] The Congressional Research Service has similarly stated that "[e]ligibility for mandatory programmes is written into law, and *any individual or entity that meets the eligibility requirements is entitled to a payment as authorized by the law*".[117]

90. The fact that the CCC can deny guarantees to individuals who do not meet the eligibility criteria does not, of course, affect the conclusion that CCC cannot "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[118] The United States' FSC measure had eligibility criteria, but

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export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs".). Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed for many years and may not be reflecting current costs".).

[112] Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, "Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees," GAO/GGD-95-60 (February 1995), p. 135-136). At paragraph 110 of its 22 August Comments on US Answers, Brazil included an extract from this General Accounting Office study demonstrating that CCC's low premium rates do not allow it to cover its costs and losses, and that the CCC programmes do not meet *non-market*, let alone *market*, benchmarks.

[113] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

[114] Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Programme classified as "Mandatory" in Table 2, and in the "Introduction", the Office of Management and Budget states that Table 2 provides "the programme's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory").

[115] *See* Exhibit Bra-117 (2 U.S.C. § 661(c)(2)).

[116] Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform", April 1991, p. 7). *See also Id.*, Table 2, which verifies that the CCC export credit guarantee programmes are "mandatory" programs. Brazil notes that this does not mean that the CCC programmes do not *receive* appropriations. The United States acknowledges in its 11 August Answer to Question 11 that the CCC programmes receive appropriations.

[117] Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget", IB95031 (16 February 1996), p. 3 (emphasis added)).

[118] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

the Appellate Body still concluded that nothing in the measure "stem[ed], or otherwise control[led], the flow of" FSC benefits, leading to a threat of circumvention of the United States' export subsidy reduction commitments.[119]

91. The entitlement that qualified applicants have to CCC guarantees is not curtailed by the requirement in US law that CCC not make available guarantees to countries that cannot adequately service debt.[120] That CCC has the authority to deny guarantees on this basis is not relevant, for at least three reasons.

92. First, under the United States' FSC measure, US authorities were permitted to undertake a factual enquiry into whether the foreign-source income of the foreign corporation was "effectively connected with the conduct of a trade or business within the United States".[121] This authority, and the possibility that the factual enquiry could limit the amount of income that would qualify for the FSC exemption, did not prevent the Appellate Body from concluding that nothing in the FSC measure "stem[ed], or otherwise control[led], the flow of" FSC benefits, leading to a threat of circumvention of the United States' export subsidy reduction commitments.[122] Similarly, the authority that CCC has to undertake an enquiry into whether particular countries are creditworthy, and the possibility that this enquiry could end up reducing the amount of CCC guarantees, does not prevent a conclusion that nothing "stem[s], or otherwise control[s], the flow of" CCC guarantees. (Brazil notes that, in any event, a conclusion by CCC that a particular country is not creditworthy would not necessarily reduce the threat of circumvention, since nothing prevents CCC from simply reassigning the country's allocation to a country that is creditworthy.)

93. Second, as Brazil has previously noted, the US General Accounting Office ("GAO") concluded that the requirement that CCC not make available guarantees to countries that cannot adequately service debt does not remotely curtail CCC's extension of its guarantees. According to the GAO, "the statute does not place any limit on the amount of guarantees that can be provided each year to high-risk countries in aggregate or individually".[123] Thus, the theoretical possibility to halt support to non-creditworthy countries does not "stem[], or otherwise control[]," the flow of CCC guarantees.[124]

94. Third, CCC is not concerned enough about creditworthiness to vary its fees based on the country risk involved.[125] Nor does US law require the CCC to take account of the creditworthiness of *individual guarantee recipients* in the fee charged. In fact, CCC fees expressly do not take account of the credit rating of an individual borrower.[126] Thus, even if CCC finds a country to be creditworthy, it is not compensated for particularly poor individual credit risks.

95. Nor is the entitlement that qualified applicants have to CCC guarantees curtailed by CCC's ability to adopt product- and country-specific allocations for its export credit guarantee programmes. Although CCC adopts initial allocations at the outset of a fiscal year, it generously increases those allocations as needed. In its announcement of initial allocations for fiscal year 2004, for example, which extends $2.8 billion in allocations for CCC guarantees, USDA stated that CCC will subsequently make additional allocations throughout the year that will bring total 2004 allocations to

[119] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 12.
[120] *See* US 30 September Further Submission, para. 154.
[121] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 16.
[122] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.
[123] Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition and Forestry, US Senate, "Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees," GAO/GGD-95-60 (February 1995), p. 7).
[124] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.
[125] Brazil's 22 August Comments on US Answers, paras. 109, 112.
[126] Brazil's 22 August Comments on US Answers, paras. 109, 112.

more than $6 billion.[127] Browsing the archived list of USDA press releases announcing supplemental allocations extended throughout fiscal year 2003,[128] for example, demonstrates that this is exactly what CCC does – it increases allocations as needed. As noted above, CCC is not required to receive new Congressional budget authority before it undertakes these additional allocations. In fact, Congress requires CCC to make available *at least* $5.5 billion in guarantees – it does not put a ceiling on the amount to be granted.[129] The allocation process does not "stem[], or otherwise control[]", the flow of CCC export credit guarantees.[130] In fact, it enables CCC to increase the guarantees it can provide.

96. Nor does CCC's ability to adopt product-specific allocations for its export credit guarantee programmes mitigate the significant threat, under Article 10.1 of the Agreement on Agriculture, that the United States will surpass its agricultural export subsidy reduction commitments by virtue of the CCC export credit guarantee programmes. This threat implicates both unscheduled and scheduled agricultural commodities.

97. For unscheduled products, the ability to adopt allocations is irrelevant. Since CCC export credit guarantees are *available* for unscheduled products[131], the threat of circumvention of the US reduction commitments is tangible, and the United States is in violation of Article 10.1. As Brazil has previously noted, the Appellate Body held that for unscheduled products, it is inconsistent with Article 10.1 to provide *any* export subsidies.[132] Moreover, the record demonstrates that the threat has materialized, since CCC guarantees have been extended to unscheduled products during, for example, 1999-2003.[133]

98. For scheduled products, the process of adopting product-specific allocations for CCC export credit guarantee programmes does not mitigate the threat of circumvention – or does not "stem[], or otherwise control[]", the flow of CCC export credit guarantees – for at least three reasons.[134]

99. First, as the list of allocations included in the programme activity report for fiscal year 2003 demonstrates[135], most allocations are only made on a country-specific basis, and not on a product-specific basis. In fact, less than 8 per cent of the allocations listed on the 2003 programme activity

[127] Exhibit Bra-296 ("USDA Announces $2.8 Billion in Export Credit Guarantees," FAS Press Release, 30 September 2003).

[128] *See* http://www.fas.usda.gov/excredits/exp-cred-guar.asp.

[129] Exhibit Bra-297 (7 U.S.C. § 5641(b)(1); 7 U.S.C. § 5622(a), (b)).

[130] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

[131] Exhibit Bra-298 ( "USDA Amends Commodity Eligibility under Credit Guarantee Programmes", FAS Press Release, 24 September 2002). Exports of unscheduled agricultural products that are eligible for CCC export credit guarantee coverage include: barley malt and barley extract, corn products, cotton (including cotton yarn, cotton fabric, cotton products, including cotton linters), fish and shellfish, fresh and dried fruits (including apples, apricots, avocados, blueberries, cherries, clementines, dates, figs, grapefruits, grapes, kiwi, watermelons, cantaloupe, honeydrew, nectarines, oranges, peaches, pears, plums, prunes, raisins, raspberries, strawberries, tangerines and mixtures thereof), fruit and vegetable concentrates, 100 per cent fruit juices, hay, hides and skins, honey, soybean protein products, vegetables (including asparagus, beans, broccoli, carrots, cauliflower, celery, garlic, lettuce, mushrooms, onions, peas, peppers, potatoes, spinach, squash, sweet corn, tomatoes, and mixtures thereof), wood products (including lumber etc.), wool (including wool fabrics, wool yarn and mohair), worms.

[132] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 150.

[133] Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Programme Activity", USDA, covering GSM-102, GSM-103 and SCGP). For 1999-2002, s*ee also* Exhibit Bra-73 ("Summary of Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003).

[134] *See* also Brazil's 24 June First Submission, paras. 300-301.

[135] Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Programme Activity", USDA, covering GSM-102, GSM-103 and SCGP).

report are product-specific.[136] The press release announcing initial allocations for 2004 contains no product-specific allocations. These allocations do not "stem[], or otherwise control[], the flow of" CCC export credit guarantees in a way that would curb the threat that they will be used to surpass the United States' export subsidy reduction commitments for scheduled products.[137]

100. Second, the allocations are made on a *monetary* basis, which provides virtually no assurance that the United States will not surpass its *quantitative* export subsidy reduction commitments. This might not happen for all scheduled products in all years, but the threat that it will happen is tangible. Rice provides a good example. Based on the monetary amounts of exporter applications received for the CCC programmes, US export data, and average world prices, CCC guarantees to support US rice exports caused the United States to surpass its quantity export subsidy reduction commitments in fiscal years 2001, 2002 and 2003.[138] (Even if monetary allocations were relevant, nothing limits the amount of funds that can be allocated. The CCC programmes operate without the constraints of the appropriations process, and Congress requires that CCC make available a *minimum* of $5.5 billion in export credit guarantees.)

101. Third, the United States' schedule demonstrates that the CCC export credit guarantees are not the only subsidies available to support exports of scheduled commodities. Combining CCC guarantees with these other export subsidies augments the threat that the United States will exceed its export subsidy reduction commitments.

102. In summary, the CCC cannot "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[139] None of the factors mentioned by the United States stem the flow of those guarantees, which CCC cannot decline to grant in cases where the programme conditions are met. The CCC export credit guarantee programmes therefore threaten to lead to (and in fact have led to) circumvention of the United States' export subsidy commitments, within the meaning of Article 10.1 of the Agriculture Agreement.

103. With respect to its claims under the SCM Agreement, Brazil notes that even if the CCC had the discretion not to grant export credit guarantees in cases where the programme conditions are met, it would not affect Brazil's claim that the guarantees confer benefits *per se*. As Brazil has discussed elsewhere, since CCC export credit guarantees from the GSM 102, GSM 103 and SCGP programmes are unique financial instruments for agricultural commodity transactions that are not available on the commercial market (certainly not for terms longer than the marketing cycles of the eligible commodities), each time they are granted, they confer benefits within the meaning of Article 1.1(b) of the SCM Agreement.

**143. Brazil agrees with National Cotton Council estimates of the effects of the GSM 102 programmes (Brazil's further submission, para. 190) but it also cites a different conclusion by Prof. Sumner (paragraph 192). Brazil cites other estimates by Prof. Sumner throughout its further submission. Does Brazil adopt Prof. Sumner's conclusions and estimates as part of its submission? BRA**

104. Brazil considers both the National Cotton Council's and Professor Sumner's estimates as independent parts of the record that demonstrate the serious prejudice caused by the GSM 102 programme to the interests of Brazil. The NCC has a staff of expert economists (including the former

[136] Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP (Total GSM 102, GSM 103 and SCGP allocations for fiscal year 2003 are listed as $6.025 billion, with product-specific allocations as follows: $370 million of GSM 102 guarantees to Korea; $85 million of GSM 102 guarantees to Pakistan; and, $10 million of GSM 102 guarantees to Tunisia).

[137] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

[138] Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP).

[139] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

director of the FAPRI cotton model) and has testified to Congress that the effects of the GSM 102 programme increase annual US cotton exports by 500,000 bales and have a 3-cent per pound price effect.[140] Brazil has no reason to doubt the accuracy and reliability of the sworn NCC testimony to the US Congress.

105. Professor Sumner has based his analysis of the effects of the GSM 102 export credit guarantee programme on the earlier work by the National Cotton Council. Professor Sumner has modelled the impact of the GSM 102 export credit guarantee programme as a shift out of the demand curve for US upland cotton by 500,000 bales.[141] Brazil believes that the resulting lower estimates of the effects of the GSM 102 programme offered by Professor Sumner are yet another illustration of the conservative (and reasonable) nature of his model.

106. In response to the Panel's Question, Professor Sumner has rerun the model analyzing the results of a fixed 500,000 bales export effect rather than a shift out of the demand curve by that amount. His original results showed an average annual 305,000 bales export-increasing effect for MY 1999-2002.[142] But the assumption of a fixed 500,000 bale export-increasing effect from the GSM 102 programme results in an average world price effect between MY 1999-2002 of 0.928 cents per pound (or 1.80 per cent) compared to 0.57 cents per pound (or 1.12 per cent) estimated under the previous assumption.[143] For the period MY 2003-2007 the average world price effect would be 1.07 cents per pound or 1.93 per cent compared to the 0.53 cents per pound or the 0.96 per cent estimated previously.[144]

107. Brazil has submitted the analysis of Professor Sumner along with results from other economists and other evidence throughout its submissions. The Panel should consider the complete record in analysing the collective effects of the US subsidies. *Both* the NCC's as well as Professor Sumner's studies are positive evidence of the export-enhancing and price-suppressing effects of the GSM 102 export credit guarantee programme. Both the NCC's testimony as well as Professor Sumner's original as well as revised analysis establishes that GSM 102 causes serious prejudice to the interests of Brazil, within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the SCM Agreement, and within the meaning of Articles XVI:1 and 3 of GATT 1994.

I. ACTIONABLE SUBSIDIES

**145. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Articles 4.7 and 7.8 of the *SCM Agreement*. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the *SCM Agreement* to withdraw the subsidy without delay, can the Panel:**

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? BRA, US**

[140] Exhibit Bra-41 ("The Future of Federal Farm Commodity Programmes (Cotton)", Hearing before the House of Representatives Committee on Agriculture, 15 February 2001, p. 12).

[141] Brazil's 9 September Further Submission, Annex I, para. 59. For reasons internal to the FAPRI model, Professor Sumner did not include the 3 cents per pound price effect estimated by the NCC in the shift out of the demand curve, thus generating more conservative results. In addition, the implicit supply and demand elasticities used by the NCC imply larger price impacts than those in the FAPRI model used by Professor Sumner, again leading to more conservative results.

[142] *See* Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of Export Credit (fixed exports)").

[143] Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of Export Credit (fixed exports)).

[144] Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of Export Credit (fixed exports)).

Brazil's Answer:

108. Regarding the first question, the Panel can conclude that prohibited subsidies have resulted in adverse effects to the interests of another Member. Article 5(c) of the SCM Agreement provides that no Member should cause serious prejudice through the use of *any* subsidy. That includes subsidies that are prohibited under Article 3. Nothing in the text of Articles 4.7 and 7.8 of the SCM Agreement suggests that a complaining party must make a choice between prohibited and actionable subsidy remedies. Brazil has a right to remedies provided by both provisions if the Panel makes the underlying findings that a prohibited subsidy such as Step 2 and export credit guarantees also are actionable subsidies that caused serious prejudice.

109. With respect to the second question, there will be value in the Panel making a recommendation under both Articles 4.7 and 7.8 of the SCM Agreement. A subsidy becomes a *prohibited* subsidy because it is contingent on exports or on the use of domestic over imported goods. If the forbidden contingency is removed, the subsidy may still cause ongoing adverse effects. In addition, there may still be continuing adverse effects from subsidies that were previously contingent on export or local content subsidies. Without a recommendation under Article 7.8, these ongoing as well as continuing adverse effects could not be remedied. Finally, recommendations on both prohibited and actionable subsidy claims may avoid later complications in the event of an appeal of the Panel's final determination.

110. Thus, Brazil urges the panel to make first a recommendation under Article 4.7 of the SCM Agreement that the Step 2, as well as GSM 102, GSM 103 and SCGP export credit guarantee programmes be withdrawn without delay. The Panel should also make a recommendation that the United States remove the adverse effects of the Step 2 and GSM 102 export credit guarantee programmes under Article 7.8 of the SCM Agreement.

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the *SCM Agreement*? BRA, US**

Brazil's Answer:

111. With respect to the first question, the text of Article 5 of the SCM Agreement provides that "[n]o Member should cause, through the use of *any subsidy referred to in paragraphs 1 and 2 of Article 1*, adverse effects". The clear intention is for panels to take into account in assessing adverse effects any and all subsidies that are specific, including those found to be prohibited under Article 3. The only subsidies excluded are those that are not specific. The ban on adverse effects also embraces adverse effects caused by the interaction between all actionable subsidy programmes.

112. Because the Panel is required to examine all actionable subsidies in making its causation determination, it is not appropriate for it to separately analyze the individual effects of each subsidy. Thus, the Panel should look at the interaction of the various types of subsidies at issue and at their *collective* effects. No attribution of the effects to individual subsidies or to prohibited and "other" actionable subsidies is necessary because the remedies of Articles 4.7 and 7.8 of the SCM Agreement are not contradictory.

113. Even if the Panel were to decide that it would be appropriate to examine individual effects of subsidies, Brazil has produced extensive evidence of the link between the serious prejudice caused

and the individual and collective effects of all of the actionable subsidies.[145] If the Panel chooses to examine the individual instead of the collective effects of some of the US subsidies, it can do so based on the evidence produced by Brazil.[146] This evidence establishes causation whether the subsidies are examined individually or collectively. With respect to the interactive effects of the various US subsidies, please see Brazil's Answer to Questions 146.

**146. Brazil acknowledges that there are some interaction effects that may increase or decrease the overall effects of the subsidies (Brazil's further submission, para. 225). How would your analysis under Articles 5(c) and 6.3 of the *SCM Agreement* and Article XVI of *GATT 1994* differ if it excluded, for example, crop insurance subsidies, PFC and/or direct payments? BRA**

Brazil's Answer:

114. The evidence in the record is more than sufficient to establish present and threat of significant price suppression, increasing world market share, and inequitable share of world export trade even if PFC/direct payments and crop insurance subsidies were not deemed to be actionable subsidies.

115. In response to the Panel's question, Brazil asked Professor Sumner to use his model described in Annex I to Brazil's 9 September Further Submission to eliminate the effects of *all subsidies except the PFC/direct payment and crop insurance subsidies*. Professor Sumner's analysis examined the effects of the remaining US subsidies with respect to a number of factors such as planted acreage, production, US price, adjusted world price etc. The complete set of results is set forth in Exhibit Bra-301.[147] Brazil describes the interactive effects of all US subsidies *except* crop insurance and PFC/direct payments on US export and world A-Index prices below.

116. Analyzing the results for the MY 1999-2002 period from Exhibit Bra-301 shows that *but for* the payments from all US subsidy programmes (except the PFC and crop insurance), US exports would have fallen by 36.81 per cent and the world A-Index prices would have increased on average by 11.00 per cent (or 5.73 cents per pound). When crop insurance and PFC/direct payments are included in the original analysis, US exports fall by 41.17 per cent and A-Index world prices would increase by 12.55 per cent (6.5 cents per pound).[148]

117. When the period for MY 2003-2007 is examined, eliminating all subsidies except for crop insurance and direct payments means that, on average, US exports would fall by 37.31 per cent and the A-Index world price would increase by 8.36 per cent (4.63 cents per pound).[149] By comparison, when all US subsidies (including PFC/direct payment and crop insurance) are eliminated, US exports, on average, would decrease by 44.02 per cent and the A-Index price would increase by 10.80 per cent.[150]

[145] Brazil's 9 September Further Submission, Sections 3.3.4.7 (individual effects) and 3.3.4.8 (collective effects). *See also* Brazil's 7 October Oral Statement, paras 31-34 (USDA's analysis of individual effects of marketing loan subsidies for cotton for marketing years 2000 and 2001).

[146] The collective and individual effects of the various US subsidies are analyzed by Professor Sumner at Tables 1.5(a) – (e) of Annex I to Brazil's 9 September Further Submission. *See also* Brazil's 9 September Further Submission, Sections 3.3.4.7 (individual effects) and 3.3.4.8 (collective effects). *See further* Brazil's 7 October Oral Statement, paras 31-34 (USDA's analysis of individual effects of marketing loan subsidies for cotton for marketing years 2000 and 2001).

[147] *See* Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of all domestic support except PFC/direct payments and crop insurance")

[148] Brazil's 9 September Further Submission, Annex I, Table I.5a.

[149] *See* Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of all domestic support except PFC/direct payments and crop insurance")

[150] Brazil's 9 September Further Submission, Annex I, Table I.5a.

118. Brazil notes that most of its evidence does not involve proof regarding PFC/direct payments or crop insurance and would, therefore, not be impacted by the assumption in the Panel's question. In addition, many of the econometric analysis cited by Brazil focus on only some of the subsidies challenged by Brazil. The results of these studies are consistent with the findings of Professor Sumner's analysis set out in Annex I to Brazil's 9 September Further Submission and Exhibit Bra-301. In sum, even ignoring the effects of the crop insurance and PFC / direct payment programmes, the US subsidies cause serious prejudice to the interests of Brazil, within the meaning of Articles 5(c), 6.3(c) and (d) and GATT Articles XVI:1 and 3.

**148. How should the significance of price suppression or depression be assessed under Article 6.3(c) of the *SCM Agreement*? In terms of a meaningful effect? Or another concept? BRA, US**

Brazil's Answer:

119. The significance of price suppression should be assessed by reference to whether it meaningfully affects producers or suppliers of the same product that receives the benefits of the challenged subsidies.[151] Price suppression that does not meaningfully affect suppliers or producers of a product cannot give rise to serious prejudice, since it would not be significant. The text of Article 6.3 does not set a numerical limit on the level of price suppression. What renders price suppression significant or insignificant is whether or not it causes adverse effects to the producers or suppliers of the Member(s) concerned, not whether an arbitrary level of numeric significance is achieved.[152]

120. Contrary to the US arguments, there is not an artificial distinction between whether price suppression is "significant" and whether such levels of suppression meaningfully affect suppliers or producers of the product receiving the benefits of the subsidies. Brazil provided considerable evidence setting forth how its producers suffered adverse effects from the levels of price suppression that can be attributed to US subsidies during MY 1999-2002.[153] A good example of the significance of the levels of price suppression demonstrated by Brazil for MY 2000-2001 is found in the testimony of Christopher Ward. He indicated that a 10-per cent increase in prices for Mato Grosso producers in MY 2000 and MY 2001 would have permitted them to cover their variable costs for MY 2001 and come close to covering variable costs in MY 2000.[154] However, because of the losses they suffered without such revenue increases, many Mato Grosso producers reduced production or were forced out of cotton production – Mato Grosso production fell by 34 per cent between MY 2000-2001.[155]

121. The record shows that the adverse effects suffered by Brazilian producers have also been suffered by producers in Africa.[156] Nicolas Minot testified for Benin at the hearing on 8 October. His econometric analysis focused on the effect of lower upland cotton prices on poverty among Benin cotton farmers. Based on his economic analysis, a ten per cent decrease in upland cotton prices drove

[151] Brazil's 9 September Further Submission, paras. 251-259; Brazil's 7 October Oral Statement, paras. 30-34.

[152] *See* also New Zealand's 1 October Further Third Party Submission, paras. 2.21-2.27, tying the analysis of significance under Article 6.3(c) to the notion of serious prejudice to the Member(s) concerned under Article 5(c).

[153] Brazil's 9 September Further Submission, paras. 444-455 and Annex III.

[154] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, paras. 8-10 and accompanying graph).

[155] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, paras. 8-10 and accompanying graph).

[156] Statement of Mr. Minot. Oral Statement of Benin, 8 October 2003, paras. 29-33 ; Statement of Mr. Ibrahim Malloum, Oral Statement of Chad, 8 October 2003, paras. 13-15.

approximately 83,500 Benin upland cotton farmers below the poverty line.[157] The evidence that African producers have suffered adverse effects by reason of the effects of the US subsidies confirms and supports the evidence presented by Brazil that its producers are suffering adverse effects as well.

122. But even if the Panel decides to adopt some sort of numerical standard not reflected in the text of Article 6.3(c), Brazil has also set forth evidence showing that the levels of price suppression found by a number of different economists are "significant".[158] In assessing whether the various levels of price suppression found by USDA and other economists are "significant," the Panel should take into account the fact that upland cotton is a primary commodity traded in huge volumes and produced and consumed in a large number of countries. Under these circumstances, any measurable and identifiable effect on the *world* price from the subsidies provided by a single Member is important. In this case, the Panel is not faced with a difficult decision because during MY 1999-2002 – and even during MY 1997-1998 – the record shows that the absolute numerical levels of price suppression caused by some or all of the US subsidies were significant, ranging from 4 to 26.3 per cent of the world price, and 10 to 33.6 per cent of the US price.[159]

**153. Would the conditions in Article 6.3(d) of the *SCM Agreement* be satisfied in respect of time periods other than the one specified? What relevance, if any, would this have for Brazil's claims? BRA**

Brazil's Answer:

123. Brazil has demonstrated that the conditions of Article 6.3(d) of the SCM Agreement are fulfilled for MY 2001, 2002 and 2003.[160] The record indicates that the conditions of Article 6.3(d) of the SCM Agreement would also have been fulfilled for MY 1999 and 2000. In addition, the increase in the US share of the world upland cotton market follows a consistent trend. This consistent trend exists whether the Panel analyzes the trend over the period MY 1996-present (described by USDA as constituting a significant change in US farm policy[161]) or over the period MY 1986-present (since the introduction of the marketing loan programme for upland cotton[162]).

124. The US world market share in MY 2000 was 24.7 per cent, an increase over the previous three-year average (MY 1997-1999) of 23.2 per cent.[163] Similarly, the US market share in MY 1999 was 24.1 per cent, an increase over the previous three-year average (MY 1997-1998) of 23.4 per cent.[164]

125. Further, if the "time period" for assessing a "consistent trend" was changed from 1996-2003 to 1985-2003, the results would not be different. The following figure demonstrates that the increase in the US world market share also follows a consistent trend since MY 1986.[165]

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[157] Benin's 8 October Oral Statement (Statement of Nicolas Minot, para. 24-25) (estimating that a 40 per cent reduction in price caused 334,000 people to fall below the poverty line, and indicating that smaller reductions in the cotton price cause roughly proportional changes in income, as shown in Table 3 of his paper attached to Benin's 1 October Further Third Party Submission).

[158] Brazil's 9 September Further Submission, Table 22, page 110; Brazil's 7 October Oral Statement, paras. 30-34.

[159] *See* Brazil's 9 September Further Submission, paras. 148-161, 190, 200-232; 254 Table 23, 379-384. *See also* Brazil's 7 October Oral Statement, paras. 31-34.

[160] Brazil's 9 September Further Submission, Sections 3.4 and 4.12.2.

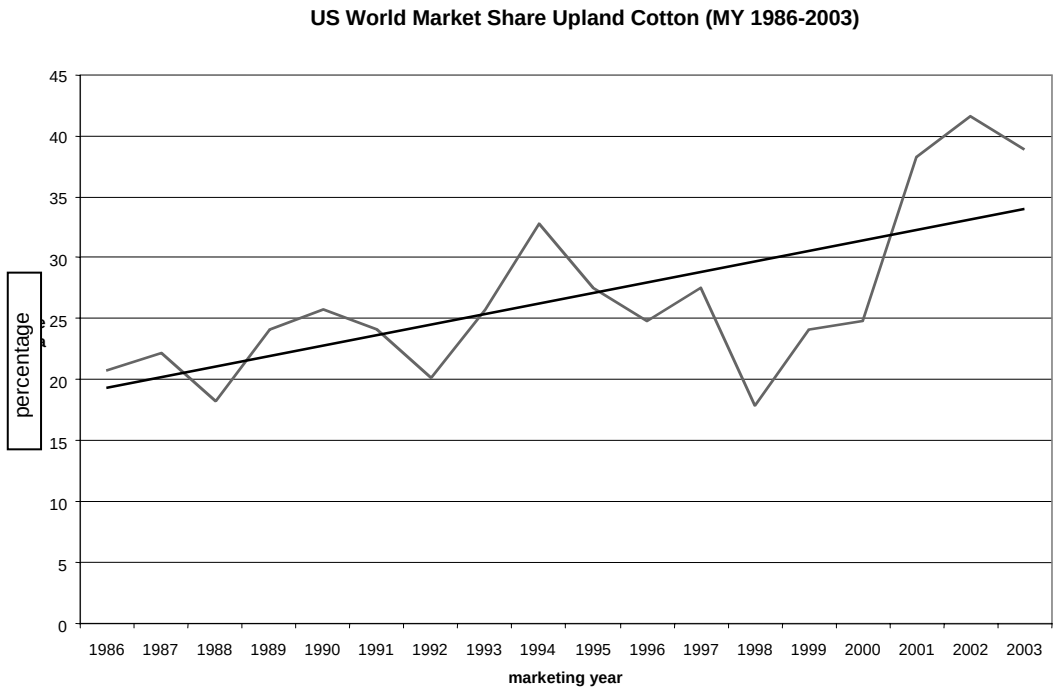
[161] Exhibit Bra-79 ("US Farm Programme Benefits: Links to Planting Decisions & Agricultural Markets", USDA, Agricultural Outlook, October 2000, p. 10).

[162] Exhibit Bra-12 ("Cotton, Background for the 1995 Farm Legislation," USDA, April 1995, p. 15)

[163] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).

[164] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).

[165] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).




126. The trend line beginning in MY 1986 in the graph above shows an overall consistent increase of US export market share over an 18-year period. This steady long-term increase coincides with the introduction of the marketing loan programme in MY 1986. Another highly trade distortive subsidy, the Step 2 payments, was introduced in MY 1990. The combination of these two subsidies, along with the other trade-distortive subsidies, played an important role in the progressive increase in US world market share over the long-term period covered by the MY 1986-2003 graph above. Thus, looking at all the trends collectively provides corroborating evidence that the large increases in the US world market share from MY 1998 to the present are caused, in significant part, by the US subsidies, in violation of Articles 5(c) and 6.3(d) of the SCM Agreement.

127. Brazil notes that MY 1998 was an unusual year with a relatively low US world market share as a direct result of a 20-per cent abandonment of upland crop acreage due to weather-related issues.[166] *But for* those weather-related problems, the US world market share would have been higher in MY 1998.

128. Finally, Brazil wishes to correct a typographical error in its calculation of the US world market share for MY 1997. The correct market share (as reflected in Figure 26 of Brazil's 9 September Further Submission) is 27.6 per cent, rather than 19.8 per cent,[167] as was incorrectly noted in Exhibit Bra-206. Brazil notes that this typographical error did not affect the calculations of the increase in the US world market share.[168] Correcting for this error, Brazil resubmits the corrected figures:

[166] *See* US 30 September Further Submission, para. 19.

[167] The error results from a typographical error in the line of the "total world exports", which were 26.7 million bales in MY 1997 and not 36.7 million bales, as erroneously included in the calculation.

[168] Brazil notes that Figure 26 of Brazil's 9 September Further Submission is unaffected by this data error and shows a very similar trend in the US world market share in cotton.

Figure 25 (para. 270)[169]

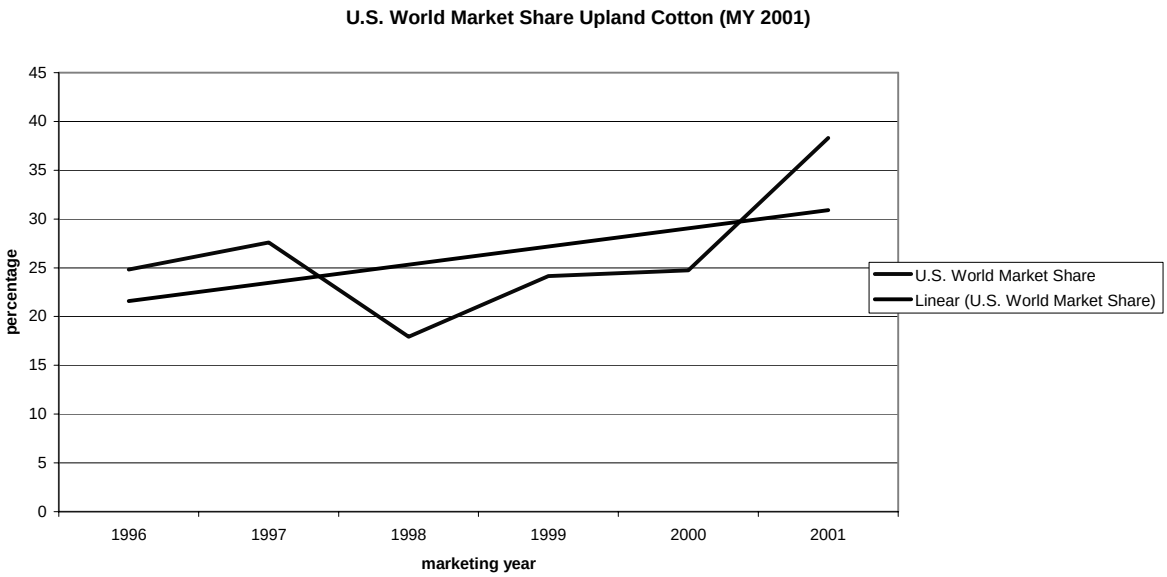
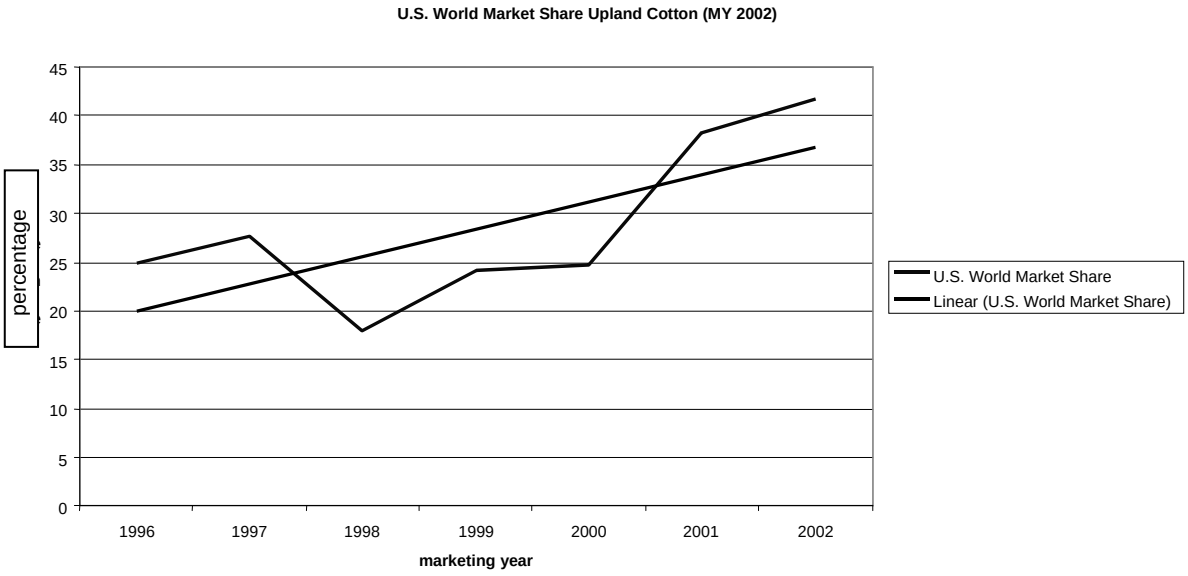
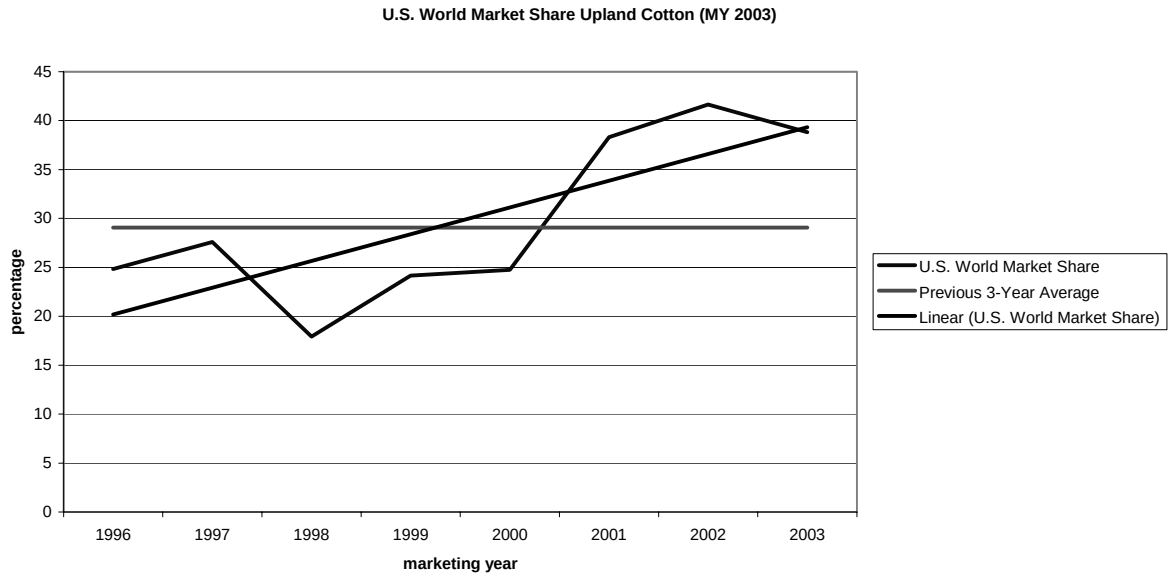



Figure 37 (para. 402)[170]




[169] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).
[170] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).

Figure 38 (para. 405)[171]




129. As the Panel can see, all three graphs show a trend line that matches the actual curve even better than the trend line presented by Brazil in its 9 September graphs. Also, all trend lines show that there is a dramatically increasing US world market share in upland cotton, in violation of Article 6.3(d) of the SCM Agreement.

**161. Would a finding of serious prejudice under Article 5(c) of the *SCM Agreement* be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the *SCM Agreement* in this context? BRA, US**

Brazil's Answer:

130. A finding of serious prejudice based on the effects described in SCM Article 6.3(a), (b), (c) or (d) would be determinative for a finding under GATT Article XVI:1. GATT Article XVI:1 concerns measures that are (i) subsidies, and which (ii) cause or threaten serious prejudice to the interests of any other Member. Footnote 13 of the SCM Agreement provides that "[t]he term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice". Footnote 13 clarifies that the instances that constitute serious prejudice within the meaning of the SCM Agreement, including Article 5(c), constitute at the same time serious prejudice within the meaning of GATT Article XVI:1. In addition, if the Panel determines that a particular measure is a "subsidy" under Articles 1 and 2 of the SCM Agreement, that measure would constitute *ipso facto* a subsidy for the purposes of GATT Article XVI:1. In sum, Articles 5(c) and 6.3 of the SCM Agreement operationalize and clarify the meaning of serious prejudice as contained in GATT Article XVI:1.[172]

**163. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ? US, BRA**

[171] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).

[172] This interpretation of the relationship between Articles 5(c) and 6.3 of the SCM Agreement and GATT Article XVI:1 is without prejudice to the continued relevance of GATT Article XVI:3, as discussed in Brazil's answers to Question 185.

Brazil's Answer:

131. Brazil has established in paragraphs 117-123 of its 9 September Further Submission that between MY 1997-2002, US upland cotton producers on average were not able to cover their total cost of production, *i.e.*, the sum of fixed and variable costs.[173] The gap between the total cost of production and the revenue generated from both upland cotton lint and cottonseed increased steadily from 2.66 cents per pound in MY 1997 to 39 cents per pound in MY 2001 before falling slightly to 34.38 cents per pound in MY 2002.[174] On a percentage basis, the average total costs to produce a pound of upland cotton in the United States between MY 1999-2002 were 77 per cent higher than the average market prices received by US farmers.[175]

132. Similarly, the Institute for Agriculture and Trade Policy in Minneapolis found in a study entitled "United States Dumping on World Agricultural Markets" that based on USDA cost of production data, the United States exported its upland cotton below its total cost of production in each year between MY 1990-2001. The study found that US upland cotton was exported between 9 and 57 per cent below the total cost of production.[176] This evidence on export prices is entirely consistent with Brazil's analysis of the gap between total cost of production and farm prices.[177]

133. Further, Brazil has used USDA data and the FAPRI 2003 baseline projections on prices and costs of production to analyze the likely gap between total costs of production and market revenues.[178] Based on this information, the gap between total cost of production and market returns to producers of upland cotton will be between 24.85 cents per pound in MY 2003 and 21.85 cents per pound in MY 2007.[179]

134. Thus, US producers were not able to meet their total cost of production since MY 1997, and based on USDA and FAPRI baselines, they will not be able to meet their total cost of production through MY 2007. This means that US upland cotton producers would not have met their cost of production for 11 consecutive years absent large US Government subsidies. The average gap between the total cost of production and market return in those eleven years will be 22.85 cents per pound.[180] The only possible conclusion is that many US producers and much US production could not exist without US subsidies, as confirmed by the National Cotton Council.[181]

135. The consistently large cost-revenue gap, among other factors, establishes the link between US subsidies and increased and maintained high levels of US production and exports. Given the high cost of production that significantly exceeds market revenues, absent the US subsidies, many US

[173] *See* also Brazil's Answer to Question 125 (2) (c).

[174] Exhibit Bra-205 (Costs and Returns of US Upland Cotton Producers).

[175] *See* Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers). The number represents the gap between the cost of production of cotton lint and the price received by producers for cotton lint. It does not take into account cottonseed revenue that would slightly narrow the gap.

[176] Exhibit Bra-212 ("United States Dumping on World Agricultural Markets," Institute for Agriculture and Trade Policy, p. 21).

[177] Farm prices are somewhat lower than export prices.

[178] Brazil's 9 September Further Submission, paras. 353-359.

[179] Exhibit Bra-205 (Costs and Returns of US Upland Cotton Producers).

[180] In such a situation it is materially irrelevant whether US producers met their variable cost of production. Meeting at least the variable cost of production may be a short-term option for farmers to stay in business. However, over the long-run, farmers need to cover their total cost of production. Not covering total cost of production for eleven consecutive years would certainly force any producer in any industry out of business.

[181] Exhibit Bra-3 (Roger Thurow / Scott Kilman, "US Subsidies Create Cotton Glut That Hurts Foreign Cotton Farms," The Wall Street Journal, 26 June 2002, p. A1) quoting Kenneth Hood, the then Chairman of the National Cotton Council as saying "cotton farmers . . . can't exist without subsidies."

producers would have to cut upland cotton production, and much upland cotton acreage would no longer be planted to upland cotton. This result is intuitively clear and is confirmed by evidence of significant production cut-backs by Mato Grosso producers (34 per cent) who are sensitive to changes in prices, as described in Christopher Ward's statement of 7 October.[182] It is also confirmed by the results of many economists examining the effects of eliminating US subsidies. They found that eliminating the US subsidies that cover the US producer cost-revenue gap would result in lower US production, leading to lower US exports and higher US and world prices.[183]

136. The Panel has also asked for US cost data on variable and fixed costs. Brazil provides below the most recent USDA data covering the period MY 1997-2002.[184] These data demonstrate that the "gross value of the US production" did not permit US upland cotton producers to cover their total costs of production. In MY 2001, the gross value of the production did not even permit them to cover their variable costs of production. In MY 2002, their revenue only covered slightly more than their variable costs. Not reflected in the chart below is the fact that US subsidies made up all (or almost all) the difference between the "gross value of the US production" and the "total costs listed" between MY 1997-2002.

US cotton production costs and returns per planted acre, excluding direct Government payments, 1997-2002 1/

| Item | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|
| | dollars per planted acre | | | | | |
| Gross value of production: | | | | | | |
| Primary product: Cotton | 477.48 | 307.20 | 274.48 | 324.33 | 222.60 | 257.88 |
| Secondary product: Cottonseed | 68.07 | 48.90 | 40.32 | 50.85 | 48.80 | 49.95 |
| Total, gross value of production | 545.55 | 356.10 | 314.80 | 375.18 | 271.40 | 307.83 |
| | | | | | | |
| Operating costs: | | | | | | |
| Seed | 17.63 | 17.87 | 18.35 | 30.10 | 37.82 | 47.99 |
| Fertilizer | 35.31 | 31.76 | 29.91 | 31.32 | 35.26 | 30.56 |
| Chemicals | 60.19 | 58.54 | 58.60 | 58.32 | 59.25 | 56.80 |
| Custom operations | 23.27 | 13.02 | 19.67 | 19.93 | 19.99 | 19.25 |
| Fuel, lube, and electricity | 31.64 | 26.29 | 26.64 | 36.97 | 36.49 | 31.37 |
| Repairs | 25.39 | 27.32 | 26.28 | 27.18 | 28.53 | 29.10 |
| Interest on operating inputs | 6.57 | 5.40 | 5.61 | 7.55 | 4.71 | 2.31 |
| Ginning | 62.75 | 43.78 | 53.08 | 51.46 | 57.14 | 55.61 |
| Purchased irrigation water | 8.71 | 6.89 | 6.12 | 6.55 | 5.05 | 5.01 |
| Total, operating costs | 271.46 | 230.87 | 244.26 | 269.38 | 284.24 | 278.00 |

[182] *See* Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 6) discussing a drop in the upland cotton acreage in Mato Grosso by 35 per cent between 2000/2001 and 2001/2002 due to low upland cotton prices.

[183] The collective and individual effects of the various US subsidies are analyzed by Professor Sumner at Tables 1.5(a) – (e) of Annex I to Brazil's 9 September Further Submission. *See also* Brazil's 9 September Further Submission, Sections 3.3.4.7 (individual effects) and 3.3.4.8 (collective effects). *See further* Brazil's 7 October Oral Statement, paras 31-34 (USDA's analysis of individual effects of marketing loan subsidies for cotton for marketing years 2000 and 2001).

[184] http://www.ers.usda.gov/Data/CostsAndReturns/data/recent/Cott/R-USCott.xls, visited 25 October 2003

| | | | | | | |
|---|---|---|---|---|---|---|
| Allocated overhead: | | | | | | |
| Hired labour | 33.72 | 33.92 | 35.48 | 36.98 | 37.89 | 38.16 |
| Opportunity cost of unpaid labour | 28.03 | 28.76 | 29.27 | 29.90 | 30.28 | 32.73 |
| Capital recovery of machinery and equipment | 94.21 | 93.16 | 96.80 | 97.97 | 101.49 | 100.39 |
| Opportunity cost of land | 58.33 | 46.04 | 51.84 | 51.68 | 43.83 | 46.76 |
| Taxes and insurance | 14.97 | 14.20 | 15.07 | 15.93 | 16.68 | 17.01 |
| General farm overhead | 15.55 | 14.21 | 15.35 | 15.82 | 16.11 | 15.97 |
| Total, allocated overhead | 244.81 | 230.29 | 243.81 | 248.28 | 246.28 | 251.02 |
| Total costs listed | 516.27 | 461.16 | 488.07 | 517.66 | 530.52 | 529.02 |
| **Value of production less total costs listed** | **29.28** | **-105.06** | **-173.27** | **-142.48** | **-259.12** | **-221.19** |
| **Value of production less operating costs** | **274.09** | **125.23** | **70.54** | **105.80** | **-12.84** | **29.83** |

1/ Estimates based on 1997 survey.

2/ Method used to determine the opportunity cost of land.

J. CAUSATION

**165. Please comment (and submit substantiating evidence) on the US assertion that the FAPRI model has been designed and developed for prospective analysis, and is not suitable for retrospective counterfactual analysis. What is the reliability of past FAPRI-produced analyses when compared with actual data for the period covered by them? Is there any other instrument that can be used to try to identify the effect of subsidies already granted, or of their removal? BRA, US**

Brazil's Answer:

137. Concerning the first question, there is nothing inherently different in using a calibrated simulation model (the category of models into which the FAPRI and many other models fall) to investigate (i) questions of the future effects on prices and quantities of a potential change in policy or, instead, (ii) questions of how the recent pattern of prices and quantities would have been different if a different set of policies would have been in place. Calibrated simulation models, including the FAPRI model, are routinely used for *both* kinds of questions. The applications are identical. In one case, the comparison for the results from the counter-factual policy option is to an unobserved future baseline. In the other case, the comparison for the results from the counter-factual policy option is retrospective to past actual events.

138. The FAPRI policy simulation framework is an elaborate set of supply and demand equations (along with associated stock equations and equilibrium conditions that set quantity supplied equal to quantity demanded). The framework includes, as a component, a set of "baseline" projections of agricultural prices and quantities for future periods that are based on explicit assumptions about policy, climate, technological change, macroeconomic conditions, etc. In many applications, the relevant questions investigated by the model are of the following form: if some specific policy were different in the future, how would this affect the future outcomes for farm commodity prices and quantities. For example, this is the form of question that is often posed in the context of options for changing US farm subsidies in the future. Because they have baseline projection components, the FAPRI framework and a few others are well suited for these future-oriented questions. But the use of such models to analyze the recent past is also common whenever that is a relevant question.

139. As with other calibrated simulation models, the FAPRI model itself is also used routinely for both projections *and* retrospective counterfactual analysis. One recent publication that applied retrospective counterfactual analysis concerned world peanut (groundnut) policy. That study adapted the basic FAPRI framework, much as it was adapted to apply to the current case for upland cotton, to consider international peanut policy questions. The model is calibrated to three recent years – 1999/2000, 2000/2001 and 2001/2002 – and examines a peanut trade liberalization scenario.[185]

140. A second recent retrospective counterfactual application was to the US sugar programme in a project conducted for the US General Accounting Office. In that analysis, a version of the FAPRI domestic sugar model was combined with the CARD international sugar model (much as Professor Sumner has done for upland cotton, as reported in Annex I to Brazil's 9 September Further Submission). The model was calibrated to 1999 data, and results considered the effects of policy reform relative to the 1999 crop year actual outcomes.[186]

141. In addition, Brazil notes that USDA has frequently used calibrated simulation models to perform retrospective, counterfactual analysis. For example, USDA economists calibrated the USDA "SWOPSIM" model, which was used extensively to analyze trade policy options in the 1980s and 1990s, to 1989 data and solved it for commodity prices and quantities that would have obtained in that year under alternative trade liberalization scenarios.[187]

142. The USDA "FAPSIM" model, which is quite similar to the FAPRI model, is a calibrated simulation model that is also used for retrospective counterfactual analysis and for considering policy options relative to projections. According to J. Michael Price of the USDA Economic Research Service, who was one of the developers of the model and currently maintains and operates the model, it is calibrated to historical data each year as well as to the official USDA baseline. That model is used for responding to questions about future policy options *and* to retrospective counterfactual questions. Indeed, one of the first published applications of the "FAPSIM" model was a retrospective counterfactual analysis of US grain storage policy.[188]

143. One of the most recent applications of the USDA "FAPSIM" model was to respond to requests for both alternative projections and retrospective counterfactual analysis from the *Commission on the Application of Payment Limitations for Agriculture*. These results, which have been discussed in previous submissions by Brazil, used the FAPSIM policy framework.[189]

144. According to the Commission Report (chaired by the Chief USDA Economist):

> "Westcott and Price analyzed the effects of eliminating marketing loans on production and prices of major crops over the period from 1998 through 2005. The

[185] Exhibit Bra-303 (John C. Beghin and Holger Matthey. "Modeling World Peanut Product Markets: A Tool for Agricultural Trade Policy Analysis." Center for Agricultural and Rural Development (CARD), May 2003).

[186] Exhibit Bra-304 (John C. Beghin, Barbara El Osta, Jay R. Cherlow, and Samarendu Mohanty. "The Cost of the US Sugar Programme Revisited," Center for Agricultural and Rural Development (CARD), March 2001).

[187] *See* http://www.ers.usda.gov/data/sdp/view.asp?f=trade/92011/ and http://www.ers.usda.gov/data/sdp/view.asp?f=trade/92012/.

[188] Exhibit Bra-305 (Larry Salathe, J.Michael Price and David Banker. "An Analysis of the Farmer Owned Reserve Program 1977-82." American Journal of Agricultural Economics, February 1984, p. 1-11).

[189] *See* Brazil's 7 October Oral Statement, paras. 31-34.

> baseline used for the analysis was the USDA 2000 baseline, which did not anticipate the sharp decline in cotton price for 2001 crop year."[190]
>
> . . .
>
> "The Commission requested that the above study be updated to take into account the sharp decline in cotton prices for the 2001 crop (Westcott). The updated analysis indicated that elimination of marketing loan benefits for the 2001 crop would have lowered cotton acreage by 2.5 to 3.0 million acres or 15-20 per cent and reduced rice acreage by 300,000 acres or 10 per cent."[191]

145. Finally, there are literally hundreds of other academic and government studies using a variety of models calibrated on retrospective data that analyze policy questions. All computable general equilibrium models use this approach, and most academic partial equilibrium simulation models do so as well.

146. Concerning the second question, it is difficult to determine the reliability of the analysis of *potential* (*i.e.*, future) policy outcomes because – by definition – the baseline approach will not mirror exactly the actual conditions. This is why baseline projections use long-term data to even out inevitable fluctuations in commodity market developments. Similarly, the *but for* analysis of a retrospective study attempts to simulate what would have (but did not actually) occur with different policy assumptions. However, the retrospective analysis has the benefit of using actual market data and not projected benchmarks. It is, of course, possible to critique selected portions of the FAPRI baseline projections if they are treated as forecasts of the future values for prices and quantities. Against this benchmark, the FAPRI projections – like all others – will sometimes miss future movements in commodity markets.

147. One measure of the reliability of the FAPRI baseline is that the FAPRI model continues to be relied upon regularly by a variety of US government and US industry organizations to guide decisions on important policy questions. USDA even provided the FAPRI economists with their highest award based on the 2002 baseline analysis.[192] In addition, FAPRI economists over the years have performed checks to ensure that the FAPRI model is as reliable as possible. For example, observed (actual) planted acreage has generally responded in the directions the model projects when the loan rates and other driving factors are relatively constant. In addition, FAPRI constantly examines the internal consistency of the model and its economic logic when compared to actual market events and conditions and makes appropriate adjustments, as necessary.

148. Concerning the third question, there are a number of other potential simulation modelling frameworks that can be used as instruments to respond to retrospective counterfactual policy questions. The USDA FAPSIM model is one such framework. It was used, for example, in the Westcott/Price analysis of the effect of removing all marketing loan payments for MY 2000 and MY 2001.[193] However, the FAPSIM model does not have a full international cotton model as used in the

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[190] Exhibit Bra-276 (Report of the Commission on the Application of Payment Limitations for Agriculture, August 2003, p. 124).

[191] Exhibit Bra-276 (Report of the Commission on the Application of Payment Limitations for Agriculture, August 2003, p. 125). *See* further: Westcott, Paul C. "Marketing Loans and Payment Limitations." Presentation to the Commission on the Application of Payment Limitations for Agriculture, May 2003 as cited in the Payment Limitations Report; Exhibit Bra-222 (Westcott, Paul C., and J. Michael Price. Analysis of the US Commodity Loan Program with Marketing Loan Provisions. USDA, ERS Agricultural Economic Report 801, April 2001); Westcott, Paul and Mike Price. Estimates done at the request of the Commission on the Application of Payment Limitations for Agriculture utilizing the Economic Research Service's FAPSIM model, 2003 as cited in the Payment Limitations Report.

[192] Brazil's 9 September Further Submission, Annex I, para. 4 (last sentence).

[193] *See* Brazil's 7 October Oral Statement, paras 32-33.

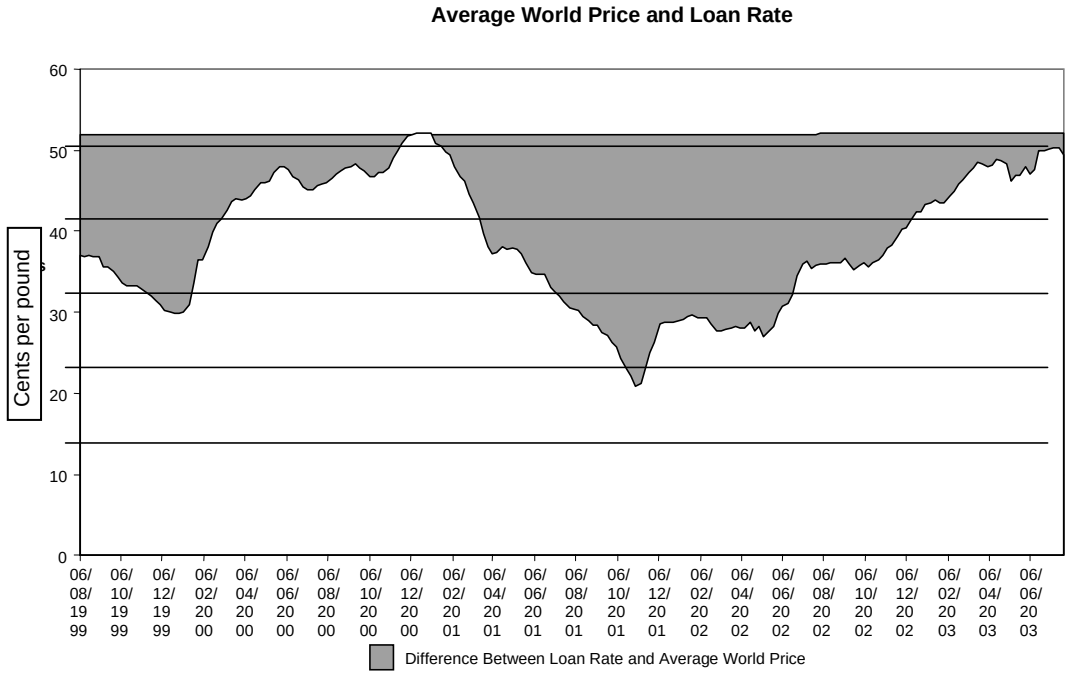
FAPRI/CARD framework, and thus would be less appropriate for dealing with the world price aspects of this case. In general, for specific questions about how quantities and prices of upland cotton would have been different but for US upland cotton subsidies, the appropriate models with which Brazil is familiar would all follow the same basic simulation framework as the FAPRI model.

**167. How does Brazil react to Exhibit US-44? BRA**

Brazil's Answer:

149. The United States claims that Exhibit US-44 demonstrates the "disconnect between the decline in cotton prices … and the incentive offered by US marketing loans."[194] But all that Exhibit US-44 does is to show monthly A-Index prices for upland cotton. These prices, as with other primary agricultural commodities, move up and down with large swings. This exhibit provides no insight into the link between US producer's decisions to keep planting upland cotton as upland cotton prices (including A-Index prices) move up and down. Further, the quantity of subsidies provided by the US marketing loan is a function of the difference between the loan rate (currently 52 cents per pound) and the adjusted world price (AWP) for upland cotton – not the A-Index price.[195] As the Panel can see from the chart provided in response to Question 181, the AWP is consistently and considerably below the A-Index.

150. A relevant graph to examine the causal link between US subsidies and US production is one with a horizontal line representing the marketing loan rate, and which compares that line against the AWP, which is the basis for the payment of marketing loans. This is illustrated in the graph below:[196]




151. This graph shows first what the Exhibit US-44 neglected to illustrate – that except for a short period in MY 2000, the AWP was *below* the loan rate throughout *all* of MY 1999-2002, and that marketing loan payments corresponding to the difference between the AWP and the loan rate were

[194] US 7 October Oral Statement, para. 23.
[195] *See* Brazil's Answer to Question 180.
[196] The data is based on the data collected for Brazil's Answer of Question 181, *see* Exhibit Bra-311.

made. All of the dark area below the 52 cents line represents marketing loan subsidies paid to US upland cotton producers. This illustrates US producers' indifference to market prices. To paraphrase the United States, the line of 52 cents per pound illustrates a "disconnect," but it is not one between the A-Index price and US subsidies. Rather, this graph illustrates the disconnect between the AWP (and more importantly, the US price received by upland cotton producers) and the acreage and production response of US producers: even when prices go to record lows, US producers' revenue is insulated from the decline. This revenue not only kept them in production, but it allowed them to *increase* production during MY 1999-2001. And more remarkably, it kept many of the producers planting 14.2 million acres of cotton when the AWP was near record lows in the period from February-June 2002. These low prices during the crucial planting decision period are clearly reflected in the figure above.[197] It was this period that USDA economists Westcott and Price examined and found that but for the marketing loan payments in MY 2001, US upland cotton production would be 2.5-3 million bales less than it actually was.

152. Thus, this graph helps explain why there is such a limited response from high-cost US upland cotton producers to changes in upland cotton prices. Of course, the graph above does not represent the full amount of revenue supplied by all US subsidies. Other programme features and other programmes provide additional subsidies that cause the effective per unit revenue guarantee to be much higher than the loan rate.

153. If the purpose of Exhibit US-44 was to demonstrate the absence of a link between US upland cotton production (and price suppression) and US marketing loan payments, then it flies in the face of the findings of USDA's own economists. Brazil has referenced the testimony of USDA's chief economist, among many other USDA economists, who have candidly acknowledged the enormous production and price effects that US marketing loan subsidies have on stimulating and maintaining large amounts of US upland cotton production.[198]

**170. Brazil quotes a report that states that a 10 per cent increase in soybean prices reduces upland cotton acreage by only 0.25 per cent (Brazil's 7 October oral statement, para. 27). Could Brazil indicate if this analysis is done on a short-run basis or a long-run basis? BRA**

Brazil's Answer:

154. The authors of the USDA study cited by Brazil – USDA economists Westcott and Meyer – use a "modified version of the estimated elasticities from Lin et al.,"[199] which Westcott/Meyer refer to as a technical improvement. The original study by Lin et al. appears to estimate short to medium-run elasticities. Lin et al. use what they describe as "new supply response elasticities . . . in short-term, acreage forecasting applications".[200] For the estimation of the elasticities themselves, Lin et al. use two models that are solved by regression analysis of the effect of expected relative price changes between crops and the resulting acreage effects in the two following years.[201]

[197] *See* Brazil's 7 October Oral Statement, paras. 32-33.

[198] Brazil's 9 September Further Submission, paras. 148-161. *See further* Brazil's 7 October Oral Statement, paras 31-34.

[199] Exhibit Bra-275 ("US Cotton Supply Response Under the 2002 Farm Act," Westcott and Meyer, USDA, 21 February 2003, p. 9). Brazil is not in a position to specify in which sense the estimated elasticities are modified.

[200] Exhibit Bra-306 ("Supply Response under the 1996 Farm Act and Implications for the US Field Crops Sector," Lin et al., USDA, July 2000, p. 2).

[201] Exhibit Bra-306 ("Supply Response under the 1996 Farm Act and Implications for the US Field Crops Sector," Lin et al., USDA, July 2000, p. 9-16).

155. Lin et al. present their results in Table 21 of their study.[202] It appears that the resulting estimates of the acreage price elasticities are short or medium-term elasticities (acreage reaction one to three years in the future), and that the adaptations by Westcott and Meyer are also short to medium-term elasticities.[203]

**172. Please estimate the price effect, in cents per pound, of the growth in the US retail market which it is said has directly contributed to strengthening world cotton prices. US**

Brazil's Comment:

156. Brazil emphasizes that its claims under Article 6.3(c) of the SCM Agreement revolve around the present and threatened suppression of prices. Thus, whether world upland cotton prices are strengthening or weakening is irrelevant to the question whether those prices would have been higher (at any price level) *but for* the US subsidies.

**176. With reference to Figure 4 of Brazil's Further Submission, how does Brazil explain the apparent decrease in prices in 2001 and the increase of the A-Index in recent months, despite the continued use of US subsidies on upland cotton? BRA**

Brazil's Answer:

157. Brazil has consistently argued that over the period of investigation (MY 1999-2002), the US subsidies caused price suppression that was significant when A-Index prices declined and when A-Index prices increased both during and near the end of the period of investigation in mid-2003.[204] As Brazil explained at the meeting on 7 October 2003, A-Index prices rise and fall for a variety of supply and demand reasons.[205] *One* of the reasons that prices fell as low as they did in MY 1999-2001 and did not rise as far as they should have in MY 2002 was due to the US subsidies. This is best illustrated in Figure 14, set out in Brazil's 9 September Further Submission and reproduced below:

[202] Exhibit Bra-306 ("Supply Response under the 1996 Farm Act and Implications for the US Field Crops Sector," Lin et al., USDA, July 2000, p. 60).

[203] Due to the adaptations, the elasticities reported by Westcott and Meyer are not identical to those reported by Lin et al.

[204] Brazil's 9 September Further Submission, paras. 83-89 (discussing definition of "price suppression"); paras. 92-93 (discussing "causation").

[205] Brazil's 7 October Oral Statement, paras. 18-28.

Figure 14[206]


158. This figure represents Professor Sumner's findings, but a similar figure could be reproduced to reflect other levels of price suppression – including the 33.6 per cent suppression of US prices found by USDA's own economists for MY 2001,[207] as well as the ICAC and other international organizations' findings of price suppression caused by US subsidies for upland cotton.[208] Professor Sumner's findings indicate that during MY 1999-2002, there were a number of global supply and demand factors (including $12.9 billion in US subsidies) that caused upland cotton prices to fall and remain at low levels compared to historical prices throughout the period of investigation. The upper line on the graph reflects the contribution of the $12.9 billion in US subsidies to keeping A-Index prices suppressed. The area below the upper line and above the darker area reflects the amount of price suppression. In other words, regardless of whether market prices rise or fall, there is always a price-suppressive effect.

159. With respect to the Panel's specific question regarding the effects of US subsidies in the latter half of MY 2002, the record shows that US and A-Index prices rose in MY 2002 for a number of supply [and] demand factors – many of which also impacted the market during the fall of prices in MY 1999-2001. The most important supply factor was the *decline* in production of 1.71 million tons in MY 2001-2002 by non-US producers such as the African Franc zone, Southern Africa, East Asia, South Asia, and the former Soviet Union countries.[209] The evidence suggests that many of these producers could not maintain existing levels of production at lower prices that existed in MY 2001 and MY 2002. For example, Christopher Ward testified that even though Brazilian Mato Grosso producers had extremely high yields and low costs, they were forced by low prices to cut their production by 34 per cent in 2001 and by 25 per cent in 2002, compared with 2000 production levels.[210] Similarly, Mr. Ibrahim Malloum, President of CottonChad, testified that lower prices in MY

[206] A-Index prices with and without subsidies are based the baseline and the change from the baseline as reflected in the results of Professor Sumner's simulation model. *See* Brazil's 9 September Further Submission, Annex I, Table I.5a.

[207] Brazil's 7 October Oral Statement, para. 32-33.

[208] *See* Brazil's 9 September Further Submission, paras. 148-162 (discussing price suppressing effects of marketing loan payments including Figure 11 at paragraph 160), para. 190 (NCC estimates of 3 cent per pound price suppressing effect from only the GSM 102 program), paras. 200-213 (various international studies), paras. 214-232 (Professor Sumner's analysis). *See also* Brazil's 7 October Oral Statement, paras 31-34 (discussion of Westcott/Price studies of price suppressing effects of marketing loans in MY 2000 and MY 2001).

[209] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 28-29).

[210] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 6).

2001-02 meant that Chadian production fell because producers could not afford inputs such as fertilizer.[211]

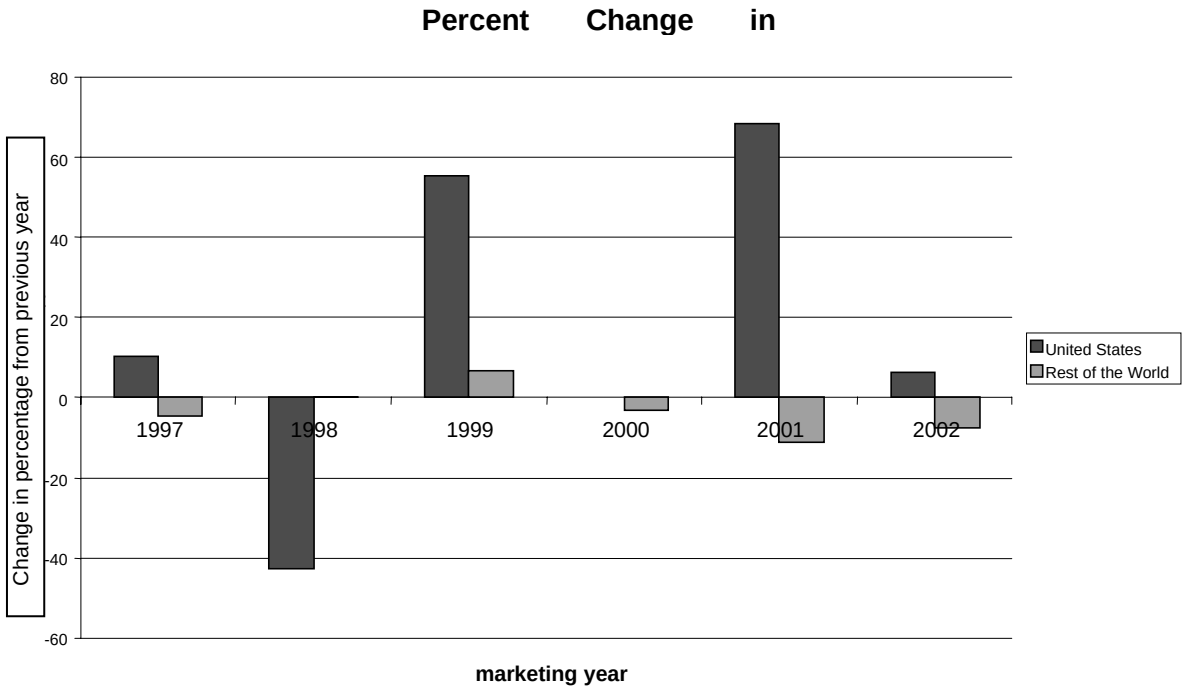
160. For US producers at the time of planting for the MY 2002 crop – between January-April 2002 – the AWP and US price received by US producers were near record lows.[212] Faced with an annual 39 cents per pound differential between total costs and such prices in MY 2001, US cotton producers still planted 14.2 million acres of upland cotton for MY 2002.[213] The resulting US production in MY 2002 was 16.73 million bales (or 3.64 million metric tons). This is an extraordinary amount of acreage and production given the huge gap between US producers' costs and expected *market* revenue. It is estimated that without US subsidies, US production in MY 2002 would have been approximately 1.92 million metric tons, or 1.72 million metric tons less than what US upland cotton farmers actually produced.[214] The effects of this additional 1.72 million metric tons of subsidy-generated production can be judged from the effects of an *actual* decline in world supply of 2.365 million metric tons[215], which contributed to an *increase* in A-Index prices of 33 per cent between MY 2001 and MY 2002.[216] If an *additional* 1.72 million metric tons of US production were taken out of world supply, prices would have been even higher. Professor Sumner has indicated that A-Index prices in MY 2002 would have increased by 17.70 per cent absent the US subsidies.[217] Thus, the effect of the US subsidies in MY 2002 – even as prices increased – was to suppress prices.

**178. The Panel notes Exhibit US-63. Could the US please provide a conceptually analogous graph concerning US export sales during the same period? US**

Brazil's Comment:

161. Brazil offers a conceptually analogous figure to Exhibit US-63 concerning US and rest-of-the-world export sales. The figure below shows the relative changes in US and non-US exports as compared to the previous year for the period MY 1997-2002, based on data covering the period MY 1996-2002.[218]

[211] Chad's 8 October Oral Statement (Statement of Ibrahim Malloum, para. 7).
[212] *See* Brazil's Answer to Question 167.
[213] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).
[214] Brazil's 9 September Further Submission, Annex I, Table I.5a applying the percentage change.
[215] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 4).
[216] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 106).
[217] Brazil's 9 September Further Submission, Annex I, Table I.5a.
[218] Exhibit Bra-307 (Change in US and World Exports in Percent). The exhibit also contains the underlying data for the figure with the sources being described in more detail in Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).




162. The figure demonstrates that US exports increased in every year except for MY 1998, during which the United States claims it suffered a major crop failure. In addition, US exports increased in all years, except for MY 1998, more than exports from non-US producers, which since MY 2000 even *decreased* continuously. The figure demonstrates that the United States gains world market share, with its own exports increasing since MY 1999, at the expense of non-US exports, which have fallen since MY 2000.

163. In sum, this figure supports Brazil's claim of serious prejudice under Articles 5(c) and 6.3(d) of the SCM Agreement. It also supports Brazil's claim of serious prejudice under Articles XVI:1 and 3 of GATT 1994 because the USshare of world export trade increased, in significant part, by the US subsidies at the expense of other lower-cost producers.

**179 Could Brazil comment on the argument that decoupled payments and other subsidies to upland cotton are largely being capitalized into land values and that removing these subsidies would reduce the cost of production of upland cotton producers (US 7 October oral statement, para. 48). What would be the net effect of these adjustments? BRA**

Brazil's Answer:

164. A February 2003 study by ERS economists estimated that "decoupled" payments lead to an increase of about 8 per cent in US farmland values.[219] A more comprehensive ERS 2001 report estimating the regional effects of all subsidies (not just decoupled subsidies) on land values found that land values increased by 16 per cent in the regions where upland cotton is grown. This is shown in the following chart:[220]

[219] Exhibit Bra-308 ("Decoupled Payments: Household Income Transfers in Contemporary US Agriculture," ERS Agricultural Economic Report No. 822).

[220] Exhibit Bra-309 (Barnard C., Nehring, R., Ryan, J., Collender, R. "Higher Cropland Value from Farm Programme Payments: Who Gains?" Economic Research Service. USDA Agricultural Outlook November 2001, p. 29).

**ERS/USDA Estimated Cropland Value Attributable to Commodity Programme Payments**

| Region | Total Value of Land Harvested in 8 Programme Crops | Estimated Value Attributable to Commodity Programme Payments | Per cent of Value Attributable to Commodity Programme Payments |
|---|---|---|---|
| Prairie Gateway | 41.70 | 9.40 | 23.00 |
| Mississippi Portal | 17.30 | 2.70 | 16.00 |
| Fruitful Rim | 21.60 | 2.20 | 10.00 |
| Southern Seaboard | 18.20 | 1.80 | 10.00 |
| Eastern Uplands | 4.60 | 0.50 | 10.00 |
| **Total** | **103.40** | **16.60** | **16.05** |

165. Brazil notes that neither of these studies provides an estimate of the percentage of each dollar of "decoupled" or total subsidy payments that are capitalized into land *values*. However, an August 2003 study by ERS economists indicates that PFC payments in MY 1997 resulted in an increase of land rents by 34-41 cents of per PFC dollar.[221] Thus, contrary to the premise of the Panel's question, this evidence suggests that PFC payments are somewhat, but not "largely capitalized" into land rents.

166. There would be only a minimal impact on total costs of production for upland cotton farmers from the removal of both "decoupled" and total US subsidies. For the allegedly "de-coupled" payments referred to in the February 2003 ERS study, the impact of an 8 per cent reduction in land values translates into a decrease in total costs of US upland cotton producers by less than one per cent (0.75 per cent).[222] If the effects on increased land values from all subsidies are taken into account (using the 2001 ERS regional study), then US upland cotton producers' costs would have declined between MY 1999-2002 by only 1.49 per cent.[223] In response to the Panel's question, the net effect of these tiny adjustments throughout MY 1999-2002 on the very wide cost-revenue gap and the other costs of production analysis conducted by Brazil in its various submissions is obviously minimal.

167. Finally, the United States at paragraph 48 of its 7 October Oral Statement criticized Professor Sumner's analysis for allegedly not factoring into his estimates the effect of direct payments being capitalized into increased land rents. The US criticism is misplaced. Professor Sumner's model used very low estimates of production incentives for every dollar of PFC payments (only 15 per cent) and direct payments (only 25 per cent).[224] By taking a very conservative approach for these direct payments, Professor Sumner's analysis more than allows for the effects these payments have in increasing land values. This can be illustrated by using the 34-41 per cent results of the August 2003 land rent study referred to above. The results of this study suggest that 66-59 cents of each PFC dollar are *not* reflected in increased rents. This leaves more than enough residue from each PFC and direct payment dollar to account for the only 15-25 per cent production effects for PFC/direct payments found by Professor Sumner.[225]

**180. Please describe the precise formula as to how USDA determines the "adjusted world price" using the Liverpool A-Index, the NY futures price and any other relevant price indicators. Please submit substantiating evidence. BRA, US**

[221] Exhibit Bra-310 ("The Incidence of Government Program Payments on Agricultural Land Rents: The Challenges of Identification", Roberts, Kirwan, and Hopkins, August 2003, American Journal of Agricultural Economics, p. 767.).
[222] Exhibit Bra-7 (ERS Data: Commodity Costs and Returns).
[223] Exhibit Bra-7 (ERS Data: Commodity Costs and Returns).
[224] Brazil's 9 September Further Submission, Annex I, para. 48.
[225] Brazil's 9 September Further Submission, Annex I, para. 48.

Brazil's Answer:

168. Brazil looks forward to receiving a detailed description of the complicated calculation of the adjusted world price from the United States in reply to this question. Brazil has set forth a brief description of the calculation of the adjusted world price in paragraph 73 of its 24 June First Submission, and will elaborate to the best of its understanding.

169. The details of the complicated calculation method for the adjusted world price are laid down in 7 CFR 1427.25.[226] The weekly *Cotton Outlook* published by Cotlook Ltd. provides a somewhat simpler description of the process. Exhibit Bra-51 includes the Cotton Outlook description of the "US Pricing Mechanism", including the calculation of the adjusted world price for the week of 31 January 2002.[227]

170. The descriptions shows that the adjusted world price is calculated based on the A-Index from which a total adjustment factor is subtracted, thus:

> The Adjusted World Price (AWP) is calculated from CIF North Europe quotations, adjusted for shipping, location and quality differentials. The Shipping Differential is derived from the average over the preceding 52 weeks, or as many of that number of weeks for which quotations are available, of the difference, calculated from Thursday's values only, between the average of the Memphis and California/Arizona CIF North Europe quotations, and the Middling 1-3/32" (31-35) domestic spot market average. However, the Shipping Differential in any week may not fall below, or rise above 115 per cent, of an assessed actual transportation cost (now 12.9 cent). A further discount, the Course Count Adjustment, is applied by reference to the amount by which the World Quality difference exceeds the appropriate Loan Quality Difference. It applies to cotton of any grade stapling 1-1/32" or shorter, and to selected lower grades in longer staples.[228]

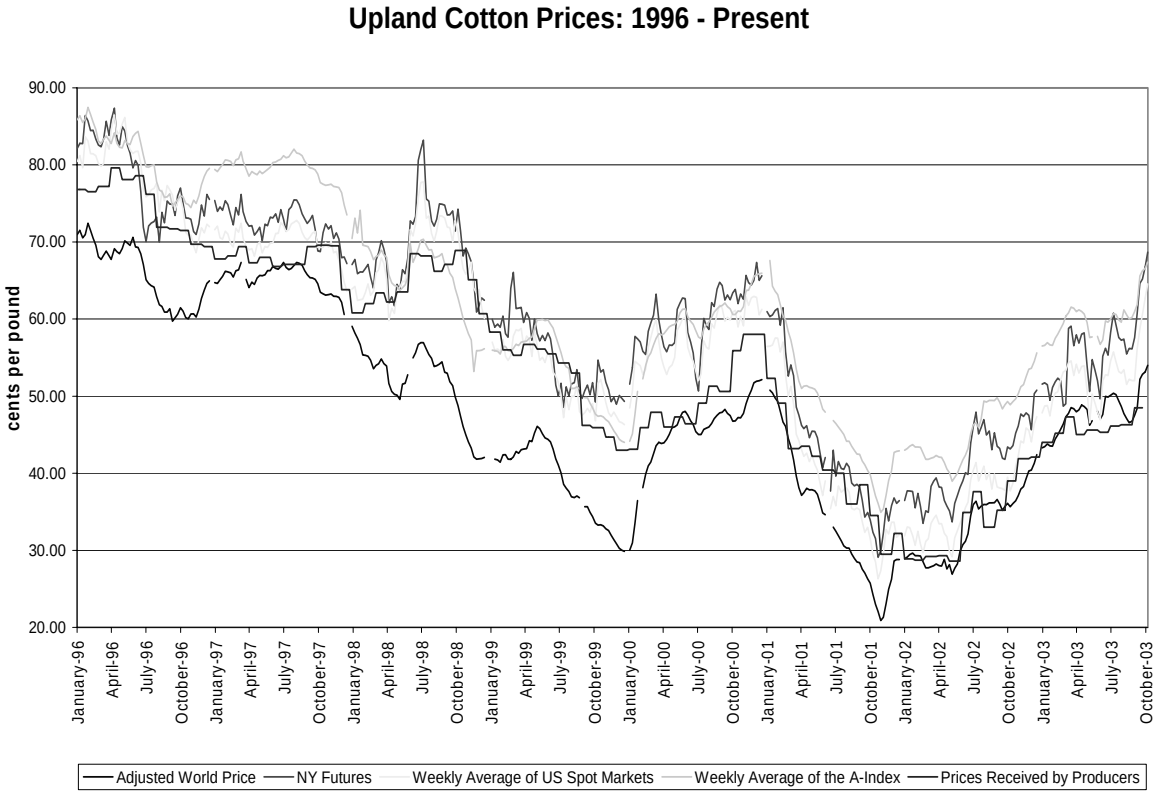
171. Brazil also notes that under certain conditions, the Secretary of Agriculture is entitled to reduce the adjusted world price below the result of this calculation – the so-called Step 1 adjustment. In such circumstances, the adjusted world price would be reduced by a maximum of the difference between the A-Index and the average of the cheapest US Middling 1-3/32" CIF North Europe quotes – thus, the amount by which the US price quotes exceed the average of the five cheapest price quotes worldwide. Such a downward adjustment would increase the amount of marketing loan payments that US upland cotton farmers receive and help close the cost-revenue gap that US producers face.

**181. Please provide a side-by-side chart of the weekly US adjusted world price, the Liverpool A-Index, the NY futures price, and spot market prices from 1996-present. What, if anything, does this reveal? BRA, US**

Brazil's Answer:

172. In Brazil Bra-311, Brazil provides a side-by-side chart of the weekly US AWP, the A-Index, the nearby New York futures price, the average US spot market price and prices received by US producers from January 1996 to the present. The figure below shows the respective price developments over this period. Exhibit Bra-311 also contains a colour copy of this chart.[229]

[226] Exhibit Bra-36 (7 CFR 1427.25).
[227] Exhibit Bra-51 (Cotton Outlook, 1 February 2002, p. 16).
[228] Exhibit Bra-51 (Cotton Outlook, 1 February 2002, p. 16) (emphasis in original).
[229] The data has been obtained from the Cotton Outlook published by Cotlook, Ltd. in Liverpool.




173. The figure demonstrates that the A-Index price is consistently 12-14 cents per pound higher than the adjusted world price ("AWP"), which constitutes the basis for the US marketing loan payments. The average difference between both prices over the 1996-present period is 13.76 cents per pound. As expected, both prices move in parallel. Further, both prices follow the price trends that originate from the New York futures market or at least move in parallel to those prices. There is also a close linkage between the average US spot market price and the New York futures and A-Index prices.

174. The figure further demonstrates that the New York futures prices and the average US spot market prices are usually more volatile than the A-Index and AWP prices. Thus, any rapid increases or decreases in the New York futures prices will not necessarily be reflected to the same extent in AWP or prices received by US producers – the prices of which marketing loan and counter-cyclical payments, respectively, are triggered. They may just be a temporary phenomenon.

175. In sum, the price movements support Brazil's argument that New York futures, US and international prices for upland cotton are closely linked, and that price movements and trends originating from the US market are closely tracked by prices on the world markets.[230]

176. That US and international – and indeed Brazilian – prices closely track each other demonstrates that production and price effects from the US subsidies on the US market are transmitted to the international upland cotton market and to third country markets such as the Brazilian market or markets where Brazil exports its upland cotton. The Panel will remember that the A-Index is composed of price quotes from 16 different upland cotton export markets around the world.[231] Thus, if USDA studies like those undertaken by Westcott and Price establish price-suppressing effects of the US subsidies for the US market, those effects will also occur on the

[230] *See* Section 3.3.4.9 of Brazil's 9 September Further Submission, para. 233-250.
[231] Brazil's 9 September Further Submission, Annex II, para. 24.

international and third country markets. The parallelism in the price movements establishes the link between price suppression in the US and international markets and other third country markets.

**182. Please explain why the US can be taken to be price *leaders*, or price *setters*, (and not just takers) when US producers receive large subsidy payment to support the difference between *world prices* and their own costs? BRA**

Brazil's Answer:

177. The Panel's question focuses first on "US producers" who receive large subsidies. One of the premises of this question is that US producers receive subsidies that account for the difference between *world* prices and their own costs. This is not entirely correct. US producers receive what the USDA refers to as "Average price received by US producers". During the MY 1999-2002 period, this US producer price was on average 9.2 cents per pound, or 17.6 per cent, *below* the world A-Index price.[232] Other than the first month of marketing year 1999, the A-Index price was always higher than the US price received by US producers between MY 1999-2002. The lower prices paid to US producers are partly explained by the transportation costs of upland cotton from the United States to foreign markets, where most US upland cotton is marketed. However, as the Panel's question suggests, the total revenue received by US producers includes marketing loan payments that are a function of the set loan rate (52 cents in MY 2002) and the adjusted world price that itself is determined in part by reference to the A-Index prices.

178. During MY 1999-2002, individual US producers of upland cotton did not "set" or "lead" A-Index prices. Most US producers were isolated from the effects of market price during MY 1999-2002. As the Panel's questions implies, on average, US producers were generally able to cover their costs based on a combination of market revenue and the large subsidies they received during MY 1999-2002.[233] The guaranteed subsidies and price support at high price levels ensured a revenue stream that left them largely indifferent to market prices throughout the entire period of investigation.

179. The Panel's question further asks how the United States could be a "price setter" in the world upland cotton market. Individual US *exporters* of US upland cotton do not "set" or "control" the price of upland cotton. In a world-wide market such as the upland cotton market, no single private trader has the market power (in an anti-trust sense) to "set" the world price. As Andrew Macdonald testified, prices of upland cotton are *discovered* hourly and daily by traders in the futures, spot, and forward delivery markets based on key supply and demand factors.[234] Nor has Brazil argued that the US *leads* prices down by initiating a price war, as may occur with industrial products.

180. What Brazil has argued is that the United States is a leading *driver* of the world upland cotton market to the extent it suppresses the price of upland cotton. The United States can do this because of its large guaranteed production and direct subsidies that inject a near permanent stream of large US production and supplies into the world market. US export subsidies drive the world market in the sense that they stimulate the demand for high-cost US upland cotton at the expense of other world producers. Further, its size (by far the largest exporter and second largest producer), its transparency, which in turn plays a major role in the price discovery in the New York futures market, and the ability of US exporters to use the Step 2 and GSM 102 tools to market US upland cotton, allow it to suppress world prices.[235] Only by taking these price-suppressing factors into account could it be said that the United States "leads" world prices.

[232] *See* Brazil's Answer to Question 181 for data on the A-Index prices and the prices received by US producers.

[233] *See* Brazil's Answer to Questions 125 (2) (c) and 163.

[234] Brazil's 9 September Further Submission, Annex II, paras 11-13, 15-25 and 38-42.

[235] Brazil's 9 September Further Submission, paras. 134-145; Annex II, paras. 38-42 and Chad's 8 October Oral Statement (Statement of Ibrahim Malloum), para. 13-14.

181. For example, the large size of the US production, which represents approximately 20 per cent of total world supply annually, is a key factor in driving and influencing world prices.[236] Shifts in US production caused by good or bad US weather influence total world supply and create an impact on world prices.[237] In much the same way as US weather plays a role in the discovery of world prices (by reducing US and, thus, world stocks), continued high levels of US production generated by US subsidies suppressed world prices throughout the period of investigation by increasing world supplies.

182. Further, the dominant (over 40 per cent) export market share of the United States coupled with the Step 2 and GSM 102 export subsidies creates a further suppressing effect on world prices.[238] These export subsidies allow US exporters to price their upland cotton below the prices of most other world producers because Step 2 gives them (not US producers) the difference between the lowest US price and the A-Index price (the average five lowest prices in the world market).[239] These subsidies, along with the domestic production and direct payment subsidies, have permitted exporters of high-cost US upland cotton to increase US world market share even as prices plunged throughout MY 1999-2001. Thus, while individual US exporters may not have "set" or "led" prices, the US subsidies allowed these exporters to continue marketing high-cost US cotton at *whatever* market price was determined by global supply and demand conditions.

K. ARTICLE XVI OF GATT 1994

**183. Why does Brazil believe that the appropriate "previous representative period" is the term of the previous Farm Bill, MY1996-2002? (Brazil's further submission, para. 282) BRA**

Brazil's Answer:

183. The Panel's question has stimulated a re-evaluation by Brazil of the appropriate "previous representative period" in relation to Article XVI:3. Brazil agrees with the US arguments made in the *EEC – Wheat Flour* GATT dispute that the appropriate "previous representative period" in Article XVI:3 should be one in which trade patterns have not been distorted by subsidies. In that dispute, the United States correctly argued:

> …that the three most recent calendar years could not be used as the representative period in the case since, given the distortion of trade patterns resulting from the heavy use of export subsidies by the EEC, it did not constitute a period during which "normal market conditions existed." There was ample GATT precedent for selecting a period when subsidization was not unduly affecting the market shares. During the 1995 Review Session it was agreed that in determining what is an equitable share of world trade, the CONTRACTING PARTIES should not lose sight of the "fact that

[236] Brazil's 9 September Further Submission, para. 135.

[237] Consider the following market reports: Exhibit Bra- 312 (Cotton Outlook, 4 October 2002, p. 3 ("Current developments on the production side – though perhaps not the consumption side – would seem to be constructive for prices. Yield potential in several parts of the world appears to be diminishing as a result of unfavourable weather – including storm systems affecting open cotton in parts of the United States.")); Exhibit Bra-312 (Cotton Outlook , 27 September 2002, p.3 ("Tropical Storm Isidore drove New York futures to higher levels earlier this week, on the grounds that its predicted path would bring heavy rainfall across a huge swathe of the south eastern United States and the Memphis Territory, and thus damage yield and quality prospects… [D]espite the adverse weather, the US will continue to need to make inroads into what remains a significant exportable surplus." )); and Exhibit Bra-312 (Cotton Outlook, 7 June 2002, p. 3 "Many eyes are directed towards developments in West Texas, where rain appears to have fallen too heavily in places where it is less needed and insufficiently in the dryland areas where soil moisture is lacking.")).

[238] *See* Brazil's 9 September Further Submission, paras. 139-142.

[239] Chad's 8 October Oral Statement (Statement of Ibrahim Malloum), para. 14; Brazil's 9 September Further Submission, Annex II, paras. 31, 49-53.

> the export subsidies in existence during the selected representative period may have influenced the share of the trade obtained by the various exporting countries." (GATT, BISD 3rd Supplement, paragraph 19, page 226). Then, in 1960, the CONTRACTING PARTIES adopted a Panel Report which dealt with notification of subsidies, in which it was agreed that an analysis of the effect of a subsidy should include statistics "… for a previous representative year, which were possible and meaningful, should be the latest period preceding the introduction of the subsidy or preceding the last major change in the subsidy." (GATT, BISD 9th Supplement, Annex II(b)(ii), page 194)…. Thus, *it was necessary to examine a period of which preceded the adoption of the EEC's subsidy system in order to assure that the trade distorting effect which the EEC system had already had on world markets was minimized as a factor in judging "equitable share."* [240]

184. There has been no period since the 1930s when US producers of upland cotton were not subsidized.[241] Since the 1980s in particular, US upland cotton producers have been guaranteed very high levels of government payments by a variety of subsidies, including the marketing loan programme that began in MY 1986. The revenue guarantee that these subsidies provide has locked in large amounts of apparently permanent high-cost US upland cotton production and exports. These distortions exist even in those years in which actual quantities of payments under the programmes are minimal due to higher prices. This is because the subsidies provided to high-cost producers in years of low prices mean they stay in business to continue to produce upland cotton also at times when subsidies fall due to increased prices. The relatively small planted acreage and production response by US producers to market prices over many years reflects the effects of this guaranteed US government revenue.

185. In view of the US arguments in *EEC – Wheat Flour* and the long-term distortions in the US production and exports caused by US subsidies, one appropriate "representative period" would be a simulated period in which no subsidies were provided. The Panel would examine the question: what would be a Member's share of world trade if it received no subsidies? This question, of course, is a function first of the amount of acreage and production, and ultimately exports attributed to the subsidies. The Panel is fortunate to have the benefit of very recent 2003 analysis by USDA economists Westcott and Price, who estimated that up to 3 million US acres of upland cotton production would have not been planted in MY 2001 if no marketing loan payments were made that year. These 3 million acres represent 19.36 per cent of US upland cotton acreage in MY 2001.[242] A reduction by this amount would imply a reduction in US production of 3.79 million bales for MY 2001.[243] Consequently, US exports would also fall by about 3.79 million bales, representing 34.74 per cent of US exports in MY 2001.[244] The implied export effects from the Westcott/Price study are very similar to those found by Professor Sumner, who estimated the export-increasing effects of the marketing loan programme in the comparable period to be 29.67 per cent and the effects of all US subsidies to increase US exports by 48.16 per cent.[245]

186. The record provides an example of what the US share of world export trade in upland cotton would be in a marketing year in which production and exports fell by amounts similar to those estimated by Professor Sumner and Westcott/Price. In MY 1998, 20 per cent of US upland cotton

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[240] GATT Panel Report, *EEC – Wheat Flour*, para. 2.8 – 2.9 (emphasis added).

[241] *See* Brazil's 9 September Further Submission, para. 269.

[242] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[243] 19.36 per cent of 19.603 million bales as reported in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[244] Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 5).

[245] Brazil's 9 September Further Submission, Annex I, Tables I.5d and I.5a. *See* paras. 17-18 and 75 for determining the comparable period.

acreage was abandoned and US harvested acreage fell by 2.8 million acres compared to MY 1997.[246] US production fell by 4.77 million bales and US exports fell by 3 million bales. As a result, US world market share declined from 27.6 per cent in MY 1997 to 17.9 per cent in MY 1998.[247] This considerable decrease in the US share of world export trade provides an approximation for the Panel to assess what the equitable US share would be *but for* the US subsidies in MY 2001-2003. Thus, MY 1998 is a useful representative period for the Panel to examine (in conjunction with Professor Sumner's and USDA economists Westcott/Price's analysis).

187. An alternative representative period that the Panel could use for assessing the *inequitable* nature of the US share of world export trade in upland cotton is the period MY 1994-96, during which the average level of US subsidies fell to "only" $495 million per year.[248] The development of the US world market share in MY 1994-1996 compared to MY 2001-2003 is shown in the graph below:[249]


188. During the period 1994-1996, US producers were generally able to cover their total costs of production largely from market revenue. In these conditions, US world market share averaged 28.4 per cent.[250] Yet, in conditions where market revenue plunged, costs of production and the cost-revenue gap increased. Average MY 1999-2002 US subsidies were six times greater than the period MY 1994-96, and US world market share increased to between 38 and 41.6 per cent in MY 2001-2002. These record high levels of world market share were purchased with large increases in both the quantity and level of guaranteed subsidies in MY 2001-2003 – huge marketing loan payments as well as increases in revenue support of 10 cents a pound resulting from the 2002 FSRI Act.[251] Thus, even though the period MY 1994-1996 was still heavily influenced by the revenue guarantees provided by the numerous US upland cotton subsidy programmes, this period could be a representative period for the Panel to examine for the purposes of making its "inequitable" share of world export trade findings.

[246] Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4-5).
[247] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).
[248] *See* Brazil's 9 September Further Submission, para. 110, note 145 and Figure 2.
[249] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).
[250] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).
[251] Brazil's 9 September Further Submission, para. 309.

**184. Why does Brazil believe that an "equitable share" is one which factors out all subsidies? To the extent that domestic support and export subsidies are permitted by the *Agreement on Agriculture*, why should they not be accepted as being normal conditions in analyzing an equitable market share? (See Brazil's further submission, paras 288-289) BRA**

Brazil's Answer:

189. Brazil believes, for the reasons articulated by the United States in the *EEC - Wheat Flour* dispute quoted in Brazil's Answer to Question 183, that the appropriate representative period for evaluating the *inequitable* share of share of world export trade is one in which no (or at most very few) trade-distorting subsidies were provided. Selecting an *earlier* representative period where the market share is not tainted with subsidies allows an assessment of whether a *later* market share *is* tainted by subsidies. As the United States argued well in *EEC – Wheat Flour*, the *inequitable* nature of a world market share can best be judged in comparison to what an *equitable*, *i.e.*, non-heavily subsidized world market share would be. This is consistent with Brazil's arguments in paragraphs 288-289 of its 9 September Further Submission that a non-subsidized world market share of 17 per cent is, by definition, an *equitable* share for the purpose of Article XVI:3. By contrast, a heavily subsidized and subsidy-increased world market share of 41.6 per cent in MY 2002 is *inequitable.*[252]

190. With respect to the second question, Brazil notes that although agricultural domestic and – to a certain extent - export subsidies are not prohibited, GATT Article XVI places clear limits to such subsidization. Section A determines, for example, that subsidies must be notified when the operate "directly or indirectly to increase exports of any product from, to reduce imports of any product into, its territory". More specifically, it established that the subsidizing Member must avoid causing serious prejudice to the interest of other Members. Therefore, even purely domestic subsidies should only be granted in a manner that does not affect the equilibrium of world trade that would be achieved in their absence.

191. The GATT Article XVI obligations – especially those of the second sentence of paragraph 3 – are primarily focused on the effects of subsidies that operate to increase exports. Paragraph 2 places particular emphasis on the fact that such subsidies "may cause undue disturbance" to the "normal commercial interests" of other Members. Large subsidies stimulating exports cannot be understood not to cause "undue disturbance" that affect the "normal commercial interest" of other Members. Otherwise, GATT Article XVI:3 would be stripped of any meaning. If, the starting point to an analysis of an equitable share grandfathers subsidies that were being previously granted, such analysis would start from an inequitable situation of equilibrium.

192. The term "equitable" is defined as something that is "characterized by equity or fairness; fair, just."[253] "Equitable" does not relate to something that is "legal" or "permitted." Something that is permitted may well be not equitable. The fact that certain subsidies are "permitted" does not grandfather their effects and transforms them into "normal conditions in analyzing an equitable market share," as put by the Panel in this question. The text of GATT Article XVI:3 requires that the test of "equitable" market share be primarily and intrinsically linked with the concept of fairness. Therefore, an "equitable" analysis of a fair equilibrium of market shares cannot be one that starts by accepting as legitimate – or as "normal conditions" – the effects of widespread and expensive subsidies that only a few Members can afford, to the expense of developing countries.

193. Brazil does not believe that subsidies representing 95 per cent of the value of a widely-traded commodity product like upland cotton can ever be considered to have been provided under "normal conditions". Nor can a dramatic increase in absolute levels of subsidies coupled with the increase in

[252] *See* Brazil's 9 September Further Submission, para. 288.
[253] The New Shorter Oxford English Dictionary, 1993 edition, p. 843.

the subsidization rate (and in absolute subsidy payments) during the period MY 1999-2002 over a previous representative period be considered to be "normal conditions". Further, when a more than doubling of world market share by a WTO Member coincides with record low world prices, record *gaps* between total costs and market revenue and record amounts of that Member's subsidies, the subsidies cannot be considered to have been provided in "normal conditions".

**185. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the *Agreement on Agriculture* and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the *SCM Agreement*. BRA, US**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions of the *Agreement on Agriculture,* relevant?**

Brazil's Answer:

194. With respect to the first question, the answer is that any domestic support programme that grants "directly or indirectly" "*any form of subsidy* which operates to increase the export of any primary product" is covered by the second sentence of Article XVI:3. All of the domestic support subsidies challenged by Brazil in this case operate to increase US exports. Professor Sumner found that each of the challenged US subsidies he examined had the effect of increasing US exports.[254]

195. Because Article XVI, including Article XVI:3, deals with serious prejudice to the interests of another Member, the direct context for interpreting its provisions is found in Article 5 of the SCM Agreement. Article 5 makes no distinction between subsidies contingent upon export and domestic support subsidies. It provides that "[n]o Member should cause, *through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1,* adverse effects to the interests of other Members". Articles 1 and 2 of the SCM Agreement in turn make no distinction between export and domestic support subsidies.

196. The United States argues that the only subsidies governed by Article XVI:3 are export subsidies.[255] This argument misreads Article XVI:3. Although the first sentence of Article XVI:3 refers to "subsidies *on* the export of primary products," the second sentence provides:

> "If, *however*, a contracting party *grants directly or indirectly any form of subsidy which operates to increase the export* of any primary product from its territory . . ."

The word "however" is important, as it signifies that the second sentence contradicts the first and does not follow from it. Similarly, the use of the phrase "on the export of primary products" in the first sentence of Article XVI:3 is quite different from the phrase "which operates to increase the export of" in the second sentence of Article XVI:3. The notion of "on the export" is analogous to the export contingency set out in Article 3.1(a) of the SCM Agreement. However, the phrase "which operates to increase the export of" does not contain an export contingency requirement. Rather, it focuses on *effects* – whether the subsidies have the effect of increasing exports. Thus, read in light of the SCM Agreement, the second sentence of Article XVI:3 encompasses a notion of export-related subsidies that is far broader than subsidies that are "contingent upon export performance;" it includes as "export subsidies" those that operate to increase exports.

[254] Brazil's 9 September Further Submission, Annex I, Tables 5a-5g.
[255] US 7 October Oral Statement, para. 61.

197. Indeed, the reading of the second sentence of Article XVI:3 as meaning "subsidies contingent upon the export of products" would render Article XVI:3 a nullity. This is because under the US interpretation, any form of subsidy covered by the second sentence of Article XVI:3 would already be deemed prohibited as an export subsidy under Article 3.1(a). Given Article 13 of the Agreement on Agriculture, GATT Article XVI:3 is clearly intended to continue to provide rights and obligations for Members. Further, Article XVI is not a prohibited subsidy provision – it is an *actionable* subsidy provision. The subsidies and the provisions of Article XVI that are not superceded by the provisions of the SCM Agreement or the Agreement on Agriculture[256] must be read consistent with the *actionable* subsidy provisions of Article 5 of the SCM Agreement. Article 5 makes no distinction between subsidies that are contingent upon export and those that are not.

198. With respect to the Panel's second question, the title of Section B is not determinative. In light of the use of the phrase "any form of subsidy" in the second sentence of Article XVI:3, the title of Section B is properly read as encompassing any subsidies that have any effect on a Member's exports – whether they be "export subsidies" contingent upon export or whether they are "export subsidies" having the effect of increasing exports. Finally, Brazil notes that the US argument that places primary reliance on the title of Section B to interpret the second sentence of Article XVI: 3 is also questionable given the fact that Article XVI:5 is also covered by the title of Section B – and it deals with all types of subsidies covered by Article XVI.

199. With respect to the Panel's reference to Article 21 of the Agreement on Agriculture, Brazil does not believe that it is particularly relevant. As the Appellate Body noted in the *EC – Bananas* case, Article 21 of the Agreement on Agriculture provides that the provisions of GATT 1994 and the other multilateral trade agreements on trade in goods "*shall apply* subject to the provisions of this Agreement".[257] The drafters of the WTO Agreement did not intend agricultural trade to be a GATT-free zone – quite the opposite. They simply provided transitional provisions in Article 13 of the Agreement on Agriculture to moderate the application of some GATT provisions, strictly on a temporary basis. [258]

200. Article 13 of the Agreement on Agriculture is not that relevant in providing guidance regarding whether domestic support measures are included within the meaning of "any type of subsidy" under Article XVI:3, second sentence. Article 13(b)(ii) exempts non-green box domestic support only from actions based on paragraph 1 of GATT Article XVI, and does not directly exempt Article XVI:3. However, Article XVI:1 and 3 must be read together in order to assert a claim of serious prejudice.[259]

201. Article 13(c)(ii) of the Agreement on Agriculture provides that during the "implementation period", export subsidies that conform fully to Part V, as reflected in a Member's Schedule, are exempt from "actions" based on Article XVI. By implication, such export subsidies *are* subject to actions under Article XVI after the expiry of the peace clause and will be subject to such actions as of the time that the Panel issues its ruling. The same applies for green box domestic support under Article 13(a)(ii). Those subsidies are also exempt from actions under GATT Article XVI, including Article XVI:3. But these subsidies can be challenged under Article XVI:3 following the termination of the peace clause.

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the *SCM Agreement,* or in any other**

[256] *See US- FSC*, WT/DS108/AB/R, para 117 *quoted* in Question 185(a).
[257] Appellate Body Report, *EC – Bananas*, WT/DS27/AB/R, para. 155.
[258] Appellate Body Report, *EC – Bananas*, WT/DS27/AB/R, para. 155.
[259] Brazil's 7 October Oral Statement, para. 59 (arguing that Articles XVI:1 and 3 are directly linked).

**provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in *US-FSC*, para. 117[260] here?**

**Brazil's Answer:**

202. Brazil agrees that Article 6.3(d) reflects one of the situations that would also fall under GATT Article XVI:3. An increase in the world market share compared to the previous three-year average through the effects of subsidies would be consistent with a finding of an inequitable share of world trade under GATT Article XVI:3. However, an increase over the previous three-year average is not a necessary prerequisite for a finding of a violation of GATT Article XVI:3. For example, a Member's share of world export trade may be inequitable even if that share has not increased over the average of the past three years. Similarly, a Member's increase in exports may be inequitable even if an increase in exports has not followed a consistent trend, as required under Article 6.3(d).

203. GATT Article XVI:3 is concerned with whether a particular level of a Members' share of world export trade is equitable, whereas Article 6.3(d) of the SCM Agreement only addresses an *increase* in the share. Article 6.3(d) creates a presumption that an increase in a Member's world market share over its previous three-year average that follows a consistent trend over a period when subsidies have been granted nullifies and impairs other Member's rights. No such presumption exists for Article XVI:3 – the nullification and impairment must be demonstrated by showing that the share

[260] WT/DS108/AB/R, para 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market." In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* must clearly take precedence over the *exemption* of primary products from export subsidy disciplines in Article XVI:4 of the GATT 1994."

of world export trade is *inequitable*. While a particular situation may – as in this dispute – fall under both provisions, the focus and proof required for both provisions can be different.

204. Thus, Article 6.3(d) of the SCM Agreement subjects a specific subset of the situations covered by GATT Article XVI:3 to the remedy provided in Article 7.8 of the SCM Agreement. But it does not cover *all* of the situations covered by GATT Article XVI:3. This marks the crucial distinction between the provisions on export subsidies in the SCM Agreement that "take precedence" over those in GATT[261] and the provisions on actionable subsidies in both agreements that are complementary.

205. With respect to the Appellate Body's holding in paragraph 117 of *US – FSC*, the provisions on export subsidies in Articles 3 and 4 of the SCM Agreement represent the results of years of negotiations that have pushed the level of obligation in this area well beyond Article XVI:4. The conclusion that the Appellate Body drew in that instance was that "whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the SCM Agreement." Brazil agrees that the provisions of Article XVI:2-4 that deal with subsidies contingent upon export performance are superceded by the respective export subsidy provision contained in the Agreement on Agriculture and in the SCM Agreement.

206. However, as Brazil has argued in response to Question 185(a), the second sentence of GATT Article XVI:3 is not a provision limited to subsidies contingent upon export performance. Rather, its disciplines apply to *any* form of subsidy that operates to increase the exports of a Member. Thus, it is not superceded by the export subsidy provisions of the Agreement on Agriculture and the SCM Agreement. Rather, it provides rights and obligations concerning any form of a subsidy independent of the right and obligations set forth in Article 3 of the SCM Agreement.[262]

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the *SCM Agreement* and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?**

Brazil's Answer:

207. The short answer is "not at all." What is important for the Panel to consider is the entire package of Uruguay Round agreements, including the GATT 1994 and the contemporaneous SCM Agreement, not what was in GATT 1947.

208. Every agreement attached to the WTO Agreement is contemporaneous with every other attached agreement. The GATT 1947 no longer binds WTO Members; what is binding is the GATT 1994. The SCM Agreement and the GATT 1994 must be read together, and each provides "context" for interpreting the other, in the sense of Article 31(2) of the Vienna Convention on the Law of Treaties. As the Appellate Body noted in *Argentina – Footwear*[263], and as is now well established, the WTO Agreement is a single undertaking. All WTO obligations are, therefore, generally cumulative, and Members must comply with all of them simultaneously: "It is important to understand that the WTO Agreement is *one* treaty."[264] Thus, in as far as GATT Article XIX and the Agreement on Safeguards apply cumulatively, GATT Article XVI and the SCM Agreement apply cumulatively.

[261] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 117.
[262] *See* GATT Panel Report, *EC – Sugar Exports (II)*, para. V.(g).
[263] Appellate Body Report, *Argentina – Footwear Safeguards*, WT/DS121/AB/R, paras. 82-84.
[264] Appellate Body Report, *Korea – Dairy Safeguards*, WT/DS98/AB/R, para. 74-75; quotation from para. 75 (emphasis added).

Brazil refers the Panel to its Answer to Question 185(a) for a further discussion of the issues relevant to Question 185(c).

N. CLARIFICATIONS

**189. Please indicate whether the correct figure in paragraph 37 of Brazil's 7 October oral statement is 38.1 per cent or 38.3 per cent? BRA**

Brazil's Answer:

209. Brazil confirms that the correct figure in paragraph 37 of Brazil's 7 October Oral Statement is 38.3 per cent, *i.e.*, that the US world market share in MY 2001 was 38.3 per cent.[265]

**190. Please confirm that the figure "17.5" in paragraph 43 of Brazil's 7 October oral statement, is "percentage point". BRA**

Brazil's Answer:

210. Brazil confirms that the figure "17.5" in paragraph 43 of Brazil's 7 October Oral Statement refers to an increase by 17.5 percentage points in the world market share. Brazil further notes that – as explained in note 468 to Figure 26 of its 9 September Further Submission – the world market share refers to the world market share in the international cotton market, including the upland cotton and extra-long staple cotton market, as data on upland cotton only is not available to Brazil. However, given the small size of the extra-long staple market as compared to the upland cotton market, this only minimally distorts the data.[266]

**191. Could Brazil clarify its statement in para. 12 of its 9 September further submission: "Alternatively crop insurance is not specific because the 2000 ARP Act denies benefits to commodities representing more than half of the value of US agriculture. Further US crops represent only 0.8 per cent of total US GDP." (emphasis added) BRA**

Brazil's Answer:

211. Brazil thanks the Panel for bringing to its attention the error in paragraph 12 of its 9 September Further Submission. As clarified in paragraphs 67-69 of the same submission, Brazil meant to state that "[a]lternatively, crop insurance *is specific* because the 2000 ARP Act denies benefits to commodities representing more that half of the value of US agriculture" (emphasis added).

[265] Exhibit Bra-206 (Data on Article 6.3(d) claim).
[266] *Compare* Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 2-7).

# ANNEX I-6

## ANSWERS OF THE UNITED STATES TO QUESTIONS FROM THE PANEL TO THE PARTIES FOLLOWING THE SECOND SESSION OF THE FIRST SUBSTANTIVE PANEL MEETING

27 October 2003

### A. REQUEST FOR PRELIMINARY RULINGS

**122. Does Brazil allege that cottonseed payments, interest subsidies and storage payments are included in the subsidies that cause serious prejudice? Do they appear in the economic calculations? BRA**

**123. Does Brazil's request for the establishment of the Panel name the statute authorizing cottonseed payments for the 1999 crop? BRA**

### B. EXEMPTION FROM ACTIONS

**124. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture? BRA, US**

1. The scheduled issuance of the Panel's report after the end of the 2003 calendar year has no impact on the applicability of Article 13(a)(ii), (b)(ii) and (c)(ii) of the Agreement on Agriculture to the US measures in this dispute. There is no question, and Brazil has not contested, that Article 13 was in effect at the time of the Panel's establishment, and the Panel's terms of reference set on that date are to examine the matter raised in Brazil's panel request in light of the covered agreements, which include the Agreement on Agriculture.

2. As a separate matter not presented by this dispute, the United States notes that the commitments of the United States with respect to cotton are specified by *marketing* year, not calendar year. Therefore, the end of the 2003 calendar year would in any case not be relevant to the question of when the provisions of Article 13 cease to have effect with respect to US support measures for upland cotton.[1]

### C. IDENTIFICATION OF THE SUBSIDIZED PRODUCT

**125.**

**(1) In view of requirements in the FAIR Act of 1996 and the FSRI Act of 2002 that contract acreage remain in agricultural or conservation uses and which impose penalties if the producer grows fruits or vegetables, how likely is it that the producer with upland cotton base acreage will not use his or her land to produce programme crops or covered commodities? US**

[1] *See* Agreement on Agriculture Article 1(i) ("'[Y]ear' in paragraph (f) above and in relation to the specific commitments of a Member refers to the calendar, financial or marketing year specified in the Schedule relating to that Member.")

3. With respect to contract acreage on a farm, the 2002 Act generally allows any commodity or crop to be planted on base acres on a farm for which direct payments are made, with limitations for certain commodities (fruits, vegetables (other than lentils, mung beans, and dry peas), and wild rice). With some exceptions, planting of those limited commodities on base acres is prohibited and could lead to reduced or eliminated direct payments.[2] Otherwise, a producer (or landowner) is permitted to make any other use of the land so long as the land on the farm in a quantity equal to base acreage is used for an agricultural or conserving use.[3] Thus, the direct payment recipient has the flexibility to plant and harvest any other commodity or crop on the land representing their upland cotton base acreage; indeed, direct payment recipients may plant nothing at all and still receive payment. (We note that the foregoing description of the "planting flexibility" under the 2002 Act is relevant only to base acres on a farm for which direct payments are made; other acres on the farm need not comply with any of the contract requirements set out in Sections 1105 and 1106 of the 2002 Act.)

4. The data demonstrate that planting and harvesting decisions by US producers result in US upland cotton area varying significantly. In marketing year 2003, for example, US farmers planted 13,748,000 acres, a decline of 11.3 per cent from the recent high reached in marketing year 2001.[4] As indicated in the US closing statement at the second session of the first panel meeting, US harvested acreage largely increases and decreases in line with the rest of the world.[5] In marketing year 2001, US area harvested increased by almost the exact same percentage as did the rest of the world. In marketing year 2002, the per cent decline in harvested acreage in the United States was *greater* than that observed in the rest of the world. Thus, regardless of whether US farmers who plant upland cotton may also be holders of upland cotton base acres, and contrary to Brazil's assertions, US farmers respond to market signals by planting or harvesting upland cotton much as producers in the rest of the world do.

**(2) Brazil has submitted that "The record suggests that historic producers are current producers." It points to factors including the specialization of upland cotton producers, the need to recoup expensive investments in cotton-specific equipment, and the geographic focus and climatic requirements of upland cotton production in the "cotton belt". (Brazil's rebuttal submission, footnote 98, on page 24)**

**(a) Regarding the specialization of upland cotton producers and the geographic focus of upland cotton production, how does Brazil take account of the fact that cotton is produced in 17 of the 50 states of the United States and that average cotton area is approximately 38% of a cotton farm's acres? (This information is taken from the US's response to question 67bis, footnote 35). BRA**

**(b) Regarding the geographic focus of upland cotton production, how many other crops can upland cotton producers viably grow in the cotton belt, other than fruits and vegetables? US**

5. Based on planted acreage data as reported by National Agricultural Statistics Service[6], US upland cotton is produced in several diverse regions across the Cottonbelt, generally known as the Southeast, Delta, Southwest, and West regions. Across the regions (as well as within a given region), producers are faced with differing physical growing environments as well as economic factors that help determine the viability of upland cotton or some other alternative crop in any given year. Over

[2] *See* US Answer to Question 26 from the Panel, para. 56.

[3] 2002 Act, § 1105(a)(1)(D) (Exhibit US-1).

[4] US Department of Agriculture, National Agricultural Statistics Service, *Acreage*. Cr Pr 2-5 (6-03). June 30, 2003. Available at: http://usda.mannlib.cornell.edu/reports/nassr/field/pcp-bba/acrg0603.pdf

[5] *See* US Closing Statement at the Second Session of the First Panel Meeting, paras. 5-6; Exhibit US-63.

[6] See Exhibit Q125(2)(b).

the last several years, producers have reduced plantings of upland cotton and increased plantings to alternatives. A list of the full range of alternative crops that are viable in these areas would be extensive. Below we present a regional breakdown of some principal alternative crops to upland cotton as well as historical plantings since 1996 of these crops compared with upland cotton.

6. Upland cotton producers in the Southeast region (Alabama, Florida, Georgia, North Carolina, South Carolina, and Virginia) have corn and soybeans as principal alternative crops. Peanuts are also an alternative, though mainly in Georgia. Between 1996 and 2003, area planted to upland cotton, corn, and soybeans in the Southeast averaged about 8.6 million acres, ranging from 8.2 to 9.1 million acres. During this same period, upland cotton area ranged from 3.0 to 3.6 million acres. Since 2001, upland cotton has been reduced in favour of corn and soybeans in this region.

7. Upland producers in the Delta region (Arkansas, Louisiana, Mississippi, Missouri, and Tennessee) also have corn and soybeans as an alternative and, to a lesser extent, rice in some areas. Between 1996 and 2003, area planted to these 4 crops averaged 22.9 million acres, ranging from 22.2 to 23.8 million. At the same time, upland cotton area ranged from 3.2 to 4.6 million acres. Like the Southeast region, the Delta area planted to upland has declined since 2001 in favour of corn and soybeans.

8. The Southwest region (Texas, Oklahoma, and Kansas) has the most diverse growing environment of the 4 regions. In the northern part of the region – where most of upland cotton is grown – principal alternatives to upland cotton may include wheat and sorghum. In the southern part, however, corn, soybeans, and sorghum are generally an alternative to upland cotton. The Southwest region planted an average of 26.3 million acres to these 5 crops between 1996 and 2003.[7] Area ranged from 24.5 to 27.9 million acres during this period. Meanwhile, upland cotton area ranged from 5.7 to 6.7 million acres. Since 2000, upland area in the Southwest has fallen in favour of sorghum, wheat, and corn.

9. In the West region (California, Arizona, and New Mexico), upland producers have a variety of alternatives, including corn, extra-long staple (ELS) cotton, alfalfa, and wheat. Between 1996 and 2003, area planted to these 5 crops averaged 4.3 million acres in the region, ranging from 4.0 to 4.6 million. At the same time, upland cotton area has ranged from 0.7 to 1.4 million acres. The last several years, however, have seen upland area decline in favour of one or more of the alternative crops.

**(c) Regarding the high cost of upland cotton production, can Brazil show that farms who planted upland cotton could only have covered their costs by receiving upland cotton, rice or peanut payments in every year from 1999 through 2002? BRA**

**(d) Regarding the need to recoup investments in cotton-specific equipment, is it important to planting decisions that upland cotton producers cannot run any other crop through their cotton-pickers? How does this affect the likelihood that they will grow other crops? US**

10. **The National Agricultural Statistics Service (NASS) reported that in 2002, farmers paid an average of $225,000 for a cotton picker**.[8] Farmers may respond to machinery costs through the contracting-out of harvesting operations and rental or leasing of cotton-picking machinery.

[7]To be conservative, we have excluded Kansas wheat and sorghum acreage from the totals presented due to the state's large production of these crops and relatively small production of cotton.

[8] US Department of Agriculture, National Agricultural Statistics Service, *Agricultural Prices 2002 Summary*. Pr 1-3 (03)a July 2003. Available at: http://usda.mannlib.cornell.edu/reports/nassr/price/zap-bb/agpran03.pdf

11. In the short run, investment costs may slow acreage adjustments to market prices. This does not mean, however, that cotton producers do not respond to changes in market prices. Research by Lin et al. suggest that cotton producers may, in fact, be more responsive to own price changes (that is, the response of cotton acreage to changes in cotton prices as opposed to changes in prices of competing crops) **than other competing crops** are.[9] In the long run, fixed assets like cotton pickers are less of a constraint to entry, and thus one would expect the acreage response to changes in price to be larger.

**Acreage own-price elasticity for major field crops**

| Crop | National acreage price elasticity |
|---|---|
| Wheat | 0.34 |
| Corn | 0.293 |
| Sorghum | 0.55 |
| Barley | 0.282 |
| Oats | 0.442 |
| Soybeans | 0.269 |
| Cotton | 0.466 |

Source: Lin *et al*., Appendix table 21 (Exhibit US-64).

**(3) In calculating the amount of PFC, MLA, direct and counter-cyclical payments that went on upland cotton, Brazil made an adjustment for the ratio of current acreage to base acreage (see its answer to question 67, footnotes 2, 3, 4 and 5). Is this an appropriate adjustment for the particular factors referred to above? Why or why not? BRA, US**

12. Brazil's adjustment is not appropriate. It does not explicitly take into account any of the factors referred to above. Instead, Brazil's belated adjustment is simply based on the assumption that all of the planted cotton acreage was by producers who had cotton base acreage exactly equal to their planted acreage. This assumption is inaccurate and causes Brazil's figures to be in error. For some producers, cotton planted acres exceed their historical base, and some cotton acres are planted by producers who have no cotton base. As noted in the US further submission, important changes such as lowered costs from pest eradication and adoption of biotechnology have lowered costs and brought new areas and farmers into cotton production. Brazil's adjustment takes no account of these changes.

13. More fundamentally, the relevant point is that any producers who have upland cotton base will receive direct and counter-cyclical payments regardless of whether they plant upland cotton. Thus, the decision to plant upland cotton will be based on expected economic returns of cotton and competing crops – not the level of direct and counter-cyclical payments that are decoupled from the decision to produce upland cotton. And the fact that these are decoupled payments means that the amount of the payment could not in any event be allocated only to cotton production.

**(4) Dr. Glauber has alleged that there are statistical problems in comparing planted acres to programme acres because of abandonment of crops and also because planted acres are only survey estimates, not reported figures (See Exhibit US-24, the first full paragraph in P2). Would it be more appropriate to divide harvested acreage by base acreage? What margin of error is there between the survey estimates and reported figures? BRA, US**

14. Exhibit US-24 outlines the statistical problems associated with dividing complying base acres by planted acres. The discussion addressed complying base acres under the Acreage Reduction Programme of 1990 Farm Bill and did not address programme payment acres as defined under the

[9] **Lin, W., *et al.*. *Supply Response Under the 1996 Farm Act and Implications for the US Field Crops Sector.* US Department of Agriculture, Economic Research Service, Technical Bulletin No. 1888**, Appendix table 21 (Exhibit US-64).

1996 Farm Bill. Dividing harvested acreage by base acreage could potentially overstate the difference if there is significant acreage abandonment after producers reported their payment acres to the Farm Service Agency. Also, there remains a problem with the comparison since harvested acres are survey-based while base acres are reported numbers.

15. In the June *Acreage* report, the National Agricultural Statistics Service reports reliability estimates for selected crops. The **reliability of acreage estimates is computed by expressing the deviations between the planted acreage estimates and the final estimates as a per cent of the final estimates and averaging the squared percentage deviations for the 1983-2002 twenty-year period; the square root of this average becomes statistically the "Root Mean Square Error." Probability statements can be made concerning expected differences in the current estimates relative to the final estimates assuming that factors affecting this year's estimate are not different from those influencing the past 20 years. For example, the "Root Mean Square Error" for the upland cotton planted estimate is 2.4 per cent. This means that chances are 2 out of 3 that the current cotton acreage will not be above or below the final estimate by more than 2.4 per cent. NASS reports that the 90 per cent confidence interval for the upland cotton estimate is 4.1 per cent. This means that chances are 9 out of 10 (90 per cent confidence level) that the difference will not exceed 4.1 per cent**.[10]

**(5) Do the acreage reports under section 1105(c) of the FSRI Act of 2002 indicate or assist in determining the number or proportion of acres of upland cotton planted on upland cotton base acres? Was there an acreage reporting requirement for upland cotton during MY1996 through 2002? BRA, US**

16. The acreage reports filed under Section 1105(c) of the 2002 Act by farms receiving direct and counter-cyclical payments indicate what crops are planted on a farm. A farm is an administrative construct that consists of tracts of land that are operated as one unit. The farm may be operated by more than one producer, and a producer may produce crops on more than one farm. The acreage report does not indicate the quantity of base acres on the farm. Because the acreage reports are filed after the planting season but before the harvest, the reports do not contain information on the quantity of production on each farm.

17. Based on a very preliminary review of a sampling of marketing year 2002 acreage reports, the United States estimates that roughly 53 per cent of farms that were eligible for direct and counter-cyclical payments for upland cotton base acreage also planted at least one acre of upland cotton in 2002. That is, approximately 47 per cent of farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all.

18. Over the period 1996 through 2002, there was no statutory requirement for acreage reports by recipients of decoupled payments or marketing loan payments. By regulation, producers who signed up for disaster assistance or who received marketing loan benefits (including loan deficiency payments) were asked to file planting acreage reports. Reports for producers receiving disaster assistance were to cover all acreage on the farm while reports for producers receiving marketing loan benefits were to cover only acreage for the crop receiving benefits. As a result, acreage reports over the period of the 1996 Act are incomplete.

**(6) Please prepare a chart showing upland cotton base acreage, planted acreage and harvested acreage for MY1996 through 2002. Does the planted acreage fluctuate within a broad band? If not, does this indicate any stability in decisions to plant the same acres to upland cotton? BRA, US**

[10] US Department of Agriculture. National Agricultural Statistics Service. *Acreage.* CrPr 2-5 (6-03). 30 June 2003. Pp 38-39.

19. The following chart shows upland cotton base acreage, planted acreage and harvested acreage for marketing years 1996 through 2002:

**US upland cotton area (thousand acres)**

| Crop year | Base acreage 1/ | Planted acreage 2/ | Harvested acreage 2/ |
|---|---|---|---|
| 1996 | 16128 | 14395 | 12632 |
| 1997 | 16213 | 13648 | 13157 |
| 1998 | 16412 | 13064 | 10449 |
| 1999 | 16377 | 14584 | 13138 |
| 2000 | 16268 | 15347 | 12884 |
| 2001 | 16239 | 15499 | 13560 |
| 2002 | 16217 (est.) | 13714 | 12184 |

1/ US Department of Agriculture, Farm Service Agency
2/ US Department of Agriculture, National Agricultural Statistics Service, selected Acreage reports

20. Over the period 1996-2002, US upland cotton planted acres ranged considerably, from 13,064,000 acres to 15,499,000 acres. Year-over-year, planted and harvested acreage can rise or fall significantly. For example, from marketing year 2001 to marketing year 2002, planted acreage fell by 1.785 million acres or 11.5 per cent; harvested acreage fell by 1.376 million acres or 10.1 per cent. As was pointed out in the US closing statement at the second session of the first substantive meeting of the Panel and in Exhibit US-63, year-over-year changes in US harvested cotton acreage have been similar to year-over-year changes for harvested cotton acreage outside of the United States. These data do not provide any information on whether the same or different acres are planted to upland cotton.

21. As noted above in the US answer to Question 125(5), based on a preliminary review of a sampling of marketing year 2002 acreage reports, it would appear that nearly half of farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all. That so many farms that produced upland cotton during the historical base period of 1993-1995 or 1998-2001 no longer plant even a single acre of upland cotton suggests that there has been a large exit of past cotton producers and a large entry of new producers or a large expansion by other historical cotton producers.

**(7) Brazil states that one third of all US farms with eligible acreage decided to update their base acreage under the direct payments and counter-cyclical payments programmes using their MY1998-2001 acreage. What is the proportion of the current base acreage for upland cotton resulting from such updating? Is the observed updating of base acreage consistent with Brazil's argument that it is only profitable to grow upland cotton on base acreage (and peanut and rice base acreage)? BRA**

**(8) How could one take account of upland cotton producers who receive PFC, MLA, direct and counter-cyclical payments for other covered commodity base acreage? BRA, US**

22. Under Brazil's approach, one would need to take account of upland cotton producers receiving decoupled payments only for base acreage for other covered commodities. This follows from Brazil's explanation that "only the portion of upland cotton [decoupled] payments that actually benefits acres planted to upland cotton can be considered support to upland cotton".[11] Thus, under Brazil's approach, one would need to deduct any production (or acreage) attributable to such producers from the acreage figures Brazil has used to adjust the amount of decoupled payments on upland cotton base acreage.

[11] Brazil's Answer to Question 67 from the Panel, fn. 2-5.

**(9) Assuming that Brazil's payment figures were to amount to a prima facie case, please answer the following questions: US**

**(a) How would the United States calculate or estimate the proportion of upland cotton producers who receive subsidy payments for upland cotton base acreage?**

**(b) Should any adjustment estimates be made for any factors besides those listed by Brazil?**

**(c) What adjustment estimate would it be appropriate to make?**

**(d) How could one take account of upland cotton producers who receive decoupled payments for other programme crop base acreage?**

**(e) Could the US specifically indicate what, in its view, are the flaws in the approach summarized in paras. 6-7 of Brazil's closing oral statement on 9 October (i.e. the use of the ration of 0.87 to adjust the amount of total upland cotton direct and CCPs for the MY to obtain the amount of subsidies received by upland cotton producers)? Can the US suggest an alternative approach that would yield reliable results in its view?**

23. Putting Peace Clause and green box issues to one side, the United States believes that the issue of what payments may be attributed to upland cotton production is fundamentally part of Brazil's burden to present evidence substantiating the amount of the subsidy that it is challenging. However, the United States would note that this issue is not a matter of "the proportion of upland cotton producers who receive subsidy payments for upland cotton base acreage." Rather, the issue is, first, what is the quantity of decoupled payments received by upland cotton producers; second, how are those payments allocated across the total value of each farm's agricultural production; and third, how much and in what amount are US cotton exports subsidized by these payments.

24. Brazil has conceded that decoupled payments made with respect to upland cotton base acreage are not "tied to the production or sale" of upland cotton, by adjusting such payments by 0.87.[12] That is, Brazil recognizes that, even on its theory, at least 0.13 of these payments "can[not] be considered support to upland cotton" because at least that fraction of upland cotton base acres were not planted to upland cotton in marketing year 2002. Because these payments are not "tied to the production or sale" of upland cotton, as suggested by Annex IV of the Subsidies Agreement, they must be allocated across the total value of production of each recipient. Brazil has not denied the applicability of the allocation methodology set out in Annex IV, but neither has Brazil provided any evidence relating to the total value of production of decoupled payment recipients.[13]

25. Brazil claims that its "suggested methodology is based on the conclusion that all upland cotton producers received these payments".[14] In fact, Brazil's methodology is based on the further assumptions that (1) every acre of upland cotton in marketing year 2002 was planted by a holder of upland cotton base acreage and (2) no such base acreage holder planted more upland cotton than his or her base acres.[15] Brazil has provided no evidence to support these assumptions, which is no

[12] In addition to issues relating to the "adjustment," the United States disagrees with the total amount of decoupled payments paid with respect to upland cotton base acreage that Brazil calculates and uses as the base for its adjusted payment amounts. *See* US Answer to Additional Question 67*bis* from the Panel, para. 28, fn. 37, 38.

[13] As noted in the Panel's Question 125(2)(a), average cotton area is approximately 38 per cent of a cotton farm's acres. Thus, a substantial portion of the average cotton farm's agricultural production will be derived from production of other crops.

[14] Brazil's Closing Statement at the Second Session of the First Panel Meeting, para. 8.

[15] Using figures for marketing year 2002 planted acreage and base acreage, Brazil claims, "Out of the 16.2 million upland cotton base acres, 2.1 million were not planted to upland cotton in MY2002." Brazil's Closing Statement at the Second Session of the First Panel Meeting, para. 6. However, given the planting and

surprise since the evidence is to the contrary. For example, the fluctuations in upland cotton planted and harvested area in recent years and the fact that one-third of all US farms with eligible acreage decided to update their base acreage using their MY1998-2001 acreage, imply substantial new entrants or new acreage that were not included in the base period figures under the 1996 Act. In fact, as noted above in the US answer to Question 125(5), based on a preliminary review of marketing year 2002 acreage reports, the United States estimates that nearly half of all farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all.

26. We also note that there are substantial requirements with which a payment recipient must comply (see US answer to Question 162), such as highly erodable cropland conservation requirements and wetland conservation requirements.

D. "LIKE PRODUCT"

**126. Does the US agree that the product at issue is upland cotton lint and that Brazilian upland cotton lint is "like" US upland cotton lint within the meaning of Article 6.3(c) of the SCM Agreement in that it is a separate like product that is identical or has characteristics similar to the upland cotton lint from the United States? (e.g. Brazil's further submission, para. 81) US**

27. For purposes of this dispute, the United States is not arguing that all US cotton is "unlike" Brazilian cotton. There are some grades of cotton that both produce. Such grades would have similar characteristics although, as noted by Mr. Ward at the second session of the first panel meeting, Brazilian lint has been sold in the past at a substantial discount to the New York futures price. That discount has been declining over time as Brazil, a relatively new supplier internationally, works to establish a reputation for quality and reliability.

**E. "SUBSIDIES"**

**127. The Panel notes that the US contests that export credit guarantees constitute "subsidies". The Panel recalls that the US agrees that Step 2 payments are "subsidies" and wishes to have confirmation that it is correct in understanding that the US does not disagree that the following are "subsidies" for the purposes of Article 1 of the SCM Agreement: marketing loan/loan deficiency payments, PFC, direct payments, market loss assistance and CCP payments, crop insurance payments, cottonseed payments, storage payments and interest subsidy (without prejudice to the Panel's rulings on the US requests for preliminary rulings on the latter two payments). US**

28. With respect to marketing loan payments, the United States agrees that these product-specific amber box payments that are made to producers of upland cotton for the production of upland cotton are subsidies within the meaning of Article 1 of the Subsidies Agreement.

29. With respect to crop insurance payments, through which the United States pays a portion of the crop insurance premium for producers, the United States agrees that these amber box payments are subsidies within the meaning of Article 1 of the Subsidies Agreement. We note, however, that these payments are not product-specific because they are not made to upland cotton producers for the production of upland cotton. Rather, they are non-product-specific support made to "producers in general" (that is, generally). Further, these crop insurance payments are not specific within the meaning of Article 2 of the Subsidies Agreement because they are available with respect to all

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base acreage numbers, the most Brazil can logically claim is that "*at least* 2.1 million [base acres] were not planted to upland cotton in MY2002". That is, if in 2002 new producers without base acres planted upland cotton or if some historical producers planted more than their base acres, then some portion of the 14.1 million planted acres in MY2002 were not planted "on" upland cotton base acres.

agricultural products for which policies are offered by private companies. Therefore, pursuant to Article 1.2, this "subsidy" is not subject to the provisions of Part III of the Subsidies Agreement.

30. With respect to cottonseed payments, we recall that these payments are not within the terms of reference of the Panel.[16] With respect to "other payments" for upland cotton notified by the United States to the WTO – that is, storage payments and interest subsidy – the United States also recalls that these payments are not within the Panel's terms of reference.[17] Without prejudice to the US request for preliminary rulings on these three types of payments, the United States considers that these product-specific amber box payments are subsidies within the meaning of Article 1.

31. With respect to green box production flexibility contract payments under the 1996 Act and direct payments under the 2002 Act, the United States does not consider that Brazil has demonstrated what is the amount of the subsidy attributable to upland cotton producers pursuant to Article 1. Article 1 requires that a financial contribution by a government or public body or income or price support confers a benefit. The subsidies Brazil challenges are subsidies to producers, users, and/or exporters of upland cotton. However, Brazil has not identified the portion of the production flexibility contract payments that is properly attributable to upland cotton producers as opposed to other recipients of this subsidy. In fact, Brazil concedes that the entire amount of these payments does not confer a benefit on upland cotton producers by reducing the amount of production flexibility contract payments and direct payments on upland cotton base acres by the proportion 14/16. However, Brazil has provided no evidence of the amount of these decoupled payments received by producers that currently produce cotton. Nor has Brazil demonstrated how much or to what extent US cotton exports are subsidized.

32. With respect to *ad hoc* market loss assistance and counter-cyclical payments under the 2002 Act, the United States also does not consider that Brazil has demonstrated what is the amount of the subsidy attributable to upland cotton producers pursuant to Article 1. Specifically, as with production flexibility contract payments and direct payments, Brazil has not identified the portion of the subsidy that is properly attributable to producers of upland cotton as opposed to other recipients of this subsidy. Brazil has not identified the benefit to upland cotton producers conferred by these payments. Rather, Brazil merely assumes that for every upland cotton harvested acre, upland cotton producers had a corresponding upland cotton base acre. However, Brazil has provided no evidence of the amount of these decoupled payments received by producers that currently produce cotton.

## F. PROHIBITED SUBSIDIES

**128. Could the US respond to Brazil's assertions relating to the meaning and effect of the introductory phrase of Article 3 ("Except as provided in the Agreement on Agriculture....")? Would the meaning/effect change if Article 13 of the Agreement on Agriculture did not exist? BRA, US**

33. It is not entirely clear to the United States to which assertions of Brazil the Panel refers in its question. Moreover, the United States does not believe Brazil has purported to ascribe a specific meaning to that particular phrase. Indeed, with respect to Article 3.1(b), Brazil's arguments would effectively delete the introductory phrase in its entirety.[18]

## G. SPECIFICITY / CROP INSURANCE

**129. In the event that the Panel does not consider that the alleged prohibited subsidies fall within the provisions of Article 3 and are therefore, pursuant to Article 2.3, "deemed to be**

[16] *See, e.g.*, US Further Submission, para. 8.
[17] *See* US Further Submission, paras. 6-7.
[18] See Answer of the United States to Panel Question 144, *infra*.

**specific", are there any other grounds on which Brazil would rely in order to support the view that such measures are "specific" within the meaning of Article 2 of the SCM Agreement (see, for example, fn 16 of Brazil's further submission)? BRA**

**130. Does Brazil agree that the US insurance premium subsidy is available in respect of all agricultural products? Please cite relevant portions of the record. BRA**

**131. How should the concept of specificity - and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the SCM Agreement apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the SCM Agreement: BRA, US**

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

34. The United States does not regard a domestic subsidy as being specific solely because the subsidy is limited to the agricultural sector. As previously noted, this proposition is codified in the US countervailing duty regulations, at 19 C.F.R. § 351.502(d). Thus, the United States is of the view that the agricultural sector is too broad and too diverse to constitute a single "enterprise or industry or group of enterprises or industries".

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

35. It is difficult to opine on this question in the abstract. However, this fact pattern does not apply to the US insurance premium subsidies, which are also available in respect of livestock.

**(c) is a subsidy in respect of certain identified agricultural products specific?**

36. It is difficult to opine on this question in the abstract. However, this fact pattern does not apply to the US insurance premium subsidies since the premium subsidy is a single subsidy programme available in respect of all products (while policies issued by private parties are in certain instances available in respect of certain identified products).

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

37. The United States assumes that this would require that the subsidy be limited to certain entities or the upland cotton industry and so would be specific. This fact pattern, however, does not apply to the US insurance premium subsidies since the premium subsidy is a single subsidy programme available with respect to all products (while policies issued by private parties are in certain instances available in respect of certain identified products).

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

38. In principle, a subsidy that is limited to a sufficiently small proportion of US commodities would be "limited", and, thus, "specific" within the meaning of Article 2.1(c). However, the Subsidies Agreement does not establish any quantitative standards for determining when a subsidy is so limited, and a proposal to establish such standards was rejected during the Uruguay Round. Therefore, the determination must be made on the basis of the facts of the particular case. This is the approach taken by the US Department of Commerce for purposes of the US countervailing duty law.

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

39. This question is not presented in this dispute, but the United States would note that "land" is neither an "enterprise" nor an "industry", and so the proportion of farmland as such would not be appear to be relevant to the analysis under Article 2 of the Subsidies Agreement. The issue also does not appear to fall within the scope of Article 2.2, which deals with regional specificity – that is, "total US farmland" does not correspond to a "designated geographical region".

**132. Please state the amount and percentage of upland cotton acreage covered by each crop insurance programme and/or policy under the ARP Act of 2000. US**

40. There is one crop insurance programme, through which the United States provides premium subsidies on crop insurance policies that are offered by private insurance companies under the authority of the Federal Crop Insurance Act. There is no specific crop insurance programme or policies for cotton authorized under the Agricultural Risk Protection Act of 2000. Within this crop insurance programme, there are different plans of insurance that offer different types of coverage, such as production plans of insurance or revenue plans of insurance. All such plans of insurance are reinsured by FCIC and a premium subsidy paid by the US Government, is available. The amount and percentage of upland cotton acreage covered by each plan of insurance is shown in Exhibit US-65.

**133. Concerning Brazil's arguments in its oral statement, para. 7, can the US indicate if any producers of livestock outside a pilot programme are covered by the crop insurance programme? US**

41. Yes, producers of livestock outside of pilot programmes are covered by the crop insurance programme. In addition, there are policies being developed pursuant to pilot programmes in order to expand the scope of insurance products offered by private insurers to livestock producers. Thus, US crop insurance payments on premiums are made to a broad range of agricultural producers across the agricultural sector, including many livestock producers.

42. Livestock producers are eligible for several forms of "crop insurance" benefits under the provisions of the same operational statute that provides for benefits for "crops". Under the Federal Crop Insurance Act (7 USC 1501-1524), the Federal Crop Insurance Corporation (FCIC), an entity within the US Department of Agriculture, can approve insurance products if there is "sufficient actuarial data" to justify it to producers of "agricultural commodities".[19] *See* 7 USC 1508(a). The Act defines "agricultural commodity" to include a lengthy list of commodities, including such non-plant commodities as "finfish" and "mollusks". The definition also includes any "other agricultural commodity", except stored grain (the crop that produced the grain would be eligible for coverage), as determined by the Board of Directors of FCIC.

43. Thus, FCIC has the authority to offer insurance for livestock under its regular insurance programmes. The FCIC has approved products providing income protection to producers with livestock on t heir farm as contemplated in the statute. In addition, with the enactment of the Agricultural Risk Protection Act of 2000 (ARPA) (Pub. Law 106-224), Congress specifically mandated that FCIC offer pilot programmes for livestock. See 7 USC 1523.

44. The Adjusted Gross Revenue (AGR) product provides protection against low revenue due to unavoidable natural disasters and market fluctuations that occur during the insurance year. Covered farm revenue consists of income from all agricultural commodities, including amounts of income from animals and animal products and aquaculture reared in a controlled environment. To be eligible to purchase an AGR policy, the producer can earn no more than 35 per cent of expected allowable income from animals and animal products. Because the amount of livestock is considered incidental,

[19] *See* 7 US Code § 1508.

the expenditures are not counted against the funding limitations for livestock contained in 7 USC 1523 (which have never been reached).

45. The 35 per cent limit does not apply in the so-called "AGR-lite" programme, which was developed by, and originally available only in, Pennsylvania , the state that developed the policy. However, beginning with the 2004 crop year, an "AGR-lite" product will be expanded to counties in Connecticut, Delaware, Maine, Vermont, Massachusetts, New Hampshire, New Jersey and Rhode Island, and selected counties in West Virginia, New York, and Maryland, as approved by RMA. In all, the AGR-lite programme will now cover about 300 counties. That expansion of AGR-Lite was announced in an 18 August 2003, press release, available on the RMA website.

46. There are at least four kinds of products specifically for livestock available to livestock producers, and they are described at the website of the Risk Management Agency (RMA) (www.rma.usda.gov). There are two different policies that are available for swine producers. The first is Livestock Risk Protect (LRP- Swine). Originally that product was available only in Iowa. RMA recently announced that the policy may be offered to swine producers in 10 additional states: Illinois, Indiana, Kansas, Minnesota, Nebraska, Nevada, Oklahoma, Texas, Utah and Wyoming. The other policy available to swine producers is Livestock Gross Margin (LGM), which is available in Iowa. For cattle, there are two specialized policies available. Livestock producers may purchase a LRP-Feeder Cattle policy in Colorado, Iowa, Kansas, Nebraska, Nevada, Oklahoma, South Dakota, Texas, Utah, and Wyoming. Finally, there are "LRP-Fed Cattle" policies in Illinois, Iowa and Nebraska.

**134. Please state the annual amount of premiums paid or contributions made by US upland cotton farmers relating to each of the crop insurance programmes and/or policies supported by the US Risk Management Agency and the Federal Crop Insurance Corporation in each year from 1992 through 2002. US**

47. Please see Exhibit US-66.

**135. Please state the annual amount of insurance indemnity payments made by the US government; or insurance companies participating in crop insurance programmes and/or policies under the ARP Act of 2000 to upland cotton farmers in each year from 1992 through 2002. US**

48. Please see Exhibit US-67.

**136. Is the US arguing that crop insurance subsidies corresponding to "over 90 per cent of insured cotton area" (US 7 October oral statement, para. 46) in MY1999 through 2002 are consistent with paragraph 8(a) of Annex 2 of the Agreement on Agriculture? Is it correct that in the past these subsidies were nonetheless notified to the Committee on Agriculture as non-product specific AMS (see, for example, G/AG/N/USA/43 in Exhibit BRA-47)? US**

49. The United States has notified crop insurance payments to the Committee on Agriculture as non-product specific support. This is consistent with the US position that crop insurance subsidies are generally available subsidies to the agricultural sector as a whole.[20] In the US oral statement of 7 October 2003, it is pointed out that over 90 per cent of the cotton area currently under the programme is insured at coverage levels of 70 per cent or less of expected yield (or revenue). Over all commodities, almost 70 per cent of total insured area is insured at 70 per cent or less of expected yield or revenue. Thus, associated subsidies would be consistent with paragraph 8(a) of Annex 2 of the Agreement on Agriculture – that is, payments for relief from natural disasters that Members have

[20] US Comments on Brazil's Rebuttal Submission, paras. 34-42; US Rebuttal Submission, paras. 93-98; US Further Submission of September 30, 2003, paras. 14-15.

agreed have no or at most minimal trade-distorting effects or effects on production. The point is made to stress that such subsidies that satisfy green box criteria are likely non-production distorting, contrary to the assertions made by Brazil.

## H. EXPORT CREDIT GUARANTEES

**137. Please elaborate the meaning of "net losses" as is used in paragraph 70 of Brazil's 7 October oral statement. BRA**

**138. Please comment on Brazil's views stated in paragraph 70 of its 7 October oral statement. US**

50. In specific response to Brazil's views stated in that paragraph, the United States invites the attention of the Panel to paragraphs 157-162 of the 22 August US Rebuttal Submission, the table accompanying paragraph 161 of that submission, and paragraphs 144-150 of 30 September Further Submission of the United States. Paragraph 70 of Brazil's 7 October oral statement is simply a recapitulation of arguments it had previously advanced.

51. As noted in paragraph 144 of the US Further Submission, current data for each of the cohorts for 1992, 1993, 1994, 1995, 1996, and 1999 indicates a profit.[21] As stated in OMB Circular No. A-11: "The subsidy cost is the estimated present value of the cash flows . . . resulting from a direct loan or loan guarantee . . . . A positive net present value means that the Government is extending a subsidy to borrowers; *a negative present value means that the credit programme generates a 'profit' (excluding administrative costs) to the Government."*[22]

**139. In the context of export credit guarantees, is the Panel correct in understanding that Brazil's claims of inconsistency with the Agriculture Agreement involve GSM 102, GSM 103 and SCGP, but that it limits its "serious prejudice" allegations in respect of export credit guarantee programmes to the GSM 102 programme, and does not challenge GSM 103 and SCGP in this respect? If so,**

**(a) could Brazil please explain why it did so, and confirm that all the data relied upon in its further submissions (e.g. in Table 13) relate to the GSM 102 programme rather than to GSM 102, GSM 103 and SCGP (and, if the data needs to be adjusted to take account of a narrower "serious prejudice" focus, supply GSM-102-relevant data)? BRA**

**(b) for the purposes of Article 13(c)(ii) of the Agreement on Agriculture, is it necessary for the Panel to examine only GSM 102 or should the Panel's examination include also GSM 103 and SCGP? Why or why not? BRA**

**140. Could Brazil explain how, if at all, it has treated export credit guarantees for the purpose of Table 1 of its further submission? BRA**

**141. The Panel notes the US argument, inter alia in its further submission, that the export credit guarantee programmes are "self-sustaining". Recalling that item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement refers to "premium rates", could the US expand upon how it takes into account the premium rates for the export credit guarantee programmes in its analysis. US**

[21] *See also* US Rebuttal Submission, para. 161 (chart of Subsidy Estimates and Reestimates by Cohort); US Further Submission, fns. 82 and 96.

[22] OMB Circular No. A-11, section 185.2, pp. 185-3 and 185-4 (italics added) (Exhibit Bra-116).

52. Item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement is concerned with whether premium rates are inadequate to cover the long-term operating costs and losses of the programmes. **A rate is applied against a transaction amount to generate revenue to cover any costs and losses. In the context of the export credit guarantee programmes, the premium rate is applied against the volume of a particular transaction to generate revenue. The mere rate as an abstract number cannot generate revenue. Consequently, premium rates as applied to the volume of transactions is necessarily the principal source of programme revenue. In addition, recoveries – whether direct or through rescheduling – are an additional source of revenue. Revenue from all these sources are applied against its operating costs (e.g., administrative expenses) and losses from its claims experience. Alternatively, such recoveries may be viewed not as revenue but as a reduction of loss arising from claims experience. For example, a full recovery of an amount already paid as a claim yields a net loss of zero. Arithmetically, this would yield the same result as treating the recovery as revenue, offsetting the equivalent amount of prior loss.**

53. As the United States noted in footnote 81 of its 30 September Further Submission, Brazil has erroneously argued that item (j) compels consideration only of premiums on the revenue side of the ledger for purposes of covering long-term operating costs and losses. In Brazil's Comment on the US answer to Panel question 77 (para. 94), Brazil states that "item (j) limits the revenue to be used to offset operating costs and losses to 'premium rates'". To the contrary, item (j) envisions an examination of whether premium rates are inadequate to cover long-term operating costs and losses. It does not say that all other revenue must be excluded from the calculation of whether a loss has occurred. Brazil would argue that if the United States paid a claim on day 1 and recouped in full on day 2 the amount it had paid, it could not include such recovery in a determination of whether the programme satisfied item (j). Such a draconian result is economically illogical and certainly not compelled by the text. As noted above, whether the recovery is viewed as revenue or as a subtraction from loss, the net result would be the same, but it must be included in any evaluation of whether premium rates cover long-term operating costs and losses.

54. As the United States further noted in its response to Panel question 77 (11 August Answers to Panel Questions, para. 145), item (j) applies to three different types of programmes: export credits, export credit guarantees, and insurance. In the case of export credit guarantees and insurance, the provider will occasionally incur claims. To the extent such claims or defaults exceed revenue from whatever source it may be derived, the net result would be a loss arising from operations. In an accounting sense such result would constitute an 'operating loss.'.

55. Revenues derived from fees paid in connection with the export credit guarantee programmes form an integral part of the estimate and re-estimate process that currently indicate profitability for each of the cohorts in 1992, 1993, 1994, 1995, 1996, and 1999.[23] The application of the rates in this regard to the analysis is properly extended to 1992, as this is the first fiscal year of applicability of government-wide accounting for federal credit programmes under the Credit Reform Act of 1990. This period also conforms with the period that Brazil recognizes as appropriate for analysis under item (j).[24] As a result of such profitability, the programmes are self-sustaining.

**142. The US has pointed out that there are many limitations on granting export credit guarantees and that there is no requirement to issue any particular guarantee (US further**

[23] *See* Answer of the United States to Panel Question 138, *supra*. *See also* US Rebuttal Submission, para. 161 (chart of subsidy estimates and reestimates by cohort); US Further Submission, fns. 82 and 96.

[24] See First Submission of Brazil (24 June 2003), para. 282: "[A] ten-year period . . . fulfils the criterion of being 'long-term' within the meaning of item (j)." In contrast, no such long-term analysis is possible with respect to the Supplier Credit Guarantee Programme, the regulations for which were first promulgated only on 1 July 1996, with transactions commencing during fiscal year 1997.

**submission, paras 153-156). Can the Commodity Credit Corporation decline to grant an export credit guarantee even in cases where the programme conditions are met? US**

56. A proper response to this question requires one to define by what is meant by "programme conditions". The arguments of Brazil would appear to create a tautological circularity: if one assumes that none of the various discretionary programmatic and budgetary bases that would permit the Commodity Credit Corporation not to issue a particular export credit guarantee are in effect, then can the CCC decline to grant that particular guarantee? Under those circumstances the question itself dictates that the answer must be "no". The United States submits, however, that assuming away all of the real-world bases that would permit CCC to decline issuance of a guarantee is not a proper basis for analysis.

57. The fact remains, as the United States has pointed out, that numerous bases exist for denial of a guarantee.[25] Brazil has argued, however, that "CCC does not enjoy the discretion to refuse to issue a guarantee to an eligible individual".[26] This is simply not true. Perhaps a practical example would further illustrate the point. As the United States mentioned during the first substantive meeting of the Panel, CCC internally maintains limits on the amount of its exposure to obligations of particular foreign banks.[27] Although a qualified applicant might apply for an export credit guarantee for an eligible good to an eligible destination (each of those elements themselves constituting potential bases for denying an application), notwithstanding the eligibility of the applicant, good, and destination, if the foreign-bank obligor envisioned in the transaction would exceed the applicable *internally established* exposure limit if it consummated the transaction, CCC could and would deny the application for the guarantee. Thus, while it is true that the CCC does not engage in any *arbitrary* or standard-less denials, the point is that no exporter seeking to engage in a particular export transaction can be certain of obtaining a credit because of CCC decisions relating to the conditions for issuance of export credit guarantees.

**143. Brazil agrees with National Cotton Council estimates of the effects of the GSM 102 programmes (Brazil's further submission, para. 190) but it also cites a different conclusion by Prof. Sumner (paragraph 192). Brazil cites other estimates by Prof. Sumner throughout its further submission. Does Brazil adopt Prof. Sumner's conclusions and estimates as part of its submission? BRA**

## I. STEP 2 PAYMENTS

**144. Is the Panel correct in understanding that the US does not dispute that Step 2 (domestic) payments are contingent upon import substitution, and that it argues that such measures are permitted due to the operation of the provisions of the Agreement on Agriculture? How is that relevant to a claim under Articles 5 and 6 of the SCM Agreement? US**

58. The United States acknowledges that to receive a payment under the Step 2 programme a domestic user must open a bale of domestically produced baled upland cotton. As the United States noted in its Further Submission of 30 September 2003[28], the introductory clause of Article 3.1 of the Subsidies Agreement, "Except as provided in the Agreement on Agriculture", applies to both Articles 3.1(a) and 3.1(b). Brazil's arguments would delete the application of the introductory clause to Article 3.1(b). As the exception's applicability to Article 3.1(b) must be given meaning, the United States has noted that the Agreement on Agriculture does permit domestic content subsidies in favour

[25] See, e.g., US Further Submission (30 September), paras. 153-156
[26] Second Oral Statement of Brazil (7 October), para. 67.
[27] See http://www.fsa.usda.gov/ccc/banks_foreign_rqts.htm.
[28] Paras. 165-176.

of agricultural producers, albeit paid to processors, if such subsidies are provided consistently with the Member's domestic support reduction commitments.[29] The European Communities concur.[30]

59. As the United States has previously indicated to the Panel[31], the United States reports all Step 2 payments as product-specific domestic support to cotton. As the United States is entitled to the protection of the Peace Clause under Article 13(b)(ii) of the Agreement on Agriculture, the United States is exempt from action under Articles 5 and 6 of the Subsidies Agreement. By their express terms, Articles 5 and 6 do "not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture".

60. The question of "import substitution" is otherwise irrelevant to Brazil's claims under Articles 5(c) and 6, which focus on the effect of the particular subsidy without regard to the origin requirements of the subsidy. In contrast, Article 3.1(b) focuses on whether a subsidy is contingent upon use of domestic over imported goods to determine whether a particular subsidy is a prohibited subsidy irrespective of its effect.

## J. ACTIONABLE SUBSIDIES

**145. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Articles 4.7 and 7.8 of the SCM Agreement. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy without delay, can the Panel:**

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? BRA, US**

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the SCM Agreement? BRA, US**

61. As a practical matter, there may be limited value in a particular dispute from making a finding that a particular subsidy is both a prohibited subsidy and causes adverse effects. If a subsidy is prohibited, then the remedy required to be recommended under Article 4.7 is to withdraw the subsidy without delay. A finding at the same time that a subsidy causes serious prejudice, if done cumulatively with an analysis of other subsidies, would mean that it would leave unclear the question of whether the other, non-prohibited subsidies cause adverse effects. That may diminish the value (in terms of resolving the dispute) of any finding concerning those other subsidies.

62. On the other hand, if the Panel were to make a separate "adverse effects" analysis for each of the non-prohibited subsidies, there would be no reason to so analyze any prohibited subsidy. First, an adverse effects analysis of a prohibited subsidy could not affect a panel's findings with respect to each non-prohibited subsidy. Second, since under Article 4 the panel would have recommended withdrawal of the prohibited subsidy, compliance with Article 4 would also comply with a recommendation under Article 7. Therefore, having made a recommendation under Article 4 with respect to a subsidy, there would be no utility to also making a recommendation under Article 7.

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[29] US Further Submission (September 30, 2003), para. 167; First Written Submission of the United States, paras. 146-150.

[30] Answers of the European Communities to Panel Question 40, paras. 72-78; First Oral Statement of the European Communities, paras. 31-37.

[31] See, e.g., First Written Submission of the United States, para. 129; G/AG/N/USA/43, at 20 (Supporting Table DS:6) (Exhibit Bra-47)

**146. Brazil acknowledges that there are some interaction effects that may increase or decrease the overall effects of the subsidies (Brazil's further submission, para. 225). How would your analysis under Articles 5(c) and 6.3 of the SCM Agreement and Article XVI of GATT 1994 differ if it excluded, for example, crop insurance subsidies, PFC and/or direct payments? BRA**

**147. Does the US agree that subsidies provided under the marketing loan programme, counter-cyclical payments and market loss assistance are or were more than minimally trade-distorting? If so, please elaborate on the type of effects which are more than minimally trade-distorting within the meaning of Annex 2 of the Agreement on Agriculture but less than adverse effects within the meaning of Article 5 of the SCM Agreement. US**

63. The issues of whether a measure is more than minimally trade-distorting and whether a measure has adverse effects require two different analyses. While it may be a necessary condition that a subsidy has trade- or production-distorting effects in order to find that it causes adverse effects, it is not a sufficient condition. The question under an adverse effects analysis is one of the effect on a particular Member's "interests" – for example, whether injury to the domestic industry of another Member, nullification or impairment, or serious prejudice to the interests of another Member. Therefore, the mere showing that a subsidy can distort trade or production does not necessarily mean it has, for example, seriously prejudiced a particular Member's interests.

64. Marketing loan payments, counter-cyclical payments, and market loss assistance payments provide different types of support that can be expected to have different effects. As noted in the US answer to Question 127, the United States notifies marketing loan payments as product-specific amber box support. These payments are linked to production of upland cotton in favour of the producers of upland cotton – a producer must have harvested cotton to receive the payment. Therefore, the United States considers that marketing loan payments could not satisfy the general and policy-specific criteria set out in Annex 2 of the Agreement on Agriculture and therefore could not be deemed to have met the fundamental requirement of that Annex.

65. That a particular support measure does not conform to the general and policy-specific criteria of Annex 2 is relevant to the type of support it is deemed to be, which has meaning for a Member's compliance with its reduction commitments. That a particular measure is not green box, however, would not suffice to demonstrate that a measure has "adverse effects" within the meaning of Articles 5 and 6 of the Subsidies Agreement. A finding that a subsidy has caused adverse effects is a fact-intensive analysis. In the case of a claim of serious prejudice, for example, one of the four effects set out in Article 6.3 must be demonstrated (such as significant price suppression or depression by the subsidized product in the same market as the non-subsidized product is found) and the effects caused by the subsidy must rise to the level of "serious prejudice." Such a fact-intensive analysis must take into account, *inter alia*, the nature and amount of the subsidy, market conditions, and other factors affecting production, consumption, and prices.

66. Therefore, a conclusion that a measure does not provide green box support and therefore would not be deemed to have no or at most minimal trade-distorting effects or effects on production cannot take the place of the fact-intensive examination required to show causation under the WTO Agreements. For example, marketing loan payments provide a revenue floor of 52 cents per pound for US upland cotton producers. The effect of this subsidy would depend in large part on the producer's expected market revenue at the time of planting – that is, whether this expected revenue was above or below 52 cents per pound. Thus, the effect of this subsidy would be quite different from a subsidy that merely provided an unchanging per unit payment (e.g., 10 cents per pound), even if as a result of prices that actually develop over the course of a marketing year the per-unit payments under these two measures turn out to be the same. As another example, a measure that provided, in the aggregate, $1 of support linked to production of upland cotton could not satisfy the general and

policy-specific criteria of Annex 2 of the Agreement on Agriculture[32], but it would be difficult to conceive that the effect of $1 in subsidies could be "significant price suppression [or] price depression" or "an increase in the world market share of the subsidizing Member" given the large number of market participants (including cotton producers worldwide), highly developed cotton markets, and volume and value of cotton trade.

67. With respect to counter-cyclical payments under the 2002 Act, the United States recalls that according to Brazil's interpretation of the first sentence of Annex 2 as a stand-alone requirement, if a measure has no more than minimal trade-distorting effects or effects on production, it follows that such a measure must be deemed green box. As the United States has demonstrated, the economic literature on decoupled payments (counter-cyclical payments are decoupled from production although linked to current prices) suggests that the effects on production of such income transfers are no more than minimal.[33] Therefore, although the United States would not contend that counter-cyclical payments conform fully to the policy-specific criteria in Annex 2, there is not only no evidence that such payments have more than minimal trade-distorting effects or effect on production, but the evidence suggests the contrary. In such a case, the effect of a payment that does not have more than minimal effects on production would not appear to be "significant price suppression [or] depression" or an "increase in the world market share of the subsidizing Member", much less "serious prejudice".

68. The expired market loss assistance payments were ad hoc payments made during the 1999, 2000, and 2001 marketing years to holders of base acreage. These payments were not linked to production – that is, a recipient need not have produced upland cotton or any crop at all in order to receive the payment.[34] However, because these payments were explicitly made in reaction to low commodity prices, the United States considered that these payments would not conform fully to the criteria in Annex 2 of the Agreement on Agriculture and therefore notified these payments as non-product-specific amber box support. As noted above with respect to the 2002 counter-cyclical payments, however, the economic literature on payments decoupled from production suggests that the effects on production of income transfers such as the market loss assistance payments are no more than minimal.[35] Therefore, the evidence suggests that the effect of such payments could not be "significant price suppression [or] depression" or an "increase in the world market share of the subsidizing Member" resulting in "serious prejudice".

**148. How should the significance of price suppression or depression be assessed under Article 6.3(c) of the SCM Agreement? In terms of a meaningful effect? Or another concept? BRA, US**

69. As the United States has previously noted[36], in Article 6.3(c) the term "significant" modifies the phrase "price suppression or depression", suggesting that it is the level of price suppression or depression itself that must be "important, notable" or "consequential".[37] As Brazil agrees[38], important

[32] For example, the measure would not qualify as decoupled income support because, by requiring that recipients have produced upland cotton, the amount of the payment would be "related to, or based on, the type or volume of production . . . undertaken by the producer in any year after the base period". *See* Agreement on Agriculture, Annex 2, para. 6(b).

[33] *See, e.g.*, US Rebuttal Submission, paras. 59-64.

[34] Supplemental legislation authorizing each of these payments was passed several months after planting for the crop year in question had occurred. Even if producers had some expectations of payment at planting time, they were eligible to receive such a payment regardless of what crop they planted. Indeed, they could choose not to plant and still be eligible for the payment. This would argue that market loss assistance payments, like production flexibility contract payments, direct payments, and counter-cyclical payments, are decoupled from planting decisions.

[35] *See, e.g.*, US Rebuttal Submission, paras. 59-64.

[36] US Opening Statement at the Second para. 58.

[37] US Further Submission, para. 83.

[38] *See* Brazil's Further Submission, para. 88 ("This interpretation of price suppression and price depression is consistent with the *relevant context of Article 6.3(c), which includes Article 15.2 of the SCM*

context for interpreting this phrase can be found in Article 15.2 of the Subsidies Agreement, which sets out for countervailing duty purposes the same effects found in Article 6.3.[39] This text confirms that the relevant analysis is whether the level of price suppression or depression itself is "significant":

> With regard to the effect of subsidized imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise *to depress prices to a significant degree or to prevent price increases*, which otherwise would have occurred, *to a significant degree*.[40]

Thus, Article 15.2 provides contextual support for reading the term "significant price suppression [or] depression" in Article 6.3(c) according to the ordinary meaning of its terms – that is, it is the degree of price suppression or depression itself that must be "significant".

70. As suggested by this analysis, it is not the effect on the producers of the complaining Member that must be "significant". In determining whether the alleged price suppression or depression is "important" or "notable", it will of course be relevant to look at that suppression or depression in the context of the prices that have been affected – that is, at the *degree* of suppression or depression. One absolute level of suppression or depression could be significant in the context of prices for one product but not for another and meaning must be given to the phrase "in the same market".

**149. What is the meaning of "may" in the chapeau of Article 6.3(c) in the context of Brazil's assertion that there is no need to conduct a distinct analysis of "serious prejudice" under Article 5(c) after having made a finding under 6.3(c) or (d)? (Brazil's further submission, paras 437 ff). How, if at all, are Articles 6.2 and 6.8 relevant in this context? What context should the Panel use for assessing serious prejudice under Article 5(c) of the SCM Agreement if the Panel takes the view that Article 6.3(c) and (d) are permissive conditions for a determination of serious prejudice? US**

71. The chapeau of Article 6.3 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or more of the following apply". The Article then goes on to detail four effects that "may" result in serious prejudice arising. Brazil's reading would re-write the chapeau of Article 6.3, changing the permissive "may" into the obligatory "shall". The ordinary meaning of "may" is "to express possibility, opportunity, or permission".[41] Therefore, the ordinary meaning of the chapeau of Article 6.3 would be that there is a "possibility" or "opportunity" for serious prejudice in the sense of Article 5(c) to arise where one or more of the effects listed in Article 6.3 is found.

72. Article 6.2 clarifies that a prerequisite for a finding of serious prejudice is that at least one of the four effects in Article 6.3 must be demonstrated. That is, Article 6.2 precludes a panel from finding serious prejudice ("serious prejudice shall not be found") if a subsidizing Member demonstrates that the subsidy has not had any of the effects listed in Article 6.3. This provided a subsidizing Member with a means to overcome the presumption created through the operation of

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*Agreement*. That provision discusses standards for the determination of injury in countervailing duty cases and provides that the investigating authorities should consider whether the effect of imports is 'to depress prices' or 'to prevent price increases, which otherwise would have occurred . . .'[.]") (emphasis added).

[39] Effects on prices form one part of a determination of injury for countervailing duty purposes. Pursuant to Article 15.1, such a determination of injury involves an objective examination of (a) the volume of subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products and (b) the consequent impact of these imports on the domestic producers of such products.

[40] Subsidies Agreement, Article 15.2 (italics added).

[41] *The Random House Dictionary of the English Language, Unabridged Edition* at 886 (1983).

Article 6.1 while that provision was still in effect. However, Article 6.1 demonstrates that Members knew how to create a presumption of serious prejudice: they did so by explicitly stating that, in certain cases, "[s]erious prejudice . . . *shall be deemed to exist*" (italics added). Article 6.2, while providing a means to rebut that presumption, does not by its terms establish that serious prejudice "shall be deemed to exist" if one of the effects in Article 6.3 exists.

73. Article 6.4 lends further contextual support to the interpretation that the use of the term "may" in the chapeau of Article 6.3 signifies that the effects listed in Article 6.3 are permissive conditions for a determination of serious prejudice. Article 6.4 states that "displacement or impeding of exports shall include any case in which, subject to the provisions of paragraph 7, it has been demonstrated that there has been a change in the relative shares of the market to the disadvantage of the non-subsidized like product". Thus, given certain situations further explained in Article 6.4, displacement or impeding of exports "shall" exist. However, Article 6.3 does not state that, given those situations, displacement or impeding of exports *resulting in serious prejudice* shall exist. That is, the situations in Article 6.4 which must result in a finding of displacement or impeding of export do not, by the terms of the Article, also result in a finding of serious prejudice.

74. Article 6.5 similarly defines a situation in which "price undercutting" under Article 6.3(c) "shall" be found but does not also mandate a finding of serious prejudice. Had Members intended (as Brazil contends) that a finding under Article 6.3 would necessarily suffice to demonstrate serious prejudice, one also would have expected Articles 6.4 and 6.5 to mandate a finding of serious prejudice where a finding of one of the effects under Article 6.3 is mandated.

75. Article 6.8 provides further contextual support for reading Article 6.3 as setting out certain permissive conditions that could result in a panel finding that serious prejudice to the interests of a Member exist. Article 6.8 states that, "in the absence of circumstances referred to in paragraph 7", which merely preclude a panel from finding displacement or impediment resulting in serious prejudice, "the existence of serious prejudice *should be* determined on the basis of the information submitted to or obtained by the panel" (italics added). Again, this provision does not mandate a finding of serious prejudice should one or more of the effects set out in Article 6.3 be demonstrated. Rather, it emphasizes that "the existence of serious prejudice" (rather than the existence of one of the effects in Article 6.3) "should be determined" by the panel based on the information before it. Thus, while a panel may be *precluded* from making a finding of serious prejudice (where, for example, a complaining party has only alleged displacement or impediment under Article 6.3, but one of the conditions in Article 6.7 exist), there is no currently effective provision under which a panel is *compelled* to find serious prejudice.

**150. Is the list in Article 6.3 of the SCM Agreement exhaustive, or could serious prejudice arise in circumstances other than those listed in paragraphs (a) through (d)? US**

76. Article 6.3 sets out four circumstances in which the effects of subsidies "may" give rise to a finding of serious prejudice. Article 6.2 establishes that "serious prejudice shall not be found" if a subsidizing Member demonstrates that a challenged subsidy has not resulted in any of those four effects. Therefore, Articles 6.3 and 6.2 indicate that serious prejudice may not be deemed to have arisen without at least one of the four effects listed in Article 6.3 having been demonstrated.

**151. Where in the text of Article 6.3(d) of the SCM Agreement is there a basis to take into account that 1998 may be a "misleading" year for the purposes of comparison? For example, unlike the text of Article XVI:3 of the GATT 1994, there does not seem to be a general reference to "special factors". US**

77. Article 6.3(d) requires that a complaining party demonstrate that the effect of a challenged subsidy is an increase in the world market share in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this

increase follows a consistent trend over a period when subsidies have been granted. Where the evidence offered by a complaining party relies in large part on abnormal production and trade data evidently caused by factors unrelated to the challenged subsidy (in the case of the United States in 1998, severe drought and record abandonment of planted acres), use of that data cannot satisfy the complaining party's burden of demonstrating causation – that is, the "effect of the subsidy".

78. Article 6.3(d) sets out a fairly mechanical two-part test: first, there must be an increase in world market share as compared to the average over the preceding period of three years. Thus, assuming *arguendo* that Brazil could challenge expired marketing year 2001 support measures, this test would compare the world market share of US upland cotton in that year to the average over the preceding three years. Brazil, however, has misinterpreted Article 6.3(d) and examined the US world *export* share.

79. The second part of the test is that any such increase over the average of the preceding three-year period "follows a consistent trend over a period when subsidies have been granted". The marketing year 2001 payments challenged by Brazil were first introduced for the 1996 marketing year by the 1996 Act. Thus, Brazil must demonstrate that the alleged increase in world market share follows a "consistent trend" between marketing years 1996-2001. In fact, there is no consistent trend showing an increasing US world market share over this period; that world market share has been inconsistent but showing a tendency to decline over that period. As demonstrated in Exhibit US-47, US world market share surpassed 20 per cent in both marketing years 1996 and 1997 but has not thereafter.

80. Finally, as the United States has noted in its further submission, Brazil has limited its claim under Article 6.3(d) to alleged effects in marketing year 2001.[42] Thus, there can be no finding that challenged US subsidies under the 2002 Act presently cause serious prejudice within the meaning of Article 6.3(d). As the United States has previously noted, moreover, payments with respect to marketing year 2001 expired with the granting of support in respect of the 2002 marketing year's production, which began on 1 August 2002 – that is, seven months before this Panel's terms of reference were established. The result is that Brazil is asking the Panel to make findings and a recommendation with respect to subsidies that had been replaced at the time of panel establishment and that no longer exist to be withdrawn even were a recommendation to be made.

**152. If the US is correct in asserting that the Article 13(b)(ii) Agreement on Agriculture analysis is a year-by-year analysis, how would this affect the Panel's examination of Brazil's claims of serious prejudice, including the three year period and the trend period in Article 6.3(d) of the SCM Agreement? US**

81. Article 13(b)(ii) exempts from action measures that, *inter alia*, conform fully to the provisions of Article 6 of the Agreement on Agriculture. Chief among those provisions is the obligation that a Member remain within its Annual and Final Bound Commitment Levels for its Aggregate Measurement of Support, a commitment that is expressed by year. Therefore, while a Member may breach the Peace Clause in a given year by exceeding its bound commitment level, that Member may in the following year not breach the Peace Clause if its domestic support measures once again do not exceed its commitment levels. Thus, to gauge whether domestic support measures have breached the Peace Clause requires a year-by-year analysis.[43]

[42] US Further Submission, para. 100.

[43] Brazil agrees that the Peace Clause requires a year-by-year comparison. Brazil insists, however, that once a Member has breached the Peace Clause once, that Member can never thereafter regain Peace Clause protection. There is nothing in the text of the Peace Clause that supports Brazil's view on this point – nor, as a result, has Brazil pointed to any supporting text.

82. The year-by-year analysis under the Peace Clause does not affect how the Panel would undertake a serious prejudice analysis; it affects only the Panel's analysis of which of the US measures that Brazil has challenged may be the subject of the serious prejudice analysis. In the event, Brazil has only claimed that the effect of US subsidies in marketing year 2001 was inconsistent with Article 6.3(d). Therefore, the Panel's task is first to analyze whether US domestic support measures in marketing year 2001 breached the Peace Clause. If so, then the Panel would be able to undertake a serious prejudice analysis – and that second analysis is distinct from the first one. The United States has demonstrated that US measures in marketing year 2001 do not grant product-specific support to upland cotton in excess of that decided during the 1992 marketing year, whether measured according to the level of support granted by those measures or a price-gap AMS calculation.

83. With respect to the two-part test of the three-year average and consistent trend over a period when subsidies have been granted, the Peace Clause would have no impact on these tests. That is, assuming *arguendo* that marketing year 2001 measures were not exempt from action, the fact that the Peace Clause exempts from action measures for other marketing years would not preclude the Panel from examining data and evidence from those years as part of its serious prejudice analysis of the 2001 measures. The payments made in those other marketing years (that is, the marketing year 1999 measures and the marketing year 2000 measures) would be exempt from action; evidence relating to those years would not be sheltered from examination by the Panel in its serious prejudice analysis of the 2001 measures.

**153. Would the conditions in Article 6.3(d) of the SCM Agreement be satisfied in respect of time periods other than the one specified? What relevance, if any, would this have for Brazil's claims? BRA**

**154. Does the US agree that upland cotton is a "primary product or commodity" within the meaning of Article 6.3(d) of the SCM Agreement? (ref. Brazil's further submission, para. 262) and within the meaning of Article XVI:3 of the GATT 1994? US**

84. Yes.

**155. Please respond to Brazil's identification of the seven-year period beginning with MY1996 (following the passage of the FAIR Act of 1996) as the "most representative period" for the purposes of Article 6.3(d)? (ref. Brazil further submission, para. 269) US**

85. Brazil has challenged only those US subsidies that allegedly had the effect of increasing US world market share in marketing year 2001 – that is, marketing year 2001 payments. The second part of the test under Article 6.3(d) is that any increase in world market share that is the effect of the challenged subsidy over the average of the preceding three-year period "follows a consistent trend over a period when subsidies have been granted". The marketing year 2001 payments were granted under the 1996 Act. Therefore, the "period when subsidies have been granted" for purposes of an analysis of the effect of marketing year 2001 support would be the marketing year 1996-2001 period.

86. The United States believes that marketing year 2001 support cannot cause present serious prejudice because these payments expired when marketing year 2002 payments began to be made. Nonetheless, if marketing year 2001 payments are the challenged measures for purposes of Brazil's Article 6.3(d) claim, there is no basis to include marketing year 2002 within the period when subsidies have been granted. (We also note that Brazil identifies a seven-year period beginning with marketing year 1996 but presents data only for the six-year period through marketing year 2001.)

**156. Does the US agree that "...footnote 17 [of the SCM Agreement] does not carve out upland cotton from the scope of Article 6.3(d) of the SCM Agreement"? (ref. Brazil further submission, para. 275). US**

87. The United States is not aware of any "other multilaterally agreed specific rules apply to the trade in the product or commodity in question" within the meaning of footnote 17 to Article 6.3(d) of the Subsidies Agreement.

**157. Does the reference to "trade" in footnote 17 of the SCM Agreement have any impact on the interpretation of "world market share" in Article 6.3(d)) If so, what is it? US**

88. The use of the term "trade" in footnote 17 provides useful context in interpreting the phrase "world market share" in Article 6.3(d). Specifically, Article 6.3(d) speaks of an increase in a Member's "world market share", not an increase in a Member's "world trade share". By using the term "market" and not "trade", Article 6.3(d) establishes that its scope is *not* limited to cross-border movements of a primary product or commodity. That is, the "world market" for a primary product or commodity encompasses all the markets in the entire "world", including the market of the allegedly subsidizing Member. Had Members desired instead to restrict the analysis under Article 6.3(d) to cross-border shipments, they could have used the phrase "world trade share" or, in Brazil's preferred formulation, "world export share", or even (as in GATT 1994 Article XVI:3) "world export trade". They did not. Finally, we note that, rather than elaborating on the test under Article 6.3(d), footnote 17 was intended to describe those products or commodities *not* covered by Article 6.3(d) and therefore could use the term "trade".

**158. Please respond to Brazil's assertion that "...the absence of any payment, production or expenditure limitations in the US marketing loan programme is analogous to the EC sugar regime that was challenged in EC - Sugar Exports II (Brazil) and EC - Sugar Exports I (Australia)." (ref. Brazil further submission, para. 317) US**

89. The EC sugar export regime challenged by Australia and Brazil under the GATT 1947 was manifestly different than the US marketing loan programme, primarily in that the challenged programme was an export subsidy providing export refunds on exportable surpluses of sugar. The *Sugar Exports* panel concluded that in the particular market situation prevailing in 1978 and 1979, the EC system had caused serious prejudice to Brazil's interests because it had been applied in a manner which contributed to depress sugar prices. The panel also concluded that the lack of "pre-established effective limitations" on those export refunds and the application of that refund system "constituted a permanent source of uncertainty in world sugar markets and therefore constituted a threat of serious prejudice. The panel's finding on serious prejudice was made carefully, circumscribed by "the particular market situation prevailing in 1978 and 1979". However, the panel's finding on threat of serious prejudice was made without any explanation and apparently without argument by the parties. Therefore, it is difficult to see how the Panel could draw useful guidance from this finding by that panel or draw conclusions on relevant types of payments.

**159. The EC, in its oral statement (paras 9 and 10), disagrees with the US interpretation of the terms "same market". Can the US comment on the EC's view? US**

90. The United States still has difficulty with the EC view. The United States cannot understand how the "world" can be one "market" for purposes of Article 6.3(c), which by its nature calls for a comparison of the prices of the goods of one Member when competing in a market with the goods of another Member. Goods are not sold to the "world" – they are sold in the market of a particular country.

91. The EC on the other hand evidently considers that it is at least possible that the world could function as one market and therefore constitute a "same market" for purposes of analyzing whether

the "effect of the subsidy" is "significant price suppression [or] depression" of the price of a non-subsidized product in the same market. For the reasons set forth in the US further submission, the United States considers that such an interpretation would render the "in the same market" language inutile because the subsidized and non-subsidized products could never be found in the same geographic market and still be considered to be in the same "world market". Furthermore, under the EC's approach, a Member could be selling at a price well above another Member's price in the same country, and yet be found to be depressing prices on the "world market" due to a comparison between sales prices of the Member in one country compared to sales prices of the other Member in a different country.

92. However, the EC itself concedes that a "world market" could only be deemed to exist if there were not significant barriers to trade in the product at issue, such as customs duties, technical barriers to trade, etc. The EC's own explanation suggests that such a "world market" is unlikely to exist because of significant barriers to trade somewhere in the world. Thus, even under the EC's approach, it is not the case that there is a "world market" for upland cotton.

**160. Without prejudice to the meaning of "world market share" as used in Article 6.3(d) of the SCM Agreement, can you confirm the world export share statistics provided in Exhibit BRA-206? US**

93. The table below reflects most recent updates for 2002-03 and 2003-04. We caution that, as noted in the footnotes in the table, the data are drawn from different sources and data sets. Also, we have corrected data in BRA-206 for 1997-98 for total world exports, world upland exports, and US export share.

**World cotton exports (million bales)**

| Year | US upland exports (1) | Total world exports (2) | ELS world exports (3) | World upland exports (4) | US Share of World Exports (5) |
|---|---|---|---|---|---|
| 1996-97 | 6.399 | 26.929 | 1.017 | 25.912 | 24.70% |
| 1997-98 | 7.06 | 26.838 | 1.106 | 25.732 | 27.44% |
| 1998-99 | 4.01 | 23.668 | 1.085 | 22.583 | 17.76% |
| 1999-00 | 6.303 | 27.326 | 1.193 | 26.133 | 24.12% |
| 2000-01 | 6.303 | 26.589 | 1.127 | 25.462 | 24.75% |
| 2001-02 | 10.603 | 29.052 | 1.325 | 27.727 | 38.24% |
| 2002-03 | 11.266 | 30.629 | 1.989 | 28.640 | 39.34% |
| Average: 98/99 - 00/01 | 5.539 | 25.861 | 1.135 | 24.726 | 22.40% |
| 99/00 - 01/02 | 7.736 | 27.656 | 1.215 | 26.441 | 29.26% |
| 00/01 - 02/03 | 9.391 | 28.757 | 1.480 | 27.276 | 34.43% |

*Source:*
*(1)* ***USDA,Fact Sheet Upland Cotton, 2003 p.5***
*(2) USDA, ERS. Cotton and Wool Yearbook, 2002, p. 31; Fact Sheet Upland Outlook, USDA, Oct 2003 table 2*
*(3)* ***ICAC, Cotton World Statistics, Sept. 2003, p. 7.***
*(4) Calculation: (2) - (3)*
*(5) Calculation: (1)*100/(4)*

**161. Would a finding of serious prejudice under Article 5(c) of the SCM Agreement be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the SCM Agreement in this context? BRA, US**

94. Article 5(c) establishes that one of the adverse effects that a subsidizing Member should not cause to the interests of other Members is "serious prejudice", and footnote 13 to that Article states that the term "'serious prejudice to the interests of another Member' is used in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994". Therefore, "serious prejudice" under Subsidies Agreement Article 5(c) and GATT 1994 Article XVI:1 must be read to have the same meaning. As Article 5(c), and Article 6 which explains it, are the more detailed provisions on "serious prejudice" and contain a more effective remedy than the consultation envisioned under GATT 1994 Article XVI:1, the Panel's analysis should begin with the Subsidies Agreement provisions. Were the Panel to agree that Brazil has not established that the effect of the challenged subsidy is "serious prejudice" within the meaning of the Subsidies Agreement, it would be difficult to see how the Panel could then determine that "serious prejudice" exists within the meaning of GATT 1994 Article XVI:1 since the term is used "in the same sense" in these provisions.

**162. Can the US confirm that marketing loan/LDP, step 2 and counter-cyclical payments are mandatory if the price conditions are fulfilled? US**

95. The statutory authority for marketing loan payments, step 2 payments, and counter-cyclical payments does not provide the Secretary with the authority to arbitrarily decline to make these payments to qualified recipients. However, certain conditions must be met before these payments will be made: price conditions must be met, the producer must meet all conditions for payment, including compliance with "sodbuster" and "swampbuster" provisions and any planting restrictions, the Commodity Credit Corporation (CCC) must not have exhausted its statutory borrowing authority, and Congress must not have cut back on the programme, by an appropriations bill or otherwise.

96. As the question notes, different price conditions apply to each of these payments. For example, in the case of marketing loan payments, the adjusted world price (as calculated by the Department of Agriculture) must be below 52 cents per pound. Recently, the adjusted world price has been above 52 cents per pound and thus no marketing loan payments have been made to qualified recipients.

97. There is no preset limit on the total amount of payments that can be made under each of these programmes although for counter-cyclical payments a maximum total outlay can be calculated using the base acres, base yields, and maximum payment rate for each commodity produced during the historical base period. In addition, for certain recipients, per-person payment limits may apply. We also note that under Section 1601(e) of the 2002 Act, the Secretary has the authority (so-called "circuit breaker" authority) to make adjustments to farm programmes because of WTO domestic support reduction commitments. Presumably, this authority could result in refusals to make certain payments.

98. Conditions for receiving counter-cyclical and marketing loan payments are numerous. The programme contract for counter-cyclical payments is required by section 1105 of the 2002 Act. That section provides explicitly that the producers must agree: (A) to comply with the requirements dealing with the highly erodible cropland conservation found at 16 USC 3811 *et seq*.; (B) comply with the wetland conservation requirements found at 16 USC 3821 *et seq*.; (C) comply with the planting flexibility requirement of Section 1106 of the 2002 Act; (D) use the land representing the base acres for an agricultural or conserving use but not for a non-agricultural, commercial, or industrial use, as determined by the Secretary; and (E) control noxious weeds and otherwise maintain the land in accordance with sound agricultural practices as determined by the Secretary of Agriculture, if the agricultural or conserving use involves the noncultivation of any portion of the land as permitted under the specification just set out in (D). For marketing loans, the loan agreement and loan

regulations, contained in 7 CFR part 1421, specify various conditions that must be met and followed by the producer. Under 16 USC 3811 *et seq*., the wetland and conservation provisions cited above are made applicable to all commodity benefits, including loans.

**163. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ? US, BRA**

99. The United States notes that even using cost data that reflects 1997 cost structures[44], US producers appear to have been able to cover variable costs through the sale of cotton at harvest time in every year but marketing years 2001 and (more narrowly) 2002. In this, US producers were no different than Brazil's farmer witness, Christopher Ward, who stated: "But even with these high yields and the excellent quality of our land, we were not able to fully recover all of our variable costs of production during the 2000/01 and 2001/02 seasons[,]" a position evidently shared by most producers in Mato Grosso, Brazil's leading cotton-producing state.[45]

100. Furthermore, even in years in which US producers may not have been able to cover fixed and variable costs, it does not follow that it is subsidies that covered these costs. Again, Mr. Ward explained that in marketing years 2000 and 2001, "Nor were we able to meet our total costs which include the additional fixed costs." Therefore, producers can cover costs from revenue sources other than subsidies. That harvest prices at times fall below costs does not necessarily mean that subsidies have had the effect of maintaining production.

**US upland cotton operating costs compared to harvest cotton price**

| Year | Cotton price at harvest ($/lb) | Average operating cost ($/lb) |
|---|---|---|
| 1998 | 0.64 | 0.481 |
| 1999 | 0.47 | 0.418 |
| 2000 | 0.57 | 0.473 |
| 2001 | 0.35 | 0.447 |
| 2002 | 0.42 | 0.453 |

*Source: USDA, Economic Research Service, Agricultural Resources Management Survey (www.ers.usda.gov/data/ costsandreturns/testpick.htm)*

## K. CAUSATION

**164. When the US points, in its oral statement of 7 October, to the alleged "bias" of Prof. Sumner's model, is it arguing that US subsidies are irrelevant to the movement in prices and production (acreage) of upland cotton? US**

101. The United States recognizes that subsidies can potentially affect production and prices of upland cotton. The question is one of the nature of the subsidy examined and the degree of any predicted effect, which could range from significant to negligible. The criticisms of Dr. Sumner's model outlined in the US oral statement of October 7, 2002 take issue with many of the underlying

[44] Recall that the Department of Agriculture conducted a survey of cotton farmers in 1997. For any cost data published by the Department since that time, the 1997 data has merely been updated by applying the producer price index to 'update' input costs. *See* US Closing Statement at the Second Session of the First Panel Meeting, paras. 10-11.

[45] Statement of Mr. Christopher Ward at the Second Session of the First Panel Meeting, para. 6 (emphasis added). Mr. Ward goes on to state: "Based on my discussions with many producers relating to Mato Grosso cotton production and revenue, *I know that most other producers in State of Mato Grosso were in the same situation as we were during the 1999-2000 period." (Id* (emphasis added)

assumptions in the model, particularly in regards to how decoupled payments were modelled and the choice of baselines used by Dr. Sumner, which have led to results that have exaggerated the impact of US subsidies on world cotton markets.

**165. Please comment (and submit substantiating evidence) on the US assertion that the FAPRI model has been designed and developed for prospective analysis, and is not suitable for retrospective counterfactual analysis. What is the reliability of past FAPRI-produced analyses when compared with actual data for the period covered by them? Is there any other instrument that can be used to try to identify the effect of subsidies already granted, or of their removal? BRA, US**

102. FAPRI uses its models for prospective analyses; that is, they analyze the future effects of proposed programme changes against a baseline that assumes current programmes are in place. Recent examples of FAPRI analyses include the effects of stricter payment limitations on US farmers[46], an analysis of the European Union's 2003 CAP Reform Agreement[47], and the effects on the US dairy industry of removing current Federal regulations.[48] These analyses are forward-looking examinations of the effects of policy changes.[49]

103. Econometric modelling systems similar to the ones maintained by FAPRI and USDA are designed for prospective analyses of alternative policy assumptions. The foundation for forward-looking analyses is the baseline projections, which are conditioned on specific assumptions for exogenous variables, i.e., those that are independent of the modelling system. The baseline model is also conditioned to incorporate the current structure of specific commodity markets through equation specifications, elasticity estimates, and structural shift and dummy variables. As a result, the baseline models will not be appropriately structured to analyze changes over a historical period. For example, models calibrated for the current structure of the US textile industry may not be appropriate to assess the structure present in the late 1990's due to the tremendous changes that have occurred. Another difficulty of using the system over a historical period is the degree of external shocks that impact the model. In prospective analysis, assessing the impacts of alternative policies occurs absent of extreme shocks from independent variables.

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[46] FAPRI. *FAPRI Analysis of Stricter Payment Limitations* FAPRI-UMC Report #05-03 17 June 2003. 15 pp. Available at: http://www.fapri.missouri.edu/FAPRI_Publications.htm.

[47] FAPRI. *Analysis of the 2003 CAP Reform Agreement.* FAPRI Staff Report #2-03, 9 September 2003. 16 pp. Available at: http://www.fapri.missouri.edu/FAPRI_Publications.htm

[48] FAPRI. *The Effects on the United States Dairy Industry of Removing Current Federal Regulations.* FAPRI-UMC Report #03-03. April 2003. 14 pp. Available at http://www.fapri.missouri.edu/ FAPRI_Publications.htm

[49] FAPRI recognizes the forward-looking nature of its analyses and the limitations of those baselines quite clearly:

> Each year, FAPRI prepares a set of baseline projections that provide information about the outlook for agricultural markets, farm programme spending, farm income, and a variety of other indicators. The baseline then serves as the point of comparison for analyses of alternative policy options....
>
> The baseline is not a forecast of what will happen, but rather a projection of what could happen under a particular set of assumptions. Current global policies are held in place, even when there is reason to suspect changes are likely....
>
> In reality, these assumptions are certain to be violated and actual market outcomes will differ from the deterministic baseline projections presented in the supply-demand tables....

FAPRI 2003 US Baseline Briefing Book, Foreward, page 1. FAPRI-UMC Technical Data Report 04-03 (March 2003) (www.fapri.missouri.edu).

104. As mentioned by Dr. Sumner in Annex I to Brazil's submission of 30 September, baseline models such as the one utilized by FAPRI or USDA are not forecasting models. They are used to analyse proposed policy changes.[50] The attached table shows the forecast accuracy for year ahead price forecasts by FAPRI.

**FAPRI farm price projections for upland cotton compared to actual prices, MY1999-2003 ($/lb)**

| FAPRI published baseline | Marketing year | FAPRI projected price | Actual price 1/ | Difference 2/ |
|---|---|---|---|---|
| January 1998 | 1999/00 | 0.689 | 0.45 | -0.239 |
| January 1999 | 2000/01 | 0.531 | 0.498 | -0.033 |
| January 2000 | 2001/02 | 0.479 | 0.298 | -0.181 |
| January 2001 | 2002/03 | 0.554 | 0.43 | -0.124 |
| January 2002 | 2003/04 | 0.385 | 0.463 3/ | 0.078 |

*Source: FAPRI, USDA World Agricultural Supply and Demand Estimates*
1/ Marketing year average farm price reported by USDA.
2/ Actual farm price minus forecast price
3/ Average cotton farm price for August 2003. USDA is prohibited from publishing cotton price forecasts.

105. One potential approach to using a baseline model to estimate the effects of subsidies during a historical period would be to use an *ex post* prospective analysis. Under an *ex post* analysis, instead of using the current baseline for measurement, one would use a past baseline to make year-ahead projections of the effects of subsidies on the cotton market. For example, to analyze the effects of subsidies on the 1998/99 marketing year, one could use the January 1998 FAPRI baseline model to project the effects of removing subsidies and compare them to baseline levels for the 1998/99 marketing year. To analyze the 1999/00 marketing year, one would update the baseline to the January 1999 baseline and so on, until the current baseline. This would provide baseline comparisons that would reflect the estimated effects of the programmes at the time of planting in each year.

**166. The US states that "futures prices demonstrate that market participants predict increasing upland prices over the course of the marketing year" (US 7 October oral statement, para. 62). Please elaborate on this argument including citing specific futures prices. US**

106. Exhibit US-68 shows average daily closing prices for the December 2003 cotton futures contract. Daily futures prices for December 2003 and May 2004 delivery have increased by as much as 35 per cent from January 2003 levels.

107. Futures prices reflect a price that a buyer is willing to pay to secure a supply at a given price and protect against the possibility of prices rising even higher. Thus, where futures contract prices are higher than current market prices, the futures prices suggest that cotton buyers are concerned about

[50] For example, the US Department of Agriculture explains:
The projections are a conditional scenario with no shocks and are based on specific assumptions regarding the macroeconomy, agricultural policy, the weather, and international developments. In particular, the baseline incorporates provisions of the Farm Security and Rural Investment Act of 2002 (2002 Farm Act) and assumes that current farm legislation remains in effect through the projections period. The projections are not intended to be a Departmental forecast of what the future will be, but instead a description of what would be expected to happen under a continuation of the 2002 Farm Act, with very specific external circumstances. Thus, the baseline provides a point of departure for discussion of alternative farm sector outcomes that could result under different domestic or international assumptions."
USDA Agricultural Baseline Projections to 2012. Office of the Chief Economist, US Department of Agriculture.

the possibility of cotton prices rising still higher and are willing to lock in a purchase price that carries a premium over current prices.

108. In fact, current futures prices reveal that market participants anticipate upland cotton prices rising over the current 2003 marketing year.

| New York Cotton Exchange, Closing Futures Prices MY03<br>Friday, 24 October 2003[51] | |
|---|---|
| December 2003 contract | 82.11 cents per pound |
| March 2004 contract | 84.34 cents per pound |
| May 2004 contract | 84.50 cents per pound |
| July 2004 contract | 84.64 cents per pound |

That is, a producer may sell cotton futures for December delivery at 82.11 cents per pound, but for deliver later in marketing year 2003 the price rises to greater than 84 cents per pound. To update the information provided by the United States to the Panel in its further submission[52], these futures prices indicate that the market expects cotton prices to remain well above their 20-year average of 67.86 cents per pound (1983-2002) within the current 2003 marketing year and well above what Brazil calculates as the 1980-98 A-index average (74 cents per pound) – that is, the average for the period *before* Brazil alleges serious prejudice through significant price suppression or depression.[53] Thus, given expected cotton prices reflected in futures contracts, Brazil has not demonstrated any clearly foreseen and imminent likelihood of serious prejudice. Quite the contrary: in marketing year 2003, upland cotton producers expect high and increasing prices.

**167. How does Brazil react to Exhibit US-44? BRA**

**168. Please confirm that the production figures cited in Exhibit US-47 are for upland cotton only and do not include textiles. US**

109. Yes, the production figures cited in Exhibit US-47 are for upland cotton production only. They do not include the raw cotton equivalent of textile production.

**169. Can the US confirm the accuracy of the facts and figures cited in the four bullet points in paragraph 12 of Brazil's 7 October oral statement? US**

110. From paragraph 12 of Brazil's 7 October oral statement:

> *Between MY 1999-2001, prices received by US upland cotton farmers fell by 34 per cent, yet US production increased by 20.3 per cent. . . . .*
>
> **Fact check**: We can confirm the price and production figures given and would note again Brazil's selective use of marketing year 2001 as the end-point for its comparison. As Brazil complains of effects over marketing years 1999-2002, it would appear that Brazil has simply chosen to use MY2001 figures to inflate the figures it presents.
>
> *Between MY 1999-2002, the average US upland cotton farmer would have lost 24.3 cents per pound for every pound of cotton produced if revenue were based only on market revenue. The US response to this huge gap between market prices and costs was to increase*

[51] Current futures contract prices are available at: http://www.nybot.com/cotton/ (click on "Futures").
[52] *See, e.g.*, US Further Submission, para. 118.
[53] Brazil's Further Submission, para. 114, figure 6.

*production leading to an increase of US exports by 78.7 per cent and to an increase in the US world market share from 24.1 per cent to 41.6 per cent. . . . .*

**Fact check**: Based on Economic Research Service (ERS) estimates provided in Exhibit US-69, the market value of upland cotton (including the value of cottonseed) averaged $325.06 per acre over MY 1999-2002. Operating costs averaged $261.35 per acre over MY 1999-2002. The value of upland cotton production less operating costs averaged $63.71 per acre. Based on an average upland cotton yield of 577 pounds per planted acre, upland cotton producers received 11.05 cents per pound above their operating costs.

We can confirm the export figure but note that the US share of "world exports" rose from 24.1 per cent in 1999/00 to 39.34 per cent in 2002/03. (See US response to Question 160). In addition, we note that US world market share over the marketing year 1999-2002 period fell from 18.6% in MY1999 to 16.9% in MY2000, rose to 19.8% in MY2001, and fell again to 19.6% in MY2002.[54]

*Between MY 1999-2001, the US dollar appreciated approximately 15 per cent against the currencies of other worldwide cotton producers. . . . US exports increased by 68 per cent. . . . .*

**Fact check**: ERS calculates a commodity-weighted exchange rate index for upland cotton based on the real exchange rates of importing countries, weighted by the share of US cotton exports.[55] Based on this index, the dollar appreciated by 6.2 per cent from 1999 to 2001. ERS also calculates a commodity weighted exchange rate index based on the currencies of other cotton producers and their share in world cotton trade. Based on this index, the dollar appreciated by 11 per cent from 1999 to 2001.

**Fact check**: We can confirm the US upland cotton export figure and again note Brazil's use of marketing year 2001 for its comparison.

*US costs of production are much higher than those of most other exporters of upland cotton, yet the US export market share increased from 24.1 per cent to 41.6 per cent between MY 1999-2002.*

**Fact check**: In paras. 284 and 285 of its Further Submission of 9 September 2003, Brazil uses data from the International Cotton Advisory Committee (ICAC) to compare costs of production across countries, which represents the most complete published comparisons of costs of cotton production for major cotton producing countries. Nevertheless, even when good survey data are available for one country, using cost of production data to draw valid economic conclusions is fraught with difficulties. In fact, the ICAC specifically discourages this kind of cross-country comparison: "***Because of a number of limitations, it is not advisable to compare the costs of production among several countries at the same time***".[56]

**Fact check**: Over the period 1999/00 to 2002/03, the US share of world exports rose from 24.1 per cent to 39.34 per cent. (See US response to Question 160).

**170. Brazil quotes a report that states that a 10% increase in soybean prices reduces upland cotton acreage by only 0.25% (Brazil's 7 October oral statement, para. 27). Could Brazil indicate if this analysis is done on a short-run basis or a long-run basis? BRA**

[54] *See* Exhibit US-47.
[55] *See* Exhibit US-69.
[56] Raffiq Chaudhry, International Cotton Advisory Committee, "Cost of Producing Raw Cotton" Presented at the III Brazilian Cotton Congress, Brazil, 31August 2001 (emphasis added).

**171. In paragraphs 22 and 23 of its further submission, we understand that the US is, in short, claiming that increased total supply (i.e. including polyester) drove prices down. On the other hand, we note that, according to the figures in the chart in paragraph 22 of the same submission, the world production of cotton during this period has basically been steady. Do all polyester fibres as represented by these figures compete directly with cotton? That is to say, do these figures for polyester fibres include, for example, those that are used for textiles that technically cannot be substituted by cotton? US**

111. The figures in the chart in paragraph 22 represent world polyester textile production. Polyester competes with cotton either directly in the fibre market or indirectly through apparel and other intermediate products.

**172. Please estimate the price effect, in cents per pound, of the growth in the US retail market which it is said has directly contributed to strengthening world cotton prices. US**

112. As was presented in the table in paragraph 27 of the Further Submission of the United States of 30 September 2003, US retail purchases of raw cotton fibre increased from 12.3 million bales in 1990 to 20.9 million bales in 2002, an increase of 8.6 million bales. This increase accounted for the entire increase in world retail purchases of raw cotton fibre over the same period and reflects an increase at the world level of 10 per cent. Based on the average demand elasticity of -0.25 used by Dr. Sumner in his analysis (see Annex 1 of Brazil's Further Submission to the Panel, para 23), an equivalent price decline of 40 per cent would be necessary to generate a 10 per cent increase in demand of cotton, all else held equal. Of course, this omits other factors such as supply response of world cotton producers and competition of manmade fibres. Nonetheless, it is clear that the growth in retail purchases of cotton fibres in the United States has strengthened world prices.

**173. The US asserts that "burgeoning US textile imports … shifted the disposition of US cotton production from domestic mills to export markets" (US further submission, para. 20). A similar description appears in paragraph 33, together with the explanation that "the share of world cotton consumption supplied by US cotton has been roughly the same since 1991/92". Why have sales of US cotton for export increased and sales of cotton imported into the US increased? US**

113. The role and impact of rapidly growing US textile and apparel imports is fundamental in explaining the shift in the use of US cotton production from domestic mills to foreign mills. As noted at paragraphs 20 and 33 of the US further submission, the US textile and apparel industry has suffered from declining competitiveness compared with off-shore producers for many years, reflecting many factors, including higher wage costs, a strong US dollar, etc. As domestic mills have shut down in the United States, and production has moved overseas, domestic demand for US cotton by domestic mills has declined sharply.

114. But US consumer demand for cotton products has not declined. That demand has increasingly been met by lower-priced imports of cotton textiles and apparel. As can be seen in the table following paragraph 34 of the US further submission, US imports of cotton textiles (in cotton equivalents) have more than tripled since 1990. It is important to note that the import, export, and consumption data in that table are expressed in bales of cotton-equivalent. In other words, the data are not "sales of cotton imports", but rather represent the amount of cotton imbedded in the particular products.[57]

[57] These estimates of the "cotton equivalent" of textile imports are done by USDA's Economic Research Service, based an a set of internationally-accepted conversion factors. See Cotton and Wool Situation and Outlook Yearbook. Market and Trade Economics Division, Economic Research Service. US Department of Agriculture, November 2002, CWS-2002.

115. US cotton is grown to be used to make cotton textiles and apparel. The point of the US submission is to explain how the location of where US cotton is manufactured into products has shifted. US and world consumers continue to purchase cotton products. But increasingly US consumers purchase those cotton products, made from exported US cotton, from overseas manufacturers as US manufacturers are less able to compete. That is the structural transformation that paras. 33-34 and the accompanying table seeks to present and explains at least in part some of the changes in US exports.

**174. How, if at all, did the Asian financial crisis affect the United States' world market share? Did it disproportionately affect the US as compared to other exporters? US**

116. The Asian financial crisis disrupted cotton consumption (spinning) in the major consuming countries of Thailand, Indonesia, and the Republic of Korea in 1997/98, reducing their mill use 9 per cent from the preceding year. In addition, the decline in world economic growth induced by the crisis reduced total world cotton consumption 3.4 per cent in 1998/99 from the pre-crisis level in 1996/97. Subsequently, however, the depreciation of currencies in these three countries boosted their cotton consumption due to expanding textile exports. World cotton consumption rose 11 per cent between 1996/97 and 2002/03, while consumption in Thailand, Indonesia, and Korea collectively rose 16 per cent. During this same period, US spinners lost market share to textile imports, due in large part to currency effects, and US domestic mill use fell 35 per cent.

117. US export share in these markets is influenced by total supply availability, qualities produced, and price. For example, US export share of the three countries' consumption fell by more than half in 1998/99, due to the drought-devastated US crop. Export share has since returned to the pre-crisis level of about 30 per cent and, with higher consumption, this added about 400,000 bales to US exports between 1996/97 and 2002/03. Since the combined total consumption increase for Thailand, Indonesia, and Korea was about 800,000 bales, this indicates that other exporters also increased exports by about 400,000 bales. As US mill use of cotton declined while exports increased, US world market share was left relatively unchanged (with a slight downward bent) by the Asian financial crisis.

**175. With reference to paragraphs 57-58 and the related table on page 21 of the US further submission, could you please clarify the arguments regarding the ratio of the soybean futures to the cotton futures prices since in the table the inverse ratio is used? US**

118. Attached is a corrected version of the table. The ratio of cotton futures price to soybean futures prices is positively correlated with movement in planted cotton area.

**Expected cotton and soybean prices and planted cotton acreage**

| Year | December cotton futures (cents/lb) | November soybean futures ($/bushel) | Ratio of cotton futures to soybean futures | Planted cotton acres (million acres) |
|---|---|---|---|---|
| 1996 | 78.58 | 7.23 | 10.87 | 14.4 |
| 1997 | 76.82 | 6.97 | 11.02 | 13.6 |
| 1998 | 72.13 | 6.64 | 10.86 | 13.1 |
| 1999 | 60.32 | 5.11 | 11.8 | 14.6 |
| 2000 | 61.31 | 5.32 | 11.52 | 15.3 |
| 2001 | 58.63 | 4.67 | 12.55 | 15.5 |
| 2002 | 42.18 | 4.50 | 9.37 | 13.7 |
| 2003 | 59.6 | 5.26 | 11.33 | 13.5 |

**176. With reference to Figure 4 of Brazil's Further Submission, how does Brazil explain the apparent decrease in prices in 2001 and the increase of the A-Index in recent months, despite the continued use of US subsidies on upland cotton? BRA**

**177. Could the United States further elaborate on paragraph 50 of its 7 October oral statement? US**

119. Lin et al. estimated that the own-price elasticity of cotton acreage under the FAIR Act was 0.466.[58] This is identical to the 2003 net-return elasticity reported by Dr. Sumner. However, it is incorrect to equate a price elasticity to net-return elasticity given the linear specification utilized by Dr. Sumner. The implied price elasticity from Dr. Sumner's model would be approximately 50 per cent larger than the net-return elasticity. Larger elasticities imply greater acreage shifts to change in policies or prices.

120. The relationship between the price elasticity and a net revenue elasticity can be shown as follows. Given a linear specification as described by Dr. Sumner, then cotton area (CA) can be expressed:

(1) $CA = a0 + a1*CNR + a2*Z,$
where CNR is Expected Cotton Net Returns and Z is a vector of other variables including returns from competing crops.

The elasticity with respect to CNR is found by differentiating the equation with respect to CNR. The derivative is the coefficient a1. The elasticity, eNR, is expressed as follows:

(2) $eNR = a1 * CNR / CA.$

With CNR a function of the cotton price P, the elasticity with respect to P can be determined by taking the derivative of the equation with respect to price P. Based on equation (1) from page 13 of Annex I, the derivative with respect to price P is a1*Y, where Y is expected yield.

It follows that the price elasticity is $eP = a1 * Y * P / CA$. One can then conclude that $eNR/eP = ENR / (Y*P)$.

The relationship between eNR and eP can be found by looking at the relationship between CNR and Y*P. Specifically, $eP = ((Y * P) / CNR) * eNR$.

In recent years, the ratio of $(Y * P) / CNR$ has been approximately 1.5, implying that $eP = 1.5 * eNR = 1.5 * 0.466 = 0.699$.

**178. The Panel notes Exhibit US-63. Could the US please provide a conceptually analogous graph concerning US export sales during the same period? US**

121. Exhibit US-70 shows in table and graph form the per cent change over the previous year for upland cotton exports by the United States and the rest of the world. In addition, the United States provides in Exhibit US-71 a table and graph demonstrating the absolute levels of US exports and domestic consumption. As the figures show, over the last seven years domestic consumption has declined by almost the same amount by which exports have increased, leaving US world market share largely unchanged.

[58] **Lin, W., P.C. Westcott, R. Skinner, S. Sanford, and D.G. De La Torre Ugarte. *Supply Response Under the 1996 Farm Act and Implications for the US Field Crops Sector.* US Department of Agriculture, Economic Research Service, Technical Bulletin No. 1888**, Appendix table 21.

**179. Could Brazil comment on the argument that decoupled payments and other subsidies to upland cotton are largely being capitalized into land values and that removing these subsidies would reduce the cost of production of upland cotton producers (US 7 October oral statement, para. 48). What would be the net effect of these adjustments? BRA**

**180. Please describe the precise formula as to how USDA determines the "adjusted world price" using the Liverpool A-Index, the NY futures price and any other relevant price indicators. Please submit substantiating evidence. BRA, US**

122. The Adjusted World Price (AWP) is equal to the Northern Europe (NE) price (the 5-day average of the 5 lowest-priced growths for Middling 1-3/32 inch cotton, cost, insurance and freight [CIF] northern Europe), adjusted to US base quality and average location. The AWP for individual qualities is determined using the schedule of loan premiums and discounts and location differentials. A "coarse count adjustment" (CCA) may be applicable for cotton with a staple length of 1-1/32 inches or shorter and for certain lower grades with a staple length of 1-1/16 inches and longer. The AWP and CCA are announced each Thursday.[59]

123. A Step 1 adjustment to the AWP may be made when the 5-day average of the lowest US growth quote for Middling 1-3/32 inch cotton, CIF United States-northern Europe (USNE) price, exceeds the NE price and the AWP is less than 115 per cent of the loan level. The Secretary of Agriculture may lower the AWP up to the difference between the USNE price and the NE price. A Step 1 adjustment has never been made, although the conditions have been met many times.

**181. Please provide a side-by-side chart of the weekly US adjusted world price, the Liverpool A-Index, the NY futures price, and spot market prices from 1996-present. What, if anything, does this reveal? BRA, US**

124. Exhibit Q181 sets out weekly price movements for the Adjusted World Price, the Liverpool A Index, the nearby New York cotton futures price and the spot market price from January 1996 to present.

**182. Please explain why the US can be taken to be price leaders, or price setters, (and not just takers) when US producers receive large subsidy payment to support the difference between world prices and their own costs? BRA**

## L. ARTICLE XVI OF GATT 1994

**183. Why does Brazil believe that the appropriate "previous representative period" is the term of the previous Farm Bill, MY1996-2002? (Brazil's further submission, para. 282) BRA**

**184. Why does Brazil believe that an "equitable share" is one which factors out all subsidies? To the extent that domestic support and export subsidies are permitted by the Agreement on Agriculture, why should they not be accepted as being normal conditions in analyzing an equitable market share? (See Brazil's further submission, paras 288-289) BRA**

**185. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the Agreement on Agriculture and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the SCM Agreement. BRA, US**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional**

[59] *See* Exhibit US-72.

**provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions of the Agreement on Agriculture, relevant?**

125. As indicated in the US opening statement at the recent panel meeting[60], GATT 1994 Article XVI:3 applies only to export subsidies. Paragraph 3 is found in Part B of Article XVI, entitled "Additional Provisions on Export Subsidies", as opposed to Part A, which is entitled "Subsidies in General". Paragraph 2 (also in Part B) states that "[c]ontracting parties recognize that the granting of a *subsidy on the export* of any product may have harmful effects for other contracting parties" (emphasis added). Paragraph 3 begins with the word "[a]ccordingly", the ordinary meaning of which is "[i]n accordance with the logical premises; correspondingly"[61], and follows with "contracting parties should seek to avoid the use of *subsidies on the export* of primary products" (emphasis added). That is, "in accordance with" the recognition in paragraph 2 that export subsidies may have harmful effects, paragraph 3 address the use of "subsidies on the export of primary products". The second sentence of paragraph 3 follows this hortatory statement with the obligation not to apply subsidies "which operate[] to increase the export of any primary product" in a manner that "results in a contracting party having more than an equitable share of world export trade in that product". Paragraph 4 "[f]urther" addresses export subsidies for "any product other than a primary product". Thus, the text and context of paragraph 3 indicate that this provision is addressed to export subsidies and not domestic support programmes.

126. The Peace Clause provides further context supporting this interpretation. Article 13(c)(ii) exempts export subsidies that conform fully with Part V of the Agreement on Agriculture from, *inter alia*, "actions based on Article XVI of GATT 1994" – that is, including Article XVI:3 on export subsidies. Article 13(b)(ii), on the other hand, exempts conforming domestic support measures from, *inter alia*, "actions based on paragraph 1 of Article XVI of GATT 1994" but does not mention Article XVI:3. Thus, Article 13 lends contextual support to the notion that Article XVI:3 applies to export subsidies on primary products or commodities but does *not* apply to domestic subsidies on such products.

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in US-FSC, para. 117 here?**

127. Article 6.3(d) of the Subsidies Agreement does not, by its terms, interpret or replace GATT 1994 Article XVI:3. In fact, the range of measures potentially actionable under Article 6.3 is broader than the export subsidies subject to GATT 1994 Article XVI:3. In addition, the analysis under these two provisions is different. Article 6.3(d) is concerned with whether the effect of a subsidy is to increase the world market share of the subsidizing Member; GATT 1994 Article XVI:3 is concerned with whether export subsidies result in a Member having "more than an equitable share in world export trade" in a particular product. However, an important similarity between these two provisions is the scope of products covered by their respective disciplines. GATT 1994 Article XVI:3 is concerned with export subsidies on primary products; Article 6.3(d) is concerned with any subsidy on "a particular subsidized primary product or commodity". This similar product coverage resulted because Members desired to provide more operationally effective subsidies disciplines with respect to these products but had found the "more than equitable share" language of GATT 1994 Article XVI:3 to be unworkable. For further discussion, please see the US response to Question 186 from the Panel.

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in**

[60] US Opening Statement at the Second Session of the First Panel Meeting, para. 60.
[61] *The New Shorter Oxford English Dictionary*, vol. 1, at 15 (1993 ed.) (third definition).

**Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?**

128. The United States notes the Appellate Body's discussion of relevant differences between the provisions of the Subsidies Agreement and those of GATT 1994 in *United States – FSC*.

**186. Could the United States please expand upon its statement that "[t]hese are the types of considerations that led to the negotiation of the Subsidies Agreement...." (US further submission, para. 109)? Is there any relevant material, including, for example, drafting history that might support this statement? US**

129. Dissatisfaction with the difficulties in applying the "more than equitable share" standard of GATT 1994 Article XVI:3 was an important motivation for the negotiation of stronger and more operational disciplines in the WTO Subsidies Agreement. In two separate challenges in 1979 and 1980 to the sugar export subsidy programme of the European Communities by Australia and Brazil, panels were unable to find that the export refunds provided by the Communities resulted in a "more than equitable share" of world export trade.[62] Similarly, in the 1983 US challenge to export subsidies on wheat flour by the European Communities (quoted in the US further submission), "[t]he [p]anel found that it was unable to conclude as to whether the increased [EC] share [of world exports of wheat flour] has resulted in the EEC 'having more than an equitable share' in terms of Article 10 [of the Subsidies Code], in light of the highly artificial levels and conditions of trade in wheat flour, the complexity of developments in the markets, including the interplay of a number of special factors, the relative importance of which it was impossible to assess, and, most importantly, the difficulties inherent in the concept of 'more than equitable share'".[63]

130. Significantly, the latter two of these panel reports explicitly considered the 1979 Tokyo Round Subsidies Code and its interpretive gloss on the "more than equitable share language". Article 10.2 of the 1979 Subsidies Code (of which both Brazil and the United States were signatories) stated, in pertinent part:

> For purposes of Article XVI:3 of the General Agreement and paragraph 1 above:
>
> (a) "more than an equitable share of world export trade" shall include any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets;
>
> (b) with regard to new markets traditional patterns of supply of the product concerned to the world market, region or country, in which the new market is situated shall be taken into account in determining 'equitable share of world export trade'[.]

That is, the 1979 Subsidies Code represented an effort to make operational the discipline provided in GATT 1994 Article XVI:3 by giving additional meaning to the phrase "more than an equitable share of world export trade". Despite that effort, however, the panel considering the Brazilian challenge to EC sugar export subsidies and the panel considering the US challenge to EC wheat flour export subsidies remained unable to find any inconsistency with GATT 1994 Article XVI:3 (in the words of

[62] *European Communities – Refunds on Exports of Sugar*, L/4833, 26S/290 (adopted 6 November 1979) (complaint by Australia); *European Communities – Refunds on Exports of Sugar*, L/5011, 27S/69 (adopted 10 November 1980).

[63] *European Economic Community – Subsidies on Export of Wheat Flour*, SCM/42, para. 5.3 (unadopted 21 March 1983).

the Wheat Flour panel) "in light of . . . , most importantly, the difficulties inherent in the concept of 'more than equitable share'".

131. Thus, there was a recognition in the Uruguay Round subsidies negotiations that the effort in the 1979 Subsidies Code to make GATT 1994 Article XVI:3 more operationally effective had not succeeded. For example, a reference paper on GATT subsidies rules and the existing status of discussion of these rules prepared by the GATT Secretariat for the Negotiating Group on Subsidies and Countervailing Measures states:

> The most pronounced difficulties have occurred in connection with the concept of "more than an equitable share" embodied in Article XVI:3 of the GATT. The Agreement on Subsidies and Countervailing Measures (Article 10) attempted to bring precision to Article XVI:3 but it has not always been found to give clear guidance on its interpretation. Consequently a number of disputes involving the concept of "more than an equitable share" have not found a satisfactory solution and in some cases have provoked retaliatory subsidization. The case-by-case application of this concept has revealed its imprecisions and the fact that it largely refers to notions which escape objective criteria. There is, for example, sufficient imprecision in this concept to allow countries using export subsidies to argue that these subsidies do not result in obtaining more than equitable share. On the other hand it is not always possible to provide causality between the subsidy and the increase share. Furthermore, it is impossible to derive a general line of case law from the decisions of panels, some of which have given divergent interpretations.[64]

132. A checklist of issues for the negotiations based on Contracting Parties' written submissions and oral statements prepared by the Secretariat demonstrates that Contracting Parties were well aware of these difficulties and the need to move away from the "more than an equitable share" concept:

> There is a need for review, with a view to improving GATT disciplines, of the provisions of Article XVI:2 and 3. Notably there is a need to build on the recognition embodied in Article XVI:2 and the exhortation in the first sentence of XVI:3 in the direction of improving the conditions of competition on world markets for primary products currently covered by the equitable share criterion in the second sentence of Article XVI:3.
>
> The review should examine the application of the "more than an equitable share" rule for primary products. This rule has serious conceptual flaws and in practice has failed to provide clear guidance as to the permissible scope of primary product subsidization. . . . .
>
> The Negotiating Group should consider negotiating a similar prohibition to that of Article 9 of the Code on the use of export subsidies for forest, fishery and farm products.
>
> The prohibition on export subsidies for products other than basic or primary products under Article XVI:4 and Article 9 of the Code should be extended to agricultural, forestry and fishery products, in other words to all basic or primary products.
>
> A major objective of these negotiations should be to extend the existing prohibition on export subsidies to cover all products, primary as well as non-primary.

[64] *Subsidies and Countervailing Measures: Note by the Secretariat*, MTN.GNG/NG10/W/4, at 79 (28 April 1987) (Section VI.3).

> There are serious deficiencies in Article XVI:3 of the GATT and in Article 10 of the Code, notably the fundamental problems connected with the 'more than equitable share' concept. However, these problems arise from the basic fact that current disciplines for primary products are significantly weaker than those which apply to manufactured goods. They cannot be resolved merely by making minor adjustments to rules which are intrinsically defective. The only genuine, long-term solution is an effective prohibition on all export subsidies. Accordingly at this stage of the negotiating process, there is little value in trying to improve the "more than equitable share" rule, which is only relevant so long as there is no general prohibition on export subsidies.[65]

133. Reflecting the desire of Members to move away from the "more than an equitable share" concept which had repeatedly been found by panels to be incapable of application, the WTO Subsidies Agreement does not provide any further definition or interpretation of GATT 1994 Article XVI:3. Instead, it contains the general prohibition on export subsidies in Article 3 and rules on adverse effects, including serious prejudice.

## M. THREAT CLAIMS

**187. Please provide USDA's projections of marketing loan/LDP payments, direct payments and counter-cyclical payments to be made during MY2003 through 2007 based on the most recent USDA baseline projection. US**

134. The following table shows projections for cotton marketing loan/LDP payments, direct payment and counter-cyclical payments for crop years 2003 through 2008, as published in the FY2004 Mid-Session Review on 15 July 2003. We note that projected outlays for marketing year 2003 are likely to be significantly overstated given the increase in prices and futures prices over the course of this marketing year. For example, no marketing loan payments are currently being made because the adjusted world price is above the marketing loan rate.

**Projected outlays (million dollars)**

| Item | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|
| Direct payments | 587 | 587 | 587 | 587 | 587 | 587 |
| Counter-cyclical payments | 929 | 602 | 521 | 521 | 521 | 521 |
| Loan deficiency payments | 420 | 298 | 193 | 137 | 137 | 82 |
| Marketing loan gains | 22 | 13 | 8 | 6 | 6 | 3 |
| Certificate gains 1/ | 196 | 114 | 75 | 55 | 52 | 29 |

1/ Includes value of non-cash marketing loan transactions.

**188. Can the United States comment on the FAPRI projections for cotton provided in Exhibit BRA-202? US**

135. The FAPRI projections presented by Brazil in Exhibit BRA-203 reflect the January 2003 FAPRI projections. These projections were published by Iowa State University in January 2003.[66] The same projections were published by FAPRI at the University of Missouri in March 2003 and were referenced by the United States in Exhibit US-52.

[65] *Checklist of Issues for Negotiations: Note by the Secretariat*, MTN.GNG/NG10/W/9/Rev.4, at 26-28 (12 December 1988).

[66] Food and Agricultural Policy Research Institute. *FAPRI 2003: US and World Agricultural Outlook.* Iowa State University Staff Report 1-03. January 2003.

136. Of significance is the difference between the January 2003 baseline and the preliminary baseline of November 2002 utilized by Dr. Sumner in his analysis. Under the January 2003 baseline, the Adjusted World Price (AWP) forecasts for 2002/03 to 2007/08 are considerably higher than the forecasts made in the preliminary November 2002 baseline. Because loan deficiency payments and marketing loan gains are calculated based on the difference between the loan rate and the AWP, this means that expected marketing loan subsidies under the November 2002 baseline are far higher than expected marketing loan subsidies under the January 2003 baseline. Thus, the effects of eliminating marketing loans would tend to be biased upwards using the preliminary November 2002 baseline.

**Differences in the Adjusted World Price forecast between the November 2002 and January 2003 FAPRI baseline ($/lb)**

| | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 | 2007/08 |
|---|---|---|---|---|---|---|
| November 2002 baseline 1/ | 0.3597 | 0.3722 | 0.3983 | 0.4194 | 0.436 | 0.4548 |
| January 2003 baseline 2/ | 0.448 | 0.454 | 0.46 | 0.46 | 0.467 | 0.48 |
| Difference | 0.0883 | 0.0818 | 0.0617 | 0.0406 | 0.031 | 0.0252 |

1/ As presented by Dr. Sumner in Annex I and oral statement of 7 October 2003.
2/ As reported in Exhibit BRA-203 and Exhibit US-52

## N. CLARIFICATIONS

**189. Please indicate whether the correct figure in paragraph 37 of Brazil's 7 October oral statement is 38.1% or 38.3%? BRA**

**190. Please confirm that the figure "17.5" in paragraph 43 of Brazil's 7 October oral statement, is "percentage point". BRA**

**191. Could Brazil clarify its statement in para. 12 of its 9 September further submission: "Alternatively crop insurance is not specific because the 2000 ARP Act denies benefits to commodities representing more than half of the value of US agriculture. Further US crops represent only 0.8 per cent of total US GDP." (emphasis added) BRA**

**List of Exhibits**

64 Lin, W., et al.. Supply Response Under the 1996 Farm Act and Implications for the US Field Crops Sector. US Department of Agriculture, Economic Research Service, Technical Bulletin No. 1888, Appendix table 21

65 Amount and percentage of upland cotton acreage coverage by crop insurance policy

66 Premiums paid by upland cotton producers

67 Insurance indemnity payments to upland cotton producers

68 New York Cotton Futures, Average Daily Closing Prices for December 2003 Contract (chart and data)

69 US Department of Agriculture, Economic Research Service, Cost of Production Estimates; Commodity-Weighted Exchange Rate Estimates

70 US and Rest of World Exports of Upland Cotton, Year-Over-Year Per cent Change, 1996-2002

71 US Exports and Domestic Consumption of Upland Cotton, 1996-2002

72 US Department of Agriculture, Press Release on Adjusted World Price (18 October 2003)

73 Weekly Price Movements: Adjusted World Price, Liverpool A-Index, New York cotton futures, spot market price, January 1996 to present

74 National Agricultural Statistics Service, Planted Acreage of Selected Crops by Region and State

# ANNEX I-7

## ANSWERS OF BRAZIL TO QUESTIONS POSED BY THE PANEL FOLLOWING THE SECOND SUBSTANTIVE MEETING OF THE PANEL

(22 December 2003)

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| *Korea – Beef* | GATT Panel Report, *Republic of Korea – Restrictions on Imports of Beef – Complaint by the United States*, BISD 36S/268, adopted on 7 November 1989. |
| *Japan – Alcoholic Beverages* | Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, adopted 1 November 1996. |
| *EC – Hormones* | Appellate Body Report, *European Communities - Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, adopted 13 February 1998. |
| *Brazil – Aircraft* | Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/R, adopted 20 August 1999. |
| *Indonesia – Automobiles* | Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, adopted 23 July 1998. |
| *Argentina – Textiles and Apparel* | Appellate Body Report, *Argentina – Measures affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/AB/R, adopted 22 April 1998. |
| *Guatemala – Cement (I)* | Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS69/AB/R, adopted 25 November 1998. |
| *Japan – Agricultural Products* | Panel Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/R, adopted 19 March 1999. |
| *India – Quantitative Restrictions* | Panel Report, *India – Quantitative Restrictions on Imports of Agricultural, Textiles and Industrial Products*, WT/DS90/R, adopted 22 September 1999. |
| *Canada – Dairy* | Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, adopted 27 October 1999. |
| *US – FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
| *Argentina – Footwear* | Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R, adopted 12 January 2000. |
| *Australia – Leather* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999. |
| *US – Certain EC Products* | Appellate Body Report, *United States –Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R, adopted 10 January 2001. |
| *US – Export Restraints* | Panel Report, *United States – Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001. |
| *Chile – Agricultural Products (Price Band)* | Appellate Body Report, *Chile- Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002. |
| *Canada – Aircraft II* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS222/R, adopted 19 February 2002. |
| *Argentina – Peach Safeguard* | Panel Report, *Argentina – Definitive Safeguard Measure on Imports of Preserved Peaches*, WT/DS238/R, adopted 15 April 2003. |
| *Japan – Apples* | Panel Report, *Japan – Measures affecting the Importation of Apples*, WT/DS245/R, adopted 10 December 2003. |
| *US – Steel Safeguards* | Appellate Body Report, *United States – Definitive Safeguard Measures on Imports of Certain Steel Products*, WT/DS248/AB/R, adopted 10 December 2003. |

## List of Exhibits

**UNITED STATES – SUBSIDIES ON UPLAND COTTON**

Questions from the Panel to the parties –
second substantive Panel meeting

## I. Terms of Reference

**192. Regarding the interest subsidies and storage payments listed by the United States in its response to the Panel's Question No. 67:**

**(a) Please provide a copy of the regulations under which they are currently provided and under which they were provided during the marketing years 1996-2002;**

**(b) Please indicate whether there are any such payments which are not provided to implement the repayment rate for upland cotton within the marketing loan programme. USA**

**193. Are interest subsidies and storage payments already included in the amounts shown in your submissions to date for payments under the marketing loan programme? Has there been any double-counting? BRA**

Brazil's Answer:

1. The answer to both questions is "no." Brazil reported interest subsidies and storage payments separately and thus did not double count them.[1] To the extent that the United States confirms that both of these payments are connected in some way to the storage of bales of cotton involved in the marketing loan programme, then they would appropriately be included within the overall marketing loan numbers. In that case, the Panel should increase the amount of payments attributable to marketing loan payments by including interest and storage payments related to bales of cotton in the marketing loan programme.

**194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? BRA, USA**

Brazil's Answer:

2. Brazil reserves its right to further comment on the US answer provides some initial thoughts.

3. Brazil reiterates its arguments that the Panel must examine data relating to payments made after the date of establishment.[2] In addition, the Panel is not prevented from examining payment data that originates after the date of the Panel's establishment because these payments are identified in Brazil's panel request and, therefore, are within the Panel's terms of reference.

4. The measures covered by Brazil's request for the establishment of the Panel are very broad and encompass, *inter alia*, any type of payment made under the 2002 FSRI Act and the 2000 ARP Act.[3] In addition, the panel request covers, *inter alia*, a time period of a "marketing year" for 2002 for

[1] *See e.g.* Brazil's 9 September Further Submission, Table 1.
[2] Brazil's 22 August Rebuttal Submission, paras. 88-96; Brazil's 22 July Oral Statement, paras. 40-44.
[3] WT/DS267/7, p. 2.

upland cotton for the period 1 August 2002 through 31 July 2003. The panel request further covers 2002 FSRI Act and 2000 ARP Act payments *to be made* during marketing years MY 2003-2007. In addition, the identified measures guarantee the right of eligible US producers, users and exporters to receive future payments.[4] Given the comprehensive scope and timing coverage of the request for the establishment of a Panel and the mandatory nature of the payments,[5] the Panel's terms of reference encompass all payments made under the 2002 FSRI Act for the period marketing year 2002.

5. As has been firmly established in WTO jurisprudence, any "measure" identified in the panel request pursuant to DSU Article 6.2, is within terms of reference of the panel.[6] As noted above, Brazil identified all relevant "measures" in its request for the establishment in the Panel. Further, in the *Chile – Agricultural Products (Price Band)* case, the Appellate Body held that a panel request which includes reference to "amendments" is sufficient to bring later enacted significant changes to legislation within the Panel's terms of reference.[7] While Brazil's panel request also included "amendments," this case does not even raise the *Chile – Agricultural Products (Price Band)* issues because Brazil's panel request identified the measures that have not changed or been amended since 18 March 2003. Further, to the extent that "payments" made since 18 March 2003 are evidence, the Appellate Body and panels have repeatedly found that evidence generated after the establishment of the panel can be used by panel's in their objective assessment of the facts under DSU Article 11.[8]

## II. Economic Data

**195. Does the United States wish to revise its response to the Panel's Question No. 67*bis*, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers"? Did the United States make enquiries of the FSA in the course of preparing its original answer? USA**

**196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. BRA, USA**

Brazil's Answer:

6. With its letter of 18 December 2003, the United States has finally confirmed – after asserting the contrary repeatedly to Brazil and then to the Panel – that it has collected complete planted acreage, contract base acreage, contract yields, and even payment data that would allow it to calculate with relative precision the amount of direct and counter-cyclical payments made to current producers of

[4] Brazil's 9 September Further Submission, para. 423.

[5] US 27 October Answers to Questions, paras. 95-97.

[6] Panel Report, *Japan – Agricultural Products*, WT/DS76/R, para. 8.4; Panel Report, *Indonesia – Automobiles*, WT/DS54/R, paras. 14.3-14.4.

[7] Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 135.

[8] Panel Report, *India – Quantitative Restrictions*, WT/DS90/R, para. 5.161-5.163 ("In this case the parties and the IMF have supplied information concerning the evolution of India's balance of payments and reserve situation until June 1998. To the extent that such information is relevant to our determination of the consistency of India's balance of payments measures with GATT rules as of the date of establishment of the Panel [18 November 1997], we take it into account."); Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, paras. 133-4 ("The deliberate disregard of, or refusal to consider, the evidence submitted to a panel is incompatible with the panel's duty to make an objective assessment of the facts. … A claim that a panel disregarded or distorted the evidence submitted to it is, in effect, a claim that the panel, to a greater or lesser degree, denied the party submitting the evidence fundamental fairness, or what in many jurisdictions is known as due process of law or natural justice."); Panel Report, *Japan – Apples*, WT/DS245/R, para. 8.49; GATT Panel Report, *Korea – Beef*, BISD 36S/268, paras. 122-123.

upland cotton in MY 2002. Therefore, Brazil looks forward to the United States answering this question in full on 22 December.

7. Unfortunately, Brazil cannot calculate direct payment and counter-cyclical payment figures because the United States refused to produce on 18 December the information requested by Brazil and the Panel. In particular, the United States refused to provide farm-specific identifying numbers, thus rendering any matching of farm-level information on contract payments with information on farm-specific plantings impossible. Only this unique farm number (or a substitute number protecting the alleged confidentiality of farmers) would allow any matching of planting and payment data critical for the calculation of the amount of contract payments that constitute support to upland cotton.[9] The United States asserts newfound "confidentiality" concerns even though it provided identical information on rice to a private US citizen making a simple FOIA request. But even these confidentiality concerns could not possibly apply to aggregate matched figures that the United States could easily calculate with the data the United States admits it has collected. On 12 January 2004, Brazil will provide a more detailed analysis of the US failure to cooperate in this proceeding by continuing to refuse to provide Brazil and the Panel with the requested information.

8. In view of the US failure to produce the requested information that would allow Brazil and the Panel to calculate easily the amount of direct and counter-cyclical payments (as well as PFC and market loss assistance payments for MY 1999-2001), Brazil must present below revised figures using its so-called "14/16$^{th}$" methodology.[10] The figures represent the best information available and are corroborated by circumstantial evidence. Moreover, in view of the US refusal to produce the actual information regarding direct payment and counter-cyclical payments, the Panel could reasonably infer that the *actual* amounts are greater than those estimated by Brazil.

[9] Brazil pointed this out more than a month ago when it stated in its 18 November Further Rebuttal Submission, that "CCC-509 *does* indicate the quantity of base acreage fir each programme crop on the farm. Since both CCC-509 and FSA-578 require identification of the *identical* 'farm' by a unique farm serial number, the base acreage from CCC-509 can be matched with the planted acreage in FSA-578. What the United States has failed to do is 'connect the dots,' *i.e.*, match the information in the two forms." (Brazil's 18 November Further Rebuttal Submission, para. 44, emphasis in original, footnotes omitted).

[10] In view of the new information provided by the United States in Exhibit US-95, Brazil has adjusted the total amount of contract payments by a ratio of 13.714 million acres of actual upland cotton plantings in MY 2002 to 18.858 million acres of total upland cotton base.

| PROGRAMME | PREVIOUS AMOUNT OF PAYMENTS[11] | NEW AMOUNT OF PAYMENTS |
|---|---|---|
| **MARKETING LOAN GAINS AND LDPS** | **$918 MILLION** | **$832.8 MILLION[12]** |
| **CROP INSURANCE** | **$194.1 MILLION** | **$194.1 MILLION[*]** **(+ $104.2 MILLION[13])** **($298.3 MILLION)** |
| **STEP 2** | **$217 MILLION** | **$217 MILLION[*]** |
| **DIRECT PAYMENTS** | **$485.1 MILLION** | **$454.5 MILLION[14]** |
| **COUNTER-CYCLICAL PAYMENTS** | **$998.6 MILLION** | **$935.6 MILLION[15]** |
| **COTTONSEED PAYMENTS** | **$50 MILLION** | **$50 MILLION[*]** |
| **OTHER PAYMENTS** | **$65 MILLION** | **$65 MILLION[*]** |
| TOTAL PAYMENTS | $2,927.8 MILLION | $2,749 MILLION ($2,853.2 MILLION) |

[*] Brazil has no new information on the amount of these payments

9. Concerning the export credit guarantee programmes, Brazil estimates the amount of payments using the "guaranteed loan subsidy" estimate FY 2003 (which largely overlaps with MY 2002) results in a subsidy amount of $17 million.[16] In sum, the latest data available to Brazil continues to demonstrate that US support to upland cotton in MY 2002 far exceeds the support decided in MY 1992.

**197. Please provide actual data for 2002/2003 for US exports, US consumption and per cent of world consumption to replace the projected data in Exhibit US-47. If available, please provide projected data for 2003/2004 to replace the forecast data. USA**

**198. Please comment on the respective merits of the price-gap calculations of MY1992 deficiency payments in US comments of 27 August, footnote 14 ($867 million), and Brazil's response to the Panel's Question No. 67 ($812 million). BRA, USA**

[11] Taken from Table 1 of Brazil's 9 September Further Rebuttal Submission.

[12] Exhibit Bra-373 (Loan Deficiency Payment and Price Support Activity as of 12/3/2003).

[13] Brazil notes that the United States also paid $104.2 million in fulfilment of its reinsurance obligations towards the insurance companies providing the insurance policies to upland cotton producers. These payments also constitute support to upland cotton, but Brazil had so far not included them in its calculation of the total support to upland cotton. This amount results from a MY 2002 loss ratio of 1.26, *i.e.*, the 26 per cent of the $400,666,618 in indemnity payments were not covered by the Federal Crop Insurance Corporation or producer premium payments. These $104.2 million were paid by the Federal Crop Insurance Corporation (*See* Exhibit Bra-374 ("Crop Year Statistics MY 2002" – Federal Crop Insurance Corporation).

[14] This calculation is based on total direct payments for upland cotton base of $625 million (US 27 August Comments, Table at para. 28 reporting PFC payments for MY 2002 of $452 million and additional direct payments of $173 million). This figure has been adjusted by the ratio of MY 2002 plantings (13.714 million acres) and MY 2002 direct payment base acreage (18.858 million acres) (*See* Exhibit US-95).

[15] Brazil has used the direct payment of $454.5 million and adjusted it by the ratio of the direct payment rate of 6.67 cent per pound basis and the CCP payment rate for MY 2002 of 13.76 cents per pound.

[16] Brazil refers the Panel to Exhibits Bra-333 (Cotton: World Markets and Trade, USDA, October 2003, Table 3) for the amount of cotton exports that were covered by export credit guarantees during the fiscal years that overlap with MY 2002 (FY 2002 and FY 2003). Since the overlap is largely with fiscal year 2003, Brazil has used the share of cotton export credit guarantees ($349.63 million) of the total guarantees made available ($5,953 million) under GSM 102 and GSM 103 in that year to calculated the amount of payments as estimated by the FCRA formula. The original subsidy estimate for FY 2003 (taken from the 2004 budget) is $294 million. The share attributable to cotton export credit guarantees would be $17 million.

Brazil's Answer:

10. Brazil has no reason to disagree with the US calculations which appear based on information exclusively within the control of the United States.

**199. What is the composition of the A-Index? We do note footnote 19 and, for example, Exhibit BRA-11, but please explain more in detail how this index is calculated. BRA**

Brazil's Answer:

11. Brazil refers the Panel to the statement made by Andrew Macdonald in Annex II of Brazil's 9 September Further Submission that provides considerable detail about the calculation and formation of the A-Index.[17] Further information is set forth in Exhibit Bra-375.[18] The A-Index, along with the B-Index, are two important indices that summarize the price developments of the physical market in various countries around the world. Both indices are published by Cotlook, Inc., a private company, and reflect an average price.[19] As an index, it is not a trading or negotiable price, but a composite of quotations from the major producing origins around the world, much like a poll.

12. The A-Index is published weekly by the Cotton Outlook and calculated daily based on daily cotton price quotes converted on the basis of delivery to Northern European ports. The A-Index is generated based on Cotlook receiving daily information as regards quotations for upland cotton referring to 16 different origins. The quotes are for an upland cotton described as quality Middling Grade with a 1 3/32" staple length. The 16 quoted prices that are eligible for inclusion in the A-Index include prices for Brazilian Middling 1 3/32" upland cotton as well as prices for US Memphis and California/Arizona Middling 1 3/32" upland cotton.[20] The A-Index value of the day represents the average of the five cheapest quotes out of the 16 quotes that are considered for the index calculation. The price quotes are derived from a variety of physical markets, merchants and trade information, which is gathered telephonically and analyzed for consistency and logic.[21]

13. Andrew Macdonald testified that growers, consumers and traders perceive the A- (and B-Index), along with the New York futures prices as reflecting the "world" market price for cotton.[22]

**200. Concerning the chart on page 37 of Brazil's further rebuttal submission, why did Brazil use a futures price at planting time? Is this a relevant measure for assessing acreage response? BRA**

Brazil's Answer:

14. Brazil presented the nearby futures chart in its 18 November Further Rebuttal Submission[23] to rebut US arguments that US producers allegedly respond to market price signals in making their

[17] Brazil's 9 September Further Submission, Annex II, paras. 22-25.
[18] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).
[19] Brazil's 9 September Further Submission, Annex II, paras. 22-25.
[20] The other quotes being Mexican Middling 1 3/32", Paraguayan Middling 1 3/32", Izmir/Ant St White 1 3/32", Syrian Middling 1 3/32", Greek Middling 1 3/32", Spanish Middling 1 3/32", Uzbekistan Middling 1 3/32", Pakistan Punjab SG 1503 1 3/32", Indian H-4/Meach-1 1 3/32", Chinese Type 329, Tanzanian AR Type 2, African "Franc Zone" Middling 1 3/32" and Australian Middling 1 3/32".
[21] Brazil's 9 September Further Submission, Annex II, para. 22.
[22] Brazil's 9 September Further Submission, Annex II, para. 22.
[23] Brazil's 18 November Further Rebuttal Submission, paras. 81-82.

planting decisions.[24] Because the United States' 18 November Further Rebuttal Submission focused on the December Futures price in February as the relevant contract month to gauge producer's revenue expectations, Brazil presented a similar chart in its 2 December Oral Statement based on average December futures prices in January-March planting period.[25] Using December futures prices (like the nearby futures chart) confirms USDA's economists – and the world's leading cotton trader's[26] – conclusions that US subsidies make cotton producers largely unresponsive to market price signals.[27]

**201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so, please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? BRA, USA**

Brazil's Answer:

15. Brazil has reviewed the questions very carefully and regrets that it does not have a clear understanding of the meanings of the terms used. Therefore, Brazil provides alternative answers depending on the possible intent of the questions/terms used. Brazil regrets if it has misinterpreted the terms in the questions and would welcome the opportunity to provide additional comments if the Panel should so desire.

16. The first question focuses on data relating to "cotton production sold under *futures contracts.*" The term "futures contracts" could have several meanings in the context of this dispute. First, if the phrase "production sold under futures contracts" means the amount of US production sold on a forward delivery basis, the answer is that Brazil has no access to any such data. However, Brazil notes that all US upland cotton that is exported is for "future delivery" because it takes time to actually ship cotton from the United States, and some contracts are more "future" than other contracts. Theoretically, it would be possible to take the volume of US upland cotton exported each week and assume that it was sold at the average A-Index price that week. However, this would only be an estimate and would not necessarily reflect the price received by the US producers, or the prices received by the exporter. Prices received by US producers are tabulated by USDA and are before the Panel.[28] Average A-Index prices are also evidence before the Panel and are found in Exhibit Bra-311. If this is the information sought by the Panel, Brazil would be pleased to provide an estimate.

17. If the phrase "production sold under futures contracts" means contracts for future delivery where the contract for sale contains a pricing clause pegged to the New York futures price at the time of delivery, then the answer to the first question is "no," *i.e.*, there is no data that would provide the amount of production sold through such contracts. The record contains evidence that Brazilian and Chad producers and purchasers of upland cotton use such clauses in their contracts.[29] Brazil has no access to information concerning the amount of US upland cotton sold through such contracts.

18. Finally, if the phrase "cotton production sold under futures contracts" means the amount of US upland cotton that is sold through the New York cotton futures exchange, the answer is "very

[24] Brazil's 7 October Oral Statement, paras. 13-15. Brazil's 27 October Answers to Questions, paras. 35-36.

[25] *See e.g.* Brazil's 2 December Oral Statement, para. 44.

[26] *See* Brazil's Answer to Question 247 *infra*.

[27] Brazil's 2 December Oral Statement, paras. 39-40.

[28] *See e.g.* Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5) and various issues of USDA's Cotton and Wool Outlook, Table 6.

[29] Brazil's 9 September Further Submission, Annex II, para. 16; Chad's 8 October Oral Statement, para. 9 (Statement by Ibrahim Malloum).

little." As Andrew Macdonald has indicated, the purpose of the futures market is not for the buying or selling of physical cotton.[30] Rather, it is used for hedging position for growers and the upland cotton industry while the speculators in the market provide the day-to-day liquidity.[31] Physical delivery is theoretically possible in order to give reality to the market, *i.e.*, it is always possible to take or give delivery of cotton at the expiration of the contract. This ensures that the futures truly reflect the market and vice versa. However, the volume normally delivered is very small compared to the total volume traded during the life of a contract. This is because traders with long (or buy) futures contracts and traders with short (or sell) futures contracts "close out" or "settle" the contracts by offsetting trades at the end of the contract period and, thus, no physical cotton is delivered.[32]

19. With respect to the final question of whether a "futures sale impacts the producer's entitlement to marketing loan programme payments," the answer is "no." A producer is entitled to receive a marketing loan payment independent from any futures price or selling price that the producer may receive. A producer receives a marketing loan benefit if – after having taken out a marketing loan – he sells the upland cotton, *i.e.*, loses the beneficial interest to the upland cotton, or foregoes the right to a marketing loan in favour of a LDP payment, which is paid upon ginning of the raw cotton.[33] The process of marketing and selling the upland cotton in the United States or for export through forward contracts to supply upland cotton in the future, or contracts which set the price based on future New York futures market prices does not impact in any way the amount the US producer receives in marketing loan payments. The amount of marketing loan payment solely depends on the difference between the loan rate and the adjusted world price. Whether the actual selling price is below or above the loan rate, or below or above the adjusted world price, has no impact on the amount of the marketing loan benefit. The fact that producers may sell at prices above the adjusted world price means that they generate a combined revenue from the market and the marketing loan programme that exceeds 52 cents per pound.

**202. Concerning paragraph 7 of the US oral statement, are the expected cash prices shown for February only? Can the US provide the prices for January and March of each year as well? USA**

**203. Please provide information concerning the organization, mandate, credentials and standing of FAPRI. BRA**

Brazil's Answer:

20. The Food and Agricultural Policy Research Institute (FAPRI) was established in 1984 by a grant of Congress and continues to be financed largely by the US Congress. FAPRI is a unique dual-university programme by the Center for Agricultural and Rural Development (CARD) at Iowa State University[34] and the Center for National Food and Agricultural Policy at the University of Missouri (Columbia),[35] with researchers at the University of Missouri focusing mainly on the domestic / US side of agriculture and researchers at Iowa State University focusing mainly on international agricultural issues. FAPRI uses comprehensive data and computer modeling systems to analyze the

[30] Brazil's 9 September Further Submission, Annex II, para. 17.
[31] Brazil's 9 September Further Submission, Annex II, paras. 14-15.
[32] The information in this paragraph was provided by Andrew Macdonald to counsel for Brazil during the week of 12 December.
[33] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 1-2).
[34] Exhibit Bra-376 ("About FAPRI," Center for Agricultural and Rural Development, Iowa State University).
[35] Exhibit Bra-377 ("About FAPRI," Food and Agricultural Policy Research Institute at the University of Missouri).

complex economic interrelationships of the food and agriculture industry.[36] FAPRI's mission is to provide objective qualitative and quantitative analyses of alternative US and international agricultural policies.

21. FAPRI is considered the leading US agricultural policy research institute and ever since the 1985 farm bill[37] has conducted analyses of alternative policies that have helped shape US farm legislation. In July 2002, FAPRI received the USDA Secretary's Honor Award, the highest award bestowed by the US Department of Agriculture, for its analysis of various farm bill proposals that led to the 2002 FSRI Act.[38] Professor Bruce Babcock described the award as follows:

> This award recognizes the outstanding research effort by FAPRI at [Iowa State University] and [the University of] Missouri in analyzing policy proposals during the 2002 farm bill debate. This group has dedicated itself to being the world's best at conducting agricultural policy analysis.[39]
>
> …
>
> World economic integration makes it increasingly vital that we understand the impacts of US policy decisions on US and world markets, producers and consumers. Increasing numbers of policy proposals and their complexity requires that we continually update our analytical capabilities and our market intelligence.[40]

22. FARPI is the leading research institution that fulfills this task in the United States. FAPRI prepares baseline projections each year for the US agricultural sector and international commodity markets. The multi-year projections are published as FAPRI Outlooks,[41] which provide a starting point for evaluating and comparing scenarios involving macroeconomic, policy, weather, and technology variables.[42] These projections are intended for use by farmers, government agencies and officials, agribusinesses, and others who do medium-range and long-term planning.[43]

23. FAPRI describes its objectives as follows:

- To prepare baseline projections for the US agricultural sector and international commodity markets. These multi-year projections are available in print and on the Web.
- To examine the major commodity markets and analyze alternative policies and external factors for implications on production, utilization, farm and retail prices, farm income, trade, and government costs.
- To help determine effective risk management tools for crop and livestock producers, and to analyze how government policy affects risk management strategies.

[36] Exhibit Bra-378 ("About FAPRI," Food and Agricultural Policy Research Institute).
[37] Exhibit Bra-379 (CARD Report, 40th Anniversary Commemorative Issue, Part 2, p. 1-2.)
[38] Exhibit Bra-380 ("Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002).
[39] Exhibit Bra-380 ("Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002).
[40] Exhibit Bra-380 ("Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002).
[41] *See* http://www.fapri.iastate.edu/outlook2003.
[42] *See* http://www.fapri.iastate.edu/publications for all of FAPRI's publications.
[43] Exhibit Bra-378 ("About FAPRI," Food and Agricultural Policy Research Institute).

- To brief staff members of the US Senate and House Agriculture Committees on projections for US and world agricultural markets.

- To disseminate research results through printed reports, staff presentations, and on the Web.[44]

24. In sum, FAPRI is the most influential organization in the United States analyzing farm policy and its effects on US and world commodity markets, *i.e.*, that has the highest reputation and experience in answering the kind of "but for" questions faced by this Panel. This is a fact implicitly recognized by Dr. Glauber who indicated on 2 December in responding to the Panel's oral questions that the United States was not contesting FAPRI's work or analysis but rather took issue with Professor's Sumner's modifications to and use of the FAPRI baseline.

**204. Which support to upland cotton is not captured in the EWG data referred to in Brazil's 18 November further rebuttal submission? BRA**

Brazil's Answer:

25. While Brazil believes that the EWG data is a useful indicator of the amount of support provided to producers of upland cotton, the EWG data undercounts the amount of support in several basic ways. First, the database *undercounts* the amount of marketing loan payments reflected in FSA's "LDP / Loan / Market Gain Activity" Summary Report by $572 million for MY 2000 through MY 2002.[45] The EWG database also undercounts the amount of contract payments by $61 million in MY 2000 and MY 2001.[46] This means that there are very likely additional farms and recipients of upland cotton contract payments that also received marketing loan payments, but that are not tracked by EWG data.

26. Second, as described more fully in Christopher Campbell's statement in Exhibit Bra-316, the database also undercounts the percentage of contract payments to farms growing upland cotton, because marketing loan certificates are often purchased by partnerships, with the partnership receiving the payment from USDA.[47] There can be multiple partners in these partnerships that eventually get a portion of the marketing loan certificate payment. These partners are not recorded in the EWG data as receiving marketing loan payment – thus as upland cotton producers – but they *are*, in fact, producers of upland cotton that will most likely receive contract payments.

27. Third, current producers of upland cotton also received contract payments from base acreage other than upland cotton. The EWG database does not readily permit the allocation of these payments without the application of a complex methodology requiring a number of assumptions. Only farm-specific data exclusively controlled by the United States, which it continues to refuse to provide to Brazil and the Panel, would permit such a calculation.

28. The EWG data, however, provides corroborating evidence that Brazil's "$14^{th}/16^{th}$" methodology is a reasonable approximation of the amount of contract payments that are support to upland cotton. In view of the continued refusal of the United States to provide the requested information on contract payments and acreage matched by farm, the Panel should infer that Brazil's methodology of calculating these payments undercounts the actual amount of contract payments that constitute support to upland cotton.

[44] Exhibit Bra-378 ("About FAPRI," Food and Agricultural Policy Research Institute).

[45] *See* Brazil 9 September Further Submission, Table 1 p. 4 and Exhibit Bra-316 (Statement of Christopher Campbell – Environmental Working Group).

[46] *Compare* Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6) with Exhibit Bra-317 (EWG Database: Tables of Results, Table 2).

[47] Exhibit Bra-316 (Statement of Christopher Campbell, para. 13).

**205. Does the United States accept or agree with the EWG data submitted by Brazil? If not, please explain your reasons. USA**

**206. Please explain how the graph in paragraph 40 of the US further rebuttal submission was derived. In so doing, please clarify whether the figures are on a cents per pound basis or some other basis. What averaging method was used? Can you prepare individual charts showing average US and Brazilian cotton prices for each of those third country markets? USA**

**207. Please indicate whether any of the measures challenged in this dispute *obliges* cotton farmers to harvest their crop in order to receive the benefit of the programme (subsidy). USA**

**208. Please provide data for the marketing years 1992 and 1999-2002 of the "quantity of production to receive the applied administered price" (*Agreement on Agriculture*, Annex 3, paragraph 8) for purposes of a price-gap calculation of support through the marketing loan programme. USA**

**209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs. BRA, USA**

Brazil's Answer:

29. The trend between those two graphs differs because they provide a different measure for US upland cotton acreage. The graph at paragraph 5 of the US 2 December Oral Statement shows *harvested* acreage, while the graph at paragraph 39 of Brazil's Oral Statement shows *planted* acreage. The figures differ because not all planted US upland cotton is harvested. The rate of abandonment that describes the difference between planted acres and harvested acres is significant in the United States. During MY 1996-2002 it varied between 3.6 per cent in MY 1997 and 20 per cent in MY 1998. The average for the period was 12.2 per cent.[48]

30. Brazil notes that US upland cotton farmers naturally reflect their planting decisions in planted – not harvested – acreage. To analyze whether the planting decisions of upland cotton farmers in the United Sates are "congruent" to farmers in other parts of the world, it would be best to compare planted acreage figures. Harvested acreage figures are a function of weather effects that may cause the abandonment of a significant portion of planted acreage. This is relatively common in the arid cotton producing areas of the US Southwest and less common in the irrigated regions of the US West or in the high rainfall regions of the South. Brazil also refers the Panel to its response to Question 210.

**210. Are worldwide planted acreage figures available? BRA, USA**

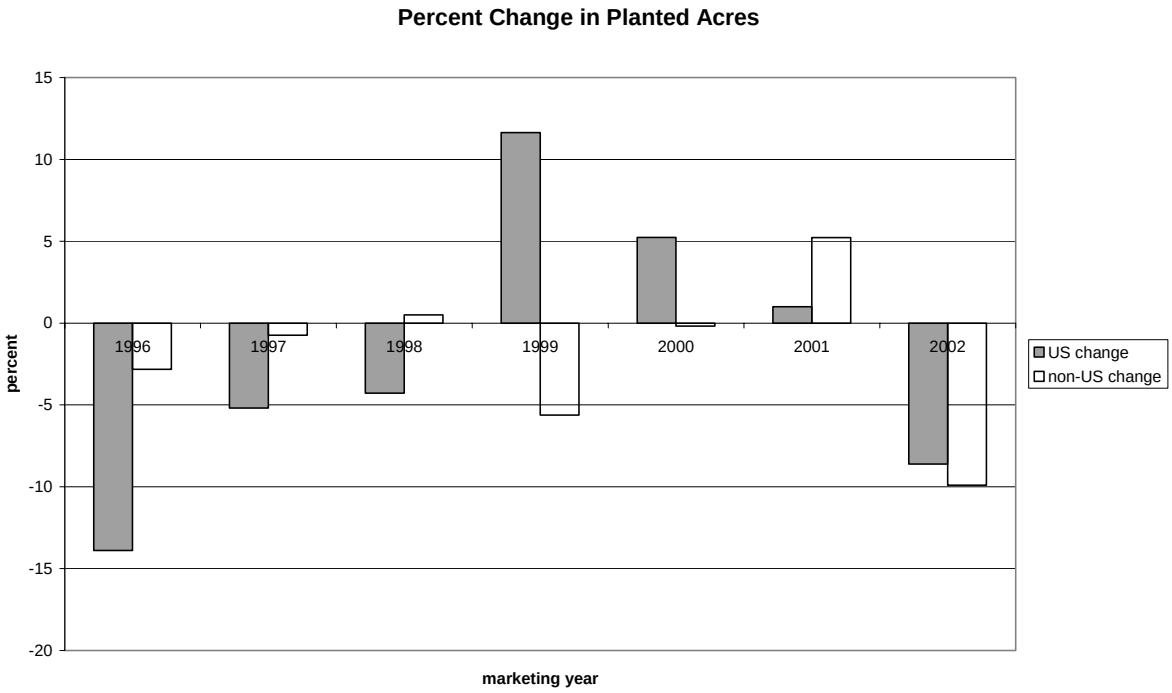
Brazil's Answer:

31. To the best of Brazil's knowledge, there are no planted acreage figures available on a worldwide basis. However, the fact that these figures do not or may not exist does not render the US harvested acreage graph valid for the purpose of evaluating the responsiveness of the US farmer to world prices.

[48] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

32. Nonetheless, variations in harvested acreage could be a reasonable proxy for variations in planted acreage for the world outside the United States. The reason is that the relationship between planted acreage and harvested acreage on a worldwide basis can be assumed to be relatively stable, *i.e.*, weather-related problems likely lead to the abandonment of about the same percentage of planted acreage at the aggregate level each year. Upland cotton is grown in many regions and worse than normal weather conditions in one region will be offset by better than normal weather in other regions. But this is not the case when only an individual country such as the United States is analyzed because individual countries have more variable weather. This is particularly true for the United States with the considerable variance in abandonment in the Southwest. Thus, for the United States, planted acreage is the appropriate measure of production decisions. By contrast, on the worldwide level, high abandonment in one region would be compensated or balanced out by low abandonment in other regions. On average, these differing trends would cancels each other out and worldwide harvested acreage would remain relatively stable over from year to year.

33. The following graph shows percentage changes in US planted acreage and percentage changes in non-US (harvested) acreage:[49]




As expected, the graph demonstrates that the decision-making process of US producers is quite different than that of non-US producers. US planted acreage moved in *opposite* directions to world harvested acreage between MY 1998-2000. In MY 1996, 1997 and 2001, US planted acreage changes to a far greater extent than non-US planted acreage.[50] Given those significant differences, for any valid statistical analysis, this graph could not possibly be used to support a claim that planting decisions in the US were analogous to those made worldwide. In fact, taken together with the other evidence that US producers are not sensitive to market signals,[51] this graph confirms that US producers are insulated from market forces and act independently of competitors' behavior.

[49] The US planted acreage is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) and Non-US acreage is taken from Exhibit US-63.

[50] The non-US planted acreage is approximated by using non-US harvested acreage. As discussed above, with a stable rate of abandonment, changes in harvested acreage equal changes in planted acreage.

[51] Brazil's 18 November Further Rebuttal Submission, Section 3.4 with further references.

34. The United States relies on its "harvested acreage" chart to argue that "US producers have increased and decreased acreage commensurately with producers in the rest of the world" relying on data for MY 1996-2002.[52] But even using this inappropriate harvested acreage chart, the same disconnect between US producers and other world producers can be seen. Only in two out of seven years is there a similar movement in the harvested acreage of the US and the rest of the world. In the other five years, the movement either goes in the opposite direction or the magnitude of the acreage movement is much smaller or greater respectively.

35. These distinctly different reactions by US and non-US farmers are consistent with the fact that non-US farmers must actually deal with market signals. The significant production declines by Mato Grosso producers in MY 2000 and 2001 in the face of record low prices (even though they are among the world's highest yield and lowest cost producers) illustrate this point well.[53] In addition, the fact that US farmers' planted acreage did not significantly decline in MY 1999-2002 is totally inconsistent with the considerable exchange rate increases of the US dollar during the same period.

36. Finally, even in MY 2002 when US acreage movements were relatively consistent with the rest of the world, the effect of the US subsidies significantly dampened the decrease in US acreage. As Professor has demonstrated, the US planted acreage in MY 2002 would have been 7.5 million acres *without* US subsidies not the 13.7 million acres actually planted.[54] Thus, the effect of the US subsidies is better estimated by examining the amount (or level) of US planted acres, rather than percentage changes in which the graph moves. Were it not for the US subsidies, the US downward trend in MY 2002 would have been much sharper, as a large number of inefficient cotton producers would have chosen not to plant or would have switched crops.

**211. Brazil presents a graph in paragraph 59 of its further rebuttal submission indicating the increasing cumulative loss incurred by cotton producers. Please comment on the argument that US cotton producers could not continue operating without subsidies. In particular:**

**(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?**

**(b) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? USA**

**212. Brazil states in paragraph 37 of its oral statement that studies of Westcott and Price found that the effect of the programme on cotton is to add an additional 1 to 1.5 million acres during marketing years 1999-2001 and to suppress US prices by 5 cents per pound. Does the US reject these findings? Why or why not? USA**

**213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? BRA, USA**

[52] US 2 December Oral Statement, para. 5. This data is different from the one contained in the above graph, as it is based on US harvested acreage data rather then planted acreage.

[53] *See* Exhibit Bra-283 (Statement by Christopher Ward – 7 October 2003).

[54] Brazil has applied the percentage change as estimated by Professor Sumner in Brazil's 9 September Further Submission, Annex I, Table I.5a.

Brazil's Answer:[55]

37. Econometric simulation models of the sort used by Professor Sumner, USDA and other independent economic analysts have not used futures markets in their projections or counterfactual analysis. Instead, analysts have used either lagged prices and revenues or some variant of lagged or actual realized prices or revenues as the representation of grower expectations. Thus, there are no comparisons that one could make in this regard.

38. As previously noted, "it is impossible to know what precisely individual farmers expect"[56] because price expectations of farmers are "fundamentally unobservable."[57] It is important to note that USDA economists Westcott and Price, like Professor Sumner, have used and relied on the same retrospective analysis of the effects of marketing loans using so-called "lagged prices" – not futures prices. The United States notes that the use of a futures price analysis for MY 2002 is not possible for "multi-commodity modeling frameworks for extended time projection."[58] The United States accepts that FAPRI, USDA and the US Congressional Budget Office use lagged prices rather than futures prices as proxies for price expectations.[59] And Dr. Glauber indicated during the second Panel meeting on 3 December that the United States accepts the FAPRI modeling system as a valid means to analyze the questions faced by this Panel.

39. The statistical estimation literature in agricultural economics has used a variety of proxies for anticipated prices and revenue for the upcoming season. These include rational expectations in which many sources of information available to decision makers are combined and the expectations are consistent with the conditional forecasts of the model. Such models have strong theoretical grounding but have been impractical in most estimation situations.

40. No systematic survey has been undertaken of the very large statistical literature estimating supply functions to study how estimates differ based on assumed models of the formation of expectations.[60] In a recent study for rice, McDonald and Sumner[61] found that most published articles for rice (another US programme crop with complex government programmes) used a variant of lagged information to project prices and future revenue per acre. None of the rice estimates used futures markets.

41. Across a wide variety of commodities, no systematic differences are noticeable in estimated supply or acreage response depending on how expectations of prices and other revenue terms are represented in the model. That is, there is no evidence that the estimated acre response elasticity are systematically lower or higher using futures markets to represent the price that then enters the projected relative net revenue function used for estimation.

42. Finally, if the United States were right (which it is not) that futures prices are a better indicator of farmers' price expectations, then Professor Sumner's results are *not wrong*, but

[55] The information and analysis in this answer was provided by Professor Sumner.

[56] Brazil's 9 September Further Submission, Annex I, para. 18.

[57] Exhibit Bra-279 (Statement of Professor Sumner – 7 October 2003, para. 9). *See also* Exhibit Bra-361 (Cotton Pricing Guide, July 2001) containing guidance for farmers to take planting and marketing decisions.

[58] US 7 October Oral Statement, para. 34.

[59] US 7 October Oral Statement, para. 34.

[60] Exhibit Bra-306 (Lin, William, Paul C. Westcott, Robert Skinner, Scott Sanford, and Daniel G. De La Torre Ugarte. *Supply Response Under the 1996 Farm Act and Implications for the US Field Crops Sector*, TB-1888, US Department of Agriculture, Economic Research Service, July 2000) provides a survey of the literature and cites mostly studies that use a variant of lagged prices. Lin et al. use both lagged prices and futures markets to represent expectations.

[61] Exhibit Bra-381 (Jeffrey D. McDonald and Daniel A. Sumner. "The Influence of Commodity Programmes on Acreage Response to Market Price: With an Illustration concerning Rice Policy in the United States." *American Journal of Agricultural Economics*, (85) 4 (November 2003): 857-871).

*conservative*. This is, because, as a matter of statistical theory, the more precise the proxy for expected price or revenue, the larger the coefficient of supply response. For example, in regression estimations, when an explanatory variable is measured with error, the regression coefficient tends to be biased toward zero, thus undercounting the significance of the variable. When there is less error in measurement (*i.e.*, the imperfectly measured proxy variable becomes more accurate) the regression coefficient tends to be larger.[62] In the present context, this means that if futures market prices were better proxies for farmers' expectations, the estimated coefficient of the price or revenue effect on acreage (the acreage response elasticity) would be larger. It follows that the estimated acreage response elasticity would be too low in the FAPRI model. US acreage would respond stronger to changes in relative cotton revenue than estimated in the FAPRI models. In the context of the Professor Sumner's simulation analysis, that would mean larger US supply response to expected price and revenue changes, and thus higher supply and export response to government programme benefits. In sum, Professor Sumner's results, which are based on FAPRI elasticity estimates, would not be wrong, but would underestimate the amount of additional acreage, production and exports from US policy incentives.

## III. Domestic Support

**214. Please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? USA**

**215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA**

Brazil's Answer:

43. It is correct that the CCP payments cease when average US farm prices for the marketing year received by US farmers rise above 65.73 cents per pound. But this has only happened four times since the 1930s and the last time was seven years ago in MY 1996. In MY 2002, the average price received by US farmers was 40.50 cents per pound.[63] Through November 2003, MY 2003 average price received by US farmers was 58.5 cents per pound.[64] Indeed, the first CCP payment has been made for MY 2003.[65]

44. The impact of the direct payments has been analyzed and quantified by Professor Sumner who found, using the FAPRI November 2002 baseline, that in MY 2002 direct payments added 120,000 acres to US upland cotton production.[66]

45. Even in the highly unlikely event that expected US farm prices were to exceed the CCP target price of 72.4 cents per pound for MY 2004[67] (prices that have occurred only twice in the past 75 years), direct payments would still be made and US producers would still require direct payments

[62] *See e.g.* William H. Green, Econometric Analysis, 5th edition, 2002, Prentice Hall or any standard textbook on regression analysis.

[63] Exhibit Bra-202 (Agricultural Outlook Tables, USDA, August 2003, p. 5).

[64] Exhibit Bra-382 (Cotton and Wool Outlook, USDA, 12 December 2003, Table 6) for September to November 2003 and Exhibit Bra-328 (Cotton and Wool Outlook, USDA, 14 October 2003, Table 6) for August 2003.

[65] Exhibit Bra-340 ("USDA Announces First Partial 2003-Crop Counter-Cyclical Payments," USDA Press Release, 17 October 2003).

[66] Brazil's 9 September Further Submission, Annex I, Table I.5a.

[67] US farm prices have exceeded 72.4 cents per pound only twice in 75 years – in MY 1995 and in MY 1980. Exhibit Bra-4 ("Fact Sheet Upland Cotton," USDA, January 2003, p. 5).

to cover the total cost of current production. These payments, like the other payments in the package of cotton subsidies, are essential to maintain past, current, and future high levels of US upland cotton production.[68] Thus, they must be taken into account in assessing the production-distorting effects they caused in MY 2002 as well as today in MY 2003.

46. Brazil recalls that even if futures price were to indicate that US farm prices will be at or somewhat above the target price, the programme has a significant impact on planting decisions. At planting time, the producer still is unsure on whether or not the target price will be met during the following marketing year. Given the considerable price fluctuations and the low prices in the MY 1997-2002 period, there is a significant risk that actual prices will be lower than the futures market predicts. The direct and counter-cyclical payments remove the risks of lower prices. The evidence of a long-term lack of any significant US acreage response to higher or lower prices since MY 1996 demonstrates that US producers have and will continue to plant upland cotton because they face no downside revenue risk. Professor Sumner outlined this effect when he responded to a similar question by the Panel at the second meeting with the parties.[69] This reinforces the argument that the Panel cannot disregard these payments in the scenario described in the question.

**216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. BRA, USA**

Brazil's Answer:

47. Under the deficiency payment programme as provided by the 1985 and 1990 Farm Acts, farmers were offered the option to update the amount of acreage participating in the programme each year. To do this, they were required to opt *out* of the programme and receive no payments during the period in which they increased the amount of acreage planted to the programme crop. Relatively few upland cotton farmers took advantage of this programme feature because the costs of forgoing payments in the current year generally outweighed the present value of benefits of higher base acres and base yield in the future.

48. In the 1996 FAIR Act, farmers established their production flexibility base acreage by carrying over the would-be deficiency payment base acreage. For example, any producers of upland cotton during the period MY 1991-1995 were entitled to place such acreage into the PFC programme along with any acreage that had been in the conservation programme and was released from that programme in MY 1996.[70] Unlike the 1985 and 1990 Farm Acts, the 1996 FAIR Act did not authorize any acreage or yield updates by individual farmers during later years. In the 1996 FAIR Act, Congress essentially told farmers they should take advantage of planting flexibility and that planting alternative crops would not affect the amount of their payments. However, several years after 1996, as commodity prices began to decline, momentum for an update in the next farm act began to build. Many upland cotton farmers and others argued that their historical acreage and yields no longer reflected the reality of their current production and that they needed additional payments on their increased programme crop acreage. These upland cotton and other programme crop growers

[68] Brazil's 18 November Further Rebuttal Submission, para. 26 citing, *inter alia*, the National Cotton Council.

[69] Exhibit Bra-371 (Simple Example of the Calculations of Marketing Lon Benefits (Probability Distribution).

[70] Any such former deficiency payment base being released from the conservation programme could be added to the PFC base once the land left the conservation programme.

including wheat, feed grains, and rice pressured Congress to include updating of acreage and yield bases in the 2002 Farm Bill.[71]

49. The 2002 FSRI Act provided for the opportunity for all farmers to update their base acreage for purposes of the direct payment programme and to update their base acreage and base yields for purposes of the counter-cyclical payment programme. They could do this without having to temporarily opt out of the programmes, which they needed to do under the deficiency payments programme. The 2002 update and the individual deficiency payment updates during 1985-1995 established the principle that acreage and yield base updates are a part of the farm policy in the United States. Even though no updates are explicitly provided for during the lifespan of the 2002 FSRI Act, farmers may reasonably expect future updates, either as a part of ad hoc legislation or as a part of the regularly scheduled new law in 2007.

50. The pressure for updates will come especially from farmers who were not in a position to take advantage of the 2002 update having switched away from higher per-acre payment crops like upland cotton or rice. For example, farmers who had planted less than their full upland cotton base to upland cotton in the MY 1998 to 2001 period would likely have found the acreage update unattractive. But, since the yield update was only available to farmers who updated acreage, these farmers also missed the opportunities to update yields. These farmers expressed deep disappointment in 2002 that they had used planting flexibility, only to find that they were penalized by not being allowed to update payment yields. These farmers saw the update of 2002 by farmers who had stayed in upland cotton production during MY 1998-2001 as unfair and look to have this redressed in the next revision of the programmes. Many of those (non-updating) farmers are now planting their full upland cotton base (or more) and are maintaining high and expanding inputs to expand their yields in order to be in a position to take advantage of an anticipated base update at the next opportunity. These farmers will add to the political pressure to update base in 2007, if not before.

**217. What is the reason for reducing payments under the PFC and direct payments programmes for planting and harvesting fruit, vegetables and wild rice on certain base acreage? Please comment on the statements by the European Communities that "the reduction in payment for fruit and vegetables, if the EC understands correctly, is in fact designed to avoid unfair competition within the subsidising Member." (EC oral statement at first session, first substantive meeting, paragraph 29) and "To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition (…)" (EC response to Panel third party Question No. 5). USA**

**218. Please comment on the testimony of USDA Chief Economist Keith Collins cited in paragraph 36 of Brazil's oral statement regarding the trade-distorting and production-distorting nature of the marketing loan payments. USA**

## IV. Export Credit Guarantees

**219. Under the *Agreement on Agriculture* the general position is that the use of export subsidies, both those listed in Article 9.1 as well as those within the scope of Article 1(e) which are not so listed, may only be used within the limits of the product specific reduction commitments specified in Part IV of Members' Schedules. One might therefore have expected that Article 3.3 of the *Agreement on Agriculture* would have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, would have simply prohibited the use of any export subsidy. Instead, the Article 3.3 prohibition is limited in both cases to export**

[71] *See e.g.* Exhibit Bra-41 (Congressional Hearing, "The Future of Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, p. 4, and 24).

**subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:**

**(a) the fact that export performance-related tax incentives, which like subsidised export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held (for example, in *United States – Tax Treatment for Foreign Sales Corporations*, WT/DS108) to be subject to the anti-circumvention provisions of Article 10.1; and**

**(b) the treatment of international food aid and non-commercial transactions under Article 10? USA**

**220. What will be the relevance of Articles 9 and 10.1 of the *Agreement of Agriculture* to export credit guarantees when disciplines are internationally agreed? BRA**

Brazil's Answer:

51. The relevance of Articles 9 and 10.1 of the Agreement on Agriculture following the conclusion of the negotiations called for by Article 10.2 of the Agreement necessarily depends on the commitments that are negotiated. Brazil does not know what the outcome of the negotiations will be, or what commitments, if any, parties will undertake. Nor does Brazil know in what way those commitments would be brought into the WTO – automatically, *via* the cross-reference in Article 10.2, or instead *via* amendments to the Agreement on Agriculture or the SCM Agreement, or yet some other means. The nature of the disciplines negotiated and the way in which those disciplines are transposed into the WTO will dictate the effect they will have on Articles 9 and 10.1. With these important reservations about the purely hypothetical nature of this exercise, Brazil will explore a number of possible outcomes and the impact those outcomes would have on Articles 9 and 10.1.

52. One possible outcome is that negotiators will reach agreement on other types of export credits, but that export credit guarantees will not be included. In Brazil's view, this would mean that export credit guarantees would continue not to be among those *per se* export subsidies listed in Article 9.1, and would continue to be subject to Article 10.1, to the extent that they constitute export subsidies and circumvent (or threaten to circumvent) a Member's export subsidy commitments.

53. Another possible outcome is an amendment to Article 9.1 that would add export credit guarantees (or possibly those export credit guarantees issued or programmes maintained on particular terms or conditions) to the list of *per se* export subsidies. Article 10.1 would no longer be applicable, since export credit guarantees would no longer be "[e]xport subsidies not listed in paragraph 1 of Article 9 … ."

54. Yet another possible outcome is agreement to subject export credit guarantees to the same type of notification, consultation and information exchange disciplines agreed in the OECD Arrangement on Officially Supported Export Credits for industrial products ("OECD Arrangement").[72] For example, the OECD Arrangement includes provisions regarding: prior notification of derogations, permitted exceptions, matching of derogations, permitted exceptions, non-conforming non-notified terms, and terms granted by countries that are not parties to the OECD Arrangement. The United States now characterizes such disciplines as "pedestrian."[73] In *Canada – Aircraft II*, however, the United States characterized these provisions and the disciplines they

[72] *See* OECD Arrangement on Guidelines for Officially Supported Export Credits, Chapter IV (Sections 1-5) available at http://www.oecd.org/dataoecd/52/3/2763846.pdf.

[73] US 3 December Closing Statement, para. 3.

provided as central to the "entire logic" of the OECD Arrangement, and as a critical way to prevent "a subsidy 'race to the bottom.'"[74]

55. Under this outcome, export credit guarantees would continue not to be among those *per se* export subsidies listed in Article 9.1, and would continue to be subject to Article 10.1, to the extent that they constitute export subsidies and circumvent (or threaten to circumvent) a Member's export subsidy commitments. Under WTO jurisprudence, the provisions regarding notification, consultation and information exchange would be read cumulatively with Article 10.1, since the obligations imposed would not be mutually exclusive or mutually inconsistent.[75]

56. Another possible outcome would be agreement on alternative benchmarks against which to determine whether export credit guarantees and export credit guarantee programmes would constitute export subsidies. In determining what constitutes an "export subsidy" within the meaning of Article 10.1, the Appellate Body's decisions in *US – FSC*[76] and *Canada – Dairy*[77] currently direct the Panel to refer to contextual guidance included in Articles 1 and 3 of the SCM Agreement and in item (j).[78] Were agreement one day reached on alternative benchmarks following negotiations pursuant to Article 10.2, that agreement might provide relevant context for a panel to determine what constitutes an "export subsidy" for the purposes of Article 10.1. Alternatively, it might serve as "subsequent practice," pursuant to Article 31(3)(b) of the Vienna Convention on the Law of Treaties, indicating the interpretation of the term "export subsidy" that the Members intend for the purposes of Article 10.1.[79]

57. Under this outcome, export credit guarantees would continue not to be among those *per se* export subsidies listed in Article 9.1. Moreover, they would continue to be subject to Article 10.1, to the extent that they constitute export subsidies, and to the extent that they circumvent (or threaten to circumvent) a Member's export subsidy commitments. The difference would be that the interpretation of the term "export subsidy" might be based, among other things, on the context or evidence of "subsequent practice" offered by the newly-negotiated alternative benchmark.

**221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be $230,127,023 instead of the figure which originally appeared ($381,345,059).**

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[74] Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2, paras. 12-13 (Third Party Submission of the United States, 22 June 2001).

[75] *See e.g.* Appellate Body Report, *Guatemala –Cement*, WT/DS60/AB/R, paras. 66, 73-74; Panel Report, *Indonesia – Automobiles*, WT/DS54, para. 14.28.

[76] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 136-140.

[77] Appellate Body Report, *Canada – Dairy*, WT/DS103/AB/R and WT/DS113/AB/R, para. 87-90.

[78] *See* Brazil's 24 June First Submission, paras. 258-261.

[79] The extent to which alternative benchmarks agreed pursuant to negotiations under Article 10.2 qualify as relevant context for or as "subsequent practice" regarding the interpretation of the term "export subsidy" in Article 10.1 will depend, in part, on the form the agreement takes. If agreement is reached among only the 10 WTO Members that participated in OECD discussions on agricultural export credit disciplines, it will be difficult to argue that the agreement serves as relevant context for interpretation of Article 10.1, which is applicable to 146 Members. Nor would such an agreement constitute evidence of "subsequent practice." *See* Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 213 (defining "subsequent practice" as "a 'concordant, common and consistent' sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties [to a treaty] regarding its interpretation."). *See also* Appellate Body Report, *Japan – Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 12-17.

**(a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.**

**(b) Please clarify whether and how the Panel should treat the figures in Exhibit BRA-182 for the net lifetime re-estimates for each respective cohort.**

**(c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of $4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately $4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result.**

Brazil's Comment:

58. With respect to the $4 million of administrative expenses for the CCC guarantee programmes, Brazil draws the Panel's attention to Congressional testimony by the administrator of the programmes, General Sales Manager Christopher Goldthwait. This testimony is included on pages 20-21 of Exhibit Bra-87. Mr. Goldthwait's testimony clarifies that premiums charged by the CCC are sufficient to cover these administrative expenses, but not other costs and losses of the programmes.

59. A member of Congress posed the following question to Mr. Goldthwait and August Schumacher, USDA's Under Secretary for Farm and Foreign Agricultural Services:

> Is [the GSM] programme operated at essentially no net costs to the US Government? By that what I mean putting to one side the Iraq and the Poland experiences which you outlined earlier in your response to questions, do we charge fees that reflect the cost of administering the programme *and the risk that is involved, the default, things such as that*, or is this a programme which is subsidized at a fairly significant level by the Federal Government? (emphasis added)

Mr. Goldthwait's response was as follows:

> Yes. The programme is *from the administrative standpoint* at least pretty much self-financing. We do collect fees. The fee structure is relatively modest. We keep the fees low because the legislation has limited us to no more than 1 per cent. But, nonetheless, we collect several million dollars a year in fees, *and that enables us to say that effectively the administrative cost of running the programme are more than covered*. Now, that money does not come directly to us at the USDA, it goes to the general Treasury account, but the amount of the money is more than *enough to cover the administrative costs of the programme*. (emphasis added)

60. Thus, although the question asked whether fees covered "the cost of administering the programme *and* the risk that is involved, the default, things such as that," Mr. Goldthwait, the administrator of the CCC guarantee programmes, responded that fees "at least pretty much" covered only "the administrative cost of running the programme." Mr. Goldthwait could not state that the fees collected also cover "the risk that is involved, the default, things such as that," since, as Brazil has established, fees for the CCC guarantee programmes are not set to (see comment to question 223) and in fact do not cover those risks and defaults.

**(d) Please identify what is considered an "administrative expense" for this purpose.**

**(e) The Panel notes the US statement in paragraph 160 of its answers to Panel questions following the first meeting that all cohorts are still open although the 1994 and 1995 cohorts will close this year. Is this still an accurate statement? If not, please indicate whether any cohorts have since "closed" for the period 1992-2002.**

**(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily* reach a "profitable" result (for example, the 1994 cohort, which has almost closed still indicates an outstanding amount)? Do "re-estimates" reflect also expectations about a cohort's future performance?**

Brazil's Comment:

61. Brazil reserves the right to comment on the US response, but would like to provide a preliminary comment on the last part of the Panel's question. To a certain extent, reestimates do reflect expectations about a cohort's future performance. Agencies are to undertake two types of reestimates – interest rate and technical reestimates. The Office of Management and Budget ("OMB") defines these two types of reestimates in the following way:

> Two different types of reestimates are made:
>
> - Interest rate reestimates, for differences between interest rate assumptions at the time of formulation (the same assumption is used at the time of obligation or commitment) and the actual interest rate(s) for the year(s) of disbursement; and
>
> - Technical reestimates, for changes in technical assumptions.[80]

62. One purpose of technical reestimates is "to adjust the subsidy estimate for . . . new forecasts about future economic conditions, and other events and improvements in the methods used to estimate future cash flows."[81] The OMB also states that one purpose of technical reestimates is to record "changes in assumptions about future cash flows."[82]

**(g) Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?**

**(h) Why should the Panel "eliminate", in addition, the 2000 cohort, as also suggested in paragraph 198 of the US further rebuttal submission for which information is presumably more "complete"?**

**(i) Under the US approach, at what point in time could a Panel ever make an assessment of the programme, if it had to wait for each cohort to be completed before it could be "properly" assessed? Why is it inappropriate for the Panel to**

[80] Exhibit Bra-116 (OMB Circular A-11, p. 185-15).
[81] Exhibit Bra-116 (OMB Circular A-11, p. 185-16).
[82] Exhibit Bra-163 ("Introduction to Federal Credit Budgeting," OMB Annual Training, 24 June 2002, White House Conference Center, p. 32).

**include these "most recent years" in its evaluation, as the US suggests in paragraph 199 of its 18 November further rebuttal submission? USA**

**222. For GSM 102, 103 and SCGP, please provide year-by-year amounts from 1992 to 2003 with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes. Please indicate any allocation methodologies used to calculate administrative costs. USA**

**223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? USA**

Brazil's Comment:

63. Brazil reserves the right to comment on the US response, but would like to provide a preliminary comment on the first part of the Panel's question. First, Brazil notes that premium rates for the three CCC guarantee programmes are not subject to regular review. In audit reports of the CCC's fiscal year 2000 and 2001 financial statements, USDA's Office of the Inspector General confirmed that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs."[83] Two changes have been made, in the fee schedule for GSM 102, since November 1994: (i) for a 12-month guarantee with semi-annual repayment intervals, the fee was changed from $0.209 per $100 of coverage to $0.229 per $100 of coverage; and (ii) borrowers are now offered the additional option of 30- and 60-day guarantees, at the same fee charged for 90-day and 4-, 6- and 7-month guarantees.[84]

64. Moreover, the US General Accounting Office ("GAO") analyzed CCC's failure to charge guarantee fees that take account of country risk or the creditworthiness of individual borrowers. The GAO emphasized that CCC's failure to do so means that it lacks the flexibility to cover the costs and losses of the programmes:

> Although GSM-102 recipient countries vary significantly from one another in terms of their risk of defaulting on GSM-102 loans, CCC does not adjust the fee that it charges for credit guarantees to take account of country risk. CCC fees are based upon the length of the credit period and the number of principal payments to be made. For example, for a 3-year GSM-102 loan with semiannual principal payments, CCC charges a fee of 55.6 cents per $100, or 0.56 per cent of the covered amount. For 3-year loans with annual principal payments, the fee is 66.3 cents per $100.[ ] CCC fees that included a risk-based component might not cover all of the country risk, but they could help to offset the cost of loan defaults.[85]

[83] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31). *See also* Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed for many years and may not be reflecting current costs.").

[84] Brazil's 11 August Answers to Questions, para. 167 (first bullet point).

[85] Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 135-136).

As noted above, CCC fees for GSM 102 have not changed materially since the GAO published its report in 1995.[86] Moreover, the United States confirmed in its 11 August Answer to Question 84 (at paragraph 180) that US law prohibits CCC from charging fees in excess of one per cent of the guaranteed dollar value of the transaction.

65. With respect to the second part of the Panel's question, Brazil has demonstrated that forfaits and export credit insurance are not similar financial instruments to CCC export credit guarantees, and therefore that the terms for forfaits and export credit insurance cannot serve as benchmarks against which to determine whether CCC export credit guarantees confer "benefits."[87] Moreover, Brazil has demonstrated that in any event, fees for forfaiting instruments are well above fees for CCC export credit guarantees.[88]

66. Although government support from the US Export-Import Bank does not constitute a market benchmark for the purposes of determining "benefit," Brazil has offered evidence that premiums for CCC guarantees are considerably lower that fees for Ex-Im Bank guarantees.[89] This demonstrates that the terms for CCC guarantees do not even meet *non-market* benchmarks. As noted by the GAO:

> The US Export-Import Bank, which provides credit guarantees to promote a variety of US exports, uses risk-based fees to defray the cost of defaults on its portfolio. Under its system, each borrower/guarantor is rated in one of eight country risk categories. Exposure fees vary based on both the level of assessed risk and the length of time provided for repayment. For example, in the case of repayment over 3 years, a country rated in the lowest risk category is charged a fee of 75 cents per $100, whereas a country in the highest risk category is charged a fee of $5.70 per $100 of coverage. Thus, the bank's fee structure includes a substantial added charge for high country risk. According to the bank, its system is designed to remain as competitive as possible with fees charged by official export credit agencies of other countries.
>
> Under section 211(b)(1)(b) of the 1990 Farm Bill, CCC is currently restricted from charging an origination fee for any GSM-102 credit guarantee in excess of an amount equal to 1 per cent of the amount of credit extended under the transaction.[90] This restriction was initially enacted in 1985 following proposed administration legislation to charge a 5-per cent user fee for exports backed with credit guarantees. Some Members of Congress were concerned that such a fee would adversely affect the competitiveness of GSM-102 exports. Under the 1-per cent restriction, CCC would be considerably limited in the size of the fee that it could charge to take account of country risk should it decide to do so. For example, as previously noted, CCC charges 0.56 per cent for a loan payable in 3 years and with principal payments due annually. The most it could increase the fee would be 0.44 per cent. In contrast, the Export-Import Bank currently charges fees as high as 5.7 per cent for 3-year loans.[91]

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[86] Brazil's 11 August Answer to Question 77 and 84, para. 167, 193-194.

[87] Brazil's 22 August Rebuttal Submission, paras. 103-105; Brazil's 27 August Comments on US Rebuttal Submission, paras. 68-70; Brazil's 7 October Oral Statement, para. 72; Brazil's 18 November Further Rebuttal Submission, paras. 233-241; Brazil's 2 December Oral Statement, para. 79.

[88] Brazil's 27 August Comments on US Rebuttal Submission, paras. 76-77 and Exhibit Bra-199 (Trade and Forfaiting Review, "Argentina Trade Finance to the Rescue," Volume 6, Issue 9 July/August 2003).

[89] Brazil's 27 August Comments on US Answers, para. 110.

[90] The United States confirmed in paragraphs 179-180 of its 11 August Answer that this remains the case.

[91] Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 135-136).

**224. Please indicate how the CCC's cost of borrowing was treated in the 2002 financial statement of the CCC, in Exhibit BRA 158. USA**

**225. Please indicate whether there was any instance where the CCC "wrote off" debt and, if so, please indicate the accounting regulation or principle used. If a "written off" debt is subsequently recovered, do the CCC's accounts reflect both the interest cost and interest received in relation to the debt during the time it was "written off"? USA**

**226. If a debt was "written off" more than ten years ago, does it still create a cost to the programme? If so, how is this reflected in the 2002 financial statement of the CCC, in Exhibit BRA 158 (or any other material)? USA**

**227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount – referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? USA**

Brazil's Comment:

67. On page 4 of the notes to the CCC 2002 financial statements, CCC defines the term "Credit Guarantee Liability" as follows:

> Credit guarantee liabilities represent the estimated net cash outflows (loss) of the guarantees on a net present value basis. To this effect, CCC records a liability and charges an expense to the extent, in management's estimate, CCC will be unable to recover claim payments under the post-Credit Reform Export Credit Guarantee programmes.[92]

Thus, Brazil stands by its characterization of the $411 million figure as a cumulative running tally of the losses for the programmes during the period 1992-2002, and as one way of demonstrating that the CCC guarantee programmes meet the elements of item (j).

**228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? BRA, USA**

Brazil's Answer:

68. Item (j), interpreted according to its ordinary meaning, in its context and according to the object and purpose of the SCM and Agriculture Agreements, does not require that the Panel use any particular accounting principles to assess long-term operating costs and losses. Similarly, under item (j), it is not *incumbent* on the Panel to conduct its analysis in accordance with US government accounting principles, whether or not those principles adhere to GAAP. (A Panel may, however, consider it particularly persuasive that the US government' own accounting principles lead to a conclusion that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes.) Nor is it necessary, at this stage of dispute settlement proceedings, for

[92] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 4)).

the Panel to arrive at a determination of the precise amount by which operating costs and losses incurred by the CCC guarantee programmes outpace premiums collected.

69. For these reasons, Brazil has offered a number of different methodologies and sets of evidence that the Panel can use to determine whether premium rates are adequate to meet the long-term operating costs and losses of the CCC guarantee programmes. Each of those methodologies or sets of evidence demonstrates that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes.

70. One methodology is the present value accounting endorsed by the US Congress and the President in the Federal Credit Reform Act ("FCRA"). The FCRA has been translated into accounting standards for US government loan guarantees by the Federal Accounting Standards Advisory Board ("FASAB"). Consistent with the FCRA, the FASAB accounting standards state that "[f]or guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability."[93] The FASAB standards (and the FCRA) state that "[t]he amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term applicable to the period during which the loans are disbursed."[94]

71. As one way to determine whether the long-term operating costs and losses of the programmes outpace premiums collected, Brazil has used the net subsidy expense (including reestimates) calculated using the FCRA and FASAB standards over the period 1992-2002.[95] The CCC has itself adopted this methodology in its 2002 financial statements, when it lists a net subsidy expense of $411 million for all post-1991 CCC guarantees.[96] Using present value accounting, CCC's 2002 financial statements also track enormous uncollectible amounts on pre-1992 and post-1991 guarantees that far outpace premiums collected for the programmes – by $2.3 billion on pre-1992 guarantees, and by $550 million on post-1991 guarantees.[97]

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[93] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, "Statement of Federal Financial Accounting Standards No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees" in STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 2, March 2001, p. 13 (para. 23)).

[94] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, "Statement of Federal Financial Accounting Standards No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees" in STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 2, March 2001, pgs. 13-14 (para. 24)).

[95] Exhibit Bra-193.

[96] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

[97] *See* Brazil's 11 August Answers to Questions, para. 167 (third and fourth bullet points); Brazil's 18 November Further Rebuttal Submission, para. 250; Notes to Financial Statements contained in Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2002, Audit Report No 06401-15-FM (December 2002), pg. 14). Contrary to the United States' assertion at paragraph 170 of its 22 August Rebuttal Submission, for post-1991 CCC guarantees, the amounts in the "subsidy allowance" column are actually the amounts of receivables associated with post-1991 CCC guarantees that CCC considers uncollectible. Under the FCRA – and as confirmed above in the quote from page 4 of the CCC 2002 financial statements – the subsidy allowance is recorded on a net present value basis, which means that it represents the cost CCC considers it will incur on a guarantee cohort *at the time that cohort is closed*. The amount listed in the "subsidy allowance" column in the receivables table of CCC's 2002 financial statements for post-1991 guarantees is therefore as uncollectible as the amount listed in the "uncollectible" column of the pre-1992 CCC guarantee receivables table.

72. The Panel asks whether, if US government regulations require costs to be treated differently than they would be under generally accepted accounting principles, the Panel must conduct its analysis in accordance with that treatment. As Brazil has already noted, nothing in item (j) would require the Panel to do so. However, Brazil notes that in its 2002 financial statements, the CCC, which relies on present value accounting, states that "[t]he accounting principles and standards applied in preparing the financial statements and described in this note are in accordance with Generally Accepted Accounting Principles (GAAP) for Federal entities."[98]

73. In this dispute, the United States objects to the use of present value accounting to determine the costs of the CCC guarantee programmes, because present value accounting entails the use of "estimates."[99] Apart from the fact that the FCRA does not in fact rely on "estimates" to the extent suggested by the United States,[100] Brazil also notes that in other contexts, the US government is comfortable with this inherent aspect of present value accounting for loan guarantees. Present value accounting has been endorsed by the US Congress and the President in the FCRA, as well as by the FASAB, the Office of Management and Budget,[101] and the General Accounting Office,[102] to name a few. Finally, Brazil notes that the United States is comfortable with the Panel relying on present value accounting and *some* estimated data, as long as the Panel limits itself to data suggesting that CCC guarantees issued in some, carefully-selected years did not lose money.[103] This is not an appropriate means of determining the performance of the "programmes," as is required by item (j).

74. Other methodologies and means of accounting for CCC's long-term operating costs and losses confirm the result reached using present value accounting. First, Brazil has constructed a methodology using actual data on income, costs and losses, which shows net losses for the CCC guarantee programmes of $1.1 billion.[104] Second, defaults of more than $4 billion on CCC guarantees for exports to Iraq and Poland alone similarly demonstrate costs and losses far in excess of total CCC premiums collected.[105] Third, a methodology adopted by the US General Accounting Office concluded that if GSM 102 and GSM 103 continued until 2007, costs would reach $7.6 billion, which exceeds maximum premiums collected by nearly $7.3 billion.[106]

75. In conclusion, item (j) does not require that the Panel use any particular accounting principles in assessing long-term operating costs and losses. Brazil has offered the Panel a number of different methodologies based on a variety of accounting principles. Each methodology confirms that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes.

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[98] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 1).

[99] US 11 August Answers to Questions, paras. 157-161, 162-163, 169-172, 173; US 22 August Rebuttal Submission, para. 162; US 18 November Further Rebuttal Submission, para. 196.

[100] Brazil's 22 August Rebuttal Submission, para. 113; Brazil's 11 August Answers to Questions, paras. 180-181.

[101] Exhibit Bra-116 (OMB Circular A-11) and Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002).

[102] Exhibit Bra-120 (GAO, Report to the Director, Office of Management and Budget, "Credit Reform: Review of OMB's Credit Subsidy Model," GAO/AIMD-97-145, August 1997, p. 3-5).

[103] US 18 November Further Rebuttal Submission, paras. 196-198.

[104] Brazil's 11 August Answers to Questions, paras. 158-166 (including chart at para. 165). Brazil's all-inclusive formula can be stated as follows: (Premiums collected + Recovered principal and interest (Line 88.40) + Interest revenue (Line 88.25)) – (Administrative expenses (Line 00.09) + Default claims (Line 00.01) + Interest expense (Line 00.02)).

[105] *See* Brazil's 11 August Answers to Questions, para. 167 (second bullet point and note 226); Brazil's 18 November Further Rebuttal Submission, para. 251.

[106] *See* calculation included at Brazil's 11 August Answers to Questions, para. 167.

## V. Serious Prejudice

**229. What is the meaning of the words "may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the *SCM Agreement*? Please comment on the possibility that these words indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice and that serious prejudice should be considered an additional or overriding criterion to the factors specified in the subparagraphs. BRA**

Brazil's Answer:

76. The phrase "*one or several*" must be interpreted in its ordinary meaning. This phrase means that the conditional clause "may arise" is satisfied when *one* of the following applies or when *more than one* of the following apply. The phrase "*one or several*" is equivalent to: "*at least one*." Such a trigger is not conditioned on any other clause. In fact, this is stressed by the words "in any case" just before the phrase *where one or several*. Therefore, serious prejudice may be shown *in any case* where *at least one* of the subparagraphs of Article 6.3 applies.

77. Brazil disagrees with the possibility that the words *one or several* indicate that one of the Article 6.3 subparagraphs may not be sufficient to establish serious prejudice. Had negotiators felt that this should be the case, they certainly would have found a way to say so. This was the case, for example, in Articles 3.2 and 3.4 of the Anti-Dumping Agreement, where after the enumeration of relevant factors, the text states that no "… one or several of these factors" can "give decisive guidance." Identical language is found in the SCM Agreement itself. Article 15.4 *in fine* reads "… nor can one or several of these factors necessarily give decisive guidance." In SCM Article 15.7 negotiators were even more explicit, affirming that "[n]o one of these factors by itself can necessarily give decisive guidance but the totality of the factors considered must lead to the conclusion that … ."

78. The provisions of the Anti-Dumping and SCM Agreement cited above relate to situations where a number of factors could lead to a determination of injury. Article 6.3 of the SCM Agreement is meant to address a similar situation: a list of factors could lead to a determination of serious injury. However, in stark contrast with Articles 3.2 and 3.4 of the Anti-Dumping Agreement and Articles 15.4 and 15.7 of the SCM Agreement, negotiators chose not to include reference to the possibility that, in Article 6.3, "the words *one or several* indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice." To find so, the Panel would need to read into Article 6.3 the words found in Articles 3.2 and 3.4 of the Anti-Dumping Agreement and Articles 15.4 and 15.7 of the SCM Agreement. The Appellate Body has made clear that panels must not read into a text words that are not there.

79. The phrase "may arise in any case where one or several of the following apply" recognizes that effects of subsidies constituting serious prejudice under one of the identified paragraphs of Article 6.3 may *also* constitute serious prejudice under another of the identified paragraphs of Article 6.3. This case is a good example. US cotton subsidies have both increased the US world market share under Article 6.3(d) as well as suppressed world market prices and prices in third country markets under Article 6.3(c). But the existence of "serious prejudice" in this or other cases does not depend upon whether the effects of the subsidies cause one or four different types of serious prejudice.

80. In its context within Article 6, the phrase "may arise in any case where one or several of the following apply" is necessary because while the facts may demonstrate that the effects of the subsidies *may* create the one, two, three or four enumerated types of serious prejudice, these effects may not be *actionable.* For example, under Article 6.3(d), there may be an increase in the world market share for a commodity product. But it "may" not be actionable because there are specific multilaterally agreed rules for that commodity, within the meaning of footnote 17. Further,

Article 6.7 of the SCM Agreement creates exemptions from serious prejudice findings even if the requirements of Article 6.3 would be fulfilled. These situations include export prohibitions by the complaining Member, *force majeure*, arrangements that limit exports, or the failure to conform to standards and regulatory requirements. Article 6.9 of the SCM Agreement covers another situation in which the "may" language would be applicable. It exempts serious prejudice that exists even where the requirements of Article 6.3 are fulfilled because the subsidies are exempt from action by virtue of the peace clause of Article 13 of the Agreement on Agriculture.

**230. Please comment on Brazil's views on Article 6.3 of the *SCM Agreement* as stated in paragraphs 92-94 of its further submission. USA**

**231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the *SCM Agreement* are relevant context for the Panel's interpretation of Article 6.3? USA**

**232. How, if at all, should the Panel take into account the effects of other factors in its analysis of the effects of US subsidies under Article 6.3? If the Panel should compare the effects of other factors to establish the relative significance of one compared to others, how would this be done? What would be relevant "factors" for this purpose? BRA**

Brazil's Answer:

81. Brazil divides its response to this question into two parts. First, Brazil will discuss Article 6.3(c), and, second, Brazil will discuss Article 6.3(d).

82. Concerning Article 6.3(c), the Panel can and should, to the extent it is relevant to do so, take into account the effects of non-subsidy related factors in its analysis of the price-suppressing effects of US subsidies. The only "other factors" identified by the United States include demand-related factors the United States claims contributed to lower cotton prices in MY 1999-2002 including weak cotton demand, flat retail consumption, falling world incomes, increasing US textile imports, and China's releasing of stocks.[107] The United States further claimed that US production-related factors accounted for increased US production including boll weevil eradication, higher yielding GMO cotton, and lower prices of alternative crops.[108]

83. Brazil addressed all of these "other" factors in earlier submissions and demonstrated that while some of the so-called other factors no doubt influenced prices, many of them either were factually incorrect (*i.e.*, not "other factors") or could not have had the effect claimed by the United States.[109] Brazil further demonstrated that Professor Sumner's analysis took account of all the "other" factors identified by the United States. Professor Sumner stated:

> The baseline is calibrated to reproduce the acreage, production, exports, prices and other variables that actually applied between the marketing years 1999-2001, the period over which data was available at the time the baseline was developed. *By calibrating the baseline to actual data for the recent past, the model incorporates all the factors that have determined the situation of the cotton market during this period.*
>
> The United States has highlighted some of these factors. In their Further Submission they discuss developments in the synthetic fiber market, such as prices of polyester; Chinese stock releases, exchange rate movements, global and US macroeconomic

[107] US 30 September Further Submission, paras. 22-44.
[108] US 30 September Further Submission, paras. 45-70.
[109] Brazil's 7 October Oral Statement, paras. 18-28; Exhibit Bra-279 (Statement of Professor Sumner – 7 October 2003, paras. 13-14); Brazil's 27October Answers to Question 176, paras. 157-160.

> conditions, and technical changes in cotton production that reduce costs, such as boll weevil eradication and release of genetically modified cotton varieties. Remember, my model is calibrated to reproduce actual cotton market data for the historical period. *Hence, my model incorporates all these historical factors into the baseline from which I analyze the impact of removing cotton subsidies.*[110]

84. The econometric evidence presented by Brazil – including the studies by USDA economists Westcott and Price, Professor Sumner, and Professor Ray of the University of Tennessee, among others – separate out the effects of the US subsidies from the effects of all other supply and demand factors that impact on the upland cotton market. In effect, these studies are designed precisely to answer the question posed by the Panel. The results of these studies sift through the "other factors" to isolate for the effects of the US subsidies. Professor Sumner has conservatively estimated that A-Index prices would on average be 12.6 per cent or 6.5 cents per pound higher without the US subsidizing upland cotton production, use and exports. The other econometric simulation models find that cotton prices are suppressed to a significant degree regardless of whether other factors push upland cotton prices up or down.

85. It bears repeating that Brazil has not claimed in this dispute that the entire decline in upland cotton prices during MY 1999-2002 was due to the effects of US subsidies. Brazil's argument has been all along that *but for* the US subsidies upland cotton prices would be higher by a significant degree, whether prices rise or fall. Thus, for example, the fact that Chinese release of stocks may have lowered world prices in MY 2000-2001 to a certain extent is entirely consistent with Brazil's evidence and its proof. Brazil demonstrated that actual market prices in MY 1999-2002 would have been higher to a significant degree but for the US subsidies.

86. Thus, the Panel can and should take "other factors" into account. But the record shows that there is no legitimate basis to conclude that "other" supply and demand factors collectively (a) accounted for *all* of the declines in prices during the period of investigation or (b) meant that prices went as high as they would have even if no US subsidies had been provided.

87. Brazil's claim under Article 6.3(d) concerns the development of actual world market share data. This world market share is the result of several key factors including US subsidies, weather effects in many countries, and exchange rate effects. However, Brazil has demonstrated that the US subsidies were a major contributing factor behind the increase in the US world market share, which occurred even when prices were falling and the US dollar increased in value. Professor Sumner has conservatively estimated that without the US subsidies, US exports would be on average 41.2 per cent lower during MY 1999-2002.[111] The US upland cotton farmers' long-term cost of production gap between market revenue and total costs of $872 per acre for over 14.38 million acres during MY 1997-2002 (or $12.5 billion) fully supports Professor Sumner's analysis.[112]

88. It follows that the US world market share would be much lower absent the US subsidies. As an example, based on Exhibit Bra-302, Brazil has calculated out the effects of a 41.2 per cent decline in US exports as estimated by Professor Sumner for MY 2002.[113] In this example, US world market shares for MY 1999-2001 remain unchanged.[114] The results are as follows:

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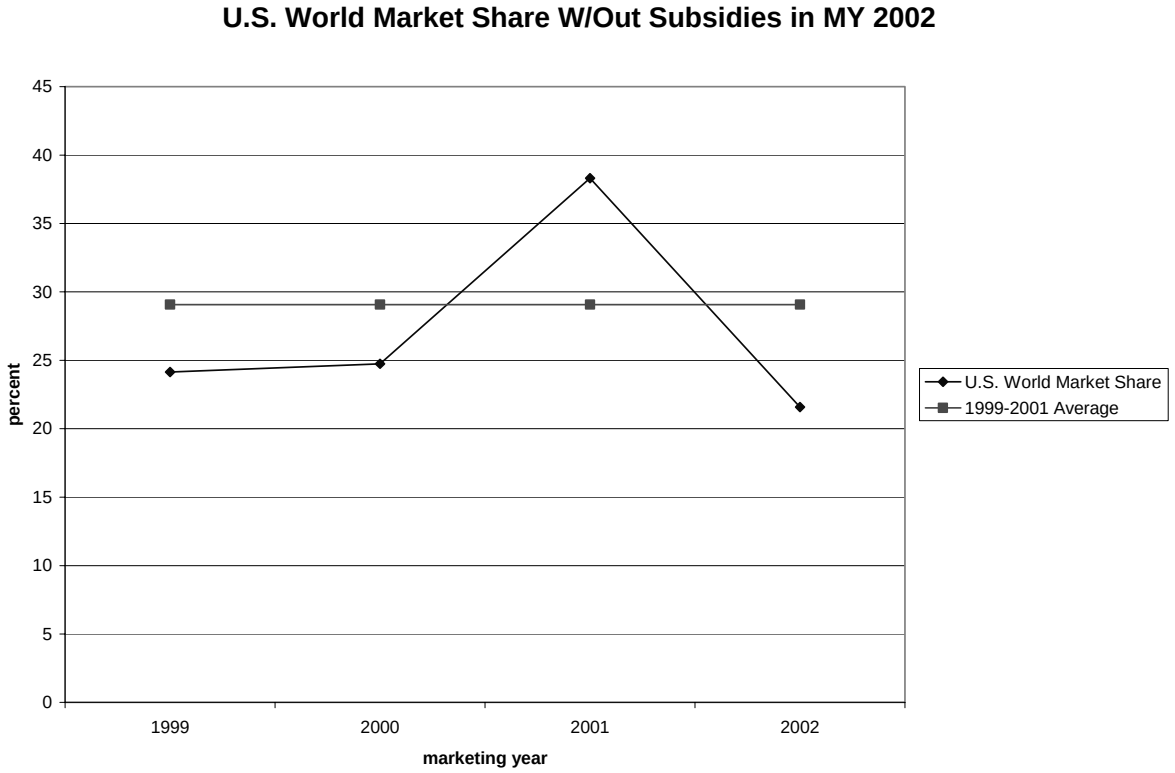
[110] Exhibit Bra-279 (Statement of Professor Sumner – 7 October 2003, paras. 13-14).

[111] Brazil's 9 September Further Submission, Annex I, Table I.5a.

[112] Brazil's 3 December Closing Statement, para. 13.

[113] This calculation assumes that total world trade would not be affected if US subsidies were not provided.

[114] Brazil emphasizes that also for these years there are strong export-enhancing effects of the US subsidies, but has assumed for this exercise that they had no effects on US world market share.




89. This graph shows that in MY 2002, US exports would have fallen and remained below their previous three-year average *without* the US subsidies for that year. In other words, *but for* the 2002 US subsidies, there would have been a reduction in US world market share, not an *increase.*[115] This analysis also demonstrates that while there may have been other factors at work stimulating US exports (such as reduced domestic US demand for upland cotton), these factors were not enough to cause an increase in US world market share over the previous 3 year period as required by Article 6.3(d).

**233. In Brazil's view, what is or are the "same market(s)" for the purposes of Article 6.3(c)? Does Brazil's view of "world market" imply that regardless of which domestic (or other) "market" is examined, price suppression will be identifiable? BRA**

Brazil's Answer:

90. The "same market(s)" for the purposes of Brazil's price suppression claims under Article 6.3(c) are (1) the world market for upland cotton, (2) the Brazilian market, (3) the US market, and (4) 40 third country markets[116] where Brazil exports its cotton. US and Brazilian "like" upland cotton is found in each of these markets.

[115] Brazil's 9 September Further Submission, Annex I, Table I.5a.

[116] Argentina, Belgium, Bangladesh, Bolivia, Cambodia, China, Chile, Colombia, Cuba, Ecuador, France, Germany, Greece, Hong Kong, Indonesia, India, Israel, Italy, Japan, South Korea, Malaysia, Morocco, Netherlands, Pakistan, Peru, Poland, Portugal, Philippines, Singapore, South Africa, Spain, Switzerland, Thailand, Tunisia, Turkey, Taiwan, United Kingdom, Ukraine, Venezuela, Vietnam.

91. The record establishes that there is a "world market" for upland cotton and that the prices for that market are reflected in the New York futures prices and in the A-Index prices.[117] Brazil established that there is a global price discovery mechanism that reflects the "world market price," which is heavily influenced by world market supply and demand factors, including the US subsidies.[118] These "world market prices," in turn, are transmitted to the US market, the Brazilian market, and to the 40 other markets where both Brazilian and US subsidized cottons are marketed as typical commodities.[119]

92. In response to the Panel's question whether the world market prices that Brazil claims are suppressed are also "identifiable" in the "domestic (or other) 'market,'" the answer is "yes." The evidence of the transmission of the global effects to these other markets includes (1) USDA's own data for the US prices received by US producers,[120] (2) USDA volume and value data for US exports to third countries,[121] (3) Brazilian Government volume and value data for Brazilian exports to 40 countries,[122] (4) Brazilian ESALQ Index data regarding internal Brazilian prices,[123] (5) data from various third countries reflecting upland cotton import prices,[124] and (6) data from several third countries reflecting their domestic prices for upland cotton.[125] In addition, Brazil has presented the evidence of Andrew Macdonald and Christopher Ward who testified concerning the importance of the A-Index. Brazil further includes the views of Gerald Estur, the ICAC's chief statistician, as set out below.[126]

93. A-Index world prices are a useful benchmark by which to judge whether prices for upland cotton traded internationally or even within domestic markets are influenced by global world market forces.[127] While the New York futures prices play a major role in influencing markets, the short term volatility of the futures market makes comparison with monthly or annual export prices more difficult. Andrew Macdonald indicated that "the price oscillations of the A and B-Index are much less pronounced than the futures market, but in the longer term they accompany the signs and trends coming from the futures market."[128] Moreover, the US Government uses the A-Index as a key basis for Step 2 and marketing loan payments. Professor Sumner's model adapted from the FAPRI model used actual A-Index prices for the period MY 1999-2001 and the "world price" simulation effects are estimated "A-Index" prices.[129]

94. Organized below is the evidence on pricing data supporting the link between A-Index prices that reflect the global supply and demand influences (including effects of the US subsidies) and prices in "other markets" as posed in the Panel's question. Brazil first presents evidence of US and Brazilian

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[117] Brazil's 2 December Oral Statement, paras. 14-16 (*citing* evidence set out in the record from earlier submissions to the Panel).

[118] Brazil's 2 December Oral Statement, paras. 14-16 (*citing* evidence set out in the record from earlier submissions to the Panel).

[119] Brazil's 2 December Oral Statement, paras. 14-16 (*citing* evidence set out in the record from earlier submissions to the Panel).

[120] Brazil's 9 September Further Submission, para. 113 (*citing* Exhibit Bra-4 and Exhibit Bra-202).

[121] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

[122] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

[123] Exhibit Bra-207 (Cotton lint: International Prices & Brazilian Prices); Brazil's 9 September Further Submission, para. 115 note 156.

[124] Exhibit Bra-384 (Import Prices from Various Countries).

[125] Exhibit Bra-385 (Domestic Prices from Various Countries).

[126] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

[127] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC)("The A-Index is a good proxy for prices of cotton traded internationally.").

[128] Brazil's 9 September Further Submission, Annex II (Statement of Andrew Macdonald, para. 23.).

[129] Brazil's 9 September Further Submission, Annex I (Sumner Analysis, para. 70 ("the model uses the Cotlook A-Index price to represent the world price . . . [and] the actual A-Index prices were used for the database for the model for marketing years 1999-2001.").

export prices to 40 different countries, based on official published US and Brazilian Government sources. It then provides (based on availability) information concerning the import prices of all imports from certain of the 40 countries where both Brazil and US upland cotton was exported during MY 1999-2002. Finally, Brazil presents information of internal domestic prices in the United States, Brazil, and China.

**Brazilian and US Export Prices**

95. In response to the Panel's question, Brazil first presents evidence of US and Brazilian export prices to 40 different markets where both Brazilian and US upland cotton was exported at some point during MY 1999-2002. The information and evidence below is based on a compilation from two sources. First, all information on US upland cotton export prices is based on the "US Trade Internet System," a web application run by USDA's Foreign Agricultural Service (FAS).[130] Second, information on Brazilian upland cotton export prices is taken from information published and maintained the Brazilian Ministry of Agriculture on its public web-site.[131] The export "prices" represent the declared contract value of the upland cotton at the US and Brazilian port of export – known as "Free Alongside Ship (FAS)" values.[132]

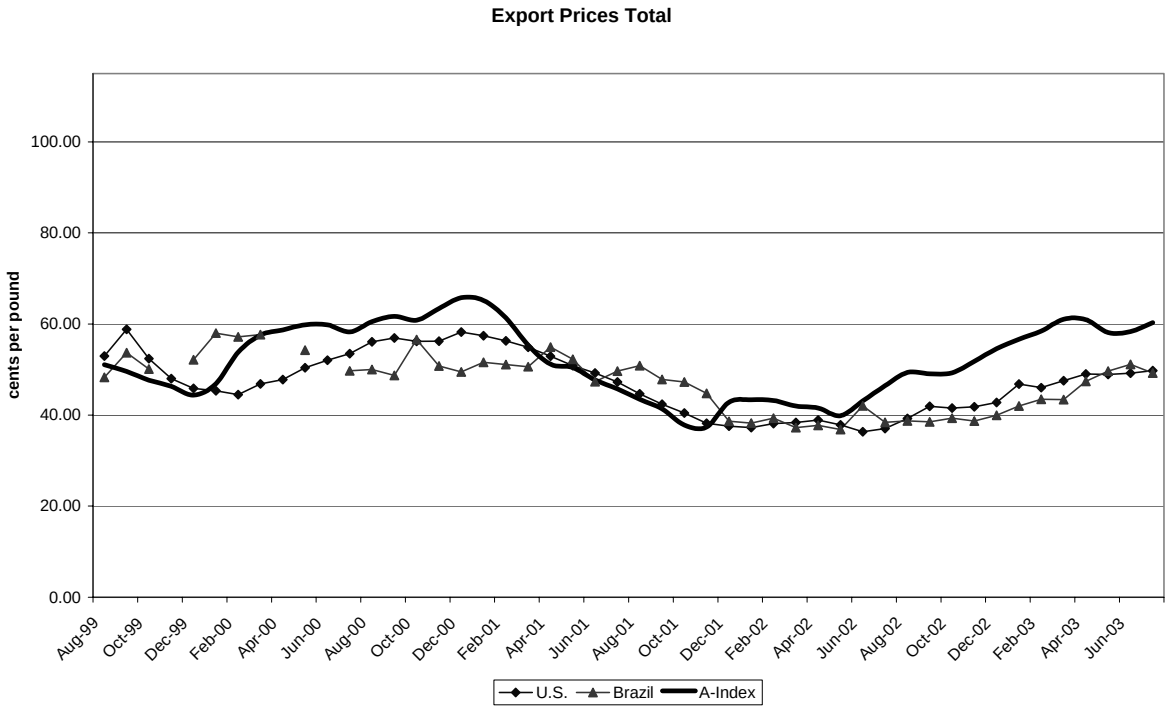
96. The first way to examine the available data is to view it collectively similar to what the United States did in Exhibit US-75. The first graph below examines the cumulative Brazilian and US export prices in MY 1999-2002 covering exports to the 40 markets where Brazil exports its upland cotton as well as US exports to Brazil.[133]

[130] *See* http://www.fas.usda.gov/ustrade/. The four upland cotton HS-10 codes used are 5201001010, 5201001020, 5201001025 and 5201001090. All data originally in tons and dollars, was converted into pounds and cents.

[131] *See* http://alicewebl.desenvolvimento.gov.br; www.mdic.gov.br/indicadores/balanca/balanca.html. See also Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country). All Brazilian data originally provided in kilograms and dollars was converted into pounds and cents.

[132] The FAS value includes all inland freight, insurance and other charges incurred in placing the merchandise alongside the carrier at shipping or insurance costs.

[133] Exhibit Bra-386 (Brazil and US Export Prices by Country). The data for all of the graphs in this subsection of Brazil's answer is contained in Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).

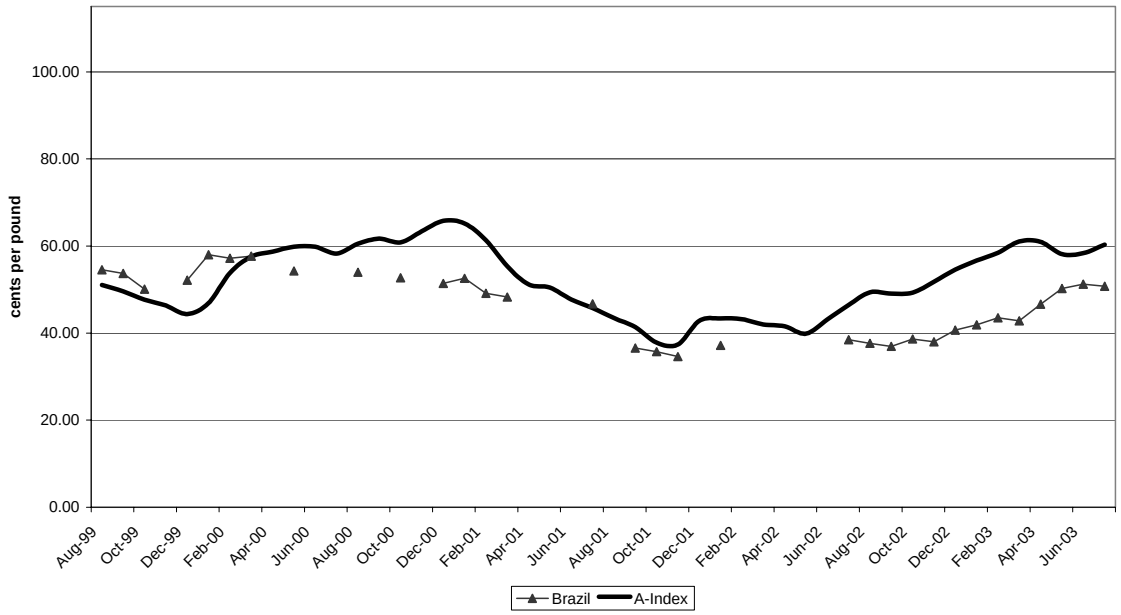



97. The A-Index on the graph is the solid black line. The Panel can see that over the four year period, US and Brazilian export prices closely follow the movements in the A-Index. In addition, as discussed in greater detail in the answer to Question 235, Brazilian prices are at times equal to, slightly greater than US prices or slightly lower than US prices.

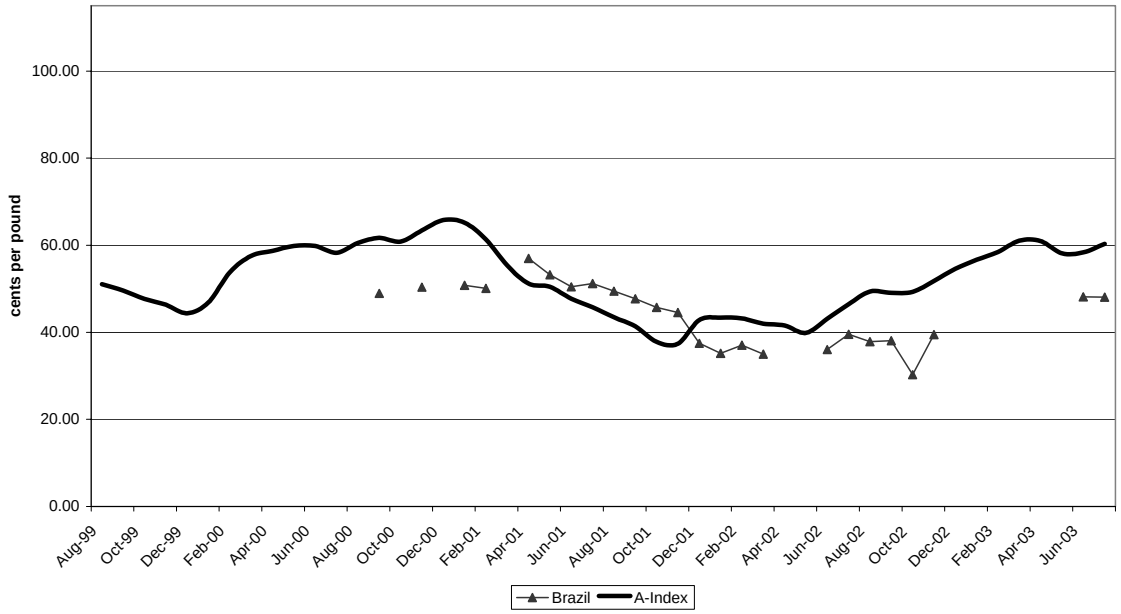
98. The Brazilian export data can be used as a proxy for third country market prices in a handful of countries where there were extensive Brazilian exports. This is illustrated in the cases of three of the larger markets for Brazilian exports – Argentina, India, and Portugal as set out in the graph below:[134]

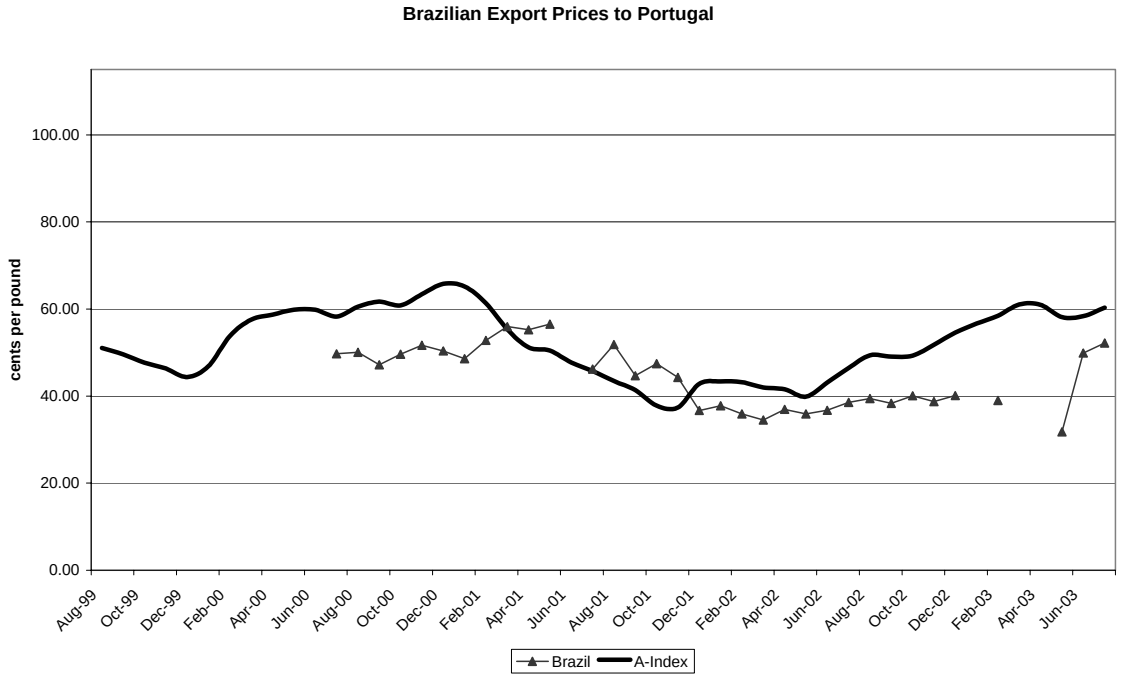
[134] The Panel will find a complete list of graphs showing A-Index prices plotted against Brazilian export prices to all countries to which Brazil exports in Exhibit Bra-387 (Brazil Export Prices v A-Index Prices by Country).

**Brazilian Export Prices to Argentina**




**Brazilian Export Prices to India**

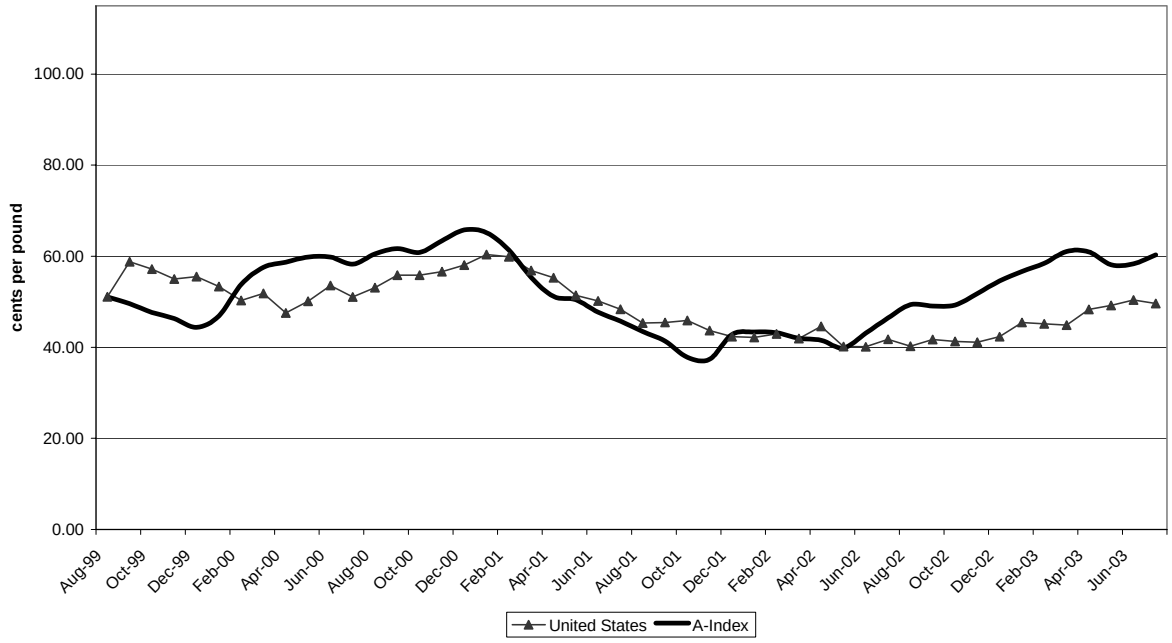




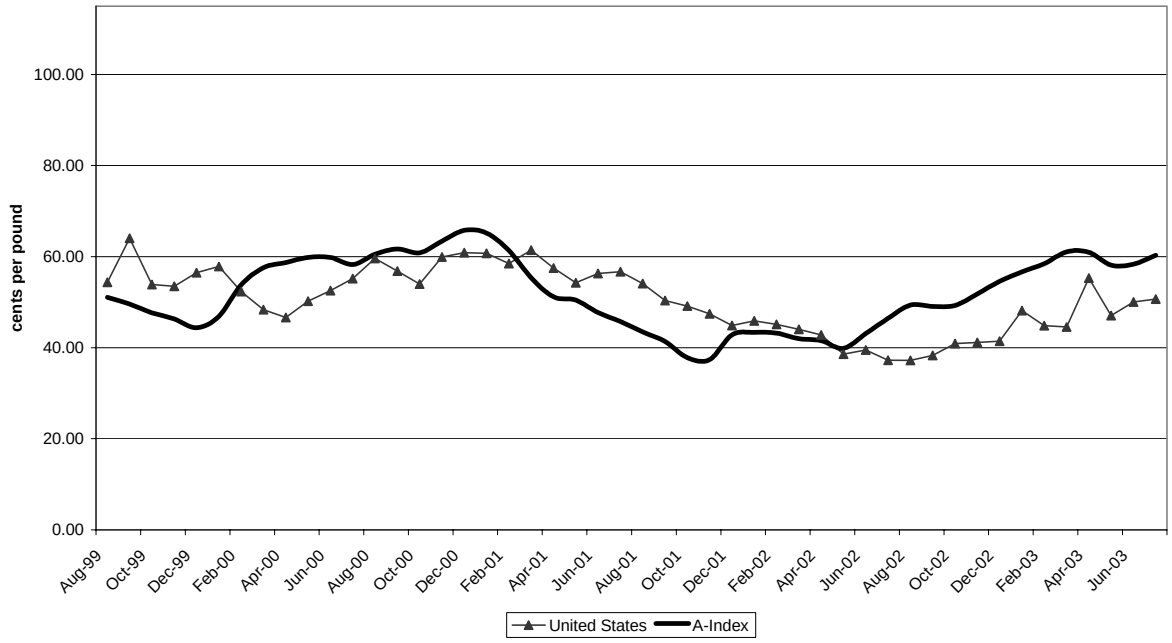

99. Because US exports were so much greater than Brazilian exports, a better way to examine the relationship between A-Index prices and prices in the 40 countries is to examine US export prices, particularly where there were large volumes of US exports. This is illustrated in the graphs below for China, Indonesia, South Korea and the Philippines (as well as other graphs in Exhibit Bra-388):[135]


[135] The Panel will find a complete list of graphs showing A-Index prices plotted against US export prices to all countries to which Brazil exports in Exhibit Bra-388 (US Export Prices v A-Index Prices by Country).

**US Export Prices to Indonesia**




**Export Prices to South Korea**




100. Brazil presents in Exhibit Bra-383 the underlying data on all 40 of the markets where Brazil and the United States export their upland cotton. This underlying data is presented in a variety of different graphs; one set compares Brazilian exports to the A-Index;[136] another compares US exports to the A-Index,[137] and a third combines Brazilian and US export prices.[138]

101. Many of the 40 markets show only very limited amounts of Brazilian exports. Compared to the volume of US exports, Brazilian exports during MY 1999-2002 were relatively small (representing approximately 1 per cent of total world market share).[139] Thus, when the monthly export data is examined on a country-by-country basis, there are very few third country markets where Brazil exported in each of the 48 months in MY 19999-2002, *i.e.*, where there is a complete set of 48 data points. Nevertheless, even the limited data points for each of the 40 countries shows that Brazilian export prices generally tracked A-Index prices.

102. Many of the graphs also reflect fairly widely ranging data point prices, particularly where the import volumes are not very great.[140] By contrast, country markets with very high volumes of imports[141] tend to have much more stable import prices that closely follow the A-Index. This is why the US high-volume import data graphs provide reliable evidence of pricing trends in some of the 40 country markets examined. There are various reasons that explain the widely ranging pricing data points. First, while US and Brazilian cottons may have the same staple length, their quality may differ significantly which, in turn, impacts their respective price.[142] For example, California A-Index cotton is consistently sold at a premium in world markets because its superior quality allows it to be

[136] Exhibit Bra-387 (Brazil Export Prices v A-Index by Country).
[137] Exhibit Bra-388 (US Export Prices v A-Index by Country).
[138] Exhibit Bra-386 (Brazil and US Export Prices by Country).
[139] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 4 and 76).
[140] *See* Exhibit Bra-387 (Brazil Export Prices v A-Index by Country). Examples are Belgium, Pakistan, South Africa.
[141] *See* Exhibit Bra-387 (Brazil Export Prices v A-Index by Country). Examples are Argentina, China, India, Italy, Portugal, Philippines, Thailand.
[142] Brazil's 9 September Further Submission, Annex II (Statement of Andrew Macdonald, paras 9-10).

used in production of finer cotton fabric.[143] During certain period between MY 1999-2002, both Brazil and the United States exported cotton with a high staple length or a particularly good quality to a third country market, resulting in higher prices. This no doubt accounts for much higher US prices compared to Brazilian cotton in some markets such as France, Germany, and Portugal.

103. Second, smaller monthly export sales to a third country market with relatively few imports may result in much higher prices than large volume sales to large importers. Larger consuming countries (with larger consumers) can demand volume price premiums and sellers can export at higher volumes and lower prices based on economies of scale. The country data of the world's largest importers such as China, Hong Kong, Taiwan, and Indonesia, for example, closely match A-Index price trends.[144] But even larger importing countries data reflects an occasional month where prices diverge from the overall trend. This may be due to the fact that smaller shipments were purchased quickly on a spot basis at higher prices.

104. Third, some exports or forward contracts for export sales are fixed-price contracts, which may be executed months before export takes place.[145] For example, a yarn spinner or textile producer in Brazil may contract to purchase 100 tons of US cotton on 1 January 2002 at an import price fixed at 40 cents per pound at that date, but when the cotton is actually exported on 1 June 2002 the A-Index price may be 50 cents. This type of contract with terms fixed at execution rather than on delivery may explain a number of country market graphs where there is a delayed reaction of the country price to declines or increases in the A-Index prices. However, even where there is a delay in response, the longer-term trends in most markets thereafter track the downward or upward climb of A-Index prices.

105. But even with the limitations in the monthly data for individual country markets, the data on the whole strongly supports the conclusion that world prices do influence local export market prices. Any anomalies in smaller importing country markets are notably eliminated by using the weighted average analysis of monthly data from all 40 markets where Brazil and US cotton exports are found. With the vast bulk of US – and most of Brazilian cotton – being exported to large volume markets, the combined analysis shows the close relationship between A-Index prices and both Brazilian and US prices. Indeed, the Chief Statistician of the ICAC, who has extensive experience with individual country and world market pricing data, came to the following conclusions:

> For all importing non-producing countries, domestic prices follow the Cotlook A Index, taking into account appropriate location and quality differentials and the quality differential for the particular type of cotton needed by the spinning industry.
>
> Prices of imported cotton in producing countries also follow the Cotlook A Index, with appropriate location and quality differentials. The international market for raw cotton is relatively open, with rather low imports taxes (averaging less than 5 per cent. The US having one of the highest).

[143] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC)(California/Arizona cottons "is usually about 2 cents more expensive than Memphis"). *See also* Brazil's 9 September Further Submission, para. 241, figure 17 (showing California A-Index quotes at higher prices than Brazil A-Index cotton which is comparable to Memphis).

[144] *See* Exhibit Bra-387 (Brazil Export Prices v A-Index by Country), Exhibit Bra-388 (US Export Prices v A-Index by Country) and Exhibit Bra-384 (Import Prices from Various Countries).

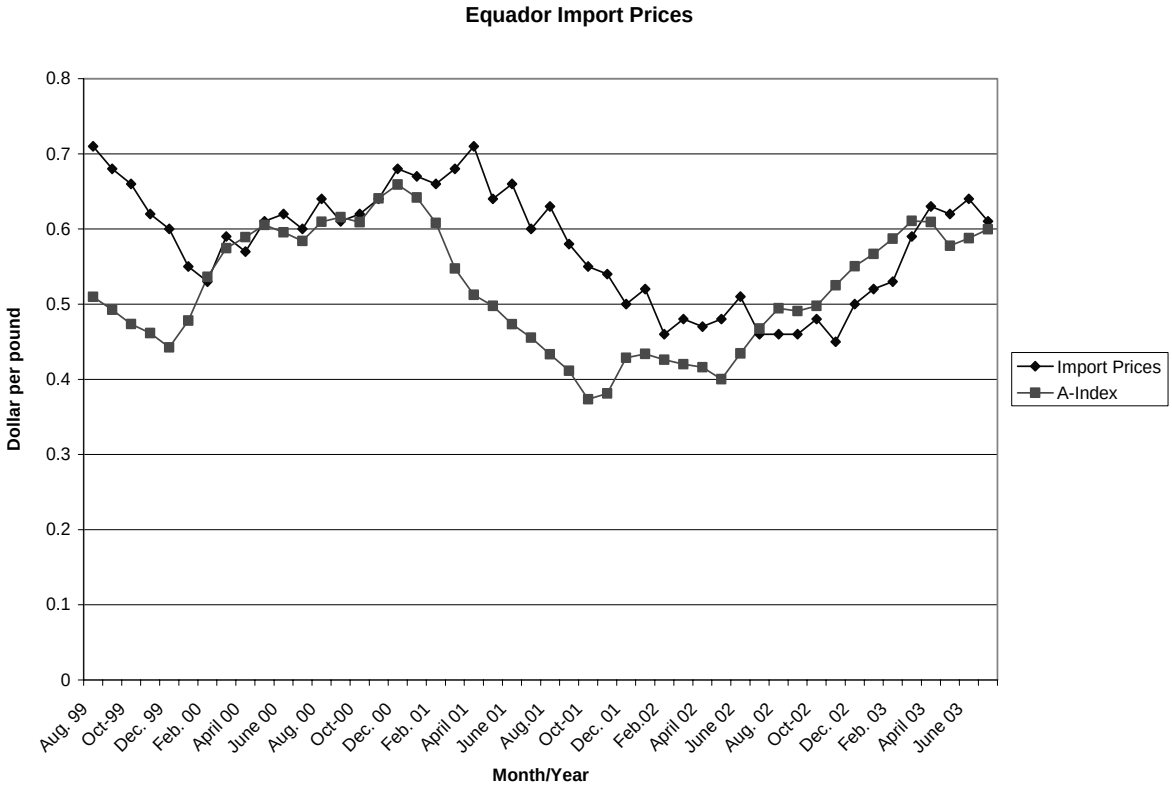
[145] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC)("Actual prices of imported cotton, in non-producing as well as in producing countries, are based on the A Index or on New York Futures . . . on the day of the contract (concluded prior to shipment, and cotton can be sold more than one year forward). As a result, the average price of imports (value divided by quantity) for a specific period is not directly related to prevailing market prices.").

> Domestic prices of cotton produced and consumed locally are influenced by the supply and demand situation in the country but are not disconnected from international prices.[146]

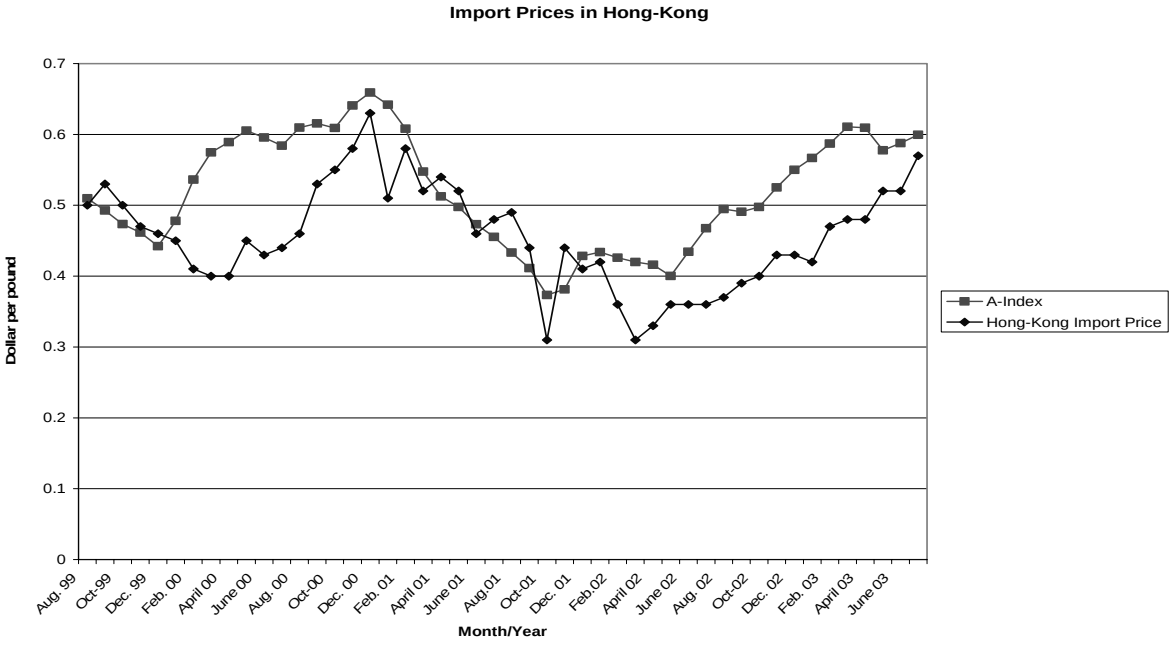
**Individual Country Market Import Price Data**

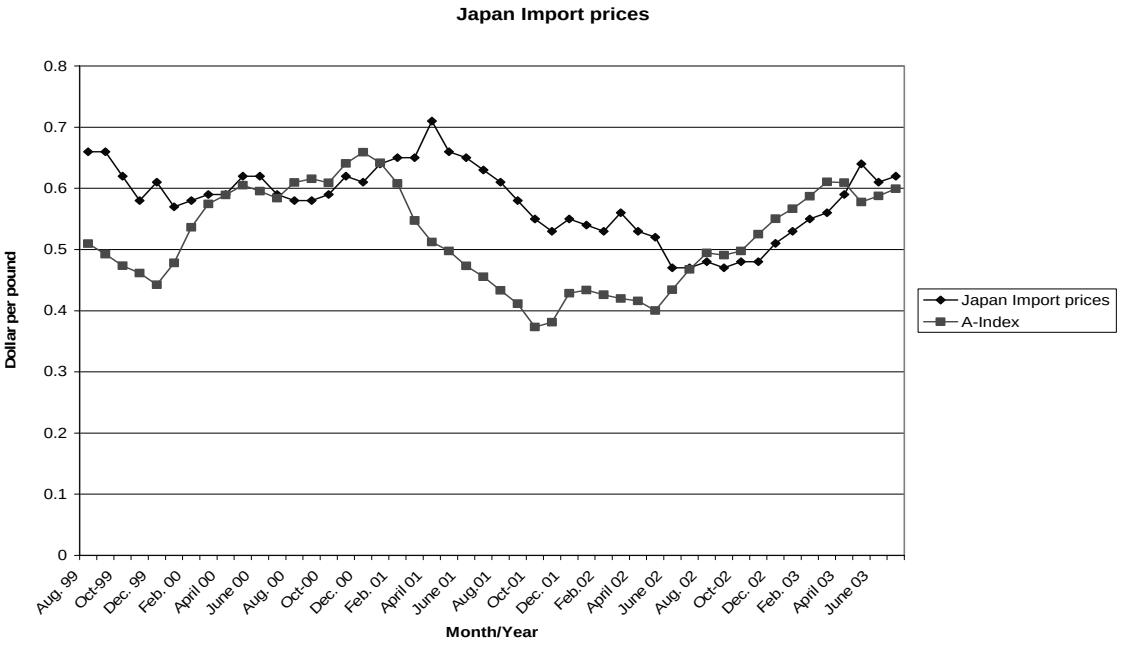
106. Additional evidence responsive to the Panel's question is found in various third country market *import* pricing data that was collected since 9 December 2003 by Brazilian embassies around the world. The data and the graphs are set out in Exhibit Bra-384. This data is available in two forms: (1) *monthly* import data from all sources, and (2) *annual* import data from all sources. While this information is not available to Brazil for many of the 40 export market countries, the available evidence confirms the other third country market data discussed above.

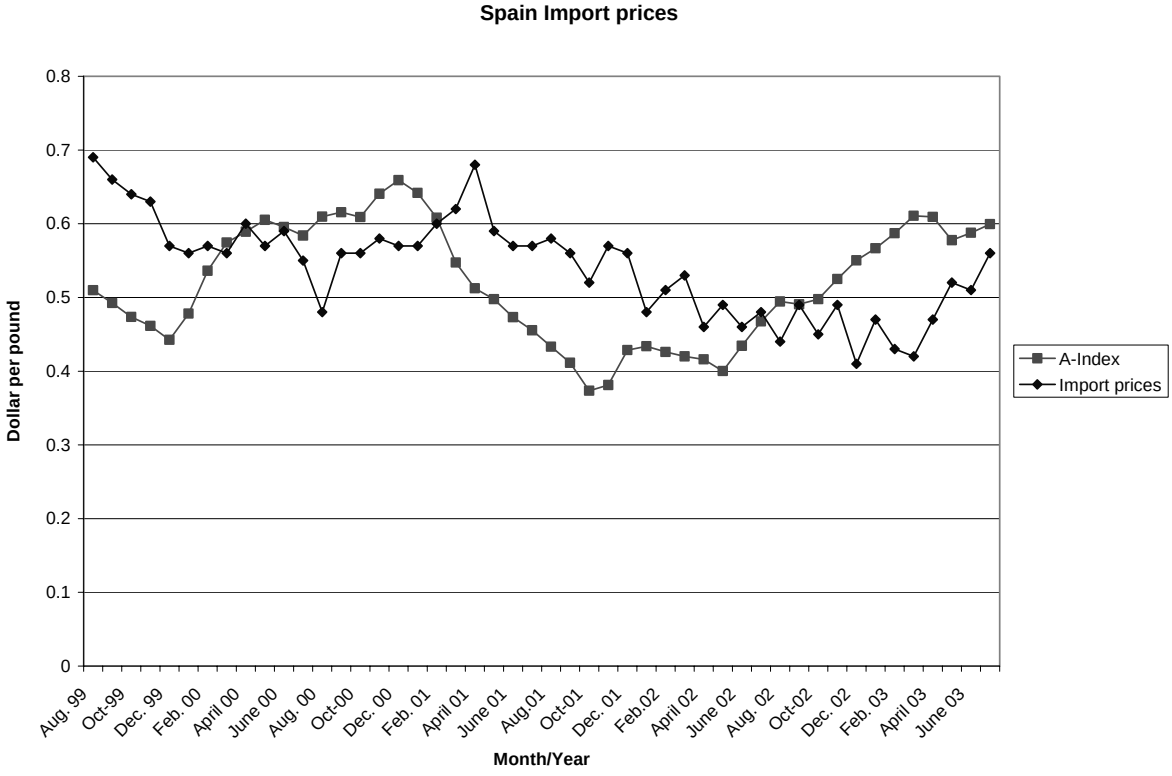
107. Monthly import data is available from Argentina, Ecuador, Hong Kong, Japan, Spain, Thailand, and the Ukraine. The data generally shows a close relationship between the movement of import prices and the movement of the A-Index. For example, set out below are graphs representing the data from Ecuador, Hong Kong, Japan and Spain:




[146] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

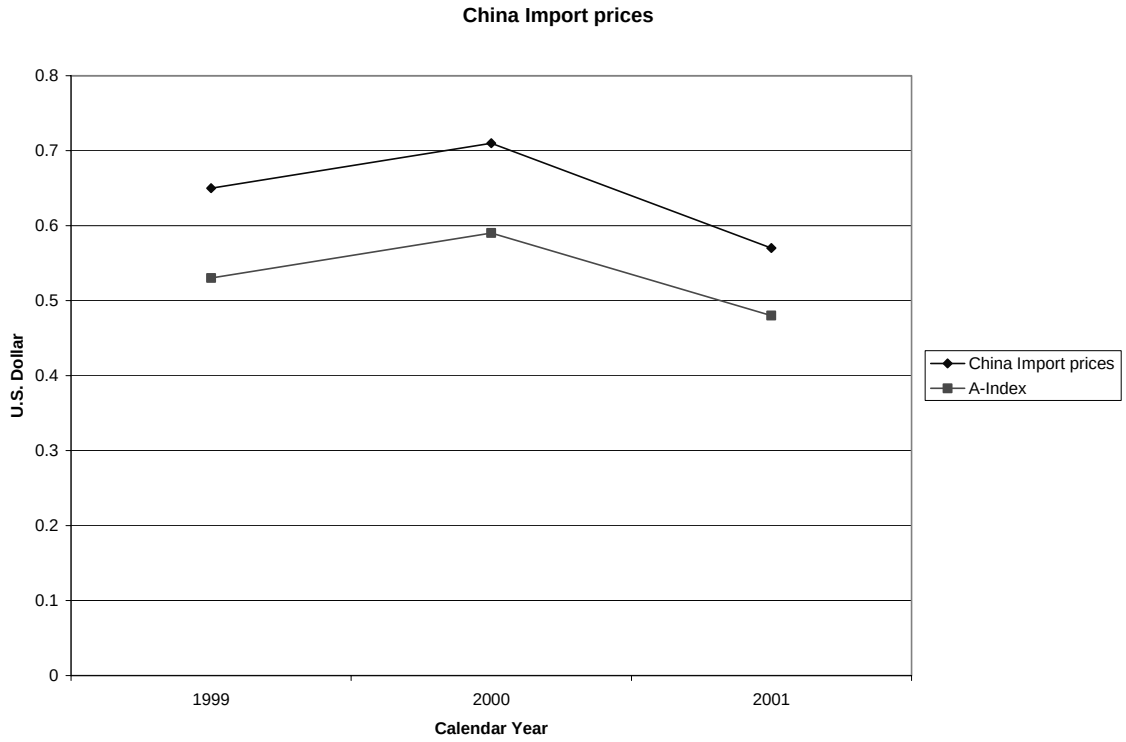




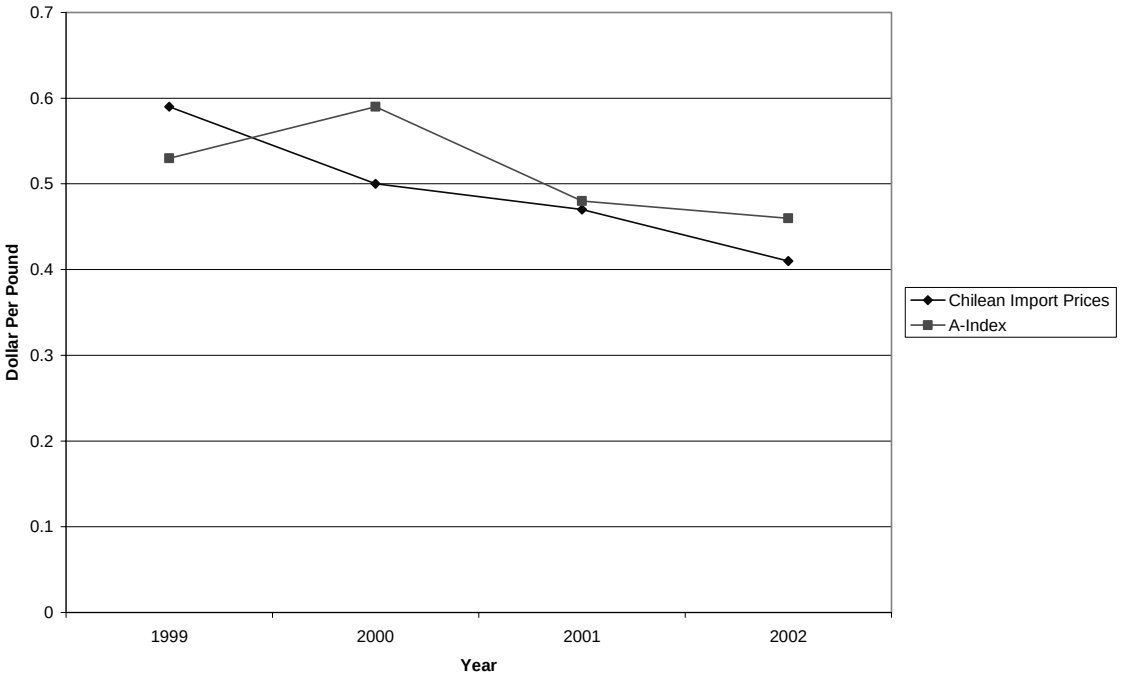

The monthly data for these countries reflects fairly high-volume imports from all worldwide sources. The higher volumes guarantee a more accurate reflection of the bulk of prices within these countries. The link between A-Index and import prices is also confirmed by the data for Argentina, Thailand and the Ukraine in Exhibit Bra-384.

108. There is also *annual* import data available from a few countries. While annual data does not provide as detailed information concerning price movements within a year, it also supports a link between the A-Index and import prices. These import prices, in turn, serve as a proxy for prices in the third country market generally. For example, the available import data from China, Chile, and the United Kingdom is set forth below:[147]

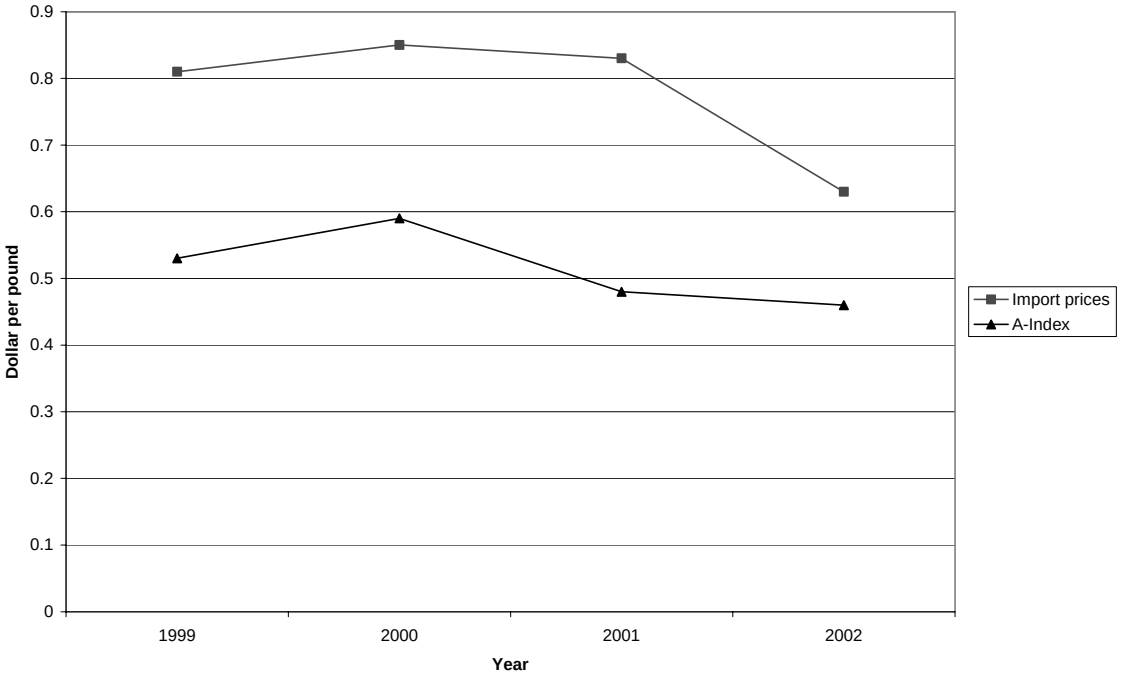



[147] Exhibit Bra-384 (Import Prices from Various Countries).

**Chilean Import prices**



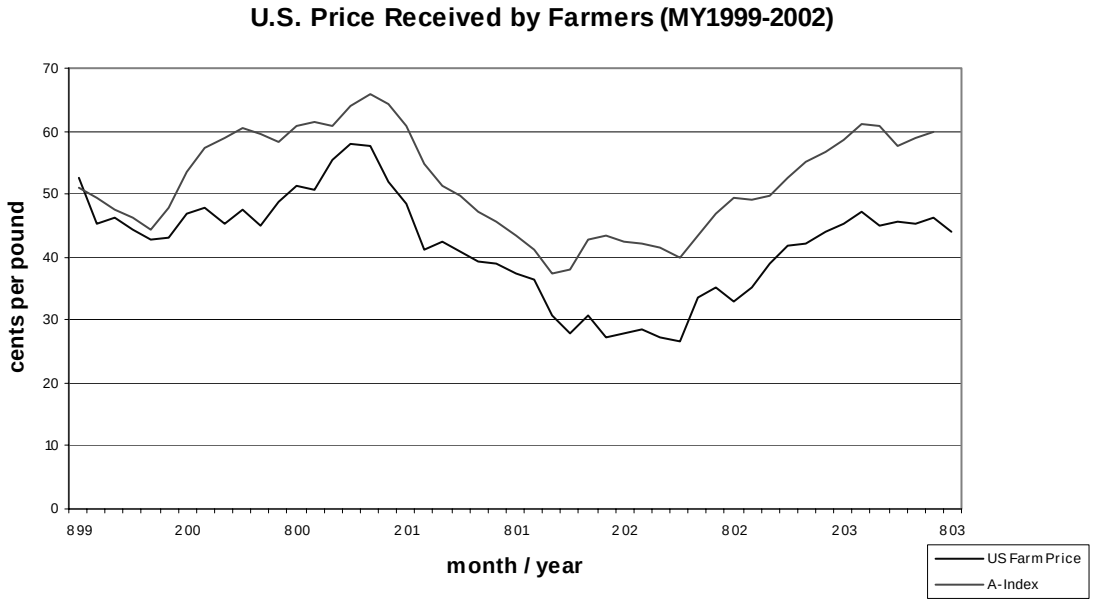

**United Kingdom Import prices**



**Individual Country Domestic Prices**

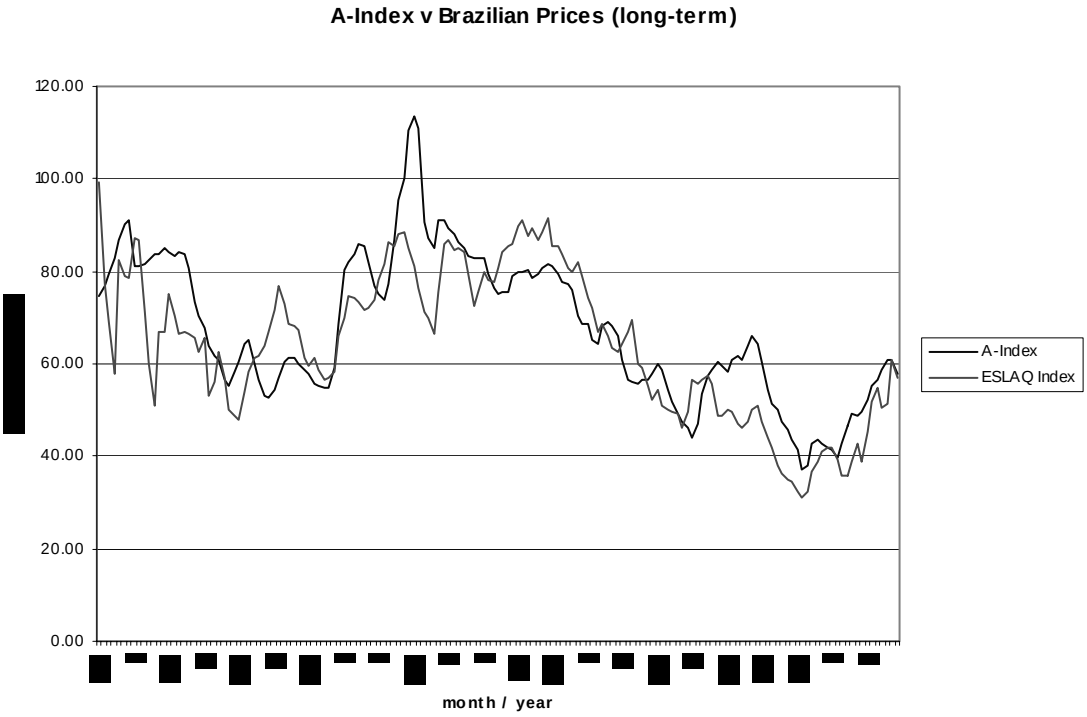
109. Finally, Brazil presents a series of graphs showing domestic prices in those countries for which domestic prices were available. Andrew Macdonald has indicated that most countries do not collect or maintain accessible data on domestic upland cotton prices. This was confirmed by the requests for such data by Brazilian embassies around the world. Therefore, Brazil can only offer information on domestic prices from a limited number of countries. These countries, however, constitute key markets, including the United States, China, Brazil and Pakistan.

110. The record shows that domestic prices within several key producing countries including the United States, Brazil, China and Pakistan also reflect and generally move with the overall trends of A-Index prices. This is shown in the graphs below:[148]



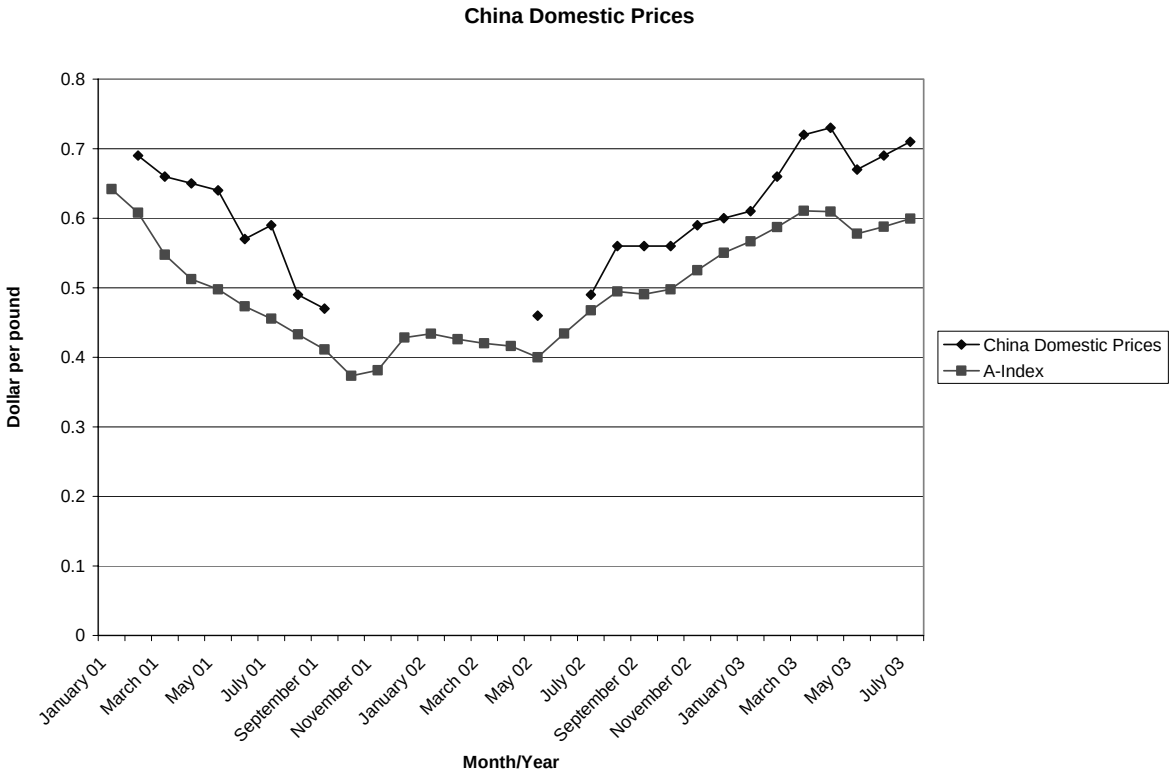

111. This data provides further confirmation of the close link between US domestic prices and the A-Index prices. As set forth below, this close link also exists for the domestic Brazilian market where most of Brazilian production is marketed:[149]

[148] This graph is reproduced from Figure 5 of Brazil's 9 September Further Submission.
[149] This graph is reproduced from Figure 7 of Brazil's 9 September Further Submission.

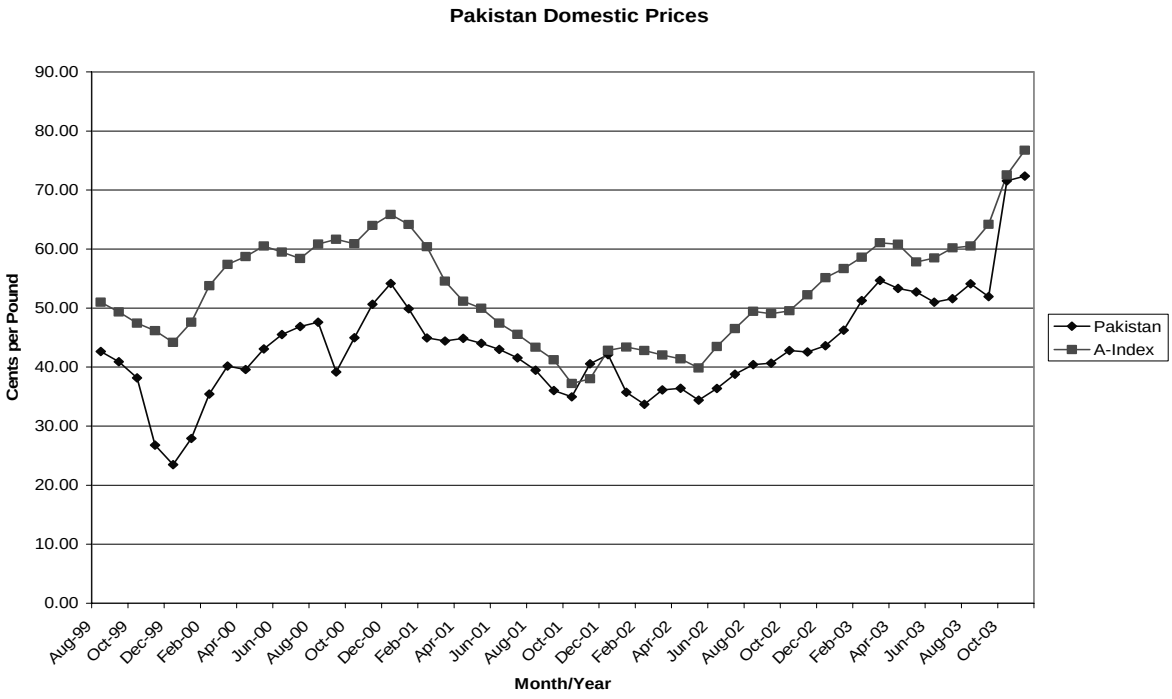



112. Finally, the domestic prices of the world's largest producer and consumer of upland cotton is the Chinese market. Because China is one of the world's largest importers of upland cotton, it is not surprising that its domestic market prices also track the A-Index prices as seen in the graph below:[150]

[150] Exhibit Bra-385 (Domestic Prices from Various Countries).




A similar pattern also evolves for domestic prices in another major producers and user of upland cotton: Pakistan.[151]




[151] Exhibit Bra-385 (Domestic Prices from Various Countries).

**Conclusion**

113. The evidence outlined above and in Brazil's earlier submissions shows that world market prices were transmitted to other markets during MY 1999-2002, and that this continues today. Whether the data is viewed collectively or individually, the data generally shows that Brazilian, US and other exporters' prices to these 42 countries are consistent with movements and trends in the A-Index price. While there are some (particularly low volume) graphs that show monthly differences from A-Index trends or movements, Brazil has set forth the quality, contract, and timing factors accounting for such anomalies. The collective statistical evidence supports the conclusion of the ICAC's chief statistician that "[a]ctual prices of imported cotton, in non-producing as well as in producing countries, are based on the Cotlook A Index or on the New York futures" and "the prices of the major types of cotton … are affected by the supply and demand situation facing the market as a whole."[152] All of this evidence is consistent with the conclusion that these third country market prices are heavily influenced by A-Index and New York futures prices. Professor Sumner analysis and the studies by USDA economists undeniably show that the US subsidies have suppressed A-Index and New York futures prices. Since these indices are the benchmarks for prices in those "same markets" where US and Brazilian upland cotton were exported, it is indisputable that the US subsidies have suppressed the prices in each of the "markets" cited in the introductory paragraph of Brazil's answer to this question.

**234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"? USA, BRA**

Brazil's Answer:

114. In response to both questions, Brazil, New Zealand, and Argentina have argued previously that whether price suppression is "significant" cannot be judged solely by reference to a non-textually based "objective" amount of price suppression.[153] Rather, the "significance" of price suppression must be assessed with reference to the quality of the impacts of *whatever* level of price suppression exists on the producers of the like product. For example, a panel could find that even large amounts of price suppression are not "significant" where the complaining party producers had *de minimis* production, or no exports, and/or that the total value of lost revenue from suppressed prices was minimal. On the other hand, very large producers of a commodity product like upland cotton would suffer serious prejudice from even smaller "objective" levels of price suppression in terms of the amount of lost revenue.

115. The Panel's question really comes down to whether Article 6.3 of the SCM Agreement requires a two step process – first, an objective finding of an amount of price suppression that is "significant," and second, whether the complaining party Member suffers serious prejudice from such "significant" levels of price suppression. Brazil does not believe the text requires such a two-step process for the reasons outlined above and in previous submissions. However, the facts of this case show that even if such a test were required, the amount of price suppression caused by the US subsidies is significant and far from *de minimis*. Brazil has also submitted undisputed evidence that its producers have suffered considerable losses in revenue from suppressed prices that could have

[152] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

[153] Brazil's 9 September Further Submission, paras. 251-259; Brazil's 7 October Oral Statement, para. 30; Brazil's 27 October Answers to Questions, paras. 119-122. New Zealand's 3 October Further Submission, paras. 2.21-2.27; New Zealand's 8 October Oral Statement, para. 8; Argentina's 3 October Oral Statement, para. 36; Argentina's 8 October Oral Statement, para. 38.

been used for further investment in high-yielding lower cost production.[154] By any measure, this evidence establishes both "significance" of the price suppression and "serious prejudice" to the interests of Brazil.

**235. Please comment on paragraphs 8, 9 and 10 of the US 2 December oral statement, in particular, why the average Brazilian price is shown as lower than the average US price. BRA**

Brazil's Answer:

116. Brazil previously has set forth its reasoning why evidence of lower Brazilian prices in some markets is irrelevant to the issue of whether or not all the prices in those markets were suppressed by the global effects of US subsidies.[155] This global price transferral mechanism is and remains the relevant analysis of Brazil's Article 6.3(c) price suppression claim as Brazil has outlined in its Answer to Question 233. Brazil sets forth its comments and rebuttal to paragraphs 8, 9 and 10 of the US 2 December Oral Statement and Exhibit US-75 below.

**Cumulative Analysis of 8 Country Export Prices**

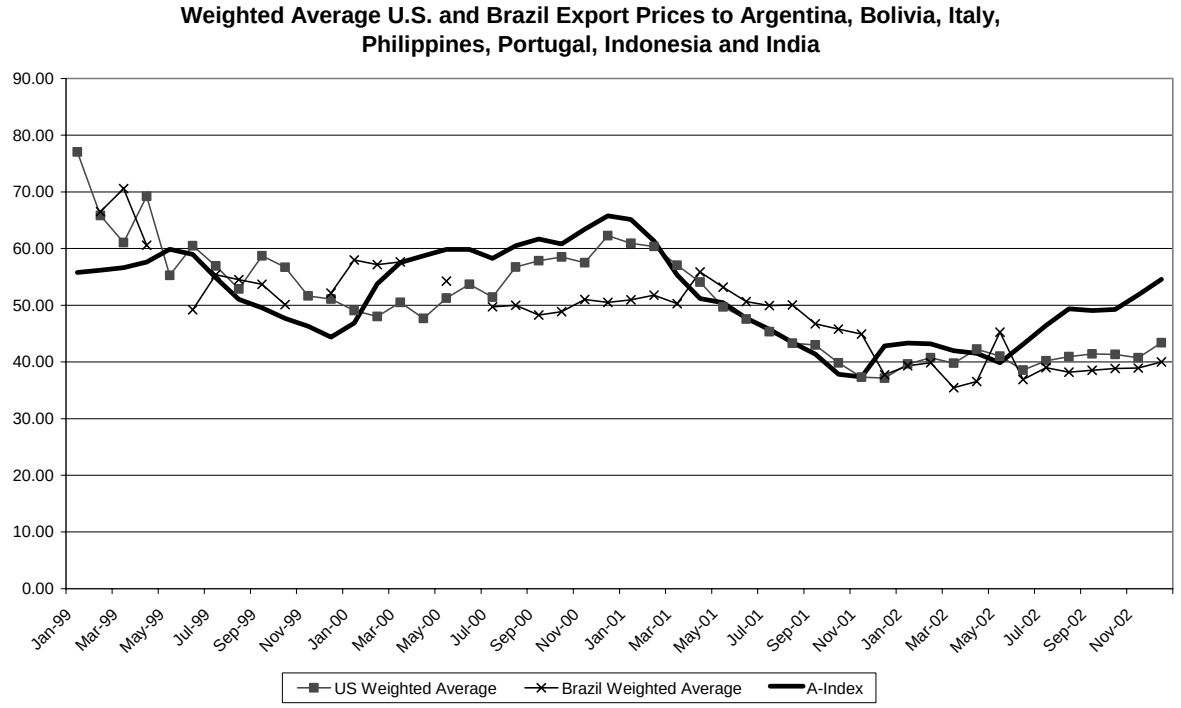
117. With respect to the US "price undercutting" argument, and in particular the US chart set out in Exhibit US-75, the factual assertion that cumulative US prices in the 8 countries examined are consistently much higher than Brazilian prices is simply wrong. One fundamental error with Exhibit US-75 is that the United States did not "weight-average" the data regarding export prices for Argentina, Bolivia, Italy, Philippines, Portugal, Indonesia, Paraguay and India. Rather, Exhibit US-75 is based on a simple average, not taking into account whether Brazilian shipments on a monthly basis were 2 tons or US shipments the same month were 100,000 tons. In addition, the US chart (and accompanying data) in Exhibit US-75 provides no volumes on monthly shipments, provides no published backup material, uses a non-public source of information, and inexplicably does not use official USDA Foreign Agricultural Service (FAS) published data on export prices.

118. Using the proper monthly weighted average methodology and FAS's own official export pricing data together with the Brazilian Government's official export pricing data,[156] the collective situation in the eight countries examined in Exhibit US-75 looks completely different than the US chart in that exhibit:

[154] Brazil's 9 September Further Submission, Section 6 and Annex III. *See* also Exhibit Bra-283 (Statement by Christopher Ward – 7 October 2003).

[155] Brazil's 2 December Oral Statement, paras. 14-19 (providing evidence and references to other evidence supporting Brazil's clams); Brazil's 9 September Further Submission, Section 3.3.4.9.

[156] This data was discussed in some detail in Brazil's Answer to Question 233 and is contained in Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).



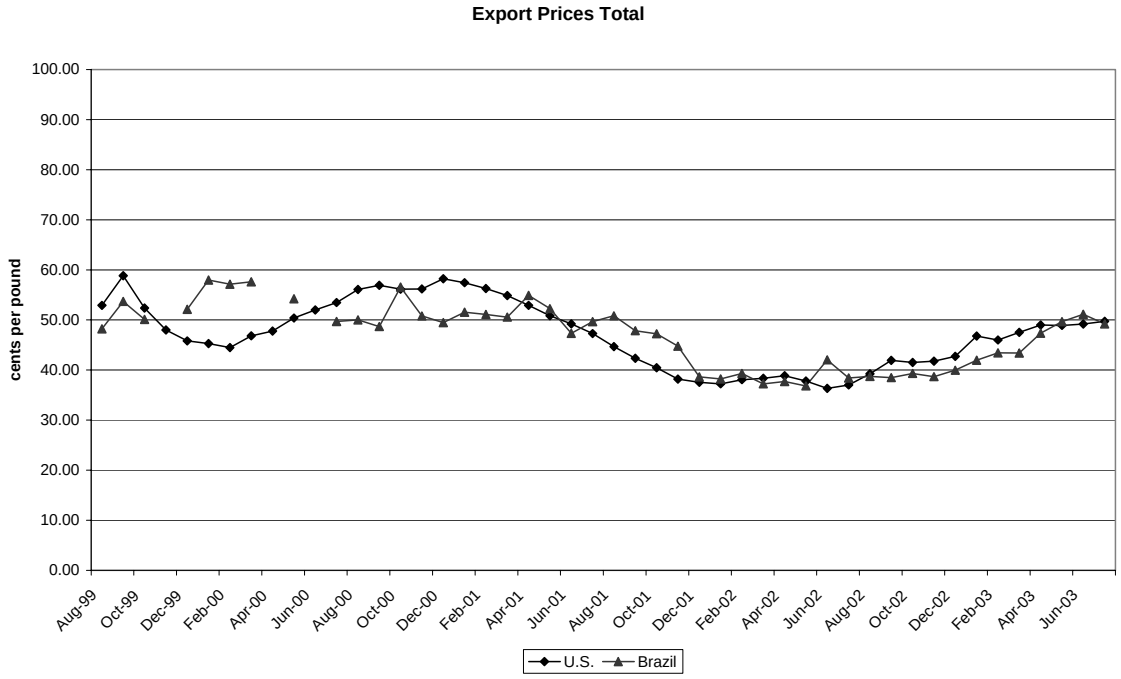

119. The graph shows that US and Brazilian prices fluctuate with Brazilian prices at times higher than US prices and US prices higher than Brazilian prices at other times. The chart shows that beginning in November 2000, US prices plunged along with the A-Index prices and that Brazilian prices quickly followed, with both US and Brazilian prices remaining at record lows until near the end of 2002 when both started rising again. Finally, the chart shows that US prices generally followed the movements or trends in A-Index prices (the solid line in the graph). As discussed in Brazil's Answer to Question 233, this is what is relevant for a price suppression claim under Article 6.3(c) as opposed to any alleged "undercutting" by Brazilian cotton in individual markets as the US claims.

**Cumulative Analysis of US and Brazilian Prices in 40 Third-Country Markets**

120. Moving beyond the 8 countries in Exhibit US-75 to all 41 countries (including Brazil) where Brazil and the US both sold at least some upland cotton between MY 1999-2002 further demonstrates the absence of so-called "price undercutting" by Brazilian products as alleged by the United States. For the period MY 1999-2002, the weighted average price covering a total of 10.5 billion pounds of US upland cotton exported to these same 41 countries (including Brazil) is 45.33 cents per pound.[157] By contrast, the average weighted price of 709 million pounds of exported Brazilian upland cotton to 40 export markets is 44.65 cents per pound.[158] This is a difference of 0.68 cents per pound. For marketing year 2001 – the year when prices plunged to record lows – the weighted average price of US upland cotton in all markets where Brazilian cotton was also exported was 38.83 cents per pound while Brazilian weighted average prices to the same markets was significantly higher at 44.05 cents per pound.[159] Brazilian prices were lower than US prices during MY 2000 and 2002, but were higher than US prices in MY 1999.[160] This is hardly evidence of "price undercutting" by Brazilian upland cotton.

[157] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
[158] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
[159] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
[160] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

121. These very close relationships – as well as movements – of Brazilian and US cumulative prices in the 41 countries are reflected in cumulative weighted average monthly prices in the graph below:[161]




122. This graph illustrates the absolute closeness of prices between Brazilian and US prices, particularly after mid-2001. But it also shows very similar *movements* in prices between Brazilian and US exports. And, as discussed in Brazil's Answer to Question 233, these similar movements are further evidence of the influence of the global pricing mechanisms on prices received by US and Brazilian exporters in third country markets.

**Individual Third-Country Analysis of Brazilian and US Export Prices**

123. When US and Brazilian prices in the 40 individual markets are examined, the evidence does not support the United States' broad assertion that Brazilian prices are consistently lower than US prices. In some of the key textile producing countries where US exporters ship large quantities of US upland cotton – Hong Kong, Taiwan, India, Pakistan, and Vietnam – US prices during MY 1999-2002 were *lower* than Brazilian prices.[162]

124. In other large consuming (textile producing) countries, while US prices were somewhat higher than Brazilian prices, the volume of US exports vastly exceeded the volume of Brazilian exports, including China (120 times greater), Bangladesh (26 times greater), Colombia (9 times greater), Indonesia (17 times greater), Japan (35 times greater), Korea (3384 times greater), and Peru (631 times greater).[163] Huge volumes of US exports in these 7 markets compared to the volumes of Brazilian exports suggest that US exports, not Brazilian exports, play a dominating role in the conditions of competition in those markets.

[161] Exhibit Bra-386 (Brazil and US Export Price by Country).

[162] A complete set of graphs for each of the 40 countries country markets and the underlying data are set forth in Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country) and Exhibit Bra-386 (Brazil and US Export Prices by Country).

[163] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

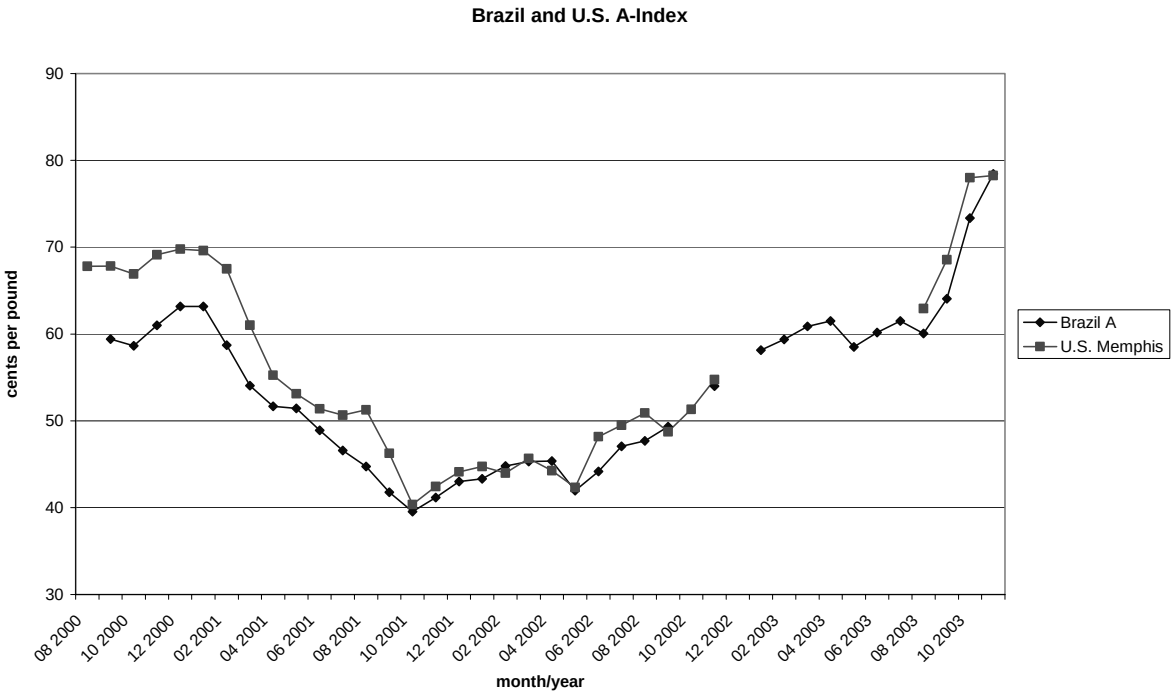
125. Indeed, overall, the cumulative volume of US exports to the 40 countries where Brazilian exports were shipped was *15 times* greater than the volume of Brazilian exports.[164] For Brazilian exports to secure any sales, let alone increase market share in competition with heavily subsidized US exports in these markets, it would not be surprising that textile consumers of upland cotton would expect Brazilian exporters to discount their prices. Andrew Macdonald confirmed that such discount pricing was necessary for non-Brazilian cottons to compete with US cotton.[165] This is particularly true in Argentina, Bolivia, Chile, Colombia, Ecuador, Indonesia, Peru, South Korea, Turkey and Venezuela where US exporters received the benefit of US export credit guarantees.[166] No exporter of non-US cotton could hope to compete with those export credits without discounting its upland cotton prices.[167]

126. But even where the volume of Brazilian exports was greater than US exports, the evidence does not suggest the absence of overall price suppression from the effects of US subsidies.[168] Brazilian exports were greater than US exports in only 10 of the 40 countries (Argentina, Bolivia, Cuba, Poland, France, Germany, Greece, Portugal, South Africa, and Spain) over the MY 1999-2002 period. These 10 countries represented a tiny fraction – 0.49 per cent – of total US exports during MY 1999-2002 to the 41 countries, and only 37.5 per cent of Brazilian exports.[169] Yet, even without significant US exports to these countries, the domestic prices of these countries still largely followed A-Index prices, as discussed in Brazil's Answer to Question 233.

127. Further, in the 10 countries where the volume of Brazilian exports was larger than the United States, Brazilian prices were higher than US prices in 3 of the 10 countries – Poland, Greece, and South Africa.[170] Further, US prices in 4 of the 10 countries – France, Germany, Spain, and Portugal – were much higher than Brazilian prices.[171] The very low volume of US exports to these same four countries suggests that far higher quality US cotton was sold in these countries which produce low-volume specialized cotton textile products.[172] Finally, US and Brazilian prices were very close in remaining 3 countries – Argentina, Bolivia, and Cuba.[173] Thus, contrary to the US arguments, this evidence does not suggest that Brazilian prices are suppressing US prices, even in those markets where there are larger volumes of Brazilian imports.

128. Similarly, the unqualified US assertion that "the Brazilian A-Index quote is consistently *below* the US A-Index quote"[174] is both untrue as well as irrelevant to the question of whether US production subsidies caused suppression of world and third country market prices. Comparing US Memphis A-Index prices with Brazil A-Index prices shows the following graph:[175]

[164] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
[165] Brazil's 9 September Further Submission, Annex II, para. 50.
[166] Exhibit Bra-73 (Summary of Export Credit Guarantee Programmes, FY 1999-2003) and Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Activity," USDA, Covering GSM 102, GSM 103 and SCGP).
[167] Brazil's 9 September Further Submission, Annex II, paras. 49-53.
[168] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[169] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[170] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[171] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[172] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[173] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[174] US 2 December Oral Statement, para. 10.
[175] Based on Exhibit Bra-242 (A and B-Index Quotes from Major Producers), extended to November 2003 using Cotton Outlook quotes.




129. As the Panel can see from the graph, since October of 2001, the US Memphis A-Index price has been slightly higher or slightly lower than the Brazilian A-Index price.[176] But throughout the entire period, the *movements* of both US Memphis and Brazilian A-Index prices track each other very closely.[177] This is the key fact illustrating the transmission of global price-suppressing effects as discussed in Answer to Question 233 *supra.*

**Domestic Prices for Brazil, US and China**

130. Nor does the record support the US claim that Brazilian prices undercut US export prices to the Brazilian market. Indeed, the evidence suggests the opposite. More than 90 per cent of Brazilian production of upland cotton was sold in Brazil during MY 1999-2002.[178] Imports represented approximately 20 per cent of Brazilian consumption during MY 1999-2002.[179] US exports to Brazil represented 21 per cent of Brazilian imports with a total of 306 million pounds of US upland cotton exported to Brazil[180] in MY 1999-2002.[181] US annual weighted average export prices to Brazil were lower in every year except MY 2000 when US exports volumes fell to very low levels.[182] Significantly, in MY 1999, when US export volumes to Brazil represented 17.6 per cent of very large Brazilian imports of upland cotton, the US weighted average prices were 10.27 cents *below* Brazilian domestic prices.[183] Similarly, in MY 2002, when US exports represented 50 per cent of total Brazilian imports, US export prices were 4.57 cents per pound *lower* than Brazilian domestic

[176] The US comparison between the Brazilian quote and the California/Arizona quote is misleading given the much higher quality of the latter cotton, as discussed above.

[177] The absence of data in MY 2002 for Memphis cotton was due to weather-related quality problems according to Gerald Estur of the ICAC. *See* Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

[178] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 76).

[179] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 76).

[180] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

[181] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 76).

[182] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

[183] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

prices.[184] This evidence confirms the testimony of Andrew Macdonald that Brazilian textile purchases of cotton used, *inter alia,* US imports – or the threat of US imports – to negotiate lower Brazilian domestic prices during MY 1999-2002.[185] It may also be an effect of US GSM 102 export credit guarantees. And this evidence further confirms the price suppressing effects of US subsidies in the Brazilian market.

**Conclusion**

131. The evidence set out above refutes the inappropriate non-weighted average analysis in Exhibit US-75, and confirms the effects of the US subsidies in each market where Brazil and the US upland cotton were found in MY 1999-2002. Any "competition" between US and Brazilian cottons took place against the background of subsidy-distorted marketplaces. In the final analysis, the fact that selected US prices are higher[186] or lower in the A-Index or in individual third country markets is largely irrelevant to the question whether US subsidies are causing significant price suppression "in the same market" where US and Brazilian cotton is marketed. Rather, as Brazil has established, it is the impact of the US subsidies on the global supply and demand factors that suppresses prices in the world market as well as in the third countries where upland cotton is marketed. This means that the prices in each of those 40 third country markets – as well as the Brazilian and US markets – were already suppressed before any cotton was shipped by US or Brazilian exporters.

132. Finally, the generalized price-suppression effect manifests itself in all 42 individual country markets[187] in which Brazilian upland cotton is consumed. Professor Sumner estimates that over 40 per cent of US upland cotton exports during MY 1999-2002 would not have been made *but for* the US subsidies.[188] Forty per cent fewer US exports necessarily means lower, or even non-existent, US exports in many of the 40 markets where Brazil exported its upland cotton. Had significant volumes of US upland cotton not received Step 2 export payments, US exports and, thus, the amount of US upland cotton competing with Brazilian cottons would have been lower. Similarly, far fewer bids of US upland cotton financed by the GSM 102 programme may well have meant higher prices for Brazilian exporters and/or an expanded market share in each of these markets.

**236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share". USA**

**237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? BRA, USA**

[184] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country); Exhibit Bra-389 (Brazilian Domestic Price Data) *updating* Exhibit Bra-240 (International, US and Brazilian Prices).

[185] Brazil's 9 September Further Submission, Annex II, para. 47 ("local purchasers of Brazilian cotton will frequently threaten to import foreign cotton if they consider the price of local cotton to be too high.").

[186] *See* Brazil's 9 September Further Submission, Figure 17 (US California A-Index prices were higher than Brazilian prices).

[187] 40 export markets plus the United States and Brazil.

[188] Brazil's 9 September Further Submission, Annex I, Table 5a. This conclusion is conservative in view of the huge $12.5 billion loss that would have been suffered by US producers with no US subsidies between MY 1997-2002.

Brazil's Answer:

133. In responding to this question, Brazil starts from the ordinary meaning of the term "consistent trend." A "trend" means "a general course, tendency or drift."[189] "Consistent" means "congruous, compatible with, not contradictory, marked by uniformity or regularity."[190] A consistent trend within the meaning of Article 6.3(d) therefore means a non-contradictory tendency marked by regularity.

134. Generally, a phenomenon that remains at approximately the same level could be considered a consistent trend. However, read in the context of Article 6.3(d), which speaks of an "increase that follows a consistent trend over a period when subsidies have been granted," the consistent trend must reflect the increase in the world market share of a Member over its previous three-year average. Thus, for a given period of time, the world market share of a Member could remain at approximately the same level and be compatible with a finding of a consistent trend. Yet, there will not be a consistent trend, within the meaning of Article 6.3(d), if during the final year there is no increase of a Member's world market share over its previous three-year average. It follows that over the period when subsidies have been granted there must be a regular tendency of an increase in the world market share of a Member – although no increase in each and every year is required for the conditions of Article 6.3(d) to be fulfilled.

135. This interpretation is confirmed by the scope of Article 6.3(d), which applies to primary products or commodities. The parties agree that this includes agricultural products that necessarily will be affected by favourable or adverse weather conditions. The United States, for example, repeatedly asserts that the weather-related problems of MY 1998 mean that data for that year should be disregarded. These weather-related effects alone could cause in particular years the world market share of a Member to increase or decrease. This may well be the reasoning behind requiring examination of a longer trend in Article 6.3(d). But to require a constant increase in the world market share during each year "when subsidies have been granted" would render the disciplines of Article 6.3(d) largely inutile for agricultural products faced with weather-related production fluctuations.

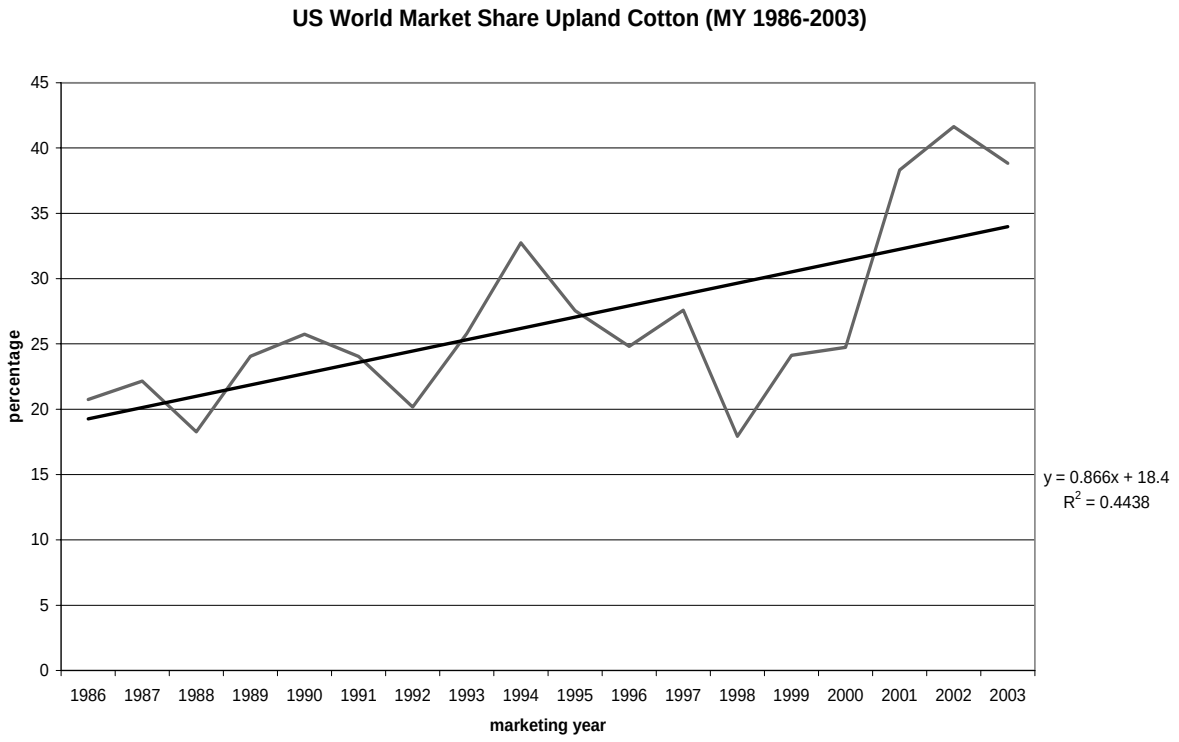
136. Brazil has offered data on the US world market share over the period since MY 1996 as well as since MY 1986.[191] The data shows that the trendline for the US world market share increases whether based on MY 1996 or MY 1986 as the starting point. The Panel's question asks for guidance on the conditions for a finding whether this trend is consistent.

137. Brazil cautious that statistical methods may not be helpful in analyzing the consistency of a trend within the meaning of Article 6.3(d) for two reasons: first, Article 6.3(d) is concerned with yearly data over a relatively short period. That means that only very few data points will be available, which will affect the statistical significance of any results. Second, as discussed above, it is the nature of world market shares in agricultural products to fluctuate due to weather-related effects. This phenomenon tends to further weaken any statistical significance of methods analyzing the consistency of a trend.

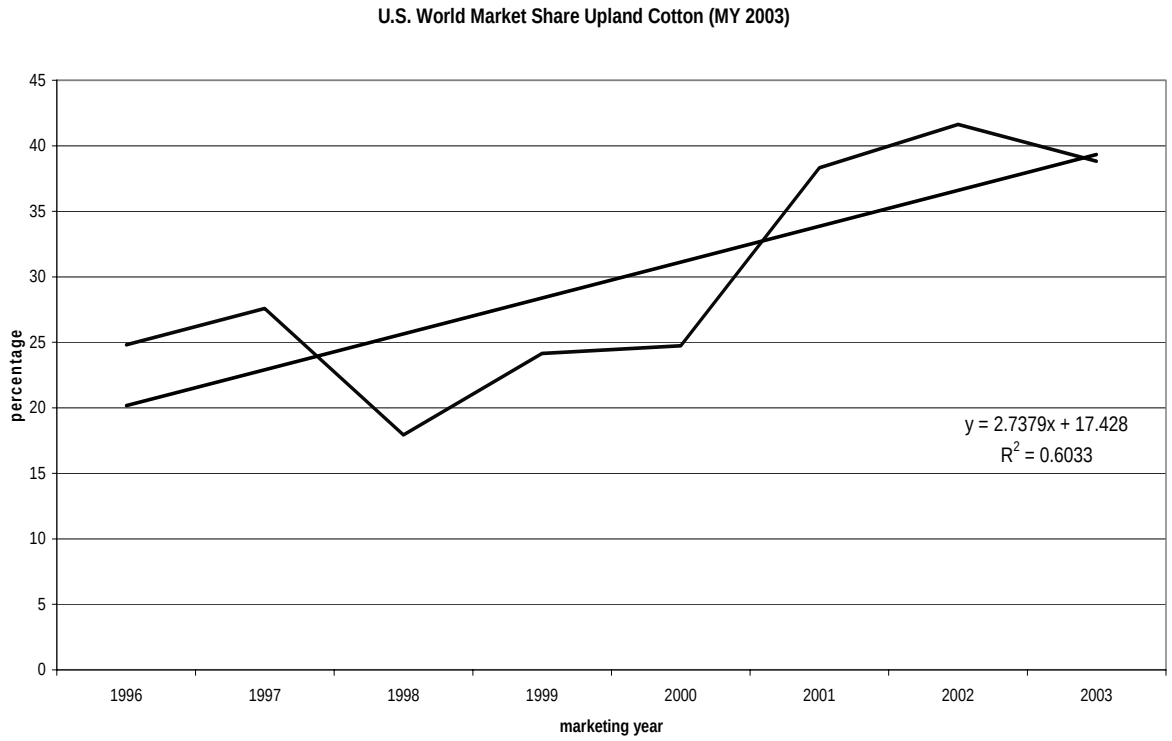
138. With these considerations in mind, Brazil suggests that the Panel analyze the trendlines offered by Brazil[192] and decide whether on their face they demonstrate – as Brazil has argued – a trend consistent with a finding that the effect of the subsidies is an increase in the US world market share for upland cotton. Brazil believes they do, particularly if the severe MY 1998 decline is disregarded.

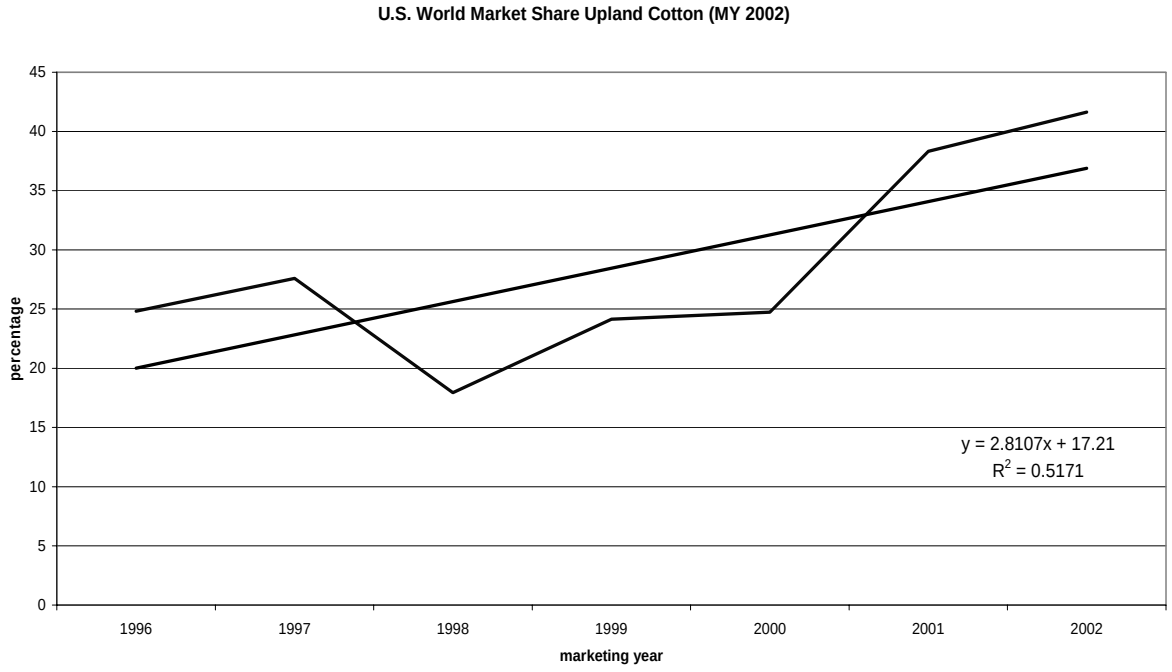
[189] The New Short Oxford English Dictionary 1993 edition, p. 3384.
[190] The New Shorter Oxford English Dictionary, 1993 edition, p. 486.
[191] Brazil's 27 October Answers to Questions, paras. 123-129 and Brazil's 9 September Further Submission, Sections 3.4 and 4.12.2.
[192] Brazil's 27 October Answers to Questions, paras. 123-129 and Brazil's 9 September Further Submission, Sections 3.4 and 4.12.2.

139. However, Brazil has also run a regression analysis for the trends over the period MY 1986-2003, MY 1996-2003 and MY 1996-2002, with the results being reproduced in the graphs below.[193]




[193] The results are based on data as reported in Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) Claim).




The $R^2$ – the measure for the fit of a regression analysis – varies between 0.44 for MY 1986-2003 and 0.60 for MY 1996-2003. The $R^2$ demonstrate that there is a positive relationship between the US world market share and its increase over time. In view of the limited number of observations and the nature of the commodity market in question, this is a very high number.

**238. According to the US interpretation of the term "world market share":**

**(a) should the domestic consumption of closed markets be added into the denominator?**

**(b) if US production and consumption increased by the same percentage, whilst the rest of the world's production and consumption remained steady, would this imply an increase in the US "world market share" by a different percentage?**

**(c) does Saudi Arabia have a small world market share for oil? USA**

**239. How does the US respond to Brazil's assertions that, under the US interpretation of the term "world market share":**

**(a) there would be no WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports? (see paragraph 64 of Brazil's 2 December oral statement);**

**(b) a Member's exports would have to be disregarded in calculating their "world market share" in terms of "world consumption"? (see e.g. paragraph 65 of Brazil's 2 December oral statement) USA**

**240. Does Article XVI:3 of GATT 1994 provide context in interpreting Article 6.3(d) of the *SCM Agreement*? Do these provisions apply separately? If not, could it indicate that "world market share" is intended to mean the same as "share of world export trade"? USA**

**241. How does the US reconcile its data on consumption for 2002 in US Exhibit 40, Table 1 with the "consumption" data it refers to in its 30 September submission, paragraph 34, Exhibit US-47 or US-71? USA**

**242. How much of the benefits of PFC, MLA, CCP and Direct Payments go to land owners? If not all of the benefits go to land owners, what proportion goes to producers? USA**

**243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? USA**

**244. What proportion of the 2000 cottonseed payments benefited *producers of upland cotton*, given that payments were made to *first handlers*, who were only obliged to share them with the producer to the extent that the revenue from sale of the cottonseed was shared with the producer? (see 7 CFR §1427.1104(c) in Exhibit US-15). BRA**

Brazil's Answer:

140. Brazil does not know "what proportion of the 2000 cottonseed payments" were paid *directly* to producers of upland cotton by first handlers. Any such information would be within the exclusive control of USDA. Therefore, Brazil looks forward to the United States providing this information in its 19 January comments.

141. However, there is evidence that the MY 2000 cottonseed payments – together with the MY 1999 and MY 2002 payments – benefited upland cotton producers either directly or indirectly. First, producers who ginned their own cotton received payments directly as "first handlers." But even producers who did not gin their own cotton received indirect benefits because the purpose and effect of the subsidy was to prevent producers from having to pay *more* for ginning because of low

cottonseed prices. This was made clear by the official USDA announcement of the USDA Secretary Glickman in announcing the MY 2000 cottonseed payments:

> Agriculture Secretary Dan Glickman announced today that USDA will propose to pay cotton farmers and ginners about $74 million to help offset losses from low 1999-crop cottonseed prices.
>
> Because of those low prices, many gins were unable to meet operating expenses normally covered by cottonseed revenues and some cotton farmers had to pay higher ginning costs," Glickman said. "This discretionary programme will help farmers make up this lost income."
>
> The proposed payments would be made to cotton gins based on seed tonnage produced from the 1999 crops of upland and Extra Long Staple cotton. USDA plans to propose that *gins share cottonseed programme payments with cotton farmers commensurate with any increased 1999-crop ginning charges as a condition of accepting programme payments.*[194]

142. This analysis makes it clear that upland cotton producers in MY 1999-2000 were required to pay more for ginning when cottonseed prices fell because ginning companies accept as part of the payment for ginning the cottonseed produced from the ginning process of raw cotton. The benefits of the cottonseed programme to producers explains why the NCC strongly supported the "the establishment of a permanent programme for cottonseed" during the debate for the 2002 FSRI Act.[195] In testimony before Congress, the Chairman of the NCC stated as follows:

> *Cottonseed is a critical component of total farm revenue* generated from cotton production. From 1994-1998, cottonseed accounted for approximately 13 per cent of the total value of cotton production, averaging $58 per acre. Unfortunately cottonseed prices weakened significantly in 1999 as a result of weak crushing demand ads well as low oilseed prices. Cottonseed values remain well below those of previous years. The special cottonseed payment authorized by Congress for the 1999 and 2000 marketing years were *vitally important on boosting producer income* and helping to maintain the industry's ginning infrastructure.[196]

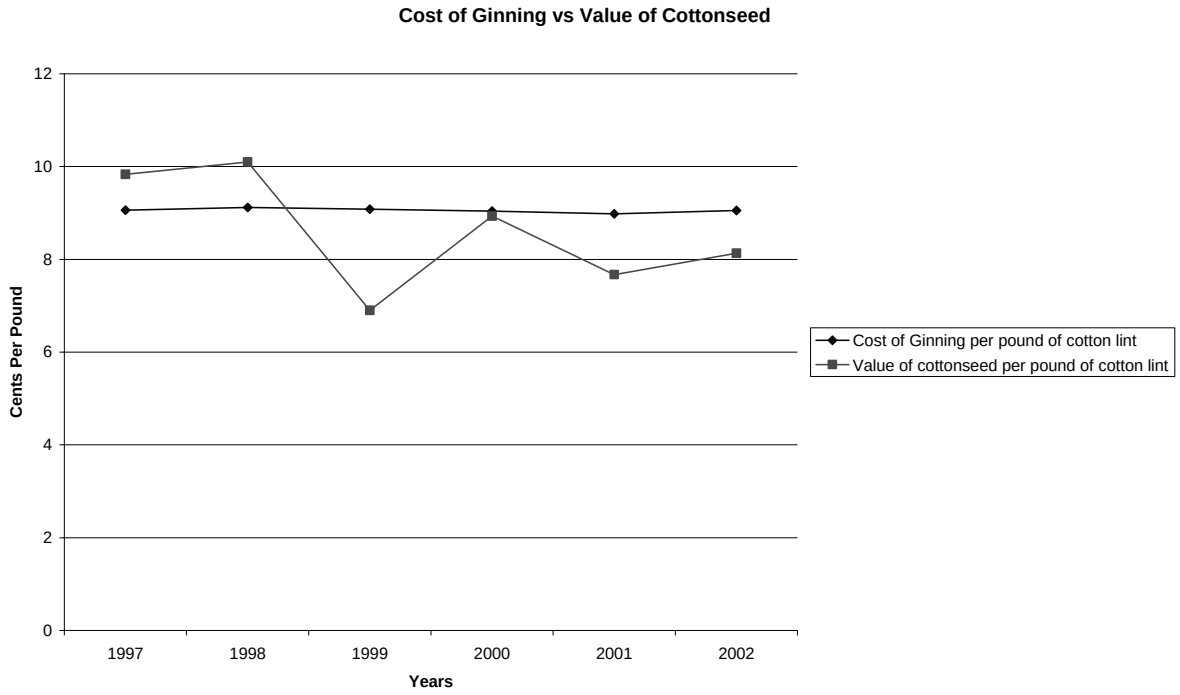
143. Finally, the importance of cottonseed payments to producers is further demonstrated by comparing the costs of ginning to the value of cottonseed. This is illustrated in the graph below:[197]

[194] Exhibit Bra-390 ("Glickman Proposes Cottonseed Payment Programme," USDA News Release, 29 February 2000) (emphasis and underlining added).

[195] Exhibit Bra-41 (Congressional Hearing, "The Future of Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, p. 5).

[196] Exhibit Bra-188 (Testimony of James Echols, Chairman of the National Cotton Council before the Committee of Agriculture, Nutrition and Forestry of the US Senate, 17 July 2001, p. 9).

[197] This graph is based on per pound figures for the value of cottonseed and the cost of ginning per pound of cotton lint produced as calculated from Exhibit Bra-323 (Costs and Returns of US Upland Cotton Farmers, MY 1997-2002). They calculated figures are reproduced in Exhibit Bra-391 (Cost of Ginning and Value of Cottonseed per Pound of Cotton Lint).




144. This graph shows that producers were the primary beneficiaries of the cottonseed programme. When cottonseed prices declined in MY 1999, ginning costs exceeded cottonseed prices by 2.18 cents per pound of cotton lint.[198] This gap between ginning costs and cottonseed prices totalled $170.5 million.[199] Congress authorized $185 million in cottonseed payments in MY 2000[200], which covered much of the MY 1999 losses. As noted, it was upland cotton *producers* – not ginners – who were required to pay the $170.5 million difference in MY 1999 between the costs of ginning and the value of the cottonseed. When cottonseed prices again plunged in MY 2001 and MY 2002, Congress provided relief to producers with the 2002 cottonseed payments. For example, the $50 million in cottonseed payments in MY 2002 covered part of a gap of $73 million between the ginning cost and the value of the cottonseed.[201] Thus, this evidence suggests not only that cottonseed payments were support to upland cotton within the meaning of Article 13(b)(ii) of the Agreement on Agriculture, but that these payments, while relatively small in comparison to the billions of dollars paid to US producers, nevertheless, provided yet further subsidies supporting large quantities of US upland cotton production.

**245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? BRA, USA**

[198] Exhibit Bra-391 (Cost of Ginning and Value of Cottonseed per Pound of Cotton Lint).

[199] This figure has been calculated based on the price gap of 2.18 cents per pound multiplied by the MY 1999 production of 16.294 million 480-pound bales (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[200] Brazil's 9 September Further Submission, Table 1.

[201] This figure has been calculated based on the price gap of 0.92 cents per pound multiplied by the MY 2002 production of 16.531 million 480-pound bales (Exhibit Bra-391 (Cotton and Wool Outlook, USDA, 12 December 2003, Table 1).

Brazil's Answer:

145. The Panel is well aware of Brazil's view that all of the US subsidies are non-green box. But if the Panel were to find that certain of the subsidies are green-box subsidies, then under the specific circumstances of this dispute, Article 13(a)(ii) of the Agreement on Agriculture prohibits – during the implementation period – the effects of these subsidies being included along with other effects of non-green box subsidies in assessing Brazil's actionable subsidy claims. Professor Sumner's analysis in Annex I of Brazil's 9 September Further Submission permits the Panel to examine both the individual as well as collective effects of the various US subsidies. In response to Question 146, Professor Sumner analyzed the production, export and price effects of all of the subsidies except PFC subsidies.[202] This analysis would also permit the Panel to ensure that effects caused by, for example, PFC payments, were not attributed to the effects caused by the other non-green box subsidies.

146. After the 9-year implementation period of the Agreement on Agriculture, there is nothing in that Agreement that exempts the effects of green box subsidies from being considered by panels in actions based on Articles 5 and 6 of the SCM Agreement. Subsidies that conform to Annex 2 of the Agreement on Agriculture are exempt from the reduction commitments established under Article 6, but there is nothing in Articles 5 or 6 of the SCM Agreement that provides for any type of exemption, beginning in 2004. On the contrary, Article 5 of the SCM Agreement clearly states the Members should not cause, "… through the use of *any* subsidy … adverse effects to the interests of other Members." The only exception provided therein refers to the temporary exception of Article 13 of the Agreement on Agriculture.

**246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? BRA, USA**

Brazil's Answer:

147. Yes, the Panel is required to take into account *all* non-green box subsidies, including prohibited subsidies in assessing Brazil's Article 5 and 6 claims under the SCM Agreement.[203] Even if the Panel were to conclude that the effects of prohibited subsidies, such as Step 2 and export credit guarantees, should not be assessed for the purposes of Brazil's Article 5 and 6 claims, Professor Sumner's analysis permits the Panel to analyze such claims for those non-green box and non-prohibited subsidies (marketing loan payments, crop insurance subsidies and contract payments).

**247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? BRA, USA**

Brazil's Answer:

148. Yes. Nothing prevents the Panel from considering – in assessing Brazil's threat of serious prejudice claims – the volatility of the upland cotton market and current and likely futures price developments after the date of establishment of the Panel. Brazil has proposed that the Panel follow the guidance of the GATT *EC – Sugar Exports* panels and the Appellate Body in *US – FSC* and analyze whether there is any mechanism that stems, or otherwise controls, the flow of US upland

[202] Brazil's 27 October Answers to Questions, paras. 114-118 and Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of all domestic support except PFC/direct payments and crop insurance).

[203] *See* Brazil's 27 October Answer to Question 145(b).

cotton subsidies and whether these mandated and unlimited subsidies constitute a permanent source of uncertainty in the upland cotton market.[204]

149. The Panel's question raises both legal and factual issues. First, as a legal matter, Brazil has previously argued that it is appropriate for the Panel to consider pricing, export, production, acreage and other evidence occurring after the date of establishment of the Panel.[205] The Panel's terms of reference in this case involve both *present* and *threat* of serious prejudice claims (*i.e.*, matters) with each of these types of claims overlapping during the period of MY 2002. Thus, the "matter" before the Panel has not changed (and cannot) since the establishment of the Panel.

150. In "making an objective assessment of the matter," the Panel must make "an objective assessment of the facts of the case" pursuant to DSU Article 11. Nothing in the text of DSU Article 11 suggests that this objective assessment of "facts" cannot include collecting and analyzing facts occurring after the establishment of a Panel. Indeed, there are a number of precedents in which panel's have considered evidence that came into existence *after* the date of the establishment of a panel.[206] As with investigating authorities in trade remedy investigations, a "period of investigation" for a WTO Panel in an Article 5 and 6 claim is useful for assessing whether present or threatened effects presently exist. There is nothing in the text of Part III of the SCM Agreement or the DSU that suggests that the time period for the collection of evidence or data to investigate must stop with the establishment of the Panel.

151. The second question raised by the Panel's question is a factual one, *i.e.*, what weight should the Panel give to the most recent evidence of volatility in the cotton futures and spot markets? It is fact that upland cotton prices have risen – and fallen – significantly since the Panel was established in March 2003. For example, futures prices for the nearby March 2004 contract rose from 55.80 cents on 6 March 2003 to a high of 86 cents on 30 October before falling to 72.32 cents on 19 December 2003.[207] But the record shows that such volatile futures price increases – and decreases – also occurred between MY 1999-2002.[208] And they will no doubt exist during MY 2003-2007.

152. In assessing whether there is a threat of serious prejudice, the Panel should be cautious about relying too heavily on only 3-4 months worth of the most recent data. Indeed, the Appellate Body has cautioned that "competent authorities are required to examine the trends in [data] over the entire period of investigation," because the "analysis could be easily manipulated to lead to different results, depending on the choice of end points."[209] Similarly, in *Argentina – Footwear* the Appellate Body held that "competent authorities are required to consider the trends in imports over the period of investigation (rather than just comparing the end points)."[210] The panel in *Argentina – Peach Safeguards* stated that "[t]the most recent past should not be considered separately from the overall

[204] *See* Brazil's 18 November Further Rebuttal Submission, Section 4.

[205] Brazil repeatedly in its many submission to the Panel refers to data that originates after the establishment of the Panel, including in these answers to the Panel's questions.

[206] Panel Report, *India – Quantitative Restrictions*, WT/DS90/R, para. 5.161-5.163 ("In this case the parties and the IMF have supplied information concerning the evolution of India's balance of payments and reserve situation until June 1998. To the extent that such information is relevant to our determination of the consistency of India's balance of payments measures with GATT rules as of the date of establishment of the Panel [18 November 1997], we take it into account."); Panel Report, *Japan – Apples*, WT/DS245/R, para. 8.49; GATT Panel Report, *Korea – Beef*, BISD 36S/268, paras. 122-123.

[207] Exhibit Bra-393 (Futures Prices as of 19 December 2003).

[208] *See* Exhibit Bra-311 (Side-By-Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average Spot Market Price and Prices Received by US Producers from January 1996 to the Present).

[209] Appellate Body Report, *US – Steel Safeguards*, WT/DS248/AB/R, paras 353-356.

[210] Appellate Body Report, *Argentina – Footwear*, WT/DS121/AB/R, para. 129.

trends during the period of analysis," as otherwise the resulting picture may be "quite misleading."[211] The Panel in this case performs a task similar to a domestic competent authority in a trade remedy case.

153. The Panel has before it two different methodologies to judge the present price levels and threat of serious prejudice. The first methodology before the Panel is the use of baseline projections such as the USDA's and FAPRI's baseline projections to assess the effects of mandated US subsidies in the year ahead. Professor Sumner's analysis based on the January 2003 FAPRI baseline, shows that the US subsidies continue to maintain large amounts of US production whether prices are high or low. Professor Sumner found that during MY 2003-2007 annual US production would be 19.4 per cent lower leading to a reduction in projected US exports by 32.4 per cent annually and world prices that would be 8.3 per cent higher absent the US subsidies.[212] Similarly, Professor Ray of the University of Tennessee also found significant production, export, and price suppressing effects from the US subsidies from MY 2003-2007.[213] These findings by two of the leading US economists cannot be ignored by the Panel.

154. A second far less valid methodology would be to use the US "futures methodology." This methodology would examine the December futures price at the time of planting (January-March 2004). What is significant about current futures prices (in December 2003) is that the "futures market" is predicting that prices will fall in MY 2004. The December 2003 price of the December 2004 futures contract is 65.85 cents per pound as of 19 December 2003, while the March 2004 futures contract is 72.32 cents per pound.[214] Assuming that the current 65.85 cents per pound December 2004 futures contract price will continue during the planting decision marking time between January-March 2004, the expected adjusted world price will be 52.48 cents per pound[215] and the expected average MY 2004 price received by US producers would be 59.73 cents per pound.[216] This means that US producers "expect" to receive a considerable CCP payment of 6 cents per pound in MY 2004 (65.73 cents minus 59.73 cents).

155. As discussed by Professor Sumner on 3 December, given the probability distribution of the expected adjusted world price,[217] producers would also expect to receive some marketing loan payments because producers expect with a certain probability that the adjusted world price would be below the marketing loan rate triggering marketing loan payments.

156. As with the period MY 1999-2002, the existing (December 2003) price levels in the upland cotton world and US markets mean that US producers will be planting in 2004 for government support during MY 2004, not for the market. This constant theme was recently emphasized by the world's largest cotton trader, William Dunavant:

> The [US] farm programme can return more when prices are low rather than when prices are high . . . [and] [t]he loan deficiency payment created by the farm programme is the name of the game – not necessarily the futures price or the cash price . . .

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[211] Panel Report, *Argentina – Peach Safeguards*, WT/DS238/R, para. 7.64-7.65 citing para. 138 of the Appellate Body Report in *US – Lamb*.

[212] Exhibit Bra-326 (Results of Professor Sumner's Modified Model, Table B).

[213] *See* Brazil's 9 September Further Submission, paras. 204-205.

[214] Exhibit Bra-393 (Futures Prices as of 19 December 2003).

[215] Exhibit Bra-370 (The Difference between the Average World Price and the Nearby December Futures Contract Price).

[216] The spread of 6.12 cents has been calculated based on the data in Exhibit Bra-370 (The Difference between the Average World Price and the Nearby December Futures Contract Price) and the average farm price in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5).

[217] *See* Exhibit Bra-371 (Simple Example of the Calculations of Marketing Lon Benefits (Probability Distribution)).

> It's interesting that we project nearly an 8 per cent increase in world production [in MY 2003], but US production is forecast to rise only slightly. *This tells me the world is certainly more price sensitive and responsive than the US cotton producer*. I think the nature of our farm programme definitely creates this situation. *Cotton futures prices need to rise to nearly 70 cents a pound to make cash prices better than the farm programme protection.*[218]

In addition, Mr. Dunavant emphasized that US producers "must have" the GSM-102 programme "if we are to export the quantities needed to support our level of cotton production in this country [*i.e.*, the United States]."[219] These statements by the world's leading cotton trader confirm the significant effects that have existed and will continue to exist at current price levels because of the mandatory nature of the subsidy programmes.

157. Finally, nothing about the price levels that have increased since 18 March 2003 has changed in any way the mandatory nature of the US subsidies. At current price levels, producers would receive benefits from crop insurance subsidies, direct payments, and indirectly from Step 2 payments and export credit guarantees. Whether prices are at 70 cents per pound or 30 cents per pound, US producers know and expect that they will be protected by the wide range of US subsidies. When US prices decline, as they inevitable will, US producers will be provided direct production incentives to continue producing at any price level. Historical data convincingly demonstrates that this downside risk protection guarantees high levels of production. Brazil proved that US planted acreage remains high within relatively narrow ranges whether market prices increase or decrease. This lack of US producers' production response to huge costs overruns of $12.5 billion over six years or to record low prices, or even to increasing prices, is at the heart of Brazil's threat case. While the cumulative price-suppressing and export-enhancing effects of the US subsidies may be smaller now than they were on 18 March 2003, they are, and will remain significant for MY 2003 and for MY 2004 based on current prices.

158. In sum, Brazil reiterates its arguments that taking all available data into account, the US subsidies pose a threat of serious prejudice to the interests of Brazil, in violation of Articles 5(c) and 6.3 of the SCM Agreement and GATT Articles XVI:1 and XVI:3.[220]

## VI. Step 2

**248. In respect of the level of Step 2 payments in certain time periods, the Panel notes, *inter alia*, footnote 129 in the US first written submission; footnote 33 in the US 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? BRA, USA**

Brazil's Answer:

159. Under the 2002 FSRI Act (with the elimination of the 1.25 cent per pound threshold), Step 2 payments will be zero when the lowest US A-Index quote is equal or below the average A-Index.[221] Thus, for Step 2 payments to expire, the lowest US quote will have to be one of the cheapest of the

[218] Exhibit Bra-392 ("William Dunavant Says: Overproduction Thwarts Cotton Price Upturn," Western Farm Press).
[219] Exhibit Bra-392 ("William Dunavant Says: Overproduction Thwarts Cotton Price Upturn," Western Farm Press).
[220] *See* Section 4 of Brazil's 18 November Further Rebuttal Submission.
[221] Exhibit Bra-29 (Section 1207 (a) of the FSRI Act).

only five quotes making up the given A-Index. During MY 2002, there were zero Step 2 payments during five weeks: 20 September, 27 September, 4 October, 11 October and 18 October 2002.[222]

160. By contrast, during MY 2001, Step 2 payments were zero during 15 weeks: 14 December, 21 December, 28 December, 4 January, 11 January, 18 January, 25 January, 1 February, 8 February, 15 February, 22 February, 1 March, 8 March, 15 March, and 22 March.[223]

161. The elimination of the 1.25 cent per pound threshold under the 2002 FSRI Act has reduced the likelihood of zero payments under the Step 2 programme because the lowest US quote must now be even lower relative to the A-Index for Step 2 payments to expire. It also means that the US government will pay the entire difference between the cheapest US price quote for the A-Index and the A-Index itself.

**249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":**

**(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer?[224] How, if at all, would this be relevant for an analysis of the issue of export contingency under the *Agreement on Agriculture* or the *SCM Agreement*? BRA**

Brazil's Answer:

162. As set out in Brazil's Answer to Question 125, Step 2 payments generally are not received by US producers but rather by eligible exporters and domestic users.[225] Of course, it is theoretically possible for a producer to receive directly Step 2 payments when the producer meets the definition of an exporter "regularly engaged in selling eligible upland cotton for *exportation* from the United States."[226] However, the fact that most US producers do not *directly* receive Step 2 payments does not mean that they do not benefit *indirectly* from Step 2 payments. Quite the contrary. Step 2 payments support significant quantities of planted upland cotton acreage, production and exports by stimulating the demand for high-cost and high-priced US cotton.[227] Brazil has provided considerable evidence of these effects in its earlier submissions that has never been rebutted by the United States.[228]

163. The answer to the second question is "not at all." Exporters are only eligible to receive Step 2 export payments if they produce evidence to CCC that they have exported an amount of US upland cotton. Thus, payments are conditional upon proof of export. Exporters will not receive any Step 2 export payments if they have not produced evidence of the export of US upland cotton. In sum, the fact that producers – in their capacity as exporters – may benefit from Step 2 export payments does not impact the export contingency of these payments.

[222] Exhibit Bra-350 (Weekly Step 2 Certificate Values).
[223] Exhibit Bra-350 (Weekly Step 2 Certificate Values).
[224] For example, Brazil's response to Panel Question 125, paragraph 14.
[225] Brazil's 27 August Answers to Question, para. 14.
[226] Exhibit Bra-37 (7 CFR 1427.104(a)(2)).
[227] *See* Brazil's 9 September Further Submission, Annex I, table I.5f.
[228] Sections 2.6.7, 2.6.8, 4.1, 5.1 and 5.2 of Brazil's 24 June First Submission; Section 3 of Brazil's 22 July Oral Statement; Brazil's 24 July Closing Statement, paras. 21-22; Section 4 of Brazil's 22 August Rebuttal Submission; Section 3.3.4.7.5 of Brazil's 9 September Further Submission; Section 3.7.3 of Brazil's 18 November Further Rebuttal Submission.

**(b) How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do *not* go directly to the producer? USA**

**(c) What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. USA**

## VII. Remedies

**250. Does Brazil seek relief under Article XVI of *GATT 1994* in respect of expired measures? What type of recommendation would the Panel be authorized to make? (Brazil further submission, paragraph 471 (iii)) BRA**

Brazil's Answer:

164. Brazil does not seek relief under GATT Article XVI of GATT 1994 in respect of expired measures, which Brazil understands the Panel to mean only the legal instruments consisting of the 1996 US Farm Bill providing, *inter alia,* for production flexibility contract payments, as well as the various emergency appropriation Acts in 1998-2001 providing, *inter alia,* for market loss assistance payments.[229]

165. With respect to the second question, the Appellate Body held in *US – Certain EC Products,* that a panel may *not* make a recommendation to the DSB that a Member bring a measure into conformity with its WTO obligations if that measure no longer exists.[230] Therefore, as detailed in paragraph 471(x) of Brazil's 9 September Further Submission, Brazil requests the Panel to recommend that the United States bring its existing measures providing or facilitating the payment of subsidies to producers, users and exporters of upland cotton into conformity with GATT Article XVI.

**251. In light, *inter alia,* of Article 7.8 of the *SCM Agreement,* if the Panel were to find that any subsidies have resulted in adverse effects to the interests of another Member within the meaning of Article 5 of the *SCM Agreement,* should it make any recommendation other than the one set out in the first sentence of Article 19.1 of the DSU? BRA**

Brazil's Answer:

166. Yes. If the Panel agrees with Brazil that the US subsidies to upland cotton cause and threaten to cause serious prejudice to the interests of Brazil, in violation of Article 5 of the SCM Agreement, the Panel should recommend pursuant to Article 7.8 of the SCM Agreement that the United States remove these adverse effects or withdraw the subsidies.[231]

**252. Without prejudice to any findings by the Panel, if the Panel were to find that any of the challenged measures constitute prohibited subsidies within the meaning of Article 3 of the *SCM Agreement,* what are the considerations that should guide the Panel in making a recommendation under Article 4.7 of the *SCM Agreement* relating to the time period "within which the measure must be withdrawn"? What should that time period be? BRA**

[229] Brazil's claims under Articles 5(a) and 6(c) of the SCM Agreement do include the continuing adverse effects today and in the future of subsidies provided under these expired legal provisions. *See* Brazil's 24 July Closing Statement, paras 4-7.

[230] Appellate Body Report, *US – Certain EC Products*, WT/DS165/AB/R, para. 81

[231] *See* Brazil's 9 September Further Submission, paras. 471(viii) and 471(ix).

Brazil's Answer:

167. Brazil suggests that the Panel follow the precedent of all previous WTO panels[232] that made findings of prohibited subsidies and specify that the measure must be withdrawn within 90 days.[233]

## VIII. Miscellaneous

**253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):**

**(a) Does it relate to export credit guarantees, crop insurance and cottonseed payments?**

**(b) Does it relate only to compliance with AMS commitments?**

**(c) Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?**

**(d) How would the Secretary exercise her authority to prevent serious prejudice to the interests of another Member? How would she exercise her authority to prevent a threat of serious prejudice to the interests of another Member? At what time and on the basis of what type of information would she exercise her authority?**

**(e) What does "to the maximum extent practicable" mean? In what circumstances would it not be practicable for the Secretary to exercise her adjustment authority? USA**

**254. Would payments made after the date of panel establishment be *mandatory* under the marketing loan, direct payments, counter-cyclical payments and user marketing certificate (step 2) programmes, but for the circuit-breaker provision? USA**

**255. How does Brazil respond to US assertions concerning the circuit-breaker provision? (see US 2 December oral statement, paragraph 82). Does this mean that US subsidies cannot be "mandatory" for the purposes of WTO dispute settlement? BRA**

Brazil's Answer:

168. The United States has admitted what the text of the "circuit breaker" provision in Section 1601(e)(1) of the 2002 FSRI Act already makes clear, *i.e.* that it only applies to "total allowable domestic support levels under the Uruguay Round Agreements," *i.e.*, "total AMS."[234] The United States further acknowledges that this provision "is not specifically addressed to forestalling

[232] Panel Report, *Brazil – Aircraft*, WT/DS46/R, para. 8.5; Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 10.4; Panel Report, *Australia – Leather*, WT/DS126/R, paras. 10.6-10.7, Panel Report, WT/DS139/R and WT/DS142/R, paras. 11.6-11.7 and Panel Report, *Canada – Aircraft II*, WT/DS222/R, para. 8.4.

[233] Brazil notes that the panel in *US – FSC* took account of the fact that the US tax system could only be changed from the beginning of the next fiscal year and therefore set the 1 October 2001 as the deadline for withdrawing the FSC subsidies "without delay."

[234] US 2 December Oral Statement, para. 82

serious prejudice."[235] Indeed, no provision in US law is designed to forestall serious prejudice to US trading partners caused by US agricultural subsidies *specifically in support of upland cotton*.

169. The current US "total AMS" is $19.1 billion. As long as the United States stays below this level, there is no legal provision in the 2002 FSRI Act granting the Secretary of Agriculture any authority to stem, or otherwise control, the amount of upland cotton subsidies. Indeed, the numerous mandatory provisions of the 2002 FSRI Act text cited in Brazil's earlier submissions[236] *requires* the Secretary to make the payments to which eligible producers, users and exporters have a legal entitlement. No exceptions for upland cotton are provided for. Thus, these provisions continue to be mandatory in all circumstances where the US total AMS is below $19.1 billion. The Appellate Body and WTO panels have held that measures are mandatory where they cannot be applied in a WTO consistent manner in certain circumstances.[237]

170. And even were the US total AMS to exceed $19.1 billion, the text of Section 1601(e)(1) does not mandate any reductions if it is not "practicable" to do so. Nor does the text mandate an even, across the board, cut for *all* programme crops. For example, the Secretary appears to have the discretion to cut corn or wheat subsidies but retain the full amount of upland cotton subsidies. Brazil will provide further comments on the "circuit breaker" provision on 19 January in response to the US Answers to Questions 253-254.

**256. The United States submits that the Panel cannot make rulings without allocating precise amounts of payments to upland cotton production. However, to the extent that such precise data is not on the Panel record, to what extent can the Panel rely on less precise data, and on reasonable assumptions, in fulfilling its duty under Article 11 of the *DSU* in this case? USA**

[235] US 2 December Oral Statement, para. 82.

[236] Brazil's 9 September Further Submission, para. 423 (summarizing the evidence and the specific statutory provisions of the 2002 FSRI Act and the 2000 ARP Act mandating payments by USDA).

[237] Appellate Body Report, *Argentina – Textiles and Apparel*, WT/DS56/AB/R, paras. 48-54, 62; Panel Report, *US – Export Restraints*, WT/DS194/R, para. 877.

# ANNEX I-8

## ANSWERS OF THE UNITED STATES TO QUESTIONS POSED BY THE PANEL FOLLOWING THE SECOND SUBSTANTIVE MEETING OF THE PANEL

(22 December 2003)

### A. TERMS OF REFERENCE

**192. Regarding the interest subsidies and storage payments listed by the United States in its response to the Panel's Question No. 67:**

**(a) Please provide a copy of the regulations under which they are currently and under which they were provided during the marketing years 1996-2002;**

1. For interest subsidies and storage payments under the 1996 Act (marketing years 1996-2002), the relevant regulations are found at 7 CFR 1427.13 and 1427.19 (2000 ed.) (first published at 61 FR 37601, 18 July 1996).[1] Under the 2002 Act, those rules are found at 7 CFR 1427.13 and 1427.19 (2003 ed.) (first published at 67 FR 64459, 18 October 2002).[2] We describe and discuss these provisions below in response to part "(b)" of this question.

**(b) Please indicate whether there are any such payments which are not provided to implement the repayment rate for upland cotton within the marketing loan programme. USA**

2. Interest subsidies and storage payments are support provided in connection with the marketing loan programme. On a forfeit of warehouse-stored upland cotton under loan, the Commodity Credit Corporation (CCC) pays warehouse charges for the loan period (even though the farmer had title during that period) and forgives interest. 7 CFR 1427.13 (2000 ed. and 2003 ed.). As for redemption of cotton under loan, repayment rates depend on the world market price. If the repayment amount set on that price is low enough, CCC may have to forgive interest and pay storage charges because the repayment amount will not be enough to satisfy the loan amount and those charges. *See* 1427.19(e) (2000 and 2002). By contrast, if the repayment rate set on the world market price is high enough, the producer pays both. *Id.* In general, if the loan is repaid, there is not an interest subsidy at all; rather, in 7 CFR Part 1405, it is provided that CCC will charge the sum of (1) the rate that CCC pays the Treasury and (2) another 1 per cent per annum. We are not aware of any other payments that would be responsive to the panel's question.

[1] *See* Exhibit US-117 (7 CFR 1427.13 and 1427.19 (2000 ed.)).
[2] *See* Exhibit US-118 (7 CFR 1427.13 and 1427.19 (2003 ed.)).

**194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? BRA, USA**

3. In response to the Panel's Question 67, which asked the parties "to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002," the United States stated, in the context of its calculation of the AMS for marketing year 2002, that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment, on which the Panel's terms of reference were set. Measures taken after the Panel was established cannot be within the Panel's terms of reference."[3] The United States continues to believe that this statement is accurate. Past panels have frequently been confronted with the issue of the date as of which measures should be examined. Panels have generally determined to examine those measures as of the date of panel establishment as a matter both of terms of reference as well as for practical reasons (for example, so as to allow findings to be made with respect to a measure withdrawn after the panel was established but before panel proceedings were completed).

4. The Panel's terms of reference were set by the DSB at its meeting on 18 March 2003, namely, "[t]o examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."[4] In that panel request, Brazil identifies the measures at issue as "prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton."[5] In Brazil's answer to question 19 from the Panel, Brazil clarified: "Brazil's Request for Establishment of a Panel ('Panel Request') challenges two types of domestic support 'measures' provided to upland cotton and various different types of export subsidy measures. *The first type of domestic support "measure" is the payment of subsidies* for the production and use of upland cotton. These payments were and continue to be made between MY 1999 to the present (and will be made through MY 2007) through the various statutory and regulatory instruments listed on pages 2-3 of Brazil's Panel Request. Brazil referred to these payments at pages 2-3 of the Panel Request as 'subsidies and domestic support provided under' or 'mandated to be provided' under the various listed statutory and regulatory instruments. Brazil has tabulated the *different types of payments (i.e., the measures)* made under these legal instruments in paragraphs 146-149 of its First Submission."[6] That is, to the extent that "payments" are at issue (as opposed to Brazil's challenge of certain legal instruments "as such")[7], the "measure" is "the payment of subsidies for the production and use of upland cotton." Only those payments made through the date of panel establishment could be "measures at issue" within the meaning of DSU Article 6.2 (as opposed to measures not yet taken, such as the Agricultural Assistance Act of 2003, which had not been enacted at the time of Brazil's panel request).

5. Thus, for purposes of the Panel's Peace Clause analysis or the evaluation of the "effect of the subsidy" for purposes of the Panel's actionable subsidies analysis, Brazil's choice to obtain establishment of this Panel several months into the 2002 marketing year but well before that marketing year was completed necessarily impacts the payments ("measure") that the Panel may examine. The payment of subsidies *after* panel establishment cannot alter the measures within the Panel's terms of reference and properly before the Panel, just as the cessation of payments after panel establishment would not prevent the Panel from making findings as to those payments that had been made as of the date of establishment.

[3] US Answer to Question 67 from the Panel, para. 134 (11 August 2003).
[4] WT/DSB/M/145, para. 35.
[5] WT/DS267/7, at 1.
[6] Brazil's Answer to Question 19 from the Panel, para 15 (emphasis added).
[7] Brazil's Answer to Question 19 from the Panel, para. 16.

## B. ECONOMIC DATA

**195. Does the United States wish to revise its response to the Panel's Question No. 67bis, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers"? Did the United States make enquiries of the FSA in the course of preparing its original answer?**

6. Question No. 67*bis* inquired about annual amounts granted to upland cotton producers per pound and in total expenditures under each of the decoupled payment programmes. The United States of course conferred with US Department of Agriculture personnel, including FSA personnel, concerning this question and reported to the Panel that USDA "does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers."[8] That response remains accurate today: because those payments are decoupled from current production, expenditures under such programmes are not tracked by whether the recipient produces upland cotton. In fact, the United States does not collect production data based on actual harvesting figures reported by farmers; we do not understand Brazil to have asserted the contrary.[9]

7. Brazil has also not asserted that the United States maintains information on the receipt of decoupled payments for upland cotton base acres by upland cotton producers. Rather, it has presented a novel methodology developed by the Environmental Working Group (EWG) to compare disparate data separately collected by the United States to attempt to infer that information. [10]EWG compared the farm numbers of recipients of decoupled payments for upland cotton base acres with the farm numbers of recipients of marketing loan payments in marketing years 2000-2002. It bears emphasis that the latter database is not a production database based on actual harvesting figures reported by farmers; the marketing loan database merely records the quantities of cotton on which a recipient has received payments. By comparing the matches by farm number between the two databases, EWG calculated that the share of decoupled payments for upland cotton base acres paid to upland cotton "producers" (that is, recipients of marketing loan payments) was 71.3 per cent in marketing year 2000, 76.9 per cent in marketing year 2001, and 73.6 per cent in marketing year 2002.

8. As we have previously mentioned[11], using the marketing loan payments database to identify "producers" would be contingent on marketing year prices; only if prices are sufficiently low would a high proportion of production of a crop receive marketing loan payments. This appears to have been the case for upland cotton in some recent marketing years but will not always be so (for example, no marketing loan payments are being made in the 2003 marketing year) and was not the case for other commodities (in marketing year 2002, *total* marketing loan payments of only $16.3 million for soybeans, $16.3 million for corn, and $16.1 million for wheat were made).[12]

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[8] US Comments and Answer to Additional Question, para. 20.

[9] We do note that the record reflects the extensive evidence the United States has presented on the programmes and crop in question, from the actual data of amounts paid under the programmes to the amounts of cotton that have been planted from year to year. Further, in response to a Brazilian request for certain information that was presented for the first time at the second panel meeting, the United States generated, through significant expenditures of time and resources, aggregate and farm-by-farm records for both the "PFC" and "DCP" period for every "cotton farm" in the United States, including the planting records for all such farms. These data were transmitted on 18 and 19 December 2003.

[10] *See* Brazil's Further Rebuttal Submission, para. 31 ("If USDA was able to provide comprehensive payment data for all (or most) payments in an electronic format, it is also able to *generate information* on subsidy payments made to farms.") (emphasis added).

[11] US Opening Oral Statement at Second Panel Meeting, para. 29.

[12] Exhibit US-93. For this reason, it is fallacious for Brazil to argue that the specialization of cotton farms on cotton is show by the alleged fact that "[i]n MY 2002, 92.45 per cent of marketing loan payments for all crops made to farms producing upland cotton were made with respect to upland cotton." Brazil's Further

9. We note that Brazil has not made any adjustment in the outlay figures it has presented to the Panel for purposes of both Peace Clause and its actionable subsidy claims to reflect the fact that the EWG percentages are substantially lower than the 87 per cent revision made by Brazil to correct its initial Peace Clause analysis. The adjustment resulting from the EWG data in the total decoupled payments for upland cotton base acres made to upland cotton "producers" is also substantial. Since Brazil presents the EWG percentages as Brazil's own data, Brazil has effectively conceded that its own figures should be corrected at least as follows:

| Decoupled payments for upland cotton base acres to upland cotton "producers" ($ millions) | | | |
|---|---|---|---|
| | Brazil initial amount[13] | Brazil corrected amount[14] | EWG amount[15] |
| 1999 PFC | 616 | 547.8 | no data presented |
| 1999 MLA | 613 | 545.1 | no data presented |
| 2000 PFC | 575 | 541.3 | 373.4 |
| 2000 MLA | 612 | 576.2 | 436.7 |
| 2001 PFC | 474 | 453 | 364.3 |
| 2001 MLA | 654 | 625.7 | 402.8 |
| 2002 Direct | 523 | 485.1 | 451.4 |
| 2002 CC | 1077 | 998.6 | 893.5 |

The Panel can see a rather striking decline in the decoupled payments at issue that have not been reflected in Brazil's argumentation to the Panel.

10. We note further, however, that the EWG figures do not end the story. These figures represent only the first step in a proper calculation of the decoupled payments received by upland cotton producers that benefit upland cotton. For example, as detailed in the US answer to question 242 from the Panel, the literature on decoupled payments indicates that these payments benefit the owners of the base acres on which payments are made; payments made on rented acres will be captured by landowners through increased rent or other arrangements. Brazil itself has conceded that as of marketing year 1997 – that is, only the first year after introduction of the production flexibility contracts – already *34-41 cents per dollar* of production flexibility contract payment were capitalized into land rents.[16] Thus, *based on its own evidence*, Brazil should have adjusted the EWG figures *downwards by 22 to 27 per cent* to reflect the capture by landowners (who are not producers) through increased rent of 34-41 per cent of decoupled payments on the 65 per cent of cotton acres that are rented.[17] Furthermore, this study as of marketing year 1997 is consistent with the evidence presented by the United States that as rental contracts come up for renewal the full value of the decoupled

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Rebuttal Submission, para. 26. If prices were above the respective loan rates for other crops produced by a farm also producing upland cotton, then logically the share of marketing loan payments for upland cotton will be high, given that upland cotton prices were so low in marketing year 2002. The fallacy of Brazil's argument is further demonstrated by reviewing the data submitted by the United States on 19 December 2003. In the aggregated data file "Dcpsum.xls", for marketing year 2002 upland cotton planted area represented only 30.7 per cent of total cropland for "cotton farms" (13.541 million acres out of total cropland of 44.036 million acres).

[13] Brazil's First Written Submission, paras. 148-49.

[14] Brazil's Answer to Question 67 from the Panel, para. 130 (adjusted amount of decoupled payments for upland cotton base acres estimated as "support for upland cotton").

[15] Brazil's Further Rebuttal Submission, para. 23 (EWG data on amount of decoupled payments for upland cotton base acres received by upland cotton "producers")

[16] Brazil's Answer to Question 179 from the Panel, para. 165; Brazil's Opening Oral Statement at the Second Panel Meeting, para. 57.

[17] *See* Exhibit US-69 (cost of production data published by the Economic Research Service, based on the 1997 ARMS survey, showing cotton producers owning 35 per cent of land they operate).

payments on rented acres will be captured by landowners and capitalized into land values.[18] Thus, to reflect the benefit to upland cotton producers, the EWG data should be adjusted *downwards by 65 per cent* to reflect the fact that "[n]ot all operators [producers] can therefore be considered as true beneficiaries of the [PFC] programme, since competitive cropland rental markets work to pass through payments from PFC recipients who are tenants to the owners of base acres."[19] Only those upland cotton producers who are owners of upland cotton base acres will receive the benefit of those decoupled payments.

11. Finally, to answer the Panel's question on the total payments for upland cotton base acres that benefit upland cotton producers would require information relating to the total value of each recipient's production. The EWG figures, adjusted to account for the capture of 65 per cent of those payments by owners of base acreage who are not cotton producers, would need to be allocated across the total value of production in order to calculate the subsidy benefit to upland cotton. Brazil has not brought forward information to permit that allocation; in fact, as discussed in more detail in the US answer to question 256 from the Panel, Brazil has not even claimed that such an allocation is necessary. Accordingly, it does not appear possible to calculate the total payments to upland cotton producers that benefit upland cotton nor any per pound measurement.

**196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. BRA, USA**

12. Data for marketing loan and user marketing certificate programmes are for upland cotton only and are current as of 12 December 2003.[20]

- Marketing loan programme (includes loan deficiency payments, marketing loan gains, and certificate gains): $832,836,963
- Step 2 payments (data are on a October 2002 - September 2003 fiscal year basis): $415,379,000

13. Data for direct payments and counter-cyclical payments are presented for upland cotton base acres only and are current as of 12 December 2003.[21]

- Direct payments: $181,811,374 million. (Because the 2002 marketing year was a transition year between the 1996 and 2002 farm bills, $436,805,000 in Production Flexibility Contract payments were made in 2002.)
- Counter-cyclical payments: $1,309,471,167

14. Data for export credit guarantee programmes are only available on a fiscal year basis (October 2002 - September 2003) and apply to all cotton. No breakout is available for upland cotton. The value of registration guarantees is $234,423,344. This figure represents the coverage applied for by exporters, not actual exports. An exporter may apply for a guarantee but not actually ship the goods.[22] Outstanding claims are $280,898, less than one-tenth of one per cent of the value of

[18] *See* US Further Rebuttal Submission, paras. 75-77.

[19] Burfisher, M. and J. Hopkins. "Farm Payments: Decoupled Payments Increase Households' Well-Being, Not Production." *Amber Waves*, Vol. 1, Issue 1, (February 2003): 38-45, at 44 (Exhibit US-78)

[20] Source: Official data base of the Commodity Credit Corporation, maintained by the Farm Service Agency, USDA; latest data are unpublished and may differ from published FSA data.

[21] Source: Official data base of the Commodity Credit Corporation, maintained by the Farm Service Agency, USDA; latest data are unpublished and may differ from published FSA data.

[22] Published data on guarantee values can be found in *Export Assistance, Food Aid, and Market Development Programmes, FY 2003 Summary* at http://www.fas.usda.gov/excredits/quarterly/archive.html. Data for FY 2003 found in this report are current as of 9/30/03 and differ slightly from these figures, which reflect exporter activity through mid-December, including cancellations and reserve activity. Data for FY 2003

registrations (further evidence, specific to cotton export credit guarantees in particular, that premiums are more than sufficient to cover operating costs and losses).

**197. Please provide actual data for 2002/2003 for US exports, US consumption and per cent of world consumption to replace the projected data in Exhibit US-47. If available, please provide projected data for 2003/2004 to replace the forecast data. USA**

15. The 11 December 2003 *World Agricultural Supply and Demand Estimates* report, published by USDA's Office of the Chief Economist, the Department's official commodity estimates, provide the latest data available. Note that 2002/03 is still considered an estimate and 2003/04 is considered a projection.[23]

**US and World Cotton Consumption** (1,000 480-lb bales)

| | 2002/03 (e) | 2003/04 (p) |
|---|---|---|
| US exports | 11,900 | 13,200 |
| US mill use | 7,270 | 6,200 |
| Total US consumption[24] | 19,170 | 19,400 |
| World consumption | 97,930 | 97,690 |
| US as a per cent of world | 19.6% | 19.9% |

The updated data show that the US world market share is basically unchanged from Exhibit US-47; in fact, US world market share using the 11 December 2003 data is the same (19.6 per cent) as reported in the exhibit.[25] Viewed in conjunction with the data in Exhibit US-47, the data further confirm that there has been no increase in US world market share following a consistent trend over a period when subsidies to upland cotton have been granted.

**198. Please comment on the respective merits of the price-gap calculations of MY1992 deficiency payments in US comments of 27 August, footnote 14 ($867 million), and Brazil's response to the Panel's Question No. 67 ($812 million).**

16. The two calculations use similar methodologies to measure MY 1992 deficiency payments. Both measures calculate deficiency payments as the deficiency payment rate times eligible production. Both the US and Brazil measures use the same deficiency payment rate for MY 1992 of 15 cents per pound. The difference between the two measures can thus be attributed to how each calculated the amount of production eligible for deficiency payments.

17. In their response to the Panel's Question No. 67, Brazil provides a simplistic calculation of payment production by multiplying the upland cotton programme yield times the amount of area eligible for deficiency payments. But as the United States previously indicated[26], the average programme yield for deficiency payment recipients in MY 1992 was 601 pounds per acre and the average programme yield for 50/92 recipients was 628 pounds per acre. By contrast, Brazil

found in this report are current as of 9/30/03 and differ slightly from these figures, which reflect exporter activity through mid-December, including cancellations and reserve activity.

[23] USDA Office of the Chief Economist, *World Agricultural Supply and Demand Estimates*, 11 December 2003 (Exhibit US-119).

[24] The US consumption figure includes imports. However, US cotton imports are often zero and, even when positive, have accounted for less than one per cent of consumption over the past decade. *See* USDA, Economic Research Service, Fibers Yearbook, Appendix Table 2, Upland Cotton Supply and Use (Exhibit US-120).

[25] *See also* US Opening Oral Statement at the Second Panel Meeting, para. 13.

[26] US Comments and Answer to Additional Question, para. 8 fn. 14.

incorrectly estimates programme yields to be 531 pounds per acre. This underestimates deficiency payments for MY 1992.

18. The US calculation uses the methodology set out in paragraphs 10 and 11 of Annex 3. Consistent with the 1995 US WTO notification, payment production is the sum of production eligible for basic deficiency payments and production eligible for 50/92 payments. Eligible production for basic deficiency payments in 1992 was equal to 5,544 million pounds (9.226 million acres times the average programme yield of 601 pounds per acre). Multiplying the price gap times eligible production gives basic deficiency payments equal to $832 million. The same formula is used to calculate deficiency payments under the 50/92 programme. For 1992, the price gap is the same as that calculated for the basic deficiency payments (15 cents per pound). Eligible production under the 50/92 programme was 254 million pounds (404 thousand acres times the average programme yield of 50/92 participants of 628 pounds per acre). Deficiency payments under the 50/92 programme were thus equal to $35 million (0.92 times 254 million times $0.15). Total deficiency payments under the price gap methodology were thus equal to $867 million ($832 million plus $35 million).

19. We also note that this calculation is conservative in that it uses the actual payment acreage (that is, acres planted for harvest or participating in the 50/92 programme on which payment was received) rather than eligible acreage to calculate the "quantity of production eligible to receive the applied administered price."[27] Using instead the base acreage minus the 10 per cent acreage reduction figure and the 15 per cent normal flex acres (14.9 million effective base acres[28] *x* 0.75 = 11.175 million acres) and multiplying by the programme yield (602 pounds per acre), the "quantity of production eligible to receive the administered price" is 6,727 million pounds, yielding a price gap deficiency payment calculation of $1,009 million.

**201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so, please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? BRA, USA**

20. In April 1999, the US General Accounting Office published a report on farmers' use of risk management strategies.[29] Based on survey data from the 1996 USDA Agricultural Resource Management Study, the study showed that between 35 and 57 per cent of cotton farmers used a hedging instrument in 1996. (The ranges reflect a 95 per cent confidence interval.) In addition, an estimated 63 to 89 per cent of cotton farms used cash forward contracts in 1996.[30] These survey results suggest that even seven years ago a large proportion of cotton farmers either directly or indirectly priced their cotton off of organized futures and options markets.

21. For 18 December 2003, total open interest for all cotton futures contracts on the New York Board of Trade was 79,283 contracts[31] while open interest for all cotton options contracts on the

[27] Agreement on Agriculture, Annex 3, para. 10.

[28] *See* Exhibit Bra-105, Annex 2 (1st source document: US Department of Agriculture, *Provisions of the Federal Agricultural Improvement and Reform Act of 1996*, at 142) (giving 1992 effective base acreage of 14.9 million acres); *id.*, Annex 2 (2nd source document: Daniel A. Sumner, *Farm Programmes and Related Policy in the United States*, at 4) (same).

[29] US General Accounting Office. *Agriculture in Transition: Farmers' Use of Risk Management Strategies*. GAO/RCED-99-90. April 1999. See page 9, table 4 (Exhibit US-121)

[30] A forward contract is defined as a cash market transaction in which two parties agree to buy or sell a commodity or asset under agreed-upon conditions. For example, a farmer agrees sell, and a ginner or warehouse agrees to buy, cotton at a specific future time for an agreed-upon price or on the basis of an agreed on pricing mechanism (such as a futures or options market). See Exhibit US-121, page 22.

[31] *See*, Exhibit US-122.

NYBOT totalled 320,657 contracts.[32] Based on a contract size of 50,000 pounds, total open interest on futures and options contracts represent 41.7 million bales. While a bale of cotton may be hedged several times throughout the marketing chain, we note that 41 million bales is approximately 2.3 times the total size of the US upland cotton crop. A futures or options contract transaction has no effect on a producer's entitlement to marketing loan programme payments.

**202. Concerning paragraph 7 of the US oral statement, are the expected cash prices shown for February only? Can the US provide the prices for January and March of each year as well? USA**

22. The following tables show the average daily closing futures price for the December contract for January, February and March, as well as the average for the three months. As the United States previously noted[33], the differences between months is small. As outlined in paragraph 162 of the US further rebuttal submission, the expected cash price is calculated as the futures prices minus a 5-cent basis.

**Average Daily December Futures Closing Prices ($/lb)**

| Month | Contract Month | | | | |
|---|---|---|---|---|---|
| | DEC 1999 | DEC 2000 | DEC 2001 | DEC 2002 | DEC 2003 |
| January | 0.6335 | 0.5912 | 0.6188 | 0.4295 | 0.5808 |
| February | 0.6027 | 0.6131 | 0.5863 | 0.4218 | 0.5960 |
| March | 0.5980 | 0.6233 | 0.5321 | 0.4292 | 0.5975 |
| Average January – March | 0.6114 | 0.6092 | 0.5791 | 0.4268 | 0.5914 |

Source: New York Board of Trade (Exhibit US-124)

**Expected Cash Price ($/lb)**

| Month | MY 1999 | MY 2000 | MY 2001 | MY 2002 | MY 2003 |
|---|---|---|---|---|---|
| January | 0.5835 | 0.5412 | 0.5688 | 0.3795 | 0.5308 |
| February | 0.5527 | 0.5631 | 0.5363 | 0.3718 | 0.5460 |
| March | 0.5480 | 0.5733 | 0.4821 | 0.3792 | 0.5475 |
| Average January – March | 0.5614 | 0.5592 | 0.5291 | 0.3768 | 0.5414 |

Source: Futures Price minus 5-cent cash basis.

**205. Does the United States accept or agree with the EWG data submitted by Brazil? If not, please explain your reasons. USA**

23. USDA provided the EWG with payment data under a Freedom of Information Act Request. Although the United States can confirm the data transmitted to EWG was correct, we do not know if the data has changed after EWG further processed the information. Taking that data at face value, the United States would note the following.

[32] *See*, Exhibit US-123.

[33] US Further Rebuttal Submission, para. 162 fn. 124 ("The United States notes that the January-March average futures price for December delivery does not differ significantly from the February average presented in the text.").

24. As was reported in the US Answer to Panel Question 125(5) and the US oral statement of 2 December, a preliminary review of data from the Farm Service Agency shows that approximately 47 per cent of upland cotton farms eligible for decoupled income support payments planted no cotton in marketing year 2002. This number is consistent with the Environmental Working Group data presented by Brazil in its further rebuttal submission that showed the per cent of farms receiving only contract payments in 2000, 2001, and 2002 (46, 45, and 45 per cent, respectively).[34] Thus, the EWG data support the US position that decoupled income support is, in fact, decoupled from production decisions since nearly half of historic upland cotton farms no longer plant even a single acre of cotton.[35]

25. The EWG data also show that Brazil's 14/16 adjustment to decoupled payments, even on Brazil's faulty allocation theory, is too small an adjustment. Brazil has asserted that 87 per cent of decoupled payments for upland cotton base acres are received by upland cotton producers and support to upland cotton. However, the EWG data suggest that in marketing years 2000, 2001, and 2002 only 71, 77, and 74 per cent, respectively of upland cotton base acreage payments went to farms that planted upland cotton. Thus, the EWG data support the US position that Brazil has overestimated and failed to properly calculate the subsidy benefit to upland cotton provided by these payments. For further detail, please see the US answer to question 195.

26. We also note a serious misuse of the EWG data when Brazil claims that, because approximately 92 per cent of total marketing loan payments received in MY 2002 by farms planting upland cotton were upland cotton payments, therefore such farms must predominantly produce cotton. In fact, marketing loan payments crucially depend on whether prices are above or below the loan rate for the crop at issue. Soybeans and corn saw high prices in MY 2002, meaning few marketing loan payments were made in MY2002.[36] Furthermore, the data collected by the United States in response to Brazil's request for certain information demonstrate that for MY 2002 upland cotton planted acres accounted for only 29.4 per cent of total cropland of those farms receiving production flexibility contract payments for upland cotton base acreage. Thus, the EWG data on marketing loan payments does *not* support an inference that farms producing upland cotton are so "specialized in upland cotton"[37] that it would be "reasonable" to attribute decoupled payments for upland cotton base acres almost entirely (87 per cent) to upland cotton.

> **206. Please explain how the graph in paragraph 40 of the US further rebuttal submission was derived. In so doing, please clarify whether the figures are on a cents per pound basis or some other basis. What averaging method was used? Can you prepare individual charts showing average US and Brazilian cotton prices for each of those third country markets? USA**

27. The data were based on official export data reported by the United States and Brazil, as obtained and published in the "World Trade Atlas". The World Trade Atlas is a service that monthly provides world-wide trade information for a fee.

28. The United States reports its export values to the World Trade Atlas as F.A.S. and Brazil reports its values as F.O.B.

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[34] Brazil's Further Rebuttal Submission, para 23.

[35] Indeed, even Brazil states that "the evidence still suggests that there are a *large number of very small farms* (with base acreage resulting from production dating back as far as MY 1981-85) *that no longer produce upland cotton*," Brazil's Further Rebuttal Submission, para. 27 (emphasis added), which would seem to support the US view that contract payments are decoupled from production decisions.

[36] *See* US Opening Oral Statement at the Second Panel Meeting, para. 29.

[37] *See* Brazil's Further Rebuttal Submission, para. 26.

> **Free Along Ship Export Value (F.A.S.) –** The value of exports at the seaport, airport, or border, port of export, based on the transaction price, including inland freight, insurance, and other charges incurred in placing the merchandise alongside the carrier at the port of exportation. The value, as defined, excludes the cost of loading the merchandise aboard the exporting carrier and also excludes freight, insurance, and any charges or transportation costs beyond the port of exportation**.**
>
> **Free On Board (F.O.B.)** – A standard reference to the price of merchandise on the border or at a national port. In F.O.B. contracts, the seller is obliged to have the goods packaged and ready for shipment at the place agreed upon, and purchaser agrees to cover all ground transport costs and to assure all risks in the exporting country, together with subsequent transport costs and expenses incurred in loading the goods onto the chosen means of transport.

FOB is greater than FAS except when the vessel is not changed at the port of export, in which case the values are equal.

29. The World Trade Atlas publishes an average unit price for exports. The average unit price is calculated by dividing the value of the exports by the quantity for selected HS codes. Average unit prices are expressed in dollars per kilogram. This value was converted to dollars per pound for the graphs.

30. The graph in paragraph 40 of the US further rebuttal submission is a comparison of simple average unit prices of cotton exports from the United States and Brazil to Argentina, Bolivia, Italy, Philippines, Portugal, Indonesia, Paraguay, and India. The data for each third country market is provided in the following table.

## Unit Export Values to Selected Countries

US

| Country | 3Q/99 | 4Q/99 | 1Q/00 | 2Q/00 | 3Q/00 | 4Q/00 | 1Q/01 | 2Q/01 | 3Q/01 | 4Q/01 | 1Q/02 | 2Q/02 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Argentina | 0.71 | 0.71 | 0.42 | 0.49 | na | na | na | na | na | na | na | na |
| Bolivia | na | 1.15 | 1.15 | na | na | na | na | 0.76 | na | na | na | na |
| India | 0.96 | 0.46 | 0.51 | 0.55 | 0.64 | 1.04 | 0.74 | 0.50 | 0.43 | 0.36 | 0.38 | 0.42 |
| Indonesia | 0.61 | 0.59 | 0.56 | 0.57 | 0.59 | 0.65 | 0.65 | 0.57 | 0.49 | 0.50 | 0.50 | 0.45 |
| Italy | 0.90 | 0.81 | 0.80 | 0.98 | 0.73 | 0.93 | 0.90 | 0.92 | 0.92 | 0.67 | 0.76 | 0.70 |
| Paraguay | na | na | na | na | na | na | na | na | na | na | na | na |
| Philippines | 0.50 | 0.42 | 0.41 | 0.41 | 0.53 | 0.54 | 0.52 | 0.44 | 0.42 | 0.41 | 0.41 | 0.38 |
| Portugal | 0.97 | 0.93 | 0.92 | 0.92 | 0.98 | 0.75 | 1.17 | 1.14 | 0.92 | 0.57 | 1.03 | 0.94 |
| Average | 0.78 | 0.72 | 0.68 | 0.65 | 0.70 | 0.78 | 0.79 | 0.72 | 0.64 | 0.50 | 0.61 | 0.58 |

Brazil

| Country | 3Q/99 | 4Q/99 | 1Q/00 | 2Q/00 | 3Q/00 | 4Q/00 | 1Q/01 | 2Q/01 | 3Q/01 | 4Q/01 | 1Q/02 | 2Q/02 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Argentina | 0.54 | 0.51 | 0.58 | 0.54 | 0.54 | 0.52 | 0.50 | na | 0.38 | 0.35 | 0.37 | na |
| Bolivia | na | na | na | na | 0.47 | 0.48 | 0.47 | na | na | na | na | na |
| India | na | na | na | na | 0.49 | 0.50 | 0.50 | 0.53 | 0.49 | 0.43 | 0.36 | 0.36 |
| Indonesia | na | na | na | na | 0.49 | 0.49 | 0.48 | 0.47 | 0.50 | 0.47 | 0.47 | 0.45 |
| Italy | na | na | na | na | 0.48 | 0.51 | 0.54 | 0.56 | 0.46 | 0.44 | 0.39 | 0.37 |
| Paraguay | na | na | 0.50 | na | na | 0.55 | na | na | 0.50 | na | na | na |
| Philippines | na | na | na | na | na | 0.59 | 0.52 | 0.53 | 0.52 | 0.49 | 0.36 | na |
| Portugal | na | na | na | na | 0.49 | 0.51 | 0.54 | 0.56 | 0.47 | 0.42 | 0.35 | 0.37 |
| Average | 0.54 | 0.51 | 0.54 | 0.54 | 0.49 | 0.52 | 0.51 | 0.53 | 0.47 | 0.43 | 0.38 | 0.39 |

Source: *World Trade Atlas*

**207. Please indicate whether any of the measures challenged in this dispute obliges cotton farmers to harvest their crop in order to receive the benefit of the programme (subsidy).**

31. One programme at issue in this dispute requires that a cotton farmer harvest upland cotton in order to receive payment: the marketing loan programme. In addition, the user marketing certificate programme (Step 2) requires that upland cotton have been harvested and marketed although payment is made to upland cotton users and not to farmers directly.

**208. Please provide data for the marketing years 1992 and 1999-2002 of the "quantity of production to receive the applied administered price" (Agreement on Agriculture, Annex 3, paragraph 8) for purposes of a price-gap calculation of support through the marketing loan programme.**

32. The marketing loan programme is a direct payment to support producer income that is "dependent on a price gap," namely, the difference between the loan rate and the Adjusted World Price. Thus, the price-gap calculation of support would be calculated under paragraphs 10 and 11 of Annex 3 of the Agreement on Agriculture on "non-exempt direct payments," not paragraph 8 on "market price support." That said, the calculations to quantify the support under these provisions are similar. Under paragraph 10, "non-exempt direct payments which are dependent on a price gap shall be calculated either using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, or using budgetary outlays."

33. Under the 1990 Act, only production produced on cotton base acres or other programme crop base acres was eligible for marketing loans. Based on the 1992 *Compliance Report* (Exhibit US-39), 11,164,726 acres programme acres were planted to upland cotton. Based on an average crop yield of 694 pounds per acre[38], 7,748,319,844 pounds or 16,142,333 480-lb bales, would have been eligible for marketing loans in 1992.

34. Under provisions of the 1996 farm bill, upland cotton planted on farms with any programme crop base were eligible for marketing loans. While production data are not collected by the Farm Service Agency, the following quantities of upland cotton were put under loan or collected a loan deficiency payment in 1999, 2000, 2001 and 2002.

**Upland cotton loan activity (pounds)**

| | Quantity receiving loan deficiency payment | Quantity placed under loan | Total |
|---|---|---|---|
| 1999 | 3,393,678,940 | 4,290,958,570 | 7,684,637,510 |
| 2000 | 3,499,431,430 | 4,349,621,850 | 7,849,053,280 |
| 2001 | 2,618,109,300 | 6,718,513,500 | 9,336,622,800 |
| 2002 | 1,603,527,850 | 6,292,102,810 | 7,895,630,660 |

Source: USDA, Farm Service Agency, *Loan Deficiency Payment and Price Support Cumulative Activity as of 10 December 2003.* Available at: http://www.fsa.usda.gov/dafp/psd

35. Thus, compared to MY1992, the quantity of cotton placed under marketing loans or receiving loan deficiency payments in MYs 1999, 2000, and 2002 were similar. In MY 2001, as a result of exceptional weather conditions and yields, a much larger quantity of cotton was eligible.

36. As noted above, the price gap calculation involves comparing a fixed reference price to an applied administered price. Under paragraph 11 of Annex 3, the fixed reference price "shall be based

[38] *See* Upland Cotton Fact Sheet at 4 (Exhibit BRA-4).

on the years 1986 to 1988 and shall generally be the actual price used for determining payment rates." The applied administered price for marketing loan payments is the marketing loan rate. The fixed reference price is the average over 1986 to 1988 of the Adjusted World Price (the "actual price used for determining payment rate").

37. The average Adjusted World Price for 1986-88 was 53.65 cents per pound – that is, higher than the loan rate in marketing years 1992 (52.35 cents per pound), 1999-2001 (51.92 cents per pound), and 2002 (52 cents per pound). The result is that the gap between the fixed reference price and the applied administered price is always negative as would be the AMS calculation. When these price gap calculations for marketing loan payments are utilized, negative numbers result, reflecting the decrease in support from the 1986-88 level. Similarly, if the applied administered price for marketing years 1999-2002 were compared to the 1992 applied administered price, the resulting negative numbers would again show the decrease in the level of support from MY 1992. Thus, the large budgetary expenditures for marketing loan payments in recent years obscures the fact that the level of support decided by the United States had declined; the price gap calculation, on the other hand, reflects this reduction in support. As the United States demonstrated in its rebuttal submission, by calculating both deficiency payments and marketing loan payments using a price gap methodology, the upland cotton AMS reveals that in no year have the challenged US measures granted support in excess of that decided during the 1992 marketing year.[39]

**209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs. BRA, USA**

38. The planted and harvested area differ because of abandonment. Over the period 1965 to 2003, the rate of abandonment (abandoned acres divided by total acres) for US upland cotton averaged 8.3 per cent, but the rate will vary from year to year primarily because of weather, primarily in the Southwest. In 1997, for example, weather in the Southwest was generally good and the abandonment rate for that year was only 3.6 per cent. By contrast, dry weather in Texas, Oklahoma and parts of the Southeast in 1998 led many farmers to abandon their cotton crop because of poor yields, resulting in an abandonment rate of 20 per cent.

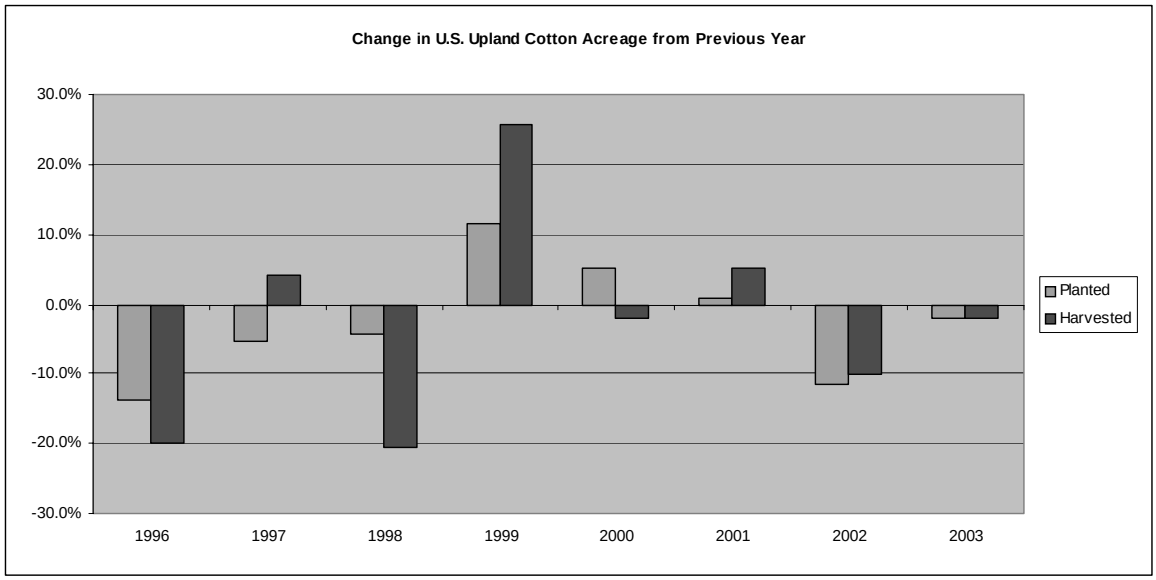
**Planted and Harvested Upland Cotton Acres** (1,000 acres)

| Crop year | Planted acres | Harvested acres | Abandoned acres | Rate of abandonment |
|---|---|---|---|---|
| 1995 | 16,717 | 15,796 | 921 | 5.5% |
| 1996 | 14,395 | 12,632 | 1,763 | 12.2% |
| 1997 | 13,648 | 13,157 | 491 | 3.6% |
| 1998 | 13,064 | 10,449 | 2,615 | 20.0% |
| 1999 | 14,584 | 13,138 | 1,446 | 9.9% |
| 2000 | 15,347 | 12,884 | 2,463 | 16.0% |
| 2001 | 15,499 | 13,560 | 1,939 | 12.5% |
| 2002 | 13,714 | 12,184 | 1,530 | 11.2% |

[39] *See* US Rebuttal Submission, paras. 115. In that calculation, the United States conservatively assigned a value of zero to marketing loan payments that in every instance were negative under the price gap methodology. Had the United States used the actual negative values resulting from the calculation, the AMS would have been even smaller for those years with a lower loan rate (marketing years 1999-2001) and larger eligible production (marketing year 2001). The end result would have been the same, however: in no year would upland cotton support (as measured by an upland cotton AMS) have exceeded the 1992 marketing year level.

| Crop year | Planted acres | Harvested acres | Abandoned acres | Rate of abandonment |
|---|---|---|---|---|
| 2003 | 13,451 | 11,939 | 1,512 | 11.2% |

Source: USDA, National Agricultural Statistics Service, *Acreage*, various issues.




39. Comparing the per cent change from the prior year of planted and harvested US upland cotton acreage shows that movements in acreage figures are fairly similar, as one would expect.

**210. Are worldwide planted acreage figures available? BRA, USA**

40. To our knowledge, planted acreage figures are not available on a consistent basis across countries. No other sources (including ICAC) carry worldwide-planted area. Harvested area is the standard, but in reality many countries do not have a sophisticated system for data collection. To provide a comparative analysis of US acreage changes to the rest of the world, the United States has therefore used harvested acreage, the most reliable acreage measure available.

**211. Brazil presents a graph in paragraph 59 of its further rebuttal submission indicating the increasing cumulative loss incurred by cotton producers. Please comment on the argument that US cotton producers could not continue operating without subsidies. In particular:**

**(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?**

41. Brazil's cost of production argument is based on erroneous facts and arguments. Brazil points to dated *average total cost* of production data over a randomly selected period, compares this to market revenue, and proclaims that any "gap" must be covered by subsidies. The United States has identified several fatal conceptual and factual flaws in Brazil's analysis.[40] For example, Brazil ignores the evidence on record that a significant number (approximately 47 per cent) of traditional (and likely high-cost) upland cotton producers no longer plant upland cotton. This structural shift in

[40] US Further Rebuttal Submission, paras. 105-51.

the industry is not reflected in cost of production data. In addition, Brazil treats the only sources of farm income as cotton market prices and government payments, ignoring crop diversification and off-farm sources of income. By ignoring alternative revenue sources, Brazil invalidates its claim that *only* government payments could serve to cover any alleged cost-revenue gap.

42. But most importantly, Brazil has no legal basis for its argument. Brazil argues that the Appellate Body in *Canada - Dairy (21.5)* has stated that total costs are the relevant measure, but that reasoning is inapt here. The only question in that dispute was whether a practice involved an export subsidy within the meaning of Article 9.1(c) of the Agriculture Agreement. Solely because the question was to determine whether certain milk provided to processors constituted a payment for purposes of Article 9.1(c) did the Appellate Body opt to use the average cost of production.[41] However, the Appellate Body explicitly recognized that "a producer may well decide to sell goods or services if the sales price covers its marginal costs." The Appellate Body also noted that cost of production can be measured "in at least two ways": (1) per unit average total cost of production and (2) marginal cost of production.[42] Here, the issue for which Brazil seeks to use total costs is not whether a subsidy exists but to evaluate the effect of the subsidy, an altogether different analysis. Thus, *Canada - Dairy (21.5)* provides no support Brazil's average total cost argument.

**(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?**

43. As described in detail in previous US submissions[43], the combination of, among other things, the boll weevil eradication programme and the extraordinary adoption rates of biotech cotton have combined to lower producers' costs and enhance net revenues. Despite the difficulty in providing precise figures on the extent of cost savings and net revenue increases for the cotton sector that have occurred since the 1997 USDA ARMS cost and returns survey, the rapid adoption of biotech cotton (over 90 per cent of area in key producing States) suggests farmers are reaping significant benefits in terms of net returns. These cost savings have been analyzed and documented in a wide range of studies.

44. In June 2002, the National Center for Food and Agricultural Policy (NCFAP) compiled 40 case studies of 27 crops to document the benefits of biotechnology.[44] These case studies were done by various universities. Among other findings, one study found that adoption of insect resistant biotech cotton in states in the Southeast and Southwest experiencing high infestations of budworm resulted in a $20 per acre increase in net income. Another study that examined the use of herbicide-resistant cotton in several Mid-South states estimated producers saved $133 million annually in weed control costs.

45. The post-1997 updates of the cost of production data assume the same technological coefficients as the 1997 survey – for example, pounds of seed per acre, the number of pesticide applications per acre, etc. Brazil correctly notes that the ERS/USDA updated COP data from 1997 show increased seed costs, which reflects the use of higher-cost biotech seed.[45] To the extent those inputs become more costly (for example, as biotech seed replaces conventional), cost increases are captured by the updating process through input price indexes. What is not captured is the *cost savings* from technological changes that alter the mix of production activities and inputs. New survey data

[41] The specific issue addressed was limited to whether the supply of certain milk to processors constituted a "payment" on the export of milk "financed by virtue of governmental action."

[42] *Canada-Dairy: First Recourse to 21.5*, AB-2001-6, para. 94.

[43] US Further Submission, paras. 46-54; US Further Rebuttal Submission, paras. 123 -132.

[44] *Plant Biotechnology: Current and Potential Impact For Improving Pest Management in US Agriculture: An Analysis of 40 Case Studies.* Leonard P. Gianessi, Cressida S. Silvers, Sujatha Sankula and Janet Carpenter. NCFAP, June 2002. The full report can be found at http://www.ncfap.org/40CaseStudies.htm.

[45] Further Rebuttal Submission of Brazil, 18 November, para. 72.

will incorporate new technological coefficients as well as changes in such practices as direct pesticide costs, changes in tillage, application and cultivation trips, and handweeding. Many of the cost-saving aspects of biotechnology or other new practices (no-till farming) cannot be accurately captured by simply updating old cost data by price indices. Thus, relying on such updated cost data that reflects an outdated technological mix is in error.

**(b) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? USA**

46. As explained in some detail in the US Further Rebuttal Submission of 18 November, the agricultural economics profession is clear that short-run production decisions are made based on the ability of a producer to cover his variable or operating costs.[46] All economic models that attempt to capture supply response (producer planting behaviour) use variable costs in the equations, not total costs. Examples include the FAPRI baseline projections model (a variation of which was used by Dr. Sumner), the ERS baseline projections model, and the Economic Research Service's FAPSIM model, the results of which are cited by Brazil.[47] No economic model of which we are aware looks to total costs as the relevant costs for producer planting decisions.

47. One can do the same exercise as done by Brazil in paragraph 59 of its further rebuttal submission, but using the economically correct variable costs instead of total costs.[48] Even using the technologically- and structurally-dated cost-of-production data based off the 1997 ARMS survey, in all years except the extraordinary year of 2001, average market returns more than covered variable costs, allowing producers to earn a sufficient margin to pay off other fixed costs, a conventional agricultural business practice, as noted by Christopher Ward.[49] Instead of a cumulative loss of $332.79 per acre over the 6-year period as claimed by Brazil, producers had a cumulative net margin of $592.65 per acre. Clearly, if all years were like 2001, US cotton farmers would go out of business.[50] But because most US cotton farmers regularly cover their variable costs – and then some – they can survive a year like 2001.

**Cumulative net returns ($ per acre)**

| Item | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|
| Variable costs | 271.46 | 230.87 | 244.26 | 296.38 | 284.24 | 278 |
| Market revenue | 545.55 | 356.1 | 314.8 | 375.18 | 271.4 | 307.83 |
| Net return | 274.09 | 125.23 | 70.54 | 105.8 | -12.84 | 29.83 |
| Cumulative net return | 274.09 | 399.32 | 469.86 | 575.66 | 562.82 | 592.65 |

Source: USDA, Economic Research Service, www.ers.usda.gov/data/costsandreturns

[46] US Further Rebuttal Submission, 18 November 2003, para. 117. Brazil continues to inappropriately make all its cost-revenue arguments using total costs. Brazil cites the Appellate Body decision in Canada – Dairy 21.5 III as support for using a total cost of production figure but that decision was unique to those circumstances and involved export subsidies. That decision does not refute accepted wisdom and long-standing economic theory, as well as farmers' usual business practices.

[47] Exhibit Bra-222.

[48] See http:/www.ers.usda.gov/data/costsandreturns/.

[49] Further Rebuttal Submission of Brazil, 18 November 2003, para. 58.

[50] Even Mr. Christopher Ward was unable to cover his variable costs in 2001. Statement of Mr. Christopher Ward at the Second Session of the First Panel Meeting, para. 6.

**212. Brazil states in paragraph 37 of its oral statement that studies of Westcott and Price found that the effect of the programme on cotton is to add an additional 1 to 1.5 million acres during marketing years 1999-2001 and to suppress US prices by 5 cents per pound. Does the US reject these findings? Why or why not?**

48. While an interesting "academic" analysis of the impacts of the US marketing loan programme, the Westcott and Price study *Analysis of the US Commodity Loan Programme With Loan Provisions* (Exhibit BRA-222) is not relevant for the Panel's assessment of the matter before it. In this study acreage decisions are based on an expected net returns which includes as the expected price term as the higher of the lagged market price or the loan rate plus additional marketing loan facilitated revenue. Since the period of analysis for the study is 1998 through 2005, rather than actual data, the authors used USDA's 2000 baseline. This baseline incorporates actual data for years prior to marketing year 1998 and partial marketing year 1999 to make projections about prices and other factors for marketing year 1999 forward. Thus the study is based on projections except for MY1998.[51]

49. A panel, however, cannot base its findings on hypothetical market conditions instead of actual conditions. That is, Brazil must show that US domestic support has actually caused serious prejudice in a given year based on actual market conditions and not that under some assumed conditions US domestic support programmes have impacted prices. Since the study is based on projected prices, the analysis is not useful for the Panel in determining whether US support programmes have caused serious prejudice to Brazil.

50. Putting aside the issue that the study is based on projections and not actual market conditions for the 1999-2001 period, the United States believes the study results overstate the impacts of the US marketing loan programme for two reasons: (1) the expectation of prices used and (2) the overstated additional marketing loan facilitated revenue.

51. As previously discussed, the authors used USDA's 2000 baseline as the input into the USDA FAPSIM model. To represent farmers' price expectations, the simulation uses lagged prices from the projections in the USDA's 2000 baseline. The model uses the higher of lagged market prices or the loan rate plus additional marketing loan facilitated revenue (fixed at 14 cents per pound for cotton). Using the price projections in the USDA 2000 baseline, farmers would expect the marketing loan programme to kick in for the period 1999-2001. The problem here is that the price expectations used by the model are not consistent with the price expectations the farmers *actually held* at the time of planting for prices at harvest. As the United States provided in its opening statement at the Second Meeting of the Panel with the Parties, the futures prices at the time of planting indicated that prices would be above the marketing loan rate during this period.

| **Harvest Futures Prices at Planting Time Compared to USDA Baseline Expected Prices (cents per pound)** | | | |
|---|---|---|---|
| | MY1999 | MY2000 | MY2001 |
| Futures Price 1/ | 60.27 | 61.31 | 58.63 |
| Expected Cash Price 2/ | 55.27 | 56.31 | 53.63 |
| 1/ February New York futures price for December delivery.<br>2/ Futures price minus 5 cent cash basis. | | | |

[51] In fact, the study found marketing loans to have negligible impacts in 1998. *See* Exhibit BRA-222, p. 16.

As the futures prices demonstrate, market expectations at the time of planting for marketing years 1999-2001 was that prices would be above the marketing loan rate and hence no marketing loan benefits. Therefore, the marketing loan programme would not have had the impact this study found.

52. In addition to having the wrong expectations about price levels and the marketing loan programme being tripped, the study has overstated the potential additional market loan facilitated revenue that can be achieved. The authors used a fixed rate of 14 cents to represent this additional revenue above the loan rate when the marketing loan programme kicks in. Their justification for this figure is that this was their calculation for 1998. The authors do not provide any discussion as to why conditions in 1998 were indicative of conditions to continue for the near future that would keep this margin at 14 cents. This margin is based on the fact that farmers can pick the date to make the claim for the marketing loan gain/deficiency payment and then sell the cotton at a later date. The premise is that a farmer is able to sell when prices have increased relative to the date they made their claim. However, in reality, there is no such guarantee. It is just as possible that prices will fall below the price when the claim was made. In fact, the additional revenue has not been as large as in MY1998.[52] In MY1999, the annual average was 6.1 cents, MY2000 was 5.8 cents, and MY2001 was 1.3 cents. As Exhibit US-126 demonstrates, the margin fluctuates from month to month, with the value in several months even negative, implying that a farmer that did not sell his crop at the time he received the marketing loan payment earned *less than* the marketing loan rate. Using a much lower value for this additional revenue above the loan rate when the marketing loan rate kicks in would have reduced the impact of the study's result.

53. By request of the Payment Limitations Commission, Westcott and Price updated this analysis using actual prices for MY2001. As the United States has discussed at the panel meetings and in its further rebuttal submission, this will overstate the impact of the marketing loan programme because it assumes that farmers had perfect foresight. That is, the model is calibrated to the actual values that occurred in that year while, in fact, producers could not have anticipated such events when planting decisions occurred. This overstates the effects of the programme because the model assumes outcomes that were unanticipated by producers when they made their planting decisions.

54. This overstatement is similar to the other third party studies that used actual outlays for marketing loans when calculating the price wedge. As the United States argued when critiquing those models, a more appropriate method to determine the impact is to look at expectations based on futures prices relative to the marketing loan rate. If the futures prices are above the loan rate, the programme will have a negligible impact on planting decisions since farmers are not expecting benefits from the programme.

55. For these reasons, the United States finds the results from these studies not relevant for the Panel in making its assessment of the effect of the marketing loan programme.

**213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? BRA, USA**

56. In this dispute two approaches have been advocated in determining farmers' expectations about prices. Brazil and its economic consultant have used lagged prices as the mechanism to gauge farmers' expectations about prices. Dr. Sumner wrote:

> Of course, it is impossible to know precisely what individual growers expect. I have adopted the long-standing approach of FAPRI, and other models[,] to approximate

[52] See Exhibit US-126 for calculations using the authors' formulation of the additional marketing loan facilitated revenue realized per unit for MY 1998-2003 (partial year), using actual data.

> these expectations by using the current year final realized market prices as the expectation for the following season's price.[53]

The lagged prices used by Brazil and its economic consultant can at best, be an approximation of farmers' price expectations. That is because the lagged prices used in Brazil's analysis incorporate pricing information that occurs *after US farmers make their planting decision* (that is, prices from April through July of a given marketing year when planting decisions are taken in the January to March period). Therefore, by necessity, farmers cannot be looking at a lagged price that incorporates prices that do not yet exist.

57. The United States, on the other hand, has advocated the use of futures prices, a market determined expectation of prices. As Mr. MacDonald, Brazil's own witness, has explained, the New York futures price is a key mechanism used by cotton growers, traders and consumers in determining current market values as well as the contract prices for forward deliveries, in the domestic US and non-US markets.[54]

58. The use of futures by market participants is supported by a US government study. In April 1999, the US General Accounting Office published a report on farmers' use of risk management strategies.[55] Based on survey data from the 1996 USDA Agricultural Resource Management Study, the study showed that between 35 and 57 per cent of cotton farmers used a hedging instrument in 1996. (The ranges reflect a 95 per cent confidence interval.) In addition, an estimated 63 to 89 per cent of cotton farms used cash forward contracts in 1996.[56] These survey results suggest that a large proportion of cotton farmers either directly or indirectly price their cotton off of organized futures and options markets.

59. Furthermore, economic literature supports the United States' approach. For example, in his classic paper on rational price expectations, Muth (Exhibit US-48) argued that there is little evidence that expectations based on past prices are economically meaningful. Additionally, in a 1976 paper Gardner (Exhibit US-49) contended that the future price for next year's crop is the best proxy for expected price.

60. Unfortunately, the use of futures prices in a multi-commodity modelling framework for extended time projection is cumbersome. First, equations must be developed that can predict values for futures contracts in simulation analysis. Second, many commodities lack an organized futures exchange (e.g., grain sorghum). For these reasons, large-scale models like those used by FAPRI, USDA and the US Congressional Budget Office typically use lagged prices rather than futures prices as proxies for price expectations.

61. Nonetheless, the use of lagged prices may result in biased results. Over the long term, where there is reasonable stability in markets, lagged prices function adequately as a proxy for price expectations. However, in those years, as in the period under investigation here, when unexpected exogenous shocks such as China dumping stocks and unexpected yields worldwide due to good weather conditions, lagged prices are poor predictors of expected prices. Future prices, by contrast, are more efficient because they are based on more current information.

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[53] Brazil's Further Submission, Annex I, para 18.

[54] Exhibit BRA-281, para 13 (statement by Andrew MacDonald)

[55] US General Accounting Office. *Agriculture in Transition: Farmers' Use of Risk Management Strategies*. GAO/RCED-99-90. April 1999. See page 9, table 4 (Exhibit US-125).

[56] A forward contract is defined as a cash market transaction in which two parties agree to buy or sell a commodity or asset under agreed-upon conditions. For example, a farmer agrees to sell, and a ginner or warehouse agrees to buy, cotton at a specific future time for an agreed-upon price or on the basis of an agreed on pricing mechanism (such as a futures or options market). See Exhibit US-125, page 22.

62. For example, during marketing years 2000, 2001, 2002, and 2003, lagged prices significantly understate the harvest season prices expected by producers as seen in the futures prices at the time of planting. The use of lagged prices thereby inflate the effect of the marketing loan rate. In fact, those lagged prices would have to be increased by 8-25 per cent, depending on the year, to equal the harvest season price actually expected by producers as indicated by the futures price.[57] For the period MY 1999-2003, only MY 2002 exhibits expected prices below the marketing loan rate when using futures prices. However, over that same period, when lagged prices are used as expected prices, the loan rate is higher than the expected price *in every year over this period* except MY1999. Thus, it is a significant error for Brazil and Dr. Sumner to use lagged prices instead of the futures prices Brazil's own expert explained to be the more accurate gauge of farmers' price expectations.

| **Harvest Futures Prices at Planting Time Compared to "Lagged Prices"(cents per pound)** | | | | | |
|---|---|---|---|---|---|
| | MY1999 | MY2000 | MY2001 | MY2002 | MY2003 |
| Futures Price 1/ | 60.27 | 61.31 | 58.63 | 42.18 | 59.6 |
| Expected Cash Price 2/ | 55.27 | 56.31 | 53.63 | 37.18 | 54.6 |
| Lagged Prices 3/ | 60.2 | 45 | 49.8 | 29.8 | 44.5 |
| Difference | -4.93 | 11.31 | 3.83 | 7.38 | 10.1 |

1/ February New York futures price for December delivery.
2/ Futures price minus 5 cent cash basis.
3/ Prior crop year average farm price, weighted by monthly marketings.[58]

63. Looking more specifically at Dr. Sumner's analysis in Annex I provides further evidence of the bias of lagged prices relative to future prices. Consider the 2002 crop year. In the Sumner analysis, area response to the removal of the cotton loan programme results in a 36 per cent reduction in US planted area – the largest single effect for any of the years considered in his analysis. Based on lagged prices, price expectations for 2002 were 29.8 cents per pound, a 40 per cent reduction from 2001 levels. Yet, the futures market data suggests a far smaller reduction in expected price. December futures prices taken as the average daily closing values in February 2002 averaged 42.18 cents per pound, a 28 per cent drop from year earlier levels. Based on Dr. Sumner's range of supply response elasticities of 0.36 to 0.47, a decline of this magnitude would suggest a drop in acreage of 10 to 13 per cent from the preceding year. In fact, actual US cotton acreage dropped 12 per cent (from 15.5 million acres in 2001 to 13.7 million acres in 2002) suggesting acreage levels entirely consistent with world market conditions and price expectations. Thus, in marketing year 2002, lagged prices would significantly overestimate the decline in plantings in the absence of a marketing loan rate.

64. While the United States would agree with Brazil that it is impossible to know precisely what individual farmers' price expectations are, the United States argues that futures prices provide the most current expectations of market participants. The United States disagrees with the approach used by Brazil in its analysis to rely solely on lagged prices and ignore information provided by futures prices. While it may be impractical to include futures prices in some models, modelling convenience is no justification to ignore these objective, market-based price expectations, and the biased results from using lagged prices do not assist the Panel in making an objective assessment of what is the effect of the US marketing loan programme.

[57] US Further Rebuttal Submission, paras. 164-65.
[58] Exhibit US-90.

## C. DOMESTIC SUPPORT

**214. Please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? USA**

65. Please see US Exhibits 117 and 118. In these document, the Department of Agriculture set the level of support for the 1993 marketing year. For example, the Department announced a marketing loan rate of 52.35 cents per pound. In addition, the Secretary did not exercise his discretion to alter the effective price, which by statute was to be "not less than" 72.9 cents per pound.[59] We also note that the March 24 notice lowered the acreage reduction percentage (the share of base acreage on which deficiency payments could not be obtained) from 10 to 7.5 per cent.

**215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA**

66. Direct payments are made to producers regardless of the price level; no production of upland cotton or any other crop is required to receive payment, and the recipient may additionally leave the land in conserving use. In contrast, the counter-cyclical payment is contingent on farm prices falling below the target price of 72.4 cents per pound less the direct payment rate of 6.67 cents per pound. Thus, at farm prices near to or over the 65.73 cents threshold, the counter-cyclical payment will be reduced or eliminated.

**216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. BRA, USA**

67. Under the 1990 Act, base acreage for purposes of deficiency payments was calculated as the average, minus the high and low year, of the previous five years plantings. There was no updating of base acres by upland cotton producers since the base period was always a rolling average of the previous five years. In effect, to increase acreage base, a producer had to overplant his or her current acreage base. The 1990 Act penalized producers who overplanted their base by declaring them ineligible for farm programme payments in the year they overplanted their base. For this reason, participation in the programme was quite high.

68. The 1996 Act eliminated deficiency payments in favour of decoupled production flexibility contract payments. The Act also did away with the rolling five-year average approach for base acreage. Instead, crop base acreage was based on the amount of base acreage that would have been in effect under the 1990 farm bill for the 1996 crop year. Producers maintained the same acreage base over the 1996 through 2001 crop years, without current plantings affecting their base acreage.

69. The 2002 Act allowed producers either to retain base acreage as under the production flexibility contracts or to update their base area equal to the average acreage planted and prevented in 1998-2001. The latter option allowed decoupled payments to be made with respect to soybeans and other oilseeds, which did not have base acreage under the 1990 Act. This new crop acreage base cannot be updated as it extends for the life of the 2002 Act (that is, through the 2006 crop year).

70. We note that the likelihood of further base updating would appear small. Currently, there is no authority for future base updating. Any changes would have to originate in Congress where there

[59] 7 USC 1444-2 (Exhibit US-5).

would likely be an associated budgetary cost. Given the current US fiscal situation, increases in the agricultural budget are seen as unlikely.

**217. What is the reason for reducing payments under the PFC and direct payments programmes for planting and harvesting fruit, vegetables and wild rice on certain base acreage? Please comment on the statements by the European Communities that "the reduction in payment for fruit and vegetables, if the EC understands correctly, is in fact designed to avoid unfair competition within the subsidising Member." (EC oral statement at first session, first substantive meeting, paragraph 29) and "To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition (…)" (EC response to Panel third party Question No. 5).**

71. The limitation only applies to base amounts of acreage, and to that end it is worthy of note that the US December 18-19 filings indicate that cotton farms plant less than one-third of their total cropland to cotton. Of note, too, is that fruit and vegetable prohibition came into play before 1996 in connection with the "flex acre" concept of the 1990 farm bill as reflected in the provisions of 7 USC 1464 (1988 ed. Supp. III) as enacted at that time. It continues to be the case under the 1996 and 2002 Farm Bill, as with the 1990 Bill, that the restrictions on plantings is only limited to the base acres amount of the farmer's cropland.

72.

73. Paragraph 6 prohibits basing payments on production requirements, not basing payments on not producing. As the United States earlier pointed out, consider a situation in which a recipient of direct payments produces fruits and vegetables and sees the direct payment reduced. How could that recipient receive the entire payment to which he or she is entitled? The marginal amount of decoupled payment is not "related to, or based on, the type or volume of production" undertaken by the producer since the recipient need not produce anything at all. Rather, to receive the marginal payment, the recipient need merely refrain from producing fruit, vegetables, or wild rice. Thus, the extra amount of payment is not "related to, or based on" production; if anything, it is "related to, or based on" non-production (of certain crops).

**218. Please comment on the testimony of USDA Chief Economist Keith Collins cited in paragraph 36 of Brazil's oral statement regarding the trade-distorting and production-distorting nature of the marketing loan payments.**

74. We agree with the statement of Dr. Collins that marketing loan payments are potentially production- and trade-distorting. The United States has consistently notified upland cotton marketing loan payments as cotton-specific amber box payments in its WTO Domestic Support notifications. The issue in this dispute is not whether marketing loan payments are potentially production- and trade-distorting, but the degree to which they have actually distorted production and trade in a particular year, given market prices and other relevant factors.

75. The degree of distortion caused by the marketing loan programme depends on the relationship of the expected harvest price to the loan rate at the time of planting. If the expected price is below the loan rate, the loan rate may provide an incentive to plant cotton because farmers will receive a

government payment for the difference between the loan rate and the adjusted world price. For this reason, we believe that the marketing loan programme was more distorting in 2002 when expected cash prices were below loan rates at planting than in 2001, when expected cash prices were higher than loan rates at the time of planting. However, as explained previously, the observed decline in upland cotton planted acreage in marketing year 2002 was commensurate with the decline in futures prices over the year before.

## D. EXPORT CREDIT GUARANTEES

**219. Under the *Agreement on Agriculture* the general position is that the use of export subsidies, both those listed in Article 9.1 as well as those within the scope of Article 1(e) which are not so listed, may only be used within the limits of the product specific reduction commitments specified in Part IV of Members' Schedules. One might therefore have expected that Article 3.3 of the *Agreement on Agriculture* would have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, would have simply prohibited the use of any export subsidy. Instead, the Article 3.3 prohibition is limited in both cases to export subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:**

**(a) the fact that export performance-related tax incentives, which like subsidised export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held (for example, in *United States - Tax Treatment for Foreign Sales Corporations*, WT/DS108) to be subject to the anti-circumvention provisions of Article 10.1; and**

**(b) the treatment of international food aid and non-commercial transactions under Article 10? USA**

76. The United States has previously noted the unremarkable fact that Article 9.1 of the Agreement on Agriculture sets forth a list of six very specific practices known to the drafters and deemed to constitute export subsidies under that Agreement.[60] The specific identification and description of these export subsidy practices, well-known and notorious in the agricultural trade sector, served at least three purposes in the text. First, under Article 3.3, these particular practices were unambiguously subject to the export subsidy reduction commitments of each member.

77. However, certain limited exceptions to this rule constitute the second and third purposes of the specific list of export subsidies in Article 9.1: Article 3.3 is by its terms "subject to the provisions of paragraphs 2(b) and 4 of Article 9." Article 9.2(b) has since lapsed, but while in effect permitted a Member to provide export subsidies listed in Article 9.1 in a given year in excess of the corresponding annual commitment levels in the Member' s schedule, subject to the cumulation limits of Articles 9.2(b)(i)-(iv). Under Article 9.4, during the implementation period, developing country Members were not required to undertake export subsidy commitments with respect to export subsidies listed in Articles 9.1(d) and 9.1(e), except not to apply them in a manner that would circumvent their reduction commitments.

78. Unlike export performance-related tax incentives, which are not expressly mentioned in the Agreement on Agriculture, export credit guarantees were subject to an altogether separate treatment and commitment: exclusion from the export subsidy disciplines altogether until agreement on

[60] US First Written Submission (11 July 2003), para. 161.

internationally agreed disciplines. Under Article 10.2, Members were (and continue to be) obligated to work toward the development of such disciplines, and once agreed, adhere to them.

79. Question 219 suggests one might have expected Article 3.3 to have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, to have simply prohibited the use of any export subsidy. Article 8, however, serves this specific role. It imposes the obligation not to provide export subsidies otherwise than in conformity with the Agreement on Agriculture and with the commitments specified in the respective Members' schedules.

80. The anti-circumvention provisions of Article 10.1 further highlight the separate treatment of export credit guarantees. That article explicitly recognizes that "non-commercial transactions" shall not be used to circumvent export subsidy commitments. This phraseology is distinctly similar to that of item (h) in Addendum 10, entitled "Export Competition: Export Subsidies to be subject to the terms of the Final Agreement," dated August 2, 1991, among the series of addenda to the Note on Options circulated by Chairman Dunkel.[61] That item(h) addressed: "Export credits provided by governments or their agencies on less than fully commercial terms."

81. However, instead of making any connection between "non-commercial transactions" and export credits, the Members agreed in the very next section - Article 10.2 as ultimately adopted - to provide wholly distinct treatment to export credits, export credit guarantees and insurance. The reference to circumvention for non-commercial transactions in the current Article 10.1 would have been the obvious place to draw the distinction that New Zealand and Brazil claim the Members allegedly made between "commercial" and "non-commercial" export credits.[62] But the text simply does not support this fictional argument.

82. Article 10.4 provides further support that export credits are part of a work programme to develop disciplines for them and consequently are not currently subject to the other disciplines of Article 10. Article 10.4 of the Agreement on Agriculture ties the discipline on food aid to terms negotiated elsewhere: the Food Aid Convention and the United Nations' Food and Agriculture Organization (FAO). This specific set of disciplines applicable to food aid demonstrate the situation that will apply once the negotiations mandated under Article 10.2 are completed. They also illustrate an approach comparable to the negotiations that subsequently occurred in the OECD and as contemplated in paragraph 5 of Attachment 5 of the Harbinson Text.[63] Once internationally agreed disciplines are achieved, then it will be possible for a given export credit practice to circumvent export subsidy disciplines as a result of failure to comply with the export credit disciplines.[64]

> **221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be $230,127,023 instead of the figure which originally appeared ($381,345,059).**
>
> **(a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.**

[61] MTN.GNG/AG/W/1/Add. 10 (2 August 1991) (Exhibit US-27)

[62] See, New Zealand Answers to Question 35 of Panel to Third Parties, Brazil Answer to Panel Question 71(a); US Rebuttal Submission (22 August 2003), para. 144-145

[63] Exhibit US-9

[64] See US First Written Submission (11 July 2003), fn. 150.

| GSM 102/GSM-103/SCGP<br>Subsidy Estimates and Reestimates By Cohort | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Original Subsidy Cohort** | **Cohort Reestimates by Fiscal Year Estimate** | **FY93-00** | **FY01** | **FY02** | **FY 03** | **Total Reestimates** | **Subsidy Estimate Net of Reestimate** |
| 1992 | 267,426,000 | 166,136,256 | -599,604,000 | 27,030,201 | 14,823,708 | -391,613,835 | -124,187,835 |
| 1993 | 171,786,000 | -10,556,906 | -257,206,000 | 23,017,631 | 16,571,778 | -228,173,497 | -56,387,497 |
| 1994 | 122,921,000 | -82,345,960 | -77,135,000 | 2,228,985 | 41,521,000 | -115,730,975 | 7,190,025 |
| 1995 | 113,000,000 | -40,555,149 | -105,216,000 | 2,823,516 | -6,351,460 | -149,299,093 | -36,299,093 |
| 1996 | 328,000,000 | 896,907 | -386,916,000 | 7,611,330 | 44,934,327 | -333,473,436 | -5,473,436 |
| 1997 | 289,000,000 | 0 | -237,316,000 | 19,845,279 | 50,733,713 | -166,737,008 | 122,262,992 |
| 1998 | 301,000,000 | 0 | -237,271,000 | 14,661,079 | - 15,693,431 | -238,303,352 | 62,696,648 |
| 1999 | 158,000,000 | 0 | -68,758,000 | 51,146,455 | -144,434,351 | -162,045,896 | -4,045,896 |
| 2000 | 195,000,000 | 0 | | -91987247 | -61,534,936 | -153,522,183 | 41,477,817 |
| 2001 | 103,000,000 | | | -33497152 | 16,381,864 | -17,115,288 | 85,884,712 |
| 2002 | 97,000,000 | | | | 40008586 | 40,008,586 | 137,008,586 |
| **Total for all Cohorts** | **2,146,133,000** | **33,575,148** | **-1,969,422,000** | **22,880,077** | **-3,039,202** | **-1916005977** | **230127023** |

Source: FSA Budget Division Reestimate Documentation and Apportionment Documents.
There were no reestimates apportioned during FY 1998 through FY 2000.

**(b) Please clarify whether and how the Panel should treat the figures in Exhibit BRA-182 for the net lifetime re-estimates for each respective cohort.**

83. The United States has no objection to use of the figures in the column entitled "Net lifetime reestimate amount" in Exhibit Bra-182 in lieu of the column entitled "Reestimates" in the table that accompanied paragraph 161 of the US Rebuttal Submission (22 August 2003) and reproduced in the response to question 221(a) immediately above. The figures are intended to represent the same thing.

84. The Panel will first note that with respect to the figures corresponding to cohorts 1997-2002, Exhibit Bra-182 and the table previously submitted by the United States match.

85. Differences appear with respect to cohorts 1992-1996. The United States attempted to explain the disparity in footnote 96 of its Further Submission of 30 September 2003. These differences would appear to be related to the cumulative re-estimates applied to these cohorts within the calculations of the budgets in fiscal years 1993-2000. The United States noted that it was searching for internal documentation to corroborate the figures included in the table previously submitted to the Panel. In the absence of such documentation and unable to explain the relatively minor disparity in figures, the United States necessarily accepts Exhibit Bra-182.

86. In fact, the United States' initial figures were more conservative than these official figures which show profitability in every year during the period 1992-1996. The following table illustrates this result:

| Cohort | Estimate | Re-estimates (Bra-182) | Net of Re-estimates |
|---|---|---|---|
| 1992 | 267426000 | -370963000 | -103537000 |
| 1993 | 171786000 | -239160000 | -67374000 |
| 1994 | 122921000 | -133746000 | -10825000 |
| 1995 | 113000000 | -159564000 | -46564000 |
| 1996 | 328000000 | -333407000 | -5407000 |
| 1997 | 289000000 | -166737000 | 122263000 |
| 1998 | 301000000 | -238304000 | 62696000 |
| 1999 | 158000000 | -162046000 | -4046000 |
| 2000 | 195000000 | -153522000 | 41478000 |
| 2001 | 103000000 | -17115000 | 85885000 |
| 2002 | 97000000 | 40009000 | 137009000 |

These figures show that all of the first five cohorts (1992-1996), including 1994, are profitable. The figures for these years, unlike the more recent cohorts, reflect much more complete data for actual operating experience (although 1999 is already showing profitability).

**(c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of $4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately $4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result**.

87. The figures in the table in paragraph 161 do not include administrative expenses. Imputed administrative costs are not subject to the re-estimation process but are reflected separately in the budget.[65] The United States has previously acknowledged that it would be appropriate to apply an administrative expense as an operating cost of the programme.[66] Consequently, it would be appropriate to add the administrative expense applicable to a particular cohort as an operating cost.

**(d) Please identify what is considered an "administrative expense" for this purpose.**

88. The Commodity Credit Corporation (CCC) has no physical presence. It also has no employees. The "administrative expense" in the budget is simply a reasonable approximation for budgetary purposes of the value of services supplied by US Department of Agriculture agencies and personnel in the administration of this particular programme subsumed within the CCC.

89. The relevant provision from the applicable appropriations legislation for fiscal year 2003 reads as follows:

> COMMODITY CREDIT CORPORATION EXPORT LOANS PROGRAMME ACCOUNT (INCLUDING TRANSFERS OF FUNDS)
>
> For administrative expenses to carry out the Commodity Credit Corporation's export guarantee programme, GSM 102 and GSM 103, $4,058,000; to cover common overhead expenses as permitted by section 11 of the Commodity Credit Corporation Charter Act and in conformity with the Federal Credit Reform Act of 1990, of which $3,224,000 may be

[65] See US First Written Submission (11 July 2003), para. 175 and fn. 160.
[66] US Answers to Panel Question 77 (11 August 2003), para. 146.

> transferred to and merged with the appropriation for "Foreign Agricultural Services, Salaries and Expenses", and of which $834,000 may be transferred to and merged with the appropriation for "Farm Service Agency, Salaries and Expenses."

Also, paragraph 38 of Statement of Federal Financial Accounting Standard No. 2[67], originally issued 23 August 1993[68], provides:

> Costs for administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of direct loans and loan guarantees.

**(e) The Panel notes the US statement in paragraph 160 of its answers to Panel questions following the first meeting that all cohorts are still open although the 1994 and 1995 cohorts will close this year. Is this still an accurate statement? If not, please indicate whether any cohorts have since "closed" for the period 1992-2002.**

90. Although the United States has not completed the formal administrative steps to close cohorts 1994 and 1995, all financial transactions necessary to do so are complete. Consistent with figures reflected in the 2004 Budget Federal Credit Supplement Table 8 (Exhibit Bra-182), the net of reestimate figure for each of cohorts 1994 and 1995 will be negative, indicating profitability.

**(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily* reach a "profitable" result (for example, the 1994 cohort, which has almost closed still indicates an outstanding amount)? Do "re-estimates" reflect also expectations about a cohort's future performance?**

91. Until a "closing reestimate" occurs with respect to a particular cohort, which is made "once all the loans in the cohort have been repaid or written off,"[69] each reestimate does necessarily reflect certain expectations about a cohort's future performance. "Reestimates mean revisions of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and/or estimated changes in future cash flows of the cohort."[70] Generally, reestimates must be made immediately after end of each fiscal year.

92. With the passage of time, of course, each reestimate necessarily more closely reflects actual results. In the case of the GSM-102 export credit guarantee programme, for example, after three fiscal years have elapsed both the actual amount of guarantees and the actual amount of defaults are known.

93. With respect to the 1994 cohort alone, as noted in the response to Panel Question 221(b) above, the numbers from Table 8 of the Federal Credit Supplement (Exhibit Bra-182), indicate profitability. As noted in the immediately preceding response, although the United States has not

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[67] See Answer to Question 228, *infra*, regarding the Federal Accounting Standards Advisory Board

[68] Statement of Federal Financial Accounting Standards No. 2: Accounting for Direct Loans and Loan Guarantees, issued 23 August 1993, pp. 187-267. (Exhibit US-127)

[69] See OMB Circular A-11 (Exhibit Bra- 116), section 185.6, page 185-15. See also, US Rebuttal Submission (22 August 2003), paras. 155-156 and fn. 189; US Answers to Panel Question 81(d) (11 August 2003), paras. 162-163.

[70] OMB Circular A-11 (Exhibit Bra- 116), Section 185.3(x), p. 185-12

completed the formal administrative steps to close cohorts 1994 and 1995, all financial transactions necessary to do so are complete. Consistent with figures reflected in the 2004 Budget Federal Credit Supplement Table 8 (Exhibit Bra-182), the net of reestimate figure for each of cohorts 1994 and 1995 will be negative, indicating profitability.

94. With respect to 1997 and 1998, the United States of course cannot with absolute certainty predict the future**.** A principal issue with respect to the 1997 cohort concerns Pakistani and Ecuadorean defaults. All of this debt has been rescheduled and is now fully performing. These rescheduled amounts currently involve approximately $209 million of outstanding principal alone. Consequently, the United States has every reason to believe that 1997 cohort will ultimately reflect profitability.

95. With respect to the 1998 cohort over $30 million of Ecuadorean and Russian (private sector) outstanding principal are in performing reschedulings.

**(g) Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?**

96. The United States has previously noted that the original subsidy estimate in the US budget begins with an historically overly optimistic projection of the actual use of the programme and then the use of government-wide estimation rules is required, including mandated risk assessment country grades without regard to the actual experience specific to the CCC export credit guarantee programmes.[71] The original subsidy estimate for these cohorts, like the original subsidy estimate for all cohorts, necessarily reflects no actual operating experience with respect to that cohort.

97. Subsequent downward reestimates (i.e., good performance) are calculated not from the original subsidy estimate but from the actual figure corresponding to amounts of guarantees actually issued.[72] Although this budgetary convention exaggerates the apparent negative performance in all years, this exaggeration is particularly acute in the nearer term. As reflected in the table entitled "CCC Export Credit Guarantee Programme Levels - Annual President's Budgets and Actual Sales Registrations - FYs 1992-2004" accompanying paragraph 148 of the US Further Submission (30 September 2003), actual sales registrations are only reflected in budgetary figures two fiscal years following the fiscal year of the particular cohort. For the 2002 cohort, therefore, the actual sales registrations of $3,388 million contrasts with the estimated programme level of $3,926 million in the immediately preceding budget. Similarly, for the 2001 cohort, the actual figure of $3,227 million is also more than one-half billion dollars less than the anticipated programme level of $3,792 million reflected in the preceding budgets. For this reason, the tables set forth in response to questions 221(a) and 221(b) commence with an "estimate" figure corresponding to the actual level of sales registrations.

98. More significant in direct response to the question, as reflected in the tables above in response to questions 221(a) and 221(b), is the trend of negative reestimates (i.e., better than expected performance). They are uniformly large for all cohorts for 1999-2000. This trend has also commenced with respect to the 2001 cohort. It is reasonable to expect that in the fullness of time the data will similarly reflect further negative reestimates for cohorts 2001 and 2002. This is likely to become more pronounced as the terms of the guarantees issued during this time expire.

99. For the foregoing reasons, the United States submits that the current budgetary subsidy estimate figures do not accurately reflect the proper relationship of premia to long-term operating costs and losses (if any) with respect to cohorts 2001 and 2002. Although over the long-term the

[71] US Further Submission (30 September 2003), paras. 147-148.
[72] See US Further Submission (30 September 2003), paras. 148-149.

subsidy estimate / re-estimate process will incorporate information relating to actual operating experience, the original subsidy estimate figures in the budget do not reflect any operating experience for the respective cohort. Thus, those subsidy estimates cannot properly be used as part of an analysis of whether the export credit guarantee programmes conform to Item (j) of the Illustrative List (i.e, the sufficiency of premia to cover long-term *operating* costs or losses (if any)).

**(h) Why should the Panel "eliminate", in addition, the 2000 cohort, as also suggested in paragraph 198 of the US further rebuttal submission for which information is presumably more "complete"?**

100. The Panel is of course correct to note that the data for the 2000 cohort is necessarily more complete than with respect to the subsequent cohorts. And, as the United States would have anticipated, the large negative reestimates have commenced for the 2000 cohort. As we are now in the third month of fiscal year 2004, all outstanding GSM-102 and SCGP guarantees will have expired, and the next budget cycle reestimate process will necessarily reflect that fact.

101. The same points made in the immediately preceding response to question 221(g) apply to the 2000 cohort. Of particular note with respect to this cohort, however, is the very large difference between the original projected level of use reflected in the 2000 budget ($4,506 million) and the actual level of sales registrations reflected in the 2002 budget for that cohort ($3,082 million). This difference, approaching $1.5 billion of initially overestimated utilization, has a profound effect on the budgetary depiction of programme performance and required estimates (although the tables set forth above eliminate this distortion in the US budget by starting from the estimate figure corresponding to actual sales registrations).

**(i) Under the US approach, at what point in time could a Panel ever make an assessment of the programme, if it had to wait for each cohort to be completed before it could be "properly" assessed? Why is it inappropriate for the Panel to include these "most recent years" in its evaluation, as the US suggests in paragraph 199 of its 18 November further rebuttal submission? USA**

102. Fortunately, neither the Panel nor the United States has to answer this question entirely in the abstract. First, Brazil and the United States agree that an examination beyond 10 years is inappropriate.[73] Indeed, as the United States has noted, to subject the programme to the analytical yoke of the unique circumstances of the Polish and Iraqi defaults over 10 years ago would effectively require elimination of the programme altogether.[74] Item(j) analysis requires a certain retrospection to make the requisite comparison between premia and net operating results of the programme. The question therefore becomes at what point does the financial data yield a sufficiently accurate picture to render this judgment.

103. The United States has noted that the budgetary figures inherently tend to exaggerate negative performance of the programme. This is more pronounced in the "most recent years" for the reasons noted above. As noted in the immediately preceding sub-question(h), in the case of fiscal year 2001 and 2002 cohorts, the original budgetary subsidy estimates do not reflect any operating results of those cohorts. In contrast, cohorts 1992-1999, taken as a whole, currently reflect a net negative reestimate (i.e., profitable performance). Although it is theoretically conceivable that status could change, every indication in the trends related to the programme, including most specifically the uniform performance of reschedulings, indicate that the negative reestimates will grow, not diminish, in time.

[73] The most recent manifestation is Brazil's statement in paragraph 81 of its 2 December 2003, Oral Statement: "Item(j) requires the Panel to determine whether the 'programmes,' . . . charge premium rates that meet operating costs and losses over a period that the United States and Brazil agree should be 10 years."

[74] US Rebuttal Submission (August 22, 2003), paras. 172-174

104. Consequently, the United States believes the Panel has sufficient data to determine that premium rates are adequate to cover long-term operating costs and losses of the programmes.

> **222. For GSM 102, 103 and SCGP, please provide year-by-year amounts from 1992 to 2003 with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes. Please indicate any allocation methodologies used to calculate administrative costs. USA**

105. The chart constituting Exhibit US-128 sets forth the information requested. This data is current through November 30, 2003. As the Panel will note, claims outstanding plus interest and administrative expenses are now well below premia plus interest otherwise collected or earned. This current data clearly reflects that premia are adequate to cover long-term operating costs and losses.

106. For each of cohorts 1992-1996, $3 million of administrative costs are allocated. For each subsequent cohort, $4 million of such costs are allocated. These are the figures reflected in the table accompanying paragraph 132 of Brazil' s Oral Statement of July 22, 2003, and the corresponding references to the US budget cited therein. As Exhibit US-128 breaks out activity for each of GSM-102, GSM-103, and SCGP, these respective administrative costs have then been allocated based on the relative registration values of these programmes. Interest costs and revenue (see response to question 224 and table therein) have similarly been allocated based on registration value.

> **223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? USA**

107. Premium rates applicable to GSM-102, GSM-103, and SCGP are reviewed annually. The premia rates vary by programme, length of coverage, and repayment interval. For GSM-102, the premium ranges from 15.3 cents per $100 of coverage to about 66 cents per $100 of coverage. Under SCGP, a two-tier fee schedule exists. For up to 90 days, the fee is 45 cents per $100 of coverage. For 91 to 180 days, the fee is 90 cents per $100 of coverage. A higher fee structure for longer term is viewed as an incentive to exporters to opt for a shorter term and correspondingly reduce the likelihood of claims, and therefore potential operating losses, associated with the programmes. Premia for both GSM-102 and SCGP are currently subject to a statutory cap of one per cent.[75]

108. Private commercial quotes for export credit insurance are simply not available to the United States. As the United States has previously noted, however[76], commercial insurers do offer export credit insurance covering agricultural commodities. According to a background paper on export credits prepared by the WTO Secretariat: "While guarantees could be unconditional, they usually have conditions attached to them, so that in practice there is little distinction between credits which are guaranteed and credits which are subject to insurance."[77]

109. With respect to forfaiting, the United States similarly does not have access to specific implicit rates available in the marketplace. The United States notes, however, that an importer does not necessarily realize any benefit from a CCC export credit guarantee. CCC has no role in the arrangements between the foreign bank issuing the letter of credit and the importer, which is typically

[75] See US Answer to Panel Question 85 (11 August 2003), paras. 181-183.
[76] US Answer to Panel Question 76 (11 August 2003), para. 144
[77] *Export Credits and Related Facilities*, G/AG/NG/S/13 (26 June 2000)

the account party under the letter of credit. Consequently, the importer may have to pay its bank in full upon disbursement under the documentary letter of credit. The existence of an export credit guarantee transaction also has no necessary effect on the pricing of financing or letter of credit fees that the importer's bank may charge. In this respect, the export credit guarantee transaction is less favourable to the importer than a forfaiting transaction.[78] As the United States has previously observed, forfaiting and export credit guarantee transactions compete as a method for trade financing over comparable tenors in similar markets, but it is difficult to make direct comparisons of implicit rates even among forfaiting transactions themselves.[79]

**224. Please indicate how the CCC's cost of borrowing was treated in the 2002 financial statement of the CCC, in Exhibit BRA 158.**

110. In the 2002 financial statements of the CCC, the cost of borrowing is treated as interest expense. It is included as part of the Net Cost of Operations set forth in Exhibit US-129, entitled "Commodity Credit Corporation Consolidated Statement of Net Cost (Note 13) for the Fiscal Year Ended 30 September 2002)." A separate column is presented for Foreign Programmes, of which the Export Credit Guarantee programmes are a part. Borrowing costs are subsumed within "Intragovernmental Gross Costs". CCC also earns interest on monies held by Treasury. These interest collections become a component of "intragovernmental earned revenue." The net result is the difference between these two figures in a given year.

111. With respect to the export credit guarantee programmes specifically, this "interest on debt to Treasury" and "interest on uninvested funds" are reflected in the financing account portion of each budget. As interest expense and revenue are necessarily homogenized numbers, they are not readily allocated to cohorts. Actual interest expense and revenue figures for a particular fiscal year are set forth in line 00.02 and 88.25 of the financing account provisions of each budget. The following table sets out these figures, which are also reflected in the table responding to question 222 above.

[78] See, generally, US Further Submission (30 September 2003), paras. 157-162
[79] US Rebuttal Submission (22 August 2003), para. 189-191

**CCC Export Credit Guarantee Programme -- Financing Account**
**Payments of Interest on Borrowings from Treasury (00.02) and**
**Interest Earned on Uninvested Funds (88.25)**
**Programming Years 1992 – 2002**
($ Millions)

| **Annual President's Budgets** | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Programme Year** | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| 1992 Actuals | | | | | | | | | | | |
| Interest on Borrowings | $0 | | | | | | | | | | |
| Interest Earned | (1) | | | | | | | | | | |
| 1993 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | $0 | | | | | | | | | |
| Interest Earned | | (16) | | | | | | | | | |
| 1994 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | $0 | | | | | | | | |
| Interest Earned | | | (0) | | | | | | | | |
| 1995 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | $10 | | | | | | | |
| Interest Earned | | | | (0) | | | | | | | |
| 1996 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | $61 | | | | | | |
| Interest Earned | | | | | (26) | | | | | | |
| 1997 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | $62 | | | | | |
| Interest Earned | | | | | | (26) | | | | | |
| 1998 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | | $62 | | | | |
| Interest Earned | | | | | | | (54) | | | | |
| 1999 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | | | $62 | | | |
| Interest Earned | | | | | | | | (0) | | | |
| 2000 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | | | | $62 | | |
| Interest Earned | | | | | | | | | (99) | | |

| **Annual President's Budgets** | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Programme Year** | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| 2001 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | | | | | $104 | |
| Interest Earned | | | | | | | | | | (125) | |
| 2002 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | | | | | | $93 |
| Interest Earned | | | | | | | | | | | -61 |

**225. Please indicate whether there was any instance where the CCC "wrote off" debt and, if so, please indicate the accounting regulation or principle used. If a "written off" debt is subsequently recovered, do the CCC's accounts reflect both the interest cost and interest received in relation to the debt during the time it was "written off"? USA**

112. A complete response to this question requires a vocabulary distinction between "write off" for purposes of CCC accounting and debt forgiveness. A "write off" conventionally is used to describe debt that CCC itself independently determines to be uncollectible. This determination is made by the Controller of CCC.

113. Debt forgiveness, on the other hand, refers to multilaterally agreed debt forgiveness, usually through the Paris Club, that is subsequently implemented by the United States and CCC through legislation or other internal mechanisms to eliminate the outstanding debt. As a result, in the more common parlance, that debt too is written off.

114. Historically, debt forgiveness is far larger than independent "write off." CCC has independently written off as uncollectible only approximately $190,000 of private sector debt with respect to the export credit guarantee programmes as follows:

| Cohort | Fiscal Year of Write Off | Country | Amount |
|---|---|---|---|
| Pre-1992 | 1995 | Nigeria | $129,000 |
| Pre-1992 | 1999 | Argentina | 48,000 |
| 1992 | 1999 | Russia and Former Soviet Union | 13,000 |

Debt forgiveness:

| Cohort | Fiscal Year of forgiveness | Country | Amount |
|---|---|---|---|
| Pre-1992 | 1991, 1994 | Poland | $1,406,000,000[80] |
| Pre-1992 | 1997 | Yemen | 1,686,000 |
| Pre-1992 | 1999 | Honduras | 5,951,000 |
| Pre-1992 | 2002 | Former Yugoslavia | 3,343,000 |
| Pre-1992 | 2002 | Tanzania | 8,806,000 |

None of the foregoing debt in either table has been recovered.

**226. If a debt was "written off" more than ten years ago, does it still create a cost to the programme? If so, how is this reflected in the 2002 financial statement of the CCC, in Exhibit BRA 158 (or any other material)?**

115. The provisions of the Federal Credit Reform Act first took effect with fiscal year 1992, which commenced on 1 October 1991. Write-offs before 1 October 1991 would have no continuing effect in the current financial statements of CCC, as such write-offs would have been reflected as part of the operating loss of the corporation, which in turn was replenished through the annual appropriations process in the year following such write-off.

[80] This amount is approximate as it requires allocation of write off related to debt arising from various programmes.

116. Write-offs after 1 October 1991 also would not independently create an expense. Upon payment of a claim on an export credit guarantee, CCC receives a fully subrogated position to collect from the defaulting obligor. As a result, this debt is then reflected as a loan receivable for both budgetary and financial statement purposes. In accordance with paragraph 61 of Statement of Federal Financial Accounting Standard No. 2,[81]:

> When post-1991 direct loans are written off, the unpaid principal of the loans is removed from the gross amount of loans receivable. Concurrently, the same amount is charged to the allowance for subsidy costs. Prior to the write-off, the uncollectible amounts should have been fully provided for in the subsidy cost allowance through the subsidy cost estimate or reestimates. Therefore, the write-off would have no effect on expenses.

> **227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount - referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? USA**

117. Brazil wrongly describes this amount as "record losses . . . for its guarantee programmes over the period 1992-2002."[82] This figure does *not* represent a loss. It is a *prospective* estimate at a particular moment in time of anticipated experience under the programme. It is, like the budget figures, an estimate.

118. The $411 million figure is simply another manifestation of the estimate and re-estimate process required under the Credit Reform Act of 1990 and reflected in the budget figures of the United States. As a result, it is another depiction, albeit in a different format, of the results of the estimate and re-estimate process.

119. Just as the estimate figures in the budget proceed in a downward direction (i.e., good performance), one would expect this corresponding estimate figure in the CCC Financial Statements to do the same. And it does. On the corresponding page of the Notes to Financial Statements 30 September 2003 and 2002[83], the $411 million figure has declined to $22 million.

120. As reflected on page 19[84] of Exhibit Bra-158 and on its 2003 analog, the $411 million figure and the more recent $22 million figure are the result net of "interest rate reestimate" and "technical/default reestimate". The figure, net of such total subsidy reestimates, is then brought forward to the subsequent year (as is manifest on page 19 from 2001 to 2002 and in turn from 2002 to 2003). Prior years' figures similarly brought forward are also figures net of "total subsidy reestimates".

121. Furthermore, Appendix E of the Statements of Federal Financial Accounting Concepts and Standards of the Financial Accounting Standards Advisory Board is a consolidated glossary of terms

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[81] Exhibit US-127.

[82] The most recent example of this repeated assertion is in paragraph 84 of the 2 December 2003, Statement of Brazil.

[83] Audit Report, Commodity Credit Corporation, Financial Statements for Fiscal Years 2003 and 2002, Note 5, page 19. (Exhibit US-129).

[84] The information and format of this page are required by Statement of Federal Financial Accounting Standards No. 18: Amendments To Accounting Standards for Direct Loans and Loan Guarantees In Statement of Federal Financial Accounting Standards No. 2, Appendix B: Schedule B, entitled "Schedule for Reconciling Loan Guarantee Liability Balances." Exhibit US-125 , p. 990 (Exhibit US-125: http://www.fasab.gov/pdf/cod4.pdf pages 967-993).

applicable to GAAP for federal entities. That glossary defines "liability" as: "For Federal accounting purposes, a probable future outflow or other sacrifice of resources as a result of past transactions or events." Loss, on the other hand, is: "Any expense or irrecoverable cost, often referred to as a form of nonrecurring charge, an expenditure from which no present or future benefit may be expected."[85] The $411 million figure in the 2002 Financial Statements and the $22 million figure in the 2003 Financial Statements describe "credit guarantee liability," not loss.

**228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? BRA, USA**

122. Financial statements of the Commodity Credit Corporation are prepared in accordance with generally accepted accounting principles (GAAP), based on accounting standards promulgated by the Federal Accounting Standards Advisory Board (FASAB).[86] In October, 1999, this board was designated by the American Institute of Certified Public Accountants (AICPA) as the standards-setting body for financial statements of federal government entities, with respect to the establishment of generally accepted accounting principles. On October 19, 1999, AICPA adopted an amendment to its Code of Professional Ethics to recognize accounting standards published by the FASAB as GAAP for federal financial reporting entities. The amendment recognized FASAB as the source of GAAP for federal entities. Consequently, no incompatibility of accounting principles exists.

## E. SERIOUS PREJUDICE

**230. Please comment on Brazil's views on Article 6.3 of the SCM Agreement as stated in paragraphs 92-94 of its further submission. USA**

123. Brazil's arguments fail to convince. First, Brazil complains that "[t]here is no valid basis for the US interpretation that the word "may" in the chapeau of Article 6.3 of the SCM Agreement [to] mean[] that a complainant - in addition to demonstrating the existence of one of the effects listed in the subparagraphs, e.g., significant price suppression - must also make a separate showing of 'serious' prejudice."[87] Brazil may choose to believe there is no "valid" basis, but there is a clear textual basis for the US interpretation: the ordinary meaning of the word "may."

124. The ordinary meaning of "may" is "have ability or power to; can."[88] Therefore, the chapeau of Article 6.3 permits but does not require a finding that serious prejudice exists when one of the situations in Article 6.3 is demonstrated.

125. Second, Brazil argues that the use of "may" in Article 6.3 is merely intended to reflect that there are "situations in which the four enumerated types of serious prejudice exist but are not actionable." For example, Brazil points to Article 6.7, which delineates certain circumstances in which displacement or impeding of exports shall not arise, and Article 6.9, which states that Article 6 does not apply to measures that conform to the Peace Clause. Brazil's argument is badly flawed. The ordinary meaning of the chapeau to Article 6.3 does not suggest that serious prejudice must arise if one of the situations in Article 6.3 exists. If the drafters had intended merely to suggest that exceptions to Article 6.3 exist, they succeeded instead in creating a provision that does not compel

[85] Statement of Federal Financial Accounting Concepts and Standards (May 2002), Appendix E, pages 1140-1141 (Exhibit US-130).
[86] The website for the FASAB is www.fasab.gov.
[87] Brazil's Further Rebuttal Submission, para. 92.
[88] *New Shorter Oxford English Dictionary*, vol.1, at 1721.

any finding of serious prejudice in a circumstance in which one of the criteria under Article 6.3 is met, even when the circumstances in Articles 6.7 and 6.9 are met.

126. Indeed, the text of Article 6 does reflect Members' decision to create in Articles 6.1 and 6.2 exactly the sort of mandatory presumption / exception structure that Brazil attempts to read into Article 6.3. Article 6.1 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 *shall be deemed to exist* in [certain] case[s]" (emphasis added). Article 6.2 states that, "*[n]otwithstanding* the provisions of paragraph 1, serious prejudice *shall not be found* if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3" (emphasis added). By way of contrast, Articles 6.3 and 6.7 do *not* use mandatory language (for example, "shall be deemed to exist" / "shall not be found") to establish a presumption / exception relationship. Rather, the language of Article 6.3 is permissive, and Article 6.7 is not expressed as an exception to a mandatory finding under Article 6.3.

127. Brazil's reference to Article 6.9 is inapt. We note that Article 6.9 does not limit its application to situations under Article 6.3. Rather, it states: "This *Article* does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture" (emphasis added). The language of Article 6.9 indicates that it applies to *all* of the provisions under "[t]his Article." Thus, according to Brazil's logic, every affirmative use of the word "shall" in Article 6 (for example, Article 6.1: "Serious prejudice shall be deemed to exist . . . ."; Article 6.4: "[D]isplacement or impeding of exports shall include . . . ."; Article 6.5: "[P]rice undercutting shall include . . . .") should have been written "may" to reflect the fact that "even where the requirements of [that provision] are fulfilled," the "subsidies are exempt from action by virtue of the peace clause of Article 13 of the Agreement on Agriculture." Those other provisions *do* use the term "shall," however, suggesting that the term "may" in Article 6.3 was used deliberately and according to its ordinary meaning.

128. Finally, Brazil asserts that "Article 6 is silent on the nature of the alleged additional requirements for a finding of 'serious' prejudice."[89] This is not wholly accurate. For example, as Question 229 from the Panel to Brazil notes, the chapeau to Article 6.3 indicates that "[s]erious prejudice . . . may arise in any case *where one or several of the following apply*" (emphasis added). Therefore, the Panel could conclude that where more than one prong of Article 6.3 is satisfied, the likelihood that the result is "serious prejudice" increases. Furthermore, Brazil points to additional details provided in Article 6.4 on displacement or impedance and in Article 6.5 on price undercutting as suggesting that a finding of "serious prejudice" must result if one prong of Article 6.3 is satisfied. However, Brazil draws no consequence from the lack of" detailed definitions" capable of application for Articles 6.3(a), 6.3(c) (significant prices suppression, price depression, or lost sales), or 6.3(d).

129. Finally, Brazil claims that the United States did not assert and the panel in *Indonesia - Automobiles* did not find any separate "serious prejudice" requirement in Article 6.3. As the United States notes in its answer to Question 234, the permissive ("may") language of the chapeau to Article 6.3 would not preclude the Panel from concluding that a finding under one prong of Article 6.3 suffices to establish serious prejudice. As Article 6.8 suggests, "the existence of serious prejudice should be determined on the basis of the information submitted to or obtained by the panel" – that is, on a case-by-case basis. Thus, the Panel will be called upon to exercise its judgment on the quality of the evidence on causation and on the extent of any alleged effects. To reiterate one hypothetical example suggested at the second panel meeting, were a complaining party to make a *prima facie* case that *one unit* of its exports had been displaced from the market of the subsidizing Member, the situation in Article 6.3(a) would technically have been demonstrated. Such a situation, however, would lend itself to the exercise of the Panel's discretion not to find serious prejudice. This is the type of flexibility that the chapeau to Article 6.3 gives the Panel and which Brazil 's interpretation would read out of the Subsidies Agreement.

[89] Brazil's Further Rebuttal Submission, para. 94.

**231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the SCM Agreement are relevant context for the Panel's interpretation of Article 6.3? USA**

130. The United States believes that both Article 6.1 and Annex IV of the Subsidies Agreement provide relevant context for interpreting "serious prejudice" within the meaning of Article 5(c) and Article 6.3. As the Panel's question notes, Article 6.1 has expired pursuant to Article 31, which established that Article 6.1 would "apply for a period of five years, beginning with the date of entry into force of the WTO Agreement," unless the Committee on Subsidies and Countervailing Measures determined to extend its application. Annex IV is entitled, "Calculation of the Total Ad Valorem Subsidization (Paragraph 1(a) of Article 6)," and by its terms establishes a methodology to calculate "the amount of a subsidy for the purpose of paragraph 1(a) of Article 6." Thus, since the provision it is meant to implement is no longer in effect, Annex IV as well is no longer directly applicable.

131. The context provided by these provisions, of course, must be judged in light of the fact that Members did *not* agree to extend Article 6.1(a). That is, it is highly relevant that the provision establishing a rebuttable presumption of serious prejudice upon a showing of a 5 per cent *ad valorem* subsidization rate was allowed by Members to lapse. On the other hand, no decision on whether to extend Annex IV was contemplated or taken pursuant to Article 31. In addition, we note that in *United States – Countervailing Measures (EC)*, the Appellate Body relied on Annex IV as context in interpreting another provision of the Subsidies Agreement.[90] Thus, although the underlying provision attaching a consequence to a certain subsidization rate lapsed, it is appropriate to examine how Members agreed in Annex IV a subsidy not tied to the production or sale of a given product would be allocated across the total value of the recipient's production.

132. The Panel must utilize some methodology to determine the benefit to upland cotton from a subsidy not tied to production of upland cotton. For example, Part V does not expressly set out an allocation methodology, but the same methodology of allocating an untied subsidy across the total value of the recipient's production is applied by several Members (for example, the European Communities and the United States) for purposes of their countervailing duty law. Indeed, Brazil itself has proposed in the Negotiating Group on Rules that Members adopt a "guideline" on calculating the amount of the subsidy for countervailing duty purposes precisely setting out the methodology contained in Annex IV.[91] The Panel should consider whether Brazil's refusal to countenance any allocation of the decoupled payments it has challenged is credible given the fact that Brazil in its Rules proposal and Annex IV as agreed by Members both express the same approach to allocating non-tied subsidies across production. Thus, the United States believes that Annex IV continues to provide useful context for the necessary task of identifying the products that benefit from a subsidy not tied to the production or sale of a given product.

**234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"?**

133. "Significant" price suppression under Article 6.3(c) does not necessarily amount to "serious prejudice" within the meaning of Article 5(c). This conclusion flows from the ordinary meaning of

[90] WT/DS212/AB/R, para. 112. Similarly, in *United States – FSC: Article 22.6*, Arbitrator cited the expired Articles 8 and 9 as "helpful . . . in understanding the overall architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address." WT/DS108/ARB, note 56.

[91] Paper by Brazil, Countervailing Measures: Illustrative Major Issues, TN/RL/W/19, at 6 (7 October 2002) ("If the benefit of a subsidy is limited to a particular product, the denominator should reflect only sales [production/exports] of that product. If this is not the case, the denominator should be the recipient's total sales.").

the text of Article 6.3(c): "Serious prejudice in the sense of paragraph (c) of Article 5 *may* arise in any case where one or several of the following apply." The ordinary meaning of "may" is "have ability or power to; can." Therefore, the existence of one of the situations in Article 6.3 is a necessary condition for a finding of serious prejudice but may not be sufficient.

134. Brazil argues that the use of "may" in Article 6.3 is merely intended to reflect that Article 6.7 delineates certain circumstances in which displacement or impeding of exports shall not arise. However, the ordinary meaning of the chapeau to Article 6.3 does not suggest that serious prejudice must arise if one of the situations in Article 6.3 exists. Further, the text of Article 6 reflects Members' decision to create just such a mandatory presumption / exception structure in Article 6.1 and 6.2. Article 6.1 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 *shall be deemed to exist* in [certain] case[s]" (emphasis added). Article 6.2 states that, "[n]otwithstanding the provisions of paragraph 1, serious prejudice *shall not be found* if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3" (emphasis added). Article 6.3 and 6.7 do *not* use mandatory language ("shall be deemed to exist" / "shall not be found") to establish a presumption / exception relationship. Rather, the language of Article 6.3 is permissive, and Article 6.7 is not expressed as an exception to a mandatory finding under Article 6.3.

135. At the same time, the United States does not believe the text of the chapeau to Article 6.3 *precludes* a finding of serious prejudice where only "significant price suppression" by the subsidized product "in the same market" as a like product and no other situation in Article 6.3 has been demonstrated. Thus, it is conceivable that the effect of a subsidy could be price suppression so significant that it alone rises to the level of serious prejudice to the interests of another Member.

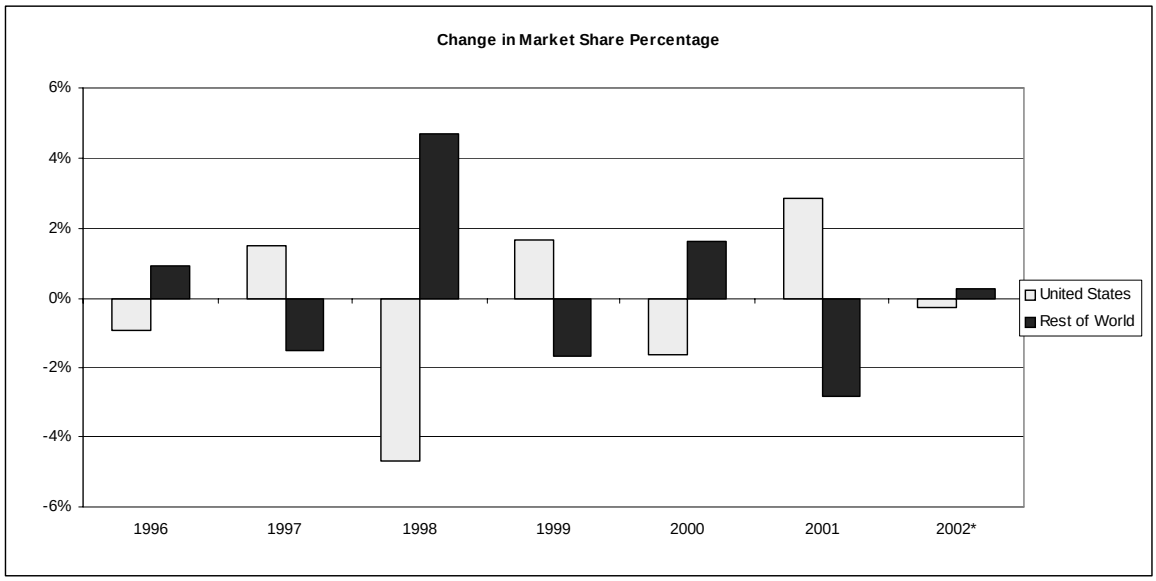
136. We recall that Brazil's interpretation is that price suppression would be "significant" even at a level of 1 cent per pound because this could still "meaningfully affect" its producers.[92] The use of the term "significant," however, would seem to be intended to prevent insignificant price effects from rising to the level of serious prejudice. For example, were the term "significant" omitted from Article 6.3(c), *any* production subsidy (for example, a per-unit payment of 0.0001 cents per pound of production) would be deemed to satisfy Article 6.3(c) because *any* increase in production resulting from the subsidy would *theoretically* result in some price effect. Coupled with Brazil's reading of "may arise" in the chapeau of Article 6.3, this would result in any production subsidy running afoul of Articles 5 and 6, effectively undermining the separation of Part III of the Subsidies Agreement on "Actionable Subsidies" from Part II on "Prohibited Subsidies."

> **236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share".**

137. The graph shows the year-over-year percentage change in the world market share over 1996-2002. US world market share is defined as in Exhibit US-47 as the quantity of consumption of US cotton (domestic mill use + exports) relative to world cotton consumption.

138. The annual change in the US market share is relatively slight with the exception of 1998 when severe drought, primarily in Texas, caused US production to fall significantly.

[92] *See* Brazil's Further Submission, para. 256.




**237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? BRA, USA**

139. It would not appear that a phenomenon (world market share) that remains at approximately the same level over a given period of time could be considered a "consistent trend" within the meaning of Article 6.3(d). This follows from the text of Article 6.3(d) itself because the "effect of the subsidy" must be an *increase* in world market share (as compared to the preceding three-year period), and "this increase [must] follow[] a consistent trend over a period when subsidies have been granted." Thus, if world market share remains at approximately the same level over a given period of time, the trend would not be an "increase" in world market share; hence, the trend would not be a "consistent trend" within the meaning of Article 6.3(d). And, in fact, the data do not demonstrate that US world market share has increased following a consistent trend over a period when subsidies have been granted.[93]

**238. According to the US interpretation of the term "world market share":**

**(a) should the domestic consumption of closed markets be added into the denominator?**

140. It is not clear from the Panel's question what is meant by "closed markets," but the US reading of Article 6.3(d) is that "world market share . . . in a particular subsidized primary product or commodity" means just that: a Member's share of the world market in, for example, upland cotton. There is nothing in the text of Article 6.3(d) that supports excluding any portion of the "world" from the analysis. For this reason, Brazil's reading of this provision as solely relating to world export trade necessarily excludes any portions of the "world market" for upland cotton that do not import, no

[93] *See, e.g.*, US Opening Statement at the Second Panel Meeting, paras. 12-13 ("That is, the facts demonstrate that since marketing year 1996, US world market share has increased and then decreased in alternating years, and US world market share in marketing year 2002 (19.6 per cent) is lower than in marketing years 1996 and 1997 (20.4 and 21.6 per cent, respectively).").

matter the size of that market. Such a result runs contrary to the ordinary meaning of the terms of the provision.

141. We note that excluding consumption from "closed markets" in the world market share calculation would increase the overall market share of the United States (and other suppliers) because the total world consumption figure would be lower. However, the variation in market share across years would not change appreciably assuming that the level of consumption in closed markets was relatively constant.

**(b) if US production and consumption increased by the same percentage, whilst the rest of the world's production and consumption remained steady, would this imply an increase in the US "world market share" by a different percentage?**

142. The United States interprets this question as asking whether the US market share would increase if an increase in US cotton consumption was completely supplied by increased US production without any changes to the consumption and supply patterns of the rest of the world. Under the US approach to "world market share," US world market share would increase.[94] The amount of increase in the US world market share would depend largely on the size of US consumption relative to world consumption.

143. Under Brazil's approach to Article 6.3(d), however, an increase in a Member's cotton consumption that was completely supplied by increased production by that Member would result in no change in that Member's world market share since there was no change in the Member's exports. Brazil's approach, therefore, would allow a larger or even dominant cotton consumer to provide huge per-unit production subsidies that increased the share of its own domestic consumption that its producers supplied without any discipline under Article 6.3(d), regardless of the impact on other Members who could potentially supply that increasing domestic consumption. Such a result runs contrary to the ordinary meaning of "world market share" in Article 6.3(d) since the term "world market" would captures impacts both in the market of the subsidizing Member (as in Article 6.3(a)) and in third-country markets (Articles 6.3(b) and 6.3(c)).

**(c) does Saudi Arabia have a small world market share for oil?**

144. The relevance of this question is not entirely clear since Article 6.3(d) does not speak of "large" or "small" world market shares. That is, it is only a certain *increase* in world market share, from whatever level, that follows a consistent trend over a period when subsidies have been granted that is relevant to the 6.3(d) analysis.

145. Nonetheless, we note that Saudi Arabia exports crude oil but also refines petroleum into products that it consumes and refines as well. Based on 2000 world petroleum supply and disposition data for 2000, Saudi crude oil exports account for about 16 per cent of total world exports. Using an analogous measure for consumption (exports plus domestic consumption–i.e., refining–divided by total world consumption) gives a market share of 12 per cent.

**239. How does the US respond to Brazil's assertions that, under the US interpretation of the term "world market share":**

**(a) there would be no WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports? (see paragraph 64 of Brazil's 2 December oral statement);**

[94] US world market share = (US domestic use of US cotton + US exports)/world consumption of cotton

**(b) a Member's exports would have to be disregarded in calculating their "world market share" in terms of "world consumption"? (see e.g. paragraph 65 of Brazil's 2 December oral statement)**

146. (a) We note that Brazil must repeatedly insert the term "export" into the phrase "world market share of export" or "world export share" in order to convey a meaning restricting the term "market share" to exports. That is because the ordinary meaning of "world market share" would be all those markets in which cotton is consumed. Further, Brazil's argument is overstated. There would be disciplines on production-enhancing subsidies, even those that increase a Member's world market share *of exports* (even though that is not an WTO obligation in and of itself). Under Article 6.3(d), for example, a Member's world market share is determined by its domestic consumption plus exports of the product it produces. If a subsidy increased the Member's exports, and domestic consumption and world consumption remained the same, the increase in the Member's exports alone would increase that Member's world market share.

147. Further, production-enhancing subsidies with export effects could be inconsistent with Article 5(a) (injury), Article 6.3(b) (displace or impede exports to third country markets), Article 6.3(c) (lost sales), or GATT 1994 XVI:1 (serious prejudice).

148. (b) It is interesting that Brazil, which roundly rejects the use of any concepts from Part V or Annex IV of the Subsidies Agreement or from the Safeguards or Anti-Dumping Agreements when these are inconvenient for it, here tries to introduce "the ordinary meaning in a trade remedy context of 'domestic consumption'." The Panel's task is not to interpret the term "domestic consumption" but rather the "world market share of the subsidizing Member in a particular subsidized primary product or commodity". The United States has proposed that the US share of the world market for upland cotton must be measured by that portion of world consumption of upland cotton satisfied by US upland cotton. That necessarily must include US domestic consumption satisfied by US upland cotton. Again, we note that a relevant "market" for serious prejudice purposes is the market of the subsidizing Member under Article 6.3(a). There is no basis in the text or context of 6.3(d) to exclude that market from the "world market" identified in 6.3(d).

**240. Does Article XVI:3 of GATT 1994 provide context in interpreting Article 6.3(d) of the SCM Agreement? Do these provisions apply separately? If not, could it indicate that "world market share" is intended to mean the same as "share of world export trade"?**

149. GATT 1994 Article XVI:3 provides some context to reading Article 6.3(d). Both provisions are addressed to subsidies that have effects on primary products. However, the context they provide also consists of the *differences* in their respective texts. GATT 1994 Article XVI:3 is limited to export subsidies, as Brazil acknowledged and agreed in the Tokyo Round Subsidies Code. (Brazil does not, because it cannot, deny that in the Tokyo Round it expressed its understanding that GATT 1994 Article XVI:3 applies only to export subsidies. The Panel can judge how credible it finds Brazil's change of opinion in this dispute.) GATT 1994 Article XVI:3 relies on an "equitable share" concept that panels and Members found incapable of definition or application. Moreover, Brazil has not provided any objective definition in this dispute of the "equitable share" concept but to argue that anything other than a non-subsidized level of exports is inequitable, a reading that would convert Article XVI:3 into a prohibition on domestic subsidies with production effects.

150. Article 6.3(d) of the Subsidies Agreement, on the other hand, applies to all subsidies and has objective criteria that are capable of application. This provision sets forward a mechanical test: a Member's share of the world market for a product must be greater than preceding 3-year average, and the increase must follow a consistent trend over a period when subsidies have been granted. Therefore, there is no "inequitable share" concept to deal with, and the consistency of a Member with its obligations is a straightforward matter to determine.

151. The United States does not see any basis to say that "world market share" was intended to mean the same as the "share of world export trade". The key difference is the use of the term "market" instead of "export". The term "market" can, of course, mean a domestic market; its meaning is not limited to markets in international trade. "Export" refers to cross-border transactions; therefore, a more limited set of transactions would be of interest. As a result, the term "world market share" requires that one look at all places where upland cotton is consumed and determine what portion of world consumption of is satisfied with US upland cotton.

**241. How does the US reconcile its data on consumption for 2002 in US Exhibit 40, Table 1 with the "consumption" data it refers to in its 30 September submission, paragraph 34, Exhibit US-47 or US-71? USA**

152. In paragraph 34 of the 30 September submission and in the accompanying table, "consumption" is used to capture both the domestic use of raw cotton production (that is, the "mill use" figure), plus the raw cotton equivalent of textile imports (that is, how much raw cotton is incorporated into manufactured cotton textile imports). This point is crucial to understanding how the growth in cotton textile imports has contributed to the decline in consumption of US domestically produced raw cotton for domestic manufacturing, which has resulted in more US domestic cotton finding a home in off-shore markets. That is, much US domestic cotton that is exported returns to the United States in the form of textiles and apparel.[95]

153. In Exhibits 40, 47, and 71, the data on consumption correspond to the "mill use" data described above. The only difference is that these data are on a crop year basis (August - July). Therefore, the mill use figure in paragraph 34 of the US further submission will differ slightly from the consumption figure in the other exhibits. They are the same data, adjusted for different periods. The most recent domestic consumption (that is, mill use) figure is given in the response to Question 197.

**242. How much of the benefits of PFC, MLA, CCP and Direct Payments go to land owners? If not all of the benefits go to land owners, what proportion goes to producers? USA**

154. As noted in the US further rebuttal submission, the literature on direct payments suggest that a large portion of direct payments get capitalized into land values. As Burfisher and Hopkins (2003) note: "Not all operators can . . . be considered as true beneficiaries of the [PFC] programme, since competitive cropland rental markets work to pass through payments from PFC recipients who are tenants to the owners of base acres."[96] Thus, the effects of increased wealth largely accrue to non-operators, and any theoretical production effects are further minimized.

155. In well-functioning markets, asset prices reflect expectations about the future returns from their ownership. The PFC programme covered a fixed number of base cropland acres, established in 1996 when farmers enrolled in the programme, and benefits did not require current production. The direct link between base acres and the known programme benefits allowed the future stream of payments to be efficiently capitalized into land values:

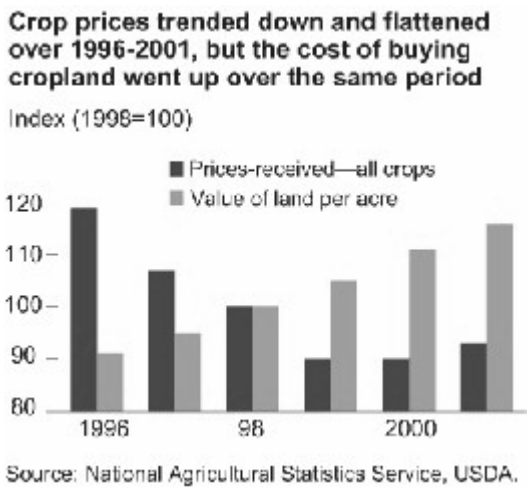
> Decoupled payments clearly increase the well-being of the operators who receive them, but only when they are owners of base acres. Otherwise, land markets allow a pass-through of payments from operators to landowners, via modified rental

[95] The data in the table in paragraph 34 are on a calendar year basis in order to match them with the import data from the US Bureau of the Census.

[96] Burfisher, M. and J. Hopkins. "Farm Payments: Decoupled Payments Increase Households' Well-Being, Not Production." *Amber Waves*, Vol. 1, Issue 1, (February 2003): 38-45, at 44 (Exhibit US-78)

arrangements. Despite uncertainty over future policy, land values already reflect the market's expectations about future programme benefits.[97]

156. Land values set by sales and rental markets can be examined to see whether they track commodity price trends. If these values diverge from prices, it suggests that land markets have additionally capitalized the present and expected future value of government payments. As the figure from Burfisher and Hopkins (2003) below demonstrates, commodity prices have fallen since 1996 due to a number of factors while land values have trended upward, consistent with land capitalization of payments. Land rent data, although more fragmented, follow the same trend as land values.




157. In its 27 October answer to Question 179 and in paragraph 57 of its oral presentation of 2 December, Brazil attempts to minimize the effects of direct payments on land by citing a recent study that showed that 34-41 cents per dollar of PFC payment were capitalized into land rents in MY 1997. However, in citing this study, Brazil effectively concedes the US analysis. The study cited by Brazil analyzes cash rent data in only *the first year* following implementation of the 1996 Act and the decoupled production flexibility contract payments. As the authors of the study acknowledge, cash rents may be "sticky" and adjust over the long run.[98] For example, not all rental contracts would be year-to-year; as additional multi-year rental contracts expire, landowners would be expected to adjust rents to capture the value of the decoupled payments made with respect to the base acreage on the land.

158. In the long run, only those upland cotton producers who are owners of upland cotton base acres will receive the benefit of those decoupled payments. Based on 1997 cost of production data, about 35 per cent of cotton production is grown by owner-operators. Therefore, only 35 per cent of the value of decoupled payments would benefit upland cotton producers, and this subsidy benefit would then have to be attributed across the total value of the recipient's production in order to determine the benefit to upland cotton.

**243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? USA**

[97] Burfisher, M. and J. Hopkins. "Farm Payments: Decoupled Payments Increase Households' Well-Being, Not Production." *Amber Waves*, Vol. 1, Issue 1, (February 2003): 38-45, at 45 (Exhibit US-78)

[98] *See* Roberts *et al.*, at 769 (Exhibit Bra-310).

159. If the United States has understood the Panel's question, the answer would appear to be no. To explain this answer, we distinguish between three types of subsidies: (1) a subsidy tied to production of upland cotton, (2) a subsidy tied to production of another commodity, and (3) a subsidy not tied to the production of any commodity. In the first case, a subsidy tied to production of upland cotton (for example, marketing loan payments) would be support to upland cotton exclusively, even if the upland cotton producer also produces other commodities. In the language of Annex IV, a subsidy that "is tied to the production or sale of a given product" is deemed to subsidize "the recipient firm's sales of that product."[99] Similarly, in the second case, a subsidy tied to the production of another commodity (for example, marketing loan payments for soybeans) are deemed to benefit that commodity exclusively. Thus, such payments – which depend upon production of a commodity other than upland cotton – would not be deemed to benefit upland cotton.

160. In the third case, a subsidy not tied to the production or sale of a given product (for example, decoupled income payments) would be deemed to subsidize any product sold by the recipient. Annex IV establishes that the value of the subsidized product for such a payment is "the total value of the recipient firm's sales."[100] Logically, a subsidy not tied to a particular product provides a benefit to the recipient in the form of increased income. Since money is fungible, the benefit can be deemed to inure to all of the products the recipient produces; a neutral way of attributing the subsidy to particular products is according to their proportion of the firm's sales. Thus, for purposes of Subsidies Agreement analysis, such a non-tied payment would be deemed to benefit upland cotton and any other commodity the recipient produces.

161. It is worthwhile to compare these Subsidies Agreement concepts of payments tied to productions or sale and payments not tied to production or sale to Agriculture Agreement concepts of product-specific and non-product-specific. The two sets of concepts are not identical. Recall that Article 1(a) of the Agreement on Agriculture establishes that product-specific support is "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product" while non-product-specific support is a residual category of "support provided in favour of agricultural producers in general." Thus, product-specific support is "tied to the production or sale of a given product" within the meaning of the Subsidies Agreement (Annex IV, para. 3) because it must be "provided for *an* agricultural product" and must be "in favour of *the producers of the* basic agricultural product."

162. Non-product-specific support is not tied to the production or sale of a particular product since it is provided to producers in general – for example, decoupled payments for which the recipient need not produce any particular commodity or any commodity at all. However, as noted above, such a non-tied payment will be allocated over the total value of the recipient's production. Hence, it could be possible to derive the benefit to upland cotton for purposes of the Subsidies Agreement from non-product-specific support.

163. Brazil would take these different concepts and suggest that any support that is not tied to production must be allocated to a particular crop; such support would be "support to a specific commodity" within the meaning of the Peace Clause. However, Brazil's approach eliminates the concept of non-product-specific support for purposes of Peace Clause since a non-tied payment may always be allocated according to the recipient's production (and, in Brazil's approach, then be deemed "support to a specific commodity"). It would appear anomalous to import into Article 13 of the Agreement on Agriculture a concept from the Subsidies Agreement (that itself is only reflected in Annex IV, which Brazil does not believe is relevant to actionable subsidies claims) that renders inutile such a key concept from the Agreement on Agriculture. Such an interpretation, moreover, runs contrary to the ordinary meaning of the phrase "support to a specific commodity." As the EC pointed out, support cannot at the same time be "support to a specific commodity" and "support to multiple

[99] *See* Subsidies Agreement, Annex IV, para. 3.
[100] *See* Subsidies Agreement, Annex IV, para. 2.

commodities." And yet, allocating a non-tied payment across the total value of the recipient's production necessarily means that the payment is support *not* to a specific commodity but rather to multiple commodities (in fact, any commodities the recipient happens to produce).

164. Thus, it is important to distinguish Agreement on Agriculture concepts for purposes of Peace Clause from Subsidies Agreement concepts for purposes of identifying the amount of subsidy benefit and subsidized products. While decoupled payments – properly allocated – may provide support to upland cotton within the meaning of the Subsidies Agreement, they do not provide support to a specific commodity within the meaning of the Peace Clause. In fact, such decoupled payments provide support to any commodities the recipient happens to produce.[101]

**245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the SCM Agreement? BRA, USA**

165. A subsidy that is green box – that is, conforms fully to the provisions of Annex 2 to the Agreement on Agriculture – is "exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement" pursuant to Article 13(a)(ii) of the Agreement on Agriculture. Therefore, green box subsidies may not be taken into account when considering whether a Member has caused serious prejudice to the interests of another Member through the use of any other subsidy for purposes of Article 5 nor when considering the "effect of" any other subsidy for purposes of Article 6.

**246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the SCM Agreement? BRA, USA**

166. The United States has previously indicated that it takes no position on whether prohibited subsidies may be taken into account in considering "the effect of the subsidy" under Article 6 or whether the use of any subsidy has caused adverse effects. We note, however, that there may be limited utility in making a finding that a subsidy is prohibited and then finding that that subsidy contributes to "adverse effects" or "serious prejudice." Once the DSB adopts findings that a subsidy is prohibited, the responding Member is required to withdraw the subsidy without delay under Article 4. If the same measure were to form part of findings that a Member had caused adverse effects in the form of serious prejudice, for example, the responding Member would presumably be free to argue that the withdrawal of the prohibited subsidy was sufficient to remove the adverse effects. Thus, as the Panel is charged with making findings to promote a prompt settlement of disputes, the Panel should not include any subsidy it deems to be prohibited as part off its actionable subsidy analysis.

**247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? BRA, USA**

167. Under its terms of reference, the Panel is called upon "[t]o examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document."[102] Past panels have concluded that it is appropriate to look at the measures at issue in a dispute as of panel establishment. By that time, it was already

[101] As the United States has noted, finding that non-tied payments, once allocated, could be "support to a specific commodity" would rob Members of the ability to design their measures to be consistent with the Peace Clause. For example, if every recipient of decoupled income support, or any other non-tied payment, decided to produce upland cotton, a Member could be deemed to have granted support in excess of that decided during the 1992 marketing year, solely as a function of producer choices, not that of the Member.

[102] WT/DSB/M/145, para. 35.

evident that the challenged US measures would not pose a threat of serious prejudice. For example, the 2003 harvest season futures price at planting time – 59.60 cents per pound, or a 54.60 expected cash price – suggested that the marketing loan rate (52.00 cents per pound) would have no or minimal effect on planting decisions.[103] The evidence already indicated that US acreage movements corresponded to acreage changes in the (largely unsubsidized) rest of the world.[104] The evidence already indicated that direct and counter-cyclical payments have no more than minimal impacts on production and trade. Thus, by the time of panel establishment the evidence did not support a clearly demonstrated and imminent likelihood of future serious prejudice.

168. The Panel is not precluded from examining evidence subsequent to panel establishment. In fact, both Brazil and the United States have presented such evidence (of course, which cannot alter the Panel's terms of reference). For example, actual market prices and future prices for the 2003 marketing year confirm that producers are receiving higher prices for their 2003 crop and expect to continue doing so for the remainder of the marketing year. Thus, that evidence arising after panel establishment serves to confirm what prior evidence suggested: the evidence does not support a clearly demonstrated and imminent likelihood of future serious prejudice.

## F. STEP 2

**248. In respect of the level of Step 2 payments in certain time periods, the Panel notes, inter alia, footnote 129 in the US first written submission; footnote 33 in the US 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? BRA, USA**

169. Step 2 payments have been zero since the elimination of the 1.25 cents per pound threshold in the 2002 farm bill. This occurred in 5 consecutive weeks beginning 19 September 2002.

170. A Step 2 payment could be zero when the AWP exceeds 134 per cent of the base loan rate (52 cents) or the US/North Europe price is less than the Northern Europe price. If either occurs, the rate will be zero for at least 4 consecutive weeks.

171. Elimination of the 1.25 cent per pound threshold increases the range of price differences in which a step 2 payment could be triggered and raises the resulting payment by 1.25 cents. To some degree, as compared with prior years, the 1.25 cent threshold elimination may correct for some long term changes in the valuation of currencies. Further, at certain price levels where the market price used to determine countercyclical payments is above the loan rate but below 65.73 cents per pound, the additional impact that the Step 2 payment can have on the market price for US cotton can reduce the amount of countercyclical payments received by US producers.

**249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":**

**(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer? How, if at all, would this be relevant for an analysis of the issue of export contingency under the Agreement on Agriculture or the SCM Agreement? BRA**

[103] The futures price in the text is the average daily February closing price for the December contract. As noted in the US further rebuttal submission, para. 162 fn. 124., the January through March average daily closing price (59.10 cents per pound) is not markedly different.

[104] *See, e.g.*, US Opening Statement at the Second Panel Meeting, paras. 5-6.

**(b) How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do not go directly to the producer? USA**

172. By referring to "producers" in this context, the US has referred to producers acting in their capacity as producers of cotton, that is as persons with a risk of loss in cotton that they have planted and harvested. It could be that some large producers of cotton in that sense could also be persons who are manufacturers of cotton or exporters who marketed their cotton directly overseas. In that sense, they could receive payments just as any other manufacturer or exporter could do, but they would be receiving the payment not as a producer of raw cotton but in their other capacity.

173. In short, the regulations are drafted simply to reflect that there may be many ways in which the public may organize itself, but we are assured that the same bundle of cotton will only produce one payment and the breaking of the bundle would only come in connection with the manufacturing process. Officials know of no instance in which a payment was made other than for a legitimate export or for some sort of legitimate manufacturing effort. Again, these payments are received by such persons in their other capacities and not as producers of raw cotton. Such payments simply reflect the universal application of the programme to all cotton uses without a market-interfering government restriction on who may be a manufacturer or exporter of cotton.

**(c) What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. USA**

174. As of the present writing, the United States does not have any data or information on how many producer/manufacturers there are, or how many producer/exporters there are. We do not think that there are many but we continue to search for additional information that might be relevant in this regard.

## H. MISCELLANEOUS

**253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):**

**(a) Does it relate to export credit guarantees, crop insurance and cottonseed payments?**

175. The adjustment authority would not reach export credit guarantees, crop insurance premium payments, or the 2003 cottonseed payment. Section 1601(e) of the 2002 Act, codified at 7 USC 7991(e), states that if the Secretary determines that expenditures under subtitles A through E of Title I of the Farm Bill (which cover the "programme crops") subject to the total allowable domestic support levels under the Uruguay Round Agreements (as defined in section 2 of the Uruguay Round Agreements Act as in effect on the date of enactment of this Act) "will exceed such allowable levels for any applicable reporting period, the Secretary shall, to the maximum extent practicable, make adjustments in the amount of such expenditures during that period to ensure that such expenditures do not exceed such allowable levels." Further the statute provides as to procedure that before making any adjustment under that authority, "the Secretary shall submit to the Committee on Agriculture, Nutrition, and Forestry of the Senate and the Committee on Agriculture of the House of Representatives a report describing the determination made under that paragraph and the extent of the adjustment to be made."

176. It should be noted that interpretation of this language should take into account that, as we have noted throughout, the government cannot predict how much actual expenditures for programme crops will be since those expenditures are sensitive to factors outside the control of the government.

What is clear is that the Congress thought that the problems with total dollar commitments, the AMS, were the only problem likely to arise given that Congress did discipline itself to stay within the support levels of the Peace Clause. The continuation of decoupled payment programmes was anticipated to protect producer income without causing distortions that could increase the level of US world share or could result in price suppression or depression in particular markets. To the contrary, because the Congress anticipated that US prices would still be higher than those elsewhere, the 2002 Act reauthorizes Step 2 payments. There was no contemplation that the mere fact of support, because of the size of the United States, would ipso fact result in a WTO violation, as Brazil would have the Panel make it through its threat of serious prejudice and *per se* claims. This point is made clear in the conference report on the 2002 Act, in which the Congress says:

> *The Conference has made it a priority to craft a programme that provides assistance to producers in a way that is consistent with our obligations under the Uruguay Round Agreement on Agriculture.*[105]

177. That said, the circuit breaker provision by its terms applies only to the cited subtitles of the 2002 Farm Bill and as such does not address expenditures under the export credit guarantees programme, crop insurance, or cottonseed programme, provided for elsewhere. Rather, the circuit breaker provision addresses only expenditures under the programme crop programmes that are covered in the cited subtitles – namely, the direct and countercyclical payments, the marketing loan payment, and Step 2, for all of the programme addressed in Title I. Those programmes would include, in addition to other crops that are the more traditional "programme crops," payments related to sugar, wool, mohair, and peanuts, and various oilseeds.

**(b) Does it relate only to compliance with AMS commitments?**

178. By reference to 19 USC 3501, the reference in Section 1601 is to the entirety of the Uruguay Round Agreements, which is identified in 19 USC 3501 and described there. Consequently, the provision would arguably recognize any total limits provided for in that agreement; thus, section 1601(e) applies to the Aggregate Measurement of Support commitments under the Uruguay Round Agreement on Agriculture. To this point, there has been no specific test to determine the precise nature of its limits. Again, however, it must be presumed in light of the history outlined above that the Congress contemplated that if there was to be a problem it would be with the AMS limit. Thus, if there is an AMS problem, the Secretary could limit the expenditures for upland cotton; in that sense, those expenditures are not "without limit."

**(c) Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?**

179. The authority is not discretionary, but rather requires that the Secretary take action as the statute provides that "the Secretary *shall*, to the maximum extent practicable, make adjustments" (emphasis added). In adopting this language, the Senate and House conference members rejected "circuit breaker" provisions proposed in the original House version of the farm bill (HR 2646) and original Senate version (Senate amendment to HR2646) which would have made the adjustment discretionary.[106] However, it should be noted that the statute does contain a Congressional referral

[105] Report 107-424, page 469 (printed at 148 Cong. Rec.H1916, May 1, 2002).

[106] Under the original House version: "[T]he Secretary *may* make adjustments in the amount of such expenditures during that period to ensure that such expenditures don not exceed, but in no case are less than, such allowable levels" (emphasis added). Under the original Senate version: "Amends Section 161 of the FAIR Act *to allow* the Secretary to adjust the amount of domestic support to assure compliance with Uruguay Round obligations." *See* Farm Security and Rural Investment Act of 2002, Conference Report to Accompany HR 2646. House of Representatives, Report 107-424, 1 May 2002, page 468.

provision, which presumably would allow the Congress to intervene in the event that the Secretary felt it necessary to implement the authority contained in 1601.

**(d) How would the Secretary exercise her authority to prevent serious prejudice to the interests of another Member? How would she exercise her authority to prevent a threat of serious prejudice to the interests of another Member? At what time and on the basis of what type of information would she exercise her authority?**

180. To the extent mandated by the statute, the Secretary would, subject to the foregoing concerns about the breadth of the statute, adjust the programme provisions to provide for reduced expenditures. But, as indicated, the statute does not appear to contemplate any such finding of serious prejudice, but rather is seemingly focussed more particularly on the overall level of expenditures as that was the only restriction agreed to in this instance by the United States and the United States believes its programme designs to be in compliance with its WTO commitments. The United States continues to maintain its compliance with the AMS levels as agreed to and with all other aspect of its obligations under the agreement, as we have shown. As noted, Congress understood and believed that it was acting within traditional levels and with the allowed levels of the agreement.

**(e) What does "to the maximum extent practicable" mean? In what circumstances would it not be practicable for the Secretary to exercise her adjustment authority? USA**

181. We believe that this provision of the 2002 Act is directed, in the first instance at least, more at domestic complainants in the event that the correction by the Secretary, because of the difficulties of predicting how much an effect a change could have, could prove more than needed. If so, this could lead, to potential legal claims by US farmers that they had been unduly denied benefits that there were entitled to receive. However, this provision could also contemplate that in some cases the results of an adjustment might well be unknown or that certain programmes or procedures would be too far along in a crop year to allow corrections to be made in any real or fair way, leading to results that otherwise might be objectionable.

**254. Would payments made after the date of panel establishment be mandatory under the marketing loan, direct payments, counter-cyclical payments and user marketing certificate (step 2) programmes, but for the circuit-breaker provision? USA**

182. Not in the sense at least that there are many conditions that a person must meet in order to qualify for payments, and in the sense that the payments are of course dependent upon the availability of funds from the Commodity Credit Corporation (CCC). The CCC has a large, however limited, borrowing authority which must be replenished from time to time. Rarely has CCC run out of funds, but it has happened for brief periods of time -- and of course, Congress can change the programme at any time.

**256. The United States submits that the Panel cannot make rulings without allocating precise amounts of payments to upland cotton production. However, to the extent that such precise data is not on the Panel record, to what extent can the Panel rely on less precise data, and on reasonable assumptions, in fulfilling its duty under Article 11 of the DSU in this case? USA**

183. Under DSU Article 11, the Panel is called upon to make an objective assessment of the matter before it, which consists of the measures challenged by Brazil and the claims Brazil has advanced. This assessment must include an objective assessment of the facts of the case. It is well-established, however, that a Panel is not to make claims for a party, nor to develop evidence for a party. As the Appellate Body explained in *Japan – Varietal Testing*, it is for the complaining party to bring forward

sufficient evidence and arguments to carry its burden of establishing a *prima facie* case. Thus, although a panel may be able to draw reasonable inferences from evidence on the record as part of its objective assessment of the facts of the case, such inferences cannot take the place of evidence necessary for a complaining party to establish its *prima facie* case.

184. The difficulty in this dispute arises because Brazil has chosen to challenge decoupled income support measures – namely, direct payments and counter-cyclical payments – that are not tied to production or sale of upland cotton. For payments that *are* tied to production of upland cotton – for example, marketing loan payments – there is no difficulty because the subsidy is solely attributed to upland cotton.[107] As set out in previous US submissions and oral statements, however, decoupled payments must be allocated across the value of each recipient's production in order to determine what is the benefit to upland cotton within the meaning of Article 1 of the Subsidies Agreement. A failure to allocate the decoupled payment either would result in arbitrarily assigning subsidy benefits to one product over another or would result in double-counting of a subsidy as providing a greater benefit than the value of the payment.

185. Brazil has not identified evidence that would allow for the challenged decoupled payments to be allocated across their recipients' production (that is, attributed to upland cotton and any other commodities produced by those recipients). Thus, Brazil has not established facts necessary for the Panel to identify the amount of the challenged subsidy nor evaluate its effects. Even if there were evidence on the record from which "reasonable assumptions" (in the words of the question) could be drawn, the Panel could not make those assumptions because Brazil has not claimed that allocating the value of these decoupled payments across the total value of each recipient's production is necessary. That is, while Brazil has improperly sought to expand the scope of this dispute by allocating decoupled payments received for non-upland cotton base acres to upland cotton producers, Brazil has *not* claimed that all such payments must be allocated across the value of the recipient's production. To the contrary, Brazil has argued that such payments would *exclusively* be support to upland cotton.[108]

186. As a result, this dispute presents a situation analogous to that in the *Japan – Varietals* dispute. Were the Panel to agree that to determine the subsidy benefit to upland cotton decoupled payments not tied to upland cotton production must be allocated across the total value of the recipient's production, the Panel could not then seek evidence or make "reasonable assumptions" relating to such an allocation because to do so would be to make a claim that Brazil has not advanced. Brazil has chosen *solely* to argue that decoupled payments for base acreage up to the amount of upland cotton planted on the farm are support to upland cotton, ignoring the production of any other crops on the

[107] In the language of Annex IV, "the value of the [subsidized] product shall be calculated as the total value of the recipient firm's sales *of that product*." Subsidies Agreement, Annex IV, para. 3 (italics added).

[108] See Brazil's Further Rebuttal Submission, para. 24 ("This EWG data also provides the amount of upland cotton contract payments attributable to upland cotton producers, broken down by PFC, market loss assistance, direct and counter-cyclical payments. These figures are also set out in the table above. However, because some upland cotton was produced on non-upland cotton contract base, it would be necessary to calculate an amount of non-upland cotton contract payments, based on the EWG data, that also constitutes support to upland cotton received by producers of upland cotton.").

farm. (For example, with respect to plantings and not production, the data provided to the Panel and Brazil on December 18 and 19, 2003, demonstrate that, in the aggregate for farms planting upland cotton in marketing year 2002, upland cotton planted acres represented only 48 per cent of total cropland on those farms. One could surmise that Brazil refuses to recognize that decoupled payments must be allocated because to do so would invalidate both Brazil's Peace Clause analysis, which merely took the value of decoupled payments for upland cotton base acres and factored such payments by approximately 14/16, and Brazil's serious prejudice analysis by eliminating a substantial portion of the "$12.9 billion" in payments alleged to have been made to upland cotton. Nonetheless, Brazil has chosen what arguments and evidence to advance to support its claims – as is its prerogative. The Panel must judge whether those arguments and evidence amount to a *prima facie* case. Where Brazil has refused to adopt the proper approach to allocation of decoupled payments and has identified no evidence to allow a proper allocation, the Panel may not step into the breach and make any "reasonable assumptions" to support Brazil' s claims.

# ANNEX I-9

## COMMENTS OF THE UNITED STATES CONCERNING BRAZIL'S ECONOMETRIC MODEL

22 December 2003

## I. THE SUMNER MODEL PRESENTED BY BRAZIL DOES NOT PROVIDE ACCEPTABLE ECONOMIC SUPPORT FOR BRAZIL'S CLAIM OF SERIOUS PREJUDICE

### A. INTRODUCTION

1. Our review of Brazil's economic model analysis as submitted by Brazil and independently by Dr. Bruce Babcock of Iowa State University shows a clear and consistent manipulation of well-known econometric tools and mischaracterization of the US cotton programme in order to exaggerate acreage and ultimate price impacts. In particular:

- The Sumner approach forces changes onto the FAPRI system, and misleadingly claims the result as a FAPRI-type analysis;
- Using flawed and often unsubstantiated economic assumptions, Brazil transformed the FAPRI model for its own purposes;
- Every economic result ascribed to a FAPRI-type analysis by Brazil contains the same flawed assumptions originally introduced by Dr. Sumner;
- Brazil did not use the correct models or assumptions according to FAPRI/CARD analysts and appears to have even changed the underlying FAPRI baseline in order to exaggerate acreage and price impacts of programme removal.

2. This critique is directed primarily at Dr. Sumner's model, the results of which were first presented to the Panel in Annex I.[1] Brazil continues to cite Annex I as a part of its fundamental economic findings. The United States notes that Brazil has introduced different analytical tools since the United States and the Panel requested to see the model used to produce the Annex I results.[2] In no instance has Brazil appeared to retreat from its impacts cited in Annex I.

3. Dr. Sumner's supply-side adaptations or modifications to the FAPRI model with respect to various components of the US cotton programme, such as direct payments or export credit guarantees, continue to be the key reason his model displayed the results presented in Annex I and are carried

[1] In evaluating Dr. Sumner's impacts (and this critique of them), the Panel should take into consideration that Annex I results have not been, and apparently cannot be, confirmed. The models used and outputs obtained were, by their own admission, not retained by Dr. Sumner nor Dr. Babcock. *See*, Letter dated 31 October 2003 from Dr. Bruce Babcock to Dr. Dan Sumner, submitted to Panel by Brazil on 5 November 2003. The record remains incomplete with respect to Dr. Sumner's adaptations. The United States has attempted in this critique to note where it has been forced to make assumptions due to missing data.

[2] The United States has based its critique on three Excel spreadsheets that have been provided by Brazil and/or Dr. Bruce Babcock. These include the CARD international cotton model, delivered by Brazil on 13 November, the cotton-only US model provided by Brazil on 18 November; and the US crops model provided by Dr. Babcock on November 26. A graphical representation of the scope and disclosure of Brazil's modelling system is provided in Exhibit US-113.

forward into all subsequent econometric demonstrations using subsequent FAPRI baselines. In many respects, Brazil's Annex I (and subsequent) results are caused directly by introduced changes to the FAPRI model.

4. Brazil offers Dr. Sumner's model results as evidence that but for the US cotton programme, US cotton acreage would have declined and world prices would have increased. While the US has in its submissions and oral statements demonstrated the fatal flaws in Brazil's arguments on subsidy identification, causation, and its actionable subsidies claims, it is clear to the United States that but for the significant manipulation and adaptation of the FAPRI model carried out by Brazil and Dr. Sumner, acreage impacts attributed to the US cotton programme by that economic model would be far less than reported in Annex I. As a result, Dr. Sumner's economic analysis cannot serve as a basis for any findings on the effect of challenged US subsidies.

## II. BRAZIL MODEL IS NOT FAPRI/CARD ANALYSIS

5. The adaptations and modifications made to the FAPRI model by Brazil have so changed the model that Brazil cannot rely on FAPRI's reputation to confirm the results.

- Dr. Babcock, Dr. Sumner's "collaborator" on the project, states that a FAPRI analysis would have used different models and applied different assumptions;

- Thus, Dr. Babcock has stated that the Sumner analysis is "in no way" an official FAPRI analysis.

6. In a recent letter, Dr. Babcock, an economist at the CARD located at Iowa State University and the "technician" that carried out much of Dr. Sumner's economic analysis[3], cleared up some of the confusion regarding the models used in Brazil's analysis. In Dr. Babcock's opinion, a true FAPRI analysis would have used different models and applied different assumptions to those models to arrive at the type of estimate presented by Brazil in its Annex I. In his letter Dr. Babcock states that the analysis carried out by Dr. Sumner and used by Brazil was

> "in no way an official FAPRI analysis and if FAPRI had done the analysis, FAPRI would have come up with different estimates of the effects of US cotton subsidies on world prices."[4]

7. Dr. Babcock also stresses the differences between FAPRI and Dr. Sumner's assumptions used to estimate the effects of various components of US cotton policy. Many of these different assumptions are described in Bra-313 and will be discussed in detail.

8. Dr. Babcock indicates a FAPRI analysis would have used different models. He states that FAPRI would have used different models entirely.

> "The domestic model used was not based on the models used for the FAPRI 2003 baseline. … the model that FAPRI uses to conduct domestic and international US policy analysis is the US stochastic model and the FAPRI international models. The

[3] Opening Statement of Dr. Sumner, 2 Dec. 2003, "I have specified equations and parameters which adapt the systems to apply to the specific questions of interest in this dispute and I have worked closely with skilled and experienced technicians who have operated the details of the system. This is the same procedure that economists routinely use in performing simulation modelling in academic research and that they use in performing complex econometric statistical analysis. I rely on the technician to operate the "machinery" of the models just as a medical doctor would rely on an X-ray or Magnetic Resonance Imaging technician to operate those systems and generate results for analysis and interpretation."

[4] Letter from Dr. Bruce Babcock, Exhibit US-114.

> international cotton model used in Dan's analysis was a stand-alone cotton model developed to better understand the role that China plays in international cotton markets."
>
> "... FAPRI would have used different models ..."[5]

9. Dr. Babcock's letter confirms that the concerns of the United States have been well-founded. While cloaking itself in the FAPRI model's reputation, Brazil and Dr. Sumner's analysis is, in fact, something quite different. The differences between FAPRI and the Brazil analysis reflected in Annex I involve much more than small, "conservative" changes. As the United States will demonstrate, Brazil's Annex I analysis relies too heavily on adaptations, modifications and adjustments to suggest acceptance based upon FAPRI's reputation. Brazil's estimates, to a very great extent, distort the FAPRI system for the express purpose of achieving pre-conceived results.

10. The United States, after completing as complete a critique of Annex I results as possible in this proceeding, respectfully submits that the results indicated in Annex I are significantly exaggerated, due either to economic errors or to Dr. Sumner's introduced biases (most of which are discussed in Bra-313 and in Annex I, and many of which contain errors). Brazil's results set out in Annex I and subsequent submissions have no explanatory power.

11. The United States submits that the results in Annex I provide very little guidance to the Panel in terms of overall impacts of the US cotton programme. The United States has stated that the FAPRI model as used by Dr. Sumner was an inappropriate tool for the intended job. This opinion has now been confirmed by Dr. Sumner's chief "technician" on this project[6], who has directly stated that FAPRI would not have used the models used by Dr. Sumner and would not have made the adaptations to that model that he discusses in Annex I and in Bra 313 if it had been requested as an organization to conduct this analysis.

## A. BRAZIL MODEL NOT COMPARABLE TO FAPRI SYSTEM

12. The differences between Dr. Sumner's analysis and the FAPRI framework are significant. Those differences arise primarily as a result of Brazil's disagreement with FAPRI and many other agricultural economists over the impact of payment programmes that are not directly linked to production decisions. There are other important differences. Most notably, FAPRI does not include crop insurance as a production-distorting programme. The FAPRI model also does not contain components designed to estimate production effects from the export credit guarantee programme, a seemingly appropriate choice since Brazil itself has stated that it cannot quantify the alleged benefit to upland cotton provided by the export credit guarantee programmes.[7]

13. Whenever the FAPRI modeling system did not tend to show acreage impacts high enough to satisfy Brazil in this case, Dr. Sumner simply made modifications to encourage it to do so. The United States disagrees with these modifications, but still cannot confirm all of these changes or the specific components of each of them. Second, whenever the FAPRI modeling system did not include a programme component challenged by Brazil, Dr. Sumner simply forced acreage impacts of that programme onto the system - showing little or no economic foundation for the introduced variables.[8]

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[5] *Id*.

[6] "…FAPRI would have used different models". Letter from Dr. Babcock, Exhibit US-114.

[7] Paragraph 82 of Answers of Brazil to Questions from the Panel, 27 October 2003.

[8] For example, Brazil cites export impacts ascribed to the export credit guarantee programme by the National Cotton Council of America and uses those impacts without further foundation. The National Cotton Council of America's economic analysis in this instance has no foundation and no demonstrated methodology.

14. All of these effects, displayed in Annex I, were introduced into the FAPRI system by Dr. Sumner. Dr. Sumner discusses some of his modifications in Bra-313, but not all of them. Dr. Sumner has never provided the United States with an electronic, verifiable version of his modifications. Efforts by the United States to replicate the Sumner formula using a FAPRI model have been unsuccessful, leading to the conclusion that other modifications, adaptations or calibrations are involved.

## B. ADAPTATIONS TO AND MODIFICATIONS OF FAPRI MODEL RESULTED IN EXAGGERATED RESULTS

15. Dr. Sumner's treatment of decoupled payments, crop insurance, and export credits are significant deviations from the FAPRI modelling framework. These changes are forced onto the FAPRI system resulting acreage effects that are much greater than would ever be anticipated by a true FAPRI analysis. Again, as Dr. Babcock has now candidly stated:

> "In addition, the modeling assumptions that Dan used to estimate the effects of the various US domestic programme components of US policy are different than FAPRI would use if asked to answer the same questions."[9]

### 1. Dr. Sumner exaggerates the impact of decoupled payments as compared to FAPRI's modelling of those payments

16. FAPRI analysis of the impacts of decoupled programmes (like Production Flexibility Contract payments (PFC), Direct Payments (DP), Market Loss Assistance payments (MLA) and Counter-cyclical Payments (CCP) was discarded by Dr. Sumner and replaced with an approach not supported by FAPRI, nor supported by the bulk of economic literature on the subject.

17. Dr. Sumner's decoupled effects are different than those normally used by FAPRI and were supposedly justified by Dr. Sumner's own estimation of producers' "anticipation" of future programme changes and on his, now proven incorrect, contrived assumptions about actual planting patterns in the United States.[10]

18. The FAPRI baseline reflects their "most-likely" outcome for acreage, production, consumption and prices under a defined set of assumptions. Acreage projections for each of the crops reflect assumptions and outcomes for market indicators and government policy. According to the US crops model (Excel file US CROPS MODEL 2002.xls) sent by Dr. Babcock on 26 November, upland cotton acreage in each region is determined by the following equation:

$$CTPLT_i = a_o + a_o * CTENR_i/PD + A*(\text{Vector of Competing Crop Returns}_i)/PD + \text{Decoupled Payment Impacts}_i + \text{CRP}[11]\ \text{Impacts}_i + \epsilon_i$$

where

CTPLT = upland cotton planted acreage in region i
CTENR = expected cotton net returns from the market and the marketing loan in region i
PD = general price deflator
A = vector of parameter estimates for competing crops.

[9] For example, Brazil cites export impacts ascribed to the export credit guarantee programme by the National Cotton Council of America and uses those impacts without further foundation. The National Cotton Council of America's economic analysis in this instance has no foundation and no demonstrated methodology.

[10] Paragraphs 39-44 of US Opening Statement at the Second Session of the First Panel Meeting, 7 October 2003.

[11] CRP = Conservation Reserve Programme.

19. Although the US does not agree that decoupled payments impact planting decisions, it is useful to compare FAPRI's view of the impacts with that of Dr. Sumner.

20. Looking further into the FAPRI model, one finds that the decoupled payments are not included on a crop-specific basis as done by Dr. Sumner in his adaptations. Instead, FAPRI allocates total decoupled payments across all crops in a region. First, the total money is put on a per-acre basis by dividing the payments by acres planted to the major crops. Second, FAPRI then determines a total acreage impact for the region based on the responsiveness of the total land to the infusion of money. Third, the total acreage impact is allocated to the individual crops in each region based on the crop's share of recent plantings.

- Dr. Sumner discarded this FAPRI approach to decoupled payments and inserted his own "coupling" factor.

- Cotton acreage impacts for US decoupled programmes as would likely be presented by FAPRI are about 0.3%, consistent with the estimates in the economic literature previously presented by the United States (e.g., Westcott et al.).[12]

- Dr. Sumner's cotton acreage impacts, by contrast, are as high as 15.9% - that is, more than 50 times larger than what the FAPRI model would indicate.

21. The following table provides a comparison of acreage impacts included in the FAPRI model to those calculated by Dr. Sumner. In the FAPRI model, the acreage contribution of all decoupled payments across all major programme crops ranges between 1.4 and 2.6 million acres. Decoupled payments to all crops contribute between 69 and 123 thousand acres to upland cotton. If we isolate the impact of decoupled payments for upland cotton base acres, the FAPRI model indicates that the shift in total cotton plantings ranges between 23 and 45 thousand acres, or less than three-tenths of one percent of upland cotton area. Impacts of this magnitude would not have appreciable impact on production and prices.

22. In stark contrast to the FAPRI model are the contrived impacts calculated by Dr. Sumner. In order to present a complete picture to the Panel, the United States presents Dr. Sumner's impacts in two ways. In Dr. Sumner's analysis of decoupled payments, equations (5) and (6) of Exhibit Bra-313 document his formulas for determining "the amount of cotton acreage that was held in cotton by these programme payments". This acreage is subtracted from the error term of the equation or the impact can also be thought of as a shift in the supply curve. This impact will be termed the "gross impact" on cotton acreage of the programme in question. Values for these "gross impacts" have been taken from the file FINAL US2003CropsModel WORKOUT.xls (received by the United States on 18 November). Dr. Sumner's "gross impacts" of cotton decoupled payments on cotton plantings range from a low of 352 thousand acres to a high of 2.2 million acres. In contrast, the FAPRI model shows a gross impact of 23 to 45 thousand acres. Dr. Sumner's impacts are almost 50 times larger than those included in the FAPRI model.

23. To avoid any confusion by the Panel, the gross impacts of the programmes are not the same values as the impacts shown in Annex I and Exhibit Bra-325. The results of Dr. Sumner's scenarios reflect his estimate of the net impact of removing various aspects of the cotton programme. Net impacts will reflect the fact that producers have responded to the higher cotton prices under the scenario and increased plantings to partially offset the initial loss in acreage.

24. The following table also provides a comparison of Dr. Sumner's net acreage impacts of removing decoupled payments. These impacts correspond to the results presented in Annex I. It is

[12] Westcott, P., Young, C. E., and Price, M., USDA, ERS, The 2002 Farm Act, Provisions and Implications for Commodity markets, Economic Research Service, November 2002. (See Exhibit Bra-42)

worthwhile to note that Dr. Sumner's net impacts are still 25 times larger than the gross impacts derived from the FAPRI model. Simply put, FAPRI's model would not show the kind of acreage impacts assumed by Dr. Sumner.

**Acreage Impacts of Decoupled Payments (Million Acres)**

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 99-02 Avg | 03-07 Avg |
|---|---|---|---|---|---|---|---|---|---|---|---|
| FAPRI Model Gross Total Area Impact of all Decoupled Pymts Across All Crops (1) | 1.379 | 1.838 | 1.912 | 2.091 | 1.534 | 2.180 | 2.566 | 2.379 | 2.101 | 1.805 | 2.152 |
| % of Plantings of All Crops | 0.5% | 0.7% | 0.8% | 0.8% | 0.6% | 0.9% | 1.0% | 0.9% | 0.8% | 0.8% | 0.8% |
| FAPRI Model Gross Impact of All Decoupled Pymts on Cotton Acreage (2) | 0.069 | 0.090 | 0.092 | 0.101 | 0.075 | 0.105 | 0.123 | 0.115 | 0.101 | 0.088 | 0.104 |
| % of Upland Cotton Area | 0.5% | 0.6% | 0.6% | 0.7% | 0.5% | 0.7% | 0.8% | 0.8% | 0.7% | 0.6% | 0.7% |
| FAPRI Model Gross Impact of Cotton Decoupled Pymts on Cotton Acreage (3) | 0.023 | 0.030 | 0.031 | 0.029 | 0.037 | 0.042 | 0.045 | 0.043 | 0.040 | 0.028 | 0.041 |
| % of Upland Cotton Area | 0.2% | 0.2% | 0.2% | 0.2% | 0.3% | 0.3% | 0.3% | 0.3% | 0.3% | 0.2% | 0.3% |
| Sumner's Gross Impact of Cotton Decoupled Pymts on Cotton Acreage (4) | 0.352 | 0.437 | 0.670 | 0.538 | 2.185 | 2.114 | 2.200 | 2.038 | 2.029 | 0.500 | 2.113 |
| % of Upland Cotton Area | 2.4% | 2.8% | 4.3% | 3.8% | 15.9% | 14.2% | 14.9% | 13.9% | 14.2% | 3.4% | 14.6% |
| Sumner's Net Impact of Cotton Decoupled Payments on Cotton Acreage (5) | 0.350 | 0.320 | 0.510 | 0.300 | 1.710 | 1.190 | 0.790 | 0.860 | 0.850 | 0.370 | 1.080 |
| % of Upland Cotton Area | 2.4% | 2.1% | 3.3% | 2.1% | 12.4% | 8.0% | 5.3% | 5.9% | 6.0% | 2.5% | 7.5% |
| FAPRI Model Gross Impact of Cotton AMTA/DP Pymts on Cotton Acreage (6) | 0.018 | 0.017 | 0.013 | 0.014 | 0.014 | 0.014 | 0.014 | 0.013 | 0.013 | 0.016 | 0.014 |
| % of Upland Cotton Area | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% |
| Sumner's Gross Impact of Cotton AMTA/DP Payments on Cotton Acreage (7) | 0.191 | 0.164 | 0.240 | 0.202 | 0.575 | 0.567 | 0.593 | 0.544 | 0.544 | 0.199 | 0.565 |
| % of Upland Cotton Area | 1.3% | 1.1% | 1.5% | 1.4% | 4.2% | 3.8% | 4.0% | 3.7% | 3.8% | 1.3% | 3.9% |
| Sumner's Net Impact of Cotton AMTA/DP Payments on Cotton Acreage (8) | 0.190 | 0.100 | 0.170 | 0.120 | 0.420 | 0.310 | 0.200 | 0.220 | 0.220 | 0.145 | 0.274 |
| % of Upland Cotton Area | 1.3% | 0.7% | 1.1% | 0.9% | 3.0% | 2.1% | 1.4% | 1.5% | 1.5% | 1.0% | 1.9% |
| FAPRI Model Gross Impact of Cotton MLA/CCP Pymts on Cotton Acreage (9) | 0.005 | 0.014 | 0.017 | 0.015 | 0.023 | 0.028 | 0.031 | 0.029 | 0.027 | 0.013 | 0.028 |
| % of Upland Cotton Area | 0.0% | 0.1% | 0.1% | 0.1% | 0.2% | 0.2% | 0.2% | 0.2% | 0.2% | 0.1% | 0.2% |
| Sumner's Gross Impact of Cotton MLA/CCP Payments on Cotton Acreage (10) | 0.161 | 0.273 | 0.431 | 0.336 | 1.610 | 1.546 | 1.607 | 1.494 | 1.484 | 0.300 | 1.548 |
| % of Upland Cotton Area | 1.1% | 1.8% | 2.8% | 2.4% | 11.7% | 10.4% | 10.9% | 10.2% | 10.4% | 2.0% | 10.7% |
| Sumner's Net Impact of Cotton MLA/CCP Payments on Cotton Acreage (11) | 0.160 | 0.220 | 0.340 | 0.180 | 1.290 | 0.880 | 0.590 | 0.640 | 0.630 | 0.225 | 0.806 |
| % of Upland Cotton Area | 1.1% | 1.4% | 2.2% | 1.3% | 9.4% | 5.9% | 4.0% | 4.4% | 4.4% | 1.5% | 5.6% |

(1) Source: File US CROPS MODEL 2002.xls, Model sheet, Row 4484.
(2) Source: File US CROPS MODEL 2002.xls, Model sheet, Row 4475.
(3) Source: Calculated in file *US CROPS MODEL 2002 NO Decoupled.xls* by setting cotton decoupled payments to zero.
(4) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, sum of Rows 728 and 740.
(5) Source: Sum of Sumner's Net Impacts of AMTA/DP Payments and MLA/CCP Payments.
(6) Source: Calculated by subtracting acreage impacts of NO MLA/CCP from acreage impacts of NO Decoupled payments.
(7) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, Row 728.
(8) Source: Table I.5b of Annex I.
(9) Source: Calculated in file *US CROPS MODEL 2002 NO MLA CCP.xls* by setting cotton MLA/CCP payments to zero.
(10) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, sum of Row 740.
(11) Source: Table I.5c of Annex I.

## 2. Dr. Sumner Assigns Production Effects to Crop Insurance that FAPRI Does Not

25. Dr. Sumner's arbitrary introduction of crop insurance into his acreage system is a direct departure from the FAPRI model. Dr. Sumner provides no statistical basis to support his incorporation of crop insurance. He simply derives a per-acre value, forces those impacts into the acreage system, and treats the results as valid analysis. There is absolutely no empirical validation associated with his results.

26. FAPRI does not explicitly attribute any acreage response to the availability of crop insurance. Dr. Sumner's gross impacts range as high as 1.05 million acres, and net impacts reach 590 thousand acres.

27. The exclusion of crop insurance from the FAPRI model is warranted. As the United States has previously suggested[13], if one were to consider the coverage levels obtained by cotton farmers, over 90 per cent of insured cotton area would be subject to coverage levels agreed by Members to have no or minimal trade-distorting effects.

28. The United States has also demonstrated that the economic literature examining acreage effects of crop insurance is clearly mixed, but have never gone so far as to attribute production impacts as great as those asserted by Brazil.[14] The literature in general reflects that by its very nature the impact of crop insurance on production may be significantly different than its impact on acreage.

29. It seems intuitive to the United States that a dollar provided in the way of an insurance premium subsidy (provided to reduce the cost of an insurance product that pays when the crop is not produced) would have different impacts on producer decisions than a dollar provided to the producer when the value of a harvested crop falls short of some defined level (such as a marketing loan payment). Dr. Sumner's analysis treats them the same. FAPRI does not.

30. Thus, it is significant that the FAPRI model does not attribute acreage response to the availability of crop insurance. Dr. Sumner deviates from that model without any empirical foundation in the economic literature.

**Acreage Impacts of Crop Insurance (Million Acres)**

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 99-02 Avg | 03-07 Avg |
|---|---|---|---|---|---|---|---|---|---|---|---|
| FAPRI Model Impact of Cotton Crop Insurance Program on Cotton Acreage (1) | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| % of Upland Cotton Area | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Sumner's Gross Impact of Cotton Crop Insurance Program on Cotton Acreage (2) | 0.584 | 0.541 | 0.798 | 0.808 | 1.040 | 1.018 | 1.056 | 0.979 | 0.974 | 0.683 | 1.013 |
| % of Upland Cotton Area | 4.0% | 3.5% | 5.1% | 5.7% | 7.5% | 6.8% | 7.1% | 6.7% | 6.8% | 4.6% | 7.0% |
| Sumner's Net Impact of Cotton Crop Insurance Program on Cotton Acreage (3) | 0.580 | 0.360 | 0.600 | 0.540 | 0.590 | 0.550 | 0.420 | 0.440 | 0.430 | 0.520 | 0.486 |
| % of Upland Cotton Area | 4.0% | 2.3% | 3.9% | 3.8% | 4.3% | 3.7% | 2.8% | 3.0% | 3.0% | 3.5% | 3.4% |

(1) Source: No impact included in file US CROPS MODEL 2002.xls.
(2) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, Row 752.
(3) Source: Table I.5d of Annex I.

[13] US Opening Statement at the Second Session of the First Panel Meeting, 7 Oct. 2003, paras. 45-47.
[14] See Exhibits US-57 through US-60.

### 3. Dr. Sumner Assigns a Production Effect to Export Credits that FAPRI Does Not

31. In a further departure from the modelling approach used by FAPRI, Dr. Sumner introduces a 500 thousand-bale impact for export credit programmes. US exports are reduced by introducing this shift in the US export equation.[15] The resulting effect is to lower the US price while increasing the world price. However, as with Dr. Sumner's other modifications, there is no statistical basis for these changes.

32. Brazil provides no statistical or other economic foundation for this level of impact from the export credit guarantee programme. Dr. Sumner's stated source for the 500,000 bale impact is testimony delivered by the National Cotton Council of America in 2001, a US trade association that operates on behalf of the US cotton industry.[16] Brazil presents no evidence of how that estimate was calculated and presents no analysis of its own.[17]

33. With respect to any actual effects on world prices caused by the application of the US export credit guarantee programme to US cotton exports, Brazil has cited no subsidy component estimates and demonstrated no economic analysis.

34. Dr. Sumner's model passes off his 500,000-bale export shift as economic analysis and forces it upon the FAPRI model. Does the Sumner model show acreage impacts from the removal of the export credit guarantee programme? Of course it does since Dr. Sumner forced it to show those impacts. Brazil, cannot, however, base its estimates on FAPRI or on any demonstrated analytical approach.

[15] Exhibit Bra-313, page 5, "For the export credit, as explained in the Annex I, I base the estimated shift in export demand conservatively on the information provided by the US Cotton Council. The FAPRI baseline, which assumes continuation of the export credit programme, implicitly includes 500,000 bales of cotton attributable to the export credit programme. So eliminating the programme is implemented by simply subtracting 500,000 bales from the intercept of equation 7 in each year."

[16] See Exhibit Bra-41. The National Cotton Council is a trade association that lobbies the US government on behalf of the US cotton industry.

[17] In the 9 September Brazil Submission before the Second Session of the First Panel Meeting, paras 192-194, Brazil carried out another economic sleight of hand by implying that Dr. Sumner's export estimates with respect to the export credit guarantee program were more conservative than the unsubstantiated estimate it cites from the National Cotton Council. Paragraph 194 of that submission acts as if the NCC estimate of a possible 3 cent per pound US price impact and Dr. Sumner's estimate of a .57 cent per pound world price impact are somehow independent analyses - and demonstrate Dr. Sumner's conservative approach. However, as demonstrated in Bra-313, all Dr. Sumner did was force a reduction in US export estimates of 500,000 bales (using the NCC testimony as his sole economic foundation), which correspondingly reduced prices in the US, which correspondingly both reduced US acreage and slightly increased exports - cutting into the initially imposed 500,000 bale shift. Further, the "different" price estimates were, in fact, estimates of two different set of prices - US and world. Brazil inappropriately characterized Dr. Sumner's results as being conservative relative to the NCC estimate. (Paragraph 192, Brazil's Further Submission to the Panel, 9 September 2003) Later when the Panel raised a question about the results, Dr. Sumner somehow forced a full 500,000 bale decline in US exports, ignoring the impacts of price response. (See, for example, Bra-325, last category of tables - export credit guarantee with fixed 500,000 bale impact) In that response, Brazil also maintained the stance that these two "analyses," neither demonstrating economic foundation, were somehow independent, while fairly clearly demonstrating that Dr. Sumner merely took the NCC testimony and imposed a 500,000 bale demand shift.

**Export Shifts due to Export Credits (Million Bales)**

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 99-02 Avg | 03-07 Avg |
|---|---|---|---|---|---|---|---|---|---|---|---|
| FAPRI Model Impact of Export Credits on Cotton Exports (1) | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| Sumner's Gross Impact of Export Credits on Cotton Exports (2) | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 |
| Sumner's Net Impact of Export Credits on Cotton Exports (3) | 0.300 | 0.290 | 0.330 | 0.300 | 0.300 | 0.300 | 0.300 | 0.310 | 0.310 | 0.305 | 0.304 |

(1) Source: No impact included in file US CROPS MODEL 2002.xls.
(2) Source: Paragraph 59 of Annex I.
(3) Source: Table I.5g of Annex I.

## III. ANNEX I RESULTS USED VARIABLES LOWER THAN CITED NOVEMBER 2002 FAPRI BASELINE

35. The United States has previously indicated to the Panel its concern that acreage impacts in Annex I were based off of the FAPRI preliminary November '02 baseline instead of the more recent and readily available final January 2003 FAPRI baseline. The United States believes this choice of baseline biased the results shown in Annex I.[18] A closer review of the Annex I results, however, show they were not exactly based off the November 2002 baseline either.

### A. USE OF VARIABLES LOWER THAN NOVEMBER 2002 BASELINE INCREASED ACREAGE IMPACTS

- By using prices and other variables that were even lower than the FAPRI November '02 baseline, Brazil managed to further increase acreage impacts it attributed to the US cotton programme.

36. Contrary to the assertions contained in Annex I, it appears that the baseline that is presented there is not the FAPRI November 2002 baseline. The following table provides a comparison of the "A" Index from the baseline presented in Annex I with the FAPRI November 2002 baseline as provided by Dr. Babcock on 26 November.

[18] US Opening Statement at the Second Session of the First Panel Meeting, 7 Oct. 2003, para. 36.

**Comparison of Annex I Baseline with FAPRI November '02 Baseline**

| | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| "A" Index (Cents/Lb) | | | | | |
| Annex I | 50.69 | 53.44 | 55.75 | 57.56 | 59.60 |
| FAPRI Nov '02 Baseline | 52.35 | 54.74 | 56.77 | 58.69 | 60.52 |
| Change from FAPRI | -1.66 | -1.30 | -1.02 | -1.13 | -0.92 |
| Upland Cotton Farm Price (Cents/Lb) | | | | | |
| Annex I | 44.96 | 47.74 | 50.30 | 51.20 | 53.89 |
| FAPRI Nov '02 Baseline | 45.66 | 48.83 | 51.18 | 52.04 | 54.67 |
| Change from FAPRI | -0.70 | -1.09 | -0.88 | -0.84 | -0.78 |
| Upland Cotton Planted Area (Million Acres) | | | | | |
| Annex I | 13.780 | 14.880 | 14.770 | 14.650 | 14.270 |
| FAPRI Nov '02 Baseline | 13.782 | 14.720 | 14.772 | 14.658 | 14.252 |
| Change from FAPRI | -0.002 | 0.160 | -0.002 | -0.008 | 0.018 |
| Upland Cotton Production (Million Bales) | | | | | |
| Annex I | 16.050 | 17.420 | 17.400 | 17.370 | 17.010 |
| FAPRI Nov '02 Baseline | 16.052 | 17.215 | 17.397 | 17.377 | 16.982 |
| Change from FAPRI | -0.002 | 0.205 | 0.003 | -0.007 | 0.028 |

Source: FAPRI Nov '02 Baseline numbers from file *US CROPS MODEL 2002.xls*

37. The baseline used by the Annex I model appears to contain slightly lower cotton planted acreage, different upland cotton production, lower upland cotton farm prices and lower "A" index cotton prices than were shown in the FAPRI preliminary November 2002 baseline.[19]

### B. BASELINE USED IN ANNEX I EXAGGERATED PROGRAMME EFFECTS BEYOND THAT PREVIOUSLY ASSUMED BY UNITED STATES

38. The baseline used in Annex I exaggerated programme effects even more than previously assumed by the United States. The baseline used in Annex I contained lower cotton prices than those included in the FAPRI November 2002 baseline. It also contains several other variables that are different from the November 2002 baseline. There is no basis for this discrepancy, if Dr. Sumner actually used the November 2002 FAPRI baseline and, as stated in Bra-313, "none of the other equations in the FAPRI specification are modified to explicitly analyze the removal of US cotton programmes".[20]

## IV. BRAZIL'S MODEL HAS NO EXPLANATORY POWER

39. It would be anticipated that a model proposed to demonstrate effects of removing programme components of the US cotton programme and the impact of that removal on planting decisions would also demonstrate the ability to correctly predict planted acreage of upland cotton, given prices and other factors.

40. The Sumner-modified model presented in Annex I does not explain cotton planting decisions.

[19] Brazil's later submissions refer to the November 2002 baseline, paragraph 114 of Brazil's Further Rebuttal Submission of 18 Nov 2003.

[20] Bra-313, page 5.

41. In fact, the simple ratio of cotton to soybeans expected harvest season futures prices at the time of planting, discussed by the United States[21], does a much better job of explaining the movement in US cotton acreage than what is found in Dr. Sumner's formulation.

42. Even an analysis of planting decisions based on lagged prices, while not as correlated as the ratio of expected futures prices, also does a better job of explaining producer planting decisions than does Dr. Sumner's net returns formulation.

43. In fact, the formulation presented in Annex I actually contains a negative correlation between expected net revenue and planting decisions in most cotton regions of the United States.

44. In other words, the Annex I model tends to predict that cotton producers will plant less cotton in response to higher returns.

45. In Annex I, Dr. Sumner reports the functional form of expected net revenue used in determining planted acreage of upland cotton (equation 1 on page 13). Empirical results indicate that Dr. Sumner's contrived formulation of expected net revenue does not explain the movement in US plantings of upland cotton.[22] The following table presents correlation coefficients between the explanatory variables in Dr. Sumner's acreage equations and actual acreage levels for each region and for the United States over the 1996-2002 period.

46. Cotton expected net revenue, in nominal terms, calculated according to equation (1) of Annex I has a negative correlation with planted acreage in 4 of the 6 cotton-producing regions modelled by Dr. Sumner. Over the 1996-2002 period, those 4 regions accounted for 93% of US acreage. Dr. Sumner's equations for planted acreage are not solely based on nominal net revenue of cotton. They also take into account competing crops in each region, and returns are converted to real dollars by dividing by a general price deflator.

47. The lack of predictive ability of Dr. Sumner's acreage equations is best illustrated by the correlation between acreage and the Weighted Expected Net Returns for all Crops in real terms. This aggregate net return is calculated by multiplying each parameter estimate by the respective real net returns for that crop calculated according to equation (1) of Annex I and then summing the resulting values. This calculation incorporates all explanatory variables that are included in Dr. Sumner's acreage equations with the appropriate elasticity.

48. The correlation results indicate that Dr. Sumner's equations are not accurate predictors of the movements in cotton acreage. The correlation in 3 regions is negative, and in two other regions, the correlation is weakly positive. Only in the smallest production region in the US is there a positive correlation that is statistically significant.

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[21] Paragraphs 152-167 of US Further Rebuttal Submission, 18 November 2003.

[22] The calculation of expected net revenue follows the general form indicated by equation (1) of Annex I. Data for expected market and marketing loan benefits are taken directly from the file FINAL US2003CropsModel WORKOUT.xls, which is a cotton-only US model supplied by Brazil. Exact calculations of per-acre PFC, DP, MLA and CCP payments, as well as crop insurance were not included in the file. Nor has this exact documentation been provided by Brazil. In the absence of a complete explanation regarding these calculations, the US has adopted the following formulas for expected per-acre payments for each region i:

PFCi = 0.85 * (PFC Payment Rate) * (Programme Yield)i,
MLAi = 0.85 * (MLA Payment Rate) * (Programme Yield)i,
DPi = 0.85 * (Direct Payment Rate) * (Programme Yield)i,
CCPi = 0.85 * max(0, Target Price – max)(Loan Rate, Farm Price)) (Programme Yield)I,

The variables for decoupled payments and crop insurance have been calculated for each crop and region and included in expected net revenue for the determination of correlation coefficients and explanatory power.

49. In fact, the explanatory power and reliability of Dr. Sumner's acreage model is far less than one explanation of recent movements in cotton acreage provided by the United States, the ratio of cotton to soybeans expected harvest season futures prices at time of planting. Because soybeans is a major competing crop of cotton in many cotton-producing regions, this ratio expresses the relative attractiveness of planting cotton from expected market returns.[23] Simply put, the ratio of expected futures prices does a much better job of explaining the movement in US cotton acreage than what is found in Dr. Sumner's arbitrary formulation.

**Correlation of Selected Explanatory Variables with Upland Cotton Planted Area, 1996-2002 Period (1)**

| | Corn Belt | Central Plains | Delta States | Far West | Southeast | Southern Plains | **US** |
|---|---|---|---|---|---|---|---|
| Sumner's Cotton Expected Net Returns (Nominal $) | -0.27 | 0.11 | -0.29 | 0.29 | -0.53 | -0.09 | **-0.28** |
| Sumner's Cotton Expected Net Returns (Real $) | -0.29 | -0.08 | -0.32 | 0.38 | -0.58 | -0.14 | **-0.30** |
| Sumner's Weighted Expected Net Returns for all Crops (Real $) | -0.21 | 0.40 | -0.25 | 0.17 | -0.35 | 0.16 | **-0.14** |
| Ratio of Cotton and Soybean Futures Prices | 0.55 | -0.37 | 0.66 | 0.23 | 0.33 | 0.63 | **0.69** |
| Ratio of Lagged Cotton and Soybean Farm Prices | 0.14 | -0.64 | 0.37 | 0.40 | -0.06 | 0.46 | **0.40** |

(1) Source: File FINAL US2003CropsModel Correl 1.xls

50. The statistics are very clear. Dr. Sumner's methodology of modelling producer expectations and planting decisions has no explanatory power, and analysis based on these equations is not reliable. His proposed formulation of net returns is not consistent with producers' expectations and acreage decisions. The equations are not reliable for assessing the removal of US programmes, and this applies to not only decoupled payments and crop insurance, but also marketing loans.

51. Recent historical data clearly indicate that producers are making their decisions on their expectations of market prices for cotton and primary competing crops.[24] Furthermore, those price expectations are not captured by the naïve approach of simply using last year's price to determine this year's acreage decision. As Brazil's expert, Mr. MacDonald explained at the second session of the first panel meeting, futures markets embody the best available information about expected prices. The data indicate that cotton farmers' planting decisions are made accordingly.

[23] Paragraphs 5-9 of Answers of the United States of America to the Questions from the Panel to the Parties following the Second Session of the First Substantive Panel Meeting, 27 October 2003.

PFCi = 0.85 * (PFC Payment Rate) * (Programme Yield)i,
MLAi = 0.85 * (MLA Payment Rate) * (Programme Yield)i,
DPi = 0.85 * (Direct Payment Rate) * (Programme Yield)i,
CCPi = 0.85 * max(0, Target Price – max)(Loan Rate, Farm Price)) (Programme Yield)I,

The variables for decoupled payments and crop insurance have been calculated for each crop and region and included in expected net revenue for the determination of correlation coefficients and explanatory power.

[24] Paragraphs 152-167 of US Further Rebuttal Submission, 18 November 2003.

52. The formulations discussed in Annex I do not reflect the expectations of producers and do not explain the movement in US cotton acreage. This is particularly troublesome as those formulations are a critical link in Brazil's attempt to ascribe significant acreage impacts to the US cotton programme. There is no credible statistical evidence that supports this linkage, and the Annex I formulations that form a part of this analytical linkage fail to accurately explain movement in acreage.

## V. DR. SUMNER'S METHODOLOGY DEVIATES FROM FAPRI'S LINEAR ACREAGE SYSTEM

53. FAPRI's linear acreage system would tend to ensure that impacts from a static change in returns should be the same across several years. However, contrary to the normal FAPRI system, the Sumner analysis shows impacts that grow substantially over several years.

54. According to the US crops model (Excel file US CROPS MODEL 2002.xls) sent by Dr. Babcock on 26 November, upland cotton acreage in each region is determined by the following equation:

$CTPLT_i = a_o + a_o * CTENR_i/PD + A*(\text{Vector of Competing Crop Returns}_i)/PD$
$+ \text{Decoupled Payment Impacts}_i + \text{CRP Impacts}_i + \epsilon_i$

where

CTPLT = upland cotton planted acreage in region i
CTENR = expected cotton net returns from the market and the marketing loan in region i
PD = general price deflator
A = vector of parameter estimates for competing crops.

Expected net returns for each crop are defined as
(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs.

55. As documented in equation (1) of Annex I, Dr. Sumner modifies expected net returns to include his calculations of decoupled payments and crop insurance benefits. The new equations for expected net returns are transformed as follows:

(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs + $b_{pfc}$ * PFC + $b_{dp}$ * DP + $b_{mla}$ * MLA + $b_{ccp}$ * CCP + CIS,
where

PFC = per-acre PFC payments
DP = per-acre direct payments
MLA = per-acre MLA payments
CCP = per-acre counter-cyclical payments
CIS = crop insurance variable
$b_{pfc}$ , $b_{dp}$ , $b_{mla}$ , $b_{ccp}$ = scaling factors.

56. An important aspect of the linear acreage equations as modified by Dr. Sumner concerns the response to changes in net returns. If net returns for cotton change by a given amount, then the impact or shift in cotton acreage is determined as $a_i$*(Change in returns)/PD. If the change in returns is the same across years, then the only difference in terms of the acreage impact is due to the value of the price deflator PD.

### A. ACREAGE IMPACTS FOR 2003-07 APPEAR INCONSISTENT WITH 1999-2002 PERIOD

57. Dr. Sumner's acreage impacts attributed to decoupled payments and crop insurance show tremendous variations over the 1999-2007 period. Specifically, acreage shifts for the 2003-07 period are much larger than those reported for the 1999-02 period. The larger impacts are not consistent with

the relative programme values assumed by Dr. Sumner. In the case of decoupled payments, incorporating Dr. Sumner's "coupling" factors does not fully explain the differences in impacts.

58. The following table provides a comparison of the average acreage impacts reported in rows 720-771 of the file FINAL US2003CropsModel WORKOUT.xls. The averages reflect the two periods of the analysis covered by the different farm bills. The US cannot verify Dr. Sumner's calculations due to insufficient information. However, some basic calculations cast serious doubt on the validity of Dr. Sumner's analysis.

59. The acreage impacts reported for DP payments over the 2003-07 period are much larger than those indicated for PFC payments during 1999-2002 even though direct payment rates under the current farm bill are actually smaller than PFC payment rates under the FAIR Act. Surprisingly, this difference cannot be adequately explained by Dr. Sumner's decision to provide much stronger acreage impacts for Direct Payments than he attributed to PFC payments. Even when the United States attempted to incorporate Dr. Sumner's "coupling" factor, the acreage impacts appear much larger than the increased (1.5 times) "coupling" factor would seem to indicate.

60. The same concern holds true for MLA and CCP payments. The acreage impact associated with CCP increases by a factor of five while the effective payment under the 2002 Act is 3.4 times larger than the MLA payment. In the Central Plains, the impact is more than 147 times larger over the 03-07 period than over 99-02. The Southeast shows an acreage impact due to CCP that is almost 8 times the size of that implied for MLA by Dr. Sumner under the 1996 Act.

B. CROP INSURANCE IMPACTS OVER 2003-2007 PERIOD VARY FROM IMPACTS OVER 1999-2002

61. In paragraphs 52 through 56 of Annex I, Dr. Sumner addresses his contrived methodology for incorporating crop insurance. He states that the per-acre crop insurance effect on net revenue is the same in all years of the analysis, and at the national level, it equals $19 per acre. He does not indicate if the value changes for each region in his acreage system. That notwithstanding, we do know that the impact on net revenue is the same in all years of the analysis. If that is the case, then the linear specification presented in equation (1) of Annex I would generate roughly the same acreage shift in each year of the analysis, with the exception of the impact of the change in the general price deflator. Since the price deflator, which is a measure of general price inflation, generally increases over time, then the actual impact on acreage should get modestly smaller over time. Instead, Dr. Sumner's acreage shifts due to crop insurance increase dramatically over the analysis period. In the early years, the impact of $19 in net revenue amounts to fewer than 600 thousand acres, while it grows to more than 1 million acres in 2003.

62. Despite the fact that the perceived benefit did not change, Dr. Sumner's methodology produced an acreage impact over the 2003-07 period that is roughly 1.5 times larger than over the 1999-2002 period. Furthermore, in the case of the Corn Belt, Dr. Sumner's analysis actually indicates that the presence of the crop insurance programme has removed acres from cotton production - a result that is implausible.

**Comparison of Calculated Payment Rates with Acreage Shifts Reported in FINAL US2003CropsModel WORKOUT.xls**

| | 99-02 Average | 03-07 Average | Ratio |
|---|---|---|---|
| AMTA/DP Effective Average Payment Rate (Cents/Lb) * | 1.10 (= 7.34 * 0.15) | 1.67 (= 6.67 * 0.25) | 1.52 |
| AMTA/DP Acreage Impacts (Mil Acres) | | | |
| Corn Belt | 0.0015 | 0.0047 | 3.03 |
| Central Plains | 0.0025 | 0.0053 | 2.11 |
| Delta States | 0.0390 | 0.1425 | 3.65 |
| Far West | 0.0004 | 0.0012 | 2.84 |
| Southeast | 0.0764 | 0.2734 | 3.58 |
| Southern Plains | 0.0794 | 0.1380 | 1.74 |
| Total U.S. | 0.1993 | 0.5650 | 2.84 |
| MLA/CCP Effective Average Payment Rate (Cents/Lb) * | 1.61 (= 6.42 * 0.25) | 5.49 (= 13.73 * 0.40) | 3.41 |
| MLA/CCP Acreage Impacts (Mil Acres) | | | |
| Corn Belt | 0.0023 | 0.0137 | 5.96 |
| Central Plains | 0.0001 | 0.0151 | 147.22 |
| Delta States | 0.0872 | 0.3867 | 4.43 |
| Far West | 0.0022 | 0.0037 | 1.67 |
| Southeast | 0.0927 | 0.7307 | 7.88 |
| Southern Plains | 0.1157 | 0.3983 | 3.44 |
| Total U.S. | 0.3002 | 1.5482 | 5.16 |
| Crop Insurance Average Benefit (Dollars/Ac) | $19 | $19 | 1.00 |
| Crop Insurance Acreage Impacts (Mil Acres) | | | |
| Corn Belt | -0.0002 | -0.0003 | 1.52 |
| Central Plains | 0.0120 | 0.0219 | 1.83 |
| Delta States | 0.0596 | 0.1018 | 1.71 |
| Far West | 0.0012 | 0.0013 | 1.06 |
| Southeast | 0.2372 | 0.4609 | 1.94 |
| Southern Plains | 0.3728 | 0.4279 | 1.15 |
| Total U.S. | 0.6826 | 1.0135 | 1.48 |

* Effective Rates Calculated by Multiplying Average Rates by Dr. Sumner's "Coupling" Factor.

C. SUMNER MODEL ADOPTS NON-LINEAR RESPONSES CONTRARY TO FAPRI

63. In Exhibit Bra-313, Dr. Sumner provides further documentation regarding the analysis of decoupled payments and crop insurance. The new documentation suggests an entirely different methodology than presented in Annex I.

64. The documentation provided in Annex I suggests that cotton area is determined by the equation:

$CTPLT_i = a_o + a_o*CTENR_i/PD + A*(\text{Vector of Competing Crop Returns}_i)/PD + \epsilon_i$

where cotton expected net returns CTENR are determined as
(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs + $b_{pfc}$ * PFC + $b_{dp}$ * DP + $b_{mla}$ * MLA + $b_{ccp}$ * CCP + CIS.

65. Based on this documentation, analyzing the impacts of no decoupled payments would be done by simply setting the decoupled payments to zero. However, in Exhibit Bra-313, equations (4)-(6) suggest a very different methodology for deriving impacts. Dr. Sumner reports to use the following approach:

Percentage difference in acreage due to programme
= (Expected programme payments/(Expected programme payments + (cotton market & market loan net revenue))) * Acreage elasticity.

Acreage impacts would be derived by multiplying the percentage difference in acreage by the baseline level of acreage.

66. The new methodology yields acreage impacts that vary depending on the level of returns from the market and marketing loan. This methodology explains how Dr. Sumner is able to derive varying impacts in a scenario where the change introduced into the system is constant, such as the crop insurance scenario.

## D. SUMNER FORMULATION IGNORES PRESENCE OF OTHER PROGRAMMES AND THEREFORE EXAGGERATES IMPACTS

67. Dr. Sumner's formulation for isolating the impacts of each individual programme produces exaggerated results. It is logical to assume that Dr. Sumner's baseline acreage represents his most likely view based on the presence of all US cotton programmes. As such, determining the acreage impact of each individual programme should be done by comparing returns from the programme in question with total returns, where total returns are defined as

(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs + $b_{pfc}$ * PFC + $b_{dp}$ * DP + $b_{mla}$ * MLA + $b_{ccp}$ * CCP + CIS.

68. Dr. Sumner's approach of comparing returns for the programme in question to returns from the market and marketing loan ignores the presence of other programmes. Since returns from the market and marketing loan are less than total returns, then the acreage impacts for a given programme based on Dr. Sumner's formulation will be larger. The following table uses data for the Southern Plains in 2005 to illustrate the differences. Following Dr. Sumner's documentation of Exhibit Bra-313, the acreage impacts of decoupled payments and crop insurance total 671 thousand acres. If the methodology was based on total revenue, then the estimated acreage impact is 543 thousand acres. Full details of the calculations are presented in the file FINAL US2003CropsModel Correl 1 (Exhibit US-115).

## E. UNITED STATES HAS DIFFICULTY REPLICATING SUMNER RESULTS - EVEN AFTER ADOPTING SUMNER METHODOLOGY

69. The estimates prepared by the US are substantially smaller than those reported by Dr. Sumner in the file FINAL US2003CropsModel WORKOUT.xls (submitted on 18 November). The discrepancies are particularly large over the 2003-07 period. Dr. Sumner reports an average acreage

impact due to decoupled payments and crop insurance of 3.1 million acres over the 2003-07 period. Estimates by the US using Dr. Sumner's formulas find an impact of only 1.2 million acres. The inability to even remotely replicate Dr. Sumner's estimates casts serious doubts about the validity of his results. Dr. Sumner's calculations appear to be as arbitrary as his economic logic.

70. Brazil may cite the fact that the elasticity with respect to net returns is lower than the estimates published in Table I.3 of Annex I. While the United States is not able to verify the discrepancy, the elasticities used in the US calculations are based on data provided in the file FINAL US2003CropsModel WORKOUT.xls. Specifically, the elasticity in each year is determined by the formula ($a_i$ / Value of price deflator)*(Value of net returns / Value of cotton acres), where a1 is the coefficient on cotton net returns in the regional cotton acreage equation. The value of net returns and cotton acres are based on regional numbers in each year. This formulation is consistent with Dr. Sumner's documentation presented in Exhibit Bra-313.

**Example of Southern Plains Acreage Impacts, 2005**

| Program | (1) Market Revenue | (2) Program Revenue | (3) = (2)/((1) + (2)) % of Market + Program Revenue | (4) Elasticity | (5) Planted | (6) = (3)*(4)*(5) Estimated Impact | (7) Sumner Impact |
|---|---|---|---|---|---|---|---|
| Direct Payments | $109.04 | $6.08 | 5.28% | 0.28 | 6.046 | 0.090 | 0.145 |
| CCP's | $109.04 | $20.02 | 15.51% | 0.28 | 6.046 | 0.265 | 0.416 |
| Crop Insurance | $109.04 | $24.67 | 18.45% | 0.28 | 6.046 | 0.316 | 0.446 |
| **Total Area Impact** | | | | | | **0.671** | **1.007** |

**Example of Southern Plains Acreage Impacts, 2005**

| Program | (1) Total Revenue | (2) Program Revenue | (3) = (2)/(1) % of Total Revenue | (4) Elasticity | (5) Planted | (6) = (3)*(4)*(5) Estimated Impact | (7) Sumner Impact |
|---|---|---|---|---|---|---|---|
| Direct Payments | $159.81 | $6.08 | 3.80% | 0.28 | 6.046 | 0.065 | 0.145 |
| CCP's | $159.81 | $20.02 | 12.53% | 0.28 | 6.046 | 0.214 | 0.416 |
| Crop Insurance | $159.81 | $24.67 | 15.44% | 0.28 | 6.046 | 0.264 | 0.446 |
| **Total Area Impact** | | | | | | **0.543** | **1.007** |

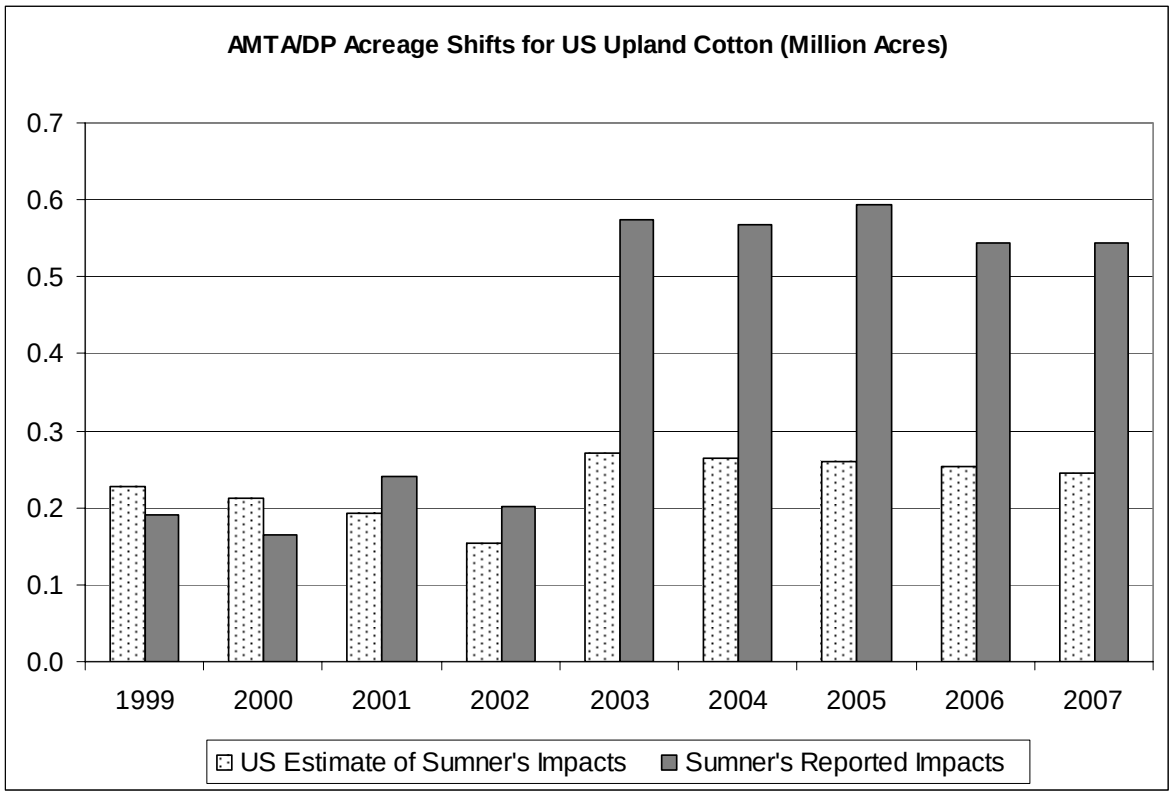
| | 1999-2002 Average Acreage Impact (Million Acres) | | | |
|---|---|---|---|---|
| | **AMTA/DP** | **MLA/CCP** | **Crop Insurance** | **Total** |
| Sumner Reported Impact | 0.199 | 0.300 | 0.683 | 1.182 |
| Estimate of Sumner Approach Using Market Returns | 0.197 | 0.286 | 0.636 | 1.119 |
| Estimate of Sumner Approach Using Total Returns | 0.166 | 0.243 | 0.587 | 0.996 |

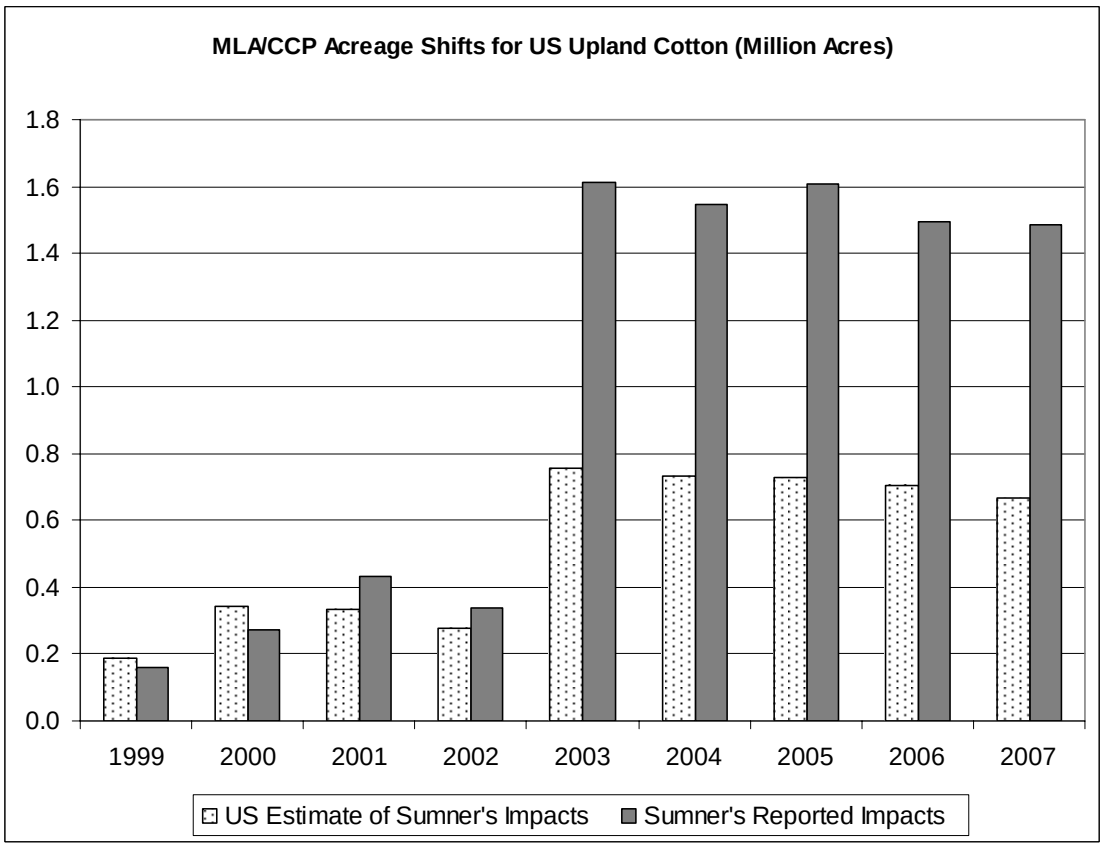
| | 2003-2007 Average Acreage Impact (Million Acres) | | | |
|---|---|---|---|---|
| | **AMTA/DP** | **MLA/CCP** | **Crop Insurance** | **Total** |
| Sumner Reported Impact | 0.565 | 1.548 | 1.013 | 3.127 |
| Estimate of Sumner Approach Using Market Returns | 0.258 | 0.718 | 0.553 | 1.529 |
| Estimate of Sumner Approach Using Total Returns | 0.179 | 0.591 | 0.432 | 1.202 |

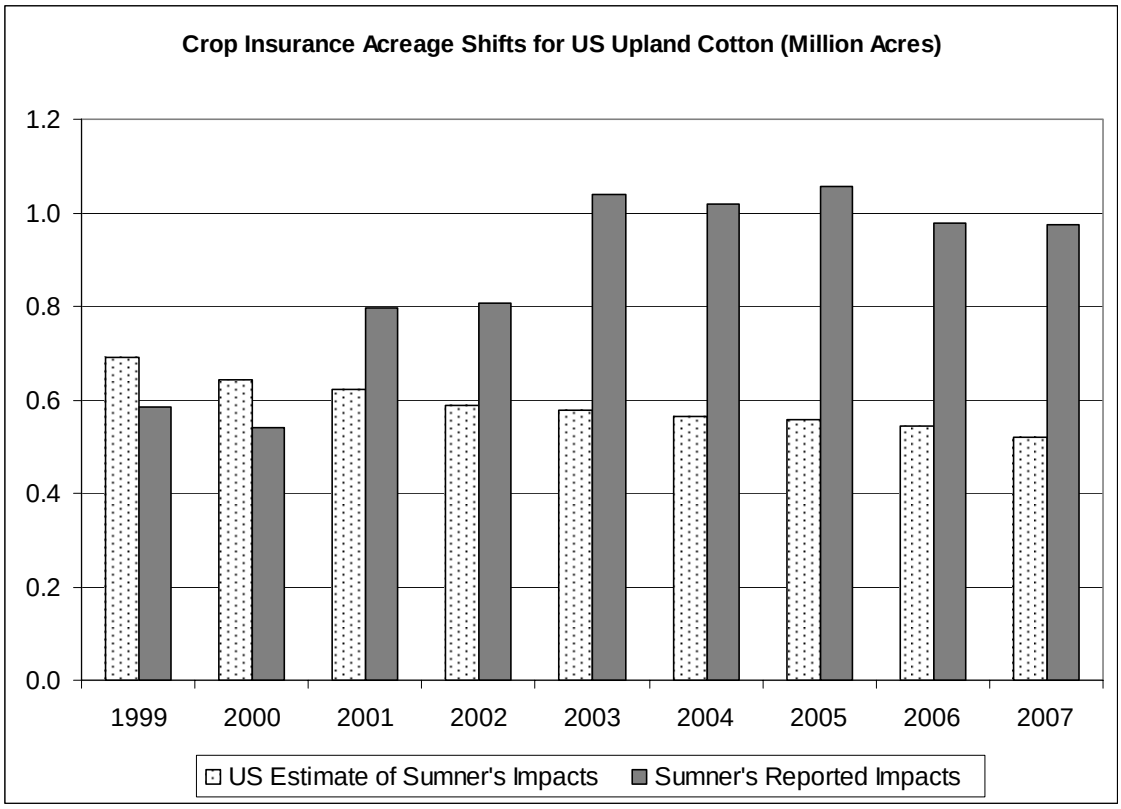
71. The following charts provide a year-by-year comparison between Dr. Sumner's reported impacts and estimates prepared by the United States. The formulas use to generate these estimates follow the documentation provided by Dr. Sumner. In cases where the information was incomplete, reasonable assumptions were made to facilitate the calculations. Complete details are provided in the file FINAL US2003CropsModel Correl 1[25].

72. Estimates by the United States for the 1999-2002 period are reasonably close to those offered by Dr. Sumner. However, there are large discrepancies over the 2003-07 period. It is inexplicable how the impact between the two periods can be so different. The differences cannot be explained by Dr. Sumner's method of incorporating alternative "coupling" factors.

[25] Exhibit US-115.






## VI. SUMNER MODIFICATIONS TO FAPRI MODEL DESCRIBED IN BRA-313 CONTAIN ERRORS

73. In Exhibit Bra-313, equation (2) on page 2 states that real net revenue for crop i in year (t-1) is a function of the price in (t-1) and the loan rate in (t-1), and other variables. It is this specification for real net revenue that determines acreage in year t, as described in equation (1). The combination of these two equations indicates that the loan rate in t-1 helps determine acreage in period t. In other words, Dr. Sumner's equation seems to assert it is last year's loan rate, and not the one in effect for this year's crop, that determines this year's plantings. Not only is this completely illogical, but it is in direct conflict with acreage equations previously developed by both FAPRI and USDA. The United States cannot determine if this equation reflects a lack of knowledge of the model, a broader deficiency in economics, or some previously unknown modification of the FAPRI or CARD models.

74. Dr. Sumner's documentation presented in equation (2) is inconsistent with equations contained in the files US CROPS MODEL 2002.xls (provided by Dr. Bruce Babcock on 26 November) and FINAL US2003CropsModel WORKOUT.xls (provided by Brazil on 18 November). Equation (2) defines real net revenue for crop i by taking the higher of the lagged farm price and the lagged loan rate, then multiplying by trend yield and subtracting variable costs. He further explains that this formulation applies to all crops except cotton and rice, where the marketing loan benefit depends on the difference between the loan rate and the AWP. However, in the two electronic versions of the crops model, which have been provided by Dr. Sumner and Dr. Babcock[26], the formulation of expected net revenue is not consistent with Dr. Sumner's documentation. According to the electronic versions, all crops incorporate the marketing loan benefit by taking the difference between the loan rate and the loan repayment price. The United States and the Panel are left to wonder why there is a discrepancy between Dr. Sumner's documentation and the models that have been provided.

[26] File US CROPS MODEL 2002.xls (provided by Dr. Bruce Babcock on 26 November) (Exhibit US-116) and FINAL US2003CropsModel WORKOUT.xls (provided by Brazil on 18 November) (Exhibit US-115).

75. Exhibit Bra-313 and Annex I provide different and conflicting methodologies for incorporating the impacts of crop insurance and decoupled payments. According to equation (1) of Annex I, the formula for determining expected net revenue has been modified to include per-acre decoupled payments and crop insurance benefits. These net returns then determine cotton planted acreage. However, in equation (1a) of Bra-313, Dr. Sumner indicates that net revenue only considers returns from the market and the marketing loan. He then incorporates the impacts of decoupled payments and crop insurance by adding some arbitrary acreage impacts into the equation. As explained earlier[27], the approach presented in Exhibit Bra-313 only serves to exaggerate his acreage impacts.

76. In equation (7), Dr. Sumner documents the equation specification for US cotton exports. His documentation indicates that exports in year t are a function of production in t-1, and other variables. Dr. Sumner's model suggests that last year's production directly determines this year's exports. This is both illogical and a departure from the specification included in the FAPRI framework.

## VII. OVERALL PRICE RESPONSIVENESS OF THE ANNEX I MODEL

77. The overall price impacts generated by a model are determined by the underlying supply and demand elasticities within the system. If overall supply and demand are more elastic, or more responsive, then an external shock to the system will generate a smaller change in price than a system that is more inelastic.

78. In the case of the scenarios examined by Dr. Sumner, the external shocks to the model are the elimination of various aspects of the US cotton programme. According to Dr. Sumner's analysis, the removal of the US cotton programme leads to a reduction in planted area, production, and subsequently exports onto the world market. The reduced supplies into the world market generate an increase in world price, with the magnitude of the price increase determined by the overall elasticities embodied within the models for foreign production and consumption.

79. The following table provides a comparison of aggregate supply and demand elasticities for foreign area and mill use. Based on individual country elasticities, the response of aggregate foreign area and consumption can be calculated based on weights derived from recent historical data. The elasticities reported in Table I.3 of Annex I are used to derive the aggregate elasticities of the Sumner-CARD international cotton[28] model provided by Brazil on 13 November. These are compared to published research from Dr. Seth Meyer at FAPRI-University of Missouri, which reports more responsiveness in both area and consumption.[29]

| Comparison of Model Elasticities | | | | |
|---|---|---|---|---|
| | Meyer – FAPRI | | Sumner – CARD | |
| | Short Run | Long Run | Short Run | Long Run |
| Foreign Area | 0.45 | 0.78 | 0.24 | N/A |
| Foreign Mill Use | -0.37 | -0.49 | -0.25 | N/A |

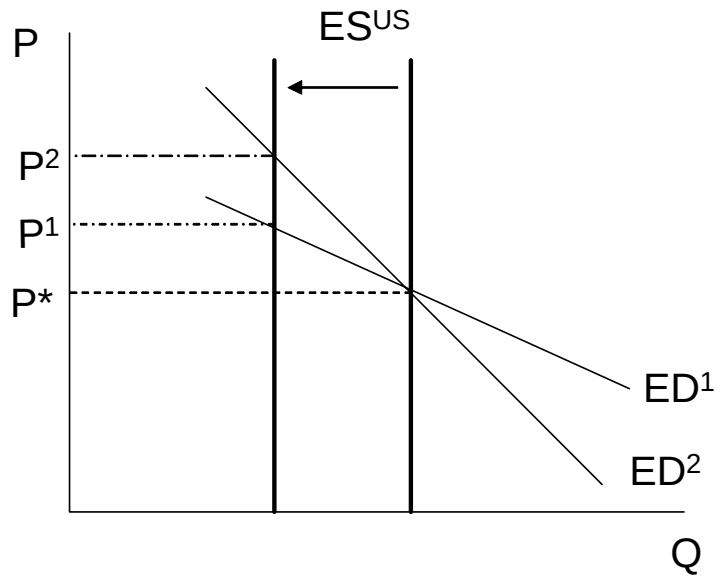
80. The net trade position of countries outside of the US is one of a net importer. Since their consumption exceeds their production, their excess demand (ED) is defined as demand (D) – supply (S). The responsiveness of their excess demand (ED) is approximated by the elasticity of the

[27] Section V.c of this document.

[28] File WDCT2002 Meltdown WORKOUT.xls, provided by Brazil on 13 November 2003. (Exhibit US-115.)

[29] Seth D. Meyer, *A Model of Textile Fiber Supply and Inter-Fiber Competition with Emphasis on the United States of America*, Food & Agricultural Policy Research Institute, University of Missouri, 2002.

domestic demand less the elasticity of their domestic supply. In the case of the Meyer model, the elasticity of excess demand is -0.37 – 0.45 = -0.82. For the Sumner model, the elasticity of excess demand is -0.25 – 0.24 = -0.49. This fundamental difference has a direct impact on the price impacts generated by the model, as evidenced by the following chart. The line ED1 represents an excess demand curve with more price responsiveness, while ED2 is an excess demand curve with less elasticity. The intersection of excess demand outside of the United States with excess supply (ESUS) from the United States generates an equilibrium price. When there is a reduction in the excess supply from the United States, the elasticity of excess demand, which is reflected by the slope of the line has a direst impact on the change in price. Dr. Sumner's choice of international supply and demand elasticities leads to exaggerated price impacts.




## VIII. CONCLUSION

81. The Sumner models, as presented by Brazil, are so laden with faulty theory on programme impacts and so deviate from the FAPRI standards that they cannot provide any foundation for the Panel's analysis of the effect of challenged United States programmes with respect to upland cotton. Not only does the Sumner model contain major differences from previous FAPRI work, it also appears to be internally inconsistent as the United States has noted changes in described methodology from the original Annex I submission to later submissions, such as Exhibit Bra-313 and subsequent documentation.

82. Virtually all of the concerns of the United States cited in this critique are directed toward Brazil economic manipulation that exaggerates acreage impacts of the United States upland cotton programme.

- Brazil's impacts attributed to decoupled programmes deviate from traditional FAPRI analysis.
- Brazil's impacts attributed to crop insurance programme are not supported by FAPRI analysis.
- Brazil's impacts attributed to the export credit guarantee programme have no demonstrated economic foundation.
- Brazil's Annex I results used baselines that were inexplicably lower than even FAPRI's preliminary November 2002 baseline.
- Brazil's non-linear approach to results deviated from the traditional FAPRI methodology.

- Many of Dr. Sumner's adaptations contain errors.

83. In the final analysis, Brazil does not rely on the FAPRI model to prove its case, it relies on its manipulation of that model to ensure it obtains the desired results.

# ANNEX I-10

## BRAZIL'S ANSWERS TO ADDITIONAL QUESTIONS FROM THE PANEL

20 January 2004

### TABLE OF CASES

| | |
|---|---|
| *EC – Sugar Exports I (Australia)* | GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Australia*, L4833 - 26S/290, adopted 6 November 1979 |
| *EC – Sugar Exports II (Brazil)* | GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Brazil)*, L/5011 – 27S/69, adopted 10 November, 1980. |
| *US – FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
| *US – 1916 Act* | Appellate Body Report, *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, adopted 26 September 2000. |
| *US – Corrosion-Resistant Steel* | Appellate Body Report, *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan*, WT/DS244/AB/R, adopted 9 January 2004. |

### List of Exhibits

| | |
|---|---|
| Agricultural Outlook Tables, USDA, November 2003, Table 19 | Exhibit Bra- 394 |
| "Trade Issues Facing the US Cotton Industry," Speech by Dr. Mark Lange, President and CEO, National Cotton Council, 6 January 2004. | Exhibit Bra- 395 |
| "Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, 2 September 2003. | Exhibit Bra- 396 |
| "Report of the Commission on the Application of Payment Limitations for Agriculture," August 2003. | Exhibit Bra- 397 |
| Western Farm Press, 7 January 2003 | Exhibit Bra- 398 |
| Acreage Discrepancies.xls | Exhibit Bra- 399 |
| List of Publications of Professors Babcock and Beghin | Exhibit Bra- 400 |

**257. The Panel takes note of the Appellate Body Report in United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.**

**(a) In that report, the Appellate Body cautioned against the "mechanistic" application of the so-called "mandatory/discretionary distinction" and stated that the import of this distinction may vary from case to case (para. 93). For the Appellate Body, the question of whether a measure is mandatory or not is relevant "if at all" only as part of the assessment of whether the measure is, as such, inconsistent with particular obligations. How, if at all, are these statements and the related findings concerning the mandatory/discretionary distinction in that Appellate Body Report relevant to:**

**(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the Agreement on Agriculture and Articles 3.1(a) and (b) of the SCM Agreement, concerning: BRA**

**- Step 2 payments (see, e.g. paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and**

**- export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, e.g., para. 90 Brazil's oral statement at second Panel meeting).**

**(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"? BRA**

**(iii) the legal standard and elements Brazil sets out to establish its "per se" "serious prejudice" claims (e.g. Brazil's 9 September further submission, para. 417 ff; US oral statement at second Panel meeting, para. 86 ff.)? BRA**

***The Appellate Body's Decision***

1. Prior to answering the Panel's specific questions, Brazil makes the following introductory comments. Generally speaking, with respect to the Panel's Questions 257(a) – (c), Brazil does not believe that the Appellate Body Report in *US – Corrosion-Resistant Steel* has a significant impact on the legal standards or the elements of Brazil's "*per se*" or threat of serious prejudice claims. This is because, unlike the USDOC Policy Bulletin in *US – Corrosion-Resistant Steel*, the measures at issue in this dispute, on their face, require the payment of subsidies to eligible producers, users, and exporters. The record in this dispute shows that US government officials enjoy no flexibility to apply the US subsidy programmes in a WTO-consistent manner.

2. The *US – Corrosion-Resistant Steel* decision does make the important conclusion that panels cannot reject on a jurisdictional basis "*per se*" claims against measures that on their face are not mandatory.[1] This Panel therefore need not examine whether the subsidy measures that Brazil has challenged are mandatory as a preliminary jurisdictional matter. However, this does not mean that the mandatory nature of measure is not important in deciding the merits of a "*per se*" (or threat of serious prejudice) claim. Indeed, the Appellate Body's analysis of the merits of Japan's "*per se*" claims in *US – Corrosion-Resistant Steel* appeared to turn largely on whether the measure was "mandatory", i.e., whether it required USDOC officials to analyze sunset reviews in a WTO-inconsistent manner.

[1] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 88.

3. The Appellate Body held that "[w]hen a measure is challenged 'as such,' the starting point for an analysis must be the measure on its face. If the meaning and content of the measure are clear on its face, then the consistency of the measure as such can be assessed on that basis alone".[2] The Appellate Body in *US – Corrosion-Resistant Steel* found that the "as such" challenge "hinges upon whether [the Sunset Policy Bulletin] instruct[s] USDOC to treat dumping margins and/or import volumes as determinative or conclusive, on the one hand, or merely indicative or probative, on the other hand, of the likelihood of future dumping".[3] Finding ambiguity in the text of the Bulletin (the use of the word "normally" and "good cause"), the Appellate Body held that the panel should have examined the history of the application of the Bulletin and individual decisions thereunder.[4] Since the panel had failed to make the necessary factual findings, the Appellate Body was unable to complete the analysis and to rule on Japan's claim.[5]

4. Nevertheless, the Appellate Body's decision appears to stand for the proposition that "*per se*" challenges require demonstration that either the text or the operation of a measure creates requirements for government officials to act in a WTO-inconsistent manner. Where the text is not completely clear, the Appellate Body found that panels must determine whether the measure creates "normative" requirements, i.e., whether the measures are treated as binding by government officials, are interpreted as binding on executive branch officials by courts, or are consistently applied in a manner suggesting that the measures are considered to be mandates for action.[6]

5. Further, the *US – Corrosion-Resistant Steel* decision highlights the importance of challenges to legal/regulatory measures as a way to avoid repeated WTO dispute settlement challenges in "as applied" claims. In describing what is a "measure," the Appellate Body recalled:

> [I]n GATT and WTO dispute settlement practice, panels have frequently examined measures consisting not only of particular acts applied only to a specific situation, but also of acts setting forth rules or norms that are intended to have general and prospective application. In other words, instruments of a Member containing rules or norms could constitute a "measure", irrespective of how or whether those rules or norms are applied in a particular instance. This is so because *the disciplines of the GATT and the WTO, as well as the dispute settlement system, are intended to protect not only existing trade but also the security and predictability needed to conduct future trade*. This objective would be frustrated if instruments setting out rules or norms inconsistent with a Member's obligations could not be brought before a panel once they have been adopted and irrespective of any particular instance of application of such rules or norms. *It would also lead to a multiplicity of litigation if instruments embodying rules or norms could not be challenged as such, but only in the instances of their application. Thus, allowing claims against measures, as such, serves the purpose of preventing future disputes by allowing the root of WTO-inconsistent behaviour to be eliminated*.[7]

6. Consistent with the language quoted above, Brazil's various challenges to US legal/regulatory instruments "*per se*" are intended to protect the security and predictability that Brazil's upland cotton producers need to conduct future trade. In addition, resolution of Brazil's separate threat of serious

[2] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 168.
[3] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 178.
[4] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, paras. 182-184, 187-189.
[5] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, paras. 189-190.
[6] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, paras. 99, 168.
[7] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 83 (emphasis added; references in original omitted).

prejudice claim under the *EC – Sugar Exports and US – FSC* rationales will prevent future disputes by addressing the root cause of the United States' WTO-inconsistent behaviour – the absence of any legal or regulatory limitations on subsidy payments, which creates a structural and permanent source of uncertainty in upland cotton markets.[8] Brazil has demonstrated that the mandatory US subsidy measures function to guarantee a high level of US upland cotton production and exports, and by definition, act to suppress world prices because of the increased supply by US producers of a fungible commodity.[9] Brazil further demonstrated that Brazilian producers are reluctant to engage in significant investments in leasing or purchasing land for upland cotton production because of the uncertainty caused by locked-in US production.[10] Brazil also recalls its position that requiring an "imminent threat" standard, as proposed by the United States, would in effect require Members such as Brazil to litigate claim after claim on the *application* of these measures, which threaten to cause serious prejudice to its interests.

7. Finally, Brazil notes that the Appellate Body's conclusions in *US – Corrosion-Resistant Steel* regarding the mandatory/discretionary distinction, although based on provisions of the Anti-Dumping Agreement, are equally relevant to claims under any of the covered agreements, including Brazil's claims under the SCM Agreement, the Agreement on Agriculture, and Article XVI of GATT 1994.[11]

**(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the Agreement on Agriculture and Articles 3.1(a) and (b) of the SCM Agreement, concerning: BRA**

- **Step 2 payments (see, e.g. paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and**

Brazil's Answer

8. Application of the *US – Corrosion-Resistant Steel* criteria requires a complainant bringing a per se claim to demonstrate that a measure does not provide relevant government officials with the flexibility to apply the measure in a WTO-consistent manner. As Brazil has argued[12], US government officials are not provided with any flexibility to make Step 2 subsidies under Section 1207(a) of the 2002 FSRI Act in a WTO-consistent manner. Thus, the Act violates Articles 3.3 and 8 of the Agreement on Agriculture, and Articles 3.1(a) and 3.1(b) of the SCM Agreement. The United States has conceded that "subject to the availability of funds (that is, the availability of CCC borrowing authority), Step 2 payments must be made to all those who meet the conditions for eligibility".[13] The

[8] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 203-216; Brazil's 9 September 2003 Further Submission, paras. 413-436.

[9] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 200-202.

[10] *See* Annex III of Brazil's 9 September 2003 Further Submission; Brazil's 9 September 2003 Further Submission, Section 6.3; Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003); Brazil's 18 November 2003 Further Rebuttal Submission, para. 203.

[11] The Appellate Body noted with respect to Article 17.3, the consultation clause of the Anti-Dumping Agreement, that there is "no threshold requirement, in Article 17.3, that the measure in question be of a certain type". Moreover, it has drawn the conclusion from the phrasing of Article 18.4 of the Anti-Dumping Agreement that "the entire body of generally applicable rules, norms and standards adopted by Members in connection with the conduct of anti-dumping proceedings" should be potentially subject to dispute settlement.[11] The provisions of Article 17.3 of the Anti-Dumping Agreement are closely modeled on those of GATT Article XXIII:1 which are cross-referenced in Article 30 of the SCM Agreement and Article 19 of the Agreement on Agriculture, and the provisions of Article 18.4 are virtually identical to Article XVI:3 of the Marrakesh Agreement Establishing the WTO.

[12] Brazil's 24 June 2003 First Submission, paras. 93-96, 244-45 and 250; Brazil's 22 August 2003 Comments to the US 11 August 2003 Answers to Questions 92-93, 96, 99 and 107.

[13] US 11 August 2003 Answer to Question 109.

United States admits that "the CCC has a large" borrowing authority and "*rarely has CCC run out of funds* but it has happened for brief periods of time".[14] Indeed, while the 1996 FAIR Act imposed a $701 million budgetary limit on the Step 2 programme during MY 1996-2001, this limit was reached by 1999. At the urging of the NCC, Congress eliminated the spending cap in 2000.[15] Unlimited funding has existed ever since, including $415 million in expenditures in MY 2002 alone.[16]

9. The Secretary of the USDA must make payments pursuant to the plain text of Section 1207(a)(1), (2), and (4) of the 2002 FSRI Act (as set out in paragraph 245 of Brazil's 24 June First Submission). Consistent with the *US – Corrosion-Resistant Steel* decision, the evidence of mandatory payments demonstrates the absence of any flexibility for US officials to apply the programme in a WTO-consistent manner. Even if US authorities, acting in the best of faith, recognize that Step 2 payments are inconsistent with the US export subsidy obligations as well as with the prohibition on local content subsidies, *Congress has not given them the discretion to stop the payments*. Indeed, Congress has created a legal right for eligible recipients to demand and receive payments.

- **export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, e.g., para. 90 Brazil's oral statement at second Panel meeting).**

Brazil's Answer

10. The Appellate Body Report in *US – Corrosion-Resistant Steel* does not affect the legal standard and elements set out by Brazil to establish its claims against the GSM 102, GSM 103 and SCGP programmes under Articles 10.1 and 8 of the Agreement on Agriculture, and under Article 3.1(a) of the SCM Agreement. In fact, the mandatory/discretionary distinction is not relevant to Brazil's claims against the CCC export credit guarantee programmes under Article 10.1 of the Agreement on Agriculture.

11. Article 10.1 prohibits circumvention, and the threat of circumvention, of export subsidy reduction commitments. Brazil has demonstrated actual circumvention, by establishing that with respect to both unscheduled products[17] and at least one scheduled product[18], the United States has in fact circumvented its export subsidy reduction commitments. This is somewhat akin to an "as applied" claim, and it is therefore not relevant to this claim whether the CCC programmes are mandatory or discretionary.

12. Brazil has also demonstrated threat of circumvention. With respect to unscheduled products, the Appellate Body has held that it constitutes threat of circumvention to provide *any* export subsidies for unscheduled products.[19] Having proven that CCC guarantees are export subsidies (under Articles 1.1 and 3.1(a) of the SCM Agreement, as well as item (j)), and having proven that those guarantees are available for unscheduled products[20], Brazil demonstrated threat of circumvention, and a violation of Article 10.1. This is the standard set out by the Appellate Body in *US – FSC*; it does not appear to be relevant to this claim whether the CCC programmes are mandatory or discretionary.

13. With respect to scheduled products, the test under Article 10.1 is not whether the CCC programmes are "mandatory" as opposed to "discretionary". Rather, to determine whether CCC export credit guarantees for scheduled products threaten to lead to circumvention of the US export

[14] US 22 December 2003 Answers to Question 254.
[15] Brazil's 24 June 2003 First Submission, para. 95.
[16] US 22 December 203 Answer to Question 196, para. 12 (based on October 2002-September 2003 fiscal year data).
[17] *See* Brazil's 2 December 2003 Oral Statement, para. 87.
[18] *See* Brazil's 2 December 2003 Oral Statement, para. 89 (and note 179).
[19] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 150.
[20] *See* Brazil's 18 November 2003 Further Rebuttal Submission, para. 256 (and note 414).

subsidy reduction commitments, Brazil has noted that the test set out by the Appellate Body in *US – FSC* is whether the CCC can "stem[], or otherwise control[], the flow of" CCC export credit guarantees. Brazil has demonstrated that CCC cannot do so.[21] One fact Brazil has noted is that the CCC programmes are "mandatory," as that term is defined in US law.[22] (In Brazil's view, the CCC programmes are also "mandatory," within the meaning of WTO/GATT law).

14. Brazil also claims that the CCC export credit guarantee programmes constitute prohibited export subsidies under Articles 1.1 and 3.1(a) of the SCM Agreement. Brazil has demonstrated that the CCC programmes confer "benefits" per se, within the meaning of Article 1.1(b) of the SCM Agreement (as well as that they are financial contributions and are *de jure* contingent on export). Brazil has relied on three types of evidence and argument to make this *per se* showing, as summarized in paragraphs 231-241 of its 18 November 2003 Further Rebuttal Submission. These three types of evidence and argument demonstrate that every time a CCC guarantee is issued, a benefit is conferred *per se*. This is effectively the equivalent of saying that the CCC programmes "mandate" a violation.

15. Finally, Brazil also claims that the CCC export credit guarantee programmes constitute prohibited export subsidies under item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement. Brazil does not consider that, to the extent the traditional mandatory/discretionary principle was modified by the Appellate Body in *US Corrosion-Resistant Steel*, those modifications have any impact on Brazil's claim.

16. Moreover, Brazil does not consider that it is particularly useful to determine whether Brazil's claim is "as applied" or "as such", thus necessitating a determination whether the CCC programmes are "mandatory" or "discretionary". Indeed, the Appellate Body in *US Corrosion-Resistant Steel* stressed that the "import of the 'mandatory/discretionary distinction' may vary from case to case", cautioning "against the application of this distinction in a mechanistic fashion".[23] Item (j) imposes a *sui generis* standard – it calls for an evaluation whether the CCC programmes are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programmes. Brazil has established these elements in two ways. First, using a number of methodologies, Brazil has looked at historical data concerning premiums collected and costs and losses incurred, to establish that costs and losses incurred exceeded premiums collected over a 10-year period.[24] Second, Brazil used statements by USDA's Office of the Inspector General and the US General Accounting Office to establish that premium rates for the CCC programmes, and not just premiums collected, do not and will continue not to meet costs because they do not, and are not adjusted to, offset credit risks, and are, further, capped at one per cent.[25] Given the forward-looking nature of this analysis, Brazil does not agree with the United States that item (j) necessarily "requires a certain retrospection".[26]

**(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"**

[21] *See* Brazil's 2 December 2003 Oral Statement, paras. 90-91; Brazil's November 2003 Further Rebuttal Submission, paras. 258-262.

[22] Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Programme classified as "Mandatory" in Table 2, and in the "Introduction", the Office of Management and Budget states that Table 2 provides "the programme's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory").

[23] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 93.

[24] *See* Brazil's 18 November 2003 Further Rebuttal Submission, paras. 243, 245-253 and the references cited therein.

[25] *See* Brazil's 18 November 2003 Further Rebuttal Submission, para. 252 (and all citations). Given the forward-looking nature of this analysis, Brazil does not agree with the United States that item (j) necessarily "requires a certain retrospection". (US 22 December 2003 Answers to Questions, para. 103).

[26] US 22 December 2003 Answers to Questions, para. 103.

Brazil's Answer

17. The *US – Corrosion-Resistant Steel* decision does not significantly change Brazil's analysis of its serious prejudice or threat of serious prejudice claims. There has never been an issue whether the statutes and regulations providing for the five US subsidies referred to in the Panel's question are "mandatory" – this has been clear from the face of the statutory and regulatory provisions, as set out in Brazil's earlier submissions and even acknowledged by the United States.27 The record establishes that marketing loan, crop insurance, direct and counter-cyclical payments, and Step 2 payments are "mandatory" provisions – payments and expenditures are required to be made by US Government officials to eligible producers, users or exporters.[28]

18. The mandatory nature of the US subsidies is relevant to (a) Brazil's "per se" claims as well as (b) Brazil's threat of serious prejudice claims that do not involve claims regarding the "*per se*" validity of the statutes. The evidence of mandatory (or "normative") measures is a required element for Brazil's "*per se*" claims. And a threat of serious prejudice under Article 6.3 and 5(c) will be more likely to exist if the subsidies are mandatory, i.e., that the subsidies must be paid to eligible producers, exporters, and users. The record demonstrates that there are no provisions in US law limiting the payments, and, thus, limiting the threat of serious prejudice (i.e., significant price suppression, increased world market share for US exports, or inequitable share of world trade). The so-called "circuit-breaker" in the 2002 FSRI Act is not applicable to individual commodities, but instead only to total US AMS.[29] The United States has admitted that there is no provision in US law that stops subsidy payments when serious prejudice is caused to other WTO Members.[30] In particular, there was no flexibility provided to US government officials to limit upland cotton payments at any time during MY 1999-2002. When prices plunged to record lows in MY 2001 and MY 2002, USDA poured funds into sustaining high levels of US upland cotton production and exports. The participants in the world market know this will happen again when prices fall. And world producers, such as those from Brazil, as well as traders discovering prices in the New York futures markets, know that this means that US production and exports will remain high for the remainder of the 2002 FSRI Act.[31]

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[27] *See* Brazil's 9 September 2003 Further Submission, Sections 4.2.1-4.2.5 (summarized in paragraph 423); US 27 October 2003 Answer to Question 162, para 95 ("The statutory authority for marketing loan payments, step 2 payments, and counter-cyclical payments does not provide the Secretary with the authority to arbitrarily decline to make these payments to qualified recipients."); para. 97 ("there is no present limit on the total amount of payments that can be made under each of these programmes although for counter-cyclical payments a maximum total outlay can be calculated using the base acres, base yields, and maximum payment rate for each commodity produced during the historical base period".).

[28] *See* also Brazil's Answer to Question 257(b) below.

[29] US 2 December 2003 Oral Statement para 82. US 22 December 2003 Answer to Question 253, para. 180.

[30] US 22 December 2003 Answer to Question 253, para. 180 (the circuit-breaker provision "does not appear to contemplate any such finding of serious prejudice, but rather is seemingly focused more particularly on the overall level of expenditures as that was the only restriction agreed to in this instance by the United States … ".).

[31] The absence of any "circuit breaker" for upland cotton is significant given the fact that producers of upland cotton received far more per unit and *ad valorem* subsidies than any other US commodity during MY 1999-2002 (Brazil's 9 September 2003 Further Submission, para. 4). No other US crop has a "competitiveness" subsidy such as Step 2, which paid $415 million to US users and exporters of upland cotton in MY 2002. No other US crop had counter-cyclical payments of over $1 billion in MY 2002. No other US crop had such large per unit marketing loan payments during MY 1999-2002. These huge guaranteed payments, along with the *unlimited* amount of upland cotton that can receive benefits from marketing loan, Step 2, and crop insurance subsidies, together with the very high per-acre direct and counter-cyclical payments (compared to other programme crops), together constitutes strong evidence that these measures have not, are not, and will not be applied in the future in a WTO-consistent manner.

19. This permanent threat of serious prejudice is similar to "threat of circumvention" of export subsidy reduction commitments, under Article 10.1 of the Agreement on Agriculture. In US – FSC, the Appellate Body held that the absence of any legal mechanism that can "stem[], or otherwise control[], the flow of"[32] subsidies creates a *threat* of circumvention. Again, as in this dispute, in *US – FSC* and *EC – Sugar Exports*, there was no legal mechanism to limit the amount of potential subsidies that could be paid. The threat was and is tangible

20. The price-trigger mechanism contained in certain of the programmes does not minimize the threat of serious prejudice. In fact, the very existence of the mandatory marketing loan, Step 2 and counter-cyclical payment programme alone impacts farmers' planting decisions. Even when farmers expect market price levels that would not trigger these payments, farmers know that there is a certain likelihood that their expectations will turn out to be wrong and prices will turn out much lower than anticipated. However, history has taught US upland cotton producers to know with certainty that they will not suffer any economic harm from their misperception of prices for the upcoming marketing year. Any downside market revenue risk is covered by the combined effects of the marketing loan and counter-cyclical payment programmes, as well as by the effects of certain crop insurance policies such as revenue insurance. In short, the mandatory US subsidies mean that high US production and exports are guaranteed.

21. Further, these programmes have effects on production decisions of US farmers *via* a second mechanism, as Brazil and Professor Sumner have detailed at the second meeting of the Panel.[33] Even if farmers expect upland cotton prices (cash prices as well as the adjusted world price) to be above the trigger prices for marketing loan, counter-cyclical and Step 2 payments, farmers will expect with a certain likelihood that prices might nevertheless turn out to be below these trigger prices, i.e., farmers have a probability distribution for expected prices. Given this probability distribution, Professor Sumner explained at the second meeting of the Panel that farmers would still expect some payments from these programmes.[34] Thus, these programmes impact farmers planting decisions, increasing and locking in a high US supply of upland cotton that causes adverse effects.

22. Finally, Brazil has demonstrated that the "chilling effect" of guaranteed US subsidies leads to reduced investment of Brazilian farmers in upland cotton production.[35] Indeed, USDA itself acknowledges – with respect to soybeans, but equally applicable to upland cotton – that low international prices have had negative impacts on additional investments and increases in production in Brazil.[36] This "chilling effect" is the result of Brazilian and other countries' farmers' perception of the threat of serious prejudice from the US upland cotton subsidies.

**(iii) the legal standard and elements Brazil sets out to establish its "per se" "serious prejudice" claims (e.g. Brazil's 9 September further submission, para. 417 ff; US oral statement at second Panel meeting, para. 86 ff.)?**

[32] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

[33] *See* Brazil's 2 December 2003 Oral Statement, para. 48 and Exhibit Bra-371 (Simple Example of the Calculation of Expected Marketing Loan Benefit); Brazil's 22 December 2003 Answers to Questions, para. 155.

[34] Exhibit Bra-371 (Simple Example of the Calculation of Expected Marketing Loan Benefit).

[35] Brazil's 9 September 2003 Further Submission, Section 6.3 and Annex III; Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003); Brazil's 18 November 2003 Further Rebuttal Submission, para. 203.

[36] Brazil's 9 September 2003 Further Submission, para. 455 and Exhibit Bra-263 ("Argentina & Brazil Sharpen Their Competitive Edge," USDA, Agricultural Outlook, September 2001, p. 32).

Brazil's Answer

23. As detailed in Brazil's answer to Question 257(a)(ii) and (b), marketing loan, Step 2, crop insurance, direct and counter-cyclical payment subsidies are mandatory within the traditional mandatory/discretionary distinction. Thus, the Appellate Body decision in *US – Corrosion-Resistant Steel* does not affect the legal standard and elements for Brazil's *per se* claims against those subsidy programmes.[37]

**(b) How and to what extent are the legal and regulatory provisions cited in paras. 415 and 423 of Brazil's 9 September further submission "normative" in nature and treated as binding within the US legal system (see, e.g., para. 99 of the Appellate Body Report)? Does your response differ depending on whether the payments are dependent upon market price conditions? BRA**

Brazil's Answer

24. Brazil understands the ordinary meaning of "normative" to be "establishing a norm or standard of; deriving from or implying a standard or norm; prescriptive".[38] In the sense of the term used by the Appellate Body in *US – Corrosion-Resistant Steel*, the US statutes and regulations summarized in paragraphs 415 and 423 of Brazil's 9 September Further Submission[39] are "normative" because they establish (a) obligations for US officials to make payments, and (b) legal rights for eligible producers, users, and exporters to receive the payments. As used by the Appellate Body, the term "normative" includes as a subcategory the group of measures that are mandatory, within the meaning of the traditional mandatory/discretionary distinction.

25. The United States has acknowledged that the "statutory authority for marketing loan payments, step 2 payments, and counter-cyclical payments does not provide the Secretary with the authority to arbitrarily decline to make these payments to qualified recipients".[40] In addition, the direct payment provisions of the 2002 FSRI Act similarly provide that "payment [is] required" and the "Secretary shall make direct payments to producers on farms for which payment yields and base acres are established".[41] Finally, the crop insurance payment provisions of the 2000 ARP Act also create "norms" in the form of mandated payments of subsidies for "catastrophic risk protection" and "alternative catastrophic coverage" that "shall" be provided to all eligible producers.[42] Thus, the statutory and regulatory provisions mandating payments for each of these five types of subsidies are, by any reasonable definition, "normative" measures.

26. The Panel asks further whether Brazil's response differs depending on whether the payments are dependent upon market price conditions. The answer is "no".

27. As Brazil has argued before, the fact that marketing loan, counter-cyclical and Step 2 payments may not be made due to higher prices does not mean that these subsidy programmes are not mandatory.[43] The focus for deciding whether a measure is mandatory or discretionary is on whether it

[37] While a *per se* claims against non-mandatory measures under Article 5(c) and footnote 13 of the SCM Agreement seems possible, the Panel is not faced with such a situation in this case, as all the measures challenged by Brazil are, in fact, of a mandatory nature.

[38] New Shorter Oxford Dictionary, 1993 edition, p. 1941.

[39] Each of these statutory and regulatory provisions were discussed in more detail in paragraphs 312-341 of Brazil's 9 September 2003 Further Submission.

[40] US 27 October 2003 Answer to Question 162, para 95.

[41] Brazil's 9 September 2003 Further Submission, para. 333 citing Section 1103(a) of the 2002 FSRI Act.

[42] Brazil's 9 September 2003 Further Submission, para. 319 citing Section 508(b)(1), (2), and 508(c)(1)(A) of the 2000 ARP Act.

[43] Brazil's 7 October 2003 Oral Statement, paras. 50-51.

provides government officials with the discretion to implement the measure in a WTO-consistent manner.[44] But the terms of the statutes/regulations provide no discretion or flexibility to any US Government official when low prices trigger the required marketing loan and counter-cyclical payments or when high prices lead payments to phase out temporarily. Rather, price levels are an eligibility condition for payment, similar to conditioning eligibility of a producer for contract payments on his not growing fruits and vegetables.

28. Objective conditions, such as market price movements, or objective eligibility criteria are not appropriately considered in determining whether a measure gives an implementing official "discretion" to act in a WTO-consistent fashion. For example, the FSC measure payments were only available where the income concerned was of foreign origin. Despite the fact that non-foreign sourced income would thus be excluded from FSC benefits, the measure was still found to threaten the circumvention of export subsidy requirements. Similarly, Step 2 payments are only available if an exporter is regularly engaged in the business of exporting upland cotton. The fact that a USDA official cannot legally make a Step 2 payment to a non-eligible exporter does not make the Step 2 programme "discretionary". And the fact that no marketing loan payments are available for upland cotton when the adjusted world price exceeds 52 cents per pound does not mean that the billions of dollars of payments made during MY 1999-2002, when prices were below that level, were "discretionary".

29. The United States argues that measures are "discretionary" if there are any conditions attached to payments – regardless of whether the executive official is permitted to exercise any discretion in refusing to make the payment. Such an interpretation would read out any meaning to the "mandatory/discretionary" distinction. Of course, at some level of abstraction, it is possible to create scenarios under which subsidies might not be paid. For example, the US Congress could decide to impose actual limits on CCC funding or change the 2002 FSRI Act to include a cotton "circuit-breaker" provision to limit cotton payments. But these theoretical possibilities do not make the existing mandatory text of the 2002 FSRI and 2000 ARP Act discretionary.

30. However, even if these existing texts were not mandatory on their face (which they are), the *US – Corrosion-Resistant Steel* decision teaches that the Panel must give weight to the long-term application of the measure to determine its normative character. The fact that billions of dollars in marketing loan, Step 2, counter-cyclical and direct payment were paid to US upland cotton producers, users and exporters of upland cotton over the past four years is highly relevant evidence for that determination. So is the fact that billions more will be paid before the 2002 FSRI ends in MY 2007. The provisions of these programmes have never been applied in a "discretionary" manner. Not a single eligible upland cotton farmer, user or exporter has been denied payment under these programmes by USDA officials. This is because there is simply no discretion vested in any US official to decide, independent of any objective market conditions or eligibility criteria, not to make these payments. Therefore, they are mandatory within the meaning WTO/GATT precedent, including the *US – Corrosion-Resistant Steel* decision.

**(c) Does Brazil challenge as "mandatory" the "subsidies" themselves, the subsidy programmes or the legal/regulatory provisions for the grant or maintenance of those subsidies, or something else? BRA**

Brazil's Answer

31. With respect to the Panel's question, Brazil does not believe that there is any difference between the "subsidy programmes" and the "legal/regulatory provisions" for the grant or maintenance of the subsidies.

[44] Appellate Body Report, *US – 1916 Act*, WT/DS132/AB/R, para. 100.

32. With respect to Brazil's "*per se*" claim, it challenges as "mandatory" the legal/regulatory provisions for the grant or maintenance of the subsidies.[45]

33. Brazil's "threat of serious prejudice" claim also challenges as "mandatory" the legal/regulatory provisions for the grant or maintenance of the subsidies. However, in this claim Brazil is not challenging the text of these provisions in the traditional "*per se*" sense, but rather under the rationale of the *EC – Sugar Exports* precedent. Under this claim, the mandatory nature of the largely unlimited subsidies required to be provided in MY 2003-2007 under the 2002 FSRI Act and the 2000 ARP Act (and implementing regulations) is key evidence demonstrating an ongoing, significant threat of significant price suppression and increased and inequitable US world market shares in the period MY 2003-2007.

34. In Brazil's view, a "threat of serious prejudice" claim is, in the Panel's word, "something else" – a *sui generis* claim. Brazil considers that the Appellate Body was advising against slavish adherence to the "*per se*" and "as applied" labels – intimately related to the traditional mandatory/discretionary distinction – when it cautioned in *US – Corrosion Resistant Steel* "against the application of this distinction in a mechanistic fashion".[46] If a claimant proves the elements of a threat claim, as set out in *EC – Sugar Exports* and *US – FSC*, it succeeds on the merits, regardless whether the claim is labelled "*per se*" or "as applied" – terms which are not themselves found in Part III of the SCM Agreement.

35. In the case of a "threat" claim, this note of caution is particularly apt. In proving its threat of serious prejudice claim, Brazil has followed the rationale in *EC – Sugar Exports* and *US – FSC*, demonstrating the "mandatory" nature of the legal/regulatory instruments by which the subsidies are paid, together with the unlimited amount of products that may receive the subsidies, and the extent to which those legal/regulatory instruments fail to stem or control the flow of the subsidies.[47] Brazil has backed up this evidence with historical data regarding the unlimited way in which the legal/regulatory instruments have been applied to grant payments to US upland cotton farmers during the period MY 1999-2002.

36. This data gives context to the nature and extent of the threat posed by the mandatory legal/regulatory instruments at hand. The data is critical, because it demonstrates that even if the measures are not mandatory (which they are), the US authorities have always applied the measures in a way that would cause serious prejudice. Since payments have never been withheld, the data demonstrates, at the very least, that the US authorities treat the measures as "normative", as that term was used by the Appellate Body in *US – Corrosion Resistant Steel*.[48]

37. Brazil turns now to its claims regarding the three CCC export credit guarantee programmes. As discussed in Brazil's response to question 257(a)(i), Article 10.1 prohibits circumvention, and the threat of circumvention, of export subsidy reduction commitments. As discussed above, Brazil has demonstrated actual circumvention with respect to both unscheduled products and at least one scheduled product. This is somewhat akin to an "as applied" claim against guarantees issued under the CCC programmes. It is therefore not relevant to this claim whether the CCC programmes are mandatory or discretionary.

38. Brazil has also demonstrated that the three CCC programmes pose a threat of circumvention. Brazil's threat of circumvention claims are against the programmes as such. With respect to unscheduled products, it constitutes threat of circumvention to provide *any* export subsidies for

[45] Brazil's 9 September 2003 Further Submission, paras. 422-423.
[46] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 93.
[47] Brazil refers the Panel to the additional discussion regarding the mandatory nature of the US measures and Brazil's threat of serious prejudice claim in its Answer to Question 257(a)(ii) *supra*.
[48] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 93.

unscheduled products. Under *US – FSC*, it does not appear to be relevant to this claim whether the CCC programmes are mandatory or discretionary. With respect to unscheduled products, the test under Article 10.1 is whether export subsidies are made available to those products. With respect to scheduled products, the test under Article 10.1 is also not whether the CCC programmes are "mandatory" as opposed to "discretionary". Rather, the question set out in *US – FSC* is whether the CCC can "stem[], or otherwise control[], the flow of" CCC export credit guarantees. Brazil has demonstrated that CCC cannot do so.

39. Brazil turns now to its claims under Articles 1.1 and 3.1(a) of the SCM Agreement, which are against the CCC programmes themselves. Brazil has demonstrated that the CCC programmes confer "benefits" *per se*, within the meaning of Article 1.1(b) of the SCM Agreement (as well as that they are financial contributions and are *de jure* contingent on export). Brazil has demonstrated that every time a CCC guarantee is issued, a benefit is conferred *per se*. This is effectively the equivalent of saying that the CCC programmes themselves "mandate" a violation, under the traditional meaning of the mandatory/discretionary principle.

40. Finally, Brazil's claims under item (j) of the Illustrative List of Export Subsidies are both against guarantees granted under the three CCC programmes, and against the CCC programmes themselves. First, Brazil has demonstrated that, retrospectively, costs and losses incurred by the programmes exceeded premiums collected over a 10-year period. This is somewhat akin to an "as applied" claim against guarantees issued under the CCC programmes. It is therefore not relevant to this claim whether the CCC programmes are mandatory or discretionary. Second, Brazil has demonstrated that, looking forward, premium rates for the CCC programmes, and not just premiums collected, do not and will continue not to meet costs because they do not, and are not adjusted to, offset credit risks, and are, further, capped at one percent.[49] As statements by USDA's Office of the Inspector General and the US General Accounting Office demonstrate, the CCC programmes do not have the flexibility under US law to offset credit risks and meet costs. This is effectively the equivalent of saying that the CCC programmes themselves "mandate" a violation, under the traditional meaning of the mandatory/discretionary principle.

**(d) Does the "requirement" upon the CCC to make available "not less than" $5.5 billion annually in guarantees have a normative character and operation? (see, e.g. Brazil's response to Panel Question 142; Exhibit BRA-297, 7 USC 5641(b)(1); 7 USC 5622(a) & (b); paragraph 201 of US 18 November further rebuttal submissions). Is this requirement "mandatory"? If so, how does the CCC have "discretion" not to make this amount of guarantees available in a given year? USA**

Brazil's Comment

41. Brazil offered the evidence mentioned by the Panel (as well as evidence regarding CCC's obligation to make available an additional annual amount of at least $1 billion in direct credits or guarantees for exports to "emerging markets"[50]) to demonstrate, with respect to scheduled products, its threat of circumvention claim under Article 10.1 of the Agreement on Agriculture. Brazil has already noted that the test under Article 10.1 is not whether the CCC programmes are "mandatory" as opposed to "discretionary". Rather, to determine whether CCC export credit guarantees for scheduled

[49] For this reason, Brazil does not agree with the United States that an item (j) analysis necessarily "requires a certain retrospection" (US 22 December 2003 Answers to Questions, para. 102).

[50] *See* Exhibit Bra-366 (7 U.S.C. § 5622 note, "Promotion of Agricultural Exports to Emerging Markets, para. (a) ("The Commodity Credit Corporation shall make available for fiscal years 1996 through 2002 not less than $1,000,000,000 of direct credits or export credit guarantees for exports to emerging markets under section 201 or 202 of the Agricultural Trade Act of 1978 (7 U.S.C. 5621 and 5622), in addition to the amounts acquired or authorized under section 211 of the Act (7 U.S.C. 5641) for the programme.")). *See also* Exhibit Bra-367 (Section 3203 of the 2002 FSRI Act (extending mandate to 2007)).

products threaten to lead to circumvention of the US export subsidy reduction commitments, the test set out by the Appellate Body in *US – FSC* is whether the CCC can "stem[], or otherwise control[], the flow of" CCC export credit guarantees. Brazil has demonstrated that CCC cannot do so.

**(e) Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (e.g. Exhibit BRA-117 (2 USC 661(c)(2))? USA**

Brazil's Comment

42. As noted in Brazil's response to question 257(a)(i), Brazil has provided evidence that the CCC programmes are "mandatory," within the meaning of that term under US law (although that is not to say that the CCC programmes are not also mandatory, within the meaning of WTO/GATT law).

**258. Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks. BRA**

Brazil's Answer

43. Brazil appreciates the opportunity to describe to the Panel the methodology that it will apply to the data, should the United States produce it on 20 January 2004. As the Panel noted in its 12 January Communication, the United States failed on 18/19 December 2003 to comply with its obligation to provide the requested data in a non-"scrambled" form. Therefore, Brazil is not in a position to apply the methodology discussed below and to present its results to the Panel today. If the United States does not produce non-scrambled and otherwise complete data responsive to the Panel's request, on 28 January 2004, Brazil will provide further comments and make requests as appropriate.

44. Generally, Brazil's methodology will calculate the amount of expenditures that support upland cotton production by examining farm-specific contract and planted acreage data. For each of these farms, Brazil would calculate the amount of contract payments for each crop for which the upland cotton farm has base acreage.[51] To that end, for each crop, the amount of contract payment units (as provided by the United States[52]) would be multiplied by the payment rate for the subsidy programme (PFC, market loss assistance, direct and counter-cyclical payments) in the marketing year in question.[53] Brazil will allocate crop contract payments to the respective crop for which they are made for each farm, up to the amount of acreage actually planted to that crop. For example, any contract payment for an upland cotton base acre that is actually planted to upland cotton is deemed

[51] These crops include all crops that constitute programme crops for purposes of the PFC, market loss assistance, direct and counter-cyclical payment programmes.

[52] In case the United States does not provide the payments units with its 20 January 2004 data, they can be easily calculated by multiplying the contract acreage for a crop with the payment yield for that crop. The payments units are calculated as 85 percent of that figure.

[53] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19 provides payment rates for PFC, direct and counter-cyclical payments in a column called "income support rates" for marketing years 1999-2002. However, rice payments for MY 2002 appear to be reported in error, since no rice counter-cyclical payments were made. In fact, the full rice counter-cyclical payment was made in MY 2002 (*see* Exhibit Bra-173 (Revised Estimate of Support Granted by Commodity via Counter-Cyclical Payments)). The full rice CCP is $1.65 (*see* Exhibit Bra-27 ("Side by Side Comparison of the 1996 and 2002 Farm Act, p. 2-5) report the rice target price as $10.50 per cwt, the direct payment rate as $2.35 per cwt and the loan rate as $6.50 per cwt, resulting in a full CCP payment of $1.65 per cwt or $0.00748 per pound).

support to upland cotton. If non-upland cotton base acres on a farm are planted to upland cotton, payments made for these base acres would also be deemed to constitute support to upland cotton.

45. Application of Brazil's methodology would require the writing of a simple computer programme that calculates the contract payments that constitute support to upland cotton for any farm in the United States that receives contract payments and plants upland cotton. The individual farm data would then be tabulated to calculate a total amount of expenditures provided in support of the production of upland cotton.

46. Brazil provides below additional details concerning its methodology. The data that has been withheld by the United States will show farms with many different combinations of base acreage and upland cotton plantings. There may be farms with more upland cotton base acres than planted acres, or with less base acres than planted acres. There may be farms that plant only upland cotton, or farms that have other programme crops as well. Finally, farms may have more or less crop base acreage than they plant to programme crops. Brazil systematically presents below a number of sample farms and illustrates how its allocation methodology will be applied to the actual data for each type of farms.

47. In a first step, Brazil considers three general categories of upland cotton farms: (1) those with fewer planted upland cotton acres than upland cotton base acres, (2) those with more planted upland cotton acres than upland cotton base acres, and (3) those planting cotton without any upland cotton base acres.[54] The table below illustrates this for the three categories of farms:

| Sample Farm No. | Farm 1 | Farm 2 | Farm 3 |
|---|---|---|---|
| Type of Cotton Farm | Farm With Cotton Plantings Below Cotton Base | Farm With Cotton Plantings Exceeding Cotton Base | Farm With Cotton Plantings But No Cotton Base |
| Cotton Base | 100 acres | 100 acres | 0 acres |
| Cotton Plantings | 50 acres | 150 acres | 100 acres |
| Payments Allocated In A First Step | Payments for 50 Cotton Base Acres | Payments for 100 Cotton Base Acres | No Payments for Cotton Base Acres |

Sample Farm 1 plants 50 acres of its 100 upland cotton base acres to upland cotton. Thus, any payments for these 50 upland cotton base acres constitute support to upland cotton.[55] Since contract payments for all acres planted to upland cotton are allocated therewith, the calculation ends for this farm (and any farm in a similar position). Any payments associated with the other 50 upland cotton base acres are not considered, as they do not constitute support to upland cotton. Sample Farm 2 plants 150 acres of upland cotton, but has only 100 acres of upland cotton base. The entire upland cotton base payments, therefore, constitute support to upland cotton. Sample Farm 3 plants 100 acres of upland cotton, but has no upland cotton base. No upland cotton base payments can be allocated in this case. Thus, in this overly simple methodology, support to upland cotton would be calculated only by adding up the amount of upland cotton payments received on land that currently produces upland cotton. However, Brazil believes the Panel should also include as support to upland cotton contract payments on non-upland cotton base acreage that is currently planted to upland cotton. For example, for Sample Farms 2 and 3 above, for which payments for less upland cotton acres than actually planted were allocated in this first step, additional contract payments made for other contract crop base could be allocated as support to upland cotton in a second step, provided they are available on

[54] In later steps, Brazil will discuss what happens when the farms have other crop contract payment base and how this may be allocated.

[55] The amount payments results from multiplying the payment rate for the contract crop, including for upland cotton, by the amount of base acres involved. The respective contract payment amounts to 85 per cent of this figure. Payment rates are published by USDA, *see* Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

the farm. These additionally allocated contract payments stem from contract payments made for other crops and not allocated to these other crops.

48. However, as with upland cotton contract payments, any contract payments for other crop base would be primarily assigned as support to the production of those crops. As with upland cotton contract payments, any other programme crop base payments are treated as support to those crops up to the amount of base acreage that is actually planted to the respective programme crop. Payments on any further base acreage for those programme crops are allocated to the crops for which planted acres exceed base acres. The following table illustrates this for Sample Farm 4:

| Sample Farm 4 | | | |
|---|---|---|---|
| Crop | Cotton | Rice | Corn |
| Crop Base | 100 acres | 100 acres | 100 acres |
| Crop Plantings | 160 acres | 40 acres | 100 acres |
| Crop Base Allocated as Support for the Crop in Question | 100 acres | 40 acres | 100 acres |
| Remaining Crop Base Available for Allocation | 0 acres | 60 acres | 0 acres |
| Crop Plantings To Which Additional Payments Will Be Allocated | 60 rice acres | 0 acres | 0 acres |

Sample Farm 4 plants three crops (upland cotton, rice and corn) having 100 base acres for each crop. All 100 corn base acres are planted to corn and, thus, any corn contract payments made for the corn base constitute support to corn. However, only 40 of the 100 rice base acres are planted to rice and, consequently, only payments for those 40 rice base acres constitute support to rice. Sample Farm 4 plants 160 acres of upland cotton, but has only 100 upland cotton base acres. Thus, all payments on the entire 100 upland cotton base acres represent support to cotton. In addition, payments for the 60 rice base acres not planted to rice but to upland cotton also represent support to upland cotton.

49. Sample Farm 4 was a farm for which the total base acreage and the total acreage planted to programme crops were equal. However, there may be instances in which farms plant more (or less) acreage to programme crops than they used to do in the past establishing their base acreage.

50. The following two tables explain how Brazil's methodology addresses the issue of farms that plant more acreage to programme crops than they have base acreage (Sample Farm 5) and farms that plant less acreage to programme crops than they have base acreage (Sample Farm 6).[56] In Brazil's methodology, payments available for allocation – i.e., not allocated to the programme crop itself – are pooled and allocated proportionally to the remaining programme crop acreage.[57] Brazil's approach of pooling payments from additional base acres not planted to the respective programme crop and allocating these payments proportionally as support to crops, for which plantings exceeds base acreage, ensures that a single dollar is not allocated to two different crops, resulting in double

[56] Brazil exemplifies the principle for farms with less upland cotton base than upland cotton plantings, but the same principle applies to farms without any upland cotton base.

[57] Since the United States has not provided the data necessary to do this allocation, Brazil has no information on how often such situations actually occur. However, the record strongly suggests that not many farms would be able to plant more program crops than they have base acreage. In particular for upland cotton, Brazil has demonstrated that it is not economically possible to produce this crop without contract payments. *See inter alia* Brazil's 2 December 2003 Oral Statement, paras. 26-27 and Exhibit Bra-353 (Cumulative Loss From Upland Cotton Production MY 1997-2002 Without Contract Payments).

counting.[58] It also ensures that each contract payment dollar is allocated to a programme crop, as exemplified by the calculations for Sample Farms 5 and 6 below.

51. The first table shows the allocation of contract payments on Sample Farm 5, a farm with fewer planted (370 acres) than base acres (400 acres).

| Sample Farm 5 | | | | |
|---|---|---|---|---|
| Crop | Cotton | Corn | Wheat | Rice |
| Crop Base | 100 acres | 100 acres | 100 acres | 100 acres |
| Crop Plantings | 140 acres | 120 acres | 40 acres | 70 acres |
| Crop Base Allocated as Support for the Crop in Question | 100 acres | 100 acres | 40 acres | 70 acres |
| Remaining Crop Base Available for Allocation | 0 acres | 0 acres | 60 acres | 30 acres |
| Crop Plantings To Which Additional Payments Will Be Allocated | 40 acres | 20 acres | 0 acres | 0 acres |
| Pooled Available Crop Base | 60 Wheat Base Acres and 30 Rice Base Acres | | | |
| Allocated Share of Payments on Pooled Crop Base | 40/60th or 2/3rd | 20/60th or 1/3rd | 0 | 0 |
| Allocation | 100 Cotton Base Acres and 2/3rd of 60 Wheat and 30 Rice Base Acres (40 and 20) | 100 Corn Base Acres and 1/3rd of 60 Wheat and 30 Rice Base Acres (20 and 10) | 70 Wheat Base Acres | 30 $rice Base Acres |

52. The second table shows the allocation of contract payments on Sample Farm 6, a farm with more planted (410 acres) than base acres (400 acres).

[58] The United States alleges that Brazil's 14/16th methodology would allocate the same contract payments to two different crops resulting in double counting (*see e.g.* US 2 December 2003 Oral Statement, para. 27). The US claim about double counting by Brazil originates in an entirely erroneous understanding of Brazil's 14/16th methodology. As explained many times, Brazil used this methodology only as a proxy, since the United States refused to provide the very data that would allow the calculation of the exact amount of support to upland cotton from contract payments. It makes the assumption that for any acre planted to upland cotton an average contract payment in the amount of an upland cotton contract payment is received.

| Sample Farm 6 | | | | |
|---|---|---|---|---|
| Crop | Cotton | Corn | Wheat | Rice |
| Crop Base | 100 acres | 100 acres | 100 acres | 100 acres |
| Crop Plantingq | 125 acres | 125 acres | 80 acres | 80 acres |
| Crop Base Allocated as Support for the Crop in Question | 100 acres | 100 acres | 80 acres | 80 acres |
| Remaining Crop Base Available for Allocation | 0 acres | 0 acres | 20 acres | 20 acres |
| Crop Plantings To Which Additional Payments Will Be Allocated | 25 acres | 25 acres | 0 acres | 0 acres |
| Pooled Available Crop Base | 20 Wheat Base Acres and 20 Rice Base Acres | | | |
| Allocation | 100 Cotton Base Acres and 1/2 of 20 Wheat and 20 Rice Base Acres (10 and 10) | 100 Corn Base Acres and 1/2 of 20 Wheat and 20 Rice Base Acres (10 and 10) | 80 Wheat Base Acres | 30 Rice Base Acres |

53. In both cases, the contract payments on wheat and rice base acres that are not allocated to production of these crops (as current plantings are below the base acreage) are pooled. The resulting amount of contract payments is distributed as support to upland cotton and corn with the share of both crops corresponding to the ratio of plantings to which additional payments are allocated.[59]

54. This same principle would be applied for farms that have *no upland cotton base acreage*. For these farms, contract payments would be allocated to upland cotton solely from the pool of payments made on crop base not planted to the respective programme crop. This is illustrated in the table below (Sample Farm 7).

| Sample Farm 7 | | | |
|---|---|---|---|
| Crop | Cotton | Rice | Corn |
| Crop Base | 0 acres | 100 acres | 100 acres |
| Crop Plantings | 100 acres | 50 acres | 50 acres |
| Crop Base Allocated as Support for the Crop in Question | 0 acres | 50 acres | 50 acres |
| Remaining Crop Base Available for Allocation | 0 acres | 50 acres | 50 acres |
| Pooled Available Crop Base | 50 Rice Base Acres and 50 Corn Base Acres | | |
| Crop Plantings To Which Additional Payments Will Be Allocated | 50 Rice Base Acres and 50 Corn Base Acre | 0 acres | 0 acres |

[59] Additional payments will only be allocated to planted crop acres exceeding the amount of base acreage.

55. For Sample Farm 7 with no upland cotton base but 100 acres of upland cotton plantings, contract payments would be allocated from the rice and corn base not allocated to these crops. In this case payments on 50 rice and 50 corn base acres are allocated to upland cotton. On average, the per-acre payment from those crop base acres is similar to the amount of upland cotton base acre payments.

# ANNEX I-11

## ANSWERS OF THE UNITED STATES TO FURTHER QUESTIONS FROM THE PANEL TO THE PARTIES FOLLOWING THE SECOND PANEL MEETING

20 January 2004

**257. The Panel takes note of the Appellate Body Report in United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.**

**(d) Does the "requirement" upon the CCC to make available "not less than" $5.5 billion annually in guarantees have a normative character and operation? (see, e.g. Brazil's response to Panel Question 142; Exhibit BRA-297, 7 USC 5641(b)(1); 7 USC 5622(a) & (b); paragraph 201 of US 18 November further rebuttal submissions). Is this requirement "mandatory"? If so, how does the CCC have "discretion" not to make this amount of guarantees available in a given year? USA**

1. With respect to the Panel's first question, the United States notes that the Appellate Body's discussion of the "normative character and operation" of an instrument came in the context of its explanation of how to determine whether an instrument is a "measure" subject to challenge in dispute settlement and that the Appellate Body distinguished this question from the separate question of whether the instrument, if a measure, mandates a breach of a WTO obligation under a "mandatory/discretionary" analysis.[1] The Appellate Body explicitly noted that it was not undertaking a comprehensive examination of the relevance or significance of that analysis and, indeed, simply applied it.[2] An analysis of the normative character and operation of this "requirement" to make available not less than $5.5 billion in guarantees is not necessary because the parties do not dispute whether the "requirement" is a "measure."

2. Under a "mandatory/discretionary" analysis, the relevant question would be not whether the requirement to make available $5.5 billion in guarantees per year is as such inconsistent with a provision of the WTO agreements (since Brazil has not claimed that it is), but rather whether the provisions establishing the export credit guarantee programmes mandate a breach of any WTO obligation. As we have explained, they do not. As an initial matter, the requirement that the CCC "make available . . . not less than $5,500,000,000 in credit guarantees" does not mandate that the CCC actually issue any particular level of credit guarantees.[3] This law merely requires that CCC "make available" certain guarantees; the actual issuance of guarantees, however, is within the discretion of the Commodity Credit Corporation, which "may guarantee the repayment of credit made available to

[1] Appellate Body report, *United States - Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan ("US -Sunset Review)*, WT/DS244/AB/R, adopted 9 January 2004, paras. 78, 81-82, 89, and 93.

[2] *US Sunset Review*, paras. 93, 156, and 172-174.

[3] As the United States has previously noted, except for programme year 1992, CCC has *never* issued $5.5 billion in guarantees in any year during the period 1992 to the present. Sales registrations have been as low as $2.876 billion for programme year 1997 and have generally hovered in the range of $3.0 billion - $3.2 billion. Further Rebuttal Submission of the United States (18 November 2003), para. 201; US Further Submission (30 September 2003), para. 148 and accompanying table entitled CCC Export Credit Guarantee Program Levels, Annual President's Budgets and Actual Sales Registrations, Fiscal Years 1992-2004.

finance commercial export sales of agricultural commodities".[4] The statute makes clear that "[e]xport credit guarantees issued pursuant to this section shall contain such terms and conditions as the Commodity Credit Corporation determines to be necessary".[5]

3. The United States has elsewhere noted the various discretionary elements in the operation of the programme that tamp down the actual issuance of guarantees. These include the regulatory authorities permitting non-issuance of guarantees with respect to any individual application for an export credit guarantee or to suspend the issuance of export credit guarantees under any particular allocation; limitations on commodities with respect to which guarantees may be made available, total guarantee value for individual commodities, destination, time within which export must occur, and internally established exposure limits applicable to individual bank obligors.[6]

4. Furthermore, and more importantly, Brazil's own approach would require a showing that the programmes mandate that the premium rates will be insufficient to cover long-term operating costs and losses of the programmes. Brazil has not made such a showing, for the simple reason that the programmes do not so mandate. The Commodity Credit Corporation ("CCC") has discretion concerning numerous aspects of any guarantees it may issue, such as the destinations, types of commodities, and length of term of the guarantee. All of these aspects could affect the question of the long-term operating costs and losses of the programmes. For example, the credit risk involved in some destinations may be less than for others. Similarly, the risk associated with a guarantee of credit extended for one year may be less than for credit extended for three years.

5. Thus, while the provisions establishing the export credit guarantee programmes are measures, they do not mandate an inconsistency with any WTO obligation. Putting aside the US argument that export credit guarantees are not subject to export subsidy disciplines by virtue of Article 10.2 of the Agreement on Agriculture until Members conclude their ongoing negotiations and agree on such disciplines, there is no basis to presume, on the basis of the law itself, that the export credit guarantee programmes provide export subsidies and threaten to lead to circumvention of US export subsidy reduction commitments.[7] Because the CCC retains the discretion to issue particular guarantees and attach terms and conditions as set out above, the statute alone does not allow a presumption that premium rates will be insufficient to cover long-term operating costs and losses of the programmes. Thus, Brazil's argument that the CCC is mandated to "make available" $5.5 billion in export credit guarantees cannot alter the fact that the CCC has discretion to control the guarantees actually provided and the terms of those guarantees; as a result, no WTO inconsistency is mandated.

**(e) Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (e.g. Exhibit BRA-117 (2 USC 661(c)(2))? USA**

6. The Budget Enforcement Act of 1990 ("BEA") divides spending into two types: "discretionary" spending and "direct" spending.[8] "Discretionary" spending means budget authority

[4] 7 U.S.C. 5622(a)(1), (b); *see also id.* 5622(k) (imposing requirement that certain percentages "of the total amount of credit guarantees *issued* for a fiscal year [be] *issued*," not merely made available, with respect to certain products) (italics added).

[5] 7 U.S.C. 5622(g).

[6] US First Written Submission (11 July 2003), fn. 134; 7 C.F.R. Sections 1493.10(d), 1493.40(b) (Exhibit US-6); US Answer to Panel Question 5 (11 August 2003), para. 12 (Exhibit US-12); US Rebuttal Submission (22 August 2003), paras. 180-182; US Further Submission (30 September 2003), paras. 153-156; US Answer to Panel Question 142 (27 October 2003), paras. 56-57.

[7] *See* Brazil's Answer to Question 142 from the Panel, para. 88 (27 October 2003).

[8] *See* OMB Circular A-11 (2003), Section 15: Basic Budget Laws (available at: http://www.whitehouse.gov/ omb/circulars/a11/current_year/s15.pdf).

controlled by annual appropriations acts and the outlays that result from that budget authority. "Direct" spending (commonly referred to as "mandatory" spending)[9] means budget authority and outlays resulting from permanent laws as well as "entitlement authority".[10] That is, whether spending is "mandatory" for purposes of the BEA is an accounting classification issue and does not control whether a measure is "mandatory" for a mandatory / discretionary analysis for WTO purposes.

7. The Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" because the "budget authority is provided by law other than appropriation Acts".[11] As a result, although the export credit guarantee programmes are exempt from the ordinary requirement that budget authority be provided in advance through annual appropriations acts, they remain subject to the continuing availability of budget authority in law other than annual appropriations legislation. Of note, the Office of Management and Budget has also recognized: "While mandatory and discretionary classifications are used for measuring compliance with the BEA, *they do not determine whether a programme provides legal entitlement to a payment or benefit*"[12] (italics added). Thus, the classification of these programmes as "mandatory" for purposes of the BEA merely means that the budget authority is not "discretionary", that is, "provided in appropriation Acts".[13] This accounting classification does not alter CCC's considerable discretion in operating the programmes, as explained in more detail in the US answer to Question 257(d), and does not make the programmes "mandatory" for purposes of a mandatory/discretionary analysis.

[9] See OMB Circular A-11 (2003), Section 20: Terms and Concepts (available at: http://www.whitehouse.gov/omb/circulars/a11/current_year/s20.pdf).

[10] This distinction between discretionary spending, mandatory direct spending and mandatory entitlement spending is reflected in the applicable statutory definitions. 2 U.S.C. Section 900(7) and 900(8) provide:

"(7) The term 'discretionary appropriations' means budgetary resources (except to fund direct-spending programmes) provided in appropriation Acts.

"(8) The term 'direct spending' means—
(A) budget authority provided by law other than appropriation Acts;
(B) entitlement authority; and
(C) the food stamp programme

[11] 2 U.S.C. 900(8).

[12] OMB Circular A-11 (2003), Section 20.9 (emphasis added).

[13] 2 U.S.C. 900(7).

# ANNEX I-12

## BRAZIL'S COMMENTS ON THE 22 DECEMBER US COMMENTS CONCERNING BRAZIL'S ECONOMETRIC MODEL

20 January 2004

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## I. BRAZIL'S INTRODUCTORY COMMENTS

1. Brazil's response to the US 22 December 2003 Comments Concerning Brazil's Econometric Model ("US Critique") is divided into two parts. First, Brazil provides some introductory comments setting the US Critique into perspective. And, second, Brazil offers Professor Sumner's detailed response to the US critique.

2. The United States Critique initially focuses on proving a point that has never been contested by Brazil, i.e., that the Sumner model is not exactly like the FAPRI model. As Professor Sumner points out, he never claimed that his model was identical to the FAPRI model. The United States points to no contradictions between what Professor Babcock has stated and what Professor Sumner stated in Annex I or his other statements concerning the links between his model and the FAPRI model. Nevertheless, while there are differences between the Sumner model and the FAPRI model, the record is undisputed that the core elements of the FAPRI model – the hundreds of demand and supply equations – are identical. The differences in Professor Sumner's model are primarily the result of his use of the CARD international cotton model and additions to the FAPRI model made by Professor Sumner. The additions were necessary to enable the FAPRI/CARD modelling framework to respond to the questions before this Panel.

3. The United States Critique asserts that Professor Sumner's choice of baselines has prejudiced the outcome to such an extent that his results are not usable.[1] But the record shows that the significant acreage, production, export and price effects found in Professor Sumner's Annex I results using the CARD international cotton model and the amended FAPRI US crops model based off the (recalibrated) FAPRI preliminary November 2002 baseline are essentially the same even when used against other baselines.[2] The United States first argued that Professor Sumner should have used the FAPRI 2003 baseline.[3] Professor Sumner responded by running his model on that later baseline.[4] There were no significant changes between Annex I and those results for either the period from MY 1999-2002 or in the period from MY 2003-2007.[5] The United States Critique raises a new argument that Professor Sumner manipulated the FAPRI preliminary November 2002 baseline.[6] This allegation is wrong. Any differences are the result of a necessary recalibration of the model following the use of the CARD international cotton model rather than the FAPRI international crops models and some update incorporating more recent macroeconomic data.[7] As Professor Sumner demonstrates below, there are no significant differences with his Annex I result by using this slightly modified baseline.[8] Indeed, the fact that Professor Sumner's simulation model generates nearly identical results regardless of the baselines used demonstrates the robustness of the Sumner model.

4. In criticizing Professor Sumner's modelling of the four different types of contract payments, the United States repeats its baseless arguments that the contract payments have absolutely no effect on production decisions for upland cotton. The notion that an estimated[9] $4.7 billion[10] of amber box

[1] US 22 December 2003 Comments on Brazil's Econometric Model, paras. 35-38, especially para. 38.

[2] These other baselines include the original FAPRI preliminary November 2002 baseline and the official FAPRI January 2003 baseline.

[3] US 7 October 2003 Oral Statement, paras. 36-39.

[4] Exhibit Bra-325 (Results of Professor Sumner's Modified Model Based on the January 2003 FAPRI baseline); Exhibit Bra-326 (Results of Professor Sumner's Modified Model) and Exhibit Bra-331 (Description of Methodology Comparing the Analysis of US Upland Cotton Subsidies Under the January 2003 Baseline to Analysis under the November 2002 Baseline, Daniel A. Sumner, November 2003).

[5] *See* Exhibit Bra-326 (Results of Professor Sumner's Modified Model).

[6] US 22 December 2003 Comments on Brazil's Econometric Model, para. 36.

[7] *See* Professor Sumner's discussions below, Response to Section III.

[8] *See* Professor Sumner's discussions below, Response to Section III.

[9] Brazil is still waiting the United States to provide the data that would permit the calculation of the exact amount of support to upland cotton from the contract payments. Brazil hopes that the United States will produce the data on 20 January 2004.

(presumptively trade- and production-distorting) subsidies paid to current producers of upland cotton and allocated as support to upland cotton had no effect on upland cotton production has been, and remains today, incredible. The United States has never explained why upland cotton base acreage payments are so much higher than other programme crops (except rice). The obvious reason is that Congress and the NCC expected the bulk of acreage historically planted to upland cotton to continue to be planted to upland cotton, a high-cost crop. Nor has the United States been able to explain how there could be no production effects when US upland cotton producers would have lost $332.79 per acre over a six-year period if they had received no contract payments.[11] NCC representatives stated that these payments were "critically needed"[12] to "make ends meet"[13], i.e., to cover their cost of production.

5. In fact, Professor Sumner has been, in the view of Brazil, probably overly conservative in his estimation of the effects of these contract payments on US upland cotton production. Brazil notes that the nature of Professor Sumner's modelling does not permit an assessment of the cumulative losses such as the $332.79 per acre over a six-year period. Even Professor Sumner acknowledges that his use of only $0.25 of each direct payment dollar as having production effects is probably low in light of the obvious impact of this subsidy in supporting the continued survival of many US producers.[14] Similarly, Professor Sumner's use of only $0.40 of each counter-cyclical payment dollar as having production effects[15] is also low in light of the fact that $1 billion in payments in MY 2002 were crucial to the economic survival of many upland cotton producers. In light of the evidence produced by Brazil, the US Critique that Professor Sumner's analysis is fundamentally wrong for not concluding that these huge subsidies, filling almost half of the cost-revenue gap, have no effects is completely unjustified.

6. The United States Critique also expresses amazement that Professor Sumner could attempt to model the effects of export credit guarantees. The fact that FAPRI has not yet modelled this subsidy is completely irrelevant. Nor is Professor Sumner blazing new economic ground by modelling export credit guarantees. The NCC has a team of economists working with the United States on this dispute, headed by Gary Adams, a former FAPRI economist who worked on the FAPRI upland cotton model.[16] NCC economists concluded in 2001 that major changes to the GSM 102 programme would result in 500,000 fewer bales being exported from the United States and result in a 3 cent per pound increase in prices.[17] It is curious that the United States, assisted by NCC economists, now seeks to contradict the conclusions of the beneficiaries of this GSM 102 programme by asserting that there were no production, export or price effects from this subsidy. The NCC's 2001 findings, which Professor Sumner used conservatively to estimate the production, export and price effects of the export credit guarantee programmes, was supported by the fact that $1.6 billion in US upland cotton exports between MY 1998-2002 were covered by GSM 102 export credit guarantees.[18] Further support for the NCC's 2001 estimate comes from the US Congressional Research Service that concluded that guarantees have "mainly benefited exports of wheat, wheat flour, oilseeds, feed grains

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[10] This figure is based on Brazil's estimates at paragraph 8 of its 9 September 2003 Further Submission as updated by the table at paragraph 8 of its 22 December 2003 Answers to Questions.

[11] Brazil's 2 December 2003 Oral Statement, para. 27.

[12] Brazil's 22 July 2003 Oral Statement, paras. 52-54 and 58-60 and exhibits cited therein.

[13] Exhibit Bra-324 (NCC Chairman's Report by Kenneth Hood, 24 July 2002, p. 2).

[14] Brazil's 9 September 2003 Further Submission, Annex I (paras 48-51 setting out high and low estimates of production effects for the four contract payments).

[15] Brazil's 9 September 2003 Further Submission, Annex I (paras 48-51 setting out high and low estimates of production effects for the four contract payments).

[16] *See* Exhibit Bra-395 ("Trade Issues Facing the US Cotton Industry," Speech by Dr. Mark Lange, President and CEO, National Cotton Council, San Antonio, 6 January 2004), Lange noted that Gary Adams had spent "countless hours" working with USTR on the Brazil upland cotton dispute.

[17] Exhibit Bra-41 ("The Future of Federal Farm Commodity Programmes (Cotton)," Hearings before the House of Representatives Committee on Agriculture, 15 February 2001, p. 12).

[18] Brazil's 9 September 2003 Further Submission, para. 188.

and cotton".[19] Andrew Macdonald has also testified to the export-enhancing effects of the US GSM 102 programme.[20] In its evaluation of the US Critique's claim that Professor Sumner – and the 2001 NCC economists – incorrectly estimated the effects of removing the GSM 102 subsidies, the Panel must consider this uncontested evidence.

7. The United States Critique also challenges Professor Sumner's modelling of the effects of removing crop insurance subsidies. The US Critique focuses primarily on the fact that FAPRI has not yet modelled these subsidies.[21] But this is irrelevant. What is relevant are the facts which show that $788 million in crop insurance subsidies were provided to upland cotton producers between MY 1999-2002.[22] And it is relevant that USDA's own economists found that lower pre-2000 ARP Act crop insurance subsidies had significant production and price effects for upland cotton (as opposed to other programme crops).[23] Current higher crop insurance benefits under the 2000 ARP Act would certainly have higher effects. Professor Sumner's crop insurance modelling is also consistent with USDA's own economists' conclusion that the "availability of subsidized crop insurance affects farmers' current crop production decisions by creating a direct incentive to expand production".[24] It is uncontested that the amount of crop insurance subsidies received by upland cotton producers is directly related to the amount of upland cotton they plant.[25] Given this evidence, it was reasonable for Professor Sumner to conclude that each dollar of crop insurance subsidies had direct effects on US production.

8. With respect to Professor Sumner's modelling of marketing loan payments, the US Critique is essentially silent.[26] This silence is no doubt due to the fact that Professor Sumner's model uses exactly the same elasticities and estimates of effects as the FAPRI model, for which the United States has indicated it has no objection.[27] Further, Professor Sumner's findings regarding the effects of marketing loan payments between MY 1999-2002 are very much consistent with those of Westcott/Price who found that in MY 2001 that marketing loan payments caused 3 million additional acres to be planted to upland cotton with an implied price decline of 10 cents per pound (or 33 percent of the MY 2001 price).[28] Brazil has already addressed the various US critiques of the use of so-called "lagged prices" by noting that USDA, FAPRI, Professor Sumner and a host of other economists have used these prices in countless models and that any use of futures market prices in large-scale simulation models is impossible.[29] Further, the faulty and primitive US futures methodology for estimating the production effects of marketing loan programmes is no substitute for the comprehensive models used by USDA, FAPRI and Professor Sumner.[30] Most pointedly, the US futures methodology suffers from the fatal flaw that it does not even focus on the price that does get

[19] Brazil's 9 September 2003 Further Submission, para. 189.

[20] Brazil's 9 September 2003 Further Submission, Annex II (Statement of Andrew Macdonald, paras 49-50).

[21] US 22 December 2003 Comments on Brazil's Econometric Model, paras 25-30.

[22] Brazil's 9 September 2003 Further Submission, Table 1, para. 8.

[23] Brazil's 22 August 2003 Rebuttal Submission, paras. 62-66.

[24] Exhibit Bra-63 (C.Edwin Young, Randall D. Schnepf, Jerry R. Skees and William W. Lin: "Production and Price Impacts of US Crop Insurance Subsidies: Some Preliminary Results, p. 4).

[25] Brazil's 22 August 2003 Rebuttal Submission, para. 53.

[26] The United States points out a typo (US 22 December 2003 Comments on Brazil's Econometric Model, paras. 73-74) that did not affect the actual analysis undertaken by Professor Sumner (*see* below, Comments on Section VI).

[27] *See* below, Comments on Section VI.

[28] Brazil's 7 October 2003 Oral Statement, paras. 31-33 and the references contained therein.

[29] *See* Professor Sumner's 9 October 2003 Closing Statement attached as Annex II to Brazil's 9 October 2003 Closing Statement, his 2 December 2003 Oral Statement (Exhibit Bra-342, paras. 24-28), Exhibit Bra-345 (paras. 6-14) as well as Brazil's 22 December 2003 Answers to Questions, paras. 37-42).

[30] *See* Brazil's 2 December 2003 Oral Statement, paras. 42-55.

the attention of US producers who depend on marketing loan payments – the adjusted world price (AWP).[31]

9. Nor does the US Critique find any fault with Professor Sumner's analysis of the Step 2 subsidies.[32] Brazil notes that Professor Sumner models the effects of Step 2 domestic and export subsidies in exactly the same manner as FAPRI. Professor Sumner's Step 2 analysis is also completely consistent with the overwhelming evidence that Step 2 export and domestic subsidies have significant production, export, and world price effects. As with the GSM 102 subsidies, the NCC has been quite vocal in praising the production and export effects of the Step 2 subsidies.[33] There would simply be no basis for the United States to contradict these testimonies from the users and beneficiaries of the Step 2 programme.

10. The Panel must also assess the validity of the US critique in view of the overwhelming non-econometric evidence that the US subsidies had significant production, export and price effects.[34] For example, the Panel must ask whether it is reasonable to conclude, as the United States argues, that $12.9 billion dollars in amber box, presumed trade-distorting subsidies had no effect on US production, US exports, and world prices. It is further uncontested that USDA's own data shows that the average US upland cotton farm would have lost $872 per acre during MY 1997-2002 – but had a "profit" of $106 per acre when subsidies are included in their revenue.

11. Further, the Panel must also examine the US Critique of Professor Sumner's analysis in light of the evidence of other econometric studies examining the effects of removing US upland cotton subsidies. The United States has argued that all these studies – including USDA's studies – were wrong in finding significant production, export, and price effects. Would the United States also argue that all of these other economists analyzed the US upland cotton subsidies and their effects on the (world) upland cotton market "for the express purpose of achieving pre-conceived results"?[35] Brazil submits that a common sense analysis of these other studies, including USDA's own studies, shows that Professor Sumner's results are both valid as well as conservative. They are certainly within the ranges of the other econometric studies in the record and consistent with what would be expected given the non-econometric evidence in the record.

12. Finally, Brazil notes US suggestions that Professor Sumner made modelling choices "for the express purpose of achieving pre-conceived results"[36] and "in order to exaggerate acreage and ultimately price impacts".[37] These are offensive and inappropriate charges directed at one of the world's leading agricultural economists. Members of the NCC admitted that "Dr. Sumner is a brilliant economist" who is "well-respected" and a "widely recognized UC [University of California] economist" who is a "confidant to the administration on trade and other issues".[38] Personal attacks by the United States against Professor Sumner's integrity are ironic given the fact that only seven months ago he was one of only two private US economists to be asked by the Chairman of the US

[31] *See* Brazil's 2 December 2003 Oral Statement, paras. 42-55.

[32] The United States points out a typo (US 22 December 2003 Comments on Brazil's Econometric Model, paras. 76) that did not affect the actual analysis undertaken by Professor Sumner (*see* below, Comments on Section VI).

[33] For an example of the extensive evidence supporting this fact, *see* Brazil's Further Submission, paras. 141, 178-180.

[34] *See inter alia* Brazil's 9 September 2003 Further Submission, Sections 3.3.4.1-3.3.4.6; Brazil's 7 October 2003 Oral Statement, Section 2; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 3.1-3.4, 3.7; Brazil's 2 December 2003 Oral Statement, Section 5.

[35] US 22 December 2003 Comments on Brazil's Econometric Model, para. 9.

[36] US 22 December 2003 Comments on Brazil's Econometric Model, para. 9.

[37] US 22 December 2003 Comments on Brazil's Econometric Model, para. 1. *See* also para. 38.

[38] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, September 2, 2003)(quoting Earl Williams, President of California Cotton Ginners and Growers Association).

Commission on the Application of Payment Limitations for Agriculture, Chief USDA Economist Keith Collins, to testify before that Commission. In evaluating the effects of additional payment limitations, the Report of the Commission relies, inter alia, on the testimony and advice provided by Professor Sumner.[39]

13. While the US Government has attacked Professor Sumner's professional integrity, the leaders and members of the US National Cotton Council have gone further during this long dispute. They have met with and pressured Professor Sumner to discontinue his work before the Panel.[40] Moreover, NCC members have and continue to seek to cut off research and scholarship funds for the University of California at Davis, in protest of Professor's Sumner's work in this dispute.[41] One NCC member representative even went so far as to be quoted as saying that "if this had been a military issue, what Dr. Sumner did would be called treason".[42] Recently, the President of the NCC threatened both Professors Sumner and Babcock with unspecified action following the end of the WTO proceedings, stating "[i]n another time and venue there will be a full examination of the actions taken by these 2 economists".[43] This threat was elaborated in a recent analysis in a leading Agricultural Newspaper, the Western Farm Press:

> In the trade issue with Brazil, NCC President and CEO Mark Lange remains incensed at [Brazil's] WTO action. More specifically, he is angry because two US economists hired on to Brazil's payroll and prepared testimony against the United States in the WTO action. University of California economist Dan Sumner, former assistant secretary of agriculture, was hired to assist in the case. Lange added that Sumner 'appears to have hired' Professor Bruce Babcock, an agricultural economist at Iowa State University and director of the Center for Agricultural and Rural Development to attempt to modify the Food and Agricultural Policy Research Institute baseline projections for use by the Brazilians. "This action was taken without the knowledge of FAPRI," said Lange of the University of Missouri-based facility. Lange said Babcock receives federal funds for the CARD programme and he pledged "a full examination of the actions of these two guys" once the WTO issue is settled. California cotton industry leaders and others have protested Sumner's actions to the dean of U.C. Davis school of agriculture and have lobbied for private research and scholarship funds to be withdrawn from the University in protest of Sumner's actions.[44]

14. Over the past six months, NCC members have been instrumental in coordinating efforts to attempt to force officials of the University of California at Davis to require Professor Sumner to stop

[39] Exhibit Bra-397 ( "Report of the Commission on the Application of Payment Limitations for Agriculture," August 2003).

[40] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute", Western Farm Press, 2 September 2003)("group of representatives from cotton, wheat and rice met with Professor Sumner in mid-August to express their displeasure over his testimony before the Panel").

[41] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute", Western Farm Press, 2 September 2003)(Earl Williams, President of the California Cotton Ginners and Growers Associations was quoted as stating "And we are going to bring pressure to bear on the university that would allow someone from a public, taxpayer supported institution to have such latitude that can reap such harm on the supporters of the University".).

[42] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute", Western Farm Press, 2 September 2003) quoting Earl Williams.

[43] Exhibit Bra-395 ("Trade Issues Facing the US Cotton Industry," Speech by Dr. Mark Lange, President and CEO, National Cotton Council, San Antonio, January 6 )(underlining added); *See* also Exhibit Bra- 398 (Western Farm Press, 7 January 2004 , p. 3).

[44] Exhibit Bra-398 (Western Farm Press, 7 January 2004, p. 2).

his work in this dispute.[45] To their credit, these U.C. Davis officials have refused to bend to the pressure.

15. As Dr. Lange's statements quoted above indicates, the NCC now has focused on Professor Babcock for his very limited role in working with Professor Sumner in the application of parts of the FAPRI and CARD models. Professor Babcock's letter[46] is addressed to leading House and Senate staff members who have "relied on FAPRI and CARD to provide objective and high quality quantitative and qualitative assessment of US farm policy alternatives". Professor Babcock's letter states he is "prepared to do whatever it takes to mend this relationship, including disassociating myself from future official FAPRI analyses if so desired". The letter provides the Panel with insights into the type of pressure imposed by the NCC on the economists providing the Panel with assistance in this dispute.

16. These efforts by the representatives of the US upland cotton producers who are heavily dependent upon US subsidies and US Congressional support for their economic survival is perhaps understandable, but nonetheless deplorable. Professor Sumner has demonstrated considerable courage and fortitude in continuing his work to assist the Panel and ultimately all WTO Members in this dispute. Brazil has no doubts that the United States is also appalled at the prospect that either of these two distinguished economists would suffer any adverse professional consequences from their assistance to the Panel and the Parties in this dispute. Given the obligation of all WTO Members to cooperate and assist the Panel in making an objective assessment of the facts of a dispute, Brazil is certain the United States will unequivocally condemn any such threats, including those now being made by the US National Cotton Council.

17. With these introductory remarks in mind, Brazil presents below Professor Sumner's response to the US 22 December 2003 Comments Concerning Brazil's Econometric Model.

[45] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, 2 September 2003).

[46] Exhibit US-114.

## II. PROFESSOR SUMNER'S COMMENTS CONCERNING THE US CRITIQUE OF HIS MODEL

Response to "Comments from the United States of America
Concerning Brazil's Econometric Model" dated December 22, 2003

Daniel A. Sumner

20 January 2004

18. This response to the US critique of the modelling work on US cotton subsidies conducted by myself and my colleagues addresses each of the US comments in the order in which they appear in the US critique submitted on 22 December 2003. However, let me start with some general comments I feel are in order.

19. Much of the US critique repeats the description of my adaptations to the FAPRI model, as provided in Annex I and subsequent documents.[47] The model I developed was based on the core domestic crops model of FAPRI with several additions and modifications to fit the questions before this Panel. I stated in detail where my model made those additions and modifications.[48] Thus, these US comments add nothing by reasserting that my model was not identical to the FAPRI model. Since I never claimed that my model was the FAPRI model, I frankly do not understand the point of these repeated assertions that are written as though they were exposing some revelation.

20. Second, the United States at least three times asserts claims about my motivations for modelling choices. Twice in the very first paragraph the United States asserts that my modelling choices were made "in order to exaggerate" acreage and price impacts. Then in paragraph 9, the United States asserts that my modelling choices were made, "for the express purpose of achieving pre-conceived results". I am puzzled how the United States would claim to have any evidence about my motivation. But more important, these statements suggest seriously immoral and unprofessional behaviour on my part. This is a very serious charge that I do not take lightly. I submit that besides being simply wrong, such attacks have no place in these proceedings.[49]

21. Most of the substantive issues raised in the US critique are simply re-statements of assertions that the United States disagrees with the modelling choices made in Annex I.[50] My arguments for why I modelled the policies as I did have been provided to the Panel on several previous occasions and there is no reason to repeat those arguments in this document. I will refer to those arguments as necessary in footnotes.

[47] *See* my Closing Statement on 9 October 2003, attached as Annex II to Brazil's 9 October 2003 Closing Statement, and my statements in Exhibits Bra-313 to 315, my 2 December 2003 Statement to the Panel in Exhibit Bra-342, as well as the detailed reactions to US criticism of my model in Exhibits Bra-343-345.

[48] *See* Annex I to Brazil's 9 September 2003 Further Submission and Exhibit Bra-313.

[49] Some of the economic material presented by the United States in this case has been authored directly by Dr. Glauber. I note that the 22 December 2003 "Comments" are not attributed to anyone by name, therefore I am unable to respond directly to any individual person with respect to these personal charges.

[50] However, the United States does not propose other methods for modelling the subsidy programmes in case they disagree with my model choices. They simply state that these programmes should not cause any effects – a position that is clearly untenable given the other economic evidence about the effects of the programs, including statements by the users and beneficiaries of the programmes.

**Section II**

22. Paragraphs 5 to 11 of the US critique are devoted to reasserting what I stressed in Annex I that was submitted many months ago, namely that I made adaptations to the FAPRI modelling framework. As I have explained, the FAPRI framework alone was not appropriate for the analysis of the questions before this Panel and therefore I modified and supplemented the framework. However, let us put these modifications and additions in perspective. Of the hundreds of equations used to compute the results, almost all are directly taken from the FAPRI domestic crops model. The basic behavioural supply and demand equations are taken directly from the FAPRI model as are the elasticities used to quantify those equations. In Annex I, and in subsequent documentation[51], I tried to avoid taking credit for work that was not mine. At the same time, I tried to be clear about the distinctions between my work and that of FAPRI and CARD.

23. Professor Bruce Babcock from CARD – with whom I worked together in his private capacity – provided a letter to Congressional staff economists[52] who are familiar with "official" FAPRI analysis of US policy questions, but who have not followed these proceeding closely. In that letter, Professor Babcock explained to them what he and I have always been clear about and had already stated to this Panel. My analysis used part of the FAPRI modelling system, but was not conducted by the full FAPRI team and was not "official" FAPRI analysis. These Congressional staff members had not had access to Annex I or other material submitted to this Panel and Professor Babcock felt a need to clarify these facts. There was no new information in the letter that he sent these staff members that was not already included in Annex I and in the subsequent material provided to the Panel.

24. For example, Professor Babcock points out that the baseline was the November 2002 preliminary FAPRI baseline not the official 2003 FAPRI baseline that became available after I undertook my analysis. He also points out that I used the CARD international cotton model rather than the FAPRI full international model in my analysis.[53] This is not new to those of us who have participated in this Panel proceeding, but Professor Babcock decided to make these clarifications to the Congressional staff members.[54]

25. One point made in the Babcock letter – and emphasized in the US critique – is the obvious fact that if a different team of analysts with a different model had conducted the analysis the results would have been different. That is always true. Different analysts to whom the same question is posed would come up with at least a somewhat different model. Obviously a FAPRI team conducting an official "FAPRI" analysis would have developed a model that is at least somewhat different from my adaptations. In part this occurs because, with complex issues involved, the questions themselves may be interpreted slightly differently, and because, in many cases, there are a range of equally acceptable approaches to an economic modelling choice. It is much less clear how the direction of the results would have changed if different teams with different models conducted analyses. As the review of the independent literature and the independent models in this case suggests, most analyses of US cotton subsidies have found larger impacts than I found in my research.[55] It is not clear whether an "official" FAPRI analysis would have found larger or smaller impacts if FAPRI would have been posed the same questions as those posed in Annex I, and if the FAPRI team analyzing these questions had considered all the evidence presented to this Panel.

[51] *See* in particular Exhibit Bra-313.

[52] Exhibit US-114.

[53] I will discuss the latter issue in greater detail in my comment on Section VII.

[54] The letter responds a perception of concern among some in the United States about the participation of US economists and US based models providing evidence on behalf of Brazil. In particular, Professor Babcock clarified that his FAPRI colleagues at the University of Missouri had not participated in the analysis and that this work was done in a private capacity not at a part of an "official" FAPRI project.

[55] *See* for example the review of independent studies in Exhibit Bra-344.

**Section II. A.**

26. The heading of this section is oddly contradicted by its content. The heading says the "Brazil Model Not Comparable to the FAPRI System", yet the next three paragraphs proceed to compare these two models. Several incorrect assertions are included here, but these are repeated in more detail in later sections and so are dealt with below. However, one clarification is important to make both here and below. Whereas the FAPRI system does not include separate explicit provisions for crop insurance and export credit guarantee programmes, this does not imply that the FAPRI system assumes that there are zero supply impacts of these programmes. Rather, effects of these programmes are imbedded in the baseline of the FAPRI framework.

27. If the FAPRI system had been posed questions about the impacts of crop insurance or export credit guarantee programmes, the natural approach would be to proceed as described in Annex I and in subsequent submissions: to ask how a new scenario with these programmes removed would differ from the baseline that includes these programmes. This procedure was precisely what FAPRI analysts did when they analyzed payment limit rules for the Commission on Payment Limitation in analysis presented in June 2003.[56] The FAPRI framework also does not contain any explicit provisions on payment limitations. These were added to the system for the analysis of the effect of payment limitations, much as I added equations on crop insurance and export credit guarantees for purposes of my Annex I analysis.

28. It is simply wrong to assert that, because a programme is not identified separately in the FAPRI framework, its effects must be assumed to be zero. Furthermore, as discussed further below, in some cases the best evidence on the impact of a programme is from the users of that programme. This was my judgment about the impacts of the export credit guarantee programmes. It certainly makes no sense whatsoever to assume that a programme has zero effect, simply because its impacts, which are known to be positive, are difficult to quantify precisely.

**Section II.B.1**

29. I explained in great detail the basis for my approach to PFC, DP, MLA and CCP payment programmes.[57] Clearly I disagree with the assertion made in paragraph 16 and 17. There is no new content here and there is no reason to repeat my argument and evidence. I note, however, that no "official" FAPRI analysis of these payment programmes has asked the question how acreage would respond if cotton programmes were removed while the payments for the other programme crops remained in place. The FAPRI analysis is concerned with the very different question of what would be the impact for all crops if the payment programmes were removed for all crops simultaneously. Therefore, I had to make some adjustments to the treatment of these programmes, as the question that faces this Panel could not be answered by the traditional FAPRI framework. In addition, as footnote

[56] *See* for example, FAPRI analysis FAPRI-UMC Report #05-03 and #06-03 to be found at http://www.fapri.missouri.edu/FAPRI_Publications.htm and partly reproduced in Exhibit Bra-228.

[57] Annex I, paras. 37-51; and my oral statements on 22 July (Exhibit Bra-105, paras 20-33), 2 December (Exhibit Bra-342, paras 31-37) and my closing statement on 9 October (Part 4); Exhibits Bra-280, Bra-313, and Bra-345 (paras 18-34). Some of the key arguments I made can be summarized as follows:

- none of the studies in the literature analyzes the amount of payments made in connection with a specific crop that are received by current producers of that crop,
- none of the studies in the literature focuses on the specific effects of these payments for cotton due to
    - the high per-acre payments for cotton reflecting higher costs of production,
    - the restrictions on planting fruits and vegetables affect particularly cotton production,
- direct and counter-cyclical payments give farmers an incentive to produce the crop for which they have base acreage,
- future updates of base induce farmers to plant their base acreage to the programme crop or even expand the area planted to the programme crop.

57 highlights, my judgment is that the programmes all have some commodity-specific acreage impact for cotton.

30. The table referred to in paragraphs 21 through 24 simply shows that when the planting impact of these payment programmes for cotton are assumed to have no specific impact on cotton acreage, but only a broad and diffuse effect on all programme crops, then the resulting acreage impact will indeed be nearly zero.

**Section II.B.2**

31. Annex I as well as subsequent submissions and oral discussions with the Panel have explained in detail my approach to the production impacts of crop insurance and why my approach, for example by leaving out risk reduction impacts, is conservative.[58] The approach is straightforward. The crop insurance subsidy lowers costs to cotton growers and the acreage impact of lower costs in percentage terms may be calculated by multiplying the lower per acre costs by the elasticity of supply. The FAPRI framework has not been used to assess the production impacts of crop insurance. But the impacts of crop insurance subsidies are implicit in the FAPRI baseline.[59] My approach made the impacts explicit so that I could assess the acreage effects of removing the subsidy. This is discussed in somewhat more detail below.

32. Paragraphs 25 through 30 and the table referred to there simply repeat the US claim that hundreds of millions of dollars of crop insurance subsidies for cotton producers has had zero effect on farmers' choices to grow cotton. I disagree and my model has quantified these impacts using FAPRI elasticities and other features of the FAPRI US crops model.

33. Not withstanding the "intuition" of the United States, the analysis that underlies paragraph 29 of the US critique is evidence of faulty economic reasoning. Furthermore, the US claim about how the FAPRI model treats crop insurance subsidies is misleading at best.[60] As noted above, the FAPRI framework includes the value of crop insurance subsidies implicitly and has not previously been used to analyze the impact of eliminating crop insurance for cotton. Crop insurance for cotton is a service purchased by farmers on a per-acre basis in their business of producing cotton. The subsidy provided by the US government lowers the cost of this service. It is a principle of basic economics that a subsidy that lowers marginal costs results in the same impact as a direct price subsidy on output. Following this principle, I first calculate the regional cotton crop insurance subsidy rate per acre of cotton as a percentage of net revenue and then multiply those subsidy ratios times the elasticity of cotton acreage response applicable to that region. The United States is right that there are more complex ways to model the impact of crop insurance, for example, by noting that crop insurance has an additional acreage impact due to risk reduction. But, the methodology I apply is straightforward, conservative and based on intuitive economic logic and basic principles.

**Section II.B.3**

34. Paragraphs 31 through 34 and the table to which they refer again simply repeat the US assertion that billions of dollars of subsidized export credit guarantees for cotton exports have zero effect on US production and exports. I find this implausible on its face and based my quantification of the impact on estimates provided by representative of users of the programme. This seems to me to be a reasonable approximation. My use of that estimate was conservative relative to the National

[58] *See* also Exhibit Bra-313.

[59] While there is no specific equation modelling the effects of crop insurance, its effects are part of the baseline that projects a level of planted acreage against the background of the continuation of the crop insurance programme.

[60] Paragraph 29 of the US Critique.

Cotton Councils estimates, as explained in detail in response to questions from the Panel[61], and as the US acknowledges in footnote 17 to paragraph 32 of its critique. The National Cotton Council testified that the impact on export was 500,000 bales and the impact that I estimate is considerably smaller. I use my model, based significantly on FAPRI elasticities and other parameters to calculate the price, acreage and other impacts of the initial shift of 500,000 bales. This resulted in much lower net impacts on price and export quantities than estimated by the National Cotton Council.[62]

**Section III**

35. In paragraphs 35 through 38 of the US critique, the United States points out that the baseline prices reported in Annex I are not the same as baseline prices provided to the United States by Professor Babcock on November 26 as part of the model documentation.[63] The United States implies that I have manipulated the baseline to generate higher effects.[64] This allegation has no basis whatsoever.

36. The documentation delivered by Professor Babcock[65] was the FAPRI US crops model that was calibrated with the system of FAPRI international crops models to reproduce the FAPRI November 2002 preliminary baseline projections. The Annex I analysis began with these FAPRI November 2002 preliminary baseline projections. However, the Annex I results were developed by linking the FAPRI US crops model with the CARD international cotton model that was developed by researchers at Iowa State University. Unfortunately, the description of the baseline in Annex I and subsequent submissions was imprecise by not making this distinction explicit. Instead, I labelled the baseline as an (unpublished) FAPRI November 2002 preliminary baseline rather than a slight modification thereof. This slight modification was required for internal consistency reasons, as explained below.

37. The table below provides a full comparison of the differences in the baseline reported in Annex I and the FAPRI November of 2002 preliminary baseline. As can be seen, they are different but those differences are very small overall.

38. There are two reasons for the small differences between the baseline projections used in the Annex I analysis and reported in Annex I and the November 2002 FAPRI preliminary baseline projections. The first was caused by the need to calibrate the CARD cotton model rather than the FAPRI international model with the US crops model. Consistency with the CARD international cotton model implied very small changes in the baseline. The second source of difference was that new macroeconomic projections became available in late November, 2002. These new macroeconomic projections were incorporated into the CARD international cotton model. I stress that the equations of the FAPRI US crops model were not changed in any way. Again, the slight changes between the baseline projections are solely a result of the calibration of the model, once with the FAPRI international crops models (FAPRI preliminary November 2002 baseline) and once with the CARD international cotton model (Annex I model), as well as the updated macroeconomic data used.

39. To put this baseline issue in perspective, Brazil has provided the Panel with several sets of results from similar models on several alternative baselines, including the official FAPRI 2003

[61] Brazil's 27 October Answers to Questions, paras. 104-107.

[62] In table 5.Ig of Annex I, I report an average export effect of 300,000 bales and an average US price effect of about 0.5 cents per pound, as opposed to the NCC estimate of 500,000 bales and 3 cents per pound.

[63] *See* Exhibit Bra-346.

[64] Paragraph 38 of the US critique.

[65] Exhibit Bra-343, para. 11 and Exhibit Bra-346.

baseline.[66] The bottom line is that these results are extremely robust to those alternative baselines and slight modifications to modelling specifics.

40. The same robustness applies to the results using the FAPRI November 2002 preliminary baseline and the modification applied. The United States assertion that the Annex I baseline meaningfully affects ("exaggerate[s]"[67]) the effects of removing US cotton subsidies is, therefore, unfounded.

41. To analyze the validity of the US assertion, we have recalibrated the CARD international cotton model (used to generate the Annex I results) to replicate exactly the FAPRI November 2002 preliminary baseline. We also used the macroeconomic projections used by FAPRI in November 2002.[68] Rerunning the model of Annex I yields results that are nearly identical to those reported in Annex I. Removal of US cotton subsidies would decrease US production by an average of 24.9 per cent from 2003 to 2007.[69] Mill use would decrease by 6.4 per cent.[70] US exports would decrease by 41.5 per cent.[71] The US Season average price would increase by 15.1 per cent.[72] Importantly, the A index price would increase by 10.6 per cent. In Annex I, I reported a change in the A index price of 10.8 per cent relative to the baseline.[73] This difference of less than 0.2 percentage points is simply not material.

42. In sum, it is unfortunate that this confusion occurred in the labeling of the baseline used in Annex I. The important point, however, is that it has not affected the results of my analysis. Indeed, having run the Annex I model off the non-modified version of the FAPRI November 2002 preliminary baseline projections provides one more indication of the robustness of those results.

[66] This includes my Annex I model based off the FAPRI preliminary November 2002 baseline, my cotton-focussed model based off the FAPRI preliminary November 2002 baseline and the FAPRI January 2003 baseline, as well as a number of independent third party studies (Exhibit Bra-344).

[67] Paragraph 38 of the US critique.

[68] Both of these modifications result in an Annex I modelling system that is calibrated to exactly generate the FAPRI preliminary November 2002 baseline. It no longer contains any modifications that the United States criticizes as generating overstated resulting effects (paragraphs 36-37 of the US critique).

[69] The Annex I result was 26.3 percent (paragraph 65).

[70] The Annex I result was equally 6.4 percent (Table I.5a).

[71] The Annex I result was 44 percent (paragraph 68).

[72] The Annex I result was 15.3 percent (paragraph 69).

[73] The Annex I result was 10.8 percent (paragraph 70).

Comparison between baseline projections

| | 2003 | 2004 | 2005 | 2006 | 2008 |
|---|---|---|---|---|---|
| | Planted Area (million acres) | | | | |
| Annex I baseline | 13.7802 | 14.8798 | 14.7722 | 14.6525 | 14.2744 |
| FAPRI baseline | 13.7820 | 14.7205 | 14.7716 | 14.6584 | 14.2519 |
| | Harvested Area (million acres) | | | | |
| Annex I baseline | 12.0444 | 13.0666 | 12.9761 | 12.8739 | 12.5282 |
| FAPRI baseline | 12.0462 | 12.9164 | 12.9751 | 12.8791 | 12.5068 |
| | Yield (bales per acre) | | | | |
| Annex I baseline | 1.3325 | 1.3328 | 1.3410 | 1.3494 | 1.3579 |
| FAPRI baseline | 1.3325 | 1.3328 | 1.3408 | 1.3492 | 1.3578 |
| | Production (million bales) | | | | |
| Annex I baseline | 16.0497 | 17.4157 | 17.4010 | 17.3715 | 17.0121 |
| FAPRI baseline | 16.0519 | 17.2152 | 17.3974 | 17.3769 | 16.9818 |
| | Free Stocks (million bales) | | | | |
| Annex I baseline | 4.9155 | 4.6527 | 4.3863 | 4.3458 | 4.0330 |
| FAPRI baseline | 4.8188 | 4.4349 | 4.2145 | 4.1920 | 3.8837 |
| | Imports (millions bales) | | | | |
| Annex I baseline | 0.0050 | 0.0050 | 0.0050 | 0.0050 | 0.0050 |
| FAPRI baseline | 0.0050 | 0.0050 | 0.0050 | 0.0050 | 0.0050 |
| | Mill Use (million bales) | | | | |
| Annex I baseline | 7.7825 | 7.7018 | 7.6339 | 7.5896 | 7.5245 |
| FAPRI baseline | 7.7429 | 7.6547 | 7.5968 | 7.5532 | 7.4927 |
| | Exports (Million bales) | | | | |
| Annex I baseline | 9.7667 | 9.9817 | 10.0384 | 9.8275 | 9.8054 |
| FAPRI baseline | 9.9042 | 9.9495 | 10.0260 | 9.8513 | 9.8024 |
| | Season Average Price ($/lb) | | | | |
| Annex I baseline | 0.450 | 0.477 | 0.503 | 0.512 | 0.539 |
| FAPRI baseline | 0.457 | 0.488 | 0.512 | 0.520 | 0.547 |
| | A Index Price ($/lb) | | | | |
| Annex I baseline | 0.507 | 0.534 | 0.558 | 0.576 | 0.596 |
| FAPRI baseline | 0.524 | 0.547 | 0.568 | 0.587 | 0.605 |
| | Adjusted World Price ($/lb) | | | | |
| Annex I baseline | 0.372 | 0.398 | 0.419 | 0.436 | 0.455 |
| FAPRI baseline | 0.387 | 0.410 | 0.428 | 0.446 | 0.463 |
| | Step 2 Payments ($/lb) | | | | |
| Annex I baseline | 0.057 | 0.060 | 0.063 | 0.047 | 0.052 |
| FAPRI baseline | 0.054 | 0.060 | 0.063 | 0.047 | 0.052 |

**Section IV**

43. In section IV of the US critique, the United States claims that my model does not forecast future or explain historical outcomes of cotton plantings and that variables, such as the ratio of soybean to cotton futures prices, are more highly correlated to acreage variations in the seven years from 1996 to 2002.[74] The United States claims that this has some relevance for the validity of my model and its simulation results. These claims are seriously flawed.

44. Section IV of the US critique demonstrates a complete lack of understanding of the role of policy simulation models. A policy simulation model is not designed to and does not have the capability of forecasting. Policy simulation models are designed to ask "but for" counterfactual questions not to attempt to replicate a specific history or forecast the future. Specific statistical tools

[74] *See inter alia* paragraphs 39-42 of the US critique. This is the entire theme of section IV.

apply to forecasting economic time series – generally based on some variant of regression analysis – to forecast/predict future or explain historic outcomes of, for instance, cotton plantings. Contrary to the assertion of paragraph 39 of the US critique, no professional economist would ever propose a simulation model designed to consider the impacts of policy alternatives as the appropriate tool for forecasting the future or for explaining historical data for an industry. I certainly would never propose the use of a policy simulation model for forecasting purposes.[75]

45. I begin my response to the US critique in section IV by noting that – as I understand it – the questions before the Panel relate to the analysis of the effects of the US cotton subsidies, not to predict cotton plantings for future marketing years.[76] The simulation model that I have presented in Annex I and in later submissions to the Panel addresses exactly that first question before the Panel. Given the baseline that covers historical data for marketing years 1999-2001 and projections for marketing years 2002-2007, my simulation model asks what would have been or what would be the effects of removing the US subsidies on US acreage, use and exports of cotton as well as on cotton prices and other variables.

46. The United States is wrong when it implicitly claims that the ability of a policy simulation model to forecast or account for variations in a time series provides any useful guide to its reliability in terms of the simulation results that it generates – for example in assessing what may happen if policy variables were to change.

47. Forecasting models are typically based on multivariate time series regression analysis that accounts for short-run and long-run trends, serial correlation of times series and exogenous factors. In agriculture, projecting acreage choices would likely involve projecting climate variations, pest trends, and many other variables. (Any standard econometrics textbook provides the basics for forecasting economic time series.[77])

48. Neither my Annex I model nor the FAPRI policy model (nor the USDA policy models) provides an appropriate framework for statistical analysis explaining historical variations in acreage or for forecasting future acreage.[78] The purpose of simulation models is to isolate the effects of, for instance, subsidy programmes as they occur against the baseline results. Policy simulation models do not claim to be useful for forecasting purposes and they are not. But this is irrelevant to their stated purpose as "but for" (counterfactual) policy analysis tools.

49. My simulation model assumes "average" trends for many variables that change in real world situations, but are set at averages in the baseline (or at historical outcomes). For example, my model assumed average weather conditions for marketing years 2002-2007. However, no doubt, there will be years with weather better than the average and years with weather worse than the average. The model cannot predict this, and, therefore, any deviations in the real world that impact on, for instance, planting decisions, would result in "projections" by the model to be necessarily wrong – to the extent that important outcomes of variables, such as weather, deviate from the baseline.

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[75] I note that the claims made by the United States about the "Sumner model" apply with equal (lack of) force to the FAPRI models themselves. No one uses these models to forecast, nor should they. The models are used and useful to ask "but for" questions, which forecasting models are not in a position to do.

[76] Thus, any assertions of the United States that my model cannot predict future or explain past outcomes of cotton planting is not a relevant factual statement that helps this Panel determine the effects of the US cotton subsidies.

[77] See for example, William H. Greene, *Econometric Analysis* Prentice Hall; 5th edition (2002) (cited in Brazil's 22 December Answers to Questions, para. 42) A classic and still useful reference is Charles R. Nelson, *Applied Time Series Analysis for Managerial Forecasting*, Holden Day, San Francisco. (1973).

[78] Running the same correlation calculations that the United States applied to my model off the FAPRI or USDA's FAPSIM model would very likely not reveal significantly higher correlations as these simulations models are – like my adaptation of the FAPRI model – not designed for that purpose.

50. A simple illustration may clarify the point that statistical regression models and policy simulation models serve different purposes. Consider a period in which a large direct production subsidy was in force, but the parameters of the programme did not change. Given changes in climate, agronomic factors or other economic incentives, planted acreage would change over the period, but none of the changes in acreage would be due to changes in the subsidy, because there were none. The result of any time-series regression analysis of a limited number of data points is incapable of isolating the effects of variables, such as subsidy programmes, that do not change considerably during the period under analysis. Other variables would explain the variation in acreage over the period and would be better predictors of future acreage shifts so long as the large subsidy programme remained unchanged.

51. But does this mean that the large direct production subsidy is irrelevant to planted acreage? No, of course not. Does this mean that a model to consider the amount of acreage that would be planted, but for the subsidy, should assume the subsidy was irrelevant? No, of course not. Therefore, a statistical regression (or correlation) model applied to analyze the effects of such "constant variables" would fail to capture their importance. In sum, only a policy simulation model, of the general sort that I have provided in Annex I will adequately isolate the effects from the cotton subsidy programme hidden in the regression analysis.

52. Similarly, policy simulation models are not usually very good at forecasting future or explaining past events, as explained above. Does this mean that the simulation analyzed the effects of the subsidy programmes incorrect?[79] No, of course not, if they are properly designed.

53. The United States further claims that there are small positive or negative correlations between the expected net revenue and planting decisions, as a result of my model.[80] The table referred to in paragraphs 43 though 52 of the US critique and the discussion in those paragraphs also illustrate the misunderstanding that the United States evidently has about model evaluation and the meaning of the statistics they produce. The table at paragraph 49 reports simple correlations coefficients based on seven observations for a few variables. First, I note that the sample size for these variables is simply too small for any meaningful statistical analysis. Second, simple (univariate) correlation coefficients are not measures of explanatory power as the United States implies, for example, in paragraph 42 of its critique.[81] Simple correlation coefficients tell us nothing of interest when many variables affect an outcome.[82] This again highlights the difference between forecasting or explanatory models and policy simulations models that ask "but for" counterfactual questions. Nothing in this section of the US critique relates in any way to the usefulness of models for policy analysis.

54. Correlation coefficients measure linear statistical relationships between two variables in isolation from all other influences. They do not indicate causation and they do not even indicate a statistical relationship between variables that takes place in the real-world situation when there are many simultaneous statistical and causal relationships in place. It follows that the figures presented in the table at paragraph 49 are not indicative of causation or even of the contribution to statistical explanatory power in the current case where many variable are interrelated. Whether the figures are

[79] The United States implies this in paragraphs 40-50 of its critique.

[80] Paragraphs 43-46 and table at paragraph 49 of the US critique

[81] Paragraphs 41-42 and 45-49.

[82] The case of cotton plantings is a good example. Planting decisions are a function of expected revenue itself determined by expected market revenue and expected government payments. It is further a function of expected revenue for other crops, of weather conditions at planting time, of expected demand for the crop, expected weather during the growing season and so forth. Simple univariate correlation measures linear statistical relationships, not causation or even statistical relationships if there are many factors that potentially affect the outcome of a variable. This explains that there may be a negative correlation where one intuitively expects a positive correlation as a result of ignoring the effects of all other factors on the variable to be explained.

positive or negative, large or small, they have no statistical significance and provide no meaningful information.

55. In sum, the US statement at paragraph 50 of its critique has no basis whatsoever. As with all policy simulation models, including the FAPRI and USDA simulation models, any single factors or set of variables in my model are not necessarily expected to "explain" the time series data. The model was not designed to explain historic events or predict future outcomes. Instead my model is designed to simulate what would be expected to happen if US subsidies were removed. A test of the model would be to observe responses if subsidies were removed and other factors were held constant. Presenting a set of simple correlation coefficients on seven years of historical data over which subsidies remained in place provides no evidence of any relevance.

56. Finally, I refer the Panel to the many instances in which I have addressed the question of lagged prices used to model farmers' price expectations at planting time.[83] I will not repeat these arguments here to respond to the US criticism that I should have used futures market prices.[84] I would note that Brazil's submissions have thoroughly addressed the US arguments that US farmers planting decisions are made in accordance with futures market prices.[85]

**Section V**

57. This section of the US critique repeats again that my model differs from the FAPRI US crops model. It also asserts that the United States had difficulties in replicating results of my analysis from the electronic files. This section also reveals that the United States made several mistaken "assumptions" about how certain variables entered the model. As indicated before, given the complexities of working with these models, both Professor Babcock and I have repeatedly offered to work with the United States to replicate my results.[86] US government or other economists working on the US critique of my model could have contacted either Professor Babcock or myself requesting any needed information or assistance with any problems they have had. If they would have done so, we could have clarified any ambiguities and the United States could have avoided the evident errors made in applying my model. However, they did not contact either of us. As a result they made inappropriate assumptions and have failed to apply the model correctly.

58. Let me begin by addressing the US statements about the differences between the Annex I model and the FAPRI model.[87] The essence of those differences was explained in Annex I while the operational details were specified more precisely in Exhibit Bra-313. Annex I attempted to provide a relatively simple heuristic discussion of the modelling approach. Exhibit Bra-313 provided the operational equations. These operational specification are made explicit in equations (4), (5) and (6) in Exhibit Bra-313. As explained in Exhibit Bra-313, my approach to the PFC, MLA, DP and CCP payment programmes and for crop insurance was to use a constant regional acreage elasticity (taken from the FAPRI crops model publications).[88] These elasticities were the averages of the time-varying elasticities used over previous periods, as reported by the FAPRI US crops model that I adapted. I

[83] *See* my 9 October Closing Statement attached as Annex II to Brazil's 9 October Closing Statement, my 2 December Oral Statement (Exhibit Bra-342, paras. 24-28), Exhibit Bra-345 (paras.6-14) as well as Brazil's answers to question 213 from the Panel on which I have provided input (Brazil's 22 December Answers to Questions, paras. 37-42).

[84] *See* paragraphs 51-52 of the US critique.

[85] Brazil's 2 December Oral Statement, Section 5.2 and the accompanying exhibits, as well as my oral explanations on 3 December, including Exhibit Bra-371.

[86] *See* my oral statement on 2 December (Exhibit Bra-342, para. 5 and 8), Exhibit Bra-331 (para. 10), letter of Professor Bruce Babcock attached to Brazil's 5 November letter to the Panel

[87] *See* section V

[88] The regional supply elasticities used for the constant elasticity calculations to determine the PFC, DP, MLA and CCP effects and the crop insurance effects are as follows: Corn Belt, 0.219; Central Plains, 0.942; Delta, 0.544; Far West, 0.041; South East, 0.615; and Southern Plains, 0.362.

then apply this constant elasticity to the percentage effects of the subsidy on net revenue. This constant elasticity modelling is well established in the literature.[89] Paragraphs 53-56 of the US critique misstate the operational model I used and ignore the information in Exhibit Bra-313 that explains how the heuristic explanation in Annex I was operationalized.

**Sections V.A to V.C**

59. In sections V.A and V.B, the Unites States fails to acknowledge that, because the level of net returns vary from year to year, the constant elasticity specification explained in Exhibit Bra-313 means that the impacts of the PFC, MLA, DP, CCP and crop insurance programmes will vary as well. When one recognizes this commonly applied feature of my specification, there is no inconsistency whatsoever between the acreage impacts in the periods 1999 through 2002 and 2003 through 2007.

60. In fact, the United States acknowledges its understanding of the operational specifications explained in Exhibit Bra-313 in paragraphs 63 through 66 of section V.C. And they acknowledge that with constant percentage effect, the number of acres shifted will depend on the percentage impacts of the subsidies on net revenue, not the absolute dollar impacts. The US observations about the programme effects in section V.A (paragraphs 57-60), section V.B (paragraphs 61-62) and in the table that follows paragraph 62 of the US critique are explained by my explicit description of the operational specifications of the Annex I model in equations (4) through (6) in Exhibit Bra-313. It is therefore puzzling why the United States included Section V.A and V.B in the document at all, since they provide no new information. The United States first simply mischaracterizes my approach as linear, and then states that the results are not in line with that linear characterization. As I explained in Exhibit Bra-313 (equations (4) through (6)) and as repeated by the United States in section V.C, my model uses a constant elasticity, constant percentage effect for these impacts.[90]

61. Let me clarify this a little further. The FAPRI US crops model applies a constant linear response to any added revenue. My Annex I model takes the same approach for all variables that are included from the standard FAPRI US crops model. This refers to all variables for which no modifications are reported in Exhibit Bra-313. The FAPRI linear system means that a $100 increase in subsidy has the same effect on acreage whether the base revenue is $200 or $1,000. My alternative approach is used for PFC, MLA, DP and CCP payments as well as crop insurance. It implies that a subsidy that is a constant 10 percent of net revenue has a constant percentage effect on acreage. Hence, a $100 increase in subsidy has a bigger percentage effect on acreage if base revenue were $200 (a 50 per cent increase) than if base revenue were $1,000 (a 10 per cent increase). Constant percentage impacts and constant elasticity models are far more common in the economics literature than are strictly linear models. Constant percentage effects do not imply larger impacts in general. In effect, a constant percentage effect says that subsidies have a bigger acreage effect when they are a bigger share of net revenue than when they are a smaller share of net revenue.

62. Section V.B on crop insurance contains some additional US mistakes in applying my model. The United States seems to apply a constant per-acre crop insurance benefit for all regions. This is inconsistent with my approach and with reality. As explained in paragraphs 54 and 55 of Annex I, crop insurance subsidy rates differ substantially by region and my model incorporates those differences. When the constant percentage effects are incorporated and when one applies the different regional subsidy rates, there is absolutely no inconsistency between the results in the period from 1999 through 2002 and the period 2003 through 2007.[91]

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[89] *See* Sumner, Daniel A., and Michael Wohlgenant, "Effects of an Increase in the Federal Excise Tax on Cigarettes," American Journal of Agricultural Economics, 1985, vol. 67, 235-242.

[90] I note that contrary to the US assertion in paragraph 66, my methodology has not changed between Annex I and Exhibit Bra-313.

[91] The United States claims in paragraph 62 that the existence of crop insurance had a negative impact in the acreage in the Corn Belt and that this would be an implausible result (paragraph 62 of the US Critique and

**Section V.D.**

63. The point of paragraphs 67 and 68 and the table to which they refer, which follows paragraph 70 ("Example of Southern Plains Acreage Impact"), are not at all clear. Most importantly, the United States is simply incorrect that I used only market revenue plus marketing loan gains as the basis for the percentage calculation.[92] The full net revenue including all programme payments are included in the model specification. It is not clear why the United States made this mistaken assumption.

64. In addition, the labelling of the table itself is not clear. For example, neither Annex I nor my other submissions include regional acreage effects of subsidy programmes. This is because the focus of this case is on national and international impacts. It appears that it was the United States which calculated the figures reported in the table following paragraph 70 ("Example of Southern Plains Acreage Impact"). I note that the marketing year 2005 planting effect of crop insurance in the Southern Plains that the United States labels "Sumner Impact" exceeds the effect I report in Annex I for the entire United States.[93] This reason for this seems to be that the United States presents first round effects, i.e., effects before any feedback effects (second-round effects) from both the US crops model itself as well as before any feedback from the CARD international cotton model. To be clear, these US figures are not the equilibrium figures that I reported in Annex I. They are also not the first-round effects that were intermediate for the results reported in Annex I because of mistaken US assumptions, as discussed below.

65. Further, the column (2) of the US table at paragraph 70 ("Example of Southern Plains Acreage Impact") is labelled "Programme Revenue," yet includes crop insurance. I assume this refers to the total subsidy per acre, not programme revenue. Also, the "programme revenue" only includes revenue from DP and CCP payments as well as crop insurance. No revenue from the marketing loan programme (10.06 cents per pound in MY 2005 pursuant to an AWP of 41.94 cents per pound reported in the baseline)[94] is included in the calculations. By not including marketing loan payments in its calculations, the United States does not follow its own proposition of what the right approach is.[95] Rather, it has excluded marketing loan revenue entirely from its calculations in the table at paragraph 70 of its critique ("Example of Southern Plains Acreage Impact"), leading to distorted elasticity calculations.

66. There are a number of further problems in the examples the United States provides in the tables at paragraph 70 of the US critique ("Example of Southern Plains Acreage Impact") that seem to account for the differences they have created by misapplying my model. Let us use the crop insurance calculations as an example. I calculate that the Southern Plains crop insurance subsidy is $26.14 per acre, not $24.67 per acre[96], as the United States enters into its table in the "programme revenue" column. Furthermore the acreage elasticity that I use is not 0.28, but rather 0.362. These

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the accompanying table). This is, however, not true. Net crop insurance subsidies in the Corn Belt were negative over time, with indemnity payments being below premium payments. Therefore, the program provided farmers with a net negative return causing negative acreage impacts. This is an entirely plausible result. *See* below the discussion on the amount of crop insurance subsidy payments (at paragraph 66, note 96 below). I also note that cotton is not an important crop in the Corn Belt and that crop insurance benefits in the more important regions in the Southern Plains and in the Southeast are much higher.

[92] *See* paragraph 68 of the US Critique.

[93] *Compare* the 0.446 million acres reported by the United States without offering any source with the results I have reported in Annex I, Table I.5d, which is 0.420 million acres.

[94] *See* Annex I, Table I.5a.

[95] *See* paragraph 68 of the US Critique.

[96] The regional crop insurance subsidy rates that I use are as follows: Corn Belt: -$0.70; Central Plains: $28.24; Delta: $7.37; Far West: $13.62; Southeast: 15.71; Southern Plains: 26.14.

two further obvious errors in the US application of my model account for the bulk of the differences that the United States seems to imply (incorrectly) were errors on my part.

67. Besides this, the table following paragraph 70 of the US critique ("Example of Southern Plains Acreage Impact") not only contain numbers that are not my reported impacts, they also make the serious conceptual error of simply adding the impact of each programme across the columns to get a "total" effect. This is an error because the effects of the programmes are not independent. In order to estimate the impacts of removing these three sets of programmes together, one must simulate that scenario explicitly. The resulting impacts will be smaller than the sum of the impacts of removing each programme one at a time. For example, if one removed the crop insurance programme for cotton, supply would fall and the market price of cotton in the United States would rise. This would imply that the CCP programme would have a smaller subsidy element and its effect would be smaller. The fact that the United States reported the simple sum of impacts across programmes and represented that as the impact due to the three sets of programmes together seems to demonstrate either an inadvertent error or a basic lack of understanding of how the programme and the model operates.

**Section V.E**

68. There are several problems and inconsistencies in the discussion and tables included in this section. These problems also apply to the calculations in section V.D.[97] The United States improperly applied my model and, therefore, it is not surprising that they found different results. I note that the United States in paragraphs 71 of its critique states that "reasonable assumptions were made to facilitate the calculations". I repeat again that Professor Babcock and myself offered the United States our assistance in replicating the results. Any request for assistance would have avoided these problems and the need for the United States to make "reasonable assumptions … to facilitate the calculations".

69. One important problem that vitiates any claims in this section is that the numbers that are labeled "Sumner's Reported Impacts" in the three charts that follow paragraph 72 are not what I reported in Annex I Tables I.5.b, I.5.c and I.5.d.98 The United States compares two sets of numbers that were evidently generated by the United States, neither of which is the result that I actually reported to this Panel.

70. As noted above, it seems that the United States provides direct acreage effects (so-called first-round effects) that do not take into account feedback effects from either the US crops model or the CARD international cotton model. These feedback adjustments are very large and the US figures do not represent the new, much smaller, equilibrium effects.

71. With this in mind, I will address the US arguments in section V.E. The United States claims that my approach to estimating the acreage impacts of removing PFC/DP, CCP/MLA, and crop insurance subsidies is deeply flawed because their attempted replication of the my methodology showed sharply lower impacts in 2002 – 2007 than what they claim were my estimated impacts.[99] As I will demonstrate, the difference between the two sets of estimates of the United States is primarily due to differences in the magnitude of elasticities of supply the United States used, as compared to the elasticities that I actually used. The United States applied time-varying, linear elasticities[100] because this is what is suggested by the FAPRI linear modelling framework. My Annex I results of the effects

[97] I have combined the discussion of these points to avoid any repetition in an already lengthy and technical document.

[98] Nor are these the figures that I have reported using the FAPRI January 2003 baseline (Exhibit Bra-325)

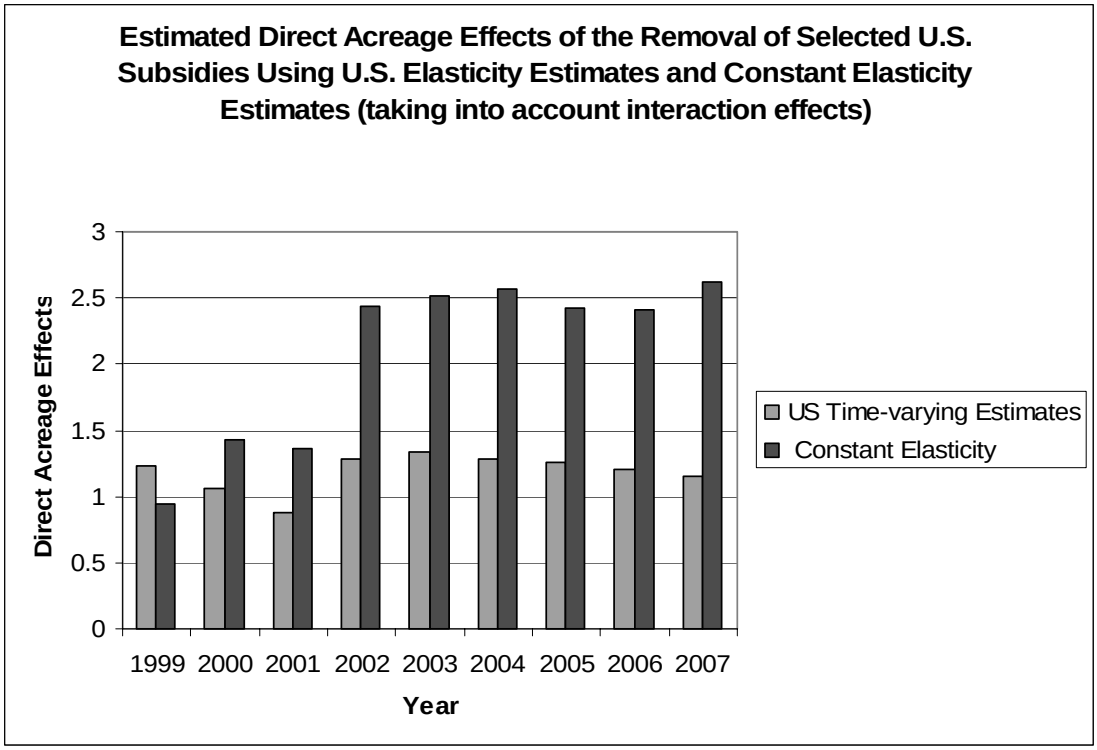
[99] Paragraph 69 of the US Critique and second set of tables following paragraph 70 of the US Critique, as well as the three charts following paragraph 72 of the US Critique.

[100] I have explained that in my comments on section V.A-V.C.

of these listed programmes are, however, based on a constant elasticity structure. As I will show, the US implementation of the United States' method using time-varying, linear elasticities is deeply flawed and leads to a dramatic underestimation of the effects. To clarify this step by step, I take as a starting point the US implementation of my Annex I methodology.[101]

72. The United States calculates time-varying, linear elasticities by multiplying the slope coefficient in the FAPRI US crops model by real net revenue (net revenue divided by a GNP deflator) and dividing the result by base acreage.[102] Net revenue used in this calculation is expected market revenue plus marketing loan gains. Contrary to the US approach and as discussed above, I use a set of elasticities that does not vary with time. The first chart below shows how the different elasticity estimates change the estimated acreage effects of removing PFC/DP, CCP/MLA, and crop insurance subsidies.[103]

Chart 1




73. I note again that these acreage effects are "first-round" effects that represent an intermediate calculation step towards estimating the new equilibrium results. Therefore, these figures are conceptually different from the equilibrium acreage effects reported in Annex I.[104]

74. These effects are also not the same as the first-round acreage effects that I have estimated using the Annex I model because of differing subsidy levels, as explained below.

[101] All calculations are presented in Exhibit Bra-399 ('AcreageDiscrepancies.xls') attached to the electronic version of this document.

[102] Base acres are the acreage planted under the baseline scenario.

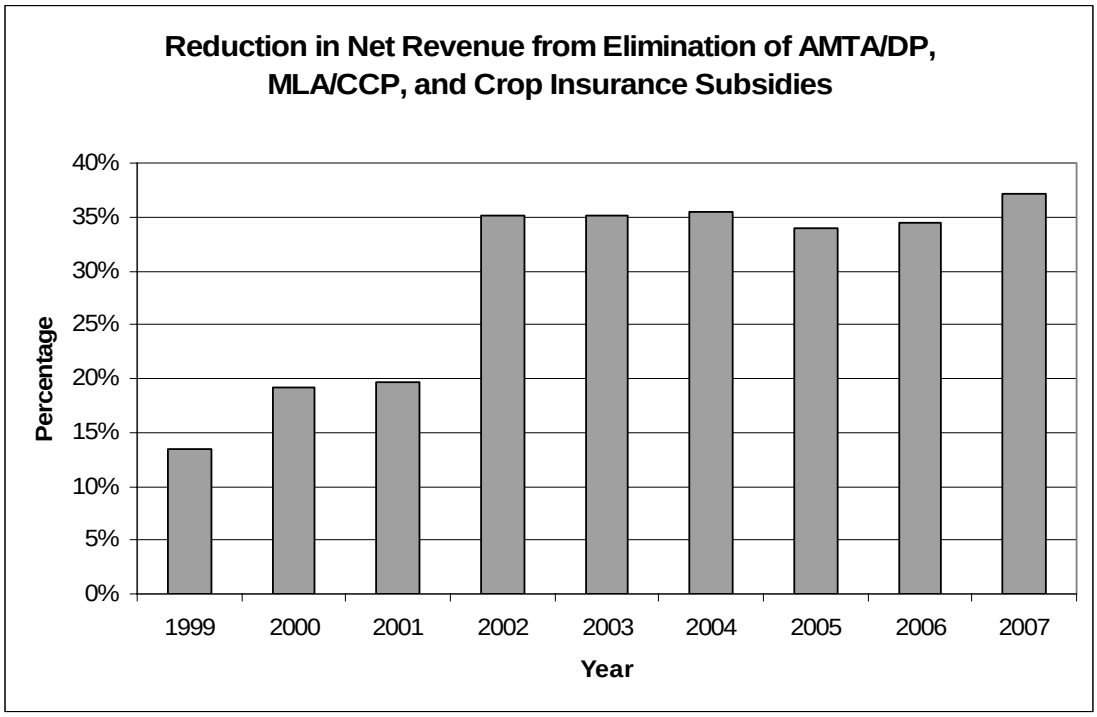
[103] The chart presents total effects from all three subsidy programs (PFC/DP, MLA/CCP and crop insurance) and controls for interaction effects.

[104] The Annex I effects take into account second round effects on price and quantities resulting from the first round effects and also the feedback from the CARD international cotton model leading to an equilibrium effect.

75. I note that the effects reported in chart 1 are quite similar to the pattern of effects presented by the United States, as reported in the charts following paragraph 72 of the US critique.[105] I have included the aggregate effects from these three programmes, controlling for interaction effects between them, which accounts for the differences between my figures and the sum of the figures presented by the United States.

76. I also note that, in chart 2, the pattern of acreage effects estimated by my use of a constant elasticity model specification[106] is consistent with the pattern of the importance of these subsidies, i.e., the share of the total net revenue presented by these subsidies.

Chart 2




77. The results in chart 1 would suggest that most of the discrepancy between the first-round effects that lead to my Annex I results and those first-round effects calculated by the United States is due to different assumptions regarding elasticities.

78. However, it is not true that the difference in the assumptions regarding the elasticities does primarily account for the difference. First, there is much less difference between the results from the two assumptions regarding the elasticities once an error in the United States' method for calculating its time-varying, linear elasticities is corrected.[107] As documented in the Final USCROPS2003.xls file[108], the United States calculates the supply elasticity by multiplying the slope parameter by real net revenue and then dividing it by base acreage. Net revenue in this calculation includes marketing loan

[105] They are not identical, as the United States used the FAPRI January 2003 baseline provided with my cotton-focused model for these calculations. The similarity of the figures demonstrates again the robustness of the model if different baselines are used.

[106] I have discussed this feature of a constant elasticity model in my comments on section V.A-V.C above.

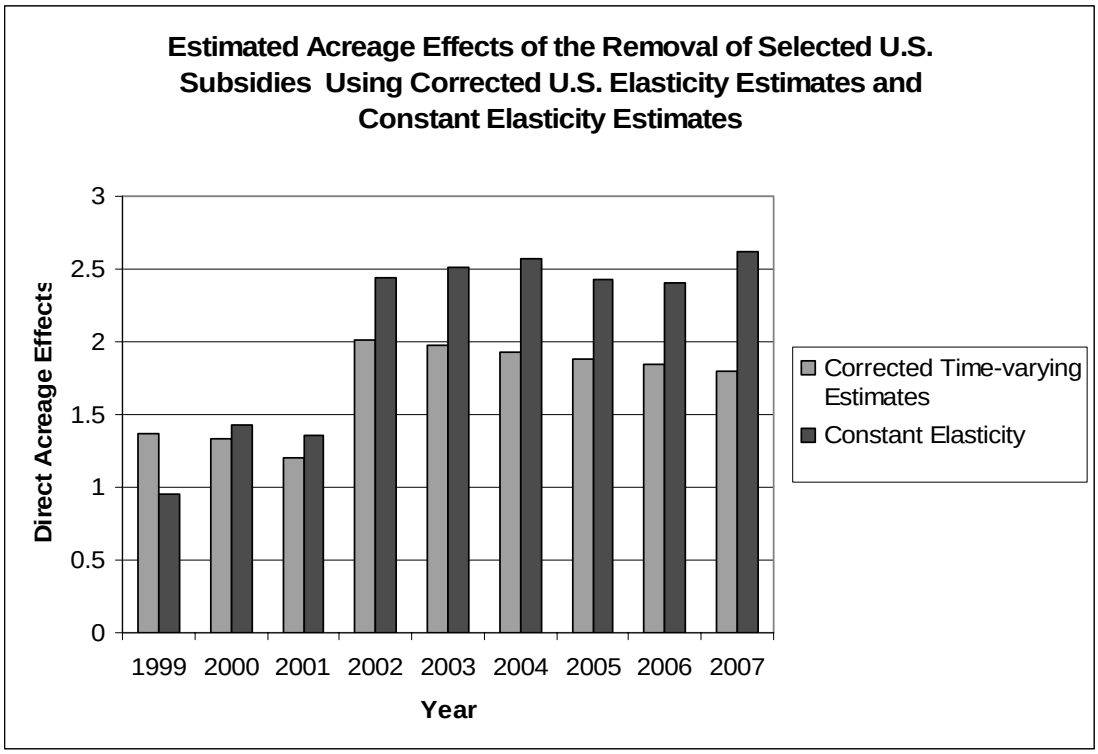
[107] As discussed below, the United States also uses compares results from two different baselines.

[108] Exhibit US-115.

gains and expected market revenue, but it does not include crop insurance subsidies and the other government subsidies that are to be removed in this simulation.[109] As the United States correctly points out when they question whether I included these subsidies for the calculation of the percentage change in net revenue from subsidy removal[110], these subsidies should also be counted towards net revenue when calculating the elasticity of supply.[111] The mistaken assumption by the United States that I have not done so seems to have let the United States to also leave these revenue components out of their calculation, thereby generating misleading results.

79. The following chart 3 shows that when the time-varying, linear elasticities are correctly calculated, then the choice of time-varying, linear elasticities or constant elasticities makes much less difference to the estimated impacts of subsidy removal than suggested by the United States in the three charts following paragraph 72 of the US critique.

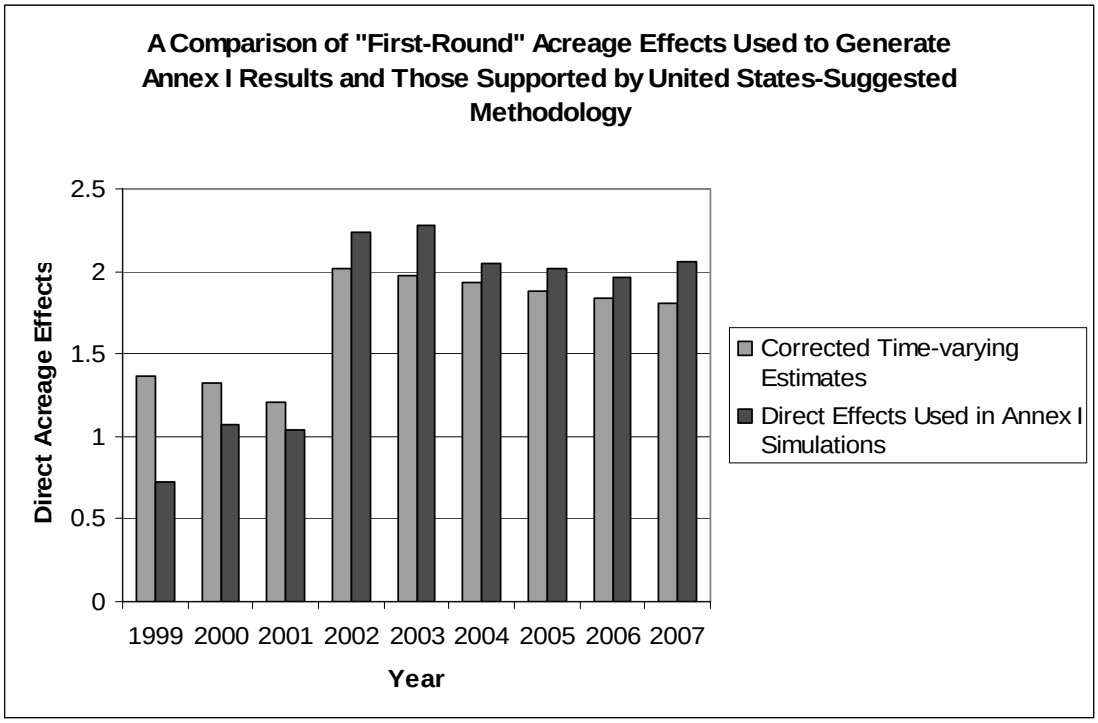
Chart 3




80. Finally, one last source of difference is that the United States uses the model calibrated to the FAPRI 2003 baseline[112] rather than the baseline used to estimate the effects reported in Annex I. The next chart (4) compares the actual direct acreage effects (first round effects) from removal of PFC/DP, CCP/MLA, and crop insurance subsidies based off the baseline used to generate the Annex I results to those that would have resulted from using the correct US time-varying, linear elasticity approach, the correct net revenue estimates and the same baseline. As shown below, adopting the corrected United States procedure compared to my constant elasticities approach would have resulted in a dramatic increase in the estimated impacts of removing these subsidies in 1999, somewhat higher estimates in 2000 and 2001, and a bit lower estimates in 2003 to 2007.

[109] I note that I also made this point in my comments on section V.D above.
[110] *See* paragraph 68 of the US Critique.
[111] I note that I correctly included these subsidies.
[112] Provided by Brazil as an attachment to its 18 November 2003 Further Rebuttal Submission.

Chart 4




81. In sum, the bottom line of these calculations is that, if the United States had followed the approach that they and I agree would be correct for calculating total net revenue and resulting time-varying, linear elasticities, the resulting effects would not be significantly different whether simulated using constant elasticities or time-varying, linear elasticities. I used the constant elasticity method because it makes the common sense assumption that equal percentage changes in net revenue should give rise to similar changes in acreage.[113] As noted above, this is also a standard approach in economic literature.

82. Finally, I would like to stress that any remaining differences from using different elasticity approaches are still on the level of "first round" effects, not equilibrium effects. The resulting equilibrium effects would show results that are even less different based on the choice of time-varying, linear versus constant elasticities. In short, this choice does not meaningfully affect my Annex I results.

**Section VI.**

83. In paragraphs 73-74 of the US critique, the United States calls into questions my modelling approach for the marketing loan programme by describing it as revealing a "lack of knowledge of the programme, a broader deficiency in economics or some previously unknown modification of the FAPRI or CARD models". These allegations are baseless. Indeed, the United States simply identified a typo in the transcription of equation 2 in Exhibit Bra-313. This transcription typo was not made in the electronic model and, therefore, does not affect the results of my Annex I model. In the Annex I model, as in the FAPRI US crops model, the acreage in year 't' is affected by the loan rate in year 't' (not the loan rate in 't-1' as erroneously reported in Exhibit Bra-313). I regret the inconvenience if this typo caused some confusion.

[113] I have discussed this above providing the example of a $100 payments and base revenues of $200 and $1000.

84. It turns out that, contrary to what the United States implies in paragraph 74 of its critique, this typo introduced no ambiguity at all and would not have affected the results in any significant way. The fact is that the loan rate for cotton is essentially constant over the full period of analysis and, thus, the loan rate in period 't' is equal to the loan rate in period 't-1'.[114] Despite the tone of the paragraph, the model was clear, and the subscript 't' or 't-1' make no difference at all in this case. Yet, I stress again that this typo only occurred in the transcript of equation (2) in Exhibit Bra-313, and not in the electronic versions of the Annex I model itself.

85. In paragraph 74 the United States makes a major issue of what amounts to their own semantic confusion. The model that I use for the marketing loan benefits for cotton is as specified in equation (2) (noting the typo discussed above). As noted by the United States, the electronic versions of the models show that the marketing loan effect is based on the difference between the loan rate and what is labeled as the loan repayment rate. For crops other than rice and cotton the loan repayment rate is the US market price of the crop (a local market price). For cotton and rice the loan repayment rate is an international price and, for cotton specifically, it is the adjusted world price (AWP). Thus, there is no discrepancy between Exhibit Bra-313 and the electronic documentation provided. The formulation that I use for the marketing loan impacts is the same as the FAPRI US crops model.

86. Paragraph 75 of the US critique simply repeats their discussion from the section V.C., which I have addressed above.

87. Finally, in paragraph 76 of its critique, the United States alleges that I have taken an "illogical" approach on specifying the export effect of Step 2 payments that constitutes "a departure from the specifications in the FAPRI framework." Similar to my response to the US critique at paragraph 73, I regret that I made another typo in the subscript in Exhibit Bra-313 that was not included in the electronic version of the model and, therefore, does not affect my results. Of course exports in period 't' market the crop produced in that period. The US marketing years are calibrated so that this is generally true. The United States is correct that, with the typo, equation (7) obviously makes no sense. The subscript should have referred to production in period 't' rather than 't-1', which, of course, is the equation contained in my model as well as in the FAPRI US crops model. Despite the US tone in paragraph 76, I expect the United States is aware that the specification of equations (7) and (8) follow the FAPRI model, as provided in the electronic verification of both the FAPRI US crops model as well as my cotton-focused model. Removal of the export step-2 and domestic step-2 subsidies increase effective demand for US cotton by lowering the effective net price paid by buyers.

**Section VII**

88. In paragraphs 77 through 80 of the US critique, the United States notes that the CARD international cotton model used different supply and demand elasticities than found in a paper by FAPRI-Missouri economist Seth D. Meyer. In fact there are several sets of such elasticities in the literature.

89. I relied on the CARD model and the CARD elasticities for four simple reasons. First, the authors of the published studies that underlie the CARD international cotton model include Professors Babcock and Beghin, who are two of the most widely-published and respected agricultural economists in the field. The scholarly credibility of their work and that of their CARD colleagues has been reinforced by scores of professionally-refereed academic articles to their credit as well as awards and other accolades.[115] In terms of quality objective research in agricultural commodity market economics and related areas, the CARD team has a long distinguished track record and a top notch

[114] I note that the loan rate was 51.92 cents per pound in marketing years 1999-2001 and 52 cents per pound in all later marketing years, so there is a tiny difference between 2001 and 2002.

[115] Exhibit Bra-400 (List of Publications of Professors Babcock and Beghin).

professional reputation. By contrast, I do not know the professional work of Seth D. Meyer, and have not been able to locate any of his work in professionally-refereed publications.

90. Second, the CARD international cotton model was the model that had been used by CARD in its respected work on other international commodity analysis. I would note that the various CARD international commodity models developed by Professors Babcock and Beghin and their colleagues have been used and relied upon in a number of different studies and been published in professionally referred publications.[116]

91. Third, the elasticity parameters incorporated in the CARD model are well within the range of estimates found and applied for many agricultural commodities. Finally, the United States provides no evidence to support a suggestion that the Meyer estimates are in any way more appropriate for the questions posed by this Panel than the estimates imbedded in the CARD model. Therefore, United States assertion that use of the CARD model somehow "exaggerates" impacts is simply unfounded.[117]

**Conclusion**

92. The Annex I model adapted from the FAPRI US crops model and the CARD international cotton model is an appropriate tool for both forward- and backward-looking "but for" counterfactual US agricultural policy analysis questions, such as those facing this Panel. The conservative results from my Annex I model are well within any plausible range and supported by other economic and econometric evidence.

93. Over the past months of this lengthy proceeding, I have responded to each criticism raised by the United States at various occasions[118] and have explained why none affects the validity of my model or its results.

94. Professor Babcock and I have been fully transparent about the manner in which the effects of the US subsidies have been simulated and I have rebutted any US allegations that I made my modelling choices to achieve pre-conceived results. To that end, I have explained each of my

[116] Refereed articles using CARD international models:

Fuller F., J. Beghin, J. Fabiosa, C. Fang, H. Matthey, and S. De Cara. "China's Accession to the WTO. What Is at Stakes for Agricultural Markets?" *Review of Agricultural Economics* 25(2) (2003): 399-414.

Beghin J., B. El Osta, J. Cherlow, and S. Mohanty. "The Cost of the US Sugar Program Revisited," *Contemporary Economic Policy* 21 (1) (2003): 106-116. Reprinted in *International Sugar Journal* 105 (2003): 293-303.

Fuller F., J. Beghin, S. Mohanty, J. Fabiosa, C. Fang, and P. Kaus. " Accession of the Czech Republic, Hungary, and Poland to the European Union: Impacts on Agricultural Markets," *The World Economy* 25(3) (2002): 407-428.

Fang C., and J. Beghin. "Urban Demand for Edible Oils and Fats in China. Evidence from Household Survey Data," *Journal of Comparative Economics*, 30 (4) (2002): 732-753.

Fabiosa, J.F., D.J. Hayes and H.H. Jensen. 2002. "Technology Choices and the Economic Effect of a Ban in the Use of Over-the-Counter antibiotics in US Swine Rations." *Food Control* 13(2), 97-101.

Hayes, D.J., H.H. Jensen, L. Backstrom, and J.F. Fabiosa. 2001. "Economic Impact of a Ban on the Use of Over-the-Counter Antibiotics in US Swine Rations." *International Food and Agribusiness Management Review* Vol 4., p 81-97.

Fuller F., J. Beghin, S. Mohanty, J. Fabiosa, C. Fang, and P. Kaus. " The Impact of the Berlin Accord and European Enlargement on Dairy Markets," *Canadian Journal of Agricultural Economics*, 47 (5) (1999 – appeared in 2000): 117-130.

[117] It is also useful to remind ourselves that larger elasticies may mean smaller price impact, but also imply larger impacts on quantities and in particular larger acreage elasticities mean more acreage in the non-subsidized countries that is driven out of cotton by the US cotton subsidy programmes.

[118] *See inter alia* US 7 October 2003 Oral Statement, paras. 26-50 and US 22 December 2003 Comments on Brazil's Econometric Model.

modelling steps and offered my assistance to the Panel and the United States to facilitate the understanding of this complicated econometric model and its results.

95. The United States has criticized my choice of baseline and I have provided analysis under various other baselines, demonstrating the robustness of my results. The United States has also criticized my modelling choices for PFC, MLA, DP and CCP payments, crop insurance and export credit guarantees. I have provided evidence that these choices were reasonable and, in fact, conservative. Concerning the largest US subsidy, the marketing loan programme, I note that the United States has not criticized its modelling. I have explained that the use of lagged prices for a large-scale policy simulation analysis is standard and does not generate biased or exaggerated results – in fact, no futures prices could or have been used in such models.

96. In sum, I stand by my conclusions in Annex I "that very large subsidies provided to US producers and users of upland cotton have had and will continue to have large impacts on quantities of US cotton produced, used and traded and on both US and world prices of cotton".

# ANNEX I-13

## COMMENTS ON US ANSWERS TO QUESTIONS POSED BY THE PANEL FOLLOWING THE SECOND SUBSTANTIVE MEETING OF THE PANEL

28 January 2004

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| *EC – Sugar Exports II (Brazil)* | GATT Panel Report, *European Communities – Refunds on Exports of Sugar Complaint by Brazil*, L/5011 – 27S/69, adopted 10 November, 1980. |
| *US – Gasoline* | Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996. |
| *EC – Hormones* | Appellate Body Report, *European Communities - Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, adopted 13 February 1998. |
| *Australia – Salmon* | Panel Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/R, adopted 6 November 1998. |
| *EC – Bananas* | Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS27/ARB, adopted 9 April 1999. |
| *Brazil – Aircraft* | Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW, adopted 28 August 2000. |
| *Indonesia – Automobiles* | Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, adopted 23 July 1998.- |
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| *Japan – Agricultural Products* | Appellate Body Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/AB/R, adopted 19 March 1999. |
| *Korea – Dairy Safeguards* | Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000. |
| *Canada – Dairy* | Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, adopted 27 October 1999. |
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| *US – FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
| *Australia – Leather* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999. |
| *Australia – Leather (21.5)* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/RW, adopted 11 February 2000. |
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| *US – Wheat Gluten* | Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted 19 January 2001. |
| *US – Wheat Gluten* | Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted 19 January 2001. |
| *Chile – Agricultural Products (Price Band)* | Appellate Body Report, *Chile- Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002. |
| *US – CVD's on EC Products* | Appellate Body Report, *United States – Countervailing Duties on EC Products*, WT/DS212/AB/R, adopted 8 January 2003. |
| *Canada – Aircraft II* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS222/R, adopted 19 February 2002. |
| *EC – Sardines* | Appellate Body Report, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002. |
| *EC – Sardines* | Panel Report, *European Communities – Trade Description of Sardines*, WT/DS231/R, adopted 23 October 2002. |
| *Japan – Apples* | Appellate Body Report, *Japan – Measures affecting the Importation of Apples*, WT/DS245/AB/R, adopted 10 December 2003. |

## List of Exhibits

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| Second Declaration of Andrew Macdonald, 27 January 2004. | Exhibit Bra- 401 |
| "Genetically Engineered Cotton Suffering from Production Problems", Organic Consumers Organization, 11 January 2002. | Exhibit Bra- 402 |
| "NCC will Intensify Emphasis for Quality, Yield Answers", Western Farm Press, 3 March 2001. | Exhibit Bra- 403 |
| "Benefits - BT Cotton", Monsanto Imagine. | Exhibit Bra- 404 |
| "Sample Costs to Produce Cotton Transgenic Herbicide- Resistant Acala Variety", San Joaquin Valley, University of California Cooperative Extension, 2003. | Exhibit Bra- 405 |
| "Cotton Cost-Return Budget in Southwest Kansas", Kansas State University Agricultural Experiment Station and Cooperative Extensive Service, October 2003. | Exhibit Bra- 406 |
| Documents on Cost of Production Insurance Plan for Cotton. | Exhibit Bra- 407 |
| Export – Import Bank of the United States, Standard Repayment Terms. | Exhibit Bra- 408 |
| Ex-Im Bank Fee Schedule. | Exhibit Bra- 409 |
| Export Insurance Services. | Exhibit Bra- 410 |
| "The Federal Scoop: US Government Financing for Service Exports", Export America, May 2003. | Exhibit Bra- 411 |
| Cotton and Wool Situation Outlook and Outlook Yearbook, USDA, November 2003, Table 16. | Exhibit Bra- 412 |
| "Agricultural Cash Rents", USDA, NASS, July 1999. | Exhibit Bra- 413 |
| "Agricultural Land Values and Cash Rents," USDA, NASS, August 2003. | Exhibit Bra- 414 |
| "Agricultural Land Values", USDA, NASS, April 1999. | Exhibit Bra- 415 |
| "What is a Farm Bill?", Congressional Research Service, Report for Congress, 5 May 2001. | Exhibit Bra- 416 |
| "Commodity Program Entitlements: Deficiency Payments", USDA, May 1993. | Exhibit Bra- 417 |
| Washington Post v. United States Department of Agriculture, 943 F. Supp. 31 (D.D.C. 1996). | Exhibit Bra- 418 |
| Allocation Calculations Based on Brazil's Methodology and US Summary Data. | Exhibit Bra- 419 |

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| Agricultural Outlook Tables, November 2003, Table 17. | Exhibit Bra- 420 |
| ERS Briefing Room: Farm Income and Costs: US Farm Sector Cash Receipts from Sales of Agricultural Commodities, USDA. | Exhibit Bra- 421 |
| Fruits and Tree Nuts Yearbook, USDA, October 2003, Table A-2. | Exhibit Bra- 422 |
| Vegetables and Melons Yearbook, USDA, July 2003, Table 3. | Exhibit Bra- 423 |
| Allocation Calculations Based on US Methodology and US Summary Data. | Exhibit Bra- 424 |

Questions from the Panel to the parties –
second substantive Panel meeting

## I. TERMS OF REFERENCE

**192. Regarding the interest subsidies and storage payments listed by the United States in its response to the Panel's Question No. 67:**

**(a) Please provide a copy of the regulations under which they are currently provided and under which they were provided during the marketing years 1996-2002;**

**(b) Please indicate whether there are any such payments which are not provided to implement the repayment rate for upland cotton within the marketing loan programme. USA**

**Brazil's Comment:**

1. The United States finally confirms that the "other payments" (*i.e.*, interest and storage payments) are not separate subsidies but rather a component of the marketing loan programme.[1] The US acknowledgement eliminates any question whether such payments are within the Panel's terms of reference.[2] Brazil's request for the establishment of a panel clearly includes "subsidies and domestic support … relating to marketing loans … providing direct or indirect support to the US upland cotton industry".[3] Based on the US answer, Brazil amends the table at paragraph 8 of its 22 December 2003 Answers to Question 196 to add $65 million "other payments" to the $832.8 million for marketing loans, for a grand total of $887.8 million in marketing loans for MY 2002. Brazil also makes similar changes for MY 1999-2001 that combine "other payments" and marketing loan payments in Table 1 of Brazil's 9 September 2003 Further Rebuttal Submission.

**193. Are interest subsidies and storage payments already included in the amounts shown in your submissions to date for payments under the marketing loan programme? Has there been any double-counting? BRA**

**194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? BRA, USA**

**Brazil's Comment:**

2. Brazil's 22 December 2003 response to this question, particularly its reference to the request for the establishment of the panel and existing jurisprudence, provides a comprehensive response to the points raised by the United States.[4] Brazil would offer the following additional comments to the US Answer.

3. Contrary to the suggestion at paragraphs 3-4 of the US 22 December 2003 response, Brazil's 11 August 2003 response to Question 19 did not change in any way the scope of Brazil's request for the establishment of a panel ("Panel Request"). Question 19 asked Brazil to clarify the measures in respect of which Brazil sought relief. Brazil's answer referred to one set of measures relating to

[1] US 22 December 2003 Answers to Questions, para. 2.
[2] US 30 September 2003 Further Submission, paras. 6-7; US 7 October 2003 Oral Statement, para. 2.
[3] WT/DS267/7, p. 2 (paragraphs relating to both the 2002 FSRI and the 1996 FAIR Act).
[4] Brazil's 22 December 2003 Answers to Questions, paras. 3-5.

Brazil's serious prejudice claims as those involving domestic support and export subsidy payments that had been made and were required to be made by the terms of the various statutory instruments identified in the Panel Request from MY 1999 through MY 2007. Some of these payments are relevant to Brazil's present serious prejudice claims for the period MY 1999-2002, and some of the payments are relevant to Brazil's threat of serious prejudice claims for the period MY 2002-2007. But as Brazil indicated in its 22 December 2003 Answer to Question 195, the text of the Panel Request (as well as Brazil's 11 August 2003 Answer to Question 19) in no way limits the type or scope of the payments made under those statutory and regulatory instruments up to 18 March 2003.

4. It is curious that the United States in its 22 December 2003 response takes an opposite position in this dispute than the one it took as the complaining party in the only other WTO serious prejudice dispute.[5] In *Indonesia – Automobiles*,,[6] the measures at issue provided for past, present, and future subsidy payments. Indonesia argued, similar to the US arguments here, that the effects of expired measures could no longer be examined for the purposes of current serious prejudice under Articles 5 and 6 of the SCM Agreement. Rejecting such a restrictive interpretation of Articles 5 and 6, the panel noted that:

> If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were "expired measures" while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice. Thus, we decline to proceed on the course suggested by Indonesia.[7]

At no time did the panel find, as Indonesia argued, that only non-expired subsidies paid under the measures at issue up until the date of establishment of the panel should have been considered for the purposes of assessing serious prejudice. Indeed, the US position in this dispute is practically the same as what Indonesia argued – and the US argued against[8] – in *Indonesia – Automobiles*. Brazil recalls the consistent US positions that (a) so-called "recurring" subsidies for MY 1999-2001 cannot be the basis for any serious prejudice claims[9], combined with (b) its claim that only *current* 2002 subsidies up to 18 March 2003 (*i.e.*, eight months of subsidies for MY 2002) can be the basis for any serious prejudice claims.[10] Given these two arguments, in the words of the *Indonesia – Automobiles* panel, "it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice".

5. As in *Indonesia – Automobiles*, the legal statutes and regulations set out in the Panel Request that mandate the payment of subsidies did not change between 18 March 2003 and 20 January 2004. Indeed, the 2002 FSRI Act and its implementing regulations will remain identical (unless amended by the US Congress) until the end of MY 2007. Nor has the 2000 ARP changed since 18 March 2003. The mandated subsidies from these statutes and regulations were flowing before 18 March 2003 and they will continue to flow thereafter. This case does not present the situation where a new legal instrument providing subsidies is enacted after the panel request was established. Nor is it even a situation as in *Chile – Agricultural Products (Price Band*,[11], in which a significant amendment to the legal instrument covered in the panel request was made long after the panel was established. The rationale of the Appellate Body in *Chile – Agricultural Products (Price Band)* and of the panel in *Indonesia – Automobiles* is to allow the Panel to conduct the required objective assessment under

[5] US 22 December 2003 Answers to Questions, paras. 3-5.
[6] Panel Report, *Indonesia – Automobiles*, WT/DS54/R.
[7] Panel Report, *Indonesia – Automobiles*, WT/DS54/R, para. 14.206.
[8] Panel Report, *Indonesia – Automobiles*, WT/DS54/R, paras. 4.44-4.50.
[9] US 30 September 2003 Further Submission, para. 94.
[10] US 11 August 2003 Answers to Questions, para. 134; US 22 December 2003 Answers to Questions, paras. 3-5.
[11] Panel Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/R, paras. 7.3-7.8.

DSU Article 11 based on all the relevant facts. These decisions are also grounded in the need for the "prompt settlement" of disputes under DSU Article 3.4 – and are structures to avoid the endless filing of precision-timed annual disputes and the litigation gaming strategy envisioned by the US argument.

## II. ECONOMIC DATA

**195. Does the United States wish to revise its response to the Panel's Question No. 67*bis*, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers"? Did the United States make enquiries of the FSA in the course of preparing its original answer? USA**

**Brazil's Comment:**

6. Brazil notes that the US answer is largely unresponsive to the Panel's question.

7. The Panel's question whether the United States "maintains information" is straight-forward. A correct answer would have been "yes". The ordinary meaning of the word "maintain" is "practice habitually", "observe", "cause to continue (a state of affairs, a condition, an activity)".[12] The United States consistently misled Brazil and the Panel by stating that USDA never collected, organized and maintained information regarding the amount of contract payments paid to current producers of upland cotton.[13] There is no doubt that these statements were false and misleading. It is significant that the United States has made no attempt to refute the evidence produced by Brazil in its 18 November 2003 Further Rebuttal Submission regarding the FSA forms completed by practically every US farm receiving contract or marketing loan payments.[14] Nor can the United States dispute that all of the information collected from the contract and acreage forms is (and was) maintained in a centralized database in USDA's Kansas City facility. The rapid response of USDA's Kansas City office to the rice FOIA request provides compelling evidence of the habitual practice of the US government in "maintaining" both contract and planted acreage information.[15] Indeed, the strongest proof of the United States' misleading conduct is the fact that USDA produced within three weeks the rice data in response to a FOIA request, and that the United States effectively admitted in its 18 and 19 December 2003 and 20 January 2004 Letters to the Panel that it maintains this information.

8. In fact, the United States continues to mislead the Panel in its 22 December 2003 Answer to Question 195. It states that "because those payments are decoupled from current production, expenditures under such programmes are not tracked by whether the recipient produces upland cotton".[16] Neither Brazil nor the Panel ever asked the United States how the programmes are "tracked". Rather, the Panel asked whether the United States "maintains information" that would permit the calculation of the amount of such payments. As Brazil has demonstrated in using the rice FOIA request[17], in discussing its proposed methodology, and in using the incomplete summary data provided by the United States on 18/19 December 2003, this is a simple exercise.[18]

[12] New Shorter Oxford Dictionary, 1993 edition, p. 1669.

[13] US 27 August 2003 Comments on Brazil's Rebuttal Submission and Answers to Additional Question, paras. 20, 21, 27; US 11 August 2003 Answer to Question 60; The United States made similar statements during the consultations held between November 2002 and January 2003.

[14] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.2.

[15] Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003).

[16] US 22 December 2003 Answers to Questions, para. 6.

[17] Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003).

[18] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55; Brazil's 28 January Comments and Requests Regarding US Data, Section 9.

9. The United States also asserts that "Brazil has also not asserted that the United States maintains information on the receipt of decoupled payments for upland cotton base acres by upland cotton producers".[19] Once again, the United States misleads and misrepresents. What Brazil asserted was that the United States maintains information in a centralized database on the amount of contract acreage, contract yields, and upland cotton plantings on contract acreage that would permit the ready calculation of the exact amount of contract payments received by current producers of upland cotton.[20] The fact that the United States claims not to have performed the simple calculation from this data does not mean the United States does not maintain the information requested by Brazil and the Panel.

**196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. BRA, USA**

## Brazil's Comment:

10. Brazil notes the new and increased figures ($415 million) that the US 22 December response presented for Step 2 payments during MY 2002. This figure should replace Brazil's figure presented at paragraph 8 of its 22 December 2003 Answers to Questions.[21]

**197. Please provide actual data for 2002/2003 for US exports, US consumption and per cent of world consumption to replace the projected data in Exhibit US-47. If available, please provide projected data for 2003/2004 to replace the forecast data. USA**

**Brazil's Comment:**

11. The US 22 December 2003 response admits at note 24 to the table at paragraph 15 that the US "consumption" standard for "world market share", within the meaning of Article 6.3(d) of the SCM Agreement, includes tabulating US exports and US imports and US domestic consumption of US origin upland cotton.[22] This acknowledgement that imports are also included highlights the fact that the United States is double counting exports as part of the world market share of the exporting country and part of the world market share of the *importing* country.[23] Since internationally-traded upland cotton is not similarly included twice in the total "world consumption," summing up the individual world market shares of all countries generates a total world market share vastly exceeding 100 per cent – a manifestly absurd result.[24] As Brazil has stated before, the Panel should not rely on the US interpretation of world market share as share of world consumption – the proper interpretation of the term refers to the share of world exports.[25]

12. Further, Brazil notes the new information presented by the United States concerning US upland cotton exports in MY 2002 and 2003. These figures (11.9 million bales and 13.2 million bales respectively) would replace Brazil's latest information, as contained in Exhibit Bra-302 (11.3 million bales and 11.2 million bales respectively). These new facts support Brazil's threat of serious prejudice claim under Article 6.3(d) and footnote 13 of the SCM Agreement. For both marketing

[19] US 22 December 2003 Answers to Questions, para. 7.

[20] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.2.

[21] *See* Brazil's comment on US 22 December 2003 Answer to Question 192(b) above concerning the treatment of "other payments." US 22 December 2003 Answers to Questions, para. 2. This US statement eliminates any doubt that "other payments" are within the Panel's terms of reference.

[22] US 22 December 2003 Answers to Questions, para. 15 (note 24).

[23] *See* Brazil's 2 December 2003 Oral Statement, para. 66. *See* also Brazil's comment on Question 136, below.

[24] *See* Brazil's comment on Question 136, below.

[25] *See* Brazil's 7 October 2003, Oral Statement, paras. 38-41; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 170-173; Brazil's 2 December 2003 Oral Statement, para. 66.

years, the US world market share, *i.e.*, the US share of world exports, is or will be even above its previous three-year average, strengthening the consistent trend of increasing world market shares since MY 1996 (as well as since MY 1986).[26]

**198. Please comment on the respective merits of the price-gap calculations of MY1992 deficiency payments in US comments of 27 August, footnote 14 ($867 million), and Brazil's response to the Panel's Question No. 67 ($812 million). BRA, USA**

**Brazil's Comment:**

13. As indicated in Brazil's 22 Decembers Answers to Questions, Brazil agrees with the US methodology of calculating MY 1992 deficiency payments[27] for purposes of an AMS approach, as developed by the United States in its 27 August 2003 Comments on Brazil's 22 August 2003 Rebuttal Submission.[28]

14. However, Brazil strongly disagrees with the US proposition that the US AMS calculation of deficiency payments is "conservative".[29] The US calculation is the only appropriate one under paragraphs 10 and 11 of Annex 3 of the Agreement on Agriculture. The United States suggests that it should have used "eligible" acreage rather than "actual" acreage for the calculation.[30] However, paragraph 10 of Annex 3 does not refer to eligible acreage; it refers to "the quantity of *production* eligible to receive the applied administered price".[31] Production eligible to receive the applied administered price under the deficiency payment programme is calculated based on the eligible, participating acreage and the applicable programme yield (not the actual yield). Any production exceeding the programme yields and any production on acreage that did not participate in the deficiency payment programme necessarily was not eligible production. Thus, the fact that theoretically more acreage could have participated in the upland cotton deficiency payment programme (*i.e.*, those farms opted to not participate) cannot artificially inflate the upland cotton AMS figure resulting from this programme. Thus, any production that takes place on a farm not participating in the deficiency payment programme is not, in fact, eligible to receive the applied administered price and, therefore, cannot be part of the AMS calculation under paragraphs 10 and 11 of Annex 3.

**199. What is the composition of the A-Index? We do note footnote 19 and, for example, Exhibit BRA-11, but please explain more in detail how this index is calculated. BRA**

**200. Concerning the chart on page 37 of Brazil's further rebuttal submission, why did Brazil use a futures price at planting time? Is this a relevant measure for assessing acreage response? BRA**

**201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so, please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? BRA, USA**

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[26] *See* Brazil's 27 October 2003 Answers to Questions, paras. 123-129. *See* also Brazil's 22 December 2003 Answers to Questions, paras. 133-139, concerning Brazil's arguments regarding a "consistent trend."

[27] Brazil emphasizes that it does not agree with to applying any price-gap calculation method for the calculation of marketing loan payments for AMS purposes. *See inter alia* Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 10-16.

[28] Brazil's 22 December 2003 Answers to Questions, para. 10.

[29] US 22 December 2003 Answers to Questions, para. 19.

[30] US 22 December 2003 Answers to Questions, para. 19.

[31] Emphasis added.

**Brazil's Comment:**

15. Brazil notes that the study cited by the United States[32] on upland cotton farmers' use of hedging instruments is relatively dated (from 1996) and analyzes a time period during which prices were high. Therefore, it may not reflect farmers' use of hedging instruments during the period of investigation.

16. In addition, Brazil notes that the futures market is not only used as a hedging instrument by US farmers, but also by farmers in other parts of the world, including Brazilian farmers.[33] It is also used by speculators.[34] It follows that the number of open contracts does not bear any relationship to the amount of the US upland cotton crop hedged by futures contracts at the New York futures market.[35]

**202. Concerning paragraph 7 of the US oral statement, are the expected cash prices shown for February only? Can the US provide the prices for January and March of each year as well? USA**

**Brazil's Comment:**

17. Brazil notes that the expected cash price is not the relevant price for purposes of analyzing the effects of the marketing loan programme. Since any marketing loan benefits are calculated as the difference between the loan rate and the adjusted world price, it would be necessary to look at the expected adjusted world price to draw any conclusions.[36] This point is admitted by the United States in paragraph 75 of its 22 December 2003 Answers to Questions: "… because farmers will receive a government payment for the difference between the loan rate and the adjusted world price".[37]

18. Brazil also notes that the figures presented by the United States differ to a minor degree from the ones presented by Brazil.[38] Brazil does not know the reason for these minor differences and does not consider them to be material.

**203. Please provide information concerning the organization, mandate, credentials and standing of FAPRI. BRA**

**204. Which support to upland cotton is not captured in the EWG data referred to in Brazil's 18 November further rebuttal submission? BRA**

**205. Does the United States accept or agree with the EWG data submitted by Brazil? If not, please explain your reasons. USA**

[32] US 22 December 2003 Answers to Questions, para. 20.

[33] Exhibit Bra-281 (Statement of Andrew Macdonald – 7 October 2003, para. 13).

[34] Exhibit Bra-281 (Statement of Andrew Macdonald – 7 October 2003, para. 13).

[35] The United States appears to suggest this relationship in paragraph 21 of its 22 December 2003 Answers to Questions.

[36] *See* Brazil's 2 December 2003 Oral Statement, Section 5.2 for further details on this point.

[37] Brazil addresses this point in greater detail in its comment on Question 212 and 213 below.

[38] *Compare* US figures at paragraph 22 of the US 22 December 2003 Answers to Questions with Brazil's figures as reported in Exhibit Bra-356 (January – March Quotes of the December Futures Contract, Expected and Actual AWP and Cash Price) and at paragraph 44 of Brazil's 2 December 2003 Oral Statement.

**Brazil's Comment:**

19. As a preliminary comment, the United States answer does not rebut evidence from EWG's expert analyst that the EWG data undercounts the amount of contract payment and marketing loan payment subsidies.[39] While it undercounts the data, the EWG data and the estimates generated by Brazil's 14/16th methodology for MY 2002 are very close. Brazil estimates the MY 2002 direct payments to current cotton producers at $454.5 million[40], while the EWG data shows MY 2002 direct payments to current cotton producers of $451.4 million.[41] Similarly, Brazil's estimates that the MY 2002 CCP payments to current cotton producers were $935.6 million[42], while the EWG data shows $893 million.[43] Thus, as Brazil has argued, the EWG data could certainly be used by the Panel as evidence *supporting* Brazil's 14/16th methodology, as explained previously and elaborated further below.

20. The US 22 December 2003 response asserts, at paragraph 25, that Brazil has overestimated the support to upland cotton from contract payments. However, the summary US data produced on 18 and 19 December 2003 seems to show that only between 10-20 per cent of US upland cotton producers planted upland cotton on non-cotton base acreage.[44] The EWG data showed that, in MY 2002, 15 per cent of the contract payments received by current producers of upland cotton were from other contract acreage crops.[45] The United States refused to produce any information regarding current upland cotton production on non-upland cotton base acreage.[46] However, the EWG database – although understating the amounts – supports a finding that farms producing upland cotton received a significant amount of non-upland cotton contract payments. The EWG database therefore also supports an adverse inference by the Panel that the actual data withheld by the United States would show even higher payments to current upland cotton producers than the EWG data or the Brazilian estimates. It also demonstrates that the EWG data is not a comparable substitute for the information requested by the Panel on 8 December 2003 and 12 January 2004.[47] The EWG data contains no information about acreage planted and, thus, does not allow for any farm-specific allocation. It is also incomplete in terms of actual payments made.

21. The US statement in paragraph 24 of its 22 December 2003 response focuses on the large number of farms not receiving direct payments. What the United States largely ignores is the predominance of very small non-cotton producing farms that receive very small upland cotton base payments. In fact, according to the US summary data, the 45 per cent of farms that received upland cotton contract payments (but did not produce upland cotton) received only between 15 and 25 per cent of the upland cotton contract payments.[48] It is undisputed that the bulk of upland cotton is

[39] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 29-30; Exhibit Bra-316 (Statement of Christopher Campbell, paras. 12-15); Brazil's 22 December 2003 Answer to Question 204, paras. 25-26.

[40] Brazil's 18 November 2003 Further Rebuttal Submission, para. 8.

[41] Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 2).

[42] Brazil's 18 November 2003 Further Rebuttal Submission, para. 8.

[43] Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 2).

[44] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively, data for upland cotton production on farms without upland cotton base. Brazil notes that this does not mean that these farms have no contract base acreage whatsoever. Instead, the United States has withheld that data (Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 2).

[45] Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 5 (MY 2002)).

[46] US 18 and 19 December 2003 Letters to the Panel and US 20 January 2004 Letter to the Panel. *See* also Brazil's 28 January 2004 Comments and Requests Regarding US Data, Sections 2-3.

[47] *See* Brazil's 28 January 2004 Comments and Requests Regarding US Data which details the information that could have been adduced with the information withheld by the United States.

[48] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. The upland cotton contract acreage on farms not producing upland cotton represents between 15 and 25 per cent of total upland cotton contract acreage. Brazil has used contract acreage

produced in very large operations[49], and the EWG data confirms this.[50] The EWG data shows that 5 per cent of farms receiving the highest amounts of upland cotton payments account for 41-45 per cent of marketing loan payments, *i.e.*, 41-45 per cent of production. The top 10 per cent of farms account for 55-58 per cent of production, and the top 20 per cent of farms account for 70-72 per cent of production.[51]

22. The United States makes the assertion in paragraph 25 of its 22 December 2003 response that in MY 2000-2002, "only 71, 77, and 74 per cent respectively of upland cotton base acreage payments went to farms that planted upland cotton". The United States claims this EWG data shows that Brazil's 14/16$^{th}$ methodology overestimates the amount of contract payments to upland cotton. This is incorrect. First, even the incomplete EWG data shows a very high percentage of upland cotton contract payments directly connected with the current production of upland cotton. Second, the EWG data cannot be used to calculate the amount of non-upland cotton base payments attributable to current producers of upland cotton.[52] Because the EWG data cannot match contract acreage and planted acreage of the same farm – it is payment data, not acreage data. Given the fact that 10-20 per cent of US upland cotton is planted on farms without upland cotton base (but some other base acreage)[53], non-upland cotton contract payments would make up for the shortfall alleged by the United States.[54] This further highlights the need for the withheld US data. The United States obviously knows what the data shows and can easily calculate the amount of non-cotton base payments allocable to upland cotton production. The US decision not to release even "non-confidential" data that would show the amount of allocated payments is strong evidence that it knows that the actual data is larger than the EWG and Brazilian estimates.

23. Finally, the United States in paragraph 26 argues that summary data it produced on 18/19 December 2003 shows that in MY 2002, 29.4 per cent of total cropland on farms receiving upland cotton contract acreage payments was planted to upland cotton. This figure is highly misleading, because it includes all of the acreage from farms with upland cotton base acreage that do not plant upland cotton. When only farms that currently produce upland cotton are included, then about 50 per cent of the cropland acreage on these farms that actually produce upland cotton was planted to upland cotton. Indeed, the United States acknowledges this fact in paragraph 186 of its 22 December 2003 Answers to Questions.

24. Further, because of the US refusal to provide the information requested by the Panel on 8 December 2003 and 12 January 2004, it is impossible to determine from the US incomplete summary data the diversity of the cropland for upland cotton producers accounting for the majority of upland cotton production. Indeed, strong evidence that upland cotton producers concentrate in upland cotton production is found in the EWG data, which shows that 85 per cent of the contract payments

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as a proxy for payments, which is a conservative proxy, as presumably the less productive farms (*i.e.* those with lower yields and thus fewer payment units per payments acre and fewer payments per acre) stopped producing upland cotton.

[49] Brazil's 27 October 2003 Answer to Questions, paras 7-8.

[50] Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 3).

[51] Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 3).

[52] Without the farm-specific data the United States has refused to produce, it is impossible to know for certain what non-upland cotton contract payments received by current upland cotton producers are properly allocated to upland cotton production.

[53] Even for those farms that mainly plant on upland cotton base, additional non-upland cotton contract payments would need to be allocated. *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. *See* also Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55 and Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 9.

[54] *See* Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 9.

received by upland cotton producers were *upland cotton* payments.[55] This supports USDA's own reports on cotton specialization, which indicate that the considerable bulk of cotton is produced in farms that specialize largely in upland cotton production.[56]

**206. Please explain how the graph in paragraph 40 of the US further rebuttal submission was derived. In so doing, please clarify whether the figures are on a cents per pound basis or some other basis. What averaging method was used? Can you prepare individual charts showing average US and Brazilian cotton prices for each of those third country markets? USA**

**Brazil's Comment:**

25. The United States asserts in paragraph 28 of its 22 December 2003 response that "FOB is greater than FAS except where the vessel is not changed at the port of export, in which case the values are equal". As set forth in the Second Declaration of Andrew Macdonald, "in practice there is in fact no difference in cost between FAS and FOB, since the ship loads and unloads the cargo, and thus, the difference in selling price between cotton which is sold FAS and cotton which is sold FOB is negligible".[57] Further, Mr. Macdonald agreed with the US statement quoted above, but noted that "vessels are rarely 'changed' in the port," and even if they were, "there would be an insignificant interest loss and thus, no difference between FAS and FOB values".[58] Brazil directs the Panel to Mr. Macdonald's Second Declaration, in which he provides additional details supporting his expert opinion.[59]

26. Brazil notes that the United States does not appear to have any difficulty with comparing Brazilian FOB prices with US FAS prices since it makes this comparison in the graph in paragraph 30 of its 22 December 2003 Answers to Questions. Because of the negligible difference between these two types of prices based on export value, Brazil agrees that there is no difficulty in comparing such FOB and FAS prices. This would include the various pricing comparisons between US and Brazilian prices set out in Brazil's 22 December 2003 Answers to Questions 233 and 235.

27. Finally, Brazil notes the US acknowledgement that the United States used only a "simple average unit price" comparison between US and Brazilian prices in paragraph 30 of its 22 December 2003 response. As Brazil has indicated, from a statistical point of view this is a totally inappropriate way to compare prices because of the enormous distortions it creates.[60] The United States should have used "weighted average" unit value pricing comparisons.

**207. Please indicate whether any of the measures challenged in this dispute *obliges* cotton farmers to harvest their crop in order to receive the benefit of the programme (subsidy). USA**

**Brazil's Comment:**

28. The United States confirms that the marketing loan programme requires farmers to harvest their upland cotton to receive marketing loan payments.[61] In addition, the Step 2 programme requires

[55] Exhibit Bra-317 (EWG Database: Table of Results, Table 5, MY 2002, top line, far right side under "percentage of total contract payments", 85.07 per cent).
[56] Brazil's 27 October 2003 Answer to Question 125(a), paras. 7-10.
[57] Exhibit Bra-401 (Second Declaration of Andrew Macdonald, 27 January 2004, p. 2).
[58] Exhibit Bra-401 (Second Declaration of Andrew Macdonald, 27 January 2004, p. 2).
[59] Exhibit Bra-401 (Second Declaration of Andrew Macdonald, 27 January 2004).
[60] *See* following webpages which discuss, in a variety of contexts, the significant distortions that can occur with statistics by using simple averages as opposed to weighted averages: http://www.statcan.ca/english/edu/power/ch13/estimation/estimation.htm; http://www.grantedc.com/publications/Grant%20Co%20Washington%20W&FB%20Report%202003.pdf
[61] US 22 December 2003 Answers to Questions, para. 31.

the use or export of upland cotton to trigger payments.[62] Brazil notes that the crop insurance programme requires farmers to *plant* upland cotton to receive premium subsidies. No harvest is required from farmers to receive indemnity payments, which in turn may trigger additional reinsurance payments to the private insurance companies running the crop insurance programme.[63]

**208. Please provide data for the marketing years 1992 and 1999-2002 of the "quantity of production to receive the applied administered price" (*Agreement on Agriculture*, Annex 3, paragraph 8) for purposes of a price-gap calculation of support through the marketing loan programme. USA**

**Brazil's Comment:**

29. Brazil notes that this question directly implicates earlier evidence and arguments demonstrating that the United States has never used a "price-gap" methodology for calculating its marketing loan portion of AMS, *inter alia*, for upland cotton.[64] Rather, the United States has always used and notified a *budgetary* methodology in accounting for marketing loan payments (marketing loans, loan deficiency, certificate payments, and interest & storage payments).[65] In particular, when it agreed with other WTO Members on what the US "base level" would be for purposes of Total AMS, the United States chose to calculate marketing loan payments using a budgetary approach.

30. This is easily seen by first examining Exhibit Bra-191[66], which is a document in which the United States notified "supporting material related to commitments on agricultural products contained in Schedule XX - United States". Marketing loan payments for upland cotton are listed on page 20 of the document. The document lists the US loan deficiency payments for upland cotton for MY 1986 as $126.860 million, for MY 1987 as $0.364 million, and for MY 1998 as $42.038 million. Comparing these figures with the actual budgetary outlays for loan deficiency payments in MY 1986-88, as set out in Exhibit Bra-4, show the same figures (rounded out). Similar *budgetary* outlays are used for marketing loan gains and interest and storage payments that are also related to "marketing loan payments". In addition, Exhibit Bra-191[67] contains an Annex which is the "Supporting Table for Cotton: Deficiency Payment Calculation for GATT AMS." This table is there because the United States used the "price-gap" formula of Annex 3, paragraph 10 of the Agreement on Agriculture to calculate the AMS for deficiency payments. But no such supporting table exists for marketing loan payments, because a *budgetary* approach was used. In short, there is no doubt that the United States Total AMS Commitments were based, *inter alia*, on the US decision to use *budgetary* outlays for calculating its marketing loan payments for upland cotton.

31. The US decision under Annex 3, paragraph 10 to use budgetary outlays instead of the price-gap formula in calculating upland cotton AMS for marketing loan payments is legally binding on the United States. Annex 3, paragraph 5 states that "[t]he AMS calculated as outlined *below* [*i.e.*, paragraphs 6-13 of Annex 3] shall constitute the *base level* for the implementation of the reduction commitments on domestic support." The marketing loan budgetary decision reflected in G/AG/AGST/USA was incorporated into the US schedules and set the US "base level" of total AMS. The title of the G/AG/AGST/USA suggests its legally binding character – "Supporting Tables Relating to Commitments on Agricultural Products in Part IV of the Schedules." These "supporting

[62] US 22 December 2003 Answers to Questions, para. 31.
[63] Brazil's 24 June 2003 First Submission, paras. 80-83.
[64] *See* Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 10-16.
[65] *See, e.g.*, Exhibit Bra-191 (G/AG/AGST/USA, p. 20); Exhibit Bra-47 (G/AG/N/USA/43, p. 20); Exhibit Bra-150 (G/AG/N/USA/10, p. 18).
[66] G/AG/AGST/USA, p. 20.
[67] G/AG/AGST/USA, p. 21-22.

tables" were the basis upon which the "final bound commitment level specified in Part IV" of the US schedule was determined.

32. Annex 3, paragraph 5 of the Agreement on Agriculture indicates that the United States is bound by its initial decision to calculate AMS using a budgetary approach (as permitted in Annex 3, paragraph 10 of the Agreement on Agriculture). This conclusion follows from the text of Article 6.3 of the Agreement on Agriculture:

> A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS *does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule.*

33. Further, Article 3.2 provides that "[s]ubject to the provisions of Article 6, a Member shall not provide support in favour of domestic producers in excess of commitment levels specified in Section I of Part IV of its Schedule". The United States' "final bound commitment level specified in Section I of Part IV" of the US Schedule is currently $19.1 billion. Nothing in Article 6 or any other provision of the Agreement on Agriculture permits a Member such as the United States to change its Annex 3, paragraph 10 choice of budgetary or price gap calculations for the purposes of calculating *current* AMS.

34. Brazil has previously detailed the reasons why permitting Members to reverse the Annex 3, paragraph 10 choice to calculate *current* AMS for a product would make the disciplines of Article 3.2 and 6.3 of the Agreement on Agriculture inutile.[68] The United States never denied it has always notified marketing loan payments using a budgetary approach, and has never rebutted Brazil's arguments that permitting a Member to change its election under Annex 3, paragraph 10 to calculate *current* AMS would lead to the nullification of a Member's obligations under Articles 3.2 and 6.3. Indeed, the US Answer to Question 208 provides the best example of such a nullification, when the United States admits that "if the applied administered price for marketing years 1999-2002 were compared to the 1992 applied administered price, the resulting negative numbers . . . show the decrease in the level of support from MY 1992."[69] Translated, this means that the huge increase in marketing loan payments to $2.5 billion in marketing loan payments in MY 2001 would not be counted towards US total AMS for MY 2001.

35. Brazil emphasizes again that while the United States makes what are theoretical arguments in this dispute, its WTO partners properly rely on the past and most recent US notifications.[70] And these notifications consistently demonstrate that the United States properly treats the *budgetary outlays* for marketing loan payments for cotton as well as other programme crops as part of its total current AMS. These notifications further demonstrate that US budgeted outlays for marketing loans have significantly increased in MY 1999-2002 over the level of such loans in MY 1992.[71]

36. In light of the arguments and evidence set out above, there is little need for Brazil to comment on the calculations provided by the US 22 December 2003 response. Brazil notes that the US applies a contradictory approach to the quantity of eligible production for MY 1992 and MY 1999-2002. For example, the United States uses actual production figures calculated from *harvested* acreage for MY 1999-2002, while it calculates eligible production for MY 1992 as *planted* eligible acreage multiplied

[68] Brazil's 27 August 2003 Comments on US 22 August 2003 Rebuttal Submission, paras. 10-16.
[69] US 22 December 2003 Answer to Question 208, para. 37.
[70] *See, e.g.,* Exhibit Bra-191 (G/AG/AGST/USA, p. 20); Exhibit Bra-47 (G/AG/N/USA/43, p. 20); Exhibit Bra-150 (G/AG/N/USA/10, p. 18).
[71] Brazil's 9 September 2003 Further Submission, Table 1.

by the *yield on harvested* acreage.[72] This grossly overstates the eligible production. In fact, the US "eligible production" figures even overstate *actual* production in MY 1992 by 432,333 bales.[73] The actual eligible production for MY 1992 was 6.485 billion pounds[74], not the 7.748 billion calculated by the United States.[75] When compared to the actual production eligible for marketing loans in MY 1999-2002, the Panel can see that significantly greater US upland cotton production was provided marketing loan benefits in each of those later years compared to MY 1992.

**209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs. BRA, USA**

**Brazil's Comment:**

37. Brazil reemphasizes its position that only planted acres constitute a reliable measure for planting decisions in a single country, such as the United States.[76] This is highlighted by the fact that changes in planted and harvested acreage for the United States during MY 1996-2003 do not move in parallel. Contrary to the US assertion that the "movements in acreage figures are *fairly similar*"[77], in fact, the US planted and harvested acreage changes are in entirely opposite directions in 3 out of 8 marketing years[78], vary by great magnitudes in a further 3 out of 8 marketing years[79], and are "fairly similar" only in 2 out of 8 marketing years.[80] This overall picture can hardly be called "fairly similar" movements. Brazil refers the Panel to its 22 December 2003 Answer to Question 210[81], demonstrating that in fact US planted acreage and a proxy for worldwide planted acreage move in quite opposite directions, demonstrating that US producers of upland cotton do not take their planting decisions based on the same market-based price factors as other producers worldwide.[82]

**210. Are worldwide planted acreage figures available? BRA, USA**

**Brazil's Comment:**

38. Brazil agrees that no data on harvested acres is available on a worldwide basis. However, Brazil strongly disagrees that the only possible comparison between US and worldwide upland cotton acreage needs to be done on the basis of harvested acreage.[83] As discussed before, the only valid measure of farmers planting decisions is planted acres, as harvested acres figures are distorted by variations over time in the abandonment rate.[84] Therefore, it is critical to use planted acreage for the

[72] US 22 December 2003 Answer to Question 208, paras 33-35.

[73] *Compare* US figure at paragraph 33 of its 22 December 2003 Answers to Questions (16,142,333 bales) with the actual production in MY 1992 of 15,710,000 bales, as reported in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[74] 11,164,726 planted eligible acres times 0.837 (share of planted acres that was harvested (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4 (Abandonment Rate))) times 694 pounds per harvested acre (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4 (Yield))).

[75] US 22 December 2003 Answers to Questions, para. 33.

[76] Brazil's 27 October 2003 Answers to Questions, paras. 27-28; Brazil's 18 November 2003 Further Rebuttal Submission, para. 87; Brazil's 22 December 2003 Answers to Questions, paras. 30-32.

[77] US 22 December 2003 Answers to Questions, para. 39.

[78] MY 1997, 1999, 2000.

[79] MY 1996, 1998, 2001.

[80] MY 2002, 2003.

[81] Brazil's 22 December 2003 Answers to Questions, para. 31-36.

[82] Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.4 (containing further references).

[83] US 22 December 2003 Answers to Questions, para. 40.

[84] Brazil's 27 October 2003 Answers to Questions, paras. 27-28; Brazil's 18 November 2003 Further Rebuttal Submission, para. 87; Brazil's 22 December 2003 Answers to Questions, paras. 30-32.

United States in any analysis of congruence in planting decisions between the United States and the rest of the world. However, harvested acres may serve as a proxy for planted acreage on a worldwide basis.[85] On this basis, no congruence exists between the planting decisions of US upland cotton farmers and upland cotton farmers worldwide.[86] But, even if one were to look at harvested acres for both US and worldwide planting decisions, there is no congruence in the movements.[87]

**211. Brazil presents a graph in paragraph 59 of its further rebuttal submission indicating the increasing cumulative loss incurred by cotton producers. Please comment on the argument that US cotton producers could not continue operating without subsidies. In particular:**

**(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?**

**Brazil's Comment:**

39. Brazil reads the Panel's question as requesting the United States to provide an estimate of how much the updated 2003 USDA ARMS 1997 survey overstates the $872 per acre deficit between total costs and market revenue for the period MY 1997-2002. The United States' 22 December 2003 response declines to provide any dollar per acre estimate. Indeed, the US response appears to raise more questions than it provides answers.

40. The United States has claimed that the 2003 USDA cost data used by Brazil in calculating the $872 per acre deficit[88] cannot be relied on by the Panel.[89] Because this is a fact asserted by the United States, it has the burden of establishing it.[90] The Panel should expect the United States, which employees the USDA personnel who created the 2003 cotton update of the 1997 ARMS study, to have provided statements or other evidence from these cost experts explaining why the 2003 update is unreliable and cannot be used by the Panel. No such statements were provided. Brazil has examined the websites of USDA and the US National Cotton Council carefully and cannot find any warnings that the 2003 upland cotton costs and revenue are unreliable. Indeed, the current NCC website provides a direct link to the ERS-USDA costs and returns website for each major US region.[91] Presumably, the NCC intended its Members to rely on such data or they would not have included the link. Further, the United States neglected to inform the Panel that the 2003 upland cotton cost and revenue data has benefited from a "new costs of production estimation methodology" implementing the American Agricultural Economics Association (AAEA) Recommendations.[92] It is reasonable for the Panel to find that the 2003 cotton updates to the 1997 ARMS study using this new AAEA-recommended methodology results in a more accurate estimate of cotton costs and revenues – not a less accurate estimate.

41. What the United States attempts to prove in its 22 December 2003 Answer to Question 211(a) is that the use of biotechnology cotton ("BT cotton") has lowered costs, and that somehow these lower costs were not reflected in the annual updated USDA costs and returns surveys. It is noteworthy that the United States now admits that the USDA personnel updating the 1997 ARMS study *properly*

[85] Brazil's 22 December 2003 Answers to Questions, para. 32.
[86] Brazil's 22 December 2003 Answers to Questions, para. 33.
[87] Brazil's 22 December 2003 Answers to Questions, para. 34.
[88] Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.1.
[89] *See e.g.* US 22 December 2003 Answers to Questions, para. 43.
[90] *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").
[91] htt://risk.cotton.org/CotBudgets/cotbudget.htm, visited 20 January 2004.
[92] *See* www.ers.usda.gov/briefing/FarmIncome/Glossary/compare.htm visited 28 January 2004. A link to this ERS page is provided on the NCC Webpage.

updated the cost of production data to show increased upland cotton seed costs.[93] But, without citing any proof, the United States asserts that these same personnel that *properly* updated the cotton cost data (to reflect *increased* (BT-cotton and overall) seed costs) improperly failed to "capture the *cost savings* from technological changes that alter the mix of production activities and inputs."[94]

42. The credibility of this assertion is difficult to accept given the fact that the US government during the period of investigation touted the productivity benefits of using, *inter alia*, BT-cotton.[95] Indeed, an Economic Research Service-USDA Report updated through 27 October 1999 analyzed ARMS data concerning the use of BT cotton.[96] The ERS report identified increased yields and lower use (and hence costs) of pesticides as indicated below:

> Comparison of mean yields shows that in most cases (4 of 7 region/year cases for which data were sufficient) adopters of Bt cotton appear to obtain statistically significant higher yields than nonadopters. Although less prevalent, similar results (2 of 5 cases) were observed for Bt corn. For the case of herbicide-tolerant crops, the results are mixed: only for a few regions and in some years are yields higher for adopters. Most of the time (4 of 5 for corn, 9 of 13 for soybeans, 3 of 5 for cotton), differences in yields are statistically insignificant.
>
> Comparison of mean pesticide acre-treatments for 1997 shows that in most cases (2 of 3) the adoption of Bt cotton reduces treatments of insecticides normally used on the pests targeted by Bt. In 1 of 3 cases, total treatments for all other cotton pests are higher for adopters than nonadopters. Insecticide treatments for Bt-targeted pests on corn are significantly lower for Bt users than for nonusers. Adoption of herbicide-tolerant varieties accompanied statistically significant reductions in herbicide treatments in 4 of 8 cases across all crops, mostly for soybeans.

It is difficult to imagine how USDA ERS personnel working with ARMS survey data could arrive at the conclusions of (a) higher yields for BT cotton and (b) lower use of pesticides and chemicals in 1999 as detailed above, but the USDA personnel updating the cotton cost data in 1999-2002 could *not.* This evidence suggests that because information on the cost savings for using BT cotton were widely available for farmers and the ERS, then they would also be known to those updating the cotton cost survey. Thus, the Panel can conclude that the published USDA cost survey properly identified both cost increases and cost savings.

43. Finally, to attempt to answer the Panel's question concerning the graph at paragraph 59 of Brazil's 18 November 2003 Further Rebuttal Submission, Brazil analyzed the extent to which any alleged overstating of costs could impact on the huge $872 per acre cost-revenue gap. The answer, as outlined below, is very little.

44. To conduct this analysis, Brazil first assumed, contrary to the evidence outlined above, that the USDA employees updating the cost savings data[97] "got it wrong". Brazil then determined that the largest published estimate of the possible cost savings for using BT-cotton was $20 per acre.[98] The

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[93] US 22 December 2003 Answer to Question 211(a), para. 45.

[94] US 22 December 2003 Answer to Question 211(a), para. 45.

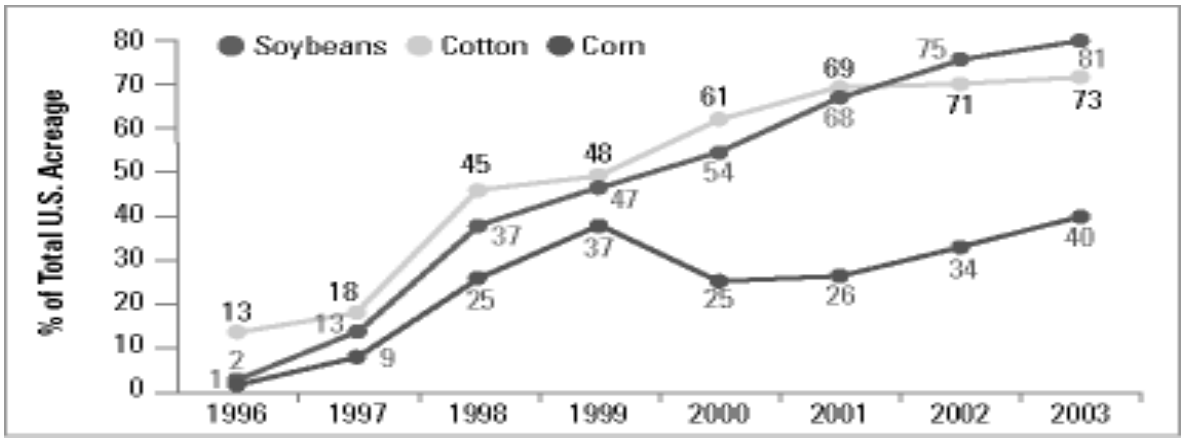
[95] See http://www.ers.usda.gov/publications/tb1906/tb1906b.pdf visited 28 January 2004; US 22 December 2003 Answers to Questions, para. 44 (note 44).

[96] http://www.pestlaw.com/x/guide/1999/USDA-19990625A.html visited 28 January 2004.

[97] Brazil's 27 October 2003 Answers to Questions, p. 56 (setting out USDA data).

[98] Exhibit Bra-404 (Monsanto Imagine, "Benefits – BT Cotton" downloaded from www.monsanto.co/monsanto/layout/our_pledge/bnefits/bt_cotton.asp visited 28 January 2004). The document concludes that the average US cotton farmer using BT –cotton has "average net incomes . . . increased by $50 per hectare in the United States" The Monsanto assertion of $50 per hectare translates into $20.2 per acre because one hectare constitutes 2.47 acres.

next step was to determine that between 1997-2002 an average of 58 per cent of cotton acreage was planted to BT-cotton between MY 1998-2002. This is reflected in the graph below:[99]




45. With 58 per cent of US acreage between 1998-2002 was planted to BT-cotton, this meant that the average per acre national cotton cost savings was $12 between 1997-2002 (0.58 x $20). But recall that the United States answer claims that the USDA 1998-2002 cost data reflects the cost increases for BT-cotton seed, but not the cost savings from use of fewer chemicals. Therefore, to reflect the *net* cost savings, Brazil further deducted the difference in between increased cotton-seed in 1997 and between 1998-2002 ($12.8 per acre).[100] Thus, in the best-case US scenario, the total amount of average cost savings allegedly *not* reflected in published USDA data was $24.8 per acre.

46. Brazil recalls that the total six-year *deficit* between total costs and total revenue from USDA's 2003 revenue and costs estimates (*i.e.*, the updated 1997 ARMS Study) is $872 per acre.[101] Brazil then assumed (1) the accuracy of the $12 per acre net cost reduction from using BT-cotton, (2) that the $12 per acre net cost savings existed for the entire 1998-2002 period, and (3) that USDA cost experts updating the 1997 ARMS Study in 1998-2002 were not aware of such cost reductions or improperly failed to include them in the latest USDA update of cotton revenue and costs, then the 1997-2002 deficit between USDA's total reported costs and total market revenue would still be $748 per acre.[102]

47. In sum, while Brazil believes that at least some of the assumptions listed above are highly questionable, the "best case" that the United States could have put forward (but did not) shows continued huge long-term deficits of $748 per acre between US producers' total costs and their market revenue. In short, the United States has not met its burden of proving that its own USDA data was hopelessly flawed. Brazil and the Panel can properly rely on the 2003 cotton cost and revenue data showing either $872 or $748 average per acre deficits between costs and market revenue during MY 1997-2002. Both figures reflect huge gaps between market revenue and total costs of production. As Brazil has argued, this evidence strongly supports the significant impact of the US subsidies on US production, exports and on world prices.

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[99] http://www.whybiotech.com/index.asp?id= visited 28 January 2004.

[100] This was done by subtracting the amount of increased seed costs in Exhibit Bra-323 (Costs and Returns of US Upland Cotton Farmers, MY 1997-2002) from MY 1997 – this was 0 in 1998, $1 in 1999, $13 in 2000, $20 in 2001, and $30 in 2002.

[101] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 59-62.

[102] This figure has been calculated by applying the $12 per acre time five years (which is conservative, because in earlier years less Bt-cotton was planted) and also deducting the yearly increases in seed costs (compared to the 1997 basis), since the $12 represented a net cost saving, *i.e.*, net of cost increases to due higher seed costs.

*(ii) Comment on US Argument concerning Canada Dairy*

48. Finally, Brazil notes the US attempt to distinguish the Appellate Body's decision in *Canada – Dairy* in paragraph 42 of the US 22 December 2003 Answer to Question 211. In assessing the credibility of these new US arguments, it is instructive to review what the United States argued before the Appellate Body in *Canada – Dairy*. First, on the issue of whether average cost of production data should be used, the United States made the following arguments in *Canada – Dairy*:

> [T]he Panel correctly recognized that an individual producer cost of production benchmark was unworkable. The Panel noted that governments rarely have the sort of detailed, producer-specific information that such a test would require. Indeed, as discussed below, Canada itself was unable to supply the necessary data regarding individual producer participation in the CEM market to support its claim that no payments were being made. … In sum, the Panel's reliance on the CDC's average total cost of production data as a 'sufficient, albeit conservative, approximation of the average total cost of production of the Canadian dairy industry' is consistent with the Appellate Body's instruction to sue an average total cost of production benchmark in this case.

49. The Panel will recall that the United States in this dispute has argued that using an average total cost of production was not appropriate.[103] Yet, as in *Canada – Dairy*, the issue in this dispute is not whether there are *certain* producers that may sell cotton (or milk) below their total cost of production. Of course, there will be some efficient producers who will be able to do so, even with few or no subsidies. Rather, the issue generally in both cases is whether, on *average*, the producers' total costs of production are above the prices received by the producers in the relevant markets. Thus, as in *Canada – Dairy*, the average total cost of production generated by USDA and used by Brazil is more than a "useful approximation".

50. The United States' arguments in this dispute that fixed costs should *not* be considered by the Panel mirrored arguments made by Canada in *Canada – Dairy*. Consider the following arguments made by the United States (which were accepted by the Appellate Body) in *Canada – Dairy* and which are practically identical to arguments made by Brazil in this dispute:

> With respect to imputed costs, the Panel correctly recognized that these are "real costs" that a producer must recoup in order to stay in business over time. In economic terms, these costs represent opportunity costs or the costs associated with opportunities that are foregone by not putting the producers' resources to their best use. The producers' resources include family labour, its managerial services, and its capital. There is a cost associated with using all of these resources. For example, if a farmer foregoes the opportunity to earn cash wages off the farm in order to contribute his labour to the farm's production, the value of his labour is properly counted as an economic cost to the farm even though the farmer does not pay cash wages to himself. Likewise, it makes no sense to suggest, as Canada does, that the farm which hires labour and management services is incurring a cost, while the farm that uses family labour and management is making a profit.[104]
>
> Likewise, the Panel correctly concluded that there was no basis to exclude the marketing, transportation, and administrative costs included in the CDC cost of production data. … [T]he panel properly concluded that these are also 'real costs'

[103] US 18 November 2003 Further Rebuttal Submission, Section IV.F.3(1) – (4).

[104] Appellee Submission of the United States, *Canada – Dairy (21.5)(II)*, para. 40 (*see* http://www.ustr.gov/enforcement/briefs.shtml).

> that producers must recoup if they are to remain in business over time. … The costs incurred by the farmer that must be recouped to avoid going out of business do not stop at the 'farm gate'.[105]

Brazil agrees with the United States that all of the costs identified above (which the Appellate Body accepted in its decision) are "real costs" that a producer must recoup "in order to stay in business over time". This is precisely Brazil's point in this case.

51. The United States argues that *Canada – Dairy* is inapposite because "the issue for which Brazil seeks to use total costs is not whether a subsidy exists but to evaluate the effect of the subsidy, an altogether different analysis".[106] First, this is incorrect as a factual matter. One use of the total cost of production data by Brazil has been as circumstantial evidence to demonstrate that contract payments are support to upland cotton and that such payments provide a benefit to US upland cotton producers.[107] This is directly analogous to the issue of whether the subsidy existed in Article 9.1(c) of the Agreement on Agriculture in *Canada – Dairy*.

52. Second, the evidence of the total cost of production was used in both cases to demonstrate that both dairy and cotton producers were selling their products into a market well below their total costs of production. In *Canada – Dairy*, Canadian producers were selling C-milk into the export market well below their total cost of production. In cotton, the US producers were selling into all identifiable markets at well below their total costs of production.[108] And in both cases, the subsidies provided by the Canadian and US governments permitted these producers to continue to produce without regard for the gap between market revenue and total costs of production. In sum, without both the *Canada – Dairy* panel and this Panel examining *total* costs of production, it would be difficult to determine whether all the alleged subsidies existed, and second, to determine the role that subsidies played in maintaining production.

**(a) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? USA**

**Brazil's Comment:**

53. Brazil generally agrees that covering operating costs are important to producers who are making planting decisions "in the short term – that is, the market price for one year".[109] And it is true that during a one-year "short term" period, a producer may be able to afford to receive revenue that only meets its operating costs and at least some of the fixed costs.[110] But the US 22 December 2003 Answer to Question 211(b) appears to suggest[111] that even over a long-term period of time – between 5-10 years – producers can continue to plant upland cotton oblivious to whether they meet their total costs of production. This is, of course, economic nonsense for agriculture or any other economic sector.

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[105] Appellee Submission of the United States, *Canada – Dairy (21.5)(II)*, para. 42 (*see* http://www.ustr.gov/enforcement/briefs.shtml).

[106] US 22 December 2003 Answer to Question 211, para. 42.

[107] Brazil's 22 August 2003 Rebuttal Submission, paras. 30-41; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 59-72; Brazil's 2 December 2003 Oral Statement, paras. 25-33.

[108] *Compare* the prices set out in Brazil's 22 December 2003 Answers to Questions 233 and 235, and in Exhibits Bra-383 – Bra-388, *with* US total cost of production data in Exhibit Bra-323 (Costs and Returns of US upland cotton Farmers MY 1997-2002).

[109] US 9 October 2003 Closing Statement, para. 12 (The full context of the quote is as follows: "Total costs are relevant over the long-term, but Brazil uses this (inaccurate) number to compare to revenue in the short term – that is, the market price for one year.").

[110] *See* Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, paras. 7-10).

[111] *See* in particular the graph at paragraph 47 of the US 22 December 2003 Answer to Question 211(b).

54. Basic economics holds that no business can continue to operate unless its total costs of production are met over the long term. The United States recognizes this when it states, in its 18 November 2003 Further Rebuttal Submission, that "in the long run, producers will have to cover these asset and overhead (i.e., economic) costs".[112] USDA's ERS suggests that the long term is a period between 5-10 years[113], and Christopher Ward testified that the normal recovery period for cotton equipment investments is 5-7 years.[114] In light of this evidence, Brazil focused on *total costs* for a six-year period of time between MY 1997-2002 in analyzing the long-term cost/revenue gap.[115] By contrast, the US graph at paragraph 47 of its 22 December 2003 Answer to Question 211(b) improperly focuses on only operating costs. Neither the US graph nor the US response provides any hint as to how US cotton producers could survive for six years without market revenue covering their fixed costs, *i.e.*, covering lease or mortgage payments, paying labor, recovering equipment costs, and paying taxes and insurance.[116] In fact, the land-specific costs must be paid every year simply to be able to continue farming on leased land or to avoid foreclosure in the case of owner-operators.[117]

55. The US arguments that economists are only concerned with examining operating costs, and not total costs, are simply not correct. For example, the University of California Cooperative Extension economists conduct a large number of studies regarding costs of production for different types of, *inter alia*, upland cotton farms in California. Every one of these studies, which are relied on throughout the agricultural industry in California and other states, contains a detailed examination of all types of costs.[118] Other economic studies of the cost of production similarly provide for total costs, including the land charge and rents.[119]

56. Additional evidence that total costs are relevant to planting decisions even in the short term of one year is found in several documents on an intended but not introduced "Cost of Production Insurance Plan for Cotton". The entire intent of this project to develop new a insurance programme was to provide comprehensive insurance covering *total costs* – not just operating costs.[120] If upland cotton producers were solely concerned with covering only their operating costs each year, then the project would not also have sought to provide cotton producers with protection from increased fixed

[112] US 18 November 2003 Further Rebuttal Submission, para. 122.

[113] Exhibit US-84 (Production Costs Critical To Farming Decisions, William D. McBride, ERS, p. 40 (quoted in US 18 November 2003 Further Rebuttal Submission, para. 118).

[114] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 10).

[115] This was not, therefore, a "randomly selected period," as the United States alleges in paragraph 41 of its 22 December 2003 Answer to Question 211(a).

[116] *See* Brazil's 18 November 2003 Further Rebuttal Submission, paras. 64-69 (setting forth composition of fixed costs. This evidence has never been rebutted by the United States).

[117] *See* Brazil's 18 November 2003 Further Rebuttal Submission, paras. 64-69 (setting forth composition of fixed costs. This evidence has never been rebutted by the United States).

[118] Exhibit Bra-405 (Sample Cost to Produce Cotton – Transgenic Herbicide-Resistant Alacla Variety, San Joaquin Valley, University of California Cooperative Extension, 2003). A large number of cost of production studies by the University of California Cooperative Extension for cotton, as well as for many other crops, can be found at www.ucanr.org/CES.CEA.shtml.

[119] Exhibit Bra-406 (Cotton Cost-Return Budget in Southwest Kansas, Kansas State University Agricultural Experiment Station and Cooperative Extensive Service, October 2003).

[120] Exhibit Bra-407 (Documents on Cost of Production Insurance Plan for Cotton)("Review of the FCIC Cost of Production Insurance Plan for Cotton," Sparks Companies, Inc., 15 September 2003, p. 11, 12 and 16. (COP insurance policy is based on the *farmer's total cost*.")); "Underwriting Review of FCIC Cost of Production Insurance Plan for Cotton," Jeffrey T. LaFrance, Ph.D, 13 September 2003, p. 5 ("… the basis for the guarantee is not a farmer-chosen percentage of expected or predicted revenue; rather it is a percentage of an estimate of the *total cost of production*."); "Review of Poposed 'Cost of Production Insurance Plan for Cotton,' Jerry R. Skees, Dr. Barry J. Barnett, Dr. J. Roy Black, and James Long, 15 September 2003, p.32 ("Purchasers will be required to provide estimates of variable expenses per acre, *fixed expenses per acre, and land expenses per acre* in addition to the acreage and historical yield information required for existing cotton insurance products.") emphasis added

costs such as leasing land, employing workers, and annual financing costs for replacement equipment. Yet, the "Cost of Production Insurance Plan for Cotton" programme focused on *annual* protection that would include all types of costs, because that is what the sponsors perceived farmers needed.

57. Finally, the Panel should recognize that the most efficient low-cost US producers will be able to withstand lower market prices without the need for significant subsidies for a year or two. But higher-cost producers will not. The ERS study on production costs cited by the United States highlighted the ability of higher-cost producers to survive in the shorter term only through government payments:

> Low-cost producers are generally better able to survive periods of low prices and thrive when prices improve, while high-cost producers are often the first to exit farming when prices are low.[121]
>
> ** ** ** **
>
> Also, this cost-price squeeze has put an emphasis on enhancing revenues through a variety of sources, such as government programmes, and on controlling or cutting costs. Government programme support has likely helped many producers remain in business and may explain why structural adjustments in these industries have been gradual.[122]

Many US upland cotton producers are "high-cost" producers, according to USDA's latest comprehensive cost of production survey.[123] Brazil notes that Professor Sumner found that roughly 70 per cent of US planted acreage would continue to be planted to upland cotton even without the US subsidies.[124] This finding that 30 per cent of the US cotton acreage would not remain planted to cotton is consistent with the conclusion that it is the category of high-cost cotton producers that would not be able to survive without US subsidies – even in the short term.

**212. Brazil states in paragraph 37 of its oral statement that studies of Westcott and Price found that the effect of the programme on cotton is to add an additional 1 to 1.5 million acres during marketing years 1999-2001 and to suppress US prices by 5 cents per pound. Does the US reject these findings? Why or why not? USA**

**Brazil's Comment:**

58. At the outset, Brazil notes that USDA economists Westcott and Price are among the most experienced and well-respected USDA analysts, who both have long records of publication of US government reports and other research studies. They have an in-depth knowledge of the marketing loan programme. Further, they received comments and suggestions for their study from leading US agricultural economists such as Professor Bruce Gardner.[125] Westcott and Price's study was their best estimate of the effects of the marketing loan programme. It bears repeating that they developed their study independently of this dispute in 2000.

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[121] Exhibit US-84 (Production Costs Critical To Farming Decisions, William D. McBride, ERS, p. 40). This study includes a graph regarding wheat farmers on page 41 which illustrates that low-cost producers can survive much lower prices while higher-cost wheat farmers require much higher prices even to meet their operating costs. The same dynamic exists for US cotton farmers.

[122] Exhibit US-84 (Production Costs Critical To Farming Decisions, William D. McBride, ERS, p. 41).

[123] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms", USDA, October 2001).

[124] Brazil's 9 September 2003 Further Submission, Annex I, Table 5a.

[125] Exhibit Bra-222 ("Analysis of the US Commodity Loan Program with Marketing Loan Provisions," USDA, AER 801, cover page).

59. The Westcott/Price study is an approved USDA paper published by USDA's Economic Research Service.[126] It is only during this dispute that the United States' government began to characterize this study as an "interesting 'academic' exercise"[127], whereas, outside this dispute, its results represent USDA's official view on the effects of the marketing loan programme.

60. Brazil recalls that the US Payment Limitations Commission, chaired by USDA's Chief Economist, requested Westcott and Price to update their study and analyze the effects of the marketing loan programme in MY 2001.[128] This official US Commission never criticized the approach chosen by Westcott and Price; rather, the Payment Limitations Commission relied on it. It is not clear to Brazil why the United States considers this study to be appropriate for analyzing effects of current agricultural policies and for considering policy reform proposals such as more effective payment limitations in a domestic political context, but, when US upland cotton subsidy programmes undergo multilateral scrutiny in a WTO context, the United States considers the very same study to be fatally flawed and unreliable.

61. Indeed, the United States goes so far as to characterize the Westcott/Price study as irrelevant for the analysis of this Panel.[129] The United States claims that using baseline projections for the period MY 1999-2001 will not suffice for the Panel's analysis, as the Panel needs to assess "actual conditions".[130] Brazil notes that the 2000 USDA baseline actually projected much higher prices than occurred during the period MY 1999-2001, thus the 5-cent per pound price suppression found by Westcott and Price understate the effects of "actual conditions".[131] This is confirmed by the fact that, when Westcott and Price used actual data to update their study for the Payment Limitations Commission, their results showed much stronger effects of the marketing loan programme.[132] Brazil notes that Professor Sumner has analyzed the effects of the marketing loan programme using actual MY 1999-2001 data.[133] Not surprisingly, the overall results of both Westcott/Price studies are in line with Professor Sumner's results.[134]

62. The United States also rejects the Westcott/Price study because its lagged price analysis based on the 2000 USDA baseline allegedly would not reflect farmers' actual price expectations.[135] Brazil and Professor Sumner have addressed the issues of the inappropriateness of using futures prices in complex modeling systems before.[136] The undisputed evidence is that – as the United States itself admits[137] – futures market prices cannot be used for such modeling systems.[138]

63. Brazil also notes that Westcott and Price in their updated MY 2001 analysis used actual MY 2001 prices as farmers' price expectations. This credits farmers with accurate information about

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[126] Exhibit Bra-222 ("Analysis of the US Commodity Loan Programme with Marketing Loan Provisions", USDA, AER 801).

[127] US 22 December 2003 Answers to Questions, para. 48.

[128] Brazil's 7 October 2003 Oral Statement, paras. 31-34.

[129] US 22 December 2003 Answers to Questions, para. 48.

[130] US 22 December 2003 Answers to Questions, para. 49. Brazil notes that the United States understands "actual conditions" to refer to actual price expectations held by US upland cotton producers. These are, however, as Brazil and the United States agree, "fundamentally unobservable".

[131] Brazil also notes that the 2000 USDA baseline contained actual data for MY 1998, *i.e.*, the Westcott/Price study used USDA's FAPSIM model for retrospective analysis.

[132] *See* Brazil's 7 October 2003 Oral Statement, paras. 31-34.

[133] *See* Annex I of Brazil's 9 September 2003 Further Submission, para. 4, Table I.5e (regarding the data used, baseline and resulting effects of the marketing loan programme).

[134] *See inter alia* Brazil's 7 October 2003 Oral Statement, paras. 9, 34.

[135] US 22 December 2003 Answers to Questions, paras. 50-51.

[136] *See* Brazil's 20 January 2004 Comments on US Model Critique, para. 56 (for further references).

[137] US7 October 2003 Oral Statement, para. 34.

[138] Brazil offers additional rebuttal arguments in its comment on the US 22 December 2003 Answer to Question 213, below.

upcoming prices and represents a third approach to modeling price expectations – the others being of course lagged prices and futures market prices.

64. In the context of its critique of the Westcott/Price study, the United States repeats its contention that futures market prices are the appropriate indicator for upland cotton farmers' price expectations, and that the effect of the marketing loan programme can be judged by looking at farmers' expectations about the US seasonal average cash price in the upcoming marketing year.[139] *This approach is simply factually wrong. There is no question that marketing loan payments are based off the adjusted world price – not a cash price.* Both Brazil and Professor Sumner explained this fact in detail on 2 and 3 December 2003.[140] Indeed, the United States acknowledges this fact elsewhere in its 22 December 2003 Answers to Questions.[141] Thus, the effects of the marketing loan programme would depend on upland cotton farmers' expectations about the adjusted world price. All of the repeated US arguments that there are no effects of the marketing loan programme for upland cotton in MY 1999-2001 because the expected US cash price was above the loan rate are simply meaningless.[142]

65. The US argument that the marketing loan programme has no effects if the expected US cash price is above the loan rate is, however, also wrong on its merits. (The same would be true had the United States relied on the correct price – the adjusted world price.) Brazil demonstrated that the spread between the January to March quotes of the December futures contract and the adjusted world price is (i) 18.5 cents[143] (if measured against the average AWP for the following marketing year) or (ii) 12.22 cents[144] (if measured against the December AWPs).[145] Subtracting this spread from the average of the January to March quotes of the December futures contract provides the expected adjusted world price (i) for the upcoming marketing year and (ii) for the upcoming December. As Professor Sumner has explained, it is also not at all clear which futures prices to use for any such calculations.[146] Taking the quotes of just one month for a single futures contract, as the United States does, is an overly simplistic approach.[147] But whether one assumes that farmers look at the average AWP for the upcoming marking year or at some particular AWP for a specific month such as

[139] US 22 December 2003 Answers to Questions, para. 51. *See* also US 18 November 2003 Further Rebuttal Submission, Section IV.G (for earlier US arguments using this fatally flawed approach).

[140] *See* Brazil's 2 December 2003 Oral Statement, Section 5.2 and Exhibits Bra-370 – Bra-371. *See* also Brazil's 22 December 2003 Answers to Questions, para. 155; Brazil's 20 January 2004 Answers to Additional Questions, para. 21.

[141] US 22 December 2003 Answers to Questions, para. 75. Also Exhibit US-126 calculates the marketing loan benefit correctly as the difference between the loan rate and the adjusted world price, rather than – as implied by the United States in its other arguments – as the difference between the loan rate and the cash price.

[142] US 22 December 2003 Answers to Questions, para. 51. Brazil is puzzled to learn that the United States continues to ignore these basic facts about the operation of the marketing loan program for upland cotton and continues to rely on this seriously flawed argument. Brazil recalls again that the United States is fully aware of its error, as demonstrated by its statements in paragraph 75 of its 22 December 2003 Answers to Questions and by Exhibit US-126, both of which rely on the adjusted world price as the basis for calculating marketing loan benefits.

[143] Exhibit Bra-356 (January – March Quotes of the December Futures Contract, Expected and Actual AWP and Cash Price).

[144] Exhibit Bra-370 (The Difference Between the Adjusted World Price and the December Futures Contract), presented by Professor Sumner on 3 December 2003.

[145] Concerning the problems inherent in the choice of the exact spread, *see* Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 13).

[146] Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 11-12).

[147] Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 12).

December, the fact is that the expected world price has always been well below the loan rate during MY 1999-2002.[148]

66. Moreover, even if the expected adjusted world price would not have been below the loan rate, that does not mean that there are no effects from the marketing loan programme. As Professor Sumner explained on 3 December 2003, this is because farmers have a probability distribution for the expected adjusted world price. That means they will expect with a certain likelihood that the adjusted world price will be below (or above) the mean of the expectation.[149] It follows that even if farmers expect the mean of the probability distribution for the AWP to be above the loan rate, they will nevertheless expect some marketing loan payments to be made.[150]

67. In sum, Brazil emphasizes that the Westcott/Price studies are important evidence of the effects of the upland cotton marketing loan programme that corroborate the effects found by Professor Sumner and the effects that are implied by all the non-econometric evidence for the effects of the US upland cotton subsidies presented by Brazil.

68. Finally, Brazil notes a new US argument that undercuts the US arguments regarding the peace clause. The United States argues for the first time in its 22 December 2003 Answers to Questions that the marketing loan programme *does not guarantee* US upland cotton producers 52 cents per pound in income.[151] Rather, there is additional revenue generated by the marketing loan programme that increases the effective support level – so-called "marketing loan facilitated revenue".[152] This revenue results from several sources. First, US farmers receive a domestic farm price when selling their crop. This price is consistently above the adjusted world price, off which the marketing loan payments are based.[153] It follows that US farmers receive additional revenue, as the US farm price plus the difference between the loan rate (52 cents) and the adjusted world price (below the US farm price) will exceed 52 cents.[154] Second, by cleverly marketing their upland cotton crop, US farmers can maximize this additional marketing loan facilitated revenue, which Westcott and Price assumed to be *14 cents*.[155]

69. In Exhibit US-126, the United States provides monthly data on the amount of additional marketing loan facilitated revenue. This actual data demonstrates considerable additional positive revenue "facilitated" by the marketing loan programme. Thus, using an adjusted world price as the loan repayment rate for upland cotton (as opposed to a local posted county price used for other crops

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[148] *See* Brazil's 2 December 2003 Oral Statement, paras. 43-47, and Professor Sumner's oral explanation on 3 December 2003.

[149] *See* Exhibit Bra-371 (Simple Example of the Calculation of Expected Marketing Loan Benefit).

[150] Professor Sumner's oral explanations on 3 December 2003; Brazil's 2 December 2003 Oral Statement, para. 48; Brazil's 22 December 2003 Answers to Questions, para. 155.

[151] In passing, Brazil notes that the use of 14 cents as marketing loan facilitated revenue was taken from the assumptions in USDA's own FAPSIM policy simulation model (Exhibit Bra-222 ("Analysis of the US Commodity Loan Program with Marketing Loan Provisions," USDA, AER 801, p. 11)). In addition, Westcott and Price demonstrate that the additional marketing loan facilitated revenue for MY 1999 is 12.7 cents – very close to the authors' assumption (Exhibit Bra-222 ("Analysis of the US Commodity Loan Programme with Marketing Loan Provisions," USDA, AER 801, p. 8)). Finally, Exhibit US-126 does not contradict the appropriateness of using 14 cents, as Exhibit US-126 does not provide the entire marketing loan facilitated revenue received by farmers (*see* Brazil's arguments in the main body of its comment).

[152] US 22 December 2003 Answers to Questions, paras. 50-52. Brazil notes that this additional revenue in rare circumstances can also turn out to be negative.

[153] *See* Brazil's 27 October 2003 Answers to Questions, chart at paragraph 172 and Exhibit Bra-311 (Side by Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average US Spot Market Price and Prices Received by US Producers from 1996 to the present).

[154] US 22 December 2003 Answers to Questions, paras. 50-52. Brazil notes that this additional revenue may also turn out to be negative, as shown by Exhibit US-126.

[155] US 22 December 2003 Answers to Questions, para. 52.

except rice) increases the revenue guarantee beyond the official loan rate, as shown by the data in Exhibit US-126. This data, however, understates the real effect for two basic reasons. First, it calculates the additional revenue based on an average national cash price that may be quite different from the price an actual upland cotton farmer receives for its crop. Second, and more importantly, it omits the second source of "marketing loan facilitated revenue" – the timing decisions of farmers in marketing their crop and taking out marketing loan benefits.

70. The existence of additional marketing loan programme facilitates revenue further highlights the importance of the upland cotton marketing loan programme in assisting upland cotton producers to close the gap between costs and market returns. It also invalidates further the US argument during the peace clause phase of this dispute that a rate of support should be used for purposes of the "peace clause" analysis, as the rate of support is the only measure that the United States controls.[156] The United States now admits that it does not control the rate of support either, as the rate of support may be above (or even below) 52 cents, depending on market conditions[157], and farmers' timing decisions for the marketing of their crop. Nor does the United States control the flow of marketing loan payments, as there is no mechanism in the upland cotton marketing loan programme to stem or control the flow of upland cotton marketing loan payments. This is precisely one of the reasons that Brazil has challenged this mandatory programme as causing a threat of serious prejudice.

**213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? BRA, USA**

## Brazil's Comment:

71. The United States focuses its response entirely on Professor Sumner's model. In fact, it does not provide an answer to the question posed by the Panel. Brazil recalls that this question asks for differences in results that can be observed from models *in the literature* that use lagged prices and futures prices. In its 22 December 2003 response to this question, Brazil detailed that there are no comparable models that use futures prices, but that all models discussed in the context of this proceeding – as well as all other large-scale multi-commodity models – use some variant of lagged prices.[158]

72. At the outset, Brazil notes that the United States *has presented no econometric model* in this dispute. The United States has not taken advantage of the economic and econometric expertise of USDA's Economic Research Service to substantiate econometrically its argument that $12.9 billion in upland cotton subsidies have had no effect on production and exports of US upland cotton and have had no effects on US or world prices.

73. Instead, the United States has criticized various aspects of Professor Sumner's model.[159] In particular, it has focused its critique on Professor Sumner's approach to modeling farmers' price expectations. However, Professor Sumner and Brazil have effectively rebutted all of these criticisms.[160]

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[156] *See inter alia* US 11 July 2003 First Submission, para. 94; US 22 July 2003 Oral Statement, paras. 12-13.

[157] These market conditions are in particular reflected in the spread between the adjusted world price and the cash price received by US upland cotton producers.

[158] Brazil's 22 December 2003 Answers to Questions, paras. 37-42.

[159] US 7 October 2003 Oral Statement, paras. 26-50; US 22 December 2003 Comments on Brazil's Econometric Model.

[160] *See* Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effects of US Cotton Subsidies – Professor Daniel Sumner, 2 December 2003, paras. 6-14, with further references).

74. The United States cites Andrew Macdonald in support of its propositions that futures prices are the better price indicators.[161] However, once again, the United States takes a quote out of context. What Mr. Macdonald actually said in the cited paragraph is that New York futures prices are an indicator of the direction in which prices will move in the future, *i.e.*, price trends, not an indicator of actual price in the future.[162]

75. The United States further cites a US government study that allegedly demonstrates that a certain percentage of US upland cotton producers rely on the New York futures market to *price* their crop for actual sales.[163] While Brazil cautions against the use of the specific results of the study (as it is somewhat dated)[164], Brazil agrees that at least some farmers *price* their crop with reference to the New York futures price. However, what this study *does not demonstrate* is that US upland cotton producers rely on the futures market in *making their planting decisions* many months before marketing.

76. The basic question that arises from the US criticism is the following: is Professor Sumner's approach to model farmers' price expectations biased towards generating stronger effects? The United States correctly notes that "[t]he lagged prices used by Brazil and [Professor Sumner] can[,] at best, be an approximation of farmers' price expectations".[165] This is an obvious fact; the actual price expectations of thousands of farmers are "fundamentally unobservable".[166]

77. There are three basic approaches to modeling farmers' price expectations: (1) using lagged prices, (2) using futures market prices if available, and (3) using rational expectations in various forms, including crediting farmers with complete information (*i.e.*, using the actual price as the expected price[167]).

78. It is not clear that any of these approaches lead to *a priori* biased results. However, it is standard practice among economists to use lagged prices in a large-scale, multi-commodity econometric policy simulation framework. FAPRI, USDA and the US Congressional Budget Office ("CBO") use lagged prices in their models. Indeed the United States admits that using futures prices for these models is not feasible and has never been done.[168] Had Brazil attempted to use this unconventional and untested approach for its model, the United States could have raised legitimate concerns as to the reliability of the model results. Any such results would have been purely speculative.[169]

79. Indeed, Brazil would have had to develop equations to predict futures prices for those commodities for which a functioning futures market exists. It also would have had to use an altogether different modeling approach for price expectations for crops for which there is no futures market. Again, this would have been purely speculative.[170]

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[161] US 22 December 2003 Answers to Questions, para. 57

[162] Exhibit Bra-281 (Statement by Andrew Macdonald – 7 October 2003, para. 13, even clearer paras. 17, 28, 31).

[163] US 22 December 2003 Answers to Questions, para. 58.

[164] *See* Brazil's comment on Question 201, above.

[165] US 22 December 2003 Answers to Questions, para. 56, *see* also para. 64.

[166] Brazil's 9 September 2003 Further Submission, Annex I, para. 18.

[167] Westcott/Price have chosen this approach for the update of their study for purposes of the Payment Limitations Commission.

[168] US 7 October 2003 Oral Statement, para. 34.

[169] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 9-14).

[170] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 9-14).

80. The approach favoured by the United States is not itself free of problems.[171] So far, futures market prices have only been used in statistical estimation using aggregate time-series data and not in econometric policy simulations.[172] Using it for modeling purposes raises further questions about the choice of futures contracts, the time period over which quotations are used, and calculations of appropriate spreads, among others.[173]

81. In sum, there are good reasons that FAPRI, USDA and the CBO use lagged prices in their policy simulation models. The Panel will recall that the FAPRI model (using lagged prices) was influential in the policy-making process leading to the 2002 FSRI Act, and that FAPRI, USDA and CBO models (all of which are based on lagged prices) are used regularly in US policy evaluation and formulation. Professor Sumner's approach uses a simple and commonly used proxy for the fundamentally unobservable price expectations of farmers.[174] Brazil is puzzled that the United States now views the very approach that every credible econometric policy simulation model takes as a significant error once this approach is used by Brazil in this dispute.

82. The United States further argues that in years with strong exogenous shocks lagged price models are poor proxies for price expectations.[175] The United States criticizes Professor Sumner's MY 2002 results as grossly overstated.[176] Brazil notes that it is has never relied on Professor Sumner's results of individual years. Instead, Brazil has used averages of the effects of the US programmes in MY 1999-2002 and MY 2003-2007. Using these averages mitigates any problems that may have existed from the use of lagged prices in any individual year.

83. Finally, Brazil notes that the United States relies on elasticities supplied by Professor Sumner in Annex I to calculate acreage responses from the expected lower cash prices in MY 2002.[177] However, these US calculations the United States are meaningless for several reasons. First, the futures prices used by the United States are problematic. Using only a single month's quotes for a single contract does not appropriately model the complexities of farmers' planting and marketing timings.[178] Second, it is unclear from the US response whether the United States used an appropriate spread for the calculation of price expectations held by farmers.[179] Third, it is therefore unclear whether the United States has calculated the appropriate change in price expectations between MY 2001 and 2002. Finally, even assuming that all of these problems did not exist, the results calculated by the United States using Professor Sumner's elasticities fail to provide meaningful results. These elasticities were applied in Professor Sumner's model to obtain direct effects, *i.e.*, effects before any feedback from the FAPRI US crops model and the CARD international cotton model.[180] Thus, the results are nowhere near the results that one would have obtained using Professor Sumner's full Annex I model. For all these reasons, Brazil strongly disagrees with the conclusion that the marketing loan programme did not have any effect in MY 2002. Brazil also recalls its arguments

[171] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 9-14).

[172] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 9).

[173] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 11-13).

[174]Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 14).

[175] US 22 December 2003 Answers to Questions, para. 61.

[176] US 22 December 2003 Answers to Questions, para. 63.

[177] US 22 December 2003 Answers to Questions, para. 63.

[178] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 12).

[179] Brazil's 2 December 2003 Oral Statement, para. 44; Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 13).

[180] *See* Brazil's 20 January 2004 Comments on US Model Critique, paras. 64, 70.

and evidence regarding the serious flaws in the US application of its futures price methodology using expected cash prices rather than expected adjusted world prices.[181]

## III. DOMESTIC SUPPORT

**214. Please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? USA**

**215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA**

**216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. BRA, USA**

**Brazil's Comment:**

84. In addition to its own answer[182], Brazil offers two comments to the US response to this question. First, the United States makes a factual mistake in describing the calculation of base acreage under the deficiency payment programme.[183] While the United States' description of the calculation of deficiency payment crop base as the rolling five-year average minus the high and low year would be correct for other deficiency payment crops, upland cotton (and rice) had a special provision.[184] 7 CFR 1413.7(c) mandates the calculation of upland cotton base as "the average of the acreages planted and considered planted to such crop for harvest on the farm in each of the 3 crop years preceding such crop year.[185] For farms participating in the programme, all current base acreage was "considered planted".[186] Therefore, for the base to change, farmers had to opt out of the programme.[187]

85. Second, Brazil does not consider credible or relevant a statement by the United States that "[g]iven the current US fiscal situation,"[188] any further base update four years from now seems "unlikely". The Panel must determine whether the 2002 FSRI Act update of the direct and counter-cyclical payment base is a violation of paragraphs 6(a) and (b) of Annex 2 of the Agreement on Agriculture.

**217. What is the reason for reducing payments under the PFC and direct payments programmes for planting and harvesting fruit, vegetables and wild rice on certain base acreage? Please comment on the statements by the European Communities that "the reduction in payment for fruit and vegetables, if the EC understands correctly, is in fact designed to avoid unfair competition within the subsidising Member." (EC oral statement at first session, first substantive meeting, paragraph 29) and "To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition (…)" (EC response to Panel third party Question No. 5). USA**

[181] *See* Brazil's comment on Question 212, above.
[182] Brazil's 22 December 2003 Answers to Questions, paras. 47-50.
[183] US 22 December 2003 Answers to Questions, paras. 67-68.
[184] Exhibit Bra-26 (7 CFR 1413, Deficiency Payment Program, 1993 edition).
[185] Exhibit Bra-26 (7 CFR 1413.7(c)).
[186] Exhibit Bra-26 (7 CFR 1413.3, "Considered planted acreage").
[187] Brazil's 22 December 2003 Answers to Questions, para. 47.
[188] US 22 December 2003 Answers to Questions, para. 70.

**Brazil's Comment:**

86. The United States does not answer the Panel's first question as to "what is the reason" that PFC and direct payments are reduced for planting and harvesting fruits, vegetables, and wild rice. No reason is provided in the US 22 December 2003 response.

87. Nor does the United States take advantage of the Panel's second question to comment on the statement made by the European Communities that "the reduction in payment for fruit and vegetables, is in fact designed to avoid unfair competition within the subsidizing Member".[189] No US comment is provided. The EC argument involves considerable speculation about the "design" of the US measures. With the United States deciding not to provide any such reasons, the Panel is left without a factual basis to know whether the US reduction of payment based on growing fruits and vegetables is intended to "minimize any distortion which may be caused by any decoupled payments in markets which were historically undistorted by subsidies".[190]

88. The EC argument appears to attempt to impose a "trade distortion" test to the criteria of Annex 2, paragraph 6. However, Brazil notes that the EC argued that a decoupled domestic support measure need *not* be tested with regard to the "fundamental requirement" in Annex 2, paragraph 1 to determine whether it has "trade distorting effects".[191] Nor do any of the specific criteria in paragraph 6(b) of Annex 2 refer to "trade distorting effects".[192] Annex 2, paragraph 5 requires the specific criteria of Annex 2, paragraph 6 to be met for a direct payment measure to be included within the green box.

89. But even if Annex 2, paragraph 6(b) included a "trade distorting effects" test, the EC is simply wrong that the elimination or reduction of PFC and direct payments when fruits and vegetables and wild rice are grown does not "distort" trade. The EC argument ignores the distortion in trade in the products on which payments are focused, *i.e.*, upland cotton and the other programme crops rather than fruits, vegetables, and wild rice. Limiting or prohibiting payments for types of products representing 60 per cent of the value of production in a region such as California, Florida, or Arizona has the effect of maintaining production in the 40 per cent of the value of crops for which programme payments are received.[193] This "distorts" the trade in the agricultural crops receiving the payment by *maintaining or increasing their production.* The practical effect of the PFC and direct payment restriction is that the resources are targeted towards certain "types" of crops only. Negotiators intended that measures that were so linked to current production were not properly part of the green box.

90. In light of this evidence, the EC's argument boils down to asserting that trade distortions for products that traditionally have been subsidized should be permitted in order to prevent trade distortion in markets for non-subsidized products. Thus, the EC's argument is not one that would avoid distortions; it is one of *maintaining* existing distortions, contrary to the object and purpose of the Agreement on Agriculture.[194]

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[189] EC 23 July 2003 Oral Statement, para. 29.

[190] EC 11 August 2003 Answer to Third Party Question 11, para. 30.

[191] EC 11 August 2003 Answer to Third Party Questions 6 and 9, paras. 17, 23-25.

[192] Indeed, the United States has acknowledged that such effects can be presumed if the specific criteria in paragraph 6 of Annex 2 are not complied with. *See* US 11 August Answer to Question 31, para. 65 ("if a new measure does not conform to the basic and applicable policy-specific criteria in Annex 2, it will not have the benefit of the presumption that it meets the fundamental requirement of the first sentence.").

[193] Exhibit Bra-105 ("Statement of Professor Daniel Sumner at the First Meeting," para. 24); Oral Statement of Brazil, paras. 65-66.

[194] *See* Brazil's 22 August 2003 Rebuttal Submission, paras. 8-9, note 15.

91. The only thing the US 22 December 2003 response does is to repeat earlier faulty arguments attempting to defend the fruits, vegetables, and wild rice payment limitation.[195] The US response is useful because it finally clarifies that the US argument boils down to the assertion that if a direct payment measure does not *require* production, then it cannot violate Annex 2, paragraph 6. The US 22 December 2003 response states, at paragraph 73, that "paragraph 6 [no subsection listed] prohibits basing payments on production requirements … ".[196] It further states that the reduced PFC and direct payments "are not 'related to, or based on, the type or volume of production' *since the recipient need not produce anything at all*".[197] But there has never been an issue whether PFC and direct payments require production. All this means is that they comply with Annex 2, paragraph 6(e), in that "no production shall be required in order to receive such payments". But what about Annex 2, paragraph 6(b), which must be interpreted to have a separate meaning apart from paragraph 6(e)?

92. Paragraph 6(b) focuses on the amount of payments related to the type of production. In other words, if a farmer decides to produce something (recognizing that he or she need not under Annex 2, paragraph 6(e)), does the direct payment provision condition the amount of payment on the type of production undertaken? The answer with respect to the 1996 FAIR and the 2002 FSRI Act for PFC and direct payments is a clear "yes". The amount of the PFC or direct payments falls when prohibited crops are grown – and increases when the prohibited crops cease to be grown. These legal provisions send a fairly compelling message to the farmer – channel your current production into *certain* crops to continue receiving the full amount of direct payments today. This re-couples payments to current production.

93. The United States claims, at paragraph 73 of its 22 December 2003 response, that all a producer need do to receive the full payment is to "*merely* refrain from producing fruit, vegetables, or wild rice".[198] This is an interesting dismissal given that the practical effect of this provision is to direct production away from crops that represent up to 60 per cent of the value of available options for cotton farmers in states such as Florida, California, and Arizona.

94. Moreover, the logic of the US argument leads to an evisceration of any disciplines in Annex 2, paragraph 6, and is therefore contrary to the object and purpose of that provision. Consider the following hypothetical: a measure provides for a direct payment that was reduced by 75 per cent if a farmer produced any of 99 per cent of the available crop options; as a practical matter, farmers could only plant one or two crops (or no crops) and still receive the full payment. Under the US argument, because the farmer had no obligation to grow any crops, it could "merely refrain" from producing 99 per cent of available crops. Like the fruits, vegetables and wild rice exception, this argument would emasculate the green box requirement of Annex 2, paragraph 6(b).

**218. Please comment on the testimony of USDA Chief Economist Keith Collins cited in paragraph 36 of Brazil's oral statement regarding the trade-distorting and production-distorting nature of the marketing loan payments. USA**

**Brazil's Comment:**

95. The United States states in its response to this question "that marketing loan payments are *potentially* production- and trade-distorting".[199] Yet, Keith Collins' statement did not say "potentially" production- and trade-distorting. Dr. Collins stated that marketing loan payments "are

[195] US 22 December 2003 Answers to Questions, para. 73.
[196] US 22 December 2003 Answers to Questions, para. 73.
[197] US 22 December 2003 Answers to Questions, para. 73.
[198] Emphasis added.
[199] US 22 December 2003, Answers to Questions, para. 74 (emphasis added).

*unambiguously* trade-distorting and production-distorting".[200] This is quite a different statement than the one the United States appears to "agree" to. Coming from the Chief Economist of the USDA, who is one of the most-widely respected agricultural economists, it is positive evidence that marketing loan payments are not only "potentially" production- and trade-distorting, but that these payments have, in fact, "unambiguously" distorted US production and exports of upland cotton. But Dr. Collin's statement also confirms what other evidence in the record already demonstrates: the effect of the marketing loan programme is to sustain economically unviable US production of upland cotton, that in turn increases US exports and suppresses world prices.[201]

96. In a further response to this question, the United States itself provides the reason why its arguments about the expected cash price as a meaningful measure of the effects of the marketing loan programme are seriously flawed. The United States confirms that marketing loan benefits are not paid off the cash price (so that any expectations about future cash prices would matter), but that "farmers will receive a government payment for the difference between the loan rate and *the adjusted world price*".[202] Thus, what potentially matters in evaluating the effects of the marketing loan programme is the expected adjusted world price, and not the expected cash price.[203] Looking at the expected adjusted world price, it is below the loan rate in all marketing years during the period of investigation and, therefore, the marketing loan programme is expected to have a significant effect on US farmers' upland cotton planting decisions.[204] This fact confirms all the other evidence presented by Brazil to demonstrate the trade- and production-distorting effects of the marketing loan programme.[205]

## IV. EXPORT CREDIT GUARANTEES

**219. Under the *Agreement on Agriculture* the general position is that the use of export subsidies, both those listed in Article 9.1 as well as those within the scope of Article 1(e) which are not so listed, may only be used within the limits of the product specific reduction commitments specified in Part IV of Members' Schedules. One might therefore have expected that Article 3.3 of the *Agreement on Agriculture* would have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, would have simply prohibited the use of any export subsidy. Instead, the Article 3.3 prohibition is limited in both cases to export subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:**

**(a) the fact that export performance-related tax incentives, which like subsidized export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held**

[200] Brazil's 2 December 2003 Oral Statement, para. 36 and Exhibit Bra-211 ("The Current State of the Farm Economy and the Economic Impact of Federal Policy," Hearings before the Committee on Agriculture, US House of Representatives, p. 43)(emphasis added).

[201] Brazil's 9 September 2003 Further Submission, Section 3.3.4.7.1; Brazil 7 October 2003 Oral Statement, paras. 31-33; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 3.1, 3.2, 3.4 and 3.7.1; Brazil's 2 December 2003 Oral Statement, Section 5.2.

[202] US 22 December 2003 Answers to Questions, para. 75 (emphasis added).

[203] Brazil's 2 December 2003 Oral Statement, Section 5.2. Brazil notes that the United States, in Exhibit US-126, appears to acknowledge this fact, as it calculates the marketing loan benefit as the difference between the loan rate and the adjusted world price, rather than the cash price, as the United States implies in its other arguments.

[204] Brazil's 2 December 2003 Oral Statement, Section 5.2, in particular paras. 44-50 (including Exhibits Bra-356-359) and Professor Sumner's oral explanations on 3 December 2003 (including Exhibit Bra-370-371).

[205] Brazil's 9 September 2003 Further Submission, Section 3.3.4.7.1; Brazil 7 October 2003 Oral Statement, paras. 31-33; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 3.1, 3.2, 3.4 and 3.7.1; Brazil's 2 December 2003 Oral Statement, Section 5.2.

**(for example, in *United States – Tax Treatment for Foreign Sales Corporations*, WT/DS108) to be subject to the anti-circumvention provisions of Article 10.1; and**

**(b) the treatment of international food aid and non-commercial transactions under Article 10? USA**

**Brazil's Comment:**

97. Brazil agrees with the United States that Article 8 of the Agreement on Agriculture assumes the role the Panel suggests one might have expected Article 3.3 to play.[206] Article 8 prohibits the use of both those export subsidies listed in Article 9.1 and those not listed in Article 9.1 other than in conformity with the Agreement on Agriculture and the commitments specified by a Member in its Schedule.

98. However, Brazil does not consider that this fact provides illuminating context for the interpretation of Article 10, including Articles 10.1 and 10.2. The question is whether Article 10.2 of the Agreement on Agriculture exempts or carves-out export credits from the disciplines included in Article 10.1. The Appellate Body has concluded that to exempt or carve-out particular categories of measures from general obligations such as the export subsidy obligations in the Agreement on Agriculture, the exemption or carve-out must be *explicit* in the text of an agreement.[207] Article 10.2 includes no such explicit exemption or carve-out.[208] The negotiators knew how to make such an exemption or carve-out explicit, as evidenced by, for example, Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.[209] The United States has not rebutted these arguments.

99. Instead, the United States appeals to what it considers to be "similarity" between the treatment of export credit instruments and international food aid in Articles 10.2 and 10.4.[210] These two provisions are fundamentally different, however. Article 10.2 announces Members' intent to work toward negotiations on specific disciplines for export credits, and calls on Members to adhere to those disciplines once they are adopted. As Brazil noted in its 22 December 2003 Answers to Questions, the nature of the disciplines negotiated and the way in which they are transposed into the WTO will dictate the effect they will have on claims against export credits under Article 10.1.[211] At least for the time being, however, Article 10.2 does not meet the standard for carve-outs or exemptions set by the Appellate Body in *EC – Sardines* and *EC – Hormones*, and export credits are subject to the disciplines of Article 10.1.[212]

100. Article 10.4 similarly does not meet the standard for exemptions or carve-outs set by the Appellate Body in *EC – Sardines* and *EC – Hormones*. However, it does provide specific disciplines for international food aid through reference to FAO and Food Aid Convention provisions. In Brazil's

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[206] *See* US 22 December 2003 Answers to Questions, para. 79.

[207] Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128.

[208] *See* Brazil's 22 July 2003 Oral Statement, paras. 100-115; Brazil's 22 August 2003 Rebuttal Submission, paras. 99-100; Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 33-52; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 219-220; Brazil's 2 December 2003 Oral Statement, paras. 73-76; Brazil's 22 December 2003 Answers to Questions, paras. 51-57.

[209] *See, e.g,*. Brazil's 2 December 2003 Oral Statement, para. 75.

[210] US 22 December 2003 Answers to Questions, paras. 80-82.

[211] Brazil's 22 December 2003 Answers to Questions, paras. 51-57.

[212] *See* Brazil's 22 July 2003 Oral Statement, paras. 100-115; Brazil's 22 August 2003 Rebuttal Submission, paras. 99-100; Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 33-52; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 219-220; Brazil's 2 December 2003 Oral Statement, paras. 73-76; Brazil's 22 December 2003 Answers to Questions, paras. 51-57.

view, Article 10.4 could be considered an example of the situation envisioned in paragraph 56 of Brazil's 22 December 2003 Answers to Questions.[213] Article 10.4 sets out a benchmark against which to determine whether particular international food aid measures constitute "export subsidies", within the meaning of Article 10.1. Thus far, the Appellate Body's decisions (in *US – FSC*[214] and *Canada – Dairy*[215]) have directed panels to contextual guidance included in the SCM Agreement for this determination. In a case against international food aid measures, however, a panel could look to the alternative benchmarks set out in Article 10.4 as context for its determination whether those measures constitute "export subsidies" for the purposes of Article 10.1. (A panel could also look to a Member's notifications to the Committee on Agriculture. The United States, for example, notifies international food aid – or some portion of the international food aid provided by it – as export subsidies to be counted towards its reduction commitments.[216])

**220. What will be the relevance of Articles 9 and 10.1 of the *Agreement of Agriculture* to export credit guarantees when disciplines are internationally agreed? BRA**

**221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be $230,127,023 instead of the figure which originally appeared ($381,345,059).**

**(a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.**

**Brazil's Comment:**

101. The data provided by the United States in the chart accompanying its response demonstrates that using the net present value methodology imposed by the US Federal Credit Reform Act ("FCRA"), premiums for the CCC guarantee programmes over the period 1992-2002 were inadequate to cover the operating costs and losses of the programmes, in the amount of $230 million.[217] For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[218]

102. Brazil addresses further the US chart in its comments on other US answers, below.

**(b) Please clarify whether and how the Panel should treat the figures in Exhibit BRA-182 for the net lifetime re-estimates for each respective cohort.**

[213] Brazil's 22 December 2003 Answers to Questions, para. 56.
[214] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 136-140.
[215] Appellate Body Report, *Canada – Dairy*, WT/DS103/AB/R and WT/DS113/AB/R, paras. 87-90.
[216] *See, e.g.*, Exhibit Bra-99 (G/AG/N/USA/39, p. 2).
[217] US 22 December 2003 Answers to Questions, chart included in response to Question 221(a).
[218] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

**Brazil's Comment:**

103. The United States' response is inaccurate. In stating that "all of the first five cohorts (1992-1996), including 1994, are profitable",[219] the United States oddly neglects to account for the most recent reestimate data, which it has included in its own chart, provided with its response to question 221(a). That chart shows massive upward reestimates in 2003 for the 1992, 1993, 1994, 1996, 1997 and 2001 cohorts. Accounting for those reestimates, the 1994 cohort, which the United States asserts is nearly closed[220], does *not* show profitability. Nor do the 1997, 1998, 2000, 2001 or 2002 cohorts.

104. The United States is implying that over time, cohorts will turn out to be positive. The data does not support this implication. Upward reestimates continue, even on "older" cohorts, and net results do not suggest profitability with anywhere near the uniformity suggested by the United States.

105. Finally, Brazil emphasizes that showing gains or losses for particular *cohorts* is not relevant for the purposes of item (j), which calls for the assessment of a "*programme*" across its entire portfolio.[221]

**(c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of $4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately $4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result.**

**Brazil's Comment:**

106. Brazil agrees that for a complete assessment under item (j), administrative expenses in the amount of approximately $39 million[222] should be added to the $230 million of losses recorded in the chart accompanying the US response to question 221(a), or to $211 million of losses recorded in the Brazilian chart included as Exhibit Bra-193.

**(d) Please identify what is considered an "administrative expense" for this purpose.**

**(e) The Panel notes the US statement in paragraph 160 of its answers to Panel questions following the first meeting that all cohorts are still open although the 1994 and 1995 cohorts will close this year. Is this still an accurate statement? If not, please indicate whether any cohorts have since "closed" for the period 1992-2002.**

**Brazil's Comment:**

107. The United States' response is inaccurate. Using the most recent data available, provided by the United States with its response to question 221(a), the subsidy figure net of reestimates for the 1994 cohort will in fact be positive, indicating losses. Based on this same data, the same thing can be said for other "older" cohorts, such as 1997 and 1998. Moreover, the United States' data demonstrates that 2002 and 2003 reestimates for "older" cohorts 1992, 1993, 1994, 1996 and 1997 are all *upward*, indicating adjustments for even greater losses than previously anticipated.

[219] US 22 December 2003 Answers to Questions, para. 86.
[220] US 22 December 2003 Answers to Questions, para. 93.
[221] *See* Brazil's 2 December 2003 Oral Statement, para. 81; Brazil's 18 November 2003 Further Rebuttal Submission, para. 248; Brazil's 27 August 2003 Comments on US Rebuttal Submission, para. 61.
[222] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

108. Brazil emphasizes, however, that showing gains or losses for particular *cohorts* is not relevant for the purposes of item (j), which calls for the assessment of a "*programme*" across its entire portfolio.

**(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily* reach a "profitable" result (for example, the 1994 cohort, which has almost closed still indicates an outstanding amount)? Do "re-estimates" reflect also expectations about a cohort's future performance?**

**Brazil's Comment:**

109. Once again, the United States' response is inaccurate. The United States asserts that data for the 1994 cohort indicate profitability.[223] Using the most recent data available, however, provided by the United States with its 22 December 2003 response to question 221(a), the subsidy figure net of reestimates for the 1994 cohort will in fact be positive, indicating losses. Based on this same data, the same thing can be said for other "older" cohorts, such as 1997 and 1998. Moreover, the United States' data demonstrates that 2002 and 2003 reestimates for "older" cohorts 1992, 1993, 1994, 1996, 1997 are all *upward*, indicating adjustments for even greater losses than previously anticipated.

110. The United States shows *no evidence* to support its assertion that Pakistani and Ecuadorean defaults account for an important part of the poor performance of the 1997 cohort.[224] Nor does it offer any evidence to show that those defaults were rescheduled, or that they are performing. Additionally, the United States' assertion that it expects the 1998 cohort to show profitability is not supported by the data included with its response to question 221(a).[225] As recently as 2002, upward reestimates were made to the 1998 cohort, indicating that there is no discernible trend of profitability.

111. In any event, Brazil notes that showing gains or losses for a particular *cohort* is not relevant for the purposes of item (j), which calls for the assessment of a "*programme*" across its entire portfolio.[226]

**(g) Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?**

**Brazil's Comment:**

112. The United States confuses two issues in paragraphs 96-97 of its response.[227] First, it notes that reestimates need to be applied to the subsidy estimate included in the prior, actual year column of the US budget, since the original subsidy estimate included in the budget year column of the US budget includes subsidy figures for some guarantees that are budgeted but not in fact granted. In other words, fewer guarantees are granted than were budgeted to be granted. Brazil recognized this in Exhibit Bra-193, as does the United States in the chart included with the US response to question 221(a). Nonetheless, both Brazil and the United States reach the same conclusion – over the 10-year period, operating costs and losses outpace premiums collected for the CCC programmes (even before administrative expenses are included in the calculation). The United States tracks losses of $230

[223] US 22 December 2003 Answers to Questions, para. 93.
[224] US 22 December 2003 Answers to Questions, para. 94.
[225] US 22 December 2003 Answers to Questions, para. 94.
[226] *See* Brazil's 2 December 2003 Oral Statement, para. 81; Brazil's 18 November 2003 Further Rebuttal Submission, para. 248; Brazil's 27 August 2003 Comments on US Rebuttal Submission, para. 61.
[227] US 22 December 2003 Answers to Questions, paras. 96-97.

million in the chart accompanying its response to Question 221(a), and Brazil tracks losses of $211 million in Exhibit Bra-193.

113. The second point the United States makes is that the data it has presented in its response to question 221(a) includes no "operating experience" with the 2001 and 2002 cohorts.[228] This is wholly inaccurate. Estimates of costs and losses are based, first and foremost, on historical experience with borrowers.[229] Moreover, the chart included in the US response to question 221(a) shows that reestimates – which are in part made to reflect operating results – have already been made for both the 2001 and 2002 cohorts.

114. Finally, the United States' assertion that there is a "trend of negative reestimates"[230] is not borne out by the data provided by the United States itself, in its response to question 221(a). In 2002, upward reestimates were made for the 1992, 1993, 1994, 1995, 1996, 1997 and 1999 cohorts. Similarly, in 2003, upward reestimates were made for the 1992, 1993, 1994, 1996, 1997, 2001 and 2002 cohorts. It is not at all "reasonable to expect that in the fullness of time the data will … reflect further negative reestimates for cohorts 2001 and 2002",[231] as the United States asserts, for the simple reason that recent data provided by the United States shows significant upward reestimates *across all cohorts*, including "older" cohorts that are presumably closer to closing.

115. For all of these reasons, the US suggestion that the 2001 and 2002 cohorts should be disregarded by the Panel in its item (j) analysis should be rejected.

**(h) Why should the Panel "eliminate", in addition, the 2000 cohort, as also suggested in paragraph 198 of the US further rebuttal submission for which information is presumably more "complete"?**

**Brazil's Comment:**

116. The United States notes that the original subsidy estimate for the 2000 cohort was reduced to reflect the fact that fewer guarantees were granted than were budgeted to be granted.[232] This is wholly irrelevant, and does not even remotely imply *profitability* for those guarantees that were actually issued in fiscal year 2000. As the data provided by the United States in its response to question 221(a) demonstrates, there is still a large positive subsidy estimate, indicating losses, for the 2000 cohort.

117. Moreover, the data provided by the United States in its response to question 221(a) shows that, as cohorts age, downward reestimates can not be assumed. In 2002, upward reestimates were made for the 1992, 1993, 1994, 1995, 1996, 1997 and 1999 cohorts. Similarly, in 2003, upward reestimates were made for the 1992, 1993, 1994, 1996, 1997, 2001 and 2002 cohorts. Brazil also notes that cohorts that are "older" than the 2000 cohort – such as the 1994, 1997 and 1998 cohorts, continue to show positive subsidy estimates, or losses.

[228] US 22 December 2003 Answers to Questions, paras. 96, 99.

[229] *See e.g.* Brazil's 22 August Rebuttal Submission, para. 113 (including notes 234-235), Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36) ("Actual historical experience of the performance of a risk category is a *primary factor* upon which an estimation of default cost is based.")).

[230] US 22 December 2003 Answers to Questions, para. 98.

[231] US 22 December 2003 Answers to Questions, para. 98.

[232] US 22 December 2003 Answers to Questions, para. 101.

118. For these reasons, the US suggestion that the 2000 cohort should be disregarded by the Panel in its item (j) analysis should be rejected.

**(i) Under the US approach, at what point in time could a Panel ever make an assessment of the programme, if it had to wait for each cohort to be completed before it could be "properly" assessed? Why is it inappropriate for the Panel to include these "most recent years" in its evaluation, as the US suggests in paragraph 199 of its 18 November further rebuttal submission? USA**

**Brazil's Comment:**

119. Brazil notes that the United States has not answered the Panel's question. In the United States' view, it is only appropriate to make an assessment of a programme under item (j) using a net present value accounting methodology once all cohorts in a period are closed. The United States specifically argues as follows:

> Not until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government.[233]

120. According to the United States, no cohort in the period 1992-2002 has yet closed. Therefore, in the United States' view, were the Panel to undertake a 10-year assessment of the CCC programmes under item (j) using a net present value accounting methodology, it could only do so for the period 1982-1991. Of course, since net present value accounting for the CCC programmes only began in 1992, following passage of the FCRA in 1990, subsidy estimate and reestimate figures would be unavailable for this period.

121. In insisting that it is necessary to wait until cohorts are closed to be used for the purposes of item (j), the United States is effectively saying that net present value accounting is not an appropriate way to assess a programme under item (j). As the United States is well aware, the whole point of net present value accounting, endorsed by the US Congress and the President of the United States in the FCRA, is to assess the costs of contingent liabilities, like guarantees, when they are issued, rather than when they are paid (on a default of the underlying loan). Brazil notes that there are important retrospective elements to the net present value accounting methodology imposed by the FCRA – initial estimates of costs and losses are based, first and foremost, on historical experience with borrowers[234], and reestimates are calculated annually to adjust initial estimates as dictated by actual results. In any 10-year period, of course, the most recent years will have been subject to fewer reestimates than the earlier years. This is not, as the United States suggests, a <u>flaw</u> in the methodology. It <u>is</u> the methodology. The methodology records what the US Congress, the US President and US government accountants agree is a more actuarially appropriate means of assessing the costs and losses of contingent liabilities like guarantees.[235]

122. The United States' rejection of net present value accounting as an accurate way to make an assessment under item (j) is particularly odd given the United States' conclusion that it would be

[233] *See e.g.* US 11 August 2003 Answers to Questions, para. 159.

[234] *See e.g.* Brazil's 22 August 2003 Rebuttal Submission, para. 113 (including notes 234-235), Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36) ("Actual historical experience of the performance of a risk category is a *primary factor* upon which an estimation of default cost is based.")).

[235] Brazil's 22 July 2003 Oral Statement, para. 128.

inappropriate "to subject the [CCC programmes] to the analytical yoke of the unique circumstances of the Polish and Iraqi defaults over 10 years ago . . ".[236]

123. The United States had previously made this assertion, albeit only with respect to Iraq.[237] The United States has offered no support whatsoever for this assertion[238], which is inaccurate in at least two respects. As Brazil has noted, these defaults were not "over 10 years ago". The US General Accounting Office reports that the losses in Iraq occurred over the period 1990-1997.[239] Nor are these defaults "unique," as the United States argues. As discussed below in Brazil's comments on the US response to question 225, the evidence regarding write-offs by the CCC (not even mentioning defaults that are not written off) demonstrates that the Iraqi and Polish defaults are not at all "unique".

124. Setting factual inaccuracies aside, if the United States wants to put post-1991 defaults on pre-1992 guarantees behind it, it should *embrace*, rather than *reject*, the net present value accounting methodology adopted in the FCRA. Using net present value accounting and the FCRA formula to make an assessment of the CCC programmes under item (j), the United States is not held accountable (in these proceedings, at least) for post-1991 defaults on pre-1992 cohorts. Post-1991 activity on pre-1992 CCC guarantees is treated separately[240], and is not in any way included in the data provided by the United States in its response to question 221(a), or by Brazil in Exhibit Bra-193. Even without the effect of the Iraqi and Polish defaults, both the United States and Brazil conclude that the CCC programmes have lost money over the period 1992-2002 (the United States puts those losses at over $230 million; Brazil at $211 million). (For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[241])

125. Rejecting the use of net present value accounting to assess the CCC programmes under item (j) does not keep the United States from cherry picking the results of the FCRA formula to make its case. According to the United States, using data for *some* cohorts that have not yet closed is acceptable, but using data for other cohorts that have not yet closed is not acceptable. Several points are clear regarding the United States' approach.

126. First, it is factually inaccurate for the United States to assert, in paragraph 103 of its response, that "trends" suggest that annual downward reestimates on older cohorts will continue and will grow. The chart included with the US response to question 221(a) indicates *upward* reestimates in 2002 *for every cohort* during the period 1992-1999. Similarly, that same chart shows *upward* reestimates in 2003 for the 1992, 1993, 1994, 1996, 1997 and 2001 cohorts. Moreover, that same chart shows "trends" of positive net subsidy estimates after adjusting for cumulative reestimates, even for cohorts that the United States considers are close to closing – 1994, 1997 and 1998. In other words, *these aging cohorts are losing money*. Thus, it is not at all factually accurate to conclude that reestimates are generally downward as a cohort ages and approaches closure, or that as a cohort approaches closure, the data suggests that it will have made money.

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[236] US 22 December 2003 Answers to Questions, para. 102.

[237] US 22 August 2003 Rebuttal Submission, para. 172.

[238] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[239] Brazil's 27 August 2003 Comments, para. 65 (and document cited at note 81).

[240] *See e.g.* Exhibit Bra-116 (Office of Management and Budget, Circular No. A-11, Section 185, p. 185-4); Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 15).

[241] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

127. Second, even if one accepts the US argument that the 2001 and 2002 cohorts should be left out of the calculation because there are not yet any "operating results" for those years (a point that is itself factually inaccurate, as addressed by Brazil above)[242], this does not explain the United States' decision to eliminate the 2000 cohort – for which it acknowledges there are "operating results" – when it concludes that "cohorts 1992-1999, taken as a whole, currently reflect a net negative reestimate (i.e., profitable performance)".[243] When the 2000 cohort is included, the data provided by the United States in the chart accompanying its response to question 221(a) show losses. This is a gross example of the cherry-picking exercise in which the United States would have the Panel engage to gerrymander a result in the United States' favour. Consistent with the Panel's duty to make an objective assessment of the facts, it should not accept this approach.

128. Third, the US approach does not tell the Panel anything about how the CCC *programmes* fare when assessed under item (j). Item (j) calls for an assessment of the entire portfolios of the *programmes* themselves.[244] In contrast, the US approach only offers some indication of how particular, carefully-selected *cohorts* are performing (and as discussed in the previous two paragraphs, the results do not even reflect profitability for those cohorts). The data provided by the United States itself demonstrates that using the net present value methodology imposed by the FCRA, premiums for the CCC guarantee *programmes* over the period 1992-2002 were inadequate to cover the operating costs and losses of the programmes, in the amount of $230 million.[245] For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[246]

129. If the Panel does not consider that net present value accounting is an appropriate way of assessing the CCC programmes under item (j), Brazil has also demonstrated that the long-term operating costs and losses of the programmes outpace premiums collected, using a *cash-basis accounting* methodology. The chart included at paragraph 165 of Brazil's 11 August 2003 Answers, reproduced below, tracks this result:

[242] US 22 December 2003 Answers to Questions, para. 99.
[243] US 22 December 2003 Answers to Questions, para. 103.
[244] *See* Brazil's 2 December 2003 Oral Statement, para. 81; Brazil's 18 November 2003 Further Rebuttal Submission, para. 248; Brazil's 27 August 2003 Comments on US Rebuttal Submission, para. 61.
[245] US 22 December 2003 Answers to Questions, chart included in response to Question 221(a). *See also* Exhibit Bra-193.
[246] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

| Fiscal year | Premiums collected (88.40) + Recovered principal and interest (88.40) + Interest revenue (88.25) | Admin. expenses (00.09) + Default claims (00.01) + Interest expense (00.02) |
|---|---|---|
| 1993 | $27,608,000 + $12,793,000 + $15,672,000[247] = $56,073,000 | $3.320,000[248] + $570,000,000[249]+ $0[250] = $573,320,000 |
| 1994 | $20,893,000 + $458,954,000 + $0[251] = $479,847,000 | $3,381,000[252] + $422,363,000[253] + $0[254] = $425,744,000 |
| 1995 | $18,000,000 + $62,000,000 + $0[255] = $80,000,000 | $3,000,000 + $551,000,000 + $10,000,000[256] = $564,000,000 |
| 1996 | $20,000,000 + $68,000,000 + $26,000,000[257] = $114,000,000 | $3,000,000[258] + $202,000,000[259] + $61,000,000[260] = $266,000,000 |
| 1997 | $14,000,000 + $104,000,000 + $26,000,000[261] = $144,000,000 | $4,000,000[262] + $11,000,000[263] + $62,000,000[264] = $77,000,000 |
| 1998 | $17,000,000 + $81,000,000 + $54,000,000[265] = $152,000,000 | $4,000,000[266] + $72,000,000[267] + $62,000,000[268] = $138,000,000 |
| 1999 | $14,000,000 + $58,000,000 + $0[269] = $72,000,000 | $4,000,000[270] + $244,000,000 + $62,000,000[271] = $310,000,000 |
| 2000 | $16,000,000 + $100,000,000 + $99,000,000[272] = $215,000,000 | $4,000,000[273] + $208,000,000[274] + $62,000,000[275] = $274,000,000 |
| 2001 | $18,000,000 + $149,000,000 + $125,000,000[276] = $292,000,000 | $4,000,000[277] + $52,000,000[278] + $104,000,000[279] = $160,000,000 |

[247] Exhibit Bra-126 (US budget for FY 1995, p. 156).
[248] Exhibit Bra-126 (US budget for FY 1995, p. 156).
[249] Exhibit Bra-126 (US budget for FY 1995, p. 156).
[250] No budget line, Exhibit Bra-126 (US budget for FY 1995, p. 156).
[251] Exhibit Bra-95 (US budget for FY 1996, p. 162).
[252] Exhibit Bra-95 (US budget for FY 1996, p. 161).
[253] Exhibit Bra-95 (US budget for FY 1996, p. 162).
[254] Exhibit Bra-95 (US budget for FY 1996, p. 162).
[255] Exhibit Bra-94 (US budget for FY 1997, p. 176).
[256] Exhibit Bra-94 (US budget for FY 1997, p. 175).
[257] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[258] Exhibit Bra-93 (US budget for FY 1998, p. 174).
[259] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[260] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[261] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[262] Exhibit Bra-92 (US budget for FY 1999, p. 105).
[263] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[264] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[265] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[266] Exhibit Bra-91 (US budget for FY 2000, p. 111).
[267] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[268] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[269] Exhibit Bra-90 (US budget for FY 2001, p. 112).
[270] Exhibit Bra-90 (US budget for FY 2001, p. 110).
[271] Exhibit Bra-90 (US budget for FY 2001, p. 111).
[272] Exhibit Bra-89 (US budget for FY 2002, p. 118).
[273] Exhibit Bra-89 (US budget for FY 2002, p. 116).
[274] Exhibit Bra-89 (US budget for FY 2002, p. 117).
[275] Exhibit Bra-89 (US budget for FY 2002, p. 117).
[276] Exhibit Bra-88 (US budget for FY 2003, p. 120).

| | | |
|---|---|---|
| 2002 | $21,000,000 + $155,000,000 + $61,000,000[280] = $237,000,000 | $4,000,000[281] + $40,000,000[282] + $93,000,000[283] = $137,000,000 |
| Total | $1,841,920,000 | $2,925,064,000 |
| **Long-term Net Cost** | **$1,083,144,000** | |

130. In Exhibit US-128, the United States has also provided data to be used for an assessment of the CCC programmes under item (j) using cash-basis accounting. As discussed further in Brazil's comment to the US response to question 222, the data offered by the United States in Exhibit US-128 leads to the same conclusion, when adjusted to account properly for the impact of rescheduling on defaults.[284]

131. Finally, an even more fundamental approach demonstrates the incredibility of the United States' assertion that "trends" suggest that the CCC programmes are making and will continue to make profits. Congressional testimony by USDA officials and reports by the US General Accounting Office demonstrate that 1990-1997 defaults on Iraqi and Polish CCC guarantees amounted to approximately $4 billion.[285] The US General Accounting Office also noted in 1995 that defaults on Russian and Former Soviet Union GSM 102 guarantees similarly reached $2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid.[286] These defaults were not, therefore, all "over 10 years ago", as the United States suggests at paragraph 102 of its 22 December 2003 response. Nor are they "unique", as the United States also suggests at paragraph 102. In addition to this $6 billion in defaults, the United States' response to question 225 cites to further "written-off" or "forgiven" defaults of $20 million. This does not, of course, account for other defaults that have not yet been written-off or forgiven.

132. *Even if premiums collected over the entire lifetime of the CCC guarantee programmes are considered, these defaults, in the amount of over $6 billion, would mean net losses in the amount of*

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[277] Exhibit Bra-88 (US budget for FY 2003, p. 118).
[278] Exhibit Bra-88 (US budget for FY 2003, p. 119).
[279] Exhibit Bra-88 (US budget for FY 2003, p. 120).
[280] Exhibit Bra-127 (US budget for FY 2004, p. 109).
[281] Exhibit Bra-127 (US budget for FY 2004, p. 107).
[282] Exhibit Bra-127 (US budget for FY 2004, p. 108).
[283] Exhibit Bra-127 (US budget for FY 2004, p. 108).
[284] At paragraph 103 of its 22 December 2003 response, the United States refers to "the uniform performance of reschedulings". The United States has offered no proof that its reschedulings are performing. Yet as the party asserting this fact, the United States bears the burden of proving it. *See, e.g.*, Appellate Body Report, *Japan – Apples*, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof."). In fact, according to the US General Accounting Office, rescheduling of GSM defaults has not historically been "performing," and has rather been in arrears. *See* Brazil's 22 August 2003 Comments, para. 99 (and note 94).
[285] *See* Brazil's 11 August 2003 Answers to Questions, para. 167 (second bullet point), *citing* Exhibit Bra-87 ("Testimony of August Schumacher Jr., Under Secretary, Farm and Foreign Agricultural Service, USDA, before the Subcommittee on General Farm Commodities, Hearing on the Asian Financial Crisis, 4 February 1998," p. 10-11) and Exhibit Bra-157 (US General Accounting Office, REPORT TO THE CHAIRMAN, TASK FORCE ON URGENT FISCAL ISSUES, COMMITTEE ON THE BUDGET, HOUSE OF REPRESENTATIVES, *International Trade: Iraq's Participation in US Agricultural Export Programs*, GAO/NSIAD-91-76 (November 1990), p. 27 (Table IV.2)). *See also* Brazil's 18 November 2003 Further Submission, para. 251.
[286] *See* Brazil's 22 August 2003 Rebuttal Submission, para. 109 (note 226), *citing* Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6). *See also* Brazil's 18 November 2003 Further Submission, para. 251.

*over $5.5 billion*.[287] Brazil emphasizes that this is just taking account of the defaults about which Brazil is aware. Brazil also notes that while the United States emphasizes the role of rescheduling in the recovery of defaults (which Brazil disputes in its comments on the US answer to question 222 below), the more than $6 billion in defaults discussed here *have not been rescheduled*, or at least where they have been (in the case of Russian and Former Soviet Union), they are in arrears.[288] This demonstrates that long-term operating un-recovered and non-recoverable costs and losses for the CCC programmes have outpaced premiums collected by a considerable amount.

133. Item (j) does not require the Panel to adopt or to reject any particular methodology to assess the CCC guarantee programmes.[289] Nor do the *facts* require the Panel to endorse any one methodology to determine that the CCC guarantee programmes constitute export subsidies under item (j). Brazil has demonstrated that under *any* methodology, properly applied, premiums for the CCC guarantee programmes over the period 1992-2002 were inadequate to cover the operating costs and losses of the programmes.

**222. For GSM 102, 103 and SCGP, please provide year-by-year amounts from 1992 to 2003 with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes. Please indicate any allocation methodologies used to calculate administrative costs. USA**

**Brazil's Comment:**

134. Exhibit US-128, provided by the United States in response to this question, allegedly demonstrates that using a cash basis accounting methodology, the CCC export credit guarantee programmes generate money. In fact, the United States claims that revenue collected outpaces total expenses for the three programmes by $666 million. Brazil has offered a similar chart at paragraph 165 of its 11 August 2003 Answers. Brazil's chart demonstrates that the CCC programmes lost $1.048 billion over the period of FY 1993-2002. The total difference between the US result and Brazil's result is $1.75 billion.

135. This figure closely corresponds to the total "Claims Rescheduled" figure reported by the United States in Exhibit US-128.[290] Indeed, the difference between the chart provided by the United States in Exhibit US-128 and Brazil's chart in paragraph 165 of its 11 August 2003 Answers lies in the treatment of rescheduled debt.[291] The United States treats defaulted guarantees that have

[287] Brazil has calculated that the highest amount of premiums that could have been generated would amount to approximately $450 million. *See* Brazil's 11 August 2003 Answers to Questions, para. 167 (second bullet point). Data included in Exhibit US-128 suggests that Brazil is over-estimating the amounts of premia collected.

[288] The US General Accounting Office noted that defaults on Russian and Former Soviet Union guarantees reached $2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid. Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6). Brazil raised this point in its 22 August 2003 Rebuttal Submission (at para. 109, note 226) and its 18 November 2003 Further Submission (para. 251). It remains unrebutted by the United States.

[289] *See* Brazil's 22 December 2003 Answers to Questions, paras. 68-75.

[290] The fact that both figures do not match exactly is explained by the fact that the United States analyses data covering FY 1992-2003 on a cohort-specific basis, while the data available to Brazil covers FY 1993-2002 and represents actual performance of the CCC programs during a given fiscal year.

[291] If the Panel were to compare all other totals, it would readily see that the totals correspond, taking into account that the US data covers FY 1992-2003 and is on the basis of cohorts, while Brazil's data covers only FY 1993-2002 and represents the actual performance of the programs in a fiscal year. Brazil does not have

been rescheduled as 100 per cent recovered on the day the terms of the rescheduling are agreed.[292] Brazil, on the other hand, has treated rescheduled claims as receivables, until they have been actually recovered.[293] Only once CCC actually collects incremental amounts on a rescheduled claim is the corresponding incremental amount of the default considered "recovered" and no longer a loss to CCC.[294] Under Brazil's approach, whatever portion of rescheduled claims is collected in a particular year is treated as a recovery, whereas under the United States' approach, the *entirety* of the rescheduled claims is treated as a recovery at the moment the terms of the rescheduling are agreed.

136. Brazil's approach is the more actuarially appropriate of the two, and is consistent with the cash-basis accounting preferred by the United States in this dispute. Under cash-basis accounting, when financial commitments are rescheduled, they would normally be re-amortized on a new, longer payment schedule that reduces the amount of each periodic payment due from the borrower. Rescheduling does not mean that a creditor *collects* on an outstanding claim – it just means that the creditor *hopes* to do so in the future by reducing the amount the borrower has to pay each month.[295] CCC, in fact, acknowledges that all it possesses following a rescheduling is a receivable, and that not all receivables are collectable.[296] (And in fact, CCC rescheduling has historically been in arrears.[297]) The US approach, therefore, overstates the effect rescheduled guarantees have on claims paid, by automatically treating rescheduled guarantees, in every instance, as actual recoveries of claims paid, at the moment the terms of the rescheduling are agreed. (Indeed, the CCC's Financial Statement for FY 2002 and 2003 confirm that rescheduling of export credit guarantee receivables covered both principle and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled.)[298]

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access to FY 2003 data, as the actual figures for that year will only be published in connection with the FY 2005 budget.

[292] *See* Exhibit US-128. The United States defines "Claims Outstanding" (G) as "Claim Payments" (D) minus "Claims Recovered" (E) minus "Claims Rescheduled" (F). It follows that a rescheduled claim no longer constitutes an outstanding claim at the moment the terms of the rescheduling are agreed. Instead, for accounting purposes, the rescheduling is simply treated as 100 percent recovered.

[293] This is the reason that Brazil treats recovered principle as a revenue inflow for accounting purposes. The principle recovered is netted against the claims paid by CCC (*see* Brazil's 11 August 2003 Answers to Questions, para. 163).

[294] Contrary to this approach, the United States nets defaults paid against the sum of recovered and rescheduled defaults (*see* Exhibit US-128). However, it only *hopes* to eventually recover rescheduled debt; the rescheduling alone does not mean it will do so.

[295] *See* Exhibit Bra-115 (US General Accounting Office ("GAO"), Report to the Chairman, Subcommittee on Criminal Justice, US House of Representatives Committee on the Judiciary, "Loan Guarantees: Export Credit Guarantee Programs' Long-Run Costs Are High," GAO/NSIAD-91-180, 19 April 1991, p. 3 (Table 1, Note *a*) ("GAO/NSIAD-91-180") (accounts receivable for the GSM programmes "[i]ncludes delinquent payments and *rescheduled debt not yet due*.") (emphasis added).

[296] Brazil's 27 August 2003 Comments on US Rebuttal Submission, para. 64.

[297] Brazil's 22 August 2003 Comments, para. 99. *See also* Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6 (noting that in 1995 defaults on Russian and Former Soviet Union guarantees reached $2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid.); Exhibit Bra-152 (GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National Security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, *Status Report on GAO's Reviews of the Targeted Export Assistance Programme, the Export Enhancement Programme, and the GSM-102/103 Export Credit Guarantee Programmes*, GAO/T-NSIAD-90-53, 28 June 1990, p. 14 (noting that historically, the majority of GSM support that is rescheduled is "in arrears.").

[298] Exhibit US-129 (CCC Financial Statements for FY 2002 and 2003 – Audit Report, USDA, Office of the Inspector General, Report No. 06401-16-FM, November 2003, Note 5, p. 22).

137. Brazil maintains its position that it is not appropriate to treat as "recovered" those losses (resulting from defaults) that were actually incurred by the CCC export credit guarantee programmes and that are rescheduled, until such a point in time when the money *actually has been recovered.* Therefore, Brazil maintains that its cash-basis formula is the appropriate one. It follows that the CCC export credit guarantee programmes suffered losses of $1.1 billion between fiscal years 1993-2002, resulting in a finding that the CCC programmes operate at premium rates inadequate to cover the long-term operating costs and losses of the programmes, within the meaning of item (j).

**223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? USA**

**Brazil's Comment:**

138. Although the United States asserts that premium rates for the GSM-102, GSM-103 and SCGP programmes are "reviewed annually"[299], it offers no evidence to support this assertion.[300] As Brazil has already noted, both USDA's Inspector General and the US General Accounting Office have noted the CCC's failure to change its premium rates or to reflect credit risk in those rates – and its inability to do so given the one-per cent fee cap included in US law – as evidence of a failure to cover costs and losses.[301]

139. The CCC guarantee programmes are unique financing instruments that are not available on the market.[302] Brazil has demonstrated that forfaits and CCC export credit guarantees are not similar financial instruments, and therefore that the terms for forfaits cannot serve as benchmarks against which to determine whether CCC export credit guarantees confer "benefits".[303] The United States has offered no evidence that the two instruments "compete as a method for trade financing over comparable tenors in similar markets …."[304] Further, the regulations for the CCC programmes belie the United States' assertion that "an importer does not necessarily realize any benefit from a CCC export credit guarantee".[305] The regulations state that the programmes operate in cases where banks "would be unwilling to provide financing without CCC's guarantee".[306] To summarize the differences between the two instruments, the essential function of a CCC guarantee is to make possible an export sale that would otherwise be impossible. A forfait, by contrast, does not make an impossible sale possible, but instead merely allows an exporter to collect its receivable without waiting for that receivable to come due.[307] This opportunity, offered by the forfait, only arises if the CCC guarantee has made the sale happen in the first place.

[299] US 22 December 2003 Answers to Questions, para. 107.

[300] As the party asserting this fact, the United States bears the burden of proving it. *See* Appellate Body Report, *Japan – Apples*, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[301] Brazil's 22 December 2003 Answers to Questions, paras. 63-64.

[302] *See* Exhibit Bra-190 (Affidavit of Marcelo Franco, Seguradora Brasileira de Crédito à Exportação).

[303] Brazil's 22 August 2003 Rebuttal Submission, paras. 103-105; Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 68-70; Brazil's 7 October 2003 Oral Statement, para. 72; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 233-241; Brazil's 2 December 2003 Oral Statement, para. 79; Brazil's 22 December 2003 Answers to Questions, paras. 65-66.

[304] US 22 December 2003 Answers to Questions, para. 109.

[305] US 22 December 2003 Answers to Questions, para. 109.

[306] Exhibit Bra-38 (7 CFR 1493.10(a)(2) (GSM 102 and GSM 103 regulations)). *See also* Exhibit Bra-38 ((7 CFR 1493.400(a)(2) (SCGP regulations)).

[307] *See, e.g.*, Brazil's 18 November 2003 Further Rebuttal Submission, para. 237.

140. Even if the two instruments were similar, the United States has not met its burden to establish (under either Article 10.3 of the Agreement of Agriculture, or as the party asserting the fact) that CCC guarantees are provided on terms no better than those offered for forfaiting instruments on the market. Although the United States curiously repeats its argument that it "does not have access to specific implicit rates available in the marketplace"[308], Brazil presented evidence regarding forfaiting fees five months ago, with its 27 August 2003 submission. That evidence demonstrates that forfaiting fees are well above fees for CCC export credit guarantees.[309] It also demonstrates that unlike CCC guarantee fees, which vary on the basis of only one factor – the length of the underlying credit – forfaiting fees additionally vary according to the risks involved in the transaction[310], as one would expect of any market-based financial instrument.

141. Similarly, export credit insurance and CCC export credit guarantees are not similar financial instruments, and therefore the terms for export credit insurance cannot serve as benchmarks against which to determine whether CCC export credit guarantees confer "benefits". The United States has acknowledged the differences between CCC guarantees and export credit insurance.[311] One critical difference, noted by the WTO Secretariat in the WTO document quoted by the United States in paragraph 108 of its 22 December 2003 response, is that premia for insurance vary according to the credit rating or risk status of both the importer and the importing country.[312] In contrast, neither importer risk nor country risk have *any* impact on the premiums payable for GSM 102, GSM 103 or SCGP guarantees.[313] Moreover, Brazil notes that while export credit insurance is indeed available for agricultural commodities, export credit insurance for agricultural commodities is limited to 360 days, or the expected/useful life of the commodity in question.[314] In contrast, CCC guarantees are available for terms of up to 10 years.[315]

142. Even if the two instruments were similar, the United States has not met its burden to establish (under either Article 10.3 of the Agreement of Agriculture, or as the party asserting the fact) that CCC guarantees are provided on terms no better than those offered for export credit insurance obtained on the market. The United States argues that "[p]rivate commercial quotes for export credit insurance are simply not available to the United States".[316] Brazil attaches two premium fee schedules: first, a fee schedule published by Export Insurance Services, Inc., a private broker for export credit insurance for small businesses offered by the US Export-Import Bank ("Ex-Im Bank") (Exhibit Bra-410); and second, a fee schedule published by Ex-Im Bank itself for export credit insurance for small businesses (Exhibit Bra-409).

143. The Panel will note that the rates in Ex-Im Bank's own fee schedule, which do not even include administrative fees that would be added by a private broker such as Export Insurance Services, exceed those offered for CCC guarantees by considerable margins.[317] When administrative

[308] US 22 December 2003 Answers to Questions, para. 109.

[309] Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 76-77 and Exhibit Bra-199 (Trade and Forfaiting Review, Volume 6, Issue 9 July/August 2003).

[310] Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 75-76.

[311] US 11 August 2003 Answers to Questions, para. 179. The United States has correctly observed that "[i]f the commercial market does not offer a particular borrower the exact terms offered by a government, then the government is providing a benefit to the recipient . . ." Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2 (para. 7) (emphasis added).

[312] G/AG/NG/S/13, para. 9.

[313] *See* US 11 August 2003 Answers to Questions, para. 184; Brazil's 11 August 2003 Answers to Questions, paras. 192, 195.

[314] Exhibit Bra-408 (Export-Import Bank, Standard Repayment Terms), p. 3 (Chart II, no. 2), 4 (second bullet point). Brazil made a similar point with respect to forfaits. *See* Brazil's 27 August 2003 Comments, para. 78.

[315] Brazil's 24 June 2003 First Submission, para. 101.

[316] US 22 December 2003 Answers to Questions, para. 109.

[317] *Compare* Ex-Im Bank schedule in Exhibit Bra-409 *with* CCC fee schedule in Exhibit Bra-155.

fees levied by a market-based institution are accounted for, the differences become even more pronounced.[318]

144. This comparison likely understates the extent to which CCC rates are below-market, for two reasons. First, government support from Ex-Im Bank does not constitute a market benchmark for the purposes of Article 1.1(b) of the SCM Agreement.[319] Nonetheless, this comparison demonstrates that the CCC guarantee programmes do not even meet *non-market* benchmarks.[320] Second, the comparison involves export credit insurance for small businesses. As noted by the US International Trade Administration's Foreign Commercial Service, export credit insurance for small businesses is offered at reduced premium rates.[321]

145. Finally, because the provisions address somewhat different disciplines and could require different means of implementation, Brazil reiterates its earlier request that the Panel find that the CCC programmes constitute export subsidies by virtue of *both* Articles 1 and 3.1(a) of the SCM Agreement *and* item (j).[322]

**224. Please indicate how the CCC's cost of borrowing was treated in the 2002 financial statement of the CCC, in Exhibit BRA 158. USA**

**Brazil's Comment:**

146. Brazil notes that it has accounted for CCC's interest expense and revenue figures (lines 00.02 and 88.25 of the US budget) in its cash-basis accounting methodology.[323]

**225. Please indicate whether there was any instance where the CCC "wrote off" debt and, if so, please indicate the accounting regulation or principle used. If a "written off" debt is subsequently recovered, do the CCC's accounts reflect both the interest cost and interest received in relation to the debt during the time it was "written off"? USA**

**Brazil's Comment:**

147. As noted in Brazil's comment on the US response to question 221(i), if the Panel uses a net present value accounting methodology to assess the CCC programmes under item (j), the United States would not be held accountable (in these proceedings, at least) for write-offs on pre-1992 cohorts. Activity on CCC guarantees issued before 1992 is not in any way included in the net present

[318] *Compare* Export Insurance Services, Inc. fee schedule in Exhibit Bra-410 (p. 6-7) *with* CCC fee schedule in Exhibit Bra-155.

[319] *See* Appellate Body Report, *United States – Countervailing Duties on EC Products*, WT/DS212/AB/R, para. 124 (Appellate Body questions whether a "fair market price" is reached when a government "shapes" the market, stating that "[t]he Panel's absolute rule of 'no benefit' may be defensible in the context of transactions between two private parties taking place in reasonably competitive markets; however, it overlooks the ability of governments to obtain certain results from markets by shaping the circumstances and conditions in which markets operate."). *See also* Arbitrator's Decision, *Brazil Aircraft*, WT/DS46/RW, para. 6.95 (One reason the Panel offered for rejecting a proposed benchmark was that the benchmark was "the direct result of a *government* guarantee," rather than an indication of the "commercial or market rate of interest."). *See also id.*, paras. 6.90-6.92, 6.104.

[320] The Panel will recall that Brazil made a similar comparison between Ex-Im Bank export guarantee fees and CCC export guarantee fees, and reached the same result. *See* Brazil's 22 August 2003 Comments, para. 110.

[321] Exhibit Bra-411 (*The Federal Scoop: US Government Financing for Service Exports*, EXPORT AMERICA (May 2000), p. 33).

[322] Brazil's 18 November 2003 Further Rebuttal Submission, para. 228.

[323] *See* Brazil's 11 August 2003 Answers to Questions, para. 165. *See also* Brazil's comments on Question 221(i), above.

value data provided by the United States in its response to question 221(a), or by Brazil in Exhibit Bra-193.[324] Even without the effect of the write-offs detailed in paragraph 114 of the US 22 December 2003 response – all of which relate to pre-1992 cohorts – both the United States and Brazil conclude that the CCC programmes have lost money over the period 1992-2002 (the United States puts those losses at over $230 million; Brazil at $211 million).[325] (For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[326])

148. Under a cash-basis accounting methodology of assessing the CCC programmes under item (j), the United States should be held accountable for write-offs and "debt forgiveness" (as defined in paragraph 113 of the US response) that occurred during the period 1992-2002, even if it relates to guarantees that were issued before 1992. Although this is not clear from the US 22 December 2003 response, to the extent that the write-offs catalogued in paragraph 114 of the US 22 December 2003 response are related to *defaults* that occurred in the period 1992-2002, Brazil presumes that the defaults themselves would be included in the line item (00.01) for default claims, which are tracked in the chart included at paragraph 165 of Brazil's 11 August 2003 Answers to Questions, and reproduced in Brazil's comments on the US response to question 221(i), *supra*. Applying a cash-basis accounting methodology, Brazil demonstrated that long-term operating costs and losses outpace premiums collected over the period 1992-2002 for the CCC programmes, by $1.083 billion.

**226. If a debt was "written off" more than ten years ago, does it still create a cost to the programme? If so, how is this reflected in the 2002 financial statement of the CCC, in Exhibit BRA 158 (or any other material)? USA**

**Brazil's Comment:**

149. As discussed in Brazil's comment on the US response to question 225, if the Panel uses a net present value accounting methodology to assess the CCC programmes under item (j), the United States would not be held accountable (in these proceedings, at least) for write-offs that occurred more than 10 years ago. The reason is that those write-offs would relate to guarantees issued prior to 1992. Activity on CCC guarantees issued before 1992 is not in any way included in the net present value data provided by the United States in its response to question 221(a), or by Brazil in Exhibit Bra-193.[327]

150. Under a cash-basis accounting methodology of assessing the CCC programmes under item (j), the United States would not be held accountable for write-offs and "debt forgiveness" that occurred more than 10 years ago (at least in this proceeding), assuming that the period of review is 1993-2002. This is because the underlying defaults would also have occurred more than 10 years ago, even before the write-offs or forgiveness.

151. However, Brazil would like to correct the United States' mischaracterization of Brazil's position about the 10-year period of review for an assessment under item (j). Brazil does not agree, as the United States asserts, that an examination beyond 10 years is "inappropriate".[328] Rather, Brazil

[324] As Brazil notes in its comment on Question 221(g), however, estimates of costs and losses made in the context of the FCRA formula are based, first and foremost, on historical experience with borrowers. Thus, prior defaults would tend to lead to positive subsidy estimates on new guarantees.

[325] *See* US 22 December 2003 Answers to Questions, response to Question 221(a); Brazil's Exhibit Bra-193.

[326] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

[327] As Brazil notes in its comment on the US response to Question 221(g), however, estimates of costs and losses made in the context of the FCRA formula are based, first and foremost, on historical experience with borrowers. Thus, prior defaults would tend to lead to positive subsidy estimates on new guarantees.

[328] US 22 December 2003 Answers to Questions, para. 102.

considers that a 10-year period is *adequate* in this case to get a picture of the performance of the CCC programmes' portfolio. If the Panel wishes to look beyond that 10-year period, Brazil does not believe that doing so would be "inappropriate". Brazil has noted that should the Panel wish to corroborate evidence showing that over the period 1992-2002, the long-term operating costs and losses for the CCC programmes outpace premiums collected, it could look to CCC's 2003 financial statements, which state that uncollectible amounts on pre-1992 CCC guarantees outpace premiums collected during the period 1981-1991 by nearly $2 billion.[329]

**227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount – referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? USA**

**Brazil's Comment:**

152. In paragraphs 117-118 of its 22 December 2003 response, the United States again rejects use of the FCRA formula as an appropriate methodology to make an assessment of the CCC programmes under item (j), since it is based on "estimates". As noted above, the United States' view is that it is only appropriate to use a net present value accounting methodology once all cohorts in a period are closed.[330] In paragraphs 117 and 121 of its 22 December 2003 response, the United States argues that the "credit guarantee liability" figure included in the CCC financial statements, which is calculated using a net present value accounting methodology, does not reflect "losses", within the meaning of item (j), but instead only estimated losses.

153. This does not stop the United States from appealing to the FCRA formula when it believes it suits its purposes to do so. In paragraph 119, the United States cites with approval the $22 million credit guarantee liability figure used in CCC's 2003 financial statements as evidence of "good performance" by the CCC guarantee programmes. Brazil notes, however, that at page 4 of the notes to its 2003 financial statements, CCC defines the term "credit guarantee liability" as "the estimated net cash outflows (loss) of the guarantees on a net present value basis".[331] Thus, the $22 million figure still represents a "loss", as does the $230 million cumulative figure listed in the chart included with the US response to question 221(a). For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[332]

154. Finally, Brazil directs the Panel's attention to the massive increase from 2002 to 2003 in the losses CCC considers it will incur at the time all post-1991 guarantee cohorts are closed. At page 15 of the notes to its 2003 financial statements, CCC estimates that when all post-1991 cohorts close, it

[329] Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 15). Brazil notes that unlike the CCC 2002 financial statements included in Exhibit Bra-158, the CCC 2003 financial statements included in Exhibit US-129 are not publicly available on the USDA website. *See* http://www.usda.gov/oig/rptsauditsccc.htm.

[330] *See e.g.* US 11 August 2003 Answers to Questions, para. 159 ("Not until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government.").

[331] Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 4).

[332] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

will have lost $1.16 billion (as opposed to the $770 million it reported in its 2002 financial statements).[333]

**228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? BRA, USA**

## V. SERIOUS PREJUDICE

**229. What is the meaning of the words "may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the *SCM Agreement*? Please comment on the possibility that these words indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice and that serious prejudice should be considered an additional or overriding criterion to the factors specified in the subparagraphs. BRA**

**230. Please comment on Brazil's views on Article 6.3 of the *SCM Agreement* as stated in paragraphs 92-94 of its further submission. USA**

**231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the *SCM Agreement* are relevant context for the Panel's interpretation of Article 6.3? USA**

**Brazil's Comment:**

155. For the reasons Brazil has previously articulated, Brazil disagrees that Article 6.1 and Annex IV of the SCM Agreement are relevant context for interpreting the present text of Part III of the SCM Agreement.[334]

156. The US 22 December 2003 response to Question 243 confirms the fundamental role that Annex IV plays in its analysis of actionable subsidies in Part III of the SCM Agreement. The United States treats Annex IV as if the title of the Annex were "Calculation of the Total Ad Valorem Subsidization for Subsidies Subject to Part III of the Agreement". But all participants know and agree that Annex IV is dead. If it were not, then Brazil's submissions would certainly have been far more concise, as the total *ad valorem* subsidization for the US subsidies is 95 per cent over the four-year period of investigation.

157. The US reference in paragraph 131 of its 22 December 2003 Answer to Question 231 to the Appellate Body report in *US – CVD's on EC Products* is inapposite. That case involved countervailing duty measures, not actionable subsidy measures and claims under Part III of the SCM Agreement. The Appellate Body's citation to Annex IV was in the context of citing to a long list of SCM provisions that refer to the "recipient" of a "benefit" in the SCM Agreement. The Appellate Body did not, as the United States seeks to do in this case, use Article IV as the sole legal basis for the wholesale inclusion of countervailing duty methodologies into Part III of the SCM Agreement.

158. In paragraph 132 of its 22 December 2003 Answer, the United States continues to make the assumption that contract payments are "not tied to the production of upland cotton". As a factual

[333] Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 15). The United States reports that premiums of $246 million were collected on CCC guarantees over the period 1992-2003. *See* Exhibit US-128.

[334] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 96-107; Brazil's 2 December 2003 Oral Statement, paras. 4-6.

matter, Brazil has demonstrated that contract payments *are* tied to the production of upland cotton.[335] The evidence of much higher upland cotton per-acre payments, among many other facts, demonstrates that the *de jure* "flexibility" is, in practice, not exercised by upland cotton producers[336], and that the bulk of the upland cotton contract payments are paid to current upland cotton producers.[337]

159. More importantly, while the United States repeats its calls for Brazil to implement various allocation methodologies in paragraph 132 of its 22 December 2003 Answers to Questions, it refuses to provide the information that would allow Brazil or the Panel to even perform a calculation using the flawed US methodology based on Annex IV. And the United States is just plain wrong to suggest in paragraph 132 of its 22 December 2003 response that Brazil has "refus[ed] to countenance any allocation of the decoupled payments it has challenged … ". Brazil's 20 January 2004 Answer to Question 258 explained in greater detail in Brazil's methodology for allocating the payments.[338] Brazil even demonstrated that applying the US allocation methodology with the flawed and incomplete US 18/19 December 2003 data resulted in levels of support to upland cotton that were consistent with Brazil's 14/16$^{th}$ Methodology.[339]

**232. How, if at all, should the Panel take into account the effects of other factors in its analysis of the effects of US subsidies under Article 6.3? If the Panel should compare the effects of other factors to establish the relative significance of one compared to others, how would this be done? What would be relevant "factors" for this purpose? BRA**

**233. In Brazil's view, what is or are the "same market(s)" for the purposes of Article 6.3(c)? Does Brazil's view of "world market" imply that regardless of which domestic (or other) "market" is examined, price suppression will be identifiable? BRA**

**234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"? USA, BRA**

[335] *See* Brazil's 22 August 2003 Rebuttal Submission, Section 2.2 and references included therein. *See* also Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

[336] *See* Brazil's 22 August 2003 Rebuttal Submission, Section 2.2 and references included therein. *See* also Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

[337] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.1; Brazil's 28 January 2004 Comments and Request Regarding US Data, Section 9. *See* also Brazil's comment on Question 205, above.

[338] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[339] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 10.

**Brazil's Comment:**

160. The US 22 December 2003 response again ignores the determination of the panel in *Indonesia – Automobiles*, which found that the term "significant" in Article 6.3(c) required examination of a link between the size of the margins of undercutting and whether those margins could "meaningfully affect suppliers of the imported product".[340] Under this "meaningfully affect" standard, the focus, at least for the purposes of Article 6.3(c)[341], is on producers of the non-subsidized like product. Have their revenue, investments, or crop choices been "meaningfully affected" by the level of price suppression experienced? These are the types of questions that provide guidance as to whether a particular level of price suppression is significant or not. The notion of "meaningfully affect" and "serious prejudice" are, in essence, equivalent for the purpose of Article 6.3(c).

161. The US 22 December 2003 response to Question 234, at paragraph 136, states that "[t]he use of the term 'significant' however, would seem to be intended to prevent insignificant price effects from rising to the level of serious prejudice." But this statement presumes some sort of an objective standard exists by which to judge what are "insignificant price effects". The United States provides no suggestions how this Panel or future panels are to make such an abstract determination. The United States' position implies that the "Panel will know them when they see them". But the Article 6.3(c) test, at least, requires the Panel to make an assessment of the relationship between the price effects and serious prejudice. And this link is to be judged by whether the price effects are "significant".

162. The Panel should firmly reject the two-step process suggested by the US interpretation. The first step would require a finding, using some unknown, non-textual standard, of whether a particular price level of suppression is "significant". Evidence that Brazilian producers would have lost $71.5 million during MY 1999-2002 from only one cent per pound of price suppression[342] would be totally irrelevant for the first step.[343] Only if a panel makes this "significant" finding, divorced from any impact on producers, would it move to the second step, *i.e.*, whether that level of now-significant price effects caused serious prejudice. But such an interpretation, like many proposed by the United States in this dispute, would leave Members who lost millions of dollars due to the effects of subsidies without a remedy. There is no textual basis for such a result, which would be contrary to the object and purpose of the SCM Agreement. In sum, the Panel should adopt the *Indonesia – Automobiles* standard of judging significance in light of whether the particular level of price suppression "meaningfully affects" non-subsidized suppliers of the like product.[344]

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[340] "Although the term "significant" is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that *margins of undercutting so small that they could not meaningfully affect suppliers of the imported product* whose price was being undercut are not considered to give rise to serious prejudice…" (emphasis added). Panel Report, *Indonesia – Automobiles*, WT/DS54/R, para. 14.254.

[341] Brazil notes that Articles 6.3(a), (b) and (d) do not contain similar qualitative or quantitative qualifiers.

[342] Brazil's 9 September 2003 Further Submission, para. 258 (citing a $143 million loss from a 2 cents per pound level of price suppression).

[343] A good example of evidence that would be irrelevant under the first part of the US test is found in the testimony of Christopher Ward. He indicated that a 10 percent increase in prices for Mato Grosso producers in MY 2000 and MY 2001 would have permitted them to cover their variable costs for MY 2001 and come close to covering variable costs in MY 2000. However, because of the losses they suffered without such revenue increases, many Mato Grosso producers reduced production or were forced out of cotton production. Mato Grosso production fell by 34 per cent between MY 2000 -2001. Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, paras. 8-10 and accompanying graph).

[344] The US example of a per-unit payment of 0.0001 cents per pound in paragraph 136 is irrelevant, because under its hypothetical, this particular level of price suppression could never "meaningfully affect" any suppliers of the like product.

163. But even if the Panel decides to adopt some sort of numerical standard not reflected in the text of Article 6.3(c), Brazil has also set forth evidence showing that the levels of price suppression found by a number of different economists are "significant".[345] In assessing whether the various levels of price suppression found by USDA and other economists are "significant," the Panel should take into account the fact that upland cotton is a primary commodity traded in huge volumes and produced and consumed in a large number of countries. Under these circumstances, any measurable and identifiable effect on the *world* price from the subsidies provided by a single Member is important. In this case, the Panel is faced with particularly compelling facts – during MY 1999-2002 (and even during MY 1997-1998) the record shows that the absolute numerical levels of price suppression caused by some or all of the US subsidies were significant, ranging from 4 to 26.3 per cent of the world price, and 10 to 33.6 per cent of the US price.[346]

164. Finally, the United States argues in paragraph 136 that the effect of Brazil's interpretation is that any production subsidy would run afoul of Part III of the SCM Agreement, thus turning it into a prohibited subsidies provision. There is no basis for this argument. First, it is difficult to see how extremely low levels of production subsidies (0.0001 cents per pound price effects in the US example) could "materially affect" any competing producers of the non-subsidized Member. Only production subsidies that generate price suppression significant enough to "materially affect" competitors would be subject to the disciplines of Part III. This is far from an insignificant threshold, and gives meaning to the word "significant".

165. Second, this US argument is similar to other arguments it has made to the effect that any limitations on the amount of subsidies would change "actionable" subsidies to "prohibited" subsidies.[347] The United States loses sight of the basic fact that an actionable subsidy that creates adverse effects is a violation of WTO rules. No Member has the right to provide unlimited production subsidies *if* they cause serious prejudice. Members deciding to impose discretionary or mandatory limits on the amount of production subsidies may significantly diminish the possibility that such subsidies create significant price suppression or an ongoing threat of serious prejudice. But it is wrong for the United States to argue that because the only practical way to impose limitations on production subsidies may be some sort of a cap on such subsidies necessarily an actionable subsidy is turned into a "prohibited subsidy".[348]

**235. Please comment on paragraphs 8, 9 and 10 of the US 2 December oral statement, in particular, why the average Brazilian price is shown as lower than the average US price. BRA**

**236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share". USA**

**Brazil's Comment:**

166. Brazil considers it telling that the United States does not provide the percentage figures underlying the chart at paragraph 138 of its 22 December 2003 response. This is because the percentage figures reveal that the US methodology suffers from a fatal flaw. The sum of the US world market share, as defined by the United States[349], and the "rest of the world" market share, as

[345] Brazil's 9 September 2003 Further Submission, Table 22; Brazil's 7 October Oral Statement, paras. 30-34.

[346] See Brazil's 9 September 2003 Further Submission, paras. 148-161, 190, 200-232, 254, 379-384 and Table 23.

[347] US 2 December 2003 Oral Statement, paras 83-84.

[348] US 2 December 2003 Oral Statement, paras 83-84.

[349] "(Domestic Mill Use + Exports)" / Total World Consumption; *see* US 22 December 2003 Answers to Questions, para. 137.

defined by the United States[350], far exceeds 100 per cent. To clarify this point, Brazil presents the following table, based on the data provided by the United States in Exhibit US-47 and in response to question 197.[351]

| | US Domestic Consumption | US Exports | World Consump-tion | Non-US[352] Domestic Consumption | Non-US Exports | US Share[353] | Non-US Share | Total Share |
|---|---|---|---|---|---|---|---|---|
| | | | million bales | | | | per cent | |
| 1995 | 10.647 | 7.675 | 86.040 | 75.393 | 19.900 | **21.29** | **110.75** | **132.05** |
| 1996 | 11.126 | 6.865 | 88.031 | 76.905 | 20.100 | **20.44** | **110.19** | **130.63** |
| 1997 | 11.349 | 7.500 | 87.138 | 75.789 | 19.300 | **21.63** | **109.12** | **130.76** |
| 1998 | 10.401 | 4.298 | 84.640 | 74.239 | 19.400 | **17.37** | **110.63** | **128.00** |
| 1999 | 10.194 | 6.750 | 90.957 | 80.763 | 20.600 | **18.63** | **111.44** | **130.07** |
| 2000 | 8.862 | 6.740 | 92.172 | 83.310 | 19.800 | **16.93** | **111.87** | **128.79** |
| 2001 | 7.696 | 11.000 | 94.381 | 86.685 | 18.100 | **19.81** | **111.02** | **130.83** |
| 2002 | 7.270 | 11.900 | 97.930 | 90.660 | 18.700 | **19.58** | **111.67** | **131.25** |
| 2003 | 6.200 | 13.200 | 97.690 | 91.490 | 19.100 | **19.86** | **113.20** | **133.06** |

167. Indeed, as the Panel can readily see, the "rest of the world" "world market share", as defined by the United States, exceeds 100 per cent – a result that defies any logic.

168. For the ease of the Panel's reference, Brazil presents an excerpt from its own figures originally presented in Exhibit Bra-302,[354] showing that, under Brazil's and USDA's definition of the "world market share," the total world market share equals 100 per cent.

[350] "(Non-US Domestic Mill Use (*i.e.* consumption) + Non-US Exports) / Total World Consumption.

[351] US 22 December 2003 Answers to Question, para. 15 and Exhibit US-120. Since the United States did not provide any data on "Non-US Exports," Brazil has used USDA published figures on "Foreign Cotton Exports" from USDA's Cotton and Wool Yearbook (Exhibit Bra-412 (Cotton and Wool Situation and Outlook Yearbook, USDA, November 2003, Table 16).

[352] "World Consumption minus US Domestic Consumption."

[353] The 2003 figure differs a little from what would seem to be the 2003 figure in the US table at paragraph 138 of the US 22 December 2003 Answers to Questions. It appears that the reason is the United States use of its non-updated figures from Exhibit US-47, rather than the updated MY 2002 and 2003 figures from its 22 December 2003 response to Question 197, para. 15.

[354] *See* also Brazil's 27 October 2003 Answers to Questions, paras. 123-129.

| | US upland cotton exports | Non-US upland cotton exports | World upland cotton exports | US Share | Non-US Share | Total Share |
|---|---|---|---|---|---|---|
| | | million bales | | | per cent | |
| 1995 | 7.375 | 19.394 | 26.769 | 27.55 | 72.45 | 100.00 |
| 1996 | 6.399 | 19.384 | 25.783 | 24.82 | 75.18 | 100.00 |
| 1997 | 7.060 | 18.534 | 25.594 | 27.58 | 72.42 | 100.00 |
| 1998 | 4.056 | 18.559 | 22.615 | 17.94 | 82.06 | 100.00 |
| 1999 | 6.303 | 19.805 | 26.108 | 24.14 | 75.86 | 100.00 |
| 2000 | 6.303 | 19.170 | 25.473 | 24.74 | 75.26 | 100.00 |
| 2001 | 10.603 | 17.072 | 27.675 | 38.31 | 61.69 | 100.00 |
| 2002 | 11.266 | 15.796 | 27.062 | 41.63 | 58.37 | 100.00 |
| 2003 | 11.225 | 17.690 | 28.915 | 38.82 | 61.18 | 100.00 |

169. Brazil will address the US arguments that the world market share means share of world consumption in detail in its comments on the following questions.

**237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? BRA, USA**

**Brazil's Comment:**

170. As noted in its 22 December 2003 response to this question, Brazil agrees that a phenomenon that remains at approximately the same level over a given period cannot be considered a consistent trend.[355] However, as detailed in that answer, this is not the situation facing this Panel. The data clearly establishes that, in MY 2001, 2002 and 2003, there is an increase in the US world market share over the previous three-year average, and that this increase follows a consistent trend since MY 1996 (and MY 1986).[356] In response to this question, the United States again relies on an utterly wrong interpretation of the term "world market share" in Article 6.3(d) of the SCM Agreement. The term

[355] Brazil's 22 December 2003 Answers to Questions, para. 134.

[356] Brazil's 22 December 2003 Answers to Questions, paras. 133-139; Brazil's 27 October 2003 Answers to Questions, paras 123-129. Brazil further notes the new information presented by the United States concerning US upland cotton exports in MY 2002 and 2003. These figures (11.9 million bales and 13.2 million bales respectively) would replace Brazil's latest information, as contained in Exhibit Bra-302 (11.3 million bales and 11.2 million bales respectively). These new facts strengthen Brazil's threat of serious prejudice claim under Article 6.3(d) and footnote 13 of the SCM Agreement. *See* US 22 December 2003 Answers to Questions, para. 15 and Brazil's comment to US 22 December 2003 Answer to Question 197, above.

does not mean "world consumption share", but world market share of exports, as detailed by Brazil many times, including in these comments.

**238. According to the US interpretation of the term "world market share":**

**(a) should the domestic consumption of closed markets be added into the denominator?**

**Brazil's Comment:**

171. Brazil understands that the Panel's question referred to the distinction between "competitive markets," where world upland cotton producers/exporters compete for available share of world exports, and "closed markets", where no competition for export market share can take place because of subsidies like the domestic Step 2 programme, tariffs, or non-tariff barriers.[357] The US 22 December 2003 response, at paragraph 140, affirms that the United States would greatly increase and distort the Article 6.3(d) denominator by including, *inter alia*, all sales of US upland cotton in the US market. Yet, there is little "international trade" in the US domestic upland cotton market, because there were only marginal imports during MY 1999-2002.[358] The effect of the US argument is to obscure and hide the huge volume and market share increase in US exports in "competitive" markets during MY 1998-2003. As Brazil has argued, the US focus on "consumption" as opposed to "trade" is contrary to the text, context, and object and purpose of Article 6.3(d).[359] Article 6.3(d) focuses on "trade", not domestic consumption, and thus involves competitive world markets where exports and trade take place.[360]

172. It is noteworthy that the US answer ignores un-rebutted evidence that USDA's top economists and analysts repeatedly use the phrase "world market share" to describe and analyze how US agricultural exporters are performing in competitive world markets for exports.[361] The United States never provided a single instance in which USDA economists – or any other Member's economists – included domestic US consumption in their analysis of the US "world market share". This is because the unique US notion of "consumption" (which combines exports, domestic use, and imports as part of "consumption") simply does not exist (in the literature or trade statistics) outside of the US arguments in this case.

**(b) if US production and consumption increased by the same percentage, whilst the rest of the world's production and consumption remained steady, would this imply an increase in the US "world market share" by a different percentage?**

**Brazil's Comment:**

173. The US 22 December 2003 response in effect acknowledges, at paragraph 142, that the US subsidies could be subject to a challenge under Article 6.3(d) even though those subsidies did not cause any increase in US exports. Under the US theory, even though none of the non-subsidized producer/exporters of upland cotton would have lost any world export market share, these producers could initiate a claim against the United States under Article 6.3(d), in addition to Article 6.3(a), because the US domestic production and domestic consumption increased. This US response

[357] Brazil detailed its arguments concerning the focus of Article 6.3(d) on competitive markets and where "trade" takes place in its 7 October 2003 Oral Statement, paras. 38-41.

[358] For example, between MY 1999-2001, US imports represented only 0.2 percent of total US mill use of upland cotton. *See* Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4-5).

[359] Brazil's 7 October 2003 Oral Statement, paras 38-41; Brazil's 27 October 2003 Answers to Question, paraa. 202-206; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 170-172; Brazil's 2 December 2003 Oral Statement, paras. 62-65.

[360] Brazil's 7 October 2003 Oral Statement, para. 39.

[361] Brazil's 7 October 2003 Oral Statement, note 78.

highlights the disconnect between its theory and the reality of what Article 6.3(d) really is about – the impact of subsidies on trade in the product in question in competitive international markets.

174. Of course, the Part III of the SCM Agreement discipline addressing the Panel's hypothetical factual situation is Article 6.3(a). The United States argues in paragraph 143 that "Brazil's approach … would allow a larger or even dominant upland cotton consumer to provide huge per-unit production subsidies that increased the share of its own domestic consumption that its production supplied *without any disciplines under Article 6.3(d)*, regardless of the impact on other Members who could potentially supply that increasing domestic consumption" (emphasis added). But what the US-posited hypothetical outlines is a classic "displacement or impedence" case under Article 6.3(a). "But for" the "huge per-unit production subsidies", the non-subsidized Member exporters would have increased or maintained their export market share in the market of the subsidizing Member. Thus, interpreting Article 6.3(d) to mean the "world market share of exports" does not leave non-subsidized Member producers who are squeezed out of the subsidizing Member's market without a remedy. And the fact that Article 6.3(d) does not *also* discipline the situation covered by Article 6.3(a) is hardly surprising, since negotiators presumably intended different provisions to cover different situations.

175. Indeed, the US argument in paragraph 143 highlights the fallacy of its interpretation. It argues that "the ordinary meaning of 'world market share' in Article 6.3(d) … would capture impacts both on the market of the subsidizing Member (as in Article 6.3(a)) and in third-country markets (Articles 6.3(b) and 6.3(c))".[362] But if that were true, then there would be no need for Articles 6.3(a) and 6.3(b).[363] The US interpretation would render one of the sets of disciplines a nullity, in violation of the customary rules of treaty interpretation as codified in the *Vienna Convention*.

176. Finally, rather than capturing all the possible instances where subsidies can cause serious prejudice in world markets, the US "consumption" interpretation of "world market share" leaves a gaping hole in the serious prejudice remedies. The facts of this case show how the US interpretation would completely hide the huge US increase in world market share of exports – from 25 per cent in MY 1999 to 41.6 per cent in MY 2002. Where a Member uses subsidies to capture export market share in the competitive world market, it causes serious prejudice by limiting the opportunities for non-subsidized Members to increase their exports.[364] The record shows that African upland cotton producers, with among the lowest world production costs, actually *lost* world market share to the United States between MY 1998-2002.[365] Yet, the US interpretation of Article 6.3(d) would deny them, as well as Brazil, any remedy to challenge such an increase in the US world market share of exports.

[362] US 22 December 2003 Answers to Questions, para. 143.

[363] Article 6.3(a) disciplines the situation described in the Panel's question: a Member using subsidies to increase the share of domestic consumption satisfied by domestic supply (*i.e.*, displacing or impeding imports into the market of the subsidizing Member). Article 6.3(b) disciplines such effects of a Member's subsidies (displacing or impeding exports) in a third country market. Article 6.3(c) disciplines significant price effects of a Member's subsidies in all markets. Brazil's 2 December 2003 Oral Statement, para. 63.

[364] *See* Brazil's 9 September Further Submission, paras. 451-456; paras 444-453 (facts supporting the interconnected relationship between the serious prejudiced due to price suppression and the serious prejudice due to increased world market share); Annex III Statements by Brazilian producers Christopher Ward, Jaime Naito, Aloysio Lerner and Ronaldo Spirlandelli de Oliveria, among others.

[365] Brazil's 9 September 2003 Further Rebuttal Submission, Section 7.1 and Figure 26 following para. 282.

**(c) does Saudi Arabia have a small world market share for oil? USA**

**Brazil's Comment:**

177. Contrary to the US 22 December 2003 response, Brazil has no difficulty appreciating the relevance of the Panel's question. Even accepting the US figures, which include Saudi Arabian consumption of crude oil to produce refined products that are then exported, the US response highlights the significant (25 per cent) difference between their "consumption" methodology and a world market share of exports methodology.[366]

**239. How does the US respond to Brazil's assertions that, under the US interpretation of the term "world market share":**

**(a) there would be no WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports? (see paragraph 64 of Brazil's 2 December oral statement);**

**Brazil's Comment:**

178. The US 22 December 2003 response confirms Brazil's arguments that the US interpretation leaves no direct remedy for a Member who either loses or is not able to increase its world market share of exports as a result of another Member's subsidies.[367] The United States asserts in paragraph 147 of its answer, that Article 6.3(b) provides such a remedy. But that provision only addresses a non-subsidizing Member's right to contest the effects of subsidies in, *inter alia*, increasing a subsidizing Member's export market share in an *individual* third country market. The *EC – Sugar Exports I (Australia)* and *EC- Sugar Exports II (Brazil)*[368] disputes demonstrated how difficult it can be for a non-subsidizing Member to demonstrate displacement or impedence in an individual third country market. Article 6.3(d) helped to address this legal vacuum by providing clear, objective guidelines for subsidizing Members to know when their increase in world market share of exports would be subject to disciplines, and to provide an objective basis for the injured non-subsidized exporting Member to evaluate and protect its rights.

179. The United States further argues, in paragraph 147 of its response, that Article 5(a) of the SCM Agreement would provide a remedy for a non-subsidized Member who lost world market share in exports. But while that provision relates to "injury to the domestic industry of another Member", footnote 11 of the SCM Agreement qualifies that the "injury" "is used in the same sense as it is used in Part V". "Injury" is defined in Article 15.1 *et seq.* of the SCM Agreement as that caused by (a) the volume of the subsidized *imports* and the effect of the subsidized imports on prices in the domestic market for like products, and (b) the consequent impact of these imports on the domestic producers of such products. In the context of this dispute, this remedy would appear to apply only to US subsidized exports to the Brazilian market (*i.e.*, the "domestic" market). Contrary to the US argument, Article 5(a) would not address the situation covered by Article 6.3(d), where Brazilian exporters suffer serious prejudice by an increase in the US world market share of exports.

180. Finally, the United States claims, at paragraph 147 of its response, that Article XVI:1 of GATT 1994 would provide Brazil with the right to challenge the US world market share for exports. Brazil agrees that GATT Article XVI:1, as read in conjunction with GATT Article XVI:3, provides for a very analogous recourse as that provided for in Article 6.3(d), *i.e.*, any subsidies that increase exports and lead to an inequitable share of world export trade. But the United States contradicts itself

[366] US 22 December 2003 Answers to Questions, para. 145.
[367] *See e.g.* Brazil's 2 December 2003 Oral Statement, para. 64.
[368] GATT Panel Report, *EC – Sugar Exports I (Australia)*, L/4833 – 26S/290, para. 4.26-4.27*;* GATT Panel Report, *EC – Sugar Exports II (Brazil)*, L/5011-27S/69, para. 414.

in offering up an Article XVI:1 remedy (which is inexorably linked to Article XVI:3, second sentence) in paragraph 147, while arguing elsewhere that this provision is no longer applicable and has been replaced by Article 6.3.[369]

181. In sum, the Panel is left with the US interpretations that (a) there is no longer any disciplines for a Member suffering from a decrease in its world market share for exports under Article XVI:3, second sentence on the one hand[370], and (b) Article XVI:3's presumed successor, Article 6.3(d), does not apply to the world market share of exports. In effect, Members are left without any explicit protection for their loss of world market share of exports due to massive subsidization. Such a result defies the text, context, and object and purpose of Article 6.3(d), as Brazil has repeatedly argued.

182. In any event, whether there may be – outside Article 6.3(d) of the SCM Agreement – indirect disciplines that may provide some relief to non-subsidizing Members whose rights have been nullified and impaired by a subsidizing Member's increase in world market share of exports does not free the Panel from its obligation to interpret the term "world market share" in Article 6.3(d) in accordance with its "ordinary meaning, in their context and in light of the treaty's object and purpose". Brazil demonstrated that under a *Vienna Convention* analysis, the term "world market share" means world market share of exports – not consumption.[371]

**(b) a Member's exports would have to be disregarded in calculating their "world market share" in terms of "world consumption"? (see e.g. paragraph 65 of Brazil's 2 December oral statement) USA**

**Brazil's Comment:**

183. In paragraph 148 of its 22 December 2003 response, the United States does not address the substance of the Panel's question or Brazil's earlier arguments. That is, the United States does not respond to the fact that its methodology double counts exports as part of the world market share of the exporting country *and* the importing country.[372] In effect, the United States requires this Panel to ignore this illogical conceptual error in its interpretation of the term "world market share". Instead, the United States insists that it is not incumbent upon the Panel "to interpret the term 'domestic consumption'".[373] Brazil agrees, but that is because the term "domestic consumption" is nowhere to be found in the text or context of Article 6.3(d) of the SCM Agreement. Nor is it consistent with the object and purpose of Article 6.3(d). But since the United States would read "consumption" into that text, then the Panel must closely examine its meaning, using appropriate context to do so. And it should reject the use of that term if it leads to an interpretation that is illogical, leads to absurd results, and otherwise fails to live up to the standards on the interpretation of international treaties, as set out in the *Vienna Convention*.

**240. Does Article XVI:3 of GATT 1994 provide context in interpreting Article 6.3(d) of the *SCM Agreement*? Do these provisions apply separately? If not, could it indicate that "world market share" is intended to mean the same as "share of world export trade"? USA**

[369] US 22 December 2003 Answers to Questions, para. 149.
[370] US 22 December 2003 Answers to Questions, para. 146.
[371] Brazil's 7 October 2003 Oral Statement, paras. 38-41; Brazil's 27 October 2003 Answers to Question, para. 202-206; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 170-172; Brazil's 2 December 2003 Oral Statement, parass 62-65.
[372] The United States admits that its methodology counts imports as part of domestic consumption. *See* US 22 December 2003 Answers to Questions, Table at para. 15 and note 24.
[373] US 22 December 2003 Answers to Questions, para. 148.

**Brazil's Comment:**

184. Regarding the first question, Brazil has previously detailed the basis for its arguments that Article XVI:3, second sentence of GATT 1994 provides very important context for interpreting Article 6.3(d).[374] In response to the Panel's second question, Brazil has demonstrated that these provisions do apply separately, for the reasons Brazil has earlier stated.[375] With respect to the third question, the phrase "world market share" in the text of Article 6.3(d) is intended to mean the same thing as "share of world export trade".[376]

185. The United States points out several differences between Article XVI:3 and Article 6.3(d), one of which is its faulty interpretation that Article XVI:3, second sentence only deals with "export" subsidies. Brazil has earlier demonstrated that the pool of subsidies that could cause serious prejudice is the same for Article 6.3(d) and Article XVI:3, second sentence.[377]

186. The United States further argues that Brazil agreed in the Tokyo Round Subsidies Code that GATT 1994 Article XVI:3 is limited to export subsidies.[378] This is not correct, as demonstrated by the text of the Tokyo Round Code.[379] It uses the language "shall include" and "export subsidy" in connection with the notion of a more than equitable share of world trade.[380] Thus, an inequitable share of world trade may result from export subsidies, but it is not limited to that source. Moreover, whatever the interpretation of these terms may have been in the now extinct plurilateral Tokyo Round Subsidies Code, the only text that continues to exist is the ordinary meaning of the words used in Article XVI:3, second sentence, which must be interpreted according to its ordinary meaning in its context, and in light of the object and purpose of the GATT. Yet, the United States argues that even that provision is "incapable of definition or application".[381]

187. The United States argues in paragraph 151 that the use of the term "market" provides the fundamental key to its interpretation. The US argument would include *all* markets where upland cotton is produced, consumed, or used when it states that Article 6.3(d) is *not* limited to "markets in international trade". But this argument ignores the fundamental focus of Article 6.3 (as well as Part III of the SCM Agreement itself) on *international* trade and the impact of subsidies on *competition* between subsidized and non-subsidized producers and their products. For example, Article 6.3(a) involves situation, in which exporters are impeded or displaced from the market of the subsidizing Member. Articles 6.3(b) and 6.4 involve the situation, in which the export share of a subsidizing Member squeezes out or limits the export share of the non-subsidizing Member in a third

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[374] Brazil's 18 November 2003 Further Rebuttal Submission, para. 172.

[375] Brazil's 27 October 2003 Answer to Question 161, para. 130 and Question 196(b), paras. 202-206.

[376] Brazil's 18 November 2003 Further Rebuttal Submission, paras 170-172; Brazil's 7 October Oral Statement, paras. 38-41.

[377] Brazil's 27 October 2003 Answer to Question 185, paras. 194-201; Brazil's 18 November 2003 Further Rebuttal Submission, paras 178-179.

[378] US 22 December 2003 Answers to Questions, para. 149.

[379] US 27 October 2003 Answers to Questions, para. 130. For purposes of Article XVI:3 of the General Agreement and paragraph 1 above:

> (a) "more than an equitable share of world export trade" shall include any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets;
>
> (b) with regard to new markets traditional patterns of supply of the product concerned to the world market, region or country, in which the new market is situated shall be taken into account in determining 'equitable share of world export trade'[.]

[380] *See* US 27 October 2003 Answers to Questions, para. 130.

[381] US 22 December 2003 Answers to Questions, para. 149; US 27 October 2003 Answers to Questions, paras. 131-132.

country market. And the United States has argued that Article 6.3(c) only involves situations, in which prices are suppressed in markets where competition between the subsidized products and the non-subsidized like products take place.[382] In essence, the key to initiating a claim under all three of these provisions is demonstrating that "trade" and "competition" have been affected through the use of subsidies.

188. The Panel must ask how is it possible that Articles 6.3(a) – (c) only apply to situations where international trade and competition actually take place (or are impeded from taking place), while Article 6.3(d) is totally different – it is to be read without any reference to competition and trade *at all*? The United States asserts that the "world" in "world market share" means the "entire world," without regard to whether there is trade or competition between subsidizing Member products and those of non-subsidizing Members.[383] But this slavishly literal reading goes too far. Brazil submits that read in this context, along with the other contextual provisions such as "trade" in footnote 17 of the SCM Agreement, and Article XVI:3, second sentence, that the US interpretation is simply wrong.

189. The United States further argues, at paragraph 149 of its response, that "Brazil has not offered any objective definition" of "equitable share". This is incorrect.[384] Further, the fact that certain GATT and WTO provisions express disciplines in broad terms, such as "equitable" or "reasonable" or "serious" or "significant," does not mean that a treaty interpreter can simply throw up his or her hands and find, as the United States urges, that a provision is incapable of interpretation. Article 31 of the *Vienna Convention* provides that "the words of a treaty are to be given their ordinary meaning, in their context and in light of the treaty's object and purpose".[385] Further, the Appellate Body held in *US – Gasoline* that "an interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility".[386] Thus, the Panel should reject this US attempt to condemn Article XVI:3.

190. However, should the Panel decide that GATT Article XVI:3, second sentence is, indeed, inapplicable, then this certainly strengthens the basis for the Panel to interpret the phrase "world market share" in Article 6.3(d) as meaning the "share of world export trade". It is inconceivable that negotiators – who certainly did not expressly terminate the application of Article XVI:3, second sentence – would also intend, without making it explicit, that there would be no disciplines for subsidies that allowed Members to seize world market share of exports in competitive markets.

**241. How does the US reconcile its data on consumption for 2002 in US Exhibit 40, Table 1 with the "consumption" data it refers to in its 30 September submission, paragraph 34, Exhibit US-47 or US-71? USA**

**Brazil's Comment:**

191. The US 22 December 2003 response appears to have clarified that the graph in paragraph 34 of its 30 September 2003 Further Submission relates to US finished cotton fibre consumption, while the "consumption" referred to in Exhibits US-40, US-47 and US-71 relates to upland cotton lint consumption by US textile mills. Brazil has demonstrated the irrationality of the US world market share of upland cotton consumption data in terms of Article 6.3(d). Brazil has also demonstrated the irrelevance of the US arguments concerning the US consumption of finished textile products.[387]

[382] US 18 November 2003 Further Rebuttal Submission, paras. 37-40.
[383] US 22 December 2003 Answer to Questions, para. 151.
[384] Brazil refers the Panel and the United States to its oral answers to the Chairman's questions during the October 2003 meeting of the Panel, paragraphs 17-18 of Brazil's 9 October 2003 Closing Statement, and paragraphs 189-193 of Brazil's 27 October 2003 Answers to Questions.
[385] Appellate Body Report, *US. – Gasoline,* WT/DS2/AB/R, p. 17.
[386] Appellate Body Report, *US – Gasoline*, WT/DS2/AB/R, p. 23.
[387] Brazil's 7 October 2003 Oral Statement, para.25.

**242. How much of the benefits of PFC, MLA, CCP and Direct Payments go to land owners? If not all of the benefits go to land owners, what proportion goes to producers? USA**

**Brazil's Comment:**

192. The Panel's question is set out in a section entitled "Serious Prejudice" and uses the word "benefit" relating to contract payments. Brazil will address its comments to the US 22 December 2003 response in two senses of the word "benefit". First, Brazil will address its comment with respect to the definition of the term "benefit" as it is used in Article 1.1(b) of the SCM Agreement. Second, the question also appears to address "benefit" in a more generic sense, as it relates to the effects of contract payments on US production, exports, and the world price of upland cotton. Brazil believes it is this second sense of the term "benefit" to which the Panel's question was directed. However, the United States' answer concludes by asserting that "35 per cent of the value of decoupled payments would benefit upland cotton producers"[388], suggesting that it interpreted the Panel's question as directed at the term "benefit" in the sense of Article 1.1(b) of the SCM Agreement. The United States also suggests that the remaining 65 per cent of the US contract payments do not constitute a benefit within the meaning of Article 1.1(b) of the SCM Agreement.

"*Benefit" under Article 1.1(b) of the SCM Agreement*

193. As set forth below, for the purposes of Article 1 of the SCM Agreement, the record shows that 100 per cent of contract payments are paid to the bank accounts of current upland cotton producers on terms that constitute "benefits".

194. Under the 2002 FSRI Act, direct and counter-cyclical payments are *only* paid to "producers on farms for which payment yields and base acres are established".[389] "Producers" are defined in the Act as "an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop and is entitled to share in the crop availability for marketing from the farm, or would have shared had the crop been produced". A similar definition of "producer" existed for the 1996 FAIR Act.[390] As implemented, USDA acknowledges that contract payments "are paid only to farm operators rather than farmland owners, with payment benefits split between the operator and owners in the case of crop-share rental arrangements".[391] Thus, the only "landlords" or "owners" who directly receive contract payments are those who are producers of upland cotton, *i.e.*, those that share in the risk of producing an upland cotton crop.[392] The USDA study further states that "[t]he operators' receipt of the PFC payments compensates for higher land costs that may result from the effects of the PFC programme".[393]

195. Brazil has proved that without the receipt of the PFC, market loss assistance, direct and counter-cyclical payments in their bank accounts, US upland cotton producers could not meet their costs – including their lease and land-related costs. Even if these current producers may subsequently write checks to their landlords who do not share in the risk of producing a crop, that does not mean that the subsidies that the producers are legally entitled to receive from USDA do not provide them with a "benefit", within the meaning of Article 1.1(b) of the SCM Agreement, as the United States appears to argue. Rather, the full amount of the payment is made to the current producers.

[388] US 22 December 2003 Answers to Questions, para. 158.
[389] Exhibit Bra-29 (Sections 1103 and 1104 of the 2002 FSRI Act).
[390] Exhibit Bra-28 (Section 111(b) of the 1996 FAIR Act).
[391] Exhibit US–78, p. 44.
[392] *See* Brazil's 22 July 2003 Oral Statement, para. 57; Brazil's 22 August 2003 Rebuttal Submission, paras. 19, 24.
[393] Exhibit US–78, p. 44.

196. The Appellate Body has held that a "benefit" exists if a financial contribution is received by a "recipient" or a "producer" of the subsidized good on terms more favourable than those available to the recipient in the market.[394] Producers of US crops who have contract base acreage receive these payments from USDA. In *Canada – Aircraft*, the Appellate Body established that "a benefit does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient", noting that "the term benefit, therefore, implies that there must be a recipient".[395] The Appellate Body in *US – CVD's on EC Products* held that "the focus of any analysis of whether a 'benefit' exists should be on 'legal or natural persons' instead of on productive operations".[396] Contrary to the US arguments, it is legally irrelevant for purposes of determining the existence of a "benefit" under the SCM Agreement whether a benefit received by a "recipient" is subsequently transferred to other non-recipients.

197. The United States' 22 December 2003 response continues its efforts to transform this dispute into a countervailing duty investigation based on now-defunct Annex IV of the SCM Agreement. The United States alleges in paragraph 158 of its 22 December 2003 response that only 35 per cent of PFC, market loss, CCP and direct payments "would benefit upland cotton producers". If the United States is using the word "benefit" in the sense of Article 1.1(b) of the SCM Agreement, then the statement is legally as well as factually wrong. As Brazil has demonstrated above, 100 per cent of the four types of contract payments are paid to the bank accounts of current upland cotton producers. Thus, there is no doubt that each of the four contract payment subsidies confers a "benefit" to upland cotton producers.

198. Finally, even if this case was a countervailing duty investigation, under existing CVD procedures, 100 per cent of the contract payments – not 35 per cent – would be allocated across the production value of the producers. This is, again, because, first, the total amount of benefits to the company producing the subsidized goods would be calculated. No deductions are made depending on how the subsidy is used by the recipients (*i.e.*, to pay rents). 100 per cent of the subsidy is countervailable. Only in case the subsidy is not *de facto* tied to the production of the subsidized product, is there in a second step an allocation of the benefit (100 per cent) over the total value of the company's production.

*Use of "benefit" to assess the amount of subsidies that could cause serious prejudice*

199. The more likely use of the term "benefit" in the Panel's question is the extent to which contract payments contributed to and will contribute to the serious prejudice suffered by Brazil. In other words, to what extent do contract payments enhance and support the production and exports of US upland cotton, and to what extent do they suppress world prices? Brazil has produced evidence, *inter alia*, through Professor Sumner's analysis, that the contract payments have various effects on production, exports and world prices. The isolated effects of these contract payments are less than those created by the marketing loan programme. Brazil acknowledged that one reason why the serious prejudice effects of PFC payments are relatively small is because a certain percentage of the payments were capitalized into land values and subsequently into land rents.[397] Brazil noted that this

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[394] In *Canada – Aircraft*, the Appellate Body found that:

> …the word "benefit", as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, *the marketplace provides an appropriate basis for comparison* in determining whether a "benefit" has been "conferred" because the trade distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market."(emphasis in original and underlining added)

Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 157; The same language is included in Appellate Body Report, *US – CVD's on EC Products*, WT/DS212/AB/R, para. 106.

[395] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 154.

[396] Appellate Body Report, *US – CVD's on EC Products*, WT/DS212/AB/R, para. 110.

[397] Brazil's 27 October 2003 Answer to Question 179, paras. 164-167.

evidence is supported by Professor Sumner's conclusions because significant amounts of the PFC payments (approximately two thirds) were available to generate production effects.[398] Finally, Brazil also demonstrated that the total USDA-estimated increase in land values from PFC payments translated into less than one per cent of an upland cotton producers' total costs.[399]

200. The United States 22 December 2003 response now claims for the first time that only 35 per cent of the value of decoupled payments benefited upland cotton production during the period of investigation.[400] Having asserted this fact, the United States bears the burden of proving it.[401] But even a cursory look at the evidence proffered by the United States shows that this assertion is simply not true.

201. The US assumption is that every dollar of every contract payment placed into the bank accounts of producers *leasing* land (approximately 65 per cent of upland cotton land is "leased" or "rented") is immediately required to be paid to non-producer landlords.[402] The United States produced no evidence that 100 per cent of even PFC payments (let alone market loss assistance, direct or counter-cyclical payments) to cash rent cotton producers were consumed by increased rents during the period of investigation or since contract payments began in 1996.[403] Further, the United States produces no evidence that 65 per cent of the upland cotton land is cash-rented. In fact, only 25 per cent of the US upland cotton land is cash-rented, whereas 40 per cent is share-rented.[404] As established above, share-rent lease agreements mean that the landlord is considered a producer of upland cotton. Therefore, even under the flawed US theory, much more than just 35 per cent, in fact at least 75 per cent, should be considered benefits to upland cotton producers.

202. But do the facts even support the US allegation that rents increased because of the contract payments? Indeed, the most recent USDA cotton cost of production data shows that the opportunity cost of land decreased from $58.33 per acre in MY 1997 to $46.76 per acre in MY 2002.[405] This data was reinforced by testimony in 2001 by the NCC President, who disagreed with the suggestion that "the payments that we are receiving are increasing land values or holding them up".[406] Instead of PFC payments, the NCC President stated his belief that the "strong economy outside of agriculture … has supported land values … ".[407] This cotton-specific cost data and testimony by the recipients of PFC payments contradicts the US "35 per cent" assumption.

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[398] Brazil's 27 October 2003 Answer to Question 179, para. 167.

[399] Brazil's 27 October 2003 Answer to Question 179, para. 167.

[400] US 22 December 2003 Answers to Questions, para. 157.

[401] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[402] US 22 December 2003 Answers to Questions, para. 158.

[403] Furthermore, even cash-rent landlords also make decisions that affect production such as land levelling, irrigation installation and related investments. Therefore benefits to landlord have significant effects on yields and acreage planted to cotton.

[404] Exhibit Bra-16 (Characteristics and Production Costs of US Cotton Farms, USDA, October 2001, p. 23).

[405] Exhibit Bra-323 (Costs and Returns of US Upland Cotton Farmers, MY 1997-2002, USDA).

[406] Exhibit Bra-41 (Congressional Hearing, "The Future of the Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, Testimony of Robert McLendon, p. 21). Mr. McLendon responded to a question by Congressman Dooley who stated: "I am concerned that a significant portion of that is going to be capitalized in rents, land values – and, you know, I hope we find ways in which we can structure our program so … we can actually see asset valuations that are more commensurate with actual market conditions … ."

[407] Mr. McLendon was accompanied at the Congressional Hearing by now-President of the NCC, Mark Lange (then Chief NCC Economist), who said nothing to contradict Mr. McLendon's sworn testimony. *See* Exhibit Bra-41 (Congressional Hearing, "The Future of the Federal Farm Commodity Programs (Cotton)," House of Representatives, 15 February 2001, p. 6).

203. It is also possible to test the US "35 per cent" assumption by examining non-cotton-specific cash rent and land value data. If the US assumption were correct, then cash land rents for cropland in states where upland cotton is produced should have increased significantly since the guaranteed PFC payments started in MY 1996. Further, it would be presumed, if the United States is correct, that 65 per cent of all the PFC upland cotton-related payments (as well as the other three contract payments) were captured by increased cash rents for cropland during MY 1996-2002. But this is simply not the case, as demonstrated below.

204. USDA carefully tracks cropland cash rents in all US states. In almost all of the 16 states where cotton is produced, land rents for cropland increased only slightly between MY 1996 and MY 2003.[408] This is in contrast to the value of cropland which increased to a far greater extent.[409] The United States seeks to have the Panel assume that both cropland values and cash rents increased significantly by stating, in paragraph 156 of its 22 December 2003 response, that "land rent data … follows the same trend" as land values. This is a misleading statement because, while cash rents increased, they did so at a much lower rate. For example, in Texas, cash rents for land increased 13.5 per cent ($18.50 to $21.00 per acre) during 1996-2003 while the value of an acre of cropland increased 28 per cent, from $674 in 1997 to $937 in 2003.[410] The increase in cash rents in Texas is less than the inflation rate (17 per cent) for the seven-year period.[411]

205. Cash rents in other US states producing upland cotton increased by similar amounts:[412]

| US State[413] | Cash Rent 1996 | Cash Rent 2002 | Difference | Percentage Change |
|---|---|---|---|---|
| Texas | $18.50 | $21.00 | $2.50 | 13.5 per cent |
| Oklahoma | $25.60 | $27.00 | $1.40 | 5.5 per cent |
| Arkansas | $48.80 | $53.00 | $4.20 | 8.6 per cent |
| Louisiana | $53.00 | $57.00 | $4.00 | 7.5 per cent |
| Mississippi | $45.00 | $54.00 | $9.00 | 20.0 per cent |
| Alabama | $39.00 | $36.00 | - $3.00 | -7.7 per cent |
| Florida | $30.00 | $32.00 | $2.00 | 6.7 per cent |
| Georgia | $36.40 | $39.00 | $2.60 | 7.1 per cent |
| South Carolina | $23.80 | $28.50 | $4.70 | 19.7 per cent |

[408] Exhibit Bra-413 (USDA, NASS "Agricultural Cash Rents, July 1999, p. 2-3); Exhibit Bra-414 (USDA, NASS "Agricultural Land Values and Cash Rents," August 2003, p. 12-13.)(examining cropland cash rent values).

[409] Exhibit Bra-415 (USDA, NASS, "Agricultural Land Values", April 1999, p. 4); Exhibit Bra-414 (USDA, NASS, "Agricultural Land Values and Cash Rents," August 2003, p. 12-13).

[410] Exhibit Bra-413 (USDA, NASS "Agricultural Cash Rents, July 1999, p. 2-3); Exhibit Bra-414 (USDA, NASS "Agricultural Land Values and Cash Rents", August 2003, p. 12-13.)(examining cropland cash rent values).

[411] http://woodrow.mpls.frb.fed.us/research/data/us/calc/ ($1.00 in 1996 is worth $1.17 in 2003).

[412] Exhibit Bra-413 (USDA, NASS "Agricultural Cash Rents, July 1999, p. 2-3); Exhibit Bra-414 (USDA, NASS "Agricultural Land Values and Cash Rents", August 2003, p. 12-13.)(examining cropland cash rent values).

[413] Data for several other states is distorted by the fact that cash rents for irrigated land, which is not used for upland cotton production, are shown.

206. As the figures demonstrate, the increase in cash rents is below the inflation rate of 17 per cent in most of the states. The highest numerical increase between 1996 and 2002 is $9 in Mississippi. Being extremely conservative, Brazil has assumed that this Mississippi increase represents the increase in cash rents for all US upland cotton cropland. It follows that for MY 2002 (with 13.8 million acres planted to upland cotton) and with about 25 per cent of upland cotton land cash-rented, these $9 mean that $31 million of the total of $454.5 million[414] in direct payments found their way into increased cash rents for upland cotton land.[415] Thus, USDA's own data shows that only 6.8 per cent of the MY 2002 direct payments could have been attributable to increased cash rents – not 65 per cent as the United States asserts.

207. It should be noted that none of this analysis includes CCP payments. If CCP payments were included with direct payments, the percentage share would be even lower. Generally, the United States agrees that cash rents also reflect long-term expectations about crop prices and programme benefits. While direct payments are paid regardless of prices, CCP payments vary with prices. Therefore, one can expect that the payments will be discounted by a margin reflecting the uncertainty about the availability of CCP payments in future years for which cash rents are fixed.

208. The United States claims that cash rents are "sticky" and do not respond quickly to the increased net revenue from the use of the land.[416] The United States further suggests that the estimated 34-41 per cent of PFC payments captured for MY 1997 as set out in an August 2003 ERS study will be higher for later years.[417] But the evidence outlined above suggests that cash rents for cropland did not increase significantly between MY 1996-2002, and thus do appear to reflect to any considerable extent the effects of PFC or other contract acreage payments. The US assertion amounts to speculation, as the authors of the August 2003 study properly acknowledge.[418] Cash rents may be just as easily, if not more, affected by expected low prices for upland cotton, as suggested by the NCC President[419], or other factors such as interest rates. The absence of evidence of significant cash rent increases more than seven years after enactment of the 1996 FAIR Act suggests that whatever production effects from direct payments and CCP payments exist presently will continue to exist in the future – supporting Brazil's threat of serious prejudice claims.

209. The above discussion has focused on PFC payments, since that is the only type of contract payment for which the United States presented evidence. However, the United States "35 per cent" assumption also was made regarding CCP payments and market loss assistance payments.[420] The Panel will look in vain for any evidence produced by the United States that only 35 per cent of MY 2002 CCP payments benefited upland cotton producers who cash rent upland cotton cropland. Because CCP payments are triggered on a year-by-year basis depending on low prices for upland cotton, a non-producing landlord cannot know in what amount CCP payments will be made. Further, as Brazil has demonstrated repeatedly, given the high non-land-related production costs involved in producing cotton, most US producers simply could not profitably produce cotton without CCP

[414] Brazil's 22 December 2003 Answer to Question 196, para. 8.
[415] 13.8 million acres times 0.25 times $9 equals $31,050,000.
[416] US 22 December 2003 Answer to Question 242, para. 157.
[417] US 22 December 2003 Answer to Question 242, para. 157.
[418] Exhibit Bra-310 ("The Incidence of Government Program Payments on Agricultural land Rents: The Challenges of Identification," Roberts, Kirwan, Hopkins, p. 769) ("It could be … [and] [m]ore research is needed to verify these incidence estimates to ascertain the time it takes for rents to reflect changes in associated government payments and to measure how incidence is ultimately capitalized into land values.").
[419] Exhibit Bra-41 (Testimony of Roberto McLendon, p. 7)("I think people that are professional farm managers have been concerned for the last 2 or 3 years that we are going to have a decrease in land values because they saw it in the 1980's. We had low prices and a bad situation. Again, in my opinion, we have had such a strong economy outside of agriculture it has supported land values, but that support won't last forever … .")
[420] US 22 December 2003Answer to Question 242, para. 158.

payments. Therefore, there is little, if any, basis for a non-producing landlord to demand increased rents to capture CCP payments.

210. The evidence that is before the Panel indicates that every eligible upland cotton producer planting on upland cotton base acreage (approximately 75 per cent of such producers), received a CCP check in MY 2002.[421] The record shows that the high costs of these producers meant that they had to use this money to cover their production costs, including the costs related to the cash rents they were required to pay. Thus, in an immediate "cover your annual costs" sense, 100 per cent of the payments each year of the period of investigation "benefited" the producers of upland cotton.[422]

211. Similarly, the United States provides no evidence concerning how much of the market loss assistance payments during MY 1998-2001 did not benefit upland cotton farmers. Brazil demonstrated that all producers (not non-producing landlords) planting on upland cotton or other base acreage were entitled to receive market loss assistance payments. The producers had the legal right to receive these payments. Thus, the United States did not meet its burden of showing that only 35 per cent of the market loss payments "benefited" upland cotton production.

212. Finally, the United States provides no evidence to support its argument that only "35 per cent" of the amount of direct payments under the 2002 FSRI Act "benefit" producers of upland cotton. As Brazil demonstrated, in MY 2002, US cotton producers needed all of the direct payment subsidies to cover their production costs and to re-coup losses from MY 2001.

213. Brazil recalls its showing that even under the US approach, the percentage should be 75 per cent rather than 35 per cent, *i.e.*, including land that is owned or share rented by producers. However, also for producers that cash rent their upland cotton land, not all of their contract payments are capitalized in land values and translated into higher cash rents. Thus, by far the greatest portion of contract payments is available to cause production effects along the lines discussed in the literature and by Professor Sumner[423], as well as by Brazil.[424]

214. In conclusion, 100 per cent of the contract payments paid to, received, and deposited in the accounts of current "producers" of upland cotton (applying Brazil's allocation methodology) in MY 1999-2002 constituted a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement.[425] The relevant issue regarding "benefit" to production is not, as the United States argues, the amount of the funds paid; this dispute does not involve a countervailing duty investigation. Rather, the focus of any generic "benefit" analysis is on the *effects* of the subsidies. The record shows that the various types of contract payments stimulated US production of upland cotton to different extents, ranging from 15 per cent for PFC payments to 40 per cent for CCP payments, as estimated by Professor Sumner.[426]

**243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? USA**

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[421] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.1, para. 23; Brazil's 9 September 2003 Further Submission, paras. 59-331; Brazil's 22 August 2003 Rebuttal Submission, para. 50 *citing* Exhibit Bra-173 (Revised Estimate of Support Granted by Commodity via Counter-Cyclical Payments).

[422] Brazil's 27 October 2003 Answers to Question 125(c), paras. 15-25.

[423] Brazil's 9 September 2003 Further Submission, Annex I, paras. 37-42 and Exhibits Bra-280 and Bra-345 (paras. 18-34).

[424] Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

[425] Similarly, 100 per cent of the contract payments, as allocated by Brazil, were "support to" upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.

[426] Brazil's 9 September 2003 Further Submission, Annex I, paras. 43-51.

**Brazil's Comment:**

215. Contrary to the assumption permeating the US 22 December 2003 response, Brazil reiterates that there is no legal requirement for a claimant under Part III of the SCM Agreement to quantify on an *ad valorem* basis the amount of the challenged US subsidies.[427] Annex IV – which the US response shows is the *only* legal basis for its arguments – is dead. Even when alive, it only applied to Article 6.1(a), not Article 6.3 of the SCM Agreement. The Panel's obligation under Part III of the SCM Agreement is to conduct an objective assessment of the evidence regarding the "effects" of the challenged subsidies. This means it must first examine the evidence regarding whether each of the supports is a "financial contribution," confers a "benefit," and is "specific".

216. Detailing the precise amount of the financial contribution ending up in the bank accounts of US upland cotton producers is not a legal pre-requisite to Brazil's actionable subsidy claims. If the Panel finds that Brazil is legally required to examine the exact *amount* of the subsidies in order to assess their "effects," then it need only ask why the United States has refused to produce the evidence to determine such an amount.[428] In the absence of the most accurate evidence, withheld by the United States, Brazil refers the Panel to evidence and the allocation of the amount of "support to upland cotton" it has presented in the peace clause portion of its various submissions.[429] This evidence is part of the record pursuant to Brazil's alternative arguments and is offered as evidence of the amount of such subsidy payments.

217. With the above-referenced qualifications, Brazil would answer the Panel's question with a qualified "yes". First, Brazil agrees with the United States' assumption, in paragraph 159 of its 22 December 2003 response, that the full amount of marketing loan payments for upland cotton production "benefits" US producers even if they also produce other crops. The logic of the US assumption means that the full amount of crop insurance and Step 2 payments, which are also *de jure* linked to production, sale or export of upland cotton, would "benefit" upland cotton production. With respect to contract payments, Brazil's allocation methodology first considers every acre of upland cotton grown on an acre of upland cotton contract base to "benefit" (or constitute "support to") upland cotton.[430] In other words, Brazil's allocation methodology does assume that all such cotton to cotton matches do "benefit" upland cotton, regardless of the other agricultural production of the farm.[431] Brazil notes that the cotton to cotton matches accounts for most of the contract payments to current upland cotton producers.[432] However, for those cotton producers growing cotton on non-upland cotton base acres, Brazil does *not* ignore other agricultural production of the particular farm. Rather, it allocates the payments attributable to upland cotton based on the overall composition of programme crops for that particular farm.[433] Of course, Brazil's methodology could not be fully applied because of the refusal of the United States to produce the necessary farm-specific information.[434]

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[427] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 96-107; Brazil's 2 December 2003 Oral Statement, paras. 4-6. *See* also Brazil's comment on Question 231, above.

[428] US 18 and 19 2003 December Letters to the Panel; US 20 January 2004 Letter to the Panel; *See* also Brazil's 28 January 2004 Comments and Requests Regarding US Data.

[429] These facts are summarized in Annex 1 to Brazil's 9 October 2003 Closing Statement, but are also contained in a number of Brazil's earlier submissions to the Panel beginning with its 24 June 2003 First Submission; S*ee* also Brazil's 18 November 2003 Further Rebuttal Submission, Sections 2.1 and 2.4; Brazil's 2 December 2003 Oral Statement, Sections 5.1 and 5.3.

[430] Brazil's 20 January 2004 Answers to Additional Questions, para. 47.

[431] Brazil's 20 January 2004 Answers to Additional Questions, paras. 44-48.

[432] *See* Electronic PFC and DCP Summary Files provided on 18 and 19 December 2003 respectively. *See* also Brazil's 18 November 2003 Further Rebuttal Submission, paras. 22-24.

[433] Brazil's 20 January 2004 Answers to Additional Questions, paras. 48-55. Thus, contrary to the US assertions in the last sentence of paragraph 163, Brazil does not advocate allocating a non-tied payment across the total value of the recipients production.

[434] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Sections 4, 8 and 9.

218. The US 22 December 2003 response highlights the differences between the parties on how to allocate the "benefit" for payments made under the four types of contract payments. Further, the US response reflects the parties' differences over whether the quantification exercise is relevant for the peace clause "support to cotton," or whether it is instead relevant for assessing Brazil's claims under Part III of the SCM Agreement.

219. Brazil's position is that the allocation[435] of contract payments is required in the peace clause portion of the proceeding. Brazil has set forth in considerable detail the factual evidence supporting the *de facto* link between the contract payments and the production of upland cotton.[436] Brazil further provided considerable detail concerning its allocation methodology and the application of that methodology.[437] Brazil even attempted to apply the US "across the value of the farm" methodology, based on the incomplete and scrambled US data.[438] Brazil presented extensive legal arguments supporting the requirement under Article 13(b)(ii) to collect and tabulate any and all support for a specific commodity such as upland cotton.[439] For example, Brazil's 22 August 2003 Rebuttal Submission stated:

> [T]he phrase "support to a specific commodity" … read in its context, requires the Panel to tabulate any non-green box domestic support payments that are linked in some manner to the production of upland cotton. Contrary to the US arguments,[440] there is nothing in the text of Article 13(b)(ii) limiting the support to only that provided to a single commodity. Nor does the text limit support to only that *requiring* a recipient to produce or to produce a specific commodity as the United States alleges.[441] Rather, it requires examining whether a specific commodity receives support from a domestic support measure identified in the chapeau of Article 13(b) and whether there is some sort of link between the support at issue and the specific commodity.[442] Thus, the question of "support to a specific commodity" is fundamentally a factual question requiring an examination of different types of support set out in the *chapeau* of Article 13(b).[443]

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[435] Brazil's 11 August 2003 Answer to Question 40 provided detailed analysis regarding the application of its 14/16th methodology. Brazil explained in its Rebuttal Submission that: "Necessarily, this process requires allocation of support that may be provided to producers of more than one type of agricultural product, but which is not provided to producers *in general*." *See* Brazil's 11 August Answer to Question 40. An allocation process is also required with respect to Annex 3 paragraph 7 support to processors of agricultural products," 'to the extent that such measures benefit the producers of the basic agricultural product." Brazil's 22 August 2003 Rebuttal Submission, note 33.

[436] The United States has refused to produce the most relevant information – the precise amount of contract payments received by current US upland cotton producers. Brazil summarized much of the available evidence, demonstrating that the contract payments are, *de facto*, tied to the production of upland cotton, in its 9 October 2003 Closing Statement, Annex I.

[437] Brazil's 11 August 2003 Answer to Question 40. Brazil's 22 December 2003 Answer to Question 258, paras. 43-55; Brazil's 28 January 2004 Comments and Requests Regarding US Data, Sections 9 and 10. *See* also Brazil's 11 August 2003 Answer to Question 40. An allocation process is also required with respect to Annex 3 paragraph 7 support to processors of agricultural products," 'to the extent that such measures benefit the producers of the basic agricultural product." Brazil's 22 August 2003 Rebuttal Submission, note 33.

[438] Brazil's 28 January 2004 Comments on Data Provided by United States, Section 10.

[439] *See* Brazil's 22 August Rebuttal Submission, paras. 13-22; Brazil's 22 August 2003 Comments on US Answers, paras. 48-53, 58, 61; Brazil's 11 August 2003 Answers to Questions, paras. 54-55, 57-58, 61-64, 66-72, 129-132; Brazil's 24 July 2003 Closing Statement, para. 8; Brazil's 22 July 2003 Oral Statement, paras. 13-26; Brazil's 24 June 2003 First Submission, paras 130-134.

[440] US 11 August Answer 2003 to Question 38, para. 81.

[441] US 11 August 2003 Answer to Question 38, para. 81.

[442] *Compare* Brazil's 11 August 2003 Answer to Question 41, paras. 57-58.

[443] Brazil's 22 August 2003 Rebuttal Submission, para. 14.

220. The US 22 December 2003 response reiterates, in paragraphs 161-163, the US peace clause arguments that the absence of any *requirement* to produce upland cotton in the statutory provisions of the 1996 and 2002 Farm Acts for direct and counter-cyclical payments (as well as PFC and market loss assistance payments) completely insulates these subsidies from any actionable subsidy challenge during the implementation period. Brazil demonstrated how this extremely narrow US "production requirement" test is contrary to the *chapeau* of Article 13(b)(ii), contrary to the context of Annex 2, paragraph 6(e), contrary to the context of Annex 3, paragraphs 10, 12, and 13, and contrary to the context of the AMS definition in Article 1(a) (referring to "in general").[444] Brazil also demonstrated that the US "production requirement" test is contrary to the object and purpose of the Agreement on Agriculture, because it carves out huge amounts of amber box subsides from any discipline of the SCM Agreement during the implementation period.[445]

221. The United States argues, at paragraph 163 of its 22 December 2003 response, that Brazil's allocation methodology "eliminates the concept of non-product specific support for purposes of the peace clause since a non-tied payment may always be allocated according to the recipient's production". Brazil notes again its fundamental disagreement with the US assumption that $935.6 million in CCP payments and $454.5 million in direct payments paid in MY 2002 to current producers of upland cotton are "untied" subsidies.[446] The overwhelming evidence in the record shows they are *de facto* "tied" to upland cotton production.[447] Further, the United States incorrectly assumes that "non-product specific support" is the language set out in Article 13(b)(ii). The actual text is "support to a specific commodity", which requires the tabulation – and allocation if necessary – of any and all support provided to producers, users, or exporters of a particular product. The test is not whether the domestic support *requires* production, but rather whether the domestic support provides support for the production of a particular commodity.[448]

222. Further, as Brazil noted in its 11 August 2003 response, all of the domestic support measures challenged by Brazil have an "upland cotton specific link in terms of historic, updated, or present upland cotton acreage, present upland cotton production or prices, or upland cotton groups of insurance policies or other specific upland cotton provisions"[449] The ordinary meaning of the terms "non-product specific" support that is provided "in general" is support to producers of all or almost all commodities or agricultural products, such as irrigation, state credit programmes, and other infrastructure subsidies such as farm roads. Thus, even if the peace clause test were "product-specific support," Brazil's interpretation does not read out any meaning to "non-product specific support".

223. In sum, Brazil's methodology for allocating the various subsidy payments that "benefit" or "support" upland cotton is reasonable and based on an extensive factual record demonstrating the link between such payments and current upland cotton production. If the United States disagreed, it was required to do more than simply assert the *de jure* form of the legal instruments of the contract payments. Rather, it must produce the farm-specific evidence that would permit a detailed assessment of the "other agricultural production" (and the value) of each producer of upland cotton. It has refused to do so. Therefore, the US 22 December 2003 response to Question 243, besides being

[444] *See*, in particular, Brazil's 22 August 2003 Rebuttal Submission, paras. 15-22 (legal arguments), as well as factual evidence regarding each direct payment subsidy, in paras. 24-52. Since August, Brazil has presented considerable additional evidence establishing the *de facto* link between each type of contract payment and the production of US upland cotton. *See* Annex 1 of Brazil's 9 October 2003 Closing Statement; Brazil's 27 October 2003 Answers to Questions, paras. 7-26, 37-40; Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5; Brazil's 2 December 2003 Oral Statement, Section 5.3.

[445] Brazil's 22 July 2003 Oral Statement, paras. 21-25.

[446] Brazil's 22 December 2003 Answers to Question 196, para 8.

[447] *See e.g.* Brazil's 9 October 2003 Closing Statement, Annex I; Brazil's 27 October 2003 Answers to Question 125(2)(a), paras. 7-25; Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

[448] Brazil's 22 August 2003 Rebuttal Submission, paras. 15-22.

[449] Brazil's 11 August 2003 Answer to Question 41, paras. 57-58.

largely legally and factually wrong, is an astounding display of hubris in light of the US refusal to produce the very evidence that would permit the application of the methodology it advocates.

**244. What proportion of the 2000 cottonseed payments benefited *producers of upland cotton,* given that payments were made to *first handlers,* who were only obliged to share them with the producer to the extent that the revenue from sale of the cottonseed was shared with the producer? (see 7 CFR §1427.1104(c) in Exhibit US-15). BRA**

**245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? BRA, USA**

**246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? BRA, USA**

**Brazil's Comment:**

224. The Panel is well aware that Brazil considers Article 5 and its reference to "any" subsidy to require the Panel to take prohibited subsidies into account for a serious prejudice claim.[450] There is no contradiction between the implementing obligations of a Member under Articles 4.7 and 7.8 of the SCM Agreement. Thus, the Panel must take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the SCM Agreement.

**247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? BRA, USA**

**Brazil's Comment:**

225. Brazil's 22 December 2003 response to this question covers most of the points raised in the US 22 December 2003 response. In response to the US argument at paragraph 149 that the Panel's terms of reference as well as Brazil's threat claims are limited to subsidy payments up to, but not after, 18 March 2003, Brazil refers the Panel to its Comments to Question 194 above, and to its 20 January 2004 Answer to Questions 257(ii), at paragraphs 17-22. Brazil has, further, responded to improper use of futures prices at the time of planting, instead of the adjusted world price, in its Comments to Questions 212 and 213, above.

**VI. STEP 2**

**248. In respect of the level of Step 2 payments in certain time periods, the Panel notes, *inter alia,* footnote 129 in the US first written submission; footnote 33 in the US 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? BRA, USA**

**Brazil's Comment:**

226. Brazil notes the US admission that one of the reasons for the elimination of the 1.25 cent threshold is to "correct for some long term changes in the valuation of currencies".[451] Thus, the United States effectively admits that Step 2 payments cause US exports to increase despite the

[450] Brazil's 22 December 2003 Answers to Questions, para. 147; Brazil's 27 October 2003 Answers to Questions, paras. 108-110.

[451] US 22 December 2003 Answers to Questions, para. 171.

appreciation of the US dollar. In fact, the United States has never rebutted the considerable evidence that one of the main effects of the US upland cotton subsidies is to cause US exports of upland cotton to increase even when the US dollar is appreciating rapidly.[452]

**249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":**

**(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer?[453] How, if at all, would this be relevant for an analysis of the issue of export contingency under the *Agreement on Agriculture* or the *SCM Agreement*? BRA**

**(b) How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do *not* go directly to the producer? USA**

**(c) What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. USA**

**VII. REMEDIES**

**250. Does Brazil seek relief under Article XVI of *GATT 1994* in respect of expired measures? What type of recommendation would the Panel be authorized to make? (Brazil further submission, paragraph 471 (iii)) BRA**

**251. In light, *inter alia*, of Article 7.8 of the *SCM Agreement*, if the Panel were to find that any subsidies have resulted in adverse effects to the interests of another Member within the meaning of Article 5 of the *SCM Agreement*, should it make any recommendation other than the one set out in the first sentence of Article 19.1 of the DSU? BRA**

**252. Without prejudice to any findings by the Panel, if the Panel were to find that any of the challenged measures constitute prohibited subsidies within the meaning of Article 3 of the *SCM Agreement*, what are the considerations that should guide the Panel in making a recommendation under Article 4.7 of the *SCM Agreement* relating to the time period "within which the measure must be withdrawn"? What should that time period be? BRA**

**VIII. MISCELLANEOUS**

**253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):**

**(a) Does it relate to export credit guarantees, crop insurance and cottonseed payments?**

**(b) Does it relate only to compliance with AMS commitments?**

**(c) Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?**

**(d) How would the Secretary exercise her authority to prevent serious prejudice to the interests of another Member? How would she exercise her authority to prevent a threat**

[452] Brazil's 9 September 2003 Further Submission, paras. 124-128 and the Exhibits cited therein; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 78-80.

[453] For example, Brazil's response to Panel Question 125, paragraph 14.

**of serious prejudice to the interests of another Member? At what time and on the basis of what type of information would she exercise her authority?**

**(e) What does "to the maximum extent practicable" mean? In what circumstances would it not be practicable for the Secretary to exercise her adjustment authority? USA**

**Brazil's Comment:**

227. In its arguments at paragraphs 176, 178 and 180 of its 22 December 2003 response, the United States speculates about the "thoughts," "anticipations," "contemplations," "understandings", and "belief" of the US Congress. Yet it provides no citation to the extensive Congressional debates on the 2002 FSRI Act. Speculation about legislative (or negotiators') intentions not backed up by reference to the record of the debates is not positive evidence. Further, if any Member could successfully plead compliance with WTO rules by simply inserting language asserting the provision "provides assistance to producers in a way that is consistent with [its] obligations under the Uruguay Round Agreement on Agriculture"[454], then there would be little role for any WTO panel. The only "evidence" of US legislators' intent before the Panel is the text of the 2002 FSRI Act.

228. In sum, the record now shows that both Brazil and the United States agree that (1) Section 1601(e) applies only to Total AMS[455], (2) Section 1601(e) does not apply to serious prejudice caused to US trading partners by US subsidies to upland cotton covered by the 2002 FSRI Act[456], and, (3) the 2002 FSRI Act does not provide any discretion for the USDA Secretary specifically to limit the amount of *upland cotton* marketing loan, Step 2, direct or counter-cyclical payments.[457]

**254. Would payments made after the date of panel establishment be *mandatory* under the marketing loan, direct payments, counter-cyclical payments and user marketing certificate (step 2) programmes, but for the circuit-breaker provision? USA**

**Brazil's Comment:**

229. Brazil established that marketing loan, Step 2, direct and counter-cyclical payments are mandatory, within the traditional mandatory/discretionary distinction under GATT/WTO law.[458] In its 20 January 2004 Answers to Additional Questions, Brazil has responded to US arguments that conditions attached to the payment of subsidies would make these subsidies non-mandatory.[459]

230. Brazil notes further that the listed programmes are not only mandatory within the meaning of WTO law, but are also mandatory under US budget law. They create a legal entitlement to the payment.[460] While the United States now argues that payments depend on the availability of funds[461],

[454] US 22 December 2003 Answer to Question 253(a), para. 176.
[455] US 22 December 2003 Answer to Question 253(b), para. 178.
[456] US 22 December 2003 Answer to Question 253(d), para. 180.
[457] US 27 October 2003 Answer to Question 162, para 95 ("The statutory authority for marketing loan payments, step 2 payments, and counter-cyclical payments does not provide the Secretary with the authority to arbitrarily decline to make these payments to qualified recipients."), para. 97 ("there is no present limit on the total amount of payments that can be made under each of these programs although for counter-cyclical payments a maximum total outlay can be calculated using the base acres, base yields, and maximum payment rate for each commodity produced during the historical base period.").
[458] *See* Brazil's 20 January 2004 Answers to Additional Questions, paras. 17 (with further references), 24-30.
[459] Brazil's 20 January 2004 Answers to Additional Questions, paras. 27-30.
[460] Exhibit Bra-416 ("What Is A Farm Bill," Congressional Research Service, Report for Congress, 5 May 2001) ("Commodity programmes are entitlements. Expenditures are based upon programme rules and commodity market conditions. Eligible farmers are guaranteed legislatively-specified support based on these rules and conditions."). USDA noted with respect to an earlier commodity program – the deficiency payment

the legal entitlement nature of these programmes means that payments must be made – if necessary after CCC funds have been replenished.

231. Finally, Brazil recalls that the United States argued in the peace clause portion of this dispute that is has no control over the flow of the upland cotton subsidies.[462] In fact, there is no legal mechanism to stem, or otherwise control, the flow of these upland cotton subsidies, which cause a permanent source of uncertainty in the world upland cotton market.[463] Thus, the US subsidies cause a threat of serious prejudice, in violation of Articles 5(c), 6.3(c) and 6.3(d) as well as footnote 13 of the SCM Agreement, and GATT Articles XVI:1 and 3.

**255. How does Brazil respond to US assertions concerning the circuit-breaker provision? (see US 2 December oral statement, paragraph 82). Does this mean that US subsidies cannot be "mandatory" for the purposes of WTO dispute settlement? BRA**

**256. The United States submits that the Panel cannot make rulings without allocating precise amounts of payments to upland cotton production. However, to the extent that such precise data is not on the Panel record, to what extent can the Panel rely on less precise data, and on reasonable assumptions, in fulfilling its duty under Article 11 of the *DSU* in this case? USA**

**Brazil's Comment:**

232. Because the United States has refused to cooperate in producing the most precise data concerning the amounts of contract payments to upland cotton producers, the Panel should (1) first draw adverse inferences from the US refusal to cooperate, and (2) use the best information available in making its determination.[464] Brazil presents the factual and legal basis permitting the Panel to make findings based on reasonable assumptions in its separate 28 January Comments and Requests Regarding US Data. These separate comments address most of the points raised in the extensive – and largely unresponsive – US answer to Question 256.[465] Additional points are set out below.

233. First, there is relevant WTO jurisprudence that provides a legal basis for the Panel to draw inferences from the best information available in the record in order to comply with the requirements of Article 11 of the DSU.[466] For example, in the *US – Wheat Gluten* case, the panel requested that the United States supply it with certain information that had been redacted from the public version of a USITC Report, but despite several requests, the United States refused to submit the information.[467] The panel decided that while having access to all the requested information from the United States would have furnished a more extensive basis for its examination and have facilitated an objective assessment of the facts, there were other facts of record that the panel was required to include in its "objective assessment".[468] Ultimately, the panel determined that the United States violated provisions of the Agreement on Safeguards on the basis of the available factual record.[469] When the

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program – that "[d]eficiency payments are entitlements; that is, spending is determined by rules that define eligibility and govern benefit levels rather than by the annual appropriations process. USDA and Congress have no control over deficiency payment outlays." (Exhibit Bra-417 ("Commodity Program Entitlements: Deficiency Payments", USDA, May 1993).

[461] US 22 December 2003 Answers to Questions, para. 182.

[462] In the context of the peace clause arguments, the United States argued that it could not control the amount of budgetary outlays under the programmes.

[463] Brazil's 20 January 2004 Answers to Additional Questions, paras. 18-22 (with further references).

[464] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 6.

[465] *See* also Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 11.

[466] Brazil's 9 October 2003 Closing Statement, paras. 2, 9 (*citing* Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.39).

[467] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 168.

[468] Panel Report, *US – Wheat Gluten*, WT/DS166/R, para. 8.12.

[469] Panel Report, *US – Wheat Gluten*, WT/DS166/R, para. 8.12.

United States appealed this decision, the Appellate Body affirmed the panel, stating that "where a party refuses to provide information requested by a panel, that refusal will be one of the relevant facts of record, and indeed, an important fact, to be taken into account in determining the appropriate inference to be drawn".[470] The Appellate Body further indicated that it "deplored the conduct of the United States" in refusing to cooperate and provide information that was within its exclusive control.[471]

234. Another example of a panel using the best information available when a Member refused to provide documents within its exclusive control is the *Argentina – Textiles and Apparel* case. In that case, the United States requested Argentina to produce complete original customs documents of all footwear imports to demonstrate that Argentina was imposing and requiring payment of specific duties in excess of its bound duty rates of 35 per cent *ad valorem*.[472] Argentina refused to provide the complete (or any) documents.[473] The United States then provided examples of customs documents, which Argentina contested on a variety of authenticity and relevance grounds.[474] The panel rejected these Argentine arguments and found that "the United States has provided *sufficient evidence*".[475] In so holding, the panel noted that "[i]n situations where direct evidence is not available, relying on inferences drawn from relevant facts of each case facilitates the duty of international tribunals in determining whether or not the burden of proof has been met".[476] The panel further held that there is a requirement for collaboration of the parties in the presentation of the facts and evidence to the panel, and emphasized especially the role of the respondent in that process.[477]

235. Applying these concepts to the allocation issues involved in the peace clause portion of this dispute indicates that the Panel has more than sufficient evidence in the record to support a reasonable estimate of the amount of contract payment support provided to upland cotton in MY 1999-2002.[478] Brazil detailed its views concerning the appropriate allocation methodology for purposes of the peace clause.[479] Faced with the US refusal to provide the data necessary to calculate the precise amount of support to upland cotton from the US contract payments using Brazil's (and the US) allocation methodology, Brazil offered extensive circumstantial evidence in support of its alternative so-called "14/16$^{th}$ methodology".[480] The Panel may properly draw adverse inferences that the United States data would, if produced, have shown that Brazil's 14/16$^{th}$ methodology undercounted the amount of support to upland cotton.[481] Such an adverse inference supports the other extensive evidence that the 14/16$^{th}$ methodology provides a reasonable estimate.[482]

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[470] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 174.
[471] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 171.
[472] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.54.
[473] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.56.
[474] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.33.
[475] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.65 (emphasis added).
[476] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.39.
[477] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.40.
[478] Brazil recalls that the United States has invoked the peace clause of Article 13 of the Agreement on Agriculture. As demonstrated by Brazil, the peace clause is in the nature of an affirmative defense. And even if the Panel were to disagree, Brazil established a *prima facie* case of inconsistency of the US measures with Article 13(b)(ii) of the Agreement on Agriculture. Neither the claim nor the measures to which it relates are outside the Panel's terms of reference, within the meaning of the Appellate Body decision in *Japan – Agricultural Products*, paras. 129-130.
[479] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.
[480] These facts are summarized in Annex 1 to Brazil's 9 October 2003 Closing Statement, but are also contained in a number of Brazil's earlier submissions to the Panel, beginning with its 24 June 2003 First Submission. *See* also Brazil's 18 November 2003 Further Rebuttal Submission, Sections 2.1 and 2.4; Brazil's 2 December 2003 Oral Statement, Sections 5.1 and 5.3.
[481] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 6.
[482] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 6.

236. Turning to its claims of serious prejudice and threat thereof, Brazil remains of the firm view that neither Part III of the SCM Agreement nor GATT Article XVI requires an exact determination of the amount of subsidies involved.[483] Rather, Brazil must demonstrate their *effects*.[484] Nevertheless, and as an alternative legal argument, Brazil presented extensive evidence concerning the *amounts as well as the effects* of each challenged subsidy. This is the same evidence Brazil used to demonstrate the amount of support to upland cotton.

237. The United States asserts that Brazil has to allocate all contract payments received by an upland cotton producing farm over the total value of that farm's sales.[485] However, even though the United States alone is in exclusive control of the information that would permit such an allocation, it has refused to produce that information. Even if it would be Brazil's burden to establish this fact, the United States has done everything to frustrate Brazil's ability to do so. In particular, the United States first wrongly asserted that data on plantings of farms was not available to it and – after Brazil demonstrated that this was incorrect[486] – refused to produce the evidence.[487]

238. Indeed, even if the Panel were of the view that the US allocation methodology would provide the best means of evaluating the amount of support to upland cotton, the refusal of the United States to produce the requested data prevents the Panel from applying that methodology. In the face of this lack of cooperation, the Panel is required to apply some other methodology to estimate the amount of contract payment support, *i.e.*, Brazil's 14/16$^{th}$ methodology, or some variant thereof. To hold otherwise would obviously penalize Brazil, who sought the information, *inter alia*, for the purpose of demonstrating that the US methodology would reveal amounts of support similar to those estimated by Brazil's own 14/16$^{th}$ methodology.

239. It is ironic that among the evidence that supports Brazil's 14/16$^{th}$ methodology is the incomplete summary data provided by the United States. Brazil attempted to use that data to perform a simplified version of the (improper) US allocation methodology.[488] Brazil does not believe, as the Panel's question suggests, that it can make reasonable assumptions using this methodology based on the fragmented summary data provided by the United States. Nevertheless, although Brazil cautions against the use of its results, and although this methodology is not relevant for purposes of the peace clause, Brazil notes that these results are only marginally smaller than the results of Brazil's own 14/16$^{th}$ methodology.[489]

240. Thus, contrary to the US 22 December 2003 arguments[490], there is evidence provided by Brazil in the record on which the Panel can rely in making an objective assessment of the facts and in deciding on Brazil's claims under Part III of the SCM Agreement and GATT Article XVI (as well as under Article 13(b)(ii) of the Agreement on Agriculture). Brazil has also met its burden of proof in establishing a *prima facie* case concerning its claims of inconsistency of the US measures with these provisions.

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[483] *See* Brazil's comment on Question 243, above.

[484] *See inter alia* Brazil's 2 December 2003 Oral Statement, paras. 4-6 (and the references cited therein).

[485] *See* US 22 December 2003 Answers to Questions, paras. 185-186, 10-11, 160-164.

[486] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.2; Exhibits Bra-368 – Bra-369.

[487] *See* generally Brazil's 28 January 2004 Comments and Requests Regarding US Data.

[488] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 10.

[489] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 10.

[490] US. 22 December 2003 Answers to Questions, paras. 185-186.

## IX. ADDITIONAL QUESTIONS POSED ON 23 DECEMBER 2003 AND 12 JANUARY 2004

**257. The Panel takes note of the Appellate Body Report in *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan* (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.**

**(a) In tht report, the Appellate Body cautioned against the "mechanistic" application of the so-called "mandatory/discretionary distinction" and stated that the import of this distinction may vary from case to case (para. 93). For the Appellate Body, the question of whether a measure is mandatory or not is relevant "if at all" only as part of the assessment of whether the measure is, as such, inconsistent with particular obligations. How, if at all, are these statements and the related findings concerning the mandatory/discretionary distinction in that Appellate Body Report relevant to:**

**(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the *Agreement on Agriculture* and Articles 3.1(a) and (b) of the *SCM Agreement,* concerning: BRA**

- **Step 2 payments (see, *e.g.* paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and**

- **export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, *e.g.*, para. 90 Brazil's oral statement at second Panel meeting).**

**(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"? BRA**

**(iii) the legal standard and elements Brazil sets out to establish its "*per se*" "serious prejudice" claims (*e.g.* Brazil's 9 September further submission, para. 417 *ff*; US oral statement at second Panel meeting, para. 86 *ff.*)? BRA**

**(b) How and to what extent are the legal and regulatory provisions cited in paras. 415 and 423 of Brazil's 9 September further submission "normative" in nature and treated as binding within the US legal system (see, *e.g.*, para. 99 of the Appellate Body Report)? Does your response differ depending on whether the payments are dependent upon market price conditions? BRA**

**(c) Does Brazil challenge as "mandatory" the "subsidies" themselves, the subsidy programmes or the legal/regulatory provisions for the grant or maintenance of those subsidies, or something else? BRA**

**(d) Does the "requirement" upon the CCC to make available "not less than" $5.5 billion annually in guarantees have a normative character and operation? (see, e.g. Brazil's response to Panel Question 142; Exhibit BRA-297, 7 USC 5641(b)(1); 7 USC 5622(a) & (b); paragraph 201 of US 18 November further rebuttal submissions). Is this requirement "mandatory"? If so, how does the CCC have "discretion" not to make this amount of guarantees available in a given year? USA**

**(e) Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (*e.g.* Exhibit BRA-117 (2 USC 661(c)(2))? USA**

**Brazil's Comment:**

241. Brazil makes several observations with respect to the United States' 20 January 2004 responses to Questions 257(d) and 257(e).

242. First, the evidence discussed in the Panel's questions and the US responses is only relevant to a determination whether the United States is in compliance with Article 10.1 of the Agreement on Agriculture with respect to scheduled products. For unscheduled products, the Appellate Body held that it is inconsistent with Article 10.1 to provide *any* export subsidies.[491] Brazil has demonstrated that CCC guarantees were extended for unscheduled products during the period 1992-2003. Having also demonstrated that the CCC programmes constitute export subsidies (under Articles 1.1 and 3.1(a) of the SCM Agreement, and under item (j)), Brazil has therefore established that the United States has circumvented its export subsidy commitments with respect to unscheduled products, in violation of Article 10.1. Brazil has also demonstrated that CCC guarantees continue to be available for unscheduled products.[492] Since it is inconsistent with Article 10.1 to provide *any* export subsidies, the availability of CCC guarantees leads to a threat of circumvention of the US export subsidy commitments.

243. Second, the test to determine whether the United States is threatening to circumvent its export subsidy commitments with respect to scheduled products is not whether the CCC guarantee programmes are "mandatory" as opposed to "discretionary."[493] Rather, to determine whether export subsidies result in, or threaten to lead to, circumvention of the United States' export subsidy commitments, the test set out by the Appellate Body in *US – FSC* is whether there is a "mechanism in the measure" for CCC to "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[494]

244. Under this test, the threat of circumvention is not abated simply because, as the United States notes, the CCC is not actually required to issue the "not less than $5,500,000,000 in credit guarantees" that it must, as a matter of law, make available every year.[495] The threat arises because, year-on-year, the CCC announces its plans to extend over $6 billion in guarantees, as it did for fiscal year 2004.[496]

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[491] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 150.

[492] Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Program Activity," USDA, covering GSM-102, GSM-103 and SCGP). For 1999-2002, s*ee also* Exhibit Bra-73 ("Summary of Export Credit Guarantee Program Activity," USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003). For 1992-1998, *see* Exhibit US-41.

[493] The Panel will recall that in addition to its threat of circumvention claims with respect to scheduled products, Brazil has also demonstrated that the United States has used the CCC guarantee programs to circumvent its export subsidy commitments with respect to rice (a scheduled product). *See* Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP). The United States has not rebutted this evidence.

[494] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149. Brazil's 27 October 2003 Answers to Questions, para. 88; Brazil's 18 November 2003 Further Rebuttal Submission, para. 257; Brazil's 2 December 2003 Oral Statement, paras. 90-91; Brazil's 20 January 2004 Answers to Additional Questions, para. 13.

[495] Brazil is aware of no other provision of US law that provides a floor, and not a corresponding ceiling, for support to US industry.

[496] Exhibit Bra-296 ("USDA Announces $2.8 Billion in Export Credit Guarantees," FAS Press Release, 30 September 2003).

It is required to do so by law.[497] It is, moreover, altogether exempt from any ceiling on the amount of guarantees it extends, and from the normal requirement that it receive new budget authority before undertaking new guarantee commitments (the programmes' "mandatory" status under US law "does not effectively constrain credit activity").[498] The CCC uses that exemption liberally, increasing allocations throughout the fiscal year to meet the needs of US exporters.[499]

245. Even if the CCC does not reach its goal of issuing over $6 billion in guarantees by year end, the fact that US law tells it that it must make available at least this amount, the fact that it sets its sights on and actually announces this amount, and the fact that nothing in US law sets any upward bound on the amount of guarantees it can issue, communicates a threat that it will circumvent its export subsidy commitments. Even if the CCC does not reach its goal of issuing $6 billion in export credit guarantees, foreign competitors of US farmers see that it has announced its intent to do so, that it has the authority to do that and an unlimited amount more, and that there is no "mechanism in the measure" for CCC to "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[500]

246. Moreover, foreign competitors of US farmers have seen how, as an historical matter, the United States has applied the CCC guarantee programmes to surpass its quantitative export subsidy reduction commitments – even when falling short of its announced intent to issue $6 billion in guarantees. Brazil has demonstrated how this threat materialized for one product – rice – in fiscal years 2001, 2002 and 2003 (despite the fact that the CCC did not reach its announced intent of handing out $6 billion in guarantees in any of those years).[501] Foreign producers' fears that the threat will materialize in other years for other products are legitimate, and the threat is therefore tangible (regardless whether or not the CCC meets its goal of handing out $6 billion in guarantees in any given year).

247. Merely having what the United States claims is the unwritten, administrative discretion to "tamp down the actual issuance of guarantees" would not be enough under this test.[502] The reason the Appellate Body in *US – FSC* looked for an affirmative "mechanism in the measure" subject to an Article 10.1 claim that would stem or control the flow of subsidies, rather than merely accepting as sufficient the unwritten administrative discretion to do so, is that only when such a mechanism exists, will foreign competitors of US farmers know with a degree of assurance that the threat of

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[497] Brazil's 18 November 2003 Further Rebuttal Submission, para. 261, *citing* Exhibit Bra-297 (7 U.S.C. § 5641(b)(1); 7 U.S.C. § 5622(a), (b)). *See also* Brazil's 2 December 2003 Oral Statement, para. 91, *citing* Exhibit Bra-366 (7 U.S.C. § 5622 note, "Promotion of Agricultural Exports to Emerging Markets, para. (a) ("The Commodity Credit Corporation shall make available for fiscal years 1996 through 2002 not less than $1,000,000,000 of direct credits or export credit guarantees for exports to emerging markets under section 201 or 202 of the Agricultural Trade Act of 1978 (7 U.S.C. 5621 and 5622), in addition to the amounts acquired or authorized under section 211 of the Act (7 U.S.C. 5641) for the program.")). *See also* Exhibit Bra-367 (Section 3203 of the 2002 FSRI Act (extending mandate to 2007)).

[498] Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Programme classified as "Mandatory" in Table 2, and in the "Introduction," the Office of Management and Budget states that Table 2 provides "the program's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory"); Exhibit Bra-117 (2 U.S.C. § 661(c)(2)) (exempting CCC programmes from appropriations requirement); Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform," April 1991, p. 7 (for quote provided in text above)).

[499] Brazil's 27 October 2003 Answers to Questions, para. 95, *citing* the archived list of USDA press releases announcing supplemental allocations extended throughout fiscal year 2003 (http://www.fas.usda.gov/excredits/exp-cred-guar.asp).

[500] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

[501] Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP). The United States has never rebutted Brazil's showing. The CCC announced guarantee allocations of $5.762 billion in 2001, $6.158 billion in 2002, and $6.247 billion in 2003, while granting guarantees in the amount of $3.227 billion in 2001, $3.388 billion in 2002, and $3.223 billion in 2003. *See* Exhibit US-41.

[502] US 20 January 2004 Answers to Questions, para. 3.

circumvention is not real. The purpose of the mechanism, in other words, is to diminish the threat. (Had this not been the Appellate Body's intent, it would simply have stuck to the traditional mandatory/discretionary formula it has used elsewhere and that the United States asserts applies in the analysis of an Article 10.1 claim.)

248. In any event, the "discretionary elements" that the United States asserts[503] abate the threat posed by its annual announcement that it will issue over $6 billion in CCC export credit guarantees are an illusion, for at least two reasons.[504]

249. First, the United States has offered no evidence that the CCC may reject "any individual application"[505] (much less that there is a "mechanism" to do so in order to avoid circumvention of US export subsidy commitments). As Brazil has previously noted, the CCC guarantee programmes are classified as "mandatory" under US law.[506] The Congressional Budget Office ("CBO") and the Congressional Research Service ("CRS") (legislative branch agencies charged with servicing the US Congress) have both noted the inability of executive branch agencies charged with implementing mandatory programmes to deny support to eligible borrowers.[507] The United States cites a non-programme specific document for a generic principle that mandatory and discretionary classifications under the Budget and Enforcement Act "'do not determine whether a programme provides legal entitlement to a payment or benefit'".[508] Speaking specifically with respect to USDA mandatory programmes, however, the CRS states that "'[e]ligibility for mandatory programmes is written into law, and any individual or entity that meets the eligibility requirements is entitled to a payment as authorized by the law'".[509]

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[503] US 20 January 2004 Answers to Additional Questions, para. 3.

[504] Brazil has elsewhere explained the CCC's authority to undertake an inquiry into whether particular countries are creditworthy, and the possibility that this inquiry could end up reducing the amount of CCC guarantees, does not prevent a conclusion that nothing "stem[s], or otherwise control[s], the flow of" CCC guarantees. Brazil's 27 October 2003 Answers to Questions, para. 92. Under the United States' FSC measure, US authorities were permitted to undertake a factual inquiry into, among other things, whether the foreign-source income of the foreign corporation was "effectively connected with the conduct of a trade or business within the United States." Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 16. This authority, and the possibility that the factual inquiry could limit the amount of income that would qualify for the FSC exemption, did not prevent the Appellate Body from concluding that nothing in the FSC measure "stem[ed], or otherwise control[led], the flow of" FSC benefits, leading to a threat of circumvention of the United States' export subsidy reduction commitments.

[505] US 20 January 2004 Answers to Additional Questions, para. 3. The United States has not offered any support for its assertion that CCC has the authority "to suspend the issuance of expert credit guarantees under any particular allocation". In any event, Brazil demonstrates *infra* that the allocation process does not remotely abate the threat that the United States will circumvent its *quantitative* export subsidy reduction commitments.

[506] Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Program classified as "Mandatory" in Table 2, and in the "Introduction", the Office of Management and Budget states that Table 2 provides "the programme's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory").

[507] *See* Exhibit Bra-117 (2 U.S.C. § 661(c)(2)); Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform," April 1991, p. 7 and Table 2); Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget," IB95031 (16 February 1996), p. 3).

[508] US 20 January 2004 Answers to Additional Questions, para. 7.

[509] Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget," IB95031 (16 February 1996), p. 3). The United States made a similar error in its 30 September 2003 Further Submission, at paragraph 156, when it cited the very same generic, non-agency-specific document (Circular A-11) for the principle that "the ability of CCC to issue guarantees is constrained by the apportionment process . . ." As Brazil has demonstrated, the CCC programs are exempt from the requirement that to receive new Congressional budget authority before undertaking new guarantee commitments. *See* Exhibit Bra-117 (2 U.S.C. § 661(c)(2)).

250. Second, the "discretionary elements" cited by the United States do not in any way abate the threat that the United States will circumvent its export subsidy commitments for scheduled products:

- The existence of eligibility criteria does not abate the threat. The focus for deciding whether a measure is discretionary is on whether it provides government officials with the discretion to implement the measure in a WTO-consistent manner.[510] Objective conditions, such as objective eligibility criteria, are not appropriately considered in determining whether a measure gives an implementing official "discretion" to act in a WTO-consistent fashion. For example, the FSC measure payments were only available where the income concerned was of foreign origin. Despite the fact that non-foreign sourced income would thus be excluded from FSC benefits, the measure was still found to threaten the circumvention of export subsidy commitments. Similarly, CCC guarantees are only available if an exporter meets the eligibility criteria set out in 7 C.F.R. § 1493.30.[511] The fact that a CCC official cannot legally issue a CCC guarantee to a non-eligible exporter does not make the CCC programmes "discretionary".

- The authority to limit guarantees given for exports to particular "destination[s]" and the authority to employ "exposure limits applicable to individual bank obligors"[512], like the authority to determine that particular destination countries are uncreditworthy and are ineligible for guarantees[513], do not reduce the threat of circumvention. The United States' export subsidy commitments are undertaken on a quantitative basis, and not on a destination or individual bank basis. Removing particular destination countries or banks from the list of those countries or banks eligible for CCC guarantees is utterly irrelevant to the CCC programmes' absolute activity levels – CCC can simply shift those guarantees to other countries and banks.

- Nor does the authority to limit the "time within which export must occur"[514] reduce the threat of circumvention. A requirement that the export that is the subject of a guarantee occur within a certain period of time following issuance of the guarantee only matters if the guarantee is issued in the first place; the requirement does nothing to control the flow of those guarantees or to abate the threat that they will circumvent the US export subsidy commitments.

- Nor does the allegedly commodity-specific allocation process that the United States cites[515] reduce the threat of circumvention. More than 95 per cent of allocations are made on a country-specific basis only, with less than 5 per cent of 2003 allocations made on a scheduled product-specific basis.[516] And the press release announcing initial allocations for 2004 contains no product-specific allocations.[517] More importantly, the allocations are made on a *monetary* basis, which provides virtually no assurance that the United States will not surpass

[510] Appellate Body Report, *US – 1916 Act*, WT/DS136/AB/R, para. 100.
[511] Exhibit US-6.
[512] US 20 January 2004 Answers to Additional Questions, para. 3.
[513] *See* US 30 September 2003 Further Submission, para. 154.
[514] US 20 January 2004 Answers to Additional Questions, para. 3.
[515] US 20 January 2004 Answers to Additional Questions, para. 3. *See also* US 30 September 2003 Further Submission, para. 155.
[516] *See* Brazil's 27 October Answers to Questions, para. 99, note 136 and Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Programme Activity," USDA, covering GSM-102, GSM-103 and SCGP (Total GSM 102, GSM 103 and SCGP allocations for fiscal year 2003 are listed as $6.025 billion, with product-specific allocations for scheduled products as follows: $200 million for wheat to Korea; $85 million for wheat to Pakistan; and, $10 million for vegetable oils for Tunisia.). *See also* Brazil's 18 November 2003 Further Rebuttal Submission, para. 261 (second bullet point).
[517] Exhibit Bra-296 ("USDA Announces $2.8 Billion in Export Credit Guarantees," FAS Press Release, 30 September 2003).

its *quantitative* export subsidy reduction commitments.[518] Brazil has demonstrated how this threat materialized for one product (rice)[519]; the threat that it might happen in some years for other products is therefore tangible.

251. Thus the "discretionary elements" cited by the United States do not abate the threat of circumvention of its export subsidy commitments. The United States erroneously states that "Brazil's own approach would require a showing that the programmes mandate that the premium rates will be insufficient to cover long-term operating costs and losses of the programmes".[520] The Panel will recall Brazil's demonstration that the United States has exported quantities of scheduled products in excess of US quantitative reduction commitments.[521] Thus, under Article 10.3 of the Agreement on Agriculture, the burden falls on the United States to prove that those excess quantities of scheduled products did not receive "export subsidies," within the meaning of Article 10.1. The burden is on the United States to show, in its own words, that the CCC programmes mandate that premium rates will be sufficient to cover long-term operating costs and losses of the programmes, within the meaning of item (j), and that CCC guarantees do not constitute financial contributions that confer benefits and are contingent on export, with the meaning of Articles 1.1 and 3.1(a) of the SCM Agreement.

252. But whomever bears the burden, Brazil has shown that the CCC does not have the discretion to charge fees that will enable it to meet its long-term operating costs and losses. Both USDA's Inspector General and the US General Accounting Office have noted the CCC's failure to change its premium rates or to reflect credit risk in those rates – *and in particular the maximum one-per cent premium rate imposed by US law*[522] – as evidence of a failure and inability to cover costs and losses.[523] There is no affirmative "mechanism" in place to stop the CCC programmes from constituting export subsidies under item (j), and in fact the fee ceiling imposed by US law is a mechanism that ensures that the programmes will operate as export subsidies.

253. Moreover, Brazil has demonstrated that the CCC export credit guarantee programmes confer "benefits" *per se*, within the meaning of Article 1.1(b) of the SCM Agreement (as well as that they are financial contributions and are contingent on export), and therefore that they constitute *per se* export subsidies for the purposes of Article 10.1.[524] Among other reasons (*e.g.*, the regulations for the CCC programmes, and a comparison to non-market benchmarks established by the US Export-Import Bank)[525], Brazil has made this *per se* showing by demonstrating that CCC export credit guarantees are unique financing instruments for agricultural commodity transactions that are not available on the commercial market for terms longer than the marketing cycles of the eligible commodities.[526] Far from an affirmative "mechanism" to prevent CCC guarantees from constituting export subsidies, guarantees under the CCC programmes constitute export subsidies *per se*.

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[518] Brazil's 27 October 2003 Answers to Questions, para. 100.

[519] Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP).

[520] US 20 January 2004 Answers to Additional Questions, para. 4.

[521] Brazil's 2 December 2003 Oral Statement, para. 78; Brazil's 24 June 2003 First Submission, para. 265.

[522] US 11 August 2003 Answers to Questions, para. 180. *See also* Exhibit Bra-297 (7 U.S.C. § 5641(b)(2)).

[523] Brazil's 22 December 2003 Answers to Questions, paras. 63-64.

[524] *See, e.g.*, Brazil's 18 November 2003 Further Rebuttal Submission, paras. 233-241.

[525] This evidence is summarized at paragraphs 231-241 of Brazil's 18 November 2003 Further Rebuttal Submission.

[526] *See* Brazil's 24 June 2003 First Submission, paras. 289-292; Brazil's 22 July 2003 Oral Statement, para. 116; Brazil's 11 August 2003 Answers to Questions, paras. 139-140, 152-157, 183-187; Brazil's 22 August 2003 Rebuttal Submission, paras. 103-105; Brazil's 22 August 2003 Comments, paras. 92-93, 109-113; Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 68-80; Brazil's 7 October 2003 Oral Statement, para. 72; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 230-242; Brazil's 2 December 2003 Oral Statement, para. 79.

254. Everything about the CCC programmes aggravates and legitimizes the fear foreign competitors of US farmers have that the programmes will be used to circumvent the United States' export subsidy commitments. Brazil has demonstrated that under Articles 1.1 and 3.1(a) of the SCM Agreement, and item (j), guarantees under the programmes constitute *per se* export subsidies. The CCC issues these export subsidies free from the normal budgetary constraints placed on federal spending. The only constraint placed on the programmes is one that in fact encourages fear of circumvention – the obligation the US Congress has placed on the CCC to make available *a minimum* of $6.5 billion of CCC guarantees every year.[527] While the United States considers CCC's failure to actually grant $6.5 billion in guarantees in a given year as significant to its defense, it misunderstands the obligation included in Article 10.1. Article 10.1 prohibits the threat of circumvention. Foreign competitors of US farmers see and fear the unchecked authority US farmers and the CCC have to circumvent US export subsidy commitments. Their fear is legitimate, since that unchecked authority has been used in the past to circumvent those commitments.[528]

255. There is no affirmative "mechanism in the measure" that will stem or control the flow of CCC guarantees in a way that will abate the threat of circumvention of the US export subsidy commitments with respect to scheduled products. To abate the fear that makes the threat real, foreign competitors need to see a mechanism in place that will keep the United States from using the CCC programmes to provide export subsidies that surpass the US reduction commitments. The nature of the obligation in Article 10.1 – the prohibition of a threat – is such that it cannot be met with a showing that there is mere discretion to avoid surpassing those commitments. That the Appellate Body failed to apply the traditional mandatory/discretionary distinction in interpreting the standard required by Article 10.1 demonstrates its understanding that to prevent a measure from posing a threat of circumvention, there needs to be some affirmative mechanism in place to reduce the legitimate fear of circumvention.

**258. Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks. BRA**

[527] For citations, *see* Brazil's 2 December 2003 Oral Statement, para. 91.
[528] Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP).

# ANNEX I-14

## COMMENTS OF THE UNITED STATES ON THE ANSWERS OF BRAZIL TO FURTHER QUESTIONS FROM THE PANEL TO THE PARTIES FOLLOWING THE SECOND PANEL MEETING

(28 January 2004)

### A. Terms of Reference

**194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? BRA, USA**

1. Brazil's answer conflates two issues: the measures a Panel is to examine and the evidence a Panel may examine. As stated in the US response, Brazil has challenged certain statutory measures "as such"; Brazil has also challenged certain "payments" as measures. With respect to payments, it is only those payments made through panel establishment that can be "specific measures at issue" between the parties. Payments made after panel establishment necessarily had not been made as of the time of establishment; therefore, those "measures" did not exist and cannot have been within the Panel's terms of reference as set out by the DSB.

2. The situation here is different from that in *Chile – Price Bands*[1] where the question was whether an amendment made to a measure that both parties agreed were within the panel's terms of reference had altered the "essence" of the measure such that it was no longer a measure within the panel's terms of reference. Here, the question concerns measures (payments) that it is without dispute did not exist at the time of panel establishment. Accordingly, the request for a panel could not have "identified" non-existent measures, nor could Brazil have consulted on measures "affecting" (present tense) the operation of a covered agreement. To find these measures to be within the Panel's terms of reference would therefore be in contravention of Articles 4 and 6 of the DSU. It was Brazil's choice to request establishment of the Panel part way through marketing year 2002; thus, Brazil's timing sets the parameters for what payments are properly before the Panel.[2] In this connection, we note that Brazil has finally conceded the correctness of the US view that this Panel's terms of reference cannot expand beyond their scope of the date of panel establishment. In its answer to the Panel's Question 247 (paragraph 149), Brazil states: "Thus, the 'matter' before the Panel has not changed (*and cannot*) since the establishment of the Panel" (emphasis added). Brazil should of course also have acknowledged that, despite this statement, it has in fact attempted to change the matter before the Panel.

3. This is not to say that a Panel may not examine evidence that is developed after panel establishment.[3] In fact, the United States would largely agree with Brazil's statement that "to the extent that 'payments' made since 18 March 2003 are evidence, the Appellate Body and panels have

[1] WT/DS207/AB/R.

[2] Past panels have examined measures subject to a dispute as they exist on the date of panel establishment. *See, e.g.*, *Panel Report, India -- Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WT/DS90/R, adopted 22 September 1999, paras. 5.159-5.163.

[3] *See, e.g.*, *Japan – Measures Affecting the Importation of Apples*, WT/DS245/R, para. 4.15 (15 July 2003) (rejecting Japan's preliminary ruling request to strike certain affirmative evidence developed and submitted after the date of panel establishment but no later than during the first panel meeting).

repeatedly found that evidence generated after the establishment of the panel can be used by [panels] in their objective assessment of the facts under DSU Article 11."[4] The Panel should carefully consider the import of this statement by Brazil, given the existence of three telling pieces of evidence that Brazil has sought to minimize or neglected:

- First, Brazil largely ignores the undisputed fact that no marketing loan payments have been made since 19 September 2003; thus, given expected prices, US outlays will be dramatically lower in marketing year 2003.

- Second, Brazil seeks to minimize the fact that futures prices indicate that the market expects cotton prices to remain high through marketing years 2003 and 2004.

- Third, and perhaps most disconcerting, Brazil has neglected to inform the Panel that, with respect to its preferred baseline approach, FAPRI has produced a (preliminary) November 2003 baseline that revises projected prices significantly upwards as compared to the outdated baseline on which Mr. Sumner's economic analysis relies.

4. The first piece of evidence demonstrates not only that marketing loan payments will be sharply lower in marketing year 2003 than in previous years, but fatally undercuts Brazil's economic analysis. The Panel will recall that in Brazil's economic analysis, the marketing loan programme alone accounted for almost 43 per cent of the effect of removal of all challenged US subsidies. Given that no marketing loan payments are being made and that futures prices and the November 2003 FAPRI baseline suggest that no marketing loan payments will be made over the remainder of marketing year 2003, the evidence does not support Brazil's argument that US marketing loans for upland cotton create a threat of serious prejudice.

5. The second piece of evidence is that futures prices indicate that the market expects cotton prices to remain high through marketing years 2003 and 2004. The table below shows settlement prices on 27 January 2004, for contracts through marketing year 2004.

| **New York Cotton Exchange, Cotton No. 2, 27 January 2000**[5] | |
|---|---|
| **Contract** | **Settlement (cents per pound)** |
| March 2004 | 73.76 |
| May 2004 | 75.06 |
| July 2004 | 75.90 |
| October 2004 | 68.25 |
| December 2004 | 69.05 |
| March 2005 | 71.05 |
| May 2005 | 71.70 |
| July 2005 | 72.40 |

6. The following table of futures prices for December 2004 upland cotton contracts further demonstrates that price expectations have risen over time, and market participants expect cotton prices to remain high through December 2004.

[4] Brazil's Answer to Question 194, para. 5.
[5] Exhibit US-142.

**Futures Prices for December 2004 Cotton**

| Month ending | Open for the Month | High for the Month | Low for the Month | Close for the Month | Average Close for the Month |
|---|---|---|---|---|---|
| 12/31/2002 | 60.63 | 62.20 | 60.49 | 60.50 | 61.34 |
| 1/31/2003 | 61.25 | 62.50 | 60.50 | 62.70 | 61.69 |
| 2/28/2003 | 62.90 | 63.00 | 61.30 | 62.87 | 62.53 |
| 3/31/2003 | 62.90 | 63.25 | 61.70 | 62.45 | 62.57 |
| 4/30/2003 | 62.40 | 64.00 | 62.00 | 62.45 | 62.69 |
| 5/31/2003 | 62.50 | 64.00 | 60.58 | 60.75 | 62.60 |
| 6/30/2003 | 60.50 | 64.60 | 59.00 | 65.25 | 62.55 |
| 7/31/2003 | 66.90 | 66.90 | 63.32 | 62.85 | 65.29 |
| 8/31/2003 | 62.90 | 63.25 | 60.70 | 63.68 | 61.95 |
| 9/30/2003 | 63.95 | 66.95 | 62.20 | 66.25 | 64.99 |
| 10/31/2003 | 65.75 | 71.00 | 64.80 | 68.85 | 67.72 |
| 11/30/2003 | 68.85 | 70.00 | 62.50 | 65.65 | 67.54 |
| 12/31/2003 | 67.50 | 68.45 | 63.25 | 68.28 | 65.60 |
| 1/22/2004 | 68.40 | 69.70 | 67.62 | 69.62 | 68.78 |

Source: New York Board of Trade, NY Cotton Exchange

7. Third, Brazil has not provided the Panel with any information relating to the most recent FAPRI November 2003 baseline. This preliminary baseline further undermines Brazil's economic analysis, which was predicated on projections of continued low cotton prices. As noted with respect to the cessation of marketing loan payments and high futures prices, that low-cotton-price projection on which Mr. Sumner relies has proven to be dramatically off-base. The November 2003 baseline now recognizes that fact.

- For example, the FAPRI November 2002 baseline used by Mr. Sumner projected an A-index of 50.7 cents per pound for marketing year 2003.

- The actual A-index in 2004 (through 22 January) has varied between a low of 75.45 cents per pound on 2 January to a high of 76.95 cents per pound on 22 January 2004 – that is, *roughly 50 per cent higher* than the FAPRI November 2002 projection.

8. The price outlook for cotton has improved considerably since publication of the November 2002 FAPRI baseline used by Dr. Sumner to estimate the effects of subsidies on US cotton production. The table below shows that projections for the Adjusted World Price are as much as *54.1 per cent higher*, or 20 cents per pound, for marketing year 2003 in the November 2003 baseline as under the November 2002 baseline.

**FAPRI's Upwards Revisions to Adjusted World Price Baseline Projections**

| Year | Adjusted World Price (cents/lb) | | | |
|---|---|---|---|---|
| | Nov 2002 (Sumner) | Jan 2003 | Nov 2003 1/ | Increase from Sumner Nov02 baseline to Nov03 |
| 2003/04 | 37.22 | 44.8 | 57.36 | 54.1 % |
| 2004/05 | 39.83 | 45.4 | 50.96 | 27.9 % |
| 2005/06 | 41.94 | 46 | 50.82 | 21.2 % |
| 2006/07 | 43.6 | 46.7 | 50.35 | 15.5 % |
| 2007/08 | 45.48 | 48 | 49.24 | 8.3 % |
| Average | 41.61 | 46.18 | 51.75 | 24.4 % |

1/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

The chart below sets out the same data graphically, showing how much FAPRI's projections have been revised upwards since the November 2002 baseline on which Mr. Sumner's analysis relies.

9. As a result of this large upwards revision in FAPRI's projected adjusted world price, FAPRI's estimated marketing loan gains have been reduced considerably.

- Under the November 2003 baseline, *the estimated marketing loan gain for marketing year 2003 is now zero*, compared to almost 15 cents per pound under the November 2002 baseline used by Dr. Sumner.

- For marketing year 2004, the estimated marketing loan gain under the November 2003 baseline is 1.04 cents per pound, *a reduction of 91.5 per cent* from the 12.17 cents per pound estimated marketing loan gain in the November 2002 baseline used by Dr. Sumner.

- In fact, over the five-year period from marketing year 2003 to marketing year 2007, the average marketing loan gain is estimated in the November 2003 baseline as 1.32 cents per pound, *87.3 per cent lower* than the 10.39 cents per pound average using the November 2002 baseline on which Dr. Sumner relied.

**FAPRI's Downwards Revisions to Its Marketing Loan Gain Baseline Projections**

| Year | Estimated marketing loan gain1/ (cents/lb) | | | |
|---|---|---|---|---|
| | Nov 2002 (Sumner) | Jan 2003 | Nov 2003 2/ | Decrease from Sumner Nov02 baseline to Nov03 |
| 2003/04 | 14.78 | 7.2 | 0 | 100.0 % |
| 2004/05 | 12.17 | 6.6 | 1.04 | 91.5 % |
| 2005/06 | 10.06 | 6 | 1.18 | 88.3 % |
| 2006/07 | 8.4 | 5.3 | 1.65 | 80.4 % |
| 2007/08 | 6.52 | 4 | 2.76 | 57.7 % |
| Average | 10.39 | 5.82 | 1.32 | 87.3 % |

1/ The estimated marketing loan gain is the difference, if positive, between the loan rate (52 cents per lb) and the Adjusted World Price.

2/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

10. Recall that the marketing loan programme accounted for more than 42 per cent of the estimated effects of removing all US subsidies over MY 1999-2007 on production under the model

developed by Dr. Sumner.[6] Thus, updating the model to the November 2003 baseline would virtually eliminate the estimated effect of the marketing loan programme and significantly reducing the overall estimated effect on production. Any remaining effects would largely be attributed to direct payments under Dr. Sumner's flawed model, with which we strongly disagree.

11. In addition, the FAPRI baseline from November 2002 projected 50.7 cents per pound for the A-Index for marketing year 2003 and the January 2003 baseline projected 58.4 cents per pound for the A-index for marketing year 2003. The FAPRI November 2003 projection for the MY2003 A-Index is 70.9 cents per pound, *40 per cent higher* than the FAPRI November 2002 projections used by Dr. Sumner. Even this revision could be low as the actual A-index for January 2004 (through 22 January) has varied between a low of 75.45 cents per pound on January 2 to a high of 76.95 cents per pound on 22 January 2004. We also note that FAPRI's November 2002 projections that Dr. Sumner employed did not show, through marketing year 2012, the A-Index *ever* rising as high as current prices.

**FAPRI Baseline Projections for A-Index** *(cents per pound)*

| A-Index | Nov 2002 (Sumner) | Jan 2003 | Nov 2003 1/ | Increase from Sumner Nov02 baseline to Nov03 |
|---|---|---|---|---|
| 2003/04 | 50.7 | 58.4 | 70.9 | 39.8% |
| 2004/05 | 53.4 | 58.8 | 64.5 | 18.9% |
| 2005/06 | 55.8 | 59.4 | 64.3 | 15.2% |
| 2006/07 | 57.6 | 60.1 | 63.8 | 10.8% |
| 2007/08 | 59.6 | 61.5 | 62.7 | 5.2% |

1/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

12. The current high cotton prices and market expectations of continued high prices are crucially relevant because, as mentioned, marketing loan payments will not be made if cotton prices are above the loan rate of 52 cents per pound and, further, counter-cyclical payments will not be made if the season average farm price is above 65.73 cents per pound (the target price of 72.5 cents minus the direct payment rate of 6.67 cents). The weighted average farm price for August-November was 62.4 cents per pound, as reported by USDA on 11 January 2004.[7]

13. Without even referencing the US critique of the modelling used by Brazil with respect to the challenged US measures, this evidence relating to prices indicates that Brazil's economic analysis is founded on price projections that are almost 40 per cent below actual prices; thus, the economic analysis put forward by Brazil does not support a finding of threat of serious prejudice. Furthermore, we recall that Brazil has argued that the 2002 Act increased the support provided to upland cotton producers, threatening continued high levels of production, exports, and price suppression. And yet, US acreage declined in both MY2002 and MY2003, and prices have steadily recovered from their MY2001-2002 trough to five-year highs. Market participants expect those high prices to continue. Thus, the evidence does not support the view that the effects of challenged US subsidies are significant price suppression.

[6] *See* Brazil's Further Submission, Annex I, table 1.4.
[7] *World Agricultural Supply and Demand Estimates*, USDA, WAOB, WASDE-406, 11 January 2004.

## B. ECONOMIC DATA

**196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. BRA, USA**

14. In its reply, Brazil makes several unfounded accusations and misrepresentations of fact. In this comment, the United States attempts to disentangle fact from fiction for the Panel.

15. Brazil asserts that through its December 18, 2003 letter, "the United States has finally confirmed – after asserting the contrary repeatedly to Brazil and then to the Panel – that it has collected complete planted acreage, contract base acreage, contract yields, and even payment data that would allow it to calculate with relative precision the amount of direct and counter-cyclical payments made to current producers of upland cotton in MY 2002." There are several errors in this passage. First, the United States recalls that it was the United States itself at the second session of the first panel meeting that brought to the Panel's and Brazil's attention the planting reporting requirement that was introduced by Section 1105 of the 2002 Act (7 USC 7915). Thus, the United States did not "finally confirm[]" the maintenance of planting data on 18 December.

16. Second, the United States never asserted that it did not have contract base acreage and contract yield information. The United States explained that it did not track decoupled payments by recipients' production and thus did not maintain information on the payments made for upland cotton base acres to upland cotton producers. That statement remains true today. In fact, while Brazil's statement asserts that "planted acreage, contract base acreage, contract yields, and . . . payment data" can be used to calculate the amount of decoupled payments "made to current producers of upland cotton," this information would allow the calculation of decoupled payments made to farms that reported *planting* upland cotton. As stated, the United States does not collect information relating to whether a farm *produces* upland cotton. Therefore, the data referenced by Brazil would allow calculation of payments made to upland cotton "planters," and in fact the United States has provided the contract data to perform this calculation on 18 and 19 December 2003.

17. Brazil claims that it "cannot calculate direct payment and counter-cyclical payment figures" because it was not provided (ignoring that Brazil bears the burden of proof in this dispute) "farm-specific identifying numbers, thus rendering any matching of farm-level information on contract payments with information on farm-specific plantings impossible." This statement was indecipherable to the United States until the Panel insisted that Brazil explain its proposed methodology for calculating those payments in Question 258. The United States comments on this proposed methodology, which lacks any basis in the Subsidies Agreement, any WTO agreement, or in economic logic, in its comment on Brazil's answer to Question 258.

18. It is, of course, ironic to read Brazil' s suggestion that only the "unique farm number (or a substitute number protecting the alleged confidentiality of farmers) would allow any matching" since *the United States expressly asked Brazil at the second panel meeting whether it could act to protect the privacy interests of US cotton producers*, perhaps by obscuring farm numbers. The Panel Chairman also inquired of Brazil whether obscuring the farm numbers would be acceptable, *but Brazil refused to agree to any such step, insisting that all of the information, including farm numbers, be provided as set out in Exhibit BRA-369.* Thus, it is Brazil that refused to allow "a substitute number protecting the . . . confidentiality of farmers" – or any other step to maintain farmer confidentiality – to be used. The United States again notes Brazil's reference to "a private US citizen making a simple FOIA request," who was in fact a member of Brazil's delegation, and reminds Brazil for the third time of the US request for assistance in curing the breach of privacy that resulted from providing that planting information.

19. We also note that in Brazil's response, Brazil references several payments that were not included in the Panel's question, namely, crop insurance payments, cottonseed payments, and "other payments." Brazil does not state for what year these payments apply.

20. With regards to crop insurance payments[8], we note that the data provided by Brazil for crop insurance net indemnities with respect to upland cotton in 2002 is incorrect.[9] However, the only crop insurance payments within the scope of Brazil's panel request are payments to "upland cotton producers, users, and exporters."[10] Thus, Brazil is once again attempting to broaden the scope of this dispute to measures beyond its panel request, and the Panel should reject that effort.

21. With respect to cottonseed payments, the United States recalls the panel's communication of 8 December 2003 in which it stated that "[t]he Panel intends to rule that cottonseed payments made under the Agricultural Assistance Act of 2003 are not within its terms of reference." Thus, Brazil's citation to the amount of cottonseed payments made under this Act are not only outside the scope of the question but also outside the scope of this dispute. With respect to "other payments," the United States recalls its preliminary ruling request that these payments are not with the Panel's terms of reference.[11]

22. With respect to direct and counter-cyclical payments, Brazil continues to put forward erroneous figures before the Panel. Brazil fails to make any adjustment in the amount of payment to reflect the proportion of cotton planted acreage that is rented or owned. However, those "subsidies" to cotton producers that are the subject of Brazil's panel request must "benefit" producers.[12] Brazil itself has conceded that land rental rates as of marketing year 1997 – that is, one year after introduction of the decoupled production flexibility contract payments – reflect the capture of more than one-third of the subsidy by landowners. Finally, Brazil has not allocated these decoupled payments that are not tied to the production, use, or sale of any product across the total value of the recipient's production, the only allocation methodology set out in the Subsidies Agreement and, in fact, applied by Brazil itself for countervailing duty purposes.[13]

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[8] We also note that Brazil has insisted that crop insurance premium payments are "specific" subsidies within the meaning of Article 2 of the Subsidies Agreement because the crop insurance statute precludes coverage of livestock. *See, e.g.*, Brazil's Further Rebuttal Submission, para. 163. At one time there was such an exclusion, but as we have previously pointed out, it was removed. In fact, Brazil simply and repeatedly misquotes its own exhibit, which does not contain the "excluding livestock" language of the old statute. *See* Exhibit BRA-30, at 1-44 to 1-45 (extending coverage to enumerated products and "any other agricultural commodity, excluding stored grain, determined by the Board, or any one or more of such commodities, as the context may indicate").

[9] Total indemnity payments paid to upland cotton producers in 2002 was $400,686,555. Total upland cotton premiums were $317,610,012 of which the government provided premium subsidies of $194,111,641 and $123,498,371 was paid by producers. Thus, net indemnities (that is, indemnities minus producer-paid premiums) paid to upland cotton producers in 2002 was $277,188,184 ($400,686,555 minus $123,498,371), not $298.3 million as reported by Brazil.

[10] *See* WT/DS267/7, at 1 ("The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton.").

[11] US Further Written Submission, Section II. The United States also recalls its point above, namely Brazil has conceded the correctness of the US view that this Panel's terms of reference cannot expand beyond their scope of the date of panel establishment. In its answer to the Panel's Question 247, Brazil states: "Thus, the 'matter' before the Panel has not changed (*and cannot*) since the establishment of the Panel." Brazil should also have acknowledged that, despite this assurance, it has in fact attempted to change the matter before the Panel.

[12] *See* Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, adopted 7 June 2000, paras. 6.65 and 6.66 (quoting and agreeing with *Canada – Aircraft* panel: "'A "benefit" does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a "benefit" can be said to arise only if a person . . . has in fact received something.'").

[13] *See* US Comment on Brazil's Answer to Question 258 from the Panel.

23. With respect to the export credit guarantee programmes, Brazil "estimates the amount of payments using the 'guaranteed loan subsidy' estimate FY 2003."[14] This figure is of course not a payment at all, but merely a prospective budgetary *estimate* calculated under the Federal Credit Reform Act of 1990. As the United States noted in its answer, for all cotton for fiscal year 2003 (October 2002 - September 2003), outstanding claims are $280,898, less than one-tenth of one per cent of the value of registrations – further evidence, specific to cotton export credit guarantees in particular, that premiums are more than sufficient to cover operating costs and losses.

**199. What is the composition of the A-Index? We do note footnote 19 and, for example, Exhibit BRA-11, but please explain more in detail how this index is calculated. BRA**

24. With respect to the explanations of Brazil of the A-Index, we note that the A-Index is not a price for a "world market" for purposes of Article 6.3(c). As Brazil's answer puts it, the A-Index is an "average price," a "composite of quotations from the major producing regions around the world, much like a poll" (para. 11). The A-Index is also not a "price" in a "world market"; it is a Northern Europe-delivered price quote. We note the statement in paragraph 16 of Brazil's answer that "the average A-index price" in the week of export "would only be an estimate and would not necessarily reflect the price received by the US producers, or the prices received by the exporters." Finally, we note that there are 16 different quotes, and the A-Index consists of the average of the lowest 5. The fact that the prices differ also indicates that there is not one "world market" price. There is also a B-Index composed of upland cotton price quotes of lower quality growths, again suggesting that the A-Index is not a "world market price."

**200. Concerning the chart on page 37 of Brazil's further rebuttal submission, why did Brazil use a futures price at planting time? Is this a relevant measure for assessing acreage response? BRA**

25. Brazil asserts that US producers are largely unresponsive to market price movements and cites a chart provided in their oral statement of December 2 that showed cotton future prices and planted cotton acreage. However, using a simple cotton price is inappropriate to measure price responsiveness. Prices for cottons alternatives also fell from 1999 to 2002. A farmer cannot just consider cotton prices but must instead consider the opportunity cost at the time of planting. Operating costs being covered (as the United States has already shown the farmer expected to do in each year), he must decide which crop to plant, and this requires looking at the cotton price relative to alternatives. In fact, this is the approach taken by FAPRI and Dr. Sumner in considering net returns of cotton versus other crops.[15]

26. When one considers movements of cotton futures versus the price of a substitute like soybeans, a far different picture emerges than the one promoted by Brazil in its response to question 200. The graph below uses the same planted area numbers and time period as Brazil. It shows planted area is price responsive when judged against the more appropriate ratio of cotton to soybeans harvest season futures prices at the time of planting.[16]

27. In the US *Comments Concerning Brazil's Econometric Model*, we point out that the correlation between planted acreage and the ratio of cotton futures to soybean futures is 0.69 over the 1996 to 2002 period. This compares to a correlation of 0.40 for lagged prices to planted acreage, and a *negative correlation* using Dr. Sumner's expected net return calculation and planted acreage. Thus,

[14] Brazil's Answer to Question 196 from the Panel, para. 9.

[15] Indeed, our objections to their approach focuses on the use of lagged prices rather than futures prices as a proxy for producer price expectations.

[16] The cotton-soybeans futures price ratio is drawn from the US answer to question 175 from the Panel, paragraph 118.

in contrast to statements by Brazil that futures prices are poor predictors of planted acreage, the correlation data suggest that the futures price ratios are better predictors of planted acreage than the arbitrary net return calculations as constructed by Dr. Sumner.

28. In conclusion, the United States has demonstrated that because the harvest season cotton futures price at planting was above the marketing loan rate (in MY99-01), farmers were planting for the market, not the loan rate. But it is simplistic for Brazil to put compare cotton plantings to futures and judge US farmers not to be price responsive. The United States has never claimed (nor would it) that cotton futures are the only variable that matters for purposes of planting decisions. The correlation data on cotton planted acres to the cotton / soybeans futures ratio shows that competing crops must be factored into any planted acreage analysis. Thus, if Brazil had been interested in presenting an accurate analysis to the Panel, it could have presented such data, or even incorporated alternative crops besides soy from each relevant growing region. Brazil preferred to put forward an analysis that could only serve to obscure the issue.

**201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so, please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? BRA, USA**

29. As was pointed out in the US response to question 201, cotton producers' use of futures and option markets is high relative to other crops. Based on survey data from the 1996 USDA Agricultural Resource Management Study, it is estimated that between 35 and 57 per cent of cotton farmers used a hedging instrument in 1996. (The ranges reflect a 95 per cent confidence interval.) In addition, an estimated 63 to 89 per cent of cotton farms used cash forward contracts in 1996.[17] These survey results suggest that even seven years ago a large proportion of cotton farmers either directly or indirectly priced their cotton off of organized futures and options markets.

30. Moreover, futures markets provide producers information regarding the future price outlook even if they do not hedge directly on the exchange. For example, the 16 January 2004 newsletter by cotton market analyst O.A.. Cleveland states:

> With December [futures contract price] exhibiting signals of breaking away from old crop prices, *hedging of new crop has increased*. Now above 69 cents, *December will need to move higher to prevent acreage loss to both soybeans and corn. A soybean/cotton ratio of 9.5 to 1 is enough to begin moving some land from cotton to soybeans (November soybeans to December cotton). A 10 to 1 ratio accelerates the switch.* A September corn ratio of 4 to 1 over December cotton takes more cotton acreage. With both management and capital risk greatly reduced for both of these crops, relative to cotton, significant cotton acreage can be loss if cotton becomes less favourable. With world cotton carryover at a decade low, the new crop December must maintain its tie to the grain/oilseed complex instead of the old crop cotton contracts.[18]

Note that Dr. Cleveland refers not just to cotton futures but to the cotton to soybean ratio and the ratio between cotton futures and corn futures. He confirms not just the importance of cotton futures prices in guiding cotton planted acreage decisions but, more significantly, the relationship of cotton futures prices to the futures prices of competing crops like soybeans and corn.

[17] A forward contract is defined as a cash market transaction in which two parties agree to buy or sell a commodity or asset under agreed-upon conditions. For example, a farmer agrees sell, and a ginner or warehouse agrees to buy, cotton at a specific future time for an agreed-upon price or on the basis of an agreed on pricing mechanism (such as a futures or options market). See Exhibit US-121, page 22.

[18] O.A. Cleveland Newsletter, January 16, 2004. Exhibit US-133.

31. Brazil has presented no evidence that any farmer ever planted based on "lagged prices" (or its "estimated adjusted world price"). Despite Brazil's criticisms of looking at December futures prices to gauge producer price expectations, farm publications are full of references (like that by O.A. Cleveland, above) to the use of December futures for upland cotton planting and hedging purposes. Consider USDA's "Weekly Cotton Market Review" of 9 January 2004.[19] It reported:

- "Most producers [in southeastern markets] have turned their focus to marketing the remainder of their 2003 crop and to *making initial preparations for planting the 2004 crop. Some producers inquired about forward contracts on 2004-crop cotton*. These inquiries were preliminary and no cotton was booked. Merchants offered contracts in Georgia at *350 to 400 points off NY December futures*" (emphasis added).

Two weeks later, the most recent "Weekly Cotton Market Review" reported:[20]

- "Producers in Georgia booked a very light volume of 2004-crop cotton at 275 to 300 basis points off NY December futures."

- "Merchants continued to offer contracts in Georgia at 300 to 375 points off NY December futures."

- "Contracts in North Carolina were offered at 450 to 475 points off NY December futures."

- "Merchants offered forward contracts at 350 points off NY December futures [in south central markets]."

That is, as the United States has explained, producers are beginning to make planting decisions for MY2004 and are using the December futures price as a guide to their expected returns from planting cotton. A farmer in Georgia can currently lock in a price for the 2004 crop of approximately 65-66 cents per pound (27 Jan. 2004 December futures price of 69.05 cents per pound less 300 to 375 points), and farmers have begun to do just that. Thus, Brazil asserts that the US methodology of looking to the December futures price to gauge producer price expectations is far less valid than using the (outdated November 2002) FAPRI baseline, but cotton producers disagree. In the final analysis, it is producer decisions – and not FAPRI's nor Dr. Sumner's decision to use "lagged prices" – that must drive the Panel's analysis of the effect of removal of marketing loan payments.[21]

**203. Please provide information concerning the organization, mandate, credentials and standing of FAPRI. BRA**

32. The United States agrees with Brazil's general characterization of FAPRI as a preeminent research institution focused on providing comprehensive analysis of the food and agricultural system. As noted by Brazil in its answer, the United States takes issue with the modifications of the FAPRI model by Dr. Sumner. These differences are outlined in detail in the *US Comments Concerning*

[19] USDA, Weekly Cotton Market Review at 1-2 (January 9, 2004) (Exhibit US-139)

[20] USDA, Weekly Cotton Market Review at 1-2 (Jan. 23, 2004) (Exhibit US-140).

[21] We also note an argument by Brazil in paragraph 19 that farmers generate a combined revenue from the market and the marketing loan program that exceeds 52 cents per pound. Brazil's analysis is once again partial. The premise is that a farmer is able to sell when prices have *increased* relative to the price on the date they claimed the marketing loan gain. However, in reality, there is no guarantee that prices will have increased. It is equally possible that prices will fall *below* the price on the date when the claim was made. As Exhibit US-126 demonstrates, the margin fluctuates from month to month, with the value in several months even negative, implying that a farmer that did not sell his crop at the time he received the marketing loan payment earned *less than* the marketing loan rate.

*Brazil's Econometric Model* of 22 December 2003. Chief among these differences is that manner in which Dr. Sumner modelled the effects direct and counter-cyclical payments. FAPRI allows for modest effects of direct payments on all crop acreage. Their result is consistent with the literature on decoupled payments, showing no or minimal effects on production.[22] By contrast, Dr. Sumner has included an arbitrary and completely *ad hoc* formulation that exaggerates the effects of these payments on acreage decisions. As compared to FAPRI's modelling, Dr. Sumner assumes and then finds effects some 50 times larger.[23]

33. The differences between the FAPRI baseline and Dr. Sumner's model were highlighted as well by Dr. Bruce Babcock, the economist who assisted Dr. Sumner in preparing the Annex I results. In a letter to Dr. Glauber, Dr. Babcock states, that the analysis of Dr. Sumner was "in no way an official FAPRI analysis and if FAPRI had done the analysis, FAPRI would have come up with different estimates of the effects of US cotton subsidies on world prices." Thus, to cloak Dr. Sumner's analysis in the reputation of "the award-winning FAPRI model" is grossly misleading. The differences between FAPRI and the Brazil analysis reflected in Annex I are substantial and, as detailed in the US Comments of 22 December, lead to the biased results presented by Brazil.

**204. Which support to upland cotton is not captured in the EWG data referred to in Brazil's 18 November further rebuttal submission? BRA**

34. In this answer on "support to upland cotton," Brazil makes reference to "contract payments from base acreage other than upland cotton" and the "allocation of these payments".[24] This answer makes clear that Brazil proposes that such payments with respect to non-upland cotton base acres can be "support to upland cotton." The United States comments on the methodology proposed by Brazil for allocating such payments, which lacks any basis in the Subsidies Agreement, any WTO agreement, or in economic logic, in its comment on Brazil's answer to Question 258. Here, we take issue with Brazil's attempt to amend this Panel's terms of reference to include such payments, and to do so at such a late stage in this proceeding.[25]

35. Nowhere in Brazil's consultation request or request for the establishment of this Panel does Brazil reference these payments under programmes unrelated to upland cotton. Accordingly these payments are not within this Panel's terms of reference. Moreover, Brazil's attempt to raise these payments at the very end of this proceeding deprives the United States of fundamental rights of due process. The United States, as well as all WTO Members, had a right, as of the date of Brazil's request for the establishment of this Panel, to know the "*specific*" measures at issue in this dispute.[26] Brazil cannot make vague allegations of "support" and then change at will the measures that it is challenging as its own position changes and to suit its convenience.

36. Brazil's own submissions to this Panel demonstrate that Brazil did not consider these payments to be measures within the Panel's terms of reference. In particular, the measures Brazil has alleged are "support to upland cotton" govern both Brazil's serious prejudice claims as well as its Peace Clause analysis. That is, the same measures that are "support for upland cotton" under Brazil's subsidies claims must be the measures that Brazil claims are "support to a specific commodity" for purposes of the analysis under Article 13(b)(ii) of the support that current measures grant versus the support decided during the 1992 marketing year. However, by seeking to allocate to upland cotton

[22] *See* US Further Rebuttal Submission, paras. 81-82 (reviewing literature, which finds less than one per cent effect on production, even making unrealistic assumptions on wealth effects).

[23] *See* US Comments on Brazil's Economic Model, para. 20.

[24] Brazil's Answer to Question 204, para. 27.

[25] As previously noted, Brazil's answers to the Panel's questions contain an important concession: in its answer to the Panel's Question 247, Brazil states: "Thus, the 'matter' before the Panel has not changed (and cannot) since the establishment of the Panel."

[26] *See* DSU, Article 6.2.

"contract payments from base acreage other than upland cotton," Brazil directly contradicts the arguments it set forth in the Peace Clause phase of this dispute. For example, in response to Question 41 from the Panel, Brazil wrote:

> The *only US domestic support measures that Brazil is aware of that would meet the test of being 'support to upland cotton' are those that it listed for purposes of calculating the level of Peace Clause support* in its First Written Submission. In the view of Brazil, these non-green box domestic support measures are the measures that constitute "support to" upland cotton for the purpose of Article 13(b).[27]

The footnote to the first quoted sentence cited paragraphs 144, 148, and 149 of Brazil's first written submission. These paragraphs, in turn, contain the tables in which calculated that budgetary outlays it alleged were support to upland cotton; crucially, these tables list production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments *for upland cotton base acres only.*[28]

37. Similarly, in response to Question 19, in which the Panel asked Brazil to identify "the measures . . . in respect of which Brazil seeks relief," Brazil wrote:

> The first type of domestic support "measure" is the payment of subsidies for the production and use of upland cotton. . . . . Brazil has tabulated the different types of payments (i.e., the measures) made under these legal instruments in paragraphs 146-149 of its First Submission.[29]

Again, the referenced paragraphs list production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments *for upland cotton base acres only.*[30]

38. Further, in explaining to the Panel why it did not allocate any portion of other payments notified by the United States to the WTO as non-product-specific, "some of which" (in the Panel's words) "presumably deliver support to upland cotton (e.g. state credit programmes, irrigation subsidies etc)," Brazil explained:

> None[] of these other measures notified by the United States as non-product specific had *any upland cotton specific link* in terms of historic, updated, or present upland cotton acreage, present upland cotton production or prices, or upland cotton groups of insurance policies or *any other specific upland cotton provisions.*[31]

Of course, the same analysis applies to decoupled income support payments made with respect to base acres for wheat, corn, soy, oats, sorghum, barley, flax, sunflower, safflower, rice, rapeseed, mustard, canola, crambe, and sesame. *None* of these payments has any "upland cotton specific" link in terms of upland cotton acreage, production, prices, or "any other specific upland cotton provisions." Indeed, these other payments are related to acreage historically planted to these other crops and may be (in the case of counter-cyclical payments) related to current prices of these other crops, *not upland cotton*. It is for that reason, presumably, that Brazil did not identify any of these payments among the measures it challenged.

39. Indeed, an important element in Brazil's argument that the decoupled income support measures it challenged were *not* non-product-specific – and thus constitute "support to a specific

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[27] Brazil's Answer to Question 41 from the Panel, para. 58 (footnote omitted) (italics added).
[28] *See* Brazil's First Written Submission, paras. 144, 148, 149.
[29] Brazil's Answer to Question 19 from the Panel, para. 15.
[30] *See* Brazil's First Written Submission, paras. 146-49.
[31] Brazil's Answer to Question 41 from the Panel, para. 57 (italics added).

commodity" – was that the challenged measures contained upland cotton-specific parameters. For example, with respect to counter-cyclical payments, Brazil wrote:

> For the purpose of calculating AMS, counter-cyclical payments (CCP) are 'product-specific' support for two main reasons: (i) they are not "support provided in favour of agricultural producers in general," and (ii) they are directly linked to *upland cotton-specific parameters* (current prices and historical acreage and yield).[32]

Brazil similarly argued that other decoupled income support measures were product-specific support in favour of upland cotton because they allegedly contain upland cotton-specific parameters.[33]

40. We also note that Brazil's request to the Panel to make rulings and recommendations does not reference any decoupled payments made with respect to non-upland cotton base acres. In fact, Brazil specifically stated that its "as such" challenge to "Sections of the 2002 FSRI Act and the referenced regulations thereto," including provisions relating to counter-cyclical payments and direct payments, were only made "to the extent that they relate to upland cotton."[34]

41. In sum, Brazil's arguments on the Peace Clause explicitly limited its claims with respect to decoupled income support measures to payments made with respect to upland cotton base acres. In fact, Brazil relied on the notion that such measures contained "upland cotton-specific" parameters to support its argument that those measures were "support to upland cotton" rather than non-product-specific support.

42. Under its serious prejudice claims, however, Brazil now seeks to expand the challenged measures to include decoupled income support measures with respect to non-upland cotton base acres[35], despite repeatedly arguing that the challenged US subsidies provided $12.9 billion in support over marketing years 1999-2002, a figure based on payments made under specific programmes, *including decoupled income support with respect to upland cotton base acres only*.[36] Decoupled payments made with respect to non-upland cotton base acres would not be within the terms of reference of this dispute; Brazil as complaining party cannot unilaterally expand the terms of reference at the conclusion of a dispute and claim that additional programmes, other than those at issue throughout the dispute, are now also challenged measures providing "subsidies to upland cotton."[37]

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[32] Brazil's Answer to Question 44 from the Panel, para. 61 (italics added).

[33] *See, e.g.*, Brazil's First Written Submission, para. 60 ("Between MY 1998-2001, upland cotton producers thereby received an additional amount of money, which was calculated based on their respective share of total upland cotton base times the amount of budgetary outlays allocated for upland cotton.").

[34] Brazil's Further Submission, para. 471(vii).

[35] The United States notes that Brazil does not appear to seriously believe that these measures are within the Panel's terms of reference since Brazil has not presented the 1992 levels of support that would include these additional payments, which Brazil would have had to do to make the Peace Clause comparison.

[36] We note that Brazil seeks to have it both ways. That is, it now argues that decoupled payments made with respect to non-upland cotton base acres can be allocated to, and become support to, upland cotton, yet at the same time, when it suits its purposes, it continues to argue that decoupled payments are support to upland cotton because of their alleged upland cotton-specific parameters. *See, e.g.*, Brazil 's Opening Statement at Second Panel Meeting, para. 60 ("[T]he 72.4 cent target price triggers CCP payments when *cotton* prices are lower – not corn, or soybeans prices – but *cotton*.").

[37] Indeed, although Brazil attempted to argue at the second panel meeting that it sought information on payments made with respect to *non-upland cotton base acres* through the Annex V procedure that the DSB did not agree to initiate, Brazil itself stated in its first written submission that its Annex V request was *limited to upland cotton base acres*: "Brazil requested the United States during the Annex V procedure to provide information on the amount of the *total upland cotton base acreage and yield under the CCP (and DP) program*." Brazil's First Written Submission, para. 68 (italics added). If so, this would be consistent with

**209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs**. **BRA, USA**

43. We note that Brazil acknowledges that a comparison of "planted to planted" area would be best. Harvested area can only be used as a proxy for planted area, and as indicated by the US data in the US Opening Statement of 2 December 2003, the two measures can diverge significantly. This divergence is especially important to note in light of Brazil's answer to Panel Question 210.

**210. Are worldwide planted acreage figures available? BRA, USA**

44. After noting in its response that consistent world-wide planting data for upland cotton are not available, Brazil continues to insist that world-wide harvested area data are a good proxy for planted area. Brazil offers a theoretical justification for using harvested area as a proxy for planted area (annual abandonment will average out over all cotton producing countries and be relatively stable over time). But Brazil has no empirical evidence to support the theory and continues to mix "apples and oranges" in its charts. For example, we note the chart at paragraph 33 of Brazil's answers is misleading: it is not a chart of "Per cent Change in Planted Acres" as labelled. Rather, it compares changes in US *planted* area for upland cotton with changes in non-US *harvested* area. This comparison is not appropriate.

45. As noted in the US answers to Question 209 from the Panel, US planted and harvested area generally move in the same direction but occasionally move in opposite directions. We note that, once again, Brazil has relied on a period that begins with marketing year 1998 to present a biased analysis. The period 1998 - 2000 that Brazil focuses on in para. 33 was an unusual period for US cotton because of weather. As noted in the US Opening Statement of December 2 (para. 6), abandonment was especially high in 1998 and area rebounded sharply in 1999. The year 2000 was a year when US planted and harvested area moved in opposite directions.

**US Planted and Harvested Upland Cotton Acres** (1,000 acres)

| Crop year | Planted acres | Harvested acres |
|---|---|---|
| 1998 | 13,064 | 10,449 |
| 1999 | 14,584 | 13,138 |
| 2000 | 15,347 | 12,884 |

Source: USDA, National Agricultural Statistics Service, *Acreage*, various issues, as submitted in the US Opening Statement of December 2 (para. 6).

46. Because foreign planted area data are not available, it is not possible to observe whether foreign planted and harvested area similarly diverged in these years. Therefore, using US planted area and foreign harvested area is a misleading comparison. Brazil uses its mislabelled chart to simplistically conclude that whenever US planted area moves in a divergent direction from foreign harvested area, the only reason must be because US subsidies insulate US upland cotton producers. That conclusion ignores any other possible factors that may affect area planted – for example, weather or competing crop prices – and is not supported by the data.

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Brazil 's Peace Clause argumentation in this dispute that only payments on upland cotton base acres could be product-specific support for upland cotton.

47. In para. 34, Brazil again complains that the US chart in the US Opening Statement of 2 Dec. (para. 6) is inappropriate. Brazil has it completely backwards. The US chart is the only appropriate comparison. We agree that a comparison of planted area data would be the best method, but the data are not available. Therefore, Brazil's conclusions based on a "planted versus harvested" comparison are not valid.

48. We again present a comparison of changes in US harvested area for upland cotton with changes in harvested area for the rest of the world. (These data are found in Exhibit US-63, but 2002 data are updated and estimated data for 2003-04 are included.) We note again the anomalous years of 1998 and 1999 for the US, where harvested area was sharply below planted area in 1998 because of severe adverse weather but then planted (and harvested) area increased sharply in 1999 in reaction both to the previous year's high abandonment and to favourable prices relative to competing crops. For the years 2000 - 2002 harvested area in the US and the rest of the world moved in tandem – declining in 2000, rising in 2001, and declining again in 2002. Brazil's claim of "distinctly different reactions"[38] are not supported by the data.

49. Brazil further claims that US area should have declined during the period 1999 - 2002. In fact, it is hard to discern any trend in US (or foreign) harvested area during this period. But since 1999, an admitted high year because of unique weather factors and favourable cotton prices relative to competing crops, US upland cotton area has generally declined. The new data provided for 2003 reinforce this conclusion: US area declined while the rest of the world, including Brazil, increased.

**Harvested Area for Upland Cotton** *(1,000 hectares and per cent change from previous year)*

| Crop year | 1998 | 1999 | 2000 | 2001 | 2002 | 2003(p) |
|---|---|---|---|---|---|---|
| | | | | | | |
| US area | 4,324 | 5,433 | 5,282 | 5,596 | 5,030 | 4,881 |
| Foreign area | 28,559 | 26,955 | 26,904 | 28,308 | 25,470 | 28,090 |
| Brazil area | 685 | 752 | 853 | 748 | 735 | 940 |
| | | | | | | |
| US (% change) | -20.3 | 25.6 | -2.8 | 5.9 | -10.1 | -3.0 |
| Foreign (% change) | 0.5 | -5.6 | -0.2 | 5.2 | -9.9 | 10.3 |
| Brazil (% change) | -10.5 | 9.8 | 13.4 | -12.3 | -1.7 | 27.9 |

Sources: USDA, Foreign Agricultural Service, Production, Supply, and Distribution Database; World Agricultural Supply and Demand Estimates, World Agricultural Outlook Board, USDA, 11 January 2004. Exhibit US-63, with 2003 added.

50. The data show that US harvested cotton area moves consistently with the rest of the world, when there are not abnormal weather events. Brazil conceded as much (in para. 36) that US acreage movements were relatively consistent with the rest of the world. How could that be if US producers are insulated from price movements because of subsidies? In marketing year 2003, US cotton area declined 3 per cent while the rest of the world rose 10 per cent. These divergent results again suggest that cotton area around the world is affected by different factors and these need to be accounted for carefully. But a *decline* in US harvested acreage in marketing year 2003, following a decline in marketing year 2002, is certainly not consistent with Brazil's theory that the United States increased support in the 2002 Act and that these "higher" payments will result in US overproduction of cotton, threatening to cause serious prejudice.

[38] Brazil's Answer to Question 210 from the Panel, para. 35.

51. In discussing how producers react to price signals, we would note recent trends in Brazil's cotton area. In MY2002, Brazil's harvested area declined about 2 per cent while the US and foreign cotton area dropped 10 per cent. In MY2003, Brazil's cotton area is estimated to have increased *28 per cent* while US cotton area fell 3 per cent. In fact, since the collapse in Brazil's cotton area in 1996, Brazil's cotton area has shown a much more consistent upward trend than US or foreign cotton area. We also note that in marketing years 1998, 1999, 2000 and 2001, Brazil's harvested area moved in the *opposite direction* from non-US cotton area. Those different responses, in absolute values, ranged from 11 per cent in MY1998 to 17.5 per cent in MY2001. In MY2002, Brazil's harvested area declined much less than the (non-US) rest of the world (1.7 per cent versus 9.9 per cent), and in MY2003 Brazil's harvested area is forecast to expand by far more than the (non-US) rest of the world (27.9 per cent versus 10.3 per cent). Thus, it would appear that, in terms of changes in harvested acres, Brazil deviates far more from the non-US rest of the world than does the United States.

52. Finally, in paragraph 35, even when Brazil' s misleading data do show a consistent decline between US planted and non-US harvested area, Brazil does not accept that US cotton producers were responding to market signals. Brazil simply claims that US cotton area should have declined more than it did.[39]

53. Brazil has tried to explain away similarities in acreage movements by asserting that Dr. Sumner's analysis suggests that US cotton acreage should have even been lower. Not only do we disagree with that analysis, but we note that it fails to explain why US and non-US harvested acreage moves commensurately from 1997-2002. If US producers were insulated from price movements, as Brazil claims, one would not expect US acreage to be highly correlated with acreage movements in the rest of the world. In fact, the data suggests the opposite; i.e., that US producers respond in similar fashion with cotton producers around the world.

**213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? BRA, USA**

54. Brazil points out that the statistical estimation literature in agricultural economics has used a variety of proxies for anticipated prices and revenue for the upcoming season. These include rational expectations in which many sources of information available to decision makers are combined and the expectations are consistent with the conditional forecasts of the model. Such models have strong theoretical grounding but have been impractical in most estimation situations.

55. Models such as used by FAPRI, USDA and the Congressional Budget Office has been developed not for retrospective analysis but for *prospective* analysis. If one wants to project out over a period for which futures prices are not available, it makes sense to rely on lagged prices since the models will produce prices for a given year that can then be used as the price expectation for the following year.

[39] In paragraph 35, Brazil again tries to buttress its claims by arguing that US exports increased during a period when the US dollar was appreciating in value. The exchange rate analysis put forward by Brazil is incomplete and inadequate. Brazil has ignored the fact that cotton is a raw material for apparel and textile products. The increase in foreign demand for raw cotton drove an increase in US exports. For example, with a strong US dollar, imported cotton textile and apparel became relatively cheaper, thereby increasing demand for such products. Increased textile and apparel demand in the United States from the higher dollar resulted in increased demand for raw cotton by foreign textile and apparel manufacturers. Foreign use of cotton increased from 80.8 million bales in MY 1999 to 91 million bales in MY 2002. Foreign production, however, remained basically the same, 70.5 million bales in MY 1999 to 70.8 million bales in MY2002. Therefore, US exports were responding to demand that was not met by foreign production. Source: Cotton and Wool Situation and Outlook Yearbook, Economic Research Service, USDA, November 2003, pg. 32.

56. Nonetheless, the use of lagged prices may result in biased results. Over the long term, where there is reasonable stability in markets, lagged prices function adequately as a proxy for price expectations. However, in those years, as in the period Brazil has pointed to here, when unexpected exogenous shocks such as China dumping stocks (late 1990s) and unexpected yields worldwide due to good weather conditions such as 2001, lagged prices are poor predictors of expected prices. Future prices, by contrast, are more efficient because they are based on more current information. Moreover, as we have argued elsewhere (see comments to question 200 and 201 above), producers base acreage decisions on futures markets. Where futures prices diverge from lagged prices, there is reason to believe that planted acreage decisions will diverge from forecast acreage from models based on lagged prices.

57. For example, during marketing years 2000, 2001, 2002, and 2003, lagged prices significantly understate the harvest season prices expected by producers as seen in the futures prices at the time of planting. The use of lagged prices thereby inflate the effect of the marketing loan rate. In fact, those lagged prices would have to be increased by 8-25 per cent, depending on the year, to equal the harvest season price actually expected by producers as indicated by the futures price.[40]

- For the period MY 1999-2003, when futures prices are used to gauge producer price expectations, only in MY 2002 were expected cash prices below the marketing loan rate.

- However, over that same period, when lagged prices are used as expected prices, the loan rate is higher than the expected price *in every year over this period* except MY1999.

Thus, it is a significant error for Brazil and Dr. Sumner to use lagged prices instead of the futures prices Brazil's own expert explained to be the more accurate gauge of farmers' price expectations. In fact, despite the hundreds of exhibits it has filed, Brazil has provided not one single piece of evidence that any farmers use or have ever used lagged prices to make planting decisions.

58. While the United States would agree with Brazil that it is impossible to know precisely what individual farmers' price expectations are, the United States (and Brazil's expert, Mr. McDonald) believe that futures prices provide the most current expectations of market participants. As such, futures prices incorporate the views of numerous market participants, including producers, regarding expectations of future market conditions. The United States disagrees with the approach used by Brazil in its analysis to rely solely on lagged prices and ignore information provided by futures prices. While it may be impractical to include futures prices in some models, modelling convenience is no justification to ignore these objective, market-based price expectations. The Panel cannot rely on Brazil's economic analysis that uses a proxy for expected prices that would have to be increased by up to 25 per cent to accurately reflect futures prices, the only objective data on the record reflecting actual price expectations of market participants. The biased results from using lagged prices do not assist the Panel in making an objective assessment of what is the effect of the US marketing loan programme.

59. Brazil ignores the fact that expected cash prices based on futures prices were above the loan rate from MY1999-2001, whereas the lagged price was below the loan rate for 2000-2002. That is, withdrawal of the marketing loan would not have greater acreage impacts because producers are planting for market prices, not loan rate.

**215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA**

[40] US Further Rebuttal Submission, paras. 164-65.

60. In the US response to question 211 (b), we demonstrate that market returns have exceeded variable costs for cotton producers in every year but one (2001) over the period of investigation. Brazil continues to argue that producers require direct payments to cover total costs of production, but this ignores the evidence that significant acreage is planted to cotton by cotton producers who have no cotton base acreage and hence are ineligible for cotton direct payments.

61. Brazil claims US producers will continue to plant upland cotton because they face no revenue risk, but this argument ignores the substantial evidence on record of huge acreage shifts, both on state level and within three categories of farms (i.e., those who plant cotton with cotton base; those who do not plant cotton but have cotton base; those farms who planted cotton but have no cotton base). Moreover, Brazil ignores the decline in plantings over last two years as other commodities have become more attractive and expected cotton prices less so. Finally, the claim that direct and counter cyclical payments remove risk of revenue loss runs contrary to theory on decoupled payments. Farmers will plant the crop that maximizes their expected revenue since the decoupled payment will be made whether they plant or not.

62. Brazil's argument that direct payments have significant effects on production runs counter to the empirical literature as well as running counter to the estimated effects from the FAPRI model that they purport to use. As pointed out in Dr. Glauber's literature review[41] and in the US discussion of direct payments in the US further submission and further rebuttal submission, empirical studies suggest that direct payments have only minimal effects on production. Indeed, as pointed out in the US Comments Concerning Brazil's Econometric Model of 22 December, the FAPRI baseline model (that is, the original FAPRI model as distinct from the model modified by Dr. Sumner) suggests that the effect of direct payments on cotton acreage is less than one per cent.

63. It is only when Dr. Sumner explicitly modifies the FAPRI model to *include* an *ad hoc* production specification for direct payments that Brazil obtains the tautological result that direct payments have a significant effect on cotton production.

**216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. BRA, USA**

64. In this answer the matter addressed has to do with base issues and whether farmers could or could not update their bases in the period that followed 1985. In our 22 December response we gave a full answer on that topic. We would note that in the US answer it is indicated that under the 1990 Act the running base provisions for cotton called for a five-year running average. This was an error. The running base period was a five-year period for other programme crops, but cotton and rice used a three-year period.

65. Brazil's contention that the United States has a base building policy is belied by Brazil's own recitation that there has been only one chance to add base cost-free (that is, without loss of benefits); that was in the 2002 Act, in which new crops were added to the programme mix, necessitating a recalculation. There is no guarantee nor any reason to believe that this will ever happen again. Brazil is simply speculating on the likelihood that updating could occur. What could happen in some cases is programme termination, such as that which occurred with the elimination of peanut quotas in the 2002 Act.

66. Brazil further speculates that some farmers could be upset by the new programme because they did not plant as much as they could have over 1998-2001 and that such farmers will now plant more than they would otherwise have. Brazil's speculation is devoid of any facts. In fact, the United States has pointed to planting data (for example, that submitted on December 18 and 19, 2003) that

[41] Exhibit US-23.

demonstrates just the opposite – that is, cotton plantings are declining. Further, Brazil's own scenario suggests that there was no such understood policy of base building – otherwise, why would any farmer be surprised? Farmers will always speculate on the shape of the future, but these speculations (for which Brazil has presented no evidence) cannot drive determinations of consistency or inconsistency of measures with WTO obligations.

67. Finally, to the extent that Members would wish to limit the ability of Members to choose a new "defined and fixed base period" for purposes of paragraph 6(a) of Annex 2 to the Agreement on Agriculture, they may do so as a result of the current Doha negotiations. However, no such limitation currently appears in the text, and Brazil is acting in contravention of Article 3.2 of the DSU in seeking to have a panel "add to or diminish" the rights and obligations of Members through dispute settlement. The United States would also note that Brazil's response to this question appears to assume that Members will not accept the US proposal for significant reductions in domestic support under the Doha negotiations. The overall AMS reduction commitment would be relevant for the amount of support, including base acres, that a Member would provide.

## D. EXPORT CREDIT GUARANTEES

**220. What will be the relevance of Articles 9 and 10.1 of the Agreement of Agriculture to export credit guarantees when disciplines are internationally agreed? BRA**

68. Brazil's response to this question demonstrates that Brazil continues to ignore the text of Article 10.2 itself. Article 10.2 is clear that once disciplines are internationally agreed, then Members undertake "to provide export credits, export credit guarantees or insurance programmes only in conformity therewith." No "amendment" to Articles 9 or 10 would be needed. Article 10.2 has already specified the obligations once the negotiations are completed. In this sense, Article 10.2 goes further than, for example, Articles XIII:2 and XV:1 of the GATS, which also call for negotiations to develop additional disciplines but do not on their face already commit Members to abide by the results of those negotiations.

69. Brazil mischaracterizes the views of the United States with respect to the role of the OECD and the interpretation of Article 10.2 of the *Agreement on Agriculture.* Brazil stated that "some participants [in the Uruguay Round negotiations] may have been seeking additional obligations regarding notification, consultation and information exchange, like those included in the OECD Arrangement on Officially Supported Export Credits for industrial products".[42] Brazil alluded to no other potential disciplines available under the OECD Arrangement. In its Closing Statement of 3 December 2003, the United States responded that Brazil minimizes the significance of Article 10.2 as reflecting:

> merely a banal compromise to accommodate potential 'additional obligations regarding notification, consultation, and information exchange.' Brazil implausibly asserts that the obvious transition between the language of the Draft Final Act that would have imposed significant substantive disciplines on export credit guarantees and the absence of such language in the Article 10.2 ultimately adopted can be fully explained as reflecting merely an agreement to work on such pedestrian disciplines as information exchange".[43]

70. Brazil, however, mischaracterizes the US statement as a dismissal of other disciplines that Brazil itself never mentioned: "permitted exceptions, matching of derogations, non-conforming non-notified items, and terms granted by countries that are not parties to the OECD Arrangement."[44]

[42] Opening Statement of Brazil, 2 December 2003, para. 74
[43] Closing Statement of the United States, 3 December 2003, para. 3.
[44] Answers of Brazil (22 December 2003), Question 220, para. 54.

71. Ironically, the United States – not Brazil – has emphasized the significance of the OECD in the interpretation of Article 10.2. During the Uruguay Round, WTO Members did not agree on disciplines to be applicable to export credit guarantee programmes and therefore opted "to work toward the development of internationally agreed disciplines," as contemplated by the text of Article 10.2, in the appropriate forum of the OECD to achieve such disciplines. As the United States has pointed out, the OECD was the logical forum for such negotiations because of the institutional experience of that organization in the development of disciplines on officially supported export credits in the industrial sector.[45] Six years of negotiations continued there until 2001.

**221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be $230,127,023 instead of the figure which originally appeared ($381,345,059).**

> **(c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of $4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately $4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result**.

72. Brazil quotes selective excerpts of 1998 testimony of then- General Sales Manager Christopher Goldthwait but misconstrues them to draw the absurd proposition that export credit premia cover only administrative expenses of the programme. These excerpts on their face not only do not say what Brazil claims - they contradict Brazil's claim. Both Brazil and the United States have noted that administrative expenses of the programme are between $3 and 4 million per year.[46] Premia collected, of course, consistently far exceed that amount.[47]

73. Moreover, Mr. Goldthwait's testimony does not state that premia cover *only* administrative expenses (even in the excerpt quoted by Brazil he twice says that the money collected is "more" than the amount of administrative expenses), and the actual figures for premia reveal the inaccuracy of Brazil's claim.

74. The testimony in Exhibit Bra-87 in fact supports the argument of the United States that it exercises considerable discretion in the administration of the programme and that contrary to Brazil's repeated mischaracterizations, CCC can "stem[], or otherwise control, the flow of" CCC export credit guarantees.[48]

75. Then Undersecretary August Schumacher stated:

> "On GSM we are continually revising the changing creditworthiness of these overseas buyers. We are extremely prudent in the use. We follow this very, very

[45] US First Written Submission (11 July 2003), paras. 155-160
[46] See, e.g., Oral Statement of Brazil (22 July 2003), para. 132.
[47] Exhibit US-128.
[48] The most recent invocation of Brazil's misapplied mantra appears in Brazil's Answer to Additional Question 257(c) (20 January 2004), para. 38

carefully. Without the [International Monetary Fund], we would be very reluctant to operate and allocate these GSM programmes as required by the Agricultural Trade Act of 1978.

"Actual credit packages are subject to interagency review. Overall, we will continue to achieve balance between our twin objectives of promoting US agricultural exports and operating Federal programmes such as the GSM with fiduciary responsibility to the taxpayers and to you in Congress."[49]

76. Further testimony not quoted by Brazil included the following:

Congressman Minge:

"I would like to ask if you could explain to us why you feel that this programme is one that will not expose the American taxpayer or the US Treasury to a loss, particularly if private sector lenders are competing with the Federal Government for repayment of their loans and these countries in Southeast Asia find their financial condition further deteriorates? Is this a risk that we are creating for the US Treasurer, or is this something you feel we are adequately protected on?"

Mr. Goldthwait:

"We developed our programme allocations by beginning with a country risk analysis. It is very much the same sort of analysis that a private bank will do in setting its . . . confirmation line for transactions with a particular foreign country.

"We . . . evaluate very carefully the financial situation of the country and the banks involved and the letters of credit that we will eventually guarantee in determining exactly how far further we can go and still remain prudent with the taxpayers' money."

Congressman Minge: "So you do not expect any greater exposure to loss here than you have had historically in the operation of the programme?"

Mr. Goldthwait: "We do not".[50]

**223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? USA**

77. Brazil asserts that "premium rates for the three CCC guarantee programmes are not subject to regular review".[51] This is incorrect. As the United States noted in its response to this question, premium rates are reviewed annually. They may or may not increase in any given year as a result of such annual review.

78. To avoid any potential misunderstanding the United States would also point out that the statutory cap on premia of one per cent applies only to GSM-102. Brazil correctly notes this in

[49] Exhibit Bra-87, page 10.
[50] *Id.*, page. 12.
[51] Answers of Brazil to Question 223 of the Panel (22 December 2003), para. 63.

paragraph 66 of its December 22 answers, but paragraph 64 could be interpreted to imply that the cap similarly applies to GSM-103, which it does not.

**227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount - referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? USA**

79. In addition to its own response to this question from the Panel, the United States would reiterate that the $411 million figure is an *estimate* and the "results of the reestimate process".[52] In addition, the $770 million in the 'subsidy allowance' is not an uncollectible amount. It is merely a loan loss *allowance* based on annual re-estimates reflected in the budget. It is obviously not an amount deemed uncollectible, because from 2001 to 2002, as reflected in the very next line of the financial statement, the number itself *declined* from $1.043 billion to $770 million.[53] Similarly, the figure applicable to pre-1992 credit guarantees in the column "allowance for uncollectible accounts" is itself only a prospective *allowance*, which may or may not ultimately correspond to actual uncollectability. As with the subsidy allowance noted above, in this case, too, the allowance declined from 2002 to 2003 by $389 million.[54]

80. Office of Management and Budget Circular A-11 defines "allowance" as follows:

> "Allowance means a lump-sum included in the budget to represent certain transactions that are expected to increase or decrease budget authority, outlays, or receipts but that are not, for various reasons, reflected in the programme details. For example, the budget might include an allowance to show the effect on the budget totals of a proposal that would affect many accounts by relatively small amounts, in order to avoid unnecessary detail in the presentations for the individual accounts. The President doesn't propose that Congress enact an allowance as such, but rather that it modify specific legislative measures as necessary to produce the increases or decreases represented by the allowance."[55]

**228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? BRA, USA**

81. Brazil incorrectly asserts that "US government's own accounting principles lead to a conclusion that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes".[56] To the contrary, under current GAAP for Federal Entities, including the application of such principles related to the Federal Credit Reform Act of 1990, the programme reflects profitability for all of the first five cohorts (1992-1996). In addition, the cohort for 1999 is already showing profitability.[57] Exhibit US-128 also reflects the long-term profitability of the programmes.

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[52] Rebuttal Submission of Brazil (22 August 2003), para. 109; US Further Submission (30 September 2003), fn. 94; See Exhibit Bra-158, Notes to Financial Statement, page 19.

[53] See Exhibit Bra-158, Notes to Financial Statement, p. 14.

[54] See Exhibit US-129, Notes to 2003 Financial Statement, p. 15.

[55] OMB Circular A-11 (2003), Section 20.3, p. 20-2.
http://www.whitehouse.gov/omb/circulars/a11/current_year/s20.pdf

[56] Answers of Brazil to Panel Question 228 (22 December 2003), para. 68.

[57] See Exhibit Bra-182 and US Answers to Panel Question 221(b) (22 December 2003, paras. 83-86.

82. The United States has every reason to believe this trend will continue with respect to more recent cohorts. Contrary to the assertions of Brazil, the United States is not "carefully selecting" or "cherry-picking" years that "did not lose money".[58] For the reasons set forth in US answers to Panel Questions 221(f), (g), (h), and (i)[59], chronologically more recent – not "carefully selected" – years are reflected unnecessarily negatively in the US budget.

## E. SERIOUS PREJUDICE

**229. What is the meaning of the words "may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the SCM Agreement? Please comment on the possibility that these words indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice and that serious prejudice should be considered an additional or overriding criterion to the factors specified in the subparagraphs. BRA**

83. Brazil states that "[t]he phrase 'one or several' must be read according to its ordinary meaning" and reads this phrase to mean "at least one." Brazil then states that it "disagrees with the possibility that the words *one or several* indicate that one of the Article 6.3 paragraphs may not be sufficient to establish serious prejudice".[60] However, Brazil's answer simply neglects to read *all* of "the words" quoted in the Panel's question (drawn from the chapeau of Article 6.3) according to their ordinary meaning: "What is the meaning of the words 'may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the *SCM Agreement*?" Crucially, Brazil simply neglects to read the words "may arise" according to their ordinary meaning.[61] The ordinary meaning of "may" is "have ability or power to; can"[62] and "to express possibility, opportunity, or permission".[63] Therefore, the ordinary meaning of the chapeau to Article 6.3 (that is, including the phrase "may arise" as well as "one or several") would be that there is a "possibility" or "opportunity" for serious prejudice in the sense of Article 5(c) to "arise" where one or more of the effects listed in Article 6.3 is found.[64]

84. Thus, when Brazil "disagrees with the possibility that the words *one or several* indicate that one of the Article 6.3 paragraphs may not be sufficient to establish serious prejudice," Brazil is not reading the chapeau of Article 6.3 according to the ordinary meaning of all of the words in the provision. Such a selective approach fails to read the treaty text according to the customary rules of interpretation of public international law. Indeed, if Article 6.3 had been intended to mean that any one of the subparagraphs would *necessarily* suffice to show serious prejudice, the text would have used obligatory language in favour of a finding of serious prejudice (such as, "serious prejudice . . . shall arise in any case where at least one of the following apply").[65]

85. Brazil's discussion of various provisions of the Antidumping Agreement and Subsidies Agreement that contain language that no one factor can necessarily "give decisive guidance" towards a pertinent finding is inapt. That is, simply because the "may arise" language in the chapeau of Article 6.3 does not necessarily *preclude* a finding of serious prejudice where the effect in only one subparagraph has been demonstrated does not convert the "possibility" or "opportunity" that serious

[58] See, e.g., Answer of Brazil to Panel Question 228 (22 December 2003), para. 73.

[59] US Answers to Panel Questions (22 December 2003), paras. 91-104.

[60] Brazil's Answer to Question 229 from the Panel, paras. 76-77.

[61] *See* Brazil 's Answer to Question 229 from the Panel, paras. 79-80 (setting forth no interpretation of "may arise" according to its ordinary meaning).

[62] *The New Shorter Oxford English Dictionary*, vol. 1, at 1721 (1993 ed.).

[63] *The Random House Dictionary of the English Language, Unabridged Edition* at 886 (1983).

[64] *See* US Answer to Question 149 from the Panel, paras. 71-75.

[65] Indeed, Article 6.1 demonstrates that Members knew how to create a presumption of serious prejudice: they did so by explicitly stating that, in certain cases, "[s]erious prejudice . . . *shall* be deemed to exist" (italics added). Article 6.2, while providing a means to rebut that presumption, does not by its terms establish that serious prejudice "shall be deemed to exist" if one of the effects in Article 6.3 exists.

prejudice arise into an *obligation* to find serious prejudice. Rather, serious prejudice "may arise" or it may not, for example, where a panel concludes that one or more subparagraphs is technically met but the effect is not sufficient to cause serious prejudice.

86. Finally, we note Brazil's new argument that the "may arise" language "is necessary because while the facts may demonstrate that the effects of the subsidies *may* create the one, two, or three enumerated types of serious prejudice, these effects may not be actionable".[66] Brazil' s argument misunderstands the nature of the serious prejudice analysis. As stated above, the plain language of Article 6.3 establishes that demonstrating one or several of the effects of the subparagraphs does not *necessarily* suffice to demonstrate serious prejudice. Thus, it is not the case that "serious prejudice" will arise where one of the effects is demonstrated but an "exemption" (in Brazil's words) in Article 6 applies; rather, the "exemptions" cited by Brazil preclude the very finding of "serious prejudice."

- For example, Brazil argues that the effect in Article 6.3(d) (an increase in world market share) may be demonstrated but may "not be actionable" because multilaterally agreed rules exist within the meaning of footnote 17. But the effect of footnote 17 is to remove certain primary products or commodities subject to such rules from the 6.3(d) analysis altogether.[67] Thus, no finding of "serious prejudice" for such a product would be possible.

- Neither does Article 6.7 support the conclusion that serious prejudice "may arise" but may not be actionable. Rather, that provision establishes that "[d]isplacement or impediment resulting in serious prejudice shall not arise under paragraph 3 where any one of the following circumstances exist"; that is, even where the effect of displacement or impediment is demonstrated under Article 6.3, a finding of serious prejudice is precluded ("shall not arise").

- Finally, Brazil points to Article 6.9 and claims that this provision "exempts serious prejudice that exists even where the requirements of Article 6.3 are fulfilled because the subsidies are exempt from action by virtue of the peace clause." Article 6.9 does not "exempt[] serious prejudice that exists," however. The text reads: "*This Article does not apply* to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture" (emphasis added). Because the entire "Article does not apply," no finding of "serious prejudice" is possible.[68]

87. Finally, we note that Brazil's argument that the "may arise" language is "necessary" because certain circumstances may exist in which a finding of serious prejudice is precluded would suggest that whenever an exception exists to a "shall" obligation, that obligation should be expressed using "may". For example, because there is an exception to the prohibition on export subsidies in Article 3.1 of the Subsidies Agreement, presumably Brazil would consider that the provision should have been written: "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, [may] be prohibited." The use of "may" in place of "shall," however,

[66] Brazil's Answer to Question 229, para. 80.

[67] Footnote 17 to Article 6.3(d) follows the words "the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity" and reads: "Unless other multilaterally agreed specific rules apply to the trade in the product or commodity in question."

[68] Brazil's argument echoes its erroneous interpretation of the "exempt from actions" language of the Peace Clause. Indeed, as the United States has pointed out, Brazil has never explained how it is that the Panel, if it ultimately determines that US measures are "exempt from actions" based on Articles 5 and 6 of the Subsidies Agreement, could nonetheless make findings on those claims without resulting in the DSB making rulings and recommendations with respect to those claims and measures. Given the automaticity in adoption of panel and Appellate Body reports, the only means by which Peace Clause-compliant US measures may be "exempt from actions" is for the Panel to decline to reach Brazil's claims based on those provisions specified in the Peace Clause.

changes the meaning of that provision from mandatory to permissive. Similarly, the use of "may" instead of "shall" in Article 6.3 means that there is a "possibility" or "opportunity" for serious prejudice to arise where one or more of the effects listed in Article 6.3 is found, rather than a certainty or necessity that serious prejudice have arisen.

**232. How, if at all, should the Panel take into account the effects of other factors in its analysis of the effects of US subsidies under Article 6.3? If the Panel should compare the effects of other factors to establish the relative significance of one compared to others, how would this be done? What would be relevant "factors" for this purpose? BRA**

88. Causation is a key issue in this dispute, and Brazil continues to gloss over this issue. The United States is interested to see Brazil argue that an econometric analysis by definition satisfies the causation requirements under the WTO.[69] Brazil's position in this dispute is at odds with its position in other disputes, such as *Steel*. Brazil appears to change its view on the correct approach to causation depending on whether it bears the burden or not. For example, Brazil now argues in its response to this question: "But the record shows that there is no legitimate basis to conclude that "other" supply and demand factors collectively (a) accounted for all of the declines in prices during the period of investigation or (b) meant that prices went as high as they would have even if no US subsidies had been provided." In other words, Brazil appears to claim that it is entitled to a finding in its favour on causation unless someone else (not Brazil) shows that other factors accounted for all the effects, rather than that Brazil must show that it is not attributing to the US measures at issue effects that are due to other factors. This is in error.

89. Brazil must establish that effect of the challenged subsidies was "significant price suppression" or an increase in world market share. Brazil has not established that it has accounted for "the effect of" other factors at play, even though it concedes that "[t]his world market share is the result of several key factors *including US subsidies*, weather effects in many countries, and exchange rate effects" (italics added). How then can Brazil claim that the effect of the subsidies is "significant"? That is, if Brazil itself argues that US subsidies were only one of "several key factors," its analysis must allow the Panel to distinguish the effects of these other factors. Brazil has not even attempted to explain what those effects were, nor did Brazil demonstrate that its economic model accounted for these factors.

90. Brazil did not answer the Panel's question about what relevant factors should be taken into account nor did it respond to the question about how this should be done. Brazil simply claims, through Dr. Sumner 's analysis, that it has taken various other factors into account. Until forced to respond to the US Further Submission of 30 Sept., Brazil had not acknowledged that any factor besides US subsidies had any effect on world cotton markets.

91. In paragraph 82, we find it curious that Brazil refers to the material on other factors presented by the United States[70] as covering "only" weak cotton demand, flat retail consumption, falling world incomes, increasing US textile imports, and China's releasing of stocks. Brazil also errs in referring to these as all "demand-related". For example, China's release of stocks affects the supply of cotton. (The US Further Submission also included an analysis of the effects of the strong US dollar on cotton prices.) These six factors were the "only" ones presented because they, in fact, provide a compelling explanation of the factors driving down world cotton prices at that time and encouraging the shift in US cotton use from domestic processing to export markets.

92. The Panel asks how it should take into account the effect of other factors. In paragraph 85, Brazil argues that *but for* the effect of US subsidies, world cotton prices would have been significantly higher. One could just as easily analyze and claim *but for* the effect of China's releasing 11.6 million

[69] Brazil's approach would certainly simplify the causation discussion in numerous other disputes.
[70] US Further Submission, paras. 22 - 44.

bales of subsidized cotton onto world markets between 1999-2001 world prices would have been significantly higher. In other words, Dr. Sumner can claim his analysis accounts for various factors because he calibrated his model to actual data for the recent past, but Brazil' s analysis has not provided an explanation of the various events and actions at play that would allow the Panel to form a reasoned conclusion that the effects of US subsidies are not in fact the effects of these other factors.

93. Finally, in paragraph 87, Brazil's repeats oft-stated arguments about the presumed revenue-cost gap faced by US cotton producers using total costs of production. Brazil has not replied to US counter arguments that using *total average costs* is misleading and inappropriate. We refer the panel to the US further rebuttal submission, paras. 116-41, and the US answer to Question 211(b). As for Brazil's exchange rate argument, we refer the panel to the US answer to Question 210 above.

**233. In Brazil's view, what is or are the "same market(s)" for the purposes of Article 6.3(c)? Does Brazil's view of "world market" imply that regardless of which domestic (or other) "market" is examined, price suppression will be identifiable? BRA**

94. In this answer, Brazil continues to make serious interpretive errors with respect to Article 6.3(c). In addition, the evidence and arguments made by Brazil with respect to each of the "markets" it identifies do not satisfy the requirements of Article 6.3(c). The United States treats each of these issues in turn.

**Brazil Misinterprets Article 6.3(c) and Fails to Bring Forward Evidence and Arguments to Establish Its Claims**

95. The United States is gratified that in this answer Brazil finally appears to recognize that the "in the same market" language of Article 6.3(c) requires that Brazil make claims with respect to markets in which both Brazilian and US upland cotton are found.[71] This follows from the use of the words "same" and "market." "Market" means "[a] place or group with a demand for a commodity or service".[72] "Same" means "[i]dentical with what has been indicated in the preceding context" and "previously alluded to, just mentioned, aforesaid".[73] In the context of Article 6.3(c), the market that is "[i]dentical with what has been indicated in the preceding context" would be that market in which there is "significant price undercutting by the subsidized product as compared with the price of a like product of another Member" (the phrase immediately preceding the phrase on significant price suppression, depression, or lost sales). Thus, Brazil may only advance claims with respect to those markets in which US upland cotton and Brazilian cotton are both found .

96. Brazil continues to argue that there is a "world market" for upland cotton in which it may demonstrate significant price suppression, depression, or lost sales. However, the text and context of Article 6.3(c) do not support the view that Brazil may assert a generalized "world" price effect. First, the significant price suppression, depression, or lost sales must be "in the same market." As explained above, this "same market" would be the market in which both Brazilian and US cotton are found and there is significant price undercutting. In asserting that a "world" market can be this "same" market, Brazil renders the "same market" phrase inutile since the products of both the complaining and responding parties will always be in the "world." Consider that one of the effects under Article 6.3(c) is "lost sales in the same market." Brazil's interpretation would mean that a complaining party could advance a claim with respect to a lost sale anywhere in the "world," even if the responding party did not export to the market in which the lost sale occurred. Again, such a result would render the "in the same market" language meaningless.

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[71] *See, e.g.*, Brazil's Answer to Question 233 from the Panel, para. 113 ("[T]hese indices are benchmarks for prices *in those 'same markets' where US and Brazilian cotton were exported* . . . .") (emphasis added).

[72] *The New Shorter Oxford English Dictionary*, vol. 1, at 1699 (1993 ed.).

[73] *The New Shorter Oxford English Dictionary*, vol. 2, at 2678 (1993 ed.).

97. Brazil's interpretation also does not make sense of important context for Article 6.3(c). Article 6.6 states that "[e]ach Member *in the market of which* serious prejudice is alleged to have arisen shall . . . make available . . . all relevant information . . . as to the changes in market shares of the parties to the dispute as well as concerning *prices of the products involved*" (emphasis added). If the "world" could be a "market" for purposes of Article 6.3, which WTO Members should provide market data? Read literally, Article 6.6 would seemingly oblige *every* WTO Member to provide data on market share and prices since every Member would be a "Member in the market of which serious prejudice is alleged to have arisen." Annex V similarly suggests that the "same market" must be an actual market, be it that of the subsidizing Member or a third-country. For example, where Article 7.4 has been invoked "any third-country Member concerned" – for example, any Member in whose market significant price suppression is alleged to have occurred – "shall notify to the DSB" the organization responsible for responding to information requests and the procedures to be used to comply.[74] Furthermore, the information gathered during the information-gathering process "should include, *inter alia*, data concerning the amount of the subsidy in question (and, where appropriate, the value of total sales of the subsidized firms), *prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers to the market*, changes in the supply of the subsidized product *to the market in question* and changes in market shares".[75] Again, these provisions suggest (as does Article 6.6) that Article 6.3(c) is directed at particular markets where competition exists between Brazilian and US upland cotton.

98. Because Brazil must demonstrate price suppression by US imports of Brazilian imports in the same market, Brazil must bring forward evidence and arguments on import volumes and prices. In numerous instances, Brazil has simply failed to present prices for Brazilian cotton and US cotton in an identified market, much less import volumes relating to the parties or other suppliers. This failure to present, *inter alia*, prices for each market sufficient to demonstrate price suppression is fatal to Brazil's claim with respect to each such market. The necessity of presenting price information for each market is suggested by the fact that each "same market" in which significant price suppression is alleged to occur is a market in which there is significant price undercutting. Article 6.6 refers to each Member "in the market of which serious prejudice is alleged to have arisen" providing the "prices of the products involved," also suggesting that prices for both Brazilian and US cotton must be examined. Further, Annex V, paragraph 5, states that a panel should examine "prices of the subsidized product, prices of the non-subsidized product, [and] prices of other suppliers *to the market*."

**There is No "World Market Price" for Upland Cotton that Can Be Significantly Suppressed**

99. The preceding legal interpretation that the "same market" means a particular market in which competition between Brazilian and US cotton imports occurs is confirmed when one considers that nature of the "world price" that Brazil claims is significantly suppressed. This "world market price" turns out not to be a price at all but several "benchmarks" or indicia of prices. As Brazil states: "The record establishes that there is a "world market" for upland cotton and that the prices for that market are *reflected* in the *New York futures prices* and in the *A-index prices"*.[76] That is, this alleged "market" does *not* have or set any price for US and Brazilian upland cotton; rather, this "price" is "reflected" in not one, but two price indices, the NY futures price and A-index price.

100. Brazil must argue that the "world market price" is "reflected" in the NY futures and A-index because *neither* of these relates to an abstract "world market."

[74] Subsidies Agreement, Annex V, para. 1.
[75] Subsidies Agreement, Annex V, para. 5.
[76] Brazil's Answer to Question 233 from the Panel, para. 91.

- Rather, the NY futures price relates to a New York-based exchange trading in contracts for future delivery with various physical delivery points in the United States: Galveston, Houston, New Orleans, Memphis, or Greenville/Spartenburg (South Carolina).[77]

Indeed, Brazil concedes that "[w]hile the New York futures prices play a major role in *influencing markets*, the short term volatility of the futures market makes comparison with monthly or annual export prices more difficult".[78]

- The A-index "price" reflects delivery to Northern Europe of upland cotton with certain quality specifications (Middling,1-1/32 inch staple length). Further, the A-index is not a "price" but an average of the five lowest *price quotes* obtained by Cotlook, a private organization based in London, from various merchants of 15 cotton growths.

101. Thus, the A-index reflects price offers but does not reflect actual prices in Northern Europe of either Brazilian or US (or any other) upland cotton. The A-index relates to the Northern European market, not to the "world" market. In fact, the A-index, with its disparate price quotes from around the world, demonstrates that prices differ around the world, not that there is a uniform, harmonious "world" market price. The fact that Brazil points to *two* disparate price indices, which deviate significantly.[79] also demonstrates that there is not a "world market price" for upland cotton. Thus, neither the NY futures price nor the A-index are a "world market price" for upland cotton.

**Brazil Cannot Demonstrate Significant Price Suppression in the United States Because There Were No Brazilian Imports**

102. Brazil also identifies the US market as a "same market." However, Brazil does not advance any arguments nor evidence establishing that there were *any* Brazilian imports into the United States in marketing years 1999-2002. In fact, our information is that there have not been any imports of Brazilian cotton to the United States since marketing year 1996.[80] Neither (and perhaps for that reason) does Brazil present any arguments or evidence on Brazilian cotton prices in the United States. Thus, Brazil has failed to establish that the United States is a "same market" for purposes of Article 6.3(c).

**Brazil's Effort to Expand the Scope of Its Claims and Arguments to 40 Third-Country Markets is Untimely**

103. Brazil belatedly attempts to argue that it is alleging "significant price suppression" in 40 third-country markets; for only seven of these had Brazil previously even attempted to make argument. Brazil has not attempted to justify presenting this new affirmative evidence at this late stage in the proceeding, contrary to the Panel's working procedures. To do so prejudices the United States, which has necessarily participated in this dispute on the basis of the claims and arguments Brazil has previously set out, and would circumvent the notification obligations of the complaining party. For example, we note that in its request to the DSB to initiate the Annex V information-gathering process, which the DSB was not able to agree to in light of the Peace Clause issue, Brazil did not notify these 40 WTO Members that they were markets in which serious prejudice was alleged to have occurred. By not naming these markets at the outset of the dispute, but seeking to

[77] *See* www.nybot.com (search No. 2 Cotton Futures Contract Specifications).

[78] Brazil's Answer to Question 233 from the Panel, para. 93 (italics added).

[79] *See* Brazil 's Answer to Question 233 from the Panel, para. 93 ("[P]rice oscillations of the A and B-index are much less pronounced than the futures market, but in the longer term they accompany the signs and trends coming from the futures market.").

[80] *See* US Department of Agriculture trade statistics at www.fas.usda.gov/ustrade (search on Imports/HS-4 for Brazil).

name them now, Brazil would preclude these Members from fulfilling their notification obligations under paragraph 1 of Annex V.

104. We also note that none of these 40 markets are listed in Brazil's request for rulings and recommendations from the Panel. That request, in pertinent part, reads: "The US subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interest of Brazil *by suppressing upland cotton prices in the US, world and Brazilian markets* for upland cotton in violation of Articles 5(c) and 6.3(c) of the SCM Agreement".[81] The United States is entitled to rely on Brazil's representations with respect to the scope of its claims and arguments.

105. Even in the markets that Brazil has raised in a timely manner, there are other suppliers into that market, and Brazil has failed to explain why any price suppression should be attributed to US sales rather than to sales from other countries. One cannot presume that US sales are the only factor that could cause any price suppression. Thus, with respect to these markets, Brazil has failed to establish a *prima facie* case on its claims.

**Brazil Incorrectly Argues that Significant Price Suppression in All Markets Can Be Shown Through Suppression of "World Market Prices"**

106. The foregoing considerations are dispositive of Brazil's claims with respect to significant price suppression in the same market. In this portion of its comment, the United States further examines the evidence and arguments Brazil has brought forward and points out that they do not establish the elements necessary to demonstrate a claim under Article 6.3(c).

107. Brazil argues that the US suppression of "world market prices" is transmitted to all markets as evidenced by the fact that price movements in individual markets are similar to the general trends of the A-index. Brazil alleges that the proof of the US suppression of the A-index is the results of Dr. Sumner's analysis and studies by USDA economists. The United States has already explained in great detail to the Panel the conceptual flaws of Dr. Sumner's analysis and will not repeat those here. Additionally, the USDA studies provided by Brazil to the Panel did not address impacts on the A-index or futures prices, but the impact of US programmes on US prices. While interesting academic exercises, moreover, those studies do not analyze the question before the Panel.[82]

108. As a factual matter, the United States has provided evidence that disproves Brazil's allegation that the United States suppresses the A-index. Exhibit US-46 demonstrates that the low US quote (either Memphis or California) for the A-Index has rarely been one of the 5 low bids. If both US quotes are always above (but for one month) the 5 lowest quotes used in the A-Index, the United States cannot be suppressing the A-Index. Nevertheless, even if one were to follow the Brazilian approach, the data provided by Brazil does not provide evidence of price suppression by the United States.

109. As set out above, a generalized claim of price suppression is not contemplated by Article 6.3(c), which requires price suppression "in the same market" – that is, that market in which there is "significant price undercutting by the subsidized product as compared to the price of a like product of another Member." Thus, we proceed here to examine Brazil 's evidence with respect to those "same markets" identified in its answer.

**Comparison based on Export Unit Values**

110. Brazil begins its analysis by comparing US and Brazilian export unit values in various markets to the A-index. It should be noted that the proper analysis would be US and Brazilian market

[81] Brazil's Further Submission, para. 471(i).
[82] *See* US Answer to Question 212 from the Panel, paras. 48-55.

*prices* in the market in question. The export price does not represent the final selling price in the market in question. Given the short time the United States had to review all of this new data, the discussion here will focus on those countries included in the main text of the Brazilian response. To the extent that Brazil has provided data in its exhibits on various markets that it does not examine or explain, we do not consider that Brazil has advanced arguments with respect to such markets sufficient to carry its burden of establishing a *prima facie* case, and we ask the Panel to so find.

111. The fact that US or Brazil export prices to the seven markets, Argentina, China, India, Indonesia, Philippines, Portugal, and South Korea generally may have had movements similar to the A-Index does not demonstrate price suppression by the United States. In fact, Brazil does not in its main text show comparisons of US and Brazilian export unit values in each market (this is only provided in Exhibit BRA-386), much less other relevant market information, such as import prices from other suppliers or import volumes. This absence of relevant argument alone demonstrates that Brazil has not met its burden of establishing its price suppression claims. However, the United States has updated the Brazilian export unit value graphs to include data through November 2003 in order to set out a cursory analysis of each "same market" for the Panel.[83] On the whole, we find that it is the Brazilian price that undercuts the US price to these markets.

112. Brazil alleges price suppression in the Argentine market due to the United States. The data, however, does not support such a claim. As can be seen in the graph, the United States is an infrequent supplier to the Argentine market. For those time periods when no US imports were found in Argentina, there could be no price suppression by the US subsidized product of the prices of Brazilian cotton "in the same market." Of the 15 periods that both are in the market, the United States' export price was greater than Brazil's export price 8 times, below Brazil 6 times, and the same once.

113. Comparing US and Brazilian export unit values to China does not demonstrate price suppression by the United States. Brazil is not a frequent participant in the China market. For those time periods when no Brazilian imports were found in China, there could be no price suppression by the US subsidized product of the prices of Brazilian cotton "in the same market." From August 1999 to June 2003, Brazil only shipped to China in 13 months. Of these 13 months, Brazil's export unit value was below the US export unit value 8 times, above the US price 4 times, and the same once. Evidence of Brazilian price undercutting the US price is inconsistent with the argument that the United States suppresses Brazilian prices to the China market.

114. India was one of the few markets Brazil discussed in which there were a good number of months in which both parties supplied cotton. Of the 25 months in which both provided cotton, the US price was narrowly below the Brazil price in 12 months, was above Brazil in 12 months, and at the same level in 1 months. The time during which the US price was below the Brazil price was during the period April 2001 to December 2001, in which the high yields of MY2001 influenced. However, during August 2000 to January 2001 period, US unit values were high and were consistently undercut by Brazil by a large margin. This Brazilian undercutting led to a plunge in US unit values. We also note that US unit values appear to increase when Brazilian cotton is not in the market. Brazilian unit values, on the other hand, show very little change; this lack of price movement is not consistent with price suppression since the Brazilian price is unresponsive. As the graph shows, there is no systemic relationship between the US and Brazilian unit values to indicate that the United States is suppressing Brazilian prices to this market.

115. Indonesia also was another country in which both the United States and Brazil were active participants, and each had the low price about an equal number of times. However, the majority of times the US had a lower price occurred during MY2001, a period in which the United States had higher than expected yields which reduced US unit values while Brazil had lower than normal yields,

[83] Exhibit US-134.

driving up the price for Brazilian cotton. In MY2002, Brazil returned to general undercutting of US unit values, failing to follow US price increases in early 2003. There does not seem to be any support for price suppression in this market as the movements between the US and Brazilian export unit values are not the same. For example, during the period October 2000 to January 2001, US export unit values increased, whereas Brazil's export unit values declined. Again in the period December 2001 to June 2002, the wide swings in the Brazil price relative to the steady US movements demonstrate that US prices are not suppressing Brazil's.

116. Philippines is a market in which Brazil had sporadic shipments over the period. For those time periods when no Brazilian imports were found in Philippines, there could be no price suppression by the US subsidized product of the prices of Brazilian cotton "in the same market." There were 19 months in which both parties supplied the Philippines. Part of the difference in price is probably due to the shipment sizes. As Exhibit BRA-383 reports, the quantities shipped are quite different between Brazil and the United States. Smaller shipments typically have higher per unit costs. Many of the months in which Brazil exhibited higher export unit values to the Philippines was during MY 2001, a year in which the US had higher than expected yields, driving down its price while Brazil had lower than expected yields, increasing its price.

117. Brazil and the United States overlapped in the Portuguese market in 27 months, a good number of samples. In all instances except for November 2003, the US unit value was greater than the Brazilian unit value, generally by a large margin. The fact the US unit value was greater than the Brazilian unit value is not consistent with price suppression by the United States. Even if there was a quality difference between the two, the spread between the two should be relatively constant. However, the movements of unit values do differ. When the US had big swings in the late 2000 and late 2001 early 2002, Brazil saw only modest changes in unit values. Since MY2003, US prices first increased and have slightly declined whereas Brazilian prices first declined and have been increasing slightly. The fact that the price movements are not consistent would weaken arguments that the United States is causing or threatens to cause price suppression to Brazil.

118. The final country market discussed directly in Brazil's response was South Korea. As the graph depicts, Brazil only supplied cotton to this market in one month. Since no Brazilian imports were found in South Korea over the complained of period, during those times there could be no price suppression by the US subsidized product of the prices of Brazilian cotton "in the same market."

**Comparing Import Values ("Import Prices") to A-Index**

119. Brazil continues its analysis by comparing average import prices to specific markets with the A-Index. As with the "export prices" these import prices are not the prices at which the product were sold but its value at the border of the importing country. Again a proper analysis would not use border valuation of the product but the actual market prices the product was sold. Also it is not clear how averaging import prices from the different sources would provide evidence that the United States has caused price suppression. In fact the various graphs provided by Brazil put in doubt their theory of world price transmission.

120. The yearly import price data in paragraphs 106-108 is too general to be of any assistance. Looking at the various graphs of monthly individual country import prices against the A-Index (paragraphs 106-107) also shows discrepancies between markets. For example, looking at the graph of Japan's prices against the A-Index, it is notable that their import prices never fell below 48 cents even though the A-Index fell to as low as 38 cents and that the gap between import prices and the A-Index were quite large when prices were falling but minimal when prices were rising. A similar pattern seems to have been present in Ecuador. On the face of it, these graphs would seem to imply that some mechanism was at work to impede the transmission of declining "world market prices." This undermines Brazil' s assertion that price suppression can be shown in all third-country markets through alleged effects on a "world market price." The Hong Kong graph is exactly opposite in these

respects from the Japanese and Ecuador graphs. This could mean that Hong Kong is less protected from world prices, but the great deal of inconsistency both within and between all of these graphs indicates the uncertainty surrounding Brazil's claims that "all these third country markets are heavily influenced by the A-Index and New York futures prices".

**Comparison of Domestic Prices and the A-Index**

121. Brazil then compares for a few countries in which it could get domestic prices, those domestic prices to the A-index. Again their analysis concludes that the A-index influences domestic prices in these markets and therefore, the United States is guilty of price suppression. We have explained that a claim of significant price suppression requires that US and Brazilian cotton be found "in the same market." In addition, there are problems with the connection between the A-Index and domestic prices as presented by Brazil. To demonstrate the problems with Brazil's analysis, the United States will look at the analysis on China.

122. We agree that China's domestic prices have always been significantly above the A-index and tracked it rather well. Indeed we include a full series below including all the data currently available to us. This starts September, 1999 and runs through April 2003 (Southern China prices as reported by East-West Inc. a Beijing agricultural consulting group) . It is consistent with Brazil's data although Brazil's only starts in January 2001. These data reveal that China's domestic prices are not consistent with China's export and import prices.

123. China's export prices, as can be seen in Exhibit US-141, are well below the A-index during most of the time China exported heavily (MY 1999 through the first half of MY 20001, and the last quarter of MY 2001 through the third quarter of MY 2002). Contrary to Brazil's assertion in paragraph 113 that export prices from all suppliers move with the A-Index, more often than not China's export price did not, staying relatively flat during the periods from August 1999 to January 2001 and from February 2002 to July 2003. What is more, as can be seen from the China Prices graph in Exhibit US-141, China's export prices were significantly lower than the Chinese domestic price when China was exporting heavily.

124. The imports are different but still problematic. During those times when China has imported heavily, from the beginning of MY 2002 until the present, prices have tracked A-Index prices fairly well.

125. These data, not presented or explained by Brazil, show that Chinese domestic prices have some connection to the A-index but hardly the "heavily influenced" and "consistent" relationship Brazil asserts. As noted in the US further submission, the Chinese Government during this time had the goal of reducing their massive, undisclosed cotton stocks in a way that would insulate there cotton producers and processors from changes in prices. The aim was to maximize cotton prices received by Chinese farmers while still insuring their cotton textile exports were competitive in world export markets. China sold as much as it could on the world market as long as the A-Index stayed at or above a trigger price around 50 cents a pound – hence the flat export price line until the stock situation was finally resolved in late MY 2002.

**Conclusion**

126. Brazil has not done a proper analysis to support its price suppression claims. To demonstrate significant price suppression that leads to serious prejudice, Brazil must provide evidence showing that US prices in a given market are suppressing Brazilian prices in that market. Brazil has not presented and explained evidence on actual market prices of US and Brazilian cotton in third-country markets. Thus, Brazil has not established a *prima facie* case with respect to its price suppression claims. In fact, the market-by-market data presented above does not support a finding of significant price suppression by US cotton.

**234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"? USA, BRA**

127. Brazil's interpretation that whether price suppression is "significant" can only "be assessed with reference to the quality of the impacts of *whatever* level of price suppression exists on the producers of the like product" raises concerns. Brazil provides the example that even where "large amounts of price suppression" have been demonstrated, this might not be "significant" if the producers of the complaining party "had *de minimis* production, or no exports, and/or that the total value of lost revenue from suppressed prices was minimal".[84] The United States believes that the conditions of the producers of the complaining party would not enter into an analysis of whether a given level of price suppression is "significant." Brazil's interpretation would create, out of one legal standard ("significant price suppression"), different thresholds that would apply to different Members depending on their financial well-being. For example, a Member with a strong position in a given third-country market might not be able to utilize Article 6.3(c) (for significant price undercutting or significant price suppression or depression") simply on the basis that "the total value of lost revenue from suppressed prices was minimal" even if the level of price suppression was large. Conversely, a Member with a nascent exporting industry might not be able to utilize Article 6.3(c) if it "had *de minimis* production, or no exports," despite a desire to increase both production and exports. Neither scenario appears to fit with the text of Article 6.3(c).

128. In addition, Brazil fails to explain how the two different terms in the text of Article 6 ("serious prejudice" and "significant price suppression") result in there being only one and the same test for both terms. This would appear to render one of the terms superfluous, contrary to customary rules of treaty interpretation.

129. Finally, we note Brazil's reference to the impacts on "complaining party producers" of the like product. We take this to mean that, contrary to its earlier position, Brazil has now conceded that "adverse effects" to other Members are irrelevant for Brazil's claims. This follows from the text of the Subsidies Agreement. Under Article 5(c), no Member is to cause "serious prejudice *to the interests of another Member*," and a request for consultations under Article 7.2 "shall include a statement of available evidence with regard to . . . serious prejudice *caused to the interests of the Member requesting consultations*."

**235. Please comment on paragraphs 8, 9 and 10 of the US 2 December oral statement, in particular, why the average Brazilian price is shown as lower than the average US price. BRA**

130. Brazil's answer to Question 235 does not refute the US evidence that Brazilian cotton prices undercut US prices from 1999-2002. Brazil does not go so far as to claim the United States undercut Brazil's prices – except in the Brazilian market, an argument that is based on prices that are not directly comparable, as will be discussed later. Instead Brazil argues that US and Brazilian prices exhibited an "absolute closeness" with Brazil's export prices sometimes higher and sometimes lower than US prices.

131. Except for their own market, Brazil does not provide data or analysis on country markets. Instead they examine aggregate data for forty markets that both the United States and Brazil exported to in MY1999 to MY 2002. As the United States explained in our comments on Question 233, this aggregate approach is not the proper method of analysis for price suppression claims under Article 6.3(c). However, even if we accept the Brazil approach, close analysis of the aggregated data presented in Brazil's response further supports the US claim of Brazilian undercutting by showing

[84] Brazil's Answer to Question 234 from the Panel, para. 114.

that consistently and on average Brazilian [unit values] prices were lower than those of the United States, even though there were periods when factors not related to subsidies led to lower US unit values.

**Average Unit Value Comparison**

132. First, Brazil in the graph following paragraph 121 compares the average unit values of Brazilian and US exports. It is this graph that Brazil uses to support its claim of "absolute closeness" between the two countries ' export prices and the absence of Brazil undercutting, but it simply does not do this. Of the 45 months when both the US and Brazil were exporting, Brazil prices were lower 25 months as opposed to the United States' 20. Further eight of the United States low-price months were in MY 2001, when good weather allowed the United States to realize record yields as opposed to sub-par yields for Brazil. The US yield of 790 kgs./hectare was 6 per cent above the five year average for MY 1999 to 2003.[85] Brazil's 1073/kgs/hectare for MY 2001 was 5 per cent below its 1999-2001 average.[86] Also Brazil planting half a year later than the United States saw a much different price signal as cotton prices dropped sharply and soybean prices, the main alternative crop for both countries, rose slightly from February to August 2001.[87] The United States increased planted area by 6 per cent but Brazil reduced planted area by 12 per cent. US production consequently rose 18 per cent to 20.3 million bales in MY 2001, whereas Brazil's dropped to 18 per cent to 3.5 million bales. This naturally drove US export prices down compared to Brazil's. Brazilian prices followed the US prices down in the last half of MY 2001 and have stayed equal to or below US prices ever since.

133. Setting aside MY1999 and MY 2001 for the moment, two years that are not representative of normal conditions, Brazil prices undercut US prices in 18 of the 24 months for MY 2000 and MY 2002.[88] This is consistent with Brazilian production changes in the two years. In MY 2000 Brazil production increased 34 per cent while US barely 1 per cent from the year earlier. In MY 2002, Brazil production fell 2 per cent while US production fell 15 per cent.[89] So, even using Brazil's own methods we can see that Brazil undercut the United States in 2 of the 3 relevant marketing years and in that third year lower US prices are clearly related to yield and normal market price signals

134. The same conclusions are apparent when looking at the graph following paragraph 118 where Brazil looks at the aggregated weighted average of the 8 countries originally analyzed by the United States. Looking at the data available in this graph for MY 1999-2002, in 16 of 37 months when both countries exported to these countries, the United States price was higher 21 times as opposed to only 16 for Brazil. Six of the 16 periods when Brazil was higher came in MY 2001, consistent with the analysis above, and 6 came in MY 1999 when results were distorted because the volume of total Brazil exports was extremely small.

**Looking at All US and Brazil Exports**

135. To better look at the issue of Brazil's undercutting of US prices, it is appropriate to expand Brazil's analysis. Although Brazil emphasizes the closely interconnected world market, as noted before, their analysis looks only at data from countries to which Brazil and the United States both

[85] Exhibit US-135.
[86] Exhibit US-135.
[87] The relevant futures prices ratio of cotton to soybean for Brazil in August 2001 was the May 2002 cotton and May 2002 soy which was 8.63. The relevant ratio for US farmers in February 2001 was the Dec 2001 cotton to Nov 2001 soybean which was 12.55. (New York Board of Trade and Chicago Board of Trade).
[88] In MY 1999, Brazil only exported 12,000 bales of cotton compared to an average of 438,000 bales in MY 2000, MY 2001, and MY 2002. (See Exhibit US-135) As discussed in the preceding paragraph, MY 2001 was a year of atypical yields for both Brazil and the United States.
[89] Exhibit US-135 (Production data )

exported. The graph below looks at unit values for the entirety of US and Brazilian exports during this period, which Brazil would argue is appropriate if in fact there is a "world price" that is transmitted with little interference to all cotton markets. The graph presents data obtained directly from the Foreign Agricultural Service/USDA web site[90] and Brazilian customs data provided through the World Trade Atlas, a for-fee service that collects and enters in an easily accessible database official data from Brazil and numerous other countries ( produced by Global Trade Information Service Inc.) showing value, quantity and unit values.[91] It also expands Brazil's data by incorporating data through November 2003.

136. This graph reenforces what was discussed above regarding Brazil's 40-same-markets data. In this case though, Brazil export unit values are lower than the United States in all but one of the 24 months in MY 2000 and MY2002. Although very similar to Brazil's graph, it is even clearer here that Brazil's export prices were consistently and often significantly lower than those of the United States. As the graph depicts, Brazil undercuts the United States during MY 2000, resulting in a decline in US unit values. In MY2001, both continued to decline because of record yields and slack demand. But at the beginning of MY2002, US export values rebound whereas Brazil's remain low, undercutting the US export values. In the start of MY 2003, US prices begin a sharp increase, but Brazilian prices decline slightly before making a slight increase resulting in an increased spread between the United States and Brazil.

**Cumulative Average Values Using all the Data**

137. Going further and looking at the cumulative weighted price as Brazil did in paragraph 120, but again using the entirety of US and Brazilian exports, the average US price for MY 1999-2002 was 47.59 cents per pound for the United States as compared to an average for Brazil of 44.70 (Brazil calculation was almost exactly the same at 44.65). This means the United States average export value during the period was 2.89 cents per pound (6 per cent) higher than that of Brazil. Looking at just the 40 markets, Brazil still found US prices were higher but by only 0.68 cents. This is an important point in itself when addressing the question of Brazil's price undercutting. This means the increased spread between average US and Brazilian prices when looking at all exports – as compared to just the 40 countries identified by Brazil – was due almost entirely to United States exporters being able to charge higher prices in markets where Brazil was not competing. This is clearly consistent with Brazil undercutting.

138. Looking at the cumulative averages for the atypical MY 2001 when there were weather-related reasons for low US prices, Brazil's method showed a cumulative US average export price lower than Brazil's by 5.22 cents (44.05 for Brazil and 38.83 for the United States). Looking at the entirety of exports, the difference was only 3.65 cents (44.14 for Brazil and 40.49 for the United States). In addition, a distortion in Brazil's cumulative analysis magnifies the importance of MY2001. Nearly 45 per cent of Brazil's exports during this 4-year period came in MY 2001.[92] By contrast, the United States only exported 30 per cent of its 4-year total in MY 2001.[93] This means the difference between the unit average values is even further skewed. Looking at the difference in average unit values for years other than MY2001 (that is, in MY1999, MY2000 and MY2002 combined), the average unit value for the United States is 50.83. In Brazil it is 45.15. *US prices are higher by 5.68 per cent or almost 12 per cent.*

[90] Exhibit US-136 (FAS US trade data)
[91] Exhibit US-137 (WTA Brazilian trade data)
[92] Exhibit US-135.
[93] Exhibit US-135.

**Prices in the Brazil Market**

139. It is also misleading for Brazil to claim as they do in paragraph 130 that US cotton imported into Brazil undercuts domestic Brazilian cotton. This claim is based on comparing US FOB export prices to Brazil domestic prices. That is, it ignores Brazil's tariff on cotton imports as well as transportation and other costs incurred shipping cotton to Brazil, which would raise the US price significantly. The Brazilian tariff was 8 per cent in 1999 and 2000, 8.5 per cent in 2001, 10 per cent in 2002 and 9.5 per cent in 2003.[94] In all years except 1999, the difference between Brazil domestic and US export prices fell well short of even covering the tariff. In 1999 the difference of 10.27 per cent only exceeded the tariff by 2.27 per cent. Recent trader price quotes for transportation to Brazil exceed 10 cents a pound, more than offsetting the difference. In sum, Brazil's use of non-comparable prices cannot support a finding of price suppression, much less significant price suppression.

**Price Suppression**

140. Even using Brazil's method of looking at the average unit value of exports, rather than actual third-country domestic prices, strong evidence of Brazilian price undercutting exists – contrary to Brazil's arguments. Brazil's second line of argument is that price undercutting is irrelevant, arguing that it is not a question of undercutting but price suppression and that the global marketplace instantaneously translates subsidy-induced lower prices in the United States into lower prices world-wide. Brazil further contends that "prices in each of those 40 third country markets as well as the Brazilian and US market were already suppressed before any cotton was shipped by US or Brazilian exporters" (paragraph 131).

141. The price mechanism in cotton is relatively sophisticated, but Brazil's explanation is unrealistic. It says essentially that everyone in the market has perfect knowledge of the market and can adjust instantly. If over the period when US subsidies increased, they had a significant suppressing effect on world markets, this would have been manifested in the United States continually lowering prices to take more market share with other suppliers being forced to follow. It is implausible to assume that this would have occurred without some time lag between US and Brazilian prices that would have been evident in monthly export data – and yet, no such dynamic can be seen in the price data.[95]

142. The fact that, other than in MY2001, US prices generally stayed above Brazilian prices indicates that is was not US subsidies, but other factors that drove down prices. The textile market was extremely competitive during this period. China's industry, operating in a tightly controlled market with access to cheap government stocks was pushing down prices. Also a sluggish world economy kept consumption growth in the same 1.5 to 1.75 per cent annual growth range it had been in the previous 4 years despite markedly lower cotton prices. Processors of raw cotton, other than those in China, demanded lower prices from suppliers in order to remain competitive with the Chinese. At the same time, the US textile and apparel industry was faced with increasing textile and apparel imports, domestic raw cotton use fell sharply, and US cotton growers and merchants had to turn to exports. The fact that US stocks grew significantly during this time also indicates that US

[94] Source: Various USDA/FAS Attache Reports (available at: www.fas.usda.gov (search on Attache Reports, Brazil, Cotton, 1999-2003)).

[95] Prices take time to adjust. Suppliers are hesitant to lower prices particularly when they have not seen a reduction in their own costs and cannot be sure the prices will stay lower. They will be willing to allow stocks to build until the need to drop prices is inevitable. Similarly, customers will not immediately switch since changing to a new unfamiliar supplier has costs particularly if the new lower prices do not continue. Additionally, as put forth by Brazil in its response to question 233 (para. 104), even if Brazilian suppliers and their customers had through the global pricing system perfect knowledge of US prices and their future direction, they would still have contractual commitments at higher prices that must be met and thus would delay the transmission of declines in price movements. Brazil, however, in its discussion ignored that this delayed transmission due to contracts also could bound a supplier to a lower price although spot prices are increasing.

suppliers were the price takers and not the price setters in this market.[96] Further, the shift in raw cotton consumption from the United States to other countries (much of which is shipped back to the United States in the form of cotton apparel) explains why US cotton exports increased as the US world market share was unchanged.

143. The point is reinforced by looking at the A-Index and the corresponding quotes for the United States and Brazil. Again one would expect that a US cotton industry with subsidized excess production to dispose of on export markets would have been consistently pricing below the average represented by the A-Index (the 5 lowest price quotes obtained by Cotlook CIF Northern Europe). But this is not the case as can be seen in the graph below of the A-Index and the US Memphis and California / Arizona A-Index quotes.

- At no point during MY1999-2003 to date was the California / Arizona quote below the A-Index.

- Only once during MY1999-2003 to date, September 2002, was the Memphis quote below the A-Index.

144. Consistent with what was discussed before, a tightening of the gap between the A-Index and US quotes is apparent in MY 2001. However, Brazil aside, a number of countries had good weather and significantly increased area in that year so that US prices were still above the average as measured by the A-Index.

145. A parallel analysis can be made by comparing the US and Brazilian A-Index quotes (data from Brazil Exhibit 242). This graph is the same as that used by Brazil in paragraph 128 (although the last 3 data points are not in the exhibit). Again, US price quotes are well above Brazil quotes in marketing years 1999, 2000, 2002, and 2003 to date. In MY 2001 quotes grew closer, and for a few months the Memphis quote fell below the Brazilian.

- At all other times, the evidence demonstrates that Brazilian exporters were offering cotton at prices well below the US A-index quote.

146. Indeed, looking at the graph below comparing the A-Index to the Brazilian A-index quote, there are considerable periods, particularly in MY 2000, when Brazil was consistently quoting below the A-Index. This evidence of low price quotes by Brazilian exporters is consistent with the view that Brazilian price undercutting exerted downward pressure on prices.

**237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? BRA, USA**

147. Although not entirely clear from Brazil's answer, Brazil appears to assert that as long as there is an increase in a Member's world market share over the preceding three-year average, the fact that the Member's world market share remains at approximately the same level could be compatible with a finding of an "increase" following a "consistent trend" within the meaning of Article 6.3(d). We would disagree. A flat world market share over a three-year period followed by a one-year increase would not demonstrate that the last year's "increase follows a consistent trend over a period when subsidies have been granted" (in the words of Article 6.3(d)). A flat "consistent trend" would not suffice since an "increase" could not "follow[] a [flat] consistent trend." In that situation, the "increase" would be deviating from, not following, the flat "consistent trend."

[96] Exhibit US-135.

148. From a statistical standpoint, we would agree with Brazil's comment in paragraph 137 that due to the limited number of observations it is difficult to calculate a trend that is statistically significant. However, the United States strongly disagrees with the analysis presented by Brazil in the graphs accompanying paragraph 139. Note that if the trend line were calculated between 1986 and 2000 or 1996 to 2000, the trend line would be flat or slightly negative. As we have argued in the Second Submission to the Panel, the change in export share is due primarily to the decline in the US textile industry which resulted in almost two-thirds of US cotton being exported in 2002 compared to almost two-thirds milled domestically in 1998.

149. Indeed, if we observe the trend in the US market share as presented in our Second Submission to the Panel and in the Concluding statements to the panel of 8 October, the share of the world market for upland cotton supplied by US cotton has been flat over the period from marketing year 1999-2002. And of course Article 6.3(d) is talking about "the effect of the subsidy" which requires that it be the same subsidy at issue for each year of the "consistent trend".

**244. What proportion of the 2000 cottonseed payments benefited producers of upland cotton, given that payments were made to first handlers, who were only obliged to share them with the producer to the extent that the revenue from sale of the cottonseed was shared with the producer? (see 7 CFR §1427.1104(c) in Exhibit US-15). BRA**

150. USDA did not require handlers of cottonseed to report their payments to producer, rather the payments went to first handlers. Handlers were allowed to settle up with their producers as they saw fit. The programme, however, *ipso facto*, did give the producers a basis for possible complaint against handlers who had effectively moved low seed prices back to their producers. If so, the remedy was lay in whatever civil remedies might be available in a particular jurisdiction.

151. It would appear that to the extent that the cost of low cottonseed prices were charged against the producer so as to create a duty for the handler to pass on the payment to the producer, the recovery by the producer would have been simply for higher ginning costs paid by the producer. That is, the producer would have suffered the loss to the extent the ginner charged more for ginning because the return to the ginner from the seed was too low.

152. Payments here are disaster-like in that the cost that was suffered and passed through to producers, to the extent that it was passed through, was after the fact. The season was long over and thus payments could not have induced the planting of the crop. In short, if there was a pass through, it was a wash to reflect higher ginning costs. Those costs were not associated with the marketing of upland cotton, but of cottonseed.

**245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the SCM Agreement? BRA, USA**

153. Brazil and the United States agree that green box subsidies may not be taken into account in considering the effects of non-green box subsidies in an action based on Articles 5 and 6 of the Subsidies Agreement. Article 13(a)(ii) of the Agreement on Agriculture states that green box measures are "exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement." We recall that previously in this dispute Brazil asserted that the phrase "exempt from actions" did not preclude the Panel from considering Brazil's serious prejudice claims but only from imposing remedies.[97] Nonetheless, in its answer, Brazil appears to have read this "exempt from

[97] Brazil's Brief on Preliminary Issue Regarding the "Peace Clause" of the Agreement on Agriculture, para. 2 (5 June 2003) (interpreting "exempt from actions" to mean that "a complaining Member cannot receive authorization from the DSB *to obtain a remedy* against another Member's domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the Agreement on Subsidies and Countervailing Measures . . . or Article XVI of GATT 1994") (emphasis added).

actions" phrase to "*prohibit* . . . the effects of these subsidies being included along with other effects of non-green box subsidies *in assessing Brazil's actionable subsidies claims"*.[98] Thus, Brazil here appears to read this phrase according to its ordinary meaning – that is, "not exposed or subject to" a "legal process or suit" or the "taking of legal steps *to establish a claim* or obtain a remedy".[99] This is the definition that the United States has advanced in this dispute, and the Panel should consider Brazil's answer to this question an endorsement of that definition.

**246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the SCM Agreement? BRA, USA**

154. Brazil errs when it claims in its response to this question that "the Panel is required to take into account all non-green box subsidies, including prohibited subsidies in assessing Brazil's Article 5 and 6 claims under the SCM Agreement." The Panel has discretion in assessing Brazil's claims. The United States would note, for example, that Article 6.3(c) and (d) each refer to the "effect of the subsidy," which clearly permits the Panel to examine the effect of each subsidy individually.

**247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? BRA, USA**

155. The United States does not disagree that facts arising after the date of panel establishment may be taken into account, for example, in analyzing Brazil's threat of serious prejudice claim. As we have explained, as market prices have recovered strongly over marketing year 2003 (continuing their upwards trend since the trough reached in marketing year 2001), Brazil has jettisoned its proposed legal standard that the Panel examine whether there is a clearly foreseen and imminent likelihood of future serious prejudice. One could speculate that it has done so because the facts are no longer favourable – that is, high cotton prices will result in significantly lower budgetary outlays for two price-based measures (marketing loan payments and counter-cyclical payments) in marketing year 2003 than seen in previous years.

156. Brazil describes the task for the Panel "in an Article 5 and 6 claim" is to "assess[] whether present or threatened effects presently exist".[100] We would agree but note that Brazil has provided no basis to conclude that past subsidies, such as payments made for the 1999-2001 marketing years, that were fully expensed in past years could have "present . . . effects [that] presently exist." To the contrary, to the extent that these subsidies are *not* allocated to future production – and the Panel will recall that Brazil itself has both expensed these payments for purposes of its Peace Clause calculation as well as recognized that these recurring subsidies payments would be expensed for countervailing duty purposes – no lingering effects can exist because the subsidies themselves are deemed to have been used up. Thus, the question before the Panel is whether present subsidies – that is, those made for marketing year 2002 through the date of panel establishment – were causing certain adverse effects to presently exist and whether the US laws and regulations in existence as of the date of establishment of the Panel threaten serious prejudice. Any payments not in existence as of the date of establishment are not measures within the Panel' s terms of reference.[101]

157. We also note that Brazil cites two reports in support of its arguments: *Argentina Footwear* and *Argentina Peaches*. Those citations are misplaced for several reasons. First, Brazil entirely ignores that both reports interpreted the *Agreement on Safeguards*, not the Subsidies Agreement, and

[98] Brazil's Answer to Question 245 from the Panel, para. 145.

[99] *See, e.g.*, Comments of the United States of America on the Comments by Brazil and the Third Parties on the Question Posed by the Panel, paras. 8-10 (June 13, 2003).

[100] Brazil's Answer to Question 247 from the Panel, para. 150.

[101] We recall once again that Brazil now admits that the matter before the Panel cannot change after establishment. Answer to Panel Question 247.

that the two agreements have different texts. Brazil compounds the problem by failing to mention that the paragraphs it quotes in both reports dealt not with the issue of threat of injury, but with the issue of whether imports had "increased" (within the meaning of the Safeguards Agreement). Finally, while Brazil does acknowledge the existence of the Appellate Body report in *US Lamb*, it fails to point out that, in the context of a discussion of threat of serious injury under the Safeguards Agreement, in that report the Appellate Body made a finding that undercuts Brazil's position dramatically:

> Like the Panel, we note that the *Agreement on Safeguards* provides no particular methodology to be followed in making determinations of serious injury or threat thereof. However, whatever methodology is chosen, we believe that data relating to the most recent past will provide competent authorities with an essential, and, usually, the most reliable, basis for a determination of a threat of serious injury. The likely state of the domestic industry in the very near future can best be gauged from data from the most recent past. Thus, we agree with the Panel that, in principle, within the period of investigation as a whole, evidence from the most recent past will provide the strongest indication of the likely future state of the domestic industry.[102]

158. The strong recovery in market prices and futures prices demonstrate that there is no clearly foreseen and imminent likelihood of future serious prejudice. As we have previously seen with respect to the December 2004 future contract, price recovery has been sustained and steady; the contract average monthly close was 61.34 cents per pound in December 2002, and the current (as of 22 January 2004) monthly average close is 68.78 cents per pound. As a result of higher prices, US outlays are markedly down, with no marketing loan payments being made. In addition, the expectation of continuing high prices embodied in current future price suggests that no further marketing loan payments will be made this marketing year and that counter-cyclical payments will be dramatically lower.

159. In assessing the credibility of Brazil's argument that the baseline projections of FAPRI are more probative than futures prices, the Panel should recall the "testimony" of Brazil's own economic expert, Mr. MacDonald. Brazil has presented no evidence or analysis to suggest that FAPRI's baselines are more accurate price projections than what the NY futures indicates; in fact, the United States has put before the Panel evidence showing that FAPRI's baseline projections have been far off the mark.

160. For corroboration, the Panel need only consider the marketing year 2003-2008 baseline projections made by FAPRI in November 2002, January 2003, and November 2003. The price outlook for cotton has improved considerably since publication of the November 2002 FAPRI baseline used by Dr. Sumner in his Annex I estimate of the effects of US subsidies on US cotton production.

- The table below shows that FAPRI's projections for the MY2003 Adjusted World Price (used for calculating the marketing loan payments) are as much as *20 cents per pound, or 54 per cent, higher* in the November 2003 baseline as under the November 2002 baseline.

- Even so, FAPRI's November 2003 projected Adjusted World Price is still almost 6 cents per pound lower than the current Adjusted World Price.[103]

161. As a result of these revisions, FAPRI's estimated marketing loan gains (the difference between the marketing loan rate and the estimated Adjusted World Price) are reduced considerably.

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[102] Appellate Body Report, *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, WT/DS177/AB/R, WT/DS178/AB/R, adopted 16 May 2001, para. 137 (footnote omitted).

[103] The Adjusted World Price for January 23-29, 2004, is 63.25 cents per pound.

- Under the November 2003 baseline, the estimated marketing loan gain for 2003/04 is *zero*, compared to *almost 15 cents per pound* under the November 2002 baseline used by Dr. Sumner.

- Over the five-year period 2003/04 to 2007/08, the average marketing loan gain under the November 2003 baseline is estimated to be only *1.32 cents per pound*. This is compared to *10.39 cents per pound* using the November 2002 baseline used by Dr. Sumner.

**FAPRI's Revised Price and Marketing Loan Gain Baseline Projections**

| Year | Adjusted World Price (cents/lb) | | | Est. marketing loan gain 1/ (cents/lb) | | |
|---|---|---|---|---|---|---|
| | Nov 2002 | Jan 2003 | Nov 2003 2/ | Nov 2002 | Jan 2003 | Nov 2003 2/ |
| 2003/04 | 37.22 | 44.8 | 57.36 | 14.78 | 7.2 | 0 |
| 2004/05 | 39.83 | 45.4 | 50.96 | 12.17 | 6.6 | 1.04 |
| 2005/06 | 41.94 | 46 | 50.82 | 10.06 | 6 | 1.18 |
| 2006/07 | 43.6 | 46.7 | 50.35 | 8.4 | 5.3 | 1.65 |
| 2007/08 | 45.48 | 48 | 49.24 | 6.52 | 4 | 2.76 |
| Average | 41.61 | 46.18 | 51.75 | 10.39 | 5.82 | 1.32 |

1/ The estimated marketing loan gain is the difference, if positive, between the loan rate (52 cents per lb) and the Adjusted World Price.

2/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

162. We also note the New York Cotton Exchange closing prices for 23 January 2004, showed the March 2004 contract at 75.94 cents, the May 2004 contract at 77.02 cents, and the July 2004 contract at 77.90 cents. Based on these futures prices, the latest (although preliminary) FAPRI baseline still appears to have projected near-term future cotton prices too low.

163. The marketing loan programme contributes to over 42 per cent of the estimated effects of removing subsidies on production under the model developed by Dr. Sumner.[104] As the November 2002 baseline projected significant marketing loan payments through 2008 whereas the November 2003 baseline projects no or minimal marketing loan payments, updating Dr. Sumner's model to the November 2003 baseline would significantly reduce the overall estimated effect of US payments on production. Any remaining effects would largely be those incorrectly attributed to decoupled income support payments under Dr. Sumner's flawed model.

164. Finally, in paragraph 154 of its answer, Brazil again tries to muddy the waters by referencing the wholly arbitrary "expected adjusted world price first mentioned in its opening statement at the second substantive meeting of the Panel with the parties. There, Brazil attempted to provide an alternative to the US futures analysis. Brazil's alternative was that farmers look to an "expected adjusted world price" when making planting decisions since the marketing loan programme benefits are ultimately determined by the Adjusted World Price. Whereas the United States has provided references to numerous sources that demonstrate farmers look to the futures prices in making planting decisions.[105] Brazil has not provided any evidence to support its assertion that farmers look to an "expected adjusted world price" in making planting decisions.

[104] *See* Brazil's Further Submission, Annex I, table 1.4.
[105] *See* US Answers to Questions 200 and 201.

165. Without any sources to back up its assertion, Brazil implied that farmers could readily calculate an "expected adjusted world price" in making planting decisions.[106] According to Brazil, a farmer at planting time for MY 1999 would take the December 1999 futures price and subtract 18.5 cents to get the "expected adjusted world price" (which would then be compared to the marketing loan rate). Why 18.5 cents? For each of MY 1996-MY2002, Brazil calculated the difference between the December futures price and the average adjusted world price for that marketing year. Brazil then calculated the average of the differences for these 7 years as 18.5 cents.

166. As with Brazil's lagged price calculation, however, this formula has never been, nor could it ever be, applied by a farmer in real-life. First, calculating the "average adjusted world price" for a given year – say, MY 1999 – requires knowledge of the adjusted world prices that actually result in that year. Thus, a farmer making a planting decision for MY 1999 (that is, in January-March 1999) has no way of calculating the "average adjusted world price" for marketing year 1999 (1 August 1999 – 31 July 2000). Moreover, the same farmer making a planting decision for MY 1999 could not possibly know the December futures prices for MY2000 - MY2002; nor could that farmer know the "average adjusted world price" for MY2000 - MY2002. Thus, that farmer could not have calculated the 18.5 cents per pound average for the "average adjusted world price," nor could he have calculated the "expected adjusted world price"[107] as set out by Brazil.[108] Thus, Brazil's critique of the US futures price approach to planting decisions is not only incorrect but grossly misleading.

167. Brazil's assertions relating to "lagged prices," "average adjusted world prices," and "expected adjusted world prices" are utterly irrelevant to an analysis of the effect of the marketing loan programme because they are simply not knowable by the farmer at the time of planting. In fact, the *only* parts of Brazil's spurious methodology that are objectively knowable at the time of planting – and undisputed facts on the record of this dispute – are (1) the December futures price at the time of planting and (2) the marketing loan rate. These are precisely the elements that make up the US analysis of the effect of the marketing loan programme.

**249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":**

> **(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer? How, if at all, would this be relevant for an analysis of the issue of export contingency under the Agreement on Agriculture or the SCM Agreement? BRA**

168. In response to Brazil's statement that Step 2 "payments are conditional upon proof of export,"[109] the United States would simply remind the Panel that such payments are made to users of upland cotton upon demonstration of the use of cotton. Such use can be manifest either by opening the bale of cotton or by export. The programme is indifferent to whether recipients of the benefit of this subsidy are exporters or parties that open bales for the manufacture of raw cotton into cotton products. Indeed, to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the payment upon submission of the requisite documentation. This subsidy is therefore not contingent on export performance and is not an export subsidy.[110] The situation here is analogous to that in the Ad Note to Article III of the GATT 1994 which makes clear

[106] The methodology is set out in Brazil's opening statement at the second panel meeting and in Exhibits BRA-356 and BRA-357.

[107] December futures - 7-year average of "average adjusted world price".

[108] *See* Brazil's Opening Statement at the Second Panel Meeting, paras. 44-47; Exhibit BRA-356, -357, -358; Brazil's Answer to Question 247, para. 154.

[109] Answers of Brazil to Question 249(a) (22 December 2003), para. 163.

[110] See, e.g., US First Written Submission (11 July 2003), paras. 127-135.

that just because a measure that covers all products evenly is applied in the case of imports (here exports) at the border, does not change it to a border measure.

169. As was pointed out in the *Opening Statement of the United States of America at the Second Session of the First Meeting of the Panel with the Parties*, Brazil's analysis of Step 2 payments exaggerates the effect of Step 2 payments on world prices. Because demand for cotton is more price responsive than supply, the incidence of processor subsidies like Step 2 accrue to supply rather than demand. That is, producers gain through higher prices paid to producers while world prices are relatively unaffected. This is consistent with a previous analysis of Step 2 by FAPRI in 1999 (Exhibit US-61). In that study, FAPRI estimated an average Step 2 payment of 5.3 cents per pound. (By way of contrast, the Step 2 payment rate in effect for January 23 - 29, 2004, is 1.62 cents per pound.) These payments resulted in an increase of the spot price of US cotton by 4 cents and a fall in the world cotton price of less than 0.5 cents.

170. While it is true as Brazil points out that the margin of difference that is required between the relevant delivered US price and the A index has been adjusted slightly by the 2002 farm bill, the Brazil answer shortchanges several aspects of the continued limitations on Step 2 payments. The statute continues to allow payments only when the delivered US price in Northern Europe is higher than the going local Northern European price, and only when that difference has existed for four weeks straight, and only when the prevailing local Northern European price (adjusted for price and location) is not more than 134 per cent of the US loan rate of 52 cents per pound. That figure, 134 per cent of the loan rate, would be about 69.6 cents, and the current adjustment for location and quality is about 13 cents per pound. This means that where the prevailing local N.E. price was more than about 82 cents, there would be no Step 2 payments irrespective of the amount of difference in the two prices that are otherwise compared to determine whether Step 2 payments are made. Also missing in the Brazil answer is a reference to reflect that the relief from the additional 1.25 cent differential is temporary as under current law that 1.25 cents will return on 1 August 2006.[111]

## G. REMEDIES

**250. Does Brazil seek relief under Article XVI of GATT 1994 in respect of expired measures? What type of recommendation would the Panel be authorized to make? (Brazil further submission, paragraph 471 (iii)) BRA**

171. In Brazil's answer, it states that it does not seek relief "under . . . Article XVI of GATT 1994" in respect of "the legal instruments consisting of the 1996 US Farm Bill providing, *inter alia*, for production flexibility contract payments, as well as various emergency appropriation Acts in 1998-2001 providing, *inter alia*, for market loss assistance payments." However, Brazil also clarifies that "Brazil's claims under Articles 5(a) and 6(c) of the SCM Agreement do include the adverse effects today and in the future of subsidies *provided* under these expired legal provisions".[112] Brazil's answer points out the difficulty in its approach to actionable subsidies.

172. As Brazil acknowledges, "a panel may *not* make a recommendation to the DSB that a Member bring a measure into conformity with its WTO obligations if that measure no longer exists."

[111] We have sought additional information on whether producers in the capacity of manufacturers or exporters ever receive Step 2 payments. As we indicated, this would only occur with very large producers, if at all. We have examined recent Step 2 payment lists, and they indicate that at the very best any such payments would be highly isolated. Cooperatives would not, in this sense, be considered "producers" since a cooperative does not, as such, have a risk in the crop during the growing season. Step 2 payments are never paid more than once for the same cotton and absent export are only paid in connection with the manufacturing process for breaking open bundles. A producer who simply bundled cotton just to break the bundle would not be eligible for the payment.

[112] Brazil's Answer to Question 250 from the Panel, para. 164 (emphasis added).

Simply put, if a measure does not exist at the time of panel establishment, then that "measure" is not part of the "matter" referred to the panel and cannot be within the panel's terms of reference. Furthermore, there is nothing to be brought into conformity. In this dispute, recurring subsidies "provided" (in Brazil's words) with respect to past years and fully expensed to those years no longer exist once a new marketing year, for which new recurring subsidies are paid, commences. Thus, not only did these measures (subsidies) for past marketing years (1999-2001) not exist at the time Brazil's panel request was filed and the panel established (during marketing year 2002), they do not exist today (half way through marketing year 2003) and cannot be the subject of any recommendation to be brought into conformity.[113]

173. For this reason, Brazil's insistence that its serious prejudice "claims . . . do include the continuing adverse effects today and in the future of subsidies provided under these expired legal provisions" is troubling. Were the Panel to consider that expired subsidies have some continuing effect (and we note that Brazil has never explained how long those effects could be deemed to last nor how they would be distinguished from the present effects of current subsidies), "include" them as part of its analysis of Brazil's serious prejudice claims, and render a finding of present serious prejudice, the Panel could not recommend that these expired measures be brought into conformity. On the other hand, a recommendation that the adverse effects be removed would be of questionable use since those "effects" would have included the effects of expired measures. Thus, Brazil's claims of present serious prejudice should be limited to those measures that currently existed at the time of Brazil's panel request and panel establishment.

**251. In light, inter alia, of Article 7.8 of the SCM Agreement, if the Panel were to find that any subsidies have resulted in adverse effects to the interests of another Member within the meaning of Article 5 of the SCM Agreement, should it make any recommendation other than the one set out in the first sentence of Article 19.1 of the DSU? BRA**

174. The United States disagrees with Brazil's answer. There is no recommendation made "pursuant to Article 7.8 of the SCM Agreement." Rather, there is an obligation under Article 7.8 on a Member granting or maintaining a subsidy inconsistently with Article 5 to "remove the adverse effects or . . . withdraw the subsidy" *after adoption* of the relevant reports "in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member." Article 19.1 of the DSU addresses the entirely separate question of what recommendations should be *in the report.*[114]1 We also note the contrast between Subsidies Agreement Articles 4.7 and 7.8 in that the text of Article 4.7 specifically authorizes the Panel to take an action ("shall recommend that the subsidizing Member withdraw the subsidy without delay") while Article 7.8 does not.

**252. Without prejudice to any findings by the Panel, if the Panel were to find that any of the challenged measures constitute prohibited subsidies within the meaning of Article 3 of the SCM Agreement, what are the considerations that should guide the Panel in making a recommendation under Article 4.7 of the SCM Agreement relating to the time period "within which the measure must be withdrawn"? What should that time period be? BRA**

175. In its answer, Brazil sets forth no considerations that could guide the Panel in making a recommendation under Article 4.7 relating to the relevant period of time, other than to say that the period should be 90 days. The United States understands that different time periods have been set by panels that have made findings of prohibited subsidies given the nature of the measure in question.

[113] This is so for all the reasons we have given earlier in this dispute, as well as for the reason that Brazil gives: the matter before a Panel "cannot" change after establishment. Brazil's Answers to Panel Question 247.

[114] DSU Article 19.1 ("Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, *it shall recommend that the Member concerned bring the measures into conformity with that agreement*.") (emphasis added; footnote omitted).

For example, in several disputes in which it appears that solely administrative action would be necessary to withdraw the measure, it appears that panels have set 90-day periods. In the *United States – FSC* dispute, the panel found that withdrawal of the measure would require legislative action and provided an appropriate period of time. The time for appeal and adoption would also be a relevant consideration. The United States has explained on several occasions the intricacies of the US legislative process and the time needed to enact legislation, including in submissions to arbitrators acting under Article 21.3(c) of the DSU. No such arbitrator has ever concluded that a period as short as 90 days is a reasonable period of time for the United States to complete implementation of the DSB's recommendations and rulings where legislative action is needed.[115]

176. Brazil has challenged Step 2 payments, the export credit guarantee programmes, and FSC benefits to upland cotton as prohibited subsidies. Brazil has also asserted that these measures are "mandatory," such that officials have no discretion to implement the measures in a WTO-consistent fashion. While the United States does not accept Brazil's assertion, the United States would suggest that the 90-day period given with respect to measures requiring only administrative fixes would not be appropriate.

177. With respect to the FSC legislation, should the Panel find this to be inconsistent with US obligations under Article 3.2 of the SCM Agreement, it is not a practical possibility that the United States could withdraw the subsidy within 90 days, given that legislative action would be required. However, the United States notes that there already are bills before both houses of Congress that would repeal the FSC and that have been reported out of their respective committees. In the event of a prohibited subsidy finding, the United States should be given until the end of this year to complete the legislative process and enact this legislation into law.

## H. MISCELLANEOUS

**255. How does Brazil respond to US assertions concerning the circuit-breaker provision? (see US 2 December oral statement, paragraph 82). Does this mean that US subsidies cannot be "mandatory" for the purposes of WTO dispute settlement? BRA**

178. The United States provides comments on the mandatory / discretionary analysis in its comments on Brazil's answer to question 257.

**257. The Panel takes note of the Appellate Body Report in *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan* (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.**

**(a) In that report, the Appellate Body cautioned against the "mechanistic" application of the so-called "mandatory/discretionary distinction" and stated that the import of this distinction may vary from case to case (para. 93). For the Appellate Body, the question of whether a measure is mandatory or not is relevant "if at all" only as part of the assessment of whether the measure is, as such, inconsistent with particular obligations. How, if at all, are these statements and the related findings concerning the mandatory/discretionary distinction in that Appellate Body Report relevant to:**

[115] The Panel may wish to refer, *inter alia*, to the 21.3(c) arbitrations conducted in the dispute *United States – Continued Dumping and Subsidy Offset Act of 2000* (WT/DS217/14, WT/DS234/22, award circulated 13 June 2003), to which Brazil was a party. Other such arbitrations include *United States - Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan* and *United States - Antidumping Act of 1916*.

179. Brazil's response to question 257 begins with a general discussion of the Appellate Body report in *United States – Sunset Review*.[116] As reflected in the US answer to the same question, the United States agrees with the view expressed in paragraphs one and two of Brazil's response that the *United States – Sunset Review* report has no significant impact on this dispute and that the Appellate Body in *United States – Sunset Review* in fact undertook an analysis of whether the measure at issue in that dispute was mandatory based on a traditional "mandatory / discretionary" analysis. The language cited in the Panel's question was drawn from a separate section of the *United States – Sunset Review* report addressing the preliminary jurisdictional issue of what is a measure, and that question is not present here.

180. While the United States agrees that the *US–Sunset* report is not relevant to the analysis in this dispute, the United States nevertheless disagrees with Brazil's further characterizations of that report.

181. For example, in paragraph three of Brazil' s answer, Brazil addresses the Appellate Body discussion on the interpretation of a Member's domestic law. In its statement at the 9 January 2004, meeting of the DSB at which the report was adopted (attached as Exhibit US-138), the United States placed the Appellate Body statement which Brazil cites in its proper context, which is that the meaning of a domestic law must be determined based on applicable *domestic* legal principles of interpretation. It is simple error to conclude that a measure mandates behaviour by government officials of a Member if, under the domestic law of that Member, the behaviour is not mandated. Thus, Brazil's speculations in paragraph four of its answer that it is permissible to examine whether "the operation of a measure" creates requirements for government officials to act in a WTO-inconsistent manner is both groundless and meaningless. US officials are required to do what US laws require, and there is no principle of US law indicating that a law's "operation" requires anything.

182. Brazil elaborates on its discussion of the "operation of a measure" with a reference to the Appellate Body's discussion of "normative" requirements. However, the United States notes, as it did in its answer to Question 257(d), that the Appellate Body's discussion of an instrument's "normative" character came in the context of its analysis of whether an instrument can be a measure, and not the separate question of whether a measure mandates a breach of any WTO obligation. It is only this latter question that is before this Panel.

183. Likewise, the Appellate Body statement on protecting future trade which Brazil cites in paragraph five of its answer and analyzes in paragraph six came in the context of the Appellate Body's discussion of why certain instruments should be considered measures, and not in the Appellate Body's separate analysis of whether that measure mandates a WTO breach. Again, it is not disputed that the measures at issue in this case *are* "measures." Thus, as Brazil itself notes, the Panel "need not examine whether the subsidy measures that Brazil has challenged are mandatory as a preliminary jurisdictional matter," but should do so only in the context of determining whether the measures breach US obligations.[117]

**(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the Agreement on Agriculture and Articles 3.1(a) and (b) of the SCM Agreement, concerning: BRA**

**- Step 2 payments (see, e.g. paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and**

[116] Appellate Body Report, *United States – Sunset Review of Anti-Dumping Duties on Corrosion Resistant Carbon Steel Flat Products from Japan*, WT/DS244/AB/R (adopted 9 January 2004) ("*United States – Sunset Review*").

[117] *See* Brazil's Answer to Question 257 from the Panel, para. 2.

184. Brazil has challenged Section 1207(a) of the 2002 Act providing for Step 2 payments as both a prohibited export subsidy under Subsidies Agreement Article 3.1(a) and an import-substitution subsidy under Subsidies Agreement Article 3.1(b).[118] Brazil argues that the statute mandates payments inconsistent with WTO obligations and therefore is *per se* WTO inconsistent.[119]

185. The *United States – Sunset Review* Appellate Body report did not analyze or alter the mandatory/discretionary analysis that has been used in past WTO disputes. Thus, for purposes of Brazil's *per se* challenge to Section 1207(a) of the 2002 Act, the relevant issue is whether that measure mandates a violation of the WTO Agreement.[120] It does not, and therefore Brazil's *per se* claim must fail.

186. The United States has explained that "subject to the availability of funds (that is, the availability of CCC borrowing authority), Step 2 payments must be made to all those who meet the conditions for eligibility."[121] That is, the United States may not arbitrarily deny payment to eligible recipients when the price conditions for payment have been met. However, the absence of discretion given these conditions does not mean the measure mandate a violation of Articles 3.1(a), 3.1(b), and 3.2 of the Subsidies Agreement.

187. Brazil states that "US government officials are not provided with any flexibility under Section 1207(a) of the 2002 FSRI Act" and therefore "the Act violates Articles 3.3 and 8 of the Agreement on Agriculture, and Articles 3.1(a) and 3.1(b) of the SCM Agreement".[122] Whether or not US government officials have flexibility with regard to administration of the Step 2 programme, Step 2 subsidies can violate Articles 3.3 and 8 of the Agreement on Agriculture only if they constitute export subsidies. For the reasons summarized in the US Comment to Brazil Answer to Panel Question 249, Step 2 subsidies are not export subsidies.

188. The Step 2 subsidy payments are included in the Total Aggregate Measurement of Support reported by the United States. The United States has also remained within its domestic support reduction commitments as set forth in Part IV of its Schedule. Pursuant to Article 6.3 of the Agreement on Agriculture and Paragraph 7 of Annex 3 of that Agreement, the United States therefore "shall be considered to be in compliance with its domestic support reduction commitments." Under Article 6.3 a Member may choose to provide "amber box" support in any direct or indirect manner so long as that Member's "Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule." Furthermore, the first words of Article 3 of the SCM Agreement render that article subject to the terms of the Agreement on Agriculture. The terms of Articles 3.1(a) and 3.1(b) of the SCM Agreement apply "except as provided in the Agreement on Agriculture".[123] Therefore, without regard to flexibility in operation of

[118] Brazil's First Written Submission, para. 235 ("The measure Brazil challenges as a *per se* violation of the Agreement on Agriculture and the SCM Agreement is the Step 2 export payment program as set forth in Section 1207(a) of the 2002 FSRI Act."); *id.*, para. 331("The measure Brazil challenges is therefore Section 1207(a) of the 2002 FSRI Act, which mandates the payment of Step 2 domestic payments.").

[119] Brazil's First Written Submission, para. 250 ("Section 1207(a) of the 2002 FSRI Act mandates Step 2 export payments that are prohibited export subsidies within the meaning of SCM Agreement Article 3.1(a)."); *id.*, para. 341 ("The programme also constitutes a per se violation of ASCM Articles 3.1(b) and 3.2, because payments are mandatory under US law. Section 1207(a) of the 2002 FSRI Act gives no discretion to the US Secretary of Agriculture to apply the measure in a WTO consistent manner.").

[120] Appellate Body Report, *US – Anti-Dumping Act of 1916*, WT/DS136/AB/R, para. 88 (adopted 26 September 2000).

[121] US Answer to Question 109 from the Panel.

[122] Brazil's Answers to Question 257(a)(i) (20 January 2004), para. 8.

[123] See US First Written Submission (11 July 2003), paras. 138-145. See also, Answers of the United States to Panel questions 111-116 (22 August 2003), paras. 222-226; US Further Submission (30 September 2003), paras. 165-176.

the Step 2 programme, to the extent the United States has not exceeded its domestic support reduction commitments, the Step 2 programme and its authorizing legislation do not constitute a *per se* violation of Article 3.1(a) or 3.1(b) of the Subsidies Agreement.[124]

- **export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, e.g., para. 90 Brazil's oral statement at second Panel meeting).**

189. With respect to export credit guarantee programmes, the United States will not reiterate its myriad points regarding the carve-out conferred by Article 10.2 of the Agreement on Agriculture and the data indicating that, in any event, premia are sufficient to cover long-term operating costs and losses.[125] We do note that, as Brazil recognizes, the programmes are currently below the 1 per cent cap on premiums. Because the United States has discretion to raise the fees to the cap, which along with other elements of discretion over provision of actual guarantees, creates a "discretionary" aspect to the programme that does not "mandate" WTO inconsistent measures.

190. However, the United States notes the disingenuous response of Brazil, in paragraph 16 of its response to Question 257(a)(i). On the one hand Brazil claims to have "looked at historical data concerning premiums collected and costs and losses incurred" to allegedly make its case under item(j), but in the very same paragraph it states that "Brazil does not agree with the United States that item(j) necessarily 'requires a certain retrospection.'" Brazil literally uses retrospection in an effort to make its case on this very point: "Brazil has demonstrated that, *retrospectively* [italics added], costs and losses incurred by the programmes exceeded premiums collected over a 10-year period".[126] The United States of course disagrees with the factual premise of the statement, but Brazil cannot credibly disagree that "a certain retrospection" is necessary for a proper analysis under item(j).

**(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"? BRA**

191. Brazil's answer does not explain the significance of assigning the "mandatory" label to challenged measures for purposes of its serious prejudice claim. Brazil has challenged certain statutory and regulatory provisions as *per se* inconsistent with Articles 5(c) and 6.3(c) and (d) of the Subsidies Agreement and Article XVI:1 and :3 of GATT 1994.[127] Brazil's challenge to these measures is "as such".[128] As explained above with respect to Section 1207(a) of the 2002 Act, under Brazil's *per se* challenge, the relevant issue is whether the challenged measures mandate a violation of the WTO Agreement.[129] They do not.

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[124] Step 2 payments are available to all users of domestic upland cotton within the United States, be they domestic users or exporters. Thus, payment is not contingent upon export performance, and Section 1207(a) does not mandate the grant or maintenance of a prohibited export subsidy within the meaning of Article 3.1(a).

[125] In the view of the United States, the relevant analysis under the Subsidies Agreement whether export credit guarantees are export subsidies could only be the cost-to-government approach set out in item (j) of the Illustrative List of export subsidies.

[126] Brazil's Answer to Question 257(c) (20 January 2004), para. 40.

[127] Brazil's Further Submission, para 413 ("Brazil challenges as *per se* violations of Articles 5(c), 6.3(c), and 6.3(d) of the SCM Agreement, and Article XVI:1 and 3 of GATT 1994 selected mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act, as they cause a threat of serious prejudice within the meaning of those provisions.").

[128] Brazil's Further Submission, para. 471(vii) ("The following Sections of the 2002 FSRI Act and the referenced regulations thereto violate, as such, Articles 5(c), 6.3(c), 6.3(d) of the SCM Agreement and Articles XVI: 1 and 3 of GATT 1994 to the extent that they relate to upland cotton.").

[129] Appellate Body Report, *US – Anti-Dumping Act of 1916*, WT/DS136/AB/R, para. 88 (adopted 26 September 2000).

192. Both Brazil and the United States agree that, given certain conditions such as price levels, these challenged measures would be "mandatory" in the sense that the United States could not arbitrarily decline to provide them. However, for purposes of a mandatory / discretionary analysis, no WTO-inconsistency is mandated by those measures because serious prejudice does not necessarily result, even where there is no discretion not to provide payment.

- For example, a finding of serious prejudice based on Article 6.3(d) requires that there be an increase in the world market share of the subsidizing Member in a subsidized primary product and the increase follow a consistent trend over a period when subsidies have been granted. This finding cannot be made in the abstract but depends upon real-world conditions, such as the current and recent shares of the world market for upland cotton held by the United States.

- Similarly, a finding of serious prejudice based on Article 6.3(c) requires that there be "significant price suppression" in the "same market" where imports of both the complaining and responding party are found. This finding also cannot be made in the abstract but requires an examination of actual prices, import levels, and an analysis of the effects of challenged subsidies.

Thus, that certain US measures "mandate" payments given certain conditions (such as price levels) does not establish that these measures mandate a WTO-inconsistency under a mandatory / discretionary analysis of Brazil's *per se* serious prejudice claim.

193. With respect to Brazil's threat of serious prejudice claims "that do not involve claims regarding the '*per se*' validity of the statutes," Brazil colloquially describes the 5 US subsidies in the Panel's question as "mandatory," but the mandatory / discretionary analysis is inapplicable to this threat claim. In this context, it is significant that certain of the challenged payments are not mandated if price conditions are not met. Thus, in evaluating the threat of serious prejudice resulting from these measures, the *likelihood* that price conditions will be satisfied must be taken into account. (For example, the price conditions have not been met for marketing loan payments since September 2003, and none are currently being made. Furthermore, farm prices have risen to the point that the counter-cyclical payment for marketing year 2003 is projected at one-third or less of its statutory maximum.)

194. Brazil argues that "a threat of serious prejudice under Articles 6.3 and 5(c) will be more likely to exist if the subsidies are mandatory" and that "there are no provisions in US law limiting the payments, and, thus, limiting the threat of prejudice." Putting aside the fact that the "circuit breaker" provision could serve to "limit[] the payments,"[130] Brazil's argument rests on the flawed notion that the absence of a "legal mechanism to limit the amount of potential subsidies that could be paid" necessarily creates a threat of serious prejudice. This proposed standard does not withstand scrutiny.

195. As the United States has noted[131], Brazil looks to the Appellate Body report in *United States – FSC*, but that report involved the "threat of circumvention" of export subsidies standard of Article 10.1 of the Agreement on Agriculture. Because agricultural export subsidies *are* subject to volume and value limits, it may be appropriate in that particular circumstance to conclude that the absence of a mechanism to control the flow of subsidies could threaten circumvention of those absolute commitment levels. However, the commitment in the case of Articles 5(c) and 6.3 is not to

[130] Although the trigger for the circuit breaker provision is compliance with the United States' AMS commitments, the Secretary would appear to have discretion over what "adjustments in the amount of such expenditures" would be made. That is, the Secretary could determine to make adjustments in expenditures for one product or multiple products or decoupled income supports.

[131] *See, e.g.*, US Opening Statement at the Second Panel Meeting, paras. 83-85.

threaten serious prejudice – that is, not threaten a particular form of adverse *effect*. Whether a particular type and level of subsidy could threaten that effect necessarily depends upon a fact-intensive examination of, *inter alia*, the subsidy, the relevant market or markets, supply and demand factors, etc. Thus, the *FSC* standard for claims of "threat of circumvention" of export subsidy commitments is not relevant in this context.

196. Brazil's continued reliance on *EC – Sugar Export Subsidies* is misplaced. In that dispute, the panel found that as there was no legal mechanism to control the EC's sugar export subsidies, the subsidy constituted a permanent threat of instability. That panel, however, provided no basis for selecting that standard, which is not reflected in the text of the Subsidies Agreement or GATT 1994 Article XVI:1.[132] We further note that Brazil itself, when it first presented this report to the Panel, commented that "[t]he panel's conclusion was based on several key factual findings".[133] Thus, even that GATT panel report's finding of threat was based on the particular factual circumstances it reviewed, and that report would not support an abstract standard that the lack of a legal mechanism to control the flow of subsidies suffices to create a threat of serious prejudice.

**(iii) the legal standard and elements Brazil sets out to establish its "per se" "serious prejudice" claims (e.g. Brazil's 9 September further submission, para. 417 ff; US oral statement at second Panel meeting, para. 86 ff.)? BRA**

197. Given the way in which Brazil structured its answer, the United States directs the Panel's attention to its comment on Brazil's answer to question 257(a)(ii). We do note, however, that Brazil has not commented on or rebutted that portion of the US oral statement referred to in the Panel's question. There, we pointed out that Brazil had asserted that in either of two price circumstances, the United States is required to act in a manner inconsistent with US WTO obligations. The first price circumstance is that "both USDA's and FAPRI's baseline expect marketing loan and counter-cyclical payments to be made during the lifespan of the 2002 FSRI Act, i.e., through MY 2007. Thus, the circumstances that will exist during the lifespan of the 2002 FSRI Act are such that all of the five mandatory subsidies will be paid until MY 2007 and that they will threaten to cause serious prejudice".[134] Brazil avoids discussing the fact that market price developments during marketing year 2003 have already superseded this analysis by Brazil.

198. The second price circumstance Brazil posits is when prices are sufficiently high that only direct payments and crop insurance payments are made. Brazil has provided no analysis of the estimated effects of direct payments and crop insurance payments at such high market price levels – that is, its economic analysis is made using baseline prices that are *not* sufficiently high that only direct payments and crop insurance payments are made. Neither has Brazil responded to this criticism.

**(b) How and to what extent are the legal and regulatory provisions cited in paras. 415 and 423 of Brazil's 9 September further submission "normative" in nature and treated as binding within the US legal system (see, e.g., para. 99 of the Appellate Body Report)? Does your response differ depending on whether the payments are dependent upon market price conditions? BRA**

[132] Indeed, the GATT panel's conclusion that "the Community system and its application constituted a permanent source of uncertainty in world sugar markets and therefore constituted a threat of serious prejudice in terms of Article XVI:1" does not clarify any standard to distinguish subsidies that threaten serious prejudice from those that do not since any subsidy that has some production effect could be deemed to "constitute[] a permanent source of uncertainty." *See* GATT Panel Report, *EC – Sugar Exports II(Brazil)*, L/5011, 27S/69, part V(g).

[133] Brazil's Further Submission, paras. 296-97.

[134] Brazil's Further Submission, para. 430.

199. As explained in the US answer to question 257(d), the Appellate Body's discussion of the "normative character and operation" of an instrument came in the context of its explanation of how to determine whether an instrument is a "measure" subject to challenge in dispute settlement. The Appellate Body distinguished this question from the separate question of whether the instrument, if a measure, mandates a breach of a WTO obligation under a "mandatory/discretionary" analysis. Since there is no dispute that the cited legal and regulatory provisions are "measures," the "normative" character of those measures is not at issue. Indeed, Brazil recognizes this in stating that, "[a]s used by the Appellate Body, the term 'normative' includes as a subcategory the group of measures that are mandatory, within the meaning of the traditional mandatory/discretionary distinction".[135] In other words, "normative" measures may or may not mandate a WTO-breach, as analyzed based on the "traditional mandatory / discretionary distinction."

200. Brazil further notes correctly that "[t]he focus for deciding whether a measure is mandatory or discretionary is on whether it provides government officials with the discretion to implement the measure in a WTO-consistent manner".[136] However, discretion is only one reason why a measure may not be found to mandate a breach of a WTO obligation. Here, Brazil's challenge is fact-dependent. There is no basis for presuming the existence of a particular set of facts, and hence no basis for presuming that measures mandate a breach of WTO obligations. Brazil erroneously denies the relevance of the conditions attached to payments.[137] For example, if, when those conditions are met, only *some* of the elements which establish a breach have been shown to exist, then there is no breach.

201. The United States has explained that, given the existence of certain conditions (for example, in the case of marketing loan payments, an adjusted world price less than 52 cents per pound), the five sets of measures Brazil challenges on a *per se* basis would mandate that payments be made. However, as set out in the US comment on Brazil 's answer to question 257(a)(ii), these measures do not mandate any inconsistency with the obligation not to cause serious prejudice because payment alone is not sufficient to establish a breach of the obligation. Even if all the conditions mandating payment have been met, one cannot simply presume that serious prejudice will result; it must also be demonstrated that the effect of the subsidy is one or more of the effects listed in Article 6.3 of the Subsidies Agreement and that serious prejudice results from such effect(s). Moreover, it cannot be disregarded that when those conditions have not been met, those payments will *not* be made and therefore cannot cause serious prejudice.

**(c) Does Brazil challenge as "mandatory" the "subsidies" themselves, the subsidy programmes or the legal/regulatory provisions for the grant or maintenance of those subsidies, or something else? BRA**

202. With respect to Brazil's arguments relating to its threat of serious prejudice claims, the United States refers the Panel to its comment on Brazil's answer to question 257(a)(ii). We do find it revealing that, as in its further rebuttal submission and its statements at the second panel meeting, Brazil makes no reference to the "clearly foreseen and imminent" standard it set forth in its further submission.[138] The absence is even more striking when one considers Brazil's argument that, "[h]aving established the existence of present serious prejudice from the actionable subsidies,

[135] Brazil's Answer to Question 257(b), para. 24.
[136] Brazil's Answer to Question 257(b), para. 27.
[137] Brazil's Answer to Question 257(b), para. 29.
[138] *See, e.g.*, Brazil's Further Submission, para. 292 ("Prior to addressing the specifics of these three claims, Brazil sets forth two legal standards that could be used to analyze the threat of serious prejudice. The first is the standard established by the GATT Panels in *EC – Sugar Exports I (Australia)* and *EC – Sugar Exports II (Brazil)* of a "permanent source of uncertainty" requiring a demonstration that guaranteed subsidies by a large exporter have no effective production or export limitations. The second standard includes the same elements necessary to demonstrate present serious prejudice focusing on the likely effects of the subsidies in suppressing world prices and in increasing and maintaining a high level of world export market share.").

demonstrating that such prejudice is 'clearly foreseen and imminent' from the effects of the same and even larger subsidies is not difficult".[139]

203. We would suggest that to argue that "such prejudice is 'clearly foreseen and imminent'" became much more difficult for Brazil as upland cotton prices recovered over the course of marketing year 2003. That is, the increase in prices had the simultaneous effect of reducing current outlays (for example, no marketing loan payments have been made since September and projected counter-cyclical payments have been reduced by two-thirds) and invalidating Brazil's (flawed) economic analysis for marketing years 2003-2007, which was based on an outdated FAPRI baseline projection that understates the MY2003 AWP by 54 per cent and overstates the estimated marketing loan gain by nearly 15 cents per pound (or 100 per cent). The 5-year high prices reached in marketing year 2003, and the high futures prices for the remainder of marketing years 2003 and for the marketing year 2004 crop, also severely undercut Brazil's rhetorical linking of the large amount of outlays in past marketing years with the extremely low prices experienced.

- That is, if US subsidies caused "significant price suppression" in marketing years 1999-2001, and Brazil claims that support under the 2002 Act has "*significantly increased*" from those levels[140], then how can prices have rebounded to 5-year highs?

Thus, Brazil has good reason not to focus the Panel's attention on actual market developments[141], which demonstrate that there is no "clearly foreseen and imminent" likelihood of future serious prejudice. To the contrary, there is a clearly foreseen and imminent likelihood of record cotton plantings in Brazil[142] and of continued high cotton prices in marketing year 2004.

204. With respect to Brazil's arguments relating to the export credit guarantee programmes, the United States refers the Panel to its comment on Brazil's answer to question 257(a)(i). In additions to those observations, the United States further notes that Brazil has not explained why premium rates at any particular level, let alone if they were significantly increased to the one per cent rate of GSM-102, will *necessarily* not be sufficient to cover long-term operating costs and losses. The United States has numerous mechanisms, such as evaluation of creditworthiness of particular countries and the establishment of individual bank limits, to insulate itself from "credit risks and meet costs".[143] Brazil does not suggest a "magic bullet" rate that would under *all* circumstances necessarily cover long-term operating costs and losses because it cannot, nor does it explain why the flexibility inherent in the operation of the export credit guarantee programme is necessarily less effective than some unknown rate.

205. With respect to Brazil's threat of circumvention claim against the CCC programmes "as such," this claim cannot stand. Assuming *arguendo* that Article 10.2 of the Agreement on Agriculture contrary to its terms did not obligate Members to work towards internationally agreed disciplines on export credit guarantees and thereafter provide export credits only in conformity with such disciplines, then the only way to judge whether the export credit guarantee programmes provide an

[139] Brazil's Further Submission, para. 308.

[140] *See* Brazil' s Further Submission, para. 309 ("The 2002 FSRI Act, along with the 2000 ARP Act, create a legal structure guaranteeing and mandating the payment of *significantly increased levels of spending* for the production, use and export of US upland cotton beyond the 1996 FAIR Act and special appropriation bills in 1998-2001.") (emphasis added).

[141] *See* Brazil's Further Submission, para. 308 ("The evidence presented by Brazil below is based on facts regarding the mandated and unlimited nature of the US subsidies, as well as on actual market conditions demonstrating the present and likely future effects of the US subsidies."). As the Panel will have noted, subsequent to Brazil's further submission, Brazil focused on the first half of this passage and sought to minimize the latter half.

[142] Exhibit US-131 ("Brazil's Mato Grosso to triple winter cotton area," Reuters, 2004-01-20 ("Increased winter cotton planting will result in a record overall area.")).

[143] Brazil's Answer to Question 257(c) (20 January 2004), para. 40.

export subsidy – and hence either circumvent US export subsidy reduction commitments or threaten to – is to look to item (j) of the Illustrative List. Under item (j), the relevant inquiry examines whether premiums are sufficient to cover long-term *operating* costs and losses. That is, it is the operating experience of the programmes that would matter. Thus, the programmes "as such" could not threaten circumvention.

206. Brazil argues in paragraph 39 that the export credit guarantee programmes themselves "confer 'benefits' *per se*." The United States has previously noted Article 10.2 provides the appropriate analysis for claims against export credit guarantee programmes for agricultural products. Were the Subsidies Agreement relevant to such programmes, the relevant test would be that of item(j) of the Illustrative List of Export Subsidies; the United States has shown that the export credit guarantee programmes meet that test. Further, we would note that Brazil has not demonstrated that any benefit is conferred by these programmes; in fact, Brazil has conceded that it "is not in a position to quantify the benefit to the recipients that has arisen from the application of the GSM 102 export credit guarantee programme to exports of US upland cotton between MY 1999-2002.[144] Neither has Brazil attempted to quantify any alleged benefit to recipients of export credit guarantees for any other agricultural products. Thus, Brazil may not obtain findings under Articles 1.1 and 3.1(a) of the Subsidies Agreement by virtue of Articles 10.2 and 21.2 of the Agreement on Agriculture, nor has Brazil established any *per se* inconsistency with Article 1.1 and 3.1(a).

**258. Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks. BRA**

207. The Panel's question highlights Brazil's failure to provide its methodology prior to this late stage of the proceedings. The United States is gratified that the Panel's question has finally compelled Brazil to come forward and explain its methodology for allocating decoupled income support payments. Brazil states that it "appreciates the opportunity to describe to the Panel" this methodology, but Brazil needed no invitation to do so. In fact, as the complaining party alleging that certain decoupled income support payments are support to upland cotton for purposes of Article 13(b)(ii) of the Agreement on Agriculture and actionable subsidies for purposes of Articles 1, 5(c), 6.3, and 7 of the Subsidies Agreement, it has always been Brazil' s burden to make claims and arguments with respect to these measures. Rather, Brazil's answer demonstrates that Brazil's proposed methodology lacks any basis in the Subsidies Agreement, any WTO agreement, or in economic logic. Thus, the Panel should find that Brazil has not made a *prima facie* case of WTO inconsistency with respect to these measures.

208. Furthermore, Brazil's response demonstrates that it is attempting to add new measures to its claims in this proceeding, an attempt that is inconsistent with the Panel's terms of reference. Payments for programmes other than upland cotton are not within the terms of reference and are to be excluded from Brazil's claims. Brazil cannot now alter the terms of reference to add programmes for base acreage for other crops. As Brazil itself has admitted (in its response to question 247): "Thus, the 'matter' before the Panel has not changed (*and cannot*) since the establishment of the Panel" (emphasis added).

**Brazil's Proposed Methodology is not Based on Any Text, Nor Does It Adequately Deal with Fundamental Subsidies Issues**

209. By way of introduction, we recall the proper approach to attributing a non-tied (or decoupled) subsidy to particular products. The United States has explained that a complaining party in a serious prejudice dispute must demonstrate which product or products benefit from the challenged subsidy.[145]

[144] Brazil's Answer to Question 140, para. 82.
[145] *See, e.g.*, US Further Rebuttal Submission, paras. 6-17.

This requirement flows from several sources. First, Article 6.3 and provisions explaining it specifically identify certain effects – for example, displacement or impediment, significant price undercutting, suppression, or depression, and increase in world market share) – caused through a "subsidized product".[146] Thus, to determine whether "the effect of the subsidy" is one of those listed in Article 6.3 requires a finding that upland cotton is a "subsidized product" with respect to that subsidy.

210. Second, a "subsidy" does not exist within the meaning of Article 1 of the Subsidies Agreement if a "benefit" is not conferred.[147] As Brazil is asserting the existence of serious prejudice with respect to upland cotton, the challenged subsidy must actually "benefit" cotton and not any other crop.

211. With respect to decoupled income support, a recipient need not produce upland cotton in order to receive payment. In fact, the recipient need not produce anything at all – hence, the support is "decoupled" from production requirements. Since decoupled income support payments do not, on their face, provide a "benefit" to upland cotton, the question of what products benefit from the subsidy arises.

212. Brazil now answers this question by inventing a methodology by which "excess" base acres – that is, base acres of a crop historically grown on the farm in excess of the planted acres of that crop in a given year – are allocated to other crops with "excess" planted acres (but only if they are "programme crops") – that is, planted acres in excess of the base acres of that crop historically grown on the farm. It is ironic to recall that Brazil criticized the US approach to this issue by writing that the "alleged requirement" to allocate untied subsidies across the total value of production on a recipient's farm "lacks any textual basis".[148]

- In fact, the Panel will search Brazil's answer to question 258 in vain for a *single citation* to a WTO provision that sets out or even indirectly supports its proposed allocation methodology.

213. The methodology explained by the United States, on the other hand, is rooted in the text and context of the Subsidies Agreement. As set out above, to establish that the effect of a subsidy is serious prejudice with respect to upland cotton, Brazil must identify the subsidized products – that is, the products that benefit from the payment and the portion of those payments that benefit upland cotton. Annex IV provides useful context in its methodology for calculating an *ad valorem* subsidization rate. An *ad valorem* subsidy rate is the quotient of a numerator (subsidy amount) and a denominator (value of the subsidized product). Thus, to perform the calculation, one must know what the subsidized product is.

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[146] For example, for purposes of a claim under Article 6.3(c) of the Subsidies Agreement, the "effect of the subsidy" must be "significant price undercutting" or "significant price suppression, price depression, or lost sales" caused by "*the subsidized product*." Article 6.5 confirms that price undercutting includes "any case in which such price undercutting has been demonstrated through a comparison of prices of the *subsidized product* with prices of a non-subsidized like product supplied to the same market." Similarly, under Article 6.3(d) "the effect of the subsidy" must be an increase in world market share "in a particular *subsidized primary product or commodity*." Finally, under Articles 6.4 and 6.3(b), pursuant to which Brazil is not claiming serious prejudice, the "change in relevant market shares" involves an examination of the "relative shares of the market" of the non-subsidized like product and "*the subsidized product*."

[147] *See* Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, adopted 7 June 2000, paras. 6.65 and 6.66 (quoting and agreeing with *Canada – Aircraft* panel: "'A "benefit" does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a "benefit" can be said to arise only if a person . . . has in fact received something.'").

[148] Brazil's Further Rebuttal Submission, para. 103.

- Paragraph 2 of Annex IV provides that "*the value of the product* shall be calculated as the *total value of the recipient firm's sales* in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted" (footnotes omitted & italics added).

- Paragraph 3 of Annex IV modifies the general principle of paragraph 2, providing that "[w]here the subsidy is *tied to the production or sale of a given product*, the value of the product shall be calculated as the *total value of the recipient firm's sales of that product* in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted" (italics added).

Thus, "[w]here the subsidy is [not] tied to the production or sale of a given product," the general methodology of paragraph 2 applies. Because the "value of the [subsidized] product" is the "total value of the recipient firm's sales," it follows that the subsidized product is the entirety of what the recipient sells. To determine the share of the subsidy that is attributable to upland cotton, one would multiply the value of the payment by the share of the total value of production accounted for by upland cotton. Brazil does not deny that both the EC and Brazil apply this very methodology for purposes of their domestic countervailing duty procedures[149], nor that Brazil has proposed that Members adopt this very methodology as a "guideline" on calculating the amount of the subsidy.[150]

214. Brazil can only assert that the allocation methodology set out in Annex IV of the Subsidies Agreement and applied by Brazil itself and the EC for purposes of their countervailing duty procedures "are irrelevant to Article 6.3 claims".[151] And yet, *some* allocation methodology for purposes of Article 6.3 is necessary to deal with non-tied (decoupled) payments – to assert otherwise is to deny the relevance of the "subsidy" definition of Article 1 as well as those provisions of Article 6 contingent on the existence of a "subsidized product". However, Brazil's proposed methodology is not even based on a Subsidies Agreement text, nor based on *its own* procedures for determining the subsidized product that benefits from a non-tied (decoupled) payment. One could reasonably ask how Brazil's own countervailing duty procedures could deal with non-tied subsidies in one way while Brazil proposes a contradictory approach for purposes of its serious prejudice claims, given that both situations are faced with the same issues of whether a subsidy benefits a particular product.

215. In judging the credibility of Brazil's proposed methodology in comparison to the methodology explained by the United States, the Panel may wish to compare the sources that Brazil and the United States, respectively, have drawn upon:

| **Comparison of Allocation Methodologies for Non-Tied (Decoupled) Payments** | | |
|---|---|---|
| **Party** | **Methodology** | **Interpretive and Other Sources** |
| Brazil | Payments for base acres for historically grown crop are attributed to current plantings of that crop, if any; payments for base acres in excess of plantings are attributed to all crops planted in excess of base acres for that historically grown crop by the proportion of a crop's excess planted acres to total excess planted acres | None[152] |

[149] *See* Brazil's Opening Oral Statement at the Second Panel Meeting, para. 4.

[150] Paper by Brazil, Countervailing Measures: Illustrative Major Issues, TN/RL/W/19, at 6 (7 October 2002) ("If the benefit of a subsidy is limited to a particular product, the denominator should reflect only sales [production/exports] of that product. If this is not the case, the denominator should be the recipient's total sales.").

[151] Brazil's Opening Statement at the Second Panel Meeting, para. 4.

[152] *See* Brazil' s Answer to Question 258, paras. 43-55.

| Comparison of Allocation Methodologies for Non-Tied (Decoupled) Payments | | |
|---|---|---|
| **Party** | **Methodology** | **Interpretive and Other Sources** |
| United States | Payments that are not tied to the production or sale of a given product are attributed to all the products the recipient produces; the subsidy benefits a particular product by its share of the total value of production | SCM Agreement, Article 1.1(a); Articles 6.3, 6.4, 6.5; Annex IV, paras. 2-3<br><br>CVD practice, Brazil and EC<br><br>Brazilian CVD proposal[153] |

Simply put, Brazil has pointed to nothing in the WTO agreements that would support its approach to the allocation of non-tied (decoupled) payments.

216. Finally, Brazil's argument that the Annex IV methodology *cannot* apply to claims of serious prejudice does not withstand scrutiny. Although the provision to which Annex IV relates – Article 6.1(a) – is no longer in effect, it may still be relevant for purposes of interpreting the Subsidies Agreement. For example, in *United States – Countervailing Measures (EC)*, the Appellate Body relied on Annex IV as context in interpreting another provision of the Subsidies Agreement.[154] Similarly, in *United States – FSC: Article 22.6*, Arbitrator cited the *expired* Articles 8 and 9 as "helpful . . . in understanding the overall architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address".[155]

217. There is a difference between looking to the expired provisions of Article 6.1 for a legal obligation (for example, the presumption created by a 5 per cent *ad valorem* subsidization rate) and looking to the provisions of Annex IV for a methodology, or logical approach to identifying the subsidized product. In the former case, it is precisely the expiry of the provision that indicates that the presumption created by that rule no longer has effect. In the latter case, unless there is some basis to draw a negative implication from the expiry of the rule in Article 6.1, the methodology can be examined for its underlying logic. If the methodology fits with pertinent subsidies concepts, it may provide useful guidance in determining the product that benefits from the subsidy. In this regard, we note Brazil's statement that the Annex IV methodology existed only because "[n]egotiators wanted to be certain that if such a presumption [of serious prejudice] was created [by virtue of Article 6.1(a)], the precise *level* of subsidization was carefully calculated".[156] To the extent that the Panel agrees that it must "be certain" that the non-tied subsidies at issue benefit upland cotton and that "the precise level of subsidization [must be] carefully calculated," we suggest that Annex IV provides the appropriate methodology.

**Brazil's Allocation Methodology Does Not Make Economic Sense**

218. The foregoing discussion suffices to show that Brazil's allocation methodology has no basis in the Subsidies Agreement. As Brazil has not demonstrated, for each challenged decoupled payment (production flexibility contract, market loss assistance, direct, and counter-cyclical payments), what is the subsidized product nor what is the benefit to upland cotton, Brazil cannot and has not made a *prima facie* case with respect to these payments. That is, Brazil cannot begin to demonstrate "the effect of the subsidy" if it has not shown the subsidy benefit and the subsidized product.

219. It may be of interest to the Panel, however, that Brazil's allocation methodology does not make economic sense. In essence, Brazil's approach arbitrarily assigns payments for base acreage to particular planted acres, as if the current crop was "planted on" base acreage, even though "base

[153] US Further Rebuttal Submission, paras. 9-13.
[154] WT/DS212/AB/R, para. 112.
[155] WT/DS108/ARB, note 56.
[156] Brazil's Further Rebuttal Submission, para. 103.

acres" do not correspond to any physical acres on a farm; they are a mere accounting concept. At the same time, however, any "excess" base acres are assigned to crops that have "excess" planted acres. This methodology leads to situations in which a particular crop could be subsidized at different rates, depending on whether it is planted on "excess" acreage or base acreage. It leads to situations in which a particular crop could receive a greater subsidy than another crop that accounts for more acreage on the farm. It also allocates payments only to certain "programme" crops, ignoring the fact that the subsidy recipient may grow crops for which no base acreage exists and may engage in other types of production. Neither situation makes sense from an economic perspective, and neither results from the correct (Annex IV) methodology explained above.

220. The first situation is one in which a particular crop, such as upland cotton, could be subsidized at different rates, depending on what type of acreage it is "planted on." For example, consider a farm with 200 base acres, 100 of cotton and 100 of soybeans, and 200 planted acres, 150 of cotton and 50 of soybeans. According to Brazil's proposed methodology, 100 base acres of cotton are allocated to 100 acres of planted cotton, leaving 50 planted acres of cotton; similarly, the 50 of the 100 base acres of soybeans are allocated to the 50 base acres of soybeans, leaving 50 "excess" soy base acres that can be allocated to the 50 "excess" cotton planted acres. However, this allocation methodology results in two different rates of subsidization for cotton acreage. The 100 cotton acres deemed to be "planted on" cotton base acreage is subsidized at the rate corresponding to decoupled payments for upland cotton base acres while the 50 cotton acres deemed to be "planted on" soy base acreage is subsidized at the rate corresponding to decoupled payments for soy base acres.[157] There is no rationale for deeming one acre of cotton to receive one subsidy and deeming the next acre of cotton to receive an entirely different subsidy. These decoupled payments are not tied to production of a particular commodity; in fact, the "upland cotton" base acreage could now be "planted to" soybeans or nothing at all. In economic terms, money is fungible, and payments received through decoupled payments are deemed to subsidize whatever the recipient chooses to produce. As all of the recipient's production is the "subsidized product," the subsidy should be neutrally allocated to all of those products.

221. The second situation is one in which a particular crop that is with "excess" plantings could receive a greater subsidy than another crop that accounts for more acreage on the farm. For example, consider a farm with 200 base acres of soybeans and none of cotton and with 75 planted acres of cotton and 50 planted acres of soybeans. Seventy-five base acres of soybeans are attributed to the 75 planted acres of soybeans, and "[p]ayments on any further base acreage for [that] programme crop[ is] allocated to the crops for which planted acres exceed base acres".[158] Since cotton is the only crop "for which planted acres exceed base acres, payments for 125 base acres of soybeans are allocated the 50 acres of cotton.[159] This produces the anomalous result that the lesser planted crop (upland cotton, with 50 planted acres) would be deemed to receive a greater subsidy than the crop with greater planted acreage (soybeans, with 75 planted acres). If the same farm decided to plant 75 acres of soybeans and only *one* acre of cotton, again, all of the "excess" base acres would be allocated to the one acre of cotton. Again, this result makes no economic sense since the farm "allocated" its plantings 75 to 1, soy over cotton. The allocation of payments not tied to production of a particular commodity should reflect the recipient's decisions on what production to undertake.

[157] *See, e.g.*, Brazil's Answer to Question 258, para. 48 (Sample Farm 4: 160 planted acres of cotton are allocated 100 base acres of cotton and 60 base acres of rice).

[158] Brazil's Answer to Question 258, para. 48.

[159] *See, e.g.*, Brazil's Answer to Question 258, para. 51 (Sample Farm 5: 140 planted acres of cotton are allocated payments for 160 base acres (100 cotton, 40 wheat, 20 rice).

222. Brazil's erroneous methodology also allocates payments only to certain "programme" crops, for which base acreage exists.[160] This ignores the fact that the subsidy recipient may grow crops for which no base acreage exists and may engage in other types of production. A farmer's activities and plantings are not restricted to "programme" crops. In the production flexibility contract era, farmers who planted cotton did not just plant wheat, oats, rice, corn, sorghum, and barley. They also planted other crops, like peanuts, sugar, soybeans, and perhaps tobacco. They may have also planted fruits and vegetables on any acreage exceeding their base acreage. They may have produced hay or had livestock operations on the farm. The possibilities are numerous. Given the myriad production activities that a payment recipient could (and did) choose to undertake, there is no basis to allocate non-tied (decoupled) payments solely to programme crops and not to the entirety of a farm's production.

223. In sum, these illogical results follow from a methodology in which payments on "excess" base acreage are allocated only to those crops for which plantings "exceed" their base. If Brazil believes a decoupled payment is capable of allocation when base acreage "exceeds" planted acreage, Brazil must concede that the payment is not tied to production, use, or sale of particular commodity. However, the same consideration must apply to those payments with respect to base acreage for which there is an equal amount of planted acres – that is, those legally indistinguishable payments on "non-excess" base acres are not tied to production, use, or sale of a particular commodity either. Thus, one, consistent allocation methodology must apply to the entire amount of a recipient's decoupled payments. Brazil's erroneous allocation methodology does not provide that. The methodology set out in Annex IV and also applied by Brazil for purposes of its countervailing duty procedures under Part V of the Subsidies Agreement does.

**Implications of Brazil's Erroneous Methodology for Subsidies Claims and Peace Clause**

224. As Brazil's answer makes perfectly clear, and as it had previously stated[161], Brazil rejects the allocation methodology for non-tied (decoupled) payments suggested, *inter alia*, by Annex IV to the Subsidies Agreement. That is, Brazil has refused to acknowledge that such payments must be allocated across the total value of the recipient's production. Therefore, as the United States suggested in its answer to question 256, Brazil has not advanced claims and arguments that would allow the Panel to determine the subsidy benefit to upland cotton. It follows that Brazil has failed to make a *prima facie* case that decoupled income support payments cause or threaten to cause serious prejudice.

225. Brazil's refusal to adopt a proper methodology for determining the subsidy benefit and subsidized product also has important implications for its Peace Clause arguments. The Panel will recall that Brazil argued that "support to a specific commodity" in the Peace Clause proviso could only be gauged by using budgetary outlays. However, calculating the subsidy benefit to upland cotton is indispensable – on Brazil's approach – to determining the "support to" upland cotton. To the extent that Brazil has not utilized the correct methodology, its Peace Clause calculation of the support to upland cotton from decoupled payments is erroneous.

226. In addition, the fact that Brazil seeks to attribute upland cotton decoupled payments made for "excess" base acres is an important point. Brazil acknowledges that these decoupled payments are not tied to production, and therefore can be attributed across production. Our difficulty with Brazil's approach, is that it claims the attribution is only made to crops with "excess" acreage. As explained above, there is no basis for attributing part of a payment to only some crops planted on the farm,

[160] *See, e.g.*, Brazil's Answer to Question 258, para. 50 ("In Brazil's methodology, payments available for allocation – *i.e.*, not allocated to the program crop itself – are pooled and allocated proportionally to the remaining program crop acreage.").

[161] Brazil's Further Rebuttal Submission, paras. 103-05; Brazil's Opening Statement at the Second Panel Meeting, para. 4.

rather than attributing the entire value of such payments across all production. Thus, Brazil has not established that US domestic support measures breach the Peace Clause, and the US domestic support measures are entitled to Peace Clause protection.

227. Brazil's answer also highlights that decoupled income support payments do not grant "support to a specific commodity" within the meaning of Article 13(b)(ii). Brazil has asserted that such support can be any support that benefits upland cotton. Thus, Brazil would seek to allocate decoupled payments to the products on the farm as set out in its methodology. However, Brazil's approach is incompatible with important Agreement on Agriculture concepts. As is clear from Brazil's answer, a payment made with respect to base acreage historically planted to one crop can be support to that crop *and* support to any other "programme" crop at the same time. Such a result is inconsistent on its face with the ordinary meaning of "support to a specific commodity" since such a payment would in fact be 'support to multiple commodities.'

228. In addition, Brazil's approach would render nugatory non-product-specific support for purposes of the Peace Clause. Brazil has argued that the decoupled income support payments it challenges are not non-product-specific support because they are not support to producers "in general." And yet, the recipients of decoupled payments *are* producers "in general" because they are free, with limited exceptions, to plant any commodity and are free, without exception, to undertake other agricultural activities. Thus, they are producers generally of whatever products they choose to produce. By asserting that the allocation of such non-product-specific support to the commodities a recipient produces renders such payments "support to a specific commodity," Brazil reads non-product-specific support out of the scope of the Peace Clause. If non-product-specific support could simply be allocated to a recipient's production and thereby become support to each specific commodity produced, there would simply be no reason to have a category of non-product-specific support in the Agreement on Agriculture.

229. In fact, the Agreement on Agriculture does not permit an interpretation that would allocate all non-product-specific support to specific commodities. First, the precise definition of product-specific support in Article 1(f) ensures that support that is *not* "provided for an agricultural product in favour of the producers of the basic agricultural product" must be categorized as non-product-specific ("support provided in favour of agricultural producers in general"). Second, paragraph 1 of Annex 3 establishes that non-product-specific support must be kept separate from product-specific support for purposes of AMS calculation.[162] Brazil has stated that "support to a specific commodity" under the Peace Clause may be measured either using budgetary outlays or an "AMS-like methodology using rules in Annex 3".[163] Therefore, since Annex 3 specifically provides that non-product-specific support must be kept separate from product-specific support, non-product-specific support must also be kept separate from "support to a specific commodity" for purposes of the Peace Clause analysis. Brazil may not allocate non-product-specific decoupled payments to certain products for Subsidies Agreement purposes and then, on that basis, assert that such allocated payments are "support to a specific commodity" for Peace Clause purposes. The product-specific / non-product-specific categories in the Agreement on Agriculture are *sui generis* and may not be rendered inutile by the application of Subsidies Agreement concepts (subsidy, benefit, subsidized product) not used in nor directly applicable to the Peace Clause.

[162] Agreement on Agriculture, Annex 3, para. 1 ("Support which is non-product-specific shall be totalled into one non-product-specific AMS in total monetary terms.").
[163] Brazil's Rebuttal Submission, para. 87.

**List of Exhibits**

| | |
|---|---|
| US131 | Brazil's Mato Grosso to triple winter cotton area 2004-01-20 20:10:01 GMT (Reuters), By Inae Riveras |
| US132 | Chart, US Crops Cotton supply and utilization, and Baseline |
| US133 | Statement By O A Cleveland 1/16/04 |
| US134 | Charts of US and Brazilian Export Unit Values to 7 Destinations |
| US135 | Production, Yield, Trade, and Stocks Data, MY99-02 |
| US136 | USDA/FAS US trade data, MY99-03 |
| US137 | World Trade Atlas official Brazilian trade data, MY99-03 |
| US138 | Statement of the United States at the DSB (9 January 2004) on adoption of the reports in *United States- Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products for Japan* |
| US139 | USDA Weekly Cotton Market Review 1/9/04 |
| US140 | USDA Weekly Cotton Market Review 1/23/04 |
| US141 | Charts of Chinese (Domestic, Import, Export) Prices vs. A-Index |
| US142 | NY Board of Trade, NY Cotton Exchange, 27 January 2004 futures data |

# ANNEX I-15

## BRAZIL'S COMMENTS AND REQUESTS REGARDING DATA PROVIDED BY THE UNITED STATES ON 18/19 DECEMBER 2003 AND THE US REFUSAL TO PROVIDE NON-SCRAMBLED DATA ON 20 JANUARY 2004

(28 January 2004)

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| *EC – Sugar Exports I (Australia)* | GATT Panel Report, *European Communities – Refunds on Exports of Sugar Complaint by Australia*, L/4833 – 26S/290, adopted 6 November, 1979. |
| *EC – Sugar Exports II (Brazil)* | GATT Panel Report, *European Communities – Refunds on Exports of Sugar Complaint by Brazil*, L/5011 – 27S/69, adopted 10 November 1980. |
| *US – Gasoline* | Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996. |
| *EC – Hormones* | Appellate Body Report, *European Communities - Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, adopted 13 February 1998. |
| *Australia – Salmon* | Panel Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/R, adopted 6 November 1998. |
| *EC – Bananas* | Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS27/ARB, adopted 9 April 1999. |
| *Brazil – Aircraft* | Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW, adopted 28 August 2000. |
| *Indonesia – Automobiles* | Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, adopted 23 July 1998.- |
| *Argentina – Textiles and Apparel* | Panel Report, *Argentina – Measures affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/R, adopted 22 April 1998. |
| *Canada – Aircraft* | Panel Report, *Canada – Measures affecting the Exports of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999. |
| *Canada – Aircraft* | Appellate Body Report, *Canada – Measures affecting the Exports of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999. |
| *Japan – Agricultural Products* | Appellate Body Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/AB/R, adopted 19 March 1999. |
| *Korea – Dairy Safeguards* | Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000. |
| *Canada – Dairy* | Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, adopted 27 October 1999. |
| *Canada – Dairy (21.5) (II)* | Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/RW, adopted 17 January 2003. |
| *US – FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
| *Australia – Leather* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999. |
| *Australia – Leather (21.5)* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/RW, adopted 11 February 2000. |
| *US – 1916 Act* | Appellate Body Report, *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, adopted 26 September 2000. |
| *US – Wheat Gluten* | Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted 19 January 2001. |

| Short Title | Full Case and Citation |
|---|---|
| *US – Wheat Gluten* | Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted 19 January 2001. |
| *Chile – Agricultural Products (Price Band)* | Appellate Body Report, *Chile- Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002. |
| *US – CVD's on EC Products* | Appellate Body Report, *United States – Countervailing Duties on EC Products*, WT/DS212/AB/R, adopted 8 January 2003. |
| *Canada – Aircraft II* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS222/R, adopted 19 February 2002. |
| *EC – Sardines* | Appellate Body Report, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002. |
| *EC – Sardines* | Panel Report, *European Communities – Trade Description of Sardines*, WT/DS231/R, adopted 23 October 2002. |
| *Japan – Apples* | Appellate Body Report, *Japan – Measures affecting the Importation of Apples*, WT/DS245/AB/R, adopted 10 December 2003. |

## 1. Introduction and Summary

1. Brazil and the Panel have repeatedly requested information from the United States regarding the amount of four different types of contract payments to upland cotton producers. The Panel requested this information *five* months ago, in August 2003, and again in October 2003, in December 2003 and, finally, in January 2004. Brazil first requested this information in November 2002. This information is relevant to the "peace clause" portion of the dispute. It would have permitted the Panel to determine with considerable accuracy the amount of support provided to upland cotton from PFC, market loss assistance, direct and counter-cyclical payment subsidies. After repeatedly denying for over *thirteen* months that it even collected or maintained the payment information, the United States finally acknowledged in its 18/19 December 2003 and 20 January 2004 Letters to the Panel that USDA collected, compiled, and organized all data that would permit an allocation of the amount of contract payments received by producers of upland cotton for MY 1999-2002. Regrettably, even after admitting it has this highly relevant information, the United States refuses to produce the data. Accordingly, Brazil has no choice but to request the Panel to draw adverse inferences from the refusal of the United States to produce this data.

2. In this document, Brazil first describes in Section 2 the factual background and the purposes behind its various requests for contract payment information. In Section 3, Brazil details exactly what the United States produced (and did not produce) on 18/19 December 2003 when it "scrambled" farm-specific data and refused to produce other types of data. Brazil then addresses in Section 4 the *post hoc* and invalid US arguments that the farm-specific information is "confidential" under US law. In Section 5, Brazil sets forth the relevant WTO jurisprudence interpreting Article 13.1 of the DSU, which requires Members to produce even confidential information when so requested by panels. In Sections 6-8, Brazil then makes its request for the Panel to draw adverse inferences that the withheld information would show contract payments higher than those estimated in Brazil's 14/16$^{th}$ methodology, and that, therefore, the Panel should find that the United States has no peace clause protection. In Sections 9 and 10, Brazil attempts to use the summary information provided by the United States on 18/19 December 2003, together with a number of assumptions, to apply Brazil's methodology for calculating the amount of the contract payments, as well as to perform the methodology advanced by the United States. The results of this analysis each support the amount of allocated payments, as calculated using Brazil's 14/16$^{th}$ methodology. Finally, in Section 11, Brazil demonstrates that the *Japan – Agricultural Products* decision relied on by the United States is inapplicable.

## 2. Brazil's Request for Information as Posed by the Panel on 8 December 2003 and 12 January 2004

3. Brazil's request for information is set out in Exhibit Bra-369. Brazil requested "farm-specific data to determine the amount of cotton planted on contract base acreage during marketing year 1999-2002." The purpose of Brazil's request for contract acreage and planted acreage data for each farm producing upland cotton was to obtain actual data to permit as exact an allocation as possible of contract payments (from both upland cotton as well as other programme crop base acreage) to current producers of upland cotton. This farm-specific base and planting information (together with requested yield base information) would have permitted the calculation of the amount of support to upland cotton from contract payments by combining two different components of support: (a) *upland cotton* contract payments to current producers of upland cotton, and (b) *other crop* contract payments to current producers of upland cotton. These payments would then be allocated to the current plantings of upland cotton on the farm and, finally, aggregated.[1] This would help the Panel in determining the amount of contract payments that constitute "support to" upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture, and to decide on the peace clause. Finally, to a large extent, the requested information would have also permitted the Panel to apply the

[1] *See* Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

(incorrect) US-proposed methodology for calculating the amount of "benefit" from these subsidies to current upland cotton producers.

4. Brazil first requested this information in November 2002.[2] The Panel requested it in August, October, and December 2003, as well as in January 2004.[3] Faced with repeated US denials that it "maintained" such information, Brazil offered its so-called "14/16$^{th}$" methodology during the peace clause phase of this dispute.[4] Because Brazil conclusively learned in late November 2003 (*inter alia via* the rice FOIA request[5]) that the United States had falsely stated that it did not maintain contract and planted acreage information for each farm, it sought the information detailed in Exhibit Bra-369 to confirm further its 14/16$^{th}$ methodology, which was already supported by a large amount of circumstantial evidence. In effect, Brazil sought to *replace* the 14/16$^{th}$ methodology with a methodology using actual farm-specific data that would provide precise information that the Panel could rely on in making its determination of the amount of support to upland cotton.[6] There is no question that the information withheld by the United States would have been the best information for allocating contract payments that constitute support to upland cotton.

5. Based on its experience working with the data produced in the rice FOIA request, Brazil knew how easy it is to use the computerized farm-specific data to perform the necessary calculations and present the evidence in a summary form. As the Panel could see from the computerized rice data displayed during the meeting on 3 December 2003, this farm-specific data permits the ready calculation of the amount of contract payment support provided to upland cotton producers. Brazil had an entire team ready on 18 December 2003 (and on 20 January 2004) to perform these operations quickly. Brazil had intended to present the evidence in a *summary* form (obviously not in a farm-specific form) for its Answers to Questions on 22 December 2003. But as described below, unlike USDA's response to the rice FOIA request, the United States intentionally "scrambled" the farm-specific information to make it useless for purposes of the comparison sought by the Panel and Brazil, i.e., for calculating the allocated contract payment figures (which the Panel had requested the United States to provide, *inter alia*, in response to Question 67*bis* on 27 August 2003).

6. On 12 January 2004, the Panel again requested the United States to produce the data, and offered the United States the option to (1) produce the data using "substitute farm numbers which still

[2] Exhibit Bra-101 (Questions for the Purpose of Consultations, Questions 3.4, 3.5, 3.13, 3.14 and 11.2). Brazil has made a similar request during the Annex V procedure, during which the United States refused to participate (Exhibit Bra-49 (Brazil's Questions for the Purpose of the Annex V Procedure, Questions 3.8 – 3.10)). Brazil reiterated its request in note 411 of its 24 June 2003 First Submission.

[3] 25 August 2003 Communication from the Panel, Question 67*bis*; 13 October 2003 Communication from the Panel, Question 125(9); 8 December 2003 Communication from the Panel, second bulled point; 12 January 2004 Communication from the Panel, p. 1.

[4] Brazil's 11 August 2003 Answers to Questions 60 and 67.

[5] Brazil's request in Exhibit Bra-369 was modeled on a very similar request regarding rice made by a private US citizen who received rice farm-specific information as set out in Exhibit Bra-368. The rice FOIA request resulted in the production of farm-specific acreage information showing (a) the amount of rice contract acreage and (b) the amount of planted rice acreage for the entirety of rice farms between MY 1996-2002. (As noted in Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, para. 6), more than 99.5 per cent of rice acreage planted is accounted for in the data provided in response to this FOIA request. The data on rice base acreage is naturally complete.) This farm-specific information allowed the easy tabulation of precise aggregate amounts of payments received by current rice producers between MY 1999-2002. Brazil presented the non-confidential *aggregate* rice information to the Panel in Exhibit Bra-368. This aggregated data demonstrates the absurdity of the US claim that the rice (or cotton) *aggregate* data is somehow "confidential."

[6] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55. Brazil also sought the information to rebut the US argument that under its "value" allocation methodology that the amount of support to upland cotton would be much smaller.

permit data-matching," and (2) to arrange for special confidentiality procedures.[7] In its 20 January 2004 Letter to the Panel, the United States refused again to provide the information.[8]

### 3. The United States 18/19 December 2003 and 20 January 2004 Responses to the Panel's and Brazil's Request for Information[9]

7. The first and fundamental conclusion from the US 18 December 2003 Letter and the accompanying data is that the United States admits, for the first time, that it collects, maintains, and can readily analyze whether every farm planting upland cotton is doing so on contract base acreage. It admits that it knows how many farms planted upland cotton in MY 1999-2002.[10] It admits that it knows the amount of acreage for each farm that planted upland cotton.[11] It admits that it knows the number of upland cotton contract acres planted to upland cotton.[12] It admits that it knows the amount of non-upland cotton contract acreage planted to upland cotton.[13] And it admits that it knows the yield information for each farm with contract acreage.[14] Indeed, it admits that it knows the amount of contract payments received by each current producer of upland cotton.[15]

8. In other words, the United States *knows* today, and it knew on 18 December 2003 and on 20 January 2004, exactly how many dollars of contract payments were paid to producers of upland cotton during MY 1999-2002. Moreover, the United States, at a minimum, had the information necessary to make all payment calculations for MY 1999-2001 in November 2002 when Brazil first requested it.[16] And the United States had this information for MY 1999-2002 in August 2003, in October 2003, in December 2003, and in January 2004 when the Panel requested its production.[17]

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[7] *See* 12 January 2004 Communication from the Panel.

[8] *See* US 20 January 2004 Letter to the Panel, p. 3.

[9] Brazil notes that the United States provided the MY 2002 data on 19 December (one day after the deadline set by the Panel). When Brazil refers to the 18 December data, any such reference includes the MY 2002 data provided on 19 December.

[10] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. These files contain summarized data based on farm-specific data that is grouped in three categories: (1) farms producing upland cotton and holding upland cotton base, (2) farms not producing upland cotton but holding upland cotton base, and (3) farms producing upland cotton but not holding upland cotton base. Categories (1) and (2) would be relevant in this respect.

[11] *See* Electronic Planted Acreage Files for MY 1999-2001 and MY 2002 provided by the United States on 18 and 19 December 2003 respectively offering farm-specific information but no farm-identifying information. *See* also Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December respectively offering summary information.

[12] This information would result from matching the farm-specific information on contract acreage and planted acreage. The United States withheld the farm identification number for the acreage information so that Brazil and the Panel are unable to match the information provided and to generate this information. However, the United States performed this exercise as can be seen from the electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. Had the United States not matched the information, it would have been impossible to group the farms into the three categories for which summary information is provided: (1) farms planting upland cotton and holding upland cotton contract base acreage, (2) farms not planting upland cotton but holding upland cotton contract base acreage, and (3) farms planting upland cotton and not holding upland cotton contract base acreage.

[13] This results from the information discussed in the previous note. It is the residual category of the amount of upland cotton planted in any marketing year minus the amount planted on upland cotton base.

[14] *See* Electronic PFC and DCP Files including yield information. The United States used the farm-specific yield information to provide summaries of payment units for each crop in each of the three categories for the contained in the PFC and DCP Summary Files provided on 18 and 19 December 2003 respectively.

[15] This would be the result of multiplying the farm-specific payment units for each programme crop on each farm that plants upland cotton by the respective payment rate for the programme crop in that marketing year.

[16] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 36-40.

[17] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 36-41.

9. The Panel can readily see from the US three-page description of the data it presented on 18 December 2003 that the data provided prevents any farm-specific analysis that would permit the calculation under either of the allocation methodologies advanced by the parties in this dispute. On page 2, the United States states that it is producing "second, a farm-by-farm file (with particular farm identification information) with all the requested data (plus additional data regarding payment quantities) *but not including planted acres and cropland*."[18] Further, the United States states that it is producing "[t]hird, farm-by-farm files for planted acres . . . *with the order of the farms scrambled in order to prevent any matching of farms.*"[19] In short, the United States admits that it does not "provide planted acreage information associated with an individual farm."[20] Translated, this means that neither the Panel nor Brazil can use the provided information to calculate the amount of contract payments made to *all* farms producing upland cotton and allocate the support to upland cotton. Brazil has explained this briefly in its 22 December 2003 Answers to Questions.[21]

10. While the United States provided a considerable amount of farm-specific data, the fact that it scrambled the data on plantings made any matching of contract base and current planting data impossible, and renders all data useless for purposes of producing any conclusive figures under any legitimate allocation methodology. Admitting this, the United States then provides aggregate data for three groups of farms: (1) those planting upland cotton and having at least some upland cotton base acreage, (2) those not planting upland cotton but having at least some upland cotton base acreage, and (3) those planting upland cotton and not holding upland cotton base.[22] The United States appears to consider that this summary data could serve as a substitute for the farm-specific information.[23] This is fundamentally wrong.

11. The United States states as follows in its 20 January 2004 Letter to the Panel:

> [T]he information relevant to the Panel's assessment *would not be farm-specific data* but rather some *aggregation* of data to permit this "assessment of . . . total expenditures." As noted above, the United States has provided both farm-specific and aggregated contract data that would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton.[24]
>
> Further, the United States has provided both farm-specific and aggregated contract data that would permit the Panel to make the assessment it identifies, that is, an

[18] US 18 December 2003 Letter to the Panel, p. 2 (emphasis and underlining added).
[19] US 18 December 2003 Letter to the Panel, p. 2 (emphasis and underlining added).
[20] US 18 December 2003 Letter to the Panel, p. 2.
[21] Brazil's 22 December 2003 Answers to Questions, para. 7.
[22] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively.
[23] US 20 January 2004 Letter to the Panel, p. 2. ("the United States notes that it has previously provided data that permits calculation of "total expenditures" for all decoupled payments made to farms planting upland cotton with respect to historical base acres (whether upland cotton base acres or otherwise). In particular, for the production flexibility contract payment era, we provided a farm-by-farm file ("Pfcby.txt") with base acreage and yield data for all programme crops for all "cotton farms" as defined in BRA-369 and data file ("Pfcsum.xls") that aggregated this data for ease of use. The "programme payment units" field allows for easy calculation of "total expenditures" to farms planting upland cotton in any given year by multiplying payment units by the applicable payment rate. Similarly, for the direct and counter-cyclical payment era, the United States provided a farm-by-farm file ("Dcpby.txt") with base acreage and yield data and an aggregate data file ("Dcpsum.xls"). Again, the "programme payment units" field allows for easy calculation of total expenditures by multiplying payment units by the applicable payment rate. Thus, the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton.") (notes omitted).
[24] US 20 January 2004 Letter to the Panel, p. 3-4 (emphasis added).

> assessment of total expenditures of decoupled payments to farms planting upland cotton. [25]

12. Both the Panel's 12 January 2004 Communication and Exhibit Bra-369 are clear that the United States was required to produce farm-specific information, on the basis of which the allocation of contract payments as support to upland cotton could be performed. The Panel's 12 January 2004 Communication states:

> [T]he Panel requests the United States to provide the *same data* that it agreed to provide in its letters dated 18 and 22 December 2003 but in a format which permits matching of *farm-specific* information on contract payments with *farm-specific* information on plantings. The Panel considers it both necessary and appropriate to seek this information in a suitable format in order to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements.[26]

13. There is a fundamental reason why the US summary (non-farm specific) data does *not* allow for an allocation of support to upland cotton in any given marketing year. To obtain undistorted results, any allocation calculation has to be done on the basis of *individual farms*. Aggregating farm-specific data does not generate the correct amount of contract payments to be allocated to upland cotton. On the contrary, using the aggregate data provided by the United States to allocate payments will inevitably trigger distortions of the results due to an aggregation problem. This problem is illustrated by considering two cotton farms with the following combination of upland cotton base and current upland cotton plantings.

| | **Farm 1** | **Farm 2** |
|---|---|---|
| Cotton Base | 99 acres | 1 acre |
| Cotton Plantings | 1 acre | 99 acres |
| Aggregate Cotton Base | 100 acres | |
| Aggregate Cotton Plantings | 100 acres | |
| Suggested Aggregate Cotton Plantings on Cotton Base | 100 acres | |
| Actual Cotton Plantings On Cotton Base | 1 acre | 1 acre |
| Real Aggregate Cotton Plantings on Cotton Base Acreage | 2 acres | |

Farm 1 plants 99 acres of upland cotton and has 1 upland cotton base acre. Farm 2 plants 1 acre of upland cotton and has 99 upland cotton base acres. In the aggregate, there are 100 acres of upland cotton planted and 100 upland cotton base acreage – a perfect match suggesting that 100 per cent of the upland cotton is planted on upland cotton base. The underlying farm-specific data reveals, however, that this is not the case. Both farms only plant 1 upland cotton acre on upland cotton base. Thus, the real aggregate upland cotton planting on upland cotton base is only 2 acres – not 100 acres. The remaining upland cotton acreage may be planted on some other crop base acreage – as the information requested by the Panel and Brazil would have established.

14. This example demonstrates that using aggregate data to allocate contract payments distorts the results, possibly to a considerable extent. Without non-scrambled farm-specific data (exclusively controlled by the United States), it is impossible to assess how severe this problem is. More importantly, the same aggregation problem arises when other crop plantings and crop base acreages

[25] US 20 January 2004 Letter to the Panel, p. 4.
[26] 12 January 2004 Communication from the Panel, p. 1 (emphasis added).

are considered. This increases the possible distortion that stems from the analysis of aggregate data and makes any judgement as to the direction of the distortion (over- or under-stating the results) impossible.

15. It follows from the discussions above that it is also necessary to have farm-specific data for any allocation exercise. It is only these farm-specific data that allow for farm-specific payment allocations, which, in turn, can be aggregated to "total expenditures."[27] Contrary to the US assertions,[28] aggregate data will not suffice. In sum, despite its numerous assertions on 18 December 2003 and 20 January 2004 to the contrary, the United States failed to provide the requested data.

16. In addition to not providing usable farm-specific planted acreage data, the United States also refused to provide other information requested by the Panel and Brazil.

17. First, the Panel and Brazil also requested the United States to produce farm-specific data on the amount of other contract crop base acreage on farms producing upland cotton with *no* upland cotton base acreage. But the United States refused to provide this information – even in summary form.[29] Although the United States claims otherwise in its 20 January 2004 Letter,[30] the summary files, in fact, do *not* contain data on contract payments to farms that plant upland cotton but do not have upland cotton base.[31] The fact that farms do not have any contract base for upland cotton cannot mean that no such farms have any base acreage whatsoever, which the US-produced data appears to suggest. To the contrary, at least some of these farms are likely to have contract base for other crops, such as rice, corn, and wheat, among others. Because the United States withheld that information, Brazil and the Panel would need to make assumptions on the amount of contract payments received by farms in this third category. Any such assumptions necessarily distort the resulting allocation of contract payments that constitute support to upland cotton.

18. It appears that the reason for the US refusal to provide even summary data on non-upland cotton contract base acreage for these farms stems from the erroneous US argument that Brazil has only challenged upland cotton contract payments made to current producers of upland cotton.[32] The United States concludes, therefore, that it is inappropriate for Brazil to allocate contract payments made to producers of upland cotton producing on other types of base acreage.[33] This refusal is based on an entirely flawed legal argument. In fact, the Panel's terms of reference include the following broad references to contract payments:

> Subsidies and domestic support provided under [the 2002 FSRI Act] … related to … direct payments, counter-cyclical payments … that provide direct or indirect support to the US upland cotton industry.[34]
>
> Subsidies and domestic support provided under [the 1996 FAIR Act] … relating to … production flexibility contract payments … providing direct or indirect support to the US upland cotton industry.[35]

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[27] 12 January 2004 Communication from the Panel, p. 1.
[28] US 20 January 2004 Letter to the Panel, p. 2-4.
[29] *See* Electronic PFC and CCP Summary Files provided by the United States on 18 and 19 December 2003 respectively (Information on contract base of farms in the third category).
[30] US 20 December Letter to the Panel, p. 2.
[31] *See* Electronic PFC and CCP Summary Files provided by the United States on 18 and 19 December 2003 respectively (Information on contract base of farms in the third category).
[32] US 2 December 2003 Oral Statement, para. 31.
[33] US 2 December 2003 Oral Statement, para. 31.
[34] WT/DS267/7, p. 2.
[35] WT/DS267/7, p. 2.

> Subsidies provided under the [1998-2001 Appropriation Acts, i.e., market loss assistance subsidies][36]

19. These terms of reference in Brazil's request for the establishment of a panel are not limited in any way to contract payments made on upland cotton base acres. Brazil listed *contract payments* (unqualified) providing support to the US upland cotton industry, *not upland cotton contract payments* providing support to the US upland cotton industry. Indeed, the reference to "indirect" subsidies is more than broad enough to encompass any type of payment, including payments made from non-upland cotton base acreage. In addition, Brazil's allocation methodology always has included payments made to producers of upland cotton on non-upland cotton base acreage.[37] In short, the US argument ignores the Panel's terms of reference, evidences a misunderstanding of Brazil's allocation methodology, and a misunderstanding of the Panel's and Brazil's requests for information.[38] (As with the other data the United States refuses to produce, Brazil discusses, in Section 5 below, how this constitutes a violation of the US obligations under Article 13.1 of the DSU to cooperate in a panel proceeding.[39])

20. Second, the United States has not provided the requested data for *market loss assistance payments* received by the farms listed for MY 1999-2001. Therefore, the Panel and Brazil would have to make assumptions about the amount of market loss assistance payments that constitute support to upland cotton, based on the information about PFC payments that constitute support to upland cotton. This might distort the results. Further, since market loss assistance payments were also made for soybean base (that otherwise was not eligible to receive PFC payments), this allocation methodology may significantly underestimate the amount of market loss assistance payments that constitute support to upland cotton.[40] In its 20 January 2004 Letter, the United States appears to recognize that market loss assistance payments were within the scope of the Panel's request.[41] It also implies that it has provided the information – at the very least on an aggregate basis.[42] The fact, however, remains that it has not done so.[43]

21. Third, Brazil notes that the 19 December 2003 US data concerning MY 2002 does not contain any information regarding the amount of direct and counter-cyclical payments made on peanut base.[44] As with the missing information on market loss assistance payments (specifically the soybean

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[36] WT/DS267/7, p. 2.

[37] Brazil's 22 August 2003 Rebuttal Submission, Section 2.2 and particularly paras. 32, 38, 42; Brazil's 27 October 2003 Answers to Questions, para. 40; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 2, 17, 50.

[38] Exhibit Bra-369 (Brazil's Request to the United States for Farm-Specific Planting and Base Acreage Data).

[39] *See* Section 5.

[40] The Electronic DCP Summary File demonstrates that farms growing upland cotton in MY 2002 (categories I and III) also grow a significant amount of soybeans, this would have been eligible for a considerable amount of market loss assistance payments in MY 1999-2001 (for which no such data is available).

[41] US 20 January 2004 Letter to the Panel, p. 2.

[42] US 20 January 2004 Letter to the Panel, p. 2 ("In particular, for the production flexibility contract payment era, we provided a farm-by-farm file ("Pfcby.txt") with base acreage and yield data for all programme crops for all "cotton farms" as defined in BRA-369 and data file ("Pfcsum.xls") that aggregated this data for ease of use.[42] The "programme payment units" field allows for easy calculation of "total expenditures" to farms planting upland cotton in any given year by multiplying payment units by the applicable payment rate. Similarly, for the direct and counter-cyclical payment era, the United States provided a farm-by-farm file ("Dcpby.txt") with base acreage and yield data and an aggregate data file ("Dcpsum.xls").[42] Again, the "programme payment units" field allows for easy calculation of total expenditures by multiplying payment units by the applicable payment rate.").

[43] *See* Electronic PFC Summary File, which contains no information on soybean base for market loss assistance payments and no information on possible discrepancies between PFC base and market loss assistance base for the other PFC crops.

[44] Exhibit US-112.

payment information), the missing data on peanut contract payments for MY 2002 would cause lower aggregate payments allocated as support to upland cotton.[45] It follows that any such figures would lead to understating the real support to upland cotton by an amount unknown to Brazil.

22. The United States asserts that the summary data it provided allows for the "easy calculation" of "total expenditures of decoupled payments to farms planting upland cotton."[46] This is simply not true. The table below presents Brazil's calculations of total contract payments to farms that actually produce upland cotton in as far as they were "easy" to perform.[47] The table also reflects the holes in the US summary data described above. These holes prevent any "easy," or even "difficult," calculation of the amount of contract payments to upland cotton farms. Only by making a number of assumptions, as detailed in Sections 9 and 10 below, can the incomplete summary data be used.

| **Subsidy Programme** | **Farms Planting Cotton and Holding Cotton Base** | **Farms Planting Cotton and Not Holding Cotton Base[1]** | **Total Payments** |
|---|---|---|---|
| Marketing Year 1999 | | | |
| PFC Payments | $695,912,510[48] | ? | ? |
| MLA Payments[2] | ? | ? | ? |
| Marketing Year 2000 | | | |
| PFC Payments | $650,579,667[49] | ? | ? |
| MLA Payments[2] | ? | ? | ? |
| Marketing Year 2001 | | | |
| PFC Payments | $520,230,908[50] | ? | ? |
| MLA Payments[2] | ? | ? | ? |
| Marketing Year 2002 | | | |
| Direct Payments[3] | $619,049,305[51] | ? | ? |
| CCP Payments[3] | $1,062,580,729[52] | ? | ? |

[1] The United States has not provided any information on contract payments to farms that plant upland cotton, but do not hold any upland cotton base in its summary files.

[45] The President of the National Cotton Council testified to Congress in 2001 that he grew primarily cotton and peanuts. Exhibit Bra-41 (Congressional Hearing, "The Future of the Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, p. 2). Peanuts are generally grown in the Southern states of the United States, where also cotton is grown. Therefore, it is likely that many cotton farms have also peanut base, which is a high per-acre payment base.

[46] US 20 January 2004 Letter to the Panel, p. 3-4.

[47] Brazil has omitted the third category of farms, for which the United States has presented data (farms not planting upland cotton but holding upland cotton base), as those farms do not produce upland cotton. Therefore, any contract payments received by these farms cannot be "support to" upland cotton.

[48] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[49] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[50] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[51] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[52] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[2] The United States has not provided specific information on market loss assistance payments. In particular, any information on soybean payments to upland cotton farms is missing.

[3] Brazil recalls that the United States withheld information on peanut base payment, thus, these figures are in all likelihood understated.

23. As the Panel can readily see, the only "easy to calculate" payment figures are the PFC, DP and CCP payments figures to farms planting upland cotton and holding upland cotton base (with the DP and CCP payment figures being understated due to the peanut base issue). The other payment figures relating to all market loss assistance payments, and to farms that plant upland cotton but hold only non-upland cotton base cannot be calculated, because the United States produced no data.

24. These calculations are, however, only one step to allocating the amount of contract payments that are actually support to "upland cotton." As Brazil has detailed above, any allocation of "support to" upland cotton has to be performed on a farm-specific basis, to avoid aggregation problems. Any calculation using the US summary data will further distort the results by due to its incompleteness, as demonstrated by the table above.

25. In sum, the fundamental shortcomings in the scrambled and incomplete data provided by the United States on 18 and 19 December 2003 render it unusable for purposes of Brazil's allocation methodology, discussed below,[53] and, for that matter, any allocation methodology.

26. While the United States argued in its 20 January 2004 Letter that the summary data it provided was useful for calculating the amount of contract acreage that constitutes support to upland cotton[54], the Panel must realize that this is – at best – "second-best" evidence, which, due to all the shortcomings just discussed, only allows for distorted calculation results, heavily depending on assumptions.

27. Nevertheless, because the redacted, scrambled and incomplete US data is what was produced, Brazil has attempted to use it.[55] In particular, in Section 9, Brazil has attempted to use the summary data provided by the United States on 18 and 19 December 2003 to allocate contract payments that constitute support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.[56] Due to the limitations of the data discussed above, Brazil was required to make a number of critical assumptions. None of Brazil's assumptions would have been necessary had the

[53] *See* Section 3 below.

[54] US 20 January 2004 Letter to the Panel, p. 2.

[55] Brazil notes that the data provided by the United States appears to be complete, as shown by the following table:

| MY | Contract Acres (US Data) | Contract Acres (USDA) | Percentage | Planted Acres (US Data) | Planted Acres (USDA) | Percentage |
|---|---|---|---|---|---|---|
| 1999 | 16,416,399.4 | 16.4 million | 100 % | 14,572,963.5 | 14.584 million | 99.92 % |
| 2000 | 16,306,696.2 | 16.3 million | 100 % | 15,388,002.9 | 15.347 million | 100.26 % |
| 2001 | 16,245,896.4 | 16.2 million | 100 % | 15,463,934.5 | 15.499 million | 99.77 % |
| 2002 | 18,558,304.2 | not yet reported | - | 13,541,505.9 | 13.714 million | 98.74 % |

Sources:

Contract Acres (USDA): Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19.

Planted Acres (USDA): MY 1999-2001: Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4); MY 2002: Exhibit US-95. Contract Acres (US Data) and Planted Acres (US Data) are taken from the Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December respectively.

[56] *See* Section 9 below. Brazil has applied publicly available information on the payment rates for the contract crops in the marketing yeas concerned (*see* Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

United States produced the requested complete farm-specific information within its exclusive control. Therefore, Brazil cautions against the use of these results. However, Brazil offers these calculations as further circumstantial evidence that its 14/16th methodology is reasonable.

28. In Section 10, Brazil has also attempted to use the US data to perform the US-proposed methodology of allocating contract payments over the total value of the crops produced on the farms producing upland cotton.[57] Brazil strongly disagrees with the US position that such an allocation is required under Part III of the SCM Agreement and GATT Article XVI.[58] Similarly, although Brazil cautions against relying on Brazil's results from applying the US-proposed methodology[59] due to the limitations of the data and the resulting assumptions it had to make, the results would indicate that Brazil's 14/16th methodology generates fairly similar results.

**4. The US Assertions of Confidentiality Are Baseless**

29. The United States attempts to justify its "scrambling" of the acreage data on the grounds that it is "confidential" data barred by the US Privacy Act.[60] A close examination of the facts, including the federal court precedent that binds USDA's administrative actions, shows that the farm-specific acreage data requested by the Panel and Brazil are not confidential.[61]

30. The primary basis for the US confidentiality assertion is an 11 April 2002 USDA FOIA decision concerning *FOOS Farm* (Exhibit US-104). This non-appealed USDA decision stands for the fairly narrow proposition that a FOIA request for a single farm's planting records is an invasion of privacy rights of that farm's operator. In that decision, USDA found that the "release of the number of acres farmed by FOOS Farms would not contribute significantly to public understanding of the operations and activities of FSA."[62]

31. As the USDA *FOOS Farm* decision in Exhibit US-104 demonstrates, there is clearly a difference between a FOIA request for a single farm's acreage data and an across-the-board request for all acreage information – such as that set out in Brazil's 3 December request, and in the rice FOIA request. USDA – and USTR – are bound by US federal court decisions that made exactly this distinction. The leading case is US district court decision in *Washington Post v. United States Department of Agriculture,* 943 F.Supp. 31 (D.D.C. 1996).[63] In that case, the federal court rejected USDA's arguments that the Privacy Act prevented it from producing information on the US cotton programme, including over $1 billion in marketing loan payments, Step 2 payments, and deficiency payments, among others, to US cotton farmers. The court found that there were no violations of privacy rights of US cotton farmers from the "disclosure of names, addresses, and payments that commodity programme recipients received."[64] A close reading of the decision highlights the illegitimacy of the *post hoc* US assertions of confidentiality raised in this dispute. Consider the following passages from the decision:

> The nature of the list [names, addresses, amount of subsidies] sought by plaintiff in this case does not create the same sort of personal privacy concerns or invite the kind of unwarranted intrusion that would justify nondisclosure. The only individualized

[57] *See* Section 10 below.

[58] *See* Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.5 and Brazil's 2 December 2003 Oral Statement, Section 3.

[59] *See* Section 10 below.

[60] US 18 December 2003 Letter to the Panel, p. 1-2.

[61] *See* also 12 January 2004 Communication from the Panel, p. 1.

[62] Exhibit US-104, p. 2.

[63] Cited in Exhibit US-104, p. 2.

[64] Exhibit Bra-418 (Washington Post v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996, p. 5).

> information that would be ascertainable from the release of the list is that a particular individual grows cotton, the address of the farm where the cotton is grown and where the subsidy is received, and how much of a subsidy that cotton farmer received in 1993. *It might also be deduced from the amount of the subsidy how much cotton the producer grew in 1993.* The Court is unable to discern, nor have defendants persuasively explained, how any of this relatively generic information about thousands of similarly situated business people could constitute clearly unwarranted invasions of their personal privacy. *Indeed, it is precisely because the list is so large and the information so generic that the impact on privacy interests are so small*.[65]

32. The court went on to note that there was a strong public interest in the disclosure of the information, rejecting USDA's arguments that the data "pertaining to the cotton programme recipients would not shed any light on the workings of the agency and that therefore there is no public interest in its disclosure." [66] The court found (in language that is particularly applicable to this WTO dispute) that "a significant public interest lies in shedding light on the workings of the Department of Agriculture and the administration of this massive subsidy programme, and plaintiffs have persuasively demonstrated how the release of the recipients names, addresses and subsidy amounts could illuminate the USDA's actions."[67] Thus, despite the Privacy Act of 1974, the court ordered USDA to turn over the farm-specific information.

33. A 1999 US federal court decision in *Hill v. United States Department of Agriculture* found there was a privacy interest in instances where the FOIA request sought information on loans made to an individual borrower. Citing the *Washington Post* case, the court reasoned that because the information related to the finances of one closely-held family corporation and not to "tens of thousands of otherwise indistinguishable business people," it found the corporation had a significant privacy interest.[68]

34. In light of this precedent, it is not surprising that USDA's FOIA office in Kansas City (which is USDA's only FOIA office for such data) agreed on 14 November 2003 to provide complete contract base and acreage data in relation to rice. This is because that request covered *all* rice planted acreage and all rice contract acreage. Pursuant to the reasoning in the *Washington Post* case, USDA's FOIA representatives necessarily must have determined that because the request did not focus on an individual producer's farm, the interests of the public in understanding and evaluating the operation of the contract payment schemes outweighed any privacy interests. Otherwise, the rice data would never have been released. The *post-hoc* attempt by the United States on 18 December 2003 and 20 January 2004 to argue that this information was provided by "mistake" is simply not credible.

35. Brazil notes, further, that the United States provided no evidence that any mandatory provisions of US law or regulations prevent the production of acreage information. The United States incorrectly argues that the Privacy Act of 1974 prohibits the release of planted acreage information for individual farms.[69] But nothing in the text of the Privacy Act cited by the United States requires this. Indeed, the fact the federal court in *Washington Post* ordered the production of farm-specific payment data shows the fallacy of this US arguments. The *Washington Post* decision teaches that the Privacy

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[65] Exhibit Bra-418 (Washington Post v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996, p. 3)(emphasis added). None of the information at issue this case is stigmatizing, embarrassing, or dangerous; it does not expose these cotton farmers to creditors and nothing about the success or failure of the farm or the wealth or poverty of the recipient.

[66] Exhibit Bra-418 (Washington Post v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996, p. 3).

[67] Exhibit Bra-418 (Washington Post v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996, p. 4).

[68] Exhibit US-104 *citing Hills v USDA* decision.

[69] US 18 December 2003 Letter to the Panel, p.2.

Act of 1974 does not function as an inviolate shield to protect individual crop planting data with no exception other than the written permission of each US farmer, as the United States incorrectly asserts.

36. In fact, the only reference to acreage reports is in what the United States incorrectly characterizes as a "long-standing policy" set out in FSA's FOIA Handbook.[70] But this FOIA "policy" does not constitute a US law mandating confidentiality of planted acreage information. It is only guidance to FOIA officers that obviously can be disregarded by the USDA Secretary or other implementing officials in individual cases. The release of the rice information by USDA's FOIA office on 14 November 2003 demonstrates that this policy guidance is not mandatory. In fact, the statutory FOIA requirements, as interpreted by the US federal courts (as in the *Washington Post* decision) clearly take priority over any internal USDA policy guidance documents. The United States is not barred by any provision of US law, either on its face or as interpreted by US courts, from providing the information requested by the Panel.

37. The evidence cited by the United States in support of its refusal to provide the requested data does not, therefore, support its conclusion that the data cannot be released.[71] In effect, the US government has attempted to create, *post-hoc*, a new mandatory policy for the purposes of this dispute. This blatant attempt to prevent the Panel and Brazil from gaining access to information that was readily supplied to a private US citizen in the case of rice was rejected by the Panel in its 12 January 2004 Communication. Unfortunately, the United States' 20 January 2004 Letter continues this approach.

38. Finally, Brazil notes that even if the USDA FOIA policy "guidance" were set out in a mandatory US statute, the United States could still provide the information requested by the Panel and Brazil without "scrambling" it. As the Panel has noted in its 12 January 2004 Communication, there would have been various options available to the United States to produce the information in a manner that would have protected the confidentiality rights of US farmers. Brazil made it clear in its 22 December 2004 Answers to Questions that a substitute number protecting the alleged confidentiality rights of farmers would be acceptable.[72] Since neither Brazil nor the Panel has any interest in an individual farm's identity, providing the requested information in such a manner would have provided Brazil and the Panel with the payment information that they have long sought.

39. In its 20 January 2004 Letter, the United States now asserts that no farm-specific data was actually requested, as the Panel has only sought to determine the total amount of contract payments to farms producing upland cotton.[73] However, both the Panel's 12 January 2004 Communication and Exhibit Bra-369 are clear that the United States was required to produce farm-specific information, on the basis of which the allocation of contract payments as support to upland cotton could be performed. And as Brazil has demonstrated above,[74] the initial allocations have to be performed on a farm-specific level to avoid any aggregation problems.

40. The United States did not even provide a complete summary of the data resulting from the farm-specific comparison between planted and contract acreage on an *aggregate* basis.[75] Such

[70] Exhibit US-106.
[71] *Similarly* 12 January Communication from the Panel, p. 1.
[72] Brazil's 22 December 2003 Answers to Questions, para. 7.
[73] US 20 January 2004 Letter to the Panel, p. 3.
[74] *See* Section 3.
[75] Of course, since the United States fails to provide other requested data, even the summary data of the farm-specific data has huge gaps. For example, the United States does not provide data on contract base on farms that have no upland cotton base but may have other crop contract base. Further, the United States does not provide any MY 2002 data on peanut base on whichever type of farm, thus triggering an understatement of the actual support to upland cotton from contract payments, calculated under any allocation methodology.

summary aggregate information is, of course, not confidential, since it could never reveal the names of any producers, their farms, or the location of the farms. Of course, such a summary document is not a perfect substitute for the complete farm-specific data requested by the Panel. But the US failure to present this obviously non-confidential data highlights its continuing non-justifiable concealment of key information from the Panel and Brazil.

41. Had the United States been willing to cooperate on this issue, it could have either provided the data, as the Panel's 12 January 2004 Communication and Brazil's 22 December Answers to Questions[76] suggested, using a dummy farm number or a consolidated single file for contract and planted acreage (with no farm number),[77] or clarified with Brazil whether there could be a way to address the US confidentiality concern, including throught special procedures for confidential information, as foreseen by Articles 13 and 18 of the DSU.[78] Instead, the United States has simply chosen to refuse to produce the information.

42. Lastly, the United States' 18 December 2003 Letter dramatically calls for Brazil to "return" the rice FOIA request data that was requested and received by a private US citizen.[79] Yet, US federal courts have held that "once records are released, nothing in FOIA prevents the requester from disclosing the information to anyone else."[80] Thus, under US law, the rice data is in the public domain. However, in the spirit of cooperation, Brazil notes that it understands that neither it, nor any person in or formerly in its delegation, or which provided statements to the Panel, currently retains any of this now-public data released by USDA pursuant to its FOIA authority. Moreover, the only information from the rice request used by Brazil in this dispute is set out in Exhibit Bra-368, which reflects *aggregated* data gleaned from the farm-specific comparisons of rice contract acreage with rice planted acreage. Brazil assumes that even the United States would agree that this aggregated data is not confidential.

### 5. There Is No Basis under WTO Rules for the United States to Withhold Planted Acreage Information on The Basis of Confidentiality

43. As described in Section 4 above, the effect of the "scrambling" of planted acreage and contract acreage data by the United States amounts to withholding information specifically requested by the Panel. Further, the failure of the United States to provide any non-cotton base acreage for the third category of farms,[81] and the failure of the United States to produce any information on market loss assistance payments and peanut direct and counter-cyclical payments, also amounts to withholding the information requested by the Panel.

44. In its 20 January 2004 Letter, the United States now makes the additional argument that it can no longer provide the requested information in an anonymous format,[82] using either a dummy farm number, or providing a consolidated file that would contain both contract acreage and planted acreage, but no farm serial number.[83] According to the United States, this is because it has already provided contract acreage with farm serial numbers, and that, with the additional information

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Finally, the United States does not provide information on market loss assistance payments during MY 1999-2001.

[76] Brazil's 22 December 2003 Answers to Questions, para. 7.

[77] The United States was aware that neither Brazil nor presumably the Panel was interested in the farm serial number *per se*.

[78] The Panel has suggested that in its 12 January 2004 Communication as well.

[79] The United States reiterates its request in its 20 January 2004 Letter to the Panel, p. 3.

[80] *Swan v. SEC*, 96 F.3d 498, No. 95-5376, slip. Op. at 4 *cited in Washington Post*, Exhibit Bra-418, p. 2.

[81] Those that produce upland cotton, but do not have upland cotton contract acreage.

[82] This was suggested by the Panel in its 12 January 2004 Communication.

[83] As suggested by Brazil in its 22 December 2004 Answers to Questions, para. 7.

requested by the Panel, Brazil would be able to deconstruct the "confidential" farm serial number.[84] This argument is irrelevant, because the United States has an obligation to produce the information, even if it is "confidential."

45. The United States asserts that, pursuant to the US Privacy Act, it cannot release so-called "confidential" farm-specific planted acreage information associated with a particular farm.[85] Nevertheless, despite the alleged bar of the US Privacy Act, the United States produced farm-specific information concerning the contract acreage designating it as "confidential due to its sensitive nature."[86] The United States never explained how it could produce *contract payment information* on a farm-specific basis, which would be protected by WTO confidentiality procedures, but not *farm-specific acreage information*. If the WTO confidentiality procedures are good enough for one set of confidential data, then they must be good enough for another set of "confidential" data.

46. But even accepting, *arguendo*, that the US acreage data is confidential under US law, there is no basis for the United States to argue or assert that the confidentiality of this information would not be protected in these WTO proceedings. Paragraph 3 of the Panel's working procedures states that "Members shall treat as confidential information submitted by another Member to the Panel which that Member has designated as confidential." These working procedures, like DSU Articles 13.1 and 18.1, require information designated as confidential by the United States to be protected as such by both the Panel and Brazil. Nothing in the Panel's working procedures or any other DSU rule suggests that the United States should be concerned that its information would not be protected. Certainly, nothing suggests that the United States may unilaterally withhold or redact requested information on confidentiality grounds. Indeed, the Panel notes in its 12 January 2004 Communication that this information "can be protected under the DSU and our working procedures."[87] Brazil fully agrees.

47. Brazil notes that the US 18 December 2004 Letter also did not request the adoption of any special confidentiality procedures. Nor did the United States attempt to contact Brazil prior to 18 December 2003 to discuss whether Brazil would agree to special procedures for the protection of the allegedly confidential information – procedures that Brazil has agreed to repeatedly in past disputes involving business confidential information.[88] The United States has similarly participated in many earlier WTO disputes in which it has agreed to such procedures.[89] Nor has the United States presented evidence or argument suggesting that existing WTO confidentiality provisions would not fully protect the confidentiality of planted acreage information. It goes without saying that Brazil would have treated such information in a confidential manner, consistent with its obligations under the Panel's working procedures, and Articles 13.1 and 18.1 of the DSU.

48. There is no legal basis under WTO rules for the United States to withhold this information following the Panel's August 2003, October 2003, 3 December 2003 and 12 January 2004 requests that it produce this information. These requests to the United States to produce the information requested by Brazil in Exhibit Bra-369 were made pursuant to the Panel's authority under DSU Article 13.1.

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[84] US 20 January 2004 Letter to the Panel, p. 3.
[85] US 18 December 2003 Letter to the Panel, p. 2.
[86] US 18 December 2003 Letter to the Panel, p. 3.
[87] 12 January 2004 Communication from the Panel.
[88] Panel Report**,** *Brazil – Aircraft***,** WT/DS46/R, para. 1.10; Panel Report, *Canada – Aircraft*, WT/DS70/R, paras. 9.57 – 59.
[89] Panel Report, *EC – Bananas (22.6) (US)*, WT/DS27/ARB, para. 2.5 (as requested specially by the United States); Panel Report, *Australia – Leather*, WT/DS126/R, para. 4.1; Panel Report, *Australia – Leather (21.5)*,WT/DS126/RW, para. 3.2; Panel Report, *US – Wheat Gluten*, WT/DS166/R, para. 3.1; Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.54-56.

49. The Appellate Body and panels have held that a Member is *required* to provide information – including confidential business information – upon a request made under DSU Article 13.1. The Appellate Body in *Canada – Aircraft* found that WTO Members "are … under a duty and an obligation to 'respond promptly and fully' to requests made by panels for information under Article 13.1 of the DSU."[90] The obligation in DSU Article 13.1 is not limited to only non-confidential information. Indeed, Article 13.1 explicitly anticipates the production of confidential information, providing that "confidential information which is provided shall not be revealed without formal authorization from the individual, body, or authorities of the Member providing the information." As the Appellate Body stated in *Canada – Aircraft*:

> [t]o hold that a Member party to a dispute is not legally bound to comply with a panel's request for information relating to that dispute, is, in effect, to declare that Member legally free to preclude a panel from carrying out its mandate and responsibility under the DSU. So to rule would be to *reduce to an illusion and a vanity the fundamental right of Members to have disputes arising between them resolved through the system and proceedings for which they bargained in concluding the DSU*.[91]

50. The "refusal by a Member to provide information requested of it" has been found by the Appellate Body to "undermine seriously the ability of a panel to make an objective assessment of the facts and the matter, as required by Article 11 of the DSU."[92] The obligation to provide information has been deemed a "requirement for collaboration of the parties in the presentation of the facts and evidence to the panel."[93] Panels have found that "the most important result of the rule of collaboration appears to be that the adversary is obligated to provide the tribunal with relevant documents which are in its sole possession."[94]

51. In *US – Wheat Gluten*, the Appellate Body reaffirmed this "obligation" and "duty" under DSU Article 13.1 to produce all information requested, including information designated as "business confidential." In that case, the United States only agreed to produce to the panel, but not to the EC, information redacted from the public version of a USITC report in a safeguard investigation. The panel in that case proposed three different special procedures for business confidential information, but the United States still refused to make the information available to the EC. The panel indicated that the information withheld "would have facilitated our objective assessment of the facts in this case, and of the matter before us."[95] On appeal, the Appellate Body reaffirmed the "obligation" and "duty" of Members to produce all information, including business confidential information, to panels when requested under DSU Article 13.1. In affirming the panel's ruling, the Appellate Body stated that it "deplore[d] the conduct of the United States" in refusing to produce business confidential information.[96]

52. The panel in *Canada – Aircraft* similarly emphasized the obligation of a Member under DSU Article 13.1 to provide "highly sensitive business confidential information,"[97] as well as information that Canada claimed was governed by a "Cabinet privilege."[98] Similar to what the United States did in "scrambling" the key information in this case, Canada argued that while it could not provide the confidential "Cabinet privilege" documents, it could provide a summary of the criteria the

[90] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 187 (emphasis added).
[91] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 189 (emphasis added).
[92] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 189.
[93] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.40.
[94] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.40.
[95] Panel Report, *US – Wheat Gluten*, WT/DS166/R, para. 8.12.
[96] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 171.
[97] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.293 (Canada's description).
[98] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.294.

Government used to award one particular contribution.[99] However, the panel rejected the utility of this proffered information, finding that the information provided by Canada was not sufficient to rebut Brazil's *prima facie* case that Canada had provided export subsidies.[100] In addition, as with the "scrambled" information provided by the United States, the panel noted the uselessness of business confidential information "redacted" by Canada. The panel found it had been so heavily redacted that it was "simply of no value to the panel."[101]

53. As in *Canada – Aircraft*, the US "scrambling" of contract and acreage data effectively "redacted" the information requested by the Panel to such an extent that it cannot be relied on. In addition, the United States' offer to provide "summary" data tabulating the incomplete "scrambled" acreage data on the one hand, and the contract acreage on the other hand, should be rejected by the Panel. As in *Canada – Aircraft*, a party refusing to cooperate under Article 13.1 should not be permitted to selectively present evidence while withholding evidence within its exclusive control that is far more directly relevant. As the panel found in *Canada – Aircraft*, "Canada has outright refused (on the basis of Cabinet privilege) to provide what in the Panel's view are the most relevant of the documentation that it requested regarding the five contributions identified by Brazil."[102] Data permitting the linking of contract and acreage data is similarly the most relevant of the documentation requested by the Panel.

54. The US refusal to provide *certain* allegedly confidential information in this dispute without even seeking special confidentiality provisions[103] (while providing other information it designates as confidential) is completely inconsistent with its arguments before the Appellate Body in *Canada – Aircraft*. In that appeal, the United States argued that "the need for additional procedures for protecting business confidential information is extremely important, because it goes to the viability of WTO dispute settlement as a vehicle for preserving the rights and obligations of Members."[104] Moreover, the United States argued that the application of procedures for protecting business confidential information promotes important objectives, because Members' rights and obligations under the covered agreements can only be preserved if due process is accorded to both the complaining party and the responding party.[105] The United States maintained that "the demands of due process are not satisfied, however, if the absence of such procedures precludes a Member from properly making its case."[106]

55. Finally, while it argues in this case that the 1974 Privacy Act allegedly prevents it from providing the acreage information *in any form*, the United States maintained in *Canada - Aircraft* that "a Member's national laws do not provide a basis for depriving another Member of its rights under the WTO Agreement."[107] In that case, the EC – as a third party – argued that requiring its officials to sign a non-disclosure form as part of special confidentiality procedures set up by the *Canada – Aircraft* panel would violate their duties of disclosure under EC law. In response, the United States argued

[99] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.294.
[100] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.345.
[101] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.345.
[102] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.345.
[103] In addition to DSU Article 13.1, DSU Article 18.2 provides procedures concerning the protection of confidential information. In addition, Article 12.1 of the DSU permits panels to adopt working procedures in addition to those established in the DSU. This would provide private business interests with adequate protection for their business information, if it is considered of sensitive nature. If the US concern was indeed confidentiality, it could have requested the Panel to arrange for the proper procedures to deal with the information the US claims has such a high confidential status, that it cannot be provided to the Panel or Brazil under normal business confidential information procedures. Therefore, such procedures could have addressed the US concerns about the confidential nature of the information withheld. The United States has not done so.
[104] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 137.
[105] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 139.
[106] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 139.
[107] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 140.

that the EC's claim that "its officials would be unable, under their staff regulations, to accept the undertaking proposed 'should not be allowed.'"[108]

56. In conclusion, there is no justification under WTO rules for the United States to refuse to produce all of the information sought by the Panel in August 2003, October 2003, and on 3 December 2003 and 12 January 2004. The continuing refusal to provide this highly-relevant information is clear evidence of non-cooperation.

**6. The Panel Should Draw Adverse Inferences from the US Failure to Cooperate**

57. In light of the US failure, in response to the Panel's four requests for information on the amount of contract payments provided to *current* producers of upland cotton, to provide information within its exclusive control, Brazil requests the Panel to draw the following adverse inferences:

- That the application of Brazil's methodology[109] for allocating PFC, MLA, CCP, and DP payments to current producer of upland cotton in each of the marketing years 1999-2002 using data exclusively within the control of the United States would have resulted in payments that were higher than those estimated by Brazil's 14/16th methodology.

- That the application of the US methodology for allocating PFC, MLA, CCP, and DP payments to current producer of upland cotton in each of the marketing years 1999-2002 using data exclusively within the control of the United States would have resulted in payments that were as high or higher than those estimated by Brazil's 14/16th methodology.

- That the information withheld by the United States would have been detrimental to its arguments that PFC, MLA, DP, and CCP payments are not support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture, or alternatively, "non-product-specific" support.

58. The legal basis for the Panel's drawing *adverse* inferences is found in the Appellate Body's decision in *Canada – Aircraft*, where it found that "the authority to draw adverse inferences from a Member's refusal to provide information belongs *a fortiori* also to panels examining claims of prohibited export subsidies. Indeed, that authority seems to us an ordinary aspect of the task of all panels to determine the relevant facts of any dispute involving any covered agreement: a view supported by the general practice usage of international tribunals."[110] The Appellate Body in *Canada – Aircraft* stated that "if we had been deciding the issue that confronted the panel [when referring to the drawing of adverse inferences] we might have concluded that the facts of the record did warrant the inference that the information Canada withheld included information prejudicial to Canada."[111] The Appellate Body based its "adverse inferences" holding on an interpretation of the DSU and the SCM Agreement, as well as on support from the following international law jurisprudence:

- In *The Corfu Channel Case*, where the International Court of Justice stated that "… the victim of a breach of international law is often unable to furnish direct proof of facts giving rise to responsibility. Such a State should be allowed a more liberal recourse to

[108] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, paras 135, 140.
[109] *See* Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.
[110] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 202; *See* also "Evidence Before International Tribunals," D.V. Sandifer, Revised Edition, University Press of Virginia 1975, p.153.
[111] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 205.

inferences of fact and circumstantial evidence. This indirect evidence is admitted in all systems of law, and its use is recognized by international decisions."[112]

- *Case Concerning Military and Paramilitary Activities In and Against Nicaragua*, where on the basis of the facts before it, the International Court of Justice found that it could reasonably infer that certain aid had been provided from Nicaraguan territory.[113]

- *Case Concerning the Barcelona Traction, Light and Power Company Limited*, where Judge Jessup, in his separate opinion, opined that "… if a party fails to produce on demand a relevant document which is in its possession, there may be an inference that the document if brought, would have exposed facts unfavourable to the party… ."[114]

- In *William A. Parker (USA) v. United Mexican States*, the Mexican-United States General Claims Commissions stated that "in any case where evidence which would probably influence its decisions is peculiarly within the knowledge of the claimant or of the respondent Government, the failure to produce it, unexplained, may be taken into account by the Commission in reaching a decision."[115]

59. In *US – Wheat Gluten*, the Appellate Body provided additional guidance on the drawing of adverse inferences, noting that the complaining party must identify which facts support a particular inference and what inferences the Panel should have drawn from those facts.[116]

60. In view of these legal standards, Brazil sets forth and references the facts which support the drawing of these three adverse inferences it has requested.

61. First, at the time it refused to produce the requested information on 20 January 2004, the United States was aware of the following key facts: (1) it knew Brazil's latest estimates using the 14/16$^{th}$ methodology,[117] (2) it knew the results of the EWG database tabulations,[118] and (3) it had access to all farm-specific contract, yield, payment and planted acreage data in a centralized database that would have permitted a calculation of the total amount of support under a variety of methodologies, including that advocated by the United States. These facts support the drawing of the first two (adverse) inferences requested by Brazil.

62. Second, the United States was fully capable of calculating the amount of payments allocable to current US producers of upland cotton. As an initial matter, the data would allow for an exact payment total of the amount of *upland cotton* contract payments received by *upland cotton* farmers. Thus, without using any allocation methodology for non-upland cotton payments, the United States knows the exact amount of all these cotton-specific payments. Further, the United States was fully instructed on how Brazil calculated the support attributable to rice in Exhibit Bra-368, Tables 2-3 and accompanying data. Further, throughout the briefings on the different allocation methodologies, the United States left no doubt that it was fully aware of how to calculate the amount of payments using a

[112] The Corfu Channel Case, 1949, ICJ, 4, p.18, *cited* in Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R; note 128.

[113] Case Concerning Military and Paramilitary Activities, 1986 ICJ 14, p. 82-86, paras. 152, 154-156, *cited* in Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R; note 128.

[114] Case Concerning the Barcelona Traction, Light and Power Company Limited, 1970 ICJ 3, p. 215, para. 97, *cited* in Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R; note 128.

[115] Reports of International Arbitral Awards, Vol. IV, 35, p.39, *cited* in Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R; note 128.

[116] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 176.

[117] Set out in Brazil's 22 December 2003 Answers to Question, para. 8.

[118] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.1. *See* also Brazil's 28 January 2004 Comments on US Answers, paras. 20-22.

number of different methodologies, including Brazil's 14/16th methodology, as well as the methodology advocated by the United States itself.[119] Given this knowledge, opportunity, and capability, the Panel may infer that the United States knew the amount of payments resulting from the application of both the Brazilian as well as their own allocation methodologies. These facts support the drawing of the first two (adverse) inferences.

63. Third, the consistently misleading information provided by the United States concerning its possession of data regarding acreage and payment information for contract payments is another fact supporting the drawing of all three adverse inferences. Brazil first requested this information in November 2002, and then repeatedly through December 2003. The Panel made similar requests. It is uncontested that the United States government, through USDA's Kansas City Administrative Office and its database, collected, organized and maintained in a centralized database all of the data that would be responsive to Brazil's and the Panel's requests. The United States now argues it did not "maintain" information on the amount of contract payments paid to current producers of upland cotton.[120] The ordinary meaning of the word "maintain" is "practice habitually," "observe," "cause to continue (a state of affairs, a condition, an activity)."[121] The rapid response of USDA's Kansas City office to the rice FOIA request provides compelling evidence of habitual practice of the US government in "maintaining" both contract and planted acreage information.[122] In sum, the pattern of misrepresentations supports the finding that the United States sought to hide this information and to mislead Brazil and the Panel, because it knew that the requested information would be harmful to its defence.

64. Fourth, a major issue in this dispute has been whether the US contract payments are support to upland cotton, or alternatively, as the United States argued, whether they are "non-product-specific support." As the United States knew on 20 January 2004, a key element of Brazil's proof of support to upland cotton is demonstrating the extent to which the allegedly "decoupled" contract payments are actually paid to current producers of upland cotton. Brazil has provided extensive circumstantial evidence demonstrating this link.[123] The refusal of the United States to provide the information provides the basis for the Panel to infer that the United States knew this information would be detrimental to its argument that these payments were not linked to current cotton production.

65. In deciding whether to draw any adverse inferences, the Panel may wish to consider the precedential impact of the US refusal to cooperate. If a Member can easily block a panel's request for information without any consequences, it will provide a clear roadmap for avoiding subsidy and other WTO disciplines in the future. It will also encourage parties to a future dispute to obfuscate and refuse to provide requested evidence. The WTO dispute settlement system will simply cease to function over the long run unless there are consequences that follow from a Member's non-cooperation. In short, the US lack of cooperation, in the words of the Appellate Body in *US – Wheat Gluten*, is to be "deplored," rather than rewarded.[124]

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[119] US 18 November 2003 Further Submission, paras. 11-17; US 2 December 2003 Oral Statement, paras. 23-24, 26-28.

[120] US 22 December 2003 Answers to Questions, paras. 6-11.

[121] New Shorter Oxford Dictionary, 1993 edition, p. 1669.

[122] The current WTO rules do not permit Brazil to recover the enormous costs it has incurred in this dispute to prove circumstantially what the United States had in its possession for the past 15 months. The Panel should consider that, if the misrepresentations made by the United States in this proceeding had been made in US Federal Courts, they would have resulted in the award of significant attorney's fees and costs in a US Federal Court. *See e.g.*, Federal Rule of Civil Procedure 26(g)(2)(A), (3) (sanctions include reasonable expenses including attorney's fees due to misleading certification of accuracy of discovery responses).

[123] *See e.g.* Brazil's 9 October Closing Statement, Annex I, although later submissions provided considerable additional information such as Brazil's 18 November Further Rebuttal Submission, Sections 2.1, 3.1 and 3.7.5.

[124] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 171.

66. Finally, any adverse inferences drawn by the Panel become part of the evidence on the basis of which the Panel must make an objective assessment of the facts under DSU Article 11. Among the best available "facts" are the adverse inferences themselves. The Appellate Body in *Canada – Aircraft* held that "a panel must draw inferences on the basis of all of the facts of record relevant to the particular determination to be made,"[125] and that "[w]here a party refuses to provide information requested by a panel, that refusal will be one of the relevant facts on record, and indeed an important fact, to be taken into account in determining the appropriate inference to be drawn."[126]

### 7. The US Refusal to Provide the Information Requested Renders Brazil's 14/16th Methodology the Most Accurate Information on Record Concerning the Amount of Support to Upland Cotton from Contract Payments

67. Since the United States has not provided the data, the best available information before the Panel is Brazil's so-called "14/16th" methodology. This information is the most accurate proxy for the amount of contract payments that constitute support to upland cotton. By this methodology, Brazil has made the assumption that all upland cotton is planted on upland cotton base. Or, put differently, for each acre planted to upland cotton an average contract payment in the amount of an upland cotton contract payment is received. Accordingly, Brazil has adjusted the amount of upland cotton contract payments made in any marketing year by the ratio of the acreage actually planted to upland cotton and the upland cotton contract payment base acreage in that marketing year.[127] For MY 2002, the original ratio was about 14/16th,[128] therefore the name of the methodology. In fact, Brazil has used a different adjustment factor for each marketing year.[129]

68. Brazil has demonstrated with circumstantial evidence that current upland cotton producers need contract payments to generate sufficient returns to remain economically viable.[130] Brazil has also demonstrated that current producers of upland cotton need high per-acre contract payments (such as those provided for upland cotton, rice, peanut or corn base) to cover the cost of upland cotton production.[131] Thus, in the absence of the withheld data, it is fair to assume that some upland cotton was planted on base acreage with higher payments than upland cotton base (*e.g.*, rice[132]), and some was planted on base acreage yielding lower contract payments than upland cotton base (*e.g.*, corn). These phenomena would, on average, cancel each other out, so that one can reasonably assume that the average planted upland cotton acre received a contract payment in the amount of an upland cotton contract payment.[133]

69. In addition, the incomplete EWG data supports the conclusion that most US upland cotton is planted on upland cotton base.[134] Three quarters of all upland cotton base payments are paid to

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[125] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 204.

[126] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 204.

[127] Since planted acreage in all marketing years is below the base acreage, this amounts to a downward adjustment of the total payments made in relation to upland cotton base acreage.

[128] The final planted acreage figure provided by the United States in a later stage of this dispute required a slight adjustment to the figure: *see* Brazil's 22 December 2003 Answers to Questions, para. 8.

[129] *See* Brazil's 11 August 2003 Answers to Questions, Notes to Table at paras. 97 and 130.

[130] These facts are summarized in Annex 1 to Brazil's 9 October 2003 Closing Statement but are contained in a number of Brazil's earlier submissions to the Panel beginning on 24 June 2003. *See* also Brazil's 18 November Further Rebuttal Submission, Sections 3.1 and 3.7.5.

[131] Brazil's 22 August 2003 Rebuttal Submission, paras. 30-34 and 39-44; Brazil's 27 October 2003 Answers to Questions, paras. 14-24 and Brazil's 2 December 2003 Oral Statement, paras 26-27.

[132] Brazil notes that the data provided by the United States does not contain any information on peanut base payments, which would also be a high per-acre payment crop.

[133] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 50-51.

[134] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 22-28. *See* also Brazil's 28 January 2004 Comments on US Answers, paras. 20-22.

producers of upland cotton.[135] The EWG data further demonstrates that the great majority of both contract payments and marketing loan payments received by upland cotton producers are for upland cotton.[136] Thus, while part of the contract payment support to upland cotton comes from non-upland cotton contract payments, any over- or under-counting resulting from Brazil's "14/16th" methodology would be minimal.

70. Finally, in making this factual finding, the Panel should also take into account, as a fact of record, the adverse inferences outlined in Section 6 above, which fully support a finding that Brazil's 14/16th methodology is correct. In addition, the Panel should take into account the adverse inference that the US allocation methodology would have resulted in contract payments at least as high as those in Brazil's 14/16th methodology. However, in making its objective assessment of the facts, the Panel should reject the partial information proffered by the United States in its 18 and 19 December 2003 Letter and reflected in various submissions.[137] As in *Canada – Aircraft*, this heavily redacted information, which excludes the most relevant information requested, should be ignored.

## 8. Brazil's Intended Methodology For Allocating Contract Payments as Support to Upland Cotton

71. Brazil intended to use the data requested from the United States to calculate the amount of contract payments that constitute "support to" upland cotton,[138] within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.[139] In its 20 January 2004 Answers to Additional Questions, Brazil provided more detailed information concerning its allocation methodology.[140] Brazil emphasizes that it intended to apply this methodology since early on in this dispute, but was prevented from doing so due to (1) the US denial that the data existed and (2) the US refusal to provide the data requested by the Panel and Brazil.[141] Only because of the US argument that it did not have the information requested and – after demonstrating the incorrectness of that argument – because of the US refusal to provide the information, Brazil suggested to apply its so-called "14/16th" methodology as a proxy.

[135] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 23-24.

[136] Brazil's 18 November 2003 Further Rebuttal Submission, para. 26.

[137] *E.g.*, in note 12 of the 22 December 2003 US Answers to Questions the United States asserts that only 30.7 per cent of cropland on US upland cotton farms was planted to upland cotton in MY 2002. This figure is however misleading, as the United States has classified as "upland cotton farm" not only farms that currently grow upland cotton, but also farms that historically grew upland cotton (and, therefore, have upland cotton base) yet have stopped to do so. This is an inappropriate categorization. By contrast, in paragraph 186 of its 22 December 2003 Answers to Questions, the United States provides the correct figure of 48 per cent of cropland on farms actually producing upland cotton is planted to upland cotton. The Panel should not allow the United States to selectively use its data (which cannot be checked), but not allow the Panel or Brazil to receive the data needed to calculate the amount of support to upland cotton from the contract payments.

[138] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 3, 17-19, 47-49; Brazil's 2 December 2003 Oral Statement, para. 2 and Exhibit Bra-369 (Brazil's Request to the United States for Farm-Specific Planting and Base Acreage Data).

[139] Brazil notes that it is its position that the peace clause is an affirmative defence and that it is the burden of the United States to demonstrate that its current support to upland cotton does not exceed the support decided during 1992 (*see inter alia* Brazil's 22 July 2003 Oral Statement, paras. 5-11). The United States has not lived up to its burden of proof and has repeatedly failed to provide the data that would allow the Panel and Brazil to calculate the exact amount of support to upland cotton.

[140] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[141] *See inter alia* Brazil's 9 October 2003 Closing Statement, paras. 2-9, in particular para. 2, 6 and 9; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 2-3, 17, 32 and 47-51.

## 9. Using the Problematic and Incomplete US 18 / 19 December 2003 Aggregate Data for Allocating Contract Payments as Support to Upland Cotton Does Not Contradict Brazil's 14/16th Methodology

72. In this Section, Brazil presents its results from applying a simplified version of its methodology applied to the US summary data. Brazil incorporates all of its reservations it has expressed regarding this data.[142] Brazil further recalls its various arguments why contract payments constitute support to specific commodities.[143] Therefore, contract payments are principally allocated to the programme crops covered, as suggested by Brazil's methodology presented in its 20 January 2004 Answers to Additional Questions.[144]

73. As the record demonstrates, none of four types of contract payments[145] is truly "decoupled," given the production of programme crops by the farms holding contract payment base. To the contrary, they are intended to and, in fact, do provide support for the production of programme crops. This is particularly true in the case of high per-acre payment crops, such as upland cotton and rice.[146] Therefore, Brazil allocates contract payments to the programme crops covered. This approach is reasonable, since contract payments are eliminated, for instance, if fruits and vegetables are grown. In sum, Brazil maintains its position – supported by all third parties[147] – that the support from contract payments that can be allocated to upland cotton is product-specific support within the meaning of the Agreement on Agriculture.[148]

74. Although Brazil could not use the data provided by the United States for its intended purpose, Brazil has attempted to apply a similar but less complex allocation methodology[149] to the aggregate data provided by the United States.[150] The summary data provided by the United States groups farms in three different categories and provides aggregate data for these categories: (1) those farms planting upland cotton and holding upland cotton contract base acreage, (2) those farms not planting upland cotton but holding upland cotton contract base acreage, and (3) those farms planting upland cotton and not holding upland cotton contract base acreage.[151] For purposes of this analysis, only the aggregate data concerning farms in category (1) and (3) are of interest, as only those farms actually plant upland cotton. Brazil discusses below how it has calculated the contract payment support to upland cotton for each of these categories.

75. Due to the summary nature of this data, Brazil had to make several critical assumptions that would not have been necessary had the United States provided usable non-scrambled farm-specific data rather than summary data and "scrambled" farm-specific data. These assumptions are set out below.

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[142] *See* Section 3.

[143] *See inter alia* Brazil's 9 October 2003 Closing Statement, Annex 1.

[144] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[145] PFC, market loss assistance, direct and counter-cyclical payments.

[146] *See inter alia* Brazil's 9 October 2003 Closing Statement, Annex I for a summary of these arguments.

[147] *See* Brazil's 22 August 2003 Rebuttal Submission, para. 13 for further references.

[148] *See e.g.* Brazil's 22 August 2003 Rebuttal Submission, paras. 13-23 and 24-52 for evidence and arguments concerning the four contract payments.

[149] Due to the limitations of the data provided by the United States, Brazil had to simplify its suggested methodology (Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55) so as to enable its application to aggregate rather than farm-specific data.

[150] Brazil notes that as explained above, the farm-specific data provided by the United States does not allow for matching the contract payment data with the data on current plantings of contract programme crops. Therefore, Brazil could only use the summary data for this allocation exercise.

[151] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively.

76. First, Brazil had to assume that no "aggregation problem" exists with the US summary data. Brazil's example in Section 3 above demonstrates that basing calculations on aggregate rather than farm-specific data can distort the results to a considerable extent. Without usable non-scrambled farm-specific data, it is impossible to avoid this problem – although Brazil does not know how severe the problem is in the case of upland cotton contract payments. Using the US aggregate base acreage data and aggregate planting data to allocate contract payments will most likely trigger distortions of the results due to the allocation problem.

77. It bears repeating that a proper allocation calculation has to be done on the basis of individual farms to obtain undistorted results. Only aggregating farm-specific allocations of contract payments as support to upland cotton generates the correct total amount of contract payments to be allocated to upland cotton.

78. Further critical assumptions are discussed in the course of the description of the allocation methodology used, as set out below.

79. *First, Brazil has considered the data for upland cotton planted on farms that also have upland cotton base*. As indicated in Brazil's allocation approach,[152] as a first step in these calculations, Brazil has assigned all aggregate upland cotton base payments received by farms producing upland cotton and holding upland cotton base as support to upland cotton – yet only up to the share of upland cotton base acreage that was actually planted to upland cotton.[153] The monetary value of contract payments to these farms was calculated by multiplying the payment units for a crop base (as provided by the United States) by the payment rate for that crop in the marketing year in question.[154] For MY 1999-2001, all upland cotton PFC payments to farms producing upland cotton and holding upland cotton base were allocated as support to upland cotton, because the aggregate acreage planted to upland cotton by that group of farms exceeded their aggregate upland cotton base acreage.[155] For MY 2002, only a percentage of total upland cotton direct and counter-cyclical payments was allocated as support to upland cotton, because upland cotton acres planted by farms holding upland cotton base were below their updated upland cotton base for that marketing year.[156] The percentage of payments allocated corresponds to the ratio of aggregated upland cotton planted acreage to aggregated upland cotton base acreage for the group of farms producing upland cotton and holding upland cotton base.[157] It follows that in MY 2002 for this group of farms no further direct or counter-cyclical payments from other crops were allocated.

80. Since for MY 1999-2001 upland cotton acreage planted by farms that also had upland cotton base exceeded that base, additional PFC payments paid on other crop base were allocated as support to upland cotton. As discussed in Brazil's methodology,[158] PFC payments for other crops were primarily allocated as support for these crops – up to the share of contract acreage planted to the respective crop – in a manner identical to the above described first step for upland cotton. Any further payments stemming from contract acreage not planted to the respective base crop were pooled and

[152] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55, in particular para. 47 discussion of Sample Farms 1-3.

[153] Brazil's 20 January 2004 Answers to Additional Questions, paras. 44-48.

[154] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

[155] *See* Exhibit Bra-419 (Allocation Calculations Based on Brazil's Methodology and US Summary Data). (Also provided electronically as 'allocation calculations.xls').

[156] *See* Exhibit Bra-419 (Allocation Calculations Based on Brazil's Methodology and US Summary Data). (Also provided electronically as 'allocation calculations.xls').

[157] *See* Exhibit Bra-419 (Allocation Calculations Based on Brazil's Methodology and US Summary Data). (Also provided electronically as 'allocation calculations.xls').

[158] Brazil's 20 January 2004 Answers to Additional Questions, para. 48 discussing Sample Farm 4.

allocated as additional support to those contract crops whose aggregate planting exceeded their aggregated base acreage.[159]

81. Second, Brazil has analyzed the US summary data concerning *upland cotton that has been planted on farms without upland cotton base*. Unfortunately, the United States did not provide the requested information (even in summary form) regarding the amount of contract acreage that existed on those farms.[160] The second critical assumption Brazil, therefore, must make is that, for each upland cotton acre planted on a farm without upland cotton base, contract payments were received in an amount identical to the average per-acre payment allocated to upland cotton planted by the first group of farms. This assumption triggers further uncertainty about the reliability of the results, because it assumes that this group of farms receives contract payments in an equal manner as compared to group planting upland cotton and holding upland cotton base.[161]

82. Third, since the United States has not provided any information on the amount of market loss assistance payments received by any farm producing upland cotton – the United States did not even provide aggregate information – Brazil has assumed[162] that any allocation of market loss assistance payment as support to upland cotton would have to be made in the same manner as the allocation of PFC payments in the marketing year in question.[163]

83. Combining the resulting PFC, market loss assistance, direct and counter-cyclical payments from these calculations yields the following amount of contract payments that would be considered support to upland cotton.

[159] *See* Brazil's 20 January 2004 Answers to Additional Questions, paras. 49-55 discussing Sample Farms 5-7. For MY 1999 and 2000, only upland cotton plantings exceeded the crop base acreage, thus, all additional payments were allocated to upland cotton. For MY 2001, also oats and sorghum were planted on more acreage than their respective contract base ("overplanted"), thus, triggering additional payments being allocated pursuant to the crop's share of the total acreage being "overplanted." *See* Exhibit Bra-419 (Allocation Calculations Based on Brazil's Methodology and US Summary Data). (Also provided electronically as 'allocation calculations.xls').

[160] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. Considering the fact that US upland cotton producers needed contract payments to produce upland cotton in an economically viable manner, it is simply not realistic to assume that there were farms without any kind of contract acreage planting upland cotton. *See* Sections 4 and 5 rejecting the US reasoning for not providing the data.

[161] Brazil also recalls that the US data for MY 2002 does not contain any information concerning the amount of direct and counter-cyclical payments made on peanut base (Exhibit US-112). Thus, the missing peanut contract payments for MY 2002 are also missing in the calculation of the amount of direct and counter-cyclical payments that constitute support to upland cotton. It follows that these figures are understated by an amount unknown to Brazil.

[162] Brazil recalls that market loss assistance payments are made on the same basis as PFC payments – with the exception that market loss assistance payments were also made for soybeans.

[163] *See* note to the summary table below. This assumption leads to an understatement of the resulting payments, since market loss assistance payments also covered soybean production in additional to any PFC payment base. Thus, just relying on PFC payments as a proxy leaves out a potential significant amount of money that may have supported upland cotton.

| MY | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | $619,336,990.11 | $564,607,044.52 | $456,554,286.78 | - |
| MLA Payments[164] | $616,320,738.53 | $601,042,809.61 | $630,594,516.48 | - |
| DP Payments | - | - | - | $464,596,092.01 |
| CCP Payments | - | - | - | $1,025,653,053.34 |

84. For purposes of comparison, Brazil presents below its results based on the "14/16th" methodology:[165]

| MY | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | $547,800,000 | $541,300,000 | $453,000,000 | - |
| MLA Payments | $545,100,000 | $576,200,000 | $625,700,000 | - |
| DP Payments | - | - | - | $454,500,000 |
| CCP Payments | - | - | - | $935,600,000 |

As the Panel can see, Brazil's figures based on the 14/16th methodology are consistently *below* the results using the US summary data provided on 18 and 19 December 2003. It follows that the results of this methodology using the flawed US summary data, at the very least, do not contradict Brazil's 14/16th methodology. Judging from these results, it appears that, even having in mind all the limitations of the US data as discussed above,[166] Brazil's methodology is rather conservative compared to an allocation based on the US summary data, which the United States seems to endorse as a valid base for calculating support to upland cotton.[167]

### 10. Application of The US-Proposed Allocation Methodology to The US Summary Data

85. Brazil recalls that its allocation methodologies offered so far and their results are provided in the context of the peace clause analysis under Article 13(b)(ii) of the Agreement on Agriculture.[168] The United States has criticized Brazil's 14/16th methodology and asserts that, for purposes of Brazil's claims under Articles 5(c) and 6.3 of the SCM Agreement, Brazil has to allocate contract payments to farms producing upland cotton over the entire sales of those farms.[169] (On the other hand, the United States maintains that any such allocation is not warranted for purposes of the peace clause[170] –

[164] The amount of market loss assistance payments has been calculated by applying the ratio of allocated PFC payments (as calculated) to upland cotton PFC payments as provided in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6) to the amount of upland cotton market loss assistance payments as provided by the same source.

[165] The figures in this table are reproduced from Brazil's 9 September 2003 Further Submission, Table 1. MY 2002 data is taken from the updated figures presented by Brazil in its 22 December 2003 Answers, para. 8.

[166] Brazil notes that some of the limitations result in distortions in different directions. The omission of peanut base information tends to lower the amount of payments allocated. The missing information on market loss assistance payments has an unknown effect and so does the aggregation problem. The missing information on base acreage of farms that produce upland cotton but have no upland cotton base could slightly overstate results – however, Brazil cautions that this effect may not be too strong, as the mount of upland cotton planted on such farms is very limited.

[167] US 20 January 2004 Letter to the Panel, p. 2.

[168] Brazil maintains that no allocation methodology is warranted under Part III of the SCM Agreement. Rather, it is the effect of the subsidies that is the subject of scrutiny.

[169] *See e.g.* US 7 October 2003 Oral Statement, para. 17; US 18 November 2003 Further Rebuttal Submission, paras. 11-17; US 2 December 2003 Oral Statement, para. 24; US 22 December 2003 Answers to Questions, paras. 11, 159-164, 184.

[170] US 22 December 2003 Answers to Questions, paras. 159-164.

an entirely untenable position, as Brazil explains in its 28 January 2004 Comments on the US 22 December 2003 Answers to Questions.[171])

86. Despite its serious misgivings about the proposed US methodology, Brazil sets forth below its analysis of the US methodology. Since the United States provided on 18/19 December 2003 some limited summary data on the production composition of upland cotton farms, Brazil has attempted to offer an estimate using the US allocation methodology. As described below, Brazil has been required to make several assumptions, given the shortcomings in the data and due to the US refusal to provide data in support of its own methodology.

87. Brazil notes that for MY 2002, the United States collected and has access to information on *all acreage planted to any crops*, including non-programme crops, produced by farmers receiving contract payments and marketing loan payments.[172] The United States has never produced this information to the Panel or Brazil in any form (either as summary or farm-specific data). Thus, while the United States asserts that the Panel should apply a particular methodology, it refuses to provide the information that would permit the Panel to calculate the payments under the US methodology.

88. But the information requested by Brazil on all different types of contract crop plantings during MY 1999-2002 would go a long way towards permitting the calculation of the value of all crop production, as well as the calculation of the value of upland cotton produced in relation to other crops produced. This is because most cotton farms producing upland cotton specialize in the production of upland cotton as opposed to other crops, and only produce a limited amount of other crops and almost no livestock.[173]

89. Brazil notes that among the selected information provided by the United States is the amount of total cropland on farms producing upland cotton.[174] The following table shows the percentage of total cropland and the percentage of total programme cropland that is planted to upland cotton (and other programme crops) on upland cotton producing farms, i.e., farms in category (1) and (3).[175]

[171] *See* Brazil's 28 January 2004 Comment on US Answer to Question 243. *See* also Brazil's 2 December 2003 Oral Statement, paras. 4-6. Brazil strongly disagrees that this is a required or appropriate methodology under Part III of the SCM Agreement or under GATT Article XVI (or even under Article 13(b)(ii) of the Agreement on Agriculture). The US arguments in that respect are not supported by any Vienna Convention interpretation of these provisions.

[172] Brazil's 18 November 2003 Further Rebuttal Submission, para. 41.

[173] Brazil's 27 October 2003 Answers to Questions, paras. 7-13. While the exclusion of tiny livestock production on upland cotton farms from the allocation of contract payments might slightly understate the resulting contract payments allocated to upland cotton, any such over counting would be outweighed by the missing data on peanut contract payments made to farms that results in an undercounting of the contract payments allocated to upland cotton.

[174] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively.

[175] Farms planting upland cotton and holding upland cotton base and farms planting upland cotton without holding upland cotton base. Farms not planting upland cotton are excluded from these calculations, as they are entirely irrelevant for purposes of this dispute. They are simply not upland cotton farms, they only have been in the past.

| | **MY 1999** | **MY 2000** | **MY 2001** | **MY 2002**[176] |
|---|---|---|---|---|
| | Total Cropland 30,628,557.4 acres | Total Cropland 31,090,742.9 acres | Total Cropland 30,635,774.0 acres | Total Cropland 28,141,085.2 acres |
| | Total Programme Cropland 21,388,415.0 acres | Total Programme Cropland 22,552,704.4 | Total Programme Cropland 22,793,179.7 acres | Total Programme Cropland 22,753,369.8 acres |
| Programme Crop | Percentage of Total Cropland on the Farm Planted to That Crop | | | |
| | Percentage of Total Programme Cropland on the Farm Planted to That Crop | | | |
| Planted to Upland Cotton | 47.58 per cent | 49.49 per cent | 50.48 per cent | 48.12 per cent |
| | 68.13 per cent | 68.23 per cent | 67.84 per cent | 59.51 per cent |
| Planted to Wheat | 8.95 per cent | 10.60 per cent | 8.58 per cent | 10.36 per cent |
| | 12.82 per cent | 14.61 per cent | 11.54 per cent | 12.82 per cent |
| Planted to Oats | 0.28 per cent | 0.32 per cent | 0.61 per cent | 0.56 per cent |
| | 0.40 per cent | 0.44 per cent | 0.82 per cent | 0.69 per cent |
| Planted to Rice | 1.72 per cent | 1.35 per cent | 1.77 per cent | 1.50 per cent |
| | 2.46 per cent | 1.86 per cent | 2.38 per cent | 1.86 per cent |
| Planted to Corn | 4.94 per cent | 5.37 per cent | 4.90 per cent | 6.35 per cent |
| | 7.07 per cent | 7.41 per cent | 6.59 per cent | 7.86 per cent |
| Planted to Sorghum | 6.17 per cent | 5.21 per cent | 7.87 per cent | 6.13 per cent |
| | 8.83 per cent | 7.19 per cent | 10.58 per cent | 7.58 per cent |
| Planted to Barley | 0.20 per cent | 0.19 per cent | 0.18 per cent | 0.18 per cent |
| | 0.29 per cent | 0.26 per cent | 0.25 per cent | 0.22 per cent |
| Planted to Soybeans | no information, as no PFC programme crop | no information, as no PFC programme crop | no information, as no PFC programme crop | 7.48 per cent |
| | | | | 9.26 per cent |
| Total Programme Farmland as a Percentage of Total Cropland | 69.83 per cent | 72.54 per cent | 74.40 per cent | 80.85 per cent |

90. As demonstrated by this table, US farms planting upland cotton are specialized in that crop. Upland cotton plantings account for 50 per cent of their cropland and for between 60 and 70 per cent of the land devoted to programme crops. Important alternative crops planted by upland cotton farms are wheat, corn, sorghum, soybeans and rice. About 20 per cent of the cropland on farms producing upland cotton is devoted to non-programme crops or to no crops.[177] As detailed below, Brazil has conservatively assumed that the value of the crops produced on this 20 per cent of farmland is the average per-acre value of production of non-programme crops in that marketing year in the entire United States, as reported by USDA.[178]

91. Performing the US-invented allocation methodology, Brazil starts again by considering the group of farms that produce upland cotton and have upland cotton base acreage. As a first step, Brazil has calculated the total amount of contract payments received by these farms by multiplying the

[176] Brazil has not indicated the percentages for other oilseeds, as the figures were so small.

[177] The lower figures for MY 1999-2001 are explained by the fact that soybeans were not a contract programme crop.

[178] This most certainly overstates their value for the farms under scrutiny, as it includes uses for the production of tobacco, greenhouse crops and other high value crops not likely produced on cotton farms. The result is an allocation of contract payments to upland cotton that is too low.

contract payment units provided in the US summary files by the payment rates applicable to the crop in any given marketing year.[179] The resulting payments have been summed up.

92. As a second step, Brazil has calculated the value of the programme crop production on farms producing upland cotton and holding upland cotton base. To estimate the value of the programme crop production on these farms,[180] Brazil has multiplied the acreage planted to a crop by its average yield in the United States and the average price received by US farmers for that crop in any given marketing year.[181] As the United States has not provided any specific information on what upland cotton farms plant on the remainder of the cropland not devoted to the programme crops, Brazil had to make several assumptions. First, Brazil assumed that the per-acre value of these non-contract programme crops equals the average per-acre value of total US non- contract programme crop production, excluding fruits and vegetables.[182] Brazil has, therefore, calculated the total value of non-contract payment crops as the total value of US crops minus the value of programme crops and fruits and vegetables for each marketing year between MY 1999-2002.[183] The resulting figure has been divided by the total US cropland[184] (minus cropland devoted to fruits[185] and vegetables[186] and programme crops[187]).[188] The per-acre value thereby generated has been multiplied by the acreage not planted to programme crops on category (1) farms,[189] resulting in a figure for the total value of non-contract programme crops produced on the group of farms that produce upland cotton and hold upland cotton base.[190]

93. Following these preparatory steps, it is now possible to allocate contract payments that constitute support to upland cotton. Summing up the value of all crops produced on the farm provides the total value of the production on farms that produce upland cotton and hold upland cotton base. Dividing the value of the upland cotton crop by the value of all crops provides the adjustment factor to be applied to the total contract payments received by that group of farms.[191] This concludes the allocation for all group (1) farms.

94. Turning to farms in group (3), the Panel will recall that these farms plant upland cotton, but do not hold upland cotton base. The Panel will further recall that the United States has not provided

[179] Payment rates are published by USDA, *see* Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

[180] Brazil recalls that the United States has only provided information on programme crop production on upland cotton farms.

[181] MY 1999-2002 yields and farm prices for programme crops are published by USDA, *see* Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17).

[182] Brazil considers this exclusion justified due to the elimination of contract payments if fruits and vegetables are planted.

[183] Exhibit Bra-421 (ERS Briefing Room: Farm Income and Costs: US Farm Sector Cash Receipts from Sales of Agricultural Commodities, USDA).

[184] Exhibit Bra-106 ("United States State Fact Sheet," ERS, USDA, 15 July 2003, p. 2). The figure represents the total amount of US cropland pursuant to the 1997 census. This is the latest figure available to Brazil. However, since the total of US cropland can be presumed to not vary too greatly, this may be a reasonable assumption.

[185] Exhibit Bra-422 (Fruits and Tree Nuts Yearbook, USDA, October 2003, Table A-2).

[186] Exhibit Bra-423 (Vegetables and Melons Yearbook, USDA, July 2003, Table 3).

[187] Exhibit Bra-420 (Agricultural Outlook Tables, USDA, November 2003, Table 17).

[188] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[189] Farms that produce upland cotton and hold upland cotton base.

[190] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[191] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

any information concerning contract payments for this group of upland cotton farms.[192] This US refusal renders any precise calculations for the third group of farms impossible. Therefore, Brazil has assumed that farms producing upland cotton but not holding upland cotton base receive per acre of upland cotton the same amount of allocated contract payments as farms producing upland cotton and holding upland cotton base.[193]

95. Since the United States has not provided any information on the amount of market loss assistance payments received by any farm producing upland cotton – the United States did not even provide aggregate information[194] – Brazil has assumed that any allocation of market loss assistance payment as support to upland cotton would have to be made in the same manner as the allocation of PFC payments in the marketing year in question.[195]

96. Contract payments allocated in both groups of upland cotton farms are aggregated. The results of this calculation are reported in the table below:

| **MY** | **1999** | **2000** | **2001** | **2002**[196] |
|---|---|---|---|---|
| PFC Payments | $477,692,236.06 | $473,744,959.03 | $333,295,919.25 | - |
| MLA Payments[197] | $475,365,812.83 | $504,317,124.58 | $460,349,590.68 | - |
| DP Payments | - | - | - | $416,216,862.44 |
| CCP Payments | - | - | - | $714,424,543.18 |

97. For purposes of comparison, Brazil presents below its results based on the "14/16th" methodology:[198]

[192] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively.

[193] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[194] *See* Section 3.

[195] *See* note to the summary table below. Brazil recalls that market loss assistance payments were made for soybeans in addition to the PFC crops. This increases the total amount of market loss assistance payments that would be allocated to upland cotton. Solely using the PFC payments as a basis, undercounts Brazil's results by an unknown amount. Brazil also recalls that the US data for MY 2002 does not contain any information concerning the amount of direct and counter-cyclical payments made on peanut base (Exhibit US-112). Thus, the missing peanut contract payments for MY 2002 are also missing in the calculation of the amount of direct and counter-cyclical payments that constitute support to upland cotton. It follows that these figures are understated by an amount unknown to Brazil.

[196] Brazil also recalls that the US data for MY 2002 does not contain any information concerning the amount of direct and counter-cyclical payments made on peanut base (Exhibit US-112). Thus, the missing peanut contract payments for MY 2002 are also missing in the calculation of the amount of direct and counter-cyclical payments that constitute support to upland cotton. It follows that these figures are understated by an amount unknown to Brazil.

[197] The amount of market loss assistance payments has been calculated by applying the ratio of allocated PFC payments (as calculated) to upland cotton PFC payments as provided in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6) to the amount of upland cotton market loss assistance payments as provided by the same source.

[198] The figures in this table are reproduced from Brazil's 9 September 2003 Further Submission, Table 1. MY 2002 data is taken from the updated figures presented by Brazil in its 22 December 2003 Answers, para. 8.

| MY | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | $547,800,000 | $541,300,000 | $453,000,000 | - |
| MLA Payments | $545,100,000 | $576,200,000 | $625,700,000 | - |
| DP Payments | - | - | - | $454,500,000 |
| CCP Payments | - | - | - | $935,600,000 |

98. As the Panel can readily see, even using the methodology proposed by the United States as relevant under Part III of the SCM Agreement results in amounts of support to upland cotton from contract payments that, accounting for the shortcomings of the US data, are roughly equivalent to the figures produced by Brazil's 14/16th methodology. Brazil cautions against the direct use of these results, as they may be tainted by the assumptions Brazil had to make due to the refusal of the United States to provide data that would render possible performing the allocation that the United States asserts is called for under Part III of the SCM Agreement.[199] In particular, the data withheld on MY 2002 peanut contract payments to farms producing upland cotton would have increased the amount of contract payments allocated to upland cotton. Other shortcomings of the data are discussed above.

### 11. The *Japan – Agricultural Products* Decision is Inapposite

99. The United States claims that the Appellate Body's decision in *Japan – Measures Affecting Agricultural Products* would have prevented the Panel from using the information the United States refused to provide to calculate the amount of contract payments across the "total value of the recipient's production."[200] However, this Appellate Body decision is inapposite.[201]

100. In *Japan – Agricultural Products*, the complaining party (the United States) did not "claim" in its request for establishment of a panel that there was an alternative SPS testing "measure" (determination of sorption levels) that was less trade restrictive.[202] Rather, the request for establishment "claimed" that testing by product (not variety) was sufficient to achieve Japan's appropriate level of protection. The panel, based on expert testimony and *not* on any arguments or evidence presented by the United States, found a violation of SPS Article 5.6 based on the alternative (sorption levels) testing "measure." This decision was taken despite a US argument to the panel that "it is not within the scope of the Panel's terms of reference to make findings with respect to the comparative efficacy of alternative treatments proposed by technical experts."[203]

101. On appeal, the Appellate Body reversed the panel's finding. Noting that a panel has authority under DSU Article 13.1 to request information, it found that "this authority cannot be used by a panel to rule in favour of a complaining party which has not established a *prima facie* case of inconsistency based on specific legal claims asserted by it." The Appellate Body found the panel had erred in relying on expert information and advice as the basis for a finding of inconsistency with SPS Article 5.6, "since the United States did not establish a *prima facie* case of inconsistency with Article 5.6 based on claims relating to the 'determination of sorption levels.'"[204]

[199] Again, Brazil notes that this allocation is not required under Part III of the SCM Agreement and GATT Article XVI:3. Both provisions deal with the effect of subsidies, and not their amount or subsidization rate.

[200] US 20 January 2004 Letter to the Panel, p.4.

[201] *See* also Brazil's 28 January 2004 Comments on Question 256.

[202] WT/DS76/2.

[203] Appellate Body Report, *Japan-Agricultural Products*, WT/DS76/AB/R, note 79.

[204] Appellate Body Report, *Japan-Agricultural Products*, WT/DS76/AB/R, para. 130.

102. The factual situation in this dispute is entirely different from that in *Japan –Agricultural Products*. Brazil's "claim" in relation to the withheld data is, first, that the United States does not enjoy peace clause protection because, *inter alia*, the non-green box contract payments provide support to upland cotton in excess of the level of support decided by the United States in MY 1992.[205] The "measures" impacted by the withheld data are PFC, market loss assistance, direct and counter-cyclical payment subsidies provided under the 1996 FAIR Act and the 2002 FSRI Act,[206] which fall squarely within the Panel's terms of reference. The withheld data is also relevant to Brazil's actionable subsidy "claims" to establish the volumes of subsidies provided for US upland cotton production.[207] Further, the withheld data is relevant to support Brazil's arguments that the contract payments are "support to upland cotton," because most of the upland cotton base payments are paid to current producers of upland cotton. Finally, the withheld data is relevant to provide the factual basis for Brazil to rebut US arguments that the US preferred "value" methodology for allocating payments results in much lower benefits to upland cotton.[208] Brazil notes that the Panel's 12 January 2004 request falls squarely within these various Brazilian claims and arguments when it states that "[d]isclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years."[209]

103. The implication in the US citation to the *Japan – Agricultural Products* decision is that the Panel's 8 December 2003 and 12 January 2004 request may be designed to establish a "claim" never advanced by Brazil. This suggestion is obviously contrary to the factual record outlined above. Moreover, it reveals a profound misunderstanding of the difference between a "claim" and an "argument." The Appellate Body in *EC –Hormones* held that there is a distinction between legal claims reflected in a panel's terms of reference, and arguments used by a complainant to sustain its legal claims. The Appellate Body ruled that "nothing in the DSU limits the faculty of a panel freely to use arguments submitted by any of the parties – *or to develop its own legal reasoning* – to support its own findings and conclusions of the matter under its consideration."[210] Numerous panel reports have narrowly interpreted "claims" to involve only legal claims and have freely permitted complaining parties to advance arguments not expressly reflected in a panel request.[211] A close reading of the Appellate Body's decision in *Japan – Agricultural Products* shows that it was based on the fact that the United States had not advanced legal "claims" relating to an alternative SPS "measure." The fact that the United States had also not made legal "arguments" on its non-claim only reinforced the underlying reasoning.[212]

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[205] This is a claim in the alternative because, as Brazil has argued, it is the United States burden of proof to establish that it enjoys peace clause protection. *See e.g.* Brazil's 24 June 2003 First Submission, paras. 110-121; Brazil's 22 July 2003 Oral Statement, paras. 5-11; Brazil's 11 August 2003 Answers to Questions, paras. 48-51; Brazil's 22 August 2003 Comments, paras 42-45.

[206] The market loss assistance payments were based on various appropriations bills.

[207] Brazil has argued that the exact amounts of the subsidies are not legally relevant (contrary to the US arguments) but rather that the "effects" of the subsidies are what is at issue in claims under Article 6.3 of the SCM Agreement.

[208] *See* Section 10 above.

[209] 12 January 2004 Communication from the Panel, p. 1.

[210] Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 156 (emphasis added).

[211] Panel Report, *EC – Sardines*, WT/DS231/R, paras. 7.142-145 ( "…Peru's requests for findings were actually just summations of its arguments and not claims."); Appellate Body Report, *Korea – Dairy Safeguards*, WT/DS98/AB/R, paras. 139-140 ("…EC reliance on the OAI report during the rebuttal stage of the panel proceeding to be a new argument rather than a new claim, and therefore, did not exclude it."); Panel Report, *Australia – Salmon*, WT/DS18/R, paras. 8.24-8.25 (Panel considered that "this 'new claim' to be a new argument, not a new claim.").

[212] Appellate Body Report, *Japan-Agricultural Products*, WT/DS76/AB/R, para 130 (Appellate Body, after ruling the Panel erred noted that "The United States did not even *argue* that the 'determination of sorption levels' is an alternative measure which meets the three elements under Article 5.6").

104. This United States suggestion that the Panel's request of 8 December 2003 and 12 January 2004 would improperly make the case for Brazil is totally baseless. In the *Japan – Agricultural Products* case, the United States did not seek the expert information to support a "claim" or "measure" within the Panel's terms of reference. By contrast, Brazil *repeatedly* sought the information withheld by the United States for fourteen months. Further, the Panel's 8 December 2003 and 12 January 2004 requests incorporated Brazil's request of 3 December 2003, as set out in Exhibit Bra-369. Brazil, as a litigating party, has no independent right to request information from the United States; that must be conducted through the Panel's authority under DSU Article 13.1. Thus, the US assertion that somehow the Panel (and not also Brazil) is seeking evidence to support a "measure," "claim" or even "argument" never advanced by Brazil is fallacious.

105. Indeed, the United States cautions that the Panel "must take care not to use the information gathered under [the] authority [of DSU Article 13.1] to relieve a complaining party from its burdens of establishing a *prima facie* case." [213] This is a curious argument given the fact that the United States has refused to produce information the Panel found was "necessary and appropriate … in order to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements."[214] Brazil must ask how the Panel is to even evaluate the evidence to "take care not to use" the information, if it does not even have it?

106. Finally, Brazil notes that this is the first dispute involving interpretations of the peace clause, as well as many provisions in Part III of the SCM Agreement. Brazil obviously does not know how the Panel will resolve many interpretative issues. A good example is the issue of the relevant allocation methodology under the peace clause, or whether subsidies challenged under Part III of the SCM Agreement are required to be allocated at all, and if so, by what methodology. Brazil believes strongly that the US methodology is not supported by any textual or legitimate contextual basis. But in order to "cover all the bases," and conscious of the absence of any remand procedures, Brazil has presented – or has attempted to present in the case of the withheld US data – considerable evidence to provide the Panel with the basis to make the factual determinations supporting any possible legal interpretation of these not previously interpreted WTO provisions. As demonstrated by Brazil's analysis in Section 3, above, the information withheld by the United States has deprived the Panel and Brazil of the opportunity to use the most accurate and complete information possible – even to apply the inappropriate US methodology for allocating contract payments.[215]

## 12. Conclusion

107. In sum, the United States has refused to provide the information concerning the amount of contract payments made to current producers of upland cotton. There are no legitimate confidentiality concerns that would prevent the United States from producing the data. And even if there were, confidentiality procedures under Article 13.1 of the DSU and/or the Panel's working procedures could have addressed these concerns.

108. Therefore, Brazil asks the Panel to draw adverse inferences (listed in Section 6) and conclude that the withheld information would have been adverse to the US defence in this case. Furthermore, Brazil asks the Panel to use the best information available, including the adverse inferences, to find that the figures Brazil has estimated under its so-called 14/16$^{th}$ methodology are supported by the

[213] US 20 January 2004 Letter to the Panel, p. 4.
[214] 12 January 2004 Communication from the Panel, p. 1.
[215] *See* Brazil's 28 January comment on Question 256.

evidence in the record. Brazil also notes that its attempts to apply the flawed and incomplete US summary data to both a simplified version of its own and the US approach yields results that further confirm the results of Brazil's 14/16$^{th}$ methodology.

# ANNEX I-16

## COMMENTS OF THE UNITED STATES ON COMMENTS BY BRAZIL ON US COMMENTS CONCERNING BRAZIL'S ECONOMETRIC MODEL

(28 January 2004)

### I. Introduction

1. The United States wishes to rebut Brazil's response to the US 22 December 2003 Comments Concerning Brazil's Econometric Model. Our aim is to make clear the fundamental flaws in Brazil's analysis that invalidate its claims. In the following section, we lay out the erroneous approach Dr. Sumner took in modelling the effects of cotton payments. We believe that our rebuttal provides convincing evidence why the Panel should reject this model as supporting a finding of serious prejudice. Moreover, Dr. Sumner's rebuttal fails to allay our concerns regarding technical issues and lack of transparency with the model. These concerns are laid out in Section III.

### II. US Concerns with the Sumner Model

2. The United States reiterates the following concerns it has with Brazil's approach to its economic analysis in this dispute:

(c) Dr. Sumner continues to imply that his model is essentially the FAPRI model. It is not. Dr. Sumner has made significant modifications to the FAPRI model. The fact that Dr. Sumner's model is "in no way a FAPRI model" is acknowledged by Dr. Babcock in his letter to staff members of the Senate and House of Representatives (Exhibit US-114).

(d) The ways in which Dr. Sumner has modelled decoupled payments (including Production Flexibility Contract payments, Market Loss Assistance payments, Direct payments and Counter cyclical payments), crop insurance payments, and export credit guarantees differ sharply from the FAPRI model and are not based on empirical studies. These *ad hoc* modifications contribute to the large effects on production and other variables obtained by Dr. Sumner when he simulates the removal of cotton subsidies. We argue that the effects are thus largely tautological with no empirical grounding.

(e) In particular, Dr. Sumner's results differ sharply from the economics literature on the effects of decoupled payments on production. As we have argued in numerous submissions, Dr. Sumner's treatment of decoupled payments (particularly from Annex I on pages 16-21) is neither a "standard" feature of other models, nor is it as "consistent" with USDA work in the area as repeated citations of that work might suggest. There has been considerable work done by the USDA and other researchers on such programmes, both theoretical and empirical, which acknowledges the programmes may have some minimal impact on production. However, the research concludes that the impact appears negligible (less than 1 per cent of acreage). As we pointed out in our *Comments Concerning Brazil's Econometric Model of 22 December 2003*, similar results are obtained by FAPRI (less than 0.3 per cent impact on cotton acreage). In contrast, Dr. Sumner's model produces results

suggesting cotton acreage impacts as high as 15.9% - that is, more than 50 times larger than what the FAPRI model would indicate.

(f) Likewise, we disagree with Dr. Sumner's modelling of the crop insurance programme. We take issue with how the subsidies were calculated and how they affect production. In particular, we have argued that most cotton production has been insured at coverage levels less than 70 per cent and thus it is likely that any production effects are minimal. Moreover, we have noted that Dr. Sumner has failed to take into account the potential effects of moral hazard on input use and crop yields that potentially offset any impacts on area.

(g) We also take issue with how Dr. Sumner modelled export credit guarantees. In our previous comments, we have argued that Dr. Sumner's formulation is entirely *ad hoc*. He has essentially assumed an effect.

(h) As for marketing loans and deficiency payments, we would agree that such programmes are potentially production distorting when expected market prices fall below loan rates. However, we have argued that the use of lagged prices, while a modelling convenience for large scale models such as FAPRI and the model used by Dr. Sumner, nonetheless introduce potential biases that can overstate effects when futures market prices differ substantially from lagged prices, as they did in 2001 and 2002.

(i) Lastly, as we point out in our *Comments on Answers of Brazil to Questions from the Parties following the Second Panel Meeting,* calibrating Dr. Sumner's model to the November 2002 FAPRI baseline exaggerates the effects of price-based programmes such as marketing loans, counter-cyclical payments and Step 2 payments. The price outlook for cotton has improved considerably since publication of the November 2002 FAPRI baseline used by Dr. Sumner to estimate the effects of subsidies on US cotton production. Improving price forecasts suggest minimal marketing loan outlays over 2003-12.

3. We will briefly summarize our points below.

**Dr. Sumner's treatment of decoupled programmes is unconventional and not based on theory or empirical evidence**

4. Dr. Sumner's treatment of decoupled payments (particularly from Annex I on pages 16-21) is neither a "standard" feature of other models, nor is it as "consistent" with USDA work in the area as repeated citations of that work might suggest. There has been considerable work done by the USDA and other researchers on such programmes, both theoretical and empirical, which acknowledges the programmes may have some impact on production, and that those impacts depend in part on farmers' expectations (Westcott et al., 2002).[1] However, the research concludes that the impact appears negligible.

5. Dr. Sumner, on the other hand, uses a stylized logic to come up with the estimates for the impact of production flexibility contract (PFC) payments that have neither empirical nor theoretical grounding. He cites, then ignores, recent USDA empirical work showing that decoupled payments have only a small impact (ERS 2003).[2] He justifies this, in part, by saying that the analysis looked at

[1] Westcott, P., Young, C.E., and Price, M., USDA, ERS, The 2002 Farm Act, Provisions and Implications for Commodity Markets, Economic Research Service, November 2002. (*See* Exhibit BRA-42)

[2] USDA, ERS, Decoupled Payments: Household Income Transfers in Contemporary US Agriculture, M.E. Burfisher and J. Hopkins, Eds. USDA ERS AER Number 822. February 2003. (*See* Exhibit US-53)

all programmes, while he is looking only at cotton. However, in both their inception and administration, these programmes must be considered as a whole. Treating part of the overall programmes as though they were a "cotton programme" distorts the programmes. It is widely accepted that these programmes have whole farm impacts rather than crop specific impacts—the payments received do not have crop-specific impacts. Furthermore, the impact is much smaller than Dr. Sumner has estimated; the whole farm impact is, at its upper estimate, perhaps one-quarter to one-fifth the impact he cites for cotton alone. He thus vastly overstates the impact of these payments on cotton production.[3]

6. Dr. Sumner argues that market loss assistance (MLA) payments have a larger effect on area than do PFC payments despite the fact that MLA payments were paid on the identical payment base as the PFC payments. Moreover, MLA payments were authorized by Congress on a *post hoc* basis as emergency supplemental payments. Supplemental legislation authorizing each of these payments was passed several months after planting for the crop year in question had occurred. Dr. Sumner included these payments in his acreage equations and asserts that producers had expectations that they would receive market loss assistance payments at the time of planting. If producers had expectations of payment, then they also knew that they would be eligible to receive such a payment regardless of what crop they planted. Indeed, they could choose not to plant and still be eligible for the payment. This would argue that market loss assistance payments, like production flexibility contract payments, direct payments, and counter-cyclical payments, are decoupled from planting decisions and should not be included in an acreage response equation.[4]

7. Like other direct payments, counter-cyclical payments are based on historical production rather than actual production. The fact that the payment rate is tied to current prices does not mean that payments are less decoupled from current production. Indeed, as economists have shown, producers can hedge counter-cyclical payment rates using options markets, thus converting a counter-cyclical payment into a fixed direct payment.[5]

8. Lastly, empirical evidence supports the decoupled nature of these payments. As reported in the US Answer to Panel Question 125(5), a preliminary review of data from the Farm Service Agency shows that 47 per cent of upland cotton farms eligible for decoupled income support payments planted no cotton in marketing year 2002. This number is consistent with the Environmental Working Group data presented by Brazil in its further rebuttal submission that showed the per cent of farms receiving only contract payments in 2000, 2001, and 2002.[6] Thus, Brazil and the United States would agree that the data support the notion that decoupled income support is, in fact, decoupled from production decisions since nearly half of historic upland cotton farms no longer plant even a single acre of cotton.

9. As was shown in Exhibit US-95, enrolled upland cotton base acreage exceeded planted acreage by over 5.1 million acres. Thus, planted acres accounted for less than 73 per cent of total base acres in 2002,[7] supporting the decoupled-from-production nature of direct and counter-cyclical

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[3] As we pointed out in our *Comments Concerning Brazil's Econometric Model of 22 December 2003*, similar results are obtained by FAPRI (less than 0.3 per cent impact on cotton acreage). In contrast, Dr. Sumner's model produces results suggesting cotton acreage impacts as high as 15.9% - that is, more than 50 times larger than what the FAPRI model would indicate.

[4] Dr. Sumner has argued that base updating provisions of the 2002 Farm Bill effectively relink direct payments to production, but as we have shown in Dr. Glauber's presentation at the Second Panel Meeting in December 2004, the economics argue the opposite and the empirical evidence suggests that concerns that producers are planting cotton in expectation of future base updating are unfounded.

[5] Anderson, C.G. "Consider "Hedging" Strategies to Enhance Income Beyond Farm Programme Payments" Texas A&M University, Extension Economics, October 2002 (*See* Exhibit US-54)

[6] Brazil's Further Rebuttal Submission, para. 23.

[7] We note that these numbers are similar to the Environmental Working Group data that show that 73.6 per cent of total contract payments in marketing year 2002 were on farms that also received marketing loan payments.

payments. The ratio of planted acreage to base acreage varies considerably by region, ranging from about 40 per cent of eligible base in the West to almost 93 per cent of eligible base in the Southeast. The data also support the notion that rather than being required to base planting decisions on acreage base allocations, producers were able to exercise their planting flexibility, clearly choosing to plant other crops instead of cotton.

**Dr. Sumner's analysis of the US crop insurance programme ignores effects of moral hazard on yields**

10. As we have documented in our previous submissions, crop insurance subsidies are generally available for most crop producers and hence do not give a specific advantage to one crop over another. Thus, their effects are not commodity specific, and have no or minimal impacts on cotton markets.

11. Moreover, crop insurance purchases by cotton growers have generally been at lower coverage levels than for other row crops. This was particularly the case before 2002 when less than 5 per cent of insured cotton acres were insured at coverage levels greater than 70 per cent. Over 2002-03, roughly 90 per cent of cotton acreage insured was at coverage levels of 70 per cent or less. This supports the notion that crop insurance has had minimal effects on production.

12. Lastly, the economic literature on the effects of crop insurance on production is clearly mixed. While many studies like the ones cited by Brazil have suggested crop insurance subsidies may have a slight effect on acreage, the effects on production are less clear. If crop insurance encourages moral hazard problems like those cited by Brazil, crop yields will be adversely affected as producers attempt to increase crop insurance indemnities. If moral hazard and adverse selection problems are severe, they could potentially have a negative effect on production.[8]

**Impacts attributed to the export credit guarantee programme are unsubstantiated**

13. Neither Brazil nor Dr. Sumner has offered empirical analysis as to how much or whether the export credit guarantee programme actually affects exports. As demonstrated in Bra-313, Dr. Sumner imposed an *ad hoc* reduction in US export estimates of 500,000 bales (using the National Cotton Council testimony as his sole economic foundation), which correspondingly reduced US prices, which correspondingly both reduced US acreage and slightly increased exports - cutting into the initially imposed 500,000 bale shift.

**The effects of marketing loans depend on underlying assumptions regarding price expectations**

14. As we have argued elsewhere, we agree with the statement of Dr. Collins that marketing loan payments are *potentially* production- and trade-distorting.[9] The United States has consistently notified upland cotton marketing loan payments as cotton-specific amber box payments in its WTO Domestic Support notifications. The issue in this dispute is not whether marketing loan payments are

[8] The Economic Research Service study cited by Dr. Sumner (Young et al. 2001) only examines the effects of crop insurance subsidies on acreage. The authors assume that yields are unaffected when they simulate production effects. Recent studies by Smith and Goodwin (1996), Babcock and Hennessy (1996) and Goodwin and Smith (2003) suggest that farms with more insurance tend to use less inputs like fertilizer and pesticides and vice versa. This demonstrates a potential moral hazard problem with crop insurance that suggests that crop insurance participation may have a negative effect on yields. Lower yields may well offset the marginal effects on crop area.

[9] *See* US Answers to Questions of the Panel to the Parties following the Second Meeting of the Panel, 22 December 2004, para. 74.

potentially production- and trade-distorting, but the degree to which they have actually distorted production and trade in a particular year, given market prices and other relevant factors.

15. The degree of distortion caused by the marketing loan programme depends on the relationship of the expected harvest price to the loan rate at the time of planting. If the expected price is below the loan rate, the loan rate may provide an incentive to plant cotton because farmers will receive a government payment for the difference between the loan rate and the adjusted world price. For this reason, we believe that the marketing loan programme was more distorting in 2002 when expected cash prices were below loan rates at planting than in 2001, when expected cash prices were higher than loan rates at the time of planting. However, as explained previously, the observed decline in upland cotton planted acreage in marketing year 2002 was commensurate with the decline in futures prices over the previous year.

16. In this dispute two approaches have been advocated in determining farmers' expectations about prices. Brazil and its economic consultant have used lagged prices as the mechanism to gauge farmers' expectations about prices. Dr. Sumner wrote:

> Of course, it is impossible to know precisely what individual growers expect. I have adopted the long-standing approach of FAPRI, and other models[,] to approximate these expectations by using the current year final realized market prices as the expectation for the following season's price.[10]

The lagged prices used by Brazil and its economic consultant can, at best, be an approximation of farmers' price expectations. That is because the lagged prices used in Brazil's analysis incorporate pricing information that occurs *after US farmers make their planting decision* (that is, prices from April through July of a given marketing year, when planting decisions are taken in the January to March period). Therefore, by necessity, farmers cannot be looking at a lagged price that incorporates prices that do not yet exist.

17. The United States, on the other hand, has advocated the use of futures prices, a market-determined expectation of prices. It is evident from the use of futures and options markets by cotton producers[11] and from numerous market reports available to producers that producers look to futures markets rather than lagged prices for information regarding future cash prices.

18. Furthermore, economic literature supports this view. For example, in his classic paper on rational price expectations, Muth (Exhibit US-48) argued that there is little evidence that expectations based on past prices are economically meaningful. Additionally, in a 1976 paper Gardner (Exhibit US-49) contended that the future price for next year's crop is the best proxy for expected price.

19. As we have repeatedly argued, the use of lagged prices may result in biased results. Over the long term, where there is reasonable stability in markets, lagged prices function adequately as a proxy for price expectations. However, in those years, as in the period under investigation here, when unexpected exogenous shocks such as China dumping stocks and unexpected yields worldwide due to good weather conditions, lagged prices are poor predictors of expected prices. Future prices, by contrast, are more efficient because they are based on more current information.

20. For example, during marketing years 2000, 2001, 2002, and 2003, lagged prices significantly understate the harvest season prices expected by producers as seen in the futures prices at the time of planting. The use of lagged prices thereby inflate the effect of the marketing loan rate. In fact, those lagged prices would have to be increased by 8-25 per cent, depending on the year, to equal the harvest

[10] Brazil's Further Submission, Annex I, para. 18.

[11] *See* US Answers to Questions of the Panel to the Parties following the Second Meeting of the Panel, 22 December 2004, para. 58.

season price actually expected by producers as indicated by the futures price.[12] For the period MY 1999-2003, only MY 2002 exhibits expected prices below the marketing loan rate when using futures prices. However, over that same period, when lagged prices are used as expected prices, the loan rate is higher than the expected price *in every year over this period* except MY1999. Thus, it is a significant error for Brazil and Dr. Sumner to use lagged prices instead of the futures prices Brazil's own expert, Mr. MacDonald, explained to be the more accurate gauge of farmers' price expectations.

| **Harvest Futures Prices at Planting Time Compared to "Lagged Prices"(cents per pound)** | | | | | |
|---|---|---|---|---|---|
| | MY1999 | MY2000 | MY2001 | MY2002 | MY2003 |
| Futures Price[1] | 60.27 | 61.31 | 58.63 | 42.18 | 59.6 |
| Expected Cash Price[2] | 55.27 | 56.31 | 53.63 | 37.18 | 54.6 |
| Lagged Prices[3] | 60.2 | 45 | 49.8 | 29.8 | 44.5 |
| Difference | -4.93 | 11.31 | 3.83 | 7.38 | 10.1 |

[1] February New York futures price for December delivery.
[2] Futures price minus 5 cent cash basis.
[3] Prior crop year average farm price, weighted by monthly marketings.[13]

21. Looking more specifically at Dr. Sumner's analysis in Annex I provides further evidence of the bias of lagged prices relative to future prices. Consider the 2002 crop year. In the Sumner analysis, area response to the removal of the cotton loan programme results in a 36 per cent reduction in US planted area – the largest single effect for any of the years considered in his analysis. Based on lagged prices, price expectations for 2002 were 29.8 cents per pound, a 40 per cent reduction from 2001 levels. Yet, the futures market data suggests a far smaller reduction in expected price. December futures prices taken as the average daily closing values in February 2002 averaged 42.18 cents per pound, a 28 per cent drop from year earlier levels. Based on Dr. Sumner's range of supply response elasticities of 0.36 to 0.47, a decline of this magnitude would suggest a drop in acreage of 10 to 13 per cent from the preceding year. In fact, actual US cotton acreage dropped 12 per cent (from 15.5 million acres in 2001 to 13.7 million acres in 2002), suggesting acreage levels entirely consistent with world market conditions and price expectations. Thus, in marketing year 2002, lagged prices would significantly overestimate the decline in plantings in the absence of a marketing loan rate.

22. While the United States would agree with Brazil that it is impossible to know precisely what individual farmers' price expectations are, the United States argues that futures prices provide the most current expectations of market participants. The United States disagrees with the approach used by Brazil in its analysis to rely solely on lagged prices and ignore information provided by futures prices. While it may be impractical to include futures prices in some models, modelling convenience is no justification for ignoring these objective, market-based price expectations, and the biased results from using lagged prices do not assist the Panel in making an objective assessment of what is the effect of the US marketing loan programme.

**Use of the November 2002 baseline exaggerates the effects of the removal of subsidies**

23. The price outlook for cotton has improved considerably since publication of the November 2002 FAPRI baseline used by Dr. Sumner to estimate the effects of subsidies on US cotton production. As we show in the *US Response to Brazil's Answers to the Questions of the Panel of the Parties Following the Second Meeting of the Panel*, FAPRI projections for the Adjusted World Price are as much as 20 cents per pound higher in the November 2003 baseline as under the November 2002 baseline.

[12] US Further Rebuttal Submission, paras. 164-65.
[13] Exhibit US-90.

24. As a result, estimated marketing loan gains are reduced considerably. Under the November 2003 baseline, the estimated marketing loan gain for 2003/04 is zero, compared to almost 15 cents per pound under the November 2002 baseline. Over the five year period 2003/04 to 2007/08, the average marketing loan gain is estimated to be 1.32 cents per pound. This is compared to 10.39 cents per pound utilizing the November 2002 baseline used by Dr. Sumner in his estimates.

25. Under Dr. Sumner's model, the marketing loan programme contributes to over 42 per cent of the estimated effects of removing subsidies on production (*see* Annex 1, table 1.4). Thus, updating the model to the November 2003 baseline would significantly reduce the estimated effect on production, with the remaining effects largely attributed to direct payments under Dr. Sumner's flawed model, with which we strongly disagree.

26. In addition, the FAPRI baseline from November 2002 projected 50.7 cents per pound for the A-Index for marketing year 2003 and the January 2003 baseline projected 58.4 cents per pound for the A-index for marketing year 2003. FAPRI's November 2003 preliminary baseline projection for the A-Index is 70.9 cents per pound, 40 per cent higher than the FAPRI projections used by Dr. Sumner.[14] The actual A-index was 76.1 cents per pound on January 15, 2004. In fact, FAPRI's November 2002 projections (through 2012/13) did not show the A-Index ever rising as high as current prices. The current high cotton prices and market expectations of continued high prices are crucially relevant because, as mentioned, marketing loan payments will not be made if cotton prices are above the loan rate of 52 cents per pound and, further, counter-cyclical payments will not be made if the season average farm price is above 65.73 cents per pound (the target price of 72.5 cents minus the direct payment rate of 6.67 cents). The weighted average farm price for August-November was 62.4 cents per pound, as reported by USDA on 11 January 2004.[15]

**Conclusions**

27. Brazil's estimates of the impact of US subsidies on world cotton markets have rested largely on the basis of Dr. Sumner's flawed model. As we pointed out in our *Comments on Brazil's Econometric Model*, Dr. Sumner's model is not the FAPRI model. The modifications he has made are *ad hoc*; rather than being based on empirical research as is claimed, they are, in fact, at odds with the empirical literature.

**III. Technical Comments on Brazil's Rebuttal**

28. Brazil's explanations of exactly what was done to the FAPRI/CARD model have been stated and restated by Brazil at least three times to this point.

29. With each new statement, different clarifications are made, different variables used. In Annex I, Brazil submitted its economic analysis of the impacts of the US cotton programme. In Bra-313, Brazil provided more detail about its original economic analysis, in light of its seeming inability to provide the Panel with the actual model used. Finally, in its submission of 20 January 2004, Brazil informs the Panel that its Annex I discussion was a "simple heuristic discussion"[16] with Bra-313 explaining how the "heuristic explanation in Annex I was operationalized" and rationalizes the fact it did not use the baseline it stated it did in Annex I as "necessary recalibration."[17] These *post hoc*

[14] *Cotton: World Markets and Trade*, Foreign Agricultural Service, USDA. January 2004, Table 8, pg. 20.
[15] *World Agricultural Supply and Demand Estimates*, USDA, WAOB, WASDE-406, 11 January 2004.
[16] *See* para. 58, Brazil's Comments on US Model Critique, 20 January 2004.
[17] *See* para. 3, Brazil's Comments on US Model Critique, 20 January 2004.

rationalizations of Annex I differ dramatically from oral statements delivered to the Panel on 7 October 2003.[18]

**Brazil further confuses the impact of its elasticity modifications**

30. Brazil clings to its repeated representations that its model uses "*exactly the same elasticities of supply and demand that are also used in the FAPRI model*,"[19] yet, in its latest iteration of what is really included in its analysis, Brazil seems to be saying something different:

> ***As I will demonstrate, the differences between the two sets of estimates of the United States is primarily due to differences in the magnitude of elasticities of supply the United States used, as compared to the elasticities that I actually used. The United States applied time-varying, linear elasticities because this is what is suggested by the FAPRI linear modelling framework. My Annex I results of the effects of these listed programmes are, however, based on a constant elasticity structure." [20] [emphasis supplied]***

31. This current claim contradicts documentation in Annex I, oral statements made before the Panel, and Bra Exhibit-313. Table I.1 of Annex I clearly presents time-varying elasticities. This time-varying approach is again reported in equation (4) – (6) of Exhibit-313. Dr. Sumner's equations clearly indicate that the supply elasticity changes depending on the year *t*.

32. The United States remains convinced that neither it nor the Panel can be fully sure of whether the elasticities used by Brazil were "exactly the same" as those used in the FAPRI model as Brazil stated on 7 October, or whether those elasticities were based on a different structure entirely, as Brazil states in its 20 January 2004 submission. Brazil has never submitted a simple table showing a comparison of the elasiticities.

33. Finally, the United States does not agree with Dr. Sumner that the time-varying, linear elasticities, which would be consistent with the FAPRI modelling framework, lead to a dramatic underestimation of the effects. The United States stands firm by its belief that FAPRI has it right and that Dr. Sumner's approach leads to a dramatic overestimation of the impacts.

**Calibration vs. manipulation vs. mislabelling[21]**

34. The United States pointed out that Brazil stated that its analysis in Annex I was based on the FAPRI November 1 baseline, when it, in fact, was not. Now, Brazil confirms that those baseline numbers were, in fact, "necessarily recalibrated" by Dr. Sumner in order to conform to his use of the CARD International model -- a use that is not consistent with FAPRI's modelling and a use that decidedly was not made clear to the Panel in Annex I,[22] contrary to Brazil's assertions in paragraph 24

[18] "For more detail on these equations and the discussion of the incentives provided, please refer to my written description of the model in Annex I. My Annex I statement discusses in detail the analysis of the production enhancing impacts of the US supply side subsidies." Oral Statement of Dr. Sumner, 7 October 2003, paragraph 11. The United States read these and other statements, and the failure of Brazil to deliver its Annex I analysis, as indication that Brazil meant what it said in Annex I. The US was unaware that the document in which Dr. Sumner "discusses in detail the analysis" was, in fact, a "simple heuristic discussion." That revelation is no doubt a surprise to the Panel, as well.

[19] Oral Statement of Dr. Sumner, 7 October 2003, paragraph 20. A similar comment was made at least twice in Annex I.

[20] *See p*ara. 71, Brazil's Comments on US Model Critique, 20 January 2004.

[21] *See* para. 24 and subsequent paragraphs in Brazil's 20 January submission.

[22] In paragraph 3 of Annex I, Dr. Sumner states that he used "the international model and parameters used in two recent publications from [CARD]…." He goes on to state that the "approach used here is standard and has been applied by the USDA Economic Research Service in their analysis of the FSRI Act of 2002….,"

of its recent submission. Ultimately, Brazil passes off this significant discrepancy as "confusion" in the "labelling of the baseline used in Annex I."[23] This continues a pattern of carelessness in modelling and analysis that has added significantly to the burden in discerning underlying data and model constructs in order to appropriately evaluate the validity of Brazil's proffered results.[24]

**Crop Insurance programme results**

35. The United States continues to disagree with Dr. Sumner's characterization of the crop insurance programme presented in paragraphs 31-33. The United States does not accept Dr. Sumner's logic that $1 from the crop insurance programme that is paid in the event of a crop failure would have the same production impact as $1 of benefit that is tied directly to the production decision. While the United States does not accept Dr. Sumner's logic, we are puzzled by his operational implementation of the acreage impacts. Dr. Sumner argues that FAPRI's net returns specification includes the value of the crop insurance programme by reducing variable costs of production. Based on this first step of reasoning, it is unclear to the United States why Dr. Sumner did not implement his scenario by simply increasing the costs of production in the FAPRI baseline by the amount of the per-acre benefit that he calculates. Such an approach would have produced smaller acreage impacts.

**Replicating history and predicting the future**

36. In paragraphs 43-56, Dr. Sumner develops a lengthy discussion regarding his view of the use of simulation models. Dr. Sumner dismisses a US concern that Dr. Sumner's analysis does a very poor job of explaining the movement in cotton acreage in the United States. Dr. Sumner appears to assert that policy simulation models do not attempt to "forecast the future." From a layman's point of view, it seems surprising that a model that changes the past and then estimates how that change would have resulted in a different future can be said to not be an attempt to forecast the future.

37. From an economic point of view, the analysis doesn't really change. Economists who develop structural models employ a number of techniques for validating the accuracy and reliability of a model. One of those techniques is testing the ability of the model to simulate actual historical outcomes. In such an historical simulation, the model is solved for each year of a historical period and predicted values for the exogenous variables are compared to the actual data. Not only is the model evaluated based on its ability to approximate historical values, but also on its ability to capture the turning points in the observed values, i.e. determine if the model's predicted values for a variable move in the same direction as the actual values from one year to the next.

38. The process of model validation involves testing the performance of the model over the historical period that corresponds to the timeframe used for the statistical estimation of parameter values, i.e. the in-sample period. In addition, the model will also be tested over a historical period outside of the estimation period. This is referred to as out-of-sample validation. If a model does not

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citing the Westcott study. However, one of the two studies referenced in footnote 4 did not use the CARD International Cotton Model; it used FAPRI's full international model. Similarly, the study referenced in footnote 5 also used FAPRI's full international model. It is clear by reviewing paragraphs 3-11 of Annex I (particularly footnote 10) and Dr. Sumner's Oral Statement of 7 October 2003, that Brazil's documents manifestly led the Panel to believe it was using a broad, multi-commodity international model in its analysis. Only later did Brazil clearly admit it did not use such a model and that all competing crops were not included in its international analysis.

[23] *See* para. 42, Brazil's Comments on US Model Critique, 20 January 2004.

[24] The United States notes also that with each discovered discrepancy, Brazil has supposedly rerun its analysis to demonstrate that none of its misstatements has had any appreciable affect on the Sumner model results and asserts this demonstrates the "robustness" of the Sumner model. As noted in the introductory statements to this submission, every economic result ascribed to a FAPRI-type analysis by Brazil contains the same flawed assumptions originally introduced by Dr. Sumner, apart from the few corrections Brazil has made. It is no surprise that each rerun of the same basic construct would reveal the same basic results.

perform well under these validation methods, then particular components or equations within the system are evaluated and re-specified.

39. It does not appear that Dr. Sumner employed any of these standard techniques for validating the robustness of his model. It is doubtful that his model, with its modified acreage equations, would pass this common test. However, despite the lack of documented validation of the model, Dr. Sumner nevertheless proceeds to use the model and treats the results as credible.

40. Dr. Sumner's "simple illustration" provided in paragraph 50 does not address the true issue and is not relevant to the example of US cotton. The United States has repeatedly shown that the overriding economic signals that have affected cotton acreage have been the expected prices of cotton and relevant competing crops.

41. To conclude our response to Dr. Sumner's arguments in paragraphs 43-56, it is abundantly clear that Dr. Sumner can produce no meaningful empirical validation for his approach. His results are based on forced outcomes that are the results of his *ad hoc* modelling specifications.

**Inconsistent descriptions of "full net revenue"**

42. In paragraph 63, Dr. Sumner states that "full net revenue including all programme payments" form the basis for his model specification. He states that he does not understand how the United States made such a mistaken assumption. Dr. Sumner's current claim is in direct contradiction to his documentation in Exhibit Bra-313.

43. On page 2, in equation (2) and the subsequent paragraph of Exhibit Bra-313, Dr. Sumner clearly states that his net revenue includes only the farm price and the marketing loan and not the full programme payments. Then, in equations (4) - (6), the net revenue, which presumably is the same as specified in equation (2), is again denoted as being a portion of the denominator in his determination of the impacts of the programme in question. The United States maintains its assertion that the full programme payments should have been in the denominator of the function. Neither the United States nor the Panel can be certain of Dr. Sumner's exact approach because his explanation changes with each submission.

**Incorrect assertions**

44. Dr. Sumner's criticisms in paragraph 65 of the calculations provided by the United States are unfounded.

45. The claim in paragraph 65 that the Southern Plains revenue of $109.04 does not include marketing loan benefits is patently incorrect. The Panel and Dr. Sumner need only to look in cell AO236 of the Equations sheet of the file FINAL US2003CropsModel WORKOUT.xls and they will find that the value of net revenue from the market and the marketing loan is $109.04. All subsequent critiques on this issue put forth by Dr. Sumner are obviously incorrect because of his error reading the spreadsheets submitted by Brazil.

46. Dr. Sumner attempts to invalidate the US criticisms in paragraph 69-70 by claiming that the numbers are not the ones reported in Annex I. He indicates that the numbers were generated by the United States, but that is incorrect. The United States properly references the source of the acreage impacts as being the file FINAL US2003CropsModel WORKOUT.xls. More specifically, the data come from rows 721-771 of the Equations sheet and are the first-round impacts reported in the model. These are appropriately compared to first-round impacts calculated in the US critique.

**Marketing loan and step 2 impacts**

47. Given Brazil's efforts to misstate the US position on marketing loan and step 2 impacts in paragraphs 8 and 9, the United States refers the Panel to its earlier discussion included in section G (paragraphs 152, et seq.) in the US Further Rebuttal Submission, 18 November 2003 where the United States stresses the need for the Panel to investigate the actual decisions facing producers making their planting decisions. The United States has also not altered its position regarding the step 2 programme. The US submission of 22 December 2003 was directed at its critique of Dr. Sumner's economic modelling. While the US has indicated to the Panel its belief that the FAPRI model is not the best measure of impacts of the marketing loan or step 2 programmes, it did not specifically criticize Brazil's analytical method in this regard as Brazil apparently did not make significant changes to the FAPRI model on these points - as it did in virtually every other aspect of its analysis.

**Annex I results have never been independently confirmed**

48. The models used and outputs obtained by Brazil and submitted to the Panel were not retained by Brazil's employed experts.[25] The record remains incomplete with respect to Dr. Sumner's adaptations.

49. The United States has found that the current submission by Dr. Sumner is fraught with many of the same types of errors contained in his previous submissions. He disputes numbers that are taken directly from files that either he or Dr. Babcock has provided to the Panel. He continues to provide contradictory explanations and documentation of his methodology. Furthermore, detailed electronic verification of his calculations used in Annex I have never been provided to the United States or the Panel. Dr. Sumner has repeatedly claimed that he has provided all information to the Panel. That is obviously not the case, since new information, such as the regional crop insurance numbers, were just provided in this most recent submission.

**Impacts attributed to the export credit guarantee programme are unsubstantiated**

50. The United States is surprised that, despite repeated opportunities to offer some degree of economic support to the 500,000 bale impact Brazil attributes to the US export credit guarantee programme, Brazil has still not done so.[26] Worse, Brazil still refers to its estimates of the impact of this programme as "conservative." As the United States indicated in its critique of the Sumner model, the figures bandied about regarding acreage impacts of the export credit guarantee programme on cotton are anything but conservative.

51. In the September 9 Brazil Submission before the Second Session of the First Panel Meeting, (paragraphs 192-194), Brazil implied that Dr. Sumner's export estimates with respect to the export credit guarantee programme were more conservative than the unsubstantiated estimate it cites from the National Cotton Council (the "NCC"). Paragraph 194 of that submission acts as if the NCC estimate of a possible 3 cent per pound US price impact and Dr. Sumner's estimate of a .57 cent per pound world price impact are somehow independent analyses - and demonstrate Dr. Sumner's conservative approach. However, as demonstrated in Bra-313, all Dr. Sumner did was force a reduction in the US export estimates of 500,000 bales (using the NCC testimony as his sole economic foundation), which correspondingly reduced prices in the US, which correspondingly both reduced US acreage and slightly increased exports - cutting into the initially imposed 500,000 bale shift.

[25] *See* Letter dated October 31, 2003 from Dr. Bruce Babcock to Dr. Dan Sumner, submitted to the Panel by Brazil on 5 November 2003.

[26] Other than citing congressional testimony offered by the National Cotton Council, a US trade association that operates on behalf of the US cotton industry.

52. The "different" price estimates were, in fact, estimates of two different sets of prices - US and world. Brazil inappropriately characterized Dr. Sumner's results as being conservative relative to the NCC estimate. (*see* para. 192, Brazil's Further Submission to the Panel, 9 September 2003) Later when the Panel raised a question about the results, Dr. Sumner somehow forced a full 500,000 bale decline in US exports, ignoring the impacts of price response. (*See, e.g.*, Bra-325, last category of tables - export credit guarantee with fixed 500,000 bale impact.) In that response, Brazil also maintained the stance that these two "analyses," neither demonstrating economic foundation, were somehow independent, while fairly clearly demonstrating that Dr. Sumner merely took the NCC testimony and imposed a 500,000 bale demand shift.

53. Neither Brazil nor Dr. Sumner have ever offered any analysis at all as to how much or whether the export credit guarantee programme actually affects exports. They took someone else's word for it, with no demonstrated economic foundation - much the same approach Brazil has asked the Panel to take with respect to important aspects of the Annex I model.

**Conclusions**

54. Dr. Sumner's economic analysis should not be relied upon by the Panel as credible support for any findings on the effect of challenged US cotton subsidies. Brazil offers Dr. Sumner's model results as evidence that *but for* the US cotton programmes, US cotton acreage would have declined and world prices would have increased. In order to support this claim, Brazil and Dr. Sumner had to make significant modifications to a previously well-respected econometric system. The United States has demonstrated the weakness inherent in those modifications and the failure of Brazil to independently validate those modifications. Throughout its submissions, Brazil has claimed that nebulous factors such as a producer's "anticipation of policy change" are legitimate pillars on which to base Dr. Sumner's modifications to the FAPRI model. Brazil has pushed this questionable logic despite the fact that FAPRI itself has refused to ascribe the type of impacts forced on its model by Brazil. When confronted by the United States and pointedly questioned about the particulars of its approach, Brazil has been unable to advance convincing, supportable or even consistent explanations of its analysis.

55. As stated previously, while the US has demonstrated fatal flaws in Brazil's arguments on subsidy identification, causation, and its actionable subsidies claims, it is clear to the United States that *but for* the significant modification and adaptation of the FAPRI model carried out by Brazil and Dr. Sumner, acreage impacts attributed to the US cotton programme by that economic model would be far less than reported in Annex I. Brazil has offered nothing in its critique to change the US view of the failure of Brazil's evidence to prove this aspect of its claim.

# ANNEX I-17

## BRAZIL'S RESPONSE TO THE PANEL'S QUESTIONS

11 February 2004

### TABLE OF CASES

| Short Title | Full Case and Citation |
|---|---|
| *EC – Hormones* | Arbitrator Report, *EC – Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/15, WT/DS48/13, circulated 29 May 1998. |
| *Brazil – Aircraft* | Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/R, adopted 20 August 1999. |
| *Canada – Aircraft* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS/70, adopted 20 August 1999. |
| *Korea – Alcoholic Beverages* | Arbitrator Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/16 and WT/DS84/14, circulated, 4 June 1999. |
| *US – FSC* | Panel Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/R, adopted 20 March 2000. |
| *Australia – Leather* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999. |
| *US – 1916 Act* | Arbitrator Report, *US – Anti-Dumping Act of 1916*, WT/DS136/11 and WT/DS162/14, circulated 28 February 2001. |
| *Canada – Automotive Industry* | Panel Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R and WT/DS/142/R, adopted 19 June 2000. |
| *US – Section 110* | Arbitrator Report, *United States – Section 110(5) of the US Copyright Act*, WT/DS160/12, circulated 15 January 2001. |
| *US – Hot-Rolled Steel* | Arbitrator Report, *US – Hot-Rolled Steel from Japan*, WT/DS184/13, circulated 19 February 2002. |
| *US – Byrd Amendment* | Arbitrator Report, *US – Continued Dumping and Subsidy Offset Act*, WT/DS217/14 and WT/DS234/22, circulated 13 June 2003. |
| *Canada – Aircraft II* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS222/R, adopted 19 February 2002. |

**276. The Panel notes the parties' responses and comments relating to Question No. 252 concerning the time period within which any prohibited measure must be withdrawn within the meaning of Article 4.7 of the *SCM Agreement*. Please supplement your original response, taking into account the particular nature of each alleged prohibited subsidy measure (i.e. "Step 2" payments under Section 1207(a) of the 2002 FSRI Act, export credit guarantee programmes and the ETI Act) and the functioning of the US legal and regulatory system in respect of these measures.**

**Brazil's Answer:**

1. Brazil thanks the Panel for the opportunity to supplement its 22 December 2003 response to Question 252.[1] As Brazil has previously noted, the three prohibited subsidies at issue in this dispute (Step 2 payments, CCC export credit guarantees and ETI Act subsidies) all involve mandatory measures requiring changes to the statutes that provide for these prohibited subsidies.

2. The ordinary meaning of the phrase "without delay" in Article 4.7 of the SCM Agreement is "as quickly as possible." While the text does not state "immediately," neither does it use a qualifier such as "reasonable delay." The term implies a certain sense of urgency. And it suggests that implementing governments must move more quickly to implement prohibited subsidies measures than other types of measures. In particular, the phrase "without delay" requires a faster implementation than the "reasonable period of time" provisions of Article 21.3 of the DSU. Article 21.3 provides that if it is "*impracticable* to comply immediately with the recommendations and rulings, the Member shall have a *reasonable* period of time in which to do so" (emphasis added). The use of terms "impracticable" and "reasonable" suggest a less urgent approach to implementation in DSU Article 21.3 than in Article 4.7 of the SCM Agreement. This is exactly how the provisions of DSU Article 21.3 have been interpreted by a number of arbitrators, as discussed below.

3. The context of Article 4.7 of the SCM Agreement strongly supports a more rapid implementation for prohibited subsidy measures than for other measures. First, there are special expedited dispute settlement procedures in Articles 4.4-4.6 of the SCM Agreement for prohibited subsidy disputes. Why would the drafters have cut the time for litigating prohibited subsidy cases in half, if they had expected "business as usual" in the implementation phase by using the same "reasonable period" implementation provisions of DSU Article 21.3? The "special rule and procedure" status of Article 4.7 of the SCM Agreement in DSU Annex 2 is also significant. This special status must be given meaning by the Panel. To simply treat implementation according to the "reasonable period of time" standard of DSU Article 21.3, as the United States argument suggests[2],would effectively denude the "without delay" standard in Article 4.7 of any "special" status.

4. The "prohibited" status of subsidies covered by Articles 3 and 4 of the SCM Agreement suggests that the object and purpose of prohibited subsidy disciplines is to create significant disincentives for Members to continue providing such subsidies. These provisions demonstrate that negotiators determined that special dispute settlement and implementation procedures were required for prohibited subsidies because of their particularly trade-distorting nature. The object and purpose of Articles 3 and 4 would be frustrated if the phrase "without delay" were interpreted to permit a Member to take as long as normally required to implement any legislative changes. Each day that a prohibited subsidy, such as Step 2 payments, continues to be provided is a day in which trade is distorted. This is particularly true given the recent fall in cotton futures prices.[3]

[1] *See* Brazil's 22 December 2003 Answers to Questions, para. 167.

[2] *See* US 28 January 2004 Comments, paras. 175-177.

[3] http://www.nybot.com (click on cotton and then futures). As of 10 February 2004, the futures price for the March 2004 contract had fallen to 64.96 cents from a high of 86 cents in October 2003.

5. There is only one precedent applying the Article 4.7 "without delay" provision to prohibited subsidy measures requiring legislative changes. In the *US – FSC* dispute, the Panel found 1 October 000 (15 months after the interim report was issued) to be the appropriate "without delay" period.[4] However, the facts of *US – FSC* highlight the reason for such a long period of implementation. In that case, the Panel found that legislation repealing a *tax* break had to be enacted *before* the start of the next US fiscal (*i.e.*, tax) year. The Panel found that in view of the likely appeal of its report and the timing of the fiscal year, 1 October 2000 would be the earliest possible implementation date and, thus, a period of time constituting "without delay".[5]

6. Unlike the FSC measure, the export credit guarantee and Step 2 subsidies at issue in this dispute are not tax breaks determined (retrospectively) on the basis of annual income and in force for a fiscal year. Step 2 payments and export credit guarantees are also not paid on the basis of marketing years or any other time period. Instead, the beneficiaries of these two types of prohibited subsidies receive financial contributions that confer benefits on a *transaction-by-transaction* basis. Therefore, the United States cannot claim that there is a need to wait to enact legislation before a "fiscal year", as was required in the *US – FSC* dispute.[6]

7. Although the DSU Article 21.3 standard requires a less rapid legislative response than Article 4.7 of the SCM Agreement, the decisions of various arbitrators provide a useful reference point for the Panel's interpretation of Article 4.7. The now standard language in almost all arbitrators' reports under DSU Article 21.3 is that implementation must occur in the shortest period possible within the *normal* legal system of a Member.[7] DSU Article 21.3(c) implementation need not employ "extraordinary legislative procedures".[8] In other words, under DSU Article 21.3, an implementing Member's legislative process need not move faster than it would *normally* operate in moving legislation through its legal system.[9]

8. But the Panel's role is to interpret the meaning of Article 4.7 of the SCM Agreement and to give meaning to the term "without delay" as a special provision *apart* from DSU Article 21.3. This does not require the Panel to find that there is a conflict between the provisions. Rather, the Panel must prevent Article 4.7 from being totally absorbed within the meaning of DSU Article 21.3, as that latter provision has been interpreted by numerous arbitrators. Any interpretation of Article 4.7 that would not give it special and independent meaning by instead adopting a "business as usual" approach to implementation for prohibited subsidy measures would render that provision inutile.

9. In determining what "without delay" means for the United States' implementation obligations in this case, Brazil notes that various arbitrators have emphasized that the US Congress has considerable flexibility to enact legislation quickly.[10] The United States has confirmed this fact.[11] Indeed, the United States enacted the FSC replacement measure in less than eight months after the adoption of the panel report in *US – FSC*.[12] Arbitrators applying DSU Article 21.3(c) have found that the United States must be given the right to use "normal" legislative procedures, and therefore granted

[4] Panel Report, *US – FSC*, WT/DS108/R, para. 8.8.
[5] Panel Report, *US – FSC*, WT/DS108/R, para. 8.8.
[6] Panel Report, *US – FSC*, WT/DS108/R, para. 8.8.
[7] Arbitrator Report, *EC – Hormones*, WT/DS26/15, para. 26. *See* also Arbitrator Report, *US – Section 110*, WT/DS160/12, para. 31.
[8] Arbitrator Report, *US – Section 110*, WT/DS160/12, para. 32; Arbitrator Report, *Korea – Alcoholic Beverages*, WT/DS75/16, para. 42.
[9] Arbitrator Report, *US – Section 110*, WT/DS160/12, para. 32.
[10] Arbitrator Report, *US – Section 110*, WT/DS160/12, para. 38; Arbitrator Report, *US – 1916 Act*, WT/DS136/11, para. 43; Arbitrator Report, *US – Byrd Amendment*, WT/DS217/14, para. 32.
[11] Arbitrator Report, *US – Section 110*, WT/DS160/12, para. 38.
[12] Arbitrator Report, *US – 1916 Act*, WT/DS136/11, para. 43.

the United States between 10[13] and 15[14] months for implementation requiring legislative changes. But Article 4.7 of the SCM Agreement is not a "normal" procedure – it is a special one. And it requires special efforts of implementing legislators to act more quickly than may be "normal".

10. The record shows that Step 2 payments are prohibited subsidies that are paid upon proof of export shipments or domestic use by US textile mills. Eliminating this prohibited subsidy requires no complex word play or textual wrangling. Rather, it simply involves the repeal of Section 1207(a) of the 2002 FSRI Act. Therefore, Brazil considers that 90 days after the adoption of the Panel Report by the DSB should be considered to be "without delay".[15]

11. With respect to the CCC export credit guarantee programmes, the Panel should specify that within six months after the adoption of the Panel Report, the prohibited subsidies must be withdrawn by enacting the necessary changes to the statutes and regulations providing for GSM 102, GSM 103 and SCGP. These changes would have to result in CCC guarantees being provided on market terms and at premium rates that are adequate to cover the long-term operating costs and losses of the programmes. Due to the more complex nature of the implementation with respect to the CCC export credit guarantee programmes, Brazil considers a period of time of six months to be consistent with the "without delay" obligation.

12. With respect to the ETI Act, the United States has repeatedly indicated that implementation is underway and that "bills are before both houses of Congress that would repeal the FSC and that have been reported out of their respective committees."[16] In view of the implementation process, which has already begun, and the text of Article 4.7 of the SCM Agreement requiring the withdrawal of the prohibited subsidies "without delay", the Panel should specify that, with respect to the ETI Act, "without delay" means a period of 90 days. This represents an appropriate period of time that would be consistent with the "without delay" obligation to withdraw the ETI Act.

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[13] Arbitrator Report, *US – 1916 Act*, WT/DS136/11, para. 45.

[14] Arbitrator Report, *US – Hot-Rolled Steel*, WT/184/13, para. 40. Brazil notes that this case also involved changes to the regulations that could only be adopted after the underlying statute had been changed by Congress. Therefore, the arbitrator considered a period of more than 10 months to be "reasonable."

[15] The period of 90 days is also consistent with the specification of earlier panels that "without delay" generally means 90 days. *See* Brazil's 22 December 2003 Answers to Questions, para. 167. *See* Panel Report, *Brazil – Aircraft*, WT/DS46/R, para. 8.5; Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 10.4; Panel Report, *US – FSC*, WT/DS108/R, paras. 8.7-8.8; Panel Report, *Australia – Leather*, WT/DS126/R, paras. 10.6-10.7, Panel Report, *Canada – Automotive Industry*, WT/DS139/R and WT/DS142/R, paras. 11.6-11.7, and Panel Report, *Canada – Aircraft II*, WT/DS222/R, para. 8.4.

[16] *See* most recently: US 28 January 2004 Comments, para. 177. *See* also US 11 July 2003 First Submission, para. 189 and US 11 August Answers to Questions, paras. 229-230.

# ANNEX I-18

## UNITED STATES' RESPONSE TO THE PANEL'S QUESTIONS

11 February 2004

**259. With respect to the Privacy Act of 1974, 5 U.S.C. 552a:**

**(a) Whose interests are protected under section 552a(b) in light of the definition of "individual" in section 552a(a)(2)? Do all payment recipients, including corporations and organizations, have Privacy Act rights? If not, is the United States prevented by its domestic law from releasing such of the information requested on 12 January 2004 as relates to payment recipients without Privacy Act rights? Please explain with references to case law.**

1. We appreciate the Panel's interest in the Privacy Act interests that the United States Department of Agriculture is obligated, under US domestic law, to protect. Farm-specific planting data is one such protected interest[1], and was one since long before the inception of this dispute. We discuss this point further in response to question 259(c) below.

2. Under the Privacy Act of 1974, generally, "[n]o agency shall disclose any record which is contained in a system of records by any means of communication to any person . . . ". 5 U.S.C. 552a(b). The statute provides a criminal penalty for any agency employee who willfully discloses protected records knowing that disclosure is prohibited. 5 U.S.C. 552(a)(I)(1). A "record" is defined as "any item, collection, or grouping of information about an individual that is maintained by an agency" (5 U.S.C. 552a(a)(4)), and an "individual" is defined as "a citizen of the United States or an alien lawfully admitted for permanent residence" (5 U.S.C. 552a(a)(2)). Therefore, courts have held that the rights of the Privacy Act of 1974 do not extend to corporations or organizations. *See*, *e.g.*, Dresser Industries v. United States, 596 F.2d 1231 (5th Cir. 1979). While corporations do not have a personal privacy interest, closely held corporations are an exception in that the release of information about the corporation is tantamount to a release of information on the individuals involved.

3. With respect to planting information of non-closely held corporations, courts have held that information voluntarily received from a corporation is to be withheld under exemption (4) of the Freedom of Information Act (FOIA), 5 U.S.C. 552 (5 USC (b)(4)), if it is not the type of information that would customarily released by the corporation to the public. See also, Center for Auto Safety v. National Highway Traffic Safety Administration, 244 F.3d 144, 147 (DC Cir. 2001). This is the case with respect to plantings. Furthermore, the Trade Secrets Act, 18 U.S.C. 1905, prohibits the release of any information that falls within the exemption from disclosure provided by 5 U.S.C. (b)(4) unless otherwise permitted by law. CNA Financial Corp. v. Donovan, 830 F.2d 1132, 1151-1152 (D.C. Cir. 1987).

4. The 1999-2001 plantings information of non-closely held corporations was voluntarily submitted. For 2002 and beyond the reports are required by statute. Thus, such data could presumably be released for non-closely held corporations (it would still be protected under the Privacy Act for individuals and closely-held corporations). However, determining which farms are

[1] We discuss below an exception to this principle for farms owned by corporations other than closely held corporations.

non-closely corporations would require examining, on a case by case basis, the circumstances of each operation. That would require the consideration in county offices across the cotton-growing country of some 200,000 files.

5. As explained in the US letter of 20 January 2004, Brazil's insistence on receipt of contract payment and planting data identified by farm number is unnecessary to resolution of the issues in this dispute. Instead, to the extent any of this information is relevant to this dispute, given Brazil's arguments, aggregation of payment data would provide information in the appropriate format, and aggregation would moreover be consistent with US law. The Panel has now requested aggregated data, and as explained elsewhere in today's submissions the United States is working to provide that.

**(b) The Panel notes that data concerning the four relevant programmes, in particular, payment amounts, identified by specific farms, is freely available on the internet. Please explain why that data can be disclosed but the requested planted acreage data cannot. Do individual recipients have Privacy Act rights with respect to their entrepreneurial activity? Please explain with references to case law.**

6. The Panel is correct to distinguish between information on government activity and government payments, and individual activity, in particular individual entrepreneurial activity. Indeed, there are long-standing and well-recognized distinctions in the United States between, on the one hand, government-generated information and conclusions formed by the government itself (such as payment amounts, bases, and yields), and, on the other hand, the private reportings of farmers (such as plantings) which do not generate any payments and which are submitted for compliance purposes only. Filings of the latter kind have long been recognized in US agricultural law as being private in nature. *See, e.g.,* 7 USC 1373 and 7 USC 1502(c) (protecting such filings under the terms of the Agricultural Act of 1938 and in the crop insurance context).[2]

7. The interrelationship between the Privacy Act of 1974 and the FOIA requires an analysis balancing the privacy interest of the individual with the "core purpose" of FOIA which is to "shed light on an agency's performance of its statutory duties". United States Department of Justice v. Reporters Committee for Freedom of the Press, 489 US 749 (1989). Information that does not directly disclose government operations cannot be factored into the balance. Reporters Committee, 489 US at 775.

8. Information concerning planted acreage does not demonstrate anything regarding the government's operation – it only demonstrates what a producer is doing. Accordingly it is protected from disclosure. By contrast, information regarding payment amounts relate to the government's implementation of farm programmes, and this outweighs any privacy interest on the part of the producer.[3]

9. With respect to the final part of the Panel's question, while there is a split of authority in US courts as to whether individuals have Privacy Act rights with respect to their entrepreneurial activities, the Department of Agriculture has determined that an individual acting in an entrepreneurial capacity is protected by the Privacy Act of 1974. *See* Metadure Corporation v. United States, 490 F. Supp. 1368 (S.D.N.Y. 1980); Campaign for Family Farms v. Glickman, 200 F.3d 1180 (8th Cir. 2000).

[2] It would be odd, to say the least, to say that such planted acreage information would be protected for crop insurance purposes but then releaseable by some other avenue.

[3] This sort of weighing process was the basis of the decision in Washington Post Company v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996). There, the court found some privacy interest in payment information, but found that interest to be both minimal and outweighed by a "substantial" public interest in identifying "fraud and conflict of interest". 943 F. Supp. at 37.

**(c) Please provide any further available evidence of the USDA's long-standing policy that planted acreage information will not be released.**

10. Exhibit US-144 is a notice dated December 1, 1998, from the Acting Administrator of the Farm Service Agency ("FSA") to all FSA employees setting out "FSA's policy on information that can be released" to the public and "exclusions to FSA's policy on releasing lists of names and addresses. Page 2 of the notice states that "[a]creage, production data, and other producer-related information, without any personal identifiers attached, may be released when grouped . . . unless the request would be able to identify an individual producer from the information provided".

11. Exhibit US-143 is a 18 September 1998, memorandum from the Director of the Legislative Liaison Staff for FSA, to State Offices. In this document, the author seeks to correct any misunderstandings that may have arisen after the Washington Post district court decision regarding what information may be releaseable under the Freedom of Information Act. The memorandum makes clear that, unlike the payment data at issue in that case, planted acreage information is not releaseable information under FOIA.

12. The Panel will see from these document that the positions taken by the Department of Agriculture here predate this dispute by several years.

**260. On 27 August 2003, in its response to Question No. 67 bis, the United States indicated that "it does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers". On 12 January 2004, the Panel requested the United States to provide information "to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years". On 20 January 2004, the United States informed the Panel that "the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton". Is the latest statement responsive to the Panel's request? If so, how can it be reconciled with the first statement?**

13. It is important to distinguish between information on plantings and information on production. The United States maintains some information on plantings, but does not maintain information on individual farm production. The 27 August 2003 statement concerned production, while the 20 January 2004 statement concerned plantings. Brazil has all of the payment data and, for every "cotton farm" (as defined in Exhibit BRA-369), all of the yield data and all of the base data. In addition, the summary files that the United States prepared also present total cropland data for these "cotton farms". However, the United States does not maintain information on whether farms that planted cotton produced (i.e., harvested) that cotton or abandoned it. For cotton, abandonment rates can be significant.

**261. Please confirm that each record in the actual planting database relates to a specific farm (Filenames: rPFCplac and rDCPplac in Exhibits US-111 and US-112). For example, in the data from rDCPplac:**

> **First line:**
> **Field9;Field16;Field22;Field28;Field34;Field40;Field46;Field52;Field58;Field64;Field70 Field76;Field82;Field88;Field94;Field100**
>
> **Second line:**
> **237.10;23059.80;5566.20;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00**
>
> **Does the second line represent data on plantings by the same farm?**

14. Yes, we can confirm that the panel's understanding of the files is correct. That is, for the detailed farm-by-farm text files, each farm was given its own line, with fields separated by semi-colons. The last field would not be followed by any mark; rather, after the last field for a given farm, a new line was started, indicating a new farm entry.

**262. The Panel has noted the two CD-ROMs delivered by the US in the evening of 23 December 2003. They are marked "US-111" and "US-112" respectively, but the contents actually do not correspond to the indication. The Panel also takes note of the US letter dated 28 January 2004 and the CD-ROM delivered together with it. For the record, please clarify the correct CD-ROMs and provide corresponding descriptions of their contents with exhibit numbers.**

15. The United States originally prepared and submitted six data files. The files designated "PFCby.txt" (the base acreage and yield file for the PFC payment era)[4] and "DCPby.txt" (the base acreage and yield file for the DCP payment era)[5] set out all base acres for each "programme crop" on every identified farm and the associated programme yield. For the Panel's and Brazil's convenience, the United States also calculated the payment units (bushels or pounds) for each "programme crop".

16. The United States also provided farm-by-farm planted acreage information, with farm-identifying information removed, in the files "PFCplac.txt" (planted acreage for the PFC payment era)[6] and "DCPplac.txt" (planted acreage for the DCP payment era).[7] The United States has explained that, under US law, it could not provide the farm-by-farm planted acreage information in a format that would permit identification of a specific farm.[8]

17. Finally, to assist the Panel and Brazil in interpreting the voluminous data provided, the United States prepared and submitted summary files setting out aggregate cropland, base acreage, base yield, payment units, and planted acreage. These summaries were labeled "PFCsum.xls" (for the PFC payment era) and "DCPsum.xls" (for the DCP payment era).

18. On 28 January 2004, the United States submitted revised data files to the Panel that corrected for certain programming errors that inevitably resulted in the rush to provide nearly 220 megabytes of data within the limited time available to reply to Brazil's request for data. As set out in the US letter of 28 January, the file names are identical to those previously submitted but with an "r" preceding the original file name. Thus, the files are now titled "rDcpsum.xls" (aggregate data file), "rDcpby.txt' (farm-by-farm base and yield data file), "rDcpplac.txt" (planted acres file), "rPfcsum.xls" (aggregate data file), "rPfcby.txt" (base and yield data file), and "rPfcplac.txt" (planted acres file).

19. In Exhibit US-145 that is being submitted today, the United States sets out the contents of the four revised farm-by-farm ".txt" files (that is, not the summary files) that were submitted to the Panel on 28 January 2004, on CD-ROM. (We note that, in each of the four ".txt" files, the fields are separated by colons and field labels are set out within the file, with each farm having its own line, just

[4] A description of the file contents for the "PFCby.txt" file was submitted as Exhibit US-109.

[5] We note that Exhibit US-111 set out a description of the file contents (by field number and heading) for the "DCPby.txt" file. Any marking of a CD-ROM delivered on 23 December 2003, as "Exhibit US-111" was therefore in error.

[6] A description of the file contents for the "PFCplac.txt" file was submitted as Exhibit US-110.

[7] We note that Exhibit US-112 set out a description of the file contents for the "DCPplac.txt" file. Therefore, any marking of a CD-ROM delivered on 23 December 2003, as "Exhibit US-112" was in error. We apologize for any confusion that may have been caused.

[8] *See* US Letter to Panel of 18 December 2003; US Letter to Panel of 20 January 2004; US Answers to Questions 259(a), (b), (c) from the Panel (11 February 2004).

as in the corresponding ".txt" files submitted on 18 and 19 December 2003.) These four revised files follow the same fields and formats as the files originally submitted on 18 and 19 December 2003. As explained on 28 January, those revised electronic files were prepared and submitted after the United States became aware of certain errors in the original data files submitted.

**263. The Panel has noted that the United States' response to Question No. 214 refers to Exhibits US-117 and US-118. Are these the correct documents to which the United States intended to refer in that response? If not, please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993.**

20. The exhibits submitted in response to Question 214 were in error. A copy of the 24 March 1993, Federal Register notice is attached as Exhibit US-263. The United States regrets any inconvenience its error may have caused.

**264. The Panel asks the United States to clarify certain aspects of Exhibit US-128:**

**(a) Is the Panel correct in understanding that -- as Brazil asserts in footnotes 290 and 291 of Brazil's 28 January 2004 comments on US responses to questions -- Exhibit US-128, all data are presented on a cohort-specific basis? If so, please also present the information originally requested by the Panel in another chart containing programme (as opposed to cohort-specific) activity by fiscal year.**

21. The data presented in Exhibit US-128 is presented on a cohort-specific basis. However, a cohort by definition reflects activity related to guarantees issued within a specific fiscal year. Exhibit US-128 also presents such data with respect to each of the individual programmes (GSM-102, GSM-103, and SCGP), as well as their cumulative totals. This data reflects actual performance of the programmes, unlike the data in the US budget to which Brazil alludes in its footnote 290, which, as the United States has repeatedly explained, are based on estimates and re-estimates required under the Federal Credit Reform Act of 1990.

22. Although the data in Exhibit US-128 is already presented by programme (as well as cumulatively), the United States infers from the Panel's question that it nevertheless would like to see a different presentation of the same data. Accordingly, Exhibit US-147 presents the same data, except Columns D (Claim Payments), E (Claims Recovered), F (Claims Rescheduled), G (Claims Outstanding), L (interest collected on claims recovered), and M (interest collected on reschedulings) are presented on a chronological basis (i.e., instead of applying the particular activity back to the cohort of the guarantee related to such activity, the cash-flows are set out in the fiscal year in which they occurred).

**(b) Does the US agree with the statement in paragraph 135 of Brazil's 28 January 2004 comments on US responses to questions that the difference between the $1,148 billion in the chart at para. 165 of Brazil's 11 August answers to questions and the $666 million amount in Exhibit US-128 ($1.75 billion) closely corresponds to the total "Claims rescheduled" figure reported by the US in Exhibit US-128 (column F)?**

23. The United States is examining the cited figures and expects to be able to provide an answer within the same period as its response to the Panel's supplemental request for information.

**(c) Does the US agree that from the formula in column G (that is: (Column (D) minus (E) minus (F)), it follows that a rescheduled claim no longer constitutes an outstanding claim at the moment the terms of the re-scheduling are agreed and that a rescheduling is**

**treated as 100 per cent recovered, as Brazil states in footnote 292 of Brazil's 28 January 2004 comments on US responses to questions?**

24. The Panel's understanding is correct. However, other than interest collected on reschedulings, Exhibit US-128 does not reflect the receipt of payments under the reschedulings. Consequently, no principal payments received under reschedulings are reflected in Exhibit US-128. As the principal amounts rescheduled are set forth in Column F and subtracted from Claims Outstanding in Column G, to include such principal payments as received would constitute double-counting.

**(d) Is the Panel correct in understanding that the amount of $888,984,792.04 in column F in Exhibit US-128 under "ALL" for 1992 represents the total continuing amount of unrecovered claims for the 1992 cohort, and that the amount of 387,692,219.39 represents the total continuing amount of unrecovered claims for the 1993 cohort, etc? Please indicate and substantiate how much principal and/or interest has actually been paid/recovered/rescheduled annually 1992-2003 in respect of each of the amounts shown in Columns D, E & F in the table.**

25. The Panel's understanding is not correct. The figures in column F to which the question refers do *not* reflect a continuing amount of unrecovered claims. As reflected in the response to question 264(c) these figures do not in any way reflect payment performance under the reschedulings themselves and therefore do not reflect a "continuing amount of unrecovered claims". Although Column M of Exhibit US-128 reflects interest collected on reschedulings, neither payment of original principal nor payments of capitalized interest are reflected in Exhibit US-128. Column M reflects only payments of interest on such original principal or on such capitalized interest.

26. Exhibit US-148 reflects, with respect to the same data as originally included in Exhibit US-128, principal and interest "paid/recovered/rescheduled" annually for 1992-2003, on a chronological cash basis.

**265. In connection with the US response to Question No. 225, please also provide amounts actually "written off" and "forgiven" annually for each post-1992 cohort, with annual details of country and amount (principal/interest).**

27. The response to Question 225 was intended to be comprehensive. CCC financial records indicate that no amounts have been "written off" or "forgiven" with respect to any post-1992 cohort.

**266. What are the precise terms, conditions and duration of each rescheduling reflected in column F in Exhibit US-128?**

28. Exhibit US-153 summarizes the principal terms, conditions, and duration of each rescheduling reflected in column F in Exhibit US-128. In each instance in which a Paris Club Agreed Minute is noted, the terms of the US rescheduling adhere to the multilateral terms agreed within the Paris Club. In no instance does the debt owed the United States and rescheduled in accordance with Paris Club terms pertain exclusively to debt arising from CCC export credit guarantee transactions.

**267. Is the Panel correct in understanding that "interest collected on reschedulings" in Column M in Exhibit US-128 refers not to amounts that have been actually collected by the CCC but rather to interest capitalized in conjunction with the rescheduling? If so, what are the terms, conditions and duration of the arrangements pertaining to these amounts?**

29. The Panel's understanding is *not* correct. As noted in the response to Question 264(d), Column M of Exhibit US-128 reflects only interest collected on reschedulings. It does not reflect

either payment of original principal nor payments of capitalized interest. At the inception of a rescheduling some outstanding interest may be capitalized or interest may be capitalized during the term of the rescheduling. Such capitalized interest is not itself reflected in any way in Exhibit US-128. Column M reflects only payments of interest on original principal or on such capitalized interest.

**268. Concerning Column N in Exhibit US-128, please elaborate upon "Interest earned from US Treasury on uninvested funds". What is the source and authority for these funds and for the interest thereon to be part of the CCC total revenues? What are the terms, conditions and duration of the arrangements pertaining to these amounts?**

30. Section 505(c) of the Federal Credit Reform Act (2 USC Section 661d(c)) applies to "Treasury transactions with financing accounts". In relevant part, it provides:

> The Secretary of the Treasury shall borrow from, receive from, lend to, or pay to the financing accounts such amounts as may be appropriate. The Secretary of the Treasury may prescribe forms and denominations, maturities, and terms and conditions for the transactions described above, except that the rate of interest charged by the Secretary on lending to financing accounts [...] and the rate of interest paid to financing accounts on uninvested balances in financing accounts shall be the same as the rate determined pursuant to [2 USC section 655(b)] [.....] This subsection shall apply to transactions related to direct loan obligations or loan guarantee commitments made on or after October 1, 1991 [...] Cash balances of the financing accounts in excess of current requirements shall be maintained in a form of uninvested funds and the Secretary of the Treasury shall pay interest on these funds.

31. Such section 655(b) provides: "In estimating net present values, the discount rate shall be the average interest rate on marketable Treasury securities of similar maturity to the cash flows of the direct loan or loan guarantee for which the estimate is being made."

32. Exhibit US-149 is Treasury Financial Manual I TFM 2-4600 (December 2003). This document, promulgated by the US Department of Treasury, prescribes Treasury reporting instructions for Federal credit programme agencies in accordance with Federal credit reform legislation. Section 4640 of that document addresses "Interest on Uninvested Funds". That section provides, in part: "Uninvested funds in the financing account consist of fund balances with Treasury from borrowings and/or offsetting collections that have not been disbursed. This balance earns interest from Treasury as determined by the disbursement-weighted average interest rate or single effective rate for each cohort in the financing account."

33. Agencies must report interest revenue and expense separately. Interest income becomes part of the cash balance in the financing account and is available to fund future disbursements.

**269. The Panel notes the table submitted by the US in its answer to Question No. 224 (CCC Financing Account Payments of Interest on Borrowings from Treasury and Interest Earned on Uninvested Funds). Is the Panel correct in understanding that the figures in this table correspond to the "ALL" figures in Columns I and N of Exhibit US-128?**

34. Yes. Column I of Exhibit US-128 corresponds to "Interest on Borrowings" found in the table associated with the response to Question 224, and Column N corresponds to "Interest Earned" in that same table.

**270. With respect to Column I in Exhibit US-128, ("Interest paid on borrowing from US Treasury") and Note 8, p. 25 of Exhibit US-129:**

**(i) please provide the total annual amounts (interest bearing and non-interest bearing) borrowed by the CCC from the US Treasury (annually since 1992), as well as the terms, conditions, interest rate (where applicable) and duration of such borrowing. Please provide details of any other amount borrowed by the CCC from the US Treasury during this period that may not have formed part of the regular annual borrowings.**

35. The Panel's Question 270 in its various sub-parts suggests that the Panel may have a misunderstanding regarding the scope of Note 8, p. 25 of Exhibit US-129. As the Panel is aware, CCC has extensive domestic and foreign operations. Note 8 reflects Debt to the Treasury with respect to myriad activities of CCC, the preponderance of which is associated with borrowings from Treasury to carry out programmes other than the export credit guarantee programmes.

36. Column I of Exhibit US-128 sets forth the total annual amount of interest paid on borrowing from the US Treasury with respect to GSM-102, GSM-103, and SCGP for the periods described. All references to "non-interest bearing" debt or repayments in Note 8, p. 25 of Exhibit US-129 are unrelated to the export credit guarantee programmes.

**(ii) Please explain the nature of "CCC's permanent indefinite borrowing authority from Treasury" referred to in Note 8, p. 25 of Exhibit US-129.**

37. This borrowing authority does not apply to the export credit guarantee programmes. Similar to "non-interesting bearing" debt or repayments noted in the preceding response, "CCC's permanent indefinite borrowing authority from Treasury" is not available with respect to export credit guarantee programmes and activities and has not been available since the advent of the Federal Credit Reform Act of 1990. It has therefore not been available with respect to any cohorts from 1992 to the present.

38. The permanent indefinite borrowing authority to which the question and Note 8, p. 125 of Exhibit US-129 refer is available to finance and carry out many (but not all) activities of the CCC, including, for example, certain domestic commodity and conservation programmes, but not including the export credit guarantee programmes. CCC may incur realized losses in the course of carrying out such other activities, and such net realized losses are restored through the annual Federal appropriations process.

**(iii) What determines the level of CCC export credit guarantee borrowing (interest-bearing and non-interest-bearing)? Is the interest-free borrowing up to the amount of unreimbursed realized losses?**

39. As noted in the preceding responses no "non-interest bearing" or "interest-free" borrowing is available with respect to the export credit guarantee programmes.

40. Generally speaking, the principal determinant of the level of CCC export credit guarantee financing will be the estimated programme activity in a particular fiscal year. Budget authority is based on estimates of all anticipated programme activity such as dollar value of guarantees projected to be issued, premia to be collected, payments to be received, and claims to be paid. Infrequently, borrowing from Treasury is also used if CCC has insufficient cash on hand to pay claims.

**(iv) Why are repayments applied to non-interest bearing notes first, as indicated at Note 8, p. 25 of Exhibit US-129?**

41. As noted in the previous responses, activity with respect to non-interest bearing notes is wholly unrelated to the export credit guarantee programmes.

**271. Note 8, p. 25 of Exhibit US-129 states that "In fiscal year 2003, CCC was fully reimbursed for its prior year net realized losses." Please indicate the amounts of prior year net realized losses (annually, since 1992) for which the CCC has been fully reimbursed.**

42. As indicated in the responses to Questions 226 (22 December 2003) and 272 below, such reimbursement is unrelated and inapplicable to the CCC export credit guarantee programmes since the inception of the Federal Credit Reform Act of 1990, which corresponds to fiscal year 1992. The table comprising Exhibit US-152 displays CCC net realized losses and all appropriations to restore those losses for fiscal years 1992 through 2003, but the United States hastens to reiterate that these figures have no relation to the export credit guarantee programmes. Such reimbursements for net realized losses do not include any portion attributable or allocable to the export credit guarantee programmes.

**272. With respect to the US response to Question No. 226, is the Panel correct in understanding that the reflection of write-offs as part of the operating loss of the CCC which in turn was replenished through the annual appropriations process ended with the entry into force of the FCRA in fiscal year 1992? If not, what amounts have been replenished through this process annually since fiscal year 1992?**

43. The Panel's understanding is correct.

**273. With respect to the US response to Question No. 225, what criteria does the CCC apply to "independently determine" that a debt is uncollectible? For post-1992 cohorts, what are these uncollectible amounts (annually) and how, if at all, are such "uncollectible amounts" shown in Exhibit US-128?**

44. With respect to post-1992 cohorts, no amounts have been determined uncollectible and therefore none are reflected in Exhibit US-128.

45. The determinations of uncollectability reflected in the response to Question No. 225, were based on the following facts. In the Argentine case, two private sector banks entered Argentine insolvency proceedings and were subsequently liquidated. CCC, after collecting a portion of the outstanding debt, received advice from the US Embassy that CCC would never receive further collection. Accordingly, the outstanding debt was written off. In the case of the Russian debt, certain debt of a private sector bank was not included in Paris Club rescheduling of debt of the former Soviet Union. The Russian Federation was therefore not liable for this debt. CCC received payments from the private sector bank but made an internal error in properly accounting for these payments. Certain late interest was not paid as a result, and CCC opted to deem such amount uncollectible. CCC has so far been unable to locate records pertaining to the Nigerian write-off.

**274. The Panel notes the US statement in the US response to Question No. 81 that "All rescheduled claims are currently performing " and that "all payments due up to this point under [rescheduling] agreements have been received". However, the Panel also notes Exhibit US-129 (in particular, Note 5 on p. 22) and Brazil's reference thereto in Brazil's 28 January comments on the US response to Question No. 222. In this connection:**

**(a) How does the US respond to Brazil's statement in Brazil's 28 January comments that Exhibit US-129 confirms that rescheduling of export credit guarantee receivables cover both principal and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled?**

46. The United States would first point out that the references to reschedulings in Note 5, p. 22, of Exhibit US-129 are not limited to reschedulings associated with the export credit guarantee

programmes, nor to post-1991 transactions. The substantial majority of the amounts rescheduled by CCC pertain to activities related to the P.L. 480 foreign food assistance programme.

47. Brazil misinterprets Exhibit US-129, Note 5, p. 22. Citing that reference, Brazil states: "Indeed, the CCC's Financial Statement for FY 2002 and 2003 confirm that rescheduling of export credit guarantee receivables covered both principle [*sic*] and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled."[9] Brazil is presumably referring to the second full paragraph of that page 22, particularly its second sentence. The full paragraph reads as follows:

> Direct credit and credit guarantee principal receivables under rescheduling agreements as of 30 September 2003 and 2002, were $7,532 million and $7,494 million, respectively. During fiscal years 2003 and 2002, CCC entered into agreements with debtor countries to reschedule their delinquent debt owed to CCC. These reschedulings totalled $591 million in delinquent principal and $196 million in delinquent interest during fiscal year 2003, and $152 million in delinquent principal and $55 million in delinquent interest during fiscal year 2002.

48. The second sentence refers primarily to delinquent debt under original obligations, not under outstanding reschedulings. All rescheduled export credit guarantee debt is currently performing.

**(b) In Note 5 on p. 22 of Exhibit US-129, what is the definition of "non-performing"? What is the meaning of "delinquent"? What is the current principal balance and amount of interest of the three CCC export credit guarantee programme "receivables" in a non-performing status (individually and together, for GSM 102, GSM 103 and SCGP))? What is the amount of interest on non-reporting "receivables"?**

49. Page 4 of Note 1 (Significant Accounting Policies) of Exhibit US-129 provides in relevant part under the paragraph entitled "Interest Income on Direct Credits and Credit Guarantees": "A non-performing direct credit or credit guarantee receivable is defined as a repayment schedule under a credit agreement, with an installment payment in arrears more than 90 days." "Delinquent" would apply to anything past due.

50. With respect to post-1991 cohorts, the principal balance of non-performing credit guarantee receivables as of 30 September 2003 is as follows:

| | |
|---|---|
| GSM-102: | $181 million |
| GSM-103: | - 0 - |
| SCGP: | 21 million |
| Total: | $202 million |

With respect to pre-1992 cohorts:

| | |
|---|---|
| GSM-102: | $2,237 million |
| GSM-103: | 11 |
| SCGP: | -not applicable- |
| Total: | $2,248 million |

[9] Brazil's Comments on US 22 December Answers (28 January 2004), para. 135.

51. With respect to the last question, the United States assumes that the Panel intended to refer to "non-performing 'receivables', rather than "non-reporting 'receivables'". The interest receivable on "non-performing 'receivables' is $146 million and is entirely related to pre-1992 GSM-102 principal.

**(c) The Panel notes the US reference to the "Paris Club" in US response to Question No. 225. What is the P.L. 480 programme referred to in Note 5 on p. 22 of Exhibit US-129 (including the Paris Club debt reduction process and the HIPC Initiative) ? To what extent is the P.L. 480 programme and Paris Club process relevant to the export credit guarantee programmes at issue in this dispute? Please identify and give the amounts of all CCC export credit guarantee debt subject to the P.L. 480 debt reduction (or other similar) process since 1992.**

52. The P.L. 480 programme is a foreign food-aid programme, under which assistance can be provided on either a grant or concessional financing basis. That programme is wholly distinct from the export credit programmes at issue in this dispute. Consequently, no CCC export credit guarantee debt overlaps with debt subject to P.L. 480 debt reduction. As the United States has noted in its prior submissions, virtually all of the rescheduling of debt in connection with the CCC export credit guarantee programmes is done in concert with a multilateral Paris Club debt rescheduling process. In addition, some debt has also been forgiven under the HIPC initiative. With reference to the United States' response to Question 225, all of the debt in the table reflecting "debt forgiveness" in paragraph 114 was associated with the Paris Club (Poland, Former Yugoslavia) or HIPC (Honduras, Tanzania, Yemen).

**(d) Can the US explain the process referred to in the second column of Note 5 on p. 22 ("CCC is awaiting an apportionment from the Office of Management and Budget before the transaction can be completed. Until such time, however, there is a 100% subsidy allowance established against the relevant debt as of 30 September 2003.") Please provide details of all such "apportionments" relating to the three export credit guarantee programmes in fiscal years 1992-2003.**

53. The transaction to which the cited reference applies involves an agreement between the United States and Pakistan to reduce debt incurred under the P.L. 480 programme, which is not within the scope of this dispute. It involves only P.L. 480 direct credits and does not involve any of the export credit guarantee programmes. It therefore does not involve transactions under federal credit reform provisions applicable to the export credit guarantee programmes. The cited reference is intended to note that although a debt reduction agreement had been signed, the requisite documentation from the Office of Management and Budget authorizing such reduction on the books of CCC had not yet been received as of the statement date.

54. The procedure in the above P.L. 480 instance is distinct from that which would apply in the case of export credit guarantee apportionments. The response of the United States to Panel Question 225 indicated three cases of debt "write-off" and five cases of debt forgiveness. Seven of those eight cases involved pre-1992 debt. Under the Federal Credit Reform Act of 1990, an apportionment is ordinarily not necessary with respect to pre-1992 transactions. In fact, only one such apportionment has ever occurred, and that was in fiscal year 1992 to establish the particular budgetary account (the "liquidating account") under which the budgetary accounting occurs for all activity associated with pre-1992 transactions. That apportionment did not reflect any debt reduction or write off.

55. The only other instance was the write-off of $13,000 owed from the Former Soviet Union/Russia. This particular write-off did not involve a sufficiently large amount to require an apportionment. The Office of Management and Budget database rounds to the nearest million dollars,

and therefore the write-off of $13,000 would not alter the relevant entries in the database for the particular budgetary account (the "financing account") applicable to post-1991 cohort transactions.

**275. Please provide evidence (or cite relevant portions of the record) that the premium rates for the export credit guarantee programmes are "reviewed annually" as stated in US 28 January comments on response to Question No. 223 (see also US 22 December response to Question No. 107; Brazil's 28 January 2004 comments on responses to Question No. 223.).**

56. Exhibit US-150 is comprised of the two most recent internal USDA documents entitled "Annual Review of Fees for USDA Credit Programmes," dated 25 March 2003, and 8 April 2002, respectively. In addition, Exhibit US-151 are Sections I and II of US Office of Management and Budget Circular No. A-129, dated November 2000, entitled "Policies for Federal Credit Programmes and Non-Tax Receivables". Section II.2.b mandates such annual review.

**List of Exhibits**

64 Memorandum from Larry Mitchell, USDA Farm Services Agency, to Various FSA Offices, Administrators, and Divisions on Release of Restricted Information under the Freedom of Information Act (18 September 1998)

65 USDA Farm Services Agency, Notice INFO-16: Releasing Lists of Names and Addresses in Response to Requests Under FOIA (1 December 1998)

66 Contents of 4 corrected data files submitted on 28 January 2004

67 USDA, Commodity Credit Corporation, 58 Federal Register 15755-15756 (24 March 1993).

68 Data in response to Panel Question 264(a): Exhibit US-128 on a Fiscal Year/ Cash Basis

69 Data in response to Panel Question 264(d): Claim Payments/ Recoveries/ Reschedulings on a Fiscal Year/ Cash Basis

70 United States Department of the Treasury Financial Manual I TFM 2-4600 (December 2003)

71 "Annual Review of Fees for USDA Credit Programmes", 25 March 2003 and 8 April 2002.

72 United States Office of Management and Budget Circular No. A-129 (November 2000), Table of Contents, General Information, Appendix A, Sections I and II.

73 Commodity Credit Corporation Realized Losses and Appropriations to Restore Such Losses for Fiscal Years 1992-2003

74 Summary of Principal Terms, Conditions, and Duration of Each Rescheduling Reflected in Column F of Exhibit US-128

Partially Corrected Calculations Allocating Decoupled Payments for Upland Cotton Base Acres to Upland Cotton Using Incomplete Annex IV Methodology

# ANNEX I-19

## COMMENTS OF THE UNITED STATES ON COMMENTS OF BRAZIL

11 February 2004

### I. Introduction

1. The United States thanks the Panel for providing a new deadline for comments on Brazil's comments on the data submitted by the United States on 18 and 19 December 2003.[1] The 48-page document filed by Brazil on 28 January 2004, goes far beyond a comment on that data or even its application to Brazil's invented allocation methodology for determining "support to" upland cotton. Instead, those "comments" on the US data present an attack on the good faith of the United States in responding to Brazil's requests for data, a lengthy attempt to re-write the history of this dispute, an inaccurate explanation of US domestic law regarding privacy interests in planting data, a request for the Panel to draw "adverse inferences" despite the fact that Brazil could have requested aggregated data that would not have implicated privacy interests, a rather circumspect application of its invented allocation methodology to the US data, and an inadequate application of the Annex IV allocation methodology[2] to the US data. Because Brazil has seen fit to raise and argue so many issues in its comments, the United States will necessarily address those in these comments. In these comments, we proceed as follows.

2. First, we put the issue of the use of the US data in its proper context. Brazil has asserted that decoupled income support payments must be allocated to upland cotton only for purposes of the Peace Clause and not for purposes of its serious prejudice claims. However, the allocation of a subsidy benefit is only mentioned in the Subsidies Agreement. The Agreement on Agriculture not only does not contain any allocation methodology, it also defines a category of support ("non-product-specific support") that consists of unallocated payments "to producers in general". Thus, Brazil gets it completely backwards: the text and context of the Peace Clause demonstrate that support is *not* to be allocated for purposes of the Peace Clause test while the text and context of Articles 5 and 6 of the Subsidies Agreement demonstrate that subsidies not tied to production of a given product (such as decoupled income support) *are* to be allocated to all of the products the recipient sells for purposes of serious prejudice claims.

3. Second, we explain the implications of Brazil's erroneous analysis and arguments, and in particular its express disavowal of any allocation methodology for purposes of its serious prejudice claims on decoupled income support payments. Brazil has failed to make a *prima facie* case on these claims; therefore, no serious prejudice findings may be made with respect to these measures, and these payments may not be included in an analysis of whether the effect of the challenged US subsidies has been serious prejudice to Brazil's interests.

4. Third, although the foregoing points should end the analysis, we nonetheless examine Brazil's application of its invented methodology to the US-supplied data. We recall that this Brazilian methodology has no basis in the text or context of the WTO agreements. Neither does Brazil's

[1] Brazil's Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled Data on 20 January 2004 (28 January 2004) ("Brazil's Data Comments").

[2] *Agreement on Subsidies and Countervailing Measures*, Annex IV, paras. 2-3 ("Subsidies Agreement").

methodology make economic sense. It does, however, allow Brazil to allocate decoupled payments exclusively or nearly exclusively to upland cotton. Thus, Brazil's invented allocation methodology can be described as an attempt to inflate the support to be allocated to upland cotton.

5. Fourth, the United States examines Brazil's cursory attempted application of the Annex IV methodology to the US-supplied data. We recall that Brazil expressly disavowed the applicability of that methodology. Brazil neither sought nor presented data to permit the Annex IV methodology to be applied. In fact, Brazil requested data relevant solely to its invented methodology, meaning there is no data before the Panel that would permit the Annex IV methodology to be applied. Finally, the calculations presented by Brazil reflect a misunderstanding of the plain meaning of that methodology and contain a number of erroneous assumptions that bias Brazil's results upwards.

6. Fifth, we correct Brazil's serious misrepresentations with respect to the data it requested and point out that the United States responded to that request as drafted and to the fullest extent permissible under US law. Thus, there is no basis to draw an inference, adverse or otherwise, from the inability to provide certain information that is not relevant to an analysis of Brazil's legal claims.

## II. Brazil Misunderstands the Relevant Analyses for the Peace Clause and for its Serious Prejudice Claims

### A. Brazil's Allocation Methodology is Inconsistent with the Definition of Product-Specific Support in the Agreement on Agriculture and, Therefore, Cannot be Used for Peace Clause Analysis

7. As has been evident since the parties' first submissions, Brazil and the United States have offered fundamentally differing interpretations of Article 13(b)(ii) of the Agreement on Agriculture and in particular the Peace Clause proviso which reads: "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year." The differences between the parties' approaches can be seen in the way they interpret the phrase "product-specific support" and apply that interpretation to decoupled income support payments.

8. Brazil argues that decoupled income support payments are not "truly 'decoupled'" since some recipients do produce programme crops, that "the support from contract payments that can be allocated to upland cotton is product-specific support within the meaning of the Agreement on Agriculture," and that Brazil's approach – "to allocate contract payments to the programme crops covered" – is "reasonable".[3] However, as the United States demonstrated in its comment on Brazil's answer to question 258, Brazil points to *no text* in the Peace Clause, the Agreement on Agriculture, nor any WTO agreement that supports its allocation methodology[4], nor does that methodology make economic sense.[5] Brazil may consider its approach to be "reasonable", but that does not make it based on any WTO provision.

9. As just one example, Brazil apparently would require that "decoupled support" *discourage* recipients from producing certain crops in order to be "decoupled" while at the same time Brazil

[3] Brazil's Data Comments, para. 73. Brazil also argues: "As the record demonstrates, none of four types of contract payments is truly 'decoupled,' given the production of programme crops by the farms holding contract payment base. To the contrary, they are *intended to* and, in fact, do provide support for the production of programme crops." *Id.* Brazil has in fact provided no evidence of such "intent" nor could it since the opposite is true. These programmes are intended to be decoupled. Moreover, under the Peace Clause, the "intent" of a payment is irrelevant; it is also irrelevant what a recipient decides to do with a payment. Rather, the issue is whether the payment as "decided" is "support to a specific commodity" or "support provided in favour of agricultural producers in general".

[4] US Comments on Brazil's Answers to Panel Questions Following the Second Panel Meeting, paras. 209-217 (28 January 2004) ("US January 28 Comments").

[5] US 28 January Comments, paras. 218-23.

complains that the payment restriction for planting fruits and vegetables means that the support is *not* "decoupled". Brazil cannot have it both ways. If support is decoupled, then there is no requirement to produce any particular commodity. If producers choose to exercise their flexibility and plant particular crops, that is perfectly consistent with the concept of decoupled support.

10. The lack of grounding of Brazil's methodology in the WTO agreements stems from its erroneous interpretation of "support to a specific commodity". Brazil has argued that any support that is not made "to producers in general" – which Brazil takes to mean "all" or "nearly all" – is not non-product-specific and therefore must be "product-specific". As the United States has pointed out before, not only does this reading of "in general" rely on an obsolete meaning[6], which therefore cannot be the ordinary meaning of the terms, but Brazil has consistently failed to read together the definitions of product-specific support and non-product-specific support in Article 1(a) of the Agreement on Agriculture. Read in conjunction with one another, non-product-specific support ("support provided in favour of agricultural producers in general") is a residual category of support that is not product-specific ("support . . . provided for an agricultural product in favour of the producers of the basic agricultural product").

11. Brazil's statement in its 28 January comments that "the support from contract payments that can be allocated to upland cotton is product-specific support within the meaning of the Agreement on Agriculture"[7] is significant because *it confirms that both parties interpret "support to a specific commodity" in the Peace Clause as meaning "product-specific support"*. Thus, the question for the Panel is whether decoupled income support measures provide product-specific support or non-product-specific support. The definitions from Article 1(a) quoted above establish that support that is *not* "provided for a basic agricultural product in favour of the producers of the basic agricultural product" cannot be product-specific support.

> The very fact that Brazil must apply an *allocation* methodology to these decoupled income support payments to attempt to determine the "support to upland cotton" demonstrates that they are not product-specific support. Rather, they are support to whatever *products* (if any) the recipients produce, rather than "support for *a* basic agricultural product." In addition, the recipients are "producers in general" because they are not required to be "producers of *the* basic agricultural product" the support is "provided for".

12. While Brazil appears to be arguing that its allocation methodology conforms to the concepts of product-specific and non-product-specific support in the Agreement on Agriculture, in fact that methodology is flatly inconsistent with those concepts.[8] There is nothing in the Agreement that suggests that support may, at one and the same time, be both product-specific and non-product-specific. For example:

> In Article 1(a), these two terms are defined disjunctively (that is, product-specific support "or" non-product-specific support).
>
> In Article 6.4(a), *de minimis* levels of support not required to be included in a Member's Current Total AMS are separately given for "product-specific domestic support" and "non-product-specific domestic support."
>
> Under Annex 3, paragraph 1, "an Aggregate Measurement of Support (AMS) shall be calculated on a product-specific basis for each basic agricultural product", and,

[6] US Comments on Brazil's Rebuttal Submission, para. 23 (noting that definition of "in general" as "in a body; universally; without exception" was marked "obsolete" in *New Shorter Oxford English Dictionary*).

[7] Brazil's Data Comments, para. 73.

[8] *See* US 28 January Comments, paras. 225-29.

> separately, "[s]upport which is non-product specific shall be totalled into one non-product-specific AMS in total monetary terms".

Despite the fact that product-specific and non-product-specific support are kept distinct in the Agreement on Agriculture, Brazil's allocation methodology necessarily collapses the two concepts.

13. For example, under Brazil's methodology decoupled income support "payments for other crops were primarily allocated as support for these crops – up to the share of contract acreage planted to the respective crop", but "[a]ny further payments stemming from contract acreage not planted to the respective base crop were pooled and allocated as additional support to those contract crops whose aggregate planting exceeded their aggregated base acreage".[9] Brazil states that in marketing year 2001, cotton, "oats and sorghum were planted on more acreage than their respective contract base ('overplanted'), thus[] triggering additional payments being allocated pursuant to the crop's share of total acreage being 'overplanted'".[10]

> That is, decoupled income support payments for base acreage with respect to other programme crops (other than upland cotton, oats, and sorghum) would, under Brazil's approach in this dispute, first be "product-specific support" to each of those programme crops to the extent of planted acreage.
>
> Then, the payments on "excess" base acreage would be "product-specific" support simultaneously to upland cotton, oats, and sorghum.

Logically, then, such payments would be support to "four different commodities" (whichever happen to be 'underplanted'), not "support to a *specific* commodity". Further, payments allegedly supporting four different commodities would not be "provided for *a* basic agricultural *product* in favour of the producers of *the* basic agricultural *product*".

14. Thus, decoupled income support payments are support to "agricultural producers in general" – that is, support to recipients who may decide (as Brazil has confirmed) to produce any of multiple commodities in general. Because such payments are non-product-specific, they may not at the same time be deemed to be product-specific. Brazil's methodology for purposes of the Peace Clause would result in non-product-specific support being allocated to the specific products the recipients produce, contrary to the separation of these concepts in the Agreement on Agriculture. As Brazil concedes that "support to a specific commodity" refers to "product-specific support within the meaning of the Agreement on Agriculture"[11], it follows that decoupled income support payments must be deemed to be non-product-specific within the meaning of Article 1(a) of the Agreement on Agriculture and therefore not part of the Peace Clause test under Article 13(b)(ii).

### B. Challenged US Measures do not Grant Support to a Specific Commodity in Excess of that Decided during the 1992 Marketing Year

15. As Brazil has conceded that the Peace Clause proviso refers to "product-specific support", the question for the Panel becomes: do challenged US measures grant product-specific support in excess of that decided during the 1992 marketing year? The United States has previously demonstrated in exhaustive detail that, removing non-product-specific support(that is, decoupled income support measures and crop insurance payments) from the Peace Clause comparison, US measures do not. We will not repeat the extensive arguments on this point, for example, relating to how the United States "decided" its support.

[9] Brazil's Data Comments, para. 80.
[10] Brazil's Data Comments, para. 80 fn. 159.
[11] Brazil's Data Comments, para. 73.

16. We do recall, however, that as the United States by design shifted the support it provided to its agricultural sector from product-specific amber box support (in the form of deficiency payments) to green box support (production flexibility contract payments and direct payments) and non-product-specific support (market loss assistance payments and counter-cyclical payments), the result was that the product-specific support to upland cotton declined substantially. The only way Brazil can overcome this fact is to argue that the only way to gauge "support to a specific commodity" is through budgetary outlays[12], which in the case of marketing loan payments will reflect through high outlays the record low cotton prices in marketing years 2001 and 2002 that the United States did not decide and could not control – as Brazil has conceded.[13]

17. As the United States has shown,[14] *any* measurement of the product-specific support for upland cotton that eliminates the effect of market prices and instead gauges the support "decided" by the United States demonstrates that upland cotton product-specific support was higher in marketing year 1992 than in any marketing year from 1999-2002. That is, whether the analysis is (as the United States believes is compelled by the Peace Clause text) the rate of support as decided in US measures,[15] or the upland cotton AMS measured through a price-gap methodology[16], or the "expected rate of per unit support" calculated by Brazil's expert[17], the result is the same: challenged US measures are not in breach of the Peace Clause.

### C. Under the Subsidies Agreement, Allocation of a Non-Tied Subsidy is Necessary to Identify the Amount of Subsidy and the Subsidized Product

18. Brazil seeks to allocate support not tied to the production of a specific commodity for purposes of the Peace Clause, despite the fact that the Agreement on Agriculture explicitly distinguishes and keeps separate product-specific and non-product-specific support. There is no mention of an allocation methodology in that Agreement because there is no need to allocate support – in fact, allocation is contrary to the very structure of the agreement. Ironically, Brazil then seeks *not* to allocate such a non-tied payment for purposes of its serious prejudice claims when there *is* an allocation methodology set out in Annex IV and when there *is* a need to identify the subsidized product as well as the subsidy amount. Brazil's approach ignores the text and context of Articles 5 and 6 of the Subsidies Agreement.[18]

19. Brazil has argued that it "strongly disagrees that this [Annex IV methodology for allocating non-tied payments] is a required or appropriate methodology under Part III of the SCM Agreement or

[12] In making this argument, Brazil ignores the fact that "support" does not mean "budgetary outlays". In fact, Annex 3 recognizes that an "Aggregate Measurement of Support" for price-based support either shall or can be calculated using a price-gap methodology, which does not rely on budgetary outlays. *See, e.g.*, Agreement on Agriculture, Annex 3, paragraph 8 ("Budgetary outlays made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS."); *id.*, para. 10.

[13] *See* Brazil's Comments on US Answers, para. 66 fn. 49 (August 22, 2003) ("Brazil acknowledges that the United States could not possibl[y] determine its expenditures as they would depend to a certain extent on market prices that were also influenced by factors outside the control of the US Government.").

[14] *See, e.g.*, US Rebuttal Submission, paras. 110-30.

[15] In marketing year 1992, 72.9 cents per pound; in marketing years 1999-2001, 51.92 cents per pound; in marketing year 2002: 52 cents per pound. US Rebuttal Submission, paras. 110-13.

[16] In marketing year 1992, $1,079 million; in 1999, $717 million; in 2000, $484 million; in 2001, $264 million; and in marketing year 2002 (as of the date of panel establishment, March 18, 2003), $205 million. US Rebuttal Submission, paras. 114-17.

[17] In marketing year 1992, 60.05 cents per pound; in marketing year 1999, 53.79 cents per pound; in marketing year 2000, 55.09 cents per pound; in marketing year 2001, 52.82 cents per pound; and in marketing year 2002, 56.32 cents per pound. US Rebuttal Submission, paras. 120-22. Removing the 1999 and 2002 marketing year cottonseed payments the Panel has determined to be not within its terms of reference results in support of 52.82 cents per pound in marketing year 1999 and 55.71 cents per pound in marketing year 2002.

[18] US Comment to Brazil's Answer to Question 258, paras. 209-17.

under GATT Article XVI (or even under Article 13(b)(ii) of the Agreement on Agriculture)".[19] However, Brazil has not provided any basis to conclude that the term "subsidy" can mean one thing in the context of Articles 5 and 6 and another in Article 1.1 (subsidy requires a "benefit" to recipient), Article 14 ("calculation of the amount of a subsidy in terms of the benefit to the recipient") and Article 15.5 (causal link necessary between injury and the subsidized imports "through the effects of subsidies"), all of which suggest that an evaluation of "the effect of the subsidy" requires an identification of the "benefit" the subsidy is alleged to provide. Further, Brazil has not provided any basis to conclude that a "subsidized product" for purposes of Articles 6.3(c), 6.3(d), 6.4, and 6.5 can be read in isolation from the methodology for determining the "subsidization" of a "product" set out in Annex IV. Therefore, the Subsidies Agreement – and Part III in particular – calls for an "allocation methodology" to determine the products that benefit from a subsidy that is not tied to production or sale of a given product.

20. Brazil denies the applicability to the Peace Clause analysis of the Annex IV methodology for allocating non-tied payments across the value of the recipients' production. However, even had Brazil suggested that the Annex IV methodology could be used for Peace Clause analysis, its interpretation would be plainly wrong. First, the phrase "support to a specific commodity" means "product-specific support" – as Brazil has conceded – and thus must be interpreted in light of the terms product-specific support and non-product-specific support in the Agreement on Agriculture (as set out above). Second, the terms "support to a specific commodity" and "product-specific support" are not found in Part III of the Subsidies Agreement, nor in Article 1 or Annex IV.[20] Neither are the terms "subsidy," "benefit," or "subsidized product" from the Subsidies Agreement found in the Peace Clause proviso or any supporting text. Thus, the plain language of the Peace Clause and Articles 5 and 6 indicate that these provisions refer to wholly different approaches and suggest that the methodology for allocating non-tied (decoupled) payments under the Subsidies Agreement may not be relevant under the Agreement on Agriculture. The definitions of product-specific support and non-product-specific support in Article 1(a) of the Agreement on Agriculture confirm that the Annex IV allocation methodology does not apply for purposes of the Peace Clause.

21. Thus, allocating a non-tied payment across the value of the recipient's production is not pertinent for Peace Clause purposes but is necessary for the Panel to be able to attempt to gauge "the effect of the subsidy" for purposes of Brazil's serious prejudice claims. We discuss Brazil's failure to bring forward evidence and arguments relating to this issue in the next section.

## III. Because Brazil Expressly Disavows Any Allocation Methodology for Purposes of its Serious Prejudice Claims on Decoupled Income Support Payments, Brazil Has Failed to Make a *Prima Facie* Case on these Claims

### A Brazil Has Presented No Evidence or Arguments Supporting the Annex IV Methodology to Allocate Decoupled Income Support Payments for Purposes of its Serious Prejudice Claims

22. As we have noted, because Brazil has chosen to include subsidies that are not tied to the production or sale of a given product within its serious prejudice claims, the Annex IV methodology is necessary to determine the subsidized product and the amount of the challenged non-tied subsidy that benefits upland cotton. Brazil recognizes that *some* allocation methodology is necessary to identify the decoupled income support payments within the scope of its panel request ("subsidies to producers, users, and/or exporters of upland cotton")[21] but relies on its wholly invented methodology (allocating decoupled payments for crop base in "excess" of planted acreage of the respective crop

[19] Brazil's Data Comments, para. 85 n. 171.

[20] The term "support" appears in Article 1.1(a)(2) of the Subsidies Agreement, which gives one definition of "subsidy" as "any form of income or price support in the sense of Article XVI of GATT 1994."

[21] WT/DS267/7, at 1.

solely to those programme crops planted on less acreage that their respective base acreage). That methodology finds no support in the text or context of the Subsidies Agreement or any other WTO agreement.

23. The result is that Brazil has not provided the Panel with evidence or arguments sufficient to establish a *prima facie* case that the effect of such decoupled payments is to cause serious prejudice to the interests of Brazil. Brazil has never sought or presented evidence and made arguments that would allow the Panel to evaluate properly "the effect of the subsidy" (decoupled income support payments) – for example, to identify the "subsidized product" through the Annex IV methodology and the "subsidy" in terms of the "benefit" to those recipients named in Brazil's panel request. Logically, if Brazil has not even identified the subsidized product with respect to such payments or the amount of the challenged subsidy, the Panel cannot evaluate "the effects".

24. Indeed, Brazil expressly disavows any allocation or even identification of the size of the subsidy for purposes of its serious prejudice claims:

> "Brazil maintains that no allocation methodology is warranted under Part III of the SCM Agreement. Rather, it is the effect of the subsidies that is the subject of scrutiny."[22]
>
> "Brazil strongly disagrees that this is a required or appropriate methodology under Part III of the SCM Agreement or under GATT Article XVI (or even under Article 13(b)(ii) of the Agreement on Agriculture."[23]
>
> "Again, Brazil notes that this allocation is not required under Part III of the SCM Agreement and GATT Article XVI:3. Both provisions deal with the effect of subsidies, and not their amount or subsidization rate."[24]

25. Further, Brazil has never sought nor presented information relating to the total value of the recipients' sales as would be necessary to apply the Annex IV methodology to decoupled income support payments.[25] Brazil has only sought base and planted acreage information to support its own invented methodology (and only for Peace Clause purposes).[26]

26. In this dispute, then, Brazil cannot have made its *prima facie* case with respect to the effect of decoupled income support payments. To find otherwise would mean a complaining party in a serious prejudice case could satisfy its burden merely by asserting that some unidentified amount of payments are received by producers of the relevant product.

### B. The *Japan – Agricultural Products* Appellate Body Report Confirms that in Such a Situation a Panel May not "Make the Case for a Complaining Party"

27. Brazil includes a discussion of the Appellate Body report in *Japan – Agricultural Products*, suggesting that the report is "inapposite" and that Brazil has advanced relevant claims and arguments such that the Panel could in no event relieve Brazil of its burden of establishing a *prima facie* case of inconsistency with WTO obligations. However, a careful reading of both Brazil's arguments as well as that report reveals that, were the Panel to seek and obtain data to apply, for purposes of its serious

[22] Brazil's Data Comments, para. 85 n. 168.
[23] Brazil's Data Comments, para. 85 n. 171.
[24] Brazil's Data Comments, para. 98 n. 199.
[25] Subsidies Agreement, Annex IV, paras. 2-3 (for a subsidy not tied to the production or sale of a given product, the subsidized product is "the total value of the recipient firm's sales").
[26] *See* Exhibit Bra-369; Brazil's Data Comments, para. 3 ("The purpose of Brazil's request for *contract acreage and planted acreage* for each farm producing upland cotton was . . . .") (italics added).

prejudice analysis, the allocation methodology set out in Annex IV of the Subsidies Agreement to the challenged decoupled income support payments, the Panel would be making Brazil's case for it.

28. We begin by examining Brazil's artfully drafted arguments. Brazil alleges that the US argument is that the *Japan – Agricultural Products* report "would have prevented the Panel from using the information the United States refused to provide to calculate the amount of contract payments across the 'total value of the recipient's production.'"[27] Brazil's assertion is wrong. First, the US argument is that the Panel may not seek and apply information to use the Annex IV methodology for decoupled income support payments because (as set out in the bulleted quotes above) Brazil has *expressly disavowed* any allocation or even identification of the size of the subsidy for purposes of its serious prejudice claims. As Brazil has brought forward no evidence or arguments to support findings on decoupled payments, it has not made its *prima facie* case.

29. Second, the United States has not "refused to provide" information to allocate decoupled payments according to the Annex IV methodology for the simple reason that *Brazil never sought this information*. Brazil merely asked for planted acreage and base acreage (and yield) information.[28] With respect to the farm-by-farm planted acreage data that the United States was unable under US law to provide in a format allowing matching with farm-specific base acreage data, that data is simply irrelevant for purposes of the Annex IV methodology. Thus, while the Panel has the authority under DSU Article 13 to seek information "as the panel considers necessary and appropriate", the inability of the United States to provide that data in the farm-by-farm format requested on 12 January 2004 is ultimately of no moment in this dispute since Brazil's allocation methodology using planted and base acreage data finds no support in any WTO text. The situation is quite different with respect to the Annex IV methodology that is found in the WTO agreements but that has been disavowed by Brazil.

30. Thus, it is Brazil that errs when it suggests that the Panel could seek and apply any information at all without making Brazil's case for it since Brazil has advanced relevant claims and arguments.[29] With respect to the allocation of non-tied (decoupled) payments across the total value of the recipients' sales for purposes of identifying the amount of the subsidy and the subsidized product, Brazil has not sought such information, has not made arguments to support use of that methodology, and has in fact argued that no allocation or identification of the subsidy amount is warranted under Part III of the Subsidies Agreement. Thus, the Panel would in fact be making Brazil's case for it were it to seek to apply the Annex IV methodology.

31. Appellate Body report. There, the Appellate Body reversed a panel finding of inconsistency with Article 5.6 of the *Agreement on the Application of Sanitary and Phytosanitary Measures* ("SPS Agreement") "because this finding was reached in a manner inconsistent with the rules on burden of proof".[30] Specifically, the Appellate Body found that "it was for the United States to establish a *prima facie* case . . . of inconsistency with Article 5.6. Since the United States did not even claim before the Panel that the 'determination of sorption levels' is an alternative measure which meets the three elements under Article 5.6, we are of the opinion that the United States did not establish a *prima facie* case that the 'determination of sorption levels' is an alternative measure within the meaning of Article 5.6".[31]

32. Brazil argues that this reversal was based on the fact that "the complaining party (the United States) did not 'claim' in its request for establishment of a panel that there was an alternative measure (determination of sorption levels) that was less trade restrictive".[32] However, in making this

[27] Brazil's Data Comments, para. 99.
[28] *See* Exhibit BRA-369.
[29] *See* Brazil's Data Comments, para. 103-04.
[30] WT/DS76/AB/R, para. 130.
[31] WT/DS76/AB/R, para. 126.
[32] Brazil's Data Comments, para. 100.

argument, Brazil itself (as it later asserts of the United States) "reveals a profound misunderstanding of the difference between a 'claim' and an 'argument'".[33] The United States agrees with Brazil (and the Appellate Body report in *EC – Hormones*) that "there is a distinction between legal claims reflected in a panel's terms of reference, and arguments used by a complainant to sustain its legal claims". There is no question, however, that the United States advanced a legal *claim* that Japan's varietal testing measure was inconsistent with Article 5.6 of the SPS Agreement.[34] The issue was whether the United States had presented evidence and arguments relating to an alternative measure that satisfied its burden of making a *prima facie* case with respect to its Article 5.6 claim.[35] Thus, the Appellate Body concluded that "the Panel was correct to seek information and advice from experts to help it to understand and evaluate the evidence submitted and arguments made by the United States and Japan with regard to the alleged violation of Article 5.6" but the panel erred "when it used that expert information and advice for a finding of inconsistency with Article 5.6 since the United States did not establish a *prima facie* case of inconsistency with Article 5.6 based on claims relating to the 'determination of sorption levels'".[36]

33. A similar situation would occur here were the Panel to seek and apply information to apply the Annex IV methodology to decoupled income support payments.[37] Brazil has neither sought nor presented any evidence relating to the total value of the recipient firms' sales. Brazil has also not only *not* argued that the Annex IV methodology is necessary to identify the subsidized product and the subsidy benefit, Brazil has also continually argued against use of the Annex IV methodology since, in its view, no allocation of the payment or quantification of the benefit is warranted under Part III of the Subsidies Agreement. Thus, it would appear that Brazil has resisted making the necessary legal arguments and refused to submit any evidence relating a proper analysis of its claims.

34. With respect to Brazil's refusal to recognize the relevance of the Annex IV methodology for purposes of its serious prejudice claims, and its resulting refusal to present evidence and arguments with respect to the application of that methodology to its claims, the findings of the Appellate Body in *Japan – Agricultural Products* remain highly relevant:

> "Article 13 of the DSU . . . suggest that panels have a significant investigative authority. However, this authority cannot be used by a panel to rule in favour of a complaining party which has not established a prima facie case of inconsistency based on specific legal claims asserted by it. A panel is entitled to seek information and advice from experts and from any other relevant source it chooses, pursuant to Article 13 of the DSU . . . *to help it understand and evaluate the evidence submitted and the arguments made by the parties, but not to make the case for a complaining party*."[38]

In this case, Brazil has not submitted evidence and made arguments sufficient to make its case that the effect of decoupled income support payments is to cause serious prejudice to Brazil's interests. In fact, Brazil's arguments have seemingly been designed to prevent the Panel from ascertaining even what is the amount of the subsidy being challenged. In such a circumstance, Brazil has not

[33] Brazil's Data Comments, para. 103.

[34] *See, e.g.*, WT/DS76/AB/R, para. 123 ("In this dispute, the United States claimed that the varietal testing requirement is more trade restrictive than required to achieve Japan's appropriate level of protection and is, therefore, inconsistent with Article 5.6."); Panel Report, *Japan – Agricultural Products*, WT/DS76/R, paras. 1.2, 4.178, 8.64.

[35] WT/DS76/AB/R, para. 124 ("As noted above, the United States argued that 'testing by product' is an alternative measure which meets the three cumulative elements under Article 5.6."); *id.*, para. 125 ("We note that the Panel explicitly stated that the United States, as complaining party, did *not specifically argue* that the 'determination of sorption levels' met any of the three elements under Article 5.6".).

[36] WT/DS76/AB/R, para. 130.

[37] *See* US Answer to Question 256 from the Panel, paras. 183-86 (22 December 2003).

[38] WT/DS76/AB/R, para. 129 (italics added).

established a *prima facie* case of inconsistency with Articles 5 and 6 of the Subsidies Agreement with respect to these payments, and the Panel cannot make findings of serious prejudice.

## IV. Brazil's Invented Methodology Has No Basis in the WTO Agreements and Represents an Effort to Maximize the Payments Allocated to Upland Cotton

35. The foregoing analysis suffices to demonstrate that Brazil has not made a *prima facie* case under its serious prejudice claims with respect to decoupled income support measures. Simply put, based on the evidence and arguments brought forward by Brazil, the Panel cannot make findings on those measures under Articles 5 and 6 of the Subsidies Agreement (as well as GATT 1994 Article XVI) without making Brazil's case for it. In this section of these comments, we nonetheless examine Brazil's application of its invented methodology to the US-supplied data.

36. The United States has previously explained, both in these comments and in its comments to Brazil's answer to Question 258, that the Brazilian allocation methodology has no basis in the text or context of the WTO agreements.[39] We do not repeat that detailed critique of Brazil's invented methodology here, other than to note that Brazil seeks to *apply* an allocation methodology for purposes of Peace Clause – despite the fact that the definitions of product-specific support and non-product-specific support (and their application in the Agreement on Agriculture) do not permit any such allocation – while at the same time Brazil seeks to *deny* any allocation methodology for purposes of serious prejudice – despite the fact that an allocation methodology is set forth explicitly in Annex IV reflecting core Subsidies Agreement concepts relating to subsidy benefits and the subsidized product. Thus, Brazil invites the Panel to adopt a legally erroneous approach that does violence to the existing texts of the Agreement on Agriculture and the Subsidies Agreement.

37. We have also previously explained that Brazil's invented allocation methodology does not make economic sense. Decoupled payments by their nature provide income support not tied to the production or sale of any given commodity[40], therefore, there is no more reason to attribute $1 in income support to upland cotton production on a farm than there is to attribute that $1 in income support to production of any other product (soybeans, corn, etc.). Brazil's approach, however, makes just such an arbitrary attribution, producing illogical results:

> The same crop (for example, upland cotton) produced on a farm could be deemed to be subsidized at different rates. For example, planted acres of upland cotton up to the amount of upland cotton base acres will be deemed to be subsidized at a rate corresponding to decoupled payments for upland cotton base acres. Planted acres of upland cotton in excess of the amount of upland cotton base acres will be deemed to be subsidized at a different rate – perhaps higher if sufficient payments corresponding to base acres for other crops are available, perhaps lower or even zero if few or no payments for "excess" base acres are available. From an economic perspective, there is no basis to say that some income support dollars are going to a certain portion of the crop but not others.[41]
>
> In addition, because payments on all the "excess" base acreage are allocated to whatever programme crop has planted acres in excess of base acreage, the subsidization of the "excess" planted acreage can be far higher than for other acres of that crop or for acreage of other crops that may be more heavily planted. (For example, if a farm has 100 base acres of soy, 10 planted acres of soy, and 1 planted

[39] *See, e.g.*, US Comments to Brazil's Answer to Question 258 from the Panel, paras. 207-29 (28 January 2004).

[40] *See, e.g.*, Brazil's First Written Submission, para. 51 (under direct payment program, the "amount of payment is not dependent upon current production" of any particular commodity).

[41] *See* US Comment on Brazil's Answer to Question 258, para. 221.

> acre of cotton, the 90 "excess" base acres of soy will be allocated to the 1 acre of cotton, resulting in a cotton subsidy and subsidization rate far higher than that for soy, despite the fact that soy plantings outstrip cotton plantings 10 to 1.)[42]
>
> Brazil's approach simply ignores the existence of crops other than "programme crops", much less other farming or non-farm economic activities the subsidy recipient may undertake. Again, there is no economic reason to attribute income support payments to some (programme) crops but not others and some (crop production) economic activities but not others.[43]

38. Fundamentally, Brazil's approach is in error because it assumes that there is a tie between the decoupled payments and current plantings. Brazil attributes payments for base acres to currently planted crops by describing the current crop as "planted on" base acres. The reality is that there are no physical "base acres" on a farm; crop base is an accounting concept that is limited by the farm's cropland. (For example, the farm may have 100 base acres of upland cotton, but if it currently plants 100 acres of cotton, that cotton may physically be "planted on" any land on the farm.) But Brazil does not carry through its own concept of crops "planted on" base acres.

> For example, in the example given above of a farm with 100 base acres of soy and current plantings of 10 acres of soy and 1 acre of cotton, under Brazil's approach, payments on the 90 "excess" base acres of soy are allocated to the 1 acre of upland cotton. But 1 acre of upland cotton could only be "planted on" 1 base acre of soy.
>
> Thus, for planted acreage *up to* the crop's base acreage, Brazil uses the concept of a crop "planted on" base acreage. But for planted acreage *beyond* the crop's base acreage, Brazil would allocate more than (or less than) one base acre per planted acre. In the preceding example, the one acre of upland cotton could not be deemed to be "planted on" 90 acres of soy.

Brazil's allocation methodology thus is not even internally consistent.

39. Given that Brazil's invention allocation methodology has no basis in the text or context of the Peace Clause, much less in the Subsidies Agreement or any other WTO agreement, given that its methodology does not make economic sense, and given that its methodology is internally inconsistent, one is left to wonder how Brazil arrived at its methodology. One answer may be that Brazil developed this methodology because it allows Brazil to allocate certain decoupled payments exclusively or nearly exclusively to upland cotton. That is, Brazil's invented allocation methodology can be described as an attempt to maximize the payments to be allocated to upland cotton, regardless of the legal or commonsense objections.

40. Consider the information set out in footnote 159 to paragraph 80 of Brazil's Data Comments. Brazil notes that "[f]or MY 1999 and 2000, *only upland cotton plantings exceeded the crop base acreage*; thus, *all additional payments were allocated to upland cotton* [italics added]. For MY 2001, also oats and sorghum were planted on more acreage than their respective contract base ('overplanted'); thus, triggering additional payments being allocated pursuant to the crop's share of the total acreage being 'overplanted'". Restated, in marketing year 2001, all "excess" contract payments were allocated to upland cotton, oats, and sorghum, but the latter two crops accounted for only a small share of plantings on farms that planted upland cotton.[44]

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[42] *See* US Comment on Brazil's Answer to Question 258, para. 221.

[43] *See* US Comment on Brazil's Answer to Question 258, para. 222.

[44] *See* US Letter to Panel (January 28, 2004) (file rPFCsum.xls: for farms planting upland cotton in MY2001 upland cotton planted acreage was 15.5 million acres, oats planted acreage was 0.19 million acres, and sorghum planted acreage was 2.4 million acres).

> Thus, for cotton plantings up to the amount of cotton base, Brazil would allocate payments on upland cotton base acres to cotton.
>
> For cotton plantings in excess of the amount of cotton base, Brazil's allocation methodology results in all "excess" contract payments for programme crops being allocated to upland cotton in marketing years 1999-2000 and almost all "excess" contract payments being allocated to upland cotton in marketing year 2001.

In this way, Brazil seeks to maximize the payments being allocated to upland cotton, regardless of the illogic of its approach. The Panel should reject Brazil's legally erroneous and economically unsound approach to allocation issues.

41. Brazil attempts to apply its unsound methodology to the summary data provided by the United States on 18 and 19 December 2003. (We note that Brazil did not request the summary data in Exhibit BRA-369. The United States generated this summary in order to assist the Panel and Brazil in viewing the aggregated results.) Brazil asserts that "Using the US aggregate base acreage data and aggregate planting data to allocate contract payments will most likely trigger distortions of the results due to the allocation problem".[45] However, we note that Brazil does not explain to the Panel that the results using the aggregated data will likely be biased upwards, overstating the decoupled payments allocated to upland cotton.

42. In Brazil's allocation methodology, a farm that plants less acreage of upland cotton than its cotton base acreage must always produce a drop in support because some payments on upland cotton base acres will not be allocated to cotton. A farm that plants more cotton acreage than its cotton base acreage, on the other hand, may still enjoy support for the "excess" planted acres but only if there are also "excess" non-upland cotton base acres on the farm. However, when all of the base acreage and planted acreage data are aggregated, Farm A's cotton planted acreage in excess of upland cotton base acres may effectively be allocated support from Farm B's "excess base acreage" in another programme crop (or more than one). Thus, while Brazil is correct that applying its methodology to the summary data will not necessarily produce the same results as a farm-by-farm calculation, Brazil fails to recognize that the results presented by Brazil in paragraph 83 of its data comments applying its invented allocation methodology to the summary data are biased upwards.

43. In sum, the United States has shown that Brazil's allocation methodology is not based on any WTO agreement text, does not make economic sense, and is not internally consistent. Based on the categorical US rejection of Brazil's methodology, the Panel should take Brazil's statement that "Brazil's methodology is rather conservative compared to an allocation based on the US summary data, *which the United States seems to endorse as a valid base for calculating support to upland cotton*"[46] as another gross distortion by Brazil. Unlike Brazil, the United States has taken a consistent position in this dispute that "support to a specific commodity" means "product-specific support" and that such support must be gauged by looking at the support "decided" by a Member through its measures.

## V. Brazil's Application of the Annex IV Methodology to the US Data Is Inadequate and Flawed

44. In this section, the United States examines Brazil's cursory application of the Annex IV methodology to the US-supplied data.[47] We note that Brazil's analysis is patently insufficient to carry Brazil's burden with respect to decoupled income support payments. First, Brazil has neither sought

[45] Brazil's Data Comments, para. 76.
[46] Brazil's Data Comments, para. 84 (italics added).
[47] *See* Brazil's Data Comments, § 10.

nor presented relevant data. Brazil requested data relevant only to its invented methodology, and there is no data before the Panel that would permit the Annex IV methodology to be applied. Brazil's complaint that the United States has "refuse[d] to provide" the information that would permit the Panel to calculate the payments under the US methodology[48] – while erroneous[49] – is also misplaced. It is not the United States' responsibility to make Brazil's *prima facie* case, and Brazil's argument reflects an impermissible effort to shift the burden onto the responding party.

45. Brazil has also not presented arguments sufficient to carry its burden. Brazil has repeatedly and expressly disavowed the applicability of the Annex IV methodology for purposes of identifying the subsidized product or quantifying the subsidy benefit for non-tied (decoupled) payments. Perhaps for that reason, the calculations presented by Brazil reflect a misunderstanding of the plain meaning of the Annex IV methodology and contain a number of erroneous assumptions that bias Brazil's results upwards.

46. Under the Annex IV methodology, a subsidy not tied to a particular product is allocated to all of the recipients' sales. That is, since money is fungible, the subsidy benefit is deemed to inure to all of the products the recipient produces; a neutral way of attributing the subsidy to particular products is according to their proportion of the firm's sales. Thus, allocating to upland cotton those Production Flexibility Contract (PFC) payments, Market Loss Assistance (MLA) payments, Direct Payments (DP) and Counter-Cyclical Payments (CCP) for upland cotton base acres would be done as follows:

> PFC payments for upland cotton base * (cotton gross sales/total sales)
> MLA payments for upland cotton base * (cotton gross sales/total sales)
> DP payments for upland cotton base * (cotton gross sales/total sales)
> CCP payments for upland cotton base * (cotton gross sales/total sales)[50]

The "total value of the recipient firm's sales" (Annex IV, para. 2) would include all economic activities by the firm (e.g., other farm and non-farm related activities). Thus, Brazil errs in limiting the denominator in its calculations to the estimated value of crops produced by the payment recipients.[51] Further, Brazil has presented no evidence relating to the total value of the recipient firm's sales that would permit the Annex IV methodology to be applied.

47. In its calculated apportionment, Brazil makes several errors that result in an overestimate of the payment value allocated to cotton. First, Brazil allocates decoupled payments for all crop base (e.g., wheat PFC payments, corn MLA payments) to upland cotton. As the United States has explained[52], Brazil impermissibly seeks to bring within the scope of this dispute payments that Brazil did not identify and that have not been at issue throughout this dispute.

48. In this regard, Brazil's argument that these programmes are within the Panel's terms of reference by virtue of the reference in Brazil's panel request to "payments . . . providing direct or indirect support to the US upland cotton industry"[53] is not sustainable. Article 6.2 of the DSU requires that the panel request "identify the specific measures at issue". Brazil's statement fails to meet this requirement; indeed, Brazil affirmatively emphasizes that its list of payments is

[48] Brazil's Data Comments, para. 87.

[49] For example, the United States has collected no information on "the recipient firm's sales" for marketing years 1999-2002.

[50] Arguably, one could include all economic activities by the firm (e.g., other farm and non-farm related activities.)

[51] Brazil's Data Comments, paras. 85-98.

[52] *See* US Comment on Brazil's Answer to Question 204 from the Panel, paras. 34-42 (28 January 2004).

[53] Para. 18.

"unqualified", and that it "is more than broad enough to encompass any type of payment".[54] In other words, Brazil by its own admission has provided virtually no information that would allow identification of the specific measures at issue.

49. Moreover, to the extent that Brazil in any way qualifies this list, it does so based on *legal* conclusions. Rather than identifying the payment measures by describing their characteristics or by citing any specific provision of US law[55], Brazil seeks to draw into the scope of this dispute an uncircumscribed and unidentified list of measures limited only by whether the *legal* conclusion may be drawn that the measure provides "direct or indirect support to the US upland cotton industry". Brazil might just as well have stated that it was challenging, "any US law that is inconsistent with US WTO obligations." In neither case would the description allow an identification of which measure is subject to the case, and in neither case would it be possible to determine whether a measure is within the scope of the case until the legal issues in the dispute are fully adjudicated. Indeed, the Appellate Body has criticized a panel for blurring the distinction between legal claims and measures when it read the term "measures" as synonymous with alleged violations, and thereby failed to require identification of the specific measure at issue.[56]

50. The DSU requirement to allow identification of the measures at issue is not a hollow one, and panels have not hesitated to conclude that measures fall outside the scope of a dispute because they are not adequately described.[57] Brazil's "unqualified" panel request does not bring non-cotton contract payments into the scope of this dispute.

51. While decoupled payments for upland cotton base account for the majority of decoupled income support payments to farms that planted cotton, including total decoupled payments in the allocation overstates the value of decoupled payments to be allocated.

| Decoupled payments: | 1999[1] | 2000[1] | 2001[1] | 2002 |
|---|---|---|---|---|
| Payments on cotton base | 515,280,580 | 482,302,565 | 387,870,741 | 1,520,701,136 |
| Total payments | 695,912,510 | 650,579,667 | 520,230,908 | 1,681,630,034 |
| Cotton as per cent of total | 74.0% | 74.1% | 74.6% | 90.4% |

1 Does not include Market Loss Assistance payments.

Source: Exhibit Bra-424; also provided electronically as "allocation calculations.xls"

52. Second, in calculating crop values for purposes of the total value of the recipient firm's sales[58], Brazil calculates crop values based on planted, not harvested, acreage. For cotton, abandonment rates can be significant. In the US response to Question 209 from the Panel, the United States demonstrated that harvested acreage differed significantly from planted acreage over the

[54] Para. 19.

[55] Brazil's reference to payment programs provided under the 2002 FSRI Act, the 1996 FAIR Act, and the 1998 -2001 Appropriations Acts in no way provides the required specificity. These laws provided for a myriad of payment programmes, and it is impossible through these references to determine the payment programmes Brazil now seeks to include within the dispute.

[56] Report of the Appellate Body, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted 25 November 1998, para. 69.

[57] *See, e.g.*, Preliminary Ruling by the Panel, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain*, WT/DS276/12, circulated 21 July 2003, paras. 28, 32.

[58] *See* Subsidies Agreement, Annex IV, para. 2.

period 1999-2002. The use of the smaller harvested acreage figure would lower the total value of cotton by as much as 16 per cent from what Brazil calculated.[59]

**Planted and Harvested Upland Cotton Acres** (1,000 acres)

| Crop year | Planted acres | Harvested acres | Abandoned acres | Rate of abandonment |
|---|---|---|---|---|
| 1999 | 14,584 | 13,138 | 1,446 | 9.9% |
| 2000 | 15,347 | 12,884 | 2,463 | 16.0% |
| 2001 | 15,499 | 13,560 | 1,939 | 12.5% |
| 2002 | 13,714 | 12,184 | 1,530 | 11.2% |

Source: USDA, National Agricultural Statistics Service, *Acreage*, various issues.

53. Third, Brazil underestimates the value of crop sales on cotton farms. To calculate the value of programme crops, Brazil multiplies acres planted to that crop (as provided electronically by the United States on December 18 and 19) times average crop yield times average farm price. For cropland not planted to programme crops, Brazil "assumed that the value of the crops produced on this 20 per cent of farmland is the average per-acre value of production of non-programme crops in that marketing year in the entire United States, as reported by USDA"[60]. Brazil has claimed repeatedly that upland cotton production is "concentrated" in several US States[61], but now that the issue matters, Brazil ignores its long-standing position. Under Brazil's approach to the Annex IV methodology, it is the per-acre value of production in cotton-producing states that would be relevant (rather than including, say, the per acre value of production of crops grown in Alaska in its average).

54. To calculate the average per-acre value of non-programme crops, moreover, Brazil also excludes the value of all fruits, tree crops, vegetables and melons, arguing that their exclusion is justified on the basis that, if fruits or vegetables are grown, "contract payments are eliminated".[62] However, this argument ignores the fact that producers may grow such crops on any cropland on the farm in excess of the farm's base acreage without any effect on payments.[63] As previously noted by Brazil, non-programme base accounts for 20 per cent of total cropland on farms that planted cotton over the period or about 6 million acres. Ignoring fruits and vegetables thus underestimates the value of non-programme crops and, as a consequence, overestimates the per cent of total crop value accounted for by cotton.[64]

55. Fifth, as Brazil concedes,[65] in estimating the total value of crop sales, Brazil excluded sales of (high value) livestock and livestock products. We would also note that Brazil excluded any other farm-related income. Brazil has put no data on the record that would allow for these sales to be included in the Annex IV allocation.

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[59] Brazil inadvertently uses the all cotton crop yield in their calculations rather than the yield for upland cotton only.

[60] Brazil's Data Comments, para. 90.

[61] *See, e.g.*, Brazil's Answer to Question 125(2)(a) from the Panel, para. 13 (27 October 2003).

[62] *See* Brazil's Data Comments, paras. 73, 92.

[63] *See, e.g.*, Brazil's First Written Submission, para. 45 (PFC payments are reduced or eliminated if fruits or vegetables are grown "on 'base acreage'" but not on total cropland).

[64] Brazil also appears to have inadvertently copied the incorrect acreage numbers for cotton planted on farms with no cotton base for 2000 and 2001. (The 1999 figure was copied to 2000 and 2001. From the spreadsheet "Raw Data 1999-2001" the correct numbers are:

1999 1,033,617.7
2000 1,222,180.1
2001 1,347,140.2

[65] Brazil's Data Comments, fn. 173.

56. Finally, Brazil fails to make any adjustment in the amount of payment to reflect the proportion of cotton planted acreage that is rented or owned.[66] However, those "subsidies" to cotton producers that are the subject of Brazil's panel request must "benefit" producers.[67] Brazil itself has conceded that land rental rates as of marketing year 1997 – that is, one year after introduction of the decoupled production flexibility contract payments – reflect the capture of more than one-third of the subsidy by landowners.[68] Thus, only those cotton producers who are also landowners of base acreage for which decoupled payments are made would benefit from those payments.[69]

57. The cumulative effect of these omissions and erroneous assumptions is to bias upwards Brazil's allocation of decoupled payments to upland cotton. In the following table, we have recalculated an estimated value of cotton production compared to the value of all crops produced on farms using corrected values for harvested acres, upland cotton yields, and per-acre value of non-programme crops.[70] Because Brazil has not put relevant data on the record, we have not been able to correct its calculations by including the value of all economic activities by the firm, for example, livestock and livestock products, other farm-related activities, and non-farm economic activities in the denominator. However, even without those necessary adjustments, the incomplete (undervalued) data show that cotton accounted for only about half of the total value of crop production on recipient farms planting upland cotton over the period.

**Value of Upland Cotton as Per cent of All Crops on Farms Planting Upland Cotton**

| | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| Upland cotton | $3,056,169,795 | $3,707,427,799 | $2,554,264,280 | $3,351,712,385 |
| All crops | $5,940,836,757 | $6,543,259,828 | $5,277,060,069 | $6,280,154,911 |
| Per cent | 51.4% | 56.7% | 48.4% | 53.4% |

58. In the table that follows, we present recalculated figures for decoupled payments on upland cotton base using the corrected value of upland cotton sales and per-acre value for non-programme crops in calculating the total value of crop sales to use in the denominator of the formula: decoupled payments received by recipient firms * (upland cotton gross sales / total crop sales). Again, contrary to Annex IV, paragraph 2, this calculation does not include in the denominator the value of *all* economic activities by the recipient firms. Nor have we adjusted the value of the decoupled payments for upland cotton base acres downwards to reflect the fact that two-thirds of cotton acreage is rented, not owned, and that landowners will capture the benefit of those payments for base acres on farms worked by tenants.

[66] *See* US Answer to Question 195 from the Panel, paras. 6-11 (22 December 2003).

[67] *See* Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, adopted 7 June 2000, paras. 6.65 and 6.66 (quoting and agreeing with *Canada – Aircraft* panel: "'A "benefit" does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a "benefit" can be said to arise only if a person . . . has in fact received something.'").

[68] *See, e.g.*, Brazil's Further Rebuttal Submission, para. 154 ("[S]ome portion of the contract payments do find their way into increased rent and cost of land") (footnote omitted).

[69] Indeed, the 2002 Act implicitly recognized that decoupled income support payments ultimately benefit landowners by giving to the landowner the authority to choose whether to update his or her base acres on the farm. *See* 2002 Act, § 1101(a)(1) ("For the purpose of making direct payments and counter-cyclical payments with respect to a farm, the Secretary shall give an owner of the farm an opportunity to elect 1 of the following as the method by which the base acres of all covered commodities on the farm are to be determined."); *see also id.*, § 1101(b), 1101(c), 1101(e)(1), (3), (5) (Exhibit US-1).

[70] Further calculations are presented in Exhibit US-154..

59. Nonetheless, the table shows that the "14/16" methodology proposed by Brazil, as well as the estimates purporting to apply the Annex IV methodology provided in section 10 of Brazil's data comments (reproduced below), are grossly inflated.

**Partially Corrected Results of Calculations Allocating Decoupled Payments for Upland Cotton Base Acres to Upland Cotton Using Incomplete Annex IV Methodology**

| | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | 265,077,970 | 273,273,870 | 187,741,729 | na |
| MLA Payments | 263,787,006 | 290,909,042 | 259,309,589 | na |
| DP Payments | na | na | na | 253,021,210 |
| CCP Payments | na | na | na | 558,575,463 |
| Total | 528,864,975 | 564,182,912 | 447,051,318 | 811,596,673 |

**Brazil's Erroneous Calculations Allocating Decoupled Payments for all Contract Base to Upland Cotton Using Incomplete Annex IV Methodology** (Brazil's Data Comments, para. 96.)

| | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | $477,692,236 | $473,744,959 | $333,295,919 | na |
| MLA Payments | $475,365,813 | $504,317,125 | $460,349,591 | na |
| DP Payments | na | na | na | $416,216,862 |
| CCP Payments | na | na | na | $714,424,543 |
| Total | $953,058,049 | $978,062,084 | $793,645,510 | $1,130,641,406 |
| **Minimum Per cent Overstated** | **80.2** | **73.4** | **77.5** | **39.3** |

**Brazil's Allocation of Decoupled Payments for all Contract Base to Upland Cotton Using Its Erroneous 14/16 Methodology** (Brazil's Data Comments, para. 97)

| | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | $547,800,000 | $541,300,000 | $453,000,000 | na |
| MLA Payments | $545,100,000 | $576,200,000 | $625,700,000 | na |
| DP Payments | na | na | na | $454,500,000 |
| CCP Payments | na | na | na | $935,600,000 |
| Total | $1,092,900,000 | $1,117,500,000 | $1,078,700,000 | $1,390,100,000 |
| **Minimum Per cent Overstated** | **106.7** | **98.1** | **141.3** | **71.3** |

That is, when the results of Brazil's calculations are compared to the results obtained by the United States correcting for certain but not all of Brazil's errors and omissions, it appears that *Brazil dramatically overstates the decoupled payments that would be allocated to upland cotton* by 39.3 to 80.2 per cent for its incomplete Annex IV calculations and by 71.3 to 141.3 per cent for its erroneous 14/16 calculations.

60. Had Brazil put other data on the record necessary to apply the Annex IV methodology, for example, the value of any livestock and livestock products, other farm-related activities, and non-farm economic activities of recipient firms, moreover, *the decoupled payments allocated to upland cotton would be reduced even further*. Had Brazil further adjusted the value of the decoupled payments for upland cotton base acres downwards to reflect the capture of two-thirds of the benefit of those payments by landowners who are not cotton producers, *the decoupled payments allocated to upland cotton would be reduced even further*. Rather than confront the fact that the Annex IV methodology and Subsidies Agreement concepts would dramatically reduce the value of decoupled payments deemed to benefit upland cotton (and hence, would dramatically reduce the supposed "$12.9 billion" in support provided to upland cotton between marketing years 1999-2002), Brazil chose to argue that *no* allocation of non-tied payments is necessary and that *no* quantification of the subsidy benefit to upland cotton is necessary. Brazil also chose *not* to seek or put on the record information relevant to this determination. Thus, as explained earlier, Brazil has deliberately chosen a course of action that results in its failure to make a *prima facie* case on its serious prejudice claims with respect to decoupled payments.

## VI. Brazil Misrepresents Both the Scope of Its Own Requests for Data as well as the US Response

61. Finally, in this portion of its comments, the United States responds to inaccurate assertions by Brazil relating to what information it sought and what information the United States provided. The United States also responds to Brazil's arguments that certain "adverse inferences" should be drawn from its inaccurate portrayal of what was requested and provided. The United States notes that these issues are of relatively minor importance given that Brazil's allocation methodology, for which it sought farm-by-farm planted and base acreage data:

> (1) may not be applied for purposes of determining the product-specific support to upland cotton for purposes of the Peace Clause analysis because the methodology inappropriately conflates product-specific and non-product-specific support and

(2) may not be applied for purposes of determining the subsidized product or the subsidy benefit for decoupled income support payments because that methodology has no basis in the WTO agreements and Brazil expressly disavows its use for purposes of its serious prejudice claims.

Nonetheless, we undertake this review of Brazil's assertions because Brazil grossly distorts the record of the dispute in an effort to make the United States appear uncooperative (at best). The truth is that the United States has expended an unprecedented amount of time and resources in responding to the fullest extent under US law to the requests for information made of it. Given our experience in WTO dispute settlement to date, we question whether other Members would have responded so fully and promptly to similarly burdensome requests.

### A. Brazil Grossly Distorts the Record of This Dispute by Suggesting that the United States Has Failed to Cooperate

62. Brazil make a number of spurious accusations regarding US participation in this dispute and simple misstatements of the record. Although we regret the imposition on the Panel's time and attention, we do feel it necessary to set the record straight.

63. Brazil First Asked for this Data in December 2003, Not November 2002: First, Brazil asserts that it "first requested this information in November 2002".[71] "This information" refers to the request for information "set out in Exhibit BRA-369" for "contract acreage and planted acreage for each farm producing upland cotton".[72] Brazil's claim is false. There is no request in Exhibit BRA-101 (Brazil's consultation questions) for "contract acreage and planted acreage for each farm producing upland cotton". Further, there is no reference in Brazil's consultation questions to decoupled income support payments for non-upland cotton base acres. For example, Consultation Question 3.6 (not referenced by Brazil in footnote 2 of its data comments) was expressly directed at payments made "in connection with upland cotton for each of the marketing years 1992 through 2002". When the United States answered those questions by referring (where appropriate) to payments made with respect to upland cotton base acres, Brazil at no point asserted that it sought information with respect to "other crop contract payments".

64. Brazil Misrepresents the Panel's Request for Information: Second, Brazil asserts that the "Panel requested [this data] in August, October, and December 2003, as well as in January 2004." The Panel well knows what it has requested, but the United States notes that the Panel's questions too did not request contract and planted acreage information. Question 67 *bis* in August 2003 requested information about annual amounts granted to upland cotton producers per pound and in total expenditures under each of the decoupled payment programmes, not information on planted or base acreage. As previously explained, the United States accurately answered that it does not maintain information on expenditures to upland cotton producers because the United States collects no farm-specific production (harvesting) data.[73] Question 125(9) in October 2003 requested, *inter alia*, information on any adjustments to make for decoupled payments for upland cotton base acreage, not for information on planted and base acreage. In its 8 December 2003, communication, the Panel did not request planted and base acreage information from the United States; rather, it stated that "the United States will be given until **18 December** to respond to *Brazil's request* made in Exhibit BRA-369".[74] Finally, the 12 January 2004, communication from the Panel *did* request the planted

[71] Brazil's Data Comments, para. 4 (footnote referencing BRA-101 omitted).
[72] Brazil's Data Comments, para. 3.
[73] *See, e.g.*, US Answer to Question 195 from the Panel, paras. 6-11 (22 December 2003).
[74] The United States notes but does not understand the reference in fn.3 to paragraph 4 of Brazil's data comments to the "second bulleted point" in the Panel's December 8 communication; that bullet point referred to "a communication from the Panel concerning the FAPRI model".

acreage and base acreage information as set out in Exhibit BRA-369, and the United States explained that it was not able to provide this information farm-by-farm under the US Privacy Act. Thus, Brazil misrepresents the facts when it asserts that the Panel has requested "this data" four times.

65. Brazil Falsely Alleges that the United States Denied Having Certain Data: Brazil then accuses the United States of "falsely stat[ing] that it did not maintain contract and planted acreage information for each farm".[75] As just explained, the United States did not "falsely state" that it did not maintain that information because it was not asked for that information until the Panel on 8 December 2003, invited it to respond to Brazil's request made in Exhibit BRA-369. In its 18 and 19 December 2003, replies to that request, the United States explained that under US law it could not provide (as Brazil specifically requested and insisted upon) planted acreage information together with base acreage and yield information and FSA farm numbers.

66. We also recall, as explained in the US comments on Brazil's answers[76], that it was the United States itself at the second session of the first panel meeting (that is, before "late November 2003" and the presentation of Exhibit BRA-369 at the second panel meeting) that brought to the Panel's and Brazil's attention the acreage reporting requirement that was introduced by Section 1105 of the 2002 Act (7 USC 7915). We trust that the fact that the United States *offered* this information to Brazil and the Panel will lay to rest the unwarranted suggestion that the United States sought to obscure it instead.

67. contract base acreage and yield information. The focus of the Panel's question 67 *bis* and Brazil's argumentation has naturally been on the amount of decoupled income support payments to upland cotton producers. The United States has explained that it does not track decoupled payments by recipients' production and thus does not maintain information on the payments made for upland cotton base acres (or any other base acres) to upland cotton *producers*. The farm-by-farm planted acreage and base acreage and yield data sought by Brazil in Exhibit BRA-369 and by the Panel in its request of 12 January 2004, does not provide information on the payments made to upland cotton *producers*. Rather, putting aside issues of the appropriate methodology to identify the amount of the subsidy, this planted and base information would allow the calculation of the amount of decoupled payments made to farms that reported *planting* upland cotton.

68. Brazil Incorrectly Accuses the United States of Refusing to Provide Data on Non-Upland Cotton Base: Brazil also argues that the United States "refused to provide" farm-specific data on the amount of other contract base acreage on farms producing upland cotton with no upland cotton base acreage.[77] The omission of non-upland cotton base acreage from the data submitted by the United States in December 2003 was inadvertent and the result of programming errors, as explained in the US letter of 28 January 2004 transmitting revised data files. Thus, Brazil's extensive protestations that the United States "withheld that information" are misplaced.

69. We do note, however, that the United States continues to believe that such decoupled payments for non-upland cotton base acreage are not within the Panel's terms of reference and that Brazil's effort to include these payments at the end of this proceeding would deprive the United States of fundamental rights of due process.[78] That such payments for non-upland cotton base acreage was not even considered by Brazil earlier in this proceeding is nowhere more clear than in Brazil's own words:

[75] Brazil's Data Comments, para. 4.
[76] US Comment on Brazil's Answer to Question 196 from the Panel, paras. 15-18 (28 January 2004).
[77] Brazil's Data Comments, para. 17.
[78] *See* US Comments on Brazil's Answer to Question 204 from the Panel, paras. 34-42 (28 January 2004).

> "Brazil requested the United States during the Annex V procedure to provide information on the total amount of *upland cotton base acreage and yield* under the CCP (and DP) program."[79]

Indeed, the accuracy of Brazil's own description of its questions is amply supported by the text of those questions relating to "Deficiency Payments/Production Flexibility Contract Payments/Direct Payments":[80]

> "Please state the number of US upland cotton farms updating their *upland cotton base acreage* for the purposes of calculating Direct Payments under the 2002 FSRI Act. Please also provide the percentage of all US farmers producing upland cotton that updated *their upland cotton base acreage*." (Question 3.1 (italics added))
>
> "Please state the annual amount of Deficiency Payments made by the US Government in connection with *upland cotton base* for each of the marketing years 1992 through 1996." (Question 3.4 (italics added))
>
> "Please state the annual amount of Production Flexibility Contract Payments made by the US Government in connection with *upland cotton base* for each of the marketing years 1996 through 2002." (Question 3.6 (italics added))
>
> "Please state the total amount of Direct Payments made by the US Government in connection with *upland cotton base* in marketing year 2002." (Question 3.7 (italics added))
>
> "Please state the amount of *upland cotton base acreage* and the *average upland cotton base yield* applicable on this acreage under the Deficiency Payment Program during each of the marketing years 1992 through 1996." (Question 3.8 (italics added))
>
> "Please state the amount of *upland cotton base acreage* and the *average upland cotton base yield* applicable on this acreage under the Production Flexibility Contract Payment Program." (Question 3.9 (italics added))· "Please state the amount of *upland cotton base acreage* and the *average upland cotton base yield* applicable on this acreage for the Direct Payment Program." (Question 3.10 (italics added))

Thus, Brazil's assertion that it has argued all along that decoupled payments for non-upland cotton base acres are challenged measures is flatly contradicted by its own questions set out above. Brazil sent these questions on 1 April 2003, a mere 14 days after the DSB established the panel to consider this matter. If Brazil had considered that payments for non-upland cotton base acreage were within the scope of this dispute, surely it would have requested information with respect to those payments as well. The sheer number of references to upland cotton base acreage and yields demonstrates Brazil's view, at the time of panel establishment, of the scope of the decoupled payments it challenged.[81]

70. Market Loss Assistance Data Was Not Requested But Was Provided: Brazil argues that the United States "has not provided the requested data for market loss assistance payments received by

[79] Brazil's First Written Submission, para. 68 (emphasis added). We note in passing that the DSB did not initiate the Annex V procedures and that Brazil's statement that it asked the United States questions "during the Annex V procedure" is therefore incorrect.

[80] *See* Exhibit BRA-49 (Brazil's questions for purposes of the Annex V procedure).

[81] The United States has previously set out further evidence that decoupled payments for non-upland cotton base acres are not within the Panel's terms of reference and that Brazil did not consider these payments to be measures within the Panel's terms of reference. *See* US Comments to Brazil's Answer to Question 204 from the Panel, paras. 32-42 (28 January 2004).

the farms listed for MY 1999-2001". Brazil's argument is confused. Exhibit BRA-369 requested planted acreage and base acreage (and yield) for marketing years 1999-2002, and the United States provided that, farm-by-farm. The base acreage did not differ for production flexibility contract payments and market loss assistance payments so there was no need to set out base data for market loss assistance payments separately.

71. It is ironic that Brazil would accuse the United States of failing to provide certain "data for market loss assistance payments" since Exhibit BRA-369 *did not even identify market loss assistance payments by name*. Instead, it defined "programme crop" as "any crop that was assigned base acreage and payment yields under the Production Flexibility Contract (MY 1999-2001). Brazil inserts a question mark for MLA payments in its table at paragraph 22 of its comments, arguing that "[t]he United States has not provided any specific information on market loss assistance payments," but again Brazil ignores its own data request. Nowhere in Exhibit BRA-369 did Brazil request actual *payment* amounts for any of the decoupled income support programmes, and in any event Brazil well knows that market loss assistance payments were calculated in the same proportion as the production flexibility contract payments.[82]

72. Soybeans Were Not Within Brazil's Data Request: Next, Brazil argues that "since market loss assistance payments were also made for soybean base (that otherwise was not eligible to receive PFC payments), this allocation methodology [based on PFC payments] may significantly underestimate the amount of market loss assistance payments that constitute support to upland cotton".[83] The existence of soybeans market loss assistance payments is simply irrelevant to the data Brazil requested from the United States. Exhibit BRA-369 requested planted acreage and base acreage (and yield) information for "programme crops." Soybeans, however, were not a programme crop (or "contract commodity") under the 1996 Act[84], and no soybean base acreage was assigned to farms before marketing year 2002. In fact, in the very statutes that provided sections that provided for payments designated as marketing loss assistance, there were separate provisions for payments for soybeans in marketing years 1999 and 2000; these payments were not designated as market loss assistance and were provided for current soybeans producers (and oilseed producers of all types).[85] Contrary to market loss assistance payments, soybeans producers received payments not based on the farm history, but their own production history (as explained in the 8 June 2000 rule), no matter where they planted the soybeans. Thus, no soybeans data was included in the US response to Exhibit BRA-369 because no soybeans data was requested. Indeed, Brazil later implicitly concedes that soybeans data could *not* have been included in its request since soybeans were not a programme crop.[86]

73. Peanuts Were Not Within Brazil's Data Request: Finally, Brazil argues that "the 19 December 2003 US data concerning MY 2002 does not contain any information regarding the amount of direct and counter-cyclical payments made on peanut base". Brazil asserts that "the missing data on peanut contract payments for MY 2002 would cause lower aggregate payments

[82] *See* Brazil's First Written Submission, para. 60 ("Between MY1998-2001, upland cotton producers thereby received an additional amount of money, which was calculated based on their respective share of total upland cotton base times the amount of budgetary outlays allocated for upland cotton.").

[83] Brazil's Data Comments, para. 20.

[84] *See* 1996 FAIR Act, § 102(5) (Exhibit BRA-28).

[85] The 1999 crop soybean program was provided for by a statute, PL 106-78, enacted 22 October 1999. In fact, the USDA's programme rules were not issued until 8 June 2000, at 65 FR 36550. The amount provided in that statute was $475 million for all oilseeds, not just soybeans. As for the 2000 crop, the soybean payments were allowed by PL 106-224, in the amount of $500 million for all oilseeds, with rules that did not issue until 65 F.R. 5709 in November 2000. The amount paid was amplified for the 2000 crop by the addition of monies, long after, in PL 107-25, enacted in August of 2001. It is worth noting that all of these payments occurred well after plantings, again contradicting the contention of Brazil that non-upland cotton payments cause farmers to plant cotton.

[86] *See* Brazil's Data Comments, para. 90 fn. 177 ("The lower figures for MY 1999-2001 are explained by the fact that soybeans were not a contract programme crop.").

allocated as support to upland cotton".[87] Again, Brazil makes assertions that do not follow from its own data request. The marketing year 2002 data contains no peanut information because no farm had peanut base in marketing year 2002; it follows that there were no payments made on any farm base. No peanut base existed for farms in marketing year 2002 because decoupled payments for peanut base acreage was brand new, and the base was not assigned by Section 1302 of the Farm Bill to a farm but to "historical peanuts producers". The statute did not require an assignment of the base acreage to a farm until the 2003 crop. In fact, the United States expressly noted in Exhibits US-111 (describing contents of farm-by-farm DCP base and yield file) and US-112 (describing contents of farm-by-farm DCP planted acres file) that "[p]eanut figures were not run as peanut bases were not farm-specific in 2002". Thus, the United States could not have provided farm-specific planted acreage and base acreage information with respect to peanuts because there was no peanuts base acreage for farms in marketing year 2002. Again, Brazil's complaints are without merit.

74. Conclusion: Brazil's Accusations Are Spurious and Complicate the Panel's Task Needlessly: In conclusion, the United States notes that not only has Brazil sought to put the United States in a difficult position through its overbroad data request and unreasonable approach to privacy issues under US law, but the lack of clarity in Brazil's approach has added considerable confusion to this proceeding. For example, Brazil at one and the same time faults the United States for not providing the farm-specific information as requested in Exhibit BRA-369 but then also faults it for not producing the information using "a substitute number protecting the alleged confidentiality rights of farmers."[88] Despite refusing to consider any deviation from BRA-369 at the second panel meeting, Brazil now asserts that the United States should have noticed a newfound flexibility in a passing reference within a Brazilian answer and on that basis produced an entirely new set of data. It was entirely reasonable for the United States to consider Exhibit BRA-369 as Brazil's request since Brazil's refusal to consider alternatives compelled the United States to make tremendous efforts to produce that requested information while simultaneously preparing answers to more than 50 panel questions and comments on Brazil's econometric evidence. (Further, as the United States explained in its 20 January 2004, letter to the Panel, the sheer number of fields involved in Brazil's request would make possible identification of specific farms based on a unique combination of planted and base acreage, even with substitute farm numbers.)

75. As another example, Brazil's request was so broad that (as set out above) Brazil itself appears not to have understood the precise scope of the information it requested. This continual overbroad argumentation wastes the time and resources of the United States and the Panel that would be better spent on issues actually pertinent to this dispute. In addition, Brazil faults the United States for "misunderstanding [] Brazil's allocation methodology," when that methodology was not set out until Brazil filed its answer to Question 258 on 20 January 2004 – that is, more than one month after the United States provided the data requested in Exhibit BRA-369 (to the extent permissible under US law) and more than eight months into this proceeding. In this regard, Brazil's litigation tactics have impacted the ability of the United States to address Brazil's claims, arguments, and evidence and have complicated this Panel's task immensely and needlessly.[89]

[87] Brazil's Data Comments, para. 21.

[88] *See* Brazil's Data Comments, paras. 38-39 (referencing Brazil's December 22 Answers to Questions, para. 7).

[89] Indeed, the United States has cooperated in good faith in this dispute and expended extraordinary resources to do so, but Brazil put the United States in the position of violating US law or providing requested data. Brazil now seeks to have the Panel draw adverse inferences when its own request for information was over-broad in that Brazil could simply have asked the United States to apply its methodology (which, as of 3 December 2003, it had not yet disclosed, and would not until forced to do so by the Panel on 20 January 2004). The Panel should consider that it was Brazil at the second panel meeting that refused to cooperate and consider alternative means to request information that could have protected US farmers' privacy interests. If there is an "adverse inference" to be drawn, it may be that Brazil withheld its methodology until the end of the proceeding because it knew it could not withstand a full analysis and review and because Brazil

## B. US Law Prohibits Disclosing Planted Acreage Information Without the Prior Consent of the Farmer

76. The United States has explained in its letters dated 18 December 2003, 19 December 2003, and 20 January 2004, that under US law it may not disclose planting information in which a farmer has a privacy interest. This has been consistent US Department of Agriculture policy and is not contradicted by the *Washington Post* district court decision referenced by Brazil (which dealt with disclosure of payment information – similarly, the United States has provided contract data on a farm-by-farm basis). The United States also explains these matters in more detail in its answer to Questions 259(a), (b), and (c).

77. Brazil's views on how US law operates in the FOIA context are not relevant to the US Department of Agriculture's statutory responsibility to respect the privacy interests of US farmers in the planted acreage data. However, Brazil's discussion of Washington Post v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996), does not support Brazil's arguments that the United States need not protect this data.

78. The US position on the privacy interests in plantings is not *post hoc* since, as we showed in the attachments to the US letter of 18 December 2003, the position on planted acres has been the same since at least 1997 – that is, after the Washington Post decision. Brazil neglects to mention that all that was at issue in the Washington Post case was crop *payments*, not farmer plantings. Hence, that case fit within the FOIA precept of disclosure of the activities of the government, which was what was of concern to the court. 943 F. Supp. at 33, 36. Plantings are quite a different matter, involving a farmer's activities, not that of the government. Moreover, such producer-supplied information, not government-generated, has long been recognized as having special privacy concerns. *See, e.g.*, 7 USC 1373 and 7 USC 1502. Thus, under specific provision of the 1938 Act and provisions of the Crop Insurance Act, the US government has long considered plantings separate matters not subject to disclosure. A similar outcome results from an analysis under the Privacy Act and to some degree the Trade Secrets Act.

79. Regarding the rice matter, Brazil argues that "USDA's FOIA representatives necessarily must have determined that because the request did not focus on an individual producer's farm, the interests of the public in understanding and evaluating the operation of the contract payment schemes outweighed any privacy interests". However, the rice matter involved one office, and that disclosure was contrary to clearly established national policy. We have explained fully what the problem was and what FSA policy is. The concerns here are much greater than in the Hill decision, moreover, because the privacy interests of 200,000 farmers are involved.

## C. There Is No Basis to Draw Any Inference, Much Less an "Adverse Inference"

80. Brazil has asked the Panel to draw certain adverse inferences from the alleged failure of the United States to cooperate fully and provide requested data. As noted in the US letter of 20 January and explained above, the United States did not have the authority to provide the farm-specific planting information in the format requested by the Panel's 12 January 2004. However, the United States did provide both farm-specific and aggregated contract data that would permit the Panel and Brazil to assess the total expenditures of decoupled payments to farms planting upland cotton.[90] Brazil itself admits that "the data provided by the United States appears to be complete" with respect to both

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sought to distract from Brazil's failure to provide evidence and data necessary to support its arguments based on its methodology.

[90] The United States notes that it had no basis to provide any other aggregation of the data than that which it provided since it was not aware of Brazil's allocation methodology until Brazil filed its answer to Question 258 on 20 January 2004.

contract acres and planted acres[91] – therefore, the willingness of the United States to provide information within the limits set by US law cannot be questioned. Further, the Panel on 3 February requested certain additional aggregated information, which therefore does not implicate privacy interests of farmers and which the United States is endeavouring to provide.

81. The situation here is thus very different from the one in *Canada - Aircraft* where the Appellate Body first opined that "a panel should be willing expressly to remind parties – during the course of dispute settlement proceedings – that a refusal to provide information requested by the panel may lead to inferences[92] being drawn about the inculpatory character of the information withheld."[93] There is no basis for an "inference" of any kind, adverse or otherwise.

82. This is particularly so in this dispute as the farm-specific planted and base acreage information was sought for purposes of Brazil's allocation methodology, which is without any textual basis in the WTO agreements. For purposes of Peace Clause, Brazil's methodology is inapplicable because Brazil concedes that "support to a specific commodity" means "product-specific support" – and yet, Brazil's allocation methodology would contradict the meaning of product-specific support and non-product-specific support set out in the Agreement on Agriculture. Further, Brazil's methodology is inapplicable for purposes of its serious prejudice claims because Brazil argues that no allocation of decoupled payments or identification of subsidy benefits or the subsidized product is necessary under Part III of the Subsidies Agreement. Further, the only allocation methodology set out in the Subsidies Agreement is that of Annex IV, for which the farm-specific planted and base acreage information would be irrelevant. Thus, there is no need to draw an inference of any sort in this dispute.

83. Brazil's proposed "adverse influences" also do not follow logically from the data before the Panel. Brazil first suggests that farm-by-farm data would have resulted in payments higher than Brazil's 14/16 methodology. However, Brazil cannot escape the fact that it has not brought forward evidence and arguments to support findings under the Annex IV methodology.

84. Second, Brazil suggests that the Annex IV methodology would have produced higher payments than Brazil's 14/16 methodology. The United States is not in exclusive possession of relevant information with respect to an Annex IV methodology, but the incomplete data and calculations above demonstrate that in fact the Annex IV methodology would produce a far *lower* subsidy amount than Brazil's 14/16 methodology.

85. Third, Brazil suggests that "the information withheld" by the United States "would have been detrimental" to US arguments that decoupled payments are non-product-specific support. As set out previously, the farm-by-farm planted acreage data that the United States could not provide under US law is simply irrelevant to the issue whether decoupled payments are "product-specific support". Brazil appears to overreach, moreover, in suggesting that a "detrimental" inference be drawn since the *Canada – Aircraft* report found that the inferences to be drawn were not punitive but factual in nature.

[91] Brazil's Data Comments, para. 27 fn. 55.

[92] The United States notes that in the same report the Appellate Body was careful to distinguish "adverse" inferences from other "inferences", remarking that: "We note, preliminarily, that the 'adverse inference' that Brazil believes the Panel should have drawn is not appropriately regarded as a punitive inference in the sense of a 'punishment' or 'penalty' for Canada's withholding of information. It is merely an inference which in certain circumstances could be logically or reasonably derived by a panel from the facts before it." *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 200 ("*Canada – Aircraft*").

[93] *Canada – Aircraft*, WT/DS70/AB/R, para. 204.

## VII. Conclusion

86. Brazil has asserted that decoupled income support payments must be allocated to upland cotton only for purposes of the Peace Clause and not for purposes of its serious prejudice claims. However, Brazil's analysis is completely backwards: the text and context of the Peace Clause demonstrate that support is *not* to be allocated for purposes of the Peace Clause test while the text and context of Articles 5 and 6 of the Subsidies Agreement demonstrate that subsidies not tied to production of a given product (such as decoupled income support) *are* to be allocated to all of the products the recipient sells for purposes of serious prejudice claims.

87. The implication of Brazil's erroneous analysis and arguments, and in particular its express disavowal of any allocation methodology for purposes of its serious prejudice claims on decoupled income support payments, is that Brazil has failed to make a *prima facie* case on these claims. As a result, no findings may be made with respect to these measures, and these payments may not be included in an analysis of whether the effect of the challenged US subsidies has been serious prejudice to Brazil's interests

**List of Exhibits**

143 Memorandum from Larry Mitchell, USDA Farm Services Agency, to Various FSA Offices, Administrators, and Divisions on Release of Restricted Information under the Freedom of Information Act (18 September 1998)

144 USDA Farm Services Agency, Notice INFO-16: Releasing Lists of Names and Addresses in Response to Requests Under FOIA (1 December 1998)

145 Contents of 4 corrected data files submitted on 28 January 2004

146 USDA, Commodity Credit Corporation, 58 Federal Register 15755-15756 (24 March 1993).

147 Data in response to Panel Question 264(a): Exhibit US-128 on a Fiscal Year/ Cash Basis

148 Data in response to Panel Question 264(d): Claim Payments/ Recoveries/ Reschedulings on a Fiscal Year/ Cash Basis

149 United States Department of the Treasury Financial Manual I TFM 2-4600 (December 2003)

150 "Annual Review of Fees for USDA Credit Programs," 25 March 2003 and 8 April 2002.

151 United States Office of Management and Budget Circular No. A-129 (November 2000), Table of Contents, General Information, Appendix A, Sections I and II.

152 Commodity Credit Corporation Realized Losses and Appropriations to Restore Such Losses for Fiscal Years 1992-2003

153 Summary of Principal Terms, Conditions, and Duration of Each Rescheduling Reflected in Column F of Exhibit US-128

154 Partially Corrected Calculations Allocating Decoupled Payments for Upland Cotton Base Acres to Upland Cotton Using Incomplete Annex IV Methodology

# ANNEX I-20

## BRAZIL'S COMMENTS ON UNITED STATES 11 FEBRUARY 2004 ANSWERS TO ADDITIONAL QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL WITH THE PARTIES

18 February 2004

### Table of Cases Cited

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| *Japan – Apples* | Appellate Body Report, *Japan – Measures affecting the Importation of Apples*, WT/DS245/AB/R, adopted 10 December 2003. |

### List of Exhibits

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| Dresser Industries v United States, 596 F.2d 1231 (5th Cir. 1979) | Exhibit Bra-425 |
| Center for Auto Safety v National Highway Traffic Safety Administration, 244 F.3d 144 (DC Cir 2001) | Exhibit Bra-426 |
| CNA Financial Corporation v Donovan, 830 F.2d 1132 (DC Cir 1987) | Exhibit Bra-427 |
| United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989) | Exhibit Bra-428 |
| Metadure Croporation v United States, 490 F. Supp. 1368 (S.D.N.Y. 1990) | Exhibit Bra-429 |
| Campaign for Family Farms v Glickman, 200 F.3d 1180 (8th Cir. 2000) | Exhibit Bra-430 |
| Comparison of US and Brazil's Cash-Basis Accounting Methodologies for Purposes of the Item (j) Analysis | Exhibit Bra-431 |
| Congressional Budget Office, Fact Sheet, row titled "Export Credit Guarantee Programme, Subsidy Account" | Exhibit Bra-432 |

**259. With respect to the Privacy Act of 1974, 5 U.S.C. 552a:**

**(a) Whose interests are protected under section 552a(b) in light of the definition of "individual" in section 552a(a)(2)? Do all payment recipients, including corporations and organizations, have Privacy Act rights? If not, is the United States prevented by its domestic law from releasing such of the information requested on 12 January 2004 as relates to payment recipients without Privacy Act rights? Please explain with references to case law.**

**Brazil's Comment:**

1. In its 11 February 2004 response, the United States repeats its assertion that (many of) US upland cotton farms' planting reports are protected by the US Privacy Act and cannot be produced to the Panel and Brazil, even under confidentiality arrangements.[1] As explained below, the United States is wrong. But more fundamentally, as the United States has argued before other WTO panels, a WTO Member's domestic laws do not provide a basis for not complying with its obligation to cooperate in a WTO dispute settlement proceeding and to provide, if requested by a panel under DSU Article 13, any information – if necessary using special confidentiality procedures.[2] In sum, as Brazil established in its 28 January 2004 Comments and Requests Regarding US Data, there is no basis for the United States, citing confidentiality concerns, to withhold data from the Panel.[3]

2. The US 11 February 2004 response to this question confuses two fundamental questions. First, are there any Privacy Act rights of US upland cotton farms that would cover information about planted acreage that is gathered by the US government *via* mandatory or voluntary planting reports? And second, do these privacy rights prevail under the US Freedom of Information Act ("FIOA")) over the interest of the public in understanding the operations or activities of the US government. While the United States partly (yet falsely) addresses the first question, it ignores the second question.

3. The starting point for addressing these issues is the relationship of the Privacy Act and the FOIA. The Privacy Act, codified as 5 U.S.C. § 552a[4], protects "records maintained on individuals" by the US government, and prevents disclosure "to any person, or to another agency", with certain exceptions.[5] One of the exceptions listed reads: "unless disclosure would be … (2) required under section 552 of this title".[6] 5 U.S.C. § 552 is the place where the FOIA is codified. It follows that the prohibition of disclosure of information on individuals provided for by the Privacy Act is subject to the requirements of the FOIA.

4. Returning to the first step, the United States admits that corporations are not covered by the Privacy Act.[7] This is confirmed by the case law cited by the United States (*Dresser Industries v United States*).[8] Yet, neither this case law, nor any other reference provided by United States, supports the United States' distinction between "normal" corporations and "closely held corporations."[9] Even if "closely held corporations" were covered by the Privacy Act – an assertion

[1] US 11 February 2004 Answers to Additional Questions, paras. 1-5.
[2] *See* Brazil's 28 January 2004 Comments and Requests Regarding US Data, para. 55.
[3] *See* Section 5 of Brazil's 28 January 2004 Comments and Requests Regarding US Data.
[4] Exhibit US-107.
[5] Exhibit US-107 (5 U.S.C. § 552a(b)).
[6] Exhibit US-107 (5 U.S.C. § 552a(b)(2).
[7] US 11 February 2004 Answers to Additional Questions, para. 2.
[8] Exhibit Bra-425 (Dresser Industries v United States, 596 F.2d 1231 (5th Cir. 1979), p. 7 [**16]).
[9] US 11 February 2004 Answers to Additional Questions, para. 8. As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant

for which the United States does not offer any proof – they would have the same status as private individuals, which are discussed below in Brazil's comment on the US 11 February 2004 response to Question 259(b).

5. The United States further refers to the District of Columbia Court of Appeals decision in *Center for Auto Safety v National Highway Traffic Safety Administration*[10] for the proposition that information voluntarily submitted to the US government by corporations may not be released if that information would not customarily be released by the corporation to the public.[11] However, the United States misquotes this decision. In fact, the decision states that the information was

> exempt from disclosure because the information was voluntarily submitted *and constituted confidential commercial information that was not customarily disclosed*. The … information at issue had been disclosed in the past only when necessary, and always with a confidentiality agreement or protective order.[12]

Thus, the restriction only applies to confidential commercial information. While the United States asserts that "[t]his is the case with respect to plantings", the United States provides no evidence for this assertion.[13] The United States' assertion is simply wrong.

6. Planting information is always in the public domain – anyone can look at a field to determine to what crop it is planted. Most US farmland is connected by paved roads and is easily accessible to the public. Further, the Aerial Photography Field Office of USDA's Farm Services Agency exists to provide detailed aerial photographs of cropland.[14] The Office maintains aerial photographs of every square kilometre of cropland in the United States and updates the photographs on a regular basis.[15] Any person can order any aerial photograph by including a legal description of the area of interest in township, range, and section number or latitude and longitude coordinates.[16] The Aerial Photography Field Office indicated that scaled enlargements of photographs are made using specialized rectifying enlargers which maintains an accuracy greater than 99 per cent for most cropland in the United States.[17] The final rectified aerial photograph is, in effect, a photographic map accurately representing ground features. In fact, USDA's local FSA offices use the aerial photographs in verifying planting reports (FSA-578 forms) required under various US farm programmes.[18] No Privacy Act warnings are shown on the order form or on the web-site where these photographs can be purchased.

7. By its very nature, planting information cannot be confidential commercial information that could always be protected by confidentiality arrangements. In that sense, planting information is very

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must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[10] Exhibit Bra-426 (Center for Auto Safety v National Highway Traffic Safety Administration, 244 F.3d 144 (DC Cir 2001)).

[11] US 11 February 2004 Answers to Additional Questions, para. 3.

[12] Exhibit Bra-426 (Center for Auto Safety v National Highway Traffic Safety Administration, 244 F.3d 144 (DC Cir 2001), p. 4 [*147]) (emphasis added).

[13] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[14] The Web-page of the Office is found at http://www.apfo.usda.gov.

[15] *See* http://www.apfo.usda.gov.

[16] *See* http://www.apfo.usda.gov.

[17] *See* http://www.apfo.usda.gov.

[18] *See* Brazil's 18 November 2003 Further Rebuttal Submission, para. 36.

different from technical information about airbags used in cars, which was at issue in *Center for Auto Safety v National Highway Traffic Safety Administration*.[19]

8. This conclusion is supported by another appellate court decision in *CNA Financial Corporation v Donovan*, also cited by the United States.[20] Referring to the Trade Secrets Act, the court defined the scope of the exception in 5 U.S.C. § 552(b)(4) as only prohibiting the disclosure of commercial or financial information if disclosure "is likely to … cause substantial harm to the competitive position of the person from whom the information was obtained", requiring "both a showing of actual competition and a likelihood of substantial competitive harm".[21] The United States has made no such showing with respect to planting information on upland cotton farms. Furthermore, the court held that "[t]o the extent that any data requested under FOIA is in the public domain, a submitter is unable to make any claim of confidentiality – a *sine qua non* of [5 U.S.C. § 552(b)(4)]".[22] None of the information requested by the Panel poses a significant threat to "cause substantial harm to the competitive position of the person from whom the information was obtained", in particular because, as demonstrated above, the information is, in fact, by its very nature not information that can remain confidential, but is in the public domain, and, indeed, offered for sale by USDA.[23] It follows that (non-closely held) upland cotton farms cannot invoke the Trade Secrets Act to prevent disclosure of planting information.

9. Since the United States characterizes information submitted to the US Government under mandatory terms to be releasable (*i.e.*, MY 2002 planting information),[24] and MY 1999-2001 planting information is not protected under the above rebutted US theory, there is nothing in the Privacy Act that would prevent the United States from producing farm-specific planting information for corporate farms using farm serial numbers or "dummy" numbers. At best, there is some ambiguity in the US law that should be resolved by the United States in favour of releasing the information, as required by its obligations under the DSU.

10. Second, even for the "individuals" covered by the protection of the Privacy Act, there is no legal basis to preclude the release of planting information. As noted above, the protection of the Privacy Act is conditional on the FOIA disclosure rules, which necessitate a weighing process between the privacy interest of the group of individuals and the public interest in the operations of the US Government. Under the applicable case law, this weighing process would be resolved in favour of disclosing the information, as discussed in Brazil's comment on the US 11 February 2004 response to Question 259(b), below.

11. In sum, none of the US Privacy Act arguments holds up to scrutiny. And none is relevant in the first place, since the United States is under an obligation to provide – possibly subject to special confidentiality procedures – information requested by the Panel under DSU Article 13, even if that information is confidential.

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[19] Exhibit Bra-426 (Center for Auto Safety v National Highway Traffic Safety Administration, 244 F.3d 144 (DC Cir 2001), p. 3-4 [*146-*147]).

[20] Exhibit Bra-427 (CNA Financial Corporation v Donovan, 830 F.2d 1132 (DC Cir 1987)).

[21] Exhibit Bra-427 (CNA Financial Corporation v Donovan, 830 F.2d 1132 (DC Cir 1987), p. 23 [*1152]).

[22] Exhibit Bra-427 (CNA Financial Corporation v Donovan, 830 F.2d 1132 (DC Cir 1987), p. 25 [*1154]).

[23] The United States neither presents the legal provisions of the Trade Secrets Act nor explains any other pertinent information with respect to that Act. (*See* U.S. 11 February 2004 Answers to Additional Questions, para. 3.) Yet, as the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[24] US 11 February 2004 Answers to Additional Questions, para. 4.

**(b) The Panel notes that data concerning the four relevant programmes, in particular, payment amounts, identified by specific farms, is freely available on the internet. Please explain why that data can be disclosed but the requested planted acreage data cannot. Do individual recipients have Privacy Act rights with respect to their entrepreneurial activity? Please explain with references to case law.**

**Brazil's Comment:**

12. In its 11 February 2004 response, the United States asserts that "[i]nformation concerning planted acreage does not demonstrate anything regarding the government's operation – it only demonstrates what a producer is doing".[25] Brazil strongly disagrees. Information about plantings of farms receiving contract payments provides important information about the extent to which the US contract payments provide support to specific commodities. US taxpayers, as in the *Washington Post* case, have a strong public interest in knowing how their tax dollars are being spent. In particular, such information would shed light on the question of how much upland cotton is planted on upland cotton base acreage – information that is important for the US public to assess whether the United States is in compliance with its obligations under the Agreement on Agriculture. As the aggregate information provided by the United States suggests, in MY 2002, 96 per cent of US upland cotton plantings took place on upland cotton base.[26]

13. If follows that the US citation to a US Supreme Court decision in paragraph 7 of the US 11 February 2004 response misses the point. Since planting information is a vital component for assessing the "the government's operation", it has to be part of the balance between "the privacy interest of the individual with the 'core purpose' of FOIA".[27] And the US district court decision in *Washington Post v. United States Department of Agriculture* confirms that in cases, where "the information is so generic that the impact on privacy interests are so small"[28], the information has to be disclosed. This interpretation is, in fact, confirmed, rather then contradicted, by the US Supreme Court Decision in *United States Department of Justice v Reporters Committee For Freedom of the Press* ("Reporters Committee").[29]

14. The *Reporters Committee* decision concerns an individual person's FBI "rap sheet" that was requested under the FOIA. The Supreme Court rejected this request as outside the purpose of the FOIA, since it did not "contribut[e] significantly to the understanding *of the operation or activities of the government*" (emphasis in original).[30] By contrast, planting information of farms clearly contributes to the understanding of the operation of the US contract payments programmes. Providing this information would, thus, not only enhance the Panel's ability to make an objective assessment of the matter before it, but would also conform to "the basic purpose of the [FOIA,] to open agency action to the light of public scrutiny".[31]

[25] US 11 February 2004 Answers to Additional Questions, para. 8.
[26] *See* Brazil's 18 February Comments on US Comments, Annex A, para. 11.
[27] US 11 February 2004 Answers to Additional Questions, para. 7.
[28] Exhibit Bra-418 (Washington Post v United States Department of Agriculture, 943 Supp. 31 (D.D.C.) 1996, p. 3). *See* Brazil's 28 January Comments and Requests Regarding U.S. Data, paras. 31-34.
[29] Exhibit Bra-428 (United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989)).
[30] Exhibit Bra-428 (United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989), p. 15 [*775]).
[31] Exhibit Bra-428 (United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989), p. 15 [*774]).

15. The US Supreme Court decision in *Reporters Committee* states that "Congress exempted nine categories of documents from the FOIA's broad disclosure requirements".[32] These exemptions are codified at 5 U.S.C. § 552(b).[33] In this case, disclosure of the information is neither prevented by other laws (5 U.S.C. § 552(b)(3)), *i.e.*, the Trade Secrets Act (because the information does not constitute trade secrets as defined by US courts[34]), or the Privacy Act (which applies subject to the FOIA Act), nor by the separate exemption (5 U.S.C. § 552(b)(4) for trade secrets and commercial or financial information). Once again, since planting information could be collected from the public domain – or rather observed by any member of the public or, indeed, purchased from USDA – it cannot be deemed confidential. In fact, as the appeals court in *CNA Financial Corporation v Donovan* held, "[t]o the extent that any data requested under FOIA is in the public domain, a submitter is unable to make any claim of confidentiality – a *sine qua non* of [5 U.S.C. § 552(b)(4)]".[35]

16. Moreover, 5 U.S.C. § 552(b)(7)(C) exempts information "compiled for law enforcement purposes, but only to the extent that the production of such … information would … (C) … constitute an unwarranted invasion of personal privacy."[36] While acreage reports are partly mandatory to enforce the requirements of various US domestic support programmes[37], disclosure of planting information does not constitute an unwarranted invasion of personal privacy. In fact, the information could be gathered by simply checking the fields of a farm or by purchasing aerial photographs from the Aerial Photography Field Office of USDA's Farm Services Agency, as discussed above.[38] It is not difficult to determine the type of crop or the amount of acreage being planted to that crop from using high resolution colour aerial photographs. If a farmer growing crops can purchase from USDA high resolution and detailed aerial photographs of his next-door neighbour's farm to calculate that information, how can it be that this same farmer can claim a Privacy Act violation for his own planted acreage data? This evidence provides the common sense answer to the question whether acreage reports are, in fact, subject to the Privacy Act.

17. Thus, from the perspective of its "public domain" character, acreage information is even less confidential than payment information, which the district court in *Washington Post* decided must be released under FOIA.[39] Since acreage information sheds light on the performance of USDA and its adherence to the WTO obligations of the United States, any weighing of the limited privacy interests in planting information and the interest of the public in evaluating the work of USDA must be resolved in favour of the latter.

18. Finally, with respect to the "split of authority in US courts as to whether individuals have Privacy Rights with respect to their entrepreneurial activities"[40], it is clear that even if a privacy interest protected under the Privacy Act should exist with respect to the entrepreneurial activity in question, the FOIA takes precedence over that interest, as explained in Brazil's comment to the US 11 February 2004 response to Question 259(a), and in the *Washington Post* and *Reporters Committee* precedent. Concerning planted acreage information at issue between the parties, it is clear that the public interest in USDA's performance, including USDA adherence to the US obligations under the WTO Agreement, takes precedence over the privacy interests of US farmers in information that is potentially always in the public domain. Even assuming, *arguendo*, that there were some ambiguity

[32] Exhibit Bra-428 (United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989), p. 6 [*755]).
[33] Exhibit US-103.
[34] *See* above.
[35] Exhibit Bra-427 (CNA Financial Corporation v Donovan, 830 F.2d 1132, p. 25 [*1154]).
[36] Exhibit US-103.
[37] *See* Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.2.
[38] *See* also http://www.apfo.usda.gov.
[39] *See* Brazil's 28 January 2004 Comments and Requests Regarding US Data, paras. 31-33.
[40] US 11 February 2004 Answers to Additional Questions, para. 9. The cases cited by the United States are reproduced as Exhibits Bra-429 (Metadure Croporation v United States, 490 F. Supp. 1368 (S.D.N.Y. 1990)) and Bra-430 (Campaign for Family Farms v Glickman, 200 F.3d 1180 (8th Cir. 2000)).

in the meaning of the US domestic law applicable to the question of confidentiality and the release of planted acreage information, the United States should resolve the ambiguity in favour of releasing the information, as required by its obligations under the DSU.

**(c) Please provide any further available evidence of the USDA's long-standing policy that planted acreage information will not be released.**

**Brazil's Comment:**

19. Brazil notes that it is not USDA's place to provide an authoritative interpretation of US law, including the Freedom of Information Act. Any "internal policy memorandum" cannot change the meaning of US law. Interpreting US laws is left to the US courts, which have issued rulings that would compel release of the planting, payment and contract payment base information.

20. Further, both Exhibits US-134 and US-144 refer to individual acreage information *in connection with names that cannot be released*. Brazil recalls that the Panel has requested farm-specific information with farm serial numbers (rather than names)[41], or, alternatively, farm-specific information using "dummy" farm numbers.[42] And Exhibit US-144 clarifies that "[a]creage, production data, and other producer-related information, without any personal identifier attached may be released". This language would certainly cover farm-specific information using "dummy" farm numbers.

21. Finally, whether there is a long-standing practice by USDA of not releasing farm-specific acreage data to the public is irrelevant to a WTO dispute. First, under DSU Article 13, the United States is required to provide even confidential information.[43] Second, any such information is not released to the public, and can – under WTO procedures – be protected as confidential information and be returned to the United States once this panel proceeding ends. Confidentiality procedures either under DSU Articles 13.1 and 18.1 or special confidentiality procedures under the Panel's working procedures can address any US concern that Brazil could match data provided by the United States with data publicly available to unveil the names of specific farmers and their plantings. In addition, any such concern would not exist had the United States provided a single file containing both base acreage and yields as well as planting information. Under these circumstances, no identification number, whether farm serial number or "dummy" number, would be necessary.

**260. On 27 August 2003, in its response to Question No. 67 *bis*, the United States indicated that "it does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers". On 12 January 2004, the Panel requested the United States to provide information "to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years". On 20 January 2004, the United States informed the Panel that "the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton." Is the latest statement responsive to the Panel's request? If so, how can it be reconciled with the first statement?**

**Brazil's Comment:**

22. The US 11 February 2004 response to the Panel's Question continues a pattern of misrepresentation that has tainted the US statements on this issue during this entire dispute.[44] In its

[41] 8 December 2003 Communication from the Panel.
[42] 12 January 2004 Communication from the Panel.
[43] *See* Section 5 of Brazil's 28 January 2004 Comments and Requests Regarding US Data.
[44] US 11 February 2004 Answers to Additional Questions, para. 13.

response, the United States draws the distinction between farms that plant upland cotton, for which the United States admits it has information, and farms that produce upland cotton, *i.e.*, farms that harvest the planted upland cotton, for which the United States asserts it does not have information.[45] Allegedly, this distinction between "planters" and "producers" of upland cotton explains the discrepancy between the two US statements referred to in the Panel's question. It does not.

23. In fact, the United States in its 11 February 2004 response engages in a play with words that hides its non-cooperation in this panel proceeding. Contract payments made to "planters" of upland cotton support the production of upland cotton and are, thus, "support to" upland cotton. This is true even if the planted upland cotton is in the end abandoned and not harvested. Indeed, the 2002 FSRI Act defines a "producer" as someone who "*shares in the risk of producing a crop* and is entitled to share in the crop available for marketing from the farm *or would have shared had the crop been produced*".[46] Thus, a person remains a "producer" even if the chances were against him or her in a given year and a planted crop failed.

24. In sum, the terms "producer" and "planter" of a crop are synonyms for purposes of defining "support to" a specific commodity. Any contract payments paid to producers/planters of upland cotton must be considered in allocating the "support to" upland cotton from contract payments – whether the crop planted on that farm was harvested or not.

25. It follows that the two US statements referred to in the Panel's question are *irreconcilable*.[47] Unfortunately, Brazil has to note that the United States continues its approach of trying to mislead the Panel and Brazil on the question of the amount of contract payments that constitute support to upland cotton. In its 11 February 2004 Comments on Brazil's 28 January 2004 Data Comments, the United States engages in a self-serving revisionist history.[48] What is left after the US rhetoric is one clear fact: that the United States has engaged in a highly successful effort over sixteen months to deny Brazil and the Panel information giving a definitive amount of the four contract payments paid to and received by producers of upland cotton during MY 1999-2002. Brazil and the Panel are still waiting for data that would allow a precise calculation of this support, either in a farm-specific manner, as requested by the Panel on 8 December 2003 and 12 January 2004, or in the aggregate manner as requested by the Panel on 3 February 2004. Brazil notes that the Panel has granted the United States an extension until 3 March 2004 to provide this information.[49]

26. Brazil believes the Panel is well aware of the US refusal to provide payment information in the numerous forms in which that information has been requested.[50] In an effort to assist the Panel with making factual findings in its report regarding this issue, Brazil sets forth a chronology of the facts relating to these various requests. These facts need little, if any, commentary or argument from Brazil, as they speak for themselves:

- **22 November 2002**: Brazil files its First Set of Questions and Request for Production of Documents to the United States.[51] Question 3.6 stated: "*What was the annual amount of . . . (ii) production flexibility contract payments and (iii) direct payments (as relevant given the particular time period) made by the US Government in connection with upland cotton for each of the marketing years 1992 through 2002*." Question 11.1 stated: "*Please state the total*

[45] US 11 February 2004 Answers to Additional Questions, para. 13. *See* also US 11 February 2004 Comments para. 67 and US 28 January 2004 Comments, para. 16 making the same argument.

[46] Exhibit Bra-29 (Section 1000(12) of the 2002 FSRI Act)(emphasis added).

[47] *See* also Brazil's 28 January 2004 Comments on Question 195, para. 6-9.

[48] US 11 February 2004 Comments, paras. 62-75.

[49] 16 February 2004 Communication from the Panel.

[50] The US 11 February 2004 Comments, para. 69 incorrectly assert that "this information" refers to contract acreage

[51] Exhibit Bra-101 (Questions for Purposes of the Consultations).

*amount of market loss assistance payments made to the US upland cotton industry in marketing years 1998 through 2001*."[52]

- **3 December 2002:** During the consultations, the United States responded orally to Question 3.6 by referring Brazil to the "Fact Sheet: Upland Cotton" (Exhibit Bra-4) and to www.fsa.usda.gov/dam/bud/bud1.htm. In response to Question 11.1, the United States similarly referred Brazil to www.fsa.usda.gov/dam/bud/bud1.htm. The data in these documents represented the total amount of payment data provided to holders of upland cotton base but did not provide any information about contract payments made to the US "upland cotton industry", which Brazil defined in its consultation and panel requests as "US producers, users and/or exporters of upland cotton". Brazil used the data included in Exhibit Bra-4 and the above-referenced web-site as the basis for its tabulation of the contract payment amount included in Table 1 of its 24 June 2003 First Submission.

- **1 April 2003:** Brazil filed a questionnaire with the United States in the Annex V procedures.[53] Question 11.1 states: "*Please state the total amount of Market Loss Assistance payments made to the US upland cotton industry in marketing years 1998 through 2002.*" Question 13.1 states: "*Please state the total amount of Counter-Cyclical Payments made by the United States to US upland cotton farmers in marketing year 2002.*" The United States provided no information in response to these questions.

- **24 June 2003:** Brazil's 24 June 2003 First Submission states, at paragraph 214, that "*[i]n the absence of the requested information from the United States on actual DP and CCP payments related to the production of upland cotton* or to farms holding upland cotton base, Brazil has used conservative methodologies to estimate the amount of 2002 DP and CCP payments received by upland cotton producers". In addition, Brazil stated that it "reiterates its requests to the United States to provide it and the Panel with actual upland cotton base acreage for the DP and CCP programmes and will revise its estimates and levels of support for MY 2002 based on updated data".[54]

- **22 July 2003:** Brazil states in its 22 July 2003 Oral Statement at the first meeting with the Panel that "Brazil notes that it has presented the best available information that it has access to and that is not exclusively within the control of the United States."[55] Brazil further stated that "the United States never provided any answers to Brazil's Annex V questions [and] [a]ccordingly, Brazil requests the Panel to rule on questions of fact based on the best information available as submitted by Brazil".[56]

- **11 August 2003**: Brazil provides an estimate of the total budgetary outlays of contract payment using its 14/16$^{th}$ methodology in its 11 August 2003 response to Question 60, as explained in paragraph 97 and notes 2-5 to the table accompanying paragraph 97. Brazil further states in response to Question 83 that "The list of Annex V questions provided to the United States by Brazil is included in Exhibit Bra-49. … [G]iven the United States' failure to cooperate in the Annex V information gathering process, Brazil has and will present its case regarding peace clause issues and serious prejudice claims based on evidence available to it. If there are gaps in the evidence provided to the Panel by Brazil in support of its *prima facie* case, and those gaps are due to the United States' failure to cooperate with and participate in

[52] Brazil defined "upland cotton industry" as "producers, users and/or exporters of upland cotton".
[53] Exhibit Bra-49 (Questions for Purposes of the Annex V Procedure).
[54] Brazil's 24 June 2003 First Submission, note 415.
[55] Brazil's 22 July 2003 Oral Statement, para. 4.
[56] Brazil's 22 July 2003 Oral Statement, para. 4.

the Annex V process, Annex V, paragraph 6 provides that 'the panel may complete the record as necessary relying on the best information otherwise available.'"[57]

- **25 August 2003**: The Panel requests the United States in Question *67bis* to provide "the annual amount granted by the US Government in each of the 1999, 2000, 2001, and 2002 marketing years (as applicable) to US upland cotton producers . . . in total expenditures, under each of the following programmes: production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments."[58]

- **27 August 2003**: The United States provides a response to Question 67*bis* which states, *inter alia*, that the United States "does not maintain and cannot calculate this information"[59] and that it "does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers".[60] The United States stated in paragraph 21 of its 27 August 2003 response that "Thus, the United States did not track total expenditures with respect to base acres of [1996 FAIR Act covered commodities] under the expired production flexibility contract payments and market loss assistance payments and does not track total expenditure with respect to base acres of [contract commodities] under the direct payments and counter-cyclical payments." Further, the United States stated in paragraph 28 of its 27 August 2003 response that "we are unable to provide to the Panel the total outlays under the cited programmes with respect to upland cotton base acreage."

- **7 October 2003**: The United States alleges that "Brazil has presented no evidence that the recipients of these decoupled payments on upland cotton base acres are, in fact, upland cotton producers".[61] And the United States alleges that Brazil's methodology is "merely a guess because Brazil has failed to demonstrate that the acres currently being used for upland cotton production are, in fact, upland cotton base acres. That is, Brazil has presented no evidence that the recipients of these decoupled payments on upland cotton base acres are, in fact, upland cotton producers".[62] The United States further alleges that Brazil has not substantiated the amount of contract payments to US upland cotton producers ("[I]t is for Brazil to establish who are the recipients of the subsidies and that the subsidies are properly attributed to upland cotton."[63] "Nor has [Brazil] demonstrated how much of the subsidy … should be allocated to other products produced by the recipient, such as corn or soybeans."[64]).

- **8 October 2003:** The Panel orally asks the United States whether it collects or maintains information concerning the amount of contract payments received by upland cotton producers. The United States answered orally that it neither collected nor retained this information.

- **9 October 2003:** Brazil stated in its closing statement that it had "requested this information [*i.e.*, information concerning the amount of contract payments to upland cotton producers] more than a year ago in the consultation phase of this dispute but never received any information".[65] The United States, following its closing statement, informed the Panel and Brazil that the 2002 FSRI Act contained a reporting requirement for the United States to

[57] Brazil's 11 August 2003 Answers to Questions, para. 190.
[58] 25 August 2003 Communication from the Panel.
[59] US 27 August 2003 Comments and Answers to Additional Question, para. 20.
[60] US 27 August 2003 Comments and Answers to Additional Question, para. 20.
[61] US 7 October 2003 Oral Statement, para. 14.
[62] US 7 October 2003 Oral Statement, para. 6.
[63] US 7 October 2003 Oral Statement, para. 10.
[64] US 7 October 2003 Oral Statement, para. 19.
[65] Brazil's 9 October 2003 Closing Statement, para. 2.

collect information on planted acreage, as a condition for recipients receiving direct payments and CCP payments.

- **13 October 2003:** The Panel asks the United States in Question 125(9) how to calculate upland cotton contract payments made to cotton producers and how to account for non-upland cotton contract payments made to producers of upland cotton.[66]

- **27 October 2003:** The United States responds to Question 125(9) by stating that it is for Brazil to prove the amount of contract payments (which the United States does not limit to upland cotton contract payments) that need to be allocated to upland cotton.[67] While referring to Annex IV, the United States declines to provide any data.[68]

- **18 November 2003:** Brazil requested the Panel to request the United States to produce information that would permit the calculation of a very precise amount of contract payment support to current producers of upland cotton.[69] Brazil further set forth evidence that USDA collects and maintains in a centralized database base acreage data and planted acreage data for all farms for MY 2002 and for almost all farms for the period MY 1999-2001.[70]

- **21 November 2003:** USDA's Kansas City FOIA office delivered to a private US citizen a completed analysis of farm-specific contract acreage data and planted acreage data for MY 1996-2002 regarding rice. The FOIA documentation indicates that the request was received on 30 October 2003, and that work was completed on 14 November 2003. The rice data showed that between 99.52 and 99.90 per cent of the farms producing rice in MY 1999-2002 completed planted acreage reports. The rice data provided by USDA permitted the calculation of the exact amount of rice contract acreage that was planted to rice during MY 1996-2002.[71]

- **2 December 2003:** Brazil requests the United States to provide farm-specific information as set out in Exhibit Bra-369.

- **3 December 2003:** Brazil presented the results of the rice FOIA request to the Panel and provided a copy of the rice data to the Panel and the United States.[72]

- **8 December 2003:** The Panel requests the United States to provide the farm-specific information set out in Exhibit Bra-369. In Question 195, the Panel asked whether "the United States wish to revise its response to the Panel's Question No. 67*bis*, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers?"[73]

- **18 December 2003:** The United States produced scrambled farm-specific information for MY 1999-2001, contrary to Brazil's and the Panel's requested set out in Exhibit Bra-369.

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[66] 13 October 2003 Communication from the Panel.
[67] US 27 October 2003 Answers to Questions, para. 23.
[68] US 27 October 2003 Answers to Questions, para. 24.
[69] Brazil's 18 November 2003 Further Rebuttal Submission, para. 48.
[70] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 33-48.
[71] Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003) and Exhibit Bra-369 as amended on 3 December 2003 (Brazil's Request to the United States for Farm – Specific Planting and Base Acreage Data, 3 December 2003).
[72] *See* Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003) and Exhibit Bra-369 as amended on 3 December 2003 (Brazil's Request to the United States for Farm – Specific Planting and Base Acreage Data, 3 December 2003).
[73] 8 December 2003 Communication from the Panel.

- **19 December 2003:** The United States produced scrambled farm-specific information for MY 2002, contrary to Brazil's and the Panel's requested set out in Exhibit Bra-369.

- **22 December 2003:** The United States responds to Question 195 but does not "state the annual amount granted by the US government in each of the 1999, 2000, 2001 and 2002 marketing years to upland cotton producers … in total expenditures under the [four contract payment programmes]", as requested by the Panel on 25 August 2003 in Question 67*bis*. The United States reasoned that it "does not collect production data based on actual harvesting figures reported by farmers".[74] The United States response did not offer any information regarding the amount of contract payments received by upland cotton farmers who planted upland cotton. Brazil indicated in its Answer to Question 196 that the scrambled information provided by the United States prevented it from calculating the amount of payments received by US upland cotton producers planting upland cotton on contract base acreage.[75]

- **12 January 2004:** The Panel requested farm-specific information from the United States indicating that "it considers it both necessary and appropriate to seek this information in a suitable format in order to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements".[76] The Panel further stated that "disclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP, and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years". The Panel requested the United States to produce the information by 20 January 2004.

- **20 January 2004:** The United States filed a letter with the Panel stating it would not produce non-scrambled farm-specific data requested by the Panel on 12 January 2004.[77] The United States did not provide total expenditure information for the four contract payments originally requested in Question 67*bis* and did not otherwise provide information that would "permit an assessment of the total expenditures" that constitute "support to" upland cotton under the four contract payments, as requested by the Panel on 12 January 2004. Brazil files a detailed description of its methodology allocating upland cotton and non-upland cotton contract payments as support to upland cotton.[78]

- **28 January 2004:** Brazil filed a request that the Panel draw adverse inferences from the United States refusal during the period November 2002 through January 2004 to produce information relating to the amount of contract payments received by upland cotton producers who planted upland cotton.[79] The United States provided revised scrambled farm-specific data.[80]

- **3 February 2004:** The Panel requested aggregated farm-specific information from the United States in a format similar to the rice FOIA request set out Exhibit Bra-369, and further requested that the United States produce planted information on crops on cropland covered by the acreage reports. The Panel gave the United States until 11 February 2004 to provide the requested data.[81] This aggregate data would allow a precise calculation of the amount of support to upland cotton from the US contract payments, whereas the US summary data

[74] US 22 December 2003 Answers to Questions, para. 6.
[75] Brazil's 22 December 2003 Answer to Question 196.
[76] 12 January 2004 Communication from the Panel.
[77] US 20 January 2004 Letter to the Panel.
[78] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.
[79] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 6.
[80] US 28 January 2004 Letter to the Panel.
[81] 3 February 2004 Communication from the Panel.

produced on 18/19 December 2003 and the revised US summary data produced on 28 January 2004 does not.[82] The Panel also asked the United States (Question 260) how it reconciled its 27 August 2003 response (that it did not maintain data on contract payments to upland cotton producers) with its 20 January 2004 Letter to the Panel stating that it had provided such information.[83]

- **11 February 2004:** The United States indicated it was not in a position to respond to the Panel's 3 February 2004 request and stated that it needed an additional four weeks to provide the aggregated data.[84]

- **13 February 2004:** Brazil requested the Panel to deny the United States any additional time to respond to the Panel's 3 February 2004 request, noting that this request represented the fifth time that the Panel had requested the United States to provide total expenditure information regarding the amount of contract payments made to upland cotton producers.[85]

- **16 February 2004:** The Panel extended the deadline for the United States to provide the data requested on 3 February 2004 and clarified its request.[86]

- **3 March 2004:** The deadline for the United States to produce the data requested by the Panel on 3 February 2004.[87]

27. Brazil hopes that the United States will finally live up to its obligation under the DSU and provide data that would permit the calculation of the support to upland cotton from the US contract payments. In one form or another, these figures have been at issue in all stages of this dispute – from the first round of consultations until the latest submissions to the Panel 16 months later. During all this time, it has been clear to the United States that what Brazil and the Panel sought was information that would enable a determination of the amount of contract payments that actually benefit upland cotton production. To be clear, that means support that benefits farms that plant upland cotton and support that can be allocated to this upland cotton planting/production.

28. In case the United States should fail to produce the information by 3 March 2004, Brazil maintains its 28 January 2004 request to the Panel to draw adverse inferences from this failure of cooperation. Drawing adverse inferences is clearly warranted given the history of his dispute settlement proceeding.

**261. Please confirm that each record in the actual planting database relates to a specific farm (Filenames: rPFCplac and rDCPplac in Exhibits US-111 and US-112). For example, in the data from rDCPplac:**

***First line*:**
**Field9;Field16;Field22;Field28;Field34;Field40;Field46;Field52;Field58;Field64;Field70;Field76;Field82;Field88;Field94;Field100**

***Second line*:**
**237.10;23059.80;5566.20;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00**

[82] Brazil's 13 February 2004 Letter to the Panel. *See* also Brazil's 18 February 2004 Comments on US 11 February 2004 Comments on Brazil's 28 January 2004 Comments and Requests Regarding U.S. Data.
[83] 3 February 2004 Communication from the Panel.
[84] Cover Letter to US 11 February 2004 Answers to Additional Questions.
[85] Brazil's 13 February 2004 Letter to the Panel.
[86] 16 February 2004 Communication from the Panel.
[87] 16 February 2004 Communication from the Panel.

**Does the second line represent data on plantings by the same farm?**

**262. The Panel has noted the two CD-ROMs delivered by the US in the evening of 23 December 2003. They are marked "US-111" and "US-112" respectively, but the contents actually do not correspond to the indication. The Panel also takes note of the US letter dated 28 January 2004 and the CD-ROM delivered together with it. For the record, please clarify the correct CD-ROMs and provide corresponding descriptions of their contents with exhibit numbers.**

**263. The Panel has noted that the United States' response to Question No. 214 refers to Exhibits US-117 and US-118. Are these the correct documents to which the United States intended to refer in that response? If not, please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993.**

**264. The Panel asks the United States to clarify certain aspects of Exhibit US-128:**

**(a) Is the Panel correct in understanding that -- as Brazil asserts in footnotes 290 and 291 of Brazil's 28 January 2004 comments on US responses to questions -- Exhibit US-128, all data are presented on a cohort-specific basis? If so, please also present the information originally requested by the Panel in another chart containing *programme* (as opposed to cohort-specific) activity by fiscal year.**

**Brazil's Comment:**

29. In paragraph 21 of its 11 February 2004 response, the United States suggests that Brazil's cash-basis accounting methodology for making an assessment under item (j), because it uses data included in the US budget, is "based on estimates and re-estimates" under the Federal Credit Reform Act ("FCRA"). This response is untruthful in the extreme.

30. None – absolutely none – of the data used for Brazil's cash-basis accounting methodology for making an assessment under item (j) is "based on estimates and re-estimates" generated for the purposes of the FCRA. As is evident from the chart included in paragraph 165 of Brazil's 11 August 2003 Answers (reproduced in paragraph 129 of its 28 January 2004 comments), Brazil's cash-basis accounting methodology relies on data from the "actual", prior year column of the US budget. Moreover, the data input into Brazil's cash-basis accounting methodology is drawn from the "financing account" for the CCC programmes.[88] The US budget makes the following statement about the financing account:

> As required by the Federal Credit Reform Act of 1990, this non-budgetary account records all cash flows to and from the Government resulting from loan guarantees committed in 1992 and beyond. The amounts in this account are a means of financing and are not included in the budget totals.[89]

31. Whether presented on a cohort-specific (Exhibit US-128) or a fiscal year (Exhibit US-147) basis, Brazil notes that none – absolutely none – of the data provided by the United States is

[88] The only exception is administrative expenses, which Brazil takes from the "programme account" included in the U.S. Budget. *See, e.g.*, Exhibit Bra-127 (2004 US Budget, p. 107 (line 00.09)). The US budget notes, however, that "administrative expenses are estimated on a cash basis", rather than a present value basis. *See, e.g.*, Exhibit Bra-127 (2004 US Budget, p. 108). *See also* Brazil's 22 July 2003 Oral Statement, para. 130 (and citations included at footnote 168). In any event, the United States and Brazil use virtually identical figures for the administrative costs of the CCC programs. *See* Exhibit Bra-431 (Columns 5(a) and 5(b)).

[89] *See, e.g.*, Exhibit Bra-127 (2004 U.S. Budget, p. 109 (emphasis added)).

verifiable. The United States has provided no documentation (or even citations to documentation that could be independently collected and reviewed by the Panel) to back up its data. The Panel asked the United States for this supporting documentation in July 2003, in Question 78 to the United States. The United States has never provided the supporting documentation requested by the Panel. In contrast, Brazil has provided US government documents to back up each and every figure input into its cash-basis accounting methodology for making an assessment under item (j).[90]

**(b) Does the US agree with the statement in paragraph 135 of Brazil's 28 January 2004 comments on US responses to questions that the difference between the $1,148 billion in the chart at para. 165 of Brazil's 11 August answers to questions and the $666 million amount in Exhibit US-128 ($1.75 billion) closely corresponds to the total "Claims rescheduled" figure reported by the US in Exhibit US-128 (column F)?**

**Brazil's Comment:**

32. The United States has failed to answer the Panel's question, stating that it will instead do so on a timeline of its own choosing.[91] The United States did not request additional time from the Panel, either in its 11 February 2004 response or in the cover letter to that response, but simply asserted in paragraph 23 of its response that it will take whatever additional time it needs.[92] In its letter to the Panel dated 13 February 2004, Brazil noted that the United States had more than adequate time (8 days) to undertake the review necessary to answer the Panel's question. After receiving the fiscal-year cash-basis accounting data included in Exhibit US-147, it took Brazil one hour to prepare a spreadsheet – included as Exhibit Bra-431 – that zeroes in on and identifies the reason that Brazil's cash-basis accounting methodology concludes that the operating costs and losses for the CCC export credit guarantee programmes have exceeded income over the period 1993-2002 by $1.083 billion, while the United States' cash-basis accounting methodology concludes that income for the CCC export credit guarantee programmes has exceeded operating costs and losses over the period 1993-2002 by $536 million.

33. In its 16 February 2004 ruling, the Panel did not respond to Brazil's request that it deny the United States' efforts to decide at what pace it wishes to offer responses to the Panel's questions. Brazil requests that if the United States, whenever it deems it convenient, eventually offers a response to Question 264(b), the Panel reject that response as not timely filed. If the Panel accepts the United States' response, Brazil reserves the right to comment.

34. In any event, the spreadsheet included as Exhibit Bra-431 confirms the assertion Brazil made in paragraph 135 of its 28 January 2004 Comments, which is that the difference between the results arrived at using the Brazilian versus the US cash-basis methodology (a difference of $1.6 billion) is largely due to the United States' treatment of rescheduled claims (listed by the United States as $1.58 billion). As confirmed by the United States in paragraph 24 of its 11 February 2004 response to Question 264(c), the United States' methodology treats defaulted guarantees that have been rescheduled as 100 per cent recovered at the moment the terms of the rescheduling are agreed.

35. Brazil, in contrast, treats rescheduled claims as receivables. Under Brazil's methodology, receivables resulting from rescheduling are treated just like any other receivable – receivables resulting from rescheduling are only treated as recovered incrementally, to the extent, in a given year, some increment of the rescheduled debt is actually collected (in column 2(a) of Exhibit Bra-431).

[90] *See* exhibits cited in Brazil's 11 August 2003 Answers, para. 165 and Brazil's 28 January 2004 Comments, para. 129.

[91] US 11 February 2004 Answers, para. 23.

[92] In a letter to the Panel dated 16 February 2004, the United States similarly declares that it "will provide any other data in response to Question 264(b) within the time indicated (and sooner if the data can be collected and examined in less time)."

This fundamental difference in approach is the reason that the "claims outstanding" recorded by the United States (in column 4(b) of Exhibit Bra-431) and Brazil (in column 4(a) of Exhibit Bra-431) differ by $1.6 billion – the only significant difference revealed in the comparison included in Exhibit Bra-431.

36. As Brazil has previously demonstrated, it is not actuarially appropriate to treat defaulted guarantees that have been rescheduled as 100 per cent recovered at the moment the terms of the rescheduling are agreed.[93] Brazil and the United States agree that a default that has been rescheduled is properly treated as a receivable[94], but as the CCC itself has acknowledged in its financial statements, not all receivables are considered collectible, let alone actually collected.[95]

37. The United States' methodology itself recognizes that defaulted guarantees that have been rescheduled are only collected over time (if at all). While the United States treats the principal amounts of rescheduled debt as an immediate, 100 per cent recovery that is passed through as a dollar-on-dollar reduction of the amount of claims outstanding in the year the terms of the rescheduling are agreed, it also tracks massive (and ever increasing) amounts of interest collected on reschedulings (column M in Exhibit US-147). Interest is collected on the rescheduled debt because significant amounts of principal remain outstanding on that rescheduled debt. It is not legitimate, therefore, for the United States to treat that rescheduled debt as recovered at the moment it is rescheduled, since it is not actually recovered at that moment.

38. In fact, no evidence suggests that CCC will collect the rescheduled principal that remains outstanding. In column F of Exhibit US-147, the United States states that $1.64 billion of defaulted CCC guarantees have been rescheduled over the period 1992-2003. Yet as of 30 November 2003, the United States reports in Exhibit US-153 that the principal outstanding on these reschedulings amounts to $1.58 billion. This means that over the period 1992-2003, the CCC has only collected $60 million, or 3.6 per cent, of the $1.64 billion in defaulted CCC guarantees that have been rescheduled. Over 96 per cent of defaulted CCC guarantees that have been rescheduled over the period 1992-2003 remain outstanding.

39. This demonstrates precisely why it is not legitimate for the United States to treat rescheduled debt as recovered at the moment it is rescheduled. The record does not suggest that the CCC will collect this rescheduled debt – in fact, the record shows that the CCC hardly collects any of the principal on its rescheduled debt. Rescheduled debt is nothing more than a receivable, and should be treated as recovered only incrementally, as portions of that debt are, in fact, recovered. This is how Brazil has treated rescheduled debt in its own cash-basis accounting methodology for making an assessment under item (j) (column 2(a) of Exhibit Bra-431).

40. Even if rescheduled debt could, as an actuarial matter, be considered 100 per cent recovered at the very moment the terms of the rescheduling are concluded but before the rescheduled debt is in actual fact collected, the United States appears to have triple-counted portions of the CCC reschedulings. The Panel will recall that under the United States' cash-basis accounting methodology for making an assessment under item (j), the entire amount of the approximately $1.6 billion in

[93] *See* Brazil's 28 January 2004 Comments, paras. 135-137; Brazil's 27 August 2003 Comments, para. 64; Brazil's 22 August 2003 Comments, para. 99; Brazil's 11 August 2003 Answers, para. 162; Brazil's 22 July 2003 Oral Statement, para. 122.

[94] *See* US 11 August 2003 Answers, para. 155.

[95] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14); Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002*, Audit Report No. 06401-16-FM (November 2003), Notes to the Financial Statements, p. 15).

rescheduled debt (in column 3(b) of Exhibit Bra-431) is subtracted from the amount of claims outstanding (in column 4(b) of Exhibit Bra-431) in the year the terms of the rescheduling are agreed. Over $636 million of the approximately $1.6 billion in reschedulings listed in Exhibit US-153 and column 3(b) of Exhibit Bra-431, however, appears to have been "[p]reviously [r]escheduled" (*see* the last two entries in Exhibit US-153, concerning CCC guarantees to Russia). It already is not legitimate for the United States to treat rescheduled debt as recovered at the moment it is rescheduled, since the record shows that the CCC has only collected 3.6 per cent of that rescheduled debt. But to allow the United States to reduce claims outstanding multiple times for successive reschedulings of the very same underlying defaults is unacceptable.

**(c) Does the US agree that from the formula in column G (that is: (Column (D) minus (E) minus (F)), it follows that a rescheduled claim no longer constitutes an outstanding claim at the moment the terms of the re-scheduling are agreed and that a rescheduling is treated as 100 per cent recovered, as Brazil states in footnote 292 of Brazil's 28 January 2004 comments on US responses to questions?**

**Brazil's Comment:**

41. Brazil notes the United States acknowledgment, in paragraph 24 of its response, that under the US cash-basis accounting methodology for making an assessment under item (j), a rescheduled claim no longer constitutes an outstanding claim as of the moment the terms of the rescheduling are agreed. Please see Brazil's comment on the United States' response to Question 264(b), which demonstrates that it is not legitimate for the United States to treat rescheduled debt as recovered at the moment it is rescheduled, since the record shows that the CCC has only collected 3.6 per cent of that rescheduled debt.

42. Additionally, Brazil notes the United States' statement, at paragraph 24 of its 11 February 2004 response, that "no principal payments received under reschedulings are reflected in Exhibit US-128". It is hardly surprising that the United States does not treat principal payments on rescheduled debt as recovered principal (under column 2(b) of Exhibit Bra-431), incrementally and year-on-year as they are actually recovered, since the United States already subtracts 100 per cent of rescheduled debt from claims outstanding (column 4(b) of Exhibit Bra-431) immediately, in the year the terms of the rescheduling are agreed.

**(d) Is the Panel correct in understanding that the amount of $888,984,792.04 in column F in Exhibit US-128 under "ALL" for 1992 represents the total continuing amount of unrecovered claims for the 1992 cohort, and that the amount of 387,692,219.39 represents the total continuing amount of unrecovered claims for the 1993 cohort, etc? Please indicate and substantiate how much principal and/or interest has actually been paid/recovered/rescheduled *annually* 1992-2003 in respect of each of the amounts shown in Columns D, E & F in the table.**

**Brazil's Comment:**

43. Please see Brazil's comment on the United States' response to Question 264(b), which demonstrates that it is not legitimate for the United States to treat rescheduled debt as recovered at the moment it is rescheduled, since the record shows that the CCC has only collected 3.6 per cent of that rescheduled debt.

44. As noted in Brazil's comment on the US response to Question 264(c), it is evident that the US methodology does not "reflect payment performance under the reschedulings themselves"[96] (under column 2(b) of Exhibit Bra-431), since the United States already subtracts 100 per cent of rescheduled

[96] US 11 February 2004 Answers, para. 25.

debt from claims outstanding (column 4(b) of Exhibit Bra-431) immediately, in the year the terms of the rescheduling are agreed.

**265. In connection with the US response to Question No. 225, please also provide amounts actually "written off" and "forgiven" annually for each *post*-1992 cohort, with annual details of country and amount (principal/interest).**

**Brazil's Comment:**

45. The United States notes, in paragraph 27 of its response, that "CCC financial records indicate that no amounts have been 'written off' or 'forgiven' with respect to any post-1992 cohort." Brazil makes two observations.

46. First, Brazil notes that the Federal Credit Reform Act took effect for the 1992 cohort. Thus, the Panel's question was likely meant to refer to "each post-1991 cohort". Brazil hopes that the United States understood the Panel's question to include the 1992 cohort.

47. Second, Brazil makes the obvious point that defaults need not be "written off" or "forgiven" to constitute an operating cost or loss for the purposes of item (j). Defaults (or other operating costs and losses) that remain on the books are just as relevant to an assessment under item (j) as they would be if they were "written off" or "forgiven".

**266. What are the precise terms, conditions and duration of each rescheduling reflected in column F in Exhibit US-128?**

**Brazil's Comment:**

48. While the Panel asked for the "precise terms, conditions and duration of each rescheduling", the United States has provided "summarized" data[97], without any documentary evidence as support.

**267. Is the Panel correct in understanding that "interest collected on reschedulings" in Column M in Exhibit US-128 refers not to amounts that have been actually collected by the CCC but rather to interest capitalized in conjunction with the rescheduling? If so, what are the terms, conditions and duration of the arrangements pertaining to these amounts?**

**Brazil's Comment:**

49. Please see Brazil's comment on the United States' response to Question 264(b), which demonstrates that it is not legitimate for the United States to treat rescheduled debt as recovered at the moment it is rescheduled, since the record shows that the CCC has only collected 3.6 per cent of that rescheduled debt.

50. As noted in Brazil's comment on the US responses to Questions 264(c) and 264(d), it is hardly surprising that the US methodology does not "reflect … payment of original principal"[98] (under column 2(b) of Exhibit Bra-431), since the United States already subtracts 100 per cent of rescheduled debt from claims outstanding (column 4(b) of Exhibit Bra-431) immediately, in the year the terms of the rescheduling are agreed.

**268. Concerning Column N in Exhibit US-128, please elaborate upon "Interest earned from US Treasury on uninvested funds". What is the source and authority for these funds and for**

[97] US 11 February 2004 Answers, para. 28.
[98] US 11 February 2004 Answers, para. 29.

**the interest thereon to be part of the CCC total revenues? What are the terms, conditions and duration of the arrangements pertaining to these amounts?**

**269. The Panel notes the table submitted by the US in its answer to Question No. 224 (CCC Financing Account Payments of Interest on Borrowings from Treasury and Interest Earned on Uninvested Funds). Is the Panel correct in understanding that the figures in this table correspond to the "ALL" figures in Columns I and N of Exhibit US-128?**

**270. With respect to Column I in Exhibit US-128, ("Interest paid on borrowing from US Treasury") and Note 8, p. 25 of Exhibit US-129:**

**(i) please provide the total annual amounts (interest bearing and non-interest bearing) borrowed by the CCC from the US Treasury (annually since 1992), as well as the terms, conditions, interest rate (where applicable) and duration of such borrowing. Please provide details of any other amount borrowed by the CCC from the US Treasury during this period that may not have formed part of the regular annual borrowings.**

**Brazil's Comment:**

51. The United States has not answered the Panel's question, which requested "the terms, conditions, interest rate (where applicable) and duration" of CCC borrowings from the US Treasury.

**(ii) Please explain the nature of "CCC's permanent indefinite borrowing authority from Treasury" referred to in Note 8, p. 25 of Exhibit US-129.**

**Brazil's Comment:**

52. The United States' response inaccurately implies that CCC's authority to extend export credit guarantees is somehow limited by the budget appropriations process. As Brazil has frequently noted, US law expressly provides that the CCC export credit guarantee programmes are exempt from the requirement that they receive new Congressional budget authority before undertaking new guarantee commitments.[99] Moreover, any "subsidy" losses the programmes incur are funded "through a permanent, indefinite appropriation and not by annual appropriation".[100]

**(iii) What determines the level of CCC export credit guarantee borrowing (interest-bearing and non-interest-bearing)? Is the interest-free borrowing up to the amount of unreimbursed realized losses?**

**(iv) Why are repayments applied to non-interest bearing notes first, as indicated at Note 8, p. 25 of Exhibit US-129?**

**271. Note 8, p. 25 of Exhibit US-129 states that "In fiscal year 2003, CCC was fully reimbursed for its prior year net realized losses." Please indicate the amounts of prior year net realized losses (annually, since 1992) for which the CCC has been fully reimbursed.**

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[99] *See* Exhibit Bra-117 (2 U.S.C. § 661(c)(2)); Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform," April 1991, p. 7 and Table 2); Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget," IB95031 (16 February 1996), p. 3).

[100] US House of Representatives, Report 105-178, Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Bill, 1998, p. 90, available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=105_cong_reports&docid=f:hr178.105.pdf.

**Brazil's Comment:**

53. The United States' response inaccurately implies that CCC's authority to extend export credit guarantees is somehow limited by the budget appropriations process. As Brazil has frequently noted, US law expressly provides that the CCC export credit guarantee programmes are exempt from the requirement that they receive new Congressional budget authority before undertaking new guarantee commitments.[101] Moreover, any "subsidy" losses the programmes incur are funded "through a permanent, indefinite appropriation and not by annual appropriation".[102]

**272. With respect to the US response to Question No. 226, is the Panel correct in understanding that the reflection of write-offs as part of the operating loss of the CCC which in turn was replenished through the annual appropriations process ended with the entry into force of the FCRA in fiscal year 1992? If not, what amounts have been replenished through this process annually since fiscal year 1992?**

**Brazil's Comment:**

54. Brazil notes that under US law, any "subsidy" losses the CCC export credit guarantee programmes incur are funded "through a permanent, indefinite appropriation and not by annual appropriation".[103]

**273. With respect to the US response to Question No. 225, what criteria does the CCC apply to "independently determine" that a debt is uncollectible? For post-1992 cohorts, what are these uncollectible amounts (annually) and how, if at all, are such "uncollectible amounts" shown in Exhibit US-128?**

**Brazil's Comment:**

55. The United States notes, in paragraph 44 of its response, that "[w]ith respect to post-1992 cohorts, no amounts have been determined uncollectible . . ." Brazil makes two observations.

56. First, Brazil notes that the Federal Credit Reform Act took effect for the 1992 cohort. Thus, the Panel's question was likely meant to refer to "each post-1991 cohort". Brazil hopes that the United States understood the Panel's question to include the 1992 cohort.

57. Second, Brazil notes that CCC's financial statements record a $1.16 billion "subsidy allowance" for all post-1991 cohorts.[104] Under the FCRA, the subsidy allowance is recorded on a net present value basis, which means that it represents the cost CCC considers it will incur on post-1991 guarantee cohorts at the time those cohorts are closed. In other words, at the time all outstanding

[101] *See* Exhibit Bra-117 (2 U.S.C. § 661(c)(2)); Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform," April 1991, p. 7 and Table 2); Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget," IB95031 (16 February 1996), p. 3).

[102] US House of Representatives, Report 105-178, Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Bill, 1998, p. 90, available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=105_cong_reports&docid=f:hr178.105.pdf.

[103] US House of Representatives, Report 105-178, Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Bill, 1998, p. 90, available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=105_cong_reports&docid=f:hr178.105.pdf.

[104] Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002*, Audit Report No. 06401-16-FM (November 2003), Notes to the Financial Statements, p. 15).

post-1991 cohorts close, the CCC considers that it will face $1.16 billion in uncollectible guarantees.[105]

**274. The Panel notes the US statement in the US response to Question No. 81 that "All rescheduled claims are currently performing " and that "all payments due up to this point under [rescheduling] agreements have been received". However, the Panel also notes Exhibit US-129 (in particular, Note 5 on p. 22) and Brazil's reference thereto in Brazil's 28 January comments on the US response to Question No. 222. In this connection:**

**(a) How does the US respond to Brazil's statement in Brazil's 28 January comments that Exhibit US-129 confirms that rescheduling of export credit guarantee receivables cover both principal and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled?**

**Brazil's Comment:**

58. The United States has offered no documentary support for its assertion that the "substantial majority" of the reschedulings referred to in Note 5, p. 22 of Exhibit US-129 "pertain to activities related to the P.L. 480 foreign food assistance programme".[106]

59. Moreover, the United States has never offered any support for its repeated assertion that "[a]ll rescheduled export credit guarantee debt is currently performing."[107] In fact, in its comment on the US response to Question 264(b), Brazil demonstrated that CCC is not collecting over 96 per cent of the rescheduled principal that remains outstanding.[108] In column F of Exhibit US-147, the United States states that $1.64 billion of defaulted CCC guarantees have been rescheduled over the period 1992-2003. Yet as of 30 November 2003, the United States reports in Exhibit US-153 that the principal outstanding on these reschedulings amounts to $1.58 billion. This means that over the period 1992-2003, the CCC has only collected $60 million, or 3.6 per cent, of the $1.64 billion in

[105] The Congressional Budget Office agrees, projecting positive subsidy estimates for every cohort during the period 2002-2013. Exhibit Bra-432 (Congressional Budget Office, Fact Sheet, row titled "Export Credit Guarantee Program, Subsidy Account," available at http://www.cbo.gov/factsheets/CCC&FCIC.pdf).

[106] US 11 February 2004 Answers, para. 46. As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[107] US 11 February 2004 Answers, para. 48. *See also* U.S. 11 August 2003 Answers, para. 155. As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[108] Moreover, the United States has never responded to reports by the U.S. General Accounting Office and testimony by GAO officials, submitted by Brazil, demonstrating that CCC rescheduling has historically been in arrears. *See* Brazil's 28 January 2004 Comments, para. 136; Brazil's 22 August 2003 Comments, para. 99. *See also* Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6 (noting that in 1995 defaults on Russian and Former Soviet Union guarantees reached $2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid.); Exhibit Bra-152 (GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National Security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, *Status Report on GAO's Reviews of the Targeted Export Assistance Programme, the Export Enhancement Program, and the GSM-102/103 Export Credit Guarantee Programs*, GAO/T-NSIAD-90-53, 28 June 1990, p. 14 (noting that historically, the majority of GSM support that is rescheduled is "in arrears.").

defaulted CCC guarantees that have been rescheduled. Over 96 per cent of defaulted CCC guarantees that have been rescheduled over the period 1992-2003 remains outstanding.

**(b) In Note 5 on p. 22 of Exhibit US-129, what is the definition of "non-performing"? What is the meaning of "delinquent"? What is the current principal balance and amount of interest of the three CCC export credit guarantee programme "receivables" in a non-performing status (individually and together, for GSM 102, GSM 103 and SCGP))? What is the amount of interest on non-reporting "receivables"?**

**(c) The Panel notes the US reference to the "Paris Club" in US response to Question No. 225. What is the P.L. 480 programme referred to in Note 5 on p. 22 of Exhibit US-129 (including the Paris Club debt reduction process and the HIPC Initiative) ? To what extent is the P.L. 480 programme and Paris Club process relevant to the export credit guarantee programmes at issue in this dispute? Please identify and give the amounts of all CCC export credit guarantee debt subject to the P.L. 480 debt reduction (or other similar) process since 1992.**

**(d) Can the US explain the process referred to in the second column of Note 5 on p. 22 ("CCC is awaiting an apportionment from the Office of Management and Budget before the transaction can be completed. Until such time, however, there is a 100% subsidy allowance established against the relevant debt as of September 30, 2003.") Please provide details of all such "apportionments" relating to the three export credit guarantee programmes in fiscal years 1992-2003.**

**Brazil's Comment:**

60. Although the United States asserts that the reference in the Panel's question is to a single transaction related to the P.L. 480 food aid programme[109], and further asserts that the "apportionment" procedure cited in the Panel's question does not apply to the CCC export credit guarantee programmes[110], the United States offers no support for these assertions.[111]

61. In any event, Brazil makes the obvious point that defaults need not be "written off" to constitute an operating cost or loss for the purposes of item (j). Defaults (or other operating costs and losses) that remain on the books are just as relevant to an assessment under item (j) as they would be if they were "written off".

**275. Please provide evidence (or cite relevant portions of the record) that the premium rates for the export credit guarantee programmes are "reviewed annually" as stated in US 28 January comments on response to Question No. 223 (see also US 22 December response to Question No. 107; Brazil's 28 January 2004 comments on responses to Question No. 223.).**

**Brazil's Comment:**

62. Even if the CCC does undertake the annual premium rate review asserted by the United States, the US Department of Agriculture's Inspector General noted in 2000 and 2001 that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programmes have not been

[109] US 11 February 2004 Answers, para. 53.
[110] US 11 February 2004 Answers, para. 54.
[111] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

changed in 7 years and may not be reflecting current costs".[112] Brazil has demonstrated that since 1993, only two changes have in fact been made to the GSM 102 fee schedule.[113]

63. Brazil makes several observations regarding Exhibit US-150, which purports to include memoranda concerning the 2003 and 2002 annual reviews of fees for the CCC export credit guarantee programmes.

64. First, page 2 of the 2003 memorandum shows that "offsetting fees" for GSM 102, GSM 103 and SCGP, both "historical[ly]" and for FY 2004, do not cover the "subsidy", within the meaning of the FCRA. As the Panel will recall, under the net present value accounting methodology endorsed by the US Congress and the President in the FCRA, a positive subsidy indicates a judgment that when the cohorts close, the CCC programmes will "lose money."[114] At page 3 of the memorandum, a major heading reinforces the point that the programmes are losing money, reading as follows: "JUSTIFICATION FOR NOT COVERING THE SUBSIDY COST OF THE PROGRAMME."

65. Second, Exhibit US-150 reinforces Brazil's claim that the CCC programmes confer "benefits" *per se*, within the meaning of Article 1.1(b) of the SCM Agreement, and therefore that they constitute *per se* export subsidies for the purposes of Article 10.1.[115] With other evidence (*e.g.*, the regulations for the CCC programmes, and a comparison to non-market benchmarks established by the US Export-Import Bank)[116], Brazil has made this *per se* showing by demonstrating that CCC export credit guarantees are unique financing instruments for agricultural commodity transactions that are not available on the commercial market for terms longer than the marketing cycles of the eligible commodities.[117] Pages 3-4 of the 2003 memorandum included in Exhibit US-150 reinforce Brazil's claim, by stating that fees for the CCC programmes are set not according to market benchmarks, but are instead set according to policy considerations. According to page 3 of the memorandum, "[s]etting prices is a policy matter, sometimes governed by statutory provisions and regulations, and other times by managerial or public policies". While it is fundamental that pricing for market-based financial instruments takes account of the risks involved in a transaction, the memorandum notes, at page 4, that "current fees for GSM-102, GSM-103, and SCGP are not risk-based", and that "[i]f the fees were changed to a risk-based system, this would most likely exceed [the statutory fee cap of] 1 per cent . . ."[118]

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[112] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31). *See also* Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programs have not been changed for many years and may not be reflecting current costs.").

[113] *See* Brazil's 11 August 2003 Answers, para. 167 (second bullet point).

[114] Exhibit Bra-121 (US General Accounting Office ("GAO"), Report to Congressional Committees, "Credit Reform: US Needs Better Method for Estimating Cost of Foreign Loans and Guarantees," GAO/NSIAD/GGD-95-31, December 1994, p. 20) ("GAO/NSIAD/GGD-95-31")).

[115] *See*, *e.g.*, Brazil's 28 January 2004 Comments, para. 253; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 233-241.

[116] This evidence is summarized at paragraphs 231-241 of Brazil's 18 November 2003 Further Rebuttal Submission.

[117] *See* Brazil's 24 June 2003 First Submission, paras. 289-292; Brazil's 22 July 2003 Oral Statement, para. 116; Brazil's 11 August 2003 Answers to Questions, paras. 139-140, 152-157, 183-187; Brazil's 22 August 2003 Rebuttal Submission, paras. 103-105; Brazil's 22 August 2003 Comments, paras. 92-93, 109-113; Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 68-80; Brazil's 7 October 2003 Oral Statement, para. 72; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 230-242; Brazil's 2 December 2003 Oral Statement, para. 79.

[118] Regarding the statutory one-per cent fee cap, *see* US 11 August 2003 Answers, para. 180. *See also* Exhibit US-150 (Annual Review of Fees for USDA Credit Programmes, March 25, 2003, p. 4 ("Section

**276. The Panel notes the parties' responses and comments relating to Question No. 252 concerning the time period within which any prohibited measure must be withdrawn within the meaning of Article 4.7 of the *SCM Agreement*. Please supplement your original response, taking into account the particular nature of each alleged prohibited subsidy measure (i.e. "Step 2" payments under Section 1207(a) of the 2002 FSRI Act, export credit guarantee programmes and the ETI Act) and the functioning of the US legal and regulatory system in respect of these measures.**

211(b)(2) of the Agricultural Trade Act of 1978, as amended, caps the current fees at 1 per cent for . . . GSM-102 and SCGP.")).

# ANNEX I-21

## COMMENTS OF THE UNITED STATES TO THE 11 FEBRUARY 2004 ANSWERS OF BRAZIL TO PANEL QUESTION 276

18 February 2004

**Question 276. "The Panel notes the parties' responses and comments relating to Question No. 252 concerning the time period within which any prohibited measure must be withdrawn within the meaning of Article 4.7 of the SCM Agreement. Please supplement your original response, taking into account the particular nature of each alleged prohibited subsidy measure (i.e. "Step 2" payments under Section 1207(a) of the 2002 FSRI Act, export credit guarantee programmes and the ETI Act) and the functioning of the US legal and regulatory system in respect of these measures."**

1. The United States appreciates this opportunity to comment on the response of Brazil to Panel question 276, posed on 3 February 2004. As an initial matter, the United States notes that the question poses a hypothetical situation: that any of the measures at issue in this dispute might be found to be a prohibited subsidy. The United States of course has explained that Brazil has not shown that any of the measures at issue is a prohibited subsidy. That being said, the United States offers the following comments on Brazil's response.

2. Of note, in its response Brazil has recognized that its previous answer to Question 252 from the Panel was inadequate. In full, that answer provided: "Brazil suggests that the Panel follow the precedent of all previous WTO panels that made findings of prohibited subsidies and specify that the measure must be withdrawn within 90 days."[1] Brazil has now revised – from 90 days to six months – its recommendation to the Panel of the time period that would constitute withdrawing "without delay" subsidies allegedly provided by the export credit guarantee programmes. However, Brazil's response sets out a faulty analysis of the meaning of "without delay" in Article 4.7 as applied in previous reports and therefore identifies what would be inappropriately short time periods for withdrawal of the measures at issue if they were prohibited subsidies, which they are not.

3. Article 4.7 of the *Agreement on Subsidies and Countervailing Measures* ("Subsidies Agreement") establishes that "[i]f the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn". The Agreement does not further define "without delay", although Brazil concedes that the "text [of Article 4.7] does not state 'immediately'".[2]

4. Past panels have dealt with the meaning of the term "without delay," and have concluded that this involves an examination of the nature of the changes to be effected and the domestic legal process involved. For example, in *Canada – Certain Measures Affecting the Automotive Industry*, the panel found that "in examining what time-period would represent withdrawal 'without delay' in a particular case, we consider that we may take into account the nature of the steps necessary to withdraw the prohibited subsidy".[3] Similarly, in *Australia – Subsidies Provided to Producers and Exporters of*

[1] Brazil's Answer to Question 252 from the Panel, para. 167 (22 December 2003) (footnotes omitted).
[2] Brazil's Answer to Question 276 from the Panel, para. 2.
[3] WT/DS139/R, WT/DS142/R, paras. 11.6-11.7 (adopted as modified 19 June 2000) (italics added).

*Automotive Leather*[4], the panel found that "the nature of the measures and issues regarding implementation might be relevant" to the time period for withdrawal of the subsidies".[5]

5. The analysis by these panels is similar to that undertaken by arbitrators under Article 21.3 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") in considering the period of time for a Member to implement DSB recommendations and rulings. There, arbitrators have also considered that Article 21.3 calls for an analysis of the nature of the changes to be effected and "the shortest period possible within the legal system of the Member to implement the recommendations and rulings of the DSB".[6] Thus, in practical terms, the "reasonable period of time" standard of DSU Article 21.3 has been interpreted to mean something akin to without "delay" ("procrastination; lingering; putting off"[7]).

6. DSU Article 21.3 is part of the context of Article 4.7. Brazil attempts to distinguish Article 4.7 of the Subsidies Agreement from Article 21.3 of the DSU.[8] However, Brazil argues that a key difference is that Article 21.3 uses the term "reasonable". Brazil thus appears to argue that under Article 4.7 any time period specified should not be reasonable. The United States agrees that there are differences between Article 4.7 of the Subsidies Agreement and Article 21.3 of the DSU. But those differences do not amount to a requirement that panels require unreasonable actions. Rather, one key difference is that DSU Article 21.3(c) provides arbitrators with a "guideline" that the "reasonable period of time" to implement panel or Appellate Body recommendations "should not exceed 15 months from the date of adoption of a panel or Appellate Body report" whereas Article 4.7 does not.[9]

7. In the current dispute, the measures at issue all involve legislation and any change would require legislative action. Brazil has proposed that withdrawal "without delay" should be considered to mean withdrawal within 90 days for allegedly prohibited subsidies under the Step 2 programme and the ETI Act and withdrawal within 6 months for alleged export subsidies under the export credit guarantee programmes. However, Brazil's proposed time periods are not supported by considerations relating to the nature of the measures at issue nor the US legislative process that would be necessary to effect changes to those measures.

8. Specifically, Brazil concedes that statutory changes would be necessary to withdraw the allegedly prohibited subsidies at issue in this dispute.[10] However, the panel reports Brazil cites as

[4] WT/DS126/R, paras. 10.4-10.7 (adopted 16 June 1999).

[5] *See also* the panel reports in the *Aircraft* disputes between Canada and Brazil, in which the panels took into account the nature of the measures and the procedures which may be required to implement the panels' recommendations.

[6] Report of the Arbitrator, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/14, WT/DS234/22, para. 42 (13 June 2003) (quotation marks and footnote omitted) (citing 3 previous reports of arbitrators).

[7] *The New Shorter Oxford English Dictionary*, vol. 1, at 623 (1993 ed.).

[8] Brazil's response to Question 276, para. 2.

[9] In the earliest arbitrations under Article 21.3(c), arbitrators viewed the guideline as meaning that each party bore the burden of proof that the reasonable period of time should depart from the 15 months period, which would be a significant difference from Article 4.7. That approach has now evolved into the practice described above of the shortest possible period of time within the legal system of the Member to implement the recommendations and rulings of the DSB.

[10] Brazil's Answer to Question 276 from the Panel, para. 10 (11 February 2004) (eliminating Step 2 "simply requires the repeal of Section 1207(a) of the 2002 FSRI Act); *id.*, para. 11 (for export credit guarantee programmes, "the prohibited subsidies must be withdrawn by enacting the necessary changes to the statutes and regulations providing for GSM102, GSM 103, and SCGP"); *id.*, para. 12 (90 days "represents an appropriate period of time . . . to withdraw the ETI Act").

support for the proposition that "without delay" generally means 90 days dealt with subsidies that required *only executive or administrative action* to withdraw:[11]

> In Canada – Certain Measures Affecting the Automotive Industry, the panel found: "we note that the [challenged measures] are both Orders-in-Council, and as such are acts of the executive, and not the legislative branch of government. The amendment of an act of the executive branch can normally be effectuated more quickly than would be the case if legislative action were required."[12] The report further notes that "in those disputes involving a prohibited subsidy in which legislative action was not required, panels have specified a time-period of 90 days".[13]
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> In Australia – Subsidies Provided to Producers and Exporters of Automotive Leather,[14] taking into account that the dispute involved payments made under a grant contract between the Australian Government and a private company, the panel recommended that the measures be withdrawn within 90 days.
>
> In Canada – Export Credits and Loan Guarantees for Regional Aircraft,[15] involving executive action concerning financing provided by Canada for particular transactions, the panel found that "Canada should withdraw the export subsidies within 90 days ("without delay").
>
> In Brazil – Export Financing Programme for Aircraft, with respect to payments under the interest rate equalization component of PROEX,[16] the panel report found that, "taking into account the nature of the measures and the procedures which may be required to implement our recommendation," Brazil should withdraw the measures within 90 days.[17]
>
> In Canada – Measures Affecting the Export of Civilian Aircraft,[18] with respect to certain executive action concerning financing and funds provided to the Canadian civil aircraft industry, the panel report found that, "[t]aking into account the procedures that may be required to implement our recommendation", Canada should withdraw the measures within 90 days.

Thus, in every panel report in which the "without delay" time period has been set as 90 days, only executive action (and not statutory amendment) has been necessary. Thus, these reports offer little guidance to the Panel, other than to indicate that 90 days would *not* be an adequate time period, given that Brazil recognizes that legislation would be required to modify the measures in dispute.

9. Brazil notes, almost in passing, that "[t]here is only one precedent applying the Article 4.7 'without delay' provision to prohibited subsidy measures requiring legislative changes"[19]: the panel

[11] Brazil's Answer to Question 276 from the Panel, para. 10 n.15.
[12] WT/DS139/R, WT/DS142/R, paras. 11.6-11.7 (adopted as modified 19 June 2000) (italics added).
[13] *Id.*, para. 11.7 n. 910 (citing panel reports in *Australia – Leather*, *Brazil – Aircraft*, and *Canada – Aircraft*).
[14] WT/DS126/R, paras. 10.4-10.7 (adopted 16 June 1999).
[15] WT/DS222/R, paras. 8.1-8.4 (adopted 19 February 2002).
[16] PROEX was being maintained by provisional measures issued by the Brazilian Government on an monthly basis, and the financing terms for which interest rate equalization payments were made were set by Ministerial Decrees. WT/DS46/R, paras. 2.1, 2.3 (adopted 20 August 1999).
[17] *Id.*, paras. 8.2-8.5.
[18] WT/DS70/R, paras. 10.3-10.4 (adopted as modified 20 August 1999).
[19] Brazil's Answer to Question 276 from the Panel, para. 5 (11 February 2004).

report in *United States – FSC*.[20] However, Brazil fails to quote or discuss that panel report's discussion of the "without delay" language, which would seem to be particularly relevant given that Brazil has challenged the ETI Act – the successor to the FSC programme – in this dispute. Brazil erroneously cites this report as supporting the proposition that "without delay" generally means withdrawal within 90 days[21], but there is no discussion of a 90-day period in the report.

10. Upon finding that the FSC scheme provided export subsidies inconsistent with Article 3.1(a) of the Subsidies Agreement, the *FSC* panel first recommended, "pursuant to Article 4.7 of that Agreement, that the DSB request the United States to withdraw the FSC subsidies without delay".[22] The panel examined what should be its recommendation with respect to the time-period within which the measure must be withdrawn. The panel noted that the time period specified "must be consistent with the requirement that the subsidy be withdrawn 'without delay'". The panel then went on to find, and recommend:

> Given that the implementation of the Panel's recommendation will require legislative action (a fact recognized by the European Communities), that the United States fiscal year 2000 starts on 1 October 1999, and that this report is not scheduled for circulation to Members until September 1999 (and, if appealed, might not be adopted until as late as early spring 2000), it is not in our view a practical possibility that the United States could be in a position to take the necessary legislative action by 1 October 1999. That being so, and acting in good faith, there is no way that this could be described as a 'delay.' However, this objective timing constraint would not be present with effect from the following fiscal year (2001), which commences on 1 October 2000. As this would be the first practicable date by which the United States could implement our recommendation, it satisfies the 'without delay' standard found in Article 4.7. Accordingly, we specify that FSC subsidies must be withdrawn at the latest with effect from 1 October 2000.[23]

Brazil recognizes that statutory changes would be necessary to modify the measures at issue in this dispute. However, Brazil fails to discuss the various considerations identified by the *FSC* panel report, such as the potential date of circulation of the Panel's report and the effect of appeal on the timing of adoption. Neither does Brazil discuss whether there would be a "practical possibility" of legislative action within its suggested time periods.

11. With respect to the potential date of circulation, the Panel's current schedule provides for the final report to be issued to the parties on 19 May. Circulation to all Members would be upon translation into the official WTO languages. Conservatively assuming one month for completion of translation of what may be a very lengthy panel report, the report would be circulated in mid-June. Panel reports may not be considered for adoption until 20 days after they have been circulated to all Members[24] – approximately early July. If the Panel report is appealed, the Appellate Body report will likely be issued 90 days from the notice of appeal[25] – approximately early October. The Appellate Body report would be adopted (unless the DSB decides by consensus not to adopt it) within 30 days of circulation[26] – approximately early November.

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[20] Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/R (adopted 20 March 2000) ("*United States – FSC*").

[21] Brazil's Answer to Question 276 from the Panel, para. 10 n.15 (11 February 2004).

[22] *United States – FSC*, WT/DS108/R, para. 8.3.

[23] *United States – FSC*, WT/DS108/R, para. 8.8.

[24] DSU Article 16.1.

[25] See *Statistical Information on Recourse to WTO Dispute Settlement Procedures: Background Note by the Secretariat*, Job(03)/225, circulated 11 December 2003, Section IV.B and Table 8.

[26] DSU Article 17.14.

12. The current US Congress is scheduled to adjourn on 1 October 2004. Accordingly, no legislative action would be possible until after the new Congress convenes in 2005 and organizes itself. The United States has previously stated that, in the event of a prohibited subsidy finding, it should be given until the end of "this year" to complete the legislative process. However, given the probable time line for this dispute noted above, that is not a possibility.

13. Once the new Congress convenes and organizes (a process that we would not expect to be completed before mid-February), any legislation would then need to proceed through the legislative process. In the United States, this involves the following.[27]

**The US Legislative Process**

14. Under the United States system of constitutional government, any changes to a federal statute must be enacted by the US Congress, which sets its own procedures and timetable. The Executive branch of the US Government has no control over these procedures and timetable. Securing the enactment of legislation in the US Congress is a complex and lengthy process. Moreover, only a small fraction of the thousands of bills introduced in each Congress ever become law. This indicates that the process of obtaining the votes necessary to enact legislation is difficult and time-consuming. Viewed in this light, there is no "practical possibility" that this process will take, as Brazil suggests, 3 months for the Step 2 programme and ETI Act and 6 months (including time for administrative action) for the export credit guarantee programmes.

15. The power to legislate is vested in the United States Congress, which has two chambers, the House of Representatives and the Senate. Both chambers must approve all legislation in identical form, before it is sent to the President of the United States for signature or other action. Only after presidential approval does proposed legislation become law. Proposed legislation that will become public law usually takes the form of a "bill". From the time that a bill is introduced in Congress to the time that it is approved by both chambers, it will have passed through at least ten steps. These ten steps include: (1) the bill is introduced in the House of Representatives or the Senate by a member of Congress; (2) the bill is referred to a standing committee or committees having jurisdiction over the subject matter of the bills, which may also refer the proposed legislation to various subcommittees; (3) the merits of the bill are considered by a subcommittee, which may include public hearings; (4) when hearings are completed, the subcommittee meets to "mark-up" the bill (make changes and amendments) prior to deciding whether to recommend (or "report") the bill to the full committee; (5) the full committee (considering the subcommittee's report) may conduct further study and hearings and then votes whether to report the bill, either as originally introduced without amendment, or as revised, to the full House; (6) the House considers the bill on its merits and, after voting on amendments, the House immediately votes on the bill itself with any adopted amendments; (7) if the bill is passed, the bill must be referred to the Senate, which, following its own legislative process and consideration, may approve the bill as received, reject it, ignore it, or change it; (8) if the Senate amends the bill or passes its own similar but not identical legislation, a conference committee is organized to reconcile differences between the House and Senate versions; (9) if the committee reaches agreement on a single bill, a "conference report" must be approved by both chambers, in identical form, or the revised legislation dies; and (10) after the bill proposed by the conference committee is approved by both chambers, it is sent to the President for approval. Most bills that are introduced do not survive this process to become law, and those that do are likely to have been significantly amended along the way.

[27] A more detailed description of the US legislative process may be found in paragraphs 21-35 of the Submission of the United States in the Arbitration under Article 21.3(c) of the DSU in the dispute *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217 & 234 (13 April 2003) (available at http://www.ustr.gov/enforcement/briefs.shtml).

16. In addition, Brazil has recognized that a finding that the programmes are prohibited export subsidies would necessarily require "changes to the statutes and regulations" providing for the programmes.[28] The regulatory changes could not be made until after the legislative changes are finalized. Thus, the time period that would constitute withdrawal "without delay" would have to allow for both legislative and regulatory changes.

17. No panel report considering Article 4.7 has ever awarded a period of less than three months. Moreover, panels have found that "[t]he amendment of an act of the executive branch can normally be effectuated more quickly than would be the case if legislative action were required".[29]

18. Indeed, in a recent arbitration under DSU Article 21.3(c) in a dispute where compliance by the United States involved both legislative and regulatory action, the arbitrator concluded that 15 months was the reasonable period of time for implementation.[30]

19. In light of the foregoing considerations, under the hypothetical situation that any of the measures at issue would be a prohibited subsidy, the United States suggests that a panel recommendation that the measure be withdrawn 15 months after adoption of the DSB recommendations and rulings would be "without delay" in the circumstances of this dispute.

[28] Brazil's Answer to Question 276 from the Panel, para. 11.

[29] *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R, paras. 11.6-11.7.

[30] Award of the Arbitrator, *United States – Anti-Dumping Measures on Certain Hot-rolled Steel Products from Japan: Arbitration under Article 21.3(c) of the DSU*, WT/DS184/13, circulated 19 February 2002.

# ANNEX I-22

## BRAZIL'S COMMENTS ON UNITED STATES 11 FEBRUARY COMMENTS ON BRAZIL'S 28 JANUARY "COMMENTS AND REQUESTS REGARDING DATA PROVIDED BY THE UNITED STATES ON 18/19 DECEMBER 2003 AND THE US REFUSAL TO PROVIDE NON-SCRAMBLED DATA ON 20 JANUARY 2004"

18 February 2004

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## 1. Introduction

1. Brazil sets forth its response to the US 11 February 2004 Comments on Brazil's 28 January Comments and Requests regarding the US Data ("US 11 February 2004 Comments"). Brazil demonstrates in Sections 2 and 3 that the US critique of any methodology for tabulating "support to a specific commodity" is based on (1) a faulty legal interpretation that only subsidies tied to the production of a specific commodity can be counted for the purposes of Article 13(b)(ii) of the Agreement on Agriculture, and (2) a faulty factual assumption that the non-green box US contract payments did not provide support to maintain US production of upland cotton between MY 1999-2002. In Section 5, Brazil responds to the US 11 February 2004 Comments by demonstrating that applying Brazil's and the US methodologies (along with two slight variations thereof) to the incomplete and inadequate US summary data (including the most recent 28 January 2004 data) demonstrates that the US budgetary expenditures in MY 1999-2002 exceed the level of support decided in MY 1992. Finally, Brazil responds to a number of other points raised by the US 11 February 2004 Comments in Sections 4, and 6-10.

## 2. The US Critique of Brazil's Methodology Is Based on the Flawed US Interpretation of "Support to a Specific Commodity" and, Alternatively, "Non-Product Specific Support"

2. The United States' 11 February 2004 Comments challenging Brazil's methodology for counting contract payments are premised on a faulty interpretation of Article 13(b)(ii) of the Agreement on Agriculture. The US comments continue the US interpretation that the Panel can only count as "support" in MY 2002 those non-green box subsidies that *require* the production of upland cotton.[1] But this leaves behind a number of subsidies that significantly and directly support production of upland cotton. As Brazil has previously argued, the Panel is required to count under Article 13(b)(ii) as "support to upland cotton" for MY 1999-2002 *all* identifiable non-green box support to upland cotton that supports, either directly or indirectly, the production or sale of upland cotton.[2]

### 2.1 US 11 February 2004 Comments Improperly Interpret the Phrase "Support to a Specific Commodity"

3. The United States argues that no allocation methodology can be applied by the Panel under Article 13(b)(ii) of the Agreement on Agriculture. This US argument is based on the US 11 February 2004 Comments that "support to" means support "tied to" the production of a specific commodity.[3] In evaluating this argument the Panel should examine the ordinary meaning of the phrase "support to a specific commodity" in Article 13(b)(ii). The word "support" is defined as "the action of preventing a person from giving way or of backing-up a person or group; assistance, backing".[4] "Support" does not mean or require, as the US comments suggest, an "incentive" or "encouragement" to produce. The SCM Agreement Annex IV, paragraph 3 phrase "tied to the production or sale of a [specific commodity]" is not found in Article 13(b)(ii). Rather, the word "support" has a more general sense of "backing up" a group of agricultural farmers producing a specific commodity. For example, subsidies that cover costs of production when a farmer chooses to grow a crop, "back up" or "support" that farmer. While some non-green box subsidies at issue in this dispute may create a greater *incentive* to produce (*i.e.*, marketing loan, counter-cyclical payments, or crop insurance subsidies) than other subsidies (PFC or direct payments), all of these subsidies at issue in this dispute "support" production of upland cotton because they cover (or contribute to) the costs of production of a crop.

[1] *See* US 11 August 2003 Answer to Question 38, para 81.
[2] Brazil's 22 August 2003 Rebuttal Submission, para. 14-16.
[3] Brazil's 11 February 2004 Comments, paras. 7-9.
[4] New Shorter Oxford Dictionary, Volume II, p. 3152 (first definition).

4. The distinction between "support for production" and "incentive for" (or "tied to") production becomes relevant only when examining the *effects* these subsidies have in causing serious prejudice, within the meaning of Part III of the SCM Agreement. Brazil and the United States agree that the contract payments, which do not *require* production, create less direct *incentives* to produce than, *e.g.*, marketing loan payments, Step 2 payments and crop insurance subsidies. But it is improper to impose an "incentive to" or "tied to" production test when counting up the non-green box "support" to a specific commodity under Article 13(b)(ii) of the Agreement on Agriculture. As noted above, the meaning of the phrase "support to" is a far broader concept. Indeed, the *chapeau* of Article 13(b)(ii) confirms this broader meaning of "support," because it includes all types of non-green box measures, without regard to whether they create direct production incentives.

5. The United States' comments continue to repeat the flawed mantra that "support to a specific commodity" means exactly the same thing as "product-specific support".[5] Negotiators presumably knew what they intended when they used the very particular term "product-specific support". They used the term repeatedly in the Agreement on Agriculture, and even defined "non-product-specific support" in Article 1(a) – yet they declined to use "product-specific support" in Article 13(b)(ii). Accepting *arguendo* the US narrow interpretation of "product-specific"[6], one reason may be that the "support to a specific commodity" phrase was *not* intended to mean *only* support that is tied to *one product*, but rather is intended to include *all* support that is *provided*, either directly or indirectly, to *a product*. The term "specific" clarifies that Article 13(b)(ii) focuses on any support to an individual commodity, not a *group* of commodities such as "grains"[7] or even all commodities. In fact, the notion of a "specific commodity" is very analogous to the "like product" in, *inter alia*, Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994 – provisions that are expressly referenced in Article 13(b)(ii) of the Agreement on Agriculture.

6. The United States argues that the Panel is prohibited from even including as "support to" upland cotton, let alone applying *any* allocation methodology to, any non-green box domestic support measure.[8] This would be true even where a measure may provide billions of dollars of support to producers of a "specific commodity". This, of course, is based on the US view that only support directly tied to the production of a specific product is covered by Article 13(b)(ii).[9] But because Article 13(b)(ii) captures *all* non-green box domestic subsidies that support a commodity, it may require the application of an allocation methodology for many trade- and production-distorting domestic support measures that may provide support to more than one commodity. The issue under Article 13(b)(ii) is whether a particular commodity receives "backing" or "support" from a domestic support measure. But the sole fact that multiple commodities are supported by a single type of (trade- and production-distorting) measure does not mean that the "support" or backing suddenly disappears when tabulating the amounts of support for the purpose of Article 13(b)(ii).

7. Applying a methodology such as that proposed by Brazil is consistent with the object and purpose of Article 13(b)(ii) – to capture all identifiable non-green box trade distorting subsides that "support" upland cotton production. To allow huge amounts of trade- and production-distorting support – such as the almost $1 billion in counter-cyclical payments received by almost every upland cotton farmer in MY 2002 – to remain uncounted renders any disciplines during the implementation period inutile. Were this the intention of negotiators, as the United States argues, then it would certainly have been stated explicitly – with language such as "exempt from actions … provided that measures *which are paid upon the production of* a specific commodity do not grant support to a specific commodity in excess of that decided during the 1992 marketing year". Or with language

[5] US 11 February 2004 Comments, paras. 11-14.

[6] Brazil disagrees with the US interpretation, as set out in Section 2.2, *infra*.

[7] Brazil's 11 August 2003 Answer to Question 42, paras. 59-60.

[8] US 11 February 2004 Comments, para 36 (arguing that "support to a specific commodity" really means "product-specific support").

[9] US 11 August 2003 Answers to Question 38, para. 81.

such as "exempt from actions … provided that *measures are directed only at a specific commodity* do not grant support … ." It would have been simple to include these explicit phrases limiting support measures to only subsidies tied to production. But no such limitations were made in the *sui generis* provisions of Article 13(b)(ii).

8. In rejecting the narrow US "required production" test for "support to" in Article 13(b)(ii), the Panel must also reject the US criticisms of Brazil's methodology for calculating support to upland cotton. This is because the US challenge to Brazil's methodology is premised on incorporating into Article 13(b)(ii) the test that the only trade and production distorting support that can be counted is support that is *de jure* "tied to the production or sale of a given product". Yet, this "tied to the production" language is found only in Annex IV, paragraph 3 of the SCM Agreement – not Article 13(b)(ii) of the Agreement on Agriculture.

### 2.2 The US 11 February 2004 Comments Improperly Interpret the Phrase "Product-Specific"

9. Brazil has argued, *in the alternative*, that the contract payments would also be considered to be "product-specific" support if the term "product-specific" had actually been used in the text of Article 13(b)(ii).[10] Brazil argued that the meaning of "product-specific" AMS must be governed by the only term providing some guidance to what it means – the definition of "non-product-specific support" in Article 1(a) of the Agreement on Agriculture.[11] Because the United States raised this issue in its 11 February 2004 Comments,[12] Brazil addresses it below, referencing Brazil's earlier arguments.

10. As a preliminary matter, however, Brazil must correct an error in the US 11 February 2004 Comments. The United States falsely asserts that Brazil has "conceded that 'support to a specific commodity' refers to 'product-specific support'".[13] The alleged "concession" by Brazil[14] becomes the foundation for the US arguments in paragraphs 11-17 of the US 11 February 2004 Comments.

11. As the Panel knows, Brazil argued extensively – and correctly – in the peace clause phase of this dispute that the phrase "support to a specific commodity" is *not* the same as "product-specific support".[15] Brazil's earlier arguments noted that under the facts of this case, all of the non-green box support payments challenged by Brazil as "support to a specific commodity" would also be considered "product-specific support", within the meaning of Article 1(a) of the Agreement on Agriculture.[16] However, this argument was only made in the alternative, to demonstrate that, even under the incorrect US theory, the amount of "product-specific" support for upland cotton in MY 1999-2002 exceeded the level of "product-specific" support for upland cotton decided in MY 1992.

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[10] Brazil's 11 August 2003 Answers to Questions 40-41; Brazil's 11 August 2003 Rebuttal Submission, paras. 24-52.

[11] Brazil's 11 August 2003 Answers to Questions 40-41; Brazil's 22 August 2003 Rebuttal Submission, para. 19.

[12] US 11 February 2004 Comments, paras. 11-14.

[13] US 11 February 2004 Comments, paras. 11, 14.

[14] The text of the alleged "concession" made by Brazil is "In sum, Brazil maintains its position – supported by all third parties – that the support from contract payments that can be allocated to upland cotton is product-specific support within the meaning of the Agreement on Agriculture." What the United State neglects to note in its "concession" assertion is that Brazil then cited to its 22 August 2003 Rebuttal Submission, paras. 3-23 and 24-52, where Brazil argued exactly the same position it has set forth in these comments. Therefore, there was no "concession" or otherwise by Brazil.

[15] Brazil's 22 August 2003 Rebuttal Submission, paras. 13-22. Brazil's 22 July 2003 Oral Statement, paras. 13-26. Brazil's 24 July 2003 Closing Statement, para. 8.

[16] Brazil's 22 August 2003 Rebuttal Submission, paras. 13-52. Brazil's 22 August 2003 Comments on US Answers to Questions 38-39, paras. 48-53, Question 43, para. 58.

12. The US 11 February 2004 Comments now go so far as to argue that *any* allocation methodology under Article 13(b)(ii) – which it argues means "product-specific" support – is prohibited by the Agreement on Agriculture.[17] One interpretative guide to determine whether support is "product-specific" is found in the definition of "non-product-specific support" in Article 1(a) of the Agreement on Agriculture. Brazil demonstrated that only non-product specific support is actually defined and that it includes "support provided in favour of agricultural producers *in general*".[18] The United States asserts that Brazil's definition of "general" is obsolete and that "general" means any support provided to more than one commodity.[19] But this is a tortured reading of the term "in general". "Non-obsolete" definitions of "general" include "relating to a whole class of objects" and "*not* partial, local or sectional".[20] As with the so-called "obsolete" definition criticized by the United States, these definitions fully support the ordinary meaning of "non-product-specific" support as support provided to a broad range of producers covering a wide variety of agricultural products, not simply more than one, as the United States argues.

13. Further context for the existence of some sort of an allocation methodology in the Agreement on Agriculture is Annex 3, paragraph 7, which provides that "[m]easures directed at agricultural processors shall be included *to the extent that such measures benefit* the producers of the basic agricultural products". This use of the term "benefit" is very similar to the notion of "support" as used in Article 13(b)(ii). The assessment of the extent to which measures directed at agricultural processors benefit producers of a particular product necessitates a delineation of support that actually benefit upstream agricultural producers. This requires an allocation methodology.

14. Further, the narrow US interpretation is contradicted by Annex 3, paragraphs 7, 8, 12 and 13 of the Agreement on Agriculture, which include as "product-specific" many types of domestic support not tied to the production of a particular commodity.[21] Nor do the Agreement on Agriculture citations in paragraph 12 of the US 11 February 2004 Comments provide guidance as to where to draw the line for "non-product specific support".

15. While future negotiators may decide to clarify exactly what "product-specific" means in future revisions of the Agreement on Agriculture, the present text does not provide the "hard and fast" "production-requirement" subsidy rules advanced by the United States in this dispute. Indeed, Brazil notes that all commenting third parties in this dispute have stated their belief that the US counter-cyclical payments and crop insurance subsidies were "product-specific".[22] This suggests that the United States' trading partners do not agree that there is a "production-requirement" test for "product-specific support". Consistent with these third party views, there is nothing in the text of the Agreement on Agriculture to support a finding that "product-specific" is determined solely by the *de jure* form of the payment or by whether the payment is tied to the production of the crop. Nor does the Agreement on Agriculture support the US hard and fast "tied to production" test. Absent such guidance, the determination of whether agricultural support is specific or "general" is a *factual* issue that must be decided on a case-by-case basis.

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[17] US 11 February 2004 Comments, paras 11 and 36 ("the definitions of product-specific support and non-product specific support (and their application in the Agreement on Agriculture) do not permit any such allocation … ".).

[18] Brazil's 11 August 2003 Answers to Questions 40-41.

[19] US 11 February 2004 Comments, para. 10.

[20] New Shorter Oxford Dictionary, Volume I, p. 1073 (definitions 1, 3, 4).

[21] Brazil's 22 August 2003 Rebuttal Submission, paras. 17-18 (illustrating that many non-green box measures considered as "product-specific" support do not contain "tied-to" production requirements). The United States never rebutted this argument.

[22] *See* New Zealand's 11 August 2003 Answer to Third Party Question 15; Argentina's 11 August 2003 Answer to Third Party Question 15 and 23 July 2003 Oral Statement, para. 8; EC's 11 August 2003 Answer to Third Party Question 15 *See* also Exhibit Bra-144 (G/AG/R/31, paras. 29-32).

16. The US 11 February 2004 Comments further state that "product-specific" and "non-product-specific" are disjunctive, and that Article 6.4 of the Agreement on Agriculture requires *de minimis* levels of support to be categorized into "product-specific" and "non-product-specific".[23] This is true, but begs the question of how and when to draw the line between product-specific and non-product-specific support. For example, the United States has argued that MY 2002 counter-cyclical payments for upland cotton are non-product specific.[24] But in MY 2002, upland cotton counter-cyclical payments of almost $1 billion were received by producers holding only 1.7 per cent of US farmland.[25] Brazil agrees with the EC, New Zealand, and Argentina that such payments are "partial, local or sectional" to particular US producers.[26] They are not provided "in general" to a broad group of US producers. Thus, they should be allocated as "product-specific support," including for purposes of an Article 6.4 *de minimis* analysis.

17. The United States argues that a single type of domestic support measure cannot be both "product-specific" and "non-product-specific" support.[27] Once again, the answer to this question would depend on the facts of the case. For example, if 95 per cent of the expenditures of a so-called decoupled payment ended up in the pockets of farmers producing a single commodity (such as upland cotton counter-cyclical payments), these facts would support the finding of product-specific support for that commodity. Whether the other nine commodities eligible to receive a similar type of payment were also receiving product-specific support would have to be decided on a case-by-case basis. Similarly, if a decoupled payment programme gave farmers the flexibility to grow four different crops, but these crops represented only 10 per cent of total commodity production in that Member, then the support for each of these crops might be considered to be "product-specific".

18. In sum, the use of the term "in general" in Article 1(b) of the Agreement on Agriculture implies that this is a question of fact, the answer to which depends on a host of factors, not a simplistic and non-textually based "tied to production" rule, as advanced by the United States. Any other interpretation would write text into the Agreement on Agriculture that is not there and was not agreed to by Members. As the comments of the EC, New Zealand and Argentina in this dispute vividly illustrate, there is not an universal understanding that product-specific support means only domestic support that is *de jure* tied to production. By defining "non-product-specific support" using the "in general" language, Members provided flexibility to examine, on an case-by-case basis, whether the domestic support was so linked to a handful of products that it could not be considered "non-product specific support".

19. Finally, Brazil does not believe that the Panel, in this dispute settlement proceeding, is required to interpret "product-specific" support to resolve the now-expired peace clause provisions of Article 13(b)(ii). The concept of "product-specific" continues to be a significant issue with respect to ongoing negotiations and in future interpretations of Members' obligations to comply with their "total AMS" requirements. Brazil's claims in this dispute do not challenge the "total AMS" of the United States. Brazil has never claimed that "AMS" must be interpreted in this dispute. The interpretative issues relating to the peace clause can and should be resolved by interpreting the terms actually used in that provision – "support to a specific commodity" – not by interpreting the term "product-specific" that the United States now seeks to substitute in place of a carefully negotiated text.

[23] US 11 February 2004 Comments, para. 12.
[24] US 22 August 2003 Rebuttal Submission, paras. 86-88.
[25] Brazil's 11 August 2003 Answers to Question 44, paragraph 62 (first and next to last bullets).
[26] *See* New Zealand's 11 August 2003 Answer to Third Party Question 15; Argentina's 11 August 2003 Answer to Third Party Question 15 and 23 July 2003 Oral Statement, para. 8; EC's 11 August 2003 Answer to Third Party Question 15 *See* also Exhibit Bra-144 (G/AG/R/31, paras. 29-32).
[27] US 11 February 2004 Comments, paras. 13-14.

### 3. Brazil's Methodology is Supported by Undisputed Evidence that the Contract Payments were Essential to Maintain Upland Cotton Production Between MY 1999-2002, and, thus, are Support to Upland Cotton

20. The US critique of Brazil's methodology rests not only on an incorrect legal interpretation of "support to a specific commodity," but more fundamentally on its false assumption that contract payments do not support the production of upland cotton. This factual assumption permeates *all* of the 32 pages of the US 11 February 2004 Comments. It is articulated by asserting that the contract payments are "decoupled" or "not tied to" the production of upland cotton. Ultimately, the combination of these flawed legal interpretations and factual assumptions result in the equally flawed US assertion that its Annex IV methodology is the only way to allocate contract payments (albeit only for purposes of Part III of the SCM Agreement).

21. In evaluating which methodology to use to count contract payment as "support to cotton", the starting point is the necessary fact that all the contract payments at issue are non-green box support.[28] For example, direct payments and counter-cyclical payments are not properly considered "decoupled income support", within the *chapeau* of paragraph 6 of Annex 2 of the Agreement on Agriculture.[29] This means that each of the contract payments is linked (or coupled), to some extent, to the production of one or more agricultural commodities. In addition, prior to applying the methodology, it must have been determined that the non-green box measures are "support to a specific commodity".

22. Having demonstrated these first two steps, the next question is the "amount of the support" to a specific commodity. This is a factual question and requires assessing *to what extent* a particular non-green box subsidy supports or maintains the production of a specific commodity or commodities. This initially requires an examination of the legal structure of the support mechanism. But more importantly, it requires an examination of the record evidence concerning the extent to which the payments *de facto* support or maintain the production of a specific commodity. Applied to this case, it means that the stronger the requirement for the contract payments to maintain (*i.e.*, cover the costs of) production of upland cotton, the more appropriate it is to use a methodology that treats each dollar of payments received directly by producers of upland cotton as "support to" upland cotton.

23. The US "Annex IV" methodology assumes that all four contract payments are not tied in any significant way to the production of upland cotton. The primary evidence relied on by the United States are the legal provisions of the 1996 FAIR Act and the 2002 FSRI Act, which permit "producers" to grow other crops (except fruits, vegetables and wild rice) and still receive the contract payments. The United States argued that the legally permitted "decoupled" form of the support requires the payment to be spread out over the entire value of a farm's production.[30] It is this assumption that underpins the US Annex IV methodology.

24. Calculating the amount of contract payments that is "support" to upland cotton by allocating the benefit of those payments across total production of farms receiving the payments might make sense *if* the four contract payments had, *in fact*, no significant role in maintaining the production of upland cotton. But the US methodology runs headlong into the overwhelming weight of the evidence showing a direct and significant link between "producers" receiving upland cotton contract payments and "producers" planting upland cotton. Brazil produced extensive evidence showing the link

[28] The Panel would not be able to count these programmes for purposes of Article 13(b)(ii) unless they are out of the green box, and thus, "non-green box" support.

[29] *See e.g.* Brazil's 24 June 2003 First Submission, Section 3.2.7 and 3.2.8; Brazil's 22 August 2003 Rebuttal Submission, Section 2.1.

[30] *See* US 11 February 2004 Comments, para. 37-38.

between these contract payments and the maintenance of upland cotton production.[31] Consider the following key uncontested facts:

- 96 per cent of MY 2002 upland cotton acreage was planted on farms that hold upland cotton base.[32] This demonstrates that the overwhelming majority of current US upland cotton production is planted on upland cotton base and shows that, in fact, direct and counter-cyclical payments are directly linked to current production.

- US upland cotton producers would have lost $332.79 per acre between MY 1997-2002 if they had not received upland cotton contract payments.[33] This demonstrates the critical role contract payments play in sustaining *production* of upland cotton during MY 1999-2002.

- Without direct and counter-cyclical payments in MY 2002, the average US cotton farmer would have lost 14.36 cents per pound. With these two payments, they earned a "profit" of 4.2 cents per pound with the cotton DP and CCP payments.[34]

- Producers growing crops on upland cotton acreage receive much higher per acre payments than all other "covered commodities", except rice. The higher per acre payments are directly related to the higher costs to produce cotton compared to other crops.[35] This fact highlights the *expectation* that former producers would continue to be present producers.[36] This is an expectation that is a reality, since 96 per cent of upland cotton farmers do plant upland cotton on high per-acre payment upland cotton base acreage.

- Upland cotton producers in MY 2002 received $446.8 million in upland cotton direct payments, representing a subsidization rate of 13.1 per cent.[37]

- Upland cotton producers in MY 2002 received $986.4 million in upland cotton counter-cyclical payments, representing a subsidization rate of 28.9 per cent.[38]

- The amount of US planted cotton acreage has shown only relatively small shifts over the past ten years regardless of market price movements, confirming the influence of the contract

[31] Brazil's 9 October 2003 Closing Statement, Annex I (Summary of Evidence Demonstrating that Upland Cotton Producers in MY 1999-2002 Produced Upland Cotton on Upland Cotton, Rice, or Peanut Base Acreage); *see also* Brazil's 27 October 2003 Answers to Question 125(a), paras. 7-25; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 2.1 and 3.1; Brazil's 2 December 2003 Oral Statement, paras. 25-27.

[32] *See* Annex A, Section 1, para. 16. This figure might be slightly overstated by possible aggregation problems. However, Brazil notes that the total amount of upland cotton base on farms planting upland cotton and holding upland cotton base exceeds MY 2002 plantings by 800,000 (13.8 million acres v 13 million acres), suggesting that any aggregation problem for MY 2002 is not significant.

[33] Brazil's 2 December 2003 Oral Statement, paras 25-27 *and* Exhibit Bra-353.

[34] Brazil's 22 August 2003 Rebuttal Submission, paras. 39-41.

[35] Brazil's 18 November 2003 Further Rebuttal Submission, para. 70 and Exhibit Bra-324 (NCC Chairman's Report by Kenneth Hood, 24 July 2002, p. 2)..

[36] *See* Brazil's 9 September 2003 Further Submission, para. 344 and Exhibit Bra-109 (Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, before the House Agriculture Committee, National Cotton Council, p. 5-7) arguing for higher upland cotton loan rates and "decoupled commodity payment rate[s]."

[37] *See* Annex A, Section 1, Table 1.5. *See* Table 3.8 for the total value of the upland cotton crop on all farms producing upland cotton.

[38] *See* Annex A, Section 1, Table 1.5. *See* Table 3.8 for the total value of the upland cotton crop on all farms producing upland cotton.

payments in maintaining large volumes of production.[39] This evidence is consistent with NCC testimony and USDA data showing that most upland cotton farmers do not shift out of specializing in upland cotton production towards the production of other crops to any great extent.[40]

- NCC officials repeatedly stated that their cotton farmer members cannot produce upland cotton without contract payments, and they have always treated contract payments as an integral part of an overall subsidy package of support for upland cotton production.[41]

25. In addition to the above, the provisions of the 2002 FSRI Act are evidence that upland cotton contract payments were intended to support the production of upland cotton. First, Section 1104(c)(1)(F) of the 2002 FSRI Act sets a "target price" for upland cotton of 72.4 cents per pound, which guarantees high revenues in much the same way that deficiency payments worked before MY 1996. This upland cotton-specific "target price" was requested by the NCC in 2001 and exists to support upland cotton – not the production of other crops. The cotton target price results in much higher per acre counter-cyclical payments for upland cotton than other crops (except rice). Second, Sections 1103(a) and 1104(a) require payments to current producers growing on covered crop base acreage. In other words, Congress intended that only farmers actually planting crops (or sharing the risk of planting a crop if one would have been produced) would directly receive the payments. Third, Section 1103(b) of the 2002 FSRI Act establishes very high direct payment rates for upland cotton base relative to other "covered commodities"[42]

26. The facts set out above are crucial for understanding why the US "Annex IV" methodology rests on a completely false assumption. That assumption is that US producers of upland cotton do not need or rely on the full amount of upland cotton payments to cover their long-term losses from the production of *upland cotton*. The United States implements this assumption by proposing that the *only* methodology that can be used is one that would spread the entire amount of the contract payments across the total value of an upland cotton farmer's production. But the record shows conclusively that most upland cotton farmers simply could not produce upland cotton profitably in MY 1999-2002 without using all contract payments they demanded and received for their upland cotton production.

27. The US 11 February 2004 Comments argue that Brazil's methodology for counting support to upland cotton makes "no economic sense".[43] But it is the US Annex IV methodology, as applied to contract payments to US upland cotton producers, that makes no economic sense. For example, if upland cotton farmers were, in fact, using these payments to support unprofitable dairy, livestock, or fish farming operations, then they would have lost money on their upland cotton production. The fact that US producers were able to grow any upland cotton at all in MY 2002 after four straight years of huge "losses" (totalling $872 per acre by MY 2002,[44] comparing production costs and market revenue) demonstrates conclusively the production-sustaining effects of these subsidies.[45] Indeed, the

[39] *See* Brazil's 27 October 2003 Answers to Questions, paras. 35-36; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 81-88.

[40] Brazil's 9 October 2003 Closing Statement, Annex I (Summary of Evidence Demonstrating that Upland Cotton Producers in MY 1999-2002 Produced Upland Cotton on Upland Cotton, Rice, or Peanut Base Acreage, paras. 9-12.

[41] Exhibits Bra-3, 108, 109, 111 and 252. Brazil's 9 October 2003 Closing Statement, Annex I (Summary of Evidence Demonstrating that Upland Cotton Producers in MY 1999-2002 Produced Upland Cotton on Upland Cotton, Rice, or Peanut Base Acreage, paras. 14-19.

[42] *See* Exhibit Bra-29 (2002 FSRI Act).

[43] US 11 February 2004 Comments, para. 37.

[44] Brazil's 27 October 2003 Answers to Questions, paras. 35-36

[45] Without contract payments, US producers would have lost $332.79 per acre over the 6-year period. Brazil's 2 December 2003 Oral Statement, paras. 25-27 *and* Exhibit Bra-353.

continued high levels of plantings in MY 2002 despite these losses are strong evidence that upland cotton producers did in fact (a) receive, and (b) use upland cotton contract payments to sustain their upland cotton production during MY 1999-2002. If not, US upland production would have been far lower, as farmers simply could not have survived economically. Thus, the US assumption in its "Annex IV" methodology that producers did not need or use upland cotton payments to sustain high-cost upland cotton production is simply wrong.

28. By contrast, Brazil's methodology properly reflects the economic reality of the key role these payments played in sustaining US upland cotton production in MY 1999-2002. Brazil, like the NCC, believes that the contract payments were necessary for the maintenance and the survival of US upland cotton production during MY 1999-2002.[46] In keeping with the key role that upland cotton contract payments played in sustaining upland cotton production, the principal element of Brazil's methodology focuses only on upland cotton contract payments made to producers of upland cotton. Such "cotton to cotton" payments represent the vast bulk of contract payments received by upland cotton producers. For example, under Brazil's methodology, 99.1 per cent of the MY 2002 direct payments received by upland cotton producers were upland cotton payments.[47] Similarly, under Brazil's methodology, 99.8 per cent of the MY 2002 counter-cyclical payments received by upland cotton producers were upland cotton payments.[48] Treating all of these "cotton to cotton" payments as support to upland cotton is fully supported by the essential role these cotton payments play in sustaining US upland cotton production.

29. The second (and relatively minor) part of Brazil's methodology is to account for the non-upland cotton contract payments received by current upland cotton producers. These non-upland cotton base payments represented a tiny 0.9 per cent in MY 2002 of the total direct payments allocated to upland cotton under Brazil's methodology, and 0.2 per cent in MY 2002 of the counter-cyclical payments allocated to upland cotton under Brazil's methodology. This small part of Brazil's methodology first pools any contract payments received for base acres not planted to their respective base crop and then distributes them as support to these contract payment crops according to their share of total "overplanted" base acreage on the farm.

30. The facts show that it is appropriate for Brazil to allocate these payments over the plantings of the other "covered commodities" produced by an upland cotton producer. Brazil demonstrated that, for each of the marketing years from 2000-2002, an upland cotton producer growing upland cotton on *non*-contract acreage would have suffered considerable losses.[49] Even growing on non-upland cotton (except rice) base acreage would have resulted in losses during most of the period of investigation.[50] Therefore, the relatively few upland cotton producers planting on some other type of base acreage needed and relied on the non-upland cotton payments to come close to making a profit. Without such payments, the average producer would have not been able to sustain upland cotton production.

31. In addition, the allocation across all contract crops (as opposed to all farm products produced) is justified by the evidence of the "specific" nature of the "covered commodity" payments. The United States never contested Brazil's evidence or argument that the contract payments are "specific" subsidies within the meaning of the SCM Agreement. For example, the United States never rebutted evidence that the 2002 FSRI Act "covered commodities" represented only 24 per cent of the value of US farm receipts (and 30 per cent of US farm acreage) in MY 2002, and that the 1996 FAIR Act "programme crops" represented less than 14 per cent of the value of US crops (and 22 per cent of the

[46] Brazil's 24 June 2003 First Submission, para. 1.
[47] *See* Annex A.2, Tables 2.9, 2.21 and 2.21.
[48] *See* Annex A.2, Tables 2.9, 2.20 and 2.21.
[49] Brazil's 27 October 2003 Answers to Question 125(c), paras. 15-25; Brazil's 22 August 2003 Rebuttal Submission, paras. 39-44, and 30-31.
[50] Brazil's 27 October 2003 Answers to Question 125(c), paras. 15-25; Brazil's 22 August 2003 Rebuttal Submission, paras. 39-44, and 30-31.

acreage) during MY 1999-2001.[51] Nor did the United States ever rebut any of the numerous statements of the users and recipients of the contract payments – the NCC – that they needed and received contract payments to survive.[52]

32. In sum, the proper allocation methodology under Article 13(b)(ii) of the Agreement on Agriculture must be consistent with the extent to which the domestic support payments directly maintain the production of a specific commodity. Brazil's methodology reflects the crucial role that each of the four contract payments plays in maintaining the production of US upland cotton. By contrast, the US "Annex IV" methodology assumes incorrectly that these payments do not support upland cotton any more than they support catfish farming or other production activities on an upland cotton farm. For the above reasons, Brazil requests that the Panel reject the US arguments, and adopt Brazil's methodology for allocating the contract payments.

### 4. A Methodology to Count Contract Payments Is Appropriate Based on the Text of Article 13(b)(ii) of the Agreement on Agriculture

33. The United States criticizes Brazil's methodology (and presumably any other methodology) because it is not based in the "text" of the peace clause or the Agreement on Agriculture.[53] Instead, the United States argues that the Panel should use Annex IV of the SCM Agreement as the basis for its calculation of the amount of the contract payments.[54]

34. Article 13(b)(ii) of the Agreement on Agriculture does not provide explicit guidance on how to count up the amount of support for contract or any other type of payments.[55] But that does not mean that no counting methodology can be used. The absence of explicit guidance on implementing more general provisions has not stopped WTO panels or parties from proposing and using methodologies to tabulate the amount of subsidies, costs, and volumes of trade impacted.

35. The Panel only need to look as far as the export credit guarantee arguments in this dispute as an example. Item (j) establishes that export credit guarantee programmes constitute export subsidies if they are operated at premium rates that are inadequate to cover the long-term operating costs and losses of the programmes.[56] There is no explicit methodology provided in the text of item (j) that would define how to apply this provision. Yet, the United States has repeatedly argued for the application of a cash-basis accounting methodology to tabulate the amount of costs and losses.

36. Similarly, DSU Article 22.7 requires any suspension of concessions to be "equivalent to the level of nullification or impairment". As with Article 13(b)(ii) of the Agreement on Agriculture, this requires the tabulation of amounts – in the case of Article 22.7, the amounts of trade impacted through the non-implementation of WTO-inconsistent measures. Again, there is no methodology provided in Article 22.7 to assess the level of nullification or impairment. Nevertheless, arbitrators, at the urging, *inter alia*, of the United States, have applied DSU Article 22.7 using a variety of methodologies developed on a case-by-case basis to assess the level of nullification or impairment.[57]

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[51] Brazil's 22 August 2003 Rebuttal Submission, paras. 24-25; Brazil's 9 September Further Submission, paras. 46, 55.

[52] *See e.g.* Brazil's 22 July 2003 Oral Statement, paras 52-53, 58-60; Brazil's 24 June 2003 First Submission, para. 1; Brazil's 18 November 2003 Further Rebuttal Submission, para. 25, 70, 102.

[53] US 11 February 2004 Comments, para. 8.

[54] The United States argues that its methodology can only be used in connection with Part III of the SCM Agreement, not the Agreement on Agriculture. (*See e.g.* US 11 February 2004 Comments, paras. 2, 86).

[55] Nor does Annex IV, as discussed in Section 4 below.

[56] Brazil also claims that the export credit guarantee programmes constitute export subsidies under the terms of Articles 1.1. and 3.1(a) of the SCM Agreement.

[57] Arbitrator Report, *EC – Bananas (US)*, WT/DS27/ARB; Arbitrator Report, *EC – Bananas (Ecuador)*, WT/DS27/ARB; Arbitrator Report, *EC – Hormones (US, Canada)*, WT/DS26/ARB and

37. Finally, other provisions of the WTO Agreement similarly require WTO Members, as a practical matter, to implement general obligations by applying different valuation and allocation methodologies under general Anti-Dumping Agreement and the SCM Agreement rules.[58]

38. The United States argues that only Annex IV of the SCM Agreement offers any useful context. While it derides Brazil's methodology as being "invented", a close look at the text of Article IV reveals that it is ill-equipped to address the tabulation of support issue before the Panel. Annex IV, which is entitled "Calculation of the Total *Ad Valorem* Subsidization (Paragraph 1(a) of Article 6)" deals – as the title indicates – with the calculation of subsidization rates, within the meaning of Article 6.1(a) of the SCM Agreement. However, the "support to cotton" question before this Panel is *not* establishing an *ad valorem* subsidization rate, but rather the calculation of the *amount of support* to upland cotton, within the meaning of Article 13(b)(ii) of the SCM Agreement.

39. But setting aside the problem that Annex IV deals with calculation of a subsidization rate, the US contract payments at issue in this dispute are *de facto* tied to upland cotton production. Thus, Annex IV paragraph 3 would be implicated, *i.e.*, the subsidization rate is determined by *dividing the total amount of the tied contract payment* subsidies by the total value of upland cotton sales. But this presupposes that the amount of the payments subsidies is known. Thus, Annex IV does not answer the crucial question how to determine the amount of the *de facto* tied contract payments that constitute support to upland cotton. Instead, it only offers a methodology to calculate the *subsidization rate* for known amounts of subsidies.

40. Indeed, Annex IV itself recognizes that there are holes in its provisions, stipulating in footnote 62 to Annex IV that "[a]n understanding among Members should be developed, as necessary, on matters which are not specified in this Annex or which need further clarification for purposes of paragraph 1(a) of Article 6". One such matter could have been the scope of the meaning of "tied to the production or sale of a given product". Must the "tie to production" be *de jure* as the United States argues, or *de facto* as Brazil asserts? But no understanding or clarification of this, or any other issue relating to Annex IV, was agreed to by Members prior to the expiration of Annex IV in 2000.

41. Thus, Annex IV does not assist the Panel in determining the amount of support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture. Contrary to the US arguments, paragraph 2 of Annex IV is inapplicable because the subsidies at issue are *de facto* tied to upland cotton production. Further, paragraph 3 of Annex IV does not provide any guidance on how to calculate the amount of the subsidy which is the goal of the Article 13(b)(ii) exercise.

42. In conclusion, it is incorrect to assert that the absence of any specific methodology precludes the Panel from applying one for the purposes of Article 13(b)(ii). It is also incorrect to claim that Annex IV provides definitive guidance, because it could only be useful for establishing a rate of subsidization, and not for calculating the amount of the subsidy. Thus, as with its item (j) analysis, the Panel needs to adopt a reasonable methodology to be applied for purposes of the peace clause in assessing the amount of support to upland cotton from the four contract payment programmes. This methodology must reflect the facts in the record and be consistent with the text, context and object

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WT/DS48/ARB; Arbitrator Report, *Brazil – Aircraft*, WT/DS46/ARB; Arbitrator Report, *US – FSC*, WT/DS108/ARB; Arbitrator Report, *Canada – Aircraft II*, WT/DS222/ARB.

[58] *See e.g.* Appellate Body Report, *US – Lumber CVDs Final*, WT/DS257/AB/R, paras. 155-166 (Appellate Body affirmed panel's finding that a "pass-through" methodology analysis must be performed by investigating authorities to determine the amount of subsidies benefiting down-stream purchases of subsidized products; this was despite the fact that no specific methodology for pass through was explicitly set out in Articles 10 and 32.1 of the SCM Agreement); Panel Report, *US – Sheet/Plate from Korea*, WT /DS179/R, paras. 6.135-36 (finding USDOC methodology applying multiple averaging periods during the investigation appropriate to implement "fair comparison" standard of Article 2.4 of the Anti-Dumping Agreement).

and purpose of Article 13(b)(ii). As Brazil has argued, its methodology – or some variant of its methodology such as the cotton-to-cotton methodology – is reasonable given the key role that contract payments played in the maintenance of upland cotton production during MY 1999-2002.[59]

### 5. The Evidence in the Record Supports a Finding, under any Methodology, that the United States' Level of Support Provided in MY 1999-2002 Exceeded the amount of Support Decided in MY 1992

43. Brazil responds in this section to the US 11 February 2004 Comments asserting that Brazil has not established that the amount of "support to upland cotton" in MY 1999-2002 is greater than the support decided in MY 1992.[60] Brazil's basic response to these arguments is that even if the United States does not produce the farm-specific information by 3 March 2004, the Panel has before it sufficient evidence, including the evidence of any adverse inferences, to establish the amount of four contract payments for MY 1999-2002. The less-than-ideal data analyzed below confirms, in the first instance, Brazil's 14/16$^{th}$ methodology. Moreover, even if the Panel were to rely directly on the figures generated below from the application of Brazil's methodology, the US Annex IV methodology and a variation of each of those methodologies to the incomplete US data,[61] these figures support a finding that the US support to upland cotton in MY 1999-2002 exceeded the level decided in MY 1992.

44. Brazil's analysis of the data below is necessary because Brazil's 28 January 2004 original analysis of the incomplete US data submitted on 18/19 December 2003 did not include additional data the United States recognized[62] it failed to produce on 18/19 December 2003, and subsequently produced on 28 January 2004. Brazil has made certain adjustments to respond to criticisms of the United States. Further, to assist the Panel, Brazil presents the calculations from a minor variation of Brazil's methodology and of the US Annex IV methodology. In the final analysis, these various methodologies are "tools" (not "claims") that assist the Panel in making an objective assessment of the US data and other evidence before it for purposes of making a peace clause finding (and, if the Panel deems this necessary, the amount of subsidization for Brazil's serious prejudice claims).

45. Below, Brazil presents its updated results of the two methodologies applied in Sections 9 and 10 of its 28 January 2004 Comments and Requests Regarding US Data. This update is based on the revised US data provided by the United States on 28 January 2004.[63] For detailed calculations, Brazil refers the Panel to Annex A to this submission.

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[59] *See* Section 3, *supra*. The fact that the great majority of upland cotton is planted on upland cotton base (86.34 per cent in MY 1999, 82.05 per cent in MY 2000, 80.10 percent in MY 2001 and 96.17 per cent in MY 2002) lends considerable support for this conclusion. These amounts are calculated as the share of upland cotton production planted on farms holding upland cotton base (up to the amount of upland cotton base) of total upland cotton plantings. MY 1999-2001 data are taken from category "1" farms and total upland cotton planting from the rPFCsum.xls file provided by the United States on 28 January 2004. Data for MY 2002 is taken from "Enrolled in Cotton PFC and planted cotton" farms and total upland cotton plantings from the rDCPsum.xls file provided by the United States on 28 January 2004.

[60] *See* US 11 February 2004 Comments, paras. 15-17. This section also responds to the US comments that Brazil has not established a *prima facie* case of the amount of the contract payment subsidies for the purpose of its serious prejudice claims.

[61] Brazil recalls that even the revised US summary data produced on 28 January 2004 suffers from aggregation problems and falls short of enabling the Panel and Brazil to account for soybean market loss assistance and peanut direct and counter-cyclical payments in its allocations. *See* Section 3 of Brazil's 28 January 2004 Comments and Requests Regarding US Data.

[62] US 28 January 2004 Letter to the Panel and accompanying CD-Rom.

[63] *See* US 28 January Letter to the Panel.

*Cotton-to-Cotton Methodology*

46. Brazil first presents the results of using a slight variation of Brazil's methodology. Brazil notes the US arguments that only upland cotton contract payments could be included in any "support to" upland cotton. Counting only upland cotton payments would undercount the amount of contract support, as Brazil argues in Section 9, *infra*. [64] But even though it undercounts the amount of support, a methodology that examines only "cotton-to-cotton" payments is supported by the evidence in the record described in Section 3 *supra*, including the fact that in MY 2002 96 per cent of upland cotton was planted on upland cotton base acreage.[65]

47. Brazil sets out the results of examining only the upland cotton contract payments received by producers planting upland cotton for MY 1999-2002 in Table 1.5 below:[66]

Annex A Table 1.5

| **Cotton-to-Cotton Methodology** [67] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $515,310,673.4 | $512,801,043.5 | - | - |
| 2000 | $482,422,346.0 | $513,554,489.0 | - | - |
| 2001 | $387,916,892.8 | $535,792,287.0 | - | - |
| 2002 | - | - | $446,796,377.9 | $986,357,993.8 |

48. As Brazil described in its 28 January 2004 Comments, the results of this analysis may be distorted somewhat because the revised US summary data does not control for aggregation problems.[68] However, given the fact that the United States can be deemed to know the amount of payments from a cotton-to-cotton match, any continued refusal of the United States to produce the data should permit the Panel to infer that the data outlined above is accurate.

*Brazil's Methodology*

49. Brazil also presents the results of applying its proposed methodology. However, given the absence of farm-specific information, Brazil can present only a modified version of its proposed methodology, as discussed in more detail in its 20 January 2004 Answers to Additional Questions[69] and applied in its 28 January 2004 Comments and Requests Regarding US Data.[70] The data presented below updates Brazil's earlier calculations by using the 28 January 2004 revised US summary data

[64] US 11 February 2004 Comments, paras. 47-51. *See* also US 28 January 2004 Comments, paras. 34-52, 208.

[65] Calculated as the share of upland cotton production planted on farms holding upland cotton base (up to the amount of upland cotton base) of total upland cotton plantings. MY 1999-2001 data are taken from category "1" farms and total upland cotton planting from the rPFCsum.xls file provided by the United States on 28 January 2004. Data for MY 2002 is taken from "Enrolled in Cotton PFC and planted cotton" farms and total upland cotton plantings from the rDCPsum.xls file provided by the United States on 28 January 2004.

[66] This is because only in MY 2002 was less acreage planted to upland cotton than the total amount of upland cotton base acreage held by farms producing upland cotton and holding upland cotton base. In MY 1999-2001, the amount of upland cotton acreage slightly exceeded the amount of upland cotton base. This phenomenon is the effect of the base update allowed for under the 2002 FSRI Act.

[67] For details of the calculations, see Annex A.1.

[68] Brazil notes that the US summary data requested by the Panel on 3 February 2004 (part (b) of the Panel's Request for Information under DSU Article 13) would not result in aggregation problems tainting the results, nor would farm-specific data withheld by the United States and requested by Brazil on 3 December 2003 and by the Panel on 8 December 2003, 12 January 2004 and 3 February 2004 (part (a) of the Panel's Request for Information under DSU Article 13).

[69] *See* Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[70] *See* Section 9 of Brazil's 28 January 2004 Comments and Requests Regarding US Data.

that includes information on contract payments to farms not holding upland cotton base but producing upland cotton.[71] The following table shows the results of applying Brazil's allocation methodology to the revised US summary data.[72]

Table 2.21

| **Brazil's Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $574,488,456.1 | $571,690,622.7 | - | - |
| 2000 | $538,079,545.3 | $572,803,412.3 | - | - |
| 2001 | $428,007,676.4 | $591,165,829.7 | - | - |
| 2002 | - | - | $450,924,339.1 | $988,252,054.4 |

*Modified US Annex IV methodology*

50. Brazil also applied the revised US summary data to a modified "Annex IV" methodology allocating total contract payments to farms producing upland cotton over the value of *contract payment* crops produced on these farms. This methodology is based on two assumptions: first, contract payments are support only to contract payment crops; and second, contract payments are allocated pursuant to the value of these contract crops' production on upland cotton producing farms.

51. Brazil believes that this methodology is not appropriate because it improperly undercounts the amount of support provided to maintain the production of upland cotton. Nevertheless, the analysis of this methodology permits the Panel to assess the impact of different assumptions on the amount of contract payments allocated. Further, because the "cotton-to-cotton" and "Brazil's" methodologies are supported by the strong link between contract payments and maintaining upland cotton production, the same evidence would more than support the modified Annex IV methodology. The following table shows the results of this allocation methodology. Brazil notes these figures are understated due to the fact that the United States did not provide any data concerning soybean market loss assistance payments and peanut direct and counter-cyclical payments.[73]

Annex A Table 3.10

| **Modified Annex IV Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $576,544,351.0 | $573,736,505.1 | - | - |
| 2000 | $546,052,507.2 | $581,290,893.0 | - | - |
| 2001 | $399,648,260.3 | $551,995,696.4 | - | - |
| 2002 | - | - | $431,923,303.9 | $722,082,667.7 |

*US Annex IV Methodology*

52. Finally, Brazil has applied the revised US summary data to the US-proposed methodology – updating the calculations presented in Section 10 of Brazil's 28 January 2004 Comments and Requests Regarding US Data. The data presented here updates Brazil's earlier calculations by using the 28 January 2004 revised US summary data that includes information on contract payments to

[71] Calculations based on this data continue to suffer from aggregation problems and the missing information on soybean contract payments and peanut direct and counter-cyclical payments to farms producing upland cotton. (*See* Section 3 of Brazil's 28 January 2004 Comments and Requests Regarding US Data).

[72] For details of the calculations, see Annex A.2.

[73] For details of the calculations, see Annex A.3.

farms not holding upland cotton base but producing upland cotton.[74] The following table shows the results of applying the US-proposed allocation methodology to the revised US summary data.[75]

Annex A Table 4.8

| **US Annex IV Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $440,061,035.8 | $437,917,881.4 | - | - |
| 2000 | $432,996,788.7 | $460,939,354.1 | - | - |
| 2001 | $304,243,319.2 | $420,222,029.1 | - | - |
| 2002 | - | - | $383,057,256.1 | $640,389,168.2 |

53. For purposes of comparison, Brazil reproduces the results of its "14/16$^{th}$" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September 2003 Further Submission.

| **Results of Brazil's 14/16$^{th}$ Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

54. Brazil notes that the results from each of the four methodologies applied to the revised US summary data suffer from shortcomings due to the incomplete and non-farm-specific data. Brazil would have to re-calculate all of these numbers if the United States produces the actual data on 3 March 2004. As it stands, the data currently available undercounts the support under each of the methodologies (except the cotton-to-cotton), because no information on soybean market loss assistance payments and peanut direct and counter-cyclical payments to farms producing upland cotton was provided by the United States. Further, due to the manner in which the US data is provided, distortions from the aggregation of farm-specific data possibly over- or under-state the results, as discussed in Section 6 below. Therefore, Brazil remains of the view that in the absence of complete farm-specific aggregated data, the Panel should rely on Brazil's 14/16$^{th}$ methodology.

55. While Brazil does not believe that the Panel should rely on either the two Annex IV-type methodologies, or even the "cotton-to-cotton" methodology, it is noteworthy that all four of the methodologies show that the United States does not enjoy peace clause protection.[76] The table below shows the results of the comparison of US support to upland cotton decided in MY 1992 with US support to upland cotton provided in MY 2002. Under any methodology, the US support to upland cotton in MY 2002 exceeds the support decided in MY 1992 considerably – by at least $464 million.

[74] Calculations based on this data continue to suffer from aggregation problems and the missing information on soybean contract payments and peanut direct and counter-cyclical payments to farms producing upland cotton. (*See* Section 3 of Brazil's 28 January 2004 Comments and Requests Regarding US Data).

[75] For details of the calculations, see Annex A.4.

[76] Only under methodology (4) in MY 2000 is the support provided in that marketing year below the support decided in MY 1992.

Budgetary Outlays For Upland Cotton MY 1992, 2002[77]

| Year | 1992 | 2002 (1) | 2002 (2) | 2002 (3) | 2002 (4) | 2002 (5) |
|---|---|---|---|---|---|---|
| Programme | ----- $ million ----- | | | | | |
| Deficiency Payments | 1017.4 | None | none | none | none | none |
| Direct Payments | none | 466.8 | 450.9 | 432.9 | 383.1 | 454.5 |
| CCP Payments | none | 986.4 | 988.3 | 722.1 | 640.4 | 935.6 |
| Marketing Loan Gains and LDP Payments[78] | 866 | 898 | 898 | 898 | 898 | 898 |
| Step 2 Payment | 207 | 415 | 415 | 415 | 415 | 415 |
| Crop Insurance | 26.6 | 194.1 | 194.1 | 194.1 | 194.1 | 194.1 |
| Cottonseed Payments | none | 50 | 50 | 50 | 50 | 50 |
| **Total** | **2,117.0** | **2,990.3** | **2,996.3** | **2,711.1** | **2,580.6** | **2,947.2** |

(1) Cotton-to-Cotton Methodology
(2) Brazil's Methodology
(3) Modified Annex IV Methodology
(4) US Annex IV Methodology
(5) Brazil's 14/16$^{th}$ Methodology

56. Brazil presents the tabulations for MY 1999-2001 in Annex B. These data show that the United States also exceeds the MY 1992 limits under each of the four methodologies (except for methodology (4) in MY 2000) and under Brazil's 14/16$^{th}$ methodology.[79]

## 6. The US Critique of Brazil's Allocation Methodology Is Baseless

57. Brazil recalls that its methodology allocates support paid for upland cotton base that is "planted to" upland cotton. It further allocates proportionally any other contract crop base payments that are not allocated to plantings of the respective contract payments crop.[80] Brazil's methodology, as well as the "cotton-to-cotton" methodology, generates results that are very close to Brazil's 14/16$^{th}$ methodology. This is not surprising since the 14/16$^{th}$ methodology is based on the assumption of very high percentages of upland cotton "planted on" upland cotton base acreage. All three of these methodologies reflect the economic reality in MY 1999-2002 that each allocated contract dollar received by upland cotton producers over a four-year period was needed to cover the costs of producing upland cotton. The fact that the vast majority of upland cotton was actually planted on upland cotton base is further confirmation of the reasonableness of these three methodologies.

58. Much of the US criticism of Brazil's methodology is tainted by the wrong assumption that contract payments provide "decoupled income support".[81] For example, the United States states, at paragraph 38 of its 11 February 2004 Comments, that "fundamentally, Brazil's approach is in error

[77] The table below reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission as updated by paragraph 8 of Brazil's 22 December 2003 Answers to Questions and paragraphs 12-14 of the US 22 December 2004 Answers to Questions. Step 2 and marketing loan payments have been updated in light of the US answer to Question 196. *See* US 22 December 2004 Answers to Questions, para. 12.

[78] "Other Payments" have been included in the marketing loan figures.

[79] Besides conclusively demonstrating that the US non-green box domestic support measures are not exempt from action by virtue of Article 13(b)(ii) of the Agreement on Agriculture, the table above, as well as the tables in Annex B, indicate the amount of subsidization of upland cotton by contract payments. Thus, should the Panel consider that an allocation methodology is warranted under Part III of the SCM Agreement, the record provides the factual basis for a finding that Brazil has met its burden of proof and established a *prima facie* case of the amount of subsidization.

[80] Brazil's 20 January 2004 Answers to Additional Questions, para. 43-55 and Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 9.

[81] *See inter alia* US 11 February 2004 Comments, paras. 37. *See* also US 28 January 2004 Comments, paras. 217, 219, 222-223.

because it assumes that there is a tie between the decoupled payments and current production". The United States is correct – Brazil's methodologies do make that assumption, for the very good reason that that assumption reflects the economic cost realities and the cotton-to-cotton planting on the ground, discussed in Section 3 *supra.* Similarly, the United States claims, at paragraph 37 of its comments, that "decoupled payments by their nature provide income support not tied to the production or sale of any given commodity". But this ignores the vast weight of the evidence, which demonstrates the link between upland cotton production and upland cotton base acre payments (and other payments) in MY 1999-2002.

59. The United States raises a number of hypothetical "problems" with Brazil's methodology.[82] But the extent of any such problems, if any, can only be assessed by examining the actual farm-specific data. It is not credible for the United States to refuse to produce key farm-specific data and then speculate about potential problems for individual farms. Upon receipt of the US response to the Panel's request, Brazil looks forward to providing the Panel with such an analysis.

60. A principle complaint of the United States is that Brazil's allocation of *non-upland cotton contract payments* results in differential subsidization rates on different acres planted to upland cotton.[83] Similarly, the United States criticizes Brazil for potentially allocating more than one *non-upland cotton* base acre payments to one planted acre of upland cotton.[84] Both of these alleged problems with the allocation of non-upland cotton contract payments do not exist for MY 2002. This is because Brazil's methodology allocates for each planted acres of upland cotton only one upland cotton base acre payment.[85] In MY 2002, the vast majority of contract payments allocated as support to upland cotton are upland cotton contract payments. In MY 2002, 99.1 per cent of direct payments[86] and 99.8 per cent of the counter-cyclical payments[87] received by upland cotton producers were upland cotton contract payments. This is because the vast majority of upland cotton is grown on farms holding upland cotton base, which in MY 2002 exceeds acreage planted to upland cotton. Farms growing upland cotton but not holding upland cotton base accounted for only 0.9 and 0.2 per cent of total allocated direct and counter-cyclical payments respectively. Since the two main US criticisms affect only the allocation of non-upland cotton contract payments, they affect, at most, 0.9 per cent of the payments at issue for MY 2002.[88]

61. Brazil notes that the "cotton-to-cotton" methodology, discussed in Section 5, does not allocate any non-upland cotton base payments. Therefore, none of the US criticisms, at paragraphs 37-42 of its 11 February 2004 Comments, affects the "cotton-to-cotton" results for MY 1999-2002. Thus, these results reflect the worst case scenario of any alleged over-counting in Brazil's methodology. Comparing the results of both methodologies, reproduced in Section 5 and Annex B demonstrates that even under the "cotton-to-cotton" methodology the Unites States surpasses its peace clause limits. The tables below reproduce the results of both methodologies:

[82] US 11 February 2004 Comments, paras. 37-42.
[83] US 11 February 2004 Comments, para. 37.
[84] US 11 February 2004 Comments, para. 38-42.
[85] The United States has not criticized Brazil's allocation of one payments on one contract payment base acres to one planted acre of cotton and the other contract payment crops. In other word, the United States accepts that the one-to-one allocation between planted and base acres.
[86] *See* Annex A.2, Tables 2.9, 2.21 and 2.21.
[87] *See* Annex A.2, Tables 2.9, 2.20 and 2.21.
[88] The United States has not criticized Brazil's allocation of one payments on one contract payment base acres to one planted acre of cotton and the other contract payment crops. In other word, the United States accepts that the one-to-one allocation between planted and base acres.

**Cotton-to-Cotton Methodology (Table 1.5 of Annex A.1)**

| MY | PFC Payments | MLA Payments[89] | Direct Payments | CCP Payments |
|---|---|---|---|---|
| 1999 | $515,310,673.4 | $512,801,043.5 | - | - |
| 2000 | $482,422,346.0 | $513,554,489.0 | - | - |
| 2001 | $387,916,892.8 | $535,792,287.0 | - | - |
| 2002 | - | - | $446,796,377.9 | $986,357,993.8 |

**Brazil's Methodology (Table 2.21 of Annex A.2)**

| MY | PFC Payments | MLA Payments[90] | Direct Payments | CCP Payments |
|---|---|---|---|---|
| 1999 | $574,488,456.1 | $571,690,622.7 | - | - |
| 2000 | $538,079,545.3 | $572,803,412.3 | - | - |
| 2001 | $428,007,676.4 | $591,165,829.7 | - | - |
| 2002 | - | - | $450,924,339.1 | $988,252,054.4 |

62. As the Panel can readily see, the differences in the results of both methodologies are minor (with $118 million in MY 1999, $114 million in MY 2000, $95.5 million in MY 2001, and $5.7 million in MY 2002).

63. In addressing the specific US criticism affecting MY 1999-2001, Brazil notes that its methodology involves analysing the planting patterns and base acres of individual farms. Each farm is unique. Some farms will have greater base acres than planted acres and *vice versa*. Some farms will plant different crops than they used to establish their base acres, and, as in the case of most upland cotton farms, they will continue to plant upland cotton holding upland cotton base acres. Brazil's methodology accounts for all contract payments as support to contract crops planted on farms holding base. This means that some farms will have "extra" base acres payments that will need to be allocated over fewer planted acres of contract payments crops or *vice versa*. This reflects economic realities for farms that have many different combinations of base and planted acres.

64. The US comments, at paragraph 37 of its 11 February 2004 Comments, raise theoretical "arbitrary" attribution problems relating to "excess cotton acreage" or "excess" base acreage situations for a hypothetical farm. But the purpose of any methodology is not to determine the "subsidization" rate of a particular farm, but rather to assess, in the aggregate, the amount of payments. Of course, different farms will have different crop subsidization rates given the inherently unique base acreage and planting combinations. Therefore, Brazil's methodology, which is based on examining individual farm data, may result, in certain cases, in different crop subsidization rates for different farms. But this is neither remarkable nor illogical, as the United States claims, but rather reflects economic reality.

[89] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

[90] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

65. The United States further complains that Brazil allocates all "excess" contract payments in MY 1999-2000 and almost all "excess" contract payments in MY 2001 to upland cotton.[91] However, the data shows that in those three marketing years, all contract payment crops (except upland cotton) were planted to a degree that fell *short* of the base acreage for these crops. Thus, the simple fact that upland cotton farms during MY 1999-2001 increased their amount of upland cotton plantings at the expense of other contract payment crops suggests that some of the payments for these non-upland cotton base acres were devoted to supporting upland cotton production. This is reflected in Brazil's 28 January 2004 calculations (as well as in its updated calculations in Annex A.2). Brazil's calculations, therefore, reflect the reality of upland cotton production in those marketing years – production on upland cotton farms shifted to upland cotton and away from other contract payment crops. Brazil notes that no such "excess" upland cotton production exists in MY 2002. This appears to be – at the very least in part – a direct consequence of the base update aligning contract payments base with production trends during MY 1998-2001.[92] The re-linkage of production meant that more current upland cotton production takes place on base acreage than during MY 1999-2001.

66. Finally, the United States asserts that the aggregation problems inherent in the US summary data will necessarily *increase* the amount of payments allocated to upland cotton.[93] This criticism is again an ironic assertion by a party that has refused to provide the very data that would answer this criticism. Whether the aggregation problem leads to an upward or downward error in estimating the amount of support to upland cotton is a factual question that cannot be answered in the abstract, as suggested by the United States.[94] Indeed, the effect of the aggregation problem is that upland cotton contract payments on farms that have "excess" upland cotton base are treated as upland cotton payments to farms that have "excess" upland cotton plantings.[95] Whether such a treatment leads to over- or under-counting depends entirely on what the amount of support allocated to the "excess" planted upland cotton acres would be, which can only be derived with using farm-specific data. Only if it is lower then the support for an upland cotton base acre (allocated due to the aggregation effect) would the aggregation problem lead to over-counting. And this is a factual, not a theoretical question. The amount of support allocated to the "excess" acres planted to upland cotton could rank from zero (no contract payments available for allocation on that farm) to an amount that exceeds the upland cotton per-acre payment rate (for instance, rice base or payments for more than one base acre). Again, it bears repeating, that there will be no "aggregation problems" if the United States produces complete farm-specific data on 3 March 2004.

67. In sum, Brazil maintains that, in view of the *de facto* tied nature of the US contract payments at issue, Brazil's methodology is a reasonable means of calculating the support to upland cotton. As for some of the US criticisms that might affect the results (except for MY 2002), Brazil will control for these effects once the United States provides aggregate data in the manner requested by the Panel. Yet, Brazil is of the firm view that none of the US criticisms will meaningfully affect its results.

## 7. The US Critique of Brazil's Application of the Improper Annex IV Methodology is Baseless

68. Brazil has earlier demonstrated, in Section 4 above, the inability of Annex IV of the SCM Agreement to provide useful guidance regarding the calculation of the amount of the contract payments that constitute support to upland cotton. Brazil further demonstrated that the entire premise behind the US attempt to use an Annex IV-like methodology is wrong, since contract payments during MY 1999-2002 were *de facto* tied to the production of upland cotton.

[91] US 11 January 2004 Comments, paras. 40.
[92] Brazil notes that part of the phenomenon also results from reduced upland cotton plantings.
[93] US 11 January 2004 Comments, para. 42.
[94] US 11 January 2004 Comments, para. 42.
[95] *See* Brazil's 28 January 2004 Comments and Requests Regarding US Data, para. 13-15.

69. Nevertheless, as an alternative argument, Brazil attempted in its 28 January 2004 Comments to apply the Annex IV paragraph 2 non-tied subsidy allocation methodology to the US summary data. As a preliminary matter, Brazil notes that the United States has never presented any data in support of its methodology.[96] Instead, the United States has repeatedly argued that it is not its "burden" to establish the amount of contract payments under its own methodology. The United States has gone even further and refused, to date, to provide the data that would permit the calculation of its "across the value of total production on the farm" methodology. As a result, Brazil had to make a number of assumptions to fill the data gaps. The United States has reserved its energy regarding its methodology for a spirited critique of Brazil's attempt to apply the US methodology. Brazil responds to these to these arguments, and the incorrect US calculations, below.

70. First, the United States challenges, in paragraph 51 of its 11 February 2004 Comments, the use of non-upland cotton base acreage payments. This criticism is incorrect, since the Panel must make an objective assessment of the amount of "support to" upland cotton under Article 13(b)(ii), including support provided from non-upland cotton base payments. Therefore, Brazil's inclusion of all contract payments in its calculation was proper. Brazil sets out its arguments in Section 9 *infra*.[97] Consequently, all of the US calculations at paragraphs 59-60 of the US 11 February 2004 Comments are incorrect, because they exclude all non-upland cotton payments.[98]

71. Second, the United States criticizes Brazil for not having included all farm and non-farm income of a farm into its calculations.[99] There is no legitimate basis to include social security and stock market investment income in any payment calculation.[100] Brazil has earlier responded to similar US arguments in cost of production discussions.[101] The focus of Article 13(b)(ii) is on tabulating the amount of *agricultural* domestic support to a specific commodity.

72. Third, the United States claims that Brazil should have included the value of livestock raised by upland cotton farmers. The United States has provided no data to support its own methodology or its implied assertion that livestock production is a major component of upland cotton farms' production. However, the record supports Brazil's decision not to include any livestock value. A USDA 1997 ARMS study on costs of production on cotton farms showed that only between 0-6 per cent (depending on the category and location) of US upland cotton farms specialize in livestock production.[102] Since no significant amount of livestock production is found on upland cotton farms, distortions in Brazil's results, if any, would be very minor.

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[96] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[97] *See* also US 11 January 2004 Comments, paras. 46-50.

[98] Otherwise, all figures seem to reflect Brazil's calculations.

[99] US 11 January 2004 Comments, paras. 46, 55 and note 50.

[100] Brazil has addressed the US argument that off-farm income may be responsible for closing the gap between upland cotton market revenue and production costs in paragraph 28 of its 2 December 2003 Oral Statement.

[101] US 18 November 2003 Further Rebuttal Submission, paras. 111, 137. Brazil is further puzzled by the fact that the United States argues for inclusion of off-farm income over which contract payments have to be allocated. In its 18 November 2003 Further Rebuttal Submission, the United States argued that off-farm income (such as social security benefits) could be support to upland cotton (para. 111). It follows that the United States would argue that social security benefits support the production of upland cotton, while contract payments support social security benefits.

[102] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms", USDA, October 2001, Appendix Tables 1-4 p. 23-26).

73. The United States also raises several issues with respect to Brazil's calculation methodology. The United States correctly points out that Brazil should have used yields on planted acreage, rather than applying yields on harvested acreage to all acreage planted.[103] Brazil has corrected for this in its updated analysis, set out in Annex A.4 – albeit only for its calculation of the value of upland cotton production.[104] Since yield information on planted acreage for other crops is not available to Brazil – assuming that the US allegation is correct and the yield data in Exhibit Bra-420 is, indeed, based on harvested acres – Brazil continues to apply this data with respect to planted acreage for other crops. Any bias caused by this inaccuracy will naturally *overstate* the value of the non-upland cotton crop production on upland cotton farms[105] and, thus, undervalue the amount of contract payments constituting support to upland cotton.[106]

74. The United States also criticizes Brazil's exclusion of fruits and vegetables from the calculation of the value of non-contract payment crop plantings.[107] However, the contract payment programmes themselves exclude fruits and vegetables as possible beneficiaries of that support, by prohibiting the growing of these crops on base acres. There is no legitimate reason to assume that these payments could be support to fruits and vegetables.[108] In any event, Brazil notes that the United States required reporting of fruits, vegetables and wild rice acreage on all farms receiving contract payments from MY 1999-2002 and that the Panel has requested this information.[109] Thus, the extent of any distortions, if any, can only be assessed when the actual data is reviewed.

75. Finally, the United States repeats its flawed arguments that contract payments have to be reduced by about two-thirds to reflect the fact that only upland cotton farms that own their land in fact benefit from contract payments.[110] Brazil refers the Panel to its 28 January 2004 Comments for its arguments on this issue.[111]

76. In sum, none of the US criticisms summarized at paragraphs 57 and 60 of its 11 February 2004 Comments withstand close scrutiny. Brazil's calculations under the US Annex IV methodology, based on the incomplete non-farm-specific data, are not biased.[112] By contrast, all of

[103] US 11 February 2004 Comments, para. 52 note 59.

[104] US 11 February 2004 Comments, para. 52 and accompanying table.

[105] This is because the upland cotton value is correct, whereas all the values of all other crops are overstated, reducing the share of the upland cotton value of total crop production on the farm.

[106] The United States also asserts, at paragraph 53 of its 11 February 2004 Comments, that Brazil should have used state-by-state data in the determination of the value of sales from non-contract payment crops. Brazil is puzzled by this US argument, as it was the United States that withheld the farm-specific data, including data that would have enabled Brazil to use state-by-state figures on non-contract payment crop plantings for the calculation of the value of non-contract payment crop plantings. The US summary data simply does not allow for a proper weighting of any state-by-state values of non-contract payments crop plantings, if such data were indeed available. Similarly, the US reference to farming in Alaska is irrelevant. Any value of production in that state would not meaningful affect aggregates for the United States. In fact, it would be the US burden to produce data that would allow for the application of its proposed methodology. As the party asserting a fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[107] US 11 January 2004 Comments, para. 54.

[108] *See* Section 6 above. *See* also Brazil's 28 January 2004 Comments and Requests Regarding US Data, paras. 92. Brazil's 20 January 2004 Answers to Questions, para. 73.

[109] 3 February 2004 Communication from the Panel.

[110] US 11 February 2004 Comments, paras. 56, 60; *See* also US 28 January 2004 Comments, para. 22.

[111] Brazil's 28 January 2004 Comments, paras. 192-214.

[112] For instance, Brazil has used yields on harvested acres for all non-upland cotton planted acres, thereby significantly overstating the value of the non-upland cotton production and understating the amount of support allocated to upland cotton. In fact, Brazil's calculations are conservative.

the calculations presented by the United States in its 11 February 2004 Comments were improperly based on upland cotton contract payments only.[113]

### 8. Brazil Has Established, in the Alternative, the Amount of Contract Payments for Purposes of its SCM Serious Prejudice Claims

77. The United States 11 February 2004 Comments continue the US argument that there is an explicit allocation requirement in Part III of the SCM Agreement "for determining the 'subsidization' of a product set out in Annex IV."[114] The US Comments also argue that "Brazil has expressly disavowed any allocation methodology for purposes of its serious prejudice claims on decoupled income support payments [and has] failed to make a *prima facie* case on these claims."[115] Both assertions are incorrect.

78. Brazil has argued that Part III of the SCM Agreement does not require detailing the precise amount of the subsidies or a subsidization rate.[116] But it has presented evidence and argument, in the alternative, regarding the size and subsidization rate of the subsidies it has challenged.[117] For the four contract payments, the subsidy quantities are those amounts generated for the purposes of the "peace clause" analysis. The amount of a subsidy for purposes of establishing "support to a specific commodity" for purposes of Article 13(b)(ii) is the same amount for Brazil's serious prejudice claims. This conclusion is supported by the fact that the phrase "domestic support" in the Agreement on Agriculture is the same as "subsidy" in the SCM Agreement (assuming the elements of a subsidy for the "support" have been established). Thus, Brazil has offered the contract payment quantities (as well as the other subsidies) established in the peace clause phase of the proceedings as the "amount of subsidization," to the extent this is required, in the serious prejudice phase of the proceedings.

### 9. The United States Improperly Seeks to Limit the Scope of the Non-Green Box Support Measures to be Examined for Determining the Amount of Support for Purposes of the Peace Clause

79. The United States' 11 February 2004 Comments argue that the Panel cannot examine any evidence of payments received by upland cotton producers growing upland cotton on non-upland cotton base acreage, because Brazil's request for the establishment of a panel ("Brazil's panel request") violates DSU Article 6.2.[118] There is no factual or legal merit to these arguments.

80. First, the Panel's obligation is to conduct an objective assessment of the facts and arguments before it. The issue of the *amount* of contract payments is a key issue that is part of the broader question of the *amount* of support to upland cotton under Article 13(b)(ii) of the Agreement on Agriculture. This broader issue is ultimately the key legal question and it is clearly within the Panel's terms of reference. Determining the amount of support requires an objective assessment by the Panel as to the amount of non-green box support to producers and users of upland cotton in MY 1992 and MY 1999-2002. It requires the Panel to include all support to upland cotton from the evidence before it – regardless of whether Brazil's panel request is broad enough to encompass all of the same subsidies for the purpose of its serious prejudice claims. For example, the fact that the Panel has ruled

[113] US 11 February 2004 Comments, paras. 58-59.
[114] US 11 February 2004 Comments, paras. 20.
[115] US 11 February 2004 Comments, paras. 22-24.
[116] *See e.g.*, Brazil's 11 February 2004 Comments on US Answers to Questions Posed by the Panel Following the Second Substantive Meeting of the Panel, paras. 196-197, 216; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 97-107; Brazil's 2 December 2003 Oral Statement, paras 3-5.
[117] *See e.g.*, Brazil's 11 February 2004 Comments on US Answers to Questions Posed by the Panel Following the Second Substantive Meeting of the Panel, para.216; Brazil's 2 December 2003 Oral Statement , para. 5; Brazil's 9 September 2003 Further Submission, Table 1 (setting out the amount and rate of subsidization of each of the four contract payment subsidies based on the 14/16th Methodology).
[118] US 11 February 2004 Data Comments, paras. 47-50.

that certain cottonseed payments are not within its terms of reference for purposes of Brazil's serious prejudice claims does not mean that these same subsidies cannot be counted as "support to upland cotton" for the purposes of the peace clause. The amount of these payments is within the Panel's terms of reference in order to resolve the peace clause issues, because they are "support to" upland cotton. Indeed, identical payments made in MY 1999 have been notified by the United States as "product-specific" upland cotton support.[119]

81. Second, with respect to the new US Article 6.2 assertion, Brazil notes that the US comments acknowledge that Brazil's panel request is broad enough to cover the contract payments received by upland cotton producers.[120] But the United States now claims the request is *too* broad claiming it "provides virtually no information that would allow identification of the specific measure at issue".[121] This argument is both untimely[122] and contradicted by Brazil's request.

82. Brazil's request complied fully with DSU Article 6.2 by identifying the specific measures at issue. Brazil's request (1) identified by name the specific laws providing for contract payments, *i.e.*, the 1996 FAIR Act, the 2002 FSRI Act, and the 1998-2001 appropriation acts for market loss assistance payments, (2) identified by name the specific payments, *i.e.*, PFC, market loss assistance, direct and counter-cyclical payments, which were required to be paid from those laws, (3) identified by name the specific recipients of those payments, *i.e.*, upland cotton producers, and (4) identified the specific time period when those payments were made, *i.e.*, MY 1999-2007. Yet, the United States would read into DSU Article 6.2 a requirement to go to a further level of detail and identify the *sub*-category (*i.e.*, payments on non-upland cotton and on upland cotton base acreage) of the specific measures that were identified (contract payments to upland cotton producers). This would impose an unprecedented and unjustified level of detail in a panel request that is not required by DSU Article 6.2.

83. In sum, it is undisputed that Brazil's panel request covered all types of contract payments to upland cotton producers, not just those based on upland cotton base acreage. Thus all types of contract payment provided to upland cotton producers, as properly allocated, are support to upland cotton that are well-within the Panel's terms of reference.

84. Finally, the United States now claims that its due process rights were somehow violated because Brazil did not present its methodology for allocating contract payments when it filed its first submission on 24 June 2004.[123] This is simply not credible. Brazil did not realize until early November 2003 that the United States had inaccurately denied for almost one year that it did not have specific information that would allow the computation of the amount of contract payments received by upland cotton producers planting upland cotton.[124] Without farm-specific data, there is no basis to develop, let alone apply, Brazil's methodology. Brazil could only develop a methodology to apply to actual data when it received the EWG data in mid-November, and when it then sought farm-specific

[119] *See* Exhibit Bra-47 (G/AG/N/USA/43, p. 20).

[120] US 11 February 2004 Comments, para. 48.

[121] US 11 February 2004 Comments, para. 48.

[122] Brazil notes that the United States did not make this assertion even at the Panel meeting of 2-3 December 2004 even though Brazil's 18 November 2003 Further Rebuttal Submission unequivocally stated that non-upland cotton contract payments were included when calculating the amount of contract support payments. *For example*, in Brazil's 18 November 2003 Further Rebuttal Submission, Brazil stated in paragraph 16 in presenting the EWG data that "the best evidence that would permit the Panel to calculate the most precise amount of support to upland cotton from these contract payments is (sic) amount of upland cotton (*and other*) contract acreage that is planted to upland cotton". The footnote to this statement indicated that "*these payments include all contract payments for upland cotton base acreage and payments for other crop base acreage that are received by US producers of upland cotton*." (emphasis added).

[123] *See* US 16 February 2004 Letter to the Panel.

[124] *See* Brazil's 18 February 2004 Comments on US Answers to Questions, para. 26 (setting out the chronology of Brazil's and the Panel's requests for information).

data from the United States.[125] This methodology then would be applied to *actual* data, and replace Brazil's 14/16th methodology. Thus, it is disingenuous in the extreme for the United States to claim now[126] that Brazil should have presented its methodology on 24 June 2003. Any delay in the United States receiving notice of Brazil's methodology is due directly to the regrettable pattern of US misrepresentations in this dispute beginning in December 2002.[127] In any event, the United States' due process rights have hardly been violated, since they have had more than sufficient opportunity to comment on Brazil's methodology.[128] Unfortunately, Brazil cannot say the same, since it has not been able to apply its methodology because the United States has not produced farm specific data requested by the Panel on several occasions.

### 10. The United States Arguments Concerning Various Issues Related to the Amount of Support "Decided" in MY 1992 Compared to the Amount Supported in MY 1999-2002 are without Merit

85. Brazil briefly responds to several arguments that the US level of support decided in MY 1999-2002 was less than that decided in MY 1992. The United States first argues that because it could not know in MY 1992 what its exact expenditures would be, it is inappropriate to use a budgetary outlay methodology for calculating the amount of support to upland cotton.[129] Brazil will not repeat all of its arguments concerning the meaning of "decided" and "support provided".[130] However, the United States cannot deny that when it passed the implementing Uruguay Round legislation and Congress approved the SAA in late 1994, it was well aware of all, or the vast majority of, the budgetary support for upland cotton provided in MY 1992. Had the United States been concerned about the certainty of its peace clause "protection", it would not have been difficult for Congress, in the 1996 FAIR Act or even the 2002 FSRI Act, to include a "circuit breaker" provision directing the USDA Secretary to stop funding of any upland cotton budgetary outlays in excess of the 1992 levels. Such a provision would have allowed the United States to ensure that it remained protected by the peace clause throughout the implementation period.[131]

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[125] *See* Brazil's 18 November 2003 Further Rebuttal Submission, para 16.

[126] The United States points to questions raised by Brazil in the Annex V procedures – questions the United States refused to answer. US 11 February 2004 Data Comments, para. 69. While Brazil focused some of its questions on upland cotton base acreage, it also focused on total market loss assistance and CCP payments to the US upland cotton industry and US upland cotton farmers in Questions 11.1 and 13.1. Exhibit Bra-49 (Questions for Purpose of Annex V Procedure). Similarly, Brazil's questions 3.6 in the consultations focused on total amount of PFC and DP to "upland cotton" for marketing years 1992-2002, and question 11.1 asked for the "total amount of market loss assistance payments made to US upland cotton industry in marketing years 1998 through 2001". Exhibit Bra-101 (Questions for Purposes of the Consultations). Obviously, Brazil is not precluded from seeking information or arguing that "support to upland cotton" also included payments to upland cotton producers on non-cotton base acreage. No party is required to cast in stone its arguments concerning a never-before interpreted WTO Agreement in responding to hundreds of questions, exhibits, and more than a thousand pages of arguments. Given the 10 months of briefing in this extraordinary panel proceeding – and the US refusal to provide requested information – it is disingenuous for the United States to claim that Brazil is prevented from further elaborating on its methodologies for allocating contract payments.

[127] Given the refusal of the United States for the past sixteen months to produce information regarding contract payments, it is incredible for the United States to argue that Brazil "has provided virtually no information that would allow identification of the specific measures at issue". US 11 February 2004 Comments, para. 48.

[128] *See* US 11 February 2004 Comments, paras 35-43.

[129] US 11 February 2004 Comments, para. 16.

[130] Brazil's 22 August 2003 Rebuttal Submission, paras. 68-87; Brazil's 22 July 2003 Oral Statement, paras. 27-36.

[131] Of course, the United States was not required to enact such a measure, because the "peace clause" does not create an obligation on Members to bring their laws into conformity, since it is in the nature of an affirmative defence.

86. Furthermore, the United States asserts that under any methodology of calculating "support to upland cotton", it provided support in MY 1999-2002 below the level of support decided in MY ^1992.[132] The United States performs this legal magic by (1) making $4.7 billion in contract payments[133], including a billion dollars of CCP upland cotton payments in MY 2002 alone, simply disappear, (2) assuming that $5.5 billion[134] in marketing loan payments were never made by applying a price-gap support methodology it never actually used or notified,[135] and (3) imposing its "statute of limitations" calculation to end MY 2002 payments on 18 March 2002.[136] Brazil has addressed all of these creative attempts to cover-up billions of dollars in support payments and will not repeat them here.

## 11. The United States Comments Regarding the Appellate Body's *Japan – Agricultural Products* Decision Are Misplaced

87. Brazil has studied the US comments regarding *Japan – Agricultural Products*[137] carefully and believes Brazil's initial analysis of the decision largely addresses the points raised in the US comments.[138] The United States continues to incorrectly interpret *Japan – Agricultural Products* by confusing "claims" with "arguments". The United States argues in paragraph 33 of its 11 February 2004 Comments that because Brazil allegedly has not *argued* that Annex IV is the proper methodology, the Panel cannot request information from the United States relevant to the application of that methodology.[139] But *Japan – Agricultural Products* stands for the proposition that a Panel cannot make a "claim" for a party, *i.e., a legal claim* that would be required to be set out in a request for the establishment of a panel. It does not stand for the proposition that a panel is prevented from requesting information from a party that would be relevant to determine the merits of *arguments* made by that same party.

88. Further, the United States' entire premise in relying on *Japan – Agricultural Products* is wrong. In its 28 January 2004 Comments and Requests Regarding US Data, Brazil has made an

[132] US 11 February 2004 Comments, para. 17 and accompanying notes.

[133] This figure is based on Brazil's 14/16th methodology, but all other methodologies performed in Annex A generate very similar amounts of support to upland cotton from the four contract payment programmes.

[134] *See* Brazil's 2 December 2003 Oral Statement, Section 5.2.

[135] *See* US 22 August 2003 Rebuttal Submission, paras. 114-119. *See* Brazil's response in its 27 August 2003 Comments, paras. 10-16 and Brazil's 28 January 2004 Comments, paras. 29-36.

[136] US 11 August 2003 Answer to Questions, para. 69, 133-134; US 22 August 2003 Rebuttal Submission, para. 115 note 145. *See* Brazil's response in its 22 August 2003 Rebuttal Submission, paras. 88-96; 22 August 2003 Comments, para. 33; Brazil's 2 December 2003 Oral Statement, paras. 7-10.

[137] US 11 February 2004 Comments, paras 27-34.

[138] Brazil's 28 January 2004 Comments and Requests Regarding US Data, paras. 99-106.

[139] US 11 February 2004 Comments, para. 33.

"argument," *in the alternative*, regarding a methodology proposed by the United States. The Panel's 3 February 2004 request for information on non-contract acreage crops grown by upland cotton producers was entirely consistent with the United States' suggestion of the US Annex IV methodology and with Brazil's attempt in its 28 January 2004 comments to apply the US Annex IV methodology. The United States responded to Brazil's argument on 11 February 2004. There is no doubt that receipt of the non-contract acreage crops grown on cotton farms would allow a more precise tabulation of the amount of payments using the Annex IV methodology. Thus, the Panel's various requests are fully consistent with the holding by the Appellate Body in *Japan – Agricultural Products* that a "panel is entitled to seek information … to help it understand and evaluate the evidence submitted and the arguments made by the parties."[140]

[140] WT/DS76/AB/R, para. 129.

# Annexes A: Calculations of the "Support To" Upland Cotton Using Various Methodologies

# and

# Annex B: Peace Clause Comparisons

## Annex A

## Calculation of Contract Payment Support to Upland Cotton

1. In this Annex, Brazil sets forth the details of its calculation of contract payments that constitute support to upland cotton, within the meaning of Article 13 of the Agreement on Agriculture. All of Brazil's calculations are based on the revised US summary files produced on 28 January 2004 and other USDA documents provided as exhibits to the Panel. Brazil explains its calculations either in the narrative of this annex or in the footnotes accompanying the tables.

### 1. Upland Cotton Contract Payments Only

2. The calculations in this section are based on the presumption that only upland cotton contract payments would be relevant for calculating support to upland cotton. As Brazil has explained in the main text of these comments, Brazil strongly opposes the US arguments that all non-upland cotton contract payments have to be excluded from the calculation of support to upland cotton. All contract payments, including those made on non-upland cotton base acreage, are properly within the Panel's terms of reference. Further, the Panel needs to include all contract payments, including those made on non-upland cotton base acreage, in its objective evaluation of the applicability of the peace clause exemption. Nevertheless, Brazil provides below the necessary calculations for allocating only upland cotton contract payments as "support to" upland cotton.

3. These calculations are performed in two different manners: First, the total amount of upland cotton contract payments to farms actually producing upland cotton is calculated. Second, the amount of upland cotton contract payments to farms actually producing upland cotton is adjusted pursuant to the amount of upland cotton actually produced by farms holding upland cotton base. Under this approach, only upland cotton payments for upland cotton base acres that are actually planted to upland cotton would be considered support to upland cotton. Since plantings of upland cotton on farms also holding upland cotton base exceed the upland cotton base acreage in MY 1999-2001,[1] the adjustment only affects MY 2002 figures.[2]

4. The first step is performed by multiplying the amount of upland cotton payments units on farms producing upland cotton and holding upland cotton base[3] (as reported by the United States in its 28 January 2004 summary files) by the applicable payment rate for upland cotton in each of the marketing years 1999-2002.

[1] *See* rPFCsum.xls and rDPCsum.xls files provided by the United States on 28 January 2004.

[2] Both approaches exclude any non-upland cotton contract payments received by farms that produce upland cotton and (1) hold upland cotton base, or (2) do not hold upland cotton base (but possible other base).

[3] These farms are called "1" in the rPFCsum.xls file and "Enrolled in Cotton PFC and planted cotton" in the rDCPsum.xls file. Presumably the latter should be called "Enrolled in Cotton DCP and planted cotton."

Table 1.1

| Upland Cotton Contract Payments to Farms Producing Upland Cotton and Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| MY | Programme | Payment Units[4] | Payment Rate[5] (cents per pound) | Subsidy Amount[6] |
| 1999 | PFC Payments | 6,539,475,550.8 | 7.88 | $515,310,673.4 |
| 2000 | PFC Payments | 6,581,478,117.7 | 7.33 | $482,422,346.0 |
| 2001 | PFC Payments | 6,476,075,004.9 | 5.99 | $387,916,892.8 |
| 2002 | Direct Payments | 7,107,791,953.5 | 6.67 | $474,089,723.3 |
| | CCP Payments | 7,622,807,085.5 | 13.73 | $1,046,611,412.8 |

5. The table below summarizes the total amount of upland cotton contract payments received by farms producing upland cotton and holding upland cotton base.

Table 1.2

| Total Upland Cotton Contract Payment Amounts on Farms Producing Upland Cotton and Holding Upland Cotton Base[7] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[8] | Direct Payments | CCP Payments |
| 1999 | $515,310,673.4 | $512,801,043.5 | - | - |
| 2000 | $482,422,346.0 | $513,554,489.0 | - | - |
| 2001 | $387,916,892.8 | $535,792,287.0 | - | - |
| 2002 | - | - | $474,089,723.3 | $1,046,611,412.8 |

6. For purposes of comparison, Brazil reproduces the results of its "14/16$^{th}$" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September Further Submission.

Table 1.3

| Results of Brazil's 14/16$^{th}$ Methodology | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

7. As the Panel can see, the results of this methodology are not considerably different from the results of Brazil's 14/16$^{th}$ methodology.

[4] Payment Units for MY 1999-2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004. Payment Units for MY 2002 are taken from the rDCPsum.xls file provided by the United States on 28 January 2004.

[5] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

[6] Subsidy Amount = Payment Units * Payment Rate.

[7] *See* Table 1.1 for the underlying calculations.

[8] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

8. In a second step, Brazil adjusts the above calculated subsidy amount pursuant to the amount of upland cotton actually planted on farms holding upland cotton base. These calculations are possible distorted due to the aggregation problems discussed in Brazil's 20 January 2004 Comments and Requests Regarding US Data.[9] The adjustment factor is calculated as the ratio of upland cotton planted acreage to upland cotton base acreage (capped a 1).

Table 1.4

| **Adjustment Factor to Be Applied to Upland Cotton Contract Payments to Farms Producing Upland Cotton and Holding Upland Cotton Base** | | | | |
|---|---|---|---|---|
| MY | Upland Cotton Planted Acreage[10] | Upland Cotton Base Acreage[11] | Ratio[12] | Adjustment Factor[13] |
| 1999 | 13,540,382.7 | 12,581,724.8 | 1.07619 | 1 |
| 2000 | 14,170,477.5 | 12,625,168.7 | 1.12239 | 1 |
| 2001 | 14,118,952.4 | 12,386,499.4 | 1.02176 | 1 |
| 2002 | 13,022,668.9 | 13,818,215.2 | 0.94243 | 0.94243 |

9. The table below includes the amount of contract payments that would constitute "support to" upland cotton, if only payments for upland cotton base acreage that is actually planted to upland cotton were considered.

Table 1.5

| **Cotton-to-Cotton Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[14] | Direct Payments | CCP Payments |
| 1999 | $515,310,673.4 | $512,801,043.5 | - | - |
| 2000 | $482,422,346.0 | $513,554,489.0 | - | - |
| 2001 | $387,916,892.8 | $535,792,287.0 | - | - |
| 2002 | - | - | $446,796,377.9 | $986,357,993.8 |

10. For purposes of comparison, Brazil reproduces the results of its "14/16$^{th}$" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September Further Submission.

[9] *See inter alia* Brazil's 28 January 2004 Comments and Requests Regarding US Data, paras. 13-15.

[10] Upland Cotton Planted Acreage for MY 1999-2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004. Upland Cotton Planted Acreage for MY 2002 is taken from "Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[11] Upland Cotton Base Acreage for MY 1999-2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004. Upland Cotton Base Acreage for MY 2002 is taken from "Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[12] Ratio = Upland Cotton Planted Acreage / Upland Cotton Base Acreage.

[13] The Adjustment Factor equals the Ratio of Upland Cotton Planted Acreage to Upland Cotton Base Acreage capped at 1. This means all upland cotton contract payments are deemed to be support to upland cotton if more (or equal) upland cotton is planted than there is upland cotton base. If upland cotton plantings are short of upland cotton base, only the respective ratio is considered to be support to upland cotton.

[14] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

Table 1.6

| Results of Brazil's 14/16th Methodology | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

11. The results of this methodology are only marginally below the results of Brazil's 14/16th methodology, although this methodology would assume that upland cotton produced on farms that do not hold upland cotton base would not receive any contract payments at all, and that upland cotton contract payments on farms that produce upland cotton and hold base would only allocated up to the share of contract acreage that is actually planted to upland cotton. The reason for the close similarity between the 14/16th methodology and the cotton-to-cotton methodology results is that the overwhelming majority of upland cotton is planted on upland cotton base (86.34 per cent in MY 1999, 82.05 per cent in MY 2000, 80.10 per cent in MY 2001 and 96.17 per cent in MY 2002).[15]

### 2. Brazil's (Simplified) Allocation Methodology

12. In this section of Annex A, Brazil provides an update of its calculations in Section 9 of its 28 January 2004 Comments and Requests Regarding US Data taking into account the revised summary data produced by the United States on 28 January 2004. Brazil has discussed its methodology in considerable detail in its 20 January 2004 response to Question 258[16] and has applied it in Section 9 of its 28 January 2004 Comments and Requests Regarding US Data. Brazil recalls that its methodology considers as support to a particular crop all crop contract payments for that crop that are made for base acres actually planted to that crop. All remaining support is pooled and allocated as support to contract crops according to their share of total "overplanted" contract crop acreage on a farm.

13. While the revised US summary data provided on 28 January 2004 neither addresses the aggregation problems resulting from the particular manner in which the United States produced its summary data,[17] nor the shortcomings in terms of soybean market loss assistance payments and peanut direct and counter-cyclical payments, the United States provides information on contract base of farms that plant upland cotton, but do not hold upland cotton base. To reflect this additional information, Brazil has updated its earlier calculations.[18]

14. In a first step, Brazil analyses farms that plant upland cotton and hold upland cotton base. By marketing year, the following four tables provide, first, by crop the total amount of contract payments received by farms that produce upland cotton and hold upland cotton base.

[15] Calculated as the share of upland cotton production planted on farms holding upland cotton base (up to the amount of upland cotton base) of total upland cotton plantings. MY 1999-2001 data are taken from category "1" farms and total upland cotton planting from the rPFCsum.xls file provided by the United States on 28 January 2004. Data for MY 2002 is taken from "Enrolled in Cotton PFC and planted cotton" farms and total upland cotton plantings from the rDCPsum.xls file provided by the United States on 28 January 2004.

[16] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[17] No such aggregation problem exists with respect to the summary data as requested by the Panel on 3 February 2004.

[18] Since there are also minor changes to the summary data on farms that plant upland cotton and hold upland cotton base, Brazil has recalculated all of the figures presented in Section 9 of its 28 January 2004 Comments and Requests Regarding US Data following the very same calculation methodology.

Table 2.1

| MY 1999 PFC Payments by Crop for Farms Producing Upland Cotton And Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[19] | Payment Rate[20] (US$ per unit) | Subsidy Amount[21] |
| Upland Cotton | PFC Payments | 6,539,475,550.8 | 0.0788 | $515,310,673.4 |
| Wheat | PFC Payments | 95,664,040.0 | 0.6370 | $60,937,993.5 |
| Oats | PFC Payments | 4,237,510.4 | 0.0300 | $127,125.3 |
| Rice | PFC Payments | 1,737,257,447.2 | 0.0128 | $22,236,895.3 |
| Corn | PFC Payments | 161,779,123.3 | 0.3630 | $58,725,821.8 |
| Sorghum | PFC Payments | 85,161,081.8 | 0.4350 | $37,045,070.6 |
| Barley | PFC Payments | 6,144,577.9 | 0.2710 | $1,665,180.6 |

Table 2.2

| MY 2000 PFC Payments by Crop for Farms Producing Upland Cotton And Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[22] | Payment Rate[23] (US$ per unit) | Subsidy Amount[24] |
| Upland Cotton | PFC Payments | 6,581,478,117.7 | 0.0733 | $482,422,346.0 |
| Wheat | PFC Payments | 97,234,507.3 | 0.5880 | $57,173,890.3 |
| Oats | PFC Payments | 4,307,676.7 | 0.0280 | $120,614.9 |
| Rice | PFC Payments | 1,835,587,326.3 | 0.0118 | $21,659,930.5 |
| Corn | PFC Payments | 160,180,015.1 | 0.3340 | $53,500,125.0 |
| Sorghum | PFC Payments | 85,770,731.7 | 0.4000 | $34,308,292.7 |
| Barley | PFC Payments | 6,408,296.1 | 0.2510 | $1,608,482.3 |

[19] Payment Units for MY 1999 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[20] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[21] Subsidy Amount = Payment Units * Payment Rate.

[22] Payment Units for MY 2000 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[23] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[24] Subsidy Amount = Payment Units * Payment Rate.

Table 2.3

| MY 2001 PFC Payments by Crop for Farms Producing Upland Cotton And Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[25] | Payment Rate[26] (US$ per unit) | Subsidy Amount[27] |
| Upland Cotton | PFC Payments | 6,476,075,004.9 | 0.0599 | $387,916,892.8 |
| Wheat | PFC Payments | 92,731,181.0 | 0.4740 | $43,954,579.8 |
| Oats | PFC Payments | 4,096,334.8 | 0.0220 | $90,119.4 |
| Rice | PFC Payments | 1,963,467,470.7 | 0.0095 | $18,652,941.0 |
| Corn | PFC Payments | 154,693,661.2 | 0.2690 | $41,612,594.9 |
| Sorghum | PFC Payments | 82,952,147.8 | 0.3240 | $26,876,495.9 |
| Barley | PFC Payments | 5,564,922.0 | 0.2060 | $1,146,373.9 |

Table 2.4

| MY 2002 Direct and Counter-Cyclical Payments by Crop for Farms Producing Upland Cotton And Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop[28] | Programme | Payment Units[29] | Payment Rate[30] (US$ per unit) | Subsidy Amount[31] |
| Upland Cotton | DP Payments | 7,107,791,953.5 | 0.0667 | $474,089,723.3 |
| | CCP Payments | 7,622,807,085.5 | 0.1373 | $1,046,611,412.8 |
| Wheat | DP Payments | 68,412,316.3 | 0.5200 | $35,574,404.5 |
| | CCP Payments | 70,209,721.9 | 0.0000 | $0 |
| Oats | DP Payments | 3,202,016.5 | 0.0200 | $64,040.3 |
| | CCP Payments | 3,227,085.9 | 0.0000 | $0 |
| Rice | DP Payments | 1,972,478,301.5 | 0.0107 | $21,105,517.8 |
| | CCP Payments | 2,133,694,144.3 | 0.0075 | $16,002,706.1 |
| Corn | DP Payments | 118,220,781.7 | 0.2800 | $33,101,818.9 |
| | CCP Payments | 132,055,130.0 | 0.0000 | $0 |
| Sorghum | DP Payments | 63,545,759.2 | 0.6300 | $40,033,828.3 |
| | CCP Payments | 64,258,624.9 | 0.0000 | $0 |
| Barley | DP Payments | 4,494,711.7 | 0.2400 | $1,078,730.8 |
| | CCP Payments | 4,663,526.3 | 0.0000 | $0 |
| Soybeans | DP Payments | 32,002,425.3 | 0.4400 | $14,081,067.1 |
| | CCP Payments | 35,163,355.6 | 0.0000 | $0 |

[25] Payment Units for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[26] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[27] Subsidy Amount = Payment Units * Payment Rate.

[28] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[29] Payment Units for MY 2002 are taken from category "Enrolled in Cotton PFC and planed cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[30] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[31] Subsidy Amount = Payment Units * Payment Rate.

15. The next four sets of calculations indicate the amount of base and planted acreage for each crop and the amount of crop contract payments allocated to each crop as well as the amount of contract payments available for allocation to other crops. They finally also indicate the amount of contract payments that constitute support to upland cotton on farms that plant upland cotton and hold upland cotton base.[32]

Table 2.5

| **MY 1999 Farms Producing Upland Cotton And Holding Upland Cotton Base (PFC Payment Allocation)** | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[33] | Planted Acres[34] | Subsidy Allocated[35] | Subsidy Available for Allocation[36] |
| Upland Cotton | 12,581,724.8 | 13,540,382.7 | **$515,310,673.4** | $0.0 |
| Wheat | 3,071,118.0 | 2,363,687.3 | $46,900,953.1 | $14,037,040.4 |
| Oats | 110,232.9 | 72,349.1 | $83,436.1 | $43,689.2 |
| Rice | 466,080.3 | 451,264.0 | $21,530,003.1 | $706,892.2 |
| Corn | 2,214,514.8 | 1,306,755.6 | $34,653,322.9 | $24,072,498.9 |
| Sorghum | 1,809,835.7 | 1,747,475.2 | $35,768,629.3 | $1,276,441.4 |
| Barley | 119,385.9 | 59,080.0 | $824,040.9 | $841,139.7 |

16. Since planted acreage exceeds base acreage only for upland cotton, the entire amount of 1999 PFC payments available for allocation (**$40,977,701.8**) is allocated to upland cotton. Therefore the amount of PFC payments that constitute support to upland cotton on farms planting upland cotton and holding upland cotton base in MY 1999 is **$556,288,375.2**.[37]

[32] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton but do not hold upland cotton base, as discussed below.

[33] Contract Acres for MY 1999 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[34] Planted Acres for MY 1999 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[35] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.1 for the calculation of the total MY 1999 PFC payment by crop).

[36] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[37] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton but do not hold upland cotton base, as discussed below.

Table 2.6

| **MY 2000 Farms Producing Upland Cotton And Holding Upland Cotton Base (PFC Payment Allocation)** | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[38] | Planted Acres[39] | Subsidy Allocated[40] | Subsidy Available for Allocation[41] |
| Upland Cotton | 12,625,168.7 | 14,170,477.5 | **$482,422,346.0** | $0.0 |
| Wheat | 3,127,581.2 | 2,866,488.2 | $52,400,967.8 | $4,772,922.5 |
| Oats | 112,722.9 | 80,100.4 | $85,708.4 | $34,906.5 |
| Rice | 491,929.7 | 350,319.2 | $15,424,743.7 | $6,235,186.8 |
| Corn | 2,201,781.0 | 1,439,083.7 | $34,967,672.9 | $18,532,452.1 |
| Sorghum | 1,833,506.9 | 1,458,672.4 | $27,294,448.5 | $7,013,844.2 |
| Barley | 124,232.0 | 55,138.4 | $713,899.3 | $894,583.0 |

17. Since planted acreage exceeds base acreage only for upland cotton, the entire amount of 2000 PFC payments available for allocation (**$37,483,895.1**) is allocated to upland cotton. Therefore the amount of PFC payments that constitute support to upland cotton on farms planting upland cotton and holding upland cotton base in MY 2000 is **$519,906,241.1**.[42]

[38] Contract Acres for MY 2000 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[39] Planted Acres for MY 2000 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[40] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.2 for the calculation of the total MY 2000 PFC payment by crop).

[41] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[42] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton but do not hold upland cotton base, as discussed below.

Table 2.7

| MY 2001 Farms Producing Upland Cotton And Holding Upland Cotton Base (PFC Payment Allocation I) | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[43] | Planted Acres[44] | Subsidy Allocated[45] | Subsidy Available for Allocation[46] |
| Upland Cotton | 12,386,499.4 | 14,118,952.4 | **$387,916,892.8** | $0.0 |
| Wheat | 2,948,042.9 | 2,235,873.5 | $33,336,312.8 | $10,618,267.0 |
| Oats | 105,068.0 | 155,272.1 | $90,119.4 | $0.0 |
| Rice | 530,490.2 | 437,596.1 | $15,386,625.9 | $3,266,315.1 |
| Corn | 2,149,751.1 | 1,272,872.9 | $24,638,919.5 | $16,973,675.4 |
| Sorghum | 1,785,775.2 | 2,228,624.6 | $26,876,495.9 | $0.0 |
| Barley | 106,907.6 | 53,286.2 | $571,389.8 | $574,984.1 |

18. The total amount of PFC payment that is available for allocation over crops whose planted acreage exceeds their base acreage is allocated as detailed in the following table:

Table 2.8

| MY 2001 Farms Producing Upland Cotton And Holding Upland Cotton Base (PFC Payment Allocation II) | | | | |
|---|---|---|---|---|
| Crop | (Contract Acres[47]) – (Planted Acres[48]) | Share of Total Overplanted Base[49] | Total Subsidy Available for Allocation[50] | Additional Subsidy Allocated[51] |
| Upland Cotton | 1,732,453.0 | 77.85 per cent | $31,433,241.7 | **$24,469,312.4** |
| Oats | 50,204.1 | 2.26 per cent | $31,433,241.7 | $709,086.9 |
| Sorghum | 442,849.4 | 19.89 per cent | $31,433,241.7 | $6,254,842.3 |
| Total | 2,225,506.5 | 100 per cent | $31,433,241.7 | $31,433,241.7 |

19. The amount of PFC payments that constitute support to upland cotton on farms planting upland cotton and holding upland cotton base in MY 2001 is **$412,386,205.2**.[52,53]

[43] Contract Acres for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[44] Planted Acres for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[45] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.3 for the calculation of the total MY 2001 PFC payment by crop).

[46] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[47] Contract Acres for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[48] Planted Acres for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[49] *See* "Total" in the preceding column.

[50] The figures in this column represent the total of the amount of MY 2001 PFC payments available for allocation as calculation in the "Subsidy Available for Allocation" column of Table 2.7.

[51] Additional Subsidy Allocated = Share of Total Overplanted Base * Total Subsidy Available for Allocation.

[52] Calculated as the sum of the two bolded figures in Tables 2.7 and 2.8.

20. Since in MY 2002, the amount of upland cotton acreage (13,022,668.9 acres[54]) on farms that planted upland cotton and held upland cotton base was below the amount of upland cotton base (13,818,215.2[55]), no additional contract payments would be allocated. Instead, the amount of support to upland cotton is calculated by multiplying the amount of upland cotton direct and counter-cyclical payments on these farms by 0.94243.[56] The table below shows the amount of payments allocated as support to upland cotton.

Table 2.9

| **MY 2002 Allocated Upland Cotton Direct and Counter-Cyclical Payments** | | | |
|---|---|---|---|
| | Total Payments[57] | Share To Be Allocated[58] | Payments Allocated[59] |
| Direct Payments | $474,089,723.3 | 94.243 per cent | **$446,796,377.9** |
| CCP Payments | $1,046,611,412.8 | 94.243 per cent | **$986,357,993,8** |

21. In a second step, Brazil analyses farms that plant upland cotton but do not hold upland cotton base. By marketing year, the following four tables provide, first, by crop the total amount of contract payments received by farms that produce upland cotton and hold upland cotton base.

Table 2.10

| **MY 1999 PFC Payments by Crop for Farms Producing Upland Cotton But Not Holding Upland Cotton Base** | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[60] | Payment Rate[61] (US$ per unit) | Subsidy Amount[62] |
| Upland Cotton | PFC Payments | 0 | 0.0788 | $0 |
| Wheat | PFC Payments | 20,027,129.9 | 0.6370 | $12,757,281.7 |
| Oats | PFC Payments | 801,406.4 | 0.0300 | $24,042.2 |
| Rice | PFC Payments | 579,443,200.3 | 0.0128 | $7,416,873.0 |
| Corn | PFC Payments | 34,650,665.6 | 0.3630 | $12,578,191.6 |
| Sorghum | PFC Payments | 12,138,759.1 | 0.4350 | $5,280,360.2 |
| Barley | PFC Payments | 551,544.3 | 0.2710 | $149,468.5 |

[53] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton but do not hold upland cotton base, as discussed below.

[54] Taken from category "Enrolled in Cotton PFC and planted cotton" farms from in rDCPsum.xls provided by the United States on 28 January 2004.

[55] Taken from category "Enrolled in Cotton PFC and planted cotton" farms from in rDCPsum.xls provided by the United States on 28 January 2004.

[56] This figure represents the share that upland cotton planted acreage constitutes of upland cotton base acreage.

[57] *See* Table 2.4 for the calculation of the total upland cotton MY 2002 direct and counter-cyclical payments.

[58] This figure represents the share that upland cotton planted acreage constitutes of upland cotton base acreage – calculated based on data taken from "Enrolled in Cotton PFC and planted cotton" farms column from in rDCPsum.xls provided by the United States on 28 January 2004.

[59] Payments Allocated = Total Payments * Share To Be Allocated.

[60] Payment Units for MY 1999are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[61] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[62] Subsidy Amount = Payment Units * Payment Rate.

Table 2.11

| MY 2000 PFC Payments by Crop for Farms Producing Upland Cotton But Not Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[63] | Payment Rate[64] (US$ per unit) | Subsidy Amount[65] |
| Upland Cotton | PFC Payments | 0 | 0.0733 | $0 |
| Wheat | PFC Payments | 22,244,808.9 | 0.5880 | $13,079,947.6 |
| Oats | PFC Payments | 952,045.1 | 0.0280 | $26,657.3 |
| Rice | PFC Payments | 633,534,085.0 | 0.0118 | $7,475,702.2 |
| Corn | PFC Payments | 36,445,141.6 | 0.3340 | $12,172,677.3 |
| Sorghum | PFC Payments | 12,928,302.9 | 0.4000 | $5,171,321.2 |
| Barley | PFC Payments | 558,190.5 | 0.2510 | $140,105.8 |

Table 2.12

| MY 2001 PFC Payments by Crop for Farms Producing Upland Cotton But Not Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[66] | Payment Rate[67] (US$ per unit) | Subsidy Amount[68] |
| Upland Cotton | PFC Payments | 0 | 0.0599 | $0 |
| Wheat | PFC Payments | 22,428,260.7 | 0.4740 | $10,630,995.6 |
| Oats | PFC Payments | 942,768.1 | 0.0220 | $20,740.9 |
| Rice | PFC Payments | 777,335,099.0 | 0.0095 | $7,384,683.4 |
| Corn | PFC Payments | 38,743,300.2 | 0.2690 | $10,421,947.8 |
| Sorghum | PFC Payments | 13,988,512.5 | 0.3240 | $4,532,278.1 |
| Barley | PFC Payments | 583,440.6 | 0.2060 | $120,188.8 |

[63] Payment Units for MY 2000 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[64] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[65] Subsidy Amount = Payment Units * Payment Rate.

[66] Payment Units for MY 2001 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[67] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[68] Subsidy Amount = Payment Units * Payment Rate.

Table 2.13

| **MY 2002 Direct and Counter-Cyclical Payments by Crop for Farms Producing Upland Cotton But Not Holding Upland Cotton Base** | | | | |
|---|---|---|---|---|
| Crop[69] | Programme | Payment Units[70] | Payment Rate[71] (US$ per unit) | Subsidy Amount[72] |
| Upland Cotton | DP Payments | 0 | 0.0667 | $0 |
| | CCP Payments | 0 | 0.1373 | $0 |
| Wheat | DP Payments | 8,301,576.6 | 0.5200 | $4,316,819.8 |
| | CCP Payments | 8,541,723.9 | 0.0000 | $0.0 |
| Oats | DP Payments | 161,464.9 | 0.0200 | $3,229.3 |
| | CCP Payments | 164,737.2 | 0.0000 | $0.0 |
| Rice | DP Payments | 495,586,654.0 | 0.0107 | $5,302,777.2 |
| | CCP Payments | 498,858,849.4 | 0.0075 | $3,741,441.4 |
| Corn | DP Payments | 16,302,167.4 | 0.2800 | $4,564,606.9 |
| | CCP Payments | 18,440,044.0 | 0.0000 | $0.0 |
| Sorghum | DP Payments | 5,944,728.1 | 0.6300 | $3,745,178.7 |
| | CCP Payments | 5,882,846.2 | 0.0000 | $0.0 |
| Barley | DP Payments | 127,254.2 | 0.2400 | $30,541.0 |
| | CCP Payments | 129,400.5 | 0.0000 | $0.0 |
| Soybeans | DP Payments | 1,732,743.1 | 0.4400 | $762,407.0 |
| | CCP Payments | 1,855,963.7 | 0.0000 | $0.0 |

22. The next four sets of calculations indicate the amount of base and planted acreage for each crop and the amount of crop contract payments allocated to each crop as well as the amount of contract payments available for further allocation to other crops. They finally also indicate the amount of contract payments that constitute support to upland cotton on farms that plant upland cotton but do not hold upland cotton base.[73]

[69] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[70] Payment Units for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planed cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[71] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[72] Subsidy Amount = Payment Units * Payment Rate.

[73] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

Table 2.14

| **MY 1999 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (PFC Payments)** | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[74] | Planted Acres[75] | Subsidy Allocated[76] | Subsidy Available for Allocation[77] |
| Upland Cotton | 0 | 1,032,580.8 | **$0** | $0 |
| Wheat | 664,033.9 | 377,929.2 | $7,260,697.5 | $5,496,584.2 |
| Oats | 20,442.4 | 12,284.9 | $14,448.2 | $9,594.0 |
| Rice | 133,161.8 | 74,642.6 | $4,157,458.7 | $3,259,414.3 |
| Corn | 495,800.2 | 205,429.0 | $5,211,626.2 | $7,366,565.4 |
| Sorghum | 224,604.4 | 141,533.7 | $3,327,401.1 | $1,952,959.1 |
| Barley | 13,086.9 | 3,021.1 | $34,504.7 | $114,963.8 |

23. Since for none of the non-upland cotton crops planted acreage exceeds base acreage, the entire amount of 1999 PFC payments available for allocation (**$18,200,080.9**[78]) is allocated to upland cotton.[79]

[74] Contract Acres for MY 1999 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[75] Planted Acres for MY 1999 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[76] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.10 for the calculation of the total MY 1999 PFC payment by crop).

[77] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[78] Sum of "Subsidy Available for Allocation" in Table 2.14.

[79] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

Table 2.15

| **MY 2000 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (PFC Payments)** | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[80] | Planted Acres[81] | Subsidy Allocated[82] | Subsidy Available for Allocation[83] |
| Upland Cotton | 0 | 1,217,550.3 | **$0** | $0 |
| Wheat | 749,812.2 | 429,019.3 | $7,483,940.6 | $5,596,007.0 |
| Oats | 25,096.0 | 19,731.5 | $20,959.1 | $5,698.2 |
| Rice | 147,118.7 | 70,088.3 | $3,561,472.9 | $3,914,229.3 |
| Corn | 523,505.2 | 231,096.1 | $5,373,505.8 | $6,799,171.5 |
| Sorghum | 244,894.8 | 162,155.4 | $3,424,154.6 | $1,747,166.6 |
| Barley | 13,533.9 | 2,808.5 | $29,074.2 | $111,031.6 |

24. Since for none of the non-upland cotton crops planted acreage exceeds base acreage, the entire amount of 2000 PFC payments available for allocation (**$18,173,304.2**[84]) is allocated to upland cotton.[85]

[80] Contract Acres for MY 2000 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[81] Planted Acres for MY 2000 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[82] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.11 for the calculation of the total MY 2000 PFC payment by crop).

[83] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[84] Sum of "Subsidy Available for Allocation" in Table 2.15.

[85] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

Table 2.16

| **MY 2001 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (PFC Payments)** | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[86] | Planted Acres[87] | Subsidy Allocated[88] | Subsidy Available for Allocation[89] |
| Upland Cotton | 0 | 1,344,982.1 | **$0** | $0 |
| Wheat | 716,566.2 | 393,648.9 | $5,840,185.8 | $4,790,809.8 |
| Oats | 23,851.4 | 32,464.5 | $28,230.8 | -$7,489.9 |
| Rice | 182,597.4 | 105,932.1 | $4,284,152.0 | $3,100,531.4 |
| Corn | 569,027.1 | 228,127.0 | $4,178,232.8 | $6,243,715.0 |
| Sorghum | 264,349.3 | 182,763.6 | $3,133,488.4 | $1,398,789.7 |
| Barley | 13,343.0 | 2,783.6 | $25,073.6 | $95,115.2 |

25. Since for none of the non-upland cotton crops planted acreage exceeds base acreage, the entire amount of 2001 PFC payments available for allocation (**$15,621,471.2**[90]) is allocated to upland cotton.[91]

[86] Contract Acres for MY 2001 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[87] Planted Acres for MY 2001 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[88] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.13 for the calculation of the total MY 2001 PFC payment by crop).

[89] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[90] Sum of "Subsidy Available for Allocation" in Table 2.16.

[91] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

Table 2.17

| **MY 2002 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (Direct Payments)** | | | | |
|---|---|---|---|---|
| Crop[92] | Contract Acres[93] | Planted Acres[94] | Subsidy Allocated[95] | Subsidy Available for Allocation[96] |
| Upland Cotton | 0 | 518,837.0 | **$0** | $0 |
| Wheat | 243,967.7 | 231,183.7 | $4,090,616.8 | $226,203.0 |
| Oats | 4,049.8 | 11,842.4 | $3,229.3 | $0.0 |
| Rice | 111,611.5 | 49,723.9 | $2,362,433.6 | $2,940,343.6 |
| Corn | 197,312.6 | 145,345.6 | $3,362,408.3 | $1,202,198.6 |
| Sorghum | 108,062.4 | 104,094.2 | $3,607,650.6 | $137,528.1 |
| Barley | 3,368.5 | 1,697.3 | $15,388.8 | $15,152.2 |
| Soybeans | 98,409.5 | 140,070.8 | $762,407.0 | $0.0 |

26. The total amount of MY 2002 direct payments that is available for allocation over crops whose planted acreage exceeds their base acreage is allocated as detailed in the following table:

Table 2.18

| **MY 2002 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (Direct Payments)** | | | | |
|---|---|---|---|---|
| Crop | (Contract Acres[97]) – (Planted Acres[98]) | Share of Total Overplanted Base[99] | Total Subsidy Available for Allocation[100] | Additional Subsidy Allocated[101] |
| Upland Cotton | 518,837.0 | 91.298 per cent | $4,521,425.4 | **$4,127,961.2** |
| Oats | 7,792.60 | 1.371 per cent | $4,521,425.4 | $61,999.3 |
| Soybeans | 41,661.30 | 7,331 per cent | $4,521,425.4 | $331,464.9 |
| Total | 568,290.90 | 100 per cent | $4,521,425.4 | $4,521,425.4 |

[92] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[93] Planted Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[94] Contract Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[95] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.14 for the calculation of the total MY 2002 direct payment by crop).

[96] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[97] Contract Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[98] Planted Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[99] *See* Total in the preceding column

[100] The figures in this column represent the total of the amount of MY 2002 direct payments available for allocation as calculated in the "Subsidy Available for Allocation" column in Table 2.17.

[101] Additional Subsidy Allocated = Share of Total Overplanted Base * Total Subsidy Available for Allocation.

27. The total amount of 2002 direct payments that constitute support to upland cotton on farms that produce upland cotton but do not hold upland cotton base is therefore **$4,127,961.2**.[102]

Table 2.19

| **MY 2002 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (CCP Payments)** | | | | |
|---|---|---|---|---|
| Crop[103] | Contract Acres[104] | Planted Acres[105] | Subsidy Allocated[106] | Subsidy Available for Allocation[107] |
| Upland Cotton | 0 | 518,837.0 | **$0** | $0 |
| Wheat | 243,967.7 | 231,183.7 | $0 | $0 |
| Oats | 4,049.8 | 11,842.4 | $0 | $0 |
| Rice | 111,611.5 | 49,723.9 | $1,666,844.9 | $2,074,596.5 |
| Corn | 197,312.6 | 145,345.6 | $0 | $0 |
| Sorghum | 108,062.4 | 104,094.2 | $0 | $0 |
| Barley | 3,368.5 | 1,697.3 | $0 | $0 |
| Soybeans | 98,409.5 | 140,070.8 | $0 | $0 |

28. The total amount of MY 2002 counter-cyclical payments that is available for allocation over crops whose planted acreage exceeds their base acreage is allocated as detailed in the following table:

[102] Additional direct payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

[103] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[104] Contract Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" from the rDCPsum.xls file provided by the United States on 28 January 2004.

[105] Planted Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" from the rDCPsum.xls file provided by the United States on 28 January 2004.

[106] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.14 for the calculation of the total MY 2002 counter-cyclical payment by crop).

[107] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

Table 2.20

| MY 2002 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (CCP Payments) | | | | |
|---|---|---|---|---|
| Crop | (Contract Acres[108]) – (Planted Acres[109]) | Share of Total Overplanted Base[110] | Total Subsidy Available for Allocation[111] | Additional Subsidy Allocated[112] |
| Upland Cotton | 518,837.0 | 91.298 per cent | $2,074,596.5 | **$1,894,060.6** |
| Oats | 7,792.60 | 1.371 per cent | $2,074,596.5 | $28,447.6 |
| Soybeans | 41,661.30 | 7,331 per cent | $2,074,596.5 | $152,088.3 |
| Total | 568,290.90 | 100 per cent | $2,074,596.5 | $2,074,596.5 |

29. The amount of 2002 counter-cyclical payments that constitute support to upland cotton on farms that produce upland cotton but do not hold upland cotton base is therefore **$1,894,060.6**.[113]

30. In a third step, Brazil presents the total amount of contract payments received by farms that produce upland cotton that constitute support to upland cotton, whether or not these farms actually hold upland cotton base.[114]

Table 2.21

| Total Contract Payment Support to Upland Cotton on Farms Producing Upland Cotton and Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[115] | Direct Payments | CCP Payments |
| 1999 | $574,488,456.1 | $571,690,622.7 | - | - |
| 2000 | $538,079,545.3 | $572,803,412.3 | - | - |
| 2001 | $428,007,676.4 | $591,165,829.7 | - | - |
| 2002 | - | - | $450,924,339.1 | $988,252,054.4 |

[108] Contract Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[109] Planted Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[110] *See* Total in the preceding column

[111] The figures in this column represent the total of the amount of MY 2002 direct payments available for allocation as calculated in the "Subsidy Available for Allocation" column in Table 2.17.

[112] Additional Subsidy Allocated = Share of Total Overplanted Base * Total Subsidy Available for Allocation.

[113] Additional counter-cyclical payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

[114] These figures have been calculated as the sum of the contract payments allocated as support to upland cotton on farms that either hold or do not hold upland cotton base and produce upland cotton.

[115] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

31. For purposes of comparison, Brazil reproduces the results of its "14/16th" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September Further Submission.

Table 2.22

| **Results of Brazil's 14/16th Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

32. As the Panel can readily see, both methodologies produce quite similar results.

### 3. Annex IV-Type Methodology Over Contract Crop Values Only

33. The calculations in this section apply an Annex IV-type allocation methodology to all contract payments received by farms that produce upland cotton, whether or not those farms hold upland cotton base. The approach is the same as in Section 10 of Brazil's 28 January Comments and Requests Regarding US Data. – with the sole exception that the allocation is performed only over the value of programme crops produced on the farm, rather than over the entire value of the upland cotton farms (crop) production.[116]

34. As a first step, Brazil tabulates the total amount of contract payments received by farms that produce upland cotton, as calculated in Section 2 above. The following four tables show the results of this calculation indicating the amount of contract payments by contract payment crop.

Table 3.1

| **Total Amount of MY 1999 PFC Payments** | | | |
|---|---|---|---|
| Crop | Farms Holding Upland Cotton Base[117] | Farms Not Holding Upland Cotton Base[118] | Total PFC Payment[119] |
| Upland Cotton | $515,310,673.4 | $0.0 | $515,310,673.4 |
| Wheat | $60,937,993.5 | $12,757,281.7 | $73,695,275.2 |
| Oats | $127,125.3 | $24,042.2 | $151,167.5 |
| Rice | $22,236,895.3 | $7,416,873.0 | $29,653,768.3 |
| Corn | $58,725,821.8 | $12,578,191.6 | $71,304,013.4 |
| Sorghum | $37,045,070.6 | $5,280,360.2 | $42,325,430.8 |
| Barley | $1,665,180.6 | $149,468.5 | $1,814,649.1 |
| **Total** | $696,048,760.5 | $38,206,217.2 | **$734,254,977.7** |

[116] This calculation based on the revised 28 January 2004 US data is replicated in Section 4 below.
[117] *See* Table 2.1 for the calculations resulting in these subsidy figures.
[118] *See* Table 2.10 for the calculations resulting in these subsidy figures.
[119] Sum of the two preceding columns

Table 3.2

| **Total Amount of MY 2000 PFC Payments** | | | |
|---|---|---|---|
| Crop | Farms Holding Upland Cotton Base[120] | Farms Not Holding Upland Cotton Base[121] | Total PFC Payment[122] |
| Upland Cotton | $482,422,346.0 | $0.0 | $482,422,346.0 |
| Wheat | $57,173,890.3 | $13,079,947.6 | $70,253,837.9 |
| Oats | $120,614.9 | $26,657.3 | $147,272.2 |
| Rice | $21,659,930.5 | $7,475,702.2 | $29,135,632.7 |
| Corn | $53,500,125.0 | $12,172,677.3 | $65,672,802.3 |
| Sorghum | $34,308,292.7 | $5,171,321.2 | $39,479,613.9 |
| Barley | $1,608,482.3 | $140,105.8 | $1,748,588.1 |
| **Total** | $650,793,681.7 | $38,066,411.4 | **$688,860,093.1** |

Table 3.3

| **Total Amount of MY 2001 PFC Payments** | | | |
|---|---|---|---|
| Crop | Farms Holding Upland Cotton Base[123] | Farms Not Holding Upland Cotton Base[124] | Total PFC Payment[125] |
| Upland Cotton | $387,916,892.8 | $0.0 | $387,916,892.8 |
| Wheat | $43,954,579.8 | $10,630,995.6 | $54,585,575.4 |
| Oats | $90,119.4 | $20,740.9 | $110,860.3 |
| Rice | $18,652,941.0 | $7,384,683.4 | $26,037,624.4 |
| Corn | $41,612,594.9 | $10,421,947.8 | $52,034,542.7 |
| Sorghum | $26,876,495.9 | $4,532,278.1 | $31,408,774.0 |
| Barley | $1,146,373.9 | $120,188.8 | $1,266,562.7 |
| **Total** | $520,249,997.7 | $33,110,834.6 | **$553,360,832.3** |

[120] *See* Table 2.2 for the calculations resulting in these subsidy figures.
[121] *See* Table 2.11 for the calculations resulting in these subsidy figures.
[122] Sum of the two preceding columns
[123] *See* Table 2.3 for the calculations resulting in these subsidy figures.
[124] *See* Table 2.12 for the calculations resulting in these subsidy figures.
[125] Sum of the two preceding columns

Table 3.4

| Total Amount of MY 2002 Direct and Counter-Cyclical Payments | | | | |
|---|---|---|---|---|
| Crop[126] | Programme | Farms Holding Upland Cotton Base[127] | Farms Not Holding Upland Cotton Base[128] | Total DP and CCP Payments[129] |
| Upland Cotton | DP Payments | $474,089,723.3 | $0.0 | $474,089,723.3 |
| | CCP Payments | $1,046,611,412.8 | $0.0 | $1,046,611,412.8 |
| Wheat | DP Payments | $35,574,404.5 | $4,316,819.8 | $39,891,224.3 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| Oats | DP Payments | $64,040.3 | $3,229.3 | $67,269.6 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| Rice | DP Payments | $21,105,517.8 | $5,302,777.2 | $26,408,295.0 |
| | CCP Payments | $16,002,706.1 | $3,741,441.4 | $19,744,147.5 |
| Corn | DP Payments | $33,101,818.9 | $4,564,606.9 | $37,666,425.8 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| Sorghum | DP Payments | $40,033,828.3 | $3,745,178.7 | $43,779,007.0 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| Barley | DP Payments | $1,078,730.8 | $30,541.0 | $1,109,271.8 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| Soybeans | DP Payments | $14,081,067.1 | $762,407.0 | $14,843,474.1 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| **Total** | DP Payments | $619,129,131.0 | $18,725,559.9 | **$637,854,690.9** |
| | CCP Payments | $1,062,614,118.9 | $3,741,441.4 | **$1,066,355,560.3** |

35. In a second step the value of all contract payment crops produced on farms that also produce upland cotton is determined. Therefore, the total amount of acreage planted to each of the contract payment crops is multiplied by the average yield and the average farm price for the crop. This is shown in the following four tables.

[126] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[127] *See* Table 2.4 for the calculations resulting in these subsidy figures.

[128] *See* Table 2.13 for the calculations resulting in these subsidy figures.

[129] Sum of the two preceding columns

Table 3.5

| MY 1999 Value of Programme Crop Production on Upland Cotton Farms | | | | | |
|---|---|---|---|---|---|
| Crop | Crop Plantings on Farms Holding Upland Cotton Base[130] | Crop Plantings on Farms Not Holding Upland Cotton Base[131] | Average Yield[132] | Farm Price per unit[133] | Total Value[134] |
| Upland Cotton | 13,540,382.7 | 1,032,580.8 | 536.095 | $0.45 | $3,515,621,790.4 |
| Wheat | 2,363,687.3 | 377,929.2 | 42.7 | $2.48 | $290,326,220.9 |
| Oats | 72,349.1 | 12,284.9 | 59.6 | $1.12 | $5,649,488.8 |
| Rice | 451,264.0 | 74,642.6 | 5,866 | $0.027 | $82,912,712.7 |
| Corn | 1,306,755.6 | 205,429.0 | 133.8 | $1.82 | $368,241,145.1 |
| Sorghum | 1,747,475.2 | 141,533.7 | 69.7 | $1.57 | $206,712,354.9 |
| Barley | 59,080.0 | 3,021.1 | 59.2 | $2.13 | $7,830,700.3 |
| **Total** | 19,540,993.90 | 1,847,421.30 | - | - | $4,477,294,413.0 |

[130] Planted Acres for MY 1999 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[131] Planted Acres for MY 1999 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[132] Upland cotton yields per planted acre (adjusted for abandonment) are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4). All other yields are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17). If these yields should constitute yields on harvested acres (the USDA document relied on by Brazil does not provide this information), then the use of these figures would bias the results leading to lower allocations for upland cotton. No other yield figures are available to Brazil.

[133] Average farm prices are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17).

[134] Total Value = (Crop Plantings on Farms Holding Upland Cotton Base + Crop Plantings on Farms Not Holding Upland Cotton Base) * Average Yield * Farm Price per Unit.

Table 3.6

| MY 2000 Value of Programme Crop Production on Upland Cotton Farms | | | | | |
|---|---|---|---|---|---|
| Crop | Crop Plantings on Farms Holding Upland Cotton Base[135] | Crop Plantings on Farms Not Holding Upland Cotton Base[136] | Average Yield[137] | Farm Price per unit[138] | Total Value[139] |
| Upland Cotton | 14,170,477.5 | 1,217,550.3 | 525.84 | $0.498 | $4,029,636,988.1 |
| Wheat | 2,866,488.2 | 429,019.3 | 42.0 | $2.62 | $362,637,645.3 |
| Oats | 80,100.4 | 19,731.5 | 64.2 | $1.10 | $7,050,128.8 |
| Rice | 350,319.2 | 70,088.3 | 6,281 | $0.025 | $67,139,462.6 |
| Corn | 1,439,083.7 | 231,096.1 | 136.9 | $1.85 | $422,998,087.0 |
| Sorghum | 1,458,672.4 | 162,155.4 | 60.9 | $1.89 | $186,558,900.6 |
| Barley | 55,138.4 | 2,808.5 | 61.1 | $2.11 | $7,470,572.3 |
| **Total** | 20,420,279.80 | 2,132,449.40 | - | - | $5,083,491,784.8 |

[135] Planted Acres for MY 200 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[136] Planted Acres for MY 2000 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[137] Upland cotton yields per planted acre (adjusted for abandonment) are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4). All other yields are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17). If these yields should constitute yields on harvested acres (the USDA document relied on by Brazil does not provide this information), then the use of these figures would bias the results leading to lower allocations for upland cotton. No other yield figures are available to Brazil.

[138] Average farm prices are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17).

[139] Total Value = (Crop Plantings on Farms Holding Upland Cotton Base + Crop Plantings on Farms Not Holding Upland Cotton Base) * Average Yield * Farm Price per Unit.

Table 3.7

| MY 2001 Value of Programme Crop Production on Upland Cotton Farms | | | | | |
|---|---|---|---|---|---|
| Crop | Crop Plantings on Farms Holding Upland Cotton Base[140] | Crop Plantings on Farms Not Holding Upland Cotton Base[141] | Average Yield[142] | Farm Price per unit[143] | Total Value[144] |
| Upland Cotton | 14,118,952.4 | 1,344,982.1 | 607.25 | $0.298 | $2,798,361,319.1 |
| Wheat | 2,235,873.5 | 393,648.9 | 40.2 | $2.78 | $293,864,905.3 |
| Oats | 155,272.1 | 32,464.5 | 61.4 | $1.59 | $18,327,973.3 |
| Rice | 437,596.1 | 105,932.1 | 6,496 | $0.019 | $68,010,000.7 |
| Corn | 1,272,872.9 | 228,127.0 | 138.2 | $1.97 | $408,653,226.8 |
| Sorghum | 2,228,624.6 | 182,763.6 | 59.9 | $1.94 | $280,217,777.2 |
| Barley | 53,286.2 | 2,783.6 | 58.2 | $2.22 | $7,244,442.4 |
| **Total** | 20,502,477.80 | 2,290,701.80 | - | - | $3,874,679,644.8 |

[140] Planted Acres for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[141] Planted Acres for MY 2001 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[142] Upland cotton yields per planted acre (adjusted for abandonment) are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4). All other yields are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17). If these yields should constitute yields on harvested acres (the USDA document relied on by Brazil does not provide this information), then the use of these figures would bias the results leading to lower allocations for upland cotton. No other yield figures are available to Brazil.

[143] Average farm prices are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17).

[144] Total Value = (Crop Plantings on Farms Holding Upland Cotton Base + Crop Plantings on Farms Not Holding Upland Cotton Base) * Average Yield * Farm Price per Unit.

Table 3.8

| MY 2002 Value of Programme Crop Production on Upland Cotton Farms | | | | | |
|---|---|---|---|---|---|
| Crop[145] | Crop Plantings on Farms Holding Upland Cotton Base[146] | Crop Plantings on Farms Not Holding Upland Cotton Base[147] | Average Yield[148] | Farm Price per unit[149] | Total Value[150] |
| Upland Cotton | 13,022,668.9 | 518,837.0 | 566.676 | $0.445 | $3,414,772,646.8 |
| Wheat | 2,685,236.6 | 231,183.7 | 35.3 | $3.56 | $366,500,706.3 |
| Oats | 145,601.7 | 11,842.4 | 56.7 | $1.81 | $16,158,015.7 |
| Rice | 373,548.5 | 49,723.9 | 6,578 | $0.019 | $53,252,747.8 |
| Corn | 1,641,968.8 | 145,345.6 | 130.0 | $2.32 | $539,054,023.0 |
| Sorghum | 1,621,276.2 | 104,094.2 | 50.7 | $2.32 | $202,944,967.9 |
| Barley | 49,167.3 | 1,697.3 | 54.9 | $2.72 | $7,595,509.0 |
| Soybeans | 1,966,061.6 | 140,070.8 | 38.0 | $5.53 | $442,582,662.5 |
| **Total** | 21,505,529.60 | 1,202,794.90 | - | - | $5,042,861,279.0 |

36. The following table shows the share that the upland cotton value represents of the total value of contract payments crops produced on farms that also produce upland cotton.

Table 3.9

| Percentage of Upland Cotton Value of Total Programme Crop Value[151] | | | |
|---|---|---|---|
| MY 1999 | MY 2000 | MY 2001 | MY 2002 |
| 78.521 per cent | 79.269 per cent | 72.222 per cent | 67.715 per cent |

37. Finally, Brazil applies these percentages (the share of upland cotton value of total contract payment crop value) to the total amount of contract payments, as calculated in the first step. The resulting figures represent the total amount of contract payments that constitute support to upland cotton under this methodology. The following table shows the amount of support to upland cotton if an Annex IV-type methodology is applied to allocate the value of contract payments over the total value of contract crops produced on farms that also produce upland cotton.

[145] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[146] Planted Acres for MY 2002 are taken from category "Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[147] Planted Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[148] Upland cotton yields per planted acre (adjusted for abandonment) are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4). All other yields are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17). If these yields should constitute yields on harvested acres (the USDA document relied on by Brazil does not provide this information), then the use of these figures would bias the results leading to lower allocations for upland cotton. No other yield figures are available to Brazil.

[149] Average farm prices are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17).

[150] Total Value = (Crop Plantings on Farms Holding Upland Cotton Base + Crop Plantings on Farms Not Holding Upland Cotton Base) * Average Yield * Farm Price per Unit.

[151] These figures have been calculated as "Total Value" of upland cotton divided by "Total Value" of all crops reported in Tables 3.5-3.8.

Table 3.10

| Total Contract Payments Allocated as Support to Upland Cotton[152] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[153] | Direct Payments | CCP Payments |
| 1999 | $576,544,351.0 | $573,736,505.1 | - | - |
| 2000 | $546,052,507.2 | $581,290,893.0 | - | - |
| 2001 | $399,648,260.3 | $551,995,696.4 | - | - |
| 2002 | - | - | $431,923,303.9 | $722,082,667.7 |

38. For purposes of comparison, Brazil reproduces the results of its "14/16$^{th}$" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September Further Submission.

able 3.11

| Results of Brazil's 14/16$^{th}$ Methodology | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

### 4. US-Proposed Annex IV Methodology

39. In this section, Brazil provides updated calculations for allocating contract payments over the entire sales of crops produced on farms producing upland cotton.[154] In Section 3 of this annex, Brazil calculated the total amounts of contract payments received by farms producing upland cotton (Tables 3.1-3.4). Brazil also calculated the value of the contract programme crop production on farms producing upland cotton (Tables 3.5-3.8). To avoid repetition, Brazil refers to Panel to these calculations.

40. While the revised US summary data provided on 28 January 2004 neither addresses the aggregation problems resulting from the particular manner in which the United States produced its summary data,[155] nor the shortcomings in terms of soybean market loss assistance payments and peanut direct and counter-cyclical payments, the United States provides information on contract base of farms that plant upland cotton, but do not hold upland cotton base. To reflect this additional information, Brazil has updated its earlier calculations.[156]

[152] These figures have been calculated by multiplying the percentage amount in Table 3.9 by the total amount of PFC, direct and counter-cyclical payments in Tables 3.1-3.4.

[153] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

[154] Brazil's original calculations are contained in Section 10 of its 28 January 2004 Comments and Requests Regarding US Data.

[155] No such aggregation problem exists with respect to the summary data as requested by the Panel on 3 February 2004.

[156] Since there are also minor changes to the summary data on farms that plant upland cotton and hold upland cotton base, Brazil has recalculated all of the figures presented in Section 10 of its 28 January 2004 Comments and Requests Regarding US Data following the very same calculation methodology.

41. Allocating the total amount of contract payments over the entire sales of crops produced on farms that also produce upland cotton requires determining the value of the non-programme crop production on these farms. In a first step, Brazil calculates the amount of acreage planted to non-programme crops on farms that produce upland cotton.

Table 4.1

| **MY 1999 Non-Contract Payment Crop Acres on Upland Cotton Farms** | |
|---|---|
| Total Acreage on Farms Holding Upland Cotton Base[157] | 27,912,407.1 acres |
| Total Acreage on Farms Not Holding Upland Cotton Base[158] | 2,716,150.3 acres |
| **Total Acreage on Upland Cotton Farms[159]** | 30,628,557.4 acres |
| Total Contract Crop Acreage on Farms Holding Upland Cotton Base[160] | 19,540,993.9 acres |
| Total Contract Acreage on Farms Not Holding Upland Cotton Base[161] | 1,847,421.3 acres |
| **Total Contract Crop Acreage on Upland Cotton Farms[162]** | 21,388,415.2 acres |
| **Total Non-Contract Crop Acreage on Upland Cotton Farms[163]** | **9,240,142.2 acres** |

[157] Data taken from category "1" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.

[158] Data taken from category "3" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.

[159] Sum of the two above figures.

[160] Sum of figures reported in Table 2.5.

[161] Sum of figures reported in Table 2.14.

[162] Sum of the two above figures.

[163] Difference between "Total Acreage on Upland Cotton Farms" and "Total Contract Crop Acreage on Upland Cotton Farms."

Table 4.2

| **MY 2000 Non-Contract Payment Crop Acres on Upland Cotton Farms** | |
|---|---|
| Total Acreage on Farms Holding Upland Cotton Base[164] | 28,104,322.2 acres |
| Total Acreage on Farms Not Holding Upland Cotton Base[165] | 2,986,458.7 acres |
| **Total Acreage on Upland Cotton Farms[166]** | 31,090,780.9 acres |
| Total Contract Crop Acreage on Farms Holding Upland Cotton Base[167] | 20,420,279.8 acres |
| Total Contract Acreage on Farms Not Holding Upland Cotton Base[168] | 2,132,449.4 acres |
| **Total Contract Crop Acreage on Upland Cotton Farms[169]** | 22,552,729.2 acres |
| **Total Non-Contract Crop Acreage on Upland Cotton Farms[170]** | **8,538,051.7 acres** |

Table 4.3

| **MY 2001 Non-Contract Payment Crop Acres on Upland Cotton Farms** | |
|---|---|
| Total Acreage on Farms Holding Upland Cotton Base[171] | 27,412,998.5 acres |
| Total Acreage on Farms Not Holding Upland Cotton Base[172] | 3,222,775.5 acres |
| **Total Acreage on Upland Cotton Farms[173]** | 30,635,774.0 acres |
| Total Contract Crop Acreage on Farms Holding Upland Cotton Base[174] | 20,502,477.8 acres |
| Total Contract Acreage on Farms Not Holding Upland Cotton Base[175] | 2,290,701.8 acres |
| **Total Contract Crop Acreage on Upland Cotton Farms[176]** | 22,793,179.6 acres |
| **Total Non-Contract Crop Acreage on Upland Cotton Farms[177]** | **7,842,594.4 acres** |

[164] Data taken from category "1" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.
[165] Data taken from category "3" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.
[166] Sum of the two above figures.
[167] Sum of figures reported in Table 2.6.
[168] Sum of figures reported in Table 2.15.
[169] Sum of the two above figures.
[170] Difference between "Total Acreage on Upland Cotton Farms" and "Total Contract Crop Acreage on Upland Cotton Farms."
[171] Data taken from category "1" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.
[172] Data taken from category "3" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.
[173] Sum of the two above figures.
[174] Sum of figures reported in Table 2.7.
[175] Sum of figures reported in Table 2.16.
[176] Sum of the two above figures.
[177] Difference between "Total Acreage on Upland Cotton Farms" and "Total Contract Crop Acreage on Upland Cotton Farms."

Table 4.4

| **MY 2002 Non-Contract Payment Crop Acres on Upland Cotton Farms** | |
|---|---|
| Total Acreage on Farms Holding Upland Cotton Base[178] | 26,576,970.2 acres |
| Total Acreage on Farms Not Holding Upland Cotton Base[179] | 1,564,115.0 acres |
| **Total Acreage on Upland Cotton Farms[180]** | 28,141,085.2 acres |
| Total Contract Crop Acreage on Farms Holding Upland Cotton Base[181] | 21,505,529.6 acres |
| Total Contract Acreage on Farms Not Holding Upland Cotton Base[182] | 1,202,794.9 acres |
| **Total Contract Crop Acreage on Upland Cotton Farms[183]** | 22,708,324.5 acres |
| **Total Non-Contract Crop Acreage on Upland Cotton Farms[184]** | **5,432,760.7 acres** |

42. Brazil notes that the calculation of the average value of the production from a non-contract crop acre in the United States is unaffected by the new summary data provided by the United States on 28 January 2004. For ease of reference, Brazil reproduces the average values in the table below.

Table 4.5

| **Average Per-Acre Value from Production of Non-Contract Programme Crops in the United States[185]** | | | |
|---|---|---|---|
| MY 1999 | MY 2000 | MY 2001 | MY 2002 |
| $150.28 | $155.58 | $154.92 | $118.42 |

43. Multiplying the per acre value of non-contract crop production by the amount of acreage planted to non-programme crops provides the total value of this production, as shown in the table below.

[178] Data taken from category "Enrolled in Cotton PFC and planted cotton" farms column in rDCPsum.xls file provided by the United States on 28 January 2004.

[179] Data taken from category "Not Enrolled in Cotton PFC and planted cotton" farms column in rDCPsum.xls file provided by the United States on 28 January 2004.

[180] Sum of the two above figures.

[181] Sum of planted acre figures on category "Enrolled in Cotton PFC and planted cotton" farms from rDCPsum.xls provided by the United States on 28 January 2004.

[182] Sum of figures reported in Tables 2.17 and 2.18.

[183] Sum of the two above figures.

[184] Difference between "Total Acreage on Upland Cotton Farms" and "Total Contract Crop Acreage on Upland Cotton Farms."

[185] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data). Brazil has provided this file also electronically as 'allocation calculations.xls' on 28 January 2004.

Table 4.6

| **Total Value of Non-Contract Programme Crops Production on Upland Cotton Farms[186]** | | | |
|---|---|---|---|
| MY 1999 | MY 2000 | MY 2001 | MY 2002 |
| $1,388,608,569.8 | $1,328,350,083.5 | $1,214,974,724.4 | $643,347,522.1 |

44. These figures are added to the value of contract programme crops determined in Section 3 and presented below.

Table 4.7

| **Total Value of Crop Production on Upland Cotton Farms** | | | | |
|---|---|---|---|---|
| | MY 1999 | MY 2000 | MY 2001 | MY 2002 |
| Value of Contract Programme Crops[187] | $4,477,294,413.0 | $5,083,491,784.8 | $3,874,679,644.8 | $5,042,861,279.0 |
| Value of Non-Contract Payment Crops[188] | $1,388,608,569.8 | $1,328,350,083.5 | $1,214,974,724.4 | $643,347,522.1 |
| Total Value[189] | $5,865,902,982.8 | $6,411,841,868.3 | $5,089,654,369.2 | $5,686,208,801.1 |
| Upland Cotton Value[190] | $3,515,621,790.4 | $4,029,636,988.1 | $2,798,361,319.1 | $3,414,772,646.8 |
| Upland Cotton Value as a Percentage of Total Value[191] | 59.933 per cent | 62.857 per cent | 54.981 per cent | 60.054 per cent |

45. Applying this percentage rate to the total amount of contract payments received by farms producing upland cotton generates the amount of contract payments that constitute support to upland cotton under this methodology. The figures are shown in the table below.

[186] Total Value = "Average Per-Acre Value of Non-Contract Payment Crop Production in the United States" (as reported in Table 4.5) * "Total Non-Contract Crop Acreage on Upland Cotton Farms" (as reported in Tables 4.1-4.4).

[187] *See* Tables 3.5-3.8.

[188] *See* Table 4.6.

[189] Sum of the two preceding figures.

[190] *See* Tables 3.5-3.8.

[191] Calculated by dividing "Upland Cotton Value" by "Total Value."

Table 4.8

| **Total Contract Payments Allocated as Support to Upland Cotton[192]** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[193] | Direct Payments | CCP Payments |
| 1999 | $440,061,035.8 | $437,917,881.4 | - | - |
| 2000 | $432,996,788.7 | $460,939,354.1 | - | - |
| 2001 | $304,243,319.2 | $420,222,029.1 | - | - |
| 2002 | - | - | $383,057,256.1 | $640,389,168.2 |

46. For purposes of comparison, Brazil reproduces the results of its "14/16$^{th}$" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September Further Submission.

Table 4.9

| **Results of Brazil's 14/16$^{th}$ Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

[192] Calculated by applying the "Upland Cotton Value as a Percentage of Total Value" (reported in Table 4.7) to the total amount of contract payments reported in Tables 3.1-3.4.

[193] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

## Annex B

## Peace Clause Comparisons MY 1999-2001 Under Various Allocation Methodologies

**Budgetary Outlays For Upland Cotton MY 1992, 1999[1]**

| Year / Programme | 1992 | 1999 (1) | 1999 (2) | 1999 (3) | 1999 (4) | 1999 (5) |
|---|---|---|---|---|---|---|
| | ----- $ million ----- | | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none | none |
| PFC Payments | none | 515.3 | 574.5 | 576.5 | 440.1 | 547.8 |
| MLA Payments | none | 512.8 | 571.7 | 573.7 | 437.9 | 545.1 |
| Marketing Loan Gains and LDP Payments[2] | 866 | 1,761 | 1,761 | 1,761 | 1,761 | 1,761 |
| Step 2 Payment | 207 | 422 | 422 | 422 | 422 | 422 |
| Crop Insurance | 26.6 | 169.6 | 169.6 | 169.6 | 169.6 | 169.6 |
| Cottonseed Payments | none | 79 | 79 | 79 | 79 | 79 |
| **Total** | **2,117.0** | **3,459.7** | **3,577.8** | **3,581.8** | **3,309.6** | **3,524.5** |

(1) Adjusted Total Upland Cotton Contract Payments to Farms Producing Upland Cotton and Holding Upland Cotton Base; (Under The Non-Adjusted Methodology, The Amount Would Be Identical)
(2) Brazil's Allocation Methodology
(3) Annex IV-Type Allocation Over Value of Contract Payment Crops Only
(4) US-proposed Methodology
(5) Brazil's 14/16th Methodology

**Budgetary Outlays For Upland Cotton MY 1992, 2000[3]**

| Year / Programme | 1992 | 2000 (1) | 2000 (2) | 2000 (3) | 2000 (4) | 2000 (5) |
|---|---|---|---|---|---|---|
| | ----- $ million ----- | | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none | none |
| PFC Payments | none | 482.4 | 538.1 | 546.1 | 433.0 | 541.3 |
| MLA Payments | none | 513.6 | 572.8 | 581.3 | 460.9 | 576.2 |
| Marketing Loan Gains and LDP Payments[4] | 866 | 636 | 636 | 636 | 636 | 636 |
| Step 2 Payment | 207 | 236 | 236 | 236 | 236 | 236 |
| Crop Insurance | 26.6 | 161.7 | 161.7 | 161.7 | 161.7 | 161.7 |
| Cottonseed Payments | none | 185 | 185 | 185 | 185 | 185 |
| **Total** | **2,117.0** | **2,214.7** | **2,329.6** | **2,346.1** | **2,112.6** | **2,336.2** |

(1) Adjusted Total Upland Cotton Contract Payments to Farms Producing Upland Cotton and Holding Upland Cotton Base; (Under The Non-Adjusted Methodology, The Amount Would Be Identical)
(2) Brazil's Allocation Methodology
(3) Annex IV-Type Allocation Over Value of Contract Payment Crops Only
(4) US-proposed Methodology
(5) Brazil's 14/16th Methodology

[1] The table below reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission.
[2] "Other Payments" have been included in the marketing loan figures.
[3] The table below reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission.
[4] "Other Payments" have been included in the marketing loan figures.

**Budgetary Outlays For Upland Cotton MY 1992, 2001**[5]

| Year / Programme | 1992 | 2001 (1) | 2001 (2) | 2001 (3) | 2001 (4) | 2001 (5) |
|---|---|---|---|---|---|---|
| | ----- $ million ----- | | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none | none |
| PFC Payments | none | 387.9 | 428.0 | 399.6 | 304.2 | 453.0 |
| MLA Payments | none | 535.8 | 597.2 | 552.0 | 420.2 | 625.7 |
| Marketing Loan Gains and LDP Payments[6] | 866 | 2,609 | 2,609 | 2,609 | 2,609 | 2,609 |
| Step 2 Payment | 207 | 196 | 196 | 196 | 196 | 196 |
| Crop Insurance | 26.6 | 262.9 | 262.9 | 262.9 | 262.9 | 262.9 |
| Cottonseed Payments | none | none | none | none | none | none |
| **Total** | **2,117.0** | **3,991.6** | **4,093.1** | **4,019.5** | **3,792.3** | **4,146.6** |

(1) Adjusted Total Upland Cotton Contract Payments to Farms Producing Upland Cotton and Holding Upland Cotton Base; (Under The Non-Adjusted Methodology, The Amount Would Be Identical)
(2) Brazil's Allocation Methodology
(3) Annex IV-Type Allocation Over Value of Contract Payment Crops Only
(4) US-proposed Methodology
(5) Brazil's 14/16th Methodology

[5] The table below reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission.

[6] "Other Payments" have been included in the marketing loan figures.

# ANNEX I-23

## COMMENTS OF THE UNITED STATES TO THE 18 FEBRUARY 2004 COMMENTS OF BRAZIL

3 March 2004

**Introduction**

1. The United States thanks the Panel for this opportunity to provide comments on the 18 February comments filed by Brazil relating to the data submitted by the United States on 18 And 19 December 2003. As an initial matter, the United States finds it odd that Brazil's 18 February comments advance a number of new arguments concerning the applicability of the Peace Clause at this late stage in the proceedings, long after the time when the Peace Clause portion of the dispute was supposed to have been concluded. This only demonstrates the shifting nature of Brazil's arguments and approach to the legal provisions at issue.

2. In these comments, we proceed as follows:

- First, the United States sets forth how Brazil's arguments on the use of the December data are mistaken because of Brazil's erroneous interpretation of the Peace Clause phrase "support to a specific commodity."

- Second, we rebut Brazil's argument that support to a specific commodity may be determined by an analysis of whether the payment in question "cover[s] (or contribute[s] to) the costs of production of a crop." Brazil's "costs of production" principle finds no support in the text of the Peace Clause or of any WTO agreement and in fact collapses when applied to its logical conclusion.

- Third, we demonstrate that Brazil's argument that decoupled income support payments are *de facto* tied to production is in error.

- Fourth, we explain that Brazil has not made a *prima facie* case under its subsidies claims with respect to decoupled payments because it has failed to advance evidence and arguments to allow for identification of the challenged subsidy and subsidized product.

- Fifth, we demonstrate that Brazil's various allocation methodologies, in addition to being irrelevant for Peace Clause Purposes and inapplicable for serious prejudice claims, are internally inconsistent and illogical and that its so-called "Annex IV" methodologies are in fact unrelated to the text of Annex IV.

- Finally, we conclude by noting that Brazil's interpretation of the Peace Clause and application of the December data would upset the balance of rights and obligations of members in the WTO agreements.

**Brazil Misinterprets the Peace Clause[1] Phrase, "Support to a Specific Commodity"**

3. We begin by noting that the entirety of section 2, and many other parts, of Brazil's comments are based on an argument that Brazil invents and falsely ascribes to the United States. Brazil seeks to paint the US interpretation of the Peace Clause proviso as "based on" an understanding that "'support to' means 'tied to' the production of a specific commodity" – that is, that "support to" in Article 13(b)(ii) of the Agreement on Agriculture means something like "tied to the production or sale of a given product" in paragraph 3 of Annex IV of the Subsidies Agreement.[2] Brazil's argument, however, is not based on any submission of the United States since the United States has never linked the Peace Clause to Annex IV. Indeed, in the US February 11 comments, we specifically noted that:

> [T]he terms "support to a specific commodity" and "product-specific support" are not found in Part III of the Subsidies Agreement, nor in Article 1 or Annex IV. Neither are the terms "subsidy," "benefit," or "subsidized product" from the Subsidies Agreement found in the Peace Clause proviso or any supporting text. Thus, the plain language of the Peace Clause and [Subsidies Agreement] Articles 5 and 6 indicate that these provisions refer to wholly different approaches and suggest that the methodology for allocating non-tied (decoupled) payments under the Subsidies Agreement may not be relevant under the Agreement on Agriculture. The definitions of product-specific support and non-product-specific support in Article 1(a) of the Agreement on Agriculture confirm that the Annex IV allocation methodology does not apply for purposes of the Peace Clause.[3]

Thus, contrary to Brazil's assertions, the United States is plainly *not* inappropriately attempting to interpret the phrase "support to" in the Peace Clause in light of the phrase "tied to" in Annex IV.[4] Having laid down a patently incorrect understanding of the US argument, Brazil proceeds never to address the true bases for the US interpretation of the Peace Clause phrase "support to a specific commodity".

4. Although Brazil correctly suggests that the Panel should look to the ordinary meaning of the phrase "support to a specific commodity," it *only* provides a dictionary definition for one term in the phrase, "support" ("assistance, backing").[5] Brazil's reliance on "support" is misplaced. When Brazil states: "The issue under Article 13(b)(ii) is whether a particular commodity receives 'backing' or support' from a domestic support measure," Brazil fundamentally misunderstands the issue.[6] "Non-product-specific support" is also "support" to various agricultural commodities. The simple fact that it supports those commodities (on a non-specific basis) does not thereby convert that support into

[1] In paragraph 19 of Brazil's 18 February comments, Brazil in passing characterizes the Peace Clause as "now-expired". As the United States has explained earlier in this proceeding, the issue of the date of expiration of the Peace Clause is not at issue in this proceeding. Brazil accepts that the Peace Clause was in effect when the Panel was established. However, the United States has also explained that the Peace Clause has not yet expired for the United States or other Members whose relevant "year" began later in 1995, so Brazil's characterization is inaccurate as well.

[2] Brazil's 18 February Comments, para. 3.

[3] US February 11 Comments, para. 20 (footnote omitted).

[4] Similarly, we are puzzled by Brazil's lengthy argument in section 4 of its comments that it is the US position that "only Annex IV of the SCM Agreement offers any useful context" to finding some methodology to apply to decoupled payments for purposes of the Peace Clause analysis. Brazil's 18 February Comments, paras. 38-41. As set out above, the Peace Clause determination is made on the basis of its text in its context; the United States does not rely on Annex IV as context or otherwise for interpretation of the Peace Clause; and no methodology to allocate non-product-specific support to a specific commodity can be found in the Agreement on Agriculture.

[5] Brazil's 18 February Comments, para. 3.

[6] Brazil's 18 February Comments, para. 6.

support to a "specific commodity" for purposes of Article 13(b)(ii). In addition, by solely defining "support," Brazil avoids the ordinary meaning of the phrase as a whole – that is, "assistance" or "backing" "specially . . . pertaining to a particular" "agricultural crop"[7] – a meaning which runs directly contrary to Brazil's approach under which support to multiple commodities is at the same time support to particular commodities. Brazil not only fails to look to the ordinary meaning of *all* of the terms in this phrase[8], it also fails to read the phrase "support to a specific commodity" in light of any other provision of the Agreement on Agriculture (the most immediate context for the Peace Clause) that contains any of the terms "support," "specific," or "commodity".[9]

5. For example, the phrase "support to a specific commodity" contains elements found in the phrases product-specific and non-product-specific support – but Brazil denies that those concepts have any relevance to the Peace Clause.[10] Brazil also fails to discuss (and therefore presumably believes irrelevant) the similarities between the phrase "*support to a specific commodity*" and the phrases "*support* . . . provided *for an agricultural product* in favour of the producers of the basic agricultural product" (Article 1(a)) and "*support for basic agricultural products*" (Article 1(h)), which, respectively, define and refer to product-specific support (without using those exact words). Brazil's interpretation of the Peace Clause phrase "support to a specific commodity", in addition to ignoring the ordinary meaning of the phrase as a whole, ignores relevant context as well – that is, those phrases in the Agreement on Agriculture that, because of their close similarities, must inform a valid interpretation.

6. As we have previously noted, "support to a specific commodity" must be read not only according to the ordinary meaning of the terms, but also in light of the structure of the Agreement on Agriculture. Brazil asserts that Members would have used the exact phrase "product-specific support" instead of "support to a specific commodity" if they had meant the two to be read as having the same meaning,[11] but Brazil sets up a false dichotomy. The Agreement elsewhere defines (Article 1(a)) and refers to (Article 1(h)) this concept without using that exact phrase. Indeed, the Agreement on Agriculture *nowhere* uses the exact phrase "product-specific support". A close approximation is the phrase "product-specific domestic support" in Article 6.4(a)(i); in Annex 3, paragraph 1, the term "product-specific" is used in the context of describing the AMS to be calculated for each basic agricultural product.[12] Despite the absence in the text of the exact phrase "product-specific support", even Brazil has no difficulty recognizing that such a concept exists in the Agreement on Agriculture; thus, that the exact phrase "product-specific support" was not used in the

[7] *See* US First Written Submission, para. 77 (July 11, 2003) (citing dictionary definitions of each term).

[8] According to the customary rules of interpretation of public international law, the Agreement is to "be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." *See* Vienna Convention on the Law of Treaties, Article 31 (General rule of interpretation).

[9] *See, e.g.*, Agreement on Agriculture, Articles 1(a), 1(d), 1(f), 6.4, and Annex 3 (paragraphs 1 and 7).

[10] Instead, Brazil claims that all of its arguments relating to product-specific support and non-product-specific support have been arguments "*in the alternative.*" Brazil also faults the United States for "falsely assert[ing] that Brazil has 'conceded that 'support to a specific commodity' refers to 'product-specific support.'" Brazil's 18 February Comments, paras. 9-10. The United States notes that the Brazilian statement previously referred to by the United States (that is, "the support from contract payments that can be allocated to upland cotton is product-specific support within the meaning of the Agreement on Agriculture", Brazil's 28 January Comments, para. 73) did *not* contain any indication that it was made "in the alternative". Nonetheless, in these comments, the United States proceeds as if Brazil's 18 February comments are its final position.

[11] Brazil's February 18 Comments, para. 5 ("Negotiators presumably knew what they intended when they used the very particular term 'product-specific support'. They used the term repeatedly in the Agreement on Agriculture, and even defined 'non-product-specific support in Article 1(a) – yet they declined to use 'product-specific support' in Article 13(b)(ii)".).

[12] *See* Agreement on Agriculture, Annex 3, para. 1 ("Subject to the provisions of Article 6, an Aggregate Measurement of Support (AMS) shall be calculated on a product-specific basis for each basic agricultural product receiving market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment ('other non-exempt policies').").

Peace Clause is no bar to finding that this is the correct interpretation of "support to a specific commodity".[13]

7. In addition, Brazil's suggestion that "support to a specific commodity" was intended to clarify that the Peace Clause test involves only "support to an individual commodity, not a *group* of commodities such as grains or even all commodities"[14], does not withstand scrutiny.

- First, the phrase "support to a commodity," without the use of the word "specific", conveys the same meaning as "support to an individual commodity" (Brazil's proffered interpretation); thus, Brazil's interpretation renders the use of the term "specific" inutile.

- Second, under Brazil's interpretation of the Peace Clause, support to "a group of commodities" or "even all commodities" could be support to a specific commodity because the payments may be allocated to an individual commodity depending on what the recipient produces. Thus, Brazil's own Peace Clause interpretation contradicts this distinction between "support to an individual commodity" and support "to a group of commodities".

In addition, Brazil's suggestion that "the *chapeau* of Article 13(b)(ii) confirms this broader meaning of 'support,' because it includes all types of non-green box measures"[15], simply begs the question. "Domestic support measures that conform fully to the provisions of Article 6" (the language in the chapeau) may be either product-specific or non-product-specific, and even Brazil would agree that non-product-specific support is not "support to a specific commodity". Thus, just because a measure falls within the Article 13(b)(ii) chapeau does not assist in determining whether that measure provides "support to a specific commodity".

8. What may be most striking about the Brazilian critique of the US reading of the Peace Clause is that it nowhere presents nor rebuts the basis for the US interpretation. The basis for the US interpretation is set out plainly in the US February 11 comments:

> The lack of grounding of Brazil's methodology in the WTO agreements stems from its erroneous interpretation of "support to a specific commodity." . . . . *Brazil has consistently failed to read together the definitions of product-specific support and non-product-specific support in Article 1(a) of the Agreement on Agriculture.* Read in conjunction with one another, non-product-specific support ("support provided in favour of agricultural producers in general") is a residual category of support that is not product-specific ("support . . . provided for an agricultural product in favour of the producers of the basic agricultural product").[16]

Brazil nowhere addresses the US argument relating to the definition of product-specific support in Article 1(a) of the Agreement on Agriculture. In fact, whereas in Brazil's Peace Clause submissions it serially misquoted the definition of product-specific support in Article 1(a), dropping key words,[17] in its 18 February comments Brazil avoids that inconvenient definition *by simply never mentioning it*.[18] At the same time, however, Brazil relies heavily on the definition of non-product-specific support

[13] For convenience sake, the United States will use the term "product-specific support" as a shorthand for the concept of support to a specific commodity, in contrast to "non-product-specific support".

[14] Brazil's 18 February Comments, para. 5.

[15] Brazil's 18 February Comments, para. 4.

[16] US 11 February Comments, para. 10 (emphasis added).

[17] *See* US Rebuttal Submission, para. 82 (22 August 2003); US Comments on Brazil's Rebuttal Submission, para. 23 n.30 (27 August 2003).

[18] *See, e.g.*, Brazil's February 18 Comments, para. 9 ("Brazil has argued that the meaning of 'product-specific' AMS must be governed by the only term providing some guidance as to what it means – the definition of 'non-product-specific support' in Article 1(a) of the Agreement on Agriculture".).

in Article 1(a).[19] Thus, once again, Brazil invites the Panel to commit legal error in interpreting the phrase "non-product-specific support provided in favour of agricultural producers in general" devoid of the context provided by the immediately preceding definition of product-specific support.

9. That Brazil's position is untenable is demonstrated by comparing Annex 3, entitled "Calculation of Aggregate Measurement of Support," with Article 1(a), which defines "Aggregate Measurement of Support" or "AMS". Paragraph 1 of Annex 3 specifies that two different types of AMS shall be calculated:

- First, "an Aggregate Measurement of Support (AMS) shall be calculated *on a product-specific basis* for each basic agricultural product." Second, "[s]upport *which is non-product specific* shall be totalled into one non-product-specific AMS in total monetary terms".

Thus, Annex 3 distinguishes and calls for the separate calculation of non-product-specific support and product-specific support, which together comprise the AMS. Article 1(a), defining AMS, contains the identical distinction. While only non-product-specific support is identified by name, the structure of the AMS definition – which parallels Annex 3, paragraph 1 – demonstrates that product-specific and non-product-specific support together comprise the AMS:

- "'Aggregate Measurement of Support' and 'AMS' mean the annual level of support, expressed in monetary terms, [1] provided for an agricultural product in favour of the producers of the basic agricultural product <u>*or*</u> [2] non-product-specific support provided in favour of agricultural producers in general . . . [bold and italics added]."[20]

That is, just as the calculation of AMS (which uses the term "product-specific") distinguishes product-specific from non-product-specific support, logically, so too does the definition of AMS (which does not use that term).[21] Thus, it is simply not credible for Brazil to refer to the definition of "non-product-specific support" in Article 1(a) but to ignore the immediately preceding definition of product-specific support.[22]

10. her, Brazil's discussion of the meaning of the term "in general" in the definition of non-product-specific support is disappointing because Brazil mischaracterizes the US position and presents the Panel with an interpretation that is not the ordinary meaning of the term. In so doing, Brazil renews a faulty argument advanced in its Peace Clause submissions. In case there were any confusion, the United States clarifies the issue here.

- Brazil has, in fact, never used a dictionary definition of "in general," the exact phrase in the definition of non-product-specific support. Rather, Brazil has attempted to define "in general" by providing definitions of the word "*general*" as "relating to a whole class of

[19] *See, e.g.*, Brazil's 18 February Comments, paras. 9, 12, and 18.

[20] Agreement on Agriculture, Article 1(a).

[21] *See also* Agreement on Agriculture, Article 6.4(a) (for purposes of *de minimis* support, distinguishing "product-specific domestic support" from "non-product-specific domestic support").

[22] *See, e.g.*, Brazil's 18 February Comments, para. 12 ("One interpretive guide to determine whether support is 'product-specific' is found in the definition of 'non-product-specific support' in Article 1(a) of the Agreement on Agriculture. Brazil demonstrated that *only non-product-specific support is actually defined . . .* .") (emphasis added).

objects" and "*not* partial, local or sectional".[23] However, in the same dictionary from which Brazil quotes, there is a definition of "in general," which Brazil continues to avoid.[24]

- The definition of "in general" that comes closest to Brazil's use (for example, "including, involving, or affecting all or nearly all the parts of a (specified or implied) whole") is "in a body; universally; without exception." *However, that definition of "in general" is marked "obsolete" in Brazil's own dictionary.*[25]

- Thus, Brazil errs when it argues that the United States has asserted "that Brazil's definition of 'general' is obsolete". Rather, the United States has asserted that Brazil has advanced a reading of the phrase "*in general*" that employs an obsolete meaning.[26]

- In contrast, the non-obsolete definition of "in general" is "in general terms, generally".[27]

Thus, the ordinary meaning of "non-product-specific support provided in favour of agricultural producers in general" in Article 1(a) would be support *not* "specially . . . pertaining to a particular"[28] product provided in favour of agricultural producers "generally".

11. Brazil uses its faulty definition of non-product-specific support to conclude that US decoupled payments are not non-product-specific. However, Brazil recognizes that decoupled income support payments do not require any production[29], a recipient may produce nothing at all or may produce any of numerous commodities. Thus, decoupled income support payments are non-product-specific because they do not "specially . . . pertain[] to a particular" product and are support "generally" to producers of whatever commodities they choose to produce (if any).

12. We also pause to note that Brazil argues that the EC, New Zealand, and Argentina believe that decoupled income support in the form of counter-cyclical payments are product-specific.[30] However, Brazil points to nothing in the arguments of these third parties that differs from its own flawed interpretation, which the United States has thoroughly rebutted. Moreover, Brazil now explicitly argues that the Peace Clause "may require the application of an allocation methodology for . . . domestic support measures that may provide support to more than one commodity".[31]

- However, in the Peace Clause phase of this dispute, Brazil had asserted that "[t]he use of the word 'specific' [in "support to a specific commodity"] makes clear that AoA [Agreement on Agriculture] Article 13(b)(ii) addresses actionable subsidy challenges made on a

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[23] Brazil's 18 February Comments, para. 12 (footnote omitted); Brazil's Answer to Question 40 from the Panel (para. 54) (defining "general" as "'including, involving, or affecting all or nearly all the parts of a (specified or implied) whole'").

[24] *See* US Rebuttal Submission, para. 83 (22 August 2003).

[25] US Comments on Brazil's Rebuttal Submission, para. 23 (noting that the definition of "in general" as "in a body; universally; without exception" was marked "obsolete" in *The New Shorter Oxford English Dictionary*).

[26] US 11 February Comments, para. 10 ("As the United States has pointed out before, *not only does this reading of 'in general' rely on an obsolete meaning, which therefore cannot be the ordinary meaning of the terms*, but Brazil has consistently failed to read together the definitions of product-specific and non-product-specific support in Article 1(a) of the Agreement on Agriculture.") (emphasis added; footnote omitted).

[27] "In general" means "in general terms, generally" and "as a rule, usually." *The New Shorter Oxford English Dictionary*, vol. 1, at 1073 (1993 ed.).

[28] *The New Shorter Oxford English Dictionary*, vol. 2, at 2972 ("specific": second definition); *see also id.* (fifth definition: "Clearly or explicitly defined; precise, exact, definite.").

[29] Brazil's 18 February Comments, para. 4 ("Brazil and the United States agree that the contract payments, which do not *require* production . . . .").

[30] Brazil's 18 February Comments, para. 15 & n.22, para. 16 & n. 26.

[31] Brazil's 18 February Comments, para. 6.

product-by-product basis, *as opposed to* challenges regarding *support for multiple commodities*".[32]

- Further, we recall that the European Communities argued that "support which is provided to a number of crops cannot at the same time be considered 'support to a specific commodity'. Such support is 'support to several commodities' or 'support to more than one commodity'".[33]

Thus, the European Communities has set out an understanding of "support to a specific commodity" in the Peace Clause that *directly contradicts* Brazil's current allocation methodology. Had Brazil revealed (or conceived of) its allocation methodology during the Peace Clause phase of the dispute, the third parties would have been in a better position to provide their informed opinions as to Brazil's Peace Clause interpretation and characterization of particular measures.

13. We also note that the context to which Brazil cites in support of its allocation methodology for Peace Clause purposes lends no support to its interpretation. First, Brazil argues that "[f]urther context for the existence of some sort of an allocation methodology in the Agreement on Agriculture is Annex 3, paragraph 7".[34] However, even if this provision were to suggest "*some sort of* an allocation methodology" in the Agreement on Agriculture, it only applies to calculate AMS with respect to measures directed at processors and does not suggest any methodology that would allocate non-product-specific support as "support to a specific commodity." Brazil also suggests that paragraphs 7, 8, 12, and 13 of Annex 3 "include as 'product-specific' many types of domestic support not tied to the production of a particular commodity."[35] The United States has noted that it is Brazil that has put forward this "tied to the production" definition; the US position is that product-specific support means what Article 1(a) says it does: "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product." That said, none of the paragraphs cited by Brazil speak to an allocation of non-product-specific support as product-specific support. That is, whether measures referred to in those provisions are product-specific or non-product-specific must be determined on the basis of the definition found in Article 1(a).[36]

14. Finally, Brazil argues that "Article 13(b)(ii) of the Agreement on Agriculture does not provide explicit guidance on how to count up the amount of support for contract or any other types of payments. But this does not mean that no counting methodology can be used. The absence of explicit guidance on implementing more general provisions has not stopped WTO panels or parties from proposing and using methodologies to tabulate the amount of subsidies, costs, and volumes of trade impacted."[37] We disagree with Brazil's diagnosis and remedy.

- First, the Peace Clause is not a "general provision[]" lacking "explicit guidance on how to count up the amount of support." In fact, the Peace Clause provides "explicit guidance" through the phrase "support to a specific commodity". Read according to its ordinary meaning and in its context, this phrase refers to product-specific support as defined in

[32] Brazil's First Submission, para. 136 (24 June 2003) (emphasis added).

[33] Oral Statement by the EC at the First Panel Meeting, para. 21. The same logic would apply to crop insurance payments: support is provided to multiple commodities through premium payments for approved insurance products. *See, e.g.*, US Rebuttal Submission, paras. 93-98 (22 August 2003).

[34] Brazil's 18 February Comments, para. 13.

[35] Brazil's 18 February Comments, para. 14.

[36] For example, Brazil cites to paragraph 8 of Annex 3 on the calculation of "market price support". This provision refers to "the quantity of *production* eligible to receive the applied administered price"; assuming that "the applied administered price" relates to production of one product, such a measure would be product-specific. Paragraph 12 of Annex 3 refers to "[n]on-exempt direct payments which are based on factors other than price" being measured using budgetary outlays; paragraph 13 refers to the measurement of the value of other non-exempt direct payments; neither provision speaks to the distinction between non-product-specific support and product-specific support nor to the allocation of the former to the latter.

[37] Brazil's 18 February Comments, para. 34.

Article 1(a) of the Agreement on Agriculture. The definitions in Article 1(a) establish a methodology by which product-specific support is included in "count[ing] up the amount of support" for Peace Clause purposes while non-product-specific is not.

- Second, given the balance struck in concluding the Uruguay Round between the need to achieve binding reduction commitments on agricultural support and the need of Members to be able to design measures to conform to those commitments – a point to which we return later – it is difficult to imagine that Members would have left the issue of how to calculate the "support to a specific commodity" for Peace Clause purposes undefined, putting the Panel in the difficult position of "proposing and using [a] methodolog[y]" on such a crucial issue. In fact, the Peace Clause provides a methodology for calculating that support. The *measures* to be included in the calculation are identified by the phrase "support to a specific commodity," as explained in the preceding bullet. The *unit of measure* to be used in the Peace Clause comparison is identified by the way in which the Member "decided" support during the 1992 marketing year.[38]

Thus, Members did not put the Panel in the untenable position of "adopt[ing] a reasonable methodology" with respect to its Peace Clause findings. Rather, they agreed to language that provides an explicit methodology both for the Panel's purposes as well as for the purposes of Members who wished to ensure their measures would conform to the Peace Clause. Neither Brazil's allocation "methodology [n]or some variant of its methodology" – however "reasonable" Brazil may believe those to be – can serve those purposes or find any basis in the Peace Clause and the Agreement on Agriculture.

15. Thus, we end where we began: the interpretation of the Peace Clause phrase "support to a specific commodity" we have provided is based on its ordinary meaning and in light of the context provided by relevant provisions of the Agreement on Agriculture,[39] in particular, the definition of product-specific support in Article 1(a). Brazil, on the other hand, does not read this phrase according to the ordinary meaning of all of its terms, ignores the context provided by those provisions of the Agreement on Agriculture that use the terms "support", "specific," and "commodity," ignores the definition of product-specific support in Article 1(a), and instead points to provisions that do not provide any relevant context.

16. The Panel may ask itself: can a methodology that (as Brazil's tortured allocation methodology would have it) results in a payment sometimes being considered as support to *no* commodity (if the recipient produces nothing), sometimes as support to *one* commodity (if the recipient has planted a number of acres of a crop at least equal to the number of recipient's base acres of that crop), or sometimes as support to *multiple* commodities (if the recipient plants fewer acres of any crop for which the recipient has base acres) provide any meaningful interpretation of the phrase "support to a specific commodity"? The United States believes that the answer is no. Brazil has, at best, appreciated the *reality* of the payments in question: they are paid to producers in any of the situations it has described. Such support is not "support to a specific commodity" under the ordinary meaning of the terms (assistance or backing specially pertaining to a particular agricultural crop) or the Article 1(a) definition (support provided for an agricultural product in favour of the producers of the basic agricultural products). Rather, it is non-product specific support (support not specially pertaining to a particular product provided in favour of agricultural producers generally).

[38] Thus, in the case of the United States, the support "decided during the 1992 marketing year" was a rate of support provided by the target price for deficiency payments of 72.9 cents per pound and the marketing loan rate of 52.35 cents per pound. *See* US February 11 Comments, paras. 15-17.

[39] *See, e.g.*, Agreement on Agriculture, Articles 1(a), 1(d), 1(f), 6.4, and Annex 3 (paragraphs 1 and 7).

**Brazil's Costs of Production Approach to Determine Whether Payments are "Support to a Specific Commodity" Does Not Withstand Scrutiny**

17. In the foregoing section, the United States set out the textual and contextual basis for reading the Peace Clause phrase "support to a specific commodity" according to the definition of product-specific support in Article 1(a). We also pointed out that it is not the United States that has attempted to apply Subsidies Agreement concepts to the Peace Clause analysis as Brazil incorrectly asserted. Rather, it is Brazil that has attempted to apply an (incorrect) allocation methodology as might be relevant for purposes of actionable subsidies claims under the Subsidies Agreement to the Peace Clause analysis. In so doing, Brazil has asserted a principle for determining whether a subsidy provides support to a commodity – that is, whether "they cover (or contribute to) the costs of production of a crop"[40] – that is unworkable and illogical.

18. First, we note that Brazil defines "support" as relating to the recipient, but later elides this into support for a crop. For example, Brazil writes: "[T]he word 'support' has a more general sense of 'backing up' *a group of agricultural farmers* producing a specific commodity. For example, subsidies that cover costs of production when a farmer chooses to grow a crop, 'back up' or 'support' *that farmer*".[41] However, the Peace Clause text is "support to a *specific commodity*" not support to *farmers* producing a specific commodity. This distinction is also found in the Article 1(a) definition of product-specific support: "support . . . provided *for an agricultural product* in favour of the producers of the basic agricultural product". The difference is that income support provided to farmers is not "support to a specific commodity" because the support is not "provided for an agricultural product" over any other; the farmer can (in Brazil's words), "choose[] to grow a crop", choose to grow no crop, or choose to grow multiple crops. Even if all recipients of a decoupled payment chose to produce one crop in particular, the payment would still not be support "for an agricultural product"; the support is "for" no specific product but rather is support not "specially . . . pertaining to a particular" product that supports producers generally. It is those producers, in turn, who may choose to produce one crop in particular.

19. Brazil then, without further explanation, links the notion that support has a "sense" of backing up a farmer who "chooses to grow a crop" to the notion that such support is "support to a specific commodity" by asserting that "all of these subsidies at issue in this dispute 'support' production of upland cotton because they cover (or contribute to) the costs of production of a crop".[42] Brazil nowhere provides any basis in the text of the Peace Clause or the Agreement on Agriculture for this test. Neither does Brazil explain the necessary implications of its approach.

20. For example, if a decoupled payment is "support to a specific commodity" if it "cover[s] (or contribute[s] to) the costs of production of a crop" then the same payment will be product-specific for some producers but not others. Brazil has pointed to survey data from 1997 – that the United States has explained is technologically and structurally out-of date[43] – for the notion that average total costs of production for US producers are $0.73 per pound. On this basis, Brazil has (incorrectly) claimed that decoupled payments were necessary to cover the gap between market revenue and costs. Putting aside the extensive US critique of Brazil's argument (such as its reliance on total costs instead of operating costs)[44], however, the out-of-date per pound total average cost on which Brazil relies is just

[40] Brazil's 18 February Comments, para. 3.
[41] Brazil's 18 February Comments, para. 3 (italics added).
[42] Brazil's 18 February Comments, para. 3.
[43] US Further Rebuttal Submission, paras. 123-33.
[44] The United States has presented a detailed critique of Brazil's alleged costs of production vs. total revenue "gap" in paragraphs 105-41 of its further rebuttal submission of 18 November 2003. As further confirmation that Brazil's "average total costs of production" argument is wrong, we note that Brazil silently has de-emphasized its assertion that, to cover their high costs of production, upland cotton producers *must* have planted upland cotton "on" upland cotton, rice, or peanut base acreage to reap decoupled payments for these

that, an average. In claiming that all decoupled payments received by upland cotton producers (satisfying its complicated allocation methodology) are support to upland cotton, Brazil takes no account of the distribution of costs across farms. That is, some farms produce at costs below the average and some produce at costs above the average.[45] Brazil attempts no analysis of whether decoupled payments received by producers who produce cotton at costs below the average "cover (or contribute to) the costs of production of" upland cotton.

- However, *under Brazil's own rationale*, if the decoupled payments do *not* "cover (or contribute to) the costs of production of a crop", then those payments do not support production of that crop and *are not support to a specific commodity*.

Thus, those payments could not form part of Brazil's Peace Clause analysis, but Brazil has not accounted for this.

21. Consider further Brazil's argument that "[w]ithout direct and counter-cyclical payments in MY 2002, the average US cotton farmer would have lost 14.36 cents per pound. With these two payments, they earned a 'profit' of 4.2 cents per pound with the cotton DP and CCP payments".[46] But Brazil has asserted that payments are "support to a specific commodity" only if they "cover (or contribute to) the costs of production of a crop".

- Thus, *under Brazil's own rationale*, the 4.2 cents per pound of "profit" – that is, returns above and beyond total costs of production – that Brazil attributes to decoupled payments cannot be "support to" upland cotton.

Brazil, of course, fails to carry through its rationale to this extent because this would reduce the decoupled payments it has calculated as support to upland cotton under its own (incorrect) approach.

22. In addition, Brazil's argument that payments are "support to a specific commodity" only if they "cover (or contribute to) the costs of production of a crop" carried through to its logical end would not only run contrary to the definitions of product-specific support and non-product-specific support in Article 1(a) of the Agreement on Agriculture but would produce illogical results. Consider the situation of marketing loan payments for soybeans:

- In the US view, there is no question that these payments are "support to a specific commodity" within the meaning of the Peace Clause because they are "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product" (Article 1(a)).

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base acres. *See, e.g.*, Brazil's Closing Statement at the Second Session of the First Panel Meeting, Annex I (summary of evidence demonstrating that upland cotton producers in MY 1999-2002 produced upland cotton on upland cotton, rice, or peanut base acreage) (October 9, 2003). In fact, without having repudiated its earlier argument, Brazil's 28 January calculations demonstrate that Brazil's allocation methodology results in payments for many other programme crops being allocated to cotton. For example, for farms producing cotton and having cotton base, in marketing year 1999, payments for *wheat, oats, rice, corn, and sorghum* are allocated to cotton; in marketing year 2000, payments for *wheat, rice, corn, sorghum, and barley* are allocated to cotton; and in marketing year 2001, payments for *wheat, rice, corn, and barley* are allocated to cotton, oats, and sorghum. Brazil's 18 February Comments, Annex A, paras. 15-19 (Tables 2.5-2.8). That is, under Brazil's 20 January allocation methodology, upland cotton is allegedly "planted on" base acres for each of the programme crops just listed, not the cotton, rice, or peanut acres in Brazil's costs argument. Brazil has never explained the contradiction in its two arguments.

[45] For example, the 1997 study shows that in that year the 25 per cent of US cotton farms with the lowest cost (accounting for 36 per cent of cotton production) had average operating costs of $0.31 cents per pound and average total costs of $0.55 cents per pound. Exhibit BRA-16, at tbl. 2.

[46] Brazil's 18 February Comments, para. 24 (third bullet) (footnote omitted).

- Under Brazil's rationale, however, marketing loan payments for soybeans might *not* be "support to" soybeans because they might not "cover (or contribute to) the costs of production of [that] crop".

- To determine whether, under Brazil's theory, those marketing loan payments for soybeans are "support to" soybeans or "support to" some other commodity (such as upland cotton) "requires an examination of the record evidence concerning the extent to which the payments *de facto* support or maintain the production of a specific commodity".[47]

- Under some combination of facts, then, marketing loan payments for soybeans could be deemed, under Brazil's theory, to be support to upland cotton (or some other commodity).

This cannot be the right result since, if the marketing loan payments provide any incentive to production (which will depend on the expected harvest season prices at planting), they provide an incentive to plant soybeans, not upland cotton (and if payments are made, they are made to producers of soybeans, not upland cotton). A correct reading of the Peace Clause does produce the right result since such payments are "support to a specific commodity," soybeans[48], regardless of "the record evidence concerning the extent to which the payments *de facto* support or maintain the production of a specific commodity".

23. Finally, as a factual matter, we would note that Brazil has not addressed the most telling data that contradicts its assertion that decoupled payments "directly maintain the production of" upland cotton. This is the significant amount of upland cotton acreage planted by farms without any upland cotton base acres.

- Under the 1996 Act, farms without any upland cotton base acres planted 1.0 million acres of upland cotton in marketing year 1999, 1.2 million acres of upland cotton in marketing year 2000, 1.3 million acres in marketing year 2001, and 1.5 million acres in marketing year 2002.[49]

- After new base acreages were established in the 2002 Act (for purposes of direct and counter-cyclical payments), farms without any upland cotton base acres planted 0.5 million acres of upland cotton in marketing year 2002.

Under Brazil's theory, none of these acres should have been planted since without decoupled payments for upland cotton base acres, these producers "would have lost $332.79 per acre between MY 1997-2002" and "would have lost 14.36 cents per pound" in marketing year 2002.[50] The fact that such large numbers of acres *were* planted without decoupled payments for upland cotton base acres demonstrates that, as a factual matter, US upland cotton producers can and do plant upland cotton without the allegedly indispensable decoupled payments for upland cotton base acres.[51]

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[47] Brazil's 18 February Comments, para. 22; *see also id.*, para. 32 ("In sum, the proper allocation methodology under Article 13(b)(ii) of the Agreement on Agriculture must be consistent with the extent to which the domestic support payments directly maintain the production of a specific commodity.").

[48] Under Article 1(a), marketing loan payments for soybeans are "support . . . provided for an agricultural product [soybeans] in favour of the producers of the basic agricultural product". Under the ordinary meaning of the terms "support to a specific commodity," marketing loan payments for soybeans are "assistance" or "backing" "specially . . . pertaining to a particular" "agricultural product": soybeans.

[49] US Letter to Panel (28 January 2004) (file "rPFCsum.xls": category 3 under column "cotton planted acres").

[50] Brazil's 18 February Comments, para. 24 (second and third bullets).

[51] The data submitted in response to the Panel's supplementary request for information further proves the point. In marketing year 2002, for example, the 52,504 farms in category B planted 7.0 million acres of

24. Thus, the principle Brazil advances to determine whether and to what extent decoupled payments are support to a specific commodity – that is, whether they "cover (or contribute to) the costs of production of a crop" – must fail. This principle is not applied by Brazil to its logical ends because to do so would reduce the amount of support to upland cotton Brazil has calculated to upland cotton. Most importantly, Brazil's costs of production principle finds no support in the text of the Peace Clause or any WTO agreement (such as the definition of product-specific support in Article 1(a)). Thus, the Panel should reject Brazil's erroneous approach.

**Brazil's Argument that Decoupled Income Support Payments Are *De Facto* Tied to Production Is Wrong**

25. Brazil argues that the decoupled income support measures at issue in this dispute cannot be allocated across "the total value of the recipient firm's sales" under paragraph 2 of Subsidies Agreement Annex IV because the payments are "*de facto* tied to upland cotton production".[52] Brazil also argues that the amount of subsidies that support upland cotton cannot be determined under Annex IV, paragraph 3, and therefore "Annex IV does not assist the Panel in determining the amount of support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture".[53] On this latter point, we are in agreement with Brazil: as set out above, the Peace Clause establishes the relevant support through the ordinary meaning of the phrase "support to a specific commodity" in its context, not by way of Annex IV. Under a correct reading of the phrase "support to a specific commodity", *no* allocation methodology may be applied to allocate non-product-specific support as "support to a specific commodity". Here, however, we note that Brazil's argument relating to the alleged *de facto* tie of payments to production does not hold.

26. In fact, the evidence does not support Brazil's argument that decoupled income support payments are "tied to the production or sale of a given product".[54] These payments are received by recipients that may choose to produce no, one, or many different products. The evidence presented by the United States – fully consistent with the Environmental Working Group data presented by Brazil[55] – is that approximately 47 per cent of upland cotton farms eligible for decoupled income support payments planted no cotton in marketing year 2002.[56] Thus, payments are not "tied to the production or sale of a given product" since nearly half of the recipients do not plant even a single acre of cotton.

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upland cotton and had, in the aggregate, 5.4 million base acres of upland cotton; the 7,420 farms in category C planted 0.5 million acres of upland cotton and had 0 base acres of upland cotton. In marketing year 2001, the 61,854 farms in category B planted 10.0 million acres of upland cotton and had 6.4 million base acres of upland cotton; the 20,322 farms in category C planted 1.3 million acres of upland cotton and had no upland cotton base acres. In marketing year 2000, the 62,557 farms in category B planted 9.8 million acres of upland cotton and had 6.4 million base acres of upland cotton; the 18,001 farms in category C planted 1.2 million acres of upland cotton and had no upland cotton base acres. In marketing year 1999, the 59,793 farms in category B planted 9.0 million acres of upland cotton and had 6.0 million base acres of upland cotton; the 15,812 farms in category C planted 1.0 million acres of upland cotton and had no upland cotton base acres. *Under Brazil's theory, none of the tens of thousands of category B farms should have planted more upland cotton acres than their respective quantities of upland cotton base acres, and none of the tens of thousands of category C farms should have planted upland cotton at all.*

[52] Brazil's 18 February Comments, para. 39.

[53] Brazil's 18 February Comments, para. 41.

[54] Subsidies Agreement, Annex IV, para. 3.

[55] Brazil's Further Rebuttal Submission, para 23 (EWG data showed that 46, 45, and 45 per cent of farms receiving upland cotton contract payments received no marketing loan payments in 2000, 2001, and 2002, respectively).

[56] US Oral statement at Second Panel Meeting, para. 56 (2 December 2003); US Answer to Panel Question 125(9).

27. Brazil points to evidence that it asserts demonstrates the "crucial role that each of the four contract payments plays in maintaining the production of US upland cotton".[57] That is, Brazil argues that without the decoupled income support payments, many US producers would not have been able to continue producing cotton. However, Brazil's argument is not, as in Annex IV, that "the subsidy is tied to the production or sale of a given product", but rather that the production or sale of a given product is tied to the subsidy. The two statements are not equivalent. That an upland cotton farmer could not produce upland cotton without a subsidy payment (an argument which the United States has rebutted) does not mean that the payment is "tied to the production or sale of a given product" if recipients may produce or sell other than a given product. This is precisely the case with respect to decoupled income support payments: there is no "tie" to the production or sale of upland cotton because payment recipients can choose not to produce upland cotton (or any other crop).

28. Thus, Brazil has not established that the decoupled income support payments are "*de facto* tied to upland cotton production"; rather, the facts that demonstrate that nearly half of the payment recipients choose not to plant upland cotton at all *de facto* contradict Brazil's argument.

**Brazil Has Not Made a *Prima Facie* Case under its Subsidies Claims with respect to Decoupled Payments**

29. The United States has previously explained that Brazil has not properly interpreted the Peace Clause proviso and has not demonstrated that the challenged US measures are in breach of the Peace Clause. This ends the analysis with respect to Brazil's subsidies claims under Subsidies Agreement Articles 5 and 6 and GATT 1994 Article XVI:1. However, even if the Panel were to look beyond the Peace Clause to Brazil's subsidies claims, Brazil has not established a *prima facie* case with respect to decoupled payments.[58]

30. Brazil now argues that, while "Part III of the Subsidies Agreement does not require detailing the precise amount of the subsidies", Brazil "has presented evidence and argument, in the alternative, regarding the size and subsidization rate of the subsidies challenged."[59] Brazil further claims that it "has offered the contract payment quantities (as well as the other subsidies) established in the peace clause phase of the proceedings as the 'amount of subsidization', to the extent this is required, in the serious prejudice phase". In light of Brazil's repeated disavowals of any need to identify the amount of the subsidy for purposes of its subsidies claims,[60] the United States does not believe that this and two other comments referenced by Brazil demonstrate that Brazil has argued and advanced evidence relating to identification of the challenged subsidy.[61]

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[57] Brazil's 18 February Comments, para. 32.

[58] The United States has elsewhere explained that Brazil has not demonstrated serious prejudice, or threat thereof, from upland cotton marketing loan payments or any other challenged US measures. *See, e.g.*, US Further Rebuttal Submission, paras. 1-177; US Further Submission, paras. 16-133.

[59] Brazil's 18 February Comments, para. 78. The United States continues to be surprised by Brazil's denial of the significance of the amount of the subsidy for purposes of determining "the effect of the subsidy' under its serious prejudice claims. For example, had the DSB initiated the Annex V information-gathering process, that process would have been concerned, in part, with establishing "the amount of subsidization," Subsidies Agreement, Annex V, para. 2, and "the amount of the subsidy in question," *id.*, Annex V, para. 7. Brazil's position that "the effect of the subsidy" may be evaluated without identifying the amount of the subsidy is akin to saying that one can determine "the effect of eating" without knowing how much is being eaten.

[60] *See, e.g.*, US 11 February comments, para. 24.

[61] *See* Brazil's Comment on US Answer to Question 214 from the Panel, para. 216 (28 January 2003) ("Detailing the precise amount of the financial contribution ending up in the bank accounts of US upland cotton producers is not a legal pre-requisite to Brazil's actionable subsidy claims. If the Panel finds that Brazil is legally required to examine the exact *amount* of the subsidies in order to assess their 'effects,' . . . Brazil refers the Panel to evidence and the allocation of the amount of 'support to upland cotton' it has presented in the peace clause portion of its various submissions. This evidence is part of the record pursuant to Brazil's alternative arguments and is offered as evidence of the amount of such subsidy payments."); Brazil's Opening Statement at

31. Nonetheless, even if the Panel were to find that Brazil's comments dated 28 January 2004, and 11 February 2004 – that is, more than eight months into this dispute and after scheduled panel meetings and written submissions have been concluded[62] – advanced an argument in the alternative, Brazil still would not have made a *prima facie* case with respect to decoupled payments. As set out in the US 11 February comments[63], Brazil has never presented evidence nor made arguments that would allow the Panel to evaluate "the effect of the subsidy [decoupled income support payments]". In particular, Brazil has never presented information relating to the total value of the recipients' sales as would be necessary to determine the amount of these subsidies benefiting upland cotton that are not tied to the production or sale of a given product. The reason for this omission is simple: Brazil has never believed, nor does it today, that the Annex IV methodology is necessary or even relevant to identify the subsidy benefit and subsidized product.[64] Because Brazil believes Annex IV is irrelevant for the Peace Clause but has offered its Peace Clause calculations (again, in the alternative) "as evidence of the amount of such subsidy payments"[65], logically, Brazil must believe that Annex IV "does not assist the Panel in determining the amount of [the subsidy]".[66]

32. We do note that Brazil has argued that, "as an alternative argument, Brazil attempted in its 28 January 2004 Comments to apply the Annex IV paragraph 2 non-tied subsidy allocation methodology to the US summary data".[67] We later set out in more detail the infirmities in Brazil's calculations. Here, we note that, Brazil evidently believes that by liberally assigning the "in the alternative" label, it will be able to assert that it has advanced evidence and arguments relating to whatever methodology the Panel adopts. Such an approach speaks volumes to Brazil's confidence in its approach to its serious prejudice claims, but it is also not enough to meet its *prima facie* case. A party may not make an argument, even if "in the alternative", for the first time nine months into briefing in a dispute, in its 18 February "Comments on US 11 February Comments on Brazil's 28 January 'Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled Data on 20 January 2004", in order to later claim to have carried its burden of making a *prima facie* case should the Panel decide to rely on this new argument. (The Panel will appreciate the irony that the party that has been complaining incessantly about delay in the proceedings has now been reduced to improperly trying to take advantage of that delay.) To allow this would deny the United States due process – as the entire dispute has been argued on other grounds and enormous amounts of time and resources have been

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the Second Panel Meeting, para. 5 ("In any event, Brazil has demonstrated a collective subsidization rate averaging 95 per cent and subsidies in the amount of $12.9 billion.").

[62] Article 12 and Appendix 3 of the DSU contemplates a process which all WTO dispute settlement proceedings must follow in order to ensure due process for the parties involved. Such a process requires that the parties "present the facts of the case, their arguments and their counter-arguments" before the first substantive meeting of the panel (*see* para. 4 of the Working Procedures of the Panel), present their case at the first substantive meeting of the panel (*see* para. 5 of the Working Procedures of the Panel), and then present their formal rebuttals by the second substantive meeting of the panel (*see* para. 6 of the Working Procedures of the Panel). In this regard, for Brazil to present new arguments for the first time now, or to use recently submitted US data to try to meet Brazil's initial burden of proof now, outside of the confines of the established panel process and without allowing the United States to provide counter-arguments or rebuttals, would appear contrary to the due process safeguards provided by the DSU and the Working Procedures of the Panel.

[63] US 11 February Comments, paras. 22-34.

[64] *See, e.g.*, Brazil's 18 February Comments, para. 38 ("[A] close look at the text of Annex IV reveals that it is ill-equipped to address the tabulation of support issue before the Panel."); *id.*, para. 41 ("Thus, Annex IV does not assist the Panel in determining the amount of support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.").

[65] *See* Brazil's Comment on US Answer to Question 214 from the Panel, para. 216.

[66] Brazil's 18 February 18 Comments, para. 41 ("Thus, Annex IV does not assist the Panel in determining the amount of support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.").

[67] Brazil's 18 February Comments, para. 69.

devoted to defending against the arguments Brazil *did* make – and deprive the Panel of the opportunity to receive fully considered briefing with respect to those issues.

33. Finally, through its belated and patently inadequate arguments and evidence relating to Annex IV, Brazil has put the Panel in the inappropriate position of "mak[ing] the case for the complaining party" were it to base any serious prejudice findings on decoupled payment subsidies allocated using the Annex IV methodology. As we stated in the February 11 comments:

- "Brazil has neither sought nor presented any evidence relating to the total value of the recipient firms' sales. Brazil has also not only *not* argued that the Annex IV methodology is necessary to identify the subsidized product and the subsidy benefit, Brazil has also continually argued against use of the Annex IV methodology since, in its view, no allocation of the payment or quantification of the benefit is warranted under Part III of the Subsidies Agreement. Thus, it would appear that Brazil has resisted making the necessary legal arguments and refused to submit any evidence relating a proper analysis of its claims."[68]

Brazil chose to challenge decoupled income support payments not tied to production or sale of a given product but also chose not to seek, develop, and present evidence relating to the total value of the recipients' sales. In fact, Brazil has not presented evidence that would allow that methodology to be applied.[69] Therefore, due to its own litigation choices, Brazil has not established the amount of the challenged subsidies and therefore has not established a *prima facie* case that the effect of decoupled income support payments is to cause serious prejudice to Brazil's interests. The United States respectfully requests the Panel to so find.

34. The United States has reviewed Brazil's new comments regarding the *Japan – Agricultural Products* Appellate Body report and believes that Brazil continues to misread that report. In fact, Brazil does not address any of the facts relating to the "claims" and "arguments" made by the United States in that dispute, instead relying on generalizations as to "the proposition" that that report "stands for".[70] The United States refers the Panel to its previous comments on this report for a more complete analysis.[71]

35. The United States does note that Brazil argues that any evidence sought by the Panel that would allow an Annex IV calculation to be made "was entirely consistent" with the US proposal of that methodology and Brazil's in the alternative argument. We have already shown that Brazil's "in the alternative" evidence and arguments are patently insufficient, and this was done without the need for additional information or the need to run any Annex IV calculations. Further, it requires no information to understand and evaluate the US rebuttal that Brazil had not brought forward evidence and arguments relating to the Annex IV methodology necessary for Brazil to identify the subsidy benefit and subsidized product. In other words, Brazil cannot use a US defence as rationale to insist that the Panel seek information and make all the Annex IV calculations necessary to make Brazil's *prima facie* case for Brazil.

**Brazil's Various Allocation Methodologies, In Addition to Being Irrelevant for Peace Clause Purposes and Inapplicable for Serious Prejudice Claims, Are Internally Inconsistent and Illogical**

36. The United States here addresses Brazil's revised, and in some cases new, allocation methodologies. Brazil advances all of these allocation calculations for purposes of the Peace Clause (and, in the alternative, to identify the amount of the challenged subsidies). For purposes of the Peace

[68] US 11 February Comments, para. 33.
[69] *See* US 11 February Comments, paras. 44-60.
[70] Brazil's 18 February Comments, para. 88.
[71] US 11 February Comments, paras. 31-34.

Clause, as set out above, the United States believes that no allocation methodology may be employed since the only relevant support is product-specific. For purposes of Brazil's serious prejudice claims, we have already explained that the Annex IV methodology would be necessary to identify the subsidy benefit and subsidized product for each of the challenged decoupled income support measures – and Brazil has not brought forward evidence and arguments to allow the Annex IV methodology to be used. Nonetheless, here we present certain additional comments on Brazil's allocation methodologies.

**Brazil's Allocation Methodology Is Internally Inconsistent and Not Applied Consistently**

37. In its February 18 comments, Brazil reaffirms that "its methodology allocates support paid for upland cotton base that is 'planted to' upland cotton. It further allocates proportionally any other contract crop base payments that are not allocated to plantings of the respective contract payments crop".[72] We note that Brazil inserted quotation marks around "planted to" in the phrase "upland cotton base that is 'planted to' upland cotton". The reason for this is, as the United States has explained, there are no physical "base acres" on a farm. Crop base acres are an accounting fiction that do not represent any particular acres on the farm.[73] Thus, base acres cannot be physically "planted to" any crop; this expression merely means that a quantity of acres has been planted that corresponds to (are equal to or less than) a farm's quantity of base acres. Thus, at the outset, there is no physical basis to say that decoupled payments for base acres of a crop must be "support to" that crop to the extent that the quantity of planted acres is less than or equal to the quantity of base acres – but that is exactly the first step in Brazil's flawed methodology.[74]

38. There is also no economic basis to conclude that (in Brazil's words) payments for base acres of a crop "planted to" that crop are support to that planted crop. Because a recipient of a decoupled income support payment is free to plant no crop, plant one crop, plant multiple crops, or engage in other economic activities, that payment is a subsidy to all of the recipient's economic activities (if any). Brazil's "planted to" approach does not take into account the fungible nature of money: if the payment recipient chooses to produce only upland cotton, that would be the sole "subsidized product", but if the recipient chooses to produce upland cotton and other products, all of those products are the "subsidized product" since the payment could have been applied to any of those activities. (In fact, recipients of decoupled payments *do* engage in a myriad of other activities; for example, in marketing year 2002, the 137,160 cotton farms falling in Category A as defined by the Panel (that is, that planted fewer cotton acres than their quantities of upland cotton base acres) planted over 1 million acres of fruits and vegetables and nearly 7 million acres of "other crops" as compared to nearly 6 million acres of upland cotton.)[75]

39. Further, we note that Brazil's reason for treating decoupled income support payments for upland cotton base acres as "support to" upland cotton was allegedly based on the *de facto* tie between such payments and upland cotton production. That is, Brazil argued that such payments were necessary to support or maintain upland cotton production.[76] But Brazil does not apply that analysis throughout its methodology.

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[72] Brazil's 18 February Comments, para. 57.

[73] US 11 February Comments, para. 38.

[74] Applied to decoupled payments for upland cotton base acres, this first step in Brazil's methodology is the "cotton-to-cotton" alternative methodology set out by Brazil. *See, e.g.*, Brazil's 18 February Comments, Annex A, para. 3 ("Under this approach, only upland cotton payments for upland cotton base acres that are *actually planted to* upland cotton would be considered support to upland cotton.") (italics added). As set out in the text above, base acres are not "actually planted to" anything; thus, in addition to not accounting for the fungible nature of money, the cotton-to-cotton methodology is not based on any physical reality.

[75] *See* file "DCP02-2W.xls" (Category A farms, "Total" row).

[76] *See, e.g.*, Brazil's 18 February Comments, paras. 22-28.

- Brazil also allocates decoupled income support payments for non-upland cotton base acres *first* to the respective programme crops.[77]

- However, Brazil has made *no analysis* of whether such decoupled payments for *non*-upland cotton base acres support or maintain the production of the respective programme crop to which they are allocated by Brazil.

Therefore, *even under its own Peace Clause analysis*, Brazil has provided no basis to a key step in its allocation methodology – that is, the allocation of payments for non-upland cotton base acres first to the respective programme crops.

40. Brazil's current Peace Clause allocation methodology also directly contradicts its position earlier in this dispute. First, Brazil argued that all payments for upland cotton base acres were support to upland cotton. Then, Brazil amended its argument and asserted that, in order to cover their total costs, upland cotton producers must have planted upland cotton "on" upland cotton base acres. Subsequently, Brazil changed that argument to upland cotton must be "planted on" base acres for upland cotton, rice, or peanuts.[78] Thus, the latter two of these arguments were predicated on the notion that each planted acre of upland cotton corresponded to one base acre. Now, however, Brazil's allocation methodology could assign payments from multiple base acres to a single planted acre of upland cotton.[79]

41. Tellingly, Brazil has no response to this critique of its methodology, other than to assert that "they affect, at most, 0.9 per cent of the payments at issue for MY 2002"[80] and a vague statement that "[a]s for some of the US criticisms that might affect the results (except for MY2002), Brazil will control for these effects once the United States provides aggregate data in the manner requested by the Panel".[81]

- That is, Brazil has *no logical explanation* for the internal inconsistency in its methodology, that one upland cotton base acre should be allocated to one upland cotton planted acre while multiple non-upland cotton base acres could be allocated to one upland cotton planted acre.

This internal inconsistency suggests that Brazil's methodology is an effort to assign the maximum amount of payments to upland cotton, regardless of whether it provides any economically neutral method to allocate decoupled payments (as Annex IV, paragraph 2, does).

42. As the United States has previously pointed out, moreover, there is no economic reason to attribute decoupled income support payments to some crops (programme crops) but not others and some economic activities (programme crop production) but not others.[82] Brazil's 18 February calculations demonstrate the point. For farms with *no* upland cotton base acres, Brazil treats all upland cotton planted acres as "overplanted base" (that is, planted acres in excess of base acres)

[77] *See, e.g.*, Brazil's February 18 Comments, Annex A, Tables 2.5-2.7; *id.*, Annex A, para. 15 n. 175 ("The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is [the] amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage.").

[78] *See, e.g.*, Brazil's Closing Statement at the Second Session of the First Panel Meeting, Annex I (summary of evidence demonstrating that upland cotton producers in MY 1999-2002 produced upland cotton on upland cotton, rice, or peanut base acreage) (9 October 2003).

[79] *See* US 11 February Comments, para. 38 (providing example of farm with 100 base acres of soy, 10 planted acres of soy, and 1 planted acre of cotton; under Brazil's methodology, the 1 acre of cotton would be "planted on" (receive payments related to) 90 base acres of soy).

[80] Brazil's 18 February Comments, para. 60.

[81] Brazil's 18 February Comments, para. 67.

[82] *See* US 11 February Comments, para. 37.

eligible for an allocation of the total subsidies available from "excess" base acres for other programme crops.[83]

- However, non-programme crops are in the *identical position* to upland cotton: that is, all non-programme crops also have base acreage equal to zero.[84]

- Even on Brazil's methodology, there is no reason (other than Brazil's assertion that it is so) to treat decoupled payments for non-upland cotton base acres as subsidizing upland cotton when a farm has overplanted its (zero) upland cotton base but *not* to non-programme crops that also (necessarily) have "overplanted" their base.

43. Finally, we note that, had Brazil desired to make its invented allocation methodology consistent with other arguments in its 18 February comments, it should have allocated "excess" base acres *not* to programme crops with "overplanted base" but rather to any crop (programme or not) produced by a payment recipient for which such payments "cover (or contribute to) the costs of production".[85] Where payments "cover (or contribute to) the costs of production," according to Brazil, payments *must* be "support to [that] specific commodity."[86] Further, if Brazil has *not* analyzed whether the challenged payments "cover (or contribute to) the costs of production" of other products produced by payment recipients, Brazil cannot assert that any payments must be "support to" one commodity over another since the payment might be necessary to "cover (or contribute to) the costs of production" of more than one product. That Brazil was unwilling to apply its "costs of production" principle throughout its allocation methodology suggests that Brazil's approach to Peace Clause interpretation has been a *post hoc* exercise in rationalization.

44. In sum, Brazil's allocation methodology is irrelevant to the Peace Clause because the only relevant support is product-specific. Unlike the Annex IV methodology, moreover, it is not a neutral and economically rational methodology for allocating a non-tied subsidy (such as decoupled payments) in order to identify the subsidized product and the amount of the subsidy. Finally, it is internally inconsistent and even contradicts other arguments Brazil has put forward in this dispute, for example, its argument that a payment is "support to a specific commodity" if it "cover[s] (or contribute[s] to) the costs of production" of that commodity.

**Brazil's "Annex IV" Methodologies Are Nothing Like the Methodology Set Out in Annex IV**

45. Brazil presents two other methodologies, a "modified Annex IV" calculation and a "US Annex IV calculation". Neither of these methodologies could serve as a basis to identify the amount of subsidy and subsidized product for purposes of Brazil's serious prejudice claims. The correct methodology is neither a "modified" nor a "US" methodology; rather, it is the methodology set out in the text of Annex IV. That text establishes that, if a payment is not "tied to the production or sale of a given product," the subsidized product is all of the recipient firm's sales, and the subsidy for any one product is that product's share of "the total value of the recipient firm's sales".[87] Brazil does not use

[83] *See, e.g.*, Brazil's 18 February Comments, Tables 2.17 & 2.18 (upland cotton base acres: 0; upland cotton planted acres: 518,837.0; planted acres over which "excess" subsidy allocated: 518,837.0).

[84] The data submitted in response to the Panel's supplementary request for information reveals that in marketing year 2002 (after base acres were established under the 2002 Act) farms planting upland cotton and having no upland cotton base acres planted substantial amounts of non-programme crop acreage, for example, 64,917 acres of fruits and vegetables, 9,664 acres of tobacco, and 169,480 acres of other crops. *See* "DCP02-2W.xls" file, Category C farms, "Total" row.

[85] Brazil's 18 February Comments, para. 3.

[86] Recall that it is for purposes of the Peace Clause that Brazil asserts its allocation methodology; in the alternative, Brazil argues that its Peace Clause methodology would also calculate the amount of the subsidy for its serious prejudice claims.

[87] Subsidies Agreement, Annex IV, paras. 2-3.

"the total value of the recipient firm's sales" in its "Annex IV calculations" and does not even attempt to calculate total sales of upland cotton producers. Thus, neither of these methodologies can fairly be called an "Annex IV" calculation.

46. With respect to Brazil's "modified Annex IV" methodology, we note that Brazil allocated total contract payments to farms producing upland cotton "over the value of *contract payment* crops produced on the farms" based on the assumption that "contract payments are support only to contract payment crops".[88] This approach is fundamentally inconsistent with Annex IV, paragraph 2, under which the subsidy is allocated over "the total value of the recipient firm's sales." Further, the United States has set out above a rebuttal of Brazil's assertion that decoupled income support payments could be considered "support only to contract payment crops". For example, such an approach ignores the fungible nature of money and contradicts Brazil's argument that payments are support to those crops whose costs are covered by the payments.

47. With respect to Brazil's "US Annex IV methodology," the United States has explained above that Brazil has not made a *prima facie* case with respect to decoupled payments because it has not presented evidence and arguments sufficient to allow an Annex IV calculation to be made. Brazil also has not corrected for errors in its calculations that the United States previously pointed out in its 11 February comments.

48. For example, Brazil's "US Annex IV methodology" errs in omitting the value of fruits and vegetables in calculating the total value of non-programme crop production. Brazil justifies this stance by asserting that fruits and vegetables could not possibly be "beneficiaries" of decoupled payments because they may not be grown on base acres. Again, this argument by Brazil ignores Annex IV, paragraph 2, under which the subsidy is allocated over "the total value of the recipient firm's sales" and ignores the non-tied (decoupled) nature of these payments. The aggregate data submitted today demonstrates that, in marketing year 2002 alone, 1.2 million acres were planted to fruits and vegetables on farms that reported cotton base acreage.[89] As pointed out in the US comments of 11 February[90], excluding fruits and vegetables biases significantly downward the value of non-programme crop acreage. For example, the per-acre value of non-programme crops including fruits and vegetables was estimated at $281[91] for 2002 – that is, 138 per cent higher than the $118 per acre Brazil calculated when fruits and vegetables are excluded.[92]

49. Including fruits and vegetables in the total value of crop production gives a more accurate reflection of the share of upland cotton as a per cent of the total value of crop production on farms that planted upland cotton. As noted previously,[93] had Brazil included fruits and vegetables in the value of non-programme crop cropland, upland cotton would have accounted for approximately 48.4 per cent to 56.7 per cent of the total value of crop production on farms that planted cotton in 1999-2002.

50. Moreover, Brazil has not taken any account of the value of on-farm production other than crops, and has presented no data that would allow that calculation to be made. Again, Brazil's approach is inconsistent with Annex IV, paragraph 2, pursuant to which the subsidy is allocated over "the total value of the recipient firm's sales." Brazil asserts that its "decision not to include any livestock value" is supported by the 1997 ARMS cotton costs of production survey, but that survey only shows that a small number of cotton farms in the survey year "specialized" in livestock production. Brazil does not define what "specialization" in livestock production would entail, but it would seem that a farm may have sales of a product without "specializing" in that product. The

[88] Brazil's 18 February Comments, para. 50.
[89] *See* file "DCP02-2W.xls" ("Grand Total (Farms A - C)" row).
[90] *See* US 11 February Comments, para. 54.
[91] See Exhibit US-154.
[92] Brazil's 18 February Comments, Annex A, Table 4.5.
[93] *See* US 11 February Comments, para. 57.

evidence suggests that, had Brazil taken into account the value of non-crop on-farm production, the share of cotton as a per cent of total farm sales would be lower still. For example, in the 1997 ARMS cotton costs of production survey, the US Department of Agriculture found that, for 1997 when the value of cotton was high, cotton accounted for only 44.5 per cent of the total value of agricultural production on cotton farms.[94]

51. Brazil also fails to include off-farm economic activity, which can be substantial, in its calculation. Annex IV, paragraph 2, establishes that the non-tied subsidy is allocated over "the total value of the recipient firm's sales"; there is no basis in that provision to limit the sales over which the subsidy is allocated to *farm* sales. Brazil's refusal to apply the Annex IV methodology in full introduces yet another serious distortion in its calculation as cotton operations earn almost 30 per cent of income from off-farm sources.[95]

52. Finally, Brazil contests the notion that, in calculating the amount of subsidy benefiting upland cotton, it must take account of the fact that decoupled payments for base acres are capitalized into higher land values and cash rents, thus benefiting land owners, not necessarily those farming the land, referring the Panel to its 28 January comments.[96] There, Brazil asserts that it is for the United States to demonstrate that payments on rented acres are capitalized into rents, thus impermissibly seeking to shift its burden of establishing the amount of challenged subsidies to the United States as responding party. Brazil also cites aggregate state-level data on cash rents to show that average cash rents in some cotton-producing states increased by less than the rate of inflation over the 1996-2002 period.[97] Such analysis, however, ignores the aggregation bias introduced by averaging (1) cash rents from farmland *with* programme base with (2) cash rents from farmland *without* programme base.

53. We recall that Brazil has previously conceded that, as of marketing year 1997, 34 to 41 cents per dollar of production flexibility contract payments were capitalized into land rent.[98] Brazil now argues that there is no evidence that further (increased) shares of production flexibility contract payments were capitalized in subsequent years. The Commission on the Application of Payment Limitations for Agriculture, to which Dr. Sumner presented testimony, reached conclusions on this very issue, however, and Brazil submitted this report as Exhibit BRA-276. The United States was therefore disappointed to see that Brazil's exhibit was missing pages 89-122, which precisely includes the portion of Chapter 5 of the Report entitled "Effects of Further Payment Limitations on Farmland Values." We attach as Exhibit US-155 the missing pages from the report.

54. The analysis of the *Report of the Commission on the Application of Payment Limitations for Agriculture* directly contradicts Brazil's conclusion that cash rent data "do [not] appear to reflect to any considerable extent the effects of PFC or other contract acreage payments".[99] To the contrary, the Commission's Report explained:

> In early 1997, professional farm managers indicated that in areas where competition for rental land was intense, *PFC payments were almost immediately captured by landowners and reflected in rental rates and land values*. Given the intense competition for leased land in many areas, tenants operating on cash leases found their lease rates being bid up until the landowner had captured most of the tenant's share of PFC payments. Producers with share leases reported that some landowners reduced their share of expenses, retained a larger crop share, or converted from share

[94] See Exhibit BRA-16, table 3.
[95] *See* US Further Rebuttal Submission, para. 137.
[96] Brazil's 18 February Comments, para. 75.
[97] *See* Brazil's Comments on US Answer to Panel Question 242, paras. 204-206 (28 January 2003).
[98] Brazil's Answer to Question 179 from the Panel, para. 165 (27 October 2003); Brazil's Opening Statement at the Second Panel Meeting, para. 57.
[99] Brazil's Comments on US Answer to Panel Question 242, para. 208 (28 January 2004).

> leases to cash leases. However, in areas where competition for rental land was less intense, tenants retained much of their PFC payments (Ryan et al). *Goodwin and Mishra estimate that each additional dollar per acre of PFC payments increased US average rents by $0.81 to $0.83 per acre during 1998-2000.*[100]

Thus, the missing pages from Brazil's own exhibit reports that, during 1998-2000, an estimated average of 81 to 83 per cent of production flexibility contract payments were captured by landowners through increased rent.[101] This conclusion is consistent with the US position that land owners capture the benefit of decoupled payments for base acres made to producers on rented land.[102] The Report also extends its conclusions to market loss assistance payments, direct payments, and counter-cyclical payments.[103]

55. We also note Brazil's argument that counter-cyclical payments could not be captured by landowners through increased rent because the payments are "triggered on a year-by-year basis depending on low prices for upland cotton", and a landowner "cannot know in what amount CCP payments will be made".[104] As noted, the Commission's Report does not support Brazil's position on counter-cyclical payments. However, Brazil does not draw the logical conclusion from its assertion: if that statement is true, then counter-cyclical payments cannot have effects on cotton farmers' planting decisions and production because farmers (and therefore landowners) cannot anticipate receiving those payments. On the other hand, to suggest that counter-cyclical payments *do* have production effects, Brazil has also argued that farmers *do* anticipate counter-cyclical payments being made.[105] If that is true, then Brazil's own evidence demonstrates that those payments will be capitalized. Brazil cannot have it both ways.

56. In sum, Brazil's two "Annex IV" methodologies are wholly inadequate because Brazil does not even attempt to apply the methodology actually set out in Annex IV: that is, to allocate the value of a non-tied subsidy across "the total value of the recipient firm's sales". Brazil has never sought nor

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[100] Exhibit US-155, at 106 (italics added).

[101] We also note that this information directly contradicts Brazil's previous argument that "contrary to the premise of the Panel's question [179], th[e] evidence suggests that PFC payments are somewhat, but not 'largely capitalized' into land rents". Brazil's Answer to Question 179 from the Panel, para. 165 (27 October 2003).

[102] Brazil also attempts to draw a distinction between land that is cash-rented versus share-rented. However, the Commission's Report describes a "non-operator landlord" as including those who "receiv[e] rent in the form of the crop produced on the land." Exhibit US-155, at 104. Thus, the Report's conclusions that the benefits of government payments largely accrue to non-operator landlords would appear to apply to owners who share-rent their land as well.

[103] *See, e.g.*, Exhibit US-155, at 106 ("Barnard et al. (2001) estimated that $62 billion or 20 per cent of the value of land producing the 8 major programme crops . . . was due to PFC payments, market loss assistance, disaster payments, and marketing loan benefits."); *id.* at 106 ("The effects of farm commodity payments on cropland values vary geographically, reflecting differences in . . . payments for crops eligible for direct and counter-cyclical payments and marketing loan benefits . . . ."); *id.* at 111 ("Government payments in the form of direct payments, counter-cyclical payments, and marketing loan benefits affect the value of farmland and land rents. Several studies indicate that government payments in recent years have increased farmland values nationally by 15-25 per cent.")

[104] Brazil's Comments on US 22 December 2003 Answers, para. 209 (28 January 2003). Brazil goes on to say: "Further, as Brazil has demonstrated repeatedly, given the high non-land-related production costs involved in producing cotton, most US producers simply could not profitably produce cotton without CCP payments. Therefore, there is little, if any, basis for a non-producing landlord to demand increased rents to capture CCP payments". *Id.* The United States is puzzled by this assertion. It would appear that Brazil is saying that landlords would not charge higher rental rates because producers "could not profitably produce cotton without CCP payments". This is not our understanding of how landlords choose to set rental rates.

[105] For example, in Dr. Sumner's model, acreage is a function of the net return to planting cotton, which includes prospective counter-cyclical payments. *See* Brazil's Further Submission, Annex I, para. 28 (equation (1)).

presented the value of *total sales* of the recipients (upland cotton producers) of the challenged decoupled income support payments. Brazil's inadequate calculations cannot meet its burden of establishing a *prima facie* case on decoupled income support payments for purposes of its serious prejudice claims.

**Conclusion: Brazil's Interpretation of the Peace Clause Would Upset the Balance of Rights and Obligations of Members in the WTO Agreements**

57. Throughout this dispute, we have noted that Brazil's Peace Clause interpretation is without foundation in the text and context of that provision and would upset the balance of rights and obligations set out in the Agreement on Agriculture. Brazil asserts that "[h]ad the United States been concerned about the certainty of its peace clause 'protection,' it would not have been difficult for Congress, in the 1996 FAIR Act or even the 2002 FSRI Act, to include a 'circuit breaker' provision directing the USDA Secretary to stop funding any upland cotton budgetary outlays in excess of the 1992 levels".[106] Of course, the United States has disciplined itself to grant support not in excess of that decided during the 1992 marketing year by shifting away from the product-specific deficiency payments with high target prices under the 1990 Act and instead to provide a mix of decoupled income supports that are green box (direct payments) or non-product-specific (counter-cyclical payments) and product-specific marketing loan payments. But Brazil's assertion raises a number of questions:

- How could the United States have known how to cap the budgetary outlays under the decoupled income support measures to stay within the 1992 levels?

- How could the United States have known what payments would be considered "support to upland cotton" under Brazil's methodology, which only appeared on 20 January 2004?

- Which of Brazil's five in-the-alternative methodologies – the "cotton-to-cotton methodology", "Brazil's methodology", the "modified Annex IV methodology", the "US Annex IV methodology", or "Brazil's 14/16th methodology"[107] – should the United States have been applying to ensure that budgetary outlays did not exceed the 1992 level?

Indeed, Brazil has ended this dispute taking the position that "the Panel needs to adopt a *reasonable* methodology to be applied for purposes of the peace clause in assessing the amount of support to upland cotton from the four contract payment programmes".[108] It is difficult to imagine how that standard could have been incorporated into the design of the challenged decoupled income support measures to ensure Peace Clause compliance.

58. The United States submits that the Peace Clause must be interpreted in a way that permits Members to comply in good faith – that is, Members must be able to tell if they will breach the Peace Clause or not. Putting legal interpretive issues aside, Brazil's budgetary outlays approach does not do that since, with price-based support such as marketing loan payments, the United States cannot "decide" market prices.[109] Brazil's allocation methodology also does not do that because the

[106] Brazil's 18 February Comments, para. 85.

[107] *See, e.g.*, Brazil's 18 February Comments, para. 55. We note that the range of budgetary outlays Brazil calculates under these five in-the-alternative methodologies range from, for 2002 direct payments, $383.1 million to $466.8 million, and for 2002 counter-cyclical payments, from $640.4 million to $988.3 million.

[108] Brazil's 18 February Comments, para. 42 (italics added).

[109] We have previously noted that "support" does not mean "budgetary outlays". US 11 February Comments, para. 16 n.12. In addition, it is ironic that Brazil criticizes the US interpretation on the grounds that the Peace Clause does not read "product-specific support" when the Peace Clause also does not read "budgetary

United States does not "decide" what a decoupled income support recipient chooses to produce (or not to produce).[110] Brazil's approach to Peace Clause issues would rob Members of the ability to design price-based and income support measures to conform to the Peace Clause and mean that Members could not know if they had complied with the Peace Clause until it was too late to do anything about it.

59. The United States has demonstrated that using any measurement that reflects the support "decided" by the United States – rather than factors (such as market prices) beyond the United States' control – US support to upland cotton in marketing years 1999-2002 has not exceeded the 1992 marketing year level.[111] The question then is whether the Panel will find that the United States has breached the Peace Clause simply because market prices were lower in some recent years than they were in 1992. We have demonstrated that the United States has disciplined itself to grant support not in excess of that decided during the 1992 marketing year.[112] Therefore, we are entitled to the protection of the Peace Clause and respectfully request the Panel to so find.

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outlays"; however, the latter *is* a defined term in Article 1(b) of the Agreement on Agriculture while the former is not, suggesting that Members' decision not to use "budgetary outlays" in the Peace Clause was deliberate.

[110] As set out above, no allocation methodology can be applied to the Peace Clause as the only support that is relevant to that determination is support to a specific commodity, read according to its ordinary meaning and in context.

[111] *See, e.g.*, US 11 February Comments, paras. 15-17.

[112] Recognizing, as the United States believes is required by the Peace Clause text, that "decided" and "grant" cover only those parameters over which Members exercise control would also be consistent with this approach of allowing "good faith" compliance since it would permit Members to control whether their measures conformed to their obligations.

# ANNEX I-24

## RESPONSE OF THE UNITED STATES TO THE PANEL'S 3 FEBRUARY 2004 DATA REQUEST, AS CLARIFIED ON 16 FEBRUARY 2004

3 March 2004

**Introduction**

1. The United States is submitting today 8 data files, as requested by the Panel in its 3 February 2004, supplementary request for information, as clarified by the Panel's communication of 16 February 2004. The files are in an EXCEL format.

2. The data has been prepared in response to those letters, and has been prepared as well as possible in the time allotted, involving much time and effort. We first address how the files were derived and issues involved in their preparation, such as the handling of 1999 and 2000 crop soybeans and 2002 peanuts. Because of the peanut and soybean issues, there were in essence two runs of data, and both sets of data are presented.

3. In the first run, the United States ran the figures for 1999 and 2000 treating soybeans as a non-base crop, and thus one which would not effect any categorizations based on comparing plantings of total programme crops to total programme crop bases (such as those necessary to sort farms into B1, B2, and B3 categories). In the second run, soybeans were treated as a full programme crop for the Market Loss Assistance payments for those years in which oilseed payments were made (1999 and 2000) with an assigned base of zero for each farm as there were no farm bases for the soybean crops for 1999 and 2000.

4. Likewise, for peanuts, there were separate runs for 2002. In the first run, the peanut crops for Direct payments and Counter-cyclical payments were treated as a non-programme crop for categorization purposes. In the second run, peanuts were treated as a programme crop with a base of zero for each farm.

5. These two runs took into account the directive of the Panel of 16 February. There, the Panel instructed us to treat soybeans for Market Loss Assistance (MLA) as a programme crop and peanuts as a Direct and Counter-cyclical Payment (DCP) crop. As indicated, this did raise a question, one which is colored somewhat by a broader issue on the MLA payments themselves. There is no separate base acreage or yields for MLA purposes. And, the oilseed programmes for 1999 and 2000 were not farm based programmes. No farm had a soybean base for those years. Likewise, with peanuts, there was no farm base for 2002, the first year that peanuts became a programme crop. Bases were not assigned for peanuts until 2003 and could not be effective until that year. For 2002, the peanut programme was a producer-based programme. The same was true for soybeans in 1999 and 2000.

6. Finally, we also present the results of our efforts to identify any farms that would not have protectable privacy interests under the Privacy Act of 1974, as requested in item (a) of the Panel's 3 February supplementary request for information.

7. We then indicate how the files were put together and identify the files.

**There were no Separate Market Loss Assistance Bases; Rather the Payments Were Made Proportionately to the Production Flexibility Contract (PFC) Payments**

8. The market loss assistance payments (MLAs) were after the fact and simply supplemented payments that were made to a person under a PFC contract. There were no new contracts, bases, or yields. There were four MLA programmes. The first was for the 1998 crop. MLA programmes followed for the 1999, 2000 and 2001 crops, each under separate legislation, each after the fact – that is after the crop was planted and in supplement of payments already made under the PFC contracts.

9. To respond to the Panel's data request of 3 February 2004, the United States was called upon to give information for the PFCs and the MLAs. The data request was for base acreage with respect to farms that were in the programme. There were no bases as such for MLAs. The payments were proportional to what has been received in the PFC. The only slight difference was that for 2000, where Congress simply prescribed a rate, drawing from the previous statute for the previous crop. Thus, we have treated the request for MLA data (as explained below, soybeans aside) to be a request for the PFC data for the PFC year for which the PFC payment was supplemented by a particular MLA payment.

**There Was No Soybean Farm Base for the 1999 and 2000 Market Loss Assistance Programme As There Were No Market Loss Assistance Programmes for Soybeans, and Oilseed Payments in those Years were Producer-Based, Not Farm-Based**

10. Soybeans complicate the analysis. The United States reads the Panel's 16 February letter to indicate that for purposes of the data request, soybeans should be treated as an MLA crop. This presents an analytical problem because no farm had a soybean base. We note that the data files do contain for every category the soybean plantings for 1999 and 2000. (We note that there was no oilseed programme, and therefore no payments for soybeans, for 2001.)

11. As an initial matter, soybean payments for 1999 and 2000 were part of an overall oilseeds programme. There was no oilseed programme for the 2001 crop; therefore, there was no soybean payment of any kind for that year. There was never, even for 1999 and 2000, a base or yield for a farm for oilseeds in the PFC era.

12. For the PFC programme crops like cotton, the "farm" had a base. The "farm" had a yield. "Producers" on the farm received the payment even if they were not the same person who had produced the crops that produced the historic base or yield or had even been on the farm when the base or yield were created. If the producer had an interest in several farms with base under the PFC programmes, the producer received several checks. The base acreage and yield derived from historical plantings on the farm.

13. In the oilseeds programme, it was completely different. The producer had a base. The producer had a yield. The farm had no base. The farm had no yield. For the 1999 programme, if the producer was on Farm X in 1999 and planted soybeans there, the producer could receive a payment based on plantings that the producer may have had on Farms A, B, C, and D in the historical period. Current producers on Farms A, B, C, and D, by contrast, would have no "base." In short, there was no base for soybeans for any farm for oilseeds payments for 1999 or 2000.

14. Thus, this is the problem in terms of the data request for the Panel: the request considers soybeans as a covered commodity for MLAs and seeks information for base acreage on "farms," but soybean base for 1999 and 2000 oilseed payments was producer-based, not farm-based. In order to be as responsive as possible, we have run the data two ways. First, for 1999 and 2000, we treat soybeans as a non-programme crop for purposes of categorizing the farms into subcategories (as explained in more detail below), but show the actual soybean plantings for all farms. In the second run, we treat

soybeans as a programme crop and, for categorization purposes, treat all farms as having a soybean base of zero.

15. We respectfully refer the Panel to its 3 February 2004, letter. Category B farms are those with cotton "overplantings" – that is with more cotton plantings than cotton base. Category B2 farms are defined are those where, for all covered crops added together, the farm underplanted the total aggregated base. B3 is the mirror image of B2. It is where there was an aggregated overplanting for all programme crops taken together.

16. Assume the following plantings on Farm A:

| | | |
|---|---|---|
| Cotton | Base 10 | Plantings 12 |
| Rice | Base 5 | Plantings 0 |
| Soybeans | -- | Plantings 5 |

If soybean plantings do not matter for categorization, then this farm is a B2 farm since the plantings for rice and cotton would be 12 and the total base would be 15. But if soybeans are counted and treated as having a zero base, then this farm is a B3 farm because the countable base would still be 15, but the plantings would now be 17. This would only be the case for MLA. Since soybeans, under the Panel's February 16 letter, would only be counted for MLAs, the farm would still be a B2 farm for purposes of the PFC calculations for the same year.

17. As we have indicated and set out further below, we have it covered both ways. We provide a file in which soybeans are treated as a covered commodity (for MLA purposes) with a farm base of zero. We also present a file in which soybeans are not considered a programme crop, in which the PFC and MLA figures are the same.

**Farms Had No Peanut Base in 2002 Because the 2002 Peanut Programme was Producer-Based, Not Farm-Based**

18. The Peanut programme presents the same problem for the 2002 Direct and Counter-cyclical Programme (DCP) as do soybeans for the 1999 and 2000 programmes, since it too was a producer-based, not a farm-based programme. There were no peanut bases for 2002 for any farm. The base was assigned to a producer for 2002. That producer had to be a "historical peanut producer" – someone who had produced peanuts in the base period. For the 2002 crop year, the producer received one check for all of the producer's base, calculated as the payment rate times the "payment acres of the historic cotton producer" times the "average peanut yield . . . for the historic cotton producer."[1] However, starting in 2003, the base and yield had to be assigned by the historical producer to a farm of that producer's choice. The designated farm did not have to be a farm in which the producer had an interest, or one on which the producer had ever produced peanuts, or, for that matter, one on which anyone had ever produced peanuts or would ever produce peanuts in the future.

19. The distinction is perhaps best demonstrated by example. Assume that a farmer had in 1998-2001 produced peanuts on rented Farms A, B, and C. Assume that for 2002 the farmer decided to get out of farming altogether, and was living in retirement in Denver, Colorado, far outside the peanut belt and with no interest in any farm or any farm production anywhere. Under the terms of the 2002 Farm Bill, that historical producer would receive a payment based on that producer's base and that producer's yield. If that farmer happened to be a producer in 2002 on Farm D, that farmer would nonetheless receive payment based on his or her production on Farms A, B, and C in the base period.

[1] 2002 Farm Bill, § 1303(c) (direct payments) (Exhibit US-1); *see id.* § 1304(e) (counter-cyclical payments).

Producers in 2002 on Farms A, B, and C would receive nothing (unless they of course had their own producer base).

20. For 2003, however, the farmer living in Denver would have to pick a farm on which to place his base.

21. In short, there were no bases for any peanut farm in 2002, and the problem is the same as for soybeans. As for soybeans, the data was run both ways – that is, treating peanuts as a covered commodity for 2002 with a farm base of zero and not treating peanuts as a covered commodity.

**How the Data was Compiled**

22. The United States now explains the source of the data. We have previously mentioned the limitations of crop reports, which is from where all the planting data in the aggregations presented here are derived. Crop reports were not generally required until 2002, at which point they were required for persons seeking benefits for crops other than peanuts in the form of direct payments, counter-cyclical payments, or marketing loans. As for peanuts, similar reporting requirements apply where the payments are in connection with farms for which a base is assigned. Hence, the peanut reporting provision only begins to apply with the 2003 crop.

23. We note that the total number of acres accounted for in 2002 may exceed the total cropland numbers set out in the 18-19 December 2003 data, as corrected on 28 January 2004. Differences may result because: (1) farmers may have reported plantings of grass on noncropland; (2) there can be double-cropping in some areas; and (3) CRP acres may not have been reported and counted as available cropland.

**The Categories of Farms for the Aggregated Data Files Responsive to Part "(b)" of the Panel's Request**

24. We have sorted and aggregated the relevant farms into those categories set out in the 3 February supplementary request from the Panel. Category A farms are those for which the farms underplanted their cotton base. The panel also asked for farms that did not plant any other covered commodities and we have classified those as "A1" farms.

25. Category B farms are farms that overplanted their base. Subcategory B1 farms are farms that, in total for all base crops, planted exactly their covered commodity base, while B2 farms under-planted and B3 farms over-planted those total bases.

26. Category C farms planted cotton but had no base.

**Data on Farms Without Privacy Interests Under the Privacy Act of 1974 As Set Out in Item (a) of the Panel's Request**

27. We now address what was item (a) of the Panel's 3 February supplementary request for information. The Panel asked for information relating to those farms that do not have a privacy interest and thus who could potentially be subject to a detailed release of planted and base acreage information. This information appears to be of little interest to Brazil at this point as Brazil indicated in its 13 February letter that "because the United States apparently intends only to provide farm-specific information for far less than the total amount of farms (i.e., those that are not held by 'individuals') this information will be useless for calculating the exact amount of total contract payments."[2] By way of contrast, Brazil commented that, "[i]f the United States provides the complete information requested in part (b) of the 3 February 2004 Request, then most of Brazil's 28 January

[2] Brazil's 13 February 2004, Letter to the Panel, at 2.

Data Comments would be rendered moot," and "[w]ith the actual and complete data, the Panel would be in a position to apply any methodology it deems acceptable."[3]

28. For non-closely held corporations, information *voluntarily* received from a corporation is to be withheld if it is not the type of information customarily released by the corporation to the public. *See* Center for Auto Safety v. National Highway Traffic Safety Administration, 244 F.3d 144 (D.C. Cir. 2001).

29. Such is the case with respect to plantings prior to 2002. It would therefore, be necessary to examine, on a case by case basis, the circumstances of each "corporate" farming operation to determine if it is a closely held corporation which might enjoy a privacy interest and if the information was voluntarily submitted and not the type of information customarily released by the corporation to the public.

30. Given the time available, we used the year 2002 when in all cases, crop reports were mandatory with the limits indicated above. The United States conducted an electronic sort of cotton farms to narrow the number of files to a manageable number, which we then examined on a farm-by-farm basis to see if they were closely-held corporations. The data file containing farm-by-farm base, yield, and planted acreage information for these farms is described below.

**The Data Files**

31. The United States is providing the following data files via CD-ROM. This information is sensitive, and we do not consent to the release of this information to the public domain. Therefore, as with the data submitted on 18 and 19 December 2003, as corrected on 28 January 2004, pursuant to paragraph 3 of the Panel's working procedures, we designate this information as confidential.

32. File Name: PFC1999W.xls: This file is the first 1999 PFC and MLA file treating soybeans as a non-base crop and showing soybeans plantings.

33. File Name: PFC99-2W.xls: This file is the second 1999 PFC and MLA file. Soybeans is treated as a crop with a zero base on all farms.

34. File Name: PFC2000W.xls: This file is the 2000 PFC and MLA files with soybeans treated as a non-base crop and showing soybeans plantings.

35. File Name: PFC00-2W.xls: This file is the 2000 PFC and MLA files treating soybeans as a crop with a zero base on all farms.

36. File Name: PFC2001W.xls: This file is the 2001 PFC and MLA file.

37. File Name: DCP2002W.xls: This file is the 2002 Direct and Counter-cyclical file with peanuts treated as a non-base crop and showing peanuts plantings.

[3] Brazil's 13 February 2004, Letter to the Panel, at 5. Brazil further commented that "by producing the complete aggregated information, there would no longer be a need to draw adverse inferences." *Id.* In light of the filing today of a complete response to item (b) of the Panel's supplementary request, the United States welcomes Brazil's withdrawal of its request that the Panel draw adverse inferences in this dispute.

38. File Name: DCP02-2W.xls: This file is the 2002 Direct and Counter-cyclical file with peanuts treated as a crop with a zero base on all farms.

39. File Name: notclose.xls: This is the result of the search for not closely held farms as described above. (Each line corresponds to one farm. The base, yield, and planting fields are set out in the file and are the same as those in the base/yield and planted acres data files provided on 28 January 2004 (as set out in Exhibit US-145).)

# ANNEX I-25

## UNITED STATES' RESPONSE TO QUESTION 264(B) DATED 3 FEBRUARY 2004 FROM THE PANEL TO THE PARTIES FOLLOWING THE SECOND MEETING OF THE PANEL

3 March 2004

**264. The Panel asks the United States to clarify certain aspects of Exhibit US-128:**

**(b) Does the US agree with the statement in paragraph 135 of Brazil's 28 January 2004 comments on US responses to questions that the difference between the $1,148 billion in the chart at para. 165 of Brazil's 11 August answers to questions and the $666 million amount in Exhibit US-128 ($1.75 billion) closely corresponds to the total "Claims rescheduled" figure reported by the US in Exhibit US-128 (column F)?**

1. The United States first notes that Exhibit US-128 portrays data on a cohort basis. The figures in Brazil's chart are on a fiscal-year basis, which do not necessarily correspond to figures on a cohort-basis. In addition, data reflected in Exhibit US-128 commence with the 1992 cohort and end with the 2003 cohort. In contrast, Brazil's chart commences with fiscal year 1993 and ends with fiscal year 2002.

2. Also, as indicated in response to question 264(c)[1], Exhibit US-128 does not reflect the receipt of principal payments under the reschedulings. Exhibit US-148 (column F) reflects approximately $205 million of principal collected on the reschedulings. As a theoretical matter, such "recovered principal" should be reflected in the budget line 88.40 that Brazil cites in its chart. Accounting research within the US Government suggests, however, that a significant portion of this amount has not in fact been reflected in that budget line.

3. Although the $1.75 billion number cited in the question and the $1.637 billion number pertaining to "claims rescheduled" are numerically of the same order of magnitude, for the reasons noted above, a direct comparison between Exhibit US-128 and Brazil's chart is not as appropriate or facile as Brazil would suggest. Nevertheless, as a general matter, the United States acknowledges that the most significant difference between the data reflected in Exhibit US-128 and the data in the Brazilian chart arises as a function of the standard accounting treatment of reschedulings by the Commodity Credit Corporation as no longer constituting an outstanding claim, but in fact a new direct

[1] US Answers to Further Panel Questions Following Second Panel Meeting (11 February 2004), para. 24

loan.[2] This is consistent with standard commercial practice in accounting for refinancings and reschedulings.[3] Such treatment is reflected in column F of Exhibit US-128.

[2] Under FASAB: Original Pronouncements, Version 3 (01/2004), a "direct loan" is defined as "a disbursement of funds by the government to a nonfederal borrower under a contract that requires the repayment of such funds within a certain time with or without interest. The term includes the purchase of, or participation in, a loan made by another lender. (Adapted from OMB Circular A-11)." http://www.fasab.gov/pdffiles/vol1v3.pdf, p. 1290. Section 185.3 of OMB Circular A-11 defines "direct loan": "a disbursement of funds by the Government to a non-Federal borrower under a contract that requires repayment of such funds with or without interest. The term includes: [. . .] Financing arrangements that defer payment for more than 90 days [. . .]." Exhibit BRA-116 (section 185.3, page 185-6).

[3] In a routine case, a lender upon rescheduling or refinancing a loan would extinguish the prior loan because payments are no longer due on the original schedule. The lender simultaneously would book the new rescheduled loan as the asset (receivable) pursuant to the terms of which payments would be received. Perhaps the most familiar illustration of this type of transaction is a home mortgage refinancing where the applicable interest rate and maturity are changed from the prior mortgage loan. Upon consummation of the refinancing, the original note and mortgage are deemed paid, and the new loan and its terms are booked as the new loan receivable.

# ANNEX I-26

## BRAZIL'S COMMENTS ON US 3 MARCH 2004 DATA

10 March 2004

**Table of Contents**

**List of Exhibits**

| | |
|---|---|
| 'Calculations Acreage Based Methodologies.xls' provided in electronic format | Exhibit Bra-433 |
| 'Calculations Value Based Methodologies.xls' provided in electronic format | Exhibit Bra-434 |

## I. INTRODUCTION

1. Brazil thanks the Panel for the opportunity to comment on the US data produced on 3 March 2004. Section II of this submission provides Brazil's comments on the completeness and usability of the 3 March 2004 US data. In Section III, Brazil presents the results of its calculations applying the same allocation methodologies as used in Brazil's 18 February 2004 Data Comments. In Section IV, Brazil offers four tables comparing MY 1992 support to upland cotton with MY 1999-2002 support to upland cotton as determined under the four allocation methodologies.

2. Brazil's results – whether based off the 3 March 2004 US summary data or the earlier US 18/19 December 2003 or 28 January 2004 summary data – remain unchanged. Under any reasonable methodology for allocating contract payment support to upland cotton, the US support to upland cotton in MY 1999-2002 exceeds the support decided in MY 1992, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture. Thus, the US domestic support measures challenged by Brazil in this dispute are not "exempt from actions" under the SCM Agreement and GATT Article XVI.

## II. THE US 3 MARCH 2004 DATA REGARDING PART B OF THE PANEL'S 3 FEBRUARY 2004 REQUEST IS GENERALLY USABLE AND SHOULD BE RELIED ON BY THE PANEL

3. Given the US refusal to provide farm-specific data, the aggregated data provided by the United States on 3 March 2004 in response to part (b) of the Panel's 3 February 2004 Request is the best information available before the Panel. While certain problems with the US 3 March 2004 data remain (which particularly affect any value-based Annex IV-type allocation methodology), the Panel can and should rely on this data in making its peace clause determination. Thus, Brazil notes that it no longer considers that relying on its "14/16th" methodology would be appropriate.

4. With respect to part (b) of the Panel's 3 February 2004 Request, the United States appears to have provided complete summary base and complete summary planted acreage data covering all crops for which data was requested by the Panel and all farms covered by the Panel's request.

5. However, the United States has engaged in a completely incorrect reading of the Panel's request for data on Category A farms. The Panel defined Category A farms as "farms [that] had fewer *upland cotton planted acres* than upland cotton base acres".[1] Unfortunately, the United States read this request as covering all farms that had upland cotton base and planted less than their full upland cotton base to upland cotton or that planted no upland cotton at all.[2] There is no basis for any such interpretation. Farms with no planted acres do not have "fewer upland cotton planted acres" – which refers to a positive amount – they have none. Indeed, from the context of the Panel's 3 February 2004 Request is becomes clear that the entire purpose of the Panel's request was to facilitate the calculation of support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture. Neither Brazil, nor the United States, has ever argued that farms, which do not even plant upland cotton, receive any "support to upland cotton". Including these farms in the calculations would inevitably lead to major distortions, as the calculations are impacted by base and planted acreage on farms that are of no relevance to a determination of the "support to upland cotton".[3] Had the United States interpreted the Panel's request according to its ordinary meaning, or, alternatively,

[1] 3 February 2004 Communication from the Panel, p. 1 (emphasis added).

[2] This is apparent from the fact that the sum of all upland cotton base acres from Category A, B and C farms in the US 3 March 2004 summary data equals the amount of total upland cotton base in the United States. Logically, farms that gave up producing upland cotton must have been included in one of the categories and could only have been included in Category A. Indeed, this inclusion explains that large amount of upland cotton base relative to the upland cotton planted acreage on these farms.

[3] Brazil notes that this problem does not affect the Cotton-To-Cotton Methodology, as discussed below.

provided the farm-specific information requested by the Panel on 8 December 2003, 12 January 2004 and 3 February 2004 (as part (a) of the Panel's Request[4]), this would not have been a problem.

6. Nevertheless, Brazil has been able to use the 28 January 2004 US summary data to largely correct for this erroneous inclusion of additional non-upland cotton producing farms in Category A. The 28 January 2004 US summary data contains a separate category for farms that hold upland cotton base but do not produce upland cotton. Brazil has used this aggregate information to subtract out of Category A data any base and planted acreage on farms that do not produce upland cotton.[5] However, this approach was not feasible for the US Annex IV Methodology, since the 28 January 2004 US summary data does not contain all the data items contained in the 3 March 2004 US summary data. In particular, specific data on planted acreage for non-contract payment crops is missing from the 28 January 2004 US summary data, limiting Brazil's ability to correct all Category A farm data items for the purposes of applying the data to the US Annex IV Methodology. Similarly, a correction was not feasible for soybean planted acreage during MY 1999-2001 and for peanut planted acreage in MY 2002, as discussed below. Thus, any remaining distortions that might result from the necessary exclusion of soybeans and peanuts of Brazil's calculations under Brazil's Methodology and under the Modified Annex IV Methodology are directly a result of the US erroneous inclusion of non-upland cotton producing farms in Category A (and its continued refusal to produce farm-specific data).

7. In addition, and again in contrast with the 28 January 2004 US summary data, the United States' 3 March 2004 response does not provide contract payment yields or payments units that would allow for a precise calculation of the total amounts of contract payments received by a category of farms. While Brazil recognizes that the Panel's 3 February 2004 Request does not ask for this information, the United States should have produced in good faith the information on payment units in order to avoid potential distortions (as it did when providing its 18/19 December 2003 and 28 January 2004 summary data). Brazil has been required, therefore, to use the contract payment yield information set out in the 28 January 2004 US summary data. Brazil believes this contract payment yield information to be a useful proxy and the potential distortions that might result from the use of this data to be relatively minor.[6]

8. The United States' 3 March 2004 summary data is furthermore inadequate because it does not permit the calculation of support from soybean market loss assistance payments and peanut direct and counter-cyclical payments. The United States notes that MY 1999-2000 soybean market loss assistance payments and MY 2002 peanut direct and counter-cyclical payments were not "farm-based" but "producer-based".[7] Therefore, payments were received by (historic) producers, rather than farms (or their owners). While the United States produced data on soybean and peanut planted acreage on upland cotton farms[8], the United States did not produce any information that would allow

[4] Brazil notes that it is of the firm view that none of the farm-specific planting data requested by the Panel would be covered by the US Privacy Act.

[5] Brazil has subtracted from the Category A summary data provided on 3 March 2004 the amount of planted and base acreage per covered commodity as reported in the 28 January 2004 US summary data for farms that hold upland cotton base but do not plant upland cotton. This calculation corrects for any erroneous inclusion of additional farms in Category A. Since the 28 January 2004 US summary data does not contain data on MY 1999-2001 soybean plantings or base and MY 2002 peanut plantings or base by farms holding upland cotton base but not producing upland cotton, no correction is possible that would cover these crops. Therefore, both soybeans (for MY 1999-2001) and peanuts (for MY 2002) needed to be excluded from the calculations under Brazil's Methodology or the value-based allocation calculations under the Modified Annex IV Methodology, as discussed below. In addition, no update of the US-Proposed Annex IV Methodology using the US 3 March 2004 summary data was possible.

[6] The United States obviously has no basis to complain about Brazil's use of this yield proxy given its failure to provide yield information on 3 March 2004 or to provide the farm-specific data.

[7] US 3 March 2004 Response to the 3 February 2004 Request by the Panel, paras. 10-21.

[8] The United States produced for MY 1999, 2000 and 2002 two sets of data, one treating soybeans and peanuts as a contract payment crop and categorizing farms accordingly and one treating the soybeans and

the calculation of "producer-based" soybean market loss assistance and peanut direct and counter-cyclical payments received by producers operating upland cotton farms.[9] Yet, these payments should be considered under any allocation exercise (except the "Cotton-To-Cotton" Methodology). The absence of this information prevents Brazil from including these payments in its allocation calculations and, thus, biases Brazil's calculations downward, as discussed below. Any distortions resulting from this shortcoming of the 3 March 2004 us summary data are a consequence of the US failure to produce data on these soybean and peanut payments.

9. With respect to part (a) of the Panel's 3 February 2004 Request pursuant to DSU Article 13, the US 3 March 2004 response provided – after four weeks of what the United States characterizes as an analysis "involving much time and effort"[10] – a file ("NotClose.xls") containing farm-specific data on 28 farms for MY 2002 that would not be covered by the US Privacy Act. At the same time, the United States indicated that, in MY 2002, 197,084 farms produced upland cotton and/or received upland cotton direct and counter-cyclical payments. It is obvious that the farm-specific data covering these 28 farms cannot provide information relevant to this dispute.[11]

10. Brazil reiterates that it does not consider farm-specific planting information to be covered by the US Privacy Act.[12] (Certainly, Brazil's summary calculations in Sections III and IV below, based on the 3 March 2004 US summary data, could not possibly be considered confidential.) But even if the farm-specific planting information were confidential under US law, DSU Article 13 would oblige the United States to produce the information for the Panel and Brazil.[13] Brazil also emphasizes that it remains of the view that farm-specific data would permit the most precise calculation of the amount of contract payments that constitute support to upland cotton, under whichever allocation methodology the Panel deems appropriate.[14]

## III. CALCULATION OF SUPPORT TO UPLAND COTTON UNDER VARIOUS ALLOCATION METHODOLOGIES

11. In this Section, Brazil presents the results of applying the four allocation methodologies discussed in Section 5 of Brazil's 18 February 2004 Data Comments. That is, Brazil has applied two acreage-based allocation methodologies ("'Cotton-To-Cotton' Methodology" and "Brazil's Methodology") and two value-based methodologies ("Modified Annex IV Methodology" and "US Annex IV Methodology") to the 3 March 2004 US summary data.[15] The results under Brazil's

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peanuts as a non-contract payment crop and categorizing farms accordingly. (*See* US 3 March 2004 Response to the 3 February 2004 Request by the Panel, paras. 17, 21, 31-38).

[9] As discussed above, no payment units are provided with the US 3 March 2004 summary data.

[10] US 3 March 2004 Response to the Panel's 3 February 2004 Request.

[11] *See* Brazil's 13 February 2004 Letter to the Panel, p. 2.

[12] Brazil's 18 February 2004 Comments, comments regarding answers 259(a)-(c), paras. 1-21. *See* also Brazil's 28 January 2004 Data Comments, Section 4.

[13] *See* Brazil's 28 January 2004 Data Comments, Section 5.

[14] While Brazil stated at page 5 of its 13 February 2004 Letter to the Panel that "by producing the complete aggregated information, there would no longer be a need to draw adverse inferences", Brazil notes that the data produced by the United States is not complete, as discussed above. Should the United States argue or the Panel believe that Brazil ought to have provided more accurate data on contract payments that constitute support to upland cotton, Brazil requests the Panel to rely nevertheless on the calculations provided by Brazil in this submission. Any shortcoming in these results stems from the refusal of the United States to produce the farm-specific data requested numerous times by the Panel and Brazil. Further, the United States' refusal (1) to produce the farm-specific data or (2) to produce proper data on Category A farms by excluding all farms that do not produce upland cotton, as well as complete contract payment yield or payment unit information would permit the Panel to draw the adverse inferences that this information – if produced – would have shown even higher payments being allocated to upland cotton (*see* Brazil's 28 January 2004 Data Comments, Section 6).

[15] While Brazil uses these results for purposes of the comparison required under Article 13(b)(ii) of the Agreement on Agriculture, the Panel could also use these results to determine the amount of subsidies provided

Methodology replace the estimated amount of support to upland cotton under Brazil's so-called "14/16th" methodology.

*Cotton-To-Cotton Methodology*[16]

12. First, Brazil has applied the "Cotton-To-Cotton" Methodology to the 3 March 2004 US summary data.[17] This methodology is not affected by the Category A "over-inclusiveness" problem.[18] The "Cotton-To-Cotton" Methodology allocates for each planted acre of upland cotton payments associated with one upland cotton base acre – if available for that category of farms. For Category A farms this means that for each acre planted to upland cotton, payments associated with one upland cotton base acre are allocated.[19] For Category B1 to B3 farms this means that for each acre planted to upland cotton, payments associated with one upland cotton base acre are allocated – up to the amount of upland cotton base acres held by these farms.[20] For category C farms this means that no allocations are made.[21]

13. Since the 3 March 2004 US summary data did not include information on contract payment yields or payment units by farm category, Brazil used the contract payment yield figures provided or implied in the 28 January 2004 US summary data to calculate payment amounts.[22] After correcting for and eliminating the non-upland cotton producing farms in Category A, Categories A, B1, B2 and B3 consist of farms that previously were included in Category 1 under the US 18/19 December 2003 and 28 January 2004 summary data, as farms planting upland cotton and holding upland cotton base.[23]

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to upland cotton for purposes of Brazil's actionable subsidy claims, should the Panel deem a finding on the amount of subsidies necessary.

[16] *See* Brazil's 18 February 2004 Data Comments, paras. 46-48 and Annex A.1.

[17] For the reasons discussed below in the context of "Brazil's Methodology," Brazil has relied on the categorization treating soybeans in MY 1999-2000 and peanuts in MY 2002 as a non-contract payment crop. That is, Brazil has used the following files: 'PFC1999W.xls', 'PFC2000W.xls', 'PFC 2001W.xls' and 'DCP2002W.xls' as provided by the United States on 3 March 2004. While the "Category A" problem does not affect this methodology, to ensure comparability between the payment allocations for each category of farms, Brazil has used the same categorization as for the calculations under Brazil's Methodology.

[18] Since Category A consists of farms that have more upland cotton base acres than upland cotton planted acres, for each planted acre of upland cotton payments associated with one upland cotton base acre are allocated. All remaining upland cotton and other crop base payments are ignored.

[19] Brazil recalls that these farms are defined as farms that plant less acres of upland cotton than they hold base acres.

[20] Brazil recalls that these farms are defined as farms that plant more acres of upland cotton than they hold base acres. Thus, there are not enough upland cotton base acres to allocate payments associated with one upland cotton base acre to each acre planted to upland cotton. No additional allocations are applied under this methodology and, therefore, some upland cotton planted acres are not allocated contract payments at all.

[21] Brazil recalls that these farms are defied as farms that plant upland cotton but do not hold upland cotton base acres. Therefore, no upland cotton contract payments are available for allocation and no non-upland cotton contract payments are allocated under this methodology.

[22] The file 'rPFCsum.xls' contains payment units and base acres per category of farms (1, 2, and 3 referring to farms that (1) hold upland cotton base and plant upland cotton, (2) hold upland cotton base and do not plant upland cotton, and (3) do not hold upland cotton base but plant upland cotton). Since payment units are defined as 85 per cent of the product of base acres and contract yields, payment units and base acres can be used to calculate the required contract yield (payment units / (base acres * 0.85)). The file 'rDCPsum.xls' contains contract yields for all three categories of farms (see above).

[23] To avoid any confusion, Brazil presents the following table detailing the nomenclature of the farm categories in the various US summary data submissions:

| **Farm Definitions** | **3 March 2004 Data** | **18/19 December 2003 28 January 2004** |
|---|---|---|
| Farms Planting Less Cotton Than Their Cotton Base | Category A (erroneously also includes farms that produce no cotton – all formerly Category 2 farms) | Included in Category 1 |

Accordingly, Brazil applied the contract payment yield for Category 1 farms from the 28 January 2004 US summary data to these four categories of farms in the 3 March 2004 US summary data.[24] The contract payment yield for Category C farms under the 3 March 2004 US summary data corresponds to that of Category 3 farms under the 28 January 2004 US categorization.

14. Next, Brazil calculated the payment units by category of farms[25] and multiplied them by the payment rate.[26] The details of Brazil's calculations are presented (by farm category) in electronic form as Exhibit Bra-433 ('Calculations Acreage Based Methodologies.xls').

15. The following table shows the amount of contract payments allocated as support to upland cotton under the "Cotton-To-Cotton" Methodology.

| **Cotton-to-Cotton Methodology**[27] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[28] | Direct Payments | CCP Payments |
| 1999 | 434,945,069 | $432,826,830 | - | - |
| 2000 | 411,776,128 | $438,349,261 | - | - |
| 2001 | 329,593,231 | $452,369,304 | - | - |
| 2002 | - | - | $391,846,198 | $864,980,104 |

*Brazil's Methodology*[29]

16. In applying Brazil's Methodology to the new 3 March 2004 US summary data, Brazil again corrected for the over-inclusiveness of farms in Category A[30] and applied the contract yields, as

| | | |
|---|---|---|
| Farms Planting Cotton And Holding Cotton Base (contract payment crop planting equals crop base) | Category B1 | Included in Category 1 |
| Farms Planting Cotton And Holding Cotton Base (contract payment crop planting falls short of crop base) | Category B2 | Included in Category 1 |
| Farms Planting Cotton And Holding Cotton Base (contract payment crop planting exceeds crop base) | Category B3 | Included in Category 1 |
| Farms Planting Cotton But Not Holding Cotton Base | Category C | Category 3 |
| Farms Not Planting Cotton But Holding Cotton Base | not requested, but erroneously included in Category A | Category 2 |

[24] Any possible distortion stemming from slightly higher or lower contract yields in Categories A, B1, B2 and B3 than the average contract yield that was reported for category 1 farms in the 28 January 2004 summary data is due to the failure of the United States to provide more specific information.

[25] 85 per cent of the product of base acres and contract yields (using the applicable contract yields).

[26] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 17).

[27] For details of the calculations, see Exhibit Bra-433 ('Calculations Acreage Based Methodologies.xls').

[28] As in previous calculations (*see* Brazil's 28 January 2004 Data Comments, Section 9 and 10; Brazil's 18 February 2004 Data Comments, Annex A), market loss assistance payments have been calculated by adjusting the PFC payment according to the ratio of total upland cotton market loss assistance payments to total upland cotton PFC payments (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). The United States has never criticized this approach and, in fact, confirmed its accuracy in paragraphs 8-9 of its 3 March 2004 response to the 3 February 2004 Request by the Panel.

[29] *See* Brazil's 20 January 2004 Answers to Questions, paras. 43-55; Brazil's 28 January 2004 Data Comments, Section 9 and Brazil's 18 February 2004 Data Comments, paras. 50-51, Section 6 and Annex A.2.

[30] For instance, Brazil has deducted the amount of upland cotton base held by farms that hold upland cotton base but do not produce upland cotton (as provided by the United States on 28 January 2004) from the amount of upland cotton base held by Category A farms (as provided by the United States in 3 March 2004). A similar deduction has been applied to base and planted acres for each crop for which such data was available in the 28 January 2004 US summary data.

provided by the 28 January 2004 summary data[31], and the payment rates[32] to calculate the amount of contract payments by category of farms.[33] Brazil recalls that its methodology allocates for each acre planted to a contract payment crop payments associated with one base acre of that crop – as available. All further contract payments not allocated to their respective contract payment crop are pooled and allocated proportionally to the planted acres of contract payment crops to which no contract payments have been assigned under the first step.[34]

17. For the purposes of Brazil's methodology, Brazil treats soybeans as a non-contract payment crop for purposes of MY 1999 and 2000 market loss assistance payments[35] and peanuts as a non-contract payment crop for purposes of MY 2002 direct and counter-cyclical payments. This treatment follows from Brazil's inability to correct the Category A data concerning soybean and peanut plantings, discussed above.[36] In addition and as discussed above, Brazil has not been able to allocate any MY 1999-2000 soybean market loss assistance payments or MY 2002 peanut direct and counter-cyclical payments because no data on these payments has been provided. Accordingly, soybeans and peanuts neither receive contract payment allocations, nor are soybean and peanut contract payments allocated for the relevant marketing years.

18. The details of Brazil's calculations are presented (by farm category) in electronic form as Exhibit Bra-433 ('Calculations Acreage Based Methodologies.xls'). Brazil applied the very same calculation methodology as in its 28 January 2004 Data Comments and in its 18 February 2004 Data Comments.[37] This methodology is not entirely identical to Brazil's 20 January 2004 discussion of its methodology, which anticipated the use of farm-specific data that was never produced by the United States.[38] Thus, certain adjustments, documented in Brazil's 28 January 2004 Data Comments, were necessary.[39]

19. The table below shows the results of Brazil's calculations.

| **Brazil's Methodology**[40] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[41] | Direct Payments | CCP Payments |
| 1999 | $501,450,663 | $499,008,534 | - | - |
| 2000 | $478,926,663 | $509,833,219 | - | - |
| 2001 | $385,723,950 | $529,409,157 | - | - |
| 2002 | - | - | $421,367,874 | $869,470,827 |

[31] *See* above discussion in the context of the "Cotton-To-Cotton" Methodology and Section II.

[32] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 17).

[33] Brazil has used the following files: 'PFC1999W.xls', 'PFC2000W.xls', 'PFC 2001W.xls' and 'DCP2002W.xls' as provided by the United States on 3 March 2004.

[34] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[35] Brazil recalls that the United States has informed Brazil and the Panel that there were no such soybean payments in MY 2001. *See* US 3 March 2004 Response to the 3 February 2004 Request by the Panel, para. 10.

[36] *See* also the more detailed discussed in the context of the Modified Annex IV Methodology, below.

[37] Brazil's 28 January 2004 Data Comments, Section 9 and Brazil's 18 February 2004 Data Comments, paras. 50-51, Section 6 and Annex A.2.

[38] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[39] *See* Brazil's 28 January 2004 Data Comments, Section 9.

[40] For details of the calculations, see Exhibit Bra-433 ('Calculations Acreage Based Methodologies.xls').

[41] As in previous calculations (*see* Brazil's 28 January 2004 Data Comments, Section 9 and 10; Brazil's 18 February 2004 Data Comments, Annex A), market loss assistance payments have been calculated by adjusting the PFC payment according to the ratio of total upland cotton market loss assistance payments to total upland cotton PFC payments (Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). The United States has never criticized this approach and, in fact, confirmed its accuracy in paragraphs 8-9 of its 3 March 2004 response to the 3 February 2004 Request by the Panel.

20. The differences between results of the "Cotton-To-Cotton" Methodology and Brazil's Methodology result from the fact that under Brazil's Methodology a limited amount of non-upland cotton contract payments is allocated as "support to upland cotton." However, the great majority of upland cotton is planted on farms holding upland cotton base acres and their amount of upland cotton base acres closely tracks their amount of upland cotton planted acres. Thus, upland cotton contract payments account for the great majority of contract payments allocated even under Brazil's methodology. The following table presents, by marketing year, the amount of upland cotton planted acres for which there exists a corresponding upland cotton base acre farm category.

| Ma**rketing Year**[42] **Category**[43] | **MY 1999** | **MY 2000** | **MY 2001** | **MY 2002** |
|---|---|---|---|---|
| | ---- acres ---- | | | |
| A | 4,548,886 | 4,386,073 | 4,146,352 | 5,997,438 |
| B1 | 87,034 | 94,377 | 78,075 | 166,619 |
| B2 | 2,412,580 | 2,389,053 | 2,173,819 | 2,035,335 |
| B3 | 3,570,724 | 3,906,688 | 4,125,899 | 3,220,762 |
| C | 0 | 0 | 0 | 0 |
| Total | 10,619,224 | 10,776,191 | 10,524,145 | 11,420,154 |
| Total Planted Acres | 14,572,963 | 15,388,028 | 15,463,934 | 13,541,506 |
| Percentage | 72.87 per cent | 70.03 per cent | 68.06 per cent | 84.33 per cent |

*Modified US Annex IV Methodology*[44]

21. In applying the first value-based methodology, the Modified Annex IV Methodology, to the new 3 March 2004 US summary data, Brazil again corrected for the over-inclusiveness of Category A and applied contract payment yields, as provided by the 28 January 2004 summary data, and the contract payment rates to calculate the total amount of contract payments by category of farms.[45]

22. Brazil was required to exclude soybeans[46] and peanuts from the allocation calculations under this methodology[47] (as well as under Brazil's Methodology) for the following reasons: First, since the United States did not provide data on soybean and peanut plantings with its 28 January 2004 summary data, Brazil is unable to correct these data items in the US 3 March 2004 Category A summary data.[48] There were three theoretical options available to Brazil to address this problem. First, Brazil could have left in Category A all farms which were included by the United States, but which do not produce upland cotton. This approach would have resulted in distortions because considerable amounts of extra contract payments received by farms not producing upland cotton as well as unknown amounts of extra contract payment crop value generated by these non-upland cotton producing farms would be included in the calculations. Or, second, Brazil could have corrected the over-inclusiveness of

[42] Brazil has used the following files: 'PFC1999W.xls', 'PFC2000W.xls', 'PFC 2001W.xls' and 'DCP2002W.xls' as provided by the United States on 3 March 2004.

[43] For Category A farms, Brazil has used the amount of upland cotton planted acres, since on those farms upland cotton base acres exceed upland cotton base acres. For the three Categories B1, B2 and B3, Brazil has used upland cotton base acres since for those farms upland cotton planted acres exceed upland cotton base acres. Finally, for Category C farms, Brazil has used "0," since those farms have no upland cotton base acres.

[44] Brazil has discussed this methodology in paragraphs 50-51 and in Annex A.3 of its 18 February 2004 Data Comments.

[45] *See* above discussion in the context of the "Cotton-To-Cotton" Methodology and in Section II.

[46] This exclusion of soybeans does not apply to MY 2002, for which complete summary data is available.

[47] Consequently, Brazil has used to following files as the basis for its calculations: 'PFC1999W.xls', 'PFC2000W.xls', 'PFC 2001W.xls' and 'DCP2002W.xls' as provided by the United States on 3 March 2004.

[48] This correction of course concerns the amount of soybean and peanut acreage planted by farms that do not produce upland cotton.

Category A for all data items that it could correct leaving the additional soybean and peanut acreage from non-upland cotton producing farms in the pool. This approach would have resulted in distortions because unknown amounts of extra value of soybean and peanut production from non-upland cotton producing farms would be included in the calculations. To avoid these distortions, Brazil has selected the third option – to exclude soybeans and peanuts from the allocation. This choice enables Brazil to correct the Category A data for the inclusion of farms not producing upland cotton, in the manner described above[49], and to proceed with its calculations.

23. Second, Brazil notes that the United States distinguishes the soybean market loss assistance and peanut direct and counter-cyclical payments in MY 1999, 2000 and 2002 as being producer-based rather than farm-based payments. But, the United States never provided information on the amount of these payments. However, payments received by producers of these crops that also owned upland cotton producing farms (to which all other contract payments were made) would need to be considered for any allocations methodology (except the "Cotton-To-Cotton" Methodology).

24. No doubt Brazil's choice not to include soybean and peanut planted acreage and soybean market loss assistance and peanut direct and counter-cyclical payments leads to distortions. These are unavoidable given the incorrect US reading of the definition of Category A farms. However, Brazil believes that these distortions are relatively minor. Brazil has excluded payments stemming from soybean market loss assistance and peanut direct and counter-cyclical payments[50] as well as the crop value of soybean (for MY 1999-2001) and peanut (for MY 2002) production.[51] Thus, soybeans and peanuts do not contribute contract payments to the pool of payments allocated over the value of the entire contract payment crop production of upland cotton producing farms. But, there are also no contract payments being allocated to soybeans and peanuts for these years. This minimizes distortions by roughly cancelling out over and under-counting effects from their exclusion from the calculation. Brazil notes that, for other crops, the amount of crop plantings and crop payment base is fairly proportionate.[52] Soybeans and peanuts in all likelihood follow a similar pattern. In excluding these crops entirely from the calculations, Brazil minimizes the distortions resulting from the shortcomings of the 3 March 2004 US summary data, based on the assumption that these crops would contribute an equal (or very similar) amount of contract payments to the pool, as they would be allocated based on their share of the total value of contract payment crop production.

25. As in its 18 February 2004 calculations, Brazil calculated, by category of farm, the value of each contract payment crop produced on farms that make up the category. Brazil multiplied the amount of planted acreage times the yield[53] and times the per unit price of the particular crop.[54] Total contract payments for each category of farm were then allocated to upland cotton according to the share of the upland cotton crop value of the total value of contract payment crop production on the farms of that category. The details of Brazil's calculations are presented (by farm category) in electronic form as Exhibit Bra-434 ('Calculations Value Based Methodologies.xls').

26. The table below shows the resulting support to upland cotton under this methodology.

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[49] *See* Section II above.

[50] For which the United States has not provided any payment information.

[51] For which Brazil is not able to correct the Category A data given the respective data items missing in the 28 January 2004 US summary data.

[52] Compare crop base and crop plantings as reported by the US 3 March 2004 summary data ('PFC1999W.xls', 'PFC2000W.xls', 'PFC 2001W.xls' and 'DCP2002W.xls').

[53] Brazil notes that similar to its 18 February 2004 calculations it has used yields on planted acres for upland cotton and yields on harvested acres for all other contract payment crops, thereby overstating the latter's value and leading to understated allocations of contract payments to upland cotton. *See* Brazil's 18 February 2004 Data Comments, para. 73 and Annex A.3, notes to Tables 3.5-3.8 for further explanation and references to the data.

[54] Exhibit Bra-420 (Agricultural Outlook Tables, USDA, November 2003, Table 17). Brazil notes that the cover page of this exhibit appears to be wrong. The table is, however, correct.

| Modified Annex IV Methodology[55] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[56] | Direct Payments | CCP Payments |
| 1999 | $562,922,665 | $560,181,159 | - | - |
| 2000 | $540,877,974 | $575,782,432 | - | - |
| 2001 | $394,791,930 | $541,855,031 | - | - |
| 2002 | - | - | $462,037,836 | $771,636,204 |

Brazil notes that these allocations are conservative. Absent data on yields per planted acre for any non-upland cotton crop, Brazil applied yields on harvested acres to calculate the amount of crop produced from all planted acres, thereby ignoring abandonment. This calculation leads to overstating the value of non-upland cotton crop production by overstating the amount of such production. By contrast, the value of the upland cotton crop has been calculated by using yields on planted acres, providing an accurate estimate.[57] Thus, Brazil's calculations overstate the value of non-upland cotton contract payment crops produced in each of the farm categories, resulting in lower allocations to upland cotton.

*US Annex IV Methodology*

27. Brazil could not perform any updated calculations under this methodology based on the 3 March 2004 US summary data. The reason is that Brazil could not exclude from Category A data those farms that do not produce upland cotton.[58] The US Annex IV Methodology would necessitate adjusting Category A data, *inter alia*, concerning planted soybeans acreage in MY 1999-2001 and peanut acreage in MY 2002. However, no such planted acreage data is available in the 28 January 2004 US summary data and, therefore, no such adjustment to Category A can be performed.

28. Further, for MY 2002, the 3 March 2004 US summary data provides more specific data items, including acreage data for fruits and vegetables, ELS cotton, tobacco and peanuts for all categories of farms. However, because these data items were also not provided in the 28 January 2004 US summary data, Brazil cannot correct the over-inclusiveness of Category A for these data items. In addition, the United States appears to have included more acreage in its "All Other Use Acres" than simply cropland. The sum of all non-contract payment crop acres in the 3 March 2004 US summary data exceeds the additional cropland as reported in the 28 January 2004 US summary data. This again

[55] For details of the calculations, see Exhibit Bra-434 ('Calculations Value Based Methodologies.xls').

[56] As in previous calculations (*see* Brazil's 28 January 2004 Data Comments, Section 9 and 10; Brazil's 18 February 2004 Data Comments, Annex A), market loss assistance payments have been calculated by adjusting the PFC payment according to the ratio of total upland cotton market loss assistance payments to total upland cotton PFC payments (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). The United States has never criticized this approach and, in fact, confirmed its accuracy in paragraphs 8-9 of its 3 March 2004 response to the 3 February 2004 Request by the Panel.

[57] *See* Brazil's 18 February 2004 Data Comments, para. 73 and Annex A.3, notes to Tables 3.5-3.8 for further explanation and references to the data.

[58] As long as only data concerning contract payment crops was relevant (excluding soybeans and peanuts under the Modified Annex IV Methodology), such an exclusion could be performed based on the 28 January 2004 US summary data, that provided congruous base and planted acreage summary information for these contract payment crops on farms that are now erroneously included in Category A. This allowed for deducting the base and planted acreage summary data for contract payment crops on farms that hold upland cotton base but do not produce upland cotton from the identical summary data items in Category A of the 3 March 2004 US summary data. For instance, Brazil has deducted the amount of upland cotton base held by farms that hold upland cotton base but do not produce upland cotton (as provided by the United States on 28 January 2004) from the amount of upland cotton base held by Category A farms (as provided by the United States in 3 March 2004). A similar deduction has been applied to base and planted acres for each crop for which such data was available in the 28 January 2004 US summary data.

precludes an adjustment of this data item in Category A for its over-inclusiveness, since the 28 January 2004 and the 3 March 2004 sets of summary data do not appear to be congruous.

29. Once more, the inability to exclude the non-upland cotton producing farms from Category A is important, because including a large number of farms that do not produce upland cotton in the allocation calculations would add a large potential for distortions given the significant amounts of plantings and contract payment crop base by these farms.

30. Further, while the 28 January 2004 US summary data provided information on the amount of non-contract payment crop acreage for MY 1999-2001, the 3 March 2004 US summary data fails to do so. Thus, for those marketing years and for purposes of the US Annex IV Methodology, Brazil could not rely on the 3 March 2004 US summary data and categorization of upland cotton farms at all, since the 3 March 2004 US summary data does not contain any information on the plantings of non-contract payment crops on these farms. For purposes of the US Annex IV Methodology, Brazil, however, needs to rely on planting data for non-contract payment crops to estimate the value of their production on upland cotton producing farms – data such as that provided by the United States in its 18/19 December 2003 and 28 January 2004 data submissions. Thus, Brazil's 18 February 2004 US Annex IV Methodology results based on the 28 January 2004 US summary data are more accurate than any calculations that could be performed based on the 3 March 2004 US summary data or some adjusted version thereof. Therefore, Brazil reproduces below its 18 February 2004 results applying the US Annex IV methodology to the 28 January 2004 US summary data.

Annex A.4 Table 4.8[59]

| **US Annex IV Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $440,061,035.8 | $437,917,881.4 | - | - |
| 2000 | $432,996,788.7 | $460,939,354.1 | - | - |
| 2001 | $304,243,319.2 | $420,222,029.1 | - | - |
| 2002 | - | - | $383,057,256.1 | $640,389,168.2 |

Brazil notes that these allocations are conservative for two reasons: (1) the calculations overstate the value of non-upland cotton contract payment crops, as discussed in the context of the Modified Annex V Methodology; and (2) the calculations do not account for soybean market loss assistance payments in MY 1999-2000 and peanut direct and counter-cyclical payments in MY 2002.[60]

## IV. THE UNITED STATES MY 1999-2002 SUPPORT TO UPLAND COTTON EXCEEDS THE MY 1992 SUPPORT TO UPLAND COTTON UNDER ANY METHODOLOGY

31. In the previous Section, Brazil has updated its 18 February 2004 calculations of the support to upland cotton applying various acreage- and value-based allocation methodologies. In this Section, Brazil combines its results with data on the amount of support to upland cotton from the other support programmes, and provides the Panel with summary tables for each of the 1999-2002 marketing years comparing the support to upland cotton in those marketing years with the MY 1992 level of support to upland cotton.

[59] *See* Annex A.4 of Brazil's 18 February 2004 Data Comments.

[60] Brazil's 18 February 2004 Data Comments, para. 52 and note 75 thereto as well as Annex A.4, para. 40. While the missing soybean and peanut contract payments could be corrected for by excluding these crops from any allocations under the previous three methodologies, soybeans and peanuts are a firm part of the allocation calculations under the US Annex IV Methodology because they are part of the overall farm's revenue. They were included in Brazil's 18 February 2004 calculations based on the US 28 January 2004 summary data. Thus, it is only the payment data that remains missing from these calculations resulting in understating the amount of contract payments allocated to upland cotton.

32. As Brazil discussed in its 18 February 2004 Data Comments, Article 13(b)(ii) of the Agreement on Agriculture endorses no particular methodology. Thus, the Panel needs to choose a reasonable methodology for allocating contract payments as support to upland cotton.[61] Brazil favours its methodology, based on an allocation pursuant to the acreage planted to contract payment crops, but also provides results under the Cotton-To-Cotton Methodology (similarly based on an acreage comparison), as well as two value-based methodologies.

33. However, Brazil strongly urges the Panel to apply an acreage-based methodology – preferably Brazil's Methodology. A particular flaw in a value-based methodology is that allocating counter-cyclical payments over the value of crop production means that allocations for a crop will decrease if prices for that crop fall.[62] Thus, at the time when counter-cyclical payments are "critically needed"[63] to offset low prices for a crop, a value-based methodology would allocate these counter-cyclical payments increasingly as support to other crops, whose prices have not fallen. Using a value-based allocation methodology shifts the share of counter-cyclical payments that are allocated to the crop with falling prices away from that crop and to crops with increasing or constant prices. By contrast, allocating contract payments over the acreage planted to contract payment crops – as done by the "Cotton-To-Cotton" Methodology and by Brazil's Methodology – provides an allocation approach that reflects the economic reality and intention behind the counter-cyclical payment support.

34. But Brazil emphasizes that, on the facts of this case, and using whichever methodology the Panel may ultimately choose, the US MY 1999-2002 support to upland cotton exceeds the MY 1992 level in each year and under each methodology (with the exception of the "Cotton-To-Cotton" and the US Annex IV Methodology in MY 2000).[64]

35. The following four tables present the peace clause comparisons for MY 1999-2002. The table below presents Brazil's peace clause comparison for MY 2002.

[61] Brazil's 18 February 2004 Data Comments, paras. 33-42.

[62] Suppose that a farm produces in two consecutive years the same amount of upland cotton and rice. The value of both crops is 50 in the first year leading to an allocation of half of the contract payments received by that farm. In the second year, prices for upland cotton fall to half their pervious level, while rice prices remain the same. Thus, the same amount of upland cotton is only worth 25 in the second year with the value of the rice crop remaining at 50. It follows that upland cotton receives a third of the contract payments allocations (its value is 25 out of a total crop value of 75) and rice receives two thirds of the contract payment allocations. The same principle would apply if rice prices had fallen by half with upland cotton remaining constant. In this case rice would receive an allocation of a third of the contract payments while upland cotton would receive two thirds of the contract payments allocations. In both cases the crop whose price is falling receives a smaller share of the support, contrary to the counter-cyclical (not pro-cyclical) approach of the payments involved.

[63] Exhibit Bra 111, ("The Six Year World Outlook for Cotton and Peanuts: Implications for Production and Prices," Bob McLendon, National Cotton Council, p.1).

[64] Brazil recalls that given the manner in which the United States presented its 3 March 2004 summary data, Brazil was prevented to provide an updated US Annex IV Methodology calculation based on the 3 March 2004 US summary data. *See* Section III, above. Further, neither of the two methodologies captures all support to upland cotton with the "Cotton-To-Cotton" Methodology not capturing any non-upland cotton contract payments that constitute support to upland cotton and the US-Proposed Annex IV Methodology suffering from various data problems, including the non-availability of data on soybean market loss assistance payments for that year.

Budgetary Outlays For Upland Cotton MY 1992 and MY 2002[65]

| Year | 1992 | 2002 (1) | 2002 (2) | 2002 (3) | 2002 (4) |
|---|---|---|---|---|---|
| Programme | ----- $ million ----- | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none |
| Direct Payments | none | 391.8 | 421.4 | 462.0 | 383.1 |
| CCP Payments | none | 865.0 | 869.5 | 771.6 | 640.4 |
| Marketing Loan Gains and LDP Payments[66] | 866 | 898 | 898 | 898 | 898 |
| Step 2 Payment | 207 | 415 | 415 | 415 | 415 |
| Crop Insurance | 26.6 | 194.1 | 194.1 | 194.1 | 194.1 |
| Cottonseed Payments | none | 50 | 50 | 50 | 50 |
| Total | 2,117.0 | 2,813.9 | 2,848.0 | 2,790.7 | 2,580.6 |

(1) Cotton-To-Cotton Methodology
(2) Brazil's Methodology
(3) Modified Annex IV Methodology
(4) US Annex IV Methodology (based on 28 January 2004 US summary data)

36. The table below presents Brazil's peace clause comparison for MY 2001.

Budgetary Outlays For Upland Cotton MY 1992 and MY 2001[67]

| Year | 1992 | 2001 (1) | 2001 (2) | 2001 (3) | 2001 (4) |
|---|---|---|---|---|---|
| Programme | ----- $ million ----- | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none |
| PFC Payments | none | 329.6 | 385.7 | 394.8 | 304.2 |
| MLA Payments | none | 425.4 | 529.4 | 541.9 | 420.2 |
| Marketing Loan Gains and LDP Payments[68] | 866 | 2,609 | 2,609 | 2,609 | 2,609 |
| Step 2 Payment | 207 | 196 | 196 | 196 | 196 |
| Crop Insurance | 26.6 | 262.9 | 262.9 | 262.9 | 262.9 |
| Cottonseed Payments | none | none | none | none | none |
| Total | 2,117.0 | 3,849.9 | 3,983.0 | 4,004.6 | 3,792.3 |

(1) Cotton-To-Cotton Methodology
(2) Brazil's Methodology
(3) Modified Annex IV Methodology
(4) US Annex IV Methodology (based on 28 January 2004 US summary data)[69]

[65] The table below includes the updated contract payment allocations to upland cotton and otherwise reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission as updated by paragraph 8 of Brazil's 22 December 2003 Answers to Questions and paragraphs 12-14 of the US 22 December 2004 Answers to Questions. Step 2 and marketing loan payments have been updated in light of the US answer to Question 196. *See* US 22 December 2004 Answers to Questions, para. 12.

[66] "Other Payments" have been included in the marketing loan figures.

[67] The table below includes the updated contract payment allocations to upland cotton and otherwise reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission.

[68] "Other Payments" have been included in the marketing loan figures.

[69] *See* Brazil's 18 February 2004 Data Comments, Annex A.4 Table

37. The table below presents Brazil's peace clause comparison for MY 2000.

Budgetary Outlays For Upland Cotton MY 1992 and MY 2000[70]

| Year | 1992 | 2000 (1) | 2000 (2) | 2000 (3) | 2000 (4) |
|---|---|---|---|---|---|
| Programme | ----- $ million ----- | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none |
| PFC Payments | none | 411.8 | 478.9 | 540.9 | 433.0 |
| MLA Payments | none | 438.3 | 509.8 | 575.8 | 460.9 |
| Marketing Loan Gains and LDP Payments[71] | 866 | 636 | 636 | 636 | 636 |
| Step 2 Payment | 207 | 236 | 236 | 236 | 236 |
| Crop Insurance | 26.6 | 161.7 | 161.7 | 161.7 | 161.7 |
| Cottonseed Payments | none | 185 | 185 | 185 | 185 |
| Total | 2,117.0 | 2,068.8 | 2,207.4 | 2,335.4 | 2,112.6 |

(1) Cotton-To-Cotton Methodology
(2) Brazil's Methodology
(3) Modified Annex IV Methodology
(4) US Annex IV Methodology (based on 28 January 2004 US summary data)

38. The table below presents Brazil's peace clause comparison for MY 1999.

Budgetary Outlays For Upland Cotton MY 1992 and MY 1999[72]

| Year | 1992 | 1999 (1) | 1999 (2) | 1999 (3) | 1999 (4) |
|---|---|---|---|---|---|
| Programme | ----- $ million ----- | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none |
| PFC Payments | none | 434.9 | 501.5 | 562.9 | 440.1 |
| MLA Payments | none | 432.8 | 499.0 | 560.2 | 437.9 |
| Marketing Loan Gains and LDP Payments[73] | 866 | 1,761 | 1,761 | 1,761 | 1,761 |
| Step 2 Payment | 207 | 422 | 422 | 422 | 422 |
| Crop Insurance | 26.6 | 169.6 | 169.6 | 169.6 | 169.6 |
| Cottonseed Payments | none | 79 | 79 | 79 | 79 |
| Total | 2,117.0 | 3,299.3 | 3,432.1 | 3,554.7 | 3,309.6 |

(1) Cotton-To-Cotton Methodology
(2) Brazil's Methodology
(3) Modified Annex IV Methodology
(4) US Annex IV Methodology (based on 28 January 2004 US summary data)

[70] The table below includes the updated contract payment allocations to upland cotton and otherwise reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal.

[71] "Other Payments" have been included in the marketing loan figures.

[72] The table below includes the updated contract payment allocations to upland cotton and otherwise reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission.

[73] "Other Payments" have been included in the marketing loan figures.

39. In sum, the contract payment data provided by the United States on 3 March 2004 (as well as the data provided on 28 January 2004) demonstrates that the United States' support to upland cotton in MY 1999-2002 exceeds the support to upland cotton decided by the United States in MY 1992, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture. The results using any allocation methodology applying any set of US summary data[74] demonstrates their robustness.

[74] *See* Brazil's results in its 28 January 2004 and 18 February 2004 Data Comments.

# ANNEX I-27

## BRAZIL'S COMMENTS ON US 3 MARCH 2004 ANSWER TO QUESTION 264(B)

10 March 2004

**264. (b) Does the US agree with the statement in paragraph 135 of Brazil's 28 January 2004 comments on US responses to questions that the difference between the $1,148 billion in the chart at para. 165 of Brazil's 11 August answers to questions and the $666 million amount in Exhibit US-128 ($1.75 billion) closely corresponds to the total "Claims rescheduled" figure reported by the US in Exhibit US-128 (column F)?**

**Brazil's Comment:**

1. The United States acknowledges, in paragraph 3 of its 3 March 2004 response, that the difference referred to in the Panel's question arises because the United States treats the principal amounts of rescheduled defaults as an immediate, 100 per cent recovery that is passed through as a dollar-on-dollar reduction from the amount of claims outstanding in the year the terms of the rescheduling are agreed.[1]

2. In paragraph 1 of its response, the United States argues that the Brazilian conclusion included in the Panel's question results from Brazil's comparison of *fiscal year* data provided by Brazil with *cohort-specific* data provided by the United States. In fact, as explained at paragraph 34 of Brazil's 18 February 2004 Comments and illustrated in Exhibit Bra-431, Brazil reaches the same conclusion with a comparison of 1993-2002 *fiscal year* data provided by Brazil with 1993-2002 *fiscal year* data provided by the United States.[2]

3. In paragraph 2 of its response, the United States asserts, citing undocumented "[a]ccounting research within the US Government," that "a significant portion" of principal collected on reschedulings "has not been reflected" in US budget line 88.40, tracked in column 2(a) of Exhibit Bra-431, despite the United States' acknowledgement that "[a]s a theoretical matter such 'recovered principal' should be reflected in budget line 88.40". As the party asserting this fact, the United States bears the burden of proving it (particularly here, where it is addressing a line item from its own budget).[3]

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[1] For Brazil's views on this aspect of the US cash-basis accounting methodology for making an assessment under item (j), s*ee* Brazil's 18 February 2004 Comments, paras. 34-40; Brazil's 28 January 2004 Comments, paras. 134-137; Brazil's 11 August 2003 Answers, para. 162; Brazil's 22 July 2003 Oral Statement, para. 122.

[2] Exhibit US-147 also lists (undocumented) data for fiscal years 1992, 2003 and 2004. Including the additional revenue and expense figures for these years does not change the fact that revenue for the CCC export credit guarantee programmes fails to cover the costs and losses of the programs. Exhibit US-147 alleges additional revenue of $38.5 million for 1992, $185.6 million for 2003, and $35.4 million for 2004; and additional costs and losses of $3 million for 1992, $130.1 million for 2003, and $22.8 million for 2004. Accounting for this data (($38.5 + $185.6 + $35.4) – ($3 + $130.1 + $22.8) = $103.6 million) would bring the total net costs and losses down from $1.083 billion, arrived at in Exhibit Bra-431, to $979.4 million.

[3] *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof."). Moreover, Brazil again notes that the United States

4. Each and every figure used in Brazil's cash-basis accounting methodology for making an assessment under item (j) represents actual (as opposed to estimated) data from official US documents that Brazil has provided to the Panel.[4] The United States has not even *cited* to any documentary support for the figures it has provided in Exhibit US-147 or US-148, let alone *provided* those documents for the Panel's review.

5. Thus, it is impossible for Brazil or the Panel to verify, for example, whether the CCC has, as the United States asserts at paragraph 2, recovered $205 million of the principal on its reschedulings. Moreover, this figure conflicts with other data provided by the United States. In column F of Exhibit US-147, the United States asserts that $1.64 billion of defaulted CCC guarantees have been rescheduled over the period 1992-2003; in Exhibit US-153, the United States asserts that the principal outstanding on these reschedulings amounts to $1.58 billion. Rather than recovering $205 million of the principal on its reschedulings, this data shows that the CCC has recovered only $60 million.

6. In any event, even if the Panel accepts the United States' unsupported assertion that the CCC has recovered $205 million of the principal on its reschedulings, this would not mean that premiums collected for the CCC export credit guarantee programmes meet the operating costs and losses of the programmes. Even if the entire $205 million figure is added to the "claims recovered" column of Brazil's cash-basis accounting calculation (column 2(a) of Exhibit Bra-341) – which by its own admission would be over-crediting the United States for recoveries of the principle on its reschedulings[5] – the result is still that long-term operating costs and losses for the CCC export credit guarantee programmes outpace revenue (not just premiums collected, but all revenue) by $878 million.[6]

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bears the burden, under Article 10.3 of the Agreement on Agriculture, of proving that quantities exported in excess of its reduction commitments have not benefited from export subsidies.

[4] *See* chart included in paragraph 165 of Brazil's 11 August 2003 Answers (reproduced in paragraph 129 of Brazil's 28 January 2004 Comments).

[5] In paragraph 2 of its response, the United States asserts that "a significant portion of" the principal recovered on its reschedulings is not included in line item 88.40 and column 2(a) of Exhibit Bra-341 – not that *none* of the principal recovered is included in that column.

[6] Exhibit Bra-431 shows that the operating costs and losses outpace revenue by $1.083 billion. Deducting the $205 million cited by the United States yields a loss of $878 million by the CCC export credit guarantee programmes.

# ANNEX I-28

## COMMENTS OF THE UNITED STATES ON THE 10 MARCH 2004 COMMENTS OF BRAZIL ON THE US DATA SUBMITTED ON 3 MARCH 2004

(15 March 2004)

**Introduction**

1. The United States thanks the Panel for this opportunity to respond to the 10 March comments filed by Brazil[1] relating to the data submitted by the United States on 3 March 2004, in response to the Panel's supplemental request for information. Brazil's 10 March comments consist primarily of a series of calculations using the US 3 March data in each of the methodologies previously explained by Brazil in its 18 February comments. The United States has previously explained, in filings on 11 February[2] and 3 March[3], that none of these methodologies is pertinent for purposes of the Peace Clause.[4] Therefore, we will not repeat much of that analysis in these comments but rather will refer the Panel, as appropriate, to those previous comments by the United States.

2. Brazil states that, because the US 3 March data "is the best information available before the Panel," Brazil "no longer considers that relying on its '14/16th methodology would be appropriate.'"[5] This means that, by Brazil's own statement, the only methodology that Brazil had brought forward from August 2003 until January 2004 to allegedly demonstrate a breach of the Peace Clause is irrelevant to this dispute. Moreover, it is difficult to reconcile Brazil's concession with its view that the Panel need only apply a "reasonable" methodology to calculate the support to upland cotton since Brazil alleges that the 14/16th methodology produces results that are similar to those under its other (flawed) methodologies.

3. Brazil's disavowal of its 14/16th methodology, however, does highlight the shifting nature of Brazil's Peace Clause arguments on decoupled payments. It may be of use to set out just how and how many times Brazil's theories have changed in this dispute.

4. First, Brazil argued that all payments for upland cotton base acres were "support to upland cotton." For example, in response to Question 41 from the Panel following the first session of the first substantive meeting, Brazil wrote:

> "The only US domestic support measures that Brazil is aware of that would meet the test of being 'support to upland cotton' are *those that it listed* for purposes of calculating the level of support in its First Written Submission. *In the view of Brazil,*

[1] Brazil's Comments on US 3 March 2004 Data (10 March 2004) ("Brazil's 10 March Comments").
[2] Comments of the United States of America on the Comments of Brazil to US Data Submitted on 18 and 19 December 2003 (11 February 2004) ("US 11 February Comments").
[3] Comments of the United States of America on the 18 February 2004, Comments of Brazil (3 March 2004) ("US 3 March Comments").
[4] *Agreement on Agriculture*, Article 13 ("Agreement on Agriculture").
[5] Brazil's 10 March Comments, paras. 2-3.

> *these non-green box domestic support measures are the measures that constitute 'support to' upland cotton* for the purpose of Article 13(b)."[6]

The decoupled measures listed in Brazil's first written submission (paragraphs 144, 148, and 149) were all production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments *for upland cotton base acres only*. Thus, "in the view of Brazil" as of the first session of the first substantive meeting, only these payments were within the Panel's terms of reference.[7]

5. Second, in response to US criticisms, Brazil realized that, on its own terms, the theory that all payments for upland cotton base acres were "support to upland cotton" was not tenable. Brazil's theory ignored the fact that there were fewer acres planted to upland cotton than there were upland cotton base acres, suggesting that payment recipients utilized planting flexibility to plant other crops or nothing at all.

> Thus, following the first session of the first panel meeting, Brazil introduced the so-called 14/16th methodology, which adjusted total expenditures for upland cotton base acres "by the ratio of upland cotton base acres actually planted." In Brazil's words, "only the portion of upland cotton [base] payments that actually benefits acres planted to upland cotton can be considered support to upland cotton."[8]

That is, Brazil amended its theory, arguing that all upland cotton was planted "on" upland cotton base acres.

6. Third, under Brazil's fallacious argument that receipt of decoupled payments was necessary for upland cotton producers to cover their costs, Brazil acknowledged that it was not "necessary" that upland cotton be planted on upland cotton base acres – that is, rice and peanuts base acreage also received payments that would allow these alleged costs to be covered. However, Brazil argued that the facts did not support the notion that upland cotton was "planted on" rice or peanuts base acreage.[9] Rather, through the second session of the Panel's first substantive meeting (that is, after the Peace Clause phase of the dispute had concluded), Brazil continued to insist that "at a minimum a significant majority of upland cotton farmers in MY 2002 were farming on upland cotton base acres."[10]

7. Fourth, however, even Brazil's own evidence indicated that not all upland cotton was planted "on" upland cotton base acres. For example, as a result of pest eradication and adoption of biotechnology, significant acres in the US Southeast previously planted to peanuts, corn, and other crops were newly being planted to upland cotton.[11] Thus, Brazil altered its theory again and argued that "Brazil's methodology assumes that US producers of upland cotton grew upland cotton on upland cotton base acreage," which is "a reasonable proxy, because there will be some upland cotton that is grown on rice (and peanut) base receiving higher payments, and some upland cotton that is grown on, *e.g.*, corn base receiving somewhat lower payments. On average, Brazil's approach would roughly cancel out the over-counting of rice and peanut payments and the under-counting of corn and any other lower-paying programme crop payments."[12]

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[6] Brazil's Answer to Question 41 from the Panel, para. 58 (footnote omitted; italics added).

[7] *See* US Comment on Brazil's Answer to Question 204 from the Panel, paras. 36-39 (providing additional citations) (28 January 2004).

[8] Brazil's Answer to Question 67 from the Panel, para. 130 (table fn. 2-5) (11 August 2003).

[9] *See, e.g.*, Brazil's Rebuttal Submission, para. 32, 38 (22 August 2003).

[10] Brazil's Further Submission, para. 335; *see also id.*, para. 331.

[11] *See* Brazil's Answer to Question 125(7), para. 38 (27 October 2003) ("Testimony from NCC representatives indicated that a number of producers in the south-eastern part of the United States grew upland cotton on corn base acreage during MY1999-2001.") (footnote omitted).

[12] Brazil's Answer to Question 125(8), para. 40 (27 October 2003).

8. Fifth, Brazil suggested in its further rebuttal submission of 18 November 2003, that "the United States has refused to generate information regarding how much and which of the contract payment base acreage was planted to upland cotton."[13] However, Brazil nowhere explained how such an analysis of "how much and which of the contract payment base acreage was planted to upland cotton" could be done. In fact, Brazil suggested that the Panel should request the United States to produce information and that "Brazil would be pleased *to provide the Panel with a precise list of parameters and questions that should be answered* in any such analysis."[14]

9. Brazil, however, did not provide any such "precise list of parameters and questions" until the second panel meeting in December 2003. While Brazil requested certain information through its request in Exhibit BRA-369, Brazil did *not* explain to the Panel or the United States how it proposed to determine the amount of upland cotton acreage "planted on" base acreage for any particular commodity. Indeed, the Panel was compelled on 12 January 2004, to ask Brazil to "submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks."[15]

10. Sixth, Brazil put forward on 20 January 2004, *for the first time* its allocation methodology – that is, after further rebuttal submissions had been filed and as the "serious prejudice" phase (and indeed the dispute settlement proceeding) was concluding. Here, Brazil set out its notion of under- and over-planting of programme crop base acreage, which the United States has criticized and rebutted in a series of filings over the last month.

11. Seventh, however, Brazil did not stop there. On 28 January 2004, in its comments on the US 18 and 19 December 2003, data (the comments that were to have been filed on 20 January), Brazil set forth yet another in-the-alternative methodology, a purported application of that December data to the Subsidies Agreement Annex IV methodology.[16]

12. Eighth, Brazil put forward on 18 February 2004 – that is, in its last substantive filing in this dispute – *two more* in-the-alternative methodologies to calculate the alleged support to upland cotton from decoupled payments. First, it explained a cotton-to-cotton methodology[17] under which only decoupled payments for upland cotton base acres would be deemed support to upland cotton. Second, it introduced a "modified (programme crop only) annex IV methodology"[18] under which decoupled payments would be allocated only to programme crops in the proportions to which they contributed to the value of programme crop production on a farm.

13. Given this never-ending stream of theories of how and to what extent decoupled income support payments could be support to upland cotton, it would appear that Brazil has made any argument that suited its immediate needs to maximize the purported support to upland cotton. There can be no question that Brazil's incessant in-the-alternative argumentation has prejudiced the United States by significantly increasing the burden in evaluating and responding to Brazil's theories.

14. Brazil has argued that "[w]ithout farm-specific data, there [was] no basis to develop, let alone apply, Brazil's methodology. Brazil could only develop a methodology to apply to actual data when

[13] Brazil's Further Rebuttal Submission, para. 50.
[14] Brazil's Further Rebuttal Submission, para. 48 (italics added).
[15] Panel Communication of January 12, 2004 (Question 258).
[16] The United States has elsewhere explained that Brazil has not brought forward evidence and arguments to allow the Annex IV methodology to be applied for purposes of its subsidies claims. *See, e.g.*, US 3 March Comments, paras. 29-35, 45-56.
[17] Brazil's 18 February Comments, para. 46 ("Brazil first presents the results of using a slight variation of Brazil's methodology.").
[18] Brazil's 18 February Comments, para. 50 ("Brazil also applied the revised US summary data to a modified 'Annex IV' methodology allocating total contract payments to farms producing upland cotton over the value of *contract payment* crops produced on these farms.").

it received the EWG data in mid-November, and when it then sought farm-specific data from the United States."[19] In this statement, however, Brazil concedes that it had not developed – because, allegedly, "there [was] no basis to develop" – its methodology until, at the earliest, mid-November 2003.

- It is simply incredible to read that a complaining party should have chosen to challenge payments which, on their face, are not product-specific support to upland cotton, yet not have developed a methodology to determine the amount of the payments it would consider "support to [that] specific commodity" until at least 6 months into the dispute.

- That is, it is rather startling that Brazil, as the complaining party, began this dispute without the evidence, *or even the legal theory*, necessary to sustain its assertions.

Further, we note that, even if Brazil *had* developed its methodology in mid-November, it did not choose to put this methodology forward until 20 January 2004 (eight months into this dispute), in response to the Panel's Question 258.

15. It is precisely this long delay in developing its Peace Clause arguments that led Brazil first to focus solely on payments for upland cotton base acres, and then only six months or more into the dispute to seek to bring in payments for non-upland cotton base acres. As the United States has argued, Brazil did not identify these payments that are not within the Panel's terms of reference[20] and which, if included in this dispute, would prejudice US rights of defence.[21] Furthermore, that Brazil had not crafted its methodology for Peace Clause purposes until six or eight months into this dispute undermines Brazil's Peace Clause interpretation: that is, Brazil has cast and recast its Peace Clause theories in order to find a theory that would result in US support exceeding the 1992 level. As the United States has demonstrated, however, non-product-specific support (whether green box or not) cannot be allocated as "support to a specific commodity" within the ordinary meaning of that phrase and as defined in Article 1(a) of the Agreement on Agriculture.[22] Thus, there is no basis to allocated decoupled income support payments to upland cotton for purposes of Peace Clause. Brazil various theories also rely on a "budgetary outlays" approach, which, for all the reasons the United States has explained previously, is not found in the Peace Clause text and is the wrong approach for Peace Clause purposes.

**Brazil's Attempt to Resurrect a Basis for the Use of Adverse Inferences Is Unsustainable**

16. After stating that the US 3 March data "is the best information available before the Panel" and that "the United States appears to have provided *complete summary base and complete summary planted data covering all crops for which data was requested by the Panel and all farms covered by the Panel's request*,"[23] Brazil nonetheless faults the United States for "certain problems" with the data and argues, in the alternative, that the alleged US "refusal" to provide certain data "would permit the Panel to draw the adverse inferences that this data – if produced – would have shown even higher payments being allocated to upland cotton."[24] Brazil's effort to resuscitate its request for "adverse inferences" to be drawn is misguided. First, in its 13 February letter, Brazil stated that "by producing the complete aggregated information, there would no longer be a need to draw adverse inferences."[25] As noted, Brazil has in its 10 March comments stated that the United States has produced "complete

[19] Brazil's 18 February Comments, para. 84.
[20] US 11 February Comments, paras. 47-50.
[21] *See* US Comments on Brazil's Answer to Question 204 from the Panel, paras. 34-42 (28 January 2004).
[22] *See, e.g.*, US 3 March Comments, paras. 3-16.
[23] Brazil's 10 March Comments, paras. 3-4 (italics added).
[24] Brazil's 10 March Comments, para. 10 fn. 14.
[25] Brazil 13 February 2004, Letter to the Panel, at 5.

summary base and complete summary planted data covering all crops for which data was requested by the Panel and all farms covered by the Panel's request." Therefore, Brazil has implicitly conceded that there is no basis to draw adverse inferences, and its suggestion otherwise is yet another in-the-alternative argument that only serves to add needlessly to the complexity of this dispute.

17. This conclusion is confirmed by examining the data that the United States allegedly "refused" to provide. First, Brazil faults the United States for providing data with respect to farms that had upland cotton base acres but planted no upland cotton within Category A.[26] We note that the Panel's supplementary request for information asked for information on farms with "fewer upland cotton planted acres than upland cotton base acres, or equal numbers of each,"[27] which does not exclude farms with no planted acres from its ambit. Indeed, as Brazil points out, on 28 January 2004, and on 19 December 2003, the United States had provided planted and base acreage information relating to (1) farms that both planted upland cotton and had upland cotton base acres and (2) farms that did not plant upland cotton and had upland cotton base acres.[28] It is not apparent from the text of item (b) of the Panel's supplementary request for information that the Panel was seeking the same information that had previously been provided. Because the United States provided the information requested under item (b) with respect to Category A farms, there is no basis for any adverse inference to be drawn.

18. Second, Brazil argues that the US 3 March data "does not provide contract payment yield or payment[] units." However, Brazil itself immediately concedes that "the Panel's 3 February 2004 Request does not ask for this information."[29] Thus, as the payment yield information was not requested by the Panel, the United States could not have refused to provide it, and there is no basis for any adverse inference to be drawn.[30]

19. Third, Brazil states that "the United States did not produce any information that would allow the calculation of 'producer-based' soybean market loss assistance [that is, "oilseed payments" for soybean producers[31]] and peanut direct and counter-cyclical payments received by producers operating upland cotton farms."[32] However, Brazil does not contest that these payments were made to producers and that there were no base acres for these payments on any farms for the relevant years (soybeans in 1999 and 2000, peanuts in 2002). The United States recalls that the Panel's supplementary request for information related to "farms" with upland cotton base acres and/or upland cotton planted acres.[33] Thus, the Panel's request did not ask for "payments received by producers

[26] Given Brazil's repeated complaints in this dispute, it is ironic that Brazil now, in effect, complains that the United States has provided too much information.

[27] Panel's Supplementary Request for Information, item (b) (3 February 2004).

[28] Brazil's 10 March Comments, para. 6 & fn. 5.

[29] Brazil's 10 March Comments, para. 7.

[30] Brazil's comment that the United States should have provided information on payment units in "good faith" as it did in its data submissions of 18 and 19 December 2004, and 28 January 2004, fails to mention that Brazil's request for data specifically asked for contract yields to be provided. Exhibit BRA-369 (second paragraph, fourth bullet: requesting "payment yield for each programme crop") (3 December 2003). The United States has responded to all requests for data in this dispute in "good faith" by providing all the data (within the limits of US law) requested.

[31] *See, e.g.*, Response of the United States of America to the Panel's 3 February 2004, Data Request, As Clarified on 16 February 2004, paras. 10-13.

[32] Brazil's 10 March Comments, para. 8.

[33] *See* Panel's Supplementary Request for Information, item (b) (first solid bullet: "How many farms had fewer upland cotton planted acres than upland cotton base acres, or equal numbers of each? We refer to these as 'Category A' farms."; second solid bullet: "How many farms had more upland cotton planted acres than upland cotton base acres? We refer to these as 'Category B' farms."; third solid bullet: "How many farms had upland cotton planted acres but no upland cotton base acres? We refer to these as 'Category C' farms.") (3 February 2004).

operating upland cotton farms," and there is no basis to draw an adverse inference from an alleged "failure" to provide information not requested.

20. In sum, Brazil's in-the-alternative renewed request concerning adverse inferences has no basis in fact; either the Panel's supplementary request for information did not request the information or the United States properly responded to the request as drafted. Furthermore, to the extent that Brazil argues that the contract payment yield data or soybeans or peanuts payments received by producers operating upland cotton farms were "necessary" for its Peace Clause analysis, this would demonstrate not that any adverse inference should be drawn but rather that Brazil, as the complaining party bearing the burden of proof, has failed to bring forth evidence to make a *prima facie* case.

**Brazil's Allocation Methodologies Are Irrelevant for Peace Clause Purposes and, in any event, Continue to Suffer from Conceptual and Methodological Flaws**

21. The United States has set forth in other comments the reasons that no allocation methodology may be employed for purposes of a Peace Clause analysis since the only relevant support is "support to a specific commodity" – that is, "assistance" or "backing" "specially pertaining to a particular" "agricultural crop" (in the ordinary meaning of the terms) or "support . . . provided for a basic agricultural product in favour of the producers of the basic agricultural product" (read in the context of the definition of product-specific support in Article 1(a) of the Agreement on Agriculture).[34]

22. Further, we have explained that for purposes of Brazil's serious prejudice claims, the Annex IV methodology[35] would be necessary to identify the subsidy benefit and subsidized product for each of the challenged decoupled income support measures – and Brazil has not brought forward evidence and arguments to allow the Annex IV methodology to be used.[36]

23. Finally, we have previously presented comments on each of Brazil's allocation methodologies.[37] As the calculations in Brazil's 10 March Comments are substantially similar to those it set out earlier, our comments on Brazil's new calculations are limited but also substantially similar to those we have previously provided. In particular, we note that Brazil has simply ignored the US criticisms of its pseudo-"Annex IV" methodology and excluded any sales from fruits and vegetables production, non-crop on-farm activities, and all other off-farm economic activity.

**Cotton-to-Cotton Methodology**

24. The United States has previously set out its criticism of this methodology, under which decoupled payments for upland cotton base acres on a farm that are equal to or less than the number of upland cotton planted acres are deemed to be support to upland cotton. Indeed, Brazil has never responded to the US explanation that "there are no physical 'base acres' on a farm. Crop base acres are an accounting fiction that do not represent any particular acres on a farm."[38] Thus, the very notion that base acres are "planted to" any particular crop (or, conversely, that a crop is "planted on" any particular base acre) is illusory.

25. We do note that the application of this erroneous methodology to the 3 March data does result in significant downwards revisions in the calculations Brazil previously presented, ranging from $58 million (MY2001 PFC) to $122 million (MY2002 CCP).[39]

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[34] *See* US 3 March Comments, paras. 3-16; US 11 February Comments, paras. 7-14.

[35] *Agreement on Subsidies and Countervailing Measures*, Annex IV, paras. 2-3 ("Subsidies Agreement").

[36] *See, e.g.*, US 3 March Comments, paras. 29-35; US 11 February Comments, paras. 18-21.

[37] *See, e.g.*, US 3 March Comments, paras. 36-56; US 11 February Comments, paras. 35-60.

[38] *See, e.g.*, US 3 March Comments, paras. 37-38.

[39] *Compare* Brazil's 10 March Comments, para. 15 *with* Brazil's 18 February Comments, para. 47.

**Brazil's Methodology**

26. Again, the United States has previously set out at length its criticisms of Brazil's methodology. The inconsistencies and logical flaws in this methodology are striking and demonstrate the *post hoc* nature of Brazil's attempt to force an allocation methodology onto decoupled payments. For example:

- There is no physical or economic basis to consider that decoupled payments for base acres of a crop are support to current production of that crop or to other (underplanted) programme crops. Base acres are not physical acres and are not "planted to" anything. A decoupled income support recipient may produce no, one, or multiple products; since money is fungible, those payments in economic terms (but not for purposes of Peace Clause) may be attributed to all (if any) of the recipient's sales.

- Brazil has never examined whether decoupled payments for non-upland cotton base acres "support or maintain" the production of those non-upland cotton programme crops – and thus has demonstrated no basis (on its own theory) for allocating such payments to those crops first.

- Brazil argues that base acres are "planted to" a particular commodity, one-for-one, but has no explanation for how an upland cotton planted acre can also be deemed to be "planted on" multiple base acres at once, as occurs when "underplanted" base acres are totalled and allocated proportionally to all "excess" planted acres (including cotton).[40]

- Brazil has never provided any logical explanation for why decoupled income support payments would be attributed to programme crops but not to other crops or other on-farm or off-farm economic activities (as economics and the Annex IV methodology would suggest is necessary).

- Neither has Brazil attempted to apply its own rationale that decoupled payments are "support to a specific commodity" when such payments "cover (or contribute to) the costs of production" of that commodity[41] to any other product produced by payment recipients, thus invalidating its own methodology, under which payments for base acreage is first support to the crop to which the acreage corresponds and then to other programme crops. Using Brazil's own "cost of production" principle, there is no basis to assert that order of analysis since Brazil has presented no evidence that such payments "cover (or contribute to) the costs of production" of those commodities but not others.

The United States has explored at some length these and other logical inconsistencies in Brazil's purported methodology for allocating decoupled payments to particular commodities. Although there is no basis in the Peace Clause to allocate non-product-specific support as support to a specific

[40] For example, in Exhibit BRA-433, Brazil presents calculations for allocating payments under its methodology for the different categories of farms set out in the Panel's supplementary request for information. For marketing year 2002, Category B2 farms planted 2,703,663 acres of cotton and had 2,035,335 base acres of cotton. Thus, Brazil calculates that there were 668,329 overplanted cotton acres eligible for allocated payments. Base acreage for other programme crops for Category B2 farms exceeded planted acreage for those crops by 1,197,785 acres, and no other programme crop was planted in excess of its base acreage. Thus, Brazil allocated the total payments "free to be allocated" ($21,290,090) from the non-upland cotton base acreage entirely to upland cotton. This means that the 668,329 overplanted cotton acres were "planted on" 1,197,785 "excess" base acres for other programme crops, or each "excess" acre of cotton was "planted on" 1.79 non-upland cotton base acres.

[41] Brazil's 18 February Comments, para. 3.

commodity, we nonetheless invite the Panel to consider these reasons why Brazil's methodology cannot serve as a neutral means to allocate decoupled payments.[42]

27. We also pause to recall that one of Brazil's primary responses to the US criticism that its methodology would result in different subsidization rates for upland cotton on a single farm and would result in the allocation of multiple non-upland cotton base acres per cotton planted acre was that "both of these alleged problems . . . do not exist from MY 2002. This is because Brazil's methodology allocates for each planted acre[] of upland cotton only one upland cotton base acre." Brazil then went on to suggest that because in MY 2002 greater than 99 per cent of direct and counter-cyclical payments received by upland cotton producers were for upland cotton base acres and because upland cotton base exceeded upland cotton planted acreage, "the two main US criticisms affect . . . at most, 0.9 per cent of the payments at issue for MY 2002."[43]

28. However, Brazil's 10 March comments tell quite a different story. There, Brazil calculates "the amount of upland cotton planted acres for which there exists a corresponding upland cotton base acre [by] farm category."[44] The percentage of upland cotton planted acreage for which an upland cotton base acre exists is 72.87 per cent in marketing year 1999, 70.03 per cent in marketing year 2000, 68.06 per cent in marketing year 2001, and 84.33 per cent in marketing year 2002.

- That is, in any given year, approximately 15 to 22 per cent of upland cotton planted acres – between 2.1 million and 4.9 million acres – were allocated payments for non-upland cotton base acres and would be subject to the US criticisms dismissed by Brazil as *de minimis*. Brazil simply ignores this issue in its 10 March comments.

Furthermore, we recall that Brazil stated that "[a]s for some of the US criticisms that might affect the results (except for MY2002), Brazil will control for these effects once the United States provides aggregate data in the manner requested by the Panel."[45] The United States is not aware of any explicit recognition by Brazil of "US criticisms that might affect the results" nor any effort by Brazil in its 10 March comments to "control for these effects."

29. Finally, we note that the application of Brazil's erroneous methodology to the 3 March data again results in significant downwards revisions in the calculations Brazil previously presented, ranging from approximately $43 million (MY2001 PFC) to $120 million (MY2002 CCP).[46]

**Modified US Annex IV methodology**

30. Brazil presents largely unchanged "modified Annex IV" calculations, for example, excluding both soybeans (marketing years 1999 and 2000) and peanuts (marketing year 2002) as a programme crop.[47] Under this "modified Annex IV" methodology, Brazil allocated total contract payments to

[42] *See* US 3 March Comments, paras. 37-44; US 11 February Comments, paras. 35-43; US Comments to Brazil's Answer to Question 258 from the Panel, paras. 207-29 (28 January 2004).

[43] Brazil's 18 February Comments, para. 60.

[44] Brazil's 10 March Comments, para. 20.

[45] Brazil's 18 February Comments, para. 67.

[46] *Compare* Brazil's 10 March Comments, para. 19 *with* Brazil's 18 February Comments, para. 49.

[47] We note that the rice prices used by Brazil in its calculations in Exhibit BRA-434 are incorrect. Brazil has mistakenly divided the average rice farm price, reported in dollars per hundredweight (i.e., 100 pounds), by 220.46 instead of by 100 to obtain a price expressed in dollars per pound.

upland cotton "according to the share of upland cotton crop value of the total value of contract payment crop production."[48] Thus, the US view of this "modified" methodology remains unchanged: Brazil's approach is fundamentally inconsistent with Annex IV, paragraph 2, under which the subsidy is allocated over "the total value of the recipient firm's sales." Furthermore, there is no plausible basis to maintain that decoupled income support payments are support only to contract payment crops. Brazil also improperly includes the total value of contract payments in its calculation when only payments for upland cotton base acres are within the scope of this dispute.

**"US Annex IV Methodology"**

31. Brazil offers no new analysis in its 10 March comments but just repeats the calculations presented in its 18 February filing. Thus, Brazil's "US Annex IV methodology" does not reflect the "US" interpretation of Annex IV, which is based on the text of Annex IV. That text establishes that, if a payment is not "tied to the production or sale of a given product," the subsidized product is all of the recipient firm's sales, and the subsidy for any one product is that product's share of "the total value of the recipient firm's sales."[49] Brazil does not use "the total value of the recipient firm's sales" in its "US Annex IV calculation" and does not even attempt to calculate total sales of upland cotton producers.

32. Because Brazil reiterates its 18 February calculations, Brazil's 10 March calculations are similarly flawed. First, Brazil errs by omitting the value of fruits and vegetables in calculating the total value of non-programme crop production. As the US 3 3 March data shows, in marketing year 2002 alone, 1.2 million acres were planted to fruits and vegetables on farms that reported cotton base acreage.[50] As pointed out in the US comments of 11 February,[51] excluding fruits and vegetables biases significantly downward the value of non-programme crop acreage. For example, the United States estimated the per-acre value of non-programme crops *including* fruits and vegetables was estimated at $281[52] for 2002 – that is, 138 per cent higher than the $118 per acre Brazil calculated when fruits and vegetables are excluded.[53]

33. Brazil suggests that it was not able to make any adjustment to its calculations because of its inability to separate those farms with no planted acres of cotton from Category A. However, Brazil does not explain why it was unable to use the actual planted acreage data, including that for fruits and vegetables, for Category B farms.[54] Nor does Brazil explain why it was unable to use the state-by-state information on plantings to make any adjustment to its use of "the average per-acre value of production of non-programme crops in that marketing year *in the entire United States*."[55]

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| | Brazil 1/ | WASDE 2/ |
|---|---|---|
| MY1999 | $0.027 | $0.0593 |
| MY2000 | $0.025 | $0.0561 |
| MY2001 | $0.019 | $0.0425 |
| MY2002 | $0.019 | $0.0449 |

1/ Exhibit BRA-434
2/ *World Agricultural Supply and Demand Estimates*, available at: http://www.usda.gov/agency/oce/waob/wasde/wasde.htm.

[48] Brazil's 10 March Comments, para. 24.
[49] Subsidies Agreement, Annex IV, paras. 2-3.
[50] *See* file "DCP02-2W.xls" ("Grand Total (Farms A - C)" row).
[51] *See* US 11 February Comments, para. 54.
[52] See Exhibit US-154.
[53] Brazil's 18 February Comments, Annex A, Table 4.5.
[54] Category C farms had no upland cotton base acres and thus received no decoupled payments within the scope of this dispute. To the extent Brazil disagrees, however, the same criticism of Brazil's failure to use the actual planted acreage data applies.
[55] Brazil's 28 January Data Comments, para. 90 (italics added).

34. Further, Brazil has not taken any account of the value of on-farm production other than crops, and has presented no data that would allow that calculation to be made. Again, the 1997 ARMS cotton costs of production survey suggested that, had Brazil taken into account the value of non-crop on-farm production, the share of cotton as a per cent of total farm sales would be lower still. For 1997, when the value of cotton was high, the 1997 ARMS cotton costs of production survey reported that cotton accounted for only 44.5 per cent of the total value of agricultural production on cotton farms.[56]

35. Brazil also fails to include off-farm economic activity, which can be substantial, in its calculation. Annex IV, paragraph 2, establishes that the non-tied subsidy is allocated over "the *total value* of the recipient firm's sales," not merely its *farm* sales. As we have previously noted, cotton operations earn almost 30 per cent of income from off-farm sources.[57]

36. Finally, Brazil continues not to make any adjustment for the fact that landowners capture the subsidy benefit of payments on rented acres. As the United States has noted, Brazil has previously conceded that, as of marketing year 1997, 34 to 41 cents per dollar of production flexibility contract payments were capitalized into land rent.[58] Furthermore, certain missing pages from Exhibit BRA-276 report that, during 1998-2000, the capture by landowners through increased rent of production flexibility contract payments increased to an estimated average of 81 to 83 per cent.[59] Thus, Brazil's own evidence does not support its decision not to adjust the subsidy benefit to upland cotton producers downwards to reflect the two-thirds of cotton acres that are rented by producers, not owned.

**Conclusion: Brazil Can Only Prevail on the Peace Clause Under an Incorrect Interpretation of the Peace Clause**

37. The United States has demonstrated that Brazil's reading of the Peace Clause is not tenable; instead, Brazil invents the concept that non-product-specific support must be allocated to specific commodities. This concept runs directly contrary to the ordinary meaning of the Peace Clause text and directly contrary to its context, including the fundamental separation of product-specific and non-product-specific support in the Agreement on Agriculture.

38. The United States has also demonstrated that Brazil's approach to its "serious prejudice" claims is misguided. As mentioned previously, Brazil's notion that "the effect of the subsidy" may be analyzed without knowing the amount of the challenged subsidy is akin to saying that "the effect of eating" may be determined without knowing how much is being eaten.[60] Of course, to determine "the effect of eating" one must also determine "what" is being eaten (in addition to "how much"); similarly, "the effect of the subsidy" will depend on the nature of the challenged subsidy.[61] Thus, the United States believes that Brazil has failed to make a *prima facie* case with respect to decoupled income support payments (direct and counter-cyclical payments)[62] under its serious prejudice claims because it has not identified either the subsidy benefit or the subsidized product(s) using the Annex IV

[56] US 3 March Comments, para. 50; US 11 February Comments, para. 55.

[57] *See* US 3 March Comments, para. 51.

[58] Brazil's Answer to Question 179 from the Panel, para. 165 (27 October 2003); Brazil's Opening Statement at the Second Panel Meeting, para. 57.

[59] US 3 March Comments, paras. 52-54; Exhibit US-155, at 106.

[60] US 3 March Comments, para. 30 fn. 59.

[61] *See* Subsidies Agreement, Article 7.2 (request for consultations under Article 7.1 "shall include a statement of available evidence with regard to (a) the existence *and nature* of the subsidy in question") (italics added).

[62] Only direct and counter-cyclical payments were measures in existence at the time the Panel was established during marketing year 2002. Both production flexibility contract payments and market loss assistance payments were recurring subsidies paid with respect to past production that had terminated by the time of the panel request and panel establishment.

methodology. In addition, Brazil has failed to establish that the *effect* of these challenged payments is "serious prejudice"; to the contrary, the United States has demonstrated that the effect of these decoupled measures is no more than minimal.[63]

39. Finally, the United States has demonstrated that using any measurement that reflects the support "decided" by the United States – rather than factors (such as market prices) beyond the United States' control – US support to upland cotton in marketing years 1999-2002 has not exceeded the 1992 marketing year level.[64] Brazil's proposed approach suffers from the key flaws (among others) that it relies on the argument that:

(1) budgetary outlays must be used, despite the fact that the United States never "decided" an expenditure level (a point confirmed by Brazil's own reliance on the marketing loan rate and counter-cyclical target price for purposes of its *per se* and threat of serious prejudice claims[65]); and

(2) decoupled income support measures – the green box direct payments and the non-product-specific counter-cyclical payments[66] – can and must be allocated as "support to a specific commodity," despite the ordinary meaning of those terms in their context in the Agreement on Agriculture.

40. That both of these conditions must be met is evident if one examines the four tables setting out Brazil's Peace Clause comparisons.[67]

- For example, even using budgetary outlays, if decoupled income support payments are removed from Brazil's Peace Clause comparisons, *US measures did not breach the Peace Clause in marketing years 2002 and 2000*. The 1992 support would be $2,117.0 million, and the 2002 and 2000 levels would be $1,557.1 million and $1,218.7 million, respectively.[68]

- On the other hand, even if decoupled income support measures were allocated according to any of Brazil's four erroneous methodologies, *US measures did not breach the Peace Clause in marketing year 2001* if a price-gap calculation is used in place of outlays for marketing loan payments. A price-gap calculation eliminates the effect of market prices on the support

[63] *See, e.g.*, US Comments on Brazil's Comments on US Comments Concerning Brazil's Econometric Model, paras. 4-9 (28 January 2004).

[64] *See, e.g.*, US 11 February Comments, paras. 15-17.

[65] *See* Brazil's Further Submission, para. 432 ("The existence of the 72.4 cents per pound support price under the 2002 FSRI Act alone causes production-enhancing and price-suppressing effects. The single fact that these programmes exist ensures a guaranteed revenue amount from the production of upland cotton. This revenue floor is a guaranteed entitlement. That guaranteed revenue floor has the effect of removing any uncertainty and risk about the revenue farmers will receive for the crop. It means that regardless of the actual price development during the marketing year, a farmer knows that he or she will receive at the very least the loan rate for their product, plus price-triggered revenue support granted by the CCP programme.").

[66] Were the Panel to examine the terminated payments prior to the 2002 Farm Act, production flexibility contract payments would be green box, and the market loss assistance payments would be non-product-specific, as notified to the WTO.

[67] Brazil's 10 March Comments, paras. 35-38.

[68] *See* Brazil's 10 March Comments, paras. 35, 37. This calculation ignores the inappropriate inclusion of crop insurance payments (non-product-specific), cottonseed payments (not in existence at time of panel establishment), and "other payments" (not identified in Panel request). We also note that the marketing year 1999 budgetary outlay level would be $2,431.6 million if decoupled support is excluded. Brazil has alleged that some portion of Step 2 payments are prohibited export subsidies, rather than domestic support, and the United States has argued that "other payments" are not within the Panel's terms of reference. The Panel's view of these issues could result in the 1999 budgetary outlay level too being below the 1992 level.

provided.[69] US measures conform to the Peace Clause in marketing year 2001 under two different Brazilian allocation methodologies if a price-gap calculation is used.[70]

- Indeed, even without making any changes to Brazil's data, under two of its current "reasonable" methodologies, US measures did not breach the Peace Clause in 2000, the year with the highest market prices and therefore the lowest marketing loan payments.[71]

41. The United States believes that a proper interpretation and application of the Peace Clause must reflect the way in which the United States "decided" support in marketing years 1992 and 2002[72] – and, in the case of US measures, the support to upland cotton as "decided" was a rate of support. However, the United States has demonstrated that even an AMS calculation that reflects the support decided by the United States rather than market prices beyond our control would also demonstrate that US measures conform to the Peace Clause. Brazil's revised budgetary outlay calculations also support this view.

- If neither condition set out above is met – that is, decoupled income support measures are properly excluded from the Peace Clause analysis and price-based marketing loan payments are calculated using a price-gap methodology – *US measures did not breach the Peace Clause in any marketing year between 1999 and 2002.*

- Support in marketing year 1992 would be $1,384 million,[73] well above the revised support levels are $659.1 million for marketing year 2002, $458.9 million for marketing year 2001, $582.7 million for marketing year 2000, and $670.6 million for marketing year 1999.[74]

- Again, these lower levels of support "decided" in recent years reflects the United States' decision after the Uruguay Round to move away from the product-specific deficiency payments with high target prices and instead to supplement producer income with a mix of decoupled income supports that are green box (direct payments) or non-product-specific (counter-cyclical payments).

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[69] *See* US Rebuttal Submission, paras. 114-17. By holding the external reference price fixed, support measured using a price-gap calculation shows the effect of changes in the level of support (the applied administered price) decided by the United States, rather than changes in outlays that may result from forces beyond our control, such as market prices.

[70] For marketing year 2001, support measured using a price-gap calculation for price-based measures and budgetary expenditures for other payments results in $1,251 million. For methodologies (1) ("cotton-to-cotton") and (4) ("US Annex IV methodology"), support was $1,240.9 million and $1,183.8 million. Again, these calculations do not remove crop insurance payments (non-product-specific), any portion of "Step 2" payments, or "other payments" (not within the scope of the dispute).

[71] Brazil's 10 March Comments, para. 37 (1992 budgetary outlays were $2,117.0 million; 2000 outlays under the cotton-to-cotton methodology were $2,068.8 million; 2000 outlays under the "US Annex IV Methodology" were $2,112.6 million).

[72] The measures (subsidies) provided with respect to marketing years 1999-2001 were no longer in existence at the time of Brazil's panel request and panel establishment. To the extent the Panel were to examine these measures, however, the same analysis would apply.

[73] This figure uses the same $1,017.4 expenditure amount that Brazil used for deficiency payments. This figure is not markedly different from the $1,009 price-gap figure calculated by the United States using eligible acreage, but even if actual payment acreage were used, the price-gap payment total would be $867 million. US Comments on New Material in Brazil's Rebuttal Filings, para. 8 (27 August 2003). Thus, the 1992 level of support would still be higher than in marketing years 1999-2002.

[74] These revised figures exclude decoupled payments and use the price-gap calculation for marketing loan payments, which results in a zero level of support since the marketing loan rate was below the fixed reference price. *See* US Rebuttal Submission, para. 117 & fn. 148 (22 August 2003). However, these revised figures do not even remove crop insurance payments (non-product-specific), any portion of "Step 2" payments (which Brazil alleges are, in part, prohibited export subsidies), or "other payments" (not within the scope of the dispute).

42. Were the Panel to reach the question of serious prejudice or threat thereof, the United States has demonstrated that Brazil has not made a *prima facie* case that the challenged US measures have had that effect. However, the Panel should not even reach that question as the facts demonstrate that the United States has disciplined itself to grant support not in excess of that decided during the 1992 marketing year. Brazil must argue that non-product-specific support can be allocated as support to a specific commodity and must argue that support "decided" means budgetary outlays because without those conditions, it cannot demonstrate a Peace Clause breach. The United States has demonstrated, however, that Brazil's approach is legally unsound and internally inconsistent. It would, moreover, provide no certainty for Members who seek to conform to their WTO obligations. Brazil's constantly shifting methodologies reflect its desire to find an approach to maximize the dollars it could argue are support to upland cotton but do not reflect the legal texts, structure, and concepts found in the Agreement on Agriculture and the Subsidies Agreement.

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**WORLD TRADE ORGANIZATION**

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# UNITED STATES – SUBSIDIES ON UPLAND COTTON

## *Report of the Panel*

Addendum

This addendum contains the Annexes J-O to the Report of the Panel to be found in document WT/DS267/R. Annexes A-H can be found in Add.1 and Annex I can be found in Add.2.

# ANNEX J

## ANSWERS OF THIRD PARTIES TO THE QUESTIONS FROM THE PANEL AND FROM OTHER THIRD PARTIES', AND COMMENTS THERETO

# ANNEX J-1

## REPLIES BY ARGENTINA TO QUESTIONS POSED BY THE PANEL TO THE THIRD PARTIES FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING OF THE PANEL

11 August 2003

**Article 13 of the *Agreement on Agriculture***

**1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions in Article 13 are a "prerequisite" to the availability of a right or privilege? Australia Would other third parties have any comments on Australia's assertion?** 3rd parties, in particular Argentina, Benin, China, Chinese Taipei

Argentina agrees with Australia that Article 13 of the Agreement on Agriculture is an affirmative defence and that in these proceedings the United States therefore carries the burden of proof on the question of whether its subsidies conform with the terms of Article 13.

According to the Appellate Body in *US-Shirts and Blouses*:

> *" … the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption".*[1]

As stated by Brazil in Paragraph 112 of its first written submission, in the case of claims of violation of the positive obligations of the WTO Agreement, it is the complaining party that has the burden of providing a prima facie case of violation. However, in the case of affirmative defences, such as Articles XX and XI:2(c)(i), the Appellate Body itself established that it is only reasonable that the burden of establishing such a defence should rest upon the party asserting it.[2]

According to the standards established by the Appellate Body,[3] Article 13 of the Agreement on Agriculture is a provision in the nature of an affirmative defence. As such, it does not create new obligations for Members, but limits the scope of certain provisions of the SCM Agreement and the GATT 1994 subject to certain conditions. Nor does it alter the legal nature of Members' measures, but simply permits Members to maintain those measures exempt from actions, if the measures meet the conditions specified in Article 13(a), (b) or (c). As Argentina stated in its Third Party Initial Brief:[4]

> *"Argentina considers that the provisions contained in Article 13 of the AoA have an exceptional nature. This would imply that the Member who alleges to be protected by the Peace Clause has the burden of proving the fulfilment of its legal requirements. As long as*

[1] Appellate Body Report, *US – Shirts and Blouses*, WT/DS33/AB/R, p. 14, text at note 16.
[2] *Id.*, p. 16, text preceding note 23.
[3] See paragraphs 113 to 116 of Brazil's First Written Submission.
[4] Argentina's Third Party Initial Brief, paragraph 14.

*the US does not demonstrate prima facie that it fulfils all the conditions that would allow a protection against a claim by virtue of Article 13 of the AoA, the Panel should consider as appropriate the claims under Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement".*

The exceptional nature of Article 13 of the Agreement on Agriculture (AoA) cannot change merely because the conditions justifying it include conformity with rules that create positive obligations for Members (e.g. Article 6 of the AoA). This legal nature comes out clearly in the chapeau of Article 13 of the AoA which begins with the words "*Notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures …*", providing guidance to the effect that the purpose of the entire Article 13 is to create exceptions, subject to certain conditions, to the provisions of the GATT 1994 and the SCM Agreement.

For example the party claiming defence under Article 13 of the AoA clearly must prove, inter alia, that the domestic support measures which it claims should be exempt from actions based on Articles 5 and 6 of the SCM Agreement and Article XVI of the GATT 1994 do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

If Article 13 of the AoA did not exist, any domestic support measure would unquestionably be subject to actions based on Articles 5 and 6 of the SCM Agreement and Article XVI of the GATT 1994. The temporary defence accorded by Article 13 is an exception to that situation, and it is therefore up to the claimant to demonstrate that the conditions permitting such defence have been fulfilled.

Mere reference, as one of the conditions justifying the measure, to conformity with a positive obligation of the AoA, cannot alter the exceptional nature that informs all of Article 13.

**Article 13(b) of the *Agreement on Agriculture*: Domestic Support Measures**

**2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*.** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

Argentina considers that while the term "defined" refers to the need for the base period to be clearly determined in the order authorising the payments, the term "fixed" refers to the need for the base period to be identified in terms which prevent it from being shifted or modified *a posteriori*. The term "fixed" indicates that the payments made in accordance with the criteria stipulated in paragraph 6(a) must always rely on the same base period, and no change is possible.

**3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3.** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

The purpose of the term "a" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture is to establish the obligation for Members to identify a single period, which may cover two, three or more years depending on the Member. For example the base periods established by the EU, the United States and Argentina are different with respect to the payments referred to in paragraph 6(a) of Annex 2. However, although different for each Member – the identification of the period is up to the Members in that it is not specified in the text of the Agreement *per se* – the period must be identified by the Member concerned and must remain constant. Otherwise, the choice of the word "a" in this provision would be difficult to explain. If the negotiators of the AoA had not wanted the period to maintain an identity over time, they would have so indicated by using a different preposition, for example, "some" period, indicating that the period could be subject to a certain mobility.

In the case at issue, the United States identified, for the purposes of paragraph 6(a) of Annex 2, the period running from 1986 to 1988, as shown in document G/AG/AGST/USA on pages 1-7, referred to in Part IV of the United States' Schedule of Commitments – Schedule XX.

In paragraph 6(b), (c) and (d), Argentina understands the term "the base period" to refer to the base period 1986-1988, the only base period identified in the AoA for domestic support (Annex 3).

"The" base period refers to the base period 1986-1988, since there is no other period for domestic support. Indeed, Article 1(a)(i) also refers to "the" base period, which is none other than the period specified in Annex 3 of the AoA. Article 1(d)(i) and Article 1(h)(i) also mention "the" base period.

In other words, "a" base period is different from "the" base period. Moreover, the second sentence of paragraph 5 of Annex 2 of the AoA requires the adoption of "the" base period established in paragraphs 6(b), (c) and (d), clearly reflecting this difference with paragraph 6(a).

In the case of payments by the United States under paragraph 6 of Annex 2 of the AoA, this distinction is irrelevant since "a" base period in the context of paragraph 6(a) and "the" base period of paragraphs 6(b), (c) and (e) are the same - 1986-1988 - having been so defined by the United States in its Schedule of Commitments.

**4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

It is Argentina's understanding that under paragraph 6 of Annex 2 of the Agreement on Agriculture, for each programme a Member may only define and establish a base period once. Otherwise, the term "fixed" would lose all of its relevance.

**5. Do you agree that a payment penalty based on crops produced is "related to type of production"?** EC

**6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the *Agreement on Agriculture* have on the meaning of the preceding sentence?** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

The word "criteria" in Article 6.1 and 7.1 signifies the parameters, rules or precepts which serve to distinguish the domestic support measures that are not subject to reduction.

In relation to the preceding sentence, the use of the word "accordingly" in paragraph 1 of Annex 2 of the Agreement on Agriculture indicates that the basic criteria listed thereafter are a corollary to the "fundamental principle" set forth in the preceding sentence. However, this does not imply that the preceding sentence does not contain "stand-alone" obligations.

On the contrary, the domestic support measures for which exemption from the reduction commitments is sought must conform to the two basic criteria (set forth in paragraph 1(a) and (b)), plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2, in addition to which they must meet "the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production". A measure which meets the two criteria set forth in paragraph 1(a) and (b) plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2 may also violate the general principle. Any other interpretation would deprive

of any meaning the first sentence of paragraph 1 of Annex 2, which the text itself qualifies as a "fundamental requirement".

**7. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the *Agreement on Agriculture*.** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

In Argentina's view, the words "the fundamental requirement" as used in paragraph 1 of Annex 2 signify the establishment of a general mandatory condition governing the establishment and application of any measure whose inclusion in the "Green Box" is claimed.

**8. In your oral statement, you emphasize the use of the word "criteria" in other parts of the *Agreement on Agriculture*, as distinct from the reference to "fundamental requirement" in the first sentence of paragraph 1 of Annex 2. Is it the case that sub-paragraphs (a) and (b) of paragraph 1 of Annex 2 are also "criteria"?** EC

**9. If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation, does this allow effects-based claims of non-compliance with Annex 2? If so, how does this affect the purpose of Article 13(b)?** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

The first sentence of paragraph 1 of Annex 2 of the AoA contains a stand-alone obligation.

Since the first sentence of paragraph 1 of Annex 2 imposes an obligation by requiring that the measures for which exemption from a reduction commitment is claimed must, as a primary or essential condition, be such that they do not artificially alter trade or production, it permits claims of non-compliance with Annex 2 based on the effects of the domestic support measures, regardless of whether they meet the basic criteria set out in the second sentence of paragraph 1 and with the policy-specific criteria and conditions set out in the rest of Annex 2.

Otherwise, we would be exempting from the reduction commitments measures that might be complying with the two basic criteria set forth in paragraph 1(a) and (b) of Annex 2 plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2 while at the same time violating the general principle of meeting "the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production."

It might then be possible to evade conformity with the provisions of Article 6 of the AoA or with the level of support to a specific commodity decided during the 1992 marketing year.

The result could be to undermine the purpose of Article 13(b) of exempting from countervailing duties or actions based on Article XVI.I or Articles 5 and 6 of the SCM Agreement only those measures which comply with the conditions set forth therein.

**10. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box?** 3rd parties, in particular Australia, Argentina, Canada. EC, NZ

Yes. Argentina considers that non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 must be excluded from the Green Box. In other words, the measures which satisfy the fundamental requirement of having no, or at most minimal, trade-distorting effects or effects on production, but which do not meet the criteria established in paragraph 1(a) and (b) of Annex 2 and the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2, cannot be exempted from reduction commitments.

**11. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2.** 3rd parties, in particular, Australia, Argentina, Canada, EC, NZ

Argentina considers that there is a clear hierarchy between the two provisions, in which the principal obligation for Members is to ensure that their support programmes, even if they could qualify as decoupled support programmes under paragraph 6 of Annex 2, do not have trade-distorting effects or effects on production, as stipulated in paragraph 1 of the same Annex.

Consequently, even if the Direct Payments programme complies with the requirements of the second sentence of paragraph 1 of Annex 2, if it does not comply with the fundamental requirement laid down in the first sentence, it cannot be considered a Green Box programme.

Argentina agrees with Brazil's statement in paragraphs 183-191 of its first written submission with respect to the strong production and trade-distorting effects of the Direct Payments programme.

**12. Where does Article 13(b) require a year-on-year comparison?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

As stated in paragraph 21 of its oral submission, Argentina maintains that the domestic support measures granted during any one of the marketing years of the period covered between the entry into force of the AoA in 1995 and the expiry of Article 13 on 31 December 2003 are relevant for the purpose of determining conformity with Article 13(b), the text of which does not explicitly establish the requirement of a year-on-year comparison.

Thus, the excess support granted during any one of the years of the period of implementation suffices to cancel the protection provided by the Peace Clause.

Nor can a year-on-year comparison be inferred from Article 13 or from its context. Otherwise, at the beginning of each marketing year the Member that had exceeded the level of support in the previous year would be covered by the Peace Clause once again and exempt from any claims.

In practical terms, this interpretation would turn Article 13 protection into an absolute defence, given the difficulty of challenging the level of support granted during the current marketing year at the time of the complaint. If it were only possible to challenge the support granted during a past marketing year independently of the support granted during the current year, what would be the use of any successful claim under Articles 5 and 6 of the SCM Agreement? How would it be possible, in that case, to eliminate the adverse effects of a subsidy already granted?

**13. Does a failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

In Argentina's view, the failure by a Member to comply in a given year with either the *chapeau* of Article 13(b) or the proviso in sub paragraph (ii) of Article 13(b) results in the loss of the protection granted by the Peace Clause.

Regarding the "*chapeau*" of Article 13(b): domestic support that does not conform to the provisions of Article 6.1, for example distorting support in excess of the reduction commitment in violation of Article 3.2 of the AoA, is outside the scope of Article 13(b). Indeed, that Article refers to "domestic support measures that conform fully to the provisions of Article 6 … ". Consequently, domestic support of the kind referred to in Article 13(b) that does not conform to Article 6 does not

bear any relation to Article 13(b)(ii). Such support is prohibited and does not enjoy the protection of the Peace Clause.

Regarding failure to comply with the proviso in Article 13(b)(ii): any failure to comply in whatever year implies exclusion from the scope of Article 13(b) for all of the distorting domestic support measures concerning the specific commodity in question.

**14. Does a failure of a Member to comply with Article 13(b) in respect of a *specific commodity* impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

In Argentina's view, failure by a Member to comply with Article 13(b)(i) and (ii) in respect of a specific commodity does not impact its entitlement to benefit in respect of other agricultural products from the exemption action provided by Article 13(b).

However, failure to comply with the conditions laid down in the *chapeau* of Article 13(b) i.e. failure of the domestic support to conform with the provisions of Article 6 of the AoA, could result in exclusion from the protection offered by Article 13(b) in respect of domestic support granted to all products, for example, if the domestic support measure exceeds the level of the commitment in the schedule of the Member concerned.

**15. Is there any basis on which counter-cyclical payments could be considered product-specific?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

As stated in paragraph 8 of its Oral Submission, Argentina considers that "*support to a specific commodity*" in Article 13(b)(ii) includes any domestic support measure that is not a Green Box measure and that provides any identifiable support to a commodity in particular, regardless of whether the measure may provide support to a greater number of commodities.[5] In this respect, counter-cyclical payments explicitly provide support to cotton (upland) as can be seen in the text of the United States Farm Act of 2002 (2002 Farm Security and Rural Investment Act, Title I, Subtitle A, Exhibit US-1).

**16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph?** 3rd parties, in particular Australia, Argentina, Benin, Canada, China, EC, NZ

The word "specific" is an adjective qualifying the noun "commodity". The adjective "specific" does not qualify the support (the calculation of which may or may not be product-specific, as stated in paragraph 1 of Annex 3 of the AoA).

If the word "specific" qualifying the noun "commodity" were not there, the text would no longer have the precision that it currently has, although this does not mean that even then it could not be interpreted as referring to any type of domestic support (regardless of whether it is categorized as product-specific or non-specific under Annex 3 of the AoA).

**17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to a "product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) *Agreement on Agriculture*?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

[5] In this respect, Argentina agrees with New Zealand: *" … New Zealand sees no basis on which to suggest that support to a specific commodity should be excluded simply because other commodities may receive similar support".* Third Party Submission of New Zealand, 15 July 2003, paragraph 2.23.

In Argentina's view the concept of specificity in Article 2 of the SCM Agreement is not linked to the term "specific commodity" in Article 13(b)(ii) of the AoA. In Article 2 of the SCM Agreement, the specificity is a characteristic of the subsidies (prohibited or actionable) covered by the current SCM Agreement, while the specificity referred to in the phrase "specific commodity" is characteristic of the commodity and not of the subsidy granted. The phrase "support to a specific commodity" cannot be identified with "specific support to a commodity".

The concept of "specificity" in Article 2 of the SCM Agreement is what indicates whether a subsidy is subject to the provisions of Part II or to the provisions of Parts III or V of that Agreement.

**18. Benin's oral statement considers the phrase "support to a specific commodity" in Article 13(b)(ii) of the *Agreement on Agriculture*. How does Benin believe that phrase is best interpreted? Please substantiate your response, commenting on other submissions by parties and third parties as you believe appropriate.** Benin

**19. Where does Article 13(b)(ii) require a year-on-year comparison?** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

Argentina submits that the domestic support measures granted in any of the marketing years of the period covered between 1995 and 2003 are relevant for the purposes of determining conformity with Article 13(b)(ii), which does not explicitly require a year-on-year comparison.

**20. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?**

In Argentina's view Article 13(b)(ii) requires a comparison of support granted with support decided. Such a comparison is possible by making a calculation in terms of budgetary outlays in each one of the periods in question (support granted in the implementation period as compared to support decided during the 1992 marketing year).

**21. Please comment on Brazil's assertion that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term?** 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ

According to the text of Article 13(b)(ii) the word "*decided*" signifies the decision to provide payments for a specific commodity (including the revenue foregone under Article 1(c) of the AoA), whether those payments are classified as product-specific or non-specific, as well as other forms of domestic support in monetary terms as set forth in Annex 3 of the AoA.

The phrase "*support decided during the 1992 marketing year*" is necessarily linked to the phrase "grant support" - indeed, there would be no basis for comparison if in one case the support was granted, while in the other case, the support was only planned. In other words, as indicated in the reply to the preceding question, the Article 13(b)(ii) requirement necessarily involves a comparison of domestic support measured in the same manner in each one of the periods in question, i.e. a "comparison of the comparable".

In principle, the comparison must be made between the support granted in any year of the implementation period and the support "decided" during 1992. The support "decided during the 1992 marketing year" refers to a legislative or administrative decision by a Member during the 1992 marketing year on the domestic support to be granted during the implementation period in terms of budgetary outlays.

Where no "decision" has been taken in terms of budgetary outlays during 1992, Argentina understands that the only support that can be considered as "decided" during that marketing year is the support granted during that year.

**22. What is the meaning of "support" in *Agreement on Agriculture* 13(b)(ii)? Why would it be used differently from Annexe 3, where it refers to total outlays?** 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ

The "support granted" in each marketing year of the implementation period must necessarily be linked to the budgetary outlays for those years.

The term "support" used in Article 13(b)(ii) of the AoA refers to budgetary outlays for any kind of support that is not Green Box. For example, the term "support" could include assistance granted by the State by foregoing tax revenue or writing off producers' debts.

**23. Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both?** 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ

Support should be compared under Article 13(b)(ii) in total monetary terms. In paragraph 16 of its oral submission, Argentina submits that the term "decided" in Article 13(b)(ii) should not be interpreted as meaning that the rate per unit of production is the factor to be considered in determining the amount of support granted. If the argument put forward by the United States were accepted, this would enable an unlimited amount of domestic support to be granted for each product provided the total AMS is not exceeded, since it would be covered by Article 13. Thus, the amount of the AMS could be granted to one or several products, provided its maximum bound level is not exceeded.

The comparison must be made in terms of total value of support for a specific product, comparing the levels for each marketing year subsequent to 1992 and up to 31 December 2003 with the levels of support decided during the 1992 marketing year.

**24. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) of the *Agreement on Agriculture* and, in particular, why the words "grant" and "decided" were used.** EC

**25. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during".** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

The term "decided during" in Article 13(b)(ii) refers to a decision made by the Member granting the support during the 1992 marketing year with respect to the budgetary outlays that would be made for domestic support, excluding Green Box.

If there was no decision during the 1992 marketing year, the budgetary outlays effectively made during that marketing year must be considered to constitute the support "decided during" the 1992 marketing year (i.e. if there is no express decision in this respect, we must fall back on what was effectively disbursed which also, implicitly, represents a "decision").

**26. Under Article 13(b)(ii), a comparison is required between support at different times. One of the issues which is contested between the parties is whether the only later period that the Panel can consider is the present one (i.e. the period underway at the time of the request for establishment of the Panel). This argument is based on the present tense of the words "do not grant" in the English text. The Panel asks whether there is any difference in the verb tense as**

**used in the Spanish-language text, or any other difference which might aid the Panel in interpreting these words?** Argentina, EC, Paraguay, Venezuela

While it is true that in the English version of the Agreement on Agriculture, the verb tense used in Article 13(b)(ii) is the present tense, as stated by the United States in paragraph 90 of its first written submission ( … the proviso is written in the present tense …), it should be stressed that in the Spanish text, the present tense is clearly used in the subjunctive mode ("*a condición de que* ***no otorguen*** *ayuda* … ")

The expression "*a condición de que*" uses the subjunctive mode to indicate the conditional or possible nature and expresses syntactic subordination.

The use of the subjunctive mode in Article 13(b)(ii) is important, because in Spanish it is used to express and form sentences in which the action remains in doubt, as opposed to the indicative mode where the tenses always indicate that the action, concretely, is taking place, has taken place, or will be taking place.

The Spanish text coincides with the verbal tense used in the French version ("*à condition que ces mesures n'accordent pas*"), in which the present subjunctive is also used.

Consequently, Argentina does not agree with the United States' contention that the present tense criterion in Article 13(b)(ii) implies that the only support the Panel may consider is current support.

**27. If the 1992 "decision" led to or was the funding source for the money provided in 1992 and later years, is it the full amount of all that funding that constitutes the "support" decided in 1992? If the answer to this question is that it is the full amount of all the support provided pursuant to the "decision" that must be taken into account, must this be compared with the total amount of support that will or might flow from the decision made in the more recent period for the purposes of the comparison required under Article 13(b)(ii)? If a Member did not make a "decision" (however that may be interpreted) in 1992 about "support", is it the case that the Member has a zero base for the purposes of the comparison required under Article 13(b)(ii)?** EC

**28. In paragraph 13 of Australia's oral statement, you state that a "question" is: "could conditions of price competition for the purposes of a non-violation or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole." Could you please clarify this statement (indicating other elements which would complete the "whole" and explain its relevance for the purposes of our consideration of Article 13 of the *Agreement on Agriculture*?)** Australia, EC

**Export Credit Guarantee Programme**

**29 (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*? Why or why not?** 3rd parties, in particular, Argentina, Canada, EC, NZ

An export credit guarantee is a "financial contribution" in the form of a "potential direct transfer of funds or liabilities" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement when it involves the granting of a financial credit in conditions more favourable than those that can normally be found on the market. Those conditions may contain all or some of the following

elements: lower interest rates, longer repayment terms for loans, lower down-payment requirement, reduced frequency of payments per year and/or total or partial exemption from any fee or premium to provide the US Government with adequate protection against potential flaws in its export credit guarantee portfolio. This is confirmed in practice by the fact that no company on the market is prepared to provide coverage equivalent to the coverage accorded with the credit guarantees of the Commodity Credit Corporation of the United States.

Moreover, items (j) and (k) of the Illustrative List in (Annex 1) of the SCM Agreement set out the circumstances in which this type of operation should be considered an export subsidy.

**29. (b) How, if at all, would this be relevant to the claims of Brazil?** 3rd parties, in particular, Argentina, Canada, EC, NZ

It is relevant to the claims of Brazil in that the fact of being a "financial contribution" is the first element of a prohibited export subsidy claim.

**30. The Panel could arguably take the view that Articles 1 and 3 of the *SCM Agreement* were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an *a contrario* interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission).** 3rd parties, in particular, Argentina, Canada, EC, NZ

As stated by the Appellate Body in *US - FSC* and in *Canada - Dairy Products*, the AoA does not contain its own definition of a subsidy, and hence we must turn to the SCM Agreement for the context. The Appellate Body has also established (FSC case) that export subsidies under Article 3.1(a) of the SCM Agreement constitute export subsidies under the AoA.

The relevance of Articles 1 and 3 of the SCM Agreement is therefore unquestionable when it comes to evaluating the consistency of the export credit guarantees with WTO rules.

Moreover, Annex I of the *SCM Agreement* identifies export subsidies by providing an illustrative list thereof. In other words, a measure which constitutes an export subsidy classified in the Illustrative List is *per se* a prohibited subsidy under Article 3.1(a) of the *SCM Agreement*. Obviously, the "Illustrative" List in no way covers all measures that could qualify as an export subsidy under Article 3.1(a) of the SCM Agreement. As its name indicates, it is only an "illustrative" list and not an exhaustive one.

Now, footnote 5 in Article 3.1(a) of the SCM Agreement states that "measures referred to" in Annex I as not constituting export subsidies shall not be prohibited.

There are two paragraphs in this Annex that refer to credit, guarantee or insurance programmes: (j) and (k). There is a fundamental difference between the two. Item (k) explicitly recognises that a measure, in the circumstances set forth in its second paragraph, shall not be considered an export subsidy (see the last sentence of the second paragraph), fulfilling the requirement set forth in footnote 5 to the SCM Agreement:

> (k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

> Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement. (Emphasis added)

Argentina does not agree with the *a contrario* interpretation provided by the United States in paragraphs 180 to 183 of its submission, either with respect to the first paragraph of item (k) or with respect to item (j) of Annex I to the *SCM Agreement*, because unlike the final sentence of the second paragraph of item (k), the text does not explicitly recognize that the measure will not be an export subsidy, and an *a contrario* interpretation that circumvents the test of Article of 3.1(a) of the *SCM Agreement* is not possible.

That is to say, even if a given credit, guarantee or insurance programme includes:

- either, in relation to item (j), premium rates which are adequate to cover the long-term operating costs and losses of the programmes;

- or, in relation to the first paragraph of item (k), interest rates below the cost of funds that are not used to secure a material advantage in the field of export credit terms,$

none of this in any way enables us to infer that because they display either or both of these characteristics, they should not be considered to be export subsidies if they meet the conditions set forth in Articles 1 and 3.1(a) of the *SCM Agreement*.

For the situation put forward by the United States to be possible, there would have to be a text similar to the final sentence of the second paragraph of item (k) which explicitly states that a given measure is not considered to be an export subsidy. Only then would footnote 5 of the *SCM Agreement* become operational.

Now, even if the appropriate language had been included in item (j) and the first paragraph of the item (k) of Annex I of the SCM Agreement and footnote 5 were operational, an *a contrario* interpretation would still be unacceptable because, in addition to the test of Article 3.1(a) of the *SCM Agreement*, Members using such programmes must also comply with the AoA obligations, in particular Articles 8, 10.1 and 10.3, without prejudice to the application of Article 3 of the *SCM Agreement* to agricultural subsidies after the expiry of the Peace Clause in Article 13 of the AoA. In other words, the absence in Article 1(e) of the AoA of a footnote such as footnote 5 of the SCM Agreement precludes any *a contrario* interpretation in favour of users of export credits for agricultural products. Furthermore, Article 10.3 of the SCM Agreement itself places on the user Member the entire burden of proof that such programmes are not export subsidies.

**31. If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance in the interpretation of the terms in Article 10 *Agreement on Agriculture*, should the Panel refer to item (j) or Articles 1 and 3 of the *SCM Agreement* or both?** 3rd parties, in particular, Argentina, Canada, EC, NZ

If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance, as established by the Appellate Body, in the interpretation of the terms of Article 10 of the *Agreement on Agriculture* (Prevention of Circumvention of Export Subsidy Commitments), the Panel should refer to both: first of all to item (j) of Annex I (*Illustrative List of Export Subsidies*) of the *SCM Agreement*, and subsidiarily to Articles 1 and 3 of the *SCM Agreement*. Naturally, if the Panel should conclude

that the challenged credit guarantees come under indent (j) of Annex I, it would have to conclude that they violate Articles 1 and 3.1(a) of the *SCM Agreement per se*.

**32. The Panel's attention has been drawn to Article 14(c) of the *SCM Agreement* (see third party submission of Canada) and to the panel report in DS 222 *Canada - Export Credits and Loan Guarantees*. How and to what extent are Article 14(c) of the *SCM Agreement,* and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material.** 3rd parties, in particular, Argentina, Canada, EC, NZ

Argentina agrees with Canada's interpretation in paragraphs 41 to 48 of its written submission to the effect that Article 14(c) of the SCM Agreement and the Panel and Appellate Body reports in WT/DS70, as well as the Panel report in WT/DS222, are relevant to the issue of whether the export credit guarantee programmes of the United States confer a "benefit". The standard established therein for the determination of the existence of a "benefit" constitutes the appropriate legal framework for the interpretation of the facts in the present case.

According to the last part of paragraph 157 of the report of the Appellate Body in WT/DS70, *" … the marketplace provides an appropriate basis for comparison in determining whether a 'benefit' has been 'conferred', because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market."*

**33. What is the relevance (if any) of Brazil's statement that: " … export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders"**. 3rd parties, in particular, Argentina, Canada, EC, NZ

The relevance of Brazil's statement lies in the fact that if the marketplace is unable to provide export credit guarantees for agricultural products, the mere granting of such guarantees by the Government of the United States would constitute an export subsidy. It would demonstrate that the market was unable to equal the conditions offered by the challenged programmes.

**34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"?** 3rd parties, in particular, Argentina, Canada, EC, NZ

**35. Did the drafters of the *Agreement on Agriculture* include export credit guarantees in Article 9.1 of the *Agreement on Agriculture*? Why or why not?** 3rd parties, in particular, Argentina, Canada, EC, NZ

Article 9.1 of the Agreement on Agriculture is a list of export subsidies that are subject to reduction commitments. As such, it does not include export credit guarantees. However, there are other export subsidies, as emerges the actual text of Article 10.1, which are also subject to disciplines.

In this respect, Argentina agrees with Canada's statement in paragraph 32 of its Written Submission that:

> *"Article 9 of the Agriculture Agreement lists and describes certain export subsidies that are subject to reduction commitments. All other export subsidies fall within the scope of Article 10.1 … "*

**36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38).** 3rd parties, in particular, Argentina, Canada, EC, NZ

**(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where U.S. financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

The fact that the programmes operate in cases where credit is necessary to increase or maintain exports and where US private financial institutions would be unwilling to provide financing without the CCC's guarantee is relevant to Brazil's claims about the GSM 102 and GSM 103 programmes in that it implies a recognition of the impact and trade-distorting effect of the export credit guarantees.

**(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

This is another recognition of the fact that without such measures, there would be no exports, or there would be fewer exports from the United States.

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

The fact that in providing this credit guarantee facility, the CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities once again reinforces the negative impact and distortion caused by the export credit guarantees to world trade.

**37. The United States seems to argue that, at present, by virtue of Article 10.2 of the *Agreement on Agriculture*, there are no disciplines on agricultural export credit guarantees under the *Agreement on Agriculture* (or the SCM Agreement).**

**(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the *Agreement on Agriculture*? Please cite any relevant material, including any past WTO dispute settlement cases.** 3rd parties, in particular, Argentina, Canada, EC, NZ

It is wrong to state that there are no disciplines on export credits and export credit guarantees. Article 10.2 must be analysed together with Article 10.1, in that when the export guarantee and credit programmes contain a subsidy component and are therefore genuine export subsidies, they must automatically comply with the requirement of not circumventing export subsidy commitments.

The export credits and export credit guarantees granted by the United States constitute export subsidies for the reasons set forth in the replies to questions 29 and 36 above. They do not comply with Articles 3, 8 and 10.1 of the AoA.

Regarding the first question of the Panel in (a) above, the answer is no. The granting of export credit guarantees under conditions in which no consideration is required, in this case a premium charged by the granting institution, is tantamount to the transfer of funds to the beneficiary. The beneficiary, in the absence of an adequate premium, transfers all of the credit and commercial risk of the operation to the institution granting the guarantee without any cost to itself. In other words, we are speaking of a subsidy.

**(b) If, as the United States argues, there are no disciplines on export credit guarantees in the *Agreement on Agriculture*, how could export credit guarantees "conform fully to the provisions of Part V" of the *Agreement on Agriculture* within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)?** 3rd parties, in particular, Argentina, Canada, EC, NZ

In Argentina's view, the United States' interpretation of Article 10.2 is entirely at odds with the context of the provision and the object and purpose of Article 10 of the AoA, since it would contribute to the circumvention of export subsidy commitments by excluding an entire category of export subsidies from the general disciplines in that area.

Article 1(e) of the AoA clearly defines export subsidies without excluding those that are not listed in Article 9.1 of the Agreement.

At the same time, Article 13(c) of the AoA stipulates that in order to be exempted, export subsides must conform fully to the provisions of Part V of the AoA, and not to a particular article. Article 10, which forms part of Part V of the AoA, stipulates in paragraph 1 that: *" … export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments … ".*

Thus, the lack of disciplines specifically developed for export credit guarantees does not necessarily imply the absence or shortage of criteria that would make it possible to establish objectively whether these instruments *"conform fully to the provisions of Part V of this Agreement"* as stipulated in the chapeau of Article 13(c).

STEP 2 PAYMENTS

**38. Please comment on the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in Canada-Dairy and the findings of the Appellate Body in US-FSC (21.5)[6], do any other dispute settlement reports offer guidance on this issue? For example, how,**

[6] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances. Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

**if at all is the Appellate Body's report in Canada-Aircraft relevant here?**[7] 3rd parties, in particular, Australia, Argentina, NZ, Paraguay

As stated by Argentina in paragraphs 80-85 of its written submission, both the corresponding section of the 2002 SFRI Act and the provisions of the Section 1427.100ff. of the Code of Federal Regulations clearly establish that the Commodity Credit Corporation (CCC) must issue marketing certificates or cash payments to exporters and/or users of US (upland) cotton.

Given that the purpose of the programme is to provide a direct incentive for US cotton exports and consists of a direct payment to exporters based on the difference between the US domestic cotton price and the world market price, there can be no doubt that whenever the former is higher than the latter, an export subsidy is present inasmuch as the existence of these payments enables the US product to compete artificially with the lower-cost products of more efficient producers.

It should be noted that the programme known as *Step 2* establishes the right of exporters to receive a subsidy for shipments made in connection with foreign sale operations, while establishing an obligation upon the CCC to grant that subsidy once the particular requirements are satisfied.

We stress that the payment is the difference between the domestic market and the international market because that would be the most relevant evidence that the subsidy seeks to ensure that the product can be exported at prices lower than the domestic price.

**39. Please comment on the United States assertions at paragraph 129 of its first written submission, that "[t]he program is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States."** 3rd parties, in particular, Australia, Argentina, NZ, Paraguay

The fact that the Step 2 programme is indifferent to whether the recipients are exporters or users of cotton in the United States does not alter its inconsistency, since the United States has not specified upland cotton in its schedule of commitments and this type of subsidy under the Step 2 programme is granted for cotton. Consequently, any provision in the legal texts with respect to the granting of such a subsidy makes it inconsistent per se with Articles 3.3 and 8 of the AoA, while for the same reason any sum distributed, budgeted or provided for under the programme constitutes a prohibited subsidy within the meaning of Article 3 of the SCM Agreement.

**40. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the AoA? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the *SCM Agreement* and Article III:4 of the GATT 1994.** 3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay

Are subsidies contingent on the use of domestic goods, because they are prohibited under Article 3.1(b) of the SCM Agreement, also prohibited under the AoA given that there is no specific provision in the AoA that is explicitly mentioned in the introductory sentence of Article 3 of the

[7] There, the Appellate Body stated that,

> "the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".[7]

SCM Agreement? Indeed, Article 3 of the SCM Agreement reads "except as provided in the Agreement on Agriculture … ". The AoA does not contain any provision which explicitly permits such subsidies.

"Except as provided in the Agreement on Agriculture …" also means that Article 3 of the SCM Agreement applies to agricultural subsidies to the extent that they are not in conflict with the AoA. In this connection, no provision can be found in the AoA that is in conflict with Article 3.1(b) of the SCM Agreement, permitting the granting of "subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." Consequently, Argentina considers that subsidies contingent upon the use of domestic over imported goods are prohibited under the AoA.

Regarding the EC's argument in which it tries to distinguish between the terms "to" and "in favour" with respect to support for agricultural producers, this difference does not tally with the Spanish text, and "in favour", "to" and "benefit" are synonyms.

| Article from the Agreement on Agriculture | Spanish | English |
|---|---|---|
| 1.a | a | in favour |
| 1.d | a | to |
| 1.h | a | in favour |
| 3.2. | a | in favour |
| 6.1. | en favor | in favour |
| 6.2. | a | to |
| 6.3. | a | in favour |
| 7.1. | en favor | in favour |
| 7.2.a | en favor | in favour |
| 7.2.b | a | to |
| 9.1.a | a | to |
| Annex 2 | a | to (in different paragraphs throughout the annex) |
| Annex 3.7 | beneficio a | benefit |
| Annex 4.4 | beneficio a | benefit |

In other words, the text does not contain the difference that the EC is attempting to expose, nor can a phrase such as "in favour" be interpreted as the waiver of a prohibition under Article 3.1(b) of the SCM Agreement, since such a waiver does not appear in the text.

Regarding the second sentence of paragraph 7 of Annex 3 of the AoA concerning "measures directed at agricultural processors", it makes no reference whatsoever to the "subsidies contingent … upon the use of domestic over imported goods" mentioned in Article 3.1(b) of the SCM Agreement. Obviously, these are two different matters. Moreover, paragraph 7 of Annex 3 contains no mention of the SCM Agreement. If the intention had been to exempt these measures from the prohibition contained in Article 3.1(b) of the SCM Agreement, this would have been expressly stated, specifically mentioning the provision of the SCM Agreement, i.e. Article 3.1(b).

As regards the second question, for the reasons provided above, the phrase "provide support in favour of domestic producers" neither refers to the subsidies in Article 3.1(b) of the SCM Agreement, nor permits them.

With respect to the third question, Article III:4 of the GATT 1994 prohibits discrimination against imported products, so that this article is also applicable, as well as Article 2.1 of the Agreement on Trade-Related Investment Measures. Moreover, the TRIMs Agreement does not make the slightest reference to the Agreement on Agriculture.

**ETI Act**

**41. Concerning its claims on the ETI Act, Brazil relies on the US – FSC case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here?** Argentina, China, EC, NZ

**42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant.** Argentina, China, EC, NZ

# ANNEX J-2

## ANSWERS BY AUSTRALIA TO THE QUESTIONS FROM THE PANEL

11 August 2003

ARTICLE 13 OF THE *AGREEMENT ON AGRICULTURE*

**1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions in Article 13 are a "prerequisite" to the availability of a right or privilege? Australia Would other third parties have any comments on Australia's assertion? 3RD parties, in particular Argentina, Benin, China, Chinese Taipei**

Reply

Australia does not see any inconsistency in its views. In Australia's view, the potential availability of an affirmative defence in the general sense is in the nature of a right or privilege. Australia wishes to clarify, however, that it considers Article 13 in the specific sense to be a right available when the conditions prescribed therein are met, rather than a privilege.

ARTICLE 13(B) OF THE *AGREEMENT ON AGRICULTURE*: DOMESTIC SUPPORT MEASURES

**2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

In Australia's view, having regard to their ordinary meanings in their context of the object and purpose of the *Agreement on Agriculture*, the words "defined" and "fixed" have distinct meanings.[1] The word "defined" refers to the period of time stipulated for the purposes of determining initial eligibility for a particular decoupled income support payment. The word "fixed" establishes that once it has been "defined", that period of time is unchangeable for that payment.

**3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

[1] *The New Shorter Oxford English Dictionary*, Ed. Lesley Brown, Clarendon Press, Oxford, Volume 1 provides the following potentially relevant definitions of the words:

"defined": "having a definite or specified outline or form; clearly marked, definite" (page 618);

"fixed": "**1** Definitely and permanently placed or assigned; stationary or unchanging in relative position; definite, permanent, lasting. **2a** Directed steadily or intently towards an object. **b** … **3** Placed or attached firmly; made firm or stable in position. …

Reply

In Australia's view, "a" is used in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 to the *Agreement on Agriculture* as an indefinite article, and is defined as meaning "one, some, any"[2]. Thus, having regard to the ordinary meaning of the words in their context and in the light of the object and purpose of the Agreement on Agriculture, "a defined and fixed base period" is the base period selected by an individual WTO Member for the purposes of determining initial eligibility for a particular decoupled income support payment. Once that base period is selected, it is fixed, that is, it is unchangeable.

"The" is defined as "designating one or more … things already mentioned or known, particularized by context or circumstances, inherently unique, familiar, or otherwise sufficiently identified".[3] Thus, the use of "the" as a definite article in the phrase "after the base period" in paragraphs 6(b), (c) and (d) of Annex 2 establishes a relationship to the base period already identified, that is, to the base period selected by an individual WTO Member for the purposes of determining initial eligibility for a particular decoupled income support payment in accordance with paragraph 6(a) and which, once fixed, is unchangeable.

Australia does not consider that there is any relationship between any base period defined and fixed for a support programme for the purposes of paragraph 6 of Annex 2 and the use of the years 1986-88 as a base period under Annex 3, nor was there intended to be. Annex 3 relates to the calculation of a Member's AMS for the purposes of implementing its reduction commitments in relation to production and trade-distorting domestic support measures, consistent with the object and purpose of the Agreement on Agriculture. By definition in the first sentence of paragraph 1, Annex 2 domestic support measures may not, or may only minimally, distort production and trade. Thus, there is no logical or other basis for there to be any relationship.

Australia notes too that Article 7.2(a) of the *Agreement on Agriculture* specifically envisages the introduction of domestic support measures after entry into force of the *WTO Agreement* by providing for "any [domestic support] measure that is subsequently introduced that cannot be shown to satisfy the criteria in Annex 2 to this Agreement". Australia considers that, had the negotiators intended that the 1986-88 period be required to be used as the base period for the purposes of making decoupled income support payments – or indeed for any other purpose envisaged in Annex 2 – paragraph 6(a) would have expressly provided for this rather than for "a defined and fixed base period".

**4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture? 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

In Australia's view, and consistent with the use of the word "a" in the phrase "a defined and fixed base period", a Member may only define and fix a base period once for the purposes of a particular decoupled income support payment. Once that base period is defined and fixed, it is unchangeable.

**5. Do you agree that a payment penalty based on crops produced is "related to type of production"? EC**

[2] *The New Shorter Oxford English Dictionary*, Volume 1, page 1.
[3] *The New Shorter Oxford English Dictionary*, Volume 2, page 3269.

**6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the Agreement on Agriculture have on the meaning of the preceding sentence? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

The ordinary meaning of "criteria", as the plural of "criterion", is "principle[s], standard[s], or test[s] by which a thing is judged, assessed, or identified"[4]. Thus, the "criteria" in Articles 6.1 and 7.1 as these relate to Annex 2 of the *Agreement on Agriculture* encompasses all of the relevant principles, standards or tests established in Annex 2 against which domestic support measures for which exemption from reduction commitments is claimed are to be judged, assessed and/or identified.

As Australia said in its Oral Statement,[5] the word "accordingly" has several, equally valid meanings that are potentially applicable in the context: "harmoniously", "agreeably", "in accordance with the logical premises" and "correspondingly"[6]. A further definition is "in conformity with a given set of circumstances".[7]

In Australia's view, having regard to its ordinary meanings in its context and in light of the object and purpose of the A*greement on Agriculture*, including to "[correct] and [prevent] … distortions in world agricultural markets",[8] the word "accordingly" can and should properly be interpreted in the sense of "consistent with" or "in conformity with" the fundamental requirement established in the first sentence. Consistent with that interpretation, the obligation that "green box" measures "meet the fundamental requirement …" is cumulative with the additional basic criteria established in paragraph 1 and the policy specific criteria established in paragraphs 2-13 of Annex 2. To interpret the word "accordingly" otherwise would be to negate the plain and unambiguous obligation established in the first sentence of paragraph 1 of Annex 2 that "[d]omestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production".

**7. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the Agreement on Agriculture. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

The word "fundamental" has a number of meanings[9] which can be summarised as "primary" or "essential". The word "requirement" too has a number of meanings[10] which can be summarised as a "condition". Thus, a "fundamental requirement" is a primary or essential condition. [11] It is an

[4] *The New Shorter Oxford English Dictionary*, Volume 1, page 551.
[5] Oral Statement by Australia, paragraphs 35-36.
[6] *The New Shorter Oxford English Dictionary*, Volume 1, page 15.
[7] *Webster's Third New International Dictionary*, Ed. Philip Babcock Gove, Merriam-Webster Inc, Springfield, Massachusetts, 1993, page 12.
[8] Third preambular paragraph of the *Agreement on Agriculture*.
[9] *The New Shorter Oxford English Dictionary*, Volume 1, page 1042, provides relevant definitions of "fundamental" as "**1** Of or pertaining to the basis or groundwork; going to the root of the matter. **2** Serving as the base or foundation; essential or indispensable. Also, primary, original; from which others are derived."
[10] *The New Shorter Oxford English Dictionary*, Volume 1, page 2557, provides definitions of "requirement" as "**1** The action of requiring something; a request. **2** A thing required or needed, a want, a need. Also the action or an instance of needing or wanting something. **3** Something called for or demanded; a condition which must be complied with."
[11] Third Party Submission of Australia, paragraph 31, and Oral Statement by Australia, paragraph 33.

overarching, freestanding obligation that applies to all "green box" measures cumulatively with the additional basic criteria established in paragraph 1 and the policy specific criteria established in paragraphs 2-13 of Annex 2. To interpret a "fundamental requirement" otherwise than as a primary or essential condition would not give the words their ordinary meaning in their context and in light of the object and purpose of the *Agreement on Agriculture*.

**8. In your oral statement, you emphasize the use of the word "criteria" in other parts of the Agreement on Agriculture, as distinct from the reference to "fundamental requirement" in the first sentence of paragraph 1 of Annex 2. Is it the case that sub-paragraphs (a) and (b) of paragraph 1 of Annex 2 are also "criteria"? EC**

**9. If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation, does this allow effects-based claims of non-compliance with Annex 2? If so, how does this affect the purpose of Article 13(b)? 3rd parties' in particular Australia, Argentina, Canada, EC, NZ**

Reply

It is not clear to Australia what is meant by "effects-based claims" in the context of this question. In Australia's view, a claim of non-compliance with the first sentence of paragraph 1 of Annex 2 would require an assessment of whether a domestic support measure meets the primary or essential condition that such measures have no, or at most minimal, trade-distorting effects or effects on production, that is, that such measures not, or only negligibly, bias or unnaturally alter trade or production.

**10. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

Yes.

**11. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. 3rd parties, in particular, Australia, Argentina, Canada, EC, NZ**

Reply

Australia assumes that the "direct payments programme" referred to in this question is the Direct Payments programme of the United States at issue in this dispute.

Even if the first sentence of paragraph 1 of Annex 2 were to express only a general principle which informs the interpretation of the other criteria in Annex 2, the US Direct Payments programme would still be non-compliant with paragraph 6(b) of Annex 2 because it:

- penalises producers based on the type of production undertaken after the base period, and
- because it allowed producers to update their base acreage and base yield(s) after the base period,

contrary to the express requirement of paragraph 6(b) that the amount of decoupled income support payments not be related to, or based on the type and/or volume of production undertaken by the producer in any year after the base period.

**12. Where does Article 13(b) require a year-on-year comparison? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

In Australia's view, a requirement for a temporal comparison of measures granting support to a specific commodity is an implicit and integral component of the requirement in Article 13(b)(ii) that such measures not be "in excess of" that decided during the 1992 marketing year. "In excess of" is defined as "more than"[12] and "to an amount or degree beyond"[13].

See question 28 below.

**13. Does a failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

It is Australia's view that there is no obligation with which a Member is required to comply in either the chapeau of Article 13(b), or the proviso of Article 13(b)(ii).

See question 28 below.

**14. Does a failure of a Member to comply with Article 13(b) in respect of a specific commodity impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Yes. In Australia's view, there is no requirement that the application of the proviso be considered only in relation to a specific commodity at issue in a dispute. The failure of a Member to comply with Article 13(b)(ii) and (iii) in respect of one specific commodity affects its right to exemption from actions under Article 13(b)(ii) and (iii) in respect of all commodities.

Australia notes that the basic text of both Article 13(b)(ii) and (iii) reads as follows:

> During the implementation period, … domestic support measures that conform fully to the provisions of Article 6 … shall be … exempt from actions based on [*the specified provisions*], provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

The phrase "such measures" in the proviso refers to "domestic support measures that conform fully to the provisions of Article 6 …". Thus, the proviso states "provided that [*domestic support measures that conform fully to the provisions of Article 6*] do not grant support to a specific commodity in excess of that decided during the 1992 marketing year".

[12] *The New Shorter Oxford English Dictionary*, Volume 1, page 873.
[13] *Webster's Third New International Dictionary*, page 792.

Similarly to its use in the context of question 3 above, "a" is used in the phrase "support to a specific commodity" as an indefinite article, and is defined as meaning "one, some, any"[14]. Having regard to the ordinary meaning of the word in its context and in light of the object and purpose of the *Agreement on Agriculture*, "support to a specific commodity" means support to any one commodity.

Further, Australia considers that this interpretation is consistent with the object and purpose of the *Agreement on Agriculture*, including as expressed in the preambular clauses to that Agreement, for example, "to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets". The *Agreement on Agriculture* resulted from lengthy and complex negotiations and provided a finely balanced set of rights and obligations aimed at reducing the unnatural distortions of global agricultural production and trade. During an agreed transition period, so long as a Member adheres to its obligations intended to achieve that objective and does not introduce domestic support measures which result in new or additional distortions in trade and production, it would enjoy, as a right, protection for actions that would otherwise be WTO-inconsistent. On the other hand, if a Member did not observe the obligations that form part of the negotiated outcome, it would lose its generic right to the protection that constituted an essential element of that outcome. See also question 28 below.

**15. Is there any basis on which counter-cyclical payments could be considered product-specific? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

In this question, Australia understands that the panel uses the term "product-specific" in the sense of "product-specific" support as argued by the United States in its First Written Submission.[15]

Australia notes that counter-cyclical payments (CCPs) are expressly differentiated by product.[16] Even though the CCP programme applies to more than one commodity and there is no requirement for a producer to grow any of those commodities, actual payments are made by product. Further, notwithstanding that there is no requirement for a producer to grow upland cotton to receive the CCP for upland cotton, it is not possible for a producer to receive the CCP for upland cotton if that producer has never actually produced upland cotton. Similarly, a producer could not receive the CCP for another eligible commodity under the program, e.g., corn, if that producer has never grown corn. Thus, CCPs for eligible commodities, in this case upland cotton, are effectively product-specific.

Australia notes too that CCPs for upland cotton are product-specific if there is a correlation between enrolled acreage for the purposes of the CCP (and Direct Payments) programme and the acreage actually used to grow upland cotton. However, there is insufficient current information available to Australia to assess whether CCPs can be considered to be product-specific on this basis.

That said, Australia re-iterates its strong view that "support to a specific commodity" within the meaning of subparagraph (ii) (and (iii)) of Article 13(b) does not equate to product-specific support and that "support to a specific commodity" includes that portion of non-product specific support that benefits the commodity at issue, in this case upland cotton.[17] Had the authors of Article 13 intended that "support to a specific commodity" not include non-product specific support, Australia believes that they would have said so, consistent with the usage of such terminology elsewhere in the *Agreement on Agriculture*, for example, in Articles 1(a), 4(a) and paragraph 1 of Annex 3.

[14] *The New Shorter Oxford English Dictionary*, Volume 1, page 1.
[15] First Written Submission of the United States, paragraphs 77-81.
[16] Section 1104, 2002 Farm Security and Rural Investment Act, Exhibit Bra-29.
[17] Oral Statement by Australia, paragraphs 20-25.

Further, "such measures" in the proviso of Article 13(b)(ii) and (iii) refers to "domestic support measures that conform fully to the provisions of Article 6" in the chapeau of Article 13(b), which include non-product specific support measures other than "green box" support measures. In Australia's view, to exclude non-product specific domestic support measures from the assessment of "support [*granted by such measures*] to a specific commodity" would be contrary to the express meaning of the text.

See also question 28 below.

**16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? 3RD parties, in particular Australia, Argentina, Benin Canada, China, EC, NZ**

Reply

No. See also questions 14 and 28.

**17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Australia does not consider that the concept of "specificity" in SCM Article 2, or references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement*, have any express textual relationship to the meaning of "support to a specific commodity" in Article 13(b)(ii).

However, Australia notes that a subsidy does not need to be enterprise or industry-specific to be "specific" within the meaning of SCM Article 2. SCM Article 2.1(c) expressly provides that a subsidy can be specific notwithstanding an appearance of non-specificity if a subsidy programme is in fact directed at certain enterprises or industries. SCM Article 2 could therefore be considered to provide broad contextual support for Australia's view that CCPs for upland cotton are product-specific .

**18. Benin's oral statement considers the phrase "support to a specific commodity" in Article 13(b)(ii) of the Agreement on Agriculture. How does Benin believe that phrase is best interpreted. Please substantiate your response, commenting on other submissions by parties and third parties as you believe appropriate. Benin**

**19. Where does Article 13(b)(ii) require a year-on-year comparison? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

See questions 12 above and 28 below.

**20. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?**

Reply

See question 28 below.

**21. Please comment on Brazil's assertion that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

See question 28 below.

**22. What is the meaning of "support" in Agreement on Agriculture 13(b)(ii) ? Why would it be used differently from Annex 3, where it refers to total outlays? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

Australia believes it is significant that the proviso of Article 13(b)(ii) and (iii) uses "support" rather than "AMS" , "support as calculated in Annex 3", or a similar term and that it bears out Australia's view that the use of the term "support" in the proviso was not intended to have the same meaning.

See question 28 below.

**23. Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

See question 28 below.

**24. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) of the Agreement on Agriculture and, in particular, why the words "grant" and "decided" were used. EC**

**25. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Australia is concerned that use of the phrase "authorised during" may be considered to imply a relationship with budgetary approval and expenditure processes and that this would not necessarily be a correct interpretation. As an alternative, Australia suggests "committed to during" could be an appropriate interpretation of the phrase "decided during". See question 28 below.

**26. Under Article 13(b)(ii), a comparison is required between support at different times. One of the issues which is contested between the parties is whether the only later period that the Panel can consider is the present one (i.e. the period underway at the time of the request for establishment of the Panel). This argument is based on the present tense of the words "do not grant" in the English text. The Panel asks whether there is any difference in the verb tense as**

**used in the Spanish-language text, or any other difference which might aid the Panel in interpreting these words? Argentina, EC, Paraguay, Venezuela**

**27. If the 1992 "decision" led to or was the funding source for the money provided in 1992 and later years, is it the full amount of all that funding that constitutes the "support" decided in 1992? If the answer to this question is that it is the full amount of all the support provided pursuant to the "decision" that must be taken into account, must this be compared with the total amount of support that will or might flow from the decision made in the more recent period for the purposes of the comparison required under Article 13(b)(ii)? If a Member did not make a "decision" (however that may be interpreted) in 1992 about "support", is it the case that the Member has a zero base for the purposes of the comparison required under Article 13(b)(ii)? EC**

**28. In paragraph 13 of Australia's oral statement, you state that a "question" is: "could conditions of price competition for the purposes of a non-violation or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole." Could you please clarify this statement (indicating other elements which would complete the "whole" and explain its relevance for the purposes of our consideration of Article 13 of the Agreement on Agriculture? Australia, EC**

Reply

The proviso "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" appears in both subparagraphs (ii) and (iii) of Article 13(b). In both cases, the basic textual provision is the same:

> During the implementation period … domestic support measures that conform fully to the provisions of Article 6 … shall be … exempt from actions based on [*the specified provisions*], provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

Yet Article 13(b)(ii) deals with situations of violation nullification or impairment complaints in relation to actionable subsidies, and Article 13(b)(iii) deals with situations of non-violation nullification or impairment complaints in relation to tariff concessions. It does not seem to Australia to be feasible that the authors of the text of Article 13 of the *Agreement on Agriculture* would have intended exactly the same language within the same Article to have distinct meanings. Indeed, Australia believes it must be assumed that, had the authors intended that the proviso be interpreted and applied differently in the context of violation and non-violation complaints, they would have used different texts, consistent with the normal rules of treaty interpretation. In Australia's view, therefore, it must be assumed that the authors of Article 13 intended that the proviso have the same meaning in the context of both violation and non-violation complaints, and the proviso must be interpreted in such a way as to be capable of being applied in relation to both situations. To this end, it would be a proper exercise of the Panel's discretionary powers to consider also the nature of a non-violation complaint to determine the proviso's meaning.

Australia recalls that the text of the proviso, as well as the draft text of what became Article 13 of the *Agreement on Agriculture* first appeared in the "Blair House Accord" and that the

Accord also included provisions concerning the *EEC – Oilseeds* dispute.[18] In Australia's view, that dispute is crucially relevant to the proper interpretation of Article 13(b)(ii) and (iii).[19]

The panel in *EEC – Oilseeds* described the purpose of GATT Article XXIII:1(b) in the following terms:

> … The Panel noted that these provisions, as conceived by the drafters and applied by the contracting parties, serve mainly to protect the value of tariff concessions.[…] The idea underlying them is that the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. …[20]

The *EEC – Oilseeds* panel went on to say:

> The Panel carefully analysed the price mechanism established in the framework of the Community's market organization for oilseeds and found that the production subsidy schemes of the Community protect Community producers completely from the movement of prices for imports and hence prevent the lowering of import duties from having any impact on the competitive relationship between domestic and imported oilseeds. …[21]

The *EEC – Oilseeds* panel also said:

> … The Panel considered that the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset. … The Panel does not share the view of the Community that the recognition of the legitimacy of such expectations would amount to a re-writing of the rules of the General Agreement. … The recognition of the legitimacy of an expectation relating to the use of production subsidies therefore in no way prevents a contracting party from using production subsidies consistently with the General Agreement; it merely delineates the scope of the protection of a negotiated balance of concessions. For these reasons the Panel found that the United States may be assumed not to have anticipated the introduction of subsidies which protect Community producers completely from the movement of prices for imports and thereby prevent tariff concessions from having any impact on the competitive relationship between domestic and imported oilseeds, and which have as one consequence that all domestically-produced oilseeds are disposed of in the internal market notwithstanding the availability of imports.[22]

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[18] *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins ("EEC – Oilseeds")*, Report of the Panel, adopted 25 January 1990, BISD 37S/86.

[19] Australia notes that the report of the *EEC – Oilseeds* panel has been cited with approval in subsequent WTO jurisprudence, for example, *Japan – Measures Affecting Consumer Photographic Film and Paper*, Report of the Panel, WT/DS44/R, paragraph 10.35, and *EC – Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, WT/DS135/AB/R, paragraph 185.

[20] *EEC – Oilseeds*, paragraph 144.

[21] *EEC – Oilseeds*, paragraph 147.

[22] *EEC – Oilseeds*, paragraph 148.

In summary, the *EEC – Oilseeds* panel considered that the basis for assessing whether the benefits of tariff concessions are being nullified or impaired in a non-violation complaint is the legitimate expectations of the "conditions of price competition" for a product. In assessing those conditions, matters to be considered included market prices and the applicable tariff concession(s) as well as any other relevant measures, including measures that were not inconsistent with GATT 1947. Further, that assessment involved a temporal comparison between the "conditions of price competition" that could legitimately have been expected at the time a tariff concession was negotiated and the conditions that actually prevailed at a later point of time.

Accordingly, to enable its application in a situation of non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member, the proviso of Article 13(b)(iii) must be interpreted in a manner capable of:

- establishing other Members' legitimate expectations of the "conditions of price competition";
- taking account of factors such as the applicable tariff concession(s), market prices and domestic support measures that conform fully to the provisions of Article 6 of the *Agreement on Agriculture*; and
- allowing a comparison between two different points in time.

In Australia's view, interpreting the phrase "grant support" in a manner that limits the factors to be considered to domestic support measures that conform fully to the provisions of Article 6 as measured by budgetary outlays, as argued by Brazil, or the rate of payment, as argued by the United States, could not lead to a proper application of the proviso of Article 13(b)(iii) in the context of a non-violation dispute. Such an interpretation cannot establish other Members' legitimate expectations of "conditions of price competition" as these have been understood in GATT and WTO jurisprudence, as it cannot capture issues relating to tariff concessions and market prices that are integral to a non-violation complaint of nullification or impairment of the benefits of tariff concessions accruing to another Member. The only essential element that such an interpretation is capable of capturing is the basic point in time for the purposes of comparison: instead of being the time at which a tariff concession was negotiated, it is the 1992 marketing year.

It would not be possible for the interpretations of the proviso offered by Brazil and the United States to apply in the context of a non-violation dispute. Thus, Australia believes it is incumbent upon the Panel to consider whether it is possible to apply in the context of an actionable subsidy complaint the proviso in the sense of legitimate expectations of the "conditions of price competition" as this applies to a non-violation nullification or impairment complaint. That application would need to take account as appropriate of tariff concessions, market prices and domestic support measures that conform fully to the provisions of Article 6.

Australia considers that such a "conditions of price competition" test is capable of being applied in the context of a violation complaint covered by Article 13(b)(ii) and was in fact intended by the authors of the text of Article 13. In Australia's view, a "conditions of price competition" test as this was interpreted and applied in *EEC – Oilseeds*, allowing as appropriate tariff concessions, market prices and domestic support measures that conform fully to the provisions of Article 6, forms "the whole".

Further, such an interpretation overcomes the many interpretive questions raised by the arguments put forward by the parties to the dispute. Notwithstanding that legitimate expectations of "conditions of price competition" are not normally applicable in the context of a violation complaint, Australia cannot identify any provision of the *Agreement on Agriculture*, or indeed any other of the covered agreements, that would preclude the application of such a test in the context of Article 13(b)(ii).

The use of such a test would explain why the phrase "grant support" was used without further elaboration, such as "support as measured by AMS", "support as calculated in Annex 3" or similar wording. "Support" in the context of subparagraphs (ii) and (iii) of Article 13(b) was purposefully intended to mean all non-"green box" domestic support measures, whether specific or not, which benefit a specific commodity in the sense of a "conditions of price competition" test. In this context, Australia notes that paragraph 8 of Annex 3 expressly excludes from the calculation of AMS some forms of "support" within the meaning of subparagraphs (ii) and (iii) of Article 13(b).

The proviso establishes "support … decided during the 1992 marketing year" as the basis for comparison. In other words, the basis for comparison is the legitimate expectations of other Members of the "conditions of price competition" having regard to the applicable tariff measures and non-"green box" domestic support measures as these were committed to by a Member during the 1992 marketing year, vis-à-vis market prices. It requires a comparison of the legitimate expectations of other Members of the "conditions of price competition" to apply in future on the basis of decisions made by a Member during the 1992 marketing year with the actual "conditions of price competition" at a future point in time. Thus, question concerning whether a year-on-year comparison is required or whether a failure by a Member to comply in a given year affects that Member's entitlement to invoke Article 13(b) in other years become moot. So long as a Member's non-"green box" domestic support measures that conform fully to the provisions of Article 6 "grant support to a specific commodity" in the sense of a "conditions of price competition" test "in excess of that decided during the 1992 marketing year", Article 13(b)(ii) and (iii) does not provide an exemption from actions based on the specified provisions. Conversely, once a Member's non-"green box" domestic support measures no longer grant support in excess of that decided during the 1992 marketing year, the Member re-acquires the right to invoke Article 13(b)(ii) and (iii).

In Australia's view, interpreting the proviso of Article 13(b)(ii) as requiring the application of a "conditions of price competition" test is consistent with the ordinary meaning of the words in their context:

> provided that [*domestic support measures that conform fully to the provisions of Article 6*] do not grant [agree to, bestow or confer][23] support [*assistance or backing*][24] to a specific commodity in excess of [*more than*][25] that decided [*determined or resolved,*[26]*, i.e., committed to*] during the 1992 marketing year.

Moreover, interpreted in the sense of legitimate expectations of "conditions of price competition" in respect of both Article 13(b)(ii) and (iii), the proviso is consistent with the object and purpose of the *Agreement on Agriculture*, including as expressed in the preamble of the Agreement "to establish a fair and market-oriented agricultural trading system and that a reform process should be initiated through the negotiation of commitments on support and protection and through the establishment of strengthened and more operationally effective … rules and disciplines" and "to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets". The provisos of Article 13(b)(ii) and (iii) establish the outer limits within which the market distorting support that continues to be permitted under the *Agreement on Agriculture* must remain during the implementation period if a Member is to benefit from the protection against actionable subsidy claims offered by Article 13(b) during that time. In other words, a Member's domestic support measures may not create a more market distorting situation in respect of any one commodity than could reasonably have been anticipated on the basis of that Member's decisions made known during the 1992 marketing year for that product.

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[23] *The New Shorter Oxford English Dictionary*, Volume 1, page 1131.
[24] *The New Shorter Oxford English Dictionary*, Volume 2, pages 3152-3153.
[25] *The New Shorter Oxford English Dictionary*, Volume 1, page 873.
[26] *The New Shorter Oxford English Dictionary*, Volume 1, 607.

However, should the Panel consider that another interpretation of the proviso of Article 13(b)(ii) was intended by the authors of the text of Article 13, Australia believes it incumbent upon the Panel to test its interpretation in the context of a non-violation complaint covered by Article 13(b)(iii).

EXPORT CREDIT GUARANTEE PROGRAMMES

**29. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

**(b) How, if at all, would this be relevant to the claims of Brazil? 3rd parties, in particular, Argentina, Canada, EC, NZ**

**30. The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an a contrario interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission). 3rd parties, in particular, Argentina, Canada, EC, NZ**

**31. If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both? 3rd parties, in particular, Argentina, Canada, EC, NZ**

**32. The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see third party submission of Canada) and to the panel report in DS 222 Canada- Export Credits and Loan Guarantees. How and to what extent are Article 14(c) of the SCM Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material. 3rd parties, in particular, Argentina, Canada, EC, NZ**

**33. What is the relevance (if any) of Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders". 3rd parties, in particular, Argentina, Canada, EC, NZ**

**34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"? 3rd parties, in particular, Argentina, Canada, EC, NZ**

**35. Did the drafters of the Agreement on Agriculture include export credit guarantees in Article 9.1 of the Agreement on Agriculture? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

**36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38) 3rd parties, in particular, Argentina, Canada, EC, NZ**

**(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

**(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

**37. The United States seems to argue that, at present, by virtue of Article 10.2 of the Agreement on Agriculture, there are no disciplines on agricultural export credit guarantees under the Agreement on Agriculture (or the SCM Agreement).**

**(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the Agreement on Agriculture? Please cite any relevant material, including any past WTO dispute settlement cases. 3rd parties, in particular, Argentina, Canada, EC, NZ**

**(b) If, as the United States argues, there are no disciplines on export credit guarantees in the Agreement on Agriculture, how could export credit guarantees "conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)? 3rd parties, in particular, Argentina, Canada, EC, NZ**

STEP 2 PAYMENTS

**38. Please comment on the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in Canada-Dairy and the findings of the Appellate Body in US-FSC (21.5)[27], do any other dispute settlement reports offer guidance on this issue? For example, how,**

[27] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.[27] Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a

**if at all is the Appellate Body's report in Canada-Aircraft relevant here?[28] 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

**39. Please comment on the United States assertions at paragraph 129 of its first written submission, that "[t]he programme is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States". 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

Reply

This comment responds to both questions 38 and 39.

Australia provided detailed comment on the "Step 2" payment programme having regard to the Appellate Body's findings in *US – FSC (21.5)* at paragraphs 49-69 of its Third Party Submission. Australia does not dispute that "Step 2" payments may be made on either export or domestic use of a bale of cotton, or that the "intent" with which a buyer purchased a bale of cotton has no effect on an entitlement to a "Step 2" payment in respect of that particular bale. However, these arguments by the United States are not determinative of the issue.

To qualify for a "Step 2" payment, a bale of cotton must be either exported or consumed by a domestic user. These are the two distinct factual situations covered by the "Step 2" payment programme: by definition, a particular bale of cotton cannot be both exported and consumed by a domestic user.

The Appellate Body's findings in *Canada – Aircraft*[29] provide further support for the view that "Step 2" payments are export or local content subsidies. In each of the distinct factual situations of export or domestic use, "Step 2" payments are contingent upon export performance or contingent upon the use of domestic over imported goods respectively.

**40. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the AoA? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the SCM Agreement and Article III:4 of the GATT 1994. 3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay**

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United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

1. [28] There, the Appellate Body stated that,

> "the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".[28]

[29] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, paragraph 179.

Reply

Australia does not consider that the phrase "provide support in favour of domestic producers" in Article 3.2 of the *Agreement on Agriculture* permits subsidies contingent upon the use of domestic goods.

In Australia's view, the legal issue in question relates to the condition attached to the grant of a subsidy, not the grant of a subsidy *per se* or who might benefit from the subsidy. The fact that a measure may benefit an agricultural producer ("support in favour of domestic producers") does not serve to override measures otherwise prohibited.

Article 21.1 of the *Agreement on Agriculture* provides that "[t]he provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement". Article 3.1 of the *SCM Agreement* applies "[e]xcept as provided in the Agreement on Agriculture". The General Interpretive Note to Annex 1A of the *Marrakesh Agreement Establishing the World Trade Organization* also provides contextual guidance. Pursuant to that Note, the *Agreement on Agriculture* would prevail to the extent of any conflict with GATT 1994.

However, in the case of subsidies contingent upon the use of domestic goods, there is no conflict between either the *Agreement on Agriculture*, which inter alia disciplines the amounts of domestic support in favour of domestic producers which distorts trade and production, and the *SCM Agreement* or GATT 1994, which discipline or prohibit certain conditions attached to subsidies, including subsidies in favour of agricultural producers (subject only to the provisions of Article III:8(b) of GATT 1994). There is no provision in the *Agreement on Agriculture* which provides for an exception to, or cover for, local content conditions attached to the grant of a subsidy.

Australia has already noted[30] that Article 13(b)(ii) does not exempt non-"green box" domestic support measures from actions based on Article 3 of the *SCM Agreement*. Neither does Article 13 anywhere refer to GATT Article III:4. Nor with regard to these Articles is there any provision comparable to Articles 5 and 12 of the *Agreement on Agriculture*. As stated in the preambular clauses of the *Agreement on Agriculture*, the "long-term objective is to provide for substantial progressive reductions in agricultural support and protection": it is not intended to provide for a weakening of disciplines, particularly when such disciplines are not specifically mentioned.

Australia also notes that the domestic support provisions of the *Agreement on Agriculture* provide for a strengthening and elaboration of the provisions of Article XVI of GATT 1994. They are not directed towards a diminution of basic GATT obligations. National treatment is central to the multilateral trading system. It is inconceivable to Australia that the negotiators of the Agreement on Agriculture would, as part of a reform programme designed to strengthen disciplines, agree to weaken national treatment disciplines.

However, in the event the Panel were to consider that the phrase "provide support in favour of domestic producers" refers to and/or permits subsidies contingent upon the use of domestic goods, Australia notes that such support could be permitted only to the extent that the support was actually passed through to the producers of the basic agricultural product.

[30] Oral Statement by Australia, paragraphs 29-30.

ETI ACT

**41. Concerning its claims on the ETI Act, Brazil relies on the US – FSC case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the Agreement on Agriculture. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Argentina, China, EC, NZ**

**42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to that dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. Argentina, China, EC, NZ**

# ANNEX J-3

## ANSWERS OF BENIN TO THE PANEL'S QUESTIONS OF 25 JULY 2003

11 August 2003

Benin offers the following responses to the 25 July questions of the Panel, as they pertain to the scope of Benin's Third Party Submission or Oral Statement:

**1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions of Article 13 are a "prerequisite" to the availability of a right or privilege? Australia. Would other third parties have any comments on Australia's assertion? 3rd parties, in particular Argentina, Benin, China, Chinese Taipei**

Reply

Benin agrees with the basic assertion of Australia that Article 13 of the *Agreement on Agriculture* is an affirmative defence.

In Benin's view, the notion of Article 13 as an affirmative defence is easily reconciled with the view that the conditions set out in Article 13 are a prerequisite to its availability. As Benin argued in its Third Party submission, the language used in Article 13 shows the clear intent of its drafters that the Member seeking to invoke the peace clause defence must bear the burden of demonstrating full compliance with all of the preconditions set out in this provision. As noted by Benin, this intent is demonstrated, *inter alia*, by the use of the proviso "provided that." In the *Quantitative Restrictions* case, also referred to in Benin's Third Party submission, the Appellate Body considered similar language in GATT Article XVIII:11, and found that the burden lay on the Member seeking to invoke the proviso.

While Benin and Australia thus share the same view on the nature of Article 13, Benin would not find it necessary to refer to the invocation of Article 13 as a "privilege." In Benin's view, a Member that has met the burden of demonstrating full compliance with all of the preconditions set out in Article 13 could invoke this defence as a right. However, the United States has clearly not met this burden in the present case.

**16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? 3rd parties, in particular Australia, Argentina, Benin, Canada, China, EC, NZ**

Reply

Please see Benin's answer to Question 18, which also addresses the issue raised in Question 16.

**18. Benin's oral statement considers the phrase "support to a specific commodity" in Article 13(b)(ii) of the *Agreement on Agriculture*. How does Benin believe that phrase is best interpreted? Please substantiate your response, commenting on other submissions by parties and third parties you believe appropriate. Benin**

Reply

In Benin's view, the phrase "support to a specific commodity" in Article 13(b)(ii) means any support, other than green box support, provided to a particular, identifiable agricultural commodity. Such support can be provided through either a product-specific or non product-specific programme.

The United States argues that "the phrase 'support to a specific commodity' should be understood to mean 'product-specific support'". This position is supported by the European Communities, which suggests that the word "specific" was inserted in Article 13 as "a qualifier to the word 'support'".

As noted by Benin in its oral statement of July 24, if the drafters of the Agreement on Agriculture had wanted to use the term "product-specific support" in Article 13(b)(ii), they obviously could have done so, as they did elsewhere in Agreement, such as in Article 6(4), or in Annex 3.

The interpretation proposed by the United States and the European Communities is contrary to the language actually used in Article 13(b)(ii), which refers to support to a "specific commodity" and not "specific support" to a commodity, or "product-specific support." The treaty interpreter must give meaning to the words actually used by the drafters of this provision.

As noted by New Zealand in its Third Party submission, the use of the term "specific commodity" in Article 13(b)(ii) was used to distinguish the "peace clause" from general domestic support commitments, which are determined on the basis of total "Aggregate Measure of Support". As stated by New Zealand, without such wording, "peace clause" protection could be lost for any agricultural product if total AMS increased, even if support to a specific product had not increased.

Moreover, to re-iterate another point raised by Benin in its oral statement, acceptance of the US interpretation would clearly elevate form over substance. Benin agrees with Brazil that the US interpretation "would carve out a category of non-'green box' subsidies simply because the measures distort trade in *multiple* commodities…This interpretation would permit Members to insulate their trade-distorting non-'green box' measures from challenge by manipulating the *form* of the support so that it does not mandate the production of a specific commodity in order to receive the subsidy, or by providing such support through a non-'product-specific' measure."

Benin also notes that the Appellate Body has made clear that the WTO-consistency of subsidies must be determined by their substance, and not by their form.[1]

Therefore, support provided to any specific or identifiable commodity, regardless of the nature of that support, must be included in the analysis required by Article 13(b)(ii). In Benin's view, this interpretation would remain the same if the word "specific" were deleted from Article 13(b)(ii),

[1] In Benin's view, it is useful to recall how the Appellate Body interpreted the export subsidy commitments of the *Agreement on Agriculture* in the *Canada Dairy* dispute, where the tribunal emphatically rejected an interpretation that would have elevated form over substance. The Appellate Body refused to read the word "payments" in Article 9.1(c) narrowly, i.e. to mean monetary payments only, but not payments-in-kind:

> "…if a restrictive reading of the words "payments" were adopted, such that "payments" under Article 9.1(c) had to be monetary, no account could be taken, under Article 9.1(c), of "revenue foregone". This would, we believe, prevent a proper assessment of the commitments made by WTO Members under Article 9.2, as envisaged by Article 1(c) of the *Agreement on Agriculture*. We, therefore, prefer a reading of Article 9.1(c) that allows full account to be taken of "revenue foregone". The contrary view would, in our opinion, elevate form over substance and permit Members to circumvent the subsidy disciplines set forth in Article 9 of the *Agreement on Agriculture*." [emphasis added]

Appellate Body Report, Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products, WT/DS103/AB/R, WT/DS113/AB/R, paragraph 110.

an issue raised in Question 16. Such a deletion, in Benin's view, would reinforce the view that support provided to "a commodity", regardless of the form of that support, would come under this provision.

In any event, whether the drafters chose the term "support to a specific commodity" or "support to a commodity", the result would be the same. The most important point is that the drafters of the Agreement could have used "product-specific support", a term of art found elsewhere in the Agreement, but did not.

In addition, Benin would offer the following views on the ETI Act:

**41. Concerning its claims on the ETI Act, Brazil relies on the *US – FSC* case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Argentina, China, EC, NZ**

Reply

Brazil has asked the Panel to find that "the ETI Act constitutes an export subsidy violating AoA Articles 10.1 and 8 and ASCM Article 3.1(a)." [Paragraph 330 of Brazil's First Submission.] As is well-known, the Appellate Body has found that the ETI measure is inconsistent, *inter alia*, with the same provisions cited by Brazil: Articles 10.1 and 8 of the *Agreement on Agriculture*, and Article 3.1(a) of the SCM Agreement.[2] The Appellate Body report was adopted by the DSB on January 29, 2002, and the ETI has remained unamended since that time.

Before responding directly to Question 41, Benin would offer some preliminary observations on the relevance of earlier Panel and Appellate Body reports.

In Benin's view, prior adopted Panel or Appellate Body reports are not technically binding on subsequent Panels. As the Appellate Body stated in *Japan Alcohol*, adopted panel reports "are not binding, except with respect to resolving the particular dispute between the parties to that dispute." [3] Thus, the adopted Appellate Body decision in the FSC/ETI dispute is binding only on the parties to that dispute, the United States and the EC.

However, the Appellate Body in *Japan Alcohol* also made clear that prior panel decisions "create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute."[4]

A similar approach was taken by the Panel in the *India – Patent Protection* case. The Panel, established at the request of the EC, had to determine what weight to give to the adopted Panel and Appellate Body reports on the same subject matter in an earlier case brought by the United States. The Panel stated that:

[2] Appellate Body report, *United States – Tax Treatment for 'Foreign Sales Corporations': Recourse to Article 21.5 of the DSU by the European Communities.* WT/DS108/AB/RW.

[3] Appellate Body report, *Japan - Taxes on Alcoholic Beverages*. WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R. Page 14.

[4] Appellate Body report, *Japan - Taxes on Alcoholic Beverages. Ibid*, page 14. In the *Shrimp-Turtle* compliance panel appeal, the Appellate Body added that: "This reasoning applies to adopted Appellate Body Reports as well." Appellate Body report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products: Recourse to Article 21.5 of the DSU by Malaysia*. WT/DS58/AB/RW, paragraph 109.

> "It can thus be concluded that panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same. In examining dispute WT/DS79 [the EC complaint] we are not legally bound by the conclusions of the Panel in dispute WT/DS50 [the prior US complaint] as modified by the Appellate Body report. However, in the course of "normal dispute settlement procedures" required under Article 10.4 of the DSU, we will take into account the conclusions and reasoning in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we should give significant weight to both Article 3.2 of the DSU, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, and to the need to avoid inconsistent rulings (which concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the DSU."[5] [original emphasis]

It is also highly instructive to recall the position taken by the United States as a third party to the EC complaint, since there are direct parallels to the current situation in *Cotton*. The US position, as summarized by the Panel, included the following:

> "The United States argued in its third party submission that the precise measures and provisions of the WTO Agreement at issue in this dispute had been the subject of a previous WTO dispute settlement proceeding….[T]he Appellate Body had thoroughly analyzed the legal issues in the case and it was neither necessary nor appropriate for the Panel to repeat that work. The Panel should consider the arguments of the parties, but be guided by the Appellate Body's recent interpretation of the obligations at issue….
>
> The United States supported the view of the EC that it was not necessary or appropriate to repeat all of the legal arguments made in the earlier dispute (WT/DS50) in the context of the present proceedings….India appeared to seek an entirely redundant proceeding. Despite India's obligation under Article 17.14 of the DSU to accept the Appellate Body's report in the earlier case unconditionally, India's submission gratuitously disparaged the work of the Appellate Body….
>
> The United States added that, moreover, India did not argue that it had modified its patent regime since the Appellate Body's ruling and that, in that situation, the Panel should be guided by the Appellate Body's decision, not by allegedly new arguments about the same patent regime.
>
> India should not be permitted to reopen legal issues that had been conclusively determined by a panel and the Appellate Body. Such a result would invite repetitive litigation….The drafters had wanted to avoid giving complainants or defendants an incentive to re-litigate disputes to see if different panels would produce different results. If such "panel shopping" did produce different results, the effect on the dispute settlement system would be profoundly destabilizing.
>
> The WTO dispute settlement system could not function effectively without consistent panel judgments….Without consistent judgments, WTO Members would find little guidance in the legal interpretations developed by dispute settlement panels and the Appellate Body. The role of the dispute settlement system [would be] greatly

[5] Panel report, India - Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS79/R, paragraph 7.30.

> diminished and the system could not fulfill its purpose: to serve as a "central element in providing security and *predictability* to the multilateral trading system." [emphasis added]

The parallels between *India – Patent Protection* and *Cotton* are striking, and the US submission in the former case provide clear guidance as to how the *Cotton* panel should examine Brazil's current ETI claims.

As was the case in *Patent Protection*, the Appellate Body has "thoroughly analyzed the legal issues in the [FSC/ETI] case" and it is "neither necessary nor appropriate" for the *Cotton* Panel to "repeat that work." The *Cotton* Panel should consider the arguments of the parties, but "be guided by the Appellate Body's recent interpretation of the obligations at issue." The United States should not be permitted to "reopen legal issues [related to the ETI] that had been conclusively determined by a panel and the Appellate Body." Benin shares the US concern that "such a result would invite repetitive litigation", would promote "panel shopping", and that different results could be "profoundly destabilizing."

Thus, in Benin's view, the *Cotton* panel should be guided by the Appellate Body's interpretation of the US ETI measure.

Turning to the specific question raised by the Panel: as noted above, Benin agrees with the position advanced by the United States in *Patent Protection* that a responding party in a subsequent case dealing with the same measure should not be permitted to reopen issues "that had been conclusively determined by a panel and the Appellate Body." However, in *Cotton*, the United States would have the right to advance specific new defences that were not considered by the Panel or the Appellate Body in the FSC/ETI dispute (e.g. that the United States is entitled to the protection of Article 13 because its export subsidies for cotton "conform fully" to the provisions of Part V of the *Agreement on Agriculture*).

Thus, as a procedural matter, the *Cotton* Panel could consider such US arguments. However, as a substantive matter, Benin would note that the relevant obligations in Part V of the *Agreement on Agriculture* are Articles 8 and 10.1. As stated above, the Appellate Body has already determined that the ETI involves export subsidies inconsistent with US obligations under both these provisions. Therefore, in Benin's view, US export subsidies for cotton do not "conform fully to the provisions of Part V." Accordingly, the ETI is not exempt from action by virtue of the Peace Clause.

**42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the *DSU*, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the *DSU*, and please cite any other provisions you consider relevant. Argentina, China, EC, NZ**

Reply

As noted in the footnote to paragraph 43 of the EC statement, the reference to adopted Appellate Body reports providing "a final resolution to the dispute" was taken from the decision of the Appellate Body in the *Shrimp-Turtle* compliance panel appeal.[6] However, the context of that case was slightly different from the present dispute. The Appellate Body decision in the Article 21.5 proceeding in *Shrimp Turtle* involved the same dispute as had been litigated earlier between Malaysia

[6] Appellate Body report, United States – Import Prohibition of Certain Shrimp and Shrimp Products: Recourse to Article 21.5 of the DSU by Malaysia. Op. Cit.

and the United States, although it had by then moved to the compliance panel stage.[7] By contrast, *Cotton* is a new dispute, albeit one that includes the same measure that had been found to be WTO-inconsistent in the earlier EC-US *FSC* dispute.

Thus, in the present context, the reference to "the dispute" in DSU Article 17.14 would refer to the EC-US dispute in FSC/ETI, since that is the "dispute" which has resulted in an adopted Appellate Body report. The "dispute" referred to in Article 12 and Appendix 3 would be the *Cotton* dispute, as these proceedings are now underway. Article 9.3 provides that if more than one panel is established to examine the complaints related to the same matter, to the greatest extent possible, the same persons shall serve as panelists on each of the separate panels, and the timetables shall be harmonized. While this provision might have had some potential relevance if the *Cotton* and *FSC* cases had been running concurrently, given the partial overlap of claims, it seems of little relevance now to the Panel as it assesses the weight to ascribe to prior rulings on the FSC/ETI.

In any event, Benin would strongly re-iterate its position, as set out above, that the *Cotton* panel should be guided by the Appellate Body's interpretation of the ETI, particularly since the measure has not been amended since the DSB adopted the Appellate Body's report.

[7] Similar kinds of issues are raised in European Communities – Antidumping Duties on Imports of Cotton-Type Bed Linen from India: Recourse to Article 21.5 of the DSU by India. Report of the Appellate Body. WT/DS141/AB/RW.

# ANNEX J-4

## CANADA'S RESPONSES TO PANEL QUESTIONS TO THIRD PARTIES AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES (FIRST SESSION)

11 August 2003

Canada sets out responses to the questions of the Panel in which Canada has a systemic interest:

**2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*.**

Reply

1. The meaning of the term "defined" is "having a definite or specified outline or form; clearly marked, definite".[1] The term "fixed" is defined as "definitely and permanently placed or assigned; stationary or unchanging in relative position; definite, permanent, lasting".[2] Based on the ordinary meaning of these terms, the base period for US direct payments must be clearly set out and remain unchanged. Because the structure of direct payment programme and the parameters for direct payments are essentially the same as those regarding PFC payments, the Panel should find that the applicable base period for direct payments is the base period for PFC payments. By allowing base acreage for direct payments to be updated, the United States acts inconsistently with paragraph 6(a) of Annex 2 because the base period is not "fixed". Canada refers the Panel to paragraphs 4-6 of its third party oral statement.

**3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3.**

Reply

2. Paragraph 6(a) of Annex 2 of the *Agriculture Agreement* requires eligibility for decoupled income support payments to be determined by "clearly-defined criteria such as… production level in a defined and fixed based period". Use of the indefinite article "a" in this provision means that no base period is specified. To the contrary, paragraph 11 of Annex 3 specifies a base period.

3. Use of the definite article "the" in paragraphs 6(b), (c) and (d) of Annex 2 creates a reference to the base period established pursuant to paragraph 6(a).

**4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*?**

[1] *New Shorter Oxford English Dictionary*, p. 618 ("defined") [Exhibit CDA-4].
[2] *New Shorter Oxford English Dictionary*, p. 962 ("fixed") [Exhibit CDA-5].

Reply

4. A Member may define and fix a base period only once for any given type of decoupled income support payment.

**16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph?**

Reply

5. The Appellate Body explained in *United States – Reformulated Gasoline* that "[o]ne of the corollaries of the 'general rule of interpretation' in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of a treaty".[3] The term "specific commodity" means a commodity that is clearly and explicitly defined.[4] Deletion of the word "specific" would imply an examination of support benefiting a potentially broader product class, a result that is not supported by the text of Article 13(b)(ii) of the *Agriculture Agreement*.

**17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement* to the meaning of "support to a specific commodity" in Article 13(b)(ii) *Agreement on Agriculture*?**

Reply

6. Article 2 of the *SCM Agreement* sets out principles that apply to determine whether a subsidy "is specific to [certain enterprises]". In the context of Article 2, the phrase "is specific to" means that a government restricts the availability of a subsidy to certain enterprises.[5] In the context of Article 13(b)(ii) of the *Agriculture Agreement*, the term "specific commodity" means a commodity that is clearly and explicitly defined.[6] Article 13(b)(ii) requires an examination of all support that is not exempt under Annex 2 and that benefits a "precise", "exact", or "defined" commodity. Such support may be provided either through product-specific or non-product-specific support programmes.

**29. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement* ? Why or why not?**

Reply

7. Yes, an export credit guarantee is a potential direct transfer of funds under Article 1.1(a)(1)(i) of the *SCM Agreement*. The GSM programmes "underwrite credit extended by the private banking sector in the United States (or, less commonly, by the US exporter) to approved foreign banks using dollar-denominated, irrevocable letters of credit to pay for food and agricultural products sold to foreign buyers."[7] Under the SCGP, "CCC guarantees a portion of payments due from importers under short-term financing (up to 180 days) that exporters have extended directly to the importers for the

[3] *United States – Standards for Reformulated and Conventional Gasoline*, Report of the Appellate Body, WT/DS2/AB/R, adopted 20 May 1996, p. 23.

[4] US First Written Submission, para. 77, fn 66. ("Clearly or explicitly defined; precise, exact, definite.")

[5] US First Written Submission, para. 77. ("'Specific' means '[s]pecially or peculiarly pertaining to a particular thing or person, or a class of these; peculiar (to)'.")

[6] US First Written Submission, para. 77, fn 66. ("Clearly or explicitly defined; precise, exact, definite.")

[7] See Exhibit BRA-71 ( "Fact Sheet: CCC Export Credit Guarantee Programmes (GSM-102/103)").

purchase of US agricultural products."[8] Where a foreign bank or foreign importer defaults under the terms of the credit/financing that has been extended, the CCC will transfer funds to the US bank or US exporter directly.

**(b) How, if at all, would this be relevant to the claims of Brazil?**

Reply

8. Where the guarantees provided under the US programmes confer a "benefit", a "subsidy" exists within the meaning of Article 1.1 of the *SCM Agreement*. Whether a "subsidy" exists under Article 1.1 of the *SCM Agreement* is relevant to determining whether the US programmes grant export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement*. Panels and the Appellate Body have relied upon the definition of a "subsidy" in Article 1.1 of the *SCM Agreement* as context to determining whether an "export subsidy" exists under Article 1(e) of the *Agriculture Agreement*. This Panel should do the same.

9. Were the Panel to find that these programmes provide export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement* (a likely result in this case), then it would also find that the United States has violated Articles 8 and 10.1 at the very least in respect of exports of upland cotton because it is an unscheduled product and the US quantitative export subsidy reduction commitment level for that commodity is therefore zero.

**30. The Panel could arguably take the view that Articles 1 and 3 of the *SCM Agreement* were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an *a contrario* interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission).**

Reply

10. Whether an export subsidy exists under Articles 1 and 3 of the *SCM Agreement* is relevant to determining whether the US programmes grant export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement*. Item (j) of the Illustrative List may not be interpreted *a contrario* to deem US export credit guarantee practices as not providing export subsidies under Article 10.1 of the *Agriculture Agreement*. Where US programmes may not be deemed to provide export subsidies because they do not meet the requirements of item (j), Articles 10.1 and 10.3 of the *Agriculture Agreement* nevertheless require the United States to demonstrate that it has not granted export subsidies within the meaning of Articles 1 and 3 of the *SCM Agreement* in respect of the relevant quantity of exports. Canada refers the Panel to paragraphs 49-50 of its written third party submission and paragraphs 12-14 of its third party oral statement.

**31. If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance in the interpretation of the terms in Article 10 *Agreement on Agriculture*, should the Panel refer to item (j) or Articles 1 and 3 of the *SCM Agreement* or both?**

[8] See Exhibit BRA-72 ("Fact Sheet: CCC Supplier Credit Guarantee Programme").

Reply

11. The Panel should refer to both. Item (j) of the Illustrative List in Annex I of the *SCM Agreement* allows the Panel to determine whether the United States provides "export credit guarantee… programmes" such that guaranteed export credit transactions guaranteed under those programmes are subsidized *per se*. Articles 1 and 3 of the *SCM Agreement* allow the Panel to determine, on a transaction-by-transaction basis, whether given quantities of US exports are subsidized.

**32. The Panel's attention has been drawn to Article 14(c) of the *SCM Agreement* (see third party submission of Canada) and to the panel report in DS 222 *Canada - Export Credits and Loan Guarantees*. How and to what extent are Article 14(c) of the *SCM Agreement*, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material.**

Reply

12. Canada refers the Panel to paragraphs 41-48 of its written third party submission with respect to how and to what extent Article 14(c) of the *SCM Agreement* and the cited panel report are relevant.

13. Whether a benefit is conferred under Article 1.1(b) of the *SCM Agreement* is a question of fact, to be assessed in the light of all the relevant financial considerations of a given export credit transaction. The Panel's findings in this respect will depend on an examination of: 1) the terms of credit transactions that are guaranteed by the CCC, including the length of the repayment period and any fees charged for the guarantee, and 2) credit transactions with similar terms that are occurring in the market without a CCC guarantee.

**33. What is the relevance (if any) of Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders."**

Reply

14. Were the Panel to find that support for exports of agricultural products such as export credit guarantees are not available on the marketplace from commercial lenders, this would suggest that a benefit under Article 1.1(b) of the *SCM Agreement* exists because the provision of such support in the market would otherwise require uneconomical terms and conditions (based on factors such as a lack of security provided by the product and a lack of lender confidence in sales of the product).

**34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"?**

Reply

15. The term "costs" must be distinct in meaning from the term "losses", otherwise the coordinating conjunction "and" is rendered meaningless. This is confirmed by the French version of the phrase ("*les frais et les pertes*"). In Canada's view, any "claims paid" may yield "losses" when they are added to any other "operating costs" incurred under the programme. Such losses would be required to be covered over the long term by the premiums charged to avoid a finding that transactions guaranteed under the programme are subsidized *per se*.

**35. Did the drafters of the *Agreement on Agriculture* include export credit guarantees in Article 9.1 of the *Agreement on Agriculture*? Why or why not?**

Reply

16. Export credit guarantees were not included in Article 9.1 of the *Agreement on Agriculture* because Members could not agree on specific language. Article 10.1 therefore covers any export subsidies granted by such guarantees.

**36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38)**

**(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

17. This statement suggests that similar credit transactions that are not guaranteed by the CCC would involve uneconomical terms and conditions. Therefore, it suggests that a "benefit" exists within the meaning of Article 1 of the *SCM Agreement*. The statement also confirms that the US programmes are contingent upon export performance within the meaning of Article 1(e) of the *Agriculture Agreement*.

**(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

18. This statement also suggests that a "benefit" exists within the meaning of Article 1 of the *SCM Agreement*, and confirms that the US programmes are contingent upon export performance within the meaning of Article 1(e) of the *Agriculture Agreement*.

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

19. This statement confirms that the US programmes are contingent upon export performance within the meaning of Article 1(e) of the *Agriculture Agreement*.

**37. The United States seems to argue that, at present, by virtue of Article 10.2 of the *Agreement on Agriculture*, there are no disciplines on agricultural export credit guarantees under the *Agreement on Agriculture* (or the *SCM Agreement*).**

**(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an**

**indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the *Agreement on Agriculture* ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the *Agreement on Agriculture*? Please cite any relevant material, including any past WTO dispute settlement cases.**

Reply

20. Were the Panel to find that US export credit guarantee programmes provide export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement*, then it would also find that the United States has violated its export subsidy commitments under the *Agriculture Agreement* at the very least in respect of exports of upland cotton. In this respect, Canada refers the Panel to paragraphs 51-54 of its written third party submission, paragraphs 15-16 of its third party oral statement, and paragraphs 133-153 of the Appellate Body's original report in *US – FSC*.[9]

**(b) If, as the United States argues, there are no disciplines on export credit guarantees in the *Agreement on Agriculture*, how could export credit guarantees "conform fully to the provisions of Part V" of the *Agreement on Agriculture* within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)?**

Reply

21. For export credit guarantees to be exempt from the obligations set out in the *Agriculture Agreement*, the Agreement would have to expressly provide for the exemption. No provision of the *Agriculture Agreement* exempts export credit guarantees from any obligation under the Agreement. The US guarantees will therefore "conform fully to the provision of Part V" only if they do not confer export subsidies within the meaning of Articles 1(e) of the *Agriculture Agreement* "in a manner which results in, or which threatens to lead to, circumvention of [US] export subsidy commitments" under Article 10.1.

[9] *United States – Tax Treatment for "Foreign Sales Corporations"*, Report of the Appellate Body, WT/DS108/AB/R, adopted March 20, 2000.

# ANNEX J-5

## RESPONSE BY CHINA TO THE PANEL'S QUESTIONS TO THIRD PARTIES

11 August 2003

1. China appreciates this opportunity to present its views to the Panel in relation to the Panel's questions posed to third parties on July 28, 2003. While it was specifically asked to address Questions 1, 4, 12, 13, 14, 15, 16, 17, 21, 22, 23, 25, 41 and 42, China notes the Panel in the fax cover page granted freedom to third parties "to respond to or comment on questions posed to the other third parties". Given the short period within which third parties are required to submit their views, China therefore responds to and comments on the following underlined questions.

ARTICLE 13 OF THE *AGREEMENT ON AGRICULTURE*

2. **Question 1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you [Australia] reconcile this with your [Australian] view that the conditions in Article 13 are a "pre-requisite" to the availability of a right or privilege? Would other third parties have any comments on Australia's assertion?**

Reply

3. China agrees with the interpretation of Article 13 of the *Agreement on Agriculture* (the "Peace Clause") put forward by Australia. As explained in its written submission, China believes that the Peace Clause does not impose positive obligations; it only stands to provide limited exemptions from actions to measures that may otherwise be subject to actions based on GATT 1994 and the Agreement on Subsidies and Countervailing Measures (the "*Subsidies Agreement*"). As wording of the Peace Clause indicates, such exemptions are not automatically available or granted upon a simple allegation by a Member that it is protected; certain conditions built into the Peace Clause must be met before such a Member can enjoy entitlement to Peace Clause exemption.

4. The United States alleged that if conditions do have to be met for availability of Peace Clause protection, it is upon the complaining party to prove that the US measures do not meet such conditions, and hence do not enjoy Peace Clause protection. In support of its reasoning, it asserts that the Peace Clause imposes positive obligations by its built-in reference to Annex 2 to and Article 6 of the *Agreement on Agriculture*[1]. China disagrees on that point. In its written submission, China stated that when Annex 2 and Article 6 are brought under the Peace Clause as conditions, they lose any positive obligation nature, if any, in their original places; they have come to form conditions precedent for entitlement to Peace Clause exemption. Since the Peace Clause contains limited exemptions from actions based on GATT and the *Subsidies Agreement*, it is affirmative defence in nature, and the party claiming its entitlement bears the burden of proving that it is so entitled.

5. China sees no need to "reconcile" the affirmative defence nature with the conditions that must be met to enjoy that defence. The latter is simply required to happen prior to availability of affirmative defence. The two elements, i.e. conditions to be met and availability of exemptions, form an organic whole of the Peace Clause. To China's understanding, parties to this dispute share greater

[1] Para. 43, US First Written Submission, United States – Subsidies on Upland Cotton, WT/DS267, 11 July 2003.

disagreement on who should bear the burden of proof under the Peace Clause than whether conditions under the Peace Clause are pre-requisites to availability of Peace Clause exemption.

ARTICLE 13(B) OF THE AGREEMENT ON AGRICULTURE: DOMESTIC SUPPORT MEASURES

**6. Question 4, How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*?**

Reply

7. In relation to US direct payments under the 2002 FRSI Act, the European Communities ("EC") in its oral statement took a unique stance different from those of all other parties. Noting the United States argument that updating of base periods was necessary in order to bring support for oilseeds production under the direct payment scheme, the EC argued that "it must be possible to have different reference periods while eligibility is based on previous eligibility for production distorting subsidies" "to ensure the progressive movement of production distorting subsidies to decoupled subsidies"; on the other hand, the EC also expressed concern that "continued updating of reference periods in respect of the same already decoupled support, creating an expectation that production of certain crops will be rewarded with a greater entitlement to supposedly decoupled payments, tends to undermine the decoupled nature of such payments"[2]. Such a line of reasoning may have given rise to the question raised by the Panel.

8. While sharing the same concern with the EC, China does not see eye to eye with the EC on the proposed allowance for an initial jump of the reference period over the transition from production distorting subsidies to "decoupled subsidies", even if the latter are found to be decoupled. In China's opinion, the issue is not about frequency of reference period updating; the issue is whether Para. 6 of Annex 2 to the *Agreement on Agriculture* allows updating of the reference period at all.

9. Specifically, the Panel in this case is faced with a direct payment programme that was initiated by a Member several years prior to the coming into effect of the *Agreement on Agriculture*, but was over the years, maintained in the Member country by successor legislations with slight variations. While Para. 6 of Annex 2 to the *Agreement on Agriculture* does not specify when "a fixed and defined base period" falls, it certainly does not provide a window of opportunity for an existing production distorting support measure to transform into a kind of payment with an increased production factor (acreage) in a new up-to-date period. Such an interpretation would grant a bonus not intended by the drafters. The requirement by Para. 6 for a "base" period reflects the drafters' intention to freeze any "Green Box" programme at its initial support level, as opposed to a period selected by a Member. If a Member wishes to carry out a transformation, it should certainly follow the spirit of Para. 6 and use the base period that is already fixed and defined by the predecessor legislation.

10. Therefore, with respect to the interpretation Para. 6 of Annex 2 to the *Agreement on Agriculture* as applied to a direct payment programme that is a direct descendent of predecessor programmes, China is of the view that no updating shall be allowed at all.

**11. Question 12. Where does Article 13(b) require a year-on-year comparison?**

[2] Para. 30, Oral Statement by the European Communities, United States – Subsidies on Upland Cotton, WT/DS267, 24 July 2003.

Reply

12. Main elements of Article 13(b)(ii) and (iii) read: "domestic support measures that fully conform to … shall be exempt from actions … , provided that such measures do not grant support to a specific commodity *in excess of that* decided *during the 1992 marketing year*" (emphasis added). The full conformity chapeau and the proviso are two conditions to the availability of exemption granted by this Article.

13. The Panel's question relates to interpretation of the proviso. Key to the interpretation are the words "that", "during the 1992 marketing year" and "in excess of". The word "that" is inserted in the second portion of the proviso to refer back to what was described in the previous portion, i.e. "support to a specific commodity". The phrase "in excess of" requires a comparison. The phrase "during the 1992 marketing year" indicates a requisite element of comparison, a common denominator in time frame without which a comparison is impossible. The combination of these three elements requires a comparison of support levels between a given year at issue and 1992 marketing year, i.e. a year-on-year comparison.

14. Obviously, the proviso does not contemplate the comparison of the sum of support levels for more than one year with that of 1992 marketing year. Such a comparison would be one between two grossly unequal numbers, resulting in no statistical significance and would destroy the purpose of the proviso being a condition precedent to the availability of a protection.

15. In addition, the proviso, properly interpreted, cannot be limited to a comparison only of measures currently in effect against those during the 1992 marketing year, as the US argues. The US based its argument on the present tense of the proviso, arguing that such a tense only calls for determination of the support that challenged measures currently grant. With respect, China disagrees. While it is indeed written in the present tense, the sentence is led by the key word "provided" in a strong limitation and demand style. As such, the present tense serves the purpose. The intention of such tense is to ensure that support levels beyond those in 1992 are not to be protected by the Peace Clause. Further, the US argument fails to recognize that the present tense is "present" only in respect of 1995, when the *Agreement on Agriculture* came into effect. It seeks to govern then "future" measures. Using the time of panel dispute resolution as the vantage point, as the United States argues, seriously limits the proviso's scope to examining only measures current as of the time of dispute. Thirdly, the US interpretation that a comparison is only limited to the measures currently in effect drives a significant loophole into the treaty language, and seeks to remove the proviso requirement for measures that are not current during the year of dispute resolution. Such an interpretation would also be tantamount to placing a period of limitation within which a complaining member must seek dispute settlement against dispute-current measures only. Neither the loophole nor the period of limitation can be intended by the drafters. It follows therefore, while Article 13(b) requires a year-on-year comparison, that comparison is not limited to measure currently in effect. The issue of what measures are before this Panel are set out in the terms reference for this Panel.

**16. Question 13. Does a failure by a Member to comply in a given *year* with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)?**

Reply

17. China proposes to address this question in two parts: one, does a failure by a Member to comply in a given year with the chapeau of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? Two, does a failure by a Member to comply in a given year with the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by

Article 13(b)? In this respect, it is again useful to turn back to the elements in Article 13(b)(ii) and (iii), which read: "domestic support measures that fully conform to … shall be exempt from actions … , provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year". As discussed in China's answers to Question 12, both the chapeau and the proviso are two co-existing conditions, and breach of either will lead to loss of the exemption granted by these Articles.

18. For the first part, a failure by a Member to comply in a given year with the chapeau of Article 13(b) will not impact its entitlement to benefit in an earlier or a later year from the exemption from action. The chapeau requires that domestic support measures conform fully to provisions of Article 6. Articles 6.1 and 6.3 in turn provide that all non-green box domestic support measures of a Member are considered to be in compliance with Article 6 if the Member's "C*urrent Total AMS* does not *exceed* the *corresponding annual* or final bound commitment level specified in Part IV of the Member's Schedule" (emphasis added). The word "exceed" requires a comparison. The words "current", "corresponding" and "annual" indicate that the comparison is to be made on an annual basis between the level of support actually provided in a given year and annual bound commitment level in the same year as indicated in the Member's Schedule. A Member's actual level of support varies from year to year, so does a Member's annual bound commitment level. Therefore a factual comparison between the two in a given year shall not have any bearing on a comparison of different support levels in an earlier or later year.

19. In respect of the second part of the question, China would like to reiterate its answer to Question 12 that Article 13 (b) requires a year-on-year comparison between the annual level of support at issue and the level of support in 1992 marketing year. Whether domestic support measures in a given marketing year exceeds same in 1992 marketing year is a matter of fact. The level of support in each given year challenged shall be compared separately to same in the 1992 marketing year. A factual conclusion on the "excess" issue for measures in one year certainly shall not preclude an examination of a different set of facts in another year.

**20. Question 14. Does a failure of a Member to comply with Article 13(b) in respect of a *specific commodity* impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)?**

Reply

21. The chapeau of Article 13(b) requires compliance with Article 6 for the purpose of determining whether Peace Clause protection is available. As discussed in China's answers to Question 13, Article 6 provides that a Member's Current Total AMS in any year shall not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule. In other words, in considering the "exceed" issue, Current Total AMS, being the monetary sum value of all measures provided by a Member in a given year shall be compared against the corresponding annual bound commitment committed by the Member in its Schedule. Such a comparison disregards the issue of support to a specific commodity. Furthermore, the phrase "support to a specific commodity" only appears in the proviso of Article 13(b), but not in the chapeau. Therefore support to a specific commodity is not an issue under consideration by the chapeau of Article 13(b).

22. In respect of the proviso of Article 13(b), China believes a failure of a Member to comply thereof in respect of *a specific commodity* does not impact its entitlement to benefit in respect of other agriculture products from the exemption from action provided by Article 13(b).

23. For the purpose of this discussion, support measures can be classified into two categories: support measures provided exclusively to one specified product or those generally available to a number of specified products.

24. Where a programme is designed to provide support exclusively to one product, e.g. upland cotton for the purpose of this case, other products are not brought under its coverage. Failure by the Member's upland cotton-specific programme (if there is any in this case) to comply with Article 13(b)'s proviso would only take the exclusively cotton support programme at issue out of the protection of exemption by Article 13(b). Whether that Member's other support programmes are protected under Article 13(b)'s protection against actions is a matter not related to the cotton support measures at issue.

25. Where support measures are generally available to a number of products including upland cotton, the term "specific commodity" requires break up and attribution of the general budgetary outlay to each specific product for comparison under the proviso. For the purpose of this case, only the portion of outlay that was used for upland cotton is relevant for that comparison. Outlays broken up for other products covered by the same programme is not at issue before this Panel. In addition, terms of reference governing this Panel procedure does not require the Panel to review measures involving other products.

**26. Question 16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph?**

Reply

27. China believes that a hypothetical deletion suggested would not change the fundamental meaning of Article 13(b)(ii).

28. China understands that the word "specific" is inserted to avoid a lump-sum treatment of measures generally applicable to a number of commodities. It is to emphasize that when calculating the amount of support granted to one commodity, the portion that is delivered to that specific commodity at issue shall be singled out and counted as part of the amount of all support granted to that specific commodity. Doing the comparison otherwise would render the requisite comparison as part of the proviso meaningless.

29. If the word "specific" were to be deleted, the proviso would read:

> …, provided that such measures do not grant support to *a* commodity in excess of that decided during the 1992 marketing year. (emphasis added)

With "specific" deleted, while the emphasis effect may be diminished, the word "a" remains and the fundamental meaning of this proviso will not change. A comparison is still required for the support levels that are directly applicable and those attributable to upland cotton.

30. The above interpretation accords with the views of New Zealand and Australia that the term "support to a specific commodity" is not synonymous with the term "product-specific support"[3]. The term "product-specific support" focuses on "product-specific", pointing to a support programme designed for and provided exclusively to a specified product. On the other hand, the term "support to a specific commodity" is used to incorporate a level of support delivered to a *specific commodity*, combining both product specific support and the attributed portion of a much larger programme generally available to a number of products including upland cotton.

[3] Paras. 23 – 24, Oral Statement by Australia, *United States – Subsidies on Upland Cotton*, WT/DS267, 24 July 2003; Para. 9, New Zealand's Oral Statement, *United States – Subsidies on Upland Cotton*, WT/DS267, 24 July 2003.

**31. Question 17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement* to the meaning of "support to a specific commodity" in Article 13(b)(ii) *Agreement on Agriculture*?**

32. China believes that the concept of "specificity" in Article 2 of the *Subsidies Agreement* is used in a sense and for purposes different from that used in the proviso of Article 13(b)(ii) of the *Agreement on Agriculture*. References to "a product" or "subsidized product" in certain provisions of the *Subsidies Agreement* is not relevant at all to the meaning of "support to a specific commodity".

33. Pursuant to Article 1.2 of the *Subsidies Agreement*, a subsidy shall be subject to WTO disciplines only if its availability is restricted to specified recipients, i.e. to a *specific enterprise or industry or a group of enterprises or industries*. (emphasis added) The word defines what falls under WTO discipline over subsidies. In contrast, the word "specific" used in the phrase "support to a specific commodity" of the Peace Clause proviso, as China explains in its answers to Question 16, is an emphasis for calculating year on year support levels on a product basis. The latter is only an indicator for a method of calculation and comparison. The same word in the two different places carry with them separate meanings and purposes.

**34. Question 21. Please comment on Brazil's assertion that "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term?**

35. Debate among the parties revolves around the word "decided" in the proviso of Article 13(b)(ii). The United States argued that its domestic support measures "did not decide on an outlay or expenditure amount in favor of upland cotton"; rather, it argued that "US measures 'determined'" a per pound rate of support during 1992 marketing year while actual outlays or expenditures were known or completed after the marketing year's end. As the actual outlay would come to its knowledge upon final accounting of the world prices, no amount of outlay was "decided" during the 1992 marketing year[4].

36. In China's opinion, the above US interpretation does not lend any utility to interpreting the proviso in Article 13(b)(ii). The proviso, of which "decided" is an element, serves, together with the chapeau, as a qualifier to the entitlement to exemption from actions. Were the US interpretation to prevail, no measure involving year end accounting for the calculation of expenditure would exceed "that decided during the 1992 marketing year", as the former is not capable of measuring up to the 1992 level.

37. In support of the US reading, EC argued that Brazil's the use of "decided" as opposed to "granted" is indication that use of budgetary outlays shall be ruled out; that "decided" implies one-off determination, not involving "deciding" countless applications for support under a particular programme; and that use of the word "during" in the same sentence means that "decided" may also cover future periods.[5] However, the EC in its arguments fails to point out expressly what should constitute the 1992 benchmark[6].

38. Interpretation of the word "decided" shall be carried out "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose"[7]. Drafters of this Article must be understood to have used the word to carry out the Article's object and purpose, being a 1992 benchmark against which to measure whether certain supports are

[4] Para. 94, *First Written Submission of the US*, 11 July 2003.
[5] Paras. 14 - 17, *Oral Statement by the European Communities*, 24 July 2003.
[6] Para. 19, Ibid.
[7] Article 31.1, *Vienna Convention on the Law of Treaties*.

entitled to exemption. Measures involving agricultural support above that benchmark must risk challenges on the basis of Article XVI:1 of the GATT and Articles 5 and 6 of the *Subsidies Agreement*. As such, the 1992 benchmark must be established for the purpose of comparison.

39. Preference of the word "decided" over "granted" by drafters of the Article may be a result of numerous possibilities. Choosing "decided" to imply a "fixed determination" can be reflective of an intention to exclude expenditures that cannot be precisely allocated to a specific marketing year; certain support payments may be granted by an administration, but may not have reached its beneficiaries in 1992; it may well be an indication of the drafters' intention to cover the exact scenario described by the US, i.e. granted in 1992 but decided in 1993. However, such choice of the word shall not push aside the core intention, which is to choose the year 1992 for establishing that benchmark support level.

40. Again, the issue of burden of proof comes up. If a subsidizing Member wishes to avail itself of the protection of Article 13(b)(ii), it is obligated to prove that the measures being challenged do not exceed the 1992 benchmark. Subsequent to the coming effect of GATT 1994, there exists a reasonable expectation that all subsidizing Members should have notified the WTO Committee on Agriculture their respective level of support in 1992 to allow a workable comparison. In the absence of such notice, evidence of a 1992 benchmark level can only be established by the complaining party, in the form of actual budgetary outlays by the subsidizing Member. Such is the best information available for a proper comparison.

**41. Question 22, What is the meaning of "support" in *Agreement on Agriculture* 13(b)(ii)? Why would it be used differently from Annex 3, where it refers to total outlays? Question 23, Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both?**

42. Annex 3 of the *Agreement on Agriculture* is an aid to calculating AMS, which is required not to exceed the corresponding annual or final bound commitment level specified in a Member's domestic support reduction commitments in the Member's schedule under Article 6 of the *Agreement on Agriculture*. In other words, the support calculated on the basis of outlays is part of the concept of replacing commitments to reduce domestic support on a product by product basis with a commitment to reduce overall support to the agricultural sector, a breakthrough in the Agreement's negotiations effected by the Blair House accord.

43. Insertion of the Peace Clause into the *Agreement on Agriculture* is again a part of the Blair House accord. Budgetary outlay, as exemplified by the calculation method in Annex 3, is the approach adopted to ensure that levels of support to upland cotton, whether generally available to a number of products including the product at issue, or product specific, do not overstep the 1992 marketing year level if it is to be protected by the Peace Clause exemption.

44. The United States argued that the comparison required should be between the "per pound rates" of product specific supports[8]. With respect, such an approach fails to recognize the thrust of the Blair House accord. In addition, while domestic support programmes may have specific designs, e.g. paid on per unit basis, such designs shall not guide how Article 13(b)(ii) should be interpreted. The Article has no reference at all to per unit calculation for the purpose of comparison.

45. If unit of production is to be accepted as an method for comparison in addition to absolution support level comparison, under Article 13(b)(ii), four possibilities exists. A decision as to whether a Member asserting affirmative defence is entitled to Peace Clause protection is possible only when both the absolute support level and the per unit support level are higher or lower than those during the

[8] Paras. 82 – 87, US First Written Submission, *United States – Subsidies on Upland Cotton*, WT/DS267, 11 July 2003.

1992 marketing year. A decision on whether Peace Clause shields the measures at issue may have to be made taking into account extraneous factors if one method yields a plus and another minus. Those factors are, however, nowhere to be found under Article 13(b)(ii) and thus the inclusion of product unit comparison is certainly not contemplated by the drafters.

ETI ACT

**46. Question 41. Concerning its claims on the ETI Act, Brazil relies on the *US – FSC* case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here?**

47. China believes that it is not necessary for the Panel to consider the issue of the Peace Clause or Article 6 of the *Agreement on Agriculture* regarding Brazil's claims on the ETI Act.

48. The issue is dealt with by Article 7.2 of the *DSU*, which provides:

> Panels shall address the relevant provisions in any covered agreement or agreements *cited by the parties* to the dispute." (emphasis added)

In effect, under this article, a Panel is required to consider and address relevant provisions *cited by the parties* only. Since the US in this case has not claimed defence for its ETI Act, there is no need for this Panel to consider same.

**49. Question 42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the *DSU*, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the *DSU*, and please cite any other provisions you consider relevant.**

50. The phrase "a final resolution to that dispute" cited by the EC in its third party oral statement comes from the Appellate Body Report in *US-Shrimp (21.5)* case, in which the Appellate Body stated,

> [I]t must also be kept in mind that Article 17.14 of the DSU provides not only that Reports of the Appellate Body 'shall be' adopted by the DSB, by consensus, but also that such Reports 'shall be unconditionally accepted by the parties to the dispute.' Thus, Appellate Body Reports that are adopted by the DSB are, as Article 17.14 provides, 'unconditionally accepted by the parties to the dispute', and, therefore, *must be treated by the parties to a particular dispute as a final resolution to that dispute.* In this regard, we recall, too, that Article 3.3 of the DSU states that the 'prompt settlement' of disputes 'is essential to the effective functioning of the WTO'. (emphasis added)

51. The word "that" appears to limit the binding force of Appellate Body report only to the parties in the case on which the Appellate Body's report is made. Panels in other cases are not bound by any precedential effect of an earlier Appellate Body report, because the facts, parties and other circumstances of claim may be entirely different. Generally speaking, such an interpretation is widely accepted by commentators[9].

[9] John H. Jackson, "The Legal Meaning of a GATT Dispute Settlement Report: Some Reflections", Towards More Effective Supervision by International Organization: Essays in Honour of Henry G. Schermers (Martinus Nijhoff Publishers, Dordrecht, Boston and London, 1994).

52. Be that as it may, the ETI Act in this current case is the very same one challenged by the EC, and found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by both the panel[10] and the Appellate Body[11] in *US – FSC (21.5)*, whose reports were adopted on 29 January 2002 by the DSB. While in *that* case, the complaint was the EC, and in *this* case, the complaint was Brazil, the measures being challenged were the same, and the Member whose measures were challenged were the same. Countermeasures against the same measures were authorized by the DSB. While both the panel and the Appellate Body reports must be treated by EC and the US as final resolution to that dispute, the US is the party whose measures were found to be non-WTO compliant, and the same measures, since not having been withdrawn, is brought to this dispute. Brazil, as a Member of the WTO system, indeed with other Members of the WTO, has reasonable expectations for the US to withdraw the measures after the DSB authorization. In respect of ETI Act, there is no difference between *that* case, being *US – FSC (21.5)* and *this* case, *US – Subsidies to Upland Cotton*. Under the circumstances, there is no reason why "final resolution to that dispute" as reflected in *US – FSC (21.5)* should not be considered and taken by this Panel.

53. In respect of the term "disputes" under Article 12 and Appendix 3 of the *DSU*, it is simply used in the general context of limiting participation to only parties to a dispute for the purpose of assisting panels in organizing their respective working procedures. Meaning and interpretation of the term "dispute" lends no support to interpretation of the Appellate Body's exclamation in *US-Shrimp (21.5)* that its report in a specific case "must be treated by the parties to a particular dispute as a final resolution to that dispute". Therefore, China believes that the term "dispute(s)" used in Article 12 and Appendix 3 of the *DSU* is not helpful for interpretation of the Appellate Body's statement.

54. Article 9.3 of the *DSU*, on the other hand, is part of *DSU* Article 9 which deals with procedures for multiple complainants. It is an attempt to consolidate panel proceedings while the matter at issue has been challenged by more than one Member. Specifically, Article 9.3 reads:

> If more than one panel is established to examine the complaints related to the same matter, to the greatest extent possible the same persons shall serve as panelists on each of the separate panels and the timetable for the panel process in such disputes shall be harmonized.

The Article seeks, to the extent possible, uniformity and consistency in panel reasoning and conclusions, in the event that more than one panel is established, by having the same jurists sitting on separate panels. The requirement for having the same panelists and harmonization of panel processes, on the other hand, is only capable of being carried out if the first panel's proceedings were on-going.

55. For the current case, direct application of Article 9.3 is practically impossible. While complaints raised by Brazil in this case do cover the same ETI Act of the United States which was the subject matter of *US – FSC (21.5)*, the panel in the latter case completed its proceedings as early as 29 January 2002. In addition, the complaint by Brazil involves a whole plethora of US measures, of which the US ETI Act was only one. The majority of the measures challenged by Brazil were not dealt with by the panel in *US – FSC (21.5)*.

56. Having said that, China believes that the spirit of Article 9.3 is still of guidance value. Since the ETI Act challenged by Brazil in this case is exactly the same challenged by the EU in *US – FSC*

[10] Panel Report, *US - FSC (21.5)*, WT/DS108/RW, adopted on 29 January, 2002.

[11] Appellate Body Report in *US - FSC (21.5)*, AB-2002-1, WT/DS108/AB/RW,adopted on 29 January 2002.

*(21.5)*, and that the panel proceedings have long progressed beyond the panelist selection stage, the only way to ensure uniformity and consistency in panel reasoning and conclusions is to have this Panel consider and adopt the reasoning and conclusion of the panel and the Appellate Body *US – FSC (21.5)* in respect of the US ETI Act.

57. China thanks this Panel for granting this opportunity to present its views on issues related to this proceeding, and hopes that this Panel will finds the above points helpful.

# ANNEX J-6

## RESPONSES TO THE PANEL'S QUESTIONS AND THE QUESTIONS OF CERTAIN THIRD PARTIES SUBMITTED BY THE EUROPEAN COMMUNITIES

11 August 2003

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## I. ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE

**Q1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions in Article 13 are a "prerequisite" to the availability of a right or privilege? Australia Would other third parties have any comments on Australia's assertion? 3RD parties, in particular Argentina, Benin, China, Chinese Taipei**

Answer

1. Australia's views cannot be reconciled. Australia is correct in noting that the conditions in Article 13 can be considered a prerequisite for taking action under the *SCM Agreement*.[1] In using the term "prerequisite", Australia essentially recognises that, in respect of measures covered by Article 13, a complainant can only invoke the relevant provisions of the *SCM Agreement* if it proves that the threshold requirements or prerequisites referred to in Article 13 have been satisfied. As the European Communities has pointed out, such a situation is very different from the situation where, in the event of a violation of a WTO Agreement, a WTO Member pleads a defence which potentially exculpates it from this violation (e.g. Article XX GATT) in respect of which it bears the burden of proof.

2. Comparing Article 13 with Article 3.3 of the *SPS Agreement* shows that Australia's views are irreconcilable. This provision permits WTO Members not to base SPS measures on international standards but to impose higher standards where there is a scientific justification or an appropriate risk assessment has been carried out. This provision has some similarities with Article 13 of the *Agreement on Agriculture* since it sets a threshold which must be met before a Member can act. However, Article 3.3 may be seen as going further than Article 13 since it provides a derogation from the central discipline of the *SPS Agreement* ; the obligation to base SPS measures on international standards. On the other hand, Article 13 is simply one element regulating the interface between the *Agreement on Agriculture* and the other Annex I Agreements and cannot be seen as a derogation therefrom. Despite the extent to which Article 3.3 could be thought of as a derogation from the *SPS Agreement*, the Appellate Body ruled in *EC Hormones* that it could not be considered an affirmative defence, and that the burden of proof did not, therefore lie with the defendant.[2] In particular, the Appellate Body noted that the situation in Article 3.3 of the SPS Agreement is "qualitatively different" from the relationship between for instance, Article 1 and XX GATT.[3]

3. Consequently, Australia is correct to consider that Article 13 is a prerequisite or a threshold condition before the other Annex I Agreements may become applicable but is incorrect to consider that Article 13 can be considered an affirmative defence.

## II. ARTICLE 13(B) OF THE *AGREEMENT ON AGRICULTURE*: DOMESTIC SUPPORT MEASURES

**Q2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

[1] Australia's Oral Statement, para. 18.

[2] Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 109.

[3] Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 105.

Answer

4. The two words have slightly different meanings, as is suggested by the use of the conjunctive "and". "Defined" means "having a definite or specified outline, or form; clearly marked, definite"[4] and thus implies, in terms of interpretation of paragraph 6, that the base period for any measure which is claimed to be green box must be set down in the measure itself. "Fixed" is defined as "definitely and permanently placed or assigned, stationary or unchanged in relative position, definite, permanent lasting"[5] and suggests that the base period for a particular measure cannot be changed at a later date. In other words, a Member may define a base period by means of a formula whereas a fixed base period implies that the years chosen for the base period do not change.

5. Decoupled support within a WTO Member need not take the form of a single measure, but may involve several measures. The first sentence of Paragraph 1 of Annex 2 refers to "domestic support measures". Different measures may have different base periods, and a single measure may have several different base periods.[6] Each measure will, or course, have to be judged against the basic and policy specific criteria set down in Annex 2. However, it would defeat the objective of Annex 2 paragraph 6 if a Member could adopt repeated, practically identical measures, in respect of which farmers are aware that they may update the base period. If a farmer knows that a base period is going to be updated, and knows the type of production that will qualify for payments, a WTO Member inevitably encourages the growth of a particular crop, cannot be considered to have decoupled support from production and inevitably creates trade or production distorting effects.

6. The European Communities also refers the Panel to its response to question 11.

**Q3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

7. In the view of the European Communities, the word "a" indicates that it is for the Member concerned to choose a base period, rather than the base period be fixed for all WTO Members.

8. "The" in paragraphs 6(b),(c) and (d) refers to the base period or periods established for eligibility for payments in paragraph 6(a).

9. There are notable differences between these phrases and the phrase "based on the years 1986 to 1988" in Annex 3. First, Annex 3 refers to an already defined and fixed period. Second, the reference period 1986-1988 refers to all measures taken by all Members, and not to specific measures which are intended to conform to Annex 2 taken by specific Members.

**Q4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*? 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

[4] The New Shorter Oxford English Dictionary, 1993.
[5] The New Shorter Oxford English Dictionary, 1993.
[6] For instance, in the experience of the European Communities, where decoupled payments are based on past payments of production aids, and not all production aids are brought under a decoupled scheme, it must be envisioned that new products could be brought into the decoupled payment scheme, with the possibility that such payments are based on a different base period.

Answer

10. As explained in question 2 above, a Member may provide decoupled support through several measures which may have different base periods. However, a Member may not renew a measure, with essentially the same characteristics as previous measures, where, as a matter of fact, farmers are aware that they will have the possibility to update their base periods and thus have an interest in producing certain crops.

11. We also refer the Panel to our response to question 11.

**Q5. Do you agree that a payment penalty based on crops produced is "related to type of production"? EC**

Answer

12. The European Communities believes that an examination of the conformity of a decoupled scheme with the criteria set out in Annex 2 must involve an examination of the scheme as a whole. In that light, the European Communities is not convinced that where, as part of a scheme where no production is required to receive payments, and that the production of any type of crop is permitted, reducing payments where certain crops are produced can be such as to make the scheme, when taken as a whole, related to a type of production. Consequently, the reduction of payment linked to the production of fruit and vegetables must be seen as part of a scheme which permits a farmer to grow any type of crop, or even not to produce at all. Such a scheme, it is submitted, taken as a whole, meets the criteria that payments are not related to a type of production. To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition, in an historical perspective, and avoid those farmers receiving decoupled payments from enjoying both the decoupled payments and a privileged position vis-à-vis farmers who are not entitled to such payments. Moreover, as the European Communities has explained, such a finding would require a Member to increase its subsidy programmes in order to prevent internal distortions of competition, running directly contrary to the process of reform instituted by the *Agreement on Agriculture*.

13. We also refer the Panel to our response to question 11.

**Q6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the *Agreement on Agriculture* have on the meaning of the preceding sentence? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

14. Both Article 6.1 and 7.1 refer to the "criteria set out in [..] Annex 2". When one considers Annex 2, there are two sets of "criteria". The first is the "basic criteria" set out in subparagraphs (a) and (b) of paragraph 1, and the second is the "policy-specific criteria" set out in paragraphs 2 to 13. This understanding is confirmed by the text of paragraph 5 of Annex 2, which refers to the "basic criteria" and the "specific criteria". Thus, Articles 6.1 and 7.1 of the *Agreement on Agriculture* refer to the basic and policy specific criteria set out in Annex 2.

15. The European Communities has already set out its understanding of the term "accordingly" in its Third Party Written Submission.[7] In the European Communities view, the term "accordingly" is

[7] First Third Party Submission of the European Communities, 15 July 2003, para. 20. The European Communities recall, in this context, the opinion of Professor Desta set out in footnote 19 to para. 20.

intended to link the purposive language of the first sentence, with the "basic criteria" set out in the second sentence. In its Third Party Submission the EC offered a dictionary definition, "in accordance with the logical premises" which showed that the word "accordingly" operates as a linkage between the premise or understanding set out in the first sentence and the operative language in the second sentence. Australia offers the Panel another definition: "harmoniously" or "agreeably", but fails to note that that the Oxford English Dictionary considers this usage of the word "accordingly" obsolete.[8]

16. The European Communities would point out that both the French and Spanish text support the view that the use of the word "accordingly" links the general statement in the first sentence with the specific obligations of the second sentence. The French text uses the term "en conséquence" and the Spanish the term "por consiguiente". Both of these terms show that the criteria in the second sentence are intended to express the principle set out in the first sentence. Moreover, had the negotiators intended that the first sentence be a self-standing obligation, rather than use the term "accordingly" they would have used the term "additionally" or "in addition", or a synonymous term.

17. Further support for this view can be found in the frequent use of the term "accordingly" in the WTO Agreement. A survey of the term's use suggests that it links a general statement, often recognising that a particular situation causes specific effects, with a right or obligation to take some type of action set out in an ancillary sentence.[9] These general statements are not such as to impose specific obligations. The Appellate Body had occasion to consider the relationship between such provisions in the *Turkey-Textiles* dispute (Articles XXIV.4 and XXIV.5 GATT). It concluded:

> The chapeau of paragraph 5 of Article XXIV begins with the word "accordingly", which can only be read to refer to paragraph 4 of Article XXIV, which immediately precedes the chapeau.
>
> [..]
>
> 57. According to paragraph 4, the purpose of a customs union is "to facilitate trade" between the constituent members and "not to raise barriers to the trade" with third countries. This objective demands that a balance be struck by the constituent members of a customs union. A customs union should facilitate trade within the customs union, but it should *not* do so in a way that raises barriers to trade with third countries. [..] Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV. Thus, the purpose set forth in paragraph 4 informs the other relevant paragraphs of Article XXIV, including the chapeau of paragraph 5. For this reason, the chapeau of paragraph 5, and the conditions set forth therein for establishing the availability of a defence under Article XXIV, must be interpreted in the light of the purpose of customs unions set forth in

[8] Australia's Oral Statement, para 35. Oxford English Dictionary, p. 15. Australia refers to the first sense of the word "accordingly" which is preceded by the symbol "=" which indicates that a particular usage is obsolete (see Abbreviations and Symbols, page xxvi).

[9] See Articles II.6(a), III.9, XII.3(d), XVI.3, XVIIII.5, XXIV.5 GATT 1994, together with Ad Article III and Ad Article XXVIII.4 to GATT 1994, Articles 2.1 and 11 of the Dispute Settlement Understanding, Article A(i) of the Trade Policy Review Mechanism, Article 12.8 of the Agreement on Technical Barriers to Trade, Article 1 of the GATS Annex on Telecommunications and Article 5.1 of the Agreement on Textiles and Clothes.

> paragraph 4. The chapeau cannot be interpreted correctly without constant reference to this purpose.[10] (emphasis added)

18. The Appellate Body has, consequently, recognised the linking function of the word "accordingly", and the fact that provisions which may be linked to later provisions through the use of the word "accordingly" may not impose separate obligations.

19. The European Communities would also point out that the Appellate Body has found that other provisions (e.g. Article III.1 GATT) which contain general principles are set up as "a guide to understanding and interpreting the specific obligations contained" in other provisions (e.g. Article III.2 and the other paragraphs of Article III).[11] Such provisions do not, however, impose additional obligations supplemental to the specific obligations, unless expressly stated.[12]

20. The Panel may find it useful to refer to the European Communities' response to a question posed by Australia (see question no. 44 in this document). In its response, the European Communities deals with Australia's unfounded assertion that the European Communities' reading of the first sentence of paragraph 1 would render that provision ineffective.

**Q7 Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the *Agreement on Agriculture*. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

21. The phrase "the fundamental requirement" signals the negotiators intent to treat differently measures which are less or not at all distortive to trade or production and sets forth the general purpose of Annex 2; a purpose which permeates the rest of Annex 2. Considering the term in the abstract does not answer the question whether a panel must examine the effects of measures for which green box status is claimed in addition to examining whether such measures respect the basic and policy-specific criteria set out in Annex 2, or whether respecting the basic and policy-specific criteria is such that a measure is deemed not to have the effects mentioned in the first sentence. As the European Communities has explained, there are compelling textual and purpose based arguments which support the latter interpretation.

**Q8. In your oral statement, you emphasize the use of the word "criteria" in other parts of the *Agreement on Agriculture*, as distinct from the reference to "fundamental requirement" in the first sentence of paragraph 1 of Annex 2. Is it the case that sub-paragraphs (a) and (b) of paragraph 1 of Annex 2 are also "criteria"? EC**

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[10] Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products ("Turkey – Textiles")*, WT/DS34/AB/R, adopted 19 November 1999, paras. 56 and 57 (emphasis added). Note that the Panel also found that Article XXIV.4 was "not expressed as an obligation" (Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products ("Turkey – Textiles")*, WT/DS34/R, adopted 19 November 1999, as modified by the Appellate Body Report, WT/DS34/AB/R, para. 9.126).

[11] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages")*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 17.

[12] See Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas ("European Communities – Bananas")*, WT/DS27/AB/R, adopted 25 September 1997, paras. 214-216 holding that the absence of a specific reference to Article III.1 GATT in Article III.4 GATT meant that an examination of the consistency of a measure with Article III.4 GATT did not require, in addition, an examination of the consistency of the measure with Article III.1 GATT.

Answer

22. Yes. The second sentence of paragraph 1 refers to sub-paragraphs (a) and (b) as "basic criteria". Paragraph 5 refers to the same "basic criteria". The European Communities considers that the "criteria" referred to in Articles 6.1 and 7.1 of the *Agreement on Agriculture* (mentioned in question 6 above) refer to both the basic criteria set out in the second sentence of paragraph 1 and the policy-specific criteria set out in paragraphs 2 to 13 of Annex 2.

**Q9. If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation, does this allow effects-based claims of non-compliance with Annex 2? If so, how does this affect the purpose of Article 13(b)? 3rd parties' in particular Australia, Argentina, Canada, EC, NZ**

Answer

23. The implication of finding that the first sentence of paragraph 1 is a stand-alone obligation is that an effects test would become applicable to assessing compliance with Annex 2. The result of such an interpretation is two fold. First, as the Panel implies, another WTO Member could bring a WTO dispute alleging that because of its effects a measure does not comply with Annex 2. Second, WTO Members, when designing measures intended to conform to Annex 2, will be required to attempt to identify the effects of such measures. Such a task is often only feasible on an *ex post facto* basis. The correct classification of measures is a vital element for a Member to ensure that it respects it domestic support ceilings. Requiring a Member to measure effects diminishes the ability of a Member to ensure correct classification. Such an interpretation should, therefore, be avoided.[13]

24. It is rather remarkable, had the drafters intended that the first sentence of paragraph 1 be a self-standing obligation, that no indication of how such effects are to be measured was included in the *Agreement on Agriculture*. It is far from obvious how the effects of a measure on production and/or trade is to be measured. Nor is it clear how it can be decided that a particular effect can be considered as going beyond "minimal". This can be contrasted with Article 6.3 of the *SCM Agreement* where the negotiators set out with some precision certain criteria deemed to cause serious prejudice to the interests of another Member. This leads to the inevitable conclusion that the criteria by which a Member or a panel is required to determine whether a measure has more than minimal trade or production distorting effects are the basic and policy specific criteria set out in Annex 2.

25. Article 13(b) is one element of a complex series of arrangements intended to provide legal security and certainty to Members who have embarked on a process of agricultural reform. It is designed to ensure that a Member may design its domestic support measures in such a way as to ensure that they do not provide support in excess of that decided in 1992 in order that it be exempted from the actions listed in Article 13(b). This requires a Member to be able to classify its measures as green box, other exempt policies, or as amber box. Only by being sure of its classification can a Member ensure that it maintains the protection provided by Article 13(b). This is one reason why the criteria for treatment as green box, or as another exempt measure, are so precisely defined. (Other exempt measures are precisely defined in Articles 6.4 and 6.4 of the *Agreement on Agriculture*). Consequently, bringing an effects test into an analysis of green box compatibility would make it very difficult for a Member to be sure that it remains within the level of support decided in 1992 and would therefore render nugatory the security and predictability necessary to permit the process of agricultural reform initiated by the Agreement on Agriculture.

**Q10. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in**

[13] See, in this sense, First Third Party Submission of the European Communities, para. 24.

**Annex 2 be classified as non-Green Box? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

26. The European Communities is not convinced that "non- or minimally trade-distorting measures" might exist which would not be covered by Annex 2. Annex 2 has at least two paragraphs which are designed as "catch–all" provisions. Paragraph 2 of Annex 2 acts as a "catch-all" for general service programmes not involving direct payments to producers or processors.[14] Paragraph 5 acts as a "catch-all" for all direct payments.[15] Moreover, Annex 2 is designed to cover all domestic support measures which are deemed to have no or at least minimal trade-distorting effects. Consequently, it would seem surprising if a non- or minimally trade-distortive measure would not meet the criteria of Annex 2.

27. In the hypothesis that a measure which had no or minimal trade-distorting effects did not conform to the criteria in Annex 2 the European Communities would conclude that it could not be considered as Green Box support. As the European Communities explained in its Third Party Submission, rather than defining those domestic support measures which were to be subject to reduction commitments, the negotiators of the *Agreement on Agriculture* chose to define all those measures which were not to be subject to reduction commitments – hence Annex 2.[16] Such a result does not run counter to the objectives of the *Agreement on Agriculture* since it ensures the security and predictability of the reform process.

**Q11 If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. 3rd parties, in particular, Australia, Argentina, Canada, EC, NZ**

Answer

28. The European Communities considers that the first sentence of paragraph 1 of Annex 2 sets out the general purpose of Annex 2 and therefore informs the interpretation of the criteria in Annex 2. It is relevant to the interpretation of paragraph 6 in that it should be considered to be part of the context of paragraph 6. Nevertheless, while the first paragraph informs the interpretation of paragraph 6 it cannot detract from the words actually used in paragraph 6.[17] As the Panel considers its interpretation of the words used in paragraph 6, it can take account of the purposive language of the first sentence of paragraph 1.

29. There are two issues which the Panel must resolve with respect to direct payments – the reduction of payments where certain crops are grown and the updating of base periods.

[14] The third sentence of paragraph 2 reads "[S]uch programmes, which include but are not restricted to the following list, shall meet the general criteria in paragraph 1 above and policy-specific conditions where set out below [..]".

[15] The second sentence of paragraph 5 reads "[w]here exemption from reduction is claimed for any existing or new type of direct payment other than those specified in paragraphs 6 through 13, it shall conform to criteria (b) through (e) in paragraph 6, in addition to the general criteria set out in paragraph 1."

[16] First Third party Submission, paras. 19 & 20. Obviously, some other exempted support measures are defined in Article 6 of the *Agreement on Agriculture*.

[17] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages")*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p.17.

30. With respect to the former, the European Communities has already explained why it considers that reducing payments upon growing certain crops cannot be considered to base payments on a type of production (see also the EC's response to Panel question 5 above). The European Communities position is supported not only by the text of paragraph 6(b) but also by an interpretation informed by the first sentence of paragraph 1. Permitting such a reduction of payments does not distort trade – it minimises any distortion which may be caused by any decoupled payments in markets which were historically undistorted by subsidies. It ensures that the equilibrium established by the market in the relevant product is maintained. To the extent decoupled support can be seen as having an effect on trade or production by providing support to farmers who produce some crops, the reduction in payment prevents subsidised farmers from potentially upsetting the market equilibrium, and thus serves to prevent effects on trade or production in the market for crops for which payment is reduced. Seen the other way, not ensuring such a reduction would allow subsidised farmers to grow the relevant crops and thus upset the historical market equilibrium with potential effects on trade and production. In the light of the first sentence of paragraph 1, the only possible application of Article 6(b) to payment reductions imposed where certain crops are grown is to find that such reductions are not such as to make the payment based on a type of production.

31. The situation is rather different with respect to the updating of base periods. The European Communities considers that where farmers know that base periods will be updated, and that the production of certain crops will give them a greater entitlement to support in a later period, there will be a production distorting effect. Such updating is clearly inconsistent with notions set out in the first sentence of paragraph 1 since knowledge of such updating will incite farmers to produce more of certain crops which qualify for support and thus will have effects on production.

**Q12. Where does Article 13(b) require a year-on-year comparison? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

32. The European Communities does not consider that Article 13(b) requires a year-on-year comparison. It permits such a year-on-year comparison and given that support is generally expressed in annual amounts, appears a reasonable basis for making such a comparison. In considering this issue, the Panel must compare two elements. The first is the domestic support measure challenged. The second is, at least for Article 13(b)(ii), support "decided" in an earlier period.

33. We examine first the domestic support measure challenged. In order to benefit from the protection of Article 13 a measure must conform to the provisions of Article 6 and must "not grant support" in excess of that decided in during the 1992 marketing year. The European Communities interprets the present tense of "not grant support" as requiring the Panel to determine the support at the time the measure is challenged when Panel is asked to determine whether Article 13 is applicable. Inevitably, such a determination requires that the Panel consider a specific period, which is comparable with an earlier period. The European Communities considers that the Panel has some discretion in choosing a specific period, although it is clear it must be as close as possible to the time of the dispute. However, since the Panel must consider the support granted it must choose a period for which data is complete. Given Article 1(i) of the *Agreement on Agriculture*, the period chosen may well be based on the calendar, financial or marketing year of the Member complained against.

34. In respect of support "decided", the Panel must consider the nature of the support decided during the 1992 marketing year. As the European Communities has explained at length elsewhere, the relevant element for comparison is not the support actually granted for the 1992 marketing year – rather it is the support decided. Consequently, in each case, the element for comparison must depend on the decision made during the 1992 marketing year. As a function of that decision, the Panel will

have to choose a period which is comparable with the most recent period. This may well be a marketing year, but need not be so.

**Q13. Does a failure by a Member to comply in a given *year* with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

35. Failure to comply with Article 6 of the *Agreement on Agriculture* or granting support in excess of that decided in 1992 in a given year does not impact a Member's entitlement to benefit from the protection of Article 13(b) in a later (or earlier) year, provided that the Member concerned complies with Article 6 of the *Agreement on Agriculture* and does not grant support at present in excess of that decided during marketing year 1992. This is clear from the present tense of "do not grant support" which makes it clear that the comparison must be with the support granted in the most recent period.

**Q14. Does a failure of a Member to comply with Article 13(b) in respect of a *specific commodity* impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

36. No. A failure to maintain support granted within the level decided during marketing year 1992 in respect of a specific commodity would not affect the availability of Article 13(b) in respect of other commodities, provided that support granted to that specific commodity was not in excess of that decided during 1992.

**Q15. Is there any basis on which counter-cyclical payments could be considered product-specific? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

37. The European Communities considers that, since counter-cyclical payments are paid as a function of fluctuations in the price of different commodities with respect to target prices also specified by commodity, they should be considered product specific.

**Q16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? 3RD parties, in particular Australia, Argentina, Benin Canada, China, EC, NZ**

Answer

38. Yes. Article 13(b)(ii) refers to product specific support. It does not refer to all support which may be attributed to a product. The use of the word "specific" has meaning, because it makes it clear that the support in question is that granted or decided in respect of a specific product, rather than that granted or decided in respect of all products and which could arguably be attributed to a product.

**Q17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement* to the meaning of "support to a specific commodity" in Article 13(b)(ii)**

***Agreement on Agriculture*? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

39. The European Communities is not convinced that the drafters of the *Agreement on Agriculture* had Article 2 of the *SCM Agreement* in mind when drafting Article 13(b) of the *Agreement on Agriculture*. It may comment further depending on the views of the other third parties on this issue.

40. The European Communities has already referred to the relevance of the references to " a product" and a "subsidised product" in its Oral Statement.[18]

**Q18. Benin's oral statement considers the phrase "support to a specific commodity" in Article 13(b)(ii) of the *Agreement on Agriculture*. How does Benin believe that phrase is best interpreted. Please substantiate your response, commenting on other submissions by parties and third parties as you believe appropriate. Benin**

Answer

41. The European Communities may comment, as necessary, on Benin's response.

**Q19. Where does Article 13(b)(ii) require a year-on-year comparison? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

42. See the answer to question 12 above.

**Q20. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?**

**Answer**

43. Yes. See the answer to question 22 below.

**Q21. Please comment on Brazil's assertion that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Answer

44. As the European Communities has explained elsewhere, the use of the term "decided" is crucial to an understanding of Article 13(b). It is now established that a panel is obliged to use the normal rules of interpretation of international law as codified in the Vienna Convention on the Law of Treaties. This requires it to look, in the first place, to the ordinary meaning of the words. "Granted" does not mean the same as "decided".

45. Granted is the past tense of the verb "grant" which means "to give or confer, (a possession, a right etc) formally; transfer (property) legally".[19] "Decided" is the past tense of the verb "decide"

[18] EC Oral Statement, 24 July 2003, para. 23.
[19] The New Shorter Oxford English Dictionary, 1993, p. 1131.

which means "come to a determination or resolution *that, to do, whether*".[20] Thus, in this context, "granted" refers to support which has been provided, to which a farmer (or all eligible farmers in a Member) has obtained a right. "Decided" implies that a political authority (be it a legislature or a government department or agency) has determined that a particular crop is to be entitled to a particular type of assistance.

46. The European Communities believes that the use of the term "decided", as opposed to "granted" and "provided" (which are used elsewhere in the *Agreement on Agriculture*) is very deliberate. Article 13(b) is designed to protect support which was "decided" during 1992. It was negotiated in November 1992 as part of the first Blair House Agreement and later multilateralised.[21] In November 1992, the negotiators could not have known the support granted for the marketing year 1992, which was of course running during that period. They did not, therefore, intend to refer to the support granted when using the term "decided". Rather, they were referring to decisions taken during 1992 in respect of support which WTO Members intended to grant – not that actually granted.

**Q22. What is the meaning of "support" in *Agreement on Agriculture* 13(b)(ii) ? Why would it be used differently from Annex 3, where it refers to total outlays? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Answer

47. With respect, the European Communities does not consider that support is equated in Annex 3 to total outlays. Annex 3 provides methodologies for calculating the Aggregate Measure of Support (AMS). Article 1(a) defines the AMS as "the annual level of support, expressed in monetary terms […]". However, AMS is not necessarily calculated in terms of budgetary outlays. For instance, market price support is calculated "using the gap between a fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price. Budgetary payments made to maintain this gap […] shall not be included in the AMS." (Annex 3, para. 8) Similarly, non-exempt payments dependent on a price gap are to be calculated "either using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, or using budgetary outlays" (Annex 3, para. 10). This makes it clear that AMS need not be calculated in terms of total outlays.

48. The European Communities considers the term "support" in Article 13(b)(ii) must be considered from several perspectives. First, it is clear that the word "support" refers to the support granted in a recent period. Second, and at the same time, the word "that" used in the phrase "that decided" is also a reference to the word "support". However, as already noted, there is crucial distinction in this comparison between the "support decided" and the "support granted". The support decided does not equal the support actually granted during marketing year 1992. For the later period, there is no reason that the support granted should not be calculated on the basis of the AMS methodology set out in Annex 3. Indeed, Article 1(a) of the *Agreement on Agriculture* refers to AMS as "the annual level of support" (emphasis added).

49. For the support decided AMS-like criteria should be used. This would take into account the reference to AMS as the annual level of support, but would also recognise that Article 13(b)(ii) refers to the support "decided" rather than granted. Crucially, the support decided must be considered as that which it was decided to provide during the 1992 marketing year. This must be determined on a case-by-case basis. It should be determined on the basis of the information available to the decision

[20] The New Shorter Oxford English Dictionary, 1993, p. 607. Italics in the original.

[21] The main change made in the second Blair House Agreement, in respect of Article 13(b) was the extension of the implementation period for the purposes of the Article 13(b).

makers. It may be that only a certain amount of production would be eligible,[22] or that the decision makers had production estimates at their disposal, and thus knew the extent of the support that was being decided. Alternatively, the amount of support decided could also be determined from budgetary acts, preparing expenditure for future years, in which the decision making authorities would have knowledge of the support they wished to grant, and the quantity of production which would likely enjoy such support. Using such a basis, it would be possible to use AMS-like criteria. AMS-like criteria can be used because it will often be possible to establish, for certain measures, a gap between the applied administered price and the internal or external fixed reference price[23] and establish, on the basis of information available to the decision makers, the amount of production which was eligible, or which was estimated. For other measures, it may also be possible to use appropriation or budgetary decisions.

**Q23. Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Answer

50. The European Communities considers that the Panel should use AMS for the most recent period, and an AMS - like calculation for calculating the support decided during the 1992 marketing year, as explained in our response to question 22.

**Q24. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) of the *Agreement on Agriculture* and, in particular, why the words "grant" and "decided" were used. EC**

Answer

51. As the European Communities has noted above, the current text of Article 13(b)(ii) formed part of the first Blair House Agreement of November 1992. We have annexed the text which resulted from these negotiations[24], together with the relevant sections of the "Dunkel Draft", which were replaced by Article 13(b)(ii).[25]

52. The European Communities also considers that it may assist the Panel to have a copy of some of the key decisions reforming the EC's Common Agricultural Policy adopted during 1992. Thus, we have annexed Council Regulation (EC) No. 1766/92 on the common organisation of the market in cereals and Council Regulation (EC) No. 1765/92 establishing a system of compensatory payments.[26]

**Q25. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

53. The European Communities finds some merit in such an interpretation. It would be consistent with the careful choice of the negotiators to use the word "decided" rather than the term "granted" or

[22] For instance, because of quotas on eligible production or definitive budgetary ceilings.
[23] See para. 9 & 11 of Annex 3.
[24] Exhibit EC-1.
[25] Exhibit EC-2.
[26] Council Regulation (EC) No. 1766/92 on the common organisation of the market in cereals (Exhibit EC-3) and Council Regulation (EC) No. 1765/92 (Exhibit EC-4).

"provided". The European Communities is concerned, however, that the term "authorised" is more restrictive than the term "decided". For that reason, while the European Communities sees support for the interpretation that "decided during" is synonymous with "authorised during", it is not clear to the European Communities that "authorised" has exactly the same meaning as "decided".

**Q26. Under Article 13(b)(ii), a comparison is required between support at different times. One of the issues which is contested between the parties is whether the only later period that the Panel can consider is the present one (i.e. the period underway at the time of the request for establishment of the Panel). This argument is based on the present tense of the words "do not grant" in the English text. The Panel asks whether there is any difference in the verb tense as used in the Spanish-language text, or any other difference which might aid the Panel in interpreting these words? Argentina, EC, Paraguay, Venezuela**

Answer

54. The European Communities notes that both the French and Spanish text also use the present tense.

**Q27. If the 1992 "decision" led to or was the funding source for the money provided in 1992 and later years, is it the full amount of all that funding that constitutes the "support" decided in 1992? If the answer to this question is that it is the full amount of all the support provided pursuant to the "decision" that must be taken into account, must this be compared with the total amount of support that will or might flow from the decision made in the more recent period for the purposes of the comparison required under Article 13(b)(ii)? If a Member did not make a "decision" (however that may be interpreted) in 1992 about "support", is it the case that the Member has a zero base for the purposes of the comparison required under Article 13(b)(ii)? EC**

Answer

55. The European Communities does not consider that it is the full amount of support decided in 1992 for later years that should be taken into account. Such an approach might not be feasible where the decision taken in 1992 was an open-ended one. This approach also sits uneasily with the practice in the *Agreement on Agriculture* of expressing support on an annual basis. Since the regulation of agricultural production takes place on a yearly basis, it seems unlikely that a decision would be taken setting a maximum amount for a number of years without regulating how such support would be allocated between specific years.

56. The European Communities considers that the Panel should use a level of support readily comparable with the support currently granted. This may well be the support decided for a particular marketing year. If a decision was made in 1992 for future years, it would be to ignore the drafters intent to rule out the possibility that the support decided for later years is the relevant support.

57. The European Communities does not consider that it will ever be the case that a Member which provides subsidies can be said never to have made a decision in 1992 which would qualify under Article 13(b). At the very least, a Member would have decided, on the basis of its subsidy programmes, and the amount of eligible production and/or estimated production, to set aside a specific amount of budgetary appropriations for future years. If, however, a Member decided not to provide support to a specific commodity, the level of support for purposes of the comparison would be zero.

**Q28. In paragraph 13 of Australia's oral statement, you state that a "question" is: "could conditions of price competition for the purposes of a non-violation or impairment claim be**

**assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole." Could you please clarify this statement (indicating other elements which would complete the "whole" and explain its relevance for the purposes of our consideration of Article 13 of the *Agreement on Agriculture*? Australia, EC**

Answer

58. The European Communities would prefer to let Australia clarify its statement. The European Communities will comment upon Australia's clarification in its comments on the responses of the other third parties.

## III. EXPORT CREDIT GUARANTEE PROGRAMMES

**Q29. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

59. Export credits may involve the provision of "loans". Export credit guarantees, like other types of guarantees, normally involve an obligation to cover losses resulting from defaults on guaranteed loans. If provided by a government, they may involve a "financial contribution" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*.

**(b) How, if at all, would this be relevant to the claims of Brazil? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

60. Whether or not export credit guarantees are "financial contributions" is directly relevant to Brazil's claim that GSM 102, GSM 103 and SCGP constitute "export subsidies" within the meaning of Article 3.1 (a) of the *SCM Agreement*.

61. It is also relevant, by way of context, for Brazil's claim that those programmes are "export subsidies" for the purposes of Article 10.1 of the *Agreement on Agriculture*.

**Q30. The Panel could arguably take the view that Articles 1 and 3 of the *SCM Agreement* were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an *a contrario* interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission). 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

62. The relationship between the Illustrative List and Article 3.1(a) is addressed specifically by footnote 5, which provides that

> Measures referred to in Annex I as not constituting export subsides shall not be prohibited under this or any other provision of the Agreement.

63. In this regard, the European Communities recalls the reasoning followed by the panels in *Brazil –Aircraft (21.5) I* and *II*[27], which concluded that the first paragraph of item (k) of the Illustrative List does not provide *a contrario* an "affirmative defence".

64. As noted by the panel in *Brazil –Aircraft (21.5) – II*, the Appellate Body's statement relied upon by the United States "does not form part of the legal basis for its disposition of the appeal, nor did the Appellate Body explain its statement".[28]

65. Item (j) of the illustrative list describes circumstances in which, *inter alia*, export credit guarantee programmes may constitute export subsidies. In certain circumstances (e.g. where the Government is the only provider), it may be that the requirement set out in item (j) – that export credit guarantees must not be provided at premium rates which are inadequate to cover the long-term operating costs and losses of the programme – represents the appropriate benchmark for determining that an export subsidy does not exist.

**Q31. If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance in the interpretation of the terms in Article 10 *Agreement on Agriculture*, should the Panel refer to item (j) or Articles 1 and 3 of the *SCM Agreement* or both? . 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

66. Both.

**Q32. The Panel's attention has been drawn to Article 14(c) of the *SCM Agreement* (see third party submission of Canada) and to the panel report in DS 222 *Canada- Export Credits and Loan Guarantees*. How and to what extent are Article 14(c) of the *SCM Agreement,* and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material. . 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

67. The European Communities agrees that Article 14(c) may be relevant context for the interpretation of Article 1.1(b) of the *SCM Agreement*, where the subsidy consists of a loan guarantee. However, Article 14(c) may not be applicable if the government is the only supplier of a certain type of service and no comparable type is provided by other suppliers. In that case it may be necessary to resort to alternative benchmarks, such as the one set out in item (j) of the Illustrative List. This would depend on the particular circumstances of the case.

**Q33 What is the relevance (if any) of Brazil's statement that : "...export credit guarantees for exports of agricultural exports [*sic*] are not available on the marketplace by commercial lenders." . 3rd parties, in particular, Argentina, Canada, EC, NZ**

[27] Panel report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS64/RW, ("Brazil – Aircraft (21.5) – I"), paras. 6.24-6.67; Panel report, *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW/2, (Brazil – Aircraft (21.5) - II, paras5.269-5.275.

[28] Panel report, *Brazil –Aircraft (21.5) – II*, footnote 214.

Answer

68. The European Communities does not agree with the proposition that the provision by a government of finance not available from other suppliers confers *per se* a benefit. The European Communities recalls that the Panel in *Canada – Export Credits and Loan Guarantees* left open this issue.[29]

**Q34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

69. The European Communities does not express an opinion on this question at this time.

**Q35. Did the drafters of the *Agreement on Agriculture* include export credit guarantees in Article 9.1 of the *Agreement on Agriculture*? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

70. Export credit guarantees are not included in Article 9.1. Article 9.1 represents a list of export subsidies which were permitted to be maintained, but which were made subject to reduction commitments. Article 9.1 is a list of permitted export subsidies negotiated by the drafters of the *Agreement on Agriculture*. All other export subsides are regulated by Article 10.1.

**Q36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38) 3rd parties, in particular, Argentina, Canada, EC, NZ**

**(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

**(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

[29] Panel report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, para. 7.341.

Answer

71. At this stage, the European Communities does not comment on the factual aspects of this claim.

**Q37. The United States seems to argue that, at present, by virtue of Article 10.2 of the *Agreement on Agriculture*, there are *no* disciplines on agricultural export credit guarantees under the *Agreement on Agriculture* (or the *SCM Agreement)*.**

**(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the *Agreement on Agriculture* ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the *Agreement on Agriculture*? Please cite any relevant material, including any past WTO dispute settlement cases. 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

72. The European Communities considers that it is only the operation of export credit guarantees as export subsidies which is regulated by the *Agreement on Agriculture*. Other elements of the provision of export credit guarantees are not regulated by the *Agreement on Agriculture*. To the extent that the scenario developed by the Panel would lead to the provision of export subsidies which circumvent, or which threaten to circumvent, a Member's export subsidy commitments the European Communities considers that it cannot be reconciled with Article 10.1 of the *Agreement on Agriculture*.

**(b) If, as the United States argues, there are no disciplines on export credit guarantees in the *Agreement on Agriculture*, how could export credit guarantees "conform fully to the provisions of Part V" of the *Agreement on Agriculture* within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

73. The European Communities disagrees with the US argument that there are no disciplines on export credit guarantees. The discipline applying to export credit guarantees, where they operate as export subsidies, is that they should not be provided in a manner inconsistent with Article 10.1. If they are provided inconsistently with Article 10.1 then they are not protected by Article 13

## IV. STEP 2 PAYMENTS

**Q38. Please comment on the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in *Canada-Dairy* and the findings of the Appellate Body in *US-FSC***

***(21.5)*[30], do any other dispute settlement reports offer guidance on this issue? For example, how, if at all is the Appellate Body's report in *Canada-Aircraft* relevant here?[31] . 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

Answer

74. This is a question of fact on which the European Communities takes no position. It will comment, as necessary, on the replies of the other third parties.

**Q39. Please comment on the United States assertions at paragraph 129 of its first written submission, that "[t]he programme is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States." . 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

Answer

75. This is a statement of fact on which the European Communities offers no comment at present. The European Communities will comment further depending on the replies of other third parties.

**Q40. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the *AoA*? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the *SCM Agreement* and Article III:4 of the GATT 1994.. 3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay**

Answer

76. The Panel's question involves two elements. First, is a Member entitled to provide domestic content subsidies under the *Agreement on Agriculture*? Second, if such subsidies are permitted, what is the relevance of such a rule to Brazil's claims under Article 3 of the *SCM Agreement* and

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[30] [Original footnote to question] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.[30] Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

[31] There, the Appellate Body stated that,

> "the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies contingent ... in fact … upon export performance".[31]

Article III.4 GATT. The European Communities has already provided elements of a response in its oral statement.[32] These are expanded upon below.

77. First, a Member is entitled to provide domestic content subsidies under the *Agreement on Agriculture* provided such subsidies are provided consistently with the Member's domestic support commitment levels. This conclusion flows from a number of factors. First, the *Agreement on Agriculture* disciplines domestic support. Article 6.1 refers to "domestic support reduction commitments". Article 3.1 refers to "domestic support [..] commitments […] constitut[ing] commitments limiting subsidization" and Article 3.2 obliges Members "not [to] provide support in favour of domestic producers in excess of the [domestic] support commitment levels". Despite these clear rules on domestic support, the *Agreement on Agriculture* does not define "domestic support".

78. AMS is the measurement of domestic support. AMS is defined as "the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general, other than [that exempted etc]." This is very general – it covers all support in favour of agricultural producers. This broad scope of domestic support measures which can be maintained consistently with the *Agreement on Agriculture* is confirmed by Article 6.1 which states that the domestic support reduction commitments "shall apply to all of its [i.e. the Member's] domestic support measures in favour of agricultural producers […]". Paragraph 1 of Annex 3 on the calculation of the AMS refers to AMS being calculated "on a product specific-basis for each basic agricultural product receiving market prices support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment". (emphasis added)

79. Consequently, the range of domestic support measures which a Member may maintain (consistent with reduction commitments) is very broad and is only limited by the condition that such support must be in favour of agricultural producers. As the European Communities has noted, paragraph 7 of Annex 3 explicitly states that "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products".[33] The European Communities considers that the term "benefit" used here must be regarded as being synonymous with "favour" in the sense of "in favour of agricultural producers". Moreover, it is clear that by "measures directed at agricultural processors" the negotiators intended subsidies which were paid to processors, where the benefit went to the agricultural producer. Consequently, in light of the broad definition of "domestic support" and the specific reference to domestic content subsidies in paragraph 7 of Annex 3, the European Communities considers that a Member is entitled to maintain domestic content subsidies consistently with the *Agreement on Agriculture*.

80. Second, in response to the Panel's question, the effect of finding that domestic content subsidies are provided consistently with the *Agreement on Agriculture* would be that they cannot be found inconsistent with either Article 3.1(b) of the *SCM Agreement* or Article III.4 GATT 1994. Article 21.1 of the *Agreement on Agriculture* states that "the provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the

[32] Paras. 34 to 38 of the EC's Oral Statement (as delivered). The Panel's reference to para. 32 corresponds to the text provided at the third party session.

[33] In terms of negotiating background, it may be useful to the Panel to note that paragraph 7 of Annex 3 was subject to negotiation during the period in which a Panel had ruled that the EC's payments to oilseed processors was not covered by Article III.8(b) GATT 1947 and were consequently inconsistent with Article III.4 GATT 1947 (*European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* Report of the Panel (L/6627 BISD 37S/86) adopted on 25 January 1990. That the negotiators retained this text must therefore be considered as a clear sign that they intended to permit Members to maintain such subsidies, subject to reduction commitments, in the *Agreement on Agriculture*.

provisions of this Agreement." As the European Communities pointed out in its oral statement, this means that provisions of the other Annex 1A Agreements are "subordinated" to the *Agreement on Agriculture*.[34]

81. To find that such subsidies were inconsistent with either Article 3.1(b) of the *SCM Agreement* or Article III.4 GATT would be to subordinate the right to provide such domestic content subsidies under the *Agreement on Agriculture* to the *SCM Agreement* or GATT 1994. Such an interpretation directly contradicts Article 21.1 of the *Agreement on Agriculture*.

82. Indeed, it can be pointed out that applying Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT to domestic content subsidies provided consistently with the *Agreement on Agriculture* would lead to stricter disciplines being applied to domestic subsidies for agriculture than are applicable to domestic subsidies for industrial goods. If Article 3.1(b) and Article III.4 were to apply, domestic subsidies for agricultural products would be subject to reduction commitments and Article 3.1(b) *SCM Agreement* and Article III.4 GATT. However, domestic subsidies for industrial products are not subject to reduction commitments. Since the *Agreement on Agriculture* establishes "a basis for initiating a process of reform of trade in agriculture", it would seem contradictory to find that domestic support for agriculture is in fact subject to stricter obligations than domestic support for other industries. This explains the "subject to" language of Article 21.1 of the *Agreement on Agriculture*. Article 21.1 and the *Agreement on Agriculture* more generally can also be compared with the other sectoral agreement included in Annex 1A of the WTO Agreement. The *Agreement on Textiles and Clothing* explicitly provides, in its Article 9, that the textiles and clothing sector is to be fully integrated into the GATT 1994. The *Agreement on Agriculture* has no such language, and Article 21.1 runs directly counter to this notion. It cannot be lightly assumed that the negotiators, while providing for the possibility to maintain domestic content subsidies, intended that such subsidies also be subject to rules which effectively makes it impossible to maintain such subsidies.[35]

83. The Panel should therefore reject Brazil's arguments that domestic content subsidies granted in favour of agricultural producers can be found to be inconsistent with Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT 1994.

## V. ETI ACT

**Q41. Concerning its claims on the ETI Act, Brazil relies on the *US – FSC* case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Argentina, China, EC, NZ**

Answer

84. The European Communities does not consider that either the Peace Clause or Article 6 of the *Agreement on Agriculture* is relevant. The ETI Act provides export subsidies.[36] Article 6 of the *Agreement on Agriculture* does not apply to export subsidies, and therefore the US would not have been in a position to invoke it.

[34] Oral Statement, para. 38.

[35] See, in a similar sense, Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 165.

[36] The Appellate Body confirmed the panel's findings of a violation of Article 3.1(a) of the SCM Agreement see Article 231.5 Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"* ("United States – FSC (21.5)"), WT/DS108/AB/RW, adopted 29 January 2002, para. 120.

85. The Peace Clause will only apply in respect of export subsidies which "conform fully to the provisions of Part V" of the *Agreement on Agriculture* (Article 13(c)). The Appellate Body upheld the panel's findings that the ETI Act provided export subsidies in violation of Article 10.1 of the *Agreement on Agriculture*.[37] Consequently, the US could not have legitimately maintained that it was entitled to peace clause protection.

**Q42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the *DSU*, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the *DSU*, and please cite any other provisions you consider relevant. Argentina, China, EC, NZ**

Answer

86. Article 17.14 DSU states that an Appellate Body Report shall be "adopted by the DSB and unconditionally accepted by the parties to the dispute". The reference in the EC's oral statement to the phrase "a final resolution to *that* dispute" (emphasis from the Panel) is from the Appellate Body in *United States – Shrimp (21.5)*.[38]

87. In the present case the Panel must decide a preliminary question. It must determine whether the claims brought by Brazil against the ETI Act are in any way different from those which the panel and Appellate Body upheld against the ETI Act in the EC's Recourse to Article 21.5. If Brazil's claims are identical to those upheld against the ETI Act, the European Communities considers that the United States must be considered to have unconditionally accepted the Appellate Body's findings as adopted by the DSB.

88. The Panel may find some assistance in the Appellate Body's findings in *United States – Shrimp (21.5).* In that recourse to Article 21.5, Malaysia attempted to challenge certain aspects of the revised US measure at issue which were identical in the measure which was subject to the original challenge.[39] These aspects had been found by the panel and the Appellate Body to be consistent with the United States' WTO obligations. The Appellate Body found that there was no need for the panel, having determined that this aspect of the measure had not changed, to re-examine the consistency of the measure with the US' WTO obligations.[40]

89. The situation before the Panel is the inverse. Here, the US measure was found to be inconsistent with US' WTO obligations. The European Communities understands that the measure before the Panel in this case and before the panel and the Appellate Body in *United States – FSC (21.5)* is identical. On the assumption that the claims are identical, applying Article 17.14 DSU and the Appellate Body's findings in *United States – Shrimp (21.5)* the United States must be assumed to have unconditionally accepted the findings against the ETI Act.

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[37] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"* ("United States – FSC (21.5)"), WT/DS108/AB/RW, adopted 29 January 2002, para. 196.

[38] Para. 97, Article 21.5 Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.-5 of the DSU by Malaysia* ("United States – Shrimp (21.5)"), WT/DS58/AB/RW, adopted 21 November 2001.

[39] United States – Shrimp (21.5), para. 96.

[40] The Appellate Body made a similar finding with respect to a claim not pursued before a panel. See, Report of the Appellate Body in *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by* India, WT/DS141/AB/RW, adopted on 24 April 2003.

90. The European Communities does not consider it material that the present case concerns a party (Brazil) which was not party to the FSC dispute. Article 17.14 states that a "party to the dispute" must unconditionally accept the findings of the Appellate Body adopted by the DSB. Of the parties before the Panel, the United States is a party to the FSC dispute, and must, therefore, unconditionally accept the Appellate Body's findings in that dispute. This is further reinforced by Articles 3.2 and 3.3 DSU which state that the dispute settlement system must provide security and predictability and promote prompt settlement of disputes. Consequently, given the United States is required to unconditionally accept the findings in the Article 21.5 procedure, the European Communities believes that Brazil, by adopting the EC' claims and the Appellate Body's findings in the FSC dispute, would make a sufficient case to compel the Panel to find that the ETI Act is inconsistent with the US' WTO obligations in this dispute.

## VI. QUESTIONS FROM OTHER THIRD PARTIES ADDRESSED TO THE EUROPEAN COMMUNITIES

### Questions from Australia to the European Communities

**Q43. Would the European Communities please explain why, in its view, the ordinary meaning of the phrase "shall meet the fundamental requirement" as it appears in the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* does not give meaning and effect to all provisions of that agreement.[41]**

Answer

91. The European Communities did not state that the phrase "shall meet the fundamental requirement" does not give meaning and effect to all provisions of that agreement. The question appears to be based on an erroneous characterisation of the EC's position. In paragraph 17 of its First Written Submission the European Communities stated that the first sentence of Annex 2 did not create a free-standing obligation. This view is compelling when an interpreter considers the ordinary meaning of the terms, in their context, and in light of the object and purpose of the provision. The European Communities has explained this in some detail in its answers to the Panel's questions 6-11 and in its previous submissions to the Panel.

**Q44. The European Communities argues that, under the "accepted canons of interpretation of international law", "context and objective" require that the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* be considered to set out an objective.[42] Would the European Communities please explain the legal authorities for its argument, having regard to relevant statements by the Appellate Body, particularly those in *Japan – Alcohol Taxes*.[43]**

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[41] [Original footnote to question] First Third Party Submission by the European Communities, paragraph 17.

[42] [Original footnote to question] Oral Statement by the European Communities, paragraph 25.

[43] [Original footnote to question] In *Japan – Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, pages 11-12, the Appellate Body said:

> Article 31 of the *Vienna Convention* provides that the words of the treaty form the foundation for the interpretive process: "interpretation must be based above all upon the text of the treaty".[…] The provisions of the treaty are to be given their ordinary meaning in their context. […] The object and purpose of the treaty are also to be taken into account in determining the meaning of its provisions.[20] A fundamental tenet of treaty interpretation flowing from the general rule of interpretation set out in Article 31 is the principle of effectiveness …[…] In *[US – Gasoline]*, we noted that "[o]ne of the corollaries of the 'general rule of interpretation' in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility". […]

Answer

92. European Communities understands from Australia's question that Australia considers that the European Communities' interpretation of the first sentence of Paragraph 1 of Annex 2 would deprive the first sentence of effect.

93. Australia's implication is quite erroneous, and built upon an incomplete, examination of the Appellate Body's rulings. The European Communities interpretation does not deprive the first sentence of effect. Stating that the first sentence does not impose a self-standing obligation is not the same as stating that it is deprived of effect. Indeed, the Appellate Body has arrived at exactly the same conclusion with respect to other provisions containing purposive language, similar to that contained in the first sentence of paragraph 1. In *Japan – Alcoholic Beverages* the Appellate Body found:

> Article III:1 articulates a general principle that internal measures should not be applied so as to afford protection to domestic production. This general principle informs the rest of Article III. The purpose of Article III:1 is to establish this general principle as a guide to understanding and interpreting the specific obligations contained in Article III:2 and in the other paragraphs of Article III, while respecting, and not diminishing in any way, the meaning of the words actually used in the texts of those other paragraphs. In short, Article III:1 constitutes part of the context of Article III:2, in the same way that it constitutes part of the context of each of the other paragraphs in Article III. Any other reading of Article III would have the effect of rendering the words of Article III:1 meaningless, thereby violating the fundamental principle of effectiveness in treaty interpretation. Consistent with this principle of effectiveness, and with the textual differences in the two sentences, we believe that Article III:1 informs the first sentence and the second sentence of Article III:2 in different ways.[44] (emphasis added)

94. Moreover, the Appellate Body has also found that Article XXIV.4 GATT , which the Appellate Body qualified as "purposive language", was relevant for the interpretation of Article XXIV.5.[45] Clearly this gave a provision which had no operational effects, an effect, within the meaning of the Appellate Body's statements in *United States – Gasoline*.[46] Similarly, the European Communities has argued that while the first sentence of paragraph 1 does not impose a self standing obligation, it does set out the purpose of Annex 2 which informs the interpretation of other elements of Annex 2. (See the European Communities response to question 11 from the Panel).

**Q45. The European Communities argues that the omission of a reference to the "fundamental requirement" as set out in the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* in paragraphs 5, 6 and 7 of that Annex provides "contextual support" to its argument that the first sentence sets out an objective.[47] Would the European Communities**

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*Footnote 20:* That is, the treaty's "object and purpose" is to be referred to in determining the meaning of the "terms of the treaty" and not as an independent basis for interpretation: …

[44] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages")*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, page 18.

[45] Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products* ("Turkey – Textiles"), WT/DS34/AB/R, adopted 19 November 1999, para. 57.

[46] Appellate Body Report, *United States - Standards for Reformulated and Conventional Gasoline* ("United States – Gasoline"), WT/DS2/AB/R, adopted 20 May 1996, page 23.

[47] [Original footnote to question] First Third Party Submission by the European Communities, paragraph 21.

**please explain the legal authorities for its argument, having regard to its arguments and the Appellate Body's findings in *Argentina – Footwear Safeguard*.[48]**

Answer

95. We refer Australia in part to the European Communities' answer to the previous question where the European Communities has explained that its interpretation of the first sentence of Paragraph 1 does not deprive the provision of effect. Second, the issue in *Argentina – Footwear Safeguards* was whether the panel had given any effect to Article XIX GATT.[49] The panel in that case erroneously concluded that because of the omission of a reference to unforeseen developments in the *Agreement on Safeguards* it need not give effect to this requirement set out in Article XIX GATT. As the European Communities has explained, by interpreting the first sentence of paragraph 1 as setting an objective informing the rest of Annex 2, the Panel would be giving effect to the first sentence.

**Questions from Argentina to the European Communities**

**Q46. In paragraph 18 of its Oral Statement, the European Communities state that Article 13 (b)(ii) and (iii) of the Agreement on Agriculture are clearly "not intended to set up a comparison between domestic support granted in 1992 and domestic support granted in a more recent period" and request the Panel to reject the equation of the term "decided" with the term "granted".**

**What would be, in the opinion of the EC, the appropriate benchmark in a hypothetical case in which a subsidizing Member has taken no decision on internal support during 1992 ?**

Answer

96. We refer Argentina to the European Communities' response to question 27.

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[48] [Original footnote to question] In *Argentina – Safeguard Measures on Imports of Footwear*, Report of the Appellate Body, WT/DS121/AB/R, the European Communities argued (paragraphs 38-44) on appeal, and the Appellate Body found (paragraph 88), that the Panel erred by:

> fail[ing] to give meaning and legal effect to *all* the relevant terms of the *WTO Agreement*, contrary to the principle of effectiveness … in the interpretations of treaties. [...] The Panel states that the '*express omission* of the criterion of unforeseen developments' in Article XIX:1(a) from the *Agreement on Safeguards* 'must, in our view, have meaning'. [...] On the contrary, in our view, if they had intended to *expressly omit* this clause, the Uruguay Round negotiations would and could have said so in the *Agreement on Safeguards*. They did not.

[49] Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear* ("Argentina – Footwear Safeguards"), WT/DS121/AB/R, adopted 12 January 2000.

# ANNEX J-7

## NEW ZEALAND ANSWERS TO QUESTIONS FROM THE PANEL TO THIRD PARTIES

11 August 2003[1]

Article 13(b) of the *Agreement on Agriculture*: Domestic support measures

**Q2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

"Defined" and "fixed" mean two different things and impose two distinct and different requirements for a base period under paragraph 6(a) of Annex 2. "Defined" means "having a definite or specified outline or form".[2] "Fixed" means "definitely and permanently placed or assigned; stationary or unchanging in relative position; definite, permanent, lasting".[3] Accordingly a base period must have a definite and specified form that is permanent.

**Q3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

"A" in the context of paragraph 6(a) refers to one single defined and fixed base period. "The" in "the base period" in the context of subsequent sub-paragraphs refers to the single base period required under paragraph 6(a). Paragraph 6(a), however, does not specify a particular base period – only that once it is determined it is fixed. On the other hand, Annex 3 specifies that the "fixed" base period in that instance must be the 1986-88 period.

**Q4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture? 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Once, when a programme is first established. Thereafter, so long as the programme retains fundamentally the same elements, it should be considered to be the same programme and apply the same base periods.

**Q6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the Agreement on**

[1] New Zealand has not responded to questions not directed specifically to New Zealand.
[2] *The New Shorter Oxford English Dictionary*, Vol 1, Clarendon Press, Oxford (1993), page 618.
[3] *Ibid*, page 962.

**Agriculture have on the meaning of the preceding sentence? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

"Criteria" are the standards by which a thing is assessed. In this case they are the standards by which domestic support measures must be assessed in order to qualify for exemption from reduction commitments. These criteria are set out in Article 6 and Annex 2 of the *Agreement on Agriculture*, and include: the "fundamental requirement" in Annex 2 paragraph 1 that measures have at most minimal trade-distorting effects; the "basic criteria" in paragraph 1(a) and (b); and the "policy-specific criteria and conditions" set out elsewhere in Annex 2. The use of the word "accordingly" signifies that the intention of the drafters was to indicate that in order to meet the first criterion – the "fundamental requirement" that they be at most minimally trade-distorting – measures would at the very least have to meet the subsequent basic and policy-specific criteria.

**Q7. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the Agreement on Agriculture. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

"The fundamental requirement" as used in paragraph 1 of Annex 2 refers to a characteristic which, if not present, excludes a measure from a claim of exemption from reduction commitments. In this case that characteristic is that the measure has "no, or at most minimal, trade-distorting effects or effects on production." Paragraph 1 specifies that measures for which exemption is claimed "shall meet" this fundamental requirement. Had the drafters intended to make only a general statement of principle they would not have referred to a "requirement" that "shall be met". The use of the term "fundamental" only serves to underline the importance placed on all measures meeting this requirement in order to be exempt.

**Q9. If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation, does this allow effects-based claims of non-compliance with Annex 2? If so, how does this affect the purpose of Article 13(b)? 3rd parties' in particular Australia, Argentina, Canada, EC, NZ**

Reply

If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation it would allow effects-based claims of non-compliance with Annex 2. This is consistent with Article 13(b) because it means that the measures excluded from Annex 2 have a more than minimal distorting effect on trade or production, and as such they could potentially give rise to the kind of adverse effects to the interests of other Members that the *GATT 1994* and the *SCM Agreement* establish a right to address. As such those measures should not be exempt from reduction commitments and should be required to meet the requirements of Article 13(b) in order to be exempt from actions under the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*") and *General Agreement on Tariffs and Trade 1994* (the "*GATT 1994*").

**Q10. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

Yes.

**Q11. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. 3rd parties, in particular, Australia, Argentina, Canada, EC, NZ**

Reply

If the first sentence of paragraph 1 of Annex 2 expresses a general principle then the criteria in paragraph 6 of Annex 2 must be strictly applied to ensure that only genuinely decoupled income support that had at most minimal impacts on trade and/or production qualified for exemption from reduction commitments.

Irrespective of whether the first sentence of paragraph 1 of Annex 2 is to be considered a general principle or a stand-alone obligation, the requirement that there be only one defined and fixed base period in paragraph 6 is unambiguous. In New Zealand's view the updating of base acreage under the Direct Payments programme alone is sufficient to exclude it from the scope of permitted green box measures set out in paragraph 6 of Annex 2, as outlined in paragraph 2.29 of New Zealand's Third Party Submission.[4]

**Q12. Where does Article 13(b) require a year-on-year comparison? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Article 13(b)(ii) and 13(b)(iii) require a comparison with 1992 of any year in which injury, nullification or impairment or serious prejudice is alleged to have occurred.

**Q13. Does a failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

The nature of the non-compliance at issue may be such that it does impact on a Member's entitlement to benefit in an earlier or later year from the exemption from action provided by Article 13(b). Whether or not that is so must be assessed on a case-by-case basis.

**Q14. Does a failure of a Member to comply with Article 13(b) in respect of a specific commodity impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

[4] Third Party Submission of New Zealand, 15 July 2003.

Reply

No. The language of Article 13(b) makes it clear that the exemption from action applies to a "specific commodity", which means that the eligibility for such exemption must be assessed on a product-by-product basis.

**Q15. Is there any basis on which counter-cyclical payments could be considered product-specific? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Yes. The basis upon which counter-cyclical payments should be considered product-specific have been outlined in the First Written Submission of Brazil,[5] and highlighted in New Zealand's Third Party Submission.[6]

**Q16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? 3RD parties, in particular Australia, Argentina, Benin Canada, China, EC, NZ**

Reply

Not necessarily. The application of the rules of treaty interpretation to the provision, taking into account its object and purpose, would still support a conclusion that the relevant support was that granted to an individual commodity. The use of the word "specific" simply reinforces that interpretation.

**Q17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the SCM Agreement and references to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

The *SCM Agreement* provisions cited would seem to shed little light on the meaning of "support to a specific commodity" in Article 13(b)(ii). Article 2 of the *SCM Agreement* sets out principles for determining whether a subsidy is specific to an enterprise or industry or group of enterprises or industries. Article 13(b)(ii) of the *Agreement on Agriculture* is concerned with the support granted to a specific commodity. The two assessments are unrelated. In relation to the second part of the question, the references to "a product" or "subsidised product" seem fully consistent with interpreting "support to a specific commodity" referred to in Article 13(b)(ii) as meaning support to a particular product.

**Q19. Where does Article 13(b)(ii) require a year-on-year comparison? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

[5] Brazil's First Submission to the Panel Regarding the "Peace Clause" and Non-"Peace Clause" Related Claims, 24 June 2003 ("First Written Submission of Brazil"), paragraphs 199-202 and 207-213.
[6] Paragraphs 2.17-2.13.

Reply

See New Zealand's answer to question 12 above.

**Q20. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?**

Reply

Such a comparison could be made by interpreting these terms logically as requiring a comparison between the total volume of support to a specific commodity in 1992 and in any other year in respect of which claims under the *SCM Agreement* and *GATT 1994* are made.

**Q21. Please comment on Brazil's assertion that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

Article 13(b)(ii) would be devoid of meaning if it were to be interpreted as requiring a comparison between two things that were not like ie if "support granted" was somehow different from "support decided". Therefore the issue is not the difference in wording used, but substantively, what comparison meets the object and purpose of the provision. In New Zealand's view that is a comparison between the total volume of support to a specific commodity in 1992 and in any other year in respect of which claims under the *SCM Agreement* and *GATT 1994* are made.

**Q22. What is the meaning of "support" in Agreement on Agriculture 13(b)(ii) ? Why would it be used differently from Annex 3, where it refers to total outlays? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

Annex 3 refers to budgetary outlays as a component of the Aggregate Measurement of Support ("AMS") calculation. There is nothing to suggest that budgetary outlays should not also be a component of the calculation of "support" in the context of Article 13(b)(ii).

**Q23. Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

The rationale behind the comparison required by Article 13(b)(ii) is to create an upper limit to the level of trade and production distortion resulting from Members' domestic support programmes. Therefore the appropriate comparison is with the total volume of support because that provides the truest indication of the real effects of the support programmes on trade and production. Support in terms of unit of production may well be a relevant factor in that calculation but it will not be the only one.

**Q25. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

New Zealand is not sure what "authorised" in such a context would mean. Presumably it requires evidence of some kind of formal "authorisation". What support was formally authorised, by legislation or regulation, might provide some insight into what level of support was received for specific commodities, but it cannot provide the full picture. It therefore makes no sense to interpret "decided" in such a limited way.

Export credit guarantee programmes

**Q29. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

An export credit guarantee is a "financial contribution" under Article 1.1(a)(1) because it is a "loan guarantee".

**Q29. (b) How, if at all, would this be relevant to the claims of Brazil? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

It is relevant because a financial contribution is a necessary element of a "subsidy" under Article 1.1(a)(1)(i) of the *SCM Agreement*. Brazil has presented arguments to support a finding that the US export credit guarantee programmes are subsidies as defined in Article 1.1(a)(1)(i), that are contingent upon export according to the terms of Article 3.1(a). The *SCM Agreement* has been found to provide useful context for determining what constitutes an export subsidy for the purposes of Article 10.1 of the *Agreement on Agriculture*. Brazil has demonstrated that, in the terms of Article 10.1, the United States export credit guarantee programmes are applied so as to result in, or threaten to lead to, circumvention of the United States export subsidy commitments.

Brazil has therefore demonstrated that the United States export credit guarantee programmes do not conform fully to the provisions of Part V of the *Agreement on Agriculture* and therefore cannot be exempt from actions based on Article XVI of *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement* by the terms of Article 13(c)(ii) of the *Agreement on Agriculture*.

**Q30. The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an a contrario interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission). 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

New Zealand notes that the Illustrative List simply lists measures that constitute export subsidies under Article 3.1(a) of the *SCM Agreement*. As stated by the Panel in Canada – Export Credits, "item (j) sets out the circumstances in which the grant of loan guarantees is *per se* deemed to

be an export subsidy (i.e. when the "premium rates … are inadequate to cover the long-term operating costs and losses" of the loan guarantee)."[7]

**Q31. If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

The Panel should refer to both. The *SCM Agreement* provides both a general definition of an "export subsidy" (specifically the definition of a "subsidy" in the terms of Article 1 and the requirement of contingency upon export in the terms of Article 3) and an Illustrative List containing specific examples of export subsidies. Therefore Articles 1 and 3 and item (j) of the Illustrative List provide contextual guidance for the interpretation of the terms in Article 10.

**Q32. The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see third party submission of Canada) and to the panel report in DS 222 Canada- Export Credits and Loan Guarantees. How and to what extent are Article 14(c) of the SCM Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material. . 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

The Panel in Canada – Export Credits and Loan Guarantees[8] considered that Article 14(c) of the *SCM Agreement* provided contextual guidance for interpreting 'benefit' in relation to loan guarantees. In that case it was determined that the relevant benchmark for determining whether a loan guarantee conferred a "benefit" was whether there was "a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed … and the amount that the firm would pay on a comparable commercial loan absent the … guarantee." This confirms that the appropriate point of reference for determining whether a "benefit" has been conferred is the marketplace, in this case the extent to which the premium rates charged on current export credit guarantees are lower than the corresponding financing rates that a commercial bank would normally require given a similar level of risk.

**Q33. What is the relevance (if any) of Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders." . 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

Brazil's statement goes toward a conclusion that a "benefit" is conferred in the terms of Article 1.1(b) of the *SCM Agreement*. It is significant because it indicates that either commercial lenders are not prepared to accept the risks associated with such guarantees or that the United States export credit programme is so big that it has forced any competition from commercial programmes out of the marketplace. For whatever reason, the United States export credit guarantee programmes

[7] Report of the Panel, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS/222, paragraph 7.395.

[8] *Ibid*, paragraph 7.397.

provide the recipient with export credit guarantees not available in, and therefore on terms more favourable than, the marketplace, and thus confers a "benefit" in the terms of Article 1.1(b).

**Q34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

"Claims paid" is one element of the calculation of the costs and losses of an export credit guarantee programme. Other elements to be taken into account would include, for example, costs and losses associated with reinsurance costs, administration costs and the costs of refinancing (i.e. the rescheduling (not the full amount, but the net present value of the losses)).

**Q35. Did the drafters of the Agreement on Agriculture include export credit guarantees in Article 9.1 of the Agreement on Agriculture? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

The drafters of the *Agreement on Agriculture* did not include export credit guarantees in Article 9.1 of the *Agreement* because export credit guarantees are not, *per se*, export subsidies. They may involve export subsidies, but this depends on whether they provide a benefit in relation to the marketplace.

**Q36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38) 3rd parties, in particular, Argentina, Canada, EC, NZ**

**"The programs operate in cases where credit is necessary to increase or maintain U.S. exports to a foreign market and where U.S. financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

See New Zealand's answer to Question 33 above.

**"The programs are operated in a manner intended not to interfere with markets for cash sales. The programs are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

This statement simply supports Brazil's analysis in relation to the "benefit" and "export contingency" elements of the export credit guarantee programme.

**"In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for U.S. agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

This statement reinforces the obvious export contingency of the export credit guarantee programme and through the reference to expand[ing] opportunities and assist[ing] long-term market development makes it clear that the intention of the programme is to provide a benefit to US exporters.

Reply

**Q37. The United States seems to argue that, at present, by virtue of Article 10.2 of the Agreement on Agriculture, there are no disciplines on agricultural export credit guarantees under the Agreement on Agriculture (or the SCM Agreement).**

**(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the Agreement on Agriculture? Please cite any relevant material, including any past WTO dispute settlement cases. 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

The proposition is not reconcilable with the title of Article 10 of the *Agreement on Agriculture* as such an export credit guarantee would clearly provide an export subsidy and thus potentially circumvent export subsidy commitments. It also ignores the findings of the Panel in US-FSC Article 21.5[9], affirmed by the Appellate Body,[10] that the threat of circumvention of export subsidy reduction commitments in the terms of Article 10.1 exists in relation to both unscheduled and scheduled agricultural products when the amount of a subsidy is unqualified or unlimited, as implied in the proposition above.

**(b) If, as the United States argues, there are no disciplines on export credit guarantees in the Agreement on Agriculture, how could export credit guarantees "conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

The United States interpretation would render the phrase "conforming fully to the provisions of Part V" meaningless in respect of export credit guarantees and it therefore cannot be sustained.

Step 2 payments

**Q38. Please comment on the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale,**

[9] Report of the Panel, *United States – Tax Treatment for "Foreign Sales Corporations", Recourse to Article 21.5 of the DSU by the European Communities* (WT/DS108/RW), paragraphs 8.118 and 8.119.

[10] Report of the Appellate Body, *United States – Tax Treatment for "Foreign Sales Corporations", Recourse to Article 21.5 of the DSU by the European Communities* (WT/DS108AB/RW).

**then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in Canada-Dairy and the findings of the Appellate Body in US-FSC (21.5), do any other dispute settlement reports offer guidance on this issue? For example, how, if at all is the Appellate Body's report in Canada-Aircraft relevant here? 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

Reply

The two distinct factual situations involved are 1) where cotton is exported, and 2) where cotton is used domestically. The notional consumer referred to by the United States cannot be both an exporter and domestic user of the same bale of cotton.

Even if the Panel were to find that there are not two distinct factual situations involved, ie that there was only one 'Step 2 payment' programme as alleged by the United States, the findings of the Appellate Body in Canada-Aircraft[11] referred to in the question above make it clear that the fact that some of the payments made under that programme are *not* contingent upon export performance, does not necessarily mean that the same is true for all of the payments under the programme. To paraphrase the Appellate Body, it is enough to show that one or some of the Step 2 payments do constitute subsidies "contingent … in fact … upon export performance." Those payments made upon production of proof of export clearly meet the export contingency requirement.

**Q39. Please comment on the United States assertions at paragraph 129 of its first written submission, that "[t]he program is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States." . 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

Reply

The fact that an applicant is required to identify themselves as either an exporter or domestic user and an exporter is required to provide proof of export in order to receive the payment would seem to suggest that the programme is not, in fact, so 'indifferent'.

**Q40. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the AoA? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the SCM Agreement and Article III:4 of the GATT 1994.. 3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay**

Reply

New Zealand does not agree that a right to provide subsidies contingent upon the use of domestic products contrary to Article 3 of the *SCM Agreement* can be found in the requirement that subsidies "directed at agricultural producers … to the extent that they benefit producers of the basic agricultural product" be included in the calculation of AMS. There is no basis for reading such a right into the *Agreement on Agriculture*. To do so would allow the possibility for exemption from action under the *SCM Agreement* to exist other than by virtue of the peace clause. The peace clause explicitly does not provide such exemption from action under Article 3 of the *SCM Agreement* when

[11] Report of the Appellate Body, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R , paragraph 179.

it quite clearly could have done so. In New Zealand's view that indicates that there was no intention on the part of the drafters that domestic support measures, whether they conform with Article 6 of the *Agreement on Agriculture* or not, should be so exempt. The same is true in respect of *GATT 1994* Article III:4 claims.

ETI Act

**Q41. Concerning its claims on the ETI Act, Brazil relies on the US – FSC case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the Agreement on Agriculture. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Argentina, China, EC, NZ**

Reply

While it is open to the United States to claim exemption from action for such measures under the peace clause, the United States has no reduction commitments in respect of upland cotton and it cannot therefore provide export subsidies to upland cotton in a WTO-consistent manner.

**Q42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to that dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. Argentina, China, EC, NZ**

Reply

References to "disputes" in the Dispute Settlement Understanding must be interpreted in context. Article 17.14 requires that parties to a dispute unconditionally accept the report of the Appellate Body once adopted by the Dispute Settlement Body ("DSB"). That acceptance is in the context of that particular dispute between those particular parties. However that does not preclude a Panel from finding that a *prima facie* case of WTO-inconsistency has been made out where a Member makes a complaint in relation to a measure that has previously been ruled to be WTO-inconsistent where that ruling has been adopted by the DSB and where the measure remains unchanged.

# ANNEX J-8

## PARAGUAY'S REPLY AS THIRD PARTY TO THE FOLLOWING QUESTION

11 August 2003

ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE

**26. Under Article 13(b)(ii), a comparison is required between support at different times. One of the issues which is contested between the parties is whether the only later period that the Panel can consider is the present one (i.e. the period underway at the time of the request for establishment of the Panel). This argument is based on the present tense of the words "do not grant" in the English text.**

**The Panel asks whether there is any difference in the verb tense as used in the Spanish-language text, or any other difference which might aid the Panel in interpreting these words?**

Reply

In its analysis of the question raised by the Panel as to the period to be considered and the verb tense used, Paraguay is expressing a view based on both versions:

> *"(ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, **provided** that such measures **do not grant support** to a specific commodity in excess of that decided during the 1992 marketing year; and …."*
>
> *"ii) estarán exentas de medidas basadas en el párrafo 1 del artículo XVI del GATT de 1994 o en los artículos 5 y 6 del Acuerdo sobre Subvenciones, **a condición de que no otorguen** ayuda a un producto básico específico por encima de la decidida durante la campaña de comercialización de 1992; y …"*

As regards the verb tense used, the English version clearly calls for a present tense interpretation, as the Panel rightly points out.

It clearly reads "**provided** that such measures do not grant support". If we take the word "provided" as indicating the occurrence of an event (**"in the event"**), we must bear in mind that this would introduce conditionality.

The Spanish text expresses the conditionality in even clearer terms through the words **"a condición de que no otorguen"**, a conditionality which introduces a notion of facts.

In Spanish, the verb is used in the present **subjunctive mode**, which according to the ***Larousse Dictionary***, *is the mode used to express possibility, as opposed to the indicative mode, which is the reality mode.*

Although we consider that both versions indicate the present, it appears to us that the Spanish version of the sentence stresses conditionality, which must be given considerable weight in order to arrive at a correct interpretation.

In the case at issue, *the condition under which the measures shall be exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement* is that support should not be granted to a specific commodity in excess of that decided during the 1992 marketing year.

The 1992 marketing year provides the standard needed to carry out a proper comparison between support at different times, so that in our view, we should be considering the entire spectrum and taking a comprehensive view of the background information.

Paraguay concludes that it is the Panel's task to consider the period it deems suitable for determining the effects of this type of measure on world trade.

# ANNEX J-9

## COMMENTS BY ARGENTINA ON THE REPLY BY THE EUROPEAN COMMUNITIES TO QUESTION 40 FROM THE PANEL

22 August 2003

Argentina would like to make the following comments on the reply by the European Communities to question 40 from the Panel.

Argentina does not share the EC's assertion that Members are entitled to provide domestic content subsidies under the Agreement on Agriculture (AoA) provided such subsidies are provided consistently with the Member's domestic support commitment levels.

It is our view that the rules of the AoA, on the one hand, and of the GATT 1994 and the Agreement on Subsidies and Countervailing Measures (ASCM), on the other, contain disciplines that apply independently unless there is a "conflict" between the provisions, in which case the rules of the AoA apply as a result of Article 21.1 of this Agreement.

Article 21.1 of the AoA states that *"The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to* ("a reserva de" in the Spanish text) *the provisions of this Agreement*."

The words "subject to" or "a reserva de" indicate dependency or a condition[1]. Such dependency or condition does not, however, mean that all the disciplines in the GATT 1994 and the Agreements in Annex 1A automatically cease to apply in the case of the AoA. On the contrary, these disciplines "shall apply" unless there is a discrepancy or conflict between a rule in the AoA and the rules in the GATT 1994 or the Agreements in Annex 1A. This conclusion also receives contextual support in the General interpretative note to Annex 1A.

The conditions for the existence for a conflict between two rules was clarified by the Appellate Body in the *Guatemala – Cement case*[2], where it is determined that there is a conflict between two provisions if adherence to one provision leads to a violation of the other. In the case before us, in order to determine whether a rule in the GATT 1994 or in an Agreement in Annex 1A (Article 3.1(b) of the ASCM in this particular case) does not apply, it must first be determined whether there is an inconsistency or discrepancy with a provision of the AoA. In other words, these rules must be applied together.

In this connection, Argentina considers that compliance with the obligations laid down in Articles 6.1 and 3.2 of the AoA, and with paragraph 7 of Annex 3, does not allow any inconsistency with Article 3.1(b) of the ASCM to be detected.

Regarding Articles 6.1 and 3.2 of the AoA, nothing in these provisions indicates that it is not possible to apply them together with the prohibition on granting subsidies contingent on the use of domestic rather than imported products. The fact that the term "domestic support" is not defined in

[1] The New Oxford Dictionary of English: "subject to: … 2 dependent or conditionally upon".
[2] WT/DS60/AB/R, paragraph 65.

the AoA or that the AMS is broadly defined, as indicated by the EC[3], does not imply that the prohibition laid down in Article 3.1(b) of the ASCM is not valid in relation to the AoA. In this connection, the AoA does not contain any reference to possible exclusion.

Regarding paragraph 7 of Annex 3, the statement that "Measures directed at agricultural processors shall be excluded to the extent that such measures benefit the producers of the basic agricultural products" does not mean that such benefits cover measures made subject to the use of national rather than imported products. Producers of the basic agricultural products are allowed the benefits without making the measure contingent on the use of domestic products.

Lastly, with regard to the EC's reference to the preamble to the AoA ("*Having decided* to establish a basis for initiating a process of reform of trade in agriculture …"), it should be noted that this process could very well envisage stricter obligations concerning certain types of measure that particularly distort international agricultural trade. On the contrary, it appears contradictory to assume that an agricultural trade reform process envisages the weakening of disciplines that could be applied in another way.

For the foregoing reasons, Argentina considers that subsidies that are granted to agricultural producers contingent on the use of domestic rather than imported products, either as a sole requirement or as one of several requirements, are inconsistent with Article 3.1(b) of the ASCM and Article III.4 of the GATT 1994.

[3] Replies by the EC to question 40, paragraph 77.

# ANNEX J-10

## COMMENTS BY AUSTRALIA ON THE RESPONSES OF THE EUROPEAN COMMUNITIES TO QUESTIONS FROM THE PANEL AFTER THE FIRST SESSION OF THE FIRST SUBSTANTIVE PANEL MEETING

22 August 2003

These comments by Australia are offered in response to some of the answers submitted by the EC to the questions from the Panel after the first session of the first substantive Panel meeting. It is not Australia's intention to comment on all of the answers submitted by the EC, as most issues have already been addressed in Australia's written Third Party Submission, Australia's Oral Statement and Australia's responses to questions from the Panel after the first session of the first substantive Panel meeting.

Panel question no. 6 and Australian question no. 2

The EC refers to the findings of the Appellate Body in the *Turkey – Textiles* dispute concerning the interpretation of the word "accordingly" at the beginning of Article XXIV:5 of GATT 1994 to support its view that the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* does not establish a freestanding obligation. However, as EC recognises, the Appellate Body expressly found in that dispute that the text of GATT Article XXIV:4 does not contain any operative language, that is, that GATT Article XXIV:4 "does not set forth a separate obligation itself". Nor do any of the other provisions cited by the EC in its footnote 9 contain operative language in the sense of setting forth a separate obligation.

The words "shall meet the fundamental requirement" establish a clear and unambiguous obligation that Annex 2 measures must conform to or satisfy the primary or essential condition that such measures have no, or at most minimal, trade-distorting effects or effects on production. "Shall", when used in the present tense as an auxiliary verb followed by an infinitive as in the first sentence of paragraph 1 of Annex 2, is defined as: "must according to a command or instruction".[1] "Meet" has a number of meanings, including "come into conformity with (a person, a person's wishes or opinion)" and "satisfy (a demand or need); satisfy the requirements of (a particular case); be able or sufficient to discharge (a financial obligation)". The words "shall meet" in context mean that Annex 2 measures must conform to or satisfy an express stipulation. Australia has previously explained that a "fundamental requirement" is a primary or essential condition.[2] When used as a definite article as in the clause "shall meet the fundamental requirement", the word "the" establishes the "fundamental requirement" as the express stipulation that Annex 2 measures must conform to or satisfy.[3]

In Australia's view, the normal rules of treaty interpretation do not permit the word "accordingly" to be interpreted so as to obviate a clear and unambiguous obligation. Australia agrees that the Appellate Body found in the *Turkey – Textiles* dispute, in the particular circumstances of GATT Article XXIV, that the word "accordingly" linked the purposive language of Article XXIV:4 to operative language in the specific obligations found elsewhere in Article XXIV. However, the first

[1] *The New Shorter Oxford English Dictionary*, Volume 2, page 2808.
[2] Australian response to Question no. 7 from the Panel.
[3] Australia addressed the meaning of "the" in more detail in its response to question 3 from the Panel.

sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* cannot be characterised as purposive. The Appellate Body's finding in the *Turkey – Textiles* dispute is not, and cannot be, a valid interpretative basis to say that because the word "accordingly" has a particular meaning in the context of GATT Article XXIV, that same meaning must apply wherever else the word "accordingly" appears.[4]

Panel question no. 9

It remains unclear to Australia what is meant by "effects-based claims" in the context of the Panel's question.

However, Australia notes that under the EC's interpretation there would be no limits to the amounts that a WTO Member could provide as Annex 2 support, even if such support had profound trade-distorting effects or effects on production. For example, the EC's interpretation would allow a Member to pay "decoupled income support" of such a magnitude that the support would provide the means for that Member's domestic producers to switch from dryland to irrigation production with resulting substantial increases in production and trade-distorting effects. Thus, even if the first sentence of paragraph 1 of Annex 2 of the *Agreement on Agriculture* were considered to express an objective, such an outcome would nevertheless be directly contrary to that objective. At the very least, the magnitude of Annex 2 payments must be able to be a factor in assessing whether Annex 2 domestic support measures "meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production".

Further, the EC's argument that identifying the effects of such measures is often only feasible on an *ex post facto* basis is not convincing. First, even the EC argument concedes that in many, if not most, cases, it is feasible to identify the effects of such measures in advance. Secondly, even if the precise effects of such measures cannot be identified in advance, policy makers could draw on past experience and econometric analyses to determine whether certain types of payments would likely be distorting.

Finally, Australia considers that the "problems" pointed to by the EC that would be engendered by interpreting the first sentence of paragraph 1 as a freestanding obligation are no different to other situations, including under the *Agreement on Agriculture*. If another Member were to argue successfully in a dispute that a measure at issue was indeed an export subsidy, the responding Member could well be required to show "after the fact" that it is in compliance with its export subsidy reduction commitments under the *Agreement on Agriculture*.[5]

[4] Australia considers that the Appellate Body's discussion of the meaning of "like products" in *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* , WTO DS135/AB/R, paragraphs 87-100, confirms this view.

[5] See, for example, *United States – Tax Treatment of "Foreign Sales Corporations"*, WT/DS108.

# ANNEX J-11

## COMMENTS BY THE EUROPEAN COMMUNITIES ON RESPONSES TO THE QUESTIONS OF THE PANEL SUBMITTED BY OTHER THIRD PARTIES

22 August 2003

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## I. INTRODUCTION

1. The European Communities has sought to comment on some of the responses to the Panel's questions submitted by other third parties. It has not been possible to do this in an exhaustive manner. Rather, the European Communities has made comments on certain responses which in its view merited further discussion. Evidently, where the European Communities has not commented on a particular argument, this does not imply that we support it.

2. For the Panel's ease of reference, we have retained in this document the Panel's original questions and the responses of the European Communities. Where the European Communities has decided to comment on a particular argument of another third party, we have inserted *verbatim* the text of the other party's arguments. We have deleted all questions which we have decided not to make comments on.

## II. ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE

**Question**

**1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions in Article 13 are a "prerequisite" to the availability of a right or privilege? Australia Would other third parties have any comments on Australia's assertion? 3rd parties, in particular Argentina, Benin, China, Chinese Taipei**

Answer

3. Australia's views cannot be reconciled. Australia is correct in noting that the conditions in Article 13 can be considered a prerequisite for taking action under the *SCM Agreement*.[1] In using the term "prerequisite", Australia essentially recognises that, in respect of measures covered by Article 13, a complainant can only invoke the relevant provisions of the *SCM Agreement* if it proves that the threshold requirements or prerequisites referred to in Article 13 have been satisfied. As the European Communities has pointed out, such a situation is very different from the situation where, in the event of a violation of a WTO Agreement, a WTO Member pleads a defence which potentially exculpates it from this violation (e.g. Article XX GATT) in respect of which it bears the burden of proof.

4. Comparing Article 13 with Article 3.3 of the *SPS Agreement* shows that Australia's views are irreconcilable. This provision permits WTO Members not to base SPS measures on international standards but to impose higher standards where there is a scientific justification or an appropriate risk assessment has been carried out. This provision has some similarities with Article 13 of the *Agreement on Agriculture* since it sets a threshold which must be met before a Member can act. However, Article 3.3 may be seen as going further than Article 13 since it provides a derogation from the central discipline of the *SPS Agreement* ; the obligation to base SPS measures on international standards. On the other hand, Article 13 is simply one element regulating the interface between the *Agreement on Agriculture* and the other Annex I Agreements and cannot be seen as a derogation therefrom. Despite the extent to which Article 3.3 could be thought of as a derogation from the *SPS Agreement*, the Appellate Body ruled in *EC Hormones* that it could not be considered an affirmative defence, and that the burden of proof did not, therefore lie with the defendant.[2] In particular, the Appellate Body noted that the situation in Article 3.3 of the SPS Agreement is "qualitatively different" from the relationship between for instance, Article 1 and XX GATT.[3]

5. Consequently, Australia is correct to consider that Article 13 is a prerequisite or a threshold condition before the other Annex I Agreements may become applicable but is incorrect to consider that Article 13 can be considered an affirmative defence.

**Response of Australia**

> Australia does not see any inconsistency in its views. In Australia's view, the potential availability of an affirmative defence in the general sense is in the nature of a right or privilege. Australia wishes to clarify, however, that it considers Article 13 in the specific sense to be a right available when the conditions prescribed therein are met, rather than a privilege.

**EC Comment**

6. The European Communities fails to see how Australia can reasonably assert that there is no "inconsistency in its views". If Article 13 *Agreement on Agriculture* is a "prerequisite" for a complainant to bring an action under the *SCM Agreement* it cannot be at the same time a defence. A defence applies when a breach of a WTO Agreement arises, and the defending Member relies on another provision of a WTO Agreement in order to exculpate itself. Article XX GATT is the best example. In such a case, the burden of proof shifts to the Member invoking a defence. A prerequisite

[1] Australia's Oral Statement, para. 18.

[2] Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 109.

[3] Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 105.

is entirely different. It implies that before a Member can undertake a particular action, it must take another action. In this context, a complaining Member must prove that Article 13 *Agreement on Agriculture* does not apply, before proving that the relevant provisions of the *SCM Agreement* apply.

7. Australia's bald assertion, glossing over its previous use of the word "prerequisite", does not adequately explain how its views can be reconciled.

## III. ARTICLE 13(B) OF THE *AGREEMENT ON AGRICULTURE*: DOMESTIC SUPPORT MEASURES

### Questions 2 - 5

8. The European Communities would only note that the changes presented by Australia to questions 2 and 3 on 15 August 2003 as "corrigenda" altered substantively the meaning of Australia's original response. The change from "program" to "payment" is a substantial change, and not a mere typographical error.

### Question

**6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the *Agreement on Agriculture* have on the meaning of the preceding sentence? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

9. Both Article 6.1 and 7.1 refer to the "criteria set out in [..] Annex 2". When one considers Annex 2, there are two sets of "criteria". The first is the "basic criteria" set out in subparagraphs (a) and (b) of paragraph 1, and the second is the "policy-specific criteria" set out in paragraphs 2 to 13. This understanding is confirmed by the text of paragraph 5 of Annex 2, which refers to the "basic criteria" and the "specific criteria". Thus, Articles 6.1 and 7.1 of the *Agreement on Agriculture* refer to the basic and policy specific criteria set out in Annex 2.

10. The European Communities has already set out its understanding of the term "accordingly" in its Third Party Written Submission.[4] In the European Communities view, the term "accordingly" is intended to link the purposive language of the first sentence, with the "basic criteria" set out in the second sentence. In its Third Party Submission the EC offered a dictionary definition, "in accordance with the logical premises" which showed that the word "accordingly" operates as a linkage between the premise or understanding set out in the first sentence and the operative language in the second sentence. Australia offers the Panel another definition: "harmoniously" or "agreeably", but fails to note that that the Oxford English Dictionary considers this usage of the word "accordingly" obsolete.[5]

11. The European Communities would point out that both the French and Spanish text support the view that the use of the word "accordingly" links the general statement in the first sentence with the specific obligations of the second sentence. The French text uses the term "en conséquence" and the Spanish the term "por consiguiente". Both of these terms show that the criteria in the second sentence

[4] First Third Party Submission of the European Communities, 15 July 2003, para. 20. The European Communities recall, in this context, the opinion of Professor Desta set out in footnote 19 to para. 20.

[5] Australia's Oral Statement, para 35. Oxford English Dictionary, p. 15. Australia refers to the first sense of the word "accordingly" which is preceded by the symbol "=" which indicates that a particular usage is obsolete (see Abbreviations and Symbols, page xxvi).

are intended to express the principle set out in the first sentence. Moreover, had the negotiators intended that the first sentence be a self-standing obligation, rather than use the term "accordingly" they would have used the term "additionally" or "in addition", or a synonymous term.

12. Further support for this view can be found in the frequent use of the term "accordingly" in the WTO Agreement. A survey of the term's use suggests that it links a general statement, often recognising that a particular situation causes specific effects, with a right or obligation to take some type of action set out in an ancillary sentence.[6] These general statements are not such as to impose specific obligations. The Appellate Body had occasion to consider the relationship between such provisions in the *Turkey-Textiles* dispute (Articles XXIV.4 and XXIV.5 GATT). It concluded:

> The chapeau of paragraph 5 of Article XXIV begins with the word "accordingly", which can only be read to refer to paragraph 4 of Article XXIV, which immediately precedes the chapeau.
>
> [..]
>
> 57. According to paragraph 4, the purpose of a customs union is "to facilitate trade" between the constituent members and "not to raise barriers to the trade" with third countries. This objective demands that a balance be struck by the constituent members of a customs union. A customs union should facilitate trade within the customs union, but it should *not* do so in a way that raises barriers to trade with third countries. [..] Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV. Thus, the purpose set forth in paragraph 4 informs the other relevant paragraphs of Article XXIV, including the chapeau of paragraph 5. For this reason, the chapeau of paragraph 5, and the conditions set forth therein for establishing the availability of a defence under Article XXIV, must be interpreted in the light of the purpose of customs unions set forth in paragraph 4. The chapeau cannot be interpreted correctly without constant reference to this purpose.[7] (emphasis added)

13. The Appellate Body has, consequently, recognised the linking function of the word "accordingly", and the fact that provisions which may be linked to later provisions through the use of the word "accordingly" may not impose separate obligations.

14. The European Communities would also point out that the Appellate Body has found that other provisions (e.g. Article III.1 GATT) which contain general principles are set up as "a guide to understanding and interpreting the specific obligations contained" in other provisions (e.g.

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[6] See Articles II.6(a), III.9, XII.3(d), XVI.3, XVIIII.5, XXIV.5 GATT 1994, together with Ad Article III and Ad Article XXVIII.4 to GATT 1994, Articles 2.1 and 11 of the Dispute Settlement Understanding, Article A(i) of the Trade Policy Review Mechanism, Article 12.8 of the Agreement on Technical Barriers to Trade, Article 1 of the GATS Annex on Telecommunications and Article 5.1 of the Agreement on Textiles and Clothes.

[7] Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products ("Turkey – Textiles")*, WT/DS34/AB/R, adopted 19 November 1999, paras. 56 and 57 (emphasis added). Note that the Panel also found that Article XXIV.4 was "not expressed as an obligation" (Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products ("Turkey – Textiles")*, WT/DS34/R, adopted 19 November 1999, as modified by the Appellate Body Report, WT/DS34/AB/R, para. 9.126).

Article III.2 and the other paragraphs of Article III).[8] Such provisions do not, however, impose additional obligations supplemental to the specific obligations, unless expressly stated.[9]

15. The Panel may find it useful to refer to the European Communities' response to a question posed by Australia (see question no. 44 in this document). In its response, the European Communities deals with Australia's unfounded assertion that the European Communities' reading of the first sentence of paragraph 1 would render that provision ineffective.

**Response of Australia**

> The ordinary meaning of "criteria", as the plural of "criterion", is "principle[s], standard[s], or test[s] by which a thing is judged, assessed, or identified"[10]. Thus, the "criteria" in Articles 6.1 and 7.1 as these relate to Annex 2 of the *Agreement on Agriculture* encompasses <u>all</u> of the relevant principles, standards or tests established in Annex 2 against which domestic support measures for which exemption from reduction commitments is claimed are to be judged, assessed and/or identified.
>
> As Australia said in its Oral Statement[11], the word "accordingly" has several, equally valid meanings that are potentially applicable in the context: "harmoniously", "agreeably", "in accordance with the logical premises" and "correspondingly".[12] A further definition is "in conformity with a given set of circumstances".[13]
>
> In Australia's view, having regard to its ordinary meanings in its context and in light of the object and purpose of the *Agreement on Agriculture*, including to "[correct] and [prevent] … distortions in world agricultural markets",[14] the word "accordingly" can and should properly be interpreted in the sense of "consistent with" or "in conformity with" the fundamental requirement established in the first sentence. Consistent with that interpretation, the obligation that "green box" measures "meet the fundamental requirement …" is cumulative with the additional basic criteria established in paragraph 1 and the policy specific criteria established in paragraphs 2-13 of Annex 2. To interpret the word "accordingly" otherwise would be to negate the plain and unambiguous obligation established in the first sentence of paragraph 1 of Annex 2 that "[d]omestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production".

**Response of New Zealand**

> "Criteria" are the standards by which a thing is assessed. In this case they are the standards by which domestic support measures must be assessed in order to qualify for exemption from reduction commitments. These criteria are set out in Article 6 and Annex 2 of the *Agreement*

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[8] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages")*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 17.

[9] See Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas ("European Communities – Bananas")*, WT/DS27/AB/R, adopted 25 September 1997, paras. 214-216 holding that the absence of a specific reference to Article III.1 GATT in Article III.4 GATT meant that an examination of the consistency of a measure with Article III.4 GATT did not require, in addition, an examination of the consistency of the measure with Article III.1 GATT.

[10] *The New Shorter Oxford English Dictionary*, Volume 1, page 551.

[11] Oral Statement by Australia, paragraphs 35-36.

[12] *The New Shorter Oxford English Dictionary*, Volume 1, page 15.

[13] *Webster's Third New International Dictionary*, Ed. Philip Babcock Gove, Merriam-Webster Inc, Springfield, Massachusetts, 1993, page 12.

[14] Third preambular paragraph of the *Agreement on Agriculture*.

> *on Agriculture*, and include: the "fundamental requirement" in Annex 2 paragraph 1 that measures have at most minimal trade-distorting effects; the "basic criteria" in paragraph 1(a) and (b); and the "policy-specific criteria and conditions" set out elsewhere in Annex 2. The use of the word "accordingly" signifies that the intention of the drafters was to indicate that in order to meet the first criterion – the "fundamental requirement" that they be at most minimally trade-distorting – measures would at the very least have to meet the subsequent basic and policy-specific criteria.

**EC Comment**

16. Neither Australia nor New Zealand examine the use of the word "criteria" in Annex 2 where it means something different from the fundamental requirement. The second sentence of the first paragraph of Annex 2 clearly distinguishes the "fundamental requirement" from the general and policy-specific "criteria". Paragraph 5 of Annex 2 is even more explicit in this regard. It would seem odd that Article 6.1 and 7.1 would use criteria to mean both the basic and policy specific criteria and the requirement, while Annex 2 itself operates a distinction between the criteria and the requirement. Thus, while it is the case that the dictionary definition of "criteria" could arguably, in the abstract, cover a "fundamental requirement" in this particular case there are compelling arguments that the use of the word "criteria" in Articles 6.1 and 7.1 does not.

17. The European Communities has already explained why Australia's interpretation of "accordingly" is incorrect. It is quite clear that "accordingly" establishes a relationship between the purposive language of the first sentence of para. 1 of Annex 2 and the operational language of the other parts of Annex 2. Synonyms of "accordingly" include "as a result, consequently, ergo, thus, therefore".[15] To read the term as meaning that the first sentence and the rest of the paragraph applied as cumulative and separate conditions (as suggested by Australia) would deprive the word "accordingly" of effect. Reading the first sentence of paragraph 1 as relevant to the interpretation of the rest of Annex 2, but not as a separate condition would, contrary to Australia's assertion, give the first sentence meaning.

18. New Zealand points out that:

> "the use of the word "accordingly" signifies that the intention of the drafters was to indicate that in order to meet the first criterion – the "fundamental requirement" […]measures would at the very least have to meet the subsequent basic and policy-specific criteria"

19. New Zealand does not explain how the first sentence can set a self-standing criterion if respecting that so-called criterion depends on satisfying other criteria. What then is the content of the separate "criterion" in the first sentence, if it is already defined in the second sentence of the first paragraph and the rest of Annex 2 ? Moreover, how, given the alleged existence of two sets of self-standing criteria, can it be sufficient to satisfy only one set of criteria and at the same time satisfy the other set (or "at the very least" satisfy the other set) as the final sentence of New Zealand's response implies. Even on its own terms, New Zealand's position that the first sentence of paragraph 1 is a self standing obligation, but that it can be satisfied by meeting the criteria set out in the rest of Annex 2, is internally inconsistent. This illustrates very well the European Communities' point that the proposition that the first sentence imposes a self-standing obligation cannot be squared with any reasonable interpretation of "accordingly".

[15] Chamber's Thesaurus, 1986.

**Question**

**7. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the *Agreement on Agriculture.* 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

20. The phrase "the fundamental requirement" signals the negotiators intent to treat differently measures which are less or not at all distortive to trade or production and sets forth the general purpose of Annex 2; a purpose which permeates the rest of Annex 2. Considering the term in the abstract does not answer the question whether a panel must examine the effects of measures for which green box status is claimed in addition to examining whether such measures respect the basic and policy-specific criteria set out in Annex 2, or whether respecting the basic and policy-specific criteria is such that a measure is deemed not to have the effects mentioned in the first sentence. As the European Communities has explained, there are compelling textual and purpose based arguments which support the latter interpretation.

**Response of Australia**

> The word "fundamental" has a number of meanings[16] which can be summarised as "primary" or "essential". The word "requirement" too has a number of meanings[17] which can be summarised as a "condition". Thus, a "fundamental requirement" is a primary or essential condition. [18] It is an overarching, freestanding obligation that applies to all "green box" measures cumulatively with the additional basic criteria established in paragraph 1 and the policy specific criteria established in paragraphs 2-13 of Annex 2. To interpret a "fundamental requirement" otherwise than as a primary or essential condition would not give the words their ordinary meaning in their context and in light of the object and purpose of the *Agreement on Agriculture*.

**EC Response**

21. Australia executes a logical leap in the fourth sentence of its response. It arrives at the conclusion that the "fundamental requirement" is a "freestanding obligation" that applies "cumulatively" with the other criteria. However, this assertion is without foundation, and is directly contradicted by the use of the word "accordingly" at the beginning of the next sentence.

**Question**

**2. In paragraph 13 of Australia's oral statement, you state that a "question" is: "could conditions of price competition for the purposes of a non-violation or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the**

[16] *The New Shorter Oxford English Dictionary*, Volume 1, page 1042, provides relevant definitions of "fundamental" as "**1** Of or pertaining to the basis or groundwork; going to the root of the matter. **2** Serving as the base or foundation; essential or indispensable. Also, primary, original; from which others are derived."

[17] *The New Shorter Oxford English Dictionary*, Volume 1, page 2557, provides definitions of "requirement" as "**1** The action of requiring something; a request. **2** A thing required or needed, a want, a need. Also the action or an instance of needing or wanting something. **3** Something called for or demanded; a condition which must be complied with."

[18] Third Party Submission of Australia, paragraph 31, and Oral Statement by Australia, paragraph 33.

**whole." Could you please clarify this statement (indicating other elements which would complete the "whole" and explain its relevance for the purposes of our consideration of Article 13 of the *Agreement on Agriculture*? Australia, EC**

Answer

22. The European Communities would prefer to let Australia clarify its statement. The European Communities will comment upon Australia's clarification in its comments on the responses of the other third parties.

**Australia's Response**

> Given the length of Australia's response, the European Communities has not reproduced it here.

**EC Comment**

23. The European Communities is unconvinced of Australia's argument. There is nothing in the text of Article 13 to suggest that in order to determine "support" under Article 13 it is necessary to consider all the factors which are relevant to examining a non-violation case. Moreover, the European Communities notes that Article 13(b)(ii) provides that Articles 5 and 6 of the *SCM Agreement* may be applicable under certain conditions. However, an assessment of whether a measure is inconsistent with Articles 5 and 6 of the *SCM Agreement* is not based on the same criteria as would be applicable in assessing a non-violation complaint. Indeed, such criteria may have nothing to do with the domestic market of the Member which is providing a subsidy. Australia does not explain why the type of criteria relevant to non-violation complaints would also be relevant in assessing a complaint under Articles 5 and 6 of the *SCM Agreement*. Nor does it explain why it is necessary to import notions from the assessment of non-violation complaints, but not notions from Articles 5 and 6 *SCM Agreement* into an assessment of support for the purposes of Article 13 *Agreement on Agriculture*.

24. In short, the European Communities sees no foundation for Australia's assertions.

## IV. STEP 2 PAYMENTS

**Question**

**40 With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the *AoA*? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the *SCM Agreement* and Article III:4 of the GATT 1994.. 3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay**

Answer

25. The Panel's question involves two elements. First, is a Member entitled to provide domestic content subsidies under the *Agreement on Agriculture*? Second, if such subsidies are permitted, what is the relevance of such a rule to Brazil's claims under Article 3 of the *SCM Agreement* and

Article III.4 GATT. The European Communities has already provided elements of a response in its oral statement.[19] These are expanded upon below.

26. First, a Member is entitled to provide domestic content subsidies under the *Agreement on Agriculture* provided such subsidies are provided consistently with the Member's domestic support commitment levels. This conclusion flows from a number of factors. First, the *Agreement on Agriculture* disciplines domestic support. Article 6.1 refers to "domestic support reduction commitments". Article 3.1 refers to "domestic support [..] commitments […] constitut[ing] commitments limiting subsidization" and Article 3.2 obliges Members "not [to] provide support in favour of domestic producers in excess of the [domestic] support commitment levels". Despite these clear rules on domestic support, the *Agreement on Agriculture* does not define "domestic support".

27. AMS is the measurement of domestic support. AMS is defined as "the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general, other than [that exempted etc]." This is very general – it covers all support in favour of agricultural producers. This broad scope of domestic support measures which can be maintained consistently with the *Agreement on Agriculture* is confirmed by Article 6.1 which states that the domestic support reduction commitments "shall apply to all of its [i.e. the Member's] domestic support measures in favour of agricultural producers […]". Paragraph 1 of Annex 3 on the calculation of the AMS refers to AMS being calculated "on a product specific-basis for each basic agricultural product receiving market prices support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment". (emphasis added)

28. Consequently, the range of domestic support measures which a Member may maintain (consistent with reduction commitments) is very broad and is only limited by the condition that such support must be in favour of agricultural producers. As the European Communities has noted, paragraph 7 of Annex 3 explicitly states that "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products".[20] The European Communities considers that the term "benefit" used here must be regarded as being synonymous with "favour" in the sense of "in favour of agricultural producers". Moreover, it is clear that by "measures directed at agricultural processors" the negotiators intended subsidies which were paid to processors, where the benefit went to the agricultural producer. Consequently, in light of the broad definition of "domestic support" and the specific reference to domestic content subsidies in paragraph 7 of Annex 3, the European Communities considers that a Member is entitled to maintain domestic content subsidies consistently with the *Agreement on Agriculture*.

29. Second, in response to the Panel's question, the effect of finding that domestic content subsidies are provided consistently with the *Agreement on Agriculture* would be that they cannot be found inconsistent with either Article 3.1(b) of the *SCM Agreement* or Article III.4 GATT 1994. Article 21.1 of the *Agreement on Agriculture* states that "the provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the

[19] Paras. 34 to 38 of the EC's Oral Statement (as delivered). The Panel's reference to para. 32 corresponds to the text provided at the third party session.

[20] In terms of negotiating background, it may be useful to the Panel to note that paragraph 7 of Annex 3 was subject to negotiation during the period in which a Panel had ruled that the EC's payments to oilseed processors was not covered by Article III.8(b) GATT 1947 and were consequently inconsistent with Article III.4 GATT 1947 (*European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* Report of the Panel (L/6627 BISD 37S/86) adopted on 25 January 1990. That the negotiators retained this text must therefore be considered as a clear sign that they intended to permit Members to maintain such subsidies, subject to reduction commitments, in the *Agreement on Agriculture*.

provisions of this Agreement." As the European Communities pointed out in its oral statement, this means that provisions of the other Annex 1A Agreements are "subordinated" to the *Agreement on Agriculture*.[21]

30. To find that such subsidies were inconsistent with either Article 3.1(b) of the *SCM Agreement* or Article III.4 GATT would be to subordinate the right to provide such domestic content subsidies under the *Agreement on Agriculture* to the *SCM Agreement* or GATT 1994. Such an interpretation directly contradicts Article 21.1 of the *Agreement on Agriculture*.

31. Indeed, it can be pointed out that applying Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT to domestic content subsidies provided consistently with the *Agreement on Agriculture* would lead to stricter disciplines being applied to domestic subsidies for agriculture than are applicable to domestic subsidies for industrial goods. If Article 3.1(b) and Article III.4 were to apply, domestic subsidies for agricultural products would be subject to reduction commitments and Article 3.1(b) *SCM Agreement* and Article III.4 GATT. However, domestic subsidies for industrial products are not subject to reduction commitments. Since the *Agreement on Agriculture* establishes "a basis for initiating a process of reform of trade in agriculture", it would seem contradictory to find that domestic support for agriculture is in fact subject to stricter obligations than domestic support for other industries. This explains the "subject to" language of Article 21.1 of the *Agreement on Agriculture*. Article 21.1 and the *Agreement on Agriculture* more generally can also be compared with the other sectoral agreement included in Annex 1A of the WTO Agreement. The *Agreement on Textiles and Clothing* explicitly provides, in its Article 9, that the textiles and clothing sector is to be fully integrated into the GATT 1994. The *Agreement on Agriculture* has no such language, and Article 21.1 runs directly counter to this notion. It cannot be lightly assumed that the negotiators, while providing for the possibility to maintain domestic content subsidies, intended that such subsidies also be subject to rules which effectively makes it impossible to maintain such subsidies.[22]

32. The Panel should therefore reject Brazil's arguments that domestic content subsidies granted in favour of agricultural producers can be found to be inconsistent with Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT 1994.

**Australia's response**

> Australia does not consider that the phrase "provide support in favour of domestic producers" in Article 3.2 of the *Agreement on Agriculture* permits subsidies contingent upon the use of domestic goods.
>
> In Australia's view, the legal issue in question relates to the condition attached to the grant of a subsidy, not the grant of a subsidy *per se* or who might benefit from the subsidy. The fact that a measure may benefit an agricultural producer ("support in favour of domestic producers") does not serve to override measures otherwise prohibited.
>
> Article 21.1 of the *Agreement on Agriculture* provides that "[t]he provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement". Article 3.1 of the *SCM Agreement* applies "[e]xcept as provided in the Agreement on Agriculture". The General Interpretive Note to Annex 1A of the *Marrakesh Agreement Establishing the World Trade Organization* also

[21] Oral Statement, para. 38.

[22] See, in a similar sense, Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 165.

provides contextual guidance. Pursuant to that Note, the *Agreement on Agriculture* would prevail to the extent of any conflict with GATT 1994.

However, in the case of subsidies contingent upon the use of domestic goods, there is no conflict between either the *Agreement on Agriculture*, which *inter alia* disciplines the amounts of domestic support in favour of domestic producers which distorts trade and production, and the *SCM Agreement* or GATT 1994, which discipline or prohibit certain conditions attached to subsidies, including subsidies in favour of agricultural producers (subject only to the provisions of Article III:8(b) of GATT 1994). There is no provision in the *Agreement on Agriculture* which provides for an exception to, or cover for, local content conditions attached to the grant of a subsidy.

Australia has already noted[23] that Article 13(b)(ii) does not exempt non-"green box" domestic support measures from actions based on Article 3 of the *SCM Agreement*. Neither does Article 13 anywhere refer to GATT Article III:4. Nor with regard to these Articles is there any provision comparable to Articles 5 and 12 of the *Agreement on Agriculture*. As stated in the preambular clauses of the *Agreement on Agriculture*, the "long-term objective is to provide for substantial progressive reductions in agricultural support and protection": it is not intended to provide for a weakening of disciplines, particularly when such disciplines are not specifically mentioned.

Australia also notes that the domestic support provisions of the *Agreement on Agriculture* provide for a strengthening and elaboration of the provisions of Article XVI of GATT 1994. They are not directed towards a diminution of basic GATT obligations. National treatment is central to the multilateral trading system. It is inconceivable to Australia that the negotiators of the *Agreement on Agriculture* would, as part of a reform program designed to strengthen disciplines, agree to weaken national treatment disciplines.

However, in the event the Panel were to consider that the phrase "provide support in favour of domestic producers" refers to and/or permits subsidies contingent upon the use of domestic goods, Australia notes that such support could be permitted only to the extent that the support was actually passed through to the producers of the basic agricultural product.

**New Zealand's Response**

New Zealand does not agree that a right to provide subsidies contingent upon the use of domestic products contrary to Article 3 of the *SCM Agreement* can be found in the requirement that subsidies "directed at agricultural producers … to the extent that they benefit producers of the basic agricultural product" be included in the calculation of AMS. There is no basis for reading such a right into the *Agreement on Agriculture*. To do so would allow the possibility for exemption from action under the *SCM Agreement* to exist other than by virtue of the peace clause. The peace clause explicitly does not provide such exemption from action under Article 3 of the *SCM Agreement* when it quite clearly could have done so. In New Zealand's view that indicates that there was no intention on the part of the drafters that domestic support measures, whether they conform with Article 6 of the *Agreement on Agriculture* or not, should be so exempt. The same is true in respect of *GATT 1994* Article III:4 claims.

[23] Oral Statement by Australia, paragraphs 29-30.

**EC Comments**

33. Australia confuses legal issues. Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT concern *inter alia* the conditions under which subsidies may be granted. The *Agreement on Agriculture* provides a right, up to a specified limit, to provide support to domestic producers, irrespective of the manner in which such support is provided. That is, a Member is entitled to provide support up to the limits and to do so in any form. Paragraph 3.7 of Annex 3 makes it clear that a Member is entitled to include in its support subsidies granted to processors which benefit agricultural producers. A Member thus has a right to provide support in the form of payments to its agricultural producers. This right conflicts with the prohibition in Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT.

34. The European Communities fails to see the relevance of Article XVI GATT to this issue. Moreover, it is inaccurate of Australia to suggest that interpreting the *Agreement on Agriculture* in this manner would result in a weakening of obligations. Australia conveniently ignores that, in placing absolute limits on the amount of domestic support which a Member may provide, WTO Members agreed to impose stricter disciplines on domestic support for agriculture than that applicable to domestic subsidies for industrial products.

35. New Zealand's argument rests on the conception that it is only Article 13 (the peace clause) which regulates the interface between the *Agreement on Agriculture* and the other Annex 1A Agreements. As Australia points out, Article 21.1 *Agreement on Agriculture* is clearly relevant, as is the General Interpretative Note to Annex 1A. New Zealand's unsubstantiated argument does not stand.

# ANNEX J-12

## REPLIES FROM ARGENTINA TO PANEL'S QUESTIONS

27 October 2003

A. QUESTIONS TO INDIVIDUAL THIRD PARTIES

**Q43. Please elaborate, citing figures, on your statement that polyester fibre prices actually follow cotton prices. Argentina**

1. Argentina submits that the explosion in the production of synthetic fibres played no part in the fall in international cotton prices; in fact, the contrary appears to have occurred.[1]

2. The "Fibre Prices" table in paragraph 23 of the Further Submission of the United States shows that polyester prices have always been lower than cotton prices (see the columns "US mill" and "US spot" as compared to "Asia poly") and, moreover, they appear to follow cotton prices. Thus, for example, in 1995, when cotton prices reached their record level for the series, polyester prices happened to follow the same trend, precisely at a time when the price of oil was practically at its lowest for the period under consideration.

3. Another example is the period from 2000 to 2002: while the price of oil was at its highest, the price of polyester reached its low point for the period under consideration, having "accompanied" the very low cotton prices.

4. Attached hereto as Annex ARG-1 is a graph comparing the evolution of cotton prices (US mill and US spot) with that of polyester fibre prices (Asian poly)[2] and with the price of oil per barrel (West Texas)[3], clearly reflecting a very close correlation between cotton and polyester prices.

5. On the other hand, the last few years do not show any correlation between the price per barrel of oil and the price of polyester fibres, which shows that polyester has had to adapt to cotton prices in order to remain competitive, and not the reverse as the United States claims.

B. QUESTIONS TO ALL THIRD PARTIES

**Q49. What is the meaning and effect of the introductory phrase of Article 3 of the SCM Agreement ("Except as provided in the *Agreement on Agriculture* ...")?**

6. The introductory phrase of Article 3 of the SCM Agreement ("*Except as provided in the Agreement on Agriculture* ...") means that the provisions of that Article apply to agricultural subsidies to the extent that they do not conflict with the Agreement on Agriculture (AoA). The phrase "*except as provided* ..." does not necessarily imply that there is a conflict between the two Agreements.

7. In this connection, Argentina replied to question 40 of the Panel to the third parties, stating that no provision could be found in the AoA that conflicted with Article 3.1(b) of the SCM Agreement. Indeed, the AoA does not contain any provision which explicitly permits the granting of

[1] Second oral third party submission by Argentina, 8 October 2003, paragraphs 15-17.
[2] Source: Further submission of the United States, "Fibre Prices" table, paragraph 23.
[3] Source: Argentine Oil and Gas Institute (IAPG).

"subsidies contingent, whether solely or as one of several other conditions, on the use of domestic over imported products."

8. It is therefore Argentina's understanding that since they are prohibited under Article 3.1(b) of the SCM Agreement, and since there is no specific provision in the AoA that is explicitly mentioned in the introductory phrase of Article 3 of the SCM Agreement, subsidies contingent on the use of domestic over imported goods are also prohibited under the AoA.

9. Likewise, Argentina pointed out in its comments on the reply by the European Communities to question 40 from the Panel that the rules of the AoA, on the one hand, and of the GATT 1994 and the SCM Agreement, on the other, contained disciplines that were applied together, unless there was a discrepancy or "conflict" between the different provisions.[4]

**Q50. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*?**

10. The impact will depend on the Panel's finding on the preliminary issue raised with respect to the Peace Clause. If the Panel finds, as Argentina maintains, that the United States does not qualify for protection under Article 13 of the AoA, the expiry date of the Peace Clause will be entirely irrelevant.

11. If after 31 December 2003 the Panel should decide not to rule on the substantive claims, this would affect Brazil's right to due process by depriving it, on the basis of rules which are no longer in force, of the right to a finding that would settle of the dispute as to whether or not the subsidies were consistent. Thus, Brazil would be deprived of a positive settlement of the dispute.

**Q51. How should the concept of specificity - and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" - in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions citing the principles in Article 2 of the *SCM Agreement*:**

**(a) Is a subsidy in respect of all agricultural, but not other, products specific?**

12. Yes.

**(b) Is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

13. Yes.

**(c) Is a subsidy in respect of certain identified agricultural products specific?**

14. Yes.

[4] As already stated, "[t]he conditions for the existence for a conflict between two rules was clarified by the Appellate Body in the *Guatemala – Cement case* (WT/DS60/AB/R, paragraph 65), where it is determined that there is a conflict between two provisions if adherence to one provision leads to a violation of the other. In the case before us, in order to determine whether a rule in the GATT 1994 or in an Agreement in Annex 1A (Article 3.1(b) of the ASCM in this particular case) does not apply, it must first be determined whether there is an inconsistency or discrepancy with a provision of the AoA. In other words, these rules must be applied together." (Comments by Argentina on the reply by the European Communities to question 40 from the Panel to the third parties).

**(d) Is a subsidy in respect of upland cotton, but not other products, specific?**

15. Yes.

**(e) Is a subsidy in respect of certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

16. Yes.

**(f) Is a subsidy in respect of certain proportion of total US farmland specific?**

17. Yes.

18. Argentina stresses that the concept of "specificity" in Article 2 of the SCM Agreement is very broad, since it refers to the subsidies for an enterprise or an industry or group of enterprises or industries.

19. From the standpoint of the SCM Agreement, agricultural subsidies are specific within the meaning of Article 2, since they are not available for all products. The mere fact that they are "agricultural" precludes any interpretation that they are not specific.

20. As regards the principle of Article 2.1, agricultural subsidies comply with the requirements of each one of its indents:

- Indent (a), because not all of the enterprises of a Member have access to subsidies under the AoA;
- indent (b), because there is no automatic eligibility for the subsidies under the AoA, nor are they based on objective criteria such as those listed in footnote 2 to Article 2, since they benefit the producers of certain products – in the case in point, those included in Annex I of the AoA;
- indent (c), because a subsidy for an agricultural product complies with all of the requirements of the first sentence thereof. As regards the second sentence of indent (c), there is no evidence for including an agricultural subsidy under any of these factors.

As to the specific case of export subsidies, Article 2.3 reaffirms their specificity. Having already pointed out that specificity is established under Article 2.1 and 2.3, there is no need to address the principle in Article 2.2.

21. Generally speaking, it should be borne in mind that in addition to the principles laid down in indents (a) and (b) of Article 2.1 for determining whether a subsidy is specific, indent (c) stipulates that in case of doubt as to the specificity of a subsidy, a number of other factors should be considered. In Argentina's view, this implies that the intention of the drafters of the Agreement was that the concept of "specificity" should be as comprehensive as possible.

**Q52. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the *SCM Agreement*. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the *SCM Agreement* to withdraw the subsidy without delay, can the Panel:**

**(a) Also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel?**

22. In Argentina's view, if the Panel were to conclude that a subsidy was prohibited and to make a recommendation – under Article 4.7 of the SCM Agreement – to withdraw the subsidy without delay, it could nevertheless also conclude that the same subsidy had resulted in adverse effects to the interests of another Member and make the same recommendation to withdraw the subsidy under Article 7.8 of the SCM Agreement.

23. Indeed, bearing in mind that we are speaking of two different claims, the value of such a conclusion would be to have made *"an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and ... such other findings as will assist the DSB in making recommendations or in giving the rulings provided for in the covered agreements"*, in conformity with Article 11 of the DSU.

24. For the reasons set forth above and as stated throughout these proceedings, Argentina requests the Panel to issue the findings and recommendations requested by Brazil, including those related to the Step 2 and GSM 102 programmes which, under Article 4.7 of the SCM Agreement, must be withdrawn without delay. Likewise, the Panel should also make a recommendation that the United States take appropriate steps to remove the adverse effect of those programmes under Article 7.8 of the SCM Agreement.

**(b) Take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the *SCM Agreement*?**

25. In Argentina's view, if the Panel concludes that there were prohibited subsidies, it should recommended – under Article 4.7 of the SCM Agreement – that they be withdrawn without delay, without prejudice to taking into account the effects of the interaction of those prohibited subsidies with other actionable subsidies.

26. Taking into account the effects of the said interaction is extremely important to determining causation under Article 5 of the SCM Agreement. Indeed, as already stated[5], Argentina considers that it is the collective impact of all the US subsidies that has effects on the cultivated area, production, exports and prices, notwithstanding the fact that the mere elimination of a prohibited subsidy would not necessarily put an end to the adverse effects of the other actionable subsidies.

**Q53. Would a finding of serious prejudice under Article 5(c) of the *SCM Agreement* be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the *SCM Agreement* in this context?**

27. A finding of serious prejudice under Article 5(c) of the SCM Agreement is determinative for a finding under Article XVI:1 of the GATT 1994, since that Article orders the contracting party granting the subsidy to consider the possibility of limiting it *"*[*i*]*n any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by such subsidization …"*. In other words, if it is determined that a subsidy causes or threatens to cause serious prejudice under Article 5(c) of the SCM Agreement, it necessarily calls for a finding of violation of Article XVI:1 of the GATT 1994.

[5] Second oral third party submission by Argentina, 8 October 2003, paragraph 33.

28. In this connection, footnote 13 of the SCM Agreement, which states that *"the term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice"*, clearly establishes the link between the two provisions.

**Q54. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims?**

29. Argentina has no evidence that US cotton producers are unable to cover their fixed and variable costs without subsidies.

30. What Argentina has repeatedly stated – referring to the evidence submitted by Brazil during these proceedings – is that the US cotton producers cannot bridge the gap between total production costs (i.e. the sum of fixed and variable costs) and market prices for cotton without subsidies.

31. Argentina has pointed out that cotton production costs in the United States are among the highest in the world.[6] According to an ICAC study[7], the cost of production in the United States was US$0.81 per pound of cotton in the marketing year 1999[8], while US producers' market prices fell from US$0.60 to US$0.30 per pound.

32. Argentina also stated that the only possible explanation how the United States bridged this widening gap between production costs and market prices is subsidies, since without them many US producers would have been compelled to cease production (in spite of the fact that they would eventually have been able to cover their fixed and variable costs).

33. This fact, that without subsidies US cotton producers could not have bridged the gap between their total production costs and market prices, is entirely relevant to Brazil's claims, since it shows that as a result of the subsidies, less efficient US producers are immune to changes in market prices. In other words, without the US subsidies which generate a world market surplus, international cotton prices would have been higher or would not have fallen as much.

34. This confirms both the actual serious prejudice and the threat of serious prejudice caused by the subsidies, in that future subsidies will be as necessary as the current ones for US producers to bridge the gap between market prices and their total production costs.[9] This will enable them to continue competing with more efficient third-country producers, especially considering that the USDA itself forecasts an increase in total production costs.[10]

**Q55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) (*"another Member"*) for the purposes of these proceedings?**

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[6] Third party submission by Argentina, 15 July 2003, paragraphs 17 and 18.

[7] Cotton: World Statistics, Bulletin of the International Cotton Advisory Committee, September 2002 (Annex BRA-9).

[8] As stated by Brazil in its first submission to the Panel of 24 June 2003, paragraph 32, according to the ICAC study the cost of production in Argentina averaged 59 cents per pound of cotton (See Annex BRA-9).

[9] Second written third party submission by Argentina, 3 October 2003, paragraph 49.

[10] See Annexes BRA-7 (ERS Data: Commodity Costs and Returns); BRA-257 ("Cost of Farm Production Up in 2003", USDA, 6 May 2003) and BRA-82 ("USDA Agricultural Baseline Projections until 2012", USDA, February 2003, p.48).

35. The concept of "another Member" within the meaning of Article 6.3(c) covers Argentina, which indeed submitted claims relating to the price effect of US subsidies.

36. Notwithstanding, Argentina is aware that in these proceedings, it is Brazil that brought the case and requested consultations and the establishment of this Panel. At the same time, Argentina – which has also suffered serious prejudice – felt that it was appropriate to ask to be joined in the consultations, participated actively in them and raised a number of issues, as well as asking to join as a third party and presenting, in its submissions, arguments relating to price effect.

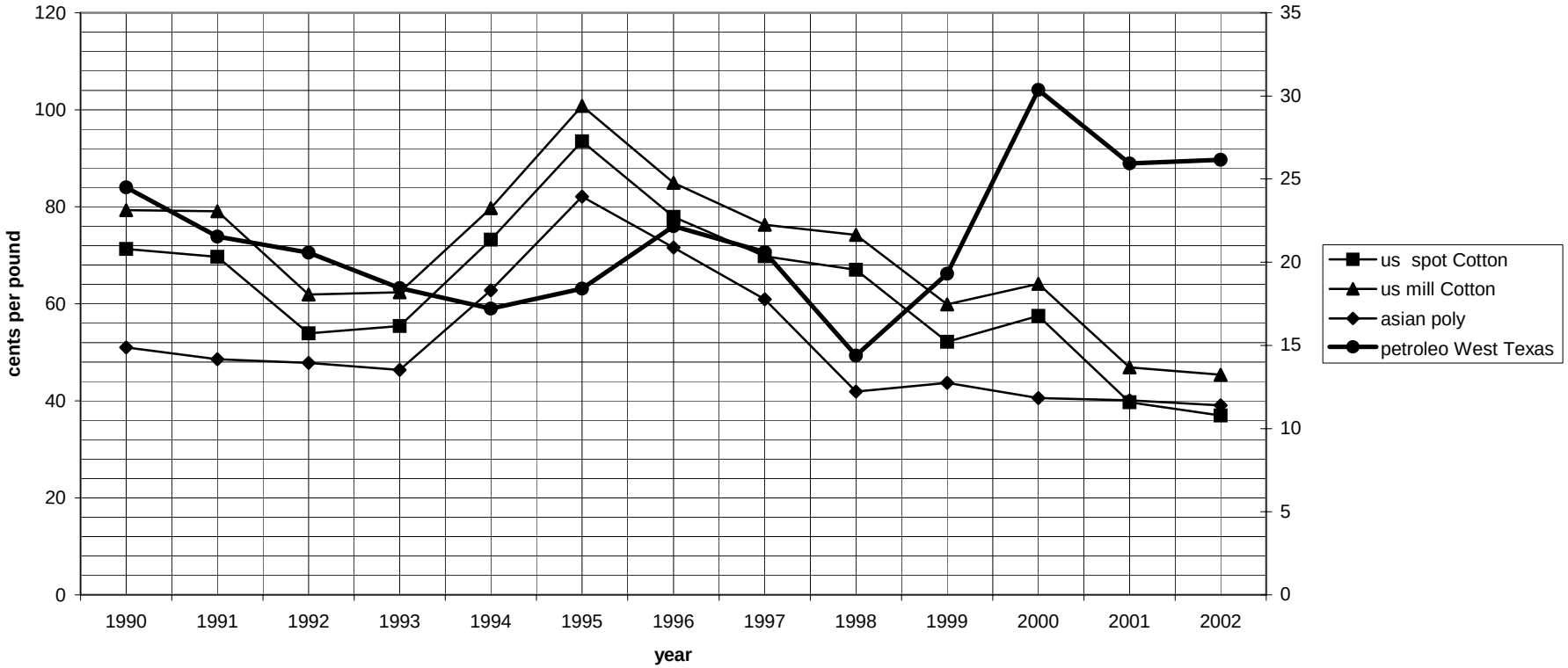
37. As stated throughout these proceedings, it is in Argentina's interest that the Panel should issue the findings and recommendations requested by Brazil, since this would mean that, in conformity with Article 7.8 of the SCM Agreement, the United States would have to *"take appropriate steps to remove the adverse effects or … withdraw the subsidy"*.

38. This interest on the part of Argentina is based on the conviction that if the Panel were to issue such findings and recommendations, the elimination of the adverse effects or the withdrawal of the subsidies would have a favourable impact on the international price of cotton – indeed, without the US subsidies which generate a world market surplus, international cotton prices could be higher or could fall less. Similarly, if its share in the world market were not increased as a result of the subsidies, the international price of cotton would be higher or would not be so low, and as a result, third party producers, including Argentina, would not suffer as much prejudice as a result of artificially depressed prices.[11]

39. As already stated, an increase in the world cotton price would be significant – even if as a result of the subsidies the suppression or depression of international prices amounted to only 1 cent per pound – since it would enable countries like Argentina to recover their competitive position in the world cotton market.[12]

[11] Second oral third party submission by Argentina, 8 October 2003, paragraph 10.

[12] Second written third party submission by Argentina, 3 October 2003, paragraphs 34 to 36, and second oral third party submission by Argentina, 8 October 2003, paragraph 38.



# ANNEX J-13

## RESPONSES BY AUSTRALIA

27 October 2003

A. QUESTIONS TO INDIVIDUAL THIRD PARTIES

43. …

44. …

45. …

46. …

47. …

48. …

B. QUESTIONS TO ALL THIRD PARTIES

**Q49. What is the meaning and effect of the introductory phrase of Article 3 of the SCM Agreement ("Except as provided in the Agreement on Agriculture …")?**

Reply

In Australia's view, with regard to subsidies for agricultural products, unless the *Agreement on Agriculture* makes express provision to the contrary, Article 3 of the *SCM Agreement* continues to apply to such subsidies. The simultaneous application of both Agreements to agricultural products is confirmed by Article 21.1 of the *Agreement on Agriculture.*

Australia noted previously in its response to the Panel's earlier question 40 that the legal issue in question concerning the relationship between the *Agreement on Agriculture* and Article 3.1(b) of the *SCM Agreement* derives from the condition attached to the grant of a subsidy, not the grant of a subsidy *per se* or who might benefit from the subsidy. The *Agreement on Agriculture* does not include any provisions concerning the conditionality of domestic support in the sense of SCM Article 3.1(b).

Moreover, the *Agreement on Agriculture* does not confer a right to grant subsidies. Rather, that Agreement establishes disciplines for the use of certain subsidies in relation to agricultural products should a Member choose to provide subsidies for such products. Arguments that the *Agreement on Agriculture* allows local content subsidies based on the phrase "support in favour of domestic producers" and similar phrasing and the provisions of paragraph 7 of Annex 3 of that Agreement are not sustainable. The word "support" is used throughout the *Agreement on Agriculture* in the sense of generic measures providing a calculable financial advantage to agricultural producers, whether price support, direct subsidy payments or any other means not exempted from a Member's commitment to reduce domestic support. Indeed, Annex 3 is headed "Domestic Support: Calculation of Aggregate Measurement of Support".

It is inconceivable to Australia that any intended exemption from the very significant and unambiguous local content subsidy disciplines of Article 3.1(b) of the *SCM Agreement* would not have been expressly set out in the *Agreement on Agriculture*. The inclusion of express provisions concerning export subsidies in the *Agreement on Agriculture* indicates that the negotiators of that Agreement were well aware of the need to include express provisions if additional or alternative disciplines concerning subsidies for agricultural products were intended vis-à-vis the disciplines established pursuant to the *SCM Agreement*.

The situation is analogous to that examined by the Panel and the Appellate Body in *EC – Bananas* wherein the Appellate Body upheld the Panel's conclusion that the *Agreement on Agriculture* did not permit the EC to act inconsistently with Article XIII of GATT 1994 in the absence of any provisions dealing specifically with the allocation of tariff quotas on agricultural products.[1] In the absence of provisions dealing specifically with local content subsidies in the *Agreement on Agriculture*, that Agreement does not allow a Member to act inconsistently with the *SCM Agreement*. The fact that the phrase "[e]xcept as provided in the Agreement on Agriculture" in the chapeau of SCM Article 3.1 also applies to paragraph (b) of that Article cannot of itself compel the interpretation that there are provision(s) of the *Agreement on Agriculture* which necessarily apply.

The Panel may not interpret the provisions of the *SCM Agreement* and the *Agreement on Agriculture* so as to diminish or override fundamental WTO obligations in the absence of express provisions to that effect. To do so would constitute, in Australia's view, a misapplication of the customary rules of interpretation of public international law.

**Q50. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture?**

Reply

In Australia's view, whether the date the Panel's report will be issued to the parties to the dispute will have any impact on any "exempt[ion] from actions" under Article 13(b)(ii) of the *Agreement on Agriculture* will depend on whether the Panel finds that the United States is granting, through domestic support measures that conform fully to the provisions of Article 6 of that Agreement, support to a specific commodity in excess of that decided during the 1992 marketing year. If the Panel finds that the United States is granting support to a specific commodity in excess of that decided during the 1992 marketing year, the United States will have no "exempt[ion] from actions" pursuant to Article 13(b)(ii), irrespective of when the Panel's report is issued. If the Panel finds that the United States is not granting such support to a specific commodity in excess of that decided during the 1992 marketing year, the United States may be "exempt from actions" pursuant to Article 13(b)(ii) until Article 13 expires.

**Q51. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" – in Article 2 of the SCM Agreement apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the SCM Agreement:**

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

[1] *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R, paragraphs 153-158.

**(c) is a subsidy in respect of certain identified agricultural products specific?**

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

Reply

Australia does not wish to comment on this issue.

**Q52. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the SCM Agreement. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy without delay, can the Panel:**

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel?**

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the SCM Agreement?**

Reply

If the Panel were to conclude that a subsidy was prohibited and to make a recommendation under Article 4.7 of the *SCM Agreement* to "withdraw the subsidy without delay", and having regard to the presumption of adverse effects implicit in a finding that a subsidy is prohibited and to the observations of the Appellate Body on the meaning of "withdraw" in SCM Article 4.7[2]:

(a) the Panel could conclude that the same subsidy had also resulted in adverse effects to the interests of another Member under SCM Article 5, particularly if that other Member were a third party to the dispute in light of the provisions of Article 10.1 of the DSU;

(b) the Panel could also consider the interaction of that prohibited subsidy with other, allegedly actionable subsidies. However, the prohibited subsidy would be required to be withdrawn without delay and thus any causative contribution its interaction with other allegedly actionable subsidies may make to the adverse effects of those other actionable subsidies will be removed as a consequence of the withdrawal of the prohibited subsidy.

**Q53. Would a finding of serious prejudice under Article 5(c) of the SCM Agreement be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the SCM Agreement in this context?**

Reply

Australia does not wish to comment on this issue.

[2] *Brazil – Export Financing Programme for Aircraft*, Recourse by Canada to Article 21.5 of the DSU, Report of the Appellate Body, WT/DS46/AB/RW, paragraph 45.

**Q54. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims?**

Reply

Australia does not wish to comment on the facts of US costs of production in relation to upland cotton, but notes the statements of the Appellate Body in relation to the calculation of costs of production in the *Canada – Dairy* dispute.[3]

**Q55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("another Member") for the purposes of these proceedings?**

Reply

Australia does not wish to comment on this issue.

**Q56. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the Agreement on Agriculture and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the SCM Agreement.**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on export subsidies" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions, of the Agreement on Agriculture, relevant?**

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in US – FSC, para. 117 here?**

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 were negotiated?**

Reply

In Australia's view, it is unambiguous that agricultural domestic support programmes are challengeable under Article XVI:3 of GATT 1994.

It is useful to recall to begin with that GATT 1947 did not provide a definition of a "subsidy" or of an "export subsidy" and that the only disciplines on subsidies of any type were the general subsidy disciplines of paragraph 1 of GATT Article XVI. The provisions of Section B of GATT Article XVI, comprising paragraphs 2-5 and headed "Additional Provisions on Export Subsidies", were added at the 1954-55 Review Session and constituted the earliest disciplines directed at "the use

[3] *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, Recourse to Article 21.5 of the DSU by New Zealand and the United States, WT/DS103/AB/RW – WT/DS113/AB/RW, paragraphs 94-96, and Second Recourse to Article 21.5 of the DSU by New Zealand and the United States, WT/DS103/AB/RW2 – WT/DS113/AB/RW2, paragraphs 91-120.

of subsidies on the export of primary products". The plurilateral 1979 Tokyo Round Subsidies Code[4] represented a further stage in the elaboration of disciplines on export subsidies and subsidies generally, in particular, Articles 8-11and the Annex. This background is helpful in understanding the evolution of the use of terminology originally found in GATT Article XVI and the relationship between provisions of the covered agreements as they exist today.

In relation to the use of subsidies on the export of primary products, the substantive discipline established by Article XVI:3 of GATT 1994 was that:

> "[i]f a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product".

Thus, the key discipline established by Article XVI:3 of GATT 1994 is that a subsidy that has the effect of increasing a Member's exports of a primary product must not be applied so as to result in that Member having more than an equitable, that is, a "just" or "fair",[5] share of world export trade in that primary product. GATT Article XVI:3 was elaborated by Article 10.1 and 10.2 of the later plurilateral Tokyo Round Subsidies Code, but these provisions were not carried forward to, and incorporated as such, in the *SCM Agreement*.

Notwithstanding the heading of Section B of GATT Article XVI, that discipline is distinct from the export subsidy disciplines later incorporated in Article 3.1(a) of the *SCM Agreement*. In particular, GATT Article XVI:3 is concerned with the effects rather than the conditions of a subsidy's grant.

Moreover, the discipline established by Article XVI:3 of GATT 1994 is distinct from the discipline established by Article 6.3(d) of the *SCM Agreement*, which relates to whether the effect of a subsidy is to increase a Member's world market share compared to the previous three-year average share. At the same time, there may be substantial commonality of facts in demonstrating non-compliance with either provision. Further, both GATT Article XVI:3 and SCM Article 6.3(d) must be applied within the same contextual framework of "serious prejudice" established by GATT Article XVI:1, and SCM Article 5(c) and its footnote.

The GATT Article XVI:3 discipline is also distinct from the disciplines established by other provisions of the covered agreements.

The Appellate Body has previously noted that the *WTO Agreement* was accepted by WTO Members as a "single undertaking".[6] The Appellate Body has also said:

> The relationship between the GATT 1994 and the other goods agreements in Annex 1A is complex and must be examined on a case-by-case basis. Although the provisions of the GATT 1947 were incorporated into, and became a part of the GATT

[4] *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade*, BISD 26S/56.

[5] *The New Shorter Oxford English Dictionary*, Ed. Lesley Brown, Clarendon Press, Oxford, 1993, Volume 1, 843.

[6] For example, *Brazil – Measures Affecting Desiccated Coconut*, Report of the Appellate Body, WT/DS22/AB/R, page 13.

> 1994, they are not the sum total of the rights and obligations of WTO Members concerning a particular matter. For example, with respect to subsidies on agricultural products, Articles II, VI and XVI of the GATT 1994 alone do not represent the total rights and obligations of WTO Members. The *Agreement on Agriculture* and the *SCM Agreement* reflect the latest statement of WTO Members as to their rights and obligations concerning agricultural subsidies. The general interpretative note to Annex 1A was added to reflect that the other goods agreements in Annex 1A, in many ways, represent a substantial elaboration of the provisions of the GATT 1994, and to the extent that the provisions of the other goods agreements conflict with the provisions of the GATT 1994, the provisions of the other goods agreements prevail. This does not mean, however, that the other goods agreements in Annex 1A, such as the *SCM Agreement*, supersede the GATT 1994. …"[7] (emphasis added)

In the absence of a conflict between the provisions of Article XVI:3 of GATT 1994 and Article 6.3(d) of the *SCM Agreement* or any other provisions of the covered agreements such that the General Interpretative Note to Annex 1A of the *WTO Agreement* becomes operative, GATT Article XVI:3 continues to apply. In Australia's view, the Appellate Body report in *US – FSC*, paragraph 117, does not affect the interpretation of the relationship between these provisions other than in the sense of confirming that the relationship must be determined on the basis of the texts of the relevant provisions as a whole.

The continued applicability of Article XVI:3 of GATT 1994 is confirmed by Article 13 of the *Agreement on Agriculture*. The exemption from action pursuant to AA Article 13(b)(ii) is only applicable in respect of paragraph 1 of GATT Article XVI, whereas the exemption from action pursuant to AA Article 13(c)(ii) is applicable to the whole of GATT Article XVI. Had the negotiators of the *WTO Agreement* believed that GATT Article XVI:3 had become redundant, they would not have expressly distinguished between the paragraphs of GATT Article XVI in AA Article 13 as they did. Moreover, Australia believes its view is fully consistent with the provisions of Article 21.1 of the *Agreement on Agriculture* and with the nature of the *WTO Agreement* as a whole as a "single undertaking".

Further, the distinction between the provisions of Article XVI of GATT 1994 in Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture* is entirely consistent with the object and purpose of the *Agreement on Agriculture*, including as expressed in the third preambular paragraph that the "long-term objective is to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets". It would be directly contrary to that objective if WTO Members were able, albeit otherwise consistently with the domestic support provisions of the *Agreement on Agriculture*, nonetheless to arrange their domestic support payments so as to achieve an inequitable share of the world export market in a particular primary product.

[7] *Brazil – Desiccated Coconut*, Report of the Appellate Body, pages 14-15.

# ANNEX J-14

## RESPONSES OF BENIN AND CHAD TO THE PANEL'S QUESTIONS

27 October 2003

Benin and Chad would offer the following responses to those Panel questions that pertain to the scope of their Third Party Submissions:

**"44. Please explain how Articles 5 and 6 of the *SCM Agreement* and Article XVI of the GATT 1994 would permit or require the Panel to take account of any effects of the subsidies in question on the interests of Members other than the complaining party. Benin and Chad."**

Brazil is the sole complaining party in this dispute, and ultimately only Brazil would have the right to any remedy provided by the SCM Agreement. However, Benin and Chad submit that the Panel is nevertheless required to take account of the effects of the US subsidies on the interest of Members other than the complaining Member, for the following reasons.

First, the chapeau of Article 5 states that "[n]o Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members". The drafters of Article 5 referred to "Members" in the plural, connoting an obligation on behalf of the subsidizing Member not to cause adverse effects to the interests of all WTO Members – not just the complaining Member.

Second, when the drafters of the SCM Agreement intended to refer only to the "complaining Member", they used this term specifically, such as in Article 6.7, or in paragraph 2 of Annex V. They could similarly have used the term "complaining Member" elsewhere in Articles 5 and 6, but they did not. Therefore, the term "other Members" cannot be interpreted as synonymous with "complaining Members", just as the term "another Member" cannot be read as limited only to the "complaining Member". The treaty interpreter must give meaning to the terms actually used in the text.[1]

Third, this interpretation is consistent with Article 3.8 of the DSU, which provides as follows:

> In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge. [emphasis added]

Article 3.8 refers to the "adverse impact" on "other Members" in the plural, referring to all WTO Members. Although the SCM Agreement provides special and additional rules for dispute settlement, these special rules have not ousted the application of DSU Article 3.8. Benin and Chad are "parties to [the] covered agreement", the SCM Agreement, and it can therefore be presumed that

[1] The textual analysis set out above applies equally to Article XVI:1 of the GATT 1994, which refers to the "other contracting party." (By virtue of paragraph 2(a) of the *Explanatory Notes to GATT 1994*, the references to "contracting party" are deemed to read "Member.") Article XVI:1 thus refers to the "other Member" and not the "complaining Member."

the breach of the SCM Agreement by the United States has an adverse impact on these two African countries.

In any event, the Panel need not rely exclusively on the presumption set out DSU Article 3.8, since Benin and Chad have already provided to the Panel detailed evidence about the adverse effects of US subsides on West and Central Africa. Benin and Chad also note the similarities in language between the SCM Agreement ("adverse effects") and DSU Article 3.8 ("adverse impact"). This reinforces the relevance and applicability of the latter provision.

Fourth, DSU Article 10.1, which deals with Third Parties, provides additional support for the position that the Panel should take into account the adverse effects on parties other than just the complaining party:

> The interests of the parties to a dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process.

DSU Article 10.1 is not limited simply to allowing Third Parties to present their views. That is dealt with elsewhere, including in DSU Article 10.2, which grants to Third Parties the right "to be heard by the Panel". By contrast, DSU Article 10.1 is not limited to providing Third Parties with the right to present views. Instead, it mandates that the "interests" of the third parties shall be "fully taken into account".

Fifth, DSU Article 24.1 provides that "[a]t all stages… of dispute settlement procedures involving a least-developed country Member, particular consideration shall be given to the special situation of least-developed country Members". Benin and Chad are both least-developed countries. The "particular consideration" that must be extended to them goes beyond simply ensuring that their views are heard – as noted above, such procedural protections are provided for elsewhere in the DSU. Instead, Panels must give "particular consideration" to their "special situation". In the context of the present case, the "special situation" of Benin and Chad has been presented in some detail to the panel. Massive US cotton subsidies have had, and continue to have, a devastating impact on the fragile economies of West Africa, pushing hundreds of thousands of people from subsistence farming into absolute poverty. If DSU Article 24.1 has any meaning, this "special situation" of Benin and Chad must be given full, substantive consideration by the Panel.

Finally, Benin and Chad note that the serious prejudice caused to their economies has also been specifically raised before the Panel by one of the disputing parties, Brazil. As the Panel will recall, Part 7 of Brazil's Further Submission of 9 September 2003 is on "Serious Prejudice to the Interests of African Countries by Reason of the US Subsidies on Upland Cotton". This provides addition support for the position that the serious prejudice to Benin and Chad needs to examined by the Panel in assessing the WTO-consistency of the US subsidies.

**"55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("another Member") for the purposes of these proceedings? All third parties."**

As noted, the drafters of the SCM Agreement used the term "complaining Member" in other provisions of the Agreement. In Article 6.3(c), they chose the term "other Member" rather than "complaining Member." For the reasons set out above, Benin and Chad are of the view that Article 6.3(c) encompasses both the complainant, Brazil, as well as other WTO Members.

The Panel has before it substantial evidence about the effects of the US subsidies, including the significant price undercutting by US cotton compared with the price of the like products of Brazil,

Benin and Chad in world markets, as well as significant price suppression and price depression in world cotton markets. In assessing the WTO-consistency of the US subsidies, the Panel is required by the SCM Agreement to take this evidence into account.

# ANNEX J-15

## CANADA'S RESPONSES TO PANEL QUESTIONS TO THIRD PARTIES FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES (RESUMED FIRST SESSION)

27 October 2003

Canada sets out responses to the questions of the Panel in which Canada has a systemic interest:

**49. What is the meaning and effect of the introductory phrase of Article 3 of the *SCM Agreement* ("Except as provided in the *Agreement on Agriculture*...")?**

Reply

The meaning and effect of this phrase is that Article 3 of the *SCM Agreement* applies *subject to* the export subsidy disciplines of the *Agreement on Agriculture*, which permit, in some instances and within certain limits, the granting or maintaining of subsidies that would otherwise be prohibited under the *SCM Agreement*.

**51. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" – in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*:**

Reply

Canada's answers assume that the phrase "in respect of" has the same meaning as the standard "is specific to" in Article 2.1 of the *SCM Agreement*. Based on the ordinary meaning of the phrase "is specific to", read in context and in light of the object and purpose of Article 2 and of the *SCM Agreement*, the specificity test is concerned with the actual availability of a programme. Analysis on availability may include an assessment of the manner in which a programme is used in the circumstances of a given case. The panel in *US – Softwood Lumber III* recently confirmed: "In our view, Article 2 SCM Agreement is concerned with the distortion created by a subsidy which either in law or in fact is not broadly available."[1] Moreover, a programme may be found either *de jure* or *de facto* specific, and either determination depends on the nature of the evidence relied upon.[2]

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

[1] *United States – Final Countervailing Duty Determination with respect to Certain Softwood Lumber from Canada*, Report of the Panel, WT/DS257/R, circulated 29 August 2003, para. 7.116.

[2] In this respect, a determination under Article 2 is similar to a determination under Article 3. The legal standard expressed by the phrase "is specific to" is the same for both *de jure* or *de facto* determinations; the only difference is the nature of the evidence relied upon. See *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999, para. 167 ("In our view, the legal standard expressed by the word 'contingent' is the same for both *de jure* or *de facto* contingency. There is a difference, however, in what evidence may be employed to prove that a subsidy is export contingent.")

Reply

No. Canada shares the view of the United States in *United States – Continued Dumping and Subsidy Offset Act of 2000*, that, as a general matter, "all agriculture" is too broad to qualify as a "group of enterprises or industries" for specificity purposes.[3]

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

Reply

The answer will depend on the facts of a given case. A panel would have to consider, among other things, the number of enterprises or industries (based on standard industrial classification) within the jurisdiction of the granting authority that are actually eligible to receive the subsidy, and the level of diversification of the "all agricultural crops" universe. Furthermore, the answer would also depend on the nature of the measure in question and whether it excludes enterprises or industries that might otherwise be reasonably or practically included. For example, weather that may cause extensive damage to crops (e.g. hail, frost, excessive moisture, drought) may not cause any damage to livestock. Therefore, it may not be reasonable or practical to include livestock under a crop insurance programme. On the other hand, an income stabilization programme could reasonably or practically include both crops and livestock.

**(c) is a subsidy in respect of certain identified agricultural products specific?**

Reply

The answer will depend on the facts of a given case, including whether the eligible products involve only "an enterprise or industry or group of enterprises or industries" (based on standard industrial classification) under Article 2.1.

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

Reply

Yes.

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

Reply

Where a programme appears *de jure* non-specific under Articles 2.1(a) and (b), predominant use of a programme by "certain enterprises" (a defined term in Article 2.1) would indicate, in the absence of any other reasonable explanation, that the availability of the subsidy is limited in fact to such enterprises or industries under Article 2.1(c) and 2.4. Likewise, where a programme appears *de jure* non-specific under Articles 2.1(a) and (b), the granting of disproportionately large amounts of subsidy to certain enterprises would indicate, in the absence of any other reasonable explanation, that the availability of the subsidy is limited in fact to such enterprises or industries under Article 2.1(c) and 2.4. In both cases, any predominance or disproportionality should be measured over an

[3] *United States – Continued Dumping and Subsidy Offset Act of 2000*, Report of the Panel, WT/DS217/R, WT/DS234/R, adopted 27 January 2003, at para 4.1146.

appropriate period of time and in relation to the value of production in question as compared to the total value of all agricultural production.

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

Reply

The answer will depend on the facts of a given case, including the proportion of total US farmland involved, whether that proportion involves "an enterprise or industry or group of enterprises or industries", and whether the programme "is specific to" (i.e., available only to) those enterprises or industries.

# ANNEX J-16

## RESPONSE BY CHINA TO THE PANEL'S QUESTIONS TO THIRD PARTIES

27 October 2003

1. China appreciates this opportunity to present its views again to the Panel in relation to the Panel's questions posed to third parties on October 13, 2003. Given the short period within which third parties are required to submit their views, China responds to and comments on the following underlined questions.

**2. Question 49. What is the meaning and effect of the introductory phrase of Article 3 of the *SCM Agreement* ("Except as provided in the *Agreement on Agriculture*…")? All third parties**

3. To answer this Panel's question, it is helpful to first look to the relationship between the *Agreement on Agriculture* and the *SCM Agreement*. Art. 21.1 of the *Agreement on Agriculture* provides:

> The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement [on Agriculture].

4. The Appellate Body, in *EC – Bananas III,* further clarified this article by stating that

> the provisions of GATT 1994, [and indeed 'other Multilateral Trade Agreements including the *SCM Agreement*, note added pursuant to Art. 21 of the *Agreement on Agriculture*], …, apply …, except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter".[1]

In other words, Art. 21.1 of the A*greement on Agriculture*, as interpreted by the Appellate Body, requires that in connection with a specific matter, the A*greement on Agriculture* prevails over the *SCM Agreement* to the extent that it has more specific provisions over the same matter covered by the *SCM Agreement*.

5. The introductory phrase of Art. 3 of the *SCM Agreement* again, in the matter of prohibited subsidies, grants deference to the *Agreement on Agriculture*. It reads:

> [E]xcept as provided in the *Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited.

Given that the *SCM Agreement* contains disciplines over all types of subsidies, including agricultural, and the *Agreement on Agriculture* imposes more specific disciplines over subsidies granted to agricultural commodities only, where such specificity of discipline can be established, the *Agreement on Agriculture* shall prevail pursuant to Article 3.1 of the *SCM Agreement*.

[1] Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, DSR 1997:II, Para. 155.

6. Therefore, in line with Art. 21.1 of the *Agreement on Agriculture* past Appellate Body interpretation above and Art. 3.1 of the *SCM Agreement*, the *Agreement on Agriculture*, where it is more specific, shall *prevail* over provisions of the *SCM Agreement*.

**7. Question 50. According to its revised timetable, the Panel will issue its report to the parties after the end of 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*? All third parties**

8. China believes Article 13 continues to be applicable to the current case even after it ceases to be in effect.

9. Art. 13 of the *Agreement on Agriculture* protects subsidy measures otherwise prohibited or actionable under the *SCM Agreement* during the nine-year implementation period commencing in 1995. Unless agreed otherwise amongst Members, Article 13 will expire in 2004.

10. Art. 70 of the *Vienna Convention on the Law of Treaties*, in dealing with the consequences of the termination of a treaty, provides to the effect that the termination of a treaty does not affect any right, obligation or legal situation of the parties created through the execution of the treaty prior to its termination. Applied to Art. 13 of the *Agreement on Agriculture*, if a Member's subsidy measures were granted and implemented prior to expiry of the Peace Clause, such Member's possible right to be protected thereunder is not removed by the expiry; neither are obligations on other Members to exercise due restraint. Such rights, obligations and legal situations created through implementation of the Peace Clause for the purpose of these proceedings are allowed by the *Vienna Convention on the Law of Treaties* to be live issues as between parties to a dispute. Even if the Panel were to make its report after the expiry, the rights and obligations and their past interaction are heavily controversial issues the interpretation and resolution of which by this Panel will have bearings on the merits of the case not only between the parties to this dispute, but also to the general WTO membership. Therefore, this Panel, even if it chooses to issue its report after the expiry date of the Peace Clause, is obligated to rule on such rights and obligations during implementation of the Peace Clause.

11. In addition, considering the likelihood of the Peace Clause being extended as reportedly suggested by some Members, however remote, an interpretation of the "exempt from action" requirement and its practical application is of extraordinary value to Members having interests in such an extension proposal; such Members, aided with the Panel's interpretation of the key components of this clause, will have a better basis to form their negotiating policy and stance, not only in terms of the Peace Clause, but also with regard to WTO discipline on agriculture.

**12. Question 51. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*: All third parties**

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

**(c) is a subsidy in respect of certain identified agricultural products specific?**

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

13. "Commodity" includes agricultural crops such as upland cotton.[2] While the *Agreement on Agriculture* identifies agricultural products by reference to their respective HS codes[3], in certain places it uses the terms "commodity" and "agricultural product" interchangeably.[4] Hence, in China's opinion, "agricultural commodity" can be understood as equivalent to "agricultural product" under the *Agreement on Agriculture*. Such equivalence is particularly relevant with regard to upland cotton, which being an agricultural product and crop, unquestionably meets the definition of a commodity.

14. On the other hand, "industry" used in the context of Art. 2 of the *SCM Agreement* normally refers to "a particular form or branch of productive labour; a trade, a manufacture"[5], while in the context of trade and commercial policy, "agriculture" means "the science and practice of cultivating the soil and rearing animals; farming".[6] Cultivate, in turn, means "prepare and use soil for crops"[7], i.e. the use of productive labour for soil preparation and use. Hence, agriculture, being the science and practice of using productive labour, meets the definition of "industry". Further, the *Agreement on Agriculture* also treats "agriculture" as an "industry" by extensively using "agricultural producers" and "agricultural production" to refer to the targets of domestic support measures.[8]

15. Art. 2 of the *SCM Agreement* provides that a subsidy is specific if it is provided to an enterprise or industry or group of enterprises or industries. Based on the analysis in Paras. 12 and 13 above, China believes that any subsidy to agricultural commodities shall be considered as specific for the purpose of Art. 2 of the *SCM Agreement.* By the same token, China believes that:

(a) a subsidy in respect of all agricultural, but not other, product is specific, since agriculture producing all agricultural products is an industry and consists of "group of enterprises" by definition.

(b) Similarly, subsidies in respect of "all agricultural crops (i.e. but not to other agricultural commodities, such as livestock)", "certain identified agricultural products" and "upland cotton, but not other products" should all be deemed as specific since "group of enterprises" producing crops (certain products, upland cotton) are targeted in all the cases.

(c) The use of "a certain proportion of the value of total US commodities" or "a certain proportion of US farmland" will necessarily be equivalent to "an enterprise or industry or group of enterprises or industries" because the "proportion" has to be generated by adding up those data from specific "enterprise or industry or group of enterprises or industries".

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[2] Commodity means "a thing of *use* or value; specially a thing that is an object of trade, especially a raw material or agriculture crop", Lesley Brown (ed.), *The Shorter Oxford English Dictionary*, 5th ed. (Oxford University Press, 2002), p.461.

[3] Art. 2, *Agreement on Agriculture*.

[4] e.g. under Art. 6, the terms "*product*-specific domestic support" and "*basic agricultural product*" are used in the context of quantifying domestic support commitments, while under Art. 13(b), domestic support measures under Art. 6 that do not grant support to *a specific commodity* in excess of that decided during the 1992 marketing year are required to be exempt from actions as specified therein.

[5] *The Shorter Oxford English Dictionary*, p.1363.

[6] Ibid, p. 44.

[7] Ibid, p. 575.

[8] e.g. Art. 6, *Agreement on Agriculture.*

**16. Question 52, The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the *SCM Agreement*. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the *SCM Agreement* to withdraw the subsidy without delay, can the Panel:**

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? All third parties**

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the *SCM Agreement*? All third parties**

17. China believes that if this Panel were to find that a subsidy was prohibited and were to recommend under Article 4.7 of the *SCM Agreement* an immediate withdraw the subsidy, there would be no need for this Panel to dwell on the issue of whether adverse effects have been generated by the same subsidy.

18. The *SCM Agreement* has a primary distinction between prohibited subsidies under Article 3 where effects are presumed and actionable subsidies under Article 5 where the complaining party must demonstrate adverse effects. Amongst differences between prohibited and actionable subsidies, such as degree of proof, dispute settlement procedures, are different remedies under Arts. 4.7 and 7.8.

19. While no panel has dealt squarely with the issued raised by this Panel, the panel on *Australia – Automotive Leather II (Article 21.5 – US)* did touch upon the relationship between Arts. 4.7 and 7.8 briefly.[9]

> As regards the context of Article 4.7, we note that the term "withdraw the subsidy" appears elsewhere in the SCM Agreement. We consider these references to "withdrawal" of subsidies to be relevant for our understanding of the term. In the case of "actionable" subsidies, Members whose trade interests are adversely affected may, under Part III of the SCM Agreement, pursue multilateral dispute settlement in order to establish whether the subsidy in question has resulted in adverse effects to the interests of the complaining Member. If such a finding is made, the subsidizing Member "shall take appropriate steps to remove the adverse effects **or shall withdraw the subsidy**".[10] Alternatively, a Member whose domestic industry is injured by subsidized imports may impose a countervailing measure under Part V of the SCM Agreement, "**unless the subsidy or subsidies are withdrawn**".[11] In both cases, withdrawal of the subsidy is an alternative, available to the subsidizing Member, to some other action. Repayment of the subsidy would certainly effectuate withdrawal of the subsidy by a subsidizing Member so as to allow it to avoid action by the complaining Member.[12]

[9] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW and Corr.1, adopted 1 February 2000.

[10] Original note, "*SCM Agreement Article 7.8* (emphasis added)".

[11] Original note, "*SCM Agreement Article 19.1* (emphasis added)".

[12] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW and Corr.1, adopted 1 February 2000, Para. 6.28.

20. The panel in that case went *on* to elaborate in light of Art. 4.7's object and purpose:

> Turning to the object and purpose of Article 4.7 of the SCM Agreement, we observe that the SCM Agreement as a whole establishes disciplines on subsidies. The SCM Agreement categorizes subsidies as non-actionable, actionable, or prohibited.[13] In the case of non-actionable and actionable subsidies, Members are only allowed to take certain prescribed steps in the event that their trade interests are harmed by another Member's subsidies. Part II of the SCM Agreement, however, establishes an absolute prohibition on certain types of subsidies: Members are obligated, under Article 3.2 of the SCM Agreement, to "neither grant nor maintain" such subsidies. **While the trade effects of prohibited subsidies may be countered under Parts III and V of the SCM Agreement, Part II of the SCM Agreement establishes special and additional rules for rapid dispute settlement in cases involving such subsidies. Article 4.7 of the SCM Agreement establishes a specific remedy to be recommended in the case of a violation - withdrawal of the subsidy**. (Original emphasis added)

21. Indeed, the panel considered the Art. 4.7 prescription of withdrawal for subsidies found to be prohibited under to be so "special" that it is "specific remedy" designed to "not merely counteract *adverse* trade effects, but is intended to enforce the absolute prohibition on the grant or maintenance of such subsidies".[14]

22. In other words, such a specific remedy under Art. 4.7 grants the subsidizing Member far less options than Art. 7.8, which allows the subsidizing Member the options of either to "remove the adverse effects" or "withdraw the subsidy".

23. The above interpretation is further supported by the difference in terminology for countermeasures allowed to be taken by a complaining Member in the event that recommendations adopted by the DSB are not followed. The Arbitrators in their Decision on *Brazil – Aircraft (Article 22.6 – Brazil)*[15], stated:

> We also note that, when the negotiators have intended to limit countermeasures to the effect caused by the subsidy on a Member's trade, they have used different terms than 'appropriate countermeasures'. Article 7.9 and 10, which is the provision equivalent for actionable subsidies to Article 4.9 and 10 for prohibited subsidies, uses the terms 'commensurate with the degree and nature of the adverse effects determined to exist'.[16]

while Art. 4.10 only used the term "appropriate countermeasures", without the qualification of commensuration with the degree and nature of adverse effects as required under Arts. 7.9 and 7.10 for actionable subsidies. In deed, the Arbitrators ruled in the arbitration that

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[13] Original note, "[w]e note *that*, pursuant to Article 31 of the SCM Agreement, the provisions of Articles 6.1 (presumption of serious prejudice), and 8 and 9 (non-actionable subsidies) shall apply for five years from the date of entry into force of the WTO Agreement unless extended for a further period."

[14] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW and Corr.1, adopted 1 February 2000, Para. 6.34.

[15] Decision by the Arbitrators, *Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS46/ARB, 28 August 2000.

[16] *Ibid*, Para. 3.49.

when dealing with a prohibited export subsidy, an amount of countermeasures which corresponds to the total amount of the subsidy is "appropriate"[17] against the Brazilian argument that such an interpretation would be punitive.[18]

24. Hence, past panels and arbitrators have determined that Art. 4.7 remedies are special, specific, and additional to those under Art. 7.8, that when recommended by a panel, they more than counteract adverse trade effects. In light of such reasoning, the need for this Panel, after it having established prohibited subsidies, to go an extra step to find adverse effects is superfluous.

25. With respect to this Panel's question as to whether the Panel can "take into account the effects of interaction of those prohibited subsidies with other, allegedly, actionable subsidies" if it were to find prohibited subsidy, China believes the answer is not straight forward.

26. Art. 5 of the *SCM Agreement* makes no express distinction between prohibited and actionable subsidies when discussing adverse effects to the interests of other Members. It simply requires that no Member shall cause adverse effects through the use of any subsidy referred to in Paras. 1 and 2 of Article 1 of the *SCM Agreement*, which covers all types of subsidies that meets the specificity test, i.e. prohibited and actionable.

27. Having said that, the structure of the *SCM Agreement* is such that it sets out highly compartmentalized sections on prohibited, actionable and non-actionable subsides. Analyses of adverse effects are specifically placed under Part III that deals with actionable subsidies only. As discussed above, establishment of a prohibited subsidy does not require any finding of adverse effect, but is contingent upon a finding of a mere existence. In that sense, when this Panel accounts and analyzes adverse effects caused by actionable subsidies, inclusion of adverse effects generated by prohibited subsidies would tend to enlarge adverse effects caused by actionable subsidies, if the former only adds to the latter. In other words, the highly compartmentalized nature of the *SCM Agreement* requires this Panel to form a precise opinion, where partition is possible, on the degree and nature of adverse effects caused by actionable subsidies alone, and such precision is vital for the subsidizing Member to "remove the adverse effects" under Art. 7.8 and for the complaining Member to take commensurate countermeasures under Arts. 7.9 and 7.10. Such a partitioning method is very much relevant to the issue of causation, as in cases where partition is possible, there should be no causal link between prohibited subsidies and adverse effects caused by actionable subsidies.

28. If, however, this Panel finds that a simple partition is not possible to exclude adverse effects generated by prohibited subsidies, due to the fact that such adverse effects compounds or amplifies adverse effects caused by actionable subsidies, the issue is more difficult. Prohibited subsidies may indeed have played a role in causing a compounding or amplification of adverse effects, caused by actionable subsidies in the first place. Such circumstances would necessitate a consideration of the totality of evidence before this Panel and a finding that best reflects a possible attribution of adverse effects to those only caused by actionable subsidies found. Such a finding, China submits, may have to be weighed against the crucial need to discourage the use of multiple types of subsidies that are not WTO compliant to create compounded adverse effects.

**29. Question 53. Would a finding of serious prejudice under Article 5(c) of the *SCM Agreement* be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the *SCM Agreement* in this context? All third parties**

[17] *Ibid*, Para. 3.60.
[18] *Ibid*, Para. 3.55.

30. China believes that a finding of serious prejudice under Article 5(c) of the *SCM Agreement* would be determinative for a finding under Article XVI:1 of the GATT 1994.

31. Art. 5(c) of the *SCM Agreement* prohibits any Member against using any subsidy to cause serious prejudice to the interests of another Member. Instances of deemed existence and possible occurrence of serious prejudice are further enumerated under Art. 6 of the same agreement. Art. XVI:1 of GATT 1994, on the other hand, requires a subsidizing Member, to discuss, upon request, with the other contracting party or parties concerned, or with the Contracting Parties, the possibility of limiting the subsidization, in the event that its granting of subsidies causes or threatens to cause serious prejudice to the interests of any other contracting party while stopping short of listing those under Art. 6 of the *SCM Agreement*.

32. China believes possible difference, if any, between serious prejudice found under Art. 5(c) of the *SCM Agreement* and serious prejudice found under GATT Art. XVI:1, is effectively removed by footnote 13 of the *SCM Agreement*, which specifically provides:

> The term "serious prejudice to the interests of another Member" is used in this [SCM] Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice.

To interpret otherwise would clearly be contrary to the intent of the drafters of this footnote.

**33. Question 55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("another Member") for the purposes of these proceedings? All third parties**

34. China believes that any Member, the prices of whose like product (upland cotton for these proceedings), as supplied in the same market, at the same level of trade and at comparable times, are capable of being compared to the prices of the subsidized product for the purpose of determining whether significant price undercutting exists under Art. 6.3(c), is *another Member* for the purpose of Art. 6.3(c) of the *SCM Agreement*..

35. First, 6.3(c) of the *SCM Agreement* reads,

> Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply: …
>
> (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market.

36. Article 6.5 subsequently explains that

> For the purpose of paragraph 3(c), price undercutting shall include any case in which such price undercutting has been demonstrated through a comparison of prices of the subsidized product with prices of a non-subsidized like product supplied to the same market. The comparison shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability. However, if such a direct comparison is not possible, the existence of price undercutting may be demonstrated on the basis of export unit values.

37. Essentially, Art. 6.5 requires a comparison between prices of the subsidized product and prices of a *non-subsidized like product supplied to the same market* for the purpose of determining whether significant price undercutting exists under Art. 6.3(c). To ensure fairness and statistical meaningfulness of such a comparison, Art. 6.5 requires it to be made at the same level of trade and at comparable times, as well as any other factor affecting price comparability. No where does Art. 6.5 limit non-subsidized like product to only those from one country, e.g. the complaining party.

38. Second, specific references to the "complaining Member" is made in other paragraphs of this very Article 6. For instance, Article 6.7, reads

> Displacement or impediment resulting in serious prejudice shall not arise under paragraph 3 where any of the following circumstances exist during the relevant period:
>
> (a) prohibition or restriction on exports of the like product from *the complaining Member* (emphasis added) or on imports from the *complaining Member* (emphasis added) into the third country market concerned;…".

39. The same word "complaining Member" is specifically used from Para. (a) through to Para. (e) under Article 6.7. The above reference clearly suggests that for the purpose of these paragraphs, the drafters explicitly distinguished the like product from "the complaining Member" from the like product from other Members. Should the drafters have the same intent to make such a distinction under Article 6.3, they would have done so.

40. Based on the above interpretations, China believes that *another Member* under Art. 6.3 of the *SCM Agreement* shall include any Member, the prices of whose like product, upland cotton for these proceedings, as supplied in the same market, at the same level of trade and at comparable times, is capable of being compared to the prices of the subsidized product for the purpose of determining whether significant price undercutting exists under Art. 6.3(c).

**41. Question 56. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the *Agreement on Agriculture* and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the *SCM Agreement*. All third parties**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions, of the *Agreement on Agriculture,* relevant?**

42. In China's opinion, agricultural domestic support programmes are not challengeable under Article XVI:3 of GATT 1994.

43. Negotiating history of the current WTO agreements, being codification of the GATT Uruguay Round, as reported by scholars, indicates that the original Art. XVI of GATT 1947 contained only the first paragraph. Section B of Art. XVI and the interpretive note thereto were added by the *1955 Protocol Amending the Preamble and Part I and II of the Agreement* with an intent to outlaw export subsidies that results in subsidizing Member "having more than equitable share of the world export trade in that product"[19] only.[20] While the added article adopted such vague wordings as "any form of

[19] Article XVI:3, GATT 1994.

[20] Terence P. Stewart (ed.), *the GATT Uruguay Round: a Negotiating History* (Kluwer Law and Taxation Publishers, 1993), p. 134.

subsidy which operates to increase the export of any product", no where can any express effort to discipline domestic support be found.

44. The addition of Art. 11, entitled "Subsidies other than export subsidies" by the *1979 Agreement on Interpretation and Application of Article VI, XVI and XXIII of the General Agreement* (the "*Subsidies Code*")[21] is further proof that Art. XVI did not contemplate any discipline on domestic support. While not all Contracting Parties of GATT signed the *Subsidies Code*, it does represent the efforts of some GATT Contracting Parties

> [t]o apply fully and to interpret the provisions of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade only with respect to subsidies and countervailing measures and to elaborate rules for their application in order to provide greater uniformity and certainty in their implementation.[22]

45. On the issue of subsidies, the *Subsidies Code* is structured to distinguish between export subsidies on certain primary (Art. 10, for the purpose of Art. XVI:3, GATT) and non-primary subsidies (Art. 9 and illustrative Annex) on the one hand, and "[s]ubsidies other than export subsidies" (Art. 11) on the other. Such a distinction represents consensus, at least amongst some GATT Contracting Parties, that GATT Art. XVI:3 only disciplines export subsidies *per se*.

46. In addition, in attempting to develop the "unlawfulness" of these "non-export subsidies", Art. 11(2) of the *Subsidies Code* only specified possible "injury to a domestic industry of another signatory", "serious prejudice to the interests of another signatory", nullification and impairment of "benefits accruing to another signatory under the General Agreement [of Tariffs and Trade] as well as adverse effect on "the conditions of normal competition", to the express exclusion of a GATT Art. XVI:3 action for "more than equitable share of world export trade". The ostensible omission of a GATT XVI:3 challenge against non-export subsides is again indication that GATT XVI:3 did not contemplate a challenge against non-export subsidies, which should include domestic support measures.

47. The *Agreement on Agriculture* of the WTO, while setting out object and quantitative disciplines on agricultural domestic supports, does not engage in a comprehensive and express definition of the term domestic support, except that it is granted in favour of domestic agricultural producers. Yet the agreement does treat domestic support and export subsidies in different sections. Art. 13, in addition, makes a symmetrical reference to the two concepts on equal footing. The polarized treatment lends support to a conclusion that the multilateral trade regime at the Uruguay Round sees a need to discipline agricultural domestic support measures. Given the progression of discipline development for agricultural domestic support and the loss of inequitable world export trade challenge in the *Agreement on Agriculture*, it appears to be a stretching of terms to interpret that Art. XVI:3 of GATT 1947 should contemplate a challenge against agricultural domestic support measures.

48. Language of Article 21.1 of the *Agreement on Agriculture* again supports the above opinion of China. The article governs the relationship of the provisions of GATT 1994 and the Agreement on Agriculture.[23] The Appellate Body, in its *EC – Bananas III* report, stated to the effect that the provisions of GATT 1994 apply to a matter except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter.[24]

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[21] 26S/56.

[22] Preamble, the S*ubsidies Code*.

[23] Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Appellate Body Report, WT/DS27/AB/R, DSR 1997:II, Paras. 155-156.

[24] See *Supra*, Para. 3.

49. Coming back to the text of GATT Art. XVI:3, as well as the general progression of multilateral trade regime on agricultural domestic support measures, specificity on domestic support discipline as provided under the *Agreement on Agriculture* clearly stands out and pales any possible equation of GATT Article XVI:3 to a discipline on agricultural domestic support.

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the *SCM Agreement*, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in *US-FSC*, para. 117[25] here?**

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the *SCM Agreement* and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?**

50. Art. 6(3)(d), on the other hand, is a natural prolongation of the inequitable world export trade challenge made available by GATT Art. XVI:3 and further developed by the *Subsidies Code*. China believes that requirements of Art. XVI:3 of the GATT 1994 are reflected in and developed by requirements in Article 6.3(d) of the *SCM Agreement*.

51. GATT Art. XVI:3 is the first attempt by the multilateral trade system to seek avoidance of the clinching of "more than equitable share of world export trade in a primary product" by a Member granting "directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory". The article, led by the word "[a]ccordingly", grants Members the inequitable world export trade challenge to address concerns over possible "harmful effects", "undue

[25] Original quote from the Appellate Body Report, WT/DS108/AB/R, Para. 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market". In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* must clearly take precedence over the *exemption* of primary products from export subsidy disciplines in Article XVI.4 of the GATT 1994."

disturbance" and hindrance to "the achievement of the objectives" of GATT cause by subsidies to primary products, as enumerated under the preceding article of XVI:2.

52. The *Subsidies Code* further defined "more than an equitable share of world export trade" as including

> any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets.[26]

In addition to attempting to discipline subsidies to primary products, signatories to the *Subsidies Code* also agreed to a number of general provisions on subsidies, not necessarily limited to primary products. Adverse effects caused by subsidies, exemplified by injury to the domestic industry of another signatory, nullification or impairments to the benefits of another Member and serious prejudice to the interests of another Members, were first introduced under Art. 8 of the *Subsidies Code* as indication of the "unlawfulness" of such subsidies. The very same standards were to be later adopted by Art. 5 of the *SCM Agreement* on actionable subsidies.

53. The concept of inequitable world export share caused by subsidies to primary products, on the other hand, was retained under Art. 6.3(d) of the SCM Agreement, with such changes as "world market share" to replace "share of world export trade" and the addition of a three year period to constitute "representative period" benchmark.

54. While China agrees that the requirements of GATT Art. XVI:3 are reflected in and developed by requirements in Article 6.3(d) of the *SCM Agreement*, prior Appellate Body reports have indicated that to the extent a specific WTO agreement conflict with the provisions of GATT 1994, the former shall prevail. In that respect, it is important to quote the Appellate Body in *Brazil – Desiccated Coconut*:

> The relationship between the GATT 1994 and the other goods agreements in Annex 1A is complex and must be examined on a case-by-case basis. Although the provisions of the GATT 1947 were incorporated into, and became a part of the GATT 1994, they are not the sum total of the rights and obligations of WTO Members concerning a particular matter. For example, with respect to subsidies on agricultural products, Articles II, VI and XVI of the GATT 1994 alone do not represent the total rights and obligations of WTO Members. The *Agreement on Agriculture* and the *SCM Agreement* reflect the latest statement of WTO Members as to their rights and obligations concerning agricultural subsidies. The general interpretative note to Annex 1A was added to reflect that the other goods agreements in Annex 1A, in many ways, represent a substantial elaboration of the provisions of the GATT 1994, and to the extent that the provisions of the other goods agreements conflict with the provisions of the GATT 1994, the provisions of the other goods agreements prevail. This does not mean, however, that the other goods agreements in Annex 1A, such as the *SCM Agreement*, supersede the GATT 1994. As the Panel has said:
>
> > ... the question for consideration is not whether the SCM Agreement supersedes Article VI of GATT 1994. Rather, it is whether Article VI creates rules which are separate and distinct from those of the SCM Agreement, and which can be applied without reference to that Agreement, or whether Article VI of GATT 1994 and the SCM

[26] Para. 10:2(a), the *Subsidies Code*.

> Agreement represent an inseparable package of rights and disciplines that must be considered in conjunction.[27]

55. The Appellate Body noted further that "[t]he relationship between the *SCM Agreement* and Article VI of GATT 1994 is set out in Articles 10 and 32.1 of the *SCM Agreement*."[28] Apart from the integrated structure of the *WTO Agreement* and the annexed agreements, the Appellate Body therefore focused on these two provisions of the *SCM Agreement*. The Appellate Body then explicitly agreed with the Panel's statement that:

> Article VI of GATT 1994 and the SCM Agreement represent a new and different package of rights and obligations, as among WTO Members, regarding the use of countervailing duties. Thus, Article VI and the respective SCM Agreements impose obligations on a potential user of countervailing duties, in the form of conditions that have to be fulfilled in order to impose a duty, but they also confer the right to impose a countervailing duty when those conditions are satisfied. The SCM Agreements do not merely impose additional substantive and procedural obligations on a potential user of countervailing measures. Rather, the SCM Agreements and Article VI together define, clarify and in some cases modify the whole package of rights and obligations of a potential user of countervailing measures.[29]

56. The Appellate Body then proceeded to find that:

> [C]ountervailing duties may only be imposed in accordance with Article VI of the GATT 1994 and the *SCM Agreement*. A countervailing duty being a specific action against a subsidy of another WTO Member, pursuant to Article 32.1, it can only be imposed "in accordance with the provisions of GATT 1994, as interpreted by this Agreement". The ordinary meaning of these provisions taken in their context leads us to the conclusion that the negotiators of the *SCM Agreement* clearly intended that, under the integrated *WTO Agreement*, countervailing duties may only be imposed in accordance with the provisions of Part V of the *SCM Agreement* and Article VI of the GATT 1994, taken together. If there is a conflict between the provisions of the *SCM Agreement* and Article VI of the GATT 1994, furthermore, the provisions of the *SCM Agreement* would prevail as a result of the general interpretative note to Annex 1A.
>
> …
>
> The fact that Article VI of the GATT 1947 could be invoked independently of the *Tokyo Round SCM Code* under the previous GATT system does not mean that Article VI of GATT 1994 can be applied independently of the *SCM Agreement* in the context of the WTO. The authors of the new WTO regime intended to put an end to the fragmentation that had characterized the previous system.[30]

57. China takes the above Appellate body statement to mean that Art. 32.1 of the *SCM Agreement*, being the linkage between Art. XVI:3 of GATT 1994 and Art. 6.3(d) of *SCM Agreement*

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[27] Original Appellate Body quote, Panel Report on *Brazil – Desiccated Coconut, Brazil – Measures Affecting Desiccated coconut*, WT/DS22/R, adopted 20 March 1997, Para. 227; Appellate Body Report, *Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/AB/R, DSR 1997:I, p. 15.

[28] Appellate Body Report on *Brazil – Desiccated Coconut*, p. 16.

[29] Panel Report, *Brazil - -Desiccated Coconut, Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/R, adopted 20 March 1997, Para. 246, as upheld by the Appellate Body Report; Appellate Body Report on *Brazil – Desiccated Coconut*, p. 17.

[30] Appellate Body Report on *Brazil – Desiccated Coconut*, pages 16 and 18.

in connection with the inequitable share of world market challenge, requires that the Art. 6.3(d) prevail over GATT Art. XVI:3. In other words, if this Panel were to find that the GATT provision in conflict with the Art. 6.3(d), a claim against agricultural export subsidies cannot be brought under GATT XVI:3, but should be brought as actionable subsidies under Art. 6.3(d) of the *SCM Agreement*; however, if this Panel does not find any conflict, agricultural export subsidies actionable under Art. 6.3(d) of the *SCM Agreement* shall not be precluded from being actionable under GATT XVI:3, which can only be logical interpretation of note 56 to the *SCM Agreement* as it applies to the relationship.

58. Conflicts or differences were obviously found by the Appellate Body in *US-FSC*. It found that Article XVI:4 of GATT 1994

> differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on* Agriculture.

Hence, "[u]nquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the Agreement on Agriculture must clearly take precedence over … the GATT 1994".

59. Such an interpretation is further supported the general interpretative note to Annex 1A, which provides to the effect that in the event of a conflict between a provision of the GATT 1994 and a provision of another agreement in Annex 1A, the latter shall prevail to the extent of the conflict.

60. This Panel's Question 56(c) is in fact answered by the quoted passage from the Appellate Body in *US-FSC*. When GATT 1947 was negotiated and codified, there was nothing in it that expressly defines the term "subsidy", or the term "export subsidy". Such definitions only came into WTO wording in the Uruguay Round in addition to the new and more comprehensive discipline on "prohibited subsidies" under the *SCM Agreement* and "domestic [agricultural] support" under the *Agreement on Agriculture*. The more explicit disciplines under the *SCM Agreement* and the *Agreement on Agriculture*, as noted by the Appellate Body in the quoted passage, being "the latest statement of WTO Members as to their rights and obligations concerning agricultural subsidies", clearly take precedence over any GATT 1994 provisions to the extent of direct conflict.

61. China thanks this Panel for granting this opportunity to present its views on issues related to this proceeding, and hopes that this Panel will finds the above points helpful.

# ANNEX J-17

## REPLIES OF THE EUROPEAN COMMUNITIES TO THE QUESTIONS FROM THE PANEL

27 October 2003

### QUESTIONS TO THE EC

Question 45

**In relation to the term "same market" in Article 6.3 (c)of the SCM Agreement states in paragraph 10 of its oral statement that a "world market" cannot exist if there are significant trade barriers between Members. On the other hand, the Panel notes that in relation to cotton, the EC takes the position in paragraph 14 of its further submission that the term "same market" in Article 6.3(c) should be read to include the domestic market of the subsidising Member. In light of the fact that many domestic cotton markets, possibly including that of China, have significant trade barriers, how can the EC reconcile these two positions?**

Reply

1. The question does not state correctly the views expressed by the EC. Contrary to what is said in the question, the EC did not state at paragraph 14 of its further submission that "the term '**same market**' in Article 6.3 **(c)** should be read to include the domestic market of the subsidising Member". Rather, the EC said in paragraphs 14-16 of its further submission that the term "**world market share"** in Article 6.3 **(d)** includes also the share of the domestic market of the subsidising Member. This reading of Article 6.3(d) is compatible with the view that the term "same market" in Article 6.3(c) may include the world market, where there is such a world market. On the other hand, there is no reason why Article 6.3(d) should apply only in those cases where it can be established that there is a world market. Rather the term "world market share" should be understood to mean, in that context, the aggregate of the shares in each of the relevant geographical markets.

2. Contrary also to what is stated in the question, the EC has taken no position on the issue of whether, "in relation to cotton", there is a world market for the purposes of Article 6.3 (c). It might well be that, as suggested in the question, there is no world market for cotton, with the consequence that the price effects mentioned in Article 6.3(c) would have to be observed separately within each distinct national or regional market and/or in the residual "rest-of-the world" market. This is a factual matter on which the EC does not wish to express any views.

Question 46

**Should the Panel prefer a concept of allocation of the benefit of subsidies to later years, to a concept of fully expensing subsidies to the year in which the benefit was provided?**

Reply

3. Whether a subsidy should be "allocated" or "expensed" depends on the nature of the subsidy concerned, having regard to relevant criteria, such as those outlined at paragraph 11 of the EC's further submission.

4. The EC is not expressing any views on the largely factual question of whether the subsidies at issue should be "allocated" or "expensed". The point made by the EC was simply that Brazil cannot have it both ways. If the subsidies are fully expensed to the marketing year where they are granted, as Brazil appears to have done, it is contradictory to claim at the same time that they continue to provide benefits beyond that marketing year.

Question 47

**In the EC further submission, it is said that significantly different conditions of competition in regional markets may prevent the Panel from arriving at the conclusion that there is a world market. Is the payment of a subsidy a "condition of competition" and, if so, how should that impact upon the Panel's analysis?**

Reply

5. To be precise, the EC's position is that there is no world market for the purposes of Article 6.3 (c) where the existence of trade barriers has the consequence that the conditions of competition, and in particular the price levels prevailing in one geographical area are significantly different from those prevailing in another geographical area.

6. Unlike, for example, import duties, quotas or transport costs, subsidies do not, of themselves, insulate the prices in one geographical area from those in other areas and, therefore, do not lead to existence of separate geographical markets.

**QUESTIONS TO ALL THIRD PARTIES**

Question 49

**What is the meaning and effect of the introductory phrase of Article 3 of the SCM Agreement ("Except as provided in the Agreement on Agriculture...")?**

Reply

7. The introductory phrase of Article 3 makes it clear that subsidies which would be inconsistent with Article 3.1, but which are provided consistently with the export competition provisions of the *Agreement on Agriculture* are not prohibited.

Question 50

**According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture?**

Reply

8. No.

9. In the first place, and contrary to the Panel's implicit suggestion, it is still an open question, in view of the definition of the terms "implementation period" and "year" in Article 1 (f) and (i), respectively, of the *Agreement on Agriculture*, whether the provisions cited in the question will cease to apply by the end of the 2003 calendar year or at a subsequent date during 2004.

10. In any event, the Panel would be precluded by its terms of reference from taking into account the consequences of the expiry of those provisions. The "matter" before the Panel was defined at the time where the DSB agreed to the establishment of the panel and cannot be modified in the course of the proceedings.[1] In accordance with its terms of reference, the Panel must consider the measures in dispute as they existed when the matter was referred to the DSB, on the basis of the facts existing at that moment and in the light of the WTO provisions that were relevant at that time.

11. Brazil's claim is that the measures at issue were WTO inconsistent at the time when the matter was referred to the DSB. The Panel would go beyond its terms of reference if it were to decide that the measures are WTO inconsistent at a subsequent moment, as a result of the expiry of the peace clause. If, on the other hand, the Panel were to apply WTO provisions that will become relevant only after the expiry of the peace clause to measures and facts as they existed at the time when the matter was referred to the DSB, it would be making an impermissible retroactive application of such provisions.

Question 51

**How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the SCM Agreement apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the SCM Agreement:**

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

**(c) is a subsidy in respect of certain identified agricultural products specific?**

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

Reply

A subsidy granted to an economic operator which does not require any production of agricultural products, and in which the subsidy may be used for any purpose, does not appear, to the EC, to be specific in the sense of Article 2.1(a)

Question 52

**The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the SCM Agreement. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy without delay, can the Panel:**

[1] See e.g. Panel report on *India – Measures Affecting the Automotive Sector*, WT/DS1465/R, WT/DS175/R, at para. 7.26.

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel?**

Reply

12. Yes. There is nothing in the *SCM Agreement* which prevents a complaining party from claiming that a subsidy is prohibited under Part II and, in addition, causes "adverse effects" under Part III.

13. A finding that a prohibited subsidy causes "serious prejudice" may still be relevant in so far as at it may be possible for the subsidising Member to withdraw the export or local content condition attached to the subsidy, which causes its prohibition, while maintaining the subsidy and its adverse effects.

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the SCM Agreement?**

14. In a situation where the complaining party has made no claim that a prohibited subsidy causes adverse effects under Part III, it would be necessary to establish the causal link between the actionable subsidies and the adverse effects. However, the EC understands that this situation does not arise in the present dispute, because Brazil claims that all the allegedly prohibited subsidies cause adverse effects.

Question 53

**Would a finding of serious prejudice under Article 5(c) of the SCM Agreement be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the SCM Agreement in this context?**

Reply

15. Footnote 13 states that the term "serious prejudice" is used in the *SCM Agreement* in the same sense as in Article XVI:1 of the GATT. Therefore, it seems that a finding that a subsidy causes "serious prejudice" under Article 5(c) of the *SCM Agreement* would have the necessary implication that the same subsidy causes also "serious prejudice" in the sense of Article XVI:1 of the GATT, in so far as that provision can be applied on its own.

Question 54

**Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ?**

Reply

16. The EC has not taken any position on the factual issue raised in the question.

17. In principle, whether or not a producer is able to cover all its costs without subsidies is not, as such, directly relevant, let alone determinative of whether the subsidies cause adverse effects.

Question 55

**In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("another Member") for the purposes of these proceedings?**

Reply

18. The EC agrees with the United States that, for the purposes of Article 6.3(c), only the price effects on the "products" of Brazil are relevant. (See US Further Submission, para. 86 and the case law cited therein)

Question 56

**Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the Agreement on Agriculture and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the SCM Agreement.**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on export subsidies" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions, of the Agreement on Agriculture, relevant?**

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in US-FSC, para. 117[2] here?**

[2] WT/DS108/AB/R, para 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market." In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?**

Reply

19. Article XVI:3 of the GATT has been elaborated in Article 6.3(d) of the *SCM Agreement*, with the consequence that it cannot be applied independently from Part III of the SCM Agreement, just like Article VI of the GATT cannot be applied independently from Part V of the *SCM Agreement*.[3] Indeed, if Article XVI:3 could be applied on its own, the additional requirements provided for in Article 6.3(d) and related provisions, such as Article 6.7, would be rendered largely redundant.

20. By its own terms, Article XVI:3 is concerned exclusively with "export subsidies". However, as noted by the Appellate Body in the passage of the *FSC* report mentioned in the question, the scope of the notion of export subsidy in Article XVI differs from the scope of the same term in the *SCM Agreement* and in the *Agreement on Agriculture*. It is conceivable, therefore, that one and the same measure may be at the same time an "export subsidy" in the sense of Article XVI:3 and "domestic support" within the meaning of the *Agreement on Agriculture*. This is not saying that the *Agreement on Agriculture* and Article XVI:3 can apply simultaneously to the same measure. Where a measure is subject to the rules on domestic support of the *Agreement on Agriculture*, those rules excludes the application of Article XVI:3 to the same measure, in accordance with Article 21.1 of the *Agreement on Agriculture* (irrespective of whether Article XVI:3 can be applied independently from the *SCM Agreement*.)

21. This interpretation is confirmed by Article 13 of the *Agreement on Agriculture*. It would be odd if the peace clause exempted export subsidies from action under Article XVI:3, but not domestic support, which is assumed to have less pernicious trade effects. Clearly, if the drafters of the peace clause did not deem necessary to exempt domestic support from action under Article XVI:3 it is because they considered that this provision did not apply to domestic support pursuant to Article 21.1 of the *Agreement on Agriculture*.

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> is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* must clearly take precedence over the *exemption* of primary products from export subsidy disciplines in Article XVI:4 of the GATT 1994."

[3] Cf. Panel and Appellate Body reports, *Brazil – Measures Affecting Desiccated Coconuts*, WT/DS22/R and WT/DS22/AB/R.

# ANNEX J-18

## ANSWER TO PANEL QUESTION TO INDIA

27 October 2003

**Question 48**

**In the further submission of India, it is stated that "there is "no obligation under the *SCM Agreement* to demonstrate serious prejudice separately after establishing that one of the effects of a subsidy listed under Article 6.3 applies, as the effects listed in Article 6.3 themselves equate to serious prejudice". How does this view relate to Article 6.3(d), which appears to contain no element of degree? India**

Reply

India presumes that by 'element of degree' the Panel means the 'intensity or amount' of the effects of the subsidy as enumerated in Article 6.3 of the SCM Agreement. India notes that for serious prejudice to arise, in respect of only one out of the four effects of the subsidy in Article 6.3, has the intensity of the effect been specified. This is in respect of the effect of the subsidy in Article 6.3 (c) wherein the 'intensity or amount' of price undercutting, price suppression or price depression has been qualified by 'significant'. Thus, for serious prejudice to arise in case of price undercutting, price suppression or price depression, such effects should be significant. What can constitute 'significant' would vary from case to case. India is of the view that the other cases of effect of the subsidy specified in paragraphs 3 (a), 3(b) and 3 (d) of Article 6 contain no element of degree.

India fails to see how the absence of any element of degree in paragraphs 3 (a), 3(b) and 3 (d) of Article 6 results in the complaining Member being separately required to prove that the prejudice is indeed serious even after having established that one of these effects exists. If the drafters had intended that the complaining Member should separately establish that the prejudice caused by the effects of the subsidy was serious they would have defined the requirements for this purpose. The SCM Agreement contains no such requirement. India is, therefore, of the view that there is no obligation under the *SCM Agreement* to demonstrate serious prejudice separately after establishing that one of the effects of a subsidy listed under Article 6.3 applies.

# ANNEX J-19

## RESUMED FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING OF THE PANEL

## NEW ZEALAND ANSWERS TO QUESTIONS FROM THE PANEL TO THIRD PARTIES

14 October 2003

**Q49. What is the meaning and effect of the introductory phrase of Article 3 of the SCM Agreement ("Except as provided in the Agreement on Agriculture …")? All third parties**

This phrase refers to provisions in the *Agreement on Agriculture* that provide specific exception from Article 3 of the *SCM Agreement*. New Zealand does not agree that any such exception exists in the *Agreement on Agriculture* that would authorise use of local content subsidies contrary to Article 3.1(b) of the *SCM Agreement*, as argued by the United States.[1] There is no basis upon which to claim that the *Agreement on Agriculture* gives Members a right to use whatever domestic support they wish with complete impunity from action under other WTO Agreements.

**Q50. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exemp[tion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture? All third parties**

No. Brazil has not claimed that the implementation period in Article 13 has expired. It has claimed that the provision of Articles 13(b) and (c) have not been respected.

**Q51. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" – in Article 2 of the SCM Agreement apply to subsidies in respect of agricultural commodities ? Please answer the following questions, citing the principles in Article 2 of the SCM Agreement. All third parties**

New Zealand agrees with Brazil that the ordinary meaning, context and object and purpose of Article 2.1(a) of the *SCM Agreement* confirm that subsidies that are available to discrete segments of an economy or to only particular industries are specific. New Zealand considers that Brazil has demonstrated that each of the subsidies provided by the United States to upland cotton are specific within the meaning of Article 2.

Whether or not a subsidy is specific within the terms of Article 2, with the exception of prohibited subsidies which are deemed specific by Article 2.3, requires examination of the particular features of the subsidy at issue, including factual information about the actual usage of the subsidy and not simply its availability. Thus in relation to the general scenarios outlined below only general responses are possible.

[1] *United States – Subsidies on Upland Cotton*, Further Submission of the United States, 30 September 2003, para 167.

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

New Zealand does not consider that this question is relevant to this dispute as none of the subsidies at issue are provided on the same terms to all agricultural products.

**(b) is a subsidy in respect of all agricultural crops (ie but not to other agricultural commodities, such as livestock) specific?**

Yes such a subsidy would be specific, because access to the subsidy is explicitly limited to certain enterprises within the meaning of Article 2.1(a), specifically to producers of agricultural crops.

**(c) is a subsidy in respect of certain identified agricultural products specific?**

Yes, because it is specific to producers of certain agricultural products and is thus explicitly limited to certain enterprises within the meaning of Article 2.1(a).

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

Yes, because it is specific to producers of one product and is thus explicitly limited to certain enterprises within the meaning of Article 2.1(a).

**(e) is a subsidy in respect of a certain proportion of the value of the total US commodities (or total US agricultural commodities) specific?**

It is not clear from the question what kind of subsidy is being referred to, and, as noted in New Zealand's general comments on this question, whether or not a subsidy is specific within the terms of Article 2 of the *SCM Agreement* requires examination of the particular features of the subsidy at issue. To the extent that the subsidy referred to in the question is limited to certain enterprises (as suggested by the fact that the subsidy is provided only in respect of a certain proportion of the total value of United States commodities or agricultural commodities) it would be specific within the meaning of Article 2.1(a).

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

See New Zealand's answer to (e) above.

**Q52. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the SCM Agreement. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy without delay, can the Panel:**

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? All third parties**

A Panel may conclude that a prohibited subsidy had resulted in adverse effects to the interests of another Member. The chapeau of Article 5 of the *SCM Agreement* refers to "any subsidy referred to in paragraphs 1 and 2 of Article 1". Reference is made in paragraph 2 of Article 1 to subsidies being subject to the provisions of Part III only if they are specific in accordance with Article 2. Article 2.3 deems any subsidy falling under the provisions of Article 3, ie prohibited subsidies, to be "specific". Thus a prohibited subsidy may also be subject to the provisions of Part III of the *SCM Agreement*. It is therefore open to a Panel to conclude that a prohibited subsidy resulted in adverse effects to the interests of another Member.

The value of such conclusion in terms of the settlement of the matter before the Panel is to clarify the adverse effects that must be removed by the subsidising Member, albeit that a subsidising Member does not have the option of removing the adverse effects attributable to prohibited subsidies other than by withdrawing the subsidy without delay.

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the SCM Agreement? All third parties**

A Panel may take into account the effects of the interaction of those prohibited subsidies with other actionable subsidies. For example, actionable subsidies could operate to neutralise the effect of removal of the prohibited subsidy, as would likely be the case in respect of removal of the Step 2 export payments. Removal of this prohibited export subsidy would be likely to lead to a decline in United States exports and thus lower the United States domestic price for upland cotton. However lower prices for upland cotton producers would trigger increased marketing loan deficiency payments that could in turn boost exports and thus maintain the adverse effect of the United States subsidies.

It is therefore important to consider the interaction of the various types of subsidies at issue and look at their collective effect. However no attribution of the effects to either prohibited or actionable subsidies is needed, because there is no conflict between the remedies for prohibited subsidies and actionable subsidies. To the extent that the subsidies causing serious prejudice to the interests of other Members include prohibited subsidies, the subsidising Member must withdraw them without delay, as they do not have the option available in respect of actionable subsidies of maintaining the subsidy so long as the adverse effect is removed.

**Q53. Would a finding of serious prejudice under Article 5(c) of the SCM Agreement be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the SCM Agreement in this context? All third parties**

A finding of serious prejudice under Article 5(c) of the *SCM Agreement* would be determinative for a finding under Article XVI:1 of the GATT 1994 because serious prejudice is used in the same sense in Article 5(c) as it is in Article XVI:1. Footnote 13 explicitly clarifies this.

**Q54. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevant is this, if any, to Brazil's actionable subsidy claims? All third parties**

Without subsidies United States cotton producers would not be covering their full costs of production and so would be making losses over the longer term. Evidence for this has been provided by Brazil in Exhibits Bra-7 and Bra-205. For example in 1999, 2000 and 2001 the USDA estimated that United States cotton producers total costs exceed the value of production by 173, 142 and 259 dollars per planted acre respectively, as shown in "US cotton production costs and returns 1997-2001".[2]

Accordingly the subsidies mean that United States production is higher than it otherwise would be. As Professor Sumner's econometric work shows, without subsidies US production over 1999-2002 would have been an average of 28.7 per cent lower than actual US production[3] and as a consequence United States exports would have declined on average by 41.2 per cent between MY

[2] Exhibit BRA 7.

[3] *United States – Subsidies on Upland Cotton*, Brazil's Further Submission to the Panel, 9 September 2003, para 105.

1999-2002[4] and world prices would have been an average of 12.6 per cent higher. This evidence thus supports Brazil's claim that the United States subsidies have caused serious prejudice to Brazil's interests and threaten to cause serious prejudice to Brazil's interests in the future.

**Q55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("another Member") for the purposes of these proceedings? All third parties**

Brazil is the "other party" in the context of Article 5(c). But that does not mean that other Members too cannot be suffering the serious prejudice through the use of the subsidies at issue by the United States. Indeed the Oral Statement of Benin to the Panel[5] makes it clear that this is the case.

**Q56. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the Agreement on Agriculture and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5 and 6.3 (d) of the SCM Agreement. All third parties.**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on export subsidies" (emphasis added) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions, of the Agreement on Agriculture relevant?**

Agricultural domestic support programmes are challengeable under GATT 1994 Article XVI:3 to the extent that they meet the requirements of that Article, including, for example, that they must provide a subsidy that "operates to increase the export of any primary product from its territory".

The title of Section B is relevant in that it reflects the narrower scope of Section B vis-à-vis Section A. Section B addresses "Additional Provisions on Export Subsidies", whereas Section A is broader and addresses "Subsidies in General" – it includes subsidies that operate to reduce imports of any product into the territory of the subsidising Member. The term "export subsidies" in the particular context of GATT Article XVI is not defined, but can be given meaning by the scope of paragraph 3 which applies to "any form of subsidy which operates to increase the export of any primary product" and is thus a broader definition than "contingent … upon export" found in the *SCM Agreement*.

Article 21.1 of the *Agreement on Agriculture*, which provides that GATT 1994 must be applied subject to the *Agreement*, is relevant in so far as it clarifies that in the event of legal conflict the provisions of the *Agreement on Agriculture* apply. During the implementation period Article 13 of the *Agreement on Agriculture* provides exemption from actions based on specific GATT 1994 provisions, subject to certain criteria being met. Article 13 exempts domestic support measures from action based on Article XVI:1 only if such measures do not grant support in excess of that decided during the 1992 marketing year.

Brazil has brought forward evidence to demonstrate that the subsidies at issue operate to increase United States exports of upland cotton and that they have been applied by the US in a manner that has resulted in the United States having a "more than equitable share of the world export trade" within the meaning of Article XVI:3 and therefore cause serious prejudice within the meaning of Article XVI:1.

[4] *Ibid*.
[5] Oral Statement of Benin, 8 October 2003.

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in US-FSC, para 117 here?**

Article 6.3(d) of the *SCM Agreement* elaborates on one specific aspect of the disciplines on subsidies in GATT Article XVI:3, and that is in relation to the situation where a subsidy, as defined in the *SCM Agreement*, results in an increase in the world market share of the subsidising Member in the particular subsidised product. However GATT Article XVI:3 addresses a broader situation – where the result of the application of the subsidies is that the subsidising Member has a "more than equitable share" of the world export trade in the product.

A Member challenging a subsidy need not demonstrate that the subsidising Member's share of the world market has necessarily increased. For example, a Member may apply a subsidy that increases its exports of a product in order to simply maintain its market share. "But for" that subsidy, relevant economic factors might have meant that a Member's exports should in fact have declined. Therefore Article 6.3(d) of the *SCM Agreement* covers one specific aspect of how a "more than equitable share" of the world market might manifest itself but not all such situations.

As such the situation is distinguishable from *US-FSC*[6] in relation to GATT Article XVI:4 where the Appellate Body found that the narrow prohibition in Article XVI:4 had been entirely subsumed by Article 3.1(a) of the *SCM Agreement*.

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?**

See New Zealand's answer to Questions (a) and (b) above.

[6] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000

# ANNEX J-20

## RESPONSES TO QUESTIONS FROM THE PANEL FOR THIRD PARTIES

## THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU

27 October 2003

**Q49. About the meaning and effect of the introductory phrase of Article 3 of the SCM Agreement.**

A: The introductory phrase of Article 3 of the SCM Agreement "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited" has the meaning that if there is different provision in the Agreement on Agriculture (AoA) with regard to the subsidies listed in Article 3 of the SCM Agreement, the AoA provision shall prevail. In other words, even if a subsidy is specific within the meaning of Article 1 of the SCM Agreement, and even if it is a subsidy contigent upon export performance or a subsidy contigent upon the use of domestic over imported goods, it is still not within the scope of prohibition under Article 3 of the SCM Agreement. The effect of such agricultural subsidy shall be decided by the AoA.

The critical point here is whether it is "provided in the Agreement on Agriculture". In this regard, Article 8 of the AoA is relevant. Article 8 provides that: "Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule." The AoA, at this current stage, only requires reduction of such subsidy, not the elimination of such subsidy. In other words, suppose the subsidy is in conformity with the AoA and with the commitments as specified in the Members' Schedule, it should be allowed by the AoA and thus would not be prohibited under the SCM Agreement according to the introductory phrase of Article 3 of the SCM Agreement.

**Q50. About the impact of the revised timetable to issue the Panel report after the end of the 2003 calendar year on the "exempt[ion] from actions" under Articles 13(b)(ii) and 13(c)(ii) of the AoA.**

A: We have no comments on this question.

**Q51. About the concept of specificity in Article 2 of the SCM Agreement applying to subsidies in respect of agricultural commodities.**

A: Article 2.1 of the SCM Agreement provides that "In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as 'certain enterprises') within the jurisdiction of the granting authority, the following principles shall apply:…" Thus, when considering the answers below, the principles set forth in Article 2.1 must also be borne in mind.

Also, the basic reason for excluding "non-specific subsidies" from being prohibited should be that the subsidies are generally available and no competitive advantage is provided to a particular sector or some specific sectors. If there is competitive advantage provided to one or more sectors

with the effect of excluding other sectors from receiving the advantages, it should be considered as specific.

Our view is that the concept if specificity applies to the agriculture sector as follows:

(a) All agricultural products: not specific. The competitive advantage is provided to all agricultural products. No agricultural products are excluded.

(b) All agricultural crops: specific. Although the coverage is broad, some agricultural products are excluded.

(c) Certain identified agricultural products: specific. Apparently it excludes a large portion of products.

(d) Upland cotton: specific. It excludes all other products and only gives advantage to one product.

(e) Certain proportion of the value of total US commodities or total US agricultural commodities: not specific. No commodities or agricultural commodities are excluded.

(f) Certain proportion of total US farmland: not specific, as long as farmland is not restricted to that producing certain commodities.

**Q52. About different remedies available in respect of prohibited and actionable subsidies.**

A(a) The SCM Agreement explicitly divides subsidies into three categories, and Part II and Part III are designed to deal with different categories of subsidies. If a subsidy falls within "Part II Prohibited Subsidies", it would not be falling within "Part III Actionable Subsidies". Thus, it is unthinkable that if the Panel were to conclude, for example, that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement, it would also have to decide whether the same subsidy had resulted in adverse effects to the interest of another Member.

(b) For the same reason, the Panel should not take into account the interactive effects of those prohibited subsidies with other subsidies.

**Q53. About the determinativeness of a finding under the SCM Agreement for a finding under GATT 1994**

A: Footnote 13 of the SCM Agreement explains that "The term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice." Although there is no same provision in Article XVI of the GATT 1994, the real intent of the WTO Members should be to harmonize the meaning and concept of the same phrase where it appears in different agreements. It would also be reasonable to interpret the same phrase in the same manner, unless there is strong reason for not doing so. Our view, therefore, would be that if there is a finding of serious prejudice under Article 5(c) of the SCM Agreement, it should be *de facto* determinative for a finding under Article XVI:1 of the GATT 1994.

**Q54. About the evidence of US cotton producers to cover or not to cover the fixed and variable costs without subsidies.**

A: We do not have information available on this.

**Q55. About "another Member" of Article 6.3(c).**

A: We do not claim that we are "another Member" in the sense of Article 6.3(c) of the SCM Agreement.

**Q56. About the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the AoA and the disciplines on prohibited export subsidies and actionable subsidies in Article 3, 5(c) and 6.3(d) of the SCM Agreement.**

A(a) Agricultural domestic support should not be challengeable under Article XVI:3 of the GATT 1994. Although the second sentence "grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory" seems to be broad enough to include domestic subsidies, this second sentence still comes after the introductory sentence, which requires Members to avoid the use of subsidies on the export of primary products. Also paragraph 3 of Article XVI of the GATT 1994 is under the title "Section B - Additional Provisions on Export Subsidies". There is no reason why the provisions in paragraph 3 should not be limited to export subsidies. Otherwise, the title would become meaningless and redundant.

(b) Paragraph 117 of the Appellate Body Report in *US-FSC* is an appropriate interpretation of the relationship between the definition of subsidies and export subsidies in Articles 1.1(a)(1) and 3.1(a) of the SCM Agreement on the one hand and export subsidies in Article XVI:4 of the GATT 1994 on the other. However, it does not have relevancy in deciding the relationship between domestic subsidies and export subsidies. The requirements of Article XVI:3 of the GATT 1994 are imposed on export subsidies, as explained above, while Article 6.3(d) of the SCM Agreement is about non-export subsidies. Thus, the requirements of Article XVI:3 of the GATT 1994 are neither reflected in, nor developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement.

(c) Under the principle set forth by the above-mentioned Paragraph 117 of the Appellate Body Report in *US-FSC*, if there is conflict between Article XVI of the GATT 1994 and the AoA, the AoA must take precedence over the GATT 1994. Based on the same principle, the SCM Agreement should take precedence over the GATT 1994 to the extent that there is conflict. However, with regard to the definition of subsidy in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in Article 3.1(a), there is no conflict provision in Article XVI of the GATT 1994. Thus, there is no issue here of whether one agreement would take preference over the other. Nevertheless, Article XVI of the GATT 1994 and the SCM Agreement are still the rules under the WTO dealing with the same set of matters. The definition of certain terms in one agreement could serve as a very important source in helping to define the same terms in another agreement. Therefore, unless there is a sound basis for having a different interpretation, we do not see any reason for different meanings of subsidies and export subsidies in Article XVI of the GATT 1994 from those in the SCM Agreement.

# ANNEX K

## COMMUNICATIONS FROM PARTIES AND THIRD PARTIES

# ANNEX K-1

## LETTER FROM THE UNITED STATES

21 May 2003

The Panel in this dispute will soon meet with the parties to discuss the Panel's timetable and working procedures. In this regard, we draw to the Panel's attention Brazil's decision to raise claims under the *Agreement on Subsidies and Countervailing Measures* ("Subsidies Agreement") prior to the expiration of the Peace Clause (Article 13 of the *Agreement on Agriculture*) together with its desire to have recourse to the Annex V procedures of the Subsidies Agreement from the outset of this dispute.

Brazil's claims raise procedural and substantive questions that have not previously been faced by a dispute settlement panel. The most fundamental of these is whether Brazil may proceed with claims under the Subsidies Agreement against US support measures, notwithstanding that these claims are barred by the Peace Clause. The United States clearly maintains that Brazil may not.[1] The United States is submitting this letter in advance of the organizational meeting in order to propose a process to resolve these novel issues in an orderly and logical fashion.

Brazil has not contested that, if US support measures conform to the Peace Clause, they are protected from action based on claims of adverse effects or serious prejudice. In fact, Brazil implicitly recognizes that the Peace Clause bars its claims unless Brazil can demonstrate that the US measures are in breach of the Peace Clause – in both its panel request (WT/DS267/7, at 3) and its consultation request (WT/DS267/1, at 3), Brazil asserts that the Peace Clause does not exempt the challenged US measures from action. Thus, Brazil may not maintain this action based on its claims of adverse effects and serious prejudice under the Subsidies Agreement and GATT 1994 Article XVI unless the Panel has found that US support measures for upland cotton do not conform to the Peace Clause.

Accordingly, the United States proposes that the Panel organize its procedures to deal with the threshold Peace Clause issue at the outset of this dispute. We would suggest that the Panel first receive written submissions from both parties on the applicability of the Peace Clause, to be followed by a meeting of the Panel with the parties on this issue, and then rebuttal submissions. The Panel would then make findings on whether any US measure is in breach of the Peace Clause. If the Panel agrees that Brazil has failed to establish that the US measures are inconsistent with the Peace Clause,

[1] In this dispute, Brazil is claiming that US support measures for upland cotton have caused adverse effects (including serious prejudice) to Brazil's interests, within the meaning of Articles 5 and 6 of the Subsidies Agreement and GATT 1994 Article XVI. Both the Agriculture Agreement and the Subsidies Agreement make clear that such claims are precluded as long as the measures conform to the Peace Clause. The Peace Clause states that domestic support measures that conform fully to the criteria in Annex 2 of the Agriculture Agreement ("green box" support) "shall be . . . exempt from actions based on," *inter alia*, claims of adverse effects, including serious prejudice. Similarly, the Peace Clause states that domestic support measures that conform fully to the criteria in Article 6 of the Agriculture Agreement (for example, "amber box" support) "shall be . . . exempt from actions based on," *inter alia*, claims of ad verse effects, including serious prejudice, "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year." The final sentences of both Article 5 (on adverse effects) and Article 6 (further explaining serious prejudice) of the Subsidies Agreement use identical language to recognize the protection afforded by the Peace Clause: "This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture." Thus, domestic support measures that conform to the criteria specified in the Peace Clause are protected against actions claiming adverse effects and serious prejudice.

then that would dispose of those claims. If the Panel finds that the US measures are inconsistent with the Peace Clause, then Brazil could have recourse to the Annex V procedures with respect to its Subsidies Agreement claims on these measures. In either event, briefing and meetings of the Panel with the parties could then proceed on any claims not disposed of by the Peace Clause findings.

This procedure would satisfy the legal requirement that certain claims not be maintained while the Peace Clause is applicable and provide the Panel with a fair and orderly means of addressing the issues in this dispute. The United States notes that the Panel has broad discretion to determine its working procedures under Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), and, under DSU Article 12.2, the Panel is charged with establishing panel procedures with "sufficient flexibility so as to ensure high-quality panel reports." Because in this dispute Brazil has made claims under 17 different provisions of the WTO Multilateral Agreements with respect to numerous US programmes under at least 12 US statutes, we believe the Panel's consideration of the critical Peace Clause issue would be aided by briefing and argumentation focused on this threshold issue. Dispute settlement panels have made use of three panel meetings to allow adequate consideration of particular issues. For example, the panel in *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain* (DS276) has recently organized its proposed timetable and procedures to provide for the possibility of a panel meeting prior to the first substantive meeting in order to consider any preliminary issues. We also note that three panel meetings have been scheduled in each of the disputes under the *Agreement on the Application of Sanitary and Phytosanitary Measures* to allow a separate meeting of the panel with scientific/technical experts. Similarly, in this dispute, a meeting focused on the Peace Clause issue would assist in considering the complex matter in dispute.

We look forward to discussing this proposal with you in more detail at the organizational meeting. The United States is providing a copy of this letter directly to Brazil.

# ANNEX K-2

## LETTER FROM BRAZIL

23 May 2003

The Government of Brazil is in receipt of a letter dated 21 May 2003 from the US Mission, proposing that the Panel's working procedures provide for a special advance proceeding to deal with issues relating to Article 13 of the Agreement on Agriculture (AoA), commonly known as the "peace clause". The United States proposes two rounds of submissions by the parties, a meeting of the Panel with the parties, a special "discovery" proceeding and Panel issuance of a separate ruling on these issues. All other work in this dispute would be suspended until after the Panel has issued findings and a preliminary panel report. Brazil opposes these unprecedented and unnecessary procedures, which would impose significant financial and human resource burdens on Brazil and significantly delay this proceeding. Brazil asks that the Panel proceed expeditiously with this case using normal dispute settlement procedures and timeframes, for the reasons set forth below.

Brazil urges the Panel to take full account of Article 3.3 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), which provides: "The *prompt settlement* of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and to the maintenance of a proper balance between the rights and obligations of Members." DSU Article 12.9 contemplates that panel proceedings will be completed within six months. DSU Article 12.2 provides that "panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, *while not unduly delaying the panel process*". The US suggested procedure would unduly delay the panel process to the detriment of Brazil's rights.

The United States has singled out AoA Article 13 as a "special" provision which allegedly requires special and unprecedented procedural treatment. Yet DSU Appendix 2, the closed list of "special and additional" rules and procedures that trump the normal rules of dispute settlement, does not include Article 13 or any other AoA provision, nor does it include the cross-references to the AoA in Articles 3.1 and 7.1 of the Agreement on Subsidies and Countervailing Measures (ASCM). There is no support in the DSU, in the Agreement on Agriculture, or elsewhere in the WTO Agreement for the proposition that a separate "mini-trial" on peace clause issues is required before any claim can be made against subsidies under the Agreement on Agriculture. Acceptance of this proposition would invent a substantial new obstacle to future claims by any government against agricultural subsidy programs, altering the rights of Brazil and many other Members, in contradiction to Article 3.2 of the DSU.

The US notion that two rounds of submissions and a special meeting are required before the parties perform any further work on the case is unprecedented. As the Panel is aware, the concept of preliminary objections is not new. There are many WTO cases in which a defending party has made preliminary objections that a claim or a panel request has not met the requirements of DSU Article 6.2, and has requested an early ruling. Sometimes panels make an early ruling,[1] and sometimes

[1] US – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany, WT/DS213/R, fn. 224.

they do not.[2] The decision on how to handle such preliminary objections procedurally is a matter of panel discretion. Where preliminary objections have been resolved in advance of other claims, normally they have been resolved in the panel's first meeting, on the basis of the first round of submissions and oral statements.

The threshold issues posed by AoA Article 13 are no more or less significant than other threshold issues in many WTO Agreements. There are "peace clause"-type provisions in Articles 27.2(b), 27.3, and 27.4 of the ASCM Agreement precluding prohibited subsidy claims against developing country export subsidies under certain conditions. When this provision was invoked by developing countries in prior cases, no special procedures were created by panels and these threshold issues were decided as part of the final panel report.[3] Similarly, no claim may be brought against a measure under the General Agreement on Trade in Services unless the measure falls within the scope of the GATS as defined in GATS Article I. No claim may be brought under Article 2 of the Agreement on Technical Barriers to Trade except in respect of a measure that is a "technical regulation" as defined by that agreement. Claims under the Agreement on Government Procurement may only be brought concerning procurement of an entity covered by Annex I of that agreement. Many more examples exist.

Following the US proposal, panels would be *required* in any case involving such threshold issues to provide for special submissions, special meetings and preliminary panel decisions on admissibility of claims before reaching the substance, adding a month or two to each panel proceeding. The same procedure would be required whenever a defending party makes a preliminary objection under DSU Article 6.2. Resolving such issues, the United States would presumably argue, would be necessary to avoid wasteful litigation of unnecessary claims. But like the Agreement on Agriculture, none of these agreements contain any special procedural provisions for resolution of these threshold issues, and there is no reference to such procedures in Appendix 2 of the DSU. Negotiators could have provided for the type of bifurcated dispute settlement process suggested by the United States for these types of issues. But they did not.

The United States notes that special meetings have been held with experts in cases involving the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS). However, these meetings were held pursuant to Article 11.2 of the SPS Agreement that gives the panel the authority to "seek advice from experts chosen by the panel in consultation with the parties to the dispute." With such authority comes an implied need for the Panel to *meet* with the experts. It also creates an expectation of additional delay from the normal panel schedule to accommodate obtaining such advice. Nothing in the AoA contains any similar authority to address peace clause issues.

The peace clause issues in this dispute are not just technical procedural issues (as the US implies in its letter) that can be quickly disposed of without extensive briefing or the presentation of considerable factual evidence and expert econometric testimony. They require careful deliberation by the Panel on the basis of the entire body of evidence submitted by the parties. The peace clause issues are also intertwined with the substance of Brazil's claims regarding prohibited and actionable subsidies under the Agreement on Subsidies and Countervailing Measures. For example:

> Among the issues presented by the peace clause are whether three of the six actionable US domestic support subsidies (Production Flexibility Payment Contract Payments, Direct Payments, and Counter-Cyclical payments) are properly in the "green" or "amber/blue" box of the AoA. To resolve these issues involves, *inter alia*,

[2] US – Anti-Dumping Measures on Certain Hot Rolled Steel Products from Japan, WT/DS184/R, fn. 16 to para. 7.1.

[3] Brazil – Export Financing Program for Aircraft, WT/DS46/R (20 August 1999), paras. 7.56-57; Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R (23 July 1998), para. 14.52

the presentation of econometric analysis of the trade distorting or production enhancing effects of each of these subsidies to determine whether or not they are properly green box subsidies within Annex 2 AoA. If they are not, then these three subsidies are included in the amount of support in marketing years 1999-2002 for the purpose of comparing against the level of support decided by the United States for marketing year 1992 under Article 13(b)(ii) AoA. However, Brazil's econometric and other extensive documentary evidence regarding the production enhancing effects of such subsidies for the purposes of the peace clause is *exactly* the same evidence Brazil presents for these three referenced subsidies to demonstrate its serious prejudice claims under ASCM Articles 5(c), 6.3(b), 6.3(c), 6.3(d), and Article XVI of GATT 1994.

Brazil has made claims under the AoA and the ASCM regarding prohibited export subsidies under the US Step-2 programme and US export credit guarantee programmes. Brazil will demonstrate in its first submission that these two export subsidies do not "conform fully to the provisions of Part V of this Agreement" in the sense of AoA Article 13(c); obviously, Brazil's evidence and argument regarding the lack of conformity of these two measures with Part V of the AoA largely overlaps with the evidence and argument necessary to demonstrate a violation of ASCM Articles 3.1(a) and (b).

The close relationship between these "threshold" issues and the merits of Brazil's case can be seen by considering the possible outcome of the Panel's preliminary rulings. For instance, if the Panel rules that Brazil may bring its export subsidy claims because the US export subsidies are inconsistent with AoA Part V, it will have decided up front a key issue regarding the merits. But would the United States accept such a ruling and not attempt to re-litigate the same issues raised in the context of the ASCM Agreement? The answer is obvious. It highlights that a preliminary mini-trial of the sort sought by the United States will not save time, expense, and trouble for the Panel or for the parties, and will simply serve to increase the length and expense of this panel proceeding.

The Panel must also consider the position of the 13 interested third parties in this dispute. Many of these third parties may wish to provide their views on the interpretation and application of AoA Article 13 given the implications of any decision for future disputes. If the panel were to decide to request submissions and/or hold a hearing in advance of its first meeting with the parties, third parties will probably claim that they must be accorded the same opportunities for participation as in normal panel proceedings. These opportunities are particularly important since the "mini-trial" called for by the United States would decide key substantive issues relating to the facts and merits of Brazil's complaint.

Brazil would also be prejudiced because the United States proposal would require it to use limited resources to bring its Brazilian counsel and its US econometric experts to Geneva for the proposed special meeting. Further, Brazil would be required to prepare essentially four additional written submissions (a first and rebuttal written submissions, an oral statement submission, and written answers to the Panel's questions) for the proposed special briefing and meeting. The acceptance of the US proposal will create travel, hotel, legal, and human resource expenditures that are particularly burdensome for a developing country with limited financial and human resources such as Brazil. In sum, the US proposal would impair Brazil's rights under WTO rules.

Finally, the United States proposes even more delay in this proceeding with its suggestion in the letter that "Brazil could have recourse to the Annex V procedures with respect to its Subsidies Agreement claims" after the determination by the Panel pursuant to the special procedures. Brazil initiated Annex V procedures on 18 March as the DSB established the panel pursuant to Brazil's request for the establishment of a panel that invoked ASCM Article 7.4. Brazil sought information

from third countries and the United States on 1 April 2003 under the provisions of Annex V, paragraphs 2 and 3. Brazil has collected information from a number of third parties pursuant to these requests. The United States on 19 March in WT/DS267/8 informed the DSB that *"any requests for information pursuant to the Annex V procedures may be provided in writing to the US Mission to the World Trade Organization. The United States will gather the information to respond to any such requests and provide the responses through the US Mission"*. Unfortunately, the United States refused to answer Brazil's questions dated 1 April 2003 during the 60-day period of the procedures that ended on 17 May 2003.

Brazil rejects any suggestion by the United States that a new Annex V procedure be conducted during the panel stage of the process to impose even further delays in this proceeding. Instead, Brazil will use the best information available to it when it files its first submission. If appropriate, Brazil will request that the Panel draw adverse inferences from any failure of the United States to provide information requested during the consultation and Annex V process.

In light of the above, Brazil strongly urges the Panel to reject the United States' unprecedented and wasteful procedural proposal. As noted above, much of the evidence involved in demonstrating the absence of peace clause protection *also* is related to Brazil's substantive claims. Given this overlap, the Panel should structure its work so that the peace clause issues and Brazil's claims regarding prohibited subsidies and serious prejudice are dealt with at the same time and in the same two meetings between the Panel and the parties. Use of the normal two meetings and briefing schedule will permit the Panel to have sufficient time to consider the views of Brazil, the United States, and the 13 third parties involved in this dispute. Use of the existing procedures and timeframes will avoid significant prejudice to Brazil by avoiding it having to use its limited resources to litigate the same issues at three, not two meetings. Use of existing procedures will avoid duplication of effort by the Panel and the third parties, and avoid significant delays in the issuance of a final report regarding the subsidies Brazil challenges in this dispute.

Brazil would be pleased to provide the Panel with additional information at the organizational meeting regarding this and any other procedural issues.

# ANNEX K-3

## LETTER FROM BRAZIL

14 July 2003

Brazil would like to bring to the attention of the Panel in *United States – Subsidies on Upland Cotton* (DS267) the following matter.

The "Working Procedures for the Panel" establish in paragraph 17(b) that,

"*the parties and third parties should provide their submissions to the Secretariat by 5:30 pm on the deadline established by the Panel, unless a different time is set by the Panel"*

and in paragraph 17(d) that,

*"the parties and third parties shall provide electronic copies of all submissions to the Secretariat at the time they provide their submissions [...]".*

The electronic version of the US first submission, which was due on Friday, 11 July, 5:30 pm, was delivered after 11 pm, almost 6 hours after the deadline. Brazil had access to the hard copy only on Saturday morning. Because it was a Friday, the failure of the United States to meet the established deadline led to delays in the transmittal and reception of the submission to different Government officials in Brazil and to Brazil's legal advisors. In addition, the delay no doubt caused third parties to have less time to react to the US submission – a not insignificant delay given the fact that third parties had only two working days to respond to the US submission before filing on 15 July. The result was that Brazilian officials were unable to review the submission until Monday, 14 July.

Brazil notes that this delay is not the first in the present case. The US Comments on the initial brief by Brazil, due on 13 July, 5:30 pm, were sent electronically after 8 pm.

Brazil has been faced with extremely short deadlines in this case, including the filing on 24 June its First Submission which required extensive changes to respond to the Panel's determination of 20 June. Nevertheless, Brazil met the deadline and filed the submission prior to 5:30 pm on 24 June. Brazil expects that the United States will, like Brazil, meet its own deadlines in a timely fashion.

Brazil would like the Panel to take note of this delay and to encourage the US to respect the deadlines, with a view to ensuring procedural fairness in these proceedings.

# ANNEX K-4

## LETTER FROM THE UNITED STATES REQUEST FOR EXTENSION OF DEADLINE FOR RESPONSES TO PANEL QUESTIONS

29 July 2003

In view of the number and the complexity of the questions addressed by the Panel to the United States and Brazil (not counting subparts, it appears that the Panel has asked the United States approximately 95 questions), the United States would like to request an extension of the deadline for the parties' responses until Friday, 15 August 2003. In particular, a number of the questions address new issues and request extensive additional information. Given the issues and volume of information involved, as well as the travel schedules of key members of the US delegation, an extension of the deadline originally proposed by the Panel would assist the parties in providing thorough responses.

While extending the deadline for answers would necessarily shorten the period for commenting on those answers, the parties would still have one week to prepare those comments. The United States considers that both the initial answers and subsequent comments would benefit if proportionately more time were allocated to ensuring that the initial answers are as complete and clear as possible.

# ANNEX K-5

## LETTER FROM BRAZIL

29 July 2003

Brazil received a letter dated today from the United States requesting until Friday 15 August to provide answers to the Panel's questions. Brazil cannot agree to this request.

Brazil has been working diligently every day since 25 July to comply with the Panel's deadline and is prepared to provide its answers to the Panel's questions by 4 August. A delay until 15 August will prejudice Brazil by not providing it with sufficient time to comment on the US answers or to prepare its Rebuttal Submission.

Brazil also notes that the Panel's questions do not raise new issues. Instead, they address issues either raised to a large extent in the First Written Submissions or that have been dealt with extensively during the first substantive meeting with the parties.

However, in the spirit of cooperation and in recognition of the fact that the Panel did request more questions of the United States than Brazil, Brazil would have no objection if the Panel were to extend the deadline to 7 August for the Parties and the Third Parties to answer the Panel's and each other's questions.

# ANNEX K-6

## LETTER FROM THE EUROPEAN COMMISSION

31 July 2003

The European Communities would like to thank the Panel for the questions it has posed to the third parties, and for extending the deadlines for responses. In light of the detailed nature of the questions asked and the importance of the issues concerned, the European Communities respectfully makes two requests to the Panel.

First, it would greatly assist the European Communities (and we assume other third parties) in preparing our responses to the Panel's questions to have sight of the oral statements of the main parties to the dispute at the first substantive meeting. So doing would permit third parties to respond to arguments made by the main parties where such a response would be of relevance in answering the Panel's questions. Since the Panel has requested the third parties to answer detailed questions, the European Communities considers that allowing the third parties access to the oral statements would allow the third parties to participate in a "full and meaningful fashion" in the stages of the proceeding where the panel has requested their input.[1] Moreover, the European Communities considers that this would benefit the Panel since the third parties will be able to provide more complete responses to the Panel's questions.

Second, the European Communities welcomes the Panel's decision to allow the third parties to comment on the response of the other third parties. However, it is not clear to the European Communities whether the third parties will also be able to comment upon the responses of the main parties to the Panel's questions, or questions the main parties have asked of each other. Once more, the European Communities considers that the third parties comments will be more full and meaningful, and consequently more beneficial to the Panel, if it is also possible to comment on the responses of the main parties in addition to commenting upon the other third parties responses.

Accordingly, the European Communities requests the Panel to ask the main parties to provide the third parties with copies of their oral statements and copies of their responses to the Panel's questions, when lodged. The European Communities also requests the Panel to invite the third parties to comment upon the responses of the main parties to the Panel's questions, and those posed by the other party.

Finally, the European Communities would also respectfully ask you to clarify the treatment of the Panel's expression of views on Article 13 of the *Agreement on Agriculture* and associated issues, scheduled for 5 September 2003. Given that the Panel's findings on this issue may be considered similar to a preliminary ruling, and that the third parties will be asked to provide the Panel with further comments on 29 September 2003, the European Communities considers that, in order to protect third parties' due process rights, the Panel's expression of views should be available to the third parties. The European Communities would be obliged if you could confirm this understanding.

[1] Para. 249, Article 21.5 Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"* ("United States – FSC (21.5)"), WT/DS108/AB/RW, adopted 29 January 2002.

A copy of this letter has been provided to the delegations of Brazil and the United States, and to the other third parties.

May I take this opportunity to thank you in advance for your consideration of these issues.

# ANNEX K-7

## LETTER FROM THE UNITED STATES

1 August 2003

The United States is in receipt of the letter dated 31 July 2003, from the European Communities (EC) relating to third parties' participation in the present dispute. The United States would consent to the Panel's release of its further views on the Peace Clause issue to the third parties as a sensible way forward in this dispute (although we would not necessarily endorse all of the reasoning expressed in the EC letter). Further, the United States has no objection to either party choosing to make its submissions or oral statements public – as the United States and, we understand, Brazil have decided to do. However, we see no basis in the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (DSU) for the additional procedural requirements that the EC is proposing – namely, that the Panel require the parties to make available to the third parties copies of their oral statements and responses to the Panel's questions, and that the third parties comment on the parties' responses to the Panel's questions. The EC proposal appears to erase the distinction between parties and third parties for purposes of dispute settlement.

The United States recalls that in the context of a panel proceeding a third party is welcome to express its interests under any covered agreement at issue in the dispute. Thus, the DSU ensures that third parties may express those interests by providing "an opportunity to be heard by the panel and to make written submissions" (DSU Article 10.2) and the right to "receive the submissions of the parties to the dispute to the first meeting of the panel" (DSU Article 10.3). These requirements have been met in every prior dispute by providing third parties the opportunity to receive the first submissions of the parties, to make one written submission, and to present statements at a third-party session of the first meeting of the panel.

We are aware of no dispute in which third parties have been granted the additional rights now sought by the EC. It would represent a fundamental change in the role of third parties in dispute settlement. Changes of this nature are being discussed in the context of the ongoing negotiations on clarifications and improvements to the DSU, and that is the proper forum for Members to consider these changes.

In addition, on a practical note, if the parties have to deal with the additional work of responding to comments by potentially more than a dozen third parties on (1) each others' answers to the Panel's third-party questions as well as (2) the parties' answers to more than 100 questions from the Panel, the already ambitious timetable established by the Panel will become totally untenable.

Finally, the United States recalls that, like all WTO Members and the public, the EC already has access to US submissions and oral statements on our website. (Indeed, we have already provided a copy of our oral statement directly to the EC at their request.) We also understand that Brazil is making its submissions public within two weeks of filing as contemplated by the parties' agreement and reflected in the Panel's Working Procedures. We would welcome Brazil's making its submissions public upon filing but do not see a basis in the DSU for requiring disclosure of those submissions to the third parties.

The United States is providing a copy of this letter directly to Brazil and the third parties.

# ANNEX K-8

## LETTER FROM BRAZIL

1 August 2003

Brazil received a letter dated 31 July 2003 from the European Communities requesting the Panel:

(i) to ask the parties to the dispute to provide third parties with copies of their oral statements and copies of their responses to the Panel's questions;
(ii) to invite the third parties to comment upon the responses of the parties to the dispute to the Panel's questions, and those posed by the other party;
(iii) to make the "Panel's expression of views on Article 13 of the *Agreement on Agriculture* and associated issues", scheduled for 5 September 2003, available to the third parties.

2. With respect to the EC's requests, Brazil would like to make the following comments.

3. In light of the Timetable for Panel Proceedings, the Working Procedures for the Panel, and DSU Articles 10.2 and 10.3, Brazil considers that the third parties to the present dispute are entitled to be provided with copies of the parties' First Written Submission and parties' Further Submission only. In Brazil's view, these are the only documents that constitute "submissions of the parties to the dispute to the first meeting of the panel" in accordance with DSU Article 10.3.

4. Brazil further notes that the parties to the dispute did not make any oral statements during the session of the substantive meeting of the Panel set aside for the third parties to present their views (24 July 2003). Thus, there are no oral statements of which the third parties should receive written versions. As a matter of fact, the oral (opening and closing) statements made by Brazil and the US were delivered exclusively at the closed session of the substantive meeting of the Panel which the third parties did not have access to. Again, there would be no reason for providing third parties with copies of those oral statements.

5. As is the case for the oral statements, Brazil submits that third parties need not be given copies of the parties' responses to the Panel's questions. The Panel's questions were put to Brazil and the US in the context of the closed session of the first substantive meeting with the parties, as were the preliminary responses given by both parties to the dispute. Moreover, such responses do not constitute "submissions" within the meaning of DSU Article 10.3.

6. Finally, with regard to the "Panel's views on certain issues", Brazil agrees with the EC that the document should be available also to third parties.

# ANNEX K-9

## LETTER FROM THE EUROPEAN COMMISSION

4 August 2003

The European Communities refers to its letter to the Panel of 31 July 2003, and the responses of the United States and Brazil of 1 August 2003.

The European Communities would like first to welcome the agreement of both the United States and Brazil that the Panel's views on the Peace Clause and related issues should be communicated to the third parties.

However, in the view of the European Communities, both the United States and Brazil misunderstand the thrust of the EC's letter of 31 July. Both parties enter into a discussion of whether the third parties are entitled to be given access to, and the chance to comment upon, the responses to the Panel's questions of the main parties. Both argue that the documents which the third parties have received are the only documents which the third parties are entitled to. However, these arguments miss the point of the European Communities request.

The European Communities central point was that, given the detailed questions which the third parties have received from the Panel, and given the Panel's decision to permit third parties to comment upon the responses of the other third parties, it would be a reasonable exercise of the Panel's discretion to organise its procedures so as to allow the third parties also to comment upon the responses of the main parties. The European Communities considers that this would be beneficial to the Panel, and would allow the third parties to participate completely, given the extent to which the Panel has already invited the third parties to participate.

The European Communities does not consider that this would set an unfavourable precedent because a panel would always have the discretion, in the light of its own procedures and the dispute before it, to decide whether to grant third parties such possibilities. Moreover, the European Communities sees no possible impairment of the due process rights of the main parties, and indeed neither the United States not Brazil have alleged any such impairment would result from the Panel acceding to the request of the European Communities.

The European Communities is aware of the practical concerns raised by the United States. However, the European Communities notes that a party always has a choice whether to comment upon responses, and that these practical concerns weigh equally on both parties.

Finally, the European Communities is, of course, aware that the United States makes it oral statements public (and is grateful that the US officials involved in this dispute have provided a copy directly to the EC delegation). We also note that the Panel's procedures provide for the submission of non-confidential summaries within 14 days of filing which could be made public.[1] However, the European Communities is not aware, first, whether such summaries shall also be provided to the third parties, and second, whether such summaries can be considered equivalent to the oral statements as

[1] Para. 3 – Panel's Working Procedures.

delivered. In that light, the European Communities recalls its arguments in favour of provision of the statements as delivered, set out in its letter of 31 July 2003.

A copy of this letter has been provided to the delegations of Brazil and the United States, and to the other third parties.

Thank you in advance for your consideration of these issues.

# ANNEX K-10

## LETTER FROM BRAZIL

14 August 2003

Once more, Brazil is faced with the need to detract from its substantive work relating to the dispute *United States – Subsidies on Upland Cotton* (DS267) to bring to the attention of the Panel a new US failure to abide by the "Working Procedures for the Panel" concerning the timing for delivery of documents required by the Panel.

As it had already done on two previous occasions[1], the US did not deliver its answers to the Panel's questions following the first substantive meeting with the parties by the time established in paragraphs 17(b) and (d) of the "Working Procedures".[2] Brazil recalls that the deadline for submitting the parties' answers to the Panel was expressly confirmed by the Panel on its communication dated 30 July 2003 informing about the extension of the deadline for the submission of the parties' responses[3].

As a matter of fact, the electronic version of the US answers, which was due on 11 August, 5:30 pm, was delivered around 11:30 pm, more than 6 hours after the deadline, more than 6 hours after Brazil delivered both its electronic version and hard copies to the Secretariat and the US. Brazil further notes that no hard copy of the US answers was made available either to the Secretariat or to Brazil by the deadline.

Brazil regrets that the US has decided to adopt such a strategy. In this particular case, the US behavior is even more egregious because the deadline – at request of the US and with the good faith and cooperation of Brazil – had been extended by 7 days by the Panel (from 4 August to 11 August).

As stated, the failure of the US to meet the established deadline provided US officials an opportunity to examine Brazil's answers before submitting their own responses more than 6 hours later. Moreover, the US failure led to delays in the transmittal and reception of the US answers to different Government officials in Brazil and to Brazil's legal advisors, diminishing an already short period for Brazil to comment upon the US responses. Due to the 5 hour time zone difference between Brasilia and Geneva, the US delay prevented work by Brazilian officials on the 11th of August. US official, however, had no such impairment since the USTR representatives in Geneva had the Brazilian answers to the Panel by 11:30 a.m. Washington D.C. time on that same date.

Needless to repeat that Brazil – a developing country with serious budgetary and human resources constraints – has been faced with extremely short deadlines in this case, including the filing on 24 June of its First Submission which required extensive changes to respond to the Panel's

[1] Also the US Comments on the initial brief by Brazil, due on 13 June 2003, and the US First Written Submission, due on 11 July 2003, were delivered after the deadline (see Brazil's letter to the Panel on 14 July 2003).

[2] WP, paragraph 17(b): "*the parties and third parties should provide their submissions to the Secretariat by 5:30 pm on the deadlines established by the Panel, unless a different time is set by the Panel.*" WP, paragraph 17(d): "*the parties and third parties shall provide electronic copies of all submissions to the Secretariat at the time they provide their submissions* [...]".

[3] "*The Panel reminds the parties that paragraph 17(b) of the Panel's working procedures indicates that the responses should be submitted by 17:30 (Geneva time).*"

determination of 20 June. However, Brazil has been meeting the deadlines established, and will continue to do so. Although the facts do not recommend Brazil to be very optimistic, Brazil continues to expect that the US will, like Brazil, meet its own deadlines in a timely fashion from now on.

Brazil respectfully asks the Panel to take note of this new delay and to encourage, again, the US to respect the deadlines, with a view to ensuring procedural fairness in these proceedings.

In addition, Brazil would like to bring to the Panel's attention an issue regarding certain of the United States' Answers to the Panel's Questions. In certain answers, the United States has indicated it will provide responsive arguments and information in its rebuttal submission. In other answers, it made allegations without providing any documentary support that would permit Brazil to challenge the accuracy and credibility of allegations. The answers in question are the following:

> Answer to Questions 14 and 26: no detailed information or arguments were provided in the US answers regarding either production flexibility contracts or market loss assistance payments. The last sentence of paragraph 57 of the U.S. answers indicates US will discuss production flexibility contract payments only in the rebuttal submission.
>
> Answer to questions 60 and 66(a): The United States provided no responsive information or calculations to respond to the Panel's questions.
>
> Answer to Questions 66(d): In paragraph 121, the United States indicates that "it will provide a detailed critique of Mr. Sumner's analysis in our rebuttal submission." In paragraph 124 it states: "We will discuss other conceptual errors in Sumner's approach in our rebuttal submission."
>
> Answer to Question 73: Other than an undocumented allegation in US answer to Question 76, the United States provided no information or argument concerning Articles 1 and 3 of the SCM Agreement. Instead, the United States stated in paragraph 140 that it would "review Brazil's submissions, including its responses to these questions, and provide any further response in the US submission".
>
> Answers to Questions 12, 71-88: The United States provided only two exhibits (US-12 and US-20) and no other documentation in support of arguments or allegations.

Brazil recalls that the purpose of scheduling the filing of the answers to the Panel's questions 11 days before the submission of the rebuttal submission was to permit the parties to review each other's answers and supporting documentation and then to comment on those answers in the rebuttal submissions. Brazil cooperated in this process by providing complete and comprehensive answers to all of the Panel's questions together with extensive documentation. As demonstrated above, for certain questions, the United States did not provide complete answers or documentation that would have allowed Brazil the opportunity to comment and rebut in its rebuttal submission.

Brazil will be prejudiced if it does not have the opportunity to comment on information, arguments, and documents the United States makes or provides for the first time in their rebuttal submission that *would have been* responsive to those Panel questions listed above. Accordingly, Brazil requests the right, only with respect to the questions above, to comment on any new information, arguments, or documents presented for the first time in the U.S. rebuttal submission.

Providing Brazil with this right is consistent with basic notions of due process. Otherwise, Brazil will not have another opportunity prior to the Panel's 5 September decision on peace clause issues, to comment on any new information, documents, or arguments presented by the United States.

The inability or unwillingness of the United States to provide complete answers should not prejudice Brazil. The United States now has the benefit of Brazil's complete answers together with extensive additional documentation to comment on in its rebuttal submission. This is particularly true with respect to issues related to export credit guarantees and issues related to Professor Sumner's analysis. Brazil is entitled the same right.

Brazil requests that it be provided until 28 August to file any such comments. In light of the fact that Brazil provided complete answers to the Panel's questions, there is no basis for the Panel to provide the United States with any corresponding right. Its due process rights have not been adversely impacted.

# ANNEX K-11

## LETTER FROM THE UNITED STATES

20 August 2003

The United States has received a copy of the letter to the Panel from Brazil of 14 August 2003. We have also received your communication of yesterday, responding to Brazil's requests for additional time to submit its rebuttal. The United States does wish to record its views on Brazil's letter, and my authorities have therefore instructed me to convey their surprise that Brazil would send such a letter and their regret over any burden that it may have placed on the Panel in what is already a very difficult and complicated dispute.

The United States would first like to thank the Panel for agreeing to extend the deadline for the responses to the Panel's questions. The United States appreciates the depth and level of understanding of the issues represented by the Panel's extensive and broad-ranging questions. Without an extension of the deadline, it would have been completely impossible for the United States to have provided responses in a timely manner. Even with the extension, the drafting, compiling, consulting internally with the various relevant officials, and finalizing the responses all required supreme effort and personal sacrifice on the part of the entire US delegation. The United States did provide responses by the August 11 deadline, although it was not possible to accommodate the 5:30 pm filing guideline despite the best efforts of the United States to do so.[1]

The same burden was not placed on Brazil and the outside legal counsel that Brazil has employed for this dispute. As a result, it is not surprising that Brazil found the deadline to be less demanding and resource-intensive. We would note that, if one only counts the main questions and not any of the subquestions, there were 104 questions posed to the United States, but only 63 posed to Brazil.[2] With all respect, the United States has considerable difficulty with Brazil's complaints about the time within which the United States filed its response in light of the total amount of work required, and effort that the United States expended, to provide its answers to the Panel's questions.[3]

The United States also could not understand how Brazil could ask for an additional opportunity to respond to new material in the rebuttal submissions while at the same time asking that the Panel deny any such opportunity to the United States. (After all, one would expect that Brazil will

[1] On the one hand, the United States is flattered that Brazil credits the United States with the ability to finalize its own responses while simultaneously reviewing Brazil's responses filed earlier in the evening. On the other hand, the United States is, to say the least, taken aback that Brazil would suggest that the United States would do so. In any event, the press of finalizing the US responses completely consumed the US delegation and no one was able to spare time to look at Brazil's responses at any point that day, let alone before the US responses were filed.

[2] The difference in the number of questions for each party means that Brazil had nearly 6-1/2 hours to prepare its responses to each question posed to it, whereas the United States had less than four hours per question. (Counting the subquestions would increase the disparity since a preliminary check indicates that there were more subquestions for the United States than for Brazil.) As a result, Brazil had approximately 65 percent more time to prepare its responses. Had the United States taken the same amount of time as Brazil to prepare each response, its responses would have taken 28 days to file (they would have been finished on August 22).

[3] The United States also failed to understand the reference in Brazil's letter to Brazil's "good faith and cooperation" in extending the deadline by seven days. In fact, Brazil did not "cooperate" in the Panel's decision to grant a seven-day extension. Brazil instead objected to any extension beyond three days.

also provide new material in its rebuttal submission on topics covered in the Panel's questions, and not just repeat material it has already submitted.) Such a one-sided approach would not have achieved the "procedural fairness" that Brazil has said it seeks. In this connection, the United States considers that the approach taken by the Panel in its communication yesterday achieves a fair balance of the parties' interests.

In conclusion, the United States would like to thank the Panel for the approach it has taken on Brazil's request, as well as for its work to date on the many issues presented by this dispute. The United States is also providing a copy of this letter directly to Brazil.

# ANNEX K-12

## LETTER FROM BRAZIL

23 August 2003

The Government of Brazil is in receipt of the Communication from the Panel dated 19 August 2003. Brazil only received this morning the *Rebuttal Submission of the United States of America*, dated 22 August 2003 ("US Rebuttal Submission"). Brazil notes that consistent with all of its earlier written submissions, the United States filed its Rebuttal Submission 6 hours late. This delay has prejudiced Brazil and prevented it from providing comments responsive to the Panel's 19 August 2003 letter until today. Brazil notes that the United States received its copy of Brazil's Rebuttal Submission, along with Brazil's Comments to the US Answers, consistent with the 5:30 p.m. deadline established in the Panel's Working Procedures.

In accordance with your communication of 19 August 2003, Brazil has reviewed the US Rebuttal Submission to determine "whether there is any specific material on which it has not had an opportunity to comment", and which it would like to address in a 27 August submission. Brazil identifies below the specific US arguments, data and documents on which it would like to comment. Brazil also shows below good cause why it should be granted the opportunity to address each specific argument, data and document.

Brazil recalls that its original 14 August 2003 request to the Panel to afford it this opportunity was triggered by explicit indications by the United States, in its 11 August responses to Panel questions, that it was not providing full responses to the Panel's questions and would instead address a number of issues for the first time in its Rebuttal Submission. Brazil argued that it would be prejudiced by this conduct. The list below is consistent with the spirit of Brazil's 14 August request. Brazil's list only includes specific issues that should have been but were not addressed in the United States' 11 August responses, or specific issues related to new documents relied on by the United States for the first time in its Rebuttal Submission.

There are a number of new arguments or re-packaging of earlier arguments presented by the United States in its Rebuttal Submission. Most of these arguments do not require a further response, since Brazil's various earlier submissions and exhibits addressed or anticipated the new or re-packaged US arguments or issues raised by those arguments. In this regard, Brazil notes that the United States' Rebuttal Submission does not respond to a number of arguments made in earlier submissions by Brazil. Brazil would object to any opportunity given to the United States to provide such a response in its 27 August submission. Brazil is of the view that the purpose of this exercise is not to provide the Parties with a whole-scale opportunity to rebut every point raised in either the United States' or Brazil's Rebuttal Submissions. The Panel should limit the United States to comments on specific issues that should have been but were not addressed in Brazil's 11 August responses, or specific issues related to new documents relied on by Brazil for the first time in its Rebuttal Submission.

Should the Panel grant the United States an opportunity to comment on issues beyond this narrow scope, Brazil reserves its right to revisit the list of material it includes in the list below.

In accordance with the above understanding, Brazil requests leave to comment on the following specific material:

**Domestic Support Issues**

Para. 43

*Subject:* US argument regarding the growing of illegal crops, etc.

*Good cause*: This is a new argument that should have been but was not raised in the United States' 11 August response to questions 25 and 26 from the Panel.

Paras. 96-98

*Subject*: US argument regarding crop insurance notifications of other Members.

*Good cause*: This is a new argument referring to new WTO documents not raised in earlier submissions.

Paras. 114-117

*Subject*: US argument regarding a price gap methodology for marketing loans.

*Good cause:* This is a new argument that should have been but was not raised in the United States' 11 August response to question 67 from the Panel, and that is directly contradictory to information provided by the United States in paragraphs 128-134 of that response.

Paras. 123-127 and Exhibit US-24

*Subject*: US new challenge to Professor Dan Sumner's analysis.

*Good cause*: This is a new argument and exhibit that should have been but was not provided in the United States' 11 August response to question 61(d) from the Panel.

Export Credit Guarantee Issues

Paras. 135-146 and Exhibits US-25 through US-29

*Subject:* New US arguments concerning the negotiating history of Article 10.2 AoA.

*Good cause:* These arguments should have been but were not raised in the United States' 11 August response to questions 88(a) and 88(b) from the Panel.

Paras. 147-152

*Subject:* New US argument that had it intended to subject export credit guarantees to the AoA and the SCM Agreement, it would have included them in the calculation of its reduction commitments.

*Good cause:* This argument should have been but was not raised in the United States' 11 August response to questions 88(a) and 88(b) from the Panel.

Paras. 156-157, 160-162, and Exhibits US-31 and US-32

*Subject:* New US arguments and data concerning the FCRA formula and the reestimate process.

*Good cause:* These arguments and data should have been but were not raised in the United States' 11 August response to questions 81(d)-(g) from the Panel.

Para. 169 and Exhibit US-33

*Subject:* New US assertion that rescheduled debt is not in arrears.

*Good cause:* This argument and evidence should have been but was not raised in the United States' 11 August response to question 81(a) from the Panel.

Paras. 172, 174-175:

*Subject:* US argument that item (j) does not require recovery of long-term losses.

*Good cause:* This argument should have been but was not raised in response to the United States' 11 August responses to questions 74 and 77 from the Panel.

Paras. 186-191, and Exhibits US-34 through US-37

*Subject:* US argument that "forfaiting" is analogous to CCC export credit guarantee programs for agricultural commodities.

*Good cause:* This argument should have been but was not raised in the United States' 11 August response to question 76 from the Panel (as well as questions 71(a) and 73).

Brazil notes that the United States has for the first time addressed Brazil's "threat of circumvention" claims under Article 10.1 AoA (paras. 180-183). In particular, Brazil notes new US arguments contrasting CCC guarantee programs from FSC (and the panel and Appellate Body decisions concerning the *United States – FSC* dispute), asserting that there is no legal entitlement to CCC guarantees, and asserting (*via* new data) compliance with scheduled quantitative reduction commitments. Consistent with the purpose of this exercise – offering an opportunity to comment solely on arguments that should have been addressed in the United States' 11 August responses to questions and to new documents proffered by the United States for the first time in its Rebuttal Submission – Brazil is not asking for an opportunity to address the US "circumvention" arguments in its 27 August submission. Brazil would be pleased, however, to address any questions the Panel has concerning these new US arguments.

Brazil thanks the Panel and the Secretariat for its consideration of this request and for its continuing work on this dispute.

# ANNEX K-13

## LETTER FROM THE UNITED STATES

25 August 2003

In the Panel's fax dated 19 August 2003, the Panel noted the possibility that a party might lack sufficient opportunity to comment on information, argumentation and documents submitted by the other party in its rebuttal submission, and the Panel invited the parties to request the opportunity to comment on specific material after receiving each other's rebuttal submissions. My authorities have instructed me to submit this letter requesting such an opportunity.

Because of Brazil's tactical decision to defer presenting its entire case with respect to Peace Clause issues, the United States is once again put in the difficult position of attempting to respond to extensive, wholly new evidence and arguments in an extremely compressed time frame. Furthermore, we note the comment of Brazil in its rebuttal submission that it "provides *additional evidence* establishing that under *a variety of interpretations and methodologies* the US level of support granted to upland cotton in MY 1999-2002 was far greater than the support decided in MY 1992".[1]

Under paragraph 13 of the Panel's working procedures, all evidence was supposed to have been submitted no later than during the first substantive meeting, except evidence necessary for purposes of rebuttals or answers to questions. Brazil has not explained why it could not have presented this evidence by the first Panel meeting or why this evidence is necessary for purposes of rebuttal. A quick review of the "additional evidence" appears to indicate that this is all evidence that should have been presented no later than the meeting with the Panel. Accordingly, unless Brazil can show "good cause" for withholding this evidence from the Panel and the parties until now, the United States would respectfully request the Panel to disregard this evidence.

In light of the shortness of time, the United States requests the opportunity to comment with respect to a number of issues raised for the first time in Brazil's rebuttal submission and comments on answers to questions, as listed below. With respect to each such issue, the United States demonstrates that there is good cause to permit such comments. The United States is requesting the opportunity to comment (even though some of this evidence may be disregarded by the Panel in response to the US request) so as to avoid further delay, pending the Panel's finding in response to the request to disregard the evidence.

Rebuttal Submission:

Paras. 4-9: Brazil for the first time responds to the US argument, made in both its opening and closing oral statements at the first panel meeting, that Brazil's interpretation of paragraph 6(b) would create an inconsistency between that provision and the fundamental requirement of the first

[1] Rebuttal Submission of Brazil, para. 1 (22 August 2003) (emphasis added). We also note that Brazil had indicated in its answers to the Panel's questions that it was deferring presenting its case on several issues pending receipt of the answers to the questions by the United States and in at least one instance by the European Communities (see *e.g.*, paragraph 80 of Brazil's answers to the Panel questions). Brazil's rebuttal submission for the first time now presents this material.

sentence of Annex 2, paragraph 1. This is a new argument not previously made to the Panel, for example, in either of Brazil's oral statements or in its answers to questions from the Panel.[2]

Paras. 24-26: On the basis of a previously submitted exhibit, Brazil now advances for the first time the argument that production flexibility contract payments may be considered "support to upland cotton" on the basis that such payments were not made "in favour of agricultural producers in general" because payments were linked to acres that produced any of seven crops during a fixed and defined base period.[3] This argument could have been made in Brazil's first submission, either of Brazil's oral statements, or in Brazil's answers to questions from the Panel.[4]

Paras. 29-35: In these paragraphs, Brazil for the first time advances an argument for market loss assistance payments that parallels the argument made for the first time in paragraphs 24-26 with respect to production flexibility contract payments: that market loss assistance payments may be considered "support to upland cotton" on the basis that such payments were not made "in favour of agricultural producers in general" because payments were linked to acres that produced any of seven crops during a fixed and defined base period. In addition, Brazil introduces a raft of assertions, new data, and calculations, including some with respect to crops other than upland cotton, to assert that production flexibility contract payments and market loss assistance payments are support for upland cotton because of costs for upland cotton farmers.[5] Brazil could have presented these data, calculations, and arguments in its previous submissions and statements.

Paras. 36-46: As with production flexibility contract payments and market loss assistance payments, Brazil argues (again for the first time) that direct payments may be considered "support to upland cotton" on the basis that such payments were not made in favor of all agricultural producers, and Brazil introduces a raft of assertions, new data, and calculations, including some with respect to crops other than upland cotton, to assert that direct payments are support for upland cotton because of costs for upland cotton farmers.[6] Brazil could have presented these data, calculations, and arguments in its previous submissions and statements.

Paras. 48-50: Brazil makes a nearly identical argument for counter-cyclical payments as for those indicated above: that is, these payments may be considered "support to upland cotton" on the basis that such payments were not made "in favour of agricultural producers in general" and on the basis of the same or similar assertions, new data, and calculations with respect to costs and subsidies for upland cotton and other crops.[7] Brazil could have presented these data, calculations, and arguments in its previous submissions and statements.

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[2] *See, e.g.*, Brazil's Answer to Question 27 from the Panel (para. 39 failed to make any such argument in the course of the answer alleging that US decoupled income support has more than a minimal effect on production (and thus is inconsistent with the fundamental requirement of the first sentence of Annex 2, paragraph 1) because such support "limit[s] payments based on the type of production").

[3] Indeed, none of the citations provided by Brazil in these paragraphs discloses the argument Brazil now advances. *See* Brazil 's Rebuttal Submission, paras. 24-35 fn. 38-44.

[4] *See* Brazil's Answer to Question 23 from the Panel (paras. 25, 27: noting base acreage and addition of crops to base acreage under direct payments program but failing to argue that limitations on base acreage render measure product-specific).

[5] *See, e.g.*, Brazil's Rebuttal Submission, para. 31 fn. 68, 69 (both of these footnotes contain new evidence that should have been presented by the first Panel meeting); *id.*, para. 33 fn. 71 (disclosing new calculation).

[6] *See, e.g.*, Brazil's Rebuttal Submission, para. 39 fn. 84 (this footnote contains new evidence that should have been presented by the first Panel meeting), 85.

[7] *See, e.g.*, Brazil's Rebuttal Submission, para. 50 fn. 112, 113, 114 (all of this is new evidence that should have been presented by the first Panel meeting).

Paras. 55-59: With respect to crop insurance payments, Brazil introduces new evidence (for example, relating to availability of specific policies) and arguments to claim that these payments are product-specific support to cotton.[8] Brazil could have presented this evidence and argument in its previous submissions and statements.

Paras. 73, 75-77: Brazil introduces revised data and calculations relating to alleged budgetary expenditures for upland cotton and an AMS for upland cotton.[9]

Paras. 88, 90-94: Brazil misstates the US position with respect to the Peace Clause analysis for support provided in past marketing years. Brazil also asserts, erroneously, the US Peace Clause interpretation is inconsistent with the position taken by the United States in previous WTO dispute settlement proceedings. These arguments could have been presented by Brazil earlier -- for instance, during its first oral statement to the Panel[10] or in its answers to the Panel's questions.[11]

Brazil's Comments on U.S. Answers

Paras. 44-45: Brazil for the first time presents an argument claiming that the US interpretation of paragraph 6(b), made in both its opening and closing oral statements at the first panel meeting, would render paragraph 6(e) a nullity. These arguments could have been presented in Brazil's answers to the Panel's questions. (*See also* paragraphs 4-9 of Brazil's Rebuttal Submission, discussed above.)

Paras. 54-56: In the guise of a "general comment" to questions 47-69, Brazil asserts for the first time that the US argument relating to the level of support decided by US measures does not account for various forms of product-specific support. This erroneous assertion could have been presented as early as Brazil's oral statements at the first panel meeting or in its answers to the Panel's questions.

The United States thanks the Panel for its consideration of these requests. In addition, like Brazil, we would of course also welcome the opportunity to respond to any further questions the Panel may have. Moreover, should the Panel consider it useful to hear further argumentation from the Parties, we would of course be pleased to make additional submissions or appear before the Panel on this complicated and sensitive matter.

The United States is providing a copy of this letter directly to Brazil.

[8] *See, e.g.*, Brazil's Rebuttal Submission, para. 56 fn. 131, 132.
[9] *See, e.g.*, para. 73 fn. 172.
[10] *See, e.g.*, Brazil's Oral Statement at First Panel Meeting, paras. 40-43.
[11] *See, e.g.*, Brazil's Answer to Question 15 from the Panel.

# ANNEX K-14

## LETTER FROM BRAZIL

25 August 2003

The Government of Brazil is in receipt of a letter from the United States dated 25 August. Brazil received that letter at 6 p.m. today. Brazil requests the Panel to take the following action as set forth below.

*Rejection of US request as untimely:*

Brazil requests that the Panel disregard the United States' request to have the Panel grant it permission to offer rebuttal arguments to Brazil's 22 August rebuttal submission and comments on the US answers. This letter, like *all* prior US submissions to the Panel, was not timely filed. This latest request was made at least 60 hours too late. The Panel's Communication of 19 August 2003 stated:

> when each party receives the other party's rebuttal submission, it is invited, *without delay* to draw the Panel's attention to any specific material on which it has not had an opportunity to comment . . . ."

The Communication further stated that "the Panel is willing to grant such permission on Saturday, 23 August 2003, if necessary."

Brazil interpreted this Communication as requiring it to make the request on Friday evening, 22 August, immediately after reviewing the US Rebuttal Submission. Unfortunately, the US Rebuttal Submission was sent shortly before midnight on Friday, 22 August and could only be accessed by the Brazilian Mission in Geneva at 9:00 a.m. Geneva time on Saturday, 23 August. Brazil informed the Secretariat on Friday evening that it could not make its request that evening since it had not received the US Rebuttal Submission. Brazil further informed the Secretariat on Saturday morning that it would file a request by 2:00 p.m. on Saturday.

By contrast, the United States received Brazil's 22 August Rebuttal Submission and Brazil's 22 August Comments to the US Answers and Brazil's exhibits at 5:30 p.m. Geneva time on Friday, 22 August. Regardless, the United States waited more than 72 hours to file its request that the Panel strike certain information in Brazil's 22 August submissions, and its request for leave to file comments on those Brazilian submissions.

Brazil has endured repeated violations by the United States of the Panel's procedural deadlines over the past three months. If the Panel's procedures are to mean anything, they must be enforced. There is no doubt that this latest request by the United States is well out of time. It was not made "without delay". There is no basis offered by the United States for such delay. There is none. Accordingly, the Panel should reject the United States request as untimely.

*Reject US Request to Strike Brazil's Rebuttal Evidence and Argument*

The United States also requests the Panel to strike large amounts of Brazil's Rebuttal Submission and Brazil's documents with the argument that Brazil allegedly violated paragraph 13 of the Panel's working procedures. Brazil notes the irony of the United States invoking the Panel's

working procedures given their repeated violations of such procedures over the past three months. Nevertheless, the United States ignores the Panel's Determination of 20 June, in which it stated, in paragraph 20, last bullet:

> For the purposes of allowing the Panel to express its views on the exemption conditions of Article 13 of the *Agreement on Agriculture* by 1 September 2003, in relation to those measures which may be affected by Article 13, *full and complete submissions on factual and legal issues related to Article 13 in this dispute will need to be provided, at the latest, in the parties' rebuttal submissions (to be submitted on 22 August 2003).*

Brazil interpreted this ruling as permitting it to provide no later than 22 August all of its evidence and argument that had not already been provided in its earlier submissions. This is the manner in which it treated the new evidence and arguments presented by the United States in its Rebuttal Submissions. Therefore, Brazil did not, in its 23 August letter to the Panel, seek to "strike" new US evidence included in the US 22 August Rebuttal Submission, but simply asked to be provided with an opportunity to respond to that evidence.

Therefore, there is no basis for the US request.

*Response to US requests to comment on Brazil's 22 August Submissions*

The United States complains at several points in its letter that Brazil is presenting for the first time, in its 22 August Rebuttal Submission, responses to US arguments made in the US opening and closing oral statements at the first panel meeting. Unless particular questions from the Panel offered Brazil the opportunity to respond to arguments made by the United States in the US statements at the first panel meeting, however, Brazil's first opportunity to respond to the US arguments was in Brazil's 22 August Rebuttal Submission.

Brazil has listed below its comments to the requests by the United States:

Brazil's 22 August Rebuttal Submission

Paragraphs 4-9:

These arguments were made by Brazil in rebuttal of US and EC arguments advanced in their first submissions, oral statements and answers to questions, or reflect summaries of earlier arguments made by Brazil. The Panel should, therefore, reject the US request to comment on them.

Paragraphs 24-26:

This evidence and arguments are based on exhibits presented previously and rebut US arguments that PFC payments do not constitute support to upland cotton. Contrary to the US assertion, there is no question by the Panel to which this evidence and arguments would be responsive. Therefore, the US request should be rejected.

Paragraphs 29-35:

This evidence was presented by Brazil in rebuttal to US arguments that market loss assistance payments do not constitute support to upland cotton. The US does not assert that there would have been a question by the Panel to which this evidence and arguments would be responsive. Therefore, the US request should be rejected.

Paragraphs 36-46:

This evidence was presented by Brazil in rebuttal to US arguments that direct payments do not constitute support to upland cotton. The US does not assert that there would have been a question by the Panel to which this evidence and arguments would be responsive. Therefore, the US request should be rejected.

Paragraphs 48-50:

This evidence was presented by Brazil in rebuttal to US arguments that counter-cyclical payments do not constitute support to upland cotton. The US does not assert that there would have been a question by the Panel to which this evidence and arguments would be responsive. Therefore, the US request should be rejected.

Paragraphs 55-59:

This evidence was presented by Brazil in rebuttal to US arguments that crop insurance payments do not constitute support to upland cotton. The US does not assert that there would have been a question by the Panel to which this evidence and arguments would be responsive. Therefore, the US request should be rejected.

Brazil's 22 August Comments on US Answers

Paragraphs 44-45:

These arguments were made in rebuttal of US arguments that the restrictions on planting flexibility contained in the US PFC and direct payment programmes are consistent with Annex 2, paragraph 6. Therefore, the US request should be rejected.

Paragraphs 54-56:

These arguments are a direct reaction and comment to new information provided by the United States in response to Question 67. It is entirely appropriate to react to this information and include it in the peace clause calculation. Therefore, the US request should be rejected.

Brazil would like once more to thank the Panel for the consideration of these requests.

# ANNEX K-15

## LETTER FROM THE UNITED STATES

27 August 2003

Attached please find the US comments on new material in Brazil's rebuttal filings and answer to the additional question from the Panel in the dispute, *United States – Subsidies on Upland Cotton* (DS267). The United States wishes to take this opportunity to thank the Panel for its rapid consideration of, and response to, the US request to file these comments.

In Brazil's letter to the Panel of 14 August 2003, Brazil raises the concern that "basic notions of due process" require providing parties the opportunity to comment on new material. Brazil's concern and the exchanges with the Panel and the parties over the days since that letter have highlighted a particular aspect of the unique proceedings in this panel process. As a result, my authorities have instructed me to draw another matter to the Panel's attention. The United States notes that the Panel intends to express its views on the issue of the Peace Clause by 5 September 2003. No prior panel nor the Appellate Body has made findings on the Peace Clause. The submissions and material provided to the Panel to date have demonstrated that the issues involved in the Panel's findings on the Peace Clause are fact-intensive, complex and sensitive.

While prior panels have made preliminary rulings on procedural issues, no prior panel has been confronted with the situation presented in this dispute. Here, the Panel will be making substantive findings on key provisions of the covered agreements. In this connection, the United States takes note of the Panel's observation that the fairness of panel proceedings may require ensuring that the parties receive sufficient opportunity to comment on new material.[1] The United States also takes note of the provisions of paragraph 2 of Article 15 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* in which Members have agreed that parties should have an opportunity to comment on a panel's findings before they are final.

In this dispute, the Panel's findings on the Peace Clause are presumably intended to be dispositive of substantive claims and arguments of the parties for the remainder of the panel proceedings. Because of the substantive nature of those findings, the Panel's findings on 5 September will need to provide the factual basis and basic rationale underlying the findings. Both parties have a significant interest in those findings, in terms not just of the ultimate conclusion reached, but also in terms of the factual findings, rationale underlying those findings, and an understanding of the scope of those findings.[2] Accordingly, in keeping with Article 15.2 of the DSU, and in order to be fair to both parties, the United States respectfully requests that the Panel provide Brazil and the United States with the Panel's 5 September Peace Clause findings in an interim form and provide the parties an opportunity to comment on the Panel's findings.[3] The United States suggests that, in keeping with the

[1] In the Panel's letter of 19 August 2003.

[2] Recent experience in the DSU with panel preliminary rulings has demonstrated the significant effect they can have on the parties and the course of the panel proceedings.

[3] The United States assumes that the Panel will also include its findings on the Peace Clause in its interim report issued towards the end of the panel proceedings. However, at that point the findings would have already determined the course of the remainder of the panel proceedings and it would be too late for either party to provide comments in a timely manner that would help ensure the accuracy of the facts on which the findings were based or to facilitate a clear understanding of the legal basis for those findings. Accordingly, the opportunity to comment at that stage would be inadequate to preserve the rights of both parties and could

practice in other panel proceedings and this Panel's timetable for the interim review in this dispute, two weeks should be sufficient time to comment.

The United States would be happy to provide further elaboration or to respond to any questions the Panel may have with respect to this request.

The United States is providing a copy of this submission directly to Brazil.

instead prejudice those rights. For the same reason, it could be perceived as circumventing the provisions of Article 15.2 of the DSU to issue substantive findings on the claims made (and that have effect on the parties) without an opportunity for the parties to comment prior to the findings having an effect.

# ANNEX K-16

## LETTER FROM BRAZIL

28 August 2003

The Government of Brazil is in receipt of a letter from the United States dated 27 August. Brazil notes that the US Comments to Brazil's 22 August Rebuttal Submission were filed five hours *after* the deadline of 5:30 p.m. In the covering letter to those Comments, the United States requests that the Panel provide the Parties with an opportunity to comment on an interim form of the Panel's 5 September rulings regarding peace clause-related issues.

Brazil opposes this request for the reasons stated below.

The Panel's ruling of 20 June 2003 revising the timetable for this dispute did so in order to "organize [its] proceedings in an orderly, effective and efficient manner". This 20 June 2003 decision, in the view of Brazil, addressed the concerns of Brazil that the extra briefing and meeting proposed by the United States on peace clause issues would not result in an overly lengthy delay of the resolution of Brazil's serious prejudice claims. To that end, the Panel established the date of September 1 for the Panel's decision and September 4 for Brazil to file its "Further Submission." Those dates were later extended to September 5 and 9 respectively pursuant to a 30 July Panel decision to accommodate a request of the United States for additional time to answer the Panel's questions.

Brazil is ready to file its Further Submission no later than 5:30 p.m. on 9 September. Establishing an unprecedented "interim review" for the peace clause preliminary finding will unquestionably delay Brazil's filing of its Further Submission and the Second meeting of the Panel scheduled for 7-9 October. This request will upset the balance created by the Panel's 20 June proceeding and negatively impact Brazil's rights to a speedy resolution of this dispute pursuant to DSU Article 3.3. The Panel was established more than five months ago and Brazil has yet to file its first submission on many of its claims.

Brazil notes further that DSU Article 15.2 provides an opportunity for the parties to request the panel to review "precise aspects of the interim report prior to the circulation of the final report to the Members". This actual text is contrary to the US statement that Article 15.2 provides Members "an opportunity to comment on a panel's finding before they are final". The parties' rights under Article 15.2 are explicitly recognized and preserved by paragraph 16 of the Panel's Working Procedures.

The US letter argues that the Panel must set forth its complete and full reasoning and factual findings in its 5 September decision. Brazil notes that paragraph 20 of the Panel's 20 June Decision stated that it would "express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the Agreement on Agriculture" and would "express its views in the form of ruling...". Brazil does not and would not presume or suggest what form the Panel's "ruling" will or should take. However, it is within the Panel's discretion, as with many previous panels, to provide the basic rulings on the preliminary issue and then to further elaborate such rulings in the final determination.

As the United States recognizes, there will be an opportunity for the parties to comment on the interim report that the Panel will issue following the second meeting of the Panel with the Parties.

Brazil believes that its procedural rights will be fully protected by the existing procedural safeguards provided by the interim review process. The United States has provided no legitimate reasons why its rights would not also be protected. Both parties will have an equal opportunity to comment on any decision by the Panel regarding the peace clause at that time.

In sum, Brazil requests that the Panel reject the United States request to establish an interim review process to the Panel's 5 September ruling.

# ANNEX K-17

## LETTER FROM THE UNITED STATES

29 August 2003

By letter of 28 August 2003 Brazil objects to the US request in the dispute *United States – Subsidies on Upland Cotton* (DS267) that the Panel provide Brazil and the United States with the Panel's September 5 Peace Clause findings in an interim form and provide the parties an opportunity to comment on the Panel's findings. My authorities have instructed me to submit this response to Brazil's letter.

The United States has reviewed carefully the concerns raised by Brazil in its letter. Brazil's objection appears solely to be based on the concern that granting this request would mean that the parties would have time to review and provide comments to assist the Panel in finalizing the Panel's findings on this key element of the dispute. Brazil expresses concern that the time for comment may result in some shifting of the schedule for the remainder of the dispute.[1]

Brazil acknowledges that the parties have the right under the DSU to comment on the Panel's Peace Clause findings before they are made final. The only apparent concern for Brazil is when that right to comment can be exercised. For Brazil, the comments should only be provided when they are too late to be effective. According to Brazil's approach, while it is to be expected that the Panel could alter any part of its findings in response to a party's comments, that alteration would come after the Panel's proceedings had already taken place on the basis of the preliminary findings. Any alteration would be unable to affect the past proceedings. The United States is unable to understand how this could possibly mean, as Brazil asserts, that a party's "procedural rights will be fully protected by the existing procedural safeguards provided by the interim review process".

Brazil would compound the problem by suggesting that findings on key substantive claims may be made in just a basic form, with none of the underlying factual basis or legal reasoning. Brazil asserts that would be in keeping "with many previous panels". Brazil's assertion has no foundation. No previous panel has ever been in the current situation, nor has any previous panel made findings part-way through a dispute on the Peace Clause or on any substantive issue, let alone one as factually complex with so many legal questions of first impression. The Panel's situation is unprecedented, thus it is no surprise that there are no precedents on which to draw. However, there *is* the text of the DSU on which to draw. As the United States explained in its 27 August 2003, letter, Article 15.2 of the DSU provides the parties with a right to comment on findings in an interim form. Brazil argues for an approach that would render that right largely hollow.

The United States has difficulty perceiving the basis for Brazil's objections. As the United States has argued, Brazil is barred by virtue of the Peace Clause from pursuing most of its claims in this dispute. It is strange then that Brazil would not want an opportunity to comment on any finding as to whether the Panel should hear evidence and argument on Brazil's claims.

[1] However, granting the request would not appear necessarily to mean any change in the date of circulation of the Panel's final report.

Brazil has failed to present a basis for denying the parties a timely and effective opportunity to exercise their right to comment on the Panel's findings. Accordingly, the United States respectfully renews its request that the Panel provide Brazil and the United States with the Panel's September 5 Peace Clause findings in an interim form and provide the parties an opportunity to comment on the Panel's findings.

The United States is providing a copy of this submission directly to Brazil.

# ANNEX K-18

## LETTER FROM BRAZIL

29 August 2003

The Government of Brazil is in receipt of a letter from the United States dated 29 August responding to Brazil's letter of 28 August. Brazil regrets the US continuation of the debate over its unprecedented "interim review" proposal that distracts the Panel and Brazil from substantive work on this dispute. In response, Brazil refers to the arguments set forth in its letter of 28 August that provides the Panel with the basis to reject the US request for a special interim review procedure.

Brazil notes that the United States does not deny that the proposed new interim procedure would result in additional delay. This is apparently not a concern to the United States. But it is a concern to Brazil. The United States ignores the balance in the Panel's June 20 decision that struck the balance protecting Brazil's rights under Article 3.3 of the DSU.

Reviewing the Panel's decision in the Article 15.2 existing procedures will not, as the United States claims, render the parties rights "largely hollow." The practical purpose of the interim review exercise under Article 15.2 is for parties to point out any particular errors of fact or citations that the Panel may wish to correct in the final report. Thus, the "timely and effective right to comment on the Panel's finding" can be accomplished in this case -- as Brazil suggests -- through the use of the normal Article 15.2 procedures in the normal timeframe for making such comments.

# ANNEX K-19

## LETTER FROM BRAZIL
## COMMENTS RE REVISED TIMETABLE

9 September 2003

1. Brazil welcomes the invitation to comment on the draft further revised timetable, as attached to the Panel's communication of 5 September 2003. In this respect, Brazil recognizes that the Panel must be given all the time necessary to make the best and most objective examination of the matter before it in order to provide the Parties to the dispute with a report founded on a sound legal basis and an accurate scrutiny of the facts. Nonetheless, the proposed date for the second substantive meeting with the Parties poses a difficulty for Brazil given commitments previously scheduled by members of the legal team according to the earlier adopted timetables. Indeed, the Brazilian team would face serious difficulties to participate in meetings in Geneva from 12 to 19 November 2003.

2. Brazil would further recall that any adjustments to the draft further revised timetable should take into account the time limits established in DSU Articles 12.8 and 12.9.

3. That said, Brazil would kindly request the Panel to examine the possibility of modifying the date for the second substantive meeting with the Parties. The subsequent deadlines would be adjusted accordingly.

# ANNEX K-20

## LETTER FROM THE UNITED STATES
## COMMENTS RE REVISED TIMETABLE

9 September 2003

In the Panel's communication of 5 September 2003, the Panel invited the parties to comment on the draft further revised timetable attached to the communication. My authorities have instructed me to submit the following comments on the draft timetable and, in addition, to request that the further submission of the United States be due on 2 October rather than 23 September.

With respect to the draft timetable, the United States notes that the Panel provides separately for comments on answers to questions, due on 27 October, one week after the rebuttal submissions and answers to questions. The United States appreciates the value of an opportunity for the parties to comment on each others' answers to questions. However, in this case that opportunity comes at the cost of adequate time to prepare the rebuttal submissions and answers to questions themselves. Given the number and complexity of issues in this dispute, and the opportunity available at the second substantive meeting for parties to comment on each other's submissions[1] and responses, it would be best to dispense with the 27 October comments, and instead have 30 October – three weeks after 9 October – as the due date for rebuttal submissions and answers to questions. The first substantive meeting may finish as late as 9 October, leaving less than two weeks for rebuttals and answers to questions[2] if they are due on 22 October. The United States notes that DSU Appendix 3 provides as a guideline for 2-3 weeks between the first substantive meeting and rebuttal submissions. Given the scope and scale of argumentation that has prevailed to date, and that is likely to continue, the United States believes that at least the three week guideline provided for in Appendix 3 is necessary for the parties to have adequate time to prepare their rebuttal submissions and answers.

The United States also wishes to request that it have until 2 October to prepare its further submission. Brazil noted in its submission of 24 June 2003 that its submission due today would include "extensive evidence"[3], and we expect that it will also include extensive new argumentation. It is therefore likely to require significant effort and time for the preparation of a response. Brazil has had months to prepare this submission, which is a first written submission for purposes of this part of the proceedings. Appendix 3 provides for 2-3 weeks for a first submission of the party complained

[1] The United States notes as well that comments on rebuttal submissions could be of equal importance or value, and those will be presented at the Panel meeting.

[2] The United States assumes that the questions may be at least as comprehensive at this stage as they were in connection with the Peace Clause, and therefore require significant time and care to research, develop and consult on the answers to those questions.

[3] Brazil stated in paragraph 18 of its submission of 24 June 2003,

> **Consistent with the Panel's decision of 20 June decision, and because (1) Brazil's claim under GATT Article XVI:3 involves export subsidies conditionally exempt from action and (2) Brazil's actionable subsidy claims under ASCM Articles 5 and 6 involve domestic support and export subsidies conditionally exempt from action, Brazil will only present its extensive evidence in support of those claims in its "further submission".**

against[4], and the burdens imposed by this dispute clearly warrant at least a three-week response period.

Preparing the submission in three weeks would likely be extremely challenging under any circumstances. However, the timing for this submission involves unusual circumstances. Many of the US officials involved in this dispute are attending the Fifth Ministerial Conference in Cancun this week and are therefore unavailable to assist with preparation of the submission. At the same time, the head of the US litigation team in this dispute became a father three weeks ahead of schedule. As a result, he will have limited time over the next week (at least) to prepare the US response. For all of these reasons, the United States respectfully requests that its next submission be due no earlier than 2 October.[5]

[4] Indeed, in the DSU negotiations many Members have indicated that this is too short a period of time and that the timeframes suggested in Appendix 3 of the DSU for first submissions should be reversed between complaining parties and responding parties.

[5] The United States notes that the third party submissions could then be due on 6 October.

# ANNEX K-21

## LETTER FROM BRAZIL
## COMMENTS RE REVISED TIMETABLE

10 September 2003

Brazil is in receipt of a letter dated 9 September 2003 from the United States commenting on the proposed timetable and requesting to be able to file their Further Submission on 2 October.

Brazil opposes the US request that it be granted until 2 October to file its Further Submission for the reasons set out below:

First, the United States has been on notice of Brazil's claims and arguments on the adverse effects portion of this dispute for almost one year when Brazil filed its 27 September 2002 request for consultations (WT/DS 267/1). The Annex to this comprehensive consultation request set forth in detail arguments, facts, and evidence (mostly consisting of US Government documents) that were available to Brazil. The great majority of these arguments and evidence are now found in Brazil's Further Submission. If this information and the three sessions of the consultations discussing these issues were not enough, Brazil's First Submission at paragraphs 1-15 outlined in summary form many of the principle arguments (and evidence) supporting Brazil's adverse effects claims. All of these arguments are again repeated in Brazil's Further Submission. Paragraphs 26-106 of Brazil's First Submission also set out comprehensive facts upon which Brazil relies but not repeated in its Further Submission. Thus, in view of the transparency of Brazil's earlier submissions, the United States' claims concerning the alleged "complexity" of this dispute as justifying more time to prepare is somewhat disingenuous.

Second, Brazil and the Third Parties need sufficient time between the filing of the US Further Submission to prepare their oral statements for the second session of the First Meeting on 7-9 October. Providing the United States until 2 October to file its Further Submission will not provide the Panel, Brazil, or the third parties enough time to prepare for the hearing on 7-9 October. Given the previous practice of the United States to file its submissions six hours late (the equivalent of unilaterally granting itself an additional working day to file each submission, and of giving Brazil one less day to respond), the US request to file on 2 October probably means that Brazil will not be able to review the submission until 3 October.

Third, Brazil (and no doubt some of the third parties) has relied upon the long-standing date of 7-9 October for the resumed session of the First Meeting. Brazil notes that while the United States' letter does not ask to reschedule the date of the resumed Second Session of the First Substantive meeting, the effect of its request to file its Further Submission on 2 October does just that. Brazil strongly opposes any delay in the resumed session of the First Meeting. Brazil intends to present at least three witnesses at the resumed session - Professor Daniel Sumner, Andrew Macdonald, and an upland cotton producer from Brazil. Each of these individuals (as well as the Brazilian delegation travelling from Brasilia) have complicated schedules and they have for some time rearranged their schedules to attend the hearing on 7-9 October.

Fourth, the working procedures of the DSU provide for 2-3 weeks for the Party complained against to file its First Written Submission and 2-3 weeks for the Parties to file their Rebuttal submissions. The United States' request to file on 2 October is beyond that maximum amount of time.

However, in the spirit of compromise, and particularly in view of circumstances set out in the fourth sentence of the last full paragraph of the US letter, Brazil could agree to an extension of time *no later than* Thursday, 25 September 2003 at 5:30 p.m. *Geneva* time. In this regard, Brazil notes that both the United States and Brazil will have, under the revised timetable for Panel proceedings, numerous opportunities to brief the various issues in the adverse effects portion of this dispute and thus to fully articulate, expand, and clarify their arguments and supporting evidence.

The United States also requests that the parties be provided until 30 October to file their rebuttal submissions. Brazil has no objection to this request but believes it is important to keep the 22 October date for answering questions intact. Under Brazil's proposed procedure – which was used in the "peace clause" portion of the proceedings – the parties could use their Rebuttal Submissions as the vehicle for commenting on the Parties' answers to the questions.

# ANNEX K-22

## LETTER FROM THE UNITED STATES RE DRAFT REVISED TIMETABLE

11 September 2003

My authorities have instructed me to respond to Brazil's letter of 10 September 2003, objecting to the US request for an extension to file its Further Submission.

In this letter, Brazil suggests first that its request for consultations offered sufficient notice of Brazil's arguments that the United States does not now require sufficient time to respond to the Brazilian Further Submission – a submission so extensive that it had to be divided in two for electronic transmission, and which in addition included extensive economic annexes. According to Brazil, the consultation request and additional summaries of Brazil's arguments render the US reference to the complexity of the issues raised by Brazil "disingenuous."

Brazil appears to be making the implausible suggestions that it is possible to respond to arguments that have not yet been written, and that complex issues become less complex if summarized in advance. One need only note again the size of Brazil's submission to conclude that Brazil itself did not consider its previous summaries to adequately present its arguments; yet Brazil considers that those summaries should have provided a sufficient basis for the United States to prepare its response. It is a statement of the obvious that Brazil's 214-page Further Submission represents the first time Brazil has set forth its detailed arguments and evidence (including the lengthy economic analysis found in the annexes). It is this Brazilian submission, and not anticipatory summaries, to which the United States must have the ability to respond. Brazil's suggestion that the United States need not have adequate time to respond to Brazil's massive submission on the basis that Brazil's argumentation cannot, under the circumstances, be considered "complex," strains credulity.

Brazil also objects to the US extension request on the ground that Brazil and third parties need adequate time to prepare for the second session of the first panel meeting. As regards Brazil, this amounts to an argument that while one week is not enough time for it to prepare for the panel meeting, two weeks must be considered sufficient for the US to respond to Brazil's 214-page submission and economic annexes. Apparently, Brazil considers it fair that, after having had months to prepare its Further Submission, the amount of time for the US response (two weeks) should be no greater than that provided to Brazil to prepare for the first panel meeting. While the United States appreciates that the time for third-party submissions will be limited, this is frequently the case in disputes given party and panel schedules. Further, third parties are free to use the third-party session to elaborate on their written statements.

Brazil is correct when it notes that the United States has not asked the Panel to postpone the date of the first panel meeting. However, it errs when it says that the US request would require a change in the date of that meeting. To the contrary, the United States made its requests for modification of the timetable in consideration of the dates of the panel meetings and on the assumption that it might be difficult for the Panel to change that date in light of the panelists' differing schedules. Indeed, but for seeking to accommodate the panelists' schedules by retaining the meeting dates, the United States would have requested a longer response period appropriate to the argumentation and evidence Brazil has submitted.

At the same time, the United States notes that Brazil has asked the Panel to postpone the date of the second meeting. The United States has no objection in principle to this request, but would request that it be consulted on any new dates that might be possible in light of the panelists' schedules. Brazil is not the only one with "complicated schedules."

Brazil also notes that Appendix 3 provides *as a guideline* 2-3 weeks for a responding party's first submission, and states that the US request exceeds that period (by two days). Brazil ignores not only the fact that a panel is free to adjust these time frames, but that a panel is required to adjust these time frames. Article 12.4 of the DSU states that panels must "provide sufficient time for the parties to the dispute to prepare their submissions." Indeed, in the past several disputes in which the United States has been a *complaining* party, panels have on average provided five weeks for the *responding* party to prepare its first written submission, twice the average called for under the DSU.[1] Article 12.4 applies fully to this proceeding, and the time requested by the United States to prepare its submission is more than justified.

In light of the above, and now with confirmation that Brazil's Further Submission does in fact contain "extensive evidence" and "extensive new argumentation", as foreshadowed by the US letter of 9 September, 2003[2], the United States respectfully renews its request that the Panel provide it until 2 October 2003, to submit its Further Submission. We thank the Panel once again for its consideration of this and previous requests.

[1] Indeed, of the last 23 panels to which the United States has been a party, the single shortest time period for preparing a responding submission has been the 17 days provided in this proceeding, a marked contrast from the over 35 days provided to responding parties when the United States has been the complaining party.

[2] US letter of September 9, 2003, para. 3.

# ANNEX K-23

## LETTER FROM BRAZIL

16 September 2003

Brazil thanks the Panel for its "Proposed revision to timetable for Panel Proceedings" of 12 September 2003.

Brazil notices that the second hearing with the parties is scheduled for 2 and 3 December, receipt of answers to Panel's questions for 22 December and receipt of parties' comments on each other's answers for 19 January 2004. Brazil also appreciates that establishing the timetable with the parties, the panelists and the Secretariat requires considerable coordination.

In light of the several changes made to the original schedule and also of the length of time between the second hearing and the answers to questions from the Panel, Brazil would like to suggest that these answers be delivered on 15 December (instead of 22 December) and that the parties' comments on the answers be due on 22 December (instead of 19 January). This would allow for the completion of the parties' main substantive work still in 2003 (the next step would then be the comments on the descriptive part).

Furthermore, Brazil notices that Article 12.9 of the DSU establishes that "in no case should the period from the establishment of the panel to the circulation of the report to the Members exceed nine months". The new proposed timetable of the Panel foresees that circulation of the final report to the WTO Members will take place after 19 May, that is, more than 5 months in excess of the strict time limit set up in DSU Article 12.9. Therefore, Brazil would stress that any changes in the schedule should not postpone the conclusion of the proceedings.

# ANNEX K-24

## LETTER FROM THE UNITED STATES
## COMMENTS ON REVISED TIMETABLE

16 September 2003

The United States thanks the Panel for its invitation to comment on the draft further revised timetable attached to its communication of 12 September 2003. My authorities have instructed me to submit the following comments.

The new dates of December 2 and 3 for the second substantive meeting are acceptable to the United States. We note, however, that there is approximately one month between the receipt of the further rebuttals (currently due November 3) and the second substantive meeting. We believe that this one month would be better allocated for the parties to consider and draft responses to the Panel's questions and prepare their rebuttal submissions. Therefore, the United States proposes that the due date for receipt of answers to Panel's questions be changed to Friday, 31 October 2003, and that the due date for the rebuttal submissions be changed to Friday, 21 November 2003. This would leave approximately 10 days before the second Panel meeting (which would be within the DSU guideline of one to two weeks between rebuttal submissions and the second panel meeting).

There also remains some concern with the 3 p.m. deadline for filing the US further submission on 29 September. While we – as always – will try our best to accommodate this deadline, we note that the time difference between Geneva and Washington (opening of business time in Washington would be 3 p.m. Geneva time) may cause additional difficulties with respect to finalizing the US submission in capital. We nonetheless appreciate the Panel's understanding in this regard.

# ANNEX K-25

## LETTER FROM BRAZIL

17 September 2003

1. The Government of Brazil is in receipt of a letter from the United States dated 16 September commenting on the proposed further revised timetable attached to the Panel's communication of 12 September.

2. Brazil would like to express its opposition to the alterations suggested by the United States. In our view the dates proposed by the Panel on 12 September ensure the parties will have the appropriate amount of time to respond to the Panel's further questions and to elaborate their further rebuttal submissions. Brazil notes, in particular, that between the last day of the resumed second session of the first substantive meeting (9 October) and the deadline for delivering their further rebuttal submissions (3 November), parties will have almost 30 days to prepare such documents. This is more than the amount of time the United States requested on 9 September to elaborate its further submission (previously due on 22 September).

3. Therefore, Brazil submits that parties need not be granted any extension of deadlines as suggested by the United States. Nonetheless, were the Panel inclined to change the timetable to accommodate the US concerns, Brazil would reiterate that any modifications in the schedule should not result in further delays of the proceedings (whose current timetable already exceeds by more than five months the time limit set out in DSU Article 12.9).

# ANNEX K-26

## LETTER FROM THE UNITED STATES

17 September 2003

My authorities have instructed me to respond to Brazil's letter of 16 September 2003, suggesting that the parties' answers to the Panel's questions related to the second substantive meeting be due 15 December instead of 22 December, and that the comments on these answers be due 22 December instead of 19 January 2004. The United States opposes these suggestions.

As it currently stands, the issues in this dispute are both wide-ranging and complicated. Therefore, it is unrealistic to expect that the parties would need only 10 days to answer the Panel's questions, and only 7 days to comment on each other's answers. Moreover, Brazil's sole justification for its suggestion, *i.e.*, that this "would allow for the completion of the parties' main substantive work still in 2003," is a *non sequitur*, particularly in light of the fact that Brazil does not object to the rest of the Panel's further revised timetable.

# ANNEX K-27

## LETTER FROM THE UNITED STATES

23 September 2003

As the Panel may be aware, hurricane Isabel hit the mid-Atlantic region of the East Coast of the United States last Thursday and Friday, bringing with it significant flooding, property damage, and extended loss of electricity to hundreds of thousands of homes and businesses. The hurricane forced all US Government offices in the Washington, D.C., area to be closed on Thursday and Friday, 18 and 19 September 2003. Further, several members of the US delegation were without power through the weekend and were unable to access materials for this dispute. During this time the United States delegation was unable to work on the US further submission that is due on 29 September. As result, the United States has been significantly impeded in its preparation of that submission. At the same time, we are mindful of the October 7 through 9 dates for the next meeting with the Panel.

Accordingly, the United States would like to request a modification of the deadline for submitting its further submission so that it would be due on Thursday, 2 October. In order to provide additional time for the Panel and the parties to review the third party further submissions, currently scheduled to be submitted on Friday, October 3, the deadline for these submissions could be changed to the opening of business on Monday, 6 October 2003.

# ANNEX K-28

## LETTER FROM BRAZIL

23 September 2003

The Government of Brazil is in receipt of a letter from the United States dated 23 September asking for a further extension of time until 2 October 2003 to respond to Brazil's Further Submission. The most recent US request for an extension of time would mean that the Panel, Brazil, and the Third Parties would have only two working days – Friday 3 October and Monday 6 October -- to review and draft an oral statement in response to the US Further Submission. Brazil would have no working days to review the numerous third party submissions.

The Panel must balance out the rights of Brazil and the Third Parties with those of the United States. The United States has been in receipt of Brazil's Further Submission for over two weeks. The United States will have a number of opportunities, including in its 7 October Oral Statement and in answering questions posed by the Panel, to clarify and expand on its responses to issues raised in Brazil's Further Submission. Under these circumstances, Brazil requests that the Panel maintain the current schedule requiring the United States to provide its Further Submission on 29 September 2003.

# ANNEX K-29

## LETTER FROM BRAZIL

2 October 2003

As the Panel may be aware, for the sixth consecutive time in the present proceedings the United States failed to deliver a document by the time expressly determined by the Panel in the Working Procedures and constantly reiterated to the United States in specific communications of the Panel. Instead of abiding by the 5h30 p.m. (Geneva time) deadline, the United States delivered the electronic version of its Further Submission around 11h45 p.m. on 30 September 2003, again more than 6 hours after the deadline. No hard copy of the document, also due on the same day by 5h30 p.m., was available to Brazil before 1 October.

Brazil will not repeat here the whole set of arguments showing the prejudices and obstacles caused by the US tactic to the rights of Brazil. We note however that this sixth delay is particularly egregious given the fact that the Panel provided the United States with two separate extensions of time to prepare its Further Submission. Therefore, Brazil cannot at this time only ask the Panel to take note of the problem and to encourage the United States to respect the deadlines. After six consecutive and totally unjustifiable delays, a more compelling action by the Panel appears to be necessary.

The strict observance of the deadlines is a centerpiece of any procedurally fair proceedings in all legal systems where the due process principle is expected to apply. Consequently, disrespect of the deadlines constitutes a fundamental breach of due process requirements, undermining the procedural fairness in the conduct of the examination of the matter in dispute. In other words, deadlines cannot be taken lightly. This is reinforced by DSU Article 12.5, which states: "Panels should set precise deadlines for written submissions by the parties and the parties should respect those deadlines."

In WTO dispute settlement procedures a Panel, together with the Appellate Body, must act as the guardian of the procedural fairness and, in order to act in this capacity, it is accorded the authority and discretion to establish its own working procedures, in addition to those set out in DSU Appendix 3, as recognized by the Appellate Body.[1] The working procedures are, in effect, the means by which a Panel exercises its authority and discretion to ensure that due process is respected and parties to the dispute have equal opportunities of defense. Brazil is fully aware that the term "working procedures" has been interpreted differently by WTO Members, but it is undeniable that the setting out and enforcement of deadlines is within the boundaries of the Panel's authority to establish its own working procedures.

In view of the fact that Brazil's rights have been systematically impaired by the US contempt of the established rules, and taking into consideration the Panel's authority to set up procedural rules to guarantee the respect for due process requirements, Brazil requests the Panel to determine that in the next steps of the present proceedings any unjustified delay in document delivery by the US results in such document being disregarded by the Panel. In addition, Brazil requests that the Panel reflect

[1] See for instance *Australia – Measures Affecting Importation of Salmon* (DS18), Report of the Appellate Body, para. 272.

each of the violations of the working procedures by the United States in the factual section of its Final Report so that the record of misconduct may be available to the full WTO Membership.

# ANNEX K-30

## LETTER FROM THE UNITED STATES

6 October 2003

The United States received on Friday, 3 October 2003, a copy of the letter to the Panel from Brazil dated 2 October 2003, and my authorities have instructed me to submit this reply. The United States regrets that Brazil once again distracts the Panel and the United States from the work required to prepare for the second session of the first panel meeting.

The United States takes seriously the time lines established by the Panel and has expended considerable resources and dedicated tremendous personnel time and effort to accommodate each of them.[1] As a result, the United States has filed each of its submissions on the date specified by the Panel. At the same time, the Panel will appreciate that the issues are not only complicated and difficult, but that there are a very large number of them – and that the materials that Brazil has submitted are voluminous.

As the complaining party in this dispute, Brazil has had the advantage of months and months in preparing its case far in advance.[2] Brazil has, however, consistently sought to deny to the United States sufficient time to prepare its own submissions, and Brazil's letter of last week regrettably continues an approach it appears to have adopted at the beginning of this dispute: to employ procedural tactics in an attempt to reduce the material and arguments that the United States could submit to the Panel to respond to Brazil's arguments, to correct factual errors by Brazil, and to explain the legal inaccuracies and omissions committed by Brazil. Those procedural tactics include in particular seeking imbalances between itself and the United States in the time provided to prepare submissions. These imbalances have been manifest from early in this dispute, as Brazil has simultaneously been submitting extraordinarily lengthy and complicated submissions and been resisting every effort of the United States to ensure that, as provided by Article 12.4 of the DSU, "the panel ... provide sufficient time for the parties to the dispute to prepare their submissions."

The United States recalls the very first example of Brazil's approach. During the organizational meeting Brazil objected to the US request that the time for the first US submission be increased beyond the two weeks contemplated in the Panel's draft timetable of 27 May. In that same meeting, however, Brazil objected to the suggestion that it have less than two weeks after filing its first submission to submit the executive summary of that submission. As the United States commented at the time, it seemed implausible that the United States could prepare a *substantive response* to a submission in two weeks if Brazil was unable to prepare a *summary* of that submission in less than that time. Brazil's attempt to hold the United States to a two-week period to reply to the first Brazilian submission is particularly telling given that, during that organizational meeting, the Panel had not yet decided to bifurcate the parties' initial submissions. Brazil thus must have hoped to force a response in two weeks to the over 350 pages of material contained in both its first submission (24 June 2003) and in its further written submission (9 September 2003).

[1] The United States also wishes to note that it arranged with the Brazilian Mission in Geneva to transmit a copy of its Further Submission directly to Brasilia upon filing in order to enable the Brazilian authorities to begin reviewing the document as soon as possible. The United States wishes to take this opportunity to express once again its thanks to the Brazilian Mission for its courtesy and cooperation in this connection.

[2] The document "properties" of Brazil's further submission to the Panel suggest quite clearly that Brazil began preparing its submission in April of ***2002*** -- i.e., more than a year before filing it.

The exchange at the organizational meeting was only the first example of a Brazilian approach to this dispute that combines extremely lengthy material with procedural inflexibility. The most recent example was Brazil's unwillingness to contemplate an extension for the filing of the US Further Submission in response to the circumstances in Washington, D.C., brought about by Hurricane Isabel (letter of 23 September 2003).

As the United States noted in its letter of 11 September 2003, the timetable that the Panel has established in this dispute for the filing of the US submissions are much shorter than the amount of time that has been provided to other WTO Members.[3] The length and complexity of Brazil's submissions makes it increasingly difficult to consider that the United States has had sufficient time to prepare its submissions or that the United States does not suffer prejudice in this proceeding as a result.[4]

It is also difficult, in the circumstances of this dispute, to credit the Brazilian suggestion that it is *Brazil* that has suffered an "impairment" of its "rights" when the United States has filed each of its written submissions on the date specified by the Panel. Brazil's sole complaint is with the time, not the date, of filing. There is certainly no basis (and indeed Brazil has not suggested one) for Brazil's astonishing suggestion that the Panel should not consider the views of the United States in the future. Brazil's suggestion is particularly startling in light of the numerous occasions on which Brazil has made extra submissions to the Panel that were nowhere provided for in the Panel's working procedures. Brazil appears to believe that it may ignore the Panel's working procedures at its convenience.[5]

Brazil's suggestion that "the Panel reflect each of the violations of the working procedures by the United States in the factual section of its Final Report" continues Brazil's one-sided approach to presenting material in these proceedings. First, of course, there is no basis for Brazil's characterization of the proceedings to date nor is there any basis for Brazil to seek to use the Panel's report[6] for Brazil's own purposes. Second, the United States notes that Brazil carefully seeks to censor out any reference to Brazil's disregard for the Panel's working procedures. Third, Brazil also would appear to want to avoid any record of the US responses to Brazil's allegations, an approach which would seem to be in keeping with Brazil's attempts throughout this proceeding to limit any material that might refute Brazil's flawed claims.

In conclusion, the United States would like to thank the Panel for its work to date on the many issues presented by this dispute. We look forward to our discussions of the parties' further submissions this week.

The United States is providing a copy of this letter directly to Brazil.

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[3] The United States noted then that in the most recent 23 panel proceedings to which it had been a party, the single shortest time period for preparing a responding submission has been the 17 days provided in this proceeding -- roughly one-half the average time period that respondents had been given when the United States was the complaining party.

[4] The United States would also like to take this opportunity to thank the Panel for agreeing to extend the deadline for the rebuttal submissions; we would hope that this extended time will help in the completion of that submission.

[5] The United States has to date in this dispute deliberately refrained from requesting that the Panel disregard Brazil' s extra-procedural material.

[6] The purpose of the Panel's report is supposed to be to help resolve the dispute in accordance with the terms of reference for the Panel, and the content of the report is specified in Articles 12.7 and 19.1 of the DSU. Brazil neglects to refer to these provisions.

# ANNEX K-31

## LETTER FROM THE UNITED STATES

14 October 2003

As discussed during the second session of the first panel meeting, the United States is providing in the attachment a written description of materials relating to Dr. Sumner's model that Brazil has agreed to provide to the Panel and the United States. The United States looks forward to receiving these materials at Brazil's earliest opportunity, with a view to permitting the United States to undertake its review of these materials in a timely fashion and without delay.

The United States is also providing in the attachment, as agreed, the two remaining exhibits referred to in its opening statement at the second session of the first panel meeting.

**ATTACHMENT**

**Request from the United States to Brazil**

Please provide the following information relating to the model used by Dr. Sumner in his analysis presented in Annex I to Brazil's further submission:

(a) Electronic copies of the actual models used for the baseline and each of the seven scenarios described in Annex I.

(b) Printed copies of the exact equation specifications used for the baseline and for each of the seven scenarios described in Annex I, including all parameter estimates. (If no such printed copies currently exist, please develop and provide.)

(c) Documentation of all adaptations to the original FAPRI modelling system made or used by Dr. Sumner for his analysis presented in Annex I. (If no such documentation currently exists, please develop and provide.)

# ANNEX K-32

## LETTER FROM BRAZIL

5 November 2003

In a letter to the Panel dated 14 October 2003, the United States requested from Brazil electronic and documentary information concerning Professor Sumner's econometric model (items a, b and c of the Annex).

In order to collect and compile that information, Professor Sumner, at the request of Brazil, has been working diligently to provide the United States with the "printed copies" of the exact equation specifications in paragraph (b) of the Annex and the "documentation of all adaptations to the original FAPRI modelling system made or used by Dr. Sumner for his analysis" as requested in paragraph (c). This process is now about to be completed and Brazil expects to provide the United States and the Panel with this information early in the week of 10 November.

As regards the request in paragraph (a) of the Annex for electronic copies of the FAPRI/CARD model used by Professor Sumner, Professor Sumner has contacted Professor Bruce Babcock of the Centre for Agricultural and Rural Development at the Iowa State University, which "owns" the FAPRI model. You will realize by the attached exchange of correspondence between Professor Sumner and Professor Babcock, that "[they] are unable to respond to your request for a simple 'electronic copy' of the FAPRI model used for the baseline and each of the seven scenarios described in Annex I because they literally do not exist".

Brazil notes, however, the last paragraph of Professor Babcock's letter which provides as follows:

> "[W]e would be willing to run USTR-requested scenarios using the FAPRI/CARD modeling system along with the operational additions and adaptations that comprise [Professor Sumner's] model of cotton policy. Our researchers would have to be compensated for the time it would take to run the model and we would have to work out the timing and other logistics of running the model".
>
> It is thus our understanding that this paragraph means that the "electronic version" of the model used by Professor Sumner is presently available for use by the US Government upon coordination with FAPRI staff."

# ANNEX K-33

## LETTER FROM THE UNITED STATES

11 November 2003

The United States is in receipt of Brazil's letter of 5 November 2003, in which it indicates that it expects to submit during the week of November 10 certain evidence relating to the analysis of Dr. Sumner presented in Annex I to Brazil 's further submission. My authorities have instructed me to submit this response.

The United States is disappointed that Brazil claims not to be able to provide electronic copies of the actual model used in that analysis. In our experience, it is common for electronic copies of econometric models to be disclosed to substantiate claimed model results, even in the context of WTO dispute settlement. Brazil's failure to make electronic copies available will hinder the ability of the Panel and the United States to analyze Dr. Sumner's claimed results.[1]

Brazil states that it will be providing printed copies of the exact equation specifications and documentation of all adaptations to the original FAPRI modelling system. This evidence is expected to be substantial and complex. Brazil has previously stated that its economic model "is built upon hundreds of linear supply, demand and related equations for major commodities - and in particular upland cotton - in the United States" and that "[t]hese equations are linked to a system of equations covering the demand and supply of upland cotton internationally".[2] This substantial new evidence relates to the core of Brazil's case relating to price suppression, as evidenced by the frequent invocation of those results in Brazil's further submission, at the second session of the first panel meeting, and in Brazil's answers to the Panel's further questions.

We note that the Panel and the United States had asked for this evidence during the first panel meeting, nearly five weeks ago. The United States expected this evidence to be submitted by the conclusion of the first panel meeting, or, at the latest, shortly after the United States provided Brazil with a written version of the information requested. Brazil, however, has now indicated that it will submit some of this new evidence mere days before the parties' rebuttal submissions are due.

The United States notes that, pursuant to paragraph 13 of the Panel's working procedures, the United States must be provided sufficient time to respond in writing to any new evidence submitted by Brazil. This paragraph reflects the Panel's obligation under Article 12.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* to "provide sufficient time for the parties to the dispute to prepare their submissions." Had Brazil presented that new evidence relating to Dr. Sumner's analysis no later than during the first panel meeting on 7-9 October 2003, as

[1] The offer by FAPRI to run simulations at the United States request for a fee is not an acceptable substitute. It is unprecedented that a party to a dispute should put another party in the position of not being able to gain access to that party's evidence, and its only recourse is to pay a private entity in order to gain even partial access.

[2] *See* Brazil's Further Submission, para. 218 ("The econometric model is built upon *hundreds of linear supply, demand and related equations* for major commodities - and in particular upland cotton - in the United States, but also accounts for regionally varying supply and demand responses in the United States. *These equations are linked to a system of equations* covering the demand and supply of upland cotton internationally.") (emphasis added).

contemplated by the Panel's working procedures, under the current timetable the United States would have been afforded nearly 6 weeks to examine and respond to that evidence.[3]

Given the anticipated complexity of the information and the fact that it will not be provided in electronic form, the United States will need sufficient time to be able to analyze and respond to Brazil's complex and substantial new evidence. To this end, and on the assumption that Brazil meets its expectation of submitting that evidence early this week, the United States would request that the rebuttal submissions be due on 22 December 2003, the current date for answers to panel questions. Remaining items on the timetable set out by the Panel could then be rescheduled accordingly. Adjusting the timetable in light of Brazil's late submission of new evidence is necessary to preserve US rights of defence by providing sufficient opportunity to analyze and critique that new evidence as well as by allowing the United States to present its response to that evidence in its rebuttal submission and at the second panel meeting.[4]

[3] Had Brazil presented this evidence as part of Annex I to its further submission of 9 September 2003, moreover, the United States would have been afforded 10 weeks to review and respond to that evidence.

[4] *See* Working Procedures for the Panel, para. 7 ("Formal rebuttals shall be made at a second substantive meeting of the Panel. . . . . The parties shall submit, prior to that meeting, written rebuttals to the Panel.") (28 May 2003).

# ANNEX K-34

## LETTER FROM BRAZIL

12 November 2003

The Government of Brazil is in receipt of a letter from the United States dated 11 November requesting yet another lengthy delay in this panel proceeding. Brazil requests the Panel to reject this request and maintain the current schedule including the deadline for rebuttal submissions of 18 November and the second Panel meeting on 2-3 December for the reasons set forth below.

The United States' letter attempts to leave the impression that there will be a tremendous amount of new evidence that will be provided to them in *written* form in response to their request of 14 October. This is incorrect. The bulk of the requested information is in *electronic* form which has been available for the United States to examine, review, and use since 5 November. Attached to this letter are (1) Professor Sumner's *written* adaptations to the FAPRI model for each of the seven scenarios described in Annex I to Brazil's Further Submission (Exhibit Bra-313), and (2) Professor Sumner's summary description of the equations in the FAPRI domestic model and the CARD international cotton model (Exhibit Bra-314). As the Panel can see from Exhibit Bra-313, this document reflecting Professor Sumner's adaptations is not lengthy and does not contain hundreds of equations as the US letter suggests. The "hundreds of equations" referred to in the US letter are those of the *FAPRI/CARD* model used by Professor Sumner and summarized in Exhibit Bra-314. Brazil believes that the US econometric experts who deal with the FAPRI model on a regular basis will not have any difficulty understanding Exhibit Bra-313. Professor Sumner, of course, will be prepared to provide any additional follow-up information and clarifications, as necessary, at the Panel meeting on 2-3 December for which he has made arrangements in his schedule to attend.

Brazil has been informed by Professor Sumner that he is working as quickly and thoroughly as he can in completing this work in addition to his other many responsibilities as the Director of the Agricultural Issues Centre at the University of California at Davis. Professor Sumner indicates he expects to be able to provide the relevant equations for the CARD international cotton model by the close of business on 13 November. This will complete Brazil's response to the US request of 14 October. Because Professor Sumner made no adaptations to the CARD international cotton model, the information to be provided will simply be the equations for a model that is much-used and well-known to USDA economists.

Brazil notes that the United States waited until 14 October to file its request for this information from Brazil. Brazil's letter of 5 November provided the United States with an offer of complete access to the electronic version of the exact same model used by Professor Sumner. The United States then waited almost a week to reply to Brazil's 5 November letter with full knowledge that the date for the Further Rebuttal Submission was 18 November. It appears as if the United States has *not* used the week since 5 November to take advantage of its ability to review and analyze the complete electronic version of everything that Professor Sumner has done in his analysis. As the last paragraph of Professor Babcock's letter of 31 October stated, upon request, the United States will be provided full and immediate access to the FAPRI and CARD models and Professor Sumner's adaptations that are available in electronic form.

Contrary to the US unsupported assertion, Brazil has not "put the United States in the position of not being able to gain access to that party's evidence." Rather, Professor Babcock's offer provides

the United States with complete access to the electronic version of *all* of the equations and analysis performed by Professor Sumner and the United States had access to them since 5 November.

Brazil further notes that it was required to use the FAPRI/CARD model for a fee, that neither Brazil nor Professor Sumner owns or can copy this model, and as explained by Professor Babcock, that there is no "written version" of the FAPRI model. The United States can, however, make arrangements with FAPRI officials to use the model and it would certainly not be unprecedented for the United States Government (or other governments or private entities) to compensate FAPRI for the use of the FAPRI model.

Brazil notes that USDA economists and officials use the FAPRI model frequently and are well aware of its parameters (for which the USDA provided it with its highest honorary award in 2002). Therefore, it will not be difficult for the United States to quickly analyze Professor Sumner's limited adaptations to the standard FAPRI/CARD models with which they are familiar. Brazil also notes that the FAPRI project is financed in large part by the US Congress

With respect to the existing schedule, Brazil considers that there is no legal or due process basis for the Panel to again delay the proceedings. Indeed, the existing schedule has considerable flexibility to provide the United States with more than sufficient time to prepare any rebuttal of Professor Sumner's analysis. In order to avoid further delay, Brazil suggests that the United States and Brazil file their rebuttal submissions on 18 November and the Panel hold the second meeting of the Panel with the Parties on 2-3 December as originally scheduled.

If the United States determines that it does not have sufficient time to (a) use the exact same FAPRI/CARD electronic model as adapted by Professor Sumner (as offered by Professor Babcock) and (b) to analyze Professor's Sumner's written equations and explanations of adaptations to the FAPRI model by 18 November, then Brazil would have no objection to the United States providing its rebuttal to Professor Sumner's analysis by 28 November, a few days prior to the Panel meeting on 2-3 December. This rebuttal, however, would be in addition to the 18 November Rebuttal on the multitude of other issues in this proceeding that do not relate in any way to Professor Sumner's analysis.

Brazil notes that the current schedule is also flexible enough to allow for rebuttal and counter-rebuttal by the Parties of the US analysis of Professor Sumner's results, *i.e.*, until the 22 December and 19 January deadlines for answering and then commenting on the Answers to the Panel's Questions. Of course, if the Panel determines that the United States and Brazil need additional time to comment on the econometric models or other issues, then the Panel has the discretion to allow for this for periods after 19 January 2004.

Brazil believes that this proposal will protect the United States' and Brazil's due process rights without yet again delaying this proceeding. It will allow the Panel and the Parties to maintain their current travel and business schedules which have now been in place for some time. Brazil notes that its delegation has scheduled a number of meetings and travel with a view towards the 2-3 December meeting date.

Finally, Brazil stresses that any changes in the schedule must not further delay the date of issuance of the final report to the parties, since the time limits of DSU Articles 12.8 and 12.9 have already been breached.

# ANNEX K-35

## LETTER FROM THE UNITED STATES

13 November 2003

My authorities have instructed me to respond to Brazil's letter of 12 November 2003, in which Brazil objects to the US request for an extension of time for the filing of rebuttal submissions in this dispute. Brazil ignores the Panel 's working procedures and the arguments in our letter of 11 November 2003, in dismissing the possibility that the United States would be prejudiced if the briefing schedule were not adjusted to take into account Brazil's decision to submit new evidence relating to the analysis of Dr. Sumner nearly five weeks after the conclusion of the first panel meeting. Brazil's 12 November letter cannot change the fact that United States will be prejudiced if it is not given adequate time to analyze the materials Brazil is only now providing.

*First*, Brazil simply does not discuss either the requirements of DSU Article 12.4, which provides that "[i]n preparing the timetable for the panel process, the panel shall provide sufficient time for the parties to the dispute to prepare their submissions," or the provisions of paragraph 13 of the Panel's working procedures, pursuant to which the United States must be provided sufficient time to respond in writing to any new evidence submitted by Brazil.

*Second*, Brazil states that it "would have no objection to the United States providing its rebuttal to Professor Sumner's analysis by 28 November, a few days prior to the Panel meeting on 2-3 December" and that "the current schedule is also flexible enough to allow for rebuttal and counter-rebuttal by the Parties of the US analysis of Professor Sumner's results, i.e., until the 22 December and 19 January deadlines for answering and then commenting on the Answers to the Panel's Questions". The United States cannot agree to this proposal. Indeed, this suggestion by Brazil would make it appear that Dr. Sumner's analysis was an issue of secondary importance to Brazil's allegations, such that the US response is not important to the Panel's evaluation. The reality, of course, is that Brazil's main economic conclusions rest on Dr. Sumner's analysis. If not, there would have been no reason for Brazil to reference that analysis repeatedly in its further submission, to attach Dr. Sumner's analysis as a 52-page annex to that submission, to call upon Dr. Sumner to deliver a 16-page statement as part of its opening statement and a four-page statement as part of its closing statement at the second session of the first panel meeting, nor to continue referencing Dr. Sumner's analysis in its answer to the Panel's further questions. It is simply not credible for Brazil to suggest that no prejudice would result to the United States if it were compelled to prepare and file a rebuttal submission without having had sufficient opportunity to examine and critique Brazil's new evidence relating to the very model which allegedly underlies Dr. Sumner's analysis.

*Third*, Brazil has also indicated that it will file *even more* new evidence on 13 November relating to Dr. Sumner's analysis. In addition to the prejudice that would result from not being able to prepare our rebuttal submission and prepare for the second panel meeting with sufficient time to analyze this new evidence, the United States notes that it has already been prejudiced because preparation of the US rebuttal submission over the last several weeks has been based on the materials which we have had at hand, that is to say, neither the materials included with Brazil 's 12 November letter nor those it says will be forthcoming on 13 November. Elements of the US rebuttal could be superseded or confirmed on the basis of Brazil's new information. Thus, without an extension of time, the United States will be forced either to reply to Dr. Sumner 's analysis in the absence of complete information or to defer responding to the centrepiece of Brazil's case.

*Fourth*, Brazil is in error when it claims that "the United States waited until 14 October to file its request for this information from Brazil". In fact, both the United States and the Panel Chairman verbally requested access to Brazil' s model on 7 October 2003, at the conclusion of opening statements on the first day of the second session of the first panel meeting. Brazil has provided no explanation for why it should have delayed providing any information in response to that request for nearly five weeks, which merely related to the very model that Dr. Sumner asserts to have employed.

*Fifith*, Brazil also claims that "Brazil's letter of 5 November provided the United States with an offer of complete access to the electronic version of the exact same model used by Professor Sumner" and "Professor Babcock's offer provides the United States with complete access to the electronic version of all of the equations and analysis performed by Professor Sumner *and the United States had access to them since 5 November*" (italics added). Presumably, Brazil is referring to its suggestion that the United States pay to *run* the model employed by Brazil[1], since FAPRI did not offer to disclose – either to the United States or the Panel – the equations underlying that model, whether for pay or otherwise (and we assume Brazil was also offering to the Panel this opportunity to pay to obtain Brazil's evidence). As stated in the US letter of 11 November, Brazil's suggestion that the responding party (and presumably the Panel) must pay for evidence on which the complaining party so heavily relies is unprecedented.

*Sixth*, Brazil also claims that "it will not be difficult for the United States to quickly analyze Professor Sumner's limited adaptations to the standard FAPRI/CARD models with which they are familiar." If it is the case that Professor Sumner has made only "limited adaptations to the standard FAPRI/CARD models," a claim we are not in a position to confirm, then again the question arises why Brazil should have delayed five weeks in providing these new materials. Presumably, Professor Sumner knew of and had documented those adaptations prior to submitting his analysis to the Panel as part of Brazil' s further submission on 9 September.

The United States respectfully requests the Panel to defer the parties' rebuttal submissions as set out in its letter of 11 November 2003. The United States is providing a copy of this letter directly to Brazil.

[1] *See* Brazil's Letter of 5 November 2003, p. 2 (quoting FAPRI letter as saying that FAPRI "'would be willing to run USTR-requested scenarios using the FAPRI/CARD modeling system along with the operational additions and adaptations that comprise [Professor Sumner's] model of cotton policy. Our researchers would have to be compensated for the time it would take to run the model and we would have to work out the timing and other logistics of running the model.'").

# ANNEX K-36

## LETTER FROM BRAZIL

13 November 2003

Brazil is in receipt of a letter from the United States dated 13 November. Brazil reiterates its request that the Panel adhere to the existing schedule along with the suggested modifications proposed by Brazil in its letter of 12 November. Brazil responds to the numbered paragraphs of the US 13 November letter below using the same paragraph numbers.

*First*, Brazil notes that with respect to DSU Article 12.4, the normal amount of time for a rebuttal submission set out in Annex 3 of the DSU is 2-3 weeks from the date of the First Substantive meeting. The Panel in this case provided the parties with a period of six weeks to prepare rebuttal submissions. Based on Brazil's suggestion that the United States have until 28 November to prepare a rebuttal on a single aspect of Brazil's evidence, the United States will have had **23 days** (from 5 November or more than three weeks) to examine, use, and analyze the full electronic version of everything that Professor Sumner examined. In addition, the United States would have **16 days** from 12 November to examine Professor Sumner's written adaptations to the FAPRI/CARD model and **15 days** (from November 13) to examine the full CARD international cotton model. All of these time frames either exceed or are within the 2-3 week period for rebuttal submissions set out in Annex 3 to the DSU. Therefore, there is no basis for the United States to claim any violation of either its due process rights or of DSU Article 12.4.

*Second*, Professor Sumner's analysis is not the "centrepiece" of Brazil's adverse effects case that the United States claims. Brazil has placed an enormous amount of evidence before the Panel that exists independently of Professor Sumner's analysis. Brazil has repeatedly emphasized in this dispute that Professor Sumner's analysis confirms econometrically what common sense and the overwhelming body of other evidence already conclusively demonstrates. The Panel need only examine paragraph 105 of Brazil's Further Submission to appreciate this point. Even Professor Sumner's econometric analysis is only one of many such analyses of the impact of US upland cotton subsidies that is referenced in Brazil's submissions. Professor Sumner has functioned for Brazil in these proceedings as a dual expert – as one who is expert in US subsidy programs and the US agricultural system, as well as an expert in econometric analysis.

*Third*, Brazil attaches as Exhibit Bra-315 the documentation for the CARD international cotton model.[1] This model is well-known to USDA economists and has not been changed for Professor Sumner's analysis. Therefore, this information will not be "new" to the United States or is something that it could not otherwise have already anticipated in preparing their arguments.

*Fourth*, the United States did not provide in writing, exactly what evidence it wanted from Professor Sumner until 14 October. Brazil provided access to the complete electronic version of Professor Sumner's analysis – which *only* exists in electronic form – on 5 November. This was not five weeks after receipt of the US request as the US claims. The additional information provided on 12 and 13 November required Professor Sumner to expend considerable amount of time. His busy

[1]Brazil is also providing herewith an electronic version of the CARD international cotton model via email.

schedule at the University of California at Davis as well as previous speaking commitments posed additional difficulties in completing this assignment.

*Fifth*, the United States again demonstrates that it has made no efforts to take advantage of the offer to gain access to *everything* that Professor Sumner did and analyzed, which is contained in the electronic version at the University of Iowa in the care of Professor Babcock. It appears to Brazil that the United States' conduct suggests it may be more interested in delaying this proceeding than in gaining access to Professor Sumner's analysis.

*Sixth*, the United States claims that it has only a small amount of time to change their rebuttal submission. Brazil notes that on 24 June 2003, it filed a lengthy submission after only being given 4 days notice of what it was required to file. Brazil, at great effort, met that deadline. Further, the additional ten days proposed by Brazil (until 28 November) provide the United States with an opportunity to react to and respond to Professor Sumner's documents delivered on 12 and 13 November. The United States will have additional time to prepare further responses for their oral statement on 2 December. Finally, as Brazil's 12 November letter indicated, both Brazil and the United States will have until 22 December and 19 January to file additional answers to questions and comments relating, *inter alia*, to the econometric models at issue in this dispute.

*In conclusion*, the Panel has to balance the right of the United States to have sufficient time to prepare a rebuttal to Professor Sumner's analysis with Brazil's right to obtain a timely panel decision. Brazil believes that its suggestion to provide the United States with an additional 10 days to prepare its rebuttal – until 28 November – is an appropriate result which is fair and protects each of the parties' due process rights. However, the request by the United States for another five weeks to prepare their rebuttal and to delay this proceeding by at least as much time, if not more, is grossly out of proportion. Brazil requests the Panel to avoid yet another long delay in these proceedings.

# ANNEX K-37

## LETTER FROM THE UNITED STATES

18 December 2003

In a communication dated 8 December 2003, the Panel afforded to the United States the opportunity to respond by 18 December 2003, to the request that Brazil had made through the Panel for certain information in Exhibit BRA-369.[1] The United States has completed work on 3 electronic files containing approximately 135 megabytes of requested data related to the production flexibility contract payment era, which are being transmitted with this letter. Work on the data files relating to the direct and counter-cyclical payment era is continuing, and the United States is endeavouring to provide this data by close of business Friday, 19 December.

However, as the United States preliminarily advised Brazil and the Panel at the second panel meeting, the release of planted acreage information associated with a particular farm, county, and state number is confidential information that cannot be released under US domestic law, in particular the Privacy Act of 1974.[2] This is consistent with the position of the United States in Freedom of Information Act[3] appeals raising this issue. One such decision is attached as Exhibit US-104.[4] Although the United States cannot provide planted acreage information associated with an individual farm, in an effort to be as fully responsive as possible, we are providing, for all programme crops and for each marketing year: (1) planted acreage data aggregated for all cotton farms and (2) farm-level planted acreage data without any fields that could identify the particular farm.

The United States is providing all of the pieces of data requested by Brazil in data files organized as follows:[5]

> First, a file with aggregate data for yields, bases, cropland, and plantings for all "cotton farms" for all programme crops as defined in the data request, using three categories: (1) farms with "cotton base" but no cotton plantings; (2) farms with cotton plantings but no "cotton base," and (3) farms with cotton plantings and "cotton base."
>
> Second, a farm-by-farm file (with particular farm identification information) with all of the requested data (plus additional data regarding payment quantities) but not including planted acres and cropland.

[1] *See* Exhibit US-102.

[2] *See* 5 USC 552a(b) (Exhibit US-107).

[3] Exhibit US-103.

[4] We note that no final denial of a release may be made by the US Department of Agriculture without the concurrence of USDA's Office of General Counsel. *See* 7 CFR 1.14 (Exhibit US-105). The attached appeal determination is consistent with USDA's long-standing policy that planted acres will not be released. For example, the policy against release has been stated explicitly since 1997 in FSA's FOIA Handbook. (*See* Exhibit US- 106.)

[5] In addition to the data requested by Brazil, the United States has provided total cropland and programme payment units (base acreage x base yield x .85) to allow for more meaningful aggregation.

> Third, farm-by-farm files for planted acres only for all programme crops, but with no other data and with the order of the farms scrambled in order to prevent any matching of farms.

The three files have been copied to a CD. The base and yield data are a text file named "Pfcby.txt." A description of that file and its 118 fields is found at Exhibit US-109. Planted acres are in "Pfcplac.txt". A description of that file is found at Exhibit US-110. Finally, the aggregate data file is named "Pfcsum.xls". That file is an Excel file and the headings within the file should be self-explanatory.

The information that we are providing is also sensitive. We do not consent to release of this information to the public domain and expect that it will be used solely for purposes of this dispute settlement proceeding. Therefore, pursuant to paragraph 3 of the Panel's working procedures, we designate this information as confidential and must exceptionally insist that this information not be disclosed outside of the delegation of the Brazilian Government and the Panel.

During the Panel meeting, Brazil referred to information released by the United States in connection with rice. This release was an error. Apparently, the Kansas City office of the Farm Services Agency (FSA) believed at some point that the Washington FOIA office had approved the release of planted acres so long as names and addresses were left out. FSA Washington personnel were not aware of that misunderstanding. It has been corrected. The farm number is unique and can be linked back to the name and address of persons on the farm using the FSA-supplied Environmental Working Group (EWG) payment and name and address files.[6] The payment files will allow a match by farm number. This leads, by the same file, to the "customer number". That number leads, in the name and address file, to the name and address of the farm owner. At the second Panel meeting, Brazil indicated that the rice request was theirs. We ask accordingly that Brazil and its agents return all copies of the erroneous rice release.[7]

The United States also notes that responding to Brazil's request has not been a simple undertaking. Because of the extensive nature of the request, it was necessary to run through approximately 10 million files to extract the pertinent information. There are approximately 2 million farms involved. For the production flexibility contract ("PFC") payment era under the 1996 Act, there were 7 programme crops. In the direct payment and counter-cyclical ("DCP") payment era under the 2002 Act, there are 10 programme crops (counting "other oilseeds", such as rapeseed, canola, etc., as one "programme crop" only). The PFC file alone, if each field for each farm was considered a cell, contains 25 million cells of information. The task involved is a far bigger, far more complicated task than the erroneous rice release. More than 250,000 farms fit the "cotton farm" definition at work in this exercise. The United States has expended a significant amount of time and resources to respond to this data request.[8]

Per Brazil's request, the United States is providing a copy of this letter, associated exhibits, and three electronic data files relating to the production flexibility contract payment era directly to Brazil through the Brazilian Embassy in Washington, D.C. Because of their size, the electronic data files will be couriered to Geneva for transmission to the Panel.

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[6] *See* Exhibit US-108 (excerpt of BRA-316).

[7] Regarding that release, the United States notes, too, that no member of the US delegation at the second panel meeting in Geneva was aware of the rice release. On inquiry, no one at FSA in Washington was aware of it either. The rice data was sent to an address in Geneva identified by the requester, a member of the Brazilian delegation, who the Kansas City office was led to understand had "relatives" there.

[8] There may well be limitations in the data output since the output depends on the completeness and accuracy of input from the FSA county offices. Moreover, not all farms file crop reports and not all plantings are plantings of programme crops. These are merely some examples.

# ANNEX K-38

## LETTER FROM THE UNITED STATES

22 December 2003

Further to the letter of the United States to the Panel on 18 December 2003, attached please find a letter from the United States to the Embassy of Brazil in Washington, D.C., dated 19 December 2003, transmitting directly to Brazil the completed electronic data files relating to the direct and counter-cyclical payment era. Please also find attached Exhibits US-111 and US-112. This letter, the electronic data files, and the two exhibits were received by the Embassy of Brazil on 19 December. The electronic data files are presently en route to Geneva, and will be transmitted to the Brazilian Mission to the WTO and to the Panel shortly.

In a letter dated 18 December 2003, to the Chairman of the Panel in the WTO dispute settlement proceeding *United States – Subsidies on Upland Cotton* (DS267), the United States indicated that it would endeavour to provide additional information responding to the request of Brazil conveyed in Exhibit BRA-369 by Friday, 19 December. In particular, we indicated that preparation of certain direct and counter-cyclical payment era electronic files was continuing. Those files have now been completed and are being transmitted with this letter.

There are three direct and counter-cyclical payment era files, containing approximately 85 megabytes of requested data, on the enclosed CD. These three files correspond to the three production flexibility contract payment era files transmitted previously. First, there is a farm-by-farm base and yield data file ("Dcpby.txt"); a description of that file and its 99 fields is found at Exhibit US-111. Second, there is a planted acres file ("Dcpplac.txt"); a description of that file is found at Exhibit US-112. For the reasons set forth in the 18 December letter to the Chairman, we note that the order of the records in the planted acre file is not the same as in the base and yield file. Finally, there is an aggregate data file ("Dcpsum.xls"); that file is an Excel file, and the headings within the file should be self-explanatory.

As indicated in the 18 December letter to the Chairman, the information that we are providing is sensitive. We do not consent to release of this information to the public domain and expect that it will be used solely for purposes of this dispute settlement proceeding. Therefore, pursuant to paragraph 3 of the Panel's working procedures, we designate this information as confidential and must exceptionally insist that this information not be disclosed outside of the delegation of the Brazilian Government and the Panel.

The United States is providing a copy of this letter, associated exhibits, and three electronic data files relating to the direct and counter-cyclical payment era directly to the Panel.

# ANNEX K-39

## LETTER FROM BRAZIL

23 December 2003

As per its Communication of 8 December 2003, the Panel established 22 December as a deadline for the delivery by Brazil and the United States of the Answers to Questions from the Panel and also for the delivery of the US comments on Brazil's econometric model.

In its Communication of 13 October, the Panel established that "*In accordance with paragraph 17 (b) of the Panel's working procedures, the Panel sets the following time for the provision of submissions by the parties: 11.59 p.m., Geneva time on the dates concerned. This time refers to receipt of submissions by the other party and the Secretariat and not to commencement of transmission. For greater clarity, this time for receipt of submissions also refers to the time of completion of receipt of any Exhibits and service of any Exhibits (if necessary electronically) to the other party and to the Secretariat as envisaged in paragraphs 17 (a)-(d) of the Panel's working procedures. All other provisions of the Working Procedures remain unchanged*".

The "Working Procedures for the Panel" establish in paragraph 17 b that

> *"the parties and third parties should provide their submissions to the Secretariat by 5:30 pm on the deadlines established by the Panel, unless a different time is set by the Panel"*

and in paragraph 17 d that,

> *"the parties and third parties shall provide electronic copies of all submissions to the Secretariat at the time they provide their submissions [...]"*.

The US submissions were not delivered within the deadline of 11.59 p.m. provided by the Panel, which is already an exception to the generally observed deadline of 5:30pm. Neither the paper nor the electronic versions of the submissions were delivered on 22 December until 11.59 p.m.. As duly registered at the form provided by the Secretary to the Panel, the US submission had not been delivered until 0.35 a.m. and it was apparently delivered as late as 1.08 a.m.. The electronic version was sent at 0.47 a.m. and received by Brazil at 1.34 a.m.

Brazil notes that, apart of the impairment of Brazil's rights under the DSU, the delay by the US also involves significant administrative constraints for the Brazilian Delegation in Geneva, which maintains human resources active until such a time as the US delivers the documents

This is already the seventh time the United States fails to deliver a document by the time expressly determined by the Panel. This issue has also been addressed during the panel hearing on 7 to 9 October and the Panel has already explicitly requested the United States to respect the deadlines of the dispute – "in order to ensure due process and secure a balance between the two parties" (Panel's Communication of 13 October). In its letter of 2 October, Brazil had requested the Panel to "determine that in the next steps of the present proceedings any unjustified delay in document delivery by the US results in such document being disregarded by the Panel".

Brazil therefore hereby requests that the documents delivered today by the United States, in renewed disrespect of the established deadline, be disregarded by the Panel.

Please accept, Sir, the assurances of my highest consideration.

# ANNEX K-40

## LETTER FROM BRAZIL

23 December 2003

The Government of Brazil is in receipt of a letter from the Panel dated 23 December enclosing a number of new questions to Brazil (eight) and to the United States (five) with a deadline set for 12 January. These questions address new interpretations by the Appellate Body, are very comprehensive, and in the view of Brazil will require a significant allocation of resources to complete properly.

Brazil notes that in addition to answering these questions, it must also respond to an extensive US critique of Professor Sumner's analysis, as well as provide comments and analysis on the US 18 December 2003 data, by 12 January. Because Brazil was not aware that the Panel would be filing these new questions, its representatives made severely tight travel and professional commitments that try to accommodate the upcoming holidays bearing in mind the original two deadlines for 12 January (Sumner and 18 December rebuttals).

In consideration of the above, Brazil requests that the Panel push the schedule back by only one week. The original 12 January deadline would be moved to 19 January, and the 19 January deadline for comments on the answers to the Parties' questions would be moved to 26 January. Other aspects of the schedule would be adjusted accordingly by the Panel, but with no more than a one week delay for the issuance of the final report, if this should be deemed necessary by the Panel.

Please accept, Sir, the assurances of my highest consideration.

# ANNEX K-41

## LETTER FROM THE UNITED STATES

23 December 2003

At the Panel's invitation, my authorities have instructed me to provide the following comments on Brazil's letter of 23 December 2003, in which Brazil requests that the upcoming schedule of filings be delayed.

The United States is amenable to Brazil's extension request, with the alternations suggested below, because it is well aware of the burdens that the very tight time frame established in this dispute has imposed on the parties (and the Panel), particularly in light of the complexity of the matter before the Panel and the volume of materials necessary to examine that matter. In fact, the United States has in the past three business days alone:

- Filed via two letters dated 18 and 19 December 2003, approximately two hundred megabytes of data requested by Brazil. Attempting to collect, prepare, and file these data within the time set out by the Panel in its 8 December communication required enormous efforts on the part of the United States, necessarily affecting preparations of the US answers to the Panel's questions and the US comments on Brazil's econometric model.

- Filed answers to approximately 51 questions from the Panel, within the same time that Brazil had to answer approximately 32 questions. (Indeed, given Brazil's comment that the "eight" new questions directed to it "in the view of Brazil will require a significant allocation of resources to complete properly" and therefore justify an extension of time, Brazil should now understand – if it did not before – the significantly greater burdens placed on the United States in responding to approximately 20 more questions than Brazil was asked to respond to.)

- Filed comments on Brazil's econometric model. In making this filing, the United States was faced with examining, and preparing and filing comments on the FAPRI model transmitted to the United States by Dr. Bruce Babcock, per the Panel's communication dated 8 December 2003, within the time originally set out by the Panel only to address Brazil's exhibits and models.

Had the United States focused its energies only on the answers to the Panel's questions and the comments on Brazil's economic modelling, the filing of those documents would not have been delayed, but the United States chose to make best efforts to comply with all of the requests and time frames set by the Panel in this dispute. It is only due to tremendous efforts by US personnel in Washington, Kansas City, and Geneva that Brazil is even in a position to cite the need to respond to the data submitted by the United States as part of the reason a delay in the schedule is needed.

In light of the foregoing, the United States would be willing to agree to an extension of time. However, instead of Brazil 's proposal, the United States would ask that the schedule be altered as follows: First, we would ask that the filing of the parties' responses to the additional questions from the Panel (dated 23 December 2003), as well as Brazil's comments originally scheduled for 12 January 2004, be moved to 21 January (to take into account the fact that 19 January is a US Federal holiday). We would then request that the parties' comments on each other's answers be

moved to 2 February. The reason for this latter proposal is because, in addition to filing comments on Brazil's answers to the Panel's additional questions on that date, the United States will also be filing – per the Panel's communication of 8 December 2003 – comments on (1) Brazil's comments on the data provided by the United States on 18 and 19 December 2003, as well as (2) Brazil's comments on the US comments on Brazil's economic model. Given Brazil's confirmation in its letter that its submissions on these matters will require four weeks to prepare, the United States and the Panel can expect that those comments will be extensive. Thus, one week to respond to Brazil 's three submissions would understandably be insufficient; for due process reasons, the United States believes at least two weeks would be needed to respond to Brazil's four weeks worth of comments and answers.

In agreeing to Brazil's extension request, with the above caveats, the United States notes that it is simply seeking to advance the goal of WTO dispute settlement – that is, the effective resolution of disputes, rather than pursuing litigation tactics designed merely to disadvantage the other party procedurally. In this regard, we regret Brazil's second letter of 23 December, requesting that certain US documents "be disregarded by the Panel". The United States has in a communication earlier today expressed its regret for any inconvenience that may have resulted to the Panel and Brazil due to the delay in submitting the US comments and its answers to questions from the Panel, noting largely the same reasons Brazil is now relying on to support its extension request. Indeed, this delay resulted in large measure from the US determination to make best efforts to respond to Brazil's request for certain information while simultaneously preparing its comments and answers. In this connection, we find it interesting that Brazil is seeking to have the Panel "disregard[]" the US answers and comments, but not the extensive data requested by Brazil, which was provided on 19 December, one day after the date set out in the Panel's 8 December communication. The significant burdens on all parties to a WTO dispute, and this dispute in particular, are well-understood. The effective functioning of the dispute settlement system and the resolution of disputes are not served through one-sided approaches that only recognize the burdens place on one party but not the other.

# ANNEX K-42

## REPLIES OF THE UNITED STATES TO ARTICLE 13 REQUEST

20 January 2004

The United States is in receipt of a request for information from the Panel pursuant to Article 13 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* transmitted on 12 January 2004. In its request, the Panel "requests the United States to provide the same data that it agreed to provide in its letters dated 18 and 22 December 2003 but in a format which permits matching of farm-specific information on contract payments with farm-specific information on plantings".[1] The Panel's request states that "[d]isclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years" and invites the United States to "protect the identity of individual producers by, for example, using substitute farm numbers which still permit data-matching". My authorities have instructed me to submit this response.

With respect to the Panel's explanation that "disclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years", the United States notes that it has previously provided data that permits calculation of "total expenditures" for all decoupled payments made to farms planting upland cotton with respect to historical base acres (whether upland cotton base acres or otherwise). In particular, for the production flexibility contract payment era, we provided a farm-by-farm file ("Pfcby.txt") with base acreage and yield data for all programme crops for all "cotton farms" as defined in BRA-369 and data file ("Pfcsum.xls") that aggregated this data for ease of use.[2] The "programme payment units" field allows for easy calculation of "total expenditures" to farms planting upland cotton in any given year by multiplying payment units by the applicable payment rate. Similarly, for the direct and counter-cyclical payment era, the United States provided a farm-by-farm file ("Dcpby.txt") with base acreage and yield data and an aggregate data file ("Dcpsum.xls").[3] Again, the "programme payment units" field allows for easy calculation of total expenditures by multiplying payment units by the applicable payment rate. Thus, the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton.

The United States has studied the Panel's request for certain farm-specific data as well as its suggestions with respect to protecting US producers' privacy interests. The United States thanks the Panel for recognizing the important confidentiality concerns which arise from Brazil's request to receive, by farm number, contract payment and planting information. The Panel will recall that at the second panel meeting the US delegation expressly inquired of the Brazilian delegation whether the

[1] The Panel's request references US letters dated 18 and 22 December 2003, providing certain information from Brazil. The United States understands the latter reference to be to the 19 December letter to Brazil that was transmitted to the Panel and the Brazilian Mission to the WTO on 22 December 2003.

[2] These files were provided, per Brazil's request, to the Brazilian Embassy in Washington, D.C., on 18 December 2003 via CD-ROM. The US letter was filed with the Panel on 18 December, and the CD-ROM was delivered via courier to Geneva and filed with the Panel on 23 December 2003.

[3] These files were provided to the Brazilian Embassy in Washington, D.C., on 19 December 2003 via CD-ROM. The US letter was filed with the Panel on 22 December, and the CD-ROM was delivered via courier to Geneva and filed with the Panel on 23 December 2003.

United States could provide the requested data in some format that also protected the identity of individual producers. The Brazilian delegation refused to answer and insisted that the requested information be provided with farm numbers, as set out in Exhibit BRA-369. In response to Brazil's request, the United States therefore provided all of the data that it could without violating the privacy interests of US producers, as required under the Privacy Act of 1974.

The United States has studied the Panel's request and has concluded that it is not possible to "protect the identity of individual producers" while providing the requested data in a format that permits data-matching. This results because the United States has already provided, by farm number, farm-specific contract information, including base acreage, base yield, and payment units, for each programme crop for each requested year. For example, for each and every "cotton farm" (as defined in the Brazilian request) identified by its FSA farm number, the United States has provided 96 separate data fields relating to 2002 direct and counter-cyclical contract payments. These 96 fields of contract data form a unique combination, such that – even in the absence of farm numbers – disclosing the farm-specific plantings that correspond to each unique combination of contract data would allow each farm's plantings to be connected to the FSA farm numbers through the farm-by-farm files previously provided. Thus, as a result of Brazil's insistence on receiving data with the FSA farm numbers and refusal to consider any alternative that would respect the privacy interests of US producers, unfortunately there would not appear to be a way to provide the requested data and "protect the identity of individual producers" given the data already provided. Under the Privacy Act of 1974, the United States could not disclose this information without the consent of the submitter.[4] Thus, the existence of confidentiality procedures would still not permit the United States to release each farm's planting information associated with the farm's particular contract payment data (given the previous submission of contract data in association with farm, county, and state numbers).[5]

With respect to the Panel's reference to the release of certain farm-specific planting data by the Farm Services Agency to a member of the Brazilian delegation, the United States has explained in its December 18 letter to the Panel that this release was in error. We have requested that Brazil assist the United States in curing this breach of confidentiality by returning all copies of the erroneous release but have yet to receive a response.

The Panel makes reference to a weighing of "the public interest in disclosure" against a payment recipient's privacy interests. The question of whether the information could be released – and even whether the "public interest" is a relevant consideration – is a complicated issue under US domestic law. In the first instance, the US Department of Agriculture has determined that it is prohibited under US law from releasing this information without the consent of each submitter. In any event, we note that the Panel states that it requests these data "to permit an assessment of the *total expenditures* of PFC, MLA, CCP and direct payments . . . to upland cotton producers". Thus, the information relevant to the Panel's assessment would not be *farm-specific data* but rather some *aggregation* of data to permit this "assessment of . . . total expenditures". As noted above, the United States has provided both farm-specific and aggregated contract data that would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton.

[4] 5 U.S.C. 552a(b) ("No agency shall disclose any record which is contained in a system of records by any means of communication to any person, or to another agency, except pursuant to a written request by, or with the prior written consent of, the individual to whom the record pertains . . . .").

[5] Moreover, because contract data by farm number may be releasable information – as we have done here with respect to Brazil's specific request – a request to release contract data associated with a farm's planting information would raise the same privacy concerns because of the potential to link such data back to farm and recipient information that could be separately obtained.

The United States further notes the Panel's statement that "[a] refusal by the United States to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn". As explained, the United States does not have the authority to provide the farm-specific planting information in the format requested. Further, the United States has provided both farm-specific and aggregated contract data that would permit the Panel to make the assessment it identifies, that is, an assessment of total expenditures of decoupled payments to farms planting upland cotton. The situation here is thus very different from the one in Canada - Aircraft where the Appellate Body first opined that "a panel should be willing expressly to remind parties – during the course of dispute settlement proceedings – that a refusal to provide information requested by the panel may lead to inferences[6] being drawn about the inculpatory character of the information withheld".[7] There is no basis for an "inference" of any kind, adverse or otherwise.[8]

Finally, we of course recognize that the Panel has the right to seek information which it deems appropriate pursuant to Article 13.1 of the DSU. We wish to recall, however, that panels must take care not to use the information gathered under this authority to relieve a complaining party from its burden of establishing a *prima facie* case of WTO inconsistency based on specific legal claims asserted by it. In *Japan – Measures Affecting Agricultural Products*, the Appellate Body explained that it is for a complaining party to make arguments supporting its specific legal claims and that the panel had erred in using information it had obtained to make a finding of inconsistency on the basis of an argument and claim not explicitly advanced by the complaining party.[9] In this dispute, Brazil has not advanced legal claims and arguments that decoupled payments should attribute across the total value of the recipients' production, nor has Brazil advanced claims and arguments setting forth any methodology for calculating the total amount of payments it challenges, as reflected in Question 258 from the Panel to Brazil. The Panel may not relieve Brazil of its burden of advancing and establishing claims and arguments relating to the value of decoupled payments benefiting upland cotton, a crucial element in Brazil's *prima facie* case under Articles 5 and 6 of the *Agreement on Subsidies and Countervailing Measures*.

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[6] The United States notes that in the same report the Appellate Body was careful to distinguish "adverse" inferences from other "inferences", remarking that: "We note, preliminarily, that the 'adverse inference' that Brazil believes the Panel should have drawn is not appropriately regarded as a punitive inference in the sense of a 'punishment' or 'penalty' for Canada's withholding of information. It is merely an inference which in certain circumstances could be logically or reasonably derived by a panel from the facts before it." *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 200 ("*Canada – Aircraft*").

[7] *Canada – Aircraft*, WT/DS70/AB/R, para. 204.

[8] The United States also notes that it is even less appropriate to draw "adverse inferences" in this dispute than in *Canada - Aircraft* in that Annex V, which was referred to by the Appellate Body in *Canada - Aircraft*, was rendered inapplicable by the Peace Clause in this dispute.

[9] Appellate Body Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/AB/R, adopted 19 March 1999, paras. 129-30.

# ANNEX K-43

## LETTER FROM THE UNITED STATES

28 January 2004

Enclosed with this letter the United States is providing a CD containing revised versions of the 6 electronic data files relating to the production flexibility contract era and the direct and counter-cyclical payment era that were transmitted to Brazil on 18 and 19 December 2003, and to the Panel on 18 and 22 December 2003. The enclosed CD contains six revised data files. The file names are identical to those previously submitted but with an "r" preceding the original file name. Thus, the files are now titled "rDcpsum.xls" (aggregate data file), "rDcpby.txt' (farm-by-farm base and yield data file), "rDcpplac.txt" (planted acres file), "rPfcsum.xls" (aggregate data filed), "rPfcby.txt" (base and yield data file), and "rPfcplac.txt" (planted acres file). We have prepared these revised electronic files after becoming aware of certain errors in the original data files submitted.

In the limited time available to reply to Brazil's request for data, certain programming errors appear to have resulted. As indicated in our letter of 18 December to the Panel, responding to the Brazilian request involved extracting pertinent information from approximately 10 million data files; because that request sought information relating to up to 10 programme crops on nearly 250,000 farms, the information provided by the United States ultimately spanned nearly 220 megabytes of data. Because that data was not the product of any established procedure with a protocol for cross-checking and verification, it was perhaps inevitable that certain errors should have occurred.

In preparing comments on Brazil's answer to question 258 from the Panel, the United States became aware that certain fields in the aggregate data files ("Pfcsum.xls" and "Dcpsum.xls") that the United States had prepared to assist the Panel and Brazil in interpreting the voluminous data in the farm-by-farm files contained no data (indicated by a zero ("0") or a dash ("-")). For example, looking at the original summary file for the direct and counter-cyclical payment era ("Dcpsum.xls"), those farms that in marketing year 2002 had upland cotton base acreage (4.7 million acres) but planted no cotton at all (0 acres), are also listed as having planted no acres of wheat, oats, rice, corn, sorghum, barley, flax, sunflower, safflower, soybeans, rapeseed, mustard, canola, crambe, or sesame on 15.9 million acres of cropland.

The United States has now expended significant effort correcting for programming errors and re-running the pertinent search. These efforts revealed that, while the cotton data continues to be correct (that is, farms with 4.7 million base acres of upland cotton planted not a single acre of cotton in marketing year 2002), in fact these farms planted approximately 10.3 million acres of these other crops and not zero as originally reported.

The corrected programming and new search generally corrected for instances in which the original search apparently failed to capture relevant data. The most significant revisions relate to (1) additional planted acres for other crops for those farms with upland cotton base acres that planted no cotton and (2) additional base acres for other crops for those farms without any upland cotton base acres that did plant cotton.

# ANNEX K-44

## LETTER FROM THE UNITED STATES

30 January 2004

The United States is in receipt of a document filed by Brazil with the Panel on 28 January 2004, providing Brazil's comments regarding data provided by the United States on 18 and 19 December 2003, and related matters. Brazil's filing of these comments was made 8 days after the deadline set by the Panel in communications dated 8 December and 24 December 2003, and on the date that had been established by the Panel for the United States to comment on Brazil's materials. Accordingly, my authorities have instructed me to respectfully request the Panel to specify the new date for the United States to file comments. The United States further suggests that since the Panel had originally provided that the United States would have eight days to provide its comments, the US comments could now be due eight days from the date the Panel establishes the new deadline.

As you know, on 8 December 2003, the Panel communicated to the Parties a revised schedule following the second panel meeting. The second paragraph of that coverfax and timetable reads: "As stated by the Chairman on 3 December, the United States will be given until **18 December** to respond to Brazil's request made in Exhibit BRA-369. Brazil will be given until **12 January 2004**, to comment on the US response." The third paragraph reads: "The parties may submit any further comments on each other's comments by **19 January 2004**."

On 24 December 2003, the Panel amended the timetable, stating that "all submissions originally due 12 January 2004 would now be due **Tuesday, 20 January 2004**" and "all submissions originally due 19 January 2004 would now be due **Wednesday, 28 January 2004**." Thus, Brazil had until 20 January 2004, to file its comments on the US data, and the United States had until 28 January 2004, to file its comments on Brazil's comments.

Brazil did not file its comments on 20 January, nor did it seek an extension of time from the Panel. Instead, Brazil simply delayed filing its 48 pages of detailed comments (with accompanying exhibits) until 28 January.[1] Providing the United States eight days to comment from the date of the Panel's communication of the new deadline would preserve the procedural balance originally established by the Panel.

[1] The United States finds Brazil's eight-day delay in meeting the Panel's deadline particularly ironic in light of Brazil's letters, such as its letter of 23 December 2003, complaining about the time of US filings.

# ANNEX K-45

## LETTER FROM BRAZIL

2 February 2004

The Government of Brazil is in receipt of a letter from the United States dated 30 January 2004 requesting an additional eight days to respond to Brazil's 28 January 2004 *Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled Data on 20 January 2004* ("*Brazil's Comments*"). Brazil would comment on the US request as follows:

First, the US 30 January 2004 letter suggests that Brazil was late in filing *Brazil's Comments*. This is incorrect. The US letter ignores the fact and the effect of the Panel's 12 January 2004 Communication, in which the Panel requested the United States to produce complete and unscrambled data concerning contract payment base and current plantings of upland cotton farms. This Communication necessarily mooted, at least temporarily, any comments by Brazil on the 18/19 December 2003 US "scrambled" data. It would have made little sense for Brazil to comment on the data deficiencies (and the implications thereof) on 20 January 2004, since Brazil trusted that the United States would have lived up to the Panel's repeated request and produced the data by 20 January 2004, as required by DSU Article 13.1. Only after the United States failed to produce the requested data was Brazil able to properly comment on the US data – and it did so on 28 January 2004 (in a much shorter time - 8 days - than originally foreseen by the Panel's 12 January 2004 deadline).

Second, the United States requests the opportunity to comment on Brazil's Comments and requests eight days to do so. Brazil is of the view that eight days from 28 January would be acceptable, which would make the US submission due on 5 February 2004. The United States already has had access to Brazil's Comments for five days (since 28 January 2004). The US request for what would amount to essentially two weeks to respond would further delay these proceedings. It would also violate Brazil's due process rights if the United States were given more time to comment on these documents than Brazil had to comment on the failure of the United States to produce the information on 20 January 2004.

Third, in order to preserve Brazil's due process rights, the Panel should limit the scope of the US "Comments" to responding to arguments that the United States has not yet had an opportunity to respond. For example, Sections 4, 5, 11 of *Brazil's Comments* simply respond to arguments and facts already presented in US letters of 18 December 2003 and 20 January 2004 in which the United States sought to justify the refusal to produce farm-specific data. The United States should not be given yet another opportunity to comment on Brazil's comments.

Fourth, the Panel should reject any attempt by the United States to present positive evidence in any comments without also giving Brazil an opportunity to respond. For example, the United States never presented the Panel with *any* application of its own proposed methodology for calculating and allocating the amount of contract payments to current upland cotton farmers. It would be manifestly unfair for the United States to present, in its last submission, positive evidence based on incomplete (non-farm specific data) in support of its defence when it has refused to provide any calculation, or even an estimate, for thirteen months – let alone produced the requested data that would permit Brazil or the Panel to do so.

Fifth, Brazil notes that the U.S. letter of 28 January 2004 provides Brazil and the panel with "revised" data files to correct for "certain errors" in the original data submitted forty days earlier on 18 December 2003. None of these "corrections" provide any useable farm-specific contract payment base and current planting data. Thus, the United States continues to violate the Panel's 8 December 2003 and 12 January 2004 requests for such information. Further, the 28 January 2004 revised data continues to suffer from the various aggregation problems identified in paragraphs 8-15, 22, 76-81, 90-98, of *Brazil's Comments*. Nor does the corrected data include complete information on market loss assistance payments (as identified in paragraphs 20, 22, 43, 82 and 95 as well as notes 40, 43, 75, 163, 164, 166, 195 and 197 of *Brazil's Comments*), or information on MY 2002 peanut base payments (as identified in paragraphs 21-23, 43 and 98 as well as notes 75, 132, 161, 166, 195 and 196 of *Brazil's Comments*). Thus, Brazil does not believe that this "revised" data, arriving *after* the 11th hour, is either timely or useful. If, however, the Panel believes that it would be useful for Brazil to provide revised calculations (based on the revised US summary data) replacing those set out in paragraphs 83 and 96 of *Brazil's Comments*, or comment in any other way on the revised US "scrambled" data, Brazil will be pleased to do so. Brazil recalls, however, that it provided the figures in those two paragraphs based on the flawed US summary data to demonstrate the existence of further support for its "14/16th" methodology estimated figures.

# ANNEX K-46

## LETTER FROM THE UNITED STATES

3 February 2004

The United States is in receipt of a letter filed by Brazil on 2 February 2004, commenting on the US request for the Panel to establish a new deadline for the United States to file comments on Brazil's comments regarding data provided by the United States on 18 and 19 December 2003, and related matters.

My authorities have instructed me to inform the Panel that the United States welcomes Brazil's statement that it has no objection to the Panel establishing a new deadline for the United States to comment on Brazil's comments. Brazil, however, objects to the United States being given eight days from the Panel's communication establishing the new deadline, arguing that it would "violate Brazil's due process rights if the United States were given more time to comment on these documents than Brazil had to comment on the failure of the United States to provide the information on 20 January 2004". With respect, this fundamentally misstates the issue.

Brazil had access to the 18 and 19 December data for nearly *six weeks* before filing its comments, due on 20 January but submitted on 28 January, and evidently used that time in order to prepare quite lengthy and detailed comments (over 50 pages plus exhibits). Yet Brazil objects to the Panel providing the United States with notice that it has eight days to prepare its response. Brazil would have the Panel upset the balance of time set out in its communications for the preparation of the respective comments of Brazil and the United States.

We also note Brazil's argument that the Panel's 12 January letter "necessarily mooted, at least temporarily", the 20 January date for the filing of Brazil's comments. It is ironic, to say the least, that Brazil should have complained about delays (measured in minutes) in filing certain US documents and then unilaterally have decided that it was entitled to an additional *eight days* in filing its comments since, in Brazil's view, "[i]t would have made little sense" for Brazil to comply with the Panel's 20 January deadline. Brazil did not request the Panel to modify the deadlines as a result of the Panel's 12 January letter. Brazil simply decided not to abide by the deadlines established by the Panel. Indeed, Brazil should have filed its comments on the 18 and 19 December data on 20 January as scheduled and has provided no reason why it was unable to do so.

If Brazil wanted a further opportunity from the Panel to comment on any response to the Panel's 12 January letter, it could have so requested. Brazil did not do so. Instead it simply ignored the Panel's deadline and used a nearly six-week period to provide comments on the US data. Thus, Brazil's February 2 letter continues to evince its one-sided tactics on procedural issues, in which Brazil seeks (or simply provides to itself) substantial periods of time to prepare its filings but seeks to deny adequate time to the United States to prepare its responses.[1]

[1] For example, the United States recalls that at the panel organizational meeting, Brazil objected to the United States having more than two weeks to prepare its first submission while at the same arguing that Brazil would need a full two weeks to prepare the executive summary of its own first submission. (Brazil did not volunteer that it had already drafted a first submission that would ultimately turn out to be more than 135 pages in length, with over 100 exhibits.) As the United States noted at the time, it seemed implausible that the United States could prepare a *substantive response* to a submission in two weeks if Brazil was unable to prepare a *summary* of that submission in less than that time.

We note Brazil's request that the Panel *ex ante* "limit the scope of the US 'Comments' to arguments [to which] the United States has not yet had an opportunity to respond" and prevent the United States from "present[ing] positive evidence". However, the Panel had previously established that the United States "may submit any further comments on [Brazil's] comments" by 19 January, 2004[2], later revised to 28 January 2004.[3] Therefore, Brazil's request does not comport with the Panel's previous communication, would prejudge what comments the United States may provide (and perhaps preclude relevant comments on new information presented by Brazil), and would impose a limitation with respect to arguments and evidence on the United States that was not imposed on Brazil.

Finally, Brazil continues to mischaracterize the situation when it asserts that the United States should have breached US law regarding the protection of individual privacy in order to produce additional data relating to planting and contract payment information on a farm-by-farm basis. We have previously explained in our letters of 20 January 2004, and 18 December, 2003 why under US law we are unable to provide the data requested. In part, this results from Brazil's refusal at the second panel meeting to allow *any* deviation from the request set out in Exhibit BRA-369, which specifically requested that the data be provided by farm with its associated FSA farm number. The United States responded to that request to the maximum extent permissible under US law.

In sum, the Panel had intended for the United States to provide comments and have 8 days from the 20 January deadline for Brazil's comments to do so. However, Brazil seeks to impose limitations that were not applied to its own comments, and which would significantly impair the information available to the Panel in evaluating the material before it and US rights of defence. We request that the Panel reject Brazil's unbalanced suggestions and suggest that the US comments be due eight days from the Panel's confirmation of the new deadline for filing those comments.

[2] Panel Communication of 8 December 2003.
[3] Panel Communication of 24 December 2003.

# ANNEX K-47

## LETTER FROM THE UNITED STATES

11 February 2004

Attached please find answers of the United States to 29 additional questions from the Panel following the second substantive meeting in the dispute *United States – Subsidies on Upland Cotton* (DS267) and the comments of the United States on Brazil's 28 January 2004 comments and new arguments on the extensive data provided by the United States.

The United States wishes to inform the Panel that it continues to work on preparing information requested by the Panel in its supplementary request for information pursuant to Article 13 of the DSU as well as certain information requested under the Panel's additional questions. Unfortunately, the very extensive nature of those requests for information have rendered it impossible for the United States to prepare and provide that information within the eight days requested by the Panel.

- For example, the Panel has requested that the United States provide "such of the information requested on 12 January 2004 in the format requested, as regards payment recipients who do not have interests protected under the Privacy Act [of] 1974, if any".[1] More than 250,000 farms fell within the farm criteria set out in Brazil's request in Exhibit BRA-369[2], to which the Panel's January 12 request referred. While it would not be possible to examine singly the records relating to each of these 250,000 farms, the United States continues to seek some means by which the identities of payment recipients who may not have protectable privacy interests could be identified. Eight days has not been sufficient time to complete that effort.

- In addition, the Panel has asked for a very substantial amount of acreage information for "covered commodities" over four marketing years under four different programmes and for all commodities for which planting information is maintained in marketing year 2002. A significant amount of time was required to generate the data in response to the Panel's earlier requests. That effort and the programming errors encountered in that response demonstrate that the response to the supplemental request also requires more than eight days.

Thus, the United States continues to work on responses to item (a) and all the bulleted subparts of item (b) of the Panel's supplementary request for information, as well as to Question 264(b) of the Panel's additional questions. Based on the work completed to date, our current understanding of the scope of the Panel's requests, and our experience completing (and revising) a similar, but smaller, computerized search for electronic files in December, the United States estimates that it would be able to provide the requested information by four weeks from the date the Panel provides the clarifications requested below. Of course, should the United States complete its preparation of the requested information prior to that date, we would make that information available to the Panel and Brazil at that time.

[1] Panel's Supplementary Request for Information Pursuant to Article 13 of the DSU, item (a) (3 February 2004).

[2] *See* US Letter to the Panel at 3 (December 18, 2003).

With respect to item (b) of the Panel's supplementary request for information, the United States would seek clarification of that request. First, the United States would ask the Panel to specify which commodities are "covered commodities" as that term is used in several of the bullet points and subbullets. Second, the United States would seek confirmation that, with respect to the information sought for marketing year 2002 "with respect to all crops on cropland covered by the acreage reports", the relevant portions of the "above questions" are those that ask for planted acreage information for each Category of farm. Clarifications of these points will assist the United States greatly in preparing data responsive to the Panel's request.

Finally, the United States notes that the Panel's communication of 3 February invites the parties "to submit, by Wednesday 18 February 2004, any comments on material submitted on 11 February by the other party". The United States understands this procedure to mean that, with respect to Brazil's 28 January comments on the data submitted by the United States on 18 and 19 December 2003, Brazil would be permitted to file comments on the US comments filed today. If this is not the case, the United States would appreciate the Panel providing clarification to the parties at its earliest convenience.

However, to the extent that the Panel has given Brazil the opportunity to file a reply on 18 February to the US comments filed today, and Brazil chooses to do so, the United States would request an opportunity to respond to Brazil's comments. The procedure set out by the Panel in its communications of 8 and 24 December 2003, originally set out one opportunity for Brazil to comment on the US data (on 20 January 2004) and one opportunity for the United States to respond to Brazil's comments (on 28 January 2004). As the responding party, the United States believes that it is important that it have the opportunity to respond to Brazil's arguments, particularly in this dispute where Brazil's arguments and legal positions have changed from submission to submission. To the extent that Brazil as complaining party is now being provided two opportunities to comment on the US data, the United States would feel bound to request a similar second opportunity to comment. We suggest that the deadline for the US reply could be set for Wednesday, 25 February.

# ANNEX K-48

## LETTER FROM BRAZIL

13 February 2004

The Government of Brazil is in receipt of a letter from the United States dated 11 February 2004 in which it informs the Panel that it is not providing the requested information by the 11 February 2004 deadline. Further, the letter requests (1) four additional weeks to provide data, and (2) the opportunity to respond to Brazil's 18 February 2004 comments on the "US data". Brazil asks the Panel to reject both of these requests.

In putting these requests into perspective, Brazil recalls that the entire contract payment exercise is to provide the Panel with sufficient data to determine and calculate (using whichever methodology the Panel deems appropriate) the amount of "support to" upland cotton for MY 1999-2002. The best way for the Panel to do this is if it has the actual data to calculate the amount of contract payments received by producers that planted cotton in MY 1999-2002. As the Panel knows, it does not yet have this actual data. Any objective assessment of the record indicates that Brazil has sought this contract payment information since November 2002, and that the Panel has sought it since it posed Question 67 *bis* to the United States in August 2003.

The immediate focus of this lengthy exercise is the Panel's 3 February 2004 "Supplementary request for information pursuant to Article 13 of the DSU and additional questions." ("3 February 2004 Request"). In part (a) of that request, the Panel asked for "such information requested on 12 January 2004 in the format requested, as regards payment recipients who do not have interests protected under the Privacy Act of 1974, if any". In a completely separate request (not conditioned on the Privacy Act), the Panel asked in part (b) for summary *aggregated* information that required the United States to compare farm-specific contract acreage data with farm-specific planting data. Data provided in response to part (b) could not possibly include any confidential information since it is aggregated.

The United States letter of 11 February 2004 states that it needs four additional weeks to complete the part (a) analysis. Brazil notes that because the United States apparently intends only to provide farm-specific information for far less than the total amount of farms (*i.e.*, those that are not held by "individuals") this information will be useless for calculating the exact amount of *total* contract payments. Therefore, Brazil does not believe that the United States should be given any additional time to produce this information. In this regard, it is important to stress that even if part of the farm-specific information were confidential under US law (which Brazil believes is not the case), the United States would still be required to produce the information requested by the Panel on 8 December 2003 and 12 January 2004 subject to WTO confidentiality procedures.

With respect to part (b) of the Panel's 3 February 2004 Request, the United States also claims it needs four additional weeks to complete this analysis. And it asks the Panel to "clarify" its request regarding what are "covered commodities" and "with respect to all crops on cropland covered by the acreage reports". The Panel's 3 February 2004 Request provided a chart which listed the "covered commodities". If the United States had any questions despite the clarity of this chart, then why did it wait 8 days to raise these questions? Further, the request for "crops on cropland covered by the acreage reports *not simply commodities covered by the programmes*" could not be clearer. Again,

why did the United States wait 8 days to bring this to the Panel's attention if it was truly puzzled by this condition of the Panel's request?

With respect to the enormous amount of time the United States claims it will take to produce information in response to part (b) of the Panel's 3 February 2004 Request, Brazil notes that the format of the Panel's Request was very similar to the *rice* FOIA request that is set out in Exhibit Bra-368. The testimony of Mark Somers before the Panel on 3 December 2003 indicated that the rice FOIA documents showed that USDA took less than a week to process the data and respond to the rice FOIA request once USDA's statistical experts began work on the project (and the time from filing the request to issuance of the data was 15 days). Indeed, Brazil was easily able to calculate the aggregate rice farm-specific base and acreage information in just a few days as set forth in Christopher Campbell's statement in Exhibit Bra-368. With its access to a number of USDA statistical experts, not to mention the centralized database with all of the records already inputted, it is simply not credible for the United States to claim that it needs more than five weeks to respond to the Panel's request.

As the Panel knows from reviewing Exhibit Bra-368, the data delivered by USDA's Kansas City office permitted the ready tabulation of the exact number of rice farms holding contract acreage and the amount of their rice acreage. The Panel's request for contract and planted acreage information on farms planting cotton is not fundamentally different from the rice request in terms of the type of data files at issue. The raw data in the contract and planted acreage (for all planted commodities) files that the United States would use to respond to the Panel's 3 February 2003 request are the same raw data files that have been in the centralized Kansas City database throughout this dispute. If there were any doubt about this, the United States demonstrated that it examined all the farm-specific data in its 18/19 December 2003 responses (albeit producing them in a scrambled format). Thus, part (b) of the Panel's 3 February 2004 Request did not involve any new data files – simply the writing of a programme that would allow the production of the data in an aggregated, non-confidential summary form, as defined and requested by the Panel.

Brazil believes that the Panel should not provide the United States with any additional time to respond to part (b) of its 3 February 2004 Request. The United States stood by and waited while the deadline approached without making any effort to request additional time or to seek clarifications. Yet, the United States had no difficulty during the same 8-day period in making extensive comments on Brazil's 28 January 2004 Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled Data on 20 January 2004. ("Brazil's 28 January Data Comments"). The United States provides no legitimate explanation why it could not complete part (b) of the Panel's request within the Panel's deadline. Indeed, the United States – in a non-litigation context – demonstrated in the rice FOIA request just how easy and fast it is to provide this information.

The Panel is now only one month away from the one-year anniversary of its establishment, and almost two months *beyond* the nine-month deadline for completing its work set out in DSU Article 12.9. Brazil has not objected to the Panel's laudable attempts to coax the United States into producing the actual non-scrambled data that would permit calculation of the amount of support provided to upland cotton producers from the four different contract payments. Brazil was willing to go along with the delays that each of these requests necessitated because it, presumably like the Panel, wanted the Panel to make use of the most complete and accurate information available to decide these important issues. Starting with its Question 67 *bis*, the Panel has now asked for contract payment information data on *five* separate occasions (Question 125(9) and 8 December 2003, 12 January 2004 and 3 February 2004 Requests). The Panel now has before it a pattern of delay by the United States that is seriously impinging on Brazil's due process rights to receive a timely resolution of its claims in this dispute.

Therefore, Brazil strongly believes that the United States has been given more than sufficient time (seven months) and opportunities (five) to produce the requested contract payment information in one form or another. If the Panel believes, however, that the required balance between ensuring high-quality panel reports and not unduly delaying the panel process requires providing yet another opportunity to the United States to produce the data requested in part (b) of the Panel's 3 February 2004 Request, then Brazil has the following additional comments. If the United States provides the complete information requested in part (b) of the 3 February 2004 Request, then most of Brazil's 28 January Data Comments would be rendered moot. The purpose of those comments was to (a) demonstrate the inadequacy of the US data production, (b) request the drawing of adverse inferences, and (c) in the absence of the actual data, to apply the inadequate summary data. Because the US 11 February 2004 comments on Brazil's 28 January 2004 Data Comments are only relevant to these underlying Brazilian comments, the US 11 February 2004 Comments will also similarly be largely rendered moot *if* the United States provides the data requested in part (b). With the actual and complete data, the Panel would be in the position to apply any methodology it determines to be acceptable. Further, by producing the complete aggregated information, there would no longer be a need to draw adverse inferences. Nor, would there be any need for Brazil to comment on the US use of the incomplete and inadequate data in applying the US methodology.

Accordingly, if the Panel provides the United States with additional time to provide the data (which Brazil opposes), it should allow Brazil the opportunity to file comments, to the extent any are still relevant, to the United States 11 February 2004 Comments to Brazil's 28 January 2004 Data Comments until 8 days *after* the United States has provided the information responsive to part (b) of the Panel's 3 February 2004 Request. By using this modified procedure, Brazil hopes to alleviate some of the considerable legal costs it has incurred in this extraordinary process. It would deny Brazil's due process rights to incur such unnecessary expenses by filing a response which would not assist the Panel in resolving the relevant issues in this dispute, assuming the United States provides the complete data requested in part (b).

Brazil also opposes the unjustified attempt by the United States to further delay this proceeding by seeking yet another opportunity to comment on Brazil's 18 February 2004 Comments. Brazil notes that the United States 11 February 2004 Comments to Brazil's 28 January 2004 Data Comments go far beyond what are legitimate comments on Brazil's original 28 January 2004 Data Comments. In particularly, in a number of instances, the US 11 February 2004 Comments address issues raised in Brazil's 28 January 2004 Comments on US Answers to Questions Posed by the Panel Following the Second Substantive Meeting of the Panel.

Thus, the United States, having already abused the Panel's procedures, now seeks yet another opportunity to comment. The Panel's 3 February 2004 Communication made it clear that the deadline for the United States to comment would be 11 February 2004. The US request would only serve to further delay these proceedings, to the detriment of Brazil.

Finally, Brazil asks the Panel to reject the United States' unilateral decision to take additional time to respond to Question 264(b). There is absolutely no legitimate reason for the United States to have failed to respond to this question; nor has the United States indicated any such reasons. The Panel's question in no sense called for a complicated analysis, and a response could readily have been provided within the 8-day response period. After reviewing the US response, Brazil was able to set up a table comparing the US and Brazilian figures in less than an hour.

# ANNEX K-49

## LETTER FROM THE UNITED STATES

16 February 2004

The United States is in receipt of a letter from Brazil dated 13 February 2004, requesting the Panel not to afford the United States additional time to provide certain requested information and the opportunity to respond to Brazil's anticipated 18 February 2004, comments on certain data submitted by the United States. My authorities have instructed me to make the following reply to these issues.

The United States has communicated to the Panel that work continues in response to the Panel's supplemental request for information and that the United States expects to complete this work within four weeks from the date the Panel provides certain clarifications to its request. The United States provided this time estimate on the basis of its work completed to date and questions that arose with respect to the Panel's request (the subject of our request for clarifications).[1] We also noted that item (a) in the Panel's request presented the challenge of seeking some means by which to review the identities of payment recipients on approximately 250,000 farms within the scope of the request, a task which was impossible to complete within the eight days the Panel had requested. Finally, in producing this time estimate, United States reflected on its experience in producing data for this dispute in December 2003. That data was provided within 15 days of its request, and, on subsequent review, contained a number of inaccuracies that had to be cured by a subsequent filing.[2] In addition to explaining the reasons supporting our estimate, we also made clear that "should the United States complete its preparation of the requested information prior to that date, we would make that information available to the Panel and Brazil at that time".[3]

If anything, the data requested by the Panel on 3 February 2004, is more extensive than the information requested in December as it requests that additional data be sought and that different aggregations be provided. By way of example, for marketing year 2002, we understand that the Panel has requested planted acreage data for all "crops" for each Category of farm set out in the request.[4] The Panel will recall that in marketing year 2002, the "crops" for which crop insurance premium subsidies were available included:

> Almonds, apples, avocado, avocado trees, barley, blackberries, blueberries, burley tobacco, cabbage, canola, cherries, chile peppers, cigar binder tobacco, cigar filler

[1] With respect to the first point of clarification sought by the United States, Brazil points to a table in the Panel's supplemental request for information. We note that two of the headings in that table, "soybeans" and "other oilseeds", are marked with an asterisk, which denotes "[w]here applicable". *See* Panel's Supplemental Request for Information, at 2 (3 February 2004). The United States has requested clarification of the Panel's supplemental request because, even with that table, the precise scope of the term "covered commodity" and where soybeans and other oilseeds are "applicable" are not clear.

[2] *See* US Letter to Panel of 28 January 2003 (transmitting CD-ROM with revised data files).

[3] *See* US Letter to Panel of 11 February 2004, at 2.

[4] Whether the data sought was planted acreage only for farms falling within each Category of farm was the second point of clarification raised by the United States. *See* US Letter to Panel of 11 February 2004, at 2. The United States was not asking for a list of "crops" covered by that request, a point which Brazil evidently misunderstands. Brazil's Letter to the Panel of 13 February 2004, at 2 ("Further, the request for 'crops on cropland covered by the acreage reports *not simply commodities covered by the programmes'* could not be clearer.").

> tobacco, cigar wrapper tobacco, citrus (grapefruit, lemons, limes, mandarins, murcotts, navel orange dollar, oranges, tangelos, tangerines), citrus trees, corn, cotton, cotton extra long staple, crambe, cranberries, cultivated clams, cultivated wild rice, dark air tobacco, dry beans, dry peas, figs, fire-cured tobacco, flax, Florida fruit trees, carambola, flue-cured tobacco, forage production, forage seed, forage seeding, fresh apricots, fresh nectarines, fresh market beans, fresh market sweet corn, fresh market tomatoes, grain sorghum, grapes, green peas, hybrid corn seed, hybrid sorghum seed, macadamia nuts, macadamia trees, mango trees, Maryland tobacco, millet, mint, mustard, nursery, oats, onions, peaches, peanuts, pears, pecans, peppers, plums, popcorn, potatoes, processing apricots, processing beans, processing cucumbers, prunes, raisins, rangeland, rapeseed, raspberries, rice, rye, safflower, soybeans, stonefruit (processing apricots, processing cling peaches, processing freestone), strawberries, sugar beets, sugarcane, sunflowers, sweet corn, sweet potatoes, table grapes, tomatoes (canning and processing), walnuts, wheat, and winter squash.[5]

Thus, this one element of the Panel's supplemental request would seem to require the United States to gather and organize a substantial amount of information not previously provided.

We do note again that the Panel's request for aggregated acreage data does not involve privacy issues and thank the Panel for seeking the data in this format, which allows the United States both to provide data in a manner consistent with its domestic law and to do so in a way that may be of assistance to the Panel. Had Brazil requested data in a similar aggregated format or responded positively to the US request at the second panel meeting for alternatives that would allow farmer privacy interests to be protected, a brief delay would not be necessary while the United States seeks to provide the requested data. Brazil did not respond positively to that request, insisted on receiving the data in a format that would reveal farmer identities, and never requested the Panel to seek data from the United States in aggregated form – despite the fact that *only Brazil was aware of its invented methodology until it responded to the Panel's Question 258 on 20 January 2004*. Had Brazil included its methodology in its first submission on Peace Clause issues (on 24 June 2003), all the time now being devoted to these topics could quite likely have been saved. Brazil's complaint that the United States is responsible for any perceived delays in the Panel's schedule would thus appear to be sorely misdirected.

We note Brazil's suggestion that, should the Panel accept the data the United States is preparing in response to item (b) of the Panel's supplemental request for information, "then most of Brazil's 28 January Data comments would be rendered moot".[6] We are not exactly sure what that statement means or how it relates to Brazil's objection to the United States requiring additional time to provide a response to the information that the Panel has requested. However, Brazil further states that "by producing the complete aggregated information, there would no longer be a need to draw adverse inferences".[7] The United States welcomes this belated recognition by Brazil that disclosure of farm-specific information of contract acreage and planted acreage is *not* necessary under Brazil's invented allocation methodology.

Brazil also questions the United States' comment that it will require additional time to respond to Question 264(b), saying that "Brazil was able to set up a table comparing the US and Brazilian figures in less than an hour." It does not appear to the United States that the Panel's question simply called for "set[ting] up a table" to compare the data referenced in that question. For

[5] Exhibit Bra-62 (US Department of Agriculture, Crops Covered Under the 2002 Crop Insurance Programme) (www.rma.usda.gov/policies/02croplist.html).

[6] Brazil's Letter to Panel of 13 February 2004, at 5.

[7] *Id.*

example, Brazil asserted in paragraph 135 of its 28 January 2004, comments on US answers that "the difference between the chart provided by the United States in Exhibit US-128 and Brazil's chart in para. 165 of its 11 August Answers lies in the treatment of rescheduled debt". To provide a helpful answer would seem to require that the United States examine what goes into each of the figures that are represented in Brazil's chart. The United States was not able to complete that analysis within the eight days provided – but was able to generate and provide in its 11 February answers copious amounts of numbers and data in response to the 29 Panel questions. Rather than seek an extension with respect to *all* questions, we provided the data we could on 11 February and will provide any other data in response to Question 264(b) within the time indicated (and sooner if the data can be collected and examined in less time).

With respect to comments by the Parties on the materials that the United States is preparing, we would not object to the Panel granting Brazil an opportunity to comment on the data to be provided by the United States in response to item (b) of the Panel's supplemental request. However, we cannot understand nor accept Brazil's suggestion that the United States should not be afforded an opportunity to reply to Brazil's comments. Since Brazil is seeking another opportunity to comment (eight days after the United States has provided the information in response to item (b)), there would be no significant "further delay in these proceedings, to the detriment of Brazil" were the United States to file its reply to Brazil's comments within, say, one week of those comments. In this respect, we note that Brazil continues its one-sided approach to procedural issues by seeking to provide itself with an opportunity to comment but to deny the same to the United States. Since this would be the first time Brazil's comments on the item (b) data would be presented, the United States as responding party must be given an opportunity to respond.[8]

Finally, the United States regrets that Brazil has repeated its suggestion that the United States should provide data protected by the Privacy Act and that the United States should rely on WTO confidentiality provisions in doing so. Apart from the fact that the United States is not able under its domestic law simply to ignore US persons' Privacy Act interests on that basis, the growing number of press articles revealing non-public information about this dispute makes that suggestion even less tenable.[9]

[8] In this connection we would like to draw the Panel's attention to a previous proceeding in which Brazil's last-minute submission of evidence and legal argumentation raised difficulties for the other party involved. Report of the Arbitrator in *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Recourse to Arbitration by Canada, WT/DS222/ARB, paras. 2.14 and 2.16. We recall that in the present dispute, Brazil first failed to explain its invented allocation methodology until 20 January 2004 – eight months into this dispute – when compelled to do so by the Panel. Then, Brazil delayed submitting its comments on the US December data until 28 January 2004 – eight days after the deadline set by the Panel. Now, Brazil would seek to have an opportunity to comment on the item (b) data – despite the necessary "delay in the proceeding" that would entail – but simultaneously seeks to deprive the United States of its "right – as respondent – to speak last." In this dispute, it would be singularly inappropriate to allow Brazil the final chance to comment.

[9] The most recent example contains a reference to the statement in a Panel communication to the United States that a failure to provide certain requested information without adequate explanation could lead to adverse inferences being drawn. (Exhibit US-155.) As far as the United States is aware, any communication from the Panel to the parties are subject to the confidentiality rules of the proceeding.

# ANNEX K-50

## LETTER FROM THE UNITED STATES

23 February 2004

The United States thanks the Panel for its communication of 20 February 2004, in which the Panel extends to the United States the opportunity to respond to Brazil's 18 February submission relating to certain data provided by the United States on 18 and 19 December 2003. The United States would like to confirm that it does wish to comment on this Brazilian submission. The Panel has asked the United States to file any comments within five days, that is, by Wednesday, 25 February. In light of the extensive material submitted by Brazil and US efforts to respond simultaneously to the Panel's supplemental request for information, the United States would like to ask the Panel to extend the deadline to provide these comments, to Wednesday, 3 March, the same due date for the US response to the Panel's supplemental request for additional information.

This extension would greatly assist the United States in providing useful comments for the Panel on Brazil's lengthy 18 February comments, which totalled 79 pages. Of these 79 pages, 41 pages were devoted to setting forth results of numerous calculations. The personnel who would need to review these calculations are also involved in the ongoing US efforts to provide data in response to the Panel's supplemental request for additional information. The extension requested would permit these personnel to better advance US efforts to respond fully and accurately to the Panel's supplemental request while simultaneously reviewing and providing comments on Brazil's 18 February submission.

In addition, we note that the extension requested would not impact any other dates set by the Panel in this proceeding. Thus, the United States respectfully requests the Panel to extend the deadline to provide the US comments, to Wednesday, 3 March.

The United States is providing a copy of this letter directly to Brazil.

# ANNEX L

## COMMUNICATIONS FROM THE PANEL



[1] Communications included as L-1.4, -1.7, -1.11, -1.12, -1.13 and -1.14 were also sent to 3rd parties.

# ANNEX L-1.1

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

21 May 2003

I refer to the letter from the United States dated 21 May 2003and addressed to the Chair of the Panel. I understand this was also copied to your delegation. The Panel wishes to ask Brazil to communicate its views, if any, in writing in response to this letter.

The Panel would appreciate if Brazil's written response could be submitted before the close of business this Friday, 23 May 2003. This is in view of the fact that the Chairman of the Panel, Mr. Rosati, is proposing to convene an organizational meeting with the parties on Monday 26 May 2003 from 11:30 a.m. The venue will be communicated to you shortly.

# ANNEX L-1.2

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

27 May 2003

The Panel takes note of the United States' comments with respect to the Panel's timetable and working procedures, dated 21 May 2003, and Brazil's communication dated 23 May 2003.

Attached you will find the Panel's proposed **working procedures and timetable**. The Panel intends to hold an **organizational meeting with the parties at 8 a.m. on Wednesday, 28 May** 2003 at room C in order to hear the parties' views on these proposals.

As indicated in the attached proposed timetable, prior to the submission by the parties of their first written submissions, the Panel intends to request the parties to address, in their initial briefs to the Panel, the following:

- whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue.

As also indicated in the attached timetable, the Panel will invite the parties to submit any written comments on each other's comments on this issue. The Panel currently wishes to signal its intention to clarify to the parties its view on these issues prior to the parties' submission of their first written submissions.

In the event that the Panel were to rule that Article 13 precludes the Panel from considering certain claims raised by Brazil prior to a conclusion that certain conditions of Article 13 remain unfulfilled, we may decide to adjust the timetable to permit the parties to make further submission(s) after the second substantive meeting and to schedule further substantive meeting(s), as necessary, with the parties.

With respect to the participation of third parties in these Panel proceedings, the Panel is aware of the provisions of Article 10.3 of the *DSU*, which states that third parties shall receive the submissions of the parties to the dispute to the first meeting of the Panel. Given the significant systemic issues in this Panel proceeding, and in exercise of our discretion to manage these Panel proceedings, we believe that it would be appropriate in this case for the third parties to have access to the parties' initial written comments (and any written comments the parties may make on each others' comments) as well as to have the ability to submit any written comments they themselves may have on the issue that we have identified above. We therefore intend to invite the parties to serve also on the third parties their initial briefs and any responding comments. At the organizational meeting, we will invite any comments you may have on this proposed approach to third party participation.

[Attachment omitted]

# ANNEX L-1.3

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

28 May 2003

Attached you will find the timetable and working procedures adopted by the Panel for this dispute in accordance with Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*"). In adopting the timetable and working procedures, the Panel has carefully considered the parties' comments at this morning's organizational meeting.

As indicated in the attached timetable, prior to the submission by the parties of their first written submissions, the Panel requests the parties to address, in their initial briefs to the Panel (to be submitted on 5 June 2003), the following:

- whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article 13.

As also indicated in the attached timetable, the Panel will invite the parties to submit any written comments on each other's comments on this issue (i.e. on 13 June 2003). The Panel intends to rule on these issues on 20 June 2003, prior to the parties' submission of their first written submissions.

As has been indicated, the Panel recognizes that it may need to revisit certain aspects of its timetable and working procedures in light of developments during the course of the Panel procedures, including the nature of the Panel's ruling that is scheduled for 20 June 2003. In particular, in the event that the Panel were to rule that Article 13 precludes the Panel from considering certain claims raised by Brazil prior to a conclusion that certain conditions of Article 13 remain unfulfilled, we may decide to adjust the timetable to permit the parties to make further submission(s) after the second substantive meeting and to schedule further substantive meeting(s), as necessary, with the parties. Related amendments to the working procedures may also be made, if necessary.

With respect to the participation of third parties in these Panel proceedings, we have carefully considered the parties' comments at this morning's organizational meeting. In exercise of our discretion to manage these Panel proceedings, we continue to believe that it would be appropriate in this case for the third parties to have access to the parties' initial written comments (and any written comments the parties may make on each others' comments) as well as to have the ability to submit any written comments they themselves may have on the issue that we have identified above. The Panel considers that such third party participation in this initial stage of the Panel proceedings is appropriate for the following reasons.

The Panel is aware of the provisions of Article 10.3 of the *DSU*, which states that third parties shall receive the submissions of the parties to the dispute to the first meeting of the Panel. We would also observe that the factual circumstance that presents itself here is not itself specifically addressed by the *DSU*. In our view, the legal issue that the Panel has asked the parties to address in their initial briefs will necessarily have ramifications for the remainder of the Panel proceedings, including the scope of the first substantive meeting, at which third parties will participate.

We therefore invite the parties to serve also on the third parties their initial briefs and any responding comments. The Panel will also invite third parties to submit any written comments they might have concerning the initial phase of these proceedings. The deadline for any third party comments is 10 June 2003. The parties' comments to be submitted on 13 June may, of course, also address comments made by third parties.

[Attachment omitted]

# ANNEX L-1.4

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THIRD PARTIES

20 June 2003

1. In a communication to the Panel, dated 21 May 2003, prior to the Panel's adoption of its working procedures, the United States had "propose[d] that the Panel organize its procedures to deal with the threshold Peace Clause issue at the outset of this dispute". The United States asserted *inter alia* that "[b]ecause in this dispute Brazil has made claims under 17 different provisions of the WTO Multilateral Agreements with respect to numerous US programmes under at least 12 US statutes, we believe the Panel's consideration of the critical Peace Clause issue would be aided by briefing and argumentation focused on this threshold issue". Brazil submitted a communication in response, dated 23 May 2003, opposing the US proposal.

2. On 28 May 2003, after having heard the views of the parties, we adopted our timetable and working procedures in accordance with Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*").

3. At the same time, we indicated that we would consider giving a ruling on certain issues on 20 June 2003, prior to the submission by the parties of their first written submissions, in relation to the following question and we requested the parties and third parties to address us in relation to it:

> "whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article 13."

4. The parties submitted their initial briefs on this question on 5 June 2003. On 10 June, the following six third parties submitted briefs: Argentina; Australia; European Communities; India, New Zealand and Paraguay. The parties submitted further comments on 13 June 2003.

5. Article 13(a)(ii) of the *Agreement on Agriculture* states that domestic support measures that conform fully to the provisions of Annex 2 of the *Agreement on Agriculture* shall be exempt from actions based on Article XVI of *GATT 1994* and Part III of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*"). Article 13(b)(ii) of the *Agreement on Agriculture* states that domestic support measures that conform fully to certain conditions shall be "exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year." Articles 5 and 6 of the *SCM Agreement* are each qualified by the proviso that "[t]his Article does not apply to subsidies maintained on agricultural

products as provided in Article 13 of the Agreement on Agriculture". Article 13(c)(ii) of the *Agreement on Agriculture* provides that export subsidies that conform fully to the provisions of Part V of that Agreement, as reflected in each Member's Schedule, shall be "exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement". Article 3.1 of the *SCM Agreement*, which prohibits export subsidies, is qualified by the proviso: "Except as provided in the *Agreement on Agriculture*...". These provisions of Article 13 afford a conditional exemption from certain obligations relating to certain actionable and prohibited subsidies under the provisions of the *SCM Agreement* and Article XVI of the *GATT 1994*. This conditionality requires, *inter alia*, a comparison of facts with the applicable exemption requirements.

6. Briefly, Brazil asserts that the Panel can simultaneously consider all of the arguments and evidence on the substance of its claims under the *SCM* and *Agriculture Agreements*, while the United States asserts that the Panel is precluded from examining the SCM claims concerning prohibited and actionable subsidies in the absence of a prior ruling that the conditions of Article 13 of the *Agreement on Agriculture* are not satisfied, and, even if not, the Panel should exercise its discretion to order its proceedings in this way. All of the six third parties that made submissions support the view that the Panel is not precluded from simultaneously considering all of the arguments and evidence on the substance of Brazil's claims under the *SCM* and *Agriculture Agreements*, or, putting this another way, that conclusions on the applicability of the Article 13 exemptions do not have to be made before consideration of SCM claims in relation to the measures concerned.

7. We are faced with two questions:

- first, whether we are *required* to defer any examination of certain of Brazil's claims based on Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* until after making a ruling or expressing views on the issue of fulfilment of *Agreement on Agriculture* Article 13 conditions; and

- second, if not, then *how* we should exercise our discretion to best structure our examination of the matter before us.

8. These questions concern the manner in which we should or must treat the claims of Brazil based on Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* having regard to the provisions of Article 13 of the *Agreement on Agriculture*.

9. We therefore look first to the dispute settlement procedures governing disputes under the *SCM Agreement*. Article 30 of the *SCM Agreement* states: "The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding shall apply to consultations and the settlement of disputes under this Agreement, except as otherwise specifically provided herein."

10. We thus turn next to the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*") and to the terms of the *SCM Agreement* itself (in order to see whether or not there is anything otherwise specifically provided therein). Article 1.1 of the *DSU* is entitled "Coverage and Application". It states that "[t]he rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the "covered agreements")."

11. As the Appellate Body has observed, "[a]rticle 1.1 of the DSU establishes an integrated dispute settlement system which applies to all of the agreements listed in Appendix 1 to the *DSU* (the "covered agreements"). The DSU is a coherent system of rules and procedures for dispute settlement

which applies to "disputes brought pursuant to the consultation and dispute settlement provisions of" the covered agreements."[1] The *SCM Agreement* and the *GATT 1994* are Multilateral Agreements on Trade in Goods in Annex 1A of the *WTO Agreement* and are therefore "covered agreements" listed in Appendix 1 of the *DSU*. The general *DSU* rules and procedures do not set forth any specific distinct way to deal with claims under the *SCM Agreement* and the *GATT 1994* having regard to the provisions of Article 13 of the *Agreement on Agriculture*.

12. Article 1.2 of the *DSU* provides, in relevant part, that the rules and procedures of the *DSU* shall apply subject to such special or additional rules and procedures on dispute settlement contained in the covered agreements as are identified in Appendix 2 to the *DSU*.

13. We therefore examine whether Appendix 2 to the *DSU* identifies any special or additional dispute settlement rules or procedures relating to the *SCM Agreement* or to Article XVI of the *GATT 1994*.

14. Appendix 2 of the *DSU* does not identify Article XVI of the *GATT 1994* as a special or additional rule. It does identify Articles 4.2-4.12 and Articles 7.2-7.10 of the *SCM Agreement* as "special or additional rules and procedures". These provisions contain special procedures and remedies for disputes involving prohibited and actionable subsidies governed by the *SCM Agreement*. However, none of these provisions purports to confer any sort of precedence or priority for considering SCM remedies in a dispute involving claims under the *Agreement on Agriculture*. Furthermore, Article 7.1 of the *SCM Agreement*, which is not identified as a special or additional rule or procedure in Appendix 2 of the *DSU*, indicates that it applies: "Except as provided in Article 13 of the Agreement on Agriculture....". This clearly indicates to us that this provision must be read in the light of the provisions of Article 13 of the *Agreement on Agriculture*. Moreover, as noted in para. 5 above, the substantive provisions to which these remedial articles are linked – Articles 3, 5 and 6 – stipulate either that they apply "except as provided in the Agreement on Agriculture" (Article 3 relating to prohibited subsidies), or that they do "not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture" (Articles 5 and 6.9 of the *SCM Agreement*, entitled "Adverse Effects" and "Serious Prejudice", respectively).

15. The cited provisions of the *SCM Agreement* refer, as just indicated, to the *Agreement on Agriculture*, and some specify more precisely Article 13 of the *Agreement on Agriculture*. We therefore examine the rules applicable to dispute settlement under the *Agreement on Agriculture*, which is also a Multilateral Agreement on Trade in Goods in Annex 1A of the *WTO Agreement* and is, therefore, a "covered agreement" listed in Appendix 1 of the *DSU*. Article 19 of the *Agreement on Agriculture* is entitled "Consultation and Dispute Settlement". It states that the provisions of Articles XXII and XXIII of *GATT 1994*, as elaborated and applied by the *DSU*, shall apply to consultations and the settlement of disputes under that Agreement.

16. Appendix 2 to the *DSU* does not identify any special or additional dispute settlement rules or procedures relating to Article 13 of the *Agreement on Agriculture*.

17. Consequently, consistent with our consideration of the relevant provisions, there is no special dispute settlement requirement foreseen in the covered agreements in respect of a panel's consideration of the fulfilment of Article 13 conditions. The issue of fulfilment of the conditions of Article 13 of the *Agreement on Agriculture* is to be resolved using generally applicable *DSU* rules and procedures. The fact that certain very specific provisions are included in Appendix 2 of the *DSU* as special or additional rules indicates that, when the drafters intended to make a particular provision

[1] Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico* ("*Guatemala – Cement I*"), WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, 3767, para. 64.

applicable as a special or additional dispute settlement rule, they did so explicitly. Therefore, their failure to include a reference to any provision of the *Agreement on Agriculture* in the text of Appendix 2 demonstrates that they did not intend to make any provision of that Agreement a special or additional dispute settlement rule. It is not necessary for us to look for any further interpretive guidance on this issue.

18. We next turn to the issue of how we should structure our procedures to consider the matter before us. As we have concluded above, this issue is subject to the *DSU* but not otherwise affected by the covered agreements. In this regard, within the overall parameters set by the *DSU* of prompt and efficient dispute resolution[2], we must exercise our discretion as to how best to organize our procedures. Our discretion must be guided by the instructions given to us by the *DSU*. Pursuant to Article 12.1 of the *DSU*, "[p]anels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute". Moreover, Article 12.2 provides: "Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process."

19. Article 11 of the *DSU*, entitled "Function of Panels" provides that the function of panels is to assist the DSB in discharging its responsibilities under the *DSU* and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Article 11 contemplates that a panel must make an "objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements." It does not require that a panel must conduct its proceedings in any particular way, provided that its requirements are fulfilled. It is within our discretion to manage our procedures so as to best fulfil the requirements of Article 11.

20. Given the potential complexity of the claims before us, the conditional nature of certain of these claims and the volume of evidence which may be introduced by the parties in support of their claims and arguments, and in order to organize our proceedings in an orderly, effective and efficient manner which serves to facilitate an objective assessment of the matter before us, and optimizes use of our resources, we have adopted the following modifications to our procedures (as indicated in the attached timetable):

- The Panel intends to express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, to the extent that it is able to do so, by **1 September 2003**, and will defer its consideration of claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as those provisions are referred to in Article 13 of the *Agreement on Agriculture* until after it has expressed those views. The Panel's views may be expressed in the form of rulings which could affect the Panel's further consideration of this dispute.

- In order that third parties may participate effectively at the first meeting at which the claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as referred to in Article 13 of the *Agreement on Agriculture* are examined (as necessary), the Panel intends to divide its first meeting into two sessions, each of which will include a third party session.

[2] Article 3.3 of the *DSU* provides: "The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

- Accordingly, for the purposes of the first session of the first substantive meeting on 22-24 July 2003, the Panel does not require the parties to address claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as referred to in Article 13 of the *Agreement on Agriculture*. Having said this, the Panel notes that this does not preclude the parties from addressing such matters in their first submissions.

- All other claims of Brazil in relation to measures which Brazil maintains do not involve a consideration of Article 13 of the *Agreement on Agriculture* should also be addressed in first submissions, in order for the other party and third parties to have an opportunity to express their views on any such claims.

- For the purposes of allowing the Panel to express its views on the exemption conditions of Article 13 of the *Agreement on Agriculture* by 1 September 2003, in relation to those measures which may be affected by Article 13, full and complete submissions on factual and legal issues related to Article 13 in this dispute will need to be provided, at the latest, in the parties' rebuttal submissions (to be submitted on 22 August 2003).

21. We recognize that we may need to revisit certain aspects of our timetable and working procedures in light of developments during the course of the Panel procedures. Related amendments to the working procedures may also be made, if necessary. We have been mindful of due process considerations in revising our timetable and will continue to ensure that the parties have reasonable time to prepare for any subsequent stages of the dispute, as appropriate.

[Attachment omitted]

# ANNEX L-1.5

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

25 July 2003

Please find attached a communication from the Panel on the following issues:

1. The Panel's view on the preliminary ruling requested by the United States.
2. Questions from the Panel to the parties.
3. A copy of the Panel's questions to third parties (sent for your reference)

The Panel's questions are intended to facilitate the work of the Panel, and do not in any way prejudge the Panel's findings on the matter before it. Nor does the fact that the Panel has placed these questions under certain headings prejudge the Panel's findings on the matter before it. Each party is free to respond to or comment on questions posed to the other party or third parties.

Please be reminded that as stated by the Chairman of the Panel in the meeting, parties are requested to submit answers by the close of business of 4 August 2003. Subsequently, parties can submit comments to each other's responses by the close of business 22 August, the same deadline applicable to the rebuttal submissions

Panels' views on the preliminary ruling requested by the United States

1. The United States requests a preliminary ruling that:

(1) export credit guarantee measures relating to eligible US agricultural commodities other than upland cotton,

(2) production flexibility contract payments and market loss assistance payments, and

(3) the Agricultural Assistance Act of 2003

are not within the Panel's terms of reference.[1]

2. Brazil asserts that these items are properly within the Panel's terms of reference and asks the Panel to reject the United States' request.[2]

3. The Panel wishes to indicate to the parties how it intends to rule on items (1) and (2), in order to assist them in deciding what argumentation and evidence to submit in their answers to questions and rebuttals.

4. The DSB established the Panel at its meeting on 18 March 2003 with the following standard terms of reference:[3]

> "To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

5. With respect to item (1), the Panel intends to rule in its report that "export credit guarantees … to facilitate the export of US upland cotton, and other eligible agricultural commodities" as addressed in document WT/DS267/7, are within its terms of reference.

6. With respect to item (2), the Panel intends to rule in its report that production flexibility contract payments and market loss assistance payments as addressed in document WT/DS267/7 are within its terms of reference. This is without prejudice to the relevance, if any, of those payments under Article 13(b) of the *Agreement on Agriculture*, Articles 5, 6 and 7 of the *SCM Agreement* and Article XVI of *GATT 1994*.

7. The Panel has not yet decided upon its approach to item (3) and asks the parties not to exclude consideration of the Agricultural Assistance Act of 2003 in responding to the Panels' written questions and in rebuttal submissions.

[1] US First Written Submission, para. 218.
[2] Brazil's Oral Statement at the First Substantive Meeting, paragraphs 90, 144 and 145.
[3] WT/DSB/M/145 (paragraph 35)

Questions from the Panel to the parties –
First session of the first substantive Panel meeting

UPLAND COTTON

1. Please confirm that all information and data that you have provided to the Panel relating to "cotton" in fact relates to upland cotton only. **BRA, USA**

PRELIMINARY ISSUES

*Note to parties: As indicated in the cover note, the Panel has expressed its views in respect of the three United States requests for preliminary rulings. The Panel's questions reflected in this compilation relating to the requested preliminary rulings on which the Panel has expressed its views are those that were posed in the course of the first session of the first Panel meeting. This is to give an opportunity for the parties to transpose into writing their oral responses.*

**Product scope of Panel's terms of reference relating to Brazil's export credit guarantee claims**

2. Is Brazil's claim in relation to export credit guarantees against the measures said to constitute the GSM-102, GSM-103 and SCGP programmes in their entire application, or against the measures said to constitute the GSM-102, GSM-103 and SCGP programmes in their application to upland cotton, or both? **BRA**

3. If the request for consultations in this dispute omitted certain *products* in relation to export credit guarantees, on what basis is it argued that it failed to identify the *measures* at issue in accordance with Article 4.4 of the *DSU*? **USA**

4. Is it argued that the export credit guarantee programmes concerning upland cotton are each a separate or independent *measure*, in that they operate independently? **USA**

5. Is there a specification in any legislation or regulation (or any other official government document) which limit or restrict the export credit guarantee programmes at issue exclusively to upland cotton? **USA**

6. For the purposes of the Panel's examination of Brazil's claims relating to GSM-102, GSM-103 and SCGP under the *Agreement on Agriculture* and the *SCM Agreement*, is accurate data and information available with respect to these export credit guarantee programmes concerning upland cotton alone (e.g. with respect to "long-term operating costs and losses")? In this respect, the Panel also directs the parties' attention to the specific questions below relating to the programmes. **USA**

7. Are commitments with respect to export subsidies under the *Agreement on Agriculture* commodity-specific? How, if at all, is this relevant? **BRA, USA**

8. Does the United States confirm that the questions referred to by Brazil in paragraph 92 of Brazil's oral statement were posed to the United States in the consultations? **USA**

9. How does the United States respond to paragraph 94 of Brazil's oral statement? **USA**

10. What actual prejudice, if any, has the United States suffered as a result of the alleged omission of products other than upland cotton from the request for consultations? **USA**

11. Does the United States agree that Brazil's request for establishment of the Panel can be understood to indicate that Brazil's export credit guarantee claims relatesto products other than upland cotton? How, if at all, is this relevant? **USA**

12. Please address issues and submit evidence regarding the three export credit guarantee programmes concerned relating to upland cotton and other eligible agricultural commodities in your answers to questions and rebuttal submissions. **BRA, USA**

13. Please include any argumentation and evidence to support your statement during the Panel meeting that the inclusion of such other eligible agricultural commodities would create additional "work" for the Panel with respect to each of these commodities under Article 13 of the *Agreement on Agriculture*. **USA**

**Expired measures**

14. Please submit evidence regarding the programmes under the 1996 FAIR Act, in particular, production flexibility contract payments and market loss assistance payments, to the extent that they would be relevant to the Panel's determination under Article 13 of the *Agreement on Agriculture* in your answers to questions and rebuttal submission. **USA**

15. Do the parties agree that it is beyond a Panel's power to recommend a remedy for an expired measure? Could the Panel could be required to examine "expired measures" in order to conduct its assessment of the matter before it? How, if at all, is Article 7.8 of the *SCM Agreement* relevant to these matters? **BRA, USA**

**Agricultural Assistance Act of 2003**

16. What, if any, prejudice in terms of the presentation of its case does the United States allege, should the Panel proceed to consider the measures constituting the cottonseed payments under the Agricultural Assistance Act of 2003? **USA**

17. (a) What is the relationship of the Agricultural Assistance Act of 2003 to other legislation in the request for establishment of the Panel? **BRA, USA**

(b) Do the legal instruments follow directly one after another, or are there temporal gaps? Are payments authorized under a broad legislative authority or are they specific to each legal instrument? **BRA, USA**

(c) Please provide any implementing regulations. Do these implementing regulations resemble those relating to previous programmes or payments? Are payments made retrospectively? How if at all is this relevant? **BRA, USA**

18. If the Panel is correct in understanding that cottonseed payments are divided between processors and producers, how is this reflected in Brazil's calculations? **BRA**

**Measures at issue**

19. The Panel notes that Brazil's panel request refers, *inter alia*, to alleged "subsidies" and "domestic support" "provided" in various contexts. Please specify the measures, in particular, the legislative and regulatory provisions, by number and letter, in respect of which Brazil seeks relief and indicate where each is referred to in the panel request. **BRA**

ARTICLE 13(B): DOMESTIC SUPPORT MEASURES

**"exempt from actions"**

20. In paragraph 8 of its initial brief (dated 5 June, 2003), the United States argued that the word "actions" as used in the phrase "exempt from actions" in Article 13 of the *Agreement on Agriculture* includes the "bringing of a case" and consultations. In paragraph 36 of its first written submission (dated 11 July, 2003), the United States stated as follows:

> "[P]rior to this point in the process, the *DSU* rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the U.S. insistence that its measures conform to the Peace Clause."

Is it the United States' understanding that the drafters used the phrase "exempt from actions" knowing that under the *DSU* it would not be possible fully to exempt "actions", as the United States interprets that term? **USA**

21. In *US - FSC* and *US - FSC (21.5)* the Appellate Body made findings under the *SCM Agreement* relating to export subsidies in respect of agricultural products without making a finding in respect of Article 13 of the *Agreement on Agriculture.* How is this relevant to the United States' interpretation of the phrase "exempt from actions" as used in Article 13? **USA**

**"such measures" and Annex 2 of the *Agreement on Agriculture***

22. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*. **BRA, USA**

23. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. **BRA, USA**

24. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*? **BRA, USA**

25. Does the United States consider that there is any ambiguity in the term "type of production" as used in paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*? **USA**

26. Can the United States confirm Brazil's assertions in paragraph 174 of its first written submission that the implementing regulations for direct payments prohibit or limit payments if base acreage is used for the production of certain crops? If so, can the United States clarify the statement in paragraph 56 of its first written submission that direct payments are made regardless of what is currently produced on those acres? Can the United States confirm the same point in relation to production flexibility contracts? **USA**

27. Does Brazil argue that any United States measure that does not comply with the fundamental requirement of paragraph 1 of Annex 2 of the *Agreement on Agriculture* is actionable independently of any failure of that measure to comply with the basic or policy-specific criteria in Annex 2? **BRA**

28. Please explain the meaning of the word "criteria" in Articles 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the *Agreement on Agriculture* have on the meaning of the preceding sentence? **BRA**

29. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the *Agreement on Agriculture.* **USA**

30. Do the parties consider that direct payments and production flexibility contract payments meet or met the basic criteria referred to in paragraph 1 of Annex 2 of the *Agreement on Agriculture*? **BRA, USA**

31. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? **BRA, USA**

32. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. **USA**

**"do not grant support to a specific commodity"**

33. According to the United States' interpretation of the word "grant", when can a Member claim that a measure is not exempt from action under Article 13(b)? What if the measure is enacted annually? Can the Member obtain a remedy in respect of that measure under the *DSU*? **USA**

34. Does Brazil interpret the word "grant" as used in Article 13(b)(ii) of the *Agreement on Agriculture* to mean payment made *in* a specific year or payment made *in respect of* a specific year? **BRA**

35. Does a failure by a Member to comply in a given *year* with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? **BRA, USA**

36. Does a failure by a Member to comply with Article 13(b) in respect of a *specific commodity* impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? **BRA, USA**

37. In the United States' view, why did the drafters not use the exact term "product-specific" in Article 13(b)(ii)? **USA**

38. Given the fact that subsidies available for more than one product could have various effects on production, how does the United States demarcate between product-specific support and non-product specific support ? **USA**

39. If "such measures" in Article 13(b)(ii) refers to all those in the chapeau of Article 13(b), why are they not all included in the potential comparisons with 1992? In what circumstances can measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the *SCM Agreement* and Article XVI of *GATT 1994*? **USA**

40. In relation to which other provisions in the *Agreement on Agriculture* is it relevant to disaggregate non-product specific support in terms of specific commodities? **BRA**

41. What is the position of Brazil with regard to certain other domestic support measures not cited by Brazil that were notified by the United States as non-product-specific (e.g. G/AG/N/USA/43), some of which presumably deliver support to upland cotton (e.g. state credit programmes, irrigation subsidies etc). Why have budgetary outlays for such measures related to upland cotton not been included in the comparison of support with 1992? **BRA**

42. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? **BRA**

43. What are the precise differences between deficiency payments and counter-cyclical payments that lead you to classify the former as product-specific and the latter as non-product specific? How do you classify market loss assistance payments? **USA**

44. Do you allege that counter-cyclical payments could be considered product-specific? **BRA**

45. If the Panel considered that Step 2 payments paid to exporters were an export subsidy, would the United States count them as domestic support measures for the purposes of Article 13(b)? Please verify Brazil's separate data for Step 2 export payments and Step 2 domestic payments in Exhibit BRA-69 or provide separate data. **BRA, USA**

46. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM* Agreement and references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement* to the meaning of "support to a specific commodity" in Article 13(b)(ii) *Agreement on Agriculture*? **BRA, USA**

**"in excess of that decided during the 1992 marketing year"**

47. Where does Article 13(b)(ii) require a year-on-year comparison? **BRA, USA**

48. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made? **BRA, USA**

49. Brazil claims that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? **BRA**

50. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) and, in particular, why both words "grant" and "decided" were used. **USA**

51. Could the United States please comment on the interpretation advanced by the EC, in paragraphs 16 and 18 of its oral statement, of the words "decided during the 1992 marketing year"? **USA**

52. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". **BRA, USA**

53. Assume, for arguments sake, that the only "decision" made in the United States in 1992 was the target price. How would Brazil make the comparison *vis-à-vis*, for example, the year 2001? **BRA**

54. Please identify all United States legal and regulatory and administrative instruments decided during the marketing year 1992, with the respective dates of decision, that decided support for upland cotton. **BRA, USA**

55. Please provide a copy of the instrument in which the rate of support for upland cotton during the marketing year 1992 was decided, indicating the date of the decision. **USA**

56. Could the United States please explain how support granted under legislation that dates back to 1990 can have been support "decided during the marketing year 1992"? **USA**

57. If the United States decided on a rate of support for MY1992, does that not mean that it decided on whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at that time? **USA**

58. Please comment on the argument advanced by the EC, in paragraph 17 of its oral statement that: "Had WTO Members intended a limitation to the support provided or granted in 1992 the word 'for' would have been used in place of 'during'." **BRA**

59. Should the rate of support as indicated in Article 13(b)(ii) include the market price? If so, why is it appropriate to include it in the comparison under Article 13(b)(ii)? **BRA, USA**

60. Can you provide information on support decided in 1992 and the years with which you believe it should be compared, on a per support programme / per unit of production / per annum basis? If possible, please specify how, if at all, budget outlays may be transposed into units of production, and which units of production are best to use. **BRA, USA**

61. Does the United States consider that Article 13(b)(ii) permits a comparison on any basis other than a per pound basis? **USA**

62. According to Prof. Sumner's calculation, the per pound support increased by approximately 24% from 1992 to 2002. On the other hand, the Panel understands that the total budget outlay, according to Brazil, increased more than that. What, in Brazil's view, is the reason for this difference in the rate of increase? **BRA**

63. In relation to Prof. Sumner's presentation at the first session of the first substantive meeting, please elaborate on the reasons behind the increase in the figures (from 1992 to 2002) concerning Loan Support and Step 2 payments. **BRA**

64. Do the figures cited in Prof. Sumner's presentation at the first session of the first substantive meeting indicate amount available or amount spent? Can the Panel derive amount spent from these figures? If Article 13(b)(ii) requires a rate of support comparison, is the rate of support the "rate" of support available or the "rate" at which the support was spent? **BRA**

65. Does Brazil consider that adjustment for inflation is relevant in the context of the comparison under Article 13 (b)(ii) ? **BRA**

66. Could you please comment on the relative merits of each of the following calculation methods for the purposes of the comparison of support to upland cotton with 1992, irrespective of whether a particular measure should be included or excluded:

(a) Total budgetary outlays (Brazil's approach). **USA**

(b) Budgetary outlays per unit of upland cotton: Could you please calculate and provide an estimate for the marketing years 1992 and 1999-2002, respectively, and draw attention to any factors/qualifications that the Panel would need to be aware of. **BRA, USA**

(c) Per unit rate of support (United States approach): How should changes in acreage, eligibility and payment limitations per farm(s) (commodity certificate programs) be factored into this approach? **BRA**

(d) Per unit rate of support for upland cotton (Prof. Sumner's approach at the first session of the first substantive meeting ). **USA**

67. The Panel requests the parties to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002. For this purpose the parties are each requested to submit AMS calculations for upland cotton (using the budgetary-outlay/non-price gap methodology employed by the United States in respect of cotton in its DS Notifications (e.g., G/AG/N/USA/43) and using the formats and supporting tables in document G/AG/2) on the same basis as would be the case in calculating a product specific AMS for the purposes of the calculation of the "Total Current AMS" in any year in accordance with the relevant provisions, including as appropriate Article 1(a), (b) and (h), Article 6 and Annex 3 to the Agreement. **BRA, USA**

68. Could you please clarify the result of the calculations of, and the meaning of the title, in Appendix Table 1 "Estimated per unit Subsidy Rates by Program and Year" in Annex 2 to Exhibit BRA-105, page 12. Why are the numbers calculated for marketing loans considered to be subsidies? Could the Panel, for example, read the "total level of support" (bottom line of the table) as the effective support *price* for upland cotton or the maximum rate of support for upland cotton? **BRA, USA**

69. Can the United States confirm that the "marketing year" for upland cotton is 1 August to 31 July ? Can the United States confirm the Panel's understanding that USDA data for the "crop year" corresponds to the "marketing year"? **USA**

EXPORT CREDIT GUARANTEE PROGRAMMES

70. How does Brazil respond to the United States' assertion that Brazil is trying to realize through litigation what it could not achieve in past negotiations ? **BRA**

71. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*? Why or why not? Does it confer a benefit within the meaning of Article 1.1(b)? Why or why not? If so, to whom? **USA**

(b) How, if at all, would these elements be relevant to the claims of Brazil, and the United States response thereto? **BRA, USA**

72. Could Brazil expand on why, as indicated in paragraph 118 of its oral statement, it does "not agree" with the United States arguments relating to the viability of an *a contrario* interpretation of item (j) of the Illustrative List of Export Subsidies in Annex 1 of the *SCM Agreement*? **BRA**

73. The Panel could arguably take the view that Articles 1 and 3 of the *SCM Agreement* were relevant in assessing the WTO-consistency of United States export credit guarantees. The United States has yet to submit any evidence or argumentation on this point, either as potential context for interpretation of the terms in Article 10 of the *Agreement on Agriculture* or in relation to Brazil's claims under the *SCM Agreement*. The Panel would therefore appreciate United States views in respect of this situation, and invites the United States to submit relevant argumentation and evidence. **USA**

74. If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance in the interpretation of the terms in Article 10 of the *Agreement on Agriculture*, should the Panel refer to item (j) or Articles 1 and 3 of the *SCM Agreement* or both? **BRA, USA**

75. The Panel's attention has been drawn to Article 14(c) of the *SCM Agreement* (see e.g. written third party submission of Canada) and to the panel report in DS 222 *Canada- Export Credits and Loan Guarantees*. How and to what extent are Article 14(c) of the *SCM Agreement*, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would be the appropriate market benchmark to use for any comparison? Please cite any other relevant material. **BRA, USA**

76. How does the United States respond to Brazil's statement that : "...export credit guarantees for exports of agricultural exports [*sic*] are not available on the marketplace by commercial lenders."? **USA**

77. How does the United States interpretation of "long term operating costs and losses" in item (j) as claims paid give meaning to *both* "costs" and "losses"? Do claims paid represent "losses" or "costs" or both? If claims paid is represented by "losses", what would go into the "cost" element of item (j)? Could the United States expand on why it disagrees with the items which Brazil identifies for inclusion in the examination to be conducted under item (j)? **USA**

78. Can the United States provide supporting documentation for data used relating to "costs and losses" in paragraph 173? Could the United States confirm that the figures cited in paragraph 173 of its first written submission relate to the SCGP? Why did the United States cite these figures after stating that it is not possible to make any assessment of the long-term operating costs and losses of this programme? **USA**

79. In respect of what time periods does Article 13(c) require an assessment of conformity with Part V of the *Agreement on Agriculture*? How does this affect, if at all, your interpretation of Article 13(b)? **BRA, USA**

80. In Brazil's view, why did the drafters of the *Agreement on Agriculture* not include export credit guarantees in Article 9.1? **BRA**

81. How does the United States respond to the following in Brazil's oral statement: **USA**

(a) paragraph 122 (rescheduled guarantees)
(b) paragraph 123 (interest on debt to Treasury)
(c) paragraphs 125 ff. (guaranteed loan subsidy)
(d) paragraphs 127-129 (re-estimates, etc.)
(e) Exhibits BRA-125-127
(f) the chart on page 53 of Brazil's oral statement at the first session of the first Panel meeting relating to "Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programs GSM-102 GSM 103 and SCGP"?
(g) In respect of (a)-(f) above, how and to what extent do the information and data presented for the export guarantee programmes concerning "program" and "financing", "summary of loan levels", "subsidy budget authority", "outlay levels", etc., in particular in Exhibits BRA-125-127, reflect "actual costs and losses" of the GSM-102, GSM-102 and SCGP export credit guarantee programmes(see e.g. Brazil's closing oral statement at the first session of the first substantive meeting, paragraph 24)? **USA**

82. Please explain each of the following statements and any possible significance it may have in respect of Brazil's claims about GSM-102 and GSM-103 (7 CFR 1493.10(a)(2), Exhibit BRA-38): **BRA, USA**

(a) "The programs operate in cases where credit is necessary to increase or maintain U.S. exports to a foreign market and where U.S. financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)

(b) "The programs are operated in a manner intended not to interfere with markets for cash sales. The programs are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)

(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)

83. Could Brazil explain how the procedure in Annex V of the *SCM Agreement* would be relevant to its claims concerning agricultural export subsidies, prohibited subsidies and agricultural domestic support? (e.g. note 301 in Brazil's first submission and paragraph 4 of Brazil's oral statement at the first session of the first substantive meeting). **BRA**

84. Is the Panel correct in understanding that, under the *GSM-102 and GSM-103 programmes*, the exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? **USA**

85. Is the Panel correct in understanding that, under the *SCGP*, the exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? Please explain any "risk" assessment involved in the programme. **USA**

86. Is there a risk categorization in relation to three export credit guarantee programmes (GSM-102, GSM-103 and SCGP)? Does this have any impact on premiums payable and the ability of the CCC to on-sell the guarantees ? **USA**

87. What proportion of CCC (export-related and total) long term operating costs and losses are represented by GSM-102, GSM-103 and SCGP programmes? **USA**

88. (a) Is the Panel correct in understanding that the United States' argument is that, at present, by virtue of Article 10.2 of the *Agreement on Agriculture*, there are ***no*** disciplines on agricultural export credit guarantees under the *Agreement on Agriculture* (or the *SCM Agreement)*? **USA**

(b) Does the United States agree with the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the *Agreement on Agriculture* ("Prevention of Circumvention on Export Subsidy Commitments"), and

with other commitments contained in the *Agreement on Agriculture*? Please cite any relevant material, including any past WTO dispute settlement cases. How would this reconcile with the United States' own statement, at paragraph 21 of its closing oral statement that "of course, the United States may not provide subsidies without any limit". **USA**

(c) If, as the United States argues, there are no disciplines on export credit guarantees in the *Agreement on Agriculture*, how could export credit guarantees "conform fully to the provisions of Part V" of the *Agreement on Agriculture* within the meaning of Article 13 (how can you assess "conformity" or non-conformity when there are allegedly no disciplines against which such an assessment could occur)? **USA**

(d) Is the United States advocating the view that its own export credit guarantee programmes, which pre-dated the Uruguay Round, are effectively "grandfathered" so as to benefit from some sort of exemption from the export subsidy disciplines of the *Agreement on Agriculture*? How, if at all, is it relevant that the SCGP did not, according to the United States, become relevant for upland cotton until the late 1990's (i.e. after the entry into force of the *WTO Agreement*)? **USA**

STEP 2 PAYMENTS

89. Does the United States confirm Brazil's statement in paragraph 331 of its first submission that "The conditions and requirements for Step 2 domestic payments remain unchanged with the passage of the 2002 FSRI Act"? What is the relevance of this, if any, to this dispute? **USA**

90. Does the United States confirm Brazil's statement in paragraph 235 of its first submission that the changes concerning Step 2 export payments from the 1996 FAIR Act to the 2002 FSRI Act are: increase in the amount of the subsidy by 1.25 cents per pound and the removal of any budgetary limits that applied under the 1996 FAIR Act? What is the relevance of this, if any, to this dispute? **USA**

91. What is the significance of the elimination of the 1.25 cent threshold payment in the 2002 FSRI Act pertaining to Step 2 payments? **USA**

92. Does the United States confirm that Exhibit BRA-65 represents a sample contract for exporters of eligible upland cotton to conclude with the CCC under the FSRI 2002, and that an application form (Exhibit BRA-66) needs to be filled out with data on weekly exports and submitted to the USDA FAS. Is Exhibit BRA-66 - Form CCC 1045-2 – also a valid example? If not, please identify any differences or distinctions. **USA**

93. Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment? **USA**

94. Is the Panel correct in understanding that Brazil alleges an inconsistency with Article 3.1(b) of the *SCM Agreement* only with respect to Step 2 *domestic* payments? **BRA**

95. Do the criteria in 7 CFR 1427.103(c)(2) (Exhibit BRA-37) that Step 2 "eligible upland cotton" must be "not imported cotton" apply to *both* domestic and export payments? **USA**

96. Is a domestic sale a "use" for the purposes of Step 2 payments? Is a sale for export, or export, considered a "use"? **USA**

97. How does the United States respond to Brazil's assertion, at paragraph 70 of Brazil's oral statement at the first session of the first substantive meeting, that "It is obvious that a single bale of cotton cannot be both exported and used domestically." Is this a relevant consideration? **USA**

98. How many Step 2 payments are received if a bale of upland cotton is exported, and then opened by a domestic user in the United States, or *vice versa*? **USA**

99. How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's oral statement at the first session of the first Panel meeting concerning the relevance of the Appellate Body Report in *US-FSC (21.5)*. **USA**

100. How does Brazil respond to the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in *Canada-Dairy* and the findings of the Appellate Body in *US-FSC (21.5)*[4], do any other dispute settlement reports offer guidance on this issue? For example, how, if at all is the Appellate Body's report in *Canada-Aircraft* relevant here?[5] **BRA**

101. How does Brazil respond to the United States' assertion at paragraph 22 of its oral statement that the programme involves "eligible users" who constitute the "entire universe" of potential purchasers of upland cotton? **BRA**

102. How does Brazil respond to the United States' assertion at paragraph 129 of its first written submission, that "[t]he program is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States." **BRA**

103. Is the Step 2 programme fund a unified fund that is available for either domestic users or exporters, without a specific amount earmarked for either domestic users or exporters? Please

[4] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.[4] Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

2 [5] There, the Appellate Body stated that,

> "the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".[5]

substantiate your response, including by reference to any applicable statutory or regulatory provisions. **USA**

104. How does the United States respond to the data presented in Exhibit BRA-69? Is it accurate? Please substantiate. **USA**

105. Why is the Step 2 programme separated into "domestic users" and "exporters"? Apart from differentiating between exporters and domestic users, with consequential differentiation as to the forms that must be filled out and certain other conditions that must be fulfilled, are the eligibility criteria for Step 2 payments identical? Are the form and rate of payment, as well as the actual payment made, identical? **USA**

106. With respect to paragraph 139 of the United States' first written submission, are Step 2 *export* payments included in the annual reduction commitments of the United States? If so, why? **USA**

107. Please comment on any relevance, to Brazil's *de jure* claims of inconsistency with the provisions of the *Agreement on Agriculture*, of Exhibit BRA-69, which shows Step 2 payments made to (i) domestic users and (ii) exporters. This Exhibit shows that, from FY 91/92 through 02, the Step 2 payments for exporters exceeded those for domestic users in FY 94; FY 95; FY 96 (in fact there were no domestic payments in FY 96); and FY 02. In the other years, the domestic payments are greater than export payments. **BRA, USA**

108. At paragraph 135 of its first written submission, the United States states : "[T]he *subsidy* is not contingent upon export performance..." (emphasis added). Again, in the course of the first Panel meeting, the United States admitted that the Step 2 payments were "subsidies". Does the United States thus concede that Step 2 payments constitute a "subsidy" within the meaning of the *WTO Agreement*? **USA**

109. How does the United States respond to Brazil's arguments concerning a mandatory/discretionary distinction and the allegation that certain United States measures (including s.1207(a) of the 2002 FSRI Act) are mandatory? (This is referred to, for example, in paragraph 28 of Brazil's first written submission). Does the United States agree with the assertion that (subject to the availability of funds) the payment by the Secretary of Step 2 payments is mandatory under section 1207(a) FSRI upon fulfilment by a domestic user or exporter of the conditions set out in the legislation and regulations? If not, then why not? To what extent is this relevant here? What determines the "availability of funds"? Please cite any other relevant measures or provisions which you consider should guide the Panel in respect of this issue. **USA**

110. Section 1207(a) of the 2002 FSRI Act provides that during the period beginning on the date of the enactment of the FSRI Act through 31 July 2008, " .. the Secretary shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters for documented purchases by domestic users and sales for export by exporters...". The Panel notes that Brazil does not appear to distinguish between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists. The United States refers to "benefits" and "payments" and "programme" in asserting that Step 2 is not export contingent (paragraphs 127-135 of the United States' first written submission).

(a) Do the parties thus agree that there is no need to draw any distinction between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists for the purposes of the *Agreement on Agriculture*? **BRA, USA**

(b) Why would a domestic user or an exporter select to receive a marketing certificate over a cash payment? What is the proportion of cash payments vs. marketing certificates granted under the programme? **USA**

111. Does the United States maintain its argument that actions based on Article 3.1(b) of the *SCM Agreement* are conditionally "exempt from actions" due to the operation of Article 13 of the *Agreement on Agriculture*? **USA**

112. In the event that the Panel finds that Article 6.3 of the *Agreement on Agriculture* does not preclude an examination of Brazil's claims under Article 3.1 of the *SCM Agreement* and Article III:4 of *GATT 1994*, how does the United States respond to the merits of Brazil's claims relating to Step 2 payments under those provisions? **USA**

113. Is it necessary for measures directed at agricultural processors included in AMS to discriminate on the basis of the origin of goods? **USA**

114. With respect to the last sentence of paragraph 22 of Brazil's closing oral statement, could Brazil elaborate on the circumstances in which a local content subsidy would comply with Article 3.1(b) of the *SCM Agreement*? **BRA**

115. What is the meaning and relevance (if any) to Brazil's claims under Article 3 of the *SCM Agreement* and Article III:4 of *GATT 1994* of the phrase "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products" in the *Agreement on Agriculture*? **BRA, USA**

116. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the *Agreement on Agriculture*? Does the phrase "provide support in favour of domestic producers" in Article 3.2 of the *Agreement on Agriculture* refer to, and/or permit such subsidies? **BRA, USA**

117. What is the relationship between Step 2 payments to exporters and the marketing loan payments, both of which appear to compensate for the price differences relative to the Liverpool A-Index? For example, is there double compensation? Or is one of the explanations that these export-related price compensatory payments are paid to different operators (namely, the producer, on the one hand under the marketing loan arrangements, and the processor/users (Step 2 programme) arrangements on the other? **USA**

118. Can the United States confirm that it does not rely on Article III:8 of *GATT 1994*? **USA**

ETI ACT

119. How does the United States respond to Brazil's reference to the panel report in *India - Patents (EC)* (at paragraph 138 of its oral statement at the first session of the first substantive meeting)?[6]

[6]That panel stated: "It can thus be concluded that panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same. In examining dispute WT/DS79 we are not legally bound by the conclusions of the Panel in dispute WT/DS50 as modified by the Appellate Body report. However, in the course of "normal dispute settlement procedures" required under Article 10.4 of the *DSU*, we will take into account the conclusions and reasoning in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we should give significant weight to both Article 3.2 of the *DSU*, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, and to the need to avoid inconsistent rulings

How, if at all, should the Panel take this report into account in considering the issues raised by Brazil's claims relating to the ETI Act? **USA**

120. Concerning its claims on the ETI Act, Brazil relies on the *US – FSC* case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the United States appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Could you direct the Panel to any relevant findings or conclusions by the panel or Appellate Body in that case? **BRA**

121. How do you respond to the reference in paragraph 43 of EC third party oral statement with respect to the relevance of Article 17.14 of the *DSU*, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the *DSU*, and please cite any other provisions you consider relevant. **USA, BRA**

[Attachment on questions to Third Parties omitted]

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(which concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the *DSU*." (footnote omitted)

# ANNEX L-1.6

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

30 July 2003

The Panel is in receipt of the communication from the United States, dated 29 July, requesting an extension of the deadline for the submission of the parties' responses to questions, as well as the response from Brazil, dated 30 July.

Taking these communications into account, the Panel has decided to extend the deadline for the submission of the parties' responses to questions from Monday 4 August to **Monday 11 August**. The Panel reminds the parties that paragraph 17(b) of the Panel's working procedures indicates that the responses should be submitted by **17:30** (Geneva time).

The Panel has also decided upon the following additional changes to its schedule:

| | |
|---|---|
| Panel's views on certain issues: | 5 September 2003 |
| Further submission of Brazil: | 9 September 2003 |
| Further submission of the US: | 23 September 2003 |
| Further submission of the third parties (as necessary): | 29 September 2003 |

For the time being, all other dates remain unchanged. This includes the deadline for the submission of the parties' comments on each other's responses, as well as the submission of the parties' rebuttal submissions (i.e. 22 August). It also includes the dates for the resumption of the first substantive meeting (as necessary) and the second substantive meeting (i.e. 7-9 October).

# ANNEX L-1.7

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THE THIRD PARTIES

5 August 2003

1. The Panel has received a letter from the European Commission, dated 31 July 2003, in which the European Communities ("EC"):

- seeks clarification of the Panel's procedures for its expression of views on 5 September 2003 in relation to Article 13 of the *Agreement on Agriculture*; and

- makes two requests for additional third party rights.

2. The Panel sought the views of the parties to the dispute on these requests, which it received in letters dated 1 August 2003. Neither party objects to the Panel communicating its views to the third parties on 5 September 2003, but neither party agrees that the Panel should accept the EC's requests for additional third party rights. The EC responded to the parties' letters in a further letter dated 4 August 2003.

### 1. Panel's procedures for its expression of views on 5 September 2003 in relation to Article 13 of the *Agreement on Agriculture*

3. The Panel confirms that, in accordance with its communication dated 20 June 2003, as amended on 30 July 2003, it intends to express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, to the extent that it is able to do so, by 5 September 2003. Those views will be communicated to third parties, as well as to the parties to the dispute, in order to enable them to participate, as necessary and appropriate, in any second session of the first substantive meeting in a full and meaningful fashion.

### 2. EC requests for additional third party rights

4. The EC requests the following additional third party rights: (a) access to the oral statements of the parties to the dispute at the first session of the first substantive meeting held on 22-24 July 2003, and (b) the opportunity to comment on their responses to the Panel's questions, or questions that they have posed to each other.[1]

5. Third parties have certain rights in panel proceedings under Article 10 of the DSU, which a panel may not deny. The grant of third party rights beyond those provided in the DSU lies within the discretion and authority of a panel. That discretion is limited by the requirements of due process. Article 10.1, 10.2 and 10.3 of the DSU provides as follows:

[1] The Panel notes that the parties to the dispute have not posed any written questions to each other, and therefore does not need to address the request to allow third parties to comment upon the responses to such questions.

*Third Parties*

> "1. The interests of the parties to a dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process.
>
> "2. Any Member having a substantial interest in a matter before a panel and having notified its interest to the DSB (referred to in this Understanding as a "third party") shall have an opportunity to be heard by the panel and to make written submissions to the panel. These submissions shall also be given to the parties to the dispute and shall be reflected in the panel report.
>
> "3. Third parties shall receive the submissions of the parties to the dispute to the first meeting of the panel."

6. In our view, written versions of the parties' oral statements and the parties' responses to the Panel's questions do not form part of "the submissions of the parties to the dispute to the first meeting of the Panel", as provided for in Article 10.3 of the DSU. Articles 10.2 and 12.6 and the working procedure in paragraph 3 of Appendix 3 use the terms "written submissions" and "submissions" interchangeably. Appendix 3 distinguishes between "written submissions" in paragraphs 3, 4 and 10 and "a written version of … oral statements" in paragraph 9. Under the standard panel working procedures set out in Appendix 3 of the DSU, third parties may only attend the third party session and are not present during the rest of the panel's meetings. The granting of access by the Panel to written versions of the parties' oral statements would run counter to the standard practice under the DSU of holding the sessions at which those statements are made in the absence of the third parties.

7. As the Panel indicated in its communication dated 20 June 2003, the first meeting in this dispute is to be held in two separate sessions two months apart, as necessary. The issues under consideration at each session are distinct, so that the written versions of oral statements at the first session cannot be considered submissions to the second session. The Panel's working procedures currently envisage that third parties will receive the parties' written submissions to any second session of the first meeting, and will have an opportunity to present their views at any such session. Thus, with respect to the issues that form the subject of each session of the first meeting, each third party will receive the rights provided for in Article 10.2 and 10.3 of the DSU.

8. Therefore, in our view, third parties have no entitlement under the DSU to the additional rights requested by the EC, and we also note that there is no agreement between the parties that such additional rights should be granted. In any case, the EC indicates in its letter dated 4 August 2003 that this was not the thrust of its requests but, rather, it would be a "reasonable exercise of the Panel's discretion" to allow the third parties also to comment on the responses of the parties to the dispute to the Panel's questions.

9. The Panel must consider whether it should grant such additional rights as part of its duty to ensure due process of law for third parties, or within its discretion to grant or refuse the rights requested as it believes appropriate, keeping firmly in mind the Panel's duty to ensure an objective assessment of the matter before it in accordance with Article 11 of the DSU, and the requirement that the interests of the parties to the dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process, in accordance with Article 10.1.

10. The EC has argued that access to oral statements would permit third parties to respond to arguments made by the parties to the dispute where such a response would be of relevance in answering the Panel's questions to third parties, and that this would benefit the Panel since the third

parties would be able to provide more complete responses to the Panel's questions. It also argues that the third parties' comments on each others' responses to questions will be more full and meaningful, and consequently more beneficial to the Panel, if it is also possible for them to comment on the responses of the parties to the dispute.

11. In addition to the issues raised by the EC, the Panel is keenly aware of the implications of this particular dispute for third parties, including the systemic importance of the interpretation of Article 13 of the *Agreement on Agriculture* and its trade policy impact.

12. In fact, the Panel has already taken into account, to a certain extent, the systemic implications of this dispute and the issues now raised by the EC. The Panel has posed a large number of questions to third parties, including 39 questions addressed specifically to the EC. Through the third parties' responses to these questions, the Panel hopes to receive their views on the merits and systemic considerations presently at issue in this dispute, which it will take into account in its assessment of the matter before it. The questions are detailed precisely to ensure that third parties' views are fully taken into account in what is a complex case. The Panel believes that, through the questions that it has posed to the parties to the dispute and to third parties, it has ensured that it will benefit from third parties' input and that nothing prevents them from participating in a full and meaningful fashion.

13. This is not the only opportunity for third parties to express their views in this dispute. The Panel specifically sought the views of third parties on the issue of whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. Six third parties, including the EC, made submissions to the Panel on that issue, which the Panel took into account.

14. Nothing precludes the Panel from posing further questions to the parties to the dispute or third parties as the Panel deems necessary or appropriate throughout the course of these proceedings. The Panel may also seek the views of third parties in further questions at any second session of the first meeting that may be held, by posing questions on the issues under consideration at that session.

15. The Panel notes that none of the third parties, including the EC, requested any additional rights prior to the first meeting, even after the Panel's communication of 20 June 2003, in which it announced that the first meeting would be held in two sessions, as necessary. The parties to the dispute therefore delivered their oral statements at that meeting in closed session without third parties present, as is the usual procedure under Article 12 and Appendix 3 of the DSU, on the basis that the confidentiality of those statements was within their own respective control. The Panel is therefore unwilling to direct the parties to grant access to written versions of those statements after the event.

16. The Panel notes that nothing in the DSU or the Panel's working procedures precludes a party to the dispute from disclosing statements of its own positions to the public, as foreseen in Article 18.2 and paragraph 3 of the working procedures, and that the United States has indicated that it makes its oral statements available on its website and has already provided a copy directly to the EC.

17. For the reasons set out above, the Panel denies both the EC's requests for additional third party rights. Nonetheless, in view of the phased nature of the first meeting, the Panel directs the parties to the dispute to make best efforts to ensure that their submissions to any second session of the first meeting are understandable either on their own or in conjunction with the submissions to the first session of the meeting. In particular, such submissions should not refer to any document to which the third parties do not have access without, at the very least, a summary, explanation or description of the contents of that document (or a citation indicating where that document may be found on the public record).

# ANNEX L-1.8

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

19 August 2003

The Panel has received a communication from Brazil dated 14 August 2003 in which Brazil draws attention to the timing and format of service of the United States' responses to the Panel's questions, in light of paragraphs 17(b) and (d) of our Working Procedures, and in which it raises issues of procedural fairness.

The Panel has taken note of the matters raised in the communication from Brazil and draws them to the United States' attention. The Panel recalls that, at its meeting with the parties on 22 July 2003, it also drew the attention of the United States to these issues as raised by Brazil in connection with the filing of the United States' first written submission and comments on Brazil's initial brief.

In its communication dated 14 August 2003, Brazil also requested the right to comment on any new information, arguments or documents presented for the first time in the United States' rebuttal submission with respect to specific questions posed by the Panel. It raised considerations of due process and requested that the Panel provide it until 28 August 2003 to file any such comments without granting the United States any corresponding right.

The Panel has a duty to ensure the fairness of its proceedings, which requires that the parties receive sufficient opportunity to comment on information, argumentation and documents submitted. Due to the phasing of the first meeting, a party might lack sufficient opportunity to comment on such material presented for the first time in a rebuttal submission before the Panel expresses its views on certain issues in dispute. However, this will depend on what the rebuttal submissions actually contain.

Accordingly, when each party receives the other party's rebuttal submission, it is invited, without delay, to draw the Panel's attention to any specific material on which it has not had an opportunity to comment and to show cause why it needs such an opportunity. Upon a showing of good cause, the Panel will permit that party to comment in writing by 27 August 2003. The Panel is willing to grant such permission on Saturday, 23 August 2003, if necessary.

# ANNEX L-1.9

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

23 August 2003

The Panel has received a communication from Brazil dated 23 August 2003 in which Brazil requests the opportunity to comment on specific paragraphs of the United States' rebuttal, and exhibits thereto, as the parties were invited to do by the Panel in its communication dated 19 August 2003.

The Panel considers that Brazil has not had sufficient opportunity to comment on new material specifically listed in its communication of 23 August 2003. The Panel notes that the argument raised in paragraph 123 of the United States' rebuttal is not new but was raised earlier in the United States' response to question 66(d) posed by the Panel and in section 2.3.2 of Brazil's rebuttal.

Accordingly, the Panel permits Brazil to comment in writing on such new material by 27 August 2003. The procedures regarding service of documents set out in paragraph 17 of the Panel's working procedures shall apply.

# ANNEX L-1.10

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

25 August 2003

The Panel has received a communication from the United States dated 25 August 2003 in which the United States requests the opportunity to comment on specific paragraphs of Brazil's rebuttal, and comments on responses to questions, as the parties were invited to do by the Panel in its communication dated 19 August 2003. The Panel has also received a response to that communication from Brazil, also dated 25 August 2003, in which Brazil submits that the United States' request should be rejected.

The Panel considers that the United States has not had sufficient opportunity to comment on new material specifically listed in its communication of 25 August 2003, other than the alleged misstatements in paragraphs 88, 90-94 of Brazil's rebuttal which the Panel can check against the cross-referenced United States' responses and Panel report, if necessary.

Accordingly, the Panel permits the United States to comment in writing on such new material by 27 August 2003. The procedures regarding service of documents set out in paragraph 17 of the Panel's working procedures shall apply.

The Panel notes that the United States welcomes the opportunity to respond to any further questions that the Panel may have. Therefore, the Panel poses the following additional question to the United States and seeks a response by 27 August 2003:

> 67*bis*. Please state the annual amount granted by the US government in each of the 1999, 2000, 2001 and 2002 marketing years (as applicable) to US upland cotton producers, per pound and in total expenditures, under each of the following programs: production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments.

# ANNEX L-1.11

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THIRD PARTIES

5 September 2003

1. On 20 June 2003, the Panel communicated to the parties and third parties that:

> "Given the potential complexity of the claims before us, the conditional nature of certain of these claims and the volume of evidence which may be introduced by the parties in support of their claims and arguments, and in order to organize our proceedings in an orderly, effective and efficient manner which serves to facilitate an objective assessment of the matter before us, and optimizes use of our resources, we have adopted the following modifications to our procedures …"

2. The first modification to our procedures was as follows:

> "The Panel intends to express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, to the extent that it is able to do so, by 1 September 2003, and will defer its consideration of claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as those provisions are referred to in Article 13 of the *Agreement on Agriculture* until after it has expressed those views. The Panel's views may be expressed in the form of rulings which could affect the Panel's further consideration of this dispute."

3. In a fax dated 30 July 2003, the Panel decided to modify the date for expression of its views to 5 September 2003.

4. The Panel takes note of the correspondence from the parties dated 27, 28 and 29 August 2003 and declines to make findings at this stage as to whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, for the reasons given in its communication dated 20 June 2003. The Panel's findings on that issue will be included in its interim report, on which the parties will have the right to comment in accordance with Article 15.2 of the *DSU*.

5. The Panel has now had the opportunity to consider the parties' and third parties' evidence and arguments to date. At this stage, the Panel cannot conclude its assessment of the matter before it on the basis that the measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*. The expression by the Panel of this view is without prejudice to the Panel's eventual findings, and is subject to paragraph 6 below. In this context, the Panel is of the view that consideration, as appropriate, of Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*, as those provisions are referred to in Article 13 of the *Agreement on Agriculture*, is warranted in order for the Panel properly to discharge its responsibilities under the *DSU* and the relevant covered agreements. Therefore, the Panel will consider those claims at a second session of the first substantive meeting.

6. The Panel also wishes to inform the parties that, on the basis of the evidence and arguments presented to date, it is unable to form any view on whether the ETI Act satisfies the relevant provisions of the *Agreement on Agriculture*.

7. Regarding the Panel's procedures:

(a) the Panel invites the parties to address in further submissions, due on 9 and 23 September respectively, the claims referred to in paragraph 5 above;

(b) the Panel also invites the parties to address further the issue whether the export credit guarantee programs at issue constitute export subsidies for the purposes of the *Agreement on Agriculture*;

(c) the Panel confirms that items (o), (p) and (q) of its timetable will be necessary, and confirms the following dates:

| | |
|---|---|
| Further submissions of the third parties: | 29 September 2003; |
| First substantive meeting with the parties (resumed second session) : | 7, 8 and (as necessary) 9 October 2003; |
| Third party session: | **8 October** 2003 [1]; |

(d) the Panel invites the third parties to address in their further submissions the claims referred to in paragraph 5 above;

(e) the Panel intends to postpone the second substantive meeting; and

(f) the Panel invites the parties to comment on the attached draft further revised timetable. Such comments should be submitted no later than close of business on Tuesday, 9 September 2003.

[Attachment omitted]

[1] The Panel wishes to inform parties and third parties that due to the availability of meeting rooms, the third party session, previously scheduled for 9 October, will now be held on Wednesday, 8 October. The Panel will continue its meeting with the parties after the third party session and also on 9 October, as necessary.

# ANNEX L-1.12

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THIRD PARTIES

12 September 2003

Having carefully considered the parties' comments received on 9, 10 and 11 September, the Panel intends to follow the revised timetable, as attached.

In this connection, the Panel would like to inform the United States that the deadline for its "further submission" is **15h00 (i.e. 3 pm) Geneva time** on Monday, 29 September.

The Panel also wishes to draw the attention of **third parties** that the **deadline for their further submissions** has been changed to **3 October**.

In light of the US request for an opportunity to comment on the new dates of the second meeting, now rescheduled to be 2 and 3 December 2003, the Panel invites the US and Brazil to submit comments, if any, on these dates. Such comments, which should focus on the date of the second substantive meeting and other dates directly affected by this date, should be submitted no later than close of business on **Tuesday, 16 September**.

[Attachment omitted]

# ANNEX L-1.13

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THIRD PARTIES

18 September 2003

The Panel has received letters from Brazil and the US dated 16 September and 17 September, in which they submit further comments on certain dates we indicated in our fax dated 12 September.

Having carefully considered the views of both parties, the Panel amends the dates indicated in the 12 September fax as follows:

- The deadline for the receipt of answers to Panel's questions (previously, 22 October) will be changed to **27 October**.

- The deadline for the receipt of further rebuttals of the parties (previously, 3 November) will be changed to **18 November.**

In respect of items (u) and (v), the Panel notes Brazil's preference for "the completion of the parties' main substantive work still in 2003". The Panel reminds the parties that, as indicated in the 12 September fax, items (u) and (v) are deadlines that would apply "as necessary". They may, therefore, depend upon various factors, including the number and nature of any questions the Panel may actually pose to one or both parties at that juncture. Therefore, at least for the time being, the Panel prefers to leave these dates as indicated (22 December and 19 January, respectively).

**All other dates indicated in the fax of 12 September remain unchanged, and are now confirmed.**

# ANNEX L-1.14

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THIRD PARTIES

24 September 2003

The Panel has received a letter from the United States dated 23 September, in which it informs the Panel of delays in the preparation of its further submission caused by hurricane Isabel, as well as a response from Brazil, also dated 23 September. Having carefully considered the views of both parties, the Panel further amends the dates we indicated in our fax of 12 September as follows:

deadline for the US's further submission: **30 September, 2003 (by 17:30 Geneva time)**

**All other dates and deadlines** indicated in the fax of 12 September (and subsequently amended in the fax of 18 September) including the deadline for the "further submission from third parties" (3 October), **remain unchanged**.

The Panel notes that the time for the third parties to review the US's "further submission" before making their respective written submissions is limited. The Panel reminds third parties that they are free to present arguments in addition to those set out in their written submissions in their oral statements to be presented on 8 October.

# ANNEX L-1.15

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

13 October 2003

1. Please find attached the Panel's questions to the parties following the resumed session of the first substantive Panel meeting. Parties are reminded that responses are due by **27 October 2003**.

2. The Panel's questions are intended to facilitate the work of the Panel, and do not in any way prejudge the Panel's findings on the matter before it. Nor does the fact that the Panel has placed these questions under certain headings prejudge the Panel's findings on the matter before it. Each party is free to respond to or comment on questions posed to the other parties or third parties.

3. The Panel takes note of Brazil's request in its letter dated 2 October 2003 regarding the late receipt of submissions, and the US response in its letter dated 6 October 2003. In accordance with paragraph 17(b) of the Panel's working procedures, the Panel sets the following time for the provision of submissions by the parties: 11:59 pm, Geneva time on the dates concerned. This time refers to *receipt* of submissions by the other party and the Secretariat and not to commencement of transmission. For greater clarity, this time for receipt of submissions also refers to the time of completion of receipt of any Exhibits and service of all Exhibits (if necessary, electronically) to the other party and to the Secretariat as envisaged in paragraphs 17(a)-(d) of the Panel's working procedures. All other provisions of the Working Procedures remain unchanged. The Panel confirms the dates in the revised timetable, as revised in its communication of 18 September 2003.

4. The Panel has set this time in light of the repeated service of submissions by the United States after 5.30 p.m. and in order to ensure due process and secure a balance between the two parties. The Panel stresses its expectation that the parties will respect all of the rules and procedures set out in the *DSU* and in the working procedures, including the new time set by the Panel above for the dates in question.

5. The Panel takes note of the United States' request in section II of its further submission for three preliminary rulings, regarding interest subsidies and storage payments; cottonseed payments; and export credit guarantees for products other than upland cotton. The Panel is not currently in a position to rule on these issues. The Panel will make rulings as necessary and appropriate in the course of this proceeding and hopes to be in a position to express its views, or give a ruling, on these requests, as appropriate, by 3 November (that is, shortly after the date of receipt of written responses to questions). Meanwhile, the Panel requests the parties not to exclude consideration of these issues in their responses to questions.

Questions from the Panel to the Parties –
Resumed first session of the first substantive Panel meeting

A. REQUEST FOR PRELIMINARY RULINGS

122. Does Brazil allege that cottonseed payments, interest subsidies and storage payments are included in the subsidies that cause serious prejudice? Do they appear in the economic calculations? **BRA**

123. Does Brazil's request for the establishment of the Panel name the statute authorizing cottonseed payments for the 1999 crop? **BRA**

B. EXEMPTION FROM ACTIONS

124. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*? **BRA, US**

C. IDENTIFICATION OF THE SUBSIDIZED PRODUCT

125.

(1) In view of requirements in the FAIR Act of 1996 and the FSRI Act of 2002 that contract acreage remain in agricultural or conservation uses and which impose penalties if the producer grows fruits or vegetables, how likely is it that the producer with upland cotton base acreage will not use his or her land to produce programme crops or covered commodities? **US**

(2) Brazil has submitted that "The record suggests that *historic* producers are *current* producers." It points to factors including the specialization of upland cotton producers, the need to recoup expensive investments in cotton-specific equipment, and the geographic focus and climatic requirements of upland cotton production in the "cotton belt". (Brazil's rebuttal submission, footnote 98, on page 24)

(a) Regarding the specialization of upland cotton producers and the geographic focus of upland cotton production, how does Brazil take account of the fact that cotton is produced in 17 of the 50 states of the United States and that average cotton area is approximately 38% of a cotton farm's acres? (This information is taken from the US's response to question 67*bis*, footnote 35). **BRA**

(b) Regarding the geographic focus of upland cotton production, how many other crops can upland cotton producers viably grow in the cotton belt, other than fruits and vegetables? **US**

(c) Regarding the high cost of upland cotton production, can Brazil show that farms who planted upland cotton could only have covered their costs by receiving upland cotton, rice or peanut payments in every year from 1999 through 2002? **BRA**

(d) Regarding the need to recoup investments in cotton-specific equipment, is it important to planting decisions that upland cotton producers cannot run any other crop through their cotton-pickers? How does this affect the likelihood that they will grow other crops? **US**

(3) In calculating the amount of PFC, MLA, direct and counter-cyclical payments that went on upland cotton, Brazil made an adjustment for the ratio of current acreage to base acreage (see its

answer to question 67, footnotes 2, 3, 4 and 5). Is this an appropriate adjustment for the particular factors referred to above? Why or why not? **BRA, US**

(4) Dr. Glauber has alleged that there are statistical problems in comparing planted acres to programme acres because of abandonment of crops and also because planted acres are only survey estimates, not reported figures (See Exhibit US-24, the first full paragraph in P2). Would it be more appropriate to divide harvested acreage by base acreage? What margin of error is there between the survey estimates and reported figures? **BRA, US**

(5) Do the acreage reports under section 1105(c) of the FSRI Act of 2002 indicate or assist in determining the number or proportion of acres of upland cotton planted on upland cotton base acres? Was there an acreage reporting requirement for upland cotton during MY1996 through 2002? **BRA, US**

(6) Please prepare a chart showing upland cotton base acreage, planted acreage and harvested acreage for MY1996 through 2002. Does the planted acreage fluctuate within a broad band? If not, does this indicate any stability in decisions to plant the same acres to upland cotton? **BRA, US**

(7) Brazil states that one third of all US farms with eligible acreage decided to update their base acreage under the direct payments and counter-cyclical payments programmes using their MY1998-2001 acreage. What is the proportion of the current base acreage for upland cotton resulting from such updating? Is the observed updating of base acreage consistent with Brazil's argument that it is only profitable to grow upland cotton on base acreage (and peanut and rice base acreage)? **BRA**

(8) How could one take account of upland cotton producers who receive PFC, MLA, direct and counter-cyclical payments for other covered commodity base acreage? **BRA, US**

(9) Assuming that Brazil's payment figures were to amount to a *prima facie* case, please answer the following questions: **US**

(a) How would the United States calculate or estimate the proportion of upland cotton producers who receive subsidy payments for upland cotton base acreage?

(b) Should any adjustment estimates be made for any factors besides those listed by Brazil?

(c) What adjustment estimate would it be appropriate to make?

(d) How could one take account of upland cotton producers who receive decoupled payments for other programme crop base acreage?

(e) Could the US specifically indicate what, in its view, are the flaws in the approach summarized in paras. 6-7 of Brazil's closing oral statement[1] on 9 October (i.e. the use of the ration of 0.87 to adjust the amount of total upland cotton direct and CCPs for the MY to obtain the amount of subsidies received by upland cotton producers)? Can the US suggest an alternative approach that would yield reliable results in its view?

[1] All of the paragraph numbers in relation to oral statements (opening statement and closing statement) cited in this document corresponds to the numbering made in the version available to the Panel on the date of the statement.

D. "LIKE PRODUCT"

126. Does the US agree that the product at issue is upland cotton lint and that Brazilian upland cotton lint is "like" US upland cotton lint within the meaning of Article 6.3(c) of the *SCM Agreement* in that it is a separate like product that is identical or has characteristics similar to the upland cotton lint from the United States? (e.g. Brazil's further submission, para. 81) **US**

E. "SUBSIDIES"

127. The Panel notes that the US contests that export credit guarantees constitute "subsidies". The Panel recalls that the US agrees that Step 2 payments are "subsidies" and wishes to have confirmation that it is correct in understanding that the US does not disagree that the following are "subsidies" for the purposes of Article 1 of the *SCM Agreement*: marketing loan/loan deficiency payments, PFC, direct payments, market loss assistance and CCP payments, crop insurance payments, cottonseed payments, storage payments and interest subsidy (without prejudice to the Panel's rulings on the US requests for preliminary rulings on the latter two payments). **US**

F. PROHIBITED SUBSIDIES

128. Could the US respond to Brazil's assertions relating to the meaning and effect of the introductory phrase of Article 3 ("Except as provided in the *Agreement on Agriculture*....")? Would the meaning/effect change if Article 13 of the *Agreement on Agriculture* did not exist? **BRA, US**

G. SPECIFICITY / CROP INSURANCE

129. In the event that the Panel does not consider that the alleged prohibited subsidies fall within the provisions of Article 3 and are therefore, pursuant to Article 2.3, "deemed to be specific", are there any other grounds on which Brazil would rely in order to support the view that such measures are "specific" within the meaning of Article 2 of the *SCM Agreement* (see, for example, fn 16 of Brazil's further submission)? **BRA**

130. Does Brazil agree that the US insurance premium subsidy is available in respect of all agricultural products? Please cite relevant portions of the record. **BRA**

131. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*: **BRA, US**

(a) is a subsidy in respect of all agricultural, but not other, products specific?

(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?

(c) is a subsidy in respect of certain identified agricultural products specific?

(d) is a subsidy in respect of upland cotton, but not other products, specific?

(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?

(f) is a subsidy in respect of a certain proportion of total US farmland specific?

132. Please state the amount and percentage of upland cotton acreage covered by each crop insurance programme and/or policy under the ARP Act of 2000. **US**

133. Concerning Brazil's arguments in its oral statement, para. 7, can the US indicate if any producers of livestock outside a pilot programme are covered by the crop insurance programme? **US**

134. Please state the annual amount of premiums paid or contributions made by US upland cotton farmers relating to each of the crop insurance programmes and/or policies supported by the US Risk Management Agency and the Federal Crop Insurance Corporation in each year from 1992 through 2002. **US**

135. Please state the annual amount of insurance indemnity payments made by the US government; or insurance companies participating in crop insurance programmes and/or policies under the ARP Act of 2000 to upland cotton farmers in each year from 1992 through 2002. **US**

136. Is the US arguing that crop insurance subsidies corresponding to "over 90 per cent of insured cotton area" (US 7 October oral statement, para. 46) in MY1999 through 2002 are consistent with paragraph 8(a) of Annex 2 of the *Agreement on Agriculture*? Is it correct that in the past these subsidies were nonetheless notified to the Committee on Agriculture as non-product specific AMS (see, for example, G/AG/N/USA/43 in Exhibit BRA-47)? **US**

H. EXPORT CREDIT GUARANTEES

137. Please elaborate the meaning of "net losses" as is used in paragraph 70 of Brazil's 7 October oral statement. **BRA**

138. Please comment on Brazil's views stated in paragraph 70 of its 7 October oral statement. **US**

139. In the context of export credit guarantees, is the Panel correct in understanding that Brazil's claims of inconsistency with the *Agriculture Agreement* involve GSM 102, GSM 103 and SCGP, but that it limits its "serious prejudice" allegations in respect of export credit guarantee programmes to the GSM 102 programme, and does not challenge GSM 103 and SCGP in this respect? If so,

(a) could Brazil please explain why it did so, and confirm that all the data relied upon in its further submissions (e.g. in Table 13) relate to the GSM 102 programme rather than to GSM 102, GSM 103 and SCGP (and, if the data needs to be adjusted to take account of a narrower "serious prejudice" focus, supply GSM-102-relevant data)? **BRA**

(b) for the purposes of Article 13(c)(ii) of the *Agreement on Agriculture*, is it necessary for the Panel to examine only GSM 102 or should the Panel's examination include also GSM 103 and SCGP? Why or why not? **BRA**

140. Could Brazil explain how, if at all, it has treated export credit guarantees for the purpose of Table 1 of its further submission? **BRA**

141. The Panel notes the US argument, *inter alia* in its further submission, that the export credit guarantee programmes are "self-sustaining". Recalling that item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* refers to "premium rates", could the US expand upon how it takes into account the premium rates for the export credit guarantee programmes in its analysis. **US**

142. The US has pointed out that there are many limitations on granting export credit guarantees and that there is no requirement to issue any particular guarantee (US further submission, paras 153-

156). Can the Commodity Credit Corporation decline to grant an export credit guarantee even in cases where the programme conditions are met? **US**

143. Brazil agrees with National Cotton Council estimates of the effects of the GSM 102 programmes (Brazil's further submission, para. 190) but it also cites a different conclusion by Prof. Sumner (paragraph 192). Brazil cites other estimates by Prof. Sumner throughout its further submission. Does Brazil adopt Prof. Sumner's conclusions and estimates as part of its submission? **BRA**

I. STEP 2 PAYMENTS

144. Is the Panel correct in understanding that the US does not dispute that Step 2 (domestic) payments are contingent upon import substitution, and that it argues that such measures are permitted due to the operation of the provisions of the *Agreement on Agriculture*? How is that relevant to a claim under Articles 5 and 6 of the *SCM Agreement*? **US**

J. ACTIONABLE SUBSIDIES

145. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Articles 4.7 and 7.8 of the *SCM Agreement*. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the *SCM Agreement* to withdraw the subsidy without delay, can the Panel:

(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? **BRA, US**

(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the *SCM Agreement*? **BRA, US**

146. Brazil acknowledges that there are some interaction effects that may increase or decrease the overall effects of the subsidies (Brazil's further submission, para. 225). How would your analysis under Articles 5(c) and 6.3 of the *SCM Agreement* and Article XVI of *GATT 1994* differ if it excluded, for example, crop insurance subsidies, PFC and/or direct payments? **BRA**

147. Does the US agree that subsidies provided under the marketing loan programme, counter-cyclical payments and market loss assistance are or were more than minimally trade-distorting? If so, please elaborate on the type of effects which are more than minimally trade-distorting within the meaning of Annex 2 of the *Agreement on Agriculture* but less than adverse effects within the meaning of Article 5 of the *SCM Agreement*. **US**

148. How should the significance of price suppression or depression be assessed under Article 6.3(c) of the *SCM Agreement*? In terms of a meaningful effect? Or another concept? **BRA**, **US**

149. What is the meaning of "may" in the chapeau of Article 6.3(c) in the context of Brazil's assertion that there is no need to conduct a distinct analysis of "serious prejudice" under Article 5(c) after having made a finding under 6.3(c) or (d)? (Brazil's further submission, paras 437 ff). How, if at all, are Articles 6.2 and 6.8 relevant in this context? What context should the Panel use for assessing serious prejudice under Article 5(c) of the *SCM Agreement* if the Panel takes the view that Article 6.3(c) and (d) are permissive conditions for a determination of serious prejudice? **US**

150. Is the list in Article 6.3 of the *SCM Agreement* exhaustive, or could serious prejudice arise in circumstances other than those listed in paragraphs (a) through (d)? **US**

151. Where in the text of Article 6.3(d) of the *SCM Agreement* is there a basis to take into account that 1998 may be a "misleading" year for the purposes of comparison? For example, unlike the text of Article XVI:3 of the GATT 1994, there does not seem to be a general reference to "special factors". **US**

152. If the US is correct in asserting that the Article 13(b)(ii) *Agreement on Agriculture* analysis is a year-by-year analysis, how would this affect the Panel's examination of Brazil's claims of serious prejudice, including the three year period and the trend period in Article 6.3(d) of the *SCM Agreement*? **US**

153. Would the conditions in Article 6.3(d) of the *SCM Agreement* be satisfied in respect of time periods other than the one specified? What relevance, if any, would this have for Brazil's claims? **BRA**

154. Does the US agree that upland cotton is a "primary product or commodity" within the meaning of Article 6.3(d) of the *SCM Agreement*? (ref. Brazil's further submission, para. 262) and within the meaning of Article XVI:3 of the GATT 1994? **US**

155. Please respond to Brazil's identification of the seven-year period beginning with MY1996 (following the passage of the FAIR Act of 1996) as the "most representative period" for the purposes of Article 6.3(d)? (ref. Brazil further submission, para. 269) **US**

156. Does the US agree that "...footnote 17 [of the SCM Agreement] does not carve out upland cotton from the scope of Article 6.3(d) of the SCM Agreement"? (ref. Brazil further submission, para. 275). **US**

157. Does the reference to "trade" in footnote 17 of the *SCM Agreement* have any impact on the interpretation of "world market share" in Article 6.3(d)) If so, what is it? **US**

158. Please respond to Brazil's assertion that "...the absence of any payment, production or expenditure limitations in the US marketing loan programme is analogous to the EC sugar regime that was challenged in *EC – Sugar Exports II (Brazil)* and *EC – Sugar Exports I (Australia)*." (ref. Brazil further submission, para. 317) **US**

159. The EC, in its oral statement (paras 9 and 10), disagrees with the US interpretation of the terms "same market". Can the US comment on the EC's view? **US**

160. Without prejudice to the meaning of "world market share" as used in Article 6.3(d) of the *SCM Agreement*, can you confirm the world export share statistics provided in Exhibit BRA-206? **US**

161. Would a finding of serious prejudice under Article 5(c) of the *SCM Agreement* be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the *SCM Agreement* in this context? **BRA, US**

162. Can the US confirm that marketing loan/LDP, step 2 and counter-cyclical payments are mandatory if the price conditions are fulfilled? **US**

163. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ? **US, BRA**

K. CAUSATION

164. When the US points, in its oral statement of 7 October, to the alleged "bias" of Prof. Sumner's model, is it arguing that US subsidies are irrelevant to the movement in prices and production (acreage) of upland cotton? **US**

165. Please comment (and submit substantiating evidence) on the US assertion that the FAPRI model has been designed and developed for prospective analysis, and is not suitable for retrospective counterfactual analysis. What is the reliability of past FAPRI-produced analyses when compared with actual data for the period covered by them? Is there any other instrument that can be used to try to identify the effect of subsidies already granted, or of their removal? **BRA, US**

166. The US states that "futures prices demonstrate that market participants predict increasing upland prices over the course of the marketing year" (US 7 October oral statement, para. 62). Please elaborate on this argument including citing specific futures prices. **US**

167. How does Brazil react to Exhibit US-44? **BRA**

168. Please confirm that the production figures cited in Exhibit US-47 are for upland cotton only and do not include textiles. **US**

169. Can the US confirm the accuracy of the facts and figures cited in the four bullet points in paragraph 12 of Brazil's 7 October oral statement? **US**

170. Brazil quotes a report that states that a 10% increase in soybean prices reduces upland cotton acreage by only 0.25% (Brazil's 7 October oral statement, para. 27). Could Brazil indicate if this analysis is done on a short-run basis or a long-run basis? **BRA**

171. In paragraphs 22 and 23 of its further submission, we understand that the US is, in short, claiming that increased total supply (i.e. including polyester) drove prices down. On the other hand, we note that, according to the figures in the chart in paragraph 22 of the same submission, the world production of cotton during this period has basically been steady. Do all polyester fibres as represented by these figures compete directly with cotton? That is to say, do these figures for polyester fibres include, for example, those that are used for textiles that technically cannot be substituted by cotton? **US**

172. Please estimate the price effect, in cents per pound, of the growth in the US retail market which it is said has directly contributed to strengthening world cotton prices. **US**

173. The US asserts that "burgeoning US textile imports … shifted the disposition of US cotton production from domestic mills to export markets" (US further submission, para. 20). A similar description appears in paragraph 33, together with the explanation that "the share of world cotton consumption supplied by US cotton has been roughly the same since 1991/92". Why have sales of US cotton for export increased and sales of cotton imported into the US increased? **US**

174. How, if at all, did the Asian financial crisis affect the United States' world market share? Did it disproportionately affect the US as compared to other exporters? **US**

175. With reference to paragraphs 57-58 and the related table on page 21 of the US further submission, could you please clarify the arguments regarding the ratio of the soybean futures to the cotton futures prices since in the table the inverse ratio is used? **US**

176. With reference to Figure 4 of Brazil's Further Submission, how does Brazil explain the apparent decrease in prices in 2001 and the increase of the A-Index in recent months, despite the continued use of US subsidies on upland cotton? **BRA**

177. Could the United States further elaborate on paragraph 50 of its 7 October oral statement? **US**

178. The Panel notes Exhibit US-63. Could the US please provide a conceptually analogous graph concerning US export sales during the same period? **US**

179. Could Brazil comment on the argument that decoupled payments and other subsidies to upland cotton are largely being capitalized into land values and that removing these subsidies would reduce the cost of production of upland cotton producers (US 7 October oral statement, para. 48). What would be the net effect of these adjustments? **BRA**

180. Please describe the precise formula as to how USDA determines the "adjusted world price" using the Liverpool A-Index, the NY futures price and any other relevant price indicators. Please submit substantiating evidence. **BRA, US**

181. Please provide a side-by-side chart of the weekly US adjusted world price, the Liverpool A-Index, the NY futures price, and spot market prices from 1996-present. What, if anything, does this reveal? **BRA, US**

182. Please explain why the US can be taken to be price *leaders*, or price *setters*, (and not just takers) when US producers receive large subsidy payment to support the difference between *world prices* and their own costs? **BRA**

## L. ARTICLE XVI OF GATT 1994

183. Why does Brazil believe that the appropriate "previous representative period" is the term of the previous Farm Bill, MY1996-2002? (Brazil's further submission, para. 282) **BRA**

184. Why does Brazil believe that an "equitable share" is one which factors out all subsidies? To the extent that domestic support and export subsidies are permitted by the *Agreement on Agriculture*, why should they not be accepted as being normal conditions in analyzing an equitable market share? (See Brazil's further submission, paras 288-289) **BRA**

185. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the *Agreement on Agriculture* and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the *SCM Agreement*. **BRA, US**

(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions of the *Agreement on Agriculture*, relevant?

(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the *SCM Agreement*, or in any other

provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in *US-FSC*, para. 117[2] here?

(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the *SCM Agreement* and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?

186. Could the United States please expand upon its statement that "[t]hese are the types of considerations that led to the negotiation of the Subsidies Agreement...." (US further submission, para. 109)? Is there any relevant material, including, for example, drafting history that might support this statement? **US**

M. THREAT CLAIMS

187. Please provide USDA's projections of marketing loan/LDP payments, direct payments and counter-cyclical payments to be made during MY2003 through 2007 based on the most recent USDA baseline projection. **US**

[2] WT/DS108/AB/R, para 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market." In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* must clearly take precedence over the *exemption* of primary products from export subsidy disciplines in Article XVI:4 of the GATT 1994."

188. Can the United States comment on the FAPRI projections for cotton provided in Exhibit BRA-202? **US**

N. CLARIFICATIONS

189. Please indicate whether the correct figure in paragraph 37 of Brazil's 7 October oral statement is 38.1% or 38.3%? **BRA**

190. Please confirm that the figure "17.5" in paragraph 43 of Brazil's 7 October oral statement, is "percentage point". **BRA**

191. Brazil clarify its statement in para. 12 of its 9 September further submission: "Alternatively crop insurance is **not specific** because the 2000 ARP Act denies benefits to commodities representing more than half of the value of US agriculture. Further US crops represent only 0.8 per cent of total US GDP." (emphasis added) **BRA**

# ANNEX L-1.16

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

3 November 2003

1. The Panel recalls that paragraph 5 of its 13 October 2003 communication reads as follows:

> "The Panel takes note of the United States' request in section II of its further submission for three preliminary rulings, regarding interest subsidies and storage payments; cottonseed payments; and export credit guarantees for products other than upland cotton. The Panel is not currently in a position to rule on these issues. The Panel will make rulings as necessary and appropriate in the course of this proceeding and hopes to be in a position to express its views, or give a ruling, on these requests, as appropriate, by 3 November (that is, shortly after the date of receipt of written responses to questions). Meanwhile, the Panel requests the parties not to exclude consideration of these issues in their responses to questions."

2. Accordingly, please find attached a communication from the Panel.

Panel's views on the preliminary ruling requested by the United States
in its further written submission of 30 September 2003

1. In its further written submission of 30 September 2003, the United States requests a preliminary ruling that:

(1) Brazil may not advance claims under either Article 4 or Article 7 of the *SCM Agreement* with respect to export credit guarantee measures relating to eligible US agricultural commodities other than upland cotton, because it did not include a statement of available evidence with respect to these measures as required by Articles 4.2 and 7.2 of the *SCM Agreement*;

(2) cottonseed payments made for the 1999 and 2000 crops are not within the Panel's terms of reference; and

(3) storage payments and interest subsidies referred to as "other payments" for upland cotton are not within the Panel's terms of reference.[1]

2. Brazil asks the Panel to reject the United States' request. In respect of item (1), Brazil asserts that the US request is not new and is untimely, groundless and "mooted by" the Panel's 25 July communication indicating that the Panel intended to rule that export credit guarantees to facilitate the export of US upland cotton and other eligible agricultural commodities are within the Panel's terms of reference.[2] Brazil asserts that items (2) and (3) are properly within the Panel's terms of reference.[3]

3. The Panel wishes to indicate to the parties how it intends to rule on items (1) and (2), in order to assist them in deciding what argumentation and evidence to submit in their further rebuttal submissions.

4. With respect to item (1), assuming *arguendo* that the US request was timely,[4] the Panel intends to rule in its report that Brazil provided a statement of available evidence with respect to export credit guarantee measures relating to eligible US agricultural commodities other than upland cotton, as required by Articles 4.2 and 7.2 of the *SCM Agreement*. As previously indicated in the Panel's communication of 25 July 2003, the Panel also intends to rule that "export credit guarantees … to facilitate the export of US upland cotton, and other eligible agricultural commodities" as addressed in document WT/DS267/7, are within its terms of reference.

5. With respect to item (2), the Panel intends to rule that cottonseed payments made under Public Laws 106-224 and 107-25 (in respect of the 2000 crop) are within its terms of reference, but that cottonseed payments made under Public Law 106-113 (in respect of the 1999 crop) are not within its terms of reference. This is without prejudice to the relevance, if any, of the cottonseed payments in respect of the 1999 crop to the conditions set out in Article 13(b) of the *Agreement on Agriculture*.

[1] US Further Written Submission, Sections II and XIII.
[2] Brazil's Oral Statement at the Resumed First Substantive Meeting, paragraphs 73-78.
[3] Brazil's Oral Statement at the Resumed First Substantive Meeting, paragraphs 79-81.
[4] The Panel recalls paragraph 12 of its working procedures but, in light of its intended ruling, does not need to address the issue of timeliness here.

6. The Panel has not yet decided upon its approach to item (3) and asks the parties not to exclude consideration of these other payments in their further rebuttal submissions.

# ANNEX L-1.17

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

14 November 2003

1. The Panel takes note of the United States' written request of 14 October 2003 for certain information relating to the quantitative simulation model used by Dr. Sumner in his analysis presented in Annex I to Brazil's 9 September 2003 further written submission. The Panel also takes note of the parties' related communications dated 5, 11, 12 and 13 November 2003, and the submissions by Brazil on 12 and 13 November 2003.

2. The Panel confirms the dates in its existing timetable, subject to the following.

3. The Panel does not require the parties' 18 November further rebuttal submissions, nor their oral statements during the second Panel meeting, to address the methodology, equations or parameters underlying the quantitative modelling simulation in Annex I to Brazil's further written submission which are directly linked to the information requested by the United States on 14 October 2003 and the submissions by Brazil on 12-13 November 2003. Having said this, the parties are not precluded from doing so.

4. Mindful of the requirements of Article 12.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* and in keeping with its duty to conduct an objective assessment of the matter before it, the Panel invites the United States to submit, on 22 December, in conjunction with its responses to any questions following the second Panel meeting, any comments that it may have on Brazil's submissions of 12-13 November 2003. Brazil may submit any comments on any such US comments by 12 January 2004, and the United States may submit any further comments by 19 January 2004. If necessary, at the discretion of the Panel, a further Panel meeting with the parties may be held to address this specific material.

5. This decision is without prejudice to the relevance and significance which the Panel may ascribe to the quantitative simulation model and related evidence and argumentation in its report.

6. Finally, the Panel wishes to ask the United States to respond, by 22 December, to the following:

> Is the Panel correct in understanding that the US government (including the United States Department of Agriculture) does not have a license or any other form of permission (standing or otherwise; free of charge or otherwise) to run, electronically, the FAPRI/CARD model and/or Professor Sumner's adaptations thereto?

# ANNEX L-1.18

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

8 December 2003

1. Please find attached:

- a communication from the Panel concerning its views on one of the preliminary ruling requests from the United States.

- a communication from the Panel concerning the FAPRI model, the essence of which was communicated to the parties by the Chairman of the Panel on 3 December 2003. As indicated therein, any US comments are due by **22 December**. Brazil will be given until **12 January 2004**, to comment on the US comments.

- the questions from the Panel. As was indicated earlier, responses to these questions are to be submitted by **22 December**.

2. As stated by the Chairman on 3 December, the United States will be given until **18 December** to respond to Brazil's request made in Exhibit BRA-369. Brazil will be given until **12 January 2004**, to comment on the US response.

3. The parties may submit any further comments on each other's comments by **19 January 2004**.

Panels' views on the preliminary ruling requested by the United States regarding the Agricultural Assistance Act of 2003

7. The United States requests a preliminary ruling that any measure under the Agricultural Assistance Act of 2003, including a cottonseed payment under that Act, is not within the Panel's terms of reference.[1]

8. Brazil asserts that that Act is properly within the Panel's terms of reference and asks the Panel to reject the United States' request.[2]

9. The Panel wishes to indicate to the parties how it intends to rule on this item in order to assist them in deciding what argumentation and evidence to submit in their answers to questions.

10. The Panel intends to rule that cottonseed payments made under the Agricultural Assistance Act of 2003 are not within its terms of reference. This is without prejudice to the relevance, if any, of those cottonseed payments to the conditions set out in Article 13(b) of the *Agreement on Agriculture*.

11. The Panel notes that it has not expressed a view concerning the United States' request for a preliminary ruling that storage payments and interest subsidies referred to as "other payments" for upland cotton are not within the Panel's terms of reference.[3] The Panel has not yet decided upon its approach to this item and asks the parties to respond to its written questions relevant to these payments, and not to exclude consideration of these payments in their answers to other questions.

[1] US First Written Submission, paras 217, 218; US Further Submission, para. 8.

[2] Brazil's Oral Statement at the first session of the First Substantive Meeting, para. 145; Brazil's Response to Panel Question No. 17 and comments on US Response to Panel Question No. 17.

[3] US Further Written Submission, Sections II and XIII.

Panels' communication concerning the FAPRI model

1. The Panel has been advised by Brazil that, to the best of Brazil's knowledge and belief, all of the information used by FAPRI to generate the various results presented in Brazil's submissions concerning the effects of the subsidies, and their removal, has been provided to the US in an electronic format. Conceptually speaking, the information is in two parts: (a) the model used as the basis for generating the results ("the FAPRI model"), and (b) adaptations to the model and other specific pieces of information which effect the calculations made by the model ("the Brazil information"). FAPRI has possession of the FAPRI model and the Brazil information. Brazil only has possession of the Brazil information. Brazil instructed FAPRI as to the use of the Brazil information that FAPRI then used to generate the various results presented by Brazil to the Panel.

2. We say that the US has all of the information (ie both the FAPRI model and Brazil's information) "to the best of Brazil's knowledge and belief" because Brazil itself has never had access to all of the data comprising the FAPRI model, which is voluminous. FAPRI considers the model to be its own work product. At the request of Brazil, FAPRI has made all of the information available to the US. Why it has done this in the case of the US, but not Brazil, relates to the relationship (commercial or otherwise) between FAPRI (which receives US funding for its work) and the US Government. FAPRI has provided all of the information to the US on the express stipulation that the model not be provided to the Panel or Brazil ("the FAPRI stipulation").

3. At para 74 of its Opening Statement at the Second Panel Meeting, the US asks this of the Panel:

> "[W]hether it intends the United States to comment on this new model, documentation, and results by the original 22 December deadline to file comments on the methodology underlying the Annex I model."

4. During the Second Panel Meeting, Brazil advised the Panel that it had no objection, then, to the US looking at the information provided to it by FAPRI, notwithstanding the FAPRI stipulation. The Panel acknowledges this, but also notes that it would be open to Brazil to reconsider its position depending on anything that the US may wish to present to the Panel about the FAPRI model.

5. The Panel's view in these circumstances is that the US should comment on the FAPRI model, if it believes that it needs to do so in the interests of presenting its case to the Panel, by **22 December**. The FAPRI stipulation does not, in the Panel's view, affect the Panel's ability to make an objective assessment of the matter before it in the terms of Article 11 of the DSU. The Panel will assess the reliability and relevance of the FAPRI model on the basis of the evidence presented to it by the parties.

6. Brazil will be given until **12 January 2004**, to comment on the above US comments.

Questions from the Panel to the Parties –
second substantive Panel meeting

A. TERMS OF REFERENCE

192. Regarding the interest subsidies and storage payments listed by the United States in its response to the Panel's Question No. 67:

(a) Please provide a copy of the regulations under which they are currently provided and under which they were provided during the marketing years 1996-2002;

(b) Please indicate whether there are any such payments which are not provided to implement the repayment rate for upland cotton within the marketing loan programme. **USA**

193. Are interest subsidies and storage payments already included in the amounts shown in your submissions to date for payments under the marketing loan programme? Has there been any double-counting? **BRA**

194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? **BRA, USA**

B. ECONOMIC DATA

195. Does the United States wish to revise its response to the Panel's Question No. 67*bis*, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers"? Did the United States make enquiries of the FSA in the course of preparing its original answer? **USA**

196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. **BRA, USA**

197. Please provide actual data for 2002/2003 for US exports, US consumption and per cent of world consumption to replace the projected data in Exhibit US-47. If available, please provide projected data for 2003/2004 to replace the forecast data. **USA**

198. Please comment on the respective merits of the price-gap calculations of MY1992 deficiency payments in US comments of 27 August, footnote 14 ($867 million), and Brazil's response to the Panel's Question No. 67 ($812 million). **BRA, USA**

199. What is the composition of the A-Index? We do note footnote 19 and, for example, Exhibit BRA-11, but please explain more in detail how this index is calculated. **BRA**

200. Concerning the chart on page 37 of Brazil's further rebuttal submission, why did Brazil use a futures price at planting time? Is this a relevant measure for assessing acreage response? **BRA**

201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so,

please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? **BRA, USA**

202. Concerning paragraph 7 of the US oral statement, are the expected cash prices shown for February only? Can the US provide the prices for January and March of each year as well? **USA**

203. Please provide information concerning the organization, mandate, credentials and standing of FAPRI. **BRA**

204. Which support to upland cotton is not captured in the EWG data referred to in Brazil's 18 November further rebuttal submission? **BRA**

205. Does the United States accept or agree with the EWG data submitted by Brazil? If not, please explain your reasons. **USA**

206. Please explain how the graph in paragraph 40 of the US further rebuttal submission was derived. In so doing, please clarify whether the figures are on a cents per pound basis or some other basis. What averaging method was used? Can you prepare individual charts showing average US and Brazilian cotton prices for each of those third country markets? **USA**

207. Please indicate whether any of the measures challenged in this dispute *obliges* cotton farmers to harvest their crop in order to receive the benefit of the programme (subsidy). **USA**

208. Please provide data for the marketing years 1992 and 1999-2002 of the "quantity of production to receive the applied administered price" (*Agreement on Agriculture*, Annex 3, paragraph 8) for purposes of a price-gap calculation of support through the marketing loan programme. **USA**

209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs. **BRA, USA**

210. Are worldwide planted acreage figures available? **BRA, USA**

211. Brazil presents a graph in paragraph 59 of its further rebuttal submission indicating the increasing cumulative loss incurred by cotton producers. Please comment on the argument that US cotton producers could not continue operating without subsidies. In particular:

(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?

(b) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? **USA**

212. Brazil states in paragraph 37 of its oral statement that studies of Westcott and Price found that the effect of the programme on cotton is to add an additional 1 to 1.5 million acres during marketing years 1999-2001 and to suppress US prices by 5 cents per pound. Does the US reject these findings? Why or why not? **USA**

213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? **BRA, USA**

C. DOMESTIC SUPPORT

214. Please provide a copy of regulations regarding the marketing loan programme and loan ..... deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? **USA**

215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? **BRA, USA**

216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. **BRA, USA**

217. What is the reason for reducing payments under the PFC and direct payments programmes for planting and harvesting fruit, vegetables and wild rice on certain base acreage? Please comment on the statements by the European Communities that "the reduction in payment for fruit and vegetables, if the EC understands correctly, is in fact designed to avoid unfair competition within the subsidising Member." (EC oral statement at first session, first substantive meeting, paragraph 29) and "To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition (…)" (EC response to Panel third party Question No. 5). **USA**

218. Please comment on the testimony of USDA Chief Economist Keith Collins cited in paragraph 36 of Brazil's oral statement regarding the trade-distorting and production-distorting nature of the marketing loan payments. **USA**

D. EXPORT CREDIT GUARANTEES

219. Under the *Agreement on Agriculture* the general position is that the use of export subsidies, both those listed in Article 9.1 as well as those within the scope of Article 1(e) which are not so listed, may only be used within the limits of the product specific reduction commitments specified in Part IV of Members' Schedules. One might therefore have expected that Article 3.3 of the *Agreement on Agriculture* would have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, would have simply prohibited the use of any export subsidy. Instead, the Article 3.3 prohibition is limited in both cases to export subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:

(a) the fact that export performance-related tax incentives, which like subsidised export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held (for example, in *United States – Tax Treatment for Foreign Sales Corporations*, WT/DS108) to be subject to the anti-circumvention provisions of Article 10.1; and

(b) the treatment of international food aid and non-commercial transactions under Article 10? **USA**

220. What will be the relevance of Articles 9 and 10.1 of the *Agreement of Agriculture* to export credit guarantees when disciplines are internationally agreed? **BRA**

221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be $230,127,023 instead of the figure which originally appeared ($381,345,059).

(a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.

(b) Please clarify whether and how the Panel should treat the figures in Exhibit BRA-182 for the net lifetime re-estimates for each respective cohort.

(c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of $4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately $4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result.

(d) Please identify what is considered an "administrative expense" for this purpose.

(e) The Panel notes the US statement in paragraph 160 of its answers to Panel questions following the first meeting that all cohorts are still open although the 1994 and 1995 cohorts will close this year. Is this still an accurate statement? If not, please indicate whether any cohorts have since "closed" for the period 1992-2002.

(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily* reach a "profitable" result (for example, the 1994 cohort, which has almost closed still indicates an outstanding amount)? Do "re-estimates" reflect also expectations about a cohort's future performance?

(g) Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?

(h) Why should the Panel "eliminate", in addition, the 2000 cohort, as also suggested in paragraph 198 of the US further rebuttal submission for which information is presumably more "complete"?

(i) Under the US approach, at what point in time could a Panel ever make an assessment of the programme, if it had to wait for each cohort to be completed before it could be "properly" assessed? Why is it inappropriate for the Panel to include these "most recent years" in its evaluation, as the US suggests in paragraph 199 of its 18 November further rebuttal submission? **USA**

222. For GSM 102, 103 and SCGP, please provide year-by-year amounts from 1992 to 2003 with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes. Please indicate any allocation methodologies used to calculate administrative costs. **USA**

223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? **USA**

224. Please indicate how the CCC's cost of borrowing was treated in the 2002 financial statement of the CCC, in Exhibit BRA 158. **USA**

225. Please indicate whether there was any instance where the CCC "wrote off" debt and, if so, please indicate the accounting regulation or principle used. If a "written off" debt is subsequently recovered, do the CCC's accounts reflect both the interest cost and interest received in relation to the debt during the time it was "written off"? **USA**

226. If a debt was "written off" more than ten years ago, does it still create a cost to the programme? If so, how is this reflected in the 2002 financial statement of the CCC, in Exhibit BRA 158 (or any other material)? **USA**

227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount – referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? **USA**

228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? **BRA, USA**

E. SERIOUS PREJUDICE

229. What is the meaning of the words "may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the *SCM Agreement*? Please comment on the possibility that these words indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice and that serious prejudice should be considered an additional or overriding criterion to the factors specified in the subparagraphs. **BRA**

230. Please comment on Brazil's views on Article 6.3 of the *SCM Agreement* as stated in paragraphs 92-94 of its further submission. **USA**

231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the *SCM Agreement* are relevant context for the Panel's interpretation of Article 6.3? **USA**

232. How, if at all, should the Panel take into account the effects of other factors in its analysis of the effects of US subsidies under Article 6.3? If the Panel should compare the effects of other factors to establish the relative significance of one compared to others, how would this be done? What would be relevant “factors” for this purpose? **BRA**

233. In Brazil's view, what is or are the "same market(s)" for the purposes of Article 6.3(c)? Does Brazil's view of "world market" imply that regardless of which domestic (or other) "market" is examined, price suppression will be identifiable? **BRA**

234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"? **USA, BRA**

235. Please comment on paragraphs 8, 9 and 10 of the US 2 December oral statement, in particular, why the average Brazilian price is shown as lower than the average US price. **BRA**

236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share". **USA**

237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? **BRA, USA**

238. According to the US interpretation of the term "world market share":

(a) should the domestic consumption of closed markets be added into the denominator?

(b) if US production and consumption increased by the same percentage, whilst the rest of the world's production and consumption remained steady, would this imply an increase in the US "world market share" by a different percentage?

(c) does Saudi Arabia have a small world market share for oil? **USA**

239. How does the US respond to Brazil's assertions that, under the US interpretation of the term "world market share":

(a) there would be no WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports? (see paragraph 64 of Brazil's 2 December oral statement);

(b) a Member's exports would have to be disregarded in calculating their "world market share" in terms of "world consumption"? (see e.g. paragraph 65 of Brazil's 2 December oral statement) **USA**

240. Does Article XVI:3 of GATT 1994 provide context in interpreting Article 6.3(d) of the *SCM Agreement*? Do these provisions apply separately? If not, could it indicate that "world market share" is intended to mean the same as "share of world export trade"? **USA**

241. How does the US reconcile its data on consumption for 2002 in US Exhibit 40, Table 1 with the "consumption" data it refers to in its 30 September submission, paragraph 34, Exhibit US-47 or US-71? **USA**

242. How much of the benefits of PFC, MLA, CCP and Direct Payments go to land owners? If not all of the benefits go to land owners, what proportion goes to producers? **USA**

243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? **USA**

244. What proportion of the 2000 cottonseed payments benefited *producers of upland cotton*, given that payments were made to *first handlers*, who were only obliged to share them with the producer to the extent that the revenue from sale of the cottonseed was shared with the producer? (see 7 CFR §1427.1104(c) in Exhibit US-15). **BRA**

245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? **BRA, USA**

246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? **BRA, USA**

247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? **BRA, USA**

F. STEP 2

248. In respect of the level of Step 2 payments in certain time periods, the Panel notes, *inter alia*, footnote 129 in the US first written submission; footnote 33 in the US 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? **BRA, USA**

249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":

(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer?[4] How, if at all, would this be relevant for an analysis of the issue of export contingency under the *Agreement on Agriculture* or the *SCM Agreement*? **BRA**

(b) How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do *not* go directly to the producer? **USA**

(c) What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. **USA**

G. REMEDIES

250. Does Brazil seek relief under Article XVI of *GATT 1994* in respect of expired measures? What type of recommendation would the Panel be authorized to make? (Brazil further submission, paragraph 471 (iii)) **BRA**

251. In light, *inter alia*, of Article 7.8 of the *SCM Agreement*, if the Panel were to find that any subsidies have resulted in adverse effects to the interests of another Member within the meaning of Article 5 of the *SCM Agreement*, should it make any recommendation other than the one set out in the first sentence of Article 19.1 of the DSU? **BRA**

[4] For example, Brazil's response to Panel Question 125, paragraph 14.

252. Without prejudice to any findings by the Panel, if the Panel were to find that any of the challenged measures constitute prohibited subsidies within the meaning of Article 3 of the *SCM Agreement*, what are the considerations that should guide the Panel in making a recommendation under Article 4.7 of the *SCM Agreement* relating to the time period "within which the measure must be withdrawn"? What should that time period be? **BRA**

H. MISCELLANEOUS

253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):

(a) Does it relate to export credit guarantees, crop insurance and cottonseed payments?

(b) Does it relate only to compliance with AMS commitments?

(c) Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?

(d) How would the Secretary exercise her authority to prevent serious prejudice to the interests of another Member? How would she exercise her authority to prevent a threat of serious prejudice to the interests of another Member? At what time and on the basis of what type of information would she exercise her authority?

(e) What does "to the maximum extent practicable" mean? In what circumstances would it not be practicable for the Secretary to exercise her adjustment authority? **USA**

254. Would payments made after the date of panel establishment be *mandatory* under the marketing loan, direct payments, counter-cyclical payments and user marketing certificate (step 2) programmes, but for the circuit-breaker provision? **USA**

255. How does Brazil respond to US assertions concerning the circuit-breaker provision? (see US 2 December oral statement, paragraph 82). Does this mean that US subsidies cannot be "mandatory" for the purposes of WTO dispute settlement? **BRA**

256. The United States submits that the Panel cannot make rulings without allocating precise amounts of payments to upland cotton production. However, to the extent that such precise data is not on the Panel record, to what extent can the Panel rely on less precise data, and on reasonable assumptions, in fulfilling its duty under Article 11 of the *DSU* in this case? **USA**

# ANNEX L-1.19

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

23 December 2003

Please find attached additional questions from the Panel.

We would ask the parties to provide their responses by **12 January 2004.** The parties may submit any comments on each other's responses by **19 January 2004**.

Additional Questions from the Panel to the parties –
following the second substantive Panel meeting

257. The Panel takes note of the Appellate Body Report in *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan* (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.

(a) In that report, the Appellate Body cautioned against the "mechanistic" application of the so-called "mandatory/discretionary distinction" and stated that the import of this distinction may vary from case to case (para. 93). For the Appellate Body, the question of whether a measure is mandatory or not is relevant "if at all" only as part of the assessment of whether the measure is, as such, inconsistent with particular obligations. How, if at all, are these statements and the related findings concerning the mandatory/discretionary distinction in that Appellate Body Report relevant to:

(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the *Agreement on Agriculture* and Articles 3.1(a) and (b) of the *SCM Agreement*, concerning: **BRA**

- Step 2 payments (see, *e.g.* paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and

- export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, *e.g.*, para. 90 Brazil's oral statement at second Panel meeting).

(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"? **BRA**

(iii) the legal standard and elements Brazil sets out to establish its "*per se*" "serious prejudice" claims (*e.g.* Brazil's 9 September further submission, para. 417 *ff*; US oral statement at second Panel meeting, para. 86 *ff.*)? **BRA**

(b) How and to what extent are the legal and regulatory provisions cited in paras. 415 and 423 of Brazil's 9 September further submission "normative" in nature and treated as binding within the US legal system (see, *e.g.*, para. 99 of the Appellate Body Report)? Does your response differ depending on whether the payments are dependent upon market price conditions? **BRA**

(c) Does Brazil challenge as "mandatory" the "subsidies" themselves, the subsidy programmes or the legal/regulatory provisions for the grant or maintenance of those subsidies, or something else? **BRA**

(d) Does the "requirement" upon the CCC to make available "not less than" $5.5 billion annually in guarantees have a normative character and operation? (see, e.g. Brazil's response to Panel Question 142; Exhibit BRA-297, 7 USC 5641(b)(1); 7 USC 5622(a) & (b); paragraph 201 of US 18 November further rebuttal submissions). Is this requirement "mandatory"? If so, how does the CCC have "discretion" not to make this amount of guarantees available in a given year? **USA**

(e) Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programs as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (*e.g.* Exhibit BRA-117 (2 USC 661(c)(2))? **USA**

# ANNEX L-1.20

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

24 December 2003

The Panel has received a letter from Brazil dated 23 December (numbered 760), in which it requests extension of certain deadlines. The Panel has also received a response from the US, dated 23 December. Having carefully considered the views of both parties, the Panel notifies the parties that it would amend the four immediate deadlines and schedules as follows:

(1) all submissions originally due 12 January 2004 would now be due **Tuesday, 20 January 2004**

(2) all submissions originally due 19 January 2004 would now be due **Wednesday, 28 January 2004**.

(3) issuance of descriptive part of the report to parties (currently scheduled for 26 January) would be rescheduled to **Wednesday, 4 February 2004**.

(4) receipt of comments by parties on the descriptive part of the report (currently scheduled for 19 February) would be rescheduled to **Monday, 1 March 2004**.

All subsequent dates remain unchanged. However, please be reminded that such dates may be changed in light of further developments.

# ANNEX L-1.21

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

12 January 2004

The Panel takes note that, as stated in its letters dated 18 and 22 December 2003, the United States provided certain data requested by Brazil, but deleted from farm-level planted acreage data any fields that could identify individual farms. Brazil commented on this in its answer to Panel Question No. 196. The United States stated in its letter dated 18 December 2003 that "the release of planted acreage information associated with a particular farm, county and state number is confidential information that cannot be released under US domestic law, in particular the Privacy Act of 1974."

The Panel has reviewed the material submitted in support in Exhibits US-102 through 107, and makes the following observations:

- in the sample Freedom of Information Act ("FOIA") determination submitted to the Panel, the FSA appears to have relied on the fact that the acreage requested concerned a single producer only and that there was no public interest in disclosure of records which did not directly reveal the operations or activities of the US Federal Government;

- in that sample FOIA determination, the FSA applied the relevant US domestic law and expressly acknowledged that disclosure of individual data on commodity programme recipients can be released where the recipients' privacy interests in that information are outweighed by the public interest in disclosure;

- the information which the US asserts that it cannot disclose is relatively generic, concerning planted acreage, and does not relate to one individual but to tens of thousands of business people, and can be protected under the DSU and our working procedures;

- farm-specific information on contract payments is already available free of charge on the internet on the EWG database, having been disclosed under the FOIA; and

- comprehensive farm-specific information concerning rice, including planted acreage data associated with particular farm, county and state numbers, was provided on request under the FOIA to a member of the public who was assisting Professor Sumner in the presentation of Brazil's case to the Panel. A sample of this data is set out in Exhibit BRA-369.

Article 13.1 of the DSU relevantly provides as follows:

> "A Member should respond promptly and fully to any request by a panel for such information as the panel considers necessary and appropriate. Confidential information which is provided shall not be revealed without formal authorization from the individual, body, or authorities of the Member providing the information."

Pursuant to Article 13 of the DSU, the Panel requests the United States to provide the same data that it agreed to provide in its letters dated 18 and 22 December 2003 but in a format which permits matching of farm-specific information on contract payments with farm-specific information

on plantings. The Panel considers it both necessary and appropriate to seek this information in a suitable format in order to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements. Disclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years.

The United States may again designate the data as confidential in accordance with paragraph 3 of the Panel's working procedures. Disclosure can be limited to Brazil's delegation, the Panel and Secretariat staff assisting the Panel. The United States may also protect the identity of individual producers by, for example, using substitute farm numbers which still permit data-matching.

A refusal by the United States to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn.

The Panel reminds Brazil that it may not disclose the above information outside its delegation in this proceeding if it is designated by the United States as confidential.

The Panel also wishes to pose the following additional question to Brazil:

> 258. Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks.

The Panel asks the parties to provide the respective information requested by 20 January 2004.

# ANNEX L-1.22

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

3 February 2004

Please find attached the Panel's supplementary request to the United States for information pursuant to Article 13 of the DSU, as well as additional questions to both parties. The Panel would like to ask the parties to provide the information requested and responses to the additional questions by **Wednesday 11 February 2004**. The Parties are invited to submit, by **Wednesday 18 February 2004,** any comments on material submitted on 11 February by the other party.

In light of the above development, the Panel intends to postpone the issuance of the descriptive part until **Friday 20 February 2004**. The remainder of the Panel's schedule remains unchanged for the time being.

The Panel recalls that it indicated, in its communication dated 14 November, that "[i]f necessary, at the discretion of the Panel, a further Panel meeting with the parties may be held" to address the issue of econometric models. The Panel would like to indicate that, at this stage, it does not see the need to hold such a meeting.

The Panel has noted the US letter dated 30 January, Brazil's response dated 2 February, and a further letter from the US dated 3 February 2004. Keeping in mind the dictates of due process and relevant provisions of the covered agreements -- including Article 12.2 of the DSU which requires Panel procedures to provide sufficient flexibility so as to ensure high-quality panel reports while not unduly delaying the panel process -- the Panel is of the view that the above revisions to the timetable provide the United States and Brazil sufficient opportunity to comment on each other's comments. Accordingly, the US is free to submit its comments on Brazil's above mentioned submission by 11 February (**but no later**).

This is without prejudice to any definitive view of the Panel on the characterization of any of the above communications by the parties and, in particular, of the document submitted by Brazil entitled "Brazil's Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-scrambled Data on 20 January 2004".

# PANEL'S SUPPLEMENTARY REQUEST FOR INFORMATION PURSUANT TO ARTICLE 13 OF THE DSU AND ADDITIONAL QUESTIONS

The Panel has reviewed the United States' letters dated 18 December 2003 and 20 January 2004, and the material submitted in support in Exhibits US-102 through 107, and Brazil's response to Question No. 258.

Pursuant to Article 13 of the DSU, the Panel requests the United States to provide:

(a) such of the information requested on 12 January 2004 in the format requested, as regards payment recipients who do not have interests protected under the Privacy Act 1974, if any; and

(b) the following information for each of the PFC, MLA, CCP and direct payments programmes for each of the 1999, 2000, 2001 and 2002 marketing years, showing as many of the underlying calculations as possible:

- How many farms had fewer upland cotton planted acres than upland cotton base acres, or equal numbers of each? We refer to these as "Category A" farms. What was the total of their upland cotton base acreage? What was the total of their upland cotton planted acreage?
    - How many Category A farms did not plant any other covered commodities? What was the total of their upland cotton base acreage? What was the total of their upland cotton planted acreage?
- How many farms had more upland cotton planted acres than upland cotton base acres? We refer to these as "Category B" farms. What was the total of their base acreage for each covered commodity, including upland cotton? What was the total of their planted acreage for each covered commodity, including upland cotton? Please also provide the following information concerning these farms:
    - How many Category B farms had equal numbers of acres planted to all covered commodities and base acres for all covered commodities? We refer to these as "Category B-1" farms. What was the total of the base acreage of Category B-1 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-1 farms for each covered commodity, including upland cotton?
    - How many Category B farms had fewer acres planted to all covered commodities than base acres for all covered commodities? We refer to these as "Category B-2" farms. How much was the total acreage of Category B-2 farms planted to all covered commodities less than their base acreage for all covered commodities? What was the total of the base acreage of Category B-2 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-2 farms for each covered commodity, including upland cotton?
    - How many Category B farms had more acres planted to all covered commodities than base acres for all covered commodities? We refer to these as "Category B-3" farms.

How much did the total acreage of Category B-3 farms planted to all covered commodities exceed their base acreage for all covered commodities? What was the total of the base acreage of Category B-3 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-3 farms for each covered commodity, including upland cotton?

- How many farms had upland cotton planted acres but no upland cotton base acres? We refer to these as "Category C" farms. What was the total of the base acreage of Category C farms for each covered commodity? What was the total of the planted acreage of Category C farms for each covered commodity, including upland cotton?

- In addition, for the marketing year 2002, please reply to the above questions with respect to all crops on cropland covered by the acreage reports, not simply commodities covered by the programmes.

- In addition, please provide all of the above information on a state-by-state basis.

You may wish to present your responses regarding acreage for each covered commodity in a table as follows:

**TABLE**

**Programme:**
**Marketing year:**
**Category of Farm:**

| | Covered commodities | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Upland Cotton | Barley | Corn | Oats | Rice | Sorghum | Wheat | Soybeans* | Other Oilseeds* |
| Base acres | | | | | | | | | |
| Planted acres | | | | | | | | | |

* Where applicable.

The Panel considers it both necessary and appropriate to seek this information to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements. However, the Panel reserves its views as to the extent to which any methodology might be appropriate to determine support provided to upland cotton in the circumstances of this case.

A refusal by the United States to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn.

The Panel also wishes to pose the following additional questions to the United States (Nos. 259 – 275) and to Brazil (No. 276):

259. With respect to the Privacy Act of 1974, 5 U.S.C. 552a:

(a) Whose interests are protected under section 552a(b) in light of the definition of "individual" in section 552a(a)(2)? Do all payment recipients, including corporations and organizations, have Privacy Act rights? If not, is the United States prevented by its domestic law from releasing such of the information requested on 12 January 2004 as relates to payment recipients without Privacy Act rights? Please explain with references to case law.

(b) The Panel notes that data concerning the four relevant programmes, in particular, payment amounts, identified by specific farms, is freely available on the internet. Please explain why that data can be disclosed but the requested planted acreage data cannot. Do individual recipients have Privacy Act rights with respect to their entrepreneurial activity? Please explain with references to case law.

(c) Please provide any further available evidence of the USDA's long-standing policy that planted acreage information will not be released.

260. On 27 August 2003, in its response to Question No. 67 *bis*, the United States indicated that "it does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers". On 12 January 2004, the Panel requested the United States to provide information "to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years". On 20 January 2004, the United States informed the Panel that "the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton." Is the latest statement responsive to the Panel's request? If so, how can it be reconciled with the first statement?

261. Please confirm that each record in the actual planting database relates to a specific farm (Filenames: rPFCplac and rDCPplac in Exhibits US-111 and US-112). For example, in the data from rDCPplac:

*First line*:
Field9;Field16;Field22;Field28;Field34;Field40;Field46;Field52;Field58;Field64;Field70;Field76;Field82;Field88;Field94;Field100

*Second line*:
237.10;23059.80;5566.20;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00

Does the second line represent data on plantings by the same farm?

262. The Panel has noted the two CD-ROMs delivered by the US in the evening of 23 December 2003. They are marked "US-111" and "US-112" respectively, but the contents actually do not correspond to the indication. The Panel also takes note of the US letter dated 28 January 2004 and the CD-ROM delivered together with it. For the record, please clarify the correct CD-ROMs and provide corresponding descriptions of their contents with exhibit numbers.

263. The Panel has noted that the United States' response to Question No. 214 refers to Exhibits US-117 and US-118. Are these the correct documents to which the United States intended to refer in that response? If not, please provide a copy of regulations regarding the

marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993.

264. The Panel asks the United States to clarify certain aspects of Exhibit US-128:

(a) Is the Panel correct in understanding that -- as Brazil asserts in footnotes 290 and 291 of Brazil's 28 January 2004 comments on US responses to questions -- Exhibit US-128, all data are presented on a cohort-specific basis? If so, please also present the information originally requested by the Panel in another chart containing *programme* (as opposed to cohort-specific) activity by fiscal year.

(b) Does the US agree with the statement in paragraph 135 of Brazil's 28 January 2004 comments on US responses to questions that the difference between the $1,148 billion in the chart at para. 165 of Brazil's 11 August answers to questions and the $666 million amount in Exhibit US-128 ($1.75 billion) closely corresponds to the total "Claims rescheduled" figure reported by the US in Exhibit US-128 (column F)?

(c) Does the US agree that from the formula in column G (that is: (Column (D) minus (E) minus (F)), it follows that a rescheduled claim no longer constitutes an outstanding claim at the moment the terms of the re-scheduling are agreed and that a rescheduling is treated as 100 per cent recovered, as Brazil states in footnote 292 of Brazil's 28 January 2004 comments on US responses to questions?

(d) Is the Panel correct in understanding that the amount of $888,984,792.04 in column F in Exhibit US-128 under "ALL" for 1992 represents the total continuing amount of unrecovered claims for the 1992 cohort, and that the amount of 387,692,219.39 represents the total continuing amount of unrecovered claims for the 1993 cohort, etc? Please indicate and substantiate how much principal and/or interest has actually been paid/recovered/rescheduled *annually* 1992-2003 in respect of each of the amounts shown in Columns D, E & F in the table.

265. In connection with the US response to Question No. 225, please also provide amounts actually "written off" and "forgiven" annually for each *post*-1992 cohort, with annual details of country and amount (principal/interest).

266. What are the precise terms, conditions and duration of each rescheduling reflected in column F in Exhibit US-128?

267. Is the Panel correct in understanding that "interest collected on reschedulings" in Column M in Exhibit US-128 refers not to amounts that have been actually collected by the CCC but rather to interest capitalized in conjunction with the rescheduling? If so, what are the terms, conditions and duration of the arrangements pertaining to these amounts?

268. Concerning Column N in Exhibit US-128, please elaborate upon "Interest earned from US Treasury on uninvested funds". What is the source and authority for these funds and for the interest thereon to be part of the CCC total revenues? What are the terms, conditions and duration of the arrangements pertaining to these amounts?

269. The Panel notes the table submitted by the US in its answer to Question No. 224 (CCC Financing Account Payments of Interest on Borrowings from Treasury and Interest Earned on Uninvested Funds). Is the Panel correct in understanding that the figures in this table correspond to the "ALL" figures in Columns I and N of Exhibit US-128?

270. With respect to Column I in Exhibit US-128, ("Interest paid on borrowing from US Treasury") and Note 8, p. 25 of Exhibit US-129:

(i) please provide the total annual amounts (interest bearing and non-interest bearing) borrowed by the CCC from the US Treasury (annually since 1992), as well as the terms, conditions, interest rate (where applicable) and duration of such borrowing. Please provide details of any other amount borrowed by the CCC from the US Treasury during this period that may not have formed part of the regular annual borrowings.

(ii) Please explain the nature of "CCC's permanent indefinite borrowing authority from Treasury" referred to in Note 8, p. 25 of Exhibit US-129.

(iii) What determines the level of CCC export credit guarantee borrowing (interest-bearing and non-interest-bearing)? Is the interest-free borrowing up to the amount of unreimbursed realized losses?

(iv) Why are repayments applied to non-interest bearing notes first, as indicated at Note 8, p. 25 of Exhibit US-129?

271. Note 8, p. 25 of Exhibit US-129 states that "In fiscal year 2003, CCC was fully reimbursed for its prior year net realized losses." Please indicate the amounts of prior year net realized losses (annually, since 1992) for which the CCC has been fully reimbursed.

272. With respect to the US response to Question No. 226, is the Panel correct in understanding that the reflection of write-offs as part of the operating loss of the CCC which in turn was replenished through the annual appropriations process ended with the entry into force of the FCRA in fiscal year 1992? If not, what amounts have been replenished through this process annually since fiscal year 1992?

273. With respect to the US response to Question No. 225, what criteria does the CCC apply to "independently determine" that a debt is uncollectible? For post-1992 cohorts, what are these uncollectible amounts (annually) and how, if at all, are such "uncollectible amounts" shown in Exhibit US-128?

274. The Panel notes the US statement in the US response to Question No. 81 that "All rescheduled claims are currently performing " and that "all payments due up to this point under [rescheduling] agreements have been received". However, the Panel also notes Exhibit US-129 (in particular, Note 5 on p. 22) and Brazil's reference thereto in Brazil's 28 January comments on the US response to Question No. 222. In this connection:

(a) How does the US respond to Brazil's statement in Brazil's 28 January comments that Exhibit US-129 confirms that rescheduling of export credit guarantee receivables cover both principal and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled?

(b) In Note 5 on p. 22 of Exhibit US-129, what is the definition of "non-performing"? What is the meaning of "delinquent"? What is the current principal balance and amount of interest of the three CCC export credit guarantee programme "receivables" in a non-performing status (individually and together, for GSM 102, GSM 103 and SCGP))? What is the amount of interest on non-reporting "receivables"?

(c) The Panel notes the US reference to the "Paris Club" in US response to Question No. 225. What is the P.L. 480 programme referred to in Note 5 on p. 22 of Exhibit US-129 (including the Paris Club debt reduction process and the HIPC Initiative) ? To what extent is the P.L. 480 programme and Paris Club process relevant to the export credit guarantee programmes at issue in this dispute? Please identify and give the amounts of all CCC export credit guarantee debt subject to the P.L. 480 debt reduction (or other similar) process since 1992.

(d) Can the US explain the process referred to in the second column of Note 5 on p. 22 ("CCC is awaiting an apportionment from the Office of Management and Budget before the transaction can be completed. Until such time, however, there is a 100% subsidy allowance established against the relevant debt as of September 30, 2003.") Please provide details of all such "apportionments" relating to the three export credit guarantee programmes in fiscal years 1992-2003.

275. Please provide evidence (or cite relevant portions of the record) that the premium rates for the export credit guarantee programmes are "reviewed annually" as stated in US 28 January comments on response to Question No. 223 (see also US 22 December response to Question No. 107; Brazil's 28 January 2004 comments on responses to Question No. 223.).

The Panel wishes to pose the following additional question to Brazil:

276. The Panel notes the parties' responses and comments relating to Question No. 252 concerning the time period within which any prohibited measure must be withdrawn within the meaning of Article 4.7 of the *SCM Agreement*. Please supplement your original response, taking into account the particular nature of each alleged prohibited subsidy measure (i.e. "Step 2" payments under Section 1207(a) of the 2002 FSRI Act, export credit guarantee programmes and the ETI Act) and the functioning of the US legal and regulatory system in respect of these measures.

# ANNEX L-1.23

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

16 February 2004

1. The Panel is in receipt of the letter from the U.S. dated 11 February, the response from Brazil dated 13 February and another US letter dated 16 February.

2. On page 2 of the United States letter of 11 February, with respect to item (b) of the Panel's supplementary request for information, the United States asks the Panel to specify which commodities are "covered commodities". We would like to clarify that "covered commodities" and "commodities covered", as used in the bullet points and sub-bullets, refer to wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, "other oilseeds" as defined in Section 1001(9) of the FSRI Act of 2002, and peanuts, except that soybeans do not apply to PFC payments and "other oilseeds" and peanuts do not apply to PFC or MLA payments.

3. The Panel also confirms that the additional information sought for marketing year 2002 "with respect to all crops on cropland covered by the acreage reports" refers to the reports filed under Section 1105(c) of the FSRI Act of 2002. The relevant portions of the "above questions" are those that ask for planted acreage information for each Category of farms. All crops other than "covered commodities" as defined in Section 1001(4) of the FSRI Act of 2002 and peanuts may be aggregated as "other crops".

4. In relation to the third point the US raises in its letter dated 11 February, the Panel informs the parties as follows:

(a) Without prejudice to whether any further comments are necessary, we would consider the US request for another opportunity to comment if Brazil submits any such comments on the US submission entitled "Comments of the United States of America on the Comments of Brazil to US data Submitted on 18 and 19 December 2003" (submitted 11 February).

(b) The US would be granted until **Tuesday 3 March**, at the latest, to submit all remaining data that was requested by the Panel in its communication dated 3 February.

(c) The issuance of the descriptive part would be changed to **Friday 5 March**.

(d) The remainder of the Panel's schedule remains unchanged for the time being.

5. The Panel notes that the data submitted by the United States, as described in Exhibit US-145, does not include data on MLA and CCP payments. The Panel asks the United States to address these payments and include this information in its response to the supplementary request for information.

6. The Panel also notes that the US response to Panel Question No. 263 refers to Exhibit US-263. Could the United States please confirm that this should refer to Exhibit US-146.

7. The Panel further notes Brazil's request for an opportunity to comment after the United States has submitted the data referred to in paragraph 4(b) above. The Panel will consider this request after it has had the opportunity to review data submitted by the United States.

# ANNEX L-1.24

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

20 February 2004

1. The Panel refers to its communication dated 16 February. Item 4 (a) of this communication deals with the request made by the United States (in its letter dated 11 February) that it be provided another opportunity to comment on a certain submission from Brazil. The Panel has informed parties in the same 4 (a) that it would consider this request if Brazil submits any such comments. The Panel has received on 18 February a submission entitled "Brazil's Comments on United States 11 February Comments on Brazil's 28 January 'Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-scrambled Data on 20 January 2004'". The Panel understands that this submission corresponds to what the United States was requesting to be given another opportunity to comment on. The Panel would now allow the United States to submit, if it so wishes, comments on this specific submission from Brazil by **Wednesday 25 February**. The Panel informs parties that it does not see, at this time, the need to have further opportunities to comment on this submission (if any) from the United States.

2. The Panel also takes note of Brazil's observation in paragraph 33 of its 18 February "Comments on US 11 February 2004 Answers to Additional Questions from the Panel Following the Second Meeting of the Panel with the Parties" that "...the Panel did not respond to Brazil's request that it deny the United States' efforts to decide at what pace it wishes to offer responses to the Panel's questions". The Panel also recalls the United States' original statement in connection with Question 264(b) that it "expects to be able to provide an answer within the same time period as its response to the Panel's supplemental request for information." In this connection, we wish to draw the parties' attention to our statement in item 4(b) of the 16 February communication, and to clarify that that statement also pertains to the United States response to Question 264(b). Thus, the United States has until **3 March**, at the latest, to submit its response. We further note that Brazil states in the same paragraph 33 that it "reserves the right to comment" on the United States response to Question 264(b). In line with what we mentioned in paragraph 7 of our communication dated 16 February, we would decide whether it is appropriate to give Brazil the opportunity, *after* we have had the opportunity to review the response from the United States.

# ANNEX L-1.25

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

24 February 2004

The Panel is in receipt of the letter from the United States dated 23 February 2004.

After carefully considering the views of the United States, we now change the date by which the United States is expected to submit its comment from the date originally designated as 25 February in our communication dated 20 February, to **3 March 2004**.

All other statements in our communication dated 20 February remain unchanged.

# ANNEX L-1.26

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

4 March 2003

The Panel is in receipt of the submissions from the United States dated 3 March. The Panel reminds parties of our communications dated 16, 20 and 24 February 2004, especially in relation to our intention to consider whether or not to allow Brazil to comment on certain US submissions. After carefully examining yesterday's submission from the United States, the Panel informs parties of the following amendment to the current timetable.

1. Brazil is granted until **10 March 2004** to submit comments, if any, on (a) the data supplied by the United States, dated 3 March, in the form of a CD-ROM (i.e. 8 data files therein) and (b) the submission entitled "Answers of the United States of America to Questions 264(b) Dated 3 February 2004, from the Panel to the Parties following the Second Panel Meeting". The Panel does not see the need to grant Brazil the opportunity to comment on any other submission from the United States.

2. The United States is granted until **15 March 2004** to submit comments, if any, on the submission from Brazil to be received by 10 March 2004.

3. The descriptive part will be issued on **16 March 2004**.

4. Comments on the descriptive part is to be received by **30 March 2004**.

5. The rest of the timetable remains unchanged for now.

# ANNEX L-1.27

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

7 April 2004

The Panel informs the parties of the following change in the timetable for this dispute. As indicated, the Panel now intends to issue the interim report to the parties on Monday 26 April 2004.

| | |
|---|---|
| Issuance of the interim report, including the findings and conclusions, to the parties: | 26 April 2004 |
| Deadline for parties to request review of part(s) of report: | 10 May 2004 |
| Interim review meeting with the parties, if requested. If interim review meeting not requested, the deadline for comments on each others' comment. | 3 June 2004<br>(if a review meeting is to be held, **4 June** as well as 3 June, as necessary.) |
| Issuance of final report to the parties: | 18 June 2004 |
| Circulation of the final report to Members: | [after translation] |

# ANNEX L-2.1

## COMMUNICATION TO THIRD PARTIES

28 May 2003

Your delegation has reserved its rights to participate as a third party in the Panel *United States - Subsidies on Upland Cotton (DS267)*- Complaint by Brazil - established by the DSB on 18 March 2003. The Panel has now started its work.

Attached you will find the timetable and working procedures adopted by the Panel for this dispute in accordance with Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*").

As indicated in the attached timetable, prior to the submission by the parties of their first written submissions in these proceedings, the Panel has requested the parties to address, in their initial briefs to the Panel (to be submitted on 5 June 2003), the following:

- whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article 13.

As also indicated in the attached timetable, the Panel will invite the parties to submit any written comments on each other's comments on this issue (i.e. on 13 June 2003). The Panel intends to rule on these issues on 20 June 2003, prior to the parties' submission of their first written submissions.

We have invited the parties to serve also on the third parties their initial briefs and any responding comments. The Panel also invites third parties to submit any written comments they might have concerning the initial phase of these proceedings. **The deadline for any initial third party comments on the specific issue identified above is 10 June 2003.**

Moreover, as also indicated in the attached timetable, the Panel invites your delegation to present its views at a meeting with the parties to the dispute and other third parties, which is scheduled for 24 July 2003. The exact time and venue will be communicated to you in due time.

The Panel would appreciate it if your delegation could provide the Panel with your written submission by 5.30 p.m. on 15 July 2003. If you so wish, this written statement may take the place of an oral presentation to the Panel. The Panel would appreciate the submission being kept as short as possible. I would appreciate it if you would advise the Panel before 1 July 2003 through me as Secretary to the Panel (telephone 022/739 6419) whether your delegation will be represented at the meeting and whether your delegation will require interpretation services into and out of English.

[Attachment omitted]

# ANNEX L-2.2

## COMMUNICATION TO THIRD PARTIES

25 July 2003

Please find attached a communication from the Panel on the following issues:

1. The Panel's view on the preliminary ruling requested by the United States.

2. Panel's questions to third parties.

The Panel's questions are intended to facilitate the work of the Panel, and do not in any way prejudge the Panel's findings on the matter before it. Nor does the fact that the Panel has placed these questions under certain headings prejudge the Panel's findings on the matter before it. Each third party is free to respond to or comment on questions posed to the other third parties.

Please be reminded that you are requested to submit answers by the close of business of 4 August 2003. Subsequently, third parties can submit comments to other's responses by the close of business 22 August.

[1st attachment omitted]

Questions from the Panel to the third parties –
First session of the first substantive Panel meeting

ARTICLE 13 OF THE *AGREEMENT ON AGRICULTURE*

1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions in Article 13 are a "prerequisite" to the availability of a right or privilege? **Australia** Would other third parties have any comments on Australia's assertion? **3RD parties, in particular Argentina, Benin, China, Chinese Taipei**

ARTICLE 13(B) OF THE *AGREEMENT ON AGRICULTURE*: DOMESTIC SUPPORT MEASURES

2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture* . **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*? **3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

5. Do you agree that a payment penalty based on crops produced is "related to type of production"? **EC**

6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the *Agreement on Agriculture* have on the meaning of the preceding sentence? **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

7. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the *Agreement on Agriculture*. **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

8. In your oral statement, you emphasize the use of the word "criteria" in other parts of the *Agreement on Agriculture*, as distinct from the reference to "fundamental requirement" in the first sentence of paragraph 1 of Annex 2. Is it the case that sub-paragraphs (a) and (b) of paragraph 1 of Annex 2 are also "criteria"? **EC**

9. If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation, does this allow effects-based claims of non-compliance with Annex 2? If so, how does this affect the purpose of Article 13(b)? **3rd parties' in particular Australia, Argentina, Canada, EC, NZ**

10. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

11. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. **3rd parties, in particular, Australia, Argentina, Canada, EC, NZ**

12. Where does Article 13(b) require a year-on-year comparison? **3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

13. Does a failure by a Member to comply in a given *year* with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? **3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

14. Does a failure of a Member to comply with Article 13(b) in respect of a *specific commodity* impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? **3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

15. Is there any basis on which counter-cyclical payments could be considered product-specific? **3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? **3RD parties, in particular Australia, Argentina, Benin Canada, China, EC, NZ**

17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement* to the meaning of "support to a specific commodity" in Article 13(b)(ii) *Agreement on Agriculture*? **3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

18. Benin's oral statement considers the phrase "support to a specific commodity" in Article 13(b)(ii) of the *Agreement on Agriculture*. How does Benin believe that phrase is best interpreted. Please substantiate your response, commenting on other submissions by parties and third parties as you believe appropriate. **Benin**

19. Where does Article 13(b)(ii) require a year-on-year comparison? **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

20. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?

21. Please comment on Brazil's assertion that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? **3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

22. What is the meaning of "support" in *Agreement on Agriculture* 13(b)(ii) ? Why would it be used differently from Annex 3, where it refers to total outlays? **3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

23. Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both? **3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

24. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) of the *Agreement on Agriculture* and, in particular, why the words "grant" and "decided" were used. **EC**

25. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". **3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

26. Under Article 13(b)(ii), a comparison is required between support at different times. One of the issues which is contested between the parties is whether the only later period that the Panel can consider is the present one (i.e. the period underway at the time of the request for establishment of the Panel). This argument is based on the present tense of the words "do not grant" in the English text. The Panel asks whether there is any difference in the verb tense as used in the Spanish-language text, or any other difference which might aid the Panel in interpreting these words? **Argentina, EC, Paraguay, Venezuela**

27. If the 1992 "decision" led to or was the funding source for the money provided in 1992 and later years, is it the full amount of all that funding that constitutes the "support" decided in 1992? If the answer to this question is that it is the full amount of all the support provided pursuant to the "decision" that must be taken into account, must this be compared with the total amount of support that will or might flow from the decision made in the more recent period for the purposes of the comparison required under Article 13(b)(ii)? If a Member did not make a "decision" (however that may be interpreted) in 1992 about "support", is it the case that the Member has a zero base for the purposes of the comparison required under Article 13(b)(ii)? **EC**

28. In paragraph 13 of Australia's oral statement, you state that a "question" is: "could conditions of price competition for the purposes of a non-violation or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole." Could you please clarify this statement (indicating other elements which would complete the "whole" and explain its relevance for the purposes of our consideration of Article 13 of the *Agreement on Agriculture*? **Australia, EC**

EXPORT CREDIT GUARANTEE PROGRAMMES

29. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*? Why or why not? **3rd parties, in particular, Argentina, Canada, EC, NZ**

(b) How, if at all, would this be relevant to the claims of Brazil? **3rd parties, in particular, Argentina, Canada, EC, NZ**

30. The Panel could arguably take the view that Articles 1 and 3 of the *SCM Agreement* were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an *a contrario* interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission). **3rd parties, in particular, Argentina, Canada, EC, NZ**

31. If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance in the interpretation of the terms in Article 10 *Agreement on Agriculture*, should the Panel refer to item (j) or Articles 1 and 3 of the *SCM Agreement* or both? . **3rd parties, in particular, Argentina, Canada, EC, NZ**

32. The Panel's attention has been drawn to Article 14(c) of the *SCM Agreement* (see third party submission of Canada) and to the panel report in DS 222 *Canada- Export Credits and Loan Guarantees*. How and to what extent are Article 14(c) of the *SCM Agreement*, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material. . **3rd parties, in particular, Argentina, Canada, EC, NZ**

33. What is the relevance (if any) of Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders." . **3rd parties, in particular, Argentina, Canada, EC, NZ**

34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"? **3rd parties, in particular, Argentina, Canada, EC, NZ**

35. Did the drafters of the *Agreement on Agriculture* include export credit guarantees in Article 9.1 of the *Agreement on Agriculture*? Why or why not? **3rd parties, in particular, Argentina, Canada, EC, NZ**

36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38) **3rd parties, in particular, Argentina, Canada, EC, NZ**

(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)

(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)

(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)

37. The United States seems to argue that, at present, by virtue of Article 10.2 of the *Agreement on Agriculture*, there are **no** disciplines on agricultural export credit guarantees under the *Agreement on Agriculture* (or the *SCM Agreement*).

(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the *Agreement on Agriculture* ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the *Agreement on Agriculture*? Please cite any relevant material, including any past WTO dispute settlement cases. **3rd parties, in particular, Argentina, Canada, EC, NZ**

(b) If, as the United States argues, there are no disciplines on export credit guarantees in the *Agreement on Agriculture*, how could export credit guarantees "conform fully to the provisions of Part V" of the *Agreement on Agriculture* within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)? **3rd parties, in particular, Argentina, Canada, EC, NZ**

STEP 2 PAYMENTS

38. Please comment on the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in *Canada-Dairy* and the findings of the Appellate Body in *US-FSC* (21.5)[1], do any other dispute settlement reports offer guidance on this issue? For example, how, if at all is the Appellate Body's report in *Canada-Aircraft* relevant here?[2] . **3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

39. Please comment on the United States assertions at paragraph 129 of its first written submission, that "[t]he programme is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States." . **3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

40. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the *AoA*? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the *SCM Agreement* and Article III:4 of the GATT 1994.. **3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay**

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[1] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances. [1] Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

3. [2] There, the Appellate Body stated that,

> "the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".[2]

ETI ACT

41. Concerning its claims on the ETI Act, Brazil relies on the *US – FSC* case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here? **Argentina, China, EC, NZ**

42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. **Argentina, China, EC, NZ**

# ANNEX L-2.3

## COMMUNICATION TO THIRD PARTIES

30 July 2003

Taking into account a 29 July 2003 communication received from the United States, and Brazil's 30 July response, the Panel has decided to extend the deadline for the submission of the parties' and third parties' responses to questions from Monday 4 August to **Monday 11 August** (**17h30** (Geneva time)).

The Panel has also decided upon the following additional changes to its schedule:

| | |
|---|---|
| Panel's views on certain issues: | 5 September 2003 |
| Further submission of Brazil: | 9 September 2003 |
| Further submission of the US: | 23 September 2003 |
| Further submission of the third parties (as necessary): | 29 September 2003 |

For the time being, all other dates remain unchanged. This includes the deadline for the submission of the parties' and third parties' comments on responses. It also includes the dates for the resumption of the first substantive meeting and the third party session (as necessary) and the second substantive meeting (i.e. 7-9 October).

# ANNEX L-2.4

## COMMUNICATION TO THIRD PARTIES

13 October 2003

Please find attached the Panel's questions to third parties following the resumed first session of the first substantive Panel meeting.

The Panel's questions are intended to facilitate the work of the Panel, and do not in any way prejudge the Panel's findings on the matter before it. Nor does the fact that the Panel has placed these questions under certain headings prejudge the Panel's findings on the matter before it. Each third party is free to respond to or comment on questions posed to the other third parties.

You are requested to submit answers by close of business on **27 October 2003**. All provisions of the existing working procedures, including the time specified in paragraph 17(b) of the Panel's existing working procedures for service of submissions by third parties, are confirmed.

Questions from the Panel to the third parties –
resumed first session of the first substantive Panel meeting

A. QUESTIONS TO INDIVIDUAL THIRD PARTIES

43. Please elaborate, citing figures, on your statement that polyester fibre prices actually follow cotton prices. Argentina

44. Please explain how Articles 5 and 6 of the *SCM Agreement* and Article XVI of the GATT 1994 would permit or require the Panel to take account of any effects of the subsidies in question on the interests of Members other than the complaining party. **Benin and Chad**

45. In relation to the term "same market" in Article 6.3(c) of the *SCM Agreement*, the EC states in paragraph 10 of its oral statement that a "world market" cannot exist if there are significant trade barriers between Members. On the other hand, the Panel notes that in relation to cotton, the EC takes the position in paragraph 14 of its further submission that the term "same market" in Article 6.3(c) should be read to include the domestic market of the subsidising Member. In light of the fact that many domestic cotton markets, possibly including that of China, have significant trade barriers, how can the EC reconcile these two positions? **EC**

46. Should the Panel prefer a concept of allocation of the benefit of subsidies to later years, to a concept of fully expensing subsidies to the year in which the benefit was provided? **EC**

47. In the EC further submission, it is said that significantly different conditions of competition in regional markets may prevent the Panel from arriving at the conclusion that there is a world market. Is the payment of a subsidy a “condition of competition” and, if so, how should that impact upon the Panel’s analysis? **EC**

48. In the further submission of India, it is stated that “there is “no obligation under the *SCM Agreement* to demonstrate serious prejudice separately after establishing that one of the effects of a subsidy listed under Article 6.3 applies, as the effects listed in Article 6.3 themselves equate to serious prejudice”. How does this view relate to Article 6.3(d), which appears to contain no element of degree? **India**

B. QUESTIONS TO ALL THIRD PARTIES

49. What is the meaning and effect of the introductory phrase of Article 3 of the *SCM Agreement* ("Except as provided in the *Agreement on Agriculture*...")? **All third parties**

50. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*? **All third parties**

51. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*: **All third parties**

(a) is a subsidy in respect of all agricultural, but not other, products specific?

(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?

(c) is a subsidy in respect of certain identified agricultural products specific?

(d) is a subsidy in respect of upland cotton, but not other products, specific?

(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?

(f) is a subsidy in respect of a certain proportion of total US farmland specific?

52. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the *SCM Agreement*. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the *SCM Agreement* to withdraw the subsidy without delay, can the Panel:

(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? **All third parties**

(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the *SCM Agreement*? **All third parties**

53. Would a finding of serious prejudice under Article 5(c) of the *SCM Agreement* be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the *SCM Agreement* in this context? **All third parties**

54. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ? **All third parties**

55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("*another Member*") for the purposes of these proceedings? **All third parties**

56. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the *Agreement on Agriculture* and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the *SCM Agreement*. **All third parties**

(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions, of the *Agreement on Agriculture*, relevant?

(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the *SCM Agreement*, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in *US-FSC*, para. 117[1] here?

(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the *SCM Agreement* and the prohibition on subsidies contingent upon export in

[1] WT/DS108/AB/R, para 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market." In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* must clearly take precedence over the *exemption* of primary products from export subsidy disciplines in Article XVI:4 of the GATT 1994."

Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?

# ANNEX M

## WORKING PROCEDURES AND TIMETABLE OF THE PANEL

# ANNEX M-1

## WORKING PROCEDURES FOR THE PANEL

1. In its proceedings the Panel shall follow the relevant provisions of the Dispute Settlement Understanding (DSU). In addition, the following working procedures shall apply.

2. The Panel shall meet in closed session. The parties to the dispute, and interested third parties, shall be present at the meetings only when invited by the Panel to appear before it.

3. The deliberations of the Panel and the documents submitted to it shall be kept confidential. Nothing in the DSU shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the Panel which that Member has designated as confidential. Where a party to a dispute submits a confidential version of its written submissions to the Panel, it shall also, upon request of a Member, provide a non-confidential summary of the information contained in its submissions that could be disclosed to the public.[1]

4. Before the first substantive meeting of the Panel with the parties, the parties to the dispute shall transmit to the Panel written submissions in which they present the facts of the case, their arguments and their counter-arguments, respectively. Third parties may transmit to the Panel written submissions after the first written submissions of the parties have been submitted.

5. At its first substantive meeting with the parties, the Panel shall ask Brazil to present its case. Subsequently, and at the same meeting, the United States will be asked to present its point of view. Third parties will be asked to present their views thereafter at the separate session of the same meeting set aside for that purpose. The parties will then be allowed an opportunity for final statements, with Brazil presenting its statement first.

6. All third parties which have notified their interest in the dispute to the Dispute Settlement Body shall be invited in writing to present their views during a session of the substantive meeting of the Panel set aside for that purpose. All such third parties may be present during the entirety of this session.

7. Formal rebuttals shall be made at a second substantive meeting of the Panel. The United States shall have the right to take the floor first, to be followed by Brazil. The parties shall submit, prior to that meeting, written rebuttals to the Panel.

8. The Panel may at any time put questions to the parties and to the third parties and ask them for explanations either in the course of the substantive meeting or in writing. Answers to questions shall be submitted in writing by the date(s) specified by the Panel. Answers to questions after the first meeting shall be submitted in writing at the same time as the written rebuttals, unless the Panel specifies a different deadline.

9. The parties to the dispute and any third party invited to present its views shall make available to the Panel and the other party or parties a written version of their oral statements, preferably at the end of the meeting, and in any event not later than the day following the meeting. Parties and third parties are encouraged to provide the Panel and other participants in the meeting with a provisional written version of their oral statements at the time the oral statement is presented.

[1] The Panel notes that parties have agreed between themselves as to applicable deadlines for the submission of non-confidential summaries: 14 days after the submission of the confidential version.

10. In the interest of full transparency, the presentations, rebuttals and statements shall be made in the presence of the parties. Moreover, each party's written submissions, including responses to questions put by the Panel, shall be made available to the other party.

11. The parties shall provide the Secretariat with an executive summary of the claims and arguments contained in their written submissions, oral presentations, and, if necessary, answers to questions. These executive summaries will be used by the Secretariat only for the purpose of assisting the Secretariat in drafting a concise arguments section of the Panel report so as to facilitate timely translation and circulation of the Panel report to the Members. They shall not serve in any way as a substitute for the submissions of the parties. The summaries of the first written submission and rebuttal written submission shall be limited to ten (10) pages each, and the summaries of the oral statements at the meetings will be limited to five (5) pages each. The Panel will determine the page limit for executive summaries of parties' responses to questions, if necessary and as appropriate. Third parties are requested to provide the Panel with executive summaries of their written submissions and oral presentations, of no more than 5 pages each. The executive summaries shall be submitted to the Secretariat within ten days of the original submission, presentation or, if necessary, written replies, concerned. Paragraph 17 shall apply to the service of executive summaries.

12. A party shall submit any request for preliminary ruling not later than its first submission to the Panel. If the complaining party requests such a ruling, the respondent shall submit its response to the request in its first submission. If the respondent requests such a ruling, the complaining party shall submit its response to the request prior to the first substantive meeting of the Panel, at a time to be determined by the Panel in light of the request. Exceptions to this procedure will be granted upon a showing of good cause.

13. Parties shall submit all factual evidence to the Panel no later than during the first substantive meeting, except with respect to evidence necessary for purposes of rebuttals or answers to questions. Exceptions to this procedure will be granted upon a showing of good cause. The other party shall be accorded a period of time for comment, as appropriate, on any new factual evidence submitted after the first substantive meeting**.**

14. The parties to the dispute have the right to determine the composition of their own delegations. The parties shall have the responsibility for all members of their delegations and shall ensure that all members of the delegation act in accordance with the rules of the DSU and the Working Procedures of this Panel, particularly in regard to confidentiality of the proceedings. The parties as well as third parties shall provide a list of their delegation before each meeting to Mr. Hiromi Yano (office 3036 ; e-mail hiromi.yano@wto.org ).

15. To facilitate the maintenance of the record of the dispute, and to maximize the clarity of submissions, in particular the references to exhibits submitted by parties, parties shall sequentially number their exhibits throughout the course of the dispute. For example, exhibits submitted by Brazil could be numbered BRA-1, BRA-2, etc. If the last exhibit in connection with the first submission was numbered BRA-5, the first exhibit of the next submission thus would be numbered BRA-6.

16. Following issuance of the interim report, the parties shall have two weeks to submit written requests to review precise aspects of the interim report and to request a further meeting with the Panel. The right to request such a meeting must be exercised no later than at that time. Following receipt of any written requests for review, if no further meeting with the Panel is requested, the parties shall have the opportunity, within a time-period specified by the Panel, to submit written comments on the other party's written requests for review. Such comments shall be strictly limited to responding to the other party's written request for review.

17. The following procedures regarding service of documents shall apply:

(a) Each party and third party shall serve all of its written submissions, executive summaries and written versions of oral statements, directly on all other parties, and on third parties as appropriate, and confirm that it has done so at the time it provides those submissions to the Secretariat.

(b) The parties and third parties should provide their submissions to the Secretariat by 5:30 p.m. on the deadlines established by the Panel, unless a different time is set by the Panel.

(c) The parties and third parties shall provide the Secretariat with nine paper copies of each of their written submissions. Seven of these copies should be filed with Mr. Ferdinand Ferranco (Office 3154). Two copies should be filed with the Secretary to the Panel. The final written versions of the parties' and third parties' oral statements shall be provided not later than noon of the day following the date of the presentation.

(d) The parties and third parties shall provide electronic copies of all submissions to the Secretariat at the time they provide their submissions, if possible in a format compatible with that used by the Secretariat. If the electronic version is provided by e-mail, it should be addressed to DSRegistry@wto.org, and cc'd to susan.hainsworth@wto.org, matthew.kennedy@wto.org, paul.shanahan@wto.org, thomas.friedheim@wto.org and hiromi.yano@wto.org. If a diskette is provided, it should be delivered to Mr. Ferdinand Ferranco.

(e) The Panel will endeavour to provide the parties with an electronic version of the descriptive part, the interim report and the final report, as well as of other documents as appropriate. When the Panel transmits to the parties or third parties both paper and electronic versions of a document, the paper version shall constitute the official version for the purposes of the record of the dispute.

# ANNEX M-2

## TIMETABLE

### UNITED STATES – SUBSIDIES ON UPLAND COTTON (WT/DS267)

**Timetable for Panel Proceedings**[1]

| | | |
|---|---|---|
| 1. | Establishment of the Panel: | 18 March 2003 |
| 2. | Constitution of the Panel: | 19 May 2003 |
| 3. | The following dates apply: | |
| (a) | Organizational meeting: | 28 May 2003 |
| (b) | Parties' comments on certain issues as indicated in the cover letter | 5 June 2003 |
| (c) | Third parties' comments on certain issues | 10 June 2003 |
| (d) | Parties' comments on each others' and third parties' comments submitted | 13 June 2003 |
| (e) | Issuance of Panel ruling on certain issues | 20 June 2003 |
| (f) | First submission of Brazil (complaining party) | 24 June 2003 |
| (g) | First submission of the US (party complained against) | 11 July 2003 |
| (h) | Submissions from third parties: | 15 July 2003 |
| (i) | First substantive meeting with the parties [2]: | 22, 23 July 2003<br>24 July 2003 |

[1] As was presented to parties and third parties on 28 May 2003. Subsequent changes are indicated in footnotes. Original footnote omitted.

[2] In a communication delivered on 20 June 2003 in accordance with item (e) of the timetable above, the Panel changed this meeting (including the third party session) to the "**first session of the first substantive meeting**" . The same communication also established the following dates: (a) the **Panel's view on certain issues** (i.e. issues relating to the "Peace Clause") to be issued on 1 September 2003, (b) **second session of the first substantive meeting** to be held on 7- 9 October 2003 (third party session held on 8 October), and (c) deadlines to submit further submissions for this second session: 4 September (from Brazil), 18 September (from the US) and 22 September (from the third parties). These dates were further changed by the Panel's communication dated 30 July to : (a) the Panel's view on "certain issues" on 5 September and (b) deadline to submit further submissions from Brazil by 9 September, from the US by 23 September (changed further to 29 September by the Panel's communication dated 12 September and changed again to 30 September by the Panel's communication dated 24 September), and from third parties by 29 September (changed further to

| | | |
|---|---|---|
| (j) | Third party session: | |
| (k) | Receipt of written rebuttals of the parties: | 29 August 2003 [3] |
| (l) | Second substantive meeting with the parties: | 17,18 September 2003 [4] |
| (m) | Issuance of descriptive part of the report to the parties: | 1 October 2003 [5] |
| (n) | Receipt of comments by the parties on the descriptive part of the report: | 15 October 2003 |
| (o) | Issuance of the interim report, including the findings and conclusions, to the parties: | 4 November 2003 [6] |
| (p) | Deadline for parties to request review of part(s) of report: | 18 November 2003 |
| (q) | Interim review meeting with the parties, if requested. If interim review meeting not requested, the deadline for comments on each others' comment. | 24 November 2003 |

3 October by the Panel's communication dated 12 September). The 12 September communication from the Panel established a deadline for parties to submit, before the second session of the second substantive meeting, "**further rebuttals**" by 3 November 2003. This date was further changed to 18 November by the Panel's communication dated 18 September.

[3] Changed to 22 August 2003 by the Panel's communication dated 20 June.

[4] Changed to 7, 8 October 2003 by the Panel's communication dated 20 June. These dates were subsequently changed to 2, 3 December by the Panel's communication dated 12 September. Apart from responses to Panel's questions, the Panel has established several deadlines after the second substantive meeting for parties to submit various documents. (See Panel's communications dated 14 November 2003, 8 December 2003, 24 December 2003, 12 January 2004, 3 February 2004, 16 February 2004, 20 February 2004, 24 February 2004 and 4 March 2004.)

[5] The dates for items (m) and (n) were delayed several times and were ultimately set to be 16 March and 30 March 2004, respectively, by the Panel's communication of 4 March 2004.

[6] The dates for items (o) - (r) were delayed several times and were ultimately set to be as follows, respectively, by the Panel's communication of 7 April, 2004: 26 April, 10 May, 3 June and 18 June 2004.

| | | |
|---|---|---|
| (r) | Issuance of final report to the parties: | 10 December 2003 |
| (s) | Circulation of the final report to Members: | [after translation] |

# ANNEX N

## REQUEST FOR CONSULTATIONS AND REQUEST FOR THE ESTABLISHMENT OF A PANEL

## ANNEX N-1

# WORLD TRADE ORGANIZATION

**WT/DS267/1**
**G/L/571**
**G/SCM/D49/1**
**G/AG/GEN/54**
3 October 2002
(02-5314)

Original: English

### UNITED STATES – SUBSIDIES ON UPLAND COTTON

Request for Consultations by Brazil

The following communication, dated 27 September 2002, from the Permanent Mission of Brazil to the Permanent Mission of the United States and to the Chairman of the Dispute Settlement Body, is circulated in accordance with Article 4.4 of the DSU.

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Upon instruction from my authorities, the Government of Brazil hereby requests consultations with the Government of the United States pursuant to Articles 4.1, 7.1 and 30 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement), Article 19 of the Agreement on Agriculture, Article XXII of GATT 1994 and Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).

The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton[1], as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry"). The measures include the following:

– Domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2002;[2]

– Export subsidies provided to the US upland cotton industry during marketing years 1999-2002;[3]

[1] Except with respect to export credit guarantee programs as explained below.

[2] The "marketing" year for upland cotton runs from 1 August through 31 July. For example, marketing year 2001 started on 1 August 2001 and ended on 31 July 2002. Brazil, as does the United States in its official USDA documents, treats "marketing year" to mean the same thing as "crop year".

[3] The adverse effects and serious prejudice and threat thereof created by the measures in the marketing years 1999-2007 also exists for the corresponding (somewhat overlapping) US fiscal years 2000-2008. The US government fiscal year runs from 1 October to 30 September. For example, the fiscal year for 2001 started on 1 October 2000 and ended on 30 September 2001.

– Subsidies provided contingent upon the use of US upland cotton;

– Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans, loan deficiency payments (LDPs), commodity certificates, direct payments, counter-cyclical payments, conservation payments (to the extent they exceed the costs of complying with such programs), Step 2 certificate program payments, export credit guarantees, and any other provisions of FSRIA that provide direct or indirect support to the US upland cotton industry;

– Subsidies and domestic support provided under the Agricultural Risk Protection Act of 2000 and any other measures that provide subsidies relating to crop, disaster or other types of insurance to the US upland cotton industry;

– Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to marketing loans, loan deficiency payments, commodity certificates, production flexibility contract payments, conservation payments, Step 2 certificate program payments, export credit guarantees, and any other FAIR Act provisions providing direct or indirect support to the US upland cotton industry;

– Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;

– Subsidies provided to the US upland cotton industry under the Agricultural Act of 1949 as amended;

– Export subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ("ETI Act");

– Subsidies provided under the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2002 (November 2001), the Crop Year 2001 Agricultural Economic Assistance Act (August 2001), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001 (October 2000), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 (October 1999), and the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1999 (October 1998);

– All subsidies or support measures benefiting upland cotton that have trade-distorting effects or effects on production by the US upland cotton industry, or that have an effect of providing price support for upland cotton, or that are otherwise not exempt from the reduction commitments of the United States, as described in Annex 2 of the Agreement on Agriculture, because they do not meet the policy-specific criteria and conditions set out in paragraphs 2-13 of Annex II of the Agreement on Agriculture (*i.e.* they are not so-called green box subsidies);

– Export subsidies, domestic support, and other subsidies provided under regulations, administrative procedures, administrative practices and any other present measures, amendments thereto, or future measures implementing any of the measures listed above, that provide for or facilitate the payment of domestic support, export subsidies, and other subsidies for the production, use and/or export of US upland cotton and upland cotton products.

The Government of Brazil considers that these measures are inconsistent with the obligations of the United States under the following provisions:

1. Article 5(c) of the SCM Agreement;
2. Article 6.3(b), (c) and (d) of the SCM Agreement;
3. Article 3.1(a) of the SCM Agreement including item (j) of the Illustrative List of Export Subsidies in Annex I thereto;
4. Article 3.1(b) of the SCM Agreement;
5. Article 3.2 of the SCM Agreement;
6. Article 3.3 of the Agreement on Agriculture;
7. Article 7.1 of the Agreement on Agriculture;
8. Article 8 of the Agreement on Agriculture;
9. Article 9.1 of the Agreement on Agriculture;
10. Article 10.1 of the Agreement on Agriculture; and
11. Article III:4 of GATT 1994.

Brazil is of the view that the US statutes, regulations, and administrative procedures listed above are inconsistent with these provisions as such and as applied.

The United States has no basis to assert a defense under Article 13(b)(ii) of the Agreement on Agriculture that the domestic support measures listed above are exempt from action based on Articles 5 and 6 of the SCM Agreement, because these measures provide support to upland cotton in marketing years 1999-2002 in excess of the support decided by the United States in the 1992 marketing year. Similarly, the United States has no basis to assert a defense under Article 13(c)(ii) of the Agreement on Agriculture that the export subsidies listed above are exempt from action based on Article 3, 5 and 6 of the SCM Agreement, because these export subsidies do not conform fully to the provisions of Part V of the Agreement on Agriculture, as reflected in the Schedule of the United States.

The measures listed above are subsidies because in each instance there is a financial contribution by the US government, or an income or price support in the sense of Article XVI of GATT 1994, and a benefit is thereby conferred within the meaning of Article 1.1(a) and (b) of the SCM Agreement. Each of the listed subsidies is specific to US producers of primary agricultural products and/or to the upland cotton industry within the meaning of Articles 2.1 and 2.3 of the SCM Agreement.

The use of these measures causes adverse effects, *i.e.* serious prejudice to the interests of Brazil:

– The effect of the measures is significant price depression and price suppression in the markets for upland cotton in Brazil and elsewhere during marketing years 1999-2002 in violation of SCM Articles 5(c) and 6.3(c).

– The effect of the measures is to displace or impede exports of Brazilian upland cotton in third country markets during marketing years 1999-2002, in violation of Articles 5(c) and 6.3(b) of the SCM Agreement.

– The effect of the measures is to increase the world market share of the United States for upland cotton in marketing year 2001 as compared to the average share of the United States between marketing years between 1998-2000, and by increasing its world market share for the production of upland cotton in the period from marketing year 1985 (the first year in which LDP and marketing loan payments were made for upland cotton) to marketing year

2001 from 16.7 to 20.6 percent in violation of Articles 5(c) and 6.3(d) of the SCM Agreement.

The statutes, regulations, and administrative measures listed above and the subsidies they mandate threaten – as such and as applied – to cause serious prejudice to the interests of Brazil as follows:

– By mandating conditions that will result in continued depressed and suppressed upland cotton prices for marketing years 2002 through 2007 through the guaranteed payment of subsidies to the US upland cotton industry, which artificially increases and/or maintains high-cost US upland cotton production in violation of SCM Articles 5(c) and 6.3(c); and

– By mandating conditions that will result in over-production of high-cost US upland cotton, which will continue to displace and impede Brazil's export market share in the world market and specific national markets for upland cotton, in violation of SCM Articles 5(c) and 6.3(b).

With respect to the Step 2 program, Brazil believes that the program as such and as applied to provide payments to exporters of US upland cotton is inconsistent with Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture, and with Articles 3.1(a) and 3.2 of the SCM Agreement. Brazil further believes that the program, as such and as applied to provide payments to US domestic mill users of US upland cotton, are inconsistent with Article 3.1(b) of the SCM Agreement, and Article III:4 of GATT 1994. Step 2 payments are actionable subsidies for the purpose of Brazil's claims under Articles 5 and 6.3 of the SCM Agreement.

Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, Brazil is of the view that these programs, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement. Subsidies provided under these programs are also actionable subsidies for the purpose of Brazil's claims under Article 6.3 of the SCM Agreement.

Articles 4.2 and 7.2 of the SCM Agreement together require that this request for consultations include a statement of available evidence (1) with regard to the existence and nature of the subsidies in question and (2) the adverse effects and serious prejudice to the interests of Brazil. This letter identifies the existence and nature of the subsidies, and further evidence is provided in the annex to this letter.

The Government of Brazil reserves the right to request the United States to produce information and documents regarding the measures in question and thir effect on the interests of Brazil, during the consultation process. The Government of Brazil also reserves the right to address additional measures and claims under other WTO provisions during the course of the consultations.

My authorities look forward to receiving in due course a reply from the United States to this request. Brazil is ready to consider with the United States mutually convenient dates to hold consultations in Geneva.

# ANNEX

## Statement of Available Evidence With Regard to the Existence and Nature of the Subsidies in Question and the Serious Prejudice Caused to the Interest of Brazil

1. Brazil's request for consultations dated 27 September 2002 identifies the prohibited and actionable subsidies that are the subject of this request for consultations.

2. The evidence set out below is evidence available to Brazil at this time regarding the existence and nature of those subsidies, and the adverse effects caused by them to the interests of Brazil. It reflects the presently available evidence regarding the claims reflected in Brazil's request for consultations and is supported by documents that are described and set out in United States Department of Agriculture (USDA) and non-governmental internet locations set out in paragraph 4 below. Brazil reserves the right to supplement or alter this list in the future, as required.

3. The evidence presently available to Brazil includes the following:

– US producers of upland cotton received domestic support in excess of 100 percent of the US crop value in marketing year 2001;

– US domestic and export support subsidies to upland cotton in marketing year 2001 exceeded $4 billion – far greater than the value of total US production;

– Compared with marketing year 1992, US Government subsidies to US producers of upland cotton have increased significantly, particularly for the 1999 and 2001 marketing year;

– The provisions of the 2002 Farm Bill mandate the payment of subsidies considerably in excess of those provided in the 1996 FAIR Act, including a new counter-cyclical payment program providing for more than $1 billion for marketing year 2002 at current market prices for upland cotton. The 2002 Farm Bill provides similar (although increased) payments as the FAIR act in the form of a "direct payment" program (a successor to production flexibility payments) and continues largely unchanged the loan deficiency payments, marketing loans payments, crop insurance payments, and the Step 2 program and other export subsidy programs that provided support to the US upland cotton industry prior to passage of the 2002 Farm Bill;

– For a significant number of US producers of upland cotton, total cost of production in 2001 (and from 1991 through 2000) was well *above* the US market price of upland cotton;

– Thus, without the benefit of US domestic and export subsidies, many US producers would not be able to produce upland cotton without sustaining a significant loss; current price projections for marketing years 2003-2007 indicate that US upland cotton prices are expected to remain well below the US cost of production;

– With upland cotton prices declining over the 4-year period from 1998 through 2001, US production increased from 14 million tons in marketing year 1998 to a record 20.3 million metric tons in marketing year 2001;

– In marketing year 2001 the United States was the world's largest exporter of upland cotton, with a 38 percent share. It is expected that the United States will remain by far the world's largest exporter of upland cotton in marketing year 2002;

– The volume of US exports of US upland cotton increased significantly from 946.000 metric tons in marketing year 1998 to 1.829.000 metric tons in marketing year 2001, with 1.960.000 metric tons expected to be exported in marketing year 2002;

– The effect of the US subsidies over the period of marketing years 1999-2001 was an increase in production of US upland cotton, an increase in US exports, and a corresponding significant decrease in Brazilian, world, and US prices of upland cotton;

– US year-end surplus stocks of upland cotton in marketing year 2001 increased steadily between marketing years 1999-2001 with the additional surplus creating a depressing and suppressing effect on US and world prices;

– Brazilian upland cotton is like or has characteristics closely resembling US upland cotton, is used interchangeably by customers in third country markets with US upland cotton and competes in the same markets for the same customers. Thus, the overproduction of US upland cotton suppresses and depresses the price that Brazilian producers can obtain for their upland cotton on the world and Brazilian market;

– Prices for upland cotton in Brazil follow trends created in the US and Northern European markets and experienced significant declines between marketing years 1999-2002;

– Brazilian production of upland cotton decreased between marketing year 2000 and 2001 from 939.000 to 718.000 metric tons;

– Prices for upland cotton in the Brazilian, worldwide, and other regional and third country markets were significantly depressed and suppressed over the period of marketing years 1999-2002 as a result of the effect of US subsidies;

– Prices for upland cotton in the Brazilian, worldwide, and other regional and third country markets continue to be suppressed in marketing year 2002 as a result of US subsidies;

– The world market share of the United States for upland cotton in marketing year 2001 increased over the average share of the United States between marketing years 1998-2000. In addition, the United States increased its world market share for the production of upland cotton in the period from marketing year 1985 (the first year in which LDP and marketing loan payments were made for upland cotton) to marketing year 2001 from 16.7 to 20.6 percent;

– The United States' notifications of subsidies to the WTO Committee on Agriculture provide information indicating that the loan deficiency payments (LDP), marketing loan gains, crop insurance programs, marketing loss payments, and Step 2 certificate payments made in connection with upland cotton are not "green" box payments;

– USDA econometric analyses demonstrate the actual or potential production enhancing effects for particular crops in the United States of LDP, marketing loan payments, crop insurance subsidies, and even production flexibility payments. Certain of these studies demonstrate the production enhancing effects of such subsidies on US production of upland cotton;

– Econometric studies by the International Cotton Advisory Committee, the World Bank, and the International Monetary Fund demonstrate that many of the US subsidies at issue in the consultation request have a price suppressive and depressive effect on prices of upland cotton and other crops;

– The US Step 1 and Step 2 programs, since their origin and up to the present, enhance the export competitiveness of US-produced upland cotton -- an effect consistent with the expressed purpose of such programs;

– US export credit guarantee programs have caused serious prejudice to Brazilian upland cotton producers by providing below-market financing benefits for the export of competing US upland cotton;

– US export credit guarantee programs, since their origin in 1980 and up the present, provide premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses;

– The volume of production and export of lower-cost Brazilian upland cotton have been impeded by US subsidies that have built and maintained excess US production by higher-cost US producers;

– The estimated losses suffered by Brazil due to price suppressed or depressed by US subsidies to the US upland cotton industry are well in excess of $ 600 million for marketing year 2001 alone including lost revenue, lost production, losses of related services, lost federal and state revenue, higher unemployment and losses in Brazil's trade balance.

4. The statistics, data and analytic documents supporting the summary of evidence above can be found in the following documents published by among others the US Department of Agriculture, the International Cotton Advisory Committee and the Food and Agriculture Policy Research Institute, University of Missouri as well as others:

US Department of Agriculture, Economic Research Service:
http://www.ers.usda.gov

– Comparison and Summary of 1996 and 2002 farm bills http://www.ers.usda.gov/Features/farmbill/titles/titleIcommodities.htm#c
– Briefing on Cotton
http://www.ers.usda.gov/briefing/cotton/
– Cotton and Wool Outlook: Various Editions
http://www.ers.usda.gov/publications/so/view.asp?f=field/cws-bb/
– Factors Affecting the US Farm Price for Upland Cotton, Cotton and Wool Situation and Outlook, April 1998
– Cotton and Wool Outlook: Latest Statistical Information
http://www.ers.usda.gov/briefing/cotton/Data/data.htm
– Statistical Information of the Cotton and Wool Yearbook
http://www.ers.usda.gov/data/sdp/view.asp?f=crops/89004/
– 1996 FAIR Act Frames Farm Policy for 7 Years
http://www.ers.usda.gov/publications/agoutlook/aosupp.pdf
– US Farm Program Benefits: Links to Planting Decisions & Agricultural Markets
http://www.ers.usda.gov/publications/agoutlook/oct2000/ao275e.pdf
– Production and Price Impacts of US Crop Insurance Subsidies: Some Preliminary Results
http://www.ers.usda.gov/briefing/FarmPolicy/ffc_insurrance.pdf
– Commodity Cost and Returns
http://www.ers.usda.gov/data/costsandreturns/
– Characteristics and Production Costs of US Cotton Farms
http://www.ers.usda.gov/publications/sb974-2/
– Analysis of the US Commodity Loan Program with Marketing Loan Provisions
http://www.ers.usda.gov/publications/aer801/aer801fm.pdf

- Agricultural Outlook December 1999: Ag Policy: Marketing Loan Benefits Supplement Market Revenues for Farmers
  http://www.ers.usda.gov/publications/agoutlook/dec1999/ao267b.pdf
- Farm and Commodity Policy: 1996-2001 Program Provisions
  http://www.ers.usda.gov/briefing/FarmPolicy/1996malp.htm
- Farm and Commodity Policy: Questions and Answers
  http://www.ers.usda.gov/briefing/FarmPolicy/questions/index.htm
- Farm and Commodity Policy: Crop Insurance
  http://www.ers.usda.gov/briefing/FarmPolicy/cropInsurance.htm
- Cotton: Background Issues for Farm Legislation
  http://www.ers.usda.gov/publications/CWS-0601-01/
- Cotton Policy: Special Program Provisions for Upland Cotton
  http://www.ers.usda.gov/briefing/cotton/specialprovisions.htm
- List of Studies Analyzing Market Effects of US Agricultural Policy
  http://www.ers.usda.gov/publications/tb1888/tb1888ref.pdf
- Major Agricultural and Trade Legislation, 1933–1996
  http://www.ers.usda.gov/publications/aib729/aib729a3.pdf

US Department of Agriculture, Farm Service Agency:
http://www.fsa.usda.gov

- Statistics on Price Support Loans and Loan Deficiency Payments
  http://www.fsa.usda.gov/pscad/:
- FSA Fact Sheets:
  http://www.fsa.usda.gov/pas/publications/facts/pubfacts.htm
- Fact Sheet: Upland Cotton: Locking the Adjusted World Price (AWP) by Loan Deficiency Payments on Upland Seed Cotton
  http://www.fsa.usda.gov/pas/publications/facts/html/upcotlock00.htm
- Price Support Programs
  http://www.fsa.usda.gov/dafp/psd/default.htm
- Loan Deficiency Payment and Price Support Cumulative Activity
  http://www.fsa.usda.gov/pscad/answer82rnat.asp

Congressional Budget Office Current Budget Projection:
http://www.cbo.gov/showdoc.cfm?index=1944&sequence=0

Food and Agriculture Policy Research Institute, University of Missouri:
http://www.fapri.missouri.edu/FAPRI_Publications.htm

International Cotton Advisory Committee:
http://www.icac.org/icac/english.html

- Cotton: Review of the World Situation August 2002
  http://www.icac.org/icac/CottonInfo/Publications/Reviews/english.html
- Production and Trade Policies Affecting the Cotton Industry, November 2000
- Production and Trade Policies Affecting the Cotton Industry, September 2001
- Production and Trade Policies Affecting the Cotton Industry, July 2002
  http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20053593~menuPK:34463~pagePK:34370~piPK:34424~theSitePK:4607,00.html
- Cotton: World Statistics
  http://www.icac.org/icac/CottonInfo/Publications/Statistics/statsws/english.html
- Report from Brazil on Injury From Low Cotton Prices
- Survey of Cost of Production of Raw Cotton

World Trade Organization:
– US notification on Domestic Support for Marketing Year 1998 - G/AG/N/USA/36

International Monetary Fund:
– World Economic Outlook September 2002
http://www.imf.org/external/pubs/ft/weo/2002/02/pdf/chapter2.pdf

World Bank:
– Cotton Producers Face Losses Because of Rich Country Subsidies
http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20053593~menuPK:34463~pagePK:34370~piPK:34424~theSitePK:4607,00.html

## ANNEX N-2

# WORLD TRADE ORGANIZATION

**WT/DS267/7**
7 February 2003

(03-0838)

Original: English

### UNITED STATES – SUBSIDIES ON UPLAND COTTON

Request for the Establishment of a Panel by Brazil

The following communication, dated 6 February 2003, from the Permanent Mission of Brazil to the Chairman of the Dispute Settlement Body, is circulated pursuant to Article 6.2 of the DSU.

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On 27 September, the Government of Brazil requested consultations with the Government of the United States pursuant to Articles 4.1, 7.1 and 30 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement), Article 19 of the Agreement on Agriculture, Article XXII of GATT 1994 and Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). This request was circulated to the WTO Members on 3 October 2002 as document WT/DS267/1, "United States – Subsidies on Upland Cotton". Consultations were held on 3, 4 and 19 December 2002 and on 17 January 2003 with a view to reaching a mutually satisfactory solution. Unfortunately, these consultations failed to settle the dispute.

The Government of Brazil therefore hereby requests that a panel be established pursuant to Articles 6 of the DSU, Article XXIII:2 of GATT 1994, Article 19 of the Agreement on Agriculture, and Articles 4.4, 7.4 and 30 of the SCM Agreement (to the extent that Article 30 incorporates by reference Article XXIII of GATT 1994).

The Government of Brazil further requests that the DSB initiate the procedures provided in Annex V of the SCM Agreement pursuant to paragraph 2 of that Annex. The Government of Brazil intends to put forward suggestions as to the information that should be sought under this procedure once the panel is established.

The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton[1], as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies (including export credit guarantees), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry"). The measures include the following:

[1] The term "upland cotton" means raw upland cotton as well as the primary processed forms of such cotton including upland cotton lint and cottonseed. The focus of Brazil's claims relate to upland cotton with the exception of the US export credit guarantee programs as explained below.

Domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2001[2];

Domestic support subsidies that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;

Export subsidies provided to the US upland cotton industry during marketing years 1999-2001;

Export subsides that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;

Subsidies provided contingent upon the use of US over imported upland cotton in marketing years 1999-2001 and that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;

Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans, loan deficiency payments (LDPs), commodity certificates, direct payments, counter-cyclical payments, conservation payments (to the extent they exceed the costs of complying with such programs), Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other provisions of FSRIA that provide direct or indirect support to the US upland cotton industry;

Subsidies and domestic support provided under the Agricultural Risk Protection Act of 2000 and any other measures that provide subsidies relating to crop, disaster or other types of insurance to the US upland cotton industry;

Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to marketing loans, loan deficiency payments, commodity certificates, production flexibility contract payments, conservation payments, Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other FAIR Act provisions providing direct or indirect support to the US upland cotton industry;

Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton, and other eligible agricultural commodities as addressed herein, provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;

Subsidies provided to the US upland cotton industry under the Agricultural Act of 1949 as amended;

Export subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ("ETI Act");

Subsidies provided under the Agricultural Assistance Act of 2003; Subsidies provided under the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2002 (November 2001), the Crop Year 2001 Agricultural Economic

[2] The "marketing" year for upland cotton runs from 1 August through 31 July. For example, marketing year 2001 started on 1 August 2001 and ended on 31 July 2002. Brazil, as does the United States in its official USDA documents, treats "marketing year" to mean the same as "crop year."

Assistance Act (August 2001), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001 (October 2000), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 (October 1999), and the Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1999 (October 1998);

All subsidies or support measures benefiting upland cotton that have trade-distorting effects or effects on production by the US upland cotton industry, or that have an effect of providing price support for upland cotton, or that are otherwise not exempt from the reduction commitments of the United States, as described in Annex 2 of the Agreement on Agriculture, because they do not meet the policy-specific criteria and conditions set out in paragraphs 2-13 of Annex II of the Agreement on Agriculture (*i.e.* they are not so-called "green box" subsidies);

Export subsidies, domestic support, and other subsidies provided under regulations, administrative procedures, administrative practices and any other present measures or future measures implementing or amending any of the measures listed above, that provide for or facilitate the payment of domestic support, export subsidies, and other subsidies for the production, use and/or export of US upland cotton and upland cotton products.

The measures, and any amendments to these measures, are inconsistent with the obligations of the United States under the following provisions:

1. Article 5(a) of the SCM Agreement;
2. Article 5(c) of the SCM Agreement;
3. Article 6.3(b), (c) and (d) of the SCM Agreement;
4. Article 3.1(a) of the SCM Agreement including item (j) of the Illustrative List of Export Subsidies in Annex I thereto;
5. Article 3.1(b) of the SCM Agreement;
6. Article 3.2 of the SCM Agreement;
7. Article 3.3 of the Agreement on Agriculture;
8. Article 7.1 of the Agreement on Agriculture;
9. Article 8 of the Agreement on Agriculture;
10. Article 9.1 of the Agreement on Agriculture;
11. Article 10.1 of the Agreement on Agriculture; and
12. Article III:4 of GATT 1994
13. Article XVI.1 and Article XVI.3 of GATT 1994

The US statutes, regulations and administrative procedures and any amendments thereto listed above are inconsistent with these provisions as such and as applied.

The United States has no basis to assert a defense under Article 13(b)(ii) of the Agreement on Agriculture that the domestic support measures listed above are exempt from action based on Articles 5 and 6 of the SCM Agreement, because these measures provide support to upland cotton in marketing years 1999-2001 in excess of the support decided by the United States in the 1992 marketing year. Similarly, the United States has no basis to assert a defense under Article 13(c)(ii) of the Agreement on Agriculture that the export subsidies listed above are exempt from action based on Article 3, 5 and 6 of the SCM Agreement, because these export subsidies do not conform fully to the provisions of Part V of the Agreement on Agriculture, as reflected in the Schedule of the United States.

The measures listed above are subsidies because in each instance there is a financial contribution by the US government, or an income or price support in the sense of Article XVI of GATT 1994, and a benefit is thereby conferred within the meaning of Article 1.1(a) and (b) of the SCM Agreement. Each of the listed subsidies is specific to US producers of primary agricultural

products and/or to the upland cotton industry within the meaning of Articles 2.1 and 2.3 of the SCM Agreement.

The use of measures provided to the US upland cotton industry causes adverse effects including material injury to the Brazilian upland cotton industry under SCM Article 5(a), and serious prejudice to the interests of Brazil under SCM Article 5(c) including:[3]

> The effect of the measures is significant price depression and price suppression in the markets for upland cotton in Brazil, the United States, other third country markets, and the world market during marketing years 1999-2002 in violation of SCM Articles 5(c) and 6.3(c).
>
> The effect of the measures is to displace or impede exports of Brazilian upland cotton in third country markets during marketing years 1999-2002, in violation of Articles 5(c) and 6.3(b) of the SCM Agreement.
>
> The effect of the measures is to increase the world export market share of the United States for upland cotton in marketing year 2001 as compared to the average share of the United States between marketing years 1998-2000, and by increasing its world export market share for the production of upland cotton in the period beginning with the FAIR Act in marketing year 1996 from 24 percent to 37 percent in marketing year 2001 in violation of Articles 5(c) and 6.3(d) of the SCM Agreement.
>
> The effect of the measures during marketing years 1999-2002 is to increase and maintain high levels of exports of upland cotton from the United States and to provide the United States with an inequitable share of world export trade in upland cotton in violation of Article XVI.1 and 3 of GATT 1994.

The statutes, regulations, and administrative measures and any amendments thereto listed above and the actionable subsidies they mandate threaten, as such and as applied, to cause material injury to the Brazilian upland cotton industry, and serious prejudice to the interests of Brazil including:

> By mandating conditions that are having and will continue to result in significant suppression and depression of upland cotton prices for marketing years 2002 through 2007 through the guaranteed payment of amounts of subsidies to the US upland cotton industry, which artificially increases and/or maintains high-cost US upland cotton production in violation of SCM Articles 5(c) and 6.3(c); and
>
> By mandating conditions that will result in over-production of high-cost US upland cotton, which will continue to displace and impede Brazil's export market share in the third country markets for upland cotton, in violation of SCM Articles 5(c) and 6.3(b).
>
> By mandating conditions that will result in over-production of high-cost US upland cotton, which will increase or continue to maintain high levels of exports of upland cotton from the United States in violation of SCM Articles 5(c) and 6.3(d) and continue to result in the United States having an inequitable share of world upland cotton export trade in violation of Article XVI.1 and 3 of GATT 1994.

[3] The adverse effects and serious prejudice and threat thereof created by the measures in the marketing years 1999-2007 also exists for the corresponding (somewhat overlapping) US fiscal years 2000 - 2008. The US government fiscal year runs from 1 October to 30 September. For example, the fiscal year for 2001 started on 1 October 2000 and ended on 30 September 2001.

With respect to subsidies provided under the so-called "Step 2" programmes, one type of subsidy under the programme provides payments to exporters contingent upon the export of US upland cotton and is inconsistent with Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture, and with Articles 3.1(a) and 3.2 of the SCM Agreement. Another type of subsidy under the Step-2 programme provides payments to US domestic mill users contingent upon the use of US upland cotton and is inconsistent with Article 3.1(b) and 3.2 of the SCM Agreement, and Article III:4 of GATT 1994. Brazil challenges these two types of subsidies under the Step 2 programme as such and as applied. These two Step 2 subsidies are actionable for the purpose of Brazil's claims under Articles 5 and 6.3 of the SCM Agreement.

Regarding export credit guarantees and export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and export credit guarantee measures relating to eligible US agricultural commodities, such as the GSM-102, GSM-103, and SCGP programmes, these programs violate, as applied and as such, Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Articles 3.1(a), 3.2 and item (j) of the Illustrated List of Export Subsidies included as Annex I to the SCM Agreement. Subsidies provided under these programs are also actionable subsidies for the purpose of Brazil's claims under Articles 5 and 6.3 of the SCM Agreement.

Brazil requests that a Panel be established with standard terms of reference, in accordance with Article 7 of the DSU.

Brazil asks that this request for the establishment of a Panel be placed on the agenda for the next meeting of the Dispute Settlement Body, which is scheduled to take place on 19 February 2003.

# ANNEX O

## LIST OF EXHIBITS

# ANNEX O-1

## TABLE OF EXHIBITS OF BRAZIL

| | |
|---|---|
| Exhibit BRA-1 | Draft Understanding on Rules and Procedures Governing the Settlement of Disputes, 15 June 1992 |
| Exhibit BRA-2 | Draft Understanding on Rules and Procedures Governing the Settlement of Disputes, 15 November 1993 |
| Exhibit BRA-3 | Roger Thurow and Scott Kilman, "US Subsidies Create Cotton Glut That Hurts Foreign Cotton Farms", The Wall Street Journal, 26 June 2002 |
| Exhibit BRA-4 | "Fact Sheet: Upland Cotton", USDA, January 2003. |
| Exhibit BRA-5 | "Agricultural Policies in OECD Countries – Monitoring and Evaluation 2003," OECD, 2003 |
| Exhibit BRA-6 | CCC Marketing Loan Write – Offs (Gains) – FY 1994-2002 |
| Exhibit BRA-7 | ERS Data: Commodity Costs and Returns |
| Exhibit BRA-8 | Cotton and Wool Situation and Outlook Yearbook 2002, USDA, November 2002 |
| Exhibit BRA-9 | "Cotton: World Statistics", ICAC, September 2002. |
| Exhibit BRA-10 | Cotton and Wool Outlook, 12 June 2003 |
| Exhibit BRA-11 | Cotton Outlook, 30 November 2001 and 5 April 2002 |
| Exhibit BRA-12 | "Cotton: Background for 1995 Farm Legislation", USDA, April 1995 |
| Exhibit BRA-13 | ERS Briefing Room Cotton: Background |
| Exhibit BRA-14 | "Survey of Cost of Production", ICAC, September 2001 |
| Exhibit BRA-15 | "Cultivating Poverty: The Impact of US Cotton Subsidies on Africa", Oxfam Briefing Paper 30, 27 September 2002 |
| Exhibit BRA-16 | "Characteristics and Production Costs of US Cotton Farms", USDA, October 2001 |
| Exhibit BRA-17 | Yearly A – Index Prices |
| Exhibit BRA-18 | "Prospective Plantings", USDA, 31 March 2003 |
| Exhibit BRA-19 | "Cotton this Month", ICAC, 1 April 2003 |
| Exhibit BRA-20 | Cotton and Wool Outlook, USDA, 11 April 2003 |
| Exhibit BRA-21 | "Cotton: World Markets and Trade", USDA Foreign Agricultural Service, January 2003 Edition |

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| Exhibit BRA-22 | "Cotton Marketing Weekly" dated 25 April 2003 |
| Exhibit BRA-23 | "Cotton: Total Accumulated Exports of Cotton by Country", USDA |
| Exhibit BRA-24 | "Provisions of the Agricultural Improvement and Reform Act of 1996, Appendix III: Major Agricultural and Trade Legislation, 1933-96", USDA |
| Exhibit BRA-25 | "1996 FAIR Act Frames Policy For 7 Years", Agricultural Outlook Supplement, April 1996 |
| Exhibit BRA-26 | 7 CFR 1413, Deficiency Payment Program, 1993 Edition |
| Exhibit BRA-27 | Side by Side Comparison of the 1996 and 2002 Farm Act, USDA |
| Exhibit BRA-28 | 1996 Federal Agriculture Improvement and Reform Act |
| Exhibit BRA-29 | 2002 Farm Security and Rural Investment Act |
| Exhibit BRA-30 | Federal Crop Insurance Act |
| Exhibit BRA-31 | 7 CFR 1412: Production Flexibility Contracts for Wheat, Feed Grains, Rice, and Upland Cotton, 2002 Edition. |
| Exhibit BRA-32 | 7 CFR 1427.1100 at seq.: Cottonseed Payment Program, 2002 Edition |
| Exhibit BRA-33 | 7 CFR 1400: Payment Limitation and Payment Eligibility, 2003 Edition |
| Exhibit BRA-34 | 7 CFR 1401: Commodity Certificates, in Kind Payments, and Other Forms of Payment, 2003 Edition |
| Exhibit BRA-35 | 7 CFR 1412: Direct and Counter-Cyclical Program and Peanut Quota Buyout Program, 2003 Edition |
| Exhibit BRA-36 | 7 CFR 1427.1 at seq.: Nonrecourse Cotton Loans and Loan Deficiency Payments, 2003 Edition |
| Exhibit BRA-37 | 7 CFR 1427.100 at seq.: Upland Cotton User Marketing Certificates, 2003 Edition |
| Exhibit BRA-38 | 7 CFR 1493: CCC Export Credit Guarantee Programs, 2003 Edition |
| Exhibit BRA-39 | 7 CFR 400 Excerpts: Federal Crop Insurance Corporation, 2003 Edition |
| Exhibit BRA-40 | ERS Briefing Room Cotton: Policy |
| Exhibit BRA-41 | Congressional Hearing, "The Future of Federal Farm Commodity Programs (Cotton)", House of Representatives, 15 February 2001 |
| Exhibit BRA-42 | "The 2002 Farm Act, Provisions and Implications for Commodity Markets", USDA, November 2002 |

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| Exhibit BRA-43 | 67 Federal Register, N° 203, 21 October 2002 |
| Exhibit BRA-44 | "Direct Payment and CCP Enrolment Report", USDA, 19 June 2003 |
| Exhibit BRA-45 | "Fact Sheet: Upland Cotton", USDA, June 2001 |
| Exhibit BRA-46 | "Cotton: Background and Issues for Farm Legislation", USDA, July 2001 |
| Exhibit BRA-47 | G/AG/N/USA/43 |
| Exhibit BRA-48 | "Counter-Cyclical Payments under the 2002 Farm Bill", National Cotton Council, June 2003 |
| Exhibit BRA-49 | Brazil's Questions for the purposes of Annex V Procedure, March 2003 |
| Exhibit BRA-50 | "Farm Services Agency Background Information: Non-recourse Marketing Assistance Loans and Loan Deficiency Payments", USDA, March 1998 |
| Exhibit BRA-51 | Cotton Outlook, 1 February 2002: US Price Mechanism |
| Exhibit BRA-52 | "Fact Sheet: Commodity Certificates", USDA, July 2000 |
| Exhibit BRA-53 | "NCC Delegates Focus on Farm Program Specifics", National Cotton Council, 31 January 2001 |
| Exhibit BRA-54 | "Farm Subsidy Limit Loophole Cost taxpayer Billions in Payments to Biggest Farmers", Environmental Working Group, 1 May 2002 |
| Exhibit BRA-55 | Loan Deficiency Payment and Price Support Cumulative Activity as of 6/11/2003, USDA, 13 June 2003. |
| Exhibit BRA-56 | Bruce Gardner, "American Agriculture in the Twentieth Century", Cambridge: Harvard University Press, 2002 |
| Exhibit BRA-57 | "Crop Year Statistics", Federal Crop Insurance Corporation |
| Exhibit BRA-58 | "US Crop Insurance: Premiums, Subsidies & Participation", USDA, Agricultural Outlook, December 2001 |
| Exhibit BRA-59 | "Briefing Room: Farm and Commodity Policy: Crop Yield and Revenue Insurance", USDA |
| Exhibit BRA-60 | RMA Online, Crop Policies, 23 March 2003 |
| Exhibit BRA-61 | "NCC Summary of Key Provisions of Crop Insurance Reform Legislation", NCC. |
| Exhibit BRA-62 | RMA Online – Crops Covered under the 2002 Crop insurance Program |
| Exhibit BRA-63 | "Production and Price Impacts of US Crop insurance Subsidies: Some Preliminary Results" |

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| Exhibit BRA-64 | "Weak Demand Dampens Outlook for US Cotton", USDA Agricultural Outlook, November 1999 |
| Exhibit BRA-65 | Upland Cotton Domestic User/Exporter Agreement |
| Exhibit BRA-66 | Sample Format Weekly Consumption/Application For Payment Report |
| Exhibit BRA-67 | Cotton Outlook |
| Exhibit BRA-68 | "Weekly Step 2 Certificate Values". EconCentral, National Cotton Council of America, 13 June 2003 |
| Exhibit BRA-69 | Step 2 Domestic and Export payments by US Fiscal Year |
| Exhibit BRA-70 | "Export News and Opportunities", USDA Foreign Agricultural Service |
| Exhibit BRA-71 | "Fact Sheet: CCC Export Credit Guarantee Programs (GSM-102/103" |
| Exhibit BRA-72 | "Fact Sheet: CCC Supplier Credit Guarantee Program" |
| Exhibit BRA-73 | Summary of Export Credit Gurantee Programs, FY 1999-2003 |
| Exhibit BRA-74 | Farm Service Agency News Room, Release N° 1532.03, 25 April 2003 |
| Exhibit BRA-75 | Stewart, Terrence, The GATT Uruguay Round, A Negotiating History, Vol. IV, p. 24-25 |
| Exhibit BRA-76 | CCC Loan Deficiency Payments – FY 1994-2002 |
| Exhibit BRA-77 | "Fact Sheet: Agricultural Assistance Act of 2003", February 2003. |
| Exhibit BRA-78 | G/AG/N/USA/17 |
| Exhibit BRA-79 | "US Farm Program Benefits: Links to Planting Decisions & Agricultural Markets", Agricultural Outlook, October 2000 |
| Exhibit BRA-80 | "How Decoupled Is US Agricultural Support for Major Crop", American Journal of Agricultural Economy 82, August 2000 |
| Exhibit BRA-81 | Ivan Roberts and Frank Jotzo, "2002 US Farm Bill: An Australian Perspective on its Impact", ABARE, Australian Commodities, Vol. 9, N° 2 June Quarter 2002 |
| Exhibit BRA-82 | "USDA Baseline Projections", USDA, February 2003 |
| Exhibit BRA-83 | Schedule XX of the United States of America, part IV, Section II entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments |
| Exhibit BRA-84 | G/AG/W/56 |
| Exhibit BRA-85 | "FATUS Export Aggregations" |
| Exhibit BRA-86 | "FAS Agricultural Export Commodity Aggregations" |

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| Exhibit BRA-87 | Testimony of August Schumacher Jr., Under Secretary, Farm and Foreign Agricultural Service, USDA, before the Subcommitte on General Farm Commodities, Hearing on the Asian Financial Crisis, 4 88February 1998 |
| Exhibit BRA-88 | US Budget for Fiscal Year 2003 |
| Exhibit BRA-89 | US Budget for Fiscal Year 2002 |
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| Exhibit BRA-94 | US Budget for Fiscal Year 1997 |
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| Exhibit BRA-103 | "1993 Cotton Management Economic Notes", University of Arizona, 27 July 1993. |
| Exhibit BRA-104 | CV and Selected Publications of Professor Daniel Sumner |
| Exhibit BRA-105 | Statement by Professor Daniel Sumner at the First Meeting of the Panel. |
| Exhibit BRA-106 | "United States State Fact Sheet", ERS, USDA Data, 15 July 2003. |
| Exhibit BRA-107 | "US and State Farm Income Data, Farm Cash Receipts, 1924-2001," ERS, USDA, June 2003. |
| Exhibit BRA-108 | « United For Profits », National Cotton Council Organizational Chart and Membership. |

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| Exhibit BRA-109 | Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, Before the House Agricultural Committee. National Cotton Council (NCC) |
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| Exhibit BRA-145 | US and State Farm Income Data, (United States and States 1997-2001), USDA |
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| Exhibit BRA-169 | Market Revenue and US Government Payments to US Upland Cotton Producers |
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| Exhibit BRA-172 | Rice Outlook, USDA, 13 August 2003, Table 1 |
| Exhibit BRA-173 | Revised Estimate of Support Granted by Commodity via Countercyclical Payments. |

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| Exhibit BRA-190 | Affidavit of Marcelo Pinheiro Franco |
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| Exhibit BRA-192 | Reestimated Guaranteed Loan Subsidy based on Original Budget Year Estimate. |
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| Exhibit BRA-194 | US Department of Agriculture Office of Inspector General Great Plains Region Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report N° 06401-4-KC, February 2002 |
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| Exhibit BRA-202 | Agricultural Outlook Tables, USDA, August 2003 |
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| Exhibit BRA-204 | "USDA's Cotton Classification Overview" |
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| Exhibit BRA-209 | Yearly A-Index Prices |
| Exhibit BRA-210 | "Production and Trade Policies Affecting the Cotton Industry," ICAC, July 2002. |

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| Exhibit BRA-272 | Fact Sheet: Adjusted Gross Revenue, Risk Management Agency, USDA, February 2003 |
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| Exhibit BRA-279 | Statement by Professor Daniel Sumner |
| Exhibit BRA-280 | "Brief Review of Empirical Assessments of Production Impacts of US Upland Cotton Subsidies" by Professor Daniel Sumner. |
| Exhibit BRA-281 | Statement by Andrew Macdonald |
| Exhibit BRA-282 | "About the Liverpool Cotton Association," The Liverpool Cotton Association Ltd. |
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| Exhibit BRA-300 | Calculation on US Rice Exports Benefiting from GSM-102, GSM-103 and SCGP. |
| Exhibit BRA-301 | Additional Results from Professor Sumner's Model. |
| Exhibit BRA-302 | Revised and Extended Data on Article 6.3(d) Claim. |
| Exhibit BRA-303 | John C. Beghin and Holger Matthey. "Modelling World Peanut Product Markets: A Tool for Agricultural Trade Policy Analysis." Center for Agricultural and Rural Development (CARD), May 2003. |
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| Exhibit BRA-311 | Side by Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average US Spot Market Price and Prices Received by US Producers from January 1996 to the present. |
| Exhibit BRA-312 | Cotton Outlook Reports dated 7 June 2002, 27 September 2002 and 4 October 2002. |
| Exhibit BRA-313 | Analysis of Counterfactual Retrospective Scenarios and Prospective Scenarios of Elimination of Upland Cotton Subsidies in the United States using an elaboration of the FAPRI/CARD Modeling Framework |
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| Exhibit BRA-316 | Statement of Christopher Campbell- Environmental Working Group. |
| Exhibit BRA-317 | EWG Database: Tables of Results |
| Exhibit BRA-318 | Discussions Held With FSA Contacts in County and State Offices. |
| Exhibit BRA-319 | FSA-578 Manual: Report of Acreage |
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| Exhibit BRA-323 | Costs and Returns of US Upland Cotton Farmers MY 1997-2002 |
| Exhibit BRA-324 | NCC Chairman's Report by Kenneth B. Hood, 24 July 2002 |
| Exhibit BRA-325 | Results of Professor Sumner's Modified Model Based on the January 2003 FAPRI Baseline |
| Exhibit BRA-326 | Results of Professor Sumner's Modified Model |
| Exhibit BRA-327 | Cotton Marketing Weekly, O.A. Cleveland, 7 November 2003 |
| Exhibit BRA-328 | Cotton and Wool Outlook, USDA, 14 October 2003 |
| Exhibit BRA-329 | Cotton and Wool Situation and Outlook Yearbook, Table 16, USDA, November 2002**.** |
| Exhibit BRA-330 | Agricultural Exchange Rate Data Set, ERS, USDA |

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| Exhibit BRA-342 | Statement of Professor Daniel Sumner – 2 December 2003 |
| Exhibit BRA-343 | Response to US Statements about Access to Background Information about my US Cotton Policy Simulation Results |
| Exhibit BRA-344 | Discussion of the US Critique of Third Party Studies of the Economic Effects of US Cotton Subsidies |
| Exhibit BRA-345 | Response to Further US Criticisms of the Annex I Model of the Effect of US Cotton Subsidies |
| Exhibit BRA-346 | Email Exchange between Professor Bruce Babcock and Dr. Joseph Glauber, 26 November 2003 |
| Exhibit BRA-347 | Brazilian Exports, MY 1999-2002 |
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| Exhibit BRA-349 | Comparison of US and Brazilian Exports, MY 1999-2002 |
| Exhibit BRA-350 | Weekly Step 2 Certificate Values, National Cotton Council, 28 November 2003 |

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| Exhibit BRA-351 | BICO Export Commodity Aggregations (Values), USDA, FSA dated 21 November 2003 |
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| Exhibit BRA-353 | Cumulative Loss from Upland Cotton Production MY 1997-2002 Without US Contract Payments |
| Exhibit BRA-354 | "Brazilian Soybeans – Can Iowa Farmers Compete?" Iowa State University, December 2000 |
| Exhibit BRA-355 | US Acreage Response to Futures Prices at Planting Time |
| Exhibit BRA-356 | January – March Quotes of the December Futures Contract, Expected and Actual AWP and Cash Price |
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| Exhibit BRA-359 | 30 October and 25 November Cotton Futures Quotes |
| Exhibit BRA-360 | Adjusted World Price v Nearby Futures Price (1996-present) |
| Exhibit BRA-361 | Cotton Pricing Guide, July 2001 |
| Exhibit BRA-362 | Suspension of Anti-Dumping Duty Investigation: Cold-Rolled Flat Rolled Carbon-Quality Steel Products from the Russian Federation, Department of Commerce, 4 February 2000 |
| Exhibit BRA-363 | Global Steel Trade, Chapter 7: Avoiding Future Crises, Department of Commerce |
| Exhibit BRA-364 | 2003 US Budget, Federal Credit Supplement, Table 8 |
| Exhibit BRA-365 | 2002 US Budget, Federal Credit Supplement, Table 8 |
| Exhibit BRA-366 | 7 U.S.C. § 5622 |
| Exhibit BRA-367 | Section 3203 of the 2002 FSRI Act |
| Exhibit BRA-368 | Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003 |
| Exhibit BRA-369 | Brazil's Request to the United States for Farm – Specific Planting and Base Acreage Data, 3 December 2003 |
| Exhibit BRA-370 | The Difference between the Average World Price and the Nearby December Futures Contract Price |
| Exhibit BRA-371 | Simple Example of the Calculations of Marketing Lon Benefits (Probability Distribution) |
| Exhibit BRA-372 | Negotiating History of Articles 6.3(c) and 6.5 of the SCM Agreement |

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| Exhibit BRA-373 | Loan Deficiency Payment and Price Support Activity as of 12/3/2003 |
| Exhibit BRA-374 | "Crop Year Statistics MY 2002" – Federal Crop Insurance Corporation |
| Exhibit BRA-375 | Information Provided by Gerald Estur, ICAC. |
| Exhibit BRA-376 | "About FAPRI," Center for Agricultural and Rural Development, Iowa State University |
| Exhibit BRA-377 | "About FAPRI," Food and Agricultural Policy Research Institute at the University of Missouri. |
| Exhibit BRA-378 | "About FAPRI," Food and Agricultural Policy Research Institute. |
| Exhibit BRA-379 | CARD Report, 40 Anniversary Commemorative Issue |
| Exhibit BRA-380 | "Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002. |
| Exhibit BRA-381 | Jeffrey D. McDonald and Daniel A. Sumner. "The Influence of Commodity Programs on Acreage Responses to Market Price: With and Illustration concerning Rice Policy in the United States." American Journal of Agricultural Economics, (85) 4 November 2003. |
| Exhibit BRA-382 | Cotton and Wool Outlook, USDA, 12 December 2003. |
| Exhibit BRA-383 | Brazil and US Export Data on Export Quantities and Values by Country |
| Exhibit BRA-384 | Import Prices from Various Countries |
| Exhibit BRA-385 | Domestic Prices from Various Countries |
| Exhibit BRA-386 | Brazil and US Export Prices by Country |
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| Exhibit BRA-389 | Brazilian Domestic Price Data |
| Exhibit BRA-390 | "Glickman Proposes Cottonseed Payment Program," USDA News Release, 29 February 2000. |
| Exhibit BRA-391 | Cost of Ginning and Value of Cottonseed per pound of Cotton Lint |
| Exhibit BRA-392 | "William Duvanant Says: Overproduction Thwarts Cotton price Upturn," Western Farm Press. |
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| Exhibit BRA-394 | Agricultural Outlook Tables, USDA, November 2003, Table 19 |
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| Exhibit BRA-396 | "Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, 2 September 2003. |
| Exhibit BRA-397 | "Report of the Commission on the Application of Payment Limitations for Agriculture," August 2003. |
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| Exhibit BRA-399 | Acreage Discrepancies.xls |
| Exhibit BRA-400 | List of Publications of Professors Babcock and Beghin |
| Exhibit BRA-401 | Second Declaration of Andrew Macdonald, 27 January 2004. |
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| Exhibit BRA-405 | "Sample Costs to Produce Cotton Transgenic Herbicide- Resistant Acala Variety," San Joaquin Valley, University of California Cooperative Extension, 2003. |
| Exhibit BRA-406 | "Cotton Cost-Return Budget in Southwest Kansas," Kansas State University Agricultural Experiment Station and Cooperative Extensive Service, October 2003. |
| Exhibit BRA-407 | Documents on Cost of Production Insurance Plan for Cotton. |
| Exhibit BRA-408 | Export – Import Bank of the United States, Standard Repayment Terms. |
| Exhibit BRA-409 | Ex-Im Bank Fee Schedule. |
| Exhibit BRA-410 | Export Insurance Services. |
| Exhibit BRA-411 | "The Federal Scoop: US Government Financing for Service Exports," Export America, May 2003. |
| Exhibit BRA-412 | Cotton and Wool Situation Outlook and Outlook Yearbook, USDA, November 2003, Table 16. |
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| Exhibit BRA-419 | Allocation Calculations Based on Brazil's Methodology and US Summary Data. |
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| Exhibit BRA-421 | ERS Briefing Room: Farm Income and Costs: US Farm Sector Cash Receipts from Sales of Agricultural Commodities, USDA. |
| Exhibit BRA-422 | Fruits and Tree Nuts Yearbook, USDA, October 2003, Table A-2. |
| Exhibit BRA-423 | Vegetables and Melons Yearbook, USDA, July 2003, Table 3. |
| Exhibit BRA-424 | Allocation Calculations Based on US Methodology and US Summary Data. |
| Exhibit BRA-425 | Dresser Industries v United States, 596 F.2d 1231 (5th Cir. 1979) |
| Exhibit BRA-426 | Center for Auto Safety v National Highway Traffic Safety Administration, 244 F.3d 144 (DC Cir 2001) |
| Exhibit BRA-427 | CNA Financial Corporation v Donovan, 830 F.2d 1132 (DC Cir 1987) |
| Exhibit BRA-428 | United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989) |
| Exhibit BRA-429 | Metadure Croporation v United States, 490 F. Supp. 1368 (S.D.N.Y. 1990) |
| Exhibit BRA-430 | Campaign for Family Farms v Glickman, 200 F.3d 1180 (8th Cir. 2000) |
| Exhibit BRA-431 | Comparison of US and Brazil's Cash-Basis Accounting Methodologies for Purposes of the Item (j) Analysis |
| Exhibit BRA-432 | Congressional Budget Office, Fact Sheet, row titled "Export Credit Guarantee Program, Subsidy Account" |
| Exhibit BRA-433 | 'Calculations Acreage Based Methodologies.xls' provided in electronic format |
| Exhibit BRA-434 | 'Calculations Value Based Methodologies.xls' provided in electronic format |

# ANNEX O-2

## LIST OF EXHIBITS OF THE UNITED STATES

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| US-1 | 2002 Farm Security and Rural Investment Act, Public Law 107-171, 116 Stat. 134 (13 May 2002) (Title I) |
| US-2 | 57 *Federal Register* 14,326 (20 April 1992) |
| US-3 | 7 C.F.R. Part 1413 (1 January 1993) |
| US-4 | 7 C.F.R. 1413.6 (1991 ed.) |
| US-5 | 7 U.S.C. § 1444-2 (1992 supp.) |
| US-6 | 7 C.F.R. Part 1493 (2003) (excerpts) |
| US-7 | Organization for Economic Co-operation and Development, *The Chairman's Revised Proposal for a Sector Understanding on Export Credits for Agricultural Products*, TD/CONSENSUS(2000)25/REV4 (9 July 2002) |
| US-8 | Cairns Group, *Negotiating Proposal on Export Competition*, JOB(02)/186 (20 November 2002) |
| US-9 | *Negotiations on Agriculture: First Draft of Modalities for the Further Commitments*, TN/AG/W/1/Rev.1 (18 March 2003) |
| US-10 | MERCOSUR *et al.*, *Export Credits for Agricultural Products*, G/AG/NG/W/139, G/AG/W/50 (21 March 2001) |
| US-11 | 2 U.S.C. §§ 661 *et seq.* (2003) |
| US-12 | Examples of export credit guarantee program announcements issued pursuant to applicable program regulations (7 C.F.R. §§ 1493.10(d), 1493.400(d)) |
| US-13 | Schedule XX – United States of America, Part IV, Section II: Export subsidy reduction commitments |
| US-14 | 2002 Crop Cottonseed Regulations, 68 *Federal Register* 20,331 (25 April 2003) |
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| US-16 | 1999 Crop Cottonseed Program Regulations, 65 *Federal Register* 36,563 (8 June 2000) |
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US-19 Marketing Year 2002 Loan Deficiency Payment and Price Support Cumulative Activity As of 3/12/2003

US-20 Schedule of current fees paid by an exporter participating in either the GSM-102 or GSM-103 program

US-21 Recently updated program documents for the Step 2 program

US-22 The Agricultural Market Transition Act, Title I of the Federal Agriculture Improvement Act of 1996, Public Law No. 104-127 (4 April 1996)

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US-33 Status of Reschedulings for CCC Export Credit Guarantee Program activity for fiscal years 1992-2002

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US-46 Low US Northern Europe quote and A-Index, 1999-2003 (graph and data)

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US-65 Amount and percentage of upland cotton acreage coverage by crop insurance policy

US-66 Premiums paid by upland cotton producers

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US-68 New York Cotton Futures, Average Daily Closing Prices for December 2003 Contract (chart and data)

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US-70 US and Rest of World Exports of Upland Cotton, Year-Over-Year Percent Change, 1996-2002

US-71 US Exports and Domestic Consumption of Upland Cotton, 1996-2002

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US-73 Weekly Price Movements: Adjusted World Price, Liverpool A-Index, New York cotton futures, spot market price, January 1996 to present

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US-75 Chart and Table of US and Brazilian Unit Value Prices to Various Third-Country Markets

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US-92 Year-to-date MY2003 A-index prices, daily

US-93 US Department of Agriculture, unofficial marketing year 2002 marketing loan payments for soybeans corn, and wheat

US-94 US Department of Agriculture, Farm Services Agency, summary of marketing year 2002 enrolled direct and counter-cyclical payment base acres, upland cotton farms

US-95 Comparison of MY2002 enrolled direct and counter-cyclical payment base acres for upland cotton to NASS upland cotton planted acres

US-96 Total US upland cotton planted acreage, MY2001-2003, by state

US-97 US MY2002 upland cotton exports to Argentina, Bolivia, and Paraguay

US-98 E-mail communication from S. Tokarick, International Monetary Fund

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US-102 Excerpts from Exhibit BRA-369

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US-104 US Department of Agriculture, Decision under FOIA (11 April 2002)

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US- 106 US Department of Agriculture, Farm Services Agency, FOIA Handbook (excerpts)

US-107 5 U.S.C. § 552a(b)

US-108 Excerpt of BRA-316

US-109 Description of electronic file "Pfcby.txt."

US-110 Description of electronic file "Pfcplac.txt."

US-111 Description of electronic file "Dcpby.txt"

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| US-112 | Description of electronic file "Dcpplac.txt" |
| US-113 | Graphical representation of scope and disclosure of Brazil's modeling system |
| US-114 | Letter from Dr. Bruce Babcock (10 December 2003) |
| US-115 | Electronic version of spreadsheets referenced in US Comments Concerning Brazil's Econometric Model |
| US-116 | Electronic version of spreadsheet referenced in US Comments Concerning Brazil's Econometric Model |
| US-117 | 7 CFR §§ 1427.13 and 1427.19 (2000 ed.) |
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| US-119 | USDA Office of the Chief Economist, *World Agricultural Supply and Demand Estimates* (11 December 2003) |
| US-120 | USDA, Economic Research Service, Fibers Yearbook, Appendix Table 2, Upland Cotton Supply and Use |
| US-121 | US General Accounting Office. *Agriculture in Transition: Farmers' Use of Risk Management Strategies*. GAO/RCED-99-90. April 1999. |
| US-122 | Total open interest for all cotton futures contracts on the New York Board of Trade for 18 December 2003 |
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| US-124 | Daily December Futures Closing Prices ($/lb) (New York Board of Trade) |
| US-125 | Statement of Federal Financial Accounting Standards No. 18: Amendments To Accounting Standards for Direct Loans and Loan Guarantees In Statement of Federal Financial Accounting Standards No. 2, Appendix B: Schedule B, entitled "Schedule for Reconciling Loan Guarantee Liability Balances." |
| US-126 | Calculations of "additional marketing loan facilitated revenue" realized per pound of cotton, MY 1998-2003 (partial year) |
| US-127 | Statement of Federal Financial Accounting Standards No. 2: Accounting for Direct Loans and Loan Guarantees, issued 23 August 1993, pp. 187-267 |
| US-128 | Chart of data from 1992 to 2003 (as of 30 November 2003) for GSM 102, 103 and SCGP with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes |
| US-129 | Commodity Credit Corporation Consolidated Statement of Net Cost (Note 13) for the Fiscal Year Ended 30 September 2002 |

US-130 Statement of Federal Financial Accounting Concepts and Standards (May 2002), Appendix E, pages 1140-1141

US-131 Inae Riveras, Brazil's Mato Grosso to triple winter cotton area (Reuters 2004-01-20)

US-132 Chart, US Crops Cotton supply and utilization, and Baseline

US-133 O.A. Cleveland, Cotton Market Weekly, 1/16/04

US-134 Charts of US and Brazilian Export Unit Values to 7 Destinations

US-135 Production, Yield, Trade, and Stocks Data, MY99-02

US-136 USDA/FAS US trade data, MY99-03

US-137 World Trade Atlas official Brazilian trade data, MY99-03

US-138 Statement of the United States at the Dispute Settlement Body (9 January 2004) on adoption of the reports in *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products for Japan*

US-139 USDA Weekly Cotton Market Review 1/9/04

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US-141 Charts of Chinese (Domestic, Import, Export) Prices vs. A-Index

US-142 NY Board of Trade, NY Cotton Exchange, 27 January 2004 futures data

US-143 Memorandum from Larry Mitchell, USDA Farm Services Agency, to Various FSA Offices, Administrators, and Divisions on Release of Restricted Information under the Freedom of Information Act (18 September 1998)

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| US-151 | United States Office of Management and Budget Circular No. A-129 (November 2000), Table of Contents, General Information, Appendix A, Sections I and II. |
| US-152 | Commodity Credit Corporation Realized Losses and Appropriations to Restore Such Losses for Fiscal Years 1992-2003 |
| US-153 | Summary of Principal Terms, Conditions, and Duration of Each Rescheduling Reflected in Column F of Exhibit US-128 |
| US-154 | Partially Corrected Calculations Allocating Decoupled Payments for Upland Cotton Base Acres to Upland Cotton Using Incomplete Annex IV Methodology |
| US-155 | *Report of the Commission on the Application of Payment Limitations for Agriculture*, Chapter 5 (2003) |

**WORLD TRADE ORGANIZATION**

**WT/DS267/R/Corr.1**[*]
8 September 2004

(04-3687)

Original: English

# UNITED STATES – SUBSIDIES ON UPLAND COTTON

## *Report of the Panel*

Corrigendum

The following corrections should be made to document WT/DS267/R:

paragraph 6.9
"paragraph 7.227" should read "paragraph 7.277".

paragraph 6.22
"paragraph 7.6314" should read "paragraph 7.634".

paragraph 6.52
"footnote 1374" should read "footnote 1432".

paragraph 7.294
"Brazil's taking of 'legal steps to establish a claim' " should read "Brazil's 'taking of legal steps to establish a claim' ".

paragraph 7.688
"Article 13(b)(ii) of the *SCM Agreement*" should read "Article 13(b)(ii) of the *Agreement on Agriculture*".

paragraph 7.691
"Article 1.1(a)2(ii)" should read "Article 1.1(a)(1)(ii)".

footnote 993
"Question No.229" should read "Question No.228".

footnote 1052
"para. 7.866" should read "para. 7.843".

paragraph 7.1131
The following changes should be made in the 4th sentence:
(i) The first pair of quotation marks should be deleted.
(ii) The first pair of double quotation marks should be deleted.
(iii) The term "certain identified agricultural products" as it first appears in the sentence should be deleted (together with the quotation mark).
(iv) A quotation mark should be put before the word "all" and after the close bracket.

[*] In English only.

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paragraph 7.1140
"enterprise" should read "enterprises".

footnote 1313
"*DSU*" should read "*SCM Agreement*".

paragraph 7.1207
"subsidized Member" should read "subsidizing Member".

footnote 1333
The words "subsidized product" and "like product" that appear in the second and third lines, respectively, should be in italics.

paragraph 7.1227
"adverse effects to the interests" should read "adverse *effects* to the interests", and "(c) the effect of the subsidy is" should read "(c) the *effect* of the subsidy is".

footnote 1358
"Article 16.4" should read "Article 16.2".

paragraph 7.1246
The word "cotton" that appears in the first line should be deleted.

footnote 1429
"(MTN/GNG/NG19/W/38/Rev.2)" should read "(MTN/GNG/NG10/W/38/Rev.2)".

footnote 1431
"to request a finding" should read "to make a finding".

paragraph 7.1401
"is capable of" should read "are capable of ".

paragraph 7.1430
"*WTO Agreement*" should read "*SCM Agreement*".

**WORLD TRADE ORGANIZATION**

**WT/DS267/R/Add.1**
8 September 2004

(04-3414)

Original: English

# UNITED STATES – SUBSIDIES ON UPLAND COTTON

## *Report of the Panel*

Addendum

This addendum contains the annexes A-H to the Report of the Panel to be found in document WT/DS267/R. Annex I can be found in Add.2 and Annexes J-O can be found in Add.3.

# ANNEX A

## INITIAL BRIEFS OF PARTIES AND THIRD PARTIES

# ANNEX A-1

## BRAZIL'S BRIEF ON PRELIMINARY ISSUE REGARDING THE "PEACE CLAUSE" OF THE AGREEMENT ON AGRICULTURE

5 June 2003

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## I. INTRODUCTION AND SUMMARY

1. Brazil responds to the Panel's 28 May 2003 request for a briefing on the following issue:

> *Whether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled.*[1]

[1] The Panel also "invites the parties to explain their interpretation of the words 'exempt from actions' as used in Article 13 of the Agreement on Agriculture, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue."

2. The short answer to this question is "no". There is no procedural rule or legal requirement for a panel to make such a preliminary finding. The phrase "exempt from actions" in Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture (AoA) means that *if all* the conditions of Article 13(b)(ii) and 13(c)(ii) are fulfilled (*i.e.*, there is peace clause protection), a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the Agreement on Subsidies and Countervailing Measures (ASCM or SCM Agreement) or Article XVI of GATT 1994. But neither the phrase "exempt from actions" nor AoA Article 13 compel the Panel to *first* make a peace clause finding before considering the substance of Brazil's ASCM and GATT Article XVI claims.

3. Article 13 of the Agreement on Agriculture is not a "special and additional" rule set out in Appendix 2 to the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). Article 19 of the AoA makes all DSU provisions applicable to the AoA. Pursuant to DSU Article 11, a panel must make an "objective assessment of the facts of the case". Assessing and weighing all relevant facts – including rebuttal facts – obtained during the normal two meeting panel process is essential to resolve properly fact-intensive issues relating to the peace clause. This Panel should follow the lead of previous panels that made similar complex threshold findings in final panel reports.

4. Brazil will be prejudiced by delays in the process because a number of Brazil's claims are not dependent on any resolution of the "peace clause". Much of the proof required for demonstrating that the US has no peace clause protection under Articles 13(b)(ii) and 13(c)(ii) is the same evidence demonstrating US violations under the SCM Agreement. Requiring separate briefings, hearing, presentation of factual evidence and legal argument for such inter-connected "peace clause" issues would seriously disrupt Brazil's presentation of its evidence, lead to duplication of its efforts, delay the proceeding, and increase Brazil's financial and human resource costs.

## II. ANALYSIS OF THE PHRASE "EXEMPT FROM ACTIONS"

1. The Panel has requested that Brazil address the meaning of the phrase "exempt from actions" in AoA Article 13. In the view of Brazil, this phrase means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that otherwise would be subject to the disciplines of certain ASCM and GATT 1994 provisions if those measures are in compliance with the various peace clause provisions. It does not mean that a Panel may not hear evidence or consider Brazil's ASCM or GATT 1994 claims while it decides whether all the peace clause conditions have been fulfilled. In sum, this phrase in no way suggests that a panel must make a finding that the peace clause provisions are unfulfilled before proceeding with the other claims.

2. The phrase "exempt from actions" is used, as relevant to this dispute, in AoA Articles 13(a), 13(b)(ii), and 13(c)(ii). The dictionary definition of "actions" is "the taking of legal steps to establish a claim or obtain a remedy."[2] In a multilateral system such as the WTO (like GATT 1947[3] before it), "actions" are taken collectively by Members. DSU Article 2.1 (last sentence) emphasizes this notion

[2] New Shorter Oxford Dictionary, Volume 1 (1993 Edition), at 22.

[3] Article XXV of GATT 1994 provides for "joint action" by the contracting parties to "further the objectives of this Agreement". The decision by the contracting parties to approve the Tokyo Round results in 1979 was entitled "Action by the CONTRACTING PARTIES on the Multilateral Trade Negotiations". BISD 26S/201.

in stating that "only those Members that are parties to that Agreement may participate in decisions or *actions* taken by the DSB with respect to that dispute." (emphasis added) "Actions" include decisions made by the Dispute Settlement Body (DSB) to adopt rulings and recommendations of panels and the Appellate Body. Article XVI:1 of GATT 1994 also provides for another action, a decision by the relevant WTO body to hold consultations with a subsidizing Member to discuss what steps that Member will take to remove the serious prejudice or threat caused by its subsidies.[4] And "actions" also include the enforcement of remedies authorized by the DSB pursuant to DSU Article 22. In sum, "actions" are multilaterally agreed decisions of WTO bodies including the DSB.

3. The ordinary meaning of the word "exempt" is "grant immunity or freedom from liability to which others are subject".[5] The chapeau of Article 13 states that the period of exemption is "during the implementation period", *i.e.*, until 1 January 2004.

4. Combining these definitions of "actions" and "exempt," the term "exempt from action" in Article 13(b)(ii) means that before 1 January 2004, a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic support measures that otherwise would be subject to the disciplines of Article XVI:1 and ASCM Articles 5 and 6. And "exempt from action" in the context of Article XVI:1 would mean that the WTO could not take a decision to require a Member to consult with the WTO on how the Member will eliminate serious prejudice or the threat of serious prejudice caused by that subsidy. However, the immediate context of the phrase "exempt from actions" in Articles 13(a), 13 (b)(ii) and 13(c)(ii) make clear that the "exemption" is not *absolute* but rather subject to a number of conditions:

- Article 13(a) only permits green box domestic subsidies to be exempt from the types of determinations listed in Article 13(a) (i), (ii) or (iii) if they "conform fully to the provisions of Annex 2" of the AoA. If a domestic support measure does not comply with one of a number of requirements of the "green box" provisions of Annex 2, then such domestic support would be evaluated under the peace clause provisions of Article 13(b) and could be subject to a remedy determination by the DSB and/or the WTO.

- Under the provisions of peace clause Article 13(b)(ii), "amber" and "blue" box domestic support measures provided during any marketing year between 1995-2003 are only exempt from determinations by the DSB and/or the WTO relating to paragraph 1 of Article XVI of GATT 1994 (not Article XVI, paragraph 3) and Articles 5 and 6 (not Article 3) of the SCM Agreement "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year". If the quantity of amber and/or blue box support granted in any marketing year from the 1995-2003 period is greater than that decided during marketing year 1992, then the subsidy programme is not "exempt" from such determinations.

- Export subsidies under the peace clause provisions of AoA Article 13(c)(ii) are only exempt from determinations by the DSB and/or the WTO relating to Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement *if* they "conform fully to the provisions of Part V of [the AoA]". Thus, if export subsidy measures are inconsistent with the provisions of AoA Articles 8, 9 or 10, then they are no longer exempt from such determinations.

[4] *See, e.g.*, Report of the Working Party on Article XVI:1 discussions on *EC- Refunds on Exports of Sugar*, BISD 28S/80.

[5] New Shorter Oxford Dictionary, Volume 1 (1993 Edition), at 878.

5. In sum, "exempt from actions" means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are "peace clause" protected. Yet, as described below, the phrase "exempt from actions" when viewed in the broader context of DSU provisions *does not require* the Panel to *first* make a peace clause compliance finding before hearing or considering any of the evidence or arguments relating to the various ASCM or GATT 1994 claims.

## III. THE CONTEXT OF ARTICLE 13 DEMONSTRATES THAT THERE IS NO LEGAL REQUIREMENT FOR THE PANEL TO FIRST MAKE A FINDING ON THE PEACE CLAUSE BEFORE PERMITTING BRAZIL TO SET OUT ITS ARGUMENT AND CLAIMS REGARDING US VIOLATIONS OF THE SCM AGREEMENT

1. There is nothing in the text of Article 13 or other provisions of the AoA, the SCM Agreement, or any other WTO Agreement *requiring* the Panel to make a preliminary factual and legal finding on the applicability of the peace clause before examining Brazil's evidence and argument regarding US violations of the SCM Agreement or GATT 1994.

2. First, and most importantly, Annex 2 of the DSU Agreement is the closed list of "special and additional" rules and procedures that trump the normal rules of dispute settlement. This list does not include Article 13 or any other AoA provisions. Thus, resolution of the "peace clause" issues, like other issues raised by Brazil's request for establishment of a panel, must be resolved using normal DSU rules and procedures.

3. Second, AoA Article 13 does not exclude AoA Article 19 which states that the "provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding, shall apply to consultations and *the settlement of disputes under this Agreement*" (emphasis added). Among the DSU procedures applicable to AoA Article 13 is DSU Article 11 which provides, in part:

> [a] panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements.

4. Article 11 contemplates that a panel must make an "objective assessment of the facts of the case". It does not state that a panel must conduct such an assessment by first examining *part* of the facts of a case before it then examines *other* facts. Further, Article 11 contemplates that the parties will have the full opportunity to search for and present rebuttal facts. This is accomplished through the normal two meeting panel process – not in a single truncated meeting. It is also accomplished through the exchange of rebuttal submissions.

5. Review by a panel of all the facts including rebuttal facts is necessary *before* deciding whether the peace clause is applicable or not. This follows from the inter-related nature of the proof necessary to demonstrate the peace clause and ASCM actionable and prohibited export subsidy claims. As the Panel will discover shortly upon reviewing Brazil's First Submission, the facts relevant to the application of the "peace clause" largely overlap with facts relevant to determining whether the programmes at issue are "actionable" or "prohibited export subsidies". Consider the following:

- Each of the domestic support subsidies at issue in Brazil's actionable subsidy claims are also at issue in Brazil's proof regarding the absence of US peace clause protection for marketing years 1999-2002. For the purposes of AoA Article 13(b)(ii) the "amber" box subsidies include marketing loan/loan deficiency payments; crop insurance payments; Step-2 payments; production flexibility contract payments; direct payments; marketing loss assistance payments; counter-cyclical payments, and cottonseed payments. Proof of both peace clause and actionable subsidies require the same detailed descriptions of the type, nature, extent, and history of each of these US domestic support programmes.

- Brazil has made claims under the AoA and the ASCM regarding prohibited export subsidies under the US Step-2 programme and US export credit guarantee programmes. Brazil will demonstrate that these two export subsidies do not "conform fully to the provisions of Part V of this Agreement" in the sense of AoA Article 13(c); obviously, Brazil's evidence and argument regarding the lack of conformity of these two measures with Part V of the AoA largely overlaps with the evidence and argument necessary to demonstrate a violation of ASCM Articles 3.1(a) and (b).

6. This close overlap of proof for both peace clause and actionable and prohibited subsidy claims highlights the need for the Panel to examine all the "facts of the case" together – including rebuttal facts presented by Brazil to contest US assertions. Such a determination can only be made after collecting information in an iterative process.

7. DSU Article 11 also requires a panel to consider the "applicability" of the "relevant covered agreements". This includes deciding whether actions are exempt from the *covered* agreements. But Article 11 contains no requirement for a special briefing, meeting or determination by a panel to resolve such applicability or exemption.

8. Of course, when fulfilling its obligations under DSU Article 11, the Panel may well need to organize its assessment of the facts in its final determination by first examining and deciding issues related to the peace clause. The Appellate Body in *Brazil Aircraft* held that this is what the panel should have done in deciding the very similar peace-clause-like issues under ASCM Articles 27.2(b) and 27.4.[6] But there is nothing in DSU Article 11 or any other WTO provision mandating that Brazil present its evidence relating to the peace clause alone, divorced from factual evidence and argument relating to the SCM Agreement. As described below, such a requirement would be inconsistent with the previous practice of panels and prejudicial to Brazil's efforts to make a coherent and unified presentation of its case.

## IV. RESOLUTION OF THRESHOLD ISSUES PRIOR TO PROVIDING PARTIES THE OPPORTUNITY TO PRESENT ALL OF ITS EVIDENCE IS CONTRARY TO THE PRACTICE OF EARLIER PANELS

1. Many panels have faced preliminary threshold issues under DSU Article 6.2 and other WTO Agreements. These preliminary issues have involved whether panels have the jurisdiction to resolve and make recommendations concerning certain claims and measures. Many of these preliminary issues involved far less complex facts than are presented by the peace clause in this dispute. Despite this, many panels waited to resolve these threshold jurisdictional issues until the final determination

[6] Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R (adopted 2 August 1999), paras. 143-44.

after reviewing all the evidence and arguments.[7] Other panels have decided these threshold issues after the first meeting of the panel with the parties where the complaining party had an opportunity to present its evidence.[8]

2. The closest case to the peace clause issue presented here was addressed in *Brazil – Export Financing Programme for Aircraft*.[9] That dispute involved Articles 27.2(b) and 27.4 of the SCM Agreement, which exempts certain developing country Members from obligations under ASCM Article 3.1(a) provided that such a Member has complied with certain stated condiditons.[10] The Appellate Body discussed the application of this peace-clause-like provision in *Brazil Aircraft.*[11]

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[7] WTO Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R (adopted 20 August 1999), para. 9.15 (Panel rejected request for preliminary ruling based claims under DSU Article 6.2 and decided issues in final report); WTO Panel Report, *Egypt – Definitive Anti-Dumping Measures on Steel Rebar from Turkey*, WT/DS211/R (adopted 1 October 2002), para. 7.27-7.31 (Panel determined in final report that certain claims were not within its terms of reference); WTO Panel Report, *India – Measures Affecting the Automotive Sector*, WT/DS146/R and WT/DS/175/R (adopted 5 April 2002), paras. 7.44-7.103 (Panel rejected India's threshold *res judicata* claims in final panel report); WTO Panel Report, *United States – Anti-Dumping Duty and Dynamic Random Access Semiconductors (DRAMS) of One Megabit or more From Korea*, WT/DS99/R (adopted 19 March 1999), para. 6.17 (Panel ruled in final report granting US's preliminary objections that certain AD measures predated the WTO and could therefore not be subject to challenge); WTO Panel Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/R, WT/DS10/R and WT/DS11/R (adopted 1 November 1996), para. 6.5 (Final report determined that a claim was outside of the Panel's terms of reference); WTO Panel Report *United States – Definitive Safeguard Measures on Circular Welded Carbon Quality Line Pipe from Korea*, WT/DS202/R (adopted 8 March 2002), para. 7.121-7.126 (Panel rejected a Korean claim as beyond its terms of reference in the final panel report); WTO Panel Report, *United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan*, WT/DS184/R (adopted 23 August 2001), para. 7.22 (final report determined that the "adverse facts available" claim was beyond its terms of reference).

[8] WTO Panel Report, *European Communities – Anti-Dumping Duties on Malleable Cast Iron Tube or Pipe Fittings from Brazil*, WT/DS219/R (not yet adopted), para. 7.14 (preliminary finding made following first meeting with the parties that certain claims were not within its terms of reference); WTO Panel Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WTDS213/R (adopted 19 December 2002), para 8.1 –8.2 and footnote 224 (Panel decided at end of first meeting that two claims were outside its terms of reference and provided reasoning in final Panel report); WTO Panel Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/R (adopted 10 January 2001), para. 6.11 (Panel issued preliminary ruling regarding scope of measures within its terms of reference at the end of the second meeting with the parties); WTO Panel Report, *United States – Safeguard Measures on Imports of Certain Fresh, Chilled and Frozen Lamb from New Zealand and Australia*, WT/DS177/R and WT/DS178/R (adopted 16 May 2001), para. 5.15 (Panel ruled during first meeting that panel request was sufficient in covering all the claims brought by Australia and New Zealand).

[9] WTO Panel Report, WT/DS46/AB/R (adopted 2 August 1999).

[10] These provisions provide as follows:

> 27.2: The prohibition of paragraph 1(a) of Article 3 [prohibited export subsidies] shall not apply to:
> ** ** ** **
> (b) other developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, subject to compliance with the provisions in paragraph 4.
>
> 27.4: Any developing country Member referred to in paragraph 2(b) shall phase out its export subsidies within the eight-year period, preferably in a progressive manner. However, a developing country Member shall not increase the level of its export subsidies, and shall eliminate them within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs. . .

[11] Appellate Body Report, WT/DS46/AB/R (adopted 2 August 1999).

> In our view, too, paragraph 4 of Article 27 provides certain obligations that developing country Members must fulfill if they are to benefit from this special and differential treatment during the transitional period. . . . If a developing country Member complies with the obligations in Article 27.4, the prohibition on export subsidies in Article 3.1(a) simply does not apply. . . . If [. . .] non-compliance is demonstrated, then, and only then, does the prohibition of Article 3.1(a) *apply* to that developing country Member.[12] (*emphasis added)*

3. The Appellate Body found that the panel should have considered first the threshold issue of whether Brazil was in compliance with Article 27.4 before deciding whether Brazil was in violation of ASCM Article 3.1(a).[13] Yet, there was never a suggestion or finding that the Panel erred by not conducting a special briefing and special determination *before* even accepting arguments of Brazil and Canada regarding the ASCM Article 3.1(a) issue. A finding on the threshold issue in that case, as here, was conditioned upon other crucial determinations such as: the definition of subsidy; the moment when a subsidy was granted; the relevant level, etc. In that case, the threshold issue was decided by the Panel in the final report only after the parties had a chance to discuss all the related issues during the full course of the Panel proceedings.

4. There are a number of other threshold issues in WTO Agreements. No claim may be brought against a measure under the General Agreement on Trade in Services (GATS) unless the measure falls within the scope of the General Agreement on Trade in Services as defined in GATS Article I. No claim may be brought under Article 2 of the Agreement on Technical Barriers to Trade except in respect of a measure that is a "technical regulation" as defined by that agreement. Claims under the Agreement on Government Procurement may only be brought concerning procurement of an entity covered by Annex I of that agreement. While the language of these provisions differs, the effect is the same as the operation of the AoA Article 13 and ASCM Articles 27.2(b) and 27.4 – if the threshold objections are granted, the Panel cannot make a finding that the defending Member has acted contrary to the covered agreements. Yet none of these provisions have special and additional rules to provide for extraordinary preliminary briefings, meetings, and determinations prior to a panel hearing all of the claims presented.

## V. BRAZIL WILL BE PREJUDICED BY SEPARATE HEARINGS AND BRIEFINGS ON THE PEACE CLAUSE ISSUE

1. Brazil has previously described in its letter of 23 May 2003 to the Panel the prejudice that will occur if special meetings and briefings are imposed to resolve peace clause issues. Such prejudice includes requiring Brazil to present the *same* evidence three – not two times – and in having to bring its legal and economic experts to Geneva for an extra meeting.

2. In addition, Brazil would note that such special proceedings would cause it prejudice because there would be significantly delays in the resolution of its claims – many of which do not implicate the peace clause. These non-peace clause claims include the following:

1. Article XVI:3 of GATT 1994 involving all domestic and export subsidies challenged by Brazil;
2. Article III:4 of GATT 1994 regarding Step-2 domestic payments;

[12] Appellate Body Report, WT/DS46/AB/R, paras. 140-41 .
[13] Appellate Body Report, WT/DS46/AB/R, paras. 143-44.

1. Articles 3.1(b) and 3.2 of SCM Agreement regarding prohibited local content Step-2 domestic payments;
2. Articles 3.3 and 9.1(a) of the AoA regarding export subsidies including Step-2 export payments;
3. Articles 8 and 10.1 of the AoA regarding the GSM 102, GSM 103, and SCGP export credit guarantee programmes;
1. Articles 8 and 10.1 of the AoA regarding ETI measure (FSC replacement measure).

3. Moreover, Brazil's proof of these claims involves evidence overlapping with that relevant to Brazil's peace clause claims, as well as with its actionable and prohibited export subsidy claims. Given this overlap, a special proceeding on only the peace clause would negatively impact on Brazil's ability to present a coherent and unified presentation of its case.

## VI. CONCLUSION

1. For the reasons set forth above, Brazil requests that this Panel find that it is not precluded from hearing evidence and considering Brazil's claims under the ASCM or Article XVI of GATT 1994 without first concluding that the peace clause conditions of AoA Article 13(b)(ii) and 13(c)(ii) remain unfulfilled.

# ANNEX A-2

## INITIAL BRIEF OF THE UNITED STATES ON THE QUESTION POSED BY THE PANEL

5 June 2003

### A. INTRODUCTION

1. The United States thanks the Panel for this opportunity to comment on the question concerning Article 13 of the *Agreement on Agriculture* ("Agriculture Agreement") posed by the Panel in its fax of 28 May 2003. The Panel asked the parties to address:

> [W]hether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions in Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue.

2. Article 13 (the "Peace Clause") precludes the Panel from considering Brazil's claims under Article XVI of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") and the *Agreement on Subsidies and Countervailing Measures* ("Subsidies Agreement") since the US support measures at issue conform with the Peace Clause. The Peace Clause "exempt[s]" conforming support measures "from actions based on" the corresponding provisions of the Subsidies Agreement and the GATT 1994.[1] Read in accordance with the customary rules of interpretation of public international law, the phrase "exempt from actions" means "not exposed or subject to" a "legal process or suit" or the "taking of legal steps to establish a claim". Therefore, Brazil cannot maintain any action – and the United States cannot be required to defend any such action – based on provisions specified in the Peace Clause[2] since the US support measures for upland cotton conform to the Peace Clause. In light of the correct interpretation of the Peace Clause, the United States respectfully requests the Panel to organize its procedures to first determine whether Brazil may maintain any action based on provisions exempted by the Peace Clause.

3. Consider the alternative approach proposed by Brazil in its 23 May letter – that is, requiring the United States to defend the substantive claims at the same time as arguing the Peace Clause issues. If the Panel were to allow Brazil to proceed with its substantive claims under the Subsidies Agreement and GATT 1994 now, and only conclude later (for example, at the time of the issuance of its report) that the US measures at issue conform to the Peace Clause based on the facts of this dispute, US measures would already have been subject to Brazil's action based on those claims. As the United States will explain, this would contradict the ordinary meaning of the phrase "exempt from actions" in Article 13, read in its context, and in light of the object and purpose of the Agriculture

[1] For example, Article XVI of the GATT 1994 and Part III of the Subsidies Agreement correspond to Article 13(a)(ii) of the Agriculture Agreement, GATT 1994 Article XVI:1 and Articles 5 and 6 of the Subsidies Agreement correspond to Article 13(b)(ii) of the Agriculture Agreement, and GATT 1994 Article XVI and Articles 3, 5, and 6 of the Subsidies Agreement correspond to Article 13(c)(ii) of the Agriculture Agreement..

[2] *See* WT/DS267/7, at 3 (asserting claims based on Subsidies Agreement Articles 3.1(a), 3.1(b), 3.2, 5(a), 5(c), 6.3(b), 6.3(c), and 6.3(d) and GATT 1994 Articles XVI:1 and Article XVI:3).

Agreement. Consequently, to allow Brazil to proceed with any action against these US measures that are exempt from actions based on such claims would contravene the Peace Clause and upset the balance of rights and obligations of WTO Members.

B. LEGAL INTERPRETATION OF THE PEACE CLAUSE

4. The Peace Clause, Article 13 of the Agriculture Agreement[3], governs the treatment during the implementation period of the Agreement of certain domestic support measures and export subsidies "notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures".[4] For purposes of the Panel 's question, there would appear to be two interpretive issues. The first is straightforward and apparently not in dispute: whether the Peace Clause is in effect for the measures at issue. The second is what is the nature of the treatment under the Peace Clause of conforming measures – i.e., what does it mean to say that conforming measures are "exempt from actions".

[3] The Peace Clause reads:

During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures (referred to in this Article as the "Subsidies Agreement"):

(a) domestic support measures that conform fully to the provisions of Annex 2 to this Agreement shall be:
  (i) non-actionable subsidies for purposes of countervailing duties;
  (ii) exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement; and
  (iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994;

(b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:
  (i) exempt from the imposition of countervailing duties unless a determination of injury or threat thereof is made in accordance with Article VI of GATT 1994 and Part V of the Subsidies Agreement, and due restraint shall be shown in initiating any countervailing duty investigations;
  (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and
  (iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year;

(c) export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be:
  (i) subject to countervailing duties only upon a determination of injury or threat thereof based on volume, effect on prices, or consequent impact in accordance with Article VI of GATT 1994 and Part V of the Subsidies Agreement, and due restraint shall be shown in initiating any countervailing duty investigations; and
  (ii) exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement.

Agriculture Agreement, Article 13 (footnote omitted).

[4] Agriculture Agreement, Article 13 (chapeau). Article 21.1 of the Agriculture Agreement also makes it clear that the Subsidies Agreement and GATT 1994 only apply "subject to" the provisions of the Agriculture Agreement, including Article 13 (the Peace Clause).

### 1. Duration of the Peace Clause: The "Implementation Period"

5. The Peace Clause is in force at present. The first words of the Peace Clause ("During the implementation period") establish the duration of the treatment afforded by this provision. Article 1(f) of the Agriculture Agreement defines "implementation period" as "the six-year period commencing in the year 1995" but goes on to specify that "for purposes of Article 13, it means the nine-year period commencing in 1995". That is, Members determined that exempting certain measures from certain actions based on otherwise applicable WTO provisions was desirable for a time period *longer* than the period for the phase-in of all other commitments under the Agriculture Agreement. Thus, the Peace Clause currently continues to exempt conforming measures – whether US, Brazilian, or of any other Member – from actions under the corresponding provisions of the GATT 1994 and the Subsidies Agreement.

### 2. Effect of the Peace Clause: "Exempt from Actions"

6. For purposes of this dispute, all of the relevant provisions of the Peace Clause utilize the same language and construction: conforming measures "shall be . . . exempt from actions based on" specified provisions of the WTO agreements. The critical phrase "exempt from actions" is not defined in the Agriculture Agreement. According to the customary rules of interpretation of public international law[5], these terms should be interpreted according to their ordinary meaning in their context, in light of the object and purpose of the Agreement.[6]

7. The ordinary meaning of the word "exempt" is "[n]ot exposed or subject to something unpleasant or inconvenient; not liable to a charge, tax, etc. (Foll. by *from, of*.)".[7] The ordinary meaning of the word "action" is "[t]he taking of legal steps to establish a claim or obtain remedy; the right to institute a legal process" and "[a] legal process or suit".[8] A legal dictionary provides further explanation of the term "action":

> Term in its *usual legal sense* means *a lawsuit* brought in a court; a *formal complaint* within the jurisdiction of a court of law. . . . . The *legal or formal demand of one's right* from another person or party made and insisted on in a court of justice. An *ordinary proceeding in a court* of justice by which one party prosecutes another for the enforcement or protection of a right, the redress or prevention of a wrong, or the punishment of a public offence. It includes *all the formal proceedings* in a court of justice attendant upon the demand of a right made by one person of another in such court, *including an adjudication* upon the right and its enforcement or denial by the court.[9]

Thus, according to the ordinary meaning of the terms, "exempt from action" means "not exposed or subject to" the "taking of legal steps to establish a claim", such as a "formal complaint" or any "formal proceedings", including an "adjudication" of the claim. An even simpler formulation would be "not liable to" a "legal process or suit".

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[5] *See Understanding on Rules and Procedures Governing the Settlement of Disputes*, Article 3.2 (The dispute settlement system "serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law.").

[6] The customary rules of interpretation of public international law are reflected in part in Article 31(1) of the Vienna Convention, which reads: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

[7] *The New Shorter Oxford English Dictionary*, vol. 1, at 878 (first definition as adjective & noun) (italics in original).

[8] *The New Shorter Oxford English Dictionary*, vol. 1, at 22 (first and second definitions).

[9] *Black's Law Dictionary* at 28 (6th ed. 1990) (emphasis added).

8. Relevant context for the phrase "exempt from actions" includes the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), which applies to "disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the 'covered agreements')". The covered agreements, of course, include the Agriculture Agreement and the Subsidies Agreement. Article 3.7 of the DSU states: "*Before bringing a case*, a Member shall exercise its judgement as to whether *action* under these procedures would be fruitful" (emphasis added). Similarly, Article 4.5 of the DSU states: "*In the course of consultations* in accordance with the provisions of a covered agreement, before resorting to *further action* under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter" (emphasis added). Thus, these provisions suggest that "action" based on the relevant provisions would include all stages of a dispute, including the "bringing [of] a case", consultations, and panel proceedings.[10]

9. In addition, Article 7, which forms part of Part III of the Subsidies Agreement (entitled "Actionable Subsidies"), serves as context for the term "exempt from actions." Article 7 provides procedures (including consultations, panel proceedings, and remedies) to enforce the legal rights contained in Article 5 (on "adverse effects") and Article 6 (on "serious prejudice"). Article 7 states in its introductory phrase that its procedures apply "[e]xcept as provided in Article 13 of the Agreement on Agriculture".[11] Thus, these provisions also support reading "exempt from actions" in Article 13 to mean "not subject to" the "taking of legal steps to establish a claim". Footnote 35 of the Subsidies Agreement provides additional context that may help explain that "exempt from action" includes not resorting to dispute settlement. Footnote 35, which deals with "non-actionable"[12] subsidies, states that "[t]he provisions of Parts III [on actionable subsidies] and V [on countervailing measures] *shall not be invoked* regarding measures considered non-actionable in accordance with the provisions of Part IV".[13] As otherwise relevant provisions cannot be "invoked" for non-actionable subsidies, footnote 35 supports reading " exempt from action" as not resorting to dispute settlement by asserting legal claims.

10. This interpretation of "exempt from actions" meshes with the object and purpose of the Agriculture Agreement. The Agreement represents the outcome of long and difficult negotiations to move towards the "long-term objective . . . to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets".[14] Members therefore agreed to the Peace Clause, recognizing that agricultural subsidies could not be eliminated immediately and needed, under certain conditions, to be exempted from the Subsidies Agreement and GATT 1994 subsidies disciplines.

## C. CONCLUSION: BRAZIL MAY NOT BRING, AND THE PANEL MAY NOT ADJUDICATE, A SUBSIDIES AGREEMENT OR GATT 1994 ARTICLE XVI ACTION AGAINST US MEASURES CONFORMING TO THE PEACE CLAUSE

11. Brazil's approach – that both the applicability of the Peace Clause and Brazil's Subsidies Agreement and GATT 1994 Article XVI claims be considered at the same time – would contravene the plain meaning of the Peace Clause by subjecting US measures to the "taking of legal steps to establish a claim". Under Brazil's approach, the US measures would be subject to an action based on the

[10] As further support for the fact that "action" includes dispute settlement, DSU Article 3.10 provides that: "It is understood that requests for conciliation and the use of the dispute settlement procedures should not be intended or considered as contentious *acts* . . ." (emphasis added).

[11] Subsidies Agreement, Article 7.1.

[12] The ordinary meaning of the term "actionable" is "[a]ffording ground for an action at law". *The New Shorter Oxford English Dictionary*, vol. 1, at 22.

[13] Subsidies Agreement, Article 10 fn. 35 (emphasis added).

[14] Agriculture Agreement, preamble (third paragraph).

corresponding provisions of the Subsidies Agreement and GATT 1994 at the same time that the Panel would be reviewing the applicability of the Peace Clause. Brazil's approach would ignore the plain meaning of the provisions of the Peace Clause exempting these measures from actions.

12. Accordingly, the United States respectfully requests the Panel to find that measures that conform to the Peace Clause are exempt from any action, including action under the DSU, based on the corresponding provisions of the Subsidies Agreement and the GATT 1994. As a result, the United States is not required to defend those measures in any action based on Brazilian claims exempted by the Peace Clause.

# ANNEX A-3

## ARGENTINA'S THIRD PARTY INITIAL BRIEF

10 June 2003

1. Argentina would like to thank the Panel for the opportunity to submit, as third party to the dispute, written comments concerning whether Article 13 of the Agreement on Agriculture (AoA) precludes the Panel from considering Brazil´s claims under the Agreement on Subsidies and Countervailing Measures (SCM Agreement) in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. To that respect, Argentina states the following:

2. The text of Article 13 of the AoA does not require the Panel to make a preliminary finding on the applicability of the peace clause before examining Brazil´s claims under the SCM Agreement or GATT 1994. If the negotiators had considered such preliminary finding was necessary, they would have set it forth.

3. Indeed, a textual analysis of Article 13 of the AoA reveals that *"actions"*, and not the analysis of claims under Article XVI of GATT 1994 or Articles 3, 5 or 6 of the SCM Agreement, can only be precluded if all conditions established in paragraphs b) (ii) or c) (ii) of the referred Article 13 are met.

4. To that regard, the Appellate Body has established:

> *"The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the Vienna Convention. But these principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended."*[1]

- **The terms *"exempt from actions"* as stated in Article 13 of the Agreement on Agriculture:**

5. From Argentina´s point of view, in the context of Article 13 of the AoA the words *"exempt from actions"* do not amount to an impossibility to request a panel procedure. *"Exempt from actions"* means that a finding of inconsistency with Articles XVI of GATT 1994 or Articles 3, 5 and 6 of SCM Agreement will not be possible if the legal requirements for the exemption are fulfilled. The immediate context of the terms "*exempt from actions"* -i.e., paragraphs b) and c)- confirms this interpretation since that exemption require a particular threshold, i.e., that domestic support measures and export subsidies "conform fully" (to different provisions of the AoA).

6. Nevertheless, it is precisely through the panel procedures that the fulfilment of those legal requirements will be determined. Argentina agrees with Brazil´s statement in paragraph 6 of its Brief that the word "actions" in the context of Article 13 of the AoA refers to decisions of WTO competent bodies, such as the DSB when it discharges its duties by establishing a panel. A different interpretation would imply giving the measures allegedly covered by the Peace Clause a character of absolute immunity, independent of whether the legal requirements established in Article 13 are fulfilled or not. This would contradict the principle of *in dubio mitius*, constituting a more onerous interpretation of the treaty provisions

[1] Appellate Body Report, *India-Patents*, adopted 16 January 1998, WT/DS50/AB/R, para. 45. (Emphasis added).

7. Therefore, the words *"exempt from actions"* do not preclude a Panel from considering a claim under the SCM Agreement or GATT 1994 while it decides whether the Peace Clause conditions have been fulfilled.

8. Argentina considers that there is no doubt that "the Peace Clause currently continues to exempt conforming measures from actions under the corresponding provisions of the GATT 1994 and the Subsidies Agreement".[2] Indeed, the key words in Article 13 b) (ii) and c) (ii) of the AoA are "*that conform fully*" and "*provided that"* and "*that conform fully*", respectively. These words imply that the exception is not absolute, but rather subject to the fulfilment of certain conditions. When considering the interpretative issues for purposes of the Panel's question at paragraph 4 of its Brief, the US seems to omit this issue by stating that what appears to be in dispute is the nature of the treatment of conforming measures under the Peace Clause. However, from Argentina's point of view, what is important here is to determine at this stage of the proceedings the treatment under the Peace Clause of measures that are supposed not to be in conformity with the legal requirements needed to be exempted from actions.

9. In addition, the fulfilment of the legal conditions set forth under Article 13 is a matter of fact that necessarily requires to be elucidated during panel procedures. If not, how can this issue be elucidated where, as in the present case, the US did not state which was its 1992 domestic support level and did not answer the specific questions during the consultations? Only through panel proceedings could those issues be elucidated.

10. On the other hand, as Brazil stated in paragraph 17 of its Brief[3], there is no WTO provision obliging a Member to present evidence relating to the Peace Clause in a manner that is divorced from factual evidence and allegations under the SCM Agreement and/or GATT 1994. As stated by Brazil in paragraphs 13 and 14 of its Brief, according to Article 11 of the DSU a panel must make an objective assessment of the facts of the case and not of part of them before examining others, specially when, as in the case at hand, there is an overlap between the evidence related to the requirements of Art. 13 of the AoA and the evidence related to the actionable and prohibited subsidy claims.

11. Argentina considers that the text of Article 13 of the AoA does not ban a Panel from considering altogether a defence invoked under the Peace Clause and the allegations of inconsistency under GATT 1994 or the SCM Agreement. If a preliminary ruling on the applicability of the Peace Clause were necessary before being able to examine Brazil´s claims under the SCM Agreement or GATT 1994, the terms "*exempt from actions"* would have too broad a sense. It would amount to the creation of a new obligations for Members clearly not envisaged in the text of Art. 13.

12. Finally , the same reasoning could apply to other preliminary issues, such us the objections to the consistency of a Panel´s terms of reference with Article 6.2 of the DSU or the general exceptions under Article XX of GATT 1994. However, different Panels and the Appellate Body have made their findings on those issues altogether with their findings regarding substantive claims.

- **Other relevant provisions of the covered agreements:**

13. The SCM Agreement is applicable both for agricultural and non-agricultural products. It is true that Article 7 of the SCM Agreement states that the request of consultations is subject to Article 13 of the AoA. However, in the case at hand the US did not put it forward neither during

[2] US Initial Brief on Question Posed by Panel, 5 June 2003.

[3] Brazil´s Brief on Preliminary Issue Regarding the "Peace Clause" of the Agreement on Agriculture, 5 June 2003.

consultations nor during the meetings where the establishment of the Panel was requested, thus engaging itself in such procedures.

- **Other considerations that should guide the assessment of this issue :**

14. Argentina considers that the provisions contained in Article 13 of the AoA have an exceptional nature. This would imply that the Member who alleges to be protected by the Peace Clause has the burden of proving the fulfilment of its legal requirements. As long as the US does not demonstrates *prima facie* that it fulfils all the conditions that would allow a protection against a claim by virtue of Article 13 of the AoA, the Panel should consider as appropriate the claims under Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement.

15. Finally, as stated by Brazil in paragraphs 13 and 14 of its Brief, according to DSU Article 11 a panel must make an objective assessment of the facts of the case and not of part of them before examining others, specially when, as in the case at hand, there is a need to clarify closely related issues of fact that relate both to the fulfilment of the conditions set forth by the Peace Clause and to the substantive claims regarding actionable and prohibited subsidies.

**Conclusion**

16. According to the above statements, Argentina considers that Article 13 of the AoA does not preclude the Panel from hearing evidence and considering Brazil´s claims under the SCM Agreement or GATT 1994 while it decides whether the Peace Clause conditions of Article 13 have or have not been met.

# ANNEX A-4

## AUSTRALIA'S WRITTEN COMMENTS

10 June 2003

1. I refer to your faxed letter of 28 May 2003 in which you invited third parties to the dispute to submit any written comments they may have in relation to the following:

> whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invite the parties to explain their interpretation of the words "exempt from action" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article 13.

2. Please note that, for the purposes of Australia's comments in relation to the issues identified in the previous paragraph, references to "Article 13" refer to Article 13(a)(ii), 13(b)(ii) and 13(c)(ii). There is nothing in Article 13 of the *Agreement on Agriculture* – nor indeed in the *Dispute Settlement Understanding ("the DSU")* – that would preclude the Panel from considering claims under the *Agreement on Subsidies and Countervailing Measures* in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled.

3. Article 13 of the *Agreement on Agriculture* provides a limited, conditional and time-limited exemption from actions based on Article XVI of GATT 1994 and certain provisions of the *Agreement on Subsidies and Countervailing Measures* ("the specified provisions") in respect of measures which conform fully to the respective provisions of the *Agreement on Agriculture* and to Article 13 itself. Article 13 does not preclude *per se* claims based on the specified provisions, that is, Article 13 does not prevent the specified provisions being invoked. Rather, Article 13 is in the nature of an "affirmative defence" for measures which are inconsistent with the specified provisions.[1]

4. Viewing Article 13 of the *Agreement on Agriculture* as an affirmative defence gives proper meaning to that provision, as well as to Article 21 of the *Agreement on Agriculture* and Articles 3.1, 6.9 and 7.1 of the *Agreement on Subsidies and Countervailing Measures*. This view would also be consistent with the interpretive principle of effectiveness, which the Appellate Body has found should guide the interpretation of the WTO Agreement.[2]

5. In assessing an affirmative defence based on Article 13 of the *Agreement on Agriculture*, the proper application of that provision would require the Panel to consider the conditions listed in Article 13 ("the prescribed conditions"), that is:

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[1] See, for example, *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, page 16.

[2] *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/AB/R, WT/DS234/AB/R, paragraph 271.

- as appropriate, whether the measure at issue constitutes a domestic support measure or an export subsidy within the meaning of Annex 2 to, or Articles 6 or 1(e) of, the *Agreement on Agriculture*; and, if so,

- as appropriate, whether the measure at issue conforms fully to the provisions of Annex 2 to, or Article 6 or Part V of, the *Agreement on Agriculture*; and

- as appropriate, whether measures falling within the provisions of Article 6 of the *Agreement on Agriculture* grant support to a specific commodity not in excess of that decided during the 1992 marketing year.

6. Only if the Panel determines that Article 13 of the *Agreement on Agriculture* is relevant because the prescribed conditions are met would it need to consider whether the measures at issue are "exempt from actions based on" the specified provisions. In that event, the Panel would need to consider whether the measures at issue are "free or released from a duty or liability to which others are held"[3] in relation to a proceeding "found[ed], buil[t] or construct[ed] on"[4] the specified provisions. In other words, if the prescribed conditions are met, a Member will be immune from liability for a measure's inconsistency with the specified provisions for the period for which Article 13 applies.

7. In this dispute, there is disagreement between the parties to the dispute whether the measures at issue conform fully to the respective provisions of the *Agreement on Agriculture*. However, disagreement between the parties to the dispute does not serve to limit the Panel's mandate. There is no provision in the covered agreements that a disagreement between the parties to the dispute about conformity would serve as a barrier to a Panel's legal mandate to examine claims in accordance with the provisions of Article 3.2 and 11 of the DSU. There is, therefore, no requirement that the Panel reach a conclusion that certain conditions of Article 13 of the *Agreement on Agriculture* remain unfulfilled before considering claims under the *Agreement on Subsidies and Countervailing Measures*.

[3] *Black's Law Dictionary*, Seventh Edition, Bryan A Garner, Editor in Chief, West Group, St Paul, Minn., 1999, page 593.

[4] *The New Shorter Oxford English Dictionary*, Ed. Lesley Brown, Volume 1, Clarendon Press, Oxford, 1993, page 187.

# ANNEX A-5

## COMMENTS BY THE EUROPEAN COMMUNITIES ON CERTAIN ISSUES RAISED ON AN INITIAL BASIS BY THE PANEL

10 June 2002

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## I. INTRODUCTION

1. The Panel has asked the Parties to this dispute, together with the third parties, to comment on the following question:

> [W]hether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions in Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue.

2. The European Communities understands the positions of the two parties as follows. The United States is arguing for a multi stage procedure – first the Panel should deal with this initial issue, second, it should examine whether the US measures at issue fall under Article 13 of the *Agreement on Agriculture*, and finally, and only if the measures do not fall under Article 13 of the *Agreement on Agriculture*, should the Panel examine whether these measures are consistent with the *Agreement on*

*Subsidies and Countervailing Duties* (*SCM Agreement*).[1] On the other hand, Brazil considers that the Panel should, after settling this initial issue, examine Brazil's claims under Article 13 of the *Agreement on Agriculture* and the *SCM Agreement* simultaneously, treating Brazil's claims under Article 13 of the *Agreement on Agriculture* as a threshold issue.[2] Neither party appears to suggest that this issue is anything other than a substantive issue. [3]

3. The parties submissions concern the manner in which the Panel should organise its procedures. In other words, should it hear arguments and evidence on Brazil's claims under Article XVI GATT and the *SCM Agreement* before it has decided whether the United States can avail itself of Article 13 of the *Agreement on Agriculture*. The European Communities considers that this issue falls within the Panel's discretion as to the organization of its procedures. Such discretion is, nevertheless, not without its limits. The European Communities considers that there are a number of factors which require the Panel to exercise its discretion so as to examine the evidence and arguments presented by the parties with respect to both Article 13 of the *Agreement on Agriculture* and Article XVI GATT and the *SCM Agreement* at the same time. The European Communities sets out its arguments on these issues in more detail in the sections below.

## II. THE QUESTION AT ISSUE FALLS WITHIN THE PANEL'S DISCRETION AS TO THE ORGANISATION OF ITS OWN PROCEDURES

4. Both parties seem to consider that the Panel is required to rule, as a matter of substance, on whether the US measures fall under Article 13 of the *Agreement on Agriculture*, and if not, whether they are consistent with Article XVI GATT and the *SCM Agreement*. Brazil's contention that the US measures are inconsistent with Article XVI GATT and the *SCM Agreement*, because they are not covered by Article 13 of the *Agreement on Agriculture* requires the Panel to determine whether Article 13 is applicable. Similarly, the United States' claim that Article 13 of the *Agreement on Agriculture* prevents the Panel from ruling on Brazil's other claims requires adjudication of the issue of the applicability of Article 13.

5. The European Communities finds support for its view that the choice between a single and multistage procedure is a matter for the Panel's discretion in the fact that Article 13 of the *Agreement on Agriculture* is not set up as a specific rule which can be distinguished from the normal DSU procedures. Thus, for instance, Article 13 is not mentioned in Annex 2 of the DSU listing special or additional rules and procedures contained in the covered agreements. Moreover, Article 19 of the *Agreement on Agriculture* states that the provisions of Article XXII and XXIII GATT, as elaborated in the DSU, apply to the *Agreement on Agriculture*. Consequently, there are no special rules foreseen in respect of Article 13 in the event that a Member requests dispute settlement in which it may be raised as an issue.

6. In order further to demonstrate that this is a matter for the Panel's discretion, it is instructive to consider the United States' arguments on the meaning of exempt from action". The United States argues that the meaning of the term "exempt from action" is that no formal proceedings can be

[1] In para. 2 of its initial brief, the US argues

> "[t]he United States respectfully requests the Panel to organize its procedures to first determine whether Brazil may maintain any action based on provisions exempted by the Peace Clause."

[2] Brazil concludes its initial brief as follows:

> "[ ..] Brazil requests that this Panel find that it is not precluded from hearing evidence and considering Brazil's claims under the ASCM or Article XVI of GATT 1994 without first concluding that the peace clause conditions of AoA Article 13(b)(ii) and 13(c)(ii) remain unfulfilled."

[3] For instance, that the arguments on Article XVI GATT and the SCM Agreement are not within the terms of reference of the Panel.

launched with respect to the matter exempt from action, and that in the WTO, this would mean that a Member could not request consultations and later request the establishment of a panel.[4] The implications of this are unclear however. The logical conclusion would appear to be that the United States is suggesting that Brazil should first bring a panel arguing that Article 13 of the *Agreement on Agriculture* is not applicable, and then (if it is successful) bring a second panel to adjudicate its claims under Article XVI GATT and the *SCM Agreement*? This notion seems implausible for a number of reasons. First, in considering whether Article 13 of the *Agreement on Agriculture* is applicable, the first Panel would not be adjudicating a dispute but would be requested to issue a declaratory judgement. Second, a Member is not under an obligation to act consistently with Article 13 of the *Agreement on Agriculture* – failing to respect Article 13 implies that a Member no longer enjoys the protection thereof. Consequently, and third, Article 13 of the *Agreement on Agriculture* can only be seen as a defence against a claim brought under other aspects of the WTO Agreements which regulate the provision of subsidies. It would seem bizarre if, before Brazil could bring a claim with respect to subsidies which it considered did not respect the US's WTO obligations, Brazil had first to establish that potential US defences did not apply.

7. The European Communities notes that, although this situation is the logical continuation of the US interpretation of the term "exempt from action", the United States does not suggest that Brazil should have launched two successive WTO panels. Rather it maintains that the Panel's hearing argument and evidence on Article XVI GATT and the *SCM Agreement* would amount to an "action" which cannot be brought against it until it is determined that the US measures do not conform to Article 13 of the *Agreement on Agriculture*. Why the United States considers that hearing evidence would amount to such a prohibited "action", while requesting consultations or the establishment of a panel does not amount to maintaining an "action" is unclear. Indeed, the European Communities would presume that the United States would agree that Article 13 of the *Agreement on Agriculture* has the ultimate effect of not requiring any subsidy maintained consistently with Article 13 of the *Agreement on Agriculture* and otherwise inconsistent with the *SCM Agreement* to be brought into conformity with the provisions of the *SCM Agreement* (typically through its withdrawal). For the European Communities, therefore, the issue of whether a measure falls under Article 13 is necessarily a question which a Panel must decide before it decides whether the measure might violate Article XVI GATT or the *SCM Agreement.* However, the mere fact that the Article 13 issues must be decided before the other claims are decided does not imply that a panel, when it is examining evidence and considering arguments with respect to Article 13 of the *Agreement on Agriculture*, is precluded from hearing the evidence and arguments relating to Article XVI GATT or the *SCM Agreement* until after it has decided on the applicability of Article 13 of the *Agreement on Agriculture*.

8. In conclusion, the Panel has substantial discretion in deciding how it will manage these issues. Article 12.1 DSU makes it quite clear that the Working Procedures set out in Appendix 3 of the DSU may be departed from if the Panel decides this is appropriate. Therefore, it is a matter for the Panel's discretion whether to arrange a multistage procedure as proposed by the United States or a single stage procedure as proposed by Brazil.

9. The European Communities considers that the normal procedure proposed by Brazil should be followed by the Panel for the reasons set out in the next section.

[4] See paras. 7 and 8 of the US initial Submission.

## III. SEVERAL FACTORS MILITATE IN FAVOUR OF EXAMINING THE EVIDENCE AND ARGUMENTS PRESENTED IN RESPECT OF ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE AT THE SAME TIME AS THE OTHER CLAIMS

10. The European Communities submits that the Panel should consider evidence and argument relating to both the applicability of Article 13 of the *Agreement on Agriculture*, and the other provisions which Brazil has alleged the United States has acted inconsistently with.

### A. THE APPLICATION OF ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE IS DEPENDENT ON THE EXAMINATION OF QUESTIOnS OF SUBSTANCE

11. As the United States and Brazil appear to have recognised, the question of the applicability of Article 13 of the *Agreement on Agriculture* is dependent on the assessment of substantive issues, notably the conformity of the measures in question with other provisions of the *Agreement on Agriculture*. In order for the Panel to establish whether Article 13 applies, the Panel will have to consider detailed arguments and evidence. For that reason, the applicability of Article 13 should be subjected to the normally applicable procedures by which Panel deal with complex issues of fact and law and not adjudicated in some form of preliminary procedure. The European Communities note, for instance, that this was the approach taken by the panel in the *United States – Export Restraints* dispute, which refused to rule on a number of preliminary objections brought by the United States (as the defendant) which went to the substance of the matter.[5]

### B. ASSESSING THE APPLICABILITY OF ARTICLE 13 AS A PRELIMINARY MEASURE MAY DELAY THE ISSUANCE OF THE REPORT

12. In the same vein, it can be noted that hearing evidence and considering arguments on the applicability of Article 13 would inevitably require a considerable amount of time, as will hearing and assessing the arguments and evidence on the other issues which could only be considered after the preliminary decision on Article 13 was taken. Given the substantial number of claims brought, their complex nature, and the substantial interest in this dispute from third parties, the Panel may, if it splits up the dispute into three stages, have problems issuing its report within nine months, as it is required to do under the Article 12.9 DSU.

13. The European Communities also has some sympathy for the concerns set out by Brazil, in section V of its Initial Submission, as to the effect of splitting the procedure on Brazil's ability to present its case.

### C. THIRD PARTY DUE PROCESS RIGHTS MAY BE INFRINGED BY A DECISION TO SPLIT THE PROCEDURE INTO THREE STAGES

14. As the Panel is aware, Article 10.3 DSU provides that third parties are entitled to receive the submissions of the parties to the first meeting with the Panel. If the first panel meeting is limited to considering the applicability of Article 13 of the *Agreement on Agriculture* and thus parties submissions are limited to that question, the third parties will not have an opportunity to be heard on issues other than Article 13 of the *Agreement on Agriculture*. If the Panel decides to adopt a three stage procedure, in order to avoid such a situation arising, the European Communities respectfully submits that the Panel should make provision to ensure that third parties have adequate access, and the opportunity to be heard on all matters (that is, also in the third stage of procedures). Inevitably,

[5] Panel report, *United States – Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001, para. 8.2.

however, setting up such a procedure will involve additional work for both the Panel and the Secretariat.

## IV. CONCLUSION

15. In conclusion, the European Communities respectfully submits that, while the Panel is obliged to decide on the applicability of Article 13 of the *Agreement on Agriculture* before it may take a decision with respect to Brazil's claims under Article XVI GATT and the *SCM Agreement* it is not precluded from considering evidence or argument on these claims until after it has decided on the applicability of Article 13 of the *Agreement on Agriculture*. As the European Communities has explained above, there are several reasons militating in favour of the Panel considering all arguments and evidence simultaneously.

# ANNEX A-6

## INDIA'S COMMENTS ON PRELIMINARY ISSUE REGARDING THE PEACE CLAUSE OF THE AGREEMENT ON AGRICULTURE

10 June 2003

1. India thanks the panel for being provided an opportunity to comment on the submissions of Brazil and the United States on the following question concerning Article 13 of the Agreement on Agriculture posed by the Panel:

> *Whether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled.*[1]

2. India notes that both Brazil and the United States evidently agree that "exempt from actions" means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are in compliance with various provisions of the Peace Clause. In other words, a measure must be in conformity with: (a) provisions of Annex 2 of the Agreement on Agriculture in respect of green box domestic support measures; (b) provisions of Article 6 of the Agreement on Agriculture in respect of amber and blue box support measures; and (c) Part V of the Agreement on Agriculture as reflected in each member's Schedule in respect of export subsidies to attract the exemption from obtaining a remedy under the Peace Clause.

3. However the United States seems to argue in various paragraphs of its submission, including in paragraphs 7, 9 and 12, that this exemption extends to "any action, including action under the DSU, based on the corresponding provisions of the Subsidies Agreement and GATT 1994". The United States thereby suggests that resort cannot be had to the dispute settlement proceedings by asserting legal claims in respect of measures claimed by a Member to be Peace Clause protected.

4. Thus, on the question posed by the Panel, the United States is of the view that the Panel should organize its procedures to first determine whether Brazil may maintain any "action" based on provisions exempted by the Peace Clause. On the other hand, Brazil has asserted that the phrase "exempt from actions" in Article 13 of the Agreement on Agriculture does not compel the Panel to *first* make a Peace Clause finding before considering the substance of Brazil's other claims.

5. The United States seeks to interpret "action" to "include all stages of a dispute, including the "bringing [of] a case," consultations, and panel proceedings." Subsequently, the United States suggests a reading of "exempt from actions" in Article 13 to mean "not subject to" the "taking of legal steps to establish a claim" or "not resorting to dispute settlement by asserting legal claims".

6. In India's view, if the interpretation of "exempt from actions" under Article 13 of the Agreement on Agriculture, as sought by the United States, extends to exemption from "any action"

[1] The Panel also "invites the parties to explain their interpretation of the words 'exempt from actions' as used in Article 13 of the Agreement on Agriculture, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue."

such that resorting to dispute settlement by asserting legal claims is precluded in respect of Peace Clause protected measures, then consequences follow that have systemic implications. This interpretation would result in countries being precluded from even resorting to the dispute settlement process in respect of measures claimed by the country to be complained against to be conforming to the Peace Clause unless there is a prior finding on the lack of conformity of the measure with the Peace Clause. This interpretation of "exempt from actions" taken to its logical end would imply that even consultations under the DSU cannot be sought in respect of such a measure, unless there is a prior finding on non-conformity of the measure with the Peace Clause. A complaining country would therefore have to resort to the dispute settlement process twice in respect of the same measure; first, for obtaining a finding whether the measure is in conformity with the Peace Clause and, if not, then whether the measure is in conformity with obligations under various WTO Agreements. In India's view this result is neither desirable nor envisaged under the DSU or any other covered agreements.

7. India believes that neither the phrase "exempt from actions" nor Article 13 of the Agreement on Agriculture compel the Panel to *first* make a peace clause finding before considering the substance of Brazil's claims in various issues in this dispute. India is of the view that Article 13 of the Agreement on Agriculture is not a "special and additional" rule set out in Appendix 2 to the DSU. Article 19 of the Agreement on Agriculture makes all DSU provisions applicable to the Agreement on Agriculture. Thus there is no legal basis under the DSU or any of the covered agreements that would support the two stage approach suggested by the United States in this dispute whereby the Panel would first make a Peace Clause finding before considering claims on other agreements.

8. In conclusion, India believes that the phrase "exempt from actions" when viewed in the context of DSU provisions *does not require* the Panel to *first* make a Peace Clause non-compliance finding before hearing or considering any of the evidence or arguments relating to the various claims under other agreements.

# ANNEX A-7

## THIRD PARTY COMMENTS BY NEW ZEALAND ON PRELIMINARY ISSUE REGARDING ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE ("THE PEACE CLAUSE")

10 June 2003

New Zealand welcomes the opportunity to comment on the preliminary issue addressed in the Panel's 28 May 2003 request:

> "Whether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion of the Panel that certain conditions of Article 13 remain unfulfilled …"

In New Zealand's view, a Panel is not required to make any prior conclusion concerning the applicability of Article 13 (the "Peace Clause") before proceeding to hear evidence and submissions relating to substance of legal claims brought under the Agreement on Subsidies and Countervailing Measures (ASCM) and GATT Article XVI. New Zealand notes in this regard that the overlapping nature of the evidence required to establish both the applicability of the Peace Clause as well as actionable and prohibited subsidies claims would make a separation of submissions and hearings on each aspect artificial.

In relation to the Panel's request for views on the term "exempt from actions" in Article 13(b)(ii) and 13(c)(ii), New Zealand considers that these words simply mean that a Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are otherwise protected by the "Peace Clause". New Zealand does not consider that this phrase should be interpreted so as to suggest that substantive claims under the ASCM and GATT Article XVI can only be addressed in written or oral submissions after a Panel has made a ruling that the Peace Clause apply.

In summary, New Zealand considers that the Panel is not precluded from hearing evidence and considering claims under the Agreement on Subsidies and Countervailing Measures or Article XVI of the GATT without first concluding that Peace Clause conditions remain unfulfilled.

# ANNEX A-8

## SUBMISSION OF PARAGUAY
## COMMENTS ON THE "PEACE CLAUSE"

10 June 2003

Paraguay does not see how, under the provisions of the Dispute Settlement Understanding (DSU), the Panel can establish that a matter calls for a "preliminary and special ruling" when the DSU does not provide for such a procedure.

If this were so, many complaints would be subject to the prior demonstration of the existence of the conditions for bringing the action, when in fact, what needs to be resolved is the main subject of the dispute and the effects caused by the failure to comply with the rules and regulations of world trade.

Paraguay considers that to set a precedent of this kind would be to undermine the DSU's purpose of providing a flexible and prompt dispute settlement procedure, since countries would be faced with an unnecessary delay in the process involving costs and time beyond their "predictions".

Since there is no established procedural rule in this respect, the Panel must proceed to the analysis of the substantive issue, and permit the parties, in this case especially Brazil as complainant – and by extension Paraguay – to demonstrate that the subsidies and support measures benefiting upland cotton have effects on trade and production by the cotton industry in the world.

Paraguay has a supreme interest in ensuring the application of strict justice with respect to this complaint, since cotton production is the sustenance of the poorest segments of its population. Indeed, 70 per cent of the country's small farmers depend on cotton production for their living.

As already stated in the past, of Paraguay's population of approximately 5,300,000, some 150,000 families work in cotton production, and the damage caused by the kinds of subsidies and support measures at issue in this case have caused an exodus of this rural population to urban areas with no relief or solution in sight, further aggravating the country's economic situation.

In view of the above, Paraguay considers that since Article XIII is not a rule forming part of the procedural system established by the DSU, a preliminary ruling by the Panel on the "Peace Clause" would be inappropriate.

# ANNEX A-9

BRAZIL'S COMMENTS ON THE BRIEFS BY THE UNITED STATES AND THE THIRD PARTIES ON CERTAIN PRELIMINARY ISSUES REGARDING THE "PEACE CLAUSE" OF THE AGREEMENT ON AGRICULTURE

13 June 2003

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## I. INTRODUCTION

1. Brazil welcomes the opportunity to provide its comments regarding the third party submissions of Argentina, Australia, the European Communities, India, New Zealand, and Paraguay filed on 10 June 2003, and to respond to the *Initial Brief of the United States of America on the Questions Posed by the Panel (US Initial Brief),* filed on 5 June 2003.

## II. THE US TEXTUAL AND CONTEXTUAL ARGUMENTS CONCERNING "EXEMPT FROM ACTIONS" ARE INCONSISTENT WITH THE MULTILATERAL NATURE OF "ACTIONS" UNDER THE DSU AND WITH US CONDUCT IN THIS DISPUTE

2. The customary rules of interpretation of public international law do not support the United States' reading of Article 13 of the Agreement on Agriculture (AoA). The United States relies on a legal dictionary for a definition of "action" and then concludes incorrectly that "action" means any "proceeding in a court of justice" including any "legal steps to establish a claim".[1] This interpretation misreads Article 13 because it starts from fundamentally mistaken premises.

3. A WTO panel is not a "court" because the WTO panel process is founded on, and guided by, *collective* action by the Members. A lawsuit in a US or Brazilian court of law starts automatically when a plaintiff takes the "action" of filing papers that are in the proper form. But a DSU panel proceeding commences only when the Members of the WTO take *collective* "action" to establish the panel. The DSU rules "elaborate and apply"[2] the rules in GATT Article XXIII:2, which speak of an investigation by the CONTRACTING PARTIES – which under GATT Article XXV:1 are all the contracting parties "acting jointly". Whereas a US or Brazilian judge has broad powers conferred on him or her constitutionally, a WTO panel is a body of limited jurisdiction acting only with powers delegated to it by the DSB. For example, defending parties challenge claims as going beyond the terms of reference under DSU 6.2, because the terms of reference define the limits of the powers delegated to the panel by the DSB through the DSB's action to establish the panel.

4. The "negative consensus" provisions in DSU Article 16.4 further support Brazil's position that "action" in AoA Article 13 must be interpreted as *joint* action by WTO Members. Decisions of a court are directly and immediately binding on the parties to the litigation, but such is not the case for decisions of a panel or the Appellate Body. Instead, the drafters of the DSU decided that the Members acting jointly would retain ultimate control of whether a panel or Appellate Body report has any binding effect. Similarly, the recommendations and rulings referred to in DSU Articles 21 and 22 are not recommendations and rulings of a panel or the Appellate Body, but are recommendations and rulings of the DSB. Accordingly, DSU 21.7 refers to *further* actions that the DSB must consider when a matter (not an "action") has been raised by a developing country.

5. The United States misinterprets DSU Article 3.7.[3] In this provision ("Before bringing a case, a Member shall exercise its judgment as to whether action under these procedures would be fruitful"), "actions" could and should be read in a *collective* context, as referring to the DSB's *action* to adopt a panel report and (if need be) to authorize suspension of concessions. DSU Article 3.7 transposed a provision in the 1979 Understanding Regarding Notification, Dispute Settlement and Surveillance[4]

[1] US Initial Brief, para. 7.

[2] AoA Article 19: provides that "The provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding, shall apply to consultations and the settlement of disputes under this Agreement."

[3] US Initial Brief, para. 8.

[4] Adopted on 28 November 1979; BISD 26S/210. The full text is set out in the GATT Analytical Index (6th Ed., 1995) at page 632. DSU Article 3.7 transposes paragraph 4 of the Agreed Description of the

which refers to "action under Article XXIII:2." As discussed in Brazil's Initial Brief, such "action" has always meant *joint* action by the CONTRACTING PARTIES, not individual action by a particular contracting party. Article 3.7 simply restates the common-sense advice that litigants must consider in advance whether the persuasive effect of a collective determination of rule violation and a collective authorization of suspension of concessions would be useful in eliminating the concrete problem. It cannot be read to suggest that any Member should be able to pressure another into dropping a valid legal claim by arguing that enforcing rights through litigation is not "fruitful."

6. The United States also misinterprets DSU Article 4.5 ("before resorting to further action under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter.").[5] Read correctly, DSU Article 4.5 simply refers to the "action" of the DSB to grant a request for establishment of a panel.[6] Thus, Article 4.5 urges a Member to attempt to obtain satisfactory adjustment of the "matter" (not the "action") before it requests the DSB to take action to establish a panel.

7. The United States also cites footnote 35 of the SCM Agreement ("The provisions of Parts III and V *shall not be invoked* regarding measures considered non-actionable in accordance with the provisions of Part IV.").[7] Yet "shall not be invoked" is a different legal standard that goes substantially farther than "shall be . . . exempt from actions." Under footnote 35, no DSB authorization could be obtained to establish a panel against a non-actionable subsidy granted by another Member. By contrast, AoA Article 13 exempts certain agricultural subsidies from actions by the DSB adopting a panel or Appellate Body report or authorizing suspension of concessions, but only *under certain conditions*. The DSB can only take "actions" against such subsidies if it decides that those conditions are unfulfilled (based on the recommendations in the report of the panel and/or Appellate Body). But this *conditionality* means that a panel must address the conditions of the peace clause if they are invoked by the Member providing the domestic support – as the United States appears to have indicated it will do in this dispute. If the drafters had intended to protect agricultural subsidies against even an *invocation* of Part II and III of the SCM Agreement, they would have said so, and they did not.

8. The United States argues in paragraph 9 that its subsidies are even "exempt" from consultations under the DSU. Paragraph 9 highlights the logical challenges presented by the US argument—particularly in light of the fact, discussed below, that Article 13 does not create *any* exception to the normal rules of WTO dispute settlement.

9. Moreover, the United States' own conduct in this dispute is at odds with paragraph 9 of the US brief. Brazil's consultation request dated 3 October 2002 clearly stated that "the United States has no basis to assert a defence under Article 13(b)(ii) . . . [and] Article 13(c)(ii) of the Agreement on Agriculture . . ".[8] Yet, the United States said nothing during three rounds of consultations about any requirement for a separate panel proceeding regarding the peace clause. Brazil's panel request also referred to the lack of any basis for the United States to assert a peace clause "defence".[9] The DSB minutes reflect that the United States did not mention the peace clause at all in the meetings of the

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Customary Practice of the GATT in the Field of Dispute Settlement (Article XXIII:2) annexed to the 1979 Understanding; paragraph 4 appears on page 635.

[5] US Initial Brief, para. 8.

[6] DSU Article 4.5 was a transposition of paragraph 4 in the Agreed Description of the Customary Practice of the GATT in the Field of Dispute Settlement annexed to the (Tokyo Round) Understanding Regarding Notification (BISD 26S/210; The full text is set out in the GATT Analytical Index on page 635). That provision refers to "action under Article XXIII:2." As discussed by Brazil, such "actions" are multilateral actions by the CONTRACTING PARTIES, not individual action by a particular contracting party.

[7] US Initial Brief, para. 9.

[8] WT/DS267/1 at 3.

[9] WT/DS267/7.

DSB that considered the panel request.[10] The first official US assertion regarding special procedural requirements relating to the peace clause did not come until a meeting in the office of the Director of the Legal Services Division, on 25 March 2003, one week after the Panel was established on 18 March 2003.

10. In considering the US request for a special "peace clause" proceeding, the Panel should take note that the panel and Appellate Body in the *US - FSC* dispute rejected US procedural claims of an allegedly defective EC consultation request. In that dispute the United States engaged in three rounds of consultations without mentioning the problem once and then attempted to raise the defect consultations request as a preliminary objection to the panel. The panel and the Appellate Body both rejected the objection. As the Appellate Body found:

> It seems to us that, by engaging in consultations on three separate occasions, and not even raising its objections in the two DSB meetings at which the request for establishment of a panel was on the agenda, the United States acted as if it had accepted the establishment of the Panel in this dispute, as well as the consultations preceding such establishment. In these circumstances, the United States cannot now, in our view, assert that the European Communities' claims under Article 3 of the *SCM Agreement* should have been dismissed and that the Panel's findings on these issues should be reversed.[11]

11. In this dispute, the United States sat mute on the subject of peace clause procedures through three rounds of consultations and two DSB meetings. Had the United States raised this particular procedural issue on a timely basis, other WTO Members may have reserved their rights under DSU Article 10. To permit such an issue to be raised on such an untimely basis also denies those other Members their rights under the DSU.

## III. THE NARROW INTERPRETATION OF THE WORD "ACTION" SUGGESTED BY THE UNITED STATES IS NOT SUPPORTED BY ALL THREE AUTHENTIC VERSIONS OF THE AOA

12. As argued in Brazil's Initial Brief of 5 June , Brazil believes that the word action refers to collective actions of the WTO Members, and not to actions by individual Members. Brazil further submits that the meaning the United States tries to impute to the word "action" is too narrow and inadequate.

13. Brazil recalls that the three versions of the WTO Agreements are authentic. The US interprets the word "action" in the English version as "legal process or suit". Brazil agrees that this is a possible meaning of the word, but so is "the process or condition of acting or doing"; or "a thing done, a deed, an act...; habitual or ordinary deeds".[12] Therefore, the word action in the English language could mean either a legal process or a simple act or deed.

14. The French version uses the word "action" which also allows both connotations. It could have the ordinary connotation of: "ce que fait qqn et par quoi il réalise une intention ou un impulsion;" "exercice de la faculté d'agir;" but it could also have the more specific meaning of the "exercice d'un droit en justice".[13]

[10] WT/DSB/M/143, WT/DSB/M/145.
[11] WT/DS108/AB/R, "United States – Tax Treatment for "Foreign Sales Corporations", para. 165.
[12] The New Shorter Oxford English Dictionary, 1993 edition.
[13] Le Petit Robert, Nouvelle édition ... 1982.

15. The Spanish version however does not allow such interpretative flexibility. The word used in Article 13 is not the word "acción", which would allow the arguable double meaning of the English and French versions: "resultado de hacer" or "*[e]n sentido procesal*, derecho a acudir a un juez o tribunal ..."[14] (emphasis added). The word used in Article 13 of the Spanish version is "medidas." While "medidas" could mean "disposición, prevención ... tomar, adoptar medidas"[15], it could not possibly have the connotation of a legal action. Again, while the dictionary meanings of the word "acción" do include the possibility of a judicial measure, the same is not true for the word "medidas".

16. Therefore, the Panel must avoid an interpretation of Article 13 that is possible in only two of the authentic versions, while there is another plausible – and in fact more adequate – interpretation that is equally possible in all three authentic versions. The Panel must accordingly reject the narrow interpretation suggested by the United States for the word "action".

## IV. THE OVERLY-BROAD US DEFINITION OF "EXEMPT FROM ACTION" IMPROPERLY CREATES NEW OBLIGATIONS AND PROCEDURES NOT CONTEMPLATED IN THE AOA OR THE DSU

17. The United States argues that the word "action" means "all stages of the dispute, including the 'bringing [of] a case,' consultations, and panel proceedings".[16] Brazil agrees with the arguments advanced by Argentina[17], the European Communities[18] and India[19] that this broad US interpretation would exempt measures allegedly covered by the "peace clause" exemption from any aspect of the DSU, including consultations. As India and the European Communities correctly point out, the result would logically lead to two separate panel proceedings – an initial proceeding deciding the peace clause issues, and after the issuance of a decision, the initiation of a second proceeding beginning with consultations to challenge the measures under the ASCM.[20] Yet, as these and other third parties highlight, there is no textual requirement or provision in the AoA, the DSU, or any other WTO provision for such a two-panel or two-stage process to resolve peace clause issues.

## V. THE US PROPOSAL FOR A SEPARATE PROCEEDING FOR PEACE CLAUSE ISSUES WOULD EFFECTIVELY ADD AOA ARTICLE 13 TO THE CLOSED LIST OF SPECIAL AND ADDITIONAL PROVISIONS IN DSU APPENDIX 2 AND GIVE AOA ARTICLE 13 A SCOPE THAT WAS NOT INTENDED BY AOA DRAFTERS

18. The United States' initial brief makes no reference to DSU Appendix 2, even though this provision was a key issue raised in Brazil's 23 May letter to the Panel. Brazil repeats that Appendix 2 provides a closed list of all the "special and additional" provisions that trump the normal rules of dispute settlement under the DSU. Article 13 does not appear in Appendix 2. Set forth below are two additional reasons in support of this argument.

19. First, providing a special proceeding for determining peace clause defences would effectively add Article 13 to DSU Appendix 2. In the first dispute settlement proceeding on *Guatemala Cement*, the panel found that Article 17 of the *Anti-Dumping Agreement* (ADA) replaced the DSU system as a whole because ADA Articles 17.4-17.7 were listed as special and additional provisions in Appendix 2

[14] Diccionario de la Lengua Española (Real Academia Española), vigésima segunda edición, 2001.
[15] *Id.*
[16] US Initial Brief para. 8.
[17] Argentina's Third Party Initial Brief, para. 6;
[18] Initial Submission by the European Communities, paras. 6-7;
[19] India's comments on preliminary issue regarding the Peace Clause of the Agreement on Agriculture, para. 6.
[20] Initial Submission by the European Communities, paras. 6-7; India's comments on preliminary issue regarding the Peace Clause of the Agreement on Agriculture, para. 6.

even though ADA Articles 17.1-17.3 were not included.[21] The Appellate Body reversed the panel's implied determination to treat ADA Articles 17.1-17.3 as special and additional rules when it found that DSU provisions generally do not apply to disputes brought pursuant to the ADA:

> Article 17.3 of the *Anti-Dumping Agreement* is not listed in Appendix 2 of the DSU as a special or additional rule and procedure. It is not listed precisely because it provides the legal basis for consultations to be requested by a complaining Member under the *Anti-Dumping Agreement.*[22]
>
> The special or additional provisions listed in Appendix 2 of the DSU are designed to deal with the particularities of dispute settlement relating to obligations arising under a specific covered agreement, while Article 1 of the DSU seeks to establish an integrated and comprehensive dispute settlement system for all of the covered agreements of the *WTO Agreements* as a whole. . . [23]

20. The effect of the United States argument and interpretation of "action" in this case would be to include AoA Article 13 as a special and additional rule in Appendix 2. Were the Panel to agree with the United States, it would create a precedent for applying a special procedure whenever a peace clause defence might be invoked. However, this is precisely what the Appellate Body rejected in *Guatemala Cement,* emphasizing that the WTO's dispute settlement system is a *unified* system, not one fragmented according to topic.[24]

21. Second, the negotiating history confirms that AoA Article 13 was not intended to alter normal dispute settlement procedures. The concept of "due restraint" first appeared in Article 18.2 of the Agriculture text in the Dunkel Draft of December 1991, which provided:

> On the basis of the commitments undertaken in the framework of this Agreement, Members will exercise due restraint in the application of their rights under the General Agreement in relation to products included in the reform programme.[25]

The concept of special and additional provisions and Appendix 2 then emerged during the work of the Legal Drafting Group on dispute settlement in Spring 1992. The final Legal Drafting Group DSU text dated 15 June 1992 included AoA Article 18.2 in its Appendix 2, as a special and additional provision.[26]

22. The United States and the EC then reached the Blair House Agreements in November 1992, providing *inter alia* for the Dunkel Draft text of Article 18.2 to be deleted, and for the insertion in the AoA of a text corresponding to the present Article 13. In the fall of 1993, the Institutions Group discussed both institutions and dispute settlement; the DSU text resulting from its work, as circulated on 15 November 1993, placed AoA Article 18.2 in brackets.[27]

23. During this period, further discussions also took place on the AoA. After a US-EU settlement in early December 1993 adjusting the Blair House deal, the Blair House changes as adjusted were

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[21] *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/R,
[22] WT/DS60/AB/R, para. 64.
[23] *Id.*, para. 66.
[24] *Id.*, para. 67.
[25] MTN/TNC/W/FA, 20 December 1991, page L.11.
[26] Brazil Exhibit 1 (hereinafter Brazil will refer to its exhibits as "Exhibit Bra-1, 2 , 3 etc.") Excerpt of *Draft Understanding on Rules and Procedures Governing the Settlement of Disputes*, Job No. 968, 15 June 1992.
[27] Exhibit Bra-2. Excerpt of *Draft Understanding on Rules and Procedures Governing the Settlement of Disputes*, 15 November 1993.

made to the AoA. In the December 15, 1993 Final Act, the text of the AoA reflected those changes [28], and Appendix 2 of the DSU[29] included no reference to the AoA. The negotiating record thus confirms that if negotiators had intended to include the peace clause in Appendix 2, they had ample opportunity to do so. The changes in the "peace clause" component of the Blair House agreements involved deleting former Article 18.2, which *was* a dispute settlement provision listed in Appendix 2, and substituting Article 13. However, although Article 13 limits the ultimate "action" that the DSB may take, as a drafting matter it is *not* placed together with the dispute settlement provisions of the AoA, it is not labeled as a dispute settlement provision, and it is not included in Appendix 2 of the DSU. Reading Article 13 as the United States requests would be inconsistent with DSU Article 3.2 by impermissibly altering the balance of rights and obligations in the WTO and its dispute settlement procedures.

24. Furthermore, AoA Article 13 deliberately makes no reference to any provisions relating to dispute settlement under the Agreement on Agriculture itself (Article 19) or other relevant WTO Agreements (ASCM Articles 4 and 7; DSU or GATT 1994 Articles XXII and XXIII). The AoA Article 13 drafting denotes that Uruguay Round negotiators were concerned about the relationship between substantive provisions of the SCM Agreement (Articles 3, 5 and 6) and GATT 1994 (Article XVI) and the substantive provisions on domestic support and export subsidies under the AoA. In short, what Article 13 does is to protect Members that comply with Article 13 conditions from actions derived from a violation of the substantive provisions cited therein, namely ASCM Articles 3, 5 and 6 and GATT 1994 Article XVI. What Article 13 does not, given the way it was drafted, is to shield Members from the dispute settlement procedures which would be necessary to identify or to confirm the substantive violation of those Articles.

25. Had the AoA drafters intended to carve domestic support and/or export subsidy measures out of the WTO dispute settlement mechanism they would have done it expressly, but they did not. This is further confirmed by the example of Article 6 of the TRIPS Agreement, which clearly states that the issue of the exhaustion of intellectual property rights cannot be addressed through dispute settlement.[30] Unlike AoA Article 13, TRIPS Article 6 expressly prohibits a Member from resorting to the WTO dispute settlement mechanism to challenge certain matters. Against all these evident facts, the only argument the US has to read a prohibition to resort to dispute settlement into Article 13 is based on a groundless definition of "action", as shown above.

## VI. A SPECIAL PEACE CLAUSE PROCEDURE WOULD AMOUNT TO HAVING THE PANEL ISSUE A DECLARATORY JUDGMENT FOR THE US AFFIRMATIVE DEFENCE

26. Brazil's request for the establishment of a panel (as well as its consultation request) stated that the "United States has no basis to assert a defence under Article 13(b)(ii) . . . and Article 13(c)(ii) of the Agreement on Agriculture . . .".[31] The third-party statements of the European Communities, Australia, and Argentina agree with Brazil's description of the peace clause as a "defence". Each of these third parties agree that the United States is required to assert and prove that all the peace clause conditions apply. For example, the European Communities stated that AoA Article 13

> can only be seen as a defence against a claim brought under other aspects of the WTO Agreements which regulate the provision of subsidies. It would seem bizarre if,

[28] MTN/FA II/A1A-3, Arts. 13, 19.

[29] MTN/FA II/A2, Appendix 2.

[30] TRIPs Article 6 reads: "*For the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.*"

[31] WT/DS267/7

> before Brazil could bring a claim with respect to subsidies which it considered did not respect the US's WTO obligations, Brazil had first to establish that potential US defences did not apply.[32]

27. In addition, Australia argues that "Article 13 is in the nature of an 'affirmative defence' for measures which are inconsistent with the specified provisions". [33] Argentina also takes the view that this provision is in the nature of an affirmative defence, stating that "the Member who alleges to be protected by the Peace Clause has the burden of proving the fulfillment of its legal requirement".[34]

28. The United States' Initial Brief alleges in paragraph 2 that "the US support measures at issue conform with the Peace Clause". Based on this allegation, the United States concludes that "Brazil cannot maintain any action – and the United States cannot be required to defend any such action. . ."[35] The United States has not labeled this as a defence, or an "affirmative defence". However, this assertion by the United States suggests its intent to invoke such a defence as part of its First Submission that it will file on 11 July 2003.[36]

29. Brazil agrees with the European Communities, Australia and Argentina that the peace clause is a defence requiring the United States – not Brazil – to demonstrate that it has met all of its conditions. Brazil also agrees with the European Communities that it would be bizarre if Brazil were required to establish that potential US defences did not apply before it could bring its own claims. And Brazil further agrees with the European Communities that what the United States is requesting in this dispute is effectively a "declaratory judgment" that the United States defences of the peace clause do or do not apply.

30. Brazil will present evidence in its First Submission that the US measures do not meet the conditions of the various peace clause provisions. Brazil will do this because the United States is on record before this Panel in asserting that its support measures are fully in compliance with the peace clause. However, Brazil is not required to present any evidence on the peace clause to assert its actionable and prohibited subsidy claims under the ASCM. Rather, this is the US burden defending against Brazil's various claims. The time and place for the Panel to hear and consider any evidence proffered by the US in any such defence is during the normal panel process, as Brazil has argued in this Comments, in its Initial Brief and in its letter dated 23 May 2003. There is no basis for the United States to demand, or for the Panel to grant, a declaratory judgment that the US peace clause defences are legitimate or not.

## VII. CONCLUSION

31. For the reasons set forth above, Brazil's Initial Brief and its letter dated 23 May 2003, Brazil requests that this Panel find that it is not precluded from hearing evidence and considering Brazil's claims under the ASCM or Article XVI of GATT 1994 without first concluding that the peace clause conditions of AoA Article 13(b)(ii) and 13(c)(ii) remain unfulfilled.

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[32] EC Initial Submisson, para. 6.
[33] Australia Initial Submission paras. 4-7.
[34] Argentina Initial Submission, para. 14.
[35] US Initial Brief, para. 2.
[36] By contrast, the United States did *not* invoke the peace clause defence in *US - FSC* even though the EC request for the establishment of a panel included claims under ASCM Article 3.1(a) with respect to export subsidies for agricultural products. AoA Article 13(c) conditionally exempts those claims from "actions."

# ANNEX A-10

## COMMENTS OF THE UNITED STATES ON THE COMMENTS BY BRAZIL AND THE THIRD PARTIES ON THE QUESTION POSED BY THE PANEL

13 June 2003

## I. OVERVIEW

1. The United States thanks the Panel for this opportunity to provide its views on the comments by Brazil and the third parties on the question concerning Article 13 of the *Agreement on Agriculture* ("Agriculture Agreement") posed by the Panel in its fax of 28 May 2003.[1] The interpretation of Article 13 (the "Peace Clause") advanced by Brazil and endorsed by some of the third parties is deeply flawed. Simply put, Brazil fails to read the Peace Clause according to the customary rules of interpretation of public international law. Its interpretation does not read the terms of the Peace Clause according to their ordinary meaning, ignores relevant context, and would lead to an absurd result.

2. Brazil reads the Peace Clause phrase "exempt from actions" to mean only that "a complaining Member cannot receive authorization from the DSB [Dispute Settlement Body] *to obtain a remedy* against another Member's domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the Agreement on Subsidies and Countervailing Measures . . . or Article XVI of GATT 1994'".[2] However, Brazil's reading simply ignores parts of the definition of "actions" that it quotes: "The dictionary definition of 'actions' is 'the *taking of legal steps* to *establish a claim* or obtain a remedy".[3] Thus, while the United States would agree that the phrase "exempt from actions" precludes "the taking of legal steps to . . . obtain a remedy", Brazil provides no explanation of why the term "exempt from actions" would not, based on its ordinary meaning, also preclude "the taking of legal steps to establish a claim".[4]

3. Brazil also bases its reading in part on the assertion that "[i]n a multilateral system such as the WTO (like GATT 1947 before it), 'actions' are taken collectively by Members".[5] Brazil cannot explain, however, why "actions" should be limited to *only* those actions taken collectively. Read in the context of provisions in the WTO agreements in which the term "action" does not refer to collective action by Members, "action" in the Peace Clause refers broadly to the "taking of legal steps to establish a claim or obtain a remedy".

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[1] The Panel asked the parties to address: "[W]hether Article 13 of the Agreement on Agriculture precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions in Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the Agreement on Agriculture, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue."

[2] Brazil's Brief on Preliminary Issue Regarding the "Peace Clause" of the Agreement on Agriculture, para. 2 (5 June 2003) ("Brazil's Initial Brief") (emphasis added).

[3] Brazil's Initial Brief, para. 6 (emphasis added).

[4] *See infra* part II.A.

[5] Brazil's Initial Brief, para. 6 (footnote omitted).

4. In addition, Brazil's suggested reading of the Peace Clause would lead to an absurd result. If the phrase "exempt from actions" means nothing more than that "a complaining Member cannot receive authorization from the DSB to obtain a remedy", then a panel would be perfectly free to make findings that a measure that conforms to the Peace Clause is inconsistent with the relevant provisions of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") or the *Agreement on Subsidies and Countervailing Measures* ("Subsidies Agreement"). Under the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), the DSB would be unable to avoid adopting the panel findings of inconsistency with the Subsidies Agreement or GATT 1994 or recommendations to bring the measure into conformity, thus depriving the Peace Clause of any meaning.

5. The remainder of Brazil's arguments do not go to a proper interpretation of the Peace Clause under the customary rules of interpretation of public international law and so do not assist in answering the question posed by the Panel concerning the Peace Clause. Nonetheless, the United States addresses various of these misplaced concerns. For example, Brazil argues that the Peace Clause is not a special or additional rule set out in Appendix 2 of the DSU; however, the Peace Clause need not be a special or additional rule because the Panel may properly deal with the Peace Clause issue under normal DSU rules. Brazil also tries to cite to unrelated issues in completely distinct disputes, arguing that some of these other panels have delayed making "complex threshold findings" until final panel reports. None of these panels is relevant since none of them has been presented with the issues presented by the Peace Clause. Brazil also asserts that consideration of alleged administrative burdens should override the plain meaning of the text of the Agriculture Agreement – an obviously erroneous approach.

6. As the United States explained in its initial brief on the Panel's question[6], the phrase "exempt from actions" (read in accordance with the customary rules of interpretation of public international law) means "not exposed or subject to" a "legal process or suit" or the "taking of legal steps to establish a claim". Therefore, Brazil cannot maintain any action – and the United States cannot be required to defend any such action – based on provisions specified in the Peace Clause since the US support measures for upland cotton conform to the Peace Clause.

7. In light of the correct interpretation of the Peace Clause, the United States affirms that it respectfully requests the Panel to organize its procedures to first determine whether Brazil may maintain any action based on provisions exempted by the Peace Clause. Bifurcation of the legal issues in this proceeding is not only required under the Peace Clause but, as an exercise of the Panel's discretion to organize its procedures, would assist the Panel in resolving the complex issues involved in this dispute in a logical and orderly fashion.

## II. BRAZIL'S INITIAL BRIEF DOES NOT READ THE PEACE CLAUSE ACCORDING TO THE CUSTOMARY RULES OF INTERPRETATION OF PUBLIC INTERNATIONAL LAW AND LEADS TO ABSURD RESULTS

### A. THE ORDINARY MEANING OF "EXEMPT FROM ACTIONS" DOES NOT SUPPORT BRAZIL'S READING

8. According to the customary rules of interpretation of public international law[7], the terms of the Peace Clause should be interpreted according to their ordinary meaning in their context, in light of

[6] Initial Brief of the United States of America on the Question Posed by the Panel, paras. 6-10 (5 June 2003) ("US Initial Brief").

[7] *See* DSU Article 3.2 (The dispute settlement system "serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law.").

the object and purpose of the Agriculture Agreement.[8] The United States agrees completely with Brazil in terms of the dictionary definition of "actions". Under that definition, "action" means "the *taking of legal steps to establish a claim* or obtain a remedy".[9] As the Panel's question has highlighted, one of the key issues in this dispute is whether the Peace Clause permits Brazil to "take legal steps" so Brazil can "establish" its Subsidies Agreement "claims".

9. Yet, as soon as Brazil provides the correct definition of "action", Brazil urges an approach that would ignore it. Combining this definition with that for the word "exempt"[10], Brazil reads the term "exempt from actions" to mean "that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are 'peace clause' protected".[11] Strikingly, neither Brazil nor any of the third parties who share this interpretation[12] provides any basis in the text of the Peace Clause for ignoring that portion of the definition of "actions" that refers to "the *taking of legal steps* to *establish a claim*".[13]

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[8] The customary rules of interpretation of public international law are reflected in part in Article 31(1) of the Vienna Convention, which reads: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

[9] Brazil's Initial Brief, para. 6 (emphasis added).

[10] Brazil has quoted the definition of the word "exempt" when used as a verb. *See The New Shorter Oxford English Dictionary*, vol. 1, at 878 (1993 ed.) (first definition as transitive verb: "Grant immunity or freedom from or *from* a liability to which others are subject") (italics in original). However, if used as a verb in the Peace Clause, the correct form of "exempt" would be "shall be *exempted* from actions." *See id.*, vol. 1, at 878 (examples for first definition of "exempt" as verb: "J. A. FROUDE Clergy who committed felony were no longer *exempted* from the penalties of their crimes. R. D. LAING I was *exempted* from military service because of asthma.") (italics added). As used in the Peace Clause in the construction "shall be . . . *exempt* from actions," "exempt" is an adjective. *See id.*, vol. 1, at 878 (examples of "exempt" as used in first definition as adjective: "R.C. TRENCH They whom Christ loves are no more *exempt* than others *from* their share of earthly trouble and anguish. J. BERGER He is *exempt* on medical grounds *from* military service.") (italics added). Therefore, the correct definition of "exempt" as used in the Peace Clause is "[n]ot exposed or subject to something unpleasant or inconvenient; not liable to a charge, tax, etc. (Foll. by *from, of*.)." *Id.*, vol. 1, at 878 (first definition as adjective) (italics in original).

[11] Brazil's Initial Brief, para. 9; *see id.*, para. 8.

[12] Regrettably, *none* of the third parties (save Australia) even attempts to read the Peace Clause – and in particular the phrase "exempt from actions" – according to the customary rules of interpretation of public international law. Australia does offer an interpretation of "exempt from actions based on" purportedly using the ordinary meaning of the terms, but it appears that Australia has interpreted "exempt from actions" merely by quoting a definition for " exempt." *Compare* Comments of Australia on Question Posed by Panel, para. 7 & n. 3, *with Black's Law Dictionary* at 593 (7th ed. 1999) (definition of "exempt" as adjective: "Free or released from a duty or liability to which others are held."). That is, Australia's interpretation ascribes no meaning to the words "from actions," reducing them to inutility. In addition to failing to provide any definition for "actions," Australia also fails to examine any context for that term in the DSU and the Subsidies Agreement. *See* US Initial Brief, paras. 7-10.

[13] Argentina reads "exempt from actions" as meaning that "a finding of inconsistency with Articles XVI of GATT 1994 or Articles 3, 5 and 6 of SCM Agreement will not be possible if the legal requirements for the exemption are fulfilled." Comments by Argentina on Question Posed by Panel, para. 5. However, in making this assertion, Argentina neither provides nor attempts to distinguish the ordinary meaning of "action" as the "taking of legal steps to establish a claim or obtain a remedy." Nor does Argentina explain why, if Members only meant to preclude "a finding of inconsistency" with specified provisions, they did not simply use the word "finding" – for example, "measures . . . shall be . . . exempt from findings based on" certain specified provisions – when the term "finding" is used at least 12 times in the DSU. *See, e.g.*, DSU Article 7.1 (standard panel terms of reference include "mak[ing] such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/those agreement(s)"); DSU Article 11 (panel should make an objective assessment of matter before it, including "such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements"); DSU

10. As the United States has demonstrated, the ordinary meaning of "action" encompasses not only the "taking of legal steps to . . . obtain a remedy" but also the "taking of legal steps to establish a claim". Other dictionary definitions of "action" – such as "the right to institute a legal process", "[a] legal process or suit", "a lawsuit brought in court", "a formal complaint", "a legal or formal demand of one's right", and "all the formal proceedings in a court of justice attendant upon the demand of a right made by one person of another in such court"[14] – provide additional support for this reading. Thus, while the United States agrees that the phrase "exempt from actions" would also preclude "the taking of legal steps to . . . obtain a remedy"[15], the United States disagrees with Brazil that one may ignore that "exempt from actions" also precludes "the taking of legal steps to establish a claim." Nothing in the text of the Peace Clause authorizes departing from the ordinary meaning of the Peace Clause phrase "exempt from actions" to narrow this text to refer *solely* to "obtaining a remedy".[16]

B. THE CONTEXT FOR "EXEMPT FROM ACTIONS" DOES NOT SUPPORT BRAZIL'S READING

11. In its analysis of the phrase "exempt from actions", Brazil quickly moves beyond the ordinary meaning of the term "action" it quotes (which encompasses "the taking of legal steps to establish a claim") to examine what it deems relevant context for the term. Brazil asserts that "[i]n a multilateral system such as the WTO (like GATT 1947 before it), 'actions' are taken collectively by Members"[17], citing DSU Article 2.1 (last sentence), GATT 1994 Article XVI:1, and DSU Article 22[18], and concludes: "In sum, 'actions' are multilaterally agreed decisions of WTO bodies including the DSB."[19] Brazil's argument overlooks the fact that there are numerous instances in various WTO agreements in which the term "action " is used to refer to action by an individual Member, not just collective action by Members.

12. Brazil notes that the term "actions" is sometimes used in the DSU to refer to collective "decisions or actions" by the DSB.[20] This observation is accurate, but the conclusion that Brazil draws from it is a *non sequitur*. The fact that the term "action" can mean "collective decision or action by the DSB" does not imply that the term "action" can mean *only* "collective decision or action by the DSB".

13. Brazil has moreover failed to consider those instances in which the term "action" is used to refer to individual action by Members.[21] For example, Article 3.7 of the DSU, which states that "[b]efore bringing a case, a Member shall exercise its judgement as to whether action under these

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Article 12.7 (panel "shall submit its findings in the form of a written report to the DSB"). There is no basis in the text or context of the Peace Clause to read "actions" to be limited to "panel findings".

[14] US Initial Brief, para. 7.

[15] Indeed, this necessarily follows from the fact that, if a party cannot take legal steps to establish a claim, it will also be precluded from obtaining a remedy.

[16] We also note that Brazil's approach of interpreting "exempt from actions" as "cannot receive authorization . . . to obtain a remedy" appears to overlook the "taking of legal steps" component of even the "remedy" portion of the definition of " action".

[17] Brazil's Initial Brief, para. 6 (footnote omitted).

[18] Brazil also asserts that "'[a]ctions' include decisions made by the Dispute Settlement Body (DSB) to adopt rulings and recommendations of panels and the Appellate Body" but provides no reference to a provision of the DSU to support the assertion. Neither DSU Article 16.4 (on adoption of panel reports) nor DSU Article 17.14 (on adoption of Appellate Body reports) uses the term "action" to describe a DSB decision to adopt panel and Appellate Body rulings and recommendations.

[19] Brazil's Initial Brief, para. 6.

[20] For example, Brazil quotes DSU Article 2.1, which states that "[w]here the DSB administers the dispute settlement provisions of a Plurilateral Trade Agreement, only those Members that are parties to that Agreement may participate in decisions or actions taken by the DSB with respect to that dispute."

[21] *See* US Initial Brief, paras. 8-9.

procedures would be fruitful," does not by its terms refer to "multilaterally agreed decisions of WTO bodies including the DSB". Similarly, Article 4.5 of the DSU states: "*In the course of consultations* in accordance with the provisions of a covered agreement, before resorting to *further action* under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter" (emphasis added). In the Subsidies Agreement, subsidies are divided into prohibited, actionable, and non-actionable categories, and a Member may impose countervailing duties against prohibited and "actionable" subsidies without first obtaining authorization through a "multilaterally agreed decision[] of WTO bodies including the DSB".[22] Brazil's interpretation is at odds with all of these provisions – for example, since during consultations the DSB will not have taken *any* action with respect to a dispute, how could a Member attempt to settle a matter before resorting to *further* action? These provisions make clear that, read in the context of the DSU and the Subsidies Agreement, "actions" has a broader scope than Brazil would like: as indicated by its ordinary meaning, "actions " refers to "the taking of legal steps to establish a claim or obtain a remedy," encompassing all stages of a dispute – obtaining DSB authorization for retaliation would only constitute one, final step.[23]

14. Indeed, had Members intended the scope of the Peace Clause to be limited solely to collective decisions taken by the DSB, they could have used in the Peace Clause the same construction as used in DSU Article 2.1 – for example, "measures . . . shall be . . . exempt from actions taken by the DSB based on" specified provisions. Members did not do so, however.

15. Finally, the United States notes that Brazil has asserted that GATT 1994 Article XVI:1 and DSU Article 22 provide relevant context for the term "actions". However, neither of these provisions uses the term "action" at all[24], and they do not support Brazil's assertion that "actions" in the Peace Clause must be read to refer solely to "multilaterally agreed decisions of WTO bodies including the DSB." Similarly, Brazil refers to GATT 1994 Article XXV, entitled "Joint Action by the Contracting Parties." The fact that the drafters referred to this one kind of "action" as *joint* action only reinforces that the term "action" by itself is not intended to be limited to *only* "joint" or "collective" action. The phrase "contracting parties acting jointly" in Article XXV would be unnecessary if Brazil's interpretation of "action" were correct.[25]

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[22] Members are obligated to "take all necessary steps to ensure that the imposition of a countervailing duty on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement." Subsidies Agreement, Article 10 (footnote omitted). *See also* GATT 1994 Article VI:6 (requiring multilateral approval of certain exceptional anti-dumping and countervailing duties).

[23] We note that Argentina implicitly concedes that relevant context in the Subsidies Agreement for the phrase "exempt from actions" suggests that the term is not limited to decisions or actions taken by the DSB. Argentina recognizes that "[i]t is true that Article 7 of the SCM Agreement states that the request of consultations is subject to Article 13 of the AoA". Argentina's Third Party Initial Brief, para. 13. This would appear to contradict its reading of "the word 'actions' in the context of Article 13 of the AoA [as] refer[ring] to decisions of WTO competent bodies, such as the DSB when it discharges its duties by establishing a panel," *id.*, para. 6. That is, if the Peace Clause precludes a request for consultations by a Member under Article 7 of the Subsidies Agreement, the term "actions" in the Peace Clause cannot solely refer to "decisions of WTO competent bodies".

[24] *See, e.g.*, GATT 1994 Article XVI:1 ("In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or contracting parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization."); DSU Article 22.6 ("When the situation described in paragraph 2 occurs, the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request.").

[25] *See* GATT 1994 Article XXV ("Wherever reference is made in this Agreement to the contracting parties acting jointly they are designated as the CONTRACTING PARTIES. ").

C. BRAZIL'S INTERPRETATION OF THE PEACE CLAUSE WOULD LEAD TO ABSURD RESULTS

16. Brazil's suggested reading of the Peace Clause would rob this provision of any real meaning. Brazil would expose measures that conform to the Peace Clause to finding of inconsistency with the relevant GATT 1994 and Subsidies Agreement provisions and would expose them to retaliation *unless* the complaining party were to agree *not* to adopt the findings or authorize retaliation.

17. Under Brazil's interpretation, the phrase "exempt from actions" means only that "a complaining Member cannot receive authorization from the DSB to obtain a remedy" – that is, the Peace Clause would exempt conforming measures from actions taken by the DSB to authorize remedies but not from findings by the Panel. A panel would therefore be perfectly free to make findings in its final report that a challenged measure that conforms to the Peace Clause is inconsistent with, *inter alia*, the Subsidies Agreement. Under the DSU, the DSB would be unable to avoid adopting the panel findings of inconsistency with the relevant GATT 1994 or Subsidies Agreement provisions or recommendations to bring the measure into conformity.[26] Panel reports are adopted automatically by the DSB under the "negative consensus" rule[27] and authorization to retaliate is also automatically given unless the DSB decides by consensus against this.[28] As a result, the DSB could not decline to adopt the report or authorize remedies unless the complaining party agreed. Thus, under Brazil's reading, the phrase "measures . . . shall be . . . exempt from actions" in the Peace Clause would exempt conforming measures from DSB authorization to retaliate, but *only if* the complaining Member itself agreed not to authorize a remedy. This would be a strange and strained interpretation of the Peace Clause indeed and would effectively render it inutile, contrary to customary rules of treaty interpretation.

18. This absurd result would also conflict with the object and purpose of the Peace Clause and the Agriculture Agreement: namely, to exempt agricultural subsidies, under certain conditions, from the subsidies disciplines of the Subsidies Agreement and GATT 1994 while Members continue negotiations to move towards the "long-term objective . . . to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time".[29] Brazil also has not explained why, on its reading, Members would have chosen to allow actions, with all of their attendant burden on Members' (and the WTO's) resources, up to but not including authorization for retaliation.

[26] Under DSU Article 19, "[w]here a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement." DSU Article 19 (emphasis added) (footnote omitted).

[27] Under DSU Article 16, a panel report "shall be adopted at a DSB meeting unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report". DSU Article 16.4 (footnote omitted).

[28] When a Member "fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings" and compensation cannot be agreed, the complaining party Member may request authorization from the DSB to suspend concessions, DSU Article 22.2, and "the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request", DSU Article 22.6.

[29] Agriculture Agreement, preamble (third paragraph).

## III. BRAZIL'S INITIAL BRIEF RAISES A NUMBER OF MISGUIDED CONCERNS WHICH CANNOT UPSET THE BALANCE OF RIGHTS AND OBLIGATIONS OF MEMBERS UNDER THE PEACE CLAUSE AND DO NOT SUPPORT CONSIDERING BOTH THE APPLICABILITY OF THE PEACE CLAUSE AND BRAZIL'S SUBSTANTIVE CLAIMS TOGETHER

19. Brazil has advanced a number of other arguments, which relate neither to the ordinary meaning and context of the phrase "exempt from actions" nor to the object and purpose of the Peace Clause and the *Agreement on Agriculture*. These arguments are thus not relevant to the Panel's task of clarifying the meaning of the Peace Clause in accordance with customary rules of interpretation of public international law. Nonetheless, an examination of each of Brazil's arguments reveals that none of these concerns is well-founded.

### A. THE PANEL MAY EXAMINE THE APPLICABILITY OF THE PEACE CLAUSE UNDER NORMAL DSU RULES

20. Brazil argues that because Article 13 is not a special or additional rule set out in Appendix 2 of the DSU, Peace Clause issues must be resolved using normal DSU rules and procedures, which Brazil believes would prohibit reaching the Peace Clause issue first. Brazil errs on two counts. There was no need to designate Article 13 of the Agriculture Agreement as a special or additional rule *precisely because* the Panel may properly deal with the Peace Clause issue using the flexibility inherent in the normal DSU rules. The DSU, in Articles 12.1 and 12.2, provides the Panel with all the authority it needs to organize its working procedures as it considers best to resolve the matter in dispute.[30] Under DSU Article 12.1, the Panel is given the authority to determine its own working procedures "after consulting the parties to the dispute".[31] Under DSU Article 12.2, moreover, the Panel is charged with establishing panel procedures with "sufficient flexibility so as to ensure high-quality panel reports".[32]

21. Brazil itself has conceded the Panel's broad authority to establish its procedures in its letter of 23 May 2003, when it wrote of objections relating to the scope of a panel request under DSU Article 6.2: "The decision on how to handle such preliminary objections procedurally *is a matter of panel discretion*".[33] Thus, Brazil implicitly recognizes that the Panel already has the flexibility and the authority under normal DSU rules to organize its procedures to consider and dispose of the Peace Clause issue first. There is no need for the Peace Clause to be listed as a "special or additional rule and procedure" in DSU Appendix 2 because under normal DSU rules the Panel may bifurcate the proceedings in order to respect the balance of rights and obligations of Members under the Peace Clause and the Agriculture Agreement – that is, to ensure that conforming US measures are "exempt from actions based on" provisions specified in the Peace Clause.

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[30] *See* Comments by the European Communities on certain issues raised on an initial basis by the Panel, para. 8 ("In conclusion, the Panel has substantial discretion in deciding how it will manage these issues. Article 12.1 DSU makes it quite clear that the Working Procedures set out in Appendix 3 of the DSU may be departed from if the Panel decides this is appropriate.").

[31] DSU Article 12.1 ("Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting with the parties to the dispute. ").

[32] DSU Article 12.2 ("Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process.").

[33] Letter from Ambassador Luiz Felipe de Seixas Corrêa, Permanent Mission of Brazil, to Mr. Dariusz Rosati, Chairman of Panel, at 3 (23 May 2003) (emphasis added). The carry-over paragraph continues: "Where preliminary objections have been resolved in advance of other claims, normally they have been resolved in the panel's first meeting, on the basis of the first round of submissions and oral statements."

22. The United States notes that the Appellate Body has urged panels to adopt working procedures providing for preliminary rulings to deal with threshold jurisdictional issues[34], even though there are no "special and additional rules" in the DSU providing for these. In addition, we note that Article 10.3 of the Agriculture Agreement (the same agreement at issue here) is not listed as a "special and additional rule," but panels and the Appellate Body have made clear that this provision nonetheless governs dispute settlement proceedings by shifting the burden of proof to the responding party.[35]

23. Finally, Brazil relies on Article 11 of the DSU – pursuant to which a panel "should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements" – to support its position. Brazil's reliance on Article 11 is misplaced as shown by a simple examination of the text of Article 11. Article 11 provides the standard of review for panels; it does not guide the procedure used by panels. According to Brazil, DSU Article 11 somehow mandates that a panel review "all the facts including rebuttal facts," hold two panel meetings, and allow for the exchange of rebuttal submissions.[36] Brazil's argument is untenable; it would read Article 11 to *mandate* a particular series of meetings and submissions when Article 11 does *not* set out *any* particular procedural steps through which a panel "should make an objective assessment of the matter before it." At the same time, Brazil argues that the Panel *may not*, consistent with Article 11, consider the applicability of the Peace Clause first because "Article 11 contains no requirement for a special briefing, meeting or determination by a panel to resolve such applicability or exemption."[37] Of course, there is nothing in the text of Article 11 that supports reading this provision to preclude the Panel's bifurcating the proceeding to respect the balance of rights and obligations in the Peace Clause. However, to be consistent with its own argument, Brazil should also read Article 11 not to mandate any particular number or sequence of procedural steps (such as those set out in DSU Appendix 3) that are not required under its terms.

B. NO PREVIOUS PANEL REPORT HAS EXAMINED THE PEACE CLAUSE, AND OTHER PROCEDURAL PROVISIONS CITED BY BRAZIL DO NOT CONTAIN THE PHRASE "SHALL BE . . . EXEMPT FROM ACTIONS"

24. Brazil suggests that deciding the issue of the applicability of the Peace Clause in advance of Brazil's substantive Subsidies Agreement and GATT 1994 claims is "contrary to the practice of earlier panels".[38] Of course, there is no such practice since this is the first dispute to face this issue.

25. Brazil also argues that there are "a number of other threshold issues in WTO Agreements" but that "none of these provisions have special and additional rules to provide for extraordinary preliminary briefings, meetings, and determinations prior to a panel hearing on all of the claims presented".[39] Brazil's invocation of previous panel proceedings is inapt. Brazil has not asserted that any of the "threshold" provisions in other WTO agreements that it cites or that have been interpreted by previous panels contain the same language as the Peace Clause (that is, "shall be . . . exempt from

[34] *See* Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, para. 144.

[35] *See* Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/RW2, WT/DS113/AB/RW2, paras. 67-75 (second recourse to DSU Article 21.5).

[36] *See* Brazil's Initial Brief, paras. 11-16.

[37] Brazil's Initial Brief, para. 16; *see id.*, para. 11 ("Thus, resolution of the 'peace clause' issues . . . must be resolved using normal DSU rules and procedures.").

[38] Brazil's Initial Brief at 7 (heading IV).

[39] Brazil's Initial Brief, para. 21.

actions").[40] Indeed, it is striking that Brazil studiously avoids comparing the text of any of these provisions with the text of the Peace Clause.[41]

26. Given the fact that *none* of the other provisions cited by Brazil contains Peace Clause-like language, these provisions have little relevance for the Panel's interpretation of the Peace Clause. At most, the relevance of these provisions lies in the fact that such " threshold" provisions do *not* use language that certain measures "shall be . . . exempt from actions." This suggests that the distinct language of the Peace Clause was intended to provide a distinct right, and one that differs from rights provided by these other WTO provisions.

27. We also note Brazil's argument that in the "closest case to the peace clause issue presented here" – that is, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R – there was "never a suggestion or finding that the panel erred by not conducting a special briefing and special determination" on the "threshold issue whether Brazil was in compliance with Article 27.4" of the Subsidies Agreement. From the Appellate Body report, it would appear that the Appellate Body did not address it because no party suggested that this threshold issue had to be taken up as a first stage of the proceeding. Nonetheless, the Appellate Body found that the panel erred in not considering the threshold Article 27.4 issue first. The Peace Clause language ("measures . . . shall be . . . exempt from actions") is different and even stronger in requiring that the Peace Clause be taken up first and separately, with findings, prior to any consideration of the relevant GATT 1994 and Subsidies Agreement provisions.

## C. BRAZIL WILL NOT BE PREJUDICED BY SEPARATE HEARINGS AND BRIEFINGS ON THE PEACE CLAUSE ISSUE

28. Brazil, referring to its 23 May letter, argues that it will be prejudiced if the Panel considers separately the issue of the applicability of the Peace Clause from Brazil's substantive claims as this will disrupt "Brazil's efforts to make a coherent and unified presentation of its case"[42] and result in greater expense to Brazil "in having to bring its legal and economic experts to Geneva for an extra meeting."[43] Of course, any concerns that Brazil's presentation of its case may be affected cannot supersede the rights and obligations of Members as set out in the covered agreements – including the Peace Clause. In fact, the Peace Clause resolves any issue of how to account for burdens on parties since it provides that the responding party's measures are exempt from any action based on the relevant GATT 1994 and Subsidies Agreement provisions – it exempts the responding party from the burden of having to respond to the complaining party's claims. Brazil ignores this aspect of the Peace Clause. In any event, we note that bifurcating this proceeding to ensure that these conforming US measures are exempt from action based on Peace Clause-specified provisions will *reduce*, rather than increase, the amount of work involved for *both* parties. Here, dealing with the Peace Clause issue first will resolve that part of the dispute, saving both parties further work, since the US measures conform to the Peace Clause. And in general, such an approach simply means that a panel would deal

[40] For example, arguments that a particular claim is not within a panel's terms of reference under DSU Article 6.2 do not involve any textual mandate that measures "shall be . . . exempt from actions." What Brazil calls the "closest case to the peace clause issue presented here" involved Articles 27.2(b) and 27.4 of the Subsidies Agreement, neither of which says that measures "shall be . . . exempt from actions based on" specified provisions. *See* Brazil's Initial Brief, para. 19 (quoting Appellate Body discussion of Subsidies Agreement Articles 27.2(b) and 27.4 in *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R; Subsidies Agreement Article 27.2 states that the "prohibition of paragraph 1(a) of Article 3 shall not apply to" developing country Members in compliance with Article 27.4). Other provisions cited by Brazil (Article 1 of the *General Agreement on Trade in Services*, Article 2 of the *Agreement on Technical Barriers to Trade*, and Annex I of the *Agreement on Government Procurement*) similarly do not provide a legal right not to be subject to actions.

[41] *See* Brazil's Initial Brief, paras. 18-21.

[42] *See* Brazil's Initial Brief, paras. 17.

[43] Brazil's Initial Brief, para. 22.

in sequence with the issues it would otherwise have to confront in a dispute. Because no additional issues would be covered (and needless work on certain claims might be avoided), it would not appear that additional effort on the part of a panel or the parties would be required.

29. We also note in any event that Brazil's concerns about duplication of its factual presentation and increased expense seem overstated. Even if this were a dispute where the relevant measures did not conform to the Peace Clause, Brazil misunderstands the process. The fact that some of the same evidence might be relevant to Peace Clause as well as Subsidies Agreement claims does *not* mean that the evidence would have to be introduced twice. Once Brazil's factual evidence were introduced, if it were relevant to later stages of the proceeding, it could of course be used for that purpose.[44] Thus, there should be no duplication of its factual presentation and no additional burden to Brazil on that count. Similarly, with respect to concerns about the additional expenditure of resources should the Panel bifurcate this proceeding, the full-time presence of Brazil's private-sector counsel in Geneva should alleviate some of the expense that extra meetings (which there is no reason to assume would be needed since the US measures conform to the Peace Clause) might entail. In any event, however, the United States finds it difficult to believe that Brazil would bring an action with claims under 17 different provisions of the WTO agreements with respect to programs under at least 12 US statutes and not expect that the resulting dispute would involve additional complications and all the accompanying demands for time and resources.

30. Finally, the United States notes that Brazil has raised the issue that separate hearings and briefing on the Peace Clause issue "would cause it prejudice because there would be significant[] delays in the resolution of its claims – many of which do not implicate the peace clause".[45]. While, on its face, Brazil's list of "non-peace clause claims" appears to include claims based on provisions specified in the Peace Clause[46], Brazil's point is not raised by the Panel's question. If the Panel requests the parties to give their views on the question of what should happen with any claims in this action based on provisions not specified by the Peace Clause, the United States would be pleased to do so.

## IV. WERE THE PANEL TO CONSIDER THAT THE PEACE CLAUSE DOES NOT REQUIRE THAT THE PANEL DETERMINE WHETHER US MEASURES ARE EXEMPT FROM ACTIONS BEFORE CONSIDERING BRAZIL'S SUBSIDIES AGREEMENT AND GATT 1994 ARTICLE XVI ACTION, THE PANEL SHOULD EXERCISE ITS DISCRETION TO BIFURCATE THE PROCEEDING

31. Putting aside the arguments related to prejudice and expense which have been discussed above, the United States notes that, in the course of allegedly discussing the "context" for the Peace Clause, Brazil makes an argument that speaks not to any relevant context but to the Panel's exercise of its discretion to organize its procedures. Brazil argues that the "close overlap of proof for both peace clause and actionable and prohibited subsidy claims highlights the need for the Panel to examine all the 'facts of the case' together".[47] First, in this context, the United States has noted, and Brazil and the European Communities apparently agree, that the Panel enjoys significant discretion under DSU Articles 12.1 and 12.2 to organize its working procedures as it considers best to resolve the matter in dispute.

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[44] To put it simply, "Brazil exhibit 419" (for example) would remain "Brazil exhibit 419" – it would not change simply because it was now being cited in a different argument.

[45] Brazil's Initial Brief, para. 23.

[46] Brazil argues that its "non-peace clause claims include . . . Article XVI:3 of GATT 1994 involving all domestic and export subsidies challenged by Brazil." Brazil's Initial Brief, para. 23. However, the Peace Clause explicitly states that conforming "export subsidies . . . shall be . . . exempt from actions based on Article XVI of GATT 1994." Agriculture Agreement, Article 13(c)(ii).

[47] Brazil's Initial Brief, para. 15.

32. However, even were the Panel to conclude that Article 13 does not require the Panel to determine whether US measures are in breach of the Peace Clause and no longer "exempt from actions based on" specified provisions, the significance and wording of the Peace Clause in this dispute would mean that the Panel should exercise its discretion to bifurcate this proceeding. The Peace Clause would remain a significant, decisive issue. As noted above, bifurcating the proceedings would save both parties as well as the Panel significant time and work since it will render it unnecessary to address the relevant GATT 1994 and Subsidies Agreement claims.

33. Furthermore, given that Brazil has signalled that its Peace Clause arguments alone will involve "the presentation of considerable factual evidence and expert econometric testimony"[48], it would appear that to hear Brazil's substantive claims at the same time would significantly complicate the Panel's work. The apparent complexity of Brazil's Peace Clause evidence also calls into significant question the likelihood that the timetable requested by Brazil is realistic with respect to the legitimate interests of the United States to defend its position. Finally, we note that, by seeking to have the Panel consider both the Peace Clause issue and Brazil's substantive claims at the same time, Brazil may be attempting to prejudice the US rights of defence – particularly since, even on Brazil's mis-reading of the Peace Clause, the US measures are "exempt from actions", Brazil is not entitled to obtain any remedy from the DSB.[49]

34. The United States also disagrees in any event that the "close overlap of proof for both peace clause and actionable and prohibited subsidy claims highlights the need for the Panel to examine all the 'facts of the case' together". For example, to establish its "serious prejudice" claims, Brazil must present evidence showing that the United States has caused "adverse effects" through "the use of any subsidy" (Subsidies Agreement, Article 5(c)) and evidence on "the effect of the subsidy" (Subsidies Agreement, Article 6.3(b), (c), (d)). Neither of these showings is relevant to the issue of whether US measures have breached the Peace Clause.

35. Frankly, if Brazil's Peace Clause arguments will involve extensive factual and econometric evidence, it is difficult to understand why the Panel would be *better* served by considering this "considerable" evidence and testimony at the same time that it receives even *more* evidence and testimony on other, unrelated issues. Thus, even if one hypothesized that the Peace Clause does not require the Panel to consider the issue of its applicability prior to examining Brazil's substantive claims and that the Panel solely needed to consider how to take the Peace Clause issue into account in exercising its discretion to organize its procedures, the United States submits that the Panel's work would be facilitated by focusing on the legally and logically distinct Peace Clause issue first.[50]

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[48] Letter from Ambassador Luiz Felipe de Seixas Corrêa, Permanent Mission of Brazil, to Mr. Dariusz Rosati, Chairman of Panel, at 4.

[49] *See* Brazil's Initial Brief, para. 9 ("In sum, 'exempt from actions' means that a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic or export support measures that are 'peace clause' protected.").

[50] *See* Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, paras. 142-44 (finding that panel should have considered threshold Article 27.4 issue before examining whether export subsidy had been provided under Subsidies Agreement Article 3.1(a)); *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, para. 144 (noting that panels would be better served by adopting working procedures providing for preliminary rulings to deal with threshold jurisdictional issues).

## V. OTHER ARGUMENTS BY THIRD PARTIES

### A. GIVEN DSU RULES, THE PANEL'S ORGANIZATION OF ITS PROCEDURES REPRESENTS THE FIRST OPPORTUNITY TO ARREST BRAZIL' S ACTION

36. India and the European Communities have suggested that, taken to its logical extreme, reading "actions" as the "taking of legal steps to establish a claim" would require a complaining party to bring two actions: first, an action to establish that the Peace Clause does not apply to certain measures, and second, if a panel were to find the Peace Clause inapplicable, an action challenging the measures based on the provisions specified in the Peace Clause. While this issue is not pertinent to the Panel's question concerning Article 13, the United States notes that it has not advanced such an interpretation by, for example, asking the Panel to find that it could not be established.[51] Thus, this issue is not before the Panel, and India's and the EC's arguments are irrelevant. Rather, we have requested more modestly that the Panel, consistent with the Peace Clause, structure its procedures so that US measures will in fact be exempted from Brazil's action based on provisions specified in the Peace Clause at the earliest possible juncture under the DSU.

37. As these third parties apparently fail to appreciate, prior to this moment, DSU rules provided for the dispute to proceed through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause. Although the United States has maintained at each and every stage that the challenged measures conform to the Peace Clause, the United States could not have stopped Brazil from asking for consultations[52], nor could it reasonably have been expected to refuse an entire request for consultations because it contains a request contrary to the Peace Clause, nor could the United States have prevented the establishment of this Panel. As a responding party cannot prevent panel establishment from occurring, it will inevitably be forced to argue to a panel that the panel's procedures should be structured so that the party' s challenged measures are not subject, from that point on, to actions based on provisions specified in the Peace Clause. Thus, given the automaticity in DSU rules relating to consultations and panel establishment, the Panel's organization of its procedures provides the first opportunity to arrest Brazil's "taking of legal steps to establish a claim", and this is all the United States has asked the Panel to do.

### B. CONTRARY TO THE SUGGESTION BY SEVERAL THIRD PARTIES, THE PEACE CLAUSE IS NOT AN AFFIRMATIVE DEFENCE

38. Australia and the European Communities have each asserted that the Peace Clause is an affirmative defence.[53] The United States believes that they are in error. However, this issue is not

[51] We also note that this potential question relating to whether a panel could have been established given the applicability of the Peace Clause could arise even under Brazil's interpretation of "exempt from actions". Brazil states that "actions are multilaterally agreed decisions of WTO bodies including the DSB". However, "exempt from actions" would then seem to reach DSU Article 6.1, under which the DSB takes a "multilaterally agreed decision" to establish a panel to consider a matter. Thus, under Brazil's own logic, "exempt from actions" in the Peace Clause should also preclude a decision by the DSB to establish a panel and not just a decision to authorize remedies. Argentina implicitly concedes the point when it states that it "agrees with Brazil's statement in paragraph 6 of its Brief that the word 'actions' in the context of Article 13 of the AoA refers to decisions of WTO competent bodies, *such as the DSB when it discharges its duties by establishing a panel*". Argentina's Third Party Initial Brief, para. 6 (emphasis added).

[52] However, the United States notes that Argentina (in paragraph 13 of its "Third Party Initial Brief") accepts that under Article 7 of the Subsidies Agreement, a Member is not to request consultations on measures conforming to the Peace Clause.

[53] *See* Comments by Australia, para. 4 (10 June 2003); Comments by the European Communities on certain issues raised on an initial basis by the Panel, para. 6 (dated 10 June "2002" on first page, 2003 in the heading).

raised by the Panel's question concerning Article 13, and there is no need to discuss it further at this time.

## VI. CONCLUSION: BRAZIL MAY NOT BRING, AND THE PANEL MAY NOT ADJUDICATE, A SUBSIDIES AGREEMENT OR GATT 1994 ARTICLE XVI ACTION AGAINST US MEASURES CONFORMING TO THE PEACE CLAUSE

39. For the reasons set out above and in its initial brief on the Panel's question concerning the Peace Clause, the United States respectfully requests the Panel to find that measures that conform to the Peace Clause are exempt from any action, including action under the DSU, based on the corresponding provisions of the Subsidies Agreement and the GATT 1994. As a result, the United States is not required to defend those measures in any action based on Brazilian claims exempted by the Peace Clause.

# ANNEX B

## SUBMISSION OF PARTIES AND THIRD PARTIES FOR THE FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING

# ANNEX B-1

## EXECUTIVE SUMMARY OF BRAZIL'S FIRST SUBMISSION TO THE PANEL REGARDING THE "PEACE CLAUSE" AND NON-PEACE CLAUSE RELATED CLAIMS

### Introduction

1. Brazil's first submission initially addresses issues relating to the substantive interpretation of Article 13 of the Agreement on Agriculture (AoA), known as the "peace clause," and details the evidence demonstrating that the United States has no basis to assert a peace clause defence regarding Brazil's actionable and prohibited subsidy claims. The second part of Brazil's first submission sets forth the evidence and arguments concerning claims involving the following US measures: Step 2 export payments, the US export credit guarantee programmes (GSM 102, GSM 103 and SCGP) and the ETI Act subsidies. These three subsidies do not fully conform to the provisions of Part V of the Agreement on Agriculture and, thus, the United States has no peace clause protection from claims under the SCM Agreement. Step 2 export payments, the three export credit guarantee programmes and the ETI Act subsidies also violate ASCM Article 3.1(a) and 3.2. Finally, Brazil demonstrates that Step 2 domestic payments violate ASCM Article 3.1(b) and GATT Article III:4.

### Issues Regarding the Peace Clause in AoA Article 13

2. The peace clause of AoA Article 13 is in the nature of an affirmative defence. The United States has indicated that it will invoke a peace clause defence. To do so, the United States bears the burden of proof that US domestic support and export subsidies to upland cotton are provided in conformity with the requirements of the peace clause. Based on public international law and Appellate Body jurisprudence on the allocation of the burden of proof, AoA Article 13 is an affirmative defence because it provides an exception to a legal regime otherwise applying to agricultural support measures. It does not alter the scope of other provisions providing positive obligations on Members, and is not itself a positive obligation. It simply allows Members to maintain measures otherwise inconsistent with their WTO obligations exempt from actions, provided that the measures meet the conditions specified in AoA Article 13.

3. In accordance with Article 31 of the *Vienna Convention*, the appropriate interpretation of AoA Article 13(b)(ii) is the following: Members may assert a peace clause defence under AoA Article 13(b)(ii) *only* if the total quantity of support granted through all non-"green box" domestic support measures (*i.e.*, measures that do not fully comply with the provisions of AoA Annex 2) to a specific commodity in any marketing year from 1995-2003 does not exceed the quantity of non-"green box" domestic support decided to be granted in MY 1992. The only "decision" made by the United States "during" MY 1992 was to grant (i.e., make actual expenditures) of $1.994 billion in non-"green box" support to upland cotton pursuant to the terms of the 1990 FACT Act.

4. The evidence regarding the amount of non-"green box" US support to upland cotton granted in MY 1999-2002 is based largely on USDA documents, which show that US non-"green box" domestic support decided to be authorized and paid to upland cotton increased to $3,445 million in MY 1999, was $2,311 million in MY 2000, and increased to a new record high of $4,093 million in MY 2001 (for a crop valued at $3,312 million). Brazil estimates that US non-"green box" domestic support for MY 2002 (which will end on 31 July 2003) is $3,113 million. This estimate is based on the last available data and the requirements set out in the 2002 FSRI Act.

5. Thus, the evidence reveals that the amount of non-"green box" support granted in MY 1999-2002 exceeds the level of support "decided" by the United States in MY 1992. Therefore, the United States does not enjoy peace clause exemption from actions based on ASCM Article 5 and 6 and Article XVI:1 of GATT 1994 involving non-"green box" domestic support to upland cotton.

6. Brazil's calculation of the MY 1999-2002 reflects the appropriate set of non-"green box" domestic support measures granted to upland cotton. The United States notified to the WTO Committee on Agriculture that the following programmes are "amber box" support for MY 1999: Step 2 payments, loan deficiency payments, marketing loan gains, crop insurance payments, cottonseed payments, and market loss assistance payments. The structure of the first five of these domestic support programmes is substantially the same in MY 2000-2001 and under the 2002 FSRI Act as it was in MY 1999. There is also no indication that these five programmes should not continue to be treated as non-"green box" domestic support to upland cotton for the purposes of MY 2002. Therefore, the support under these five programmes, as well as market loss assistance payments, are non-"green box" support to upland cotton and are properly included in the set of domestic support measures for purposes of assessing possible US peace clause exemption from action.

7. With respect to production flexibility contract payments (PFC), direct payments (DP) and counter-cyclical payments (CCP), the evidence demonstrates that these payments are also non-"green box" support granted to upland cotton. The basis of this conclusion is summarized below.

8. *Production Flexibility Contract Payments (PFC)*: There are two reasons why PFC payments are not properly "green box" support. First, PFC payments are inconsistent with AoA Annex 2 paragraph 6(b), because Section 118(b) of the 1996 FAIR Act and the regulations implementing the PFC programme eliminates or reduces payments if producers grow certain products – fruits, vegetables and wild rice – on contract acreage.

9. AoA Annex 2 paragraph 6(b) requires that the "amount" of payments "shall not be related to or based on, the type of production…" The object and purpose of paragraph 6(b), based on its text and context, is to ensure that decoupled "green box" payments are not focused or channelled for a single product or a particular sub-set of products. It covers only *completely* decoupled domestic support measures. Paragraph 6(b) seeks to guarantee that a producer who receives such payments can produce any product covered by the Agreement on Agriculture.

10. Section 118(b) of the 1996 FAIR Act and its regulations make it clear that the *amount* of PFC payments in any given marketing year between 1996 and 2001 was related to or was based on the *type* of production undertaken by a producer who entered into a PFC contract. The general rule is that "planting fruits and vegetables (except lentils, mung beans, and dry peas) shall be prohibited on contract acreage". If fruits and vegetables are grown on contract acreage, then the regulations provide that "the Deputy Administrator shall terminate the contract with respect to the producer on each farm in which the producer has an interest". The regulations also provide that in less serious cases of violation, the penalty may be a reduction of contract payments equal to the market value of the fruits and vegetables or the contract payment for each acre used for fruits and vegetables. Thus, the PFC payments are not "decoupled income support" as set out in AoA Annex 2 paragraph 6(b) and therefore, are not "green box" support.

11. The second reason that PFC payments provided to upland cotton producers are not properly "green box" support is that they are inconsistent with the "fundamental" requirement in AoA Annex 2 paragraph 1 that they have "no, or at most minimal, trade distorting effects or effects on production". The quantity or level of production or trade distorting effects need only be very minimal to trigger denial of "green box" status under AoA Annex 2. This follows from the text of AoA Annex 2 paragraph 1, which contains the phrases "no," "at most," and "fundamental".

12. The record in this case demonstrates that PFC payments have had more than "at most" a "minimal" effect on production of US upland cotton during MY 1999-2002. Almost all upland cotton producers participated in the PFC programme. Furthermore, domestic US upland cotton producers view PFC payments as an important component of payments provided to upland cotton farmers. The percentage of subsidization by PFC payments relative to the market value measured by the price received by US upland cotton producers represents between 14 and 17 per cent for period MY 1999-2001. This provides US producers with a significant advantage in export competition with producers in the rest of the world who do not receive such a level of (or any) subsidies.

13. The PFC payments also have production effects because of the very high cost of production for upland cotton in the United States. Given the high US costs, without 14-17 per cent subsidies some higher-cost US producers would likely stop producing upland cotton. This would have resulted in lower levels of US upland cotton production. USDA economists have acknowledged the production-enhancing effects of PFC payments. They have also identified likely patterns of production effects.

14. Because the *quantity* or *level* or trade distorting effects need only be very minimal to trigger denial of "green box" status under AoA Annex 2, the evidence of the production enhancing effects of PFC payments necessitates the conclusion that PFC payments are not properly included within the AoA Annex 2 "green box". They are, thus, properly included within the domestic support measures to be used for the calculation of the amount of domestic support to upland cotton for MY 1999, 2000 and 2001.

15. *Direct payments (DP)*: with the passage of the new FSRI Act in May 2002, PFC payments were discontinued and replaced with DP. These began to be paid in MY 2002 and will be paid until the end of MY 2007. USDA has identified the DP programme as the direct successor to the PFC programme under the 1996 FAIR Act.

16. There are three reasons why DP are not properly within AoA Annex 2. First, as with PFC payments, the amount of DP are related to or based on the type of production undertaken in any year after the base period in violation of AoA Annex 2 paragraph 6(b). The 2002 FSRI Act and its implementing regulations eliminate or limit the amount of DP if base acreage is used for the production of certain crops, i.e., fruits, vegetables and wild rice.

17. Second, the DP provisions of the 2002 FSRI Act violate AoA Annex 2, paragraph 6(a) and (b) because producers were permitted to "update" their base acreage using MY 1998-2001 production totals. This is inconsistent with Annex 2, paragraph 6(a), which requires a *single, fixed* base period for a programme of support. The object and purpose of AoA Annex 2 paragraph 6(a) and (b) is to ensure that Members do not permit payments to increase over time in a manner linked to increases in production over time. This also follows from the AoA Annex 2 paragraph 1 requirement that "green box" support measures have no or at most minimal production effects. That can only occur if the base (i.e., the base for increased payments) does not adapt to recent changes in the production of a farmer.

18. The major structural elements of the PFC programme and the DP programme are the same for both programmes in terms of the basic types of crops covered, the producer's obligations to receive payments, prohibited plantings of certain crops, and freedom to receive payments for one crop and farm another crop. The change from the PFC programme to the DP programme is not "de-coupling" but rather "re-coupling" of MY 2002 and future DP with MY 1998-2001 production.

19. One third of farms receiving PFC payments between MY 1996-2001 updated their acreage for the DP programme using MY 1998-2001 production data. Thus, interpreting AoA Annex 2 paragraph 6(a) and (b) to permit an updating of the "fixed" base period by essentially changing the name of the "PFC payment" programme to DP programme would render these provisions a nullity.

20. Third, DP also have more than "at most minimal" production and trade-distorting effects contrary to the chapeau of AoA Annex 2 paragraph 1. DP, like PFC payments, can increase production of upland cotton through (1) a direct wealth effect through risk aversion reduction, (2) a wealth facilitated increased investment reflecting reduced credit constraints, and (3) a secondary wealth effect resulting from the increase in investment. In addition, the updating of base acres in the 2002 FSRI Act created an ongoing production-enhancing effect because farmers will expect future updates and continue to maintain high levels and even increase production between MY 2002 - 2007. Continued low cotton prices will increase the need of producers to protect their base as a hedge against low prices. In addition, US upland cotton producers are among the world's highest cost producers. That means that the amount of DP (and CCP) is critical to the economic survival of many US upland cotton producers. Thus, there will be a very strong incentive to maintain and increase upland cotton base in anticipation of future base updates in future farm legislation to offset potentially lower world prices.

21. In sum, DP are properly included within the set of domestic support measures to be used for calculating the amount of domestic support to upland cotton for MY 2002.

22. *Counter-Cyclical Payments (CCP)*: are non-"green box" domestic support because they are inconsistent with AoA Annex 2 paragraphs 6(a), 6(b) and 6(c). First, like PFC and DP, CCP are inconsistent with Annex 2 paragraph 6(b) because the CCP programme eliminates or limits the amount of payments for *those* producers who grow fruits, vegetables and wild rice on base acres.

23. Second, CCP also violate AoA Annex 2 paragraph 6(c) because the amount of payments is based on current market prices. The ordinary meaning of AoA Annex 2 paragraph 6(c) is that any direct income support to a producer of agricultural products must not be linked to an international or domestic price established after the base period, *i.e.*, to a current price. CCP are not based on the prices of upland cotton production that took place in a prior base period but rather on prices of present production. As the current upland cotton prices received by US farmers fluctuate between $0.52 and $0.6573 per pound, the amount of payments for each year between MY 2002-2007 changes. This is inconsistent with AoA Annex 2 paragraph 6(c), which requires that payments cannot be based on "the prices…applying to any production undertaken in any period after the base period". But the CCP programme has no fixed "base period" for the purposes of setting "prices". It uses current prices, *i.e.*, prices that apply to current production and, thus, to a "production undertaken in a period after the base period".

24. Third, like PFC and DP, CCP have production and trade distorting effects in violation of AoA Annex 2 paragraph 1. The new CCP programme for upland cotton is one of the main sources of increased payments for US cotton producers between the 1996 FAIR Act and the 2002 FSRI Act. The payments to US upland cotton farmers in MY 2002 will exceed $1 billion and represent over 32 per cent of the market value of US upland cotton. USDA economists have acknowledged that CCP have identifiable and measurable production effects.

25. In sum, CCP are non-"green box" domestic support properly included within the set of domestic support measures to be used for calculating the amount of domestic support to upland cotton for MY 2002.

26. *DP and CCP are support to upland cotton*: DP and CCP made in MY 2002 are support to upland cotton within the meaning of AoA Article 13(b)(ii). The great majority of upland cotton producers are enrolled in the programmes and will receive the full amount of these payments in MY 2002. Most of the producers of upland cotton in MY 2002 used upland cotton base acres to produce upland cotton. US farms growing the bulk of upland cotton tend to grow upland cotton year after year because of considerable investments in cotton-specific equipment and the lack of alternative crops. Thus, most farmers with cotton "base acreage" generally do not use that base acreage to grow other

crops. In addition, CCP create incentives to maintain upland cotton production at the level of the base period in order to minimize the risk of low revenues.

27. In sum, the United States cannot successfully invoke peace clause protection against Brazil's actionable subsidy claims under ASCM Articles 5 and 6 or Brazil's claims under GATT Article XVI:1.

28. *Export Subsidy Peace Clause Issues Under AoA Article 13 (c):* The United States also has no peace clause protection under AoA Article 13(c) for claims against export subsidies under the SCM Agreement regarding Step 2 export payments, the export credit guarantees and subsidies provided under the ETI Act. AoA Article 13(c) can only be invoked by a WTO Member as an affirmative defence if that WTO Member can demonstrate that its export subsidies "conform fully to the provisions of Part V" of the AoA. Part V of the AoA consists of Articles 8 to 11. A Member violates Part V of the AoA if it provides export subsidies for products for which it has not undertaken any export subsidy reduction commitments; or second, if it has export subsidy reduction commitments for the product under consideration, but exceeds the maximum amount of export subsidies to or the maximum value of the product that it has scheduled to be exported with the assistance of export subsidies. The United States does not enjoy peace clause protection for the agricultural export subsidies challenged by Brazil under the SCM Agreement because – as Brazil demonstrates – each of the subsidies at issue does not fully conform to Part V of the AoA.

**Brazil's Claims Regarding Prohibited US Export and Local Content Subsidies**

29. The United States maintains three types of export subsidies related to US upland cotton and other commodities. These subsidies violate AoA Articles 3.3, 8 and 10.1 and are prohibited under ASCM Articles 3.1(a) and 3.2. Brazil challenges all three measures to the extent they provide subsidies to upland cotton. In addition, it challenges the export credit guarantee programmes for all products covered.

30. The first measure, the Step 2 export programme, relates solely to exports of US upland cotton and provides grants to exporters. The second group of measures are three export credit guarantee programmes – the General Sales Manager 102 ("GSM 102"), the General Sales Manager 103 ("GSM 103") and the Supplier Credit Guarantee Programme ("SCGP") – provided by the United States in connection with the export of agricultural goods in general. The third measure providing export subsidies is the FSC Repeal and Extraterritorial Income (ETI) Act of 2000, by which the United States provides tax breaks for exporters of US products, including agricultural products such as upland cotton.

31. *Step 2 Export Payments:* Section 1207(a) of the 2002 FSRI Act mandates Step 2 export payments contingent on the export of US upland cotton lint. Section 1207(a) of the 2002 FSRI Act requires USDA to pay US exporters the difference between higher priced US upland cotton and the average of the five lowest price quotes for exports of upland cotton worldwide (Cotlook's A-Index). The size of this subsidy averaged 8 per cent of the price received by US producers between MY 1999-2001 and an estimated 9.9 per cent in MY 2002.

32. Step 2 export payments constitute export subsidies within the meaning of the AoA. The Appellate Body has indicated that context for interpretation of an "export subsidy" under the AoA is found in the ASCM. Step 2 export payments involve grants within the meaning of ASCM Article 1.1(a)(1)(i), as the US Government pays money to US exporters. Such grants are direct transfers of economic *resources* for which the US Government receives no consideration. Step 2 export payments constitute "free money" for which exporters incur no corresponding obligations and, thus are made for "less than full consideration". They, therefore, confer a benefit within the meaning of ASCM Article 1.1(b). Finally, Step 2 payments are also export contingent within the meaning of ASCM

Article 3.1(a) because exporters are only eligible to receive Step 2 export payments if they produce evidence that they have exported an amount of US upland cotton.

33. Section 1207(a) of the 2002 FSRI Act requires the US Secretary of Agriculture to make Step 2 export payments to eligible exporters upon proof of the export of US cotton. Therefore, Section 1207(a) of the 2002 FSRI Act is inconsistent with AoA Articles 3.3 and 8, because it requires payments of export subsidies to upland cotton without the United States having undertaken any export subsidy reduction commitments under the AoA. Thus, the United States has no peace clause protection against claims made under the ASCM for Step 2 export payments. In addition, for the same reasons the Step 2 export payments violate AoA Articles 3.3 and 8, Section 1207(a) of the 2002 FSRI Act also mandates payment of export subsidies in violation of ASCM Articles 3.1(a) and 3.2.

34. *Export Credit Guarantee Programmes:* The United States, through the US Commodity Credit Corporation (CCC), operates three export credit guarantee programmes – General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103) and the Supplier Credit Guarantee Programme (SCGP). The programmes guarantee the repayment of loans granted to foreign importers of all US agricultural commodities and are not limited to upland cotton. Brazil's also challenges the whole programmes, not just as they relate to upland cotton.

35. USDA export data demonstrates that US exports of most scheduled commodities exceed the respective US quantitative export subsidy reduction commitment. For unscheduled commitments, there is no such commitment, which means *that* every export of these commodities is in excess of the United States' commitments. In *Canada – Dairy Article 21.5 (II)*, the Appellate Body characterized export subsidy claims under the AoA as involving both a "quantitative aspect" and an "export subsidization aspect". It held that AoA Article 10.3 allocates the burden of proof for the export subsidization part to the defending Member – in this case the United States – if the complaining Member – in this case Brazil – establishes that the level of exports in exceeds of the export subsidy reduction commitments. Therefore, the United States bears the burden to prove that its excess exports did not benefit from export subsidies, including export credit guarantees

36. Nevertheless, Brazil also provides evidence that the three export credit guarantee programmes are export subsidies within the meaning of the AoA. The Appellate Body in *US – FSC* held that export subsidies within the meaning of the SCM Agreement are also export subsidies for the purposes of the AoA. Brazil demonstrates in two distinct ways that GSM 102, GSM 103 and SCGP are "export subsidies". First, context for determining whether the US programmes are export subsidies under the AoA is provided by reference to ASCM Annex I, Item (j) of the Illustrative List of Export Subsidies. Item (j) provides that export credit guarantee programmes are export subsidies if they are operated "at premium rates which are inadequate to cover the long-term operating costs and losses of the programme". Second, export credit guarantees also constitute export subsidies under the AoA and in light of the Appelllate Body decisions in *US- FSC* and *Canada – Dairy*, if they involve "financial contributions" that confer "benefits" and are contingent upon export performance within the meaning of ASCM Articles 1.1 and 3.1(a).

37. US documents demonstrate that GSM 102, GSM 103 and SCGP are export subsidies because they are operated at premium rates which are far below the level necessary to cover the programmes operating costs and losses. The programmes are, thus, export subsidies as defined in item (j) of the Illustrative List of Export Subsidies. Under Appellate Body and panel jurisprudence, export subsidies defined in the ASCM Agreement are relevant context for a finding of export subsidies under the AoA. Therefore these three programmes constitute export subsidies within the meaning of the AoA.

38. In addition, GSM 102, GSM 103 and SCGP are export subsidies within the meaning of the AoA because they are financial contributions consistent with ASCM Article 1.1(a)(1)(i), and confer benefits within the meaning of ASCM Article 1.1(b). The United States itself, in its budget, treats them as subsidies. In addition, no such guarantees are commercially available in the marketplace.

GSM 102, GSM 103 and SCGP are, furthermore, contingent upon export performance within the meaning of ASCM Article 3.1(a). Thus, the programme constitutes export subsidies within the meaning of both the SCM Agreement and the AoA.

39. The export subsidies GSM 102, GSM 103 and SCGP result in, or threaten to lead to, circumvention of the United States' export subsidy commitments within the meaning of AoA Article 10.1. GSM 102, GSM 103 and SCGP, in so far as they are available for unscheduled products, violate AoA Articles 10.1 and 8 because they make export subsidies available for unscheduled products. The Appellate Body has held that for unscheduled products, it is inconsistent with AoA Article 3.3 to provide export subsidies listed in AoA Article 9.1, and that it is inconsistent with AoA Articles 10.1 and 8 to provide any other export subsidy. GSM 102, GSM 103 and SCGP provide export subsidies to unscheduled products, and thus violate AoA Article 10.1 and 8.

40. With respect to scheduled products, GSM 102, GSM 103 and SCGP as such also threaten to lead to circumvention of the US export subsidy reduction commitments. The United States provides monetary allocations for export credit guarantees to individual third countries either on a commodity specific basis or on a non-commodity specific basis. This common feature of the three export credit guarantee programmes creates a threat that the United States will exceed its quantitative export subsidy reduction commitment for scheduled products in violation of AoA Articles 10.1 and 8.

41. In sum, the export credit guarantee programmes GSM 102, GSM 103 and SCGP are inconsistent with AoA Articles 10.1 and 8. As they do not fully conform to AoA Part V, they do not enjoy peace clause protection under AoA Article 13(c)(ii).

42. Brazil has already established that GSM 102, GSM 103 and SCGP are export subsidies within the meaning of item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement, and within the meaning of ASCM Article 3.1(a). It follows that GSM 102, GSM 103 and SCGP are prohibited export subsidies within the meaning of ASCM Articles 3.1(a) and 3.2.

43. *ETI Act Export Subsidies*: The third export subsidy provided by the United States to upland cotton consists of tax cuts under the FSC Repeal and Extraterritorial Income Act of 2000. This Act eliminates tax liabilities for exporters, *inter alia*, of upland cotton. A WTO panel and the Appellate Body have previously found that the ETI Act violates AoA Articles 10.1 and 8 and ASCM Articles 3.1(a) and 3.2. The tax breaks provided for under the ETI Act constitute export subsidies within the meaning of AoA Article 10.1. The ETI Act threatens to circumvent the US export subsidy commitments by providing an export subsidy to upland cotton while the United States does not have any export subsidy reduction commitments for upland cotton in violation of AoA Articles 10.1 and 8. As the ETI Act subsidies do not fully conform to AoA Part V, there is no peace clause exemption from actions under the SCM Agreement. Consequently, the ETI Act *also* constitutes a prohibited export subsidy within the meaning of ASCM Article 3.1(a) and 3.2.

44. *Step 2* Domestic *Payments*: Section 1207(a) of the 2002 FSRI Act mandates the payment of the Step 2 domestic payments. Step 2 domestic payments are subsidies within the meaning of the ASCM Article 1.1. They involve grants because the US Government pays domestic users of US upland cotton the difference between higher priced US upland cotton and the average of the five lowest upland cotton price quotes for exports (A-Index) without receiving any consideration in return. These grants are direct transfers of funds and constitute a financial contribution by a Government within the meaning of ASCM Article 1.1(a)(1)(i). They confer a "benefit" within the meaning of ASCM Article 1.1(b) because the domestic user of US upland cotton receives the financial contribution on terms more favorable than those available in the market. Step 2 domestic payments constitute "free money" for which domestic users of US upland cotton incur no corresponding obligations. Finally, Step 2 domestic payments are contingent on the use of domestic over imported goods. Domestic users of US cotton can only receive payments upon proof of opening a bale of domestic US upland cotton. In sum, Section 1207(a) of the 2002 FSRI Act mandating Step 2 domestic

payments violates ASCM Articles 3.1(b) and 3.2 by requiring the provision of subsidies contingent upon the use of domestic over imported goods.

45. The Step 2 domestic payment programme also constitutes a violation of GATT Article III:4. Section 1207(a) requires the US Secretary of Agriculture to treat upland cotton of non-US source less favorable than like US upland cotton. Only upland cotton that "is domestically produced baled upland cotton" is eligible for the Step 2 domestic payment programme. Paying a subsidy to like domestic upland cotton while denying such payments to imported like cotton negatively affects the competitiveness of imported cotton by making it less attractive to US purchasers. The Step 2 domestic payment programme therefore extends "less favorable treatment" to imported goods within the meaning of GATT Article III:4.

**Conclusion**

46. In Brazil's further submission (scheduled for 4 September 2003 following the Panels expression of its views on AoA Article 13 on 1 September 2003) Brazil will present its arguments concerning its claims under ASCM Articles 5(c), 6.3(b), 6.3(c) and 6.3(d), as well as under GATT Article XVI.

# ANNEX B-2

## EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF THE UNITED STATES

1. In this submission, the United States principally focuses on the issues involving the Peace Clause. However, three sets of measures identified by Brazil – (1) export credit guarantee measures relating to eligible US agricultural commodities other than US upland cotton; (2) production flexibility contract payments and market loss assistance payments; and (3) cottonseed payments – were, respectively, not the subject of consultations, had expired before consultations were requested, or had not yet been adopted at the time of the consultation and panel requests. With respect to these measures, the United States requests that the Panel make preliminary rulings that they are not within the Panel's terms of reference.

2. **General Interpretation of the Peace Clause and "Exempt from Actions"**: As set out in more previous submissions, read in accordance with the customary rules of interpretation of public international law, the key Peace Clause phrase "exempt from actions" means "not exposed or subject to" a "legal process or suit" or the "taking of legal steps to establish a claim or obtain a remedy". Relevant context in DSU Article 3.7 and 4.5 and Subsidies Agreement Article 7 supports this reading. For example, contrary to Brazil's suggestion that "action" only refers to "collective action" by the Dispute Settlement Body, DSU Article 4.5 uses the phrase "further" action. Since no "action" will have been taken by the DSB "in the course of consultations," the phrase "further action" suggests that requesting consultations is part of the action brought by a complaining party. Thus, these provisions suggest that "action" based on the relevant provisions would include all stages of a dispute, including the "bringing [of] a case", consultations, and panel proceedings and would support reading "exempt from actions" in Article 13 to mean "not subject to" the "taking of legal steps to establish a claim".

3. Prior to this point in the process, DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause. As a responding party cannot prevent panel establishment from occurring, it will inevitably be forced to argue to a panel that its procedures should be structured so that the party's challenged measures are not subject, from that point on, to actions based on provisions specified in the Peace Clause. Thus, the Panel's organization of its procedures provided the first opportunity to arrest Brazil's "taking of legal steps to establish a claim".

4. **The Peace Clause Is Not an Affirmative Defence**: The Peace Clause applies *"[n]otwithstanding* the provisions of GATT 1994" and the Subsidies Agreement – that is, *in spite of* and *without regard to or prevention by* the subsidies obligations contained in those agreements. Article 21.1 of the Agriculture Agreement further clarifies that the obligations of Members under the Subsidies Agreement and GATT 1994 *only* apply "*subject to*" the provisions of the Agriculture Agreement, including the Peace Clause. There is no need to determine if a measure is inconsistent with WTO subsidies disciplines before applying the Peace Clause as would be the case if the Peace Clause were an affirmative defence to those obligations.

5. As in *United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, in which the Appellate Body explained that a provision that was described as an "exception" was not an affirmative defence and in fact was "an integral part" of the arrangement under the *Agreement on Textiles and Clothing* that "reflects an equally carefully drawn balance of rights and obligations of Members", here, too, the Peace Clause is part and parcel of the balance of rights and

obligations with the subsidies disciplines of GATT 1994 and the Subsidies Agreement and explains which measures are subject to actions based on those disciplines.

6. Article 13(a)(i) establishes that green box measures are "non-actionable subsidies for purposes of countervailing duties". This obligation is not contingent on whether a Member asserts an "affirmative defence" that a particular measure is "green box"; that is, one Member is not free to impose a countervailing duty until another establishes a Peace Clause "affirmative defence". There is no textual basis to interpret the Peace Clause to be an affirmative defence under one provision (Article 13(b)(ii)) but not another. In fact, rather than a defence, the Peace Clause could be used on the *offense* (as a cause of action) if, for example, a Member imposed a countervailing duty on a "green box" measure while the Peace Clause was in force.

7. Brazil has erroneously asserted that the Peace Clause "provides no positive obligations itself". Brazil overlooks the text of, for example, Article 13(a)(ii) and (b)(ii), which incorporates positive obligations of Annex 2 and Article 6 by reference. The Peace Clause also differs from the fifth sentence of footnote 59 to item (e) and under the second paragraph of item (k) of the Illustrative List, under which it appears that a measure otherwise prohibited under Article 3 of the Subsidies Agreement would nonetheless be permitted given the existence of circumstances detailed in those provisions. However, under the Peace Clause, conforming measures are not even exposed or subject to the taking of legal steps to establish a claim or obtain a remedy based on Peace Clause-specified provisions. Further, Subsidies Agreement Articles 3, 5, and 6 recognize that measures conforming to the Peace Clause are not subject to those disciplines by expressly excluding such measures from the scope of those obligations.

8. Brazil asserted in both its panel and consultation requests that the Peace Clause does not exempt the challenged US measures from action. Brazil implicitly recognized in these documents that it must surmount the Peace Clause hurdle to bring this action against US agricultural support measures. Even were the United States to present no arguments on the applicability of the Peace Clause, Article 13 would bar Brazil's claims unless Brazil made a *prima facie* case that the US measures breach the Peace Clause.

9. **US Direct Payments Meet and Conform to the Criteria in Article 13(a)**: Pursuant to Agriculture Agreement Article 13(a)(ii) domestic support measures that "conform fully to the provisions of Annex 2 to this Agreement" are "exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement". The 2002 Act establishes several types of measures that qualify for green box protection, including one, direct payments, that is challenged by Brazil.

10. Direct payments under the 2002 Act conform fully to the basic criteria in paragraph 1, Annex 2, as well as the five "policy-specific criteria and conditions" in paragraph 6, Annex 2, for "decoupled income support". Consistent with paragraph 1, direct payments are provided by a publicly-funded government programme and do not provide price support. Consistent with paragraph 6, direct payments establish eligibility by reference to the clearly-defined criteria of factor use or production level in a defined and fixed base period. Payments are not related to production or prices or the factors of production employed in any year after the base period, and no production is required in order to receive such payments.

11. In short, direct payments do not provide support for upland cotton because they are not linked to current cotton production. These payments are made with respect to farm acreage that was devoted to agricultural production in the past, including previous upland cotton production. Direct payments, however, are made regardless of whether cotton is currently produced on those acres or whether anything is produced at all. Because all of the criteria in paragraphs 1, 5, and 6 are met, direct payments conform to the requirements of Annex 2 and are "exempt from actions" based on Part III of the Subsidies Agreement and GATT 1994 Article XVI.

12. **Applicability of Agriculture Agreement Article 13(b)(ii):** Pursuant to Agriculture Agreement Article 13(b)(ii), "domestic support measures that conform fully to the provisions of Article 6" are "exempt from actions" based on GATT 1994 Article XVI:1 and Subsidies Agreement Articles 5 and 6. Brazil does not contest that US non-green box domestic support measures conform fully to the requirements of Article 6. Thus, the only question is whether US non-green box domestic support measures do or do not "grant support to a specific commodity in excess of that decided during the 1992 marketing year."

13. The phrase "grant support to a specific commodity" is not explicitly defined. Read according to its ordinary meaning, this phrase means to "give" or "confer" formally a "subsidy" ("assistance, backing") "specially . . . pertaining to a particular" "agricultural crop". Read in the context of, *inter alia*, the definition of "Aggregate Measurement of Support" in Article 1(a), "support to a specific commodity" refers to support "provided for an agricultural product in favour of the producers of the basic agricultural product" or "product-specific support".

14. The product-specific support granted by such Article 6 measures must be compared to "that decided during the 1992 marketing year". According to its ordinary meaning, this phrase would mean the product-specific support that was "determined" or "pronounced" during the 1992 marketing year. With reference to support or subsidies, the term "decided" is not used elsewhere in the Agriculture Agreement nor in the Subsidies Agreement. Various provisions that define the overall domestic support in favour of agricultural producers that has been, is being, and may be provided by a Member use the phrase "support *provided*" in favour of an agricultural product or agricultural producers no fewer than 13 times. Context thus suggests that the use of the term "*decided"* in Article 13(b) was deliberate so as to make the availability of the Peace Clause not dependent upon the support – for example, as measured through budgetary outlays – actually "provided" during the 1992 marketing year. This interpretation is further supported by Members' decision not to use the term "Aggregate Measurement of Support" in this part of Article 13(b)(ii). That is, Members did not choose to make the applicability of the Peace Clause contingent on comparison of a Member's product-specific Aggregate Measurement of Support.

15. The Peace Clause thus exempts from certain actions a Member's non-green box domestic support measures that conform to that Member's overall reduction commitments under Article 6, provided that such measures do not currently "give" or "confer" "product-specific support" in excess of that "determined" or "pronounced" during the 1992 marketing year. The relevant test for the applicability of Article 13(b)(ii) is to compare the product-specific support as it was decided in 1992 versus the product-specific support that existing measures currently grant.

16. **US Measures Conform to the Criteria in Article 13(b) and Are Exempt from Actions**: US domestic support measures under the 2002 Act were written to grant support for upland cotton within the 1992 marketing year level so that such measures would conform to the Peace Clause criteria. In particular, the 2002 Act shifts support away from the product-specific support that prevailed in 1992 to reduce support linked to the production of upland cotton.

17. **The Product-Specific Support for Upland Cotton Decided During 1992 Was To Ensure Income of 72.9 Cents per Pound**: The product-specific support in favour of upland cotton decided during the 1992 marketing year was to ensure a level of income ($0.729) for upland cotton farmers for each pound of upland cotton production. That is, US domestic support measures set a *rate* of support, rather than deciding *ex ante* a level of budgetary outlay or expenditures. This support was granted by the 1990 Act through two programmes: marketing loans (including marketing loan gains and loan deficiency payments) and deficiency payments.

18. Through marketing loans, the United States in effect guaranteed that cotton producers would realize income equivalent to at least 52.35 cents per pound of upland cotton produced. The United States further ensured cotton farmers would realize income equivalent to 72.9 cents per pound

of upland cotton produced by making "deficiency payments". By the terms of the 1990 Act and all subsequent implementing regulations, the support "decided" (that is, " determined" or "pronounced") in favour of upland cotton was *not* expressed in terms of outlays or appropriations but rather as a *rate*: that is, through both marketing loans and deficiency payments, producer income of 72.9 cents per pound of upland cotton. Thus, budgetary outlays, which reflect the difference between the rates set out in US legislation and regulations (which *were* decided by the US Government) and market prices (which obviously were *not*), do not represent the product-specific support "decided" during the 1992 marketing year.

19. **US Domestic Support Measures Currently Grant Product-Specific Support to Upland Cotton to Ensure Producer Income of 52 Cents per Pound**: Under the 2002 Act, product-specific support is again granted to upland cotton through the marketing loan programme and through user marketing (step 2) payments. Despite a small adjustment in the user marketing (step 2) payment formula, US measures currently in effect grant product-specific support to upland cotton far lower than that decided in the 1992 marketing year. Through the marketing loan programme, the US Government has in effect guaranteed that cotton producers will realize income equivalent to at least 52 cents ($0.52) per pound (the "2002 loan rate") of upland cotton produced. Marketing loans and loan deficiency payments are contingent on a farm's actual production of upland cotton in the current marketing year.

20. Product-specific support decided during the 1992 marketing year for upland cotton was to ensure producer income of 72.9 cents per pound; US domestic support measures currently grant product-specific support only at the rate of 52 cents per pound of production. Even taking into account the minor differences in payment rates for user marketing payments, this comparison indicates that US measures do not grant product-specific support to upland cotton in excess of that decided during the 1992 marketing year; in fact, current US measures grant product-specific support at a rate more than 20 cents per pound *less* than that decided during 1992.

21. **US Payments That Brazil Has Mischaracterized As Providing Support to a Specific Commodity Do Not Form Part of the Peace Clause Comparison**: Direct payments, counter-cyclical payments, and crop insurance are not product-specific support for upland cotton and are therefore irrelevant to the 1992 to 2002 Peace Clause comparison. Direct payments are green box support because they conform to the applicable general and policy-specific criteria under Annex 2 of the Agriculture Agreement. As green box measures, direct payments are not part of the comparison of "product-specific" support under Article 13(b)(ii). Because direct payments are based on quantities of acreage that historically produced certain commodities, including upland cotton, and there is no requirement to produce upland cotton to receive these payments, however, direct payments are non-product-specific.

22. With respect to counter-cyclical payments, the United States notes that these measures do not grant product-specific support to upland cotton. Product-specific support is " provided for an agricultural product" for the benefit of "the *producers* of the basic agricultural product". The payment formula for counter-cyclical payments demonstrates that these payments are not "provided for an agricultural product" because it is not current production of upland cotton that qualifies a recipient to receive payment. In addition, it is not "the producers of the basic agricultural product" – that is, current upland cotton growers – that are entitled to receive the counter-cyclical payments but rather persons (farmers and landowners) on farm acres with *past histories* of producing covered commodities, including upland cotton. Because counter-cyclical payments are not product-specific support for upland cotton, such payments are not properly part of the Peace Clause comparison under Article 13(b)(ii).

23. Neither does crop insurance grant product-specific support to upland cotton. A variety of insurance plans are now subsidized and reinsured by the United States. The basic programme provisions for crop insurance are generic, not commodity-specific. For example, the US Government

provides an incentive to participate in the crop insurance programme by subsidizing the premium paid by the farmer. This premium subsidy is available to a broad array of commodities around the country and does not vary by commodity. Thus, while the United States notifies crop insurance as "amber box" domestic support subject to US reduction commitments, crop insurance is "non-product-specific support in favour of agricultural producers in general".

24. **Conclusion: US Non-Green Box Domestic Support Measures Are Exempt from Brazil's Subsidies Agreement and GATT 1994 Article XVI Action**: Brazil has asserted that US domestic support measures breach the Peace Clause by comparing US budgetary outlays for the 1992 marketing year to US budgetary outlays for marketing years 1999-2001 and its "reasonable" estimates of US outlays for the 2002 marketing year. As noted above, Brazil's interpretation of the Peace Clause and resulting analysis is fundamentally in error. Because the level of income support granted to upland cotton producers is far lower now than the support decided in marketing year 1992, Brazil may not maintain this action and advance claims under GATT 1994 Article XVI:1 or Subsidies Agreement Articles 5 and 6 with respect to US non-green box domestic support measures – marketing loan programme payments, user marketing (step 2) certificates, counter-cyclical payments, and crop insurance subsidies.

25. **US Step 2 Payments Are Not an Export Subsidy for Upland Cotton**: User marketing (Step 2) payments are made to users of upland cotton. Under section 1207 of the 2002 Act, the Secretary of Agriculture is authorized to issue marketing certificates or cash payments *to domestic users and exporters* of upland cotton *for documented purchases by domestic users and sales for export by exporters*. The programme is indifferent to whether recipients of the benefit of this programme are parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States or exporters. Accordingly, the United States reports the benefits conferred under the Step 2 programme as product-specific amber box domestic support.

26. The Step 2 programme is not an export subsidy under Agriculture Agreement Article 9.1 and not an export subsidy in circumvention of the US obligation not to confer an export subsidy with respect to cotton, contrary to Article 10.1. Article 1(e) of the Agriculture Agreement states that "'export subsidies' refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement". Consequently, to constitute an "export subsidy" for any purposes of the Agreement, the subsidy must first be "contingent on export performance". The benefits of the Step 2 programme are not contingent on export performance.

27. A WTO dispute settlement panel has already determined that such facts do not involve an export subsidy for purposes of both Articles 9 and 10 of the Agriculture Agreement, because the subsidy is not "contingent on export performance". The panel in *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products* concluded that where a subsidy was available in connection with the exported product but also to processors producing for the domestic market, "access to milk under such other classes is not 'contingent on export performance.' We therefore find that such other milk classes do not involve an export subsidy under Article 9.1(a)". For precisely the same reasons, the panel also found that "these other milk classes do not involve an export subsidy in the sense of Article 10.1". Similarly, the Step 2 programme is not an export subsidy inconsistent with Articles 9 and 10 of because the subsidy is not contingent on export performance and therefore is not an export subsidy.

28. **Brazil Bears the Burden of Proof to Demonstrate the Existence of an Export Subsidy for Upland Cotton**: Brazil as complainant bears the burden of proof with respect to any export subsidy claim relating to upland cotton. Brazil cites Agriculture Agreement Article 10.3 to assert that the United States bears this burden. However, the burden-shift set forth in Article 10.3 is only applicable with respect to exports in excess of a *reduction* commitment level. As Brazil correctly points out, the United States does not have such a *reduction* commitment level with respect to upland cotton. Article 10.3 therefore does not apply with respect to US cotton exports. With respect to products for

which a Member has no scheduled export subsidy reduction commitments, the burden of proof remains with the complainant.

29. **US Step 2 Payments Are Not a Prohibited Subsidy Under Article 3 of the Subsidies Agreement**: With respect to domestic support, the negotiators of the Agriculture Agreement devised the novel concept of "Aggregate Measurement of Support" (AMS), defined in Article 1(a). As the definition provides, all annual domestic support provided for an agricultural product, like cotton, in favour of the producers of that product that is not otherwise exempt under the "green box" (Annex 2) from reduction commitments, or as otherwise provided in Articles 6.4 and 6.5 of the Agreement, is included in the AMS. The definition further contemplates that support provided during any one year is to be calculated in accordance with the provisions of Annex 3. Paragraph 7 of Annex 3 requires that "measures directed at agricultural processors shall be included [in the AMS] to the extent such measures benefit the producers of the basic agricultural products".

30. Accordingly, Step 2 user payments, directed at upland cotton processors and other users but intended to benefit US producers of upland cotton, are included in the annual AMS calculation of the United States. As a result, such payments are subject to reduction commitments applicable to the United States. Agriculture Agreement Article 6.3 provides that "a Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule". Where a particular programme exists in favour of agricultural producers within such Current Total AMS, the Agriculture Agreement is entirely agnostic as to the method of delivery of such support.

31. The United States is in compliance with its domestic support reduction commitments, of which support in the form of the Step 2 programme is a constituent part, as provided in the Agriculture Agreement. Articles 3.1(a) and 3.1(b) of the Subsidies Agreement apply "except as provided in the Agreement on Agriculture". The conformity of the Step 2 programmes with the terms, object and purpose of the Agriculture Agreement – and in particular the domestic support reduction commitments – constitute precisely the kind of exception contemplated in the introductory words of Article 3. Inasmuch as Articles 3.1(a) and (b) do not apply to Step 2 payments, the Step 2 programme also cannot violate Subsidies Agreement Article 3.2.

32. **US Step 2 Payments Are Not Inconsistent with GATT 1994 Article III:4**: As contemplated by the terms of the Step 2 programme itself, as well as Annex 3 of the Agriculture Agreement, the Step 2 programme provides benefits in favour of US upland cotton producers. As noted above, the Step 2 programme is in conformity with Agriculture Agreement Article 6. In addition, Agriculture Agreement Article 3.1 provides that the domestic support commitments in Part IV of each Member's Schedule are made an integral part of GATT 1994. The domestic support commitments of the United States are therefore an integral part of GATT 1994 itself, and Agriculture Agreement Article 21.1 expressly states that "the provisions of GATT 1994 . . . shall apply subject to the provisions of this Agreement".

33. Pursuant to Article 6.3 of the Agriculture Agreement, "a Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule". Annex 3, paragraph 7, specifically requires that "[m]easures directed at processors shall be included" in the calculation of AMS to subject these measures to the domestic support reduction commitments established for the first time in the Agriculture Agreement. The Step 2 programme exists in favour of agricultural producers within such Current Total AMS, and the text of the Agriculture Agreement does not prohibit any particular form of delivery of such amber box domestic support.

34. The Agriculture Agreement imposed for the first time rigorous disciplines on agricultural support. The domestic support reduction commitments of the United States constitute an integral part of GATT 1994. A coherent reading of the Agriculture Agreement with the GATT 1994 indicates that the Step 2 programme does not violate GATT 1994 Article III:4.

35. **The Commodity Credit Corporation Export Credit Guarantee Programmes are Not Export Subsidies**: During the Uruguay Round, negotiators did not reach agreement on disciplines on all areas that had been the subject of negotiations, in several cases agreeing to continue negotiating after the close of the Round and the entry into force of the WTO Agreement. The simple fact is that during the Uruguay Round WTO Members did not agree on disciplines to be applicable to export credits, export credit guarantees, and insurance programmes. Unable to reach agreement on such disciplines within the Uruguay Round, Members opted to continue discussions in an appropriate forum, deferring the imposition of substantive disciplines until a consensus was achieved.

36. Following the entry into force of the WTO Agreement, numerous WTO Members commenced negotiations under the auspices of the OECD to achieve such internationally agreed disciplines. When such negotiations failed to achieve an agreement, negotiations on disciplines for export credits and export credit guarantees have subsequently continued both under the reform process contemplated under Article 20 of the Agriculture Agreement and the mandate of the Doha Ministerial Declaration.

37. The scope and detail of the current agriculture negotiations as reflected in the Harbinson text demonstrate that the Members are currently engaged in active negotiations on disciplines for export credits and credit guarantees. Among the areas under active discussion include disciplines on the relationship between premiums, term, and long-term operating costs and losses. These discussions would be unnecessary if existing disciplines applied to such programmes in agriculture. The Panel should not pre-empt such negotiations.

38. The text of Article 10.2 of the Agriculture Agreement reflects the deferral of disciplines on export credit guarantee programmes contemplated by WTO Members. As simply reflected in the structure and text of the Agriculture Agreement, Members came to no agreement with respect to substantive disciplines on export credit guarantee programmes. Article 10.2 stands in stark contrast to Article 9.1. Article 9.1 sets forth a list of six very specific practices known to the drafters and deemed to constitute export subsidies under the Agriculture Agreement. Significantly, the Illustrative List of Export Subsidies in the Subsidies Agreement explicitly addresses export credit and credit guarantee practices in its item (j). Conspicuously absent in Article 9.1 is any provision addressing such practices, even though US export credit guarantee programmes had been in existence for nearly fifteen years preceding the inception of obligations under the WTO.

39. To include US export credit guarantee programmes within the ambit of Article 10.1 or within the definition of export subsidy under Article 1(e) of the Agreement would render the work programme envisioned by Article 10.2 unnecessary. Further, to adhere to the approach that Brazil advocates would allow for the utter irrelevance of Article 10.2. Indeed, Brazil unabashedly makes not one reference to Article 10.2 in its initial submission.

40. **CCC Export Credit Guarantees are Not Prohibited Export Subsidies Under the Subsidies Agreement**: Brazil has alleged that the CCC export credit guarantee programmes are prohibited subsidies under Article 3.1(a) of the Subsidies Agreement. The very first words of Article 3.1 of the Subsidies Agreement, however, are: "Except as provided in the Agreement on Agriculture." Article 10.2 of the Agriculture Agreement, as noted above, provides for the deferral of disciplines unless and until internationally agreed disciplines are in fact achieved. Brazil has conveniently ignored both Article 10.2 and the explicit introductory words of the Subsidies Agreement Article 3.1 in its first submission. However, Brazil concedes that the export credit guarantees are "exempt from action under ASCM Article 3.1(a) if they fully conform to the provisions of [Agreement

on Agriculture] Part V". These programmes are in conformity with Article 10.2, which is within such Part V. In addition, Article 21.1 explicitly provides that the Multilateral Trade Agreements in Annex 1A to the WTO Agreement, which include the Subsidies Agreement, shall apply *subject* to the Agriculture Agreement.

41. Brazil alleges that the export credit guarantee programmes constitute an export subsidy for purposes of the Subsidies Agreement because such programmes fall within item (j) of the Illustrative List of Export Subsidies. Brazil alleges the United States provides export credit guarantees for cotton "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes" and that a ten-fiscal-year period "fulfils the criterion of being 'long-term' within the meaning of item (j)". Quite simply, with respect to cotton, for the last 10 fiscal years for which complete data is available, premiums paid exceed claims paid. As with any other insurance-type programme, moreover, a proper analysis of "losses" should involve the calculation of the net result of premiums collected, plus claims amounts repaid or rescheduled, minus claims paid. Such calculation would properly reflect the net position of the programme.

42. For the 10-year period from fiscal year 1993 through fiscal year 2002, premiums collected total $16,026,202 and losses incurred via claims total $4,768,096. Consequently, even *before* any post-default recoveries, premiums exceeded claims paid. Of claims incurred, $1,015,365 were subsequently directly recovered, and an additional $8,175,570 have been rescheduled. Brazil argues that the United States "must at the very least recover their operating costs by virtue of fees or premiums collected". Without conceding that this is the applicable test by which the conformity of export credit guarantee programmes with WTO obligations should be assessed, nevertheless, the US programmes for cotton satisfy this Brazilian suggestion.

43. Brazil, like any complainant, bears the burden of establishing that export credit programmes fall within the terms of item (j). Brazil, the United States, and the Appellate Body would apparently agree, however, that *a contrario*, to the extent a WTO Member provides, as the United States has already demonstrated with respect to cotton, export credit guarantees at premium rates which *do* cover long-term operating costs and losses of the programmes, then it is *not* an export subsidy within the meaning of item (j) and the Subsidies Agreement. Premiums collected for US export credit guarantees in connection with cotton transactions over the last 10 fiscal years exceed long-term operating costs and losses. Under the criteria of item (j) alone, these programmes do not constitute a prohibited export subsidy within the meaning of the Subsidies Agreement and are not prohibited under Article 3.1(a) nor inconsistent with Article 3.2.

44. **Brazil Has Failed to Make a Prima Facie Case Regarding the FSC Repeal and Extraterritorial Income Exclusion Act of 2000**: With respect to its claims concerning the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ("ETI Act"), in its first submission Brazil has not presented any evidence regarding the ETI Act itself and does nothing more than "reiterate[] the claims brought by the European Communities under the [Agriculture Agreement] and the Subsidies Agreement in *US – FSC (21.5)*, and ask[] the Panel to apply the reasoning as developed by the panel and as modified by the Appellate Body in that case *mutatis mutandis*". In so doing, Brazil has failed to make a *prima facie* case with respect to the ETI Act. Brazil's approach would put the Panel in the position of having to violate its obligation under DSU Article 11 to "make an *objective assessment of the matter* before it, including an *objective assessment of the facts* of the case and the *applicability of and conformity with* the relevant covered agreements". As a result of Brazil's approach, the Panel is in no position to exercise its judgment to follow, or decline to follow, prior reports concerning the ETI Act, nor even in a position to make factual findings concerning the Act. In the absence of a *prima facie* case by Brazil, the Panel should reject Brazil's claims concerning the ETI Act.

# ANNEX B-3

THIRD-PARTY SUBMISSION BY ARGENTINA

15 July 2003

**TABLE OF CONTENTS**

## I. INTRODUCTION

1. Argentina thanks the Panel for this opportunity to present its views as a third party to these proceedings and will address Brazil's claims[1] of inconsistency of the subsidy programmes provided by the United States to US producers, users and exporters of upland cotton, as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies.

In addition, Argentina will discuss the export credit guarantee programmes provided by the United States for exports of cotton and other commodities that are also exported by Argentina.

2. Given the little time available between the receipt on 11 July of the responding party submission of the United States and the date fixed for this third-party submission, Argentina will comment on the US submission at the meeting of the Panel with the parties and third parties scheduled on 24 July.

3. Firstly, Argentina proposes to argue the absence of US protection under Article 13(b)(ii) and (c)(ii) of the Agreement on Agriculture (hereinafter "AoA"), since the United States does not fulfil the legal requirements for protection against claims under Article XVI of the GATT 1994 and Articles 3, 5 and 6 of the Agreement on Subsidies and Countervailing Measures (hereinafter "SCM Agreement").

4. Secondly, Argentina will argue that the domestic support measures challenged by Brazil are inconsistent with Articles 5 and 6 of the SCM Agreement to the extent that they cause adverse effects to the interests of other Members, including Argentina. It will also argue that the United States grants export subsidies that are prohibited under Article 3(a) and (b) of the SCM Agreement.

5. Nevertheless, Argentina has taken note of the Panel's decision of 20 June to express its views, by 1 September next, on whether the measures at issue satisfy the conditions in Article 13 of the AoA and to differ its consideration of the claims under Article XVI of the GATT 1994 and Articles 3, 5 and 6 of the SCM Agreement as those provisions are referred to in Article 13 of the AoA.

6. Argentina will therefore address the inconsistency of the US subsidies with Articles 5 and 6 of the SCM Agreement in the submission of 22 September next, providing evidence that the US may not invoke protection under Article 13 of the AoA since it does not fulfil the conditions for protection under that provision.

7. Lastly, Argentina maintains that US cotton export subsidies are inconsistent with Articles 3.3, 8 and 10.1 of the AoA, since the Peace Clause cannot be used as a defence in respect of such claims.

## II. WORLD COTTON MARKET SITUATION AND IMPACT OF THE US SUBSIDIES IN ARGENTINA

### II.1. WORLD COTTON MARKET SITUATION

8. According to data from the Statement of the 61st Plenary Meeting of the International Cotton Advisory Committee (ICAC), held in Cairo, Egypt, from 20 to 25 October 2002[2], world cotton

[1] "Brazil´s First Submission to the Panel regarding the 'Peace Clause' and Non-Peace Clause Related Claims", 24 June 2003. (Hereinafter "Brazil's Submission").

[2] Representatives of 38 governments and eight international organizations took part in the meeting. MEMBER GOVERNMENTS: Argentina, Australia, Belgium, Brazil, Burkina Faso, Cameroon, Chad, Chinese Taipei, Colombia, Côte d'Ivoire, Egypt, Finland, France, Germany, Greece, India, Iran, Israel, Italy, Japan, Republic of Korea, Mali, Netherlands, Nigeria, Pakistan, Paraguay, Philippines, Poland, Russia, South Africa,

production reached a record 21.5 million tons in marketing year 2001/2002, exceeding global consumption by 1.3 millions tons.

9. Over the same period, world cotton exports increased by 10 per cent to an unprecedented 6.5 million tons, while international cotton prices fell to the lowest average level in 30 years of US$0.418 per pound (according to Cotlook Index A).

10. The value of world production declined by US$5 billion from the previous season, affecting the incomes of millions of growers, input suppliers and service providers in unsubsidized countries.

11. Since the mid-1990s, the world cotton economy has been marked by chronic price depression. Average international cotton prices, adjusted for inflation, are at their lowest since the Great Depression of 1930, having remained below US$0.60 per pound for the last four consecutive years (1998/1999 to 2001/2002) against an average of US$0.725 per pound over the past 25 years.

12. According to the ICAC, at 1 July 2003 the average international cotton price in marketing year 2002/2003 was estimated at US$0.56 per pound, still well below the average of the last 30 years. Under such conditions, even the most efficient producers find themselves operating at a loss, unable to cover even their production costs. ICAC projections suggest that prices will remain chronically depressed for the foreseeable future. Forecasts point to a modest recovery in 2003/2004, but prices will stay within the US$0.50-0.60/lb range until 2015.

## II.2. COTTON SITUATION IN THE UNITED STATES

13. As a rule, when prices slump production undergoes a similar downturn. However, while world cotton prices have fallen by 54 per cent since the mid-1990s, the United States has increased its output and exports.

14. Since 1998, US cotton production has experienced 42 per cent growth from 14 million metric tons to a record 20.3 million metric tons in 2001.

15. Likewise, at a time of dramatically declining international cotton prices the volume of US exports has expanded to unprecedented levels, from 946,000 tons in 1998 to 2,395,000 tons in 2002.[3]

16. In addition, US cotton production costs are among the highest in the world. According to a recent ICAC study[4], the cost of production in the United States was US$0.81 per pound of cotton in marketing year 1999,[5] while US producers market prices fell from US$0.60 to US$0.30 per pound.

17. The only possible explanation how the United States bridged the widening gap between production costs and market prices is subsidies, for without them many US producers would have been compelled to cease production.

18. Hence the factor underlying the world cotton market crisis is the US subsidies. As Brazil points out at paragraph 2 of its Submission, it was the subsidies that enabled the United States to

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Spain, Sudan, Switzerland, Syria, Tanzania, Togo, Turkey, Uganda, United Kingdom, United States, Uzbekistan and Zimbabwe.

[3] According to data from "*Cultivating Poverty: The Impact of U.S. Cotton Subsidies on Africa*", Oxfam Briefing Paper 30, 27 September 2002 (See Exhibit Bra-15) and ICAC Secretariat.

[4] "Cotton: World Statistics". Bulletin of the International Cotton Advisory Committee, September 2002. (Exhibit Bra-9).

[5] As stated by Brazil at paragraph 32 of its Submission, the cost of production in Argentina averaged 59 cents/lb of cotton, according to the ICAC study (See Exhibit Bra-9).

increase production and exports while market prices remained far below the cost of production over marketing years 1999 to 2002.

19. The total value of US cotton subsidies during this period – as stated at paragraph 3 of Brazil's Submission – amounted to almost US$13 billion and the average cotton subsidization rate was 95 per cent.[6]

20. While there are a great many cotton producing countries, four of them (China, the United States, India and Pakistan, in descending order) alone account for two thirds of world cotton production. Most of the cotton is used in the producing country itself. The great exception to this rule is the United States, which exports over half of the cotton it produces[7] and is the world's leading exporter. This is why the level of subsidization in the United States is so important as far as the world cotton market is concerned.

## II.3. COTTON SITUATION IN ARGENTINA

21. Argentina's cotton sector is a substantial source of employment and income for many of the country's provinces. The Argentine cotton sector has been contracting since 1998, as a result of declining international prices. In 2001/2002, cultivated area and production plummeted to historic low levels. Cultivated area has shrunk by 76 per cent since 1998, with 174,000 hectares planted to cotton, and production has fallen by 63 per cent compared to 1998, with an estimated 73,000 tons of cotton fibre produced.[8]

22. According to the Argentine Ministry of Agriculture, Livestock, Fisheries and Food, provisional estimates as at 13 June 2003 for marketing year 2002/2003 were 157,930 hectares of cultivated area and 60,000 tons of cotton produced.

23. The decline is even more significant when considered in terms of a 10-year annual average, record prices in 1994/1995 (US$0.9275/lb Cotlook A Index) having led to record figures for both cultivated area and production (1,010,000 hectares and 437,000 tons of cotton fibre in 1995/1996).

24. The contraction of the cotton sector started in 1997/1998. Since then, steadily falling prices and increased US government support have gradually driven raw cotton[9] producer prices down to their lowest level (US$192/ton) since 1991/1992, which in turn has entailed constant reductions in cultivated area and production.

25. Although domestic consumption is dwindling, Argentine exports of cotton fibre set another historic low record of 18,366 tons in 2001/2002. Data updated at 31 May 2003 show even worse results, since exports for marketing year 2002/2003 barely reached 2,000 metric tons.

### *(a) Impact of low international prices on Argentine production*

26. Over the last three years, low international prices – because of the huge US subsidies – have impacted heavily on producers' decisions, with only 309,287 cultivated hectares, representing a 58 per cent reduction from a 10-year annual average (1989/1990 to 1998/1999). This has led to sharp reductions in cotton fibre production. Over that same three-year period (1999/2000 to 2001/2002), production averaged 122,883 tons – a 62 per cent fall from the annual average of 327,360 tons

[6] USDA Fact Sheet: Upland Cotton (January 2003). (See Exhibit Bra-4).

[7] As indicated at paragraph 10 of Brazil's Submission, domestic cotton consumption in the United States is dwindling steadily.

[8] "Argentina: Economic Injury to the Cotton Sector as a Result of Low Prices", Working Group on Government Measures of the International Cotton Advisory Committee, 2002.

[9] Seed cotton; unginned.

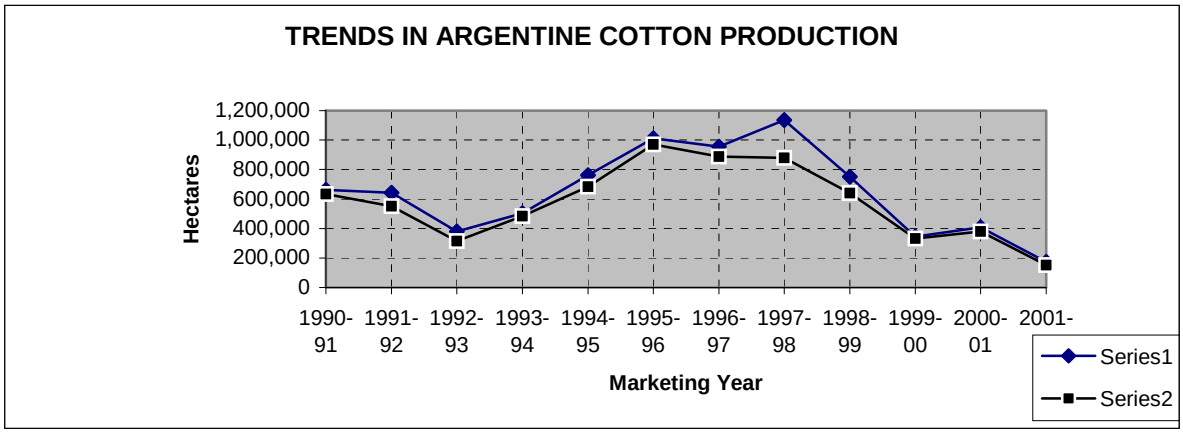
between 1994/1995 and 1998/1999. Worse still, production in 2001/2002 was estimated at 69,810 tons and in 2002/2003 at 60,000 tons, against 163,000 tons in 2000/2001.

27. This collapse of the Argentine cotton sector is reflected in the high level of indebtedness of producers estimated at US$600 million and equivalent to twice the size of agricultural GDP of Argentina's largest cotton producing province.

28. The table below shows the direct relationship between the area of cultivated and harvested cotton and fibre production in Argentina, and trends in world cotton prices according to Cotlook A Index.

| **Season** | **Cotton area (hectares)** | | **Fibre production** | **World price A Index** |
|---|---|---|---|---|
| | ***Cultivated*** | ***Harvested*** | ***(Metric tons)*** | ***(US cents/lb)*** |
| **1995/96** | **1,010,000** | **969,400** | **437,000** | **85.60** |
| 1996/97 | 955,600 | 887,140 | 338,000 | 78.55 |
| 1997/98 | 1,133,500 | 877,900 | 311,000 | 72.20 |
| 1998/99 | 751,000 | 639,700 | 200,000 | 58.90 |
| 1999/00 | 345,950 | 332,100 | 134,000 | 52.80 |
| 2000/01 | 407,980 | 384,850 | 165,000 | 57.20 |
| 2001/02 | 173,930 | 170,000 | 73,000 | 41.80 |
| **2002/03*** | **157,930** | **147,410** | **60,000** | **55.30** |

* Estimate




*(b) Impact of low international prices on employment*

29. Total employment in raw cotton production in Argentina amounts to 93,470 workers; this figure includes 32,060 cotton producers and is based on an average harvested area of 810,828 hectares. The ginning sector employs 3,946 workers and the marketing and input supply chain represents 12,550 additional jobs.

30. Between 1999/2000 and 2001/2002, employment in the cotton sector decreased to an average of 70,400 workers, i.e. a **reduction in employment of 64 per cent**. These figures were obtained from the official employment records of registered workers but they are probably underestimated. According to private estimates, there are 50,000 non-registered workers, which would increase labour loss to 102,000 jobs.

31. Argentina's cotton production is concentrated in 11 provinces and, according to a 1999 World Bank study, 56.6 per cent of the population in these provinces live under the poverty line and 18.2 per cent below the indigence line. The same study shows that 36.1 per cent of Argentina's population live

under the poverty line and 8.6 per cent below the indigence line, which reflects the higher level of poverty in the cotton producing provinces.[10]

*(c) Impact of low international prices on income*

32. Between 1999/2000 and 2001/2002, average raw cotton production[11] was 652,872 tons lower than the 1994/1995 to 1998/1999 average. Using an average price received by producers of US$358/ton[12] between 1994/1995 and 1998/1999, annual gross revenue has dropped by US$255 million over the past three years.

*(d) Impact of low international prices on the value and volume of Argentine exports*

33. In marketing year 2002/2003, planted area shrank to a mere 157,930 hectares, its lowest level in the last 66 years, and production will not even succeed in meeting domestic demand. Even in circumstances like these, it might have been possible to generate sufficient export supply had international prices not been artificially depressed.

34. It should be emphasized that in 1996 Argentina exported 70 per cent of its production, ranking that year as the world's fourth largest exporter.

35. The table below shows the trends in Argentine cotton exports.

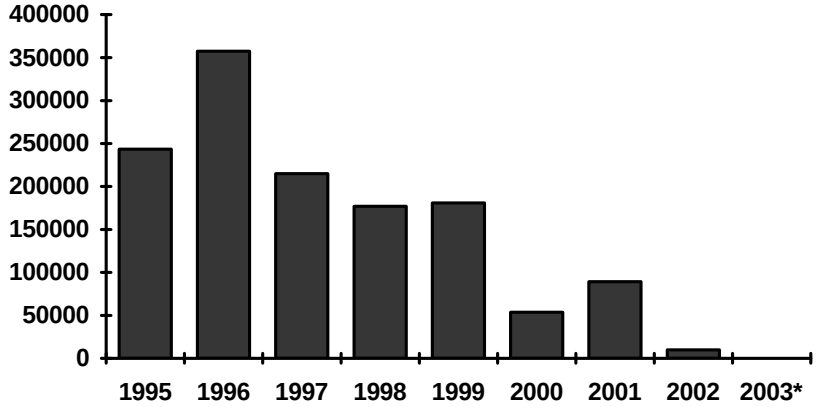
**TRENDS IN ARGENTINE COTTON EXPORTS**

| Years | Volume (tons) | FOB value (US$ millions) | Argentina's per cent share of world exports |
|---|---|---|---|
| **1995** | 243,474 | 432.8 | 4% |
| **1996** | 357,447 | 497.0 | 6% |
| **1997** | 214,904 | 332.3 | 3.6% |
| **1998** | 177,025 | 224.3 | 3.2% |
| **1999** | 180,897 | 177.9 | 3% |
| **2000** | 53,637 | 53.2 | 0.9% |
| **2001** | 89,262 | 72.8 | 1.5% |
| **2002** | 18,366 | 11.9 | 0.1% |
| **2003*** | **1,985** | **1.6** | -- |

*****(Estimate at 31 May 2003)

[10] *Id.*
[11] Seed cotton; unginned.
[12] For a quality equal to a C-1/2 grade.

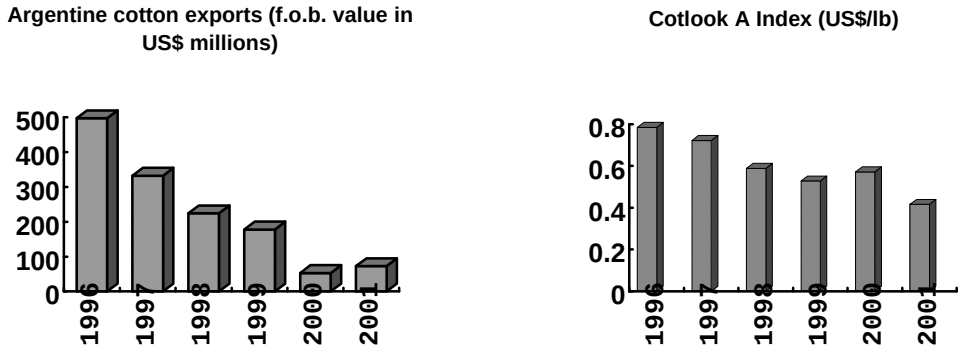
36. In chart form, Argentine cotton exports (tons) since 1995 show the following trends:




37. This chart shows – as does the table below – a direct relationship between the decline in international cotton prices, which began in 1996/1997, along with the implementation of the 1996 US Farm Act, and the collapse of the Argentine cotton economy.

| **Years** | **Argentine cotton exports (FOB value in US$ millions)** | **Cotlook A Index (US$/lb)** |
|---|---|---|
| **1996** | 497.0 | 0.7855 |
| **1997** | 332.3 | 0.7220 |
| **1998** | 224.3 | 0.5890 |
| **1999** | 177.9 | 0.5280 |
| **2000** | 53.2 | 0.5720 |
| **2001** | 72.8 | 0.4180 |
| **2002** | 11.9 | 0.5530 |
| **2003*** | 1.6 | --- |

38. The following chart clearly illustrates the direct relationship (except for the year 2000) between Argentine exports and international cotton prices.




## III. LOSS OF PROTECTION UNDER THE PEACE CLAUSE: ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE (AOA)

39. As stated in paragraph 6 above, Argentina will address the inconsistency of the United States subsidies with Articles 5 and 6 of the SCM Agreement in the 22 September submission. On that occasion, Argentina will explain why the United States cannot seek the protection of Article 13 of the AoA because of non-compliance with the legal requirements for protection under that provision.

PEACE CLAUSE DEFENCE SUBJECT TO CONDITIONS

40. The "Peace Clause" – Article 13 of the AoA – precludes actions against a Member's agricultural subsidies up to 1 January 2004 if such measures comply with certain legal requirements.

41. As stated by Argentina in its Third Party Initial Brief:

> "… a textual analysis of Article 13 of the AoA reveals that *"actions"*… can only be precluded if all conditions established in paragraphs (b) (ii) or (c) (ii) of the referred Article 13 are met".[13] (Emphasis added).
>
> …
>
> " … *'Exempt from actions'* means that a finding of inconsistency with Article XV1 of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement will not be possible if the legal requirements for the exemption are fulfilled. The immediate context of the term *'exempt from actions'* – i.e., paragraphs (b) and (c) – confirms this interpretation since that exemption requires a particular threshold, i.e. that domestic support measures and export subsidies 'conform fully' (to different provisions of the AoA)".[14]
>
> …
>
> " … A different interpretation would imply giving the measures allegedly covered by the Peace Clause a character of absolute immunity, independent of whether the legal requirements established in Article 13 are fulfilled or not. This would contradict the principle of *in dubio mitius*, constituting a more onerous interpretation of the treaty provisions".[15]
>
> …
>
> " … Indeed, the key words in Article 13 (b) (ii) and (c) (ii) of the AoA are *"that conform fully"* and *"provided that"* and *"that conform fully"*, respectively. These words imply that the exception is not absolute, but rather subject to the fulfilment of certain conditions … ".[16]

BURDEN OF PROOF WITH RESPECT TO THE CONDITIONS FOR THE PEACE CLAUSE DEFENCE

42. As Argentina stated in its Third Party Initial Brief, the defence under Article 13 of the AoA is in the nature of an exception (affirmative defence).

43. It follows that in accordance with the WTO rules on the burden of proof (laid down by the Appellate Body in (*United States – Shirts and Blouses from India)*, the burden is on the party invoking the exception to show that its use is justified. In the present case, it is clearly for the party invoking the protection of Article 13 of the AoA to show that the conditions stipulated in that Article are satisfied.

44. Accordingly, for the United States domestic support measures to be exempt from actions based on Article XVI.1 of GATT 1994 or Articles 5 and 6 of the SCM Agreement, the United States must show that:

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[13] See Argentina's Third Party Initial Brief of 10 June 2003, paragraph 3.
[14] *Ibidem* paragraph 5.
[15] *Ibidem*, paragraph 6.
[16] *Ibidem*, paragraph 8.

- The domestic support measures for cotton conform fully to the provisions of Annex 2 to the AoA (or belong in the "green box", at the risk of being included in the Current Total AMS in accordance with Article 7.2 (a) of the AoA), or that

- the domestic support measures that do not belong in the "green box" and grant support to cotton do not exceed the support decided during the 1992 marketing year.

45. Likewise in order for the export subsidies granted by the United States to be exempt from actions based on Article XVI of GATT 1994 and Articles 3, 5 and 6 of the SCM Agreement the United States must show that these export subsidies conform fully to Articles 8 to 11 of the AoA (Part V).

III.1 LOSS OF PEACE CLAUSE PROTECTION IN RELATION TO DOMESTIC SUPPORT MEASURES: ARTICLE 13 (B) (II) OF THE AoA

46. In particular, in relation to domestic support measures, Article 13 (b) (ii) of the AoA states that:

> *"During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies … :*
>
> *… domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within de minimis levels and in conformity with paragraph 2 of Article 6, shall be:*
>
> …
>
> *exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; …" (emphasis added).*

47. In Argentina's opinion, in the present case, for lack of a specific WTO notification or known US laws or regulations, the support *"decided during the 1992 marketing year"* by the United States should be considered to be the non-"green box" domestic support granted by that country to cotton during the 1992 marketing year.

48. Argentina agrees with Brazil that the level of subsidies granted by the United States to its cotton sector during marketing years 1999 to 2002 exceeded that of 1992, thereby depriving the United States of Peace Clause protection, for non-compliance with the legal requirements of Article 13 (b) (ii) of the AoA.

49. In this respect, the Oxfam Briefing Paper ("*Cultivating Poverty*: The impact of USCotton Subsidies on Africa")[17] states that:

> *"The US has lost this protection (the Peace Clause protection) by virtue of the fact that* ***the level of subsidies it provided in 2001 was double that provided in 1992****".*
>
> …

[17] See Exhibit Bra – 15.

*"Every acre of cotton farmland in the US attracts a subsidy of $230, or around five times the transfer for cereals.* ***In 2001/02 farmers reaped a bumper harvest of subsidies amounting to $3.9bn – double the level in 1992.*** *This increase in subsidies is a breach of the "Peace Clause" in the WTO Agreement on Agriculture …"*

…

*"The United States accounts for approximately one-half of the world's production subsidies for cotton.* ***In 2001/02 the value of US cotton production amounted to $3bn at world market prices. In the same year, the value of outlays in the form of subsidies to cotton farmers by the USDA's Commodity Credit Corporation (CCC) was $3.9bn.*** *In other words, cotton was being produced at a net cost to the American economy".*

50. The domestic support measures which, in Argentina's view, do not enjoy Peace Clause protection under Article 13 (b) (ii) are the following programmes established in the United States legislation as described by Brazil in its First Submission: Deficiency Payments[18], Loan Deficiency Payments[19], Production Flexibility Contract Payments[20], Direct Payments[21], Market Loss Assistance[22], Counter-Cyclical Payments[23], Marketing Loan Gains[24], Crop Insurance Subsidies[25], Step 2 Domestic Payments[26], and Cottonseed Payments[27].

51. It should be pointed out that in the consultations held on 3, 4 and 19 December 2002 – in which Argentina was joined – in relation to the above-mentioned programmes Argentina requested the United States for information on the amount of support granted to cotton producers in the years 1999, 2000 and 2001, considering that the last domestic support notification had been for the year 1998[28].

52. In this connection, the United States confined itself to pointing out that various answers to the Argentine questions could be found in US domestic support notifications in the process of being submitted to the Committee on Agriculture, without specifying what these answers were or when these notifications would be made.

*The programmes Production Flexibility Contract (PFC), Direct Payment (DP) and Counter-Cyclical Payment (CCP) are non-"green box"*

53. As Brazil shows in its Submission, the PFC, DP and CCP programmes are not subsidies that can be classified as "domestic support measures that conform fully to the provisions of Annex 2" of the AoA.

54. Accordingly, the amounts granted to cotton producers under these programmes must be treated as domestic support in calculating total support under Article 13(b)(ii).

55. These three programmes are inconsistent with Annex 2 of the AoA, *inter alia*, because they are not in accordance with the provisions of paragraph 6 (b) of that Annex in as much as the amount of

[18] Submission by Brazil, paragraphs 45 to 47.
[19] *Ibidem*, paragraphs 70 to 78 and Exhibits Bra – 28, Bra – 29 and Bra – 36.
[20] *Ibidem*, Sections 2.6.1 and 3.2.6.
[21] *Ibidem*, Sections 2.6.2 and 3.2.7.
[22] *Ibidem*, Section 2.6.3.
[23] *Ibidem*, Sections 2.6.4 and 3.2.8.
[24] *Ibidem*, Section 2.6.5.
[25] *Ibidem*, Section 2.6.6
[26] *Ibidem*, Section 2.6.8
[27] *Ibidem*, Section 2.6.10.
[28] It should be noted that after the consultations the United States notified the Committee on Agriculture of the amount of domestic support for the year 1999 (G/AG/N/USA/43; Exhibit Bra – 47).

payments is related with the type of production undertaken by the producer in years after the base period.

56. In this respect, Argentina agrees with Brazil that the term "type … of production …" means the type of crop planted and not the production method employed.

*Failure of the United States to comply with its notification obligations*

57. Considering (i) that the last domestic support notification available is that for the year 1999[29] and (ii) the delay of more than three years, since the end of that year, in submitting a notification, Argentina wishes to make the following points:

58. Argentina considers that the United States has failed to fulfil its notification obligations under Article 18.2 of the AoA, the Decision on Notification Procedures adopted on 15 December 1993 and the Notification Requirements and Formats (G/AG/2) adopted by the Committee on Agriculture on 8 June 1995.

59. This failure to comply with notification obligations makes it very difficult to verify the domestic support provided from 2000 onwards as regards compliance with the commitments under Article 3.2 of the AoA, that is to say, whether or not the United States' non-"green box" subsidy programmes remain within the limits to which it is committed in its Schedule. The lack of notification also makes it difficult to verify whether the domestic support measures "conform fully to Article 6" of the AoA.

60. It is also difficult to review the implementation of the AoA by the United States under Article 18.2 in relation to the categorization of its subsidies, in particular whether some of them are "green box" or not.

61. The seriousness of failure to comply with the obligation to inform Members is such that paragraph 7 of Annex V to the SCM Agreement actually sanctions instances of non-cooperation by requiring the Panel to draw adverse inferences.

62. Argentina considers that this failure should be taken into account in deciding whether the United States' domestic support is consistent with Article 3.2 of the AoA and whether that domestic support should be included among the subsidies of Annex II to the Agreement.

THE US LEVELS OF DOMESTIC SUPPORT FOR COTTON EXCEED THE 1992 LEVEL

63. Argentina agrees with Brazil's figures in paragraphs 144, 148 and 149 of its First Submission showing that the United States budgetary outlays for domestic support for the cotton sector have been as follows (in millions of dollars), on the basis of information supplied by the USDA itself[30]:

[29] G/AG/N/USA/43 (Exhibit Bra-47).
[30] See Exhibits Bra-6, Bra-76, Bra-4, Bra-57, Bra-55, Bra-47, and footnotes 301 and 321.

| Domestic Support | Marketing Year 1992 | Marketing Year 1999 | Marketing Year 2000 | Marketing Year 2001 | Marketing Year 2002* |
|---|---|---|---|---|---|
| **Loan Deficiency Payments** | 268 | 685 | 152 | 743 | 206[31] |
| **Marketing Loan Gains** | 476 | 860 | 390 | 1.763 | 602[32] |
| **(Total Marketing Loan Payments)** | --- | --- | --- | --- | 952[33] |
| **Deficiency Payments** | 1,017 | --- | --- | --- | --- |
| **Production Flexibility Contract Payments[34]** | --- | 616 | 575 | 474 | --- |
| **Direct Payments[35]** | --- | --- | --- | --- | 523 |
| **Step 2 Payments** | 207 | 422 | 236 | 196 | 317 |
| **Crop Insurance Payments** | 26.5 | 170 | 161 | 263 | 194 |
| **Market Loss Assistance Payments** | --- | 613 | 612 | 654 | --- |
| **Counter-Cyclical Payments[36]** | --- | --- | --- | --- | 1,077 |
| **Cottonseed Payments** | --- | 79 | 185 | --- | 50 |
| **TOTAL** | **1,994.5** | **3,445** | **2,311** | **4,093** | **3,113** |

* The information relating to United States support for cotton during marketing year 2002 is not yet complete as the marketing year does not end until 31 July 2003. Nevertheless, Argentina has used the best available evidence provided by Brazil in paragraph 149 of its Submission using partial USDA data and estimates based on criteria and provisions of support under the 1996 FAIR Act.

64. Thus, the subsidy levels for cotton in 1999, 2000, 2001 and 2002 are considerably in excess of the level for 1992 and, as already pointed out, the United States therefore lacks a basis for its claim,

[31] See Exhibit Bra-55.
[32] See Exhibit Bra-55.
[33] See footnote 338 of Brazil's Submission.
[34] According to paragraph 45 of Brazil's Submission, PFC payments replaced the Deficiency Payment Programme that had existed for years and had been renewed in the 1990 FACT Act.
[35] As indicated by Brazil in paragraph 49 of its Submission, direct payments began to be paid in marketing year 2002 with the passage of the new Farm Act in May 2002 (2002 FSRI Act) and will be paid until the end of marketing year 2007, in place of the Production Flexibility Contract payments.
[36] As indicated by Brazil in paragraph 63 of its Submission, the 2002 Farm Act (2002 FSRI Act) institutionalized the market loss assistance payments that the United States enacted in marketing years 1998- 2001 with a new programme of counter-cyclical payments up to the end of marketing year 2007.

under Article 13(b)(ii) of the AoA, that its domestic support measures for cotton are exempt from actions based on Article XVI.1 of GATT 1994 or Articles 5 and 6 of the SCM Agreement.

III.2 LOSS OF PEACE CLAUSE PROTECTION IN RELATION TO EXPORT SUBSIDIES: ARTICLE 13(c)(ii) OF THE AoA

65. With respect to export subsidies, Article 13(c)(ii) of the AoA states that:

> *"During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies … :*
>
> …
>
> *export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be:*
>
> …
>
> *exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement".* (Emphasis added).

66. In relation to export subsidies, the Peace Clause could only be invoked by the United States if its export subsidies conformed fully to the provisions of Part V of the AoA, that is, Articles 8-11 of the AoA.

67. According to Article 8 of the AoA, "Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule".

68. Thus, as Brazil asserts in paragraph 222 of its Submission, the United States can provide export subsidies for agricultural products if it satisfies two conditions: (i) has a reduction commitment for the product in question and (ii) the amount of export subsidies provided does not exceed this reduction commitment.

69. In this case, the measures that Argentina considers to be inconsistent with WTO rules are:

I. the export subsidies for US (upland) cotton established in the United States legislation under the Step 2 Export Program[37];

II. the export credit guarantee programmes for cotton and other products, General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103), and Supplied Credit Guarantee Programme (SCGP), as described by Brazil in its First Submission[38]; and

III. the cotton export subsidies granted under the FSC Repeal and Extraterritorial Income Act of 2000(ETI Act).

[37] CFR 1427.103 to 1427.107.
[38] Submission by Brazil, sections 2.6.7, 4.1 and 4.1.1 and 2.6.9.

*Inconsistency with the provisions of Part V (Articles 8 to 11) of the AoA*

70. Article 3.3 of the AoA prohibits the granting of export subsidies in respect of agricultural products not specified in Section II of Part IV of a Member's Schedule[39]. This provision forms part of the reference to "unconformity with this Agreement and with the commitments as specified in that Member's Schedule" in Article 8 of the AoA.[40]

71. In fact, Schedule XX of the United States, Part IV (Agricultural Products: Commitments Limiting Subsidization), Section II (Export Subsidies: Budgetary Outlay and Quantity Reduction Commitments)[41], **does not specify cotton among the products subject to commitments**.

72. Consequently, because its export subsidies are not in conformity with the provisions of Part V of the AoA, the United States has no basis for invoking, under Article 13 (c) (ii) of the AoA, the exception to the effect that its cotton export subsidies are exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement.

73. Moreover, as described in Section IV of this submission, neither the US (upland) cotton export subsidies established in the United States legislation under the Step 2 Export programme, nor the export credit guarantee programmes for cotton and other products General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103) and Supplied Guarantee Programme (SCG), nor the subsidies granted to cotton exports under the FSC Repeal and Extraterritorial Income Act of 2000 (ETI Act) are in conformity with Part V of the AoA since they are inconsistent with Articles 3.3, 8 and 10.1 of the AoA.

## IV. INCONSISTENCY WITH ARTICLES 3.3, 8 AND 10.1 OF THE AoA AND ARTICLE 3 OF THE SCM AGREEMENT

74. In accordance with paragraph 7 above, Argentina maintains that the United States cotton export subsidies are inconsistent with Articles 3.3, 8 and 10.1 of the AoA.

75. As already pointed out, Schedule XX of the United States, Part IV (Agricultural Products: Commitments Limiting Subsidization), Section II (Export Subsidies: Budgetary Outlay and Quantity Reduction Commitments)[42], **does not specify cotton among the products subject to commitments**.

76. Consequently, as noted by Brazil in paragraph 237 of its Submission, any export subsidy provided by the United States to its cotton industry will be inconsistent with Articles 3.3 and 8 of the AoA. In other words, as it has not specified cotton as a product subject to subsidy reduction commitments, the United States has no right to grant this type of support for the product in question, any support granted or proposed constituting a breach of the provisions of Articles 3.3 and 8 of the AoA:

[39] Article 3.3 of the AoA reads as follows: *"…a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule"*. (Emphasis added).

[40] Article 8 of the AoA reads as follows:

*"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule"*.

[41] See Exhibit Bra-83.

[42] See Exhibit Bra-83.

ARTICLE 10.3 OF THE AoA

77. Argentina wishes to point out that, in accordance with Article 10.3 of the AoA and the Appellate Body's interpretation in "*Canada - Dairy Products: Article 21.5 DSU (II)*[43]", it is for the United States to show that quantities exported in excess of the export subsidy reduction commitment level have not been subsidized.

78. Figures 18 and 19 in paragraphs 265 and 266 of Brazil's submission clearly indicate that in the case of both cotton and other agricultural commodities exports of which qualify for the export credit guarantee programmes GSM 102, GSM 103 and SCGP United States exports during the year 2001 were well in excess of the reduction commitments in its Schedule.

79. Consequently, the United States bears the burden of proving that both for cotton and for other products that benefit from export credit guarantee programmes the export segment in excess of the scheduled reduction commitment has not received any export subsidy.

THE INDIVIDUAL EXPORT SUBSIDY PROGRAMMES

- *Step 2 Export Programme*

80. Referring to Brazil's observations in paragraphs 244 and 245 of its Submission, Argentina agrees that Section 1207(a) of the Farm Act of 2002 (*2002 FSRI Act*)[44] – establishing the *Step 2 Export Programme* – constitutes a *per se* violation of AoA Articles 3.3 and 8 as it is a mandatory provision, in the same way that the *Step 2 Export Programme* also constitutes a *per se* violation of those provisions because of its mandatory nature.

81. Both the corresponding section of the 2002 FSRI Act and the provisions of Section 1427.100 ff. of the *Code of Federal Regulations* clearly establish that the *Commodity Credit Corporation* (CCC) *must* issue marketing certificates or cash payments to exporters and/or users of US (upland) cotton.

82. The purpose of the programme is to provide a direct incentive for US cotton exports and consists of a direct payment to exporters based on the difference between the US domestic cotton price and the world market price. There can be no doubt that whenever the former is higher than the latter an export subsidy is present in as much as the existence of these payments enables the US product to compete artificially with the lower-cost products of more efficient producers. All these aspects are dealt with *in extenso* by Brazil in its Submission dated 24 June 2003[45], and Argentina therefore considers it unnecessary to dwell on a description of the operational details of the programme itself.

83. What Argentina wishes to make clear is the fact – to which attention has already been drawn by Brazil – that the programme known as *Step 2* establishes the right of exporters to receive a subsidy for shipments made in connection with foreign sale operations, while establishing an obligation upon the CCC to grant that subsidy once the particular requirements are satisfied.

84. In "*US EXPORT CREDITS: Denials and Double Standards*"[46], published by Oxfam America, it is noted that:

> *"In the case of cotton, developing countries are clearly losing out because of the unfair competitive advantage given to US cotton exports. For the marketing year*

[43] WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted17 January 2003.
[44] See Exhibit Bra-29.
[45] Submission by Brazil, Sections 4.1, 4.1.1, 4.1.2, 4.2 ff.
[46] Oxfam American Briefing Note, March 2003.

> *2001/2002, US subsidies to cotton amounted to $4 billion, including, among other programs, export credits. In the 2001/2002 marketing year, the transfer linked with Step 2 cotton subsidies ranged from 0-7 cents per pound, or up to 18 per cent of the world market price. Total export subsidization under this heading was around $197 million in 2001".*

85. Insofar as the United States does not specify Upland Cotton in its Schedule of Commitments (see paragraphs 72 and 75 above) and this type of subsidy is granted to cotton under the *Step 2* programme, any provision in the legal texts with respect to the granting of such a subsidy makes those texts inconsistent *per se* with Articles 3.3 and 8 of the AoA, while for the same reason any sum distributed, budgeted or provided for under this programme constitutes a prohibited subsidy within the meaning of Article 3 of the SCM Agreement, which expressly establishes a reservation in respect of the Agreement on Agriculture.

- *The programmes GSM 102, GSM 103 and SCGP:*

86. In its submission of 24 June, Brazil establishes unequivocally that the US export credit guarantee programmes constitute export subsidies. For this purpose Brazil carries out a combined analysis of the provisions of the AoA and the SCM Agreement, while also basing its arguments on the relevant WTO case-law[47].

87. Argentina agrees with the Brazilian analysis and therefore considers it unnecessary to repeat the description of the operational programmes or the analysis of their legal coverage under the Agreement on Agriculture and the SCM Agreement. Suffice it to note that Argentina also considers that these programmes constitute export subsidies under item (j) of the Illustrative List in Annex I to the SCM Agreement – in as much as the export credit guarantees are granted "*at premium rates which are inadequate to cover the long term operating costs and losses of the programmes*" – thereby resulting in a violation of the provisions of Article 10.1 of the AoA.

88. At the same time, Argentina wishes to emphasize the impact and distorting effect on trade of these export credit guarantees.

89. The export credit guarantee programmes provide incentives for exports for United States agricultural products, in this case cotton and other agricultural products, and the credits are granted on terms more favourable than those available on the market. This situation is clearly reflected in paragraphs 275 to 286 of Brazil's First Written Submission and further illustrated by the Oxfam study "*US EXPORT CREDITS: Denials and Double Standards*"[48] which on page 3 states:

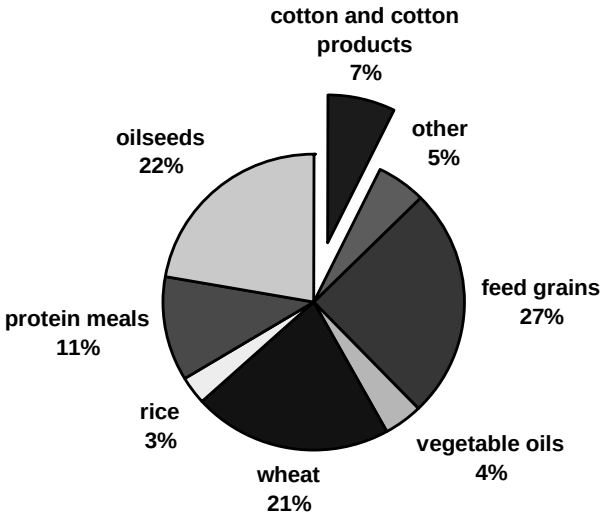
> *" … those favourable conditions include lower interest rates, a longer loan repayment period, a smaller down payment, less frequent payments per year and/or the virtual waiver of a fee or premium designed to provide the US government with adequate protection against potential defaults".*

90. Likewise, a study carried out by the OECD in 2000, in which the effects of export subsidies granted by various countries are evaluated, indicates that the United States credit guarantee programmes are the most trade-distorting of all those analyzed, in as much as the premiums paid by the beneficiaries are too low to cover the high level of the guarantees granted for long term credits.[49]

[47] Submission by Brazil, Section 4.2.1.4.2.
[48] Oxfam America Briefing Note, March 2003.
[49] "An analysis of officially supported export credits in agriculture", OECD, 2000.

91. According to the "*Summary of FY 2002 Export Credit Guarantee Programme Activity*", published on the Federal Agricultural Service (FAS) Website[50], the percent shares of export credit guarantee applications, by commodity, for fiscal year 2002 were as follows:

**Applications for export credit guarantees, by commodity,**
**Fiscal year 2002, Percent share**




92. Thus, as the United States does not have export subsidy reduction commitments specified in its Schedule for cotton and other products such as soya, maize (corn) and oilseeds and given the existence of United States export subsidies for cotton and other products, the United States is in violation of Articles 3.3, 8 and 10.1 of the Agreement on Agriculture.

93. Finally, it should be noted that the GSM 102, GSM 103 and SCGP programmes can be granted both to products for which reduction commitments exist and to those for which no such commitments exist[51]. With the respect to the products for which there are reduction commitments, the amounts exported by the United States are well in excess of the levels of those commitments.[52] Accordingly, Argentina considers – as indicated by Brazil[53]- that the burden lies with the United States to prove that its excess exports did not benefit from export subsidies, including export credit guarantees.

94. Moreover, since the GSM 102, GSM 103 and SCGP programmes are intended to promote exports of cotton, confirmation of their export subsidy component would imply the presence of a subsidy prohibited within the meaning of Article 3.1 (a) of the SCM Agreement and a violation of Article 10.1 of the AoA –

[50] "US EXPORT CREDITS: Denials and Double Standards", Oxfam America Briefing Note, March 2003.
[51] See Exhibit Bra-84, pages 9, 12 and 17, and Exhibit Bra-73.
[52] Submission by Brazil, paragraphs 265 and 266.
[53] Submission by Brazil, paragraph 268.

- *ETI ACT*

95. With respect to the export subsidies granted to cotton under the ETI Act, which provides tax exemptions for US exporters who sell products outside the United States, Argentina refers to the fact that this Act was declared inconsistent with Article 3.1 (a) of the SCM Agreement and Articles 10.1 and 8 of the AoA in the "*United States - FSC*[54]" dispute.

## V. CONCLUSION

96. For the above reasons Argentina considers that both the domestic support measures and the export subsidies granted by the United States to its cotton sector and called into question in these proceedings do not qualify for the protection provided under Article 13, paragraphs (b) (ii) and (c) (ii) of the Agreement on Agriculture.

97. Furthermore, the export subsidies for cotton and other products provided for in the United States legislation in the form of export credit guarantees (GSM 102, GSM 103, and SCGP) are likewise not protected by Article 13 (c) (ii).

98. Argentina also maintains that the subsidies for cotton exports provided for in the United States legislation are inconsistent with Articles 3.3, 8 and 10.1 of the Agreement on Agriculture.

[54] WT/DS108/AB/R adopted on 20 March 2000.

# ANNEX B-4

## AUSTRALIA'S THIRD PARTY SUBMISSION

### TABLE OF CONTENTS

## I. INTRODUCTION

1. Australia welcomes the opportunity to present its views in this proceeding on US subsidies for upland cotton.

2. Australia notes that this dispute is the first to involve the interpretation and application of Article 13 of the *Agreement on Agriculture* (AA), the so-called "peace clause". As such, this dispute has particular systemic as well as commercial significance.

3. In this third party Submission, Australia addresses:

I. the nature of AA Article 13 as an affirmative defence, and the meaning of Article 13(b)(ii);

II. whether "production flexibility contract payments" and their successor "direct payments" may be claimed as "green box" support within the meaning of AA Annex 2;

III. whether s.1207(a) of the Farm Security and Rural Investment Act of 2002 ("the FSRI Act") mandating payments to exporters of US cotton ("Step 2" export payments) is inconsistent with AA Articles 3.3 and 8 and thus is also inconsistent with Article 3 of the *Agreement on Subsidies and Countervailing Measures* (the *SCM Agreement*); and

IV. whether s.1207(a) of the FSRI Act mandating payments to domestic users of US cotton ("Step 2" domestic payments) is inconsistent with Article 3 of the *SCM Agreement*.

4. Because of the very limited time that has been available to consider the First Written Submission of the United States, Australia will address issues raised in that Submission in its oral statement before the Panel.

## II. ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE

### A. AA ARTICLE 13 IS IN THE NATURE OF AN AFFIRMATIVE DEFENCE AND THE UNITED STATES HAS THE BURDEN OF PROOF

5. Australia agrees with Brazil that AA Article 13 is in the nature of an affirmative defence and that the United States has the burden of proof on the question of whether the measures at issue fully conform with the applicable conditions of Article 13.

6. Like Article XX of the *General Agreement on Tariffs and Trade* ("GATT"), AA Article 13 "does not establish any 'positive obligations' relevant to determining the proper scope of the obligations under *[the specified provisions of GATT 1994 and the SCM Agreement]*. Instead, it sets out circumstances in which Members are entitled to 'adopt or maintain' measures that are inconsistent with the obligations imposed under other provisions of *[the GATT 1994 and the SCM Agreement]*".[1]

7. AA Article 13 does not of itself impose any obligation on a Member granting domestic support measures falling within Annex 2 or Article 6 or granting export subsidies falling within Part V of the *Agreement on Agriculture*.

[1] *United States – Tax Treatment for "Foreign Sales Corporations"*, Recourse to Article 21.5 of the DSU by the European Communities, Report of the Appellate Body, WT/DS108/AB/RW, paragraph 127.

8. Instead, AA Article 13 sets out the circumstances in which Members will be immune, either wholly or partially, from the consequences of granting domestic support measures or export subsidies that otherwise constitute grounds for a claim of infringement of the obligations contained in the provisions of GATT 1994 and the *SCM Agreement* specified in that Article. Thus, for example, under AA Article 13(b)(ii), "domestic support measures that conform fully to the provisions of Article 6 of *[the Agreement on Agriculture]* … shall be: … exempt from actions based on" the specified provisions of GATT 1994 and the *SCM Agreement*, "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year".

9. The nature of AA Article 13 as an affirmative defence is confirmed by an examination of the protection afforded by Article 13.

10. Under AA Article 13(a)(i), domestic support measures that conform fully to the provisions of AA Annex 2 "shall be non-actionable subsidies for purposes of countervailing duties". Under AA Article 13(b)(i), domestic support measures that conform fully to AA Article 6 shall be "exempt from the imposition of countervailing duties unless …". Under AA Article 13(c)(i), export subsidies that conform fully to the provisions of AA Part V shall be "subject to countervailing duties only upon a determination of …".

11. Under the other provisions of AA Article 13, domestic support measures or export subsidies that conform fully with the prescribed conditions "shall be exempt from actions based on …" the specified provisions of GATT 1994 and the *SCM Agreement*. If domestic support measures or export subsidies infringe the relevant provisions specified in Article 13, they are nevertheless "free or released from a duty or liability to which others are held"[2] in relation to a proceeding[3] "found[ed], buil[t] or construct[ed] on"[4] those provisions, as long as the measures meet the relevant conditions specified in Article 13.

12. Thus, the protection afforded by AA Article 13 becomes available only in circumstances where the domestic support measures or export subsidies at issue have been found:

V. to be actionable subsidies, or to be otherwise countervailable, under Article 13(a)(i), 13(b)(i) or 13(c)(i); or

VI. in all other cases, to be inconsistent with the relevant specified provisions of GATT 1994 and/or the *SCM Agreement*;

and if the applicable conditions for the availability of that protection as specified in Article 13 are met.

13. Further, had the negotiators of the *Agreement on Agriculture* intended that AA Article 13 should mean that a Member would not be liable to a legal process of dispute, it is reasonable to assume that they would have said so. For example, the negotiators could have provided that the specified provisions of GATT and the *SCM Agreement* could not be "invoked", as they did in footnote 35 to Article 10 of the *SCM Agreement* in relation to non-actionable subsidy measures.

[2] *Black's Law Dictionary*, Seventh Edition, Bryan A Garner, Editor in Chief, West Group, St Paul, Minn., 1999, page 593.

[3] *Black's Law Dictionary*, page 593, defines "action" as "1. The process of doing something; conduct of behaviour. 2. A thing done; act. 3. A civil or criminal judicial proceeding."

[4] *The New Shorter Oxford English Dictionary*, Ed. Lesley Brown, Volume 1, Clarendon Press, Oxford, 1993, page 187.

14. The Appellate Body has previously clarified that "the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence"[5], and that "[i]t is only reasonable that the burden of establishing *[an affirmative defence]* should rest on the party asserting it".[6]

15. Thus, in order to qualify for the protection afforded by AA Article 13, the United States must prove that the measures at issue conform fully to the applicable provisions of the *Agreement on Agriculture*. Further, in the case of the protection potentially afforded by Article 13(b)(ii), as well as by Article 13(b)(iii), the United States must prove that it has not granted, and does not grant, support to a specific commodity in excess of that decided during the 1992 marketing year.

## B. THE MEANING OF AA ARTICLE 13(B)(II)[7]

16. In its First Written Submission, Brazil correctly highlights that there are a number of interpretative issues raised by the text of AA Article 13(b)(ii).[8]

### (i) "Implementation period"

17. Under AA Article 1(f) and 1(i) read together, the "implementation period" is, for the purposes of Article 13, defined as the nine-year period commencing in 1995 according to the calendar, financial or marketing year specified in the Schedule relating to that Member.

### (ii) "Domestic support measures that conform fully to the provisions of *[AA]* Article 6"

18. Australia supports Brazil's interpretation that the chapeau of AA Article 13(b) includes all non-"green box" domestic support measures, including product specific and non-product specific, *de minimis* and production-limiting domestic support, as well as investment subsidies and "diversification" support in developing countries.[9]

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[5] *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, Report of the Appellate Body, WT/DS33/AB/R, page 14.

[6] *United States – Woven Wool Shirts and Blouses* , WT/DS33/AB/R, page 16.

[7] Article 13(b)(ii) of the *Agreement on Agriculture* provides as follows:

> During the implementation period, notwithstanding the provisions of GATT 1994 and *[the SCM Agreement]*:
>
> …
>
> (b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:
>
> …
>
> (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the *[SCM Agreement]*, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and
>
> …

[8] First Submission of Brazil, paragraph 127.

[9] First Submission of Brazil, paragraph 133.

(iii) "Exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the *[SCM Agreement]*"

19. As noted in Section II.A above, if domestic support measures within the scope of the chapeau of AA Article 13(b) infringe the specified provisions, they are nevertheless "free or released from a duty or liability to which others are held"[10] in relation to a proceeding[11] "found[ed], buil[t] or construct[ed] on"[12] those provisions as long as the conditions specified in Article 13 are met. Again, had the negotiators of the *Agreement on Agriculture* intended that a Member would not be liable to a legal process of dispute, it is reasonable to assume that they would have said so, for example, by providing that the specified provisions may not be "invoked" as in footnote 35 to Article 10 of the SCM Agreement in relation to non-actionable subsidy measures.

20. Australia notes, however, that only actions based on paragraph 1 of GATT Article XVI and Articles 5 and 6 of the SCM Agreement are covered under AA Article 13(b)(ii). Thus, for example, any actions based on paragraph 3 of GATT Article XVI or on SCM Article 3 would not benefit from the protection afforded by AA Article 13(b)(ii). In Australia's view, the limitation of protection under Article 13(b)(ii) to actions based on GATT Article XVI:1 and on SCM Articles 5 and 6 is consistent with the object and purpose of the *Agreement on Agriculture* as expressed in the preamble to the Agreement, including to "[prevent] … distortions in world agricultural markets" and "to [achieve] specific binding commitments in … export competition". The attainment of those objectives would be too easily subverted if commitments in regard to export subsidies could be circumvented through the provision of domestic support.

(iv) "Such measures"

21. In Australia's view, the phrase "such measures" in AA Article 13(b)(ii) refers to the universe of non-"green box" measures covered by the chapeau of Article 13(b), consistent with the ordinary meaning of "such" as "of the kind, degree, or category previously specified or implied contextually".[13]

(v) "Grant support"

22. In Australia's view, having regard to the ordinary meaning of the words in their context and in light of the object and purpose of the *Agreement on Agriculture*, "support" means the actual support, other than legitimate "green box" support, provided to an agricultural product. Thus, to "grant support" is to "agree to", "promise", "bestow", "allow", "give", "confer" or "transfer"[14] non-"green box" domestic support of the type referred to in the chapeau of AA Article 13(b), which calculation must include that portion of non-product specific support that benefits the specific commodity at issue.

(vi) "To a specific commodity"

23. Australia agrees with Brazil's interpretation[15] that the ordinary meaning of this phrase, read in its context and in light of the object and purpose of the *Agreement on Agriculture*, is support granted

[10] *Black's Law Dictionary*, page 593.
[11] *Black's Law Dictionary*, page 28, defines "action" as "1. The process of doing something; conduct of behaviour. 2. A thing done; act. 3. A civil or criminal judicial proceeding."
[12] *The New Shorter Oxford English Dictionary*, Volume 1, page 187.
[13] *The New Shorter Oxford English Dictionary*. Volume II, page 3129.
[14] *The New Shorter Oxford English Dictionary*. Volume I, page 1131.
[15] First Submission of Brazil, paragraph 136.

to an individual agricultural commodity covered by AA Annex 1, such as upland cotton, whether through product specific, or non-product specific, support.

(vii) "That decided during the 1992 marketing year"

24. In Australia's view, this phrase, read in its context and in light of the object and purpose of the *Agreement on Agriculture*, means the level of non-"green box" domestic support, including support provided through non-product specific non-"green box" domestic support measures, "decided" by a Member in the course of the 1992 marketing year to be provided to the benefit of a specific agricultural commodity in the future.

25. The use of the word "decided" in this context was deliberate.

26. Australia notes that the other operative provision of the *Agreement on Agriculture* in which the word "decided" is used is Article 13(b)(iii), which relates to non-violation nullification or impairment actions. Australia notes too that Article 13(b)(iii) contains precisely the same language – "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" – as used in Article 13(b)(ii). Thus, the meaning of the word "decided" in the context of Article 13(b)(ii) must be capable of having that same meaning in the context of non-violation nullification and impairment actions under Article 13(b)(iii).

(viii) Summary of the meaning of AA Article 13(b)(ii)

27. During the nine calendar, financial or marketing year period specified in a Member's Schedule period commencing in 1995, all non-"green box" domestic support measures that conform fully to the provisions of AA Article 6 are immune from the consequences of infringing GATT Article XVI:1 or Part V of the SCM Agreement, provided that the level of support to an individual commodity does not exceed the level of support for that commodity that was decided by the Member to be made available during the relevant 1992 marketing year.

## III. "PRODUCTION FLEXIBILITY CONTRACT PAYMENTS" AND "DIRECT PAYMENTS" MAY NOT BE CLAIMED AS "GREEN BOX" MEASURES UNDER ANNEX 2 TO THE AGREEMENT ON AGRICULTURE

28. The United States has previously notified "Production Flexibility Contract (PFC) Payments"[16] as AA Annex 2 "green box" measures.[17] The United States has not made a domestic support notification since PFC payments were replaced by "Direct Payments" (DP)[18] under the 2002 FSRI Act. Like Brazil[19], Australia considers that neither of these payments programs may be claimed as "green box" measures for the reasons outlined below.

### A. THE RELEVANT REQUIREMENTS OF PARAGRAPHS 1 AND 6(B) OF AA ANNEX 2

29. AA Annex 2.1 provides that "[d]omestic support measures for which exemption from reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production".

[16] "Production Flexibility Contract Payments" are described at Section 2.6.1 of the First Submission of Brazil.

[17] See, for example, WTO document G/AG/N/USA/43 of 5 February 2003, page 8, Exhibit Bra-47.

[18] "Direct Payments" are described at Section 2.6.2 of the First Submission of Brazil.

[19] First Submission of Brazil, Sections 3.2.6 and 3.2.7.

30. In addition, in relation to decoupled income support, AA Annex 2.6(b) provides that "[t]he amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period".

(i) "No, or at most minimal, trade-distorting effects or effects on production"

31. In requiring that domestic support measures "shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production", AA Annex 2.1 imposes a stringent standard. Annex 2.1 requires that such measures must, as a primary or essential condition, not "bias" or "unnaturally alter"[20] trade or production. Alternatively, Annex 2.1 requires that, at most, such measures must have "extremely small; of a minimum amount, quantity or degree; very slight, negligible"[21] effects on trade or production.

32. In Australia's view, this standard cannot be met if the domestic support measure at issue directly and specifically stimulates production and/or trade of a particular commodity, or if that support measure directly retards or halts the transfer of economic resources to other forms of economic activity, other than as specifically provided for under paragraphs 2-13 of AA Annex 2. If a domestic support measure results in a level of production and/or trade in a particular product or group of products higher than would otherwise be the case except as specifically provided for in Annex 2, the support measure cannot meet the standard established in Annex 2.1. Thus, if the direct effect of a support measure is that farmers keep producing, or keep producing a particular product, in circumstances that would be uneconomic but for the support measure, that measure cannot meet the requirements of Annex 2.1.

(ii) "The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period"

33. Paragraph 6 of AA Annex 2 is headed "decoupled income support". Paragraph 6(a) provides that "[e]ligibility for *[decoupled income support]* payments shall be determined by clearly defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period". Thus, consistent with the customary rules of interpretation codified at Article 31 of the *Vienna Convention on the Law of Treaties*, "after the base period" in paragraph 6(b) means after the base period defined and fixed pursuant to paragraph 6(a).

34. Accordingly, the meaning of paragraph 6(b) of AA Annex 2 is clear. Once a base period has been defined and fixed pursuant to paragraph 6(a), decoupled income support payments may not be "connected"[22] to or "found[ed], buil[t] or construct[ed] on"[23] the type of production or the volume of production undertaken by a producer in a later period.

[20] *The New Shorter Oxford English Dictionary*. Volume I, page 707.
[21] *The New Shorter Oxford English Dictionary*. Volume I, page 1781.
[22] *The New Shorter Oxford English Dictionary*. Volume II, page 2534.
[23] *The New Shorter Oxford English Dictionary*, Volume 1, page 187.

B. "PRODUCTION FLEXIBILITY CONTRACT (PFC) PAYMENTS" COULD NOT BE CLAIMED AS "GREEN BOX" PAYMENTS

(i) PFC payments had more than a negligible trade-distorting effect or effect on production, contrary to paragraph 1 of AA Annex 2$

35. Like Brazil, Australia considers that PFC payments directly stimulated, and stimulated by more than a negligible amount, US production of, and trade in, upland cotton and Australia endorses Brazil's arguments in this respect.[24]

36. Further, the value of PFC payments rates as a proportion of the marketing year average farm price received by US upland cotton growers can be seen from data published by the United States Department of Agriculture (USDA) and included in Table 1 below.

*Table 1: The value of PFC payments as a percentage proportion of the marketing year average farm price received by US upland cotton growers*

| *Marketing or Crop Year* | *Production flexibility contract (PFC) payment rates US¢/lb.*[25] | *Average farm price US¢/lb.*[26] | *PFC payment rates as a proportion of the marketing year average farm price %* |
|---|---|---|---|
| 1996/97 | 8.882 | 69.3 | 12.82 |
| 1997/98 | 7.625 | 65.2 | 11.69 |
| 1998/99 | 8.173 | 60.2 | 13.58 |
| 1999/2000 | 7.990 | 45.0 | 17.76 |
| 2000/01 | 7.330 | 49.8 | 14.72 |
| 2001/02 | 5.990 | 29.8 | 20.10 |

37. In addition, data published by the USDA for this period show that PFC payments constituted 26.37%, 36.5% and 22.90% of government payments by crop year for the 1999, 2000 and 2001 years respectively.[27]

38. PFC payments constituting such high proportions of the marketing year average farm prices and of domestic support measures must have a production and trade-distorting effect.

39. But this view is further confirmed when the marketing year average farm prices as shown in Table 1 are considered against the fact that in 1997 the average of total economic costs for all US cotton farms was approximately 73 cents per pound and operating costs averaged 38 cents per pound[28]. In such circumstances, economically rational producers should have begun to transfer resources to other forms of economic activity. This did not happen. USDA data shows that the area planted to cotton in the United States over this period increased, from 13.1 million acres in 1998 to 15.5 million acres in 2001.[29] It is clear that many US producers of upland cotton could only have

[24] First Submission of Brazil, Section 3.2.6.2.

[25] Figures extracted from *Agricultural Outlook*, USDA, May 2000 and May 2002, Table 19, available at http://www.ers.usda.gov/publications/agoutlook/may2000/ao271k.pdf and http://www.ers.usda.gov/publications/agoutlook/May2002/ao291j.pdf respectively.

[26] . *Fact Sheet: Upland Cotton: Summary of 2002 Commodity Loan and Payment Program*, USDA, January 2003, page 5, Exhibit Bra-4.

[27] *Fact Sheet: Upland Cotton*, page 6, Exhibit Bra-4.

[28] *Cotton: Background and Issues for Farm Legislation*, USDA, July 2001, page 6, Exhibit Bra-46.

[29] *Fact Sheet: Upland Cotton*, page 4, Exhibit Bra-4.

remained viable over this period through subsidisation. Further, US exports of upland cotton increased from 4.1 million bales in 1998 to 10.6 million bales in 2001.[30]

40. In Australia's view, PFC payments during this period contributed directly to increased production and export levels and that they did so contrary to the express requirement of AA Annex 2.1 that the domestic support measures at issue not, or only negligibly, bias or unnaturally alter trade or production.

(ii) PFC payments were related to the type of production undertaken by the producer, contrary to paragraph 6(b) of AA Annex 2

41. By excluding fruits and vegetables (other than lentils, mung beans, and dry peas) from the planting flexibility otherwise available in respect of the contract acreage for which PFC payments could be made, s.118 of the Federal Agriculture Improvement and Reform Act of 1996 (the FAIR Act) related, or connected, PFC payments to the type of production undertaken by the producer in any year after the base period, contrary to the requirements of AA Annex 2.6(a).

C. "DIRECT PAYMENTS" FOR UPLAND COTTON MAY NOT BE CLAIMED AS "GREEN BOX" PAYMENTS

(i) Direct payments are likely to have more than a negligible trade-distorting effect or effect on production, contrary to paragraph 1 of AA Annex 2

42. Australia considers that direct payments for upland cotton are likely to stimulate, by more than a negligible amount, US production of, and trade in, upland cotton. The 2002 FSRI Act has established a direct payment rate for upland cotton of 6.67 cents per pound for each of the 2002 through 2007 crop years.

43. In addition to the arguments put forward by Brazil[31], which Australia endorses, Australia considers that, so long as there is a reasonable possibility of continuing and significant longer-term volatility in the gross returns to producers (as measured by the marketing year average farm price), the assured availability of a direct payment for upland cotton at the rate of 6.67 cents per pound must be presumed to influence directly and specifically the decisions of growers to continue producing upland cotton, notwithstanding significant peaks and troughs in their income, rather than to transfer resources to other forms of economic activity.

(ii) Direct payments are related to the type of production undertaken by the producer, contrary to paragraph 6(b) of Annex 2 of the Agreement on Agriculture

44. Under s.1106(b) of the 2002 FSRI Act, fruits, vegetables (other than lentils, mung beans and dry peas) and wild rice are generally prohibited from being planted on base acreage unless the commodity, if planted, is destroyed before harvest except that trees and other perennial plants are prohibited. The implementing regulations make clear that, where it is determined that a producer made a good faith effort to comply with the "planting flexibility" provisions of s.1106 of the FSRI Act but that that producer's acreage report of fruits, vegetables or wild rice planted on a farm's base acreage is inaccurate and exceeds the allowed tolerance levels, the producer "shall accept a reduction in the direct and counter-cyclical payments for the farm …".[32]

[30] *Fact Sheet: Upland Cotton*, page 5, Exhibit Bra-4.
[31] First Submission of Brazil, at Section 3.2.7.3.
[32] 7 CFR 1412.602(a)(2), Exhibit Bra-35.

45. Thus, direct payments are related, or connected, to the type of production undertaken by the producer, contrary to paragraph 6(a) of AA Annex 2.

(iii) Direct payments are related to, or based on, the type or volume of production undertaken by the producer in a year after the base period, contrary to paragraph 6(b) of Annex 2 of the Agreement on Agriculture

46. Sections 1101 and 1102 of the 2002 FSRI Act allow producers to update their base acres and payment yields respectively for the purposes of receiving direct payments. As set out in Section III.A.ii above, only one base period is possible for the purposes of paragraph 6 of AA Annex 2. Once the base period has been defined and fixed, no further updating of either the type or volume of production is permissible if a support program is to comply with the conditions of paragraph 6 of Annex 2.

47. Under the 2002 FSRI Act, direct payments replaced PFC payments.[33] Since the United States has claimed PFC payments as "green box" decoupled income support[34], Australia considers that the United States has selected the base period that it used to determine base acres and payment yields under the 1996 FAIR Act as its defined and fixed base period for the purposes of paragraph 6 of AA Annex 2.

48. By providing for base acres and payment yields to be updated under the 2002 FSRI Act, the United States has related the amount of direct payments to, or based the amount of direct payments on, the type and volume of production undertaken by a producer in any year after the base period, contrary to paragraph 6(b) of AA Annex 2.

## IV. "STEP 2" PAYMENTS ARE PROHIBITED SUBSIDIES CONTRARY TO ARTICLES 3.3 AND 8 OF THE AGREEMENT ON AGRICULTURE AND/OR ARTICLE 3 OF THE SCM AGREEMENT

49. Section 1207(a)(1) of the 2002 FSRI Act provides: "… the Secretary shall issue marketing certificates or cash payments … to domestic users and exporters for documented purchases by domestic users and sales for export by exporters …". Section 136 of the 1996 FAIR Act provided similarly that "… the Secretary shall issue marketing certificates or cash payments to domestic users and exporters …".

50. The regulations to implement s.1207(a)(1) of the FSRI Act provide:

> Eligible upland cotton must not be: … (2) imported cotton …[35]
>
> Payments … shall be made available to eligible domestic users and exporters who have entered into an Upland Cotton Domestic User/Export Agreement with CCC and who have complied with the terms and conditions in this subpart, the Upland Cotton Domestic User/Exporter Agreement and instructions issued by CCC.[36]

51. The standard Upland Cotton Domestic User/Export Agreement[37] provides *inter alia*:

[33] *Fact Sheet: Upland Cotton*, Exhibit Bra-4.
[34] WTO document G/AG/N/USA/43, page 8, Exhibit Bra-47.
[35] 7 CFR 1427.103(c), Exhibit Bra-37.
[36] 7 CFR 1427.105(a), Exhibit Bra-37.
[37] Exhibit Bra-65.

> Upland cotton eligible for payment is cotton consumed by the Domestic User in the United States … (Section B-2)
>
> Eligible upland cotton will be considered consumed by the Domestic User on the date the bagging and ties are removed from the bale in the normal opening area, immediately prior to use, … (Section B-3(b))
>
> Upland cotton eligible for payment is cotton which is shipped by an eligible Exporter … (Section C-2)
>
> Eligible upland cotton will be considered exported based on the on-board-vessel-date as shown on the bill of lading. (Section C-3)

52. A "Step 2" payment is unquestionably a subsidy within the meaning of the *Agreement on Agriculture* and the *SCM Agreement*. A "Step 2" payment involves a direct transfer of economic resources (cash or the equivalent value in ownership of goods) to a domestic user or exporter of US upland cotton.

53. The Article 21.5 stage of *United States – Tax Treatment for "Foreign Sales Corporations" (US – FSC (21.5))* involved provisions under which more favourable tax treatment was available in either of two, mutually exclusive, situations. The availability of the favourable tax treatment was found to be a prohibited export subsidy in one of those situations notwithstanding that the favourable tax treatment was freely available in both situations, subject to the prescribed conditions for entitlement being met. The Appellate Body said:

> In our view, it is … necessary, under Article 3.1(a) of the *SCM Agreement*, to examine separately the conditions pertaining to the grant of the subsidy in the two different situations addressed by the measure. We find it difficult to accept the United States' arguments that such examination involves an 'artificial bifurcation" of the measure. The measure itself identifies the two situations which must be different since the very same property cannot be produced both within and outside the United States.[38]

54. The availability of "Step 2" payments under s.1207(a)(1) is analogous to the situation examined in *US – FSC (21.5)*. "Step 2" payments are available only to exporters ("Step 2" export payments) or to domestic users ("Step 2" domestic payments). Section 1207(a)(1) "identifies the two situations which must be different since the very same property cannot be" exported or used within the United States.

A. "STEP 2" EXPORT PAYMENTS ARE PROHIBITED EXPORT SUBSIDIES CONTRARY TO ARTICLES 3.3 AND 8 OF THE AGREEMENT ON AGRICULTURE AND ARTICLE 3.1(A) AND 3.2 OF THE SCM AGREEMENT

(i) "Step 2" export payments are subsidies contingent upon export performance

55. For "Step 2" export payments, the export contingency is expressly provided for in s.1207(a)(1), which provides "… the Secretary shall issue marketing certificates or cash payments … to exporters for … sales for export by exporters …" and in the implementing regulations.

[38] *United States – Tax Treatment of "Foreign Sales Corporations"*, Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/AB/RW, paragraph 115.

56 "Step 2" export payments are only payable once US-produced upland cotton has been placed aboard a vessel: they are "conditional" upon the cotton actually being exported. Thus, "Step 2" export payments are contingent upon export performance.

(ii) "Step 2" export payments are export subsidies contrary to Articles 3.3 and 8 of the Agreement on Agriculture

57. "Step 2" export payments are a type of export subsidy expressly foreseen by AA Article 9.1(a) and subject to budgetary outlay and quantity reduction commitments thereunder. They are a direct subsidy, including through payment-in-kind, to an industry, to producers of an agricultural product, or to a cooperative or other association of such producers, contingent on export performance.

58. The United States has not specified any reduction commitments in its Schedule for upland cotton.

59. Consequently, by providing "Step 2" export payments under both the 1996 FAIR Act and the 2002 FSI Act, the United States has provided export subsidies contrary to its obligations:

VII. pursuant to AA Article 3.3 not to provide export subsidies in respect of any agricultural product not specified in Section II of Part IV of its Schedule; and

VIII. pursuant to its obligation pursuant to Article 8 not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in its Schedule.

(iii) "Step 2" export payments are prohibited export subsidies contrary to SCM Article 3

60. Because "Step 2" export payments are export subsidies that do not conform fully to the provisions of Part V of the *Agreement on Agriculture*, Article 13(c)(ii) of that Agreement is not applicable and the payments are not protected from the operation of SCM Article 3.

61. A "Step 2" export payment is a subsidy within the meaning of SCM Article 1.1(a)(1)(i) for the purposes of SCM Article 3.1: it involves a direct transfer of economic resources to a domestic user or exporter of US upland cotton, and confers a benefit on the recipient by making US upland cotton commercially competitive.

62. Further, a "Step 2" export payment is contingent upon export performance: it is only payable once the upland cotton has been placed aboard a vessel for export. The Appellate Body has said:

> We see no reason, and none has been pointed out to us, to read the requirement of "contingent upon export performance" in the *Agreement on Agriculture* differently from the same requirement imposed by the *SCM Agreement*.[39]

63. As a consequence, because "Step 2" export payments mandated by s.1207(a)(1) of the FSRI Act are export subsidies that are not being made "as provided in the *Agreement on Agriculture*", they are prohibited export subsidies pursuant to SCM Article 3.1(a), and the United States is acting contrary to its obligations under SCM Article 3.2 by granting or maintaining such subsidies pursuant to s.1207(a)(1) of the FSRI Act. Consistent with the provisions of SCM Article 4.7, Australia

[39] *United States – Tax Treatment for "Foreign Sales Corporations"*, Report of the Appellate Body, WT/DS108/AB/R, paragraph 141.

endorses Brazil's request[40] that the Panel recommend that the United States withdraw the "Step 2" export payments without delay.

B. "STEP 2" DOMESTIC PAYMENTS ARE LOCAL CONTENT SUBSIDIES CONTRARY TO ARTICLE 3 OF THE SCM AGREEMENT

64. For "Step 2" domestic payments, the local content requirement is expressly provided for in s.1207(a)(1), which provides "… the Secretary shall issue marketing certificates or cash payments … to domestic users … for documented purchases by domestic users …" and in the implementing regulations, which provide that "eligible cotton must not be … imported cotton".

65. "Step 2" domestic payments are only payable once US-produced upland cotton is consumed by a domestic user. "Step 2" domestic payments are contingent upon the use of domestic over imported goods.

66. Thus, s.1207(a)(1) of the FSRI Act mandates the payment of subsidies which are prohibited pursuant to SCM Article 3.1(b), and the United States is acting contrary to its obligations under SCM Article 3.2 by granting or maintaining such subsidies. Consistent with the provisions of SCM Article 4.7, Australia endorses Brazil's request[41] that the Panel recommend that the United States withdraw the "Step 2" domestic payments without delay.

C. THE UNITED STATES CANNOT AVOID ITS OBLIGATIONS RELATING TO PROHIBITED SUBSIDIES BY DESIGNING A MEASURE UNDER WHICH ENTITLEMENTS ARE OSTENSIBLY AVAILABLE IN MULTIPLE CIRCUMSTANCES

67. In Australia's view, the United States cannot avoid its obligations relating to prohibited subsidies under the *Agreement on Agriculture* and the *SCM Agreement* by designing a measure under which entitlements are ostensibly available in multiple circumstances. As the Appellate Body concluded in *US – FSC (21.5)*:

> Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.[42]

68. Moreover, in the circumstances of the present case, it would be a manifestly inequitable outcome if a WTO Member was able to avoid its obligations relating to prohibited subsidies under the *Agreement on Agriculture* and the *SCM Agreement* on the basis that there is a second set of circumstances in which a subsidy can be paid, when the second set of circumstances is itself a prohibited subsidy.

69. Australia considers that, through the "Step 2" payments mandated by s.1207(a)(1) of the FSRI Act, the United States is paying: (1) export subsidies contrary to its obligations pursuant to AA Articles 3.3 and 8 and SCM Article 3.1(a) and 3.2; and (2) local content subsidies contrary to its obligations pursuant to SCM Article 3.1(b) and 3.2.

[40] First Submission of Brazil, paragraph 251.
[41] First Submission of Brazil, paragraph 341.
[42] *United States – Tax Treatment for "Foreign Sales Corporations"*, Recourse to Article 21.5 of the DSU by the European Communities, Report of the Appellate Body, WT/DS108/AB/RW, paragraph 119

## V. CONCLUSION

70. This dispute raises fundamental issues concerning the object and purpose of the *Agreement on Agriculture*, and the balance of rights and obligations accepted by all Members under the *Marrakesh Agreement Establishing the World Trade Organization*. The outcome of this dispute will determine whether, in fact, Members accepted any meaningful obligations in relation to domestic support measures pursuant to the *Agreement on Agriculture*.

71. In Australia's view, Brazil has provided *prima facie* evidence that the United States has not acted consistently with its obligations in relation to domestic support measures and export subsidies provided to upland cotton under the *Agreement on Agriculture*. Further, Australia considers that the "Step 2" payments for domestic users and exporters of upland cotton are clearly subsidies prohibited by the *SCM Agreement*, and endorses Brazil's request that these be withdrawn without delay.

# ANNEX B-5

## THIRD PARTY SUBMISSION OF BENIN

15 July 2003

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## I. INTRODUCTION

1. The issue in this dispute is of critical importance for Benin, West Africa, and many developing countries: whether WTO Members must respect agreed disciplines for the provision of agricultural subsidies.

2. The right to grant agricultural subsidies is by no means absolute. During the Uruguay Round, the drafters of the *Agreement on Agriculture* and the SCM Agreement established a number of preconditions for the provision of WTO-consistent subsidies. These preconditions, including those embodied in Article 13 of the *Agreement on Agriculture* - the so-called "peace clause" - were part of the overall balance of rights and obligations accepted by the United States and other participants at the conclusion of the Round.

3. Benin, upon its accession to the WTO in 1996, accepted the Uruguay Round package. In doing so, it expected that the subsidies provided by its trading partners, including the United States, would remain within these agreed parameters.

4. However, contrary to its WTO obligations, the United States has provided huge subsidies for the production, use and export of US cotton. These WTO-inconsistent subsidies have been highly damaging to Benin.

5. Benin supports the positions advanced by Brazil in this dispute, particularly those set out in Brazil's first submission of June 24. Benin welcomes the opportunity to provide its views to the Panel, divided into two headings:

(a) Benin and US cotton subsidies, which provides appropriate additional context to the issues facing the Panel; and

(b) WTO legal issues.

## II. BENIN AND US COTTON SUBSIDIES

6. Benin is a least-developed country, with a GNP per capita of US $380. Of the 175 countries listed in the 2003 Human Development Index of the United Nations Development Programme, Benin is ranked 159th.[1]

7. Cotton plays a crucial role in the development of Benin. It is the most important cash crop in the national economy. Cotton accounts for 90 per cent of agricultural exports, and has provided around 75 per cent of the country's export earnings over the past four years. Benin is the 12th largest exporter of cotton in the world.

8. Cotton generates 25 per cent of the country's revenues. A third of all households in Benin depend on the cultivation of cotton, and a fifth of wage-earning workers are employed in the cotton sector. Overall, about a million people in Benin – out of a population of six million – are dependant on cotton, or cotton-related activities.

9. The cotton sector in Benin, which is mainly in the rural regions, has suffered considerable hardship. As the International Monetary Fund noted in a report earlier this year, "poverty is prevalent in cotton-producing areas".[2] Cotton growers are concentrated in the north of the country, a more arid region where the potential for any agricultural diversification is lower, and where opportunities for non-farm employment are scare.[3]

10. Despite these problems of persistent poverty, the cotton sector in Benin and the region remains highly competitive by world standards. The cost of producing cotton in West Africa is 50 per cent lower than comparable costs in the United States.[4]

11. As recent report noted: "West Africa is one of the world's most efficient cotton producing regions. The IMF estimates that the sector can operate profitably at world price levels of around 50 cents/lb. Few producers in the US could compete at this price. Indeed, the USDA estimates average production costs at 75 cents/lb."[5]

12. Moreover, the sector has also undergone major structural reforms in recent years to increase efficiency. The IMF reported that: "Benin has moved away from the integrated monopoly that characterized the organization of cotton production and marketing of seed cotton in western and central Africa. Benin's reform process is among the most advanced in the region."[6]

13. Unfortunately, the benefits of such reforms have been completely negated by massive US subsidies. As noted by Brazil in its First Submission, total upland cotton subsidies amounted to

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[1] *Human Development Report 2003*, United Nations Development Programme, http://www.undp.org/hdr2003.

[2] According to the IMF, "The cotton zone in central Benin (the Zou and Borgou) presents one of the highest incidences of poverty, while the deepest poverty (as measured by the poverty gap index) can be found in the north (cotton-producing area in northern Borgou). International Monetary Fund, Country Report No. 03/120. *Benin: Fourth Review Under the Poverty Reduction and Growth Facility – Staff Report*. April 2003. Page 28.

[3] *Impact of Global Cotton Markets on Rural Poverty in Benin*. Nicholas Minot and Lisa Daniels. International Food Policy Research Institute, Washington, D.C. November 2002. Page 19.

[4] See Louis Goreux, *"Préjudices causés par les subventions aux filières cotonnières de l'AOC."* March 2003. Cited in TN/AG/GEN/4, 16 May 2003.

[5] *Northern Agricultural Policies and World Poverty: Will the Doha 'Development Round' Make a Difference?* Kevin Watkins, Head of Research, Oxfam Great Britain. Paper presented to the Annual World Bank Conference of Development Economics. 15-16 May, 2003. Page 65.

[6] IMF Country Report, *Op. Cit.*, page 23

US$12.9 billion during the 1999-2002 marketing years.[7] The International Cotton Advisory Cotton estimates that US subsidies are equivalent to 24 cents per pound of cotton produced.[8]

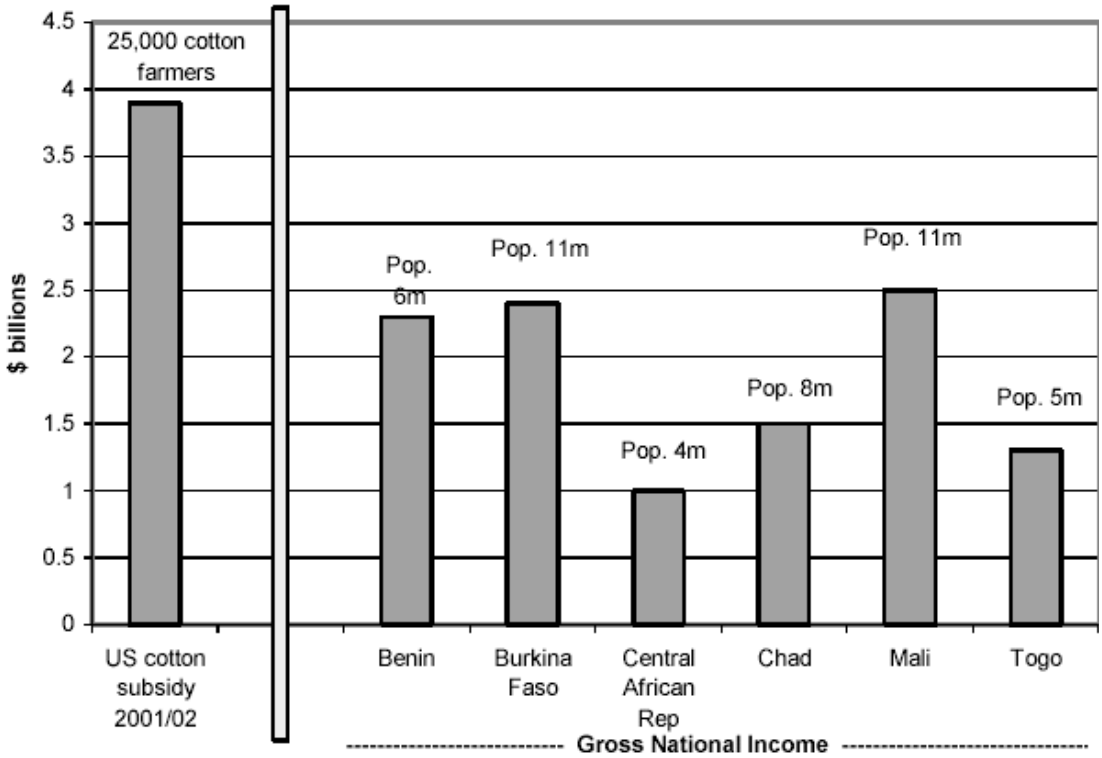
14. Subsidies of this magnitude have sharply increased supplies on the international market, thereby producing a collapse in global cotton prices. From January, 2001 to May, 2002, world cotton prices fell by nearly 40 per cent, from 64 cents to about 39 cents per pound, the lowest level since the 1930s. Although prices have improved since last year, the world market for cotton remains characterized by oversupply as a result of US subsidies. This has extremely serious consequences for Benin and other West African countries.

15. Benin is highly vulnerable to changes in the world price of this cash crop. The International Food Policy Research Institute has estimated that a 40 per cent reduction in farm-level prices of cotton results in an increase in rural poverty in Benin of 8 per cent in the short term, and 6-7 per cent in the long term. An increase of 8 per cent is equivalent to pushing an additional 334,000 people below the poverty line.[9] This, in turn, has produced a deterioration in the social conditions of many rural communities, including conditions pertaining to housing, schooling, sanitation, nutrition and other basic needs.

16. The overwhelming magnitude of US cotton subsidies, and the impossibility of Benin competing with them, are well illustrated in the table below.[10] As the table indicates, the subsidies paid by the United States to 25,000 US cotton farmers exceeds the gross national income of Benin. These subsidies also exceed the gross national income of Burkina Faso, the Central African Republic, Chad, Mali and Togo.

[7] First Submission of Brazil, paragraph 3.
[8] Minot and Daniels, *op. cit*, page 1.
[9] Minot and Daniels, *op cit*., page 50.
[10] This table is from *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa.* Oxfam Briefing Paper 30. 27 September 2002. Brazil has filed the full Oxfam report as exhibit Bra–15.

**Figure 3: US cotton subsidy and the gross national incomes for selected West African countries in 2000 ($billions)**




*Source: World Development Indicators, World Bank, 2002, and US Department of Agriculture*

17. Thus, when cotton from Benin enters world markets, it must compete against such massively subsidized US cotton.

18. Oxfam has estimated that US subsidies have caused Benin to lose US $33 million in foreign exchange earnings, equivalent to 9 per cent of the country's export earnings.[11]

19. Indeed, the shock of such subsidies, and their attendant effect on prices, threatens the very existence of the cotton sector in Benin. It has created a genuine economic crisis in the sector, and it is possible that the cotton sector in Benin could simply disappear during the 2003/04 marketing year. This would have catastrophic effects both for the national economy, and for the social cohesion of the country in regions where cotton production predominates. This also poses a significant threat to Benin's efforts at poverty alleviation in economically precarious rural areas.

20. With these preliminary comments as additional context, Benin now comments briefly on some of the legal issues raised in Brazil's submission.

## III. WTO LEGAL ISSUES

21. Benin agrees with Brazil that the United States cannot successfully invoke the peace clause to bar the actionable subsidy claims that have been advanced in this dispute.

[11] *Ibid*., page 17.

22. The peace clause is an affirmative defence. The United States, not Brazil, must bear of burden of demonstrating that US domestic support and export subsidies comply with the requirements of Article 13.

23. Affirmative defences, as the Appellate Body made clear in *United States – Wool Shirts and* Blouses, are "limited exceptions from obligations under certain other provisions", not "positive rules establishing obligations in themselves". In the view of the Appellate Body, "[i]t is only reasonable that the burden of establishing such a defence should rest on the party asserting it".

24. The language in Article 13 shows the clear intent of the drafters that the Member seeking to invoke the peace clause must bear the burden of demonstrating full compliance with all of the preconditions set out in this provision.

25. In addition to the arguments advanced by Brazil, Benin would note that the use of the proviso "provided that" in Article 13(b)(ii) and (iii) also shows the intent of the drafters to shift the burden to the Member seeking to invoke this exception. In both subsections, the exemption from actions has been qualified by the addition of this proviso:

(b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:

(ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year; and

(iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year…" [emphasis added]

26. A similar proviso can be found in GATT Article XVIII:11, dealing with the elimination of restrictions imposed for balance of payments purposes:

> "[T] he contracting party concerned… shall progressively relax any restrictions applied under this Section as conditions improve, maintaining them only to the extent necessary under the terms of paragraph 9 of this Article and shall eliminate them when conditions no longer justify such maintenance; Provided that no contracting party shall be required to withdraw or modify restrictions on the ground that a change in its development policy would render unnecessary the restrictions which it is applying under this Section." [emphasis added]

27. In construing GATT Article XVIII:11, the Appellate Body made clear in the *Quantitative Restrictions* case that the burden of proof lay clearly on the responding party – in that case, India – seeking to invoke the proviso:

> "The proviso precludes a Member, which is challenging the consistency of balance-of payments restrictions, from arguing that such restrictions would be unnecessary if the developing country Member maintaining them were to change its development policy. In effect, the proviso places an obligation on Members not to require a developing country Member imposing balance-of payments restrictions to change its development policy….

> [W]e do not exclude the possibility that a situation might arise in which an assertion regarding development policy does involve a burden of proof issue. Assuming that the complaining party has successfully established a *prima facie* case of inconsistency with Article XVIII:11 and the Ad Note, the responding party may, in its defence, either rebut the evidence adduced in support of the inconsistency or invoke the proviso. In the latter case, it would have to demonstrate that the complaining party violated its obligation not to require the responding party to change its development policy. This is an assertion with respect to which the responding party must bear the burden of proof. We, therefore, agree with the Panel that the burden of proof with respect to the proviso is on India."[12]

28. Although the use of the proviso "provided that" is not determinative, it does provide strong textual support for the proposition that the drafters of Article 13 of the *Agreement on Agriculture*, like the drafters of GATT Article XVIII:11, intended the burden of proof to shift to the party seeking to invoke the proviso.

29. Indeed, the situation in the Cotton dispute is very similar to that examined by the Appellate Body in the *Quantitative Restrictions* case. The United States is seeking to invoke the "provided that" proviso set out in Article 13. This is, as the Appellate Body reasoned, "an assertion with respect to which the responding party must bear the burden of proof". Therefore, as with India in *Quantitative Restrictions*, the burden of proof with respect to the proviso is on the United States.

30. Article 13, construed as a whole, also supports the position that if the United States seeks entry into the "safe harbour", it bears the burden of demonstrating that it has met the preconditions necessary to justify entry.

31. For example, the chapeau to paragraphs (a), (b) and (c) all provide that the measures or subsidies "must conform fully" with the applicable disciplines. Domestic support measures or export subsidies that do not "conform fully" to the specified provisions cannot benefit from the peace clause. Since the United States claims that it "conforms fully" to the relevant provisions of the *Agreement on Agriculture*, the SCM Agreement, and the GATT 1994, and it is up to the United States to provide sufficient evidence in support of this defence.

32. Thus, as argued above, the burden falls on the United States if it wishes successfully to invoke the affirmative defence of Article 13.

33. However, even if the burden rested on Brazil – which it does not – Brazil has amply demonstrated in its First Submission that the United States is providing domestic support and export subsidies far in excess of WTO commitments.

34. For example, as Brazil demonstrated in its submission, US non-"green box" domestic support to upland cotton in the 1992 marketing year was $1,994.4 million. By 2001, US non-"green box" domestic support increased to $4,093 million. Thus, the defence that may have been conditionally available to the United States – had it "conformed fully" to the requirements of Article 13 – is unavailable.

35. Brazil presents compelling evidence on the WTO-inconsistency of all of the impugned US measures, encompassing both domestic support payments and export payments. Benin agrees with Brazil that the US measures violate the *Agreement on Agriculture*, the SCM Agreement, and the GATT 1994.

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[12] Appellate Body Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile an Industrial Products*, WT/DS90/AB/R, paragraph 134 and 136.

36. The United States, in its submission of July 11, has done nothing to rebut the presumption of WTO-inconsistency established by Brazil.

## IV. CONCLUSIONS

37. As noted above, US cotton subsidies exceed the Gross National Income of Benin. Benin has few options available to it to respond to subsidies of such magnitude. The resulting impact on the economy of the country has been devastating.

38. Benin is not seeking any special and differential treatment in this dispute. It simply asks the Panel to ensure that the relevant provisions of the WTO Agreements, including Article 13 of the *Agreement on Agriculture*, are interpreted and applied as negotiated. The United States must respect the disciplines that it, and other WTO Members, agreed to at the end of the Uruguay Round.

39. Benin is grateful for the opportunity to present its views to the Panel in this extremely important dispute. Benin notes that further submissions are intended, and reserves the right to provide additional views to the Panel (including in response to the US First Written Submission of 11 July) as necessary and appropriate, at a later stage.

# ANNEX B-6

## THIRD PARTY SUBMISSION OF CANADA

15 July 2003

TABLE OF CONTENTS

## I. INTRODUCTION

1. Canada has a systemic interest in the correct interpretation of Annex 2 of the *Agreement on Agriculture* (*Agriculture Agreement*), as well as the export subsidy provisions of both the *Agriculture Agreement* and the *Agreement on Subsidies and Countervailing Measures* (*SCM Agreement*).

2. In its first written submission, Brazil makes a number of claims. Canada's comments relate to the claims of Brazil in respect of the following:

IX. Whether US production flexibility contract payments (PFC payments) made under the Federal Agriculture Improvement and Reform Act of 1996 and US direct payments made under the US Farm Security and Rural Investment Act of 2002 (2002 FSRI Act) satisfy the policy-specific criteria for decoupled income support in Annex 2, paragraph 6(b) of the *Agriculture Agreement*; and

X. Whether US GSM-102, GSM-103, and the SCG export credit guarantee programmes provide export subsidies in violation of Articles 8 and 10.1 of the *Agriculture Agreement*.

## II. CLAIMS REGARDING US DOMESTIC AGRICULTURAL SUPPORT MEASURES

3. Among the claims brought by Brazil against the United States in this dispute are those concerning the conformity of US domestic subsidies with US obligations under Part III of the *SCM Agreement* and Article XVI of the *General Agreement on Tariffs and Trade 1994* (*GATT 1994*).

4. On 20 June 2003, the Panel preliminarily ruled that it would defer consideration of Brazil's claims under Part III of the *SCM Agreement* and Article XVI of *GATT 1994* until after it had expressed views on whether the US measures satisfy the conditions of Article 13 of the *Agriculture Agreement* (the so-called "Peace Clause"). Accordingly, Brazil argues in its first written submission that PFC payments and direct payments (US measures involving direct payments to US agricultural producers) are not exempt from action under the Peace Clause because they do not conform fully to the criteria in Annex 2 of the *Agriculture Agreement*.[1] The United States argues in response that PFC payments are not within the Panel's terms of reference because they were no longer in effect at the time of the consultation or panel requests.[2] Regarding direct payments, the United States argues that these measures are exempt from action because they conform fully to the provisions of Annex 2 and are therefore covered by Article 13(a)(ii) of the *Agriculture Agreement*.[3]

5. Canada provides views in this submission on the conformity of PFC payments and direct payments with criteria in Annex 2 of the *Agriculture Agreement*.

### A. PFC PAYMENTS AND DIRECT PAYMENTS DO NOT QUALIFY AS EXEMPT DECOUPLED INCOME SUPPORT UNDER THE *AGRICULTURE AGREEMENT*

6. It is Canada's view that PFC payments and direct payments do not fully conform to the provisions of paragraph 6(b) of Annex 2 of the *Agriculture Agreement* for the reasons set out below.

[1] First Written Submission of Brazil, 24 June 2003 , at paras. 153 and 173 [hereinafter Brazil First Written Submission].

[2] First Written Submission of the United States, 11 July 2003, at paras. 190 and 207-211 [hereinafter "US First Written Submission"].

[3] US First Written Submission, paras. 64-68.

**1. Decoupled income support under Annex 2 of the *Agriculture Agreement* is exempt from action under the *SCM Agreement* and *GATT 1994***

7. Annex 2 of the *Agriculture Agreement* is relevant to actionable subsidy cases under the *SCM Agreement* and *GATT 1994* because the *Agriculture Agreement* provides for certain conditional exemptions. In this section, Canada sets out the relationship between these three agreements in this respect.

8. Action under Part III of the *SCM Agreement* and Article XVI of *GATT 1994* depends on a determination of the existence of a "subsidy".[4] Article 1.1 of the *SCM Agreement* sets out the definition of a subsidy:

**1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:**

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member…

or

(a)(2) here is any form of income or price support in the sense of Article XVI of GATT 1994;

and

(b) a benefit is thereby conferred.

9. Article 1.2 provides that a subsidy is actionable under Part III of the Agreement if it is "specific" in accordance with the provisions of Article 2.

10. Article 5 begins Part III of the *SCM Agreement* on actionable subsidies by providing that "[n]o Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members...". Articles 5 and 6 describe "adverse effects" and set out the basis for determining whether they exist. Article 7 sets out the available remedies where adverse effects do exist. All of these provisions are subject to Article 13 of the *Agriculture Agreement*.[5]

11. Article 13 of the *Agriculture Agreement* conditionally exempts domestic support measures from actionable subsidy complaints. It provides in relevant part:

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[4] See *United States – Tax Treatment for "Foreign Sales Corporations"*, Report of the Appellate Body, WT/DS108/AB/R, adopted March 20, 2000 at para. 93 [hereinafter *US FSC* AB Report]:

> Article 1.1 sets forth the general definition of the term "subsidy" which applies "for the purpose of this Agreement". This definition, therefore, applies wherever the word "subsidy" occurs throughout the *SCM Agreement* and conditions the application of the provisions of that Agreement regarding *prohibited* subsidies in Part II, *actionable* subsidies in Part III, *non-actionable* subsidies in Part IV and countervailing measures in Part V [emphasis in original].

[5] Article 5 ends with: "This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture". Article 6.9 contains identical language. Article 7.1 begins: "Except as provided in Article 13 of the Agreement on Agriculture, …".

> Regarding action under Article XVI of *GATT 1994*, in addition to the provisions in Article 13 of the *Agriculture Agreement*, Article 21.1 states: "The provisions of GATT 1994… shall apply subject to the provisions of this Agreement."

> During the implementation period, notwithstanding the provisions of *GATT 1994* and the SCM Agreement on Subsidies and Countervailing Measures (referred to in this Article as the "Subsidies Agreement"):
>
> (a) domestic support measures that conform fully to the provisions of Annex 2 to this Agreement shall be:
>
> …
>
> (ii) exempt from actions based on Article XVI of *GATT 1994* and Part III of the Subsidies Agreement;
>
> …
>
> (b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:
>
> …
>
> (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year…

12. Accordingly, domestic subsidies are exempt from application of the provisions in Part III of the *Subsidies Agreement* and of Article XVI of *GATT 1994* if they conform to Annex 2 of the *Agriculture Agreement*. Domestic subsidies that do not conform to Annex 2 are exempt if such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

**2. Decoupled income support must not be linked to the type of commodity produced in any year after the base period**

13. To determine whether a measure is exempt under Article 13(a) of the *Agriculture Agreement*, it must be assessed under the criteria of Annex 2. Canada sets out the relevant Annex 2 provisions.

14. Annex 2 is the basis for the conditional exemption of domestic subsidies, under Article 13(a) of the *Agriculture Agreement*, from the application of Part III of the *SCM Agreement* and Article XVI of *GATT 1994*. Annex 2 also conditionally (and principally) exempts domestic support measures from reduction commitments pursuant to exceptions under Articles 3.2, 6 and 7 of the Agreement. Paragraph 1 of Annex 2 reads as follows:

> 1. Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:
>
> (a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,
>
> (b) the support in question shall not have the effect of providing price support to producers;
>
> plus policy-specific criteria and conditions as set out below.

15. The policy-specific criteria are for each of the following measures: general services (paragraph 2); public stockholding (paragraph 3); domestic food aid (paragraph 4); and direct payments to producers (paragraphs 5-13).

16. Paragraph 5 of Annex 2 provides that direct payments to producers are exempt only if they meet the basic criteria in paragraph 1 of Annex 2 and the "specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13…". Paragraph 5 further specifies that, to be exempt, any measure that does *not* constitute a type of direct payment covered by paragraphs 6-13 must conform to the criteria in paragraph 6(b) through (e) as well as the basic criteria listed in paragraph 1.

17. Paragraph 6 of Annex 2 reads:

> 6. Decoupled income support
>
> (a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.
>
> (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.
>
> (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.
>
> (d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.
>
> (e) No production shall be required in order to receive such payments.

18. For direct payments to qualify as decoupled income support, paragraph 6(b) requires that the amount of the payments not be "related to, or based on, the type… of production… undertaken by the producer in any year after the base period." The ordinary meaning of "production" is "something which is produced by an action, process, etc.; a product".[6] Nothing in the context or in the object and purpose of this subparagraph, of Annex 2, or of the *Agriculture Agreement* as a whole detracts from this ordinary meaning. Accordingly, under paragraph 6(b), the amount of the payment must not be linked to the kind of product that is produced.

### 3. PFC payments and direct payments do not conform to Annex 2 of the *Agriculture Agreement* because the amount of these payments is linked to the type of commodity produced after the base period

19. Based on the evidence and arguments presented in the submissions of the disputing parties at this stage of the proceedings, it is Canada's assessment that the amount of PFC payments and direct payments are based on the type of commodity produced after the base period. Were the Panel to accept the evidence submitted by Brazil, it would find that PFC payments and direct payments are inconsistent with paragraph 6(b) of Annex 2 of the *Agriculture Agreement*.

[6] *The New Shorter Oxford English Dictionary*, p. 2367 [Exhibit CDA-1.].

20. Brazil asserts that under US law implementing PFC payments, the amount of such payments "could fluctuate from 100 percent of the PFC payments if [a producer] did not grow any fruits and vegetables, to zero percent in case such prohibited products are grown" or "[to] a reduced and pro-rated decrease based on acreage and/or value of the fruit or vegetable crop grown on PFC contract acres."[7] According to Brazil, US implementing law also provides that "PFC payments are reduced for each acre of wild rice that is produced." [8] Regarding direct payments, Brazil argues that under US implementing law, current fruit, vegetable, or wild rice production affects the amount of the direct payment in the same manner as such production affects the amount of the PFC payment. [9]

21. The United States describes direct payments under the 2002 FSRI Act as direct payments "to persons (farmers and landowners) with farm acres that formerly produced any of a series of commodities during the base period."[10] The United States claims that these payments constitute "decoupled income support" under Annex 2 of the *Agriculture Agreement* because they: (1) are provided through a publicly-funded government programme not involving transfers from consumers; (2) do not have the effect of providing price support to producers; and (3) conform to the five policy-specific criteria and conditions set out in paragraph 6.[11] The United States claims in particular that the direct payments are "decoupled from production" because the amount of the payments is not based on the type of production undertaken after the base period, in conformity with paragraph 6(b). In this respect, the United States argues:

> Not only is there no requirement that a direct payment recipient engage in any *particular* type or volume of production, a recipient need not engage in *any* current agricultural production in order to receive the direct payment.[12] [emphasis in original]

22. The United States does not describe or assess PFC payments, given its request for a preliminary ruling by the Panel that such payments are not within its terms of reference.[13]

23. Canada's assessment of the facts and arguments presented so far in this case is that the United States has incorrectly classified PFC payments as decoupled income support,[14] and that US direct payments do not qualify as such support.[15] Nowhere in its submission does the United States address the evidence of implementing legislation and regulations regarding either measure. Its argument that direct payment recipients are not required to engage in any particular type or volume of production (or any current agricultural production at all) to receive direct payments fails to address the evidence indicating that the amount of the payment may change based on whether base acreage is used for current production of fruits, vegetables, or wild rice. For both measures, the evidence indicates that the amount of the payment is based on the type of production: payments are full, nil, or some amount in between where base acres are used for current fruit, vegetable or wild rice production.

[7] Brazil First Written Submission, para. 160.
[8] *Ibid*., para. 161.
[9] Brazil First Written Submission, para 174.
[10] US First Written Submission, para. 57.
[11] *Ibid*., paras. 64-68.
[12] *Ibid*., para. 67.
[13] *Ibid*., para. 211.
[14] Brazil First Written Submission, para. 153.
[15] *Ibid*., paras. 175 and 198.

## III. CLAIMS REGARDING US EXPORT CREDIT GUARANTEE PROGRAMMES

24. Brazil asserts that the US GSM-102, GSM-103, and SCG programmes provide export subsidies with respect to upland cotton and other agricultural commodities in violation of Articles 8 and 10.1 of the *Agriculture Agreement*.[16] According to Brazil, the United States violates Articles 8 and 10.1 of the *Agriculture Agreement* because these programmes:

XI. provide export subsidies under item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement;*[17] and

XII. provide "subsidies" that are "contingent upon export performance" under Articles 1.1 and 3.1(a) of that Agreement.[18]

25. As a result, Brazil argues, these measures do not fully conform to the provisions of Part V of the *Agriculture Agreement* and the Peace Clause, therefore, does not exempt them from actions based on Article 3 of the *SCM Agreement.*[19] Brazil also argues that these programmes provide prohibited export subsidies within the meaning of Article 3.1(a) of the *SCM Agreement* and requests the Panel to recommend to the DSB that the measures be withdrawn without delay under Article 4.7.[20]

26. The United States argues in response that its export credit guarantee programmes are not export subsidies subject to Article 10.1 of the *Agriculture Agreement* because Article 10.2 permits export credit guarantee practices "to continue, unaffected by export subsidy disciplines otherwise negotiated and reflected in the text of the Agreement".[21] The United States asserts that these programmes do not provide prohibited export subsidies under Article 3.1(a) of the *SCM Agreement* because export credit guarantees are carved out from export subsidy commitments by virtue of Article 10.2 of the *Agriculture Agreement* and any application of Article 3 of the *SCM Agreement* is subject to the provisions of the *Agriculture Agreement*.[22] Finally, according to the United States, its measures do not satisfy the standard in item (j) of Annex I of the *SCM Agreement* and are not, for that reason alone, export subsidies under Article 3.1(a).[23]

27. The United States also requests the Panel to rule preliminarily that Brazil's arguments in connection with all commodities other than upland cotton are not properly before the Panel, and limits its arguments to upland cotton accordingly.[24]

28. In this submission, Canada limits its views to whether the United States has violated Articles 8 and 10.1 of the *Agriculture Agreement* by providing export subsidies in the form of export credit guarantees resulting in the circumvention of US export subsidy commitments with respect to upland cotton. Canada notes that this aspect of Brazil's claim is both independent and determinative of the applicability in this dispute of the Peace Clause under Article 13(c)(ii) of the *Agriculture Agreement*. That is, a violation of Articles 8 and 10.1 in this case would itself form the basis for both a recommendation by the DSB to the United States to bring its measures into conformity and would also form the basis for continued action by Brazil under Article 3 of the *SCM Agreement.*

[16] *Ibid*., para. 304.
[17] *Ibid*., paras. 272-286.
[18] *Ibid*., paras. 287-294.
[19] *Ibid*., para. 306.
[20] *Ibid*., para. 306.
[21] US First Written Submission, para. 160.
[22] *Ibid*., para. 167.
[23] *Ibid*., paras. 171 to 183.
[24] US First Written Submission, paras. 171 and 218.

A. EXPORT CREDIT GUARANTEES MAY PROVIDE "EXPORT SUBSIDIES" UNDER THE *AGRICULTURE AGREEMENT*

29. Under the *SCM Agreement*, export subsidies are prohibited. Under the *Agriculture Agreement*, certain export subsidies are allowed up to certain limits. The export subsidy disciplines of the *SCM Agreement* apply subject to the export subsidy disciplines of the *Agriculture Agreement*.[25] The Appellate Body confirmed in its first *Canada - Dairy* implementation report that "the WTO-consistency of an export subsidy for agricultural products has to be examined, in the first place, under the *Agreement on Agriculture*."[26] Canada sets out the relevant provisions of both Agreements in this section.

30. Article 1(e) of the *Agriculture Agreement* defines "export subsidies" as "subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement". Article 3.3 sets out the obligation of Members not to provide export subsidies listed in Article 9 in excess of scheduled commitment levels:

> Subject to the provisions of paragraphs 2(b) and 4 of Article 9, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule.

31. Article 8 of the *Agriculture Agreement* confirms the fundamental obligations of Members with respect to the provision of export subsidies:

> Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule.

32. Article 9 of the *Agriculture Agreement* lists and describes certain export subsidies that are subject to reduction commitments. All other export subsidies fall within the scope of Article 10.1, which reads:

> Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments.

33. The *Agriculture Agreement* does not define the term "subsidy" in the definition of "export subsidy" in Article 1(e) of the Agreement. The Appellate Body drew upon the definition of a "subsidy" in Article 1.1 of the *SCM Agreement* as context to the term "subsidy" in Article 1(e) of the *Agriculture Agreement* in both its original *Canada – Dairy* report and its original and implementation

[25] See Article 3.1 of the *SCM Agreement* and Articles 13(c)(ii) and 21.1 of the *Agriculture Agreement*.

[26] *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products: Recourse to Article 21.5 of the DSU by New Zealand and the United States*, Report of the Appellate Body, WT/DS103/AB/RW, WT/DS113/AB/RW, adopted 18 December 2001, paras. 123-124.

reports in *US - FSC*.[27] The Appellate Body also held in *US - FSC* that the "contingent upon export performance" requirements in the *Agriculture Agreement* and the *SCM Agreement* are the same.[28]

34. Article 1.1 of the *SCM Agreement* sets out the definition of a subsidy, which reads in relevant part:

> 1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:
>
> (a)(1) there is a financial contribution by a government or any public body within the territory of a Member…, i.e. where:
>
> (i) a government practice involves… potential direct transfers of funds or liabilities (e.g. loan guarantees); …
>
> and
>
> (b) a benefit is thereby conferred.

35. Article 3.1(a) of the *SCM Agreement* describes export subsidies as follows:

> 3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I…

36. Annex I of the *SCM Agreement* includes in particular item (j), which reads:

> The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

37. Canada provides views only on key elements of Articles 1 and 3.1(a) of the *SCM Agreement* that are applicable to a determination of whether the US programmes provide "export subsidies" under Article 1(e) of the *Agriculture Agreement.* If they do, then they are subject to US obligations under Articles 8 and 10.1 of the *Agriculture Agreement*.

## B. US EXPORT CREDIT GUARANTEES MAY GRANT EXPORT SUBSIDIES UNDER ARTICLE 1(E) OF THE *AGRICULTURE AGREEMENT* AND ARTICLE 3.1(A) OF THE *SCM AGREEMENT*

38. Based on the evidence and arguments presented by the disputing parties at this stage in the proceedings, it is Canada's assessment that US export credit guarantee programmes may provide "subsidies contingent upon export performance" under Article 1(e) of the *Agriculture Agreement* that

[27] See *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, Report of the Appellate Body, WT/DS103/AB/R, WT/DS113/R, adopted 27 October 1999, para. 87; *US – FSC* AB Report, paras. 136-137; *United States – Tax Treatment for "Foreign Sales Corporations: Recourse to Article 21.5 of the DSU by the European Communities*, Report of the Appellate Body, WT/DS108/AB/RW, adopted 29 January 2002, para. 194 [hereinafter *US – FSC* Article 21.5 AB Report].

[28] *US – FSC* AB Report, paras. 141-142; *US – FSC* Article 21.5 AB Report, para. 192.

are "not listed in paragraph 1 of Article 9", pursuant to Article 10.1. Because the United States has no export subsidy reduction commitments for upland cotton, it may have violated Article 10.1 by applying such subsidies in a manner that results in circumvention of its export subsidy commitments. The United States may have also therefore violated Article 8 by providing export subsidies "otherwise than in conformity with this Agreement".

39. Evidence submitted by Brazil indicates that the United States has exceeded its quantitative export subsidy reduction commitment level for various agricultural commodities, including upland cotton.[29] Accordingly, were the Panel to accept such evidence, the United States would bear the burden of establishing that no export subsidies have been granted in respect of the quantity of exports in question pursuant to Article 10.3 of the *Agriculture Agreement*.[30]

40. The United States cannot deny that US export credit guarantees involve a "financial contribution" in the form of a "potential direct transfer of funds" under Article 1.1(a)(1)(i) of the *SCM Agreement*. Export credit guarantees are loan guarantees. Nor can the United States deny that the export guarantees are contingent upon export performance under Article 3.1(a) of the Agreement. Canada therefore addresses only the "benefit" requirement of the subsidy definition under Article 1.1(b) of the *SCM Agreement*.

41. The determination of a "benefit" in transactions involving agricultural commodities is necessarily factual. However, any assessment of the facts in this dispute must be undertaken within an appropriate legal framework. The applicable framework in this dispute is based on well-established WTO case law.

42. In *Canada – Aircraft*, the panel found that:

> … a financial contribution will only confer a "benefit", *i.e.*, an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market.[31]

43. The Appellate Body upheld this finding:

> We ... believe that the word "benefit", as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market.[32]

44. Based on this reasoning, the question is whether there is a difference between the amount that the firm receiving the guarantee pays on credit guaranteed under the US programmes and the amount that the firm would pay on a comparable commercial loan absent that guarantee. The benefit is the

[29] Brazil First Written Submission, paras. 265-266.

[30] See *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products: Second Recourse to Article 21.5 of the DSU by New Zealand and the United States*, Report of the Appellate Body, WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted 17 January 2003, para. 73.

[31] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Panel, WT/DS70/R, adopted 20 August 1999, para. 9.112.

[32] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted August 20, 1999 at para. 157.

difference between these two amounts adjusted for any differences in fees. The useful context provided by Article 14(c) of the *SCM Agreement* supports such a standard. Article 14(c) reads:

> [A] loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees[.]

45. The panel in *Canada - Aircraft II* established a similar standard in respect of equity guarantees provided through a Canadian provincial government financing institution called *Investissement Québec* (IQ).[33] The panel reasoned as follows:

> Consistent with the findings of the panel and Appellate Body in *Canada – Aircraft*, we consider that *IQ* equity guarantees will confer a "benefit" to the extent that they are made available to Bombardier customers on terms more favourable than those on which such Bombardier customers could obtain comparable equity guarantees in the market. We note that the parties appear to agree that this standard can be applied by reviewing the fees, if any, charged by *IQ* for providing its equity guarantees. We agree that the "benefit" standard could be applied to *IQ* equity guarantees in this manner. Thus, to the extent that *IQ*'s fees are more favourable than fees that would be charged by guarantors with Québec's credit rating in the market for comparable transactions, *IQ*'s equity guarantees may be deemed to confer a "benefit".[34]

46. The panel went on to find that:

> … a "benefit" could arise if there is a difference between the cost of equity with and without an *IQ* equity guarantee, to the extent that such difference is not covered by the fees charged by *IQ* for providing the equity guarantee. In our opinion, it is safe to assume that such cost difference would not be covered by *IQ*'s fees if it is established that *IQ*'s fees are not market-based.[35]

47. Regarding IQ loan guarantees, the panel applied the same reasoning:

> In considering precisely what Brazil must show in order to demonstrate the existence of a "benefit", we note the findings of the panel and Appellate Body in *Canada – Aircraft*. We therefore consider that *IQ* loan guarantees will confer a "benefit" to the extent that they are made available to Bombardier customers on terms more favourable that those on which such Bombardier customers could obtain comparable loan guarantees in the market. In applying this standard, we are guided by Article 14(c) of the SCM Agreement, which provides contextual guidance for interpreting the term "benefit" in the context of loan guarantees.
>
> (…)
>
> In our view, and taking into account the contextual guidance afforded by Article 14(c), we consider that an *IQ* loan guarantee will confer a "benefit" when

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[33] *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Report of the Panel, WT/DS222/R, adopted 19 February 2002, para. 7.397 [hereinafter *Canada – Export Credits*, Panel Report].

[34] *Canada – Export* Credits, Panel Report, para. 7.344.

[35] *Canada – Export* Credits, Panel Report, para. 7.345.

> "there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by [*IQ*] and the amount that the firm would pay on a comparable commercial loan absent the [*IQ*] guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees". In other words, there will be a "benefit" when the cost-saving for a Bombardier customer for securing a loan with an *IQ* loan guarantee is not offset by *IQ*'s fees. In our opinion, it is safe to assume that this will be the case if it is established that *IQ*'s fees are not market-based.[36]

48. The same standard applies in the current dispute.

49. The United States avoids addressing the standard under Article 1.1(b) and argues simply that its export credit guarantee programmes "do not run afoul of the criteria of item (j)" of Annex I of the *SCM Agreement* and that, therefore, "…they are not a prohibited export subsidy under Article 3.1(a) of the Subsidies Agreement."[37] The United States asks the panel to interpret item (j) *a contrario*, meaning that if its measures meet the description of the programmes in the provisions but do not meet the standard for being considered a subsidy *per se*, the measures must be deemed not to confer export subsidies. However, item (j) does not create a "safe haven" for export credit guarantees where "premium rates… are [adequate] to cover the long-term operating costs and losses of the [programme]." To the contrary, item (j) "sets out the circumstances in which the grant of loan guarantees is *per se* deemed to be an export subsidy."[38] It simply "illustrates" deemed export subsidy practices. Nothing in the context or object and purpose of the *SCM Agreement* supports the US interpretation.

50. The issue of whether the premium rates under the US programmes are adequate under item (j) of Annex I of the *SCM Agreement* is necessarily factual. However, even if the US programmes charge adequate fees under the item (j) standard, the United States must nevertheless demonstrate that no export subsidies have been granted in respect of the quantity of exports in question in accordance with Articles 10.1 and 10.3 of the *Agriculture Agreement*. In other words, it must demonstrate the absence of subsidization on a transaction-by-transaction basis under Articles 1 and 3.1(a) of the *SCM Agreement*.

51. The United States also argues at length that Article 10.2 of the *Agriculture Agreement* exempts export credit practices from subsidy disciplines under the Agreement. This argument is untenable.

52. Article 10.2 of the Agreement on Agriculture reads:

> Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

53. Article 10.2 refers to "disciplines to govern the provision of export credits, export credit guarantees or insurance programmes" and not to "disciplines to govern the provision of *export subsidies in the form of* export credits, export credit guarantees or insurance programmes". This provision sets out an intention on the part of Members to undertake further work regarding these measures – the simple fact of agreeing to do so, however, does not amount to a permission to use those measures to confer export subsidies without consequence and without limit. The US

[36] *Canada – Export Credits*, Panel Report, paras. 7.397 and 7.398.
[37] US First Written Submission, para. 183.
[38] *Canada – Export Credits*, Panel Report, para. 7.395.

interpretation of Article 10.2 ignores the important context provided by Article 10.1. It also directly contradicts the stated object and purpose of Article 10 as a whole: "Prevention of Circumvention of Export Subsidy Commitments".[39]

54. Article 10.2 of the *Agriculture Agreement* does not exempt the United States from its obligation to demonstrate, under Article 10.3, that no export subsidies have been granted in respect of the quantity of exports in question in this dispute contrary to Article 10.1. For the United States to meet the requirements of Article 10.3, it must demonstrate the absence of subsidization as understood under Article 1(e) of the *Agriculture Agreement*. Indeed, the United States does not address Articles 1(e) or 10.1, or any prior panel and Appellate Body findings thereon.

## IV. CONCLUSION

55. At this stage of the proceedings, it is Canada's view that if the panel accepts the evidence presented by Brazil in its first written submission, it would find that PFC payments and direct payments do not satisfy the policy-specific criteria in paragraph 6(b) of Annex 2 of the *Agriculture Agreement*. Contrary to those requirements, the amount of these payments would be found to vary based on current production of certain fruit, vegetables and wild rice.

56. Regarding the US export credit guarantee programmes, in Canada's view, were the Panel to find that these programs provide export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement*, then it would also find that the United States has violated Articles 8 and 10.1 at the very least in respect of exports of upland cotton.

[39] See also "Export Credits and Related Facilities", Background Paper by the Secretariat, G/AG/NG/S/13, 26 June 2000 [Exhibit CDA-2.] at para. 44:

> [A]s matters currently stand the only rules and disciplines on agricultural export credits are those of the Agreement on Agriculture but only to the extent that such measures constitute export subsidies for the purposes of the Agreement on Agriculture. Where exports of an agricultural product are considered to be subsidised through export credits or related facilities, ascertaining the exported quantities benefitting [sic] from such measures for the purposes of determining conformity with export quantity reduction commitments would be reasonably straight forward. Quantifying related budgetary outlays and revenue foregone for the annual commitment level in question, using market-related premium or interest rate benchmarks for example (it is not clear what, if any, role there might be for export credit "subsidy equivalents" in this context), may be less straight forward but not necessarily problematic.

# ANNEX B-7

## THIRD PARTY SUBMISSION OF CHINA

15 July 2003

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## 1. INTRODUCTION

1. China is appreciative of this opportunity to present its views to the Panel in this proceeding on various domestic supports and export subsidies granted by the United States (the "US") for the production, use and export of US upland cotton.

2. In line with this Panel's decision dated 20 June 2003, China will focus its submission to issues relating to

(1) the burden of proof under Article 13 of the *Agreement on Agriculture* (the "Peace Clause");

(2) proper categorization of direct payments under the US. Farm Security and Rural Investment Act of 2002 ("FSRI"); and

(3) treatment of a non-complying measure by this Panel.

In China's opinion, these three issues, amongst others, call for close attention and analysis by the Panel.

## 2. ARGUMENTS

### 2.1. The Burden Of Proof Under The Peace Clause

3. China agrees with Brazil that "the [P]eace [C]lause is in the nature of an affirmative defense, and that the burden of proof that US domestic support and export subsidies to upland cotton are provided in conformity with the requirements of the [P]eace [C]lause lies with the United States and not with Brazil as the complainant"[1].

4. The burden of proof issue has been squarely dealt with by the Appellate Body in the *US – Shirts and Blouses* Case[2]. It stated that a complaining party asserting a claim under a positive rule, establishing obligations in themselves, first has the burden of proof to establish a prima facie case of an infringement of obligations by the responding Member, then the burden shift to the responding Member to adduces sufficient evidence to rebut the presumption[3]. However, with respect to rules providing "limited exceptions from obligations under certain other provisions of the GATT 1994", the Appellate Body is of the view that they are "in the nature of affirmative defense, thus it is only reasonable that the burden of establishing such a defense should rest on the party asserting it"[4].

5. The parties to this dispute disagree on the nature of the Peace Clause. The US does not see the Peace Clause as an affirmative defense; it argues that portions of the Peace Clause impose positive obligations. It cites Articles 13(a)(i), 13(a)(ii) and 13(b)(ii) of the Peace Clause to prove that by incorporating obligations under Article 6 and Annex 2 within the "conform fully to" requirement, the Peace Clause contains positive obligations on members[5].

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[1] Para. 107, Page 50, *First Submission of Brazil*, 24 June 2003.

[2] Section IV, Appellate Body Report, *US - Shirts and Blouses, WT/DS33/AB/R*.

[3] Page13-14, Section IV Burden of Proof, Appellate Body Report, *US - Shirts and Blouses, WT/DS33/AB/R*.

[4] Page 15-16, Section IV and Text at Note 23, Appellate Body Report, *US - Shirts and Blouses, WT/DS33/AB/R* .

[5] Paras. 43 and 45, *US First Written Submission*, 11 July 2003.

6. China has a different opinion. When stand-alone, Article 6 in and Annex 2 to the *Agreement on Agriculture* and may contain positive obligations on Members. However, when cross-referred to by Articles 13(a)(ii) and 13(b)(ii) respectively, they are brought under the Peace Clause to form part and parcel of pre-conditions to its application. Generic components of the relevant Peace Clause provisions[6] are (i) domestic support measures or export subsidies; (ii) that fully conform to Annex 2 and/or Article 6 of the *Agreement on Agriculture*; (iii) are exempt from actions; (iv) provided that…[7] The thrust of the relevant provisions of the Peace Clause lies in its exemption of measures from certain actions. To qualify under the exemption, a measure under item (i) above must first meet the requirements under items (ii) and (iv) above. The moment either Annex 2 or Article 6 are brought into "fully conform to" formula under item (ii) above, it ranks *pari passu* with the other requirement under item (iv) above to form conditions precedent to a successful exemption.

7. China believes the US errs on seeing no distinction between "obligation" and "condition". The Peace Clause requirement for full conformity to Article 6 and Annex 2 does not create new obligations because Members have to comply with Article 6 and Annex 2 whether Article 13 exists or not. Within the Peace Clause, these requirements do not stand to impose obligations on Members, but to set conditions precedent for a Members intending to invoke Peace Clause protection. Positive obligations to comply with Article 6 and Annex 2, lie under where they are, i.e. under Article 6 and Annex 2, but not under the Peace Clause.

8. China does not see any "absurdity" as described by the United States in its written submission[8]. No such "absurdity" would be instilled into the process if at the first stage, the party alleging protection of Peace Clause for its measures is required to discharge its burden to prove that such measures do conform to the relevant Peace Clause conditions; if it cannot so prove, the measures would lose Peace Clause protection. A second stage will follow for the party claiming against the measures to establish its substantive case, without the Peace Clause shield.

9. China hopes the above two-step approach will help both this Panel and the parties to move the procedures on towards resolution of the case.

### 2.2 Proper Categorization Of US FSRI 2002 Direct Payments

10. The United States in its first written submission argues that direct payments ("DP") under FSRI conforms fully to Annex 2 of the *Agreement on Agriculture*[9] and are therefore "Green Box" in nature. Brazil argues that DP programme is inconsistent with Paras. 1, 6(a) and (b) of Annex 2 to the *Agreement on Agriculture*, as

(1) it conditions the type of production undertaken by the producer[10];

(2) it sanctions base period updating[11]; and

(3) it has production and trade-distorting effects[12].

11. Para. 6(a) of Annex 2 to the *Agreement on Agriculture* provides to the effect that eligibility for "Green Box" direct payment support measures "shall be determined by clearly-defined criteria"

[6] Articles 13(b)(ii), 13(b)(iii) and 13(c)(ii), the *Agreement on Agriculture*.
[7] Note that Article 13(c)(ii) of the Peace Clause has no such proviso.
[8] Para. 36, *US First Written Submission*, 11 July 2003.
[9] Paras. 54 through to 68, *US First Written Submission*, 11 July 2003.
[10] Para. 174, *First Submission of Brazil*, 24 June 2003.
[11] Paras. 176 through to 182, *First Submission of Brazil*, 24 June 2003.
[12] Paras. 183 through to 191, *First Submission of Brazil*, 24 June 2003.

"*in* a defined and fixed base period." The word "in" requires a link between the "criteria" and the "defined and fixed base period". In other words, to qualify for "Green Box" direct payment measure under Para. 6(a), a criterion adopted by a Member must be tied, in a chronological sense, to a starting time frame that cannot be moved up on the calendar.

12. As the United States concedes, production acreage is a criterion for making FSRI DP[13]. However, under FSRI, production acreage for the purpose of DP is not tied to a defined and fixed base period. It moves progressively along the calendar.

13. Under the FSRI DP scheme, payment acreage, being one factor in calculating payment[14], is 85% of a person's base acreage. Base acreage, in turn, are either (i) "a four year average (1998-2001) of plantings of covered commodities (including upland cotton)", or (ii) the total of production flexibility contract ("PFC") acreage under the US 1996 Federal Agricultural Reform Improvement and Reform Act ("FAIR") and the four-year average (1998-2001) of plantings of eligible oilseeds[15]. With respect to base acreage calculation method (i) above, the United States explains, FSRI DP allowed landowners to retain PFC base acres and "add 1998-2001 acres of eligible oilseeds or simply declare base acreage for all covered commodities" (including upland cotton)[16]. With respect to base acreage calculation method (ii) above, the United States explains that while a landowner may elect to simply utilize acres devoted to covered commodities during the 1998-2001 period for purpose of DP, a landowner need not do so; base acres may remain those under FAIR, implying no cotton production need have occurred since the 1993-1995 period for a landowner to have "cotton base acres". The United States then concludes that "[t]hese … base acres are defined in the 2002 [FSRI] Act and fixed for the duration of the legislation (that it, from marketing year 2002-2007)"[17]. Such a conclusion ignores the fact that during the progression from PFC to DP, the requisite link between the programme acreage as a criterion and the "defined and fixed" starting time frame is broken. The change of legislation from FAIR to FSRI and the replacement of PFC with DP were utilized for producers to leap from their previous coverage acreage, which should have been tied to the base period, to a new updated acreage in 2002.

14. Enticement certainly exists for a producer to obtain more payments by leaping over the calendar and updating production acreage. The fundamental requirement that "no, or at most minimal trade distorting effects or effects on production" as required by Article 1 of Annex 2 to the *Agreement on Agriculture* is therefore not met.

15. In China's opinion, without dwelling upon the burden of proof issue, the preponderance of evidence as produced by the parties indicates that the US DP under FSRI fails to meet the "tie" requirement under Para. 6(a) of Annex 2 of the *Agreement on Agriculture* and shall be properly categorized as non-"Green Box" measures.

### 2.3 Panel Treatment Of Measures Found By Earlier Proceedings To Be In Violation

16. Brazil also brought claims against export subsidy support granted for upland cotton export sales by US "Foreign Sales Corporations" ("FSCs") under the "FSC Repeal and Extraterritorial Income Act of 2000" ("ETI Act") [18].

[13] Paras. 56 and 67, *US. First Written Submission*, July 11, 2003.,
[14] Para. 58, *Ibid.*
[15] Para. 59, *Ibid.*
[16] Para. 60, *Ibid.*
[17] Subpara. 67(1), *Ibid.*
[18] Paras. 315 through to 330, *First Submission of Brazil*.

17. The US ETI Act has previously been found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by both the panel[19] and the Appellate Body[20] in *US – FSC (21.5)*. On 29 January 2002, the WTO Dispute Settlement Body (the "DSB") adopted the panel and Appellate Body reports, declaring that the ETI Act violates Articles 3.1(a) and 4.7 of the *Subsidies Agreement*, Articles 8 and 10.1 of the *Agreement on Agriculture* and Article III:4 of *GATT 1994*.

18. As the United States had failed to implement the DSB recommendations and rulings within the prescribed time framework, on 25 April 2003, the European Communities (the "EC") requested the DSB authorization to take appropriate countermeasures and to suspend concessions pursuant to Article 4.10 of the *Subsidies Agreement* and Article 22.7 of the *DSU*[21]. On 7 May 2003, the DSB authorized the EC to impose countermeasures against the US.

19. Brazil quoted main EC arguments and portions of the panel's and the Appellate Body's reasoning from *their* respective reports in *US – FSC (21.5)*, all to persuade this Panel into taking the same reasoning and conclusion[22].

20. China believes that the panel and the Appellate Body's reasoning and their conclusion in *US – FSC (21.5)* are of extraordinary value to the current Panel.

21. First, "[a]dopted panel reports are an important part of the GATT *acquis*. They are often considered by subsequent panels. They create *legitimate expectations* among WTO members, and, therefore, *should be taken into account where they are relevant to any dispute*. [emphasis added]." [23] Export subsidy support provided to upland cotton export sales by US "Foreign Sales Corporations" under the ETI Act as challenged by Brazil in this case, is exactly the very same one challenged by the EC and found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by the panel[24] and the Appellate Body[25] in *US – FSC (21.5)*. The panel and the Appellate Body's decisions, as well as DSB's adoption of same in *US – FSC (21.5)*, have already created "legitimate expectations" among WTO members. Should this Panel re-consider the arguments, analysis and conclusions in respect of the same measure adopted by the same Member in dispute, and re-decide with even the slightest difference, the WTO Members' legitimate expectations will be seriously disturbed and offended. Unless the current Panel finds the FSC export subsidies under the ETI Act challenged by Brazil in this case different from the FSC export subsidies under the ETI Act challenged by the EC in the *US – FSC (21.5)*, relevancy is fulfilled to the maximum extent possible. The very same export subsidies shall be governed by the same juridical analysis, rule and conclusion. Substantive deviation from that the reasoning and conclusion of the earlier case on the same measure may well cast misgivings on the established DSB authority and reputation.

22. The United States in its *First Written Submission* argues that:

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[19] Panel Report, *US - FSC (21.5)*, WT/DS108/RW, adopted on 29 January, 2002.

[20] Appellate Body Report in *US - FSC (21.5)*, AB-2002-1, WT/DS108/AB/RW,adopted on 29 January, 2002.

[21] Recourse by the European Communities to Article 4.10 of the *Subsidies Agreement* and Article 22.7 of the *DSU*, WT/DS/108/26, circulated on April 25, 2003.

[22] Paras. 315 through to 327, *First Submission of Brazil*.

[23] Para. E, Report of the Appellate Body, *Japan - Taxes on Alcoholic Beverages*, AB-1996-2, adopted on 1 November 1996).

[24] Paras.8.30, 8.46, 8.48, 8.50, 8.74, 8.75, and 9.1(a.), Panel Report, *US - FSC (21.5)*, WT/DS108/RW, adopted on 29 January 2002.

[25] Paras.111, 116 through to 120, 122, 194, 196, and 256(d), Appellate Body Report, *US - FSC (21.5)*, AB-2002-1, WT/DS108/AB/RW, adopted on 29 January 2002.

> It also is well-established that even though panels may take into account prior panel and Appellate Body reports, "panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same."[26]

China notes that US had omitted the immediate subsequent paragraph, in which the panel states:

> However, in the course of "normal dispute settlement procedures" required under Article 10.4 of the DSU, we *will take into account the conclusions and reasoning* in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we *should give significant weight to both Article 3.2 of the DSU,* which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, *and to the need to avoid inconsistent rulings* (which concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the DSU.[27] [emphasis added]

China believes that second sentence following the US quote from the panel's report could not be more relevant to the US ETI Act before this Panel.

23. Secondly, the DSB has already, upon request by the EC, authorized the EC to impose countermeasures against the US, for its failure to implement the DSB recommendations and rulings within the prescribed time framework. DSB's authorization to counteract

(1) further strengthens the weight of the panel and the Appellate Body's decisions in *US – FSC (21.5).* Authorization by the DSB for countermeasures against the very same measures is a collective reflection that the measures shall have been withdrawn, and;

(2) brings up the need for efficiency. Given the DSB's heavy caseload, as well as workload of this Panel, benefits of efficiency far overweighs whatever need for repeating the work that had been completely accomplished by a previous panel and the Appellate Body.

24. Thirdly, in light of difficulties encountered by the DSB in encouraging compliance subsequent to the *US – FSC (21.5)* proceedings, a different finding by this Panel in relation to ETI in the current dispute will frustrate WTO's effectiveness as reflected in the DSB mechanism. The essence of "[p]rompt compliance with recommendations or rulings of the DSB" "to ensure effective resolution of disputes to the benefit of all Members" called for under Article 21.1of the *DSU* will evaporate.

25. Being a multilateral system, the WTO cannot afford to permit non-compliance by any Member in its face. One dispute settled will definitively involve several legal issues having been clarified and practices of certain members adjudicated. Such clarification and adjudication in one case must serve to benefit all members in the multilateral system. As Article 3.2 of the *DSU* tries to impress, the dispute settlement system of the WTO is a pivotal element in providing uniform security and predictability to the multilateral trading system and to avoid multiplication of the same practices being disputed in separate but non-distinct cases. To compel panels in later instances to re-visit the

[26] Para. 185, *First Written Submission of the US,* 11 July 2003, quoting in quotation marks Para. 7.30, Panel Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS79/R, adopted 22 September 1998.

[27] Para. 7.30, Panel Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Product*, WT/DS79/R, adopted 22 September 1998.

same legal issue and re-adjudicate the same practices the DSB recommends against on a second or even indefinite analytical journey would relegate WTO dispute settlement regime into disrepute.

26. The concern is not unfounded. The fact that Brazil had to resort to the WTO dispute settlement system and bring the ETI Act before this Panel is distinctly telling. This current Panel must put an end to that concern by ruling that the panel and the Appellate Body's reasoning *and* their conclusion in *US – FSC (21.5)* be taken by this Panel, unless by the time the current Panel makes it decision, such measures will have already been withdrawn by the US.

## 3. CONCLUSION

27. To sum up, China is of the following opinion:

(1) The Peace Clause is an affirmative defense in nature, and a party seeking its protection bears the burden of proof;

(2) The US DP, which removes production acreage from its required nexus with a defined and fixed based period by allowing acreage updating, is not "Green Box" measure within the meaning of Para. 6(a) of Annex 2 to the *Agreement on Agriculture*; and

(3) The US ETI Act has been found by a prior panel and the Appellate Body to violate the *Agreement on Agriculture* and the *Subsidies Agreement*. In addition, the DSB has authorized the complaining party in the prior proceeding to take countermeasures. In light of coherency and efficiency of the WTO dispute settlement mechanism, this Panel shall take the reasoning and conclusion of the Appellate Body in the earlier case.

28. China thanks this Panel for granting this opportunity to present its views on issues related to this proceeding, and hopes that this Panel will finds the above points helpful.

# ANNEX B-8

## FIRST THIRD PARTY SUBMISSION BY THE EUROPEAN COMMUNITIES

15 July 2003

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## I. INTRODUCTION

1. This dispute raises a number of complex yet important questions in respect of the applicable WTO regime for trade in agricultural goods. In this First Third Party Submission, the European Communities has submitted arguments on a number of questions raised by Brazil's First Written Submission.[1] However, the present submission should not be seen as exhaustive. Given the very short period between the deadline for the US First Written Submission and the deadline for submissions from third parties, the European Communities has not been able to incorporate in this submission a response to all of the arguments brought in the US First Written Submission which might merit a comment. Consequently, the European Communities reserves its right to submit argument on other questions (or to further develop the arguments set out here) at the First Session of the First Substantive Meeting with the Parties.

2. Following the Panel's invitation of 20 June 2003, the European Communities has essentially limited itself to questions related to the interpretation of Article 13 of the *Agreement on Agriculture*, and some of the "non-peace clause" related claims brought by Brazil. The European Communities will therefore argue that :

- As a preliminary matter, Brazil is incorrect to consider that only legislation which mandates a particular action can be found inconsistent with the WTO Agreements;

- Article 13 *Agreement on Agriculture* is not an affirmative defence;

- The first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* does not create a free-standing obligation, separate from the basic criteria set out in the second sentence of paragraph 1; and,

- Article 10.2 of the *Agreement on Agriculture* does not exempt export credits and export credit guarantees from the disciplines of the *Agreement on Agriculture*.

3. The European Communities does not express an opinion on the application of the relevant legal interpretations to the facts of this dispute.

## II. PRELIMINARY ISSUE - BRAZIL'S REFERENCE TO A "MANDATORY / DISCRETIONARY DOCTRINE" IS UNFOUNDED

4. Before turning to the substantive questions of interpretation the European Communities would like to touch briefly upon one systemic issue raised in Brazil's submission. Brazil states in its First Written Submission that:

> "It is established under WTO law that a Member can only challenge measures of another Member *per se* if such measures mandate a violation of the WTO Agreement."[2]

5. Brazil cites as authority for this position para. 88 of the Appellate Body's Report in *United States – 1916 Act*. However, the Appellate Body did not "establish" that measures can only be

[1] Brazil's First Submission to the Panel regarding the "Peace Clause" and Non-Peace Clause Related Claims, 24 June 2003 ("Brazil's First Written Submission").

[2] Brazil's First Written Submission, para. 244. See, in the same sense, paras. 250 and 341.

challenged if they mandate a violation of the WTO Agreements. In that case, the Appellate Body upheld the panel's finding that the legislation in question was not discretionary and thus;

> "[did] not find it necessary to consider [..] whether Article 18.4, or any other provision of the *Anti-Dumping Agreement*, has supplanted or modified the distinction between mandatory and discretionary legislation".[3]

6. Panels have taken different approaches to this issue. The panel in *United States – Section 301* found that discretionary legislation may violate certain WTO obligations.[4] This approach can be contrasted with that of the panel in *United States – Export Restraints*.[5] More recently, the Appellate Body in considering an EC claim against US legislation noted that;

> "[it did not] preclud[e] the possibility that a Member could violate its WTO obligations by enacting legislation granting discretion to its authorities to act in violation of its WTO obligations. We [the Appellate Body] make no finding in this respect".[6]

7. Consequently, it is far from established that only mandatory legislation can be found *per se* inconsistent with the WTO Agreements. The European Communities, for one, is convinced that discretionary legislation may, in certain circumstances, be found to be inconsistent with WTO obligations. However, further discussion of this issue does not appear necessary at present, since Brazil claims that the legislation in question permits of no discretion and the United States does not appear to dispute this point.[7] Consequently, the European Communities will not develop its arguments on this issue further in this submission.

## III. ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE CANNOT BE CONSIDERED AN AFFIRMATIVE DEFENCE

8. Brazil argues that Article 13 of the *Agreement on Agriculture* should be understood as an affirmative defence and thus that the United States bears the burden of proof.[8] The United States has indicated that it disagrees with this characterisation, and considers that Article 13 is not an affirmative defence.[9]

9. The European Communities shares the view of the United States that there are compelling reasons to consider that Article 13 is not an affirmative defence.[10] Article 13 cannot be considered an

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[3] Appellate Body Report, *United States – Anti-Dumping Act of 1916 ("United States – 1916 Act")*, WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, para. 99

[4] Panel Report, *United States – Sections 301-310 of the Trade Act of 1974 ("United States – Section 301")*, WT/DS152/R, adopted 27 January 2000, footnote 23, paras. 7.53-7.54. Note that the Appellate Body in *United States – 1916 Act* mentioned this finding, without suggesting that it was incorrect (see footnote 59 of the Appellate Body Report).

[5] Panel report, *United States – Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001, paras. 8.8 and 8.9.

[6] Footnote 334, Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 8 January 2003.

[7] Brazil's First Written Submission, para. 245.

[8] Brazil's First Written Submission, paras. 110 to 121.

[9] Para. 38, Comments of the United States of America on the Comments by Brazil and the Third Parties on the Question Posed by the Panel,.13 June 2003. See also First Written Submission of the United States of America, 11 July 2003 ("US First Written Submission"), paras. 38 to 47.

[10] The European Communities is aware of the fact that it used the term "defence" in its Initial Submission to the Panel of 10 June 2003 (Para. 6 , Comments by the European Communities on certain issues raised on an initial basis by the Panel, 10 June 2003). It did so, however, in the context of a discussion of what

affirmative defence which will excuse a violation of another provision of the WTO Agreements. Rather, it seems to the European Communities, Article 13 is a form of "gateway" or "threshold" provision, which regulates the use of certain mechanisms (countervailing duties, serious prejudice claims, non-violation complaints) in respect of certain types of subsidies. Conformity with the conditions of Article 13 has the effect of providing an exemption from action under Article XVI GATT 1994 and the *SCM Agreement*. Consequently, once a panel has determined whether or not agricultural subsides conform to the conditions of Article 13, it need not, indeed cannot, rule on whether those agricultural subsidies are consistent with Article XVI GATT 1994 and the *SCM Agreement*. For that reason, it cannot be equated to a defence to a violation of a provision of a WTO Agreement, in the way, for instance, Article XX may be considered a defence to a violation of Article I or III GATT 1994.

10. Even assuming, *arguendo*, Brazil's contention that Article 13 of the *Agreement on Agriculture* is an exception to the otherwise applicable disciplines[11], the Appellate Body has pointed out in *EC-Hormones* that merely characterising a provision as an "exception" and consequently an affirmative defence is insufficient to shift the burden of proof in dispute settlement proceedings.[12] Any finding reversing the ordinary rule that the complaining party bears the burden of proof to establish a *prima facie* case must be derived from an application of the normal rules of treaty interpretation. The ordinary rules of treaty interpretation do not lead to such a conclusion in this case.

11. First, as noted above, the Panel is not asked to examine a general rule – exception situation with respect to Article 13. Article 13 is more akin to a threshold permitting further action if that threshold is not complied with.

12. Second, Article 13 is an integral part of the *Agreement on Agriculture*. In that sense, it is comparable to Article 6 of the *Agreement on Textiles and Clothing*, Article 3.3 of the *Sanitary and Phytosanitary Agreement* and the second sentence of Article 2.4 of the *Agreement on Technical Barriers to Trade* which were found not to be affirmative defences by the Appellate Body.[13] Article 13 incorporates the obligations which a WTO Member assumes under the *Agreement on Agriculture* should it decide to provide agricultural subsidies to its producers, and regulates the status of such subsidies with respect to potential dispute settlement and the application of countervailing duties. In a similar fashion, Article 6 of the *Agreement on Textiles and Clothing* provides certain obligations which a WTO Member assumes if it decides to dis-apply the disciplines of the ATC in the form of a "transitional safeguard measure". Likewise, Article 3.3 of the *Sanitary and Phytosanitary*

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appeared to be the extreme logical conclusion of the arguments which the United States made, in order to refute the proposition that the issue of conformity with Article 13 could only be dealt with in a separate panel proceeding, divorced from a panel proceeding which dealt with the claims conditional upon Article 13 not being applicable. The term "defence" was used in a general sense to connote an argument which could be invoked in reaction to another argument. Moreover, the European Communities did not use the term "affirmative defence" and did not use the term "defence" in the sense of a "defence […] to a claim of violation of a GATT obligation" or as a "limited exception from certain other provisions of the [WTO Agreements]" (Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India* ("United States – Shirts and Blouses"), WT/DS33/AB/R, adopted 23 May 1997, page 15-16). Finally, the European Communities was addressing only the question posed by the Panel and not the question of the burden of proof applicable to Article 13.

[11] Brazil's First Written Submission, para. 120.

[12] Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 104.

[13] Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India* ("United States – Shirts and Blouses"), WT/DS33/AB/R, adopted 23 May 1997, page 16. *European Communities – Hormones* Para. 104, Appellate Body Report, *European Communities — Trade Description of Sardines (European Communities – Sardines)*, WT/DS231/AB/R, adopted 23 October 2002. Paras. 274-275.

*Agreement* sets out obligations on a Member wishing to maintain a higher level of sanitary or phytosanitary protection than provided for in international standards. These provisions, like Article 13 of the *Agreement on Agriculture* provide certain rights to WTO Members, but cannot be seen as exceptions.

13. Third, as pointed out by the United States, considering Article 13 as an affirmative defence leads to perverse effects.[14] If a complaining Member makes a claim that a Member has acted inconsistently with the *Agreement on Agriculture*, the complaining Member will bear the burden of proof to establish a breach of the Agreement. However, if Article 13 is considered an affirmative defence, where a complaining Member brings a claim arguing breach of both the *Agreement on Agriculture* and the *SCM Agreement* the complaining Member would bear the burden of establishing a breach of the *Agreement on Agriculture*, the responding Member would bear the burden of proving that it was in compliance with the same provisions of the *Agreement on Agriculture* in order to apply Article 13, and the complaining Member would bear the burden of proof under the *SCM Agreement*. This cannot be what WTO Members intended when they negotiated Article 13. Indeed, the negotiators were aware of the issue of burden of proof and explicitly reversed the burden of proof in Article 10.3 *Agreement on Agriculture* with respect to potential circumvention of export subsidy commitments. That they did not agree on similar language with respect to Article 13 suggests that they intended the ordinary rules of burden of proof to apply.

14. Consequently, the European Communities respectfully requests that the Panel find that Article 13 is not an affirmative defence.

## IV. THE INTERPRETATION OF ANNEX 2 OF THE AGREEMENT ON AGRICULTURE

### A. THE RELEVANCE OF THE FIRST SENTENCE OF PARAGRAPH 1 OF ANNEX 2

15. Brazil argues in several instances that the first sentence of paragraph 1 of Annex 2 of the *Agreement on Agriculture* is an independent obligation which must be satisfied in addition to the basic criteria set out in paragraph 1 and the policy-specific criteria set out in paragraphs 2 to 13 of Annex 2.[15] The European Communities considers that this interpretation is incorrect. The first sentence does not set out an independent obligation. It simply signals the objective of Annex 2.

16. Paragraph 1 of Annex 2 reads as follows:

> 1. Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:
>
> (a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,
>
> (b) the support in question shall not have the effect of providing price support to producers;
>
> plus policy-specific criteria and conditions as set out below.

[14] US First Written Submission, para. 44
[15] See, e.g. Brazil's First Written Submission, paras. 163-172, 183-191 and 199-201.

17. The European Communities will set out its understanding of the first sentence below. While some ambiguity as to the effect of the first sentence might arise when considering its ordinary meaning in isolation, as Brazil does, it is quite clear that, when seen in context, the first sentence should not be considered to be a free-standing obligation. This result also follows from a consideration of the objective of Annex 2.

18. It should be recalled that the provision of domestic subsidies for industrial products (i.e. non-export contingent subsidies) is not prohibited as such under the *SCM Agreement* or other *WTO Agreements*.[16] Such subsidies will only be actionable if they meet the requirements of Articles 1 and 2 of the *SCM Agreement*, and cause adverse effects to the interests of another Member in the sense of Article 5 of the *SCM Agreement*.

19. The *Agreement on Agriculture* initiated a process of reform for domestic support for agricultural products.[17] Negotiators recognised that domestic support for agricultural products required discipline and binding limits on the amount of domestic support. However, given that the provision of domestic subsidies to industrial products can be unlimited, provided there is no infringement of Article 5 of the *SCM Agreement*, it would have been inequitable to subject all types of domestic support to the strict discipline and limitations of the *Agreement on Agriculture* when the economic effects of different types of measures are not comparable. Consequently, it was necessary for the negotiators to differentiate between those types of support measures whose economic effect was deemed significant[18], and those types of measures whose economic effects were deemed less significant. This differentiation was achieved, not by defining those measures deemed to have a significant effect, but rather those deemed to have a less significant effect. The result was Annex 2 to the *Agreement on Agriculture*.

20. The first sentence of paragraph 1 announces the differentiation which is achieved by the criteria set out in Annex 2.[19] It sets out the logic for distinguishing between the types of domestic support which come under Annex 2 and are exempt from reduction commitments and other domestic support measures. That the first sentence does not set out an independent obligation can be seen from the next sentence of Paragraph 1 which starts with the word "accordingly". "Accordingly" means "in accordance with the logical premises; correspondingly".[20] "Accordingly" consequently links the "fundamental requirement" in the first sentence with the "basic criteria" in the second sentence making it clear that in order to be considered to have "no, or at most minimal, trade-distorting effects or effects on production" the measure must meet the basic criteria in the second sentence of paragraph 1 together with the policy-specific criteria set out in paragraphs 2 to 13.

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[16] Provided the subsidisation is not contingent upon the use of domestic over imported goods, in the sense of Article 3.1(b) of the *SCM Agreement*.

[17] See the Preamble to the *Agreement on Agriculture*.

[18] Without analysing whether the effects would, in the absence of the *Agreement on Agriculture* and assuming the *SCM Agreement* to be applicable to agricultural goods, lead, in a particular case, for a particular product, to a finding of inconsistency with the *SCM Agreement*.

[19] It can be noted that one commentator, who has undertaken one of the most comprehensive reviews of the *Agreement on Agriculture*, notes that the requirement in the first sentence of paragraph 1 is:

> "[t]oo vague to translate into concrete and enforceable obligations. As an appreciation of this fact, the Agreement on Agriculture has gone to great lengths to provide a detailed and comprehensive [..] list of measures along with the general and specific criteria they have to satisfy before they are exempted from the reduction commitments."

P. 420-421, M. G. Desta, *The Law of International Trade in Agricultural Products* (Kluwer Law International 2002).

[20] The New Shorter Oxford English Dictionary, 1993.

21. Contextual support for this position can be found in Annex 2 itself and in Articles 6 and 7 of the *Agreement on Agriculture*.

22. Paragraph 5 of Annex 2 states that support provided through direct payments which are to be exempted from reduction commitments "shall meet the basic criteria set out in paragraph 1 above, plus specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13." It is quite clear that the "basic criteria" referred to here is the "basic criteria" referred to in the second sentence of paragraph 1 of Annex 1. There is no reference to the fundamental requirement and thus that the measures should have "no or at least minimal trade distorting effects or effects on production". Consequently, this fundamental requirement cannot be an additional criteria for a domestic measure to be exempted from reduction commitments under Annex 2.

23. Further support for this view is found in the *Agreement on Agriculture*. Article 6.1 applies to domestic support measures other than those "which are not subject to reduction in terms of the criteria set out in this Article and in Annex 2" (emphasis added). Article 7.1 obliges Members to ensure that domestic support measures "not subject to reduction commitments because they qualify under the criteria set out in Annex 2 to this Agreement are maintained in conformity therewith" (emphasis added). Article 7.2(a) goes on to state that "any measure that is subsequently introduced that cannot be shown to satisfy the criteria in Annex 2 to this Agreement […] shall be included in the Member's calculation of its Current Total AMS" (emphasis added). Annex 2 itself clearly distinguishes between the "fundamental requirement" of the first sentence of paragraph 1 and the "basic criteria" of the second sentence of paragraph 1 and the "policy-specific criteria" set out in paragraphs 1 to 13. The use of the word "criteria" in Articles 6 and 7, and its use in Annex 2 make it quite clear that in order to be exempted from reduction commitments by virtue of inclusion in the green box a domestic support measure must meet the criteria. It is obvious that the negotiators developed the criteria in order to determine whether a policy could be deemed to meet the "fundamental requirement" set out in paragraph 1 of Annex 2 and did not intend the first sentence to set out an independent obligation.

24. This interpretation is also supported by the objective behind Annex 2 and the *Agreement on Agriculture* more generally. In the administration of its agricultural policy, in order to ensure respect for their reduction commitments, a WTO Member must know how to classify its support measures. It is thus vital, for reasons of legal security and predictability, that a Member can determine the classification of its measures. The clear and specific criteria set out in Annex 2 provides WTO Members with guidance on how to approach this task. Assuming Brazil's argument to be correct, a Member would also have to determine whether a particular measure to be taken might have a more than minimal trade distorting effect or effect on production. This is inevitably a difficult exercise, based on a subjective appreciation of a particular situation, which often may only be performed on an *ex post facto* basis. This is not a reasonable basis for advancing reform of trade in agriculture, and promoting the predictability of the system. Moreover, it can be noted that there is no such "effects" text in respect of other exempted domestic support measures *viz.* "de minimis payments" under Article 6.4 of the *Agreement on Agriculture* and "blue box payments" under Article 6.5 of the *Agreement on Agriculture*.

25. On the basis of the above, the European Communities respectfully requests the Panel to conclude that the first sentence of Paragraph 1 of Annex 2 of the *Agreement on Agriculture* does not impose an obligation independent of the basic and policy-specific criteria set out in Annex 2.

B. INTERPRETATION OF PARAGRAPH 6 OF ANNEX 2

26. Brazil's first written submission raises a number of questions as to the correct interpretation of paragraph 6 of Annex 2. The European Communities attaches the utmost importance to the correct interpretation of these provisions. While the European Communities is still analysing the Brazilian

and US arguments, it already takes note of the fact that the US does not claim that its counter-cyclical payments qualify as exempt under the green box.[21]

## V. INTERPRETATION OF ARTICLES 10.1 AND 10.2 OF THE AGREEMENT ON AGRICULTURE (EXPORT CREDIT GUARANTEES)

27. Brazil argues that the US export credit guarantee schemes violate the *Agreement on Agriculture* and the *SCM Agreement*.[22] The European Communities can concur with this argument to the extent it can be confirmed that the export credit guarantees in question are to be considered export subsidies.

28. The European Communities points out, in this regard, that Article 10.2 of the *Agreement on Agriculture* cannot be considered to exempt export credit guarantees from the disciplines of Article 10.1 of the *Agreement on Agriculture*.[23] Article 10.2 states:

> Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

29. Article 10.2 makes it clear that the provision of export credit guarantees is not one of the types of export subsidies listed in Article 9.1 which a Member is given a limited authorisation to apply. Article 10.1 provides that non-listed export subsidies may not be applied in order to circumvent export subsidy commitments. Since export credit guarantees may be "export subsidies not listed in paragraph 1 of Article 9" they may be applied in a manner which "results in or threatens to lead to, circumvention of export subsidy commitments" and thus may be prohibited by Article 10.1. For unscheduled products, since the listed export subsidies cannot be provided, the Appellate Body has found that the transfer of economic resources in the form of non-listed export subsidies (e.g. export credit guarantees) threatens to circumvent the prohibition on giving listed export subsidies to such products.[24] Thus, export credit guarantees which qualify as export subsidies may be illegal under Article 10.1 where they might lead to circumvention of the export subsidy commitments.

30. Such a conclusion does not render Article 10.2 devoid of meaning. Article 10.2 is designed to develop disciplines of a broader nature than simply the regulation of export credits and export credit guarantees which operate as an export subsidy, since whether an export credit guarantee is an export subsidy depends on an analysis of the structure of that instrument. One reason why Article 10.2 was necessary is that export credits and export credit guarantees for agricultural commodities are not covered by the OECD Arrangement on Guidelines for Officially Supported Export Credits (see Article 3d).[25] Export credits which conform to this arrangement are considered not to be prohibited export subsidies.[26] Consequently, Article 10.2 sets up an obligation to develop disciplines for export credits and export credit guarantees irrespective of the question whether such instruments operate as

[21] US First Written Submission, para 5, para. 118.

[22] Brazil's First Written Submission, paras. 252-314.

[23] The European Communities notes that the US has made this argument in paras. 154-166 of its First Written Submission.

[24] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" ("United States – FSC")*, WT/DS108/AB/R, adopted 20 March 2000, para. 150.

[25] OECD Arrangement on Guidelines for Officially Supported Export Credits of 15 October 2002 available at www.oecd.org/dataoecd/52/3/2763846.pdf.

[26] See Item K of the Illustrative List of Export Subsidies, Annex 1 to the *SCM Agreement*.

export subsidies. It does not permit any differentiation in treatment between export credits, export credit guarantees or insurance programmes and other non-listed export subsidies.[27]

31. The European Communities submits, therefore, that Article 10.2 cannot be seen as exempting export credit guarantees granted to agriculture products from WTO disciplines.

## VI. CONCLUSION

32. By way of conclusion, the European Communities respectfully requests the Panel to find that:

- Article 13 *Agreement on Agriculture* should not be considered an affirmative defence;
- The first sentence of the first paragraph of Annex 2 to the *Agreement on Agriculture* should not be interpreted as a free-standing obligation; and,
- Article 10.2 of the *Agreement on Agriculture* does not exempt export credits and export credit guarantees, which are export subsidies, from the disciplines of the *Agreement on Agriculture*.

33. The European Communities reserves its right to address new arguments, and further develop the arguments set out herein, in its oral statement to the first session of the first substantive meeting.

[27] Note that Desta arrives at a similar conclusion:

> "To the extent that no such agreement [on the provision of export credits etc] has been reached, this provision simply remains to be an agreement to maintain good faith for a planned future negotiation devoid of any substantive additional obligation for some time to come. Until then, there seems to exist no legal distinction in the treatment of these three practices and the other forms of export subsidies not listed under Article 9.1."
>
> See Desta, p. 234 op cit. footnote 19.

# ANNEX B-9

## THIRD PARTY SUBMISSION OF NEW ZEALAND

15 July 2003

CONTENTS

## I. INTRODUCTION

1.01 The present dispute between Brazil and the United States regarding United States subsidies to upland cotton, as well as being important in respect of addressing the rights and obligations of the parties concerned, is also timely. New Zealand hopes this dispute will give greater clarity to the proper interpretation of important WTO disciplines applicable to agricultural trade. Although New Zealand is not a producer or exporter of cotton, New Zealand has a systemic interest in ensuring the continued integrity of these disciplines and has therefore joined this dispute as a third party.

1.02 New Zealand also acknowledges the importance of the cotton sector for a number of developing countries. In this regard New Zealand recalls the recent joint proposal made in the context of the Doha Development Agenda negotiations by Benin, Burkina Faso, Chad, Mali entitled 'Poverty Reduction: Sectoral initiative in favour of cotton'.[1] The joint proposal calls for recognition of the strategic nature of cotton for development and poverty reduction in many least developed countries and for the complete phasing out of support measures for the production and export of cotton. As the paper points out, the efforts of cotton producers in West and Central African countries towards liberalisation and competitiveness are virtually nullified by the fact that certain WTO Members continue to apply support measures to cotton that distort global markets.

1.03 The joint proposal outlines the damage caused by the very high levels of support given to cotton producers in certain WTO Member countries, including artificially increasing supply in international markets and bringing down export prices. This is the very same damage that Brazil is attempting to address through this dispute.

1.04 With respect to WTO disciplines, one of the biggest achievements of the Uruguay Round was the recognition that domestic support policies were instrumental in determining the overall nature of international agricultural trade. For the first time specific disciplines were placed on the ability of Members to use domestic support programmes in an unfettered manner. Trade-distorting or production-distorting domestic support measures became subject to reduction commitments.

1.05 New Zealand is concerned to ensure trade-distorting or "amber box" measures cannot be used contrary to the "peace clause" in a manner that negatively affects other Members.

1.06 At the same time as addressing trade-distorting support, Members recognized that some forms of domestic support were less trade-distorting than others and that certain types of programmes should continue to play a role in Members' policy "tool box". Accordingly the "green box", as set out in Annex 2 of the *Agreement on Agriculture*, was designed to allow Members to pursue agricultural objectives such as the provision of general services, disaster relief, food security and structural adjustment assistance and to support incomes as long as that was done in a way totally "decoupled" from production. The "green box" therefore allows WTO Members to meet legitimate non-trade objectives in a non-trade distorting way.

1.07 Strict eligibility criteria have been set down in Articles 6 and 7 and Annex 2 of the *Agreement on Agriculture* to ensure that only genuine non-trade distorting measures escape reduction commitments, including explicit inclusion of the "fundamental requirement" that such measures "have no, or at most minimal, trade-distorting effects or effects on production".[2]

1.08 The fact that basic and policy-specific criteria were included in the *Agreement on Agriculture* shows Members recognised the potential for the "green box" to be abused and domestic support commitments circumvented. In New Zealand's view it is critical that the integrity of the disciplines

[1] TN/AG/GEN/4
[2] *Agreement on Agriculture* Annex 2, paragraph 1.

on "green box" measures are not weakened or their legitimate purpose undermined through the inclusion of measures that fail to meet the strict requirements of Annex 2, including the fundamental criterion that such measures are non-trade or production distorting. Accordingly one of New Zealand's key objectives in joining this dispute as a third party is to ensure that the "green box" cannot be used to circumvent commitments on trade-distorting measures.

1.09 Under the Uruguay Round Members also agreed to a "peace clause" (Article 13 of the *Agreement on Agriculture*). Of particular relevance to this dispute is Members' agreement that provided non-"green box" measures meet the requirements of the *Agreement on Agriculture* and the levels of support did not exceed 1992 levels, such measures would be exempt during the implementation period of the *Agreement* from certain actions that would otherwise be available to Members under the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*") and *General Agreement on Tariffs and Trade 1994* (the "*GATT 1994"*). "Peace clause" protection was also extended to export subsidies conforming with the requirements of the *Agreement on Agriculture*.

1.10 Accordingly, New Zealand is also concerned to ensure that Members are able to utilise their rights under the *SCM Agreement* and *GATT 1994* to take action in respect of domestic support measures and export subsidies where the requirements of the "peace clause" have not been respected.

1.11 New Zealand believes that the arguments put forward by Brazil[3] show that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years ("MY") 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the *GATT 1994* and the *SCM Agreement*.

1.12 This submission, as requested by the Panel[4], primarily addresses issues raised in the submissions of Brazil and the United States relating to the substantive interpretation of Article 13 of the *Agreement on Agriculture*. As further elaborated in this submission New Zealand supports the claims made by Brazil. New Zealand has had only limited time to consider the First Written Submission of the United States[5] and therefore addresses only some of the issues raised therein. In particular New Zealand addresses, at the end of this submission,[6] the request by the United States for a Preliminary Ruling on certain matters.[7] New Zealand looks forward to the next phase of the case which will examine Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*.

## II. DOMESTIC SUPPORT MEASURES

### A. THE UNITED STATES HAS NO "PEACE CLAUSE" PROTECTION AGAINST ACTIONABLE SUBSIDY CLAIMS RELATED TO SUPPORT PROVIDED TO UPLAND COTTON IN MARKETING YEARS 1999, 2000, 2001 AND 2002

2.01 New Zealand agrees with Brazil that Members may assert a "peace clause" defence under *Agreement on Agriculture* Article 13(b)(ii) only if the total quantity of support granted through all

[3] Brazil's First Submission to the Panel Regarding the "Peace Clause" and Non-"Peace Clause" Related Claims, 24 June 2003 ("First Written Submission of Brazil").

[4] Panel communication to the Parties, 20 June 2003.

[5] First Written Submission of the United States of America, July 11 2003 ("First Written Submission of the United States").

[6] Para 5.01-5.02.

[7] First Written Submission of the United States, Pt V.

non-"green box" domestic support measures to a specific commodity does not exceed the quantity of non-green box domestic support decided to be granted in MY 1992.

2.02 New Zealand endorses the process outlined by Brazil[8] for determining whether the United States can claim peace clause protection against serious prejudice claims under *SCM Agreement* Articles 5(c) and 6.3 and *GATT 1994* Article XVI.1.

2.03 Specifically New Zealand agrees that the first step is to identify and quantify all the United States non-"green box" support for the production of upland cotton in MY 1992. The second step is to identify and quantify all non-"green box" United States payments that grant support to upland cotton in MY 1999, 2000, 2001 and to provide estimates for MY 2002. The final step is to determine whether United States support to upland cotton in MY 1999-2002 exceeded its 1992 support to upland cotton.

2.04 The information provided by Brazil[9] demonstrates that the level of domestic support for upland cotton in each of those marketing years did in fact exceed the level decided during the 1992 marketing year and therefore such domestic support measures may be subject to claims based on *GATT 1994* Article XVI or *SCM Agreement* Articles 5 and 6.

2.05 New Zealand notes that the United States argues that the relevant concept for the comparison required by Article 13(b)(ii) is only the 'per pound' rate of support set by the relevant domestic support measures.[10] Using this concept the United States argues that the support currently granted to upland cotton ($0.52 per pound) does not exceed that granted to upland cotton in the 1992 marketing year ($0.729 per pound).[11]

2.06 New Zealand agrees that the measures concerned (the loan rate) contribute to the effect of guaranteeing a producer price at a specified rate per pound of production and that the per pound rate of guaranteed price for producers is one of the relevant factors in making the comparison required by Article 13(b)(ii). However New Zealand does not agree that the use of the word "decided" in Article 13(b)(ii) was intended to be, or should be, construed to mean that the per pound rate of guaranteed price to producers of a commodity is the only factor to be considered in determining the amount of support granted. Indeed, New Zealand sees no support for such an approach in either the specific wording of Article 13(b)(ii) or in its object and purpose.

2.07 New Zealand considers that the comparison must take into account the totality of payments to upland cotton producers in order to reflect the true nature of the support that is being granted to a producer – the United States approach ignores this objective. For example, in relation to support granted to United States producers of upland cotton, Step 2 payments and crop insurance payments are also factors which affect farmers production decisions as is, of course, the "counter-cyclical" payments programme that effectively guarantees a price of $0.724 per pound. Therefore even under the United States assumption that the use of a "rate" is key, the story is very different from that claimed by the United States.

2.08 Further, New Zealand considers that an evaluation of budgetary payments is also essential in order to see the real effects of the support programmes. Focussing solely on a rate per pound ignores the actual levels of domestic support represented by budgetary outlays that must be granted in order to maintain those rates and the other payments received.

[8] First Written Submission of Brazil, para 123.
[9] *Ibid*, para 124.
[10] First Written Submission of the United States, paras 94 and 105.
[11] *Ibid*, para 125.

2.09 In this respect New Zealand recalls that the rationale behind the proviso in Article 13(b)(ii) that such measures not grant support to a specific commodity in excess of that decided during the 1992 marketing year is to create an upper limit in the level of trade or production distortion caused by such measures. The clear overarching intention of WTO Members in the negotiation of the *Agreement on Agriculture* was that henceforth such distortions would be reduced, consistent with the long term objective of "correcting and preventing restrictions and distortions in world agriculture markets".[12] Accordingly it would be inconsistent with the object and purpose of the *Agreement*, and Article 13(b)(ii) specifically, to adopt an interpretation that artificially limits consideration of the scope of support granted to that of a 'per pound rate' of guaranteed price to a producer rather than the totality of the support granted that creates the trade and production distortions.

2.10 In that respect the fact that United States budgetary outlays have increased from their 1992 levels is not coincidental. Such increases are due, at least in part, to the production and market distorting effects of the United States measures that have lead to higher export levels of upland cotton from the United States that have in turn pushed world market prices for cotton down. In essence, the level of trade distortion has increased as the gap between the price farmers expect to receive and the world price has increased. Looking at it the other way around, had the United States maintained the 1992 level of support its producers would be far more aware of the realities of the world market for cotton and have less incentive to add further to the trade distortion.

**1. Step 2 payments, loan deficiency payments, marketing loan gains and cottonseed payments**

2.11 These payments are clearly non-"green box" support, as implied by the notification by the United States to the WTO Committee on Agriculture for MY 1999.[13] As Brazil points out, the structure of most of these programmes is substantially the same in MY 2000-2001 and under the Farm Security and Rural Investment Act of 2002 (the "2002 FSRI Act")[14] as it was in MY 1999. New Zealand considers that these payments should continue to be treated as non-"green box" support to upland cotton and must therefore be used in calculating the total quantity of support granted to upland cotton in MY 1999-2002.

**2. Marketing loss payments, counter-cyclical payments and crop insurance payments**

2.12 The United States has notified crop insurance payments and marketing loss assistance payments as "amber box" domestic support.[15] Brazil notes that the 2002 FSRI Act institutionalised marketing loss assistance payments with a new program of "counter-cyclical" payments ("CCP").[16]

2.13 New Zealand notes that Brazil argues that CCP subsidies do not meet the criteria set out in *Agreement on Agriculture* Annex 2, specifically paragraphs 6(b) and (c), and fail to meet the fundamental requirement that "green box" measures "have no, or at most minimal, trade-distorting effects or effects on production".

2.14 Brazil argues that the CCP programme is not a "green box" measure because payments are not based on prices of upland cotton that took place in a prior base period but are linked to present prices for the product concerned, contrary to the requirements of Annex 2 paragraph 6(c).[17]

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[12] Preambular paragraph 3 of the *Agreement on Agriculture*.
[13] G/AG/N/USA/43, Exhibit BRA-47.
[14] Exhibit BRA-29.
[15] G/AG/N/USA/43 page 37. Exhibit BRA-47.
[16] First Written Submission of Brazil, para 62.
[17] *Ibid*, para 197.

2.15 Paragraph 6(c) of Annex 2 makes it clear that the amount of decoupled income support payments "shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period." As Brazil notes, the amount of the payment under the CCP programme varies with fluctuations in the national average market price, that is, it is linked to a current price. Accordingly, in New Zealand's view this is sufficient to support a finding by the Panel that the CCP programme involves payments that are not "green box" support measures in accordance with Annex 2 of the *Agreement on Agriculture* and must therefore be used in calculating the total quantity of domestic support granted to upland cotton for MY 2002. Indeed, the United States endorses this approach.[18]

2.16 New Zealand notes, however, that the United States has argued that the term "support to a specific commodity" used in Article 13(b)(ii) should be interpreted to mean "product-specific support".[19] On this basis the United States argues that the CCP programme and crop insurance programme should be excluded from the scope of support granted to upland cotton for the purposes of Article 13(b)(ii). [20]

2.17 While New Zealand notes that the United States has notified marketing loss assistance and crop insurance (and presumably will notify CCP payments) as non-product specific domestic support,[21] it is clear from discussion in the WTO Committee on Agriculture that Members, including New Zealand, have questioned whether that is appropriate.[22]

2.18 The United States asserts that CCP payments are non-product specific because they are not coupled to current production of any specific commodity but rather are based on historical fixed base acreage and yields.[23] However in New Zealand's view Brazil has brought forward significant evidence of a strong linkage between the CCP payments and production of upland cotton, such that farmers with upland cotton base acreage are likely to continue to produce upland cotton.

2.19 In particular Brazil points out that most cotton farmers have made considerable investments in cotton-specific equipment, or farm in locations where cotton is the most productive crop, and are therefore more likely to continue to produce cotton.[24] The linkage between the receipt of CCP payments and production of cotton is further reinforced by the CCP payments being explicitly calculated on the basis of current cotton prices.

2.20 Brazil also points out that CCP payments create incentives for farmers with upland cotton base acreage to maintain upland cotton production.[25] In fact under the CCP programme the only way a farmer can guarantee a particular outcome is to continue to grow the same crop, otherwise the farmer runs the risk of missing out. For example, if he or she chooses to produce wheat and cotton prices are high enough that no CCP payment is made but wheat prices fall, the farmer will make a loss they would not have made had they stayed with cotton production.

2.21 Irrespective of whether or not these payments are notified as product-specific or not, they must still be considered "support granted to a specific commodity" for the purposes of Article 13(b)(ii). There is no foundation for the assertion by the United States that "support granted to a specific commodity" should be read as meaning "product-specific support". Given the detailed listing

[18] First Written Submission of the United States, para 118.
[19] *Ibid*, para 78.
[20] *Ibid*, para 122.
[21] G/AG/N/USA/43, Exhibit BRA-47.
[22] See for example, G/AG/R/34 'Summary report of the meeting held on 27 March 2003' at page 32.
[23] First Written Submission of the United States, para 115.
[24] First Written Submission of Brazil, para 207.
[25] *Ibid*, para 211.

of domestic support measures potentially exempt in the chapeau to Article 13(b)(ii) itself, had Members intended to exclude non-product specific support they would surely have said so. Further, had they meant that "support granted to a specific commodity" was to be read as "product specific" support they would have said so – the phrase was used at least five times elsewhere in the *Agreement*.

2.22 Rather, the reference to support to a "specific commodity" in Article 13(b)(ii) was used to distinguish the nature of the "peace clause" from the domestic support commitments more generally which are on a "Total" (i.e. over all agriculture) Aggregate Measurement of Support ("AMS") basis. Only if support increases for a particular product can it be open to challenge under the *SCM Agreement*. Without such clarification "peace clause" protection could potentially be lost for any agricultural product if Total AMS increases, even though support to that specific product had not increased. This would have unpredictable results for individual products and cannot have been the intended effect of the "peace clause".

2.23 Nothing in Article 6 suggests that treating product-specific and non-product specific support separately under Article 13 is warranted. New Zealand sees no basis on which to suggest that support to a specific commodity should be excluded simply because other commodities may receive similar support. Support provided through generally available programmes (which, New Zealand notes, the marketing loss assistance programme and now the CCP programme are not) is still support received for the individual products. Taking the United States argument to its logical extreme would effectively render all agricultural support non-product specific so long as the same kind of support was being provided to more than one product.

2.24 Accordingly, New Zealand considers that the United States incorrectly categorises CCP payments as non-product specific support. But whether they are product-specific or non-product specific is, in fact, irrelevant for the purposes of Article 13(b)(ii) as there is no basis upon which to read such a limitation on the kinds of domestic support to be considered within the meaning of that provision. Instead, the portion of any non-product specific support granted to a specific commodity, in this case to upland cotton, must be included in the comparative analysis required by Article 13(b)(ii). In this respect New Zealand notes that what Brazil is proposing is no more than what the United States has done in relation to export credits in its First Written Submission where it has allocated export credit administrative costs to the specific product of upland cotton.[26]

2.25 The same arguments can be made with respect to the payments under the crop insurance programmes.

## 3. Production Flexibility Contract Payments, Direct Payments

2.26 In New Zealand's view one important aspect of the "Direct Payments" ("DP") programme rules out inclusion of those payments in the "green box", specifically the ability of farmers to update the base acreage used for calculation of DP payments.[27] As outlined by Brazil, the DP programme is the successor to the Production Flexibility Contract Payments ("PFC") programme and to permit an updating of the 'fixed' base period by changing the name of the PFC programme to a DP program would render the provisions of paragraph 6(a) and (b) of *Agreement on Agriculture* Annex 2 a nullity.[28]

2.27 The option for farmers to update base acreage under the 2002 FSRI Act directly violates the requirement under Annex 2 paragraph 6 that decoupled income support be determined in relation to a

[26] First Written Submission of the United States, para 175.
[27] First Written Submission of Brazil, para 52; Exhibit BRA-35.
[28] *Ibid*, para 182.

"defined and fixed base period". New Zealand agrees with Brazil's interpretation that paragraph 6(a) and (b) contemplates only one base period that is fixed and unchanging.

2.28 As Brazil points out, permitting the updating of the base period to capture additional payment acreage (as one third of all United States farms with eligible acreage opted to do)[29] would link increased recent volumes of production with the amount of current payments.[30] Brazil is also correct to state that this is contrary to the object and purpose of "de-coupled income support", which is to break the link between production and the amount of support and thereby ensure that such measures "have no, or at most minimal" effects on production. As the evidence brought forward by Brazil shows, an expectation of being able to update base acreage and payment yields influences production in a number of ways,[31] particularly as, having had one opportunity to update their base acreage, farmers could reasonably expect further opportunities to do so in the future.

2.29 In New Zealand's view the updating of base acreage for the DP programme alone is sufficient to exclude it from the scope of permitted "green box" measures as set out in Annex 2. Instead such payments are "amber box" measures that, in accordance with Article 6 of the *Agreement on Agriculture*, are domestic support to upland cotton in MY 2002.

2.30 Brazil has also argued that the PFC and DP programmes have more than a minimal effect on production and trade and therefore fail to meet the "fundamental requirement" of "green box" domestic support measures.

2.31 New Zealand agrees with Brazil's interpretation that the "fundamental requirement" that "green box" domestic support measures "have no, or at most minimal, trade-distorting effects or effects on production" means that the quantity or level of production or trade distorting effects need only be very small to trigger denial of "green box" status under Annex 2 of the *Agreement on Agriculture*.[32] The language of paragraph 1 of Annex 2 makes it clear that this fundamental requirement and the other criteria set out in Annex 2 are to be strictly applied to any measures in order to obtain exemption from reduction commitments.

2.32 The trade-distorting effects or effects on production of any domestic support measure must be determined on a case-by-case basis, looking at the specific circumstances and characteristics of each particular measure. Brazil has provided comprehensive information regarding the effects of the PFC and DP programmes to enable the Panel to determine whether those payments have even very minimal production or trade distorting effects and thus fail to meet the "fundamental requirement" for "green box" measures as provided in *Agreement on Agriculture* Annex 2.

2.33 New Zealand notes that the United States provides no response to any of Brazil's arguments regarding the PFC/DP programme and the level of production distortion it causes other than to claim that changing the name of the programme indemnifies it from consideration. Accordingly Brazil's arguments should stand.

[29] *Ibid*, para 181.
[30] *Ibid*, para 179.
[31] *Ibid*, paras 185 – 190.
[32] *Ibid*, para 165.

## III. PROHIBITED EXPORT SUBSIDIES

### A. THE UNITED STATES HAS NO "PEACE CLAUSE" PROTECTION AGAINST PROHIBITED AND ACTIONABLE SUBSIDY CLAIMS RELATED TO EXPORT SUBSIDIES

3.01 New Zealand supports the arguments made by Brazil that the three types of export subsidies applied to upland cotton and other commodities by the United States (the Step 2 Export Programme, the Export Credit Guarantee Programme, and the FSC Replacement Programme) violate Articles 3.3, 8 and 10.1 of the *Agreement on Agriculture* and therefore fail to meet the requirement of conformity with Part V of the *Agreement*, with the result that such subsidies are not exempt from claims by Brazil based on Article XVI of *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement*.

### B. THE UNITED STATES EXPORT SUBSIDIES VIOLATE THE AGREEMENT ON AGRICULTURE AND THE SCM AGREEMENT

#### 1. Step 2 Export Payments

(a) Per se violation of Articles 3.3 and 8 of the *Agreement on Agriculture*

3.02 As outlined by Brazil,[33] Step 2 export payments clearly fall within the description of an export subsidy set out in Article 9.1(a) of the *Agreement on Agriculture* in that it is a direct subsidy provided by the United States government to exporters of upland cotton contingent upon export.

3.03 Even if the Panel were to find that Step 2 export payments did not fall within the description set out in Article 9.1(a) of the *Agreement on Agriculture*, the Appellate Body has determined, as Brazil notes, that the effect of Article 10.1 is that a Member can only provide export subsidies in conformity with the *Agreement on Agriculture* if it has scheduled export subsidy reduction commitment levels for the agricultural product concerned.[34] The use of any other type of export subsidy will "at the very least" threaten circumvention of subsidy reduction commitments within the meaning of Article 10.1.

3.04 Accordingly New Zealand agrees with Brazil that the Step 2 export payments violate *per se* Articles 3.3 and 8 of the *Agreement on Agriculture*

3.05 New Zealand notes that the United States has argued that Step 2 export payments are not export subsidies as defined by Article 9.1(a) and 10 of the *Agreement on Agriculture* (and Article 3.1(a) of the *SCM Agreement*) because the Step 2 payments are available to domestic users as well as exporters of upland cotton.[35] As the Appellate Body in *US-FSC Recourse to Article 21.5*[36] recognised, the fact that a scheme allows for payments to be made otherwise than contingently on export does not diminish the export contingency of those that are.

3.06 In *US-FSC Recourse to Article 21.5* the United States argued that a measure that provided tax exclusion for exported products, but also allowed tax exclusion to be obtained without exportation, could not be considered to be 'contingent upon export performance'. The Appellate Body disagreed.

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[33] *Ibid*, paras 238-243.

[34] Report of the Appellate Body, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R ("*US-FSC*"), para 150-152; First Written Submission of Brazil, para 237.

[35] First Written Submission of the United States, para 132.

[36] Report of the Appellate Body, *United States – Tax Treatment for "Foreign Sales Corporations" Recourse to Article 21.5 of the Dispute Settlement Understanding by the European Communities*, WT/DS108/AB/RW ("*US-FSC Recourse to Article 21.5"*).

3.07 The Appellate Body said that the measure "contemplates two different factual situations"; where property is produced within the United States and held for use outside the United States, and where property is produced outside the United States and held for use outside the United States. The Appellate Body said that "the fact that the subsidies granted in the second set of circumstances might not be export contingent does not dissolve the export contingency arising in the first set of circumstances".[37]

3.08 New Zealand considers that the fact that payments are also able to be made to domestic users of upland cotton does not 'dissolve' the export contingency of the payments that are made to exporters. Payments to eligible exporters of upland cotton are dependent on proof of export being provided and are therefore contingent on export performance.

3.09 Accordingly Step 2 export payments breach the obligation of the United States under Article 3.3 not to provide such subsidies in respect of any agricultural product that it has not specified in Section II of Part IV of its Schedule and therefore violates *per se* the undertaking by the United States in Article 8 not to provide export subsidies otherwise than in conformity with the *Agreement on Agriculture*.

(b) Violation of Article 3.1(a) and 3.2 of the *SCM Agreement*

3.10 New Zealand supports Brazil's conclusion that the Step 2 export payments meet the requirements of a subsidy under Article 1.1(a)(1)(i) and Article 1.1(a)(2) of the *SCM Agreement* and are contingent upon export within the meaning of Article 3.1(a) of the *SCM Agreement*.

3.11 Accordingly if the Panel finds, as New Zealand believes it should, that Step 2 export payments constitute *per se* prohibited subsidies under Article 3.1(a) and 3.2 of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the programme without delay. New Zealand therefore supports Brazil's request that the Panel expressly make such a recommendation.

**2. Export Credit Guarantee Programme**

(a) Violation of Articles 8 and 10.1 of the *Agreement on Agriculture*

3.12 New Zealand supports Brazil's arguments that the export credit guarantee programme provides export subsidies that can lead to, or threaten to lead to, circumvention of export subsidy commitments under Article 10.1. As established by the Appellate Body in *US-FSC*,[38] Article 10.1 of the *Agreement on Agriculture* is violated where an export subsidy is available for unscheduled agricultural products for which no reduction commitments have been made, as, "at the very least", this threatens to lead to circumvention of export subsidy commitments.

3.13 It is evident that Members considered that export credit programmes could provide export subsidies through the specific reference to such programmes in *Agreement on Agriculture* Article 10.2. While not all government export credit programmes necessarily provide export subsidies, it is clear that the United States programme does so in both of the ways demonstrated by Brazil (ie because it clearly falls within Item j of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*[39] or is otherwise an export subsidy as defined in Articles 1.1 and 3.1(a) of the

[37] *Ibid*, para 119.
[38] Report of the Appellate Body, *US-FSC*, para 150-152.
[39] First Written Submission of Brazil, paras 272-286.

*SCM Agreement*).[40] The export credit scheme is therefore a subsidy contingent on export in the context of Article 10.1 of the *Agreement on Agriculture*.

3.14 New Zealand notes that the United States has argued that "the plain words of Article 10.2 (of the *Agreement on Agriculture*) indicate that the export credit guarantee programs are not subject in any way to the export subsidy disciplines of that *Agreement*."[41] New Zealand disagrees with this assertion. The heading of Article 10 is 'Prevention of circumvention of export subsidy commitments' and the inclusion of reference to export credits under that Article clearly reflects Members' concern that export credits can provide export subsidies.

3.15 Nor does Article 10.2 in any way suggest that it provides an exception from the disciplines of Article 10.1. New Zealand agrees with the United States that Article 10.2 does not say "in addition to the export subsidy commitments" of the *Agreement*.[42] That is because it did not have to, coming as it does directly after the general prohibition against circumvention in Article 10.1. While Article 10.1 currently provides the only discipline on the use of export credits, it is expected that the work envisaged in Article 10.2 will elaborate further and more specific disciplines that will presumably make identification of the extent to which such export credit programmes constitute export subsidies more straightforward. However it is incorrect to assume that there is a vacuum in the meantime. Item j of the Illustrative List of the *SCM Agreement* clearly already provides guidance on when export credit guarantee or insurance programmes are to be considered to be 'export subsidies' and beyond this the general definition in Articles 1.1 and 3.1(a) of the *SCM Agreement* also applies. While the provisions of Item j do not apply to agricultural products *mutatis mutandis* there is no reason to believe that the guidance there and elsewhere in the *SCM Agreement* is not appropriate for analyses under the *Agreement on Agriculture*.

3.16 Nor should the application of the disciplines in the *Agreement on Agriculture* in the meantime obviate the need for continued negotiations as envisaged by Article 10.2, as New Zealand hopes that those negotiations will result in clearer and more specific rules. Indeed it may even be that the result of the negotiations is that an export credit programme that is considered to be an export subsidy under the current, more generally applicable rules, will be deemed not to be an export subsidy in the future. However in that respect New Zealand notes, for example, that the United States Intermediate Export Credit Guarantee Program (GSM-103) provides for a repayment term of between 3 and 10 years[43], terms clearly well outside the scope of disciplines to govern the use of export credit guarantee programmes currently being considered in the negotiations.

(b) Violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*

3.17 As export credits are not in conformity with Part V of the *Agreement on Agriculture* and thus do not benefit from protection under the "peace clause", they can equally be examined under the *SCM Agreement*. If the Panel finds, as New Zealand believes it should, that export credit guarantee payments are prohibited subsidies under Article 3.1(a) of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the payments without delay. New Zealand therefore supports Brazil's request that the Panel expressly make such a recommendation.

[40] *Ibid*, paras 287-293.
[41] First Written Submission of the United States, para 164.
[42] *Ibid.*
[43] *Ibid*, para 151.

### 3. FSC Replacement Measure

3.18 New Zealand supports the claims made by Brazil,[44] based on the findings already made by the Appellate Body in *US-FSC Recourse to Article 21.5*, that the tax cuts under the FSC Repeal and Extraterritorial Income Act of 2000 threaten to circumvent United States export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture* and therefore cannot be exempt from actions under the *SCM Agreement* under Article 13(c)(ii) of the *Agreement on Agriculture*. In addition the Appellate Body found that there was a prohibited subsidy under Article 3.1(a) of the *SCM Agreement*.

3.19 Accordingly if the Panel finds, as New Zealand believes it should, that the tax cuts under the FSC Repeal and Extraterritorial Income Act of 2000 are prohibited subsidies under Article 3.1(a) of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the subsidies without delay. New Zealand therefore supports Brazil's request that the Panel expressly make such a recommendation.

## IV. PROHIBITED SUBSIDIES

### A. STEP 2 DOMESTIC PAYMENTS VIOLATE THE SCM AGREEMENT AND GATT ARTICLE III:4

4.01 New Zealand supports Brazil's argument that the "peace clause" provides no immunity for "amber box" subsidies from prohibited subsidy claims under Article 3.1(b) of the *SCM Agreement.*[45] New Zealand believes that Brazil has demonstrated that Step 2 domestic payments are a prohibited subsidy under Article 3.1(b) in that the payments are contingent on the use of domestic over imported upland cotton. On that basis they also violate Article III.4 of *GATT 1994*.

4.02 Accordingly if the Panel finds, as New Zealand believes it should, that Step 2 domestic payments violate per se Article 3.2 of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the payments without delay. New Zealand therefore supports Brazil's request that the Panel expressly make such a recommendation.

## V. UNITED STATES REQUEST FOR A PRELIMINARY RULING ON CERTAIN MATTERS

5.01 New Zealand rejects the arguments of the United States that measures no longer in effect are not within the Panel's terms of reference.[46] Such measures should be within the scope of the Panel's consideration, particularly when the programmes in question have effectively only been renamed and in fact continue in a slightly different form. In addition, the nature of serious prejudice claims may necessitate consideration of data beyond a single year and may in fact require a Panel to consider trends over a number of years. Accordingly New Zealand rejects the United States claim that market loss assistance payments and PFC payments should be excluded from the Panel's consideration of Brazil's claims.

5.02 New Zealand also considers that the Panel should reject the United States request that that Panel rule that export credit guarantee measures relating to eligible United States agricultural commodities (other than upland cotton) are not within its terms of reference.[47] While New Zealand did not participate in the consultations, in New Zealand's view Brazil had little choice but to look at a broader commodity coverage in relation to export credits because the information specific to upland

[44] First Written Submission of Brazil, paras 315-330.
[45] First Written Submission of Brazil, para 332.
[46] First Written Submission of the United States, paras 207-211.
[47] *Ibid*, paras 191-206.

cotton alone was not available. To prevent Brazil from doing so would unjustly allow a lack of transparency to preclude scrutiny of measures by Members taking disputes, especially where the information at a higher level of aggregation showed there was clearly a case to answer in respect of a particular measure, in this instance export credits. While more time is needed to analyse the information brought forward by the United States (which does not appear to be sourced from publicly available documents), at this stage of the Panel's consideration of Brazil's claims, New Zealand considers that the Panel should not make the ruling requested by the United States.

## VI. CONCLUSION

6.01 In conclusion, New Zealand believes that Brazil had demonstrated that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the *GATT 1994* and the *SCM Agreement*. New Zealand looks forward to the next phase of the case which will examine Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*.

# ANNEX B-10

THIRD PARTY SUBMISSION BY PARAGUAY

## INTRODUCTION

1. Paraguay is grateful for the opportunity to express its views on the matter at issue in this dispute.

2. Because Paraguay is a firm believer in a fair system of international trade, it feels that it should explain its position on this issue which is of particular interest to its economy.

### Applicable rules

3. In the Marrakesh Ministerial Declaration of April 1994 itself, Ministers affirmed that the establishment of the WTO ushered in a new era of global economic cooperation, reflecting the widespread desire to operate in a fairer and more open multilateral trading system for the benefit and welfare of their peoples, and expressed their determination to resist protectionist pressures of all kinds as well as their belief that the strengthened rules achieved in the Uruguay Round would lead to a progressively more open world trading environment.

4. Moreover, in October 2002, on the occasion of the meeting of the International Cotton Advisory Committee, governments observed the critical situation that the world cotton industry was going through and its link to subsidies, suggesting the establishment of a schedule for the elimination of measures that distorted world production and trade in cotton, and stressing the need to submit complaints before the WTO for violation of the applicable rules.

5. Paraguay considers that the subsidies and support granted by the United States to its cotton production are inconsistent with the Agreement on Subsidies and Countervailing Measures, the Agreement on Agriculture and the rules and principles of the GATT 1994, and that for the purposes of this dispute it is therefore essential to take account of WTO legislation, which was carefully drafted to avoid causing distortions in international trade and prejudice to developing countries such as Paraguay.

6. WTO jurisprudence and the principles of interpretation of international law applied to the various cases suggests that the applicable rules should be read cumulatively, taking account of all elements applied to the case in order to support the system as an integrated whole.

7. Paraguay considers Brazil's complaint and the legal justifications invoked with respect to the inconsistency of the United States' laws, regulations and administrative procedures with the applicable WTO rules to be fully consistent with the law.

## PEACE CLAUSE

8. With respect to the applicability of Article 13(b)(ii) concerning domestic support measures that conform fully to the provisions of Article 6 of the Agreement including direct payments that conform to the requirements to paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, Paraguay considers they shall be exempt from actions based on paragraph 1 of Article XVI of GATT

1994 or Articles 5 and 6 of Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

9. This implies that it is not limited or confined to specific products. Thus, it can be concluded that the United States does not enjoy protection from actions relating to subsidies using 1999, 2001 and 2002 as a basis, as Brazil duly proved.

10. In interpreting the Peace Clause, account must be taken of the serious prejudice that Member economies could suffer, and an assessment made of the overall significance of all of the agreements relating to the case.

11. Paraguay does not grant subsidies, either under the Subsidies Agreement or under the Agreement on Agriculture. Paraguay did notify the Committee on Agriculture, on 22 July 2002, of its domestic support commitments for 2000 and 2001 (G/AG/N/PRY/10, supporting table DS.1 and related supporting tables) as required under the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures.

12. Consequently, as long as discriminatory support not provided for under WTO Agreement on Agriculture or the WTO Agreement on Subsidies on Countervailing Measures continues to be granted, Paraguay will have no choice but to file complaints with the relevant bodies.

**Inconsistency with the Agreement on Agriculture**

13. The Step 2 programme introduced by the United States to stimulate exports and the competitiveness of its products on the international market is inconsistent with Articles 3.3 and 8 of the Agreement on Agriculture.

14. Article 3 of the Agreement on Agriculture refers to the incorporation of concessions and commitments. Paragraph 3 thereof stipulates that:

> *Subject to the provisions of paragraphs 2(b) and 4 of Article 9 of this Agreement, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule.*

15. The above paragraph enables Members to provide the subsidies listed in Article 9.1 of the Agreement on Agriculture subject to fulfilment of the commitments assumed.

16. Similarly, Article 8 of the said Agreement regulates export competition commitments, stipulating that:

> *Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and the commitments as specified in that Member's Schedule.*

17. For the above reasons, and because it does not consider the provisions of the Agreement on Agriculture to have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

**Inconsistency with the Agreement on Subsidies and Countervailing Measures**

18. The agricultural subsidies cause "serious prejudice" to the domestic industry of other Members under Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures.

19. The introductory paragraph of part III, Article 5 of the said Agreement provides that no Member should cause, through the use of any subsidy – specific and not exempted under the Agreement – adverse effects to the interests of other Members, more specifically, as categorically stated in the indents that follow, (a) injury to the domestic industry of another Member and (c) serious prejudice to the interests of another Member.

20. Article 6 specifically refers to cases in which "serious prejudice" is deemed to exist in the sense of paragraph (c) of Article 5.

**Effects of agricultural subsidies**

21. Agricultural subsidies have effects on world trade, and measures such as those applied by the United States have a significant impact on developing countries like Paraguay.

22. Indeed, Paraguay is all the more affected by the said measures in that it is precisely cotton production that provides sustenance for the most needy segments of the population.

23. Paraguay has a total population of approximately 5,300,000, of which more than 500,000 are linked to cotton production. If we add the related industries and activities, the figure reaches an estimated 1,500,000, or approximately 30 per cent of the country's total population.

24. Any slump in the cotton trade causes an exodus of rural population towards the urban areas which do not offer any relief or solution, and this further undermines the economic situation of a country that depends on its agriculture.

25. As regards exports, in 1991, the foreign exchange revenue generated by sales of cotton and byproducts thereof reached US$318,912,000, approximately 43 per cent of the total for the country's exports that year. At the time, a total of 299,259 farms, 190,000 were cultivating cotton.

26. By 2001, the figures had changed considerably. Export revenue had fallen to US$90,505,000, a 72 per cent drop in the value of exports. The number of farms producing cotton decreased to about 90,000, representing a 52 per cent decrease in farms, employment and small farmer income. In other words, the impoverishment was real.

27. Regarding international cotton fibre prices, in 1991, the price per ton of Paraguayan type fibre was quoted on the New York Exchange at US$1,624, while in 2001, it was quoted at US$934.

28. In Paraguay, some 60 per cent of cotton is produced on farms of less than 10 hectares, making it the main or only source of income for small farmers and the main source of employment for the rural workforce in the most disadvantaged segment of society where access to capital and technology is more restricted and the leading socio-economic welfare indicators are lower than anywhere else.

**CONCLUSION**

29. Paraguay is a small economy. It is a land-locked country that has no oil, gas, gold or other natural resources of a kind that could make it of particular interest to the developed countries. The Paraguayan economy is essentially based on agricultural production, including the production and sale of cotton.

30. Paraguay therefore considers that the measures adopted by the United States cause serious prejudice to world trade, affecting Paraguay in particular, and that the necessary steps should be taken to eliminate the adverse effects and seek to achieve a balance in world trade.

31. Paraguay respectfully requests the Panel to conclude that the measure applied by the United States is inconsistent with its WTO obligations under the various provisions of the Agreement on Agriculture, the GATT 1994 and the Agreement on Subsidies and Countervailing Measures.

# ANNEX B-11

## THIRD PARTY SUBMISSION OF THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU.

15 July 2003

1. In its fax of 28 May 2003 to the parties to this dispute, the Panel poses questions regarding the correct interpretation of Article 13 of the Agreement on Agriculture and the on the issue of preliminary rulings. As the Panel's questions raise an important point of law and the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu has a systemic interest in the proper interpretation and operation of these and other relevant provisions involved in the procedures, we would like to submit our views on the following aspects:

**I. THE BURDEN OF PROOF REQUIRED BY ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE (THE "PEACE CLAUSE"), AND**

**II. THE QUESTION OF PRELIMINARY RULINGS.**

### I. BURDEN OF PROOF IN THE "PEACE CLAUSE"

2. In attempting to arrive at a proper interpretation of the burden of proof as provided in Article 13 of the Agreement on Agriculture, we suggest comparing different types of exemptions, defences, or carving-out under different agreements.

3. It could happen that a matter is brought under an agreement not covered by the DSU. Since Article 1 of the DSU provides that the DSU shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to the DSU and the WTO Agreement, it follows that consultation or dispute arising from or in connection with any non-covered agreement would not be within the scope of the dispute settlement procedures under the DSU. Thus, if a Member brings a complaint alleging a breach of certain international environmental treaties, for example, the complaining party would bear the burden to prove that the issue in dispute falls within the purview of the DSB.

4. It could also be that a matter is specifically excluded from the dispute settlement procedures by certain relevant agreements. A typical example of this would be the provision in Article 6 of the TRIPS agreement, which provides that "for the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights". It is apparent that as long as it is an "issue of the exhaustion of intellectual property rights," the dispute settlement procedure shall not be used. There is no threshold or prerequisite for applying such provision. The Member applying this provision would be able to prevent such dispute settlement procedures unless the complaining party asserts and proves that the measure concerned is not such an "exhaustion issue".

5. It could also happen that exceptions or exemptions are granted under relevant agreements providing specific obligations. There are different ways of providing exceptions for specific activities or measures. Examples include paragraph 2 of Article XI of the GATT stating "...shall not extend to the following"; Articles XX and XXI of the GATT stating "nothing in this Agreement shall be

construed to..." These are in the nature of an affirmative defence. Here, the burden of proof rests on the party invoking the exception.

6. It is clear that Article 13 of the Agreement on Agriculture is not a "matter under an agreement not covered under the DSU". Neither is it a matter specifically excluded from the dispute settlement procedures as provided in Article 6 of the TRIPS Agreement. It is also not typical of the type of exception as contained in Articles XI, XX or XXI of the GATT. In our view, Article 13 falls between the type of exception in Article 6 of the TRIPS and that in Article XI, XX or XXI of the GATT. Thus the procedures for applying the provision should be interpreted differently.

7. In its First Written Submission, Brazil asserted that, "Article 13 is in the nature of an affirmative defense, because it provides an exception to a legal regime otherwise applying to agricultural support measures. It does not alter the scope of other provisions providing positive obligations on Members, and is not itself a positive obligation" and as a consequence, in this proceeding the United States has the burden of proof on the question of whether its subsidies "are in conformity with the AOA Article 13"[1].

8. In our view, the very nature of Article 13 is such that it is not appropriate for any particular description or "label" such as an "affirmative defence", or "exception", to be ascribed to it, simply for the convenience of resolving the question of burden of proof.[2] We consider that Article 13 in itself contains both rights and obligations of Members. The right conferred by Article 13, i.e. entitlement to "exempt from actions" is conditional; conditional upon a positive obligation of full conformity to the requirements as set out in the relevant provisions of the Agreement on Agriculture. We agree with the view put forward by the United States at paragraph 43 of its First Written Submission which purports to identify such positive obligations. If the contention that Article 13 confers a right as well as imposes a positive obligation, is accepted, then, as a complainant, it is for Brazil to prove a breach of this positive obligation by demonstrating non-conformity rather than for the United States to bear the burden of proving conformity. We consider that the above contention is the only logical conclusion in giving effect to Article 13. Since there is no scheme for a Member under Article 13 to prevent the initiation and the establishment of a panel, suppose Article 13 is interpreted in such a way as to still require the United States to bear the burden of proving the conformity of relevant provisions of the Agreement of Agriculture, it would mean Article 13 having less than its originally intended effect.

9. In addition to the above, drafters' intent should be taken into account when interpreting this Article. Domestic support measures are expressly allowed under this Article with the intention of giving Members some flexibility on domestic support measures to help the progressive liberalization of their agriculture. Requiring the respondent to bear the burden to prove that the subsidy measure in question is consistent with this Agreement will, to a certain degree, offset the respondent's right to claim for the exceptions provided by this Provision, which is contrary to the drafters' intention.

10. To impose the burden of proof on the respondent has another negative implication. In the case before us, if Brazil's argument stands, it would render the words "exempt from actions" pointless as the result would inevitably be a full-blown dispute settlement proceeding with Brazil submitting evidence to substantiate its complaints and the US filing its defence by invoking Article 13 and submitting proof of conformity thereto.

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[1] Brazil first Written Submission, paragraph 23.

[2] In *EC-Hormones*, the Appellate Body is of the view that the particular description of "exception" did not discharge the burden of the complaining party in establishing a prima facie case. At para 104, the Appellate Body stated: the general rule in a dispute settlement proceeding requiring a complaining party to establish a prima facie case of inconsistency of a provision…before the burden of showing consistency with that provision is taken by the defending party is not avoided by simply describing the same provision as an exception."

## II. THE QUESTION OF PRELIMINARY RULINGS

11. Although on the evidence of past dispute settlement cases the normal practice of the Panel tends to be that it hears preliminary issues, provides indicative rulings and consolidates detailed reasoning only in the final Panel report, the questions associated with the correct interpretation of Article 13 are such that they merit the Panel's consideration and disposition at the earliest opportunity.

12. We consider that the preliminary issues raised in this dispute determine the manner in which the parties to this proceeding prepare their case. If the question of the correct interpretation of the words "exempt from actions" is not resolved along with the question of the allocation of burden of proof, considerable resources will be wasted both by complaining and defending claims. Needless to say, due process will not be properly served in such a case. Accordingly, we respectfully urge this Panel to adopt a special procedure to deal with this preliminary issue at the earliest opportunity so that parties to this dispute will not be prejudiced.[3]

[3] This Panel may recall that the Appellant Body in *EC-Banana* indicated its opinion that "…this kind of issue could be decided early in panel proceedings, without causing prejudice and unfairness to any party or third party,.." WT/DS27/AB/R, at para. 144.

# ANNEX C

## ORAL STATEMENTS OF PARTIES AND THIRD PARTIES AT THE FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING

# ANNEX C-1

## EXECUTIVE SUMMARY OF THE ORAL STATEMENT OF BRAZIL AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

### I. INTRODUCTION

1. Brazil addresses first various peace clause issues, followed by Step 2 export and domestic payments, export credit guarantees and the ETI Act subsidies. Finally, Brazil addresses the "preliminary issues" raised by the United States.

### II. PEACE CLAUSE ISSUES

**The Peace Clause is an Affirmative Defence**

2. The peace clause is in the nature of an affirmative defence and it is, thus, the US burden to prove that Brazil's claims under the SCM Agreement are "exempt from actions". An affirmative defence is a provision that does not set out any positive obligations but enables Members to maintain measures that are otherwise inconsistent with its WTO obligations. The peace clause does not in itself set out any positive obligations for Members, but simply provides a conditional shelter against certain actionable and prohibited export subsidy claims under the SCM Agreement. The peace clause meets the criteria set forth by the Appellate Body for an affirmative defence in *US – FSC* and in the *Aircraft* disputes, by being an exception to a legal regime otherwise applicable. Given the extraordinary protection it provides, it is not "bizarre", as the United States argues, that the peace clause requires the defending Member to prove that its domestic and export subsidies meet the conditions for peace clause protection.

**"such measures do not grant support to a specific commodity"**

3. This phrase in AoA Article 13(b)(ii) means that in calculating the amount of support for any marketing year between 1995-2003, all non-"green box" support provided to a specific commodity must be tabulated, regardless of whether the *type* or *form* of the support is "product-specific", "non-product specific", *de minimis*, or "blue box". This is certainly evidenced by the decision of negotiators *not* to use the phrases "product-specific" and "AMS" in Article 13(b)(ii) to qualify the type of support to a specific commodity. The US attempt to read "product-specific" into Article 13(b)(ii) is inconsistent not only with the text but also the context of the phrase "such measures" in Article 13(b)(ii). The US interpretation of "product-specific support" is further incompatible with the object and purpose of the Agreement on Agriculture. It would create a new category of non-actionable trade-distorting non-"green box" subsidies and sanction huge increases in spending for "amber box" and, therefore trade-distorting, domestic support as long as it took the form of support for *multiple* commodities. This is contrary to the presumption of trade and production-distorting effects for individual products from non-"green box" domestic support, which flows from a domestic measure being inconsistent with the "green box" requirements of AoA Annex 2.

**"that decided during the 1992 marketing year"**

4. This word "decided" does not require any particular *type* of "decision". As a neutral term, the meaning of "decided" must be interpreted in a way that does justice to the ordinary meaning of other terms in Article 13(b)(ii) that are *not* neutral. Most importantly, the term "decided" must be interpreted in a manner that permits a comparison between a "*grant*" of non-"green box" "*support*" to a specific commodity for individual marketing years between 1995-2003, and a "decision" regarding such support in MY 1992. A textual interpretation reveals that the term "that" refers back to "support" and that support is accompanied by the term "granted".

5. The Appellate Body agreed with the panel in *Brazil – Aircraft* that the phrase "the *level* of export subsidies *granted*" meant "something actually provided", which means actual budgetary expenditures. Thus, the neutral term "decision" (for MY 1992) can only be read harmoniously with the term "grant support" (for MY 1995-2003) where the "decision" is to fund non-"green box" support to a specific commodity for marketing year 1992.

6. In addition, even if Article 13 would refer to a *level* of (income) support, as the United States alleges, the Appellate Body has held in *Brazil – Aircraft* that the "level" of export subsidies refers to actual expenditures.

7. The US interpretation of a "level of support" is furthermore inconsistent with its own interpretation of Article 13(b)(ii) in its Statement of Administrative Action (SAA). In the SAA, it stated that governments would have peace clause protection from adverse effects and serious prejudice challenges in the WTO "*unless the AMS for the particular* commodity exceeds the level decided in the 1992 marketing year". Brazil strongly disagrees with the notion of "AMS" as the relevant standard for the peace clause, *but* this official US interpretation of the peace clause in 1995 is nevertheless compelling evidence of the United States view of the "decision" it had taken during MY 1992. The calculation of the AMS for a particular commodity requires the calculation of the support provided in monetary terms. AoA Annex 3 offers two options for the calculation of AMS: budgetary outlays or the price gap formula detailed on paragraphs 10 and 11. Under either option, the AMS represents a measurement of support in monetary terms.

8. In sum, Brazil is of the firm view that the text of Article 13(b)(ii) requires comparing MY 1992 support with MY 1995-2003 support by comparing actual expenditures. This methodology produces an "amount" of support – not a "rate". Thus, any decision under Article 13(b)(ii), by definition, must relate in some way to an "amount" of expenditures. Only this methodology allows a clear comparison between the two time periods, regardless of the *type* of support.

9. However, even if the Panel were to decide that the relevant standard is a "rate of support" standard, Brazil has provided the testimony of Professor Daniel Sumner indicating that – following the US approach to measuring "support to upland cotton" – the "rate of support" to upland cotton in MY 1999-2002 was much higher than the "rate of support" to upland cotton in MY 1992. Based on the evidence and analysis presented by Professor Sumner, Brazil also asserts that even under the US "rate of support" methodology, the United States has failed to demonstrate that its MY 1999-2002 support does not exceed its support to upland cotton decided in MY 1992.

**US "statute of limitations" interpretation of the peace clause**

10. There is no express or implied "statute of limitations" in the peace clause. Subsidizing Members such as the United States are offered conditional protection under the peace clause during a 9-year period. But the rights of Members injured by subsidies provided in excess of 1992 marketing year levels are preserved throughout the implementation period as well. This is the balance struck by the peace clause.

11. The US "statute of limitations" argument in this case is very similar to one rejected by the Appellate Body in *US – Lead Bars*. This argument is further inconsistent with the views of the *Indonesia – Automobiles* panel, which held that measures applied in the past must be examined to assess present serious prejudice. The US interpretation would cut off a Member's right to challenge such measures because it missed an imaginary deadline. This US interpretation is inconsistent with the object and purpose of the AoA because it would permit Members to provide huge "non-green" box support one year without peace clause protection, and then claim absolution as soon as the next marketing year began.

**"Support to Upland Cotton"**

12. Brazil has produced extensive evidence providing the factual basis for the Panel to find that CCP, DP, market loss, and PFC payments are "support to" upland cotton within the meaning of the peace clause. USDA categorizes the PFC and market loss payments as part of "total payments" to upland cotton. US National Cotton Council officials repeatedly testified and produced documents revealing that their producer members requested, received, and depended on all four of these subsidies. Crop insurance is also support to cotton as evidenced by specific upland cotton crop insurance policies and groups of policies for upland cotton. Moreover, USDA specifically identifies and tabulates crop insurance subsidies for upland cotton. In addition, all five domestic support measures fail to meet the requirements of AoA Annex 2. Therefore, they constitute non-"green box" support that is presumed to be production and trade distorting. Such distortions can, however, only occur with respect to the production of or the trade in a particular commodity. Because, PFC, market loss assistance, direct and counter-cyclical payments as well as crop insurance subsidies are available to producers of upland cotton, these production and trade-distorting subsidies affect the production of and trade in upland cotton. The Panel should, therefore, find that all five of these programmes granted support to upland cotton in MY 1999-2002.

**Restrictions on Plantings of Fruits and Vegetables under the PFC and DP Programmes**

13. Brazil presents evidence that PFC and direct payments are not "decoupled" domestic support. These payments are dependent on the requirement that a farmer does not produce fruits, vegetables, nuts or wild rice on the contract acreage. This restrictions has the effect of channelling production on contract acreage into production of programme crops, including upland cotton, and is of particular importance for upland cotton base acreage located in regions of the United States where production of fruits and vegetables is a viable alternative to the production of upland cotton.

## III. STEP 2 EXPORT AND DOMESTIC PAYMENTS

14. The US Step 2 export payments clearly constitute subsidies contingent upon proof of export of US upland cotton. Step 2 export payments are export subsidies that violate AoA Articles 3.3 and 8 and that are prohibited by ASCM Articles 3.1(a) and 3.2.

15. Similarly, US Step 2 domestic payments are prohibited local content subsidies in violation of ASCM Article 3.1(b). There is no explicit derogation of ASCM Article 3.1(b) built into the Agriculture Agreement. In fact, the opposite is true, since AoA Article 13(b)(ii) provides a conditional exemption only for claims under ASCM Articles 5 and 6, but not for claims under ASCM Article 3. There is also no conflict between ASCM Article 3.1(b) and AoA Article 6 or Annex 3, paragraph 7, because there are two types of domestic support, including domestic support to processors of agricultural commodities – those that comply with Article 3.1(b) of the SCM Agreement and those that do not.

## IV. EXPORT CREDIT GUARANTEES

16. With respect to the consultations regarding the US export credit guarantee programmes, there is no doubt that the United States and Brazil consulted on three occasions about the GSM 102, GSM 103, and SCGP programmes as they relate to all eligible products. Thus, these measures are properly within the Panel's terms of reference and the Panel should reject the US request for a preliminary ruling.

17. With respect to Brazil's claims regarding the GSM 102, GSM 103 and SCGP export credit guarantee programmes, the United States interpretation of AoA Article 10.2 should be rejected. AoA Article 10.2 does not carve out export credit guarantees from the disciplines on export subsidies under the AoA. Nowhere does the provision exempt export credit guarantees from the disciplines on export subsidies, while exemption need to be made explicit in the text of an agreement following the Appellate Body reports in *EC – Hormones* and *EC – Sardines*. Similarly the context of AoA Article 10 as well as its object and purpose do not support the US view of AoA Article 10.2 as enabling Members to grant export credit support at zero percent interest and for unlimited terms – all for *free* – until Members complete negotiations on specific disciplines for export credits.

18. Concerning the substance of Brazil's claims against export credit guarantees, the United States has not even addressed Brazil's claim that since there is no commercial market for export credit guarantees on terms such as those provided by the CCC programmes, those programmes confer benefits *per se*. Brazil furthermore demonstrates that under the US formula accounting for the budgetary costs of contingent liabilities of CCC export credit guarantees, operating costs and losses for GSM 102, GSM 103 and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992. These figures represent *actual* costs and losses of the US export credit guarantee programmes.

19. Thus, the programmes constitute export subsidies within the meaning of ASCM Articles 1.1 and 3.1(a), item (j) of the Illustrative List, and AoA Articles 10.1, 1(e) and 8. They "at the very least" threaten to circumvent US export subsidy commitments, in violation of Articles 10.1 and 8 and are prohibited under ASCM Articles 3.1(a) and 3.2.

## V. ETI ACT

20. Lastly, the United States argues that Brazil has failed to meet is burden of proof that ETI Act subsidies constitute export subsidies violating the AoA and prohibited by the SCM Agreement. Brazil has adopted and reiterated all of the successful arguments of the EC in the *US – FSC (21.5)* dispute. Brazil asks the Panel to follow the panel in *India – Patents (EC)* and to give "significant weight" to the rulings in the *US – FSC (21.5)* dispute and to avoid "inconsistent rulings", while recognizing that the Panel is not formally bound by that decision.

## VI. PRELIMINARY ISSUES

21. Brazil has addressed the US request for a preliminary ruling on export credit guarantees above.

22. Concerning the US request for a preliminary ruling on the MY 2002 cottonseed payments, the record indicates that Brazil's consultation request covered "future" measures related to existing measures; it indicates further that Brazil and the United States consulted about the "Cottonseed Payment Programme", and that the Agricultural Assistance Act of 2003 provided funding for the existing administrative structure of the Cottonseed Payment Programme. Therefore, following the Appellate Body decision in *Chile – Agricultural Products (Price Band)*, the Agricultural Assistance Act of 2003 is properly within the Panel's terms of reference. In any event, the $50 million in

cottonseed payments are properly treated as "support to cotton" for the purposes of the peace clause calculation of the amount of support granted in MY 2002.

23. Regarding the US arguments that PFC and market loss assistance payments are outside the Panels terms of reference, as they constitute expired measures, Brazil asks the Panel to reject this third US request for a preliminary ruling. Brazil has properly included PFC and market loss assistance payments as part of its claims relating to *present* serious prejudice. Consultations under DSU Article 4.2 may be held concerning measures affecting the operation of a covered agreement. ASCM Article 5 requires a Member to avoid causing adverse effects, which may be the effects of current or previous, expired subsidies. As in the *Indonesia – Automobiles* dispute, expired measures are eminently within the Panel's terms of reference. Denying Members the possibility to challenge expired measures would yield the result that a Member could enact "one-time" subsidy measures that could never be challenged and the provisions of ASCM Articles 5 and 6 would thereby be rendered a nullity.

## VI. CONCLUSION

24. Brazil requests the Panel to reject all three US requests for preliminary rulings and to rule that AoA Article 13 does not exempt US domestic support and export subsidies from actions under the SCM Agreement.

# ANNEX C-2

## EXECUTIVE SUMMARY OF THE CLOSING STATEMENT OF BRAZIL AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

### I. INTRODUCTION

1. Brazil addresses first the "preliminary issues" raised by the United States, and then the various peace clause issues. Finally, Brazil addresses the Step 2, ETI Act and export credit guarantee measures.

### II. PRELIMINARY ISSUES

2. With respect to the consultations regarding the US export credit guarantee programmes, there is no doubt that the United States and Brazil consulted on three occasions about the GSM 102, GSM 103, and SCGP programmes as they relate to all eligible products. Thus, these measures are properly within the Panel's terms of reference.

3. Regarding the MY 2002 cottonseed payments, the record indicates that Brazil's consultation request covered "future" measures related to existing measures; it indicates further that Brazil and the United States consulted about the "Cottonseed Payment Programme", and that the Agricultural Assistance Act of 2003 provided funding for the existing administrative structure of the Cottonseed Payment Programme. Therefore, the Agricultural Assistance Act of 2003 is properly within the Panel's terms of reference. In any event, the $50 million in cottonseed payments are properly treated as "support to cotton" for the purposes of the peace clause calculation of the amount of support granted in MY 2002.

4. Regarding the US arguments that PFC and market loss assistance payments are outside the Panels terms of reference, as they constitute expired measures, Brazil asks the Panel to reject this third US request for a preliminary ruling. Brazil has properly included PFC and market loss assistance payments as part of its claims relating to *present* serious prejudice. ASCM Article 5 requires a Member to avoid causing adverse effects, which may be the effects of current or previous, expired subsidies. Adverse present effects caused by both types of measures are eminently within the Panel's terms of reference. As a factual matter, the Panel must decide on the question whether a particular expired subsidy has an actual causal connection with currently existing adverse effects. Yet, by granting the US request for a preliminary ruling the Panel would effectively dismiss Brazil's claim. Therefore, the fact that a subsidy measure has expired cannot be the basis for *a priori* excluding it from the Panel's terms of reference.

5. Furthermore, DSU Article 4.2 and 6.2 – invoked by the United States – must be applied in the context of the remedies provided for actionable subsidies under ASCM Articles 7.2-7.10. Under DSU Article 19 a panel can only recommend that the Member bring a wrongful measure into conformity with the covered agreement(s) at issue. However, for disputes concerning ASCM Articles 5 and 6, ASCM Article 7.8 contemplates two different remedies: removal of the adverse effects or withdrawal of the subsidy. While a Member cannot bring an expired measure into conformity with the covered agreements, both of the ASCM Article 7.8 remedies are valid options even for remedying the effects of a subsidy measure no longer in effect (as in the *Australia – Leather* dispute). As ASCM Articles 7.2-7.10 are "special and additional rules and procedures" under DSU Article 1.2 and DSU Appendix 2, they must prevail to the extent there is a difference between them and DSU Articles 4

and 6. This means that contrary to disputes involving other covered agreements, the Panel is required to address the adverse effects of expired subsidy measures.

6. Further, ASCM Articles 5 and 6.3 make no distinction between subsidies that are now being paid and subsidies that are no longer being paid but have a causal relationship to continuing adverse effects, as evidenced by the Panel report in *Indonesia – Automobiles*, which found serious prejudice arising, *inter alia*, from expired subsidy measures that had been provided for one year and – like the market loss assistance payments – been terminated.

## III. PEACE CLAUSE ISSUES

**"such measures do not grant support to a specific commodity"**

7. This phrase in Article 13(b)(ii) means that in calculating the amount of support for any marketing year between 1995-2003, all non-"green box" support provided to a specific commodity must be tabulated, regardless of whether the *type* or *form* of the support is "product-specific," "non-product specific", *de minimis*, or "blue box". This is certainly evidenced by the decision of negotiators *not* to use the phrases "product-specific" and "AMS" in Article 13(b)(ii) to qualify the type of support to a specific commodity. The US attempt to read "product-specific" into Article 13(b)(ii) is inconsistent not only with the text but also the context of the phrase "such measures" in Article 13(b)(ii). The US interpretation is further incompatible with the object and purpose of the Agreement on Agriculture. It would create a new category of non-actionable trade-distorting non-"green box" subsidies and sanction huge increases in spending for "amber box" and, therefore trade-distorting, domestic support as long as it took the form of support for *multiple* commodities. This is contrary to the presumption of trade and production-distorting effects for individual products from non-"green box" domestic support, which flows from a domestic measure being inconsistent with the "green box" requirements of Annex 2 of the Agriculture Agreement.

**"that decided during the 1992 marketing year"**

8. This word "decided" does not require any particular *type* of "decision". As a neutral term, the meaning of "decided" must be interpreted in a way that does justice to the ordinary meaning of other terms in Article 13(b)(ii) that are *not* neutral. Most importantly, the term "decided" must be interpreted in a manner that permits a comparison between a "*grant*" of non-"green box" "*support*" to a specific commodity for individual marketing years between 1995-2003, and a "decision" regarding such support in MY 1992. The Appellate Body agreed with the panel in *Brazil – Aircraft* that the phrase "the *level* of export subsidies *granted*" meant "something actually provided", which means actual budgetary expenditures. Thus, the neutral term "decision" (for MY 1992) can only be read harmoniously with the term "grant support" (for MY 1995-2003) where the "decision" is to fund non-"green box" support to a specific commodity for marketing year 1992.

9. The US argument that the only decision it took during MY 1992 was a "fixed rate of support" for MY 1992 is totally inconsistent with the US Statement of Administrative Action (SAA), in which the United States provided its official interpretation of the peace clause. In the SAA, the United States stated that governments would have peace clause protection from adverse effects and serious prejudice challenges in the WTO "*unless the AMS for the particular* commodity exceeds the level decided in the 1992 marketing year." Brazil strongly disagrees with the notion of "AMS" as the relevant standard for the peace clause, and draws the attention of the Panel to the fact that the United States now admits that "AMS" is nowhere found in the text of Article 13(b)(ii). *But* this official US interpretation of the peace clause in 1995 is nevertheless compelling evidence of the United States view of the "decision" it had taken during MY 1992. And this interpretation did not reflect a decision regarding only a rate of support. Instead, the only two "decision" options were set out in the AoA Annex 3, where "AMS" is calculated. This calculation is based on either budgetary

outlays, or a calculated *amount* based on the difference between a fixed reference price and the applied administered price multiplied by the amount of production eligible to receive the administered price. Under either option, the United States' interpretation indicates that an "amount" (not a "rate of support") is the measure of support under the peace clause.

10. The SAA statement is also strong evidence that the alleged US "decision" to continue the 1990 FACT Act level of support at 72.9 cents per pound is simply *post hoc* rationalization. Brazil presents evidence that prior to this dispute, the United States had not made up its mind on what would constitute the relevant decision for peace clause purposes. A series of questions asked by Brazil in the Committee on Agriculture and answers provided by the United States reveals that as of 28 June 2002, the United States had not yet made a "decision" regarding which year the United States was using with respect to Article 13(b)(ii). These questions provided the United States with every opportunity to announce the decision that it had allegedly taken 10 years before. Yet, it said nothing about a "rate of support".

11. In sum, Brazil is of the firm view that the text of Article 13(b)(ii) requires comparing MY 1992 support with MY 1995-2003 support by comparing actual expenditures. This methodology produces an "amount" of support – not a "rate". Thus, any decision under Article 13(b)(ii), by definition, must relate in some way to an "amount" of expenditures. Only such methodology allows a clear comparison between the two time periods, regardless of the *type* of support.

12. However, even if the Panel were to decide that the relevant standard is a "rate of support" standard, Brazil has provided the testimony of Professor Daniel Sumner indicating that the "rate of support" to upland cotton in MY 1999-2002 was much higher than the "rate of support" to upland cotton in MY 1992. Based on the evidence and analysis presented by Professor Sumner, Brazil also asserts that even under the US "rate of support" methodology, the United States has failed to demonstrate that its MY 1999-2002 support does not exceed its support to upland cotton decided in MY 1992.

**US "statute of limitations" interpretation of the peace clause**

13. There is no express or implied "statute of limitations" in the peace clause. Subsidizing Members such as the United States are offered conditional protection under the peace clause during a 9-year period. But the rights of Members injured by subsidies provided in excess of 1992 marketing year levels are preserved throughout the implementation period as well. This is the balance struck by the peace clause.

14. The US "statute of limitations" argument in this case is very similar to one rejected by the Appellate Body in *US – Lead Bars*. This argument is further inconsistent with the views of the *Indonesia – Automobiles* panel, which held that measures applied in the past must be examined to assess present serious prejudice. The US interpretation would cut off a Member's right to challenge such measures because it missed an imaginary deadline. This US interpretation is inconsistent with the object and purpose of the AoA because it would permit Members to provide huge "non-green" box support one year without peace clause protection, and then claim absolution as soon as the next marketing year began.

**"Support to Upland Cotton"**

15. Brazil has produced extensive evidence providing the factual basis for the Panel to find that CCP, DP, market loss, and PFC payments are "support to" upland cotton within the meaning of the peace clause. USDA categorizes the PFC and market loss payments as part of "total payments" to upland cotton. US National Cotton Council officials repeatedly testified and produced documents revealing that their producer members requested, received, and depended on all four of these subsidies. Crop insurance is also support to cotton as evidenced by specific upland cotton crop insurance policies and groups of policies for upland cotton. Moreover, USDA specifically identifies and tabulates crop insurance subsidies for upland cotton. Thus, the Panel should find that all five of these programmes granted support to upland cotton in MY 1999-2002.

## IV. STEP 2 PAYMENTS

16. The US Step 2 export subsidies clearly constitute export subsidies that violate Articles 3.3 and 8 of the Agriculture Agreement and that are prohibited by Articles 3.1(a) and 3.2 of the SCM Agreement because they are contingent upon proof of export of US upland cotton.

17. Similarly, US domestic Step 2 subsidies are prohibited local content subsidies in violation of Article 3.1(b) of the SCM Agreement. There is no explicit derogation of Article 3.1(b) built into the Agriculture Agreement. In fact, the opposite is true, since Article 13(b)(ii) provides a conditional exemption only for claims under Articles 5 and 6 of the SCM Agreement, but not for claims under Article 3 of the SCM Agreement. There is also no conflict between Article 3.1(b) of the SCM Agreement and Agriculture Agreement Article 6 or Annex 3, paragraph 7, because there are two types of domestic subsidies – those that comply with Article 3.1(b) of the SCM Agreement and those that do not.

## V. EXPORT CREDIT GUARANTEES

18. With respect to Brazil's claims regarding the GSM 102, GSM 103 and SCGP export guarantee programmes, the United States interpretation of AoA Article 10.2 should be rejected. Under the US view of Article 10.2, it can grant export credit support at zero percent interest and for unlimited terms – all for *free* – at least until Members complete negotiations on specific disciplines for export credits. This interpretation is not supported by a Vienna Convention analysis.

19. The United States has not even addressed Brazil's claim that since there is no commercial market for export credit guarantees on terms such as those provided by the CCC programmes, those programmes confer benefits *per se*. And Brazil has demonstrated that under the cost formula used by the White House, the US Congress, US government accountants and the CCC itself, operating costs and losses for GSM 102, GSM 103 and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992. These figures represent *actual* costs and losses of the US export credit guarantee programmes. The programmes therefore constitute export subsidies within the meaning of ASCM Articles 1.1 and 3.1(a), item (j) of the Illustrative List, and AoA Articles 10.1, 1(e) and 8. They "at the very least" threaten to circumvent US export subsidy commitments, in violation of Articles 10.1 and 8 and are prohibited under ASCM Articles 3.1(a) and 3.2.

## VI. CONCLUSION

20. Brazil requests the Panel to reject the numerous attempts by the United States to delay the initiation of Brazil's serious prejudice claims. Brazilian upland cotton producers are experiencing present serious prejudice from continued huge amounts of US subsidies to upland cotton. Applying

either methodology of calculating the support for peace clause purposes, the United States has no basis to claim peace clause protection.

# ANNEX C-3

## EXECUTIVE SUMMARY OF THE OPENING STATEMENT OF THE UNITED STATES AT THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. The United States has stayed within the disciplines and acted consistently with its WTO obligations negotiated and agreed in the Uruguay Round. We share many of Brazil's objectives with respect to reform of measures that affect agricultural trade, but we obviously do not endorse the means by which Brazil is attempting to obtain changes to WTO-consistent US support measures for upland cotton. Brazil seeks to impose disciplines and achieve results through this litigation that were not agreed in the Uruguay Round through negotiation.

2. Brazil suggests that whether a Member's measures are in breach of the Peace Clause should be judged by comparing the *aggregate outlays* that may be *attributed* to a commodity to the aggregate outlays that were made during the 1992 marketing year that, again, may be attributed to that commodity. Brazil's erroneous analysis stems from three interpretive missteps.

3. First, with respect to measures currently in effect, Brazil mistakenly suggests that support under previous measures in past years is relevant to the Peace Clause comparison. The proviso, however, is written in the present tense and thus, with respect to measures *currently* in effect, calls for a determination of the support that challenged measures *currently* grant. Brazil *nowhere* explains how the support in any previous years is relevant to the present-tense criterion that Peace Clause-exempted measures "do not grant support" in excess of a certain level. In fact, Brazil's analysis of the ordinary meaning and context of the phrase "grant support" assigns no meaning to Members' choice of verb tense.

4. Second, Brazil misunderstands the support that is relevant to the Peace Clause comparison because it misreads the phrase "support to a specific commodity". Brazil and New Zealand have asserted that, had Members intended for the phrase "support to a specific commodity" to mean "product-specific support", they would have used the latter phrase. With respect, this pushes the general interpretive aid of reading different word choices to carry different meanings too far. It ignores the relevant task for an interpreter, which is to read the text according to its ordinary meaning, in context, and in light of the object and purpose of the agreement. The ordinary meaning of the phrase "support to a specific commodity," in the context of the Agriculture Agreement, is "product-specific support".

5. We note that the Agriculture Agreement suggests that domestic support consists, in part, of product-specific and non-product-specific support. Brazil's interpretation of "support to a specific commodity," however, would apparently also capture "non-product-specific support". Absent a clear indication that such a contrary-to-logic result was intended, the interpreter should read "support to a specific commodity" to exclude "non-product-specific support". We note that the Agriculture Agreement suggests that domestic support consists, in part, of product-specific support and non-product-specific support. Brazil's interpretation of "support to a specific commodity", however, would apparently also capture "non-product-specific support". Absent a clear indication that such a contrary-to-logic result was intended, the interpreter should read "support to a specific commodity" to exclude "non-product-specific support".

6. Third, Brazil ignores the way in which the United States "decided" (that is, "determined" or "pronounced") the product-specific support for upland cotton during the 1992 marketing year. As

Brazil explained in its first submission, the Peace Clause text resulted from the EC's desire to protect from challenge measures "decided" in 1992 for purposes of CAP reform, rather than support "provided" during marketing year 1992. That is precisely the approach the United States suggests: examine the product-specific support "decided" during marketing year 1992 and compare it to the product-specific support that measures currently in effect grant. Brazil fails to explain to the Panel how US measures *actually* decided support during the 1992 marketing year in favour of Brazil's pre-baked conclusion that the "term 'decided during the 1992 marketing year' requires an examination of the *amount or quantity of support* . . . for a specific commodity that a WTO Member 'decided' to provide during the 1992 marketing year". In fact, US measures "decided" support in the 1992 marketing year by ensuring upland cotton producer income at a rate of 72.9 cents per pound. Brazil nowhere explains how US domestic support measures could have "decided" the amount of outlays since those outlays resulted from the difference between the income support level and world prices during Marketing Year 1992 beyond the US Government's control.

7. Brazil has argued that the US approach would create an annual "statute of limitations" for the applicability of the Peace Clause and that the problem with this approach is budgetary outlays are not known until after a given marketing year is completed. This comment, rather, points out the difficulties of *Brazil's* approach that *only* budgetary outlays may be examined under the Peace Clause. That is, Brazil effectively concedes that under *its* approach there would be no certainty for Members whether measures are exempt from actions. For example, it would be difficult to know whether budgetary outlays under the 2002 Act exceeded 1992 outlays as of Brazil's panel request in February 2003.

8. With respect to US direct payments, which the United States believes are "green box" measures, Brazil argues that these payments do not satisfy the "fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production" under the first sentence of paragraph 1 of Annex 2. However, the text of Annex 2 indicates that "domestic support measures" shall be deemed to have met this "fundamental requirement" if the measures "conform to the . . . basic criteria" of the second sentence, plus any applicable policy-specific criteria, by beginning the second sentence with "accordingly". This interpretation is supported by relevant context in the Agreement; as the European Communities notes in its third party submission, Articles 6.1, 7.1, and 7.2 refer to the measures "which are not subject to reduction commitments because they qualify under the *criteria* set out in Annex 2".

9. In addition to the basic criteria in paragraph 1, US direct payments must also conform to the five "policy-specific criteria and conditions" set out in paragraph 6 of Annex 2. Brazil brings forward two arguments that direct payments do not satisfy the criterion under paragraph 6(b) of Annex 2 that the amount of payments not be related to, or based on, production undertaken in any year after the base period. First, Brazil argues that by eliminating or reducing payments if recipients harvest certain fruits or vegetables, payments are related to production in a year after the base period. However, no particular type of production is required in order to receive such payments – indeed, no production is necessary at all. Brazil's argument, moreover, proves too much. Under Brazil's analysis, *any* limitation on a producer's choices in a year after the base period that would alter the amount of payment would be inconsistent with paragraph 6(b). However, a requirement that a recipient of direct payments produce *nothing at all* (or see the payment reduced or eliminated) *would* link the amount of payment to the type or volume of production in the current year. Such a requirement would also *ensure* that such payments meet the "fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production" because there would be no production at all. Thus, under Brazil's analysis, paragraph 6(b) would *prevent* a payment that would demonstrably achieve the "fundamental requirement" of Annex 2. This result is not required by the text of paragraph 6(b) and should be avoided.

10. Second, Brazil argues that direct payments are based on production in a year after the base period because once one type of direct payment to producers under Annex 2 has been made, *all*

subsequent measures providing direct payments must be made with respect to the same base period. The Annex 2 text does not support such a reading, however. Annex 2 says that "[d]omestic support measures for which exemption from the reduction commitments is claimed" shall meet the fundamental requirement of the first sentence through the relevant basic and policy-specific criteria of the second sentence. For example, in the case of decoupled income support, the particular "domestic support measure" must meet "policy-specific criteria and conditions as set out" in paragraph 6. Paragraph 6(a), (b), (c), and (d) relate "such payments" to "a defined and fixed base period". Thus, payments with respect to a given "domestic support measure for which exemption from the reduction commitments is claimed" must satisfy conditions relating to "*a* defined and fixed base period". There is no textual requirement that *all* domestic support measures for which exemption from the reduction commitments is claimed utilize the *same* "defined and fixed base period". Brazil also reads paragraph 6 as though the text were "*the* defined and fixed base period". However, this is not what the text says nor what the negotiators agreed.

11. Brazil and the rest of the Cairns Group seek to address this very issue by proposing in the ongoing agriculture negotiations that Annex 2, paragraph 6, be amended to change the reference from "a defined and fixed base period" to "a defined, fixed *and unchanging historical* base period". The revised Harbinson text, in Attachment 8, incorporates this Cairns Group proposal by proposing adding to paragraphs 5, 6, 11, and 13 of Annex 2 the text: "Payments shall be based on activities in a fixed and *unchanging historical* base period." Again, Brazil is seeking to gain through litigation what it has not yet gained through negotiation.

12. The Step 2 programme has been constructed and implemented in a manner to support the price paid to US upland cotton producers by purchasers of their product. Step 2 is a single programme that provides for payments on all sales of all upland cotton produced in the United States in a given marketing year – whether those sales are for export or for domestic consumption. Step 2 payments are provided to merchandisers or manufacturers who use upland cotton as they represent the first step in the marketing chain where these payments could be made and have the greatest impact on producer prices.

13. The authorizing statute plainly does not state that the Step 2 payment is contingent upon export. The statute provides for Step 2 payments to a class of eligible users who constitute the entire universe of potential purchasers of upland cotton from producers. Payment occurs upon demonstration of the requisite use of the cotton. Unlike the facts of *United States - FSC (Recourse to Article 21.5)* , the Step 2 subsidy involves a universally available subsidy on sales of one agricultural product produced entirely in the United States, not tied to exportation or foreign commerce. Stated most simply, US upland cotton does *not* have to be exported to receive the payment. Assuming the conditions in the payment formula are met, all US upland cotton is sold with an entitlement to the Step 2 subsidy, whether it leaves the United States or is consumed there.

14. For nearly 15 years before the inception of obligations under the Agreement on Agriculture, as well as since that time, the core features of the two main agricultural export credit guarantee programmes of the United States (GSM-102 and GSM-103) have remained substantially the same. They are well-known and well-established export credit guarantee programmes, specifically discussed by negotiators during the Uruguay Round, as well as in the OECD and in the current Doha Round.

15. Article 9.1 of the Agriculture Agreement identifies and lists specific export subsidy programmes, also well-known to the negotiators, who wanted to assure that such specific practices were embraced within the definition of an export subsidy for purposes of the Agreement on Agriculture. Other export subsidies are captured within the anti-circumvention provision of Article 10.1. In contrast, export credit guarantees were not included in either Article 9.1 or 10.1. Instead, as part of the balance struck in the Uruguay Round, negotiators opted to extend the negotiations on this subject but determined to hold Members to a commitment that if and when internationally agreed disciplines emerged, the United States, like all other WTO Members, could

only grant export credit guarantees in conformity with such disciplines. To do otherwise would at that time constitute a violation of the Member's obligations under the Agreement on Agriculture.

16. Article 10.2 expresses the two commitments of the Members in this regard: (1) to engage in such negotiations notwithstanding the conclusion of the Uruguay Round and (2) upon development of internationally agreed disciplines to render them WTO commitments through the portal of Article 10.2. Article 10.2 does not state that export credit guarantees shall be subject to such future negotiated disciplines *in addition to* the anti-circumvention provisions of Article 10.1. To the contrary, Article 10.2 and the reference to export credit guarantees is juxtaposed to Article 10.1 to reflect the intention of the drafters to distinguish export credit guarantee programmes from other programmes that otherwise would be export subsidies subject to Article 10.1.

17. For the foregoing reasons and those set out in our first written submission, the United States believes that US non-green box measures are exempt from actions pursuant to Agriculture Agreement Article 13(b)(ii); US direct payments are exempt from actions pursuant to Agriculture Agreement Article 13(a)(ii); and US export credit guarantee programmes for upland cotton and Step 2 payments are consistent with our WTO obligations.

# ANNEX C-4

## EXECUTIVE SUMMARY OF THE CLOSING STATEMENT OF THE UNITED STATES AT THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. On the US requests for preliminary rulings, the Panel expressed some interest in the question of what prejudice would result to the United States if we were forced to defend export credit guarantees with respect to commodities other than upland cotton. First and foremost, the United States would have lost the benefit of consultations on these measures. Consultations serve a number of important functions, including helping the parties to understand each others' concerns and aiding in efforts to resolve the dispute. The DSU affirms the importance of consultations and requires that a Member cannot proceed to a panel unless the Member has consulted on that measure.

2. Moreover, to require the United States to address Brazil's allegations on these measures would impose additional burdens on the United States and detract from the time and resources available to respond for those measures that *are* within the terms of reference. The United States has export subsidy reduction commitments with respect to 12 commodities. Each such commodity is therefore subject to individual Peace Clause analysis under Article 13(c). In addition, under Brazil's approach, the type of analysis the United States has offered for upland cotton concerning item (j) of the Subsidies Agreement would be appropriate for all commodities subject to the coverage of the Agriculture Agreement. This would necessitate a commodity-by-commodity analysis of the export credit guarantee programmes, as applied, concerning premiums and long-term operating costs and losses (if any).

3. But in the end, the issue of prejudice to the United States does not figure in the question of whether a measure is within the Panel's terms of reference. It is *that* question that underlies the United States' preliminary ruling requests.

4. First, the United States has requested that the Panel find that export credit guarantee measures relating to other eligible agricultural commodities are not within the Panel's terms of reference. While Brazil's *panel* request *did* refer to "export credit guarantees . . . to facilitate the export of US upland cotton and other eligible agricultural commodities," its *consultation* request did not. That consultation request nowhere included the "other eligible agricultural commodities" language, nor did Brazil include these measures in its statement of available evidence. Thus, those measures on other eligible agricultural commodities were not part of the "measures at issue" that Brazil identified in its consultation request as it is required to do under DSU Article 4.4. Contrary to Brazil's statement a few moments ago, the United States and Brazil never consulted on export credit guarantees on commodities other than cotton – not once and certainly not three times. Brazil said as much on the first day of the first panel meeting when it acknowledged that the United States told Brazil at the first consultation that its questions were beyond the scope of the consultations.

5. On the question whether the export credit guarantee programmes were one measure or multiple measures: There is no reason why export guarantees for multiple products cannot be multiple measures. Under DSU Article 4.4, it is incumbent upon Brazil to identify in its consultation request "the measures at issue." Here, Brazil identified the measure as the "export credit guarantees . . . to facilitate the export of US upland cotton," and the United States may, and did, rely on that consultation request (including the attached statement of evidence) for notice.

6. For example, if a Member banned imports of all animal products for a stated health reason, and another Member filed a consultation request on the ban solely with respect to imports of beef, that complaining Member could not then expand the scope of the dispute through its written consultation questions or its panel request to challenge that ban with respect to other affected agricultural commodities. This is, however, what Brazil is attempting to do here.

7. Brazil also relies on footnote 1 of its consultation request, which refers to an explanation "below". Such an explanation expanding the scope of the request to include "other eligible agricultural commodities" is *not* found in the consultation request. DSU Article 4.4 requires Brazil to provide "an identification of the measures at issue," not a cryptic reference that is not explained further. Despite notice from the United States and despite ample opportunity to submit a new consultation request, Brazil never did so. Therefore, export credit guarantee measures relating to eligible US agricultural commodities other than US upland cotton were not the subject of consultations and pursuant to DSU Articles 4.4, 4.7, and 6.2 do not form part of the Panel's terms of reference.

8. With respect to production flexibility contract payments and market loss assistance payments, we have explained that these payments were completed, the programmes terminated, and the statutory instruments providing them were superseded before Brazil's consultation request was filed. The measures that Brazil challenges are subsidies or payments provided by these programmes. The laws authorizing these payments designated that each such payment was *allocated* to a particular crop or fiscal year. Thus, pursuant to the 1996 Act, the last production flexibility contract payment for fiscal year 2002 was made no later than the end of fiscal year 2002. As Brazil states in its first submission, "[w]ith the passage of the new FSRI Act in May 2002, PFC payments were discontinued". The last market loss assistance payment was made with respect to the 2001 marketing year (1 August 2001-31 July 2002) pursuant to legislation enacted on 13 August 2001. Because the relevant fiscal year and the relevant marketing year, respectively, had been completed by the time of Brazil's consultation and/or panel requests, these measures cannot have been consulted upon within the meaning of DSU Article 4.2 *nor* have been "measures at issue" within the meaning of DSU Article 6.2. They therefore do not fall within the Panel's terms of reference. Brazil's suggestion that Articles 7.2 to 7.10 of the Subsidies Agreement should supersede the DSU provisions concerning this Panel's terms of reference is novel. Preliminarily, we note that Article 7.4 does mention the Panel's terms of reference, but only in the context of setting a 15-day deadline for establishing them, as opposed to the time line under DSU Article 7.1.

9. Finally, with respect to subsidies provided under the Agricultural Assistance Act of 2003 – the cottonseed payment – these are measures that were not even in existence at the time of Brazil's panel request. As the cottonseed payment had not been made (implementing regulations were not even issued until 25 April 2003) and the legislation authorizing the payments had not been enacted at the time of Brazil's panel request, this subsidy or measure was not consulted upon and could not have been a measure at issue between the parties. Therefore, the United States requests that the Panel make preliminary rulings that these three sets of measures are not within its terms of reference.

10. To summarize briefly where our discussions on the Peace Clause have brought us: Brazil suggests in *this* dispute that the word " actions" in the phrase "exempt from actions" only refers to "collective action" by the DSB. However, we note that Brazil's interpretation runs directly contrary to the view it expressed in its consultation request in the dispute *European Communities – Export Subsidies on Sugar* (WT/DS266/1). With respect to Article 13(c)(ii), which uses the same phrase "exempt from actions" at issue in this dispute, Brazil wrote: "In respect of the claims based on Article 3 of the SCM Agreement, because the export subsidies provided by the EC on sugar do not conform fully to the provisions of Part V of the Agreement on Agriculture, those export subsidies are not *exempt from challenge* by virtue of Article 13(c)(ii) of the Agreement on Agriculture." That is, in that WTO document Brazil does *not* read the phrase "exempt from actions" to mean "exempt from remedies" or "exempt from collective action by the DSB" but rather "exempt from *challenge*".

Brazil's interpretation in that WTO consultation request could only result if "exempt from action" in the Peace Clause means "not subject to" the "taking of legal steps to establish a claim" – as the United States has been contending in this dispute. We submit that *this* interpretation by Brazil is correct.

11. The Peace Clause – in Brazil's words – "exempt[s] from challenge" certain measures. It follows that the Peace Clause is not an affirmative defence but rather a threshold issue for Brazil in this dispute. As Brazil implicitly recognized in both its panel and consultation requests, to even reach the point where it will, as the complaining party, be allowed to pursue its substantive claims, Brazil must first demonstrate that the Peace Clause does not exempt US measures from action – that is "from challenge".

12. On US direct payments, which the United States believes are "green box" measures because they satisfy the criteria set out in Annex 2: As a question from the Chair to Brazil suggested, assessing the conformity of a claimed green box measure against the "fundamental requirement" of the first sentence of paragraph 1 would be a difficult, if not impossible task, for a Panel. Members foresaw the problem and therefore provided guidance on how a measure would fulfill that fundamental requirement – that is, if the measures "conform to the . . . basic criteria" of the second sentence plus any applicable policy-specific criteria, they shall be deemed to have met the fundamental requirement.

13. With respect to the criterion in paragraph 6(b) that the amount of decoupled income support payments not be based on, or linked to, production undertaken in any year after the base period, this provision need not and should not be read as Brazil suggests. The text supports a reading that a Member may not base or link payments to production requirements. The EC endorsed this view this morning. US direct payments require no particular type of production – indeed, no production is necessary at all. As we have suggested, Brazil's reading of paragraph 6(b) would prevent a Member from prohibiting a recipient from producing crops – that is, would prevent a measure that bases or links payments to a type or volume of production: none at all. If there is no production at all as a result of the measure, such a measure necessarily can have no "trade-distorting effects or effects on production". Thus, Brazil's reading of paragraph 6(b) would *preclude* a Member from establishing a measure that meets the "fundamental requirement" of Annex 2. Paragraph 6(b) need not and should not be read in opposition to that fundamental requirement. In the context provided by the first sentence of Annex 2, then, paragraph 6(b) should be read as establishing that a Member may not base or link payments to requirements to produce any crop in particular – again, US direct payments require no upland cotton production and do not require any production at all.

14. Brazil has repeatedly raised the spectre of unchecked US domestic subsidies should the Panel agree with the US interpretation of the Peace Clause. Brazil's fears are groundless. Of course the United States may not provide subsidies without any limit. US subsidies are disciplined in several ways, and the US has deliberately kept itself within those limits. There are two main disciplines that apply. The first is the US final bound commitment level under the Current Total Aggregate Measurement of Support. The second, as we have discussed at length, is the Peace Clause itself and its effective limitation to a level of producer support of 72.9 cents per pound. The United States has stayed within the boundaries of those limits despite, as outlined in Brazil's filings, pressure to do otherwise. We are entitled to the benefit of that compliance.

15. We can understand that Brazil might feel that these limits are not enough. New limits may be negotiated in the ongoing agriculture negotiations, in which the United States shares many of the same goals as Brazil. Until that happens, however, Brazil may not seek to overturn the balance of rights and obligations negotiated and agreed by Members in the Uruguay Round. Brazil's Peace Clause interpretation would do violence to the text of the Agriculture Agreement and would penalize the United States for deciding support to upland cotton producers within the limits set by the Agreement. We therefore ask the Panel to find that Brazil has not established that US domestic

support measures breach the Peace Clause and that such measures are therefore exempt from Brazil's action at this time.

# ANNEX C-5

## ORAL THIRD PARTY COMMUNICATION BY THE ARGENTINE REPUBLIC

24 July 2003

## I. INTRODUCTION

1. The Argentine Republic thanks the Panel for the opportunity to present its views as a third party to these proceedings and, in pursuant to its Submission dated 15 July[1], will comment on the claims contained in the First Written Submission of the United States, dated 11 July.

2. In this connection, Argentina will comment more particularly on:

(a) The US interpretation of the provisions of the Peace Clause, particularly in Article 13(b)(ii);

(b) the US interpretations regarding Annex 2 of the Agreement on Agriculture and, lastly;

(c) the US interpretation whereby Article 10.2 of the Agreement on Agriculture excludes export credit guarantees from the general export subsidy disciplines in the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures.

## II. UNITED STATES CLAIMS

(a) Interpretation of the Peace Clause

3. Argentina will discuss what it regards as a mistaken US interpretation of the terms of the Peace Clause, particularly in Article 13(b) of the Agreement on Agriculture[2], whereby it draws the conclusion – equally mistaken – that its domestic support measures are exempt from the measures based on Article XVI.I of the GATT 1994 or Articles 5 and 6 of the Agreement on Subsidies (ASCM).

*(i) Grant support to a specific commodity*

4. First, the United States mistakenly interprets the phrase "grant support to a specific commodity".

5. In paragraph 71 of its Submission, the United States says that counter-cyclical payments and crop insurance payments do not constitute "support to a specific commodity" because they are not linked to specific commodity but are based on *historical* acreage and payment yields.[3]

6. The United States contends that "support to a specific commodity", in Article 13(b)(ii), means "product-specific support". Its argument is thus based on trying to incorporate the phrase "product-

[1] "Third party Submission by Argentina", paragraph 2.
[2] First Written Submission of the United States of America, 11 July 2003, Section III.D.
[3] *Ibid.*, paragraph 115.

specific support" into Article 13(b)(ii) when the phrase is not to be found in the wording of the article.[4]

7. If the negotiators had meant to say that "product-specific support" was exempt, they would have introduced that phrase into the wording of the article, but they did not do so.[5] Hence, AA Article 13(b)(ii) refers to a Member's non-Green Box domestic support measures, including domestic support measures granted only to individual specific products and also those relating to several specific products.

8. In other words, "support to a specific commodity", in Article 13(b)(ii), includes any non-Green Box domestic support measure providing identifiable support to an individual commodity, regardless of whether the measure can provide support to a larger number of commodities.[6]

9. In its argument, the US ignores the most relevant context of Article 13(b)(ii), namely the chapeau, which refers not to "product-specific support" but to "domestic support measures" in general. This means that the measures which, under Article 13(b)(ii) are relevant in determining whether a Member has granted support to a specific commodity in excess of that decided during the 1992 marketing year necessarily includes non-product-specific domestic support.

10. The US interpretation would mean no claim could be made against any Amber Box domestic support measure granted to more than one commodity. The US argument would thus allow Members to make enormous increases in domestic support to a relatively small number of commodities (such as the ten crops covered by the counter-cyclical payments programme), something which is inconsistent with the object and purpose of the AA, namely, cutting down the level of domestic support, as is apparent from the Preamble.[7]

11. Argentina considers that "support to a specific commodity", in Article 13(b)(ii), indicates that, in calculating the domestic support granted by a Member, the support must relate to a particular or precise commodity, regardless of whether the support is product-specific or specific to more than one product.[8]

12. Contrary to the US suggestion, the phrase "support to a specific commodity" does not mean "support exclusively or only" to a specific commodity. The fact that, through the same domestic

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[4] According to the Appellate Body in the *India-Patents Case* (WT/DS50/AB/R, adopted 16 January 1998, paragraph 45):

"*The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the Vienna Convention. But these principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended".* (Emphasis added)

[5] "*… had Members intended to exclude non-product specific support they would surely have said so", "Third Party Submission of New Zealand*", 14 July 2003, paragraph 2.21.

[6] In this respect, Argentina agrees with New Zealand: "*… New Zealand sees no basis on which to suggest that support to a specific commodity should be excluded simply because other commodities may receive similar support*". Third-party submission of New Zealand, 15 July 2003, paragraph 2.23.

[7] *"... the above-mentioned long-term objective is to provide substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets"* (Agreement on Agriculture, third preambular paragraph).

[8] Australia's Third Party Submission to the Panel, 15 July 2003, paragraph 23: "*... the ordinary meaning of this phrase* ("To a specific commodity"), *read in its context and in light of the object and purpose of the Agreement on Agriculture, is support granted to an individual agricultural commodity covered by AA Annex 1, such as upland cotton, whether through product specific, or non-product specific, support*".

support measures, the United States grants support to different products does not cancel out the fact that part of the support is granted to one specific product.

*(ii) Support "decided during the 1992 marketing year"*

13. After analysing the phrase "*that decided during the 1992 marketing year*", the United States reaches the conclusion that the phrase does not relate to support actually provided to a specific product during that year[9], but to support *determined* during the 1992 marketing year and that it consisted in "deciding" or "determining" a level of income support for cotton producers of US$0.72 per pound.

14. With this interpretation, the United States can get around the need to respond to Brazil's contention[10] - supported by Argentina[11] - that the US budgetary outlays on domestic support for the cotton sector for the 1999, 2000, 2001 and 2002 marketing years were far in excess of the US$1,994 million granted in 1992.

15. Argentina considers that, under Article 13(b)(ii), the word "decided" means a decision to make payments. The US argument ignores the fact that the text first uses the term "grant support" with reference to the support granted or provided to a specific commodity during the period of implementation (1995-2003). The phrase "grant support", however, is necessarily tied in with the support "decided during the 1992 marketing year"; otherwise, there would be no basis for comparison if one case involved the support granted and the other involved only the support scheduled.

16. In this connection, Argentina contends that the word "decided", in Article 13(b)(ii), should not be interpreted in such a way that the per pound guaranteed price for commodity producers (scheduled support) is the factor to be taken into consideration in determining the amount of support granted. If the criterion advanced by the United States were accepted, it would mean that an unlimited amount of domestic support could be granted to each product provided the total AMS is not exceeded.

17. In other words, the comparison required in Article 13(b)(ii) necessarily entails comparing the same type of support in each of the periods in question (period of implementation versus 1992 marketing year), in other words "comparing the comparable". The "support granted" in each marketing year during the period of implementation must necessarily be tied in with the budgetary outlays in those years.

18. In this respect, the definition of "granted" formulated by the Appellate Body in the "Brazil-Aircraft" case is relevant, namely that it is "*something actually provided*" and, thus, "*to determine the amount of export subsidies "granted" in a particular year, we believe that the actual amounts provided by a government, and not just those authorized or appropriated in its budget for that year, is the proper measure … Therefore, … we believe that the proper reference is to actual expenditures by a government …*".

19. Similarly, Argentina considers that, under AA Article 13(b)(ii), the definition of the term "support granted" must refer to a government's actual expenditures and not to a scheduled level of costs or a rate of support per unit of production.

20. Accordingly, Argentina takes the view that the support "decided during the 1992 marketing year" refers to payments actually made during that marketing year.

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[9] First Written Submission of the United States of America, paragraph 94: "… *no amount of outlays was 'decided' … during the 1992 marketing year …*".

[10] First Written Submission by Brazil, paragraphs 144-149.

[11] Third Party Submission by Argentina, paragraphs 64-65.

*(iii) The time dimension of Peace Clause protection*

21. In contrast to the US interpretation, Argentina contends that the domestic support measures granted in any of the marketing years in the period from 1995 to 2003 are relevant in determining compliance with Article 13(b)(ii). In this connection, we consider that any injurious effects of the subsidies are extended time-wise.

22. An interpretation like the one postulated by the United States would seriously restrict the possibility of questioning whether such subsidies are consistent with ASCM Articles 5 and 6, while effects causing injury, nullification or impairment or serious prejudice can be linked to domestic support measures granted in previous marketing years.

(b) Annex II of the Agreement on Agriculture

*(i) Interpretation of paragraph 1*

23. The United States claims that its direct payments programme is in conformity with AA Annex II[12] and, therefore, is exempt from measures under the protection afforded by Article 13(a). In reaching this conclusion, however, the United States makes a mistaken interpretation of paragraph 1 of AA Annex II.

24. The United States maintains that the structure of this provision, where the second sentence starts with the word "Accordingly", suggests that measures that conform to the two basic criteria set out in paragraph 1(a) and (b), plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex II are designed to meet the "fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production"[13].

25. Argentina considers this interpretation to be erroneous, since the text of the first sentence establishes a clear obligation that the domestic support measures to be exempted from the reduction commitments "… *shall meet the fundamental requirement that they have no … trade-distorting effect or effects on production …*". In Argentina's opinion, the language of this first sentence establishes a general requirement governing the application of all Green Box measures.

26. The structure of paragraph 1 of AA Annex 2 thus creates four types of obligation:

(i) The fundamental requirement of no, or at least minimal, trade-distorting effects or effects on production;

(ii) the support given in a government-financed programme does not entail transfers from consumers;

(iii) the support does not have the effect of providing producers with price support; and

(iv) the policy-specific criteria and conditions set out in paragraphs 2 to 13 of Annex 2 are also taken into account.

27. In this connection, Argentina believes that Green Box measures must respect the guiding principle of avoiding trade-distorting or production effects or at most minimal effects. A measure that meets the two basic criteria set out in paragraph 1(a) and (b), plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2 could also be at variance with the general

[12] First Written Submission by the United States of America, paragraph 53.
[13] *Ibid.,* paragraph 50.

principle. The opposite interpretation would render meaningless the first sentence of paragraph 1 of Annex 2, which the text describes as a "fundamental requirement".

28. Therefore, it is Argentina's view that, however much the United States claims that its direct payments programme conforms to the requirement established in the second sentence of paragraph 1 of Annex 2[14], since it does not meet the fundamental requirement established in the first sentence it cannot be viewed as a Green Box programme.

29. In this respect, Argentina concurs with Australia and New Zealand that the first sentence of Annex 2 paragraph 1, imposes a stringent standard by requiring that the measures to be exempted from reduction commitments must, as a primary or essential condition, not artificially alter trade or production.[15]

30. Consequently, if a domestic support measure leads to a higher level of production of trade in a particular product or group of products, the measure does not meet the standard established in Annex 2, Article 1.

31. It should be emphasized that the US has in no sense answered the statements by Brazil in paragraphs 183 to 191 of its Submission concerning the trade-distorting and production effects of the direct payments programme, according to studies made by the US Department of Agriculture's own economists.

32. In other words, because the direct payments programme does have trade-distorting and production effects, it cannot be included among the domestic support measures exempted from reduction commitments.

*(ii) Interpretation of paragraph 6(b)*

33. The United States maintains that the Production Flexibility Contract Payments (PFC) and Direct Payments programmes are not tied in with production and, therefore, are not Green Box domestic support.

34. Argentina considers that the alleged "flexibility" of producers to plant different crops is in fact seriously restrictive. The amount of payments made depends on the type of production. Indeed, particular crops (fruits, vegetables, etc.) are excluded from these programmes. The effect of this is to channel production to the remaining crops, which do benefit from the programmes. This shows that the amount of the payments made is linked to the type of product sown, as Argentina pointed out in its Third Party Submission[16] and, therefore, the payments are not in conformity with AA Annex 2 paragraph 6(b).

(c) Article 10.2 of the Agreement on Agriculture does not exclude export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture and the Agreement on Subsidies.

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[14] *Ibid.*, paragraphs 64-68.

[15] Australia's Third Party Submission to the Panel, 15 July 2003, paragraph 31: "… *AA Annex 2.1 imposes a stringent standard. Annex 2.1 requires that such measures must, as a primary or essential condition, not "bias" or "unnaturally alter trade or production …*"; Third Party Submission of New Zealand, 15 July 2003, paragraph 1.08: " … *In New Zealand's view it is critical that the integrity of the disciplines on "Green Box" measures are not weakened or their legitimate purpose undermined through the inclusion of measures that fail to meet the strict requirements of Annex 2, including the fundamental criterion that such measures are non-trade or production distorting …*".

[16] Third Party Submission by Argentina, 15 July 2003, paragraphs 54-57.

35. The United States asserts that the text of Article 10.2 of the Agreement on Agriculture permits Members to continue export credit guarantee programmes unaffected by export subsidy disciplines,[17] since the text reflects the fact of that, during the Uruguay Round, Members came to no agreement on the substantive disciplines applicable. In other words, the United States contends that the actual text of Article 10.2 of the Agreement on Agriculture indicates that the export credit guarantee programmes are not subject in any way to the Agreement's export subsidy disciplines.[18]

36. In this regard, Argentina would point out that the fact that WTO Members are negotiating disciplines in order to implement Article 10.2 does not in any way support the US reading to the effect that Article 10.2 excludes export credit guarantees from the general disciplines on export subsidies.[19] A commitment "to work towards the development" of specific international disciplines on the granting export credits, export guarantees or insurance programmes is not the same as excluding them from the general disciplines on export subsidies. If that had been the intention, then the negotiators would have expressly said so.

37. Contrary to the US contention, Argentina does not find any indication of this type in the wording of Article 10.2. The fact that the negotiators did not include an express reference to the effect that export credit guarantees are not included in the definition of export subsidies or are not subject to the disciplines established in AA Articles 3.3, 8 or 10.1 means that such disciplines apply to export credit support measures.

38. In other words, in conformity with the wording of AA Article 10.2, export credit guarantees are not exempt from the general disciplines of the Agreement on Agriculture, and where the measures are not in conformity with that Agreement, from the disciplines of the Agreement on Subsidies.

39. This interpretation is reinforced by the immediate context and the object and purpose of AA Article 10.2. Paragraph 2 forms part of Article 10, which is entitled *"Prevention of Circumvention of Export Subsidy Commitments"*. Paragraph 1 of Article 10 establishes that export subsidies not listed in paragraph 1 of Article 9 *"… shall not be applied in a manner which results in … circumvention of export subsidy commitments …"*. This provision imposes disciplines on export credit guarantees, just as it imposes disciplines on the whole universe of export subsidies not covered by Article 9.1.

40. In turn, the object and purpose of AA Article 10 is to prevent any form of circumvention of export subsidy commitments.[20] Consequently, the US interpretation of Article 10.2 is completely at variance on the context of the provision and the object and purpose of AA Article 10, since it contributes to circumvention of the export subsidy commitment by excluding an entire category of export subsidies from the general disciplines.

41. Lastly, contrary to what the US maintains,[21] the fact that an export subsidy is not included in AA Article 9.1 does not mean that it is not an export subsidy, for Article 9.1 is not an exhaustive list,

[17] First Written Submission of the United States of America, paragraph 160.

[18] *Ibid.*, paragraph 164.

[19] Third Party Submission of Canada, 15 July 2003, paragraph 53: "*This provision (*Article 10.2) *sets out an intention on the part of Members to undertake further work regarding these measures – the simple fact of agreeing to do so, however, does not amount to a permission to use those measures to confer export subsidies without consequence and without limit. The US interpretation of Article 10.2 ignores the important context provided by Article 10.1. It also directly contradicts the stated object and purpose of Article 10 as a whole …"*. Similarly, in its Third Party Submission, New Zealand states: "*Nor does Article 10.2 in any way suggest that it provides an exception from the disciplines of Article 10.1…*", paragraph 3.15.

[20] Article 10.3 reverses the burden of proof in cases of export subsidies under the Agreement on Agriculture where exports are in excess of the reduction commitment level. Article 10.4 establishes disciplines on international food aid.

[21] First Written Submission of the United States of America, paragraphs 161-162.

as is evidenced by the wording of Article 10.1.[22] Nor does it mean that such an export subsidy is not subject to the export subsidy disciplines of the Agreement on Agriculture.

42. Argentina agrees with the European Committees[23] that Article 10.2 makes it clear export credit guarantees are not one of the types of export subsidy listed in Article 9.1 and, in that connection, Article 10.1 establishes that non-listed export subsidy must not be applied in a manner which results in circumvention of export subsidy commitments.

43. Hence, as the European Communities contend, wherever export credit guarantees are export subsidies not listed in Article 9.1, those guarantees could be applied in a manner which would result in circumvention of commitments and, therefore, would be prohibited under Article 10.1.

## III. CONCLUSION

44. In accordance with the foregoing, Argentina considers that the United States has mistakenly interpreted the provisions of the Peace Clause, in particular in Article 13(b)(ii), has failed to bear the burden of proving that the domestic support measures it granted to cotton during the 1999, 2000, 2001 and 2002 marketing years were not in excess of the support "decided during the 1992 marketing year".

45. Second, Argentina considers that the US interpretations regarding Annex 2 of the Agreement on Agriculture are mistaken and that, therefore, the Direct Payments and PFC programmes do not fall under the protection of Article 13(a) of the Agreement on Agriculture for Green Box measures.

46. Third, Argentina considers that the United States export credit guarantee schemes (GSM 102, 103 and SGCP) constitute export subsidies subject to the general export subsidy disciplines of the Agreement on Agriculture (Articles 3.3, 8 and 10.1) and the Agreement on Subsidies and Countervailing Measures (Article 3.1(a) and 3.2).

[22] Third Party Submission of Canada, 15 July 2003, paragraph 32; *"Article 9 of the Agriculture Agreement lists and describes certain export subsidies that are subject to reduction commitments. All other export subsidies fall within the scope of Article 10-1…*".

[23] First Third Party Submission by the European Communities, 15 July 2003, Section V.

# ANNEX C-6

## ORAL STATEMENT BY AUSTRALIA

24 July 2003

Mr Chairman, Members of the Panel,

1. I appreciate this further opportunity to present Australia's views on matters at issue in this dispute.

2. In this statement, I will provide some elaboration of Australia's views on the meaning of Article 13(b)(ii) of the *Agreement on Agriculture*. I will also address some of the matters raised in the First Written Submission of the United States and in the First Third Party Submission of the European Communities.

Mr Chairman, Members of the Panel,

3. I will begin with matters relating to the meaning of Article 13(b)(ii) of the *Agreement on Agriculture*.

4. As Australia noted in its Written Submission[1], the word "decided" appears twice in the operative provisions of the *Agreement on Agriculture* – in subparagraphs (ii) and (iii) of Article 13(b). Further, the immediate context for the word "decided" is exactly the same in each case: "provided that such measures do not grant support to a specific commodity in excess of that *decided* during the 1992 marketing year". Yet Article 13(b)(iii) deals with a completely different type of action: one based on non-violation or impairment under GATT Article XXIII:1(b).

5. Thus, Australia believes that it will be necessary for the Panel to consider two key threshold questions.

6. Firstly, is the meaning of the phrase "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" the same in each of Article 13(b)(ii) and (iii)?

7. Australia recalls that the phrase, as well as draft text for what became Article 13, first appeared in the "Blair House Accord". Also included in the Accord were provisions concerning the *EEC – Oilseeds* dispute.[2]

8. In Australia's view, that dispute is crucially relevant to the interpretation of Article 13(b)(ii) and (iii).

9. Australia recalls that it clearly understood in the resumed Uruguay Round agriculture negotiations in 1993 that the words "decided during the 1992 marketing year" had been chosen to

[1] Third Party Submission of Australia, paragraph 26.

[2] *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins ("EEC – Oilseeds")*, Report of the Panel, adopted 25 January 1990, BISD 37S/86, and *Follow-Up on the Panel Report "European Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, DS28/R, BISD 39S/91.

incorporate into the text of Article 13(b)(ii) and (iii) the sense of expectations of "conditions of price competition" as this had been interpreted and applied in the *EEC – Oilseeds* dispute.

10. The panel in *EEC – Oilseeds* described the purpose of GATT Article XXIII:1(b) in the following terms:

> … The panel noted that these provisions, as conceived by the drafters and applied by the contracting parties, serve mainly to protect the value of tariff concessions.[…] The idea underlying them is that the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. …[3]

11. That Panel went on to say:

> … The Panel considered that the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset. …[4]

12. In any case, having regard to the customary principles of interpretation, Australia considers that the phrase "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" must have the same meaning in both Article 13(b)(ii) and (iii).

13. Thus, there is a second threshold question that the Panel needs to consider. That question is: could conditions of price competition for the purposes of a non-violation nullification or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole.

Mr Chairman, Members of the Panel,

14. I would now like to comment on some matters raised in the First Written Submission of the United States.

15. Firstly, Australia disagrees with the United States' approach to interpreting the "peace clause" and the meaning of "exempt from action based on".[5]

16. If the United States' interpretation is correct and the WTO Agreement negotiators intended the interpretation offered by the United States, surely the negotiators would have included provisions clarifying how such situations should be resolved? At the very least, surely Article 13 of the *Agreement on Agriculture* would have been listed in the Special or Additional Rules and Procedures Contained in the Covered Agreements at Appendix 2 to the *Dispute Settlement Understanding*? Yet the negotiators did neither of these things.

17. The United States argues as well that its interpretation is supported by the fact that the peace clause applies "[n]otwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and

[3] *EEC – Oilseeds*, paragraph 144.
[4] *EEC – Oilseeds*, paragraph 148.
[5] First Written Submission of the United States, paragraph 33.

Countervailing Measures".[6] However, the United States ignores that, for its argument to be valid, the peace clause would also have to apply "notwithstanding the provisions of the *Dispute Settlement Understanding*".

18. The United States argues too that Brazil is in error by asserting that the peace clause itself "provides no positive obligations".[7] In Australia's view, however, this argument confuses obligations and conditions: the United States is equating a binding requirement to act in a certain way with a prerequisite for the availability of a right or privilege. Article 13 of the *Agreement on Agriculture* does not of itself establish any binding requirements with which WTO Members are required to comply.

19. That confusion between rights and obligations continues when the United States argues that "Brazil's approach would produce bizarre results".[8] Indeed, the United States' arguments could be considered to confirm the nature of Article 13 as an affirmative defence. Had Brazil alleged a breach of the United States' obligations under Article 6, Brazil would have had the initial burden of making a *prima facie* case of inconsistency. Article 13, however, is a right or privilege available to the United States, provided that its measures fully conform to the relevant conditions. Thus, it is for the United States to demonstrate that it is entitled to invoke that right or privilege.

20. Secondly, the United States argues that "support to a specific commodity" is equivalent to "product-specific support".[9]

21. The United States asserts that the definition of Aggregate Measurement of Support – or AMS – at Article 1(a), and Article 6 concerning Domestic Support Commitments, provide relevant context. The United States asserts that because the calculation of AMS, and exemptions from Current Total AMS, differentiate between product specific and non-product specific domestic support, "support" in the context of Article 13(b)(ii) and (iii) means product-specific AMS.

22. Australia does not agree. AMS is defined by Article 1(a) to mean "the annual level of support … provided for an agricultural product in favour of the producers of the basic agricultural product". However, Article 13(b)(ii) and (iii) refer to "support to a specific commodity".

23. Had the negotiators intended that "support to a specific commodity" in the context of Article 13(b)(ii) and (iii) mean product-specific AMS only, they would have said so in the text. They did not. Further, the United States' argument ignores that a Member's reduction commitments include both product specific and non-product specific domestic support measures unless they are exempt from inclusion.

24. Thus, in Australia's view, "support to a specific commodity" means: all non-"green box" support that benefits a specific commodity, whether that support be through product specific, or non-product specific, programmes. Indeed, Australia believes that "support to a specific commodity" in the context of Article 13(b)(ii) and (iii) can include forms of support additional to those captured in an AMS calculation.

25. It follows, of course, that Australia considers – in the context of this dispute – that the portions of the direct payment and counter-cyclical payment programmes that benefit upland cotton should be included in the calculation of "support to a specific commodity" within the meaning of Article 13(b)(ii). Moreover, Australia notes that the counter-cyclical payment programme provides a

[6] First Written Submission of the United States, paragraph 39.
[7] First Written Submission of the United States, Paragraph 43.
[8] First Written Submission of the United States, paragraph 44.
[9] First Written Submission of the United States, paragraph 78.

target price of 72.4 cents per pound for upland cotton,[10] and that entitlements to "Step 2" payments and some other domestic support programmes are additional to the target price, as they were to the 1992 target price of 72.9 cents per pound.

26. Thirdly, the United States argues that direct payments under the 2002 Farm Act meet the criteria of Annex 2 Decoupled Income Support payments. Australia has already addressed the issue of planting restrictions on fruit and vegetables and wild rice in its Written Submission.

27. The United States argues that "eligibility for direct payments is defined by clearly defined criteria … in a defined and fixed base period" and that "payment yields and base acres are defined in the 2002 Act and fixed for the duration of the legislation".[11] The United States' interpretation means that a WTO Member could re-define and re-fix a base period every time it introduced new domestic support legislation. This cannot be a correct interpretation of the provisions of paragraph 6 of Annex 2 to the *Agreement on Agriculture*.

28. Fourthly, the United States argues that "a Member may choose to provide 'amber box' support in any … manner so long as that Member's Current Total AMS does not exceed … *[its]* commitment level".[12]

29. Australia disagrees. The United States' argument ignores that Article 13(b)(ii) does not exempt non-"green box" domestic support measures from actions based on Article 3 of the *SCM Agreement*. It also ignores the provisions of Article 21.1 of the *Agreement on Agriculture*. In an analogous situation in the *EC – Bananas* dispute, the Appellate Body said: "… the provisions of the GATT 1994 … apply … except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter".[13] The Appellate Body went on to say in that dispute:

> … [T]he negotiators of the *Agreement on Agriculture* did not hesitate to specify … limitations elsewhere in that agreement; had they intended to do so with respect to Article XIII of the GATT 1994, they could, and presumably would, have done so. …[14]

30. The Appellate Body's statement is equally applicable in the context of this dispute. Had the negotiators of the *Agreement on Agriculture* intended that non-"green box" domestic support measures be "exempt from actions based on" Article 3 of the *SCM Agreement*, they would have said so. The negotiators did expressly exempt export subsidies from actions based on SCM Article 3 to the extent that such export subsidies conformed fully to the provisions of Part V of the *Agreement on Agriculture*. In Australia's view, therefore, the omission from Article 13(b)(ii) of the *Agreement on Agriculture* of an express exemption from actions based on SCM Article 3 for local content subsidies has meaning.

31. Fifthly, the United States has requested that the Panel issue a preliminary ruling that Production Flexibility Contract and Market Loss Assistance payments are not within the Panel's terms of reference because these programmes have expired. The fact that a measure has expired cannot be sufficient to remove it from the Panel's purview. If the Panel were to grant the United States' request solely on that basis, it would mean that any Member could authorise WTO-inconsistent domestic support programmes through short-lived measures and avoid the consequences of such actions.

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[10] Section 1104, 2002 FSRI Act, Exhibit Bra-29.

[11] First Written Submission of the United States, paragraph 67.

[12] First Written Submission of the United States, paragraph 144.

[13] *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R, paragraph 155.

[14] *EC – Bananas*, paragraph 157.

Mr Chairman, Members of the Panel,

32. The final matter on which I will comment today concerns the Third Party Submission of the European Communities and its arguments in relation to the interpretation of the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture*. The European Communities argues that the first sentence "simply signals the objective of Annex 2" and does not set out an independent obligation.[15]

33. That argument ignores the plain meaning of the text and renders the first sentence of paragraph 1 inutile, which of course a treaty interpreter may not do. If an exemption from reduction commitments is being claimed for any domestic support measures, the first sentence says they "shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production". As explained in Australia's written submission,[16] a fundamental requirement is a primary or essential condition. To interpret a "fundamental requirement" other than as a separate and independent obligation would be contrary to the plain meaning of the words and thus to the normal rules of treaty interpretation. The use of the words "shall meet" establishes an express obligation to comply with the specified condition that such measures not, or only minimally, bias or unnaturally alter trade or production.[17]

34. The European Communities argues that the word "accordingly" at the beginning of the second sentence of paragraph 1 links the 'fundamental requirement' in the first sentence with the 'basic criteria' in the second sentence" and thus makes clear that the fundamental requirement is complied with if the basic criteria in the second sentence and the policy-specific criteria set out in paragraphs 2 to 13 are met.[18]

35. However, the meanings for "accordingly" cited by the European Communities – "in accordance with the logical premises" and "correspondingly" – do not compel the interpretation it has offered. Moreover, there are other, equally valid meanings of the word "accordingly", provided by the same dictionary, such as "harmoniously" and "agreeably".[19]

36. It is possible to interpret the whole of paragraph 1 to Annex 2 so as to give effect to all of its provisions:

- domestic support measures for which exemption from the reduction commitments is claimed shall not, or shall only minimally, distort trade or production; and

- to the extent that measures of the type described in paragraphs 2 to 13 of the Annex are consistent and harmonious with that fundamental requirement and conform to the basic and policy-specific criteria as set out in the second sentence, they are exempt from reduction commitments.

37. Thus, notwithstanding that they may meet the basic and policy-specific criteria set out in paragraphs 1 and 6 of the Annex, a Member may not claim Decoupled Income Support payments as "green box" where those payments do not meet the fundamental requirement that they shall not, or shall only minimally, distort trade or production. Such could be the case, for example, where the level of Decoupled Income Support payments are sufficient to affect directly producer decisions concerning the allocation of economic resources to production of a particular commodity.

[15] First Third Party Submission by the European Communities, paragraph 15.
[16] Australia's Third Party Submission to the Panel, paragraph 31.
[17] Australia's Third Party Submission to the Panel, paragraphs 31-32.
[18] First Third Party Submission by the European Communities, paragraph 20.
[19] *The New Shorter Oxford English Dictionary*, Volume I, Ed. Lesley Brown, Clarendon Press, Oxford, 1993, page 15.

Mr Chairman, Members of the Panel,

38. Should you have questions on any matters concerning Australia's Written Submission and Oral Statement, I would be pleased to take these on notice and arrange for written answers to be provided.

Thank you, Mr Chairman, Members of the Panel.

# ANNEX C-7

## THIRD PARTY ORAL STATEMENT OF BENIN

24 July 2003

Mr. Chairman, members of the Panel,

It is my honour to represent Benin at this Third Party session today. The other two members of our delegation are Mr. Eloi Laourou of the Permanent Mission of Benin, and Mr. Brendan McGivern of White & Case, our legal adviser.

Although Benin acceded to the WTO back in 1996, this marks our first entry into WTO dispute settlement. We have been led to take this unprecedented step by the magnitude of the threat posed by US cotton subsidies, and the highly damaging effect that such subsidies have on the exports and economy of our country.

In our third party submission, we sought to provide to the Panel, at the earliest possible stage, information on the impact of the WTO-inconsistent US subsidies on Benin. In our view, this provides essential additional context to the issues facing the panel.

I do not intend to repeat what was in our submission, but it is worth highlighting some key facts.

The importance of the cotton sector to Benin can hardly be overstated. As noted in our submission, it accounts for 90 per cent of our agricultural exports, and three-quarters of our export earnings over the past four years. It generates 25 per cent of national revenues. In total, about a million people in Benin – out of a total population of six million – depend on cotton or cotton-related activities. Cotton plays a particularly important role in rural areas, where national poverty reaches its highest levels.

Mr. Chairman, Members of the Panel: the results of US cotton subsidies are readily apparent in West Africa. The United States provides huge, and WTO-inconsistent, subsidies for cotton. This leads to an oversupply of cotton on the world market, and a consequent decline in prices. Moreover, when cotton from Benin enters world markets, it must compete against massively-subsidized US cotton.

The dollar value of these subsidies dwarfs all other economy activity in Benin. As indicated in our submission, the subsidies paid by the United States to its 25,000 cotton farmers exceed the entire gross national income of Benin – and indeed the other countries in the region as well.

This demonstrates, rather dramatically, the impossibility of Benin ever competing with such subsidies. It is inconceivable that any developing country – let alone a least-developed country in West Africa – could ever match the virtually limitless resources of the United States.

Therefore, for us, the solution to this problem lies in the WTO. We ask simply that the United States respect its WTO obligations regarding subsidies.

Mr. Chairman, we agree with Brazil that the United States cannot invoke the peace clause to bar the claims that have been advanced in this dispute. We agree that the peace clause constitutes an

affirmative defence, and that the burden lies on the United States to demonstrate that has met all the conditions for the successful invocation of this affirmative defence. This it has failed to do.

In any event, whether the peace clause constitutes an affirmative defence, as we believe, or is part of the "balance of rights and obligations of Members", as the United States argues, the result is the same. Brazil's First Submission has established, clearly and unambiguously, that the United States is in breach of its WTO obligations. The US First Submission has provided no convincing rebuttal of Brazil's claims.

Mr. Chairman, Members of the Panel:

In its submission of July 11, the United States argued that the phrase "support to a specific commodity" should be understood to mean "product-specific support". However, the term "product-specific" does not appear in Article 13(b)(ii). If the drafters of the Agreement on Agriculture had wanted to use this term in Article 13(b)(ii), they obviously could have done so, as they did elsewhere in Agreement, such as in Article 6(4), or in Annex 3. Moreover, if the US interpretation were accepted, measures providing support to more than one commodity could not be challenged under Article 13(b)(ii). This elevates form over substance, and is contrary to both the language and the object and purpose of this provision.

Finally, the United States asks this Panel to exclude from its terms of reference certain measures that it argues were not the subject of consultations. We were not part of the consultations, and will not delve into the facts of this disagreement. However, Benin would recall the statement of the Appellate Body in *Brazil Aircraft* (DS46):

> "We do not believe….that Articles 4 and 6 of the DSU, or paragraphs 1 to 4 of the SCM Agreement, require a <u>precise and exact identity</u> between the specific measures that were the subject of consultations and the specific measures identified in the request for the establishment of a panel. As stated by the Panel, '[o]ne purpose of consultations, as set forth in Article 4.3 of the SCM Agreement, is to 'clarify the facts of the situation', and it can be expected that information obtained during the course of consultations may enable the complainant to focus the scope of the matter with respect to which it seeks establishment of a panel." [emphasis added]

Indeed, Benin notes that the United States itself took a similar approach in the recent *Japan – Apples* case. In the US replies to the Panel on October 16, 2002, USTR stated that:

> "[T]here is no requirement in the DSU to consult on a particular claim in order to include that claim in a panel request and to have such a claim form part of the panel's terms of reference. The purpose of consultations is to provide a better understanding of the facts and circumstances of a dispute; logically, then, a party may identify new claims in the course of consultations."

Although this US reply dealt with claims rather than measures, it is consistent with the ruling of the Appellate Body in *Brazil Aircraft* that panels should not require a "precise and exact identity" between the measures that were the subject of consultations and the measures identified in the panel request.

Mr. Chairman, Members of the Panel:

For Benin, this dispute is of critical national importance. As we stated in our Third Party submission, we are not seeking any special and differential treatment in the present case. We are simply asking that the United States abide by the disciplines that it agreed to at the end of the Uruguay Round.

Thank you for allowing Benin to present its views to the Panel. We would be pleased to reply to any questions you may have.

# ANNEX C-8

## THIRD PARTY ORAL STATEMENT OF CANADA

24 July 2003

### I. INTRODUCTION

1. Mr. Chairman, members of the Panel, on behalf of my Government, I thank you for your consideration of Canada's views in this dispute.

2. Canada's statement today conveys our systemic interest in the interpretation of certain provisions of the Agriculture Agreement and the SCM Agreement regarding certain aspects of Brazil's claims. The first two points we address relate to US domestic support measures and the applicability of the Peace Clause. In this respect, we set out why:

- first, the updating of the base period for US direct payments renders these payments inconsistent with paragraphs 6(a) and (b) of Annex 2 of the Agriculture Agreement; and

- second, US counter-cyclical payments to producers of upland cotton must be counted as "support to a specific commodity" under Article 13(b)(ii) of the Agriculture Agreement.

3. The last point we address is whether there is any exemption for US export credit guarantee programmes from US export subsidy commitments under the Agriculture Agreement. Here, we set out why:

- first, item (j) of the SCM Agreement may not be interpreted a contrario to deem export credit guarantee practices as not providing export subsidies under Article 10.1 of the Agriculture Agreement; and

- second, Article 10.2 of the Agriculture Agreement does not exempt export subsidies granted under export credit guarantee programmes from US export subsidy commitments in the Agriculture Agreement.

### II. US DOMESTIC AGRICULTURAL SUPPORT MEASURES

#### A. TO BE EXEMPT UNDER ANNEX 2, DIRECT PAYMENTS MUST HAVE THE SAME BASE PERIOD AS PFC PAYMENTS

4. We turn first to US direct payments. The United States defends these measures by asserting, among other things, that the 2002 FSRI Act redefines and fixes the base period for the duration of the legislation.[1] According to the United States, direct payments therefore fully conform to Annex 2 of the Agriculture Agreement.

5. This, in Canada's view, raises form over substance. In addition to the views we provided in our written third party submission, Canada observes that US direct payments also do not conform to the base period requirement in paragraphs 6(a) and (b) of Annex 2. The structure of the PFC payment

[1] US First Written Submission, para. 67.

and direct payment programmes are essentially the same[2], so are the payment parameters.[3] The applicable base period therefore is that for PFC payments. However, the United States allows base acreage determining the receipt and the amount of direct payments to be updated.[4] The base period is therefore not "fixed", contrary to subparagraph (a). The amount of the payments may also be increased based on the volume of production undertaken by a producer in a year after the applicable base period, contrary to subparagraph (b).

6. The United States itself demonstrates the linkage between PFC payments and direct payments; they are closely related and successor programmes.[5] Yet, the United States takes the position that because the payments are continued under a separate piece of legislation and new regulations, an updating of the base period does not affect their exempt status.[6] In Canada's view, such formalistic arguments cannot prevail.

B. COUNTER-CYCLICAL PAYMENTS ARE "SUPPORT TO A SPECIFIC COMMODITY"

7. Mr. Chairman and members of the Panel, the formalism of US arguments does not stop there. In an effort to avoid the logical conclusion that counter-cyclical payments "grant support to a specific commodity" within the meaning of Article 13 of the Agriculture Agreement, the United States cites varied meanings of the term "specific" and inappropriately incorporates into Article 13 concepts relating to the calculation of the AMS. These arguments are an attempt to detract from the plain text of Article 13 and its straight-forward application to the facts of this case.

8. In Canada's view, counter-cyclical payments "grant support to a specific commodity" under Article 13(b)(ii) of the Agriculture Agreement.[7] It is hard to see how a measure that grants support that is specific to a "specific commodity" would not be included in the assessment under Article 13(b). It is uncontested that the US measure provides payments in an amount determined by target prices that are specific to certain covered products.[8] The setting of commodity-specific target prices necessarily leads to different levels of support for different products. The cotton-specific support granted in this respect must be taken into account for the purposes of Article 13(b).

## III. US EXPORT CREDIT GUARANTEE PROGRAMMES

9. I now turn to US export credit guarantee programmes.

10. In Canada's written third party submission we set out the applicable standard for determining whether transactions under these programmes are subsidized within the meaning of Articles 1(e) and 10.1 of the Agriculture Agreement. Canada takes no position on the facts in this respect, but notes that USDA's own description of its guarantee programmes implies that a benefit is conferred. I quote: "The programmes encourage exports to buyers in countries where credit is necessary to maintain or increase US sales, but where financing may not be available without CCC guarantees."[9] The Panel should assess CCC premiums in the light of this admitted reality.

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[2] See Brazil First Written Submission, para. 182; Third Party Submission of New Zealand, para. 2.26; Third Party Submission of Australia, paras. 47-48.

[3] US First Written Submission, paras. 58-63.

[4] US First Written Submission, para. 59.

[5] US First Written Submission, fn. 47.

[6] US First Written Submission, para. 67.

[7] See also Exhibit Br-27 ("Title I - *Commodity Programmes*"; "Counter-cyclical payments *for* wheat, feed grains, upland cotton, rice, and oilseeds" (emphasis added)).

[8] See US First Written Submission, para. 117.

[9] USDA, "Export Credit Guarantee Programmes", FAS Online at http://www.fas.usda.gov/excredits/exp-cred-guar.html, (second sentence) [Exhibit CDA-3].

11. Today, Canada addresses the two exemptions alleged by the United States in support of its assertion that the US programmes do not grant export subsidies in violation of US export subsidy commitments under Articles 8 and 10.1 the Agriculture Agreement. The claimed exemptions are the following:

- First, item (j) of the SCM Agreement sanctions any US export subsidy provided through CCC-guaranteed credit transactions because the programmes come within the scope of item (j) yet do not meet the standard it establishes. According to the United States, item (j) may be interpreted a contrario to allow subsidized export credit transactions. It follows for the United States that its programmes do not confer export subsidies within the meaning of Article 3.1(a) of the SCM Agreement and Article 1(e) of the Agriculture Agreement;

- Second, Article 10.2 of the Agriculture Agreement exempts outright any subsidized export credit transactions from US export subsidy commitments.

12. The panel in Brazil – Aircraft considered the first type of alleged exemption at length in its first implementation report. The United States was a third party in that case, and argued for an a contrario interpretation of the first paragraph of item (k) of the Illustrative List.[10] The panel rejected all arguments in this respect and concluded that the provision could not be used to establish that a prohibited export subsidy under the SCM Agreement is otherwise permitted.

13. The panel's reasoning in that case applies with equal force here. Briefly, the panel found that:

- First, Annex I is purely "illustrative" and does not purport to exhaustively list all export subsidy practices[11],

- Second, a measure that falls within the scope of Annex I is deemed to be a prohibited export subsidy such that where a Member demonstrates that the measure meets the standard in any of the listed items, it does not also have to demonstrate that the measure comes within the scope of Articles 1 and 3.1(a) of the SCM Agreement[12], and

- Third, footnote 5 of the SCM Agreement provides that practices described in Annex I may be properly considered not to constitute an export subsidy only in two situations. The first situation is where an affirmative statement in the Agreement provides that the measure in question is not an export subsidy; the second is where an affirmative statement in the Agreement provides that measures satisfying the conditions of an item in Annex I are not prohibited.[13] Footnote 5 reads "Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement".

14. In its second implementation report in Brazil – Aircraft, the panel applied the same reasoning.[14] Applying this reasoning to the case at hand, footnote 5 to the SCM Agreement precludes reliance on an a contrario interpretation of item (j) as an implied exclusion to any finding of subsidized transactions under the US programmes.

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[10] *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, adopted 4 August 2000, paras. 6.24-6.67 [*Brazil – Aircraft, First Recourse*].

[11] *Ibid.*, para. 6.30.

[12] *Ibid.*, para. 6.31.

[13] *Ibid.*, paras. 6.37.

[14] *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW2, adopted 23 August 2001 at paras. 5.274 and 5.275.

15. Regarding Article 10.2 of the Agriculture Agreement, Canada's view is that the words of that provision speak for themselves. Members have undertaken to work towards internationally agreed disciplines to govern the provision of export credit guarantees. Nothing in that provision states that the export subsidy obligations in Article 10.1 of the Agreement do not apply to US export credit guarantee practices. Where Members have wanted to exempt measures from export subsidy obligations, they have been clear– such as in the second paragraph of item (k) of the SCM Agreement.[15]

16. In addition, the US interpretation of this provision does not accord with its object and purpose. Canada shares the views of other third party participants in this dispute that the ongoing work under Article 10.2 is expected to further elaborate on current disciplines regarding export credit practices and to perhaps more clearly identify when such practices shall or shall not be deemed to confer export subsidies within the meaning of Article 1(e) of the Agriculture Agreement.[16] The obvious precedent in this respect is the second paragraph of item (k) of the SCM Agreement.

## IV. CONCLUSION

17. In conclusion, Mr. Chairman and members of the Panel, the Panel should find that the United States rendered direct payments inconsistent with Annex 2 of the Agriculture Agreement by allowing the base period to be updated. This finding would be in addition to a finding that PFC payments and direct payments do not conform to Annex 2 because the amount of the payment is linked to the type of production after the base period. Regarding counter-cyclical payments, the Panel should find that this support to US producers of upland cotton must be counted as "support to a specific commodity" under Article 13(b)(ii) of the Agreement. Finally, regarding US export credit guarantee programmes, the Panel should confirm that neither the Agriculture Agreement nor the SCM Agreement contain an exemption for any US export credit guarantee subsidy found in this case. Were the Panel to find that such subsidies exist – which in Canada's view is the most likely outcome to the Panel's assessment of the facts – then the Panel must conclude that the United States grants export subsidies in violation of its export subsidy commitments under Articles 8 and 10.1 the Agriculture Agreement and that Article 13(c)(ii) therefore does not apply.

[15] See also *Brazil – Aircraft, First Recourse*, para. 6.36.

[16] See First Third Party Submission by the European Communities, para. 30 and Third Party Submission of New Zealand, paras. 3.15-3.16.

# ANNEX C-9

## ORAL STATEMENT OF CHINA AT THE THIRD PARTY SESSION

24 July 2003

1. Thank you, Mr. Chairman, and members of the Panel. China is appreciative of this opportunity to present its views on the issues raised in this Panel proceeding. In its third party written submission of 15 July, China explained its views in relation to three issues. In this statement, I will summarize China's major points.

2. The first issue that China would like to have this Panel's attention is about the burden of proof issue under the Peace Clause.

3. China agrees with Brazil's argument that the Peace Clause is an affirmative defence in nature. If the United States claims that defence, the burden of proof is on the United States.

4. Contrary to what the United States see, China believes that the Peace Clause does not impose positive obligations. Stand-alone, Annex 2 and Article 6 of the *Agreement on Agriculture* may have positive obligations; but when they are cross-referred to by the Peace Clause, they become part and parcel of conditions that must be met before a Member can move under its safety.

5. China believes the US errs on seeing no distinction between "obligation" and "condition". The Peace Clause requirement for full conformity with Article 6 and Annex 2 does not create new obligations because Members have to comply with Article 6 and Annex 2 whether Article 13 exists or not. Within the Peace Clause, these requirements do not stand to impose obligations on Members, but to set conditions precedent for a Members intending to invoke Peace Clause protection. Positive obligations to comply with these requirements, if there is any, lie under where they are, i.e. under Article 6 and Annex 2, but not under the Peace Clause.

6. China does not see any "absurdity" as described by the United States in its written submission. No such "absurdity" would be instilled into the process if at the first stage, the party alleging protection of Peace Clause for its measures is required to discharge its burden to prove that such measures do conform to the relevant Peace Clause conditions; if it cannot so prove, the measures would lose Peace Clause protection. A second stage will follow for the party claiming against the measures to establish its substantive case, without the Peace Clause shield.

7. With respect, China submits that the burden of proof issue must be resolved first. China also hopes that the above two-step approach will help this Panel and the parties to move the procedures on towards resolution of the case.

8. The second point that China made in its written submission relates to proper categorization of US Direct Payments (shortened as "DP") under the US Fair Security and Rural Investment Act of 2002 (shortened as "FSRI"). Allow me to shorten that act to FSRI. Without repeating the issue of burden of proof, preponderance of evidence suggests that such Direct Payments are not "Green Box" in nature.

9. One of the requirements for "Green Box" Direct Payment support measures lies under Para. 6(a) of Annex 2 to the *Agreement on Agriculture*. The paragraph provides to the effect that eligibility shall be determined by "clearly-defined criteria" "in a defined and fixed base period".

10. The word "in" requires a link between the "criteria" and the "defined and fixed base period". In other words, to qualify for "Green Box" direct payment measure under Para. 6(a), a criterion adopted by a Member must be tied, in a chronological sense, to a starting time frame that cannot be moved up on the calendar.

11. As the United States has explained, 2002 FSRI DP allowed landowners to retain PFC base acreage under the 1996 Federal Agriculture Improvement and Reform Act (shortened as "FAIR") and "add 1998-2001 acres of eligible oilseeds or simply declare base acreage for all covered commodities" (including upland cotton). In addition, while a landowner may elect to simply utilize acres devoted to covered commodities during the 1998-2001 period for purpose of DP, a landowner need not do so; base acres may remain those under FAIR of 1996, implying no cotton production need have occurred since the 1993-1995 period for a landowner to have "cotton base acres" Consideration the progression from PFC to DP, one can see that contrary to the US argument that "base acres are defined in the 2002 [FSRI] Act and fixed for the duration of the legislation", the requisite link between the programme acreage as a criterion and the starting time frame under the DP is broken. The change of legislation from FAIR to FSRI and the replacement of PFC with DP were utilized to for producers to leap from their previous coverage acreage, which should have been tied to the base period, to a new updated acreage in 2002.

12. Therefore, in China's opinion, preponderance of evidence proves that the US direct payments under the FSRI shall be properly categorized as non-"Green Box" measures.

13. The last issue that China considers important is about export subsidy support granted by US "Foreign Sales Corporations" for upland cotton export sales under the "FSC Repeal and Extraterritorial Income Act of 2000". Its short name is ETI Act.

14. The ETI Act has previously been found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by both the panel and the Appellate Body in *US – FSC (21.5)* case. On 29 January 2002, the DSB adopted the panel and Appellate Body reports. Following US failure to withdraw such export subsidy support, on 7 May 2003, the DSB authorized the EC to impose countermeasures against the US.

15. China believes that the panel and the Appellate Body's reasoning and their conclusion in *US – FSC (21.5)* should be considered and taken by this Panel.

16. The measures challenged by Brazil in the current proceeding are exactly the same challenged by the EC in *US – FSC (21.5)*. Reasoning and conclusion by the earlier panel and the Appellate Body are more than relevant to the current case. Their reports, once adopted by DSB not only create legitimate expectations, but also reflect the collective will of the WTO membership.

17. In that respect, allow me to quote the panel in *India – Patent Protection for Pharmaceutical and* Agricultural *Chemical Products*, for this Panel:

> [I]n the course of "normal dispute settlement procedures" required under Article 10.4 of the DSU, we *will take into account the conclusions and reasoning* in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we *should give significant weight to both Article 3.2 of the DSU*, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, *and to the need to avoid inconsistent rulings* (which

concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the DSU.

18. This concludes my oral presentation. China welcomes questions from the Panel regarding these issues.

# ANNEX C-10

## ORAL STATEMENT BY THE EUROPEAN COMMUNITIES

24 July 2003

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## I. INTRODUCTION

1. Mr. Chairman, Distinguished Members of the Panel, the European Communities is grateful for the opportunity to express its views in this third party session.

2. We would first like to welcome the involvement of Benin in this procedure. The European Communities is of the view that the involvement of least developed countries in dispute settlement is highly desirable. We hope that other least developed countries follow Benin's lead.[1]

3. This is a complex case which raises many difficult and important interpretative issues. Those responsible for drafting Article 13 of the *Agreement on Agriculture* have left you with some difficult questions. Despite those difficulties, Article 13 in particular, and the *Agreement on Agriculture* more generally, represent a finely balanced and much fought over package of rights and obligations assumed by WTO Members. The European Communities is confident that this Panel will undertake a careful examination of these very precise terms and preserve the delicate balance of rights and obligations which has been negotiated.

4. This dispute raises a large number of issues. In our interventions, we have concentrated on those issues of principle which we consider are of systemic concern. Today, we will largely address issues which were not addressed in our written submission. At the same time, we also consider it necessary to revisit some issues which we have already addressed in order to rebut some of the arguments raised by other parties.

5. The European Communities starts by setting out its conception of the role of the peace clause (section II). We will then address several questions of interpretation relating to the peace clause (section III). We then turn to consider the interpretation of Annex 2 of the *Agreement on Agriculture* (the Green Box) (Section IV) before considering the status of domestic content subsidies and export credits under the *Agreement on Agriculture* (Section V). We conclude with some comments on one of the requests for preliminary rulings raised by the United States (Section VI).

## II. THE ROLE OF THE PEACE CLAUSE

6. We turn first to consider the role of the Peace Clause (Article 13).

7. The European Communities views Article 13 as one element regulating the interface between the *Agreement on Agriculture* and the *SCM Agreement*. It defines, in some cases, how subsidies granted pursuant to the *Agreement on Agriculture* should be treated for the purposes of countervailing duty investigations, and in other cases exempts such subsidies from actions under the *SCM Agreement*. The European Communities disagrees with both Brazil and the United States as to how the term "exempt from action" should be understood. However, while we disagree with the United States' logic, we do not disagree with the practical result of the application of its logic.

8. The term "exempt from action" cannot mean, as Brazil claims, that, even if the peace clause is applicable, the Panel must examine Brazil's claims under the *SCM Agreement*, and that if the Panel finds that the United States has acted inconsistently with the *SCM Agreement*, the DSB should somehow "refrain" from recommending the United States to bring itself into conformity with the *SCM Agreement*. The European Communities finds it difficult to imagine how the DSB, operating under the negative consensus rule, could refrain from recommending the United States bring itself into conformity should the Panel find that the United States had acted inconsistently with the *SCM Agreement*. Moreover, the United States can reasonably argue that it is not required to bring itself

[1] This text was not in the written statement circulated at the third party session, but reflects unscripted comments made during that session.

into conformity with the *SCM Agreement* by withdrawing measures which it is perfectly entitled to maintain under the *Agreement on Agriculture*, pursuant to both Article 13 and Article 21. The only answer to this question is that if the United States is entitled to peace clause protection, the Panel cannot find in favour of Brazil's *SCM Agreement* claims.

9. The European Communities does not agree with the United States that Article 13 prevents a Member from requesting consultations or the establishment of a panel with respect to a measure which might be entitled to Article 13 protection. It is not, as the US argues, the mere fact that the defendant Member is unable to block a request for consultations, or for establishment of a panel, that the applicability of the peace clause has come before this Panel. The need for the Panel to adjudicate this issue flows from the fundamental principle underlying the WTO Agreement that every question of interpretation of the WTO Agreements which "affects the operation of any covered agreement" must be subject to the DSU.[2] However, as we have noted, if the Panel determines that the US measures in question are protected by Article 13, it cannot find in favour of Brazil's claims under the *SCM Agreement*.

## III. INTERPRETATION OF THE PEACE CLAUSE

10. The Panel has a number of challenging questions before it on the interpretation of various aspects of Article 13(b). The European Communities turns now to set out its position on some of the issues before the Panel.

### A ARTICLE 13 IS NOT AN AFFIRMATIVE DEFENCE

11. The European Communities will only briefly touch upon the issue of the burden of proof for Article 13. The European Communities has yet to hear a credible response to the argument that putting the burden of proof on the defendant has perverse effects. As the European Communities and the United States have pointed out, when a complainant brings a case only under the *Agreement on Agriculture* (for instance alleging breach of Article 6) it will bear the burden of proof. However, if Article 13 is considered an affirmative defence, when a complainant brings a dispute under Articles 5 and 6 of the *SCM Agreement* and, for instance, Article 6 of the *Agreement on Agriculture*, the complainant would be required to prove a breach of Article 6 while at the same time the defendant would also be required to prove that it had not infringed Article 6 of the Agreement. The burden of proof cannot switch between parties simply on the basis of whether the complainant cites the *SCM Agreement* or not, but this would be the result of interpreting Article 13 as an affirmative defence.

12. Further confirmation that Article 13 is not an affirmative defence can be drawn from the fact that Article 13 also regulates the application of countervailing duties on agricultural subsidies. In this context, a determination that the subsidy in question is not protected by Article 13 must be taken by an investigating authority before it may impose countervailing duties. Article 13 is consequently a pre-condition for an individual Member in taking action against subsidised exports. It cannot, in that context, be considered as a defence for exporters co-operating in an investigation and may, as the United States have pointed out, be used as the foundation for a claim in a WTO dispute by the exporting Member that countervailing duties have been illegally imposed. There is no reason why that conception of Article 13 should change simply because the issue arises in WTO dispute settlement.

[2] Article 4.2 DSU.

B. RELEVANT COMPARISON FOR THE PURPOSES OF ARTICLE 13

13. Brazil has argued that any breach of the 1992 level during the 9 year implementation period removes the protection of Article 13.[3] The European Communities agrees with the United States that this is incorrect.[4] The present tense of the phrase "do not grant support" makes this clear. The comparison for the purpose of Article 13(b) must be between the level of support decided in the 1992 marketing year and that granted by virtue of the measures being challenged. This would typically mean the most recent marketing year.

C. THE MEANING OF "DECIDED DURING THE 1992 MARKETING YEAR"

14. We now turn to consider the meaning of the phrase "decided during the 1992 marketing year". Brazil argues that the term "decided" refers to a decision to budget a specific amount of domestic support over a number of years.[5] Brazil then goes on to suggest that because the United States did not make a "decision" during marketing year 1992 with respect to upland cotton, the only decision which the United States can be said to have made during marketing year 1992 was the continued funding of its programmes for upland cotton. Brazil then calculates the US' budgetary outlays in respect of upland cotton in 1992; in other words, Brazil looks at the support actually granted.[6]

15. The European Communities is concerned that Brazil appears to consider that the support "decided" in the sense of Article 13 can be equated with the support granted as Brazil has done in its use of US budgetary outlays. Such an interpretation ignores the meaning of the word "decided". That the use of the word "decided" cannot be equated with the term "granted" is illustrated by the following.

16. First, the use of the word "decided" itself is notable. It is, however, notable primarily for what it is not. WTO Members did not use the word "granted" which is the word which one would expect to be used had this phrase been intended to refer only to the domestic support actually used during the 1992 marketing year. The use of the word "decided" stands out particularly when it is compared to the use of the word "grant" in the very same sentence. The United States has made the same point with respect to the decision not to use the word "provided".[7] If WTO Members had intended that the support granted in the most recent period was to be compared to that granted in marketing year 1992 the word "decided" would not have been used. For this reason, Brazil's use of US budgetary outlays for marketing year 1992 is clearly flawed.

17. Second, the word "decided", meaning "settled, certain",[8] also implies a one-off decision. It would be odd to talk of an administration "deciding" countless applications for support under a particular programme. However, this is what Brazil's use of US budgetary outlays implies.

18. Finally, the use of the word "during" confirms that WTO Members intended that the decision need not be of application only in marketing year 1992 but may also cover future periods. The use of the word "during" (meaning "in the course of"[9]) implies a one-off decision, and does not suggest that the period of application of the decision must be limited to marketing year 1992. Had WTO Members intended a limitation to the support provided or granted in 1992 the word "for" would have been used

[3] Brazil's First Written Submission, paras.142 and 146-150.
[4] US First Written Submission, para. 79 and 90.
[5] Brazil's First Written Submission, paras. 139 and 140.
[6] Brazil's First Written Submission, paras. 141-145.
[7] US First Written Submission, paras.83-84.
[8] The New Shorter Oxford English Dictionary, 1993.
[9] The New Shorter Oxford English Dictionary, 1993.

in place of "during". This further confirms that Brazil's use of US budgetary outlays cannot be considered correct.

19. Consequently, Article 13(b)(ii) and (iii) are intended to set up as a benchmark an amount of support adopted by some form of decision (be it political, legislative or administrative) in which support for a specific product is decided and allocated for future years. It is clearly not intended to set up a comparison between domestic support granted in 1992 and domestic support granted in a more recent period. The European Communities respectfully requests the Panel not to follow Brazil's equation of the term decided with the term granted.

20. For the European Communities, the question of what decision was adopted during 1992 by the United States is a question of fact which we do not take a position on, especially as we are not fully aware of all the elements which might be relevant.

### D. THE MEANING OF THE TERM "SUPPORT TO A SPECIFIC COMMODITY"

21. The United States has argued that the term "support to a specific commodity" is synonymous with the term "product-specific support".[10] Brazil had, in its First Written Submission, taken all support which was specific to cotton, and added to it a proportion of generally available support intended to represent the amount of such support which could be attributed to cotton.[11]

22. The European Communities shares the approach of the United States. Quite simply, support which is provided to a number of crops cannot at the same time be considered "support to a specific commodity". Such support is "support to several commodities" or "support to more than one commodity".

23. With respect, Brazil and New Zealand are wrong to suggest that the word "specific" was added to make clear that the applicable benchmark under Article 13 was not the overall level of subsidies decided but rather was to be undertaken on a product-by-product basis.[12] A brief glance at the *SCM Agreement* finds it replete with references to "a product" or "a subsidised product".[13] Consequently, it could make no sense to interpret Article 13 as being based on overall support. The word "specific" was not, therefore, inserted to differentiate the use of Article 13 in respect of specific products to the application of Article 6 to overall agricultural support, but rather as a qualifier to the word "support".

24. Consequently, the Panel should conclude that the correct comparison is between product specific support decided in 1992 and product specific support currently provided.

## IV. THE INTERPRETATION OF ANNEX 2 OF THE *AGREEMENT ON AGRICULTURE* (THE "GREEN BOX")

### A. FIRST SENTENCE OF THE FIRST PARAGRAPH OF ANNEX 2[14]

25. Australia has argued in its comments today that the European Communities is incorrect to consider that the first sentence of the first paragraph of Annex 2 does not impose a separate obligation. The European Communities notes, however, that Australia does not comment and does not

[10] US First Written Submission, paras. 77-78.
[11] Brazil's First Written Submission, para. 143.
[12] Brazil's First Written Submission, para. 136; New Zealand Third Party Submission Para. 2.22.
[13] See, in particular, Article 6.3.
[14] This section was not in the written statement circulated at the third party session, but reflects unscripted comments made during that session.

attempt to rebut the compelling contextual arguments that the European Communities has made in its written submission.[15] The European Communities pointed out that in several instances that the *Agreement on Agriculture* refers to the "criteria" for inclusion in the green box, specifically in Articles 6 and 7, and most importantly, in paragraph 5 of Annex 2. There is no such reference to the "fundamental requirements". The European Communities recalls that a panel is obliged to follow the accepted canons of interpretation of international law, and therefore, to view the ordinary meaning of the words concerned in light of their context and objective. Consequently, it is clear that the first sentence of paragraph 1 of Annex 2 is not, in and of itself, an independent obligation. This does not render it inutile, as Australia charges. The first sentence sets out an objective and indicates the type of effects which respect for the criteria in the green box is deemed to create. The European Communities urges the Panel to reject Australia's unsubstantiated arguments.

B. TYPE OF PRODUCTION

26. Brazil has argued that the fact payments are reduced where fruits and vegetables, and certain other crops are grown on contract acreage for the purposes of PFC and direct payments means that the "amount of such payments [is] related to or based on, the type or volume of production [ ..] in any year after the base period" (Paragraph 6(b) of Annex 2). However, Brazil also appears to recognise that farmers claiming the benefit of direct payments may plant crops other than the programme crops, and may even not produce any crops.[16] The United States asserts that no current agricultural production is required in order to benefit from direct payments.[17]

27. Assuming the US' assertion to be correct (as seems to be acknowledged by Brazil) the Panel is faced with a dilemma. Is the amount of funding provided by a programme, from which a farmer can benefit without producing anything, to be considered to be "based on or linked to a certain type of production", when payments under that programme can be reduced by growing certain crops? Brazil and some third parties simply assume that where payments can be reduced by growing certain crops, the programme is based on or linked to a certain type of production. Such a view does not, however, take account of the complexity of the situation.

28. In the view of the European Communities, reducing payments under a programme, where a farmer grows fruit or vegetables does not mean that the amount of the payment is linked to type of production. This is because the farmer is free to produce a whole range of other crops, or even not to produce at all and receive the full payment.

29. What Brazil and other third parties fail to realise is that the reduction in payment for fruits and vegetables, if the European Communities understands correctly, is in fact designed to avoid unfair competition within the subsidising Member. Brazil and the other third parties have not challenged the right of a subsidising Member to decide decoupled payments based on past production of, or acreage utilised for, certain crops. Indeed, this is permitted in paragraph 6(a) of Annex 2. However, in the case where, for instance, upland cotton production enjoyed support, while fruit and vegetable production did not, decoupled payments based on past cotton production would allow subsidised former cotton farmers to grow fruit and vegetables, and thus unfairly compete with pre-existing fruit and vegetable producers who could not benefit from the decoupled payments because they had not produced cotton or other supported products in the base period. Thus, the reduction in payments is a necessary element in ensuring that the equilibrium established by the market for the production of fruit and vegetables is not artificially disturbed by the introduction of decoupled support.

[15] EC's First Third Party Submission, paras. 15-25 and in particular paras. 22 and 23.
[16] Brazil's First Written Submission, para. 49.
[17] US First Written Submission, para. 68.

30. Furthermore, finding that Brazil and the other third parties are correct would have perverse effects. The whole *Agreement on Agriculture* is geared at gradually reducing certain types of domestic support. However, if a Member could not reduce decoupled payments when certain types of products which had previously not enjoyed any support are grown, the net effect would be that WTO Members wishing to provide decoupled support would have to increase overall support, and provide producers previously excluded with support which they had not previously enjoyed. This is clearly not an effect which the negotiators of the *Agreement on Agriculture* intended.

31. In this light, this potential reduction of payment is very different from the prohibition set down in paragraph 6(b) of Annex 2. Paragraph 6(b) is intended to prevent an artificial pressure to produce certain crops in order to obtain decoupled payments. Reducing payments where fruit and vegetables are produced does not act to pressure farmers into growing a particular type of crop. Rather, it prevents internal unfair competition. At the same time, as we understand the US measure, it does not oblige a farmer to produce any particular type of crop, in fact requires no production, and therefore should not be considered inconsistent with paragraph 6(b).

### C. A DEFINED AND FIXED BASE PERIOD

32. The European Communities would also like to comment briefly on the arguments raised by Brazil and some of the third parties with respect to the updating of the base periods in the 2002 FRSI Act. We take note of the US statement that the updating of the base period was necessary in order to bring support for oilseeds production under the direct payments scheme.[18] In order to ensure the progressive movement of production distorting subsidies to decoupled subsidies we consider that it must be possible to have different reference periods where eligibility is based on previous eligibility for production distorting subsidies. We see nothing in paragraph 6 of Annex 2 which might prevent this. At the same time, however, the European Communities is concerned that continued updating of reference periods in respect of the same already decoupled support, creating an expectation that production of certain crops will be rewarded with a greater entitlement to supposedly decoupled payments, tends to undermine the decoupled nature of such payments.

## V. INTERPRETATION OF THE *AGREEMENT ON AGRICULTURE* /RELATIONSHIP WITH THE *SCM AGREEMENT* AND GATT 1994

### A. ARE DOMESTIC CONTENT SUBSIDIES EXPRESSLY PERMITTED BY THE AGREEMENT ON AGRICULTURE ?

33. Brazil has argued that US Step 2 payments, which it alleges are conditional upon use of domestic goods, are inconsistent with Article 3 of the *SCM Agreement* and Article III.4 GATT 1994. New Zealand supports this claim. However, as with other claims, their analysis does not take fully into account the complexities of the situation. The European Communities agrees with the United States that subsidies contingent upon the use of domestic goods, which are maintained consistently with the *Agreement on Agriculture* are not inconsistent with either the *SCM Agreement* or GATT 1994.

34. The first question is whether subsidies contingent upon the use of domestic goods are consistent with the *Agreement on Agriculture*. The answer is a clear yes. Article 3.2 of the *Agreement on Agriculture* requires Members not to:

> "…provide support <u>in favour of</u> domestic producers in excess of the commitment levels specified in Section I of Part IV of its Schedule." (emphasis added).

[18] US First Written Submission, para. 60.

35. We have emphasised the phrase "in favour of". This is significant because it does not require that support be "to" domestic producers. The same term is used in Article 1(a) (the definition of AMS) and in Article 1(h) (definition of Total AMS). Moreover, it is established with respect to Article 1 of the *SCM Agreement* that a financial contribution and benefit need not be bestowed on the same person.[19] Consequently, it is simply logical that support may be provided in favour of domestic producers through the provision of funds to processors of the product concerned, and consequently that access to such subsidies be limited to domestic produce, in order to ensure that it is domestic producers who benefit from this subsidy. Indeed, WTO Members, in their wisdom, recognised precisely this possibility in Annex 3 to the *Agreement on Agriculture* where they explained how the AMS was to be calculated. Paragraph 7 thereof explicitly contemplates that:

> "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products."

36. Consequently, it is clear that a Member has a right to provide subsidies contingent upon use of domestic products under the *Agreement on Agriculture*. On this, the US and the European Communities agree.

37. The second question for the Panel is how does that right relate to the prohibition in Article 3 of the *SCM Agreement* and the national treatment obligation in Article III.4 of GATT. Here, again, we agree with the United States.

38. Article 21.1 of the *Agreement on Agriculture* provides that the other goods agreements will apply "subject to" the provisions of the *Agreement on Agriculture*. That is, the other Annex 1A Agreements will be subordinated to the *Agreement on Agriculture*.[20] A finding that a measure was a domestic content subsidy would mean that such a subsidy would be prohibited under Article 3.1(b) of the *SCM Agreement* and would (in all likelihood) be inconsistent with Article III.4 GATT. In such an event, the consequences of such a finding would have to be subordinated to the right to adopt such measures under the *Agreement on Agriculture* (provided reduction commitments are respected). Moreover, the chapeau of Article 3.1 of the *SCM Agreement* clearly exempts from the scope of that Article domestic content subsidies which are maintained consistently with the *Agreement on Agriculture* and Article III.8 may be relevant to any claim under Article III.4. GATT.

39. Consequently, Brazil's claims that domestic content subsidies maintained consistently with the *Agreement on Agriculture* can be found to be inconsistent with the *SCM Agreement* and Article III.4 GATT should be dismissed.

## B. EXPORT CREDIT GUARANTEES WHICH OPERATE AS EXPORT SUBSIDIES ARE SUBJECT TO AGREEMENT ON AGRICULTURE OBLIGATIONS ON EXPORT SUBSIDIES

40. The United States maintains, in its first written submission, that Article 10.2 of the *Agreement on Agriculture* operates so as to exclude export subsidies in the form of export credits or export credit guarantees. This is not borne out by the text of Article 10.2. Article 10.2 provides for disciplines to be negotiated on the provision of export credits and export credit guarantees; it does not provide an exemption to the export subsidy obligations of the *Agreement on Agriculture*.

41. The United States provides numerous examples of instances in which the WTO has foreseen further negotiations. However, none of these examples support the United States argument that there are no disciplines for export credit guarantees which operate as export subsidies.

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[19] See, Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 8 January 2003, para. 110.

[20] The New Shorter Oxford English Dictionary, 1993.

42. The best example to illustrate this point is the agreement to negotiate disciplines on harmonised rules of origin. The fact that it was agreed to have negotiations on rules of origin simply means that there is no requirement for a WTO Member to apply an as yet un-finalised set of harmonised rules of origin. However, this does not imply that a WTO Member is exempted from other WTO obligations when it comes to apply rules of origin. A WTO Member must, for instance, in applying its rules of origin, respect the most-favoured nation principle set out in Article 1 GATT. Similarly, while there may not be disciplines on the provision of export credits and export credit guarantees, clearly export credits or export credit guarantees which operate as export subsidies are subject to the export subsidy disciplines of the *Agreement on Agriculture* and the *SCM Agreement*.

43. Other examples are equally illustrative. The US cites provisions in the GATS providing for negotiations on government procurement, emergency safeguards and subsidies on trade in services. However, it does not point out the fact that these subjects are clearly not subject to GATS disciplines, and thus negotiations are required to develop even minimal disciplines. Government procurement in services is the best example – GATS disciplines are explicitly excluded by Article XIII GATS. In contrast, there is no clear exclusion of export credits or export credit guarantees which operate as export subsidies from the *Agreement on Agriculture*.

44. Finally, contrary to the US suggestions, such an interpretation does not render Article 10.2 meaningless. Article 10.2 is not intended to regulate export credits and export credit guarantees as export subsidies but rather to provide for a general set of disciplines comparable to the OECD guidelines for export credits for industrial goods. That the Harbinson text (which of course has yet to be agreed) contains provisions on export credit and export credit guarantees is a recognition that disciplines must be negotiated and that clarification must be provided as to which export credits or export credits guarantees are, in the case of agricultural products, to be considered export subsidies, but is not a recognition that such support which operates as an export subsidy are not currently subject to the obligations of the *Agreement on Agriculture*.

## VI. MEASURES BEFORE THE PANEL (FSC REPLACEMENT SCHEME)

45. The United States has argued that Brazil has failed to make a prima facie case of the inconsistency of the FSC Replacement scheme (the ETI) with the covered agreements. The European Communities must admit to being surprised that the United States considers that Brazil has to present a prima facie case of inconsistency. According to Article 17.14 of the DSU parties to a dispute must "unconditionally accept" adopted Appellate Body Reports as "a final resolution to that dispute."[21] Given that the United States must be assumed to have unconditionally accepted the findings of the Appellate Body in the FSC 21.5 dispute, which, by definition also included a finding that the United States was illegally providing export subsidies to unscheduled agricultural products such as upland cotton, the European Communities fails to see how the United States can argue that Brazil needs to establish a prima facie case. On the contrary, Brazil simply needs to assert a claim.

## VII. CONCLUSION

46. This brings us to the end of our statement today. Thank you for bearing with us through a statement which was inevitably long, given the complexity of the issues, and the very short time we had to prepare our written submission.

47. There are a few central points which we would like to leave you with:

- The peace clause is not an affirmative defence;

[21] Appellate Body Report US- Shrimp (21.5 – Malaysia) para. 97.

- The term "decided" cannot be equated with "granted";

- Reducing payments where certain crops are grown for reasons of internal competition does not amount to basing payments on a certain type of production;

- Domestic content subsidies in favour of domestic producers are permitted under the *Agreement on Agriculture*, and can be maintained irrespective of other provisions; and,

- Export credit guarantees which operate as export subsidies are subject to the *Agreement on Agriculture*.

48. Thank you for your attention. We are, of course, happy to answer your questions, here or in writing.

# ANNEX C-11

## INDIA'S ORAL STATEMENT

Mr. Chairman and Members of the Panel,

I thank you for the opportunity to present India's views in this third party session. India has a few short comments to make on the issues in the dispute.

1. Brazil has challenged the US Subsidy programme relating to cotton. The main schemes challenged are

(i) Step 2 export payments
(ii) US export credit guarantee programmes, and
(iii) Extra Territorial Income (ETI) Act export subsidies.

2. These schemes do not conform to the provisions of Part V of the Agreement on Agriculture and thus have no "peace clause" protection from claims under the Subsidies Agreement. These schemes also violate Article 3.1(a) & 3.2 of the Subsidies Agreement.

3. The scheme relating to Step 2 export payments constitutes an export subsidy within the meaning of the Agreement on Agriculture. It also violates the Subsidies Agreement as

(i) It involves grants within the meaning of the Subsidies Agreement as the US Government pays money to its exporters
(ii) These grants involve direct transfer of economic resources for which the US Government receives no consideration
(iii) The scheme confers a benefit within the meaning of Article 1.1(b) of the Subsidies Agreement as they constitute "free money" for which exporters incur no corresponding obligations and they are made for " less than full consideration" and
(iv) The Scheme is also export contingent within the meaning of Article 3.1(a) of the Subsidies Agreement because exporters are only eligible for payments if they produce evidence that they have exported an amount of US upland cotton.

4. The three Export Credit Guarantee Programmes (GSM 102, GSM 103 & SCGP) are export subsidies within the meaning of the Agreement on Agriculture (AOA) as

(i) They are operated " at premium rates which are inadequate to cover the long term operating costs and losses of the program" as per item (j) of the illustrative list of export subsidies in ASCM.
(ii) They involve financial contributions that confer "benefits" and are contingent upon export performance within the meaning of Article 1.1 & 3.1(a) of the Subsidies Agreement. The US itself treats them as subsidies in its budget.

5. The ETI Act constitutes export subsidies within the meaning of Article 10.1 of the Agreement on Agriculture. This Act operates to circumvent the US export subsidy commitments by providing an export subsidy to upland cotton while the US does not have any export subsidy reduction commitments for cotton in violation of Articles 10.1 & 8 of the AOA.

6. The Step 2 Domestic Payment Scheme grants are direct transfers of funds and constitute a financial contribution by a Government within the meaning of Article 1.1(a)(1)(i) of the Subsidies Agreement. They also confer a "benefit" within the meaning of Article 1.1(h) of the Subsidies Agreement because the domestic user of US upland cotton receives the financial contribution on terms more favourable than those available in the market. Moreover these payment are contingent upon the use of domestic over imported goods.

Mr. Chairman, Members of the Panel,

7. Brazil has provided the legal arguments as to why the US has no basis to assert a "peace clause" defence against Brazil's claims on actionable/prohibited subsidies being given by the US.

8. According to Brazil, the "peace clause" of AOA Article 13 is in the nature of an affirmative defence. The US has indicated that it will invoke a "peace clause" defence in the matter. This means that the burden of proof will be on US to show that the US domestic support and export subsidies to upland cotton are provided in conformity with the requirements of the "peace clause".

9. Brazil has argued that US has no "peace clause" protection under AOA Article 13(c) as the US while invoking an affirmative defence must demonstrate that its export subsidies confirm fully to the provisions of Part V of the AOA. Part V of the AOA consists of Articles 8 to 11. A member violates Part V of the AOA if it provides export subsidies for products for which it has not undertaken any export subsidy reduction commitments.

10. Issues relating to affirmative defence and peace clause defence are mainly legal in nature and should be subject to interpretation under the Vienna Convention on the Law of Treaties and the WTO jurisprudence as seen through Appellate Body findings.

11. As regards subsidies contingent upon export performance, export credit guarantees and premiums, and use of domestic over imported inputs, Mr. Chairman, India believes that they all fall in the category of prohibited subsidies and are actionable under the ASCM.

Thank you for your kind attention.

# ANNEX C-12

## NEW ZEALAND'S ORAL STATEMENT

24 July 2003

1. Mr Chairman, Members of the Panel, New Zealand's views on the issues of concern in this dispute are set out in our Third Party Submission of 15 July and in the time available today it is clearly not possible to canvass all of those views. Accordingly, and as suggested by you in your opening remarks Mr Chairman, I will focus only on some key points.

**(i) New Zealand's systemic interest in the dispute**

2. First, as outlined in our Third Party Submission, New Zealand has joined this dispute because of our systemic interest in ensuring the continued integrity of WTO disciplines applicable to agricultural trade. In particular we are concerned to ensure that trade-distorting or "amber box" measures cannot be used contrary to the "peace clause" in a manner that negatively affects other Members.

3. It is equally important that where the requirements of the "peace clause" have not been respected Members are able to utilise their rights under the *SCM Agreement* and *GATT 1994* to take action in respect of domestic support measures and export subsidies.

**(ii) Brazil's demonstration that the United States cannot claim "peace clause" protection for domestic support provided in marketing years 1999, 2000, 2001 and 2002**

4. Second, Brazil has demonstrated that the level of domestic support for upland cotton granted by the United States in each of the marketing years in question did in fact exceed the level decided during the 1992 marketing year and that there is therefore no "peace clause" protection for those support measures.

5. The United States argues that this is not the case, on the basis that the comparison required by the "peace clause" should be between the 'per pound' rates of support set by the relevant domestic support measures and that certain domestic support measures should be excluded from the comparison.

6. Turning first to the United States claim that the relevant comparison should be between 'per pound' rates of support, in New Zealand's view such an interpretation would be inconsistent with the object and purpose of Article 13(b)(ii). Instead, Article 13(b)(ii) requires a comparison that takes into account the totality of payments to upland cotton producers in order to reflect the true nature of the support that is being granted, including for example, total budgetary outlays. This is especially so when those budgetary outlays have been increasing because of falling world market prices. And those prices are falling due, at least in part, to the fact that United States producers are shielded from true price signals by the guaranteed 'per pound' rates.

7. Furthermore, New Zealand sees no basis for excluding certain domestic support measures from the calculation required by the "peace clause" as requested by the United States.

8. The "counter-cyclical" payments are plainly not "green box" support measures in accordance with Annex 2 of the *Agreement on Agriculture*, as the amount of the payment is linked to current prices for upland cotton, in direct contravention of Annex 2 paragraph 6(c).

9. Nor is the scope of support to be measured under Article 13(b)(ii) limited to "product-specific" support in the sense proposed by the United States. There is no basis for such an interpretation in either the wording or the intent of Article 13(b)(ii). [Just to depart from the prepared statement for a moment, the EC has reminded us this morning of the importance of taking context into account when interpreting WTO Agreements. We would note that it is also important to consider the ordinary and natural meaning of the actual words appearing in the Agreements. Here the words used are "support to a specific commodity" – the text does not say "product-specific support". If the drafters had intended to mean "product-specific support", they surely would have said so. After all, the phrase "product-specific support" is used at least five times elsewhere in the *Agreement on Agriculture*. Returning now to the prepared text,] even if such an interpretation as suggested by the US, could be supported, "counter-cyclical" payments are in any event product-specific support because, as Brazil has demonstrated, there is a strong linkage between those payments and production of upland cotton.

10. New Zealand also considers that there is no basis for excluding the Production Flexibility Contract payments or Direct Payments from the required calculation. The ability of farmers to update the base acreage used for calculation of Direct Payments rules out inclusion of those payments in the "green box", which contemplates only one base period that is fixed and unchanging. To permit a Member to avoid this limitation by simply changing the names of its domestic support programmes would seriously undermine the requirement that there be no link between production and the amount of support.

**(iii) Brazil's demonstration that the United States cannot claim "peace clause" protection in respect of export subsidies;**

11. Looking now at export subsidies, New Zealand agrees with Brazil that the three types of export subsidies applied to upland cotton and other commodities by the United States (the Step 2 Export Programme, the Export Credit Guarantee Programme, and the FSC Replacement Programme) violate Articles 3.3, 8 and 10.1 of the *Agreement on Agriculture*.

12. New Zealand rejects the argument made by the United States that Step 2 export payments are not export subsidies because payments are available to domestic users as well as exporters of upland cotton. The Appellate Body (in *US-FSC Recourse to Article 21.5*) has made it clear that the fact that payments are also able to be made to domestic users of upland cotton does not 'dissolve' the export contingency of the payments that are made to exporters.

13. New Zealand also finds no basis for the assertion by the United States that export credit guarantee programmes are not subject in any way to the export subsidy disciplines of the *Agreement on Agriculture*. In fact the inclusion of reference to such programmes in the context of Article 10 supports the opposite conclusion and demonstrates that Members were in fact concerned at the potential for such programmes to circumvent Members' export subsidy reduction commitments.

14. In summary Brazil has demonstrated that the export subsidies to upland cotton do not have "peace clause" protection, and also that they are prohibited subsidies under Article 3.1(a) and 3.2 of the *SCM Agreement*.

**(iv) The request by the United States for a Preliminary Ruling**

15. Finally Mr Chairman, New Zealand does not consider that the Panel should grant the preliminary ruling requested by the United States.

16. First, New Zealand believes that measures no longer in effect are not outside the scope of the Panel's consideration, particularly where the programmes in question, while renamed, in fact continue in a slightly different form. Furthermore, the nature of serious prejudice claims means that Panels may need to consider data beyond a single year and consider trends over a number of years.

17. Second, New Zealand considers that export credit guarantee measures relating to eligible United States agricultural commodities (other than upland cotton) are within the Panel's terms of reference. To determine otherwise would be to allow a lack of transparency in the operation of particular measures to shield them from scrutiny by Members taking disputes.

**Conclusion**

18. In conclusion, Mr Chairman, New Zealand believes that Brazil has demonstrated that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the *GATT 1994* and the *SCM Agreement*. New Zealand looks forward to the next phase of the case which will examine those claims.

# ANNEX C-13

## ORAL SUBMISSION BY PARAGUAY

24 July 2003

Mr Chairman, members of the Panel:

1. Paraguay is grateful for the opportunity to participate in these proceedings and to present its views on the matter at issue in this dispute.

2. Because Paraguay is a firm believer in a fair system of multilateral trade, it feels that it should explain its position on this issue as a third party because it is an issue of particular interest to its economy.

3. Paraguay considers that the subsidies and support granted by the United States to its cotton production are inconsistent with the Agreement on Subsidies and Countervailing Measures, the Agreement on Agriculture and the rules and principles of the GATT 1994, and that for the purposes of this dispute it is therefore essential to take account of WTO legislation, which was carefully drafted to avoid causing distortions in international trade and prejudice to developing countries such as Paraguay.

4. WTO jurisprudence and the principles of interpretation of international law applied to the various cases suggests that the applicable rules should be read cumulatively, taking account of all elements applied to the case in order to support the system as an integrated whole.

5. With respect to the applicability of Article 13(b)(ii) concerning domestic support measures that conform fully to the provisions of Article 6 of the Agreement including direct payments that conform to the requirements to paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, Paraguay considers they shall be exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

6. This implies that it is not limited or confined to specific products. Thus, it can be concluded that the United States does not enjoy protection from actions relating to subsidies using 1999, 2001 and 2002 as a basis, as Brazil duly proved.

7. In interpreting the Peace Clause, account must be taken of the serious prejudice that Member economies could suffer, and an assessment made of the overall significance of all of the agreements relating to the case.

8. Regarding inconsistency with the Agreement on Agriculture, the Step 2 programme introduced by the United States to stimulate exports and the competitiveness of its products on the international market is inconsistent with Articles 3.3 and 8 of the Agreement on Agriculture.

9. Article 3 of the Agreement on Agriculture refers to the incorporation of concessions and commitments. Paragraph 3 thereof stipulates that:

> *3.3 "Subject to the provisions of paragraphs 2(b) and 4 of Article 9 of this Agreement, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule."*

10. The above paragraph enables Members to provide the subsidies listed in Article 9.1 of the Agreement on Agriculture subject to fulfilment of the commitments assumed.

11. Similarly, Article 8 of the said Agreement regulates export competition commitments, stipulating that:

> *"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and the commitments as specified in that Member's Schedule."*

12. For the above reasons, and because it does not consider the provisions of the Agreement on Agriculture to have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

13. The agricultural subsidies cause "serious prejudice" to the domestic industry of other Members under Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures.

14. The introductory paragraph of part III, Article 5 of the said Agreement provides that no Member should cause, through the use of any subsidy – specific and not exempted under the Agreement – adverse effects to the interests of other Members, more specifically, as categorically stated in the indents that follow, (a) injury to the domestic industry of another Member and (c) serious prejudice to the interests of another Member.

15. Article 6 specifically refers to cases in which "serious prejudice" is deemed to exist in the sense of paragraph (c) of Article 5.

16. Agricultural subsidies have effects on world trade, and measures such as those applied by the United States have a significant impact on developing countries like Paraguay.

17. Paraguay has a total population of approximately 5,300,000, of which more than 500,000 are linked to cotton production. If we add the related industries and activities, the figure reaches an estimated 1,500,000, or approximately 30 per cent of the country's total population.

18. Any slump in the cotton trade causes an exodus of rural population towards the urban areas which do not offer any relief or solution, and this further undermines the economic situation of a country that depends on its agriculture.

19. As regards exports, in 1991, the foreign exchange revenue generated by sales of cotton and byproducts thereof reached US$318,912,000, approximately 43 per cent of the total for the country's exports that year. At the time, of a total of 299,259 farms, 190,000 were cultivating cotton.

20. By 2001, the figures had changed considerably. Export revenue had fallen to US$90,505,000, a 72 per cent drop in the value of exports. The number of farms producing cotton decreased to about 90,000, representing a 52 per cent decrease in farms, employment and small farmer income. In other words, the impoverishment was real.

21. Regarding international cotton fibre prices, in 1991, the price per ton of Paraguayan type fibre was quoted on the New York Exchange at US$1,624, while in 2001, it was quoted at US$934.

22. In Paraguay, some 60 per cent of cotton is produced on farms of less than 10 hectares, making it the main or only source of income for small farmers and the main source of employment for the rural workforce in the most disadvantaged segment of society where access to capital and technology is more restricted and the leading socio-economic welfare indicators are lower than anywhere else.

23. In spite of its marked decline, cotton continues to be an important cash crop for the "capitalized" farms, and the main – if not only – cash crop of the farms that are on the decline.

24. The agricultural sector is fundamental to the Paraguayan economy, accounting for 90 per cent of exports, 35 per cent of employment and 25 per cent of GDP, in addition to which it supports an agro-industry that accounts for 11 per cent of GDP and 10 per cent of total employment.

Mr Chairman, members of the Panel:

25. The importance of cotton for Paraguay, both in social and economic terms, is such that an increase in international cotton fibre prices as a result of the elimination of significant market distortions such as subsidization of production would not only bring about a general improvement in the standard of living of the country's inhabitants, in a very fragile sector in particular, but it would also lead to an improvement in macroeconomic conditions, balance-of-payments, monetary reserves, etc. that would enable Paraguay to be more reliable in meeting its international financial commitments.

26. For the above reasons, and because it does not consider that the provisions of the Agreement on Agriculture have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

27. Paraguay therefore considers that the measures adopted by the United States cause serious prejudice to world trade, affecting Paraguay in particular, and that the necessary steps should be taken to eliminate the adverse effects and seek to achieve a balance in world trade.

28. Finally, Paraguay respectfully requests the Panel to conclude that the measure applied by the United States is inconsistent with its WTO obligations under various provisions of the Agreement on Agriculture, the GATT 1994 and the Agreement on Subsidies and Countervailing Measures.

# ANNEX C-14

## ORAL STATEMENT BY THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU AS A THIRD PARTY ON THE CASE OF THE UNITED STATES SUBSIDIES ON UPLAND COTTON

The Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu is pleased to be here as a third party in this case. We have a systemic interest in the particular question of the burden of proof required by Article 13 of the AOA, and would like to focus on this issue in our remarks. We have previously submitted our views in writing accordingly.

**The Burden of Proof (the "Peace Clause")**

In the case in point, Brazil asserts in its first written submission that Article 13 is by nature an "affirmative defence" or "exception" and "not itself a positive obligation", therefore the United States carries the burden of proof on whether its subsidies are in conformity with Article 13.

Our view, in summary, is that it is inappropriate to label Article 13 as an "affirmative defence" or "exception". Indeed this would mean the Article having much less than its originally intended effect. Article 13 in itself confers rights and imposes positive obligations on Members. It is not there simply for the convenience of resolving the question of the burden of proof. The right that it confers of entitlement to being "exempt from actions", for example, would be rendered pointless if the burden of proof were on the respondent. It is surely for Brazil, therefore, as a complainant, to prove a breach of a positive obligation by demonstrating non-conformity, rather than for the United States to bear the burden of proof.

In our written submission, we suggest that in arriving at a proper interpretation of the burden of proof in Article 13, it might also be helpful to make some comparisons with the different types of exceptions, exemptions and defences that exist in other Articles of WTO Agreements.

We mention, for example, disputes arising in connection with agreements not covered by the DSU, where the complaining party would bear the burden to prove that the issue in dispute falls within the purview of the DSB.

Also, where a matter is specifically excluded from the dispute settlement procedures by certain relevant agreements – such as Article 6 of the TRIPS agreement - the provision concerned allows the Member applying it to prevent dispute settlement procedures and the burden of proof falls on the complaining party.

And by way of further comparison, we refer to other cases where exceptions or exemptions are granted under relevant agreements providing specific obligations.

While Article 13 of the AOA is clearly in this case not dealing with a matter under a non-covered agreement or a matter that is specifically excluded from the dispute settlement procedures as in Article 6 of TRIPS, it is also not typical of the type of exception contained in a number of the GATT Articles. By its singular nature, Article 13, in our view, falls between these examples, therefore the procedures for applying its provision should be interpreted separately and differently.

And finally, as far as the burden of proof is concerned, we submit that requiring the respondent to prove that the subsidy measure in question is in conformity with the Agreement on Agriculture will, to a certain extent, offset the respondent's right to claim for the exceptions provided by the Article 13 provisions, which is surely contrary to the drafters' intent.

# ANNEX D

## REBUTTAL SUBMISSIONS OF PARTIES

# ANNEX D-1

## BRAZIL'S REBUTTAL SUBMISSION TO THE PANEL REGARDING THE "PEACE CLAUSE" AND NON-PEACE CLAUSE RELATED CLAIMS EXECUTIVE SUMMARY

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### 1.1. Production Flexibility Contracts and Direct Payments Are Non-Green Box Domestic Support

#### 1.1.1. The Amounts of PFC and Direct Payments Depend on the "Type" of Production

1. PFC payments and direct payments are non-green box support because both limit the "amount" of payment based on the "type" of production inconsistent with the requirements of Annex 2, paragraph 6(b) of the Agreement on Agriculture. The relevant text of paragraph 6(b) prohibits any linkage of the "amount of payments" to any "type of production" of an agricultural product. The "amount" of payments under the PFC and direct payment programmes *falls* when base acres are used to produce fruits, vegetables and wild rice. Thus, the undisputed evidence demonstrates that PFC and direct payments do not meet the policy-specific criteria for "de-coupled income support" in Annex 2, paragraph 6(b).

2. Prohibiting payments if *certain* types of crops are produced while at the same time permitting payments if *other* types of crops are produced violates Annex 2, paragraph 6(b). Contrary to the US argument, requiring no production, *i.e.*, prohibiting production, does not relate the amount of payments to the "type" of production, as no individual "type" of production would be eligible to payments. The notion of "type of production" in paragraph 6(b) is necessarily linked to the amount of payment to some "type" of commodity that is "produced" and not to a production requirement itself.

3. In addition, Brazil also presented evidence that the US restrictions on fruits, vegetables and wild rice prevent producers with PFC and direct payment base acreage from growing these alternative crops. This restriction, therefore, channels production into particular "types of production" by prohibiting *other* "types of production" and, therefore, violates Annex 2, paragraph 6(b).

#### 1.1.2. Direct Payments Are Not Green-Box Because the Base Periods for Determining Eligibility Have Been Updated in the 2002 FSRI Act

4. Direct payments are also not properly in the green box because the amount of payments are based on an updated "base period" and not on a "fixed" base period as required by Annex 2, paragraphs 6(a) and (b). Paragraphs 6(a) and (b) require a fixed and, therefore, unchanging base period for de-coupled domestic support measures with the same structure, design, and eligibility criteria. The evidence demonstrates that there are no significant changes in the payment eligibility criteria between the PFC programme and its direct successor, the direct payment program. Indeed, PFC payments made during 2002 were deducted from the amount of direct payments due in 2002.

5. Further, the updating permitted under the 2002 FSRI Act for direct payments was significant – one-third of eligible farms updated their PFC base acreage as of June 2003 in order to *increase* the base acreage – and payments – under the direct payment programme. This updating creates production-distorting effects because it creates expectations of future updates and will incite farmers to produce more of the programme crops that qualify for support.

6. The United States interprets the word "fixed" in Annex 2, paragraph 6(a) and (b) as being "fixed" only for the life of a particular legal measure. A Member could change a measure every year, update the "base period" to reflect the prior year's acreage, increase current payments to reflect the updated (and increased) "historical" acreage, and label it differently under a new law. Thus, the US interpretation would permit payments to be completely "coupled" to production, just with a one-year time lag. It would render any disciplines reflected in the use of the term "a" and "fixed" "base

period" in Annex 2, paragraph 6(a) a nullity. This is contrary not only to the ordinary meaning of the term "fixed" but also to the object and purpose of Annex 2, paragraph 6(a) to not permit Members to increase payments over time in a manner linked to increases in production over time. The re-linkage of payments to production is also inconsistent with the "fundamental requirement" in Annex 2, paragraph 1.

### 1.2. PFC, Market Loss Assistance, Direct and Counter-Cyclical Payments (CCP) and Crop Insurance Subsidies Are "Support To" Upland Cotton

7. The narrow US specificity test of "tied to production" seeks to impose a "form" of specificity on the text of Article 13(b)(ii) that is not there. It further contradicts the only analogous criteria to Article 13(b)(ii) for calculating annual levels of support – the AMS calculation criteria of Annex 3. In addition, it contradicts the broad definition of "in favour of" in defining AMS in Article 1(a) of the Agreement on Agriculture, and the "in general" language of the same provision. The "substance" the United States seeks to avoid with this unjustified interpretation is the $12.9 billion dollars in payments for the production of upland cotton from MY 1999-present.

8. Applying its narrow specificity criteria, the United States argues that PFC, market loss assistance, direct and counter-cyclical payments as well as crop insurance subsidies are not "support to" upland cotton. Brazil presents evidence that all five domestic support measures provide "support to" the production of upland cotton between MY 1999-2002.

#### 1.2.1. Production Flexibility Contract Payments

9. Brazil has presented considerable evidence demonstrating that PFC payments to holders of upland cotton base acreage in MY 1999-2001 are support to upland cotton. The 1996 FAIR Act established a specific payment formula permitting those upland cotton farmers who had traditionally farmed upland cotton to continue to receive payments following the elimination of the deficiency payment program. The 1996 FAIR Act singled out upland cotton and only six other crops for such PFC payments. Recipients were "producers" who "shared in the risk of producing a crop", and who farmed one of the seven crops in the three immediate years prior to the 1996 FAIR Act (MY 1993-95). Only a small minority of the producers of crops in the United States received PFC (and market loss assistance) payments. Brazil has demonstrated that between MY 1999-2001, the seven types of programme crops receiving PFC represented on average between MY 1999-2001 only 14.19 per cent of total US farm revenue. In addition, the total acreage of the seven PFC and market loss assistance crops in MY 2001 represented only 22 per cent of total US farmland. Thus, PFC payments were not provided to US producers *in general*.

10. The best available evidence demonstrates that upland cotton producers during MY 1999-2001 received PFC (and market loss assistance) payments. USDA reported that 97 per cent of farms producing upland cotton representing 99 per cent of upland cotton acreage from MY 1993-95 signed up to receive upland cotton PFC payments for MY 1996-2001. Upland cotton base acreage under the PFC (and market loss assistance) programme was 16.2 million acres. Between MY 1999-2001, the average acreage planted to upland cotton was 15.24 million acres. In addition, USDA reported that 95.7 per cent of the 16.2 million US upland cotton base acreage was planted to PFC programme crops in MY 2001 – a higher percentage than for any of the other 6 types of PFC programme crops. Thus, the evidence suggests that upland cotton producers in MY 1999-2001 were receiving PFC (and market loss assistance) payments.

11. Brazil has presented evidence demonstrating that PFC payments have production and trade distorting effects that arise from the prohibition on planting fruits, vegetables, and wild rice, as well as from the various "wealth effects" that result from the size of the subsidy averaging more than 15 per cent of the market value of upland cotton between MY 1999-2001. These effects provide further

confirming evidence that the selected, targeted PFC (and market loss assistance) payments are support to upland cotton.

### 1.2.2. Market Loss Assistance Payments

12. The evidence provided by Brazil with respect to PFC payments is also relevant to market loss assistance payments because these payments were made only to farmers with PFC contracts for the seven PFC crops, and additionally to soybeans. Thus, historic upland cotton producers (producing upland cotton in MY 1993-1995) received "upland cotton-specific" market loss assistance payments in MY 1998-2001. Even with the addition of soybeans, these 8 crops only represented on average 20.75 per cent of total US farm revenue in MY 1999-2001. PFC crop base acreage and soybean acreage in MY 2001 represented only 29 per cent of total US farmland. Thus, as with PFC payments, market loss assistance payments were not paid to US agricultural producers *in general* but rather to only a select group of US producers.

13. The evidence presented by Brazil indicates that while producers holding PFC/market loss assistance base acreage had the legal "freedom to farm" different crops, if they produced upland cotton, they would suffer adverse financial consequences *unless* they produced upland cotton on *upland cotton*, *corn* or *rice* base acres. The evidence highlights the practical impossibility of growing upland cotton without any type of PFC and market loss assistance payment in MY 2001. This evidence confirms NCC statements and supports a conclusion that any upland cotton produced in MY 1999-2001 – as a matter of economic reality and viability – needed and received PFC and market loss assistance payments to meet the high cost of production.

14. Further evidence that market loss assistance payments are support to upland cotton stems from the fact that the United States notified these subsidies as trade and production distorting amber box support. The evidence demonstrates that the targeted market loss assistance payments triggered by market price declines have even more trade and production-distorting effects than PFC payments. Further, as with PFC payments, production and trade distortions occurred because of the prohibition or restriction on receiving such payments based on growing fruits, vegetables, or wild rice. The production and trade-distorting effects on upland cotton are further confirmed by the fact that market loss assistance payments represented on average 17.87 per cent of the market value of upland cotton between MY 1999-2001. Thus, even though upland cotton producers were not *required* to produce upland cotton to receive market loss assistance payments, the record demonstrates that they continued to produce upland cotton between MY 1999-2001, and they continued to benefit from the 17.87 per cent subsidies represented by these payments.

### 1.2.3. Direct Payments

15. Direct payments are targeted support to "producers" farming, *inter alia*, on upland cotton base acreage. The eligible upland cotton producers who grew upland cotton in MY 1998-2001 (or in MY 1993-95) – together with eligible producers of only nine other crops – are a select group, who grew crops representing only 23.49 per cent of total farm cash receipts and 30 per cent of total US farm acreage. Thus, direct payments are *not* available to the great majority of US producers of agricultural commodities, *i.e.*, they are not provided to US agricultural producers *in general.*

16. The United States argues that direct payments and CCP payments are not "support to upland cotton" because there is no *legal requirement* under the 2002 FSRI Act for holders of upland cotton base acreage to grow upland cotton. However, Brazil has demonstrated that the theoretical legal *planting flexibility* in the 2002 FSRI Act is not reflected in the *economic* reality of growing high-cost crops like upland cotton. Farmers who did plant the 14.2 million acres of upland cotton for MY 2002 could only have covered their costs by receiving *upland cotton*, *rice* or *peanut* direct payments and counter-cyclical payments. This evidence strongly confirms what the NCC officials have stated

repeatedly, that their members need, rely on, and *receive* direct payment and counter-cyclical payment support. And this evidence refutes the United States argument that the *legal* flexibility to grow other crops – or not produce at all – is the single relevant fact justifying a finding that direct payments and CCP payments did not support upland cotton in MY 2002.

17. Further evidence that direct payments are support to upland cotton is derived from the effects on upland cotton production caused by the updating of the base acreage between the PFC and the direct payment programmes. Brazil has presented evidence indicating that this updating creates a re-linkage between production and the direct (and counter-cyclical) payments. Production effects are also caused by channeling the payments into crops other than fruits, vegetables, and wild rice. Further, the size of the subsidy (over 15 per cent of the current upland cotton market value) also contributes to wealth creation that has production effects. These production effects demonstrate that the direct payments (and CCP payments) are not de-linked from production – as argued by the United States – and support a conclusion that they are support to upland cotton.

### 1.2.5. Counter-Cyclical Payments

18. The United States argues that because producers receiving CCP payments are not required to produce upland cotton to receive payments, these payments cannot, as a matter of law, be considered support to upland cotton within the meaning of Article 13(b)(ii). Nevertheless, the evidence provided by Brazil demonstrates that CCP funds in MY 2002 paid to "historic" (i.e., 1998-2001 or 1993-1995) upland cotton producers are paid to a tiny fraction of total US producers of agricultural commodities and not to US producers of agricultural products "in general". Further, the evidence supports the conclusion that the recipients of these payments in MY 2002 needed these payments to continue producing upland cotton. They constitute "support to upland cotton".

19. Moreover, CCP payments create additional production effects due to the "base-update" permitted under the 2002 FSRI Act for both base yields and base acreage compared to market loss assistance payments. Further, the fruits, vegetables, and wild rice prohibitions or restrictions channel production into upland cotton. This evidence collectively supports a conclusion that CCP payments are "support to upland cotton".

### 1.2.6. Crop Insurance Payments

20. Brazil has demonstrated that upland cotton farmer benefit from specialized and specific crop insurance policies provided under the 2000 Agricultural Risk protection Act. Premium subsidies are directly tied to the amount of acreage planted by an upland cotton farmer. Also the participation rate, the share of policies at higher buy-up levels and the crop insurance loss ratio are higher for upland cotton than for other crops. This is confirmed by USDA's own economists, who have found that crop insurance subsidies cause much higher production and export effects for upland cotton than for other crops. In sum, crop insurance subsidies tied directly to the production of upland cotton are "support to a specific commodity" for the purposes of Article 13(b)(ii).

## 1.3. The US Support to Upland Cotton in MY 1999-2002 Exceeded the Support Decided in MY 1992

21. The United States has raised a number of *post hoc* arguments related to a supposed "rate of support" decision it alleges to have made during MY 1992. In the SAA, the United States stated that Members would have peace clause protection from adverse effects and serious prejudice challenges in the WTO "*unless the AMS for the particular* commodity exceeds the level decided in the 1992 marketing year". The phrase "AMS for the particular commodity" is an explicit recognition by the United States of the test in Annex 3, paragraph 6 which states: "For each basic agricultural product, a specific AMS shall be established *expressed in total monetary terms.*" The US "rate of support"

methodology is not an expression in "total monetary terms," nor does it permit such a calculation. There are only two types of methodologies that would allow an expression in monetary terms of a decision (or decisions) taken by the United States in MY 1992 regarding its level of support to upland cotton: "using budgetary outlays" or the "gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price".

22. Brazil disagrees with the United States' assertion that it did not "decide" on budgetary outlays. The alleged US decision to provide a rate of support must necessarily be accompanied by a decision to authorize whatever budgetary outlays would be necessary to meet the rate of support. The United States took specific administrative decisions which meant that the United States decided on the payment rates that resulted from the "rate of support" and, therefore, on the amount of budgetary outlays it would use from its unlimited spending authority. For the United States to argue, *post hoc,* that these decisions did not also include expenditures is inconsistent with its SAA interpretation of the peace clause that the 1992 decision must be expressed in "total monetary terms."

23. Brazil has demonstrated that expenditures for MY 1992 are lower than they are for any of the marketing years from 1999-2002. Therefore, under this methodology, the United States has no peace clause exemption for MY 1999-2002. While Brazil does not believe that calculating the upland cotton AMS based on the AMS methodology in Annex 3 is the appropriate methodology – based on the absence of the terms "AMS", "product-specific" and "non-product-specific" in Article 13(b)(ii) – Brazil has provided evidence that by using this methodology the United States support to the basic agricultural commodity "upland cotton" exceeded the support decided during the 1992 marketing year in all marketing years from 1999-2002.

24. In the event the Panel decides not to use a "total monetary value" methodology, then there are two "rate of support" methodologies: (1) budgetary outlays per pound of support, and (2) the expected guaranteed income rate of support set out in Professor Sumner's analysis. Brazil has provided extensive analysis of each of these two methodologies. However, Brazil does not endorse either methodology.

25. Brazil has demonstrated that the preferable methodology would be to rely on budgetary outlays per pound of upland cotton production. Professor Sumner's approach should be used only as an alternative to the simplistic US "72.9 methodology" because it is much more accurate than the United States approach accounting for eligibility criteria, effective programme limitations and costs that the US ignores. In any event, Brazil has demonstrated that also under both rate of support methodologies the US support in MY 1999-2002 exceeds the support decided during MY 1992

26. Any methodology that does not account for eligibility and effective participation criteria is inconsistent with Article 13(b)(ii). It is also inconsistent with the context of Article 13(b)(ii) which includes Annex 3, paragraphs 8 and 10 requiring calculation of the monetary value of support by factoring in "*production eligible to receive the administered price*." And it is also inconsistent with object and purpose of the Agreement on Agriculture, which is – after all – "correcting and preventing restrictions and distortions in world agricultural markets."

### 1.4. Challenges to Actionable Subsidies under Article 5 and 6 of the SCM Agreement and Article XVI of GATT 1994 Are Not Limited to the Marketing Year in which a WTO Panel Is Established

27. The United States argues that the Panel may only count *current* US non-green box support in determining whether the United States enjoys peace clause exemption under Article 13(b). Applying a strict "statute of limitations" approach, the United States argues that Brazil (1) cannot challenge any US trade and production-distorting agricultural support for MY 2001 (or MY 2000, or MY 1999) because it did not ensure that the Panel was established during MY 2001 (or MY 2000, or MY 1999), and (2) it cannot challenge *all* of the trade and production-distorting support for all of MY 2002 because it did not ensure that the Panel was established by 31 July 2003 – the last day of the 2002 marketing year. The United States goes so far as to argue that the Panel may only compare MY 1992 support decided with *partial* MY 2002 data through 18 March 2003 – the date the Panel was established. According to the US theory, the only date the Panel could have been established to ensure comparison with full MY 2002 data would have been 31 July 2003 – the last day of MY 2002.

28. Brazil has demonstrated that the United States has constructed an irrational interpretation of Article 13(b)(ii). It is bizarre to interpret Article 13(b)(ii) in a way that requires Members to carefully "time" a request for establishment of a panel to maximize the amount of support to be counted for the "current" marketing year. Nothing in the "present tense" of Article 13(b)(ii) compels this result. The Panel must interpret Article 13(b)(ii) according to its ordinary meaning and with regard to its context. The relevant context is Articles 1(h)(ii) and 6.3 of the Agreement on Agriculture. The *Korea – Beef* dispute exemplifies that a Member can challenge violations of "Current Total AMS" at any time after a marketing year ends. The ability of challenging Current Total AMS violations in later years by analogy suggests that non-conformity with the peace clause requirements in much the same way leads to lifting the peace clause exemption also for marketing years other than the current marketing year. Thus, the proper interpretation of Article 13(b)(ii) permits actionable subsidy challenges under the SCM Agreement and GATT Article XVI:1 for any marketing year for which peace clause exemption does not exist – under either its chapeau (Current Total AMS) or the proviso of Article 13(b)(ii).

### 2. The GSM 102, GSM 103 and SCGP Export Credit Guarantee Programmes Constitute Export Subsidies in Violation of Articles 10.1 and 8 of the Agreement on Agriculture, and Item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement

29. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP export credit guarantee programmes administered by the CCC constitute export subsidies within the meaning of Articles 10.1, 1(e) and 8 of the Agreement on Agriculture, Article 3.1(a) of the SCM Agreement, and item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement. Brazil also demonstrated that those export subsidies circumvent, or threaten to circumvent, the United States' export subsidy reduction commitments, in violation of Articles 10.1 and 8 of the Agreement on Agriculture. Additionally, because they violate the Agreement on Agriculture, these programmes are not exempt from actions by Article 13(c)(ii) of the Agreement on Agriculture, and constitute prohibited export subsidies within the meaning of item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement.

30. Article 10.2 does not, as the United States asserts, carve out export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture, including the anti-circumvention provisions of Article 10.1. The Appellate Body concluded that exemptions and carve-outs from general obligations must be provided for explicitly in the text of an agreement. Article 10.2 includes no such explicit carve-out or exemption. Rather, Article 10.2 announces Members' intent to work toward negotiations on specific disciplines for export credits. In the meantime, the general disciplines on export subsidies included in the Agreement on Agriculture apply to export credits.

### 2.1. CCC Export Credit Guarantees Constitute Export Subsidies under Articles 1 and 3.1(a) of the SCM Agreement

31. Brazil notes that CCC export credit guarantees are "financial contributions" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. Since CCC export credit guarantees are unique financing vehicles for agricultural commodity transactions that are not available on the commercial market, let alone on terms consistent with the market, they confer "benefits" within the meaning of Article 1.1(b) of the SCM Agreement. Brazil presents the affidavit of Marcelo Pinheiro Franco from the Brazilian Export Credit Insurance Agency who confirms that no

> comparable market-based export credit guarantees or financing instruments for international transactions involving agricultural commodities [exist] that provide these same terms [as the GSM and SCGP programmes].

32. Further, the United States compares agricultural export credit guarantees to export credit insurance for agricultural commodities, which it asserts is available on the private commercial market. However, it acknowledges that insurance coverage is structured altogether differently from guarantee coverage. Thus, even if the United States had proven its assertion with evidence, it acknowledges that the market for private insurance cannot serve as a benchmark against which to determine whether CCC guarantees confer "benefits".

33. Finally, CCC guarantees are contingent in law on export performance and therefore constitute prohibited export subsidies under Article 3.1(a) of the SCM Agreement.

34. Lastly, Brazil recalls that since the United States surpassed its quantity commitment levels, Article 10.3 of the Agreement on Agriculture allocates the burden to the United States to prove that its excess exports did not benefit from export subsidies, including export credit guarantees.

### 2.2. The CCC Export Credit Guarantee Programmes Constitute Export Subsidies under Item (j) of the Illustrative List of Export Subsidies

35. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes also constitute export subsidies because they charge premium rates that are inadequate to cover the long-term operating costs and losses of the programmes, within the meaning of item (j) of the Illustrative List. Item (j) does not require the Panel to endorse any particular methodology or formula for determining whether the CCC programmes cover their long-term operating costs and losses, or to decide by precisely how much those costs and losses exceed premiums collected. Rather, Brazil has provided the Panel with numerous alternatives, each of which demonstrates that long-term operating costs and losses for the GSM 102, GSM 103 and SCGP programmes outpace premiums collected, including data under the FCRA, Brazil' constructed formula, data from CCC's 2002 financial statements reporting large uncollectible amounts on post-1991 and pre-1992 guarantees, among others.

36. The United States criticizes the FCRA cost formula as inappropriate because it allegedly relies on "estimated" rather than "actual" data about the costs of the programmes. It is not true that the FCRA cost formula reflects only "an *estimate* of the long-term costs to the Government". A significant portion of the inputs into the FCRA cost formula reflect actual historical experience with borrowers, and actual contract terms such as interest rates, maturity, fees and grace periods.

37. Moreover, the results of the FCRA cost formula are modified throughout the lifetime of a cohort, pursuant to the "reestimation" process. The results of the reestimate process demonstrate that CCC has "los[t] money" during the period 1992-2002. When these total lifetime reestimates for all

cohorts of guarantees disbursed since 1992 are netted against the total *original* subsidy estimates adopted each budget year during the period 1992-2002, *the resulting loss is nearly $1.75 billion*.

38. The implication of the United States' position concerning "estimated data" is that it is impossible to judge whether premiums for the GSM 102, GSM 103 and SCGP programmes have covered operating costs and losses until all guarantee cohorts for a period constituting the "long term" are closed, so that purely "actual" rather than partial "estimate" data are available. Because all cohorts disbursed since the inception of federal credit reform remain open, the United States effectively argues that it is impossible for this Panel to judge whether the CCC guarantee programmes satisfy the elements of item (j). Brazil notes however that the US Congress and the President have endorsed the use of the FCRA cost formula as the principal way to "measure more accurately the costs of Federal credit programmes", *even in the budget year column of the US budget*, let alone several years out, when cohorts have been subject to successive rounds of reestimates.

39. In closing, Brazil reminds the Panel that the US criticism regarding the use of "estimated" data does not address the many other bases apart from the FCRA formula on which Brazil has demonstrated that the long-term operating costs and losses of the GSM 102, GSM 103 and SCGP programmes exceed premiums paid.

### 2.3. The CCC Export Credit Guarantee Programmes Threaten to Circumvent US Export Subsidy Reduction Commitments

40. At paragraphs 295-305 of its First Submission, Brazil demonstrated that with respect to both unscheduled and scheduled commodities, the GSM 102, GSM 103 and SCGP export subsidy programmes result in, or threaten to lead to, circumvention of the United States' export subsidy commitments, in violation of Article 10.1 of the Agreement on Agriculture. For the same reason, the United States violates Article 8, which requires a Member not to provide export subsidies otherwise than in conformity with the Agreement on Agriculture and with its scheduled commitments. The threat of circumvention for scheduled commodities is further enhanced by the fact that CCC is exempt from the requirement in the FCRA that a programme receive new Congressional budget authority before it undertakes new loan guarantee commitments. Mandatory programmes like the CCC export credit guarantee programmes must be available to all eligible borrowers, without regard to appropriations limits. In an important sense, this resembles the United States' FSC regime, which the Appellate Body found is available without limit. The Appellate Body considered that the unlimited nature of the regime posed a significant threat, under Article 10.1, that the United States would surpass its agricultural export subsidy reduction commitments.

### 2.4. The GSM 102, GSM 103 and SCGP Export Credit Guarantee Programmes Constitute Export Subsidies in Violation of Item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement

41. Since the CCC export credit guarantee programmes violate Articles 10.1 and 8 of the Agreement on Agriculture, the United States is not entitled to the "peace clause" exemption. Therefore, GSM 102, GSM 103 and SCGP programmes constitute prohibited export subsidies, in violation of item (j) of the Illustrative List of Export Subsidies, and of Articles 3.1(a) of the SCM Agreement.

## 3. The Step 2 Export and Domestic Subsidies Are Prohibited Subsidies in Violation of Articles 3.1(a) and 3.1(b) of the SCM Agreement

42. The United States asserts that all US upland cotton is eligible to receive Step 2 payments and that this removes the export and local content contingency. Brazil refutes the US assertion both as a

matter of law as well as fact. The Step 2 export provisions are not, as the United States now argues, simply domestic support payments made to US producers of upland cotton. Brazil again emphasizes that the *US – FSC* and *Canada – Aircraft* Appellate Body decisions are relevant jurisprudence and apply to the facts of the two situations set out in the regulations to Section 1207(a) of the 2002 FSRI Act. Thus, even if all US production since 1990 or even during MY 1999-2002 received Step 2 payments – which the United States has failed to document with any data – it would not remove the export and local content contingencies mandated by those regulations that violate SCM Agreement Articles 3.1(a) and (b).

43. US domestic Step 2 subsidies are prohibited local content subsidies in violation of Article 3.1(b) of the SCM Agreement. There is no explicit derogation of Article 3.1(b) built into the Agreement on Agriculture. The United States argues that there is an inherent conflict between Annex 3, paragraph 7 and Article 6.3 of the Agreement on Agriculture with Article 3.1(b) of the SCM Agreement because in the view of the United States, there can be no payments to processors of agricultural products included within AMS that do *not* violate Article 3.1(b) of the SCM Agreement. Brazil demonstrates that this is not true and that there are subsidies to agricultural processors that do not violate Article 3.1(b) and presents various examples to that respect.

44. Finally, Brazil notes the EC argument that applying Article 3.1(b) of the SCM Agreement "would lead to stricter disciplines being applied to domestic subsidies than are applicable for industrial goods". Local content subsidies – whether for agricultural and industrial products – are prohibited by Article 3.1(b). As "prohibited" subsidies, they are subject to the ultimate discipline – they cannot legally exist. The two packages of disciplines for agricultural and industrial products have both been negotiated during the Uruguay Round. The resulting rules have to be interpreted according to the customary rules of treaty interpretation as contained in the *Vienna Convention*. This interpretation results in agricultural local content subsidies being prohibited. Whether that results in there being more or less strict disciplines than would be applicable to industrial subsidies is not a relevant consideration for the interpretation of the disciplines.

### 4. The ETI Act Subsidies Violate Articles 10.1 and 8 of the Agreement on Agriculture and Are Prohibited by Articles 3.1(a) and 3.2 of the SCM Agreement

45. Brazil has made a *prima facie case* with respect to its claims against the ETI Act. Brazil challenges exactly the same measure based on the same claims asserted by the EC that the panel and the Appellate Body in *US – FSC (21.5)* held to violate the Agreement on Agriculture and the SCM Agreement. The sole difference is that Brazil limits its claims to ETI Act subsidies benefiting the export of upland cotton only.

# ANNEX D-2

## EXECUTIVE SUMMARY OF THE REBUTTAL SUBMISSION OF THE UNITED STATES

### Introduction and Overview

1. The comparison under the Peace Clause proviso in Article 13(b)(ii) must be made with respect to the support as "decided" by those measures. In the case of the challenged US measures, the support was decided in terms of a rate, not an amount of budgetary outlay. The rate of support decided during marketing year 1992 was ***72.9 cents*** per pound of upland cotton; the rate of support granted for the 1999-2001 crops was only ***51.92 cents*** per pound; and the rate of support that measures grant for the 2002 crop is only ***52 cents*** per pound. Thus, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.[1]

2. Brazil has claimed that additional "decisions" by the United States during the 1992 marketing year to impose a 10 per cent acreage reduction programme and 15 per cent "normal flex acres" reduced the level of support below 72.9 cents per pound. However, the 72.9 cents per pound rate of support most accurately expresses the revenue ensured by the United States to upland cotton producers. Even on the unrealistic assumption that these programme elements reduced the level of support by 10 and 15 per cent, respectively (that is, the maximum theoretical effect these programme elements could have had), the 1992 rate of support would still be ***67.625*** cents per pound, well above the levels for marketing years 1999-2001 and 2002.

3. Although such a comparison would not conform to the text, the result of the Peace Clause comparison is no different if one compares the support via an Aggregate Measurement of Support calculation. Using the price gap methodology (as provided under Annex 3 of the Agriculture Agreement) for US price-based deficiency payments and marketing loan payments, the upland cotton Aggregate Measurement of Support (in US $, millions) for these years is MY1992: 1,079; MY1999: 717; MY2000: 484; MY2001: 264; MY2002: 205. Again, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

4. Finally, the analysis presented by Brazil's expert at the first panel meeting actually supports the United States, not Brazil. Removing the non-product-specific support that Brazil erroneously tries to pass off as support to upland cotton, Brazil's own expert calculates the total support per unit

[1] Brazil has asserted that the United States' approach does not provide any way of taking Step 2 payments into account. Because the availability of Step 2 payments is contingent on certain price conditions existing during the marketing year, the level of support decided must relate to the payment parameters. These have remained the same for Step 2, with the exception of the suspension, through 2006, of the 1.25 cent price difference threshold and payment availability at slightly higher market prices. However, because Step 2 merely provides an alternative avenue of providing support (through processors rather than directly to producers), these minor adjustments do not alter the revenue ensured for producers by the marketing loan rate of 52 cents per pound. In addition, these minor adjustments cannot overcome the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002. Similarly, and without prejudice to whether these measures are within the Panel's terms of reference, we note that cottonseed payments in 1999, 2000, and 2002 ranged in value between 0.6 to 2.3 cents per pound (factoring expenditures over production); thus, they too do not materially affect the comparison between marketing year 1992 and any other year.

(cents/lb.) as MY1992: 60.05; MY1999: 53.79; MY2000: 55.09; MY2001: 52.82; MY2002: 56.32. Again, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

5. Thus, whether gauged via the rate of support decided by US measures (whether or not adjusted for the acreage reduction programme and normal flex acres), *or* via the AMS for upland cotton (calculated through a price gap methodology), *or* via the calculations of Brazil's expert (limited to product-specific support), the result is exactly the same: in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

**US Green Box Measures are "Exempt from Actions" Pursuant to Article 13(a)(ii)**

6. A measure shall be deemed to meet the "fundamental requirement" of the first sentence of Annex 2 if it meets the basic criteria of the second sentence plus any applicable policy-specific criteria. As suggested by the use of the word "fundamental" ("from which others are derived") and the structure of Annex 2 (that is, beginning the second sentence with the word "accordingly"), compliance with the requirement ("something called for or demanded") of the first sentence will be demonstrated by conforming to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6 through 13.

7. ***Direct Payments:*** Eligibility for direct payments under the 2002 Act is based on criteria in a "defined and fixed base period " (paragraph 6(a)) in the ordinary meaning of those terms: a base period that is "definite" (set out in the 2002 Act) and "stationary or unchanging in a relative position" (does not change in relative position for the six-year duration of the 2002 Act).

8. Paragraph 6(a) establishes that eligibility for payments under a decoupled income support measure shall be determined by clearly-defined criteria in "*a* defined and fixed base period," not "*the* base period" (as in paragraph 9 of Annex 3, which is defined in that same paragraph as "the years 1986 to 1988"). Brazil's reading of "a defined and fixed base period" would read into that text the term "unchanging", language Brazil has proposed in the ongoing WTO negotiations but is not currently found in the Agreement.

9. Annex 2, by its terms, sets out the fundamental requirement and basic and (if applicable) policy-specific criteria to which green box "*domestic support measures*" must conform. Other provisions in the Agreement similarly establish that the criteria set out in Annex 2 apply to "domestic support measures". Thus, with respect to a given decoupled income support measure, eligibility for payments must be determined by criteria in a "defined and fixed base period".

10. Brazil argues that a *new* decoupled income support measure must be based on the same base period as a previous measure if the new measure "is essentially the same" or "[i]f the structure, design, and eligibility criteria have not significantly changed." There is no provision in Annex 2 or the Agreement on Agriculture that supports Brazil's approach. It is thus irrelevant whether two decoupled income support measures are "essentially the same".

11. Brazil would read paragraph 6(b) as requiring a Member to make support available for *any* type of production; a Member could not preclude a recipient from producing certain crops.[2] While direct payments are reduced if certain crops are produced, a recipient need not produce any "type of"

[2] Brazil's reading would also seemingly require a Member to make payments even if the recipient's production was illegal – for example, the production of narcotic crops such as opium poppy or the production of unapproved biotech varieties or environmentally damaging production (for example, planting on converted rain forest or wetlands) – because, under Brazil's approach, by reducing or eliminating payments for any of these production activities, a decoupled income support measure could be understood to base or relate the amount of payment to the "type" of production undertaken.

crop in particular in order to receive the full payment for which a farm is eligible; the recipient need merely refrain from producing the forbidden fruit or vegetable. Thus, it is not any "type . . . of production . . . undertaken by the producer" that results in the full direct payment but rather production *not* undertaken by the producer – that is, *ceasing* certain production.

12. ***Production Flexibility Contract Payments:*** Production flexibility contract payments (now expired) were made with respect to farm acreage that was devoted to agricultural production in the past, including acreage previously devoted to upland cotton production. The payments, however, were made regardless of whether upland cotton was produced on those acres or whether anything was produced at all. As with direct payments, because production flexibility contract payments were decoupled from production, they met the five policy-specific criteria set out in paragraph 6 for decoupled income support measures.

13. Brazil has failed to make a *prima facie* case that US green box measures do not satisfy the fundamental requirement of Annex 2.[3] In fact, Brazil's "evidence" consists simply of selectively quoting and emphasizing conceptual and theoretical statements from the economic literature. *None of the papers Brazil cites concludes that these payments in particular, or decoupled income support measures in general, have more than "minimal[] trade-distorting effects or effects on production."*

14. The Agreement on Agriculture does not define a numerical threshold on what degree of effects will be considered "minimal[] trade-distorting effects or effects on production". However, given that *no study has found that these payments have effects on production of more than one per cent*, it would appear that direct payments have and production flexibility contract payments had no more than "minimal[] trade-distorting effects or effects on production". Thus, not only has Brazil failed to present a *prima facie* case, but the United States has affirmatively shown that these payments satisfy the fundamental requirement of the first sentence of Annex 2.

**US Non-Green Box Domestic Support Measures are not in Breach of Article 13(b)(ii)**

15. **: Peace Clause Proviso – Support was "Decided" During Marketing Year 1992 Using a Rate, Not a Budgetary Outlay**: The Peace Clause proviso requires a comparison to the product-specific support "decided" during the 1992 marketing year. A Member cannot "decide" world market prices or actual production or any other element outside a government's control. Yet Brazil would read the Peace Clause as though Members were omnipotent and could "decide" every factor influencing support.

16. Brazil lists nine different "decisions taken by the United States in relation to MY 1992 upland cotton support programmes". At least three of these "decisions" relate to the rate of support and *not a single decision relating to budgetary outlays or market prices.* Thus, Brazil's own answer confirms that the proper analysis of the support "decided" by US measures is to look to the terms of the US measures, which set a rate of support.

17. The use of the term "grant" in the Peace Clause proviso with respect to challenged measures does not compel an examination of budgetary outlays. The ordinary meaning of "grant" is to "bestow as a favour" or "give or confer (a possession, a right, etc.) formally". Thus, the use of the term "grant" would permit an evaluation of the rate of support that challenged measures "give or confer . . . formally". Members did not choose to use the word "granted" in place of "decided," and a valid

[3] If, as Brazil has argued, the first sentence is "fundamental" and has independent force, then presumably if a measure meets that "fundamental requirement", it will be deemed to be green box, irrespective of whether it meets the subordinate basic and policy-specific criteria. Thus, on Brazil's reading, if a measure does not conform to the criteria in Annex 2, it still could meet the "fundamental requirement", and the complaining party would bear the burden of proof to demonstrate a measure's inconsistency with that provision.

interpretation must make sense of that choice rather than reading it out of the Agreement. In addition, had Members intended the Peace Clause comparison to be made *solely* on the basis of budgetary outlays, they could have used that term, which is a defined term in Article 1(c) and used frequently in the Agreement.

18. **Peace Clause Proviso – "Support to a Specific Commodity" Means Product-Specific Support**: The phrase "support to a specific commodity" means "product-specific support". That the Peace Clause does not use the phrase "product-specific support" is neither surprising nor telling. The basic definition of product-specific support is given in Article 1(a), as "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product." Article 1(h) also refers to the concept but does not use the exact phrase "product-specific support"; in fact, the language this provision uses ("support for basic agricultural products") is strikingly similar to the Peace Clause proviso ("support to a specific commodity"). Neither Article 1(a) nor 1(h) *even uses the term "specific"* whereas the Peace Clause *contains all three elements of that phrase* (product, specific, and support).

**19. Brazil Simply Ignores the Definition of Product-Specific Support in the Agreement on Agriculture**: Brazil argues that certain challenged US measures are *not* "non-product-specific" and therefore must be "support to a specific commodity." Brazil focuses on the definition of "non-product-specific" support in Article 1(a) but simply fails to interpret that definition in light of the definition of product-specific support that immediately precedes it. The universe of domestic support measures under Article 1(a) consists of product-specific support and non-product-specific support; these two parts must be read together and in harmony.

20. The definition of product-specific support consists of two elements: First, the support must be provided "*for an agricultural product*," that is, the subsidy is given "in favour of" a product and not in respect of criteria not related to the product or in respect of multiple products. Second, such support is "in favour of the *producers of the basic agricultural product*", which suggests that subsidy benefits those who produce the product – that is, production is necessary for the support to be received. *Both* of these elements must be present for support to be product-specific since, should either be missing, the definition would not be satisfied.

21. The second category of support in Article 1(a) is defined as "non-product-specific support provided in favour of agricultural producers in general." The ordinary meaning of "in general" is "in general terms, generally". Non-product-specific support *cannot* be interpreted as support provided "for *an* agricultural product in favour of the *producers* of the basic agricultural product" because to do so would reduce the first half of the Article 1(a) definition to redundancy or inutility. Thus, non-product-specific support is support in favour of agricultural producers "generally" – that is, a residual category of support covering those measures that do not fall within the more detailed criteria set out in the definition of product-specific support.

22. **Counter-Cyclical Payments are Non-Product-Specific Support:** Counter-cyclical payments are non-product-specific support. The payment formula for counter-cyclical payments demonstrates that these payments are not "provided for an agricultural product" because a recipient need not currently produce upland cotton (or any other crop) to receive payment. In addition, it is not "the producers of the basic agricultural product" – that is, current upland cotton growers – that are entitled to receive the counter-cyclical payments but rather persons (farmers and landowners) on farm acres with *past histories* of producing covered commodities, including upland cotton, during the base period. Thus, counter-cyclical payments satisfy neither element of the definition of product-specific support and do not form part of the Peace Clause comparison.

23. Despite Brazil's attempts to mischaracterize the two as similar, counter-cyclical payments and deficiency payments differ in crucial respects. To receive a deficiency payment, a producer was

*required* to plant upland cotton for harvest and would be paid on the *acres planted to upland cotton for harvest* up to the maximum payment acreage. Thus, deficiency payments were support for an agricultural product (upland cotton) in favour of the *producers* of the product. By contrast, to receive the counter-cyclical payment a person with "upland cotton base acres" *need not plant for harvest or produce upland cotton* (nor any other crop nor any crop at all). Thus, counter-cyclical payments do not provide support for "an agricultural product" in favour of " the producers" of the basic agricultural product and do not form part of the Peace Clause comparison under the proviso in Article 13(b)(ii).

24. **Crop Insurance Payments Provide Non-Product-Specific Support**: Crop insurance is not support "provided for *an* agricultural product". For marketing year 2002, crop insurance payments are available to approximately 100 agricultural commodities, representing approximately 80 per cent of US area planted and greater than 85 per cent of the value of all US crops. Support which is provided to a number of crops is not "support to a specific commodity"; it is ' support to several commodities' or 'support to more than one commodity' and does not form part of the Peace Clause comparison. The United States notifies crop insurance as non-product-specific "amber box" domestic support subject to US reduction commitments. *No WTO Member has notified crop insurance programmes as product-specific*; in fact, Hungary, Canada, the EC, and Japan have notified crop insurance programmes as non-product-specific support. The United States is not aware of any other Member's crop insurance programme that has as broad product coverage as the US programme.

25. **Market Loss Assistance Payments are Non-Product-Specific Support**: As indicated in the US 1999 WTO domestic support notification (G/AG/N/USA/43), the expired market loss assistance payments were non-product-specific support. As with production flexibility contract payments, market loss assistance payments were made to persons with farm acres that previously had been devoted to production of certain crops, including upland cotton, during an historical base period. A recipient was not required to produce upland cotton or any other crop in order to receive payment, and no production was required at all. Thus, these payments are not product-specific support and would not form part of the Peace Clause proviso comparison.

26. **Direct Payments**: Were the Panel to conclude that direct payments do not conform fully to the provisions of Annex 2, direct payments would be non-product-specific support. As with counter-cyclical payments, direct payments are based on quantities of acreage that historically produced cotton, and there is no requirement to produce upland cotton (or any other crop) to receive these payments. Thus, direct payments would not be product-specific support.

27. **Production Flexibility Contract Payments**: Were the Panel to consider that these payments are within its terms of reference, the United States has explained that they would be green box support. Were the Panel to conclude further that production flexibility contract payments do not conform fully to the provisions of Annex 2, these payments would also be non-product-specific support for the reasons given with respect to direct payments. As such, they would not form part of the Peace Clause proviso comparison.

28. **Cottonseed Payments**: The Agricultural Assistance Act of 2003 and the cottonseed payment made pursuant to it is not within the Panel's terms of reference because the legislation authorizing the payments had not even been enacted at the time of Brazil's panel request, much less its consultation request. The "legal instruments" pursuant to which prior cottonseed payments were made, moreover, do not appear in Brazil's consultation or panel requests. Thus, it would appear that cottonseed payments for the 1999 and 2000 crops of cottonseed also do not form part of the Panel's terms of reference.

29. **Peace Clause Comparison – The Product-Specific AMS for Upland Cotton Also Demonstrates That Challenged US Measures Do Not Breach the Peace Clause**: The United States believes the Peace Clause compels comparing the rate of support decided by US

measures, whether or not adjusted for the acreage reduction programme and normal flex acres, with the current rate of support. Were the Panel to determine to use an Aggregate Measurement of Support calculation, however, the price gap methodology is the only appropriate one for Peace Clause purposes.

30. The price gap methodology eliminates the effect of prevailing market prices on the calculation of support. Instead, paragraphs 10 and 11 of Annex 3 designate that the support be calculated by multiplying the quantity of eligible production by the gap between the applied administered price (for example, the marketing loan rate) and the *fixed reference price* (that is, the actual price for determining payment rates for the years 1986 to 1988). Thus, by holding the reference price "fixed", support measured using a price gap calculation shows the effect of changes in the level of support (applied administered price) decided by a Member, rather than changes in outlays that result from movements in market prices that a Member does *not* control. In fact, the United States has calculated an AMS for upland cotton using the price gap methodology for both deficiency payments and marketing loan payments (marketing loan gains, certificate exchange gains, and loan deficiency payments) and using budgetary outlays for all other payments. The result is exactly the same as a rate of support comparison: in no marketing year from 1999 through 2002 is the support US measures grant in excess of the 1992 marketing year level.

**US Export Credit Guarantee Programme**

31. **The Negotiating History of Article 10.2 Reveals that the Negotiators Explicitly Deferred the Application of All Export Subsidy Disciplines on Export Credit Guarantees**: The GATT/WTO negotiating history regarding export credits and export credit guarantees in agriculture supports the US interpretation of Article 10.2. On 24 June 1991, Chairman Dunkel circulated a Note on Options in the Agriculture Negotiations requesting decisions by the principals on "whether subsidized export credits and related practices . . . would be subject to reduction commitments". Subsequently, on 2 August 1991, he circulated a proposed "Illustrative List of Export Subsidy Practices." Item (h) is explicitly "Export Credits provided by governments or their agencies on less than fully commercial terms." Similarly, item (i) is "Subsidized export credit guarantees or insurance programmes."

32. On 20 December 1991, the "Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations" was issued. Article 10.2 of the Draft Final Act states: "Participants undertake *not* to provide export credits, export credit guarantees or insurance programmes *otherwise than in conformity with* internationally agreed disciplines" (emphasis added). This draft text would clearly prohibit the use of export credit guarantees *except* in conformity with agreed disciplines. Such internationally agreed disciplines would include those contemplated by the SCM Agreement. This would be precisely the language necessary to support Brazil's reading.

33. Ironically, Brazil's interpretation would require export credit guarantees in agriculture to be subject to *greater* disciplines than any other practice addressed in the Agreement on Agriculture. Under Brazil's view, not only would export credit guarantees constitute export subsidies and be subject to *all* of the export subsidy disciplines, but Members would also be specifically obligated to work toward and then apply *additional* disciplines.

34. **Brazil's approach would result in gross injustice**: As part of the negotiations, the parties had to prepare and submit schedules of quantities and budget outlays during a base period to derive the export subsidy reduction commitments ultimately reflected in the respective schedules of the Members. Had Members' export credit guarantees been considered export subsidies for these purposes from the outset, then the export credit guarantee activity during the base period would also have to have been added to the base figures from which each Member's export subsidy reduction commitments were calculated. For example, the United States has no export subsidy reduction

commitment with respect to corn, yet during the 1986-1990 base period an average of over *5.5 million tons* of corn were exported *each year* under the GSM-102 and GSM-103 programmes. The United States would have reduction commitments for many more products than currently and would have had significantly increased commitments for the 13 products that are scheduled. However, Brazil would have the Panel impose the disciplines now but deny Members the corresponding changes in reduction commitments. Brazil's approach would be grossly inequitable and the Panel should reject it.

35. **The Application of Government-Wide Accounting Rules Indicates that the Export Credit Guarantee Programmes are Covering Long-Term Operating Costs and Losses:** The application of the Federal Credit Reform Act of 1990 ("FCRA") over time to the export credit guarantee programmes as a whole currently indicates that the net result of all activity associated with export credit guarantees issued in fiscal years 1994 and 1995 is a total net receipt to the United States of $29 million. The experience of 1994 and 1995 is viewed as representative, and the United States expects that the net results for other years will be similar to the experience for 1994 and 1995. Re-estimates thus far have resulted in a net reduction in the estimated costs of these programmes of over $1.9 *billion* since the inception of credit reform budgeting in fiscal year 1992. Based on those results, the Brazilian claim that "operating costs and losses for GSM 102, GSM 103, and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992" is not supportable.

36. The United States has gathered cumulative reestimates on a cohort basis: For example, for cohort 1992 (not yet closed) the current data reflects an estimate of a *profit* to the United States of approximately $124 million; for 1993 (not yet closed), the corresponding current figure is a *profit* of approximately $56 million; and, as indicated, cohorts 1994 and 1995 together project a *profit* of $29 million. With the exception of 2002, for which only very recent data is necessarily available, the Panel will note that the trend for all cohorts is uniformly favourable as compared to the original subsidy estimate.

37. Brazil asserts that "historically, the majority of GSM support that is rescheduled is 'in arrears'" and that this increases costs. Brazil largely relies, however, on a 1990 government report that is dated and precedes FCRA itself. No rescheduling applicable to export credit guarantees issued in fiscal year 1992 or later is in arrears.

38. **Brazil's Suggestion to Use Estimated Data to Determine Long-Term Costs and Losses Supports the View that the Export Credit Guarantees Do Not Provide Export Subsidies**: The United States notes Brazil's statement that "a certain degree of estimated data would be perfectly acceptable in an analysis of the costs and losses of guarantee programmes under item(j)" for two reasons. First, the re-estimate process for fiscal years 1994, 1995, and virtually every other year since fiscal year 1992 indicates a very strong net positive trend with respect to the programmes and that therefore current premium rates do cover long-term operating costs and losses. Second, it is relevant with respect to Brazil's reliance on the significant losses that the United States admittedly incurred with respect to Poland and Iraq. Presumably, to attempt to recover such losses in any practical time frame would require such a prohibitive fee increase that few, if any, exporters would take advantage of the program. Consequently, the United States would be whipsawed by a prohibition on the export credit guarantee as currently constituted because of the large losses incurred between 10 and 20 years ago, and the inability to create a conforming programme because the fee structure necessary to compensate for such historical losses would foreclose use of the programme. Item (j) cannot be reasonably interpreted to require an examination of all activity since the beginning of a programme, no matter how old it may be. The data provided with respect to fiscal years 1994 and 1995 and for the programmes as a whole indicates that current premium rates are presently adequate to cover long-term operating costs and losses as currently projected. The United States is also in a net positive position with respect to cotton transactions in the ten years commencing with fiscal year 1993.

39. **The Export Credit Guarantee Programmes Are Not Applied in a Manner which Results in or which Threatens to Lead to, Circumvention of Export Subsidy Commitments**: Brazil has challenged the export credit guarantee programmes, GSM 102, GSM 103, and SCGP, as such. Brazil has failed, however, to demonstrate that these programmes as such mandate a violation of US WTO obligations. It is well established under GATT and WTO jurisprudence that legislation of a Member violates that Member's WTO obligations only if the legislation *mandates* action that is inconsistent with those obligations or precludes action that is consistent with those obligations. If the legislation provides discretion to administrative authorities to act in a WTO-consistent manner, the legislation, as such, does not violate a Member's WTO obligations. This distinction has continued under the WTO system.

40. The Commodity Credit Corporation ("CCC") has complete statutory and regulatory discretion at any time not to issue guarantees with respect to any individual application for an export credit guarantee or to suspend the issuance of export credit guarantees under any particular allocation. This is in marked contrast to the situation in *US- FSC*, in which the Appellate Body found a threat of circumvention because the FSC legislation created a legal entitlement to the payment. There is no statutory legal entitlement to an export credit guarantee. Furthermore, even if an application and fee are received, the applicant is not necessarily entitled to receive the guarantee. Issuance is discretionary.

41. Finally, Brazil has alleged that the United States has exceeded its quantitative export subsidy reduction commitments during the period July 2001-June 2002. Even if the export credit guarantee programmes were deemed export subsidies, the United States would be in compliance with the quantitative reduction commitments for that period with respect to wheat, coarse grains, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, live dairy cattle, and eggs. This may also be true with respect to vegetable oil. In fiscal year 2002, it would also be true for poultry meat. The United States did not use the GSM-102 or GSM-103 programmes during 2001-2002 with respect to butter and butter oil, skim milk powder, cheese, other milk products, or eggs.

42. **Financial Arrangements Analogous to the CCC Export Credit Guarantee Programmes are Available in the Marketplace**: In light of Article 10.2, it is neither appropriate nor necessary to analyze the export credit guarantees with respect to Article 1.1(b) of the SCM Agreement. However, we note that financing is available in the marketplace that is analogous to export credit guarantees. A prominent example in the commercial market would be "forfaiting." It would appear, then, that a competitive marketplace exists for trade financing even in emerging markets where more conventional financing is not available. The United States is not privy to the precise terms at any time available in forfaiting transactions because those terms can vary by country, commodity, bank risk, size of transaction and numerous other factors. In addition, like most private financial activity, that information is ordinarily held confidentially by the parties.

**The Step 2 Programme is not Contingent on Export Performance**

43. Brazil apparently does not contest that all uses of upland cotton are eligible for the Step 2 subsidy. Instead, Brazil suggests, erroneously, that not the entire universe of users of upland cotton is eligible for the subsidy. First, the requirement that a recipient must be "regularly engaged" in the use of cotton is simply an anti-fraud provision to preclude an attempt to receive a payment with respect to cotton on which a payment has already been made. Brazil also correctly notes that "the eligible domestic user criteria exclude all firms that are domestic cotton brokers or simple resellers". These parties are not using the cotton and are therefore ineligible. Brazil suggests a third category of persons who are users but are not eligible to receive the payment: "firms that have not entered into CCC contracts" as either manufacturers or exporters. It is true that CCC cannot pay parties that

choose to remain unknown to it, but this requires an assumption of economic irrationality and does not diminish the point that all who use cotton have it entirely within their power to receive the subsidy.

# ANNEX D-3

## BRAZIL'S COMMENTS ON US REBUTTAL SUBMISSION

27August 2003

1. Pursuant to the Panel's ruling of 23 August 2003, Brazil presents the following comments on the paragraphs listed below relating to the Rebuttal Submission of the United States of America. In addition, Brazil offers comments on Question 67a posed to the United States by the Panel's Communication of 25 August 2003.

**Paragraph 43**

2. In paragraph 43 of its Rebuttal Submission, the United States argues that "Brazil's reading would seemingly require a Member to make payments even if the recipient's production was illegal, for example the production of narcotic crops such as opium poppy or the production of unapproved biotech varieties or environmentally damaging production." The United States claims this would have "potentially far reaching results." This new argument has no merit.

3. The two examples provided by the United States involving the growing of illegal plants/crops are, by definition, situations in which a national (or state/regional) domestic criminal (or civil) law would prohibit or regulate the growing of such plants/crops. The criminal (or civil) law would operate separately from any de-coupled direct payment to prohibit or regulate all forms of such production. There would be no reason in that situation to have a further statute limiting the payment if such illegal plants (or illegal production methods) – the activity would already be illegal. That is exactly the case with the 1996 FAIR Act and the 2002 FSRI Act regarding PFC and direct payments respectively. Neither limits the amount of payments for the growing of plants that would be illegal under US law. There is no need to because US federal and/or State law already prohibits such activity.

4. In addition, the US example in paragraph 43 about a restriction on "environmentally damaging production" is not relevant because such a restriction does not relate to the "type" of production (*i.e.*, the type of crop) but rather the "manner" of production.[4] Therefore, Annex 2, paragraph 6(b), which focuses on the "type" of production related to the "amount" of payment, it does not address the manner in which production is conducted. The context of Annex 2, paragraph 6(b) includes Annex 2, paragraph 12 ("Payments under environmental programmes") which permits Members to impose specific conditions on the growing of crops in order to receive environmentally related direct payments.

5. Thus, the "potentially far-reaching results" [5] from Brazil's text-based approach to the ordinary meaning of "the amount of such payments" related to or based on the "type of production " do not and

[4] *See* First Submission of Brazil, para. 157 in which Brazil makes the distinction between Paragraph 6(b) in which the word "type" relating to the type of crop produced contrasted with Paragraph 6(d) which is concerned with the type of production process. The United States has never contested this distinction.

[5] The United States reference to "potentially far-reaching results" appears also to include its additional new argument in paragraph 43 relating to the EC's possible CAP reform imposing, *inter alia*, fruits and vegetable restrictions. That potential "reform" is obviously not at issue in this case. The EC will have to make a decision how to notify any such measure when it is required to do so under Article 18 of the Agreement on Agriculture. It goes without saying that an improperly categorized green box measure of one Member cannot be justified by relying on a possible future improperly categorized green box measure of another Member.

will not exist. Brazil further notes that in the extraordinary situation in which one Member could theoretically seek to challenge a de-coupled direct payment limiting payments for growing plants such as opium poppy as an actionable subsidy, the Member restricting the "type" of production of such plants could, for instance, assert defences under Article XX(b) or (d) of GATT 1994.[6]

**Paragraphs 96-98**

6. The United States raises the new argument that "no other WTO Member has notified crop insurance programmes as product-specific."[7] At the outset, Brazil notes that it is the US crop insurance programmes and the detailed record of the product-specific nature of the US crop insurance programmes that is at issue in this dispute – not those of other WTO Members.

7. None of the WTO notifications of the EC, Canada, or Japan cited by the United States reflect the existence of the type of special product-specific policies or special treatment for certain crops within a broader insurance programme. In particular, there is no indication that these Members provide any specific crop insurance provisions for a specific crop, such as the insurance programmes provided by the United States for upland cotton.[8] For example, while Canada appears to have a similar programme for "crops" as the United States, there is no indication that Canada provides special polices or groups of policies within its broader programme for individual crops. Thus, in contrast to the evidence of other Member's insurance policies, the *nature, type, value,* and *participation rate* of the crop insurance policies provided by the United States differs widely among commodities. As Brazil has explained, it is simply not a "one size fits all" programme. The EC agrees. It has argued before the Committee on Agriculture that the US crop insurance programme is product-specific support.[9]

8. The United States further argues that it "is not aware of any crop insurance programme maintained by any other Member" that covers as many commodities as the United States.[10] However, the Article 13(b)(ii) test is whether a specific commodity receives support from a domestic measure identified in the *chapeau* and whether there is some sort of a link between the support measure and the specific commodity. Evidence of such a link in the case of crop insurance exists, as with the US crop insurance programme, when particular commodities are provided special policies, coverage, or additional subsidies compared to other commodities covered by the crop insurance programme. There is no such evidence reflected in the notifications of Mexico whose notification states that "insurance premium subsidy [is] available for all producers."[11] Japan's "Agricultural Insurance Scheme" also includes subsidies for policies covering all crops (except vegetables), all livestock (except poultry) and sericulture.[12] By contrast, the US insurance programmes challenged by Brazil do not provide subsidies for any insurance for livestock or many other commodities. Indeed, the commodities *not* covered by the US 2000 ARP Act and relevant regulations represent more than half of the value of US farm cash receipts.[13]

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[6] These same exceptions would be available in the unlikely event a Member challenged a direct de-coupled payment for any of the three scenarios posed by the United States in paragraph 43.

[7] Rebuttal Submission of the United States, para. 96-98.

[8] *See* Rebuttal Submission of Brazil, paras 54 (special irrigation-related policies for upland cotton), para. 55 (upland cotton producers have much larger pool of insurance subsidies than other types of crops), para. 56 (specific upland cotton income protection policies and catastrophic risk protection), para 57 (much greater use of insurance subsidies than other crops), para. 58 (reinsurance payments for upland cotton).

[9] Exhibit Bra-144 (G/AG/R/31, para. 31).

[10] Rebuttal Submission of the United States, para. 98.

[11] G/AG/N/MEX/7, p. 4.

[12] Rebuttal Submission of the United States, para. 98.

[13] Rebuttal Submission of Brazil, para. 59 (Excluded agricultural commodities from US insurance programme represent 52 per cent of the value of all US farm cash receipts).

9. Finally, as the United States recognizes, more than half of the notifications (which include part of Japan's) cited by the United States refer to insurance programmes as green box support.[14] Members so notifying are not obliged to make a determination under Article 6 of the Agreement on Agriculture whether such support is product-specific or not because it is exempt from any reduction commitments. The United States has not provided evidence suggesting these green box categorizations are incorrect. For these reasons, these notifications are also irrelevant.

**Paragraphs 114-117**

10. The United States argues for the first time in paragraphs 114-117 of its Rebuttal Submission that using the "price-gap" methodology is the appropriate way to calculate the portion of upland cotton AMS that stems from marketing loan gains, certificate exchange gains, and loan deficiency payments (collectively known as "marketing loan payments"). The effect of applying the price gap methodology would be to transform the $2.5 billion in budgetary expenditures for marketing loan payments in MY 2001 into a "negative" amount for purposes of total current AMS.[15] The United States bases its new argument on an alleged statement by Brazil and "agrees" that "Brazil is correct when it states that a non-exempt direct payment dependent on a price gap may be calculated using a price gap methodology, rather than budgetary outlays. . .."[16]

11. The United States refers to Brazil's 11 August Answer to Question 67, paragraph 130, as the basis for its assertion. Brazil's statement cited by the United States reads as follows:

> Brazil notes that the United States has notified the deficiency payments using the price gap methodology provided for in Annex 3. [footnote citing Exhibit Bra-150 (G/AG//N/USA/10)] Brazil considers it appropriate to follow the US decision and will therefore, calculate the amount of support to upland cotton provided by the deficiency payment programme by using the "price gap" approach detailed in Annex 3 paragraph 10 and 11.

Contrary to the US interpretation of this statement, Brazil's point was that any calculation of AMS for deficiency payments (and for the other programmes that require such calculation) must be consistent with the actual choice of methodology originally made by the United States for calculating its domestic support reduction commitments as well as its yearly current AMS notifications. Indeed, the United States' entire argument in paragraphs 114-117 of its Rebuttal Submission is based on the alleged obligation for Brazil "to be consistent."[17] As demonstrated below, it is Brazil's AMS calculation, not that of the United States, that is "consistent."

12. Members are required to notify annually their current total AMS to provide other Members the opportunity to review the consistency with their domestic support reduction commitments pursuant to Article 6.3 of the Agreement on Agriculture.[18] The total AMS reduction commitments were negotiated during the Uruguay Round based on a calculation of "total AMS" provided in marketing years 1986-1988. The initial AMS calculation used for the purposes of the reduction commitments was performed pursuant to Annex 3 of the Agreement on Agriculture with Members choosing either budgetary expenditures or a "price-gap" methodology expressed in total monetary terms. Like Article 13(b)(ii), the comparison between *current* total AMS and the AMS ceiling, *i.e.*,

[14] Rebuttal Submission of the United States, para. 97.

[15] The United States even claims credit for being conservative by not netting the negative support by the marketing loan benefits against the positive support provided by the other domestic support programmes, Rebuttal Submission of the United States, para. 116 and note 148.

[16] Rebuttal Submission of the United States, para. 114.

[17] Rebuttal Submission of the United States, para 114 (last sentence).

[18] *See* Article 18.2 of the Agreement on Agriculture and various US notifications cited herein.

the reduction commitment, must allow for an "apples to apples" annual comparison in accounting for the same measures. It follows that once a Member uses a budgetary approach for one measure to establish the AMS ceiling, it cannot use a price gap approach for that same measure in calculating total *current* AMS. Instead, a Member is required to report *current* total AMS consistently with the choice it made for that particular type of support in its *original* total AMS calculation.

13. This interpretation of Annex 3 and Article 6.3 of the Agreement on Agriculture is consistent with its context and object and purpose. Opting for a methodology that would permit Members to change their original methodology (*i.e.*, from budgetary to price-gap) could sanction what the United States proposes – the covering up of billions of dollars of marketing loan payments (originally calculated on a budgetary basis) and turns them into "negative support" by using a "price-gap" formula. This would be inconsistent with the entire reason for the reduction commitments of Article 6 of the Agreement on Agriculture.

14. Brazil's calculation of AMS for, *inter alia*, marketing loan payments followed the actual decision of the United States during the Uruguay Round[19] as reflected in its notifications.[20] During the Uruguay Round, the United States calculated the upland cotton portion of what would eventually become its domestic support reduction commitment by using the following methodologies: it used the price gap formula for upland cotton deficiency payments[21] and used budgetary outlays for all other domestic support measures.[22] In its MY 1995 notification to the Committee on Agriculture the United States similarly notified deficiency payments using the price-gap formula and using budgetary outlays for all other domestic support measures subject to reduction commitments[23] consistent with its AMS calculation during the Uruguay Round. After the termination of the deficiency payment programme in 1996, all later domestic support (current total AMS) notifications of the United States for upland cotton only use budgetary outlays. Thus, Brazil's approach to calculating upland cotton AMS for MY 1992 and 1999-2002 is entirely consistent with the US approach as evidenced in its domestic support notifications[24] and with the US obligations under the Agreement on Agriculture.

15. The United States accounted for the marketing loan payments in the same manner as in its notifications when it answered Question 67 in its 11 August submission.[25] This is, furthermore, the methodology the Panel indicated the United States should use – referring to the US notification of MY 1999 domestic support in G/AG/N/USA/43, in which the United States – in line with its obligation – used budgetary outlays.[26]

16. In sum, like many other US arguments in this phase of the dispute, this US argument is designed to cover-up expenditures and support to upland cotton that increased significantly since the US Uruguay Round commitments came into effect. Therefore, the Panel should reject it.

[19] Exhibit Bra-191 (G/AG/AGST/USA, p. 20)
[20] Exhibit Bra-150 (G/AG/N/USA/10, p. 18)
[21] Exhibit Bra-191 (G/AG/AGST/USA, p. 20 and supporting tables on p. 21-22).
[22] Exhibit Bra-191 (G/AG/AGST/USA, p. 20).
[23] Exhibit Bra-150 (G/AG/N/USA/10, p. 18).
[24] The United States entire argument in paragraphs 114-117 is premised on the alleged need for Brazil "to be consistent" as stated in the last sentence in paragraph 114. As noted, it is Brazil who has been consistent in using actual US notifications and the US calculation method during the Uruguay Round, not the United States who now seeks to ignore them.
[25] US 11 August Answer to Question 67, para. 128-134.
[26] Exhibit Bra-47 (G/AG/N/USA/43, p. 20).

**Paragraphs 124-127 and Exhibit US-24**

17. The United States presents an additional critique of Professor Sumner's analysis in Exhibit US-24 prepared by Dr. Joseph W. Glauber, the Deputy Chief Economists of USDA, as well as in paragraphs 124-127 of its Rebuttal Submission.

Marketing Loan Benefits

18. Dr. Glauber notes that the analysis of Professor Sumner did not include in the upland cotton acres eligible for marketing loans 447,164 acres of upland cotton planted on Flex acres from other programme crops.[27] Dr. Glauber is correct that any such acreage would be eligible for receiving marketing loan payments and therefore should be included in the calculation.[28] Dr. Glauber refers to "Acreage Reduction compliance reports" as his source of this number. Dr. Glauber does not provide a citation for these compliance reports and the United States has not made them available to Brazil. Therefore, Brazil cannot confirm the actual number of acres. Brazil also notes that the number listed is planted acres not harvested acres.[29]

19. Dr. Glauber further rests his finding that 100 per cent of US upland cotton production in MY 1992 benefited from marketing loan payments on his statement that upland cotton farmers "often" report land that had been planted and abandoned as land left idle and therefore never planted. No citation, authority or reference is provided for this assertion. The assumption in this assertion is that farmers report one thing to the US Federal Government, yet actually do something else. Thus, Dr. Glauber's presumption appears to be that farmers engage in what would appear to be widespread misrepresentation. Brazil does not know if such assumed large-scale misrepresentations were legal under the 1992 US programme, but it certainly contradicts "programme" expectations.

20. Professor Sumner concluded that 1.99 million acres used to produce upland cotton in MY 1992 were not eligible for the marketing loan payments because they did not participate in the deficiency programme. Dr. Glauber confirms Professor Sumner's general approach on non-participating acreage in footnote 1 on page 2 where he acknowledges that "some base building occurred during the early 1990's." What this means is that a substantial amount of upland cotton must have been planted outside the programme to accommodate expansion of upland cotton base by 200,000 acres in 1993, as identified by Dr. Glauber. This acknowledgement supports Professor Sumner's analysis that a significant amount of upland cotton must have been grown *outside* the deficiency programme. The basis for this analysis is as follows:

21. Under the rules existing in MY 1992, in order to "build" base a farm was required to plant all of its upland cotton outside the programme.[30] The expansion of upland cotton base is equal to one-

[27] Exhibit US-24, p. 1.

[28] Neither Brazil nor Professor Sumner were aware of any flex acres from other programme crops planted to upland cotton or of data concerning any such plantings.

[29] Dr. Glauber raises in the first sentence of paragraph 2 what he called "statistical problems in comparing planted acres to programme acres." He points out that "planted acres" information was collected and reported by NASS, while "programme acres" are reported by the Farm Service Agency. (In 1992 this part of USDA was known as the Agricultural Stabilization and Conservation Service.) Dr. Glauber goes on to explain that a significant amount of cotton acreage is planted and abandoned each year. But the relevance of this information in critiquing Professor Sumner's analysis remains unclear. Brazil notes that contrary to Dr. Glauber's assumption, Professor Sumner's calculations do *not* rely on data published by NASS, but instead on published information in the Farm Service Agency's "Fact Sheet: Upland Cotton" (Exhibit Bra-4). This Farm Service Agency source provides data on planted acres, the abandonment rate as well as harvested acres of upland cotton for MY 1992.

[30] Exhibit US-3 (7 CFR 1413.7(c)). ("[T]he crop acreage base shall be equal to the average of the acreage planted and considered planted to such crop for harvest on the farm in each of the 3 crop years

third of the amount of additional cotton acres planted in each of the previous three years. An acre of base is added if an additional acre of cotton is planted for three consecutive years.[31] In order to plant more than the current base, a farm was required to leave the programme *altogether* so that current base acres would also be planted outside the programme. For example, assume a farm had 1000 acres of upland cotton base and wanted to add – over the two-year period 1991-1992 – 200 acres of base by 1993. That farm would withdraw from the programme for those two years and plant 1300 acres of cotton (300 acres more than the previous base) in 1991 and 1992. The 1993 upland cotton base would than be calculated as follows: (1000 acres + 1300 acres + 1300 acres) / 3 equalling 1200 acres, thus 200 acres more than previously. Therefore, to add the 200,000 acres of base in 1993 (which Dr. Glauber stated were actually added) a much larger amount of upland cotton would have been required to be planted *outside* the programme in 1992. In addition to building of additional base, farmers planted upland cotton outside the programme because they did not comply with payment limit rules and for some more idiosyncratic reasons.

22. In summary, the evidence of an expanding base is consistent with the assessment of Professor Sumner that a substantial amount of acreage was planted to upland cotton outside the programme. This evidence is not consistent with Dr. Glauber's undocumented or unsubstantiated claim that *all* upland cotton harvested was eligible for marketing loans.

23. To summarize, if the Panel were to accept the undocumented assertion by Dr. Glauber that 447,164 acres of cotton were planted on flex acres from other programme crop base acreage, then there would be 1.54 million acres (1.99 million acres – 0.45 million acres) that were planted to upland cotton but were not eligible for marketing loan payments. This 1.54 million represents 12 per cent of planted acreage.[32] Thus, adjusting 52.35 cents per pound by 0.88 results in a support from the marketing loan programme of 46.1 cents per pound. This is an increase of 1.76 cents over the marketing loan level of support set forth in Appendix Table 1 to Professor Sumner's 22 July 2003 Statement.

Deficiency Payments

24. Brazil has already rebutted the US argument that it is inappropriate to adjust the support provided by the deficiency payment programme by non-participation and the resulting non-eligibility to receive payments.[33]

25. The various "decisions" in MY 1992 with respect to the deficiency payment programme were calculated to establish rules that encouraged some producers to forego eligibility of the programme. Furthermore, the record establishes that US policy makers had relatively precise prior knowledge of how many acres would remain out of the programme based on their policy choices on required land idling and loan rates.[34]

26. Dr. Glauber criticizes Professor Sumner for relying on a programme yield of 531 pounds per acre to calculate the ratio of payment yield to expected yield and states that the true programme yield

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preceding such crop year"). For a farmer within the programme the acreage could never change, as all the acreage was planted (or if idled or – in case of flex acreage – if planted to other crop, it was "considered" planted to upland cotton). Thus, an increase of acreage could only take place, if a farmer withdrew from the programme and exceeded the planting limits imposed by the programme. Thus, MY 1992 base acreage is constitutes the 3-year average of acreage planted and considered planted in MY 1989-1991.

[31] Or of 3 additional acres are planted in the previous year, among other possible constellations.

[32] *Compare* Annex 2 to Exhibit Bra-105, p. 3.

[33] Brazil's 22 August Comment on Question 66, para. 81.

[34] Brazil's 22 August Comment on Question 66, para. 81.

in MY 1992 was 602 pounds per acre.[35] Dr. Glauber references a USDA press release that is not available to those outside the US government as his source of the payment yield information.[36] Assuming that the figure of 602 pounds per acre used by Dr. Glauber is correct, he incorrectly continues to rely on Professor Sumner's calculation of the expected yield by stating that the "expected yield based on an average of the upland cotton yields over the five preceding crop years is 601 pounds per acre." Professor Sumner estimated the payment yield based on actual yields per *planted* acre, whereas the payment yields that Dr. Glauber cites appears to be the approximate average yields per *harvested* acre. To achieve an apples-to-apples comparison, Brazil has re-calculated the expected yield for MY 1992 as the average yield per *harvested* acre during the 1990 to 1994 based on USDA's "Fact Sheet: Upland Cotton" (656.4 pounds per acre).[37] Thus, the relevant adjustment factor is not 1.002 as suggested by Dr. Glauber, but 0.917 (603 / 656.4).

27. Dr. Glauber offers no critique of Professor Sumner's analysis of the mandatory land idling cost component in the calculation of deficiency payment support. However, Dr. Glauber neglected to include these costs associated with the participation in the programme. As Professor Sumner explained, such costs are properly subtracted from the gross benefits of the cotton deficiency payment programme.

28. Brazil provides a revised calculation below, taking account of the revised yield adjustment factor of 0.917 – reflecting the deficiency payment yield as provided by Dr. Glauber's and the expected comparable yield for MY 1992 that Dr. Glauber erroneously did not correct. In addition, Brazil continues to deduct the cost figure calculated by Professor Sumner from the deficiency payment programme. The revised formula is as follows:

> Deficiency payment support = 20.55 cents per pound * 0.75 * 0.917 – 0.84 cents per pound = 13.29 cents per pound

Using the new payment yield and the new expected yield that is comparable to it, results in a 0.04 cents per pound upward adjustment to the 13.25 cents per pound presented by Professor Sumner in his 22 July Statement.

Other Payments

29. Brazil has already responded at length to Dr. Glauber's claims endorsing the arguments of the United States that PFC, market loss assistance, direct and CCP payments, as well as crop insurance payments are not "support to" upland cotton. Dr. Glauber's statement simply restates assertions in the legal briefs of the United States and offers no economic analysis to support his assertions.

30. Dr. Glauber asserts that it is relevant that Step 2 payments are not paid directly to producers.[38] As Brazil explains in its 11 August Answer to Question 18, a basic principle is that the effect of a subsidy is independent of who initially receives the subsidy.[39] That is the economic common sense behind the United States notifying Step 2 payments as product-specific support to upland cotton. And it is the basis for including such payments as "support to a specific commodity" "decided" by a

[35] Exhibit US-24, p. 3.

[36] The United States has not made this document available and thus we are unable to evaluate its applicability to the current situation. Professor Sumner had relied on the best information available to him and Brazil, which was the average upland cotton yield per planted acre during the reference period of MY 1981-1985.

[37] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[38] Exhibit US-24, p. 3.

[39] Exhibit Bra-140 (Pindyck, Robert S. and Rubinfeld, Daniel L. , *Microeconomics*, 5th edition (2002), Prentice Hall, New Jersey, p. 313-317).

Member with respect to MY 1992. The text of Article 13(b)(ii) requires, under any methodology, the calculation of a level of support *to upland cotton*, not *to producers* of upland cotton.

31. Dr. Glauber's assertions about "double counting" are also incorrect. All the support programmes Dr. Glauber discusses (marketing loan payments, CCP payments and deficiency payments) have production and trade effects largely independent of Step 2 payments. But the purpose of calculating a rate of support under Article 13(b)(ii) is not to assess the *amount* of production, export, and price effects of the simultaneous application of all measures of support. Brazil will present an equilibrium analysis of the full economic effects of these support programmes simultaneously for Brazil's "Further Submission." Such an analysis is, however, not required for the purposes of calculating the rate of support under Article 13(b)(ii). The fact that the United States notified Step 2 as "product-specific" support indicates its position that the Step 2 programme provides additional support to upland cotton. This has certainly been the strongly held view of the US National Cotton Council.[40] Thus, it was appropriate for Professor Sumner to include this production and trade-distorting subsidy in the total rate of support.

32. Brazil notes that Dr. Glauber does not criticize any other calculation made by Professor Sumner. For the convenience of the Panel, Brazil reproduces the chart containing Professor Sumner's calculation as amended following the detailed US critique of Professor Sumner's methodology. As the Panel will note, the results do not materially change. The support granted by the United States in MY 1999-2002 exceeds the support decided in MY 1992. Thus, even under this methodology, the United States does not enjoy peace clause exemption from actions based on Articles 5 and 6 of the SCM Agreement or Article XVI:1 of GATT 1994.

| Year | 1992 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| | (Cents per pound) | | | | |
| **1. Marketing Loan** | 46.10 | 50.36 | 50.36 | 50.36 | 52.00 |
| **2. Deficiency Payments** | 13.29 | na | na | na | na |
| **3. Step 2** | 2.46 | 2.46 | 2.46 | 2.46 | 3.71 |
| **4. Crop Insurance** | 0.36 | 2.00 | 2.00 | 2.62 | 2.62 |
| **5. PFC Payments** | na | 6.13 | 5.70 | 4.65 | na |
| **6. Market Loss** | na | 6.10 | 6.07 | 6.42 | na |
| **7. Direct Payments** | na | na | na | na | 5.31 |
| **8. CCP Payments** | na | na | na | na | 10.65 |
| **9. Cottonseed Payments** | 0.00 | 0.97 | 2.27 | 0.00 | 0.61 |
| **10. Total Support** | **62.21** | **68.03** | **68.87** | **66.51** | **74.91** |

**Paragraphs 135-146, and Exhibits US-25 through US-29**

33. Brazil has demonstrated that under the ordinary meaning of Article 10.2 of the Agreement on Agriculture, in its context and according to the object and purpose of Article 10 and the Agreement on Agriculture overall, export credit guarantees are subject to the general export subsidy disciplines contained in that Agreement.[41] Article 10.2 announces Members' intent to work toward negotiations

[40] Brazil Rebuttal Submission, para. 127.

[41] *See* Brazil Statement at the First Panel Meeting, paras. 100-115; Brazil 11 August Responses to Panel Questions 70 (para. 138); Brazil 22 August Rebuttal Submission, paras. 99-100; Brazil 22 August Comments on Answers to Panel Questions 74 (paras. 89-90), 80 (para. 98), 88(b) (paras. 117-119).

on specific disciplines for export credits. In the meantime, the general disciplines on export subsidies included in the Agreement on Agriculture apply to export credits, if those export credits constitute export subsidies.[42]

34. The United States asserts that Article 10.2 carves out export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture, including the anti-circumvention provisions of Article 10.1. The Appellate Body has, however, concluded that to exempt or carve-out particular categories of measures from general obligations such as the export subsidy obligations in the Agreement on Agriculture, the exemption or carve-out must be *explicit* in the text of an agreement.[43] Article 10.2 includes no such explicit carve-out or exemption. The negotiators knew how to make such an exemption or carve-out explicit, as evidenced by, for example, Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.[44]

35. In support of its interpretation, the United States appeals to "subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation," within the meaning of Article 31(3)(b) of the *Vienna Convention*.[45] According to the United States, negotiations on agricultural export credit issues that have taken place in the OECD subsequent to the effective date of the WTO Agreement, and a statement by the OECD Secretariat, constitute "subsequent practice" establishing the agreement of WTO Members that Article 10.2 of the Agreement on Agriculture exempts export credits from any and all disciplines.

36. The United States is wrong. The United States has not established "a 'concordant, common and consistent' sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties [to a treaty] regarding its interpretation," which is the standard adopted by the Appellate Body to establish "subsequent practice" under Article 31(3)(b) of the *Vienna Convention*.[46] It is evident from the positions taken by Canada, the European Communities and New Zealand in this dispute that *not even those WTO Members that participated in the OECD negotiations* agree with the United States' interpretation of Article 10.2.[47] Nor is there any evidence of "subsequent practice" signifying agreement on the United States' interpretation amongst the 136 WTO Members that did not participate in the OECD negotiations.

37. Brazil notes, moreover, that the WTO Secretariat, which is in a better position to address interpretations of the covered agreements than is the OECD Secretariat, does not appear to agree that

[42] Export credit guarantees are not *per se* subject to these disciplines, as they would be if they were included in Article 9.1 of the Agreement on Agriculture (*See e.g.*: Brazil's 22 August Comment, para. 97, New Zealand's Answer to Third Party Question 35, EC's Answers to Third Party Questions 35, para. 70). Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes constitute export subsidies under Articles 1(e) and 10.1 of the Agreement on Agriculture, under Articles 1.1 and 3.1(a) of the SCM Agreement, and under item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement.

[43] Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128. *See* discussion at paragraphs 107-108 of the Oral Statement of Brazil.

[44] Oral Statement of Brazil, paras. 105-106.

[45] Rebuttal Submission of the United States, para. 135.

[46] Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 213; Appellate Body Report, *Japan – Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 107.

[47] *See* Third Party Submission of Canada (paras. 51-54); Third Party Submission of the European Communities (paras. 28-31); Third Party Submission of New Zealand (paras. 3.13-3.16).

agricultural export credits are exempt from the general export subsidy disciplines of the Agreement on Agriculture by virtue of Article 10.2.[48]

38. The United States also argues that the negotiating history of Articles 9.1 and 10.2 of the Agreement on Agriculture supports its argument that export credit guarantees are exempt from the general export subsidy disciplines of the Agreement on Agriculture. The United States raises three arguments in this regard.

39. *First*, the United States addresses the negotiating history of Article 9.1.[49]

40. In the DeZeeuw framework agreement, the United States points to paragraph 20(e), which contemplated Members providing "data on financial outlays or revenue foregone . . . in respect of export credits provided by governments or their agencies on less than fully commercial terms."[50] The United States apparently considers that since paragraph 20(e) was not carried over into the Agreement on Agriculture, export credits are not subject to the export subsidy disciplines in the Agreement.

41. Brazil notes, however, that paragraph 20(g) addressed "export performance-related taxation concessions or incentives." This provision was also not carried over into the Agreement on Agriculture. Nonetheless, panels and the Appellate Body have ruled that export performance-related taxation concessions or incentives like the United States' FSC and ETI measures are subject to the general export subsidy disciplines of the Agreement on Agriculture, including Article 10.1.

42. Similarly, the United States points to Addendum 10 of Chairman Dunkel's Note on Options, which includes an illustrative list of export subsidy practices.[51] A number of the items on that illustrative list were eventually included, with modifications, in Article 9.1 of the Agreement on Agriculture.[52] Others were not, including item (h), which refers to "[e]xport credits provided by governments or their agencies on less than fully commercial terms," and item (i), which refers to "[s]ubsidized export credit guarantees or insurance programmes." The United States apparently considers that since items (h) and (i) were not carried over into the Agreement on Agriculture, export credits, including export credit guarantees and insurance programmes, are not subject to the export subsidy disciplines in the Agreement.

43. Brazil notes, however, that item (g) of Chairman Dunkel's illustrative list refers to "[e]xport performance-related taxation concessions or incentives other than the remission of indirect taxes." This provision was also not carried over in Article 9.1 of the Agreement on Agriculture. Nonetheless, as Brazil has already noted, panels and the Appellate Body have ruled that export performance-related taxation concessions or incentives like the United States' FSC and ETI measures are subject to the general export subsidy disciplines of the Agreement on Agriculture, including Article 10.1.

44. Brazil assumes that the United States simply overlooked paragraph 20(g) of the DeZeeuw framework agreement and item (g) from Chairman Dunkel's illustrative list when it states, in paragraph 143 of its Rebuttal Submission, that

[48] G/AG/NG/S/13 (26 June 2000), para. 44 ("[A]s matters currently stand the only rules and disciplines on agricultural export credits are those of the Agreement on Agriculture but only to the extent that such measures constitute export subsidies for the purposes of the Agreement on Agriculture.").

[49] Rebuttal Submission of the United States, paras. 136-138.

[50] *See* Exhibit US-25.

[51] Exhibit US-27.

[52] Paragraph 48(a) corresponds to Article 9.1(a), paragraph 48(e) to Article 9.1(e), paragraph 48(f) to Article 9.1(d), paragraph 48(j) to Article 9.1(f), paragraph 48(k) to Article 9.1(c).

> the negotiating history reveals that the Members very early specifically included export credits and export credit guarantees as a subject for negotiation and specifically elected *not* to include such practices among export subsidies. In contrast, the negotiating history reveals no comparable discussion involving FSC.

45. In light of these facts, it is evident that the negotiating history of Article 9.1 does not offer support for the United States' argument that export credit guarantees are exempt from the general export subsidy disciplines of the Agreement on Agriculture.

46. *Second*, the United States argues that changes introduced to the text of Article 10.2 between the Draft Final Act and the final version of the Agreement on Agriculture mean that export credits are not subject to the export subsidy disciplines included in the Agreement.[53]

47. The version of Article 10.2 included by negotiators in the Draft Final Act read as follows:

> Participants undertake not to provide export credits, export credit guarantees or insurance programmes otherwise than in conformity with internationally agreed disciplines.

The United States argues that this version of Article 10.2 "would clearly prohibit the use of export credit guarantees except in conformity with [internationally] agreed disciplines," which it asserts "would include those contemplated by the SCM Agreement."[54]

48. The version of Article 10.2 included in the Agreement on Agriculture reads as follows:

> Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

The United States argues that having changed the draft, "[t]he Members clearly subsequently decided *not* to condition the use of export credit guarantees on conformity with the export subsidy disciplines of the Agreement on Agriculture or the SCM Agreement."[55]

49. The United States' interpretation of the negotiating history requires the Panel to accept that the version of Article 10.2 included in the Draft Final Act would have imposed a *greater burden* on Members than does the version of Article 10.2 ultimately included in the Agreement on Agriculture. In fact, however, Article 10.2 of the Draft Final Act was amended to make it clear that negotiators expected Members actually *to pursue* negotiations on specific disciplines. Whereas the version of Article 10.2 included in the Draft Final Act did not include an undertaking to pursue those negotiations, the final version of Article 10.2 does include such an undertaking. The amendment did not *relieve* the Members of any burden, but instead *increased* the burden.

50. At least some Members understood this to be the case, since soon after the conclusion of the Uruguay Round, they launched negotiations in the OECD on specific export credit disciplines.[56] The

[53] Rebuttal Submission of the United States, paras. 140-142.
[54] Rebuttal Submission of the United States, para. 140.
[55] Rebuttal Submission of the United States, para. 141.
[56] The United States' assertion that the phrase "internationally agreed disciplines" in Article 10.2 of the Draft Final Act referred to those disciplines "contemplated by the SCM Agreement of the Draft Final Act" is not credible. Where negotiators meant to refer to pending WTO agreements outside of the draft Agreement on

United States implies that Brazil's "admission" that those negotiations have not yet resulted in agreement on specific disciplines for export credits is fatal to its claims. Brazil has demonstrated elsewhere, however, that while those negotiations are pending, nothing in Article 10.2 (or Article 1(e)) exempts export credits from the general disciplines on export subsidies included in, for example, Article 10.1 of the Agreement on Agriculture. If export credits constitute export subsidies, they are subject to those disciplines. As noted above, the Appellate Body has concluded that to exempt particular categories of measures from general obligations such as Article 10.1, the exemption must be explicit.[57] The negotiators knew how to make exemptions explicit, but did not do so in the case of export credits.[58]

51. *Third*, the United States argues that "Brazil's interpretation would require export credit guarantees in agriculture to be subject to more disciplines than any other practice addressed in the Agreement on Agriculture," since "not only would export credit guarantees constitute export subsidies and be subject to all of the export subsidy disciplines, but Member's [sic] would also be specifically obligated to work toward and then apply *additional* disciplines."[59] This statement is incorrect for several reasons:

- As clarified by Brazil, New Zealand and the European Communities, since export credits are not included in Article 9.1, they do not necessarily "constitute export subsidies."[60] They only constitute export subsidies if they are financial contributions that confer benefits and are contingent on export, or if they satisfy the elements of one of the items on the Illustrative List of Export Subsidies annexed to the SCM Agreement.

- Export credits are only "subject to all of the export subsidy disciplines" of the Agreement on Agriculture if they lead to circumvention of a Member's export subsidy reduction commitments.

- It is not clear that any specific disciplines resulting from negotiations undertaken pursuant to Article 10.2 will be "additional" to those already included in the Agreement on Agriculture or the SCM Agreement. Those negotiations are not yet completed. Depending on the agreement negotiated, it is presumably possible that the resulting text could replace the disciplines included in the Agreement on Agriculture.

52. Therefore, the United States' argument is inaccurate, and does not support its assertion that export credit guarantees are exempt from the general export subsidy disciplines in the Agreement on Agriculture, even if they meet the definition of "export subsidy."

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Agriculture, they cited those WTO agreements by name. For example, Article 5.8 of the Draft Final Act (regarding special agricultural safeguards) refers specifically to the GATT and the Safeguards Agreement. Similarly, the final version of Article 13 of the Agreement on Agriculture includes numerous specific citations to the SCM Agreement.

[57] Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128. *See* discussion at paragraphs 107-108 of the Oral Statement of Brazil.

[58] *See, e.g.*, Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.

[59] Rebuttal Submission of the United States, para. 142.

[60] *See e.g.*: Brazil's 22 August Comment, para. 97, New Zealand's Answer to Third Party Question 35, EC's Answers to Third Party Questions 35, para. 70.

**Paragraphs 147-152**

53. The United States argues that it did not include the quantities exported under the CCC programmes in its calculation of average export subsidies during 1986-1990 (the base period from which export subsidy reduction commitments were calculated during the Uruguay Round)[61] because it did not consider that CCC export credit guarantees are export subsidies subject to reduction commitments.[62] According to the United States, subjecting export credit guarantee programmes to export subsidy reduction commitments in the Agreement on Agriculture would therefore lead to "gross injustice."[63]

54. This is not the logical conclusion to be drawn, however. It appears that during the Uruguay Round negotiations the United States took the same position as it has taken in this dispute – that CCC export credit guarantee programmes do not constitute export subsidies within the meaning of item (j) and Articles 1.1 and 3.1(a) of the SCM Agreement and that CCC export credit guarantees are, therefore, not subject to the general export subsidy disciplines included in the Agreement on Agriculture.[64] The United States did not feel compelled to include the CCC export credit guarantees in its calculation of export subsidy reduction commitments because it did not consider that they constituted export subsidies under those provisions. Brazil agrees that not all export credit guarantees are export subsidies and that, therefore, not all export credit guarantees are subject to export subsidy reduction commitments. However, if those guarantees meet the criteria of item (j) or constitute subsidies contingent upon export performance under Articles 1.1 and 3.1(a) of the SCM Agreement, they are export subsidies.[65] (Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes are export subsidies. It follows that GSM 102, GSM 103 and SCGP are subject to reduction commitments and, in fact, circumvent or threaten to circumvent the US export subsidy commitments.)

**Paragraphs 156-157, 160-162 and Exhibits US-31 and US-32**

55. The United States argues that it would not give an accurate picture to compare the reestimates made in any given year (and recorded in the US budget) with the cohort-specific subsidy estimates for guarantees disbursed in that year. Specifically, the United States argues that "upward reestimates and downward reestimates reflected in a single budget cannot necessarily be applied against each other for a notional 'net reestimate.'"[66] Brazil has never argued otherwise. In the chart included in paragraph 115 of its 22 August Rebuttal Submission, Brazil compares *cohort-specific* original subsidy estimates to *cohort-specific* reestimates, cumulated over the period 1992-2002, to give a picture of the long-term operating costs and losses of the "programmes," as required by item (j) (rather than costs and losses for a particular cohort). The United States itself uses this same method (albeit with different data) in paragraph 161 of its 22 August Rebuttal Submission.

56. With respect to FCRA-related data, it would in fact only be inappropriate to attempt to tie a cohort-specific subsidy estimate for one year to fiscal year, non-cohort-specific reestimates recorded in the budget for any one year. Brazil has never made this comparison. As the United States notes,

[61] Rebuttal Submission of the Untied States, para. 148.
[62] Rebuttal Submission of the United States, para. 149.
[63] Rebuttal Submission of the United States, paras. 147-153, *see* the heading to that section.
[64] Rebuttal Submission of the United States, para. 151. The arguments of the United States in this case demonstrate that it continues to be of the view that its programmes do not constitute export subsidies within the meaning of Articles 1.1 and 3.1(a), including item (j) of the SCM Agreement, nor within the meaning of Articles 1(e), 10.1 and 8 of the Agreement on Agriculture.
[65] Brazil's 22 August Comment on Question 80, para. 98. *See* also EC's 11 August Answer to Third Party Question 30, para. 65. New Zealand's 11 August Answer to Third Party Question 35.
[66] Rebuttal Submission of the United States, para. 160.

this would be inappropriate because reestimates recorded in the budget as made in a year do not necessarily relate to subsidy estimates for guarantees disbursed in that year. If the data is presented cumulatively over a period constituting the long term, however, and does not purport to *tie* cohort-specific subsidy estimates to fiscal year, non-cohort-specific reestimates recorded in the budget for any one year, a comparison is perfectly acceptable. Specifically, comparing the cumulative subsidy estimates to the cumulative reestimates shows whether the "programme" is loss-making or profit-generating over the long term. Making a comparison of the cumulative figures does not require that the estimates and reestimates recorded in the budget for any year correspond.

57. For example, this approach can be applied to the data included in Exhibit US-31 to the United States' 22 August Rebuttal Submission. The "subsidy" column included in Exhibit US-31 lists the subsidy estimate from the "prior year" column of the US budget for each cohort during the period 1992-2003. Subtracting cumulative annual downward reestimates from and adding cumulative annual upward reestimates to the cumulative original subsidy amount *yields a positive subsidy of $500 million*.[67] Adding administrative expenses over the period 1992-2003 increases this amount by a further $43 million.[68] Taking the data provided by the United States in Exhibit US-31 at face value demonstrates that the CCC guarantee programmes are losing money. This result is not tainted by the "apples-to-oranges" criticism levied in paragraph 160 of the United States' 22 August Rebuttal Submission.

58. Nor does Brazil's treatment of the data included in the chart at paragraph 165 of its 11 August Answers to Questions suffer from an "apples-to-oranges comparison" between fiscal year and cohort-specific data, as the United States alleges at paragraph 160 of its 22 August Rebuttal Submission. The chart at paragraph 165 is wholly unrelated to the FCRA cost formula. It tracks the results of a formula Brazil has constructed to verify, by alternative means, that long-term operating costs and losses for the CCC export guarantee programmes outpace premiums collected. The data in that chart are not FCRA-related subsidy estimates that are recorded on a cohort basis or that are subject to reestimates mandated by the FCRA. Instead, the left-hand column of that chart records revenue collected on a fiscal year (not a cohort-specific) basis, and the right-hand column of that chart records costs incurred on a fiscal year (not a cohort-specific) basis. Over the period 1993-2002, total revenue in the left-hand column is significantly less than total costs in the right-hand column. This entails no "apples-to-oranges comparison," and demonstrates that the CCC export guarantee programmes constitute export subsidies under item (j) of the Illustrative List of Export Subsidies.

59. In the chart included at paragraph 161 of its 22 August Rebuttal Submission, the United States nets cumulative reestimates on a cohort basis against the original, cohort-specific subsidy estimate from the US budget. There are some factual problems with the US data.[69]

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[67] (2,737 – 297) – (2,629 + 870) + (1,262 + 297) = 500. Since no reestimates have yet been made for 2004, Brazil has reduced the original subsidy amount included in Exhibit US-31 by the $297 million estimate included in the 2004 budget. Had the United States subtracted downward reestimates from and added upward reestimates to the *original* subsidy estimate included in the "budget year" column of the "guaranteed loan subsidy" line of the annual US budget, it would have yielded a positive subsidy, and thus a loss, of $2.038 billion. *See* Exhibit Bra-192.

[68] *See* paragraph 132 of Brazil's 22 July Statement at the First Panel Meeting, and accompanying citations.

[69] First, the United States has offered no documentation verifying the accuracy of the reestimate figures provided in the chart for the period 1993-2000. In contrast, the chart included in paragraph 115 of Brazil's 22 August Rebuttal Submission provides cumulative reestimates on a cohort basis that are taken directly from Table 8 of the Federal Credit Supplement included with the 2004 US budget. *See* Exhibit Bra-182. Second, although the United States asserts that it has netted cumulative reestimates against the "*original* subsidy estimate," it has in fact netted cumulative reestimates against the "guaranteed loan subsidy" figure included in the "*prior year*" column of the US budget, which yields a lower number. Using, subsidy data from the US budget for "prior year," the chart included at paragraph 115 of Brazil's 22 August Rebuttal Submission would

Resolving these problems is not particularly important, however, since the chart included at paragraph 161 of the United States' 22 August Rebuttal Submission itself shows a cumulative positive subsidy for the programmes of over $381 million for the period 1992-2002.[70] This positive subsidy is consistent with CCC's 2002 financial statements, which provide a cumulative, running tally of the subsidy figure for all post-1991 CCC export credit guarantees in the amount of $411 million.[71] The CCC export guarantee programmes have lost money over the period 1992-2002.

60. The United States' point seems to be that because subsidy reestimates are generally downward, the CCC programmes generate profits over the long term. However, all this means is that CCC's original estimates were too high.[72] The real test is the result when cohort-specific reestimates are netted against the original subsidy estimates for each cohort and cumulated over a period constituting the long term, so that the long-term costs and losses of the programmes can be determined, as required by item (j). Netting reestimates against original subsidy estimates on a cohort-specific basis yields a positive subsidy, revealing that over the long term, the CCC is losing money with its export guarantee programmes. This result is obtained whether the Panel accepts the chart at paragraph 161 of the United States' 22 August Rebuttal Submission, the chart at paragraph 115 of Brazil's 22 August Rebuttal Submission,[73] or the cumulative subsidy figure included in CCC's 2002 financial statements.[74]

61. The United States may be suggesting that reestimates will always, eventually, result in negative subsidies and profits. The data shows that this is not the case, however. Netting reestimates against original subsidy estimates does not consistently yield a negative subsidy, or profits, on a cohort basis. The charts included at paragraph 161 of the United States' 22 August Rebuttal Submission and at paragraph 115 of Brazil's 22 August Rebuttal Submission demonstrate this. Nor is it even relevant to focus on the results of individual cohorts, since item (j) require an analysis of the "long-term" costs and losses of export guarantee "programmes," rather than cohorts. That is why Brazil, and presumably the United States, has calculated cumulative results for the charts included at

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still yield a positive subsidy of $211 million, to which the $43 million in administrative expenses should be added, for a total loss of $254 million over the period 1992-2002. *See* Exhibit Bra-193. Third, the United States has not included administrative expenses for the CCC export guarantee programmes, which amount to $43 million for the period 1992-2003.

[70] Even accepting the validity of the data entered in the US chart, Brazil notes that summing up those figures yields a result different from the $381.35 million total provided by the United States. Using the US data, Brazil reaches a subsidy figure net of reestimates of $230,127,023.

[71] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

[72] Brazil notes that according to USDA's Inspector General, CCC estimates are in fact *understated*. In audit reports for fiscal years 1999, 2000 and 2001, CCC's estimates and reestimates were found to have "understated" costs and losses by amounts ranging from to $11 million to $430 million. Exhibit Bra-194 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC, February 2002, p. 11); Exhibit Bra-195 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, Audit Report No. 06401-14-FM, Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, June 2001, p. 9); Exhibit Bra-196 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, US Department of Agriculture Consolidated Financial Statements for Fiscal Year 1999, Report No. 50401-35-FM, February 2000, p. 9).

[73] Again, using "prior year" subsidy figures for this chart results in a positive subsidy of $211 million over the period 1992-2002. *See* Exhibit Bra-193 (Net Lifetime Reestimates of Guaranteed Loan Subsidy by Cohort)

[74] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

paragraph 161 of the United States' 22 August Rebuttal Submission and at paragraph 115 of Brazil's 22 August Rebuttal Submission.

62. In any event, if CCC considered that it would eventually make money on its guarantees on a cohort basis, why does it continue to offer original estimates that are so high? While some factors included in the estimation process are dictated by the FCRA and the US Office of Management and Budget, the original subsidy estimate is primarily driven by CCC's historical experience with its guarantees. Brazil has elsewhere noted that according to the US Federal Accounting Standards Advisory Board, the Government-Wide Audited Financial Statements Task Force on Credit Reform, the Office of Management and Budget and the Department of Agriculture itself, "[m]ethods of estimating future cash flows for existing credit programmes need to take account of past experience,"[75] "[a]ctual historical experience of the performance of a risk category is a *primary factor* upon which an estimation of default cost is based,"[76] and technical assumptions underlying subsidy calculations reflect "historical cash reports and loan performance."[77] If historical experience dictated that CCC would consistently make profits, CCC would reflect that historical experience in its subsidy estimates. Actual historical experience is, after all, a "primary factor" on which those estimates are based. That CCC continues to provide significant positive original subsidy estimates demonstrates that its actual historical experience does *not* suggest that it will make money on its loan guarantees. Since those estimates are calculated and recorded on a *net present value basis*, CCC apparently continues to consider that it will incur significant net costs at the time the cohorts are closed.

63. CCC's apparent views regarding its historical experience with the export guarantee programmes are justified. Evidence regarding CCC's actual historical experience confirms that the long-term operating costs and losses for the CCC guarantee programmes outpace premiums collected. At paragraph 109 of its 22 August Rebuttal Submission, Brazil summarizes this evidence.[78] Although, the United States implies at paragraph 172 of its 22 August Rebuttal Submission that Brazil's evidence is all "between 10 and 20 years" old, a cursory review of the evidence, which includes data from the 2004 US budget and CCC's 2002 financial statements proves otherwise. Therefore, even if the Panel agrees with the United States' conclusion, at paragraph 162 of its 22 August Rebuttal Submission, that the FCRA cost formula is not an ideal way to determine the costs of the CCC export guarantee programmes, Brazil has established by alternative means that CCC premiums fail to meet the long-term operating costs and losses of the programmes.

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[75] Exhibit Bra-162 (Government-Wide Audited Financial Statements Task Force on Credit Reform, ISSUE PAPER, *Model Credit Programme methods and Documentation for Estimating Subsidy Rates and the Model Information Store*, 96-CR-7 (1 May 1996), p. 2).

[76] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36)). *See also* Exhibit Bra-160 (US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2003), p. 120 ("In estimating default costs, the following risk factors are considered: (1) loan performance experience; . . .")).

[77] Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002, p. 9).

[78] Contrary to the United States' assertion at paragraph 170 of its Rebuttal Submission, Brazil has not misread Note 5 to CCC's 2002 financial statements. The amounts in the "subsidy allowance" column are in fact the amounts of receivables associated with post-1991 CCC guarantees that CCC considers uncollectible. The Panel will recall that under the FCRA, the subsidy allowance is recorded on a net present value basis, which means that it represents the cost CCC considers it will incur on a guarantee cohort at the time that cohorts is closed. The $770 million listed in the "subsidy allowance" column in the receivables table for post-1991 guarantees is therefore as uncollectible as the $ 2,567 billion listed in the "uncollectible" column of the pre-1992 CCC guarantee receivables table (*See* Notes to Financial Statements contained in Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2002, Audit Report N° 06401-15-FM (December 2002) p. 14).

**Paragraph 169 and Exhibit US-33**

64. The United States has asserted that there are no "arrearages" with respect to debt reschedulings.[79] Brazil has two comments. First, the United States does not state the source of the data it included at Exhibit US-33. Second, Brazil maintains that it is not appropriate to treat rescheduled debt as recoveries.[80] The US assumption that there will be no arrearages not only ignores the cost of rescheduling but also the fact that there may be further defaults on rescheduled debt.[81] Although rescheduled debt is treated as a receivable, CCC acknowledges in its financial statements that not all receivables are deemed collectible.[82] Moreover, Brazil presumes that rescheduled debt is subject to the FCRA estimation or reestimation process, which involves calculations of net present value of what the CCC expects to lose (or gain) on the rescheduled debt. The CCC does not assume that all rescheduled debt will be collected.

**Paragraphs 172, 174-175**

65. The United States has argued that Brazil improperly relies on CCC losses incurred *via* Iraqi and Polish defaults. The United States implies that these defaults occurred between 10 and 20 years ago.[83] This is incorrect. The US General Accounting Office ("GAO") reports that the losses in Iraq occurred over the period 1990-1997.[84] (The United States makes no specific challenge to the $2 billion in Polish defaults.) Thus, defaults and losses did not occur as long ago as the United States suggests.

66. Moreover, the United States argues that the Panel should only look into the question whether "*current*" premium rates are adequate to cover the long-term operating costs and losses of the programmes.[85] The United States relies on a "present tense" argument to exclude major defaults in Iraq and Poland that occurred in the recent past. Even if the Panel only looks to "current" premiums, item (j) calls for an analysis of "long-term" operating costs and losses.[86] The United States apparently agrees, since it looks to the performance of the CCC programmes in such years as 1994 and 1995 (a time period even longer ago than part of the defaults in Iraq[87]) to claim that premium rates charged were adequate to meet costs,[88]

67. If the United States believes that it is only appropriate to look at *current* premiums, given the present tense of the term "are" in item (j), then the FCRA cost formula is useful. The FCRA cost formula measures the *net present value* "of the following cash flows: (i) payments by the Government

[79] Rebuttal Submission of the United States, para 169.
[80] Oral Statement of Brazil, para. 122.
[81] Oral Statement of Brazil, para. 122. Brazil's 11 August Answer to Question 77, para. 162.
[82] *See* Brazil's 22 August Comments, para. 99. Exhibit Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14).
[83] Rebuttal Submission of the United States, para. 172.
[84] Bra-157 (US General Accounting Office, REPORT TO THE CHAIRMAN, TASK FORCE ON URGENT FISCAL ISSUES, COMMITTEE ON THE BUDGET, HOUSE OF REPRESENTATIVES, *International Trade: Iraq's Participation in US Agricultural Export Programmes*, GAO/NSIAD-91-76 (November 1990), p. 27 (Table IV.2)).
[85] Rebuttal Submission of the United States, para. 174.
[86] The United States has elsewhere endorsed a 10-year period (First Submission of the United States, para. 173; Rebuttal Submission of the Untied States, para. 161).
[87] *Compare* Rebuttal Submission of the United States, para. 172 and 175.
[88] Rebuttal Submission of the United States, para. 175.

. . . and (ii) payments to the Government" of guarantees at the time they are disbursed.[89] In other words, it measures the amount CCC expects today to lose (or gain) on a guarantee cohort at the time the cohort is closed tomorrow. Even if this involves some estimates, the United States has noted that those estimates are acceptable.[90] In fact, the US budget for fiscal year 2004 demonstrates that current premiums paid for guarantees disbursed in fiscal years 2002-2004 will generate losses worth hundreds of million of dollars.[91] Thus, current premiums are inadequate to cover the long-term operating costs and losses of the CCC export credit guarantee programmes. These programmes constitute export subsidies.

**Paragraphs 186-191 and Exhibits US-34 through US-37**

68. Brazil has argued that since CCC export credit guarantees from the GSM 102, GSM 103 and SCGP programmes are unique financial instruments for agricultural commodity transactions that are not available on the commercial market – certainly not for terms longer than the marketing cycles of the eligible commodities – they confer "benefits" within the meaning of Article 1.1(b) of the SCM Agreement.[92] The United States asserts that "financing is available in the marketplace that is analogous to the export credit guarantee programmes" – namely, forfaiting.[93]

69. The United States' assertion should be rejected. As discussed below, the two instruments are not "analogous," and are, in fact, different.

70. Brazil begins with a very rough sketch of the role a forfait can play in a typical transaction involving agricultural commodities. In a typical transaction, an importer will issue a promissory note to an exporter for the agreed price. The exporter will generally demand that the note be backed by a guarantee (or an aval) from the importer's bank and/or, as the United States points out in paragraph 187 of its 22 August Rebuttal Submission, by a guarantee from the importer's government export credit agency.

71. A forfait comes into play because, while both the exporter and the importer want the transaction to occur, they have different interests. The exporter wants to get paid immediately on a cash basis, and the importer wants credit that it can repay on a deferred basis. Even with a guarantee from the importer's bank or a government export credit agency, the exporter bears responsibility for collecting the receivables (in the absence of default). A forfaiter (which could be the exporter's own bank) will step in and purchase the promissory note at a discount to face value, without recourse to the exporter.[94] The exporter will receive payment immediately from the forfaiter. The forfait essentially enables the exporter to convert a credit sale into a cash sale.

72. A forfaiter will generally demand that the importer's obligation is backed by a guarantee from a bank or the importer's government export credit agency.[95] Rather than *substituting* for a guarantee,

[89] Exhibit Bra-117 (2 U.S.C. 661a(5)(C)).

[90] Rebuttal Submission of the United States, para. 171.

[91] *See* chart at paragraph 161 of the Rebuttal Submission of the United States. *See* also Exhibit Bra-127 (US budget for FY 2004, p. 107) referencing guaranteed loan subsidy amounts of $97 million, $294 million and $297 million respectively. Brazil notes that the figure for FY 2002 has been reestimated to $137,008,586 since the publication of the FY 2004 budget (*See* Rebuttal Submission of the United States, chart at para. 161).

[92] First Submission Brazil, para. 289; Oral Statement of Brazil, para. 116; Brazil 11 August Comment and Answer to Questions 71(a) (para. 139), 75 (para. 156); Rebuttal Submission of Brazil, para. 103.

[93] Rebuttal Submission of the United States, para. 186.

[94] *See* Exhibit Bra-197 (http://www.nedcor.co.uk/forfait-website/forfaiting.htm).

[95] United Rebuttal Submission of the United States, para. 187. *See also* Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 258 (Spring 2001) ("In most cases, the forfaiter requires the obligation of the importer to be guaranteed by a bank in the importer's country because of the impossibility of evaluating the credit risk of every importer in

therefore, guarantees and forfaiting are *complementary* instruments. For this reason alone, the US assertion that the two instruments are analogous is incorrect.

73. There are other differences between the two instruments. The importer realizes a tangible and extremely valuable benefit from a CCC guarantee; namely, the bank prices financing to the importer based on the credit rating of the United States, rather than the credit rating of the importer itself. Importantly, the CCC guarantee allows the importer to secure financing in the first place. As the regulations for the GSM and SCGP programmes state, the programmes operate in cases where banks "would be unwilling to provide financing without CCC's guarantee."[96] Forfaiting helps an exporter accept deferred payment terms for the importer, but does not otherwise beneficially affect the price for the financing secured by the importer. Nor would a bank require that forfaiting be involved in a transaction as a prerequisite for it to provide financing to the importer.

74. As a further distinction between the two instruments, while there is a secondary forfaiting market,[97] there is no secondary market for CCC guarantees.[98] Purchasers in the secondary market for forfaiting instruments assume that forfaited promissory notes will yield more at maturity than the purchaser paid for them in the secondary market.[99] Since no secondary market exists for CCC guarantees, apparently no such assumption can be made with respect to CCC guarantees (which itself reveals much about the quality of those guarantees).

75. Most importantly, the pricing for forfaiting instruments is substantially different than pricing for CCC guarantees. As noted above, a forfaiter purchases an exporter's trade receivables at a discount to face value. The discount rate and associated commitment fees are driven by the risks involved – country risk, political risk, currency risk, entity risk (essentially, the risk of the guarantor), etc., and by the length of the underlying credit.[100]

76. Brazil has attached as Exhibit Bra-199 a list of indicative forfaiting rates that vary greatly from market to market.[101] In contrast, the United States has confirmed that country risk "has no impact on the premiums payable" under the GSM 102, GSM 103 and SCGP programmes.[102] Brazil provided the Panel with evidence documenting that GSM and SCGP fees were the same whether guarantees were for transactions with the Dominican Republic, Ghana, Japan, South Korea or Vietnam (among others).[103]

77. Moreover, the *very lowest rate* in the forfaiting rate list included in Exhibit Bra-199 is 1.6638 per cent (6-month tenor). The rates for GSM 102 and GSM 103 guarantees are prohibited by law from being greater than 1 per cent,[104] and are currently (as they have been at least since 1994)[105]

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every country, particularly when medium or small sized companies are involved."). *See also Id*., p. 259 ("[I]f a bank guarantee is required, it must be unconditional, irrevocable and freely transferable.").

[96] Exhibit Bra-38 (7 CFR 1493.10(a)(2); 7 CFR 1493.400(a)(2)). *See* Brazil 11 August Response to Question 82(a) (paras. 183-184).

[97] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 251-252 (Spring 2001)).

[98] *See* US 11 August Answer to Question 86 (para. 184).

[99] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 251-252 (Spring 2001)).

[100] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 256 (Spring 2001)).

[101] Exhibit Bra-199 (Trade and Forfaiting Review, "Argentina Trade Finance to the Rescue," Volume 6, Issue 9, July/August 2003)

[102] United States 11 August Response to Question 86 (para. 184).

[103] *See* Brazil 11 August Comments to Questions 84 (para. 192) and 85 (para. 195).

[104] United States 11 August Responses to Question 84 (para. 179).

[105] Brazil 11 August Comment to Question 84 (para. 193).

no greater than 0.663 per cent for GSM 102 (36-month tenor)[106] and 0.05 per cent for GSM 103 (120-month tenor).[107]

78. Furthermore, although the United States' assertion that the tenor of forfaiting instruments can range from six months to 10 years is accurate, forfaiting instruments *for agricultural commodities* will not exceed tenors of 360 days, or in other words will not exceed a tenor "matching the typical period of consumption of most commodities."[108] This is consistent with Brazil's statement that commercial financing for exports of agricultural goods that exceeds the marketing cycles of the agricultural good is not available on the marketplace.[109]

79. Under Article 10.3 of the Agreement on Agriculture, the United States bears the burden of demonstrating that no export subsidies have been granted in respect of quantities of agricultural commodities exported in excess of its reduction commitments.[110] Although it is not its burden to do so, Brazil has demonstrated that CCC export credit guarantees are financial contributions that confer benefits and are contingent on export, within the meaning of Articles 1.1 and 3.1(a) of the SCM Agreement. With respect to "benefit," CCC regulations concerning the GSM and SCGP programmes demonstrate that the programmes grant better-than-market terms *per se*.[111] Brazil has also demonstrated that CCC export credit guarantees confer benefits *per se* since they are unique financial instruments for agricultural commodity transactions that are not available on the commercial market – and certainly not for terms longer than the marketing cycles of the eligible commodities.

80. The United States has not established that forfaiting is analogous to CCC export credit guarantees. Even if it had done so, and the market terms for forfaiting instruments could theoretically serve as a benchmark against which to judge whether CCC export credit guarantees confer "benefits," the United States has not: (i) established the terms on which forfaiting is provided on the market; or, (ii) demonstrated that CCC export credit guarantees do not provide terms better than those provided for forfaiting instruments. The United States acknowledges, at paragraph 191 of its 22 August Rebuttal Submission, that it has not provided market terms for forfaiting instruments that could serve as a benchmark. Thus, the United States has not met its burden under Article 10.3 of the Agreement on Agriculture.

**Brazil's Comment on Question 67a posed by Panel to the United States**

81. While Brazil obviously does not know how the United States will ultimately respond, Brazil offers the following information supporting Brazil's calculations of the amounts provided to these four crops as "support to upland cotton."

82. First, to the extent that the United States criticizes Brazil's calculations made to determine the different per acre payments for direct payment and CCP crops in paragraph 42 of its Rebuttal Submission, Brazil notes that these calculations are confirmed by the Food Agricultural Policy Research Institute at the University of Missouri (FAPRI).[112] As Brazil further notes that the FAPRI

[106] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, "Notice to GSM-102 and GSM-103 Programme Participants," 24 September 2002).

[107] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, "Notice to GSM-102 and GSM-103 Programme Participants," 24 September 2002).

[108] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 254 (Spring 2001)).

[109] Oral Statement of Brazil, para. 116.

[110] *See* First Submission of Brazil, paras. 263-268.

[111] *See* Brazil's 11 August Answer to Question 82, paras. 182-189.

[112] http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf. The information on CCP and direct payment per acre payments in US dollars for each of the programme crops is found in the last two lines of pages 55 (wheat), 57 (rice), 59 (corn), 61 (sorghum), 63 (barley), 65 (oats), 69

baseline itself and FAPRI analysis has often been influential in US policy formation process, including in analysis of the FSRI Act of 2002, for which FAPRI won the USDA's highest honour.[113]

83. Second, FAPRI's 2003 US Baseline is a long-run scenario projecting what would happen to various elements of US agriculture under the 2002 FSRI Act. In this analysis, FAPRI includes all of the different types of support provided by the 2002 FSRI Act into its projections of, *inter alia*, upland cotton planted acreage, production, exports, prices, revenue, costs, etc. In doing so, the FAPRI economists assume that, *inter alia*, upland cotton producers were holding upland cotton base acreage and receiving upland cotton CCP and direct payments.[114] These CCP payments and direct payments are reflected in their analysis of "Gross Market Revenue" to upland cotton producers on page 79 of their report, which constitutes the sum of LDP (marketing loan), CCP revenue, and direct payments.[115]

84. In addition, FAPRI states that "US cotton producers do not benefit from the projected price increases. Higher prices are offset by lower payments from the loan programme and the CCP programme."[116] This reflects the FAPRI economists' assumption that upland cotton producers receive upland cotton direct and CCP payments.

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(soybeans), 75 (peanuts) and 79 (upland cotton). Brazil notes that its figures for soybeans and peanuts differ slightly. The underlying reason for this difference is that Brazil had to base its figures on its estimates about the payments yields and it appears that FAPRI's figures for payment yields are slightly different from Brazil's.

[113] See for example, "Analysis of the grain, oilseed and cotton provision of the, 'Agriculture, Conservation, and Rural Enhancement Act of 2001 – S.1731.'" FAPRI-UMC Report #18-01 November 2001. http://www.fapri.missouri.edu/FAPRI_Publications.htm. Also see http://www.card.iastate.edu/about_card/news/press_releases/Highest_Honor.html

[114] FAPRI's 2003 US Baseline, http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf, p. 78.

[115] FAPRI's 2003 US Baseline, http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf, p. 79.

[116] FAPRI's 2003 US Baseline, http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf, p. 78.

**List of Exhibits**

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|---|---|
| G/AG/AGST/USA | Exhibit Bra- 191 |
| Reestimated Guaranteed Loan Subsidy based on Original Budget Year Estimate. | Exhibit Bra- 192 |
| Net Lifetime Reestimates of Guaranteed Loan Subsidy by Cohort. | Exhibit Bra- 193 |
| US Department of Agriculture Office of Inspector General Great Plains Region Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report N° 06401-4-KC, February 2002 | Exhibit Bra- 194 |
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| http://www.nedcor.co.uk/forfait-website/forfaiting.htm | Exhibit Bra- 197 |
| Vincent Whittaker, "The Quick Buck, International Finance and Forfaiting," 23 *Thomas Jefferson Law Review* (Spring 2001) | Exhibit Bra- 198 |
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# ANNEX D-4

## COMMENTS OF THE UNITED STATES ON NEW MATERIAL IN BRAZIL'S REBUTTAL FILINGS AND ANSWER OF THE UNITED STATES TO THE ADDITIONAL QUESTION FROM THE PANEL

27 August 2003

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## I. Introduction

1. The United States thanks the Panel for its prompt reply to the US request of 25 August 2003, granting an opportunity to comment on new material in Brazil's rebuttal submission and Brazil's comments on the US responses to questions. We also thank the Panel for its additional question. We present both the US comments on new material in Brazil's submissions and our answer to that additional question below.

2. As the United States notes in these comments and answer, Brazil's Peace Clause argument depends on three issues:

- First, Brazil relies on budgetary outlays that reflect prevailing market prices that could not have been "decided" by the United States. Brazil ignores the fact that "support" does not mean "budgetary outlays"; in fact, Annex 3 recognizes that an "Aggregate Measurement of

Support" for price-based support either shall[117] or can[118] be calculated using a price gap methodology, which does not rely on budgetary outlays.

- Second, Brazil conflates "non-product-specific support" with "support to a specific commodity" by attempting to allocate certain payments to upland cotton. To do so, however, Brazil relies on a reading of the definition of "non-product-specific support" in Article 1(a) that ignores the most relevant context for this term – that is, the (immediately preceding) definition of product-specific support in that same article. Indeed, Brazil's approach would appear to render the concept of "non-product specific support" so narrow that it becomes almost, if not completely, meaningless.

- Third, Brazil mischaracterizes US direct payments and production flexibility contract payments as non-green box support. Brazil has not established that these measures fail to conform to the policy-specific criteria in Annex 2. In fact, Brazil has not even established – pursuant to Brazil's own reading of the first sentence of Annex 2, paragraph 1, as a stand-alone obligation – that these payments have more than "minimal[] trade-distorting effects or effects on production."[119]

3. The weakness of Brazil's interpretation that "support" in the Peace Clause means "budgetary outlays" can be seen in this example. Even if US measures were *exactly* the same in *every year* of the implementation period as they were in the 1992 marketing year (that is, the same deficiency target price, same marketing loan rate, same acreage reduction percentage, same normal flex acres with planting flexibility[120], etc.), under Brazil's interpretation, US measures would have breached the Peace Clause in each and every year in which outlays increased due to external factors, for example, whenever market prices dipped below the 1992 level.

- Would 1999-2002 US measures *identical in every respect* to those in 1992 "grant support in excess of that decided during the 1992 marketing year"?

- In other words, if a Member had decided its support during 1992 for the period through 2004 and never changed its decision, could the Member be deemed to grant support in excess of the

[117] In the case of market price support. In fact, Annex 3, paragraph 8, states: "Budgetary outlays made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS."

[118] In the case of non-exempt direct payments dependent on a price gap. *See* Agreement on Agriculture, Annex 3, paragraph 10.

[119] Of course, the US view is that the "fundamental requirement" of the first sentence is met by a measure that conforms to the basic criteria and any applicable policy-specific criteria. In this regard, Brazil errs in claiming that the United States has "acknowledged that such effects can be presumed if the specific criteria in paragraph 6 of Annex 2 are not complied with." Brazil's Rebuttal Submission, para. 8 fn. 13. In fact, we believe the opposite. Meeting the basic and policy-specific criteria of Annex 2 establishes that a measure meets the "fundamental requirement" of paragraph 1. However, the converse is not necessarily true. So, according to Brazil's approach, Brazil would bear the burden of establishing that a measure that did not comply with the basic and policy-specific criteria in Annex 2 failed to meet the "fundamental requirement" of paragraph 1 of Annex 2.

[120] Recall that "under 1992 programme provisions, producers of non-cotton programme crops (i.e., wheat, corn, barley, grain sorghum, oats, and rice) could plant up to 25 per cent of their [non-cotton] crop programme base to cotton as Normal Flex Acres or Optional Flex Acres. Acreage Reduction Programme compliance reports indicate that, in 1992, 447,164 acres of cotton were planted on a much larger quantity of available Normal Flex Acres and Option Flex Acres of non-cotton programme base.") Exhibit US-24 (Report by Dr. Joseph Glauber, Deputy Chief Economist, US Department of Agriculture). In 1992, there were 153.9 million acres of non-cotton "complying base" and 197.2 million acres of non-cotton "effective base." *See* Exhibit US-39. Thus, the marketing loan was effectively available with respect to all upland cotton production.

> level decided during 1992 just because outlays increased, for example, because market prices changed?[121]

We believe the answer must be "No" because market prices are not "decided" by a Member (as paragraphs 8 and 10 of Annex 3 recognize). And yet, the situation in this dispute is analogous: the United States has changed its measures to *reduce* the product-specific level of support (by eliminating deficiency payments) since 1992, and yet Brazil claims that the Peace Clause has been breached simply because lower market prices resulted in increased price-based outlays.

4. Market prices are beyond the control of the United States, and therefore the United States cannot "decide" them. Removing the effect of market prices beyond the control of the United States from the measure of support demonstrates that US measures do not and did not grant support in excess of that decided during the 1992 marketing year. In fact, whether gauged (as the United States believes is compelled by the Peace Clause) via the rate of support expressed by US measures[122], *or* via the AMS for upland cotton (calculated through a price gap methodology), *or* via the erroneous calculations of Brazil's expert (but limited to product-specific support), the result is exactly the same: in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

## II. Brazil's AMS Calculation Is Flawed and, Had It Consistently Reflected a Price Gap Calculation, Would Demonstrate No Peace Clause Breach

5. We recall that Brazil has argued that budgetary outlays are the only measurement of "support" for purposes of the Peace Clause proviso comparison, without any foundation in the Peace Clause text and despite the context provided by Annex 3, which explicitly indicates that Members have agreed "support" *can* be measured without using budgetary outlays. Brazil itself concedes that US measures do not decide support on the basis of budgetary outlays:

> Brazil acknowledges that *the United States could not possibl[y] determine its expenditures* as they would depend to a certain extent on *market prices* that were also influenced by factors *outside the control of the US Government*.[123]

The United States agrees with this statement by Brazil and believes that this statement demonstrates that Brazil's approach to the Peace Clause comparison is not based on the text nor is it realistic. Instead, in order to hope to succeed, Brazil's claims *require* Brazil to use budgetary outlays and so to take into account low prevailing market prices. An Aggregate Measurement of Support calculation using a price gap methodology – that is, that eliminates the effect of market prices and reflects instead the eligible production and applied administered price decided by a Member – reveals that in no year from 1999-2002 have US measures breached the Peace Clause.

6. Brazil has argued that "there are only two types of methodologies that would allow an expression in monetary terms of a decision (or decisions) taken by the United States in MY 1992 regarding its level of support to upland cotton. The first is budgetary expenditures. The second is the calculation of AMS for a particular commodity."[124] In both its table of expenditures[125] and its AMS

[121] Other factors beyond a Member's control could also influence outlays, such as whether some additional producers chose to begin participating in the support programmes.

[122] Even taking into account the maximum theoretical effect on the deficiency payment effective price of the 1992 acreage reduction percentage (10 per cent) and normal flex acres (15 per cent) for the 1992 marketing year. Since the acreage reduction percentage was lower for 1993 marketing year (7.5 per cent versus 10 per cent) support, which was also decided during the 1992 marketing year, the adjusted level of support (68.27625 cents per pound) was even higher for the 1993 marketing year.

[123] Brazil's Comments on US Answers, para. 66 fn. 49.

[124] Brazil's Rebuttal Submission, para. 71.

table[126], Brazil has attempted to allocate non-product-specific support to a specific commodity. There is no basis in Annex 3 to do so. Annex 3, paragraph 1, explicitly requires an AMS to be calculated "on a product-specific basis for each basic agricultural product" and separately requires that non-product-specific support be calculated and "totalled into one non-product-specific AMS in total monetary terms." The point bears emphasis: "for each basic agricultural product," Annex 3 states that an AMS "shall be calculated on a product-specific basis." Similarly, were "support to a specific commodity" (upland cotton) to be calculated using an Aggregate Measurement of Support, it *must* be calculated "on a product-specific basis."

7. As a result, both Brazil's expenditure table and its AMS table run counter to the terms of Annex 3. Were the Panel to calculate an AMS for upland cotton for marketing years 1992 and 1999-2002, the United States has set forth a calculation consistent with Annex 3 in its rebuttal submission.[127] By using a price-gap methodology for both deficiency payments and marketing loan payments[128], the upland cotton AMS in 1992 is far higher than in any marketing year from 1999 to 2002, reflecting the US decision to move away from the high support levels of product-specific deficiency payments.

8. In fact, we note that the AMS data presented in paragraph 115 of the US rebuttal submission understates the AMS for marketing year 1992. For example, the United States reduced the price gap calculation for 1992 basic deficiency payments by an adjustment factor (approximately .875) to replicate the calculation used in G/AG/AGST/USA, p. 18. Without the adjustment, which is not called for by paragraphs 10 and 11 of Annex 3, the 1992 deficiency payment calculation would have been $858 million, rather than $755 million as reported in paragraph 115.[129] (In case of interest, we also present below the deficiency payment calculation in more detail, reflecting more accurate data, which would increase the deficiency payment calculation slightly, to $867 million.)[130] This

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[125] Brazil's Rebuttal Submission, para. 73.

[126] Brazil's Rebuttal Submission, para. 76.

[127] US Rebuttal Submission, paras. 114-118.

[128] Brazil has stated (with respect to deficiency payments) that "the formula approach under Annex 3, paragraphs 10-11 of the Agreement on Agriculture [is] warranted for upland cotton AMS calculations." Brazil's Rebuttal Submission, para. 73 fn. 172. Because the Peace Clause proviso comparison must compare the support that challenged measures grant to "that decided during the 1992 marketing year," the price gap methodology is the only AMS approach that reflects only the United States' decisions and not market prices beyond the United States' control. For the same reason, it is equally appropriate to use the price gap methodology for marketing loan payments.

[129] Total deficiency payments calculated via the price gap methodology equal unadjusted basic deficiency payments ($724 million / 0.875) + 50/92 deficiency payments ($30 million) – that is, $858 million. *See* US Rebuttal Submission, para. 115 fn. 144.

[130] To calculate the deficiency payment support using the price gap methodology and consistent with the 1995 US WTO notification and G/AG/AGST/USA, we made the following calculations.

Total deficiency payments are equal to basic deficiency payments plus 50/92 payments. Basic deficiency payments are equal to eligible production times a price gap measured as the difference between the target price and a fixed reference price. Eligible production is measured as eligible base acreage times average programme yield. Eligible base acreage is equal to participating base acreage minus Acreage Conservation Reserve acres minus Normal Flex Acres minus acres enrolled in the 50/92 programme. The fixed reference price is the1986-88 average of the higher of the market price or loan rate for each year.

Payments for the 50/92 programme were calculated in a similar fashion by multiplying base acres in the 50/92 programme times the average programme yield times 92 per cent of the price gap.

In 1992, the target price was 72.9 cents per pound and the fixed reference price for 1986-88 was 57.9 cents per pound. This gives a price gap of 15.0 cents per pound. Eligible production for basic deficiency payments in 1992 was equal to 5,544 million pounds (9.226 million acres times the average programme yield of 601 pounds per acre). Multiplying the price gap times eligible production gives basic deficiency payments equal to $832 million.

The same formula is used to calculate deficiency payments under the 50/92 programme. For 1992, the price gap is the same as that calculated for the basic deficiency payments (15 cents per pound). Eligible

calculation, moreover, uses the actual payment acreage (that is, acres planted for harvest or participating in the 50/92 programme on which payment was received) to calculate the "eligible production." Using instead the base acreage minus the 10 per cent acreage reduction figure and the 15 per cent normal flex acres (14.9 million effective base acres[131] *x* .75 = 11.175 million acres) and multiplying by the programme yield (602 pounds per acre), the "quantity of production eligible to receive the administered price"[132] is 6,727 million pounds, yielding a price gap deficiency payment calculation of $1,009 million. Thus, the figure in paragraph 115 of the US rebuttal reflected a conservative approach that understated the support resulting from a price gap calculation.

9. In this regard, the United States notes Brazil's argument with respect to the 1995 Statement of Administrative Action, which explained that Peace Clause protection would apply "unless the AMS for the particular commodity exceeds the level decided in the 1992 marketing year."[133] We agree with Brazil that this reference to "AMS" is "non-textual[]" because the Peace Clause uses the term "support decided" and not "AMS."[134] However, to the extent that the Panel were to examine "the AMS for the particular commodity" – that is, the upland cotton AMS – the United States has demonstrated that in no year from 1999-2002 does that AMS exceed the 1992 level.

## III. The US Level of Support Argument Does Take Into Account All Product-Specific Support That Challenged US Measures Grant

10. Brazil has argued that "the United States '72.9 methodology' does not – and cannot account for cottonseed payments, Step 2 payments, storage payments and interest rate subsidies," which the United States has identified as product-specific support.[135] Brazil then alleges that the US methodology "would sanction the cover-up of hundreds of millions – if not billions – of dollars of expenditures."[136] Over-heated rhetoric aside, Brazil's argument is simply erroneous.

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production under the 50/92 programme was 254 million pounds (404 thousand acres times the average programme yield of 50/92 participants of 628 pounds per acre). Deficiency payments under the 50/92 programme were thus equal to $35 million (0.92 times 254 million times $0.15).

Total deficiency payments under the price gap methodology were thus equal to $867 million ($832 million plus $35 million). *Sources:* US Department of Agriculture, Compliance Report for 1992 Acreage Reduction Programme (1993) (Exhibit US-39); Commodity Credit Corporation Commodity Estimates Book for the FY 1995 President's Budget (February 1994); G/AG/AGST/USA, p. 18.

[131] *See* Exhibit Bra-105, Annex 2 (1st source document: US Department of Agriculture, *Provisions of the Federal Agricultural Improvement and Reform Act of 1996*, at 142) (giving 1992 effective base acreage of 14.9 million acres); *id.*, Annex 2 (2nd source document: Daniel A. Sumner, *Farm Programmes and Related Policy in the United States*, at 4) (same).

[132] Agreement on Agriculture, Annex 3, para. 10.

[133] We also note that Brazil never quotes that passage in full since the first half reflects the US view throughout this dispute that "exempt from actions" means not liable to a legal process or suit. *See* 1995 Statement, at 68 ( "Under Article 13(b)(ii) and (iii), governments *may not initiate* adverse effects, serious prejudice or non-violation nullification and impairment *challenges* in the WTO . . . .") (emphasis added). There are numerous other statements in the 1995 Statement that Brazil similarly does not draw to the Panel's attention. *See id.* at 67 ("Article 13, commonly referred to as the peace clause, reflects *an agreement among WTO countries to refrain from challenging* certain of each other's agricultural subsidy programmes . . . *through WTO dispute settlement procedures* . . . .") (emphasis added); *id.* ("*Article 13(b) addresses possible challenges* to domestic support measures falling outside the green box in circumstances in which the WTO member providing the subsidy is meeting its total AMS commitments.") (emphasis added).

[134] Brazil's Opening Statement, para. 35; Brazil's Rebuttal Submission, para. 75; *see also* 1995 Statement of Administrative Action, at 68 (subsequently in same paragraph quoted by Brazil stating "a WTO Member will not be protected by the Peace Clause if its support for the product is above that decided during the 1992 marketing year.") (emphasis added).

[135] Brazil's General Comment on US Answers to Questions 47-69 from the Panel (para. 55).

[136] Brazil's General Comment on US Answers to Questions 47-69 from the Panel (para. 56).

11. Brazil argues that the United States has not accounted for Step 2 payments. The United States directs the Panel's attention to the US rebuttal submission, paragraphs 111 and 113, and the US first written submission, paragraph 111. The United States has noted that, because the availability of Step 2 payments is contingent on certain price conditions existing during the marketing year, the level of support decided must relate to the payment parameters. While these have changed slightly with the 2002 Act, these minor adjustments do not alter the revenue ensured for producers by the marketing loan rate of 52 cents per pound because Step 2 merely provides an alternative avenue of providing support (through processors rather than directly to producers). In addition, these minor adjustments cannot overcome the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002.

12. Brazil argues that the United States has not accounted for cottonseed payments. The United States directs the Panel's attention to the US rebuttal submission, paragraph 111 fn. 136, 137 and paragraph 113. While the United States maintains that these measures are not within the Panel's terms of reference[137], we note that cottonseed payments for the 1999, 2000, and 2002 crops ranged in value between 0.6 to 2.3 cents per pound (factoring expenditures – the way these measures were decided – over production). Thus, given the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002, cottonseed payments too do not materially affect the comparison between marketing year 1992 and any other year.

13. With respect to storage payments and interest rate subsidies, we note that these are US Government estimates of support provided through activities relating to operating the upland cotton marketing loan programme.[138] This support is already captured, however, in the level of support expressed by the marketing loan rate. Were these costs not borne by the United States, the costs to the producer would reduce the guaranteed revenue below the loan rate. In fact, Annex 3 of the Agreement on Agriculture explains that, for purposes of market price support calculated using a price gap, "[b]udgetary payments made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS." Similarly, where the support provided by marketing loans is measured using a price gap methodology (the only appropriate AMS calculation for purposes of the Peace Clause)[139], "payments made to maintain this gap," such as storage payments and interest rate subsidies, should not be counted separately.

## IV. Brazil's New Green Box Arguments Are in Error

14. In its rebuttal submission and comments on US answers to questions from the Panel, Brazil advances two novel arguments. First, Brazil for the first time responds to the US argument that Brazil's interpretation of paragraph 6(b) would create an inconsistency between that provision and the fundamental requirement of the first sentence of Annex 2, paragraph 1.[140] Second, Brazil argues that the US interpretation of Annex 2, paragraph 6(b), would render paragraph 6(e) of that Annex a nullity. Neither of these arguments withstands scrutiny.

15. First, Brazil misunderstands the US argument that Brazil's reading of paragraph 6(b) creates an inconsistency between that paragraph and the fundamental requirement of the first sentence of Annex 2, paragraph 1, and therefore its arguments go astray. The United States has noted that if payments under a decoupled income support measure were reduced or eliminated if a recipient were to produce any commodity, then the amount of payments would be (on Brazil's reading) linked to the type of production and therefore inconsistent with paragraph 6(b), even though such a measure would

[137] *See* US Rebuttal Submission, paras. 106-09.
[138] For example, for storage payments we estimate expenses incurred with respect to upland cotton put under loan and pledged as collateral.
[139] *See* US Rebuttal Submission, paras. 114-17.
[140] Brazil's Rebuttal Submission, paras. 4-9.

meet the fundamental requirement of Annex 2. Brazil does not contest that such a measure would meet that fundamental requirement but instead argues that "requiring no production, *i.e.*, on all base acres is not a 'type of production'" because "[t]he notion of 'type of production' in paragraph 6(b) is necessarily linked to the amount of payment to some 'type' of commodity that is 'produced' and not to a production requirement itself."[141]

16. With respect, if one were to credit this argument, then Brazil would appear to have misunderstood its own objection to US direct payments and production flexibility contract payments. That is, in the US example, payments are reduced or eliminated if a recipient produces *any type* of commodity. Similarly, Brazil's objection to US green box payments is that payments are reduced or eliminated if a recipient produces *certain types* of commodities. Thus, in the former example, the amount of payment is "based on" (in the sense of being reduced by) "the type" of production undertaken by the producer – for example, production of upland cotton, fruits, vegetables, or wild rice – just as in Brazil's argument on US green box payments, the amount of payment is "based on" (in the sense of being reduced by) "the type" of production undertaken by the producer – that is, fruit, vegetable, or wild rice production. Brazil's objection to US green box payments under paragraph 6(b) would therefore apply with equal force to the US example,[142] again, posing an inconsistency between Brazil's interpretation of paragraph 6(b) and the fundamental requirement of Annex 2.[143]

17. Brazil also argues that the US interpretation of paragraph 6(b) "would render Annex 2, paragraph 6(e)[,] a nullity" because the "US interpretation of paragraph 6(b) as not requiring the production of 'certain crops' is the same as 6(e)'s prohibition on not requiring production of 'any crops.'"[144] Brazil's own re-phrasing of the US argument, however, points to the distinction between the obligations contained in these two provisions. Paragraph 6(e) establishes that under a green box measure: "No production shall be required in order to receive such payments." Thus, there can be no production requirement "in order to receive such payments," but the provision is silent with respect to the *amount* of such payments at any particular time and any links to the "type or volume of production." That is, were paragraph 6(e) alone part of Annex 2, a Member could arguably link the amount of payments to requirements on the "type or volume of production" so long as payment eligibility were not contingent on production.

18. Paragraph 6(b) forecloses that option by prohibiting a green box measure from linking the "amount of such payments in any given year" to "the type or volume of production." That is, not only may a green box measure not require production, but the measure may not require a particular "type or volume of production" in order to obtain a payment amount. As the United States has noted, both direct payments and production flexibility contract payments meet that test because no "type or volume of production" is required to receive payments. For example, with respect to the fruits, vegetables, and wild rice planting flexibility issue, a payment recipient need not undertake any "type or volume of production" in order to receive the full "amount of payments" to which the farm's base acres are entitled. Rather, the recipient need only *desist* from planting certain commodities. Thus, Brazil's objection is nothing more than a statement that, under US green box measures, the amount of payments is linked to production *not* undertaken by the producer.

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[141] Brazil's Rebuttal Submission, para. 6. Brazil concludes the thought: "Otherwise, it logically could not be a 'type' of production. It would be nothing at all."

[142] *See* Brazil's Rebuttal Submission, para. 4 ("The relevant text of paragraph 6(b) prohibits any linkage of the 'amount of payments' to *any* 'type of production' of an agricultural product.") (emphasis added).

[143] Brazil's reference to paragraph 6(e) does not answer this objection. Brazil argues that "negotiators addressed any possible misunderstanding in this regard by including the very concept of prohibiting the requirement to produce in paragraph 6(e)." Brazil's Rebuttal Submission, para. 6. However, as Brazil immediately points out, conformity with paragraph 6(e) "does not exempt . . . payments from conforming to the requirement of paragraph 6(b)."

[144] Brazil's Comment on US Answer to Question 32 from the Panel (para. 44).

19. Finally, we note that Brazil's reading of paragraph 6(b) could prevent Members from imposing on decoupled income support payment recipients any conditions relating to the type of production – for example, the planting of illegal crops or production of unapproved biotech varieties or environmentally damaging production. As a practical matter, no Member could accept not being able to impose any such conditions on payment recipients. The result of Brazil's reading, then, would be to read decoupled income support out of Annex 2. This may be a favourable result from the Brazilian perspective, but the Panel should not adopt an interpretation of paragraph 6(b) not required by the text, not consistent with its context (in particular, the fundamental requirement of Annex 2), and with such potentially far-reaching results.

## V. Answer to Additional Question 67*bis* from the Panel

**67*bis*. Please state the annual amount granted by the US government in each of the 1999, 2000, 2001 and 2002 marketing years (as applicable) to US upland cotton producers, per pound and in total expenditures, under each of the following programmes: production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments.**

20. The Panel's question would require ascertaining for each programme the amount of upland cotton produced by recipients of payments under the programme. However, the United States does not maintain and cannot calculate this information – that is, it does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers. This is because the payments do not relate to, and do not depend on, what crop, if any, is actually produced. Instead, each of these programmes makes payments with respect to *past* production on base *acreage* in a fixed and defined base period, not with respect to whether one is currently a producer.

21. Thus, the United States did track total expenditures with respect to base acres of wheat, corn, barley, grain sorghum, oats, upland cotton, and rice under the expired production flexibility contract payments and market loss assistance payments and does track total expenditure with respect to base acres of wheat, corn, barley, grain sorghum, oats, upland cotton, rice, peanuts, soybeans, sunflower seed, canola, rapeseed, safflower, flaxseed, mustard seed, crambe, and sesame seed under the direct payments and counter-cyclical payments.[145] However, the fact that a recipient at one time produced one of these crops says nothing about what crops the recipient is currently producing, if any. In other words, payments made on the basis of past production of upland cotton do not tell anything about whether the recipient is currently producing cotton, corn, livestock, hay, or any other crop or is not producing at all. As a result, it is not possible to derive from these payments whether the payment is being received by an upland cotton producer.

22. The Panel's question points to a fundamental difficulty with Brazil's approach. Brazil would have the Panel allocate "support to a specific commodity" – upland cotton – on the basis that certain of these measures determine payment amounts (for base acres) based on current or recent market prices for that commodity. However, how could the payment be "support to a specific commodity" (support "provided for an agricultural product in favour of the producer of the basic agricultural product") if there need be no production of upland cotton in order to receive payment?

23. Brazil attempts to avoid this result by arguing that various US payments (direct, counter-cyclical, production flexibility contract, and market loss assistance payments) are *not* non-product-specific support because they are not payments to "producers in general." The United States has addressed this erroneous interpretation in detail in its rebuttal submission. In short, Brazil's reading requires ignoring the definition of product-specific support in Article 1(a) (that is "support . . .

[145] *See* US First Written Submission, para. 57 fn. 46.

provided for an agricultural product in favour of the producers of the basic agricultural product"), which Brazil has not interpreted, in over 450 pages of submissions and statements, even once.[146] In fact, Brazil's reading of the definition of non-product-specific support ("support provided in favour of agricultural producers in general") reads the phrase "in general" as meaning "in a body; universally; without exception." However, this dictionary definition is considered "obsolete"[147] and so would hardly be the "ordinary meaning" of the term.

24. As Brazil has conceded, moreover, payments made with respect to upland cotton base acres are not necessarily in favor of upland cotton producers since those acres may not be planted to upland cotton – indeed, may not be planted at all. We note that Brazil has adjusted its entire AMS calculation to reflect its belated realization that, under its own theory, "only the portion of . . . payments [on "upland cotton" base acres] that actually benefits acres planted to upland cotton can be considered support to upland cotton."[148] But Brazil's adjustment is not enough. Brazil simply takes the ratio of actual upland cotton acreage to "upland cotton" base acreage under a given programme. However, there is no reason why upland cotton acreage need be planted on "upland cotton" base acreage. Consider this example:

- One farm could have 100 base acres of upland cotton and currently plant those 100 acres to corn; direct and counter-cyclical payments would be made on those 100 "upland cotton" base acres that actually are planted to corn.

- Another farm could have 100 base acres of corn and currently plant those 100 acres to upland cotton; direct and counter-cyclical payments would be made on those 100 "corn" base acres that actually are planted to upland cotton.

- Brazil's approach (dividing upland cotton planted by upland cotton base acres) would simply say that *all* of the direct and counter-cyclical payments on "upland cotton" base acres are "support to upland cotton" because there are 100 "upland cotton" base acres on which payments were made and 100 acres currently planted to upland cotton, even though these are found on completely separate farms.

Thus, Brazil's ratio does not identify, *even on Brazil's own terms*, the alleged support to upland cotton (that is, "payments that actually benefit[] acres planted to upland cotton") under these programmes.[149]

25. Brazil's own approach would require Brazil to match up payments for upland cotton base acres with the amount of upland cotton production on those base acres, but Brazil has not done so.[150]

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[146] *See, e.g.*, Brazil's Rebuttal Submission, para. 19 (again misquoting the definition of product-specific support in Article 1(a) by eliminating the phrase support provided "for an agricultural product" and failing to interpret that definition according to the customary rules of interpretation of public international law); Brazil's Comments on US Answer to Question 43 from the Panel (paras. 58-60) (criticizing US interpretation of product-specific support but failing to interpret that definition according to the customary rules of interpretation of public international law); Brazil's Comments on US Answer to Question 38 from the Panel (paras. 48-49) (same).

[147] *See The New Shorter Oxford English Dictionary*, vol. 1, at 1073 (first definition of "in general": "† (*a*) in a body; universally; without exception"); *id.*, vol. 1, at xv (sec. 4.5.2: Status symbols) ("The dagger [†] indicates that a word, sense, form, or construction is obsolete. It is placed before the relevant word(s) or relevant sense number.").

[148] *See, e.g.*, Brazil's Answer to Question 67 from the Panel (table, fn. 2, 3, 4, 5).

[149] We also would reiterate that such payments would not be "support to a specific commodity" as explained in Article 1(a) and reflected in Annex 3.

[150] For example, Brazil admits that "this acknowledged legal flexibility to grow other crops does not answer the question of whether the producers planting 14.2 million aces of upland cotton in MY 2002 received direct and counter-cyclical payments. Nor does it answer the question of whether the 14.2 million acres planted

At best, Brazil speculates as to the *likelihood* of a person with cotton base acres actually producing upland cotton on those base acres, and even that speculation is flawed.[151] However, such an approach amounts to little more than speculation and, even if Brazil's erroneous interpretation were used, does not meet Brazil's burden of establishing a *prima facie* case.

26. In addition, under Brazil's own approach, the payments made in relation to corn base acres would be support for *corn* even if planted to upland cotton. However, Brazil's approach would appear to result in double counting the support – the same payment would be support to corn (because it was related to corn base acres) and support to upland cotton (because cotton was produced on base acres eligible for payments). In other words, Brazil is trying to have it both ways:

- First, Brazil argues that payments made based on production on base acres during a base period is support to the crop that was produced during that base period, regardless of what is actually produced currently (that is, payments made for upland cotton base acreage is support to upland cotton even if the producer is now growing corn on that acreage).

- Second, Brazil argues that payments made under these programmes are support to the crop that is currently being produced, even if the crop being produced is different from the base crop (that is, payments made for corn base acreage is support to upland cotton if upland cotton is being produced on the corn base).

27. Furthermore, because payments under the cited programmes are made with respect to historic acres and yields during a base period, it is not possible to calculate the "annual amount granted by the US government . . . to US upland cotton producers, per pound." Counter-cyclical payments, for example, determine the payment rate for base period production as the difference between a target price and the sum of the direct payment rate plus the higher of the market price or the loan rate. However, the per pound payment rate for upland cotton base acres applies only for base period production (base acres *x* payment yields), not current production. Thus, to express these payments per pound begs the question: "Per pound of what?" Any production figure used – whether base period production or production in any year from 1999 through 2002 – results in a highly artificial per pound

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to upland cotton in MY 2002 were planted on *upland cotton* base acreage." Brazil's Rebuttal Submission, para. 38 (emphasis in original). The United States agrees completely, and while Brazil's approach would require that these questions be answered, Brazil has not answered them, even though under Brazil's approach, Brazil would have the burden of proof in this regard. Rather, Brazil tries to construct a series of assumption based on what Brazil considers "likely" or "maybe" or "probably."

[151] *See* Brazil's Rebuttal Submission, paras. 24-50. Brazil makes a lengthy presentation of new data and calculations, including some with respect to crops other than upland cotton, to assert that these four payments are support for upland cotton because without them upland cotton farmers could not cover their costs. However, Brazil's approach is flawed in terms of its facts and the premises on which it relies. In the time available we have not been able to identify and describe all the flaws and inaccuracies in Brazil's presentation of the data. Simply by way of example, however, we note that (1) Brazil includes a figure for cottonseed payments in its graph purporting to show MY 2001 market revenue and government support (Rebuttal Submission, paragraph 30), but Brazil's own table at paragraph 84 of its rebuttal submission reflects that there were no cottonseed payments for the 2001 marketing year; (2) Brazil's theory would appear to be that cotton production on cotton base acres are "necessary" because without government payments costs of production would not be covered, but Brazil presents information only with respect to one year, marketing year 2001, with record low prices - Brazil does not explain its theory or present any data with respect to other years with more typical prices; (3) Brazil asserts that upland cotton production "is produced only in particular regions . . . and producers tend to specialize and not readily switch to other crops" – whereas cotton is produced in 17 of the 50 United States and, for all US cotton farms, average cotton area is approximately 38 per cent of a farm's acres (469 of 1,222 acres) (US Department of Agriculture, Characteristics and Production Costs of US Cotton Farms (October 2001).)

rate since (as noted above) these payments will be or were (as the case may be) received by a recipient regardless of whether he or she produced any upland cotton production.

28. We are able to provide to the Panel the total outlays under the cited programmes with respect to upland cotton base acreage:

| **Total Outlays Under Certain Programmes with respect to Upland Cotton Base Acres (millions US$)** | | | | |
|---|---|---|---|---|
| Payments[152] | MY1999 | MY2000 | MY2001 | MY2002 |
| Production flexibility contract | 614 | 575 | 474 | 452 |
| Market loss assistance | 613 | 612 | 524 | NA |
| Direct | NA | NA | NA | not yet available[153] |
| Counter-cyclical | NA | NA | NA | not yet available[154] |

## VI. Payments With Respect to Base Period Production of Certain Commodities But Not Others Are Not Inherently Product-Specific Support

29. Brazil has argued that production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments are product-specific support. The United States had addressed some infirmities in Brazil's approach in response to Additional Question 67*bis* from the Panel and in previous submissions.[155] The United States now briefly addresses two arguments presented by Brazil.

30. First, Brazil argues that each of these payments is product-specific because base acreage is defined as acreage on which only some commodities were historically produced during a defined and fixed base period. This argument, again, rests on an "obsolete" definition of "in general" (in the definition of non-product-specific support) as "universal" or "without exception" and a determined refusal to quote accurately and interpret the definition of product-specific support in Article 1(a).[156]

[152] *See* Exhibit US-38 (http://www.fsa.usda.gov/dam/BUD/bud1.htm) (for crop years 1999, 2000, and 2001).

[153] The US Department of Agriculture estimates that direct payments for the 2002 marketing year with respect to upland cotton base acres will total $173 million. Exhibit US-18 (www.fsa.usda.gov/dam/BUD/estimatesbook.htm).

[154] The US Department of Agriculture estimates that counter-cyclical payments for the 2002 marketing year with respect to upland cotton base acres will total $873 million. Exhibit US-18 (www.fsa.usda.gov/dam/BUD/estimatesbook.htm).

[155] *See, e.g.*, US Rebuttal Submission, paras. 79-92, 99-105.

[156] We note that, once again, Brazil has misquoted the definition of product-specific support in Article 1(a). Brazil quotes that definition as follows: "For support not provided to agricultural producers *in general*, the test is whether the support is 'provided in favour of the producers of the basic agricultural product.'" Brazil's Rebuttal Submission, para. 19. The actual text of Article 1(a), in pertinent part, reads:

That these payments are made with respect to base acreage for only some commodities is not relevant to the question whether they are support "provided for an agricultural product in favour of the producers of the basic agricultural product."[157] None of these payments satisfies either part of this definition: they are neither provided "for an agricultural product" (rather, they are made with respect to historic production of several products) nor "in favour of the producers of the basic agricultural product" (no production is necessary for payments to be made).

31. Brazil also appears to now argue that the requirement under paragraph 6(a) of Annex 2 that eligibility for payments under a decoupled income support measure "shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period" requires that these payments be made to *all* producers for *all* commodities. This approach would seriously limit the ability of Members to move to decoupled income support. It is not clear that any Member would be willing to switch to decoupled income support if it required expanding support to whole new classes of producers or commodities. We can find no basis for this approach in the text of paragraph 6(a). This definition does not require comprehensive coverage of all or nearly all production in "a defined and fixed base period"; it merely requires "clearly-defined criteria." Thus, under Brazil's reading, a measure could satisfy the requirement of Annex 2, paragraph 6(a), and yet qualify as product-specific support under Article 1(a).

32. Second, Brazil again selectively quotes the statutory definition of "producers" to suggest that recipients of these payments had to be growers who "shared in the risk of producing a crop."[158] As the United States has previously noted, the statute defines "producers" (those eligible in the first instance to receive payment) as persons who "would have shared had the crop been produced."[159] Thus, both the 2002 and 1996 Acts make clear that a payment recipient need not produce any crop (including upland cotton) to receive payment. It is thus a serious error to imply that a payment recipient is necessarily a "producer" in the Agreement on Agriculture rather than a "producer" (meaning "recipient") in the statutory sense.

33. Nowhere in Brazil's submission is there any suggestion of how its approach can be found in the Agreement on Agriculture. It does not make sense of the definitions of product-specific support and non-product-specific support in Article 1(a), which Brazil has recognized guide the interpretation of the phrase "support to a specific commodity" in the Peace Clause. In sum, Brazil's argument

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"support . . . provided *for an agricultural product* in favour of the producers of the basic agricultural product" (emphasis added). What Brazil describes as "the narrow US Article 13(b)(ii) specificity standard" in fact flows from an interpretation of Article 13 that makes sense of the *entire* text of Article 1(a) and not just selected parts of it.

[157] Indeed, Brazil's argument in paragraph 36 of its rebuttal submission rests on a *non sequitur*. Brazil's statement is that: "Thus, direct payments are *not* available to the great majority of US producers of agricultural commodities, *i.e.*, they are not provided to US agricultural producers *in general*." (Emphasis in original.) The illogic in Brazil's statement is that, by removing the requirement to produce any particular crop or any crop at all in order to receive these payments, the United States does in fact make the payments available to producers in general. Recipients are free to produce a broad range of commodities, and so are producers of agricultural commodities "in general." Brazil appears to acknowledge that the payments are not in fact tied to current production when, in paragraph 50, Brazil concedes that the payments are made to "upland cotton base acreage holders" rather than to upland cotton *producers*.

[158] *See* Brazil's Rebuttal Submission, paras. 24 (quoting first half of definition), 29 ("Thus, as with PFC payments, market loss assistance payments were not paid to agricultural producers *in general* but rather to only a select group of US producers), 36 ("Direct payments are targeted support to "producers" farming, *inter alia*, on upland cotton base acreage."), 48 ("But the evidence demonstrates that CCP funds in MY 2002 paid to "historic" (i.e., 1998-2001 or 1993-1995) upland cotton producers are paid to a tiny fraction of total US producers of agricultural commodities.").

[159] US Rebuttal Submission, paras. 36-38.

provides ample evidence that the phrase "support to a specific commodity" in the Peace Clause must be interpreted in the context provided by the Agreement on Agriculture. To divorce it from that context may result in an unworkable and illogical interpretation along the lines suggested by Brazil.

## VII. Brazil's New Arguments Relating to Crop Insurance Do Not Demonstrate that Crop Insurance Payments Are Product-Specific Support

34. Brazil presents a number of arguments claiming that crop insurance payments are "support to a specific commodity." In part, this argument relies on the notion that such payments are not support provided to agricultural producers "in general" and, hence, not non-product-specific support. We note, however, that in making these arguments Brazil avoids any reference to the definition of product-specific support in Article 1(a). This is a fundamental interpretive error: Brazil cannot claim that payments are not support to "agricultural producers in general" under Article 1(a) without providing an interpretation of the other component of support in Article 1(a), namely, product-specific support (support "provided for an agricultural product in favour of the producers of the basic agricultural product"). In fact, given that crop insurance support is available to approximately 100 agricultural commodities, representing approximately 80 per cent of US area planted and greater than 85 per cent of the value of all US crops, crop insurance payments are not support "provided for *an* agricultural product."[160] The support to these approximately 100 commodities is the same: that is, the crop insurance premium subsidies do not vary by commodity or plan of insurance.

35. Brazil's specific arguments fail to address the definition of product-specific support in Article 1(a); thus, each fails to demonstrate that crop insurance payments are "support to a specific commodity" rather than "support to several commodities."

36. First, Brazil argues that certain policies (and accompanying premiums) on irrigation failures are available only to upland cotton and a few other commodities. The United States has previously addressed this argument and directs the Panel's attention to that argument.[161]

37. Second, Brazil argues that a larger pool of types of insurance policies are offered to upland cotton than most other crops. Brazil has not explained how the types of crop insurance policies offered by private companies[162] can affect whether US crop insurance payments (premium subsidies that do not vary by commodity or insurance plan) are product-specific or not. Brazil's "facts" are also misleading in some instances and erroneous in others. For example, Brazil suggests that "in many instances, the policies available for cotton enterprises are not available for other crops."[163] However, we note that commodities other than upland cotton can be insured under the same types of policies as upland cotton.[164]

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[160] US Rebuttal Submission, paras. 93-98.

[161] *See* US Rebuttal Submission, para. 54.

[162] Under the Agricultural Risk Protection Act, new insurance products must be developed by the private sector and approved by the Board of Directors of the Federal Crop Insurance Corporation. The US Department of Agriculture is expressly prohibited from conducting research and development on new products. Thus, the variety and availability of insurance products reflects the fact that private companies, not the US Government, have developed and offered these products.

[163] Brazil's Rebuttal Submission, para. 55.

[164] Upland cotton producers can insure their crops under the following types of policies: Actual Production History, Group Risk Plan, Income Protection, Crop Revenue Coverage, and Revenue Assurance. Other crops that are eligible for the policies include:

for Actual Production History – Alfalfa seed, all other grapefruit, almonds, apples, avocados, barley, blueberries, cabbage, canola, cigar binder tobacco, cigar filler tobacco, cigar wrapper tobacco, corn, cotton, ELS cotton, crambe, cranberries, cultivated wild rice, dry beans, dry peas, early and midseason oranges, figs, flax, forage production, fresh apricots, fresh freestone peaches, fresh market tomatoes, fresh nectarines, grain sorghum, grapefruit, grapes, green peas, late oranges, lemons, macadamia nuts, mandarins, Maryland tobacco,

38. Third, Brazil argues that are there specific upland cotton provisions in certain policies.[165] This is true – an insurance product offered by a private company must be tailored for the situation and desires of the insurance purchasers – but also irrelevant as the policies are generally similar in underwriting rules and share the same subsidy schedule.

39. Fourth, Brazil argues that upland cotton producer participation rates in the crop insurance programme "is much higher that for other crops."[166] We first note that Brazil neglects to mention that participation rates for the major field crops are generally quite high (over 75 per cent of insurable acres). Any producer who received disaster assistance was required to purchase federal crop insurance in the following year; cotton participation may be slightly higher because of droughts that have hit cotton regions in recent years. More importantly, that cotton producers may choose to take up crop insurance more than producers of other commodities might is irrelevant to whether the payments are provided "for an agricultural product." Again, the crop insurance premium subsidy is identical for all commodities and for each plan of insurance.

40. Fifth, Brazil argues that tracking the cost of reinsurance provided to private companies is "further evidence that USDA treats crop insurance for upland cotton separately from crop insurance provided to other crops."[167] Of course, the way the US Department of Agriculture "tracks cost[s]" is irrelevant to the analysis of whether crop insurance payments provide support "for an agricultural product." Brazil also misinterprets the Standard Reinsurance Agreement between the US Government and private insurers. Under that Agreement, net underwriting gains and losses for each insurer are calculated *at the state level* over *all crops*, not separately for individual crops (such as upland cotton).[168] Thus, Brazil errs when it claims that reinsurance provides evidence that crop insurance for upland cotton is treated separately from crop insurance provided to other crops.

41. Sixth, Brazil claims that "the 2000 ARP Act denies subsidies to producers of other agricultural products."[169] It is true that there are certain products for which policies have not been developed. However, development of new policies is ongoing; for example, provisions of the Agricultural Risk Protection Act of 2000 allow for the development of livestock insurance products. A number of livestock products are currently available on a pilot basis, including price insurance for hogs and feeder cattle and gross margin insurance. We also note that producers may currently insure livestock and dairy revenue as part of whole farm insurance offered through the Adjusted Gross Revenue Insurance.[170] Finally, Brazil's argument here again reads domestic producers "in general' to mean "universally" or "without exception"; as noted above, that definition is now considered obsolete.

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millet, Minneola tangelos, mint, mustard, navel oranges, oats, onions, Orlando tangelos, peaches, peanuts, pears, plums, popcorn, potatoes, processing apricots, processing beans, processing cling peaches, processing freestone, prunes, rice, Rio Red and Star Ruby grapefruit, Ruby Red grapefruit, rye, safflower, soybeans, sugar beets, sugarcane, sunflowers, sweet corn, sweet oranges, sweet potatoes, table grapes, tomatoes, Valencia oranges, walnuts, wheat;

for Group Risk – corn, cotton, forage production, grain sorghum, rangeland, soybeans, wheat;

for Income Protection – barley, corn, cotton, grain sorghum, soybeans, wheat; and

` for Revenue Assurance – barley, canola, cotton, grain sorghum, rice, soybeans, sunflowers, wheat.

*See* http://www3.rma.usda.gov/apps/sob/current_week/crop2003.pdf.

[165] Brazil's Rebuttal Submission, para. 55.

[166] Brazil's Rebuttal Submission, para. 57.

[167] Brazil's Rebuttal Submission, para. 58.

[168] The provisions of the Standard Reinsurance Agreement are available on the Risk Management Agency website at: http://www.rma.usda.gov/pubs/ra/98SRA.pdf.

[169] Brazil's Rebuttal Submission, para. 59.

[170] More information on Adjusted Gross Revenue Insurance can be found on the Risk Management Agency website at: http://www.rma.usda.gov/pubs/2003/PAN-1667-06rev.pdf.

42. Finally, with respect to Brazil's references to the literature on the effects of crop insurance on production,[171] the findings are (contrary to what Brazil has claimed) mixed. While several studies (such as those cited by Brazil) have suggested crop insurance payments may have a slight effect on acreage, the effects on *production* are less clear.[172] If crop insurance encourages moral hazard problems (as claimed by Brazil), crop yields will be adversely affected as producers attempt to increase crop insurance indemnities. If moral hazard and adverse selection problems are severe, crop insurance support could potentially have a *negative* effect on production.[173] The potential production effects of crop insurance payments, moreover, goes to whether such payments are "amber box" support but does not figure in the question whether such payments (which are offered at the same rate across commodities and policies) can be support "for an agricultural product."

## VIII. Brazil May Not Act Unilaterally on Procedural Matters

43. The United States takes note of Brazil's statement in its 25 August 2003 letter to the Panel[174] that, concerning paragraph 20 of the Panel's determination of 20 June 2003, "Brazil interpreted this ruling as permitting it to provide no later than 22 August all of its evidence and argument that had not already been provided in its earlier submissions. This is the manner in which it treated the new evidence and arguments presented by the United States in its Rebuttal Submissions." The United States is unable to reconcile Brazil's position concerning its own ability to provide evidence and arguments at any time up through August 22 with Brazil's repeated assertions that the United States "should have" provided particular material in its replies to the Panel's questions.[175] There is of course no basis for Brazil's assertions that particular material "should have been" provided in replies to questions rather than in a rebuttal submission. There is no basis for Brazil to dictate to another Member what it may or may not include in its rebuttal submission. Brazil is fabricating an obligation and attempting to impose it on the United States at the same time that it exempts itself from this obligation. In this, Brazil's approach is similar to its repeated attempts in this dispute to add to the obligations in the Agreement on Agriculture and the Subsidies Agreement.

[171] Brazil's Rebuttal Submission, paras. 60-67.

[172] The US Department of Agriculture, Economic Research Service, studies cited by Brazil only examine the effects of crop insurance subsidies on acreage. They do not consider effects on crop yields.

[173] Recent studies by Smith and Goodwin (1996), Babcock and Hennessy (1996) and Goodwin and Smith (2003) suggest that farms with more insurance tend to use less inputs like fertilizer and pesticides and vice versa. This demonstrates a potential moral hazard problem with crop insurance that suggests that crop insurance participation may have a negative effect on yields. *See* Babcock, B. and D. Hennessy. "Input Demand Under Yield and Revenue Insurance" *American Journal of Agricultural Economics* 78(1996):416-27; Goodwin, B. and V. Smith. "An Ex Post Evaluation of the Conservation Reserve, Federal Crop Insurance, and other Government Programmes: Programme Participation and Soil Erosion." *Journal of Agriculture and Resource Economics* 28(2003):201-216; Smith, V. and B. Goodwin. "Crop Insurance, Moral Hazard and Agricultural Chemical Use." *American Journal of Agricultural Economics* 78(1996):428-38.

[174] The United States also notes that the Panel's communication of 19 August 2003 had not indicated that the parties would have an opportunity to comment on each other's requests to comment. Had there been such an opportunity, the United States would have been happy to comment on Brazil's request of 23 August 2003. Perhaps Brazil could reconsider whether it has a basis to assert a right to decide that it may unilaterally provide comments to the Panel while denying the United States the same procedural rights. Under Brazil's approach, it would not have needed to request permission from the Panel to file comments on Wednesday, August 27, but could have simply provided those comments, unsolicited, while denying equal access for the United States. The United States is grateful that the Panel's extremely prompt reply to the US request obviated any need to respond to Brazil's unauthorized and out of order comments on that request.

[175] *See* Brazil's 23 August 2003 letter to the Panel.

## IX. Conclusion

44. The United States has demonstrated that using any measurement that reflects the support "decided" by the United States rather than factors (such as market prices) beyond the United States' control, US support to upland cotton in marketing years 1999-2002 has not exceeded the 1992 marketing year level. The question then is whether the Panel will find that the United States has breached the Peace Clause simply because market prices were lower in some recent years than they were in 1992.

45. The United States submits that the Peace Clause must be interpreted in a way that permits Members to comply in good faith – that is, Members must be able to tell if they will breach the Peace Clause or not. Brazil's budgetary outlays approach does not do that. Brazil's approach would mean that Members could not know if they had complied with the Peace Clause until it was too late to do anything about it. The best way to interpret the Peace Clause in a way that allows Members to comply is to use the "support" as "decided" by a Member during the 1992 marketing year as the basis for comparison. Recognizing, as the United States believes is required by the Peace Clause text, that "decided" and "grant" cover only those parameters over which Members exercise control would also be consistent with this approach of allowing "good faith" compliance since it would permit Members to control whether their measures conformed to their obligations.

46. The United States has disciplined itself to grant support not in excess of that decided during the 1992 marketing year. Therefore, we are entitled to the protection of the Peace Clause, and we respectfully request the Panel to find that Brazil may not maintain this action challenging these conforming US measures.

## List of Exhibits

1. US Department of Agriculture, Fiscal Year Actual Budgetary Expenditures by Crop Year (http://www.fsa.usda.gov/dam/BUD/bud1.htm)

2. US Department of Agriculture, Compliance Report for 1992 Acreage Reduction Programme

# ANNEX C

## ORAL STATEMENTS OF PARTIES AND THIRD PARTIES AT THE FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING

# ANNEX C-1

## EXECUTIVE SUMMARY OF THE ORAL STATEMENT OF BRAZIL AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

### I. INTRODUCTION

1. Brazil addresses first various peace clause issues, followed by Step 2 export and domestic payments, export credit guarantees and the ETI Act subsidies. Finally, Brazil addresses the "preliminary issues" raised by the United States.

### II. PEACE CLAUSE ISSUES

**The Peace Clause is an Affirmative Defence**

2. The peace clause is in the nature of an affirmative defence and it is, thus, the US burden to prove that Brazil's claims under the SCM Agreement are "exempt from actions". An affirmative defence is a provision that does not set out any positive obligations but enables Members to maintain measures that are otherwise inconsistent with its WTO obligations. The peace clause does not in itself set out any positive obligations for Members, but simply provides a conditional shelter against certain actionable and prohibited export subsidy claims under the SCM Agreement. The peace clause meets the criteria set forth by the Appellate Body for an affirmative defence in *US – FSC* and in the *Aircraft* disputes, by being an exception to a legal regime otherwise applicable. Given the extraordinary protection it provides, it is not "bizarre", as the United States argues, that the peace clause requires the defending Member to prove that its domestic and export subsidies meet the conditions for peace clause protection.

**"such measures do not grant support to a specific commodity"**

3. This phrase in AoA Article 13(b)(ii) means that in calculating the amount of support for any marketing year between 1995-2003, all non-"green box" support provided to a specific commodity must be tabulated, regardless of whether the *type* or *form* of the support is "product-specific", "non-product specific", *de minimis*, or "blue box". This is certainly evidenced by the decision of negotiators *not* to use the phrases "product-specific" and "AMS" in Article 13(b)(ii) to qualify the type of support to a specific commodity. The US attempt to read "product-specific" into Article 13(b)(ii) is inconsistent not only with the text but also the context of the phrase "such measures" in Article 13(b)(ii). The US interpretation of "product-specific support" is further incompatible with the object and purpose of the Agreement on Agriculture. It would create a new category of non-actionable trade-distorting non-"green box" subsidies and sanction huge increases in spending for "amber box" and, therefore trade-distorting, domestic support as long as it took the form of support for *multiple* commodities. This is contrary to the presumption of trade and production-distorting effects for individual products from non-"green box" domestic support, which flows from a domestic measure being inconsistent with the "green box" requirements of AoA Annex 2.

**"that decided during the 1992 marketing year"**

4. This word "decided" does not require any particular *type* of "decision". As a neutral term, the meaning of "decided" must be interpreted in a way that does justice to the ordinary meaning of other terms in Article 13(b)(ii) that are *not* neutral. Most importantly, the term "decided" must be interpreted in a manner that permits a comparison between a "*grant*" of non-"green box" "*support*" to a specific commodity for individual marketing years between 1995-2003, and a "decision" regarding such support in MY 1992. A textual interpretation reveals that the term "that" refers back to "support" and that support is accompanied by the term "granted".

5. The Appellate Body agreed with the panel in *Brazil – Aircraft* that the phrase "the *level* of export subsidies *granted*" meant "something actually provided", which means actual budgetary expenditures. Thus, the neutral term "decision" (for MY 1992) can only be read harmoniously with the term "grant support" (for MY 1995-2003) where the "decision" is to fund non-"green box" support to a specific commodity for marketing year 1992.

6. In addition, even if Article 13 would refer to a *level* of (income) support, as the United States alleges, the Appellate Body has held in *Brazil – Aircraft* that the "level" of export subsidies refers to actual expenditures.

7. The US interpretation of a "level of support" is furthermore inconsistent with its own interpretation of Article 13(b)(ii) in its Statement of Administrative Action (SAA). In the SAA, it stated that governments would have peace clause protection from adverse effects and serious prejudice challenges in the WTO "*unless the AMS for the particular* commodity exceeds the level decided in the 1992 marketing year". Brazil strongly disagrees with the notion of "AMS" as the relevant standard for the peace clause, *but* this official US interpretation of the peace clause in 1995 is nevertheless compelling evidence of the United States view of the "decision" it had taken during MY 1992. The calculation of the AMS for a particular commodity requires the calculation of the support provided in monetary terms. AoA Annex 3 offers two options for the calculation of AMS: budgetary outlays or the price gap formula detailed on paragraphs 10 and 11. Under either option, the AMS represents a measurement of support in monetary terms.

8. In sum, Brazil is of the firm view that the text of Article 13(b)(ii) requires comparing MY 1992 support with MY 1995-2003 support by comparing actual expenditures. This methodology produces an "amount" of support – not a "rate". Thus, any decision under Article 13(b)(ii), by definition, must relate in some way to an "amount" of expenditures. Only this methodology allows a clear comparison between the two time periods, regardless of the *type* of support.

9. However, even if the Panel were to decide that the relevant standard is a "rate of support" standard, Brazil has provided the testimony of Professor Daniel Sumner indicating that – following the US approach to measuring "support to upland cotton" – the "rate of support" to upland cotton in MY 1999-2002 was much higher than the "rate of support" to upland cotton in MY 1992. Based on the evidence and analysis presented by Professor Sumner, Brazil also asserts that even under the US "rate of support" methodology, the United States has failed to demonstrate that its MY 1999-2002 support does not exceed its support to upland cotton decided in MY 1992.

**US "statute of limitations" interpretation of the peace clause**

10. There is no express or implied "statute of limitations" in the peace clause. Subsidizing Members such as the United States are offered conditional protection under the peace clause during a 9-year period. But the rights of Members injured by subsidies provided in excess of 1992 marketing year levels are preserved throughout the implementation period as well. This is the balance struck by the peace clause.

11. The US "statute of limitations" argument in this case is very similar to one rejected by the Appellate Body in *US – Lead Bars*. This argument is further inconsistent with the views of the *Indonesia – Automobiles* panel, which held that measures applied in the past must be examined to assess present serious prejudice. The US interpretation would cut off a Member's right to challenge such measures because it missed an imaginary deadline. This US interpretation is inconsistent with the object and purpose of the AoA because it would permit Members to provide huge "non-green" box support one year without peace clause protection, and then claim absolution as soon as the next marketing year began.

**"Support to Upland Cotton"**

12. Brazil has produced extensive evidence providing the factual basis for the Panel to find that CCP, DP, market loss, and PFC payments are "support to" upland cotton within the meaning of the peace clause. USDA categorizes the PFC and market loss payments as part of "total payments" to upland cotton. US National Cotton Council officials repeatedly testified and produced documents revealing that their producer members requested, received, and depended on all four of these subsidies. Crop insurance is also support to cotton as evidenced by specific upland cotton crop insurance policies and groups of policies for upland cotton. Moreover, USDA specifically identifies and tabulates crop insurance subsidies for upland cotton. In addition, all five domestic support measures fail to meet the requirements of AoA Annex 2. Therefore, they constitute non-"green box" support that is presumed to be production and trade distorting. Such distortions can, however, only occur with respect to the production of or the trade in a particular commodity. Because, PFC, market loss assistance, direct and counter-cyclical payments as well as crop insurance subsidies are available to producers of upland cotton, these production and trade-distorting subsidies affect the production of and trade in upland cotton. The Panel should, therefore, find that all five of these programmes granted support to upland cotton in MY 1999-2002.

**Restrictions on Plantings of Fruits and Vegetables under the PFC and DP Programmes**

13. Brazil presents evidence that PFC and direct payments are not "decoupled" domestic support. These payments are dependent on the requirement that a farmer does not produce fruits, vegetables, nuts or wild rice on the contract acreage. This restrictions has the effect of channelling production on contract acreage into production of programme crops, including upland cotton, and is of particular importance for upland cotton base acreage located in regions of the United States where production of fruits and vegetables is a viable alternative to the production of upland cotton.

## III. STEP 2 EXPORT AND DOMESTIC PAYMENTS

14. The US Step 2 export payments clearly constitute subsidies contingent upon proof of export of US upland cotton. Step 2 export payments are export subsidies that violate AoA Articles 3.3 and 8 and that are prohibited by ASCM Articles 3.1(a) and 3.2.

15. Similarly, US Step 2 domestic payments are prohibited local content subsidies in violation of ASCM Article 3.1(b). There is no explicit derogation of ASCM Article 3.1(b) built into the Agriculture Agreement. In fact, the opposite is true, since AoA Article 13(b)(ii) provides a conditional exemption only for claims under ASCM Articles 5 and 6, but not for claims under ASCM Article 3. There is also no conflict between ASCM Article 3.1(b) and AoA Article 6 or Annex 3, paragraph 7, because there are two types of domestic support, including domestic support to processors of agricultural commodities – those that comply with Article 3.1(b) of the SCM Agreement and those that do not.

## IV. EXPORT CREDIT GUARANTEES

16. With respect to the consultations regarding the US export credit guarantee programmes, there is no doubt that the United States and Brazil consulted on three occasions about the GSM 102, GSM 103, and SCGP programmes as they relate to all eligible products. Thus, these measures are properly within the Panel's terms of reference and the Panel should reject the US request for a preliminary ruling.

17. With respect to Brazil's claims regarding the GSM 102, GSM 103 and SCGP export credit guarantee programmes, the United States interpretation of AoA Article 10.2 should be rejected. AoA Article 10.2 does not carve out export credit guarantees from the disciplines on export subsidies under the AoA. Nowhere does the provision exempt export credit guarantees from the disciplines on export subsidies, while exemption need to be made explicit in the text of an agreement following the Appellate Body reports in *EC – Hormones* and *EC – Sardines*. Similarly the context of AoA Article 10 as well as its object and purpose do not support the US view of AoA Article 10.2 as enabling Members to grant export credit support at zero percent interest and for unlimited terms – all for *free* – until Members complete negotiations on specific disciplines for export credits.

18. Concerning the substance of Brazil's claims against export credit guarantees, the United States has not even addressed Brazil's claim that since there is no commercial market for export credit guarantees on terms such as those provided by the CCC programmes, those programmes confer benefits *per se*. Brazil furthermore demonstrates that under the US formula accounting for the budgetary costs of contingent liabilities of CCC export credit guarantees, operating costs and losses for GSM 102, GSM 103 and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992. These figures represent *actual* costs and losses of the US export credit guarantee programmes.

19. Thus, the programmes constitute export subsidies within the meaning of ASCM Articles 1.1 and 3.1(a), item (j) of the Illustrative List, and AoA Articles 10.1, 1(e) and 8. They "at the very least" threaten to circumvent US export subsidy commitments, in violation of Articles 10.1 and 8 and are prohibited under ASCM Articles 3.1(a) and 3.2.

## V. ETI ACT

20. Lastly, the United States argues that Brazil has failed to meet is burden of proof that ETI Act subsidies constitute export subsidies violating the AoA and prohibited by the SCM Agreement. Brazil has adopted and reiterated all of the successful arguments of the EC in the *US – FSC (21.5)* dispute. Brazil asks the Panel to follow the panel in *India – Patents (EC)* and to give "significant weight" to the rulings in the *US – FSC (21.5)* dispute and to avoid "inconsistent rulings", while recognizing that the Panel is not formally bound by that decision.

## VI. PRELIMINARY ISSUES

21. Brazil has addressed the US request for a preliminary ruling on export credit guarantees above.

22. Concerning the US request for a preliminary ruling on the MY 2002 cottonseed payments, the record indicates that Brazil's consultation request covered "future" measures related to existing measures; it indicates further that Brazil and the United States consulted about the "Cottonseed Payment Programme", and that the Agricultural Assistance Act of 2003 provided funding for the existing administrative structure of the Cottonseed Payment Programme. Therefore, following the Appellate Body decision in *Chile – Agricultural Products (Price Band)*, the Agricultural Assistance Act of 2003 is properly within the Panel's terms of reference. In any event, the $50 million in

cottonseed payments are properly treated as "support to cotton" for the purposes of the peace clause calculation of the amount of support granted in MY 2002.

23. Regarding the US arguments that PFC and market loss assistance payments are outside the Panels terms of reference, as they constitute expired measures, Brazil asks the Panel to reject this third US request for a preliminary ruling. Brazil has properly included PFC and market loss assistance payments as part of its claims relating to *present* serious prejudice. Consultations under DSU Article 4.2 may be held concerning measures affecting the operation of a covered agreement. ASCM Article 5 requires a Member to avoid causing adverse effects, which may be the effects of current or previous, expired subsidies. As in the *Indonesia – Automobiles* dispute, expired measures are eminently within the Panel's terms of reference. Denying Members the possibility to challenge expired measures would yield the result that a Member could enact "one-time" subsidy measures that could never be challenged and the provisions of ASCM Articles 5 and 6 would thereby be rendered a nullity.

## VI. CONCLUSION

24. Brazil requests the Panel to reject all three US requests for preliminary rulings and to rule that AoA Article 13 does not exempt US domestic support and export subsidies from actions under the SCM Agreement.

# ANNEX C-2

## EXECUTIVE SUMMARY OF THE CLOSING STATEMENT OF BRAZIL AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

### I. INTRODUCTION

1. Brazil addresses first the "preliminary issues" raised by the United States, and then the various peace clause issues. Finally, Brazil addresses the Step 2, ETI Act and export credit guarantee measures.

### II. PRELIMINARY ISSUES

2. With respect to the consultations regarding the US export credit guarantee programmes, there is no doubt that the United States and Brazil consulted on three occasions about the GSM 102, GSM 103, and SCGP programmes as they relate to all eligible products. Thus, these measures are properly within the Panel's terms of reference.

3. Regarding the MY 2002 cottonseed payments, the record indicates that Brazil's consultation request covered "future" measures related to existing measures; it indicates further that Brazil and the United States consulted about the "Cottonseed Payment Programme", and that the Agricultural Assistance Act of 2003 provided funding for the existing administrative structure of the Cottonseed Payment Programme. Therefore, the Agricultural Assistance Act of 2003 is properly within the Panel's terms of reference. In any event, the $50 million in cottonseed payments are properly treated as "support to cotton" for the purposes of the peace clause calculation of the amount of support granted in MY 2002.

4. Regarding the US arguments that PFC and market loss assistance payments are outside the Panels terms of reference, as they constitute expired measures, Brazil asks the Panel to reject this third US request for a preliminary ruling. Brazil has properly included PFC and market loss assistance payments as part of its claims relating to *present* serious prejudice. ASCM Article 5 requires a Member to avoid causing adverse effects, which may be the effects of current or previous, expired subsidies. Adverse present effects caused by both types of measures are eminently within the Panel's terms of reference. As a factual matter, the Panel must decide on the question whether a particular expired subsidy has an actual causal connection with currently existing adverse effects. Yet, by granting the US request for a preliminary ruling the Panel would effectively dismiss Brazil's claim. Therefore, the fact that a subsidy measure has expired cannot be the basis for *a priori* excluding it from the Panel's terms of reference.

5. Furthermore, DSU Article 4.2 and 6.2 – invoked by the United States – must be applied in the context of the remedies provided for actionable subsidies under ASCM Articles 7.2-7.10. Under DSU Article 19 a panel can only recommend that the Member bring a wrongful measure into conformity with the covered agreement(s) at issue. However, for disputes concerning ASCM Articles 5 and 6, ASCM Article 7.8 contemplates two different remedies: removal of the adverse effects or withdrawal of the subsidy. While a Member cannot bring an expired measure into conformity with the covered agreements, both of the ASCM Article 7.8 remedies are valid options even for remedying the effects of a subsidy measure no longer in effect (as in the *Australia – Leather* dispute). As ASCM Articles 7.2-7.10 are "special and additional rules and procedures" under DSU Article 1.2 and DSU Appendix 2, they must prevail to the extent there is a difference between them and DSU Articles 4

and 6. This means that contrary to disputes involving other covered agreements, the Panel is required to address the adverse effects of expired subsidy measures.

6. Further, ASCM Articles 5 and 6.3 make no distinction between subsidies that are now being paid and subsidies that are no longer being paid but have a causal relationship to continuing adverse effects, as evidenced by the Panel report in *Indonesia – Automobiles*, which found serious prejudice arising, *inter alia*, from expired subsidy measures that had been provided for one year and – like the market loss assistance payments – been terminated.

## III. PEACE CLAUSE ISSUES

**"such measures do not grant support to a specific commodity"**

7. This phrase in Article 13(b)(ii) means that in calculating the amount of support for any marketing year between 1995-2003, all non-"green box" support provided to a specific commodity must be tabulated, regardless of whether the *type* or *form* of the support is "product-specific," "non-product specific", *de minimis*, or "blue box". This is certainly evidenced by the decision of negotiators *not* to use the phrases "product-specific" and "AMS" in Article 13(b)(ii) to qualify the type of support to a specific commodity. The US attempt to read "product-specific" into Article 13(b)(ii) is inconsistent not only with the text but also the context of the phrase "such measures" in Article 13(b)(ii). The US interpretation is further incompatible with the object and purpose of the Agreement on Agriculture. It would create a new category of non-actionable trade-distorting non-"green box" subsidies and sanction huge increases in spending for "amber box" and, therefore trade-distorting, domestic support as long as it took the form of support for *multiple* commodities. This is contrary to the presumption of trade and production-distorting effects for individual products from non-"green box" domestic support, which flows from a domestic measure being inconsistent with the "green box" requirements of Annex 2 of the Agriculture Agreement.

**"that decided during the 1992 marketing year"**

8. This word "decided" does not require any particular *type* of "decision". As a neutral term, the meaning of "decided" must be interpreted in a way that does justice to the ordinary meaning of other terms in Article 13(b)(ii) that are *not* neutral. Most importantly, the term "decided" must be interpreted in a manner that permits a comparison between a "*grant*" of non-"green box" "*support*" to a specific commodity for individual marketing years between 1995-2003, and a "decision" regarding such support in MY 1992. The Appellate Body agreed with the panel in *Brazil – Aircraft* that the phrase "the *level* of export subsidies *granted*" meant "something actually provided", which means actual budgetary expenditures. Thus, the neutral term "decision" (for MY 1992) can only be read harmoniously with the term "grant support" (for MY 1995-2003) where the "decision" is to fund non-"green box" support to a specific commodity for marketing year 1992.

9. The US argument that the only decision it took during MY 1992 was a "fixed rate of support" for MY 1992 is totally inconsistent with the US Statement of Administrative Action (SAA), in which the United States provided its official interpretation of the peace clause. In the SAA, the United States stated that governments would have peace clause protection from adverse effects and serious prejudice challenges in the WTO "*unless the AMS for the particular* commodity exceeds the level decided in the 1992 marketing year." Brazil strongly disagrees with the notion of "AMS" as the relevant standard for the peace clause, and draws the attention of the Panel to the fact that the United States now admits that "AMS" is nowhere found in the text of Article 13(b)(ii). *But* this official US interpretation of the peace clause in 1995 is nevertheless compelling evidence of the United States view of the "decision" it had taken during MY 1992. And this interpretation did not reflect a decision regarding only a rate of support. Instead, the only two "decision" options were set out in the AoA Annex 3, where "AMS" is calculated. This calculation is based on either budgetary

outlays, or a calculated *amount* based on the difference between a fixed reference price and the applied administered price multiplied by the amount of production eligible to receive the administered price. Under either option, the United States' interpretation indicates that an "amount" (not a "rate of support") is the measure of support under the peace clause.

10. The SAA statement is also strong evidence that the alleged US "decision" to continue the 1990 FACT Act level of support at 72.9 cents per pound is simply *post hoc* rationalization. Brazil presents evidence that prior to this dispute, the United States had not made up its mind on what would constitute the relevant decision for peace clause purposes. A series of questions asked by Brazil in the Committee on Agriculture and answers provided by the United States reveals that as of 28 June 2002, the United States had not yet made a "decision" regarding which year the United States was using with respect to Article 13(b)(ii). These questions provided the United States with every opportunity to announce the decision that it had allegedly taken 10 years before. Yet, it said nothing about a "rate of support".

11. In sum, Brazil is of the firm view that the text of Article 13(b)(ii) requires comparing MY 1992 support with MY 1995-2003 support by comparing actual expenditures. This methodology produces an "amount" of support – not a "rate". Thus, any decision under Article 13(b)(ii), by definition, must relate in some way to an "amount" of expenditures. Only such methodology allows a clear comparison between the two time periods, regardless of the *type* of support.

12. However, even if the Panel were to decide that the relevant standard is a "rate of support" standard, Brazil has provided the testimony of Professor Daniel Sumner indicating that the "rate of support" to upland cotton in MY 1999-2002 was much higher than the "rate of support" to upland cotton in MY 1992. Based on the evidence and analysis presented by Professor Sumner, Brazil also asserts that even under the US "rate of support" methodology, the United States has failed to demonstrate that its MY 1999-2002 support does not exceed its support to upland cotton decided in MY 1992.

**US "statute of limitations" interpretation of the peace clause**

13. There is no express or implied "statute of limitations" in the peace clause. Subsidizing Members such as the United States are offered conditional protection under the peace clause during a 9-year period. But the rights of Members injured by subsidies provided in excess of 1992 marketing year levels are preserved throughout the implementation period as well. This is the balance struck by the peace clause.

14. The US "statute of limitations" argument in this case is very similar to one rejected by the Appellate Body in *US – Lead Bars*. This argument is further inconsistent with the views of the *Indonesia – Automobiles* panel, which held that measures applied in the past must be examined to assess present serious prejudice. The US interpretation would cut off a Member's right to challenge such measures because it missed an imaginary deadline. This US interpretation is inconsistent with the object and purpose of the AoA because it would permit Members to provide huge "non-green" box support one year without peace clause protection, and then claim absolution as soon as the next marketing year began.

**"Support to Upland Cotton"**

15. Brazil has produced extensive evidence providing the factual basis for the Panel to find that CCP, DP, market loss, and PFC payments are "support to" upland cotton within the meaning of the peace clause. USDA categorizes the PFC and market loss payments as part of "total payments" to upland cotton. US National Cotton Council officials repeatedly testified and produced documents revealing that their producer members requested, received, and depended on all four of these subsidies. Crop insurance is also support to cotton as evidenced by specific upland cotton crop insurance policies and groups of policies for upland cotton. Moreover, USDA specifically identifies and tabulates crop insurance subsidies for upland cotton. Thus, the Panel should find that all five of these programmes granted support to upland cotton in MY 1999-2002.

## IV. STEP 2 PAYMENTS

16. The US Step 2 export subsidies clearly constitute export subsidies that violate Articles 3.3 and 8 of the Agriculture Agreement and that are prohibited by Articles 3.1(a) and 3.2 of the SCM Agreement because they are contingent upon proof of export of US upland cotton.

17. Similarly, US domestic Step 2 subsidies are prohibited local content subsidies in violation of Article 3.1(b) of the SCM Agreement. There is no explicit derogation of Article 3.1(b) built into the Agriculture Agreement. In fact, the opposite is true, since Article 13(b)(ii) provides a conditional exemption only for claims under Articles 5 and 6 of the SCM Agreement, but not for claims under Article 3 of the SCM Agreement. There is also no conflict between Article 3.1(b) of the SCM Agreement and Agriculture Agreement Article 6 or Annex 3, paragraph 7, because there are two types of domestic subsidies – those that comply with Article 3.1(b) of the SCM Agreement and those that do not.

## V. EXPORT CREDIT GUARANTEES

18. With respect to Brazil's claims regarding the GSM 102, GSM 103 and SCGP export guarantee programmes, the United States interpretation of AoA Article 10.2 should be rejected. Under the US view of Article 10.2, it can grant export credit support at zero percent interest and for unlimited terms – all for *free* – at least until Members complete negotiations on specific disciplines for export credits. This interpretation is not supported by a Vienna Convention analysis.

19. The United States has not even addressed Brazil's claim that since there is no commercial market for export credit guarantees on terms such as those provided by the CCC programmes, those programmes confer benefits *per se*. And Brazil has demonstrated that under the cost formula used by the White House, the US Congress, US government accountants and the CCC itself, operating costs and losses for GSM 102, GSM 103 and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992. These figures represent *actual* costs and losses of the US export credit guarantee programmes. The programmes therefore constitute export subsidies within the meaning of ASCM Articles 1.1 and 3.1(a), item (j) of the Illustrative List, and AoA Articles 10.1, 1(e) and 8. They "at the very least" threaten to circumvent US export subsidy commitments, in violation of Articles 10.1 and 8 and are prohibited under ASCM Articles 3.1(a) and 3.2.

## VI. CONCLUSION

20. Brazil requests the Panel to reject the numerous attempts by the United States to delay the initiation of Brazil's serious prejudice claims. Brazilian upland cotton producers are experiencing present serious prejudice from continued huge amounts of US subsidies to upland cotton. Applying

either methodology of calculating the support for peace clause purposes, the United States has no basis to claim peace clause protection.

# ANNEX C-3

## EXECUTIVE SUMMARY OF THE OPENING STATEMENT OF THE UNITED STATES AT THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. The United States has stayed within the disciplines and acted consistently with its WTO obligations negotiated and agreed in the Uruguay Round. We share many of Brazil's objectives with respect to reform of measures that affect agricultural trade, but we obviously do not endorse the means by which Brazil is attempting to obtain changes to WTO-consistent US support measures for upland cotton. Brazil seeks to impose disciplines and achieve results through this litigation that were not agreed in the Uruguay Round through negotiation.

2. Brazil suggests that whether a Member's measures are in breach of the Peace Clause should be judged by comparing the *aggregate outlays* that may be *attributed* to a commodity to the aggregate outlays that were made during the 1992 marketing year that, again, may be attributed to that commodity. Brazil's erroneous analysis stems from three interpretive missteps.

3. First, with respect to measures currently in effect, Brazil mistakenly suggests that support under previous measures in past years is relevant to the Peace Clause comparison. The proviso, however, is written in the present tense and thus, with respect to measures *currently* in effect, calls for a determination of the support that challenged measures *currently* grant. Brazil *nowhere* explains how the support in any previous years is relevant to the present-tense criterion that Peace Clause-exempted measures "do not grant support" in excess of a certain level. In fact, Brazil's analysis of the ordinary meaning and context of the phrase "grant support" assigns no meaning to Members' choice of verb tense.

4. Second, Brazil misunderstands the support that is relevant to the Peace Clause comparison because it misreads the phrase "support to a specific commodity". Brazil and New Zealand have asserted that, had Members intended for the phrase "support to a specific commodity" to mean "product-specific support", they would have used the latter phrase. With respect, this pushes the general interpretive aid of reading different word choices to carry different meanings too far. It ignores the relevant task for an interpreter, which is to read the text according to its ordinary meaning, in context, and in light of the object and purpose of the agreement. The ordinary meaning of the phrase "support to a specific commodity," in the context of the Agriculture Agreement, is "product-specific support".

5. We note that the Agriculture Agreement suggests that domestic support consists, in part, of product-specific and non-product-specific support. Brazil's interpretation of "support to a specific commodity," however, would apparently also capture "non-product-specific support". Absent a clear indication that such a contrary-to-logic result was intended, the interpreter should read "support to a specific commodity" to exclude "non-product-specific support". We note that the Agriculture Agreement suggests that domestic support consists, in part, of product-specific support and non-product-specific support. Brazil's interpretation of "support to a specific commodity", however, would apparently also capture "non-product-specific support". Absent a clear indication that such a contrary-to-logic result was intended, the interpreter should read "support to a specific commodity" to exclude "non-product-specific support".

6. Third, Brazil ignores the way in which the United States "decided" (that is, "determined" or "pronounced") the product-specific support for upland cotton during the 1992 marketing year. As

Brazil explained in its first submission, the Peace Clause text resulted from the EC's desire to protect from challenge measures "decided" in 1992 for purposes of CAP reform, rather than support "provided" during marketing year 1992. That is precisely the approach the United States suggests: examine the product-specific support "decided" during marketing year 1992 and compare it to the product-specific support that measures currently in effect grant. Brazil fails to explain to the Panel how US measures *actually* decided support during the 1992 marketing year in favour of Brazil's pre-baked conclusion that the "term 'decided during the 1992 marketing year' requires an examination of the *amount or quantity of support* . . . for a specific commodity that a WTO Member 'decided' to provide during the 1992 marketing year". In fact, US measures "decided" support in the 1992 marketing year by ensuring upland cotton producer income at a rate of 72.9 cents per pound. Brazil nowhere explains how US domestic support measures could have "decided" the amount of outlays since those outlays resulted from the difference between the income support level and world prices during Marketing Year 1992 beyond the US Government's control.

7. Brazil has argued that the US approach would create an annual "statute of limitations" for the applicability of the Peace Clause and that the problem with this approach is budgetary outlays are not known until after a given marketing year is completed. This comment, rather, points out the difficulties of *Brazil's* approach that *only* budgetary outlays may be examined under the Peace Clause. That is, Brazil effectively concedes that under *its* approach there would be no certainty for Members whether measures are exempt from actions. For example, it would be difficult to know whether budgetary outlays under the 2002 Act exceeded 1992 outlays as of Brazil's panel request in February 2003.

8. With respect to US direct payments, which the United States believes are "green box" measures, Brazil argues that these payments do not satisfy the "fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production" under the first sentence of paragraph 1 of Annex 2. However, the text of Annex 2 indicates that "domestic support measures" shall be deemed to have met this "fundamental requirement" if the measures "conform to the . . . basic criteria" of the second sentence, plus any applicable policy-specific criteria, by beginning the second sentence with "accordingly". This interpretation is supported by relevant context in the Agreement; as the European Communities notes in its third party submission, Articles 6.1, 7.1, and 7.2 refer to the measures "which are not subject to reduction commitments because they qualify under the *criteria* set out in Annex 2".

9. In addition to the basic criteria in paragraph 1, US direct payments must also conform to the five "policy-specific criteria and conditions" set out in paragraph 6 of Annex 2. Brazil brings forward two arguments that direct payments do not satisfy the criterion under paragraph 6(b) of Annex 2 that the amount of payments not be related to, or based on, production undertaken in any year after the base period. First, Brazil argues that by eliminating or reducing payments if recipients harvest certain fruits or vegetables, payments are related to production in a year after the base period. However, no particular type of production is required in order to receive such payments – indeed, no production is necessary at all. Brazil's argument, moreover, proves too much. Under Brazil's analysis, *any* limitation on a producer's choices in a year after the base period that would alter the amount of payment would be inconsistent with paragraph 6(b). However, a requirement that a recipient of direct payments produce *nothing at all* (or see the payment reduced or eliminated) *would* link the amount of payment to the type or volume of production in the current year. Such a requirement would also *ensure* that such payments meet the "fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production" because there would be no production at all. Thus, under Brazil's analysis, paragraph 6(b) would *prevent* a payment that would demonstrably achieve the "fundamental requirement" of Annex 2. This result is not required by the text of paragraph 6(b) and should be avoided.

10. Second, Brazil argues that direct payments are based on production in a year after the base period because once one type of direct payment to producers under Annex 2 has been made, *all*

subsequent measures providing direct payments must be made with respect to the same base period. The Annex 2 text does not support such a reading, however. Annex 2 says that "[d]omestic support measures for which exemption from the reduction commitments is claimed" shall meet the fundamental requirement of the first sentence through the relevant basic and policy-specific criteria of the second sentence. For example, in the case of decoupled income support, the particular "domestic support measure" must meet "policy-specific criteria and conditions as set out" in paragraph 6. Paragraph 6(a), (b), (c), and (d) relate "such payments" to "a defined and fixed base period". Thus, payments with respect to a given "domestic support measure for which exemption from the reduction commitments is claimed" must satisfy conditions relating to "*a* defined and fixed base period". There is no textual requirement that *all* domestic support measures for which exemption from the reduction commitments is claimed utilize the *same* "defined and fixed base period". Brazil also reads paragraph 6 as though the text were "*the* defined and fixed base period". However, this is not what the text says nor what the negotiators agreed.

11. Brazil and the rest of the Cairns Group seek to address this very issue by proposing in the ongoing agriculture negotiations that Annex 2, paragraph 6, be amended to change the reference from "a defined and fixed base period" to "a defined, fixed *and unchanging historical* base period". The revised Harbinson text, in Attachment 8, incorporates this Cairns Group proposal by proposing adding to paragraphs 5, 6, 11, and 13 of Annex 2 the text: "Payments shall be based on activities in a fixed and *unchanging historical* base period." Again, Brazil is seeking to gain through litigation what it has not yet gained through negotiation.

12. The Step 2 programme has been constructed and implemented in a manner to support the price paid to US upland cotton producers by purchasers of their product. Step 2 is a single programme that provides for payments on all sales of all upland cotton produced in the United States in a given marketing year – whether those sales are for export or for domestic consumption. Step 2 payments are provided to merchandisers or manufacturers who use upland cotton as they represent the first step in the marketing chain where these payments could be made and have the greatest impact on producer prices.

13. The authorizing statute plainly does not state that the Step 2 payment is contingent upon export. The statute provides for Step 2 payments to a class of eligible users who constitute the entire universe of potential purchasers of upland cotton from producers. Payment occurs upon demonstration of the requisite use of the cotton. Unlike the facts of *United States - FSC (Recourse to Article 21.5)* , the Step 2 subsidy involves a universally available subsidy on sales of one agricultural product produced entirely in the United States, not tied to exportation or foreign commerce. Stated most simply, US upland cotton does *not* have to be exported to receive the payment. Assuming the conditions in the payment formula are met, all US upland cotton is sold with an entitlement to the Step 2 subsidy, whether it leaves the United States or is consumed there.

14. For nearly 15 years before the inception of obligations under the Agreement on Agriculture, as well as since that time, the core features of the two main agricultural export credit guarantee programmes of the United States (GSM-102 and GSM-103) have remained substantially the same. They are well-known and well-established export credit guarantee programmes, specifically discussed by negotiators during the Uruguay Round, as well as in the OECD and in the current Doha Round.

15. Article 9.1 of the Agriculture Agreement identifies and lists specific export subsidy programmes, also well-known to the negotiators, who wanted to assure that such specific practices were embraced within the definition of an export subsidy for purposes of the Agreement on Agriculture. Other export subsidies are captured within the anti-circumvention provision of Article 10.1. In contrast, export credit guarantees were not included in either Article 9.1 or 10.1. Instead, as part of the balance struck in the Uruguay Round, negotiators opted to extend the negotiations on this subject but determined to hold Members to a commitment that if and when internationally agreed disciplines emerged, the United States, like all other WTO Members, could

only grant export credit guarantees in conformity with such disciplines. To do otherwise would at that time constitute a violation of the Member's obligations under the Agreement on Agriculture.

16. Article 10.2 expresses the two commitments of the Members in this regard: (1) to engage in such negotiations notwithstanding the conclusion of the Uruguay Round and (2) upon development of internationally agreed disciplines to render them WTO commitments through the portal of Article 10.2. Article 10.2 does not state that export credit guarantees shall be subject to such future negotiated disciplines *in addition to* the anti-circumvention provisions of Article 10.1. To the contrary, Article 10.2 and the reference to export credit guarantees is juxtaposed to Article 10.1 to reflect the intention of the drafters to distinguish export credit guarantee programmes from other programmes that otherwise would be export subsidies subject to Article 10.1.

17. For the foregoing reasons and those set out in our first written submission, the United States believes that US non-green box measures are exempt from actions pursuant to Agriculture Agreement Article 13(b)(ii); US direct payments are exempt from actions pursuant to Agriculture Agreement Article 13(a)(ii); and US export credit guarantee programmes for upland cotton and Step 2 payments are consistent with our WTO obligations.

# ANNEX C-4

## EXECUTIVE SUMMARY OF THE CLOSING STATEMENT OF THE UNITED STATES AT THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. On the US requests for preliminary rulings, the Panel expressed some interest in the question of what prejudice would result to the United States if we were forced to defend export credit guarantees with respect to commodities other than upland cotton. First and foremost, the United States would have lost the benefit of consultations on these measures. Consultations serve a number of important functions, including helping the parties to understand each others' concerns and aiding in efforts to resolve the dispute. The DSU affirms the importance of consultations and requires that a Member cannot proceed to a panel unless the Member has consulted on that measure.

2. Moreover, to require the United States to address Brazil's allegations on these measures would impose additional burdens on the United States and detract from the time and resources available to respond for those measures that *are* within the terms of reference. The United States has export subsidy reduction commitments with respect to 12 commodities. Each such commodity is therefore subject to individual Peace Clause analysis under Article 13(c). In addition, under Brazil's approach, the type of analysis the United States has offered for upland cotton concerning item (j) of the Subsidies Agreement would be appropriate for all commodities subject to the coverage of the Agriculture Agreement. This would necessitate a commodity-by-commodity analysis of the export credit guarantee programmes, as applied, concerning premiums and long-term operating costs and losses (if any).

3. But in the end, the issue of prejudice to the United States does not figure in the question of whether a measure is within the Panel's terms of reference. It is *that* question that underlies the United States' preliminary ruling requests.

4. First, the United States has requested that the Panel find that export credit guarantee measures relating to other eligible agricultural commodities are not within the Panel's terms of reference. While Brazil's *panel* request *did* refer to "export credit guarantees . . . to facilitate the export of US upland cotton and other eligible agricultural commodities," its *consultation* request did not. That consultation request nowhere included the "other eligible agricultural commodities" language, nor did Brazil include these measures in its statement of available evidence. Thus, those measures on other eligible agricultural commodities were not part of the "measures at issue" that Brazil identified in its consultation request as it is required to do under DSU Article 4.4. Contrary to Brazil's statement a few moments ago, the United States and Brazil never consulted on export credit guarantees on commodities other than cotton – not once and certainly not three times. Brazil said as much on the first day of the first panel meeting when it acknowledged that the United States told Brazil at the first consultation that its questions were beyond the scope of the consultations.

5. On the question whether the export credit guarantee programmes were one measure or multiple measures: There is no reason why export guarantees for multiple products cannot be multiple measures. Under DSU Article 4.4, it is incumbent upon Brazil to identify in its consultation request "the measures at issue." Here, Brazil identified the measure as the "export credit guarantees . . . to facilitate the export of US upland cotton," and the United States may, and did, rely on that consultation request (including the attached statement of evidence) for notice.

6. For example, if a Member banned imports of all animal products for a stated health reason, and another Member filed a consultation request on the ban solely with respect to imports of beef, that complaining Member could not then expand the scope of the dispute through its written consultation questions or its panel request to challenge that ban with respect to other affected agricultural commodities. This is, however, what Brazil is attempting to do here.

7. Brazil also relies on footnote 1 of its consultation request, which refers to an explanation "below". Such an explanation expanding the scope of the request to include "other eligible agricultural commodities" is *not* found in the consultation request. DSU Article 4.4 requires Brazil to provide "an identification of the measures at issue," not a cryptic reference that is not explained further. Despite notice from the United States and despite ample opportunity to submit a new consultation request, Brazil never did so. Therefore, export credit guarantee measures relating to eligible US agricultural commodities other than US upland cotton were not the subject of consultations and pursuant to DSU Articles 4.4, 4.7, and 6.2 do not form part of the Panel's terms of reference.

8. With respect to production flexibility contract payments and market loss assistance payments, we have explained that these payments were completed, the programmes terminated, and the statutory instruments providing them were superseded before Brazil's consultation request was filed. The measures that Brazil challenges are subsidies or payments provided by these programmes. The laws authorizing these payments designated that each such payment was *allocated* to a particular crop or fiscal year. Thus, pursuant to the 1996 Act, the last production flexibility contract payment for fiscal year 2002 was made no later than the end of fiscal year 2002. As Brazil states in its first submission, "[w]ith the passage of the new FSRI Act in May 2002, PFC payments were discontinued". The last market loss assistance payment was made with respect to the 2001 marketing year (1 August 2001-31 July 2002) pursuant to legislation enacted on 13 August 2001. Because the relevant fiscal year and the relevant marketing year, respectively, had been completed by the time of Brazil's consultation and/or panel requests, these measures cannot have been consulted upon within the meaning of DSU Article 4.2 *nor* have been "measures at issue" within the meaning of DSU Article 6.2. They therefore do not fall within the Panel's terms of reference. Brazil's suggestion that Articles 7.2 to 7.10 of the Subsidies Agreement should supersede the DSU provisions concerning this Panel's terms of reference is novel. Preliminarily, we note that Article 7.4 does mention the Panel's terms of reference, but only in the context of setting a 15-day deadline for establishing them, as opposed to the time line under DSU Article 7.1.

9. Finally, with respect to subsidies provided under the Agricultural Assistance Act of 2003 – the cottonseed payment – these are measures that were not even in existence at the time of Brazil's panel request. As the cottonseed payment had not been made (implementing regulations were not even issued until 25 April 2003) and the legislation authorizing the payments had not been enacted at the time of Brazil's panel request, this subsidy or measure was not consulted upon and could not have been a measure at issue between the parties. Therefore, the United States requests that the Panel make preliminary rulings that these three sets of measures are not within its terms of reference.

10. To summarize briefly where our discussions on the Peace Clause have brought us: Brazil suggests in *this* dispute that the word " actions" in the phrase "exempt from actions" only refers to "collective action" by the DSB. However, we note that Brazil's interpretation runs directly contrary to the view it expressed in its consultation request in the dispute *European Communities – Export Subsidies on Sugar* (WT/DS266/1). With respect to Article 13(c)(ii), which uses the same phrase "exempt from actions" at issue in this dispute, Brazil wrote: "In respect of the claims based on Article 3 of the SCM Agreement, because the export subsidies provided by the EC on sugar do not conform fully to the provisions of Part V of the Agreement on Agriculture, those export subsidies are not *exempt from challenge* by virtue of Article 13(c)(ii) of the Agreement on Agriculture." That is, in that WTO document Brazil does *not* read the phrase "exempt from actions" to mean "exempt from remedies" or "exempt from collective action by the DSB" but rather "exempt from *challenge*".

Brazil's interpretation in that WTO consultation request could only result if "exempt from action" in the Peace Clause means "not subject to" the "taking of legal steps to establish a claim" – as the United States has been contending in this dispute. We submit that *this* interpretation by Brazil is correct.

11. The Peace Clause – in Brazil's words – "exempt[s] from challenge" certain measures. It follows that the Peace Clause is not an affirmative defence but rather a threshold issue for Brazil in this dispute. As Brazil implicitly recognized in both its panel and consultation requests, to even reach the point where it will, as the complaining party, be allowed to pursue its substantive claims, Brazil must first demonstrate that the Peace Clause does not exempt US measures from action – that is "from challenge".

12. On US direct payments, which the United States believes are "green box" measures because they satisfy the criteria set out in Annex 2: As a question from the Chair to Brazil suggested, assessing the conformity of a claimed green box measure against the "fundamental requirement" of the first sentence of paragraph 1 would be a difficult, if not impossible task, for a Panel. Members foresaw the problem and therefore provided guidance on how a measure would fulfill that fundamental requirement – that is, if the measures "conform to the . . . basic criteria" of the second sentence plus any applicable policy-specific criteria, they shall be deemed to have met the fundamental requirement.

13. With respect to the criterion in paragraph 6(b) that the amount of decoupled income support payments not be based on, or linked to, production undertaken in any year after the base period, this provision need not and should not be read as Brazil suggests. The text supports a reading that a Member may not base or link payments to production requirements. The EC endorsed this view this morning. US direct payments require no particular type of production – indeed, no production is necessary at all. As we have suggested, Brazil's reading of paragraph 6(b) would prevent a Member from prohibiting a recipient from producing crops – that is, would prevent a measure that bases or links payments to a type or volume of production: none at all. If there is no production at all as a result of the measure, such a measure necessarily can have no "trade-distorting effects or effects on production". Thus, Brazil's reading of paragraph 6(b) would *preclude* a Member from establishing a measure that meets the "fundamental requirement" of Annex 2. Paragraph 6(b) need not and should not be read in opposition to that fundamental requirement. In the context provided by the first sentence of Annex 2, then, paragraph 6(b) should be read as establishing that a Member may not base or link payments to requirements to produce any crop in particular – again, US direct payments require no upland cotton production and do not require any production at all.

14. Brazil has repeatedly raised the spectre of unchecked US domestic subsidies should the Panel agree with the US interpretation of the Peace Clause. Brazil's fears are groundless. Of course the United States may not provide subsidies without any limit. US subsidies are disciplined in several ways, and the US has deliberately kept itself within those limits. There are two main disciplines that apply. The first is the US final bound commitment level under the Current Total Aggregate Measurement of Support. The second, as we have discussed at length, is the Peace Clause itself and its effective limitation to a level of producer support of 72.9 cents per pound. The United States has stayed within the boundaries of those limits despite, as outlined in Brazil's filings, pressure to do otherwise. We are entitled to the benefit of that compliance.

15. We can understand that Brazil might feel that these limits are not enough. New limits may be negotiated in the ongoing agriculture negotiations, in which the United States shares many of the same goals as Brazil. Until that happens, however, Brazil may not seek to overturn the balance of rights and obligations negotiated and agreed by Members in the Uruguay Round. Brazil's Peace Clause interpretation would do violence to the text of the Agriculture Agreement and would penalize the United States for deciding support to upland cotton producers within the limits set by the Agreement. We therefore ask the Panel to find that Brazil has not established that US domestic

support measures breach the Peace Clause and that such measures are therefore exempt from Brazil's action at this time.

# ANNEX C-5

## ORAL THIRD PARTY COMMUNICATION BY THE ARGENTINE REPUBLIC

24 July 2003

## I. INTRODUCTION

1. The Argentine Republic thanks the Panel for the opportunity to present its views as a third party to these proceedings and, in pursuant to its Submission dated 15 July[1], will comment on the claims contained in the First Written Submission of the United States, dated 11 July.

2. In this connection, Argentina will comment more particularly on:

(a) The US interpretation of the provisions of the Peace Clause, particularly in Article 13(b)(ii);

(b) the US interpretations regarding Annex 2 of the Agreement on Agriculture and, lastly;

(c) the US interpretation whereby Article 10.2 of the Agreement on Agriculture excludes export credit guarantees from the general export subsidy disciplines in the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures.

## II. UNITED STATES CLAIMS

(a) Interpretation of the Peace Clause

3. Argentina will discuss what it regards as a mistaken US interpretation of the terms of the Peace Clause, particularly in Article 13(b) of the Agreement on Agriculture[2], whereby it draws the conclusion – equally mistaken – that its domestic support measures are exempt from the measures based on Article XVI.I of the GATT 1994 or Articles 5 and 6 of the Agreement on Subsidies (ASCM).

*(i) Grant support to a specific commodity*

4. First, the United States mistakenly interprets the phrase "grant support to a specific commodity".

5. In paragraph 71 of its Submission, the United States says that counter-cyclical payments and crop insurance payments do not constitute "support to a specific commodity" because they are not linked to specific commodity but are based on *historical* acreage and payment yields.[3]

6. The United States contends that "support to a specific commodity", in Article 13(b)(ii), means "product-specific support". Its argument is thus based on trying to incorporate the phrase "product-

[1] "Third party Submission by Argentina", paragraph 2.
[2] First Written Submission of the United States of America, 11 July 2003, Section III.D.
[3] *Ibid.*, paragraph 115.

specific support" into Article 13(b)(ii) when the phrase is not to be found in the wording of the article.[4]

7. If the negotiators had meant to say that "product-specific support" was exempt, they would have introduced that phrase into the wording of the article, but they did not do so.[5] Hence, AA Article 13(b)(ii) refers to a Member's non-Green Box domestic support measures, including domestic support measures granted only to individual specific products and also those relating to several specific products.

8. In other words, "support to a specific commodity", in Article 13(b)(ii), includes any non-Green Box domestic support measure providing identifiable support to an individual commodity, regardless of whether the measure can provide support to a larger number of commodities.[6]

9. In its argument, the US ignores the most relevant context of Article 13(b)(ii), namely the chapeau, which refers not to "product-specific support" but to "domestic support measures" in general. This means that the measures which, under Article 13(b)(ii) are relevant in determining whether a Member has granted support to a specific commodity in excess of that decided during the 1992 marketing year necessarily includes non-product-specific domestic support.

10. The US interpretation would mean no claim could be made against any Amber Box domestic support measure granted to more than one commodity. The US argument would thus allow Members to make enormous increases in domestic support to a relatively small number of commodities (such as the ten crops covered by the counter-cyclical payments programme), something which is inconsistent with the object and purpose of the AA, namely, cutting down the level of domestic support, as is apparent from the Preamble.[7]

11. Argentina considers that "support to a specific commodity", in Article 13(b)(ii), indicates that, in calculating the domestic support granted by a Member, the support must relate to a particular or precise commodity, regardless of whether the support is product-specific or specific to more than one product.[8]

12. Contrary to the US suggestion, the phrase "support to a specific commodity" does not mean "support exclusively or only" to a specific commodity. The fact that, through the same domestic

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[4] According to the Appellate Body in the *India-Patents Case* (WT/DS50/AB/R, adopted 16 January 1998, paragraph 45):

"*The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the Vienna Convention. But these principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended".* (Emphasis added)

[5] "*… had Members intended to exclude non-product specific support they would surely have said so", "Third Party Submission of New Zealand*", 14 July 2003, paragraph 2.21.

[6] In this respect, Argentina agrees with New Zealand: "*… New Zealand sees no basis on which to suggest that support to a specific commodity should be excluded simply because other commodities may receive similar support*". Third-party submission of New Zealand, 15 July 2003, paragraph 2.23.

[7] *"... the above-mentioned long-term objective is to provide substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets"* (Agreement on Agriculture, third preambular paragraph).

[8] Australia's Third Party Submission to the Panel, 15 July 2003, paragraph 23: "*... the ordinary meaning of this phrase* ("To a specific commodity"), *read in its context and in light of the object and purpose of the Agreement on Agriculture, is support granted to an individual agricultural commodity covered by AA Annex 1, such as upland cotton, whether through product specific, or non-product specific, support*".

support measures, the United States grants support to different products does not cancel out the fact that part of the support is granted to one specific product.

*(ii) Support "decided during the 1992 marketing year"*

13. After analysing the phrase "*that decided during the 1992 marketing year*", the United States reaches the conclusion that the phrase does not relate to support actually provided to a specific product during that year[9], but to support *determined* during the 1992 marketing year and that it consisted in "deciding" or "determining" a level of income support for cotton producers of US$0.72 per pound.

14. With this interpretation, the United States can get around the need to respond to Brazil's contention[10] - supported by Argentina[11] - that the US budgetary outlays on domestic support for the cotton sector for the 1999, 2000, 2001 and 2002 marketing years were far in excess of the US$1,994 million granted in 1992.

15. Argentina considers that, under Article 13(b)(ii), the word "decided" means a decision to make payments. The US argument ignores the fact that the text first uses the term "grant support" with reference to the support granted or provided to a specific commodity during the period of implementation (1995-2003). The phrase "grant support", however, is necessarily tied in with the support "decided during the 1992 marketing year"; otherwise, there would be no basis for comparison if one case involved the support granted and the other involved only the support scheduled.

16. In this connection, Argentina contends that the word "decided", in Article 13(b)(ii), should not be interpreted in such a way that the per pound guaranteed price for commodity producers (scheduled support) is the factor to be taken into consideration in determining the amount of support granted. If the criterion advanced by the United States were accepted, it would mean that an unlimited amount of domestic support could be granted to each product provided the total AMS is not exceeded.

17. In other words, the comparison required in Article 13(b)(ii) necessarily entails comparing the same type of support in each of the periods in question (period of implementation versus 1992 marketing year), in other words "comparing the comparable". The "support granted" in each marketing year during the period of implementation must necessarily be tied in with the budgetary outlays in those years.

18. In this respect, the definition of "granted" formulated by the Appellate Body in the "Brazil-Aircraft" case is relevant, namely that it is "*something actually provided*" and, thus, "*to determine the amount of export subsidies "granted" in a particular year, we believe that the actual amounts provided by a government, and not just those authorized or appropriated in its budget for that year, is the proper measure … Therefore, … we believe that the proper reference is to actual expenditures by a government …*".

19. Similarly, Argentina considers that, under AA Article 13(b)(ii), the definition of the term "support granted" must refer to a government's actual expenditures and not to a scheduled level of costs or a rate of support per unit of production.

20. Accordingly, Argentina takes the view that the support "decided during the 1992 marketing year" refers to payments actually made during that marketing year.

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[9] First Written Submission of the United States of America, paragraph 94: "… *no amount of outlays was 'decided' … during the 1992 marketing year …*".

[10] First Written Submission by Brazil, paragraphs 144-149.

[11] Third Party Submission by Argentina, paragraphs 64-65.

*(iii) The time dimension of Peace Clause protection*

21. In contrast to the US interpretation, Argentina contends that the domestic support measures granted in any of the marketing years in the period from 1995 to 2003 are relevant in determining compliance with Article 13(b)(ii). In this connection, we consider that any injurious effects of the subsidies are extended time-wise.

22. An interpretation like the one postulated by the United States would seriously restrict the possibility of questioning whether such subsidies are consistent with ASCM Articles 5 and 6, while effects causing injury, nullification or impairment or serious prejudice can be linked to domestic support measures granted in previous marketing years.

(b) Annex II of the Agreement on Agriculture

*(i) Interpretation of paragraph 1*

23. The United States claims that its direct payments programme is in conformity with AA Annex II[12] and, therefore, is exempt from measures under the protection afforded by Article 13(a). In reaching this conclusion, however, the United States makes a mistaken interpretation of paragraph 1 of AA Annex II.

24. The United States maintains that the structure of this provision, where the second sentence starts with the word "Accordingly", suggests that measures that conform to the two basic criteria set out in paragraph 1(a) and (b), plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex II are designed to meet the "fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production"[13].

25. Argentina considers this interpretation to be erroneous, since the text of the first sentence establishes a clear obligation that the domestic support measures to be exempted from the reduction commitments "… *shall meet the fundamental requirement that they have no … trade-distorting effect or effects on production …*". In Argentina's opinion, the language of this first sentence establishes a general requirement governing the application of all Green Box measures.

26. The structure of paragraph 1 of AA Annex 2 thus creates four types of obligation:

(i) The fundamental requirement of no, or at least minimal, trade-distorting effects or effects on production;

(ii) the support given in a government-financed programme does not entail transfers from consumers;

(iii) the support does not have the effect of providing producers with price support; and

(iv) the policy-specific criteria and conditions set out in paragraphs 2 to 13 of Annex 2 are also taken into account.

27. In this connection, Argentina believes that Green Box measures must respect the guiding principle of avoiding trade-distorting or production effects or at most minimal effects. A measure that meets the two basic criteria set out in paragraph 1(a) and (b), plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2 could also be at variance with the general

[12] First Written Submission by the United States of America, paragraph 53.
[13] *Ibid.,* paragraph 50.

principle. The opposite interpretation would render meaningless the first sentence of paragraph 1 of Annex 2, which the text describes as a "fundamental requirement".

28. Therefore, it is Argentina's view that, however much the United States claims that its direct payments programme conforms to the requirement established in the second sentence of paragraph 1 of Annex 2[14], since it does not meet the fundamental requirement established in the first sentence it cannot be viewed as a Green Box programme.

29. In this respect, Argentina concurs with Australia and New Zealand that the first sentence of Annex 2 paragraph 1, imposes a stringent standard by requiring that the measures to be exempted from reduction commitments must, as a primary or essential condition, not artificially alter trade or production.[15]

30. Consequently, if a domestic support measure leads to a higher level of production of trade in a particular product or group of products, the measure does not meet the standard established in Annex 2, Article 1.

31. It should be emphasized that the US has in no sense answered the statements by Brazil in paragraphs 183 to 191 of its Submission concerning the trade-distorting and production effects of the direct payments programme, according to studies made by the US Department of Agriculture's own economists.

32. In other words, because the direct payments programme does have trade-distorting and production effects, it cannot be included among the domestic support measures exempted from reduction commitments.

*(ii) Interpretation of paragraph 6(b)*

33. The United States maintains that the Production Flexibility Contract Payments (PFC) and Direct Payments programmes are not tied in with production and, therefore, are not Green Box domestic support.

34. Argentina considers that the alleged "flexibility" of producers to plant different crops is in fact seriously restrictive. The amount of payments made depends on the type of production. Indeed, particular crops (fruits, vegetables, etc.) are excluded from these programmes. The effect of this is to channel production to the remaining crops, which do benefit from the programmes. This shows that the amount of the payments made is linked to the type of product sown, as Argentina pointed out in its Third Party Submission[16] and, therefore, the payments are not in conformity with AA Annex 2 paragraph 6(b).

(c) Article 10.2 of the Agreement on Agriculture does not exclude export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture and the Agreement on Subsidies.

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[14] *Ibid.*, paragraphs 64-68.

[15] Australia's Third Party Submission to the Panel, 15 July 2003, paragraph 31: "… *AA Annex 2.1 imposes a stringent standard. Annex 2.1 requires that such measures must, as a primary or essential condition, not "bias" or "unnaturally alter trade or production …*"; Third Party Submission of New Zealand, 15 July 2003, paragraph 1.08: " … *In New Zealand's view it is critical that the integrity of the disciplines on "Green Box" measures are not weakened or their legitimate purpose undermined through the inclusion of measures that fail to meet the strict requirements of Annex 2, including the fundamental criterion that such measures are non-trade or production distorting …*".

[16] Third Party Submission by Argentina, 15 July 2003, paragraphs 54-57.

35. The United States asserts that the text of Article 10.2 of the Agreement on Agriculture permits Members to continue export credit guarantee programmes unaffected by export subsidy disciplines,[17] since the text reflects the fact of that, during the Uruguay Round, Members came to no agreement on the substantive disciplines applicable. In other words, the United States contends that the actual text of Article 10.2 of the Agreement on Agriculture indicates that the export credit guarantee programmes are not subject in any way to the Agreement's export subsidy disciplines.[18]

36. In this regard, Argentina would point out that the fact that WTO Members are negotiating disciplines in order to implement Article 10.2 does not in any way support the US reading to the effect that Article 10.2 excludes export credit guarantees from the general disciplines on export subsidies.[19] A commitment "to work towards the development" of specific international disciplines on the granting export credits, export guarantees or insurance programmes is not the same as excluding them from the general disciplines on export subsidies. If that had been the intention, then the negotiators would have expressly said so.

37. Contrary to the US contention, Argentina does not find any indication of this type in the wording of Article 10.2. The fact that the negotiators did not include an express reference to the effect that export credit guarantees are not included in the definition of export subsidies or are not subject to the disciplines established in AA Articles 3.3, 8 or 10.1 means that such disciplines apply to export credit support measures.

38. In other words, in conformity with the wording of AA Article 10.2, export credit guarantees are not exempt from the general disciplines of the Agreement on Agriculture, and where the measures are not in conformity with that Agreement, from the disciplines of the Agreement on Subsidies.

39. This interpretation is reinforced by the immediate context and the object and purpose of AA Article 10.2. Paragraph 2 forms part of Article 10, which is entitled *"Prevention of Circumvention of Export Subsidy Commitments"*. Paragraph 1 of Article 10 establishes that export subsidies not listed in paragraph 1 of Article 9 *"… shall not be applied in a manner which results in … circumvention of export subsidy commitments …"*. This provision imposes disciplines on export credit guarantees, just as it imposes disciplines on the whole universe of export subsidies not covered by Article 9.1.

40. In turn, the object and purpose of AA Article 10 is to prevent any form of circumvention of export subsidy commitments.[20] Consequently, the US interpretation of Article 10.2 is completely at variance on the context of the provision and the object and purpose of AA Article 10, since it contributes to circumvention of the export subsidy commitment by excluding an entire category of export subsidies from the general disciplines.

41. Lastly, contrary to what the US maintains,[21] the fact that an export subsidy is not included in AA Article 9.1 does not mean that it is not an export subsidy, for Article 9.1 is not an exhaustive list,

[17] First Written Submission of the United States of America, paragraph 160.

[18] *Ibid.*, paragraph 164.

[19] Third Party Submission of Canada, 15 July 2003, paragraph 53: "*This provision (*Article 10.2) *sets out an intention on the part of Members to undertake further work regarding these measures – the simple fact of agreeing to do so, however, does not amount to a permission to use those measures to confer export subsidies without consequence and without limit. The US interpretation of Article 10.2 ignores the important context provided by Article 10.1. It also directly contradicts the stated object and purpose of Article 10 as a whole …"*. Similarly, in its Third Party Submission, New Zealand states: "*Nor does Article 10.2 in any way suggest that it provides an exception from the disciplines of Article 10.1…*", paragraph 3.15.

[20] Article 10.3 reverses the burden of proof in cases of export subsidies under the Agreement on Agriculture where exports are in excess of the reduction commitment level. Article 10.4 establishes disciplines on international food aid.

[21] First Written Submission of the United States of America, paragraphs 161-162.

as is evidenced by the wording of Article 10.1.[22] Nor does it mean that such an export subsidy is not subject to the export subsidy disciplines of the Agreement on Agriculture.

42. Argentina agrees with the European Committees[23] that Article 10.2 makes it clear export credit guarantees are not one of the types of export subsidy listed in Article 9.1 and, in that connection, Article 10.1 establishes that non-listed export subsidy must not be applied in a manner which results in circumvention of export subsidy commitments.

43. Hence, as the European Communities contend, wherever export credit guarantees are export subsidies not listed in Article 9.1, those guarantees could be applied in a manner which would result in circumvention of commitments and, therefore, would be prohibited under Article 10.1.

## III. CONCLUSION

44. In accordance with the foregoing, Argentina considers that the United States has mistakenly interpreted the provisions of the Peace Clause, in particular in Article 13(b)(ii), has failed to bear the burden of proving that the domestic support measures it granted to cotton during the 1999, 2000, 2001 and 2002 marketing years were not in excess of the support "decided during the 1992 marketing year".

45. Second, Argentina considers that the US interpretations regarding Annex 2 of the Agreement on Agriculture are mistaken and that, therefore, the Direct Payments and PFC programmes do not fall under the protection of Article 13(a) of the Agreement on Agriculture for Green Box measures.

46. Third, Argentina considers that the United States export credit guarantee schemes (GSM 102, 103 and SGCP) constitute export subsidies subject to the general export subsidy disciplines of the Agreement on Agriculture (Articles 3.3, 8 and 10.1) and the Agreement on Subsidies and Countervailing Measures (Article 3.1(a) and 3.2).

[22] Third Party Submission of Canada, 15 July 2003, paragraph 32; *"Article 9 of the Agriculture Agreement lists and describes certain export subsidies that are subject to reduction commitments. All other export subsidies fall within the scope of Article 10-1…*".

[23] First Third Party Submission by the European Communities, 15 July 2003, Section V.

# ANNEX C-6

## ORAL STATEMENT BY AUSTRALIA

24 July 2003

Mr Chairman, Members of the Panel,

1. I appreciate this further opportunity to present Australia's views on matters at issue in this dispute.

2. In this statement, I will provide some elaboration of Australia's views on the meaning of Article 13(b)(ii) of the *Agreement on Agriculture*. I will also address some of the matters raised in the First Written Submission of the United States and in the First Third Party Submission of the European Communities.

Mr Chairman, Members of the Panel,

3. I will begin with matters relating to the meaning of Article 13(b)(ii) of the *Agreement on Agriculture*.

4. As Australia noted in its Written Submission[1], the word "decided" appears twice in the operative provisions of the *Agreement on Agriculture* – in subparagraphs (ii) and (iii) of Article 13(b). Further, the immediate context for the word "decided" is exactly the same in each case: "provided that such measures do not grant support to a specific commodity in excess of that *decided* during the 1992 marketing year". Yet Article 13(b)(iii) deals with a completely different type of action: one based on non-violation or impairment under GATT Article XXIII:1(b).

5. Thus, Australia believes that it will be necessary for the Panel to consider two key threshold questions.

6. Firstly, is the meaning of the phrase "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" the same in each of Article 13(b)(ii) and (iii)?

7. Australia recalls that the phrase, as well as draft text for what became Article 13, first appeared in the "Blair House Accord". Also included in the Accord were provisions concerning the *EEC – Oilseeds* dispute.[2]

8. In Australia's view, that dispute is crucially relevant to the interpretation of Article 13(b)(ii) and (iii).

9. Australia recalls that it clearly understood in the resumed Uruguay Round agriculture negotiations in 1993 that the words "decided during the 1992 marketing year" had been chosen to

[1] Third Party Submission of Australia, paragraph 26.

[2] *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins ("EEC – Oilseeds")*, Report of the Panel, adopted 25 January 1990, BISD 37S/86, and *Follow-Up on the Panel Report "European Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, DS28/R, BISD 39S/91.

incorporate into the text of Article 13(b)(ii) and (iii) the sense of expectations of "conditions of price competition" as this had been interpreted and applied in the *EEC – Oilseeds* dispute.

10. The panel in *EEC – Oilseeds* described the purpose of GATT Article XXIII:1(b) in the following terms:

> … The panel noted that these provisions, as conceived by the drafters and applied by the contracting parties, serve mainly to protect the value of tariff concessions.[…] The idea underlying them is that the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. …[3]

11. That Panel went on to say:

> … The Panel considered that the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset. …[4]

12. In any case, having regard to the customary principles of interpretation, Australia considers that the phrase "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" must have the same meaning in both Article 13(b)(ii) and (iii).

13. Thus, there is a second threshold question that the Panel needs to consider. That question is: could conditions of price competition for the purposes of a non-violation nullification or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole.

Mr Chairman, Members of the Panel,

14. I would now like to comment on some matters raised in the First Written Submission of the United States.

15. Firstly, Australia disagrees with the United States' approach to interpreting the "peace clause" and the meaning of "exempt from action based on".[5]

16. If the United States' interpretation is correct and the WTO Agreement negotiators intended the interpretation offered by the United States, surely the negotiators would have included provisions clarifying how such situations should be resolved? At the very least, surely Article 13 of the *Agreement on Agriculture* would have been listed in the Special or Additional Rules and Procedures Contained in the Covered Agreements at Appendix 2 to the *Dispute Settlement Understanding*? Yet the negotiators did neither of these things.

17. The United States argues as well that its interpretation is supported by the fact that the peace clause applies "[n]otwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and

[3] *EEC – Oilseeds*, paragraph 144.
[4] *EEC – Oilseeds*, paragraph 148.
[5] First Written Submission of the United States, paragraph 33.

Countervailing Measures".[6] However, the United States ignores that, for its argument to be valid, the peace clause would also have to apply "notwithstanding the provisions of the *Dispute Settlement Understanding*".

18. The United States argues too that Brazil is in error by asserting that the peace clause itself "provides no positive obligations".[7] In Australia's view, however, this argument confuses obligations and conditions: the United States is equating a binding requirement to act in a certain way with a prerequisite for the availability of a right or privilege. Article 13 of the *Agreement on Agriculture* does not of itself establish any binding requirements with which WTO Members are required to comply.

19. That confusion between rights and obligations continues when the United States argues that "Brazil's approach would produce bizarre results".[8] Indeed, the United States' arguments could be considered to confirm the nature of Article 13 as an affirmative defence. Had Brazil alleged a breach of the United States' obligations under Article 6, Brazil would have had the initial burden of making a *prima facie* case of inconsistency. Article 13, however, is a right or privilege available to the United States, provided that its measures fully conform to the relevant conditions. Thus, it is for the United States to demonstrate that it is entitled to invoke that right or privilege.

20. Secondly, the United States argues that "support to a specific commodity" is equivalent to "product-specific support".[9]

21. The United States asserts that the definition of Aggregate Measurement of Support – or AMS – at Article 1(a), and Article 6 concerning Domestic Support Commitments, provide relevant context. The United States asserts that because the calculation of AMS, and exemptions from Current Total AMS, differentiate between product specific and non-product specific domestic support, "support" in the context of Article 13(b)(ii) and (iii) means product-specific AMS.

22. Australia does not agree. AMS is defined by Article 1(a) to mean "the annual level of support … provided for an agricultural product in favour of the producers of the basic agricultural product". However, Article 13(b)(ii) and (iii) refer to "support to a specific commodity".

23. Had the negotiators intended that "support to a specific commodity" in the context of Article 13(b)(ii) and (iii) mean product-specific AMS only, they would have said so in the text. They did not. Further, the United States' argument ignores that a Member's reduction commitments include both product specific and non-product specific domestic support measures unless they are exempt from inclusion.

24. Thus, in Australia's view, "support to a specific commodity" means: all non-"green box" support that benefits a specific commodity, whether that support be through product specific, or non-product specific, programmes. Indeed, Australia believes that "support to a specific commodity" in the context of Article 13(b)(ii) and (iii) can include forms of support additional to those captured in an AMS calculation.

25. It follows, of course, that Australia considers – in the context of this dispute – that the portions of the direct payment and counter-cyclical payment programmes that benefit upland cotton should be included in the calculation of "support to a specific commodity" within the meaning of Article 13(b)(ii). Moreover, Australia notes that the counter-cyclical payment programme provides a

[6] First Written Submission of the United States, paragraph 39.
[7] First Written Submission of the United States, Paragraph 43.
[8] First Written Submission of the United States, paragraph 44.
[9] First Written Submission of the United States, paragraph 78.

target price of 72.4 cents per pound for upland cotton,[10] and that entitlements to "Step 2" payments and some other domestic support programmes are additional to the target price, as they were to the 1992 target price of 72.9 cents per pound.

26. Thirdly, the United States argues that direct payments under the 2002 Farm Act meet the criteria of Annex 2 Decoupled Income Support payments. Australia has already addressed the issue of planting restrictions on fruit and vegetables and wild rice in its Written Submission.

27. The United States argues that "eligibility for direct payments is defined by clearly defined criteria … in a defined and fixed base period" and that "payment yields and base acres are defined in the 2002 Act and fixed for the duration of the legislation".[11] The United States' interpretation means that a WTO Member could re-define and re-fix a base period every time it introduced new domestic support legislation. This cannot be a correct interpretation of the provisions of paragraph 6 of Annex 2 to the *Agreement on Agriculture*.

28. Fourthly, the United States argues that "a Member may choose to provide 'amber box' support in any … manner so long as that Member's Current Total AMS does not exceed … *[its]* commitment level".[12]

29. Australia disagrees. The United States' argument ignores that Article 13(b)(ii) does not exempt non-"green box" domestic support measures from actions based on Article 3 of the *SCM Agreement*. It also ignores the provisions of Article 21.1 of the *Agreement on Agriculture*. In an analogous situation in the *EC – Bananas* dispute, the Appellate Body said: "… the provisions of the GATT 1994 … apply … except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter".[13] The Appellate Body went on to say in that dispute:

> … [T]he negotiators of the *Agreement on Agriculture* did not hesitate to specify … limitations elsewhere in that agreement; had they intended to do so with respect to Article XIII of the GATT 1994, they could, and presumably would, have done so. …[14]

30. The Appellate Body's statement is equally applicable in the context of this dispute. Had the negotiators of the *Agreement on Agriculture* intended that non-"green box" domestic support measures be "exempt from actions based on" Article 3 of the *SCM Agreement*, they would have said so. The negotiators did expressly exempt export subsidies from actions based on SCM Article 3 to the extent that such export subsidies conformed fully to the provisions of Part V of the *Agreement on Agriculture*. In Australia's view, therefore, the omission from Article 13(b)(ii) of the *Agreement on Agriculture* of an express exemption from actions based on SCM Article 3 for local content subsidies has meaning.

31. Fifthly, the United States has requested that the Panel issue a preliminary ruling that Production Flexibility Contract and Market Loss Assistance payments are not within the Panel's terms of reference because these programmes have expired. The fact that a measure has expired cannot be sufficient to remove it from the Panel's purview. If the Panel were to grant the United States' request solely on that basis, it would mean that any Member could authorise WTO-inconsistent domestic support programmes through short-lived measures and avoid the consequences of such actions.

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[10] Section 1104, 2002 FSRI Act, Exhibit Bra-29.

[11] First Written Submission of the United States, paragraph 67.

[12] First Written Submission of the United States, paragraph 144.

[13] *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R, paragraph 155.

[14] *EC – Bananas*, paragraph 157.

Mr Chairman, Members of the Panel,

32. The final matter on which I will comment today concerns the Third Party Submission of the European Communities and its arguments in relation to the interpretation of the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture*. The European Communities argues that the first sentence "simply signals the objective of Annex 2" and does not set out an independent obligation.[15]

33. That argument ignores the plain meaning of the text and renders the first sentence of paragraph 1 inutile, which of course a treaty interpreter may not do. If an exemption from reduction commitments is being claimed for any domestic support measures, the first sentence says they "shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production". As explained in Australia's written submission,[16] a fundamental requirement is a primary or essential condition. To interpret a "fundamental requirement" other than as a separate and independent obligation would be contrary to the plain meaning of the words and thus to the normal rules of treaty interpretation. The use of the words "shall meet" establishes an express obligation to comply with the specified condition that such measures not, or only minimally, bias or unnaturally alter trade or production.[17]

34. The European Communities argues that the word "accordingly" at the beginning of the second sentence of paragraph 1 links the 'fundamental requirement' in the first sentence with the 'basic criteria' in the second sentence" and thus makes clear that the fundamental requirement is complied with if the basic criteria in the second sentence and the policy-specific criteria set out in paragraphs 2 to 13 are met.[18]

35. However, the meanings for "accordingly" cited by the European Communities – "in accordance with the logical premises" and "correspondingly" – do not compel the interpretation it has offered. Moreover, there are other, equally valid meanings of the word "accordingly", provided by the same dictionary, such as "harmoniously" and "agreeably".[19]

36. It is possible to interpret the whole of paragraph 1 to Annex 2 so as to give effect to all of its provisions:

- domestic support measures for which exemption from the reduction commitments is claimed shall not, or shall only minimally, distort trade or production; and

- to the extent that measures of the type described in paragraphs 2 to 13 of the Annex are consistent and harmonious with that fundamental requirement and conform to the basic and policy-specific criteria as set out in the second sentence, they are exempt from reduction commitments.

37. Thus, notwithstanding that they may meet the basic and policy-specific criteria set out in paragraphs 1 and 6 of the Annex, a Member may not claim Decoupled Income Support payments as "green box" where those payments do not meet the fundamental requirement that they shall not, or shall only minimally, distort trade or production. Such could be the case, for example, where the level of Decoupled Income Support payments are sufficient to affect directly producer decisions concerning the allocation of economic resources to production of a particular commodity.

[15] First Third Party Submission by the European Communities, paragraph 15.
[16] Australia's Third Party Submission to the Panel, paragraph 31.
[17] Australia's Third Party Submission to the Panel, paragraphs 31-32.
[18] First Third Party Submission by the European Communities, paragraph 20.
[19] *The New Shorter Oxford English Dictionary*, Volume I, Ed. Lesley Brown, Clarendon Press, Oxford, 1993, page 15.

Mr Chairman, Members of the Panel,

38. Should you have questions on any matters concerning Australia's Written Submission and Oral Statement, I would be pleased to take these on notice and arrange for written answers to be provided.

Thank you, Mr Chairman, Members of the Panel.

# ANNEX C-7

## THIRD PARTY ORAL STATEMENT OF BENIN

24 July 2003

Mr. Chairman, members of the Panel,

It is my honour to represent Benin at this Third Party session today. The other two members of our delegation are Mr. Eloi Laourou of the Permanent Mission of Benin, and Mr. Brendan McGivern of White & Case, our legal adviser.

Although Benin acceded to the WTO back in 1996, this marks our first entry into WTO dispute settlement. We have been led to take this unprecedented step by the magnitude of the threat posed by US cotton subsidies, and the highly damaging effect that such subsidies have on the exports and economy of our country.

In our third party submission, we sought to provide to the Panel, at the earliest possible stage, information on the impact of the WTO-inconsistent US subsidies on Benin. In our view, this provides essential additional context to the issues facing the panel.

I do not intend to repeat what was in our submission, but it is worth highlighting some key facts.

The importance of the cotton sector to Benin can hardly be overstated. As noted in our submission, it accounts for 90 per cent of our agricultural exports, and three-quarters of our export earnings over the past four years. It generates 25 per cent of national revenues. In total, about a million people in Benin – out of a total population of six million – depend on cotton or cotton-related activities. Cotton plays a particularly important role in rural areas, where national poverty reaches its highest levels.

Mr. Chairman, Members of the Panel: the results of US cotton subsidies are readily apparent in West Africa. The United States provides huge, and WTO-inconsistent, subsidies for cotton. This leads to an oversupply of cotton on the world market, and a consequent decline in prices. Moreover, when cotton from Benin enters world markets, it must compete against massively-subsidized US cotton.

The dollar value of these subsidies dwarfs all other economy activity in Benin. As indicated in our submission, the subsidies paid by the United States to its 25,000 cotton farmers exceed the entire gross national income of Benin – and indeed the other countries in the region as well.

This demonstrates, rather dramatically, the impossibility of Benin ever competing with such subsidies. It is inconceivable that any developing country – let alone a least-developed country in West Africa – could ever match the virtually limitless resources of the United States.

Therefore, for us, the solution to this problem lies in the WTO. We ask simply that the United States respect its WTO obligations regarding subsidies.

Mr. Chairman, we agree with Brazil that the United States cannot invoke the peace clause to bar the claims that have been advanced in this dispute. We agree that the peace clause constitutes an

affirmative defence, and that the burden lies on the United States to demonstrate that has met all the conditions for the successful invocation of this affirmative defence. This it has failed to do.

In any event, whether the peace clause constitutes an affirmative defence, as we believe, or is part of the "balance of rights and obligations of Members", as the United States argues, the result is the same. Brazil's First Submission has established, clearly and unambiguously, that the United States is in breach of its WTO obligations. The US First Submission has provided no convincing rebuttal of Brazil's claims.

Mr. Chairman, Members of the Panel:

In its submission of July 11, the United States argued that the phrase "support to a specific commodity" should be understood to mean "product-specific support". However, the term "product-specific" does not appear in Article 13(b)(ii). If the drafters of the Agreement on Agriculture had wanted to use this term in Article 13(b)(ii), they obviously could have done so, as they did elsewhere in Agreement, such as in Article 6(4), or in Annex 3. Moreover, if the US interpretation were accepted, measures providing support to more than one commodity could not be challenged under Article 13(b)(ii). This elevates form over substance, and is contrary to both the language and the object and purpose of this provision.

Finally, the United States asks this Panel to exclude from its terms of reference certain measures that it argues were not the subject of consultations. We were not part of the consultations, and will not delve into the facts of this disagreement. However, Benin would recall the statement of the Appellate Body in *Brazil Aircraft* (DS46):

> "We do not believe….that Articles 4 and 6 of the DSU, or paragraphs 1 to 4 of the SCM Agreement, require a <u>precise and exact identity</u> between the specific measures that were the subject of consultations and the specific measures identified in the request for the establishment of a panel. As stated by the Panel, '[o]ne purpose of consultations, as set forth in Article 4.3 of the SCM Agreement, is to 'clarify the facts of the situation', and it can be expected that information obtained during the course of consultations may enable the complainant to focus the scope of the matter with respect to which it seeks establishment of a panel." [emphasis added]

Indeed, Benin notes that the United States itself took a similar approach in the recent *Japan – Apples* case. In the US replies to the Panel on October 16, 2002, USTR stated that:

> "[T]here is no requirement in the DSU to consult on a particular claim in order to include that claim in a panel request and to have such a claim form part of the panel's terms of reference. The purpose of consultations is to provide a better understanding of the facts and circumstances of a dispute; logically, then, a party may identify new claims in the course of consultations."

Although this US reply dealt with claims rather than measures, it is consistent with the ruling of the Appellate Body in *Brazil Aircraft* that panels should not require a "precise and exact identity" between the measures that were the subject of consultations and the measures identified in the panel request.

Mr. Chairman, Members of the Panel:

For Benin, this dispute is of critical national importance. As we stated in our Third Party submission, we are not seeking any special and differential treatment in the present case. We are simply asking that the United States abide by the disciplines that it agreed to at the end of the Uruguay Round.

Thank you for allowing Benin to present its views to the Panel. We would be pleased to reply to any questions you may have.

# ANNEX C-8

## THIRD PARTY ORAL STATEMENT OF CANADA

24 July 2003

### I. INTRODUCTION

1. Mr. Chairman, members of the Panel, on behalf of my Government, I thank you for your consideration of Canada's views in this dispute.

2. Canada's statement today conveys our systemic interest in the interpretation of certain provisions of the Agriculture Agreement and the SCM Agreement regarding certain aspects of Brazil's claims. The first two points we address relate to US domestic support measures and the applicability of the Peace Clause. In this respect, we set out why:

- first, the updating of the base period for US direct payments renders these payments inconsistent with paragraphs 6(a) and (b) of Annex 2 of the Agriculture Agreement; and

- second, US counter-cyclical payments to producers of upland cotton must be counted as "support to a specific commodity" under Article 13(b)(ii) of the Agriculture Agreement.

3. The last point we address is whether there is any exemption for US export credit guarantee programmes from US export subsidy commitments under the Agriculture Agreement. Here, we set out why:

- first, item (j) of the SCM Agreement may not be interpreted a contrario to deem export credit guarantee practices as not providing export subsidies under Article 10.1 of the Agriculture Agreement; and

- second, Article 10.2 of the Agriculture Agreement does not exempt export subsidies granted under export credit guarantee programmes from US export subsidy commitments in the Agriculture Agreement.

### II. US DOMESTIC AGRICULTURAL SUPPORT MEASURES

#### A. TO BE EXEMPT UNDER ANNEX 2, DIRECT PAYMENTS MUST HAVE THE SAME BASE PERIOD AS PFC PAYMENTS

4. We turn first to US direct payments. The United States defends these measures by asserting, among other things, that the 2002 FSRI Act redefines and fixes the base period for the duration of the legislation.[1] According to the United States, direct payments therefore fully conform to Annex 2 of the Agriculture Agreement.

5. This, in Canada's view, raises form over substance. In addition to the views we provided in our written third party submission, Canada observes that US direct payments also do not conform to the base period requirement in paragraphs 6(a) and (b) of Annex 2. The structure of the PFC payment

[1] US First Written Submission, para. 67.

and direct payment programmes are essentially the same[2], so are the payment parameters.[3] The applicable base period therefore is that for PFC payments. However, the United States allows base acreage determining the receipt and the amount of direct payments to be updated.[4] The base period is therefore not "fixed", contrary to subparagraph (a). The amount of the payments may also be increased based on the volume of production undertaken by a producer in a year after the applicable base period, contrary to subparagraph (b).

6. The United States itself demonstrates the linkage between PFC payments and direct payments; they are closely related and successor programmes.[5] Yet, the United States takes the position that because the payments are continued under a separate piece of legislation and new regulations, an updating of the base period does not affect their exempt status.[6] In Canada's view, such formalistic arguments cannot prevail.

B. COUNTER-CYCLICAL PAYMENTS ARE "SUPPORT TO A SPECIFIC COMMODITY"

7. Mr. Chairman and members of the Panel, the formalism of US arguments does not stop there. In an effort to avoid the logical conclusion that counter-cyclical payments "grant support to a specific commodity" within the meaning of Article 13 of the Agriculture Agreement, the United States cites varied meanings of the term "specific" and inappropriately incorporates into Article 13 concepts relating to the calculation of the AMS. These arguments are an attempt to detract from the plain text of Article 13 and its straight-forward application to the facts of this case.

8. In Canada's view, counter-cyclical payments "grant support to a specific commodity" under Article 13(b)(ii) of the Agriculture Agreement.[7] It is hard to see how a measure that grants support that is specific to a "specific commodity" would not be included in the assessment under Article 13(b). It is uncontested that the US measure provides payments in an amount determined by target prices that are specific to certain covered products.[8] The setting of commodity-specific target prices necessarily leads to different levels of support for different products. The cotton-specific support granted in this respect must be taken into account for the purposes of Article 13(b).

## III. US EXPORT CREDIT GUARANTEE PROGRAMMES

9. I now turn to US export credit guarantee programmes.

10. In Canada's written third party submission we set out the applicable standard for determining whether transactions under these programmes are subsidized within the meaning of Articles 1(e) and 10.1 of the Agriculture Agreement. Canada takes no position on the facts in this respect, but notes that USDA's own description of its guarantee programmes implies that a benefit is conferred. I quote: "The programmes encourage exports to buyers in countries where credit is necessary to maintain or increase US sales, but where financing may not be available without CCC guarantees."[9] The Panel should assess CCC premiums in the light of this admitted reality.

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[2] See Brazil First Written Submission, para. 182; Third Party Submission of New Zealand, para. 2.26; Third Party Submission of Australia, paras. 47-48.

[3] US First Written Submission, paras. 58-63.

[4] US First Written Submission, para. 59.

[5] US First Written Submission, fn. 47.

[6] US First Written Submission, para. 67.

[7] See also Exhibit Br-27 ("Title I - *Commodity Programmes*"; "Counter-cyclical payments *for* wheat, feed grains, upland cotton, rice, and oilseeds" (emphasis added)).

[8] See US First Written Submission, para. 117.

[9] USDA, "Export Credit Guarantee Programmes", FAS Online at http://www.fas.usda.gov/excredits/exp-cred-guar.html, (second sentence) [Exhibit CDA-3].

11. Today, Canada addresses the two exemptions alleged by the United States in support of its assertion that the US programmes do not grant export subsidies in violation of US export subsidy commitments under Articles 8 and 10.1 the Agriculture Agreement. The claimed exemptions are the following:

- First, item (j) of the SCM Agreement sanctions any US export subsidy provided through CCC-guaranteed credit transactions because the programmes come within the scope of item (j) yet do not meet the standard it establishes. According to the United States, item (j) may be interpreted a contrario to allow subsidized export credit transactions. It follows for the United States that its programmes do not confer export subsidies within the meaning of Article 3.1(a) of the SCM Agreement and Article 1(e) of the Agriculture Agreement;

- Second, Article 10.2 of the Agriculture Agreement exempts outright any subsidized export credit transactions from US export subsidy commitments.

12. The panel in Brazil – Aircraft considered the first type of alleged exemption at length in its first implementation report. The United States was a third party in that case, and argued for an a contrario interpretation of the first paragraph of item (k) of the Illustrative List.[10] The panel rejected all arguments in this respect and concluded that the provision could not be used to establish that a prohibited export subsidy under the SCM Agreement is otherwise permitted.

13. The panel's reasoning in that case applies with equal force here. Briefly, the panel found that:

- First, Annex I is purely "illustrative" and does not purport to exhaustively list all export subsidy practices[11],

- Second, a measure that falls within the scope of Annex I is deemed to be a prohibited export subsidy such that where a Member demonstrates that the measure meets the standard in any of the listed items, it does not also have to demonstrate that the measure comes within the scope of Articles 1 and 3.1(a) of the SCM Agreement[12], and

- Third, footnote 5 of the SCM Agreement provides that practices described in Annex I may be properly considered not to constitute an export subsidy only in two situations. The first situation is where an affirmative statement in the Agreement provides that the measure in question is not an export subsidy; the second is where an affirmative statement in the Agreement provides that measures satisfying the conditions of an item in Annex I are not prohibited.[13] Footnote 5 reads "Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement".

14. In its second implementation report in Brazil – Aircraft, the panel applied the same reasoning.[14] Applying this reasoning to the case at hand, footnote 5 to the SCM Agreement precludes reliance on an a contrario interpretation of item (j) as an implied exclusion to any finding of subsidized transactions under the US programmes.

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[10] *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, adopted 4 August 2000, paras. 6.24-6.67 [*Brazil – Aircraft, First Recourse*].

[11] *Ibid.*, para. 6.30.

[12] *Ibid.*, para. 6.31.

[13] *Ibid.*, paras. 6.37.

[14] *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW2, adopted 23 August 2001 at paras. 5.274 and 5.275.

15. Regarding Article 10.2 of the Agriculture Agreement, Canada's view is that the words of that provision speak for themselves. Members have undertaken to work towards internationally agreed disciplines to govern the provision of export credit guarantees. Nothing in that provision states that the export subsidy obligations in Article 10.1 of the Agreement do not apply to US export credit guarantee practices. Where Members have wanted to exempt measures from export subsidy obligations, they have been clear– such as in the second paragraph of item (k) of the SCM Agreement.[15]

16. In addition, the US interpretation of this provision does not accord with its object and purpose. Canada shares the views of other third party participants in this dispute that the ongoing work under Article 10.2 is expected to further elaborate on current disciplines regarding export credit practices and to perhaps more clearly identify when such practices shall or shall not be deemed to confer export subsidies within the meaning of Article 1(e) of the Agriculture Agreement.[16] The obvious precedent in this respect is the second paragraph of item (k) of the SCM Agreement.

## IV. CONCLUSION

17. In conclusion, Mr. Chairman and members of the Panel, the Panel should find that the United States rendered direct payments inconsistent with Annex 2 of the Agriculture Agreement by allowing the base period to be updated. This finding would be in addition to a finding that PFC payments and direct payments do not conform to Annex 2 because the amount of the payment is linked to the type of production after the base period. Regarding counter-cyclical payments, the Panel should find that this support to US producers of upland cotton must be counted as "support to a specific commodity" under Article 13(b)(ii) of the Agreement. Finally, regarding US export credit guarantee programmes, the Panel should confirm that neither the Agriculture Agreement nor the SCM Agreement contain an exemption for any US export credit guarantee subsidy found in this case. Were the Panel to find that such subsidies exist – which in Canada's view is the most likely outcome to the Panel's assessment of the facts – then the Panel must conclude that the United States grants export subsidies in violation of its export subsidy commitments under Articles 8 and 10.1 the Agriculture Agreement and that Article 13(c)(ii) therefore does not apply.

[15] See also *Brazil – Aircraft, First Recourse*, para. 6.36.

[16] See First Third Party Submission by the European Communities, para. 30 and Third Party Submission of New Zealand, paras. 3.15-3.16.

# ANNEX C-9

## ORAL STATEMENT OF CHINA AT THE THIRD PARTY SESSION

24 July 2003

1. Thank you, Mr. Chairman, and members of the Panel. China is appreciative of this opportunity to present its views on the issues raised in this Panel proceeding. In its third party written submission of 15 July, China explained its views in relation to three issues. In this statement, I will summarize China's major points.

2. The first issue that China would like to have this Panel's attention is about the burden of proof issue under the Peace Clause.

3. China agrees with Brazil's argument that the Peace Clause is an affirmative defence in nature. If the United States claims that defence, the burden of proof is on the United States.

4. Contrary to what the United States see, China believes that the Peace Clause does not impose positive obligations. Stand-alone, Annex 2 and Article 6 of the *Agreement on Agriculture* may have positive obligations; but when they are cross-referred to by the Peace Clause, they become part and parcel of conditions that must be met before a Member can move under its safety.

5. China believes the US errs on seeing no distinction between "obligation" and "condition". The Peace Clause requirement for full conformity with Article 6 and Annex 2 does not create new obligations because Members have to comply with Article 6 and Annex 2 whether Article 13 exists or not. Within the Peace Clause, these requirements do not stand to impose obligations on Members, but to set conditions precedent for a Members intending to invoke Peace Clause protection. Positive obligations to comply with these requirements, if there is any, lie under where they are, i.e. under Article 6 and Annex 2, but not under the Peace Clause.

6. China does not see any "absurdity" as described by the United States in its written submission. No such "absurdity" would be instilled into the process if at the first stage, the party alleging protection of Peace Clause for its measures is required to discharge its burden to prove that such measures do conform to the relevant Peace Clause conditions; if it cannot so prove, the measures would lose Peace Clause protection. A second stage will follow for the party claiming against the measures to establish its substantive case, without the Peace Clause shield.

7. With respect, China submits that the burden of proof issue must be resolved first. China also hopes that the above two-step approach will help this Panel and the parties to move the procedures on towards resolution of the case.

8. The second point that China made in its written submission relates to proper categorization of US Direct Payments (shortened as "DP") under the US Fair Security and Rural Investment Act of 2002 (shortened as "FSRI"). Allow me to shorten that act to FSRI. Without repeating the issue of burden of proof, preponderance of evidence suggests that such Direct Payments are not "Green Box" in nature.

9. One of the requirements for "Green Box" Direct Payment support measures lies under Para. 6(a) of Annex 2 to the *Agreement on Agriculture*. The paragraph provides to the effect that eligibility shall be determined by "clearly-defined criteria" "in a defined and fixed base period".

10. The word "in" requires a link between the "criteria" and the "defined and fixed base period". In other words, to qualify for "Green Box" direct payment measure under Para. 6(a), a criterion adopted by a Member must be tied, in a chronological sense, to a starting time frame that cannot be moved up on the calendar.

11. As the United States has explained, 2002 FSRI DP allowed landowners to retain PFC base acreage under the 1996 Federal Agriculture Improvement and Reform Act (shortened as "FAIR") and "add 1998-2001 acres of eligible oilseeds or simply declare base acreage for all covered commodities" (including upland cotton). In addition, while a landowner may elect to simply utilize acres devoted to covered commodities during the 1998-2001 period for purpose of DP, a landowner need not do so; base acres may remain those under FAIR of 1996, implying no cotton production need have occurred since the 1993-1995 period for a landowner to have "cotton base acres" Consideration the progression from PFC to DP, one can see that contrary to the US argument that "base acres are defined in the 2002 [FSRI] Act and fixed for the duration of the legislation", the requisite link between the programme acreage as a criterion and the starting time frame under the DP is broken. The change of legislation from FAIR to FSRI and the replacement of PFC with DP were utilized to for producers to leap from their previous coverage acreage, which should have been tied to the base period, to a new updated acreage in 2002.

12. Therefore, in China's opinion, preponderance of evidence proves that the US direct payments under the FSRI shall be properly categorized as non-"Green Box" measures.

13. The last issue that China considers important is about export subsidy support granted by US "Foreign Sales Corporations" for upland cotton export sales under the "FSC Repeal and Extraterritorial Income Act of 2000". Its short name is ETI Act.

14. The ETI Act has previously been found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by both the panel and the Appellate Body in *US – FSC (21.5)* case. On 29 January 2002, the DSB adopted the panel and Appellate Body reports. Following US failure to withdraw such export subsidy support, on 7 May 2003, the DSB authorized the EC to impose countermeasures against the US.

15. China believes that the panel and the Appellate Body's reasoning and their conclusion in *US – FSC (21.5)* should be considered and taken by this Panel.

16. The measures challenged by Brazil in the current proceeding are exactly the same challenged by the EC in *US – FSC (21.5)*. Reasoning and conclusion by the earlier panel and the Appellate Body are more than relevant to the current case. Their reports, once adopted by DSB not only create legitimate expectations, but also reflect the collective will of the WTO membership.

17. In that respect, allow me to quote the panel in *India – Patent Protection for Pharmaceutical and* Agricultural *Chemical Products*, for this Panel:

> [I]n the course of "normal dispute settlement procedures" required under Article 10.4 of the DSU, we *will take into account the conclusions and reasoning* in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we *should give significant weight to both Article 3.2 of the DSU*, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, *and to the need to avoid inconsistent rulings* (which

concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the DSU.

18. This concludes my oral presentation. China welcomes questions from the Panel regarding these issues.

# ANNEX C-10

## ORAL STATEMENT BY THE EUROPEAN COMMUNITIES

24 July 2003

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## I. INTRODUCTION

1. Mr. Chairman, Distinguished Members of the Panel, the European Communities is grateful for the opportunity to express its views in this third party session.

2. We would first like to welcome the involvement of Benin in this procedure. The European Communities is of the view that the involvement of least developed countries in dispute settlement is highly desirable. We hope that other least developed countries follow Benin's lead.[1]

3. This is a complex case which raises many difficult and important interpretative issues. Those responsible for drafting Article 13 of the *Agreement on Agriculture* have left you with some difficult questions. Despite those difficulties, Article 13 in particular, and the *Agreement on Agriculture* more generally, represent a finely balanced and much fought over package of rights and obligations assumed by WTO Members. The European Communities is confident that this Panel will undertake a careful examination of these very precise terms and preserve the delicate balance of rights and obligations which has been negotiated.

4. This dispute raises a large number of issues. In our interventions, we have concentrated on those issues of principle which we consider are of systemic concern. Today, we will largely address issues which were not addressed in our written submission. At the same time, we also consider it necessary to revisit some issues which we have already addressed in order to rebut some of the arguments raised by other parties.

5. The European Communities starts by setting out its conception of the role of the peace clause (section II). We will then address several questions of interpretation relating to the peace clause (section III). We then turn to consider the interpretation of Annex 2 of the *Agreement on Agriculture* (the Green Box) (Section IV) before considering the status of domestic content subsidies and export credits under the *Agreement on Agriculture* (Section V). We conclude with some comments on one of the requests for preliminary rulings raised by the United States (Section VI).

## II. THE ROLE OF THE PEACE CLAUSE

6. We turn first to consider the role of the Peace Clause (Article 13).

7. The European Communities views Article 13 as one element regulating the interface between the *Agreement on Agriculture* and the *SCM Agreement*. It defines, in some cases, how subsidies granted pursuant to the *Agreement on Agriculture* should be treated for the purposes of countervailing duty investigations, and in other cases exempts such subsidies from actions under the *SCM Agreement*. The European Communities disagrees with both Brazil and the United States as to how the term "exempt from action" should be understood. However, while we disagree with the United States' logic, we do not disagree with the practical result of the application of its logic.

8. The term "exempt from action" cannot mean, as Brazil claims, that, even if the peace clause is applicable, the Panel must examine Brazil's claims under the *SCM Agreement*, and that if the Panel finds that the United States has acted inconsistently with the *SCM Agreement*, the DSB should somehow "refrain" from recommending the United States to bring itself into conformity with the *SCM Agreement*. The European Communities finds it difficult to imagine how the DSB, operating under the negative consensus rule, could refrain from recommending the United States bring itself into conformity should the Panel find that the United States had acted inconsistently with the *SCM Agreement*. Moreover, the United States can reasonably argue that it is not required to bring itself

[1] This text was not in the written statement circulated at the third party session, but reflects unscripted comments made during that session.

into conformity with the *SCM Agreement* by withdrawing measures which it is perfectly entitled to maintain under the *Agreement on Agriculture*, pursuant to both Article 13 and Article 21. The only answer to this question is that if the United States is entitled to peace clause protection, the Panel cannot find in favour of Brazil's *SCM Agreement* claims.

9. The European Communities does not agree with the United States that Article 13 prevents a Member from requesting consultations or the establishment of a panel with respect to a measure which might be entitled to Article 13 protection. It is not, as the US argues, the mere fact that the defendant Member is unable to block a request for consultations, or for establishment of a panel, that the applicability of the peace clause has come before this Panel. The need for the Panel to adjudicate this issue flows from the fundamental principle underlying the WTO Agreement that every question of interpretation of the WTO Agreements which "affects the operation of any covered agreement" must be subject to the DSU.[2] However, as we have noted, if the Panel determines that the US measures in question are protected by Article 13, it cannot find in favour of Brazil's claims under the *SCM Agreement*.

## III. INTERPRETATION OF THE PEACE CLAUSE

10. The Panel has a number of challenging questions before it on the interpretation of various aspects of Article 13(b). The European Communities turns now to set out its position on some of the issues before the Panel.

### A ARTICLE 13 IS NOT AN AFFIRMATIVE DEFENCE

11. The European Communities will only briefly touch upon the issue of the burden of proof for Article 13. The European Communities has yet to hear a credible response to the argument that putting the burden of proof on the defendant has perverse effects. As the European Communities and the United States have pointed out, when a complainant brings a case only under the *Agreement on Agriculture* (for instance alleging breach of Article 6) it will bear the burden of proof. However, if Article 13 is considered an affirmative defence, when a complainant brings a dispute under Articles 5 and 6 of the *SCM Agreement* and, for instance, Article 6 of the *Agreement on Agriculture*, the complainant would be required to prove a breach of Article 6 while at the same time the defendant would also be required to prove that it had not infringed Article 6 of the Agreement. The burden of proof cannot switch between parties simply on the basis of whether the complainant cites the *SCM Agreement* or not, but this would be the result of interpreting Article 13 as an affirmative defence.

12. Further confirmation that Article 13 is not an affirmative defence can be drawn from the fact that Article 13 also regulates the application of countervailing duties on agricultural subsidies. In this context, a determination that the subsidy in question is not protected by Article 13 must be taken by an investigating authority before it may impose countervailing duties. Article 13 is consequently a pre-condition for an individual Member in taking action against subsidised exports. It cannot, in that context, be considered as a defence for exporters co-operating in an investigation and may, as the United States have pointed out, be used as the foundation for a claim in a WTO dispute by the exporting Member that countervailing duties have been illegally imposed. There is no reason why that conception of Article 13 should change simply because the issue arises in WTO dispute settlement.

[2] Article 4.2 DSU.

B. RELEVANT COMPARISON FOR THE PURPOSES OF ARTICLE 13

13. Brazil has argued that any breach of the 1992 level during the 9 year implementation period removes the protection of Article 13.[3] The European Communities agrees with the United States that this is incorrect.[4] The present tense of the phrase "do not grant support" makes this clear. The comparison for the purpose of Article 13(b) must be between the level of support decided in the 1992 marketing year and that granted by virtue of the measures being challenged. This would typically mean the most recent marketing year.

C. THE MEANING OF "DECIDED DURING THE 1992 MARKETING YEAR"

14. We now turn to consider the meaning of the phrase "decided during the 1992 marketing year". Brazil argues that the term "decided" refers to a decision to budget a specific amount of domestic support over a number of years.[5] Brazil then goes on to suggest that because the United States did not make a "decision" during marketing year 1992 with respect to upland cotton, the only decision which the United States can be said to have made during marketing year 1992 was the continued funding of its programmes for upland cotton. Brazil then calculates the US' budgetary outlays in respect of upland cotton in 1992; in other words, Brazil looks at the support actually granted.[6]

15. The European Communities is concerned that Brazil appears to consider that the support "decided" in the sense of Article 13 can be equated with the support granted as Brazil has done in its use of US budgetary outlays. Such an interpretation ignores the meaning of the word "decided". That the use of the word "decided" cannot be equated with the term "granted" is illustrated by the following.

16. First, the use of the word "decided" itself is notable. It is, however, notable primarily for what it is not. WTO Members did not use the word "granted" which is the word which one would expect to be used had this phrase been intended to refer only to the domestic support actually used during the 1992 marketing year. The use of the word "decided" stands out particularly when it is compared to the use of the word "grant" in the very same sentence. The United States has made the same point with respect to the decision not to use the word "provided".[7] If WTO Members had intended that the support granted in the most recent period was to be compared to that granted in marketing year 1992 the word "decided" would not have been used. For this reason, Brazil's use of US budgetary outlays for marketing year 1992 is clearly flawed.

17. Second, the word "decided", meaning "settled, certain",[8] also implies a one-off decision. It would be odd to talk of an administration "deciding" countless applications for support under a particular programme. However, this is what Brazil's use of US budgetary outlays implies.

18. Finally, the use of the word "during" confirms that WTO Members intended that the decision need not be of application only in marketing year 1992 but may also cover future periods. The use of the word "during" (meaning "in the course of"[9]) implies a one-off decision, and does not suggest that the period of application of the decision must be limited to marketing year 1992. Had WTO Members intended a limitation to the support provided or granted in 1992 the word "for" would have been used

[3] Brazil's First Written Submission, paras.142 and 146-150.
[4] US First Written Submission, para. 79 and 90.
[5] Brazil's First Written Submission, paras. 139 and 140.
[6] Brazil's First Written Submission, paras. 141-145.
[7] US First Written Submission, paras.83-84.
[8] The New Shorter Oxford English Dictionary, 1993.
[9] The New Shorter Oxford English Dictionary, 1993.

in place of "during". This further confirms that Brazil's use of US budgetary outlays cannot be considered correct.

19. Consequently, Article 13(b)(ii) and (iii) are intended to set up as a benchmark an amount of support adopted by some form of decision (be it political, legislative or administrative) in which support for a specific product is decided and allocated for future years. It is clearly not intended to set up a comparison between domestic support granted in 1992 and domestic support granted in a more recent period. The European Communities respectfully requests the Panel not to follow Brazil's equation of the term decided with the term granted.

20. For the European Communities, the question of what decision was adopted during 1992 by the United States is a question of fact which we do not take a position on, especially as we are not fully aware of all the elements which might be relevant.

### D. THE MEANING OF THE TERM "SUPPORT TO A SPECIFIC COMMODITY"

21. The United States has argued that the term "support to a specific commodity" is synonymous with the term "product-specific support".[10] Brazil had, in its First Written Submission, taken all support which was specific to cotton, and added to it a proportion of generally available support intended to represent the amount of such support which could be attributed to cotton.[11]

22. The European Communities shares the approach of the United States. Quite simply, support which is provided to a number of crops cannot at the same time be considered "support to a specific commodity". Such support is "support to several commodities" or "support to more than one commodity".

23. With respect, Brazil and New Zealand are wrong to suggest that the word "specific" was added to make clear that the applicable benchmark under Article 13 was not the overall level of subsidies decided but rather was to be undertaken on a product-by-product basis.[12] A brief glance at the *SCM Agreement* finds it replete with references to "a product" or "a subsidised product".[13] Consequently, it could make no sense to interpret Article 13 as being based on overall support. The word "specific" was not, therefore, inserted to differentiate the use of Article 13 in respect of specific products to the application of Article 6 to overall agricultural support, but rather as a qualifier to the word "support".

24. Consequently, the Panel should conclude that the correct comparison is between product specific support decided in 1992 and product specific support currently provided.

## IV. THE INTERPRETATION OF ANNEX 2 OF THE *AGREEMENT ON AGRICULTURE* (THE "GREEN BOX")

### A. FIRST SENTENCE OF THE FIRST PARAGRAPH OF ANNEX 2[14]

25. Australia has argued in its comments today that the European Communities is incorrect to consider that the first sentence of the first paragraph of Annex 2 does not impose a separate obligation. The European Communities notes, however, that Australia does not comment and does not

[10] US First Written Submission, paras. 77-78.
[11] Brazil's First Written Submission, para. 143.
[12] Brazil's First Written Submission, para. 136; New Zealand Third Party Submission Para. 2.22.
[13] See, in particular, Article 6.3.
[14] This section was not in the written statement circulated at the third party session, but reflects unscripted comments made during that session.

attempt to rebut the compelling contextual arguments that the European Communities has made in its written submission.[15] The European Communities pointed out that in several instances that the *Agreement on Agriculture* refers to the "criteria" for inclusion in the green box, specifically in Articles 6 and 7, and most importantly, in paragraph 5 of Annex 2. There is no such reference to the "fundamental requirements". The European Communities recalls that a panel is obliged to follow the accepted canons of interpretation of international law, and therefore, to view the ordinary meaning of the words concerned in light of their context and objective. Consequently, it is clear that the first sentence of paragraph 1 of Annex 2 is not, in and of itself, an independent obligation. This does not render it inutile, as Australia charges. The first sentence sets out an objective and indicates the type of effects which respect for the criteria in the green box is deemed to create. The European Communities urges the Panel to reject Australia's unsubstantiated arguments.

B. TYPE OF PRODUCTION

26. Brazil has argued that the fact payments are reduced where fruits and vegetables, and certain other crops are grown on contract acreage for the purposes of PFC and direct payments means that the "amount of such payments [is] related to or based on, the type or volume of production [ ..] in any year after the base period" (Paragraph 6(b) of Annex 2). However, Brazil also appears to recognise that farmers claiming the benefit of direct payments may plant crops other than the programme crops, and may even not produce any crops.[16] The United States asserts that no current agricultural production is required in order to benefit from direct payments.[17]

27. Assuming the US' assertion to be correct (as seems to be acknowledged by Brazil) the Panel is faced with a dilemma. Is the amount of funding provided by a programme, from which a farmer can benefit without producing anything, to be considered to be "based on or linked to a certain type of production", when payments under that programme can be reduced by growing certain crops? Brazil and some third parties simply assume that where payments can be reduced by growing certain crops, the programme is based on or linked to a certain type of production. Such a view does not, however, take account of the complexity of the situation.

28. In the view of the European Communities, reducing payments under a programme, where a farmer grows fruit or vegetables does not mean that the amount of the payment is linked to type of production. This is because the farmer is free to produce a whole range of other crops, or even not to produce at all and receive the full payment.

29. What Brazil and other third parties fail to realise is that the reduction in payment for fruits and vegetables, if the European Communities understands correctly, is in fact designed to avoid unfair competition within the subsidising Member. Brazil and the other third parties have not challenged the right of a subsidising Member to decide decoupled payments based on past production of, or acreage utilised for, certain crops. Indeed, this is permitted in paragraph 6(a) of Annex 2. However, in the case where, for instance, upland cotton production enjoyed support, while fruit and vegetable production did not, decoupled payments based on past cotton production would allow subsidised former cotton farmers to grow fruit and vegetables, and thus unfairly compete with pre-existing fruit and vegetable producers who could not benefit from the decoupled payments because they had not produced cotton or other supported products in the base period. Thus, the reduction in payments is a necessary element in ensuring that the equilibrium established by the market for the production of fruit and vegetables is not artificially disturbed by the introduction of decoupled support.

[15] EC's First Third Party Submission, paras. 15-25 and in particular paras. 22 and 23.
[16] Brazil's First Written Submission, para. 49.
[17] US First Written Submission, para. 68.

30. Furthermore, finding that Brazil and the other third parties are correct would have perverse effects. The whole *Agreement on Agriculture* is geared at gradually reducing certain types of domestic support. However, if a Member could not reduce decoupled payments when certain types of products which had previously not enjoyed any support are grown, the net effect would be that WTO Members wishing to provide decoupled support would have to increase overall support, and provide producers previously excluded with support which they had not previously enjoyed. This is clearly not an effect which the negotiators of the *Agreement on Agriculture* intended.

31. In this light, this potential reduction of payment is very different from the prohibition set down in paragraph 6(b) of Annex 2. Paragraph 6(b) is intended to prevent an artificial pressure to produce certain crops in order to obtain decoupled payments. Reducing payments where fruit and vegetables are produced does not act to pressure farmers into growing a particular type of crop. Rather, it prevents internal unfair competition. At the same time, as we understand the US measure, it does not oblige a farmer to produce any particular type of crop, in fact requires no production, and therefore should not be considered inconsistent with paragraph 6(b).

### C. A DEFINED AND FIXED BASE PERIOD

32. The European Communities would also like to comment briefly on the arguments raised by Brazil and some of the third parties with respect to the updating of the base periods in the 2002 FRSI Act. We take note of the US statement that the updating of the base period was necessary in order to bring support for oilseeds production under the direct payments scheme.[18] In order to ensure the progressive movement of production distorting subsidies to decoupled subsidies we consider that it must be possible to have different reference periods where eligibility is based on previous eligibility for production distorting subsidies. We see nothing in paragraph 6 of Annex 2 which might prevent this. At the same time, however, the European Communities is concerned that continued updating of reference periods in respect of the same already decoupled support, creating an expectation that production of certain crops will be rewarded with a greater entitlement to supposedly decoupled payments, tends to undermine the decoupled nature of such payments.

## V. INTERPRETATION OF THE *AGREEMENT ON AGRICULTURE* /RELATIONSHIP WITH THE *SCM AGREEMENT* AND GATT 1994

### A. ARE DOMESTIC CONTENT SUBSIDIES EXPRESSLY PERMITTED BY THE AGREEMENT ON AGRICULTURE ?

33. Brazil has argued that US Step 2 payments, which it alleges are conditional upon use of domestic goods, are inconsistent with Article 3 of the *SCM Agreement* and Article III.4 GATT 1994. New Zealand supports this claim. However, as with other claims, their analysis does not take fully into account the complexities of the situation. The European Communities agrees with the United States that subsidies contingent upon the use of domestic goods, which are maintained consistently with the *Agreement on Agriculture* are not inconsistent with either the *SCM Agreement* or GATT 1994.

34. The first question is whether subsidies contingent upon the use of domestic goods are consistent with the *Agreement on Agriculture*. The answer is a clear yes. Article 3.2 of the *Agreement on Agriculture* requires Members not to:

> "…provide support <u>in favour of</u> domestic producers in excess of the commitment levels specified in Section I of Part IV of its Schedule." (emphasis added).

[18] US First Written Submission, para. 60.

35. We have emphasised the phrase "in favour of". This is significant because it does not require that support be "to" domestic producers. The same term is used in Article 1(a) (the definition of AMS) and in Article 1(h) (definition of Total AMS). Moreover, it is established with respect to Article 1 of the *SCM Agreement* that a financial contribution and benefit need not be bestowed on the same person.[19] Consequently, it is simply logical that support may be provided in favour of domestic producers through the provision of funds to processors of the product concerned, and consequently that access to such subsidies be limited to domestic produce, in order to ensure that it is domestic producers who benefit from this subsidy. Indeed, WTO Members, in their wisdom, recognised precisely this possibility in Annex 3 to the *Agreement on Agriculture* where they explained how the AMS was to be calculated. Paragraph 7 thereof explicitly contemplates that:

> "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products."

36. Consequently, it is clear that a Member has a right to provide subsidies contingent upon use of domestic products under the *Agreement on Agriculture*. On this, the US and the European Communities agree.

37. The second question for the Panel is how does that right relate to the prohibition in Article 3 of the *SCM Agreement* and the national treatment obligation in Article III.4 of GATT. Here, again, we agree with the United States.

38. Article 21.1 of the *Agreement on Agriculture* provides that the other goods agreements will apply "subject to" the provisions of the *Agreement on Agriculture*. That is, the other Annex 1A Agreements will be subordinated to the *Agreement on Agriculture*.[20] A finding that a measure was a domestic content subsidy would mean that such a subsidy would be prohibited under Article 3.1(b) of the *SCM Agreement* and would (in all likelihood) be inconsistent with Article III.4 GATT. In such an event, the consequences of such a finding would have to be subordinated to the right to adopt such measures under the *Agreement on Agriculture* (provided reduction commitments are respected). Moreover, the chapeau of Article 3.1 of the *SCM Agreement* clearly exempts from the scope of that Article domestic content subsidies which are maintained consistently with the *Agreement on Agriculture* and Article III.8 may be relevant to any claim under Article III.4. GATT.

39. Consequently, Brazil's claims that domestic content subsidies maintained consistently with the *Agreement on Agriculture* can be found to be inconsistent with the *SCM Agreement* and Article III.4 GATT should be dismissed.

## B. EXPORT CREDIT GUARANTEES WHICH OPERATE AS EXPORT SUBSIDIES ARE SUBJECT TO AGREEMENT ON AGRICULTURE OBLIGATIONS ON EXPORT SUBSIDIES

40. The United States maintains, in its first written submission, that Article 10.2 of the *Agreement on Agriculture* operates so as to exclude export subsidies in the form of export credits or export credit guarantees. This is not borne out by the text of Article 10.2. Article 10.2 provides for disciplines to be negotiated on the provision of export credits and export credit guarantees; it does not provide an exemption to the export subsidy obligations of the *Agreement on Agriculture*.

41. The United States provides numerous examples of instances in which the WTO has foreseen further negotiations. However, none of these examples support the United States argument that there are no disciplines for export credit guarantees which operate as export subsidies.

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[19] See, Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 8 January 2003, para. 110.

[20] The New Shorter Oxford English Dictionary, 1993.

42. The best example to illustrate this point is the agreement to negotiate disciplines on harmonised rules of origin. The fact that it was agreed to have negotiations on rules of origin simply means that there is no requirement for a WTO Member to apply an as yet un-finalised set of harmonised rules of origin. However, this does not imply that a WTO Member is exempted from other WTO obligations when it comes to apply rules of origin. A WTO Member must, for instance, in applying its rules of origin, respect the most-favoured nation principle set out in Article 1 GATT. Similarly, while there may not be disciplines on the provision of export credits and export credit guarantees, clearly export credits or export credit guarantees which operate as export subsidies are subject to the export subsidy disciplines of the *Agreement on Agriculture* and the *SCM Agreement*.

43. Other examples are equally illustrative. The US cites provisions in the GATS providing for negotiations on government procurement, emergency safeguards and subsidies on trade in services. However, it does not point out the fact that these subjects are clearly not subject to GATS disciplines, and thus negotiations are required to develop even minimal disciplines. Government procurement in services is the best example – GATS disciplines are explicitly excluded by Article XIII GATS. In contrast, there is no clear exclusion of export credits or export credit guarantees which operate as export subsidies from the *Agreement on Agriculture*.

44. Finally, contrary to the US suggestions, such an interpretation does not render Article 10.2 meaningless. Article 10.2 is not intended to regulate export credits and export credit guarantees as export subsidies but rather to provide for a general set of disciplines comparable to the OECD guidelines for export credits for industrial goods. That the Harbinson text (which of course has yet to be agreed) contains provisions on export credit and export credit guarantees is a recognition that disciplines must be negotiated and that clarification must be provided as to which export credits or export credits guarantees are, in the case of agricultural products, to be considered export subsidies, but is not a recognition that such support which operates as an export subsidy are not currently subject to the obligations of the *Agreement on Agriculture*.

## VI. MEASURES BEFORE THE PANEL (FSC REPLACEMENT SCHEME)

45. The United States has argued that Brazil has failed to make a prima facie case of the inconsistency of the FSC Replacement scheme (the ETI) with the covered agreements. The European Communities must admit to being surprised that the United States considers that Brazil has to present a prima facie case of inconsistency. According to Article 17.14 of the DSU parties to a dispute must "unconditionally accept" adopted Appellate Body Reports as "a final resolution to that dispute."[21] Given that the United States must be assumed to have unconditionally accepted the findings of the Appellate Body in the FSC 21.5 dispute, which, by definition also included a finding that the United States was illegally providing export subsidies to unscheduled agricultural products such as upland cotton, the European Communities fails to see how the United States can argue that Brazil needs to establish a prima facie case. On the contrary, Brazil simply needs to assert a claim.

## VII. CONCLUSION

46. This brings us to the end of our statement today. Thank you for bearing with us through a statement which was inevitably long, given the complexity of the issues, and the very short time we had to prepare our written submission.

47. There are a few central points which we would like to leave you with:

- The peace clause is not an affirmative defence;

[21] Appellate Body Report US- Shrimp (21.5 – Malaysia) para. 97.

- The term "decided" cannot be equated with "granted";

- Reducing payments where certain crops are grown for reasons of internal competition does not amount to basing payments on a certain type of production;

- Domestic content subsidies in favour of domestic producers are permitted under the *Agreement on Agriculture*, and can be maintained irrespective of other provisions; and,

- Export credit guarantees which operate as export subsidies are subject to the *Agreement on Agriculture*.

48. Thank you for your attention. We are, of course, happy to answer your questions, here or in writing.

# ANNEX C-11

## INDIA'S ORAL STATEMENT

Mr. Chairman and Members of the Panel,

I thank you for the opportunity to present India's views in this third party session. India has a few short comments to make on the issues in the dispute.

1. Brazil has challenged the US Subsidy programme relating to cotton. The main schemes challenged are

(i) Step 2 export payments
(ii) US export credit guarantee programmes, and
(iii) Extra Territorial Income (ETI) Act export subsidies.

2. These schemes do not conform to the provisions of Part V of the Agreement on Agriculture and thus have no "peace clause" protection from claims under the Subsidies Agreement. These schemes also violate Article 3.1(a) & 3.2 of the Subsidies Agreement.

3. The scheme relating to Step 2 export payments constitutes an export subsidy within the meaning of the Agreement on Agriculture. It also violates the Subsidies Agreement as

(i) It involves grants within the meaning of the Subsidies Agreement as the US Government pays money to its exporters
(ii) These grants involve direct transfer of economic resources for which the US Government receives no consideration
(iii) The scheme confers a benefit within the meaning of Article 1.1(b) of the Subsidies Agreement as they constitute "free money" for which exporters incur no corresponding obligations and they are made for " less than full consideration" and
(iv) The Scheme is also export contingent within the meaning of Article 3.1(a) of the Subsidies Agreement because exporters are only eligible for payments if they produce evidence that they have exported an amount of US upland cotton.

4. The three Export Credit Guarantee Programmes (GSM 102, GSM 103 & SCGP) are export subsidies within the meaning of the Agreement on Agriculture (AOA) as

(i) They are operated " at premium rates which are inadequate to cover the long term operating costs and losses of the program" as per item (j) of the illustrative list of export subsidies in ASCM.
(ii) They involve financial contributions that confer "benefits" and are contingent upon export performance within the meaning of Article 1.1 & 3.1(a) of the Subsidies Agreement. The US itself treats them as subsidies in its budget.

5. The ETI Act constitutes export subsidies within the meaning of Article 10.1 of the Agreement on Agriculture. This Act operates to circumvent the US export subsidy commitments by providing an export subsidy to upland cotton while the US does not have any export subsidy reduction commitments for cotton in violation of Articles 10.1 & 8 of the AOA.

6. The Step 2 Domestic Payment Scheme grants are direct transfers of funds and constitute a financial contribution by a Government within the meaning of Article 1.1(a)(1)(i) of the Subsidies Agreement. They also confer a "benefit" within the meaning of Article 1.1(h) of the Subsidies Agreement because the domestic user of US upland cotton receives the financial contribution on terms more favourable than those available in the market. Moreover these payment are contingent upon the use of domestic over imported goods.

Mr. Chairman, Members of the Panel,

7. Brazil has provided the legal arguments as to why the US has no basis to assert a "peace clause" defence against Brazil's claims on actionable/prohibited subsidies being given by the US.

8. According to Brazil, the "peace clause" of AOA Article 13 is in the nature of an affirmative defence. The US has indicated that it will invoke a "peace clause" defence in the matter. This means that the burden of proof will be on US to show that the US domestic support and export subsidies to upland cotton are provided in conformity with the requirements of the "peace clause".

9. Brazil has argued that US has no "peace clause" protection under AOA Article 13(c) as the US while invoking an affirmative defence must demonstrate that its export subsidies confirm fully to the provisions of Part V of the AOA. Part V of the AOA consists of Articles 8 to 11. A member violates Part V of the AOA if it provides export subsidies for products for which it has not undertaken any export subsidy reduction commitments.

10. Issues relating to affirmative defence and peace clause defence are mainly legal in nature and should be subject to interpretation under the Vienna Convention on the Law of Treaties and the WTO jurisprudence as seen through Appellate Body findings.

11. As regards subsidies contingent upon export performance, export credit guarantees and premiums, and use of domestic over imported inputs, Mr. Chairman, India believes that they all fall in the category of prohibited subsidies and are actionable under the ASCM.

Thank you for your kind attention.

# ANNEX C-12

## NEW ZEALAND'S ORAL STATEMENT

24 July 2003

1. Mr Chairman, Members of the Panel, New Zealand's views on the issues of concern in this dispute are set out in our Third Party Submission of 15 July and in the time available today it is clearly not possible to canvass all of those views. Accordingly, and as suggested by you in your opening remarks Mr Chairman, I will focus only on some key points.

**(i) New Zealand's systemic interest in the dispute**

2. First, as outlined in our Third Party Submission, New Zealand has joined this dispute because of our systemic interest in ensuring the continued integrity of WTO disciplines applicable to agricultural trade. In particular we are concerned to ensure that trade-distorting or "amber box" measures cannot be used contrary to the "peace clause" in a manner that negatively affects other Members.

3. It is equally important that where the requirements of the "peace clause" have not been respected Members are able to utilise their rights under the *SCM Agreement* and *GATT 1994* to take action in respect of domestic support measures and export subsidies.

**(ii) Brazil's demonstration that the United States cannot claim "peace clause" protection for domestic support provided in marketing years 1999, 2000, 2001 and 2002**

4. Second, Brazil has demonstrated that the level of domestic support for upland cotton granted by the United States in each of the marketing years in question did in fact exceed the level decided during the 1992 marketing year and that there is therefore no "peace clause" protection for those support measures.

5. The United States argues that this is not the case, on the basis that the comparison required by the "peace clause" should be between the 'per pound' rates of support set by the relevant domestic support measures and that certain domestic support measures should be excluded from the comparison.

6. Turning first to the United States claim that the relevant comparison should be between 'per pound' rates of support, in New Zealand's view such an interpretation would be inconsistent with the object and purpose of Article 13(b)(ii). Instead, Article 13(b)(ii) requires a comparison that takes into account the totality of payments to upland cotton producers in order to reflect the true nature of the support that is being granted, including for example, total budgetary outlays. This is especially so when those budgetary outlays have been increasing because of falling world market prices. And those prices are falling due, at least in part, to the fact that United States producers are shielded from true price signals by the guaranteed 'per pound' rates.

7. Furthermore, New Zealand sees no basis for excluding certain domestic support measures from the calculation required by the "peace clause" as requested by the United States.

8. The "counter-cyclical" payments are plainly not "green box" support measures in accordance with Annex 2 of the *Agreement on Agriculture*, as the amount of the payment is linked to current prices for upland cotton, in direct contravention of Annex 2 paragraph 6(c).

9. Nor is the scope of support to be measured under Article 13(b)(ii) limited to "product-specific" support in the sense proposed by the United States. There is no basis for such an interpretation in either the wording or the intent of Article 13(b)(ii). [Just to depart from the prepared statement for a moment, the EC has reminded us this morning of the importance of taking context into account when interpreting WTO Agreements. We would note that it is also important to consider the ordinary and natural meaning of the actual words appearing in the Agreements. Here the words used are "support to a specific commodity" – the text does not say "product-specific support". If the drafters had intended to mean "product-specific support", they surely would have said so. After all, the phrase "product-specific support" is used at least five times elsewhere in the *Agreement on Agriculture*. Returning now to the prepared text,] even if such an interpretation as suggested by the US, could be supported, "counter-cyclical" payments are in any event product-specific support because, as Brazil has demonstrated, there is a strong linkage between those payments and production of upland cotton.

10. New Zealand also considers that there is no basis for excluding the Production Flexibility Contract payments or Direct Payments from the required calculation. The ability of farmers to update the base acreage used for calculation of Direct Payments rules out inclusion of those payments in the "green box", which contemplates only one base period that is fixed and unchanging. To permit a Member to avoid this limitation by simply changing the names of its domestic support programmes would seriously undermine the requirement that there be no link between production and the amount of support.

**(iii) Brazil's demonstration that the United States cannot claim "peace clause" protection in respect of export subsidies;**

11. Looking now at export subsidies, New Zealand agrees with Brazil that the three types of export subsidies applied to upland cotton and other commodities by the United States (the Step 2 Export Programme, the Export Credit Guarantee Programme, and the FSC Replacement Programme) violate Articles 3.3, 8 and 10.1 of the *Agreement on Agriculture*.

12. New Zealand rejects the argument made by the United States that Step 2 export payments are not export subsidies because payments are available to domestic users as well as exporters of upland cotton. The Appellate Body (in *US-FSC Recourse to Article 21.5*) has made it clear that the fact that payments are also able to be made to domestic users of upland cotton does not 'dissolve' the export contingency of the payments that are made to exporters.

13. New Zealand also finds no basis for the assertion by the United States that export credit guarantee programmes are not subject in any way to the export subsidy disciplines of the *Agreement on Agriculture*. In fact the inclusion of reference to such programmes in the context of Article 10 supports the opposite conclusion and demonstrates that Members were in fact concerned at the potential for such programmes to circumvent Members' export subsidy reduction commitments.

14. In summary Brazil has demonstrated that the export subsidies to upland cotton do not have "peace clause" protection, and also that they are prohibited subsidies under Article 3.1(a) and 3.2 of the *SCM Agreement*.

**(iv) The request by the United States for a Preliminary Ruling**

15. Finally Mr Chairman, New Zealand does not consider that the Panel should grant the preliminary ruling requested by the United States.

16. First, New Zealand believes that measures no longer in effect are not outside the scope of the Panel's consideration, particularly where the programmes in question, while renamed, in fact continue in a slightly different form. Furthermore, the nature of serious prejudice claims means that Panels may need to consider data beyond a single year and consider trends over a number of years.

17. Second, New Zealand considers that export credit guarantee measures relating to eligible United States agricultural commodities (other than upland cotton) are within the Panel's terms of reference. To determine otherwise would be to allow a lack of transparency in the operation of particular measures to shield them from scrutiny by Members taking disputes.

**Conclusion**

18. In conclusion, Mr Chairman, New Zealand believes that Brazil has demonstrated that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the *GATT 1994* and the *SCM Agreement*. New Zealand looks forward to the next phase of the case which will examine those claims.

# ANNEX C-13

## ORAL SUBMISSION BY PARAGUAY

24 July 2003

Mr Chairman, members of the Panel:

1. Paraguay is grateful for the opportunity to participate in these proceedings and to present its views on the matter at issue in this dispute.

2. Because Paraguay is a firm believer in a fair system of multilateral trade, it feels that it should explain its position on this issue as a third party because it is an issue of particular interest to its economy.

3. Paraguay considers that the subsidies and support granted by the United States to its cotton production are inconsistent with the Agreement on Subsidies and Countervailing Measures, the Agreement on Agriculture and the rules and principles of the GATT 1994, and that for the purposes of this dispute it is therefore essential to take account of WTO legislation, which was carefully drafted to avoid causing distortions in international trade and prejudice to developing countries such as Paraguay.

4. WTO jurisprudence and the principles of interpretation of international law applied to the various cases suggests that the applicable rules should be read cumulatively, taking account of all elements applied to the case in order to support the system as an integrated whole.

5. With respect to the applicability of Article 13(b)(ii) concerning domestic support measures that conform fully to the provisions of Article 6 of the Agreement including direct payments that conform to the requirements to paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, Paraguay considers they shall be exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

6. This implies that it is not limited or confined to specific products. Thus, it can be concluded that the United States does not enjoy protection from actions relating to subsidies using 1999, 2001 and 2002 as a basis, as Brazil duly proved.

7. In interpreting the Peace Clause, account must be taken of the serious prejudice that Member economies could suffer, and an assessment made of the overall significance of all of the agreements relating to the case.

8. Regarding inconsistency with the Agreement on Agriculture, the Step 2 programme introduced by the United States to stimulate exports and the competitiveness of its products on the international market is inconsistent with Articles 3.3 and 8 of the Agreement on Agriculture.

9. Article 3 of the Agreement on Agriculture refers to the incorporation of concessions and commitments. Paragraph 3 thereof stipulates that:

> *3.3 "Subject to the provisions of paragraphs 2(b) and 4 of Article 9 of this Agreement, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule."*

10. The above paragraph enables Members to provide the subsidies listed in Article 9.1 of the Agreement on Agriculture subject to fulfilment of the commitments assumed.

11. Similarly, Article 8 of the said Agreement regulates export competition commitments, stipulating that:

> *"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and the commitments as specified in that Member's Schedule."*

12. For the above reasons, and because it does not consider the provisions of the Agreement on Agriculture to have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

13. The agricultural subsidies cause "serious prejudice" to the domestic industry of other Members under Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures.

14. The introductory paragraph of part III, Article 5 of the said Agreement provides that no Member should cause, through the use of any subsidy – specific and not exempted under the Agreement – adverse effects to the interests of other Members, more specifically, as categorically stated in the indents that follow, (a) injury to the domestic industry of another Member and (c) serious prejudice to the interests of another Member.

15. Article 6 specifically refers to cases in which "serious prejudice" is deemed to exist in the sense of paragraph (c) of Article 5.

16. Agricultural subsidies have effects on world trade, and measures such as those applied by the United States have a significant impact on developing countries like Paraguay.

17. Paraguay has a total population of approximately 5,300,000, of which more than 500,000 are linked to cotton production. If we add the related industries and activities, the figure reaches an estimated 1,500,000, or approximately 30 per cent of the country's total population.

18. Any slump in the cotton trade causes an exodus of rural population towards the urban areas which do not offer any relief or solution, and this further undermines the economic situation of a country that depends on its agriculture.

19. As regards exports, in 1991, the foreign exchange revenue generated by sales of cotton and byproducts thereof reached US$318,912,000, approximately 43 per cent of the total for the country's exports that year. At the time, of a total of 299,259 farms, 190,000 were cultivating cotton.

20. By 2001, the figures had changed considerably. Export revenue had fallen to US$90,505,000, a 72 per cent drop in the value of exports. The number of farms producing cotton decreased to about 90,000, representing a 52 per cent decrease in farms, employment and small farmer income. In other words, the impoverishment was real.

21. Regarding international cotton fibre prices, in 1991, the price per ton of Paraguayan type fibre was quoted on the New York Exchange at US$1,624, while in 2001, it was quoted at US$934.

22. In Paraguay, some 60 per cent of cotton is produced on farms of less than 10 hectares, making it the main or only source of income for small farmers and the main source of employment for the rural workforce in the most disadvantaged segment of society where access to capital and technology is more restricted and the leading socio-economic welfare indicators are lower than anywhere else.

23. In spite of its marked decline, cotton continues to be an important cash crop for the "capitalized" farms, and the main – if not only – cash crop of the farms that are on the decline.

24. The agricultural sector is fundamental to the Paraguayan economy, accounting for 90 per cent of exports, 35 per cent of employment and 25 per cent of GDP, in addition to which it supports an agro-industry that accounts for 11 per cent of GDP and 10 per cent of total employment.

Mr Chairman, members of the Panel:

25. The importance of cotton for Paraguay, both in social and economic terms, is such that an increase in international cotton fibre prices as a result of the elimination of significant market distortions such as subsidization of production would not only bring about a general improvement in the standard of living of the country's inhabitants, in a very fragile sector in particular, but it would also lead to an improvement in macroeconomic conditions, balance-of-payments, monetary reserves, etc. that would enable Paraguay to be more reliable in meeting its international financial commitments.

26. For the above reasons, and because it does not consider that the provisions of the Agreement on Agriculture have been complied with, Paraguay believes that the export subsidies granted by the United States to its cotton industry are inconsistent with Articles 3.3, 8 and 9.1 of the Agreement on Agriculture.

27. Paraguay therefore considers that the measures adopted by the United States cause serious prejudice to world trade, affecting Paraguay in particular, and that the necessary steps should be taken to eliminate the adverse effects and seek to achieve a balance in world trade.

28. Finally, Paraguay respectfully requests the Panel to conclude that the measure applied by the United States is inconsistent with its WTO obligations under various provisions of the Agreement on Agriculture, the GATT 1994 and the Agreement on Subsidies and Countervailing Measures.

# ANNEX C-14

## ORAL STATEMENT BY THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU AS A THIRD PARTY ON THE CASE OF THE UNITED STATES SUBSIDIES ON UPLAND COTTON

The Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu is pleased to be here as a third party in this case. We have a systemic interest in the particular question of the burden of proof required by Article 13 of the AOA, and would like to focus on this issue in our remarks. We have previously submitted our views in writing accordingly.

**The Burden of Proof (the "Peace Clause")**

In the case in point, Brazil asserts in its first written submission that Article 13 is by nature an "affirmative defence" or "exception" and "not itself a positive obligation", therefore the United States carries the burden of proof on whether its subsidies are in conformity with Article 13.

Our view, in summary, is that it is inappropriate to label Article 13 as an "affirmative defence" or "exception". Indeed this would mean the Article having much less than its originally intended effect. Article 13 in itself confers rights and imposes positive obligations on Members. It is not there simply for the convenience of resolving the question of the burden of proof. The right that it confers of entitlement to being "exempt from actions", for example, would be rendered pointless if the burden of proof were on the respondent. It is surely for Brazil, therefore, as a complainant, to prove a breach of a positive obligation by demonstrating non-conformity, rather than for the United States to bear the burden of proof.

In our written submission, we suggest that in arriving at a proper interpretation of the burden of proof in Article 13, it might also be helpful to make some comparisons with the different types of exceptions, exemptions and defences that exist in other Articles of WTO Agreements.

We mention, for example, disputes arising in connection with agreements not covered by the DSU, where the complaining party would bear the burden to prove that the issue in dispute falls within the purview of the DSB.

Also, where a matter is specifically excluded from the dispute settlement procedures by certain relevant agreements – such as Article 6 of the TRIPS agreement - the provision concerned allows the Member applying it to prevent dispute settlement procedures and the burden of proof falls on the complaining party.

And by way of further comparison, we refer to other cases where exceptions or exemptions are granted under relevant agreements providing specific obligations.

While Article 13 of the AOA is clearly in this case not dealing with a matter under a non-covered agreement or a matter that is specifically excluded from the dispute settlement procedures as in Article 6 of TRIPS, it is also not typical of the type of exception contained in a number of the GATT Articles. By its singular nature, Article 13, in our view, falls between these examples, therefore the procedures for applying its provision should be interpreted separately and differently.

And finally, as far as the burden of proof is concerned, we submit that requiring the respondent to prove that the subsidy measure in question is in conformity with the Agreement on Agriculture will, to a certain extent, offset the respondent's right to claim for the exceptions provided by the Article 13 provisions, which is surely contrary to the drafters' intent.

# ANNEX D

## REBUTTAL SUBMISSIONS OF PARTIES

# ANNEX D-1

## BRAZIL'S REBUTTAL SUBMISSION TO THE PANEL REGARDING THE "PEACE CLAUSE" AND NON-PEACE CLAUSE RELATED CLAIMS EXECUTIVE SUMMARY

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## 1. The United States Has No Peace Clause Protection for Non-Green Box Domestic Support Measures to Upland Cotton for MY 1999-2002

### 1.1. Production Flexibility Contracts and Direct Payments Are Non-Green Box Domestic Support

#### 1.1.1. The Amounts of PFC and Direct Payments Depend on the "Type" of Production

1. PFC payments and direct payments are non-green box support because both limit the "amount" of payment based on the "type" of production inconsistent with the requirements of Annex 2, paragraph 6(b) of the Agreement on Agriculture. The relevant text of paragraph 6(b) prohibits any linkage of the "amount of payments" to any "type of production" of an agricultural product. The "amount" of payments under the PFC and direct payment programmes *falls* when base acres are used to produce fruits, vegetables and wild rice. Thus, the undisputed evidence demonstrates that PFC and direct payments do not meet the policy-specific criteria for "de-coupled income support" in Annex 2, paragraph 6(b).

2. Prohibiting payments if *certain* types of crops are produced while at the same time permitting payments if *other* types of crops are produced violates Annex 2, paragraph 6(b). Contrary to the US argument, requiring no production, *i.e.*, prohibiting production, does not relate the amount of payments to the "type" of production, as no individual "type" of production would be eligible to payments. The notion of "type of production" in paragraph 6(b) is necessarily linked to the amount of payment to some "type" of commodity that is "produced" and not to a production requirement itself.

3. In addition, Brazil also presented evidence that the US restrictions on fruits, vegetables and wild rice prevent producers with PFC and direct payment base acreage from growing these alternative crops. This restriction, therefore, channels production into particular "types of production" by prohibiting *other* "types of production" and, therefore, violates Annex 2, paragraph 6(b).

#### 1.1.2. Direct Payments Are Not Green-Box Because the Base Periods for Determining Eligibility Have Been Updated in the 2002 FSRI Act

4. Direct payments are also not properly in the green box because the amount of payments are based on an updated "base period" and not on a "fixed" base period as required by Annex 2, paragraphs 6(a) and (b). Paragraphs 6(a) and (b) require a fixed and, therefore, unchanging base period for de-coupled domestic support measures with the same structure, design, and eligibility criteria. The evidence demonstrates that there are no significant changes in the payment eligibility criteria between the PFC programme and its direct successor, the direct payment program. Indeed, PFC payments made during 2002 were deducted from the amount of direct payments due in 2002.

5. Further, the updating permitted under the 2002 FSRI Act for direct payments was significant – one-third of eligible farms updated their PFC base acreage as of June 2003 in order to *increase* the base acreage – and payments – under the direct payment programme. This updating creates production-distorting effects because it creates expectations of future updates and will incite farmers to produce more of the programme crops that qualify for support.

6. The United States interprets the word "fixed" in Annex 2, paragraph 6(a) and (b) as being "fixed" only for the life of a particular legal measure. A Member could change a measure every year, update the "base period" to reflect the prior year's acreage, increase current payments to reflect the updated (and increased) "historical" acreage, and label it differently under a new law. Thus, the US interpretation would permit payments to be completely "coupled" to production, just with a one-year time lag. It would render any disciplines reflected in the use of the term "a" and "fixed" "base

period" in Annex 2, paragraph 6(a) a nullity. This is contrary not only to the ordinary meaning of the term "fixed" but also to the object and purpose of Annex 2, paragraph 6(a) to not permit Members to increase payments over time in a manner linked to increases in production over time. The re-linkage of payments to production is also inconsistent with the "fundamental requirement" in Annex 2, paragraph 1.

### 1.2. PFC, Market Loss Assistance, Direct and Counter-Cyclical Payments (CCP) and Crop Insurance Subsidies Are "Support To" Upland Cotton

7. The narrow US specificity test of "tied to production" seeks to impose a "form" of specificity on the text of Article 13(b)(ii) that is not there. It further contradicts the only analogous criteria to Article 13(b)(ii) for calculating annual levels of support – the AMS calculation criteria of Annex 3. In addition, it contradicts the broad definition of "in favour of" in defining AMS in Article 1(a) of the Agreement on Agriculture, and the "in general" language of the same provision. The "substance" the United States seeks to avoid with this unjustified interpretation is the $12.9 billion dollars in payments for the production of upland cotton from MY 1999-present.

8. Applying its narrow specificity criteria, the United States argues that PFC, market loss assistance, direct and counter-cyclical payments as well as crop insurance subsidies are not "support to" upland cotton. Brazil presents evidence that all five domestic support measures provide "support to" the production of upland cotton between MY 1999-2002.

#### 1.2.1. Production Flexibility Contract Payments

9. Brazil has presented considerable evidence demonstrating that PFC payments to holders of upland cotton base acreage in MY 1999-2001 are support to upland cotton. The 1996 FAIR Act established a specific payment formula permitting those upland cotton farmers who had traditionally farmed upland cotton to continue to receive payments following the elimination of the deficiency payment program. The 1996 FAIR Act singled out upland cotton and only six other crops for such PFC payments. Recipients were "producers" who "shared in the risk of producing a crop", and who farmed one of the seven crops in the three immediate years prior to the 1996 FAIR Act (MY 1993-95). Only a small minority of the producers of crops in the United States received PFC (and market loss assistance) payments. Brazil has demonstrated that between MY 1999-2001, the seven types of programme crops receiving PFC represented on average between MY 1999-2001 only 14.19 per cent of total US farm revenue. In addition, the total acreage of the seven PFC and market loss assistance crops in MY 2001 represented only 22 per cent of total US farmland. Thus, PFC payments were not provided to US producers *in general*.

10. The best available evidence demonstrates that upland cotton producers during MY 1999-2001 received PFC (and market loss assistance) payments. USDA reported that 97 per cent of farms producing upland cotton representing 99 per cent of upland cotton acreage from MY 1993-95 signed up to receive upland cotton PFC payments for MY 1996-2001. Upland cotton base acreage under the PFC (and market loss assistance) programme was 16.2 million acres. Between MY 1999-2001, the average acreage planted to upland cotton was 15.24 million acres. In addition, USDA reported that 95.7 per cent of the 16.2 million US upland cotton base acreage was planted to PFC programme crops in MY 2001 – a higher percentage than for any of the other 6 types of PFC programme crops. Thus, the evidence suggests that upland cotton producers in MY 1999-2001 were receiving PFC (and market loss assistance) payments.

11. Brazil has presented evidence demonstrating that PFC payments have production and trade distorting effects that arise from the prohibition on planting fruits, vegetables, and wild rice, as well as from the various "wealth effects" that result from the size of the subsidy averaging more than 15 per cent of the market value of upland cotton between MY 1999-2001. These effects provide further

confirming evidence that the selected, targeted PFC (and market loss assistance) payments are support to upland cotton.

### 1.2.2. Market Loss Assistance Payments

12. The evidence provided by Brazil with respect to PFC payments is also relevant to market loss assistance payments because these payments were made only to farmers with PFC contracts for the seven PFC crops, and additionally to soybeans. Thus, historic upland cotton producers (producing upland cotton in MY 1993-1995) received "upland cotton-specific" market loss assistance payments in MY 1998-2001. Even with the addition of soybeans, these 8 crops only represented on average 20.75 per cent of total US farm revenue in MY 1999-2001. PFC crop base acreage and soybean acreage in MY 2001 represented only 29 per cent of total US farmland. Thus, as with PFC payments, market loss assistance payments were not paid to US agricultural producers *in general* but rather to only a select group of US producers.

13. The evidence presented by Brazil indicates that while producers holding PFC/market loss assistance base acreage had the legal "freedom to farm" different crops, if they produced upland cotton, they would suffer adverse financial consequences *unless* they produced upland cotton on *upland cotton*, *corn* or *rice* base acres. The evidence highlights the practical impossibility of growing upland cotton without any type of PFC and market loss assistance payment in MY 2001. This evidence confirms NCC statements and supports a conclusion that any upland cotton produced in MY 1999-2001 – as a matter of economic reality and viability – needed and received PFC and market loss assistance payments to meet the high cost of production.

14. Further evidence that market loss assistance payments are support to upland cotton stems from the fact that the United States notified these subsidies as trade and production distorting amber box support. The evidence demonstrates that the targeted market loss assistance payments triggered by market price declines have even more trade and production-distorting effects than PFC payments. Further, as with PFC payments, production and trade distortions occurred because of the prohibition or restriction on receiving such payments based on growing fruits, vegetables, or wild rice. The production and trade-distorting effects on upland cotton are further confirmed by the fact that market loss assistance payments represented on average 17.87 per cent of the market value of upland cotton between MY 1999-2001. Thus, even though upland cotton producers were not *required* to produce upland cotton to receive market loss assistance payments, the record demonstrates that they continued to produce upland cotton between MY 1999-2001, and they continued to benefit from the 17.87 per cent subsidies represented by these payments.

### 1.2.3. Direct Payments

15. Direct payments are targeted support to "producers" farming, *inter alia*, on upland cotton base acreage. The eligible upland cotton producers who grew upland cotton in MY 1998-2001 (or in MY 1993-95) – together with eligible producers of only nine other crops – are a select group, who grew crops representing only 23.49 per cent of total farm cash receipts and 30 per cent of total US farm acreage. Thus, direct payments are *not* available to the great majority of US producers of agricultural commodities, *i.e.*, they are not provided to US agricultural producers *in general.*

16. The United States argues that direct payments and CCP payments are not "support to upland cotton" because there is no *legal requirement* under the 2002 FSRI Act for holders of upland cotton base acreage to grow upland cotton. However, Brazil has demonstrated that the theoretical legal *planting flexibility* in the 2002 FSRI Act is not reflected in the *economic* reality of growing high-cost crops like upland cotton. Farmers who did plant the 14.2 million acres of upland cotton for MY 2002 could only have covered their costs by receiving *upland cotton*, *rice* or *peanut* direct payments and counter-cyclical payments. This evidence strongly confirms what the NCC officials have stated

repeatedly, that their members need, rely on, and *receive* direct payment and counter-cyclical payment support. And this evidence refutes the United States argument that the *legal* flexibility to grow other crops – or not produce at all – is the single relevant fact justifying a finding that direct payments and CCP payments did not support upland cotton in MY 2002.

17. Further evidence that direct payments are support to upland cotton is derived from the effects on upland cotton production caused by the updating of the base acreage between the PFC and the direct payment programmes. Brazil has presented evidence indicating that this updating creates a re-linkage between production and the direct (and counter-cyclical) payments. Production effects are also caused by channeling the payments into crops other than fruits, vegetables, and wild rice. Further, the size of the subsidy (over 15 per cent of the current upland cotton market value) also contributes to wealth creation that has production effects. These production effects demonstrate that the direct payments (and CCP payments) are not de-linked from production – as argued by the United States – and support a conclusion that they are support to upland cotton.

### 1.2.5. Counter-Cyclical Payments

18. The United States argues that because producers receiving CCP payments are not required to produce upland cotton to receive payments, these payments cannot, as a matter of law, be considered support to upland cotton within the meaning of Article 13(b)(ii). Nevertheless, the evidence provided by Brazil demonstrates that CCP funds in MY 2002 paid to "historic" (i.e., 1998-2001 or 1993-1995) upland cotton producers are paid to a tiny fraction of total US producers of agricultural commodities and not to US producers of agricultural products "in general". Further, the evidence supports the conclusion that the recipients of these payments in MY 2002 needed these payments to continue producing upland cotton. They constitute "support to upland cotton".

19. Moreover, CCP payments create additional production effects due to the "base-update" permitted under the 2002 FSRI Act for both base yields and base acreage compared to market loss assistance payments. Further, the fruits, vegetables, and wild rice prohibitions or restrictions channel production into upland cotton. This evidence collectively supports a conclusion that CCP payments are "support to upland cotton".

### 1.2.6. Crop Insurance Payments

20. Brazil has demonstrated that upland cotton farmer benefit from specialized and specific crop insurance policies provided under the 2000 Agricultural Risk protection Act. Premium subsidies are directly tied to the amount of acreage planted by an upland cotton farmer. Also the participation rate, the share of policies at higher buy-up levels and the crop insurance loss ratio are higher for upland cotton than for other crops. This is confirmed by USDA's own economists, who have found that crop insurance subsidies cause much higher production and export effects for upland cotton than for other crops. In sum, crop insurance subsidies tied directly to the production of upland cotton are "support to a specific commodity" for the purposes of Article 13(b)(ii).

## 1.3. The US Support to Upland Cotton in MY 1999-2002 Exceeded the Support Decided in MY 1992

21. The United States has raised a number of *post hoc* arguments related to a supposed "rate of support" decision it alleges to have made during MY 1992. In the SAA, the United States stated that Members would have peace clause protection from adverse effects and serious prejudice challenges in the WTO "*unless the AMS for the particular* commodity exceeds the level decided in the 1992 marketing year". The phrase "AMS for the particular commodity" is an explicit recognition by the United States of the test in Annex 3, paragraph 6 which states: "For each basic agricultural product, a specific AMS shall be established *expressed in total monetary terms.*" The US "rate of support"

methodology is not an expression in "total monetary terms," nor does it permit such a calculation. There are only two types of methodologies that would allow an expression in monetary terms of a decision (or decisions) taken by the United States in MY 1992 regarding its level of support to upland cotton: "using budgetary outlays" or the "gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price".

22. Brazil disagrees with the United States' assertion that it did not "decide" on budgetary outlays. The alleged US decision to provide a rate of support must necessarily be accompanied by a decision to authorize whatever budgetary outlays would be necessary to meet the rate of support. The United States took specific administrative decisions which meant that the United States decided on the payment rates that resulted from the "rate of support" and, therefore, on the amount of budgetary outlays it would use from its unlimited spending authority. For the United States to argue, *post hoc,* that these decisions did not also include expenditures is inconsistent with its SAA interpretation of the peace clause that the 1992 decision must be expressed in "total monetary terms."

23. Brazil has demonstrated that expenditures for MY 1992 are lower than they are for any of the marketing years from 1999-2002. Therefore, under this methodology, the United States has no peace clause exemption for MY 1999-2002. While Brazil does not believe that calculating the upland cotton AMS based on the AMS methodology in Annex 3 is the appropriate methodology – based on the absence of the terms "AMS", "product-specific" and "non-product-specific" in Article 13(b)(ii) – Brazil has provided evidence that by using this methodology the United States support to the basic agricultural commodity "upland cotton" exceeded the support decided during the 1992 marketing year in all marketing years from 1999-2002.

24. In the event the Panel decides not to use a "total monetary value" methodology, then there are two "rate of support" methodologies: (1) budgetary outlays per pound of support, and (2) the expected guaranteed income rate of support set out in Professor Sumner's analysis. Brazil has provided extensive analysis of each of these two methodologies. However, Brazil does not endorse either methodology.

25. Brazil has demonstrated that the preferable methodology would be to rely on budgetary outlays per pound of upland cotton production. Professor Sumner's approach should be used only as an alternative to the simplistic US "72.9 methodology" because it is much more accurate than the United States approach accounting for eligibility criteria, effective programme limitations and costs that the US ignores. In any event, Brazil has demonstrated that also under both rate of support methodologies the US support in MY 1999-2002 exceeds the support decided during MY 1992

26. Any methodology that does not account for eligibility and effective participation criteria is inconsistent with Article 13(b)(ii). It is also inconsistent with the context of Article 13(b)(ii) which includes Annex 3, paragraphs 8 and 10 requiring calculation of the monetary value of support by factoring in "*production eligible to receive the administered price*." And it is also inconsistent with object and purpose of the Agreement on Agriculture, which is – after all – "correcting and preventing restrictions and distortions in world agricultural markets."

### 1.4. Challenges to Actionable Subsidies under Article 5 and 6 of the SCM Agreement and Article XVI of GATT 1994 Are Not Limited to the Marketing Year in which a WTO Panel Is Established

27. The United States argues that the Panel may only count *current* US non-green box support in determining whether the United States enjoys peace clause exemption under Article 13(b). Applying a strict "statute of limitations" approach, the United States argues that Brazil (1) cannot challenge any US trade and production-distorting agricultural support for MY 2001 (or MY 2000, or MY 1999) because it did not ensure that the Panel was established during MY 2001 (or MY 2000, or MY 1999), and (2) it cannot challenge *all* of the trade and production-distorting support for all of MY 2002 because it did not ensure that the Panel was established by 31 July 2003 – the last day of the 2002 marketing year. The United States goes so far as to argue that the Panel may only compare MY 1992 support decided with *partial* MY 2002 data through 18 March 2003 – the date the Panel was established. According to the US theory, the only date the Panel could have been established to ensure comparison with full MY 2002 data would have been 31 July 2003 – the last day of MY 2002.

28. Brazil has demonstrated that the United States has constructed an irrational interpretation of Article 13(b)(ii). It is bizarre to interpret Article 13(b)(ii) in a way that requires Members to carefully "time" a request for establishment of a panel to maximize the amount of support to be counted for the "current" marketing year. Nothing in the "present tense" of Article 13(b)(ii) compels this result. The Panel must interpret Article 13(b)(ii) according to its ordinary meaning and with regard to its context. The relevant context is Articles 1(h)(ii) and 6.3 of the Agreement on Agriculture. The *Korea – Beef* dispute exemplifies that a Member can challenge violations of "Current Total AMS" at any time after a marketing year ends. The ability of challenging Current Total AMS violations in later years by analogy suggests that non-conformity with the peace clause requirements in much the same way leads to lifting the peace clause exemption also for marketing years other than the current marketing year. Thus, the proper interpretation of Article 13(b)(ii) permits actionable subsidy challenges under the SCM Agreement and GATT Article XVI:1 for any marketing year for which peace clause exemption does not exist – under either its chapeau (Current Total AMS) or the proviso of Article 13(b)(ii).

### 2. The GSM 102, GSM 103 and SCGP Export Credit Guarantee Programmes Constitute Export Subsidies in Violation of Articles 10.1 and 8 of the Agreement on Agriculture, and Item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement

29. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP export credit guarantee programmes administered by the CCC constitute export subsidies within the meaning of Articles 10.1, 1(e) and 8 of the Agreement on Agriculture, Article 3.1(a) of the SCM Agreement, and item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement. Brazil also demonstrated that those export subsidies circumvent, or threaten to circumvent, the United States' export subsidy reduction commitments, in violation of Articles 10.1 and 8 of the Agreement on Agriculture. Additionally, because they violate the Agreement on Agriculture, these programmes are not exempt from actions by Article 13(c)(ii) of the Agreement on Agriculture, and constitute prohibited export subsidies within the meaning of item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement.

30. Article 10.2 does not, as the United States asserts, carve out export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture, including the anti-circumvention provisions of Article 10.1. The Appellate Body concluded that exemptions and carve-outs from general obligations must be provided for explicitly in the text of an agreement. Article 10.2 includes no such explicit carve-out or exemption. Rather, Article 10.2 announces Members' intent to work toward negotiations on specific disciplines for export credits. In the meantime, the general disciplines on export subsidies included in the Agreement on Agriculture apply to export credits.

### 2.1. CCC Export Credit Guarantees Constitute Export Subsidies under Articles 1 and 3.1(a) of the SCM Agreement

31. Brazil notes that CCC export credit guarantees are "financial contributions" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. Since CCC export credit guarantees are unique financing vehicles for agricultural commodity transactions that are not available on the commercial market, let alone on terms consistent with the market, they confer "benefits" within the meaning of Article 1.1(b) of the SCM Agreement. Brazil presents the affidavit of Marcelo Pinheiro Franco from the Brazilian Export Credit Insurance Agency who confirms that no

> comparable market-based export credit guarantees or financing instruments for international transactions involving agricultural commodities [exist] that provide these same terms [as the GSM and SCGP programmes].

32. Further, the United States compares agricultural export credit guarantees to export credit insurance for agricultural commodities, which it asserts is available on the private commercial market. However, it acknowledges that insurance coverage is structured altogether differently from guarantee coverage. Thus, even if the United States had proven its assertion with evidence, it acknowledges that the market for private insurance cannot serve as a benchmark against which to determine whether CCC guarantees confer "benefits".

33. Finally, CCC guarantees are contingent in law on export performance and therefore constitute prohibited export subsidies under Article 3.1(a) of the SCM Agreement.

34. Lastly, Brazil recalls that since the United States surpassed its quantity commitment levels, Article 10.3 of the Agreement on Agriculture allocates the burden to the United States to prove that its excess exports did not benefit from export subsidies, including export credit guarantees.

### 2.2. The CCC Export Credit Guarantee Programmes Constitute Export Subsidies under Item (j) of the Illustrative List of Export Subsidies

35. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes also constitute export subsidies because they charge premium rates that are inadequate to cover the long-term operating costs and losses of the programmes, within the meaning of item (j) of the Illustrative List. Item (j) does not require the Panel to endorse any particular methodology or formula for determining whether the CCC programmes cover their long-term operating costs and losses, or to decide by precisely how much those costs and losses exceed premiums collected. Rather, Brazil has provided the Panel with numerous alternatives, each of which demonstrates that long-term operating costs and losses for the GSM 102, GSM 103 and SCGP programmes outpace premiums collected, including data under the FCRA, Brazil' constructed formula, data from CCC's 2002 financial statements reporting large uncollectible amounts on post-1991 and pre-1992 guarantees, among others.

36. The United States criticizes the FCRA cost formula as inappropriate because it allegedly relies on "estimated" rather than "actual" data about the costs of the programmes. It is not true that the FCRA cost formula reflects only "an *estimate* of the long-term costs to the Government". A significant portion of the inputs into the FCRA cost formula reflect actual historical experience with borrowers, and actual contract terms such as interest rates, maturity, fees and grace periods.

37. Moreover, the results of the FCRA cost formula are modified throughout the lifetime of a cohort, pursuant to the "reestimation" process. The results of the reestimate process demonstrate that CCC has "los[t] money" during the period 1992-2002. When these total lifetime reestimates for all

cohorts of guarantees disbursed since 1992 are netted against the total *original* subsidy estimates adopted each budget year during the period 1992-2002, *the resulting loss is nearly $1.75 billion*.

38. The implication of the United States' position concerning "estimated data" is that it is impossible to judge whether premiums for the GSM 102, GSM 103 and SCGP programmes have covered operating costs and losses until all guarantee cohorts for a period constituting the "long term" are closed, so that purely "actual" rather than partial "estimate" data are available. Because all cohorts disbursed since the inception of federal credit reform remain open, the United States effectively argues that it is impossible for this Panel to judge whether the CCC guarantee programmes satisfy the elements of item (j). Brazil notes however that the US Congress and the President have endorsed the use of the FCRA cost formula as the principal way to "measure more accurately the costs of Federal credit programmes", *even in the budget year column of the US budget*, let alone several years out, when cohorts have been subject to successive rounds of reestimates.

39. In closing, Brazil reminds the Panel that the US criticism regarding the use of "estimated" data does not address the many other bases apart from the FCRA formula on which Brazil has demonstrated that the long-term operating costs and losses of the GSM 102, GSM 103 and SCGP programmes exceed premiums paid.

### 2.3. The CCC Export Credit Guarantee Programmes Threaten to Circumvent US Export Subsidy Reduction Commitments

40. At paragraphs 295-305 of its First Submission, Brazil demonstrated that with respect to both unscheduled and scheduled commodities, the GSM 102, GSM 103 and SCGP export subsidy programmes result in, or threaten to lead to, circumvention of the United States' export subsidy commitments, in violation of Article 10.1 of the Agreement on Agriculture. For the same reason, the United States violates Article 8, which requires a Member not to provide export subsidies otherwise than in conformity with the Agreement on Agriculture and with its scheduled commitments. The threat of circumvention for scheduled commodities is further enhanced by the fact that CCC is exempt from the requirement in the FCRA that a programme receive new Congressional budget authority before it undertakes new loan guarantee commitments. Mandatory programmes like the CCC export credit guarantee programmes must be available to all eligible borrowers, without regard to appropriations limits. In an important sense, this resembles the United States' FSC regime, which the Appellate Body found is available without limit. The Appellate Body considered that the unlimited nature of the regime posed a significant threat, under Article 10.1, that the United States would surpass its agricultural export subsidy reduction commitments.

### 2.4. The GSM 102, GSM 103 and SCGP Export Credit Guarantee Programmes Constitute Export Subsidies in Violation of Item (j) and Articles 3.1(a) and 3.2 of the SCM Agreement

41. Since the CCC export credit guarantee programmes violate Articles 10.1 and 8 of the Agreement on Agriculture, the United States is not entitled to the "peace clause" exemption. Therefore, GSM 102, GSM 103 and SCGP programmes constitute prohibited export subsidies, in violation of item (j) of the Illustrative List of Export Subsidies, and of Articles 3.1(a) of the SCM Agreement.

## 3. The Step 2 Export and Domestic Subsidies Are Prohibited Subsidies in Violation of Articles 3.1(a) and 3.1(b) of the SCM Agreement

42. The United States asserts that all US upland cotton is eligible to receive Step 2 payments and that this removes the export and local content contingency. Brazil refutes the US assertion both as a

matter of law as well as fact. The Step 2 export provisions are not, as the United States now argues, simply domestic support payments made to US producers of upland cotton. Brazil again emphasizes that the *US – FSC* and *Canada – Aircraft* Appellate Body decisions are relevant jurisprudence and apply to the facts of the two situations set out in the regulations to Section 1207(a) of the 2002 FSRI Act. Thus, even if all US production since 1990 or even during MY 1999-2002 received Step 2 payments – which the United States has failed to document with any data – it would not remove the export and local content contingencies mandated by those regulations that violate SCM Agreement Articles 3.1(a) and (b).

43. US domestic Step 2 subsidies are prohibited local content subsidies in violation of Article 3.1(b) of the SCM Agreement. There is no explicit derogation of Article 3.1(b) built into the Agreement on Agriculture. The United States argues that there is an inherent conflict between Annex 3, paragraph 7 and Article 6.3 of the Agreement on Agriculture with Article 3.1(b) of the SCM Agreement because in the view of the United States, there can be no payments to processors of agricultural products included within AMS that do *not* violate Article 3.1(b) of the SCM Agreement. Brazil demonstrates that this is not true and that there are subsidies to agricultural processors that do not violate Article 3.1(b) and presents various examples to that respect.

44. Finally, Brazil notes the EC argument that applying Article 3.1(b) of the SCM Agreement "would lead to stricter disciplines being applied to domestic subsidies than are applicable for industrial goods". Local content subsidies – whether for agricultural and industrial products – are prohibited by Article 3.1(b). As "prohibited" subsidies, they are subject to the ultimate discipline – they cannot legally exist. The two packages of disciplines for agricultural and industrial products have both been negotiated during the Uruguay Round. The resulting rules have to be interpreted according to the customary rules of treaty interpretation as contained in the *Vienna Convention*. This interpretation results in agricultural local content subsidies being prohibited. Whether that results in there being more or less strict disciplines than would be applicable to industrial subsidies is not a relevant consideration for the interpretation of the disciplines.

### 4. The ETI Act Subsidies Violate Articles 10.1 and 8 of the Agreement on Agriculture and Are Prohibited by Articles 3.1(a) and 3.2 of the SCM Agreement

45. Brazil has made a *prima facie case* with respect to its claims against the ETI Act. Brazil challenges exactly the same measure based on the same claims asserted by the EC that the panel and the Appellate Body in *US – FSC (21.5)* held to violate the Agreement on Agriculture and the SCM Agreement. The sole difference is that Brazil limits its claims to ETI Act subsidies benefiting the export of upland cotton only.

# ANNEX D-2

## EXECUTIVE SUMMARY OF THE REBUTTAL SUBMISSION OF THE UNITED STATES

### Introduction and Overview

1. The comparison under the Peace Clause proviso in Article 13(b)(ii) must be made with respect to the support as "decided" by those measures. In the case of the challenged US measures, the support was decided in terms of a rate, not an amount of budgetary outlay. The rate of support decided during marketing year 1992 was ***72.9 cents*** per pound of upland cotton; the rate of support granted for the 1999-2001 crops was only ***51.92 cents*** per pound; and the rate of support that measures grant for the 2002 crop is only ***52 cents*** per pound. Thus, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.[1]

2. Brazil has claimed that additional "decisions" by the United States during the 1992 marketing year to impose a 10 per cent acreage reduction programme and 15 per cent "normal flex acres" reduced the level of support below 72.9 cents per pound. However, the 72.9 cents per pound rate of support most accurately expresses the revenue ensured by the United States to upland cotton producers. Even on the unrealistic assumption that these programme elements reduced the level of support by 10 and 15 per cent, respectively (that is, the maximum theoretical effect these programme elements could have had), the 1992 rate of support would still be ***67.625*** cents per pound, well above the levels for marketing years 1999-2001 and 2002.

3. Although such a comparison would not conform to the text, the result of the Peace Clause comparison is no different if one compares the support via an Aggregate Measurement of Support calculation. Using the price gap methodology (as provided under Annex 3 of the Agriculture Agreement) for US price-based deficiency payments and marketing loan payments, the upland cotton Aggregate Measurement of Support (in US $, millions) for these years is MY1992: 1,079; MY1999: 717; MY2000: 484; MY2001: 264; MY2002: 205. Again, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

4. Finally, the analysis presented by Brazil's expert at the first panel meeting actually supports the United States, not Brazil. Removing the non-product-specific support that Brazil erroneously tries to pass off as support to upland cotton, Brazil's own expert calculates the total support per unit

[1] Brazil has asserted that the United States' approach does not provide any way of taking Step 2 payments into account. Because the availability of Step 2 payments is contingent on certain price conditions existing during the marketing year, the level of support decided must relate to the payment parameters. These have remained the same for Step 2, with the exception of the suspension, through 2006, of the 1.25 cent price difference threshold and payment availability at slightly higher market prices. However, because Step 2 merely provides an alternative avenue of providing support (through processors rather than directly to producers), these minor adjustments do not alter the revenue ensured for producers by the marketing loan rate of 52 cents per pound. In addition, these minor adjustments cannot overcome the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002. Similarly, and without prejudice to whether these measures are within the Panel's terms of reference, we note that cottonseed payments in 1999, 2000, and 2002 ranged in value between 0.6 to 2.3 cents per pound (factoring expenditures over production); thus, they too do not materially affect the comparison between marketing year 1992 and any other year.

(cents/lb.) as MY1992: 60.05; MY1999: 53.79; MY2000: 55.09; MY2001: 52.82; MY2002: 56.32. Again, in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

5. Thus, whether gauged via the rate of support decided by US measures (whether or not adjusted for the acreage reduction programme and normal flex acres), *or* via the AMS for upland cotton (calculated through a price gap methodology), *or* via the calculations of Brazil's expert (limited to product-specific support), the result is exactly the same: in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

**US Green Box Measures are "Exempt from Actions" Pursuant to Article 13(a)(ii)**

6. A measure shall be deemed to meet the "fundamental requirement" of the first sentence of Annex 2 if it meets the basic criteria of the second sentence plus any applicable policy-specific criteria. As suggested by the use of the word "fundamental" ("from which others are derived") and the structure of Annex 2 (that is, beginning the second sentence with the word "accordingly"), compliance with the requirement ("something called for or demanded") of the first sentence will be demonstrated by conforming to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6 through 13.

7. ***Direct Payments:*** Eligibility for direct payments under the 2002 Act is based on criteria in a "defined and fixed base period " (paragraph 6(a)) in the ordinary meaning of those terms: a base period that is "definite" (set out in the 2002 Act) and "stationary or unchanging in a relative position" (does not change in relative position for the six-year duration of the 2002 Act).

8. Paragraph 6(a) establishes that eligibility for payments under a decoupled income support measure shall be determined by clearly-defined criteria in "*a* defined and fixed base period," not "*the* base period" (as in paragraph 9 of Annex 3, which is defined in that same paragraph as "the years 1986 to 1988"). Brazil's reading of "a defined and fixed base period" would read into that text the term "unchanging", language Brazil has proposed in the ongoing WTO negotiations but is not currently found in the Agreement.

9. Annex 2, by its terms, sets out the fundamental requirement and basic and (if applicable) policy-specific criteria to which green box "*domestic support measures*" must conform. Other provisions in the Agreement similarly establish that the criteria set out in Annex 2 apply to "domestic support measures". Thus, with respect to a given decoupled income support measure, eligibility for payments must be determined by criteria in a "defined and fixed base period".

10. Brazil argues that a *new* decoupled income support measure must be based on the same base period as a previous measure if the new measure "is essentially the same" or "[i]f the structure, design, and eligibility criteria have not significantly changed." There is no provision in Annex 2 or the Agreement on Agriculture that supports Brazil's approach. It is thus irrelevant whether two decoupled income support measures are "essentially the same".

11. Brazil would read paragraph 6(b) as requiring a Member to make support available for *any* type of production; a Member could not preclude a recipient from producing certain crops.[2] While direct payments are reduced if certain crops are produced, a recipient need not produce any "type of"

[2] Brazil's reading would also seemingly require a Member to make payments even if the recipient's production was illegal – for example, the production of narcotic crops such as opium poppy or the production of unapproved biotech varieties or environmentally damaging production (for example, planting on converted rain forest or wetlands) – because, under Brazil's approach, by reducing or eliminating payments for any of these production activities, a decoupled income support measure could be understood to base or relate the amount of payment to the "type" of production undertaken.

crop in particular in order to receive the full payment for which a farm is eligible; the recipient need merely refrain from producing the forbidden fruit or vegetable. Thus, it is not any "type . . . of production . . . undertaken by the producer" that results in the full direct payment but rather production *not* undertaken by the producer – that is, *ceasing* certain production.

12. ***Production Flexibility Contract Payments:*** Production flexibility contract payments (now expired) were made with respect to farm acreage that was devoted to agricultural production in the past, including acreage previously devoted to upland cotton production. The payments, however, were made regardless of whether upland cotton was produced on those acres or whether anything was produced at all. As with direct payments, because production flexibility contract payments were decoupled from production, they met the five policy-specific criteria set out in paragraph 6 for decoupled income support measures.

13. Brazil has failed to make a *prima facie* case that US green box measures do not satisfy the fundamental requirement of Annex 2.[3] In fact, Brazil's "evidence" consists simply of selectively quoting and emphasizing conceptual and theoretical statements from the economic literature. *None of the papers Brazil cites concludes that these payments in particular, or decoupled income support measures in general, have more than "minimal[] trade-distorting effects or effects on production."*

14. The Agreement on Agriculture does not define a numerical threshold on what degree of effects will be considered "minimal[] trade-distorting effects or effects on production". However, given that *no study has found that these payments have effects on production of more than one per cent*, it would appear that direct payments have and production flexibility contract payments had no more than "minimal[] trade-distorting effects or effects on production". Thus, not only has Brazil failed to present a *prima facie* case, but the United States has affirmatively shown that these payments satisfy the fundamental requirement of the first sentence of Annex 2.

**US Non-Green Box Domestic Support Measures are not in Breach of Article 13(b)(ii)**

15. **: Peace Clause Proviso – Support was "Decided" During Marketing Year 1992 Using a Rate, Not a Budgetary Outlay**: The Peace Clause proviso requires a comparison to the product-specific support "decided" during the 1992 marketing year. A Member cannot "decide" world market prices or actual production or any other element outside a government's control. Yet Brazil would read the Peace Clause as though Members were omnipotent and could "decide" every factor influencing support.

16. Brazil lists nine different "decisions taken by the United States in relation to MY 1992 upland cotton support programmes". At least three of these "decisions" relate to the rate of support and *not a single decision relating to budgetary outlays or market prices.* Thus, Brazil's own answer confirms that the proper analysis of the support "decided" by US measures is to look to the terms of the US measures, which set a rate of support.

17. The use of the term "grant" in the Peace Clause proviso with respect to challenged measures does not compel an examination of budgetary outlays. The ordinary meaning of "grant" is to "bestow as a favour" or "give or confer (a possession, a right, etc.) formally". Thus, the use of the term "grant" would permit an evaluation of the rate of support that challenged measures "give or confer . . . formally". Members did not choose to use the word "granted" in place of "decided," and a valid

[3] If, as Brazil has argued, the first sentence is "fundamental" and has independent force, then presumably if a measure meets that "fundamental requirement", it will be deemed to be green box, irrespective of whether it meets the subordinate basic and policy-specific criteria. Thus, on Brazil's reading, if a measure does not conform to the criteria in Annex 2, it still could meet the "fundamental requirement", and the complaining party would bear the burden of proof to demonstrate a measure's inconsistency with that provision.

interpretation must make sense of that choice rather than reading it out of the Agreement. In addition, had Members intended the Peace Clause comparison to be made *solely* on the basis of budgetary outlays, they could have used that term, which is a defined term in Article 1(c) and used frequently in the Agreement.

18. **Peace Clause Proviso – "Support to a Specific Commodity" Means Product-Specific Support**: The phrase "support to a specific commodity" means "product-specific support". That the Peace Clause does not use the phrase "product-specific support" is neither surprising nor telling. The basic definition of product-specific support is given in Article 1(a), as "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product." Article 1(h) also refers to the concept but does not use the exact phrase "product-specific support"; in fact, the language this provision uses ("support for basic agricultural products") is strikingly similar to the Peace Clause proviso ("support to a specific commodity"). Neither Article 1(a) nor 1(h) *even uses the term "specific"* whereas the Peace Clause *contains all three elements of that phrase* (product, specific, and support).

**19. Brazil Simply Ignores the Definition of Product-Specific Support in the Agreement on Agriculture**: Brazil argues that certain challenged US measures are *not* "non-product-specific" and therefore must be "support to a specific commodity." Brazil focuses on the definition of "non-product-specific" support in Article 1(a) but simply fails to interpret that definition in light of the definition of product-specific support that immediately precedes it. The universe of domestic support measures under Article 1(a) consists of product-specific support and non-product-specific support; these two parts must be read together and in harmony.

20. The definition of product-specific support consists of two elements: First, the support must be provided "*for an agricultural product*," that is, the subsidy is given "in favour of" a product and not in respect of criteria not related to the product or in respect of multiple products. Second, such support is "in favour of the *producers of the basic agricultural product*", which suggests that subsidy benefits those who produce the product – that is, production is necessary for the support to be received. *Both* of these elements must be present for support to be product-specific since, should either be missing, the definition would not be satisfied.

21. The second category of support in Article 1(a) is defined as "non-product-specific support provided in favour of agricultural producers in general." The ordinary meaning of "in general" is "in general terms, generally". Non-product-specific support *cannot* be interpreted as support provided "for *an* agricultural product in favour of the *producers* of the basic agricultural product" because to do so would reduce the first half of the Article 1(a) definition to redundancy or inutility. Thus, non-product-specific support is support in favour of agricultural producers "generally" – that is, a residual category of support covering those measures that do not fall within the more detailed criteria set out in the definition of product-specific support.

22. **Counter-Cyclical Payments are Non-Product-Specific Support:** Counter-cyclical payments are non-product-specific support. The payment formula for counter-cyclical payments demonstrates that these payments are not "provided for an agricultural product" because a recipient need not currently produce upland cotton (or any other crop) to receive payment. In addition, it is not "the producers of the basic agricultural product" – that is, current upland cotton growers – that are entitled to receive the counter-cyclical payments but rather persons (farmers and landowners) on farm acres with *past histories* of producing covered commodities, including upland cotton, during the base period. Thus, counter-cyclical payments satisfy neither element of the definition of product-specific support and do not form part of the Peace Clause comparison.

23. Despite Brazil's attempts to mischaracterize the two as similar, counter-cyclical payments and deficiency payments differ in crucial respects. To receive a deficiency payment, a producer was

*required* to plant upland cotton for harvest and would be paid on the *acres planted to upland cotton for harvest* up to the maximum payment acreage. Thus, deficiency payments were support for an agricultural product (upland cotton) in favour of the *producers* of the product. By contrast, to receive the counter-cyclical payment a person with "upland cotton base acres" *need not plant for harvest or produce upland cotton* (nor any other crop nor any crop at all). Thus, counter-cyclical payments do not provide support for "an agricultural product" in favour of " the producers" of the basic agricultural product and do not form part of the Peace Clause comparison under the proviso in Article 13(b)(ii).

24. **Crop Insurance Payments Provide Non-Product-Specific Support**: Crop insurance is not support "provided for *an* agricultural product". For marketing year 2002, crop insurance payments are available to approximately 100 agricultural commodities, representing approximately 80 per cent of US area planted and greater than 85 per cent of the value of all US crops. Support which is provided to a number of crops is not "support to a specific commodity"; it is ' support to several commodities' or 'support to more than one commodity' and does not form part of the Peace Clause comparison. The United States notifies crop insurance as non-product-specific "amber box" domestic support subject to US reduction commitments. *No WTO Member has notified crop insurance programmes as product-specific*; in fact, Hungary, Canada, the EC, and Japan have notified crop insurance programmes as non-product-specific support. The United States is not aware of any other Member's crop insurance programme that has as broad product coverage as the US programme.

25. **Market Loss Assistance Payments are Non-Product-Specific Support**: As indicated in the US 1999 WTO domestic support notification (G/AG/N/USA/43), the expired market loss assistance payments were non-product-specific support. As with production flexibility contract payments, market loss assistance payments were made to persons with farm acres that previously had been devoted to production of certain crops, including upland cotton, during an historical base period. A recipient was not required to produce upland cotton or any other crop in order to receive payment, and no production was required at all. Thus, these payments are not product-specific support and would not form part of the Peace Clause proviso comparison.

26. **Direct Payments**: Were the Panel to conclude that direct payments do not conform fully to the provisions of Annex 2, direct payments would be non-product-specific support. As with counter-cyclical payments, direct payments are based on quantities of acreage that historically produced cotton, and there is no requirement to produce upland cotton (or any other crop) to receive these payments. Thus, direct payments would not be product-specific support.

27. **Production Flexibility Contract Payments**: Were the Panel to consider that these payments are within its terms of reference, the United States has explained that they would be green box support. Were the Panel to conclude further that production flexibility contract payments do not conform fully to the provisions of Annex 2, these payments would also be non-product-specific support for the reasons given with respect to direct payments. As such, they would not form part of the Peace Clause proviso comparison.

28. **Cottonseed Payments**: The Agricultural Assistance Act of 2003 and the cottonseed payment made pursuant to it is not within the Panel's terms of reference because the legislation authorizing the payments had not even been enacted at the time of Brazil's panel request, much less its consultation request. The "legal instruments" pursuant to which prior cottonseed payments were made, moreover, do not appear in Brazil's consultation or panel requests. Thus, it would appear that cottonseed payments for the 1999 and 2000 crops of cottonseed also do not form part of the Panel's terms of reference.

29. **Peace Clause Comparison – The Product-Specific AMS for Upland Cotton Also Demonstrates That Challenged US Measures Do Not Breach the Peace Clause**: The United States believes the Peace Clause compels comparing the rate of support decided by US

measures, whether or not adjusted for the acreage reduction programme and normal flex acres, with the current rate of support. Were the Panel to determine to use an Aggregate Measurement of Support calculation, however, the price gap methodology is the only appropriate one for Peace Clause purposes.

30. The price gap methodology eliminates the effect of prevailing market prices on the calculation of support. Instead, paragraphs 10 and 11 of Annex 3 designate that the support be calculated by multiplying the quantity of eligible production by the gap between the applied administered price (for example, the marketing loan rate) and the *fixed reference price* (that is, the actual price for determining payment rates for the years 1986 to 1988). Thus, by holding the reference price "fixed", support measured using a price gap calculation shows the effect of changes in the level of support (applied administered price) decided by a Member, rather than changes in outlays that result from movements in market prices that a Member does *not* control. In fact, the United States has calculated an AMS for upland cotton using the price gap methodology for both deficiency payments and marketing loan payments (marketing loan gains, certificate exchange gains, and loan deficiency payments) and using budgetary outlays for all other payments. The result is exactly the same as a rate of support comparison: in no marketing year from 1999 through 2002 is the support US measures grant in excess of the 1992 marketing year level.

**US Export Credit Guarantee Programme**

31. **The Negotiating History of Article 10.2 Reveals that the Negotiators Explicitly Deferred the Application of All Export Subsidy Disciplines on Export Credit Guarantees**: The GATT/WTO negotiating history regarding export credits and export credit guarantees in agriculture supports the US interpretation of Article 10.2. On 24 June 1991, Chairman Dunkel circulated a Note on Options in the Agriculture Negotiations requesting decisions by the principals on "whether subsidized export credits and related practices . . . would be subject to reduction commitments". Subsequently, on 2 August 1991, he circulated a proposed "Illustrative List of Export Subsidy Practices." Item (h) is explicitly "Export Credits provided by governments or their agencies on less than fully commercial terms." Similarly, item (i) is "Subsidized export credit guarantees or insurance programmes."

32. On 20 December 1991, the "Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations" was issued. Article 10.2 of the Draft Final Act states: "Participants undertake *not* to provide export credits, export credit guarantees or insurance programmes *otherwise than in conformity with* internationally agreed disciplines" (emphasis added). This draft text would clearly prohibit the use of export credit guarantees *except* in conformity with agreed disciplines. Such internationally agreed disciplines would include those contemplated by the SCM Agreement. This would be precisely the language necessary to support Brazil's reading.

33. Ironically, Brazil's interpretation would require export credit guarantees in agriculture to be subject to *greater* disciplines than any other practice addressed in the Agreement on Agriculture. Under Brazil's view, not only would export credit guarantees constitute export subsidies and be subject to *all* of the export subsidy disciplines, but Members would also be specifically obligated to work toward and then apply *additional* disciplines.

34. **Brazil's approach would result in gross injustice**: As part of the negotiations, the parties had to prepare and submit schedules of quantities and budget outlays during a base period to derive the export subsidy reduction commitments ultimately reflected in the respective schedules of the Members. Had Members' export credit guarantees been considered export subsidies for these purposes from the outset, then the export credit guarantee activity during the base period would also have to have been added to the base figures from which each Member's export subsidy reduction commitments were calculated. For example, the United States has no export subsidy reduction

commitment with respect to corn, yet during the 1986-1990 base period an average of over *5.5 million tons* of corn were exported *each year* under the GSM-102 and GSM-103 programmes. The United States would have reduction commitments for many more products than currently and would have had significantly increased commitments for the 13 products that are scheduled. However, Brazil would have the Panel impose the disciplines now but deny Members the corresponding changes in reduction commitments. Brazil's approach would be grossly inequitable and the Panel should reject it.

35. **The Application of Government-Wide Accounting Rules Indicates that the Export Credit Guarantee Programmes are Covering Long-Term Operating Costs and Losses:** The application of the Federal Credit Reform Act of 1990 ("FCRA") over time to the export credit guarantee programmes as a whole currently indicates that the net result of all activity associated with export credit guarantees issued in fiscal years 1994 and 1995 is a total net receipt to the United States of $29 million. The experience of 1994 and 1995 is viewed as representative, and the United States expects that the net results for other years will be similar to the experience for 1994 and 1995. Re-estimates thus far have resulted in a net reduction in the estimated costs of these programmes of over $1.9 *billion* since the inception of credit reform budgeting in fiscal year 1992. Based on those results, the Brazilian claim that "operating costs and losses for GSM 102, GSM 103, and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992" is not supportable.

36. The United States has gathered cumulative reestimates on a cohort basis: For example, for cohort 1992 (not yet closed) the current data reflects an estimate of a *profit* to the United States of approximately $124 million; for 1993 (not yet closed), the corresponding current figure is a *profit* of approximately $56 million; and, as indicated, cohorts 1994 and 1995 together project a *profit* of $29 million. With the exception of 2002, for which only very recent data is necessarily available, the Panel will note that the trend for all cohorts is uniformly favourable as compared to the original subsidy estimate.

37. Brazil asserts that "historically, the majority of GSM support that is rescheduled is 'in arrears'" and that this increases costs. Brazil largely relies, however, on a 1990 government report that is dated and precedes FCRA itself. No rescheduling applicable to export credit guarantees issued in fiscal year 1992 or later is in arrears.

38. **Brazil's Suggestion to Use Estimated Data to Determine Long-Term Costs and Losses Supports the View that the Export Credit Guarantees Do Not Provide Export Subsidies**: The United States notes Brazil's statement that "a certain degree of estimated data would be perfectly acceptable in an analysis of the costs and losses of guarantee programmes under item(j)" for two reasons. First, the re-estimate process for fiscal years 1994, 1995, and virtually every other year since fiscal year 1992 indicates a very strong net positive trend with respect to the programmes and that therefore current premium rates do cover long-term operating costs and losses. Second, it is relevant with respect to Brazil's reliance on the significant losses that the United States admittedly incurred with respect to Poland and Iraq. Presumably, to attempt to recover such losses in any practical time frame would require such a prohibitive fee increase that few, if any, exporters would take advantage of the program. Consequently, the United States would be whipsawed by a prohibition on the export credit guarantee as currently constituted because of the large losses incurred between 10 and 20 years ago, and the inability to create a conforming programme because the fee structure necessary to compensate for such historical losses would foreclose use of the programme. Item (j) cannot be reasonably interpreted to require an examination of all activity since the beginning of a programme, no matter how old it may be. The data provided with respect to fiscal years 1994 and 1995 and for the programmes as a whole indicates that current premium rates are presently adequate to cover long-term operating costs and losses as currently projected. The United States is also in a net positive position with respect to cotton transactions in the ten years commencing with fiscal year 1993.

39. **The Export Credit Guarantee Programmes Are Not Applied in a Manner which Results in or which Threatens to Lead to, Circumvention of Export Subsidy Commitments**: Brazil has challenged the export credit guarantee programmes, GSM 102, GSM 103, and SCGP, as such. Brazil has failed, however, to demonstrate that these programmes as such mandate a violation of US WTO obligations. It is well established under GATT and WTO jurisprudence that legislation of a Member violates that Member's WTO obligations only if the legislation *mandates* action that is inconsistent with those obligations or precludes action that is consistent with those obligations. If the legislation provides discretion to administrative authorities to act in a WTO-consistent manner, the legislation, as such, does not violate a Member's WTO obligations. This distinction has continued under the WTO system.

40. The Commodity Credit Corporation ("CCC") has complete statutory and regulatory discretion at any time not to issue guarantees with respect to any individual application for an export credit guarantee or to suspend the issuance of export credit guarantees under any particular allocation. This is in marked contrast to the situation in *US- FSC*, in which the Appellate Body found a threat of circumvention because the FSC legislation created a legal entitlement to the payment. There is no statutory legal entitlement to an export credit guarantee. Furthermore, even if an application and fee are received, the applicant is not necessarily entitled to receive the guarantee. Issuance is discretionary.

41. Finally, Brazil has alleged that the United States has exceeded its quantitative export subsidy reduction commitments during the period July 2001-June 2002. Even if the export credit guarantee programmes were deemed export subsidies, the United States would be in compliance with the quantitative reduction commitments for that period with respect to wheat, coarse grains, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, live dairy cattle, and eggs. This may also be true with respect to vegetable oil. In fiscal year 2002, it would also be true for poultry meat. The United States did not use the GSM-102 or GSM-103 programmes during 2001-2002 with respect to butter and butter oil, skim milk powder, cheese, other milk products, or eggs.

42. **Financial Arrangements Analogous to the CCC Export Credit Guarantee Programmes are Available in the Marketplace**: In light of Article 10.2, it is neither appropriate nor necessary to analyze the export credit guarantees with respect to Article 1.1(b) of the SCM Agreement. However, we note that financing is available in the marketplace that is analogous to export credit guarantees. A prominent example in the commercial market would be "forfaiting." It would appear, then, that a competitive marketplace exists for trade financing even in emerging markets where more conventional financing is not available. The United States is not privy to the precise terms at any time available in forfaiting transactions because those terms can vary by country, commodity, bank risk, size of transaction and numerous other factors. In addition, like most private financial activity, that information is ordinarily held confidentially by the parties.

**The Step 2 Programme is not Contingent on Export Performance**

43. Brazil apparently does not contest that all uses of upland cotton are eligible for the Step 2 subsidy. Instead, Brazil suggests, erroneously, that not the entire universe of users of upland cotton is eligible for the subsidy. First, the requirement that a recipient must be "regularly engaged" in the use of cotton is simply an anti-fraud provision to preclude an attempt to receive a payment with respect to cotton on which a payment has already been made. Brazil also correctly notes that "the eligible domestic user criteria exclude all firms that are domestic cotton brokers or simple resellers". These parties are not using the cotton and are therefore ineligible. Brazil suggests a third category of persons who are users but are not eligible to receive the payment: "firms that have not entered into CCC contracts" as either manufacturers or exporters. It is true that CCC cannot pay parties that

choose to remain unknown to it, but this requires an assumption of economic irrationality and does not diminish the point that all who use cotton have it entirely within their power to receive the subsidy.

# ANNEX D-3

## BRAZIL'S COMMENTS ON US REBUTTAL SUBMISSION

27August 2003

1. Pursuant to the Panel's ruling of 23 August 2003, Brazil presents the following comments on the paragraphs listed below relating to the Rebuttal Submission of the United States of America. In addition, Brazil offers comments on Question 67a posed to the United States by the Panel's Communication of 25 August 2003.

**Paragraph 43**

2. In paragraph 43 of its Rebuttal Submission, the United States argues that "Brazil's reading would seemingly require a Member to make payments even if the recipient's production was illegal, for example the production of narcotic crops such as opium poppy or the production of unapproved biotech varieties or environmentally damaging production." The United States claims this would have "potentially far reaching results." This new argument has no merit.

3. The two examples provided by the United States involving the growing of illegal plants/crops are, by definition, situations in which a national (or state/regional) domestic criminal (or civil) law would prohibit or regulate the growing of such plants/crops. The criminal (or civil) law would operate separately from any de-coupled direct payment to prohibit or regulate all forms of such production. There would be no reason in that situation to have a further statute limiting the payment if such illegal plants (or illegal production methods) – the activity would already be illegal. That is exactly the case with the 1996 FAIR Act and the 2002 FSRI Act regarding PFC and direct payments respectively. Neither limits the amount of payments for the growing of plants that would be illegal under US law. There is no need to because US federal and/or State law already prohibits such activity.

4. In addition, the US example in paragraph 43 about a restriction on "environmentally damaging production" is not relevant because such a restriction does not relate to the "type" of production (*i.e.*, the type of crop) but rather the "manner" of production.[4] Therefore, Annex 2, paragraph 6(b), which focuses on the "type" of production related to the "amount" of payment, it does not address the manner in which production is conducted. The context of Annex 2, paragraph 6(b) includes Annex 2, paragraph 12 ("Payments under environmental programmes") which permits Members to impose specific conditions on the growing of crops in order to receive environmentally related direct payments.

5. Thus, the "potentially far-reaching results" [5] from Brazil's text-based approach to the ordinary meaning of "the amount of such payments" related to or based on the "type of production " do not and

[4] *See* First Submission of Brazil, para. 157 in which Brazil makes the distinction between Paragraph 6(b) in which the word "type" relating to the type of crop produced contrasted with Paragraph 6(d) which is concerned with the type of production process. The United States has never contested this distinction.

[5] The United States reference to "potentially far-reaching results" appears also to include its additional new argument in paragraph 43 relating to the EC's possible CAP reform imposing, *inter alia*, fruits and vegetable restrictions. That potential "reform" is obviously not at issue in this case. The EC will have to make a decision how to notify any such measure when it is required to do so under Article 18 of the Agreement on Agriculture. It goes without saying that an improperly categorized green box measure of one Member cannot be justified by relying on a possible future improperly categorized green box measure of another Member.

will not exist. Brazil further notes that in the extraordinary situation in which one Member could theoretically seek to challenge a de-coupled direct payment limiting payments for growing plants such as opium poppy as an actionable subsidy, the Member restricting the "type" of production of such plants could, for instance, assert defences under Article XX(b) or (d) of GATT 1994.[6]

**Paragraphs 96-98**

6. The United States raises the new argument that "no other WTO Member has notified crop insurance programmes as product-specific."[7] At the outset, Brazil notes that it is the US crop insurance programmes and the detailed record of the product-specific nature of the US crop insurance programmes that is at issue in this dispute – not those of other WTO Members.

7. None of the WTO notifications of the EC, Canada, or Japan cited by the United States reflect the existence of the type of special product-specific policies or special treatment for certain crops within a broader insurance programme. In particular, there is no indication that these Members provide any specific crop insurance provisions for a specific crop, such as the insurance programmes provided by the United States for upland cotton.[8] For example, while Canada appears to have a similar programme for "crops" as the United States, there is no indication that Canada provides special polices or groups of policies within its broader programme for individual crops. Thus, in contrast to the evidence of other Member's insurance policies, the *nature, type, value,* and *participation rate* of the crop insurance policies provided by the United States differs widely among commodities. As Brazil has explained, it is simply not a "one size fits all" programme. The EC agrees. It has argued before the Committee on Agriculture that the US crop insurance programme is product-specific support.[9]

8. The United States further argues that it "is not aware of any crop insurance programme maintained by any other Member" that covers as many commodities as the United States.[10] However, the Article 13(b)(ii) test is whether a specific commodity receives support from a domestic measure identified in the *chapeau* and whether there is some sort of a link between the support measure and the specific commodity. Evidence of such a link in the case of crop insurance exists, as with the US crop insurance programme, when particular commodities are provided special policies, coverage, or additional subsidies compared to other commodities covered by the crop insurance programme. There is no such evidence reflected in the notifications of Mexico whose notification states that "insurance premium subsidy [is] available for all producers."[11] Japan's "Agricultural Insurance Scheme" also includes subsidies for policies covering all crops (except vegetables), all livestock (except poultry) and sericulture.[12] By contrast, the US insurance programmes challenged by Brazil do not provide subsidies for any insurance for livestock or many other commodities. Indeed, the commodities *not* covered by the US 2000 ARP Act and relevant regulations represent more than half of the value of US farm cash receipts.[13]

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[6] These same exceptions would be available in the unlikely event a Member challenged a direct de-coupled payment for any of the three scenarios posed by the United States in paragraph 43.

[7] Rebuttal Submission of the United States, para. 96-98.

[8] *See* Rebuttal Submission of Brazil, paras 54 (special irrigation-related policies for upland cotton), para. 55 (upland cotton producers have much larger pool of insurance subsidies than other types of crops), para. 56 (specific upland cotton income protection policies and catastrophic risk protection), para 57 (much greater use of insurance subsidies than other crops), para. 58 (reinsurance payments for upland cotton).

[9] Exhibit Bra-144 (G/AG/R/31, para. 31).

[10] Rebuttal Submission of the United States, para. 98.

[11] G/AG/N/MEX/7, p. 4.

[12] Rebuttal Submission of the United States, para. 98.

[13] Rebuttal Submission of Brazil, para. 59 (Excluded agricultural commodities from US insurance programme represent 52 per cent of the value of all US farm cash receipts).

9. Finally, as the United States recognizes, more than half of the notifications (which include part of Japan's) cited by the United States refer to insurance programmes as green box support.[14] Members so notifying are not obliged to make a determination under Article 6 of the Agreement on Agriculture whether such support is product-specific or not because it is exempt from any reduction commitments. The United States has not provided evidence suggesting these green box categorizations are incorrect. For these reasons, these notifications are also irrelevant.

**Paragraphs 114-117**

10. The United States argues for the first time in paragraphs 114-117 of its Rebuttal Submission that using the "price-gap" methodology is the appropriate way to calculate the portion of upland cotton AMS that stems from marketing loan gains, certificate exchange gains, and loan deficiency payments (collectively known as "marketing loan payments"). The effect of applying the price gap methodology would be to transform the $2.5 billion in budgetary expenditures for marketing loan payments in MY 2001 into a "negative" amount for purposes of total current AMS.[15] The United States bases its new argument on an alleged statement by Brazil and "agrees" that "Brazil is correct when it states that a non-exempt direct payment dependent on a price gap may be calculated using a price gap methodology, rather than budgetary outlays. . .."[16]

11. The United States refers to Brazil's 11 August Answer to Question 67, paragraph 130, as the basis for its assertion. Brazil's statement cited by the United States reads as follows:

> Brazil notes that the United States has notified the deficiency payments using the price gap methodology provided for in Annex 3. [footnote citing Exhibit Bra-150 (G/AG//N/USA/10)] Brazil considers it appropriate to follow the US decision and will therefore, calculate the amount of support to upland cotton provided by the deficiency payment programme by using the "price gap" approach detailed in Annex 3 paragraph 10 and 11.

Contrary to the US interpretation of this statement, Brazil's point was that any calculation of AMS for deficiency payments (and for the other programmes that require such calculation) must be consistent with the actual choice of methodology originally made by the United States for calculating its domestic support reduction commitments as well as its yearly current AMS notifications. Indeed, the United States' entire argument in paragraphs 114-117 of its Rebuttal Submission is based on the alleged obligation for Brazil "to be consistent."[17] As demonstrated below, it is Brazil's AMS calculation, not that of the United States, that is "consistent."

12. Members are required to notify annually their current total AMS to provide other Members the opportunity to review the consistency with their domestic support reduction commitments pursuant to Article 6.3 of the Agreement on Agriculture.[18] The total AMS reduction commitments were negotiated during the Uruguay Round based on a calculation of "total AMS" provided in marketing years 1986-1988. The initial AMS calculation used for the purposes of the reduction commitments was performed pursuant to Annex 3 of the Agreement on Agriculture with Members choosing either budgetary expenditures or a "price-gap" methodology expressed in total monetary terms. Like Article 13(b)(ii), the comparison between *current* total AMS and the AMS ceiling, *i.e.*,

[14] Rebuttal Submission of the United States, para. 97.

[15] The United States even claims credit for being conservative by not netting the negative support by the marketing loan benefits against the positive support provided by the other domestic support programmes, Rebuttal Submission of the United States, para. 116 and note 148.

[16] Rebuttal Submission of the United States, para. 114.

[17] Rebuttal Submission of the United States, para 114 (last sentence).

[18] *See* Article 18.2 of the Agreement on Agriculture and various US notifications cited herein.

the reduction commitment, must allow for an "apples to apples" annual comparison in accounting for the same measures. It follows that once a Member uses a budgetary approach for one measure to establish the AMS ceiling, it cannot use a price gap approach for that same measure in calculating total *current* AMS. Instead, a Member is required to report *current* total AMS consistently with the choice it made for that particular type of support in its *original* total AMS calculation.

13. This interpretation of Annex 3 and Article 6.3 of the Agreement on Agriculture is consistent with its context and object and purpose. Opting for a methodology that would permit Members to change their original methodology (*i.e.*, from budgetary to price-gap) could sanction what the United States proposes – the covering up of billions of dollars of marketing loan payments (originally calculated on a budgetary basis) and turns them into "negative support" by using a "price-gap" formula. This would be inconsistent with the entire reason for the reduction commitments of Article 6 of the Agreement on Agriculture.

14. Brazil's calculation of AMS for, *inter alia*, marketing loan payments followed the actual decision of the United States during the Uruguay Round[19] as reflected in its notifications.[20] During the Uruguay Round, the United States calculated the upland cotton portion of what would eventually become its domestic support reduction commitment by using the following methodologies: it used the price gap formula for upland cotton deficiency payments[21] and used budgetary outlays for all other domestic support measures.[22] In its MY 1995 notification to the Committee on Agriculture the United States similarly notified deficiency payments using the price-gap formula and using budgetary outlays for all other domestic support measures subject to reduction commitments[23] consistent with its AMS calculation during the Uruguay Round. After the termination of the deficiency payment programme in 1996, all later domestic support (current total AMS) notifications of the United States for upland cotton only use budgetary outlays. Thus, Brazil's approach to calculating upland cotton AMS for MY 1992 and 1999-2002 is entirely consistent with the US approach as evidenced in its domestic support notifications[24] and with the US obligations under the Agreement on Agriculture.

15. The United States accounted for the marketing loan payments in the same manner as in its notifications when it answered Question 67 in its 11 August submission.[25] This is, furthermore, the methodology the Panel indicated the United States should use – referring to the US notification of MY 1999 domestic support in G/AG/N/USA/43, in which the United States – in line with its obligation – used budgetary outlays.[26]

16. In sum, like many other US arguments in this phase of the dispute, this US argument is designed to cover-up expenditures and support to upland cotton that increased significantly since the US Uruguay Round commitments came into effect. Therefore, the Panel should reject it.

[19] Exhibit Bra-191 (G/AG/AGST/USA, p. 20)
[20] Exhibit Bra-150 (G/AG/N/USA/10, p. 18)
[21] Exhibit Bra-191 (G/AG/AGST/USA, p. 20 and supporting tables on p. 21-22).
[22] Exhibit Bra-191 (G/AG/AGST/USA, p. 20).
[23] Exhibit Bra-150 (G/AG/N/USA/10, p. 18).
[24] The United States entire argument in paragraphs 114-117 is premised on the alleged need for Brazil "to be consistent" as stated in the last sentence in paragraph 114. As noted, it is Brazil who has been consistent in using actual US notifications and the US calculation method during the Uruguay Round, not the United States who now seeks to ignore them.
[25] US 11 August Answer to Question 67, para. 128-134.
[26] Exhibit Bra-47 (G/AG/N/USA/43, p. 20).

**Paragraphs 124-127 and Exhibit US-24**

17. The United States presents an additional critique of Professor Sumner's analysis in Exhibit US-24 prepared by Dr. Joseph W. Glauber, the Deputy Chief Economists of USDA, as well as in paragraphs 124-127 of its Rebuttal Submission.

Marketing Loan Benefits

18. Dr. Glauber notes that the analysis of Professor Sumner did not include in the upland cotton acres eligible for marketing loans 447,164 acres of upland cotton planted on Flex acres from other programme crops.[27] Dr. Glauber is correct that any such acreage would be eligible for receiving marketing loan payments and therefore should be included in the calculation.[28] Dr. Glauber refers to "Acreage Reduction compliance reports" as his source of this number. Dr. Glauber does not provide a citation for these compliance reports and the United States has not made them available to Brazil. Therefore, Brazil cannot confirm the actual number of acres. Brazil also notes that the number listed is planted acres not harvested acres.[29]

19. Dr. Glauber further rests his finding that 100 per cent of US upland cotton production in MY 1992 benefited from marketing loan payments on his statement that upland cotton farmers "often" report land that had been planted and abandoned as land left idle and therefore never planted. No citation, authority or reference is provided for this assertion. The assumption in this assertion is that farmers report one thing to the US Federal Government, yet actually do something else. Thus, Dr. Glauber's presumption appears to be that farmers engage in what would appear to be widespread misrepresentation. Brazil does not know if such assumed large-scale misrepresentations were legal under the 1992 US programme, but it certainly contradicts "programme" expectations.

20. Professor Sumner concluded that 1.99 million acres used to produce upland cotton in MY 1992 were not eligible for the marketing loan payments because they did not participate in the deficiency programme. Dr. Glauber confirms Professor Sumner's general approach on non-participating acreage in footnote 1 on page 2 where he acknowledges that "some base building occurred during the early 1990's." What this means is that a substantial amount of upland cotton must have been planted outside the programme to accommodate expansion of upland cotton base by 200,000 acres in 1993, as identified by Dr. Glauber. This acknowledgement supports Professor Sumner's analysis that a significant amount of upland cotton must have been grown *outside* the deficiency programme. The basis for this analysis is as follows:

21. Under the rules existing in MY 1992, in order to "build" base a farm was required to plant all of its upland cotton outside the programme.[30] The expansion of upland cotton base is equal to one-

[27] Exhibit US-24, p. 1.

[28] Neither Brazil nor Professor Sumner were aware of any flex acres from other programme crops planted to upland cotton or of data concerning any such plantings.

[29] Dr. Glauber raises in the first sentence of paragraph 2 what he called "statistical problems in comparing planted acres to programme acres." He points out that "planted acres" information was collected and reported by NASS, while "programme acres" are reported by the Farm Service Agency. (In 1992 this part of USDA was known as the Agricultural Stabilization and Conservation Service.) Dr. Glauber goes on to explain that a significant amount of cotton acreage is planted and abandoned each year. But the relevance of this information in critiquing Professor Sumner's analysis remains unclear. Brazil notes that contrary to Dr. Glauber's assumption, Professor Sumner's calculations do *not* rely on data published by NASS, but instead on published information in the Farm Service Agency's "Fact Sheet: Upland Cotton" (Exhibit Bra-4). This Farm Service Agency source provides data on planted acres, the abandonment rate as well as harvested acres of upland cotton for MY 1992.

[30] Exhibit US-3 (7 CFR 1413.7(c)). ("[T]he crop acreage base shall be equal to the average of the acreage planted and considered planted to such crop for harvest on the farm in each of the 3 crop years

third of the amount of additional cotton acres planted in each of the previous three years. An acre of base is added if an additional acre of cotton is planted for three consecutive years.[31] In order to plant more than the current base, a farm was required to leave the programme *altogether* so that current base acres would also be planted outside the programme. For example, assume a farm had 1000 acres of upland cotton base and wanted to add – over the two-year period 1991-1992 – 200 acres of base by 1993. That farm would withdraw from the programme for those two years and plant 1300 acres of cotton (300 acres more than the previous base) in 1991 and 1992. The 1993 upland cotton base would than be calculated as follows: (1000 acres + 1300 acres + 1300 acres) / 3 equalling 1200 acres, thus 200 acres more than previously. Therefore, to add the 200,000 acres of base in 1993 (which Dr. Glauber stated were actually added) a much larger amount of upland cotton would have been required to be planted *outside* the programme in 1992. In addition to building of additional base, farmers planted upland cotton outside the programme because they did not comply with payment limit rules and for some more idiosyncratic reasons.

22. In summary, the evidence of an expanding base is consistent with the assessment of Professor Sumner that a substantial amount of acreage was planted to upland cotton outside the programme. This evidence is not consistent with Dr. Glauber's undocumented or unsubstantiated claim that *all* upland cotton harvested was eligible for marketing loans.

23. To summarize, if the Panel were to accept the undocumented assertion by Dr. Glauber that 447,164 acres of cotton were planted on flex acres from other programme crop base acreage, then there would be 1.54 million acres (1.99 million acres – 0.45 million acres) that were planted to upland cotton but were not eligible for marketing loan payments. This 1.54 million represents 12 per cent of planted acreage.[32] Thus, adjusting 52.35 cents per pound by 0.88 results in a support from the marketing loan programme of 46.1 cents per pound. This is an increase of 1.76 cents over the marketing loan level of support set forth in Appendix Table 1 to Professor Sumner's 22 July 2003 Statement.

Deficiency Payments

24. Brazil has already rebutted the US argument that it is inappropriate to adjust the support provided by the deficiency payment programme by non-participation and the resulting non-eligibility to receive payments.[33]

25. The various "decisions" in MY 1992 with respect to the deficiency payment programme were calculated to establish rules that encouraged some producers to forego eligibility of the programme. Furthermore, the record establishes that US policy makers had relatively precise prior knowledge of how many acres would remain out of the programme based on their policy choices on required land idling and loan rates.[34]

26. Dr. Glauber criticizes Professor Sumner for relying on a programme yield of 531 pounds per acre to calculate the ratio of payment yield to expected yield and states that the true programme yield

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preceding such crop year"). For a farmer within the programme the acreage could never change, as all the acreage was planted (or if idled or – in case of flex acreage – if planted to other crop, it was "considered" planted to upland cotton). Thus, an increase of acreage could only take place, if a farmer withdrew from the programme and exceeded the planting limits imposed by the programme. Thus, MY 1992 base acreage is constitutes the 3-year average of acreage planted and considered planted in MY 1989-1991.

[31] Or of 3 additional acres are planted in the previous year, among other possible constellations.

[32] *Compare* Annex 2 to Exhibit Bra-105, p. 3.

[33] Brazil's 22 August Comment on Question 66, para. 81.

[34] Brazil's 22 August Comment on Question 66, para. 81.

in MY 1992 was 602 pounds per acre.[35] Dr. Glauber references a USDA press release that is not available to those outside the US government as his source of the payment yield information.[36] Assuming that the figure of 602 pounds per acre used by Dr. Glauber is correct, he incorrectly continues to rely on Professor Sumner's calculation of the expected yield by stating that the "expected yield based on an average of the upland cotton yields over the five preceding crop years is 601 pounds per acre." Professor Sumner estimated the payment yield based on actual yields per *planted* acre, whereas the payment yields that Dr. Glauber cites appears to be the approximate average yields per *harvested* acre. To achieve an apples-to-apples comparison, Brazil has re-calculated the expected yield for MY 1992 as the average yield per *harvested* acre during the 1990 to 1994 based on USDA's "Fact Sheet: Upland Cotton" (656.4 pounds per acre).[37] Thus, the relevant adjustment factor is not 1.002 as suggested by Dr. Glauber, but 0.917 (603 / 656.4).

27. Dr. Glauber offers no critique of Professor Sumner's analysis of the mandatory land idling cost component in the calculation of deficiency payment support. However, Dr. Glauber neglected to include these costs associated with the participation in the programme. As Professor Sumner explained, such costs are properly subtracted from the gross benefits of the cotton deficiency payment programme.

28. Brazil provides a revised calculation below, taking account of the revised yield adjustment factor of 0.917 – reflecting the deficiency payment yield as provided by Dr. Glauber's and the expected comparable yield for MY 1992 that Dr. Glauber erroneously did not correct. In addition, Brazil continues to deduct the cost figure calculated by Professor Sumner from the deficiency payment programme. The revised formula is as follows:

> Deficiency payment support = 20.55 cents per pound * 0.75 * 0.917 – 0.84 cents per pound = 13.29 cents per pound

Using the new payment yield and the new expected yield that is comparable to it, results in a 0.04 cents per pound upward adjustment to the 13.25 cents per pound presented by Professor Sumner in his 22 July Statement.

Other Payments

29. Brazil has already responded at length to Dr. Glauber's claims endorsing the arguments of the United States that PFC, market loss assistance, direct and CCP payments, as well as crop insurance payments are not "support to" upland cotton. Dr. Glauber's statement simply restates assertions in the legal briefs of the United States and offers no economic analysis to support his assertions.

30. Dr. Glauber asserts that it is relevant that Step 2 payments are not paid directly to producers.[38] As Brazil explains in its 11 August Answer to Question 18, a basic principle is that the effect of a subsidy is independent of who initially receives the subsidy.[39] That is the economic common sense behind the United States notifying Step 2 payments as product-specific support to upland cotton. And it is the basis for including such payments as "support to a specific commodity" "decided" by a

[35] Exhibit US-24, p. 3.

[36] The United States has not made this document available and thus we are unable to evaluate its applicability to the current situation. Professor Sumner had relied on the best information available to him and Brazil, which was the average upland cotton yield per planted acre during the reference period of MY 1981-1985.

[37] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[38] Exhibit US-24, p. 3.

[39] Exhibit Bra-140 (Pindyck, Robert S. and Rubinfeld, Daniel L. , *Microeconomics*, 5th edition (2002), Prentice Hall, New Jersey, p. 313-317).

Member with respect to MY 1992. The text of Article 13(b)(ii) requires, under any methodology, the calculation of a level of support *to upland cotton*, not *to producers* of upland cotton.

31. Dr. Glauber's assertions about "double counting" are also incorrect. All the support programmes Dr. Glauber discusses (marketing loan payments, CCP payments and deficiency payments) have production and trade effects largely independent of Step 2 payments. But the purpose of calculating a rate of support under Article 13(b)(ii) is not to assess the *amount* of production, export, and price effects of the simultaneous application of all measures of support. Brazil will present an equilibrium analysis of the full economic effects of these support programmes simultaneously for Brazil's "Further Submission." Such an analysis is, however, not required for the purposes of calculating the rate of support under Article 13(b)(ii). The fact that the United States notified Step 2 as "product-specific" support indicates its position that the Step 2 programme provides additional support to upland cotton. This has certainly been the strongly held view of the US National Cotton Council.[40] Thus, it was appropriate for Professor Sumner to include this production and trade-distorting subsidy in the total rate of support.

32. Brazil notes that Dr. Glauber does not criticize any other calculation made by Professor Sumner. For the convenience of the Panel, Brazil reproduces the chart containing Professor Sumner's calculation as amended following the detailed US critique of Professor Sumner's methodology. As the Panel will note, the results do not materially change. The support granted by the United States in MY 1999-2002 exceeds the support decided in MY 1992. Thus, even under this methodology, the United States does not enjoy peace clause exemption from actions based on Articles 5 and 6 of the SCM Agreement or Article XVI:1 of GATT 1994.

| Year | 1992 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| | (Cents per pound) | | | | |
| **1. Marketing Loan** | 46.10 | 50.36 | 50.36 | 50.36 | 52.00 |
| **2. Deficiency Payments** | 13.29 | na | na | na | na |
| **3. Step 2** | 2.46 | 2.46 | 2.46 | 2.46 | 3.71 |
| **4. Crop Insurance** | 0.36 | 2.00 | 2.00 | 2.62 | 2.62 |
| **5. PFC Payments** | na | 6.13 | 5.70 | 4.65 | na |
| **6. Market Loss** | na | 6.10 | 6.07 | 6.42 | na |
| **7. Direct Payments** | na | na | na | na | 5.31 |
| **8. CCP Payments** | na | na | na | na | 10.65 |
| **9. Cottonseed Payments** | 0.00 | 0.97 | 2.27 | 0.00 | 0.61 |
| **10. Total Support** | **62.21** | **68.03** | **68.87** | **66.51** | **74.91** |

**Paragraphs 135-146, and Exhibits US-25 through US-29**

33. Brazil has demonstrated that under the ordinary meaning of Article 10.2 of the Agreement on Agriculture, in its context and according to the object and purpose of Article 10 and the Agreement on Agriculture overall, export credit guarantees are subject to the general export subsidy disciplines contained in that Agreement.[41] Article 10.2 announces Members' intent to work toward negotiations

[40] Brazil Rebuttal Submission, para. 127.

[41] *See* Brazil Statement at the First Panel Meeting, paras. 100-115; Brazil 11 August Responses to Panel Questions 70 (para. 138); Brazil 22 August Rebuttal Submission, paras. 99-100; Brazil 22 August Comments on Answers to Panel Questions 74 (paras. 89-90), 80 (para. 98), 88(b) (paras. 117-119).

on specific disciplines for export credits. In the meantime, the general disciplines on export subsidies included in the Agreement on Agriculture apply to export credits, if those export credits constitute export subsidies.[42]

34. The United States asserts that Article 10.2 carves out export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture, including the anti-circumvention provisions of Article 10.1. The Appellate Body has, however, concluded that to exempt or carve-out particular categories of measures from general obligations such as the export subsidy obligations in the Agreement on Agriculture, the exemption or carve-out must be *explicit* in the text of an agreement.[43] Article 10.2 includes no such explicit carve-out or exemption. The negotiators knew how to make such an exemption or carve-out explicit, as evidenced by, for example, Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.[44]

35. In support of its interpretation, the United States appeals to "subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation," within the meaning of Article 31(3)(b) of the *Vienna Convention*.[45] According to the United States, negotiations on agricultural export credit issues that have taken place in the OECD subsequent to the effective date of the WTO Agreement, and a statement by the OECD Secretariat, constitute "subsequent practice" establishing the agreement of WTO Members that Article 10.2 of the Agreement on Agriculture exempts export credits from any and all disciplines.

36. The United States is wrong. The United States has not established "a 'concordant, common and consistent' sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties [to a treaty] regarding its interpretation," which is the standard adopted by the Appellate Body to establish "subsequent practice" under Article 31(3)(b) of the *Vienna Convention*.[46] It is evident from the positions taken by Canada, the European Communities and New Zealand in this dispute that *not even those WTO Members that participated in the OECD negotiations* agree with the United States' interpretation of Article 10.2.[47] Nor is there any evidence of "subsequent practice" signifying agreement on the United States' interpretation amongst the 136 WTO Members that did not participate in the OECD negotiations.

37. Brazil notes, moreover, that the WTO Secretariat, which is in a better position to address interpretations of the covered agreements than is the OECD Secretariat, does not appear to agree that

[42] Export credit guarantees are not *per se* subject to these disciplines, as they would be if they were included in Article 9.1 of the Agreement on Agriculture (*See e.g.*: Brazil's 22 August Comment, para. 97, New Zealand's Answer to Third Party Question 35, EC's Answers to Third Party Questions 35, para. 70). Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes constitute export subsidies under Articles 1(e) and 10.1 of the Agreement on Agriculture, under Articles 1.1 and 3.1(a) of the SCM Agreement, and under item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement.

[43] Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128. *See* discussion at paragraphs 107-108 of the Oral Statement of Brazil.

[44] Oral Statement of Brazil, paras. 105-106.

[45] Rebuttal Submission of the United States, para. 135.

[46] Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 213; Appellate Body Report, *Japan – Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 107.

[47] *See* Third Party Submission of Canada (paras. 51-54); Third Party Submission of the European Communities (paras. 28-31); Third Party Submission of New Zealand (paras. 3.13-3.16).

agricultural export credits are exempt from the general export subsidy disciplines of the Agreement on Agriculture by virtue of Article 10.2.[48]

38. The United States also argues that the negotiating history of Articles 9.1 and 10.2 of the Agreement on Agriculture supports its argument that export credit guarantees are exempt from the general export subsidy disciplines of the Agreement on Agriculture. The United States raises three arguments in this regard.

39. *First*, the United States addresses the negotiating history of Article 9.1.[49]

40. In the DeZeeuw framework agreement, the United States points to paragraph 20(e), which contemplated Members providing "data on financial outlays or revenue foregone . . . in respect of export credits provided by governments or their agencies on less than fully commercial terms."[50] The United States apparently considers that since paragraph 20(e) was not carried over into the Agreement on Agriculture, export credits are not subject to the export subsidy disciplines in the Agreement.

41. Brazil notes, however, that paragraph 20(g) addressed "export performance-related taxation concessions or incentives." This provision was also not carried over into the Agreement on Agriculture. Nonetheless, panels and the Appellate Body have ruled that export performance-related taxation concessions or incentives like the United States' FSC and ETI measures are subject to the general export subsidy disciplines of the Agreement on Agriculture, including Article 10.1.

42. Similarly, the United States points to Addendum 10 of Chairman Dunkel's Note on Options, which includes an illustrative list of export subsidy practices.[51] A number of the items on that illustrative list were eventually included, with modifications, in Article 9.1 of the Agreement on Agriculture.[52] Others were not, including item (h), which refers to "[e]xport credits provided by governments or their agencies on less than fully commercial terms," and item (i), which refers to "[s]ubsidized export credit guarantees or insurance programmes." The United States apparently considers that since items (h) and (i) were not carried over into the Agreement on Agriculture, export credits, including export credit guarantees and insurance programmes, are not subject to the export subsidy disciplines in the Agreement.

43. Brazil notes, however, that item (g) of Chairman Dunkel's illustrative list refers to "[e]xport performance-related taxation concessions or incentives other than the remission of indirect taxes." This provision was also not carried over in Article 9.1 of the Agreement on Agriculture. Nonetheless, as Brazil has already noted, panels and the Appellate Body have ruled that export performance-related taxation concessions or incentives like the United States' FSC and ETI measures are subject to the general export subsidy disciplines of the Agreement on Agriculture, including Article 10.1.

44. Brazil assumes that the United States simply overlooked paragraph 20(g) of the DeZeeuw framework agreement and item (g) from Chairman Dunkel's illustrative list when it states, in paragraph 143 of its Rebuttal Submission, that

[48] G/AG/NG/S/13 (26 June 2000), para. 44 ("[A]s matters currently stand the only rules and disciplines on agricultural export credits are those of the Agreement on Agriculture but only to the extent that such measures constitute export subsidies for the purposes of the Agreement on Agriculture.").

[49] Rebuttal Submission of the United States, paras. 136-138.

[50] *See* Exhibit US-25.

[51] Exhibit US-27.

[52] Paragraph 48(a) corresponds to Article 9.1(a), paragraph 48(e) to Article 9.1(e), paragraph 48(f) to Article 9.1(d), paragraph 48(j) to Article 9.1(f), paragraph 48(k) to Article 9.1(c).

> the negotiating history reveals that the Members very early specifically included export credits and export credit guarantees as a subject for negotiation and specifically elected *not* to include such practices among export subsidies. In contrast, the negotiating history reveals no comparable discussion involving FSC.

45. In light of these facts, it is evident that the negotiating history of Article 9.1 does not offer support for the United States' argument that export credit guarantees are exempt from the general export subsidy disciplines of the Agreement on Agriculture.

46. *Second*, the United States argues that changes introduced to the text of Article 10.2 between the Draft Final Act and the final version of the Agreement on Agriculture mean that export credits are not subject to the export subsidy disciplines included in the Agreement.[53]

47. The version of Article 10.2 included by negotiators in the Draft Final Act read as follows:

> Participants undertake not to provide export credits, export credit guarantees or insurance programmes otherwise than in conformity with internationally agreed disciplines.

The United States argues that this version of Article 10.2 "would clearly prohibit the use of export credit guarantees except in conformity with [internationally] agreed disciplines," which it asserts "would include those contemplated by the SCM Agreement."[54]

48. The version of Article 10.2 included in the Agreement on Agriculture reads as follows:

> Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

The United States argues that having changed the draft, "[t]he Members clearly subsequently decided *not* to condition the use of export credit guarantees on conformity with the export subsidy disciplines of the Agreement on Agriculture or the SCM Agreement."[55]

49. The United States' interpretation of the negotiating history requires the Panel to accept that the version of Article 10.2 included in the Draft Final Act would have imposed a *greater burden* on Members than does the version of Article 10.2 ultimately included in the Agreement on Agriculture. In fact, however, Article 10.2 of the Draft Final Act was amended to make it clear that negotiators expected Members actually *to pursue* negotiations on specific disciplines. Whereas the version of Article 10.2 included in the Draft Final Act did not include an undertaking to pursue those negotiations, the final version of Article 10.2 does include such an undertaking. The amendment did not *relieve* the Members of any burden, but instead *increased* the burden.

50. At least some Members understood this to be the case, since soon after the conclusion of the Uruguay Round, they launched negotiations in the OECD on specific export credit disciplines.[56] The

[53] Rebuttal Submission of the United States, paras. 140-142.
[54] Rebuttal Submission of the United States, para. 140.
[55] Rebuttal Submission of the United States, para. 141.
[56] The United States' assertion that the phrase "internationally agreed disciplines" in Article 10.2 of the Draft Final Act referred to those disciplines "contemplated by the SCM Agreement of the Draft Final Act" is not credible. Where negotiators meant to refer to pending WTO agreements outside of the draft Agreement on

United States implies that Brazil's "admission" that those negotiations have not yet resulted in agreement on specific disciplines for export credits is fatal to its claims. Brazil has demonstrated elsewhere, however, that while those negotiations are pending, nothing in Article 10.2 (or Article 1(e)) exempts export credits from the general disciplines on export subsidies included in, for example, Article 10.1 of the Agreement on Agriculture. If export credits constitute export subsidies, they are subject to those disciplines. As noted above, the Appellate Body has concluded that to exempt particular categories of measures from general obligations such as Article 10.1, the exemption must be explicit.[57] The negotiators knew how to make exemptions explicit, but did not do so in the case of export credits.[58]

51. *Third*, the United States argues that "Brazil's interpretation would require export credit guarantees in agriculture to be subject to more disciplines than any other practice addressed in the Agreement on Agriculture," since "not only would export credit guarantees constitute export subsidies and be subject to all of the export subsidy disciplines, but Member's [sic] would also be specifically obligated to work toward and then apply *additional* disciplines."[59] This statement is incorrect for several reasons:

- As clarified by Brazil, New Zealand and the European Communities, since export credits are not included in Article 9.1, they do not necessarily "constitute export subsidies."[60] They only constitute export subsidies if they are financial contributions that confer benefits and are contingent on export, or if they satisfy the elements of one of the items on the Illustrative List of Export Subsidies annexed to the SCM Agreement.

- Export credits are only "subject to all of the export subsidy disciplines" of the Agreement on Agriculture if they lead to circumvention of a Member's export subsidy reduction commitments.

- It is not clear that any specific disciplines resulting from negotiations undertaken pursuant to Article 10.2 will be "additional" to those already included in the Agreement on Agriculture or the SCM Agreement. Those negotiations are not yet completed. Depending on the agreement negotiated, it is presumably possible that the resulting text could replace the disciplines included in the Agreement on Agriculture.

52. Therefore, the United States' argument is inaccurate, and does not support its assertion that export credit guarantees are exempt from the general export subsidy disciplines in the Agreement on Agriculture, even if they meet the definition of "export subsidy."

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Agriculture, they cited those WTO agreements by name. For example, Article 5.8 of the Draft Final Act (regarding special agricultural safeguards) refers specifically to the GATT and the Safeguards Agreement. Similarly, the final version of Article 13 of the Agreement on Agriculture includes numerous specific citations to the SCM Agreement.

[57] Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128. *See* discussion at paragraphs 107-108 of the Oral Statement of Brazil.

[58] *See, e.g.*, Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.

[59] Rebuttal Submission of the United States, para. 142.

[60] *See e.g.*: Brazil's 22 August Comment, para. 97, New Zealand's Answer to Third Party Question 35, EC's Answers to Third Party Questions 35, para. 70.

**Paragraphs 147-152**

53. The United States argues that it did not include the quantities exported under the CCC programmes in its calculation of average export subsidies during 1986-1990 (the base period from which export subsidy reduction commitments were calculated during the Uruguay Round)[61] because it did not consider that CCC export credit guarantees are export subsidies subject to reduction commitments.[62] According to the United States, subjecting export credit guarantee programmes to export subsidy reduction commitments in the Agreement on Agriculture would therefore lead to "gross injustice."[63]

54. This is not the logical conclusion to be drawn, however. It appears that during the Uruguay Round negotiations the United States took the same position as it has taken in this dispute – that CCC export credit guarantee programmes do not constitute export subsidies within the meaning of item (j) and Articles 1.1 and 3.1(a) of the SCM Agreement and that CCC export credit guarantees are, therefore, not subject to the general export subsidy disciplines included in the Agreement on Agriculture.[64] The United States did not feel compelled to include the CCC export credit guarantees in its calculation of export subsidy reduction commitments because it did not consider that they constituted export subsidies under those provisions. Brazil agrees that not all export credit guarantees are export subsidies and that, therefore, not all export credit guarantees are subject to export subsidy reduction commitments. However, if those guarantees meet the criteria of item (j) or constitute subsidies contingent upon export performance under Articles 1.1 and 3.1(a) of the SCM Agreement, they are export subsidies.[65] (Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes are export subsidies. It follows that GSM 102, GSM 103 and SCGP are subject to reduction commitments and, in fact, circumvent or threaten to circumvent the US export subsidy commitments.)

**Paragraphs 156-157, 160-162 and Exhibits US-31 and US-32**

55. The United States argues that it would not give an accurate picture to compare the reestimates made in any given year (and recorded in the US budget) with the cohort-specific subsidy estimates for guarantees disbursed in that year. Specifically, the United States argues that "upward reestimates and downward reestimates reflected in a single budget cannot necessarily be applied against each other for a notional 'net reestimate.'"[66] Brazil has never argued otherwise. In the chart included in paragraph 115 of its 22 August Rebuttal Submission, Brazil compares *cohort-specific* original subsidy estimates to *cohort-specific* reestimates, cumulated over the period 1992-2002, to give a picture of the long-term operating costs and losses of the "programmes," as required by item (j) (rather than costs and losses for a particular cohort). The United States itself uses this same method (albeit with different data) in paragraph 161 of its 22 August Rebuttal Submission.

56. With respect to FCRA-related data, it would in fact only be inappropriate to attempt to tie a cohort-specific subsidy estimate for one year to fiscal year, non-cohort-specific reestimates recorded in the budget for any one year. Brazil has never made this comparison. As the United States notes,

[61] Rebuttal Submission of the Untied States, para. 148.
[62] Rebuttal Submission of the United States, para. 149.
[63] Rebuttal Submission of the United States, paras. 147-153, *see* the heading to that section.
[64] Rebuttal Submission of the United States, para. 151. The arguments of the United States in this case demonstrate that it continues to be of the view that its programmes do not constitute export subsidies within the meaning of Articles 1.1 and 3.1(a), including item (j) of the SCM Agreement, nor within the meaning of Articles 1(e), 10.1 and 8 of the Agreement on Agriculture.
[65] Brazil's 22 August Comment on Question 80, para. 98. *See* also EC's 11 August Answer to Third Party Question 30, para. 65. New Zealand's 11 August Answer to Third Party Question 35.
[66] Rebuttal Submission of the United States, para. 160.

this would be inappropriate because reestimates recorded in the budget as made in a year do not necessarily relate to subsidy estimates for guarantees disbursed in that year. If the data is presented cumulatively over a period constituting the long term, however, and does not purport to *tie* cohort-specific subsidy estimates to fiscal year, non-cohort-specific reestimates recorded in the budget for any one year, a comparison is perfectly acceptable. Specifically, comparing the cumulative subsidy estimates to the cumulative reestimates shows whether the "programme" is loss-making or profit-generating over the long term. Making a comparison of the cumulative figures does not require that the estimates and reestimates recorded in the budget for any year correspond.

57. For example, this approach can be applied to the data included in Exhibit US-31 to the United States' 22 August Rebuttal Submission. The "subsidy" column included in Exhibit US-31 lists the subsidy estimate from the "prior year" column of the US budget for each cohort during the period 1992-2003. Subtracting cumulative annual downward reestimates from and adding cumulative annual upward reestimates to the cumulative original subsidy amount *yields a positive subsidy of $500 million*.[67] Adding administrative expenses over the period 1992-2003 increases this amount by a further $43 million.[68] Taking the data provided by the United States in Exhibit US-31 at face value demonstrates that the CCC guarantee programmes are losing money. This result is not tainted by the "apples-to-oranges" criticism levied in paragraph 160 of the United States' 22 August Rebuttal Submission.

58. Nor does Brazil's treatment of the data included in the chart at paragraph 165 of its 11 August Answers to Questions suffer from an "apples-to-oranges comparison" between fiscal year and cohort-specific data, as the United States alleges at paragraph 160 of its 22 August Rebuttal Submission. The chart at paragraph 165 is wholly unrelated to the FCRA cost formula. It tracks the results of a formula Brazil has constructed to verify, by alternative means, that long-term operating costs and losses for the CCC export guarantee programmes outpace premiums collected. The data in that chart are not FCRA-related subsidy estimates that are recorded on a cohort basis or that are subject to reestimates mandated by the FCRA. Instead, the left-hand column of that chart records revenue collected on a fiscal year (not a cohort-specific) basis, and the right-hand column of that chart records costs incurred on a fiscal year (not a cohort-specific) basis. Over the period 1993-2002, total revenue in the left-hand column is significantly less than total costs in the right-hand column. This entails no "apples-to-oranges comparison," and demonstrates that the CCC export guarantee programmes constitute export subsidies under item (j) of the Illustrative List of Export Subsidies.

59. In the chart included at paragraph 161 of its 22 August Rebuttal Submission, the United States nets cumulative reestimates on a cohort basis against the original, cohort-specific subsidy estimate from the US budget. There are some factual problems with the US data.[69]

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[67] (2,737 – 297) – (2,629 + 870) + (1,262 + 297) = 500. Since no reestimates have yet been made for 2004, Brazil has reduced the original subsidy amount included in Exhibit US-31 by the $297 million estimate included in the 2004 budget. Had the United States subtracted downward reestimates from and added upward reestimates to the *original* subsidy estimate included in the "budget year" column of the "guaranteed loan subsidy" line of the annual US budget, it would have yielded a positive subsidy, and thus a loss, of $2.038 billion. *See* Exhibit Bra-192.

[68] *See* paragraph 132 of Brazil's 22 July Statement at the First Panel Meeting, and accompanying citations.

[69] First, the United States has offered no documentation verifying the accuracy of the reestimate figures provided in the chart for the period 1993-2000. In contrast, the chart included in paragraph 115 of Brazil's 22 August Rebuttal Submission provides cumulative reestimates on a cohort basis that are taken directly from Table 8 of the Federal Credit Supplement included with the 2004 US budget. *See* Exhibit Bra-182. Second, although the United States asserts that it has netted cumulative reestimates against the "*original* subsidy estimate," it has in fact netted cumulative reestimates against the "guaranteed loan subsidy" figure included in the "*prior year*" column of the US budget, which yields a lower number. Using, subsidy data from the US budget for "prior year," the chart included at paragraph 115 of Brazil's 22 August Rebuttal Submission would

Resolving these problems is not particularly important, however, since the chart included at paragraph 161 of the United States' 22 August Rebuttal Submission itself shows a cumulative positive subsidy for the programmes of over $381 million for the period 1992-2002.[70] This positive subsidy is consistent with CCC's 2002 financial statements, which provide a cumulative, running tally of the subsidy figure for all post-1991 CCC export credit guarantees in the amount of $411 million.[71] The CCC export guarantee programmes have lost money over the period 1992-2002.

60. The United States' point seems to be that because subsidy reestimates are generally downward, the CCC programmes generate profits over the long term. However, all this means is that CCC's original estimates were too high.[72] The real test is the result when cohort-specific reestimates are netted against the original subsidy estimates for each cohort and cumulated over a period constituting the long term, so that the long-term costs and losses of the programmes can be determined, as required by item (j). Netting reestimates against original subsidy estimates on a cohort-specific basis yields a positive subsidy, revealing that over the long term, the CCC is losing money with its export guarantee programmes. This result is obtained whether the Panel accepts the chart at paragraph 161 of the United States' 22 August Rebuttal Submission, the chart at paragraph 115 of Brazil's 22 August Rebuttal Submission,[73] or the cumulative subsidy figure included in CCC's 2002 financial statements.[74]

61. The United States may be suggesting that reestimates will always, eventually, result in negative subsidies and profits. The data shows that this is not the case, however. Netting reestimates against original subsidy estimates does not consistently yield a negative subsidy, or profits, on a cohort basis. The charts included at paragraph 161 of the United States' 22 August Rebuttal Submission and at paragraph 115 of Brazil's 22 August Rebuttal Submission demonstrate this. Nor is it even relevant to focus on the results of individual cohorts, since item (j) require an analysis of the "long-term" costs and losses of export guarantee "programmes," rather than cohorts. That is why Brazil, and presumably the United States, has calculated cumulative results for the charts included at

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still yield a positive subsidy of $211 million, to which the $43 million in administrative expenses should be added, for a total loss of $254 million over the period 1992-2002. *See* Exhibit Bra-193. Third, the United States has not included administrative expenses for the CCC export guarantee programmes, which amount to $43 million for the period 1992-2003.

[70] Even accepting the validity of the data entered in the US chart, Brazil notes that summing up those figures yields a result different from the $381.35 million total provided by the United States. Using the US data, Brazil reaches a subsidy figure net of reestimates of $230,127,023.

[71] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

[72] Brazil notes that according to USDA's Inspector General, CCC estimates are in fact *understated*. In audit reports for fiscal years 1999, 2000 and 2001, CCC's estimates and reestimates were found to have "understated" costs and losses by amounts ranging from to $11 million to $430 million. Exhibit Bra-194 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC, February 2002, p. 11); Exhibit Bra-195 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, Audit Report No. 06401-14-FM, Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, June 2001, p. 9); Exhibit Bra-196 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, US Department of Agriculture Consolidated Financial Statements for Fiscal Year 1999, Report No. 50401-35-FM, February 2000, p. 9).

[73] Again, using "prior year" subsidy figures for this chart results in a positive subsidy of $211 million over the period 1992-2002. *See* Exhibit Bra-193 (Net Lifetime Reestimates of Guaranteed Loan Subsidy by Cohort)

[74] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

paragraph 161 of the United States' 22 August Rebuttal Submission and at paragraph 115 of Brazil's 22 August Rebuttal Submission.

62. In any event, if CCC considered that it would eventually make money on its guarantees on a cohort basis, why does it continue to offer original estimates that are so high? While some factors included in the estimation process are dictated by the FCRA and the US Office of Management and Budget, the original subsidy estimate is primarily driven by CCC's historical experience with its guarantees. Brazil has elsewhere noted that according to the US Federal Accounting Standards Advisory Board, the Government-Wide Audited Financial Statements Task Force on Credit Reform, the Office of Management and Budget and the Department of Agriculture itself, "[m]ethods of estimating future cash flows for existing credit programmes need to take account of past experience,"[75] "[a]ctual historical experience of the performance of a risk category is a *primary factor* upon which an estimation of default cost is based,"[76] and technical assumptions underlying subsidy calculations reflect "historical cash reports and loan performance."[77] If historical experience dictated that CCC would consistently make profits, CCC would reflect that historical experience in its subsidy estimates. Actual historical experience is, after all, a "primary factor" on which those estimates are based. That CCC continues to provide significant positive original subsidy estimates demonstrates that its actual historical experience does *not* suggest that it will make money on its loan guarantees. Since those estimates are calculated and recorded on a *net present value basis*, CCC apparently continues to consider that it will incur significant net costs at the time the cohorts are closed.

63. CCC's apparent views regarding its historical experience with the export guarantee programmes are justified. Evidence regarding CCC's actual historical experience confirms that the long-term operating costs and losses for the CCC guarantee programmes outpace premiums collected. At paragraph 109 of its 22 August Rebuttal Submission, Brazil summarizes this evidence.[78] Although, the United States implies at paragraph 172 of its 22 August Rebuttal Submission that Brazil's evidence is all "between 10 and 20 years" old, a cursory review of the evidence, which includes data from the 2004 US budget and CCC's 2002 financial statements proves otherwise. Therefore, even if the Panel agrees with the United States' conclusion, at paragraph 162 of its 22 August Rebuttal Submission, that the FCRA cost formula is not an ideal way to determine the costs of the CCC export guarantee programmes, Brazil has established by alternative means that CCC premiums fail to meet the long-term operating costs and losses of the programmes.

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[75] Exhibit Bra-162 (Government-Wide Audited Financial Statements Task Force on Credit Reform, ISSUE PAPER, *Model Credit Programme methods and Documentation for Estimating Subsidy Rates and the Model Information Store*, 96-CR-7 (1 May 1996), p. 2).

[76] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36)). *See also* Exhibit Bra-160 (US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2003), p. 120 ("In estimating default costs, the following risk factors are considered: (1) loan performance experience; . . .")).

[77] Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002, p. 9).

[78] Contrary to the United States' assertion at paragraph 170 of its Rebuttal Submission, Brazil has not misread Note 5 to CCC's 2002 financial statements. The amounts in the "subsidy allowance" column are in fact the amounts of receivables associated with post-1991 CCC guarantees that CCC considers uncollectible. The Panel will recall that under the FCRA, the subsidy allowance is recorded on a net present value basis, which means that it represents the cost CCC considers it will incur on a guarantee cohort at the time that cohorts is closed. The $770 million listed in the "subsidy allowance" column in the receivables table for post-1991 guarantees is therefore as uncollectible as the $ 2,567 billion listed in the "uncollectible" column of the pre-1992 CCC guarantee receivables table (*See* Notes to Financial Statements contained in Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2002, Audit Report N° 06401-15-FM (December 2002) p. 14).

**Paragraph 169 and Exhibit US-33**

64. The United States has asserted that there are no "arrearages" with respect to debt reschedulings.[79] Brazil has two comments. First, the United States does not state the source of the data it included at Exhibit US-33. Second, Brazil maintains that it is not appropriate to treat rescheduled debt as recoveries.[80] The US assumption that there will be no arrearages not only ignores the cost of rescheduling but also the fact that there may be further defaults on rescheduled debt.[81] Although rescheduled debt is treated as a receivable, CCC acknowledges in its financial statements that not all receivables are deemed collectible.[82] Moreover, Brazil presumes that rescheduled debt is subject to the FCRA estimation or reestimation process, which involves calculations of net present value of what the CCC expects to lose (or gain) on the rescheduled debt. The CCC does not assume that all rescheduled debt will be collected.

**Paragraphs 172, 174-175**

65. The United States has argued that Brazil improperly relies on CCC losses incurred *via* Iraqi and Polish defaults. The United States implies that these defaults occurred between 10 and 20 years ago.[83] This is incorrect. The US General Accounting Office ("GAO") reports that the losses in Iraq occurred over the period 1990-1997.[84] (The United States makes no specific challenge to the $2 billion in Polish defaults.) Thus, defaults and losses did not occur as long ago as the United States suggests.

66. Moreover, the United States argues that the Panel should only look into the question whether "*current*" premium rates are adequate to cover the long-term operating costs and losses of the programmes.[85] The United States relies on a "present tense" argument to exclude major defaults in Iraq and Poland that occurred in the recent past. Even if the Panel only looks to "current" premiums, item (j) calls for an analysis of "long-term" operating costs and losses.[86] The United States apparently agrees, since it looks to the performance of the CCC programmes in such years as 1994 and 1995 (a time period even longer ago than part of the defaults in Iraq[87]) to claim that premium rates charged were adequate to meet costs,[88]

67. If the United States believes that it is only appropriate to look at *current* premiums, given the present tense of the term "are" in item (j), then the FCRA cost formula is useful. The FCRA cost formula measures the *net present value* "of the following cash flows: (i) payments by the Government

[79] Rebuttal Submission of the United States, para 169.
[80] Oral Statement of Brazil, para. 122.
[81] Oral Statement of Brazil, para. 122. Brazil's 11 August Answer to Question 77, para. 162.
[82] *See* Brazil's 22 August Comments, para. 99. Exhibit Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14).
[83] Rebuttal Submission of the United States, para. 172.
[84] Bra-157 (US General Accounting Office, REPORT TO THE CHAIRMAN, TASK FORCE ON URGENT FISCAL ISSUES, COMMITTEE ON THE BUDGET, HOUSE OF REPRESENTATIVES, *International Trade: Iraq's Participation in US Agricultural Export Programmes*, GAO/NSIAD-91-76 (November 1990), p. 27 (Table IV.2)).
[85] Rebuttal Submission of the United States, para. 174.
[86] The United States has elsewhere endorsed a 10-year period (First Submission of the United States, para. 173; Rebuttal Submission of the Untied States, para. 161).
[87] *Compare* Rebuttal Submission of the United States, para. 172 and 175.
[88] Rebuttal Submission of the United States, para. 175.

. . . and (ii) payments to the Government" of guarantees at the time they are disbursed.[89] In other words, it measures the amount CCC expects today to lose (or gain) on a guarantee cohort at the time the cohort is closed tomorrow. Even if this involves some estimates, the United States has noted that those estimates are acceptable.[90] In fact, the US budget for fiscal year 2004 demonstrates that current premiums paid for guarantees disbursed in fiscal years 2002-2004 will generate losses worth hundreds of million of dollars.[91] Thus, current premiums are inadequate to cover the long-term operating costs and losses of the CCC export credit guarantee programmes. These programmes constitute export subsidies.

**Paragraphs 186-191 and Exhibits US-34 through US-37**

68. Brazil has argued that since CCC export credit guarantees from the GSM 102, GSM 103 and SCGP programmes are unique financial instruments for agricultural commodity transactions that are not available on the commercial market – certainly not for terms longer than the marketing cycles of the eligible commodities – they confer "benefits" within the meaning of Article 1.1(b) of the SCM Agreement.[92] The United States asserts that "financing is available in the marketplace that is analogous to the export credit guarantee programmes" – namely, forfaiting.[93]

69. The United States' assertion should be rejected. As discussed below, the two instruments are not "analogous," and are, in fact, different.

70. Brazil begins with a very rough sketch of the role a forfait can play in a typical transaction involving agricultural commodities. In a typical transaction, an importer will issue a promissory note to an exporter for the agreed price. The exporter will generally demand that the note be backed by a guarantee (or an aval) from the importer's bank and/or, as the United States points out in paragraph 187 of its 22 August Rebuttal Submission, by a guarantee from the importer's government export credit agency.

71. A forfait comes into play because, while both the exporter and the importer want the transaction to occur, they have different interests. The exporter wants to get paid immediately on a cash basis, and the importer wants credit that it can repay on a deferred basis. Even with a guarantee from the importer's bank or a government export credit agency, the exporter bears responsibility for collecting the receivables (in the absence of default). A forfaiter (which could be the exporter's own bank) will step in and purchase the promissory note at a discount to face value, without recourse to the exporter.[94] The exporter will receive payment immediately from the forfaiter. The forfait essentially enables the exporter to convert a credit sale into a cash sale.

72. A forfaiter will generally demand that the importer's obligation is backed by a guarantee from a bank or the importer's government export credit agency.[95] Rather than *substituting* for a guarantee,

[89] Exhibit Bra-117 (2 U.S.C. 661a(5)(C)).

[90] Rebuttal Submission of the United States, para. 171.

[91] *See* chart at paragraph 161 of the Rebuttal Submission of the United States. *See* also Exhibit Bra-127 (US budget for FY 2004, p. 107) referencing guaranteed loan subsidy amounts of $97 million, $294 million and $297 million respectively. Brazil notes that the figure for FY 2002 has been reestimated to $137,008,586 since the publication of the FY 2004 budget (*See* Rebuttal Submission of the United States, chart at para. 161).

[92] First Submission Brazil, para. 289; Oral Statement of Brazil, para. 116; Brazil 11 August Comment and Answer to Questions 71(a) (para. 139), 75 (para. 156); Rebuttal Submission of Brazil, para. 103.

[93] Rebuttal Submission of the United States, para. 186.

[94] *See* Exhibit Bra-197 (http://www.nedcor.co.uk/forfait-website/forfaiting.htm).

[95] United Rebuttal Submission of the United States, para. 187. *See also* Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 258 (Spring 2001) ("In most cases, the forfaiter requires the obligation of the importer to be guaranteed by a bank in the importer's country because of the impossibility of evaluating the credit risk of every importer in

therefore, guarantees and forfaiting are *complementary* instruments. For this reason alone, the US assertion that the two instruments are analogous is incorrect.

73. There are other differences between the two instruments. The importer realizes a tangible and extremely valuable benefit from a CCC guarantee; namely, the bank prices financing to the importer based on the credit rating of the United States, rather than the credit rating of the importer itself. Importantly, the CCC guarantee allows the importer to secure financing in the first place. As the regulations for the GSM and SCGP programmes state, the programmes operate in cases where banks "would be unwilling to provide financing without CCC's guarantee."[96] Forfaiting helps an exporter accept deferred payment terms for the importer, but does not otherwise beneficially affect the price for the financing secured by the importer. Nor would a bank require that forfaiting be involved in a transaction as a prerequisite for it to provide financing to the importer.

74. As a further distinction between the two instruments, while there is a secondary forfaiting market,[97] there is no secondary market for CCC guarantees.[98] Purchasers in the secondary market for forfaiting instruments assume that forfaited promissory notes will yield more at maturity than the purchaser paid for them in the secondary market.[99] Since no secondary market exists for CCC guarantees, apparently no such assumption can be made with respect to CCC guarantees (which itself reveals much about the quality of those guarantees).

75. Most importantly, the pricing for forfaiting instruments is substantially different than pricing for CCC guarantees. As noted above, a forfaiter purchases an exporter's trade receivables at a discount to face value. The discount rate and associated commitment fees are driven by the risks involved – country risk, political risk, currency risk, entity risk (essentially, the risk of the guarantor), etc., and by the length of the underlying credit.[100]

76. Brazil has attached as Exhibit Bra-199 a list of indicative forfaiting rates that vary greatly from market to market.[101] In contrast, the United States has confirmed that country risk "has no impact on the premiums payable" under the GSM 102, GSM 103 and SCGP programmes.[102] Brazil provided the Panel with evidence documenting that GSM and SCGP fees were the same whether guarantees were for transactions with the Dominican Republic, Ghana, Japan, South Korea or Vietnam (among others).[103]

77. Moreover, the *very lowest rate* in the forfaiting rate list included in Exhibit Bra-199 is 1.6638 per cent (6-month tenor). The rates for GSM 102 and GSM 103 guarantees are prohibited by law from being greater than 1 per cent,[104] and are currently (as they have been at least since 1994)[105]

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every country, particularly when medium or small sized companies are involved."). *See also Id*., p. 259 ("[I]f a bank guarantee is required, it must be unconditional, irrevocable and freely transferable.").

[96] Exhibit Bra-38 (7 CFR 1493.10(a)(2); 7 CFR 1493.400(a)(2)). *See* Brazil 11 August Response to Question 82(a) (paras. 183-184).

[97] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 251-252 (Spring 2001)).

[98] *See* US 11 August Answer to Question 86 (para. 184).

[99] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 251-252 (Spring 2001)).

[100] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 256 (Spring 2001)).

[101] Exhibit Bra-199 (Trade and Forfaiting Review, "Argentina Trade Finance to the Rescue," Volume 6, Issue 9, July/August 2003)

[102] United States 11 August Response to Question 86 (para. 184).

[103] *See* Brazil 11 August Comments to Questions 84 (para. 192) and 85 (para. 195).

[104] United States 11 August Responses to Question 84 (para. 179).

[105] Brazil 11 August Comment to Question 84 (para. 193).

no greater than 0.663 per cent for GSM 102 (36-month tenor)[106] and 0.05 per cent for GSM 103 (120-month tenor).[107]

78. Furthermore, although the United States' assertion that the tenor of forfaiting instruments can range from six months to 10 years is accurate, forfaiting instruments *for agricultural commodities* will not exceed tenors of 360 days, or in other words will not exceed a tenor "matching the typical period of consumption of most commodities."[108] This is consistent with Brazil's statement that commercial financing for exports of agricultural goods that exceeds the marketing cycles of the agricultural good is not available on the marketplace.[109]

79. Under Article 10.3 of the Agreement on Agriculture, the United States bears the burden of demonstrating that no export subsidies have been granted in respect of quantities of agricultural commodities exported in excess of its reduction commitments.[110] Although it is not its burden to do so, Brazil has demonstrated that CCC export credit guarantees are financial contributions that confer benefits and are contingent on export, within the meaning of Articles 1.1 and 3.1(a) of the SCM Agreement. With respect to "benefit," CCC regulations concerning the GSM and SCGP programmes demonstrate that the programmes grant better-than-market terms *per se*.[111] Brazil has also demonstrated that CCC export credit guarantees confer benefits *per se* since they are unique financial instruments for agricultural commodity transactions that are not available on the commercial market – and certainly not for terms longer than the marketing cycles of the eligible commodities.

80. The United States has not established that forfaiting is analogous to CCC export credit guarantees. Even if it had done so, and the market terms for forfaiting instruments could theoretically serve as a benchmark against which to judge whether CCC export credit guarantees confer "benefits," the United States has not: (i) established the terms on which forfaiting is provided on the market; or, (ii) demonstrated that CCC export credit guarantees do not provide terms better than those provided for forfaiting instruments. The United States acknowledges, at paragraph 191 of its 22 August Rebuttal Submission, that it has not provided market terms for forfaiting instruments that could serve as a benchmark. Thus, the United States has not met its burden under Article 10.3 of the Agreement on Agriculture.

**Brazil's Comment on Question 67a posed by Panel to the United States**

81. While Brazil obviously does not know how the United States will ultimately respond, Brazil offers the following information supporting Brazil's calculations of the amounts provided to these four crops as "support to upland cotton."

82. First, to the extent that the United States criticizes Brazil's calculations made to determine the different per acre payments for direct payment and CCP crops in paragraph 42 of its Rebuttal Submission, Brazil notes that these calculations are confirmed by the Food Agricultural Policy Research Institute at the University of Missouri (FAPRI).[112] As Brazil further notes that the FAPRI

[106] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, "Notice to GSM-102 and GSM-103 Programme Participants," 24 September 2002).

[107] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, "Notice to GSM-102 and GSM-103 Programme Participants," 24 September 2002).

[108] Exhibit Bra-198 (Vincent Whittaker, "The Quick Buck, International Finance, and Forfaiting," 23 *Thomas Jefferson Law Review* 249, 254 (Spring 2001)).

[109] Oral Statement of Brazil, para. 116.

[110] *See* First Submission of Brazil, paras. 263-268.

[111] *See* Brazil's 11 August Answer to Question 82, paras. 182-189.

[112] http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf. The information on CCP and direct payment per acre payments in US dollars for each of the programme crops is found in the last two lines of pages 55 (wheat), 57 (rice), 59 (corn), 61 (sorghum), 63 (barley), 65 (oats), 69

baseline itself and FAPRI analysis has often been influential in US policy formation process, including in analysis of the FSRI Act of 2002, for which FAPRI won the USDA's highest honour.[113]

83. Second, FAPRI's 2003 US Baseline is a long-run scenario projecting what would happen to various elements of US agriculture under the 2002 FSRI Act. In this analysis, FAPRI includes all of the different types of support provided by the 2002 FSRI Act into its projections of, *inter alia*, upland cotton planted acreage, production, exports, prices, revenue, costs, etc. In doing so, the FAPRI economists assume that, *inter alia*, upland cotton producers were holding upland cotton base acreage and receiving upland cotton CCP and direct payments.[114] These CCP payments and direct payments are reflected in their analysis of "Gross Market Revenue" to upland cotton producers on page 79 of their report, which constitutes the sum of LDP (marketing loan), CCP revenue, and direct payments.[115]

84. In addition, FAPRI states that "US cotton producers do not benefit from the projected price increases. Higher prices are offset by lower payments from the loan programme and the CCP programme."[116] This reflects the FAPRI economists' assumption that upland cotton producers receive upland cotton direct and CCP payments.

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(soybeans), 75 (peanuts) and 79 (upland cotton). Brazil notes that its figures for soybeans and peanuts differ slightly. The underlying reason for this difference is that Brazil had to base its figures on its estimates about the payments yields and it appears that FAPRI's figures for payment yields are slightly different from Brazil's.

[113] See for example, "Analysis of the grain, oilseed and cotton provision of the, 'Agriculture, Conservation, and Rural Enhancement Act of 2001 – S.1731.'" FAPRI-UMC Report #18-01 November 2001. http://www.fapri.missouri.edu/FAPRI_Publications.htm. Also see http://www.card.iastate.edu/about_card/news/press_releases/Highest_Honor.html

[114] FAPRI's 2003 US Baseline, http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf, p. 78.

[115] FAPRI's 2003 US Baseline, http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf, p. 79.

[116] FAPRI's 2003 US Baseline, http://www.fapri.iastate.edu/Outlook2003/PageMker/OutlookPub%20USCrops.pdf, p. 78.

**List of Exhibits**

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|---|---|
| G/AG/AGST/USA | Exhibit Bra- 191 |
| Reestimated Guaranteed Loan Subsidy based on Original Budget Year Estimate. | Exhibit Bra- 192 |
| Net Lifetime Reestimates of Guaranteed Loan Subsidy by Cohort. | Exhibit Bra- 193 |
| US Department of Agriculture Office of Inspector General Great Plains Region Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report N° 06401-4-KC, February 2002 | Exhibit Bra- 194 |
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| US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report, US Department of Agriculture Consolidated Financial Statements for Fiscal Year 1999, Report N° 50401-35-FM, February 2000 | Exhibit Bra- 196 |
| http://www.nedcor.co.uk/forfait-website/forfaiting.htm | Exhibit Bra- 197 |
| Vincent Whittaker, "The Quick Buck, International Finance and Forfaiting," 23 *Thomas Jefferson Law Review* (Spring 2001) | Exhibit Bra- 198 |
| Trade and Forfaiting Review, *"Argentina Trade Finance to the Rescue"* Volume 6, Issue 9 July/August 2003 | Exhibit Bra- 199 |

# ANNEX D-4

## COMMENTS OF THE UNITED STATES ON NEW MATERIAL IN BRAZIL'S REBUTTAL FILINGS AND ANSWER OF THE UNITED STATES TO THE ADDITIONAL QUESTION FROM THE PANEL

27 August 2003

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## I. Introduction

1. The United States thanks the Panel for its prompt reply to the US request of 25 August 2003, granting an opportunity to comment on new material in Brazil's rebuttal submission and Brazil's comments on the US responses to questions. We also thank the Panel for its additional question. We present both the US comments on new material in Brazil's submissions and our answer to that additional question below.

2. As the United States notes in these comments and answer, Brazil's Peace Clause argument depends on three issues:

- First, Brazil relies on budgetary outlays that reflect prevailing market prices that could not have been "decided" by the United States. Brazil ignores the fact that "support" does not mean "budgetary outlays"; in fact, Annex 3 recognizes that an "Aggregate Measurement of

Support" for price-based support either shall[117] or can[118] be calculated using a price gap methodology, which does not rely on budgetary outlays.

- Second, Brazil conflates "non-product-specific support" with "support to a specific commodity" by attempting to allocate certain payments to upland cotton. To do so, however, Brazil relies on a reading of the definition of "non-product-specific support" in Article 1(a) that ignores the most relevant context for this term – that is, the (immediately preceding) definition of product-specific support in that same article. Indeed, Brazil's approach would appear to render the concept of "non-product specific support" so narrow that it becomes almost, if not completely, meaningless.

- Third, Brazil mischaracterizes US direct payments and production flexibility contract payments as non-green box support. Brazil has not established that these measures fail to conform to the policy-specific criteria in Annex 2. In fact, Brazil has not even established – pursuant to Brazil's own reading of the first sentence of Annex 2, paragraph 1, as a stand-alone obligation – that these payments have more than "minimal[] trade-distorting effects or effects on production."[119]

3. The weakness of Brazil's interpretation that "support" in the Peace Clause means "budgetary outlays" can be seen in this example. Even if US measures were *exactly* the same in *every year* of the implementation period as they were in the 1992 marketing year (that is, the same deficiency target price, same marketing loan rate, same acreage reduction percentage, same normal flex acres with planting flexibility[120], etc.), under Brazil's interpretation, US measures would have breached the Peace Clause in each and every year in which outlays increased due to external factors, for example, whenever market prices dipped below the 1992 level.

- Would 1999-2002 US measures *identical in every respect* to those in 1992 "grant support in excess of that decided during the 1992 marketing year"?

- In other words, if a Member had decided its support during 1992 for the period through 2004 and never changed its decision, could the Member be deemed to grant support in excess of the

[117] In the case of market price support. In fact, Annex 3, paragraph 8, states: "Budgetary outlays made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS."

[118] In the case of non-exempt direct payments dependent on a price gap. *See* Agreement on Agriculture, Annex 3, paragraph 10.

[119] Of course, the US view is that the "fundamental requirement" of the first sentence is met by a measure that conforms to the basic criteria and any applicable policy-specific criteria. In this regard, Brazil errs in claiming that the United States has "acknowledged that such effects can be presumed if the specific criteria in paragraph 6 of Annex 2 are not complied with." Brazil's Rebuttal Submission, para. 8 fn. 13. In fact, we believe the opposite. Meeting the basic and policy-specific criteria of Annex 2 establishes that a measure meets the "fundamental requirement" of paragraph 1. However, the converse is not necessarily true. So, according to Brazil's approach, Brazil would bear the burden of establishing that a measure that did not comply with the basic and policy-specific criteria in Annex 2 failed to meet the "fundamental requirement" of paragraph 1 of Annex 2.

[120] Recall that "under 1992 programme provisions, producers of non-cotton programme crops (i.e., wheat, corn, barley, grain sorghum, oats, and rice) could plant up to 25 per cent of their [non-cotton] crop programme base to cotton as Normal Flex Acres or Optional Flex Acres. Acreage Reduction Programme compliance reports indicate that, in 1992, 447,164 acres of cotton were planted on a much larger quantity of available Normal Flex Acres and Option Flex Acres of non-cotton programme base.") Exhibit US-24 (Report by Dr. Joseph Glauber, Deputy Chief Economist, US Department of Agriculture). In 1992, there were 153.9 million acres of non-cotton "complying base" and 197.2 million acres of non-cotton "effective base." *See* Exhibit US-39. Thus, the marketing loan was effectively available with respect to all upland cotton production.

> level decided during 1992 just because outlays increased, for example, because market prices changed?[121]

We believe the answer must be "No" because market prices are not "decided" by a Member (as paragraphs 8 and 10 of Annex 3 recognize). And yet, the situation in this dispute is analogous: the United States has changed its measures to *reduce* the product-specific level of support (by eliminating deficiency payments) since 1992, and yet Brazil claims that the Peace Clause has been breached simply because lower market prices resulted in increased price-based outlays.

4. Market prices are beyond the control of the United States, and therefore the United States cannot "decide" them. Removing the effect of market prices beyond the control of the United States from the measure of support demonstrates that US measures do not and did not grant support in excess of that decided during the 1992 marketing year. In fact, whether gauged (as the United States believes is compelled by the Peace Clause) via the rate of support expressed by US measures[122], *or* via the AMS for upland cotton (calculated through a price gap methodology), *or* via the erroneous calculations of Brazil's expert (but limited to product-specific support), the result is exactly the same: in no marketing year from 1999 through 2002 have US measures breached the Peace Clause.

## II. Brazil's AMS Calculation Is Flawed and, Had It Consistently Reflected a Price Gap Calculation, Would Demonstrate No Peace Clause Breach

5. We recall that Brazil has argued that budgetary outlays are the only measurement of "support" for purposes of the Peace Clause proviso comparison, without any foundation in the Peace Clause text and despite the context provided by Annex 3, which explicitly indicates that Members have agreed "support" *can* be measured without using budgetary outlays. Brazil itself concedes that US measures do not decide support on the basis of budgetary outlays:

> Brazil acknowledges that *the United States could not possibl[y] determine its expenditures* as they would depend to a certain extent on *market prices* that were also influenced by factors *outside the control of the US Government*.[123]

The United States agrees with this statement by Brazil and believes that this statement demonstrates that Brazil's approach to the Peace Clause comparison is not based on the text nor is it realistic. Instead, in order to hope to succeed, Brazil's claims *require* Brazil to use budgetary outlays and so to take into account low prevailing market prices. An Aggregate Measurement of Support calculation using a price gap methodology – that is, that eliminates the effect of market prices and reflects instead the eligible production and applied administered price decided by a Member – reveals that in no year from 1999-2002 have US measures breached the Peace Clause.

6. Brazil has argued that "there are only two types of methodologies that would allow an expression in monetary terms of a decision (or decisions) taken by the United States in MY 1992 regarding its level of support to upland cotton. The first is budgetary expenditures. The second is the calculation of AMS for a particular commodity."[124] In both its table of expenditures[125] and its AMS

[121] Other factors beyond a Member's control could also influence outlays, such as whether some additional producers chose to begin participating in the support programmes.

[122] Even taking into account the maximum theoretical effect on the deficiency payment effective price of the 1992 acreage reduction percentage (10 per cent) and normal flex acres (15 per cent) for the 1992 marketing year. Since the acreage reduction percentage was lower for 1993 marketing year (7.5 per cent versus 10 per cent) support, which was also decided during the 1992 marketing year, the adjusted level of support (68.27625 cents per pound) was even higher for the 1993 marketing year.

[123] Brazil's Comments on US Answers, para. 66 fn. 49.

[124] Brazil's Rebuttal Submission, para. 71.

table[126], Brazil has attempted to allocate non-product-specific support to a specific commodity. There is no basis in Annex 3 to do so. Annex 3, paragraph 1, explicitly requires an AMS to be calculated "on a product-specific basis for each basic agricultural product" and separately requires that non-product-specific support be calculated and "totalled into one non-product-specific AMS in total monetary terms." The point bears emphasis: "for each basic agricultural product," Annex 3 states that an AMS "shall be calculated on a product-specific basis." Similarly, were "support to a specific commodity" (upland cotton) to be calculated using an Aggregate Measurement of Support, it *must* be calculated "on a product-specific basis."

7. As a result, both Brazil's expenditure table and its AMS table run counter to the terms of Annex 3. Were the Panel to calculate an AMS for upland cotton for marketing years 1992 and 1999-2002, the United States has set forth a calculation consistent with Annex 3 in its rebuttal submission.[127] By using a price-gap methodology for both deficiency payments and marketing loan payments[128], the upland cotton AMS in 1992 is far higher than in any marketing year from 1999 to 2002, reflecting the US decision to move away from the high support levels of product-specific deficiency payments.

8. In fact, we note that the AMS data presented in paragraph 115 of the US rebuttal submission understates the AMS for marketing year 1992. For example, the United States reduced the price gap calculation for 1992 basic deficiency payments by an adjustment factor (approximately .875) to replicate the calculation used in G/AG/AGST/USA, p. 18. Without the adjustment, which is not called for by paragraphs 10 and 11 of Annex 3, the 1992 deficiency payment calculation would have been $858 million, rather than $755 million as reported in paragraph 115.[129] (In case of interest, we also present below the deficiency payment calculation in more detail, reflecting more accurate data, which would increase the deficiency payment calculation slightly, to $867 million.)[130] This

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[125] Brazil's Rebuttal Submission, para. 73.

[126] Brazil's Rebuttal Submission, para. 76.

[127] US Rebuttal Submission, paras. 114-118.

[128] Brazil has stated (with respect to deficiency payments) that "the formula approach under Annex 3, paragraphs 10-11 of the Agreement on Agriculture [is] warranted for upland cotton AMS calculations." Brazil's Rebuttal Submission, para. 73 fn. 172. Because the Peace Clause proviso comparison must compare the support that challenged measures grant to "that decided during the 1992 marketing year," the price gap methodology is the only AMS approach that reflects only the United States' decisions and not market prices beyond the United States' control. For the same reason, it is equally appropriate to use the price gap methodology for marketing loan payments.

[129] Total deficiency payments calculated via the price gap methodology equal unadjusted basic deficiency payments ($724 million / 0.875) + 50/92 deficiency payments ($30 million) – that is, $858 million. *See* US Rebuttal Submission, para. 115 fn. 144.

[130] To calculate the deficiency payment support using the price gap methodology and consistent with the 1995 US WTO notification and G/AG/AGST/USA, we made the following calculations.

Total deficiency payments are equal to basic deficiency payments plus 50/92 payments. Basic deficiency payments are equal to eligible production times a price gap measured as the difference between the target price and a fixed reference price. Eligible production is measured as eligible base acreage times average programme yield. Eligible base acreage is equal to participating base acreage minus Acreage Conservation Reserve acres minus Normal Flex Acres minus acres enrolled in the 50/92 programme. The fixed reference price is the1986-88 average of the higher of the market price or loan rate for each year.

Payments for the 50/92 programme were calculated in a similar fashion by multiplying base acres in the 50/92 programme times the average programme yield times 92 per cent of the price gap.

In 1992, the target price was 72.9 cents per pound and the fixed reference price for 1986-88 was 57.9 cents per pound. This gives a price gap of 15.0 cents per pound. Eligible production for basic deficiency payments in 1992 was equal to 5,544 million pounds (9.226 million acres times the average programme yield of 601 pounds per acre). Multiplying the price gap times eligible production gives basic deficiency payments equal to $832 million.

The same formula is used to calculate deficiency payments under the 50/92 programme. For 1992, the price gap is the same as that calculated for the basic deficiency payments (15 cents per pound). Eligible

calculation, moreover, uses the actual payment acreage (that is, acres planted for harvest or participating in the 50/92 programme on which payment was received) to calculate the "eligible production." Using instead the base acreage minus the 10 per cent acreage reduction figure and the 15 per cent normal flex acres (14.9 million effective base acres[131] *x* .75 = 11.175 million acres) and multiplying by the programme yield (602 pounds per acre), the "quantity of production eligible to receive the administered price"[132] is 6,727 million pounds, yielding a price gap deficiency payment calculation of $1,009 million. Thus, the figure in paragraph 115 of the US rebuttal reflected a conservative approach that understated the support resulting from a price gap calculation.

9. In this regard, the United States notes Brazil's argument with respect to the 1995 Statement of Administrative Action, which explained that Peace Clause protection would apply "unless the AMS for the particular commodity exceeds the level decided in the 1992 marketing year."[133] We agree with Brazil that this reference to "AMS" is "non-textual[]" because the Peace Clause uses the term "support decided" and not "AMS."[134] However, to the extent that the Panel were to examine "the AMS for the particular commodity" – that is, the upland cotton AMS – the United States has demonstrated that in no year from 1999-2002 does that AMS exceed the 1992 level.

## III. The US Level of Support Argument Does Take Into Account All Product-Specific Support That Challenged US Measures Grant

10. Brazil has argued that "the United States '72.9 methodology' does not – and cannot account for cottonseed payments, Step 2 payments, storage payments and interest rate subsidies," which the United States has identified as product-specific support.[135] Brazil then alleges that the US methodology "would sanction the cover-up of hundreds of millions – if not billions – of dollars of expenditures."[136] Over-heated rhetoric aside, Brazil's argument is simply erroneous.

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production under the 50/92 programme was 254 million pounds (404 thousand acres times the average programme yield of 50/92 participants of 628 pounds per acre). Deficiency payments under the 50/92 programme were thus equal to $35 million (0.92 times 254 million times $0.15).

Total deficiency payments under the price gap methodology were thus equal to $867 million ($832 million plus $35 million). *Sources:* US Department of Agriculture, Compliance Report for 1992 Acreage Reduction Programme (1993) (Exhibit US-39); Commodity Credit Corporation Commodity Estimates Book for the FY 1995 President's Budget (February 1994); G/AG/AGST/USA, p. 18.

[131] *See* Exhibit Bra-105, Annex 2 (1st source document: US Department of Agriculture, *Provisions of the Federal Agricultural Improvement and Reform Act of 1996*, at 142) (giving 1992 effective base acreage of 14.9 million acres); *id.*, Annex 2 (2nd source document: Daniel A. Sumner, *Farm Programmes and Related Policy in the United States*, at 4) (same).

[132] Agreement on Agriculture, Annex 3, para. 10.

[133] We also note that Brazil never quotes that passage in full since the first half reflects the US view throughout this dispute that "exempt from actions" means not liable to a legal process or suit. *See* 1995 Statement, at 68 ( "Under Article 13(b)(ii) and (iii), governments *may not initiate* adverse effects, serious prejudice or non-violation nullification and impairment *challenges* in the WTO . . . .") (emphasis added). There are numerous other statements in the 1995 Statement that Brazil similarly does not draw to the Panel's attention. *See id.* at 67 ("Article 13, commonly referred to as the peace clause, reflects *an agreement among WTO countries to refrain from challenging* certain of each other's agricultural subsidy programmes . . . *through WTO dispute settlement procedures* . . . .") (emphasis added); *id.* ("*Article 13(b) addresses possible challenges* to domestic support measures falling outside the green box in circumstances in which the WTO member providing the subsidy is meeting its total AMS commitments.") (emphasis added).

[134] Brazil's Opening Statement, para. 35; Brazil's Rebuttal Submission, para. 75; *see also* 1995 Statement of Administrative Action, at 68 (subsequently in same paragraph quoted by Brazil stating "a WTO Member will not be protected by the Peace Clause if its support for the product is above that decided during the 1992 marketing year.") (emphasis added).

[135] Brazil's General Comment on US Answers to Questions 47-69 from the Panel (para. 55).

[136] Brazil's General Comment on US Answers to Questions 47-69 from the Panel (para. 56).

11. Brazil argues that the United States has not accounted for Step 2 payments. The United States directs the Panel's attention to the US rebuttal submission, paragraphs 111 and 113, and the US first written submission, paragraph 111. The United States has noted that, because the availability of Step 2 payments is contingent on certain price conditions existing during the marketing year, the level of support decided must relate to the payment parameters. While these have changed slightly with the 2002 Act, these minor adjustments do not alter the revenue ensured for producers by the marketing loan rate of 52 cents per pound because Step 2 merely provides an alternative avenue of providing support (through processors rather than directly to producers). In addition, these minor adjustments cannot overcome the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002.

12. Brazil argues that the United States has not accounted for cottonseed payments. The United States directs the Panel's attention to the US rebuttal submission, paragraph 111 fn. 136, 137 and paragraph 113. While the United States maintains that these measures are not within the Panel's terms of reference[137], we note that cottonseed payments for the 1999, 2000, and 2002 crops ranged in value between 0.6 to 2.3 cents per pound (factoring expenditures – the way these measures were decided – over production). Thus, given the greater than 20 cents per pound difference in product-specific support between marketing years 1992 and 1999-2002, cottonseed payments too do not materially affect the comparison between marketing year 1992 and any other year.

13. With respect to storage payments and interest rate subsidies, we note that these are US Government estimates of support provided through activities relating to operating the upland cotton marketing loan programme.[138] This support is already captured, however, in the level of support expressed by the marketing loan rate. Were these costs not borne by the United States, the costs to the producer would reduce the guaranteed revenue below the loan rate. In fact, Annex 3 of the Agreement on Agriculture explains that, for purposes of market price support calculated using a price gap, "[b]udgetary payments made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS." Similarly, where the support provided by marketing loans is measured using a price gap methodology (the only appropriate AMS calculation for purposes of the Peace Clause)[139], "payments made to maintain this gap," such as storage payments and interest rate subsidies, should not be counted separately.

## IV. Brazil's New Green Box Arguments Are in Error

14. In its rebuttal submission and comments on US answers to questions from the Panel, Brazil advances two novel arguments. First, Brazil for the first time responds to the US argument that Brazil's interpretation of paragraph 6(b) would create an inconsistency between that provision and the fundamental requirement of the first sentence of Annex 2, paragraph 1.[140] Second, Brazil argues that the US interpretation of Annex 2, paragraph 6(b), would render paragraph 6(e) of that Annex a nullity. Neither of these arguments withstands scrutiny.

15. First, Brazil misunderstands the US argument that Brazil's reading of paragraph 6(b) creates an inconsistency between that paragraph and the fundamental requirement of the first sentence of Annex 2, paragraph 1, and therefore its arguments go astray. The United States has noted that if payments under a decoupled income support measure were reduced or eliminated if a recipient were to produce any commodity, then the amount of payments would be (on Brazil's reading) linked to the type of production and therefore inconsistent with paragraph 6(b), even though such a measure would

[137] *See* US Rebuttal Submission, paras. 106-09.
[138] For example, for storage payments we estimate expenses incurred with respect to upland cotton put under loan and pledged as collateral.
[139] *See* US Rebuttal Submission, paras. 114-17.
[140] Brazil's Rebuttal Submission, paras. 4-9.

meet the fundamental requirement of Annex 2. Brazil does not contest that such a measure would meet that fundamental requirement but instead argues that "requiring no production, *i.e.*, on all base acres is not a 'type of production'" because "[t]he notion of 'type of production' in paragraph 6(b) is necessarily linked to the amount of payment to some 'type' of commodity that is 'produced' and not to a production requirement itself."[141]

16. With respect, if one were to credit this argument, then Brazil would appear to have misunderstood its own objection to US direct payments and production flexibility contract payments. That is, in the US example, payments are reduced or eliminated if a recipient produces *any type* of commodity. Similarly, Brazil's objection to US green box payments is that payments are reduced or eliminated if a recipient produces *certain types* of commodities. Thus, in the former example, the amount of payment is "based on" (in the sense of being reduced by) "the type" of production undertaken by the producer – for example, production of upland cotton, fruits, vegetables, or wild rice – just as in Brazil's argument on US green box payments, the amount of payment is "based on" (in the sense of being reduced by) "the type" of production undertaken by the producer – that is, fruit, vegetable, or wild rice production. Brazil's objection to US green box payments under paragraph 6(b) would therefore apply with equal force to the US example,[142] again, posing an inconsistency between Brazil's interpretation of paragraph 6(b) and the fundamental requirement of Annex 2.[143]

17. Brazil also argues that the US interpretation of paragraph 6(b) "would render Annex 2, paragraph 6(e)[,] a nullity" because the "US interpretation of paragraph 6(b) as not requiring the production of 'certain crops' is the same as 6(e)'s prohibition on not requiring production of 'any crops.'"[144] Brazil's own re-phrasing of the US argument, however, points to the distinction between the obligations contained in these two provisions. Paragraph 6(e) establishes that under a green box measure: "No production shall be required in order to receive such payments." Thus, there can be no production requirement "in order to receive such payments," but the provision is silent with respect to the *amount* of such payments at any particular time and any links to the "type or volume of production." That is, were paragraph 6(e) alone part of Annex 2, a Member could arguably link the amount of payments to requirements on the "type or volume of production" so long as payment eligibility were not contingent on production.

18. Paragraph 6(b) forecloses that option by prohibiting a green box measure from linking the "amount of such payments in any given year" to "the type or volume of production." That is, not only may a green box measure not require production, but the measure may not require a particular "type or volume of production" in order to obtain a payment amount. As the United States has noted, both direct payments and production flexibility contract payments meet that test because no "type or volume of production" is required to receive payments. For example, with respect to the fruits, vegetables, and wild rice planting flexibility issue, a payment recipient need not undertake any "type or volume of production" in order to receive the full "amount of payments" to which the farm's base acres are entitled. Rather, the recipient need only *desist* from planting certain commodities. Thus, Brazil's objection is nothing more than a statement that, under US green box measures, the amount of payments is linked to production *not* undertaken by the producer.

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[141] Brazil's Rebuttal Submission, para. 6. Brazil concludes the thought: "Otherwise, it logically could not be a 'type' of production. It would be nothing at all."

[142] *See* Brazil's Rebuttal Submission, para. 4 ("The relevant text of paragraph 6(b) prohibits any linkage of the 'amount of payments' to *any* 'type of production' of an agricultural product.") (emphasis added).

[143] Brazil's reference to paragraph 6(e) does not answer this objection. Brazil argues that "negotiators addressed any possible misunderstanding in this regard by including the very concept of prohibiting the requirement to produce in paragraph 6(e)." Brazil's Rebuttal Submission, para. 6. However, as Brazil immediately points out, conformity with paragraph 6(e) "does not exempt . . . payments from conforming to the requirement of paragraph 6(b)."

[144] Brazil's Comment on US Answer to Question 32 from the Panel (para. 44).

19. Finally, we note that Brazil's reading of paragraph 6(b) could prevent Members from imposing on decoupled income support payment recipients any conditions relating to the type of production – for example, the planting of illegal crops or production of unapproved biotech varieties or environmentally damaging production. As a practical matter, no Member could accept not being able to impose any such conditions on payment recipients. The result of Brazil's reading, then, would be to read decoupled income support out of Annex 2. This may be a favourable result from the Brazilian perspective, but the Panel should not adopt an interpretation of paragraph 6(b) not required by the text, not consistent with its context (in particular, the fundamental requirement of Annex 2), and with such potentially far-reaching results.

## V. Answer to Additional Question 67*bis* from the Panel

**67*bis*. Please state the annual amount granted by the US government in each of the 1999, 2000, 2001 and 2002 marketing years (as applicable) to US upland cotton producers, per pound and in total expenditures, under each of the following programmes: production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments.**

20. The Panel's question would require ascertaining for each programme the amount of upland cotton produced by recipients of payments under the programme. However, the United States does not maintain and cannot calculate this information – that is, it does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers. This is because the payments do not relate to, and do not depend on, what crop, if any, is actually produced. Instead, each of these programmes makes payments with respect to *past* production on base *acreage* in a fixed and defined base period, not with respect to whether one is currently a producer.

21. Thus, the United States did track total expenditures with respect to base acres of wheat, corn, barley, grain sorghum, oats, upland cotton, and rice under the expired production flexibility contract payments and market loss assistance payments and does track total expenditure with respect to base acres of wheat, corn, barley, grain sorghum, oats, upland cotton, rice, peanuts, soybeans, sunflower seed, canola, rapeseed, safflower, flaxseed, mustard seed, crambe, and sesame seed under the direct payments and counter-cyclical payments.[145] However, the fact that a recipient at one time produced one of these crops says nothing about what crops the recipient is currently producing, if any. In other words, payments made on the basis of past production of upland cotton do not tell anything about whether the recipient is currently producing cotton, corn, livestock, hay, or any other crop or is not producing at all. As a result, it is not possible to derive from these payments whether the payment is being received by an upland cotton producer.

22. The Panel's question points to a fundamental difficulty with Brazil's approach. Brazil would have the Panel allocate "support to a specific commodity" – upland cotton – on the basis that certain of these measures determine payment amounts (for base acres) based on current or recent market prices for that commodity. However, how could the payment be "support to a specific commodity" (support "provided for an agricultural product in favour of the producer of the basic agricultural product") if there need be no production of upland cotton in order to receive payment?

23. Brazil attempts to avoid this result by arguing that various US payments (direct, counter-cyclical, production flexibility contract, and market loss assistance payments) are *not* non-product-specific support because they are not payments to "producers in general." The United States has addressed this erroneous interpretation in detail in its rebuttal submission. In short, Brazil's reading requires ignoring the definition of product-specific support in Article 1(a) (that is "support . . .

[145] *See* US First Written Submission, para. 57 fn. 46.

provided for an agricultural product in favour of the producers of the basic agricultural product"), which Brazil has not interpreted, in over 450 pages of submissions and statements, even once.[146] In fact, Brazil's reading of the definition of non-product-specific support ("support provided in favour of agricultural producers in general") reads the phrase "in general" as meaning "in a body; universally; without exception." However, this dictionary definition is considered "obsolete"[147] and so would hardly be the "ordinary meaning" of the term.

24. As Brazil has conceded, moreover, payments made with respect to upland cotton base acres are not necessarily in favor of upland cotton producers since those acres may not be planted to upland cotton – indeed, may not be planted at all. We note that Brazil has adjusted its entire AMS calculation to reflect its belated realization that, under its own theory, "only the portion of . . . payments [on "upland cotton" base acres] that actually benefits acres planted to upland cotton can be considered support to upland cotton."[148] But Brazil's adjustment is not enough. Brazil simply takes the ratio of actual upland cotton acreage to "upland cotton" base acreage under a given programme. However, there is no reason why upland cotton acreage need be planted on "upland cotton" base acreage. Consider this example:

- One farm could have 100 base acres of upland cotton and currently plant those 100 acres to corn; direct and counter-cyclical payments would be made on those 100 "upland cotton" base acres that actually are planted to corn.

- Another farm could have 100 base acres of corn and currently plant those 100 acres to upland cotton; direct and counter-cyclical payments would be made on those 100 "corn" base acres that actually are planted to upland cotton.

- Brazil's approach (dividing upland cotton planted by upland cotton base acres) would simply say that *all* of the direct and counter-cyclical payments on "upland cotton" base acres are "support to upland cotton" because there are 100 "upland cotton" base acres on which payments were made and 100 acres currently planted to upland cotton, even though these are found on completely separate farms.

Thus, Brazil's ratio does not identify, *even on Brazil's own terms*, the alleged support to upland cotton (that is, "payments that actually benefit[] acres planted to upland cotton") under these programmes.[149]

25. Brazil's own approach would require Brazil to match up payments for upland cotton base acres with the amount of upland cotton production on those base acres, but Brazil has not done so.[150]

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[146] *See, e.g.*, Brazil's Rebuttal Submission, para. 19 (again misquoting the definition of product-specific support in Article 1(a) by eliminating the phrase support provided "for an agricultural product" and failing to interpret that definition according to the customary rules of interpretation of public international law); Brazil's Comments on US Answer to Question 43 from the Panel (paras. 58-60) (criticizing US interpretation of product-specific support but failing to interpret that definition according to the customary rules of interpretation of public international law); Brazil's Comments on US Answer to Question 38 from the Panel (paras. 48-49) (same).

[147] *See The New Shorter Oxford English Dictionary*, vol. 1, at 1073 (first definition of "in general": "† (*a*) in a body; universally; without exception"); *id.*, vol. 1, at xv (sec. 4.5.2: Status symbols) ("The dagger [†] indicates that a word, sense, form, or construction is obsolete. It is placed before the relevant word(s) or relevant sense number.").

[148] *See, e.g.*, Brazil's Answer to Question 67 from the Panel (table, fn. 2, 3, 4, 5).

[149] We also would reiterate that such payments would not be "support to a specific commodity" as explained in Article 1(a) and reflected in Annex 3.

[150] For example, Brazil admits that "this acknowledged legal flexibility to grow other crops does not answer the question of whether the producers planting 14.2 million aces of upland cotton in MY 2002 received direct and counter-cyclical payments. Nor does it answer the question of whether the 14.2 million acres planted

At best, Brazil speculates as to the *likelihood* of a person with cotton base acres actually producing upland cotton on those base acres, and even that speculation is flawed.[151] However, such an approach amounts to little more than speculation and, even if Brazil's erroneous interpretation were used, does not meet Brazil's burden of establishing a *prima facie* case.

26. In addition, under Brazil's own approach, the payments made in relation to corn base acres would be support for *corn* even if planted to upland cotton. However, Brazil's approach would appear to result in double counting the support – the same payment would be support to corn (because it was related to corn base acres) and support to upland cotton (because cotton was produced on base acres eligible for payments). In other words, Brazil is trying to have it both ways:

- First, Brazil argues that payments made based on production on base acres during a base period is support to the crop that was produced during that base period, regardless of what is actually produced currently (that is, payments made for upland cotton base acreage is support to upland cotton even if the producer is now growing corn on that acreage).

- Second, Brazil argues that payments made under these programmes are support to the crop that is currently being produced, even if the crop being produced is different from the base crop (that is, payments made for corn base acreage is support to upland cotton if upland cotton is being produced on the corn base).

27. Furthermore, because payments under the cited programmes are made with respect to historic acres and yields during a base period, it is not possible to calculate the "annual amount granted by the US government . . . to US upland cotton producers, per pound." Counter-cyclical payments, for example, determine the payment rate for base period production as the difference between a target price and the sum of the direct payment rate plus the higher of the market price or the loan rate. However, the per pound payment rate for upland cotton base acres applies only for base period production (base acres *x* payment yields), not current production. Thus, to express these payments per pound begs the question: "Per pound of what?" Any production figure used – whether base period production or production in any year from 1999 through 2002 – results in a highly artificial per pound

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to upland cotton in MY 2002 were planted on *upland cotton* base acreage." Brazil's Rebuttal Submission, para. 38 (emphasis in original). The United States agrees completely, and while Brazil's approach would require that these questions be answered, Brazil has not answered them, even though under Brazil's approach, Brazil would have the burden of proof in this regard. Rather, Brazil tries to construct a series of assumption based on what Brazil considers "likely" or "maybe" or "probably."

[151] *See* Brazil's Rebuttal Submission, paras. 24-50. Brazil makes a lengthy presentation of new data and calculations, including some with respect to crops other than upland cotton, to assert that these four payments are support for upland cotton because without them upland cotton farmers could not cover their costs. However, Brazil's approach is flawed in terms of its facts and the premises on which it relies. In the time available we have not been able to identify and describe all the flaws and inaccuracies in Brazil's presentation of the data. Simply by way of example, however, we note that (1) Brazil includes a figure for cottonseed payments in its graph purporting to show MY 2001 market revenue and government support (Rebuttal Submission, paragraph 30), but Brazil's own table at paragraph 84 of its rebuttal submission reflects that there were no cottonseed payments for the 2001 marketing year; (2) Brazil's theory would appear to be that cotton production on cotton base acres are "necessary" because without government payments costs of production would not be covered, but Brazil presents information only with respect to one year, marketing year 2001, with record low prices - Brazil does not explain its theory or present any data with respect to other years with more typical prices; (3) Brazil asserts that upland cotton production "is produced only in particular regions . . . and producers tend to specialize and not readily switch to other crops" – whereas cotton is produced in 17 of the 50 United States and, for all US cotton farms, average cotton area is approximately 38 per cent of a farm's acres (469 of 1,222 acres) (US Department of Agriculture, Characteristics and Production Costs of US Cotton Farms (October 2001).)

rate since (as noted above) these payments will be or were (as the case may be) received by a recipient regardless of whether he or she produced any upland cotton production.

28. We are able to provide to the Panel the total outlays under the cited programmes with respect to upland cotton base acreage:

| **Total Outlays Under Certain Programmes with respect to Upland Cotton Base Acres (millions US$)** | | | | |
|---|---|---|---|---|
| Payments[152] | MY1999 | MY2000 | MY2001 | MY2002 |
| Production flexibility contract | 614 | 575 | 474 | 452 |
| Market loss assistance | 613 | 612 | 524 | NA |
| Direct | NA | NA | NA | not yet available[153] |
| Counter-cyclical | NA | NA | NA | not yet available[154] |

## VI. Payments With Respect to Base Period Production of Certain Commodities But Not Others Are Not Inherently Product-Specific Support

29. Brazil has argued that production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments are product-specific support. The United States had addressed some infirmities in Brazil's approach in response to Additional Question 67*bis* from the Panel and in previous submissions.[155] The United States now briefly addresses two arguments presented by Brazil.

30. First, Brazil argues that each of these payments is product-specific because base acreage is defined as acreage on which only some commodities were historically produced during a defined and fixed base period. This argument, again, rests on an "obsolete" definition of "in general" (in the definition of non-product-specific support) as "universal" or "without exception" and a determined refusal to quote accurately and interpret the definition of product-specific support in Article 1(a).[156]

[152] *See* Exhibit US-38 (http://www.fsa.usda.gov/dam/BUD/bud1.htm) (for crop years 1999, 2000, and 2001).

[153] The US Department of Agriculture estimates that direct payments for the 2002 marketing year with respect to upland cotton base acres will total $173 million. Exhibit US-18 (www.fsa.usda.gov/dam/BUD/estimatesbook.htm).

[154] The US Department of Agriculture estimates that counter-cyclical payments for the 2002 marketing year with respect to upland cotton base acres will total $873 million. Exhibit US-18 (www.fsa.usda.gov/dam/BUD/estimatesbook.htm).

[155] *See, e.g.*, US Rebuttal Submission, paras. 79-92, 99-105.

[156] We note that, once again, Brazil has misquoted the definition of product-specific support in Article 1(a). Brazil quotes that definition as follows: "For support not provided to agricultural producers *in general*, the test is whether the support is 'provided in favour of the producers of the basic agricultural product.'" Brazil's Rebuttal Submission, para. 19. The actual text of Article 1(a), in pertinent part, reads:

That these payments are made with respect to base acreage for only some commodities is not relevant to the question whether they are support "provided for an agricultural product in favour of the producers of the basic agricultural product."[157] None of these payments satisfies either part of this definition: they are neither provided "for an agricultural product" (rather, they are made with respect to historic production of several products) nor "in favour of the producers of the basic agricultural product" (no production is necessary for payments to be made).

31. Brazil also appears to now argue that the requirement under paragraph 6(a) of Annex 2 that eligibility for payments under a decoupled income support measure "shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period" requires that these payments be made to *all* producers for *all* commodities. This approach would seriously limit the ability of Members to move to decoupled income support. It is not clear that any Member would be willing to switch to decoupled income support if it required expanding support to whole new classes of producers or commodities. We can find no basis for this approach in the text of paragraph 6(a). This definition does not require comprehensive coverage of all or nearly all production in "a defined and fixed base period"; it merely requires "clearly-defined criteria." Thus, under Brazil's reading, a measure could satisfy the requirement of Annex 2, paragraph 6(a), and yet qualify as product-specific support under Article 1(a).

32. Second, Brazil again selectively quotes the statutory definition of "producers" to suggest that recipients of these payments had to be growers who "shared in the risk of producing a crop."[158] As the United States has previously noted, the statute defines "producers" (those eligible in the first instance to receive payment) as persons who "would have shared had the crop been produced."[159] Thus, both the 2002 and 1996 Acts make clear that a payment recipient need not produce any crop (including upland cotton) to receive payment. It is thus a serious error to imply that a payment recipient is necessarily a "producer" in the Agreement on Agriculture rather than a "producer" (meaning "recipient") in the statutory sense.

33. Nowhere in Brazil's submission is there any suggestion of how its approach can be found in the Agreement on Agriculture. It does not make sense of the definitions of product-specific support and non-product-specific support in Article 1(a), which Brazil has recognized guide the interpretation of the phrase "support to a specific commodity" in the Peace Clause. In sum, Brazil's argument

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"support . . . provided *for an agricultural product* in favour of the producers of the basic agricultural product" (emphasis added). What Brazil describes as "the narrow US Article 13(b)(ii) specificity standard" in fact flows from an interpretation of Article 13 that makes sense of the *entire* text of Article 1(a) and not just selected parts of it.

[157] Indeed, Brazil's argument in paragraph 36 of its rebuttal submission rests on a *non sequitur*. Brazil's statement is that: "Thus, direct payments are *not* available to the great majority of US producers of agricultural commodities, *i.e.*, they are not provided to US agricultural producers *in general*." (Emphasis in original.) The illogic in Brazil's statement is that, by removing the requirement to produce any particular crop or any crop at all in order to receive these payments, the United States does in fact make the payments available to producers in general. Recipients are free to produce a broad range of commodities, and so are producers of agricultural commodities "in general." Brazil appears to acknowledge that the payments are not in fact tied to current production when, in paragraph 50, Brazil concedes that the payments are made to "upland cotton base acreage holders" rather than to upland cotton *producers*.

[158] *See* Brazil's Rebuttal Submission, paras. 24 (quoting first half of definition), 29 ("Thus, as with PFC payments, market loss assistance payments were not paid to agricultural producers *in general* but rather to only a select group of US producers), 36 ("Direct payments are targeted support to "producers" farming, *inter alia*, on upland cotton base acreage."), 48 ("But the evidence demonstrates that CCP funds in MY 2002 paid to "historic" (i.e., 1998-2001 or 1993-1995) upland cotton producers are paid to a tiny fraction of total US producers of agricultural commodities.").

[159] US Rebuttal Submission, paras. 36-38.

provides ample evidence that the phrase "support to a specific commodity" in the Peace Clause must be interpreted in the context provided by the Agreement on Agriculture. To divorce it from that context may result in an unworkable and illogical interpretation along the lines suggested by Brazil.

## VII. Brazil's New Arguments Relating to Crop Insurance Do Not Demonstrate that Crop Insurance Payments Are Product-Specific Support

34. Brazil presents a number of arguments claiming that crop insurance payments are "support to a specific commodity." In part, this argument relies on the notion that such payments are not support provided to agricultural producers "in general" and, hence, not non-product-specific support. We note, however, that in making these arguments Brazil avoids any reference to the definition of product-specific support in Article 1(a). This is a fundamental interpretive error: Brazil cannot claim that payments are not support to "agricultural producers in general" under Article 1(a) without providing an interpretation of the other component of support in Article 1(a), namely, product-specific support (support "provided for an agricultural product in favour of the producers of the basic agricultural product"). In fact, given that crop insurance support is available to approximately 100 agricultural commodities, representing approximately 80 per cent of US area planted and greater than 85 per cent of the value of all US crops, crop insurance payments are not support "provided for *an* agricultural product."[160] The support to these approximately 100 commodities is the same: that is, the crop insurance premium subsidies do not vary by commodity or plan of insurance.

35. Brazil's specific arguments fail to address the definition of product-specific support in Article 1(a); thus, each fails to demonstrate that crop insurance payments are "support to a specific commodity" rather than "support to several commodities."

36. First, Brazil argues that certain policies (and accompanying premiums) on irrigation failures are available only to upland cotton and a few other commodities. The United States has previously addressed this argument and directs the Panel's attention to that argument.[161]

37. Second, Brazil argues that a larger pool of types of insurance policies are offered to upland cotton than most other crops. Brazil has not explained how the types of crop insurance policies offered by private companies[162] can affect whether US crop insurance payments (premium subsidies that do not vary by commodity or insurance plan) are product-specific or not. Brazil's "facts" are also misleading in some instances and erroneous in others. For example, Brazil suggests that "in many instances, the policies available for cotton enterprises are not available for other crops."[163] However, we note that commodities other than upland cotton can be insured under the same types of policies as upland cotton.[164]

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[160] US Rebuttal Submission, paras. 93-98.

[161] *See* US Rebuttal Submission, para. 54.

[162] Under the Agricultural Risk Protection Act, new insurance products must be developed by the private sector and approved by the Board of Directors of the Federal Crop Insurance Corporation. The US Department of Agriculture is expressly prohibited from conducting research and development on new products. Thus, the variety and availability of insurance products reflects the fact that private companies, not the US Government, have developed and offered these products.

[163] Brazil's Rebuttal Submission, para. 55.

[164] Upland cotton producers can insure their crops under the following types of policies: Actual Production History, Group Risk Plan, Income Protection, Crop Revenue Coverage, and Revenue Assurance. Other crops that are eligible for the policies include:

for Actual Production History – Alfalfa seed, all other grapefruit, almonds, apples, avocados, barley, blueberries, cabbage, canola, cigar binder tobacco, cigar filler tobacco, cigar wrapper tobacco, corn, cotton, ELS cotton, crambe, cranberries, cultivated wild rice, dry beans, dry peas, early and midseason oranges, figs, flax, forage production, fresh apricots, fresh freestone peaches, fresh market tomatoes, fresh nectarines, grain sorghum, grapefruit, grapes, green peas, late oranges, lemons, macadamia nuts, mandarins, Maryland tobacco,

38. Third, Brazil argues that are there specific upland cotton provisions in certain policies.[165] This is true – an insurance product offered by a private company must be tailored for the situation and desires of the insurance purchasers – but also irrelevant as the policies are generally similar in underwriting rules and share the same subsidy schedule.

39. Fourth, Brazil argues that upland cotton producer participation rates in the crop insurance programme "is much higher that for other crops."[166] We first note that Brazil neglects to mention that participation rates for the major field crops are generally quite high (over 75 per cent of insurable acres). Any producer who received disaster assistance was required to purchase federal crop insurance in the following year; cotton participation may be slightly higher because of droughts that have hit cotton regions in recent years. More importantly, that cotton producers may choose to take up crop insurance more than producers of other commodities might is irrelevant to whether the payments are provided "for an agricultural product." Again, the crop insurance premium subsidy is identical for all commodities and for each plan of insurance.

40. Fifth, Brazil argues that tracking the cost of reinsurance provided to private companies is "further evidence that USDA treats crop insurance for upland cotton separately from crop insurance provided to other crops."[167] Of course, the way the US Department of Agriculture "tracks cost[s]" is irrelevant to the analysis of whether crop insurance payments provide support "for an agricultural product." Brazil also misinterprets the Standard Reinsurance Agreement between the US Government and private insurers. Under that Agreement, net underwriting gains and losses for each insurer are calculated *at the state level* over *all crops*, not separately for individual crops (such as upland cotton).[168] Thus, Brazil errs when it claims that reinsurance provides evidence that crop insurance for upland cotton is treated separately from crop insurance provided to other crops.

41. Sixth, Brazil claims that "the 2000 ARP Act denies subsidies to producers of other agricultural products."[169] It is true that there are certain products for which policies have not been developed. However, development of new policies is ongoing; for example, provisions of the Agricultural Risk Protection Act of 2000 allow for the development of livestock insurance products. A number of livestock products are currently available on a pilot basis, including price insurance for hogs and feeder cattle and gross margin insurance. We also note that producers may currently insure livestock and dairy revenue as part of whole farm insurance offered through the Adjusted Gross Revenue Insurance.[170] Finally, Brazil's argument here again reads domestic producers "in general' to mean "universally" or "without exception"; as noted above, that definition is now considered obsolete.

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millet, Minneola tangelos, mint, mustard, navel oranges, oats, onions, Orlando tangelos, peaches, peanuts, pears, plums, popcorn, potatoes, processing apricots, processing beans, processing cling peaches, processing freestone, prunes, rice, Rio Red and Star Ruby grapefruit, Ruby Red grapefruit, rye, safflower, soybeans, sugar beets, sugarcane, sunflowers, sweet corn, sweet oranges, sweet potatoes, table grapes, tomatoes, Valencia oranges, walnuts, wheat;

for Group Risk – corn, cotton, forage production, grain sorghum, rangeland, soybeans, wheat;

for Income Protection – barley, corn, cotton, grain sorghum, soybeans, wheat; and

` for Revenue Assurance – barley, canola, cotton, grain sorghum, rice, soybeans, sunflowers, wheat.

*See* http://www3.rma.usda.gov/apps/sob/current_week/crop2003.pdf.

[165] Brazil's Rebuttal Submission, para. 55.

[166] Brazil's Rebuttal Submission, para. 57.

[167] Brazil's Rebuttal Submission, para. 58.

[168] The provisions of the Standard Reinsurance Agreement are available on the Risk Management Agency website at: http://www.rma.usda.gov/pubs/ra/98SRA.pdf.

[169] Brazil's Rebuttal Submission, para. 59.

[170] More information on Adjusted Gross Revenue Insurance can be found on the Risk Management Agency website at: http://www.rma.usda.gov/pubs/2003/PAN-1667-06rev.pdf.

42. Finally, with respect to Brazil's references to the literature on the effects of crop insurance on production,[171] the findings are (contrary to what Brazil has claimed) mixed. While several studies (such as those cited by Brazil) have suggested crop insurance payments may have a slight effect on acreage, the effects on *production* are less clear.[172] If crop insurance encourages moral hazard problems (as claimed by Brazil), crop yields will be adversely affected as producers attempt to increase crop insurance indemnities. If moral hazard and adverse selection problems are severe, crop insurance support could potentially have a *negative* effect on production.[173] The potential production effects of crop insurance payments, moreover, goes to whether such payments are "amber box" support but does not figure in the question whether such payments (which are offered at the same rate across commodities and policies) can be support "for an agricultural product."

## VIII. Brazil May Not Act Unilaterally on Procedural Matters

43. The United States takes note of Brazil's statement in its 25 August 2003 letter to the Panel[174] that, concerning paragraph 20 of the Panel's determination of 20 June 2003, "Brazil interpreted this ruling as permitting it to provide no later than 22 August all of its evidence and argument that had not already been provided in its earlier submissions. This is the manner in which it treated the new evidence and arguments presented by the United States in its Rebuttal Submissions." The United States is unable to reconcile Brazil's position concerning its own ability to provide evidence and arguments at any time up through August 22 with Brazil's repeated assertions that the United States "should have" provided particular material in its replies to the Panel's questions.[175] There is of course no basis for Brazil's assertions that particular material "should have been" provided in replies to questions rather than in a rebuttal submission. There is no basis for Brazil to dictate to another Member what it may or may not include in its rebuttal submission. Brazil is fabricating an obligation and attempting to impose it on the United States at the same time that it exempts itself from this obligation. In this, Brazil's approach is similar to its repeated attempts in this dispute to add to the obligations in the Agreement on Agriculture and the Subsidies Agreement.

[171] Brazil's Rebuttal Submission, paras. 60-67.

[172] The US Department of Agriculture, Economic Research Service, studies cited by Brazil only examine the effects of crop insurance subsidies on acreage. They do not consider effects on crop yields.

[173] Recent studies by Smith and Goodwin (1996), Babcock and Hennessy (1996) and Goodwin and Smith (2003) suggest that farms with more insurance tend to use less inputs like fertilizer and pesticides and vice versa. This demonstrates a potential moral hazard problem with crop insurance that suggests that crop insurance participation may have a negative effect on yields. *See* Babcock, B. and D. Hennessy. "Input Demand Under Yield and Revenue Insurance" *American Journal of Agricultural Economics* 78(1996):416-27; Goodwin, B. and V. Smith. "An Ex Post Evaluation of the Conservation Reserve, Federal Crop Insurance, and other Government Programmes: Programme Participation and Soil Erosion." *Journal of Agriculture and Resource Economics* 28(2003):201-216; Smith, V. and B. Goodwin. "Crop Insurance, Moral Hazard and Agricultural Chemical Use." *American Journal of Agricultural Economics* 78(1996):428-38.

[174] The United States also notes that the Panel's communication of 19 August 2003 had not indicated that the parties would have an opportunity to comment on each other's requests to comment. Had there been such an opportunity, the United States would have been happy to comment on Brazil's request of 23 August 2003. Perhaps Brazil could reconsider whether it has a basis to assert a right to decide that it may unilaterally provide comments to the Panel while denying the United States the same procedural rights. Under Brazil's approach, it would not have needed to request permission from the Panel to file comments on Wednesday, August 27, but could have simply provided those comments, unsolicited, while denying equal access for the United States. The United States is grateful that the Panel's extremely prompt reply to the US request obviated any need to respond to Brazil's unauthorized and out of order comments on that request.

[175] *See* Brazil's 23 August 2003 letter to the Panel.

## IX. Conclusion

44. The United States has demonstrated that using any measurement that reflects the support "decided" by the United States rather than factors (such as market prices) beyond the United States' control, US support to upland cotton in marketing years 1999-2002 has not exceeded the 1992 marketing year level. The question then is whether the Panel will find that the United States has breached the Peace Clause simply because market prices were lower in some recent years than they were in 1992.

45. The United States submits that the Peace Clause must be interpreted in a way that permits Members to comply in good faith – that is, Members must be able to tell if they will breach the Peace Clause or not. Brazil's budgetary outlays approach does not do that. Brazil's approach would mean that Members could not know if they had complied with the Peace Clause until it was too late to do anything about it. The best way to interpret the Peace Clause in a way that allows Members to comply is to use the "support" as "decided" by a Member during the 1992 marketing year as the basis for comparison. Recognizing, as the United States believes is required by the Peace Clause text, that "decided" and "grant" cover only those parameters over which Members exercise control would also be consistent with this approach of allowing "good faith" compliance since it would permit Members to control whether their measures conformed to their obligations.

46. The United States has disciplined itself to grant support not in excess of that decided during the 1992 marketing year. Therefore, we are entitled to the protection of the Peace Clause, and we respectfully request the Panel to find that Brazil may not maintain this action challenging these conforming US measures.

## List of Exhibits

1. US Department of Agriculture, Fiscal Year Actual Budgetary Expenditures by Crop Year (http://www.fsa.usda.gov/dam/BUD/bud1.htm)

2. US Department of Agriculture, Compliance Report for 1992 Acreage Reduction Programme

# ANNEX E-5

## CANADA'S FURTHER THIRD PARTY SUBMISSION

3 October 2003

Canada's systemic interest in this case lies in the interpretation of the provisions of Article 13 and Annex 2 of the *Agreement on Agriculture*, as they related to certain US domestic support measures. It also lies in the interpretation of the export subsidy provisions of both the *Agreement on Agriculture* and the *SCM Agreement*, as they related to US export credit guarantee programmes.

Regarding US domestic support measures, were the Panel to accept the evidence presented by Brazil, it would find that US PFC payments and direct payments do not satisfy the policy-specific criteria in paragraph 6 of Annex 2 of the *Agreement on Agriculture*. The Panel should also count US counter-cyclical payments going to US producers of upland cotton as "support to a specific commodity" under Article 13(b)(ii) of the Agreement.

Regarding US export credit guarantees, were the Panel to find that the programs provide export subsidies within the meaning of Article 1(e) of the *Agreement on Agriculture*, then it would also find that the United States has violated Articles 8 and 10.1 at the very least in respect of exports of upland cotton. In this respect, the Panel should confirm that neither the *Agreement on Agriculture* nor the *SCM Agreement* contain an exemption for any US export credit guarantee subsidy found to exist in this case.

Canada has no further views to provide to the Panel at this point in the proceedings.

# ANNEX E-6

## FURTHER THIRD PARTY SUBMISSION OF THE EUROPEAN COMMUNITIES

3 October 2003

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## 1. Introduction

1. The European Communities (the "EC") makes this submission because of its systemic interest in the correct interpretation of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*"), the *Agreement on Agriculture* (the "AA") and the *General Agreement on Tariffs and Trade 1994* (the "GATT").

2. This submission provides the views of the EC with respect to Brazil's further submission of 9 September 2003. Due to the short deadline imparted to third parties, this submission does not address the further submission made by United States on 30 September 2003. The EC intends to provide its comments on the US submission at the meeting with the Panel.

3. Many of the issues raised in Brazil's further submission concern factual matters on which the EC is not in a position to comment. Accordingly, the EC will limit itself to provide its views with respect to a number of issues of legal interpretation to which it attaches particular importance. More specifically, the EC will argue in this submission that:

- in assessing the "significance" of price depression or suppression for the purposes of Article 6.3 (c) of the *SCM Agreement*, only their impact on the producers concerned is relevant;
- Brazil cannot complain about the continuing effects of recurring subsidies while expensing the full amount of such subsidies to the year in which they were granted;
- the phrase "world market share" in Article 6.3(d) of the *SCM Agreement* includes also the market of the subsidising Member;
- the mere fact that a subsidy is not subject to "pre-established limitations" is not sufficient for a finding of "threat of serious prejudice";
- Articles 5 and 6 of the *SCM Agreement* do not prohibit *per se* legislation that mandates subsidies that threaten serious prejudice "in certain circumstances".

4. The EC reserves the right to address other issues raised by Brazil's further submission at the meeting with the Panel.

## 2. The meaning of "significant" in Article 6.3 (c) of the SCM Agreement

5. Brazil argues that, in assessing the "significance" of price depression or suppression for the purposes of Article 6.3 (c), it is relevant to consider not only their impact on the producers concerned, but also on the Government of the complaining Member. Specifically, Brazil contends that

> A developing country Government facing foreign reserve or fiscal problems may find the loss of foreign exchange or tax revenue from its producers to be significant even if the level of price suppression is relatively small. In this regard, the amount of actual and potential revenue losses suffered by a complaining Member as a result of price suppression may be evidence of the significance of the price suppression.[1]

[1] Brazil's submission, para. 96.

6. The EC takes issue with this interpretation. As rightly argued by Brazil elsewhere in its submission[2], the existence of serious prejudice must be presumed whenever it is established that the effect of the subsidy is to cause *inter alia* significant price depression or suppression, without it being necessary to show, as an additional and separate requirement, that such price depression or suppression causes a serious prejudice to the interest of the Member concerned. Brazil's interpretation, however, amounts to reading such a separate requirement into the term "significant".

7. In *Indonesia – Autos*, which is cited with approval by Brazil, the panel held that

> Although the term 'significant' is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully affect suppliers of the imported product whose price was undercut are not considered to rise to serious prejudice …[3]

8. The above interpretation takes into account only the effects of price undercutting on the performance of the domestic producers of the complaining party, to the exclusion of any indirect effects on Government revenue. By the same token, where serious prejudice takes the form of price suppression or price depression, its significance should be evaluated only with respect to the producers concerned.

9. In any event, the EC rejects Brazil's suggestion that the threshold for establishing the existence of serious prejudice should be lower when the complaining party is a developing country Member. Article 6.3 (c) is not a provision on Special and Differential Treatment. There is no basis for giving different meanings to the term "significant" depending on the identity of the parties to a dispute.

### 3. Continuing effects of recurring subsidies

10. Brazil alleges that the effects of the subsidies paid during Marketing Years ("MY") 1999-2002 continue after they have been provided. More precisely, according to Brazil, by providing farmers with a significant source of income, these payments result in increased investment and production.

11. The EC finds it difficult to understand what point, if any, Brazil is trying to make. Brazil does not seem to be arguing that part of the benefit conferred by the subsidies granted during MY 1999-2002 should be allocated to subsequent years. That position would depart from the usual practice of most countervailing duty authorities, which is to consider that recurring subsidies must, in principle, be deemed "expensed" during the time period in which they are made. Similarly, the report of the Informal Group of Experts concerning Article 6.1(a) of the *SCM Agreement* recommended that subsidies should be expensed rather than allocated unless: (1) the purpose of the subsidy is linked to the purchase of fixed assets; (2) the subsidy is non-recurring or large; (3) the subsidy is oriented towards future production; (4) the subsidy consists of equity; or (5) is carried forward in the recipient's accounting records.[4]

12. Elsewhere in its submission Brazil appears to have expensed the full amount of the subsidies paid during each marketing year to that marketing year, rather than allocate it over a number of marketing years. Brazil cannot have it both ways. If it considers that part of the benefit should be allocated to subsequent marketing years, it should justify that position in light of the criteria outlined

[2] Ibid., paras 437-443.
[3] Panel report, *Indonesia – Automobiles*, WT/DS54/R, para. 14.254.
[4] Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures, 25 July 1997, G/SCM/W/415, paras. 5-12.

above and provide the Panel with a detailed allocation. Moreover, Brazil should deduct the amounts allocated to subsequent years from the yearly amounts for the period 1999-2001, so as to avoid any "double counting" of benefits. Needless to say, this could make more difficult for Brazil to establish that the subsidies paid during MY 1999 – 2001 have caused serious prejudice during that period.

13. In any event, while Brazil claims that the subsidies continue to have effects after MY 1999-2001, the alleged continuing effects (increased investments and production) do not of themselves amount to "serious prejudice" within the meaning of Article 5. Brazil has not explained, let alone proved, how those effects translated into one of the categories of "serious prejudice" described under Article 6.3 after 2001.

**4. World Market Share in Article 6.3(d)**

14. Brazil contends that the phrase "world market share" in Article 6.3(d) of the *SCM Agreement* means the "share of world market for exports".[5] The EC sees no basis for this proposition. The ordinary meaning of "world market" is the sum of all the geographical markets for the product concerned, including also the domestic market of the subsidising Member.

15. This reading is supported by the context. As evidenced by paragraph (a) of Article 6.3, the notion of "serious prejudice" may include also the prejudice suffered in the market of the subsidising Member. There is no reason, therefore, why the effects of a subsidy in that market should be excluded from the analysis under paragraph (d).

16. The phrase "world market share" may be contrasted with the phrase "share of world export trade", which is used in Article XVI:3 of the GATT. Surely, if the drafters of Article 6.3(d) had meant the "share of world market for exports", as argued by Brazil, they would have used the same terms as in Article XVI:3. Moreover, in the context of Article XVI:3, it makes perfect sense to use as a benchmark the "share of the world market for exports" because that provision is concerned exclusively with export subsidies, which have no direct effect on the domestic market of the subsidising Member. In contrast, the disciplines on "serious prejudice" contained in Articles 5 and 6 of the *SCM Agreement* apply equally to both export and domestic subsidies and, in practice, are meant to address primarily the effects of the latter, since export subsides are prohibited by Article 3 (except where provided in conformity with the *Agreement on Agriculture* or Article 27 of the *SCM Agreement*).

**5. Threat of injury**

17. Brazil sets forth two legal standards in order to analyse the existence of threat of serious prejudice. According to the first standard, there is threat of serious prejudice whenever "the legislation and practice of granting subsidies has no effective limits in terms of the volume of exports or domestic subsidies production eligible to receive subsidies".[6] Brazil contends that this standard can be "distilled" from the two GATT panel reports in *EC – Sugar* and from the Appellate Body report in *US – FSC*.[7]

18. For the reasons explained below, the EC considers that, while the fact that a subsidy is not subject to any "pre-established limitations" is certainly a relevant factor in considering the existence of threat of serious prejudice, it is not necessarily dispositive.

[5] Brazil's submission, para. 265.
[6] Brazil's submission, para. 301.
[7] Ibid.

19. The two GATT reports in *EC – Sugar* are of questionable authority on this point. Neither of the panels made any attempt to provide a generally applicable interpretation of the notion of "threat of serious prejudice". The findings cited by Brazil are just bare assertions, without any supporting reasoning. Furthermore, other passages of the reports indicate that both panels took the view that the unlimited availability of subsidies could not be, of itself, a cause of serious prejudice. Thus, the panel in *EC – Sugar (Australia)* noted that

> The Panel felt that since the Community sugar exporters were leading the world market for white sugar, traditionally covering more than half of the world market for refined sugar, the availability of exportable Community surpluses of sugar combined with the possibility of non-limited amounts available to cover export refunds, may well have had a depressing effect on world market prices for both white and raw sugar.[8]

Similarly, the panel in *EC – Sugar (Brazil)* observed that

> The Panel concluded that in view of the Community sugar made available for export with maximum refunds and the non-limited funds available to finance export refunds, the Community system of granting export refunds on sugar had been applied in a manner which in the particular situation prevailing in 1978 and 1979contributed to depress sugar prices in the world market, and that this constitutes a serious prejudice to Brazilian interests, in terms of Article XVI:1.[9]

20. The above passages suggest that both panels considered that the unlimited availability of the EC subsides was a cause of serious prejudice only because, in conjunction with the availability of supplies of sugar in the EC and with the "particular situation" prevailing during the years 1978 and 1979, it had a depressing effect on prices. It follows that, unless the same or similar circumstances were also present or imminent in this case, the mere availability of subsidies could not be considered to pose, as such, a threat of serious prejudice.

21. Brazil's arguments based on *US – FSC* are also without merit. Unlike Articles 5 and 6 of the S*CM Agreement*, Article 10.1 of the *Agreement on Agriculture* is not subject to a "trade effects" test. It prohibits any export subsidies not covered by Article 9, which exceed, or threaten to exceed, a Member's reduction commitments (in terms of budgetary outlays or exported volumes), regardless of the trade effects of the subsidy. In contrast, Articles 5 and 6 do not stipulate any limitations on the volume or value of subsidies. Rather, they prohibit the granting of subsidies in so far as they have certain "adverse effects" for the interests of another Member. Whether or not a subsidy has such effects will depend not only on the amount of the subsidy or the volume of subsided goods but also on other circumstances. For that reason, the mere fact that a subsidy is not subject to "pre-established limitations" is not a sufficient reason to conclude that it threatens to cause serious prejudice.

22. Brazil appears to agree with the view that the elements of a threat of serious prejudice injury are the same as those of a serious prejudice case, the only difference between the two being that "in a serious prejudice case, all the elements already exist, whereas in a threat of serious prejudice case, all of the elements need not have come to pass."[10] Yet that view cannot be reconciled with Brazil's first standard. Article 6 of the *SCM Agreement* makes it clear that the existence of "serious prejudice" cannot be established by looking only at the value of the subsidy (with the exception of the no-longer operational presumption in Article 6.1 (a)) or to the absolute volume of subsidised goods (as opposed

[8] Panel report, *European Communities – Refunds on Exports of Sugar (Australia)*, BISD 26S/290, para. 4.31

[9] Panel report, *European Communities –Refunds on Exports of Sugar (Brazil)*, BISD 27S/69, V(f).

[10] Brazil's submission, para. 304.

to their market share). Therefore, a determination of threat of serious prejudice cannot be based on those factors alone either.

23. The EC considers that Article 15.7 of the *SCM Agreement* provides relevant context for the interpretation of the notion of "threat of serious prejudice". Both "injury to the domestic industry" and "serious prejudice" are "adverse effects" within the meaning of Article 5. There is no good reason why the threshold for establishing the existence of "threat of injury" should be higher than the threshold for establishing the existence of "threat of serious prejudice". The EC is of the view, therefore, that the requirements set out in Article 15.7 of the *SCM Agreement* must be deemed implicit in the notion of "threat of serious prejudice". Accordingly, a determination of threat of serious prejudice, like a determination of injury, must "be based on facts and not merely on allegation, conjecture or remote possibility". Also, the relevant "changes in circumstances" must be "clearly foreseen and imminent".

24. As recalled by Brazil, Article 15.7(i) of the *SCM Agreement* provides that the "nature of the subsidy or subsidies in question and the trade effects likely to arise therefrom" is one of the factors that should be considered for the purposes of a threat of injury determination.[11] The EC agrees that this is also one of the factors that should be considered for the purposes of a determination of threat of serious prejudice. But it is not the only relevant factor. Brazil glosses over the last sentence of Article 15.7, which provides that no one of the factors listed in that provision "can necessarily give guidance". Rather, "the totality of the factors considered must lead to the conclusion that further subsidised exports are imminent and that, unless protective action is taken, material injury would occur". This confirms that, while the absence of "pre-established limitations" is a relevant factor, it is not necessarily dispositive.

25. Brazil further asserts that the other factors listed in Article 15.7 "are not directly relevant to a threat of serious prejudice case because they address the situation of imports that would harm the domestic industry in the country of importation."[12] This is, of course, correct. Nonetheless, Article 15.7 suggests that analogous factors may be relevant for a determination of serious prejudice. For example, the following factors could be relevant for establishing the existence of serious prejudice in an export market:

- a significant rate of increase of subsidised exports to the export market;
- sufficiently freely disposable, or an imminent, substantial increase in, capacity of the exporter indicating the likelihood of substantially increased subsidised exports, taking into account the availability of other export markets to absorb any additional exports;
- whether subsidised exports are entering into the export market at prices that will have a significant depressing or suppressing effect in prices, and would likely increase demand for further imports; and
- inventories of the product investigated.

26. In sum, the EC is of the view that, while the fact that a subsidy is not subject to any "pre-established limitations" as regards the value of the subsidies or the volume of subsidised goods is a relevant factor in order to establish the existence of threat of serious prejudice, it is not necessarily dispositive. Other factors, including in particular factors analogous to those listed in Article 15.7 (ii)-(v) of the *SCM Agreement*, may also be relevant and should be examined as well.

[11] Ibid., para. 302.
[12] Ibid., para. 303.

### *6.* ***Per se* claims**

27. Brazil claims that the US legislation conferring the subsidies at issue in this case is inconsistent *per se* with Article 5(c) of the *SCM Agreement* and Article XVI:3 of the GATT because it *mandates* the payment of subsidies that will necessarily threaten serious prejudice *in certain circumstances*. This claim is based on the assumption that

> It is established under WTO law that a Member can challenge measures of another Member on a per se basis when those measures mandate, in certain circumstances, a violation of its WTO obligations.[13]

28. The above proposition, however, is nowhere stated in the WTO Agreement and, as noted already in its first submission[14], the EC disputes its validity. True, some panels have asserted this position on the basis of an erroneous interpretation of the panel report in *US - Superfund*. Other panels, however, have taken a contrary, or at least more qualified view.[15] In particular, the panel in *US – Section 301* observed that

> we believe that resolving the dispute as to which type of legislation, *in abstract*, is capable of violating WTO obligations is not germane to the resolution of the type of claims before us. In our view the appropriate method in cases such as this is to examine with care the nature of the WTO obligation at issue and to evaluate the Measure in question in the light of such examination. The question is then whether, on the correct interpretation of the specific WTO obligation at issue, only mandatory or also discretionary national laws are prohibited. We do not accept the legal logic that there has to be one fast and hard rule covering all domestic legislation. After all, is it so implausible that the framers of the WTO Agreement, in their wisdom, would have crafted some obligations which would render illegal even discretionary legislation and crafted other obligations prohibiting only mandatory legislation? Whether or not Section 304 violates Article 23 depends, thus, first and foremost on the precise obligations contained in Article 23.[16]

29. The Appellate Body has not pronounced itself yet clearly on this issue. Thus, in *US – 1916 Act*, which is sometimes cited erroneously as an endorsement of the principle invoked by Brazil, the Appellate Body noted that

> … the 1916 Act is clearly not discretionary legislation, as that term has been understood for purposes of distinguishing between mandatory and discretionary legislation. Therefore, we do not find it necessary to consider, in these cases, whether

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[13] Brazil's submission, para. 417.

[14] EC's First Third Party Submission, paras. 4-7.

[15] See e.g. the Panel report on *United States – Countervailing Measures Concerning Certain products from the European Communities*, WT/DS212/R, para. 7.123:

> While only legislation that mandates a violation of WTO obligations can be WTO-inconsistent, we are of the view that the existence of some form of executive discretion alone is not enough for a law to be prima facie WTO - consistent, what is important is whether the government has an effective discretion to interpret and apply its legislation in a WTO-inconsistent manner.

[16] Panel report, *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, para. 7.53. [footnotes omitted]

> Article 18.4, or any other provision of the Anti-Dumping Agreement, has supplanted or modified the distinction between mandatory and discretionary legislation.[17]

30. The Appellate Body was even more cautious in a subsequent case, *US – Lead and Bismuth II*, where it noted that

> We are not, by implication, precluding the possibility that a Member could violate its WTO obligations by enacting legislation granting discretion to its authorities to act in violation of its WTO obligation. We make no finding in this respect.[18]

31. The EC agrees with the panel in *US – Section 301* that whether or not *discretionary* legislation may be subject to challenge depends on the specific obligations imposed by each provision of the WTO Agreement. Thus, for example, it is arguable that Article XI:1 of the GATT prohibits not only mandatory legislation, but also legislation which authorises expressly the executive branch to apply an import restriction under well specified circumstances, because such authorisation, of itself, may have a chilling effect on imports.

32. For the same reasons, it would be mistaken to assume, as Brazil does, that legislation which mandates action that would result in a violation of a WTO provision *in certain circumstances* is necessarily inconsistent with that provision. As illustrated by the present case, this notion would have absurd and unacceptable results when applied to WTO provisions which, like Article 5(c) of the *SCM Agreement* and Article XVI:3 of the GATT, incorporate a "trade effects" test. The EC considers that, once again, whether or not legislation that mandates a violation *in certain circumstances* can be challenged *per se* will depend on the specific obligations impose by the WTO provision at issue.

33. It is often overlooked that in *US– Superfund* the panel justified its finding that the tax legislation at issue could be challenged, even though it had not entered into effect, by reasoning that Article III of the GATT is not concerned with trade volumes, but rather with competitive opportunities[19]:

> The Panel noted that the United States objected to an examination of this tax because it did not go into effect before 1 January 1989, and - having no immediate effect on trade and therefore not causing nullification or impairment – fell outside the framework of Article XXIII. […]
>
> […] The general prohibition of quantitative restrictions under Article XI, which the Panel on Japanese Measures on Imports of Leather examined, and the national treatment obligation of Article III … have essentially the same rationale, namely to protect expectations of the contracting parties as to the competitive relationship between their products and those of the other contracting parties. Both articles are not only to protect current trade but also to cerate the predictability needed to plan future trade. That objective could not be attained if contracting parties could not challenge existing legislation mandating actions at variance with the General Agreement until the administrative acts implementing it had actually been applied to their trade. Just as the very existence if a regulation providing for a quota, without it restricting particular imports, has been recognized to constitute a violation of Article XI;1, the

[17] Appellate Body report, *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, WT/DS162/AB/R, para. 99.

[18] Appellate Body report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, footnote 334.

[19] Panel report, *United States – Taxes on Petroleum and Certain Imported Products*, BISD 34/136, 160, paras.5.2.1-5.2.2.

> very existence of mandatory legislation providing for an internal tax, without it being applied to a particular imported product, should be regarded as falling within the scope of Article III:2, first sentence. …

34. It is also a common mistake to assume that, like Articles III or IX of the GATT, all other WTO provisions are concerned also with competitive opportunities. Some WTO provisions, however, are not concerned with competitive opportunities, but instead with trade effects. Article 5(c) of the *SCM Agreement* and Article XVI:3 of the GATT fall within that category. They prohibit the granting of subsidies only to the extent that the subsidies cause "adverse effects" in the form of "serious prejudice". Such effects must be actual or threatened, not just theoretical.

35. The "mandatory" standard invoked upon by Brazil would result in the creation of third category of prohibited adverse effects in addition to actual and threatened serious prejudice, which is nowhere mentioned in Article 5(c): the mere possibility of threat of serious prejudice *in certain circumstances*. Furthermore, as a result, Brazil's interpretation would render redundant the two categories of effects which are mentioned in Article 5(c). As explained above, threat of serious prejudice must be *imminent* and *foreseeable*. Yet, on Brazil's interpretation, it would be sufficient, in order to establish a *per se* violation, to show that the legislation at issue mandates action that threatens serious prejudice *in certain circumstances*, no matter how remote the likelihood that such circumstances will ever materialise. For example, on Brazil's interpretation, it would be enough to show that the legislation mandates the payment of subsidies that will threaten serious prejudice in a purely hypothetical situation where world prices fall to an extremely low level, even if the chances that prices may actually fall to such level are negligible in practice.

36. In sum, Brazil's *per se* claim is an ingenious but misguided attempt to avoid the requirements of Article 5(c) of the *SCM Agreement*, which should be rejected by the Panel.

# ANNEX E-7

## FURTHER THIRD PARTY SUBMISSION OF NEW ZEALAND

3 October 2003

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## I. INTRODUCTION

1.01 Although New Zealand is not a producer or exporter of cotton, New Zealand has a systemic interest in ensuring the continued integrity of important WTO disciplines applicable to agricultural trade and has therefore joined this dispute as a third party. As outlined in New Zealand's First Submission to the Panel[1], New Zealand is concerned to ensure that Members are able to utilise their rights under the *Agreement on Subsidies and Countervailing Measures* (the *SCM Agreement*) and GATT 1994 to take action in respect of domestic support measures and export subsidies where the requirements of the "peace clause" have not been respected.

1.02 New Zealand believes that Brazil has demonstrated that the "peace clause" has not been respected in relation to domestic support and export subsidies provided by the United States to upland cotton in the marketing years ("MY") 1999, 2000, 2001 and 2002, and that accordingly Brazil is entitled to bring actionable and prohibited subsidy claims against the United States under the GATT 1994 and the *SCM Agreement*.

1.03 In its Further Submission to the Panel,[2] Brazil has provided the legal and factual basis upon which the Panel should conclude that the United States subsidies cause or threaten to cause serious prejudice to the interests of Brazil within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement* and violate GATT Article XVI. New Zealand therefore considers that the Panel should make the findings and recommendations requested by Brazil.

1.04 This submission addresses issues raised in the Further Submissions of Brazil and the United States[3] and should be read in conjunction with New Zealand's First Submission. As recognised by the Panel in its communication of 24 September 2003, New Zealand has had only limited time to consider the Further Submission of the United States and therefore reserves the right present arguments in addition to those set out in this written submission in its oral statement to the Panel on 8 October 2003.

## II. PRESENT SERIOUS PREJUDICE

2.01 Brazil has demonstrated that the United States subsidies[4] cause serious prejudice to the interests of Brazil within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement* and violate GATT Article XVI.

2.02 Brazil has demonstrated that the United States subsidies during marketing year (MY) 1999-2002:

- cause present significant price suppression[5] in the world and Brazilian markets, as well as in markets where Brazilian producers export, within the meaning of Article 6.3(c) of the *SCM Agreement*;

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[1] *United States – Subsidies on Upland Cotton*, Third Party Submission of New Zealand, 15 July 2003 ("New Zealand's First Submission").

[2] *United States – Subsidies on Upland Cotton*, Brazil's Further Submission to the Panel, 9 September 2003 ("Further Submission of Brazil").

[3] *United States – Subsidies on Upland Cotton*, Further Submission of the United States of America, 30 September 2003 ("Further Submission of the US").

[4] New Zealand uses that term as it is used by Brazil in its Further Submission (para 7). Details of these programmes were provided by Brazil in its First Submission to the Panel Regarding the "Peace Clause" and Non-"Peace Clause" Related Claims, 24 June 2003 ("First Written Submission of Brazil"), paras 45 – 106.

[5] New Zealand uses the term as it is used by Brazil in its Further Submission to also encompass circumstances showing price depression characteristics.

- had the effect of increasing the United States share of the world upland cotton market within the meaning of Article 6.3(d) of the *SCM Agreement*, and

- contributed significantly to the United States having more than an equitable share of world export trade within the meaning of GATT Article XVI:3.

New Zealand will focus in particular on Brazil's claim that the United States subsidies cause "significant price suppression".

**1. The effect of the United States subsidies is significant price suppression**

2.03 Brazil has demonstrated that the United States subsidies during marketing year (MY) 1999-2002 cause present significant price suppression in the Brazilian and world markets, including in markets where Brazilian and United States producers export, within the meaning of Article 6.3(c) of the *SCM Agreement* and thus cause serious prejudice. Brazil has demonstrated that the United States subsidies suppressed A-index prices by an average of 12.6% over MY 1999-2002.[6] That translates into a total amount of lost revenue for Brazilian producers of $478 million[7] and suppressed revenue worldwide of $3.587 billion.[8]

2.04 With subsidisation at levels of 95 per cent on average[9], subsidies are the greater part of farmers' incomes and have a major impact on farmers' production decisions. Producers of upland cotton in the United States are thereby largely insulated from the effects of the market. Thus, when prices for upland cotton were falling[10], and the value of the United States dollar[11] and costs of production were rising[12], production of upland cotton and United States exports of upland cotton significantly increased.[13] United States farmers planted 13.5 per cent more acres with upland cotton.[14] United States production hit a record high.[15] United States exports and the United States share of the world market increased.[16]

2.05 Professor Sumner estimates that if all United States government support to upland cotton were eliminated, United States exports would have been 41 per cent less in MY 1999-2002.[17] By contrast, *with* the subsidies the United States world market share in fact more than doubled over that period.[18]

2.06 This subsidy-fuelled production and export growth resulted in significant price suppression within the meaning of Article 6.3(c). Prices were suppressed by the increased world supply of upland cotton and increased competition from United States upland cotton in world markets. Brazil has also outlined the influence that the United States has on world prices for upland cotton[19] - the sheer size of

[6] Further Submission of Brazil, para 229.
[7] *Ibid*, para 446.
[8] *Ibid*, para 256.
[9] *Ibid*, para 105.
[10] *Ibid*, part 3.3.4.2.
[11] *Ibid*, part 3.3.4.4.
[12] *Ibid*, Part 3.3.4.3. Brazil has demonstrated that by the end of MY 2001 the cost-revenue gap had increased to 39 cents per pound (para 121).
[13] See *Ibid*, para 105. Between 1998 and 2001 production increased by 45.5 per cent and exports by 161 per cent.
[14] *Ibid*, para 130.
[15] In MY 2001 United States production reached 19.603 million bales (*Ibid*, para 131).
[16] *Ibid*, para 132.
[17] *Ibid*, para 288.
[18] *Ibid*, para 283.
[19] *Ibid*, para 3.3.4.6.

the United States share of total world production[20] and of world exports magnifies the trade distorting effects of the United States subsidies. Any doubt about the impact that United States subsidies have on the world market for upland cotton should be quickly dispelled by the graphic demonstration of United States dominance of the world market illustrated by Brazil in Figure 26.

2.07 New Zealand agrees with Brazil that the absolute size and average subsidisation level of the United States subsidies creates a strong *de facto* presumption of production, export and price effects.[21] However Brazil has not simply relied on such a presumption. Brazil has produced econometric analysis demonstrating that the United States subsidies caused significant price suppression, as actual market prices throughout MY 1999-2002 would have been higher but for the effects of the United States subsidies.[22]

2.08 At no point in its submission does the United States dispute the accuracy of this econometric analysis. Instead, in response to Brazil's claims, the United States seeks to argue that Brazil's case "suffers from a failure of factual proof"[23] and that Brazil has failed to make a *prima facie* case of serious prejudice or more than equitable market share because Brazil has done no more than assert that causation is established because there were large United States outlays during marketing years with low prevailing upland cotton prices.[24] According to the United States, factors other than United States subsidies "were the causes of the dramatic plunge in cotton prices experienced in recent years,"[25] namely: competition from low price polyester; flat retail consumption of cotton outside of the United States; slow world economic growth; burgeoning United States textile imports leading to more United States cotton exports; a stronger United States dollar leading to weakened commodity prices and China's trade position.

2.09 However Brazil's argument is not that declining cotton prices were due solely to the impact of the United States subsidies. Nor does Article 6.3(c) require that to be the case. It is Brazil's contention, backed up by sound econometric analysis, that the United States subsidies have a significant price-suppressing effect. And that effect exists regardless of whether cotton prices are rising or falling.[26] Nor did Brazil's analysis fail to take into account the impact of other adverse factors affecting upland cotton prices as alleged by the United States.[27] The econometric models used by Brazil, in particular FAPRI, hold other relevant factors affecting the price of cotton constant while cotton subsidies are removed, thereby isolating the effect of those subsidies. Therefore Brazil's analysis did not attribute to cotton subsidies the effects of other factors affecting cotton prices. As noted above, at no point in its submission does the United States question the integrity of the models referred to by Brazil and upon which the estimated impacts of the removal of United States cotton subsidies is based.

*(i) Interpretation of Article 6.3(c)*

2.10 New Zealand disagrees with the United States interpretation of Article 6.3. Essentially the United States reached the wrong conclusion from its comparison of the language of Article 6.1 with that of Article 6.3. The United States concluded that because Article 6.3 used the phrase "*may* arise in

[20] 19.5 per cent in MY 2002 (*Ibid*, para 135).
[21] *Ibid*, paras 106 and 107.
[22] Evidence adduced by Brazil, specifically the Quantitative Simulation Analysis by Professor Daniel Sumner, shows that but for the United States subsidies A-Index prices between MY 1999-2002 would have been, on average, 12.6 per cent higher.
[23] Further Submission of the US, para 16.
[24] *Ibid*, para 17.
[25] *Ibid*.
[26] Further Submission of Brazil, para 231.
[27] Further Submission of the US, para 80.

any case where one or several of the following apply", whereas Article 6.1 states "serious prejudice *shall be deemed to exist* in the case of …", that this means that serious prejudice "need not arise even under Article 6.3 even where one of the listed effects is found".[28] The United States goes on to infer from this difference in language that a complainant, in addition to demonstrating the existence of one of the listed effects, must also meet a separate "serious prejudice" standard – the content of which is undefined by the *SCM Agreement*. The United States states that a complainant must show that the "prejudice" suffered is "serious".[29]

2.11 First, the example given by the United States in footnote 43 seems to be covered by the terms of Article 6.4. Second, and more importantly, there is no basis for drawing from a comparison of language used in Articles 6.1 and 6.3 the conclusion that there is some other standard, independent of Article 6, that must be demonstrated in order to show "serious prejudice". In fact, as New Zealand will show, a comparison of both the language *and substance* of Articles 6.1 and 6.3, in the context of Articles 5 and 6 of the *SCM Agreement*, supports the contrary conclusion – that if a complainant has demonstrated the existence of one or more of the effects enumerated in Article 6.3 there is "serious prejudice" that is an adverse effect of the subsidy within the meaning of Article 5.

2.12 That is because the difference in language simply reflects the different way in which both Article 6.1 and Article 6.3 give meaning to the term "serious prejudice". Both must be seen in the context of concern in this part of the *SCM Agreement* with the effects of subsidies on other Members. In relation to Article 6.1, "serious prejudice" was given meaning by reference to specific types of subsidies or qualities of a subsidy that were "deemed" to have effects that were adverse to the interests of other Members. However, it was open to a subsidising Member under Article 6.2 to overturn that presumption by showing that in fact the subsidy did not cause serious prejudice – i.e. that the subsidy *had not resulted in any of the effects enumerated in Article 6.3*.

2.13 The terms of Article 6.2 make it clear that the effects enumerated in Article 6.3 equate to "serious prejudice" and that nothing more than demonstration that one of those effects exists is necessary to find serious prejudice.

2.14 Further, by contrast with Article 6.1, Article 6.3 looks more broadly at the effects of the subsidy, rather than its specific characteristics. There is thus no need to "deem" certain effects to arise from certain types or characteristics of a subsidy as there was in Article 6.1. Instead Article 6.3 is more broadly cast to take an effects-based approach – in essence it is designed to encompass any kind of subsidy that has the adverse effects enumerated and is therefore "actionable". However there is no basis to draw from this difference in approach, and therefore in language, the conclusion that more is required under Article 6.3 than simply demonstrating that one or more of the prescribed effects exists in order show that there is serious prejudice. Such an interpretation undermines the careful structure of Article 6 and the clear intent of Article 5 and must be rejected.

2.15 Nor does the use of the word "may" in Article 6.3 lead to any other conclusion. In that respect it is important to note that Article 5(c) incorporates, as specified in Footnote 13 to the *Agreement*, GATT Article XVI.1 which includes *inter alia* the threat of serious prejudice. Therefore it was appropriate to state that serious prejudice in the sense of paragraph (c) of Article 5 *may* arise where any of the listed effects exists because there may be other circumstances in which serious prejudice can be demonstrated, including, for example, where there is a threat of serious prejudice. If the word "shall" had been used this would have been taken to mean that Article 6.3 provides the definitive set of circumstances in which serious prejudice can arise. By virtue of Footnote 13 that is not the case.

[28] *Ibid*, para 77.
[29] *Ibid*, para 79.

2.16 Consideration of Article 6.3 in the context of the rest of Article 6 provides further support for the interpretation outlined above. First, it makes little sense to have gone to such detail in Article 6.4 to describe what is required to meet the requirements of Article 6.3(b) if there is another set of undefined requirements that must also be demonstrated in order to find serious prejudice.

2.17 Second, in terms of Article 6.2, if there were other elements outside those in Article 6.3 that had to be demonstrated to show serious prejudice, why would a subsidising Member not also have had to show that those elements were not present in order to avoid the presumption in Article 6.1?

2.18 Third, Article 27.8 (although now defunct because Article 6.1 is no longer in effect), also provides that serious prejudice arising from subsidies by developing country Members "shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6". This makes it clear that serious prejudice need only be determined by reference to Articles 6.3–6.8 of the *SCM Agreement*.

2.19 Finally, Article 6.8 provides that "in the absence of circumstances referred to in paragraph 7, the existence of serious prejudice should be determined on the basis of the information submitted in accordance with the provisions of Annex V". This confirms that paragraph 7 of Article 6 outlines the only set of circumstances in which it is not possible to make a determination as to the existence of serious prejudice when one of the situations in Article 6.3 is demonstrated to exist. The direction in Article 6.8 to determine the "existence" of serious prejudice on the basis of the record would be deprived of meaning if a determination of serious prejudice also had to be made by reference to additional criteria not specified by the *SCM Agreement* that could lead to a materially different outcome as a matter of fact and law.

2.20 Serious prejudice is not the abstract concept the United States attempts to portray it as. Serious prejudice refers to the concrete adverse effects of a subsidy on the interests of another Member that are clearly elaborated in Article 6.3. However, even if the United States is right and a complainant, having demonstrated the existence of significant price suppression within the meaning of Article 6.3(c), must also meet a separate test of "serious prejudice" under Article 5(c), Brazil has demonstrated that serious prejudice exists by providing the Panel with additional information outlining the harm caused to its upland cotton producers as well as to the Brazilian economy.[30]

(a) "Significant"

2.21 Article 6.3(c) of the *SCM Agreement* requires that the level of price suppression caused by the United States subsidies must be "significant", that is, it may not be so small as to have no meaningful effect on other producers or suppliers of the same product.[31] Logically, price suppression that is so small as to have no meaningful effect could not give rise to serious prejudice. However, such an interpretation does not mean that a very small level of price suppression may not have a meaningful effect, for example where large volumes of a product may be traded.[32] As Brazil demonstrates, even a 1 cent per pound price-suppressing effect can reduce worldwide export revenue by $552 million. Average price declines of 12.6 per cent for upland cotton clearly have a meaningful affect on

[30] Further Submission of Brazil, Part 6.

[31] Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted 23 July 1998 ("*Indonesia – Automobiles*"). The Panel considered (at para 254) the meaning of "significant" in the context of Article 6.3(c) and concluded:

> Although the term "significant" is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully effect suppliers of the imported product whose price was being undercut are not considered to give rise to serious prejudice.

[32] Further Submission of Brazil, para 95and para 256.

Brazilian producers of upland cotton. New Zealand fully agrees with Brazil that such price suppression is thus "far beyond any legitimate threshold of 'significance'".[33]

2.22 The United States argues that Brazil's interpretation of "significant" collapses the concept of "significant price suppression or depression" with the concept of "serious prejudice" because Brazil's assessment of the significance of the price suppression has wrongly focussed on the effect of the subsidy on producers rather than on prices. As outlined in paragraphs 2.10–2.20 above, in New Zealand's view the construction of Articles 5 and 6 makes it clear that "significant price suppression or depression" is simply a form or manifestation of "serious prejudice" and therefore it is artificial to make into two separate inquiries what is clearly meant to be only one.

2.23 In any event the United States argument that the significance of the price suppressive effect of the subsidy can only be determined by reference to the effect on 'price' should be rejected. Articles 5 and 6 are concerned with the *adverse effects* of a subsidy – Article 5 states that "no Member should cause, through the use of any subsidy … *adverse effects* to the interests of other Members." Therefore it is entirely appropriate under Article 6.3(c) to consider whether price suppression is "significant" by reference to the effect of the price suppression on the Member alleging adverse effects to its interests. In other words, what renders price suppression significant or insignificant is whether or not it causes adverse effects to the Member concerned, not whether or not an arbitrary level of numeric significance is achieved as implied by the United States. Under the United States approach, a numerically small suppressive effect on prices could be disregarded, even though it may have significant adverse effects on the complainant Member. Thus, using the example given by Brazil, price suppression by only 1 cent per pound may not be "significant" enough under the United States standard and therefore could not give rise to serious prejudice, even though that level of price suppression would reduce worldwide export revenue by $552 million.[34]

2.24 Nor does the United States explain how 'significance' is to be determined under its proposed approach. That is because such an approach would require Panels to apply some kind of arbitrary standard of significance – would 5 per cent be significant? Would 10 per cent or 20 per cent? Would the level of required significance vary from case to case, and if so how is a Panel to determine what that level should be?

2.25 By contrast, the approach taken by Brazil of interpreting "significant" as requiring the level of price suppression to be "meaningful" in its effect, reflecting the Panel's reasoning in *Indonesia – Automobiles*, provides a more logical and consistent basis upon which to determine whether the price suppression is "significant". It is also consistent with the objective of Articles 5 and 6 which is to address subsidies that have an adverse effect on the interests of other WTO members. Nor is such an approach inconsistent with the United States assertion that the drafters of Article 6.3(c) used the term "significant" to create a threshold to ensure that not just "any theoretical price effect"[35] would suffice. In fact the Panel in *Indonesia – Automobiles* appears to have made the same assessment of the intention of the drafters when it stated that

> the inclusion of this qualifier (ie "significant") in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not

[33] *Ibid*, para 95.

[34] This example is of course based on the effect of subsidies on "like products", which, as Brazil has demonstrated (Further Submission of Brazil, part 3.3.2), United States upland cotton and Brazilian upland cotton are.

[35] Further Submission of the US, para 84.

> meaningfully affect suppliers of the imported product whose price was being undercut are not considered to give rise to serious prejudice.[36]

2.26 Nor does the United States argument find support in the reference to the price suppression being "in the same market" in Article 6.3(c). The United States argues this means that the price suppression must be significant in "market terms" and therefore the question is the effect of the price suppression on the market and not on the Member concerned.[37] While New Zealand agrees that the effect of the price suppression on the market may be relevant to considering whether that price suppression is "significant", New Zealand notes that the phrase "in the same market" simply serves to locate the price suppressive effects rather than define their substance. In fact the United States acknowledges as much further on it in its submission.[38] Further, the United States has not attempted to claim that its exports are not to the same market as exports from Brazil. And of course it cannot, because, as Brazil has demonstrated, Brazilian upland cotton and United States upland cotton are like products and are treated by upland cotton traders as interchangeable and substitutable.[39]

2.27 Finally, New Zealand notes that the United States arguments do not seek to suggest that the level of price suppression found to exist in the present case - 12.6 per cent - is not "significant" within the meaning of Article 6.3(c). Therefore the Panel should find that "significant price suppression" exists as a result of the United States subsidies and that therefore the United States subsidies cause serious prejudice to the interests of Brazil.

(b) Time Period for Demonstrating Causal Effects

2.28 The United States argues that "a past subsidy no longer exists as of the time a new subsidy payment in respect of current production is made".[40] Therefore, argues the United States, subsidies prior to the most recent period, MY 2002, can have no "effect" within the meaning of Article 6.3 and the "effect of the subsidy must be demonstrated in each year and for each year that Brazil has challenged".[41]

2.29 By the United States reasoning a complainant may only take a serious prejudice case in the year in which the serious prejudice is caused. To say that a "past subsidy no longer exists" once a further payment is made under the same subsidy scheme is entirely artificial. Leaving aside the practical difficulties the United States approach would pose given the nature of the evidence that is required and the timelines for WTO dispute settlement – which would effectively preclude any Members from ever taking serious prejudice cases – this approach ignores that fact that the subsidy programmes are in existence for a period of years and have effects on the decisions of producers beyond simply the year in which they have been paid.[42] Producers expectations of continued subsidies are integral to planting decisions and it is clear that United States producers expect ongoing subsidies as these have been legislatively mandated until MY 2007.

2.30 Similarly the serious prejudice caused to a WTO Member over the lifetime of a subsidy programme is not easily compartmentalised into a particular year and such an artificial constraint on the appropriate time period for consideration by a Panel would seem to undermine the object and

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[36] Panel Report, *Indonesia – Automobiles*, para 14.254.
[37] Further Submission of the US, para 87.
[38] *Ibid*, para 90.
[39] Further Submission of Brazil, para 80.
[40] Further Submission of the US, para 94.
[41] *Ibid*, para 95.
[42] Brazil has demonstrated that the effects of the United States subsidies continue after they have been provided because, for example, they have "wealth" and "investment" effects (Further Submission of Brazil, part 3.3.4.7.7).

purpose of the disciplines on actionable subsidies in the Agreement. New Zealand therefore agrees with Brazil that MY 1999-2002 is a reasonable period for the Panel to use for the present serious prejudice claims.

**2. The effect of the United States subsidies is an increase in the United States world market share**

2.31 Brazil has demonstrated that the United States subsidies resulted in an increase in the United States world market share for upland cotton in MY 2001 within the meaning of Article 6.3(d). The data provided by Brazil shows that the United States world market share in MY 2001 of 38.3 per cent is considerably higher than the previous three-year average,[43] and that this was due to the effect of the United States subsidies.[44]

2.32 The United States argues that the term "world market share" refers to "all consumption" of upland cotton and thus would include "consumption by a country of its own cotton production". The United States appears to suggest that Article 6.3(d) is thus concerned with the effect of the subsidy on world consumption of cotton.

2.33 It is true that GATT Article XVI:3 uses the phrase "world export trade". However it is quite a leap of logic to then conclude that because Article 6.3(d) uses the term "world market share" then it must refer to a Member's share of world consumption. The United States makes this leap on the basis that the relevant context for determining what "world market share" means is GATT Article XVI:3. However the first point of reference should in fact be Article 6.3 itself, and Article 5 to which it is so integrally related. Thus the appropriate context in which to give meaning to "world market share" is the aim of Articles 5 and 6, ie to address the adverse effects of subsidies on the interests of other Members.

2.34 Subsidies are the concern of WTO members to the extent that they distort trade – hence the differentiation in treatment of trade-distorting and non-trade distorting subsidies. Therefore the adverse effects with which Article 6.3 is concerned is the effect of subsidies on trade in the world market. Specifically, it is concerned with adverse effects to other Members caused when one Member uses subsidies in order to increase its share of the world market for a particular product. To construe "world market share" as referring to a Member's share of world consumption of a product would therefore completely subvert the underlying rationale of Article 6.3(d).

**3. The United States has a "more than equitable share" of world export trade in upland cotton**

2.35 Brazil has demonstrated that the United States subsidies have operated to increase United States exports of upland cotton resulting in the United States having a "more than equitable share" of world export trade in upland cotton within the meaning of GATT Article XVI:3 and has thus caused serious prejudice to the interests of Brazil within the meaning of GATT Article XVI:1.[45]

2.36 The United States seeks to dismiss the relevance of GATT Article XVI:3 by reference to pre-Uruguay Round comment by the Panel on Wheat Flour[46], addressing the Tokyo Round Subsidies Code, in an unadopted report, that there are "difficulties inherent in the concept of 'more than equitable share'."[47] The United States also seeks to assert that "Members are generally permitted to

[43] Further Submission of Brazil, para 267 and Figure 24.
[44] *Ibid*, paras 271 – 272.
[45] Further Submission of Brazil, part 3.5.
[46] GATT Panel Report, *EEC – Subsidies on Export of Wheat Flour*, SCM/42, (unadopted).
[47] Further Submission of the US, paras 108 and 109.

provide subsidies."[48] That is true up to the point at which those subsidies cause serious prejudice to the interests of the other Members. And in this context the Panel should consider whether, as the world's largest exporter of upland cotton with average levels of subsidisation of 95 per cent, the United States has a "more than equitable" share of world export trade. New Zealand submits that Brazil has demonstrated that the United States does.

**4. Issues relating to particular United States subsidies**

2.37 Brazil sets out arguments relating to the full complement of United States subsidies and the serious prejudice they cause both individually and collectively. New Zealand will comment only on marketing loan payments, Step 2 payments and market loss assistance/counter-cyclical payments.

*(i) Marketing Loan Payments*

2.38 Brazil has highlighted that these payments are considered by the USDA and by other economists as having the greatest production and export enhancing effects and thus the greatest A-Index price suppressing effects of all the United States subsidies.[49] Brazil has described how the effect of the marketing loan programme is to increase production, increase exports of upland cotton, and suppress upland cotton prices (on average by 5.75% in MY 1999-2002).[50] The marketing loan programme is thus responsible for almost half of the estimated average price suppressing effects of the United States subsidies.

*(ii) Step 2 Payments*

2.39 The availability of Step 2 payments increases production in the United States, displaces imports of lower priced foreign upland cotton and enables additional United States exports of upland cotton. The Step 2 payment programme is specifically designed to stimulate export demand for United States upland cotton. Brazil has shown that the trade distorting effect of the Step 2 payments is widely acknowledged.[51] Professor Sumner estimates that Step 2 payments suppressed world prices between MY 1999-2002 by 3.04 per cent.[52]

2.40 Brazil has demonstrated that Step 2 domestic payments are a prohibited subsidy under Article 3.1(b) of the *SCM Agreement* in that the payments are contingent on the use of domestic over imported upland cotton and thus also violate Article III.4 of GATT 1994.

*(iii) Market loss assistance/Counter-cyclical payments*

2.41 The United States continues to argue that market loss assistance payments and counter-cyclical payments (CCP) are not linked to production and accordingly cannot have "effects" for the purposes of Article 6.3(c) nor operate to increase exports as required by GATT Article XVI:3.[53] The United States implies that their production effects are less than one percent.[54] However Professor Sumner's analysis shows that although their production effects were less than one percent in 1999, since then they have been significantly higher and are projected to increase in the future.[55] He

[48] *Ibid*, para 105.
[49] Further Submission of Brazil, para 17.
[50] *Ibid*, para 157.
[51] *Ibid*, para 287.
[52] *Ibid*, Table 12.
[53] Further Submission of the US, para 74.
[54] *Ibid*, paras 73 and 74.
[55] Further Submission of Brazil, Annex 1, Table I.4.

concluded that these payments have a production impact because their effect is to keep land in the production of upland cotton that would not be otherwise because of low prices.[56]

2.42 As outlined by New Zealand in its First Written Submission to the Panel, the CCP payments create incentives for farmers with upland cotton base acreage to maintain upland cotton production.[57] New Zealand pointed out that in fact under the CCP programme the only way a farmer can guarantee a particular income is to continue to grow the same crop, otherwise the farmer runs the risk of missing out. For example, if he or she chooses to produce wheat and cotton prices are high enough that no CCP payment is made but wheat prices fall, the farmer will make a loss they would not have made had they stayed with cotton production. This, combined with other factors set out by Brazil,[58] for example the investment by farmers in cotton-specific machinery, virtually guarantees farmers will continue to produce cotton. The CCP payments are thus far from "de-coupled" in effect.

2.43 In fact Professor Sumner concluded that the CCP payments (as the institutionalised marketing loss assistance payments are now known under the Farm Security and Rural Investment Act 2002[59]) create *more* production incentive than the market loss payments, through base and yield updating and the increased per pound amount of support.[60] Professor Sumner determined that the market loss assistance payments and the CCP payments stimulated production by an average of 1.34% during MY 1999-2002.[61] And, as noted by Brazil, the full effects of the greater production incentives inherent in the CCP programme will only be realised in MY 2003.

## III. THREAT OF SERIOUS PREJUDICE

3.01 Brazil has brought evidence to show that the United States subsidies are not only causing serious prejudice to Brazil's interests today, but also threaten to cause serious prejudice to Brazil's interests in the future. Brazil has demonstrated that the United States subsidies cause a threat of serious prejudice to Brazil's interests within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*, as well as GATT Article XVI:3 in the period MY 2003-2007 because of the continued operation of the Farm Security and Rural Investment Act 2002 and the Agricultural Risk Protection Act 2000.

3.02 Brazil has demonstrated that the very same factors creating present serious prejudice also create a threat of serious prejudice in the future. The United States subsidies are mandated to continue until MY 2007. They are effectively unlimited. Brazil has demonstrated that they have already caused serious prejudice to Brazil's interests. Their continued operation for a further four years cannot but be considered to threaten further serious prejudice to Brazil's interests.

3.03 The United States argues that the two standards proposed by Brazil are incorrect and that Brazil has, in any event, met neither of them.

3.04 To take Brazil's first proposed legal standard, Brazil argues, drawing on the findings of the GATT Panel in *EC – Sugar Exports I*[62] and *EC – Sugar Exports II*[63] and the Appellate Body in *US* –

[56] *Ibid*, para 169.
[57] New Zealand's First Submission, para 2.20.
[58] Further Submission of Brazil, para 207.
[59] *Ibid*, para 62.
[60] *Ibid*, para 171.
[61] *Ibid*, para 172.
[62] GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Australia)*, L4833 – 26S/290, adopted 6 November 1979.
[63] GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Brazil)*, L5011 – 27S/69, adopted 10 November 1980.

*FSC*,[64] that where there is effectively no limit on the provision of a subsidy a permanent source of uncertainty exists that threatens serious prejudice to other WTO Members. In such circumstances there is no check on the provision of a subsidy that would prevent it from causing adverse effects to the interests of other Members.

3.05 That is the precise situation in the present case. United States legislation requires the provision of the subsidies irrespective of whether or not those subsidies have adverse effects on other Members. In that respect it is important to bear in mind that the present case involves a level of subsidisation of, on average, 95 per cent, with a dollar value of US$12.9 billion, being provided by a country that currently has a 41.6 per cent share of the world market for upland cotton. The possibility that United States subsidies will continue to cause serious prejudice to the interests of Brazil in the future, is a real one – it is well removed from the realm of "allegations, conjecture or remote possibility" alluded to by the United States.[65]

3.06 In that respect Brazil's second proposed legal standard for determining whether such a threat exists is highly relevant. As Brazil has demonstrated, all of the factors that currently exist that mean that the United States subsidies cause serious prejudice to their interests will continue to exist in the future. Furthermore, United States producers of upland cotton will act in the expectation of future subsidy payments and will make their planting decisions accordingly. Therefore the fact that the legislation creating those subsidies will continue until 2007, and United States producers know that those subsidy programmes will continue until 2007, creates a very strong *prima facie* case that those subsidies will continue to cause serious prejudice to Brazil for the full term of their existence.

3.07 Finally New Zealand supports Brazil's request that if the Panel makes a finding of present serious prejudice, it should not feel constrained in making a further finding that the subsidies also create a threat of serious prejudice in the future.[66] Firstly, even though the present effects of the subsidies are already being felt, their future effects have not yet eventuated and therefore necessarily remain a threat. Secondly, the purpose of dispute settlement is to assist Members in the resolution of disputes – in this case a finding by the Panel on the threat of future serious prejudice is important to resolve this dispute.

## IV. EXPORT CREDIT GUARANTEE PROGRAMMES

4.01 New Zealand notes that the United States raises further arguments in relation to the negotiating history and appropriate interpretation of Article 10.2 of the *Agreement on Agriculture* in order to support its claim that there are currently no export subsidy disciplines on the use of export credit guarantee programmes.

4.02 However the United States does not address the applicability of Article 10.1. As outlined by New Zealand in its First Submission, Article 10.2 does not in any way suggest that it provides an exception from the disciplines of Article 10.1. While Article 10.1 currently provides the only discipline on the use of export credits, it is expected that the work envisaged in Article 10.2 will elaborate further and more specific disciplines that will presumably make identification of the extent to which such export credit programmes constitute export subsidies more straightforward. However it is incorrect to assume that there is a vacuum in the meantime. Item j of the Illustrative List of the *SCM Agreement* clearly already provides guidance on when export credit guarantee or insurance programmes are to be considered to be 'export subsidies' and beyond this the general definition in Articles 1.1 and 3.1(a) of the *SCM Agreement* also applies.

[64] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000.

[65] Further Submission of the US, para 115.

[66] Further Submission of Brazil, para 291.

## V. CONCLUSION

5.01 In conclusion, New Zealand considers that Brazil has provided the legal and factual basis upon which the Panel should conclude that the United States subsidies cause or threaten to cause serious prejudice to the interests of Brazil within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement* and violate GATT Article XVI. New Zealand therefore requests the Panel to make the findings and recommendations requested by Brazil.

# ANNEX E-8

## SECOND WRITTEN SUBMISSION OF PARAGUAY (THIRD PARTY)

3 October 2003

1. Paraguay is grateful for the opportunity to express its views in this dispute.

2. As already stated, Paraguay maintains that the subsidies and support granted to cotton production of the type at issue are inconsistent with the Agreement on Subsidies and Countervailing Measures and other WTO rules.

3. The agricultural subsidies cause serious prejudice to the domestic industries of many WTO Members, in violation of Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures. Indeed, these measures involve a financial contribution which, by conferring a benefit, could adversely affect the determination of the world price of the product.

4. Article 5(c) stipulates that "no Member should cause, through the use of any subsidy [-specific and not exempted under the Agreement –] adverse effects to the interests of other Members, i.e.: … (c) serious prejudice to the interests of another Member."

5. The threat of serious prejudice takes the form of price undercutting and unfairness in international trade, particularly as regards developing countries like Paraguay, which is highly dependent on its cotton production.

6. Article 6, which concerns serious prejudice, states that serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems; and direct forgiveness of debt, i.e. forgiveness of government-held debt, and grants to cover debt repayment.

7. Paraguay submits that the measures adopted by the United States do not fit these descriptions and cause injury to its economy, Paraguay being a predominantly agricultural country.

8. Because of the amounts involved, the subsidies granted to the cotton industry have a significant impact on the world market as reflected in increased production and export and price variations on the global market.

9. In the International Cotton Advisory Committee (ICAC) as in other forums, governments have remarked on the critical situation that the world cotton industry is going through and its link to subsidies, stressing the need to submit complaints before the WTO for violation of the applicable rules. The Committee considers that without the subsidization, the average world cotton price would undergo a reasonable increase.

10. Paraguay's cotton trade is affected by such measures because cotton production has a considerable impact on its economy, and especially on its rural populations which depend on cotton for their livelihood. In the sectors involved, such as transport and related industries, the impact is considerable, with approximately 30 per cent of the population affected.

11. Thus, the impact on trade in countries like Paraguay is devastating and causes the migration of rural populations to the urban areas, further aggravating the economic situation of a country dependent on its agriculture.

12. As shown in the attached table, cotton fibre exports to the United States was 518 tons, for a value of US$898,000.

13. The effect is clear: in 2001, the volume of exports to the same market practically doubled, reaching 924 tons, and yet the price decreased in equal proportions, with exports generating US$830,000. The world cotton trade figures reflect the same trend.

**CONCLUSION**

14. There is sufficient evidence to prove that the subsidies are causing problems to the international marketing of cotton and that the American subsidies are further aggravating the situation of cotton exports from Paraguay.

15. We respectfully request the Panel to find that the measure applied by the United States is inconsistent with the obligations laid down by the WTO in various provisions of the GATT 1994 and the Agreement on Subsidies on Countervailing Measures, and to take account of the arguments put forward by Brazil.

## *PARAGUAYAN COTTON EXPORTS BY DESTINATION*

*(Tons / ThUS$)*

| | 1997 | | 1998 | | 1999 | | 2000 | | 2001 | | 2002 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE |
| GERMANY | 0 | 0 | 0 | 0 | 193 | 179 | 1,215 | 1,229 | 6,029 | 4,594 | 2,877 | 1,981 |
| ARGENTINA | 150 | 46 | 4,623 | 6,594 | 649 | 759 | 1,250 | 1,460 | 250 | 231 | 5,001 | 4,132 |
| BANGLADESH | 0 | 0 | 0 | 0 | 0 | 0 | 461 | 532 | 630 | 568 | 155 | 119 |
| BELGIUM | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 266 | 215 | 149 | 128 |
| BERMUDA | 473 | 757 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| BOLIVIA | 0 | 0 | 0 | 0 | 0 | 0 | 1,200 | 1,084 | 0 | 0 | 0 | 0 |
| BRAZIL | 39,898 | 64,492 | 47,267 | 64,914 | 47,115 | 55,933 | 56,726 | 61,113 | 31,063 | 29,465 | 29,599 | 22,877 |
| COLOMBIA | 0 | 0 | 0 | 0 | 0 | 0 | 1,660 | 1,556 | 200 | 224 | 0 | 0 |
| SOUTH KOREA | 0 | 0 | 79 | 102 | 0 | 0 | 0 | 0 | 98 | 92 | 0 | 0 |
| NORTH KOREA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 605 | 557 | 0 | 0 |
| CHILE | 845 | 1,509 | 624 | 938 | 1,107 | 1,208 | 1,183 | 1,309 | 424 | 404 | 1,675 | 1,262 |
| NATIONALIST CHINA (TAIWAN) | 0 | 0 | 191 | 219 | 0 | 0 | 0 | 0 | 2,126 | 1,865 | 579 | 450 |
| CHINA, PEOPLE'S REPUBLIC OF | 0 | 0 | 0 | 0 | 0 | 0 | 698 | 769 | 1,310 | 1,230 | 0 | 0 |
| DENMARK | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 128 | 102 |
| SLOVAKIA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 100 | 76 | 0 | 0 |
| SPAIN | | | | | | | 313 | 364 | 18 | 19 | 0 | 0 |
| UNITED STATES | 518 | 898 | 0 | 0 | 0 | 0 | 60 | 67 | 924 | 830 | 0 | 0 |
| PHILIPPINES | 0 | 0 | 0 | 0 | 102 | 119 | 33 | 39 | 569 | 616 | 155 | 132 |
| FRANCE | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 231 | 187 | 104 | 83 |
| HONG KONG | 0 | 0 | 0 | 0 | 0 | 0 | 1,116 | 1,188 | 148 | 111 | 185 | 123 |
| NETHERLANDS | 0 | 0 | 0 | 0 | 500 | 606 | 0 | 0 | 62 | 41 | 0 | 0 |
| INDIA | 0 | 0 | 0 | 0 | 0 | 0 | 526 | 408 | 33,463 | 28,267 | 3,088 | 2,738 |
| INDONESIA | 0 | 0 | 0 | 0 | 0 | 0 | 120 | 116 | 2,461 | 2,295 | 582 | 453 |
| ITALY | 0 | 0 | 462 | 550 | 0 | 0 | 25 | 23 | 360 | 345 | 363 | 271 |
| MALAYSIA | 0 | 0 | 0 | 0 | 0 | 0 | 500 | 449 | 130 | 109 | 0 | 0 |
| NIGERIA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 241 | 229 | 0 | 0 |
| PAKISTAN | 0 | 0 | 0 | 0 | 0 | 0 | 68 | 65 | 1,006 | 790 | 0 | 0 |
| PANAMA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 48 | 29 |

| | 1997 | | 1998 | | 1999 | | 2000 | | 2001 | | 2002 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE | VOLUME | VALUE |
| PORTUGAL | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 989 | 702 | 200 | 133 |
| UNITED KINGDOM | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 2 | 1 | 0 | 0 |
| SWITZERLAND | 0 | 0 | 0 | 0 | 0 | 0 | 200 | 216 | 592 | 551 | 251 | 169 |
| THAILAND | 0 | 0 | 0 | 0 | 0 | 0 | 397 | 403 | 2,298 | 1,959 | 294 | 198 |
| TURKEY | 0 | 0 | 0 | 0 | 0 | 0 | 819 | 886 | 2,244 | 2,431 | 0 | 0 |
| URUGUAY | 2,684 | 3,927 | 1,165 | 1,453 | 501 | 601 | 475 | 529 | 198 | 200 | 65 | 53 |
| VENEZUELA | 720 | 1,227 | 459 | 649 | 1,942 | 2,140 | 4,403 | 4,687 | 4,035 | 3,731 | 632 | 528 |
| VIETNAM | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 602 | 533 | 0 | 0 |
| **TOTAL** | **45,288** | **72,856** | **54,870** | **75,419** | **52,109** | **61,545** | **73,448** | **78,492** | **93,674** | **83,468** | **46,130** | **35,961** |

Prepared by the Paraguayan Directorate of Foreign Trade.
*Source:* Central Bank of Paraguay.

# ANNEX F

## ORAL STATEMENTS OF PARTIES AND THIRD PARTIES AT THE RESUMED SESSION OF THE FIRST SUBSTANTIVE MEETING

# ANNEX F-1

## EXECUTIVE SUMMARY
## STATEMENT OF BRAZIL AT THE
## RESUMED FIRST SUBSTANTIVE MEETING
## OF THE PANEL WITH THE PARTIES

### 1. Brazil's Claims of Present Serious Prejudice Relating to Subsidies Provided in MY 1999-2002

1. Brazil's *present* serious prejudice claims relate to US subsidies provided for the production, export and use of US upland cotton during the period MY 1999-2002. This period covers the measures challenged by Brazil and represents the relevant period of investigation to examine *present* serious prejudice caused by the US subsidies under Articles 5(c) and 6.3 of the SCM Agreement. This four-year period is long enough to allow the Panel to make a determination (in the words of the Appellate Body in the recent *EC – Pipe Fittings* decision) "that is less likely to be subject to market fluctuations or other vagaries that may distort a proper evaluation."

### 2. Brazil Has Established That the US Subsidies between MY 1999-2002 Caused Significant Price Suppression within the Meaning of Article 6.3(c) of the SCM Agreement

2. Brazil has shown in its Further Submission the amount and the subsidization rate of the US subsidies which cause serious prejudice to Brazil as well as demonstrated that all of the US subsidies are specific within the meaning of Article 2 of the SCM Agreement. The United States asserts that crop insurance subsidies provided to upland cotton producers by the 2000 Agricultural Risk Protection ("ARP") Act are not specific. In seeking to rebut Brazil's evidence that more than 50 per cent of the value of US agricultural commodities did not benefit from crop insurance benefits, the United States now argues that livestock is covered in "pilot programmes". Yet, a close examination of the "pilot" programmes indicates that the great majority of livestock production was *not* covered by the crop insurance programmes during the period of investigation. Therefore, the crop insurance programme is specific.

3. Contrary to the US arguments, the Panel is required by Article 5 of the SCM Agreement to examine the collective and interactive effects of *all* US subsidies. While different economists have estimated varying degrees of acreage, production, export and price effects of the US subsidies, no economist has ever found or suggested that removing all of the US subsidies would have only minimal effects.

4. The conditions of competition in the upland cotton market that existed during MY 1999-2002 (and that exist today) explain why: **First**, upland cotton is a basic fungible commodity that is widely traded throughout the world; **Second**, demand for upland cotton is relatively price-inelastic and consumption increased steadily during MY 1999-2002**,** whether upland cotton prices rose or fell; **Third**, world market prices for upland cotton as reflected in the New York futures price and the A-Index are sensitive to changes in supply – prices tend to rise when world supply decreases and fall when world supply increases; **Fourth**, US producers in MY 2002 supplied 41.6 per cent of world export market demand – the next largest exporter (Uzbekistan) had only 13 per cent of the world market share. **Fifth**, US producers of upland cotton are among the world's highest cost producers and total average costs between MY 1999-2002 were 77 per cent higher than market revenue received for

upland cotton lint; and **Sixth,** US upland cotton subsidies covered the cost-revenue gap with subsidies averaging 95 per cent which are 19 times greater than the five per cent subsidization rate formerly deemed to create a presumption of serious prejudice under Article 6.1(a) of the SCM Agreement.

5. US subsidies are a key element of the conditions of competition in the world market for upland cotton. The US subsidies create a situation in which USDA's Chief Economist has acknowledged that many US upland cotton producers are immune from market forces. This is readily illustrated by the extensive record provided by Brazil.

6. The United States now argues that US upland cotton farmers are sensitive to changes in market prices. Yet, US planted acreage *increased* as prices *declined* between MY 1999-2001. There can be little doubt that without the US subsidies, many US upland cotton producers would have to switch to crops providing a higher market return or take marginal land out of production. This means that without subsidies, US acreage and production would fall considerably. In addition to falling US production, the removal of US subsidies would also result in significant reductions in US exports contributing to increased world prices. Professor Sumner found that, *but for* the US subsidies between MY 1999-2002, US exports would fall from the annual *actual* average exports of 8.62 million bales by 41.2 per cent to 5.07 million bales. This reduction of 3.55 million bales represents 13.4 per cent of the total average world export market between MY 1999-2002. Given the relatively inelastic demand for upland cotton, it would be remarkable if world prices did not increase with a 13.4 per cent decrease in the supply of upland cotton to the world export market.

7. Brazil has examined some of the non-subsidy market factors that the United States apparently now claims account for *all* of the fall in prices in MY 1998-2002. Even though some of these factors may have contributed to lower and suppressed prices during MY 1999-2002, the US arguments and evidence do not refute Brazil's evidence that the impact of $12.9 billion in US subsidies on US acreage, production, exports and prices was significant. Moreover, Brazil does not dispute that there were other factors causing world prices to fluctuate throughout MY 1999-2002. And these same types of factors are causing prices to fluctuate today – and they will do so tomorrow. Changes in weather, exchange rates, economic growth, and financial conditions, among other factors, will always play a role in price discovery in world commodity markets. But it is simply not credible for the United States to argue now that $12.9 billion in subsidies to US producers faced with an average 24.3 cents per pound cost-revenue gap, who nevertheless increased their world market share to 41.6 per cent at times of record low prices, had no impact on production or world prices.

8. Having established that US production and exports would fall significantly if US upland cotton subsidies were eliminated, Brazil also demonstrated that the effects of lower US exports would result in world upland cotton prices being higher by an amount that is "significant". Brazil presents additional evidence on the price-suppressing effect of the US subsidies from the Report of the Commission on the Application of Payment Limitations for Agriculture. At the request of the Commission, USDA economists Westcott and Price examined the effects of eliminating marketing loan benefits for MY 2000 and MY 2001 finding significant acreage and price effects representing 33.6 per cent of the average prices received by US farmers in MY 2001. The record contains the results of a number of different simulations of price suppression effects caused by all or some of the US subsidies. All of these results reveal "significant" price suppression within the meaning of Article 6.3(c). They are "significant" because these results of price suppression are far from *de minimis*.

9. Finally, Brazil has demonstrated the close link between world A-Index prices, Brazilian internal prices and prices received by Brazilian producers in the export markets.

10. Andrew Macdonald has provided his expert testimony and described the importance of US market factors in influencing the perception of traders in the New York futures market and in shaping the perceptions of price movements by traders in international transactions as reflected in the A-Index price development. Mr. Macdonald has also provided evidence of the close relationship between these two sets of prices and the determination of prices in the Brazilian market. This evidence fully supports the pricing data reflecting the close connection between US domestic prices, US export prices, A-Index prices, Brazilian prices, and the prices received by Brazilian and third country exporters.

11. The United States has asserted that the term world market share in Article 6.3(d) "would appear to encompass all consumption of upland cotton, including consumption by a country of its own production". This is incorrect. The ordinary meaning of the term "world market share" in Article 6.3(d) of the SCM Agreement is not "world production share" or "world consumption share". Rather, it is the share of the world market for exports. This interpretation is consistent with USDA's and the EC's use of the term "world market share". In addition, footnote 17 to Article 6.3(d) states: "Unless other multilaterally agreed specific rules apply to the *trade* in the product or commodity in question." This provision refers explicitly to "trade" referring to international commercial sales and purchases in export markets, not global consumption or production.

**3. Threat of Serious Prejudice**

12. By guaranteeing a level of support of approximately 75 cents per pound, the US Subsidies create a continuing threat of excess US acreage, production, and exports, and continued suppressed world prices. This threat is a seamless continuation of the *present* serious prejudice that Brazil has already demonstrated. The threat exists today and will exist throughout the lifetime of the 2002 US Farm Act – until the end of MY 2007. A key initial issue for the Panel to decide is the time period for assessing data regarding the existence of a threat of serious prejudice. The Appellate Body has noted that a threat analysis requires examination of "facts" not "conjecture" and requires the "use of facts from the present and the past to justify the conclusion about the future". The Appellate Body also has held it is important to examine data for the entire period of investigation "to allow the investigating authority to make a . . . determination that is less likely to be subject to market fluctuations or other vagaries that may distort a proper evaluation".

13. A threat of serious prejudice exists for the following reasons: The mandatory US subsidies in the 2002 US Farm Act create a guaranteed revenue stream for US producers of 75 cents per pound. This revenue cannot be stopped between MY 2003-2007 regardless of how *low* US and world prices may fall, regardless of how much US production of upland cotton *increases*¸ and regardless of the amount of US exports. As found by the *EC – Sugar Exports* panels, and the Appellate Body in *US – FSC,* the absence of any legal mechanism to limit the quantity of subsidies is a critical factor to assess in determining the existence of threat.

14. Brazil has demonstrated the existence of *present* price suppression, increases in world market share and an inequitable share of world export trade based on actual data and market conditions for MY 1999-2002. This four-year period of serious prejudice is the best guide for the Panel to assess whether during the remaining five years of the 2002 US Farm Act there is a significant threat that serious prejudice will occur *again.* In making this assessment, the Panel should also consider the fact that the US National Cotton Council estimated that the 2002 US Farm Act *increased* the revenue stream to US producers by 10 cents a pound over that provided in MY 1999-2001.

15. US planted acreage during MY 2003-2007 will remain at significant levels – around 14 million acres (slightly less than the average for MY 1999-2002). USDA and FAPRI both estimate that there will be *no* significant reduction in US acreage or production between MY 2003-2007. The

guaranteed high US acreage between MY 2003-2007 means high levels of production and exports. It also means suppressed world prices.

16. USDA estimates that US producers' cost of production will increase during MY 2003-2007 and remain high relative to market revenue. The most recent data shows that US producers' cost of production in MY 2002 was 83.59 cents per pound. At these cost levels, many US upland cotton producers will not be able to meet total costs of production without receiving all of the US subsidies. This fact demonstrates the clear causal connection between US subsidies and continuously high acreage, production, and exports along with significantly suppressed prices throughout MY 2003-2007.

17. With respect to Brazils threat claim under Article 6.3(d), Brazil notes that the threat of an increased US world market share in MY 2002 has already materialized, as the US world market share continued to increase in MY 2002 to 41.6 per cent, well above the MY 1999-2001 three-year average of 29.1 per cent. Brazil also notes that there is a real and clear threat of an Article 6.3(d) violation for MY 2003 as recent USDA projections for MY 2003 US exports indicate that the likely US share will be 38.8 per cent in MY 2003 – an increase over the three-year (MY 2000-2002) average of 34.9 per cent. This evidence further supports the finding of a threat that the US share of world export trade will continue to be inequitable for MY 2003-2007.

18. Finally, Brazil has established that GATT Articles XVI:1 and 3 allow for threat claims to be based on this provision. Brazil has also demonstrated that a threat of the United States to have a more than equitable share of world export trade exists.

**5. Export Credit Guarantees**

19. Contrary to the US allegation, Brazil has demonstrated that the CCC export credit guarantee programmes are "mandatory" programmes. Moreover, the CCC export credit guarantee programmes are expressly exempt from the requirement that a programme receive new Congressional budget authority before it undertakes new loan guarantee commitments. The Appellate Body considered that the unlimited nature of the FSC regime posed a significant threat, under Article 10.1 of the Agriculture Agreement, that the United States would surpass its agricultural export subsidy reduction commitments. In addition, Brazil again notes that for guarantees, the United States, through the Federal Credit Reform Act, has concluded that costs and losses are best measured and recorded on a net present value basis, rather than on a cash basis, at the time the guarantees are issued.

**6. New US Requests for Preliminary Rulings**

20. The United States' "new" request for a preliminary ruling addresses Brazil's failure to provide a statement of available evidence with respect to export credit guarantees for commodities other than upland cotton. This request is in fact not "new".

21. The US request for a preliminary ruling that Brazil should have included more information in its statement of available evidence has no merit. Brazil has already addressed this issue. Brazil was required to file a statement of the evidence available to it at the time.

22. Second, the United States claims that cottonseed payments for 1999 and 2000, and 2002 are not within the terms of reference of the Panel because the measures allegedly were not identified within Brazil's consultation or panel request, and because Brazil and the United States allegedly did not consult regarding these measures. Both of these claims are false. Brazil and the United States did consult about "any programme providing support to the US upland cotton industry for the production, processing, use, sale, promotion or export of cottonseed or products derived from cottonseed."

Similarly, Brazil's Panel request specifically identified in four different places "measures" that would encompass all forms of cottonseed payments from MY 1999-2007.

23. Finally, the United States argues that the "other payments" such as "storage payments" and "interest subsidies" allegedly were not included in Brazil's consultation or panel request, that Brazil and the United States did not consult about such payments, and that these payments are not properly within the Panel's terms of reference. These assertions are also false. Both the consultation and panel requests identify in four different paragraphs as "measures" payments which encompass "other payments" and "storage" and "interest subsidy" payments. Further, Brazil understands that "storage payment" and "interest subsidy" are part of the operation of the marketing loan programme, which Brazil specifically identified in both the consultation and panel requests, as well as in its questions to the United States during the consultations. The record demonstrates that Brazil and the United States consulted about all marketing loan and loan deficiency payments, as well as "any other support to or government funding for the US upland cotton industry". Therefore, it is properly before the Panel.

# ANNEX F-2

## EXECUTIVE SUMMARY
## CLOSING STATEMENT OF BRAZIL AT THE RESUMED FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

### 1. Introduction

1. In its Closing Statement, Brazil reiterates that at the core of this case are $12.9 billion of US subsidies for upland cotton for MY 1999-2002. These subsidies increase and maintain the production of high-cost US upland cotton, increase US upland cotton exports, suppress US, world and Brazilian prices and lead to the United States having a more than equitable share of world export trade. In short, these US subsidies cause and will continue to cause serious prejudice to the interests of Brazil.

### 2. Direct, CCP, PFC, and Market Loss Assistance payments were received by producers of upland cotton

2. In its Oral Statement of 7 October, the United States alleged that Brazil has not substantiated the amount of PFC, market loss assistance, direct and counter-cyclical payments to US upland cotton producers. Brazil requested this information from the United States more than a year ago in the consultation phase of this dispute but never received any information. Yesterday, the United States indicated to the Panel that it did not collect or have this information. In similar circumstances, WTO panels have held that "[i]n situations where direct evidence is not available, relying on inferences drawn from relevant facts . . . to determine whether applicable and unrebutted inferences are sufficient for satisfying the burden of proof". In lieu of this non-existent *direct* proof, Brazil presented extensive *circumstantial* evidence that all or nearly all of these producers of upland cotton in MY 1999-2002 received PFC, market loss assistance, direct and counter-cyclical payments.

3. Brazil previously set forth this circumstantial evidence in a number of different Submissions between 24 June and 9 September 2003. To assist the Panel, Brazil has collected this evidence in Annex I to its Closing Statement.

4. A summary of the evidence set out in the Annex is the following: It demonstrates very high production levels of cotton relative to total upland cotton base acreage throughout MY 1999-2002. It shows near universal participation of eligible upland cotton producers in the 1996 PFC programme and 95.7 per cent participation of upland cotton base acreage planted to programme crops in MY 2001. By June 2003, nearly all eligible farms producing, upland cotton in MY 1993-95 or MY 1998-2001 signed up for the direct and counter-cyclical payments. USDA recognized that cotton farmers benefited from PFC and market loss assistance payments and even treated such payments as part of "Government Payments by Crop Year" to upland cotton. Additional evidence shows relatively small fluctuation of cotton planted acreage between MY 1999-2002 and the strong cotton equipment and geographic forces maintaining historic cotton producers in current cotton production. Numerous statements by the National Cotton Council establish that their members received PFC and market loss assistance payments, and would (and do) receive direct and counter-cyclical payments.

5. In addition, the 2002 FSRI Act provides much higher per acre payments for upland cotton than other programme crops (except rice and peanuts). The 1996 FAIR Act similarly provided higher per acre payments for upland cotton (except rice). The only possible rationale for the much higher

upland cotton per acre payments for PFC, market loss assistance, direct and counter-cyclical payment base acreage than other programme crops was the expectation that historical producers of upland cotton needed the higher per-acre income to continue to produce high-cost upland cotton on base acreage. This conclusion is further supported by the fact that given their high costs of production, US upland cotton producers would have lost 10 cents per pound in MY 2002 if they had planted on corn (or six other programme crops) direct and counter-cyclical payment base acreage in MY 2002. Similar losses would also have been experienced in MY 1999-2001 if upland cotton were grown on most other programme crop base acreage.

6. The evidence in Annex I supports Brazil's methodology to calculate the amount of PFC, market loss assistance, direct and counter-cyclical payments by using the ratio of actual US upland cotton production and the amount of upland cotton base acres for programme payments. For example, total planted upland cotton acreage in MY 2002 was 14.1 million acres. The total amount of upland cotton base acreage in MY 2002 was 16.2 million acres. The ratio of these two amounts is 0.87. Brazil used this ratio to adjust the amount of total upland cotton direct and counter-cyclical payments for the marketing year to obtain the amount of subsidies received by upland cotton producers. Out of the 16.2 million upland cotton base acres, 2.1 million acres were not planted to upland cotton in MY 2002. Thus, holders of these 2.1 million cotton base acres either did not plant any crops or planted other crops. Consequently, Brazil has not included direct and counter-cyclical payments on these 2.1 million acres in its calculation of payments to upland cotton producers.

7. The total amount of upland cotton base acreage for direct payments in MY 2002 (which include the portion of PFC payments that were deemed to be direct payments) was $558 million. USDA paid out the maximum amount of upland cotton CCP payments in MY 2002 – $1.148 billion. Multiplying those figures by 0.87 results in $485 million in direct payments and $998 million in counter-cyclical payments to US upland cotton producers.

8. The United States refuses to offer a methodology for calculating the amount of direct and counter-cyclical (or PFC and market loss assistance) payments made to upland cotton farmers. Brazil's suggested methodology is based on the conclusion that all upland cotton producers received these payments. In particular, the evidence suggests that the amount of payments can be best calculated by finding that US upland cotton producers received those payments using upland cotton base acreage. This follows from the evidence listed in Annex I to Brazil's Closing Statement.

9. The United States asserts that "Brazil has presented no evidence that the recipients of these decoupled payments on upland cotton base acres are, in fact, upland cotton producers". Apparently what the United States had in mind in making this statement is that Brazil must produce data detailing the amount of each direct payment received by every single upland cotton farmer between MY 1999-2002. This is data the United States admits does not exist. But such a burden would require the Panel to disregard all the circumstantial evidence provided by Brazil. DSU Article 11 requires the Panel to "make an objective assessment of the facts of the case". In the absence of any alternative methodology proposed by the United States, the "facts of the case" are those presented by Brazil.

10. Therefore, what the United States suggests is that the Panel ignores $1.7 billion in PFC and direct payments simply because the United States does not collect data that could ascertain the precise figure – which will be very small – of upland cotton farmers that did not receive those payments. Such an approach would permit WTO Members to write off large amounts of subsidies by simply refusing to collect data. The Panel must not allow this position to prevail.

### 3. Brazil's Article 6.3(c) Price Suppression Claims and the Econometric Studies

11. Brazil has offered considerable evidence in the form of documents and witness statements demonstrating the existence and payment of subsidies, as well as the causal link between the subsidies

and significant price suppression. In addition, Brazil presented the Panel with evidence of a number of different studies that show significant price suppressing effects. Notably among these are the two Westcott/Meyer USDA studies (referred to and commissioned by the Payment Limitation Commission) showing 10 per cent price suppression for MY 2000 and an estimated 33.6 per cent price suppression in MY 2001 from *only* the effects of removing the marketing loan subsidies. By contrast, Professor Sumner found that US prices were suppressed by 32.7 per cent by the effects of *all* US subsidies that applied during MY 2001. In light of the lower level of price effects found by Professor Sumner, the United States claim that Professor Sumner's analysis is not "conservative" is curious. Other studies by the ICAC – of which the United States and Brazil are both Members – show increases in world prices from the removal of some US subsidies of 10.5 per cent for MY 2000 and 26.3 per cent for MY 2001. Professor Sumner found that the effects of a removal of *all* US subsidies that applied during MY 2000 and MY 2001 would have resulted in world price increases of 7.74 per cent and 17.7 per cent respectively. Brazil has presented many other studies as evidence. They all show significant price suppression.

12. What has been the US reaction to every one of these studies? As they indicated over the past two days, they have found many initial problems with all of them. But they reserved the broad scale attack for Professor Sumner's FAPRI model that has been repeatedly relied on by the US Congress and USDA. The United States even identified flaws in the results of the Westcott/Meyer 2000 and 2001 marketing loan studies. And the United States promises they will be busy for the next six weeks in critiquing all the studies cited by Brazil.

13. But the Panel must ask whether *all* these economists, including some of USDA's own leading economists, could be wrong although their results support USDA's own Chief Economist's views that US producers are insulated from market forces by these subsidies? Could these economists be wrong because they made the mistake of applying the fundamental notion that large production subsidies create larger supplies, and larger supplies result in significantly lower prices?

14. In the final analysis, these econometric studies are useful tools to confirm what common sense already tells us. That $12.9 billion in subsidies provided between MY 1999-2002 have production effects. That the National Cotton Council was correct when it argued that US upland cotton farmers could not exist without all of the cotton-specific subsidies. That many US producers needed subsidies to bridge the huge gap between their total costs and market revenue. That US acreage did not decrease as prices plummeted to record lows between MY 1999-2001 – rather planted US acreage increased. That US producers planted 14.1 million acres of upland cotton when prices were at record lows in the spring of 2002. That US exports did not decrease as prices plunged and the US dollar appreciated, rather they increased. And that the effects of US subsidies on suppressed prices are transmitted to the world and individual country markets, including Brazil.

**4. Brazil has established a claim under Article 6.3(d)**

15. With respect to Brazil's claim under Article 6.3(d), Brazil demonstrated that the ordinary meaning of the term "world market share" is the world market share of exports. USDA, the EC and Canada all use this term to refer to export market share, not share of world consumption. This interpretation is consistent with the use of the term "trade" in footnote 17 of the SCM Agreement which means the "sale and distribution of goods and services across international borders". It is also consistent with the object and purpose of Article 6.3(d) which is to prevent a Member from using its subsidies to *increase* its share of the world market for a particular product.

16. Undisputed facts show that the US share of world trade increased considerably from MY 1998 to MY 2002, and is projected to remain at very high levels in MY 2003. This increase follows a consistent trend from MY 1996. The "consistent trend" need not be an unbroken line of increases during the trend period examined, as the United States appears to argue. Because of severe

weather problems, such as occurred in the United States in MY 1998, export market share in agricultural problems will always susceptible to some annual variations not caused by subsidies. Rather the trend must reflect an overall increase and not reflect a number of wide swings within the period examined. The trend for US world market share of upland cotton from MY 1996, and particularly the period from MY 1998 onward, shows a sustained and significant increase in the US world market share. And the undisputed facts show that the record US world market share reached in MY 2001 and 2002 occurred at the same time as record high levels of US subsidies.

**5. Brazil has established that the US share of world export trade is not equitable**

17. The notion of "equitable share of world export trade" necessarily depends on the facts of each case. The fact-intensive nature of each case is reflected in the text of Article XVI:3, which requires the Panel to examine "special factors". Brazil suggests that examining whether there were any subsidy-induced *increases* in market share is one factor to consider. Another factor is the relative cost of production of the Members competing for world market share. The undisputed facts show (based on September 2003 ICAC data) that the US share of world exports of cotton more than *doubled* between MY 1998-2002 – from 18.7 to 39.3 per cent. At the same time, the African producers' collective share of world exports *decreased* from 10.2 to 8.1 per cent of world trade. Figure 26 shows these trends. If a picture is worth a thousand words, it is this one.

18. Brazil submits it is not equitable for a heavily subsidized WTO Member to more than double its share of competitive world markets for upland cotton in only five years reflecting a significant contribution of subsidies. And it is not equitable for that Member to do so when its costs of production were double those of the poorest and neediest producers in the world. Yet, when faced with these facts, the United States' only response is that the definition of "inequitable" is hopelessly vague. Brazil does not believe the inequity in this case is so difficult to determine.

# ANNEX F-3

## EXECUTIVE SUMMARY OF THE OPENING STATEMENT OF THE UNITED STATES AT THE SECOND SESSION OF THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. **Brazil's Analysis Fails to Establish to Whom Certain Payments Go and Whether Certain Payments May Properly Be Attributed to Exported Upland Cotton**. One of the fundamental elements of Brazil's claims is that Brazil needs to identify the "subsidized product" that is causing the serious prejudice that Brazil claims its interests are suffering.[1] Brazil has not even explained, however, what is the "subsidized product" for each of the types of subsidies from which it claims serious prejudice. Brazil appears to assume that the "subsidized product" is upland cotton in the form traded on the world market. Yet many of the subsidies at issue are paid to producers of cotton. Cotton is processed and sold before being traded. Brazil has made no showing of how the subsidy to the producer can be assumed to pass through to the exporter.

2. Brazil's panel request identifies the challenged measures as "subsidies provided to US producers, users, and/or exporters of upland cotton". However, it is for Brazil as the complaining party to establish who are the recipients of the subsidies and that the subsidies are properly attributed to upland cotton. Brazil's failure to do so means that it has not carried its burden in demonstrating that cotton is subsidized for purposes of considering adverse effects.

3. In the Peace Clause portion of this dispute, the United States has discussed at length certain decoupled payments that are not linked to production of upland cotton. With respect to these decoupled payments, Brazil has failed to demonstrate who the recipients of these payments are in connection with any exported upland cotton. Brazil simply presumes that every upland cotton producer is an upland cotton base acreage holder and receives a decoupled payment. Brazil has brought forward no facts to demonstrate that this is the case.

4. Even if Brazil had brought forward evidence that the recipients of these payments were upland cotton producers, that would not be enough. Brazil would still need to allocate these payments, which Brazil concedes are not linked to current production of upland cotton, over total production on a recipient's farm.[2]

[1] For example, for purposes of a claim under Article 6.3(c) of the Subsidies Agreement, the "effect of the subsidy" must be "significant price undercutting" or "significant price suppression, price depression, or lost sales" caused by "the subsidized product." Similarly, under Article 6.3(d) "the effect of the subsidy" must be an increase in world market share "in a particular *subsidized primary product or commodity*."

[2] Subsidies Agreement, Annex IV, paras. 1-3 (We note the context provided by Annex IV of the Subsidies Agreement, which explained the calculation of the ad valorem subsidization of a product under the now-defunct Article 6.1(a) of the Subsidies Agreement. This Annex provided that (among other conditions), unless "the subsidy is tied to the production or sale of a given product," the overall rate of subsidization of a "product" is found by taking the amount of the subsidy over the "total value of the recipient firm's sales in the most recent 12-month period".).

5. Thus, Brazil assumes that the subsidies[3] at issue are received by someone currently producing cotton, based simply on the fact that the subsidy is based on past production of cotton. Brazil has not explained how this makes upland cotton currently for sale on the export market the "subsidized product" with respect to these payments. Brazil has failed to demonstrate that the recipients of the subsidies are involved in current cotton production, nor has it demonstrated how much of the subsidy, even under Brazil's approach, should be allocated to other products produced by the recipient, such as corn or soybeans.

6. **Brazil Has Not Established that US Subsidies Have Suppressed or Depressed Prices in the Same Market**. As noted above, Brazil has in fact not even demonstrated the subsidized product for each of the subsidies it challenges or the size of the subsidies to exported upland cotton. However, without relieving Brazil of its burden on these issues, we note that even Brazil's overly simplified approach does not suffice to demonstrate causation. US subsidies largely resulted from low market prices, not the other way around.

7. This is nowhere more evident than in marketing year 2001, a year with historically low market prices. Brazil has failed to explain that market signals (futures prices) at the time when planting decisions were taken by US producers suggested prices would remain high. Thus, the large marketing loan payments ultimately made in marketing year 2001 do not demonstrate that marketing year 2001 payments had the effect of increasing US production. Brazil's expert acknowledges this very point, but Brazil has not presented in its further submission *any* information on "the expectations about production incentives that growers hold at the time they make their planting decisions", information on which its own expert has stated "cotton plantings depend". Thus, Brazil's simple explanation of the conditions in marketing years 1999 through 2002 ignores "the basic economic principles" its own expert says are relevant in this case.

8. **The Sumner Model Presented by Brazil Is Inadequately Explained, Inappropriately Applied for a Retrospective Analysis, and Apparently Uses Faulty Assumptions and Estimations.** In presenting this reaction to Brazil's expert's analysis, the United States notes that the use of a simulation model to explore the counter-factual of removal of US subsidies cannot be made without answers to previous questions on the subsidized product and size of the subsidies. That is, the use of a simulation model cannot relieve Brazil of its burden of arguing the elements necessary to establish its claims. This critique of Dr. Sumner's analysis is made to show that Brazil's approach is fundamentally flawed in all aspects.

9. Since Brazil has not provided access to the model itself, one cannot say with certainty how the modelling affects the results.[4] Nonetheless, based on what has been presented in Annex I, Brazil's analysis appears flawed in several respects and as a result, the conclusions drawn are biased and misleading. While the modelling approach used is well accepted for forward-looking projections, using a baseline model to simulate counterfactual outcomes over the historical period 1999-2002 is

[3] Brazil purports to include export credit guarantees under the GSM-102 programme within its actionable subsidy claims. However, Brazil has merely alleged the quantities of export credit guarantees benefitting cotton and the value of exports. Brazil has nowhere presented evidence on any alleged subsidy rate resulting from this programme nor the amount of the subsidy. Therefore, Brazil again has not provided any evidence with respect to the amount of the subsidy alleged to be provided by US export credit guarantees.

[4] The report provided by Brazil as Annex I to its further submission does not provide the model itself, including detailed specifications of the equations used therein. As a result, Brazil is essentially asking the Panel and the United States to accept Dr. Sumner's results on faith alone. The United States points out why Brazil's expert's approach is inappropriate for a retrospective analysis of the effect of US subsidies. Even were Brazil's expert's approach appropriate, however, Brazil has failed to provide sufficient evidence to allow the Panel to fully understand and evaluate that model. Thus, quite apart from flaws identified by the United States, Brazil's reliance on Dr. Sumner's inadequately explained results, evident throughout Brazil's latest submission, further demonstrates that Brazil has not established a *prima facie* case that US subsidies have the effects complained of.

problematic because of the implicit assumption of perfect foresight by producers of actual conditions in the historical year. This potentially overstates the effects of the programme because the model assumes outcomes that were unanticipated by producers when they made their planting decisions. Also, it is not clear to what extent actual observed data enter into the solution process. The difference is not merely conceptual: the choice of values can potentially affect the reported results.

10. Brazil's use of lagged prices as a proxy for expected prices is also problematic. Recent studies have criticized the use of lagged variables as substitutes for expectations, and numerous papers use the futures price for next year's crop as the best proxy for expected price. The use of futures prices in a multi-commodity modelling framework for extended time projection is cumbersome. Nonetheless, the use of lagged prices as a modelling convenience does not preclude the possibility of bias. In those years where there are large shocks, lagged prices are poor predictors of expected price. Futures prices, by contrast, are more efficient because they are based on more current information.[5]

11. Brazil's expert's estimates of US programme impacts after marketing year 2001 are further inflated by his choice of a low-price baseline for the counter-factual comparison.[6] The low-price baseline exaggerates the 2003-07 results and ensures projections of significant marketing loan payments throughout 2003-07.

12. The economic literature on decoupled payments acknowledges the programmes may have some impact on production, and that those impacts depend in part on farmer' s expectations. However, the research concludes that the impact appears negligible. Brazil's expert, on the other hand, uses a stylized logic to come up with the estimates for the impact of production flexibility contract (PFC) payments that have neither empirical nor theoretical grounding. It is widely accepted that these programmes have whole farm impacts rather than crop specific impacts. Furthermore, the impact is much smaller than Brazil has estimated; the whole farm impact is, at its upper estimate, perhaps one-quarter to one-fifth the impact Brazil's expert cites for cotton alone.

13. Brazil argues that market loss assistance (MLA) payments have a larger effect on area than do PFC payments, despite the fact that MLA payments were paid on the identical payment base as the PFC payments. Supplemental legislation authorizing each of these MLA payments was passed several months after planting for the crop year in question had occurred. Brazil asserts that producers had expectations about MLA payments at the time of planting. However, if producers had expectations of payment, then they also knew that they would be eligible to receive such a payment whether or not they planted cotton. Indeed, they could choose not to plant any crop at all and still be eligible for the payment.

14. Brazil argues that counter-cyclical payments "clearly provide more production incentive than the market loss or the direct payments," yet offers no empirical evidence to justify such a claim. The claim, as well as Brazil's expert's treatment of decoupled payments in general, is particularly puzzling

[5] Consider as an example the 2002 crop year. In Brazil's analysis, area response to the removal of the cotton loan programme results in a 36-per cent reduction in US planted area–the largest single effect for any of the years considered in his analysis. Based on lagged prices, price expectations for 2002 were 29.8 cents per pound, a 40 per cent reduction from 2001 levels. Yet, the futures market data suggests a far smaller reduction in expected price. December futures prices taken as an average in February 2002 averaged 42.18 cents per pound, a 28 per cent drop from year earlier levels. Based on Brazil's range of supply response elasticities of 0.36 to 0.47, a decline of this magnitude would suggest a drop in acreage of 10 to 13 per cent from the preceding year. In fact, actual US cotton acreage dropped 12 per cent (from 15.5 million acres in 2001 to 13.7 million acres in 2002) suggesting acreage levels entirely consistent with world market conditions and price expectations.

[6] Brazil's expert's estimate for the 2002 A-Index is 51 cents, compared with 54 cents in FAPRI' s March 2003 baseline, and an actual price of 56 cents. For 2003, Brazil's expert's A-Index is estimated again at 51 cents, whereas FAPRI's baseline has a 58.4 cent forecast; as of 15 September 2003, the A-Index is at 65.5 cents.

given a recent paper by Brazil's expert in which he concludes that the 2002 farm bill would have a minimal effect on cotton area and world prices. Brazil's expert also remarked that: "The impacts of the FSRIA will be hard to isolate amid the normal flux of world markets".[7] We agree with Dr. Sumner's previously *published* conclusions on these points.

15. Crop insurance subsidies are generally available for most crop producers and hence do not give a specific advantage to one crop over another. Thus, their effects are not commodity specific, and have no or minimal impacts on cotton markets. Moreover, crop insurance purchases by cotton growers have generally been at lower coverage levels than for other row crops. Over 2002-03, roughly 90 per cent of cotton acreage insured was at coverage levels at 70 per cent or less, consistent with the criterion under paragraph 8(a) of Annex 2 of the Agreement on Agriculture. This suggests that even if one were to consider cotton crop insurance subsidies as crop specific, over 90 per cent of insured cotton area would be exempt as having no or minimal trade-distorting effects.

16. Lastly, while some studies like the ones cited by Brazil have suggested crop insurance subsidies may have a slight effect on acreage, the effects on production are less clear. Recent studies suggest that farms with more insurance tend to use less inputs like fertilizer and pesticides and vice versa. This demonstrates a potential moral hazard problem with crop insurance: a negative effect on yields, which may well offset any marginal effects on crop area.

17. The size of Step 2 payments under Brazil's baseline appears to be biased upwards, in part, due to the low-price baseline discussed earlier. Brazil's results are inconsistent with other analyses of Step 2.[8] Thus, contrary to the results of Brazil's expert's model, the benefits of Step 2 payments would appear to largely accrue to the producer, with only negligible effects on world markets. While Brazil's model documentation is lacking, one explanation for the difference may be a more price responsive acreage equation by Brazil.

18. While Brazil has presented a modelling framework that is conventional, much of how Brazil's expert has modelled US farm payments can be considered "unconventional". Thus, the analysis presented by Brazil in Annex I is not "conservative", but rather produces results that are inconsistent with a wider body of academic research.

19. **Additional Legal Arguments**. With respect to price suppression or depression under Article 6.3(c) of the Subsidies Agreement, Brazil believes that it is the effect on the producers of the complaining Member that must be "significant". We find it implausible that the Subsidies Agreement was intended to create multiple standards for panels to apply: that is, what may be "significant" to one Member's producers may be "insignificant" to another's. Context for rejecting Brazil's approach can be found in Article 15.2 of the Subsidies Agreement, which sets out for countervailing duty purposes the same effects found in Article 6.3. This text makes it even more clear that the analysis is whether the level of price suppression or depression itself is "significant".[9] Brazil has not suggested that the analysis under Articles 15.2 and 6.3(c) should be different.

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[7] Sumner, D.A. "Implications of the US Farm Bill of 2002 for Agricultural Trade Negotiations." Australian Journal of Agricultural and Resource Economics. 47(2003): 99-123, at 114. (See Exhibit US-56)

[8] In Brazil's baseline, Step 2 payments average 5.6 cents per pound over the 2003-07 period, elimination of Step 2 payments raises world prices by an average of 1.6 cents, while farm prices fall by 2.5 cents per pound. These alleged effects are higher than those found by others. For example, in 1999, when Congress was debating whether to reauthorize Step 2 subsidies, the FAPRI analyzed the effects of reauthorization for the Senate Committee on Agriculture, Nutrition and Forestry. Their analysis estimated an average Step 2 payment of 5.3 cents per pound, resulting in an increase of the US spot price by 4 cents and a fall in the world cotton price of less than 0.5 cents.

[9] Subsidies Agreement, Article 15.2 ("With regard to the effect of subsidized imports on prices, the investigating authorities shall consider whether . . . the effect of such imports is otherwise to depress prices *to a*

20. With respect to GATT 1994 Article XVI:3, Brazil appears to assume that it may advance a claim under this provision on all challenged US subsidies. However, Article XVI:3 only applies to export subsidies. Therefore, as Brazil has predicated its claim under Article XVI:3 on evidence relating to all challenged US subsidies and not only those subsidies it alleges are export subsidies, Brazil has failed to establish a *prima facie* case on its claims.

21. Finally, with respect to Brazil's claims of a threat of serious prejudice, the United States notes Brazil's failure to present recent market and futures price data, which belie the notion that there is a clearly demonstrated and imminent likelihood of future serious prejudice. In fact, prices are currently above the level at which the marketing loan programme confers any benefit on US upland cotton producers and are expected to remain so. If there is not a "clearly demonstrated and imminent likelihood" of serious prejudice in marketing year 2003, it follows that there cannot be a threat of serious prejudice for marketing years 2004-07, either.

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*significant degree* or to prevent price increases, which otherwise would have occurred, *to a significant degree*.").

# ANNEX F-4

## EXECUTIVE SUMMARY OF THE CLOSING STATEMENT OF THE UNITED STATES AT THE SECOND SESSION OF THE FIRST MEETING OF THE PANEL WITH THE PARTIES

1. The US comments speak briefly to Brazil's allegations regarding "the effect" of US subsidies. Brazil has not shown causation between the US subsidies and the effects Brazil attributes to those subsidies. The United States has pointed out the failure of Brazil to separate and distinguish evidence on the effect of other factors from the alleged effect of the challenged US subsidies. Ultimately, this issue goes to the quality of the evidence before the Panel and whether Brazil has established a *prima facie* case on its claims.

2. There are three main elements of Brazil's argument. First is the "temporal proximity" argument – that is, that low world prices correspond in time with high US subsidies.[1] Mr. Chairman, there are subsidies and there are subsidies. For example, there is a difference if I give you a $10 subsidy to produce versus $10 whether you produce or not. Depending on the nature of the payment, one would estimate different effects. Therefore, one cannot merely aggregate the value of all US payments and claim that those subsidies have had "an effect" on production and prices.

3. In this part of its argument, Brazil misuses the data on production by making comparisons using marketing years 1998 and 2001. In 1998, production was driven downward by drought and record crop abandonment. In 2001, production was driven upward by record yields. To use 1998 and 2001 as the beginning and end of a comparison therefore distorts a proper analysis.

4. Brazil stated yesterday that the increase in US production in marketing year 2001 was not solely due to record yields but also to an increase in acreage. That is true – there was some increase in acreage in 2001, but Brazil has failed to make the proper comparison to put that information in context. Brazil should have compared the US acreage increase between marketing years 2000 and 2001 with that in the rest of the world. The United States invites the Panel's attention to Exhibit US-63 circulated today. This exhibit reflects, for marketing years 1996-2002, the percentage change in harvested acreage over the previous marketing year in the United States and the rest of the world.

5. In marketing year 1996, when the programmes challenged by Brazil were introduced, you see a large decrease in US acreage compared to the rest of the world. The United States draws your attention to marketing year 1998, in which there is a large decline in US harvested acreage due to drought, followed by a large increase in marketing year 1999, which largely cancel each other out. In marketing year 2001, we see that the increase in acreage in the United States corresponds to the increase in acreage for the rest of the world. In marketing year 2002, the percent decline in harvested acreage in the United States is *greater* than that observed in the rest of the world. Thus, the data do not support Brazil's contention that US producers are insulated from market forces. In fact, US harvested acreage largely increases and decreases in line with the rest of the world.

6. (Yesterday Mr. Moulis asked about the data in the upland cotton fact sheet. The data in Exhibit US-63 does not come from that fact sheet but from the most recent US Department of Agriculture data base – the specific source is indicated on the second page of the exhibit. Brazil has used this same source for numerous exhibits in its submissions.)

[1] The United States has addressed the disconnect between low world prices and the level of subsidy in Exhibit US-44.

7. The second element of Brazil's arguments that the United States would like to address is its reliance on Mr. Sumner's model. We first would like to comment on something Mr. Sumner said today in his statement to the effect that the United States does not object to the use of the FAPRI baseline model. In fact, as reflected in the portion of the US opening statement delivered by Dr. Glauber, we do criticize as inappropriate the use of a baseline simulation model for retrospective analysis, a type of analysis for which it is not designed and is poorly suited.

8. Mr. Sumner's analysis also uses an inappropriately low baseline for his prospective analysis of future years. I noted with interest Mr. Sumner's statement that he used the November 2002 preliminary FAPRI baseline because this was available when he ran his model and that the results would have been even more extreme had he used FAPRI's published 2002 baseline "released the previous winter". The United States realizes it would have been inconvenient for Mr. Sumner to re-run his model, but FAPRI released a more recent baseline in January 2003 (published in March 2003[2]), many months before Brazil submitted the results of its model to the Panel and the United States. We believe this more recent FAPRI baseline would have been a more appropriate baseline with which to do calculations, but Brazil has chosen not to do so, instead presenting to the Panel results based on more out-of-date and inaccurate data. We wonder what would arise from a prospective analysis using such more recent data.

9. The third issue concerns the allegations of high US costs, an issue we have touched on only briefly in this hearing and will return to in more detail in our submissions. Brazil asks: without subsidies how could high-cost US producers have stayed in business? It is important first to point out that all of the cost projections by the US Department of Agriculture cited by Brazil are merely updates of a 1997 cost survey. In every year subsequent to 1997, the Department simply takes the results of the 1997 cost survey and updates it to reflect the general increase in prices according to the producer price index.

10. This approach assumes that the mix of inputs remains the same in 1997 as in subsequent years. However, this causes a presentation of inaccurate data on what costs are now. Brazil has several times in this hearing stated that it is not denying that factors reducing costs have occurred – for example, pest eradication bringing new, low-cost areas of the United States into production or the adoption of biotech cotton which requires fewer pesticide applications. Brazil, however, has not updated the cost information it presents to the Panel to account for such new developments and information.

11. The United States also notes Brazil's repeated references to a so-called cost/revenue gap. In fact, Brazil presents another such comparison for marketing year 2002 at page 5 to the annex to its Closing Statement. However, Brazil's so-called "gap" is the difference between an inaccurate average total cost per pound and the average marketing year farm price. Mr. Chairman, this is a faulty comparison. Total costs are relevant over the long-term, but Brazil uses this (inaccurate) number to compare to revenue in the short term – that is, the market price for one year. Such a comparison tells you nothing and does not establish that it is only the effect of US subsidies to keep US cotton farmers in business.

12. In fact, Brazil has apparently not listened to the testimony of its own farmer witness, Mr. Christopher Ward. In his statement during the first day of this hearing, he said the following (and I quote from paragraph 6 of his statement):

> But even with these high yields and the excellent quality of our land, *we were not able to fully recover all of our variable costs of production during the 2000/01* ***and***

[2] Exhibit US-52.

> *2001/02 seasons*. These variable costs included depreciation and maintenance of equipment, seed and fertilizer, labor, insurance, and fuel. ***Nor were we able to meet our total costs*** *which include the additional fixed costs*.[3]

That is, Mr. Ward says he has not been able to cover *either* his variable costs *or* his total costs for a period of two marketing years, and yet he continues producing. Under Brazil's analysis, he should be out of the business of producing cotton. He is not, and Brazil claims he is not subsidized, so how can Brazil claim that it is "the effect of the subsidy" to keep US farmers in business when they allegedly were not able to cover their total costs in marketing year 2002? What's true for Brazil should also be true for the United States.

13. Mr. Chairman, members of the Panel, on the basis of these arguments and the evidence presented to date, the United States does not believe that Brazil has established a *prima facie* case that the challenged US subsidies have caused the effects complained of. We will continue to develop and provide our response to the voluminous submissions of Brazil in our answers to your questions and in our rebuttal submission. Thank you.

[3] Statement of Mr. Christopher Ward at the Second Session of the First Panel Meeting, para. 6 (emphasis added). Mr. Ward goes on to state: "Based on my discussions with many producers relating to Mato Grosso cotton production and revenue, *I know that most other producers in State of Mato Grosso were in the same situation as we were during the 1999-2002 period*." *Id.* (emphasis added).

# ANNEX F-5

## ORAL STATEMENT OF ARGENTINA

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### I. INTRODUCTION

1. Argentina would like thank the Panel for this renewed opportunity to submit its views as a third party in these proceedings, and as stated in its submission of 3 October[1], it will be commenting on some of the claims made by the United States in its written submission of 30 September.[2]

### II. CLAIMS OF THE UNITED STATES

#### II.1 Causal relationship and other factors which affected and still affect the world cotton economy

2. In paragraph 5 of its submission, the United States asserts with respect to marketing loan payments and step 2 payments that Brazil seeks to ascribe extraordinarily low cotton market prices in recent years to US subsidy payments without presenting or explaining to the Panel the factors that led to this low market price level that in turn resulted in larger US subsidies.

3. Similarly, in paragraph 80 of its submission, the United States claims that Brazil's argument rests largely on the assertion that large US outlays under the challenged measures necessarily demonstrate that US measures caused those price declines.[3]

[1] Second Written Third-Party Submission of Argentina, 3 October 2003, paragraph 4.
[2] Further Submission of United States, 30 September 2003.
[3] Further Submission of the United States, paragraph 80.

4. The United States claims that Brazil has not been able to demonstrate the causal connection between the US measures and their effects, nor has it considered other factors which affected and still affect the world cotton economy.

5. Argentina believes that Brazil, in its First Written Submission, provided a precise and comprehensive description of the world cotton market situation, backing the facts with considerable evidence and documentation.[4] Similarly, in its Further Submission, Brazil took account of other factors which also contributed to demonstrating the suppressing or depressing effect on prices of the US subsidies.[5]

6. Argentina would further like to point out that despite the existence of factors other than the US subsidies that could also have had a depressing effect on international prices (such as the development of synthetic fibres, Chinese trade polices and other factors raised by the United States in its further submission[6], some of which will be considered by Argentina further on), Article 6.3 of the SCM Agreement[7] clearly states that "*serious prejudice … may arise in **any case** where … the effect of the subsidy...*".

7. In other words, Argentina considers that Brazil has demonstrated the causal relationship between the subsidies that the United States has granted and continues to grant to its cotton sector and the fall in international cotton prices.

8. That is, Argentina considers that under the SCM Agreement **it is not necessary for a subsidy to be the only factor** in the decline in international prices in order to be able to establish a causal relationship between that subsidy and the serious prejudice.[8] Rather, the subsidy must be a determining factor or, according to the text of Article 6.3(c), its effect must be a "**significant**" price suppression or price depression, and this was demonstrated by Brazil.

9. Argentina recalls that the United States, given the size and global impact of its cotton market – with a 41.6 per cent share of the world market – is the international market "price-setter" *par excellence.*

10. Thus, without the US subsidies which generate a world market surplus, international cotton prices would have been higher or would not have fallen as much. Similarly, if the US share in the world market had not increased as a result of the subsidies, the international price of cotton would have been higher or would have not fallen as much, and as a result, third-country producers, including Argentina, would not have suffered as much prejudice as a result of artificially depressed prices.[9]

11. Argentina does not agree with the US statement that Brazil has not established a *prima facie* case because it has failed to provide sufficient evidence of the causal relationship between the enormous budgetary outlays and the low international cotton prices.[10]

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[4] Brazil's First Submission to the Panel, 24 June 2003.
[5] Brazil's Further Submission to the Panel, 9 September 2003, Section 3.3.4.4.
[6] Further Submission of the United States, Section IV.B and C.
[7] Agreement on Subsidies and Countervailing Measures.
[8] "*Further Third Party Submission of New Zealand"* (3 October 2003), *para. 2.09: "Brazil's argument is not that declining cotton prices were due solely to the impact of the United States subsidies. Nor does Article 6.3(c) require that to be the case … ".*
[9] Second Written Third-Party Submission of Argentina, 3 October 2003, paragraphs 21, 26 and 27.
[10] Further Submission of the United States, paragraphs 17 and 80.

12. Brazil has not based its claims on a mere assertion, but rather, as we have already stated[11], the number and quality of the empirical and econometric analyses presented by Brazil in its Further Submission[12], which were carried out both by international organizations and by various prestigious US institutions, not to mention the USDA itself, provide irrefutable evidence of the *collective* and *individual* effects of each subsidy programme on the price of cotton.

13. It is therefore difficult for Argentina to understand how the United States can claim that other factors, and not its subsidies, were the cause of the dramatic fall in cotton prices over the past few years. Nor does Argentina understand how the United States can disregard the evidence provided by Brazil[13] to the effect that during the marketing years 1999 to 2002, the total value of US cotton subsidies amounted to almost US$13 billion while the average cotton subsidization rate was 95 per cent.[14]

14. In the paragraphs that follow, Argentina will refute some of the arguments put forward by the United States concerning other factors that may have influenced the fall in international cotton prices:

15. FIRST: the United States claims that the explosion in the production of synthetic fibres played a considerable part in causing cotton prices to fall. Argentina submits that the contrary appears to be true.

16. Indeed, the "Fibre Prices" Table in paragraph 23 of the US Further Submission shows that polyester prices have always been lower than cotton prices (see: "US mill" as compared to "US spot" and "Asia poly") and, moreover, they appear to follow cotton prices (see 1995, when cotton prices reached their record level for the series and polyester happened to follow the same trend).

17. The fact that polyester had to adapt to cotton prices, and not the reverse as the United States claims, is confirmed by the very close correlation between cotton and polyester prices. On the other hand, the last few years do not show any correlation between the price per barrel of oil and the price of polyester fibres.

18. SECOND: Argentina does not understand how the United States can claim that without the increase in US retail consumption, international cotton prices would currently be lower[15] (which is not being questioned), while disregarding the role that its enormous subsidies have played and still play in the fall of international cotton prices.

19. As we have already pointed out[16], price movements of the US Cotlook "A" Index and third country (e.g. Brazilian and Argentine) market prices are directly interconnected, and this is an unquestioned and irrefutable fact. This being the case, the amount of the US subsidies granted to the cotton sector added to the scale of US production and exports are decisive when it comes to determining the extent to which the subsidies affect the fixing of both international and third market prices.[17]

20. THIRD: The United States correctly points out that since the world's cotton trade is managed in US dollars, an appreciation of the dollar will lead to a fall in the price of cotton both in the

[11] Second Written Third-Party Submission by Argentina, paragraphs 34-36.
[12] Further Submission of Brazil, Section 3.3.4.8.1.
[13] USDA's "Fact Sheet: Upland Cotton" (January 2003). (See Annex BRA-4).
[14] Written Third-Party Submission by Argentina, 15 July 2003, paragraph 20.
[15] Further Submission of the United States, paragraph 26.
[16] Second Written Third-Party Submission by Argentina, paragraph 22.
[17] *Idem*, paragraph 28.

United States and in third markets.[18] What the United States does not explain in connection with this fact is why this appreciation of the dollar by some 37 per cent between 1995 and 2002[19] did not also result in a fall in production, and consequently, in US cotton exports. The National Cotton Council (NCC) gives us the answer, pointing out that without its subsidies, the United States' share in the world cotton market would have declined.

21. FOURTH: Regarding the United States argument that China is the giant of the world cotton industry, and hence the impact of its trade policies and stocks, we note that neither Brazil nor third parties, such as Argentina, overlooked this fact. We repeat, Argentina has already pointed out[20] that while there were a great many cotton producing countries, four of them (China, the United States, India and Pakistan, in descending order) alone account for two thirds of world cotton production.

22. However, Argentina also pointed out that most of the cotton was used in the producing country itself, and that the great exception to that rule was the United States, which exported over a half of the cotton it produced and was the world's leading exporter. This was why the level of subsidization in the United States was the main factor in determining the world cotton market price. In other words, while China may be the giant in the world cotton **industry**, the United States is the giant in world cotton **trade**.

23. FIFTH: The United States claims that the decisions of farmers are based on expected cotton prices for the upcoming crop year and not prices from the previous crop year as cited by Brazil, and that US cotton producers are not insulated from international price movements.[21] We can only repeat some of the questions that we addressed to the United States during the consultations[22], namely:

24. If this is so, how does the United States explain the fact that in 2001 – the fifth year of falling prices – US cotton producers achieved a record harvest of 20.3 million tons, an increase of 42 per cent compared to 1998, and that the cotton planted area increased by 6 per cent during the same period? Why does the USDA estimate a 10 per cent drop in the world production for 2002 – reflecting the impact of world prices on investment – and at the same time estimate for this year another record harvest in the US – the fourth biggest ever recorded? How does the US explain the reasons for the increase in the volume of its cotton exports from 946,000 tons in 1998 to 1.8 million tons in 2001, while there was a drop in international prices?

25. Besides, the United States is not a low-cost producer[23] (despite its claim that pest eradication programmes and the adoption of genetically modified varieties of cotton have lowered its production costs[24]), and its productivity levels are lower than those of other exporting countries. Nevertheless, while international prices have fallen by some 54 per cent since the middle of the 1990s, the United States has expanded the area under cotton and increased its production. How does the United States explain the lack of correlation between the world cotton price and US cotton production?

26. Brazil has given answers to all of these questions. Argentina has also pointed out that if the United States did not grant subsidies to its cotton sector, the US cultivated acreage and production

[18] Further Submission of the United States, paragraph 35.
[19] *Idem*, paragraph 32.
[20] Written Third-Party Submission by Argentina, 15 July 2003, paragraph 21.
[21] Further Submission of the United States, paragraph 45.
[22] Second Written Third-Party Submission by Argentina, 3 October 2003, paragraph 7.
[23] International Cotton Advisory Committee, "Survey of the Cost of Production of Raw Cotton", 2001.
[24] Further submission of the United States, paragraph 46.

would diminish. US exports would also diminish and, the US being the world's leading supplier of cotton, international prices would be higher or would not have decreased as much.[25]

27. Argentina considers that the evidence submitted with respect to the increase in US production and exports which took place entirely independently or in isolation from the fall in the international price clearly demonstrates that US cotton producers are immune to changes in the market prices for cotton.[26]

28. SIXTH: The United States claims that the eradication of pests and the adoption of genetically modified varieties of cotton have lowered production costs.[27] We stress that even so, there continues to be a widening gap between those costs and market prices.

29. We repeat what has already been stated by Brazil and Argentina[28], namely that while US cotton production costs are among the highest in the world, US producers' market prices have fallen from US$0.60 to US$0.30 per pound.[29] The only possible explanation of how the United States has been and continues to be able to bridge the widening gap between production costs and market prices is subsidies, since without them many US producers would have been or would be compelled to cease cotton production.

30. SEVENTH: Argentina does not understand how the United States can claim that US cotton producers are highly sensitive to price changes when in spite of a 54 per cent fall in international prices since the middle of 1990s, the area under cotton and the production of cotton in the United States expanded considerably. In other words, contrary to what the United States has claimed, the area under cotton has responded to the fall in international prices by increasing steadily. The only way to achieve such a result is to grant enormous subsidies, since without them the cultivated area, and hence production, would have decreased.

31. EIGHTH: Argentina does not understand how the United States can state that its cotton producers show greater sensitivity to price changes than is demonstrated by third markets when, for example in Argentina – which is basically a "price-taker" in the international cotton market – the cultivated area shrank by 76 per cent during the marketing year 2001/2002, while production fell by 63 per cent compared to 1998.[30]

### II.2 Exclusion of measures

32. Regarding the US argument that some of its domestic support measures should not be included in the analysis[31], Argentina considers that the Panel should examine the collective effects of all of the support measures that are not green box measures. Argentina does not agree with the US statement that direct payments and counter-cyclical payments should be excluded from the analysis simply because their individual effects may not be that significant.

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[25] Second Written Third-Party Submission by Argentina, 3 October 2003, paragraphs 11 and 12.

[26] *Idem*, paragraph 5.

[27] Further Submission of the United States, 30 September 2003, paragraph 46.

[28] Written Third-Party Submission by Argentina, 15 July 2003, paragraphs 17 and 18.

[29] According to a recent ICAC study, the cost of production in the United States was US$0.81 per pound of cotton in the marketing year 1999. In contrast, as pointed out by Brazil in paragraph 32 of its submission, Argentina's production costs averaged 59 cents per pound of cotton. "Cotton: World Statistics", Bulletin of the International Cotton Advisory Committee, September 2002 (Annex BRA-9).

[30] "Argentina: Economic Injury to the Cotton Sector as a Result of Low Prices", Working Group on government Measures of the International Cotton Advisory Committee, 2002. Written Third-Party Submission by Argentina, 15 July 2003, paragraph 22.

[31] Further submission of the United States, 30 September 2003, paragraphs 71 to 75.

33. It is the collective impact of all of the US subsidies that has effects on the cultivated area, production, exports and prices.

## II.3. Interpretation of Article 6.3(c)

### II.3.1 Effect of the subsidy

34. Argentina considers that Brazil has made a proper *prima facie* case with respect to its claim of inconsistency with Article 6.3(c) of the SCM Agreement, conclusively demonstrating the significant price suppression or depression effect.

35. Firstly, Argentina does not understand how the United States can simply brush aside the Panel's findings in *Indonesia-Automobiles*[32], since this was the only dispute under the GATT-WTO which dealt with the interpretation of the term "significant".

36. Secondly, Argentina fails to understand how the United States can claim that Brazil argued that it is the effect on producers that must be significant, and not on prices, when Brazil has submitted copious evidence, based on numerous empirical and econometric analyses, of the effects of the subsidies on prices.

37. It is remarkable that the United States should completely disregard these analyses, especially considering they were conducted by international organizations and by different prestigious US institutions, not to mention the USDA itself[33], in an attempt to distort Brazil's evidence.

38. Argentina repeats that over and above any endorsement that may be given to the conclusions of any one of these studies (and each study's estimate of the price effect of the subsidies), an increase in the world price of cotton would be significant, even if international price suppression or depression were to amount to only one per cent per pound, since such an increase would enable countries such as Brazil and Argentina to recover their competitive positions in the world cotton market.[34]

39. Finally, at no time does the United States seem to suggest that a suppression or depression effect of 12.6 per cent on international cotton prices is not "significant" within the meaning of Article 6.3(c). The Panel should therefore find that the subsidies in question have caused and still cause significant depression of cotton prices in the world market resulting in serious prejudice to Brazil's interests.

### II.3.2 "In the same market"

40. Contrary to what the United States has claimed[35], Argentina considers that Brazil has presented sufficient evidence with respect to the significant effect of subsidies on prices for each relevant geographical market, including the United States, Brazil, the African Countries, other producer countries and Brazilian export markets.

41. The United States provides no legitimate reason why the Panel should not consider the world market. As stated earlier[36], price movements of the United States, of the Cotlook "A" Index and third

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[32] *Idem*,paragraph 82.

[33] Further Submission of Brazil, 9 September 2002, Section 3.3.4.8.1.

[34] Second Written Third-Party Submission by Argentina, 3 October 2003, paragraph 34 to 36. See also Further Third-Party Submission of New Zealand (3 October 2003), paragraph 2.21: "*...As Brazil demonstrates even a 1 cent per pound price-suppressing effect can reduce world wide export revenue by 552 million dollars"*.

[35] Further Submission of the United States, paragraphs 90 to 92.

[36] See paragraph 17 above.

country (e.g. Brazilian and Argentine) market prices are directly interconnected, and this is an unquestioned and irrefutable fact.

42. Moreover, US cotton forms part of Cotlook's "A" Index basket, so that the Panel cannot ignore the fact that the US subsidies have a decisive impact on the price of cotton in the world market.

43. Indeed, this being the case, the amount of US subsidies granted to the cotton sector added to the scale of US production and exports is decisive when it comes to determining the extent to which the subsidies affect the fixing of both third market and world market prices.

II.3.3 Time period to be considered

44. Regarding the US argument that subsidies that have ceased to exist can have no "effect"[37], Argentina would like to recall the Panel's remarks in the *Indonesia-Automobiles* concerning the irrelevance of serious prejudice having been caused by programmes that are no longer in force. Upon examining whether the subsidies caused serious prejudice to the interests of the complainants, the Panel in the said case rejected the argument that the effects of an expired subsidy programme could not be considered.[38]

45. Moreover, Argentina considers that it is necessary to consider a sufficiently extensive period to reflect market trends, and a period of one year as suggested by the United States is not sufficient.[39]

**II.4 Interpretation of article 6.3(d)**

II.4.1 World market share

46. The United States errs in its interpretation of the expression "world market share" by trying to identify it with "share in world consumption".[40] If, as the United States contends, the expression "world market share" in Article 6.3(d) refers to the increase in consumption of the country granting the subsidy, it would be contrary to the object and purpose of Articles 5 and 6 of the SCM Agreement, namely to avoid adverse effects of subsidies to the interests of other Members.

47. Indeed, if there were an increase in the share in world consumption of the product subsidized by the Member granting the subsidy, this would very probably lead to an increase in the international price of the product in question, and hence, there would be no adverse effects for other Members. In other words, to identify "world market share" with "share of world consumption" would completely subvert the underlying rationale of Article 6.3(d).[41]

[37] Further Submission of the United States, paragraph 94.

[38] The Panel stated that: *"[W]e must assess the 'effect of the subsidies' on the interests of another Member to determine whether serious prejudice exists, not the effect of 'subsidy programmes'. We note that at any given moment in time some payments of subsidies have occurred in the past while others have yet to occur in the future. If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were 'expired measures' while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice.*" Panel Report on *Indonesia – Automobiles*, paragraph 14.206.

[39] See WT/DS219/AB/R, paragraph 80: *" … we understand a POI to provide data collected over a sustained period of time, which period can allow the investigating authority to make a dumping determination that is less likely to be subject to market fluctuations or other vagaries that may distort a proper evaluation"*.

[40] Further Submission of the United States, paragraph 97.

[41] See also Further Third-Party Submission of New Zealand, paragraph 2.34.

48. Moreover, if we take account of the immediate context of Article 6.3(d), i.e. footnote 17, which states *"unless other … rules apply* ***to trade*** *… "*, we have a clear indication that the expression "world market share" can only refer to the share in world exports.

II.4.2 Time period to be considered

49. Contrary to the US claim that the trend in the period considered is not consistent because it includes years in which the United States world market share decreased rather than increasing[42], the fact is that there will always be peaks and troughs in agricultural production and export for climatic and other reasons. This does not mean that a trend over the years cannot be "consistent".

50. In other words, the word "consistent" cannot be interpreted in such a way as to allow a decrease in world market share during a given year to invalidate a trend over several years. On the contrary, the word "consistent" should be interpreted in the context of the investigation period, disregarding the market variations.

### II.5 Threat of serious injury

51. Argentina considers that since Brazil has established the existence of serious prejudice caused by the US subsidies, the threat of serious prejudice is clearly foreseeable and imminent as a result of the even higher subsidies planned under mandatory US legislation for the marketing years 2003-2007. Consequently, Argentina maintains that Brazil has established a prima facie case that these subsidies threaten to cause serious prejudice to Brazil.

52. Argentina contends that this guaranteed flow of subsidies will unquestionably lead to a higher level of US cotton production and exports. This will inevitably result in price suppression and depression as well as an increasing and inequitable US market share for cotton, thus creating a source of permanent uncertainty that confirms the threat of serious prejudice generated by the subsidies.

53. Argentina further considers that the link between US cotton subsidies and the threat of significant price suppression and depression and of an increase in the US world market share for cotton stems from the fact that the future subsidies will be as necessary as the current ones for US producers to bridge the gap between market prices and their total production costs. This will enable US producers to continue competing with more efficient third country producers, especially considering that the USDA itself forecasts an increase in total production costs.[43]

## III. EXPORT CREDIT GUARANTEES

54. In its Further Submission, the United States reverts to its argument in connection with the negotiating history for the interpretation of Article 10.2 of the Agreement on Agriculture, maintaining that there are no disciplines regulating the use of export credit guarantees.

55. Argentina repeats what it stated in its oral submission of 24 July 2003, namely that Article 10.2 in no way provides an exception to the general disciplines on export subsidies, and in particular, to the applicability to Article 10.1. As Argentina has pointed out, *"if that had been the intention, then the negotiators would have expressly said so."*[44]

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[42] *Idem*, paragraph 101.

[43] See Annexes BRA-7 (ERS Data: Commodity Costs and Returns); BRA-257 ("Cost of Farm Production Up in 2003", USDA, 6 May 2003) and BRA-82 (USDA Agricultural Baseline Projections until 2012, USDA, February 2003, p.48).

[44] See Oral Third-Party Submission by Argentina, paragraphs 35 to 43.

## IV. CONCLUSION

56. For the reasons set forth both in this statement and in previous submissions, Argentina requests the Panel to issue the findings and recommendations requested by Brazil throughout these proceedings.

# ANNEX F-6

## ORAL STATEMENT OF BENIN

8 October 2003

Mr. Chairman, members of the Panel,

1. My name is Eloi Laourou from the Mission of Benin. I am joined by Mr. Nicholas Minot of the International Food Policy Research Institute in Washington, D.C., the co-author of the study that has been annexed to our Third Party submission, "Effect of Falling Cotton Prices on Rural Poverty in Benin". I will ask Mr. Minot to speak to you in a moment. The other members of our delegation are our legal advisers, Mr. Brendan McGivern and Mr. Stefan Ramel, both from White & Case.

2. As noted in our Third Party submission, this is the first time that Benin has participated in a WTO dispute. We have not taken the decision to participate lightly. Indeed, it was only the serious threat posed to the economic and social stability of our country by massive, WTO-inconsistent US subsidies on cotton that has led us to take this unprecedented step.

3. The cotton farmers of Benin are efficient producers. The World Bank has estimated that the cost of producing cotton in West Africa is about 50 per cent of the cost of production in the United States. Moreover, the cotton sectors of both countries have undergone considerable structural reforms.

4. Yet the economic efficiencies of our producers, and the painful reforms they have accepted, have in the end proved to be almost completely irrelevant. US subsidies have had a ruinous effect on the world price of cotton, which in turn has had devastating effects on the economies of West Africa.

5. US cotton subsidies do not just dwarf the cotton sectors of West Africa. They dwarf all economic activity in the region. As noted in our submission, the subsidies paid by the United States to its prosperous 25,000 cotton farmers exceed the gross national income of Benin, Chad, Burkina Faso, Mali, Togo and the Central African Republic.

6. Oxfam estimates that for the period from 1999/2000 to 2001/2002, Benin suffered a total cumulative loss of $61 million in export earnings. Mr. Chairman, this is not an abstract, anodyne statistic. This translates into genuine suffering on the ground, as hundreds of thousands of people, deprived of export earnings, are pushed from bare subsistence to absolute poverty. Indeed, Dr. Minot estimates that a 40 per cent reduction in farm-level prices of cotton has the effect of pushing an additional 334,000 thousand people below the poverty line in Benin.

7. This is an important point, one that should be considered carefully by the panel as it assesses the meaning of "serious prejudice" to one of the poorest countries in the world.

8. With your permission, I would now ask Mr. Minot to summarize briefly the results of his study on how depressed world prices for cotton translate into poverty in Benin.

Dr Minot:

9. Thank you for the opportunity to present the results of a study that I hope will be relevant to the dispute. Before I begin, I would like to provide some background. I am a Research Fellow at the International Food Policy Research Institute, a Washington-based international organization whose mandate is to generate information to address problems of hunger and poverty in developing countries. I received my Ph.D. in agricultural economics from Michigan State University and have worked on issues of agriculture in developing countries for more than 15 years, including four years living in sub-Saharan Africa.

10. From 1998 to 2000, I led a German-funded study of the impact of agricultural reforms on farmers in Benin. In collaboration with a local research firm, we carried out four surveys in Benin: surveys of farmers, traders, market managers, and village cooperatives. In 2002, I was contracted by the World Bank to use these survey data to examine the impact of falling world cotton prices on poverty in Benin. My co-author, Lisa Daniels, and I finished the report later that year and a version of it was distributed as an IFPRI working paper in November.

11. Cotton prices are affected by competition with synthetic fibres, weather-related supply shocks, the rate of growth in the global economy, and government policies, among other factors. Cotton prices are pushed below what they otherwise would be by government support to cotton growers. The International Cotton Advisory Committee estimates that worldwide direct assistance to cotton growers was US$ 4.9 billion in 2001/02. Of this amount, the United States accounted for US$2.3 billion, equivalent to 24 cents per pound of cotton produced. Other sources, using a broader definition of assistance, estimate that the government provides US$ 3.9 billion to the cotton sector.

12. Until 2002, US cotton policy consisted of various programs, including two (the marketing loan program and loan deficiency payments) that ensured that farmers receive at least 52 cents/pound. This has the effect of insulating US farmers from falling world prices. In 2001, in spite of low world prices, the US posted record cotton production and near-record export volumes. Furthermore, US subsidies to cotton have increased since these studies were carried out. The 2002 Farm Bill introduced target prices for the major commodities and programs that effectively pay US farmers most of the difference between market prices and the target price. For upland cotton, the target price is 72 cents/pound. In addition, by allowing farmers to update their "base acreage", the new policy provides incentives for farmers to expand production.

13. Several recent studies have attempted to assess the impact of subsidies on world prices. The Centre for International Economics in Canberra uses a five-region world model of fibre, textile, and garment markets in 2000-01 to simulate the impact of US and European subsidies on cotton production and export. They find that removing US and European subsidies to cotton growers would raise the world cotton price by 6 cents/pound or 11 per cent. Another study, carried out by ICAC, estimates that removing US production subsidies would have increased the world price by 11 cents/pound in 2001/02. And most recently, Sumner estimates that, in the absence of US subsidies, the world cotton price would have been 12.6 per cent higher over 1999-2002.

14. The adverse impact of lower cotton prices on export revenue and GDP in cotton exporting ations is clear, but does this translate into higher incidence of rural poverty? If cotton is grown mainly by larger farmers with relatively high incomes, then the effect of changes in cotton prices on rural poverty may be modest. Even if cotton is grown primarily by small farmers, the magnitude of the effect on rural poverty will be small if few farmers grow cotton or if it accounts for a small share of rural income. Assessing the direct impact of changes in cotton prices on rural poverty requires detailed household-survey data on incomes and expenditures.

15. The paper examined the impact of changes in cotton prices on rural poverty in Benin. In particular, it had two objectives:

- to describe the living conditions and level of poverty for cotton growers and other farmers in Benin; and

- to estimate the short and long-run impact of lower cotton prices on the income of cotton growers and on the incidence of poverty in rural Benin.

16. The Republic of Benin has a population of about six million, 59 per cent of whom live in rural areas. Its rural economy is based on maize, sorghum, millet, yams, cotton, and livestock production. The per capita gross national product is US$380, placing Benin among the poorest countries in the world. Indeed, the per capita income of Benin is lower than the average for sub-Saharan Africa.

17. In 1989, Benin entered a period of economic and political reform. It made a peaceful transition from a military government to a constitutional multi-party democracy. It also began to move from a quasi-socialist economy to a free-market economy. In the agricultural sector, state farms and cooperatives were disbanded, food crop prices and marketing were liberalized, and many state-owned enterprises were privatized or closed. In January 1994, the CFA franc was devalued by 50 per cent, effectively doubling the price of imports and the returns to exports. Although this imposed hardship on manufacturing firms and urban consumers, it stimulated the local production of cotton, rice, and other tradable goods.

18. In the past two years, Benin has greatly reduced the role of the state cotton marketing board, introducing competition in the distribution of inputs and the marketing of cotton. The fall in world cotton prices has led to political pressure for the government to support the domestic price or even to re-assume control of the sector to protect farmer interests. Cotton represents 90 per cent of agricultural exports and around 70 per cent of its total exports (excluding re-exports).

19. Because the reliability of the results depends heavily on the quality of the survey data, it is worth briefly describing the survey methods. The survey, called the *Enquête des Petits Agriculteurs* (EPP) or Small Farmer Survey, was carried out in 1998 by the IFPRI and a local research firm, the *Laboratoire d'Analyse Régionale et d'Expertise Sociale* (LARES). The survey used a 24-page questionnaire covering 16 topics. The households were selected using a two-stage stratified random sample procedure based on the 1997 Pre-Census of Agriculture. In total, one hundred villages were selected. In each village, nine households were randomly selected using household lists prepared for the pre-Census of Agriculture. Due to some variation in the number of households interviewed in each village, the final sample was 899 rural households. The interviews were carried out in local languages by two teams of Benin interviewers, supervised by staff from LARES and IFPRI.

20. In order to study poverty, we need to define it. In this analysis, the poor are defined as those living in households whose per capita expenditure is below the $40^{th}$ percentile in rural areas. Expenditure is used instead of income because it is more reliably measured and is a better measure of household well-being. It includes cash spending on consumption goods, the value of home-produced food, and the rental equivalent of owner-occupied housing. The resulting poverty line is equivalent to US$123 per person per year. It is worth noting that this is a low poverty line, far below the US$1 per day frequently used by the World Bank.

21. We simulated the impact of various percentage reductions in cotton prices on the incomes of rural households using the concept of producer surplus. The details of the calculation are shown in the paper, but these are standard formulas used in economic analysis. In the short run (before households respond to lower prices), the change in income of each household is simply the percentage

change in the value of cotton production multiplied by the quantity produced. In the long run, lower cotton prices will cause farmers to substitute away from cotton, so the impact is smaller. We simulated the impact of these cotton price changes in the short and long run on each of the 899 household in the sample to generate estimates of the impact on rural income and poverty.

22. Before turning to the simulation results, I will describe the role of cotton in the rural economy and the characteristics of cotton growers. According to the IFPRI-LARES survey, cotton is grown by roughly one-third of the farm households. Cotton accounts for about 18 per cent of the area planted by farm households and 22 per cent of the gross value of crop production. In value terms, cotton is the second most important crop, after maize. Among cotton farmers, the average area planted with cotton is 2.3 hectares, producing 2.7 tons of seed cotton. The value of this output is US$ 901 per cotton farm. Cotton accounts for about one-third of the value of crop sales (these figures are shown in Table 2 of our paper).

23. Cotton growers tend to have farms that are larger than other farmers, but they are similar to other farmers in terms of the poverty rate and average per capita expenditure. The larger farms do not translate into a higher standard of living because cotton production is concentrated in the north, which is more arid and has fewer opportunities for non-farm employment. It is not that cotton farmers are poorer than average, but rather that almost all farmers in Benin, including cotton farmers, are quite poor.

24. Turning to the simulations, the short-term impact of a 40 per cent reduction in the farm-gate price of cotton reduces the income of cotton growers 21 per cent. Taking into account the incomes of non-growers, which do not change in this simulation, the average income of rural households falls 7 per cent. Smaller reductions in the cotton price cause roughly proportional changes in income, as shown in Table 3 of our paper.

25. With a 40 per cent fall in the cotton price, the average incidence of poverty, including both cotton growers and other farmers rises 8 percentage points, from 40 per cent to 48 per cent. In absolute terms, this implies that about 334 thousand people would fall below the poverty line. A 40 per cent decrease in the price of cotton results in a 40 per cent increase in the depth of poverty ($P_1$) and a 61 per cent increase in the severity of poverty ($P_2$).

26. Does it matter what poverty line we use? By looking at the cumulative distribution of income with and without the price change, we can evaluate the sensitivity of the results to alternative poverty lines. As shown in Figure 2 in our paper, similar results would have been obtained for higher and lower poverty lines. The results are not very sensitive to the elasticity assumption.

27. In summary, our paper analyzed the impact of changes in world cotton prices on farmers in Benin. Both quantitative measures of per capita expenditure from household surveys and qualitative responses to our 1998 survey suggest that rural living conditions improved over the 1990s. Furthermore, farmers tended to attribute this improvement in rural living conditions to economic factors such as crop prices, availability of food, and access to non-farm employment. Although the causal link is difficult to establish with certainty, it appears the economic reforms of the 1990s (including the 1994 devaluation) and the growth of cotton production during this period contributed to a noticeable improvement in rural standards of living.

28. The link between world cotton markets and rural living conditions can, however, work gainst farmers as well. The analysis in this paper is based on the 39 per cent decline in the world price of cotton between January 2001 and May 2002. We combined farm survey data from 1998 with assumptions about the decline in farm-level prices to estimate the short- and long-term direct effects of cotton price reductions on rural income and various measures of poverty.

29. The results indicated that there is a strong link between cotton prices and rural welfare in Benin. A 40 per cent reduction in farm-level prices of cotton is likely to result in a reduction in rural per capita income of 7 per cent in the short-run and 5-6 per cent in the long-run. Furthermore, poverty rises 8 percentage points in the short-run, equivalent to an increase of 334 thousand in the number of people below the poverty line. In the long run, as household adjust to the new prices, the poverty rate settles down somewhat, remaining 6-7 percentage points higher than it was originally.

30. Furthermore, these estimates may well underestimate the actual effect of lower cotton prices on rural poverty in Benin. First, in an economy with unemployed resources and excess capacity, an external shock affecting income (such as a change in cotton prices) has a multiplier effect. Changes in cotton farmer income result in changes in demand for goods and services produced by their non-cotton-growing neighbours, which in turn influences their income and their demand for goods and services. Estimates for four countries in sub-Saharan Africa suggest that the multiplier is in the range of 1.7 to 2.2, meaning that the total effect on income (positive or negative) is 1.7 to 2.2 times greater than the direct impact.

31. Second, we assume that farm prices change by the same proportion as world prices. In competitive markets with a fixed marketing margin, the percentage change in farm prices will be greater than the percentage change in world prices. Until recently, the effect of changes in world prices on farm-level prices in Benin was muted by government regulation of the market which stabilized prices. Under market reforms being carried out in Benin and elsewhere in West Africa, markets are becoming more competitive and changes in farm prices will closely match changes in world prices.

32. Third, our estimates do not take into account other indirect effects associated with declining cotton production. An earlier analysis of the Small Farmer Survey data from Benin indicated that cotton farmers are three times more likely to apply fertilizer to their maize crops compared to non-cotton farmers. This is because growing cotton gives farmers access to fertilizer on credit, some of which they "divert" to their maize fields. The implication is that lower cotton prices will indirectly reduce the yields of food crops.

33. Overall, the results in this paper challenge the stereotype of the rural poor in developing countries as consisting of subsistence farmers that are relatively unconnected to, and thus unaffected, by swings in world commodity markets. At least in the case of Benin, to the extent that fluctuations in world cotton prices are transmitted to farmers, they will have a significant effect on rural incomes and poverty. The broader implication is that policies that subsidize cotton production in the United States and elsewhere, dampening world prices, have an adverse impact on rural poverty in Benin and (by extension) other poor cotton-exporting countries. Thank you, Mr. Chairman and members of the Panel.

Mr. Laourou:

34. Thank you for allowing Dr. Minot to present his paper, and for allow Benin to present its views.

35. This concludes our oral statement. We respectfully ask this Panel to find that the United States is in breach of its WTO obligations, including by causing serious prejudice to the interests of Benin and other Members. We would be pleased to answer any questions that you may have.

# ANNEX F-7

## ORAL STATEMENT OF CHAD

8 October 2003

Mr. Chairman, members of the Panel,

I am Abderahim Yacoub N'Diaye, the Ambassador of Chad to the WTO. The other members of my delegation are Mr. Mouata Nanrabaye, as well as our legal advisers, Mr. Brendan McGivern and Mr. Stefan Ramel, both from White & Case.

Chad stands by its written Third Party submission of 3 October 2003. In addition, I wanted to supplement this by reading to the Panel a recent statement by Mr. Ibrahim Malloum, who is both the President of the Société Cotonnière du Tchad, as well as the President of the African Cotton Association. Given his unique qualifications, I asked him to prepare a statement for this third party session. Unfortunately, however, he could not attend the hearing, since he had to be in Chad this week. However, his statement is of direct relevance to the issues facing the Panel, and so with your permission, Mr. Chairman, I would like to read it to you.

"Statement by Mr Ibrahim Malloum

**Introduction**

1. My name is Ibrahim Malloum. I am the President of the Société Cotonnière du Tchad, commonly known as Cotontchad. Cotontchad is a public/private organization that controls the production and marketing of cotton in Chad. Cotontchad is responsible for supplying farmers with inputs on credit, purchasing and collecting the harvested seed-cotton, ginning the crop into upland cotton lint, as traded internationally, and finally selling the finished product. Cotontchad is required to purchase all cotton produced by Chad cotton farmers. In addition, Cotontchad is responsible for selling and marketing the cotton produced by more than 2.5 million people in Chad involved in the production of cotton.

2. I am also currently President of the African Cotton Association (ACA). The ACA was formally created during a summit meeting of African cotton producers in Cotonou, Benin, in September 2002. It includes all the West, Central and East African producers, ginners and merchants. Many international merchants, shipping companies, and banks are also members of this Association. The ACA's goals are to defend and promote African cotton in the world market and to encourage knowledge sharing among African cotton producers.

3. I have been involved with selling and marketing cotton for more than 18 years for Cotontchad, during which time I have been involved in all the cotton activities:

- I was in Memphis Cotton School in 1985.
- From the end of 1997 to 1999 I was the General Manager of Cotontchad.
- When I was General Manager I was in charge of supplying the farmers with fertilizers, and pesticides; we buy all the production from farmers, we gin the cotton, we classify and export the cotton.

- Today I am in charge of marketing all Chad cotton production around the world. I am thus selling in more than 30 countries (Europe, Far East, Africa and South America.).

- Our selling prices are based on the international prices driven by the New York Cotton Futures Market and the Liverpool "A" Index.

**Cotton in Chad**

4. Cotton is essential to the livelihood of more than 2.5 million people in Chad. It has been the major cash crop and driver of Chad's economy dating back to the 1920s and continues to be today. Cotton represents 25 per cent of Chad's export earnings and 5.1 per cent of its GDP.

5. Chad has about 8.1 million inhabitants of which over 2.5 million are in one way or the other involved in the production of cotton. Cotton is typically produced on small family farms that lack mechanization and modern equipment, and electricity. Irrigation is completely reliant on rain and all harvesting is done by hand. Many farms are not even accessible by road. Despite these handicaps, production costs are approximately between 54 and 58 cents per pound. This is approximately one-half of the costs of producing cotton in the United States.

6. In order to streamline the production of cotton, farmers are organized into roughly 5,000 Village Associations (Associations Villageoises), each comprising about 100 households of both cotton and non-cotton producers. These Associations Villageoises also provide some basic social structure for about 80 per cent of Chad's eight million people who live in rural areas and that depend on subsistence farming. Normally cotton production in each Association Villageoise is a group effort with everyone in the community contributing to the production process. The cotton harvest and the amount produced is a source of both pride and prestige in each Association Villageoise.

**The Role of Prices for Chadian Cotton**

7. As already mentioned, Cotontchad plays a central role in the production of cotton in Chad. The production cycle of cotton in Chad starts when each Association Villageoise requests input supplies from Cotontchad's field agents or "interface", based on their planned land cultivation. Cotontchad then allocates inputs to each Association Villageoise on credit using future cotton harvests as collateral. The amount of inputs acquired and distributed is influenced directly by the prices that are able to be obtained by Cotontchad in its international sales. When prices are low, as they were during 2001-2002, Cotontchad cannot afford to provide all of the imports demanded by the Associations Villageoises. This in turn reduces the amount of cotton produced by each Association Villageoise and in Chad in general. When prices increase, more inputs are purchased which are then provided to each of the Association Villageoise and causes cotton production – and incomes generated by those Associations – to increase. Thus, higher prices obtained in international markets directly impacts the amount of present and future income received by cotton producers in Chad.

8. Cotontchad purchases upland cotton from each Association Villageoise at its 2,500 nation-wide weigh stations. The price received by the producers is a countrywide uniform price that is set each year by a committee representing both farmers and Cotontchad. The price determined by the committee is a function of the price received by Cotontchad in its physical sales of cotton. Cotontchad can only offer a price to the farmers that is consistent with the international market price.

9. Cotontchad then transports the upland cotton to its nine ginning stations to be sorted, ginned and commercialized. Finally Cotontchad sells the finished cotton in physical markets on the spot and forward market. Cotontchad markets its cotton on both an immediate (spot) and on a forward contract

basis. I am the principal negotiator for sales of Chad cotton. In marketing cotton, I provide information to a number of purchasers concerning the availability of Chad cotton. In some countries (Europe, Japan, and partially India) Cotontchad uses the agent channels to sell directly to the spinning mills. In other countries, we sell directly to the international merchants. We fix prices in relation with New York Future prices, Liverpool "A" index and also in relation to the competition prices offered in the market. Everyday we inform our agents and merchants of the available quantities and the prices of the different qualities we are offering.

10. In negotiations for the spot market or immediate shipment of cotton, the price negotiation involves reference to the current N.Y. futures contract price as well as the A and B-index prices. I will always make reference to the N.Y. futures price if prices are increasing and the N.Y. futures price is higher than the A-index price.

11. The New York Cotton futures market is the main cotton market place in the world. It goes without saying that the cotton price is dictated by New York. All the business men can forecast the index "A" by looking to what New York did the night before.

12. The vast majority of cotton produced in Chad is exported (about 95 per cent). Cotton produced in Chad is in direct competition with other regional and foreign exporters of cotton. The extremely small world market share of Chadian cotton exports (about 1 per cent) invariably makes Chad a price taker.

**The United States and Its Influence on World Cotton Prices**

13. The United States' production of upland cotton has a large influence on the world market price for cotton. All traders of upland cotton keep a close watch on developments in the United States. As the largest exporter of cotton, the United States supplies more than 40 per cent of cotton sold in international sales. The United States is by far the largest exporter of upland cotton. Because of the large size of the US production and exports, when stocks of US cotton for sale decrease because of weather problems in the United States, then the world price of upland cotton invariably increases. This is normally first reflected in increased N.Y. futures prices and then later by increases in prices in the A-Index. On the other hand, when US production of upland cotton increases because of increased land planted to cotton or because of favourable weather conditions, then the increased stocks of US upland cotton in the world markets press world prices lower. I have seen this process repeatedly over the years that I have been trading upland cotton on world markets. In my view, it is obvious that if the US producers did not have access to very large subsidies, they would plant less cotton and world upland cotton prices would increase. There is no doubt in my mind that the large US subsidies keep world prices lower. This includes prices received by Chad cotton.

14. To give the Panel some idea of the impact of the large US exports, I frequently encounter during negotiations purchasers who indicate that they can purchase US cotton at a price lower than what I am seeking to obtain in negotiations. These purchasers frequently tell me that US upland cotton is available to them at a lower price because of the US Step 2 payments. These payments are well known in the industry and are reported in trade publications. The Step 2 payments for US cotton allows exporters selling US cotton to underbid my bids when I am in direct competition for sales. This has happened to me on a number of occasions. Again, the result is lower prices for cotton that I am able to negotiate for Cotontchad.

**Suppressed Cotton Prices and Their Effect on Chad**

15. I would tell you that the low prices received by Chad producers contributes to poverty in Chad. The description of what happened in Benin is the same as what has been happening in Chad. Cotton for most Associations Villageoises in Chad is the only source of outside income. Therefore Chadian schools, hospitals and local governments rely directly on money received from cotton sales. The cotton industry in Chad is still trying to recover from record low prices from 2001-2002. While prices are now increasing, prices will have to increase considerably more to make up for the unprecedented crisis caused by extremely low prices last year. In my view, the continuing high levels of US production are still depressing world prices. I look forward to the day when I do not have to compete with US upland cotton for every sale. Increased prices will allow Chad producers and Chad communities to obtain additional income and improve the life of our very poor people".

Thank you for your attention. I would be happy to answer any questions you may have.

# ANNEX F-8

## ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

8 October 2003

### 1. Introduction

1. The European Communities (the "EC") welcomes this opportunity to submit orally its views to the Panel.

2. The EC has already submitted in writing its views with respect to Brazil's further submission of 9 September 2003. Today, the EC will provide its comments on the further submission of the United States of 30 September 2003. Many of the issues raised in the US submission concern factual matters. The EC will limit itself to address three of questions of legal interpretation. Specifically, the EC will argue in this Statement that:

III. the crop insurance payments made by the United States would be "specific" in so far as it can be established that different insurance policies result in different benefits being conferred with respect to different products;

IV. the issue of whether green box payments can cause "serious prejudice" within the meaning of Article 5(c) of the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement") does not arise in this dispute;

V. the term *same market* in Article 6.3 (c) may refer to any geographical market, including also the world market, provided that there is such a world market for the product under consideration.

3. Before addressing these issues, the EC would like to put on record its agreement with the United States with respect to a number of questions on which it does not consider it necessary to submit additional arguments:

VI. the EC agrees with the US interpretation of the term "world market share" in Article 6.3(d) of the *SCM Agreement*;

VII. the EC endorses the U.S. interpretation of the term "more than equitable share" in Article XVI:3 of the GATT;

VIII. the EC also agrees with the US position that Brazil's first standard to establish the existence of "threat of serious prejudice" for the purposes of Article 5(c) of the *SCM Agreement* is incorrect;

IX. finally, the EC agrees with the United States that the *Agreement on Agriculture* (the "AA") excludes the application of Article III:4 of the GATT and of Article 3.1 (b) of the *SCM Agreement* to subsidies "in favour of agricultural producers" which are paid to the processors.

4. On the other hand, the EC would like to restate its disagreement with the US position that Article 10.1 of the AA does not apply to export credits and guarantees.

**2. Specificity of crop insurance payments**

5. The United States contests Brazil's claim that the subsidies allegedly provided in the form of crop insurance payments are specific. The United States argues that crop insurance is not "specific" because it is available, in one way or another, with respect to all agricultural products.[1]

6. The EC understands, however, that different crop insurance policies apply to different agricultural products.[2] If such differences had the consequence that some agricultural products will receive a benefit in circumstances where other products will receive no benefit, or only a smaller benefit, the difference would be clearly "specific".

**3. Green Box subsidies**

7. The United States argues that Brazil has failed to make a prima facie case that the payments for which it claims green box status cause serious prejudice. The United States recalls that paragraph 1 of Annex 2 of the AA makes clear that green box payments have no, or at most minimal, trade-distorting effects and that, under Article 21.1 of the AA, the *SCM Agreement* applies "subject to" the AA.[3]

8. This is correct. But this argument does not appear to be relevant in the context of this dispute. If the payments at issue meet all the criteria of Annex 2, they would be exempted from action under the *SCM Agreement* in accordance with Article 13 (a)(i) AA. If not, the United States could not invoke their conformity with Annex 2 and Article 21.1 in order to argue that they have no or minimal trade-distorting effects. Logically, the issue raised by the United States could arise only in the absence of the peace clause, or if the peace clause had expired at the initiation of this dispute.

**4. The meaning of "same market" in Article 6.3 (c)**

9. The United States contends that the term "same market" in Article 6.3 (c) cannot be interpreted to include the world market, because that would render redundant the word "same".[4] The EC disagrees. In accordance with its ordinary meaning, the term "market" may refer to any geographical market, including not only national or regional markets but also the world market, provided that there is such a world market for the product under consideration.

10. The US argument is based on the assumption that there will always be a world market for any given product. That assumption is incorrect. In order to characterise a certain geographical area, whether it is the territory of one or more Members or the entire world, as a "market" it must be shown that the conditions of competition prevailing within that geographical area are sufficiently homogenous. If there are significant trade barriers between Members, or between groups of Members, with the consequence that conditions of competition are significantly different within each Member or group of Members, it will not be possible to consider that there is a world market for the purposes of Article 6.3(c), but only national or regional markets.

[1] US further submission, para. 14.
[2] Ibid., para. 15.
[3] Ibid., para. 72.
[4] Ibid., paras. 90-92.

# ANNEX F-9

## ORAL STATEMENT OF INDIA

8 October 2003

1. We thank you for giving us the opportunity to present India's views in this third party session. India is the third largest producer of cotton in the world and has the highest area under cotton cultivation in the world. India has a substantial trade interest as well as systemic interest in this dispute. In the first part of this session on 24 July 2003, we had presented some views on the three US subsidy programmes that we consider as violative of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). Today we wish to present our views on the term 'serious prejudice' used in Article 6.3 of the Agreement.

2. The measures challenged by Brazil in its claims of *present* serious prejudice include the payment of subsidies through various programmes which include marketing loan payments, counter-cyclical payments, direct payments, production flexibility contract payments, market loss assistance payments, crop insurance subsidies, Step 2 payments, and GSM 102 export credit guarantees. The legal instruments providing these subsidies include the 1996 FAIR Act, the 2002 FSRI Act and the 2000 ARP Act as well as various appropriations bills for Marketing Years (MY) 1999-2002.

3. The subsidies given by US at issue are explicitly limited to certain enterprises or industries. None of the subsidies at issue are widely available throughout the US economy across industries. Eligibility for the domestic support and export subsidies at issue in this dispute is either "explicitly" limited to the subset of the US industry producing *agricultural crops*, to subgroups of industries producing *certain* agricultural crops, or to *only* upland cotton. None of the subsidies are available for any non-agricultural product. Thus the subsidies given by US to cotton are "specific" as understood under the SCM Agreement.

Mr. Chairman, Members of the Panel,

4. For establishing serious prejudice caused by the subsidies given by the US to cotton, Brazil has provided numerous facts that independently as well as collectively demonstrate the causal link between these subsidies and significant price suppression in upland cotton markets in MY 1999-2002.

5. It has been demonstrated, *inter-alia* through the analysis of Professor Daniel Sumner, details of which are available in Section 3.3.4.8.2 of Brazil's Further Submission to the Panel, that in terms of significant price suppression, removal of the subsidies given by the US would increase the A-index prices by an average of 12.6 per cetn or 6.5 cents per pound between MY 1999 and 2002. Brazil has demonstrated that the subsidies given by the US during MY 1999-2002 cause *present* significant price suppression within the meaning of Article 6.3(c) of the SCM Agreement in the Brazilian and world markets, including in markets where both Brazilian and United States producers export, and thus cause serious prejudice.

6. The average rate of subsidisation of cotton in the US during MY 1999-2002 as revealed in the Table at page 4 of Brazil's Further Submission was as high as 95 per cent. These subsidies, therefore, almost entirely constitute the farmers' incomes and have a major impact on farmers' production decisions. Producers of upland cotton in the United States are thereby largely insulated from the effects of the market. Thus, even when prices for upland cotton were falling, and the value of the United States dollar and costs of production were rising, production and exports of upland cotton by

the United States increased significantly. Similarly, the acreage under upland cotton in the US increased by 13.5 per cent between MY 1998 and MY 2001. Thus, in our view, Brazil has made a prima facie case of having suffered "serious prejudice" on account of the subsidies given by the US to cotton.

7. In its Further Submission, the United States has argued that after Brazil demonstrates that one or more of the effects of the subsidy mentioned in Article 6.3 is applicable, Brazil must then further demonstrate that the "prejudice" caused by the effects of the subsidy were "serious" enough to constitute "serious prejudice" within the meaning of the term in that Article. The argument of the United States appears to be based on the use of the words "may arise" in Article 6.3 as against the use of the words "shall be deemed to exist" in Article 6.1. The US seems to conclude that serious prejudice need not arise even if one or more of the effects of the subsidy listed in Article 6.3 is found. The United States goes on to infer from this difference in language that a complainant, in addition to demonstrating the existence of one of the listed effects, must also meet a separate "serious prejudice" standard – the content of which is undefined by the SCM Agreement.

8. In India's view nothing more than the demonstration that one of the effects enumerated in Article 6.3 exists is necessary to arrive at a finding of "serious prejudice". Subsidies listed under Article 6.1 are *deemed* to cause serious prejudice, hence such a presumption is rebuttable under Article 6.2 if the subsidy does not result in any of the effects enumerated in Article 6.3. No such rebuttal is envisaged under Article 6.3. There is, thus, no obligation under the SCM Agreement to demonstrate serious prejudice separately after establishing that one of the effects of a subsidy listed under Article 6.3 applies, as the effects listed in Article 6.3 themselves equate to serious prejudice. This interpretation is also confirmed by a reading of Article 6.2, which equates serious prejudice to effects listed under Article 6.3. India disagrees with the US interpretation of Article 6.3.

9. In conclusion, Mr. Chairman and Members of the Panel, India holds the view that the subsidies given by the US on upland cotton are specific, causal link exists between these subsidies and the significant price depression, and these subsidies given by the US have caused serious prejudice within the meaning of the term in Article 6.3 of the SCM Agreement.

# ANNEX F-10

## NEW ZEALAND'S ORAL STATEMENT

8 October 2003

1. Mr Chairman, Members of the Panel, New Zealand's Further Submission to the Panel of 3 October outlines New Zealand's support for the claims made by Brazil and its views on the issues raised in the Further Submission of the United States. The evidence brought by Brazil in support of its claims is overwhelming and conclusive.

2. New Zealand's submission, and our statement today, focuses in particular on Brazil's demonstration that the United States subsidies cause significant price suppression within the meaning of Article 6.3(c) of the *Agreement on Subsidies and Countervailing Measures* (or the *SCM Agreement*). Evidence brought by Brazil shows that the United States subsidies suppressed A-index prices by an average of 12.6 per cent over MY 1999-2002. That means a total amount of lost revenue for Brazilian producers of $478 million and suppressed revenue worldwide of $3.587 billion.

3. The United States has produced no evidence or argument to rebut this claim. Instead the United States points to a number of factors that it says caused prices for upland cotton to fall. However, those factors are entirely irrelevant to the issue of whether the United States subsidies cause significant price suppression. Nothing in the *SCM Agreement* requires a complainant to show that the subsidies at issue are the sole or major cause of prices falling in order to demonstrate serious prejudice.

4. In fact, the *SCM Agreement* does not even require prices to fall for there to be price suppression. As demonstrated by Brazil, price suppression can occur even when prices are rising. All a complainant is required to show to satisfy Article 6.3(c) is that significant price suppression is caused by the subsidies at issue. Brazil has done that, and the econometric models Brazil has used have not been challenged by the United States. Furthermore, those models isolate the effects of the subsidy from other factors, and thereby ensure that the effects of other factors affecting cotton prices are not attributed to cotton subsidies.

5. By contrast, the United States advocates an interpretation of Articles 5 and 6 that would completely undermine their objective, which is of course to allow WTO Members to act when adversely affected by other Members' use of subsidies.

6. In particular the United States draws the wrong conclusion from a comparison of Article 6.1 and Article 6.3, namely that it is not sufficient for a complainant to show that one of the effects set out in Article 6.3 exists for there to be serious prejudice. A closer look at the substance and nature of those provisions in the broader context of Articles 5 and 6 makes it clear that once a Member has demonstrated the existence of significant price suppression within the meaning of Article 6.3, there is serious prejudice. We note that the EC agrees with this interpretation in its Further Third Party Submission. New Zealand has described in detail in its Further Submission why the United States interpretation of Article 6 should be rejected.

7. The United States takes a similar approach to interpretation of the phrase "significant" in Article 6.3(c). The United States approach would require "significant price suppression" to be demonstrable solely by reference to some arbitrary level of numeric significance. Yet the United States does not suggest what level of significance would be appropriate in the present case, nor

does the United States go so far as to suggest that 12.6 per cent is not "significant". The United States offers no explanation at all of how "significance" is to be determined under its proposed approach. This is perhaps because such an approach is unworkable in practice.

8. Whether or not price suppression is significant within the meaning of Article 6.3(c) will depend on the circumstances of the case. And such a determination must be anchored in the overall context of consideration of the adverse effects of the subsidy if the *Agreement* is to operate as Members intended it to. Thus Brazil's approach of considering whether the level of price suppression is "meaningful" in its effect is entirely appropriate and workable, and offers the best means of ensuring that Article 6.3(c) is effectively and consistently applied.

9. These are but two examples of attempts by the United States to read into the *SCM Agreement* additional requirements that are simply not there and distort the requirements that are there. If accepted, such interpretations would make it virtually impossible for Members to show the existence of serious prejudice. Such an erosion of the rights negotiated by Members under the *SCM Agreement* cannot be permitted.

**Threat of Serious Prejudice**

10. New Zealand's Further Third Party Submission also outlines why the Panel should find that the United States subsidies create a threat of serious prejudice to the interests of Brazil in the future. The fact that Brazil's interests are already suffering serious prejudice as a result of the United States subsidies leads to a strong presumption that they will continue to do so. United States legislation requires the continued provision of the subsidies irrespective of whether or not they have adverse effects on other Members. The present case involves a level of subsidisation of, on average, 95 per cent, with a dollar value of US$12.9 billion, being provided by a country that currently has a 41.6 per cent share of the world market for upland cotton The threat of future serious prejudice is therefore a real one.

11. In addition to the points addressed in New Zealand's Further Submission, New Zealand takes this opportunity to record its views on two further issues raised by the United States.

**Crop Insurance**

12. The first is the United States argument that crop insurance payments fail to meet the requirement for specificity in Article 2 of the *SCM Agreement*. As demonstrated by Brazil, the crop insurance subsidies to upland cotton producers enhanced United States upland cotton production. The payments act as a direct production stimulant by keeping marginal upland cotton land in production. Professor Sumner's analysis concludes that in the period MY 1999-2002 United States crop insurance subsidies resulted in suppression of world prices by 1.2 per cent.

13. Brazil has demonstrated that the crop insurance programme is limited to certain enterprises and thus is not generally available but is effectively available only in respect of crops. The crop insurance programme is therefore specific within the meaning of Article 2 of the *SCM Agreement*.

**Step 2 domestic payments**

14. Second, New Zealand wishes to elaborate its view in support of Brazil's claim that the Step 2 domestic payments are prohibited subsidies under Article 3.1(b) of the *SCM Agreement* and GATT Article III.4. There is no basis upon which to claim that the *Agreement on Agriculture* gives Members a right to use whatever domestic support they wish with complete impunity from action under other WTO Agreements. The *Agreement on Agriculture* is silent on the issue of local content subsidies. Such silence cannot be taken as creating an "entitlement".

15. Nor does New Zealand accept that Members could have so encroached on the fundamental GATT principle of national treatment any way other than explicitly and expressly. The United States has been unable to demonstrate that Members intended, through the *Agreement on Agriculture*, to effectively waive their rights under GATT Article III in respect of agricultural products. Nor is there any evidence that Members traded those rights in return for reduction commitments on domestic support. Where there was a trade-off was between the application of Articles 5 and 6 of the *SCM Agreement* (for a limited period of time) and reduction commitments, as set out explicitly in the peace clause. There is no such trade-off in the peace clause for Article 3.1(b) of the *SCM Agreement*.

16. Paragraph 7 of Annex 3 of the *Agreement on Agriculture*, relied upon by the United States and EC as evidence that the *Agreement* authorises the use of local content subsidies, provides no basis for such a conclusion. All paragraph 7 does is recognise that it is possible for measures directed at agricultural processors to benefit the producers of basic agricultural products. For example, a government may pay a subsidy to a processor which it is required to pass on to the domestic producers. This can occur without affecting the competitive relationship between imports and domestic production. The measure would be consistent with Article 3.1(b) of the *SCM Agreement* and GATT Article III, and the support rightly counted against the Member's AMS. Nothing in paragraph 7 suggests that it should be interpreted as referring to domestic content subsidies, let alone that it authorises them in contravention of Article 3.1(b) of the *SCM Agreement* or GATT Article III.

**Conclusion**

17. In conclusion, New Zealand considers that Brazil has presented the factual evidence necessary to substantiate its claims under the *SCM Agreement*. Brazil has also demonstrated that the United States cannot avail itself of protection under the peace clause. The interpretation advanced by the United States of the provisions of the *SCM Agreement* would render actionable subsidies inactionable, thereby undermining the carefully negotiated balance of rights and obligations in the *SCM Agreement* and the *Agreement on Agriculture*. New Zealand therefore requests the Panel to make the findings and recommendations requested by Brazil.

# ANNEX G

## FURTHER REBUTTAL SUBMISSIONS OF PARTIES

# ANNEX G-1

## EXECUTIVE SUMMARY OF BRAZIL'S FURTHER REBUTTAL SUBMISSION

1. Brazil responds in its Further Rebuttal Submission to various arguments raised and evidence presented by the United States in earlier stages of this proceeding.

2. Brazil presents new evidence in rebuttal of US assertions that it has failed to demonstrate that contact payments were paid to current producers of upland cotton in MY 1999-2002. This evidence is in the form of USDA payment data obtained and analyzed by the Environmental Working Group (EWG) concerning, *inter alia*, upland cotton and other crop base contract payments between MY 2000-2002, as well as upland cotton marketing loan payments. The EWG database matches the upland cotton recipients and farms receiving each type of payment. It shows that the great majority of upland cotton producers grew upland cotton on upland cotton base acreage. It also shows that upland cotton producers received approximately three-quarters of all upland cotton contract payments between MY 2000-2002. Additional contract payments supporting upland cotton are found by attributing contract payments on non-cotton base acreage. While the EWG data underestimates the amount of contract payments in support of upland cotton, it nevertheless corroborates and supports Brazil's "14/16" methodology. Moreover, this data is also consistent with the large body of evidence demonstrating that upland cotton producers receive, rely on, and need upland cotton contract payments to make "ends meet."

3. Better evidence of the amount of contract payments in support of upland cotton would come from an examination of the amount of upland cotton currently planted on upland cotton (or other) contract acreage. This evidence is collected and exclusively in the control of the United States. Brazil rebuts the US assertions that it does not collect or maintain information permitting it to respond to the Panel's Question 67bis or to Brazil's repeated requests for information regarding the amount of contract payments received by current producers of upland cotton. In fact, the United States has access to all of the farm-specific and commodity specific commodity acreage and payment data from both current upland cotton producers as well as holders of crop base under contract payment programmes that would permit it to (1) provide a close approximation of the PFC and market loss assistance payments to current upland cotton producers in MY 1999-2001, and (2) provide the precise amount of direct and counter-cyclical payments to current upland cotton producers in MY 2002. Brazil requests the Panel to ask the United States, for the third time, to produce this information.

4. In the absence of information within the exclusive control of the United States, the information on marketing loan and contract payments in the EWG database, together with the considerable other evidence presented by Brazil, is the best information available to assist the Panel in making the determination concerning the amount of "support to upland cotton" for the purposes of the peace clause.

5. Regarding Brazil's price suppression and increase in world market share claims under Articles 6.3(c) and 6.3(d) of the SCM Agreement, Brazil first responds to US arguments that only variable costs are relevant to any cost of production analysis. This is the wrong legal as well as economic benchmark. Brazil notes the Appellate Body's decisions in the *Canada – Dairy (21.5)* disputes held that a cost of production analysis should focus on *total*, not *variable*, costs. That is, only an analysis of the total cost of production takes account of the economic resources the producer

invests in the product. The Appellate Body's jurisprudence on this issue reflects the economic reality that, over the long term, producers have to recover *all* their costs and make profits to stay in business. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source.

6. USDA cost data shows that US producers would have lost $871 per acre if they had grown upland cotton without subsidies between MY 1997-2002. With subsidies, these upland cotton producers made a per-acre "profit" of $120 over the six-year period. Further, most of the fixed costs of US producers must be covered over a long-term six-year period, or upland cotton producers would be forced to halt production. This evidence supports the close causal link between US subsidies and continued high levels of US upland cotton production and exports, as well as suppressed prices. These facts demonstrate the veracity of the National Cotton Council's Chairman's statement that US upland cotton producers "can't exist without subsidies".

7. The United States' argument that a cost of production analysis may be limited to variable costs defies all economic logic. This is particularly true in light of the items that the United States counts towards fixed costs, including hired labour, opportunity cost of unpaid labour, capital recovery of machinery and equipment, opportunity cost of land, taxes and insurance, and general farm overhead. These facts confirm the common sense notion that without the US subsidies, a significant portion of the US upland cotton production would not be economically viable and would not be produced.

8. Brazil rebuts US arguments that US subsidies had no price-suppressing effects by demonstrating the close relationship between increases or decreases in world cotton stocks and A-Index prices. USDA's own economists estimate that US subsidies increased US upland cotton world supply by 1.9 million bales in MY 2000 and 4.3 million bales in MY 2001. Because the United States has admitted that the injection of 11.6 million bales of Chinese government stocks into world supply between MY 1999-2001 depressed prices, it is not surprising that USDA economists, as well as Professor Sumner, found that the addition of similar quantities of US subsidy-generated upland cotton had similar price-suppressing effects. Moreover, if Chinese Government sales of stocks significantly depressed prices, as the US claims, then withdrawing a similar amount of US upland cotton during the same period certainly would significantly increase prices.

9. In addition, market experts predict that a 14 million bale US crop in MY 2004 (resulting from a potential crop failure) would have a significant impact in MY 2004 on increasing the New York futures price – and the world (and Brazilian) price of cotton. Brazil demonstrated the interconnected nature of world upland cotton market and the direct relationship between large US subsidies in sustaining US production and in lowering world and Brazilian prices.

10. Brazil rebuts US arguments that the appreciation of the US dollar does not demonstrate any causal link between US subsidies and increased US world market share and suppressed prices. Using data from Exhibit US-69, Brazil demonstrates that there has been a dramatic increase in the appreciation of the US dollar against a cotton-trade weighted basket of currencies of other world cotton producers by 154 per cent between the period 1996-2003. US exports – instead of falling as predicted by USDA economists – almost doubled.

11. The impact of the subsidies on international cotton trade is best assessed by analyzing the cotton trade-weighted exchange rate for cotton-exporting countries in general. This where the competition exists and where the impact of exchange rate movements on the competitiveness of countries should be found. With their currencies depreciating dramatically against the US dollar, US competitors should have been able to increase their market share and their exports compared to high-priced and high-cost US exports of the same commodity product. But since these competitors do not

have access to subsidies averaging 95 per cent of the value of their production, as a result, these competitors saw their exports and world market share reduced.

12. Brazil responds to US arguments that US producers are responsive to changes in futures prices at the time of planting. Brazil demonstrates that average January-March futures prices *declined* between MY 1998-2002, while US planted acreage *increased.* This is exactly opposite of what would be expected without the effect of US subsidies (that *increased* significantly during the same period). All of the analysis presented by Brazil is consistent with Congressional testimony by USDA's Chief Economist Keith Collins that there is little supply (i.e., planted acreage) response from US upland cotton farmers because of the subsidies they receive.

13. Further, the 72.4 cents target price support level available to US upland cotton producers in MY 2002 meant that US producers could not expect to receive higher revenue even if prices increased throughout MY 2002. In fact, US planted acreage declined in MY 2002 because some US upland cotton producers had suffered significant losses even with US subsidies, as they could not recover their cost of production.

14. Brazil responds to US legal arguments seeking to impose countervailing duty concepts in adverse effects claims by demonstrating that there is no textual basis in either Article 1 or Part III (adverse effects) of the SCM Agreement for the imposition of "pass-through," "value of subsidy**",** "subsidized product" or "tied-untied" methodologies. Unlike a countervailing duty investigation, it is the cumulative effects of the US subsidies that are the focus of price suppression and increase in world market share claims under Articles 6.3(c ) and (d) of the SCM Agreement. The current US position is directly contrary to its arguments in Indonesia – Automobiles, where the United States rejected Indonesian efforts to have the Panel examine each subsidy of the National Car Programme" individually.

15. The focus of Articles 5 and 6 of the SCM Agreement is on the effect of the subsidies in suppressing prices or increasing world market share. These cumulative effects of a variety of US subsidies caused price suppression and an increase in the US world market share between MY 1999-2002, and will continue to do so through the end of MY 2007.

16. Contrary to the US argument to sustain its serious prejudice claims, Brazil does not have to prove "that the 'prejudice' caused by the effects of the subsidies were 'serious'". Brazil's interpretation of the chapeau of Article 6.3 of the SCM Agreement does not read "may" to mean "shall". Rather, the term "may" refers to various situations in which the four enumerated types of serious prejudice exist but are not actionable.

17. Brazil highlights the collective effects of the US subsidies by noting that numerous econometric studies that Brazil has presented to the Panel, all conclude that US subsidies significantly increase US production and suppress US and world prices. Moreover, no study has ever found that the US subsidies to upland cotton would not have a significant production and export-enhancing as well as a price-suppressing effect.

18. Furthermore, Brazil rebuts US arguments that Professor Sumner's results, using the November 2002 FAPRI baseline misrepresent the real effects. Brazil demonstrates that using the most recent January 2003 FAPRI baseline, Professor Sumner's results also show significant production and export-enhancing and price-suppressing effects. Brazil further argues that a USDA study and an IMF study that the United States claims show that Professor Sumner's analysis was inflated are, in fact, consistent with Professor Sumner's findings.

19. Therefore, the US assertion that Professor Sumner's results are grossly overstated due to the use of a baseline projecting artificially low upland cotton prices is false. Whether the results of the modified or the original model and whether the November 2002 or the January 2003 baseline are used, continue to fully support that the US subsidies cause significant price suppression and an increase in the US world market share, as well as that those subsidies caused the United States to have more than an equitable share of world export trade.

20. Brazil further demonstrates the causal link between US subsidies and price suppression and increased exports by showing that the individual effects of the various US subsidies increase US production and exports, and result in suppressed prices. USDA and other economists are unanimous in finding that marketing loan payments to upland cotton created significant production- and export-enhancing and price-suppressing effects during the period of investigation. The effect of this subsidy alone caused serious prejudice to the interests of Brazil in MY 1999-2002.

21. Furthermore, USDA economists also found that crop insurance subsidies for upland cotton have far more production-enhancing effects than for other crops.

22. The National Cotton Council and cotton market experts have repeatedly emphasized the importance of the Step 2 subsidy in stimulating US production and exports. Brazil has provided compelling evidence that the Step 2 subsidies are trade- distorting and have caused increased US upland cotton exports and suppressed world prices.

23. Lastly, Brazil rebuts the United States so-called "literature review" for contract payment subsidies by pointing out that none of the studies addresses the specific situation of upland cotton during the period of investigation, none focuses on the impact of the restrictions on planting fruits and vegetables, none examine the impact of the updating of the base acreage and yield in 2002, and none focuses on the production effects caused when CCP payments are triggered by lower prices, or the production effects of more than $1 billion paid to producers of upland cotton in MY 2002. Finally, the studies do not explain the much higher per acre cotton payments than other base acres or the fact that US average upland cotton producers could not have covered their total costs without contract payments during MY 2000-2002.

24. Therefore, the evidence submitted to the Panel demonstrates that the decoupled payments have production-enhancing effects. While these effects are smaller than the effects of the marketing loan payments, they are an important part of the collective effects of the US subsidies in creating price suppression and increased and inequitable world market share.

25. Brazil demonstrates that crop insurance subsidies are specific within the meaning of Article 2 of the SCM Agreement. There are different crop insurance policies that are available for only limited products, as well as groups of policies available for certain crops. Therefore, the US crop insurance system is simply not the "one size fits all" programme as argued by the United States. Furthermore, Brazil rebuts US arguments concerning the specificity of crop insurance subsidies by showing that there are no crop insurance policies available for livestock, with the exception of four pilot programmes. Even these pilot programmes are very limited in terms of recipients, and have only a total budget of $20 million, a tiny fraction of the crop insurance subsidies paid for crops.

26. Additionally, the *US – Softwood Lumber CVD* panel report endorsed a finding by USDOC that subsidies paid to only a handful of industries in an economically diverse economy are "limited" (and therefore "specific") within the meaning of Article 2.1 of the SCM Agreement. The record continues to demonstrate that agricultural products representing approximately 50 per cent of the value of US agricultural commodities are not covered by crop insurance subsidies. This, together with the evidence submitted of specific policies and groups of coverage that are provided to only

selected crops such as upland cotton, highlight the fact that only certain enterprises receive the benefits of these subsidies.

27. Regarding Brazil's Article 6.3(d) claim, the United States is incorrect in claiming that Brazil's claims relate only to MY 2001. As discussed in Section 3.9, those claims also include claims for MY 2002, 2003 and the period from 2004-2007.

28. Furthermore, the United States argues that the term "world market share" in Article 6.3(d) of the SCM Agreement means "world consumption share". Contrary to the US arguments, the "world market share" does not refer to "all the markets in the entire 'world', including the market of the subsidizing Member. Brazil has demonstrated that the ordinary meaning of "world market share" refers to the share of a Member in the world export trade.

29. This interpretation is further supported by the context of Article 6.3(d), which includes the reference to the word "trade" in footnote 17. Additional context can also be found in the close similarity between the concepts used in Article 6.3(d) and Article XVI:3, second sentence (both involve primary products, increase in exports, representative periods, effects of any subsidy). Given the similarities between these provisions, the use of the terms "world market share" and "share of world export trade" does not state that both provisions deal with separate situations, as the United States argues. Instead, both terms refer to a share of export transactions in the world market. Therefore, the phrase "world market share" means the world market share of exports, not consumption.

30. In sum, Brazil has demonstrated that the US subsidies caused serious prejudice and threat thereof to the interests of Brazil, because for each marketing year between 2001-2003 the US world market share in upland cotton increased over its previous three-year average. These increases followed a consistent trend, within the meaning of Article 6.3(d) of the SCM Agreement.

31. Brazil rebuts US arguments that GATT Article XVI:3 only applies to export subsidies and, thus, has been superseded by Article 3.1(a) of the SCM Agreement. GATT Article XVI:3 is an actionable subsidy provision that applies to all subsidies having the effect of increasing exports. The phrase "which operates to increase the export" is quite different from the phrase "subsidy on the export". Furthermore, the phrase "operates to increase the export" does not contain any export contingency requirement. Therefore, read in the context of the SCM Agreement and GATT 1994, Article XVI:3, second sentence refers to export-related subsidies, which is a far broader notion than subsidies that are "contingent upon export performance".

32. In sum, GATT Article XVI:3 is not superseded by the export subsidy provisions of the Agreement of Agriculture and the SCM Agreement. Instead, it provides obligations concerning any form of subsidy, independent of the obligations set forth in Article 3 of the SCM Agreement.

33. Brazil also conclusively demonstrates that US upland cotton subsidies violate GATT Article XVI:3 by causing the United States to have a more than equitable share of world export trade in upland cotton.

34. With respect to Brazil's threat serious prejudice claims, Brazil argues that the appropriate standard for serious prejudice claims is not the "imminent threat" standard argued by the United States, but rather whether the unlimited and mandatory US subsidies create a structural and permanent source of uncertainty in suppressing prices, increasing world market share, and securing an inequitable share of world trade.

35. Brazil has demonstrated that it is appropriate for the Panel to rely on the standard proposed by the GATT *EC-Sugar Exports* panels to determine whether the mandatory and unlimited US subsidies on upland cotton create a permanent source of uncertainty in the world upland cotton market. The facts of this dispute meet that standard. The United States has admitted that the US subsidies are both mandatory and unlimited. Given the large US world market share and share of total world production, the US subsidies will have the effect of locking in large amounts of US production, of creating an ongoing significant threat of suppressed prices, and of securing an increasing and inequitable US world market share throughout MY 2003-2007.

36. The "imminent threat" standard is not found in the text of Part III of the SCM Agreement, and is only applicable to investigations by investigating authorities in countervailing duty, anti-dumping, or safeguard contexts. It is inconsistent with the remedies provided for in Article 7.8 of the SCM Agreement, which are imposed well after the period of investigation examined by a Panel.

37. Therefore, the collective effects of the mandated and unlimited US subsidies in MY 2003-2007 threaten to maintain a large US upland cotton production, to increase and maintain US exports, and to significantly suppress world upland cotton prices during MY 2003-2007, in violation of Articles 5(c), 6.3(c), and (d), and GATT Articles XVI:1 and 3.

38. In sum, the mandatory and unlimited US upland cotton subsidies cause threat of serious prejudice to the interests of Brazil. They constitute a structural and permanent source of uncertainty in the world upland cotton market, in which the United States enjoys a dominant position. This conclusion is further supported by the trade-distorting nature of the US subsidies, their effects in causing present serious prejudice in MY 1999-2002.

39. Finally, with respect to export credit guarantees, Brazil offers the Panel a recounting of its evidence and argument in support of its claims against the CCC export credit guarantee programmes, along with footnote citations to all of the places in its various submissions in which it makes those arguments and offers that evidence. Brazil also responds to particular points raised by the United States that Brazil has not yet addressed. The GSM 102, GSM 103 and SCGP export credit guarantee programmes constitute export subsidies that circumvent, or threaten to circumvent, the US export subsidy reduction commitment, within the meaning of Articles 10.1 and 8 of the Agreement on Agriculture. They also constitute prohibited export subsidies within the meaning of Articles 3.1(a) and 3.2 of the SCM Agreement and item (j) of the Illustrative List of Export Subsidies.

# ANNEX G-2

## EXECUTIVE SUMMARY OF THE UNITED STATES FURTHER REBUTTAL SUBMISSION

### 1. Brazil has failed to establish all of the elements necessary to establish its subsidies claims

1. For the Panel to make the findings Brazil requests, Brazil must adduce evidence and arguments sufficient for the Panel to identify the product(s) that a particular subsidy benefits. This requirement of identification can come up in a variety of ways, but the two most frequently encountered questions are: Which product(s) benefits from the subsidy? and Should the benefits of a subsidy be allocated to future production and sales of the product in question, or should such benefits be "expensed" – that is, allocated only to current production and sales during the time period in which the subsidy is received? Brazil has not provided a basis for a clear and unambiguous explanation on its conclusions for each of these points in order for the Panel to fulfil
its obligations under Article 12.7 of the DSU.

2. With respect to the first question – which product(s) benefits from the subsidy? – Annex IV to the Subsidies Agreement provides guidance. Annex IV provides guidelines for calculating total *ad valorem* subsidization for purposes of the now-expired Article 6.1(a). A subsidy not "tied to the production or sale of" cotton ("a given product") cannot be regarded as subsidizing merely "that product"; rather, the subsidy benefits all of the "recipient firm's sales". In the Negotiating Group on Rules, Brazil has proposed that Members adopt a "guideline" on calculating the amount of the subsidy precisely along these lines.

3. Implicit in both paragraphs 2 and 3 of Annex IV is the principle that a subsidy provides a benefit with respect to products that the recipient produces. A corollary of this principle is that a subsidy does not provide a benefit with respect to products that the recipient does *not* produce. Thus, a subsidy provided to a recipient who does not produce upland cotton cannot be said to provide a benefit to upland cotton. Such a subsidy cannot be regarded as having one of the effects described in Article 6.3 insofar as upland cotton is concerned.

4. The foregoing analysis suggests that, for each challenged subsidy, Brazil must identify (as would the Panel in its report) the product that benefits. In the case of product-specific support – that is, a payment that is linked to production of a specific product – such as the marketing loan payments and Step 2 payments, the issue is not difficult. In the case of a payment in which the subsidy is not "tied to the production or sale of a given product", the product subsidized by that payment is all the products produced by the recipient. To determine the portion of a payment not tied to the production or sale of a given product that benefits upland cotton, the value of the payment must be allocated over the "total value of the recipient firm' s sales".

5. With respect to the second question – how should subsidies be allocated over time? – Annex IV also provides guidance. Paragraph 7 provides that: "Subsidies granted prior to the date of entry into force of the WTO Agreement, *the benefits of which are allocated to future production*, shall be included in the overall rate of subsidization" (emphasis added). A corollary of this principle – that the benefits of certain subsidies should be allocated to future production – is that if subsidy benefits are *not* allocated to future production, they must be expensed – that is, allocated to production in the time period during which the subsidy is received. Thus, in the context of this dispute, a subsidy the benefits of which are expensed to production/sales in 2001 cannot be said to be causing serious prejudice in 2002 because the subsidy has ceased to exist. The "benefit" – one of the constituent

elements of a "subsidy" under Article 1 – was used up in 2001. Once the benefit was exhausted, the subsidy ceased to exist.

6. The Subsidies Agreement does not expressly identify those subsidies "the benefits of which are allocated to future production". However, guidance is available on this question, and it suggests that subsidies that are "non-recurring" should be allocated over time, while subsidies that are "recurring" should be expensed to the year of receipt.[1] For example, the Informal Group of Experts recommended to the Subsidies Committee that, as a general proposition, recurring subsidies be expensed and non-recurring subsidies be allocated. The Group also specifically recommended that price support payments generally be expensed. In making these recommendations, the Group follows the logic noted above: where there are *not* reasons to allocate subsidy benefits to future production, the subsidy must be expensed, and once the benefit was exhausted in the time period during which the subsidy is received, the subsidy ceased to exist. The analysis presented above and the conclusions and recommendations of the Group are not controversial. The domestic countervailing duty regulations of various Members, including those of Brazil and the European Communities, reflect this very approach.

7. Thus, it is appropriate for the Panel to expense the value of these payments – that is, allocate them to production in the time period during which the subsidy is received. No payment at issue is made for the acquisition of fixed assets. Rather, the challenged payments are recurring. Brazil's own arguments endorse the notion of expensing these payments. That is, for purposes of its Peace Clause arguments, *Brazil expenses these payments* by allocating the total value of each of these payments to the marketing year for which the payment is received. For purposes of Brazil's actionable subsidies claims, *Brazil adopts the identical approach and expenses these payments to the marketing year for which the payment is received*. Thus, despite Brazil's silence on the issue of expensing recurring subsidies, its actions and arguments reveal that it accepts and applies the concept to the challenged US subsidies.

8. The United States has explained, and Brazil tacitly accepts, that the payments challenged in this dispute are recurring subsidies that 0are expensed – that is, allocated to production in the time period during which the subsidy is received. It follows that a recurring subsidy provided in marketing years 1999, 2000, or 2001, respectively, cannot be said to be causing serious prejudice in marketing year 2002. Because the payments in each of those prior years was allocated to production in those years, no "benefit" exists after each of those years – a benefit could only exist in a subsequent year if the payment had been allocated to future production and not expensed.

9. Because the recurring subsidies provided in each of marketing years 1999, 2000, and 2001 ceased to exist when the benefit was used up for production in those years, the effect of those subsidies cannot be the subject of subsidies claims in marketing year 2002. Under Article 5(c) and 6.3, Brazil must demonstrate what "the effect of the subsidy *is*". Similarly, under GATT 1994 Article XVI:3, Brazil must demonstrate that the United States grants or maintains export subsidies "which operate[] to increase the export of any primary product," resulting in a more than equitable

[1] First, Article 2.2.1.1 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* ("Anti-Dumping Agreement"), which deals with the calculation of cost of production, singles out "*non-recurring* items of cost which benefit *future and/or current* production" (emphasis added). Second, the Appellate Body has acknowledged that non-recurring subsidies may be allocated over time. In *US - Lead Bar II*, the Appellate Body found that it was permissible for an investigating authority in a countervailing duty proceeding to rely on a rebuttable presumption "that a 'benefit' continues to flow from an untied, *non-recurring* 'financial contribution'" (emphasis added). Third, the *Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures*, G/SCM/W/415/Rev.2 (15 May 1998), recommends that certain subsidies be expensed to the year of receipt and that the benefits from other subsidies be allocated over time.

share of world export trade. Subsidies that were expensed and benefited historical production in marketing years 1999, 2000, and 2001cannot also benefit current production. Thus, these past payments would not form part of Brazil's subsidies claims nor the Panel's analysis. Serious prejudice has to be based on findings for the 2002 marketing year.

## 2. Brazil's legal interpretive errors also demonstrate that it has failed to make a *prima facie case on its subsidies claims*

10. As complainant Brazil must identify properly the measures within the Panel's terms of reference – that is, "subsidies provided to US producers, users and/or exporters of upland cotton" in respect of upland cotton, the subsidized product. The challenged measures are subsidies, or payments, and in order to assess their effect, one needs to know, *inter alia*, how large the subsidy is. Brazil has not properly identified the size of each challenged subsidy.[2]

11. **Brazil Misinterprets Article 6.3(c) on Price Suppression or Depression**. Brazil has not alleged any facts to establish that US and Brazilian cotton are found "in the same market" pursuant to Article 6.3(c) – that is, in each of the markets identified by Brazil (at various times, the United States, Brazil, Argentina, Bolivia, India, Indonesia, Italy, Paraguay, Philippines, and Portugal). Brazil has not identified the extent of subsidization of the US cotton in each market (the subsidized volume) – that is, which exports benefit from which challenged subsidy. Brazil has also not shown a price-suppressing effect by those US imports in each market. Brazil simply asserts that prices in those markets are correlated to the NY futures and A-index prices. This allegation of a generalized price effect cannot satisfy Brazil's burden of showing a price effect by the subsidized product of a like product of another Member "in the same market".

12. Brazilian price quotes in fact consistently undercut US price quotes for delivery CIF Northern Europe. It is also the case that in most of the markets identified by Brazil (Argentina, Bolivia, India, Indonesia, Italy, Paraguay, Philippines, and Portugal), Brazilian prices have been consistently lower than US prices. Thus, rather than US upland cotton suppressing Brazilian prices, the data suggests that it is Brazilian cotton that is undercutting US prices.

13. Article 6.3(c) does *not* establish that serious prejudice may arise if the effect of the subsidy is *any* price suppression or depression. Indeed, were the term "significant" omitted from Article 6.3(c), it would be the case that any production subsidy that was granted on a per-unit basis could be deemed to result in serious prejudice: any increase in production resulting from the subsidy would theoretically lead to some price effect. The use of the term "significant" prevents such theoretical or minor effects from rising to the level of serious prejudice.

14. Because "significant" modifies "price suppression" or "depression", it is the level of price suppression or depression itself that must be significant. One way of examining whether any alleged price suppression is significant would be to examine that degree or level in light of the price of the product itself. Another analytical tool that suggests itself is to look at the nature of the product's price. Strong or frequent fluctuations in price would themselves tend to cut against a finding that any alleged suppression or depression is "significant", especially if the variability frequently brings the

[2] For example, Brazil includes payments made to recipients that do not produce upland cotton and fails to allocate non-product-specific payments across the total value of the recipient firm's sales. Brazil has not reduced the value of decoupled income support payments to account for the capture by landowners of those payments made to farms on which cotton cropland is rented (65 per cent of total cotton cropland). Further, Brazil has Brazil has not identified the value of the cotton export credit guarantees under the GSM-102 programme, conceding that it "is not in a position to quantify the benefit to the recipients that has arisen from the application of the GSM 102 export credit guarantee programme to exports of US upland cotton between MY 1999-2002".

price of the product to a level at which the alleged suppression or depression (judged in light of that price) would not be significant. The United States notes that the price of upland cotton is highly variable, with frequent swings of substantial degree. Thus, this evidence relating to the price variability of upland cotton must be taken into account in any analysis of whether alleged price suppression or depression is "significant".

15. **Brazil Misinterprets Article 6.3(d) on an Increase in World Market Share**. Brazil misinterprets the phrase "world market share" in Article 6.3(d) as the share of world export trade. The plain meaning of the phrase "world market share" is not limited to export trade in products but includes all worldwide consumption – that is, the aggregate of all markets that make up the world. The United States is a "market" for upland cotton and part of the "world"; therefore, its domestic consumption forms part of the "world market" for upland cotton.

16. Context supports this reading of "world market share". For example, Article 6.3(a) identifies the "market of the subsidizing Member" as a relevant market from which a complaining Member's exports can be displaced or impeded. Logically, then, the market of the subsidizing Member should also be relevant for determining the "world market share". Various provisions also provide context for *not* reading "world market share" as relating to "world export trade".[3] Given repeated examples of the use of the terms "trade," "world trade," and "world export trade" in the covered agreements, the choice of the phrase "world market share" must be given meaning in accordance with the plain meaning of those terms.

17. The challenged US payments were only introduced in marketing year 2002; therefore, there can be no "trend" in US world market share with respect to those payments. Nonetheless, were the Panel to examine US world market share using data under the 1996 Act (consumption data, not the export data presented by Brazil), the criteria of Article 6.3(d) are not met.[4]

18. **Brazil Has Not Demonstrated a Clear and Imminent Likelihood of Future Serious Prejudice**. Although Brazil has presented evidence after the date of panel establishment (indeed, after conclusion of its three-year period of investigation), it advises the Panel to consider more probative, for purposes of explaining price developments in marketing year 2003, the conditions *in marketing year 1999* than the actual price developments *in marketing year 2003*. Brazil's approach carries with it a high potential for erroneous findings by the Panel. Given current high market prices and the expectations embodied in futures prices that such high prices will remain through the course of the 2003 marketing year, it would appear that US price-related payments (marketing loan payments and counter-cyclical payments) will decline dramatically, contrary to Brazil's assertions. In such a circumstance, it is difficult to see how challenged US payments would pose a clearly foreseen and imminent likelihood of future serious prejudice.

[3] First, footnote 17 to Article 6.3(d) provides an exception to the provision where "[o]ther multilaterally agreed specific rules apply to the trade in the product or commodity in question". This exception applies only to "trade" because "multilaterally agreed specific rules" would be unlikely to apply exclusively to domestic consumption; however, the use of the world "trade" in the *footnote* to Article 6.3(d) but *not* in the text of the Article itself suggests that "world market share" does not merely encompass shares in world "trade". Second, Article 27.6 speaks of a developing country Member reaching export competitiveness when its "share . . . in world trade of that product" reaches a certain level. This use of "world trade" stands in contrast to the phrase "world market share" in Article 6.3(d). Third, GATT 1994 Article XVI:3 uses the phrase "world export trade", which also stands in contrast to the phrase "world market share".

[4] While US share of world consumption in MY2002 was projected to be higher than the preceding three-year average, that increase has not followed "a consistent trend over a period when subsidies have been granted" – in this case, for purposes of argument, since the 1996 Act came into effect. Reversing direction every year since marketing year 1996 cannot constitute "a consistent trend".

19. **Brazil Has Misinterpreted GATT 1994 Article XVI:3**. Contrary to Brazil's arguments in this dispute, Brazil has previously agreed in a GATT plurilateral setting that GATT 1994 Article XVI:3 is limited in scope to export subsidies. Both the United States and Brazil were signatories to the Tokyo Round *Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade*, commonly known as the Subsidies Code. Article 10 of the Subsidies Code is entitled "Export subsidies on certain primary products" and states (in paragraph 1): "*In accordance with the provisions of Article XVI:3* of the General Agreement, signatories agree not to grant directly or indirectly *any export subsidy on certain primary products* in a manner which results in the signatory granting such subsidy having more than an equitable share of world export trade in such product . . . ." Thus, Article 10.1 of the Subsidies Code makes clear the understanding of both the United States and Brazil that GATT 1994 Article XVI:3 applies only to "export subsid[ies] on certain primary products". Therefore, Brazil has not made a *prima facie* case under Article XVI:3 on the basis of its arguments relating to *all* challenged US payments.

20. **Brazil Errs in Asserting that Threat of Serious Prejudice Includes "More than an Equitable Share" under GATT 1994 Article XVI:3**. There is no textual basis to assert that a claim of "threat of serious prejudice" under GATT 1994 Article XVI:1 may be founded on the "more than equitable share" language of GATT 1994 Article XVI:3. Neither Brazil nor the *EC – Sugar Exports* GATT panel report on which it relies cites any and that panel report does not appear to explain the basis for its decision to read the standard of Article XVI:3 into Article XVI:1. By way of contrast, footnote 13 to Article 5(c) of the Subsidies Agreement states that "[t]he term serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI:1 of GATT 1994, and includes threat of serious prejudice". This footnote does not reference Article XVI:3, and as there is no "more than equitable share" prong to Article 6.3, there would not appear to be any basis to advance a threat of serious prejudice claim using that standard under Article 5(c) of the Subsidies Agreement. Footnote 13 states that "serious prejudice" in the Subsidies Agreement and GATT 1994 Article XVI:1 should be read "in the same sense". Therefore, footnote 13 provides a further textual basis for finding that a threat of serious prejudice claim under GATT 1994 Article XVI:1 may not be based on the "more than equitable share" language of Article XVI:3.

### 3. Brazil has failed to demonstrate the challenged US subsidies caused the effects complained of

21. **The "Temporal Proximity" of US Payments and Low Cotton Prices Fails to Demonstrate that US Subsidies Caused Low Prices**. Brazil has failed to make a *prima facie* case based on the assertion that large US outlays during marketing years with low prevailing upland cotton prices necessarily establishes causation. Brazil makes selective use of data to present a number of erroneous claims about US production or exports during a period of low and declining cotton prices. Brazil repeatedly begins the period of comparison with marketing year 1998 or ends it with marketing year 2001. Such comparisons are inappropriate for several reasons and can produce misleading results.[5] The fact that high US payments were made when cotton prices were low does not establish causation.

[5] First, to use either marketing years 1998 or 2001 as one end of a period for comparison contradicts Brazil's own argument that the "period of investigation" should be marketing years 1999-2002. Second, marketing year 1998 was a year in which US harvested acreage and production were severely impacted by weather conditions, in particular, drought. The record shows record abandonment during that year (that is, the difference between planted acres and harvested acres). Thus, to begin a comparison of harvested acreage or production with marketing year 1998 will overstate any resulting increase. Third, marketing year 2001 was a year in which US production increased, primarily because of record yields (as Brazil has acknowledged). That is, while planted acreage increased over marketing year 2000 in large part due to the decline in expected returns from competing crops, production increased by a much greater percentage because of uncommonly favourable

22. **Brazil Erroneously Alleges Production Effects from Decoupled Payments, Contrary to the Economic Literature**. A fundamental error made by Brazil throughout its submissions and statements is to assert that decoupled payments are production-distorting. Brazil's conclusion that decoupled payments have had a large effect on cotton prices appears to be a direct consequence of Dr. Sumner's faulty analysis – one that is inconsistent with the empirical and theoretical literature on such payments. Economic theory suggests that, if producers are seeking to maximize profits, the decision of which crop to plant is based on expected returns offered by the market or government payments above operating (variable) costs. Decoupled income support payments do not figure in this decision because such payments will be paid to the producer regardless of the programme crop that is planted or whether any crop is planted at all.[6]

23. The main impact of decoupled payments is likely on land values. In well-functioning markets, asset prices reflect expectations about the future returns from their ownership. The direct link between base acres for decoupled payments and the known programme benefits allowed the future stream of payments to be efficiently capitalized into land values. Thus, much of the increase in wealth from farm payments accrues to non-operator landlords (Burfisher and Hopkins, 2003). Thus, the effects of increased wealth largely accrue to non-operators, and any theoretical production effects are further minimized. In fact, land values set by sales and rental markets have diverged from commodity prices, suggesting that land markets have additionally capitalized the present and expected future value of government payments.

24. Data also indicate that decoupled payments, by increasing income and wealth, have allowed households to increase their leisure and reduce their work hours. If the downturn in labour comes from agricultural activities, the effect of such payments could be to *decrease* the household's agricultural production, which would support world commodity prices. Data indicate that farm households that received decoupled payments in 2001 consumed more than farm households with similar incomes not participating in the programme. Thus, these data suggest that decoupled payments allow recipients to consume more out of income and may allow them to draw down savings that they typically carry as a precaution against income shortfalls.

25. Empirical studies have generally concluded that the effects of decoupled payments are minimal. For example, using an intertemporal Computable General Equilibrium model, Burfisher et al. (2003) estimate that production flexibility contract payments had "no effects on agricultural production in either the short run or the long run". These and other results are fully consistent with the fundamental requirement of Annex 2 of the Agreement on Agriculture that green box decoupled income support have no or at most minimal trade or production effects.

26. The available data also show large shifts in cotton acreage. Based on a preliminary review of a sampling of marketing year 2002 acreage reports, the United States estimates that nearly half (47 per cent) of farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage in fact planted no cotton at all. Preliminary estimates from the Farm Services Agency indicates that cotton producers enrolled upwards of 2 million acres for the 2002 Direct and Counter-Cyclical Programme that had not been enrolled under the 2002 Production Flexibility Contract programme. Marketing year 1999 planted acreage deviated substantially from base acreage, both by region and by

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weather conditions. Thus, to end any comparison of production with marketing year 2001 will overstate any resulting increase.

[6] Brazil has alleged that increased income can induce producers to take riskier choices, thus potentially increasing production and distorting markets. The economic literature suggests any such effects are empirically trivial. Recipients of decoupled payments use many market mechanisms to reduce their risk exposure in their farm operation. These strategies to manage risk reduce the extent to which changes in risk attitude due to decoupled payments, if any, will be evidenced in their production levels or demand for inputs.

State.[7] Thus, the data indicate that recipients of "upland cotton base acreage" decoupled payments plant alternative crops or no crops at all, and other farmers who do not hold upland cotton base acres choose to produce upland cotton.

27. **Third-Party Economic Studies Have Not Properly Modeled Cotton Production Decisions and Therefore Cannot Assist in Determining the Effect of US Subsidies on Cotton Production**. Brazil has pointed to various third-party economic studies which find price effects from US payments. Upon review, the United States concludes that they do not present relevant results because they generally suffer from two conceptual flaws. These fundamental flaws establish that these papers do not provide a basis to find a causal link between US payments and the effects of which Brazil complains.

28. First, several of these studies do not model the marketing loan programme appropriately.[8] Simply put, if Dr. Sumner and FAPRI's understanding of producer decisions is correct, then Brazil would have to agree that these papers do not properly model farmers' production decisions and any potential impact of marketing loans on those decisions. As a result, these models do not provide insight into the question this Panel has been asked to examine.

29. Second, most of these studies do not distinguish between payments linked to production and payments decoupled from any requirement to produce, instead treating them as having equal impacts on production. Again, Brazil's own expert recognizes that decoupled payments do *not* have the same impact as, for example, product-specific marketing loan payments. Thus, Dr. Sumner's own modelling of the impact of decoupled payments (with which the United States disagrees as contrary to the economic literature in ascribing *any* impact on production to these payments) indicates that these papers treat decoupled payments inappropriately.

30. **Brazil's "Total Costs of Production / Revenue Gap" is Meaningless and Cannot Establish Causation**. Brazil's so-called "gap" between the average total cost of production per pound of cotton for US cotton producers and the revenue such producers received from the market is an economically meaningless measure and is based on a simplistic calculation that misstates both the revenue and cost sides of the calculation. Brazil's revenue calculation is based on an erroneous representation of government support, especially crop insurance, decoupled payments, and Step 2 payments, and of market revenue.[9] More fundamentally, the existence of a "gap" does not establish

[7] Comparing marketing year 1999 planted acreage to base acreage, the ratio of planted to enrolled acreage, by region, in 1999 ranged from only 51% in the West to 141.25% in the Southeast. In the Southeastern United States (Alabama, Florida, Georgia, North Carolina, South Carolina and Virginia), for example, upland cotton planted acreage *exceeded* base acreage *by over 1 million acres*. In each of the other three regions, planted acreage was between 879,000 and 1 million acres *less than* base acreage. The variations by State are even more extreme.

[8] (a) Specifically, several of these papers simply remove the full outlay of the marketing loan program. This implies that farmers at the time of planting knew what actual prices would be at harvest time. Brazil's own expert recognizes that it is producers' expectations of harvest season prices that drive planting decisions. Thus, using the full outlays will overstate the influence of the marketing loan programme on the planting/production decision when actual prices turn out to be below the expected prices at the time of the planting/production decision.

[9] In three different submissions, Brazil presents three different per pound revenue figures derived from market revenue and US support programmes, and purports to represent this figure as average revenue received by upland cotton farmers in that year for every pound of cotton produced. This combined per pound figure in no way represents what a cotton farmer would have received – or even could have expected to receive – in the specific year in the way of government support. In addition, Brazil's measure of revenue for upland cotton producers – revenue from sales of cotton lint and cottonseed – is incomplete. Revenue from all sources – commodity sales, contracts in futures markets, off-farm employment, investment income – are needed to put the costs into perspective.

that US production would necessarily decline without the US payments Brazil has decided to challenge. For example, Brazil concedes that a substantial amount of US upland cotton in recent years was grown on non-upland cotton base acreage, at the same time that government payments were allegedly "necessary" for US producers to remain in business. Brazil fails to explain how it accounts for these inconvenient facts that do not support its cost-revenue gap theory.

31. On the cost side, Brazil's use of average total cost of production for US cotton to make its revenue gap argument is the wrong figure to measure costs – it is operating costs, not total costs, that figure in production decisions. Brazil also has made no effort to update cost data that is based on a 1997 survey and so does not take into account any technological or structural changes that have occurred in the interim. Since 1997, significant technological changes have occurred in US cotton production, changes which are not reflected in the estimated costs of production, such as increased production in low-cost regions and the introduction and adoption of genetically modified varieties of cotton with significantly increased yields while reducing pest control costs.

32. Finally, Brazil has used data from the International Cotton Advisory Committee (ICAC) to compare costs of production across countries arguing that the United States is a higher-cost producer than many other countries. Even when good survey data are available for one country, using cost of production data to draw valid economic conclusions is fraught with difficulties. The comparison of costs across countries poses greater difficulties, rendering such comparisons invalid. The ICAC itself notes that the cost data it presents is not appropriate for making these kinds of cross-country comparisons.

33. **Brazil Has Failed to Make A Proper Analysis of Conditions Actually Faced by Producers in Making Production Decisions Using Futures Prices, Which Reveals No Expected Impact from Marketing Loans Except for MY2002**. An analysis of the effect of marketing loan payments must begin with an understanding of farmers' planting decisions. The United States agrees with Mr. MacDonald, Brazil's expert on cotton markets, that the New York futures price provides the principal indicator of how market participants expect cotton prices to develop in the future. Unfortunately, Brazil's other expert, Dr. Sumner, has ignored Mr. MacDonald's testimony in modelling producers' expectations of harvest season market prices by using "lagged prices" instead of futures prices. Had Dr. Sumner conferred with Mr. MacDonald, Dr. Sumner would have learned that "[t]he ' New York futures price' is a key mechanism *used by cotton growers . . . in determining the current market values as well as the contract prices for forward deliveries*."

34. Comparing the planting-time (February) New York futures price for the following harvest season (December delivery) to the marketing loan rate for upland cotton for each marketing year reveals that in every year but marketing year 2002, *the planting time futures price was above the marketing loan rate*. That is, New York futures prices indicated to producers that in every year but marketing year 2002 the return from the market would *exceed* the marketing loan rate. Thus, the marketing loan programme in marketing years 1999-2001 would not be expected to have had an effect on the decision to plant.

35. Only in marketing year 1999 does Dr. Sumner's "lagged price" approach result in a value for producers' expectations that equals or exceeds the futures price. In every other marketing year, *the "lagged price" method significantly understates the harvest season price expected by producers* and thus would distort an analysis of the effect of US subsidies. In fact, the use of "lagged prices" would lead to the erroneous conclusion that expected prices in every year but marketing year 1999 were *below* the applicable marketing loan rate. However, market price expectations actually were *above* the loan rate in every year but marketing year 2002. Thus, the use of "lagged prices" instead of futures prices to gauge producers' price expectations at the time of planting in the specific years in which Brazil has alleged effects from US subsidies would seriously overstate the expected impact of

US marketing loans. To the extent Brazil relies on Dr. Sumner's analysis, which uses lagged prices rather than futures prices, Brazil's analysis is fundamentally flawed.

36. The futures price data and "lagged price" data above also reveal that, despite declining market prices over the course of marketing years 1999-2002, *market participants persisted in expecting prices to recover.*[10] Thus, Brazil's reliance on actual market year prices to claim that US cotton plantings should have been declining ignores the fact that harvest season cotton futures prices at the time of planting were fairly stable from marketing year 1999 through marketing year 2001, even as futures for other competing crops fell in value.

37. In marketing year 2002, harvest season futures prices at the time of planting had fallen below the loan rate. In this marketing year, there is a least the possibility that producers were planting for the loan rate and not for the harvest season expected price. However, the decline in US planted cotton acreage was within the range of expected values given the decline in the harvest season futures price from the previous year. Had US producers been planting for the 52 cents per pound marketing loan rate, one would have expected to see only one-tenth of the decline in planted acreage that actually occurred from marketing year 2001 to 2002.

38. Moreover, the per cent decline from marketing year 2001 to 2002 in US harvested acreage was very similar to (but larger than) the change in harvested acreage in the rest of the world. Despite the *theoretical* possibility that the marketing loan rate could have had some impact on planting decisions in marketing year 2002, the *actual* decline in US planted and harvested acreage suggests that US acreage levels were entirely consistent with price expectations and world market conditions. Thus, even in marketing year 2002, there is no evidence on this record that the marketing loan rate serves to insulate US producers' planting decisions from market price movements. To the contrary, the evidence suggests that US producers do respond to changes in expected prices (for cotton and for other competing crops) and are as responsive if not more so than producers in other countries.

[10] The marketing year 2000 harvest season futures price at planting time was 61.31 cents per pound, suggesting that the market expected prices in marketing year 2000 to recover from the previous year's levels. For marketing year 2001, the harvest season futures price at planting time was 58.63 cents per pound (nearly the same as futures in marketing years 1999 and 2000), once again indicting that market participants expected prices in marketing year 2001 to recover from their marketing year 2000 levels. It is only in marketing year 2002 that persistent lower-than-expected farm prices translated into a lower harvest season futures price at planting. For marketing year 2002, the February average futures price for December delivery fell to 42.18 cents per pound. However, even in marketing year 2002, market participants expected prices to recover and run higher than the "lagged price" of 29.80 cents per pound suggested.

# ANNEX H

## ORAL STATEMENTS OF PARTIES AT THE SECOND SUBSTANTIVE MEETING

# ANNEX H-1

## EXECUTIVE SUMMARY
## STATEMENT OF BRAZIL AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

**The United States Has Invented Threshold Burdens for Serious Prejudice Challenges that Do Not Exist in the Text of Articles 5 and 6.3 of the SCM Agreement**

1. The United States' has raised a number of threshold burdens that an Article 6.3 complainant allegedly must meet to establish a claim which are not based in the text of the serious prejudice provisions of the SCM Agreement.

2. First, the United States incorrectly asserts that under Article 6.3, Brazil must show an *ad valorem* subsidy rate and the amount for each of the challenged US subsidies. The only textual basis the United States provides is Annex IV of the SCM Agreement, which has expired with the text of Article 6.1(a) that contained the now-expired presumption of serious prejudice from a 5 per cent *ad valorem* subsidization. The United States further relies on *countervailing duty* measure procedures and interpretations of Brazil and the EC. But these allocation methodologies are irrelevant to Article 6.3 claims because unlike the expired Article 6.1(a) or Part V of the SCM Agreement, the focus of Articles 5(c) and 6.3 is on an examination of the *effects* of subsidies that are provided either directly or indirectly to producers of a product, such as cotton. In any event, Brazil has demonstrated a collective subsidization rate averaging 95 per cent and subsidies in the amount of $12.9 billion.

3. Second, the United States makes the sweeping argument that there is a legal prohibition on bringing adverse effects claims against subsidies that it alleges cannot be "expensed" or allocated to future years. The United States argues that all subsidies to cotton are "recurring" and therefore, as a matter of law, "cannot be said to be causing serious prejudice" except in the year in which they are provided. In fact, there is *no* textual basis in Part III or Article 6.3 of the SCM Agreement (or Article XVI:3 of GATT 1994) for distinguishing between the adverse effects of "recurring or non-recurring" subsidies. Nor is there any basis for "expensing" subsidies in one year or another year, as is often done in a countervailing duty investigation. Because Article 5 requires Members to *prevent effects*, a breach of Article 5 does not necessarily arise when a subsidy is granted, but only when actionable adverse effects occur.

4. The US argument is also inconsistent with the object and purpose of the SCM Agreement which is to protect Members from *any* subsidy causing serious prejudice. Under the US interpretation, a Member can permanently avoid any liability under Article 6.3 simply by carefully constructing the form of the payment as a recurring annual subsidy. Brazil has also presented evidence of continuing effects from subsidies provided in MY 1999-2002.

**Brazil Has Established the Existence of Price Suppression in the US, World, Brazilian, and Other Markets Where Brazilian Producers Export**

5. The United States now asserts that even though there may be evidence that New York futures market and A-Index prices as well as prices in other countries are suppressed by a "generalized effect," the "in the same market" language in Article 6.3(c) requires that US exports be present in the same geographical markets in which Brazilian cotton is present.

6. Brazil has established, consistent with the requirements of Article 6.3(c), that the effects of the US subsidies were to suppress prices in the "same market" in which Brazilian producers marketed their "like" cotton – i.e., in the world's, Brazil and in third countries. First, Brazil demonstrated the impact of US overproduction on the US and the "world market" prices (A-Index and New York futures market prices). Brazil then demonstrated that prices in Brazil and the countries to which Brazilian exporters shipped their cotton between MY 1999-2002 were suppressed and heavily influenced by US subsidies. The effects of those subsidies are communicated world-wide via a global price discovery mechanism. The parties agree that US, Brazilian and other countries' cotton are "like products". Throughout the world, prices for this fungible, price-sensitive commodity are determined by reference to the New York futures market and A-Index prices. Thus, Brazil established that the effect of the US subsidies is significant price suppression in the United States and Brazil, and in countries to which Brazilian producers exported their cotton. Further, the evidence shows that US subsidized cotton was present and contributed to the suppression of prices in 37 of the countries in which Brazilian producers marketed their cotton.

**Brazil Has Established the Causal Link between the US Subsidies and Significant Price Suppression, Increased US World Market Shares, and the Inequitable US Share of World Trade**

7. Brazil has properly analyzed both US revenues and costs using USDA's own data and conclusively demonstrated that the US industry producing cotton is heavily dependent on all US subsidies to cover total costs over the short and long run. This finding provides a key economic rationale for the large production-enhancing effects from the US cotton subsidies found by USDA, as well as by US and international economists.

8. Over the long term, even the United States agrees that producers must recover all of their costs and make a profit to stay in business. USDA's own cost and planted acreage data shows that US producers' long-term costs from MY 1997-2002 were $12.5 billion greater than their market revenue received. The United States argues that off-farm income should have been included in Brazil's revenue calculations. This US approach is conceptually as well as legally wrong. The relevant question is whether the "US cotton industry" is profitable from market revenue, not whether this industry is kept alive by cross-financing from other (non-subsidy) sources, such as social security payments.

9. US cotton producers would have suffered a cumulative loss of $332.79 per acre of cotton during MY 1997-2002 if they did not receive contract payments. But USDA's own data in the Environmental Working Group database demonstrates that almost all US producers of cotton did receive contract payments. And as a result, they made cumulative 6-year "profit" of $106 per acre by MY 2002, allowing them to plant significant acreage to cotton in MY 2002 and 2003.

10. Finally, the United States criticizes Brazil's comparison of costs of production among various countries. While Brazil agrees that the ICAC "data must be used carefully", the problems with ICAC's data do not render them unusable. Comparing ICAC "Variable Cash Costs" – which the United States does not challenge – demonstrates that it is much cheaper to produce a kilogram of cotton in Brazil than the United States.

11. The United States has argued that "in no year from marketing year 1999-2001 would the marketing loan rate be expected to have much of an impact, if any, on producer planting decisions," and that it did not affect producer decisions in MY 2002. This new US argument contradicts numerous USDA studies. In assessing the credibility of the new US argument that marketing loans provided no production incentives, the Panel should consider that USDA's own economists Westcott and Price found considerable effects of the marketing loan programme on US cotton production. The results of the Westcott and Price study are neither unique nor unexpected. Numerous other

economists have found similar results. Looking at futures prices also reveals that US producers are unresponsive to price changes at planting time.

12. Moreover, the basic US assumption is that if the *futures* price (minus five cents) is above the marketing loan rate of 52 cents per pound, then "economic logic" demands that the marketing loan can have no impact on planting decisions.

13. The United States' analysis of the marketing loan programme is based on a completely irrelevant comparison between the "expected cash price" and the marketing loan rate. Cotton marketing loan payments are based on the difference between the loan rate (52 cents) and the adjusted world price ("AWP") not the price received by US farmers. The AWP is typically far lower than the price received by U.S. farmers. The average spread between the December contract futures price during the period January-March and the adjusted world price of the following marketing year was 18.5 cents per pound. Thus, even using the US "futures price" methodology at planting time, for every year between MY 1999-2002, there was the expectation at planting time that significant marketing loan payments would be made.

14. Even if the expected AWP is above the loan rate, this does not mean that farmers expect a zero marketing loan payment. If the expected AWP lies above the loan rate, farmers would still expect, with a certain likelihood, that the actual AWP could be below the loan rate because the expectations about the AWP is a probability distribution. Thus, they would still expect a positive marketing loan payment.

15. Brazil emphasizes that the US futures price approach suffers from several significant shortcomings. Both farmers' decisions about planting and marketing of cotton are more complex. Planting decisions take place between January-March and the marketing of cotton takes place during the whole marketing year. Thus, just the February quote of the December futures contract does not properly address the complexity of farmers decisions.

16. The evidence is that the US cotton industry is sceptical of relying too heavily on present futures market prices as an accurate guide to future prices. Farmers have seen such volatility in the past as well as today. Therefore, any cotton farmer planting in the MY 1996-2002 period who actually relied on futures prices would know that the futures market is far from constituting a perfect predictor of future prices. Thus, as Professor Sumner correctly stated, "it is impossible to know what precisely individual farmers expect;" price expectations are "fundamentally unobservable".

17. The record supports a finding by the Panel that more than $4 billion in contract payments were provided to *current* producers of cotton in MY 1999-2002. Brazil has demonstrated that the publications listed in the US review literature were largely irrelevant because they are not cotton-specific, as they do not address the re-coupling of production due to the base acreage updating for direct and CCP payments, or the huge target price CCP payments provided to cotton producers. Brazil has also shown that the US subsidies do not meet the criteria of paragraph 6 of Annex 2 of the Agreement on Agriculture, and are therefore not "decoupled".

18. The record supports a finding by the Panel that the "other effects" apart from increased rental costs include significant production effects tied to upland cotton. First, the large majority of current cotton producers receive much higher per-acre payments for cotton than for other programme crops. The Panel must ask why much higher per acre direct and CCP payments are made to cotton base acreage *if* these payments are totally de-connected from current production? If that were the intention, as the United States argues and USDA presumes, then all contract payments in the same state or county would provide the same per acre benefit. The reason for the higher payments, of course, is that cotton is a high-cost crop and that cotton farmers insisted they were not receiving enough payments during MY 1999-2001 "to make ends meet".

19. Second, the United States has now admitted that two million additional cotton base acres were added to the total contract "base" acreage. This means that in MY 2002, an additional $227 million in payments were made to farmers producing cotton during MY 1998-2001. This is not "decoupling" payments from production, but re-coupling to reward farmers for increasing their recent production. And the prospect of future updates will keep many farmers planting cotton in order to protect and even increase future bases. Even USDA economists agree that this creates a link to current production.

20. Third, the 72.4 cent target price triggers CCP payments when *cotton* prices are lower – not corn, or soybeans prices – but *cotton*. Why is that? Because the NCC argued and Congress agreed that given the high costs of producing cotton in the United States, *current* and *future* cotton farmers will need high payments when prices decline. There would be no reason to set a "target price" to protect against low cotton prices if Congress expected that most farmers with upland cotton base acreage would start planting apple trees.

21. Fourth, Brazil presented the Panel with information from USDA's own electronic payment data showing that during MY 2000-2002 at least 71.3 to 76.9 per cent of total so-called "de-coupled" cotton base acreage payments were paid to producers of cotton. The data further shows that, in MY 2002, these producers of cotton received 85 per cent of their contract payments from cotton base acreage.

**The US Subsidies Increase Exports, in Violation of Article 6.3(d) of the SCM Agreement**

22. Brazil has demonstrated that, in violation of Article 6.3(d) of the SCM Agreement, the effect of the US subsidies played a significant role in the increase of the US world market share in MY 2001-2003 over its previous three-year average, following a consistent trend since MY 1996.

23. The US argues that "[u]nder Brazil's reading, a Member would be free to provide subsidies that increased the share of its own domestic consumption that its producers supplied without any disciplines under Article 6.3(d)". But this argument ignores the fact that Article 6.3(a) disciplines subsidies that increase domestic production in the market of the subsidizing Member. Further, Article 6.3(b) addresses any export displacement or impedance effects of subsidies in third country markets.

24. Second, the United States now argues explicitly that Article 6.3 has superseded Article XVI:3, second sentence. Assuming *arguendo* that the United States is correct, the effect of the US interpretation of "world market share" as meaning "world market share of consumption" would be to eliminate any WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports. As Brazil has pointed out, this would be contrary to the fact that the language and scope of both Article XVI:3, second sentence and the text of Article 6.3(d) are very closely related.

25. Finally, the entire concept of a "world market share of consumption" is flawed for the purposes of Article 6.3(d) as it results in double counting. The United States argues that "the US share of the world market for upland cotton should be defined as US consumption plus US exports over world consumption". However, the ordinary meaning in a trade remedy context of "domestic consumption" is total domestic "shipments" (i.e., net use from production or stocks) plus imports *minus* exports. Total "world consumption" is the sum of each country's domestic shipments plus imports minus exports. But the US methodology addresses as "consumption" both imports and exports and thus, double counts.

**CCC Export Credit Guarantee Programmes**

26. The United States considers that Article 10.2 exempts export credit guarantees from the disciplines included in Article 10.1. In Article 10.2, the negotiators reached a good faith agreement to work toward specific disciplines on export credits. That need for a good faith commitment to negotiate explains the difference between the Draft Final Act and the final version of Article 10.2. Given the "magnitude" of those programmes, the United States argues that no Member could possibly have intended for its agricultural export credit programmes to be subject to Article 10.1. But, among others, the EC and Canada, both massive users of export credits, have told the Panel that they consider export credits to be subject to Article 10.1 if they meet the definition of an "export subsidy". The United States did not think it needed to account for the CCC programmes in its reduction commitments, since it did not consider them to be export subsidies.

27. The United States says that it has offered "uncontroverted evidence" that for 12 of 13 scheduled products, US exports under the CCC export credit guarantee programmes did not exceed the United States' reduction commitment levels. The correct question, however, is whether *total* US exports of a scheduled product exceed the quantitative reduction commitments, which Brazil has demonstrated. It is for the United States, under Article 10.3, to prove that those excess quantities did not receive export subsidies.

28. Whomever bears the burden, Brazil has demonstrated that the CCC export credit guarantee programmes confer "benefits" *per se*, and also constitute export subsidies within the meaning of item (j). The United States argues that even if the CCC programmes constitute export subsidies, because "the quantities were within the applicable US export subsidy reduction commitments[,] they would conform fully to the provisions of Part V of the Agreement on Agriculture". The United States is in error.

29. With respect to *unscheduled* products, Brazil has established both actual circumvention and the threat of circumvention. Brazil's Exhibits 73 and 299 and Exhibit US-41list the billions of dollars of CCC guarantee support that have been provided for exports of unscheduled products during fiscal years 1992-2003, thereby circumventing the US commitment not to provide export subsidies. The mere availability of CCC guarantees for unscheduled products threatens circumvention, since Article 10.1 prohibits *any* export subsidy for such products.

30. With respect to s*cheduled* products, Brazil has demonstrated actual circumvention for US rice exports benefiting from CCC guarantees that have exceeded the US quantitative export subsidy reduction commitment. In its 18 November submission, the United States argues that because CCC has not disbursed the minimum amounts (at least $5.5 billion in guarantees each year, plus an additional annual amount of at least $1 billion in direct credits or guarantees for exports to "emerging markets") there is no threat of circumvention. The United States misunderstands the test set out by the Appellate Body in US – FSC. The lack of a legal mechanism that stems, or otherwise controls, the flow of CCC guarantees threatens circumvention. There is no limit on the amount of CCC guarantees and CCC's is exempt from the standard requirement of new Congressional budget authority for new guarantees.

# ANNEX H-2

## EXECUTIVE SUMMARY
## CLOSING STATEMENT OF BRAZIL AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES

### 1. The United States enjoys No Peace Clause Protection

1. The record demonstrates that the United States enjoys no peace clause immunity for its upland cotton subsidies. Under any of three methodologies – a "budgetary outlay/expenditure", an "aggregate measure of support", or a "rate of support" methodology – the level of support provided in MY 1999-2002 exceeds the level of support decided in MY 1992. The United States has acknowledged that all challenged US subsidies, except PFC and direct payments, are non-green box (trade and production-distorting) subsidies. Brazil and all third parties agree that direct payments under the 2002 FSRI Act are non-green box because of the updating of a fixed base period contrary to Annex 2, paragraphs 6(a) and (b) of the Agreement on Agriculture. Further, PFC and direct payments are non-green box support because of the prohibition on fruits and vegetables contrary to Annex 2, paragraph 6(b). Moreover, payments for cotton base acreage are higher than those for other crop base acreage. The weight of evidence shows that all the challenged US subsidies are "support to" upland cotton within the meaning of Article 13(b)(ii) because they were received by current producers or by users and exporters of US upland cotton. Brazil's "14/16ths" methodology for estimating the amount of the four contract payments is reasonable and supported by the EWG database and considerable circumstantial evidence.

### 2. Brazil has established the Elements to Support its Significant Price Suppression Claims under Article 6.3(c)

2. Upland cotton is a basic, widely-traded commodity. Both Brazil and the United States agree that Brazilian upland cotton and other upland cottons are "like" subsidized US upland cotton. Because of this widespread interchangeability among world cottons, increases in world cotton supply by major cotton-producing countries have a major impact on discovery or establishment of world prices reflected in the A-Index and the New York cotton futures exchange.

3. The United States has made a great deal about what it terms some "fundamental" issues about the nature and amount of subsidies. Brazil has demonstrated the absence of any textual basis for incorporating various countervailing duty principles from Part V of the SCM Agreement into Part III and resurrecting Annex IV from the dead. However, Brazil used USDA's own data to show both the amount and rate of subsidization for each of the subsidies. To make up for US acreage and yield information the US has hidden from Brazil and the Panel for 16 months, Brazil has demonstrated through the EWG database and other circumstantial evidence that its "14/16th" methodology is reasonable. This methodology allocates payments only to current producers of upland cotton and does not "double count" payments provided to other producers of crops. And since the peace clause phase of this proceeding, Brazil has demonstrated that all the US subsidies are "tied" to the production of upland cotton and are "support to" upland cotton.

4. The US government has poured $12.9 billion over the past four years into a number of subsidy programmes specifically targeted at US upland cotton. No other US commodity has a Step 2 programme and no other US commodity received subsidies as high as 136 per cent *ad valorem*. Even

the so-called decoupled contract payments for "historical" cotton base acreage are much higher than for any other crop except rice. The subsidies provide a specific "target price support" of 72.4 cents per pound for upland cotton – not for other crops. And Congress insisted that USDA has no discretion to limit any of the required payments, all of which are mandatory and place no limit on the amount of upland cotton that could be produced with the support of these subsidy programmes.

5. The United States has agreed that all of the challenged US subsidies are "specific" except crop insurance. But USDA's own evidence showed that this programme is also specific since it is targeted at the industry growing crops, not livestock and thus covers only half of the value of US agricultural commodities and 38 per cent of farmland.

6. While Brazil continues to wait for farm-specific acreage and yield information from the United States, the incomplete Environmental Working Group data based on USDA farm-specific data show almost $3 billion in contract payments paid to upland cotton producers in MY 2000-2002 alone. And the great bulk of the other evidence shows that US upland cotton farmers are dependent upon, need and, in fact, receive such payments to "make ends meet" and "to survive".

7. Having established the fungible nature of the product and the existence and specificity of the subsidies, Brazil must link the effects of the subsidies to significant price suppression. The first important fact is that the United States is by far the world's largest exporter, with a world market share of 41.6 per cent, and the second largest producer of upland cotton in the world, with a 20 per cent share. The US subsidization rate of 95 per cent provided by the second largest producer and largest exporter creates the potential of causing serious prejudice to the interests of other Members, including Brazil. It is useful to recall the size of these subsidies compared to the 5 per cent *ad valorem* rate establishing a presumption of serious prejudice under Article 6.1(a) and compared to the amount, if any, of subsidies received by US competitors.

8. But what was the impact of the large US subsidies on production and world supplies of cotton? One answer to this question is found in the difference between market revenue and the US producers' total costs. While claiming that only variable costs are important in the short term, the United States admits that in the long-term, US producers have to make a profit to stay in business. Using only USDA's data for the period MY 1997-2002, the *average* US upland cotton producer received market revenue that was $872 dollars *per acre less* than its total costs. This means the cost/revenue gap for all upland cotton farmers between MY 1997-2002 was $12.5 billion.

9. The United States has attempted to leave you with the impression that its upland cotton producers do not rely or need any subsidies between MY 1997-2002 to make up this $12.5 billion gap. In assessing the credibility of these claims, consider that during this same 6-year period, US cotton producers received $16 billion in US subsidies and ended up with a 6-year "profit" of $127 per acre. The US claims that the PFC, market loss assistance, direct payment and CCP payments were not support to cotton. But without those 4 payments, US cotton producers would have lost $333 per acre between MY 1997-2002. The US further claims that the marketing loan payments in MY 1999-2002 made no difference to producers' planting decisions. But this argument ignores the impact of the subsidies in those producers' costs. By MY 2002, the average US producer would have been faced with a 3-year loss of $372 per acre if they had *not* received marketing loan payments during MY 1999-2001. This evidence confirms the conclusion of the Chief USDA economist that by making marketing loan payments "*you don't get cutbacks in production*". Clearly, the marketing loan programme kept many producers from reducing their planted acreage between MY 1999-2002.

10. Indeed, US producers planted between 14.2 – 15.5 million acres of upland cotton between MY 1999-2002 as prices fell to record lows. The combined revenue from *all* the US subsidies and market prices allowed producers to earn a long-term "profit" of $17.67 per year over the 6-year period. What is most amazing is that after having received record low prices for their cotton in MY

2001 and with futures prices at the time of planting suggesting market prices would remain at record low levels, US producers still planted 14.2 million acres of upland cotton – a similar amount of acreage that was planted when prices were much higher in MY 1996-1998. However, even 135 per cent *ad valorem* subsidies in MY 2001 were not sufficient to provide a profit to the highest-cost and lowest-yield US producers. This explains why US planted acreage declined to 1996-98 levels in MY 2002.

11. Having established that the US subsidies prevented production cutbacks, the Panel has to estimate how much of a cutback would have been made without US subsidies. USDA economists Westcott and Price estimate a 20 per cent cutback in MY 2001 from only the marketing loan programme. Professor Sumner estimates an average production cutback of 28.7 per cent or a total of 19.8 million bales between MY 1999-2002 from eliminating all subsidies.

12. The Panel then must estimate the effect of these estimated US production cutbacks on world prices. First, Brazil demonstrated the impact of US overproduction on the US and the "world market" prices (A-Index and New York futures market prices). Brazil then demonstrated that prices in Brazil and the countries to which Brazilian exporters shipped their cotton between MY 1999-2002 were also suppressed and heavily influenced by US subsidies. The effects of those subsidies are communicated world-wide *via* a global price discovery mechanism. Throughout the world, prices for this fungible, price-sensitive commodity are determined by reference to the New York futures market and A-Index prices. There is a world market for upland cotton. Subsidized US cotton and Brazilian cotton compete in this world market, i.e., "in the same market", as used in Article 6.3(c) of the SCM Agreement. Brazil established that the effect of the US subsidies is significant price suppression in that world market.

13. There are numerous studies from a number of economists finding clear and identifiable amounts of price suppression ranging from 10-33 per cent for the US price and 10-26 per cent of the world A-Index price. Professor Sumner responded to the US critiques of these studies by showing that they are not biased and correcting for some shortcomings are consistent with his results. The United States also claims these studies are useless for this dispute because they did not use "futures prices", but then admits that USDA and FAPRI models also use "lagged prices" because it is not possible to use futures prices in models to judge farmers' revenue expectations. Brazil also demonstrated that, using the US futures methodology, farmers expected significant revenue from marketing loan programmes in MY 1999-2002.

14. Finally, the Panel should judge the "significance" of the price suppression by the extent of the impact on Brazilian producers. But even judged in relation to objective levels, any of the price suppression estimated in the various econometric studies is sufficient to establish "significance".

### 3. Claims under Article 6.3(d) of the SCM Agreement

15. The facts strongly support Brazil's claims that US subsidies contributed to an increased US world market share of exports. USDA's data show that US exports increased in MY 2001, MY 2002, and are projected to increase in MY 2003 to levels well above the previous 3-year averages as required by Article 6.3(d).

16. The US domestic subsidies played a major role in the increased US exports by maintaining high-cost US production. Similarly, the Step 2 subsidy was paid in 188 out of 208 weeks and more than $1.6 billion worth of US upland cotton exports received GSM 102 export credit guarantee financing. The NCC confirmed that both subsidies played a major role in the significant expansion of US exports, in particular against the background of a rapidly appreciating US dollar. Professor Sumner's analysis estimates that on average, US exports would be 41.2 per cent lower without any of the US subsidies between MY 1999-2002. US world export market share expanded

rapidly from MY 1999 even as prices plunged to record lows. After reaching 41.6 per cent in MY 2002, the US market share is projected to remain very high at 39 per cent in MY 2003.

17. The United States response to this evidence is to argue that the term "world market share" means "world market share of consumption". But USDA, Canada, and the EC agricultural experts, among others, use and interpret the phrase as "world market share of exports". This is the correct meaning as confirmed by the use of the word "trade" in the footnote qualifying Article 6.3(d), and by the close similarity between the scope and text of Article 6.3(d) and Article XVI:3, second sentence, which also deals with world market share of exports. Further, as we demonstrated yesterday, the US "consumption" interpretation is unworkable and illogical because US consumption is total domestic "shipments" (i.e. net use from production or stocks) plus imports *minus* exports. To count US exports as consumption means double counting other countries' imports as consumption.

**4. Claims under GATT Article XVI:1 and 3**

18. The facts strongly support a finding that the US share of world export trade is inequitable. While world market prices plunged and the US dollar appreciated rapidly, the huge US subsidies allowed US exporters to purchase a record high share of 41.6 per cent. At the same time, the share of much lower cost and non-subsidized producers declined between MY 1999-2002. The text of Article XVI:3, second sentence, covers any type of subsidy that "operates to increase the export" of a primary product such as upland cotton. Contrary to the US arguments, nothing in the text of the WTO or GATT 1994 suggests that Article XVI:3, second sentence, has been superseded by Article 6.3.

**5. Claims of Threat of Serious Prejudice**

19. Brazil has also established that there is a present threat of serious prejudice during the lifespan of the 2002 FSRI Act. This threat covers the threat of significant price suppression, threat of a further increased US world market share and the threat that the United States continues to have a more than equitable share of world export trade. The mandatory and unlimited nature of the production and trade-distorting US upland cotton subsidies and the absence of a legal mechanism that stems, or otherwise controls, the flow of these subsidies constitutes the actionable threat of serious prejudice to the interests of Brazil. The timing and nature of actionable subsidy cases, as well as the remedies available under the SCM Agreement compel that such a threat need not be "imminent", but instead "present" to be actionable.

20. Brazil has demonstrated that there is a present threat of serious prejudice from the existence of the US subsidies. There is no dispute between the United States and Brazil that the US marketing loan, Step 2, crop insurance and contract payments are mandatory subsidies. There is no limit on the amount of upland cotton that can be produced, used and exported from farmers receiving these payments. Brazil has also demonstrated that all of these subsidies are production and trade-distorting and have caused present serious prejudice between MY 1999-2002.

21. The most recent USDA and FAPRI baselines project continued high levels of US planting and continued high costs that will not be covered by market revenue. Therefore, the US subsidies will continue to have large production and export-enhancing and price-suppressing effects. In particular, until MY 2007, the US subsidies threaten to cause significant price suppression in the US, world, Brazilian and in third-country markets to which Brazil exports its upland cotton.

22. Finally, the US subsidies mandated until the end of MY 2007 will cause serious prejudice under any market conditions. Thus, the provisions mandating marketing loan, Step 2, crop insurance and direct and counter-cyclical payments constitute per se violations of Articles 5 and 6.3(c) and (d) of the SCM Agreement.

## 6. Brazil's Claims regarding Step 2 Export and Domestic Payments under Article 3.1(a) and (b) of the SCM Agreement

23. The Step 2 export and Step 2 domestic subsidies are prohibited subsidies under Article 3.1(a) and (b) of the SCM Agreement. The Step 2 export subsidies violate Article 3.1(b) because they are subsidies expressly contingent upon proof of export of US upland cotton and are paid only to eligible exporters. The NCC describes the Step 2 programme as "export assistance" and the USDA acknowledges it makes U.S. exports of upland cotton more "competitive".

24. The United States acknowledges that Step 2 domestic subsidies are local content subsidies within the meaning of Article 3.1(b) of the SCM Agreement. Local content subsidies to processors of agricultural commodities are not expressly exempted from the disciplines in the SCM Agreement by either Agreement on Agriculture or by the chapeau of Article 3.1. In particular, Annex 3, paragraph 7 and Article 6.3 of the Agreement on Agriculture do not create rights and obligations that by necessity conflict with Article 3.1(b). Brazil has demonstrated the absence of any inherent conflict because it is possible to provide domestic support to processors of agricultural products without violating Article 3.1(b). Further, Article 13(b)(ii) is properly read as meaning that even if a local content domestic support measure may conform to Article 6.3 of the Agreement on Agriculture, it is not exempted from claims under Article 3 of the SCM Agreement. If the drafters had intended to exempt agricultural local content subsidies from Article 3 claims, they would have included Article 3 in Article 13(b)(ii), the same way that they included Article 3 of the SCM Agreement in Article 13(c)(ii) for purposes of exempted export subsidies for scheduled products.

## 7. Brazil's Claims regarding the CCC Export Credit Guarantees

25. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP export credit guarantee programmes administered by the CCC constitute export subsidies within the meaning of Articles 10.1, 1(e) and 8 of the Agreement on Agriculture, Articles 1.1 and 3.1(a) of the SCM Agreement, and item (j) of the Illustrative List of Export Subsidies. Brazil has also demonstrated that those export subsidies circumvent, or threaten to circumvent, the United States' export subsidy reduction commitments, in violation of Articles 10.1 and 8 of the Agreement on Agriculture. Additionally, because they violate the Agreement on Agriculture, these programmes are not exempt from actions by Article 13(c)(ii) of the Agreement on Agriculture, and constitute prohibited export subsidies within the meaning of item (j) and Articles 1.1, 3.1(a) and 3.2 of the SCM Agreement.

## 8. Brazil's Claims regarding the ETI Act Subsidies

26. With respect to the ETI Act, Brazil and the United States agree that the Panel should follow the precedent of the panel in *India – Patents (EC)*. Indeed, the United States has effectively admitted the inconsistency of the ETI Act by repeatedly stressing to the Panel that it intends to implement the rulings and recommendations of the Dispute Settlement Body to bring the ETI Act into conformity with the Articles 10.1 and 8 of the Agreement on Agriculture and Articles 3.1(a) and 3.2 of the SCM Agreement.

# ANNEX H-3

## EXECUTIVE SUMMARY
## OPENING STATEMENT OF THE UNITED STATES AT THE SECOND MEETING OF THE PANEL WITH THE PARTIES

### I. THE EFFECT OF US SUBSIDIES IS NOT SIGNIFICANT PRICE SUPPRESSION

1. Brazil's theory of its case is that subsidies result in greater production, increased exports, and suppressed world prices for upland cotton. Brazil does not, because it cannot, refute the fact that US producers have increased and decreased acreage commensurately with producers in the rest of the world. Thus, there is no evidence that US producers are insulated from market forces in making production decisions.

2. In every year but one in which Brazil has alleged price suppression, and in marketing year 2003 in which it alleges a threat of price suppression, expected harvest season prices at the time of planting have been *above* the US marketing loan rate. In marketing year 2002, the only year in which expected harvest season price was below that rate, US harvested acres fell by a slightly *larger* percentage than the rest of the world. In fact, US planted acres fell by the amount expected from the decline in expected harvest season prices from marketing year 2001 to 2002 and by *far more* than would have been expected had producers been planting for the marketing loan rate. Therefore, rather than supporting Brazil's argument – that the effect of US payments is to make US producers unresponsive to market price changes – the evidence contradicts it.[1]

3. Brazil's allegation that the effect of US subsidies is price suppression is dispelled by the fact that Brazilian cotton undercuts the US price in various third-country markets.[2] Aggregated data on average US and Brazilian upland cotton prices to various markets identified by Brazil unambiguously show that Brazilian cotton undercuts the US price in these third-country markets. Thus, these data demonstrate that it is not US upland cotton that has suppressed Brazilian upland cotton prices, but Brazilian cotton prices that have undercut US prices.

### II. THE EFFECT OF US SUBSIDIES IS NOT AN INCREASE IN WORLD MARKET SHARE

4. The facts do not demonstrate any increase in US world market share. While US world market share in marketing year 2002 was projected to be higher than the average of the preceding three-year period, the 2002 subsidies are different from the subsidies for prior marketing years, and 2002 payments were only introduced with the 2002 Act. It is the effect of the 2002 subsidies that Brazil must demonstrate under Article 6.3(d) of the SCM Agreement establishes an increase that follows a

[1] We also recall that Brazil failed to properly analyze marketing loan payments through its use of "lagged prices" instead of futures prices. During marketing years 2000-2003, lagged prices significantly understate the harvest season prices expected by producers, thereby inflating the expected effect of the marketing loan rate.

[2] Brazil's evidence under Article 6.3(c) must establish the volume of subsidized US upland cotton that is "in the same market" as Brazilian upland cotton, the extent of subsidization, and the prices of those respective products sufficient to establish its claim of "significant price suppression". Brazil has not even shown that for each foreign market, there have been *any* US exports of upland cotton.

"consistent trend." One year does not make a "consistent trend". Thus, there can be no "consistent trend over a period when subsidies have been granted".[3]

## III. THE EFFECT OF US SUBSIDIES IS NOT A THREAT OF SERIOUS PREJUDICE

5. The facts do not support a finding of threat of serious prejudice. We submit that Brazil seeks to have the Panel reject the "imminent threat" standard, even though it was Brazil itself that previously suggested this standard to the Panel, because market prices have recovered to the point that *no marketing loan payments have been made since 18 September 2003*, and counter-cyclical payments are expected to be well below their statutory maximum for marketing year 2003.[4]

6. Brazil concedes that "market prices [may] increase to the point where the present effects of the subsidies are minimal". Given current and expected prices for marketing year 2003, even Brazil might have to concede that the present effects of US subsidies could be "minimal". However, Brazil seeks to prevent the Panel from basing its threat of serious prejudice analysis on that same marketing year 2003 data. If Brazil cannot demonstrate an imminent threat of serious prejudice in marketing year 2003, logically, neither can it demonstrate a threat of serious prejudice in farther off years, given that (in Brazil's words) "market[] prices move up and down," and "[n]o Member . . . can predict the course of future prices".

## IV. BRAZIL HAS FAILED TO SHOW THE ELEMENTS NECESSARY TO ESTABLISH ITS SUBSIDIES CLAIMS

7. Brazil has argued that no concepts or analysis drawn from other parts of the SCM Agreement or provisions from other agreements may be applied to claims under Part III of the Subsidies Agreement. This position is untenable. The United States is not suggesting some radical methodology dreamt up for purposes of this dispute but instead is proposing methods based on principles set forth in the SCM Agreement and accepted and applied by other WTO Members, including Brazil, for purposes of their countervailing duty practice.

8. Brazil says there is no need for it to quantify the subsidy benefit attributable to the product at issue nor the rate of subsidization but does not explain how to evaluate the effect of the subsidy without identifying the amount or rate of support. Further, Brazil has repeatedly alleged a subsidy amount and subsidization rate for the marketing year 1999-2002 period. Presumably, then, the value of the subsidy and the subsidization rate of exported US upland cotton would be highly relevant to the Panel's analysis of the effect of the challenged subsidies; Brazil's position would deprive the Panel of that crucial element.

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[3] Even if one were to look to the period since the 1996 Act when different subsidies were in place, there is no consistent trend over a period when those subsidies have been granted. The facts demonstrate that since marketing year 1996, US world market share has increased and decreased in alternating years, and US world market share in marketing year 2002 is lower than in marketing years 1996-1997. These data cannot support a finding of a consistent trend. Brazil seeks to evade these facts by ignoring the change in subsidies over the years and by interpreting "world market share" contrary to the ordinary meaning of those terms.

[4] The effect of such higher market prices is vividly suggested by Brazil's use of the January 2003 FAPRI baseline versus the November 2002 preliminary FAPRI baseline in Dr. Sumner's new model. We, of course, strongly disagree with what we understand to have been the way in which Dr. Sumner has most recently modeled all of the US payments at issue, but we note that a mere change in baselines that increased the baseline A-index price by an average of *4.24 cents per pound* per year over MY 2003-2007 *reduced* the estimated impact of removal of all US subsidies on A-index prices by *nearly one-third*. Price movements since January 2003 would suggest that Dr. Sumner's estimated impacts using more current data would be smaller still. For example, the January 2003 FAPRI baseline projected a 2003 marketing year A-index price of 58.40 cents per pound while the year-to-date A-index price has been *68.73 cents per pound*, an increase of more than 10 cents per pound over the January baseline.

9. Brazil errs in asserting that it need not identify the "subsidized product", ignoring or selectively quoting various provisions – Subsidies Agreement Articles 6.1(a), 6.3(c), 6.3(d), 6.4, and 6.5 – that expressly mention the "subsidized product". Subsidies to products other than upland cotton would not be within the Panel's terms of reference nor relevant to the Panel's analysis of the effect of the challenged subsidies. Again, Brazil's position would deprive the Panel of a crucial element in determining, for example, whether and to what extent the US product in the same market as the Brazilian product was a subsidized product.

10. Brazil also errs in arguing that it need not attribute payments not tied to production across the recipient's total value of production. The methodology of attributing subsidies not tied to production across the value of a recipient 's production is spelled out in Annex IV to Part III of the Subsidies Agreement. Attributing such non-tied payments across the total value of the recipient's production is necessary to avoid double-counting of the subsidy.

11. The United States does not see how decoupled payments made with respect to non-upland cotton base acres would be within the scope of this dispute. Given Brazil's own explanation of the measures it has challenged[5], it cannot be possible that one set of measures was within the scope of the dispute at one point but that Brazil has the sole discretion to change the scope of that dispute by changing its legal position as to what it is challenging as support to upland cotton.

12. Finally, Brazil says effects of subsidies can linger, even if allocated to a particular year for countervailing duty purposes. It is clear in Annex IV, paragraph 7, that Members took it for granted that some subsidies are allocated to future production and others are not. Brazil, however, does violence to this principle by essentially asserting that all subsidies – including so-called "recurring" subsidies that most experts and national authorities (including its own) would expense to current production – should be allocated to future production. Brazil has now conceded that the subsidies at issue in this dispute are "recurring".[6] Brazil cannot have it both ways: it cannot expense the entire value of a payment to a particular crop year but also claim that the subsidy continues to exist in a later year in which new recurring subsidies are made.

## III. BRAZIL'S HAS FAILED TO SHOW THE EFFECT OF THE CHALLENGED SUBSIDIES

13. **Decoupled Payments**. Brazil has fundamentally erred in its explanation and modelling of decoupled payments by ascribing a production effect to them that is based on little more than conjecture. This assertion contradicts basic economic theory, the economic literature on such payments, and the available data showing large shifts in cotton acreage as recipients of decoupled payments plant alternative crops or no crops at all and other farmers who do not hold upland cotton base acres choose to produce upland cotton.[7] Thus, there is no basis to ascribe production-distorting

[5] For example, Brazil has repeatedly argued that the challenged US subsidies provided $12.9 billion in support over marketing years 1999-2002; this figure was based on payments made under specific programmes, including decoupled income support with respect to upland cotton base acres only. Brazil also has argued that decoupled payments for upland cotton base acres (net of base acres not "planted to cotton") are all support to upland cotton irrespective of what is planted on the land now.

[6] *See* Brazil's Further Rebuttal Submission, para. 208 n. 344 ("Brazil agrees that the recurring subsidies at issue would be allocated to the year in which they are paid for purposes of a CVD analysis . . . .").

[7] For example, the marketing year 2002 base acreage increase means that, on average over marketing years 1998-2001, 2.6 million acres of upland cotton were planted on farms without upland cotton base acreage or in excess of those farms' upland cotton base acreage, suggesting that Brazil's theory that upland cotton must be planted on upland cotton base acreage is not supported by the facts.

effects to decoupled payments. In fact, most empirical studies have concluded that the effects of decoupled payments are minimal.[8]

14. **Third-Party Papers**. Brazil cannot cite to results from papers that employ an approach fundamentally at odds with its own. These third-party economic studies do not provide insight into the question this Panel has been asked to examine because they generally suffer from two crucial conceptual flaws. First, most of the cited studies do not distinguish between payments linked to production of upland cotton and payments decoupled from any requirement to produce, instead treating them as having equal production impacts. Second, most of the third party studies do not model the marketing loan programme appropriately, simply removing revenue from the producer without focusing on the producer's expected harvest season price at the time of planting. Thus, Brazil would have to agree that these third party papers do not properly model farmers' production decisions.

## IV. BRAZIL HAS ADVANCED ERRONEOUS LEGAL STANDARDS UNDER ITS CLAIM IN THIS DISPUTE

15. **Threat of Serious Prejudice/Article XVI:3**. Brazil may not advance a claim of threat of serious prejudice using the "more than equitable share of world export trade" standard from GATT 1994 Article XVI:3. Nothing in the text of GATT 1994 Article XVI indicates that a threat claim under paragraph 1 may utilize the more than equitable share standard under paragraph 3. Neither is there any analysis in the *EC – Sugar Exports* GATT panel report that provides a textual basis to import that standard. Further, Brazil's interpretation would also introduce a contradiction between GATT 1994 Article XVI:1 and SCM Agreement Articles 5 and 6 even though the term "serious prejudice" is used "in the same sense" in these provisions.[9]

16. **Threat of Serious Prejudice and *Per Se* Serious Prejudice Standard**. Brazil's argument is that "[c]onsistent with prior precedent [the GATT *EC – Sugar Export Subsidies* panel report], the threat of serious prejudice is caused by the absence of any legal mechanism that stems or otherwise controls the flow of mandatory and unlimited US subsidies". The GATT *Sugar Export Subsidies* panel report, however, provided no basis for selecting that standard, and neither we nor Brazil find any basis for that standard in the text of the Subsidies Agreement or GATT 1994 Article XVI:1.

17. Brazil is simply wrong that US payments are "mandatory" and "unlimited".[10] More fundamentally, however, Brazil's argument that "the availability of a mandatory subsidy for an unlimited amount of production and exports will inevitably create a threat and support a finding of a per se violation" proves too much. Brazil's standard means that only way a Member could act consistently with its WTO obligations would be to have a cap on expenditures with respect to a

[8] A recent study concluded that production flexibility payments had "no effects on agricultural production in either the short run or the long run". USDA, ERS, Decoupled Payments: Household Income Transfers in Contemporary US Agriculture, M.E. Burfisher and J. Hopkins, Eds. (February 2003), at 23. (See Exhibit US-53). Other studies cited in Exhibit US-23 and discussed in the US rebuttal and further rebuttal submissions suggest that the effects of decoupled payments on planted area are less than 0.5 per cent.

[9] Under Articles 5 and 6 a Member cannot claim threat of serious prejudice using the "more than equitable share" standard because that standard is not enumerated in SCM Agreement Article 6.3(c). Therefore, under Brazil's interpretation, a Member could show a threat of "serious prejudice" (under GATT 1994 Article XVI:1) by showing a threat of something that is not "serious prejudice" within the meaning of Articles 5 and 6.

[10] The payments Brazil identifies as "mandatory" are "mandatory" only if price conditions are fulfilled. Thus, the *likelihood* that price conditions will be satisfied must be taken into account. The payments Brazil identifies are also not "unlimited". For decoupled payments, the payments are set by multiplying fixed base acres times fixed base yields times the fixed or statutory maximum payment rate. The challenged payments are also not unlimited because a "circuit breaker" in the 2002 Act could result in these "mandatory" payments not being made.

particular product. It is not at all clear at what level such a cap would have to be set. But Members rejected product-specific expenditure caps in the Uruguay Round, instead agreeing on a commitment across *all* commodities (the Total and Final Aggregate Measurement of Support).

## V. BRAZIL'S SUBSIDIES AND PEACE CLAUSE ARGUMENTS MUST BE CONSISTENT

18. Brazil's arguments in this dispute must be consistent. First, it is evident that Brazil has conceded that various payments it previously claimed were product-specific – namely, decoupled income support and crop insurance – are, in fact, non-product-specific support. That is, these subsidies are provided to "agricultural producers in general", either because they do not specify any production that must occur for receipt of payment or because they are provided to producers of a wide range of products.[11] As non-product-specific support, they should not be included in the comparison under Article 13(b)(ii) of the Agreement on Agriculture. This contradicts the Brazilian approach, and is consistent with the US approach, to the Peace Clause.

19. Second, Brazil not only recognizes that support to upland cotton *may* be measured in terms of a rate but also that this is the only way to gauge the support decided by the United States for future years; therefore, Brazil relies on the rate of support concept for its threat and *per se* claims.[12] By advancing such arguments, Brazil has effectively conceded the basis for the US Peace Clause analysis – that is, that the only way for Members to know whether US measures for any given year will comply with Peace Clause requirements is to examine the way in which they "decide" support: that is, the rate of support. If Brazil makes arguments under its subsidy claims based on the rate of support, it cannot credibly assert that the rate of support is inapt in the context of the Peace Clause. As demonstrated during the Peace Clause phase, the United States disciplined itself to remain within those limits by deliberately moving away from production-linked deficiency payments with a high target price to decoupled income support.

[11] For example, if a recipient of decoupled income support can choose to produce cotton, something else, or nothing at all, the payment is not tied to production of a particular product. There is nothing in the Agreement on Agriculture to suggest that support may be at one and the same time "product-specific support" and "non-product-specific support". Thus, in attributing part of the decoupled payments on upland cotton base acres to producers and part to non-producers, Brazil concedes that such payments are non-product-specific support.

[12] Brazil's Further Submission, para. 432 ("When US upland cotton farmers plant their crop in spring, farmers expect a certain price level. But, by no means is it ensured that this price level will be accomplished. However, given the US subsidies, that is irrelevant. . . . . *The single fact that these programmes exist ensures a guaranteed revenue amount from the production of upland cotton.*") (italics added).

# ANNEX H-4

## EXECUTIVE SUMMARY
## CLOSING STATEMENT OF THE UNITED STATES AT THE SECOND MEETING OF THE PANEL WITH THE PARTIES

### I. CCC EXPORT CREDIT GUARANTEE PROGRAMMES ISSUES

#### A. BRAZIL WRONGLY MINIMIZES THE SIGNIFICANCE OF ARTICLE 10.2 OF THE AGREEMENT ON AGRICULTURE

1. Brazil's assertions in its opening oral statement regarding the CCC export credit guarantee programmes invite a brief response.

2. First, as discussed with the Panel during this meeting, Brazil asserts that Article 10.2 of the Agreement on Agriculture reflects merely a banal compromise to accommodate potential "additional obligations regarding notification, consultation, and information exchange". Brazil implausibly asserts that the obvious transition between the language of the Draft Final Act that would have imposed significant substantive disciplines on export credit guarantees and the absence of such language in the Article 10.2 ultimately adopted can be fully explained as reflecting merely an agreement to work on such pedestrian disciplines as information exchange.

3. Brazil asserts that the Members had agreed on the applicability of export subsidy disciplines to export credit guarantees and that Article 10.2 was an apparently insignificant "good faith agreement". However, Article 10.2 did not arise only because "other participants were not willing to offer more than general disciplines included in Article 10.1". It arose because part of the grand compromise of the Agreement on Agriculture was that export credit guarantees were excluded from the export subsidy disciplines.

4. Ironically, however, Brazil's statement further serves to illustrate that export credit guarantees were *not* considered export subsidies under the Agreement on Agriculture. In December 1994, the Preparatory Committee for the World Trade Organization issued *Notification Requirements and Formats Under the WTO Agreement on Agriculture*.[1] These notification requirements remain in effect. Elaborate reporting requirements are set forth for Members with respect to numerous aspects of the disciplines of the agreement, including with respect to export subsidies.[2] However, no reporting requirement is indicated for export credit guarantees. This is consistent with treatment of such programmes as outside export subsidy disciplines. Had the parties agreed that all were "willing to offer" at least "the general disciplines included in Article 10.1", as Brazil asserts, then it would have been logical to include reporting requirements for such purposes. It is hard to imagine parties willing to make such an offer in the absence of the United States, among the largest providers of export credit guarantees. In fact, the United States never offered to include export credit guarantees in Article 10.1, and the Members never so agreed. Indeed, the agreement reflected in Article 10.2 is expressly to the contrary.

5. Article 10.2, furthermore, would be unnecessary for mere "notification, consultation, and information exchange". Had export credit guarantees been subject to export subsidy disciplines,

[1] PC/IPL/12, circulated 2 December 1994 (exhibit US-99).
[2] See, e.g., Exhibit US-99, paras. 1(c), 1(e), 1(i), 2; Table ES:1 and Supporting Tables ES:1 and ES:2.

Article 18 of the Agreement on Agriculture, to review the progress in the implementation of commitments negotiated under the Uruguay Round reform programme, and the Notification Requirements, which are still in effect, could amply accommodate any "notification, consultation, and information exchange".[3]

B. BRAZIL INVENTS A STANDARD NOT REQUIRED UNDER ARTICLE 10.3 OF THE AGREEMENT ON AGRICULTURE

6. Second, with respect to Article 10.3 of the Agreement on Agriculture, Brazil asserts that the only way for the United States to satisfy any burden applicable under that provision is "to demonstrate the absence of subsidization on a transaction-by-transaction basis". Such a standard would obviously be impossible to satisfy. Perhaps more importantly, Article 10.3 requires no such demonstration. Brazil simply invents this. The only authority it offers for this novel proposition is a Third Party Submission of Canada, which itself offers no authority for the assertion.

7. Article 10.3 applies only to export subsidy *reduction* commitments. We believe that Brazil agrees at least with that. Brazil has alleged that the United States has exceeded only its quantitative export subsidy reduction commitments and only during the period July 2001-June 2002. The United States has demonstrated that with respect to 12 of the 13 commodities for which the United States has reduction commitments the respective exports during that period under the export credit guarantee programme did not exceed applicable quantitative reduction commitments. Other than the Dairy Export Incentive Programme applicable to cheese and skim milk powder, with respect to which the United States previously noted in a prior submission the issuance of export subsidies, the United States provided no export subsidies for the other scheduled commodities. To avoid any further ambiguity the United States submits a copy of its notification concerning export subsidy commitments for fiscal year 2001, which reflects no export subsidies provided by the United States other than for cheese and skim milk powder.[4]

C. BRAZIL'S RECENT STATEMENTS CONCERNING THE CORRECT ANALYSIS UNDER ITEM(J) ARE INCONSISTENT AND INCORRECT

8. Third, with respect to item (j) Brazil directly acknowledges its view that the relevant period of time for examination is 10 years.[5] Yet Brazil disingenuously urges the Panel to examine allegedly "uncollectible amounts" on pre-1992 guarantees, and defaults of Iraq and Poland, which commenced in 1990 and the 1980's, respectively.[6]

9. Brazil also mysteriously alleges that "according to CCC's 2002 financial statements, CCC has been relieved of what the United States argues are onerous government-wide accounting rules that 'compel' projection of enormous losses". CCC, however, has never been so "relieved". It remains compelled to adhere to the requirements of the federal Credit Reform Act of 1990, and relevant provisions of the Office of Management and Budget Circular A-11, implementing that legislation. CCC remains subject to government-wide requirements for subsidy estimates and the risk categories mandated by OMB with respect to exposure to debt from different countries. The government-wide rules continue to dictate the methodology for calculation of estimates, and reestimates, and as the United States has previously noted, a principal reason for overly high initial estimates is continuously overly optimistic projections of programme use. Also, as the United States has previously noted, the result of the estimate (and reestimate) process is simply carried forward to the CCC financial statements; Brazil continues to misrepresent the $411 million figure in the 2002 financial statement

[3] See, e.g., Article 18.5, 18.6, and 18.7.
[4] *Notification*, G/AG/N/USA/47, circulated 6 June 2003 (exhibit US-100).
[5] Statement of Brazil - Second Panel Meeting (2 December 2003), para. 81.
[6] Statement of Brazil - Second Panel Meeting (2 December 2003), para. 84.

as well as to mistakenly assert the inclusion of "enormous uncollectible amounts . . . on post-1991 guarantees".

D. BRAZIL CONTINUES TO WRONGLY ASSERT THAT THE ISSUANCE OF CCC EXPORT CREDIT GUARANTEES IS UNBOUNDED

10. Fourth, with respect to Brazil's circumvention arguments, Brazil continues to insist that notwithstanding the myriad programmatic impediments to issuance of guarantees the export credit guarantee programmes are a runaway train, beyond the ability of CCC to "stem or otherwise control the flow of" CCC export credit guarantees. With respect, this is simply not so.

11. Similarly, in its oral statement, Brazil has increased the supposed annual mandatory minimum dollar amount of guarantees to $6.5 billion from $5.5 billion.[7] As the United States has previously observed, CCC has never remotely approached issuing any such fancifully large amount of export credit guarantees.[8]

## II. ACTIONABLE SUBSIDY ISSUES

12. The United States has reviewed Brazil's evidence and arguments underlying Brazil's actionable subsidy claims and found them lacking. We will not repeat our criticisms of fundamental errors in Brazil's legal interpretations. We do note that the evidence on the record does not demonstrate that US producers are unresponsive to market price signals, does not demonstrate significant price suppression in any "same market", does not demonstrate an increase in world market share, and does not demonstrate a threat of serious prejudice. Our comments today go principally to the consistency, or lack thereof, in Brazil's arguments.

A. BRAZIL HAS FAILED TO ESTABLISH ALL OF THE ELEMENTS NECESSARY TO ESTABLISH ITS SUBSIDIES CLAIMS

13. Consider the fundamental issue of identifying the subsidized product and the subsidy.

### 1. Brazil has not identified which products benefit from the subsidy

14. If Brazil cannot distinguish the benefit to cotton provided by a subsidy from the benefit to other products – that is, attribute the subsidy to the recipient's production – then it will lead to double-counting of the subsidy benefit. Recall the example the United States provided in the opening statement with respect to soybeans and cotton. If a producer grows both soybeans and cotton and receives a $1 payment not tied to the production of any crop, according to Brazil's approach, the *entire* $1 payment is attributed to and support for upland cotton. However, were Brazil to bring a dispute settlement proceeding against US support for soybeans (as was reported almost occurred roughly two years ago), under Brazil's approach, the entire $1 payment would *also* be support for soybeans. The same $1 payment cannot provide both $1 in benefit to cotton and $1 in benefit to soybeans – that's double-counting. Therefore, the payment must be attributed across the value of the recipient's production. As noted in the US further rebuttal submission, Brazil *would* attribute the value of the payment across all of a recipient's production for countervailing duty purposes.

[7] *Compare* Statement of Brazil - Second Panel Meeting (2 December 2003), para. 91, *with* Answer of Brazil to Panel Question 142 (October 27, 1993) paras. 95, 100.

[8] US Further Rebuttal Submission (18 November 2003), para. 201.

**2. Brazil has not quantified the subsidy benefit attributable to upland cotton**

15. If Brazil cannot properly quantify the amount of subsidy benefit to upland cotton producers, how can the Panel analyze the effect of the subsidy? Brazil cannot both claim that it need not quantify the benefit and at the same time argue that the subsidies provide $12.9 billion in aggregate support.

16. Similarly, if Brazil cannot properly identify the level of subsidization of the exported product, the Panel's analysis will be impacted. Again, Brazil cannot claim that it need not identify the subsidization rate and at the same time claim a 95 per cent subsidization rate over the 1999-2002 marketing year period.

**3. Brazil has not expensed the recurring payments at issue, contrary to its countervailing duty practice and inconsistent with its arguments in this dispute**

17. Finally, Brazil cannot both expense the *entire* amount of these subsidies it admits are "recurring" to the year for which the payment was received (for example, marketing year 1999) and *also* claim that the subsidy continues to exist in a later year in which new recurring subsidies are made (for example, marketing year 2002). That is, if the subsidy continues to exist in a later year, it *must* have been allocated to future production. Indeed, Brazil would expense these recurring payments for purposes of countervailing duties.

18. The Panel must demand consistency from Brazil. It is not enough for Brazil to say that those concepts are for countervailing duty purposes, not for serious prejudice purposes. We were not aware that the concept and definition of "subsidy" as used in Part III and Part V of the Subsidies Agreement were intended to have different meanings. In fact, there is nothing in the Subsidies Agreement to suggest that they should mean different things.

19. Brazil not only rejects the Subsidies Agreement Annex IV methodology with respect to these issues, and not only rejects its own countervailing duty methodology, but does not provide any rational method of approaching these issues. Brazil's approach results in dramatically inflated quantities of support and dramatically inflated levels of subsidization. The Panel should reject Brazil's unprincipled approach to subsidy identification issues.

B. BRAZIL'S APPROACH TO ITS SERIOUS PREJUDICE CLAIMS AND THE PEACE CLAUSE MUST BE CONSISTENT

20. Similarly, as indicated in the US opening statement, the Panel must demand consistency from Brazil between its arguments for purposes of serious prejudice and the Peace Clause. First, Brazil cannot rely on the *rate* of support in US. law and regulations for purposes of its threat and *per se* claims and *deny* their relevancy to the Panel's Peace Clause analysis.

21. Second, with respect to decoupled payments (such as direct payments), Brazil cannot attribute part of a decoupled payment to upland cotton producers and part to non-producers, and *simultaneously* claim that such decoupled payments are not non-product-specific support. They are non-product-specific support because they are (in the language of Article 1(a) of the Agreement on Agriculture) "support provided to agricultural producers in general" and because they are not (in the language of Article 1(a)) "support provided *for an agricultural product* in favour of the producers of an agricultural product". That is, Brazil has acknowledged that some recipients of, for example, direct payments are not producers of upland cotton; they are, rather, "producers in general". Under the Agreement on Agriculture, support (such as direct payments) cannot at the same time be both product-specific support and non-product-specific support. Thus, these payments would not form part of the Peace Clause (Article 13(b)(ii)) analysis.

22. Finally, it is clear that, under Brazil's approach, there can be *no* non-product-specific support for purposes of the Peace Clause. This results because a subsidy payment can always be traced to a final recipient and then can always be attributed to whatever products he or she produces. One problem with this result is that a Member can then have no certainty that it will be in compliance with the Peace Clause in any given year.

23. Consider a hypothetical: under Brazil's outlay approach to the Peace Clause, if a Member gave only decoupled support to producers, but in a given year all the recipients of the payment decided *only* to produce one commodity, the support (outlays) attributed to that commodity in that year could exceed the 1992 support level. But that would purely be a function of the recipients' decisions, not the decision of the United States. Brazil's approach therefore would rob Members of the ability to decide their support in a way to ensure conformity with Peace Clause requirements, and it must be rejected.

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**WORLD TRADE ORGANIZATION**

**WT/DS267/R/Add.2**
8 September 2004

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# UNITED STATES – SUBSIDIES ON UPLAND COTTON

## *Report of the Panel*

Addendum

This addendum contains the Annex I to the Report of the Panel to be found in document WT/DS267/R. Annexes A-H can be found in Add.1 and Annexes J-O can be found in Add.3.

# ANNEX I

## ANSWERS OF PARTIES TO THE PANEL'S QUESTIONS AND OTHER COMMENTS AND DOCUMENTS RECEIVED FROM PARTIES

# ANNEX I-1

## ANSWERS OF BRAZIL TO QUESTIONS POSED BY THE PANEL FOLLOWING THE FIRST SUBSTANTIVE MEETING OF THE PANEL

11 August 2003

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# TABLE OF CASES CITED

| Short Title | Full Case and Citation |
|---|---|
| *Brazil - Aircraft* | Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 20 August 1999 |
| *Brazil – Aircraft (21.5)* | Panel Report, *Brazil – Export Financing Programme for Aircraft. Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, , adopted 4 August 2000 |
| *Brazil – Aircraft (21.5)* | Appellate Body Report, *Brazil – Export Financing Programme for Aircraft. Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/AB/RW, adopted 4 August 2000 |
| *US – Shrimp (21.5)* | Panel Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products. Recourse to Article 21.5 by Malaysia*, WT/DS58/RW, adopted 21 November 2001 |
| *Canada – Aircraft (21.5)* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW, adopted 20 August 1999 |
| *Canada - Aircraft* | Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999 |
| *India – Patents (EC)* | Panel Report, *India – Patent Protection for Pharmaceutical and Agricultural Products*, WT/DS/79R, adopted 2 October 1998 |
| *Canada – Dairy* | Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R and WT/DS113/AB/R, adopted 27 October 1999. |
| *US - FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
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| *EC – Bed Linen (21.5)* | Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton – Type Bed Linen from India. Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003 |
| *Chile – Agricultural Products (Price Band)* | Appellate Body, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002. |
| *Canada – Aircraft II* | Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, adopted 19 February 2002. |

**LIST OF EXHIBITS**

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|---|---|
| Agricultural Assistance Act of 2003, in P.L. 108-7 | Exhibit Bra-135 |
| P.L. 106-113 | Exhibit Bra-136 |
| P.L. 106-224 | Exhibit Bra-137 |
| P.L. 107-25 | Exhibit Bra-138 |
| 68 Federal Register 20331, 20331-20332 | Exhibit Bra-139 |
| Pindyck, Robert S. and Rubinfeld, Daniel L., Microeconomics, 5 Edition (2002), Prentice hall, New Jersey. | Exhibit Bra-140 |
| 7 U.S.C. 5622 | Exhibit Bra-141 |
| Agricultural Outlook, USDA, May 2002 | Exhibit Bra-142 |
| Agricultural Statistics 2003, USDA | Exhibit Bra-143 |
| G/AG/R/31 | Exhibit Bra-144 |
| US and State Farm Income Data, (United States and States 1997-2001), USDA | Exhibit Bra-145 |
| Acreage, NASS, 28 June 2002 | Exhibit Bra-146 |
| Estimate of Support Granted by Commodity via Counter-Cyclical Payments. Agricultural Prices | Exhibit Bra-147 |
| Statement of Administrative Action | Exhibit Bra-148 |
| Agricultural Outlook, USDA, August 2002 | Exhibit Bra-149 |
| G/AG/N/USA/10 | Exhibit Bra-150 |
| "US Export Credit Guarantee Programs: What Every Importer Should Know About the GSM-102 and GSM-103 Programs", USDA, November 1996. | Exhibit Bra-151 |
| GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, "Status Report on GAO's Reviews of the Targeted Export Assistance Program, the Export Enhancement Program, and the GSM 102/103 Export Credit Guarantee Programs," GAO/T-NSIAD-90-53, 28 June 1990. | Exhibit Bra-152 |

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| US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report N° 06401-14-FM, June 2001 | Exhibit Bra-153 |
| US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report N° 06401-4-KC, February 2002. | Exhibit Bra-154 |
| US Department of Agriculture Foreign Agricultural Service, "Notice to GSM – 102 and GSM – 103 Programme Participants", 24 September 2002 | Exhibit Bra-155 |
| US Export-Import Bank, "Comparison of Major Features of Programs Offered by Ex-Im Bank and Commodity Credit Corporation for Support of Bulk Agricultural Commodities" | Exhibit Bra-156 |
| US General Accounting Office, Report to the Chairman, Task Force on Urgent Fiscal Issues, Committee on the Budget, House of Representatives, "International Trade: Iraq's Participation in US Agricultural Export Programs", GAO/NSIAD-91-76, November 1990 | Exhibit Bra-157 |
| US Department of Agriculture, Office of Inspector General, Financial and IT Operations Audit Report, "Commodity Credit Corporation's Financial Statement for Fiscal Year 2002", Audit Report N° 06401-15-FM, December 2002 | Exhibit Bra-158 |
| US General Accounting Office, Report to Congressional Requesters, "Loan Guarantees: Export Credit Guarantees Programs' Costs are High", GAO/GGD-93-45, December 1992 | Exhibit Bra-159 |
| US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, "Agriculture Financial Standards Manual (May 2003) | Exhibit Bra-160 |
| US Federal Accounting Standards Advisory Board, Federal Financial Accounting and Auditing Technical Release 3, "Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act", 31 July 1999. | Exhibit Bra-161 |
| Government – Wide Audited Financial Statements Task Force on Credit Reform, "Issue Paper, Model Credit Programme Methods and Documentation for Estimating Subsidy Rates and the Model Information Store", 96-CR-7, 1 May 1996 | Exhibit Bra-162 |
| Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002 | Exhibit Bra-163 |
| US Department of Agriculture, Foreign Agricultural Service, "Revised FY 2001 and FY 2002 Annual Performance Plan". | Exhibit Bra-164 |

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| US Department of Agriculture, Foreign Agricultural Service, "Revised FY 2000 and FY 2001 Annual Performance Plan". | Exhibit Bra-165 |
| US Department of Agriculture Foreign Agricultural Service, News Releases regarding extension of GSM 102 and GSM 103 guarantees to Dominican Republic, Morocco, Ghana, South Korea, Vietnam and Algeria | Exhibit Bra-166 |
| 12 Steps to Participating in the USDA Supplier Credit Guarantee Program, Step 5. | Exhibit Bra-167 |
| US Department of Agriculture Foreign Agricultural Service, News Releases regarding extension of SCGP guarantees to Tunisia, Azerbaijan, Vietnam, South Korea, Japan and Nigeria | Exhibit Bra-168 |

A. UPLAND COTTON

**1. Please confirm that all information and data that you have provided to the Panel relating to "cotton" in fact relates to upland cotton only. BRA, USA**

Brazil's answer:

1. Brazil can confirm that, except as explicitly stated otherwise, all the data and references made by Brazil to "cotton" relate and will relate to "upland cotton" only.

B. PRELIMINARY ISSUES

*Note to parties: As indicated in the cover note, the Panel has expressed its views in respect of the three United States requests for preliminary rulings. The Panel's questions reflected in this compilation relating to the requested preliminary rulings on which the Panel has expressed its views are those that were posed in the course of the first session of the first Panel meeting. This is to give an opportunity for the parties to transpose into writing their oral responses.*

**1. Product scope of Panel's terms of reference relating to Brazil's export credit guarantee claims**

**2. Is Brazil's claim in relation to export credit guarantees against the measures said to constitute the GSM-102, GSM-103 and SCGP programmes in their entire application, or against the measures said to constitute the GSM-102, GSM-103 and SCGP programmes in their application to upland cotton, or both? BRA**

Brazil's answer:

2. Brazil confirms that its claims against GSM 102, GSM 103 and SCGP concern the programmes in their entirety and are *not* limited to their application to upland cotton.

**3. If the request for consultations in this dispute omitted certain products in relation to export credit guarantees, on what basis is it argued that it failed to identify the measures at issue in accordance with Article 4.4 of the DSU? USA**

**4. Is it argued that the export credit guarantee programmes concerning upland cotton are each a separate or independent measure, in that they operate independently? USA**

**5. Is there a specification in any legislation or regulation (or any other official government document) which limit or restrict the export credit guarantee programmes at issue exclusively to upland cotton? USA**

**6. For the purposes of the Panel's examination of Brazil's claims relating to GSM-102, GSM-103 and SCGP under the Agreement on Agriculture and the SCM Agreement, is accurate data and information available with respect to these export credit guarantee programmes concerning upland cotton alone (e.g. with respect to "long-term operating costs and losses")? In this respect, the Panel also directs the parties' attention to the specific questions below relating to the programmes. USA**

**7. Are commitments with respect to export subsidies under the Agreement on Agriculture commodity-specific? How, if at all, is this relevant? BRA, USA**

Brazil's answer:

3. Under Articles 3.3 and 8 of the Agreement on Agriculture, a Member can only grant export subsidies for agricultural products if that Member has an export subsidy reduction commitment for the agricultural product in question. The commodity specific aspect becomes relevant in Step 2 and ETI export subsidies because the United States scheduled no reduction commitments for upland cotton. In the case of the export credit guarantee programs challenged by Brazil, the commodity specific aspect becomes relevant only after the Panel has found that export credit guarantees are export subsidies within the meaning of the Agreement on Agriculture. At that stage, the Panel needs to examine whether (a) for the group of *unscheduled* commodities, which includes upland cotton, and (b) for each of *scheduled* commodities, there is a threat of circumvention of the US export subsidy reduction commitments. Brazil has set forth its arguments that GSM 102, GSM 103 and SCGP violate Article 10.1 of the Agreement on Agriculture for both scheduled and unscheduled commodities in paragraphs 295-305 of its First Submission.

4. The commodity-specific nature of export subsidy reduction commitments is, however, irrelevant for determining whether GSM 102, GSM 103 and SCGP in their application to all eligible products are within the Panel's terms of reference.

**8. Does the United States confirm that the questions referred to by Brazil in paragraph 92 of Brazil's oral statement were posed to the United States in the consultations? USA**

**9. How does the United States respond to paragraph 94 of Brazil's oral statement? USA**

**10. What actual prejudice, if any, has the United States suffered as a result of the alleged omission of products other than upland cotton from the request for consultations? USA**

**11. Does the United States agree that Brazil's request for establishment of the Panel can be understood to indicate that Brazil's export credit guarantee claims relatesto products other than upland cotton? How, if at all, is this relevant? USA**

**12. Please address issues and submit evidence regarding the three export credit guarantee programmes concerned relating to upland cotton and other eligible agricultural commodities in your answers to questions and rebuttal submissions. BRA, USA**

Brazil's answer:

5. Brazil has presented its arguments and evidence concerning the three export credit guarantee programmes always with respect to all eligible agricultural commodities[1] and will continue to do so in its answers to these questions and in future submissions to the Panel.

**13. Please include any argumentation and evidence to support your statement during the Panel meeting that the inclusion of such other eligible agricultural commodities would create additional "work" for the Panel with respect to each of these commodities under Article 13 of the Agreement on Agriculture. USA**

[1] *See* paragraphs 252-314 of the First Submission of Brazil and paragraphs 116-133 of the Oral Statement of Brazil.

**2. Expired measures**

**14. Please submit evidence regarding the programmes under the 1996 FAIR Act, in particular, production flexibility contract payments and market loss assistance payments, to the extent that they would be relevant to the Panel's determination under Article 13 of the Agreement on Agriculture in your answers to questions and rebuttal submission. USA**

**15. Do the parties agree that it is beyond a Panel's power to recommend a remedy for an expired measure? Could the Panel could be required to examine "expired measures" in order to conduct its assessment of the matter before it? How, if at all, is Article 7.8 of the SCM Agreement relevant to these matters? BRA, USA**

Brazil's answer:

6. The Panel must examine any continuing effects of subsidies provided by expired measures, and it can recommend a remedy for any such continuing effects. Brazil has set forth its arguments in that respect in paragraphs 4-7 of its Closing Statement at the First Substantive Meeting of the Panel with the Parties, as well as in paragraphs 141-144 of its Oral Statement at the same meeting. Subsidies provided under expired subsidy measures can be the source of present adverse effects. Preventing a panel from examining expired measures in its assessment of the matter before it would render the adverse effects provisions of the SCM Agreement a nullity, as a Member would be freed from any responsibility for the effects of its subsidies by, for example, simply letting the legislation expire and renewing it every year (or in even shorter periods). The Panel is, thus, required to analyze the effects of subsidies provided by production flexibility contract ("PFC") payments and market loss assistance payments in its assessment of Brazil's adverse effects claims. Disregarding those payments would not enable the Panel to conduct "an objective assessment of the matter before it", as it would disregard a source of present adverse effects.[2]

7. Article 7.8 of the SCM Agreement offers the Panel the possibility to recommend a remedy for the adverse effects from subsidies provided by expired measures. Under Article 7.8, a Panel can recommend that a Member withdraw the adverse effects of the expired measures. By virtue of DSU Appendix 2, Article 7.8, not DSU Article 19, provides the basis for remedies involving claims under Articles 5 and 6 of the SCM Agreement. In making recommendations under such claims, the Panel is not limited to a recommendation that a Member bring its measures into conformity with a covered agreement. Rather, a Panel finding adverse effects caused by a Member's actionable subsidies must recommend that the Member withdraw the subsidy or remove the adverse effects.

8. In sum, the Panel is required to objectively assess the present effects of PFC and market loss assistance payments on US production, US exports and prices of upland cotton. If it finds that these subsidies cause adverse effects within the meaning of Articles 5 and 6 of the SCM Agreement – as Brazil believes the Panel will find based on the arguments and evidence to be presented by Brazil on 9 September 2003 – the Panel should recommend that the United States remove the adverse effects pursuant to ASCM Article 7.8.

**3. Agricultural Assistance Act of 2003**

**16. What, if any, prejudice in terms of the presentation of its case does the United States allege, should the Panel proceed to consider the measures constituting the cottonseed payments under the Agricultural Assistance Act of 2003? USA**

[2] The analysis in this paragraph is relevant to the first paragraph of Brazil's Answer to Panel Question 19.

**17. (a) What is the relationship of the Agricultural Assistance Act of 2003 to other legislation in the request for establishment of the Panel? BRA, USA**

**(b) Do the legal instruments follow directly one after another, or are there temporal gaps? Are payments authorized under a broad legislative authority or are they specific to each legal instrument? BRA, USA**

**(c) Please provide any implementing regulations. Do these implementing regulations resemble those relating to previous programmes or payments? Are payments made retrospectively? How if at all is this relevant? BRA, USA**

Brazil's answer:

9. Cottonseed payments for MY 2002, as with the previous cottonseed payments in MY 1999 and 2000, were authorized by annual appropriations acts involving a variety of other legislative provisions that do not relate to cottonseed payments.[3] Public Law 106-113, inter alia, appropriated funds otherwise unused for assistance to producers or first-handlers of the MY 1999 crop of cottonseed.[4] The United States indicated in consultations that $79 million had in fact been used for that purpose. Public Law 106-224, inter alia, appropriates $100 million for assistance to producers and first-handlers of the MY 2000 crop of cottonseed.[5] Public Law 107-25, inter alia, added an appropriation of $84.7 million for assistance to producers and first-handlers of the same MY 2000 crop of cottonseed.[6] No cottonseed payments were authorized for MY 2001. The Agricultural Assistance Act of 2003, inter alia, appropriated cottonseed payments for the 2002 crop in the amount of $50 million.[7]

10. None of these statutory provisions contains any guidance on how USDA was to implement the cottonseed payments. Eligibility, administration, application and payment rates and details are all provided for in regulations. Brazil has provided in Exhibit Bra-32 the regulations applicable to the MY 2000 crop of cottonseed. Regulations governing payments for the MY 2002 crop of cottonseed were issued on 25 April 2003 and are set forth in Exhibit Bra-139. Comparing these regulations with the regulations that implement 2002 cottonseed payments[8] demonstrates that both regulations are almost identical. In fact, the preamble to the 2002-crop regulations provides that "[p]revious 1999-crop and 2000-crop cottonseed programs were codified in 7 CFR part 1427. This rule follows the model set by those preceding programs."[9] Additionally the preamble to the regulations states:

> Presumably, Congress expected the old programme to serve as the model for the new programme provided for in the new legislation as no dissatisfaction was expressed.[10]

11. This evidence demonstrates that the Cottonseed Payment Programme in MY 2002 was a continuation of the Cottonseed Payment Programme with respect to MY 1999 and 2000. The Agricultural Assistance Act of 2003 appropriated new funds for the MY 2002 crop to the existing programme (after no such appropriations took place for MY 2001). The 2002 cottonseed payments provided for in the Agricultural Assistance Act of 2003 are "future measures implementing"[11] the

[3] Exhibit Bra-135 (Agricultural Assistance Act of 2003, in P.L. 108-7), Exhibit Bra-136 (P.L. 106-113), Exhibit Bra-137 (P.L. 106-224) and P.L. Exhibit Bra-138 (107-25).
[4] Exhibit Bra-136 (Section 104 of P.L. 106-113).
[5] Exhibit Bra-137 (Section 204(e) of P.L. 106-224).
[6] Exhibit Bra-138 (Section 6 of P.L. 107-25).
[7] Exhibit Bra-135 (Section 206 of P.L. 108-7).
[8] Exhibit Bra-139 (68 Federal Register 20331).
[9] Exhibit Bra-139 (68 Federal Register 20331, p. 20331).
[10] Exhibit Bra-139 (68 Federal Register 20331, p. 20332).
[11] Brazil's Request For the Establishment of a Panel, WT/DS267/7, p. 2. *See* Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, paras. 135-136 and 144.

existing (but unfunded) Cottonseed Payment Program, which formed part of the request for consultations and which has been consulted upon. The MY 2002 cottonseed payments are therefore within the terms of reference of this Panel and Brazil is entitled to challenge the adverse effects caused by these payments.

12. Finally, the Agricultural Assistance Act of 2003 appropriated $50 million in cottonseed payments expressly for the MY 2002 crop. Payments will be made after the United States has received all applications and has calculated the payment rate.[12] Since, payments are made after the 2002 crop has been harvested, payments can be considered to be made retrospectively. Yet, irrespectively of when the payments are made and irrespective of the Panel's decision whether they form part of the Panel's terms of reference, they are made in respect of MY 2002[13] and, therefore, these payments should be included in the calculation of the MY 2002 support to upland cotton for purposes of the test under Article 13(b)(ii) of the Agreement on Agriculture.

**18. If the Panel is correct in understanding that cottonseed payments are divided between processors and producers, how is this reflected in Brazil's calculations? BRA**

Brazil's answer:

13. Brazil has included the full amount of cottonseed payments in its peace clause calculations for MY 1999, 2000 and 2002 because cottonseed payments constitute support to upland cotton. This approach is consistent with the United States' notifications of these payments as product-specific support to upland cotton in its notification of domestic support for MY 1999.[14]

14. Brazil furthermore notes that the full amount of cottonseed payments is available to stimulate production and distort trade. Including the full amount of cottonseed payments is also consistent with basic principles of microeconomics that the incidence of a tax or subsidy does not depend on where in the processing chain the tax or subsidy is applied. The production or consumption effects of a tax or subsidy depends on supply and demand elasticities and market conditions, but these market impacts do not depend on whether government checks are written in the name of farmers or initial processors.[15]

C. MEASURES AT ISSUE

**19. The Panel notes that Brazil's panel request refers, inter alia, to alleged "subsidies" and "domestic support" "provided" in various contexts. Please specify the measures, in particular, the legislative and regulatory provisions, by number and letter, in respect of which Brazil seeks relief and indicate where each is referred to in the panel request. BRA**

Brazil's answer:

15. Brazil's Request for Establishment of a Panel ("Panel Request") challenges two types of domestic support "measures" provided to upland cotton and various different types of export subsidy measures. The first type of domestic support "measure" is the payment of subsidies for the production and use of upland cotton. These payments were and continue to be made between MY 1999 to the present (and will be made through MY 2007) through the various statutory and regulatory instruments listed on pages 2-3 of Brazil's Panel Request. Brazil referred to these payments at pages 2-3 of the Panel Request as "subsidies and domestic support provided under" or "mandated to

[12] Exhibit Bra-139 (7 CFR 1427.1107-1110 as provided in 68 Federal Register 20331, p. 20333).
[13] *See* Brazil's answer to Question 34.
[14] *See* Exhibit Bra-47 (G/AG/N/USA/43, p. 20).
[15] Exhibit Bra-140 (Pindyck, Robert S. and Rubinfeld, Daniel L. , *Microeconomics*, 5th edition (2002), Prentice Hall, New Jersey, p. 313-317).

be provided" under the various listed statutory and regulatory instruments. Brazil has tabulated the different types of payments (i.e., the measures) made under these legal instruments in paragraphs 146-149 of its First Submission. Brazil's "Further Submission" on 9 September 2003 will provide considerable detail concerning the effects of the subsidies provided and mandated to be provided by the United States. It is these effects in respect of which Brazil seeks relief with respect to the first type of domestic support measures.

16. A second type of domestic support "measure" challenged by Brazil are legal instruments as such. The "legislative and regulatory provisions, by number and letter, in respect of which Brazil seeks relief" are those involving the 2002 FSRI Act and the 2000 Agricultural Risk Protection Act and in particular the following:[16]

- **Marketing loan/loan deficiency payments:** Sections 1201(a)-(b), 1202(a)(6), 1202(b)(6), 1204(b), 1205(a)(1), 1205(b), 1205(c)(1), 1608 of the 2002 FSRI Act and 7 U.S.C. 7286 (Section 166 of the 1996 FAIR Act as amended) and 7 CFR 1427.22 to the extent that these provisions require the provision of marketing loan and loan deficiency payments for all production of upland cotton.

- **Counter-cyclical payments:** Section 1104(a)-(f)(1) of the 2002 FSRI Act and 7 CFR 1412.503.

- **Direct payments:** Section 1103(a)-(d)(1) of the 2002 FSRI Act and 7 CFR 1412.502.

- **Step 2 Domestic Payments:** Section 1207(a) of the 2002 FRSI Act and 7 CFR 1427.103, 7 CFR 1427.104(a)(1), 7 CFR 1427.105(a), 7 CFR 1427.108(d) requiring cotton user marketing certificate ("Step 2") payments to be made to domestic users of US upland cotton.

- **Crop Insurance payments:** Section 508(a)(8), 508(b)(1), 508(b)(2)(A)(ii), 508(b)(3), 508(e) and 508(k) of the 2000 ARP Act[17] mandating the provision or crop insurance policies to farmers, premium subsidies to farmers and reinsurance to insurance providers to the extent that these provisions apply to upland cotton. Section 516 providing for unlimited funding of the crop insurance programme to the extent that these funds are available to upland cotton producers

17. Finally, Brazil challenges three types of export subsidies provided by the United States. Regarding Step 2 export subsidies, the measure Brazil challenges is Section 1207(a) of the FSRI Act, and 7 CFR 1427.103, 7 CFR 1427.104(a)(2), 7 CFR 1427.105(a), and 7 CFR 1427.108(d) requiring cotton user marketing certificate ("Step 2") payments to be made to exporters of US upland cotton.[18] Brazil also challenges as a "measure" subsidies provided by Step 2 export programme as actionable subsidies.

18. Regarding Brazil's ETI Act claim, the measure challenged by Brazil is the FSC Repeal and Extraterritorial Exclusion Act of 2000, Public Law 106-519, 114 Stat. 2423 (2000), and in particular, Section 3 (entitled "Treatment of Extraterritorial Income"), which amends the US Internal Revenue

[16] These Acts are referenced on page 2 of Brazil's Panel Request (WT/DS267/7), and Brazil's *per se* claim regarding these Acts and the regulations is referenced at page 4 of Brazil's Panel Request.

[17] Page 2 of Brazil's Panel Request (WT/DS267/7) identifies the Agricultural Risk Protection Act of 2000.

[18] Page 2 of Brazil's Panel Request (WT/DS267/7) identifies the 2002 FSRI and the regulations in relation to Step 2 payments.

Code (IRC) by inserting into it a new Section 114, as well as a new Subpart E, which is in turn composed of new IRC Sections 941, 942 and 943.[19]

19. With respect to Brazil's export credit guarantee claims, the measures challenged by Brazil are the GSM 102, GSM 103 and SCGP programs as established and maintained by 7 U.S.C. 5622[20] and 7 CFR 1493.[21] Brazil challenges 7 U.S.C. 5622(a)(1) and (b),[22] which provide for the extension of export credit guarantees on terms better than those available on the marketplace. Furthermore, Brazil challenges the maintenance of the GSM 102, GSM 103 and SCGP programs at premium rates that are inadequate to cover the long-term operating costs and losses of the programs. Additionally, Brazil challenges the failure of 7 U.S.C. 5622 and 7 CFR 1493 to prevent circumvention (or the threat of circumvention) of the US export subsidy commitments under the Agreement on Agriculture. Brazil also challenges as a "measure" GSM 102, GSM 103 and SCGP export credit guarantees facilitating the production and export of US upland cotton as actionable subsidies and thereby causing adverse effects to the interests of Brazil.

D. ARTICLE 13(B): DOMESTIC SUPPORT MEASURES

**1. "exempt from actions"**

**20. In paragraph 8 of its initial brief (dated 5 June, 2003), the United States argued that the word "actions" as used in the phrase "exempt from actions" in Article 13 of the Agreement on Agriculture includes the "bringing of a case" and consultations. In paragraph 36 of its first written submission (dated 11 July, 2003), the United States stated as follows:**

> **"[P]rior to this point in the process, the DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause."**

**Is it the United States' understanding that the drafters used the phrase "exempt from actions" knowing that under the DSU it would not be possible fully to exempt "actions", as the United States interprets that term? USA**

**21. In US - FSC and US - FSC (21.5) the Appellate Body made findings under the SCM Agreement relating to export subsidies in respect of agricultural products without making a finding in respect of Article 13 of the Agreement on Agriculture. How is this relevant to the United States' interpretation of the phrase "exempt from actions" as used in Article 13? USA**

**2. "such measures" and Annex 2 of the Agreement on Agriculture**

**22. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture. BRA, USA**

[19] Page 2 of Brazil's Panel Request (WT/DS267/7) identifies the ETI Act.

[20] Exhibit Bra-141 (7 U.S.C. 5622) codifies the relevant provisions of the 1978 Agricultural Trade Act as amended, identified on page 2 of Brazil's Panel Request (WT/DS267/7).

[21] *See* Exhibit Bra-38 (7 CFR 1493). Pages 2 and 5 of Brazil's Panel Request (WT/DS267/7) identifies GSM 102, GSM 103, and SCGP programs.

[22] Exhibit Bra-141 (7 U.S.C. 5622) codifies the relevant provisions of the 1978 Agricultural Trade Act as amended, identified on page 2 of Brazil's Panel Request (WT/DS267/7).

Brazil's answer:

20. The meaning of the term "defined" in relation to "base period" is the period of time used to define the parameters ("indicate the extent"[23]) of the base period. The word "period" is defined as "a course or extent of time".[24] For example, the "defined" "base period" to determine the amount of upland cotton base acreage for the PFC (and market loss assistance) payments was the average planted and considered planted acreage during MY 1993-95.[25] The term "fixed" in relation to "base period" means that the "defined" base period cannot change or be updated. This is confirmed by the dictionary meaning of the term "fixed," which is "definitely and permanently placed or assigned; stationary or unchanging in relative position; definite, permanent, lasting."[26] In sum, a base period is first "defined" in terms of a period of time, and then that period remains definitely and permanently assigned.

**23. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. BRA, USA**

Brazil's answer:

21. Paragraph 6(a) requires Members to establish clearly defined eligibility criteria for a de-coupled direct payment measure. These eligibility criteria must be taken from "a" defined and fixed base period of time. Paragraph 5 of Annex 2 makes it clear that all of the subparagraphs of paragraph 6 apply to the same type of de-coupled income support. Thus, a de-coupled income support measure with "a" "fixed base period" must also comply with Annex 2, paragraphs 6(b), (c) and (d). These sub-paragraphs use the phrase "after the base period." Because Article 6(a) establishes that there can only be "a" (single) "fixed" base period for a particular de-coupled domestic support measure, the use of the term "the" in 6(b)-(d) refers back to "a" "fixed" base period established in Article 6(a). Thus, a de-coupled income support measure can have only one "fixed" base period.

22. The Panel is faced with the question whether a Member can make minor adjustments to a decoupled support measure, label it a new decoupled support measure and then update the base period. Guidance for this question is provided by the first part of Annex 2, paragraph 6(a), which sets out a transparency requirement that eligibility criteria for decoupled support measures be determined by "clearly-defined criteria". In assessing whether one decoupled income support measure is essentially the same as a replacement decoupled income support measure, the Panel could examine the eligibility criteria for each set of measures. If the structure, design, and eligibility criteria have not significantly changed between the original measure (containing the "fixed base period") and its replacement, then there is no basis for any updating of the "fixed base period".

23. The factual question the Panel must address in this case is whether the "direct payment" programme in the 2002 FSRI Act contains similar design, structure, and eligibility criteria as the "production-flexibility contract payments" for upland cotton in the 1996 FAIR Act. The clearest evidence that the direct payment programme is the direct successor to production flexibility contracts is found in Section 1107(b) of the 2002 FSRI Act. It provides as follows:

> If a producer receives all or any portion of the payment authorized for fiscal year 2002 under a production flexibility contract, the Secretary shall reduce the amount of

[23] The New Shorter Oxford English Dictionary, 1993 edition, p. 618 (definition of "define").
[24] The New Shorter Oxford English Dictionary, 1993 edition, p. 2163.
[25] *See* First Submission of Brazil, para. 46. *See* also Exhibit Bra-31 (7 CFR 1412.103) in connection with Exhibit US-3 (7 CFR 1413.7(c)).
[26] The New Shorter Oxford English Dictionary, 1993 edition, p. 962.

> the direct payment otherwise due the producer for the 2002 crop year under section 1103 by the amount of fiscal year 2002 payment received by the producer under the production flexibility contract.[27]

24. Trading PFC dollars for direct payment dollars makes perfect sense given the very close similarities in the eligibility criteria between PFC and direct payments reflected in the statutes and regulations governing each. This is best illustrated in the following table:

**Similarities of Production Flexibility Contract and Direct Payments**

| Eligibility Criteria | **Production Flexibility Contracts** | Direct Payments |
|---|---|---|
| **Payment contract** | Annual fiscal payment based on 7 year contract[28] | Annual payment based on annual contract[29] |
| **Eligible Recipients** | "Producers" who assume all or part of the risk of producing a crop[30] | Same[31] |
| **Contract Acreage (Base Acreage)** | MY 1993-95[32] | MY 1993-95 or MY 1998-2001[33] |
| **Programme crops** | 7 Crops[34] | Same plus soybeans, other oilseeds, and peanuts[35] |
| **Planting Flexibility and Restrictions** | Limitations on fruits and vegetables (wild rice added in 2000).[36] | Same.[37] |
| **Payment Yield** | Base yield same as deficiency payment base average MY 1981-85[38] | Same.[39] |
| **Cotton Payment** | Payment on 85% of base acres times base yield times 7.07 cents per pound[40] on average between 1999-2001 for upland cotton[41] | Payment on 85% of base acres times base yield times 6.67 cents per pound for upland cotton[42] |
| **Compliance conditions** | Abide by conservation compliance requirements[43] | Same. [44] |

[27] Exhibit Bra-29 (Section 1107(b) of the 2002 FSRI Act).
[28] Exhibit Bra-31 (7 CFR 1412.101 and 1412.103)
[29] Exhibit Bra-35 (7 CFR 1412.401)
[30] Exhibit Bra-31 (7 CFR 1412.202)
[31] Exhibit Bra-35 (7 CFR 1412.402)
[32] Exhibit Bra-31 (7 CFR 1412.103)
[33] Exhibit Bra-35 (7 CFR 1412.201)
[34] Exhibit Bra-31 (7 CFR 1412)
[35] Exhibit Bra-35 (7 CFR 1412.103)
[36] Exhibit Bra-31 (7 CFR 1412.206)
[37] Exhibit Bra-35 (7 CFR 1412.407)
[38] Exhibit Bra-31 (7 CFR 1412.103)
[39] Exhibit Bra-35 (7 CFR 1412.301 and 1412.302)
[40] Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50). Brazil notes that these payment rates were not statutory rates but resulted from the allocation of a fixed amount of budgetary outlays to holders of upland cotton base under the PFC programme in MY 1999-2001.
[41] Exhibit Bra-31 (7 CFR 1412.103)
[42] Exhibit Bra-35 (7 CFR 1412.502(e))
[43] Exhibit Bra-31 (7 CFR 1410.20)

25. For an upland cotton producer with upland cotton base in MY 2001 and MY 2002, the direct payments available in MY 2002 were based on the following four elements: (1) yield (the average of the farm for MY 1981-85), (2) base acreage for the farm (resulting from either MY 1993-95 or MY 1998-2001 production), (3) only 85 percent of base acres could receive payment, and (4) the payment rate of $0.0677 cents per pound (applied to base acreage x yield x .85). The production flexibility contract payment for that same upland cotton farmer in MY 2001 would have been based on (1) yield (the average for MY 1981-85), (2) base acreage resulting from MY 1993-95 production, (3) only 85 percent of base acres could receive payment, and (4) 5.99 cents per pound.[45] Thus, with the exception of the per pound payment rate – which increased under the 2002 FSRI Act – and the ability in 2002 to update base acreage, the payment formula was the same under both programmes.

26. In addition to these payment formula similarities, the eligibility criteria for an upland cotton producer in MY 2001 and MY 2002 are either identical or very similar under both programmes. For example, eligible recipients under both programmes are "producers," defined in each programme as "an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop".[46] The "producer" under each programme could not plant fruits, vegetables, tree nuts or wild rice without either a forfeiture of all payments or a reduction of payments.[47] And each "producer" under both programmes had to maintain the land in agricultural use and adhere to conservation requirements.[48]

27. In addition to the possibility to update the base acreage, another difference between the PFC and direct payment is the addition of three additional programme crops for purposes of the direct payment programme – soybeans, other oilseeds, and peanuts.[49] Further, instead of a single seven-year contract, annual contacts are entered into between USDA and "producers" who must demonstrate that they are eligible for payments based, *inter alia,* on demonstrating that they "share in the risk of producing a crop and are entitled to share in the crop available for marketing from the farm".[50] The final difference was to set fixed amounts of payments per pound that did not decrease over the six-year term of the 2002 FSRI Act. The 1996 FAIR Act based the payment rate on annual budgeted amounts and as the budgeted amounts declined, the payment rate declined.

28. None of these changes to the direct payment programme in any way changed the eligibility criteria, the design, or the structure of the production flexibility programme as it applied to upland cotton producers. For the typical upland cotton producer farming on upland cotton base acreage, the only thing that changed was that the producer received the option to *increase* payments by updating base acreage and obtained an *increased* payment rate. Given the identical nature of most aspects of the production flexibility contract payments and direct payments, there was no basis to change the "fixed base period" of marketing years 1993-1995 for the calculation of these direct payments.

29. In light of this evidence, the Panel is not faced in this case with the situation where a Member significantly changes the structure, design, and eligibility criteria of an older measure. For example, if a Member replaces an amber box domestic support measure with a green box measure, the structure

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[44] Exhibit Bra-35 (7 CFR 1412.203)

[45] Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50). Brazil notes that this payment rate was not a statutory rate but resulted from the allocation of a fixed amount of budgetary outlays to holders of upland cotton base under the PFC programme in MY 2001.

[46] Exhibit Bra-29 (7 CFR 1001(1) of the 2002 FSRI Act), Exhibit Bra-28 (Section 102(12) of the 1996 FAIR Act)

[47] Exhibit Bra-28 (Section 118 b(1) of the 1996 FAIR Act), Exhibit Bra-29 (Section 1106 b(3) of the 2002 FSRI Act).

[48] Exhibit Bra-31 (7 CFR 1410.20) and Exhibit Bra-35 (7 CFR 1412.203)

[49] Exhibit Bra-29 (Section 1101-1103 of the 2002 FSRI Act), Exhibit Bra-27 ("Side by Side Comparison of the 1996 and 2002 Farm Act, USDA).

[50] Exhibit Bra-29 (Section 1001(1) of the 2002 FSRI Act).

and eligibility criteria is likely to be sufficiently different to permit the establishment of a new "fixed" base period for the new measure. But replacing an older green box measure with a new alleged green box measure, which basically only updates the base period and thereby results in increased payments, violates the requirement of "a" "fixed" base period in Article 6(a).[51]

30. Finally, Brazil believes that Annex 3, paragraphs 9 and 11 provide contextual support for the requirement that "a" "fixed" base period for essentially the same measure should not be changed. For the purposes of calculating total AMS, Annex 3 establishes "a" "fixed" base period – 1986-1988 – for determining the reference price that serves as a basis for the formula approach to calculating AMS for price support measures. This base period could not be changed without eliminating the basis for calculating the total AMS and the required reductions in domestic support. Similarly, paragraphs 6(a) and 6(b) of Annex 2 require a fixed base period and prevent an updating of a base period for "green box" domestic support measures that remain essentially the same programme.

**24. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture? BRA, USA**

Brazil's answer:

31. As set out in Brazil's Answer to Panel Question 23, the answer is *never* if the replacement de-coupled direct payment measure has a comparable structure, design and eligibility criteria as the older de-coupled direct payment measure.

**25. Does the United States consider that there is any ambiguity in the term "type of production" as used in paragraph 6(b) of Annex 2 of the Agreement on Agriculture? USA**

**26. Can the United States confirm Brazil's assertions in paragraph 174 of its first written submission that the implementing regulations for direct payments prohibit or limit payments if base acreage is used for the production of certain crops? If so, can the United States clarify the statement in paragraph 56 of its first written submission that direct payments are made regardless of what is currently produced on those acres? Can the United States confirm the same point in relation to production flexibility contracts? USA**

**27. Does Brazil argue that any United States measure that does not comply with the fundamental requirement of paragraph 1 of Annex 2 of the Agreement on Agriculture is actionable independently of any failure of that measure to comply with the basic or policy-specific criteria in Annex 2? BRA**

Brazil's Answer:

32. Yes. A domestic support measure that does not meet the "fundamental requirement" of the first sentence of Annex 2, paragraph 1, cannot be considered to be properly in the "green box". In addition to the arguments at paragraphs 163-172 of Brazil's First Submission, Brazil provides additional rationale for this argument below.

33. The use of the words "fundamental requirement" in the first sentence of paragraph 1, Annex 2, demonstrates that the obligation contained in the sentence is separate and distinct from the obligation to meet the basic and policy-specific requirements set forth in Annex 2. The ordinary meaning of those words, in that context and in light of the object and purpose of the Agreement in Agriculture, support this interpretation.

[51] *See* First Submission of Brazil, paras. 177-181.

34. The ordinary meaning of "requirement" is "a thing required or needed, a want, a need; something called for or demanded; a conditions which must be complied with".[52] Interpreted in the context of paragraph 1, Annex 2, it means that having no, or at most minimal, trade-distorting effects or effects on production is a condition for a domestic support measure, which must be complied with, for exempting this domestic support measure from the reduction commitments.

35. The word "fundamental" qualifies the word "requirement". The ordinary meaning of the term "fundamental" is "going to the root of the matter; serving as the base or foundation; essential or indispensable".[53] The use of this adjective emphasizes and underscores that the requirement that a measure does not have trade-distorting effects or effects on production is *essential and indispensable* for a domestic support measure to be exempted from reduction commitments.

36. In sum, the ordinary meaning of a "fundamental requirement" is an "essential and indispensable condition that must be complied with". It follows that the fundamental requirement in the first sentence of Annex 2, paragraph 1 must be read as a stand-alone obligation and that it is untenable to relegate the obligation in the first sentence of Annex 2, paragraph 1 to a policy objective role that merely informs the rest of the Annex. Instead, it is a condition of central importance that all domestic support measures must meet in order to be exempted from reduction commitments. Its importance is such that it serves as the premise on which the basic and policy-specific criteria are predicated.

37. The principle of effective interpretation (*l'effet utile*), recognized by panels and the Appellate Body, requires that a treaty be interpreted to give meaning and effect to all the terms of the treaty. The first sentence of Annex 2, paragraph 1 of the Agreement on Agriculture, which imposes an obligation in clear and unequivocal terms, has to be accorded full meaning. Nothing suggests that recognizing the fundamental requirement as a stand-alone obligation would undermine or render inutile the obligation to conform to the basic and policy-specific criteria. To interpret the fundamental requirement as a policy objective that merely informs the rest of Annex 2 would detract from the unambiguous obligation that domestic support measures have no, or at most minimal, trade-distorting effects or effects on production.

38. The obligation to meet the fundamental requirement set forth in Annex 2, paragraph 1 is the overriding principle that determines whether a measure can be exempt from reduction commitments. The purpose of the disciplines on domestic support in the Agreement on Agriculture, made effective in part through the reduction commitments, is to eliminate trade and production-distorting effects of domestic support measures or permit these measures to only have at most minimal trade or production-distorting effects. Where a measure does not create trade-distorting effects or effects on production, the rationale for limiting the use of that support measure disappears. Conversely, where a measure *does* have trade-distorting effects or effects on production, it must be subject to reduction commitments, regardless of whether it complies with certain other basic or policy-specific criteria. To exempt a measure because a Member alleges that it is classified as a green box measure, despite having trade-distorting effects or effects on production, would be to accept a circular reasoning and would undoubtedly undermine the disciplines on domestic support measures.

39. Brazil has set forth the evidence demonstrating that production flexibility contracts and direct payments have more than a minimal effect on production and thus are inconsistent with the fundamental requirement of the first sentence of Annex 2, paragraph 1.[54] These production effects are not surprising given the fact that both PFC and direct payments limit payments based on the *type* of

[52] The New Shorter Oxford English Dictionary, 1993 edition, p. 2557.
[53] The New Shorter Oxford English Dictionary, 1993 edition, p. 1042.
[54] First Submission of Brazil, paras. 163-172; 183-191; First Oral Statement of Brazil, paras 50-54, 57-61; Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel 22 July 2003, paras. 20-28).

production. Further, the updating of the base acreage for the direct payment programme (which one third of all eligible US farms took advantage of to increase their base acres eligible to receive direct payments), created further production enhancing effects today (as well as in the future) as detailed by Professor Sumner in paragraphs 20-29 of his Statement at the First Meeting of the Panel on 22 July 2003.[55]

40. Brazil finally notes that if follows from the first sentence of Annex 2, paragraph 1 that any domestic support measures not complying with one of the basic or policy-specific criteria in Annex 2 is to be presumed to violate the fundamental requirement that it have no, or at most minimal, trade-distorting effects or effects on production. This conclusion holds regardless of the finding of the Panel on the character of the first sentence of Annex 2, paragraph 1 as a stand-alone obligation.[56]

**28. Please explain the meaning of the word "criteria" in Articles 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the Agreement on Agriculture have on the meaning of the preceding sentence? BRA**

Brazil's Answer:

41. Articles 6.1 and 7.1 reference "criteria" in general, without a specific mention of "basic criteria", or "policy-specific" criteria. To give meaning to the "fundamental requirement" of Annex 2, paragraph 1, the use of the word "criteria" must encompass all the rules, standards, or requirements established by Annex 2 as conditions for determining whether a domestic support measure can be exempted from reduction commitments. There is no basis, therefore, on which to exclude the fundamental requirement in Annex 2, paragraph 1 from the criteria that a domestic support measure must meet to be exempted from the reduction commitments.

42. Brazil further notes that, while Article 6.1 refers to "criteria set out in this Article", nowhere in the subsequent sub-paragraphs of Article 6 can the word "criteria" be found. This suggests that the term "criteria" as used in the Agreement on Agriculture cannot be interpreted in such a way as to limit its coverage to "basic criteria" or "policy-specific criteria" in Annex 2. The word "criterion" means "a principle, standard or test by which a thing is judged, assessed or identified".[57] It follows that the term "criteria" encompasses all standards and tests set up by the provisions in the Agreement on Agriculture and its Annexes to which Article 6.1 and 7.1 refer. This standards and tests include the fundamental requirement in the first sentence of Annex 2, paragraph 1.

43. The word "accordingly" does not (and cannot be read to) emasculate a "fundamental requirement". It introduces the related but distinct obligation to conform to the basic and policy-specific criteria. "Accordingly" is defined as "in accordance with the logical premise". It is also defined as "harmoniously, agreeably," or "in natural sequence,"[58] or "appropriate, fitting".[59] The word "accordingly" indicates that the "basic criteria" are derivative of the more fundamental obligation in the first sentence of that same paragraph. "Accordingly" simply explains that because it is a fundamental requirement that domestic support measures have no, or at most minimal, trade-distorting effects or effects on production, it is necessary that the measures also meet certain basic criteria. Thus, the "fundamental requirement" is a premise, and the "basic criteria" in the second sentence of Annex 2, paragraph 1 are in accordance – *i.e.*, not contrary – to that fundamental requirement. Because the first is a premise of the second, it is incorrect, indeed illogical, to say that the second sentence takes precedence, subsumes or subordinates the first more fundamental obligation.

[55] *See* Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).
[56] *See* First Oral Statement of Brazil, para. 21.
[57] The New Shorter Oxford English Dictionary, 1993 edition, p. 551.
[58] The New Shorter Oxford English Dictionary, 1993 edition, p. 15.
[59] The New Shorter Oxford English Dictionary, 1993 edition, p. 15.

**29. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the Agreement on Agriculture. USA**

**30. Do the parties consider that direct payments and production flexibility contract payments meet or met the basic criteria referred to in paragraph 1 of Annex 2 of the Agreement on Agriculture? BRA, USA**

Brazil's Answer**:**

44. The direct payments and production flexibility contract payments meet the first basic criteria in paragraph 1(a) of Annex 2. With respect to the second basic criteria, Brazil is not alleging that either of these two types of payments "have the effect of providing price support to producers".

**31. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? BRA, USA**

Brazil's Answer:

45. Yes. As explained in answer to Question 27 above, any domestic support measures that do not comply with the basic or policy-specific criteria in Annex 2 shall be presumed to violate the fundamental requirement in the first sentence of paragraph 1 of Annex 2 and must, therefore, be considered non green-box domestic support measures. This is true regardless whether the Panel concludes that the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation.

**32. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. USA**

**3. "do not grant support to a specific commodity"**

**33. According to the United States' interpretation of the word "grant", when can a Member claim that a measure is not exempt from action under Article 13(b)? What if the measure is enacted annually? Can the Member obtain a remedy in respect of that measure under the DSU? USA**

**(34) Does Brazil interpret the word "grant" as used in Article 13(b)(ii) of the Agreement on Agriculture to mean payment made in a specific year or payment made in respect of a specific year? BRA**

Brazil's Answer:

46. Brazil interprets the word "grant" to mean "payment made in respect of a specific year".[60]

**35. Does a failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? BRA, USA**

[60] *See* First Oral Statement of Brazil, para. 31 ("Thus, the neutral term 'decision' must be read consistently with 'grant.' In sum, a harmonious interpretation of 'decided' exists where the 'decision' is to fund marketing year 1992 non-'green-box' expenditures for a specific commodity.").

Brazil's Answer:

47. Yes. A failure of a Member's measures to meet in any given year the conditions of the peace clause lifts the entitlement to peace clause protection for the whole implementation period for all measures found to fail meeting the conditions of the peace clause. This conclusion applies to domestic support measures as well as export subsidies.

48. At the outset, Brazil would like to recall that the peace clause provides Members only limited protection from actionable and prohibited subsidy claims under the SCM Agreement and GATT Article XVI. Domestic support measures are only exempt from action under Articles 5 and 6 of the SCM Agreement and under GATT Article XVI:1, if the domestic support measures do not violate the Total AMS reduction commitments of a Member and if they do not grant support to a specific commodity in excess of that decided during the 1992 marketing year. Export subsidies are only exempt from actions under Articles 3, 5 and 6 of the SCM Agreement and GATT Article XVI, if they conform fully to the provisions of Part V of the Agreement on Agriculture.

49. The peace clause does not impose any positive obligations and can, thus, not be violated. It constitutes a right and defence of a Member that this Member may or may invoke. The *US – FSC* and *US – FSC (21.5)* dispute are examples of disputes, in which a Member has chosen not to invoke the peace clause defence. Brazil has demonstrated before, that the peace clause is in the nature of an affirmative defence.[61] Accordingly, a complaining party does not bear the burden of proof that the measures at issue do not meet the conditions of the peace clause.

50. Nothing in the text of Article 13 suggests that a Member, which foregoes its peace clause exemption for particular measures in one year during the implementations period, shall be entitled to claim peace clause exemption for those measures for other – earlier or later – years. Article 13 offers peace clause exemption for measures that "fully conform" to Article 6 and that do not "grant support" "in excess of" that decided during the 1992 marketing year, as well as for measures that "fully conform" to Part V of the Agreement on Agriculture. If measures fail to meet one of the relevant conditions in any year – be it the current year or an earlier year during the implementation period – those measures can no longer be considered to "fully conform" or to not "grant support" "in excess of". Consequently, those measures are not exempt from action.

51. Finally, Brazil notes that the Panel need not decide this issue due to the circumstances of the present case. Brazil has demonstrated that the United States' domestic support measures at issue in this dispute do not meet the conditions of the peace clause in any marketing year from MY 1999 to the present and that the US export subsidies also do not conform fully to Part V of the Agreement on Agriculture. Thus, none of the subsidies at issue in this dispute is entitled to exemption from actions pursuant to the peace clause.

**36. Does a failure by a Member to comply with Article 13(b) in respect of a specific commodity impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? BRA, USA**

Brazil's Answer:

52. No. In fact, this is one of the purposes of the word "specific" in Article 13(b)(ii) – to differentiate a specific commodity whose amount of support was greater than the amount of support in marketing year 1992 from other specific commodities whose support may not have exceeded the 1992 marketing year level.

[61] *See* First Submission of Brazil, para. 110-121, and First Oral Statement of Brazil, para. 5-11.

**37. In the United States' view, why did the drafters not use the exact term "product-specific" in Article 13(b)(ii)? USA**

**38. Given the fact that subsidies available for more than one product could have various effects on production, how does the United States demarcate between product-specific support and non-product specific support ? USA**

**39. If "such measures" in Article 13(b)(ii) refers to all those in the chapeau of Article 13(b), why are they not all included in the potential comparisons with 1992? In what circumstances can measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994? USA**

**40. In relation to which other provisions in the Agreement on Agriculture is it relevant to disaggregate non-product specific support in terms of specific commodities? BRA**

Brazil's Answer:

53. The Panel's question uses the phrase "non-product specific support", which is not defined explicitly in the Agreement on Agriculture. Therefore, before responding to this question, Brazil will set forth its understanding of what this term means and which measures at issue in this dispute fall within that definition.

54. "Aggregate Measurement of Support" and "AMS" are defined in Article 1(a) as the "annual level of support, expressed in monetary terms" (a) "in favour of the producers of the basic agricultural product" or (b) "non-product-specific support provided in favour of agricultural producers in general . . ." (emphasis added). Brazil notes that the ordinary meaning of the word "general" is "including, involving, or affecting all or nearly all the parts of a (specified or implied) whole."[62] The "whole" in the case of Article 1(a) of the Agriculture Agreement refers to agricultural producers of all or nearly all basic agricultural products covered by the Agreement on Agriculture. Because the universe of domestic support measures includes either "product-specific" or "non-product-specific" domestic support measures, it follows that any domestic support that is not provided "in favour of agricultural producers in general" is deemed to be "in favour of the producers of the basic agricultural product". Accordingly, the test for determining whether a domestic support measure is "non-product specific" for the purpose of calculating AMS is whether, as a factual matter, the measure provides support to "agricultural producers in general".

55. The United States has argued that Article 1(a) is useful context for interpreting the meaning of "support to a specific commodity".[63] However, the United States latches on to only the first part of Article 1(a), and ignores the "in general" qualification in the second part, which provides the essential meaning as to the scope of what is and is not "product-specific". Brazil notes that none of the measures it used to calculate the levels of support for purposes of Article 13(b)(ii) for MY 1992 or MY 1999-2002 could properly be deemed to be "non-product-specific" support as defined in Article 1(a) of the Agreement on Agriculture. And, as Brazil has previously argued, all of these measures are "support to" upland cotton within the meaning of Article 13(b)(ii).

56. With that introduction, the answer to the Panel's question is that Brazil is not aware of any provision of the Agreement on Agriculture requiring the dis-aggregation of support that is "provided in favour of agricultural producers in general", as discussed above. However, Brazil notes that Article 13(b)(ii) is a sui generis provision of the Agreement on Agriculture that does not use the phrases "AMS", "non-product specific" or "product-specific" support. Contrary to all of the other

[62] The New Shorter Oxford English Dictionary, 1993 edition, p. 1073.

[63] First Submission of the United States, para. 78; *See* also Closing Statement of the United States, para. 18 (ignoring "in general" language).

provisions of the Agreement on Agriculture, Article 13(b)(ii) alone addresses the process for disciplining domestic support provided to a specific commodity under Articles 5 and 6 of the SCM Agreement and Article XVI:1 of GATT 1994.

**41. What is the position of Brazil with regard to certain other domestic support measures not cited by Brazil that were notified by the United States as non-product-specific (e.g. G/AG/N/USA/43), some of which presumably deliver support to upland cotton (e.g. state credit programmes, irrigation subsidies etc). Why have budgetary outlays for such measures related to upland cotton not been included in the comparison of support with 1992? BRA**

Brazil's Answer:

57. Brazil did not include any other types of domestic support measures for MY 1992 or MY 1999-2002 in calculating peace clause amounts because no other measures appeared to meet the test of being non-green box "support to" upland cotton in Article 13(b)(ii). Similarly, these measures appear to meet the test of being provided "in favour of agricultural producers in general". None, of these other measures notified by the United States as non-product specific had any upland cotton specific link in terms of historic, updated, or present upland cotton acreage, present upland cotton production or prices, or upland cotton groups of insurance policies or any other specific upland cotton provisions. Further, the United States has not indicated in any documents that these state credit programmes, irrigation subsidies, etc. were not made available "in favour of agricultural producers in general". If the United States is able to provide such information, then it would be appropriate for the Panel to allocate such support to, inter alia, upland cotton. As detailed in Brazil's answer to Question 40, the United States was obligated to notify to the Committee on Agriculture and to allocate as "product-specific support" to upland cotton any domestic measure that did not provide support "in favour of agricultural producers in general. . .".

58. The only US domestic support measures that Brazil is aware of that would meet the test of being "support to upland cotton" are those that it listed for purposes of calculating the level of peace clause support in its First Written Submission.[64] In the view of Brazil, these non-green box domestic support measures are the measures that constitute "support to" upland cotton for the purpose of Article 13(b).

**42. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? BRA**

Brazil's Answer:

59. Brazil believes that the meaning would change. The deletion of the word "specific" would create some ambiguity. The ordinary meaning of the phrase "a commodity" is "a thing that is an object of trade, esp. a raw material or agricultural crop". Therefore, the meaning of a commodity is rather broad and could for instance refer to "grains".[65] While the term "grains" may refer to "a commodity," it cannot connate "a specific commodity". Specific commodities that make up the commodity "grains" would be wheat, barley, oats, rice etc. Thus, the use of the term "specific commodity" clarifies that the subject of Article 13(b)(ii) is support to specific, i.e., individual, commodities and that this provisions does not deal with groups of individual commodities such as grains.

[64] First Submission of Brazil , paras. 144, 148, 149.

[65] Also Annex 1 of the Agreement on Agriculture refers to some broad commodity categories such as "animal hair" and "essential oils." These would cover several specific commodities such as specific types of animal hair, or specific essential oils like jasmin oil or peppermint oil.

60. Further, the phrase "a specific commodity" also makes it clearer that the "commodity" at issue is equivalent to the "like product" as defined, inter alia, in the SCM Agreement. This parallel construction of the term "specific commodity" and "like product" is consistent with the fact that the peace clause provides a conditional exemption from Articles 5 and 6 of the SCM Agreement and Article XVI:1 of GATT 1994 – which require the examination of effects of subsidies on products "like" those receiving the subsidies.

**43. What are the precise differences between deficiency payments and counter-cyclical payments that lead you to classify the former as product-specific and the latter as non-product specific? How do you classify market loss assistance payments? USA**

**44. Do you allege that counter-cyclical payments could be considered product-specific? BRA**

Brazil's Answer:

61. Brazil notes its discussion of "non-product specific" and "product-specific" support in its Answers to Questions 40-41. For the purpose of calculating AMS, counter-cyclical payments (CCP) are "product-specific" support for two main reasons: (i) they are not "support provided in favour of agricultural producers in general", and (ii) they are directly linked to upland cotton-specific parameters (current prices and historical acreage and yield). Indeed, when the US 2002 FSRI Act was examined by the WTO Committee on Agriculture, the European Communities agreed with Brazil that CCP payments could not be considered "non-product-specific" support.[66] New Zealand has taken a similar view in its Third Party Submission in this dispute.[67]

62. Brazil has provided extensive facts that upland cotton producers receive CCP payments as support to upland cotton and that such payments are support to upland cotton for the purposes of Article 13(b)(ii). These facts also support a finding that CCP payments are "product-specific" support. Further, Brazil notes the following facts demonstrating that counter-cyclical payments (and direct payments) are not provided "in favour of agricultural producers in general", but are instead provided to only a fraction of US agricultural production:

- CCP payments are made to holders of upland cotton base acreage when US upland cotton prices fall below 65.73 cents per pound. Producers/holders of all other farm acreage in the United States do not receive CCP payments when US upland cotton prices received by US producers fall. In MY 2001, (non-updated) upland cotton base acreage represented 1.7 percent of total US farmland.[68]

- CCP payments for upland cotton (and direct payments) are received by holders of upland cotton base acreage, i.e. for land that grew upland cotton between 1998-2001 or between

[66] Exhibit Bra-144 (G/AG/R/31, para. 30) ("Brazil would not accept [CCP] classification as 'non-product-specific payment'."); para 31 ("The EC also shared Brazil's analysis on how the counter-cyclical payments should be classified and pointed to US insurance programmes as not being properly classified at present").

[67] Third Party Submission of New Zealand, para. 2.24 ("Accordingly, New Zealand considers that the United States incorrectly categorizes CCP payments as non-product specific support.").

[68] In MY 2001, total US farmland was 959.163 million acres (*See* Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6). Average US upland cotton base acreage for MY 1997-2001 was 16.3 million acres (*See* Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, Table 19). Brazil has requested the United States to provide information on updated base acreage for the CCP and direct payment programme in questions during consultations and in the Annex V proceedings. Brazil has not received that information and, therefore, uses 16.3 million acreage as a proxy for the direct payment base acreage noting that USDA reports that more than 99 percent of eligible acreage signed up for the CCP and direct payment programme (Exhibit Bra-44 ("Direct Payment and CCP Enrollment Report," USDA, 19 June 2003).

1993-1995. USDA reported in 2001 that the 1997 census showed there were 31,500 upland cotton farms. Assuming no increase in the number of US upland cotton farms since 1997, this represents 1.46 percent of all farms in the United States.[69]

- Upland cotton cash receipts as a percentage of total cash receipts from all agricultural commodities was 2.5 percent in MY 1999, 2.35 percent in MY 2000, and 3.05 percent in MY 2001.[70]

- The 10 "programme" crops in the CCP (and direct payment) programme represented only 23.49 per cent of total farm cash receipts from all agricultural commodities on average between MY 1997-2001.[71]

- The base acreage of the 10 "programme" crops in the CCP (and direct payment) programme represented only 30 percent of total US farm acreage in MY 2001.[72]

- In MY 2002, CCP payments to holders of upland cotton base acreage represented approximately 80 percent – or $1.143 billion – of total CCP payments ($1.420 billion) for the ten eligible programme crops.[73]

- In MY 2002, no CCP payments were made to holders of 8 of the 10 eligible crops. In particular, holders of base acreage for barley, corn, grain sorghum, oats, soybeans, other oilseeds, and wheat received no CCP payments.[74]

- CCP base acreage receiving CCP payments in MY 2002 (upland cotton and rice base acreage) represented only 2.2 percent of total US farmland.[75]

- 90 percent of US acreage eligible to receive upland cotton CCP payments for upland cotton is located in only 10 out of 50 US states, with the top 5 US States accounting for 66 percent of US upland cotton production.[76] Thus, upland cotton CCP payments are focused on farms in a limited number of US States (i.e., the "cotton belt").

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[69] Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9-9). There were 2.155 million farms in the United States in 2001. USDA reported that in 1997, there were 31,500 farms that grew cotton. Exhibit Bra-46 ("Cotton: Background and Issues for Farm Legislation," USDA, July 2001, p. 2).

[70] Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 59). The calculations cited above were derived from comparing upland cotton cash receipts compared to total commodity cash receipts net of government payments.

[71] Exhibit Bra-145 (US and State Farm Income Data (United States and States 1997-2001), USDA, Table 5).

[72] Brazil does not have access to actual CCP base acreage figures. Therefore, Brazil has used MY 2001 figures as a proxy and relies on MY 2001 PFC base acreage for the 7 crops covered by PFC payments (Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 50) and has added MY 2001 soybean, peanut and other oilseed acreage (Exhibit Bra-146 (Acreage, NASS, 28 June 2002, p. 14, 15 and 17) (286.8 million acres). Total US farmland in 2001 was 959,163,331 million acres (Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6).

[73] Exhibit Bra-147 ("Estimate of Support Granted by Commodity via Counter-Cyclical Payments").

[74] Exhibit Bra-147 ("Estimate of Support Granted by Commodity via Counter-Cyclical Payments").

[75] Upland cotton and rice PFC base acreage represented 16.2 and 4.1 million acres (Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 50)). Brazil does not have any information on the effects of the base acreage update and, therefore, uses the PFC base acreage as a proxy for CCP base acreage. Total US farmland in 2001 was 959,163,331 million acres (Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6).

[76] Exhibit Bra-107 ("US and State Farm Income Data, Farm Cash Receipts," ERS, USDA, June 2003).

63. This evidence demonstrates that CCP (and direct payments) are provided to only a fraction of the producers of agricultural commodities in the United States and that payments are focused to producers of a limited number agricultural products. In view of these facts – particularly that upland cotton has its own "target price" of 72.4 cents per pound and accounted for 80 percent of all CCP payments in MY 2002 – it is appropriate for the Panel to consider only upland cotton statistics to conclude that these payments are "support to cotton" and are also "product-specific".

64. But even if the Panel relies on data regarding all 10 CCP programme crops, the evidence still demonstrates that CCP and direct payments are "support to cotton" and "product-specific" support because they are not provided to producers of US agricultural commodities "in general". Only around 30 percent of the farm acreage in the United States is farmed by producers with the possibility of receiving CCP payments.[77] In MY 2002, only 2.2 percent of total US farmland was eligible to receive CCP payments.[78] In light of these facts, it is not surprising that the EC correctly recognized in June 2002 that the US CCP programme does not represent a domestic support programme "provided in favour of agricultural producers in general".[79]

**45. If the Panel considered that Step 2 payments paid to exporters were an export subsidy, would the United States count them as domestic support measures for the purposes of Article 13(b)? Please verify Brazil's separate data for Step 2 export payments and Step 2 domestic payments in Exhibit BRA-69 or provide separate data. BRA, USA**

Brazil's Answer:

65. Brazil can verify that the Step 2 information its representatives received and that is tabulated in Exhibit Bra-69 was obtained from Wayne Bjorlie (wayne_bjorlie@wdc.usda.gov) in the Kansas City Commodity Office (KCCO) upon request for such data in December 2002.

**46. What is the relevance, if any, of the concept of "specificity" in Article 2 of the SCM Agreement and references to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture? BRA, USA**

Brazil's Answer:

66. The concept of "specificity" in Article 2 of the SCM Agreement is useful context in interpreting the meaning of "support to a specific commodity" in Article 13(b)(ii). As the United States recognized at the First Meeting of the Panel with the parties, the word "support" as used in the Agreement on Agriculture is a synonym for "subsidy".[80] The term "support to a specific commodity" has a similar meaning as "subsidized product," as used in, inter alia, Article 6.3(c) of the

[77] Brazil does not have access to actual CCP base acreage figures. Therefore, Brazil has used MY 2001 figures as a proxy and relies on MY 2001 PFC base acreage for the 7 crops covered by PFC payments (Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 50) and has added MY 2001 soybean, peanut and other oilseed acreage (Exhibit Bra-146 (Acreage, NASS, 28 June 2002, p. 14, 15 and 17) (286.8 million acres). Total US farmland in 2001 was 959,163,331 million acres (Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6).

[78] Upland cotton and rice PFC base acreage represented 16.2 and 4.1 million acres (Exhibit Bra-142 (Agricultural Outlook, USDA, May 2002, p. 50)). Brazil does not have any information on the effects of the base acreage update and, therefore, uses the PFC base acreage as a proxy for CCP base acreage. Total US farmland in 2001 was 959,163,331 million acres (Exhibit Bra-143 (Agricultural Statistics 2003, USDA, Table 9.6).

[79] Exhibit Bra-144 (G/AG/R/31, paras. 30-31).

[80] Brazil does not mean to imply that in the second phase of this proceeding it will not have the burden of demonstrating that each of the domestic support programs are "subsidies" within the meaning of the SCM Agreement.

SCM Agreement. Given the textual similarities between "subsidized product" and "support to a specific commodity", assessment of whether "support to a specific product" exists could be examined with at least some reference to the specificity criteria of Article 2 of the SCM Agreement. Article 2 of the SCM Agreement provides, in relevant part:

> 2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:
>
> (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.. . .
>
> (c) If, notwithstanding any appearances of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of the subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionally large amounts of subsidy to certain enterprises . . .
>
> 2.2 A subsidy which is limited to certain enterprises within a designated geographical region within the jurisdiction of the granting authority shall be specific.

67. The US Statement of Administrative Action ("SAA") describes in some detail how the United States intends to administer the specificity provisions, suggesting that the US Department of Commerce applies a low threshold for finding both "de jure" and "de facto" specificity:

> The Administration intends to apply the specificity test in light of its original purpose, which is to function as an initial screening mechanism to winnow out only those foreign subsidies which truly are broadly available and widely used throughout an economy.[81]

Brazil agrees with this statement that the "original purpose" of the specificity criterion is to make subsidies non-specific only when they are broadly available and widely used throughout an economy.

68. The ordinary meaning of the plural term "certain enterprises," as set out in the chapeau to ASCM Article 2.1, underscores that a subsidy can be specific even if it applies to a "group of . . . industries." The term "industry" is defined as "a particular form or branch of productive labour; a trade, a manufacture".[82] Thus, the text of the chapeau supports the notion that for a subsidy to be specific under the SCM Agreement it must be limited to a certain number of industries that may be involved in different trades or manufacturing processes.

69. The object and purpose of the specificity requirement in Article 2.1(a) of the SCM Agreement is consistent with a broad scope for specificity. One key purpose for the specificity requirement is to avoid the countervailability of those subsidies widely available in an economy, while at the same time ensuring that those subsidies that benefit some groups of industries or enterprises more than others are covered. As the United States noted in the SAA:

> The specificity test was intended to function as a rule of reason and to avoid the imposition of countervailing duties in situations where, because of the widespread

[81] *See* Exhibit Bra-148 ("Statement of Administrative Action," p. 929) (emphasis added).
[82] The New Shorter Oxford English Dictionary, 1993 edition, p. 1356.

> availability and use of a subsidy, the benefit of the subsidy is spread throughout an economy. Conversely, the specificity test was not intended to function as a loophole through which narrowly focused subsidies provided to or used by discrete segments of an economy could escape the purview of the CVD law.[83]

70. Therefore, the ordinary meaning, context and object and purpose of Article 2.1(a) of the SCM Agreement confirm that subsidies that are available to discrete segments of an economy or to only particular industries are specific. Under these standards, each of the subsidies challenged by Brazil in this dispute (and listed as support for the purposes of the peace clause analysis) are provided to "discrete segments" of the US economy. Indeed, they are provided to discrete segments of the sub-section of the US economy known as "agriculture". Thus, if the Panel were to apply the specificity standard set out in Article 2 of the SCM Agreement to Article 13(b)(ii) of the Agreement on Agriculture, the identified domestic support subsidies would be considered "specific".

71. Brazil notes that further support for the use of specificity concepts from the SCM Agreement in interpreting Article 13(b)(ii) of the Agriculture Agreement is found in the definition of "AMS" in Article 1(a) of the Agriculture Agreement. The definition of "non-product specific" support ("support provided in favour of agricultural producers in general") illustrates that the concept of specificity in the context of the SCM Agreement and of AMS in the Agreement on Agriculture are similar. Both would require a finding of specificity unless support is provided to an economy generally, in the case of the SCM Agreement, or to "producers" of agricultural commodities "in general," in the case of AMS under the Agriculture Agreement.

72. In contrast, the United States seeks to apply an extremely restricted concept of specificity to the peace clause that begins and ends with the question whether production of a specific commodity is required to receive the payment. This is one of the "policy-specific" criteria of a "green box" test in Annex 2, paragraph 6, but not the test of "support to a specific commodity" required by Article 13(b)(ii). Further, as demonstrated above, this narrow US interpretation finds no support in the provisions of the SCM Agreement and the Agreement on Agriculture that speak to specificity.

**4. "in excess of that decided during the 1992 marketing year"**

**47. Where does Article 13(b)(ii) require a year-on-year comparison? BRA, USA**

Brazil's Answer:

73. The text of Article 13(b)(ii) sets up a comparison between the "support" "grant[ed]" during the implementation period with support "decided" during the 1992 marketing year. Brazil cannot conceive of a methodology in which all support granted during the entire implementation period could be compared with the support decided during marketing year 1992. In order to generate an "apples to apples" ("support to support") comparison, it is necessary to compare the support granted in any marketing year during the implementation period with the support decided during marketing year 1992. No other reading of Article 13(b)(ii) would permit the required comparison.

74. Additionally, Brazil notes that the second condition for domestic support measures to be exempted from actions under the SCM Agreement is that a Member's domestic support measures conform fully to Article 6, and, thus, grant support within the limits of that Member's Total AMS reduction commitments. These Total AMS reduction commitments are made on a yearly basis. The nature of the reduction commitment and the manner, in which compliance with Article 6 is determined, demonstrates that Article 13(b)(ii) – read in accordance with its chapeau and the reference to Article 6 therein – requires a year-by-year comparison. The context of the chapeau provides support for Brazil's argument made above that the relevant comparison for Article 13(b)(ii)

[83] Exhibit Bra-148 (Statement of Administrative Action, p. 930).

involves a comparison of support granted in any of the marketing years during the implementation period with support decided in MY 1992.

75. Similarly, Article 13(c) provides further context to support the conclusion that Article 13(b)(ii) requires a year-by-year comparison. Brazil notes in its answer to Question 7, that export subsidy reduction commitments under the Agreement on Agriculture are made on a commodity-specific basis. Brazil has also pointed out in its answer to Question 79 that a violation of Part V of the Agreement on Agriculture, and the resulting loss of peace clause exemption, must also be assessed on a yearly basis.

**48. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made? BRA, USA**

Brazil's Answer:

76. The answer to the first question is yes, the text of Article 13(b)(ii) requires a comparison between the "support granted" for marketing years between 1995-2003 with the "support decided" in marketing year 1992. Brazil has explained in detail in its First Oral Statement the basis for this legal conclusion.[84]

77. The second question asks how the comparison must be made. Brazil is of the view that a harmonious interpretation of "support decided" with "support granted" requires an examination of the expenditures incurred for all of the support related to the 1992 marketing year and each of the marketing years during the implementation period ending 1 January 2004. This expenditure approach permits an objective, easily verifiable approach to compare the support for each of the two time periods. That is particularly important when, as in this case, there are a wide variety of programmes that do not provide support on a "cents per pound" basis to all production. Brazil does not consider that a comparison based on a "rate of support" approach as suggested by the United States allows the same objective and easily verifiable comparison. Professor Sumner explained the difficulty of comparing, on a "cents per pound" basis, deficiency payments, Step 2, marketing loans, and crop insurance provided in marketing year 1992 with the marketing year 1999-2002 measures that replaced or changed the 1992 measures.[85] Nevertheless, Professor Sumner was able, through a relatively complex methodology, to calculate and compare a level of support on a per pound basis between marketing year 1992 and marketing years 1999-2002.

78. Another methodology is the rate of support taking into account expenditures, as detailed in Brazil's answer to Question 60 infra. Brazil would note that a last methodology that would have been possible, had the text of Article 13(b)(ii) included the term "AMS," would be to calculate support based on the criteria set forth in Annex 3 of the Agriculture Agreement. The results of this calculation are set forth in Brazil's answer to Question 67 *infra*.

**49. Brazil claims that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? BRA**

[84] First Oral Statement of Brazil, para. 31.
[85] Exhibit Bra-105 (Statement of Professor Sumner at the First Meeting of the Panel).

Brazil's Answer:

79. Brazil set forth its interpretation of the terms "grant" and "decided" in its First Oral Statement.[86] Brazil concluded that the text, context, and object and purpose of Article 13(b)(ii) meant that the MY 1992 "decision" must be related to "support granted" in order to make possible the comparison between MY 1992 and marketing years during the implementation period. Yet, Brazil does not believe that the "decision" in marketing year 1992 means that all of the support had to be "granted" (i.e., paid) during the 12-month period of that single marketing year. Rather, the decision had to authorize payment in respect of a specific marketing year, including MY 1992.[87] However, a Member could have decided during the 1992 marketing year to budget a certain amount of support to specific commodities for the next several marketing years, including MY 1995 et seq. In that case, the relevant peace clause comparison would involve comparing the support granted to a specific commodity in any marketing year during the implementation period to what was decided during the 1992 marketing year to be provided for that later marketing year.

80. Brazil has cited the negotiating history of Article 13(b)(ii), which indicates that the EC insisted on the use of the word "decided" to obtain a safe harbour for the total quantity of its domestic support subsidies that it had already budgeted in marketing year 1992 for marketing year 1995 and thereafter.[88] Brazil will comment further, as required, on the intentions of the "drafters" following receipt of the answers of the European Communities and the United States.

**50. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) and, in particular, why both words "grant" and "decided" were used. USA**

**51. Could the United States please comment on the interpretation advanced by the EC, in paragraphs 16 and 18 of its oral statement, of the words "decided during the 1992 marketing year"? USA**

**52. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". BRA, USA**

Brazil's Answer:

81. Brazil agrees that in its proper context, the term "decided during" in Article 13(b)(ii) is synonymous with the words "authorized during". Brazil has set forth the reasoning and citations supporting this conclusion in its Answers to Question 49 supra and Question 58 infra, as well as in its First Oral Statement at paragraph 31.

**53. Assume, for arguments sake, that the only "decision" made in the United States in 1992 was the target price. How would Brazil make the comparison vis-à-vis, for example, the year 2001? BRA**

Brazil's Answer:

82. Brazil maintains that the relevant comparison under Article 13(b)(ii) is to compare expenditures incurred relating to MY 1992 with expenditures incurred relating to marketing years during the implementation period. Only this methodology allows for a comparison irrespective of the nature and characteristics of the domestic support measures provided and does not suffer from the

[86] First Oral Statement of Brazil, paras. 27-34

[87] Brazil and the United States appear to agree that MY 1992 is the relevant marketing year for purposes of this dispute.

[88] First Submission of Brazil, para. 140.

shortcomings of other approaches, on which Brazil will comment below. In particular only an expenditure incurred approach allows for an effective comparison in the following situation: Assume, a Member introduces a payment that is made at a fixed rate per pound and is paid for each pound of actual upland cotton production. In this situation, it would be difficult to compare this domestic support measure, which is completely unrelated to market prices to a domestic support measure decided by a Member in MY 1992 and which sets a target price and provides price support.

83. With this qualification in mind, Brazil's understanding of this question is that the assumed single "decision" was the establishment of a target price of 72.9 cents per pound for eligible US upland cotton production during MY 1992. The assumed single "decision" on a target price of 72.9 cents per pound comprised of many other sub-decisions on the mandatory acreage reduction programme, on the operation of the 50/92-programme option, and on optional flex acres, among others.[89] Professor Sumner has analyzed in detail the process through which such a target price of support could be compared to the support provided in MY 1999-2002.[90] For MY 1992, he found that the estimated per unit support rates for all programs was 60.41 cents per pound. For MY 2001, he found the per unit support rates for all programmes was 66.51 cents per pound. Brazil refers to Professor Sumner's detailed description of the methodology he used to make these calculations.[91]

84. The irrationality of the simplistic "72.9 is greater than 51.92" approach by the United States is revealed by comparing it with the results of Professor Sumner taking into account in the calculation of the "rate of support" eligibility criteria and the costs imposed by participation in the US upland cotton support programs. It is also demonstrated by comparing the expenditures in MY 1992 ($1.9 billion) with the expenditures in MY 2001 ($4 billion).

**54. Please identify all United States legal and regulatory and administrative instruments decided during the marketing year 1992, with the respective dates of decision, that decided support for upland cotton. BRA, USA**

Brazil's Answer:

85. Brazil will comment further upon receipt of the answer provided by the United States to this question. The United States obviously has access to records related to all the decisions taken by the United States concerning its support programs for MY 1992. However, Brazil notes that given its understanding of the operation of the US support programmes, the United States took a number of decisions with respect to the upland cotton support programmes for MY 1992.

86. Many of the US support programmes for MY 1992 were decided by Title V of the Food, Agriculture, Conservation and Trade (FACT) Act of 1990 (P.L. 101-624), which established US farm policy for the 5 crop years 1991/92-1995/96, and by the Omnibus Budget Reconciliation Act (OBRA) of 1990 (P.L. 101-508), which established several programme provisions in order to reduce programme costs. Brazil considers that among the decisions taken by the United States in relation to MY 1992 upland cotton support programmes were the following:

- Continuation of the upland cotton target price under the deficiency payment programme at the 1990 level of 72.9 cents per pound set by the 1990 FACT Act. The OBRA limited the maximum payment acreage at 85 percent of the crop acreage minus the acreage reduction programme requirement, which was set annually. Therefore, the United States had to take a decision with respect to the MY 1992 percentage of deficiency programme

[89] For a more thorough discussion of the decisions Brazil understands the United States has taken with respect to MY 1992, *see* Brazil's answer to Question 54.

[90] *See* Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).

[91] Annex 2 to Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).

base acreage that would be required to be set aside under the acreage reduction programme.

- In connection with the former, the United States also took a decision allowing producers to plant up to 25 percent of upland cotton acreage base, the so-called "flex acreage," to any commodity except fruits and vegetables and mung beans.

- Furthermore, the United States had to decide on how to implement the 50/92-programme option under the deficiency payment program.

- The United States also needed to determine the upland cotton acreage base for purposes of the deficiency payment programme, which for MY 1992 represents the previous three-year average of planted and considered planted upland cotton acreage.

- Concerning the deficiency payment program, the United States finally had to decide on the payment rate for upland cotton.

- Concerning the marketing loan programme, the United States had to take a decision setting the marketing loan rate for upland cotton.

- Furthermore, the United States had to establish a weekly "adjusted world price" and, thus, the repayment rate for marketing loans determining the rate of marketing loan gains or loan deficiency payments.

- Furthermore, the United States took a weekly decision in MY 1992 with respect to the Step 2 payment rate applicable for that week.

- Regarding crop insurance, the Federal Crop Insurance Act of 1980 was the authorizing legislation, but it was necessary to adopt decisions concerning individual insurance policies that would apply to upland cotton and to set the respective rates of premium subsidies.

87. While Brazil does not consider this list to be exhaustive, it gives the Panel an overview on the variety of decisions the United States had to take to make the support programme to upland cotton operational. Brazil looks forward to the answer provided by the United States and reserves its right to comment as appropriate.

**55. Please provide a copy of the instrument in which the rate of support for upland cotton during the marketing year 1992 was decided, indicating the date of the decision. USA**

**56. Could the United States please explain how support granted under legislation that dates back to 1990 can have been support "decided during the marketing year 1992"? USA**

**57. If the United States decided on a rate of support for MY1992, does that not mean that it decided on whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at that time? USA**

**58. Please comment on the argument advanced by the EC, in paragraph 17 of its oral statement that: "Had WTO Members intended a limitation to the support provided or granted in 1992 the word 'for' would have been used in place of 'during'." BRA**

Brazil's Answer:

88. Brazil agrees with the EC that the word "during" does not mean that all of the support need be provided or granted within the 12-month period of marketing year 1992. Rather, the decision must have been related to the amount of support to be granted in respect of marketing year 1992. This interpretation is consistent with an expenditure methodology that compares expenditures for upland cotton in respect of MY 1992 with expenditures for upland cotton in MY 1995-2003, and thereby permits a comparison of 1992 levels of support with levels of support in marketing years 1995-2003.

89. The negotiating history cited by Brazil in its First Submission indicates that the EC is in a special situation vis-à-vis the peace clause.[92] It apparently made the decision in marketing year 1992 to budget an amount of support for commodities for marketing years 1995-2000 in its CAP reform. Brazil agrees with the EC that Article 13(b)(ii) was "intended to set up as a benchmark an amount of support adopted by some form of decision (be it political, legislative or administrative) in which support for a specific product is decided . . ." But the EC qualifies this assertion with the notion that that decision can only be "allocated for future years."[93] This qualification would appear to be compelled by the EC's particular situation. But that situation does not justify the EC's conclusion that its "future years" concept means that Article 13(b)(ii) "clearly is not intended to set up a comparison between domestic support granted in 1992 and domestic support granted in a more recent period."

90. The notion of a "decision" suggests that individual Members each made some sort of a decision with respect to the peace clause. The United States and Brazil agree that the decision made by the United States – whatever it may have been – related to the level of support provided to upland cotton in MY 1992. Brazil's argument with the United States concerns the type of decision and the methodology that can be used to account for the level of support decided during MY 1992.

**59. Should the rate of support as indicated in Article 13(b)(ii) include the market price? If so, why is it appropriate to include it in the comparison under Article 13(b)(ii)? BRA, USA**

Brazil's Answer:

91. The most natural measure of support is budgetary expenditures, and these implicitly include market price in the sense that, for several US upland cotton programs, higher market prices lead to lower budgetary outlays. The US Government payments under the marketing loan, deficiency and counter-cyclical programs all decline with increasing market prices, as they cover the difference between the loan rate or the target price and the market price. Step 2 payments are also related to market prices in that they cover the difference between the A-Index and the lowest-priced US quote for upland cotton and, therefore, vary with market prices.[94] Incorporating the different degrees to which the market price influences the support provided by the US Government to its upland cotton farmers is best achieved by looking at the results in terms of budgetary outlays for the programs. This measure of support is straightforward to apply and allows a ready and accurate comparison between 1992 and subsequent marketing years.

92. Under the US approach and Professor Sumner's adaptation of the US approach, market prices enter the calculation of the "rate of support" in the sense that the expected rate of support from the loan rate and the target price per eligible unit of production includes revenue expected to be received from the market (expected market price) and revenue expected from the US Government (subsidies). The market price enters inversely in the sense that the outlay is inversely related to the market price, as for instance the loan rate benefits make up the difference between the loan rate and the adjusted

[92] First Submission of Brazil, para. 140.
[93] Oral Statement of the European Communities, 24 July, para. 18.
[94] Brazil notes, however, that the relationship between market price and level of Step 2 payments by the US Government is not as straightforward and positively correlated as for the other price-based programmes.

world price for the eligible share of production.[95] The higher the market price, the higher the resulting budgetary outlays.

93. Additionally, there is one further important reason why the notion of support in Article 13(b)(ii) should include the market price. Without reference to the market price, it is impossible to say what the rate of support means to farmers. It may be that the support is completely irrelevant, because market prices are much higher than the loan rate or the target prices set by the US Government. For instance, the loan rate was irrelevant for US upland cotton producers in MY 1994-1996,[96] because market prices were so high that no payments occurred. However, under essentially the same program, market loan benefits amounted to 26.6 cents per pound in MY 2001.[97] Thus, without taking market prices into account, it is impossible to translate a "rate of support" into actual support provided and to give meaning to the term "support."

**60. Can you provide information on support decided in 1992 and the years with which you believe it should be compared, on a per support programme / per unit of production / per annum basis? If possible, please specify how, if at all, budget outlays may be transposed into units of production, and which units of production are best to use. BRA, USA**

Brazil's Answer:

94. Brazil maintains that the appropriate measure of support decided during MY 1992 is total actual expenditures resulting from any decisions regarding support to upland cotton. This must then be compared to total actual expenditures for support to upland cotton for MY 1999, 2000, 2001 and 2002. Presenting expenditures as a "rate of support" per pound of upland cotton disguises the fact that US expenditures for upland cotton have increased considerably since MY 1992. This is due to the fact that the increased US expenditures are now spread over an also increased US production. Therefore, a "rate of support" based on budgetary outlays or expenditure understates the real increase in US support to upland cotton. However, even disregarding the underestimation of the amount spent for upland cotton by presenting the budgetary outlays in the form of support per pound of actual upland cotton production, the data presented below show that also this measurement demonstrates that the US support in MY 1999-2002 is higher in each year than it was in MY 1992.

95. In answering this question, and responding to the Panel's requests, Brazil presents the support provided by the various US support programmes for a given marketing year on a per pound of actual upland cotton production basis. This approach takes into account market prices. Thus, the "support level" from deficiency payments, from the marketing loan programme and from counter-cyclical and Step 2 payments no longer reflects the "target price" approach favoured by the United States, but reflects actual payments made per unit of actual production.

96. Brazil believes that the unit of production that should be used is a pound of upland cotton actually produced in the United States for that marketing year in question. US support programmes provide support based on actual production (marketing loan programme, Step 2 and cottonseed payments), actual acres planted (crop insurance), updated historical production and current prices (deficiency payments and counter-cyclical payments), historical production (PFC, market loss assistance), and finally, updated historical production (direct payments). The most natural comparison on a per unit basis is to use actual production. The US National Cotton Council also calculates the support provided by all of these programmes to its upland cotton producer members in "cents per pound" of actual production.[98] This reflects the reality that an upland cotton farmer

[95] Brazil notes that budgetary outlays have not been part of Professor Sumner's calculation of the rate of support provided by the marketing loan, deficiency payment and CCP payment program.

[96] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5-6).

[97] *See* Brazil's answer to question 60.

[98] Exhibit Bra-109; Exhibit Bra-111; Exhibit Bra-112.

seeking to remain in business must calculate whether the amount of government support plus market revenue compensates for the cost of production incurred by producing a pound of upland cotton.

97. Brazil arrives at the figures presented in the following table by dividing the total annual amount of budgetary outlays to upland cotton from a US support programme by the total amount of production of upland cotton in the relevant marketing year.

**Support Per Pound Of Upland Cotton By Year And Support Programme**

| Year<br>Programme | 1992 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| | ----- cents/pound ----- | | | | |
| Deficiency Payments[1] | 13.49 | none | none | none | none |
| PFC Payments[2] | none | 7.00 | 6.71 | 4.81 | none |
| Market Loss Assistance Payments[3] | none | 6.97 | 7.15 | 6.65 | none |
| Direct Payments[4] | none | none | none | none | 6.04 |
| Counter-cyclical Payments[5] | none | none | none | none | 12.43 |
| Marketing loan (Loan gains and LDP)[6] | 9.86 | 19.75 | 6.72 | 26.63 | 11.85 |
| Step 2 Payment[7] | 2.74 | 5.39 | 2.93 | 2.09 | 3.95 |
| Crop Insurance[8] | 0.35 | 2.17 | 2.00 | 2.79 | 2.42 |
| Cottonseed Payment[9] | none | 1.01 | 2.29 | none | 0.62 |
| **Total** | **26.44** | **42.29** | **27.8** | **42.97** | **37.31** |

Notes

[1] Deficiency payment per pound of actual production = deficiency payment expenditure / (total production [bales] * 480 [pounds/per bale]). Total deficiency payments in MY 1992 were $1.0174 billion, while total production was 15,71 million bales (Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4-6)). One bale equals 480 pound of upland cotton.

[2] PFC payment per pound of actual production = PFC payment expenditure for upland cotton base * (actual upland cotton acreage / PFC upland cotton base acreage) / (total production [bales] * 480 [pounds/per bale]). Total PFC payments to upland cotton are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). This amount has been adjusted by the ratio of upland cotton acres actually planted (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4)) to upland cotton base acres in the PFC programme (Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). This adjustment is necessary because only the portion of upland cotton PFC payments that actually benefits acres planted to upland cotton can be considered support to upland cotton. Because the latter figure is higher than the former, this leads to a reduction in the payment rate reflecting actual production in each year. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[3] Market loss assistance payment per pound of actual production = Market loss assistance expenditure for upland cotton base * (actual upland cotton acreage / PFC upland cotton base acreage) / (total production [bales] * 480 [pounds/per bale]). Total market loss assistance payments to upland cotton are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). This amount has been adjusted by the ratio of upland cotton acres actually planted (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4)) to upland cotton base acres in the PFC programme (Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton. Because the latter figure is higher than the former, this leads to a reduction in the payment rate. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[4] Direct payments per pound actually produced = total direct payment expenditure for upland cotton base * (actual upland cotton acreage/direct payment upland cotton base acreage) / (total production [bales] * 480 [pounds/per bale]). Total direct payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 59. The new figure is based on the statutory payment rate of 6.67 cents per pound of upland cotton base multiplied by the direct payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)) multiplied by the direct payment yield of 604 pounds per acre (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). Payments are made on 85 percent of base acres. This translates into a total of $558.17 million. This amount has been adjusted by the ratio of upland cotton acres actually planted Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) to upland cotton base acres in the direct payment program. Because the latter figure is higher than the former, this leads to a reduction in the direct payment rate. This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[5] Counter-cyclical payments per pound actually produced = total counter-cyclical payment expenditure for upland cotton base * (actual upland cotton acreage / counter-cyclical payment upland cotton base acreage) / (total production [bales] * 480 [pounds/per bale]). Total counter-cyclical payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 69. The new figure is based on the MY 2002 payment rate of 13.73 cents per pound of upland cotton base multiplied by the counter-cyclical payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)) multiplied by the counter-cyclical payment yield of 604 pounds per acre (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50) Brazil notes that this underestimates the payments, as it disregards the yield update for purposes of the counter-cyclical payments). Payments are made on 85 percent of base acres. This translates into a total of $1,148.98 million. This amount has been adjusted by the ratio of upland cotton acres actually planted Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) to upland cotton base acres in the counter-cyclical payment programme. Because the latter figure is higher than the former, this leads to a reduction in the direct payment rate. This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[6] Marketing loan benefit per pound of actual production = total marketing loan expenditures / (total production [bales] * 480 [pounds/per bale]). Total marketing loan payments (marketing loan gains plus loan deficiency payments) are taken para. 144, 148-149 of the First Submission of Brazil. Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[7] Step 2 payments per pound of actual production = total Step 2 expenditures/(total production [bales] * 480 [pounds/per bale]). Total Step 2 payments are contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Brazil has estimated the MY 2002 amount at note 335 in its First Submission to be $317 million. The amount of production has been taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4). Brazil notes that the difference between 3.95 cents per pound resulting from this calculation and 4 cents per pound – which was the basis for Brazil to calculate the total Step 2 payment for MY 2002 – is due to rounding effects.

[8] Crop insurance payments per pound of actual production = total crop insurance expenditures / (total production [bales] * 480 [pounds/per bale]). Total crop insurance payments are taken from Exhibit Bra-57 ("Crop Year Statistics", Federal Crop Insurance Corporation). Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[9] Cottonseed payment per pound of actual upland cotton production = total cottonseed expenditures/(total production [bales] * 480 [pounds/per bale]). Total cottonseed payments are listed in Brazil's answer to question 17 (see para. 9). Total production is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

98. Brazil notes that also under this approach, the total US support to upland cotton in MY 1999-2002 surpasses the support decided by the United States in MY 1992. Brazil furthermore notes that even considering the support programs (and their respective replacements)[99] individually, nearly all of them provide higher support in MY 1999-2002 than they (or their predecessors) did in MY 1992 (with the exception of Step 2 and PFC / market loss assistance in MY 2001).

**61. Does the United States consider that Article 13(b)(ii) permits a comparison on any basis other than a per pound basis? USA**

**62. According to Prof. Sumner's calculation, the per pound support increased by approximately 24 % from 1992 to 2002. On the other hand, the Panel understands that the**

[99] The deficiency payments were replaced by PFC and market loss assistance payments in MY 1999-2001 and by direct and counter-cyclical payments in MY 2002.

**total budget outlay, according to Brazil, increased more than that. What, in Brazil's view, is the reason for this difference in the rate of increase? BRA**

Brazil's Answer:

99. US budgetary outlays for upland cotton are a function of the level of price, income and other support provided by the US support programmes. Everything being equal, an increase in the "rate of support" as interpreted by the United States would translate one-to-one into an increase of expenditure. However, the "rate of support" is not the only determinant of budgetary outlays, as two important qualifications apply. First, the most important US subsidy programmes for upland cotton are price-based.[100] For instance the marketing loan payment in MY 2002 guarantees a return of 52 cents per pound. With lower market prices, the gap between the adjusted world price and the loan rate, i.e., the basis for the calculation of the marketing loan benefit, widens and payments per pound increase. During the period MY 1992-2001, prices for upland cotton fell drastically.[101] For example, average upland cotton prices received by farmers in the United States were 53.7 cents per pound in MY 1992 and dropped to a low of 29.8 cents per pound in MY 2001.[102] Therefore, even for an identical set of programs providing an identical "rate of support," budgetary outlays would have vastly increased due to the drop in prices.

100. Second, the United States increased the production of upland cotton between MY 1992 and MY 1999-2002 from 15.7 million bales in MY 1992 to 16.3 million bales in MY 1999, 16.8 million bales in MY 2000, 19.6 million bales in MY 2001 and 16.7 million bales in MY 2002.[103] Thus, the increased "rate of support" was applicable to an increased production of upland cotton.

101. In sum, budgetary outlays for upland cotton increased between MY 1992 and MY 2002 for three main reasons: first, the United States increased its "rate of support", second, lower upland cotton prices led to higher budgetary outlays per pound of upland cotton produced; and third, at times of falling market prices, the United States expanded its upland cotton production so that more upland cotton was eligible to receive the increased rate of support. All of this resulted in an increase of budgetary outlays for upland cotton that is relatively bigger than the increase in the US "rate of support".

102. Lastly, Brazil notes that none of the figures presented by Professor Sumner[104] represent actual payments or actual rates of support. Rather, those figures represent average or expected rates of support in any given marketing year. They are not based on actual production or prices,[105] but solely on expected production and prices. Therefore, they cannot easily be compared to actual payments made by the United States in support of upland cotton. Professor Sumner chose the expected support approach in order to match the approach suggested by the United States as closely as possible, while correcting for its simplistic reliance on the target price that disregarded the eligibility criteria and other features of the programmes.

**63. In relation to Prof. Sumner's presentation at the first session of the first substantive meeting, please elaborate on the reasons behind the increase in the figures (from 1992 to 2002) concerning Loan Support and Step 2 payments. BRA**

[100] These include the marketing loan program, the deficiency payment program, the counter-cyclical payment programme and the Step 2 programs.

[101] *See* First Submission of Brazil, para. 28.

[102] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5).

[103] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[104] *See* Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).

[105] Which would only be important for the rate of Step 2 payments, as only this programme depends on actual prices for purposes of a rate of support. The other programs reduce Government payments with increasing prices, so that the total rate of support remains basically the same, or are not price-related.

Brazil's Answer:

103. The support rate from the marketing loan programme calculated by Professor Sumner represents the expected support rate from the marketing loan programme. Concerning the marketing loan programme, Brazil notes that the statutory loan rate, indeed, fell from 52.35 cents per pound in MY 1992 to 51.92 cents per pound in MY 1999-2001[106] before being slightly increased in MY 2002 to 52 cents per pound.[107] However, the somewhat higher loan rate in MY 1992 was accompanied by strict eligibility criteria.[108] In MY 1992, only production on farmland that participated in the upland cotton deficiency payment programme was eligible for marketing loan benefits, which restricted eligibility to 84.7 percent of production.[109] In MY 1999-2001, only upland cotton produced on farmland that participated in the PFC programme was eligible. Professor Sumner has conservatively used 97 percent of upland cotton production in MY 1999-2001 as the participation rate of upland cotton.[110] Finally, in MY 2002, all US production of upland cotton was eligible to receive marketing loan benefits.[111] Thus, taking into account the eligibility criteria for benefiting from the marketing loan programme, the slightly higher loan rate in MY 1992 provided less support to total expected US upland cotton production than the slightly lower loan rates in later years.

104. Concerning the difference between the expected Step 2 rate of support in MY 1992-2001 and MY 2002, this difference stems from the fact that the United States eliminated the 1.25 cents per pound threshold for Step 2 payments in the 2002 FSRI Act. Before MY 2002, Step 2 payments were made in the amount of the difference between the A-Index and the lowest priced US quote for upland cotton minus a 1.25 cents per pound threshold. Section 1207(a)(4) of the 2002 FSRI Act postpones the application of this threshold until 1 August 2006.[112] Thus, expected Step 2 payments for MY 2002 (and through MY 2005) will be 1.25 cents per pound higher than under the 1990 and 1996 Farm Acts, which both applied the threshold.[113]

**64. Do the figures cited in Prof. Sumner's presentation at the first session of the first substantive meeting indicate amount available or amount spent? Can the Panel derive amount spent from these figures? If Article 13(b)(ii) requires a rate of support comparison, is the rate of support the "rate" of support available or the "rate" at which the support was spent? BRA**

Brazil's Answer:

105. The figures in Professor Sumner's calculation do not indicate amounts spent, but were an attempt to approximate the expected rate of support for an expected pound of upland cotton production under the specific rules in place for each support programme in that year. The figures attempt to represent the normal result that would have been expected by policy makers and farmers as a result of the programme decisions taken by the United States. They do not represent actual expenditures per unit for any programme in any year because, in every year, the actual programme payments per pound of actual production deviates from the expected or normal payments, because the actual production will not exactly equal the expected production.

[106] Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 5).
[107] Exhibit Bra-29 (Section 1202(a)(6) and 1202(b)(6) of the 2002 FSRI Act).
[108] *See* Exhibit US-3 (7 CFR 1427.4(a)(3) and 7 CFR 1413 (1992 edition)).
[109] Annex 2 to Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel, p. 3).
[110] Annex 2 to Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel, p. 4).
[111] Exhibit Bra-29 (Section 1201(b) of the 2002 FSRI Act).
[112] Exhibit Bra-29 (Section 1207(a)(4) of the 2002 FSRI Act).
[113] *See* Exhibit Bra-12 ("Cotton: Background for 1995 Farm Legislation", USDA, April 1995, p. 16) and Exhibit Bra-46 ("Cotton: Background and Issues for Farm Legislation," USDA, July 2001, p. 9).

106. For some of the US support programs, the support indicated can be considered – within certain limits – as support available per pound. However, there is not a complete identity between the "expected rate of support" and the "support available to a pound of actual upland cotton production," because – as noted above – expected and actual production will vary from each other.

107. For marketing loan benefits, the loan rate can be considered the maximum support available to eligible production in case the market price would fall to zero. Similarly, for deficiency and counter-cyclical payments, the difference between the loan rate and the target price can be considered the maximum support available, albeit again only for the eligible production. The expected support differs from that, as it takes into account that not all of the expected production will benefit from those subsidies. The actual support differs again, as expected and actual production may not be identical. Finally, actual US Government payments depend on market prices.

108. For PFC, market loss assistance, direct and cottonseed payments and crop insurance subsidies, the "expected rates of support" represent expected expenditures per unit of expected production. This has been calculated by using average budget expenditures over an appropriate period as expected support, and by using average production as the expected production. Thus, these payments are not maximum available "rates of support". For example, under the crop insurance programme the US Government pays premium subsidies. Higher per unit support would have been available had all farms joined the programme at the maximum subsidized rates. However, this was not an expected or normal occurrence. Especially in MY 1992, when subsidy rates were relatively low, many upland cotton farms were expected to forgo participation in the programme. Both maximum available crop insurance subsidies as well as expected or normal crop insurance subsidies increased for MY 1999 through 2002, as premium subsidies rose and more cotton acreage found the programme attractive. For crop insurance, but also for PFC and direct payments as well as market loss assistance, the actual support per pound of upland cotton production will vary with the actual production undertaken and actual yields achieved.

109. The actual "rate of support" from the Step 2 payments depends on the actual price differential between the A-Index and the lowest-prices US quote. While it varies from the expected "rate of support" with the actual realization of the price gap, it is not expected to be systematically correlated to the actual level of prices.

110. In sum, it is not possible to derive the amount spent from the "expected rate of support" calculated by Professor Sumner without adding additional information on the level of market prices and the actual US upland cotton acreage, yield and production, among other variables. Following the US approach, Professor Sumner has calculated an expected rate of support that could be characterized as an expected guaranteed revenue. This approach is distinct from an approach looking into actual expenditures, as favoured and advocated by Brazil. In fact, Professor Sumner applied the US approach to a rate of support that would abstract in as far as possible from actual expenditures.

111. Brazil refers the Panel to its answers to questions 60 and 67 for actual expenditures by year, by programme – both per pounds of upland cotton production and as total expenditures for upland cotton.

112. Should the Panel decide that the required test under Article 13(b)(ii) is a "rate of support", Brazil submits that the relevant rate of support is "expenditures per pound of production", and thus the "'rate' at which support was spent", as discussed in Brazil's answer to Question 60.

**65. Does Brazil consider that adjustment for inflation is relevant in the context of the comparison under Article 13 (b)(ii) ? BRA**

Brazil's Answer:

113. Brazil does not believe that an adjustment for inflation is relevant in the context of the comparison under Article 13(b)(ii). First, there is nothing in the text of Article 13(b)(ii) that provides for such an adjustment. Second, the only provision of the Agreement on Agriculture addressing inflation is Article 18.4, which provides: "In the review process Members should give due consideration to the influence of excessive rates of inflation on the ability of any Member to abide by its domestic support commitments." The "review process" is the review by the Committee on Agriculture of the progress of implementation of commitments as set out in Article 18 of the Agreement on Agriculture. The fact that negotiators explicitly opened the possibility of "giving due consideration to the influence of excessive rates of inflation" in the review process, but not for purposes of Article 13(b)(ii), is evidence that this omission was intentional.

114. Furthermore, at no time during the review process has the United States ever stated or made any notifications that "excessive rates of inflation" in the US economy have negatively impacted "the ability of [the United States] to abide by its domestic support commitments". Even, if it had, Article 18.4 has no relevance for the purposes of the comparison required by Article 13(b)(ii), as it refers to the review process only, and not to the peace clause. Accordingly, there is no basis for the Panel to apply any adjustment to the US level of support to upland cotton in marketing year 1992.

115. Nevertheless, if the Panel should decide to use such an adjustment, Brazil submits that the appropriate index to be used is the applicable US agricultural price index. Three alternative indexes could be used. The first and most direct is the index of prices received for cotton. Other indexes that may be considered are the index of prices received for crops and the index of prices received for all farm products.

| | **2000** | **2001** | **2002** |
|---|---|---|---|
| Index of prices received for cotton | 82 | 65 | 49 |
| Index of prices received for all crops | 96 | 99 | 103 |
| Index of prices received for all farm products | 96 | 102 | 99 |

1990 to 1992 average = 100[114]

116. Thus, under none of the applicable indices is there any significant inflation to be taken into account. To the contrary, the cotton price index fell by 51 percent, while price indices for crops and all farm products have been stable if compared to the 1990-1992 base used by USDA.

**66. Could you please comment on the relative merits of each of the following calculation methods for the purposes of the comparison of support to upland cotton with 1992, irrespective of whether a particular measure should be included or excluded:**

**(a) Total budgetary outlays (Brazil's approach). USA**

**(b) Budgetary outlays per unit of upland cotton: Could you please calculate and provide an estimate for the marketing years 1992 and 1999-2002, respectively, and draw attention to any factors/qualifications that the Panel would need to be aware of. BRA, USA**

[114] Exhibit Bra-149 (Agricultural Outlook, August 2002, p. 38)

Brazil's Answer:

117. Brazil has presented figures for budgetary outlays by unit of actual production in its answer to Question 60. However, Brazil would like to add some further considerations on the shortcomings of this approach.

118. A significant issue in using these per unit figures to represent support rather than total budgetary outlays is that a per-unit approach discounts the fact that some of the change in production is itself caused by changes in the rate of support or subsidy. If support is calculated by dividing budgetary outlays by total production, the result neglects this effect. As support rises in the numerator, production rises in the denominator and the ratio or per unit of an increased support rate rises by less than total support (and may even decline).

119. The perverse effect is that the more production is stimulated by the US domestic support programmes and, thus, the more those programmes distort trade, the smaller the per unit measure effect of the increased subsidy. For this reason, a subsidy rate per unit of actual production should be avoided or used with extreme caution.

**(c) Per unit rate of support (United States approach): How should changes in acreage, eligibility and payment limitations per farm(s) (commodity certificate programmes) be factored into this approach? BRA**

Brazil's Answer:

120. The approach of the United States was simply to assert that the target price represented the rate of support per unit in MY 1992 and the loan rate alone represented the rate of support per unit in MY 2002. This approach rests on several fundamental errors.

121. First, the approach left out major support programs in each year. For 1992, the approach left out the Step 2 programme and crop insurance, both of which provided support to upland cotton in that year. For 2002, the approach of the United States left out support provided by the direct payment programme, the counter-cyclical payment programme and the cottonseed payment programme as well as the Step 2 and crop insurance programmes.

122. Second, the United States did not account for any factors that limited eligibility for support or imposed costs of participation as a mandatory condition of receiving support from the US support programmes. The failure to account for these factors in each year completely ignores the true nature of the US support programmes for upland cotton and seriously distorts the rate of support.

123. Lastly, these two per pound numbers cannot simply be added together because the eligibility criteria differ between them and, in particular, the support from the upland cotton deficiency payment programme was expected to apply to an even smaller share of actual production than the support from the marketing loan programme.

124. Professor Sumner's calculation attempted to correct the US presentation for these serious flaws in the implementation of the US approach. Professor Sumner added back the programmes that provide support to upland cotton, but that have been left out by the United States. He also corrected the rate of support for eligibility restrictions and the cost of participation, and presented the rate of support on the basis of expected production in order to be able to sum up the various "rates of support." At the same time, Professor Sumner has attempted to remain true to the approach of the United States by avoiding the use of actual production or actual payments, and instead relying on expected programme support per unit and expected or normal production to arrive at per unit support. Professor Sumner's approach also deals in detail with the question of how to account for eligibility

restrictions and costs of participation. Brazil refers the Panel to Annex 2 to Exhibit Bra-105 for the details of Professor Sumner's methodology.

125. In addition to eligibility, the Panel's question refers specifically to payment limits. Payment limits are applied on the basis of persons, including corporations, partnerships, producers and other persons actively engaged in agriculture.[115] Typically, for larger farms, there is more than one person actively engaged in agriculture, including spouses, and landlords on a share rental basis. In addition, there is typically more than one legal entity per farm and under the three entity rule, a person may receive programme payments from three entities and up to double the payment limit for that person for one entity.[116]

126. Payment limits for deficiency payments in MY 1992 were $50,000.[117] Payment limits for PFC (in MY 1999-2001)[118] were $40,000,[119] as is the case for direct payments (in MY 2002).[120] Payment limits for counter-cyclical payments are $65,000 (in MY 2002).[121] For the marketing loan programme, a payment limitation of $75,000 per person applied in MY 1992. In the 1996 FAIR Act, the payment limits for the marketing loan programme was also $75,000, but was increased to $150,000 for MY 1999-2001 by supplemental legislation.[122] The 2002 FSRI Act limits the amount of marketing loan gains and loan deficiency payments to a total of $75,000 for each producer.[123] However, the key change between MY 1992 and MY 1999-2002 was the establishment of the certificate programme in MY 1999,[124] which effectively eliminated any payment limit for the marketing loan programme.[125]

127. Brazil has no data that would allow it to factor payment limitations into the calculation of an expected rate of support. However, Brazil notes that with the inception of the commodity certificate programme in MY 1999, the limitations imposed by payment limits have – if anything – been relaxed. Additionally, Brazil notes that its approach to Article 13(b)(ii), by comparing total budgetary outlays, takes the budgetary effects of payment limitations into account. For farmers that have reached their payment limit, the US Government incurs no further expenditures, and consequently, the amount of expenditures is lower than it would be absent the payment limit. In that sense, actual expenditures reflect the effects of payment limits.

128. Finally, Brazil notes that Professor Sumner's calculations also do not account for the increase in production or acreage devoted to upland cotton between MY 1992 and MY 2002. Taking this into account by indexing the "expected rate of support" to the level of MY 1992 production – as one

[115] Exhibit Bra-33 (7 CFR 1400.1 et seq.).
[116] Exhibit Bra-33 (7 CFR 1400.1 et seq.).
[117] Exhibit Bra-12 ("Cotton: Background for 1995 Farm Legislation," USDA, April 1995, p. 14).
[118] Additional market loss assistance payments were made that did not count towards the PFC payment limit.
[119] Professor Sumner has stated in his statement at the first meeting of the Panel that a typical cotton farm with 3000 acres received about $300,000 in PFC payments per year (*see* Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel, p. 22). This amount results both from the fact that several persons on a farm may be eligible for payment and from the fact that the three-entity rule doubled the payment limit amount a single person could legally receive (for an explanation on the three-entity rule *see* paragraphs 74-76 of the First Submission of Brazil).
[120] Exhibit Bra-27 (Side by Side Comparison of the 1996 and 2002 Farm Act, USDA, p. 12).
[121] Exhibit Bra-27 (Side by Side Comparison of the 1996 and 2002 Farm Act, USDA, p. 12).
[122] Exhibit Bra-27 (Side by Side Comparison of the 1996 and 2002 Farm Act, USDA, p. 12).
[123] Exhibit Bra-42 (The 2002 Farm Act, Provisions and Implications for Commodity Markets," USDA, November 2002, p. 7).
[124] Exhibit Bra-42 (The 2002 Farm Act, Provisions and Implications for Commodity Markets," USDA, November 2002, p. 8); Exhibit Bra-29 (Section 1603 of the 2002 FSRI Act).
[125] The certificate programme is described in detail in paragraphs 75-76 of the First Submission of Brazil.

possible approach to account for the increase in production – would increase the "expected rate of support" for later marketing years, as the amount of US production of upland cotton increased.[126] The result of the comparison of MY 1992 and MY 1999-2002 support will, however, be the same: The United States' support to upland cotton in MY 1999-2002 exceeded the support to upland cotton decided in MY 1992 and the US domestic support measures fail to meet the condition in Article 13(b)(ii) for exemption from actions under Articles 5 and 6 of the SCM Agreement and GATT Article XVI:1.

**(d) Per unit rate of support for upland cotton (Prof. Sumner's approach at the first session of the first substantive meeting ). USA**

**(67) The Panel requests the parties to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002. For this purpose the parties are each requested to submit AMS calculations for upland cotton (using the budgetary-outlay/non-price gap methodology employed by the United States in respect of cotton in its DS Notifications (e.g., G/AG/N/USA/43) and using the formats and supporting tables in document G/AG/2) on the same basis as would be the case in calculating a product specific AMS for the purposes of the calculation of the "Total Current AMS" in any year in accordance with the relevant provisions, including as appropriate Article 1(a), (b) and (h), Article 6 and Annex 3 to the Agreement. BRA, USA**

Brazil's Answer:

129. Brazil sets forth the following table that summarizes the AMS calculation for upland cotton for marketing years 1992 and 1999-2002. Using the definition of non-product specific support detailed in Brazil's answer to the Panel's Question 40, all of the programmes listed constitute non-exempt direct payments, within the meaning of G/AG/2, providing product-specific support to upland cotton. The table includes all support programs that should have been included in "Supporting Table DS:6", within the meaning of G/AG/2. To the best of Brazil's knowledge, no other "product-specific" support to upland cotton has been provided by the US Government.

130. Brazil notes that the United States has notified the deficiency payments using the price gap methodology provided for in Annex 3.[127] Brazil considers it appropriate to follow the US decision and will, therefore, calculate the amount of support to upland cotton provided by the deficiency payment programme by using the "price gap" approach detailed in Annex 3, paragraph 10 and 11. Brazil notes that US budgetary expenditures for MY 1992 for the deficiency programme were $1,017.4 million.[128]

[126] Exhibit Bra-4 ("Fact Sheet, Upland Cotton," USDA, January 2003, p. 4)
[127] Exhibit Bra-150 (G/AG/N/USA/10)
[128] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6).

**AMS For Upland Cotton By Year And Support Programme**

| Year<br>Programme | 1992<br>----- $ million ----- | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| Deficiency Payments[1] | 812.1 | none | none | none | none |
| PFC Payments[2] | none | 547.8 | 541.3 | 453 | none |
| Market Loss Assistance Payments[3] | none | 545.1 | 576.2 | 625.7 | none |
| Direct Payments[4] | none | none | none | none | 485.1 |
| Counter-cyclical Payments[5] | none | none | none | none | 998.6 |
| Marketing loan (Loan gains and LDP)[6] | 743.8 | 1,545 | 542 | 2,506 | 952 |
| Step 2 Payment[7] | 206.7 | 421.6 | 236.1 | 196.3 | 317 |
| Crop Insurance[8] | 26.6 | 169.6 | 161.7 | 262.9 | 194.1 |
| Cottonseed Payment[9] | none | 79 | 184.7 | none | 50 |
| **Total** | **1,789.2** | **3,308.1** | **2,242.0** | **4,043.9** | **2,996.8** |

Notes

[1] This calculation is based on the price gap formula set forth in para. 10 and 11 of AoA Annex 3. In its notification of marketing year 1995 support (Exhibit Bra-150 (G/AG/N/USA/10, p. 18), the United States that the applied administered price for upland cotton under the deficiency payment programme is $1,607.169 per ton. The applied administered price (or target price) has been the same in MY 1992 and MY 1995 (Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 5). Therefore, Brazil uses that figure. The external reference price has been notified by the United States to be $1,275.741 per ton. Paragraph 11 of AoA Annex 3 specifies that the external reference price is based on 1986-1988 averages that have not changed between MY 1992 and MY 1995. Thus, Brazil bases the price-related direct payments from the deficiency payment programme in MY 1992 on the difference between $1,607.169 per ton and $1,275.741 per ton ($331.428 per ton) multiplied by the eligible production, which results from multiplying the eligible upland cotton base acreage and the payment yield. Professor Sumner has calculated the eligible upland cotton base acreage for MY 1992 to be 10.17 million acres, while the payment yield is 531 pounds per acres (Exhibit Bra-105 (Annex 2 to Statement of Professor Daniel Sumner at the First Meeting of the Panel, p. 5-6). Thus, the eligible production is 5,400,270,000 pounds or 2,450,213 metric tons (2204 pounds equal one metric ton). Thus, the amount of deficiency payments in that enters the calculation of total AMS for MY 1992 is 2,450,213 metric tons * $331.428 per ton = $812.069 million.

[2] PFC payment expenditure for upland cotton = total PFC payment expenditure for upland cotton base * (actual upland cotton acreage / PFC upland cotton base acreage). Total PFC payment expenditure for upland cotton is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). This amount has been adjusted by the ratio of upland cotton acres actually planted (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4)) to upland cotton base acres in the PFC programme (Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). This adjustment is necessary because only the portion of upland cotton PFC payments that actually benefits acres planted to upland cotton can be considered support to upland cotton.

[3] Market loss assistance expenditure for upland cotton = total market loss assistance expenditure for upland cotton base * (actual upland cotton acreage / market loss assistance (i.e., PFC) upland cotton base acreage). Total market loss assistance expenditures for upland cotton is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). This amount has been adjusted by the ratio of upland cotton acres actually planted (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4)) to upland cotton base acres in the market loss assistance (i.e., PFC) programme (Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton.

[4] Direct payments = total direct payment expenditure for upland cotton base * (actual upland cotton acreage / direct payment upland cotton base acreage). Total direct payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 59. The new figure is based on the statutory payment rate of 6.67 cents per pound of upland

cotton base multiplied by the direct payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)) multiplied by the direct payment yield of 604 pounds per acre (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)). Payments are made on 85 percent of base acres. This translates into a total of $558.17 million. This amount has been adjusted by the ratio of upland cotton acres actually planted Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) to upland cotton base acres in the direct payment program. This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton.

[5] Counter-cyclical payments = total counter-cyclical payment expenditure for upland cotton base * (actual upland cotton acreage / counter-cyclical payment upland cotton base acreage). Total counter-cyclical payments for MY 2002 have been re-estimated from the figure presented by Brazil in its First Submission, para. 69. The new figure is based on the MY 2002 payment rate of 13.73 cents per pound of upland cotton base multiplied by the counter-cyclical payment upland cotton base acreage of 16.3 million acres (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50)) multiplied by the counter-cyclical payment yield of 604 pounds per acre (Brazil has assumed it to be the previous 5-year average as reported by USDA in Exhibit Bra-142 (Agricultural Outlook, May 2002, p. 50) Brazil notes that this underestimates the payments, as it disregards the yield update for purposes of the counter-cyclical payments). Payments are made on 85 percent of base acres. This translates into a total of $1148.98 million. This amount has been adjusted by the ratio of upland cotton acres actually planted Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) to upland cotton base acres in the counter-cyclical payment program. This adjustment is necessary because only the portion of upland cotton market loss assistance payments that actually benefits acres planted to upland cotton can be considered support to upland cotton.

[6] Total marketing loan payments (marketing loan gains plus loan deficiency payments) are taken para. 144, 148-149 of the First Submission of Brazil.

[7] Total Step 2 payments are contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). Brazil has estimated the MY 2002 amount at note 335 in its First Submission to be $317 million.

[8] Total crop insurance payments are taken from Exhibit Bra-57 ("Crop Year Statistics," Federal Crop Insurance Corporation).

[9] Total cottonseed payments are listed in Brazil's answer to question 17 (see para. 9).

131. The figures presented above indicate that, using the AMS approach, the US level of support for MY 1992 is lower than in each of the marketing years between 1999 and 2002.

132. Brazil also notes that – as explained in the notes on the sources and methodology for arriving at the reported figures – the AMS figures for MY 1999-2002 reflect revised amounts of budgetary expenditures that should replace those listed in Brazil's First Submission at paragraphs 148-149.[129] These revised (and somewhat smaller) expenditures reflect new information collected by Brazil and more accurately tabulate support to upland cotton in MY 1999-2002. Brazil notes that none of these revisions results in any significant change to the total support to upland cotton, and that expenditures decided in MY 1992 are still well below expenditures related to MY 1999-2002.

**68. Could you please clarify the result of the calculations of, and the meaning of the title, in Appendix Table 1 "Estimated per unit Subsidy Rates by Programme and Year" in Annex 2 to Exhibit BRA-105, page 12. Why are the numbers calculated for marketing loans considered to be subsidies? Could the Panel, for example, read the "total level of support" (bottom line of the table) as the effective support price for upland cotton or the maximum rate of support for upland cotton? BRA, USA**

Brazil's Answer:

133. The Appendix Table 1 in Annex 2 to Exhibit Bra-105 should have been titled, "Estimated per unit Support Rates by Programme and Year". Brazil apologizes for any confusion caused by mis-titling this table.

134. The marketing loan programme support listed in Table 1 of Annex 2 to Exhibit Bra-105 is a "support rate" and not an actual loan deficiency payment or marketing loan gain. It does not represent a subsidy amount. The loan deficiency payment or marketing loan gain is calculated as the difference between the loan rate and the adjusted world price (AWP). When the AWP falls, the loan benefit per

[129] No such revision is necessary for MY 1992.

unit of eligible production rises to offset the fall in the AWP. In the US "rate of support" methodology, because the AWP is expected to be positively related to the price received by individual farmers in the United States, the loan rate of 52.35 cents per pound in MY 1992 can be considered an approximate rate of support per unit of eligible production.

135. The deficiency payment rate of support is similar to the marketing loan rate of support and represents the maximum rate of support per eligible unit, where eligibility is measured by the rules applicable in 1992. By contrast, actual support payments under Brazil's expenditure methodology are calculated as the difference between the higher of the average price received by farmers and the loan rate.

136. The other programmes listed in Table 1 provide support per unit of eligible production to upland cotton in addition to the loan rate and deficiency payment target price. These other programmes are calculated as the estimated expected support rates. These rates are not maximum rates of support but rather normal or expected rates of support. The other domestic support measures are not equivalent in overall effect to a price support, but they are calculated on a per unit basis and are added across programmes to give a total support rate.

137. The production and trade distorting effects of these subsidies are each different and are also different from a support price.[130] Brazil will discuss the adverse effects caused by each of those subsidies in its Further Submission, scheduled for 9 September 2003. The variety of the support programmes employed by the United States precludes interpreting the sum of the various support contributions as a "support price." However, their sum can be read as an expected guaranteed income that results from market revenue and US Government payments. Marketing loan benefits, deficiency payments and counter-cyclical payments will increase with falling market prices. Other support programs are relatively decoupled from market prices, and provide an expected rate of support, that can be added to the loan rate and target price established by the marketing loan, the deficiency and counter-cyclical payments.

**69. Can the United States confirm that the "marketing year" for upland cotton is 1 August to 31 July ? Can the United States confirm the Panel's understanding that USDA data for the "crop year" corresponds to the "marketing year"? USA**

E. EXPORT CREDIT GUARANTEE PROGRAMMES

**70. How does Brazil respond to the United States' assertion that Brazil is trying to realize through litigation what it could not achieve in past negotiations? BRA**

Brazil's Answer:

138. In WTO dispute settlement, there is only one way to determine what was achieved in past negotiations – to interpret those provisions actually concluded according to the customary rules of interpretation included in the Vienna Convention. In paragraphs 100-115 of Brazil's Statement at the First Panel Meeting, Brazil demonstrated that it is not in fact attempting "to realize through litigation what it could not achieve in past negotiations." In those paragraphs, Brazil demonstrated that under the ordinary meaning of Article 10.2 of the Agreement on Agriculture, in its context and according to the object and purpose of Article 10 and the Agreement on Agriculture overall, export credit guarantees are subject to the general export subsidy disciplines in the Agreement on Agriculture. Brazil will not repeat those arguments here, but simply notes that by ignoring an interpretation of Article 10.2 according to the Vienna Convention rules, it is the United States that is trying to escape what was in fact achieved in the Uruguay Round negotiations. Other participants in those

[130] *See* Exhibit Bra-105 (Statement by Professor Daniel Sumner at the First Meeting of the Panel, paras 20-39) for a summary of the economic impacts of these various support programs.

negotiations who are third parties in this dispute and who in fact use export credits – Canada, the European Communities and New Zealand – agree with Brazil.

**71. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? Does it confer a benefit within the meaning of Article 1.1(b)? Why or why not? If so, to whom? USA**

Brazil's Comment:

139. In paragraphs 287-289 of its First Submission, and again at paragraph 116 of its Statement at the First Panel Meeting, Brazil demonstrated that CCC export credit guarantees are expressly included as "financial contributions" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. Although export credit guarantees do not automatically confer benefits, CCC export credit guarantees confer "benefits" within the meaning of Article 1.1(b) because they are extended at premium rates and on repayment terms that are not available and in fact do not exist on the market. In its comments and answers to Questions 75 and 82 below, Brazil discusses passages from the GSM 102, GSM 103 and SCGP regulations and materials from USDA's Foreign Agricultural Service (FAS) concerning the programmes, which demonstrate that GSM 102, GSM 103 and SCGP confer "benefits".

140. Brazil notes that a number of agents benefit from the subsidy provided by the guarantees. The US financial institutions and the foreign bank enter into lucrative contracts they would not otherwise have, the importer also gets financing that would not otherwise have be available in the market, but the US Government ultimately designed the programs to provide a benefit to US farmers and exporters. On the FAS website "What Every Exporter Should Know About The GSM-102 and GSM-103 Programmes" it stated that the "USDA will consider announcing, for a specific country or region, the availability of guarantees for any US commercial commodity, if the market for US exports will be expanded or maintained as a result" (emphasis added).[131] Brazil also notes that it is the US exporter who applies for the guarantee and who triggers the process of obtaining coverage for each particular transaction.

**(b) How, if at all, would these elements be relevant to the claims of Brazil, and the United States response thereto? BRA, USA**

Brazil's Answer:

141. Brazil notes that because CCC export credit guarantees constitute subsidies *per se*, and because they are, further, de jure contingent on export, the GSM 102, GSM 103 and SCGP programmes constitute export subsidies within the meaning of Article 3.1(a) of the SCM Agreement. According to the reasoning of the Appellate Body in US – FSC,[132] this means that those programs are also export subsidies within the meaning of the Agreement on Agriculture. In paragraphs 295-304 of its First Submission, Brazil then demonstrated that those programs threaten to lead to circumvention of the United States' export subsidy commitments (both with respect to scheduled and unscheduled commodities), in violation of Article 10.1 of the Agreement on Agriculture and, as a consequence, of Article 8 of that Agreement. Having established a violation of Part V of the Agriculture Agreement, Brazil's claims under Article 3.1(a) of the SCM Agreement against the CCC export credit guarantee programmes are not exempt from action by Article 13(c)(ii) of the Agreement on Agriculture.

[131] Exhibit Bra-151 ("US Export Credit Guarantee Programs: What Every Exporter Should Know About The GSM-102 and GSM-103 Programmes", USDA, November 1996).

[132] Appellate Body Report, *US – FSC*, WT/DS108/AB/R. para. 139-141.

142. Articles 1.1(a)(1)(i) and 1.1(b) of the SCM Agreement are relevant for a number of reasons, including for the purposes of Article 10.3 of the Agreement on Agriculture. As demonstrated in paragraphs 263-268 of Brazil's First Submission, the United States has surpassed its export quantity commitment levels for commodities eligible for GSM 102, GSM 103 and SCGP support. Under Article 10.3, the burden now lies with the United States to prove that its exports in excess of these commitments did not benefit from export subsidies, including export credit guarantees. United States will, inter alia, have to prove that those programs do not grant "benefits" within the meaning of Article 1.1(b) of the SCM Agreement.[133]

**72. Could Brazil expand on why, as indicated in paragraph 118 of its oral statement, it does "not agree" with the United States arguments relating to the viability of an a contrario interpretation of item (j) of the Illustrative List of Export Subsidies in Annex 1 of the SCM Agreement? BRA**

Brazil's Answer**:**

143. As the Panel is aware, Brazil was earlier involved in a dispute (Brazil – Aircraft) that addressed the question whether certain items in the Illustrative List of Export Subsidies admit of an a contrario defense. Although, as the United States notes, Brazil argued in that dispute that a contrario interpretations of certain items included in the Illustrative List (in particular the first paragraph of item (k)) are enabled by footnote 5 to the SCM Agreement, the panel disagreed.

144. Footnote 5 provides that "Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." The first Article 21.5 panel in Brazil – Aircraft concluded as follows with respect to footnote 5:[134]

> 6.36 In its ordinary meaning, footnote 5 relates to situations where a measure is referred to as not constituting an export subsidy. Thus, one example of a measure that clearly falls within the scope of footnote 5 involves export credit practices that are in conformity with the interest rate provisions of the Arrangement on Guidelines for Officially Supported Export Credits ("Arrangement"). The second paragraph of item (k) provides that such measures "shall not be considered an export subsidy prohibited by this Agreement". Arguably, footnote 5 in its ordinary meaning could extend more broadly to cover cases where the Illustrative List contains some other form of affirmative statement that a measure is not subject to the Article 3.1(a) prohibition, that it is not prohibited, or that it is allowed, such as, for example, the first and last sentences of footnote 59[34] and the proviso clauses of items (h)[35] and (i)[36] of the Illustrative List.[37]
>
> 6.37 The first paragraph of item (k), however, does not contain any affirmative statement that a measure is not an export subsidy nor that measures not satisfying the conditions of that item are not prohibited. To the contrary, the first paragraph of item (k) on its face simply identifies measures that are prohibited export subsidies. Thus, the first paragraph of item (k) on its face does not in our view fall within the scope of footnote 5 read in conformity with its ordinary meaning.

[34] The first sentence of footnote 59 provides that "Members recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected." The last sentence states that "[p]aragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member."

[133] The United States will also have to prove that the programmes are not inconsistent with item (j) of the Illustrative List of export subsidies.

[134] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, paras. 6.36-6.37.

[35] ". . . provided, however, that prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products sold for domestic consumption, if the prior stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product . . . ." (emphasis added).

[36] ". . . provided, however, that in particular cases a firm may use a quantity of home market inputs equal to, and having the same quality and characteristics as, the imported inputs as a substitute for them . . . ."

[37] In any event, such measures may well fall within the scope of footnote 1, and thus not represent subsidies at all, whether prohibited or otherwise.

145. Reflecting on footnote 5, the panel recalled and rejected the US argument that "'[t]he Illustrative List does not deal with all possible financial contributions, but for those it does deal with, it establishes, by virtue of footnote 5, a dispositive legal standard insofar as prohibited subsidies are concerned'".[135] While the panel agreed that "an illustrative list could in principle operate in such a manner", it concluded that because of footnote 5, the Illustrative List of Export Subsidies annexed to the SCM Agreement did not operate in that manner.[136] According to the panel, "if the drafters had intended the meaning which the United States attributes to footnote 5, they could certainly have found appropriate language to do so".[137]

146. The panel noted that the first paragraph of item (k) has effect even if it does not admit of an a contrario interpretation. The panel likened the Illustrative List to "a list of per se violations".[138] According to the panel, even if a measure does not fulfill the elements of one of the items in the Illustrative List and therefore does not constitute a per se violation, it could still be deemed prohibited if the complaining party demonstrates that it fulfills the elements of Articles 1 and 3 of the SCM Agreement.[139]

147. In dicta, the Appellate Body suggested that the first paragraph of item (k) may indeed admit of an a contrario interpretation.[140] In Brazil's view, however, this suggestion is limited to the first paragraph of item (k), and at least does not extend to item (j). Although the Appellate Body emphasized in the initial appeal in Brazil – Aircraft that the term "material advantage" in item (k) had to be given meaning independent of the term "benefit" in Article 1.1(b)[141], it found that the difference between the two terms is the qualification in item (k) that the advantage conferred relative to the market must additionally be "material".[142] In other words, proving "material advantage" includes a showing that a "benefit" is conferred, but also requires something more. While disproving the existence of a "material advantage" may mean that, in some narrow circumstances, a benefit may nevertheless still exist, the first paragraph of item (k) at least still relies on an analysis whether a "material advantage" is conferred to the recipient, as compared to some market benchmark. This "to the recipient" standard does not undercut and in fact complements the market benchmark "to the recipient" standard included in Article 1.1(b). An a contrario reading of item (k), therefore, does not read out the market benchmark "to the recipient" standard from the test applicable to export credits, but simply gives it a particular meaning in the context of export credits.

[135] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, paras. 6.32, 6.38.
[136] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, para. 6.38.
[137] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, para. 6.38.
[138] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, para. 6.42.
[139] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, para. 6.42.
[140] Appellate Body Report, *Brazil – Aircraft (21.5)*, WT/DS46/AB/RW (adopted 4 August 2000), para. 80 ("If Brazil had demonstrated that the payments made under the revised PROEX were not 'used to secure a material advantage in the field of export credit terms', and that such payments were 'payments' by Brazil of 'all or part of the costs incurred by exporters or financial institutions in obtaining credits', then we would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List.").
[141] Appellate Body Report, *Brazil – Aircraft*, WT/DS46/AB/R, para. 179.
[142] Appellate Body Report, *Brazil – Aircraft*, WT/DS46/AB/R, para. 177.

148. In contrast, the evidence required to meet the elements of item (j) are completely unrelated to the evidence necessary to establish that a guarantee programme confers a benefit "to the recipient" of a loan guarantee. Whether the premia collected under an export credit guarantee programme meet the long-term operating costs and losses of the programme is completely irrelevant to the question whether a benefit "to the recipient" of the export credit guarantee is conferred. Consequently, allowing an a contrario reading of item (j) that provides, as the United States argues, "a dispositive legal standard"[143] for determining whether guarantees are prohibited, would suggest that the "to the recipient" market benchmark standard does not apply to guarantees. This cannot be true, since guarantees are expressly included in Article 1.1 (and Article 14(c)) as "financial contributions" that can confer "benefits" to a recipient relative to a market benchmark.

149. The conclusion that item (j) does not admit of an a contrario defense is relevant for a number of reasons, including for the purposes of Article 10.3 of the Agreement on Agriculture. As demonstrated in paragraphs 263-268 of Brazil's First Submission, the United States has surpassed its export quantity commitment levels for commodities eligible for GSM 102, GSM 103 and SCGP support. Under Article 10.3, the burden now lies with the United States to prove that its exports in excess of these commitments did not benefit from export subsidies, including export credit guarantees. Even if the United States is able to demonstrate that premia for the GSM 102, GSM 103 and SCGP programs meet long-term operating costs and losses, it will also have to prove that those programs do not grant "benefits" within the meaning of Article 1.1(b) of the SCM Agreement. Since item (j) does not admit of an a contrario interpretation, disproving the elements of item (j) will not be sufficient to remove the programs from the definition of "export subsidy."

**73. The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The United States has yet to submit any evidence or argumentation on this point, either as potential context for interpretation of the terms in Article 10 of the Agreement on Agriculture or in relation to Brazil's claims under the SCM Agreement. The Panel would therefore appreciate United States views in respect of this situation, and invites the United States to submit relevant argumentation and evidence. USA**

**74. If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 of the Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both? BRA, USA**

Brazil's Answer:

150. In determining what constitutes an export subsidy within the meaning of Article 10.1 of the Agreement on Agriculture, Brazil considers that the Panel should refer to contextual guidance included in Articles 1 and 3 of the SCM Agreement, and in item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement. As discussed in paragraphs 258-261 of Brazil's First Submission, this is consistent with the Appellate Body's decisions in US – FSC[144] and Canada – Dairy.[145] As a factual matter, Brazil has demonstrated that the GSM 102, GSM 103 and SCGP programmes constitute export subsidies under Articles 1.1 and 3.1(a) of the SCM Agreement, and under item (j) of the Illustrative List (as well as under Articles 1(e) and 10.1 of the Agreement on Agriculture.

**75. The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see e.g. written third party submission of Canada) and to the panel report in DS 222 Canada- Export Credits and Loan Guarantees. How and to what extent are Article 14(c) of the SCM**

[143] Panel Report, *Brazil – Aircraft (21.5)*, WT/DS46/RW, para. 6.32
[144] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 136-140.
[145] Appellate Body Report, *Canada – Dairy*, WT/DS103/AB/R and WT/DS113/AB/R, para. 87-90.

**Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would be the appropriate market benchmark to use for any comparison? Please cite any other relevant material. BRA, USA**

Brazil's Answer:

151. As one way of demonstrating that the GSM 102, GSM 103 and SCGP programs constitute export subsidies within the meaning of Article 10.1 of the Agreement on Agriculture, Brazil has demonstrated that those programmes constitute financial contributions that confer benefits and that are contingent on export, within the meaning of Articles 1.1 and 3.1(a) of the SCM Agreement. Brazil recalls that as discussed above in response to Question 72, Article 10.3 of the Agreement on Agriculture in fact places the burden on the United States to prove that export quantities in excess of its export commitments have not benefited from export subsidies.

152. In any event, Brazil has demonstrated that the CCC guarantee programs confer "benefits" within the meaning of Article 1.1(b) because they are extended at premium rates and on repayment terms that are not available on the market. In fact, the CCC programmes are unique financing vehicles for agricultural commodity transactions that are not available on the commercial market.

153. Brazil notes that the United States has argued in Canada – Aircraft II that where there is no comparable financial product on the market, a programme confers benefits per se. It stated:

> If the commercial market does not offer a particular borrower the exact terms offered by a government, then the government is providing a benefit to the recipient whenever those terms are more favorable than the terms that are available in the market. A government entity "operating on commercial principles" is still a government entity. It is not the commercial market.[146]

154. Brazil agrees with the United States. This interpretation is, in fact, consistent with the benchmark established by Article 14(c) of the SCM Agreement. In relevant part, Article 14 provides as follows:

> For the purposes of Part V, any method used by the investigating authority to calculate the benefit to the recipient … shall be transparent and adequately explained. Furthermore, any such method shall be consistent with the following guidelines:
>
> …
>
> > (c) a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees.

155. Brazil first draws the Panel's attention to the fact that Article 14 was specifically conceived for the purposes of Part V of the SCM Agreement only. It should be referred to exclusively as context to determine whether a benefit exists when a particular transaction is backed by a government export credit guarantee. Secondly, Brazil observes that subparagraph (c) of Article 14 is simply a

[146] Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2 (para. 7).

"guideline", not the sole method of calculating the benefit to the recipient. Other methods may be applied as long as they are "consistent" with the guideline set out in subparagraph (c).

156. There is no market benchmark in the case of the GSM 102, GSM 103 and SCGP programmes, since there are no financial products available on the market on the terms provided by the programmes. As discussed in response to Question 82, the regulations regarding the GSM 102 and GSM 103 programmes, as well as regarding the SCGP programme note that "[t]he programs operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee".[147] Moreover, the regulations state that "[t]he programs are targeted towards those countries where the guarantee is necessary to secure financing of the export but which have sufficient financial strength so that foreign exchange will be available for scheduled payments."[148] These passages prove that without a CCC guarantee, a borrower would not be able to secure financing at all – not just financing on less attractive terms than could be secured with the CCC guarantee (or on terms that would constitute a benefit under Article 14(c) of the SCM Agreement) – but no financing at all. The regulations also emphasize that the CCC guarantee is necessary – a commercial guarantee would not be sufficient.

157. Moreover, as the FAS website explains, "[t]he reduction of risk to financial institutions in the United States … may make possible financing that would otherwise be unavailable".[149] The FAS further clarifies that "a CCC guarantee can encourage extension of credit in cases where financial institutions might otherwise be unwilling to finance export on credit terms".[150] In addition, the FAS points out that such guarantees would "facilitate credit to foreign banks in larger amounts and on more favorable commercial terms than would otherwise be available".[151] Whatever the meaning of Article 14(c), the provision by CCC of guarantees that do not exist on the market entails the provision of a benefit per se. The benefit to the recipient, under the benchmark established by Article 14(c), would be the total amount of the loan backed by the guarantee, since there would be no "comparable commercial loan absent the government guarantee".

**76. How does the United States respond to Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders"? USA**

**77. How does the United States interpretation of "long term operating costs and losses" in item (j) as claims paid give meaning to both "costs" and "losses"? Do claims paid represent "losses" or "costs" or both? If claims paid is represented by "losses", what would go into the "cost" element of item (j)? Could the United States expand on why it disagrees with the items which Brazil identifies for inclusion in the examination to be conducted under item (j)? USA**

Brazil's Comment:

158. Brazil may wish to comment in its rebuttal submission on the response the United States ultimately provides to this question. In the meantime, however, Brazil would like to comment on US criticisms of the initial formula Brazil constructed to determine whether the GSM 102, GSM 103 and SCGP programmes fail to meet their long-term operating costs and losses, within the meaning of

[147] Exhibit Bra-38 (7 CFR 1493.10(a)(2)) and Exhibit Bra-38 (7 CFR 1493.400(a)(2)).
[148] Exhibit Bra-38 (7 CFR 1493.10(a)(2)) and Exhibit Bra-38 (7 CFR 1493.400(a)(2)).
[149] Exhibit Bra-151 ("US Export Credit Guarantee Programs: What Every Exporter Should Know About The GSM-102 and GSM-103 Programs," USDA, November 1996).
[150] Exhibit Bra-151 ("US Export Credit Guarantee Programs: What Every Exporter Should Know About The GSM-102 and GSM-103 Programs," USDA, November 1996).
[151] Exhibit Bra-151 ("US Export Credit Guarantee Programs: What Every Exporter Should Know About The GSM-102 and GSM-103 Programs," USDA, November 1996).

item (j). The Panel will recall that Brazil's initial formula, which was included in paragraph 281 and Figure 20 of its First Submission, can be stated as follows:

Premiums collected – (Administrative expenses + Default claims + Interest expenses)

159. Where this formula yields a negative number over a period constituting the "long term", Brazil argued that loan guarantees are provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programme", within the meaning of item (j).[152] Applying this formula to data for the period 1994-2003, Brazil demonstrated that premiums collected for the CCC guarantee programmes were indeed inadequate to cover operating costs and losses for the programmes.

160. To correct for alleged errors in Brazil's initial constructed formula, which was included in paragraph 281 and Figure 20 of its First Submission, the United States adopted its own alternative formula, in paragraph 173 of its First Submission, which can be stated as follows:

(Fees + Claims recovered + Claims rescheduled) – Claims paid

161. Where this formula yields a positive number over a period constituting the "long term," the United States asserts that loan guarantees are provided at premium rates that are adequate to cover the long-term operating costs and losses of the program, within the meaning of item (j).

162. Brazil made several criticisms of the US formula. In paragraph 123 of its Statement at the First Panel Meeting, Brazil demonstrated that the failure to account for interest paid by the CCC to the Treasury Department leads to artificially low accounting of operating costs. In paragraph 122, Brazil additionally demonstrated that it is incorrect to treat rescheduled debt as a recovery of a default claim. Brazil notes that rescheduling can in fact have the effect of increasing the costs incurred by the government, rather than reducing those costs. In its budget documents, the US Government treats Paris Club rescheduling of imminent defaults as "work-outs."[153] According to the US Office of Management and Budget ("OMB"), work-outs can either have a negative or a positive effect on cash flow.[154] The U. General Accounting Office ("GAO") has in fact stated that historically, the majority of GSM support that is rescheduled is "in arrears."[155] If anything, this increases CCC's cost.

[152] Revenue for "premiums collected" is recorded in the "Financing Account" section of the CCC budget, in the row titled "Loan origination fee" (line 88.40). *See* the US budget documents included as Exhibits Bra-88 to Bra-95. "Administrative expenses" are recorded in the "Programme Account" section of the CCC budget, in the row titled "Administrative expenses" (line 00.09). *See* the US budget documents included as Exhibits Bra-88 to Bra-95. Expenses for "default claims" are recorded in the "Financing Account" section of the CCC budget, in the row titled "Default claims" (line 00.01). *See* the US budget documents included as Exhibits Bra-88 to Bra-95. "Interest expenses" are recorded in the "Financing Account" section of the CCC budget, in the row titled "Interest on debt to Treasury" (line 00.02). *See* the US budget documents included as Exhibits Bra-88 to Bra-95.

[153] Exhibit Bra-121 (US General Accounting Office ("GAO"), Report to Congressional Committees, *Credit Reform: US Needs Better Method for Estimating Cost of Foreign Loans and Guarantees*, GAO/NSIAD/GGD-95-31, December 1994, p. 63) ("GAO/NSIAD/GGD-95-31").

[154] Exhibit Bra-116 (Executive Office of the President, Office of Management and Budget, Circular No. A-11, Part 5, *Federal Credit Programs* (June 2002), p. 185-13) ("OMB Circular A-11")).

[155] Exhibit Bra-152 (GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National Security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, *Status Report on GAO's Reviews of the Targeted Export Assistance Program, the Export Enhancement Programme, and the GSM-102/103 Export Credit Guarantee Programmes*, GAO/T-NSIAD-90-53, 28 June 1990, p. 14).

163. The United States' formula did correct for one shortcoming of Brazil's initial constructed formula, however. The United States is correct that Brazil's formula did not include recoveries.[156] Brazil therefore introduces a revised constructed formula that accounts for recoveries and interest on those recoveries, as recorded in the "Principal collections" and "Interest collections" rows[157] of the US budget. It also accounts for the interest accruing to the CCC on balances maintained in its so-called "financing account" for the purposes of potential claims,[158] as recorded in the "Interest on uninvested funds" row of the US budget documents.[159] Brazil's revised constructed formula can be stated as follows (including references to the specific budget lines involved):

(Premiums collected + Recovered principal and interest (Line 88.40) + Interest revenue (Line 88.25)) – (Administrative expenses (Line 00.09) + Default claims (Line 00.01) + Interest expense (Line 00.02))

164. Brazil emphasizes that it does not intend for this revised constructed formula to replace the formula used by the US government itself to track the costs of the CCC guarantee programs, pursuant to the US Federal Credit Reform Act ("FCRA"). In paragraphs 124-133 of its Statement at the First Panel Meeting, Brazil discussed the FCRA cost formula in considerable detail. The chart included at paragraph 132 of Brazil's Statement demonstrates that under the FCRA cost formula, CCC's export credit guarantee programs are offered at premium rates that are inadequate to cover their long-term operating costs and losses. Brazil believes that the FCRA cost formula is one very useful way to determine the performance of the CCC guarantee programs relative to the elements of item (j). However, if the Panel would like to confirm the results of the FCRA cost formula, or refer to an alternative formula, Brazil offers its revised constructed formula for these purposes.

165. Where Brazil's revised constructed formula indicates a net cost over a period constituting the "long term", export credit guarantees are provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programme", within the meaning of item (j). The following chart demonstrates that during the ten-year period FY 1993-2002, premiums for GSM 102, GSM 103 and SCGP export credit guarantees have been inadequate to cover long-term operating costs and losses. Net costs for the programmes during this period total more than $1 billion as set forth below:

| Fiscal year | Premiums collected (88.40) + Recovered principal and interest (88.40) + Interest revenue (88.25) | Admin. expenses (00.09) + Default claims (00.01) + Interest expense (00.02) |
|---|---|---|
| 1993 | $27,608,000 + $12,793,000 + $15,672,000[160] = $56,073,000 | $3.320,000[161] + $570,000,000[162]+ $0[163] = $573,320,000 |
| 1994 | $20,893,000 + $458,954,000 + $0[164] = $479,847,000 | $3,381,000[165] + $422,363,000[166] + $0[167] = $425,744,000 |

[156] First Submission of the United States, para. 173.

[157] In combination with loan origination fees, these rows are collectively recorded as line 88.40 in the US budget documents.

[158] Exhibit Bra-116 (OMB Circular A-11, p. 185-51). *See* also Exhibit Bra-118 (Federal Accounting Standards Advisory Board, *Statement of Federal Financial Accounting Standards No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in* STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 2, March 2001, p. 16 (para. 37)).

[159] This row is recorded as line 88.25 in the US budget documents. The payment of interest to an agency for uninvested balances in financing accounts is addressed in Exhibit Bra-117 (2 U.S.C. § 661d(c)).

[160] Exhibit Bra-126 (US budget for FY 1995, p. 156).

[161] Exhibit Bra-126 (US budget for FY 1995, p. 156).

[162] Exhibit Bra-126 (US budget for FY 1995, p. 156).

[163] No budget line Exhibit Bra-126 (US budget for FY 1995, p. 156).

[164] Exhibit Bra-95 (US budget for FY 1996, p. 162).

[165] Exhibit Bra-95 (US budget for FY 1996, p. 161).

[166] Exhibit Bra-95 (US budget for FY 1996, p. 162).

| | | |
|---|---|---|
| 1995 | $18,000,000 + $62,000,000 + $0[168] = $80,000,000 | $3,000,000 + $551,000,000 + $10,000,000[169] = $564,000,000 |
| 1996 | $20,000,000 + $68,000,000 + $26,000,000[170] = $114,000,000 | $3,000,000[171] + $202,000,000[172] + $61,000,000[173] = $266,000,000 |
| 1997 | $14,000,000 + $104,000,000 + $26,000,000[174] = $144,000,000 | $4,000,000[175] + $11,000,000[176] + $62,000,000[177] = $77,000,000 |
| 1998 | $17,000,000 + $81,000,000 + $54,000,000[178] = $152,000,000 | $4,000,000[179] + $72,000,000[180] + $62,000,000[181] = $138,000,000 |
| 1999 | $14,000,000 + $58,000,000 + $0[182] = $72,000,000 | $4,000,000[183] + $244,000,000 + $62,000,000[184] = $310,000,000 |
| 2000 | $16,000,000 + $100,000,000 + $99,000,000[185] = $215,000,000 | $4,000,000[186] + $208,000,000[187] + $62,000,000[188] = $274,000,000 |
| 2001 | $18,000,000 + $149,000,000 + $125,000,000[189] = $292,000,000 | $4,000,000[190] + $52,000,000[191] + $104,000,000[192] = $160,000,000 |
| 2002 | $21,000,000 + $155,000,000 + $61,000,000[193] = $237,000,000 | $4,000,000[194] + $40,000,000[195] + $93,000,000[196] = $137,000,000 |
| Total | $1,841,920,000 | $2,925,064,000 |
| **Long-term Net Cost** | **$1,083,144,000** | |

166. To arrive at this result, Brazil notes that it did not rely on "estimates" of the programmes' costs.[197] The annual US budget documents upon which Brazil relied track CCC data for three consecutive years – the prior year, the current year and the budget year. The 2004 budget, for example, which is completed in 2003, includes data for 2002, 2003 and 2004. Budget year data is

[167] Exhibit Bra-95 (US budget for FY 1996, p. 162).
[168] Exhibit Bra-94 (US budget for FY 1997, p. 176).
[169] Exhibit Bra-94 (US budget for FY 1997, p. 175).
[170] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[171] Exhibit Bra-93 (US budget for FY 1998, p. 174).
[172] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[173] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[174] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[175] Exhibit Bra-92 (US budget for FY 1999, p. 105).
[176] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[177] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[178] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[179] Exhibit Bra-91 (US budget for FY 2000, p. 111).
[180] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[181] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[182] Exhibit Bra-90 (US budget for FY 2001, p. 112).
[183] Exhibit Bra-90 (US budget for FY 2001, p. 110).
[184] Exhibit Bra-90 (US budget for FY 2001, p. 111).
[185] Exhibit Bra-89 (US budget for FY 2002, p. 118).
[186] Exhibit Bra-89 (US budget for FY 2002, p. 116).
[187] Exhibit Bra-89 (US budget for FY 2002, p. 117).
[188] Exhibit Bra-89 (US budget for FY 2002, p. 117).
[189] Exhibit Bra-88 (US budget for FY 2003, p. 120).
[190] Exhibit Bra-88 (US budget for FY 2003, p. 118).
[191] Exhibit Bra-88 (US budget for FY 2003, p. 119).
[192] Exhibit Bra-88 (US budget for FY 2003, p. 120).
[193] Exhibit Bra-127 (US budget for FY 2004, p. 109).
[194] Exhibit Bra-127 (US budget for FY 2004, p. 107).
[195] Exhibit Bra-127 (US budget for FY 2004, p. 108).
[196] Exhibit Bra-127 (US budget for FY 2004, p. 108).
[197] First Submission of the United States, paras. 175-178.

indeed based on estimates. Current year data is revised to account for any change to the cost or revenue item at issue. Since the current year is not yet complete when the budget is issued, however, current year data remains, at least in part, based on estimates. Prior year data, however, is based on actual costs and revenues. In applying its formula, Brazil used the data in the prior year column, and therefore used actual costs and revenues, rather than estimates.[198]

167. Several other factors corroborate the fact that the CCC export guarantee programmes do not charge premia that allow them to meet their long-term operating costs and losses.

- First, in audit reports of the CCC's fiscal year 2000 and 2001 financial statements, the US Department of Agriculture's Office of the Inspector General noted that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programs have not been changed in 7 years and may not be reflecting current costs."[199] While Brazil does not have fee schedules for the entire period 1993-2002, it provides for the Panel's review fee schedules for GSM 102 and GSM 103 from November 1994, 4 September 2001 and 24 September 2002.[200] According to CCC's website, the latter is the fee schedule that is currently in force. The Panel will note that between November 1994 and 23 September 2002, CCC made only one change in its fee schedule for GSM 102: while the fee for a 12-month guarantee with semi-annual repayment intervals was $0.209 per $100 of coverage in November 1994, by 4 September 2001 it had changed to $0.229 per $100 of coverage. On 24 September 2002, one additional change was made: borrowers were offered the additional option of 30 and 60 day guarantees, at the same fee charged for 90-day and 4-, 6- and 7-month guarantees.

- Second, US Department of Agriculture Under Secretary August Schumacher testified to Congress in 1998 that the GSM 102 programme suffered nearly $2 billion in losses as a result of Iraqi defaults, and an additional nearly $2 billion resulting from Polish defaults.[201] GAO stated that liabilities on the Iraqi debt accrued over the period 1990-1997, as the guaranteed Iraqi borrowings came due.[202] As noted by Brazil in paragraph 284 of its First Submission, however, the maximum in GSM 102 premiums the United States could have generated from all export credit guarantees provided during the lifetime of the programmes up to 1998 – had it applied the highest possible

[198] Of the 1994-2003 period tracked in Figure 20 to Brazil's First Submission, the only figures that reflected estimates were those for the year 2003, since actual data is not yet available for that year. To correct this, and to ensure that the data is still sufficient to reveal whether the CCC export credit guarantee programmes incur "long term" operating costs and losses, the chart above tracks CCC guarantees for the period 1993-2002.

[199] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31). *See also* Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed for many years and may not be reflecting current costs.").

[200] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 and GSM-103 Programme Participants*, 24 September 2002); Exhibit Bra-98 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 & GSM-103 Programme Participants*, 4 September 2001); Exhibit Bra-156 (US Export-Import Bank, *Comparison of Major Features of Programmes Offered by Ex-Im Bank and Commodity Credit Corporation for Support of Bulk Agricultural Commodities*, available at http://www.exim.gov/pub/ins/pdf/eib99-13.pdf). Brazil was unable to locate from public sources other fee schedules from the period 1993-2002.

[201] Exhibit Bra-87 ("Testimony of August Schumacher Jr., Under Secretary, Farm and Foreign Agricultural Service, USDA, before the Subcommittee on General Farm Commodities, Hearing on the Asian Financial Crisis, 4 February 1998", p. 10-11).

[202] Exhibit Bra-157 (US General Accounting Office, REPORT TO THE CHAIRMAN, TASK FORCE ON URGENT FISCAL ISSUES, COMMITTEE ON THE BUDGET, HOUSE OF REPRESENTATIVES, *International Trade: Iraq's Participation in US Agricultural Export Programs*, GAO/NSIAD-91-76 (November 1990), p. 27 (Table IV.2)).

premium rate to all guarantees – is $358.54 million.[203] The total amount of received applications for GSM 102 export credit guarantees for the period 1999-2002 was $11.77 billion, resulting in a theoretical additional maximum premium of $78.08 million for that period.[204] Thus, the highest amount of premiums the United States could have generated under this programme from its inception through 2002 would amount to $436.62 million.[205] This does not come close to covering the programme's losses from the Iraqi and Polish defaults alone.

- Third, CCC financial statements for fiscal year 2002 report that uncollectible amounts on post-1991 CCC guarantees total $770 million.[206] As noted in the chart above at paragraph 165, CCC collected premiums of $222.641 million for GSM 102, GSM 103 and SCGP during the period 1992-2002.[207] Thus, even without accounting for other operating costs, or for receivables that CCC hopes to collect but may not, losses for the CCC export credit guarantee programmes outpace premiums during the period 1992-2002 by nearly $550 million.

- Fourth, CCC's 2002 financials also report uncollectible amounts on pre-1992 CCC guarantees of $2.567 billion.[208] While actual data concerning premiums during the period 1981-1991 (from the first year GSM 102 was available until the last year before credit reform was introduced with the Federal Credit Reform Act) is not publicly available, Brazil has applied a proxy based on the average annual fees collected during the period 1992-2002 ($20.24 million). Multiplying $20.24 million by the 11 years included in the 1981-1991 period results in total fees of $222.64 million. Thus, even without accounting for other operating costs, or for receivables that CCC hopes to collect but does not, losses for the CCC export credit guarantee programs outpace premiums during the period 1981-1991 by more than $2.3 billion.

- Finally, the US General Accounting Office ("GAO") estimated in 1992 that if GSM 102 and GSM 103 continued until 2007, costs for the programs would reach $7.6 billion.[209] Premium fees

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[203] *See* Exhibit Bra-73 ("Summary of Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003) for the total amounts of allocations. These have been multiplied by 0.663 percent to obtain the theoretical maximum premium.

[204] Exhibit Bra-73 ("Summary of Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003).

[205] This amount is a substantial overstatement, as premiums for periods of coverage shorter than 3 years will yield substantially lower premiums of as low as 15.3 cents per $100 as compared to 66.3 cents for a 3-year coverage. Exhibit Bra-98 ("Guarantee Fee Rate Schedule Under GSM 102 and GSM 103").

[206] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14). This figure theoretically includes not only uncollectible amounts for the GSM 102, GSM 103 and SCGP programs, but also uncollectible amounts for CCC's Facility Guarantee Programme ("FGP"). Brazil has not challenged the FGP in this dispute. Brazil notes, however, that in fiscal years 1999-2003 (for which programme activity data is available on CCC's website, at http://www.fas.usda.gov/excredits/Monthly/ecg.html), exporter applications were only received for a total of $4.8 million in coverage under the FGP. Thus, defaults on FGP guarantees, if any, would contribute only negligibly to the $770 million figure discussed above.

[207] The chart in paragraph 165 does not include premiums for 1992. Those premiums totalled $36.14 million. *See* Exhibit Bra-125 (US budget for FY 1994, p. 383). According to US budget documents, premiums for the FGP are included in the budget line item for fees on the GSM and SCGP programs.

[208] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14). The FGP did not exist during this period, and thus is not a factor.

[209] Exhibit Bra-159 (US General Accounting Office, REPORT TO CONGRESSIONAL REQUESTERS, *Loan Guarantees: Export Credit Guarantee Programmes' Costs are High*, GAO/GGD-93-45 (December 1992), p.4). *See also* Exhibit Bra-115 (US General Accounting Office, Report to the Chairman, Subcommittee on Criminal Justice, US House of Representatives Committee on the Judiciary, "Loan Guarantees: Export Credit Guarantee Programmes' Long Run Costs are High," GAO/NSIAD-91-180, 19 April 1991, p. 2-3) ("We estimate that the

for the period 1992-2007 (assuming current rates) would only reach $323.84,[210] demonstrating that fees for the programme do not meet costs.

In sum, CCC financials state that during the period 1981-2002, costs and losses for CCC export credit guarantee programmes exceeded premiums collected.

**78. Can the United States provide supporting documentation for data used relating to "costs and losses" in paragraph 173? Could the United States confirm that the figures cited in paragraph 173 of its first written submission relate to the SCGP? Why did the United States cite these figures after stating that it is not possible to make any assessment of the long-term operating costs and losses of this programme? USA**

**79. In respect of what time periods does Article 13(c) require an assessment of conformity with Part V of the Agreement on Agriculture? How does this affect, if at all, your interpretation of Article 13(b)? BRA, USA**

Brazil's Answer:

168. Part V of the Agreement on Agriculture requires that Members grant export subsidies in conformity with that agreement and with that Member's export subsidy reduction commitments. These commitments are made on a commodity specific basis.[211] The relevant section of the US Schedule of Concessions (Part IV, Section II) clarifies that the US export subsidy commitments are to be assessed on a US fiscal year basis.[212] A Member's export subsidy reduction commitments cover annual budgetary outlays and quantitative reduction commitments – in the US case on a fiscal year basis.[213] It follows that the US compliance with its export subsidy reduction commitments must be assessed on the basis of specific agricultural products and fiscal years.

169. Thus, similar to domestic support measures, the conformity of a Member's export subsidies with Part V of the Agreement on Agriculture must be assessed by comparing the amounts actually granted (both in term of budgetary outlays as well as in terms of quantities of specific agricultural products benefiting from export subsidies) with a benchmark, i.e., with a Member's export subsidy reduction commitments.

170. According to Article 3.3 of the Agreement on Agriculture, for agricultural products not included in Part IV, Section II of a Member's Schedule (i.e. unscheduled products) any export subsidy granted leads to a violation of Part V of the Agreement on Agriculture. Brazil's claims against Step 2 export subsidies and against ETI Act subsidies benefiting upland cotton fall in this category, as the United States does not have an export subsidy reduction commitment for upland cotton.[214] Furthermore, Brazil's claims concerning export credit guarantee programs fall in this category, in as far as export credit guarantees are available for unscheduled agricultural products.

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GSM programmes will cost the Corporation about $6.7 billion in the long run . . . This estimate assumes that the outstanding loans and guarantees remain at the same level for about 16 years and that their average risk remains unchanged as new guarantees replace old ones).

[210] This has been calculated based on actual fees for 1992-2002 and using average 1992-2002 fees as expected fees for the remainder of the time period (2003-2007).

[211] *See* Brazil's answer to Question 7.

[212] Exhibit Bra-83 (Schedule XX of the United States of America, Part IV, Section II entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments).

[213] Exhibit Bra-83 (Schedule XX of the United States of America, Part IV, Section II entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments).

[214] Exhibit Bra-83 (Schedule XX of the United States of America, Part IV, Section II entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments).

171. For scheduled agricultural products, the Panel needs to determine whether the export subsidies for a particular scheduled agricultural product are in excess of the export subsidy reduction commitment levels for that agricultural product in the year in question, or whether the application of the export subsidies threatens to lead to circumvention of the export subsidy reduction commitments. More specifically, in this dispute, the Panel needs to assess whether the CCC export credit guarantee programmes threaten to circumvent the export subsidy reduction commitments of the United States for scheduled agricultural products.

**80. In Brazil's view, why did the drafters of the Agreement on Agriculture not include export credit guarantees in Article 9.1? BRA**

Brazil's Answer:

172. The negotiating history of the Agreement on Agriculture does not reveal why the drafters did not include export credits guarantees in Article 9.1, just as it does not reveal why the drafters did not include well-known and widely-used export subsidies like the United States' FSC regime in Article 9.1. Yet, the Appellate Body concluded that the FSC regime constitutes an export subsidy and is subject to the general export subsidy disciplines in the Agreement on Agriculture, including Article 10.1 thereto. As Brazil has previously noted, Article 1(e) defines export subsidies as "including" those listed in Article 9.1 of the Agreement on Agriculture, and Article 10.1 refers to a universe of export subsidies "not listed in" Article 9.1. As the Appellate Body's report in US – FSC illustrates, if a measure meets the definition of "export subsidy", it is subject to Article 10.1, even though it is not included in Article 9.1.

173. Under the Vienna Convention rules, Articles 9.1 and 10.1, as well as Article 10.2 of the Agreement on Agriculture, are to be interpreted according to their ordinary meaning, in their context, and according to the object and purpose of the Agreement on Agriculture. Brazil has demonstrated that the CCC export credit guarantee programs fulfill the definition of "export subsidy" in the Agreement on Agriculture and the SCM Agreement, and that export credit guarantees are not, under a Vienna Convention interpretation of Article 10.2, excluded from the general export subsidy disciplines in Article 10.1.

**81. How does the United States respond to the following in Brazil's oral statement: USA**

**(a) paragraph 122 (rescheduled guarantees)**
**(b) paragraph 123 (interest on debt to Treasury)**
**(c) paragraphs 125 ff. (guaranteed loan subsidy)**
**(d) paragraphs 127-129 (re-estimates, etc.)**
**(e) Exhibits BRA-125-127**
**(f) the chart on page 53 of Brazil's oral statement at the first session of the first Panel meeting relating to "Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programs GSM-102 GSM 103 and SCGP"?**
**(g) In respect of (a)-(f) above, how and to what extent do the information and data presented for the export guarantee programmes concerning "program" and "financing", "summary of loan levels", "subsidy budget authority", "outlay levels", etc., in particular in Exhibits BRA-125-127, reflect "actual costs and losses" of the GSM-102, GSM-102 and SCGP export credit guarantee programmes(see e.g. Brazil's closing oral statement at the first session of the first substantive meeting, paragraph 24)? USA**

Brazil's Comment on Question 81(g):

174. Brazil may wish to comment in its rebuttal submission on the response the United States ultimately provides to this and the other sub-parts of question 81. In the meantime, however, Brazil would like to comment on the distinction between actual and estimated costs and losses.

175. As noted above in comments on Question 77, Brazil has used data from the prior year column of the US budget. This column is titled "actual," since it reflects reconciled data for a full fiscal year. Data reported in the prior year column of the "guaranteed loan subsidy" row of the US budget is "actual" in this sense. Brazil explained in paragraph 127 of its Statement at the First Panel Meeting that the FCRA calls for the CCC to make annual "reestimates" to the cost calculation and thus to the "guaranteed loan subsidy" line in the budget. Reestimates "take into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries,"[215] to the extent that those factors have changed since the initial estimate was made for purposes of the budget year column of the budget.

176. The results of the reestimate process are captured in the US budget and in CCC's financial statements.[216] Reestimates made in a given fiscal year are netted and recorded in the "reestimates of subsidy" (line 00.07) and "interest on reestimate" (line 00.08) lines of the US budget. In the 2002 column of the 2004 budget, for example, "reestimates of subsidy" were recorded in the amount of $118 million, and "interest on reestimate" was recorded as $8 million.[217] In the 2002 column of the 2004 budget, the United States in fact aggregates these two amounts with the "guaranteed loan subsidy" amount of $97 million and the "administrative expenses" of $4 million to arrive at a total subsidy of $227 million (which is in turn deducted from the budgetary resources available to the CCC in line 23.95 of the budget).[218] While Brazil could have followed this same convention to accentuate the amount by which the CCC guarantee programmes' costs and losses outstrip revenue by even more than that listed in the chart included in paragraph 132 of Brazil's Statement to the First Panel Meeting, it chose to be conservative and did not do so.

177. The results of the reestimate process are also captured in a cumulative, "running tally" of the FCRA subsidy figure included in CCC's annual financial statements. CCC's fiscal year 2002 financial statements track the "credit guarantee liability" for post-1991 guarantees disbursed under the CCC export guarantee programmes. "Credit guarantee liability" is defined in the CCC financials as representing "the estimated net cash outflows (loss) of the guarantees on a net present value basis."[219] The Panel will recall that the "guaranteed loan subsidy" line in the US budget similarly tracks the net present value of payments to and from the government for CCC export guarantees, although only with respect to guarantees disbursed in one particular year. The 2002 financial statement provides a cumulative subsidy figure for all post-1991 guarantees under the CCC programmes. The analysis included in the 2002 financial statement begins with the credit guarantee liability included in the 2001

[215] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, "Statement of Federal Financial Accounting Standards No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees" in STATEMENT OF FEDERAL FINANCING ACCOUNTING STANDARDS NO. 2, March 2001, p. 15 (para. 32)). *See also* Exhibit Bra-160 (US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2003), p. 80, 117, 199); Exhibit Bra-161 (US Federal Accounting Standards Advisory Board, FEDERAL FINANCIAL ACCOUNTING AND AUDITING TECHNICAL RELEASE 3, *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* (31 July 1999), p. 17-21).

[216] According to OMB, reestimates are to be recorded in the budget. Exhibit Bra-116 (OMB Circular A-11, p. 185-4).

[217] Exhibit Bra-127 (US budget for FY 2004, p. 107).

[218] Exhibit Bra-127 (US budget for FY 2004, p. 107).

[219] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 4).

financial statement, makes adjustments for defaults, fees and reestimates undertaken in fiscal year 2002 with respect to all post-1991 guarantees, and results in a new subsidy figure of $411 million for those post-1991 guarantees.[220] This positive net present value means that CCC has "los[t] money" during the period 1992-2002.[221]

178. While Brazil has demonstrated that the reestimation process applied to the FCRA formula does in fact track actual data and does in fact account for actual performance of CCC export credit guarantees, Brazil notes that a certain degree of estimated data would be perfectly acceptable in an analysis of the costs and losses of guarantee programs under item (j). The purpose of the FCRA and its cost formula was, after all, "to measure more accurately the costs of Federal credit programmes," including contingent liabilities like export credit guarantees.[222] As the United States evidently agrees, accounting for the costs of contingent liabilities like guarantees on a cash basis is not appropriate, since it masks the real costs of those guarantees. Even if the FCRA cost formula does entail the use of some estimated data, the US Congress and the President consider that that formula is the most accurate way of tracking costs.

179. Brazil notes, finally, that it is not entirely accurate to call the data used to arrive at initial estimates of the "guaranteed loan subsidy" figure "estimated" data. The US Federal Accounting Standards Advisory Board, the Government-Wide Audited Financial Statements Task Force on Credit Reform, the Office of Management and Budget and the Department of Agriculture itself have emphasized that "[m]ethods of estimating future cash flows for existing credit programs need to take account of past experience,"[223] that "[a]ctual historical experience of the performance of a risk category is a primary factor upon which an estimation of default cost is based",[224] and that the technical assumptions underlying subsidy calculations reflect "historical cash reports and loan performance".[225] This demonstrates that "estimates" of the subsidy cost of CCC guarantees are informed by actual historical experience with borrowers.

180. Brazil also notes that a number of factors involved in setting the FCRA subsidy cost are "explicit" and not "forecast". The Office of Management and Budget identifies contract terms such as maturity, borrower's interest rate, fees and grace periods as "explicit," and therefore not "estimated".[226] Moreover, as the Panel is well aware, none of the "reestimates" at issue is Brazil's. They are all estimates by official agencies of the United States.

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[220] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19). As noted above in Brazil's comments on Question 77, while this figure theoretically includes CCC's Facility Guarantee Programme ("FGP"), activity under that programme is virtually non-existent.

[221] Exhibit Bra-121 (US General Accounting Office ("GAO"), Report to Congressional Committees, "Credit Reform: US Needs Better Method for Estimating Cost of Foreign Loans and Guarantees," GAO/NSIAD/GGD-95-31, December 1994, p. 20).

[222] Exhibit Bra-117 (2 U.S.C. § 661(1)).

[223] Exhibit Bra-162 (Government-Wide Audited Financial Statements Task Force on Credit Reform, ISSUE PAPER, *Model Credit Programme methods and Documentation for Estimating Subsidy Rates and the Model Information Store*, 96-CR-7 (1 May 1996), p. 2).

[224] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36)). *See also* Exhibit Bra-160 (US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2003), p. 120 ("In estimating default costs, the following risk factors are considered: (1) loan performance experience; . . .")).

[225] Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002, p. 9).

[226] Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002, p. 9).

**82. Please explain each of the following statements and any possible significance it may have in respect of Brazil's claims about GSM-102 and GSM-103 (7 CFR 1493.10(a)(2), Exhibit BRA-38): BRA, USA**

Brazil's Answer:

181. As discussed below, these passages corroborate evidence provided by Brazil to demonstrate that the CCC guarantee programmes constitute export subsidies within the meaning of Articles 1.1 and 3.1(a) of the SCM Agriculture, and thus within the meaning of Articles 1(e), 10.1 and 8 of the Agreement on Agriculture.

> **(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Brazil's Answer:

182. The passage cited by the Panel provides corroborating evidence that CCC guarantees provide "benefits", within the meaning of Article 1.1(b) of the SCM Agreement. Specifically, the passage states that the CCC programmes "operate in cases . . . where US financial institutions would be unwilling to provide financing without CCC's guarantee". This demonstrates at least two things. First, it establishes that the CCC guarantee programs are used in situations where, without a CCC guarantee, a borrower could not secure financing at all – not just financing on less attractive terms than could be secured with the CCC guarantee (or on terms that would constitute a benefit under Article 14(c) of the SCM Agreement), but no financing at all. Second, it establishes that financing could not be secured without a CCC guarantee – a commercial guarantee would not do. This corroborates Brazil's assertion that CCC provides something that has no equivalent on the commercial market.

183. Brazil notes that the regulations for the SCGP programme contain an identical provision, in 7 CFR 1493.400(a)(2). That section states that "[t]he SCGP operates in cases where credit is necessary to increase or maintain US exports to a foreign market and where private US exporters would be unwilling to provide financing without CCC's guarantee".[227]

184. Moreover, in its Annual Performance Plans for fiscal years 2000, 2001 and 2002, the US Department of Agriculture's Foreign Agricultural Service similarly stated that the SCGP programme "was created to expand high-value product exports by facilitating credit for such purchases in foreign markets lacking sufficient liquidity to purchase openly on the commercial market".[228] This demonstrates that the SCGP programme extends "benefits," since it facilitates credit for the purchase of US agricultural commodities in circumstances where credit would not otherwise be available at all.

> **(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programs are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

[227] Exhibit Bra-38 (7 CFR 1493.400 *et seq*.).

[228] Exhibit Bra-164 (US Department of Agriculture, Foreign Agricultural Service, *Revised FY 2001 and FY 2002 Annual Performance Plan*, p. 11); Exhibit Bra-165 (US Department of Agriculture, Foreign Agricultural Service, *Revised FY 2000 and FY 2001 Annual Performance Plan*, p. 17).

Brazil's Answer:

185. This passage also demonstrates that CCC guarantees confer "benefits". Specifically, the passage states that "[t]he programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports . . .". Like the passage included in 82(a), this passage establishes at least two things. First, that without a CCC guarantee, a borrower would not be able to secure financing at all – not just financing on less attractive terms than could be secured with the CCC guarantee (or on terms that would constitute a benefit under Article 14(c) of the SCM Agreement), but no financing at all. Second, that the CCC guarantee is necessary – a commercial guarantee would not be sufficient.

186. Brazil notes that the regulations for the SCGP programme contain an identical provision, in 7 CFR 1493.400(a)(2). That section states that "The programme is operated in a manner intended not to interfere with markets for cash sales. The programme is targeted toward those countries where the guarantees are necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments."[229]

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

*Brazil's Answer:*

187. This passage demonstrates that the CCC guarantee programmes are contingent on export, within the meaning of Article 3.1(a) of the SCM Agreement. Specifically, the passage establishes that the CCC guarantee programs are for use by "US agricultural exporters". It also confirms that the programmes operate to the benefit of US exporters, who with the help of the programmes are able to expand their market share.

188. Brazil notes that the regulations for the SCGP programme contain an identical provision, in 7 CFR 1493.400(a)(2). That section states that "[i]n providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities."[230]

**83. Could Brazil explain how the procedure in Annex V of the SCM Agreement would be relevant to its claims concerning agricultural export subsidies, prohibited subsidies and agricultural domestic support? (e.g. note 301 in Brazil's first submission and paragraph 4 of Brazil's oral statement at the first session of the first substantive meeting). BRA**

Brazil's Answer:

189. The United States failed to respond to Brazil's questions and document requests during the Annex V procedures. Indeed, the United States refused to participate in any way in the Annex V procedures mandated by Brazil's invocation of Annex V in its request for establishment of this Panel. This refusal to participate has consequences under the express terms of Annex V. The list of Annex V questions provided to the United States by Brazil is included in Exhibit Bra-49. As directed by paragraph 6 of Annex V, given the United States' failure to cooperate in the Annex V information-gathering process, Brazil has and will present its case regarding peace clause issues and serious prejudice claims based on evidence available to it. If there are gaps in the evidence provided to the Panel by Brazil in support of its prima facie case, and those gaps are due to the United States' failure

[229] Exhibit Bra-38 (7 CFR 1493.400 *et seq.*).
[230] Exhibit Bra-38 (7 CFR 1493.400 *et seq.*).

to cooperate with and participate in the Annex V process, Annex V, paragraph 6 provides that "the panel may complete the record as necessary relying on best information otherwise available".

190. As a final note, Brazil's Annex V questions to the United States included questions concerning US agricultural export subsidies and domestic content subsidies because these are also "actionable" subsidies that cause serious prejudice to Brazil's interests.

**84. Is the Panel correct in understanding that, under the GSM-102 and GSM-103 programmes, the exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? USA**

Brazil's Comment:

191. The Panel is correct in stating that fees for GSM 102 and GSM 103 guarantees vary only according to the dollar value of the transaction and the length of the guarantee. GSM 102 and GSM 103 fees do not otherwise vary and are charged according to a fee schedule that does not account for the country risk involved or the credit rating of the borrower. Brazil attaches news releases from the US Department of Agriculture's Foreign Agricultural Service announcing GSM 102 and GSM 103 guarantees to Dominican Republic, Morocco, Ghana, South Korea, Vietnam and Algeria.[231] The Panel will note that the fees do not vary, and are based on the standard GSM 102 and GSM 103 fee schedule included as Exhibit Bra-155.[232]

192. As noted above in Brazil's comment on Question 77, the US Department of Agriculture's Office of the Inspector General has noted in June 2001 that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs".[233] It repeated this statement in February 2002.[234] Thus, GSM 102 and GSM 103 fees remained virtually unchanged from at least 1994 until February 2002. The current fee schedule demonstrates that this trend continues to the present.[235]

193. In reviewing the historical fee schedules available from public sources,[236] Brazil notes that from at least 1994 until the present, CCC made two changes in its fee schedule for GSM 102. First, it

[231] Exhibit Bra-166 (US Department of Agriculture Foreign Agricultural Service, News Releases regarding extension of GSM 102 and GSM 103 guarantees to Dominican Republic, Morocco, Ghana, South Korea, Vietnam and Algeria).

[232] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 and GSM-103 Programme Participants*, 24 September 2002).

[233] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31).

[234] Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed for many years and may not be reflecting current costs.").

[235] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 and GSM-103 Programme Participants*, 24 September 2002).

[236] Exhibit Bra-155 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 and GSM-103 Programme Participants*, 24 September 2002); Exhibit Bra-98 (US Department of Agriculture Foreign Agricultural Service, *Notice to GSM-102 and GSM-103 Programme Participants*, 4 September 2001); Exhibit Bra-156 (US Export-Import Bank, *Comparison of Major Features of Programmes Offered by Ex-Im Bank and Commodity Credit Corporation for Support of Bulk Agricultural Commodities*, available at http://www.exim.gov/pub/ins/pdf/eib99-13.pdf). Brazil was unable to locate from public sources other fee schedules from the period 1993-2002.

changed the fee for a 12-month guarantee with semi-annual repayment intervals from $0.209 per $100 of coverage to $0.229 per $100 of coverage. Second, it decided to offer borrowers the additional option of 30- and 60-day guarantees, at the same fee charged for 90-day and 4-, 6- and 7-month guarantees.

**85. Is the Panel correct in understanding that, under the SCGP, the exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? Please explain any "risk" assessment involved in the programme. USA**

Brazil's Comment:

194. The Panel is correct in stating that fees for SCGP guarantees vary only according to the dollar value of the transaction and the length of the guarantee. SCGP fees do not otherwise vary and are charged according to a fee schedule that does not account for the country risk involved or the credit rating of the borrower. For SCGP guarantees of up to 90 days, the fee is $0.45 per $100 of coverage, and for SCGP guarantees from 90-180 days, the fee is $0.90 per $100 of coverage.[237] Brazil attaches news releases from the US Department of Agriculture's Foreign Agricultural Service announcing SCGP guarantees to Tunisia, Azerbaijan, Vietnam, South Korea, Japan and Nigeria.[238] The Panel will note that the fees do not vary.

**86. Is there a risk categorization in relation to three export credit guarantee programmes (GSM-102, GSM-103 and SCGP)? Does this have any impact on premiums payable and the ability of the CCC to on-sell the guarantees ? USA**

Brazil's Comment:

195. Fees for GSM 102, GSM 103 and SCGP guarantees do not vary depending upon the credit rating of the borrower. As noted in Brazil's comments on Questions 84 and 85, guarantee fees for these three programs vary only according to the dollar value of the transaction and the length of the guarantee. Fees do not otherwise vary and are charged according to a fee schedule that does not account for the country risk involved or the credit rating of the borrower.

196. In calculating the "subsidy cost" for the purposes of the Federal Credit Reform Act, agencies like the CCC account for country risk. According to the narrative description included in the US budget,

> [t]he subsidy estimates for the GSM-102 and GSM-103 programs are determined in large part by the obligor's sovereign or non-sovereign country risk grade. These grades are developed annually by the International Credit Risk Assessment System Committee (ICRAS). . . . The default estimates for GSM guarantees are determined in large part by the risk premia assigned for each risk grade.[239]

197. According to the GAO, "OMB requires executive branch agencies to calculate the costs of foreign loans and guarantees using annually updated ICRAS ratings and . . . country risk interest premiums when foreign loans or guarantees are budgeted, authorized, disbursed, or modified. . . ."[240]

[237] Exhibit Bra-167 (12 Steps to Participating in the USDA Supplier Credit Guarantee Programme, Step 5).

[238] Exhibit Bra-168 (US Department of Agriculture Foreign Agricultural Service, News Releases regarding extension of SCGP guarantees to Tunisia, Azerbaijan, Vietnam, South Korea, Japan and Nigeria).

[239] Exhibit Bra-127 (US budget for FY 2004, p. 108).

[240] Exhibit Bra-121 (GAO/NSIAD/GGD-95-31, p. 7).

198. Thus, while CCC fees for GSM 102, GSM 103 and SCGP fees do not account for country risk or the credit risk of the borrower, the "guaranteed loan subsidy" line in the US budget and the subsidy figures in the CCC's financial statements do take account of country risk.

**87. What proportion of CCC (export-related and total) long term operating costs and losses are represented by GSM-102, GSM-103 and SCGP programmes? USA**

**88. (a) Is the Panel correct in understanding that the United States' argument is that, at present, by virtue of Article 10.2 of the Agreement on Agriculture, there are no disciplines on agricultural export credit guarantees under the Agreement on Agriculture (or the SCM Agreement)? USA**

**(b) Does the United States agree with the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the Agreement on Agriculture? Please cite any relevant material, including any past WTO dispute settlement cases. How would this reconcile with the United States' own statement, at paragraph 21 of its closing oral statement that "of course, the United States may not provide subsidies without any limit". USA**

**(c) If, as the United States argues, there are no disciplines on export credit guarantees in the Agreement on Agriculture, how could export credit guarantees "conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity when there are allegedly no disciplines against which such an assessment could occur)? USA**

Brazil's Comment:

199. As the Panel's question suggests, if the Panel determines that export credit guarantees are not subject to the export subsidy disciplines in the Agreement on Agriculture, the United States is nevertheless not entitled to the protection afforded by Article 13(c). Article 13(c) provides an exemption from action for those export subsidies that "conform fully to the provisions of Part V" of the Agriculture Agreement. If, as the United States argues, export credit guarantees are not subject to Part V, then they cannot "conform fully to the provisions of Part V," and are not entitled to the safe haven in Article 13(c).

200. The panel in Canada – Aircraft (21.5) took a similar approach with respect to the safe haven included in the second paragraph of item (k) to the Illustrative List of Export Subsidies appended to the SCM Agreement.[241] The second paragraph of item (k) provides as follows:

> Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

[241] Panel Report, *Canada – Aircraft (21.5)*, para. 5.143-5.145.

The "international undertaking on official export credits" cited in this provision is the Organization for Economic Co-operation and Development's Arrangement on Guidelines for Officially Supported Export Credits ("OECD Arrangement").[242]

201. To determine whether a particular Canadian measure could benefit from the safe haven in the second paragraph of item (k), the Panel first reviewed which types of "export credit practices" could potentially be "in conformity with" the "interest rates provisions" of the OECD Arrangement. According to the Panel, it could only "determine the conformity of a given export credit practice with those interest rate provisions . . . [if] it is of the type that conceptually could be subject to, and thus in conformity with, those provisions".[243] Similarly, if the United States is correct that CCC export credit guarantees are not subject to the disciplines in Part V of the Agriculture Agreement, then CCC guarantees cannot logically "conform fully to the provisions of Part V" and trigger the exemption from action provided for in Article 13(c).

**(d) Is the United States advocating the view that its own export credit guarantee programmes, which pre-dated the Uruguay Round, are effectively "grandfathered" so as to benefit from some sort of exemption from the export subsidy disciplines of the Agreement on Agriculture? How, if at all, is it relevant that the SCGP did not, according to the United States, become relevant for upland cotton until the late 1990's (i.e. after the entry into force of the WTO Agreement)? USA**

F. STEP 2 PAYMENTS

**89. Does the United States confirm Brazil's statement in paragraph 331 of its first submission that "The conditions and requirements for Step 2 domestic payments remain unchanged with the passage of the 2002 FSRI Act"? What is the relevance of this, if any, to this dispute? USA**

**90. Does the United States confirm Brazil's statement in paragraph 235 of its first submission that the changes concerning Step 2 export payments from the 1996 FAIR Act to the 2002 FSRI Act are: increase in the amount of the subsidy by 1.25 cents per pound and the removal of any budgetary limits that applied under the 1996 FAIR Act? What is the relevance of this, if any, to this dispute? USA**

**91. What is the significance of the elimination of the 1.25 cent threshold payment in the 2002 FSRI Act pertaining to Step 2 payments? USA**

**92. Does the United States confirm that Exhibit BRA-65 represents a sample contract for exporters of eligible upland cotton to conclude with the CCC under the FSRI 2002, and that an application form (Exhibit BRA-66) needs to be filled out with data on weekly exports and submitted to the USDA FAS. Is Exhibit BRA-66 - Form CCC 1045-2 – also a valid example? If not, please identify any differences or distinctions. USA**

[242] Available at http://www.oecd.org/dataoecd/52/3/2763846.pdf.

[243] WT/DS70/RW, para. 5.93. The Panel concluded that "the only forms of export credit practices" subject to the interest rate provisions of the *OECD Arrangement* are "direct credits/financing, refinancing and interest rate support," since only those forms of official financing support are subject to the *Arrangement*'s commercial interest reference rates ("CIRR") – "the only *existing* systems of minimum interest rates under the *Arrangement*." *Id*., paras. 5.98, 5.101 (emphasis in original). Since the CIRR are only expressed as fixed rates, the Panel concluded that they could only be applied to fixed (and not floating) interest rate transactions. *Id*., para. 5.102. Nor could the CIRR be applied to official support with a shorter maturity than two years (the minimum term expressly listed in the *OECD Arrangement*), or to guarantees or insurance. *Id*., para. 5.106.

Brazil's Comment:

202. Brazil includes a new version of the current "Upland Cotton Domestic User/Exporter Agreement" (Revision 7, in effect as of 1 August 2003 and issued on 17 June 2003), which replaces Revision 6 that Brazil has included as Exhibit Bra-65 to its First Submission.

**93. Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment? USA**

**94. Is the Panel correct in understanding that Brazil alleges an inconsistency with Article 3.1(b) of the SCM Agreement only with respect to Step 2 domestic payments? BRA**

Brazil's Answer:

203. Yes.

**95. Do the criteria in 7 CFR 1427.103(c)(2) (Exhibit BRA-37) that Step 2 "eligible upland cotton" must be "not imported cotton" apply to both domestic and export payments? USA**

**96. Is a domestic sale a "use" for the purposes of Step 2 payments? Is a sale for export, or export, considered a "use"? USA**

**97. How does the United States respond to Brazil's assertion, at paragraph 70 of Brazil's oral statement at the first session of the first substantive meeting, that "It is obvious that a single bale of cotton cannot be both exported and used domestically." Is this a relevant consideration? USA**

**98. How many Step 2 payments are received if a bale of upland cotton is exported, and then opened by a domestic user in the United States, or vice versa? USA**

**99. How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's oral statement at the first session of the first Panel meeting concerning the relevance of the Appellate Body Report in US-FSC (21.5). USA**

**100. How does Brazil respond to the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in Canada-Dairy and the findings of the Appellate Body in US-FSC (21.5)[244], do any other dispute settlement reports offer guidance on this issue? For example, how, if at all is the Appellate Body's report in Canada-Aircraft relevant here?[245] BRA**

[244] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.[244] Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use

Brazil's Answer:

204. The applicable regulations (7 CFR 1427.104)[246] define eligible domestic users and exporters of upland cotton.[247] To receive a Step 2 export payment, a person (including a cotton producer or a cooperative) must be "regularly engaged in selling eligible [US] upland cotton for export".[248] To receive a domestic payment, a person must be "regularly engaged in the business of opening bales of eligible [US] upland cotton to manufacture US upland cotton into cotton products in the United States".[249] The only actor who can be indifferent whether they export or use cotton domestically is a hypothetical domestic US cotton product manufacturer regularly engaged in opening US bales for domestic US manufacture that also regularly engages in exporting US cotton. In that situation, if a bale of cotton is opened by mistake instead of being exported, the exporter who is also the US cotton product manufacturer will receive a Step 2 domestic payment for that bale if the company has already entered into a contract with CCC for Step 2 payments, and subject to proof that bale is in fact used for manufacturing cotton products in the United States. But even if that hypothetical situation were to occur, then the payment would be contingent upon the domestic use of only US upland cotton (prohibited by Article 3.1(b) of the SCM Agreement). And if the bale were exported, the US exporter would receive the Step 2 payments subject to proof of export of US (not foreign) upland cotton (prohibited by Article 3.1(a) of the SCM Agreement).

205. It follows that the "two distinct factual situations" resulting in the payment of Step 2 subsidies are (1) the domestic "use" of eligible US upland cotton by a manufacturer of cotton products regularly engaged in opening bales; and (2) the "export" of eligible US cotton by exporters regularly engaged in selling US upland cotton. The United States argues that this case is distinguishable from US – FSC (21.5) because in that case one situation involved property produced within the United States and held for use outside the United States, and the other situation involved property produced outside the United States and held for use outside the United States.[250] This is irrelevant.

206. The point of the distinction by the Appellate Body in US – FSC (21.5) was not the geographic location of the property at issue, but rather whether one portion of payment under a programME was export contingent. In fact, in US – FSC (21.5), the products found to be subject to the export contingency were those produced within the United States and held for use outside the United States. This is exactly the situation with Step 2 export payments. Upland cotton produced in the United States receives Step 2 payment upon proof of export ("held for use outside the United States") outside the United States. As in US – FSC (21.5), the fact that subsidies available under the programme are also granted in a second situation, i.e., when upland cotton produced within the United States is used within the United States "does not dissolve the export contingency arising in the first set of circumstances".[251]

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outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

[245] There, the Appellate Body stated that,

"the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".

[246] Exhibit Bra-37 (7 CFR 1427.104).

[247] First Submission of Brazil, paras 92, 98.

[248] Exhibit Bra-37 (7 CFR 1427.104(a)(2)).

[249] Exhibit Bra-37 (7 CFR 1427.104(a)(1)).

[250] First Oral Statement of the United States, paras. 21-22.

[251] Appellate Body Report, *US – FSC (21.5)*, para. 119.

207. Concerning other relevant dispute settlement reports, Brazil believes that the Canada – Aircraft decision is useful precedent. In that case, Canada argued that Technology Partnership Canada (TPC) was a funding mechanism providing "support to a broad base of sectors and technologies" "that result in a high technology product or process for sale in domestic and export markets".[252] Canada claimed that "Brazil has not adduced any evidence to show that TPC contributions are contingent on export performance, in the sense that the contributions would not be paid unless exports took place, that there would be rewards if exports took place. . .".[253] The Appellate Body affirmed the panel's finding of export contingency, noting that "it is enough to show that one or some of TPC's contributions do constitute subsidies 'contingent . . . in fact . . . upon export performance.'"[254] This finding is consistent with the Appellate Body's later decision in US – FSC (21.5). It stands for the proposition that where a programme makes some payments contingent upon export of products, the fact that other payments under the programme are made for domestic use does not eliminate the export contingency of the programmes.

**101. How does Brazil respond to the United States' assertion at paragraph 22 of its oral statement that the programme involves "eligible users" who constitute the "entire universe" of potential purchasers of upland cotton? BRA**

Brazil's Answer:

208. Brazil considers that the United States' statement is not correct. As noted in the previous answer, an "eligible" user cannot include firms that are not "regularly engaged in" opening bales of upland cotton for manufacturing upland cotton products in the United States or exporting upland cotton from the United States.[255] The eligible domestic user criteria exclude all firms that are domestic cotton brokers or simple resellers. Nor would "eligible domestic users" include firms that have not entered into CCC contracts or who open bales but do not use them in the manufacture of upland cotton products or who only occasionally open bales of upland cotton for manufacture of upland cotton products. Similarly, the regulations for eligible "exporters" do not include persons who occasionally export and who are, thus, not considered to be persons "regularly engaged" in exporting upland cotton.[256] Furthermore, the regulations do not cover exporters who have not entered into a CCC contract as exporters eligible for payment.[257]

**102. How does Brazil respond to the United States' assertion at paragraph 129 of its first written submission, that "[t]he programme is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States." BRA**

Brazil's Answer:

209. Brazil notes that the same "programme indifference" argument could have been made by the United States in the US – FSC (21.5) case (tax deferred whether products produced within or outside the United States) or by Canada in the Canada – Aircraft case (TPC payments made whether products consumed or used domestically or exported). These two Appellate Body decisions clarify that what matters is whether one segment of the programme is contingent upon export. This is consistent with the Article 3.1(a) text that the export contingency be "solely or as one of several other conditions". Step 2 export payments are clearly contingent upon proof of export of US upland cotton by eligible exporters. The fact that another class of persons in a different situation (domestic users) also may

[252] WT/DS70/R, paras. 6.231, 6.235
[253] WT/DS70/R, para. 6.248.
[254] *Canada – Aircraft*, WT/DS70/AB/R, para. 179.
[255] Exhibit Bra-37 (7 CFR 1427.104(a)(1)).
[256] Exhibit Bra-37 (7 CFR 1427.104(a)(2) and (b)).
[257] Exhibit Bra-37 (7 CFR 1427.104(a)(2) and (b)).

receive the payment does not remove this export contingency. Additionally, Brazil notes that Step 2 domestic payments violate Article 3.1(b).

**103. Is the Step 2 programme fund a unified fund that is available for either domestic users or exporters, without a specific amount earmarked for either domestic users or exporters? Please substantiate your response, including by reference to any applicable statutory or regulatory provisions. USA**

**104. How does the United States respond to the data presented in Exhibit BRA-69? Is it accurate? Please substantiate. USA**

**105. Why is the Step 2 programme separated into "domestic users" and "exporters"? Apart from differentiating between exporters and domestic users, with consequential differentiation as to the forms that must be filled out and certain other conditions that must be fulfilled, are the eligibility criteria for Step 2 payments identical? Are the form and rate of payment, as well as the actual payment made, identical? USA**

**106. With respect to paragraph 139 of the United States' first written submission, are Step 2 export payments included in the annual reduction commitments of the United States? If so, why? USA**

**107. Please comment on any relevance, to Brazil's de jure claims of inconsistency with the provisions of the Agreement on Agriculture, of Exhibit BRA-69, which shows Step 2 payments made to (i) domestic users and (ii) exporters. This Exhibit shows that, from FY 91/92 through 02, the Step 2 payments for exporters exceeded those for domestic users in FY 94; FY 95; FY 96 (in fact there were no domestic payments in FY 96); and FY 02. In the other years, the domestic payments are greater than export payments. BRA, USA**

Brazil's Answer:

210. This document is not relevant for either Brazil's Article 3.1(a) or Article 3.1(b) claims under the SCM Agreement. Even if the Step 2 export payments were zero in certain years (which they have never been), it would not remove the export contingency. Similarly, the fact that Step 2 domestic payments were not made in one time period does not resolve their contingency upon use of domestic over imported upland cotton. Brazil's claims are that whenever a Step 2 payment for exported or domestically used upland cotton takes place, this payment is required to be made in a manner inconsistent with Articles 3.1(a) or 3.1(b) of the SCM Agreement and with Articles 3.3 and 8 of the Agreement on Agriculture in the case of Step 2 export payments.

**108. At paragraph 135 of its first written submission, the United States states : "[T]he subsidy is not contingent upon export performance..." (emphasis added). Again, in the course of the first Panel meeting, the United States admitted that the Step 2 payments were "subsidies". Does the United States thus concede that Step 2 payments constitute a "subsidy" within the meaning of the WTO Agreement? USA**

**109. How does the United States respond to Brazil's arguments concerning a mandatory/discretionary distinction and the allegation that certain United States measures (including s.1207(a) of the 2002 FSRI Act) are mandatory? (This is referred to, for example, in paragraph 28 of Brazil's first written submission). Does the United States agree with the assertion that (subject to the availability of funds) the payment by the Secretary of Step 2 payments is mandatory under section 1207(a) FSRI upon fulfilment by a domestic user or exporter of the conditions set out in the legislation and regulations? If not, then why not? To what extent is this relevant here? What determines the "availability of funds"? Please cite any**

**other relevant measures or provisions which you consider should guide the Panel in respect of this issue. USA**

**110. Section 1207(a) of the 2002 FSRI Act provides that during the period beginning on the date of the enactment of the FSRI Act through July 31 2008, " .. the Secretary shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters for documented purchases by domestic users and sales for export by exporters...". The Panel notes that Brazil does not appear to distinguish between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists. The United States refers to "benefits" and "payments" and "program" in asserting that Step 2 is not export contingent (paragraphs 127-135 of the United States' first written submission).**

**(a) Do the parties thus agree that there is no need to draw any distinction between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists for the purposes of the Agreement on Agriculture? BRA, USA**

Brazil's Answer:

211. Brazil agrees there is no need to draw any distinction between cash payments and "commodity certificates". The Step 2 regulations indicate that Step 2 payments "shall be made available in the form of commodity certificates issued under part 1401 of this Chapter, or in cash, at the option of the programme participants".[258] Part 1401 of the regulations indicated that commodity certificates may be exchanged for cash.[259]

**(b) Why would a domestic user or an exporter select to receive a marketing certificate over a cash payment? What is the proportion of cash payments vs. marketing certificates granted under the programme? USA**

**111. Does the United States maintain its argument that actions based on Article 3.1(b) of the SCM Agreement are conditionally "exempt from actions" due to the operation of Article 13 of the Agreement on Agriculture? USA**

**112. In the event that the Panel finds that Article 6.3 of the Agreement on Agriculture does not preclude an examination of Brazil's claims under Article 3.1 of the SCM Agreement and Article III:4 of GATT 1994, how does the United States respond to the merits of Brazil's claims relating to Step 2 payments under those provisions? USA**

**113. Is it necessary for measures directed at agricultural processors included in AMS to discriminate on the basis of the origin of goods? USA**

**114. With respect to the last sentence of paragraph 22 of Brazil's closing oral statement, could Brazil elaborate on the circumstances in which a local content subsidy would comply with Article 3.1(b) of the SCM Agreement? BRA**

Brazil's Answer:

212. Brazil believes the Panel is referring to paragraph 21 of the final "as delivered" version of Brazil's Closing Statement on 24 July 2003. The text of this sentence reads as follows: "There is also no conflict between Article 3.1(b) of the SCM Agreement and Agriculture Agreement Article 6 or

[258] Exhibit Bra-37 (7 CFR 1427.106).
[259] Exhibit Bra-34 (7 CFR 1401.4(a)).

Annex 3, paragraph 7, because there are two types of domestic subsidies – those that comply with Article 3.1(b) of the SCM Agreement and those that do not." Paragraph 85 of Brazil's First Oral Statement of 22 July 2003 was more precise in focusing on the relevant type of support, i.e., support provided to processors of agricultural products, stating that "[t]here are two types of 'non-green box' support to processors that could benefit producers of agricultural goods: support that violates ASCM Article 3.1(b) and GATT Article III:4 and support that does not."

213. There are no circumstances in which a "local content subsidy" would comply with Article 3.1(b) of the SCM Agreement.

**115. What is the meaning and relevance (if any) to Brazil's claims under Article 3 of the SCM Agreement and Article III:4 of GATT 1994 of the phrase "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products" in the Agreement on Agriculture? BRA, USA**

Brazil's Answer:

214. The phrase from Annex 3, paragraph 7 of the Agriculture Agreement cited by the Panel requires Members to tabulate and include as part of AMS to individual products an amount of benefit provided to producers of basic agricultural products resulting from "measures directed at agricultural processors. . . ". The obligations of Members to comply with reduction commitments tied to AMS, and the obligations of Members under SCM Article 3 and GATT Article III, all apply cumulatively and simultaneously. This phrase recognizes that subsidies to processors of agricultural products may benefit producers of the basic agricultural product and, thus, must be included within total AMS. However, as Brazil has argued, this phrase does not provide an exemption from the SCM Agreement or GATT Article III for such subsidies, and no such exemption can be interpolated into the text.[260] The cumulative nature of the obligations incurred under the WTO Agreement results in the prohibition of certain "measures directed at agricultural processors" that otherwise would be included in the AMS calculation, namely those that are contingent upon the use of domestic over imported agricultural products contrary to Article 3.1(b) of the SCM Agreement.

**116. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the Agreement on Agriculture? Does the phrase "provide support in favour of domestic producers" in Article 3.2 of the Agreement on Agriculture refer to, and/or permit such subsidies? BRA, USA**

Brazil's Answer:

215. Brazil agrees with the EC that Articles 1(a), 3.2, 6.3 of the Agreement on Agriculture include the phrase "domestic support in favour of agricultural producers". And Brazil further recognizes that all types of "domestic support in favour of agricultural producers" must be tabulated for the purposes of setting and enforcing a Member's domestic support reduction commitments (Total AMS). But Brazil notes that neither the EC nor the United States can point to any inherent conflict between these provisions and the prohibition of local content subsidies under Article 3.1(b) of the SCM Agreement for the reasons set forth in Brazil's First Oral Statement and in Brazil's answer to the Panel's Question 114.[261]

216. The EC and the United States fail to acknowledge that there can be subsidies/domestic support measures provided to processors of the basic agricultural product that can be consistent with Article 3.1(b) of the SCM Agreement and that also "provide support in favour of domestic producers". The EC appears to assume that all support to processors of a basic agricultural

[260] First Oral Statement of Brazil, paras. 81-86.
[261] First Oral Statement of Brazil, paras. 81-86.

commodity violates Article 3.1(b) of the SCM Agreement. That is simply not correct. Yet, without this assumption, there is no inherent conflict between the SCM Agreement and the Agreement on Agriculture. The absence of any conflict coupled with the absence of any explicit exemption for local content subsidies in Article 13(b) or anywhere else in the Agreement on Agriculture supports the conclusion that local content subsidies related to agricultural goods violate Article 3.1(b) of the SCM Agreement.

**117. What is the relationship between Step 2 payments to exporters and the marketing loan payments, both of which appear to compensate for the price differences relative to the Liverpool A-Index? For example, is there double compensation? Or is one of the explanations that these export-related price compensatory payments are paid to different operators (namely, the producer, on the one hand under the marketing loan arrangements, and the processor/users (Step 2 programme) arrangements on the other? USA**

**118. Can the United States confirm that it does not rely on Article III:8 of GATT 1994? USA**

G. ETI ACT

**119. How does the United States respond to Brazil's reference to the panel report in India - Patents (EC) (at paragraph 138 of its oral statement at the first session of the first substantive meeting)?[262] How, if at all, should the Panel take this report into account in considering the issues raised by Brazil's claims relating to the ETI Act? USA**

**120. Concerning its claims on the ETI Act, Brazil relies on the US – FSC case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the United States appear to invoke Article 6 of the Agreement on Agriculture. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Could you direct the Panel to any relevant findings or conclusions by the panel or Appellate Body in that case? BRA**

Brazil's Answer:

217. Brazil is not aware that there are any differences between the US position regarding the peace clause in the US – FSC case and the present case. There is no reference in the entire record of that dispute that the United States ever asserted that the EC's claims regarding the ETI Act were exempt by the peace clause. Also in this dispute, Brazil is not aware that the United States has ever asserted that Brazil's claims regarding the ETI Act were exempted by the peace clause. In this regard, the United States has taken a consistent approach in the present case and in US – FSC.

218. Because the United States never raised the peace clause as a defense in US – FSC, there were no findings by the panel or the Appellate Body regarding the peace clause. And neither the panel nor the Appellate Body held that the EC was required to demonstrate that the United States was not entitled to peace clause protection before proceeding to the substance of the EC's claims against the ETI Act. In any event, the United States has been unable to establish that the ETI Act is consistent

[262] That panel stated: "It can thus be concluded that panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same. In examining dispute WT/DS79 we are not legally bound by the conclusions of the Panel in dispute WT/DS50 as modified by the Appellate Body report. However, in the course of "normal dispute settlement procedures" required under Article 10.4 of the *DSU*, we will take into account the conclusions and reasoning in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we should give significant weight to both Article 3.2 of the *DSU*, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, and to the need to avoid inconsistent rulings (which concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the *DSU*." (footnote omitted)

with Part V of the Agreement on Agriculture. Therefore, the United States does not enjoy peace clause exemption under Article 13(c) of the Agreement on Agriculture.

**121. How do you respond to the reference in paragraph 43 of EC third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to that dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. USA, BRA**

Brazil's Answer:

219. Brazil is of the view that DSU Article 17.14 requires that following the adoption of an Appellate Body report, the parties to the dispute, i.e., the defending and complaining Member, are unconditionally bound by the results of that report. This interpretation is consistent with the Appellate Body decisions in US – Shrimps (21.5)[263] and EC – Bed Linen (21.5),[264] both confirming that panel and Appellate Body reports adopted by the Dispute Settlement Body must be considered final resolutions to a dispute between the parties to that dispute. There is no precedent in the WTO or GATT that would require the Panel to find that the United States alone is bound in this case. It is difficult to imagine, however, how the United States could take a different position in defending against Brazil's ETI claims in this case, in light of the adoption by the DSB of the Appellate Body and panel reports in US – FSC (21.5), and the recommendation by the DSB that the United States bring the ETI Act into conformity with the Agreement on Agriculture and the SCM Agreement.

220. In this case, Brazil challenges exactly the same measure as that found by the panel and the Appellate Body in US – FSC (21.5) to violate the Agreement on Agriculture and the SCM Agreement. There have been no changes to the ETI Act since the adoption of the panel and Appellate Body reports by the WTO Dispute Settlement Body.[265] Brazil challenges the ETI Act with exactly the same rationale as the EC. Thus, there is a complete identity between the "measure" and the "claims" in this case and the US – FSC (21.5) dispute (noting that upland cotton is a sub-set of all the products covered by the ETI Act). Under these circumstances, it is appropriate for the Panel to make similar findings of fact, conclusions of law, and recommendations as the panel and Appellate Body in US – FSC (21.5).[266]

221. Brazil does not consider any of the other provisions cited by the Panel to be relevant to this particular question. Should the Panel wish Brazil to elaborate on any of provisions more specifically, Brazil will be pleased to do so.

[263] Appellate Body Report, *US – Shrimps (21.5)*, para. 97.
[264] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 90-96.
[265] The United States has indicated in its First Submission (para. 189) that both branches of Congress are considering legislative proposals that would repeal the ETI Act. However, Brazil notes that it has been over 18 months since 29 January 2002, the date on which the panel and Appellate Body reports on the ETI Act were adopted by the DSB.
[266] First Oral Statement of Brazil, paras. 138-39.

# ANNEX I-2

## ANSWERS OF THE UNITED STATES TO THE QUESTIONS FROM THE PANEL TO THE PARTIES FOLLOWING THE FIRST SESSION OF THE FIRST SUBSTANTIVE PANEL MEETING

(11 August 2003)

*UPLAND COTTON*

**1. Please confirm that all information and data that you have provided to the Panel relating to "cotton" in fact relates to upland cotton only. BRA, USA**

1. The United States can confirm that, with the exception of export credit guarantees, all of the information and data we have provided to-date relates to upland cotton only. With respect to export credit guarantees, the Commodity Credit Corporation does not maintain data to distinguish transactions involving different types of cotton (for example, upland cotton versus extra-long staple (ELS) cotton). However, the United States has no reason to believe that types of cotton other than upland cotton constitute a material percentage of such transactions.

*PRELIMINARY ISSUES*

*Product scope of Panel's terms of reference relating to Brazil's export credit guarantee claims*

**3. If the request for consultations in this dispute omitted certain products in relation to export credit guarantees, on what basis is it argued that it failed to identify the measures at issue in accordance with Article 4.4 of the DSU? USA**

2. The only export credit guarantee measures identified in the Brazilian consultation request were those in respect of upland cotton. The request for consultations did not identify export credit guarantee measures for any other agricultural commodities.

3. The request for consultations identified the measures subject to consultations in a single sentence:[1]

> The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton[1], as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry").

[1] Except with respect to export credit guarantee programmes as explained below.

Another sentence followed this one, setting out (in a page and a half) a listing of measures that were included within the identification in the first sentence.

4. Apart from the footnote, the first two lines of the sentence quoted in the previous paragraph address "subsidies provided to US producers, users and/or exporters of upland cotton"; thus, apart

[1]WT/DS267/1, at 1.

from the footnote, it is clear that subsidies provided to US producers of, say, soybeans are not included within the scope of the request. Equally, apart from the footnote, it is clear that subsidies provided to, say, banks that finance US cotton exports (but do not produce, use or export cotton) are not included within the scope of the request. To give an example from another part of the request, Brazil's consultation request identified "[e]xport subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000" as a challenged measure. Having identified that measure at issue for purposes of DSU Article 4.4 as subsidies provided to upland cotton exporters under that legislation, Brazil could not then have included in its panel request such subsidies provided to exporters of all agricultural commodities or all industrial goods.

5. Brazil, however, contends that "[t]he footnote clarifies that Brazil's request with respect to export credit guarantees is *not* limited to upland cotton."[2] Brazil's contention is incorrect. The footnote does nothing more than direct the reader of the consultation request to look "below" for an explanation. The footnote by itself does not contain any "identification of [a] measure at issue" as required by DSU Article 4.4, and therefore cannot itself bring any additional measures within the scope of the consultation request. Any such additional measures would have to be found -- if anywhere -- in an explanation "below."

6. However, as described in the first US submission, no such explanation or identification of additional measures ever appears. In fact, though Brazil devoted several paragraphs to this issue in its oral statement, it has never pointed to any explanation of any kind -- or any other identification of additional measures -- "below."

7. In addition, the statement of evidence attached to Brazil's consultation request did not include any evidence related to measures other than those for upland cotton. For Brazil to now argue that its consultation request was broader than its statement of evidence is for Brazil to admit that its consultation request was in breach of Article 7.2 of the Subsidies Agreement. Brazil cannot have it both ways.[3]

8. In summary, while Brazil's consultation request did identify measures at issue for purposes of DSU Article 4.4, the measures it actually identified did not include export credit guarantees for agricultural commodities other than cotton. Thus, the latter measures were not within the scope of consultations, were not consulted upon, and could not have been included in Brazil's panel request.

**4. Is it argued that the export credit guarantee programmes concerning upland cotton are each a separate or independent measure, in that they operate independently? USA**

9. The CCC export credit guarantee programme (GSM-102), the CCC intermediate export credit guarantee programme (GSM-103), and the Supplier Credit Guarantee Programme (SCGP) each constitute separate programmes. The distinct operation of the programmes themselves is manifested in both the terms of the particular programmes as well as in the nature of the obligation guaranteed. The GSM-102 and GSM-103 programmes guarantee obligations of banks. SCGP extends exclusively to obligations of importers. Obligations guaranteed under the GSM-102 programme may not extend beyond three years. SCGP guarantees a far lower percentage of principal (65 per cent).

10. Within each programme, allocations are made by country, by commodity, and by amount.[4] Thus, discrete programming decisions are made in connection with each such country, commodity,

[2]Brazil's Opening Oral Statement, para. 90.

[3]In light of the Panel's intended finding on the scope of Brazil's consultation request with respect to export credit guarantees, the United States will be making a request for a preliminary ruling on this point.

[4]*See* 7 C.F.R. §§ 1493.4, 1493.5 (setting forth allocation criteria). These criteria also apply to SCGP. 7 C.F.R. § 1493.400.

programme, and amounts (in terms of a guarantee value).[5] As a result, for the last 10 fiscal years, for example, as described in the First Written Submission of the United States, no cotton transactions occurred under the GSM-103 programme.

11. Furthermore, each export credit guarantee issued is a separate measure. Under DSU Article 4.4, it is incumbent upon Brazil to identify in its consultation request "the measures at issue." Here, Brazil identified the measure as "export credit guarantees . . . to facilitate the export of US upland cotton," and the United States may, and did, rely on that consultation request (including the attached statement of evidence) for notice.

**5. Is there a specification in any legislation or regulation (or any other official government document) which limit or restrict the export credit guarantee programmes at issue exclusively to upland cotton? USA**

12. Programme announcements issued pursuant to applicable programme regulations (7 C.F.R. §§ 1493.10(d), 1493.400(d)) serve to limit the availability of CCC export credit guarantees. These limitations are expressed in terms of one or more of the following criteria: commodities, total guarantee value for individual commodities, destination, and time within which export must occur. Examples of such programme announcements are included as Exhibit US-12. Thus, export credit guarantee offerings through programme announcements may be limited to cotton, pursuant to the authority of programme regulations.

**6. For the purposes of the Panel's examination of Brazil's claims relating to GSM-102, GSM-103 and SCGP under the Agreement on Agriculture and the SCM Agreement, is accurate data and information available with respect to these export credit guarantee programmes concerning upland cotton alone (e.g. with respect to "long-term operating costs and losses")? In this respect, the Panel also directs the parties' attention to the specific questions below relating to the programmes. USA**

13. The United States endeavoured to provide precisely such data with respect to cotton alone in paragraph 173, and associated tables, in its First Written Submission.

**7. Are commitments with respect to export subsidies under the Agreement on Agriculture commodity-specific? How, if at all, is this relevant? BRA, USA**

14. Export subsidy commitments under the Agriculture Agreement are, indeed, commodity specific. Each Member may have a schedule of reduction commitments with respect to specified commodities. To illustrate, the export subsidy reduction commitment schedule of the United States is attached as Exhibit US-13. As reflected in that schedule, for each of the 12 scheduled commodities, the United States has a reduction commitment with respect to both budget outlays and subsidized quantities. Other Members have similar schedules involving different commodities and reduction commitments. In all cases, however, the budgetary and quantitative commitments are unique to each commodity on each Member's respective schedule of export subsidy reduction commitments.

15. An individual Member, therefore, could apply an export subsidy programme with respect to all commodities for which it has undertaken reduction commitments. By operation of such an export subsidy programme, however, a Member may be in conformity with none, some, or all of its commodity-specific reduction commitments. So long as a Member applies such export programme in a given year in accordance with the commodity-specific reduction commitment for each year, such export subsidy programme is permitted with respect to each commodity and conforms fully with respect to Part V of the Agreement on Agriculture. The fact that commitments are taken on a product-

[5] *See* Exhibit US-12.

specific basis confirms that alleged export subsidy measures can be defined on a product-specific basis – and that is exactly what Brazil did here.

16. In contrast, for those specific commodities for which such Member does not have a reduction commitment, then such Member may not provide export subsidies at all in connection with such specific commodities. As a result, the same programme that, as applied, may be entirely in conformity with that Member's reduction commitment vis-à-vis one commodity may be a prohibited subsidy with respect to another commodity.

**8. Does the United States confirm that the questions referred to by Brazil in paragraph 92 of Brazil's oral statement were posed to the United States in the consultations? USA**

17. Yes. When Brazil posed them during the consultations, the United States immediately objected to questions about commodities other than cotton as being outside the scope of the consultations (as paragraph 94 of Brazil's oral statement acknowledges).

**9. How does the United States respond to paragraph 94 of Brazil's oral statement? USA**

18. It is incumbent on the complaining party to identify the specific measure at issue, and it should not fall to the responding party to intuit that measures not specified in the request for consultations are considered included by the complaining party. This deprives the responding party of an opportunity to understand the measures that are at issue and to enjoy the benefit of appropriate consultations. In the final analysis, Brazil essentially argues that its consultation questions and statement at consultations could expand the scope of the measures at issue as identified in its consultation request beyond "export credit guarantees . . . to facilitate the export of US upland cotton." This is not the case. (For further information, please refer to the US answer to Question 3.)

**10. What actual prejudice, if any, has the United States suffered as a result of the alleged omission of products other than upland cotton from the request for consultations? USA**

19. The issue of prejudice is not relevant to the question of whether a measure not consulted upon may be the subject of panel proceedings. The requirement of consultations at the beginning of a dispute is a central characteristic of the dispute settlement system, and is reflected throughout DSU Article 4. Consultations serve a number of important functions, including helping the parties to understand each others' concerns and aiding in efforts to resolve the dispute. The DSU affirms the importance of consultations and *requires* that a Member cannot proceed to a panel unless the Member has consulted on that measure.

20. Article 4.4 delimits the scope of the consultations through its requirement that the complaining Member identify the measures at issue. In light of the jurisdictional nature of the consultation requirement, Article 4.4's explicit requirement that the measures be identified serves the useful role of establishing a bright line as to the matters which are within the scope of the consultations and the dispute. Any resort to an analysis of what topics were actually discussed at the consultations – beyond conflicting with the DSU Article 4.6 requirement that consultations "shall be confidential," designed to facilitate the resolution of the dispute – would invite litigation over the unverifiable recollections of each party.

21. The United States notes that in past disputes in which the scope of the dispute was at issue, it was accepted as a given that the consultation request defined the scope of the consultations. For example, in the *US – Import Measures* dispute, the European Communities did not assert that US actions taken on 19 April 1999 were the subject of consultations even though consultations took place two days later, on 21 April 1999. Instead, accepting that its 4 March 1999, consultation request delimited the scope of the consultations, and could not have covered measures taken after that time,

the EC argued (unsuccessfully) that the April 19 actions were the same measure as that identified in the 4 March consultation request.[6]

22. Brazil's consultation request identified export credit guarantees on upland cotton as the sole export credit guarantee measures within the scope of the consultations and, hence, the dispute. Had it wished to include export credit guarantees with respect to other products within the scope of the consultations, Brazil could have re-filed its consultation request to include these guarantees, much as other Members have re-filed consultation requests when they have wished to expand the scope of the dispute.[7] Brazil chose not to, instead apparently hoping to be relieved of the procedural requirements of the DSU, requirements enforced with respect to, and taken seriously by, other Members.[8]

23. While prejudice is not relevant to whether the scope of this dispute includes export credit guarantees for products other than upland cotton, the United States observes that, not only *has* it suffered prejudice as a result of Brazil's omission of allegations concerning products other than upland cotton, but more importantly, the United States *will* suffer even further prejudice if it is compelled to respond to allegations that Brazil never properly included in its request for consultations. The United States has suffered an inability to prepare, respond, and consult with respect to allegations on measures never presented to the United States in accordance with the DSU. The United States was entitled to rely on the measures identified by Brazil in its request for consultations and also rely on that which Brazil declined to put at issue by its failure to so state in its request. This justifiable reliance is furthered by Brazil's failure to amend its request for consultations after ample notice from the United States of its reasonable understanding of Brazil's request.

24. Consequently, the US has not had proper opportunity to consult with respect to the application of the three separate export credit guarantee programmes and their specific application to the myriad of commodities exported in connection with these programmes nor with respect to the conformity of the WTO obligations of the United States with the application of such programmes to such commodities. If export credit guarantees with respect to other eligible commodities were now included in this dispute, the United States will suffer the prejudice of having to prepare and defend its actions in a severely compressed time frame without the benefit of any consultations whatsoever.

**11. Does the United States agree that Brazil's request for establishment of the Panel can be understood to indicate that Brazil's export credit guarantee claims relates to products other than upland cotton? How, if at all, is this relevant? USA**

25. Brazil's panel request changed the language relating to export credit guarantees to include the words "other eligible agricultural commodities." However, Brazil may not unilaterally alter the scope of the "measures at issue" in its panel request simply by adding measures not previously identified. Thus, while Brazil would have been free to add additional *claims* in its panel request, it was not free to broaden the scope of the challenged *measures*.

26. Indeed, Brazil and at least one third party have argued that in two SPS disputes between the United States and Japan panels found that a complaining party may introduce new claims in its panel

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[6] Appellate Body report, *United States - Import Measures on Certain Products of the European Communities*, WT/DS165/AB/R, adopted 10 January 2001, para.70.

[7] *See, e.g.*, WT/DS204/1& WT/DS204/1/Add.1 (consultation request supplemented to add measures); WT/DS174/1 & WT/DS174/1/Add.1 (consultation request to add consultations under additional covered agreement).

[8] The United States refers the Panel to the preliminary ruling of the panel in the *Canada Wheat Board* dispute, WT/DS276/12, which necessitated the refiling of the US panel request and establishment of a second panel. Likewise, the United States refers the panel to India's refiling of its panel request in the *US Rules of Origin* dispute (WT/DS243/5/Rev.1) when made aware of deficiencies in that request at the DSB meeting at which the request was considered. *See also* WT/DS210/2 & WT/DS210/2/Rev.1.

request that were not included in its consultation request. In both of these cases, Japan argued that the United States could not introduce new claims (cite to new legal provisions) not in its consultation request. The United States argued, and both panels agreed, that every legal claim need not be included in the consultation request. However, these disputes are not relevant here because they did not involve identifying a new *measure* in the panel request. As noted in the 3d party oral statement of Benin, "claims" and "measures" are distinct concepts; indeed, the distinction between "claims" and "measures" is fundamental.[9]

**12. Please address issues and submit evidence regarding the three export credit guarantee programmes concerned relating to upland cotton and other eligible agricultural commodities in your answers to questions and rebuttal submissions. BRA, USA**

27. In light of the Panel's preliminary ruling and without prejudice to the US position that these measures are not within the scope of this dispute, the United States will respond to Brazil's arguments in the US submissions.

**13. Please include any argumentation and evidence to support your statement during the Panel meeting that the inclusion of such other eligible agricultural commodities would create additional "work" for the Panel with respect to each of these commodities under Article 13 of the Agreement on Agriculture. USA**

28. Article 10.2 defers disciplines on, *inter alia*, export credit guarantees until such time as internationally agreed disciplines are reached – as Members hope to do in the Doha Development Round. Therefore, export credit guarantees are not export subsidies within the meaning of the Agriculture Agreement, and Article 13(c) does not apply. However, for purposes of argument, we note that Article 13(c)(ii) of the Agreement on Agriculture provides that:

> (c) export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's schedule, shall be:
>
> * * * * *
>
> (ii) exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5, and 6 of the Subsidies Agreement.

Pursuant to Article 13(c)(ii), to the extent a Member *is* providing export subsidies in conformity with its reduction commitments under Part V of the Agreement on Agriculture, such export subsidies are exempt from action under Article XVI of the GATT and Articles 3, 5, and 6 of the SCM Agreement.

29. Article 13(c) is not relevant with respect to export subsidies granted in connection with commodities not subject to reduction commitments in the applicable schedule of the Member. For example, the United States does not have a reduction commitment with respect to upland cotton. Therefore, the United States may not provide any export subsidy for upland cotton. The Peace Clause protection of Article 13(c) therefore cannot apply to any theoretical export subsidy of the United States for upland cotton.

30. In contrast, however, the United States has reduction commitments for 12 commodities. (Please refer to the response of the United States to Question 7 for a description of how the export subsidy reduction commitments – and therefore export subsidy obligations – of the United States and all other members are, therefore, commodity specific.) Because such commitments are commodity specific, the extent to which Article 13(c)(ii) may apply to export subsidy measures of the United

[9]*See, e.g.*, Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted 25 November 1998, para. 72.

States is also commodity specific. Conformity with WTO obligations and the application of Article 13(c)(ii) to export credit guarantees with respect to those twelve commodities could only be evaluated by an examination of *each* commodity subject to reduction commitments.

*Expired measures*

**14. Please submit evidence regarding the programmes under the 1996 FAIR Act, in particular, production flexibility contract payments and market loss assistance payments, to the extent that they would be relevant to the Panel's determination under Article 13 of the Agreement on Agriculture in your answers to questions and rebuttal submission. USA**

31. The United States will present evidence and arguments regarding payments under the 1996 Act as may be relevant to the Panel's Peace Clause analysis with respect to those measures.

**15. Do the parties agree that it is beyond a Panel's power to recommend a remedy for an expired measure? Could the Panel could be required to examine "expired measures" in order to conduct its assessment of the matter before it? How, if at all, is Article 7.8 of the SCM Agreement relevant to these matters? BRA, USA**

32. The United States agrees that it is beyond a panel's power to recommend that a Member bring into conformity a measure that no longer exists.[10] However, more fundamentally, the issue is whether the expired measures in this dispute could have been measures affecting the operation of any covered agreement within the meaning of DSU Article 4.2 or "measures at issue" within the meaning of DSU Article 6.2. Because the production flexibility contract payments and market loss assistance payments were completed, the programmes terminated, and the statutory instruments providing them superseded before Brazil's consultation and/or panel requests were filed, they could not have been "measures at issue," and they could not properly have been consulted upon or brought within the terms of reference of the Panel. This is a broader concern than whether the Panel may recommend a remedy since findings cannot be made with respect to such expired measures.

33. To determine whether past subsidies may currently be challenged, it is useful to distinguish between recurring and non-recurring subsidies. A non-recurring subsidy is a measure that continues in existence for the duration of the allocation of the subsidy to production.[11] For example, a subsidy to acquire capital stock to be used in future production would be non-recurring and allocated over the useful life of the stock. Where a subsidy is non-recurring and is allocated to future production[12], the measure (subsidy) may continue to be actionable even if the authorizing programme or legislation has expired. For example, in the *Indonesia – Autos* dispute, where a non-recurring subsidy was provided, the panel deemed the measure to continue even though the subsidy programme had allegedly been terminated (and it is worth noting that the termination allegedly occurred well after the panel and consultation requests– in fact, after the second panel meeting).

34. In contrast, a recurring subsidy is typically provided year-after-year and is made in respect of current rather than future production. Once production has occurred and the measure been replaced or

[10]Appellate Body Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R, adopted 10 January 2001, para. 81.

[11]*See, e.g.*, Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures, G/SCM/W/415, para. 12 (25 July 1997) ("Whether a subsidy is oriented towards production in future periods, consists of equity, or is carried forward in the recipient's accounts were viewed as related to the question whether its benefits persist beyond a single period, and hence whether it should be allocated to future periods.").

[12]Subsidies Agreement, Annex IV, para. 7 (referring to "[s]ubsidies . . . the benefits of which are allocated to future production).

superseded, there would no longer be any measure in existence to challenge. Accordingly, a Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures suggested that recurring subsidies – such as grants for purposes other than the purchase of fixed assets and price support payments – should be expensed, or attributed to a single year, rather than allocated over some multi-year period.[13]

35. In the case of production flexibility contract payments and market loss assistance payments, these measures were subsidies allocated to a particular crop or fiscal year by the respective authorizing legislation. Pursuant to the 1996 Act, the last production flexibility contract payment was made for fiscal year 2002 (1 October 2001 – 30 September 2002) "not later than" 30 September 2002.[14] Pursuant to legislation enacted on 13 August 2001, the last market loss assistance payment was for the 2001 marketing year (1 August 2001 – 31 July 2002), that is, for market conditions prevailing in that year.[15] Once the relevant fiscal year and marketing year, respectively, had been completed, these measures would no longer exist. Thus, by the time of Brazil's consultation and/or panel requests, there were no measures to consult upon nor to be at issue under the DSU; production flexibility contracts and market loss assistance payments therefore do not fall within the Panel's terms of reference.

*Agricultural Assistance Act of 2003*

**16. What, if any, prejudice in terms of the presentation of its case does the United States allege, should the Panel proceed to consider the measures constituting the cottonseed payments under the Agricultural Assistance Act of 2003? USA**

36. It has been a fundamental characteristic of both the GATT 1947 and the WTO dispute settlement systems that proposed measures may not be the subject of dispute settlement. This has meant that dispute settlement proceedings, including consultations, could not begin until the measure at issue actually came into existence. In seeking to bring into the scope of this dispute the Agricultural Assistance Act of 2003, Brazil is seeking to fundamentally expand and change the nature of WTO dispute settlement. This issue goes well beyond the question of whether a particular responding party is prejudiced in a particular dispute and cannot be resolved on the basis of whether such prejudice has occurred. The reasons that the United States would be prejudiced if the Panel considered any measure under the Agricultural Assistance Act of 2003, including a cottonseed payment under that Act, are the reasons that the dispute settlement system has been organized to only allow proceedings on actual, not proposed, measures. First, the responding party would have lost the benefit of consultations on these measures. Consultations serve a number of important functions, including helping the parties to understand each others' concerns and aiding in efforts to resolve the dispute. The DSU affirms the importance of consultations and *requires* that a Member cannot proceed to a panel unless the Member has consulted on that measure. Likewise, the DSU requires that the "measures at issue" be identified in the panel request, and non-existent measures quite simply are not measures at all.

37. Apart from reflecting the importance Members have placed on consultations, the DSU's requirement that a measure exist before it can be the subject of dispute settlement proceedings avoids a waste of resources since anticipated measures may never come into effect, or may, when enacted, be in substantially changed form. Further, allowing challenges to measures not yet in existence would

[13]G/SCM/W/415, paras. 1-12; *id.*, Recommendation 1, at 26-27.

[14]Federal Agriculture Improvement and Reform Act of 1996, § 112(d)(1), Public Law No. 104-127 (4 April 1996); 7 US Code § 7212(d)(1).

[15]Public Law No. 107-25, § 1(a) (23 Aug. 2001) ("The Secretary of Agriculture . . . shall, to the maximum extent practicable, use $4,622,240,000 of funds of the Commodity Credit Corporation to make a market loss assistance payment to owners and producers on a farm that are eligible for a final payment for fiscal year 2001 under a production flexibility contract for the farm under the Agriculture Market Transition Act.").

effectively authorize panels to issue advisory opinions. Should Members desire to expand the scope of the dispute settlement system in this manner, they may do so – indeed could only do so – through amendment of the DSU. The DSU now requires the existence of a measure before consultations may be requested or a panel established.

38. Finally, were the issue of the specific prejudice to the United States relevant in deciding whether a panel's terms of reference could include a measure not in existence at the time of consultations or the panel request, the United States notes that this dispute is already complex, with multiple measures at issue involving multiple claims. To require the United States to address Brazil's allegations on the Agricultural Assistance Act of 2003 would detract from the time and resources available to respond to questions and make arguments relating to those measures that *are* properly within the terms of reference.

**17. (a) What is the relationship of the Agricultural Assistance Act of 2003 to other legislation in the request for establishment of the Panel? BRA, USA**

**(b) Do the legal instruments follow directly one after another, or are there temporal gaps? Are payments authorized under a broad legislative authority or are they specific to each legal instrument? BRA, USA**

**(c) Please provide any implementing regulations. Do these implementing regulations resemble those relating to previous programmes or payments? Are payments made retrospectively? How if at all is this relevant? BRA, USA**

39. (a) The Agricultural Assistance Act of 2003[16] was part of a large piece of legislation covering a diverse range of topics. The Act had several disaster provisions including some relief for sugar interests and more generalized relief for persons who lost other crops. One of the provisions provided for a cottonseed payment to be applied to the 2002 cotton crop (the crop that was harvested in that calendar year):

> Sec. 206. COTTONSEED. The Secretary shall use $50,000,000 of funds of the Commodity Credit Corporation to provide assistance to producers and first-handlers of the 2002 crop of cottonseed.

No law compelled or authorized the cottonseed payment for the 2002 crop except for the 2003 Act, which bears no relation to other legislation cited by Brazil.

40. There was no cottonseed payment authorized in either 2002 or 2001 for the 2001 crop. Cottonseed payments were made for the 1999 and 2000 crops. Of the three pieces of legislation authorizing cottonseed payments for the 1999 and 2000 crops, only one arguably may be found in Brazil's consultation and panel requests. Brazil identifies the "Crop Year 2001 Agricultural Economic Assistance Act (August 2001)" as a challenged measure. The Emergency Agricultural Assistance Act, Public Law No. 107-25 (13 August 2001), authorized a cottonseed payment of $85 million. In addition, Section 204(e) of Public Law No. 106-224, enacted 20 June 2000, directed the Secretary to use $100 million of Commodity Credit Corporation (CCC) funds to provide assistance to producers and first handlers of the 2000 crop of cottonseed. Finally, the cottonseed payment for the 1999 crop was authorized by section 104(a) of Public Law No. 106-113, enacted 19 Nov. 1999; $79 million in residual funds were used for the 1999 crop programme.

41. (b) The temporal gaps between the various cottonseed payments are indicated in the answer to (a), above. That is, no cottonseed payments were made in 2001 or 2002 for the 2001 crop (nor

[16]Public Law No. 108-7 (Feb. 23, 2003).

prior to 1999). This gap serves to emphasize that these payments are *ad hoc*, and there was no legislative guarantee that there would be a payment for any of the years involved until the payment was actually authorized. Thus, what Brazil has termed the "cottonseed programme" is readily distinguished from those programmes under the 2002 Act that recur for each crop harvested from 2002 through 2007.[17] In contrast, the legal authority for each cottonseed payment was separate and distinct; no underlying piece of legislation mandated that cottonseed payments be made.

42. (c) We note that each time a cottonseed payment is authorized, new rules must be issued to disburse the funds because there is no ongoing cottonseed "programme"; thus, when new rules are issued, the old rules are either removed at the same time or had been removed previously. That is, there is no publication that included rules for all three programmes.

43. The cottonseed payment under the 2003 Agricultural Assistance Act is not related to the other cottonseed payments except by subject matter. As indicated at the panel hearing, the text in the Agricultural Assistance Act (quoted above) is broad and simple, leaving much to the Department of Agriculture. Because of the discretion vested in the Secretary to disburse the 2002 crop cottonseed payment, and for reasons of administrative convenience, the 2003 regulations borrow from the regulations that implemented the cottonseed payments for the 2000 crop and for the 1999 crop. On 25 April 2003, the Department published regulations at 68 Federal Register 20331 to disburse funds in respect of the 2002 crop.[18] The regulations to disburse the 2000 crop cottonseed payment were published at 65 Federal Register 65718 (2 November 2000).[19] The regulations to disburse the 1999 crop cottonseed payment were published on 8 June 2000 at 65 Federal Register 36550.[20]

*ARTICLE 13(B): DOMESTIC SUPPORT MEASURES*

*"exempt from actions"*

**20. In paragraph 8 of its initial brief (dated 5 June, 2003), the United States argued that the word "actions" as used in the phrase "exempt from actions" in Article 13 of the Agreement on Agriculture includes the "bringing of a case" and consultations. In paragraph 36 of its first written submission (dated 11 July, 2003), the United States stated as follows:**

**"[P]rior to this point in the process, the DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause."**

**Is it the United States' understanding that the drafters used the phrase "exempt from actions" knowing that under the DSU it would not be possible fully to exempt "actions", as the United States interprets that term? USA**

44. There is a difference between a commitment to exempt from action and the mechanism to enforce that commitment, just as there is a difference between rights and obligations under the WTO and the mechanism to enforce those rights and obligations. For example, where one Member

[17]Farm Bills are initiated by Agricultural Committees of the US Congress and recur every 5 or 6 years. Programmes provided for in a Farm Bill are generally not tied to finite amounts of money but rather make use of the funds of the Commodity Credit Corporation (CCC), which has borrowing authority in the US Treasury. *See* 15 US Code § 713 a-11 *et seq.* As a result, no appropriation is needed. By contrast, cottonseed payments (similar to other disaster payments) are *ad hoc* with targeted monies.

[18]Exhibit US-14.

[19]Exhibit US-15.

[20]Exhibit US-16.

breaches a tariff binding, another Member will need to resort to dispute settlement in order to resolve the issue. This does not mean that it is not possible to fully obligate the Member to observe its tariff bindings. The similar situation arises with respect to procedural obligations as well.

45. When responding Members have been confronted by situations in which they considered that complaining parties did not meet requirements for invoking dispute settlement procedures, those responding Members can voice their objections at consultations and the DSB meetings at which panel establishment has been considered, but then must accept that the issue will ultimately be decided by the panel. For example, notwithstanding that the DSU requires consultations on a measure before a panel may be established, there is no mechanism available to address a complaining party's failure to consult absent resolution by a panel.

46. Responding Members have allowed jurisdictional issues to go to the panel for resolution as a practical way forward that offers sufficient protection for their interests while also protecting the integrity of the dispute settlement system. This does not mean that responding Members in any way lost their rights, for example, to consult on the measures at issue before being subject to panel proceedings; it has simply been practical to allow the issue to be decided by panels.

47. Likewise, in this dispute, the fact that Brazil has attempted improperly to invoke dispute settlement procedures notwithstanding the Peace Clause – and the fact that the United States has accepted that the issue should be resolved by the Panel – does not and cannot diminish the right of the United States to be exempt from Brazil's action. The fact that Members may disregard their obligations, or act based on a misunderstanding of the facts or obligations, does not affect those obligations. In this case, Brazil considers that the Peace Clause is inapplicable. As our argumentation to date indicates, we disagree and consider that, based on a correct reading of the law and facts, the Peace Clause is applicable, and Brazil was obliged not to bring this dispute. Upon making a finding on this issue in our favour, the Panel would effectively be concluding that Brazil's invocation of dispute settlement was improper – even if undertaken in good faith – just as panels have in the past concluded that complaining parties have improperly included measures that were not consulted upon in their panel requests or claims that were not within the panel's terms of reference in their argumentation.

**21. In US - FSC and US - FSC (21.5) the Appellate Body made findings under the SCM Agreement relating to export subsidies in respect of agricultural products without making a finding in respect of Article 13 of the Agreement on Agriculture. How is this relevant to the United States' interpretation of the phrase "exempt from actions" as used in Article 13? USA**

48. The FSC findings are not relevant since they do not address the Peace Clause issue. The issue was not raised by either party, and so neither the panel nor the Appellate Body made any finding with respect to Article 13, nor did they offer any reasoning on this issue. Indeed, in the absence of any party raising or arguing this issue, it would be difficult to see how the panel or Appellate Body could have made any findings concerning Article 13. Those DSB recommendations and rulings thus provide no guidance for purposes of this dispute.

*"such measures" and Annex 2 of the Agreement on Agriculture*

**22. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture. BRA, USA**

49. These terms should be interpreted according to the customary rules of interpretation of public international law. The ordinary meaning of "defined" is "clearly marked, definite" and "set out

precisely."[21] "Fixed" means "stationary or unchanging in relative position."[22] Thus, as used in paragraph 6(a), a "defined and fixed base period" means a base period that is "set out precisely" and "stationary or unchanging in relative position." That is, the "definite" base period must not be "changing in relative position"; for example, the "base period" for purposes of determining "base acres" for the deficiency payments under the 1990 Act was a farm's average acreage over the three most recent years[23], and so, was not a "fixed" base period but a moving one. On the other hand, US direct payments satisfy this criterion because eligibility is determined by historical production of any of a number of crops (including upland cotton) in a base period that is "definite" (set out in the 2002 Act) and "stationary or unchanging in a relative position" (does not change in relative position for the duration of the 2002 Act).

**23. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. BRA, USA**

50. Paragraph 6(a) establishes that eligibility for payments under a decoupled income support measure shall be determined by clearly-defined criteria in "*a* defined and fixed base period." That is, paragraph 6(a) does not mandate that any particular base period be used for a decoupled income support measure and does not mandate that the same base period be used for all decoupled income support measures. This contrasts with the use of the phrase "*the* base period" in paragraph 9 of Annex 3, which is defined in that same paragraph as "the years 1986 to 1988."[24]

51. Paragraphs 6(b), (c), and (d) use the term "*the* base period." As these subparagraphs all follow paragraph 6(a), in which eligibility is set in "a" defined and fixed base period, the later references to "the base period" should be read to refer to the base period used for eligibility under paragraph 6(a). Again, because paragraph 6(a) does not mandate that any particular base period be used (as opposed to paragraph 9 of Annex 3), "the base period" for paragraphs 6(b), (c), and (d) will be the "defined and fixed base period" used for purposes of eligibility under the decoupled income support measure. The definite article "the" is commonly used to refer back to a member of a indefinite set identified by the indefinite article "a." For example, it would be common grammatically to say: "A Member may take action if the Member makes the appropriate notification to the WTO."

**24. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture? BRA, USA**

52. Paragraph 6 establishes policy-specific criteria applying to a decoupled income support measure. Under paragraph 6(a), eligibility for payments under such a measure shall be determined by criteria "in a defined and fixed base period." Other policy-specific criteria under paragraph 6 establish that the amount of payments under a decoupled income support measure shall not be related to or based on the type or volume of production, the prices, or the factors of production employed in any year after the base period used for purposes of determining eligibility under paragraph 6(a).

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[21]*The New Shorter Oxford English Dictionary*, vol. 1, at 618 (1993 ed.).

[22]*The New Shorter Oxford English Dictionary*, vol. 1, at 962 (1993 ed.).

[23]*See* US First Written Submission, para. 101 n. 92.

[24]Agriculture Agreement, Annex 3, paragraph 9 ("The fixed external reference price *shall be based on the years 1986 to 1988* and shall generally be the average f.o.b. unit value for the basic agricultural product concerned in a net exporting country and the average c.i.f. unit value for the basic agricultural product concerned in a net importing country *in the base period*.") (emphasis added). *See also id.*, Annex 3, paragraph 5 ("The AMS calculated as outlined below for *the* base period shall constitute the base level for the implementation of the reduction commitment on domestic support.") (emphasis added). Appellate Body Report, *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef* , WT/DS161/AB/R - WT/DS169/AB/R, adopted 10 January 2001, paras. 115-16.

Thus, with respect to a decoupled income support measure, the base period used must be "defined and fixed."

53. There is no requirement in paragraph 6 that a *particular* base period be used for a decoupled income support measure nor that the *same* base period be used for purposes of every decoupled income support measure. Thus, so long as the base period for a particular measure is "defined and fixed," this element of the policy-specific criteria in paragraph 6 will be met.

54. For purposes of this dispute, the base period for US direct payments under the 2002 Act is defined by the 2002 Act and fixed for the duration of the 2002 Act – that is, for marketing years 2002-2007. Thus, one "defined and fixed base period" applies for payments under the US direct payment programme for the six-year period to which the 2002 Act applies.

**25. Does the United States consider that there is any ambiguity in the term "type of production" as used in paragraph 6(b) of Annex 2 of the Agreement on Agriculture? USA**

55. When read according to the customary rules of interpretation of public international law, the United States does not consider that the meaning of the term "type . . . of production" as used in paragraph 6(b) is ambiguous or obscure. This paragraph establishes that the amount of decoupled income support payments may not be "based on, or linked to, the type or volume of production . . . undertaken in any year after the base period." Interpreted according to the ordinary meaning of the terms, in context, and in light of the object and purpose of the Agriculture Agreement, this provision means that a decoupled income support measure may not base or link payments to production requirements, whether by type or volume.

**26. Can the United States confirm Brazil's assertions in paragraph 174 of its first written submission that the implementing regulations for direct payments prohibit or limit payments if base acreage is used for the production of certain crops? If so, can the United States clarify the statement in paragraph 56 of its first written submission that direct payments are made regardless of what is currently produced on those acres? Can the United States confirm the same point in relation to production flexibility contracts? USA**

56. The 2002 Act allows any commodity or crop to be planted on base acres on a farm for which direct payments are made with limitations regarding certain commodities. Those commodities are fruits, vegetables (other than lentils, mung beans, and dry peas), and wild rice. Planting of those commodities on base acres is prohibited, except: (1) in a region with a history of double-cropping those commodities with those crops the historical production of which makes acres eligible for direct payments, double-cropping is permitted; (2) on a farm with a history of planting those commodities, planting is permitted, and direct payments would be reduced for every acre so planted; and (3) for a producer with a history of planting those commodities, planting is permitted, and direct payments would be reduced for every acre so planted.[25]

57. To be more precise, the third sentence of paragraph 56 of the US first submission should have used the phrase "whether upland cotton" in place of "what." As the United States has previously indicated,[26] direct payments are not "related to, or based on, the type or volume" of current production

[25]Farm Security and Rural Investment Act of 2002, § 1106 ("2002 Act") (Ex. US-1).

[26]US First Submission, para. 22 ("These [direct] payments are made with respect to farm acreage that was devoted to agricultural production in the past; the payments, however, are made regardless of whether upland cotton is currently produced on those acres or whether anything is produced at all."); *id.*, para. 24 ("As stated, no current production of upland cotton (or any other crop) is required to receive payment – or, put another way, the payment is the same regardless of how much, or any, upland cotton is produced."); *id.*, para. 67 ("Not only is there no requirement that a direct payment recipient engage in any particular type or volume of

because there is *no requirement* that a recipient produce upland cotton or any other crop in order to receive these payments. Direct payments are made with respect to farm acreage that was devoted to agricultural production in the past. In its rebuttal submission, the United States will describe production flexibility contract payments, which would share these characteristics but not others with direct payments, and explain why production flexibility contract payments are "green box" measures.

**29. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the Agreement on Agriculture. USA**

58. "Fundamental" means "[s]erving as the base or foundation" and "primary, original; from which others are derived."[27] A "requirement" is "[s]omething called for or demanded."[28] Thus, the "fundamental requirement" that measures for which exemption from reduction commitments under Article 6 is claimed must have "no, or at most minimal, trade-distorting effects or effects on production" is "something called for or demanded" "from which others are derived."

59. The United States, perhaps in distinction from the European Communities, does not view this "requirement" ("something called for or demanded") as merely setting out in hortatory terms the objective of Annex 2. However, as suggested by the use of the word "fundamental" ("from which others are derived") and the structure of Annex 2 (that is, beginning the second sentence with the word "accordingly"), compliance with the fundamental requirement of the first sentence will be demonstrated by conforming to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraph 6 through 13. Relevant context supports this interpretation: Articles 6.1, 7.1, and 7.2 refer to measures which are not subject to reduction commitments because they qualify under "*the criteria* set out in Annex 2." Article 18.3 requires a Member to notify "details of the new or modified measure and its conformity with the *agreed criteria* as set out either in Article 6 or in Annex 2." Annex 2 itself, in describing the policy-specific criteria that must be met under paragraphs 2 and 5, emphasizes that measures must meet the "*basic criteria* set out in paragraph 1" rather than the "fundamental requirement" of that paragraph.

60. The text and context of paragraph 1 is also confirmed by the object and purpose of the Agriculture Agreement. Members need to be able to design green box measures with certainty that these measures will be exempt from reduction commitments so that they can meet their binding commitments on domestic support in furtherance of the goal of "substantial progressive reductions in agricultural support . . . sustained over an agreed period of time."[29] Assessing the conformity of a claimed green box measure against the "fundamental requirement" of the first sentence in isolation would be a difficult, if not impossible task, for a Panel. Members foresaw the problem and therefore provided guidance on how a measure would fulfill that fundamental requirement – that is, if the measures "conform to the . . . basic criteria" of the second sentence plus any applicable policy-specific criteria, they shall be deemed to have met the fundamental requirement of the first sentence of Annex 2.

**30. Do the parties consider that direct payments and production flexibility contract payments meet or met the basic criteria referred to in paragraph 1 of Annex 2 of the Agreement on Agriculture? BRA, USA**

61. The "basic criteria" referred to in paragraph 1 of Annex 2 are: (a) the support in question shall be provided through a publicly-funded government programme (including government revenue

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production, a recipient need not engage in any current agricultural production in order to receive the direct payment."); US Opening Statement at the First Panel Meeting, para. 18 ("The payments, however, are made regardless of whether cotton is currently produced on those acres or whether anything is produced at all.").

[27]*The New Shorter Oxford English Dictionary*, vol. 1, at 1042 (1993 ed.)

[28]*The New Shorter Oxford English Dictionary*, vol. 2, at 2557 (1993 ed.)

[29]Agriculture Agreement, preamble.

foregone) not involving transfers from consumers and (b) the support in question shall not have the effect of providing price support to producers. Direct payments under the 2002 Act meet these basic criteria, and the expired production flexibility contract payments under the 1996 Act met these criteria as well.

62. As noted in the US first written submission, direct payments under the 2002 Act are support provided through a publicly-funded government programme not involving transfers from consumers. Under Section 1103 of the 2002 Act, the Secretary of Agriculture "shall make direct payments to producers on farms [including landowners where no production occurs] for which payment yields and base acres are established," and, under Section 1601 of the Act, the Secretary "shall use the funds, facilities, and authorities of the Commodity Credit Corporation to carry out this title." Thus, no transfers from consumers are involved.[30]

63. Direct payments under the 2002 Act also do not have the effect of providing price support to producers. Direct payments augment the income of persons on farms based on historic acres and yields. They are not made to support any "applied administered price" for upland cotton (or that for any other commodity), for example, by increasing upland cotton demand or reducing upland cotton supply.[31] To-date, Brazil has not contested that US direct payments satisfy both "basic criteria" under paragraph 1.

64. As set out in the US answer to Question 15 from the Panel, the expired production flexibility contract payments are not within the Panel's terms of reference. Nonetheless, as we shall explain in more detail in our rebuttal submission, these payments too satisfy the "basic criteria" referred to in paragraph 1 of Annex 2. Production flexibility contract payments provide support through a publicly-funded government programme not involving transfers from consumers.[32] In addition, production flexibility contract payments did not have the effect of providing price support to producers; these payments augmented the income of persons on farms based on historic acres and yields but were not made to support any "applied administered price" for upland cotton (or that for any other commodity). Again, Brazil has not contested that US production flexibility contract payments satisfy both "basic criteria" under paragraph 1.

**31. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? BRA, USA**

65. As set out in the US answer to Question 29 from the Panel, the United States views the first sentence of paragraph 1 as an obligation in that it establishes a "fundamental requirement" for green box measures under Annex 2. This obligation is met when measures conform to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6 through 13. If a new measure does not conform to the basic and applicable policy-specific criteria in Annex 2, it will not have the benefit of the presumption that it meets the fundamental requirement of the first sentence.

**32. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. USA**

[30]*See* US First Written Submission, para. 65.

[31]*See* US First Written Submission, para. 66.

[32]Federal Agricultural Improvement Act of 1996, Title I, § 161(a) ("Use of Commodity Credit Corporation. — The Secretary shall carry out this title through the Commodity Credit Corporation."); *id.*, Title I, § 111 (providing for production flexibility contract payments).

66. As set out in the US answer to Question 29 from the Panel, the United States does not view the first sentence of paragraph 1 as merely setting out a general principle; according to its term, it establishes a "fundamental requirement" for green box measures under Annex 2. However, Annex 2 also indicates that measures that conform to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6 through 13 comply with that fundamental requirement. Thus, the first sentence of paragraph 1 provides important context for the interpretation of other provisions of Annex 2.

67. US direct payments satisfy the criteria set out in Annex 2 and therefore comply with the fundamental requirement of the first sentence of paragraph 1. As explained in the US answer to Question 30, US direct payments satisfy the two basic criteria under the second sentence of paragraph 1. In addition, as set out in the US first written submission,[33] direct payments satisfy the five policy-specific criteria set out in paragraph 6 of Annex 2 for decoupled income support.

68. The context provided by the first sentence of paragraph 1 indicates that Brazil's argument that direct payments do not satisfy paragraph 6(b) because payments are eliminated or reduced if payment recipients harvest certain fruits or vegetables is wrong.[34] Brazil's argument essentially is that paragraph 6(b) precludes a Member from requiring a recipient *not* to produce certain crops, rather than precluding a Member from requiring a recipient *to* produce certain crops. As indicated above, however, Brazil's interpretation leads to a conflict between paragraph 6(b) and the fundamental requirement of the first sentence. That is, a measure that demonstrably meets that fundamental requirement (there are no trade-distorting effects or effects on production because production of no crop is allowed) would be inconsistent with paragraph 6(b) (the amount of payment would be based on the type of production – production of no crops – in a year after the base period). In the context of the first sentence of paragraph 1, then, paragraph 6(b) should be read to prevent a Member from requiring a recipient *to produce* certain crops. US direct payments do not require a recipient to produce upland cotton or any other crop in order to receive payment.

*"do not grant support to a specific commodity"*

**33. According to the United States' interpretation of the word "grant", when can a Member claim that a measure is not exempt from action under Article 13(b)? What if the measure is enacted annually? Can the Member obtain a remedy in respect of that measure under the DSU? USA**

69. The United States has interpreted the word "grant" according to its ordinary meaning: to "bestow as a favour" or "give or confer (a possession, a right, etc.) formally."[35] Because the phrase "such measures do not grant support to a specific commodity" is expressed in the present tense, we have explained that this criterion indicates that whether measures currently in effect are exempt from actions depends upon the support they currently grant.[36] For example, whether payments under the 2002 Act can be challenged in the WTO at this time requires an examination of the product-specific support such measures currently grant (understood to be as of the date of the panel request or panel establishment), not the support measures granted 1, 2, or 3 years ago. A finding of a Peace Clause breach by current measures would allow a Member to proceed with an action based on Peace Clause-specified provisions and potentially obtain remedies with respect to those current subsidies.

70. A Member can make the claim that a measure is not exempt from action under Article 13(b) when the Member believes the measures at issue fail to conform to the Peace Clause, including that the Member believes the measure provides support in excess of that decided in 1992. It would not

[33]US First Written Submission, para. 67.
[34]*See also* US Answer to Question 25 from the Panel.
[35]*The New Shorter Oxford English Dictionary*, vol. 1, at 1131 (fourth & fifth definitions).
[36]US First Written Submission, paras. 79-81.

matter whether the measure were enacted annually. If there were a finding of a breach of the Peace Clause, then the complaining party could obtain a remedy in the form of a recommendation to bring the measure into conformity with the WTO agreements.

71. The issue of when a Member can claim that a measure is not exempt from action highlights the difficulty in adopting Brazil's interpretation that *only* budgetary outlays are relevant to the Peace Clause comparison. In the case of US domestic support measures, budgetary outlays are not known ahead of time. Accordingly, Brazil could only provide *estimates* of marketing year 2002 budgetary outlays in its first submission, explaining that "the evidence to tabulate the support granted to upland cotton during MY 2002 is not yet complete as the marketing year does not end until 31 July 2003."[37] Brazil has not demonstrated that US product-specific budgetary outlays for upland cotton exceeded marketing year 1992 outlays as of the time of its panel request, as of the time of panel establishment, nor, indeed, as of today.[38]

72. This problem is not presented when one looks at the support *as decided by* US domestic support measures. Because those measures, both in 1992 and today, set a rate of support (72.9 cents per pound during marketing year 1992; 52 cents per pound during marketing year 2002), the level of support is known at the outset (or even in advance) of the relevant crop year in which payments are made, permitting a rapid challenge and perhaps panel findings before a given crop year is over. Thus, a Member *would* be able to claim that a current measure is not exempt from action under Article 13(b) and *would* be able to obtain a remedy under the DSU.

**35. Does a failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? BRA, USA**

73. A failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) would only lift the exemption from action for those measures for the year of that breach. Measures (subsidies) in a later year would remain exempt from action so long as those measures in the given year comply with the conditions in Article 13(b)(ii).

74. This conclusion flows from the text of the Peace Clause as well as the nature of the subsidies challenged by Brazil. The universe of measures exempt from actions under Article 13(b)(ii) is "domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6." Because the fundamental commitment under Article 6 is to limit domestic support as measured by the Current Total Aggregate Measurement of Support to a Member's final bound commitment level, and that commitment is judged on a year-by-year basis[39], a Member may breach its commitments under Article 6 in one year and come back into compliance in the following year. Thus, conformity with this element of Article 13 must be judged on a year-by-year basis.

75. The proviso to Article 13 states that such measures shall be exempt from actions "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year." Thus, with respect to past subsidies (and putting aside the issue of whether there is a measure that can be challenged under the DSU), the Peace Clause proviso would require an

[37]Brazil's First Written Submission, para. 149.

[38]*See* US Answer to Question 67 from the Panel.

[39]Agriculture Agreement, Article 6.3 ("A Member shall be considered to be in compliance with its domestic support reduction commitments *in any year* in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule.") (emphasis added).

examination of the support those measures were granting as of the time such measures were in existence. Were the Peace Clause breached in any particular year, a Member could bring an action against such measure (subsidy), but only for the year of the breach. For example, where subsidies were provided on a yearly basis, a Member could breach the Peace Clause in one year in which the support such measures grant is in excess of that decided during the 1992 marketing year but could be in conformity in the following year if support were again within the 1992 marketing year level. Only the subsidies for the year in which the Peace Clause were breached would not be exempt from actions.

76. Finally, we note that payments under the 2002 Act are recurring subsidies, expensed in the crop year to which they apply and superseded by new payments in the following crop year.[40] (So too were past payments under the expired 1996 Act.) Thus, whether such measures conform fully to Article 6 and do not grant support in excess of that decided during the 1992 marketing year – that is, whether such measures are exempt from action under Article 13(b) – must be judged on a year-by-year basis. A breach of the Peace Clause in any particular year would allow a Member to bring an action against such measures, but only for the year of the breach.

**36. Does a failure by a Member to comply with Article 13(b) in respect of a specific commodity impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? BRA, USA**

77. No. For example, were the Panel to find a breach of the Peace Clause because the product-specific support US measures grant for upland cotton is in excess of that decided during the 1992 marketing year, this would not remove Peace Clause protection for support for soybeans (or any other commodity). In any subsequent action, a complaining Member would have to demonstrate that the challenged measures breach the Peace Clause with respect to that commodity and support.

**37. In the United States' view, why did the drafters not use the exact term "product-specific" in Article 13(b)(ii)? USA**

78. It is not possible to determine exactly why the drafters of Article 13(b)(ii) did not use the term "product-specific support" in place of "support to a specific commodity." Nonetheless, the phrase "support to a specific commodity" must be interpreted according to its ordinary meaning, in context, and in light of the object and purpose of the Agreement. As the United States has explained, this phrase means "product-specific support."[41] We note that while it is no doubt a good *drafting* rule to use one and only one term for any given concept in an agreement, the drafters' failure to follow that rule does not alter a treaty *interpreter's* obligation to interpret under the customary rules of public international law the words that actually are in the treaty.

79. Further, it is not surprising that this exact phrase is not used in the Peace Clause. The phrase "product-specific support" is not a defined term to be found in Agriculture Agreement Article 1. Not surprisingly, then, in different provisions the Agriculture Agreement uses different words to describe the concept of product-specific support. For example, in Article 1(a), the basic definition of product-specific support (although not identified as such) is given as "support . . . provided *for* an agricultural product in favour of the *producers* of the basic agricultural product." In Article 1(h), the Agreement again refers to product-specific support not by using that term but by using the words "support for basic agricultural products."[42] None of these references to "product-specific support" even uses the term "specific" whereas the phrase "support to a specific commodity" contains all three elements of that phrase (that is, product, specific, and support), using "commodity" in place of

[40]*See* US Answer to Question 15 from the Panel.

[41]US First Written Submission, paras. 77-78.

[42]Similarly, in Annex 3, paragraph 6, the Agreement refers to a "product-specific" AMS not by using those words but by using the phrase "for each basic agricultural product, a specific AMS shall be established."

"support."[43] The use of the phrase "support to a specific commodity" in the Peace Clause to refer to "product-specific support" is not remarkable in light of these multiple examples of different words in the Agreement that describe the same concept.[44]

**38. Given the fact that subsidies available for more than one product could have various effects on production, how does the United States demarcate between product-specific support and non-product specific support ? USA**

80. The phrase "support to a specific commodity" in the Peace Clause proviso, read according to its ordinary meaning, in context, and in light of the object and purpose of the Agreement, means "product-specific support." The United States finds the demarcation between product-specific and non-product-specific support in the Agriculture Agreement. Specifically, Article 1(a) defines the universe of support making up the Aggregate Measurement of Support as follows:

> "Aggregate Measurement of Support" and "AMS" mean the annual level of *support,* expressed in monetary terms, *provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general,* other than support provided under programmes that qualify as exempt from reduction under Annex 2 to this Agreement . . . (italics added).

Article 1(h), which defines the "Total Aggregate Measurement of Support,"[45] and paragraph 1 of Annex 3, explaining the calculation of the Aggregate Measurement of Support[46], also distinguish between product-specific and non-product-specific support, without providing additional detail to that found in Article 1(a).

81. Article 1(a), therefore, provides the basic demarcation between product-specific and non-product-specific support; as mentioned at the first panel meeting, Brazil has not contested this point. Product-specific support, then, is "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product." This definition contains two elements. First, the support must be provided "*for an agricultural product*," which suggests that the subsidy is given "in favour of"[47] a product and not in respect of criteria not related to the product or in respect of multiple products. Second, such support is "in favour of the *producers of the basic agricultural product*,"

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[43]Again, the use of the term "commodity" in place of "product" may result from the unique negotiating history of the Peace Clause. While the term "product" is used exclusively elsewhere in the Agreement, in the course of the Uruguay Round agriculture negotiations, the term "commodity" had been commonly used. *See, e.g.*, Framework Agreement on Agriculture Reform Programme, Draft Text by the Chairman, MTN.GNG/NG5/W/170, paras. 3, 5, 6, Annex I (11 July 1990). Despite the fact that the Peace Clause uses "commodity" in place of "product," Brazil has not suggested that "commodity" should be interpreted as anything other than agricultural "products" subject to the Agreement.

[44]The United States also notes that under paragraph 1 of Annex 3, non-product-specific support is to be aggregated into one separate AMS, which supports the notion that non-product-specific support is *not* to be allocated to specific products, contrary to what Brazil urges the Panel to do here.

[45]Agriculture Agreement, Article 1(h) ("'Total Aggregate Measurement of Support' and 'Total AMS' mean the sum of all domestic support provided in favour of agricultural producers, calculated as the sum of all aggregate measurements of *support for basic agricultural products*, all *non-product-specific aggregate measurements of support* and all equivalent measurements of support for agricultural products . . . .").

[46]Agriculture Agreement, Annex 3, paragraph 1 ("Subject to the provisions of Article 6, an Aggregate Measurement of Support (AMS) shall be calculated *on a product-specific basis for each basic agricultural product* receiving market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment ('other non-exempt policies'). *Support which is non-product specific shall be totalled into one non-product-specific AMS* in total monetary terms." (emphasis added)).

[47]*The New Shorter Oxford English Dictionary*, vol. 1, at 996 (1993 ed.) (definition of "for": "in favour of"; "[w]ith the purpose or result of benefitting").

which suggests that subsidy benefits those who produce the product – that is, production is necessary for the support to be received.

82. Article 1(a) explains non-product-specific support as "support provided in favour of agricultural producers in general." That is, non-product-specific support is not support provided "for *an* agricultural product" and is not support in favour of "the *producers* of the basic agricultural product" but rather is support in favour of agricultural producers "generally."[48] Thus, read according to its ordinary meaning and in the context of Article 1(a), non-product-specific support is a residual category of support covering those measures that do not fall within the more detailed criteria set out in the definition of product-specific support.

83. Finally, we note Brazil's argument that "[t]he term 'product-specific' that the United States seeks to read into Article 13(b)(ii) has a very technical and particular meaning as set out in Article 6(4), and Annex 3 to the Agreement on Agriculture."[49] As explained above, while both of these provisions use the term "product-specific" as well as "non-product-specific," the Panel will search these provisions in vain for a "technical and particular meaning" of either of these terms. Brazil fails to direct the Panel's attention to the only explanation of the meaning of those terms, Article 1(a), perhaps because this explanation of the "technical and particular meaning" of product-specific support suggests that several of the measures challenged by Brazil provide non-product-specific support and are not part of the comparison under the Peace Clause proviso.

**39. If "such measures" in Article 13(b)(ii) refers to all those in the chapeau of Article 13(b), why are they not all included in the potential comparisons with 1992? In what circumstances can measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994? USA**

84. The introductory phrase of Article 13(b) establishes the full universe of measures that are potentially exempt from actions under this provision – that is, domestic support measures "that conform fully to the provisions of Article 6." The phrase "such measures" in Article 13(b)(ii) occurs in the proviso, and the use of the word "such" refers back to those measures identified in the introductory phrase. However, the type of support that must be compared pursuant to the proviso is set out by the *text* of the proviso: the comparison is not between the *total* (product-specific and non-product-specific) support provided by all measures that existed in 1992 versus those that exist currently; rather, the proviso comparison is between the "support to a specific commodity" that challenged measures grant versus that decided during the 1992 marketing year.

85. With respect to Article 13(b), then, the Peace Clause has two tiers of analysis and effect. First, non-green box domestic support measures collectively lose Peace Clause protection if they do not conform fully to the provision of Article 6 – that is, if they exceed a Member's domestic support commitment level. Second, even if a Member's Current Total Aggregate Measurement of Support is within the reduction commitment, the support to a specific commodity can still lose its Peace Clause protection if it exceeds the level decided during marketing year 1992. This second tier was intended to prevent a Member from increasing its non-green box support to a specific commodity while staying within the domestic support commitment level. When a Member *has* disciplined its product-specific support, however, by staying within the level decided during the 1992 marketing year (as the United States has done), it is entitled to the benefit of observing that commitment.

86. Finally, we note that Brazil's interpretation of the proviso calls for allocating support from all non-green box measures to an agricultural product regardless of whether that support is product-

[48] "In general" means "in general terms, generally" and "as a rule, usually." *The New Shorter Oxford English Dictionary*, vol. 1 , at 1073 (1993 ed.).

[49] Brazil's Opening Oral Statement at the First Panel Meeting, para. 16.

specific or non-product-specific. This analysis has no foundation in the Agriculture Agreement. In fact, Brazil has not followed its own approach through to its logical conclusion: as alluded to by Question 41 from the Panel, presumably Brazil could have taken *all* non-product-specific support provided by the United States and allocated some portion of that support to upland cotton producers. Brazil has not done so, but there is no basis in the Agreement to distinguish the non-product-specific support Brazil excluded from the non-product-specific support Brazil *included* for purposes of its Peace Clause analysis (for example, counter-cyclical payments and crop insurance). The only basis to distinguish whether a measure provides "support to a specific commodity" that is found in the Agriculture Agreement is to rely on the distinction between product-specific and non-product-specific support as explained in Article 1(a).

**43. What are the precise differences between deficiency payments and counter-cyclical payments that lead you to classify the former as product-specific and the latter as non-product specific? How do you classify market loss assistance payments? USA**

87. As indicated in the US answer to Question 38 from the Panel, Article 1(a) of the Agriculture Agreement provides the demarcation between product-specific and non-product-specific support. The definition of product-specific support contains two elements. First, the support must be provided "*for an agricultural product*," which suggests that the subsidy is given in respect of a product and not in respect of criteria not related to the product or in respect of multiple products. Second, such support is "in favour of the *producers of the basic agricultural product*," which suggests that subsidy recipients are those who produce the product – that is, production is necessary for the support to be received. Non-product-specific support is a residual category of "support provided in favour of agricultural producers in general" – that is, "generally."

88. In light of these definitions, it follows that deficiency payments under the 1990 Act were product-specific support whereas counter-cyclical payments are non-product-specific. The relevant differences may be summarized as follows:

| **Deficiency Payments** | **Counter-Cyclical Payments** |
|---|---|
| Farmer must plant upland cotton to receive payment | No requirement to plant upland cotton (or any crop) |
| Payment based on acres "planted for harvest" to upland cotton in that crop year | Payment based on historical "base acres" irrespective of acres currently planted to upland cotton |

In short, deficiency payments required production of upland cotton whereas counter-cyclical payments do not. Thus, deficiency payments were support *for* upland cotton in favour of *the producers* of upland cotton.

89. In order to receive a deficiency payment, a producer was *required* to plant upland cotton for harvest. The "farm programme payment acreage" for an individual farm – that is, the acres on the farm for which the producer would receive a deficiency payment in a given crop year – was defined as "the smaller of the maximum payment acreage or *the acreage planted to the crop on the farm for harvest* within the permitted acreage of the crop of the farm."[50] That is, a farmer would be paid on the acres planted to upland cotton for harvest up to the maximum payment acreage. Under the programme regulations, "crop acreage planted for harvest" was generally defined as "[t]he acreage

[50]7 Code of Federal Regulations § 1413.108(d) (1 Jan. 1993) (emphasis added) (Exhibit US-3); 7 US Code § 1444-2(c)(1)(B)(i) (1992 Supp.) (4 January 1993) (Exhibit US-5).

harvested."[51] Thus, in a given crop year, production was required to receive a deficiency payment, and the amount of the deficiency payment was based on the acreage on which upland cotton was harvested. Thus, both elements of the definition of product-specific support in Article 1(a) are satisfied. The deficiency payment was support for an agricultural product in favour of the producers of the product because recipients had to have planted upland cotton for harvest to receive payment in a given crop year.

90. On the other hand, counter-cyclical payments are decoupled from production requirements. Counter-cyclical payments are made to persons with farm acres that were devoted to production of any of a number of crops, including upland cotton, during an historical base period. That base period was defined in the 2002 Act and is fixed for the life of the legislation (that is, for marketing years 2002-2007).[52] However, a person with "upland cotton base acres" need not produce upland cotton (nor any other particular crop) to receive the counter-cyclical payment. A person with "upland cotton base acres" also need not produce any crop at all. Thus, counter-cyclical payments do not satisfy the definition of product-specific support: they are not payments *for* an agricultural product in favour of *the producers* of the product since *no production of any product, including upland cotton, need occur for payment*.

91. As indicated in our 1999 WTO domestic support notification (G/AG/N/USA/43), the United States believes that market loss assistance payments are non-product-specific amber box support. As with production flexibility contract payments, market loss assistance payments were made to persons with farm acres that previously had been devoted to production of certain crops, including upland cotton, during an historical base period. No production of upland cotton or of any other crop was required to receive payment, and no production was required at all. Thus, these payments do not meet the definition of product-specific support in Annex 1(a).

92. However, the United States did notify these payments as amber box because they were made in response to low prevailing commodity prices. As such, the United States does not consider that they conform to the criterion in paragraph 6(c) of Annex 2 that the amount of decoupled income support payments "in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period". We note that while Brazil has included market loss assistance payments in its Peace Clause comparison, it has not contested the US position (as evidenced by G/AG/N/USA/43) that these payments are non-product-specific amber box support.[53]

**45. If the Panel considered that Step 2 payments paid to exporters were an export subsidy, would the United States count them as domestic support measures for the purposes of Article 13(b)? Please verify Brazil's separate data for Step 2 export payments and Step 2 domestic payments in Exhibit BRA-69 or provide separate data. BRA, USA**

[51]7 Code of Federal Regulations § 1413.4(b) (1 Jan. 1993) (Exhibit US-3). Under the 1990 Act, there were so-called 50-92 provisions, under which a producer could devote part of the maximum payment acreage (that is, 85 per cent of the established crop acreage base less any acreage under an acreage reduction programme) to conserving uses and still receive deficiency payments on the acreage. To take advantage of that provision, the producer was still required to plant upland cotton for harvest on *at least* 50 per cent of the maximum payment acreage. 7 US Code § 1444-2(c)(1)(D)(ii) (1992 Supp.) (4 Jan. 1993) ("To be eligible for payments . . . the producers on a farm must actually plant upland cotton for harvest on at least 50 per cent of the maximum payment acres for cotton for the farm.") (Exhibit US-5).

[52]By way of contrast, under the deficiency payment program, "base acres" were determined by a farmer's yearly upland cotton planting decisions. Base acres were defined as "the average of the acreages planted and considered planted to such crop for harvest on the farm in each of the 3 crop years preceding such crop year." 7 Code of Federal Regulations § 1413.7(c) (1 Jan. 1993) (Exhibit US-3).

[53]*See* Brazil's First Written Submission, paras. 60-62.

93. If the Panel were to conclude that the Step 2 programme and payments made thereunder could be separated in to domestic and export components, and the export component were deemed to be an export subsidy, logically, that component would no longer constitute domestic support. Therefore, that measure would not form part of an analysis under Article 13(b), but rather would fall under Article 13(c). For data relating to Step 2 payment by fiscal year and use, please see the US answer to Question 104 from the Panel.

**46. What is the relevance, if any, of the concept of "specificity" in Article 2 of the SCM Agreement and references to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture? BRA, USA**

94. The concept of specificity in Article 2 of the Subsidies Agreement is entirely unrelated to the meaning of "support to a specific commodity" in Article 13(b)(ii) of the Agreement on Agriculture. Generally, under Article 2 of the Subsidies Agreement, a subsidy is specific if it is limited, in law or in fact, to "an enterprise or industry or group of enterprises or industries." The relevant context for "support to a specific commodity" is found in Articles 1(a), 1(h), 6.4, and Annex 3 of the Agriculture Agreement.

*"in excess of that decided during the 1992 marketing year"*

**47. Where does Article 13(b)(ii) require a year-on-year comparison? BRA, USA**

95. Please see the US answer to Question 35 from the Panel for a reply to this question.

**48. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made? BRA, USA**

96. The proviso to Article 13(b)(ii) requires a comparison of the product-specific support that challenged measures grant (in this case, for upland cotton) to the product-specific support decided during the 1992 marketing year. The United States agrees with Brazil that the Peace Clause proviso requires an apples-to-apples comparison. However, while Brazil's proposed comparison (the budgetary outlays that may be allocated to a commodity, whether product-specific or non-product-specific) has no grounding in the text or context of the Peace Clause, the United States believes the basis for this comparison is established by the use of the word "decided."

97. The term "decided" is not explicitly defined in the Agreement and is not used elsewhere in the Agriculture Agreement nor in the Subsidies Agreement to refer to support or subsidies. Members' unique choice of words must be given meaning. "Decide" means to "[d]etermine on as a settlement, pronounce in judgement" and "[c]ome to a determination or resolution *that, to do, whether*."[54] Thus, the basis for the comparison under the Peace Clause proviso is the product-specific support that was "determined" or "pronounced" during the 1992 marketing year. US measures "decided" product-specific support for upland cotton in terms of a rate of 72.9 cents per pound through the combination of marketing loans and deficiency payments. Thus, to make an apples-to-apples comparison, this rate of support must be compared to the rate of support that challenged measures "grant."

98. Contrary to Brazil's assertion, the use of the term "grant" does not compel an examination of budgetary outlays. The ordinary meaning of "grant" is to "bestow as a favour" or "give or confer (a possession, a right, etc.) formally".[55] Thus, the use of the term "grant" would permit an evaluation of the rate of support that challenged measures "give or confer . . . formally". Brazil's reference to

[54]*The New Shorter Oxford English Dictionary*, vol. 1, at 607 (first and third definitions) (italics in original).

[55]*The New Shorter Oxford English Dictionary*, vol. 1, at 1131 (fourth & fifth definitions).

footnote 55 of the Subsidies Agreement[56] is not pertinent as this is one of several Subsidies Agreement references to a *Member* granting a *subsidy*,[57] which differs from the Peace Clause phrase, "such *measures* do not grant support". More importantly, Members did not choose to use the word "granted" in place of "decided", and a valid interpretation must make sense of that choice rather than reading it out of the Agreement. In addition, had Members intended the Peace Clause comparison to be made *solely* on the basis of budgetary outlays, they could have used that term. After all, "budgetary outlays" is a defined term in Article 1(c) and repeatedly referred to in the Agreement.[58]

99. Thus, the comparison of the product-specific support "decided" during the 1992 marketing year to the support challenged measures "grant" must be made on the terms established by US measures themselves. The United States decided to ensure producer support at a rate of 72.9 cents per pound of upland cotton during the 1992 marketing year. In this case, the comparison presents no difficulty because the challenged measures also grant a rate of support (52 cents per pound). Because the latter is not in excess of the former, challenged US domestic support measures are exempt from actions pursuant to Article 13(b)(ii).

**50. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) and, in particular, why both words "grant" and "decided" were used. USA**

100. The United States is not aware of any written drafting history on this point.

**51. Could the United States please comment on the interpretation advanced by the EC, in paragraphs 16 and 18 of its oral statement, of the words "decided during the 1992 marketing year"? USA**

101. The United States agrees with parts of the interpretation advanced by the EC. The Communities too see the use of the term "decided" in the Peace Clause as notable and suggest that it compels an examination of "an amount of support adopted by some form of decision". The Communities argues that a Member cannot be deemed to have "decided" all of the "applications for support under a particular programme" (as is implied by an examination of budgetary outlays) and that the term "decided" cannot "set up a comparison between domestic support [actually] granted in 1992 and domestic support granted in a more recent period". The United States agrees with these statements.

102. The Communities also advance argumentation that may not flow from the ordinary meaning of the term "decided." For example, the Communities suggests that the term "implies a one-off decision", without further explanation. It would appear that the support "decided" during a marketing

[56]*See* Subsidies Agreement, fn. 55 ("For a developing country Member not granting export subsidies as of the date of entry into force of the WTO Agreement, this paragraph shall apply on the basis of the level of export subsidies granted in 1986.").

[57]*See, e.g.*, Subsidies Agreement, Article 2.1(c) ("Such factors are: . . . the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy"); *id.*, Article 3.2 ("A Member shall neither grant nor maintain [prohibited] subsidies referred to in paragraph 1."); *id.*, Article 4.1 ("Whenever a Member has reason to believe that a prohibited subsidy is being granted or maintained by another Member, such Member may request consultations with such other Member."); *id.*, Article 7.1 ("Except as provided in Article 13 of the Agreement on Agriculture, whenever a Member has reason to believe that any subsidy referred to in Article 1, granted or maintained by another Member, results in injury to its domestic industry, nullification or impairment or serious prejudice, such Member may request consultations with such other Member."); *id.*, Article 9.2 ("Upon request for consultations under paragraph 1, the Member granting or maintaining the subsidy programme in question shall enter into such consultations as quickly as possible."); *id.*, Article 25.2 ("Members shall notify any subsidy as defined in paragraph 1 of Article 1, which is specific within the meaning of Article 2, granted or maintained within their territories.").

[58]*See* Agriculture Agreement, Articles 3.3, 9.2; *id.*, Annex 3, paras. 2, 10, 12, 13; *id.*, Annex 4, para. 2.

year could be made through more than one decision, however. In addition, the Communities suggests that this decision is one "in which support for a specific product is decided and allocated for future years." While it may be that a Member decided support for a future year during the 1992 marketing year, forming the benchmark for the comparison under the Peace Clause proviso, it would also appear likely that a Member decided on a level of support for the marketing year during that marketing year. Thus, the support decided during the 1992 marketing year would not appear to be necessarily limited to support for future years.

**52. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". BRA, USA**

103. The ordinary meaning of the words "decided during" would be "determined or pronounced during" or "having come to a determination or resolution that or to do during." The United States understands that the term "decided during" was intended to capture not just a decision during 1992 for 1992, but also, as the EC indicates, a decision in 1992 of the support to be granted in a future year, in particular the EC's decision during 1992 for future years. The term "authorized during" would not appear to capture all of these dimensions of the term "decided during". In fact, a measure could be "authorized" during 1992 based on a "decision" during an earlier year so the two terms are not synonymous.

**54. Please identify all United States legal and regulatory and administrative instruments decided during the marketing year 1992, with the respective dates of decision, that decided support for upland cotton. BRA, USA**

104. The level of support decided during marketing year 1992 was to ensure a rate of return to producers of 72.9 cents per pound. Numerous legal, regulatory, and administrative instruments "determined" or "pronounced" this support. This level of support was first determined or pronounced by the 1990 Act, which covered the 1991-1995 marketing years. This legislation stated that "[t]he established price for upland cotton shall not be less than $0.729 per pound" for deficiency payments[59] and promised to make up the difference between that price and the higher of the (1) marketing loan rate or (2) market price. The 1990 Act was enacted on 28 November 1990. We note that the established price was set at "not less than" 72.9 cents per pound; that is, the Secretary of Agriculture was given some discretion to set the effective price so long as this did not fall below 72.9 cents. The Secretary, in fact, did not decide to alter this effective price prior to, during, or after the 1992 marketing year.

105. The Secretary decided on the marketing loan rate applicable for the 1992 crop via a series of regulations. A proposed rule was published on 13 September 1991, at 56 Federal Register 46574. The final decision on a loan rate of 52.35 cents per pound was announced on 31 October 1991, published on 20 April 1992, at 57 Federal Register 14326.[60] Those determinations applied to all marketings during marketing year 1992.

106. The United States decided to maintain the effective price for deficiency payments and loan rate for marketing loans at those levels during the 1992 marketing year as reflected in several published documents. The 1 January 1993, Code of Federal Regulations (Exhibit US-3) codified these levels of support.[61] The 1992 Supplement to the US Code also codified the legislated effective price of "not less than" 72.9 cents per pound. In addition, the Department of Agriculture published an upland cotton fact sheet in September 1992 announcing that "[t]he 1992 target price [for deficiency payments] is 72.9 cents per pound" and the "1992 loan rate . . . is 52.35 cents per pound".[62]

[59]7 US Code § 1444-2(c)(1)(B)(ii) (1992 Supp.) (4 Jan. 1993) (Exhibit US-5).
[60]Exhibit US-2.
[61]7 Code of Federal Regulations § 1413.104(a) (1 Jan. 1993) (Exhibit US-3).
[62]US Department of Agriculture, Upland Cotton Fact Sheet, at 2 (September 1992) (Exhibit US-17).

107. Finally, we note that in anticipation of the 1993 crop year the Department of Agriculture also initially pronounced the level of support for the 1993 crop year during the 1992 marketing year. On 24 March 1993, regulations were published at 58 Federal Register 15755 setting the marketing loan rate at 52.35 cents per pound and leaving undisturbed the effective price for deficiency payments at 72.9 cents per pound.[63] Thus, the support decided for the 1993 crop was the same as that decided for the 1992 crop: to ensure producer support of 72.9 cents per pound of upland cotton.[64]

**55. Please provide a copy of the instrument in which the rate of support for upland cotton during the marketing year 1992 was decided, indicating the date of the decision. USA**

108. As indicated in the US answer to Question 54 from the Panel, the United States has provided copies of multiple legal, regulatory, and administrative instruments and publications reflecting the rate of support decided during marketing year 1992. These multiple decisions stem from the fact that an effective price and marketing loan rate were first published in advance of the 1992 marketing year in order to allow producers to become familiar with the programmes; subsequently, the Secretary of Agriculture decided not to change either the effective price (72.9 cents per pound) or the marketing loan rate (52.35 cents per pound), despite having the authority to do so.

**56. Could the United States please explain how support granted under legislation that dates back to 1990 can have been support "decided during the marketing year 1992"? USA**

109. Payments during the 1992 marketing year were made pursuant to the 1990 Act, which directed the Secretary of Agriculture to make marketing loan payments and deficiency payments (as well as Step 2 payments). The 1990 Act, however, was only the first decision on the level of support. The Act provided that the marketing loan rate could "not be reduced below 50 cents per pound".[65] The 1990 Act also stated that the "established price for upland cotton shall not be less than $0.729 per pound".[66] Thus, the Secretary had discretion to alter those rates of support.

110. The Secretary decided to set the marketing loan rate at 52.35 cents per pound in April 1992 but also decided not to change the implementing regulations establishing the effective price for deficiency payments. Similarly, during the 1992 marketing year, the Secretary had the discretion *to raise* the deficiency payment target price above 72.9 cents per pound and *to raise* the marketing loan rate above 52.35 cents per pound but decided not to. Documents published during 1992 evidence this decision: the 1992 supplement to the United States Code published in January 1993 reflects the decision not to alter the statutory provisions relating to upland cotton rates. The 1993 Code of Federal Regulations was published in January 1993 and also reflects the decision not to alter the regulatory rate provisions. Finally, when the upland cotton fact sheet was published in September 1992, the effective price and marketing loan rate were left unchanged, reflecting the Secretary's decision not to change the level of support.

111. In this case, the support determined or pronounced by US measures during the 1992 marketing year was also the support determined or pronounced for the 1992 marketing year. This result is entirely consistent with the Peace Clause text; in fact, it provides certainty to both Members seeking to provide support within Peace Clause limits and Members seeking to understand whether the Peace Clause has been breached.

[63]A proposed rule for the 1993 crop was published on 29 September 1992. The 1993 rates were announced on 2 November 1992, and published in the 24 March Notice.

[64]We note that one distinction made by the 24 March 2003 regulations between the 1993 crop and the 1992 crop was that the acreage reduction program percentage was lowered from 10 per cent in 1992 to 7.5 per cent in 1993.

[65]7 U.S.C. 1444-2(a)(1), (2)(A) (1992 Supp.) (Jan. 4, 1993) (Exhibit US-5).

[66]7 U.S.C. 1444-2(c)(1)(B)(ii) (1992 Supp.) (Jan. 4, 1993) (Exhibit US-5).

112. Thus, the 1990 Act initially established a level of support applicable to the 1991-95 crops. The US Congress could have changed the 72.9 cents per pound level at any time during MY 1992, but it decided not to. The Secretary of Agriculture also had discretion to alter the level of support (that is, to raise it) but also decided not to. Thus, 72.9 cents per pound was decided and remained decided as the level of support for each day of the 1992 marketing year.

**57. If the United States decided on a rate of support for MY1992, does that not mean that it decided on whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at that time? USA**

113. The Peace Clause proviso establishes the benchmark for comparison: the support "decided" during the 1992 marketing year. To say that the United States "determined" or "pronounced" an indefinite amount of budgetary outlays would not fit those meanings of the term. The United States could also not have come to a "determination or resolution" to make any budgetary outlay since that outlay would be determined by market prices during the year, *not* by the US Government. To read support "decided" as encompassing not only the explicit rate of support set out in US measures but also "whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at the time," would also appear to make the Peace Clause comparison impossible. That is, because both during the 1992 marketing year and under the 2002 Act the support decided would be "whatever budgetary outlay was required to meet that rate of support," both budgetary outlay "decisions" by the United States would appear to be unlimited, and one could not be in excess of the other. Alternatively, one could reason that a decision to provide whatever budgetary outlays would be necessary implies that the 1992 decided level would be higher because, even if prices fell to zero, the higher nominal level in 1992 would mean higher budgetary outlays.

114. The only support "decided" by the United States was the 72.9 cents per pound level of support. In effect, the United States provided a revenue floor for producers by guaranteeing a rate of income for plantings. The United States has never exceeded that level of incentive "for the commodity." Brazil's approach, which would ascribe to the United States a decision to make budgetary outlays resulting from differences between market prices and the level of support, is an effort to impose something akin to an AMS limit on US support for upland cotton. (We note, however, that Brazil cannot simply argue for calculating an AMS for upland cotton because that would exclude non-product-specific support, which Brazil wishes to include in the Peace Clause comparison, and would not require that support be measured through budgetary outlays.) Members considered and rejected any product-specific AMS limits in the Uruguay Round, however, and such a concept may not be overlaid onto the Article 13 language. The United States has introduced payments decoupled from production precisely to lower the incentive to produce the marginal pound of cotton and avoid exceeding the product-specific level of support of 72.9 cents per pound.

**59. Should the rate of support as indicated in Article 13(b)(ii) include the market price? If so, why is it appropriate to include it in the comparison under Article 13(b)(ii)? BRA, USA**

115. No, the market price is not relevant for purposes of the Peace Clause comparison. As indicated in the US answers to Questions 48 and 57 from the Panel, the benchmark for that comparison is the support "decided" during the 1992 marketing year. That support was decided by the United States as a rate of support: 72.9 cents per pound. The actual amount of expenditures necessary to provide that support depended on the market prices during the marketing year. However, these prices were not "determined" or "pronounced" by the United States and therefore cannot have been (or be) part of any US decision.

**60. Can you provide information on support decided in 1992 and the years with which you believe it should be compared, on a per support programme / per unit of production/per**

**annum basis? If possible, please specify how, if at all, budget outlays may be transposed into units of production, and which units of production are best to use. BRA, USA**

116. The United States has explained that the product-specific support decided during the 1992 marketing year for upland cotton was 72.9 cents per pound through the combined effect of the target price for deficiency payments and the loan rate for marketing loans. This rate was the only support "decided" by the United States as evidenced by the relevant legislation, regulations, and programme announcements. By comparison, the product-specific support that upland cotton support measures currently grant is only 52 cents per pound through the loan rate for the marketing loan programme.

117. The United States believes that any analysis that takes budgetary outlays into account necessarily will not reflect the support "decided" by the United States. Because US domestic support measures are largely dependent on a price-gap, budgetary outlays will reflect prevailing market prices during the applicable marketing year, prices the United States cannot decide. Budgetary outlays will also reflect, for the product-specific support that marketing loans grant, various *producer* decisions on programme participation, timing of receipt of payments, and production levels. Again, these factors cannot be decided by the United States. Thus, given the way in which the challenged US measures decide the level of support, the Peace Clause comparison may only be made on the basis of rates of support, not budgetary outlays.

**61. Does the United States consider that Article 13(b)(ii) permits a comparison on any basis other than a per pound basis? USA**

118. Article 13(b)(ii) requires that the benchmark for comparison be the support "decided" during the 1992 marketing year. The United States decided on an a rate of support of 72.9 cents per pound during the 1992 marketing year. Therefore, the evaluation must be whether challenged measures grant product-specific support in excess of that decided during the 1992 marketing year – that is, in excess of the 1992 rate of support. Were the relevant US domestic support measures structured differently, the term "decided" might imply a different comparison.

**66. Could you please comment on the relative merits of each of the following calculation methods for the purposes of the comparison of support to upland cotton with 1992, irrespective of whether a particular measure should be included or excluded:**

**(a) Total budgetary outlays (Brazil's approach). USA**

119. As stated in the US answer to Question 60 from the Panel, the United States believes that any analysis that takes budgetary outlays into account necessarily will not reflect the support "decided" by the United States. Because some US domestic support measures are dependent on a price-gap (for example, marketing loans), budgetary outlays will reflect prevailing market prices during the applicable marketing year, prices the United States cannot decide. Budgetary outlays will also reflect, for the product-specific support that marketing loans grant, various *producer* decisions on programme participation, timing of receipt of payments, and production levels. Again, these factors cannot be decided by the United States. Thus, given the way in which the challenged US measures decide the level of support, the Peace Clause comparison may only be made with respect to these measures on the basis of rates of support, not budgetary outlays.

**(b) Budgetary outlays per unit of upland cotton: Could you please calculate and provide an estimate for the marketing years 1992 and 1999-2002, respectively, and draw attention to any factors/qualifications that the Panel would need to be aware of. BRA, USA**

120. For the reasons stated in response to Question 66(a), any analysis involving budgetary outlays necessarily will not reflect the support "decided" by the United States. A budgetary outlays per unit

of upland cotton approach thus would not only be based on a faulty premise, but to calculate outlays per unit might also necessitate an *ex post* or retrospective analysis. Again, this cannot reflect the support "decided" by the United States.

**(d) Per unit rate of support for upland cotton (Prof. Sumner's approach at the first session of the first substantive meeting ). USA**

121. The United States continues to examine Mr. Sumner's approach to calculating a per-unit subsidy rate. We will present a detailed critique of Mr. Sumner's analysis in our rebuttal submission. Here, we limit our comments to two points.

122. First, as with the budgetary outlays approach favoured by Brazil, this per unit rate of support analysis ascribes to the United States choices made by producers themselves. For example, the first line of Sumner's analysis of the deficiency payment programme stated: "The following qualifications and adjustments must [] be made to the level of support provided by the deficiency payment programme: (1) payments were made *only if a farm chose to participate* in the deficiency payment programme; in 1992, farms representing 11 per cent (1.64 million acres) of the total 'effective' upland cotton acreage base (14.9 million acres) *did not agree to participate in the programme* and hence cotton production on this land could not receive support."[67] Sumner makes a similar argument and adjustment for the 1992 loan rate.[68]

123. Attempting to adjust the per unit rate of support to take account of producers that chose not to participate in the programme is a serious conceptual error. In economic terms, a farmer that participated in the upland cotton programme received full programme benefits; a farmer who chose not to participate did not. Averaging these numbers produces a "per unit rate of support" that no cotton farmer ever could have expected to receive.

124. Nor could a Member have "decided" such a level of support. In legal terms, an individual producer's choices on programme participation do not reflect any decision by the US Government. Thus, estimated rates of support that reflect these producer decisions are not relevant to the Peace Clause analysis under Article 13(b)(ii). We will discuss other conceptual errors in Sumner's approach in our rebuttal submission.

125. In reviewing Sumner's analysis, the United States was particularly struck by another point. The Panel may recall Brazil commenting at the first panel meeting that Sumner's calculations were not entirely unfavourable to the US position. A look at Appendix Table 1 to Sumner's statement (Exhibit BRA-105) reveals why.

126. Even using Sumner's flawed calculations, if one excludes the non-product-specific support that Brazil is attempting to "allocate" to upland cotton from the table, Sumner's analysis supports the United States, not Brazil. That is, Sumner's estimated per unit rate of support was *lower* in every year from marketing year 1999 through marketing year 2002 than the level of support during marketing year 1992:

[67]Exhibit BRA-105 (Statement of Mr. Daniel Sumner, para. 10) (emphasis added).
[68]Exhibit BRA-105 (Statement of Mr. Daniel Sumner, para. 12).

| Product-Specific Support in Sumner's per Unit Subsidy Rates (Cents per Pound) by Programme and Year | | | | | |
|---|---|---|---|---|---|
| | **MY1992** | **MY1999** | **MY2000** | **MY2001** | **MY2001** |
| Marketing Loan | 44.34 | 50.36 | 50.36 | 50.36 | 52.00 |
| Deficiency | 13.25 | na | na | na | na |
| Step 2 | 2.46 | 2.46 | 2.46 | 2.46 | 3.71 |
| Cottonseed | na | 0.97 | 2.27 | na | 0.61[69] |
| ***Total*** | **60.05** | **53.79** | **55.09** | **52.82** | **56.32** |

127. Thus, even were one to accept for purposes of argument Sumner's approach, comparing the product-specific support the challenged measures grant to the product-specific support decided during marketing year 1992 reveals that *in no marketing year from 1999 through 2002 did the level of support exceed the marketing year 1992 level*. Under Article 13(b)(ii), then, Sumner's own analysis reveals that US domestic support measures that conform fully to the provisions of Article 6 are exempt from actions based on Peace Clause-specified WTO subsidies provisions.

**67. The Panel requests the parties to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002. For this purpose the parties are each requested to submit AMS calculations for upland cotton (using the budgetary-outlay/non-price gap methodology employed by the United States in respect of cotton in its DS Notifications (e.g., G/AG/N/USA/43) and using the formats and supporting tables in document G/AG/2) on the same basis as would be the case in calculating a product specific AMS for the purposes of the calculation of the "Total Current AMS" in any year in accordance with the relevant provisions, including as appropriate Article 1(a), (b) and (h), Article 6 and Annex 3 to the Agreement. BRA, USA**

128. The United States has calculated a product-specific Aggregate Measurement of Support for upland cotton for marketing years 1992, 1999, 2000, 2001, and 2002, as explained below. This table summarizes the results of those calculations, and the following paragraphs provide additional detail:

| US Upland Cotton Aggregate Measurement of Support | |
|---|---|
| **Marketing Year** | **AMS (US $, millions)** |
| 1992 | 2,085 |
| 1999 | 2,262 |
| 2000 | 1,057 |
| 2001 | 2,804 |
| | |

[69]The United States includes the cottonseed amount from the table without prejudice to our preliminary ruling request that the Panel find the 2003 cottonseed payment not to be within the scope of this dispute.

| US Upland Cotton Aggregate Measurement of Support | |
|---|---|
| 2002[70] | 970 |

129. For marketing year 1992, the United States has used official data on budgetary outlays[71] to calculate the upland cotton Aggregate Measurement of Support, except for other product-specific support in the form of storage payments and interest subsidies. The latter payment amounts are based on estimates by the US Department of Agriculture. The calculations, in millions of US dollars, are as follows:

| **Crop year 1992 (estimate)** | **Payments** | **Source** |
|---|---|---|
| Deficiency payments | 1,017 | US Department of Agriculture (USDA), Upland Cotton Fact Sheet (Ex. Bra-4) |
| Marketing loan gains / Certificate exchange gains | 476 | USDA budget data (Ex. Bra-6) |
| Loan deficiency payments | 268 | USDA budget data (Ex. Bra-76) |
| User marketing certificates | 207 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| Commodity loan forfeit | (5) | USDA estimate |
| Other payments | 122 | USDA estimate of storage payments & interest subsidy |
| *Product-Specific AMS* | 2,085 | |

130. To calculate the upland cotton Aggregate Measurement of Support for marketing year 1999, the United States has used official budgetary outlays data for loan deficiency payments, marketing loan gains, certificate exchange gains, user marketing certificates, and the 1999 crop year cottonseed payment. For storage payments and interest subsidies, we have used estimates by the US Department of Agriculture as notified to the WTO. The calculations, in millions of US dollars, are as follows:

[70]As explained further below, the United States has calculated the 2002 Aggregate Measurement of Support for upland cotton as of the date of panel establishment, 18 March 2003.

[71]In light of the question from the Panel, we have used budgetary outlays to estimate payments.

| Crop year 1999 | Payments | Source |
|---|---|---|
| Marketing loan gains/ Certificate exchange gains | 860 | USDA budget data (Ex. Bra-55) |
| Loan deficiency payments | 685 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| User marketing certificates | 422 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| Cottonseed payments | 79 | G/AG/N/USA/43 |
| Other payments | 216 | USDA estimate of storage payments & interest subsidy (G/AG/N/USA/43) |
| *Product-Specific AMS* | 2,262 | |

131. To calculate the upland cotton Aggregate Measurement of Support for marketing year 2000, the United States has again used official budgetary outlays data for loan deficiency payments, marketing loan gains, certificate exchange gains, and user marketing certificates; the amounts set by legislation for the 2000 crop year cottonseed payments; and estimates by the US Department of Agriculture for storage payments and interest subsidies. The calculations are as follows:

| Crop year 2000 (estimate) | Payments | Source |
|---|---|---|
| Marketing loan gains | 61 | USDA budget data (www.fsa.usda.gov/dam/ BUD/estimatesbook.htm)[72] |
| Loan deficiency payments | 152 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| User marketing certificates | 236 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| Cottonseed payments | 185 | Public Law 106-224, § 204(e) (20 June 2000); Public Law 107-25, § 6 (13 Aug. 2001) |
| Certificate exchange gains | 360 | USDA budget data (www.fsa.usda.gov/dam/ BUD/estimatesbook.htm) |
| Other payments | 63 | USDA estimate of storage payments & interest subsidy |
| *Product-Specific AMS* | 1,057 | |

132. For marketing year 2001, the United States has used estimates by the US Department of Agriculture for storage payments and interest subsidies and official data on budgetary outlays for all other payments to calculate the upland cotton Aggregate Measurement of Support. The calculations, in millions of US dollars, are as follows:

[72]Exhibit US-18.

| Crop year 2001 (estimate) | Payments | Source |
|---|---|---|
| Marketing loan gains | 47 | USDA budget data (www.fsa.usda.gov/dam/BUD/estimatesbook.htm) |
| Loan deficiency payments | 744 | USDA budget data (Ex. Bra-76) |
| User marketing certificates | 196 | USDA, Upland Cotton Fact Sheet (Ex. Bra-4) |
| Certificate exchange gains | 1,750 | USDA budget data (www.fsa.usda.gov/dam/BUD/estimatesbook.htm) |
| Other payments | 68 | USDA estimate of storage payments & interest subsidy |
| *Product-Specific AMS* | 2,805 | |

133. For crop year 2002, the United States has provided unofficial data on budgetary outlays as of 18 March 2003, the date of establishment of the Panel, for marketing loan gains, certificate exchange gains, loan deficiency payments, and user marketing certificates. Because the crop year has just ended (as of 31 July 2003), official budgetary outlay data is not yet available. For the 2002 crop year cottonseed payment, the United States has used the amount set by legislation ($50 million). We use a crop-year's-end estimate by the US Department of Agriculture for storage payments and interest subsidies. The calculation, in millions of US dollars, is as follows:

| Crop year 2002 (estimate as of panel establishment) | Payments | Source |
|---|---|---|
| Marketing loan gains/ Certificate exchange gains | 563 | USDA unofficial data (www.fsa.usda.gov/pscad/answer82rnat.asp (18 March 2003))[73] |
| Loan deficiency payments | 202 | USDA unofficial data (www.fsa.usda.gov/pscad/answer82rnat.asp (18 March 2003)) |
| User marketing certificates | 137 | USDA unofficial data |
| Other payments | 68 | USDA estimate of storage payments & interest subsidy |
| *Product-Specific AMS* | 970 | |

134. We note that it would not be appropriate for the Panel to examine payments made after the date of panel establishment, on which the Panel's terms of reference were set. Measures taken after the Panel was established cannot be within the Panel's terms of reference. However, for the Panel's convenience, we have also estimated an Aggregate Measurement of Support for the entire crop year 2002, using US Department of Agriculture projections of all payments with respect to the 2002 crop

[73]*See* Exhibit US-19 (Marketing Year 2002 Loan Deficiency Payment and Price Support Cumulative Activity As of 3/12/2003). Upland cotton data is shown in the row marked "UP." The loan deficiency payment amount is shown in the third column, and the marketing loan gain and certificate exchange gain amounts are shown in the eighth column (second from left). This Report, the PSL-82R, provides weekly, unofficial data. Brazil provided the same report as Bra-55 but chose to present the report with data as of 13 June 2003.

year. These projections show no dramatic change from the unofficial budgetary outlays as of 18 March. The full-year 2002 crop year estimate, in millions of US dollars, is as follows:

| Crop year 2002 (full-year estimate) | Payments | Source |
|---|---|---|
| Marketing loan gains | 11 | USDA estimate (www.fsa.usda.gov/dam/BUD/estimatesbook.htm)[74] |
| Loan deficiency payments | 206 | USDA estimate (www.fsa.usda.gov/dam/BUD/estimatesbook.htm) |
| User marketing certificates | 217 | USDA estimate (www.fsa.usda.gov/dam/ BUD/estimatesbook.htm) |
| Cottonseed payments | 50 | Public Law 108-7, § 206 (24 Feb. 2003) |
| Certificate exchange gains | 701 | USDA estimate (www.fsa.usda.gov/dam/BUD/estimatesbook.htm) |
| Other payments | 65 | USDA estimate of storage payments & interest subsidy |
| *Product-Specific AMS* | 1,250 | |

**68. Could you please clarify the result of the calculations of, and the meaning of the title, in Appendix Table 1 "Estimated per unit Subsidy Rates by Programme and Year" in Annex 2 to Exhibit BRA-105, page 12. Why are the numbers calculated for marketing loans considered to be subsidies? Could the Panel, for example, read the "total level of support" (bottom line of the table) as the effective support price for upland cotton or the maximum rate of support for upland cotton? BRA, USA**

135. The United States looks forward to reviewing Brazil's explanation of its Appendix Table 1 to Annex 2 to Exhibit BRA-105.

**69. Can the United States confirm that the "marketing year" for upland cotton is 1 August to 31 July ? Can the United States confirm the Panel's understanding that USDA data for the "crop year" corresponds to the "marketing year"? USA**

136. The United States confirms that the "marketing year" for upland cotton is 1 August to 31 July.[75] In response to a question from the Panel at the first meeting, we also communicate that payments listed in the Upland Cotton Fact Sheet (Ex. Bra-4) are for monies spent with respect to cotton harvested in a particular crop year, not necessarily for payments made during the marketing year.

*EXPORT CREDIT GUARANTEE PROGRAMMES*

**71. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? Does it confer a benefit within the meaning of Article 1.1(b)? Why or why not? If so, to whom? USA**

[74]Exhibit US-19.
[75]7 Code of Federal Regulations 1412.103.

**(b) How, if at all, would these elements be relevant to the claims of Brazil, and the United States response thereto? BRA, USA**

137. (a) For the reasons stated in its first written submission[76] and in response to Question 71(b), the United States does not believe that the appropriate analysis of the US export credit guarantee programme should begin with the Subsidies Agreement, much less Article 1of that Agreement. The text of Article 10.2 defers WTO obligations for export credit guarantees until disciplines are internationally agreed, such as within the OECD or WTO. Under the Agriculture Agreement, the provisions of the Subsidies Agreement "apply subject to the provisions of this Agreement,"[77] and the export subsidy disciplines of Article 3.1(a) of the Subsidies Agreement expressly apply "[e]xcept as provided in the Agreement on Agriculture."[78] Thus, the appropriate analysis would begin and end with Agriculture Agreement Article 10.2.

138. Even were the Subsidies Agreement relevant to US export credit guarantees, given that export credit guarantees are covered by item (j) of the Illustrative List of Export Subsidies, the appropriate mode of analysis under the Subsidies Agreement is to examine whether the programme is covering its long-term operating costs and losses.

139. (b) Article 3 of the SCM Agreement specifically states that Article 3.1(a), prohibiting export subsidies, applies "[e]xcept as provided in the Agreement on Agriculture". Article 21.1 of the Agriculture Agreement states that "[t]he provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement". Under Article 10.2 of the Agreement on Agriculture, the negotiators specifically deferred the application of export subsidy disciplines on agricultural export credit guarantee programmes like those of the United States. Any incidental "benefit" of any such measures is therefore irrelevant. Similarly, even if a particular (non-export credit) measure comprised a contribution and conferred a benefit for purposes of the Subsidies Agreement, to the extent the resulting subsidy was contingent on export performance, such export subsidy might nevertheless be permitted under the Agreement on Agriculture if within a Member's applicable reduction commitment.

**73. The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The United States has yet to submit any evidence or argumentation on this point, either as potential context for interpretation of the terms in Article 10 of the Agreement on Agriculture or in relation to Brazil's claims under the SCM Agreement. The Panel would therefore appreciate United States views in respect of this situation, and invites the United States to submit relevant argumentation and evidence. USA**

140. The United States does not believe that Brazil has submitted evidence and argumentation that would establish a *prima facie* case in favour of Brazil's claims, in particular in light of Article 10.2 of the Agriculture Agreement. However, the United States will review Brazil's submissions, including its responses to these questions, and provide any further response in the US submission.

**74. If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 of the Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both? BRA, USA**

[76]US First Written Submission, paras. 167-170.
[77]Agriculture Agreement, Article 21.1.
[78]Subsidies Agreement, Article 3.1.

141. As the United States has argued, the first point of analysis is Article 10.2 of the Agreement on Agriculture, in which Members agreed that they would only provide export credit guarantees in conformity with internationally agreed disciplines, which they undertook to develop. That is, Article 10.2 indicates that no "internationally agreed disciplines" currently exist. The obligation with respect to export credit guarantees is, in effect, a work programme to establish a future discipline. Brazil has not contested that challenged US export credit guarantee programmes are within the scope of Article 10.2. Therefore, neither item (j) nor Articles 1 and 3 of the Subsidies Agreement are relevant to the Panel's analysis of Article 10.2. We do note, however, that item (j) of the Illustrative List of Export Subsidies was agreed in the Uruguay Round, and, in fact, had previously formed part of the Illustrative List under the Tokyo Round Subsidies Code. Thus, the fact that Members had agreed on item (j) and yet, in Article 10.2, agreed to "undertake to work toward *the development* of internationally agreed disciplines to govern the provision of export credits, export credit guarantees" and, once agreed, only to provide export credit guarantee programmes "in conformity with" such developed and agreed disciplines, suggests that item (j) does *not* impose disciplines on export credit guarantees for agricultural goods.

142. Context for Article 10 is found in Article 9.1 of the Agreement on Agriculture, which describes specific practices that constitute export subsidies for purposes of the Agreement on Agriculture. Export credit guarantees were not listed among such practices. As to the practices described in Article 9.1, no recourse is necessary to Articles 1 and 3 of the SCM Agreement to determine whether a particular practice is an export subsidy. Article 1(e) of the Agreement on Agriculture defines an export subsidy only as a subsidy contingent on export performance. To determine the applicability of Article 10.1 to a particular measure not described in Article 9.1 first requires a determination whether a subsidy exists. In this regard, Article 1of the SCM Agreement would provide relevant context.

**75. The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see e.g. written third party submission of Canada) and to the panel report in DS 222 Canada-Export Credits and Loan Guarantees. How and to what extent are Article 14(c) of the SCM Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would be the appropriate market benchmark to use for any comparison? Please cite any other relevant material. BRA, USA**

143. For reasons set out in more detail in the US answer to Question 71(b) and Question 71(c) from the Panel, the United States does not believe that Article 14(c) is relevant to the Panel's analysis. An appropriate analysis of the US export credit guarantee programme begins and ends with Article 10.2 of the Agreement on Agriculture. Even were the Subsidies Agreement relevant to US export credit guarantees, the only appropriate mode of analysis under the Subsidies Agreement is to examine whether US export credit guarantee programmes are covering their long-term operating costs and losses under item (j) of the Illustrative List of Export Subsidies.

**76. How does the United States respond to Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders."? USA**

144. Brazil is incorrect. Commercial insurers do offer export credit insurance covering agricultural commodities. According to a background paper on export credits prepared by the WTO Secretariat, "While guarantees could be unconditional, they usually have conditions attached to them, so that in practice there is little distinction between credits which are guaranteed and credits which are subject to insurance."[79] However, for the sake of completeness we wish to note that such private insurance is structured differently than CCC credit guarantees. Most commonly, private insurers offer portfolio

[79]*See Export Credits and Related Facilities*, G/AG/NG/S/13 (26 June 2000).

coverage, covering multiple customers and transactions for a particular exporter. Because the coverage is not based on individual transactions (like CCC's coverage), it may be difficult or impossible to discern which particular transactions involve agricultural commodities.

**77. How does the United States interpretation of "long term operating costs and losses" in item (j) as claims paid give meaning to both "costs" and "losses"? Do claims paid represent "losses" or "costs" or both? If claims paid is represented by "losses", what would go into the "cost" element of item (j)? Could the United States expand on why it disagrees with the items which Brazil identifies for inclusion in the examination to be conducted under item (j)? USA**

145. Item (j) applies to three different types of programmes: export credits, export credit guarantees, and insurance. In the case of the latter two types of programmes, the provider will necessarily incur claims from time to time. In the case of direct export credits (the first type of programme), the provider will experience defaults on occasion. To the extent such claims or defaults exceed revenue from whatever source it may be derived, the net result would be a loss arising from operations. In an accounting sense such result would constitute an "operating loss."

146. In addition, it is appropriate to identify and allocate costs necessary to operate such programmes. For example, the United States agrees that certain administrative expenses should be allocated to the operation of the export credit guarantee programmes, and an annual figure is attributed as administrative expense in the budget of the United States. Other costs necessary for the operation of a programme would constitute "operating costs" of such programme.

147. Were item (j) to be relevant in this dispute, therefore, that item compels an examination of losses derived from the operation of the programme plus the costs necessarily allocable to the programme for its operation. In the case of US export credit guarantee programmes, as reflected in paragraph 173 and accompanying tables of the US first written submission, the Commodity Credit Corporation (CCC) charges and receives premiums from applicants. In addition, CCC receives post-claim revenue through late payments and rescheduling. As reflected in the tables, with respect to cotton, such revenue exceeds the relevant claims experience. The United States has, therefore, not incurred an operating loss.

148. It is appropriate to allocate operating costs of the programme in the final analysis within the meaning of item (j). The United States disagrees, however, with the allegation of Brazil concerning interest allocation and the manner in which it attempts to ascribe figures from the US budget to operating costs for purposes of item (j). These items are addressed specifically in the US response to Question 81 from the Panel.

**78. Can the United States provide supporting documentation for data used relating to "costs and losses" in paragraph 173? Could the United States confirm that the figures cited in paragraph 173 of its first written submission relate to the SCGP? Why did the United States cite these figures after stating that it is not possible to make any assessment of the long-term operating costs and losses of this programme? USA**

149. The United States maintains a comprehensive electronic data base of export credit guarantee programme activity. The data base is updated on a regular basis and is the source of the data shown in paragraph 173 and accompanying table. Data is recorded in the system at the time of each transaction. These include such items as claim payments, recoveries, rescheduling agreements, and fees received.

150. As indicated in the tables accompanying paragraph 173, the figures shown in paragraph 173 relate to GSM-102 in the first table and SCGP in the second table. During the ten fiscal years reflected in the tables, no GSM-103 export credit guarantees were issued with respect to cotton.

**79. In respect of what time periods does Article 13(c) require an assessment of conformity with Part V of the Agreement on Agriculture? How does this affect, if at all, your interpretation of Article 13(b)? BRA, USA**

151. Article 13(c) applies to "export subsidies that conform fully to the provisions of Part V of th[e Agriculture] Agreement, as reflected in each Member's Schedule." Part V of the Agreement, and in particular Article 8, establishes that "Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule." Those export subsidy reduction commitments, which are expressed in both export quantity and budgetary outlay terms, apply on a yearly basis.[80] Accordingly, a Member may be in conformity one year and not in conformity in another with regard to any particular commodity subject to reduction commitments.

152. If a Member has provided export subsidies to a particular commodity in any one year in excess of the applicable reduction commitments, then export subsidies for that commodity during such year would not "conform fully to the provisions of Part V", and those subsidies would not have Peace Clause protection. In a subsequent year, a Member may again comply with its export subsidy commitments. Its export subsidies would then conform fully to Part V of the Agreement and would again receive Peace Clause protection.

153. Similarly, a failure by a Member to comply in a given year with the criteria in Article 13(b) would lift the exemption from action for those domestic support measures only for the year of the breach. Measures (subsidies) in a later year would remain exempt from action so long as those measures in the given year comply with the conditions in Article 13(b)(ii). This conclusion flows from the text of the Peace Clause (measures must conform to Article 6, and Members' final bound commitment levels are expressed in yearly terms) as well as the nature of the subsidies challenged by Brazil (recurring subsidies that are provided yearly and expensed in the year given). For further explanation of the US interpretation of Article 13(b), please see the US answers to Questions 33 and 35 from the Panel.

**81. How does the United States respond to the following in Brazil's oral statement: USA**

**(a) paragraph 122 (rescheduled guarantees)**

154. Brazil is correct to assert "debt rescheduling does not involve any reduction in the value of outstanding debt". A rescheduling does not involve debt forgiveness. As reflected in the terms of the various rescheduling agreements, outstanding interest is capitalized, and interest accrues on such capitalized interest as well as on outstanding principal. Further, the United States expects to recover in full pursuant to such rescheduling.

155. Therefore, from an accounting perspective, rescheduled amounts are counted as *receivables*, not losses, and are reflected as such in paragraph 173 of the US First Written Submission. Contrary to the assertion of Brazil, the United States does in fact collect on the rescheduling. The history of rescheduled Commodity Credit Corporation (CCC) export credit guarantee claims over the long-term (the 10-year period 1993-2002) confirms this position. All rescheduled claims are currently performing. In other words, all payments due up to this point under these agreements have been received.

[80]With the exception of Agriculture Agreement Article 9.2(b), which is no longer applicable.

**(c) paragraphs 125 ff. (guaranteed loan subsidy)**[81]

156. The Credit Reform Act of 1990 establishes the procedures and parameters for US credit and credit guarantee programmes. In accordance with the provisions of that Act, the budgeting and accounting for US credit programmes, including the CCC export credit guarantee programmes, are based on the estimated lifetime costs to the Federal Government of making the credit available. In the case of credit guarantees, those costs are based on estimated payments by the Government to cover defaults and delinquencies, interest subsidies, and other requirements, and payments to the Government, including origination and other fees, penalties, and recoveries.

157. In presenting the annual budget, the subsidy costs of the programme reflect an *estimate* of the long-term costs to the Government. This estimate reflects various assumptions regarding credit risk, interest costs, and other factors that will apply over the lifetime period of the credit. At the time the budget is prepared, these costs are presented as estimates as of the date the budget is prepared – that is, they are a snapshot of the estimated costs. In fact, Brazil acknowledges in paragraph 125 of its oral statement that the "guaranteed loan subsidy" entry in the annual US budget is an estimate of the cost of the guarantees projected to be issued.

158. A fundamental tenet of credit reform accounting is the requirement that the performance of the credit be tracked over its lifetime. This is accomplished by tracking each cohort of credit until the credit period has expired or lapsed. A cohort consists of all transactions associated with each type of guarantee issued during a particular year – for example, all guarantees issued during fiscal year 2002 comprise a distinct cohort.

159. Activity (disbursement, repayment, claims, etc.) occurs within a given cohort over the life of all guarantees that were disbursed against that cohort. To view the data and activity strictly on an annual basis and not by cohort limits the utility of the data and distorts the costs of the programme. Not until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government.

160. All cohorts for the CCC export credit guarantee programmes under credit reform are still open although cohorts for 1994 and 1995 should close this year. At present, the 1994 cohort has a total net downward subsidy re-estimate of $116 million. The original subsidy cost estimate for the 1994 programme was $123 million; thus, applying the downward re-estimate, the net cost of the programme to the US Government is currently projected at $7 million. The 1995 cohort has a total net downward subsidy re-estimate of $149 million, versus an original subsidy estimate of $113 million. Thus, the net cost of the 1995 programme is a receipt of $36 million to the US Government. For 1994 and 1995 together, the total net receipt to the US Government is $29 million.

161. The experience of 1994 and 1995 is viewed as representative of the costs of the CCC export credit programmes generally, and it is expected that, once the cohorts for other years of credit activity are closed, they will follow closely the experience of the 1994 and 1995 programmes.

**(d) paragraphs 127-129 (re-estimates, etc.)**

162. As discussed in response to Question 81(c), it is necessary to understand the difference between activity that occurs on a fiscal year basis as opposed to the estimates and re-estimates of subsidy that calculate net present value over the life of the programme. Although estimates and re-estimates are made annually for each cohort, these include both actual data to date and estimates of future activity for the remainder of the life of the cohort.

[81]The US answer to Question 81(b) follows the answer 81(d), which discusses budget re-estimates.

163. With the exception of 2002, all cohorts for annual export credit programming since the inception of credit reform accounting in 1992, have a cumulative downward re-estimate. The net total for all cohorts for guarantees issued since 1992 currently stands at a downward re-estimate of $1.9 billion. This experience with re-estimates indicates that performance under the programme has been better than originally projected and that the original cost estimates for those programming years as presented in the annual US budget were too high. This experience also demonstrates that the assertion by Brazil at paragraph 129 of its oral statement that the original estimate of "guaranteed loan subsidy" line in the budget is an "ideal basis" for determining the costs of the programme is in error. Those estimates will be re-estimated on an annual basis until each cohort is closed and, as demonstrated above, to date the re-estimates for each cohort on a net basis have been almost exclusively downward.

**(b) paragraph 123 (interest on debt to Treasury)**

164. Under the guidelines for credit reform budgeting as established in the Credit Reform Act of 1990, there are two kinds of interest calculations that affect the CCC export guarantee programmes. These calculations are "snapshots" in time and will change annually for a cohort until the cohort has closed. Therefore, any one number shown in the budget for a given year is an estimate. The actual cost of the programme can be determined only when all financial activity for the cohort is completed.

165. An interest rate re-estimate is a component of the annual re-estimates of a cohort, which are made for as long as the guarantees are outstanding. The interest rate re-estimate calculates the difference between the estimated interest at the time the guarantee programme was budgeted and the actual interest at the time the guarantee is disbursed. If the actual interest is higher, the additional cost is shown in the programme account as a re-estimate. It should be noted that this cost would change with subsequent re-estimates in future years depending on the timing of the guarantee disbursement.

166. Interest on borrowings occurs in the financing account only if additional funds beyond those budgeted for a cohort is needed to pay claims. Again, these costs will vary from year to year as borrowings with a particular cohort change and the interest rate varies.

167. It is important to understand that should any interest on borrowings occur, they would be fully reflected in the costs attributed to the individual cohort. Thus, as the costs of the cohort are adjusted during the period it is active, any costs associated with the interest on borrowings are fully reflected in the programme costs. It is, therefore, incorrect to state as Brazil asserts in paragraph 123 that those payments are not fully reflected in the operating costs of the CCC export credit guarantee programmes.

**(e) Exhibits BRA-125-127**

168. Exhibits BRA-125-127 are pages from the Budget Estimates for the United States Government for fiscal years 1994, 1995, and 2004. These particular pages show one aspect of the budgeting for the CCC export credit guarantee programmes, the Export Loans Programme Account. In and of themselves, they do not reflect all aspects of the budgeting and financing transactions for the programmes. For example, Exhibit 127 for the fiscal year 2004 budget estimates excludes the Export Guarantee Financing Account, which appears on the following page. The data presented in the financing account is important because it presents information on both downward and upward re-estimates for the programme.

**(f) the chart on page 53 of Brazil's oral statement at the first session of the first Panel meeting relating to "Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM-102 GSM 103 and SCGP"?**

169. The table on page 53 of Brazil's oral statement at the first panel meeting presents information on budget estimates for the CCC export credit programmes for fiscal years 1992 through 2004. The data presented in the table are correct. However, as discussed previously in the answers to questions 81(c) and 81(d) above, the "guaranteed loan subsidy" is a snapshot estimate of the lifetime costs of the guarantees issued during the course of a given fiscal year. As the cohorts for those guarantees are reviewed annually over their lifetime, those estimates will change and, until the cohorts are closed out, the estimated costs of the programmes are simply that, estimates. Accordingly, Brazil is incorrect in asserting in paragraph 132 of its oral statement that, because the guaranteed loan subsidy line of the annual budget has always reflected a positive net present value, that fact indicates the programmes are "extending a subsidy to borrowers". That statement misinterprets and misrepresents the information presented in the budget.

170. In addition, Brazil makes a statement in paragraph 131 of its oral presentation with regard to the table on page 53 that likewise is incorrect. Brazil asserts that the column heading in the budget for the last completed fiscal year represents "actual" costs for the programme for that particular year. In fact, the numbers appearing in that column simply represent the latest, revised *estimate* of the costs of the programme for the fiscal year just completed. The estimate of those costs will change over the lifetime of the credit as the cohort for that year is tracked. The term "actual" is used in the column because the revised estimate is based on an actual level of guarantees issued by CCC during the year just completed.

171. Frequently, the level of guarantees issued by CCC in any given year is less than the level projected in the original budget for that year. In the case of the 2002 budget that was released in February 2001, it projected that $3.9 billion of guarantees would be issued by CCC during that year. However, only $3.4 billion of guarantees were actually issued. Thus, the estimate of programme costs in 2002 column of the 2004 budget has been revised to reflect that actual level of activity. Nevertheless, the cost presented in the column remains an estimate, and the estimate will continue to be revised as long as the cohort for 2002 remains active.

172. With respect to the "administrative expenses" that are displayed in the table on page 53 of Brazil's oral statement, the United States has noted elsewhere that those are imputed costs ascribed to the operation of the CCC export credit programmes as a whole.

**(g) In respect of (a)-(f) above, how and to what extent do the information and data presented for the export guarantee programmes concerning "programme" and "financing", "summary of loan levels", "subsidy budget authority", "outlay levels", etc., in particular in Exhibits BRA-125-127, reflect "actual costs and losses" of the GSM-102, GSM-102 and SCGP export credit guarantee programmes (see e.g. Brazil's closing oral statement at the first session of the first substantive meeting, paragraph 24)? USA**

173. The closing oral statement of Brazil at the first session of the first substantive meeting of the Panel, and paragraph 24 in particular, display a fundamental misunderstanding of the budget and accounting for the CCC export credit programmes. Contrary to what is asserted in that paragraph, the information presented in the annual budget of the United States does in fact represent estimates of the lifetime costs of the programmes. Those estimates are being revised annually to reflect actual performance and, until the cohorts for the annual programmes have been closed out, the actual costs cannot be determined definitively. However, as demonstrated in response to Question 81(d), the

re-estimates thus far have resulted in a net reduction in the estimated costs of these programmes of over $1.9 billion since the inception of credit reform budgeting in fiscal year 1992.

174. Further, as discussed in response to Question 81(c), the combined net costs of the cohorts associated with the 1994 and 1995 guarantee programmes, which are expected to close this year, are a receipt of $29 million to the Federal Government. Based on those results, the Brazilian claim in paragraph 24 that "operating costs and losses for GSM 102, GSM 103, and SCGP have outpaced premiums collected in every single year since the United States started applying the formula in 1992" is not supportable.

**82. Please explain each of the following statements and any possible significance it may have in respect of Brazil's claims about GSM-102 and GSM-103 (7 CFR 1493.10(a)(2), Exhibit BRA-38): BRA, USA**

**(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2), Exhibit BRA-38)**

175. The export credit guarantee programmes are generally made available in connection with middle-tier economies in which liquidity is constricted. In such cases, cash sales for all suppliers are not occurring readily. US financial institutions may face requirements regarding loan-loss reserves that impede their ability to lend.

**(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

176. The export credit guarantee programmes are intended to operate and indeed are applied in a manner not to displace cash sales. As liquidity improves in certain countries, the use of the programme recedes. This explains, in part, the dramatic reduction in US export credit guarantees since the years immediately preceding the inception of the WTO Agreement.

177. The following table shows the dollar value of guarantees provided by the United States in US fiscal years 1992-1994, along with the average value of guarantees for fiscal years 1995 - 2002:

| Fiscal Year(s) | Guarantee Value (Millions of USD) |
|---|---|
| 1992 | $5,671.8 |
| 1993 | $3,853.7 |
| 1994 | $3,177.4 |
| 1995 - 2002 | $3,061.9 |

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market**

**development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

178. Although the goal of the export credit guarantee programmes is to expand market opportunities, such goal alone has no bearing on the proper characterization of the programmes, the measures in dispute, or the conformity of the application of such programmes with the WTO obligations of the United States. Moreover, the United States is statutorily compelled to be mindful not to provide any such guarantees in connection with any country that the Secretary of Agriculture determines cannot adequately service the debt associated with such sales, nor does the United States provide guarantees in connection with any foreign bank that it has not approved and with respect to which it has not established an exposure limit.

**84. Is the Panel correct in understanding that, under the GSM-102 and GSM-103 programmes, the exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? USA**

179. Fees paid by an exporter participating in either the GSM-102 or GSM-103 programme vary by the guaranteed dollar value of the transaction, the repayment period, and the principal repayment interval (annual or semi-annual). A schedule of current fees is attached as Exhibit US-20. Section 211(b)(2) of the Agricultural Trade Act of 1978, 7 U.S.C. 5641(b)(2), limits the origination fee in connection with transactions under the GSM-102 programme, except for those transactions under the CCC Facility Guarantee Programme, to no more than 1 per cent of the amount of credit to be guaranteed. There is no other legislation or regulation addressing the specific fee rates.

180. Other than the legislative restriction noted above, the CCC sets and changes the fee rates as it deems appropriate. Fee rates are changed via a press announcement to the public. The most recent change in guarantee fee rates occurred on 1 October 2002, at which time the fee schedule was modified to include rates for transactions with 30- and 60-day repayment periods. Previously, the fee schedule had been adjusted to accommodate variable interest rates as opposed to fixed rates. Legislative amendment is not required to change the fee rates unless the rates for the GSM-102 programme are to exceed 1 per cent of the guaranteed dollar value of a transaction. Neither is it necessary to amend the programme regulations in order to change the fee rates.

**85. Is the Panel correct in understanding that, under the SCGP, the exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? Please explain any "risk" assessment involved in the programme. USA**

181. Under the SCGP, the exporter pays a fee to CCC based on the guaranteed dollar value of the export transaction and the repayment period. The current guarantee fee rates are $0.45 per $100 of coverage for credit terms up to 90 days, and $0.90 per $100 of coverage for credit terms up to 180 days. Section 211(b)(2) of the Agricultural Trade Act of 1978, 7 U.S.C. 5641(b)(2), limits the origination fee in connection with transactions under the SCGP to no more than 1 per cent of the amount of credit to be guaranteed. There is no other legislation or regulation addressing the specific fee rates.

182. Other than the legislative restriction noted above, the CCC sets and changes the fee rates as it deems appropriate. For example, fee rates for the SCGP were changed in US fiscal year 2000 (beginning 1 October 1999) and set at their current level. Prior to that time, the fee rate was $0.95 per

$100 of coverage regardless of the repayment period. The fee rates were changed to give exporters and importers an incentive to negotiate repayment terms of less than 180 days. Legislative amendment is not required to change the fee rates unless the rates for the SCGP are to exceed 1 per cent of the guaranteed dollar value of a transaction. It is not necessary to amend the programme regulations in order to change the fee rates.

183. CCC carries out a country risk assessment for each country prior to announcing its eligibility for SCGP participation. Country risk assessment entails a review of the economic and political situation in each country to ensure there is a reasonable expectation that the country's importers will be able to repay debts incurred under the programme. CCC does not determine the creditworthiness of importers participating in the SCGP. CCC provides a guarantee covering 65 per cent of the export transactions under the programme; the exporter or his assignee (US bank) must accept the remaining 35 per cent of the transaction's risk. This "risk sharing" between CCC and the exporter/assignee is intended to ensure that due diligence is performed in assessing an importer's creditworthiness before undertaking a transaction with that importer.

**86. Is there a risk categorization in relation to three export credit guarantee programmes (GSM-102, GSM-103 and SCGP)? Does this have any impact on premiums payable and the ability of the CCC to on-sell the guarantees ? USA**

184. All countries eligible for any of the CCC export credit guarantee programmes are categorized according to risk. CCC categorization of countries is based on a US government internal risk classification system. This system is administratively controlled and may not be released outside of the US Government. A country's risk classification has no impact on the premiums payable under the US export credit guarantee programmes. There is no secondary market for CCC guarantees; therefore, CCC does not "on-sell" the guarantees.

**87. What proportion of CCC (export-related and total) long term operating costs and losses are represented by GSM-102, GSM-103 and SCGP programmes? USA**

185. With the advent of the Credit Reform Act, the export guarantee programmes are not financed out of the Commodity Credit Corporation. While the programmes continue to be run through the authorities and facilities of the CCC, all budget authority (funding) for the guarantee programmes is provided directly to accounts for those programmes from the US Treasury.

**88. (a) Is the Panel correct in understanding that the United States' argument is that, at present, by virtue of Article 10.2 of the Agreement on Agriculture, there are no disciplines on agricultural export credit guarantees under the Agreement on Agriculture (or the SCM Agreement)? USA**

186. Article 10.2 provides: "Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines to provide export credits, export credit guarantees or insurance programmes only in conformity therewith." Article 10.2 imposes an obligation on Members to work toward "internationally agreed disciplines" and, upon agreement on such disciplines, to provide export credit guarantees only in conformity with such disciplines. This was the purpose of the negotiations in the OECD that followed the Uruguay Round, and which now are occurring under the aegis of the WTO. If and when such disciplines are agreed upon, they are WTO obligations under the Agreement on Agriculture.[82]

[82]This is similar to other work programs that continued beyond the close of the Uruguay Round. *See* US First Written Submission, paras. 154-66.

187. Brazil's argument is that such "internationally agreed disciplines" already apply. If export credit guarantee programmes were already subject to export subsidy disciplines, then Article 10.2 would be unnecessary. That is, Members would *already* have "to provide . . . export credit guarantees . . . only in conformity" with the internationally agreed disciplines of the WTO. In Brazil's oral statement, Brazil attempts to avoid this implication of its reading by repeatedly attempting to insert the word "specific" into the text of Article 10.2 – that is, "undertake to work toward the development of *specific* internationally agreed disciplines ."[83] That word is not there, however. The United States' interpretation of Article 10.2 gives meaning to the text of Article 10.2 as drafted and agreed by Members whereas Brazil's reading would effectively read it out of the Agreement on Agriculture.

**(b) Does the United States agree with the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the Agreement on Agriculture? Please cite any relevant material, including any past WTO dispute settlement cases. How would this reconcile with the United States' own statement, at paragraph 21 of its closing oral statement that "of course, the United States may not provide subsidies without any limit". USA**

188. Article 10.2 applies only to export credit guarantees (and export credits and insurance programmes) properly characterized as such. In the case of the United States, export credit guarantees are offered pursuant to programmes which charge premiums; impose limits on tenor; impose limits on exposure to individual bank obligations; impose limits on exposure to risk of default from different countries; define shipping periods; and issue allocations (value limitations) of potential guarantee availability for specific commodities to be exported to specific destinations. The United States also guarantees only a relatively small portion of interest. Consequently, participants remain exposed to a significant component of the over-all risk of default.

189. The United States submits that the deferral of disciplines under Article 10.2 properly applies to export credit guarantees offered pursuant to a programme with such characteristics; indeed, Brazil has not contested that US export credit guarantee programmes are encompassed by the terms of Article 10.2. Illegitimate attempts to characterize export subsidy programmes as export credit guarantee programmes would be subject to the anti-circumvention provisions of Article 10.1 and the other commitments of the Agreement on Agriculture.[84]

190. The US interpretation of Article 10.2 presents no conflict with the title of Article 10, which provides relevant context in interpreting the provisions of Article 10. Article 10 is entitled "Prevention of Circumvention on Export Subsidy Commitments." Article 10.2 contributes to the prevention of circumvention of export subsidy commitments by imposing two obligations on Members: first, they must undertake to work toward the development of internally agreed disciplines

[83]*See, e.g.*, Brazil's Oral Statement, para. 100 ("Article 10.2 instead announces Members' intent to work toward negotiations on *specific* disciplines for export credits.") (italics in original); *id.* ("In the meantime, while those *specific* disciplines are being discussed . . .") (emphasis added); *id.*, para. 102 ("Under the first part of Article 10.2, therefore, WTO Members have pledged to work toward the development of *specific* disciplines . . . .") (emphasis added); *id.*, para. 103 ("If Members do conclude an agreement on these *specific* disciplines . . . .") (emphasis added); *id.* (Brazil and the United States agree that there has been no agreement on any such *specific* disciplines . . . .") (emphasis added).

[84]For example, the United States could not simply change the name of the FSC Repeal and Extraterritorial Income Exclusion Act to the "FSC Repeal and Extraterritorial Income Exclusion Export Credit Guarantee Program" and successfully assert that the deferral of disciplines contemplated by Article 10.2 applies to such re-named program.

on export credit guarantees; second, "after agreement on such disciplines," they must provide export credit guarantees "only in conformity therewith". Thus, Members agreed that those internationally agreed disciplines would constrain the provision of export credit guarantees, which in turn would contribute to the goal of Article 10, to prevent the circumvention of export subsidy commitments.

191. Although the language quoted from paragraph 21 of the United States' closing oral statement was intended to address concerns involving domestic support for upland cotton,[85] it also applies in the case of export subsidies. The United States also cannot provide export subsidies without limit. It has a schedule of export subsidy reduction commitments for 12 commodities. For these commodities, export subsidies can only be provided in accordance with such schedule. For the remainder of agricultural commodities, the United States cannot provide export subsidies at all.

192. Although internationally agreed disciplines on export credit guarantee programmes have yet to be agreed, the characteristics of such programmes and the discipline inherent in the risk-sharing aspects of such programmes impose an internal constraint on their use. Indeed, the use of US export credit guarantee programmes has *declined* since the period before the inception of Uruguay Round commitments. As shown in the US answer to Question 82(b), the dollar value of guarantees provided by the United States in US fiscal year 1992 was $5,671.8 million, in fiscal year 1993 was $3,853.7 million, and in fiscal year 1994 was $3,177.4 million. In contrast, the average value of guarantees for fiscal years 1995 - 2002 was only $3,061.9 million. Any concerns about unchecked use of export credit guarantee programmes, then, are not supported by the post-Uruguay Round experience.

**(c) If, as the United States argues, there are no disciplines on export credit guarantees in the Agreement on Agriculture, how could export credit guarantees "conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity when there are allegedly no disciplines against which such an assessment could occur)? USA**

193. US export credit guarantee programmes provide "export credit guarantees" within the meaning of Article 10.2 and therefore will be subject to disciplines only as contemplated by that Article. Because no such disciplines currently exist, these programmes cannot be out of compliance with Part V of the Agriculture Agreement. Moreover, export credit guarantees are not export subsidies within the meaning of either Article 9.1 or 10.1, and since they are not export subsidies, Article 13(c) does not apply to them.

**(d) Is the United States advocating the view that its own export credit guarantee programmes, which pre-dated the Uruguay Round, are effectively "grandfathered" so as to benefit from some sort of exemption from the export subsidy disciplines of the Agreement on Agriculture? How, if at all, is it relevant that the SCGP did not, according to the United States, become relevant for upland cotton until the late 1990's (i.e. after the entry into force of the WTO Agreement)? USA**

194. It is not entirely clear what is meant by the term "grandfathering" in this connection. Agriculture Agreement Article 10.2 defers the imposition of disciplines on export credits, export

[85]The statement itself was intended to note that the United States is subject to the limit set forth in its domestic support reduction commitments for the Current Total Aggregate Measurement of Support. This amount, across all US commodities, is $19.1 billion. In addition, a very specific limit applies with respect to domestic support for upland cotton under the Peace Clause. It may not exceed the rate of 72.9 cents per pound, as decided in 1992, without removing the Peace Clause protection of Article 13 of the Agreement of Agriculture.

credit guarantees, and insurance programmes until internationally agreed disciplines are reached, and in that sense the export subsidy disciplines of the Agreement do not apply to the export credit guarantee programmes at issue in this dispute.

195. The SCGP began in 1996, and no transactions occurred under this programme in connection with cotton until fiscal year 1998, which began in September 1997. Although the negotiators obviously could not have considered the application of this specific programme, it is substantially similar in its operation to other US export credit guarantee programmes. Again, Brazil has not contested that SCGP provides export credit guarantees within the meaning of Article 10.2. Thus, the deferral of disciplines under Article 10.2 similarly applies.

*STEP 2 PAYMENTS*

**89. Does the United States confirm Brazil's statement in paragraph 331 of its first submission that "The conditions and requirements for Step 2 domestic payments remain unchanged with the passage of the 2002 FSRI Act"? What is the relevance of this, if any, to this dispute? USA**

196. While the Step 2 programme under the 2002 Act is largely consistent with the programme under the 1996 Act, there have been some modifications since the inception of the programme, relating to the precise nature of the price differential formula and the price ceiling for the Step 2 payments. The 2002 programme was unchanged from the 1996 Act programme, as amended, except for suspending the 1.25 cent differential. In the end, this is inconsequential because it does not materially affect the levels of support decided in marketing year 1992 (72.9 cents per pound) or that measures currently grant (52 cents per pound).

**90. Does the United States confirm Brazil's statement in paragraph 235 of its first submission that the changes concerning Step 2 export payments from the 1996 FAIR Act to the 2002 FSRI Act are: increase in the amount of the subsidy by 1.25 cents per pound and the removal of any budgetary limits that applied under the 1996 FAIR Act? What is the relevance of this, if any, to this dispute? USA**

197. As noted in the US answer to Question 89, the 2002 Act suspended the 1.25 cents differential, but the United States disagrees with the assertion of increased budgetary exposure for the programme. First, we note that Step 2 for the 1992 crop and marketing years was covered by the provisions of the 1990 Act, which had no limit on the amount of expense that could be undertaken in Step 2. For the 1996 Act, which covered the 1996-2002 crops until supplanted by the 2002 Act, there was a limit of $701 million for the six-year duration of the Act, and in fact that money did run out in December 1998. However, the Congress removed the budgetary limit of the 1996 Act as of October 1999 (Public Law No. 106-78, 22 Oct. 1999). Therefore, neither the 2002 Act, nor the 1996 Act (as of October 1999), nor the 1990 Act had budgetary limits on Step 2 expenditures.

198. While the potential step 2 payment (when price conditions in the statute are met) is higher in the 2002 Act than under the 1996 Act by as much as (but not more than) 1.25 cents per pound, step 2 merely changes the vehicle of support.

**91. What is the significance of the elimination of the 1.25 cent threshold payment in the 2002 FSRI Act pertaining to Step 2 payments? USA**

199. Please see the US answers to Question 89, 90, and 117.

**92. Does the United States confirm that Exhibit BRA-65 represents a sample contract for exporters of eligible upland cotton to conclude with the CCC under the FSRI 2002, and that an application form (Exhibit BRA-66) needs to be filled out with data on weekly**

**exports and submitted to the USDA FAS. Is Exhibit BRA-66 - Form CCC 1045-2 - also a valid example? If not, please identify any differences or distinctions. USA**

200. The Brazilian exhibits appear to be accurate versions of old Step 2 programme documents. Some of the documents in the exhibit are for domestic handlers and involved programme payment assignments. We also note that, in making an export claim, other documentation like bills of lading may be needed.

201. The official documents for the upland cotton step 2 programme can be found at the Farm Services Agency website (www.fsa.usda.gov/daco, click on "cotton" and on "upland cotton user marketing certificate programme".) There is a common contract that exists for both domestic users and exports under the Step 2 programme, CCC Form CCC-1045UP. Because of the different nature of uses and therefore applications, there are separate reporting forms: CCC-1045UP-1 for domestic users and CCC-1045UP-2 for Exporter Users. Recently updated documents used for this programme are attached as Exhibit US-21.

**93. Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment? USA**

202. As the United States has indicated, all upland cotton produced in the United States is eligible for the benefit of the Step 2 cotton subsidy. If the statutory price condition applies, all US upland cotton used during the applicable period of time will received the subsidy. "Use" in domestic manufacture or export constitutes the universe of potential use of US upland cotton. The United States submits that when the entirety of production of a good in a country is eligible to receive a subsidy, no contingency on export exists. The Step 2 subsidy is entirely distinct in this regard from a hypothetical situation in which a subsidy is theoretically available for domestic use, but in reality is exclusively or nearly exclusively available in connection with exports.

**95. Do the criteria in 7 CFR 1427.103(c)(2) (Exhibit BRA-37) that Step 2 "eligible upland cotton" must be "not imported cotton" apply to both domestic and export payments? USA**

203. Only domestic cotton is eligible for Step 2 payment, which is made if the statutory price conditions are met and requisite proof of use is submitted.

**96. Is a domestic sale a "use" for the purposes of Step 2 payments? Is a sale for export, or export, considered a "use"? USA**

204. A sale is not a use for purposes of the Step 2 subsidy. For domestic manufacture, opening the cotton bale constitutes use. For exports, similarly, the sale alone does not itself constitute use; the exporter must demonstrate actual exportation.[86]

**97. How does the United States respond to Brazil's assertion, at paragraph 70 of Brazil's oral statement at the first session of the first substantive meeting, that "It is obvious that a single bale of cotton cannot be both exported and used domestically." Is this a relevant consideration? USA**

205. It is unclear what Brazil's assertion is intended to demonstrate. The Step 2 programme makes payments to documented users of US upland cotton. If a bale cannot be both opened domestically and exported (although it is not clear why that would be so), that amounts to arguing that a single bale

[86]7 Code of Federal Regulations 1427.103(a).

cannot be "used" twice. The fact remains that *either* opening the bale domestically *or* exporting it – that is, the universe of activities resulting in use of US upland cotton – is entitled (given certain market conditions) to a Step 2 payment.

206. The United States notes, moreover, that it may actually be possible (economic realities aside) that the same bale could be exported and then brought back into the country and opened for domestic use. (Please see the US answer to Question 98 for more detail.) The US Department of Agriculture's position would be that the payment should be made on the bale once only. The purpose of the programme is to provide support to upland cotton farmers. Once the bale has been purchased by an upland cotton user, there would be no additional support for upland cotton farmers from providing Step 2 payments on additional "uses" of the same bale.

**98. How many Step 2 payments are received if a bale of upland cotton is exported, and then opened by a domestic user in the United States, or vice versa? USA**

207. If a bale were exported and then imported and opened up (or vice versa) it would be the US position that only one payment would be made. It does not appear that this situation has ever arisen in fact, but we note that the Step 2 regulations specifically provide that "imported" cotton is not eligible for payment. Such cotton may include any cotton that was imported, even if it had been produced in the United States.

**99. How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's oral statement at the first session of the first Panel meeting concerning the relevance of the Appellate Body Report in US-FSC (21.5). USA**

208. In contrast to the facts of the *United States – FSC (21.5)* dispute, in this dispute all of the product is produced in the United States; all of the product is eligible to receive the benefit of the subsidy; and all of the potential uses of the product are similarly eligible. If the statutory formula of price conditions applies, all US upland cotton used during that time – regardless of how such use is manifested – will receive the subsidy. This case involves only one factual situation: use of cotton during a particular period of time. The only factual distinction applicable here is whether the applicable price conditions are on or off. Brazil's emphasis on the "different instructions" in the programme regulations is misplaced. Such instructions are simply to demonstrate the requisite use and to assure payment is made to the proper party. If upland cotton could be used in a third or fourth way, this would not change the eligibility for subsidy but would necessitate a parallel third or fourth set of instructions to demonstrate that form of use as well.

**103. Is the Step 2 programme fund a unified fund that is available for either domestic users or exporters, without a specific amount earmarked for either domestic users or exporters? Please substantiate your response, including by reference to any applicable statutory or regulatory provisions. USA**

209. The upland cotton user marketing certificate programme (Step 2) makes no differentiation between funds for payments to exporters and domestic handlers – it is all one programme. The first paragraph of the Step 2 rule states:

> These regulations set forth the terms and conditions under which CCC shall make payments, in the form of commodity certificates or cash, to eligible domestic users and exporters of upland cotton who entered into an Upland Cotton Domestic User/Exporter Agreement with CCC to participate in the upland cotton user marketing certificate

The Step 2 rule was published on 18 October 2002, at 67 Federal Register 64454, and is codified at 7 Code of Federal Regulations 1427.100-.108.

210. As with other US domestic support measures, Step 2 payments are funded through the Commodity Credit Corporation, which has a borrowing authority in the Treasury and as such does not rely on appropriations. This is provided for in Sections 1207 and 1601(a) of the 2002 Act and codified at 7 US Code 7937 and 7991.

**104. How does the United States respond to the data presented in Exhibit BRA-69? Is it accurate? Please substantiate. USA**

211. The data in Exhibit BRA-69 is not official US Government data, and Brazil has not indicated the source of the information. Thus, we cannot confirm its reliability. The United States has tried in any event to obtain information in the format of Bra-69, which is not maintained and published by the US Government in that manner. The following data has been collected by the US Department of Agriculture and attempts to designate (as in Bra-69) Step 2 payments by fiscal year[87] and use.

| User Marketing Certificate (Step 2) Payments, by Fiscal Year and Use | | |
|---|---|---|
| **Fiscal Year** | **Mill Use (US $)** | **Export Use (US $)** |
| 1991 | 4,311,991 | 17,259 |
| 1992 | 102,769,543 | 30,852,107 |
| 1993 | 113,401,813 | 89,095,640 |
| 1994 | 28,251,613 | 178,266,742 |
| 1995 | 17,571,224 | 75,200,203 |
| 1996 | 0 | 34,798,579 |
| 1997 | 6,201,540 | 2,875,936 |
| 1998 | 255,502,154 | 158,924,004 |
| 1999 | 165,831,362 | 113,521,476 |
| 2000 | 260,075,318 | 185,273,956 |
| 2001 | 144,849,807 | 90,903,021 |
| 2002 | 72,425,112 | 105,415,152 |

A comparison with Exhibit BRA-69 suggests that the Brazilian data is inaccurate.

212. During the first panel meeting, the Panel asked about the figures shown for fiscal year 1996, which showed a zero payment for mill use and a positive number for export use. We suggested that perhaps appropriated amounts had suddenly run out, but our suggestion was not accurate. Rather, the odd numbers for fiscal year 1996 resulted because, at the time, payments for export use accrued when the contract for export was made. However, such payments were not paid until the export actually took place, at which time the exporter would be paid based on the Step 2 rates that applied when the

[87]The US fiscal year runs from October 1 - September 30, such that the 2002 fiscal year would run from 1 October 2001, through 30 September 2002.

contract was made. As the Panel is aware, Step 2 payments can be made only when there is a difference between world and US prices for cotton for a certain time period. In the case of fiscal year 1996, these prices did not satisfy the Step 2 conditions, but there were some payments that were made during that fiscal year because they had accrued by an export contract made in the previous fiscal year. That rule is now changed[88] so that the rate that applies for export use is the rate that is in effect when the export is made not when the contract for export was made.

**105. Why is the Step 2 programme separated into "domestic users" and "exporters"? Apart from differentiating between exporters and domestic users, with consequential differentiation as to the forms that must be filled out and certain other conditions that must be fulfilled, are the eligibility criteria for Step 2 payments identical? Are the form and rate of payment, as well as the actual payment made, identical? USA**

213. US law does not separate the Step 2 programme into domestic users and exporters. There is but one Step 2 statute – codified at 7 US Code 7937 – and but one Step 2 rule for all users – found at 7 Code of Federal Regulations 1427.100-.108. The statute and rule do identify "domestic users" and "exporters" as the universe of *bona fide* users of upland cotton and thus potential recipients for Step 2 payments. Therefore, the only distinction drawn between these recipients is the proof of use: domestic handlers are paid when they open a bale, and exporters are paid when they export. The form and rate of payment are identical.

**106. With respect to paragraph 139 of the United States' first written submission, are Step 2 export payments included in the annual reduction commitments of the United States? If so, why? USA**

214. The United States does not distinguish between the uses of US upland cotton for purposes of reporting the subsidy because the subsidy is not contingent on export performance. *All* Step 2 payments are reported as product-specific domestic support for upland cotton and are included within the Total Aggregate Measurement of Support calculation for purposes of *domestic support* reduction commitments.

**107. Please comment on any relevance, to Brazil's de jure claims of inconsistency with the provisions of the Agreement on Agriculture, of Exhibit BRA-69, which shows Step 2 payments made to (i) domestic users and (ii) exporters. This Exhibit shows that, from FY 91/92 through 02, the Step 2 payments for exporters exceeded those for domestic users in FY 94; FY 95; FY 96 (in fact there were no domestic payments in FY 96); and FY 02. In the other years, the domestic payments are greater than export payments. BRA, USA**

215. Without commenting on the accuracy of the specific numbers set forth in Exhibit BRA-69, it is entirely possible that in certain years one type of user happened to receive a larger share of payments than another type of user. This would entirely be a function of market conditions and relative demand for manufacture or for export. That is, differences in amounts paid to exporters and domestic users during any time period are happenstance based on actual use of US upland cotton.

216. The United States notes that payments to exporters were previously made based on when exporters finalized the sale contract, not on when the cotton was actually exported. In the specific case of fiscal year 1996, it appears that payments for exported upland cotton *accrued* during a period when Step 2 payments were allowed by the statute, but that the payments were actually made at a time when market conditions no longer met the statutory criteria for payment. The rule has been changed,[89] and that situation can no longer recur.

[88] *See* 61 Federal Register 37544, 37548 (18 July 1996).
[89] *See* 61 Federal Register 37544, 37548 (July 18, 1996).

**108. At paragraph 135 of its first written submission, the United States states : "[T]he subsidy is not contingent upon export performance..." (emphasis added). Again, in the course of the first Panel meeting, the United States admitted that the Step 2 payments were "subsidies". Does the United States thus concede that Step 2 payments constitute a "subsidy" within the meaning of the WTO Agreement? USA**

217. The United States has always maintained that Step 2 payments are subsidies that provide domestic support in favour of US agricultural producers.

**109. How does the United States respond to Brazil's arguments concerning a mandatory/discretionary distinction and the allegation that certain United States measures (including s.1207(a) of the 2002 FSRI Act) are mandatory? (This is referred to, for example, in paragraph 28 of Brazil's first written submission). Does the United States agree with the assertion that (subject to the availability of funds) the payment by the Secretary of Step 2 payments is mandatory under section 1207(a) FSRI upon fulfilment by a domestic user or exporter of the conditions set out in the legislation and regulations? If not, then why not? To what extent is this relevant here? What determines the "availability of funds"? Please cite any other relevant measures or provisions which you consider should guide the Panel in respect of this issue. USA**

218. The United States does not disagree that, subject to the availability of funds (that is, the availability of CCC borrowing authority), Step 2 payments must be made to all those who meet the conditions for eligibility. With respect to the well-accepted mandatory/discretionary distinction reflected in GATT 1947 and WTO panel and Appellate Body reports, the United States notes that the distinction is the natural consequence of the fact that there can be no presumption of bad faith in WTO dispute settlement, a fact that numerous Members, including the European Communities, have emphasized.[90] Thus, to the extent that a Member retains discretion under a measure to act in accordance with a WTO obligation, it may not be presumed that the Member will violate that obligation, or to conclude that the measure itself – separately from the measure's application in a specific instance – may be found inconsistent with that obligation.

**110. Section 1207(a) of the 2002 FSRI Act provides that during the period beginning on the date of the enactment of the FSRI Act through July 31 2008, " .. the Secretary shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters for documented purchases by domestic users and sales for export by exporters...". The Panel notes that Brazil does not appear to distinguish between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists. The United States refers to "benefits" and "payments" and "programme" in asserting that Step 2 is not export contingent (paragraphs 127-135 of the United States' first written submission).**

**(a) Do the parties thus agree that there is no need to draw any distinction between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists for the purposes of the Agreement on Agriculture? BRA, USA**

219. The United States agrees that there is no need to draw a distinction between cash payments and marketing certificates in terms of whether a subsidy exists for purposes of the Agreement on Agriculture.

[90] *See* Appellate Body Report, *United States - Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R, adopted 1 February 2002, para. 259.

**(b) Why would a domestic user or an exporter select to receive a marketing certificate over a cash payment? What is the proportion of cash payments vs. marketing certificates granted under the programme? USA**

220. A user of upland cotton that elects to receive payment in the form of a marketing certificate is entitled to redeem that certificate for an equivalent amount of upland cotton held by the Commodity Credit Corporation (CCC). Although authorized by statute, no Step 2 payments have been made in recent times in the form of certificates. Marketing certificates in lieu of cash payments for Step 2 were last used heavily in the early to mid-1990s. The CCC does not currently maintain high upland cotton inventories from which such certificates if issued could be redeemed.

**111. Does the United States maintain its argument that actions based on Article 3.1(b) of the SCM Agreement are conditionally "exempt from actions" due to the operation of Article 13 of the Agreement on Agriculture? USA**

221. Article 13(c) provides that "export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be . . . exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement." Article 13(b), which applies to domestic support measures, does not reference Subsidies Agreement Article 3. Brazil has advanced claims under Article 3.1(b) of the Subsidies Agreement only with respect to Step 2 payments, which are domestic support measures and not export subsidies. Thus, on the US view the Peace Clause would not appear to be applicable; however, to the extent Brazil asserts that Step 2 payments (or some part thereof) are export subsidies, Article 13(c) would be relevant.

222. We also note that paragraph 7 of Annex 3 requires that support in favour of domestic agricultural producers that is provided through payment to processors shall be included in the AMS of the Member. If payments are made in connection with both domestic and foreign product then such payments are not support in favour of domestic agricultural producers. Consequently, the Agriculture Agreement necessarily contemplates that support paid to processors may be paid solely with respect to domestic production. Under Article 6.3 of the Agriculture Agreement, if a Member is providing support within its domestic support reduction commitments, then such support may not be challenged under Article 3.1(b) because that Article applies "[e]xcept as provided in the Agreement on Agriculture". If a Member exceeds its domestic support reduction commitments, on the other hand, then such support paid to processors would be actionable under Article 3.1(b).

**112. In the event that the Panel finds that Article 6.3 of the Agreement on Agriculture does not preclude an examination of Brazil's claims under Article 3.1 of the SCM Agreement and Article III:4 of GATT 1994, how does the United States respond to the merits of Brazil's claims relating to Step 2 payments under those provisions? USA**

223. As indicated in the US answer to Question 111 from the Panel, and as the European Communities has noted in its third party submission, inasmuch as paragraph 7 of Annex 3 of the Agreement on Agriculture requires support in favour of agricultural producers that is paid to processors to be included in the Member's Aggregate Measurement of Support, then the Agreement on Agriculture necessarily contemplates that such payments to processors may apply solely with respect to domestic product. Otherwise, as in the case of Step 2 payments, domestic cotton producers would not receive the relative price benefit conferred by the payment. Consequently, such discrimination in favour of domestic production is permitted under the Agreement on Agriculture and, under Article 21.1 of that Agreement, the provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement are expressly "subject to the provisions of [the Agriculture] Agreement." For that reason, neither Article 3.1(b) of the Subsidies Agreement nor GATT 1994 Article III:4 precludes such payments to users of US upland cotton, unless the United States exceeds its domestic support reduction commitments.

**113. Is it necessary for measures directed at agricultural processors included in AMS to discriminate on the basis of the origin of goods? USA**

224. The United States does not express an opinion whether it is necessary in all circumstances for all Members with respect to all commodities. However, paragraph 7 of Annex 3 of the Agreement on Agriculture certainly contemplates that support in favour of domestic producers provided by payments to processors is included in the Aggregate Measurement of Support. In the case of Step 2 payments on upland cotton, if payments were provided in favour of all upland cotton, whether domestic or foreign, used by domestics mills or exporters, the price benefit for US producers would not be achieved. Without such a benefit to US producers, these payments would not need to be included in the Aggregate Measurement of Support. The Agreement on Agriculture does not preclude payments that solely benefit domestic producers; indeed, paragraph 7 contemplates such discriminatory subsidy payments. Accordingly, the United States reports all Step 2 payments as domestic support in favour of US producers of upland cotton.

**115. What is the meaning and relevance (if any) to Brazil's claims under Article 3 of the SCM Agreement and Article III:4 of GATT 1994 of the phrase "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products" in the Agreement on Agriculture? BRA, USA**

225. The United States directs the Panel's attention to the US answers to Questions 111, 112, and 113 from the Panel.

**116. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the Agreement on Agriculture? Does the phrase "provide support in favour of domestic producers" in Article 3.2 of the Agreement on Agriculture refer to, and/or permit such subsidies? BRA, USA**

226. Subsidies contingent on the use of domestic goods may be consistent with the Agreement on Agriculture. Paragraph 7 of Annex 3 of the Agreement requires the United States to include its Step 2 payments in favour of domestic upland cotton producers, even though such payments are made to processors, within its calculation of its Aggregate Measurement of Support. The United States has complied with its domestic support reduction commitments. Therefore, Step 2 payments to upland cotton users that provide support to domestic producers contingent on the use of domestic goods is consistent with the Agreement on Agriculture. If Members could not discriminate in favour of domestic producers when making subsidy payments through processors, there would be no reason for paragraph 7 of Annex 3. Such payments that are not limited to domestic products would not be in favour of domestic producers because the relative economic benefit of the subsidy vis-à-vis foreign production would not exist.

**117. What is the relationship between Step 2 payments to exporters and the marketing loan payments, both of which appear to compensate for the price differences relative to the Liverpool A-Index? For example, is there double compensation? Or is one of the explanations that these export-related price compensatory payments are paid to different operators (namely, the producer, on the one hand under the marketing loan arrangements, and the processor/users (Step 2 programme) arrangements on the other? USA**

227. Both marketing loan payments and Step 2 payments are domestic support for upland cotton, but the marketing loan payment is made directly to the producer whereas the Step 2 payment is made to users of the cotton. The marketing loan repayment formula, in section 1204 of the 2002 Act, and the Step 2 payment formula in section 1207 of the 2002 Act, differ by their terms and are simply

different forms of support, the latter (Step 2) being a form of support that can facilitate higher market prices for US cotton. We will address this more fully in our rebuttal submission.

**118. Can the United States confirm that it does not rely on Article III:8 of GATT 1994? USA**

228. The United States can confirm that the Step 2 payment is not made exclusively to domestic producers.

*ETI ACT*

**119. How does the United States respond to Brazil's reference to the panel report in India - Patents (EC) (at paragraph 138 of its oral statement at the first session of the first substantive meeting)? How, if at all, should the Panel take this report into account in considering the issues raised by Brazil's claims relating to the ETI Act? USA**

229. We agree with the passage quoted from the *India – Patents* dispute and consider it relevant to the extent that: Brazil has identified the challenged measure; Brazil has argued why the reasoning of the panels and Appellate Body are relevant in determining that the measure is inconsistent; and the Panel finds the reasoning in *FSC/ETI* persuasive. Our argument in the first written submission went to whether Brazil had carried its burden of bringing a *prima facie* case, in order to assist the Panel to fulfill its obligation under DSU Article 11 to make an objective assessment of the matter before it. Brazil may consider that it should not have to meet this burden, but under DSU rules as currently agreed, it must.[91] Finally, we note our statement in the first submission that "[w]hile the United States cannot specify the precise date on which this will occur, the United States is confident that the ETI Act will be repealed in the reasonably near future."[92]

**121. How do you respond to the reference in paragraph 43 of EC third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to that dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. USA, BRA**

230. The United States considers the EC's references to be irrelevant to the resolution of this dispute. As noted in the US first written submission, the United States intends to implement the DSB's recommendations and rulings in the *FSC/ETI* dispute. Further, the issues raised in the US first written submission related solely to whether Brazil had met its burden of argumentation in this dispute and not to the substantive correctness and applicability, or lack thereof, of the adopted findings in *FSC/ETI*. Nor did the US arguments relate to the breadth of the US obligation to implement the DSB's rulings and recommendations in that dispute. The United States considers that Brazil's burden in this dispute requires, at a minimum, that it identify those aspects of the measure which are WTO-consistent and explain why that is the case.

[91]*See* TN/DS/W/45 (Brazilian proposal in ongoing DSU review: "Brazil understands that one of the drawbacks of the current dispute settlement mechanism is the necessity for a Member to litigate a case *de novo* through all the established phases even if the same measure nullifying or impairing benefits of this Member has already been found WTO inconsistent in previous panel or appeal proceedings initiated by another Member.").

[92]US First Written Submission, para. 189.

# ANNEX I-3

## COMMENTS OF BRAZIL TO ANSWERS TO QUESTIONS POSED BY THE PANEL FOLLOWING THE FIRST SUBSTANTIVE MEETING OF THE PANEL

22 August 2003

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| US – Shirts and Blouses | Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB, adopted 23 May 1997 |
| Brazil - Aircraft | Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 20 August 1999 |
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| Canada – Aircraft II | Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, adopted 19 February 2002. |
| EC - Sardines | Appellate Body Report, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002. |

**List of Exhibits**

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| O.A. Cleveland Newsletter, 25 April 2003; O.A. Cleveland Newsletter, 8 August 2003 | *Exhibit Bra- 187* |
| Testimony of James Echols, Chairman of the National Cotton Council before the Committee on Agriculture, Nutrition and Forestry of the US Senate, 17 July 2001 | *Exhibit Bra- 188* |
| Cotton and Wool Outlook, USDA, 13 August 2003 | *Exhibit Bra- 189* |
| Affidavit of Marcelo Pinheiro Franco | *Exhibit Bra- 190* |

## I. PRELIMINARY ISSUES

**(3) If the request for consultations in this dispute omitted certain products in relation to export credit guarantees, on what basis is it argued that it failed to identify the measures at issue in accordance with Article 4.4 of the DSU?**

**Brazil's Comment on US Answer:**

1. In paragraphs 5-6 of its 11 August Answer to Question 3, the United States argues that footnote 1 to Brazil's request for consultations does not expand the scope of the request, with regard to the US export credit guarantee programmes, beyond upland cotton. This is inaccurate. The footnote number falls *immediately after the words "upland cotton"* in the first sentence of the first paragraph of the request. With reference to "upland cotton", the footnote reads, "[e]xcept with respect to export credit guarantee programmes as explained below".[1] Although the United States claims that there is no explanation "below", there is indeed such an explanation. In particular, Brazil described its potential claim as follows, on page 4 of the request:

> Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as GSM-102, GSM-103, and SCGP programmes, Brazil is of the view that these programmes, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included in Annex I to the SCM Agreement.[2]

The Panel will note that there is no limitation in this sentence to any particular commodity or commodities.

2. At paragraph 7 of its 11 August Answer, the United States asserts that "the statement of evidence attached to Brazil's consultation request did not include any evidence related to measures other than those for upland cotton." This too is inaccurate. The United States conveniently leaves the word "available" out of the term "statement of available evidence" used in Articles 4.2 and 7.2 of the SCM Agreement. Brazil was required to provide a statement of the evidence available to it at the time. It was not required to attach exhibits with the evidence; nor was it required to provide a statement regarding all of the evidence that it would eventually present to this Panel. In paragraph 3 of its statement of available evidence, Brazil addressed what it knew at that point about the US export credit guarantee programmes:

> US export credit guarantee programmes, since their origin in 1980 and up [to] the present, provide premium rates that are inadequate to cover the long-term operating costs and losses of the programmes; in particular there were losses caused by large-scale defaults totaling billions of dollars that have not been reflected in increased premiums to cover such losses.

3. This sentence speaks not just to the existence of the US export credit guarantee programmes, but also to the way in which they constitute export subsidies, given the explicit use of the language included in item (j) of the Illustrative List of Export Subsidies. The statement fulfils the requirement in Articles 4.2 and 7.2 of the SCM Agreement. The Panel will also note that there is no limitation in this sentence to any particular commodity or commodities.

4. In footnote 3 to its response, the United States states that it "will be making a request for a preliminary ruling" that Brazil's consultation request was broader than its statement of evidence, in

[1] WT/DS/267/1, p. 1.
[2] WT/DS/267/1, p. 4.

violation of Article 7.2.[3] As demonstrated above, Brazil's request, and the accompanying statement of available evidence, do not support the United States' assertion. Both the request and the statement of available evidence address the US export credit guarantee programmes without limitation to any particular commodity or commodities.

5. Moreover, even if the United States were to make this request for a preliminary ruling and the Panel were to grant it, it would not affect Brazil's claims. Brazil's compliance with Article 7.2 of the SCM Agreement can have no effect on its claims under the Agreement on Agriculture, or on its prohibited subsidy claims under the SCM Agreement, or on its actionable subsidy claims with respect to upland cotton.

6. Finally, according to the Panel's Working Procedures, requests for preliminary rulings by a party were to have been made "not later than its first submission to the Panel".[4] Thus, the US request would not be timely. Brazil submits this information at this stage in the hope of avoiding another lengthy procedural objection by the United States.

**(4) Is it argued that the export credit guarantee programmes concerning upland cotton are each a separate or independent measure, in that they operate independently?**

**Brazil's Comment on US Answer:**

7. In paragraph 11 of its 11 August Answer to Question 4, the United States argues that "each export credit guarantee issued is a separate measure". It is not for the United States to define the measures that are the subject of Brazil's challenge. Brazil's requests for consultations and establishment identify the measures at issue as the GSM 102, GSM 103 and SCGP programs, both as such and as applied. In its submissions, Brazil has demonstrated that the programmes constitute export subsidies under Articles 1.1 and 3.1(a) of the SCM Agreement, since they are unique financing vehicles that are not available on the market for agricultural commodity transactions and as such provide something better than is available on the market. Brazil has also demonstrated that the long-term operating costs and losses for the programs outpace premiums collected, under item (j) of the Illustrative List (item (j) speaks to the long-term operating costs and losses of "programmes," and not individual guarantees).

**(8) Does the United States confirm that the questions referred to by Brazil in paragraph 92 of Brazil's oral statement were posed to the United States in the consultations?**

**Brazil's Comment on US Answer:**

8. In paragraph 17 of its 11 August Answer, the United States concedes that Brazil posed the questions included at Exhibit Bra-101. The Panel will note that many of the questions included in Section 9 of Brazil's list of questions cover export credit guarantees for all commodities. The United States therefore concedes that Brazil consulted with it on the matters raised in those questions. As Brazil discussed in paragraphs 95-98 of its Statement at the First Meeting of the Panel, panels and the Appellate Body have concluded that for a matter to be properly within the scope of a request for establishment, actual consultations must have been held. That has also been the United States' position in a number of other disputes, including *US – DRAMS* and *Japan – Agricultural Products*.[5]

9. The refusal of the United States to answer Brazil's questions cannot hinder Brazil's ability to pursue its claims against the CCC export guarantee programmes without any limitation to a particular

[3] US 11 August Answer to Question 3, para. 7 and footnote 3 to that paragraph.
[4] Working Procedures of the Panel, 27 May 2003, para. 12.
[5] Oral Statement of Brazil, para. 96-97.

commodity or commodities. If it did, responding Members would have every incentive to refuse to answer any questions during consultations, thereby halting dispute settlement proceedings altogether.

**(10) What actual prejudice, if any, has the United States suffered as a result of the alleged omission of products other than upland cotton from the request for consultations?**

**Brazil's Comment on US Answer:**

10. Brazil agrees that "a Member cannot proceed to a panel unless the Member has consulted on that measure", as the United States argues in paragraph 19 of its response. Brazil's request for consultations included the CCC export guarantee programmes in connection with all commodities, however, and the United States concedes, in paragraph 17 of its answer to Question 8, that it consulted with Brazil via the list of questions included in Exhibit Bra-101.

11. Brazil does not agree with the United States' assertion, at paragraph 20 of its 11 August Answer, that the consultation request is of a "jurisdictional nature". While the Appellate Body has concluded that a complaining Member's request for *establishment* is jurisdictional in nature, and strictly delimits a panel's terms of reference[6], it has not made this statement with respect to a request for *consultations*. In fact, in *Brazil – Aircraft*, the Appellate Body concluded that there is no requirement for a "*precise and exact identity*" between a request for consultations and a request for establishment, which suggests that a request for consultations is *not* jurisdictional in nature.[7]

12. In paragraph 23 of its 11 August Answer, the United States argues, without any proof, that it "has suffered an inability to prepare, respond, and consult with respect to allegations on measures never presented to the United States in accordance with the DSU". As noted above, Brazil's request for consultations specifically addressed potential claims against the US export credit guarantee programs in connection with all commodities, and not just upland cotton. Moreover, the United States acknowledges that Brazil posed questions to it regarding those programmes in connection with all commodities. The questions were provided to the United States in writing on 22 November, in advance of the consultations session.[8] In paragraph 92 of its Oral Statement at the First Meeting of the Panel, Brazil offered extracts from those questions, which clarify that consultations regarding the US export credit guarantee programs were not limited to upland cotton.

13. The United States, therefore, was aware, both from Brazil's request for consultations and from Brazil's extensive list of questions, that the consultations included US export credit guarantee programs with respect to all commodities, and not just upland cotton. That the United States refused to respond to Brazil's questions does not mean that it had an "*inability*" to prepare, respond, and consult with Brazil – it means that the United States made a strategic decision not to do so. The United States had more than seven months from receipt of Brazil's questions until it filed its First Submission to "prepare and respond" to Brazil's claims. This demonstrates that no due process rights were violated nor any prejudice caused. The United States alone bears responsibility for any alleged "prejudice" it has suffered as a result of its own strategic decision.

14. In paragraph 24 of its 11 August Answer, the United States argues that it "has not had [sic] proper opportunity to consult" with Brazil on the US export credit guarantee programs with respect to all commodities. In paragraph 17 of its 11 August Answer to Question 8, however, the United States concedes that Brazil did pose questions on the US export credit guarantee programmes with respect to all commodities. Consultations did, therefore, occur with respect to export credit guarantees covering all eligible agricultural products. The United States refused during meetings on 3-4 December, 19 December 2002 and 17 January 2003 to provide answers to Brazil's questions. With its

[6] Appellate Body Report, *EC – Bananas III*, WT/DS27/AB/R, para. 142.
[7] Appellate Body Report, *Brazil – Aircraft*, WT/DS46/AB/R, para. 132.
[8] Exhibit Bra-101 (Brazil's Questions for the Purposes of Consulations, 22 November 2002).

consultations request and its extensive list of questions, however, Brazil fulfilled the requirement to consult with the United States on the full scope of the programmes.

**(11) Does the United States agree that Brazil's request for establishment of the Panel can be understood to indicate that Brazil's export credit guarantee claims relates to products other than upland cotton? How, if at all, is this relevant?**

**Brazil's Comment on US Answer:**

15. At paragraphs 96-97 of its Statement at the First Panel Meeting, Brazil noted that in other disputes, the US position has been that "'a Member should be permitted to refer a claim to a panel if it was actually raised during consultations, even though it may not have been included in the written request for consultations.'"[9] In its 11 August Answer to Question 11, the United States now suggests that its position is different with respect to measures than it is with respect to claims. According to the United States, while a Member can add *claims* not present in its consultations request to its panel request, it cannot add *measures*.[10]

16. Brazil repeats that its request for consultations does in fact address the US measures (the GSM 102, GSM 103 and SCGP programs) in connection with all commodities. Every measure included in its request for establishment was similarly included in its request for consultations. The US argument is therefore irrelevant.

17. In any event, the US reliance on the Appellate Body's decision in *Guatemala – Cement (I)* is misplaced.[11] In that case, the Appellate Body explained that the text of Article 6 of the DSU and Article 17.4 of the Anti-Dumping Agreement required a distinction between measures and claims. The United States has, however, failed to explain the textual reason why the distinction between measures and claims is relevant *for the purpose of comparing a request for consultations with a request for establishment*. In fact, the Appellate Body has specifically held that Articles 4 and 6 of the DSU do not "require a *precise and exact identity* between the specific measures that were the subject of consultations and the specific measures identified in the request for the establishment of a panel".[12] Nor has the United States offered any logical reason why a Member should be allowed to add claims not covered by its consultations request to its request for establishment, but not measures. If anything, a defending Member would seem to suffer greater prejudice by the addition of claims than by the addition of measures, since the Member is likely more familiar with its *own* measures than it would be with *another Member's* claims.

**(16) What, if any, prejudice in terms of presentation of its case does the United States allege, should the Panel proceed to consider the measures constituting the cottonseed payments under the Agriculture Assistance Act of 2003?**

**Brazil's Comment on US Answer:**

18. There have been many disputes in which Panel found that measures, which were replacement measures to measures originally consulted on, were included in the panel's terms of reference, *Korea – Beef*[13] *and Chile- Agricultural Products (Price Band)*[14], to name a few. The Agricultural Assistance Act of 2003 is in the nature of a revised measure, as Brazil has argued in paragraphs 145-150 of its

[9] Panel Report, *US – DRAMS*, WT/DS99/R, para. 6.8.
[10] US 11 August Answer to Question 11, para. 25.
[11] US 11 August Answer to Question 11, para. 26 note 9
[12] Appellate Body Report, *Brazil – Aircraft*, WT/DS46/AB/R, para. 132.
[13] Panel Report, *Korea – Beef*, WT/DS161/R and WT/DS169/R, para. 563-564.
[14] Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 143-144.

Oral Statement. Brazil also notes that the United States has identified no prejudice to its ability to defend this measure in this dispute.

**(17) (a) What is the relationship of the Agricultural Assistance Act of 2003 to other legislation in the request for establishment of the Panel?**

**(b) Do the legal instruments follow directly one after another, or are there temporal gaps? Are payments authorized under a broad legislative authority or are they specific to each legal instrument?**

**(c) Please provide any implementing regulations. Do these implementing regulations resemble those relating to previous programmes or payments? Are payments made retrospectively? How if at all is this relevant?**

**Brazil's Comment on US Answer**

19. The United States argues that the four legislative acts that authorize cottonseed payments for the MY 1999, 2000 and 2002 crop are completely unrelated measures and that – while the regulations implementing these payments are very similar – this is immaterial to the question of whether such payments are part of a single programme.[15]

20. If a Member like Brazil would be prevented from challenging yearly renewed measures that provide support under the very same mechanism – and in fact under nearly identical regulations[16] – than another Member like the United States could continue to enact yearly measures and limit the challenge by WTO Members to old measures without a prevailing challenge having any effect on its current and future identical measures. The result would put a complaining Member in the impossible situation of having to challenge identical measures year after year, just because they are based on legislation that "bears no relation"[17] to preceding *identical* legislation *on the same matter*.

21. The Panel in *Argentina – Footwear* rejected similar arguments to those made by the United States:

Moreover, it appears that an interpretation whereby these subsequent Resolutions are considered to be measures separate and independent from the definitive safeguard measure, and thus outside our terms of reference, could be contrary to Article 3.3 of the DSU. Such an interpretation could allow a situation where a matter brought to the DSB for prompt settlement is not *resolved when the defendant changes the legal form of the measure through a separate but closely related instrument, while the measure in dispute remains essentially the same in substance*. In this way, Members could always keep one step ahead of any WTO dispute settlement proceeding because in such a situation, the complaining Member would indeed, challenge a "moving target", and panel and Appellate Body's findings could already be overtaken by events when they are rendered and adopted by the DSB.[18]

22. Brazil maintains that the Agricultural Assistance Act of 2003 constitutes a subsequent, separate but closely related instrument, that is essentially the same as the legal instruments authorizing the MY 1999 and MY 2000 cottonseed payments and that is, therefore, within the Panel's terms of reference.

[15] US 11 August Answer to Question 17, para. 39-43.
[16] *Compare* Exhibit US14-US16.
[17] US 11 August Answer to Question 17, para. 39.
[18] Panel Report, *Argentina – Footwear*, WT/DS121/R, para. 8.41 (emphasis added).

## II. ARTICLE 13(B): DOMESTIC SUPPORT MEASURES

### A. "EXEMPT FROM ACTIONS"

**(20) In paragraph 8 of its initial brief (dated 5 June, 2003), the United States argued that the word "actions" as used in the phrase "exempt from actions" in Article 13 of the Agreement on Agriculture includes the "bringing of a case" and consultations. In paragraph 36 of its first written submission (dated 11 July, 2003), the United States stated as follows:**

**"[P]rior to this point in the process, the DSU rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the US insistence that its measures conform to the Peace Clause."**
**Is it the United States' understanding that the drafters used the phrase "exempt from actions" knowing that under the DSU it would not be possible fully to exempt "actions", as the United States interprets that term?**

**(21) In US - FSC and US - FSC (21.5) the Appellate Body made findings under the SCM Agreement relating to export subsidies in respect of agricultural products without making a finding in respect of Article 13 of the Agreement on Agriculture. How is this relevant to the United States' interpretation of the phrase "exempt from actions" as used in Article 13? USA**

**Brazil's Comment on US Answers:**

23. The United States and the European Communities maintain that the complaining party has the burden of proof under Article 13 of the Agreement on Agriculture. More specifically, they claim that Article 13 is not in the nature of an affirmative defence. Brazil's comment will again show that their position is untenable.

24. In its 11 August Answer to Question 20 of the Panel, the United States asserts, under the "exempt from action" argument, that "Brazil has attempted to improperly invoke dispute settlement procedures notwithstanding the Peace Clause."[19] According to the United States, a dispute settlement procedure could only be initiated after a determination of non-compliance with Article 13 has been made. In its 11 August Answer to Question 21, the United States then dismisses the findings in *US – FSC* by simply stating that they do not address the peace clause and that the issue was not raised by either party in that case.[20] Therefore, those rulings and recommendations "provide no guidance for purposes of this dispute".

25. The EC maintains that "Article 13 is more akin to a threshold permitting further action if the threshold is not complied with."[21] The EC affirms that Article 13 "is an integral part of the *Agreement on Agriculture*".[22] In that sense it would be comparable to Article 6 of the ATC, Article 3.3 of the SPS Agreement, and Article 2.4 of the TBT Agreement, which were found not to be affirmative defences by the Appellate Body.[23] According to the EC, those provisions, like Article 13 of the Agreement on Agriculture, "provide certain rights to WTO Members, but cannot be seen as exceptions".[24]

[19] US 11 August Answer to Question 20, para. 47.
[20] US 11 August Answer to Question 21, para. 48.
[21] Third Party Submission of the EC, para. 11.
[22] Third Party Submission of the EC, para. 12.
[23] Third Party Submission of the EC, para. 12.
[24] Third Party Submission of the EC, para. 12.

26. Brazil disagrees. The Appellate Body addressed the issue of burden of proof on numerous occasions. In *US – Shirts and Blouses*, the Appellate Body made a general finding stating that

... the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.
In the context of the GATT 1994 and the WTO Agreement, precisely how much and precisely what kind of evidence will be required to establish such a presumption will necessarily vary from measure to measure, provision to provision, and case to case.[25]

27. When examining Article 6 of the ATC, Article 3.3 of the SPS Agreement, and Article 2.4 of the TBT Agreement, the Appellate Body did not stray from this principle. In fact, it was the cornerstone of all determinations concerning the above-cited provisions. Paragraph 275 of the Appellate Body report in *EC – Sardines* reads:

> In EC – Hormones, we found that a "general rule-exception" relationship between Articles 3.1 and 3.3 of the SPS Agreement does not exist, with the consequence that *the complainant had to establish a case of inconsistency with both Articles 3.1 and 3.3*.[196] We reached this conclusion as a consequence of our finding there that "Article 3.1 of the SPS Agreement simply excludes from its scope of application the kinds of situations covered by Article 3.3 of that Agreement".[197] Similarly, the circumstances envisaged in the second part of Article 2.4 are excluded from the scope of application of the first part of Article 2.4. Accordingly, as with Articles 3.1 and 3.3 of the SPS Agreement, there is no "general rule-exception" relationship between the first and the second parts of Article 2.4. Hence, in this case, it is for Peru – *as the complaining Member seeking a ruling on the inconsistency with Article 2.4 of the TBT Agreement* of the measure applied by the European Communities – to bear the burden of proving its claim. (emphasis added) (footnotes omitted)[26]

28. With regard to Article 6 of the ATC, the Appellate Body found that provision to be a fundamental part of the rights and obligations of WTO Members concerning non-integrated textile and clothing products covered by the ATC during the transition period. Consequently a party claiming a violation of a provision of the WTO Agreement by another Member must assert and prove its claim. In this case, *India claimed a violation by the United States of Article 6 of the ATC.* We agree with the Panel that it, therefore, was up to India to put forward evidence and legal argument sufficient to demonstrate that the transitional safeguard action by the United States was inconsistent with the obligations assumed by the United States under Articles 2 and 6 of the ATC. (emphasis added)[27]

29. Unlike the EC, Brazil believes that these Appellate Body findings underscore the striking differences between Article 13 of the Agreement on Agriculture and the other provisions cited by the EC and which the Appellate Body found not to be in the nature of an affirmative defence.

30. First, Brazil notes that in all Appellate Body findings, the complaining party claimed a violation of the provision at issue. The complaining party tried to impute the burden of proof on the respondent by alleging that those provisions also contained language that provided an opportunity for an affirmative defence under an “exception” to the general rule.

[25] Appellate Body Report, *US – Shirts and Blouses*, p. 14.
[26] Appellate Body Report, *EC – Sardines*, para. 275.
[27] Appellate Body Report, *US – Shirts and Blouses*, p. 16.

31. Article 13 of the Agreement on Agriculture is entirely different. The peace clause imposes no obligations on WTO Members. As the EC rightfully stated in paragraph 6 of its Initial Submission of 10 June 2003:

> a Member is not under an obligation to act consistently with Article 13 of the *Agreement on Agriculture* – failing to respect Article 13 implies that a Member no longer enjoys protection thereof. Consequently ... Article 13 of the *Agreement on Agriculture* can only be seen as a defence against a claim brought under other aspects of the WTO Agreements which regulate the provision of subsidies. It would seem bizarre if before Brazil could bring a claim with respect to subsidies which it considered did not respect the US's obligations, Brazil had first to establish that potential defences did not apply. (italics in original) (underlining added)[28]

32. Brazil entirely agrees with the characterization of Article 13 as a potential defence against claims brought before the WTO. In fact, as the Panel is well aware, in Brazil's request for the establishment of the Panel, Brazil does not claim that the United States violated Article 13. Such violation is indeed impossible, since Article 13 of the Agreement on Agriculture imposes no obligations whatsoever on WTO Members. Article 13 simply provides shelter to Members that invoke its exemption from actions based on certain other provisions of the WTO Agreements. Again, as the Appellate Body stressed every single time it addressed the issue, "the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence."[29]

33. Second, Brazil's interpretation is entirely compatible with the findings of the panel and the Appellate Body in *US – FSC*. Brazil, unlike the United States, considers these finding to be very relevant to this dispute. In *US – FSC*, the United States decided not to invoke Article 13 of the Agreement on Agriculture as a possible defence against the challenges brought by the EC. The panel and the Appellate Body did not need to address Article 13 simply because it was not used as a defence by the respondent. This situation is not necessarily unusual. For example, a respondent that knows, in advance, that it is not complying with the requirements of Article 13, may well choose to directly rebut the prima facie case of the complainant by providing rebuttal arguments and evidence without attempting to use the Article 13 shelter.

34. Indeed, interpreting Article 13 of the Agreement on Agriculture as a "threshold"[30] provision is at odds with the Appellate Body's findings in *US – FSC*, *US– FSC* (21.5), *Mexico – HFCS* (21.5) and *US – Byrd Amendment*. In Mexico – HFCS (21.5), the Appellate Body held that

> We believe that a panel comes under a duty to address issues in at least two instances. First, as a matter of due process, and the proper exercise of the judicial function, panels are required to address issues that are put before them by the parties to a dispute. Second, *panels have to address and dispose of certain issues of a fundamental nature, even if the parties to the dispute remain silent on those issues*. In this regard, we have previously observed that '[t]he vesting of jurisdiction in a panel is a fundamental prerequisite for the lawful panel proceeding.' For this reason, panels cannot simply ignore issues which go to the root of their jurisdiction – that is, to their authority to deal with and dispose of matters. Rather, *panels must deal with such issues – if necessary, on their own motion – in order to satisfy themselves that they have authority to proceed*. (emphasis added) (footnote omitted)[31]

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[28] Initial Third Party Submission of the EC, para. 6.
[29] Appellate Body Report, *US – Shirts and Blouses*, p. 14.
[30] Third Party Submission of the EC, para. 11.
[31] Appellate Body Report, *Mexico – HFCS (21.5)*, WT/DS132/AB/RW, para. 36.

35. The Appellate Body applied this reasoning to itself in *US – Byrd Amendment*. In that case, the Appellate Body examined an issue related to the Panels jurisdiction, although it was not addressed before the Panel or, indeed mentioned in the notice of appeal.[32] If Article 13 of the Agreement on Agriculture were a threshold provision affecting the jurisdiction of a panel or the Appellate Body, both the panels and the Appellate Body in *US – FSC* and *US – FSC* (21.5) would have had to address the issue of peace clause exemption of the claims brought by the EC. The fact that none of them did is further evidence that Article 13 is not a "threshold" or jurisdictional provision. As Brazil maintains, Article 13 of the Agreement on Agriculture is an affirmative defence.

36. Further, Brazil does not claim that Article 13 is an "exception". Brazil does not claim that the United States "violated" Article 13 and, therefore, Brazil does not bear the burden of proving any such assertion. Actually, Brazil simply does not believe that Article 13 is at all relevant to claims raised under the SCM Agreement or GATT Article XVI until the respondent claims that it is exempt by the provisions of the peace clause. The respondent claiming such exemption has the burden of proving that it is entitled to it.[33] If the respondent does not claim such protection, Article 13 is moot, as demonstrated by the *US – FSC* case.

37. In paragraph 11 of its Oral Statement of 24 July, the EC points out that no "credible response" was given to the argument it put forward suggesting that Brazil's approach "has perverse effects".[34] The EC claimed that

> if Article 13 is considered an affirmative defence, when a complainant brings a dispute under Articles 5 and 6 of the SCM Agreement and, for instance, Article 6 of the *Agreement on Agriculture*, the complainant would be required to prove a breach of Article 6 while at the same time the defendant would also be required to prove that it had not infringed Article 6 of the Agreement. The burden of proof cannot switch between parties simply on the basis of whether the complainant cites the *SCM Agreement* or not ..." (italics on the original)[35]

38. Brazil fails to see the conundrum that seems to puzzle the EC. If the complainant cites the SCM Agreement or, better still, alleges a violation of the SCM Agreement together with a violation of Article 6 of the *Agreement on Agriculture*, the burden of proving both assertions rests on the complainant irrespective of the fact that the respondent may invoke Article 13. If the complainant fails to establish the violation of Article 6 of the *Agreement on Agriculture*, then the task of the respondent to invoke the Article 13 shelter against a possible violation of the SCM Agreement is made that much easier. In fact, the burden of proof concerning the violation of Article 6 of the *Agreement on Agriculture* will simply *start* with the complainant. As the Appellate Body noted in *US – Shirts and Blouses*, if the complainant "adduces evidence sufficient to raise a presumption that what is claimed is true, the burden shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption". Therefore, the burden of proof may well switch between parties, but not "on the basis of whether the complainant cites the *SCM Agreement*", as the EC suggested in its Oral Statement.

39. In sum, Brazil reemphasizes that the peace clause is in the nature of an affirmative defence.

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[32] Appellate Body Report, *US – Byrd Amendment*, WT/DS217/AB/R and WT/DS234/AB/R, para. 206-208.

[33] Appellate Body Report, *US – Shirts and Blouses*, p. 14.

[34] Oral Statement of the EC, para. 11

[35] Oral Statement of the EC, para. 11.

B. "SUCH MEASURES" AND ANNEX 2 OF THE AGREEMENT ON AGRICULTURE

**(22) Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture.**

**Brazil's Comment on US Answer:**

40. The United States 11 August Answer to Question 22 renders the meaning of the word "fixed" meaningless by isolating the phrase "relative position" from the full dictionary definition.[36] The complete definition includes the phrase "definite, permanent, and lasting".[37] There is nothing "permanent" about the US interpretation of the meaning of "fixed base period" for the PFC and direct payment programmes. For further comments on the issue, Brazil refers the Panel to paragraphs 10-12 of its Rebuttal Submission.

**(24) How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture?**

**Brazil's Comment on US Answer:**

41. Brazil agrees with the United States' statement that there is "no requirement in paragraph 6 that a particular base period be used for a decoupled income support measure nor that the same base period be used for purposes of every decoupled income support measure."[38] But this misses the point. The legal and factual question is whether a measure for which a new base period is "*fixed*" has the same structure, design, and eligibility criteria as an older replaced measure which had a *different* base period. The evidence demonstrates that PFC payments and direct payments have a similar structure, design, and eligibility criteria.[39]

**(29) Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the Agreement on Agriculture.**

**Brazil's Comment on US Answer:**

42. The United States argues in response to this question that "compliance with the fundamental requirement of the first sentence will be demonstrated by conforming to the basic criteria of the second sentence plus the applicable policy-specific criteria of paragraphs 6-13."[40] Brazil disagrees that compliance with the basic and policy-specific criteria is a sufficient condition for compliance with the fundamental requirement. For example, the volume of direct payments that conform to the criteria in paragraph 6 is not limited. However, the amount of support a Member provides may be so large that the payments create significant production and trade-distorting effects. Therefore, even if direct payments conform to the basic and policy-specific criteria in Annex 2, they may still have considerable production and trade-distorting effects. Brazil refers to its arguments in support of the "stand-alone" nature of the fundamental requirement.[41]

[36] Brazil 11 August Answer to Question 22, para. 20.
[37] The New Shorter Oxford English Dictionary, 1993 edition, p. 962.
[38] US 11 August Answer to Question 24.
[39] *See* Rebuttal Submission of Brazil, para. 10.
[40] US 11 August Answer to Question 29, para. 59.
[41] First Submission of Brazil, para. 163-165; Brazil's 11 August Answer to Questions 27-28, para. 32-43.

**(32) If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2.**

**Brazil's Comment on US Answer:**

43. Contrary to the US argument at paragraph 68 of its 11 August Answers, there is no conflict between the Brazil's position regarding the fruits, vegetables and wild rice prohibition and Annex 2, paragraph 1 "fundamental requirement". The undisputed facts show that this prohibition on the production of certain crops channels production to other crops that are permitted to be produced to receive the payment.[42] This channeling of payments creates production and trade distorting effects inconsistent with Annex 2, paragraph 1.

44. Further, the United States engages in a wishful interpretation when it states in paragraph 68 of its 11 August Answer that "paragraph 6(b) should be read to prevent a Member from requiring a recipient *to produce* certain crops". This interpretation would render Annex 2, paragraph 6(e) a nullity. Paragraph 6(e) provides that "no production shall be required in order to receive such payments". The US interpretation of paragraph 6(b) as not requiring the production of "certain crops" is the same as 6(e)'s prohibition on not requiring production of "any crops".

45. Paragraph 6(b) is distinct from paragraph 6(e) because it provides a clear test that *the amount* of payment cannot be related to the type of production. There is no factual dispute among the parties that the amount of PFC and direct payments *falls* when base acres are used to produce fruits, vegetables, tree nuts, and wild rice. There is no factual dispute that the 1996 FAIR Act and the 2002 FSRI Act *require* the prohibition or reduction in payments if these crops are produced on base acreage. Given these two undisputed facts and the clear text of Annex 2, paragraph 6(b), the only conclusion is that PFC and direct payments do not meet the policy specific criteria of Annex 2.

C. "DO NOT GRANT SUPPORT TO A SPECIFIC COMMODITY"

**(33) According to the United States' interpretation of the word "grant", when can a Member claim that a measure is not exempt from action under Article 13(b)? what if the measures is enacted annually? Can the Member obtain a remedy in respect of that measure under the DSU?**

**Brazil Comment to US Answer:**

46. Brazil's addresses in detail the US "statute of limitations" argument at paragraphs 88-96 of its Rebuttal Submission, as well as at paragraphs 40-47 of its Oral Statement.

**(37) In the United States' view, why did the drafters not use the exact term "product-specific" in Article 13(b)(ii)?**

**Brazil Comment on US Answer:**

47. The United States' 11 August Answer once again reveals that it equates the term "support to a specific commodity" with "product-specific". Brazil notes again that neither the phrase "product-specific" nor "AMS" is found in the text of Article 13(b). Given the use of such terms in the Agreement on Agriculture, the Drafters must be presumed to have used the term "support to a specific commodity" for a reason. The US answer ignores the likely reason which is that "support to a specific commodity" is qualified by the term "such measures" which includes the universe of non-

[42] *See* Rebuttal Submission of Brazil, para. 7.

green box support measures in the *chapeau* to Article 13(b). This universe of measures from which such support may be found is not limited to simply "product-specific" measures.

**(38) Given the fact that subsidies available for more than one product could have various effects on production, how does the United States demarcate between product-specific support and non-product specific support?**

**Brazil's Comment on US Answer:**

48. The United States demarcation line does not take into account the definition of "non-product specific" in Article 1(a) which is "provided in favour of agricultural producers *in general*". This "in general" language shows where the line between product-specific and non-product specific must be drawn. Any support that is *not* provided to producers "*in general*" cannot, by definition, be non-product specific support. It must instead fall into the category of "product-specific support". The United States fails to recognize that the term "in general" is directly related to and qualifies the phrase "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product".

49. The "demarcation" line drawn by the United States between "product-specific" and "non-product specific" support is necessary to justify the narrow US specificity test for Article 13(b)(ii). The United States argues that support could only be "product-specific" if "production is necessary for the support to be received."[43] Yet, the Article 1(a) notion of "support" "provided for an agricultural product in favour of the producers of the basic agricultural product" is very broad. It could include any *type* of support, regardless of whether production was required or not. For example, if the facts demonstrate that $1 billion of support were received by the "producers of a basic agricultural product" (such as in the case of CCP payments to upland cotton producers in MY 2002), the language of Article 1(a) would support the finding that this support is "product-specific". The only restraint on such a conclusion is if it could be shown that all, or most of the producers of agricultural products received the same type of support. However, none of the five domestic support payments at issue in this dispute comes even close to such an "in general" finding. The inclusion of such subsidies as "support to a specific commodity" is confirmed by the context of Article 13(b)(ii) which includes Annex 3 of the Agreement on Agriculture as discussed in paragraphs 17-22 of Brazil's Rebuttal Submission.

50. Further, the United States never addresses the premise of the Panel's question, i.e, that subsidies for more than one product could have various effects on production. This is exactly the situation with PFC, market loss, direct payments, CCP payments, and crop insurance subsidies. The evidence (which consists in large part of the statements of present or former USDA economists) shows the production enhancing effects of each of these subsidies.

51. The US 11 August Answer highlights the narrowness of its Article 13(b)(ii) specificity test. Trade and production-distorting amber box support from each of these five subsidies increases US production and sustains high levels of US exports of upland cotton. Yet, under the US specificity test, it could never be deemed "support to" upland cotton because no production of upland cotton is legally required. The Panel should reject this approach and find that these programmes provide support to upland cotton.

**(39) If "such measures" in Article 13(b)(ii) refers to all those in the chapeau of Article 13(b), why are they not included in the potential comparisons with 1992? In what circumstances can measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994?**

[43] US 11 August Answer to Question 38, para. 81.

**Brazil Comment to US Answer:**

52. The United States 11 August Answer does not address the second of the Panel's questions directly. But based on the argument in the "answer," the direct answer to the question would have been "*there are no circumstances in which measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994*." The arguments presented by the United States in its answer confirms that its interpretation creates a broad new category of "exempt" non-green box support – those presumptively trade and production-distorting measures it labels "non-product specific". The US constructs this new exempt category by improperly interpreting the phrase "product-specific" to include only non-green box support legally requiring the production of upland cotton. This incorrect definition is inconsistent with the fact that in analogous situations involving calculation of AMS, paragraphs 12-13 of Annex 3 of the Agreement on Agriculture require all types of non-green box support providing support to the producers of an agricultural commodity be included in the amount tabulated. These points are further discussed in paragraphs 13-67 of Brazil's Rebuttal Submission.

53. The US 11 August Answer to the first question in paragraph 84 indicates that it interprets the phrase "such measures" as only including "product-specific" support. Even apart from the incorrect US definition, such an interpretation renders a nullity the reference to most of the "measures" referred to in the "such measures" phrase of Article 13(b)(ii). If the drafters had intended to limit the universe of non-green box support in the manner suggested by the United States, they would have used the phrase "product-specific" instead of "such measures". The better interpretation that does not render the *chapeau* a nullity is that suggested by Brazil: any type of support listed in the chapeau which provides "support to a specific commodity" must be included within the support to be counted for the purpose of the required 13(b)(ii) comparison.

D. "IN EXCESS OF THAT DECIDED DURING THE 1992 MARKETING YEAR"

**General Comment by Brazil on the US Answers to Questions 47-69**

54. Brazil notes that the United States has not fully answered many of the questions posed by the Panel. The United States further announced in various questions that it would provide its views on certain questions posed by the Panel in its rebuttal submission. In the answers provided, the United States has continued to pursue its overly simplistic view of an alleged "decision" to provide a rate of support of 72.9 cents per pound in MY 1992. Brazil has pointed out that this rate of support does not accurately reflect the operation of the US support system to upland cotton and that it ignores restrictions on the availability of support and costs associated with the participation in the support programmes.[44] Professor Sumner has attempted to correct the overly simplistic US approach and has presented data to that respect.[45]

55. A fundamental flaw exposed by the US 11 August Answers is the inability of the US "72.9 methodology" to account for a number of different types of "support to upland cotton". In its 11 August Answer to Question 67, the United States provides a calculation of upland cotton AMS that lists as "product-specific" support Step 2 payments (user marketing certificates), cottonseed payments, storage payments, and interest subsidies, in addition to deficiency payments, and marketing loan payments. Yet, the United States "72.9 methodology" does not – and cannot – account for cottonseed payments, Step 2 payments, storage payments and interest rate subsidies. The United States takes no account of these subsidies – no matter how large the expenditures may be – because they do not fit within the US methodology. So they simply disappear.

[44] Oral Statement of Brazil, para. 36; Brazil's 11 August Answer to Question 66(c), para. 120-128.
[45] *See* Exhibit Bra-105 (Statement of Professor Sumner at the First Meeting of the Panel).

56. Any methodology that cannot account for *all* of the support "decided" and "granted" in MY 1992 and during the implementation period cannot be legitimate. A methodology that would sanction the cover-up of hundreds of millions – if not billions – of dollars of expenditures cannot be justified by the object and purpose of Agreement on Agriculture or by any reasonable reading of the text of Article 13(b)(ii).

57. With these general points in mind, Brazil comments on the answers provided by the United States.

**(43) What are the precise differences between deficiency payments and counter-cyclical payments that lead you to classify the former as product-specific and the latter as non-product specific? How do you classify market loss assistance payments?**

**Brazil's Comment on US Answer:**

58. The US 11 August Answer at paragraph 87-90 reveals its erroneous interpretation of the phrase "product-specific" in Article 1(a) of the Agreement on Agriculture. The United States ignores the phrase "in general" and assumes that "non-product specific" support is a huge residual category of support that includes everything *except* support which *requires* production of a specific product. Further, the United States' answer ignores the fact that all types of support in favour of domestic producers of a basic commodity are included in the analogous AMS calculation of Annex 3 – including "product-specific" support where the recipient is *not* required to produce a specific commodity. Brazil outlines the erroneous US interpretation in paragraphs 13-23 of its Rebuttal Submission.

59. The improper narrow US interpretation of "product-specific" is highlighted in its discussion of counter-cyclical payments where the only relevant fact is that a producer receiving CCP payments need not plant any crop at all. Brazil addresses in detail the evidence demonstrating that CCP payments are "support to" upland cotton in paragraphs 48-52 of its Rebuttal Submission.

60. With respect to market loss assistance payments, Brazil notes that it provides a detailed analysis of how such payments are "support to upland cotton" in paragraphs 29-35 of its Rebuttal Submission, as well as in paragraphs 50-54 of its Oral Statement. Contrary to the US statement in paragraph 92 of its 11 August Answers, Brazil has always asserted that market loss assistance payments are "support to a specific commodity", i.e., to upland cotton.

**(46) What is the relevance, if any, of the concept of "specificity" in Article 2 of the SCM Agreement and reference to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture?**

**Brazil's comment to US Answer:**

61. For the reasons set forth in Brazil's 11 August Answer to this question, Brazil believes that Article 2 of the SCM Agreement provides useful context in interpreting the concept of specificity in Article 13(b)(ii). Brazil notes that the very narrow US notion of specificity (only support *requiring* recipients to produce the commodity in question) for Article 13(b)(ii) is quite different than the very broad concept of specificity applying to all commodities (including agricultural commodities) as set out in the US SAA referred to in Brazil's answer. The United States has not provided any reasons why there should be such a radically different concept of specificity involving non-green box domestic support measures under Article 13(b)(ii) and all types of products (including agricultural goods) under the SCM Agreement. Brazil sees no basis for such a significant difference.

**(48) Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?**

**Brazil's Comment on US Answer:**

62. Brazil comments on the US 11 August Answer to Question 48 in the context of its Rebuttal Submission at paragraphs 68-96.

**(54) Please identify all United States legal and regulatory and administrative instruments decided during the marketing year 1992, with the respective dates of decision, that decided support for upland cotton.**

**Brazil's Comment on US Answer:**

63. As Brazil has noted in its general comment at paragraphs 54-57 above, the United States focuses solely on the alleged target price decision of 72.9 cents per pound. This simplistic approach does not accurately reflect the actual operation of the US support programmes to upland cotton. As detailed by Professor Sumner in his Statement at the First Meeting, the United States took a number of decisions concerning support for the 1992 marketing year.[46]

64. Professor Sumner – who actually participated in the decision making process concerning the MY 1992 acreage reduction programme decision – explained during the First Meeting of the Panel that the decision on the percentage of upland cotton base that farmers participating in the deficiency payment programme had to leave idle was a conscious decision based on, *inter alia*, budgetary considerations. Given expectations about production and prices in the upcoming marketing year, the decision on the acreage reduction programme was also a decision on expected participation. The United States could base expected participation on historical experience about participation in the deficiency payment program. Professor Sumner indicated that USDA was able to fairly accurately predict actual participation. The decision on the amount of mandatory acreage reduction is, thus, a decision on the level of participation.

65. Professor Sumner's testimony is supported by the Chief and Deputy Chief Economist of USDA who have explained that the aim of the acreage reduction programme was "to balance supply and demand"[47], i.e., to influence prices and thereby US budgetary outlays. They furthermore report that the United States implemented the acreage reduction programme with a view of reducing costly government stocks, and that the United States – with further budget considerations in mind – reduced target prices.[48]

66. Furthermore, the United States ignores various required additional administrative decisions that were necessary to make its domestic support programmes operative. These decisions include decisions on the deficiency payment rate, on weekly Step 2 payment rates and on a weekly-determined adjusted world price setting the amounts of marketing loan benefits available for that week. By taking all of these decisions, the United States directly influenced the expenditures related to the MY 1992 crop.[49] In addition, as the United States now reflects in its AMS data, the

[46] Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting, para. 7-8).

[47] Exhibit Bra-180 ("Will Policy Changes Usher in a New Era of Increased Agricultural Market Variability?," Keith J. Collins, Joseph W. Glauber, Choices, Second Quarter 1998, p. 27).

[48] Exhibit Bra-180 ("Will Policy Changes Usher in a New Era of Increased Agricultural Market Variability?," Keith J. Collins, Joseph W. Glauber, Choices, Second Quarter 1998, p. 27).

[49] Brazil acknowledges that the United States could not possible determine its expenditures as they would depend to a certain extent on market prices that were also influenced by factors outside the control of the US Government.

United States considers storage payments and interest subsidies[50] as product-specific support to upland cotton. Consequently, under the US approach, these product-specific domestic support measures need to be taken into account for purposes of the Article 13(b)(ii) decision. Yet, the United States fails to account for these programmes in its list of decisions taken concerning support to upland cotton, just as it failed to account for various decisions relating to the deficiency payment, marketing loan and Step 2 programmes.

67. Brazil also notes that the United States failed to answer Question 54 that asked the United States to identify "all" instruments that decided support for upland cotton. This would also cover instruments other than product-specific instruments. However, the United States has only followed its simplistic view of what kind of decision it took and has not provided information on other decisions. This appears to be an attempt to avoid the conclusion under all other approaches: that the United States provided support in MY 1999-2002 in excess of that decided during the 1992 marketing year.

**(55) Please provide a copy of the instruments in which the rate of support for upland cotton during the marketing year 1992 was decided, indicating the date of the decision.**

**Brazil's Comment on US Answer:**

68. As noted in Brazil's Comment to the previous question, the United States failed to identify a list of decisions taken with respect to support for upland cotton in MY 1992. As a consequence, the United States also failed to provide copies of those instruments.[51]

**(57) If the United States decided on a rate of support for MY1992, does that not mean that it decided on whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at that time?**

**Brazil's Comment on US Answer:**

69. At the outset, Brazil refers the Panel to the general comment made in respect of the set of questions referring to the term "decision" in Article 13(b)(ii) of the Agreement on Agriculture. Also this answer suffers from the simplistic picture the United States draws of its MY 1992 support programmes to upland cotton.

70. Brazil disagrees with the United States that it could not be said that the United States decided on budgetary outlays. Indeed, for *all* of the US programmes, there was a decision to authorize whatever budgetary outlays would be necessary to meet the rate of support.[52] In addition, the United States ignores that it has admitted that there were other programmes that meet its definition of "product-specific" and that do not provide a rate of support: Step 2, cottonseed, storage payments and interest subsidies. The United States accounted for those subsidies by providing budgetary outlays in its upland cotton AMS calculation, but it does not provide any information on the decision taken with respect to those domestic support measures and the rate of support provided by them. In addition, the United States took specific administrative decisions on the deficiency payment rate for MY 1992 (20.3 cents per pound[53]), weekly Step 2 payment rates as well as weekly decision on the adjusted world price and, thus, the rate of marketing loan benefits. By taking these decisions, the United States decided on the payment rates that resulted from the "rate of support" and, therefore, on the amount of budgetary outlays it would use from its unlimited spending authority.

[50] Brazil notes that the United States nowhere provides any information concerning the type and conditions of payments that are covered by these terms.

[51] *See* paras. 63-67 *supra*.

[52] First Submission of Brazil, para. 141.

[53] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5).

71. Brazil further disagrees with the US assertion at paragraph 113 of its 11 August Answers that the programs decided by the United States required an unlimited budgetary authority in both MY 1992 and in later marketing years.[54] Even at prices of zero cents per pound, the amount of US expenditure for the deficiency payment and the marketing loan programme in MY 1992 was, in fact, limited by decisions restricting the participation in the programs to farmers that historically had grown upland cotton, who were eligible, and who decided to participate based on the eligibility criteria. By contrast, participation in the MY 2002 marketing loan programme, the crop insurance programme, and the Step 2 programme, for instance, is no longer limited and now has an unlimited budgetary authority coupled with mandatory payment provisions. In particular, the marketing loan programme is now unlimited whereas in MY 1992, eligibility to marketing loan benefits was restricted to upland cotton grown on acreage that was enrolled in the deficiency payment programme.

72. In sum, the United States not only "decided on whatever outlay was required to meet that rate of support", it also took various administrative decisions that implemented the rate of support and transposed it into specific payment rates that resulted in identifiable budgetary outlays. The United States took those decisions with respect to all of the programmes including crop insurance and Step 2, as well as with respect to storage payments and interest subsidies.[55] Thus, the collective effect of these multiple decisions was to decide on the amount of expenditures for MY 1992. The only way to express this multitude of decisions and conduct the required comparison with MY 1999-2002 is to use total monetary amounts of budgetary expenditures.

**(60) Can you provide information on the support decided in 1992 and the years with which you believe it should be compared, on a per support programme / per unit of production basis / per annum basis? If possible, please specify how, if at all, budget outlays may be transposed into units of production, and which units of production are best to use.**

**Brazil's Comment on US Answer:**

73. Brazil notes that the United States has not provided, as requested, any per support measure, per unit figures of support that it decided in 1992 and support it granted in other years. Nor did the United States provide any information whatsoever on how to account for Step 2 payments, cottonseed payments, storage payments and interest subsidies because there is no way such measures could be measured using the simplistic US rate of support only approach.

74. In addition, the United States does not respond to the Panel's request to transpose this rate of support into budgetary outlays per pound of production. Brazil refers the Panel to paragraphs 84-85 of its Rebuttal Submission, where it provides a new chart reflecting new information provided by the United States for various programmes.[56]

**(61) Does the United States consider that Article 13(b)(ii) permits a comparison on any other than a per pound basis?**

**Brazil's Comment on US Answer:**

75. The United States admits that Article 13(b)(ii), and in particular the term "decided", permit a comparison different from comparing a rate of support, *had the US domestic support measures been structured* (*i.e.* decided) *differently* than characterized by the United States.[57] This admission is significant, because, in fact, the US measures *were structured quite differently* from what the

[54] US 11 August Answer to Question 57, para. 113.
[55] US 11 August Answer to Question 67.
[56] US 11 August Answer to Question 67, para. 129-134.
[57] US 11 August Answer to Question 61, para. 118.

United States asserts. Professor Sumner[58] established that the US support programmes in MY 1992 did *not* provide a rate of support of 72.9 cents per pound to each pound of upland cotton produced in the United States. Numerous restrictions on the availability of the support by the deficiency payment programme and the marketing loan programme existed. In addition, participation in both programmes was costly to farmers, as farmers were mandated to set aside a certain percentage of acreage every year. USDA Chief Economist Keith J. Collins and USDA Deputy Chief Economist Joseph W. Glauber explain that

> [s]everal programme changes beginning with the 1985 Farm Act reduced the ability of deficiency payments to stabilize incomes by fixing programme payment yields, reducing the amount of acreage eligible for payments, and tightening payment limits. In addition, many producers elected not to participate in farm programs, making a large portion of production not covered by payments and a large portion of producers ineligible for them by the early 1990s.[59]

76. This statement confirms the existence of severe restrictions on the availability of deficiency payments and the cost of participating in the programmes. Were there no cost associated with the programme, no rational farmer would opt to not take the "free money", *i.e.*, nearly everybody would participate. These conscious decisions by USDA and other US Government agencies must, therefore, be reflected in the claimed rate of support provided by the various non-green box domestic support measures during MY 1992.

77. Brazil agrees with the European Communities that such a mélange of domestic support measures decided in MY 1992 must be accounted for "in monetary terms".[60] While the European Communities advocates using an AMS-like approach for the support decided in MY 1992,[61] Brazil considers that an expenditure approach more accurately reflects the text of Article 13(b)(ii), which does not refer to AMS or "product-specific". Brazil emphasizes that the domestic support measures that need to be included in this approach are all those domestic support measures that provide support to upland cotton.

78. Furthermore, the US "72.9 methodology" is inconsistent with the object and purpose of Article 13(b)(ii) and of the Agreement on Agriculture to correct and prevent restrictions and distortions in world agricultural markets.

79. Accepting the US interpretation that eligibility criteria and participation costs of a programme are irrelevant would enable Members like the United States to avoid the disciplines of the SCM Agreement on trade-distortive subsidies. For example, the United States in MY 1992 decided and applied restrictive support programmes that required costly land set aside programs, low payment yields, restricted payments to 85 per cent of eligible acres, tied benefits from the marketing loan programme to participation in the costly deficiency payment programs, and applied payment limitations, among others. The US interpretations would allow it in MY 2002 to lift all of these restrictions and maintain the rate of support without affecting its entitlement to peace clause exemption. The approach taken to its extreme would allow a Member that decided a rate of support of 72.9 cents per pound for 0.0001 per cent of its production in MY 1992, to provide a rate of support of 72.9 cents per pound to 100 per cent of its production in MY 2002 without affecting its entitlement to peace clause exemption. Every legitimate comparison must take account of economic realities of support regimes in MY 1992 and in later marketing years during the implementation period. And these realities show that the support increased massively.

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[58] Exhibit Bra-105 (Statement of Professor Daniel Sumner at the First Meeting of the Panel).

[59] Exhibit Bra-180 ("Will Policy Changes Usher in a New Era of Increased Agricultural Market Variability?," Keith J. Collins, Joseph W. Glauber, Choices, Second Quarter 1998, p. 28).

[60] EC Answer to Third Party Question 22, para. 47 and 49.

[61] EC Answer to Third Party Question 22, para. 49.

**(66) Could you please comment on the relative merits of each of the following calculation methods for purposes of the comparison of support to upland cotton with 1992, irrespective of whether a particular measure should be included or excluded:**

**(a) Total budgetary outlays (Brazil's approach)**

**(b) Budgetary outlays per unit of upland cotton: Could you please calculate and provide an estimate for the marketing years 1992 and 1999-2002, respectively, and draw the Panel's attention to any factors / qualifications that the Panel would need to be aware of.**

**Brazil's Comment on US Answers:**

80. Brazil comments jointly on both of the 11 August Answers provided by the United States. In essence, the United States rejects any approach based on budgetary outlays as *ex post* or retrospective and as does not reflecting its alleged single decision taken during MY 1992.[62] Based on the same argument, the United States also declines the Panel's request for information on how to calculate budgetary outlays per unit of upland cotton.[63] Therefore, Brazil refers the Panel to its own 11 August Answer to Question 60 and 66(b) for the only evidence in that respect as well as to Brazil's reservations concerning this approach.[64]

81. The United States maintains that because its support programmes depend on a price-gap, only a rate of support approach can reflect the US decision.[65] It further maintains, that any budgetary approach would automatically reflect also producers' planting and participation decisions and market prices, factors that the United States alleges, it could not have decided.[66] However, Brazil has demonstrated that the anticipated participation in the deficiency payment and marketing loan programme was an important aspect of the decision on the acreage reduction programme. Professor Sumner has indicated that, based on historical participation data and projections about other programme parameters, the United States in MY 1992 had a very good idea of the participation rate that would result from the setting of a 10-per cent acreage reduction rate under the deficiency payment programme.

82. Further, Brazil has demonstrated above that the range of programme decisions the United States has taken, including decisions on deficiency payment rates, adjusted world prices and Step 2 payment rates in connection with decisions on other programme parameters, impacted the amount of budgetary outlays. Thus, while the United States certainly did not decide on market prices, it took a number of decisions that translated these market prices into actual expenditures for MY 1992.

83. The European Communities and other third parties to this dispute agree with Brazil that the appropriate basis for a comparison of the support decided in MY 1992 with support granted in later marketing years during the implementation period is a approach based "on monetary terms".[67] Given the special situation of the EC with respect to the peace clause decision, it may be appropriate to use an *ex ante* AMS-like approach to its decision during MY 1992 compared to the actual AMS for later marketing years.[68] But even that decision would be expressed in "monetary terms".

[62] US 11 August Answer to Question 66, para. 119-120.
[63] US 11 August Answer to Question 66, para. 120.
[64] *See* Brazil's 11 August Answer to Question 60, para. 94-98 and Brazil's Answer to Question 66(b), para. 117-119.
[65] US 11 August Answer to Question 66, para. 119.
[66] US 11 August Answer to Question 66, para. 119.
[67] EC Answer to Third Party Question 22, para. 47.
[68] EC Answer to Third Party Question 22, para. 47-49.

84. Total expenditures for MY 1992 and total expenditures for marketing years during the implementation period are the only legitimate bases for the comparison required by Article 13(b)(ii) of the Agreement on Agriculture. All other calculation methods are either not supported by a *Vienna Convention* analysis of Article 13(b)(ii) (US rate of support approach; US rate of support approach as modified by Professor Sumner), or have major shortcomings that should lead them to be used them with extreme caution (budgetary outlays per unit). Brazil notes that its expenditure approach and the analogous AMS calculation yield identical results, if one were to account for deficiency payments in terms of expenditures rather than by using the formula approach offered by Annex 3, paragraph 10-11 of the Agreement on Agriculture.[69]

*(d) Per unit rate of support for upland cotton (Prof. Sumner's approach at the first session of the first substantive meeting).*

**Brazil's Preliminary Comment on US Answer:**

85. Brazil will further comment on any answer pursuant to the US promise to provide "a detailed critique of Mr. Sumner's analysis."[70] As for the 11 August US comments, Brazil has earlier in its 22 August Comments to Questions 66(a) and (b) argued that Professor Sumner properly accounted for all US decisions.[71] Concerning the inclusion of crop insurance subsidies, PFC and market loss assistance payments, as well as direct and counter-cyclical payments, Brazil has demonstrated in its Rebuttal Submission[72] and in comments to Questions 38 and 43 that these domestic support measures constitute support to upland cotton as well as product-specific support. Thus, there is no basis to exclude these payments from any US calculation of upland cotton AMS.

**(67) The Panel requests the parties to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002. For this purpose the parties are each requested to submit AMS calculations for upland cotton (using the budgetary-outlay/non-price gap methodology employed by the United States in respect of cotton in its DS Notifications (e.g., G/AG/N/USA/43) and using the formats and supporting tables in document G/AG/2) on the same basis as would be the case in calculating a product specific AMS for the purposes of the calculation of the "Total Current AMS" in any year in accordance with the relevant provisions, including as appropriate Article 1(a), (b) and (h), Article 6 and Annex 3 to the Agreement.**

**Brazil's Comment on US Answers:**

86. The United States' calculation of upland cotton AMS is incomplete because it does not account for the product-specific support provided to upland cotton from PFC and market loss assistance payment, direct and counter-cyclical payments and crop insurance subsidies. Brazil has discussed the nature of these programs as product-specific (and as constituting "support to upland cotton") and the incorrect US interpretation of "product-specific" elsewhere.[73] Brazil further notes that the United States has included in its calculation of upland cotton AMS storage payments and interest subsidies – product-specific support measures that the United States has not mentioned so far during this dispute.[74] Based on this and other new data supplied by the United States, Brazil provides an update of its AMS calculation and of its analysis of total budgetary outlays.[75]

[69] Brazil's 11 August Answer to Question 60, para. 97, and to Question 67, para. 130.
[70] US 11 August Answer to Question 66, para. 121.
[71] *See* para. 81-85 *supra*.
[72] Rebuttal Submission of Brazil, paras. 24-67.
[73] Rebuttal Submission of Brazil, para. 13-67.
[74] Brazil notes that it has asked the United States in consultations for information on any other domestic support measures the provides support to upland cotton and that the United States did not mention these

## III. EXPORT CREDIT GUARANTEES

**71 (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? Does it confer a benefit within the meaning of Article 1.1(b)? Why or why not? If so, to whom?**

**(b) How, if at all, would these elements be relevant to the claims of Brazil, and the United States response thereto?**

87. In responding to this Question, the United States relies solely on Article 10.2 of the Agreement on Agriculture and – alternatively – restricts the use of context from the SCM Agreement to item (j) only.[76] Brazil addresses the United States' arguments regarding Article 10.2 of the Agreement on Agriculture at paragraphs 99-100 of its Rebuttal Submission. In determining what constitutes an export subsidy within the meaning of Article 10.1 of the Agreement on Agriculture, Brazil considers that the Panel should refer to Articles 1(e) and 10.1 of the Agreement on Agriculture itself, as well as to contextual guidance included in Articles 1 and 3 of the SCM Agreement, and in item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement. This is consistent with the Appellate Body's decisions in *US – FSC*[77] and *Canada – Dairy*.[78]

**(73) The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The United States has yet to submit any evidence or argumentation on this point, either as potential context for interpretation of the terms in Article 10 of the Agreement on Agriculture or in relation to Brazil's claims under the SCM Agreement. The Panel would therefore appreciate United States views in respect of this situation, and invites the United States to submit relevant argumentation and evidence.**

**Brazil's Comment on US Answer:**

88. The United States argues that it does not need to address Articles 1 and 3 of the SCM Agreement because it "does not believe that Brazil has submitted evidence and argumentation that would establish a *prima facie* case in favour of Brazil's claims . . ."[79] Since the United States has surpassed its quantitative export quantity reduction commitment levels, Article 10.3 of the Agreement on Agriculture allocates the burden to the United States to prove that its excess exports did not benefit from export subsidies, including export credit guarantees.[80] Therefore, it is not Brazil, but the United States, that is faced with satisfying the elements of a *prima facie* case in favour of its defence.

**(74) If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 of the Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both?**

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programs during consultations. *See* Exhibit Bra-101 (Brazil's Questions for the Purposes of the Consultations, 22 November 2002, Questions 15.1-15.6).

[75] Rebuttal Submission of Brazil, paras. 73-74.

[76] US 11 August Answer to Question 71, para. 137-139.

[77] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 136-140.

[78] Appellate Body Report, *Canada – Dairy*, WT/DS103/AB/R and WT/DS113/AB/R, para. 87-90.

[79] US 11 August Answer to Question 73, para. 140.

[80] *See* First Submission of Brazil, paras. 263-268.

**Brazil's Comment on US Answer:**

89. In paragraph 141 of its 11 August Answer to Question 74 (and again in paragraphs 189 and 195 of its 11 August Answers to Questions 88(b) and (d), respectively), the United States asserts that "Brazil has not contested that challenged US export credit guarantee programs are within the scope of Article 10.2." The United States is incorrect. While it is possible that GSM 102, GSM 103 and SCGP export credit guarantees might be included in any international agreement that Members might some day reach in negotiations pursuant to Article 10.2 of the Agreement on Agriculture, no one knows at this stage what the scope of that agreement, if any, will be. The agreement might only cover export credits other than guarantees, like the OECD Arrangement on Guidelines for Officially Supported Export Credits, which does not cover export credit guarantees.

90. In any event, the relevant question is not whether export credit guarantees are "covered" by Article 10.2, but whether they are "exempted" by Article 10.2 from the general export subsidy disciplines of the Agreement on Agriculture. Brazil's position is that Article 10.2 does not exempt export credits like export credit guarantees from the general export subsidy disciplines of the Agreement on Agriculture, including Article 10.1 thereof. If those export credit guarantees constitute export subsidies, then they are subject to those disciplines. (In paragraph 142 of its 11 August Answer, the United States appears to concede this point, when it acknowledges that "[t]o determine the applicability of Article 10.1 to a particular measure not described in Article 9.1 first requires a determination whether a subsidy exists.")

**(75) (identical to Third Party Question 32)**

**The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see third party submission of Canada) and to the panel report in DS 222 Canada- Export Credits and Loan Guarantees. How and to what extent are Article 14(c) of the SCM Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material.**

**(Third Party Question 33)**

**What is the relevant (if any) of Brazil's statement that: " … export credit guarantees for exports of agricultural products [sic] are not available on the marketplace by commercial lenders."**

**Brazil's Comment on EC Answers on Third Party Question 32 (identical to Question 75) and 33 and on US Answer to Question 75:**

91. The United States argues that item (j) alone is relevant context for a determination whether CCC export credit guarantee programmes are export subsidies.[81] The European Communities argues that the fact that a particular financing instrument offered by a government (such as CCC guarantees) is not available on the marketplace does not mean that such financing confers a benefit *per se* within the meaning of Article 1.1(b) of the SCM Agreement.[82] The European Communities maintain that in circumstances in which a comparable type of financing is not available on the marketplace, an "alternative" benchmark such as item (j) has to be used for determining whether a benefit exists.[83] While Brazil agrees with the European Communities that item (j) is an *alternative* test for the existence of an export subsidy, Brazil strongly disagrees that Article 1.1 of the SCM Agreement is – as the European Communities effectively and the United States explicitly argues – inapplicable in

[81] US 11 August Answer to Question 75, para. 143.
[82] EC's Answers to Third Party Questions, para. 68.
[83] EC's Answer to Third Party 35, para. 67.

such situations. Article 1.1 defines the existence of a subsidy for the purposes of the SCM Agreement and provides relevant context for the interpretation of the term "export subsidy" under the Agreement on Agriculture. Article 1.1(b) requires a comparison between what the recipient of a financial contribution received from the government and what the recipient could have received on the marketplace.[84] The Appellate Body clarified that the standard under Article 1.1(b) is not the cost incurred by the government (as under item (j)).[85] The relevant standard is the "benefit to the recipient" standard.

92. This definition of a subsidy cannot simply be read out of the SCM Agreement in a situation where there is no comparable commercial financing available. Nothing suggests that Article 1.1(b) is inapplicable in such a situation. The United States and the European Communities would certainly agree that a direct transfer of funds without consideration is not commercially available. In these circumstances, a benefit within the meaning of Article 1.1(b) of the SCM Agreement is conferred. A similar situation exists with respect to CCC guarantees. A recipient of CCC guarantees cannot receive a similar financial contribution on commercial terms, as no such financing is available on the marketplace.[86] Thus, the CCC export credit guarantee programmes confer benefits. Brazil notes that the United States agreed, in its third party submission in *Canada – Aircraft II*, that where there is no comparable financial product on the market, a programme confers benefits *per se*.[87]

**(76) How does the United States respond to Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders."?**

**Brazil's Comment on US Answer:**

93. The United States asserts that export credit insurance may be a comparable commercial product to CCC export credit guarantees.[88] As noted in paragraph 103-104 of Brazil's Rebuttal Submission, the United States acknowledges that there are distinctions between insurance coverage and guarantees. Thus, the terms of insurance coverage by private, market-based financial institutions cannot serve as a benchmark against which to determine whether the CCC guarantee programmes confer "benefits," within the meaning of Article 1.1(b) of the SCM Agreement. As the United States has elsewhere noted, "[i]f the commercial market does not offer a particular borrower the *exact terms* offered by a government, then the government is providing a benefit to the recipient whenever those terms are more favourable than the terms that are available in the market."[89] Moreover, the United States has not provided actual terms for insurance coverage by private, market-based financial institutions. Brazil understands that private, market-based insurance coverage for agricultural products is not available for periods extending nearly as long as periods provided by CCC guarantees.

**(77) How does the United States interpretation of "long term operating costs and losses" in item (j) as claims paid give meaning to both "costs" and "losses"? Do claims paid represent "losses" or "costs" or both? If claims paid is represented by "losses", what would go into the "cost" element of item (j)? Could the United States expand on why it disagrees with the items which Brazil identifies for inclusion in the examination to be conducted under item (j)?**

[84] Appellate Body, *Canada – Aircraft*, WT/DS70/AB/R, para. 157.
[85] Appellate Body, *Canada – Aircraft*, WT/DS70/AB/R, para. 160.
[86] *See* also Rebuttal Submission of Brazil, paras. 103-105.
[87] Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2 (para. 7). *See* also Answers to Questions by Brazil, para. 151.
[88] US 11 August Answer to Question 76, para. 144.
[89] Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2 (para. 7).

**Brazil's Comment on US Answer:**

94. In paragraph 145 of its response, the United States suggests that claims and defaults must exceed "revenue from whatever source it may be derived" to meet the elements of item (j), despite the fact that item (j) limits the revenue to be used to offset operating costs and losses to "premium rates". On the other hand, the United States maintains that it is only legitimate to account for claims and defaults in the context of item (j), and not for other operating costs and losses such as interest on debt to Treasury[90], even though those sorts of other costs and losses are covered by the ordinary meaning of the terms included in item (j).[91] This is incongruous, and not supported by the text of item (j).

95. Further, Brazil refers the Panel to its Rebuttal Submission and to its 22 August Comments to the US Answers to Question 81 below for a more detailed discussion on the elements that are to be included in an item (j) analysis.

**(78) Can the United States provide supporting documentation for data used relating to "costs and losses" in paragraph 173? Could the United States confirm that the figures cited in paragraph 173 of its first written submission relate to the SCGP? Why did the United States cite these figures after stating that it is not possible to make any assessment of the long-term operating costs and losses of this programme?**

**Brazil's Comment on US Answer:**

96. The United States has failed to provide the supporting documentation requested by the Panel. The data mentioned in paragraph 149 of the United States' 11 August Answer could have been provided for review and analysis by the Panel and Brazil. As a result, Brazil requests that the Panel reject the United States' assertions in paragraph 173 of the US First Submission.

**(80) (identical to Third Party Question 35)**

**Did the drafters of the Agreement on Agriculture include export credit guarantees in Article 9.1 of the Agreement on Agriculture? Why of why not?**

**Brazil's Comment on EC Answer:**

97. Brazil agrees with the European Communities that "Article 9.1 represents a list of export subsidies … that are subject to reduction commitments."[92] Export credit guarantees are not included, as they do not constitute *per se* export subsidies subject to reduction commitments. Only if export credit guarantees confer a benefit within the meaning of Article 1.1(b) and/or Article 14(c) of the SCM Agreement, or if they are provided at premium rates that are inadequate to cover the long-term operating costs and losses of the export credit guarantee programme, do they constitute export subsidies to be assessed against the export subsidy reduction commitments of a Member. In these circumstances, export credit guarantees must not be provided in a manner inconsistent with Article 10.1 of the Agreement on Agriculture.

98. Because export credit guarantees are not – under a *Vienna Convention* interpretation of Article 10.2 of the Agreement on Agriculture – excluded from the general export subsidy disciplines in AoA Article 10.1, their provision counts towards the export subsidy reduction commitments of a Member. Article 10.2 states that after agreement on disciplines governing the provision of export credits is reached, these credits can only be provided in conformity therewith. Brazil does not want to speculate on whether the internationally-agreed disciplines will subject export credit guarantees to

[90] First Submission of the United States, para. 178.
[91] *See* Oral Statement of Brazil, para. 123.
[92] EC's Answers to Third Party Questions 35, para. 70.

reduction commitments. In any event, under the current regime governing the provision of export credit guarantees, they are subject to the anti-circumvention disciplines in Article 10.1 of the Agreement on Agriculture and count towards a Member's export subsidy reduction commitments, if they constitute export subsidies within the meaning of the Agreement on Agriculture (and, by context, the SCM Agreement).

**(81) How does the United States respond to the following in Brazil's oral statement**

**(a) paragraph 122 (rescheduled guarantees)**

**Brazil's Comment on US Answer:**

99. Although "rescheduled amounts are counted as *receivables*, not losses," that does not mean that rescheduled amounts are actually collected, or even expected to be collected. CCC's 2002 financial statements demonstrate that many of CCC receivables are classified as "uncollectible" – in fact, $3.34 billion of total receivables of $6.93 billion are classified as "uncollectible."[93] Moreover, as noted in Brazil's 11 August Comment on Question 77 (at paragraph 162), the US General Accounting Office has stated that historically, the majority of GSM support that is rescheduled is "in arrears".[94] Based on this evidence, it is simply not accurate for the United States to argue, in paragraph 155 of its 11 August Answer, that "[t]he history of rescheduled Commodity Credit Corporation (CCC) export credit guarantee claims over the long-term (the 10-year period 1993-2002) confirms" that "the United States does in fact collect on the rescheduling."

100. Brazil also notes that the United States has not provided any documentary evidence that would support its assertion.

**(c) paragraphs 125 ff. (guaranteed loan subsidy)**

**Brazil's Comment on US Answer:**

101. In paragraphs 108-110 of its Rebuttal Submission, Brazil summarizes the several bases on which the Panel can rest a finding that the GSM 102, GSM 103 and SCGP programmes constitute export subsidies under item (j). The United States criticizes one of those bases – the FCRA cost formula – as inappropriate because it allegedly relies on "estimated" rather than "actual" data about the costs of the programmes.[95] This appears to be the United States' sole defence, which Brazil again notes applies only to the FCRA cost formula and not the other evidence and bases summarized by Brazil in paragraphs 108-110 of its Rebuttal Submission. In any event, Brazil rebuts the US arguments concerning "estimated" versus "actual" data in paragraphs 111-119 of its Rebuttal Submission, and asks the Panel to refer to Brazil's arguments therein.

[93] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14).

[94] Exhibit Bra-152 (GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National Security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, *Status Report on GAO's Reviews of the Targeted Export Assistance Programme, the Export Enhancement Programem, and the GSM-102/103 Export Credit Guarantee Programmes*, GAO/T-NSIAD-90-53, 28 June 1990, p. 14). *See also* Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 (demonstrating that most of the rescheduled Russian and Former Soviet Union GSM claims have been in arrears)).

[95] *See* US 11 August Answers to Questions, paras. 157-161, 162-163, 169-172, 173.

102. Brazil notes that the United States has offered no documentation and data to support the figures included in paragraph 160 of its 11 August Answer. The Panel should not accept these unsupported assertions by the United States.

103. At paragraphs 122-123 of its 11 August Answer to Question 81(c), the United States asserts that "[a] cohort consists of all transactions associated with each type of guarantee issued during a particular year", and that "[n]ot until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government". Brazil notes that a "cohort" is not necessarily composed of *all* guarantees issued in a particular year. As the US Office of Management and Budget notes, cohorts may also be divided according to risk categories, with annual reestimates calculated according to those risk category-based cohorts.[96] The United States in fact acknowledges at paragraph 148 of its 11 August Answer to Question 86 that "[a]ll countries eligible for any of the CCC export credit guarantee programmes are categorized according to risk".

**(d) paragraphs 127-129 (re-estimates, etc.)**

**Brazil's Comment on US Answer:**

104. In paragraph 163 of its 11 August Answer, the United States asserts that the "net total for all cohorts for guarantees issued since 1992 currently stands at a downward re-estimate of $1.9 billion", suggesting that by the time a cohort is closed and final data becomes available, the cohort becomes profitable. Although the United States offers no citation, the $1.9 billion lifetime reestimate figure appears to be taken from the Federal Credit Supplement attached to the 2004 US budget. As discussed further in paragraphs 115-117 of Brazil's Rebuttal Submission, however, the United States fails to note that when these total lifetime reestimates for all cohorts of guarantees disbursed since 1992 are netted against the total *original* subsidy estimates adopted each budget year during the period 1992-2002, *the resulting loss is nearly $1.75 billion.*

**(b) paragraph 123 (interest on debt to Treasury)**

**Brazil's Comment on US Answer:**

105. The United States' 11 August Answer addresses interest rate reestimates under the FCRA cost formula. Paragraph 123 of Brazil's Statement at the First Panel Meeting, however, to which the Panel's question refers, does not address the treatment of interest paid by the CCC to the Treasury Department under the FCRA cost formula. Rather, in paragraph 123 of its Oral Statement at the First Meeting of the Panel, Brazil was responding to the US assertion that *Brazil's constructed formula* for determining whether the CCC guarantee programmes' operating costs and losses outpaced premiums collected should not have included interest paid by the CCC to the Treasury Department. In paragraph 123 of its Oral Statement, Brazil argued that under the ordinary meaning of the term "operating costs", interest paid by the CCC to the Treasury Department should be included in an assessment of the programmes under item (j). Brazil's arguments have nothing to do with interest rate reestimates under the FCRA cost formula. The United States' answer is, therefore, only relevant in so far as the United States now seems to acknowledge that, for the purposes of Brazil's revised constructed formula, interest payments to Treasury are properly included.[97]

[96] Exhibit Bra-116 (OMB Circular A-11, p. 185-16 – 185-17).
[97] US 11 August Answer to Question 81(b), para. 167.

**(e) Exhibits BRA-125-127**

**Brazil's Comment on US Answer:**

106. The United States' 11 August Answer is incorrect. Reestimates are recorded in the "programme account" segment of the CCC guarantee programme budget, in line item 00.07 (interest on reestimates is recorded in line 00.08).[98] Furthermore, Brazil has consistently also included the financing account in its exhibits, including – contrary to the US allegation[99] – in Exhibit Bra-127.

**(f) the chart on page 53 of Brazil's oral statement at the first session of the first Panel meeting relating to "Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM-102 GSM 103 and SCGP"?**

**Brazil's Comment on US Answer:**

107. Brazil refers the Panel to paragraphs 111-119 of Brazil's Rebuttal Submission for discussion of the US arguments concerning "estimated" versus "actual" data.

**(g) In respect of (a)-(f) above, how and to what extent do the information and data presented for the export guarantee programmes concerning "programme" and "financing", "summary of loan levels", "subsidy budget authority", "outlay levels", etc., in particular in Exhibits BRA-125-127, reflect "actual costs and losses" of the GSM-102, GSM-102 and SCGP export credit guarantee programmes(see e.g. Brazil's closing oral statement at the first session of the first substantive meeting, paragraph 24)?**

**Brazil's Comment on US Answer:**

108. Brazil refers the Panel to paragraphs 111-119 of Brazil's Rebuttal Submission for discussion of the US arguments concerning "estimated" versus "actual" data.

**(84) Is the Panel correct in understanding that, under the GSM-102 and GSM-103 programmes, the exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates?**

**Brazil's Comment on US Answer:**

109. As noted in Brazil's 11 August Comment on Question 84 (at paragraphs 192-194), GSM 102 and GSM 103 fees are charged according to a fee schedule that does not account for the country risk involved or the credit rating of the borrower. The US Department of Agriculture's Office of the Inspector General noted in June 2001 that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs".[100] It repeated this statement in February 2002.[101]

[98] *See* Exhibits Bra-88 to Bra-95 (US budgets for the years 1996-2003); Exhibits Bra-125 to Bra-127 (US budgets for the years 1994, 1995 and 2004). *See also* Exhibit Bra-184 (US budget for fiscal year 1993); Exhibit Bra-183 (US budget for fiscal year 1992).

[99] US 11 August Answer to Question 81(e), para. 168.

[100] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31).

110. Moreover, the US General Accounting Office ("GAO") analyzed CCC's failure to charge guarantee fees that take account of country risk or the creditworthiness of individual borrowers. Brazil quotes at length from the GAO study, since it provides further corroborating evidence that beneficiaries of CCC guarantees receive terms better than available on the market, and that CCC guarantee fees do not cover the costs of the CCC guarantee programmes:

> Although GSM-102 recipient countries vary significantly from one another in terms of their risk of defaulting on GSM-102 loans, CCC does not adjust the fee that it charges for credit guarantees to take account of country risk. CCC fees are based upon the length of the credit period and the number of principal payments to be made. For example, for a 3-year GSM-102 loan with semiannual principal payments, CCC charges a fee of 55.6 cents per $100, or 0.56 per cent of the covered amount. For 3-year loans with annual principal payments, the fee is 66.3 cents per $100.[ ] CCC fees that included a risk-based component might not cover all of the country risk, but they could help to offset the cost of loan defaults.
>
> USDA officials told us that including a fee for country risk could reduce the competitiveness of GSM-102 exports. However, they said they did not have recent or current data to support their claim.
>
> The US Export-Import Bank, which provides credit guarantees to promote a variety of US exports, uses risk-based fees to defray the cost of defaults on its portfolio. Under its system, each borrower/guarantor is rated in one of eight country risk categories. Exposure fees vary based on both the level of assessed risk and the length of time provided for repayment. For example, in the case of repayment over 3 years, a country rated in the lowest risk category is charged a fee of 75 cents per $100, whereas a country in the highest risk category is charged a fee of $5.70 per $100 of coverage. Thus, the bank's fee structure includes a substantial added charge for high country risk. According to the bank, its system is designed to remain as competitive as possible with fees charged by official export credit agencies of other countries.
>
> Under section 211(b)(1)(b) of the 1990 Farm Bill, CCC is currently restricted from charging an origination fee for any GSM-102 credit guarantee in excess of an amount equal to 1 per cent of the amount of credit extended under the transaction.[102] This restriction was initially enacted in 1985 following proposed administration legislation to charge a 5-per cent user fee for exports backed with credit guarantees. Some Members of Congress were concerned that such a fee would adversely affect the competitiveness of GSM-102 exports. Under the 1-per cent restriction, CCC would be considerably limited in the size of the fee that it could charge to take account of country risk should it decide to do so. For example, as previously noted, CCC charges 0.56 per cent for a loan payable in 3 years and with principal payments due annually. The most it could increase the fee would be 0.44 per cent. In contrast, the Export-Import Bank currently charges fees as high as 5.7 per cent for 3-year loans.[103]

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[101] Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programs have not been changed for many years and may not be reflecting current costs.").

[102] The United States confirmed in paragraphs 179-180 of its 11 August Answer that this remains the case.

[103] Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 135-136). Although government support from the Export-Import Bank does not constitute a market benchmark for the purposes of

111. Brazil notes that CCC fees for GSM 102 have not changed materially since the GAO published its report in 1995.[104] Moreover, the United States confirmed in its 11 August Answer to Question 84 (at paragraph 180) that US law prohibits CCC from charging fees in excess of one per cent of the guaranteed dollar value of the transaction.

**(85) Is the Panel correct in understanding that, under the SCGP, the exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? Please explain any "risk" assessment involved in the programme**.

**Brazil's Comment on US Answer:**

112. As noted in Brazil's 11 August Comment on Question 85 (at paragraph 195), SCGP fees do not vary according to the country risk involved or the credit rating of the borrower. With or without the "risk sharing" described in paragraph 183 of the United States' 11 August Answer, Brazil notes the United States' acknowledgement that "CCC does not determine the creditworthiness of importers participating in the SCGP."[105] This presents further corroborating evidence that beneficiaries of CCC guarantees receive terms better than available on the market, and that CCC guarantee fees do not cover the costs of the CCC guarantee programmes.

**(86) Is there a risk categorization in relation to three export credit guarantee programmes (GSM-102, GSM-103 and SCGP)? Does this have any impact on premiums payable and the ability of the CCC to on-sell the guarantees ?**

**Brazil's Comment on US Answer:**

113. Brazil notes the United States' acknowledgement that "[a] country's risk classification has no impact on the premiums payable under the US export credit guarantee programmes". CCC's failure to account for country risk provides further corroborating evidence that beneficiaries of CCC guarantees receive terms better than available on the market, and that CCC guarantee fees do not cover the costs of the CCC guarantee programmes.

**(87) What proportion of CCC (export-related and total) long term operating costs and losses are represented by GSM-102, GSM-103 and SCGP programmes?**

**Brazil's Comment on US Answer:**

114. The United States asserts that funding for the CCC export guarantee programs is provided from the US Treasury, and is not "financed out of" the CCC. This suggests that the CCC export guarantee programs are not self-sustaining. This suggests in turn that the CCC export guarantee programmes meet the elements of item (j) and, thus, constitute export subsidies.

**(88a) Is the Panel correct in understanding that the United States' argument is that, at present, by virtue of Article 10.2 of the Agreement on Agriculture, there are no disciplines on agricultural export credit guarantees under the Agreement on Agriculture (or the SCM Agreement)?**

---

Article 1.1(b) of the SCM Agreement, Brazil offers this example to demonstrate that the CCC guarantee programs do not even meet *non-market* benchmarks.

[104] Brazil's 11 August Answer to Question 77 and 84, para. 167, 193-194.

[105] US 11 August Answer to Question 85, para. 138.

**Brazil's Comment on US Answer:**

115. The United States incorrectly argues, in paragraph 187 of its 11 August Answer, that "[i]f export credit guarantee programmes were already subject to export subsidy disciplines, then Article 10.2 would be unnecessary." The negotiators may have considered it useful to negotiate additional disciplines for export credit guarantees one day, but that does not mean that they intended for export credits to be exempted from the general disciplines of the Agreement on Agriculture while those negotiations were pending.

116. The United States also argues in paragraph 187 that Brazil's use of the term "specific" disciplines somehow defeats Brazil's interpretation of Article 10.2. Brazil uses the term "specific" disciplines merely as a way of distinguishing between one actual and one potential category of export subsidy disciplines under the Agreement on Agriculture: (i) those "general" disciplines that apply to export credit guarantees today; and (ii) those "specific" disciplines that would additionally apply to export credits upon the completion of the negotiations called for by Article 10.2.

> **(b) Does the United States agree with the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the Agreement on Agriculture? Please cite any relevant material, including any past WTO dispute settlement cases. How would this reconcile with the United States' own statement, at paragraph 21 of its closing oral statement that "of course, the United States may not provide subsidies without any limit".**

**Brazil's Comment on US Answer:**

117. Please see Brazil's 22 August Comment on the United States' 11 August Answer to Question 74 for observations on the United States' assertion, in paragraph 189, that "Brazil has not contested that US export credit guarantee programmes are encompassed by the terms of Article 10.2."

118. The United States argues that an interpretation of Article 10.2 of the Agreement on Agriculture that exempts export credits from the general export subsidy disciplines of that agreement is consistent with the title of Article 10 – "Prevention of Circumvention of Export Subsidy Commitments."[106] The United States' argument is absurd. Since negotiations on specific disciplines pursuant to Article 10.2 have not been concluded, the United States' interpretation of Article 10.2 would leave export credit support completely undisciplined, and open to the abuse outlined in the text of the Panel's question. In this way, the United States' interpretation of Article 10.2 *facilitates*, rather than *prevents*, circumvention of its export subsidy commitments.

119. The United States also argues that the portion of Article 10.2 calling for Members to work toward the negotiation of specific disciplines on export credits also contributes to the prevention of circumvention. As the ordinary meaning of the first portion of Article 10.2 demonstrates, however[107], Members are not even required to actually negotiate specific disciplines for export credits, let alone to reach actual agreement on those specific disciplines. All Members have agreed to do is to work toward the development of those specific disciplines, which does not in itself prevent circumvention.

> **(c) If, as the United States argues, there are no disciplines on export credit guarantees in the Agreement on Agriculture, how could export credit guarantees**

[106] US 11 August Answer to Question 88(b), para. 190.
[107] *See* Oral Statement of Brazil, para. 102.

**"conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity when there are allegedly no disciplines against which such an assessment could occur)?**

**Brazil's Comment on US Answer:**

120. The United States argues that since export credit guarantees are not subject to export subsidy disciplines in the Agreement on Agriculture, they "cannot be out of compliance with Part V" of the that agreement. The pertinent question is whether export credit guarantees can, under the terms of Article 13(c), "conform fully to the provisions of Part V" of the Agreement on Agriculture. In this regard, the United States ignores the conclusions of the panel in *Canada – Aircraft (21.5)*.[108] As noted in Brazil's 11 August Comment on Question 88(c) (paragraphs 200-202), if the United States is correct that CCC export credit guarantees are not subject to the disciplines in Part V of the Agreement on Agriculture, then CCC guarantees cannot logically "conform fully to the provisions of Part V" and trigger the exemption from action provided for in Article 13(c).

121. Alternatively, the United States suggests that Article 13(c) does not apply to export credit guarantees because "export credit guarantees are not export subsidies within the meaning of either Article 9.1 or 10.1" of the Agreement on Agriculture. This assertion is not supported by the United States with any reference to the tools of interpretation included in the *Vienna Convention*, and is fundamentally incorrect. Brazil has demonstrated that the GSM 102, GSM 103 and SCGP export credit guarantee programs administered by the CCC constitute export subsidies within the meaning of Articles 10.1, 1(e) and 8 of the Agriculture Agreement, Article 3.1(a) of the SCM Agreement, and item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement.[109]

**(d) Is the United States advocating the view that its own export credit guarantee programmes, which pre-dated the Uruguay Round, are effectively "grandfathered" so as to benefit from some sort of exemption from the export subsidy disciplines of the Agreement on Agriculture? How, if at all, is it relevant that the SCGP did not, according to the United States, become relevant for upland cotton until the late 1990's (i.e. after the entry into force of the WTO Agreement)?**

**Brazil's Comment on US Answer:**

122. Please see Brazil's comment on the United States' 11 August Answer to Question 74 for observations on the US assertion in paragraph 189 that "Brazil has not contested that SCGP provides export credit guarantees within the meaning of Article 10.2."

## IV. STEP 2 PAYMENTS

**(92) Does the United States confirm that Exhibit Bra.65 represents a sample contract for exporters of eligible upland cotton to conclude with the CCC under the FSRI 2002, and that an application form (Exhibit Bra-66) needs to be filled out with data on weekly exports and submitted to the USDA FAS. Is Exhibit Bra-66- Form CCC 1045-2 also a valid example? If not, please identify any differences or distinctions.**

**(96) Is a domestic sale a "use" for the purposes of Step 2 payments? Is a sale for export, or export, considered a "use"?**

[108] Panel Report, *Canada – Aircraft (21.5)*, WT/DS70/RW, para. 5.143-5.145.

[109] First Submission of Brazil, para. 271-294; Oral Statement of Brazil, para. 116-133; Brazil's 11 August Answers to Quetions, para. 139-168, 175-189 and 192-199.

**Brazil's Comments to the US Answers:**

123. Brazil notes that the Step 2 regulations make a clear distinction between "domestic *users*" and "exporters".[110] "Domestic *users*" may only receive payment upon "proof of purchase and *consumption of eligible cotton by the domestic user*. . .".[111] The agreement for domestic users provides that a domestic user is a person regularly engaged in manufacturing eligible upland cotton into cotton products in the United States and that "in the event that the cotton is not used for that purpose, the payment received shall be returned immediately and with interest".[112] There is no requirement that "exporters" prove, prior to receiving payment, that exported US upland cotton be "used" for anything upon export. Rather, the payment is a function of "proof of export of eligible cotton by the exporter".[113] Thus, the structure of the Step 2 programme clearly differentiates between "export" and "use". Article 3.1(b) applies the phrase "contingent upon *use*." Article 3.1(a) uses the phrase "contingent . . . upon export performance".

124. In relation to Exhibit US-21, Brazil agrees with the United States that the two different forms that have to be annexed to the User/Exporter Agreement have different objectives depending on the final destination of upland cotton. That is, if the upland cotton is *used* domestically, then the CCC-1045UP-1 form has to be completed and annexed to the User/Exporter Agreement. If the cotton is exported, then the CCC-1045UP-2 form has to be used. However, contrary to the US statement at paragraph 201 of its 11 August Answer to Question 92, the latter makes no reference whatsoever to an "Exporter User." Indeed, the term "exporter user" is not contained either in the Step 2 regulations nor in the form that has to be annexed to the User/Exporter Agreement if the upland cotton will be exported. This is consistent with the fact that an exporter is not a "user" under the Step 2 programme and the act of exporting is unlikely a final "use" of upland cotton. In sum, Step 2 export payments are not made contingent upon "use," but contingent upon "*export*".

**(93) Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment?**

**(99) How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's Oral Statement at the first session of the first panel meeting concerning the relevance of the Appellate body Report in US- FSC(21.5)**

**Brazil's Comment on US Answers:**

125. The United States in its 11 August Answer to Question 93 states at paragraph 202 that "all upland cotton produced in the United States is eligible for the benefit of the Step 2 cotton subsidy".[114] Furthermore, it submits that "when the entirety of production of a good in a country is eligible to receive a subsidy, no contingency on export exists".[115]

126. Brazil provides a detailed comment to these assertions in its Rebuttal Submission.[116] In fact, Step 2 payments are not made to every pound of upland cotton that is "used". Rather, Step 2 payments are made on every pound of upland cotton that is *exported by <u>eligible</u> <u>exporters</u>* or that is

[110] Exhibit Bra-37 (7 CFR 1427.104)
[111] Exhibit Bra-37 (7 CFR 1427.108(d)).
[112] Exhibit US-21 (Upland Cotton Domestic User / Exporter Agreement, Section, Section B1)
[113] Exhibit Bra-37 (7 CFR 1427.108(d))
[114] US 11 August Answer to Question 93, para. 202.
[115] US 11 August Answer to Question 93, para. 202.
[116] *See* Rebuttal Submission of Brazil, paras. 129-130.

*used by eligible domestic users*. No Step 2 payment is made for upland cotton exported or used by ineligible persons, or for upland cotton that is neither used domestically nor exported, but that is for instance stored, stolen or incidentally destroyed by for example fire.

127. Furthermore, the criterion whether Step 2 payments are available to all upland cotton produced in the United States is entirely irrelevant for Brazil's claims under Article 3 of the SCM Agreement. That provision prohibits the payment of subsidies that are contingent upon export or contingent upon the use of domestic over imported goods. It follows that a subsidy is prohibited if its payment is conditional on the existence of one of the two situations: export or use of local content.

**(107) At paragraph 135 of its first written submission, the United States states: "The subsidy is not contingent upon export performance…"(emphasis added). Again, in the course of the first Panel meeting, the United States admitted that the Step 2 payments were "subsidies". Does the United States thus concede that Step2 payments constitute a "subsidy" within the meaning of the WTO Agreement?**

**Brazil's Comment on US Answer:**

128. The arguments provided by the United States are not responsive to the question posed by the Panel. Brazil reiterates that Exhibit Bra-69 is not relevant for its *de jure* claims. Whenever a Step 2 payment for exported or domestically used upland cotton takes place, the payment is made inconsistently with Articles 3.1(a) or 3.1(b) of the SCM Agreement and with Articles 3.3 and 8 of the Agreement of Agriculture in the case of Step 2 export payments. Step 2 export payments are contingent upon export performance and Step 2 domestic payments are contingent upon use of domestic over imported upland cotton. Neither the respective share of Step 2 export and domestic payments nor the share of eligible US upland cotton production materially affects this conclusion.

**(111) Does the United States maintain its argument that actions based on Article 3.1(b) of the SCM Agreement are conditionally « exempt from actions » due to the operation of Article 13 of the Agreement on Agriculture?**

**(112) In the event that the Panel finds that Article 6.3 of the Agreement on Agriculture does not preclude an examination of Brazil's claims under Article 3.1 of the SCM Agreement and Article III:4 of GATT 1994, how does the United States respond to the merits of Brazil's claims relating to Step 2 payments under those provisions?**

**(113) Is it necessary for measures directed at agricultural processors included in AMS to discriminate on the basis of the origin of goods?**

**(115) What is the meaning and relevance (if any) to Brazil's claims under Article 3 of the SCM Agreement and Article III:4 of GATT 1994 of the phrase "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products" in the Agreement on Agriculture?**

**(116) With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the Agreement on Agriculture? Does the phrase "provide support in favour of domestic producers" in Article 3.2 of the Agreement on Agriculture refer to, and/or permit such subsidies?**

**Brazil's Comment to the US Answers:**

129. Brazil addresses the US 11 August Answers to the questions listed above in its Rebuttal Submission at paragraphs 131-144. Brazil further refers the Panel to paragraphs 78-86 of its Oral Statement and to its 11 August Answers to Questions 100-102 and 115-116.

# ANNEX I-4

Please refer to Section V. of Annex D-4.

# ANNEX I-5

## ANSWERS OF BRAZIL TO QUESTIONS POSED BY THE PANEL FOLLOWING THE RESUMED FIRST SUBSTANTIVE MEETING OF THE PANEL

27 October 2003

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| *EEC – Wheat Flour* | GATT Panel Report, *European Economic Community – Subsidies on Export of Wheat Flour,* SCM/42, circulated 21 March 1983. |
| *EC - Hormones* | Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones),* WT/DS26/AB/R, adopted 13 February 1998. |
| *EC- Bananas* | Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas,* WT/DS27/AB/R, adopted 25 September 1997. |
| *Argentina – Textiles and Apparel* | Panel Report, *Argentina – Measures affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/R, adopted 22 April 1998. |
| *Canada - Aircraft* | Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft,* WT/DS70/AB/R, adopted 20 August 1999. |
| *India – Quantitative Restrictions* | Panel Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WT/DS90/R, adopted 22 September 1999. |
| *Korea – Dairy Safeguards* | Appellate Body Report, *Korea* – Definitive Safeguard Measure on Imports of Certain Dairy Products, WT/DS98/AB/R, adopted 12 January 2000. |
| *US - FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
| *US – FSC (21.5)* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation."* Recourse to Article 21.5 of the DSU by the European Communities. WT/DS108/AB/R, adopted 29 January 2002. |
| *Argentina – Footwear Safeguards* | Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear,* WT/DS121/AB/R, adopted 12 January 2000. |
| *US – Section 301* | Panel Report, *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, adopted 27 January 2000. |
| *EC - Sardines* | Appellate Body Report, *European Communities – Trade Descriptions of Sardines*, WT/DS231/AB/R, adopted 23 October 2002. |

## List of Exhibits

| | |
|---|---|
| "Production and Trade Policies Affecting the Cotton Industry," ICAC, September 2003 | Exhibit Bra- 284 |
| "Agriculture Fact Book 2001-2002," Chapter 3 – American Farms. | Exhibit Bra- 285 |
| Direct and Counter-Cyclical Programme Contract, Form CCC-509, USDA, Commodity Credit Corporation | Exhibit Bra- 286 |
| Market Revenue and US Government Payments to US Upland Cotton Producers. | Exhibit Bra- 287 |
| "NASS to Update Acreage If Necessary," National Agricultural Statistics Service, USDA, 29 September 2003. | Exhibit Bra- 288 |
| 7 CFR 1412.606; 7 CFR 718.102, 2003 Edition | Exhibit Bra- 289 |
| "Farmers Must File Acreage to Receive 2002 Payments," Kansan Online Ag Briefs; AFBIS Inc. Crop Watch, June 2003 | Exhibit Bra- 290 |
| "Direct and Counter-Cyclical Payment Programme", Farm Service Agency, USDA, April 2003. | Exhibit Bra- 291 |
| 7 CFR 718.102, 2002 Edition | Exhibit Bra- 292 |
| Data for Acreage Chart | Exhibit Bra- 293 |
| "The World Fact Book – Benin," CIA. | Exhibit Bra- 294 |
| 2004 US Budget, Federal Credit Supplement, Introduction and Table 2 | Exhibit Bra- 295 |
| "USDA Announces $2.8 Billion in Export Credit Guarantees," FAS Press Release, 30 September 2003 | Exhibit Bra- 296 |
| 7 U.S.C § 5641(b)(1); 7 U.S.C. § 5622(a), (b) | Exhibit Bra- 297 |
| "USDA Amends Commodity Eligibility under Credit Guarantee Programmes", FAS Press Release, 24 September 2002. | Exhibit Bra- 298 |
| "Summary of FY 2003 Export Credit Guarantee Programme Activity", USDA, Covering GSM-102, GSM 103 and SCGP | Exhibit Bra- 299 |
| Calculation on US Rice Exports Benefiting from GSM-102, GSM-103 and SCGP. | Exhibit Bra- 300 |
| Additional Results from Professor Sumner's Model. | Exhibit Bra- 301 |
| Revised and Extended Data on Article 6.3(d) Claim. | Exhibit Bra- 302 |

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|---|---|
| John C. Beghin and Holger Matthey. "Modelling World Peanut Product Markets: A Tool for Agricultural Trade Policy Analysis". Center for Agricultural and Rural Development (CARD), May 2003. | Exhibit Bra- 303 |
| John C. Beghin, Barbara El Osta, Jay R. Cherlow, and Samarendu Mohanty. "The Cost of the US Sugar Programme Revisited", Centre for Agricultural and Rural Development (CARD), March 2001. | Exhibit Bra- 304 |
| Larry Salathe, J. Michael Price and David Banker. "An Analysis of the Farmer Owned Reserve Programme 1977-82. American Journal of Agricultural Economics, February 1984. | Exhibit Bra- 305 |
| "Supply Response under the 1996 Farm Act and Implications for the US Field Crops Sector," Lin et al., USDA, July 2000. | Exhibit Bra- 306 |
| Change in US and World Exports in Per cent. | Exhibit Bra- 307 |
| "Decoupled Payments: Household Income Transfers in Contemporary US Agriculture," ERS, Agriculture Economic Report N° 822. | Exhibit Bra- 308 |
| Barnard C., Nehring, R., Ryan, J., Collender, R. "Higher Cropland Values from Farm Programme Payments: Who Gains?" Economic Research Service. USDA, Agricultural Outlook November 2001. | Exhibit Bra- 309 |
| "The Incidence of Government Payments on Agricultural Land Rents: The Challenges of Identification," Roberts, Kirwan and Hopkins, August 2003, American Journal of Agricultural Economics. | Exhibit Bra- 310 |
| Side by Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average US Spot Market Price and Prices Received by US Producers from January 1996 to the present. | Exhibit Bra- 311 |
| Cotton Outlook Reports dated 7 June 2002, 27 September 2002 and 4 October 2002. | Exhibit Bra- 312 |

A. REQUEST FOR PRELIMINARY RULINGS

**122. Does Brazil allege that cottonseed payments, interest subsidies and storage payments are included in the subsidies that cause serious prejudice? Do they appear in the economic calculations? BRA**

Brazil's Answer:

1. Cottonseed payments, interest subsidies and storage payments are included in the set of subsidies that Brazil alleges cause serious prejudice to its interests within the meaning of Articles 5(c) and 6.3 of the SCM Agreement and Article XVI of GATT 1994. The amounts of cottonseed payments and interest subsidies/storage payments range from $50 million to $216 million per year.[1] To appreciate the size of these subsidies, the annual amount of each of them separately far exceeds the total amount of Brazilian assistance to its upland cotton farmers of $10 million in MY 2001 by a factor of 4 to 21.[2] Indeed, the annual, individual amount of US cottonseed payments, interest subsidies and storage payments also by far exceeds the amounts of subsidies paid by most other cotton-producing countries.

2. The United States has notified cottonseed payments as trade-distorting amber box subsidies to the WTO.[3] Thus, these payments are presumed to be trade-distortive. Interest subsidies and storage payments appear to be part of the operation of the marketing loan programme that has also been notified to the WTO as a trade-distortive amber box subsidy, and is therefore presumed to be trade-distortive. The United States has not notified them separately to the WTO.[4]

3. The economic calculations provided by Brazil on the effect of US subsidies in filling the cost revenue gap include cottonseed payments and interest subsidies/storage payments.[5] They are also included as part of the overall level of US subsidization provided. However, they are not part of the econometric model developed by Professor Daniel Sumner.[6]

**123. Does Brazil's request for the establishment of the Panel name the statute authorizing cottonseed payments for the 1999 crop? BRA**

Brazil's Answer:

4. To the extent that cottonseed payments for the MY 1999 crop were authorized by Section 204(e) of the Agricultural Risk Protection Act of 2000, Brazil's request for the establishment of the Panel names the statute authorizing these payments.[7] This act authorized the payment of $100 million in cottonseed payments. However, Brazil did not explicitly identify in its request for establishment P.L. 106-113, which serves as the legal basis for a further $79 million in cottonseed payments for the MY 1999 cottonseed payments.

[1] Brazil's 9 September Further Submission, Table 1, p. 4.

[2] Exhibit Bra-284 ("Production and Trade Policies Affecting the Cotton Industry," ICAC, September 2003, p. 6).

[3] Exhibit Bra-47 (G/AG/N/USA/43, p. 20).

[4] Exhibit Bra-47 (G/AG/N/USA/43, p. 20).

[5] Brazil's 22 August Rebuttal Submission, para. 30 and 40.

[6] To the extent that interest subsidies and storage payments operate to compensate for any cost incurred by US upland cotton producers from the participation in the marketing loan program (for instance, for the storage cost resulting from storing physical upland cotton as collateral for the marketing loan), these subsidies have been considered in Professor Sumner's model. However, those costs do not occur, if a producer decides to opt for a loan deficiency payment rather then taking out a marketing loan.

[7] WT/DS267/7, p. 2.

5. Brazil emphasizes that it is not challenging the underlying statutes authorizing the payment of cottonseed payments in MY 1999, 2000 and 2002, *i.e.*, Brazil does not challenge those payments *per se*. Brazil challenges as "measures" the payments of those subsidies as causing adverse effects to its interests. The United States and Brazil have consulted about those payments.[8] Brazil properly included reference to all "payments" for upland cotton in its request for the establishment of the Panel.[9] This is sufficient to properly identify cottonseed payments as measures for the purposes of Brazil's request for the establishment of the Panel.

B. EXEMPTION FROM ACTIONS

**6. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*? BRA, US**

Brazil's Answer:

6. No. Brazil's claims relate to prohibited and actionable subsidies provided during MY 1999-2002 when the United States had no peace clause protection. Brazil's threat of serious prejudice claims relate to the present threat of serious prejudice caused by subsidies provided during MY 1999-2002, as well as the threat caused by subsidies that are required to be provided through the end of MY 2007 by the 2002 FSRI Act and the 2000 ARP Act. The fact that the Panel will issue its determination regarding these subsidies after the termination of the "peace clause" in 2004 has no impact on the analysis of these claims.

C. IDENTIFICATION OF THE SUBSIDIZED PRODUCT

**125.**

**(2) Brazil has submitted that "The record suggests that *historic* producers are *current* producers." It points to factors including the specialization of upland cotton producers, the need to recoup expensive investments in cotton-specific equipment, and the geographic focus and climatic requirements of upland cotton production in the "cotton belt". (Brazil's rebuttal submission, footnote 98, on page 24)**

**(a) Regarding the specialization of upland cotton producers and the geographic focus of upland cotton production, how does Brazil take account of the fact that cotton is produced in 17 of the 50 states of the United States and that average cotton area is approximately 38% of a cotton farm's acres? (This information is taken from the US's response to question 67*bis*, footnote 35). BRA**

[8] Exhibit Bra-101 (Questions for the Purposes of the Consultations, Questions 14.1 *et seq.*, p. 13).

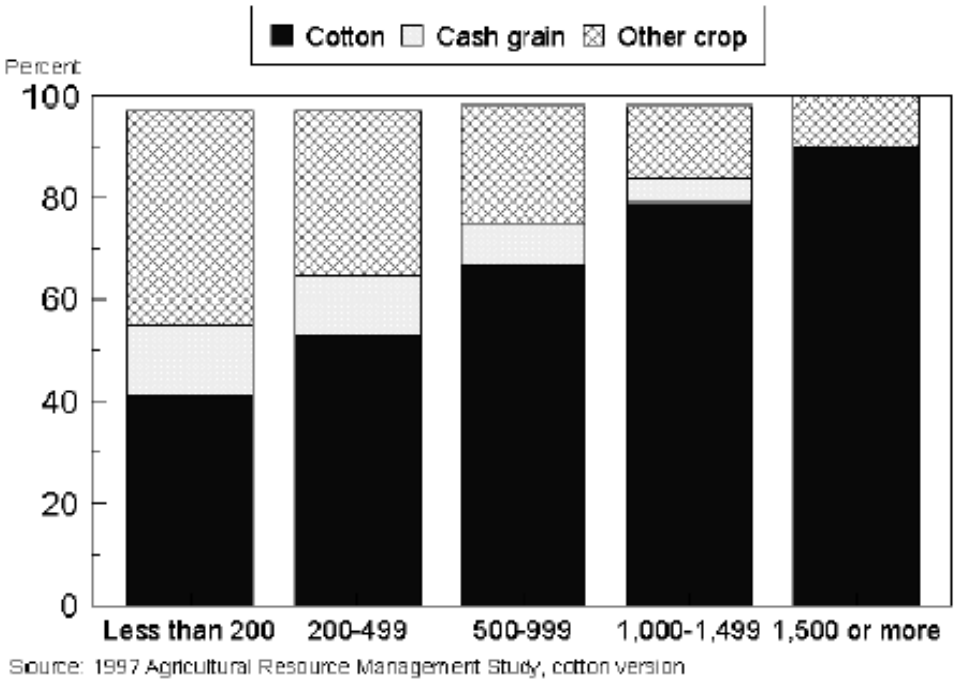
[9] The "measures" identified include (1) "domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2001", (2) "domestic support subsidies that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007", (3) "all subsidies benefiting upland cotton that have trade distorting effects or effects on production by the US upland cotton industry", (4) "domestic support, and all other subsidies provided under regulations, administrative procedures . . . for the production, use and/or export of US upland cotton and upland cotton products". WT/DS267/7, pages 1, 2, 3.

Brazil's Answer:

7. In contrast to the information cited in the Panel's question, more relevant information concerning specialization of cotton producers in cotton farms is set out in Exhibit Bra-16, which is a 2001 USDA report on the cost of production of cotton farms. That report contains the following figure:[10]

**Figure 3 Specialization of cotton farms**

Ninety percent of farms with 1,500 or more cotton acres specialized in cotto while roughly 40 percent of farms with less than 200 cotton acres specialized in either cotton or other crops.




Source: 1997 Agricultural Resource Management Study, cotton version

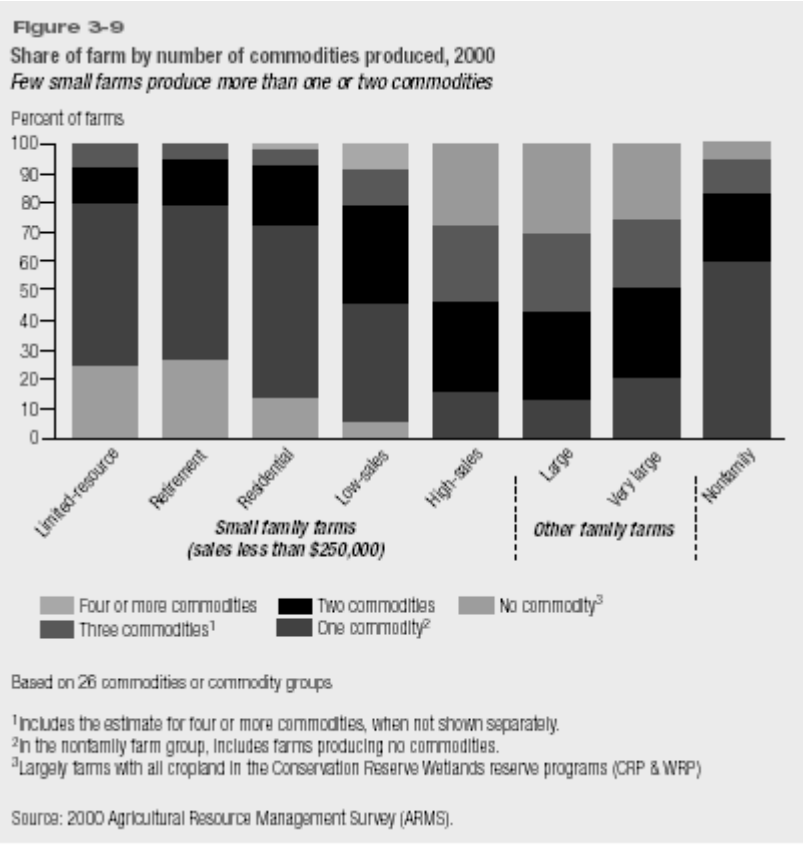
8. This evidence shows that farms with 500 or more acres of upland cotton are heavily specialized in the production of cotton. While these farms represented 33 per cent of US farms producing upland cotton, they produced 75 per cent of total US upland cotton in MY 1997.[11] Thus, the great majority of US production of upland cotton takes place on farms that largely specialize in the production of upland cotton.

9. Other data regarding specialization is found in a 1998 USDA report indicating that most smaller farms – defined as farms with income below $250,000 and which account for 92 per cent of all US farms – tend to produce only one or at most two crops.[12] This is illustrated in the chart below:

[10] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms", USDA, October 2001, p. 9).

[11] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms". USDA, October 2001, p. 7).

[12] Exhibit Bra-285 ("Agriculture Fact Book 2001-2002", Chapter 3 - American Farms, p. 32).




10. Approximately 55 per cent of upland cotton is produced on such smaller farms.[13] Thus, even for those smaller farms producing upland cotton, the evidence suggests that over 50 per cent produce mainly upland cotton and the rest produce at most one additional crop. This evidence is consistent with Brazil's argument concerning cotton specialization.

11. With respect to the Panel's question, the 38 per cent figure cited by the United States refers to "planted cotton acreage" as a percentage of "total acreage operated".[14] The United States provides no information on what "total acreage *operated*" means. Nor does the United States provide the Panel with the amount of "planted cotton acreage" as a percentage of "total PFC/DP base acreage". It may be that the cotton acreage accounts for most of a farm's "base acreage". Thus, the "total acreage operated" is not the appropriate basis to calculate a percentage of base acreage for farms producing upland cotton. The best evidence of specialization is the actual payments made to upland cotton producers discussed in Brazil's Answer to Question 125 (5). The next best evidence is the USDA data on specialization of cotton farms cited above.

12. Moreover, Brazil's arguments are not dependent on proof that the majority of cotton farms produce *only* upland cotton. The evidence suggests that larger farms tend to grow at least some other crops and, therefore, may have more than one type of PFC/market loss assistance or direct and counter-cyclical payment "base acreage".[15] As Christopher Ward testified, farmers rotate the production of several different crops, planting one crop on a certain portion of the farmland, and then

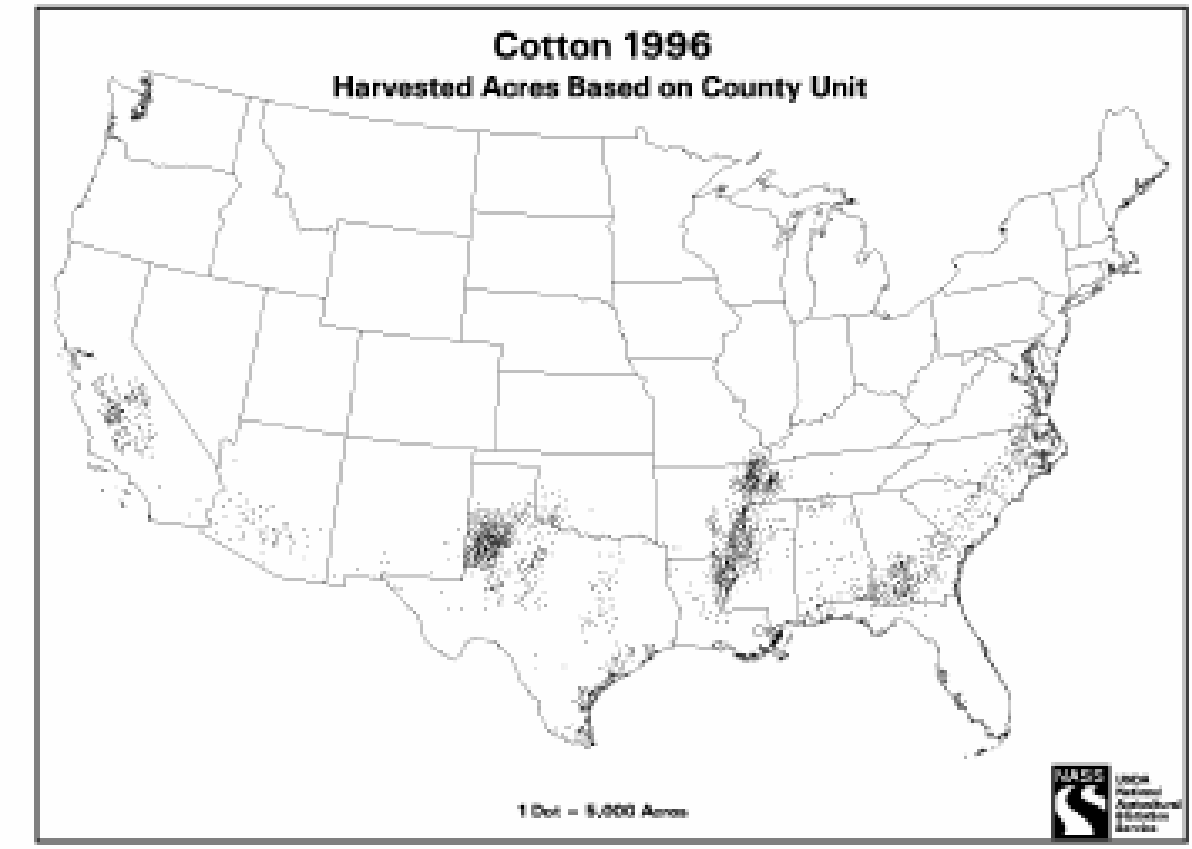
[13] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms," USDA, October 2001, Table 7) tabulating farms with value of production less than $250,000.

[14] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms," USDA, October 2001, Table 3).

[15] This is also demonstrated by Exhibit Bra-286 (Direct and Counter-cyclical Program Contract, Form CCC-509, USDA, Commodity Credit Corporation), which provides for the possibility to establish base acres for different crops.

moving the production of that same crop to another portion of the farmland.[16] But the fact that crops are rotated or that some farmers have multiple types of "base acres" and produce more than one crop on their farm does not mean that farmers do not continue to plant upland cotton and use cotton-specific machinery and ginning facilities. This is confirmed by the fact that between MY 1999-2002, there were no wide swings in planted upland cotton acreage.[17]

13. Finally, while the United States is correct in stating that upland cotton is produced in 17 states, 66 per cent of upland cotton is produced in only 5 states, and 90 per cent is produced in only 10 out of the 50 US states.[18] In addition, even within each of these 10 states, upland cotton tends to be grown in relatively distinct geographical regions. This is shown in the graph below:[19]




**(c) Regarding the high cost of upland cotton production, can Brazil show that farms who planted upland cotton could only have covered their costs by receiving upland cotton, rice or peanut payments in every year from 1999 through 2002? BRA**

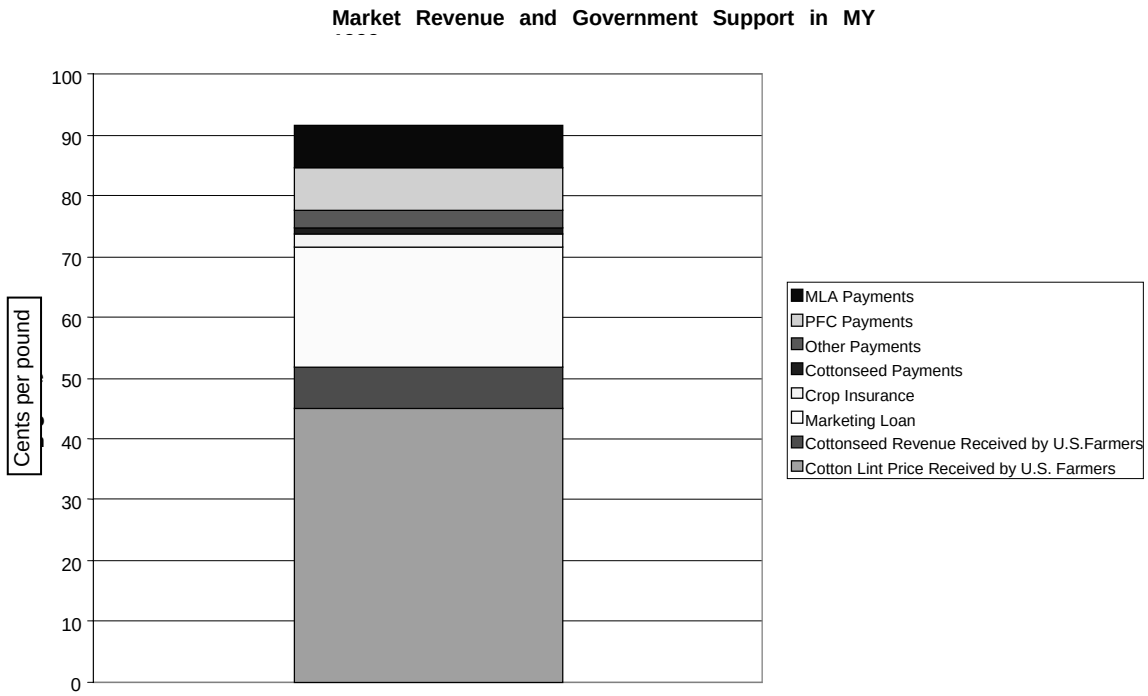
Brazil's Answer:

14. Between MY 2000-2002, US upland cotton producers could not make a profit, unless they grew upland cotton on upland cotton or rice (or peanut in MY 2002) base acreage. Brazil provides data below for each of the four marketing years covering the period of investigation (MY 1999-2002). This evidence is consistent with a conclusion that the great majority of upland cotton was produced on upland cotton base acreage. In responding to this question from the Panel, Brazil took into account

[16] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 2)
[17] *See* Brazil's Answer to Question 125(6).
[18] Exhibit Bra-107 (US and State Farm Income Data, Farm Cash Receipts, ERS, USDA, June 2003).
[19] http://usda.mannlib.cornell.edu/reports/nassr/field/planting/uph97.pdf , Usual Planting and Harvesting Dates for US Field Crops, National Agricultural Statistics Service, USDA, December 1997, p. 7.

Dr. Glauber's comment that Step 2 payments are not received by US upland cotton producers but rather by exporters and domestic users.[20] Brazil generally agrees with this statement. Therefore, Brazil has excluded Step 2 payments from the pool of revenue received by US upland cotton producers.[21] It presents data on the total amount of market revenue for upland cotton lint and seed, marketing loan benefits, crop insurance payments, cottonseed payments, so-called "other payments"[22] and PFC, market loss assistance, direct and counter-cyclical payments.

15. The following chart shows revenues of upland cotton producers in MY 1999:[23]




16. The chart shows that US upland cotton producers received total revenue of 91.54 cents per pound of upland cotton produced. At the same time, the average cost of production was 82.03 cents per pound in MY 1999[24] and prices received by producers were 45 cents per pound.[25] It follows that US producers could not produce upland cotton without the financial assistance of the US Government in the form of large amounts of subsidies. US producers needed 4.46 cents per pound from the total combined upland cotton PFC and market loss assistance payment of 13.97 cents per pound to recover their costs.[26]

[20] Exhibit US-24, p. 3 fifth and sixth paragraph.

[21] This does not affect Brazil's view that Step 2 payments are properly included in the peace clause analysis under Article 13(b)(ii) of the Agreement on Agriculture as "support to upland cotton". While Step 2 payments may not directly benefit domestic producers of upland cotton, they do so indirectly. As they increase demand for US upland cotton, they increase prices received by US producers and are, therefore, properly described as "support to upland cotton".

[22] Interest subsidies and storage payments.

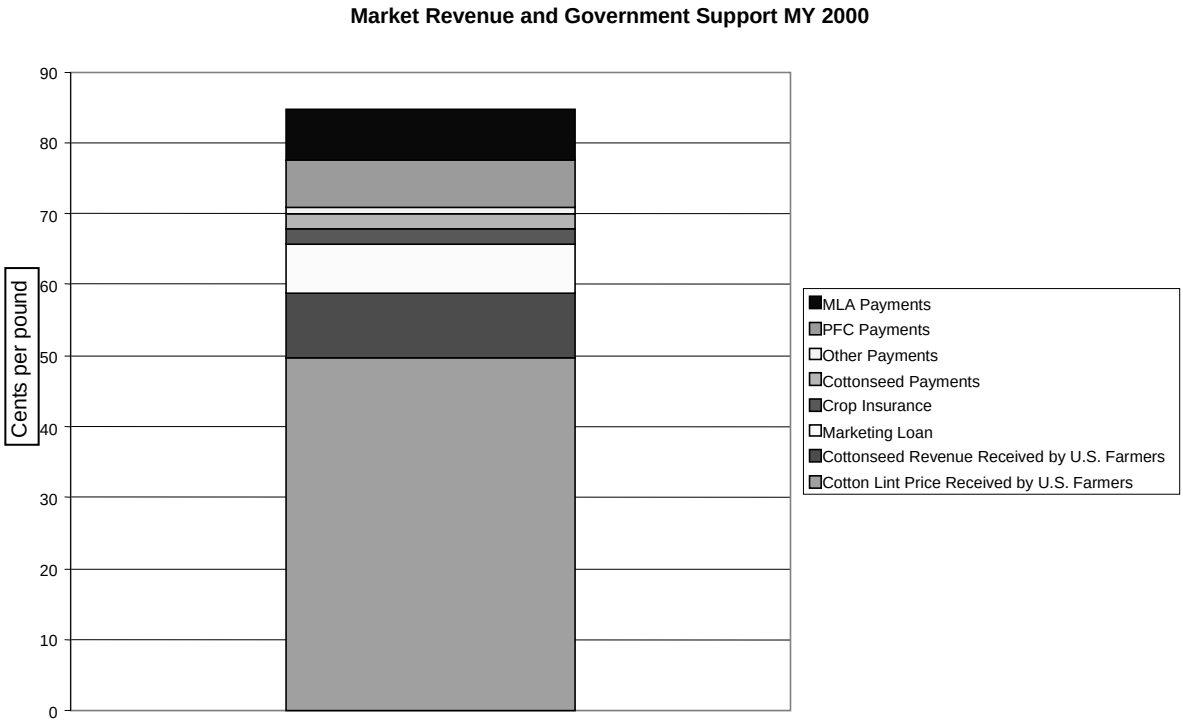
[23] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

[24] Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers).

[25] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5).

[26] Thus, they could have produced upland cotton on wheat, corn, grain sorghum, cotton and rice base acreage without suffering a loss.

17. In MY 2000, the financial situation of US upland cotton producers worsened. While the price they received for upland cotton lint increased to 49.8 cents per pound[27], their total revenue fell to 84.74 cents per pound[28], only slightly above their average cost of production of 82.69 cents per pound.




18. Again, large amounts of US subsidies were instrumental in closing the gap between the US cost of production and the market returns of producers. For MY 2000, the 13.86 cents per pound in upland cotton PFC and market loss assistance payments as well as all other subsidies were needed to close the gap between the cost of production and the market returns.[29] Average US upland cotton producers could also have covered their total costs had they planted upland cotton on rice base acres. But they would have suffered a marginal loss on corn or other crop base acres.

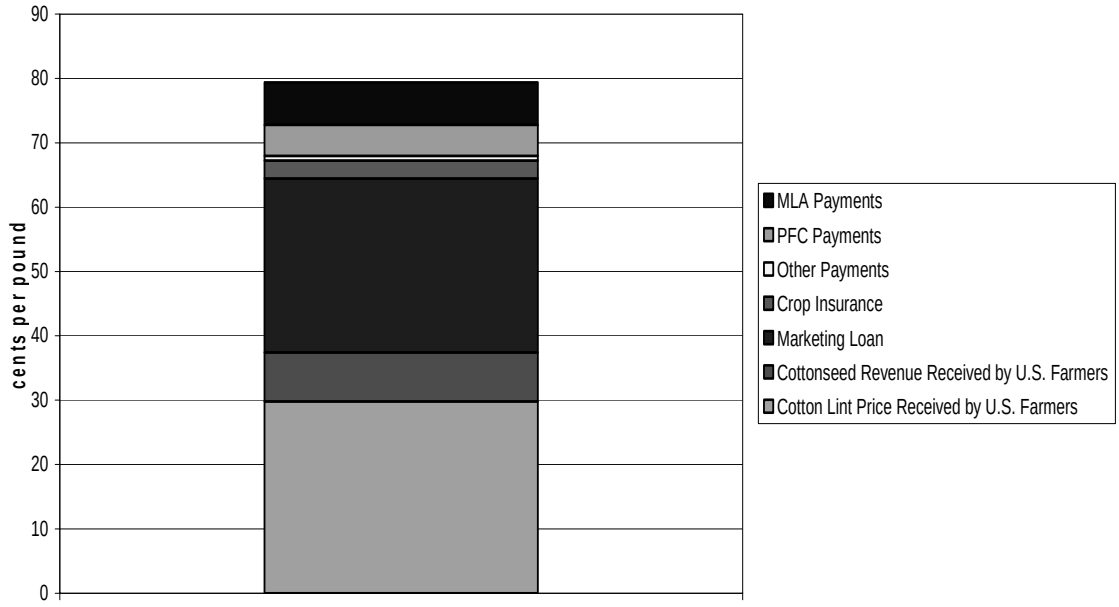
19. The results for MY 2001 show a similar result:

[27] Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 5).

[28] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

[29] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

**Market Revenue and Government Support in MY 2001**




20. US producers received a total revenue of 79.41 cents per pound,[30] only 29.8 cents per pound of which was market revenue for upland cotton lint. At the same time, they faced an average cost of production of 76.44 cents per pound.[31] Thus, the average US producer of upland cotton needed an upland cotton or rice PFC and market loss assistance payment to break even, while upland cotton production on corn or any other crop base acreage would have generated a loss.

21. For MY 2002, average US producers even suffered a loss from upland cotton production on upland cotton base acres[32], let alone corn or other crop base acres, except for rice and peanuts.[33] The average US upland cotton producer received total revenues of 82.96 cents per pound[34], while their average total cost for MY 2002 was 83.59 cents per pound.[35]

[30] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

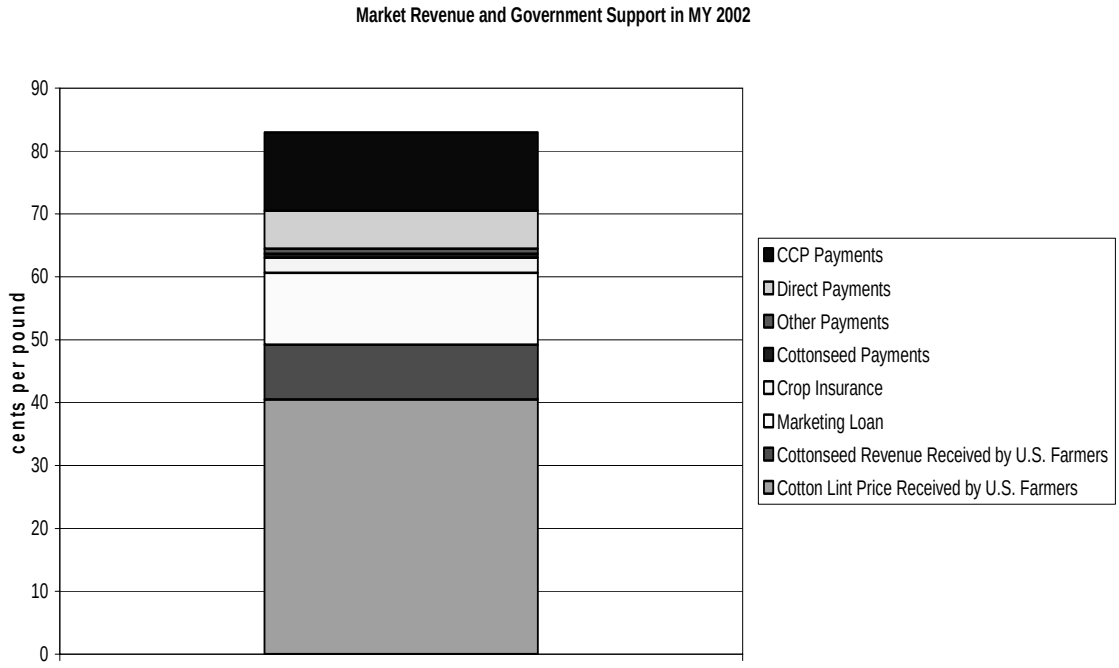
[31] Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers).

[32] Brazil notes that it is not in a position to quantify the effect of the yield update for purposes of the counter-cyclical payments and, thus, likely underestimated the amount of those payments (*See* Brazil's Answer to Questions 125 (8)). With slightly higher counter-cyclical payments than assumed by Brazil, US producers of upland cotton might have made a small profit in MY 2002.

[33] Brazil notes that while evidently some former corn producers had shifted to upland cotton production, the fact that they were allowed to update their base acres to upland cotton base acres meant that they could now receive upland cotton payments (*See* Brazil's Answer to Question 125 (7)).

[34] *See* Exhibit Bra-287 (Market Revenue and US Government Payment to US Upland Cotton Producers).

[35] Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers).




22. The overall conclusion of this analysis is that, on average over the period of investigation, US upland cotton producers needed and received upland cotton or rice programme payments to cover (or almost cover) their total cost of production. At the same time, as total revenue decreased relative to the cost of production, US upland cotton acreage increased between MY 1999-2001.[36] Because upland cotton producers with non-upland cotton or rice base acreage would have lost money (even with the subsidies), they would have been forced to switch out of upland cotton production. This means that the only producers that could remain were those with upland cotton or rice base. The fact that upland cotton acreage increased through MY 2001 suggests that only a small portion of upland cotton in the United States could have been grown on non-upland cotton base acres.

23. Similarly, in MY 2002, the option to update the base acreage (and yield for the CCP payment programme) allowed those producers that produced on non-upland cotton base acres in MY 1998-2001 to receive the considerably higher upland cotton payments under the 2002 FSRI Act. Because it is not economically sustainable to grow upland cotton on non-upland cotton (-rice or -peanut) base, the ability to update suggests that by MY 2002 nearly all US producers grew on upland cotton base.

24. Moreover, the data above indicates that even with subsidies, the average US producers did not earn any or, at most, a small profit during MY 1999-2002. As Christopher Ward testified, there is a strong need to generate profits to stay in the upland cotton business.[37] These profits pay for investments in new machinery and technologies, as well as for losses incurred in years with low prices. But even with large subsidies, US producers only met their costs. Without subsidies, they were not even able to meet their variable cost in MY 2001.

25. In sum, during most of the period of investigation, US producers of upland cotton needed the high upland cotton payments from the PFC, market loss assistance, direct and counter-cyclical payment programmes to generate sustainable returns (MY 1999), simply break even (MY 2000-

[36] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4). *See* also Brazil's Answer to Question 125 (6).

[37] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 10).

2001), or almost meet their total costs (MY 2002). It is, therefore, reasonable to assume that the great majority of US upland cotton was grown on upland cotton base acres.

**(3) In calculating the amount of PFC, MLA, direct and counter-cyclical payments that went on upland cotton, Brazil made an adjustment for the ratio of current acreage to base acreage (see its answer to question 67, footnotes 2, 3, 4 and 5). Is this an appropriate adjustment for the particular factors referred to above? Why or why not? BRA, US**

Brazil's Answer:

26. Brazil refers the Panel to its answers to Question 125 (8), Question 125(2)(a), and to Question 125(2)(c) for Brazil's arguments why its methodology is reasonable to use in the absence of direct evidence collected and controlled exclusively by the United States concerning the amount of those payments to upland cotton producers.[38] In the absence of such direct evidence, Brazil has set forth[39] extensive circumstantial evidence that US producers of upland cotton received such payments.[40]

**(4) Dr. Glauber has alleged that there are statistical problems in comparing planted acres to programme acres because of abandonment of crops and also because planted acres are only survey estimates, not reported figures (See Exhibit US-24, the first full paragraph in P2). Would it be more appropriate to divide harvested acreage by base acreage? What margin of error is there between the survey estimates and reported figures? BRA, US**

Brazil's Answer:

27. The appropriate figures to use for farmers' decisions on upland cotton acreage are the official USDA figures for acres planted to upland cotton. Dr. Glauber discussed certain programme and statistical issues that may have applied in the early 1990s, but which – with the termination of the deficiency payment programme from MY 1996 on – are no longer relevant.[41]

28. The planted acre figures used by Brazil are the only official USDA data for planted acres of crops. These data are reported by the Farm Service Agency (FSA) in its Fact Sheet on Upland Cotton.[42] Planted acres reflect the choice by farmers to commit land to upland cotton production by cultivating, fertilizing, seeding and applying other inputs during the pre-planting and planting period. In some parts of the United States, variable weather and other conditions mean that some land that has been planted to upland cotton, or to some other crops, is not harvested. But, there is no question that this land was committed at the time of planting to upland cotton production. Further, once the planting takes place, that decision generally precludes further upland cotton production (or other crops) for that marketing year.

29. According to USDA's National Agricultural Statistics Service (NASS), the procedure for measuring and reporting planted acres for upland cotton and other crops starts with a June survey of planted acres for each crop, which is well after planting commitments for upland cotton have been made early in spring. The June planted acre figures are updated in NASS files each month as additional data becomes available. Revisions in the figures on planted acres are determined in December and reported in the Crop Production report each year. These data include revisions based

[38] *See* also Brazil's 9 October Closing Statement, para. 2.

[39] Inferences drawn from this evidence satisfy Brazil's burden of proof in the absence of direct evidence. *See* Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.39.

[40] *See* Brazil's 9 October Closing Statement, Annex I for a summary of the evidence and further references.

[41] Brazil notes that Dr. Glauber's assertions were made in the context of the acreage reduction and set aside requirements under the US deficiency payment programme.

[42] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

on FSA's certified acreage information. As Exhibit Bra-288 makes clear, NASS reported the 2003 revisions using FSA information in the October Crop Production report, rather than waiting until December.[43]

**(5) Do the acreage reports under section 1105(c) of the FSRI Act of 2002 indicate or assist in determining the number or proportion of acres of upland cotton planted on upland cotton base acres? Was there an acreage reporting requirement for upland cotton during MY1996 through 2002? BRA, US**

Brazil's Answer:

30. The short answer to both of the Panel's questions is "yes". Regrettably, the United States has refused to provide Brazil or the Panel with the number or proportion of acres of upland cotton planted on upland cotton base acres for MY 1999-2002, despite Brazil's repeated efforts to obtain this information over the past year and despite the Panel's Question 67bis, in which the United States claimed incorrectly that it did not have access to this information.[44]

31. As implemented, Section 1105(c) of the 2002 FSRI Act requires any recipient of direct and counter-cyclical payments to submit, as a condition of eligibility of receiving the payments, "annual acreage reports with respect to all cropland on the farm".[45] This means that the precise acreage for each crop grown on the farm must be tabulated and identified in an annual report. Depending on the state and the county, these acreage reports are generally due by the middle of each calendar year.[46]

32. In addition to the annual acreage reports, the 2002 FSRI Act required all farms eligible for direct and counter-cyclical payments to file application forms establishing and proving their historic production of the 10 programme crops.[47] The required information includes the types, amount, and yields of all direct and counter-cyclical payment base acreages during the period 1998-2001 or reference to the earlier PFC base acreage. All of these applications were due no later than 1 June each year.[48] USDA reported in July 2003 that 99.6 per cent of eligible farms had completed the required applications and signed up for the direct and counter-cyclical programme.[49] Farms submitting both the annual programme acreage reports and the historic base-acreage application form were required to provide a specific farm identification number. This farm "ID" would appear to permit USDA to determine for each reporting farm the annual *acreage* mix of crops and the amount of direct and counter-cyclical base acreage for each one of those crops.

33. With respect to the period 1996-2001, the regulations under the 1996 FAIR Act required any recipient of PFC payments and marketing loans (or loan deficiency payment) to submit annual acreage reports for each of the commodities planted for harvest on a farm enrolled in such a programme.[50] This reporting requirement was a mandatory condition to receive payment. It would

[43] Exhibit Bra-288 ("NASS To Update Acreage If Necessary," National Agricultural Statistics Service, USDA, 29 September 2003).

[44] *See* US 27 August Comments on Brazil's Rebuttal Submission and Answer to Question 67bis, para. 21 (The United States admitted that it "tracked total expenditures," but denied that it collected or could derive the information requested by the Panel).

[45] Exhibit Bra-29 (Section 1105 of the 2002 FSRI Act) and Exhibit Bra-289 (7 CFR 1412.606) and Exhibit Bra-289 (7 CFR 718.102, 2003 edition).

[46] Exhibit Bra-290 ("Farmers must file acreage to receive 2002 payments," Kansan Online Ag Briefs, second paragraph); Exhibit Bra-290 (AFBIS Inc. Crop Watch, June 2003).

[47] Exhibit Bra-286 (Direct and Counter-cyclical Program Contract, Form CCC-509, USDA, Commodity Credit Corporation)

[48] Exhibit Bra-291 ("Direct and Counter-Cyclical Payment Program," Farm Service Agency, USDA, April 2003).

[49] Annex 2 to Exhibit Bra-105 (National Enrollment Report, USDA, 17 July 2003, last attachment).

[50] Exhibit Bra-292 (7 CFR 718.102, 2002 edition)

appear that the United States has collected precise acreage and payment information on (1) farms with PFC cotton base acreage, and (2) farms that produced upland cotton and received PFC and marketing loan payments. Combined with the specific farm identification number, this information would clearly permit the matching of information on a farm's crop base acreage and current planting and, thus, the collection of the amount and type of PFC (and market loss assistance) payments made to producers of upland cotton between MY 1999-2001.

34. In sum, the United States has exclusive control of the information that would provide the *amount* and *type* of PFC, market loss assistance, direct and counter-cyclical payments made by the US Government to US cotton producers during MY 1999-2002. The United States also has not provided information regarding the amount of updated upland cotton direct and counter-cyclical payment base acreage, the average yields applying to that (updated) base acreage, or the total amount of direct and counter-cyclical payment funds paid to holders of upland base acreage for MY 2002. All of this information is exclusively in the control of the United States and was first requested by Brazil over a year ago.[51] The Panel first requested this information in August 2003.[52] If the United States continues to refuse to provide this information, then Brazil submits that the Panel must either (1) draw adverse inferences that the information retained by the United States reflects greater payments than those estimated by Brazil,[53] or alternatively, (2) rely on Brazil's estimate that the payments equal total upland cotton base acreage payments times the ratio of upland cotton planted acreage to upland cotton base acreage.

**(6) Please prepare a chart showing upland cotton base acreage, planted acreage and harvested acreage for MY1996 through 2002. Does the planted acreage fluctuate within a broad band? If not, does this indicate any stability in decisions to plant the same acres to upland cotton? BRA, US**

Brazil's Answer:

35. Brazil has prepared the requested chart showing the developments of upland cotton base acreage, planted acreage and harvested acreage between MY 1996-2002.[54] The chart below shows that planted acreage does *not* fluctuate within a *broad* band. Instead, planted acreage fluctuates between a low of 13.1 million acres in MY 1998 and a high of 15.5 million acres in MY 2001.[55]

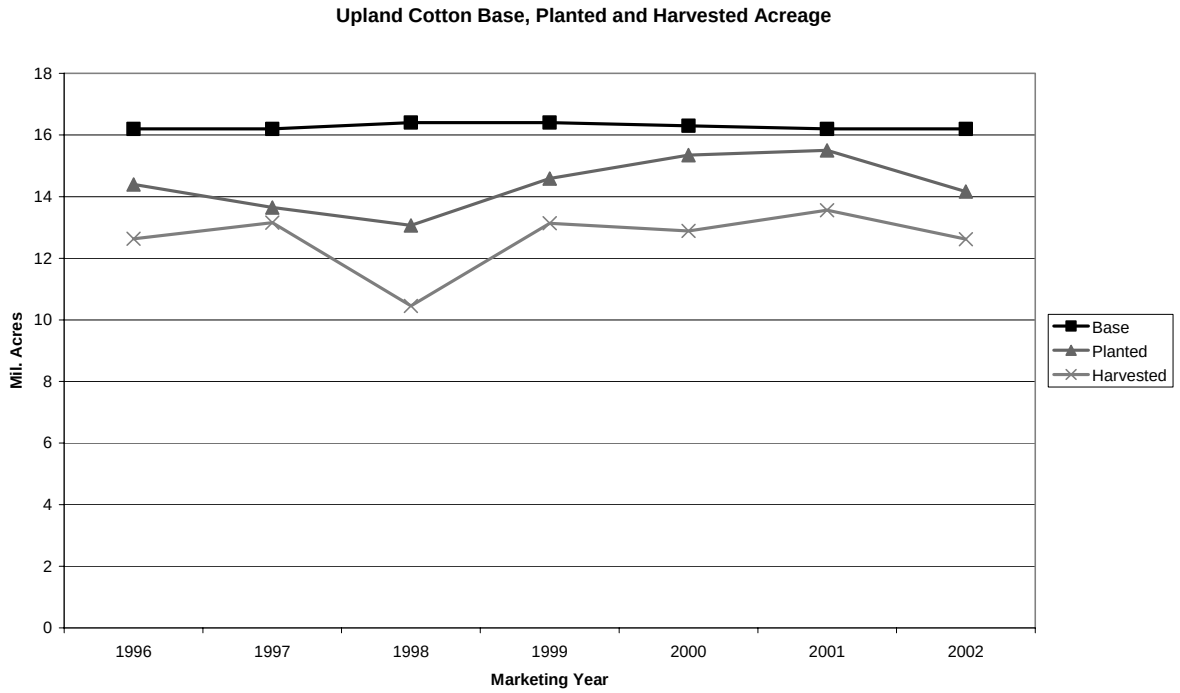
[51] Exhibit Bra-49 (Brazil's Questions for the Purposes of Annex V Procedure, March 2003) and Exhibit Bra-101 (Brazil's Questions for the Purposes of the Consultations, 22 November 2002)

[52] Question 67bis.

[53] The Appellate Body in *Canada – Aircraft* addressed the issue of drawing adverse inferences from a party's refusal to provide information requested by a panel. It stated that "a panel has the legal authority and the discretion to draw inferences from the facts before it." Moreover, it stated that a panel should examine very closely whether the full *ensemble* of the facts on the record reasonably permits the inference urged by one of the parties to be drawn, because a party's refusal to collaborate has the potential to undermine the functioning of the dispute settlement system. Furthermore, the Appellate Body noted that if it had been "deciding the issue that confronted the Panel, we might well have concluded that the facts of record did warrant the inference that the information Canada withheld . . . included information prejudicial to Canada's denial that the EDC had conferred a benefit and granted a prohibited export subsidy." (Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 205).

[54] Brazil again notes that it is not in a position to provide the updated MY 2002 base acreage, but uses the upland cotton PFC base acreage for that year.

[55] Exhibit Bra-293 (Data for Acreage Chart).




36. Indeed, aggregate producers' decisions to plant upland cotton are fairly stable. Despite drastic changes in upland cotton prices, the amount of planted acres only varies within a narrow range, confirming that US producers are largely isolated from upland cotton market price incentives. The data shown in this chart is also consistent with Brazil's argument that most upland cotton was planted on upland cotton base acreage. The amount of acreage planted to upland cotton always remains *below* the amount of upland cotton base acreage – a fact that supports Brazil's assumption that upland cotton producers receive payments related to upland cotton base.[56]

**(7) Brazil states that one third of all US farms with eligible acreage decided to update their base acreage under the direct payments and counter-cyclical payments programmes using their MY1998-2001 acreage. What is the proportion of the current base acreage for upland cotton resulting from such updating? Is the observed updating of base acreage consistent with Brazil's argument that it is only profitable to grow upland cotton on base acreage (and peanut and rice base acreage)? BRA**

Brazil's Answer:

37. Regarding the first question, Brazil does not know the proportion of current base acreage for upland cotton resulting from the 2002 updating of the base acreage. This information is exclusively collected and maintained by the United States. As indicated in answer to Question 125(5), USDA required all eligible farms to file applications by 1 June 2002 establishing and updating their base acreage. Brazil notes that the United States was quickly able to report that *overall* 99.6 per cent of eligible farms enrolled in the programme. This suggests that the United States is in possession of farm-specific information regarding the percentage of (1) the total amount of upland cotton direct and counter-cyclical payment base acreage, and (2) the number of farms growing upland cotton that chose to update their base acreage. Brazil reiterates its request to the United States for this information.[57]

[56] Brazil has discussed the validity of this assumption in its answers to Questions 125 (3) and (8).

[57] Exhibit Bra-49 (Brazil's Questions for the Purposes of Annex V Procedure, March 2003) and Exhibit Bra-101 (Brazil's Questions for the Purposes of the Consultations, 22 November 2002)

38. The answer to the second question is yes. As indicated in Brazil's Answer to Question 125(2)(c), upland cotton producers would lose money in MY 2000-2001 (even with the subsidies) if they grew upland cotton on anything other than upland cotton or rice base acreage. The record indicates that PFC per acre payments were $30.84 for upland cotton and $23.48 per acre for corn in MY 2001.[58] There were no PFC or market loss payments for peanut base under the 1996 FAIR Act.[59] Testimony from NCC representatives indicated that a number of producers in the south-eastern part of the United States grew upland cotton on corn base acreage during MY 1999-2001.[60] NCC representatives argued that it would only be "fair" for producers with corn base acreage that had switched into upland cotton production to be able to update their base acreage to receive *upland cotton* direct and counter-cyclical payments.[61] NCC's efforts were successful, as reflected in the fact that under the 2002 FSRI Act, maximum total direct and counter-cyclical per acre payments for upland cotton base acreage is $109.50, while for corn it is $54.10 per acre. This large increase in per acre payment for cotton relative to corn in the 2002 FSRI Act reflects the much higher cost of producing upland cotton – and the expectation that historic cotton producers receiving such high payments will continue to grow high-cost upland cotton.

39. Given the much higher per acre payments in MY 2002 for upland cotton base acreage, any producer who could gain more upland cotton base acreage would certainly take advantage of the chance to update. Thus, any increases in the updated upland cotton base in MY 2002 reflect the economic incentive to obtain significantly greater additional revenue by switching to upland cotton acreage than in staying with historical corn, wheat, oats, barley sorghum and barley acreage. Finally, the higher per acre payments for upland cotton also reflect the squeeze in profits for those cotton producers that grew upland cotton in MY 1999-2001 on corn base acreage, as testified to by NCC representatives, discussed above.

**(8) How could one take account of upland cotton producers who receive PFC, MLA, direct and counter-cyclical payments for other covered commodity base acreage? BRA, US**

Brazil's Answer:

40. The best information to use would be the actual data collected by the United States concerning the amount of PFC, MLA, DP, and CCP payments to US upland cotton producers. In the absence of this information, Brazil's methodology assumes that US producers of upland cotton grew upland cotton on upland cotton base acreage. This is a reasonable proxy, because there will be some upland cotton that is grown on rice (and peanut) base receiving higher payments, and some upland cotton that is grown on, *e.g.*, corn base receiving somewhat lower payments. On average, Brazil's approach would roughly cancel out the *over*-counting of rice and peanut payments and the *under*-counting of corn and any other lower-paying programme crop payments.

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[58] Brazil's 9 October Closing Statement, Annex 1, para. 31, *citing* Brazil's 22 August Rebuttal Submission, paras 32-34.

[59] Brazil's 24 June First Submission, para. 45; Brazil's 22 August Rebuttal Submission, para. 24

[60] *See* NCC testimony quoted in Brazil's 24 June 2003 First Submission, para. 53 *citing* Exhibit Bra-41 (Congressional Hearing, "The Future of Federal Farm Commodity Programs (Cotton)," House of Representatives, 15 February 2001, p.32).

[61] "[W]hat has happened is, under Freedom to Farm . . . in the Southeast we moved from corn, like I have done, to cotton. *So the last few years we have increased our cotton acreage in Georgia, for instance, to about a million and a half acres; we are getting [PFC] payments on about 900,000 acres*. [W]e have a tremendous production in the Southeast that is not getting a [Market Loss] payment or a regular [PFC] payment. So we are recommending . . . to this committee that a farmer have a choice with remaining with his existing acreage and yield, *or he has an option to move to a modified acreage and yield on his farm or acreage on his farm, and this would make this, we think, fair*. . . And this happened . . . outside the Southeast, but it is been more pronounced in the Southeast than any other section of the Country." (emphasis added) Exhibit Bra-41 ("The Future of Federal Farm Commodity Programs (Cotton)," Hearing before the House of Representatives Committee on Agriculture, 15 February 2001, p. 32). Brazil's 24 June First Submission, para. 53.

F. PROHIBITED SUBSIDIES

**128. Could the US respond to Brazil's assertions relating to the meaning and effect of the introductory phrase of Article 3 ("Except as provided in the *Agreement on Agriculture*....")? Would the meaning/effect change if Article 13 of the *Agreement on Agriculture* did not exist? BRA, US**

Brazil's Answer:

41. In commenting on the first question directed to the United States, Brazil notes that the United States argues that the phrase "except as provided in the Agreement on Agriculture" necessarily means that negotiators intended to carve out both domestic local content and export subsidies for agricultural products from the disciplines of Article 3 of SCM Agreement.[62] But the United States' argument twists the meaning of the phrase "*except* as provided". The word "except" does not imply that there *must* be something in the Agreement on Agriculture that carves out the disciplines on local content subsidies in the SCM Agreement. The phrase only means that *if* the Agreement on Agriculture clearly and unambiguously (i) exempts such agricultural subsidies from the SCM Agreement, or (ii) changes the obligations contained in the SCM Agreement, then the provisions of the Agreement on Agriculture that conflict with those of the SCM Agreement will prevail. The Appellate Body's jurisprudence teaches that it is only where the text clearly and unambiguously provides for modified obligations does the "except as provided" language become operational.[63]

42. In essence, what the United States seeks from the Panel is an interpretation that the prohibition on local content subsidies does not apply to agricultural goods. Yet, nothing in the Agreement on Agriculture or the SCM Agreement provides the carve-out the United States now seeks.

43. Brazil agrees that the Agreement on Agriculture constitutes *lex specialis* as opposed to the *lex generalis* of the SCM Agreement. The Agreement on Agriculture applies to a subset of goods covered by the SCM Agreement and, in case of conflicting provisions, the rights and obligations contained therein should prevail over those of the SCM Agreement. Brazil agrees that the introductory phrase of Article 3 of the SCM Agreement makes explicit the *lex specialis* nature of the Agreement on Agriculture.

44. However, the US argument goes further than the principle of *lex specialis derogat generalis* as it is normally applied. The United States wants the Panel to apply this principle in a way that effectively derogates explicit and specific provisions of the SCM Agreement whenever the Agreement on Agriculture is silent about such provisions. This is an absurd application of the *lex specialis* principle. The *lex specialis* is to be read together with the *lex generalis*. In fact, every effort must be made to read the two provisions in a harmonious manner. The derogation of the *lex generalis* is called for only in situations when an irreconcilable conflict between the two texts arises. It is a fundamental tenet of law that absolute contradictions between laws cannot be presumed; they must be established by a systematic analysis of the texts involved to identify any unequivocal incompatibility. Such conflict or incompatibility does not exist with regard to Article 3.1(b) of the SCM Agreement. The Agreement on Agriculture specifies no right or obligation that would, *by necessity*, derogate the obligation contained in Article 3.1(b) of the SCM Agreement. The Appellate Body and panels have

[62] US 30 September Further Submission, para. 171.

[63] Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128; Appellate Body Report, *EC – Bananas*, WT/DS27/AB/R, paras. 157-158; Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, paras. 201, 208.

rightly cautioned against interpretations that would exempt disciplines from entire sections of WTO agreements in the absence of a clear and unambiguous carve-out of rights and obligations.[64]

45. Furthermore, the United States' interpretation, which would (permanently) carve out all agricultural products from the prohibition of Article 3.1(b), is contrary to the object and purpose of Article 3 of the SCM Agreement. Negotiators expressed their intent that local content subsidies are a special class of trade-distorting subsidies. Because of their particularly trade-distortive nature, negotiators dispensed with the requirement of showing any adverse effects and made them prohibited subsidies. Given the special prohibited nature of such subsidies – coupled with the ability of negotiators to carve such subsidies out explicitly from the operation of the SCM Agreement – it would be expected that any exception from the disciplines would be clear and unambiguous.

46. The answer to the second question is "no". As Brazil's earlier submissions have articulated, Article 13(b) is not the only basis for Brazil's argument that the Agreement on Agriculture does not carve out agricultural local content subsidies from the Article 3.1(b) prohibition of local content subsidies.[65] As Brazil has argued, there is no inherent conflict between requiring the notification and scheduling of payments to processors of agricultural goods benefiting domestic producers under Annex 3, paragraph 7 of the Agreement on Agriculture and the prohibition on payments to processors of agricultural goods that are contingent upon the use of domestic over imported goods.[66] Nevertheless, the absence of any reference to Article 3 of the SCM Agreement in Article 13(b) of the Agreement on Agriculture (while a similar reference exists for export subsidies) is consistent with Brazil's other arguments that local content subsidies for agricultural goods are prohibited subsidies.

47. The US interpretation eliminating any prohibitions on agricultural local content subsidies creates a sharp distinction in the way that the other group of normally prohibited subsidies – subsidies contingent upon export – are treated under the Agreement on Agriculture. The Agreement on Agriculture provides many instances in which export subsidies for an individual agricultural product may be challenged as prohibited subsidies under the Agreement on Agriculture. These include prohibitions on export subsidies for unscheduled products, prohibitions on subsidies given to products where support is beyond the scheduled reduction commitments, and prohibitions on subsidies that lead to circumvention of export subsidy reduction commitments. By contrast, under the US interpretation of local content subsidies, there will never be an instance in which local content subsidies for an individual agricultural product would ever be prohibited.

48. It would be expected that such radically different treatment of local content subsidies would be spelled out clearly in the Agreement on Agriculture. Yet, the only link the United States can find to justify its total exclusion of local content prohibited subsidies is the provision in Annex 3, paragraph 7 to include local content subsidies – along with the multitude of other types of domestic subsidies that are *not* prohibited subsidies – in the support to be counted for total AMS. All that Annex 3, paragraph 7 stipulates is that AMS calculations shall include measures that "benefit the producers of the basic agricultural products". Such language contains nothing that conflicts with the obligation established in Article 3.1(b) of the SCM Agreement. Brazil notes that measures that "benefit the producers of the basic agricultural products" may or may not be "contingent upon the use of domestic over imported good". In both situations these subsidies must be included in AMS calculations. However, when challenged under the DSU, those subsidies that require local content

[64] Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128; Appellate Body Report, *EC – Bananas*, WT/DS27/AB/R, paras. 157-158; Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, paras. 201, 208; Panel Report, *India – Quantitative Restrictions*, WT/DS90/R, para. 5.103.

[65] Brazil's 22 July Oral Statement, paras. 84-86; Brazil's 11 August Answers to Questions, paras. 215-217; Brazil's 22 August Rebuttal Submission, paras. 131-144.

[66] Brazil's 22 August Rebuttal Submission, paras. 137-140 (setting out examples where no such conflict would exist).

will be found to violate Article 3.1(b) of the SCM Agreement, and the subsidizing Member will be urged to withdraw such measures.

G. SPECIFICITY/CROP INSURANCE

**129. In the event that the Panel does not consider that the alleged prohibited subsidies fall within the provisions of Article 3 and are therefore, pursuant to Article 2.3, "deemed to be specific", are there any other grounds on which Brazil would rely in order to support the view that such measures are "specific" within the meaning of Article 2 of the *SCM Agreement* (see, for example, fn 16 of Brazil's further submission)? BRA**

Brazil's Answer:

49. Brazil brought prohibited subsidy claims against the Step 2 export and domestic payments, as well as against the CCC export credit guarantee programmes GSM 102, GSM 103 and SCGP. Concerning the latter, only GSM 102 is relevant for Brazil's serious prejudice claims and, thus, the questions of specificity within the meaning of Article 2 of the SCM Agreement only needs to be addressed for that subsidy.

50. Step 2 export and domestic payments are *de jure* specific subsidies because they are only available for exporters and domestic users of upland cotton.[67] Exporters or domestic users of extra-long staple cotton, any other crop or any other product are not eligible to receive Step 2 payments. Consequently, the United States has notified Step 2 payments as cotton-specific non-green box domestic support.[68] Thus, Step 2 payments are specific within the meaning of Article 2.1 of the SCM Agreement in much the same way as marketing loan payments or cottonseed payments.

51. Brazil notes that the Panel's question raises a hypothetical situation that is highly unlikely given the clear export contingency of the GSM 102 export credit guarantee programme. Unlike the crop insurance programme, GSM 102 export credit guarantees are available for exports of most US agricultural commodities.[69] However, GSM 102 support is provided only to enterprises exporting agricultural products and, thus, for the reasons set forth in Brazil's answer to Question 131(a), these subsidies are both *de jure* and *de facto* specific. [70]

**130. Does Brazil agree that the US insurance premium subsidy is available in respect of all agricultural products? Please cite relevant portions of the record. BRA**

Brazil's Answer:

52. Brazil does not agree that the US crop insurance premium subsidy is available in respect of all agricultural products. At the outset, Brazil would like to clarify that the US crop insurance programme encompasses two different types of subsidies. First, the US Federal Crop Insurance Corporation pays *farmers* a portion of the premiums that they have to pay for obtaining crop insurance.[71] Second, the Federal Crop Insurance Corporation covers losses under crop insurance

[67] Exhibit Bra-29 (Section 1207(a) of the 2002 FSRI Act) and Exhibit Bra-28 (Section 136(a) of the 1996 FAIR Act).

[68] *See e.g.* Exhibit Bra-47 (G/AG/N/USA/43, p. 20). Brazil disagrees with the classification of Step 2 export payments as "domestic support." Brazil also considers Step 2 domestic payments to be prohibited local content subsidies within the meaning of Article 3.1(b) of the SCM Agreement and Article III:4 of GATT 1994.

[69] *See* Brazil's Comment to Question 142.

[70] *See* Brazil's Answer to Question 131.

[71] Exhibit Bra-30 (Section 508(e) and Section 508(h)(5)(A) of the Federal Crop Insurance Act). Exhibit Bra-59 ("Briefing Room: Farm and Commodity Policy: Crop Yield and Revenue Insurance").

policies that exceed the amount of premiums collected, thus providing free *reinsurance for private insurance companies* offering crop insurance.[72]

53. Brazil has demonstrated that crop insurance policies that are eligible for subsidy payments – both premium and reinsurance subsidies – are not available in respect of all agricultural products. The United States claims that crop insurance subsidies are and will in the future be available to livestock and dairy producers.[73] This assertion is incorrect. First, it is entirely irrelevant if crop insurance will be available to livestock and dairy producers in the future. The question that faces the Panel is whether the US crop insurance subsidies in MY 1999-2002 are specific, not whether they may at some point in the future become less specific. Brazil demonstrated that except for a very narrow pilot programme that began in MY 2002, there were no livestock "crop" insurance policies during MY 1999-2002.

54. Second, Brazil has demonstrated that crop insurance is currently – in MY 2003 – only available to livestock producers in a limited number of US states and counties.[74] The Adjusted Gross Revenue policy cited by the United States[75] covers only "incidental amounts of income from animals and animal products and aquaculture reared in a controlled environment," which must not exceed "35 per cent of expected allowable income".[76] In addition, this policy is only available for producers in a limited number of counties in 18 US states.[77] Even making the entirely unrealistic assumption that *all* US livestock in those pilot counties would be eligible for adjusted gross revenue coverage, that production[78] would only represent 7.58 per cent of the value of total US livestock production.[79] In addition, Brazil has demonstrated that the total value of US livestock and dairy production represents 52 per cent of the value of total US agriculture.[80] Thus, even taking into account the pilot counties for the adjusted gross revenue coverage, at least 48 per cent of the value of US agriculture is excluded from crop insurance subsidy benefits.

55. Third, the 2000 ARP Act itself explicitly limits its application to, *inter alia*, US crops, and does not cover insurance for the production of dairy, beef, poultry, pork and other livestock.[81]

56. In sum, the US crop insurance subsidies are not available to all US agricultural production.

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[72] Exhibit Bra-30 (Section 508(k) of the Federal Crop Insurance Act). For the reinsurance agreement standards *see* Exhibit Bra-39 (7 CFR 400.161 et seq.).

[73] US 30 September Further Submission, para. 15.

[74] Brazil's 7 October Oral Statement, para. 7.

[75] Brazil notes that this policy is the only one that is cited by the United States in support of its allegation that crop insurance would be available to all US agricultural products. Brazil is not aware of any other policy that would enable and in particular enabled US dairy or livestock producers during MY 1999-2002 to benefit from crop insurance subsidies.

[76] Exhibit Bra-272 ("Fact Sheet: Adjusted Gross Revenue," Risk Management Agency, USDA, February 2003, p. 1).

[77] Exhibit Bra-272 ("Fact Sheet: Adjusted Gross Revenue," Risk Management Agency, USDA, February 2003, p. 1,3).

[78] The record shows that most farms are small, and that many small farms specialize in beef production. *See* Bra-285 ("Agriculture Fact Book 2001-2002, Chapter 3 – American Farms, Figures 3.1 and 3.8). Therefore, these farms could not be eligible under the pilot programme because more than 35 per cent of their revenue is generated from the production of livestock. This suggests that even the figure of 7.58 per cent of total US livestock production is a significant overestimate.

[79] Exhibit Bra-271 (Analysis of the Market Value of Livestock in Adjusted Gross Revenue Insurance Pilot States and Counties).

[80] Brazil's 22 August Rebuttal Submission, para. 59 and Exhibit Bra-177 ("ERS Briefing Room: Farm Income and Costs: Farm Income Forecasts").

[81] Exhibit Bra-30 (Section 518 of the Federal Crop Insurance Act) contains a list of the "agricultural commodities" covered by insurance policies that are subsidized under the Federal Crop Insurance Act.

**131. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*: BRA, US**

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

**(c) is a subsidy in respect of certain identified agricultural products specific?**

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

Brazil's Answer:

57. The short answer to Questions 131(a) – (f) is "yes."

58. Brazil's Further Submission sets forth a detailed analysis of the legal requirements for *de facto* and *de jure* specificity (paras. 34-40), demonstrating the broad agreement between the official US interpretation of Article 2 of the SCM Agreement in the Statement of Administrative Action ("SAA") and the position of Brazil. Brazil also provided a detailed application of those requirements for each of the relevant subsidies (paras. 41-70). Brazil offers the following additional comments below:

59. With respect to Question 131(a), a US subsidy that is made available to all enterprises in the industry producing agricultural commodities is specific. As Brazil and the United States agree, the purpose of the specificity requirements is to "function as an initial screening mechanism to winnow out only those foreign *subsidies which truly are broadly available and widely used throughout an economy*".[82] The United States' SAA notes that "all governments, including the United States, intervene in their economies to one extent or another, and to regard all such interventions as countervailable would produce absurd results". Among such "absurd results" would be countervailing "public highways and bridges, as well as a tax credit for expenditures on capital investment even if available to all industries and sectors".[83] After providing these examples, the SAA states that "the specificity test was not intended to function as a loophole through which narrowly focused subsidies provided to or used by discrete segments of an economy could escape the purview of the CVD law".[84]

60. The US subsidies at issue in this case – including crop insurance – are *de jure* limited under Article 2.1(a) because they "explicitly limit access to a subsidy to certain enterprises", *i.e.*, those producing, using, or exporting either crops, certain crops, or one crop.[85] The US subsidies are also *de facto* specific under Article 2.1(c) because they are used by a limited number of enterprises in relation to all enterprises and industries making up the US economy. Only the group of enterprises

[82] Exhibit Bra-148 ("Statement of Administrative Action," p. 929).
[83] Exhibit Bra-148 ("Statement of Administrative Action," p. 929-30).
[84] Exhibit Bra-148 ("Statement of Administrative Action," p. 930).
[85] Brazil's 9 September Further Submission, paras. 34-70.

producing agricultural crops is entitled to receive or actually use these subsidies. All other enterprises and all other industries are excluded from the right to receive and, in fact, do not use such subsidies.

61. The broad diversification of the US economy is a relevant fact for the Panel to consider for *de facto* specificity under Article 2.1(c) ("account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority".). The US SAA indicates that the US Department of Commerce should take "account of the number of industries in the economy in question" in "determining whether the number of industries using a subsidy is small or large".[86] The US industry growing and producing agricultural products, or even the sub-industry of US producers who grow crops, are in the words of the US SAA, "a discrete segment" of the US economy. The value of all US agricultural production of all commodities is only 0.8 per cent of total US GDP.[87] Article 2.1(c) requires a Panel to undertake a "case by case" approach to diversification, and Brazil believes the approach presented here and endorsed by the US SAA is an appropriate application of the provision. In the case of the United States, there is a multitude of US industries that do not use the US subsidies at issue in this case. By contrast, in the case of Benin, the agricultural industry represents 38 per cent of its GDP.[88] For a country like Benin, subsidies to the entire agriculture sector would most likely not be considered to be specific because they are widely available to a large portion of the producers within the economy. No such facts exist for the cotton subsidies at issue in this dispute.

62. Brazil sees no basis in the text of Article 2 of the SCM Agreement for a different specificity test to be applied to subsidies for the purpose of Part V (countervailing measures) and Part III (actionable subsidies) of the SCM Agreement. Nor does Brazil see any basis to apply a different test of specificity for agricultural and other types of goods and industries – no such distinction exists in Article 2 of the SCM Agreement. For example, would a subsidy provided only to the US automotive parts industry (which includes thousands of enterprises) be specific while a subsidy provided to thousands of enterprises producing agricultural crops *not* be specific? There cannot be much doubt that the US automotive parts industry is a discrete segment of the US economy, and a discrete "industry". Brazil (and the US SAA) is of the view that in both these instances, the subsidy would be specific. All of the US subsidies challenged by Brazil are narrowly focused on, at most, a *portion* of the industry producing agricultural products.

63. With respect to Question 131(b), a subsidy that is provided to enterprises producing all agricultural *crops* is specific. Because the applicable industry is the one producing all agricultural commodities, a subsidy to only enterprises producing crops but not to enterprises producing *other* agricultural commodities is specific. Brazil notes the entirely different approach the United States now asserts in this case, regarding crop insurance, and the official interpretation offered in the SAA.[89] While the Panel, of course, is not bound by the unilateral interpretation of the United States in the SAA, Brazil believes that the SAA, in this instance, correctly described the intent of the drafters regarding specificity. The producers of US crops are discrete enterprises within a US industry. None of these subsidies is provided to enterprises producing other types of agricultural products that make up approximately 50 per cent of the value of the US agricultural commodities.[90] In the case of crop insurance, it is useful to recall that many of the small US farming enterprises – representing 92 per cent of US farms – produce livestock, including beef.[91]

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[86] Exhibit Bra-148 ("Statement of Administrative Action," p. 931).

[87] Exhibit Bra-269 ("Gross Domestic Product by Industry for MY 1999-2001," Robert J. McCahill and Brian C. Moyer, November 2002, p. 36).

[88] Exhibit Bra-294 ("The World Fact Book – Benin," CIA, p.6)

[89] The "SAA thus contains the view of the Administration, submitted by the President to Congress and receiving its imprimatur, concerning both interpretation and application and containing commitments, to be followed by future Administration, on which domestic as well as international actors can rely." Panel Report, *US – Section 301*, WT/DS152/R, para. 7.111.

[90] *See* Brazil's Answer to Question 130.

[91] Exhibit Bra-285 (Agriculture Fact Book 2001-2002, Chapter 3 – American Farms, Figures 3.1 and 3.8).

64. In deciding the question, the Panel should also take into account the significant implications of accepting the US arguments that any subsidy provided to all agricultural producers of all agricultural commodities would be non-specific. This interpretation would create a new class of trade-distorting agricultural subsidies that are non-actionable. The United States has always notified its crop insurance subsidies as amber box subsidies, *i.e.*, presumptively trade distorting. And USDA economists have found that even lower subsidies provided by the pre-2000 ARP Act increased US upland cotton acreage by 1.2 per cent and US upland cotton exports by 2 per cent.[92] Professor Sumner found that the higher subsidies provided by the 2002 ARP Act increased US upland cotton acreage by 3.3 per cent, US exports by 3.8 per cent, and decreased world A-Index prices by 1.3 per cent on average for each year between MY 2000-2002.[93]

65. The US specificity interpretation would permit, for example, a Member to provide a revenue guarantee to every enterprise producing any agricultural commodity to pay for the total cost of production plus a reasonable profit margin of 10 per cent. The US interpretation would permit Members to make direct payments to every farming enterprise that are tied to a constructed average price index for all agricultural products (not individual prices such as the CCP) and a farmer's current total production. A Member could also provide free inputs for the production of all agricultural commodities to every enterprise producing any agricultural product without that subsidy being actionable under Articles 5 and 6 of the SCM Agreement. In short, if the criteria is, as the United States argues, that the subsidy only need be provided to all farming enterprises, then *any* type of trade distorting non-green box domestic subsidy meeting that universal application criteria would escape discipline under the SCM Agreement.

66. The USinterpretation would create a gaping hole in the disciplines of the Agreement on Agriculture and the SCM Agreement. Such an interpretation is clearly inconsistent with the object and purpose of the Agreement on Agriculture, which is to "correct[] and prevent[] restrictions and distortions in world agricultural markets". It is inconsistent with the SCM Agreement's object and purpose of disciplining trade-distorting actionable subsidies. And it is completely inconsistent with the interpretation including in the United States' SAA.

67. With respect to Questions 131(c) and (d), for the reasons set forth above and in Brazil's earlier submissions, a subsidy that is mandated to be provided to only certain enterprises in respect of a handful of identified agricultural products (such as the 10 "programme" crops of the direct and counter-cyclical payment programme) but not provided to most other enterprises within the agricultural industry producing crops or agricultural commodities, is specific under Article 2.1(a) of the SCM Agreement. Similarly, there is *de facto* specificity because these same subsidies covered by the Panel's questions (c) and (d) are only used by certain enterprises of the overall industry producing agricultural commodities (which is the case for all the US subsidies except crop insurance and GSM 102).[94]

68. Regarding Question 131(e), if a subsidy is paid only to enterprises that produce or manufacture products representing a certain *portion* of the value of the products of a single industry (such as the US industry producing agricultural commodities), then the subsidy would be specific. Evaluating specificity based on the "value" of products produced by a single industry is a useful tool for measuring the extent to which the subsidy is provided to discrete enterprises within an industry, or within an economy. When many enterprises in the most highly revenue generating segments of an industry do not receive a subsidy – such as the absence of crop insurance for livestock including beef, poultry and pork, among others – then the subsidy is specific because it is only used by a certain number of enterprises within the industry.

[92] Brazil's 22 August Rebuttal Submission, paras. 63-64.
[93] Brazil's 9 September Further Submission, Annex I, Table 1.5d.
[94] Brazil's 9 September Further Submission, paras. 41-61.

69. Finally, with respect to Question 131(f), another tool for evaluating the specificity of a subsidy is the amount of total US farmland that receives the subsidy. The use of "farmland" is a rough proxy for the number of enterprises producing agricultural products within the meaning of Article 2.1. For example, only 38 per cent of US farmland is used for the growing of crops (including hay) that are eligible for the payment of crop insurance.[95] By contrast, 62 per cent of US farmland is used for the production of livestock that, with only a few exceptions, is not covered by US crop insurance. When used in conjunction with the "value" data discussed in Question 131(e) above, this acreage data confirms the fact that a number of enterprises within the industry producing agricultural commodities do *not* receive the crop insurance subsidy. Brazil notes that the United States has not contested the use of similar acreage data to demonstrate the specificity of other US subsidies.[96]

H. EXPORT CREDIT GUARANTEES

**137. Please elaborate the meaning of "net losses" as is used in paragraph 70 of Brazil's 7 October oral statement. BRA**

Brazil's Answer:

70. The term "net losses" was, in the context of an oral statement, merely a shorthand reference to the elements of item (j) – the provision of the CCC guarantee programmes at "premium rates which are inadequate to cover the long-term operating costs and losses of the programmes".

71. To prove that the CCC guarantee programmes suffered "net losses" (or in other words meet the elements of item (j)), Brazil referred, in paragraph 70, to the comparison of cohort-specific subsidy figures from the "guaranteed loan subsidy" line of the US budget with cohort-specific reestimates from Table 8 of the Federal Credit Supplement[97], summed over the period 1992-2002 to determine the performance of the CCC programmes over the long term.

72. Whether starting with the cohort-specific subsidy figure from the budget year column of the US budget or with the cohort-specific subsidy figure from the prior year column of the US budget, the result of this exercise is a positive subsidy number.[98] The CCC arrives at the very same result in its 2002 financial statements. Specifically, the 2002 financial statements provide a cumulative subsidy figure for *all* post-1991 CCC guarantees, taking account of all adjustments for defaults, fees and reestimates undertaken for all cohorts in all years through 2002. This exercise results in a cumulative

[95] Exhibit Bra-143 (Agricultural Statistics 2003, National Agricultural Statistics Service, USDA. Table IX-6; *See also* Summary of Business Application, Risk Management Agency. USDA. Accessed 21/10/03, http://www3.rma.usda.gov/apps/sob/ Based on the 1997 census (the most recent year), the total land in farms is 968,338,000 acres; the total cropland used for crops was 348,701,000 acres; idle cropland and grassland pasture was 580,165,000 acres; the number of acres insured on rangeland, forage seed, forage production, alfalfa seed (*i.e.*, crops that could be grown on grassland pasture) was 12,575,000 acres. If cropland not used for crops was included, then the total amount of acreage not producing insured commodities would be 58.61 per cent and the total amount of acreage used to produce insured (or potentially insured) commodities under the 2002 ARP Act would be 41.39 per cent. Brazil notes that this does not include any reference to the recent pilot programs discussed elsewhere. However, the percentages would not change to any great extent if such acreage were included, given the 35 per cent limit on livestock imposed by the crop insurance program.

[96] *See* Brazil's 9 September Further Submission, paras. 43-61 (discussion of specificity regarding PFC, MLA, DP, and CCP subsidies).

[97] Table 8 of the 2004 Federal Credit Supplement is included at Exhibit Bra-182.

[98] Brazil has offered calculations using the cohort-specific subsidy estimate from the budget year column of the US budget (para. 115 of Brazil's 22 August Rebuttal Submission), and using the cohort-specific subsidy estimate from the prior year column of the US budget (Exhibit Bra-193).

positive subsidy figure of $411 million for the period 1992-2002.[99] The Panel will recall that under the Federal Credit Reform Act, when "payments from" the government exceed "payments to" the government on a net present value basis, a positive subsidy results, meaning that CCC is "los[ing] money".[100]

73. Brazil has explained that the FCRA cost formula is one way to determine the performance of the CCC export credit guarantee programmes relative to the elements of item (j). Application of the formula demonstrates that over the period 1992-2002, CCC guarantees under the GSM 102, GSM 103 and SCGP programmes were provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes."

74. The United States objects to the appropriateness of the FCRA formula as a proxy for the analysis required by item (j).[101] The United States' objection is based on the fact that re-estimates are still being undertaken for all CCC guarantee cohorts during the period 1992-2002. Brazil has therefore also offered a number of other methods to confirm that operating costs and losses for the CCC guarantee programmes outpace premiums collected during the period 1992-2002[102], or in other words, that the CCC guarantee programmes suffered "net losses" over that long-term period.

**138. Please comment on Brazil's views stated in paragraph 70 of its 7 October oral statement. US**

Brazil's Comment:

75. Brazil notes an inadvertent error in paragraph 70 of its 7 October Oral Statement. Exhibit Bra-193 does indeed compare cohort-specific reestimates to cohort-specific subsidy figures from the prior year column of the US budget. However, the comparison of cohort-specific reestimates to cohort-specific subsidy figures from the budget year column of the US budget is reflected in the table at paragraph 115 of Brazil's 22 August Rebuttal Submission, rather than in Exhibit Bra-192.

76. In Exhibit Bra-192, Brazil subtracted downward reestimates from and added upward reestimates to the original subsidy figure included in the budget year column of the "guaranteed loan subsidy" line of the annual US budget.

**139. In the context of export credit guarantees, is the Panel correct in understanding that Brazil's claims of inconsistency with the *Agriculture Agreement* involve GSM 102, GSM 103 and SCGP, but that it limits its "serious prejudice" allegations in respect of export credit guarantee programmes to the GSM 102 programme, and does not challenge GSM 103 and SCGP in this respect? If so,**

**(a) could Brazil please explain why it did so, and confirm that all the data relied upon in its further submissions (e.g. in Table 13) relate to the GSM 102 programme rather than to GSM 102, GSM 103 and SCGP (and, if the data needs to be adjusted to take account of a narrower "serious prejudice" focus, supply GSM-102-relevant data)? BRA**

[99] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, "Commodity Credit Corporation's Financial Statements for Fiscal Year 2002", Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

[100] Exhibit Bra-121 (US General Accounting Office, Report to Congressional Committees, "Credit Reform: US Needs Better Method for Estimating Cost of Foreign Loans and Guarantees," GAO/NSIAD/GGD-95-31, December 1994, p. 20)). For the FCRA formula, *see* Exhibit Bra-117 (2 U.S.C. § 661a(5)(c)).

[101] US 22 August Rebuttal Submission, para. 162.

[102] Brazil's 11 August Answers to Panel Questions, paras. 163-168; Brazil's 22 August Rebuttal Submission, para. 109.

77. The Panel is correct in understanding that Brazil's serious prejudice claims involve only GSM 102. All tables and figures that make reference to export credit guarantees in the context of Brazil's serious prejudice claims represent data on GSM 102 only. The reason that Brazil's serious prejudice claims do not cover GSM 103 and SCGP is that either no cotton allocations were made under the programme (GSM 103 for most of the marketing years covered by the period of investigation) or that only negligible amounts of cotton were exported under the programme (SCGP and – if exports took place – GSM 103).[103] Almost all US upland cotton exports that benefited from a CCC export credit guarantee were covered by the GSM 102 programme. Thus, the only CCC export credit guarantee programme that significantly contributed to the upland cotton-related serious prejudice suffered by Brazil was the GSM 102 programme. Consequently, Brazil has excluded GSM 103 and SCGP from its serious prejudice claims.

78. However, Brazil has included GSM 102, GSM 103 and SCGP in its export subsidy claims under the Agreement on Agriculture and the SCM Agreement. All three CCC export credit guarantee programmes constitute export subsidies within the meaning of Articles 10.1, 8 and 1(e) of the Agreement on Agriculture and Articles 1 and 3.1(a) of the SCM Agreement, and fulfil the criteria of item (j) of the Illustrative List of Export Subsidies attached as Annex I to the SCM Agreement.

**(b) for the purposes of Article 13(c)(ii) of the *Agreement on Agriculture*, is it necessary for the Panel to examine only GSM 102 or should the Panel's examination include also GSM 103 and SCGP? Why or why not? BRA**

79. The Panel needs to examine all three programmes under Article 13(c)(ii) of the Agreement on Agriculture. This provision exempts export subsidies from actions based on Article XVI of GATT 1994 and Articles 3, 5 and 6 of the SCM Agreement. Brazil has brought claims under Article XVI of GATT and Articles 5 and 6 of the SCM Agreement against CCC's GSM 102 export credit guarantee programme. Thus, to properly address these claims, the Panel needs to determine whether the GSM 102 programme fully conforms to the provisions of Part V of the Agreement on Agriculture, within the meaning of Article 13(c)(ii) of that Agreement.

80. In addition, Brazil has brought claims under Article 3.1(a) of the SCM Agreement against CCC's GSM 102, GSM 103 and SCGP export credit guarantee programmes. To properly address these claims, the Panel needs to determine whether the GSM 102, GSM 103 and SCGP programmes fully conform to the provisions of Part V of the Agreement on Agriculture, within the meaning of Article 13(c)(ii) of that agreement.

81. To demonstrate that CCC's GSM 102, GSM 103 and SCGP programmes do not fully conform to the provisions of Part V of the Agreement on Agriculture, Brazil has established that GSM 102, GSM 103 and SCGP constitute export subsidies and violate Articles 10.1 and 8 of the Agreement on Agriculture by circumventing or threatening to circumvent US export subsidy reduction commitments. The programmes, thus, do not conform fully to the provisions of Part V of the Agreement on Agriculture.

**140. Could Brazil explain how, if at all, it has treated export credit guarantees for the purpose of Table 1 of its further submission? BRA**

82. Brazil has not included GSM 102 for the purpose of Table 1 of its Further Submission. While Brazil has demonstrated that GSM 102 export credit guarantees constitute export subsidies within the meaning of the Agreement on Agriculture and the SCM Agreement[104], Brazil is not in a position to quantify the benefit to the recipients that has arisen from the application of the GSM 102 export credit

[103] Exhibit Bra-73 (Summary of Export Credit Guarantee Programs FY 1999-2003).
[104] Brazil's 22 August Rebuttal Submission, para. 102-110

guarantee programme to exports of US upland cotton between MY 1999-2002. Brazil has no data – nor has the United States provided any – that would enable it to calculate the benefit involved in the GSM 102 transactions.[105]

83. However, the National Cotton Council, which represents the industry benefiting from the GSM 102 programme, has provided what appears to be a reasonable estimate of the benefits to US upland cotton producers, users and exporters. These benefits are significant enough to generate an additional 500,000 bales of US upland cotton exports per year and to raise domestic US prices by 3 cents per pound.[106]

84. Having proven the export subsidy character of the GSM 102 programme, as well as having proven the production and export-enhancing as well as A-Index-suppressing effects of the programme[107], Brazil has met its burden of proof under Articles 5 and 6.3 of the SCM Agreement and GATT Article XVI to establish that the GSM 102 programme causes serious prejudice to the interests of Brazil.

**141. The Panel notes the US argument, *inter alia* in its further submission, that the export credit guarantee programmes are "self-sustaining". Recalling that item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* refers to "premium rates", could the US expand upon how it takes into account the premium rates for the export credit guarantee programmes in its analysis. US**

Brazil's Comment:

85. As Brazil has argued elsewhere, the United States cannot make a showing that the CCC guarantee programmes do not constitute export subsidies by appealing to an *a contrario* interpretation of item (j), since item (j) does not admit of an *a contrario* defense.[108]

86. Even if item (j) does admit of an *a contrario* defense, proving that the CCC programmes are "self-sustaining" is not enough. Were an *a contrario* defense possible, it would require the United States to demonstrate that over a period constituting the long term, "premium rates" are adequate to cover operating costs and losses, which include but are not limited to "claims or defaults". In contrast, the United States has argued that it is sufficient to show that "claims or defaults" do not exceed "revenue from whatever source it may be derived".[109] "Revenue from whatever source it may be derived" gives credit to the United States for revenue that is not recognized as relevant for the purposes of item (j), and "claims or defaults" ignores "operating costs and losses" that are relevant for the purposes of item (j).[110]

87. As a factual matter, Brazil quite evidently does not agree that the premium rates for the CCC programmes meet their long-term operating costs and losses. Brazil has presented voluminous quantitative data demonstrating that long-term operating costs and losses incurred by the CCC programmes outpace premiums collected. Brazil has also provided statements from the USDA Inspector General[111] and the US General Accounting Office[112] establishing that CCC's failure to

[105] However, Brazil has established that GSM 102 guarantees confer benefits *per se*, since there is no comparable commercial instrument available in the marketplace.

[106] *See* also Brazil's Answer to Question 143.

[107] Brazil's 9 September Further Submission, paras. 184-192.

[108] Brazil's 11 August Answers to Panel Questions, paras. 143-149.

[109] US 11 August Answers to Panel Questions, para. 145.

[110] *See* Brazil's 11 August Answers to Panel Questions, para. 162; Brazil's 22 July Oral Statement, paras. 122-123.

[111] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31 ("[T]he fees CCC charges for its GSM-102 and GSM-103

account for country risk or the credit rating of the borrower in setting guarantee fees means that CCC is charging "premium rates" that do not allow it to cover its operating costs and losses over the long-term.

**142. The US has pointed out that there are many limitations on granting export credit guarantees and that there is no requirement to issue any particular guarantee (US further submission, paras 153-156). Can the Commodity Credit Corporation decline to grant an export credit guarantee even in cases where the programme conditions are met? US**

Brazil's Comment:

88. No, the CCC cannot decline to grant an export credit guarantee even in cases where the programme conditions are met. The CCC cannot "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[113] The CCC export credit guarantee programmes therefore threaten to lead to (and in fact have led to) circumvention of the United States' export subsidy reduction commitments, within the meaning of Article 10.1 of the Agreement on Agriculture.

89. Under the Budget Enforcement Act of 1990, the US Office of Management and Budget classifies the CCC export credit guarantee programmes as "mandatory".[114] Mandatory programmes like the CCC export credit guarantee programmes are exempt from the requirement in US law that a programme receive new Congressional budget authority before it undertakes new loan guarantee commitments.[115] As the Congressional Budget Office has noted, support *via* mandatory programmes like the CCC export credit guarantee programmes "must be available to all eligible borrowers", without regard to appropriations limits.[116] The Congressional Research Service has similarly stated that "[e]ligibility for mandatory programmes is written into law, and *any individual or entity that meets the eligibility requirements is entitled to a payment as authorized by the law*".[117]

90. The fact that the CCC can deny guarantees to individuals who do not meet the eligibility criteria does not, of course, affect the conclusion that CCC cannot "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[118] The United States' FSC measure had eligibility criteria, but

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export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs".). Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed for many years and may not be reflecting current costs".).

[112] Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, "Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees," GAO/GGD-95-60 (February 1995), p. 135-136). At paragraph 110 of its 22 August Comments on US Answers, Brazil included an extract from this General Accounting Office study demonstrating that CCC's low premium rates do not allow it to cover its costs and losses, and that the CCC programmes do not meet *non-market*, let alone *market*, benchmarks.

[113] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

[114] Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Programme classified as "Mandatory" in Table 2, and in the "Introduction", the Office of Management and Budget states that Table 2 provides "the programme's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory").

[115] *See* Exhibit Bra-117 (2 U.S.C. § 661(c)(2)).

[116] Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform", April 1991, p. 7). *See also Id.*, Table 2, which verifies that the CCC export credit guarantee programmes are "mandatory" programs. Brazil notes that this does not mean that the CCC programmes do not *receive* appropriations. The United States acknowledges in its 11 August Answer to Question 11 that the CCC programmes receive appropriations.

[117] Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget", IB95031 (16 February 1996), p. 3 (emphasis added)).

[118] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

the Appellate Body still concluded that nothing in the measure "stem[ed], or otherwise control[led], the flow of" FSC benefits, leading to a threat of circumvention of the United States' export subsidy reduction commitments.[119]

91. The entitlement that qualified applicants have to CCC guarantees is not curtailed by the requirement in US law that CCC not make available guarantees to countries that cannot adequately service debt.[120] That CCC has the authority to deny guarantees on this basis is not relevant, for at least three reasons.

92. First, under the United States' FSC measure, US authorities were permitted to undertake a factual enquiry into whether the foreign-source income of the foreign corporation was "effectively connected with the conduct of a trade or business within the United States".[121] This authority, and the possibility that the factual enquiry could limit the amount of income that would qualify for the FSC exemption, did not prevent the Appellate Body from concluding that nothing in the FSC measure "stem[ed], or otherwise control[led], the flow of" FSC benefits, leading to a threat of circumvention of the United States' export subsidy reduction commitments.[122] Similarly, the authority that CCC has to undertake an enquiry into whether particular countries are creditworthy, and the possibility that this enquiry could end up reducing the amount of CCC guarantees, does not prevent a conclusion that nothing "stem[s], or otherwise control[s], the flow of" CCC guarantees. (Brazil notes that, in any event, a conclusion by CCC that a particular country is not creditworthy would not necessarily reduce the threat of circumvention, since nothing prevents CCC from simply reassigning the country's allocation to a country that is creditworthy.)

93. Second, as Brazil has previously noted, the US General Accounting Office ("GAO") concluded that the requirement that CCC not make available guarantees to countries that cannot adequately service debt does not remotely curtail CCC's extension of its guarantees. According to the GAO, "the statute does not place any limit on the amount of guarantees that can be provided each year to high-risk countries in aggregate or individually".[123] Thus, the theoretical possibility to halt support to non-creditworthy countries does not "stem[], or otherwise control[]," the flow of CCC guarantees.[124]

94. Third, CCC is not concerned enough about creditworthiness to vary its fees based on the country risk involved.[125] Nor does US law require the CCC to take account of the creditworthiness of *individual guarantee recipients* in the fee charged. In fact, CCC fees expressly do not take account of the credit rating of an individual borrower.[126] Thus, even if CCC finds a country to be creditworthy, it is not compensated for particularly poor individual credit risks.

95. Nor is the entitlement that qualified applicants have to CCC guarantees curtailed by CCC's ability to adopt product- and country-specific allocations for its export credit guarantee programmes. Although CCC adopts initial allocations at the outset of a fiscal year, it generously increases those allocations as needed. In its announcement of initial allocations for fiscal year 2004, for example, which extends $2.8 billion in allocations for CCC guarantees, USDA stated that CCC will subsequently make additional allocations throughout the year that will bring total 2004 allocations to

[119] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 12.
[120] *See* US 30 September Further Submission, para. 154.
[121] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 16.
[122] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.
[123] Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition and Forestry, US Senate, "Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees," GAO/GGD-95-60 (February 1995), p. 7).
[124] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.
[125] Brazil's 22 August Comments on US Answers, paras. 109, 112.
[126] Brazil's 22 August Comments on US Answers, paras. 109, 112.

more than $6 billion.[127] Browsing the archived list of USDA press releases announcing supplemental allocations extended throughout fiscal year 2003,[128] for example, demonstrates that this is exactly what CCC does – it increases allocations as needed. As noted above, CCC is not required to receive new Congressional budget authority before it undertakes these additional allocations. In fact, Congress requires CCC to make available *at least* $5.5 billion in guarantees – it does not put a ceiling on the amount to be granted.[129] The allocation process does not "stem[], or otherwise control[]", the flow of CCC export credit guarantees.[130] In fact, it enables CCC to increase the guarantees it can provide.

96. Nor does CCC's ability to adopt product-specific allocations for its export credit guarantee programmes mitigate the significant threat, under Article 10.1 of the Agreement on Agriculture, that the United States will surpass its agricultural export subsidy reduction commitments by virtue of the CCC export credit guarantee programmes. This threat implicates both unscheduled and scheduled agricultural commodities.

97. For unscheduled products, the ability to adopt allocations is irrelevant. Since CCC export credit guarantees are *available* for unscheduled products[131], the threat of circumvention of the US reduction commitments is tangible, and the United States is in violation of Article 10.1. As Brazil has previously noted, the Appellate Body held that for unscheduled products, it is inconsistent with Article 10.1 to provide *any* export subsidies.[132] Moreover, the record demonstrates that the threat has materialized, since CCC guarantees have been extended to unscheduled products during, for example, 1999-2003.[133]

98. For scheduled products, the process of adopting product-specific allocations for CCC export credit guarantee programmes does not mitigate the threat of circumvention – or does not "stem[], or otherwise control[]", the flow of CCC export credit guarantees – for at least three reasons.[134]

99. First, as the list of allocations included in the programme activity report for fiscal year 2003 demonstrates[135], most allocations are only made on a country-specific basis, and not on a product-specific basis. In fact, less than 8 per cent of the allocations listed on the 2003 programme activity

[127] Exhibit Bra-296 ("USDA Announces $2.8 Billion in Export Credit Guarantees," FAS Press Release, 30 September 2003).

[128] *See* http://www.fas.usda.gov/excredits/exp-cred-guar.asp.

[129] Exhibit Bra-297 (7 U.S.C. § 5641(b)(1); 7 U.S.C. § 5622(a), (b)).

[130] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

[131] Exhibit Bra-298 ( "USDA Amends Commodity Eligibility under Credit Guarantee Programmes", FAS Press Release, 24 September 2002). Exports of unscheduled agricultural products that are eligible for CCC export credit guarantee coverage include: barley malt and barley extract, corn products, cotton (including cotton yarn, cotton fabric, cotton products, including cotton linters), fish and shellfish, fresh and dried fruits (including apples, apricots, avocados, blueberries, cherries, clementines, dates, figs, grapefruits, grapes, kiwi, watermelons, cantaloupe, honeydrew, nectarines, oranges, peaches, pears, plums, prunes, raisins, raspberries, strawberries, tangerines and mixtures thereof), fruit and vegetable concentrates, 100 per cent fruit juices, hay, hides and skins, honey, soybean protein products, vegetables (including asparagus, beans, broccoli, carrots, cauliflower, celery, garlic, lettuce, mushrooms, onions, peas, peppers, potatoes, spinach, squash, sweet corn, tomatoes, and mixtures thereof), wood products (including lumber etc.), wool (including wool fabrics, wool yarn and mohair), worms.

[132] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 150.

[133] Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Programme Activity", USDA, covering GSM-102, GSM-103 and SCGP). For 1999-2002, s*ee also* Exhibit Bra-73 ("Summary of Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003).

[134] *See* also Brazil's 24 June First Submission, paras. 300-301.

[135] Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Programme Activity", USDA, covering GSM-102, GSM-103 and SCGP).

report are product-specific.[136] The press release announcing initial allocations for 2004 contains no product-specific allocations. These allocations do not "stem[], or otherwise control[], the flow of" CCC export credit guarantees in a way that would curb the threat that they will be used to surpass the United States' export subsidy reduction commitments for scheduled products.[137]

100. Second, the allocations are made on a *monetary* basis, which provides virtually no assurance that the United States will not surpass its *quantitative* export subsidy reduction commitments. This might not happen for all scheduled products in all years, but the threat that it will happen is tangible. Rice provides a good example. Based on the monetary amounts of exporter applications received for the CCC programmes, US export data, and average world prices, CCC guarantees to support US rice exports caused the United States to surpass its quantity export subsidy reduction commitments in fiscal years 2001, 2002 and 2003.[138] (Even if monetary allocations were relevant, nothing limits the amount of funds that can be allocated. The CCC programmes operate without the constraints of the appropriations process, and Congress requires that CCC make available a *minimum* of $5.5 billion in export credit guarantees.)

101. Third, the United States' schedule demonstrates that the CCC export credit guarantees are not the only subsidies available to support exports of scheduled commodities. Combining CCC guarantees with these other export subsidies augments the threat that the United States will exceed its export subsidy reduction commitments.

102. In summary, the CCC cannot "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[139] None of the factors mentioned by the United States stem the flow of those guarantees, which CCC cannot decline to grant in cases where the programme conditions are met. The CCC export credit guarantee programmes therefore threaten to lead to (and in fact have led to) circumvention of the United States' export subsidy commitments, within the meaning of Article 10.1 of the Agriculture Agreement.

103. With respect to its claims under the SCM Agreement, Brazil notes that even if the CCC had the discretion not to grant export credit guarantees in cases where the programme conditions are met, it would not affect Brazil's claim that the guarantees confer benefits *per se*. As Brazil has discussed elsewhere, since CCC export credit guarantees from the GSM 102, GSM 103 and SCGP programmes are unique financial instruments for agricultural commodity transactions that are not available on the commercial market (certainly not for terms longer than the marketing cycles of the eligible commodities), each time they are granted, they confer benefits within the meaning of Article 1.1(b) of the SCM Agreement.

**143. Brazil agrees with National Cotton Council estimates of the effects of the GSM 102 programmes (Brazil's further submission, para. 190) but it also cites a different conclusion by Prof. Sumner (paragraph 192). Brazil cites other estimates by Prof. Sumner throughout its further submission. Does Brazil adopt Prof. Sumner's conclusions and estimates as part of its submission? BRA**

104. Brazil considers both the National Cotton Council's and Professor Sumner's estimates as independent parts of the record that demonstrate the serious prejudice caused by the GSM 102 programme to the interests of Brazil. The NCC has a staff of expert economists (including the former

[136] Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Programme Activity", USDA, covering GSM 102, GSM 103 and SCGP (Total GSM 102, GSM 103 and SCGP allocations for fiscal year 2003 are listed as $6.025 billion, with product-specific allocations as follows: $370 million of GSM 102 guarantees to Korea; $85 million of GSM 102 guarantees to Pakistan; and, $10 million of GSM 102 guarantees to Tunisia).

[137] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

[138] Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP).

[139] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

director of the FAPRI cotton model) and has testified to Congress that the effects of the GSM 102 programme increase annual US cotton exports by 500,000 bales and have a 3-cent per pound price effect.[140] Brazil has no reason to doubt the accuracy and reliability of the sworn NCC testimony to the US Congress.

105. Professor Sumner has based his analysis of the effects of the GSM 102 export credit guarantee programme on the earlier work by the National Cotton Council. Professor Sumner has modelled the impact of the GSM 102 export credit guarantee programme as a shift out of the demand curve for US upland cotton by 500,000 bales.[141] Brazil believes that the resulting lower estimates of the effects of the GSM 102 programme offered by Professor Sumner are yet another illustration of the conservative (and reasonable) nature of his model.

106. In response to the Panel's Question, Professor Sumner has rerun the model analyzing the results of a fixed 500,000 bales export effect rather than a shift out of the demand curve by that amount. His original results showed an average annual 305,000 bales export-increasing effect for MY 1999-2002.[142] But the assumption of a fixed 500,000 bale export-increasing effect from the GSM 102 programme results in an average world price effect between MY 1999-2002 of 0.928 cents per pound (or 1.80 per cent) compared to 0.57 cents per pound (or 1.12 per cent) estimated under the previous assumption.[143] For the period MY 2003-2007 the average world price effect would be 1.07 cents per pound or 1.93 per cent compared to the 0.53 cents per pound or the 0.96 per cent estimated previously.[144]

107. Brazil has submitted the analysis of Professor Sumner along with results from other economists and other evidence throughout its submissions. The Panel should consider the complete record in analysing the collective effects of the US subsidies. *Both* the NCC's as well as Professor Sumner's studies are positive evidence of the export-enhancing and price-suppressing effects of the GSM 102 export credit guarantee programme. Both the NCC's testimony as well as Professor Sumner's original as well as revised analysis establishes that GSM 102 causes serious prejudice to the interests of Brazil, within the meaning of Articles 5(c), 6.3(c) and 6.3(d) of the SCM Agreement, and within the meaning of Articles XVI:1 and 3 of GATT 1994.

I. ACTIONABLE SUBSIDIES

**145. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Articles 4.7 and 7.8 of the *SCM Agreement*. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the *SCM Agreement* to withdraw the subsidy without delay, can the Panel:**

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? BRA, US**

[140] Exhibit Bra-41 ("The Future of Federal Farm Commodity Programmes (Cotton)", Hearing before the House of Representatives Committee on Agriculture, 15 February 2001, p. 12).

[141] Brazil's 9 September Further Submission, Annex I, para. 59. For reasons internal to the FAPRI model, Professor Sumner did not include the 3 cents per pound price effect estimated by the NCC in the shift out of the demand curve, thus generating more conservative results. In addition, the implicit supply and demand elasticities used by the NCC imply larger price impacts than those in the FAPRI model used by Professor Sumner, again leading to more conservative results.

[142] *See* Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of Export Credit (fixed exports)").

[143] Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of Export Credit (fixed exports)).

[144] Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of Export Credit (fixed exports)).

Brazil's Answer:

108. Regarding the first question, the Panel can conclude that prohibited subsidies have resulted in adverse effects to the interests of another Member. Article 5(c) of the SCM Agreement provides that no Member should cause serious prejudice through the use of *any* subsidy. That includes subsidies that are prohibited under Article 3. Nothing in the text of Articles 4.7 and 7.8 of the SCM Agreement suggests that a complaining party must make a choice between prohibited and actionable subsidy remedies. Brazil has a right to remedies provided by both provisions if the Panel makes the underlying findings that a prohibited subsidy such as Step 2 and export credit guarantees also are actionable subsidies that caused serious prejudice.

109. With respect to the second question, there will be value in the Panel making a recommendation under both Articles 4.7 and 7.8 of the SCM Agreement. A subsidy becomes a *prohibited* subsidy because it is contingent on exports or on the use of domestic over imported goods. If the forbidden contingency is removed, the subsidy may still cause ongoing adverse effects. In addition, there may still be continuing adverse effects from subsidies that were previously contingent on export or local content subsidies. Without a recommendation under Article 7.8, these ongoing as well as continuing adverse effects could not be remedied. Finally, recommendations on both prohibited and actionable subsidy claims may avoid later complications in the event of an appeal of the Panel's final determination.

110. Thus, Brazil urges the panel to make first a recommendation under Article 4.7 of the SCM Agreement that the Step 2, as well as GSM 102, GSM 103 and SCGP export credit guarantee programmes be withdrawn without delay. The Panel should also make a recommendation that the United States remove the adverse effects of the Step 2 and GSM 102 export credit guarantee programmes under Article 7.8 of the SCM Agreement.

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the *SCM Agreement*? BRA, US**

Brazil's Answer:

111. With respect to the first question, the text of Article 5 of the SCM Agreement provides that "[n]o Member should cause, through the use of *any subsidy referred to in paragraphs 1 and 2 of Article 1*, adverse effects". The clear intention is for panels to take into account in assessing adverse effects any and all subsidies that are specific, including those found to be prohibited under Article 3. The only subsidies excluded are those that are not specific. The ban on adverse effects also embraces adverse effects caused by the interaction between all actionable subsidy programmes.

112. Because the Panel is required to examine all actionable subsidies in making its causation determination, it is not appropriate for it to separately analyze the individual effects of each subsidy. Thus, the Panel should look at the interaction of the various types of subsidies at issue and at their *collective* effects. No attribution of the effects to individual subsidies or to prohibited and "other" actionable subsidies is necessary because the remedies of Articles 4.7 and 7.8 of the SCM Agreement are not contradictory.

113. Even if the Panel were to decide that it would be appropriate to examine individual effects of subsidies, Brazil has produced extensive evidence of the link between the serious prejudice caused

and the individual and collective effects of all of the actionable subsidies.[145] If the Panel chooses to examine the individual instead of the collective effects of some of the US subsidies, it can do so based on the evidence produced by Brazil.[146] This evidence establishes causation whether the subsidies are examined individually or collectively. With respect to the interactive effects of the various US subsidies, please see Brazil's Answer to Questions 146.

**146. Brazil acknowledges that there are some interaction effects that may increase or decrease the overall effects of the subsidies (Brazil's further submission, para. 225). How would your analysis under Articles 5(c) and 6.3 of the *SCM Agreement* and Article XVI of *GATT 1994* differ if it excluded, for example, crop insurance subsidies, PFC and/or direct payments? BRA**

Brazil's Answer:

114. The evidence in the record is more than sufficient to establish present and threat of significant price suppression, increasing world market share, and inequitable share of world export trade even if PFC/direct payments and crop insurance subsidies were not deemed to be actionable subsidies.

115. In response to the Panel's question, Brazil asked Professor Sumner to use his model described in Annex I to Brazil's 9 September Further Submission to eliminate the effects of *all subsidies except the PFC/direct payment and crop insurance subsidies*. Professor Sumner's analysis examined the effects of the remaining US subsidies with respect to a number of factors such as planted acreage, production, US price, adjusted world price etc. The complete set of results is set forth in Exhibit Bra-301.[147] Brazil describes the interactive effects of all US subsidies *except* crop insurance and PFC/direct payments on US export and world A-Index prices below.

116. Analyzing the results for the MY 1999-2002 period from Exhibit Bra-301 shows that *but for* the payments from all US subsidy programmes (except the PFC and crop insurance), US exports would have fallen by 36.81 per cent and the world A-Index prices would have increased on average by 11.00 per cent (or 5.73 cents per pound). When crop insurance and PFC/direct payments are included in the original analysis, US exports fall by 41.17 per cent and A-Index world prices would increase by 12.55 per cent (6.5 cents per pound).[148]

117. When the period for MY 2003-2007 is examined, eliminating all subsidies except for crop insurance and direct payments means that, on average, US exports would fall by 37.31 per cent and the A-Index world price would increase by 8.36 per cent (4.63 cents per pound).[149] By comparison, when all US subsidies (including PFC/direct payment and crop insurance) are eliminated, US exports, on average, would decrease by 44.02 per cent and the A-Index price would increase by 10.80 per cent.[150]

[145] Brazil's 9 September Further Submission, Sections 3.3.4.7 (individual effects) and 3.3.4.8 (collective effects). *See also* Brazil's 7 October Oral Statement, paras 31-34 (USDA's analysis of individual effects of marketing loan subsidies for cotton for marketing years 2000 and 2001).

[146] The collective and individual effects of the various US subsidies are analyzed by Professor Sumner at Tables 1.5(a) – (e) of Annex I to Brazil's 9 September Further Submission. *See also* Brazil's 9 September Further Submission, Sections 3.3.4.7 (individual effects) and 3.3.4.8 (collective effects). *See further* Brazil's 7 October Oral Statement, paras 31-34 (USDA's analysis of individual effects of marketing loan subsidies for cotton for marketing years 2000 and 2001).

[147] *See* Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of all domestic support except PFC/direct payments and crop insurance")

[148] Brazil's 9 September Further Submission, Annex I, Table I.5a.

[149] *See* Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of all domestic support except PFC/direct payments and crop insurance")

[150] Brazil's 9 September Further Submission, Annex I, Table I.5a.

118. Brazil notes that most of its evidence does not involve proof regarding PFC/direct payments or crop insurance and would, therefore, not be impacted by the assumption in the Panel's question. In addition, many of the econometric analysis cited by Brazil focus on only some of the subsidies challenged by Brazil. The results of these studies are consistent with the findings of Professor Sumner's analysis set out in Annex I to Brazil's 9 September Further Submission and Exhibit Bra-301. In sum, even ignoring the effects of the crop insurance and PFC / direct payment programmes, the US subsidies cause serious prejudice to the interests of Brazil, within the meaning of Articles 5(c), 6.3(c) and (d) and GATT Articles XVI:1 and 3.

**148. How should the significance of price suppression or depression be assessed under Article 6.3(c) of the *SCM Agreement*? In terms of a meaningful effect? Or another concept? BRA, US**

Brazil's Answer:

119. The significance of price suppression should be assessed by reference to whether it meaningfully affects producers or suppliers of the same product that receives the benefits of the challenged subsidies.[151] Price suppression that does not meaningfully affect suppliers or producers of a product cannot give rise to serious prejudice, since it would not be significant. The text of Article 6.3 does not set a numerical limit on the level of price suppression. What renders price suppression significant or insignificant is whether or not it causes adverse effects to the producers or suppliers of the Member(s) concerned, not whether an arbitrary level of numeric significance is achieved.[152]

120. Contrary to the US arguments, there is not an artificial distinction between whether price suppression is "significant" and whether such levels of suppression meaningfully affect suppliers or producers of the product receiving the benefits of the subsidies. Brazil provided considerable evidence setting forth how its producers suffered adverse effects from the levels of price suppression that can be attributed to US subsidies during MY 1999-2002.[153] A good example of the significance of the levels of price suppression demonstrated by Brazil for MY 2000-2001 is found in the testimony of Christopher Ward. He indicated that a 10-per cent increase in prices for Mato Grosso producers in MY 2000 and MY 2001 would have permitted them to cover their variable costs for MY 2001 and come close to covering variable costs in MY 2000.[154] However, because of the losses they suffered without such revenue increases, many Mato Grosso producers reduced production or were forced out of cotton production – Mato Grosso production fell by 34 per cent between MY 2000-2001.[155]

121. The record shows that the adverse effects suffered by Brazilian producers have also been suffered by producers in Africa.[156] Nicolas Minot testified for Benin at the hearing on 8 October. His econometric analysis focused on the effect of lower upland cotton prices on poverty among Benin cotton farmers. Based on his economic analysis, a ten per cent decrease in upland cotton prices drove

[151] Brazil's 9 September Further Submission, paras. 251-259; Brazil's 7 October Oral Statement, paras. 30-34.

[152] *See* also New Zealand's 1 October Further Third Party Submission, paras. 2.21-2.27, tying the analysis of significance under Article 6.3(c) to the notion of serious prejudice to the Member(s) concerned under Article 5(c).

[153] Brazil's 9 September Further Submission, paras. 444-455 and Annex III.

[154] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, paras. 8-10 and accompanying graph).

[155] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, paras. 8-10 and accompanying graph).

[156] Statement of Mr. Minot. Oral Statement of Benin, 8 October 2003, paras. 29-33 ; Statement of Mr. Ibrahim Malloum, Oral Statement of Chad, 8 October 2003, paras. 13-15.

approximately 83,500 Benin upland cotton farmers below the poverty line.[157] The evidence that African producers have suffered adverse effects by reason of the effects of the US subsidies confirms and supports the evidence presented by Brazil that its producers are suffering adverse effects as well.

122. But even if the Panel decides to adopt some sort of numerical standard not reflected in the text of Article 6.3(c), Brazil has also set forth evidence showing that the levels of price suppression found by a number of different economists are "significant".[158] In assessing whether the various levels of price suppression found by USDA and other economists are "significant," the Panel should take into account the fact that upland cotton is a primary commodity traded in huge volumes and produced and consumed in a large number of countries. Under these circumstances, any measurable and identifiable effect on the *world* price from the subsidies provided by a single Member is important. In this case, the Panel is not faced with a difficult decision because during MY 1999-2002 – and even during MY 1997-1998 – the record shows that the absolute numerical levels of price suppression caused by some or all of the US subsidies were significant, ranging from 4 to 26.3 per cent of the world price, and 10 to 33.6 per cent of the US price.[159]

**153. Would the conditions in Article 6.3(d) of the *SCM Agreement* be satisfied in respect of time periods other than the one specified? What relevance, if any, would this have for Brazil's claims? BRA**

Brazil's Answer:

123. Brazil has demonstrated that the conditions of Article 6.3(d) of the SCM Agreement are fulfilled for MY 2001, 2002 and 2003.[160] The record indicates that the conditions of Article 6.3(d) of the SCM Agreement would also have been fulfilled for MY 1999 and 2000. In addition, the increase in the US share of the world upland cotton market follows a consistent trend. This consistent trend exists whether the Panel analyzes the trend over the period MY 1996-present (described by USDA as constituting a significant change in US farm policy[161]) or over the period MY 1986-present (since the introduction of the marketing loan programme for upland cotton[162]).

124. The US world market share in MY 2000 was 24.7 per cent, an increase over the previous three-year average (MY 1997-1999) of 23.2 per cent.[163] Similarly, the US market share in MY 1999 was 24.1 per cent, an increase over the previous three-year average (MY 1997-1998) of 23.4 per cent.[164]

125. Further, if the "time period" for assessing a "consistent trend" was changed from 1996-2003 to 1985-2003, the results would not be different. The following figure demonstrates that the increase in the US world market share also follows a consistent trend since MY 1986.[165]

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[157] Benin's 8 October Oral Statement (Statement of Nicolas Minot, para. 24-25) (estimating that a 40 per cent reduction in price caused 334,000 people to fall below the poverty line, and indicating that smaller reductions in the cotton price cause roughly proportional changes in income, as shown in Table 3 of his paper attached to Benin's 1 October Further Third Party Submission).

[158] Brazil's 9 September Further Submission, Table 22, page 110; Brazil's 7 October Oral Statement, paras. 30-34.

[159] *See* Brazil's 9 September Further Submission, paras. 148-161, 190, 200-232; 254 Table 23, 379-384. *See also* Brazil's 7 October Oral Statement, paras. 31-34.

[160] Brazil's 9 September Further Submission, Sections 3.4 and 4.12.2.

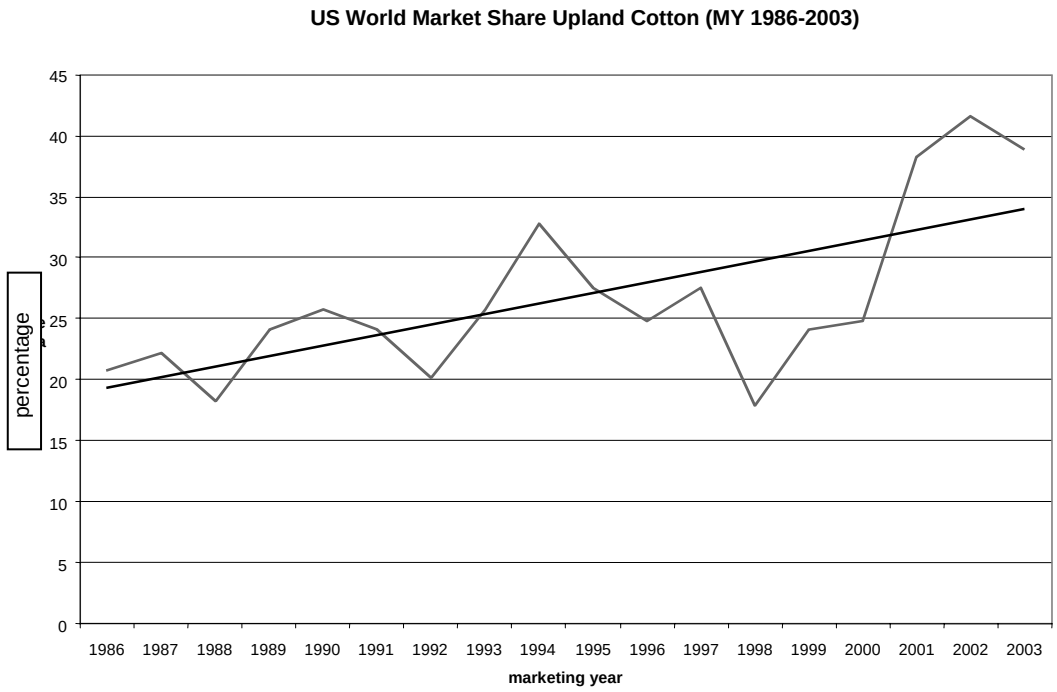
[161] Exhibit Bra-79 ("US Farm Programme Benefits: Links to Planting Decisions & Agricultural Markets", USDA, Agricultural Outlook, October 2000, p. 10).

[162] Exhibit Bra-12 ("Cotton, Background for the 1995 Farm Legislation," USDA, April 1995, p. 15)

[163] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).

[164] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).

[165] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).




126. The trend line beginning in MY 1986 in the graph above shows an overall consistent increase of US export market share over an 18-year period. This steady long-term increase coincides with the introduction of the marketing loan programme in MY 1986. Another highly trade distortive subsidy, the Step 2 payments, was introduced in MY 1990. The combination of these two subsidies, along with the other trade-distortive subsidies, played an important role in the progressive increase in US world market share over the long-term period covered by the MY 1986-2003 graph above. Thus, looking at all the trends collectively provides corroborating evidence that the large increases in the US world market share from MY 1998 to the present are caused, in significant part, by the US subsidies, in violation of Articles 5(c) and 6.3(d) of the SCM Agreement.

127. Brazil notes that MY 1998 was an unusual year with a relatively low US world market share as a direct result of a 20-per cent abandonment of upland crop acreage due to weather-related issues.[166] *But for* those weather-related problems, the US world market share would have been higher in MY 1998.

128. Finally, Brazil wishes to correct a typographical error in its calculation of the US world market share for MY 1997. The correct market share (as reflected in Figure 26 of Brazil's 9 September Further Submission) is 27.6 per cent, rather than 19.8 per cent,[167] as was incorrectly noted in Exhibit Bra-206. Brazil notes that this typographical error did not affect the calculations of the increase in the US world market share.[168] Correcting for this error, Brazil resubmits the corrected figures:

[166] *See* US 30 September Further Submission, para. 19.

[167] The error results from a typographical error in the line of the "total world exports", which were 26.7 million bales in MY 1997 and not 36.7 million bales, as erroneously included in the calculation.

[168] Brazil notes that Figure 26 of Brazil's 9 September Further Submission is unaffected by this data error and shows a very similar trend in the US world market share in cotton.

Figure 25 (para. 270)[169]

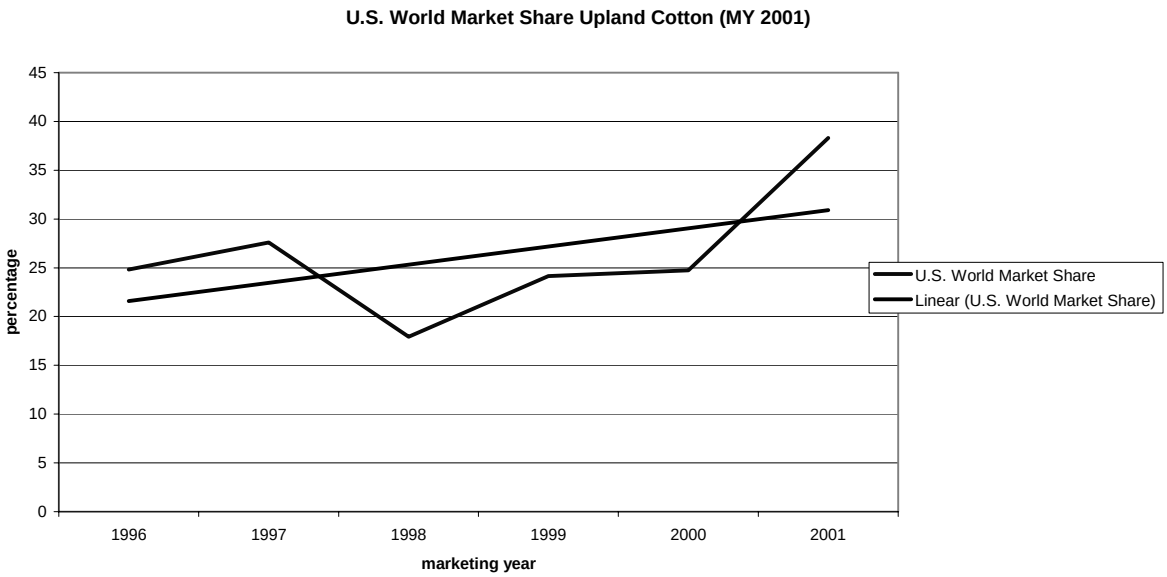
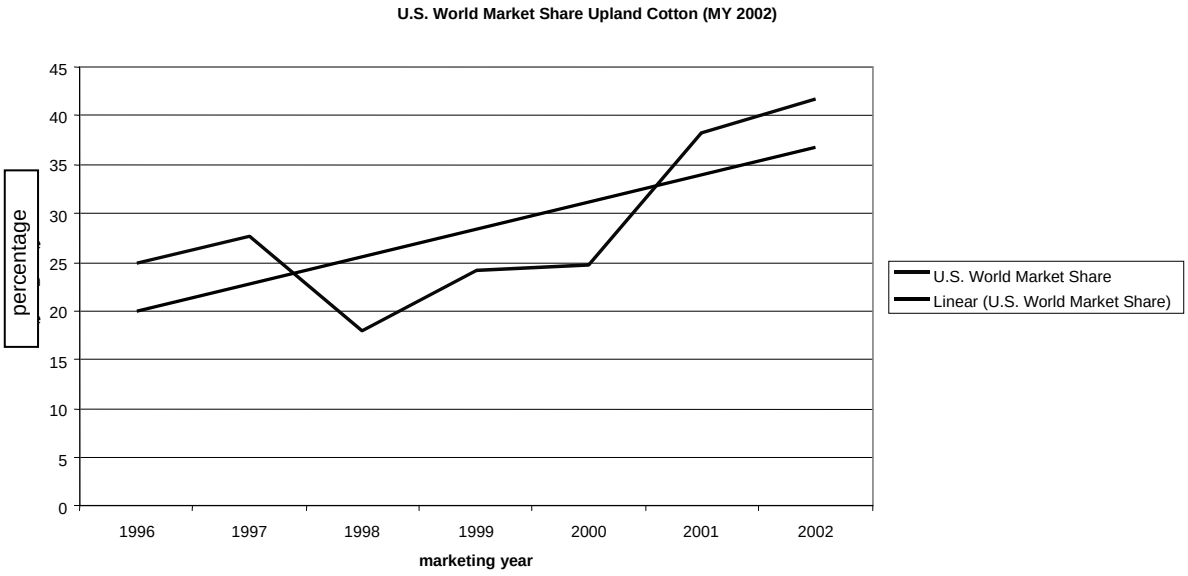
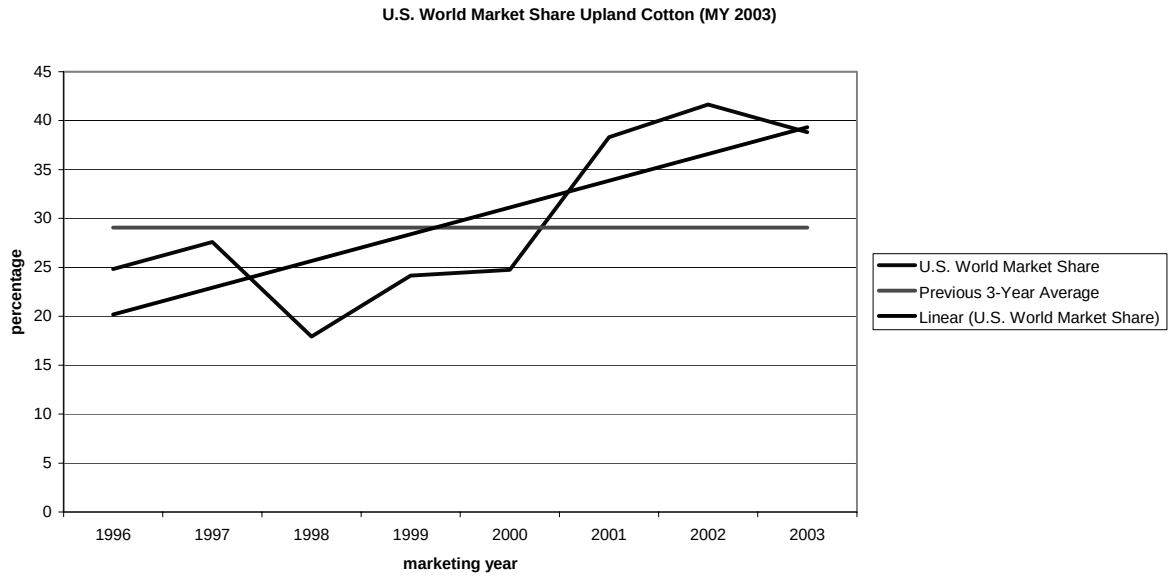



Figure 37 (para. 402)[170]




[169] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).
[170] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).

Figure 38 (para. 405)[171]




129. As the Panel can see, all three graphs show a trend line that matches the actual curve even better than the trend line presented by Brazil in its 9 September graphs. Also, all trend lines show that there is a dramatically increasing US world market share in upland cotton, in violation of Article 6.3(d) of the SCM Agreement.

**161. Would a finding of serious prejudice under Article 5(c) of the *SCM Agreement* be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the *SCM Agreement* in this context? BRA, US**

Brazil's Answer:

130. A finding of serious prejudice based on the effects described in SCM Article 6.3(a), (b), (c) or (d) would be determinative for a finding under GATT Article XVI:1. GATT Article XVI:1 concerns measures that are (i) subsidies, and which (ii) cause or threaten serious prejudice to the interests of any other Member. Footnote 13 of the SCM Agreement provides that "[t]he term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice". Footnote 13 clarifies that the instances that constitute serious prejudice within the meaning of the SCM Agreement, including Article 5(c), constitute at the same time serious prejudice within the meaning of GATT Article XVI:1. In addition, if the Panel determines that a particular measure is a "subsidy" under Articles 1 and 2 of the SCM Agreement, that measure would constitute *ipso facto* a subsidy for the purposes of GATT Article XVI:1. In sum, Articles 5(c) and 6.3 of the SCM Agreement operationalize and clarify the meaning of serious prejudice as contained in GATT Article XVI:1.[172]

**163. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ? US, BRA**

[171] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).

[172] This interpretation of the relationship between Articles 5(c) and 6.3 of the SCM Agreement and GATT Article XVI:1 is without prejudice to the continued relevance of GATT Article XVI:3, as discussed in Brazil's answers to Question 185.

Brazil's Answer:

131. Brazil has established in paragraphs 117-123 of its 9 September Further Submission that between MY 1997-2002, US upland cotton producers on average were not able to cover their total cost of production, *i.e.*, the sum of fixed and variable costs.[173] The gap between the total cost of production and the revenue generated from both upland cotton lint and cottonseed increased steadily from 2.66 cents per pound in MY 1997 to 39 cents per pound in MY 2001 before falling slightly to 34.38 cents per pound in MY 2002.[174] On a percentage basis, the average total costs to produce a pound of upland cotton in the United States between MY 1999-2002 were 77 per cent higher than the average market prices received by US farmers.[175]

132. Similarly, the Institute for Agriculture and Trade Policy in Minneapolis found in a study entitled "United States Dumping on World Agricultural Markets" that based on USDA cost of production data, the United States exported its upland cotton below its total cost of production in each year between MY 1990-2001. The study found that US upland cotton was exported between 9 and 57 per cent below the total cost of production.[176] This evidence on export prices is entirely consistent with Brazil's analysis of the gap between total cost of production and farm prices.[177]

133. Further, Brazil has used USDA data and the FAPRI 2003 baseline projections on prices and costs of production to analyze the likely gap between total costs of production and market revenues.[178] Based on this information, the gap between total cost of production and market returns to producers of upland cotton will be between 24.85 cents per pound in MY 2003 and 21.85 cents per pound in MY 2007.[179]

134. Thus, US producers were not able to meet their total cost of production since MY 1997, and based on USDA and FAPRI baselines, they will not be able to meet their total cost of production through MY 2007. This means that US upland cotton producers would not have met their cost of production for 11 consecutive years absent large US Government subsidies. The average gap between the total cost of production and market return in those eleven years will be 22.85 cents per pound.[180] The only possible conclusion is that many US producers and much US production could not exist without US subsidies, as confirmed by the National Cotton Council.[181]

135. The consistently large cost-revenue gap, among other factors, establishes the link between US subsidies and increased and maintained high levels of US production and exports. Given the high cost of production that significantly exceeds market revenues, absent the US subsidies, many US

[173] *See* also Brazil's Answer to Question 125 (2) (c).

[174] Exhibit Bra-205 (Costs and Returns of US Upland Cotton Producers).

[175] *See* Exhibit Bra-205 (Costs and Revenues of US Upland Cotton Producers). The number represents the gap between the cost of production of cotton lint and the price received by producers for cotton lint. It does not take into account cottonseed revenue that would slightly narrow the gap.

[176] Exhibit Bra-212 ("United States Dumping on World Agricultural Markets," Institute for Agriculture and Trade Policy, p. 21).

[177] Farm prices are somewhat lower than export prices.

[178] Brazil's 9 September Further Submission, paras. 353-359.

[179] Exhibit Bra-205 (Costs and Returns of US Upland Cotton Producers).

[180] In such a situation it is materially irrelevant whether US producers met their variable cost of production. Meeting at least the variable cost of production may be a short-term option for farmers to stay in business. However, over the long-run, farmers need to cover their total cost of production. Not covering total cost of production for eleven consecutive years would certainly force any producer in any industry out of business.

[181] Exhibit Bra-3 (Roger Thurow / Scott Kilman, "US Subsidies Create Cotton Glut That Hurts Foreign Cotton Farms," The Wall Street Journal, 26 June 2002, p. A1) quoting Kenneth Hood, the then Chairman of the National Cotton Council as saying "cotton farmers . . . can't exist without subsidies."

producers would have to cut upland cotton production, and much upland cotton acreage would no longer be planted to upland cotton. This result is intuitively clear and is confirmed by evidence of significant production cut-backs by Mato Grosso producers (34 per cent) who are sensitive to changes in prices, as described in Christopher Ward's statement of 7 October.[182] It is also confirmed by the results of many economists examining the effects of eliminating US subsidies. They found that eliminating the US subsidies that cover the US producer cost-revenue gap would result in lower US production, leading to lower US exports and higher US and world prices.[183]

136. The Panel has also asked for US cost data on variable and fixed costs. Brazil provides below the most recent USDA data covering the period MY 1997-2002.[184] These data demonstrate that the "gross value of the US production" did not permit US upland cotton producers to cover their total costs of production. In MY 2001, the gross value of the production did not even permit them to cover their variable costs of production. In MY 2002, their revenue only covered slightly more than their variable costs. Not reflected in the chart below is the fact that US subsidies made up all (or almost all) the difference between the "gross value of the US production" and the "total costs listed" between MY 1997-2002.

US cotton production costs and returns per planted acre, excluding direct Government payments, 1997-2002 1/

| Item | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|
| | dollars per planted acre | | | | | |
| Gross value of production: | | | | | | |
| Primary product: Cotton | 477.48 | 307.20 | 274.48 | 324.33 | 222.60 | 257.88 |
| Secondary product: Cottonseed | 68.07 | 48.90 | 40.32 | 50.85 | 48.80 | 49.95 |
| Total, gross value of production | 545.55 | 356.10 | 314.80 | 375.18 | 271.40 | 307.83 |
| | | | | | | |
| Operating costs: | | | | | | |
| Seed | 17.63 | 17.87 | 18.35 | 30.10 | 37.82 | 47.99 |
| Fertilizer | 35.31 | 31.76 | 29.91 | 31.32 | 35.26 | 30.56 |
| Chemicals | 60.19 | 58.54 | 58.60 | 58.32 | 59.25 | 56.80 |
| Custom operations | 23.27 | 13.02 | 19.67 | 19.93 | 19.99 | 19.25 |
| Fuel, lube, and electricity | 31.64 | 26.29 | 26.64 | 36.97 | 36.49 | 31.37 |
| Repairs | 25.39 | 27.32 | 26.28 | 27.18 | 28.53 | 29.10 |
| Interest on operating inputs | 6.57 | 5.40 | 5.61 | 7.55 | 4.71 | 2.31 |
| Ginning | 62.75 | 43.78 | 53.08 | 51.46 | 57.14 | 55.61 |
| Purchased irrigation water | 8.71 | 6.89 | 6.12 | 6.55 | 5.05 | 5.01 |
| Total, operating costs | 271.46 | 230.87 | 244.26 | 269.38 | 284.24 | 278.00 |

[182] *See* Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 6) discussing a drop in the upland cotton acreage in Mato Grosso by 35 per cent between 2000/2001 and 2001/2002 due to low upland cotton prices.

[183] The collective and individual effects of the various US subsidies are analyzed by Professor Sumner at Tables 1.5(a) – (e) of Annex I to Brazil's 9 September Further Submission. *See also* Brazil's 9 September Further Submission, Sections 3.3.4.7 (individual effects) and 3.3.4.8 (collective effects). *See further* Brazil's 7 October Oral Statement, paras 31-34 (USDA's analysis of individual effects of marketing loan subsidies for cotton for marketing years 2000 and 2001).

[184] http://www.ers.usda.gov/Data/CostsAndReturns/data/recent/Cott/R-USCott.xls, visited 25 October 2003

| | | | | | | |
|---|---|---|---|---|---|---|
| Allocated overhead: | | | | | | |
| Hired labour | 33.72 | 33.92 | 35.48 | 36.98 | 37.89 | 38.16 |
| Opportunity cost of unpaid labour | 28.03 | 28.76 | 29.27 | 29.90 | 30.28 | 32.73 |
| Capital recovery of machinery and equipment | 94.21 | 93.16 | 96.80 | 97.97 | 101.49 | 100.39 |
| Opportunity cost of land | 58.33 | 46.04 | 51.84 | 51.68 | 43.83 | 46.76 |
| Taxes and insurance | 14.97 | 14.20 | 15.07 | 15.93 | 16.68 | 17.01 |
| General farm overhead | 15.55 | 14.21 | 15.35 | 15.82 | 16.11 | 15.97 |
| Total, allocated overhead | 244.81 | 230.29 | 243.81 | 248.28 | 246.28 | 251.02 |
| Total costs listed | 516.27 | 461.16 | 488.07 | 517.66 | 530.52 | 529.02 |
| **Value of production less total costs listed** | **29.28** | **-105.06** | **-173.27** | **-142.48** | **-259.12** | **-221.19** |
| **Value of production less operating costs** | **274.09** | **125.23** | **70.54** | **105.80** | **-12.84** | **29.83** |

1/ Estimates based on 1997 survey.

2/ Method used to determine the opportunity cost of land.

J. CAUSATION

**165. Please comment (and submit substantiating evidence) on the US assertion that the FAPRI model has been designed and developed for prospective analysis, and is not suitable for retrospective counterfactual analysis. What is the reliability of past FAPRI-produced analyses when compared with actual data for the period covered by them? Is there any other instrument that can be used to try to identify the effect of subsidies already granted, or of their removal? BRA, US**

Brazil's Answer:

137. Concerning the first question, there is nothing inherently different in using a calibrated simulation model (the category of models into which the FAPRI and many other models fall) to investigate (i) questions of the future effects on prices and quantities of a potential change in policy or, instead, (ii) questions of how the recent pattern of prices and quantities would have been different if a different set of policies would have been in place. Calibrated simulation models, including the FAPRI model, are routinely used for *both* kinds of questions. The applications are identical. In one case, the comparison for the results from the counter-factual policy option is to an unobserved future baseline. In the other case, the comparison for the results from the counter-factual policy option is retrospective to past actual events.

138. The FAPRI policy simulation framework is an elaborate set of supply and demand equations (along with associated stock equations and equilibrium conditions that set quantity supplied equal to quantity demanded). The framework includes, as a component, a set of "baseline" projections of agricultural prices and quantities for future periods that are based on explicit assumptions about policy, climate, technological change, macroeconomic conditions, etc. In many applications, the relevant questions investigated by the model are of the following form: if some specific policy were different in the future, how would this affect the future outcomes for farm commodity prices and quantities. For example, this is the form of question that is often posed in the context of options for changing US farm subsidies in the future. Because they have baseline projection components, the FAPRI framework and a few others are well suited for these future-oriented questions. But the use of such models to analyze the recent past is also common whenever that is a relevant question.

139. As with other calibrated simulation models, the FAPRI model itself is also used routinely for both projections *and* retrospective counterfactual analysis. One recent publication that applied retrospective counterfactual analysis concerned world peanut (groundnut) policy. That study adapted the basic FAPRI framework, much as it was adapted to apply to the current case for upland cotton, to consider international peanut policy questions. The model is calibrated to three recent years – 1999/2000, 2000/2001 and 2001/2002 – and examines a peanut trade liberalization scenario.[185]

140. A second recent retrospective counterfactual application was to the US sugar programme in a project conducted for the US General Accounting Office. In that analysis, a version of the FAPRI domestic sugar model was combined with the CARD international sugar model (much as Professor Sumner has done for upland cotton, as reported in Annex I to Brazil's 9 September Further Submission). The model was calibrated to 1999 data, and results considered the effects of policy reform relative to the 1999 crop year actual outcomes.[186]

141. In addition, Brazil notes that USDA has frequently used calibrated simulation models to perform retrospective, counterfactual analysis. For example, USDA economists calibrated the USDA "SWOPSIM" model, which was used extensively to analyze trade policy options in the 1980s and 1990s, to 1989 data and solved it for commodity prices and quantities that would have obtained in that year under alternative trade liberalization scenarios.[187]

142. The USDA "FAPSIM" model, which is quite similar to the FAPRI model, is a calibrated simulation model that is also used for retrospective counterfactual analysis and for considering policy options relative to projections. According to J. Michael Price of the USDA Economic Research Service, who was one of the developers of the model and currently maintains and operates the model, it is calibrated to historical data each year as well as to the official USDA baseline. That model is used for responding to questions about future policy options *and* to retrospective counterfactual questions. Indeed, one of the first published applications of the "FAPSIM" model was a retrospective counterfactual analysis of US grain storage policy.[188]

143. One of the most recent applications of the USDA "FAPSIM" model was to respond to requests for both alternative projections and retrospective counterfactual analysis from the *Commission on the Application of Payment Limitations for Agriculture*. These results, which have been discussed in previous submissions by Brazil, used the FAPSIM policy framework.[189]

144. According to the Commission Report (chaired by the Chief USDA Economist):

> "Westcott and Price analyzed the effects of eliminating marketing loans on production and prices of major crops over the period from 1998 through 2005. The

[185] Exhibit Bra-303 (John C. Beghin and Holger Matthey. "Modeling World Peanut Product Markets: A Tool for Agricultural Trade Policy Analysis." Center for Agricultural and Rural Development (CARD), May 2003).

[186] Exhibit Bra-304 (John C. Beghin, Barbara El Osta, Jay R. Cherlow, and Samarendu Mohanty. "The Cost of the US Sugar Programme Revisited," Center for Agricultural and Rural Development (CARD), March 2001).

[187] *See* http://www.ers.usda.gov/data/sdp/view.asp?f=trade/92011/ and http://www.ers.usda.gov/data/sdp/view.asp?f=trade/92012/.

[188] Exhibit Bra-305 (Larry Salathe, J.Michael Price and David Banker. "An Analysis of the Farmer Owned Reserve Program 1977-82." American Journal of Agricultural Economics, February 1984, p. 1-11).

[189] *See* Brazil's 7 October Oral Statement, paras. 31-34.

> baseline used for the analysis was the USDA 2000 baseline, which did not anticipate the sharp decline in cotton price for 2001 crop year."[190]
>
> . . .
>
> "The Commission requested that the above study be updated to take into account the sharp decline in cotton prices for the 2001 crop (Westcott). The updated analysis indicated that elimination of marketing loan benefits for the 2001 crop would have lowered cotton acreage by 2.5 to 3.0 million acres or 15-20 per cent and reduced rice acreage by 300,000 acres or 10 per cent."[191]

145. Finally, there are literally hundreds of other academic and government studies using a variety of models calibrated on retrospective data that analyze policy questions. All computable general equilibrium models use this approach, and most academic partial equilibrium simulation models do so as well.

146. Concerning the second question, it is difficult to determine the reliability of the analysis of *potential* (*i.e.*, future) policy outcomes because – by definition – the baseline approach will not mirror exactly the actual conditions. This is why baseline projections use long-term data to even out inevitable fluctuations in commodity market developments. Similarly, the *but for* analysis of a retrospective study attempts to simulate what would have (but did not actually) occur with different policy assumptions. However, the retrospective analysis has the benefit of using actual market data and not projected benchmarks. It is, of course, possible to critique selected portions of the FAPRI baseline projections if they are treated as forecasts of the future values for prices and quantities. Against this benchmark, the FAPRI projections – like all others – will sometimes miss future movements in commodity markets.

147. One measure of the reliability of the FAPRI baseline is that the FAPRI model continues to be relied upon regularly by a variety of US government and US industry organizations to guide decisions on important policy questions. USDA even provided the FAPRI economists with their highest award based on the 2002 baseline analysis.[192] In addition, FAPRI economists over the years have performed checks to ensure that the FAPRI model is as reliable as possible. For example, observed (actual) planted acreage has generally responded in the directions the model projects when the loan rates and other driving factors are relatively constant. In addition, FAPRI constantly examines the internal consistency of the model and its economic logic when compared to actual market events and conditions and makes appropriate adjustments, as necessary.

148. Concerning the third question, there are a number of other potential simulation modelling frameworks that can be used as instruments to respond to retrospective counterfactual policy questions. The USDA FAPSIM model is one such framework. It was used, for example, in the Westcott/Price analysis of the effect of removing all marketing loan payments for MY 2000 and MY 2001.[193] However, the FAPSIM model does not have a full international cotton model as used in the

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[190] Exhibit Bra-276 (Report of the Commission on the Application of Payment Limitations for Agriculture, August 2003, p. 124).

[191] Exhibit Bra-276 (Report of the Commission on the Application of Payment Limitations for Agriculture, August 2003, p. 125). *See* further: Westcott, Paul C. "Marketing Loans and Payment Limitations." Presentation to the Commission on the Application of Payment Limitations for Agriculture, May 2003 as cited in the Payment Limitations Report; Exhibit Bra-222 (Westcott, Paul C., and J. Michael Price. Analysis of the US Commodity Loan Program with Marketing Loan Provisions. USDA, ERS Agricultural Economic Report 801, April 2001); Westcott, Paul and Mike Price. Estimates done at the request of the Commission on the Application of Payment Limitations for Agriculture utilizing the Economic Research Service's FAPSIM model, 2003 as cited in the Payment Limitations Report.

[192] Brazil's 9 September Further Submission, Annex I, para. 4 (last sentence).

[193] *See* Brazil's 7 October Oral Statement, paras 32-33.

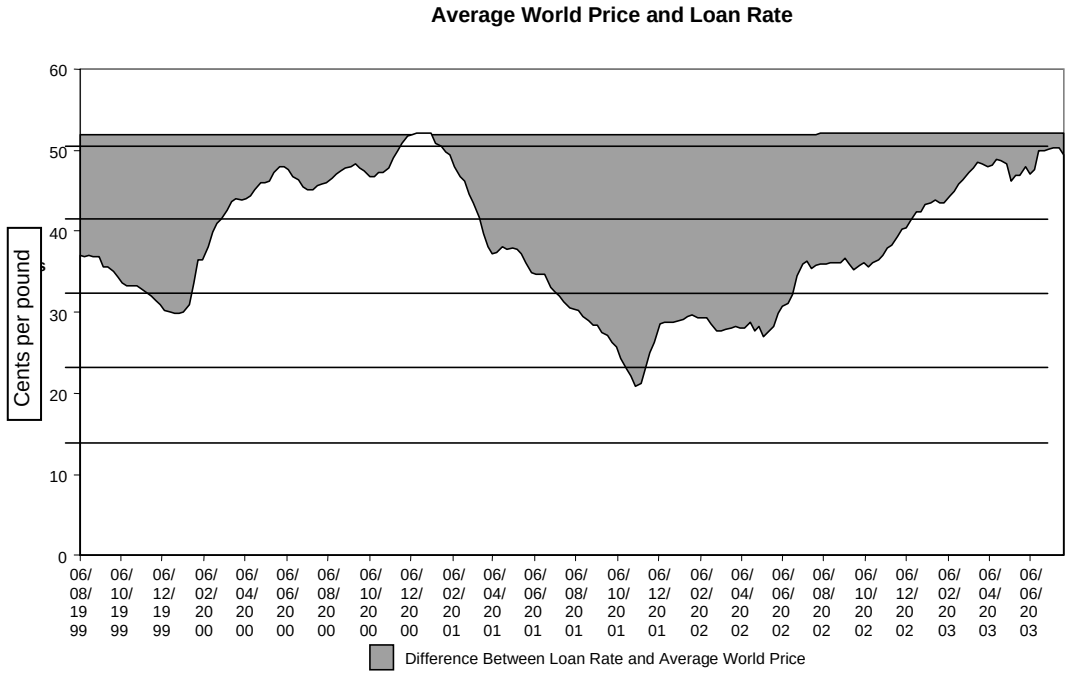
FAPRI/CARD framework, and thus would be less appropriate for dealing with the world price aspects of this case. In general, for specific questions about how quantities and prices of upland cotton would have been different but for US upland cotton subsidies, the appropriate models with which Brazil is familiar would all follow the same basic simulation framework as the FAPRI model.

**167. How does Brazil react to Exhibit US-44? BRA**

Brazil's Answer:

149. The United States claims that Exhibit US-44 demonstrates the "disconnect between the decline in cotton prices … and the incentive offered by US marketing loans."[194] But all that Exhibit US-44 does is to show monthly A-Index prices for upland cotton. These prices, as with other primary agricultural commodities, move up and down with large swings. This exhibit provides no insight into the link between US producer's decisions to keep planting upland cotton as upland cotton prices (including A-Index prices) move up and down. Further, the quantity of subsidies provided by the US marketing loan is a function of the difference between the loan rate (currently 52 cents per pound) and the adjusted world price (AWP) for upland cotton – not the A-Index price.[195] As the Panel can see from the chart provided in response to Question 181, the AWP is consistently and considerably below the A-Index.

150. A relevant graph to examine the causal link between US subsidies and US production is one with a horizontal line representing the marketing loan rate, and which compares that line against the AWP, which is the basis for the payment of marketing loans. This is illustrated in the graph below:[196]




151. This graph shows first what the Exhibit US-44 neglected to illustrate – that except for a short period in MY 2000, the AWP was *below* the loan rate throughout *all* of MY 1999-2002, and that marketing loan payments corresponding to the difference between the AWP and the loan rate were

[194] US 7 October Oral Statement, para. 23.
[195] *See* Brazil's Answer to Question 180.
[196] The data is based on the data collected for Brazil's Answer of Question 181, *see* Exhibit Bra-311.

made. All of the dark area below the 52 cents line represents marketing loan subsidies paid to US upland cotton producers. This illustrates US producers' indifference to market prices. To paraphrase the United States, the line of 52 cents per pound illustrates a "disconnect," but it is not one between the A-Index price and US subsidies. Rather, this graph illustrates the disconnect between the AWP (and more importantly, the US price received by upland cotton producers) and the acreage and production response of US producers: even when prices go to record lows, US producers' revenue is insulated from the decline. This revenue not only kept them in production, but it allowed them to *increase* production during MY 1999-2001. And more remarkably, it kept many of the producers planting 14.2 million acres of cotton when the AWP was near record lows in the period from February-June 2002. These low prices during the crucial planting decision period are clearly reflected in the figure above.[197] It was this period that USDA economists Westcott and Price examined and found that but for the marketing loan payments in MY 2001, US upland cotton production would be 2.5-3 million bales less than it actually was.

152. Thus, this graph helps explain why there is such a limited response from high-cost US upland cotton producers to changes in upland cotton prices. Of course, the graph above does not represent the full amount of revenue supplied by all US subsidies. Other programme features and other programmes provide additional subsidies that cause the effective per unit revenue guarantee to be much higher than the loan rate.

153. If the purpose of Exhibit US-44 was to demonstrate the absence of a link between US upland cotton production (and price suppression) and US marketing loan payments, then it flies in the face of the findings of USDA's own economists. Brazil has referenced the testimony of USDA's chief economist, among many other USDA economists, who have candidly acknowledged the enormous production and price effects that US marketing loan subsidies have on stimulating and maintaining large amounts of US upland cotton production.[198]

**170. Brazil quotes a report that states that a 10 per cent increase in soybean prices reduces upland cotton acreage by only 0.25 per cent (Brazil's 7 October oral statement, para. 27). Could Brazil indicate if this analysis is done on a short-run basis or a long-run basis? BRA**

Brazil's Answer:

154. The authors of the USDA study cited by Brazil – USDA economists Westcott and Meyer – use a "modified version of the estimated elasticities from Lin et al.,"[199] which Westcott/Meyer refer to as a technical improvement. The original study by Lin et al. appears to estimate short to medium-run elasticities. Lin et al. use what they describe as "new supply response elasticities . . . in short-term, acreage forecasting applications".[200] For the estimation of the elasticities themselves, Lin et al. use two models that are solved by regression analysis of the effect of expected relative price changes between crops and the resulting acreage effects in the two following years.[201]

[197] *See* Brazil's 7 October Oral Statement, paras. 32-33.

[198] Brazil's 9 September Further Submission, paras. 148-161. *See further* Brazil's 7 October Oral Statement, paras 31-34.

[199] Exhibit Bra-275 ("US Cotton Supply Response Under the 2002 Farm Act," Westcott and Meyer, USDA, 21 February 2003, p. 9). Brazil is not in a position to specify in which sense the estimated elasticities are modified.

[200] Exhibit Bra-306 ("Supply Response under the 1996 Farm Act and Implications for the US Field Crops Sector," Lin et al., USDA, July 2000, p. 2).

[201] Exhibit Bra-306 ("Supply Response under the 1996 Farm Act and Implications for the US Field Crops Sector," Lin et al., USDA, July 2000, p. 9-16).

155. Lin et al. present their results in Table 21 of their study.[202] It appears that the resulting estimates of the acreage price elasticities are short or medium-term elasticities (acreage reaction one to three years in the future), and that the adaptations by Westcott and Meyer are also short to medium-term elasticities.[203]

**172. Please estimate the price effect, in cents per pound, of the growth in the US retail market which it is said has directly contributed to strengthening world cotton prices. US**

Brazil's Comment:

156. Brazil emphasizes that its claims under Article 6.3(c) of the SCM Agreement revolve around the present and threatened suppression of prices. Thus, whether world upland cotton prices are strengthening or weakening is irrelevant to the question whether those prices would have been higher (at any price level) *but for* the US subsidies.

**176. With reference to Figure 4 of Brazil's Further Submission, how does Brazil explain the apparent decrease in prices in 2001 and the increase of the A-Index in recent months, despite the continued use of US subsidies on upland cotton? BRA**

Brazil's Answer:

157. Brazil has consistently argued that over the period of investigation (MY 1999-2002), the US subsidies caused price suppression that was significant when A-Index prices declined and when A-Index prices increased both during and near the end of the period of investigation in mid-2003.[204] As Brazil explained at the meeting on 7 October 2003, A-Index prices rise and fall for a variety of supply and demand reasons.[205] *One* of the reasons that prices fell as low as they did in MY 1999-2001 and did not rise as far as they should have in MY 2002 was due to the US subsidies. This is best illustrated in Figure 14, set out in Brazil's 9 September Further Submission and reproduced below:

[202] Exhibit Bra-306 ("Supply Response under the 1996 Farm Act and Implications for the US Field Crops Sector," Lin et al., USDA, July 2000, p. 60).

[203] Due to the adaptations, the elasticities reported by Westcott and Meyer are not identical to those reported by Lin et al.

[204] Brazil's 9 September Further Submission, paras. 83-89 (discussing definition of "price suppression"); paras. 92-93 (discussing "causation").

[205] Brazil's 7 October Oral Statement, paras. 18-28.

Figure 14[206]


158. This figure represents Professor Sumner's findings, but a similar figure could be reproduced to reflect other levels of price suppression – including the 33.6 per cent suppression of US prices found by USDA's own economists for MY 2001,[207] as well as the ICAC and other international organizations' findings of price suppression caused by US subsidies for upland cotton.[208] Professor Sumner's findings indicate that during MY 1999-2002, there were a number of global supply and demand factors (including $12.9 billion in US subsidies) that caused upland cotton prices to fall and remain at low levels compared to historical prices throughout the period of investigation. The upper line on the graph reflects the contribution of the $12.9 billion in US subsidies to keeping A-Index prices suppressed. The area below the upper line and above the darker area reflects the amount of price suppression. In other words, regardless of whether market prices rise or fall, there is always a price-suppressive effect.

159. With respect to the Panel's specific question regarding the effects of US subsidies in the latter half of MY 2002, the record shows that US and A-Index prices rose in MY 2002 for a number of supply [and] demand factors – many of which also impacted the market during the fall of prices in MY 1999-2001. The most important supply factor was the *decline* in production of 1.71 million tons in MY 2001-2002 by non-US producers such as the African Franc zone, Southern Africa, East Asia, South Asia, and the former Soviet Union countries.[209] The evidence suggests that many of these producers could not maintain existing levels of production at lower prices that existed in MY 2001 and MY 2002. For example, Christopher Ward testified that even though Brazilian Mato Grosso producers had extremely high yields and low costs, they were forced by low prices to cut their production by 34 per cent in 2001 and by 25 per cent in 2002, compared with 2000 production levels.[210] Similarly, Mr. Ibrahim Malloum, President of CottonChad, testified that lower prices in MY

[206] A-Index prices with and without subsidies are based the baseline and the change from the baseline as reflected in the results of Professor Sumner's simulation model. *See* Brazil's 9 September Further Submission, Annex I, Table I.5a.

[207] Brazil's 7 October Oral Statement, para. 32-33.

[208] *See* Brazil's 9 September Further Submission, paras. 148-162 (discussing price suppressing effects of marketing loan payments including Figure 11 at paragraph 160), para. 190 (NCC estimates of 3 cent per pound price suppressing effect from only the GSM 102 program), paras. 200-213 (various international studies), paras. 214-232 (Professor Sumner's analysis). *See also* Brazil's 7 October Oral Statement, paras 31-34 (discussion of Westcott/Price studies of price suppressing effects of marketing loans in MY 2000 and MY 2001).

[209] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 28-29).

[210] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 6).

2001-02 meant that Chadian production fell because producers could not afford inputs such as fertilizer.[211]

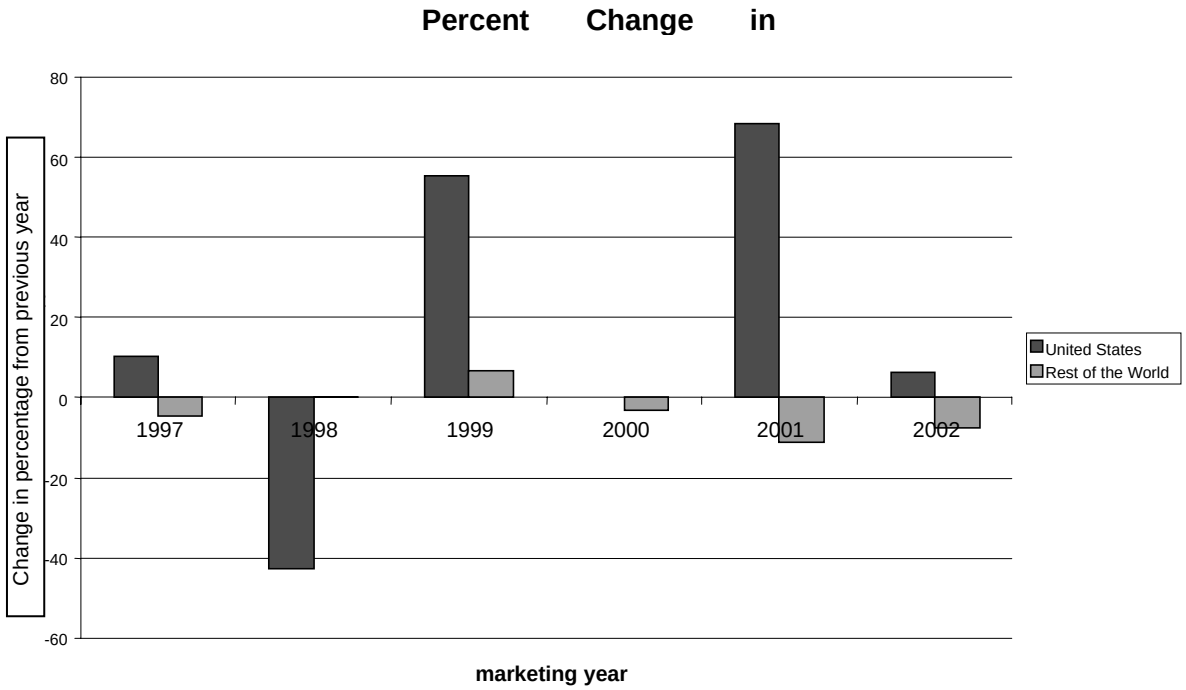
160. For US producers at the time of planting for the MY 2002 crop – between January-April 2002 – the AWP and US price received by US producers were near record lows.[212] Faced with an annual 39 cents per pound differential between total costs and such prices in MY 2001, US cotton producers still planted 14.2 million acres of upland cotton for MY 2002.[213] The resulting US production in MY 2002 was 16.73 million bales (or 3.64 million metric tons). This is an extraordinary amount of acreage and production given the huge gap between US producers' costs and expected *market* revenue. It is estimated that without US subsidies, US production in MY 2002 would have been approximately 1.92 million metric tons, or 1.72 million metric tons less than what US upland cotton farmers actually produced.[214] The effects of this additional 1.72 million metric tons of subsidy-generated production can be judged from the effects of an *actual* decline in world supply of 2.365 million metric tons[215], which contributed to an *increase* in A-Index prices of 33 per cent between MY 2001 and MY 2002.[216] If an *additional* 1.72 million metric tons of US production were taken out of world supply, prices would have been even higher. Professor Sumner has indicated that A-Index prices in MY 2002 would have increased by 17.70 per cent absent the US subsidies.[217] Thus, the effect of the US subsidies in MY 2002 – even as prices increased – was to suppress prices.

**178. The Panel notes Exhibit US-63. Could the US please provide a conceptually analogous graph concerning US export sales during the same period? US**

Brazil's Comment:

161. Brazil offers a conceptually analogous figure to Exhibit US-63 concerning US and rest-of-the-world export sales. The figure below shows the relative changes in US and non-US exports as compared to the previous year for the period MY 1997-2002, based on data covering the period MY 1996-2002.[218]

[211] Chad's 8 October Oral Statement (Statement of Ibrahim Malloum, para. 7).
[212] *See* Brazil's Answer to Question 167.
[213] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).
[214] Brazil's 9 September Further Submission, Annex I, Table I.5a applying the percentage change.
[215] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 4).
[216] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 106).
[217] Brazil's 9 September Further Submission, Annex I, Table I.5a.
[218] Exhibit Bra-307 (Change in US and World Exports in Percent). The exhibit also contains the underlying data for the figure with the sources being described in more detail in Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).




162. The figure demonstrates that US exports increased in every year except for MY 1998, during which the United States claims it suffered a major crop failure. In addition, US exports increased in all years, except for MY 1998, more than exports from non-US producers, which since MY 2000 even *decreased* continuously. The figure demonstrates that the United States gains world market share, with its own exports increasing since MY 1999, at the expense of non-US exports, which have fallen since MY 2000.

163. In sum, this figure supports Brazil's claim of serious prejudice under Articles 5(c) and 6.3(d) of the SCM Agreement. It also supports Brazil's claim of serious prejudice under Articles XVI:1 and 3 of GATT 1994 because the USshare of world export trade increased, in significant part, by the US subsidies at the expense of other lower-cost producers.

**179 Could Brazil comment on the argument that decoupled payments and other subsidies to upland cotton are largely being capitalized into land values and that removing these subsidies would reduce the cost of production of upland cotton producers (US 7 October oral statement, para. 48). What would be the net effect of these adjustments? BRA**

Brazil's Answer:

164. A February 2003 study by ERS economists estimated that "decoupled" payments lead to an increase of about 8 per cent in US farmland values.[219] A more comprehensive ERS 2001 report estimating the regional effects of all subsidies (not just decoupled subsidies) on land values found that land values increased by 16 per cent in the regions where upland cotton is grown. This is shown in the following chart:[220]

[219] Exhibit Bra-308 ("Decoupled Payments: Household Income Transfers in Contemporary US Agriculture," ERS Agricultural Economic Report No. 822).

[220] Exhibit Bra-309 (Barnard C., Nehring, R., Ryan, J., Collender, R. "Higher Cropland Value from Farm Programme Payments: Who Gains?" Economic Research Service. USDA Agricultural Outlook November 2001, p. 29).

**ERS/USDA Estimated Cropland Value Attributable to Commodity Programme Payments**

| Region | Total Value of Land Harvested in 8 Programme Crops | Estimated Value Attributable to Commodity Programme Payments | Per cent of Value Attributable to Commodity Programme Payments |
|---|---|---|---|
| Prairie Gateway | 41.70 | 9.40 | 23.00 |
| Mississippi Portal | 17.30 | 2.70 | 16.00 |
| Fruitful Rim | 21.60 | 2.20 | 10.00 |
| Southern Seaboard | 18.20 | 1.80 | 10.00 |
| Eastern Uplands | 4.60 | 0.50 | 10.00 |
| **Total** | **103.40** | **16.60** | **16.05** |

165. Brazil notes that neither of these studies provides an estimate of the percentage of each dollar of "decoupled" or total subsidy payments that are capitalized into land *values*. However, an August 2003 study by ERS economists indicates that PFC payments in MY 1997 resulted in an increase of land rents by 34-41 cents of per PFC dollar.[221] Thus, contrary to the premise of the Panel's question, this evidence suggests that PFC payments are somewhat, but not "largely capitalized" into land rents.

166. There would be only a minimal impact on total costs of production for upland cotton farmers from the removal of both "decoupled" and total US subsidies. For the allegedly "de-coupled" payments referred to in the February 2003 ERS study, the impact of an 8 per cent reduction in land values translates into a decrease in total costs of US upland cotton producers by less than one per cent (0.75 per cent).[222] If the effects on increased land values from all subsidies are taken into account (using the 2001 ERS regional study), then US upland cotton producers' costs would have declined between MY 1999-2002 by only 1.49 per cent.[223] In response to the Panel's question, the net effect of these tiny adjustments throughout MY 1999-2002 on the very wide cost-revenue gap and the other costs of production analysis conducted by Brazil in its various submissions is obviously minimal.

167. Finally, the United States at paragraph 48 of its 7 October Oral Statement criticized Professor Sumner's analysis for allegedly not factoring into his estimates the effect of direct payments being capitalized into increased land rents. The US criticism is misplaced. Professor Sumner's model used very low estimates of production incentives for every dollar of PFC payments (only 15 per cent) and direct payments (only 25 per cent).[224] By taking a very conservative approach for these direct payments, Professor Sumner's analysis more than allows for the effects these payments have in increasing land values. This can be illustrated by using the 34-41 per cent results of the August 2003 land rent study referred to above. The results of this study suggest that 66-59 cents of each PFC dollar are *not* reflected in increased rents. This leaves more than enough residue from each PFC and direct payment dollar to account for the only 15-25 per cent production effects for PFC/direct payments found by Professor Sumner.[225]

**180. Please describe the precise formula as to how USDA determines the "adjusted world price" using the Liverpool A-Index, the NY futures price and any other relevant price indicators. Please submit substantiating evidence. BRA, US**

[221] Exhibit Bra-310 ("The Incidence of Government Program Payments on Agricultural Land Rents: The Challenges of Identification", Roberts, Kirwan, and Hopkins, August 2003, American Journal of Agricultural Economics, p. 767.).
[222] Exhibit Bra-7 (ERS Data: Commodity Costs and Returns).
[223] Exhibit Bra-7 (ERS Data: Commodity Costs and Returns).
[224] Brazil's 9 September Further Submission, Annex I, para. 48.
[225] Brazil's 9 September Further Submission, Annex I, para. 48.

Brazil's Answer:

168. Brazil looks forward to receiving a detailed description of the complicated calculation of the adjusted world price from the United States in reply to this question. Brazil has set forth a brief description of the calculation of the adjusted world price in paragraph 73 of its 24 June First Submission, and will elaborate to the best of its understanding.

169. The details of the complicated calculation method for the adjusted world price are laid down in 7 CFR 1427.25.[226] The weekly *Cotton Outlook* published by Cotlook Ltd. provides a somewhat simpler description of the process. Exhibit Bra-51 includes the Cotton Outlook description of the "US Pricing Mechanism", including the calculation of the adjusted world price for the week of 31 January 2002.[227]

170. The descriptions shows that the adjusted world price is calculated based on the A-Index from which a total adjustment factor is subtracted, thus:

> The Adjusted World Price (AWP) is calculated from CIF North Europe quotations, adjusted for shipping, location and quality differentials. The Shipping Differential is derived from the average over the preceding 52 weeks, or as many of that number of weeks for which quotations are available, of the difference, calculated from Thursday's values only, between the average of the Memphis and California/Arizona CIF North Europe quotations, and the Middling 1-3/32" (31-35) domestic spot market average. However, the Shipping Differential in any week may not fall below, or rise above 115 per cent, of an assessed actual transportation cost (now 12.9 cent). A further discount, the Course Count Adjustment, is applied by reference to the amount by which the World Quality difference exceeds the appropriate Loan Quality Difference. It applies to cotton of any grade stapling 1-1/32" or shorter, and to selected lower grades in longer staples.[228]

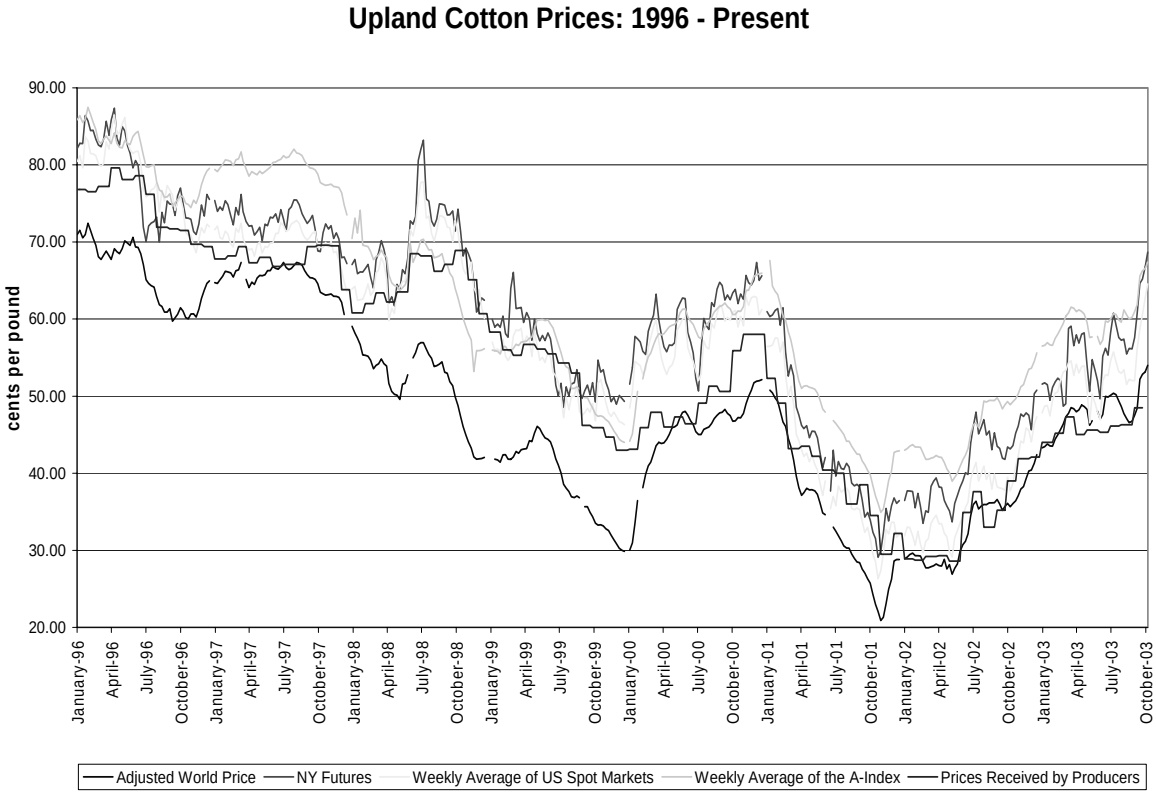
171. Brazil also notes that under certain conditions, the Secretary of Agriculture is entitled to reduce the adjusted world price below the result of this calculation – the so-called Step 1 adjustment. In such circumstances, the adjusted world price would be reduced by a maximum of the difference between the A-Index and the average of the cheapest US Middling 1-3/32" CIF North Europe quotes – thus, the amount by which the US price quotes exceed the average of the five cheapest price quotes worldwide. Such a downward adjustment would increase the amount of marketing loan payments that US upland cotton farmers receive and help close the cost-revenue gap that US producers face.

**181. Please provide a side-by-side chart of the weekly US adjusted world price, the Liverpool A-Index, the NY futures price, and spot market prices from 1996-present. What, if anything, does this reveal? BRA, US**

Brazil's Answer:

172. In Brazil Bra-311, Brazil provides a side-by-side chart of the weekly US AWP, the A-Index, the nearby New York futures price, the average US spot market price and prices received by US producers from January 1996 to the present. The figure below shows the respective price developments over this period. Exhibit Bra-311 also contains a colour copy of this chart.[229]

[226] Exhibit Bra-36 (7 CFR 1427.25).
[227] Exhibit Bra-51 (Cotton Outlook, 1 February 2002, p. 16).
[228] Exhibit Bra-51 (Cotton Outlook, 1 February 2002, p. 16) (emphasis in original).
[229] The data has been obtained from the Cotton Outlook published by Cotlook, Ltd. in Liverpool.




173. The figure demonstrates that the A-Index price is consistently 12-14 cents per pound higher than the adjusted world price ("AWP"), which constitutes the basis for the US marketing loan payments. The average difference between both prices over the 1996-present period is 13.76 cents per pound. As expected, both prices move in parallel. Further, both prices follow the price trends that originate from the New York futures market or at least move in parallel to those prices. There is also a close linkage between the average US spot market price and the New York futures and A-Index prices.

174. The figure further demonstrates that the New York futures prices and the average US spot market prices are usually more volatile than the A-Index and AWP prices. Thus, any rapid increases or decreases in the New York futures prices will not necessarily be reflected to the same extent in AWP or prices received by US producers – the prices of which marketing loan and counter-cyclical payments, respectively, are triggered. They may just be a temporary phenomenon.

175. In sum, the price movements support Brazil's argument that New York futures, US and international prices for upland cotton are closely linked, and that price movements and trends originating from the US market are closely tracked by prices on the world markets.[230]

176. That US and international – and indeed Brazilian – prices closely track each other demonstrates that production and price effects from the US subsidies on the US market are transmitted to the international upland cotton market and to third country markets such as the Brazilian market or markets where Brazil exports its upland cotton. The Panel will remember that the A-Index is composed of price quotes from 16 different upland cotton export markets around the world.[231] Thus, if USDA studies like those undertaken by Westcott and Price establish price-suppressing effects of the US subsidies for the US market, those effects will also occur on the

[230] *See* Section 3.3.4.9 of Brazil's 9 September Further Submission, para. 233-250.
[231] Brazil's 9 September Further Submission, Annex II, para. 24.

international and third country markets. The parallelism in the price movements establishes the link between price suppression in the US and international markets and other third country markets.

**182. Please explain why the US can be taken to be price *leaders*, or price *setters*, (and not just takers) when US producers receive large subsidy payment to support the difference between *world prices* and their own costs? BRA**

Brazil's Answer:

177. The Panel's question focuses first on "US producers" who receive large subsidies. One of the premises of this question is that US producers receive subsidies that account for the difference between *world* prices and their own costs. This is not entirely correct. US producers receive what the USDA refers to as "Average price received by US producers". During the MY 1999-2002 period, this US producer price was on average 9.2 cents per pound, or 17.6 per cent, *below* the world A-Index price.[232] Other than the first month of marketing year 1999, the A-Index price was always higher than the US price received by US producers between MY 1999-2002. The lower prices paid to US producers are partly explained by the transportation costs of upland cotton from the United States to foreign markets, where most US upland cotton is marketed. However, as the Panel's question suggests, the total revenue received by US producers includes marketing loan payments that are a function of the set loan rate (52 cents in MY 2002) and the adjusted world price that itself is determined in part by reference to the A-Index prices.

178. During MY 1999-2002, individual US producers of upland cotton did not "set" or "lead" A-Index prices. Most US producers were isolated from the effects of market price during MY 1999-2002. As the Panel's questions implies, on average, US producers were generally able to cover their costs based on a combination of market revenue and the large subsidies they received during MY 1999-2002.[233] The guaranteed subsidies and price support at high price levels ensured a revenue stream that left them largely indifferent to market prices throughout the entire period of investigation.

179. The Panel's question further asks how the United States could be a "price setter" in the world upland cotton market. Individual US *exporters* of US upland cotton do not "set" or "control" the price of upland cotton. In a world-wide market such as the upland cotton market, no single private trader has the market power (in an anti-trust sense) to "set" the world price. As Andrew Macdonald testified, prices of upland cotton are *discovered* hourly and daily by traders in the futures, spot, and forward delivery markets based on key supply and demand factors.[234] Nor has Brazil argued that the US *leads* prices down by initiating a price war, as may occur with industrial products.

180. What Brazil has argued is that the United States is a leading *driver* of the world upland cotton market to the extent it suppresses the price of upland cotton. The United States can do this because of its large guaranteed production and direct subsidies that inject a near permanent stream of large US production and supplies into the world market. US export subsidies drive the world market in the sense that they stimulate the demand for high-cost US upland cotton at the expense of other world producers. Further, its size (by far the largest exporter and second largest producer), its transparency, which in turn plays a major role in the price discovery in the New York futures market, and the ability of US exporters to use the Step 2 and GSM 102 tools to market US upland cotton, allow it to suppress world prices.[235] Only by taking these price-suppressing factors into account could it be said that the United States "leads" world prices.

[232] *See* Brazil's Answer to Question 181 for data on the A-Index prices and the prices received by US producers.

[233] *See* Brazil's Answer to Questions 125 (2) (c) and 163.

[234] Brazil's 9 September Further Submission, Annex II, paras 11-13, 15-25 and 38-42.

[235] Brazil's 9 September Further Submission, paras. 134-145; Annex II, paras. 38-42 and Chad's 8 October Oral Statement (Statement of Ibrahim Malloum), para. 13-14.

181. For example, the large size of the US production, which represents approximately 20 per cent of total world supply annually, is a key factor in driving and influencing world prices.[236] Shifts in US production caused by good or bad US weather influence total world supply and create an impact on world prices.[237] In much the same way as US weather plays a role in the discovery of world prices (by reducing US and, thus, world stocks), continued high levels of US production generated by US subsidies suppressed world prices throughout the period of investigation by increasing world supplies.

182. Further, the dominant (over 40 per cent) export market share of the United States coupled with the Step 2 and GSM 102 export subsidies creates a further suppressing effect on world prices.[238] These export subsidies allow US exporters to price their upland cotton below the prices of most other world producers because Step 2 gives them (not US producers) the difference between the lowest US price and the A-Index price (the average five lowest prices in the world market).[239] These subsidies, along with the domestic production and direct payment subsidies, have permitted exporters of high-cost US upland cotton to increase US world market share even as prices plunged throughout MY 1999-2001. Thus, while individual US exporters may not have "set" or "led" prices, the US subsidies allowed these exporters to continue marketing high-cost US cotton at *whatever* market price was determined by global supply and demand conditions.

K. ARTICLE XVI OF GATT 1994

**183. Why does Brazil believe that the appropriate "previous representative period" is the term of the previous Farm Bill, MY1996-2002? (Brazil's further submission, para. 282) BRA**

Brazil's Answer:

183. The Panel's question has stimulated a re-evaluation by Brazil of the appropriate "previous representative period" in relation to Article XVI:3. Brazil agrees with the US arguments made in the *EEC – Wheat Flour* GATT dispute that the appropriate "previous representative period" in Article XVI:3 should be one in which trade patterns have not been distorted by subsidies. In that dispute, the United States correctly argued:

> …that the three most recent calendar years could not be used as the representative period in the case since, given the distortion of trade patterns resulting from the heavy use of export subsidies by the EEC, it did not constitute a period during which "normal market conditions existed." There was ample GATT precedent for selecting a period when subsidization was not unduly affecting the market shares. During the 1995 Review Session it was agreed that in determining what is an equitable share of world trade, the CONTRACTING PARTIES should not lose sight of the "fact that

[236] Brazil's 9 September Further Submission, para. 135.

[237] Consider the following market reports: Exhibit Bra- 312 (Cotton Outlook, 4 October 2002, p. 3 ("Current developments on the production side – though perhaps not the consumption side – would seem to be constructive for prices. Yield potential in several parts of the world appears to be diminishing as a result of unfavourable weather – including storm systems affecting open cotton in parts of the United States.")); Exhibit Bra-312 (Cotton Outlook , 27 September 2002, p.3 ("Tropical Storm Isidore drove New York futures to higher levels earlier this week, on the grounds that its predicted path would bring heavy rainfall across a huge swathe of the south eastern United States and the Memphis Territory, and thus damage yield and quality prospects… [D]espite the adverse weather, the US will continue to need to make inroads into what remains a significant exportable surplus." )); and Exhibit Bra-312 (Cotton Outlook, 7 June 2002, p. 3 "Many eyes are directed towards developments in West Texas, where rain appears to have fallen too heavily in places where it is less needed and insufficiently in the dryland areas where soil moisture is lacking.")).

[238] *See* Brazil's 9 September Further Submission, paras. 139-142.

[239] Chad's 8 October Oral Statement (Statement of Ibrahim Malloum), para. 14; Brazil's 9 September Further Submission, Annex II, paras. 31, 49-53.

> the export subsidies in existence during the selected representative period may have influenced the share of the trade obtained by the various exporting countries." (GATT, BISD 3rd Supplement, paragraph 19, page 226). Then, in 1960, the CONTRACTING PARTIES adopted a Panel Report which dealt with notification of subsidies, in which it was agreed that an analysis of the effect of a subsidy should include statistics "… for a previous representative year, which were possible and meaningful, should be the latest period preceding the introduction of the subsidy or preceding the last major change in the subsidy." (GATT, BISD 9th Supplement, Annex II(b)(ii), page 194)…. Thus, *it was necessary to examine a period of which preceded the adoption of the EEC's subsidy system in order to assure that the trade distorting effect which the EEC system had already had on world markets was minimized as a factor in judging "equitable share."* [240]

184. There has been no period since the 1930s when US producers of upland cotton were not subsidized.[241] Since the 1980s in particular, US upland cotton producers have been guaranteed very high levels of government payments by a variety of subsidies, including the marketing loan programme that began in MY 1986. The revenue guarantee that these subsidies provide has locked in large amounts of apparently permanent high-cost US upland cotton production and exports. These distortions exist even in those years in which actual quantities of payments under the programmes are minimal due to higher prices. This is because the subsidies provided to high-cost producers in years of low prices mean they stay in business to continue to produce upland cotton also at times when subsidies fall due to increased prices. The relatively small planted acreage and production response by US producers to market prices over many years reflects the effects of this guaranteed US government revenue.

185. In view of the US arguments in *EEC – Wheat Flour* and the long-term distortions in the US production and exports caused by US subsidies, one appropriate "representative period" would be a simulated period in which no subsidies were provided. The Panel would examine the question: what would be a Member's share of world trade if it received no subsidies? This question, of course, is a function first of the amount of acreage and production, and ultimately exports attributed to the subsidies. The Panel is fortunate to have the benefit of very recent 2003 analysis by USDA economists Westcott and Price, who estimated that up to 3 million US acres of upland cotton production would have not been planted in MY 2001 if no marketing loan payments were made that year. These 3 million acres represent 19.36 per cent of US upland cotton acreage in MY 2001.[242] A reduction by this amount would imply a reduction in US production of 3.79 million bales for MY 2001.[243] Consequently, US exports would also fall by about 3.79 million bales, representing 34.74 per cent of US exports in MY 2001.[244] The implied export effects from the Westcott/Price study are very similar to those found by Professor Sumner, who estimated the export-increasing effects of the marketing loan programme in the comparable period to be 29.67 per cent and the effects of all US subsidies to increase US exports by 48.16 per cent.[245]

186. The record provides an example of what the US share of world export trade in upland cotton would be in a marketing year in which production and exports fell by amounts similar to those estimated by Professor Sumner and Westcott/Price. In MY 1998, 20 per cent of US upland cotton

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[240] GATT Panel Report, *EEC – Wheat Flour*, para. 2.8 – 2.9 (emphasis added).

[241] *See* Brazil's 9 September Further Submission, para. 269.

[242] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[243] 19.36 per cent of 19.603 million bales as reported in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[244] Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 5).

[245] Brazil's 9 September Further Submission, Annex I, Tables I.5d and I.5a. *See* paras. 17-18 and 75 for determining the comparable period.

acreage was abandoned and US harvested acreage fell by 2.8 million acres compared to MY 1997.[246] US production fell by 4.77 million bales and US exports fell by 3 million bales. As a result, US world market share declined from 27.6 per cent in MY 1997 to 17.9 per cent in MY 1998.[247] This considerable decrease in the US share of world export trade provides an approximation for the Panel to assess what the equitable US share would be *but for* the US subsidies in MY 2001-2003. Thus, MY 1998 is a useful representative period for the Panel to examine (in conjunction with Professor Sumner's and USDA economists Westcott/Price's analysis).

187. An alternative representative period that the Panel could use for assessing the *inequitable* nature of the US share of world export trade in upland cotton is the period MY 1994-96, during which the average level of US subsidies fell to "only" $495 million per year.[248] The development of the US world market share in MY 1994-1996 compared to MY 2001-2003 is shown in the graph below:[249]


188. During the period 1994-1996, US producers were generally able to cover their total costs of production largely from market revenue. In these conditions, US world market share averaged 28.4 per cent.[250] Yet, in conditions where market revenue plunged, costs of production and the cost-revenue gap increased. Average MY 1999-2002 US subsidies were six times greater than the period MY 1994-96, and US world market share increased to between 38 and 41.6 per cent in MY 2001-2002. These record high levels of world market share were purchased with large increases in both the quantity and level of guaranteed subsidies in MY 2001-2003 – huge marketing loan payments as well as increases in revenue support of 10 cents a pound resulting from the 2002 FSRI Act.[251] Thus, even though the period MY 1994-1996 was still heavily influenced by the revenue guarantees provided by the numerous US upland cotton subsidy programmes, this period could be a representative period for the Panel to examine for the purposes of making its "inequitable" share of world export trade findings.

[246] Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4-5).
[247] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).
[248] *See* Brazil's 9 September Further Submission, para. 110, note 145 and Figure 2.
[249] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).
[250] Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) claim).
[251] Brazil's 9 September Further Submission, para. 309.

**184. Why does Brazil believe that an "equitable share" is one which factors out all subsidies? To the extent that domestic support and export subsidies are permitted by the *Agreement on Agriculture*, why should they not be accepted as being normal conditions in analyzing an equitable market share? (See Brazil's further submission, paras 288-289) BRA**

Brazil's Answer:

189. Brazil believes, for the reasons articulated by the United States in the *EEC - Wheat Flour* dispute quoted in Brazil's Answer to Question 183, that the appropriate representative period for evaluating the *inequitable* share of share of world export trade is one in which no (or at most very few) trade-distorting subsidies were provided. Selecting an *earlier* representative period where the market share is not tainted with subsidies allows an assessment of whether a *later* market share *is* tainted by subsidies. As the United States argued well in *EEC – Wheat Flour*, the *inequitable* nature of a world market share can best be judged in comparison to what an *equitable*, *i.e.*, non-heavily subsidized world market share would be. This is consistent with Brazil's arguments in paragraphs 288-289 of its 9 September Further Submission that a non-subsidized world market share of 17 per cent is, by definition, an *equitable* share for the purpose of Article XVI:3. By contrast, a heavily subsidized and subsidy-increased world market share of 41.6 per cent in MY 2002 is *inequitable.*[252]

190. With respect to the second question, Brazil notes that although agricultural domestic and – to a certain extent - export subsidies are not prohibited, GATT Article XVI places clear limits to such subsidization. Section A determines, for example, that subsidies must be notified when the operate "directly or indirectly to increase exports of any product from, to reduce imports of any product into, its territory". More specifically, it established that the subsidizing Member must avoid causing serious prejudice to the interest of other Members. Therefore, even purely domestic subsidies should only be granted in a manner that does not affect the equilibrium of world trade that would be achieved in their absence.

191. The GATT Article XVI obligations – especially those of the second sentence of paragraph 3 – are primarily focused on the effects of subsidies that operate to increase exports. Paragraph 2 places particular emphasis on the fact that such subsidies "may cause undue disturbance" to the "normal commercial interests" of other Members. Large subsidies stimulating exports cannot be understood not to cause "undue disturbance" that affect the "normal commercial interest" of other Members. Otherwise, GATT Article XVI:3 would be stripped of any meaning. If, the starting point to an analysis of an equitable share grandfathers subsidies that were being previously granted, such analysis would start from an inequitable situation of equilibrium.

192. The term "equitable" is defined as something that is "characterized by equity or fairness; fair, just."[253] "Equitable" does not relate to something that is "legal" or "permitted." Something that is permitted may well be not equitable. The fact that certain subsidies are "permitted" does not grandfather their effects and transforms them into "normal conditions in analyzing an equitable market share," as put by the Panel in this question. The text of GATT Article XVI:3 requires that the test of "equitable" market share be primarily and intrinsically linked with the concept of fairness. Therefore, an "equitable" analysis of a fair equilibrium of market shares cannot be one that starts by accepting as legitimate – or as "normal conditions" – the effects of widespread and expensive subsidies that only a few Members can afford, to the expense of developing countries.

193. Brazil does not believe that subsidies representing 95 per cent of the value of a widely-traded commodity product like upland cotton can ever be considered to have been provided under "normal conditions". Nor can a dramatic increase in absolute levels of subsidies coupled with the increase in

[252] *See* Brazil's 9 September Further Submission, para. 288.
[253] The New Shorter Oxford English Dictionary, 1993 edition, p. 843.

the subsidization rate (and in absolute subsidy payments) during the period MY 1999-2002 over a previous representative period be considered to be "normal conditions". Further, when a more than doubling of world market share by a WTO Member coincides with record low world prices, record *gaps* between total costs and market revenue and record amounts of that Member's subsidies, the subsidies cannot be considered to have been provided in "normal conditions".

**185. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the *Agreement on Agriculture* and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the *SCM Agreement*. BRA, US**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions of the *Agreement on Agriculture,* relevant?**

Brazil's Answer:

194. With respect to the first question, the answer is that any domestic support programme that grants "directly or indirectly" "*any form of subsidy* which operates to increase the export of any primary product" is covered by the second sentence of Article XVI:3. All of the domestic support subsidies challenged by Brazil in this case operate to increase US exports. Professor Sumner found that each of the challenged US subsidies he examined had the effect of increasing US exports.[254]

195. Because Article XVI, including Article XVI:3, deals with serious prejudice to the interests of another Member, the direct context for interpreting its provisions is found in Article 5 of the SCM Agreement. Article 5 makes no distinction between subsidies contingent upon export and domestic support subsidies. It provides that "[n]o Member should cause, *through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1,* adverse effects to the interests of other Members". Articles 1 and 2 of the SCM Agreement in turn make no distinction between export and domestic support subsidies.

196. The United States argues that the only subsidies governed by Article XVI:3 are export subsidies.[255] This argument misreads Article XVI:3. Although the first sentence of Article XVI:3 refers to "subsidies *on* the export of primary products," the second sentence provides:

> "If, *however*, a contracting party *grants directly or indirectly any form of subsidy which operates to increase the export* of any primary product from its territory . . ."

The word "however" is important, as it signifies that the second sentence contradicts the first and does not follow from it. Similarly, the use of the phrase "on the export of primary products" in the first sentence of Article XVI:3 is quite different from the phrase "which operates to increase the export of" in the second sentence of Article XVI:3. The notion of "on the export" is analogous to the export contingency set out in Article 3.1(a) of the SCM Agreement. However, the phrase "which operates to increase the export of" does not contain an export contingency requirement. Rather, it focuses on *effects* – whether the subsidies have the effect of increasing exports. Thus, read in light of the SCM Agreement, the second sentence of Article XVI:3 encompasses a notion of export-related subsidies that is far broader than subsidies that are "contingent upon export performance;" it includes as "export subsidies" those that operate to increase exports.

[254] Brazil's 9 September Further Submission, Annex I, Tables 5a-5g.
[255] US 7 October Oral Statement, para. 61.

197. Indeed, the reading of the second sentence of Article XVI:3 as meaning "subsidies contingent upon the export of products" would render Article XVI:3 a nullity. This is because under the US interpretation, any form of subsidy covered by the second sentence of Article XVI:3 would already be deemed prohibited as an export subsidy under Article 3.1(a). Given Article 13 of the Agreement on Agriculture, GATT Article XVI:3 is clearly intended to continue to provide rights and obligations for Members. Further, Article XVI is not a prohibited subsidy provision – it is an *actionable* subsidy provision. The subsidies and the provisions of Article XVI that are not superceded by the provisions of the SCM Agreement or the Agreement on Agriculture[256] must be read consistent with the *actionable* subsidy provisions of Article 5 of the SCM Agreement. Article 5 makes no distinction between subsidies that are contingent upon export and those that are not.

198. With respect to the Panel's second question, the title of Section B is not determinative. In light of the use of the phrase "any form of subsidy" in the second sentence of Article XVI:3, the title of Section B is properly read as encompassing any subsidies that have any effect on a Member's exports – whether they be "export subsidies" contingent upon export or whether they are "export subsidies" having the effect of increasing exports. Finally, Brazil notes that the US argument that places primary reliance on the title of Section B to interpret the second sentence of Article XVI: 3 is also questionable given the fact that Article XVI:5 is also covered by the title of Section B – and it deals with all types of subsidies covered by Article XVI.

199. With respect to the Panel's reference to Article 21 of the Agreement on Agriculture, Brazil does not believe that it is particularly relevant. As the Appellate Body noted in the *EC – Bananas* case, Article 21 of the Agreement on Agriculture provides that the provisions of GATT 1994 and the other multilateral trade agreements on trade in goods "*shall apply* subject to the provisions of this Agreement".[257] The drafters of the WTO Agreement did not intend agricultural trade to be a GATT-free zone – quite the opposite. They simply provided transitional provisions in Article 13 of the Agreement on Agriculture to moderate the application of some GATT provisions, strictly on a temporary basis. [258]

200. Article 13 of the Agreement on Agriculture is not that relevant in providing guidance regarding whether domestic support measures are included within the meaning of "any type of subsidy" under Article XVI:3, second sentence. Article 13(b)(ii) exempts non-green box domestic support only from actions based on paragraph 1 of GATT Article XVI, and does not directly exempt Article XVI:3. However, Article XVI:1 and 3 must be read together in order to assert a claim of serious prejudice.[259]

201. Article 13(c)(ii) of the Agreement on Agriculture provides that during the "implementation period", export subsidies that conform fully to Part V, as reflected in a Member's Schedule, are exempt from "actions" based on Article XVI. By implication, such export subsidies *are* subject to actions under Article XVI after the expiry of the peace clause and will be subject to such actions as of the time that the Panel issues its ruling. The same applies for green box domestic support under Article 13(a)(ii). Those subsidies are also exempt from actions under GATT Article XVI, including Article XVI:3. But these subsidies can be challenged under Article XVI:3 following the termination of the peace clause.

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the *SCM Agreement,* or in any other**

[256] *See US- FSC*, WT/DS108/AB/R, para 117 *quoted* in Question 185(a).
[257] Appellate Body Report, *EC – Bananas*, WT/DS27/AB/R, para. 155.
[258] Appellate Body Report, *EC – Bananas*, WT/DS27/AB/R, para. 155.
[259] Brazil's 7 October Oral Statement, para. 59 (arguing that Articles XVI:1 and 3 are directly linked).

**provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in *US-FSC*, para. 117[260] here?**

**Brazil's Answer:**

202. Brazil agrees that Article 6.3(d) reflects one of the situations that would also fall under GATT Article XVI:3. An increase in the world market share compared to the previous three-year average through the effects of subsidies would be consistent with a finding of an inequitable share of world trade under GATT Article XVI:3. However, an increase over the previous three-year average is not a necessary prerequisite for a finding of a violation of GATT Article XVI:3. For example, a Member's share of world export trade may be inequitable even if that share has not increased over the average of the past three years. Similarly, a Member's increase in exports may be inequitable even if an increase in exports has not followed a consistent trend, as required under Article 6.3(d).

203. GATT Article XVI:3 is concerned with whether a particular level of a Members' share of world export trade is equitable, whereas Article 6.3(d) of the SCM Agreement only addresses an *increase* in the share. Article 6.3(d) creates a presumption that an increase in a Member's world market share over its previous three-year average that follows a consistent trend over a period when subsidies have been granted nullifies and impairs other Member's rights. No such presumption exists for Article XVI:3 – the nullification and impairment must be demonstrated by showing that the share

[260] WT/DS108/AB/R, para 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market." In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* must clearly take precedence over the *exemption* of primary products from export subsidy disciplines in Article XVI:4 of the GATT 1994."

of world export trade is *inequitable*. While a particular situation may – as in this dispute – fall under both provisions, the focus and proof required for both provisions can be different.

204. Thus, Article 6.3(d) of the SCM Agreement subjects a specific subset of the situations covered by GATT Article XVI:3 to the remedy provided in Article 7.8 of the SCM Agreement. But it does not cover *all* of the situations covered by GATT Article XVI:3. This marks the crucial distinction between the provisions on export subsidies in the SCM Agreement that "take precedence" over those in GATT[261] and the provisions on actionable subsidies in both agreements that are complementary.

205. With respect to the Appellate Body's holding in paragraph 117 of *US – FSC*, the provisions on export subsidies in Articles 3 and 4 of the SCM Agreement represent the results of years of negotiations that have pushed the level of obligation in this area well beyond Article XVI:4. The conclusion that the Appellate Body drew in that instance was that "whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the SCM Agreement." Brazil agrees that the provisions of Article XVI:2-4 that deal with subsidies contingent upon export performance are superceded by the respective export subsidy provision contained in the Agreement on Agriculture and in the SCM Agreement.

206. However, as Brazil has argued in response to Question 185(a), the second sentence of GATT Article XVI:3 is not a provision limited to subsidies contingent upon export performance. Rather, its disciplines apply to *any* form of subsidy that operates to increase the exports of a Member. Thus, it is not superceded by the export subsidy provisions of the Agreement on Agriculture and the SCM Agreement. Rather, it provides rights and obligations concerning any form of a subsidy independent of the right and obligations set forth in Article 3 of the SCM Agreement.[262]

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the *SCM Agreement* and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?**

Brazil's Answer:

207. The short answer is "not at all." What is important for the Panel to consider is the entire package of Uruguay Round agreements, including the GATT 1994 and the contemporaneous SCM Agreement, not what was in GATT 1947.

208. Every agreement attached to the WTO Agreement is contemporaneous with every other attached agreement. The GATT 1947 no longer binds WTO Members; what is binding is the GATT 1994. The SCM Agreement and the GATT 1994 must be read together, and each provides "context" for interpreting the other, in the sense of Article 31(2) of the Vienna Convention on the Law of Treaties. As the Appellate Body noted in *Argentina – Footwear*[263], and as is now well established, the WTO Agreement is a single undertaking. All WTO obligations are, therefore, generally cumulative, and Members must comply with all of them simultaneously: "It is important to understand that the WTO Agreement is *one* treaty."[264] Thus, in as far as GATT Article XIX and the Agreement on Safeguards apply cumulatively, GATT Article XVI and the SCM Agreement apply cumulatively.

[261] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 117.
[262] *See* GATT Panel Report, *EC – Sugar Exports (II)*, para. V.(g).
[263] Appellate Body Report, *Argentina – Footwear Safeguards*, WT/DS121/AB/R, paras. 82-84.
[264] Appellate Body Report, *Korea – Dairy Safeguards*, WT/DS98/AB/R, para. 74-75; quotation from para. 75 (emphasis added).

Brazil refers the Panel to its Answer to Question 185(a) for a further discussion of the issues relevant to Question 185(c).

N. CLARIFICATIONS

**189. Please indicate whether the correct figure in paragraph 37 of Brazil's 7 October oral statement is 38.1 per cent or 38.3 per cent? BRA**

Brazil's Answer:

209. Brazil confirms that the correct figure in paragraph 37 of Brazil's 7 October Oral Statement is 38.3 per cent, *i.e.*, that the US world market share in MY 2001 was 38.3 per cent.[265]

**190. Please confirm that the figure "17.5" in paragraph 43 of Brazil's 7 October oral statement, is "percentage point". BRA**

Brazil's Answer:

210. Brazil confirms that the figure "17.5" in paragraph 43 of Brazil's 7 October Oral Statement refers to an increase by 17.5 percentage points in the world market share. Brazil further notes that – as explained in note 468 to Figure 26 of its 9 September Further Submission – the world market share refers to the world market share in the international cotton market, including the upland cotton and extra-long staple cotton market, as data on upland cotton only is not available to Brazil. However, given the small size of the extra-long staple market as compared to the upland cotton market, this only minimally distorts the data.[266]

**191. Could Brazil clarify its statement in para. 12 of its 9 September further submission: "Alternatively crop insurance is not specific because the 2000 ARP Act denies benefits to commodities representing more than half of the value of US agriculture. Further US crops represent only 0.8 per cent of total US GDP." (emphasis added) BRA**

Brazil's Answer:

211. Brazil thanks the Panel for bringing to its attention the error in paragraph 12 of its 9 September Further Submission. As clarified in paragraphs 67-69 of the same submission, Brazil meant to state that "[a]lternatively, crop insurance *is specific* because the 2000 ARP Act denies benefits to commodities representing more that half of the value of US agriculture" (emphasis added).

[265] Exhibit Bra-206 (Data on Article 6.3(d) claim).
[266] *Compare* Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 2-7).

# ANNEX I-6

## ANSWERS OF THE UNITED STATES TO QUESTIONS FROM THE PANEL TO THE PARTIES FOLLOWING THE SECOND SESSION OF THE FIRST SUBSTANTIVE PANEL MEETING

27 October 2003

### A. REQUEST FOR PRELIMINARY RULINGS

**122. Does Brazil allege that cottonseed payments, interest subsidies and storage payments are included in the subsidies that cause serious prejudice? Do they appear in the economic calculations? BRA**

**123. Does Brazil's request for the establishment of the Panel name the statute authorizing cottonseed payments for the 1999 crop? BRA**

### B. EXEMPTION FROM ACTIONS

**124. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture? BRA, US**

1. The scheduled issuance of the Panel's report after the end of the 2003 calendar year has no impact on the applicability of Article 13(a)(ii), (b)(ii) and (c)(ii) of the Agreement on Agriculture to the US measures in this dispute. There is no question, and Brazil has not contested, that Article 13 was in effect at the time of the Panel's establishment, and the Panel's terms of reference set on that date are to examine the matter raised in Brazil's panel request in light of the covered agreements, which include the Agreement on Agriculture.

2. As a separate matter not presented by this dispute, the United States notes that the commitments of the United States with respect to cotton are specified by *marketing* year, not calendar year. Therefore, the end of the 2003 calendar year would in any case not be relevant to the question of when the provisions of Article 13 cease to have effect with respect to US support measures for upland cotton.[1]

### C. IDENTIFICATION OF THE SUBSIDIZED PRODUCT

**125.**

**(1) In view of requirements in the FAIR Act of 1996 and the FSRI Act of 2002 that contract acreage remain in agricultural or conservation uses and which impose penalties if the producer grows fruits or vegetables, how likely is it that the producer with upland cotton base acreage will not use his or her land to produce programme crops or covered commodities? US**

[1] *See* Agreement on Agriculture Article 1(i) ("'[Y]ear' in paragraph (f) above and in relation to the specific commitments of a Member refers to the calendar, financial or marketing year specified in the Schedule relating to that Member.")

3. With respect to contract acreage on a farm, the 2002 Act generally allows any commodity or crop to be planted on base acres on a farm for which direct payments are made, with limitations for certain commodities (fruits, vegetables (other than lentils, mung beans, and dry peas), and wild rice). With some exceptions, planting of those limited commodities on base acres is prohibited and could lead to reduced or eliminated direct payments.[2] Otherwise, a producer (or landowner) is permitted to make any other use of the land so long as the land on the farm in a quantity equal to base acreage is used for an agricultural or conserving use.[3] Thus, the direct payment recipient has the flexibility to plant and harvest any other commodity or crop on the land representing their upland cotton base acreage; indeed, direct payment recipients may plant nothing at all and still receive payment. (We note that the foregoing description of the "planting flexibility" under the 2002 Act is relevant only to base acres on a farm for which direct payments are made; other acres on the farm need not comply with any of the contract requirements set out in Sections 1105 and 1106 of the 2002 Act.)

4. The data demonstrate that planting and harvesting decisions by US producers result in US upland cotton area varying significantly. In marketing year 2003, for example, US farmers planted 13,748,000 acres, a decline of 11.3 per cent from the recent high reached in marketing year 2001.[4] As indicated in the US closing statement at the second session of the first panel meeting, US harvested acreage largely increases and decreases in line with the rest of the world.[5] In marketing year 2001, US area harvested increased by almost the exact same percentage as did the rest of the world. In marketing year 2002, the per cent decline in harvested acreage in the United States was *greater* than that observed in the rest of the world. Thus, regardless of whether US farmers who plant upland cotton may also be holders of upland cotton base acres, and contrary to Brazil's assertions, US farmers respond to market signals by planting or harvesting upland cotton much as producers in the rest of the world do.

**(2) Brazil has submitted that "The record suggests that historic producers are current producers." It points to factors including the specialization of upland cotton producers, the need to recoup expensive investments in cotton-specific equipment, and the geographic focus and climatic requirements of upland cotton production in the "cotton belt". (Brazil's rebuttal submission, footnote 98, on page 24)**

**(a) Regarding the specialization of upland cotton producers and the geographic focus of upland cotton production, how does Brazil take account of the fact that cotton is produced in 17 of the 50 states of the United States and that average cotton area is approximately 38% of a cotton farm's acres? (This information is taken from the US's response to question 67bis, footnote 35). BRA**

**(b) Regarding the geographic focus of upland cotton production, how many other crops can upland cotton producers viably grow in the cotton belt, other than fruits and vegetables? US**

5. Based on planted acreage data as reported by National Agricultural Statistics Service[6], US upland cotton is produced in several diverse regions across the Cottonbelt, generally known as the Southeast, Delta, Southwest, and West regions. Across the regions (as well as within a given region), producers are faced with differing physical growing environments as well as economic factors that help determine the viability of upland cotton or some other alternative crop in any given year. Over

[2] *See* US Answer to Question 26 from the Panel, para. 56.

[3] 2002 Act, § 1105(a)(1)(D) (Exhibit US-1).

[4] US Department of Agriculture, National Agricultural Statistics Service, *Acreage*. Cr Pr 2-5 (6-03). June 30, 2003. Available at: http://usda.mannlib.cornell.edu/reports/nassr/field/pcp-bba/acrg0603.pdf

[5] *See* US Closing Statement at the Second Session of the First Panel Meeting, paras. 5-6; Exhibit US-63.

[6] See Exhibit Q125(2)(b).

the last several years, producers have reduced plantings of upland cotton and increased plantings to alternatives. A list of the full range of alternative crops that are viable in these areas would be extensive. Below we present a regional breakdown of some principal alternative crops to upland cotton as well as historical plantings since 1996 of these crops compared with upland cotton.

6. Upland cotton producers in the Southeast region (Alabama, Florida, Georgia, North Carolina, South Carolina, and Virginia) have corn and soybeans as principal alternative crops. Peanuts are also an alternative, though mainly in Georgia. Between 1996 and 2003, area planted to upland cotton, corn, and soybeans in the Southeast averaged about 8.6 million acres, ranging from 8.2 to 9.1 million acres. During this same period, upland cotton area ranged from 3.0 to 3.6 million acres. Since 2001, upland cotton has been reduced in favour of corn and soybeans in this region.

7. Upland producers in the Delta region (Arkansas, Louisiana, Mississippi, Missouri, and Tennessee) also have corn and soybeans as an alternative and, to a lesser extent, rice in some areas. Between 1996 and 2003, area planted to these 4 crops averaged 22.9 million acres, ranging from 22.2 to 23.8 million. At the same time, upland cotton area ranged from 3.2 to 4.6 million acres. Like the Southeast region, the Delta area planted to upland has declined since 2001 in favour of corn and soybeans.

8. The Southwest region (Texas, Oklahoma, and Kansas) has the most diverse growing environment of the 4 regions. In the northern part of the region – where most of upland cotton is grown – principal alternatives to upland cotton may include wheat and sorghum. In the southern part, however, corn, soybeans, and sorghum are generally an alternative to upland cotton. The Southwest region planted an average of 26.3 million acres to these 5 crops between 1996 and 2003.[7] Area ranged from 24.5 to 27.9 million acres during this period. Meanwhile, upland cotton area ranged from 5.7 to 6.7 million acres. Since 2000, upland area in the Southwest has fallen in favour of sorghum, wheat, and corn.

9. In the West region (California, Arizona, and New Mexico), upland producers have a variety of alternatives, including corn, extra-long staple (ELS) cotton, alfalfa, and wheat. Between 1996 and 2003, area planted to these 5 crops averaged 4.3 million acres in the region, ranging from 4.0 to 4.6 million. At the same time, upland cotton area has ranged from 0.7 to 1.4 million acres. The last several years, however, have seen upland area decline in favour of one or more of the alternative crops.

**(c) Regarding the high cost of upland cotton production, can Brazil show that farms who planted upland cotton could only have covered their costs by receiving upland cotton, rice or peanut payments in every year from 1999 through 2002? BRA**

**(d) Regarding the need to recoup investments in cotton-specific equipment, is it important to planting decisions that upland cotton producers cannot run any other crop through their cotton-pickers? How does this affect the likelihood that they will grow other crops? US**

10. **The National Agricultural Statistics Service (NASS) reported that in 2002, farmers paid an average of $225,000 for a cotton picker**.[8] Farmers may respond to machinery costs through the contracting-out of harvesting operations and rental or leasing of cotton-picking machinery.

[7]To be conservative, we have excluded Kansas wheat and sorghum acreage from the totals presented due to the state's large production of these crops and relatively small production of cotton.

[8] US Department of Agriculture, National Agricultural Statistics Service, *Agricultural Prices 2002 Summary*. Pr 1-3 (03)a July 2003. Available at: http://usda.mannlib.cornell.edu/reports/nassr/price/zap-bb/agpran03.pdf

11. In the short run, investment costs may slow acreage adjustments to market prices. This does not mean, however, that cotton producers do not respond to changes in market prices. Research by Lin et al. suggest that cotton producers may, in fact, be more responsive to own price changes (that is, the response of cotton acreage to changes in cotton prices as opposed to changes in prices of competing crops) **than other competing crops** are.[9] In the long run, fixed assets like cotton pickers are less of a constraint to entry, and thus one would expect the acreage response to changes in price to be larger.

**Acreage own-price elasticity for major field crops**

| Crop | National acreage price elasticity |
|---|---|
| Wheat | 0.34 |
| Corn | 0.293 |
| Sorghum | 0.55 |
| Barley | 0.282 |
| Oats | 0.442 |
| Soybeans | 0.269 |
| Cotton | 0.466 |

Source: Lin *et al*., Appendix table 21 (Exhibit US-64).

**(3) In calculating the amount of PFC, MLA, direct and counter-cyclical payments that went on upland cotton, Brazil made an adjustment for the ratio of current acreage to base acreage (see its answer to question 67, footnotes 2, 3, 4 and 5). Is this an appropriate adjustment for the particular factors referred to above? Why or why not? BRA, US**

12. Brazil's adjustment is not appropriate. It does not explicitly take into account any of the factors referred to above. Instead, Brazil's belated adjustment is simply based on the assumption that all of the planted cotton acreage was by producers who had cotton base acreage exactly equal to their planted acreage. This assumption is inaccurate and causes Brazil's figures to be in error. For some producers, cotton planted acres exceed their historical base, and some cotton acres are planted by producers who have no cotton base. As noted in the US further submission, important changes such as lowered costs from pest eradication and adoption of biotechnology have lowered costs and brought new areas and farmers into cotton production. Brazil's adjustment takes no account of these changes.

13. More fundamentally, the relevant point is that any producers who have upland cotton base will receive direct and counter-cyclical payments regardless of whether they plant upland cotton. Thus, the decision to plant upland cotton will be based on expected economic returns of cotton and competing crops – not the level of direct and counter-cyclical payments that are decoupled from the decision to produce upland cotton. And the fact that these are decoupled payments means that the amount of the payment could not in any event be allocated only to cotton production.

**(4) Dr. Glauber has alleged that there are statistical problems in comparing planted acres to programme acres because of abandonment of crops and also because planted acres are only survey estimates, not reported figures (See Exhibit US-24, the first full paragraph in P2). Would it be more appropriate to divide harvested acreage by base acreage? What margin of error is there between the survey estimates and reported figures? BRA, US**

14. Exhibit US-24 outlines the statistical problems associated with dividing complying base acres by planted acres. The discussion addressed complying base acres under the Acreage Reduction Programme of 1990 Farm Bill and did not address programme payment acres as defined under the

[9] **Lin, W., *et al.*. *Supply Response Under the 1996 Farm Act and Implications for the US Field Crops Sector.* US Department of Agriculture, Economic Research Service, Technical Bulletin No. 1888**, Appendix table 21 (Exhibit US-64).

1996 Farm Bill. Dividing harvested acreage by base acreage could potentially overstate the difference if there is significant acreage abandonment after producers reported their payment acres to the Farm Service Agency. Also, there remains a problem with the comparison since harvested acres are survey-based while base acres are reported numbers.

15. In the June *Acreage* report, the National Agricultural Statistics Service reports reliability estimates for selected crops. The **reliability of acreage estimates is computed by expressing the deviations between the planted acreage estimates and the final estimates as a per cent of the final estimates and averaging the squared percentage deviations for the 1983-2002 twenty-year period; the square root of this average becomes statistically the "Root Mean Square Error." Probability statements can be made concerning expected differences in the current estimates relative to the final estimates assuming that factors affecting this year's estimate are not different from those influencing the past 20 years. For example, the "Root Mean Square Error" for the upland cotton planted estimate is 2.4 per cent. This means that chances are 2 out of 3 that the current cotton acreage will not be above or below the final estimate by more than 2.4 per cent. NASS reports that the 90 per cent confidence interval for the upland cotton estimate is 4.1 per cent. This means that chances are 9 out of 10 (90 per cent confidence level) that the difference will not exceed 4.1 per cent**.[10]

**(5) Do the acreage reports under section 1105(c) of the FSRI Act of 2002 indicate or assist in determining the number or proportion of acres of upland cotton planted on upland cotton base acres? Was there an acreage reporting requirement for upland cotton during MY1996 through 2002? BRA, US**

16. The acreage reports filed under Section 1105(c) of the 2002 Act by farms receiving direct and counter-cyclical payments indicate what crops are planted on a farm. A farm is an administrative construct that consists of tracts of land that are operated as one unit. The farm may be operated by more than one producer, and a producer may produce crops on more than one farm. The acreage report does not indicate the quantity of base acres on the farm. Because the acreage reports are filed after the planting season but before the harvest, the reports do not contain information on the quantity of production on each farm.

17. Based on a very preliminary review of a sampling of marketing year 2002 acreage reports, the United States estimates that roughly 53 per cent of farms that were eligible for direct and counter-cyclical payments for upland cotton base acreage also planted at least one acre of upland cotton in 2002. That is, approximately 47 per cent of farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all.

18. Over the period 1996 through 2002, there was no statutory requirement for acreage reports by recipients of decoupled payments or marketing loan payments. By regulation, producers who signed up for disaster assistance or who received marketing loan benefits (including loan deficiency payments) were asked to file planting acreage reports. Reports for producers receiving disaster assistance were to cover all acreage on the farm while reports for producers receiving marketing loan benefits were to cover only acreage for the crop receiving benefits. As a result, acreage reports over the period of the 1996 Act are incomplete.

**(6) Please prepare a chart showing upland cotton base acreage, planted acreage and harvested acreage for MY1996 through 2002. Does the planted acreage fluctuate within a broad band? If not, does this indicate any stability in decisions to plant the same acres to upland cotton? BRA, US**

[10] US Department of Agriculture. National Agricultural Statistics Service. *Acreage.* CrPr 2-5 (6-03). 30 June 2003. Pp 38-39.

19. The following chart shows upland cotton base acreage, planted acreage and harvested acreage for marketing years 1996 through 2002:

**US upland cotton area (thousand acres)**

| Crop year | Base acreage 1/ | Planted acreage 2/ | Harvested acreage 2/ |
|---|---|---|---|
| 1996 | 16128 | 14395 | 12632 |
| 1997 | 16213 | 13648 | 13157 |
| 1998 | 16412 | 13064 | 10449 |
| 1999 | 16377 | 14584 | 13138 |
| 2000 | 16268 | 15347 | 12884 |
| 2001 | 16239 | 15499 | 13560 |
| 2002 | 16217 (est.) | 13714 | 12184 |

1/ US Department of Agriculture, Farm Service Agency
2/ US Department of Agriculture, National Agricultural Statistics Service, selected Acreage reports

20. Over the period 1996-2002, US upland cotton planted acres ranged considerably, from 13,064,000 acres to 15,499,000 acres. Year-over-year, planted and harvested acreage can rise or fall significantly. For example, from marketing year 2001 to marketing year 2002, planted acreage fell by 1.785 million acres or 11.5 per cent; harvested acreage fell by 1.376 million acres or 10.1 per cent. As was pointed out in the US closing statement at the second session of the first substantive meeting of the Panel and in Exhibit US-63, year-over-year changes in US harvested cotton acreage have been similar to year-over-year changes for harvested cotton acreage outside of the United States. These data do not provide any information on whether the same or different acres are planted to upland cotton.

21. As noted above in the US answer to Question 125(5), based on a preliminary review of a sampling of marketing year 2002 acreage reports, it would appear that nearly half of farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all. That so many farms that produced upland cotton during the historical base period of 1993-1995 or 1998-2001 no longer plant even a single acre of upland cotton suggests that there has been a large exit of past cotton producers and a large entry of new producers or a large expansion by other historical cotton producers.

**(7) Brazil states that one third of all US farms with eligible acreage decided to update their base acreage under the direct payments and counter-cyclical payments programmes using their MY1998-2001 acreage. What is the proportion of the current base acreage for upland cotton resulting from such updating? Is the observed updating of base acreage consistent with Brazil's argument that it is only profitable to grow upland cotton on base acreage (and peanut and rice base acreage)? BRA**

**(8) How could one take account of upland cotton producers who receive PFC, MLA, direct and counter-cyclical payments for other covered commodity base acreage? BRA, US**

22. Under Brazil's approach, one would need to take account of upland cotton producers receiving decoupled payments only for base acreage for other covered commodities. This follows from Brazil's explanation that "only the portion of upland cotton [decoupled] payments that actually benefits acres planted to upland cotton can be considered support to upland cotton".[11] Thus, under Brazil's approach, one would need to deduct any production (or acreage) attributable to such producers from the acreage figures Brazil has used to adjust the amount of decoupled payments on upland cotton base acreage.

[11] Brazil's Answer to Question 67 from the Panel, fn. 2-5.

**(9) Assuming that Brazil's payment figures were to amount to a prima facie case, please answer the following questions: US**

**(a) How would the United States calculate or estimate the proportion of upland cotton producers who receive subsidy payments for upland cotton base acreage?**

**(b) Should any adjustment estimates be made for any factors besides those listed by Brazil?**

**(c) What adjustment estimate would it be appropriate to make?**

**(d) How could one take account of upland cotton producers who receive decoupled payments for other programme crop base acreage?**

**(e) Could the US specifically indicate what, in its view, are the flaws in the approach summarized in paras. 6-7 of Brazil's closing oral statement on 9 October (i.e. the use of the ration of 0.87 to adjust the amount of total upland cotton direct and CCPs for the MY to obtain the amount of subsidies received by upland cotton producers)? Can the US suggest an alternative approach that would yield reliable results in its view?**

23. Putting Peace Clause and green box issues to one side, the United States believes that the issue of what payments may be attributed to upland cotton production is fundamentally part of Brazil's burden to present evidence substantiating the amount of the subsidy that it is challenging. However, the United States would note that this issue is not a matter of "the proportion of upland cotton producers who receive subsidy payments for upland cotton base acreage." Rather, the issue is, first, what is the quantity of decoupled payments received by upland cotton producers; second, how are those payments allocated across the total value of each farm's agricultural production; and third, how much and in what amount are US cotton exports subsidized by these payments.

24. Brazil has conceded that decoupled payments made with respect to upland cotton base acreage are not "tied to the production or sale" of upland cotton, by adjusting such payments by 0.87.[12] That is, Brazil recognizes that, even on its theory, at least 0.13 of these payments "can[not] be considered support to upland cotton" because at least that fraction of upland cotton base acres were not planted to upland cotton in marketing year 2002. Because these payments are not "tied to the production or sale" of upland cotton, as suggested by Annex IV of the Subsidies Agreement, they must be allocated across the total value of production of each recipient. Brazil has not denied the applicability of the allocation methodology set out in Annex IV, but neither has Brazil provided any evidence relating to the total value of production of decoupled payment recipients.[13]

25. Brazil claims that its "suggested methodology is based on the conclusion that all upland cotton producers received these payments".[14] In fact, Brazil's methodology is based on the further assumptions that (1) every acre of upland cotton in marketing year 2002 was planted by a holder of upland cotton base acreage and (2) no such base acreage holder planted more upland cotton than his or her base acres.[15] Brazil has provided no evidence to support these assumptions, which is no

[12] In addition to issues relating to the "adjustment," the United States disagrees with the total amount of decoupled payments paid with respect to upland cotton base acreage that Brazil calculates and uses as the base for its adjusted payment amounts. *See* US Answer to Additional Question 67*bis* from the Panel, para. 28, fn. 37, 38.

[13] As noted in the Panel's Question 125(2)(a), average cotton area is approximately 38 per cent of a cotton farm's acres. Thus, a substantial portion of the average cotton farm's agricultural production will be derived from production of other crops.

[14] Brazil's Closing Statement at the Second Session of the First Panel Meeting, para. 8.

[15] Using figures for marketing year 2002 planted acreage and base acreage, Brazil claims, "Out of the 16.2 million upland cotton base acres, 2.1 million were not planted to upland cotton in MY2002." Brazil's Closing Statement at the Second Session of the First Panel Meeting, para. 6. However, given the planting and

surprise since the evidence is to the contrary. For example, the fluctuations in upland cotton planted and harvested area in recent years and the fact that one-third of all US farms with eligible acreage decided to update their base acreage using their MY1998-2001 acreage, imply substantial new entrants or new acreage that were not included in the base period figures under the 1996 Act. In fact, as noted above in the US answer to Question 125(5), based on a preliminary review of marketing year 2002 acreage reports, the United States estimates that nearly half of all farms receiving direct and counter-cyclical payments in 2002 for upland cotton base acreage planted no upland cotton at all.

26. We also note that there are substantial requirements with which a payment recipient must comply (see US answer to Question 162), such as highly erodable cropland conservation requirements and wetland conservation requirements.

D. "LIKE PRODUCT"

**126. Does the US agree that the product at issue is upland cotton lint and that Brazilian upland cotton lint is "like" US upland cotton lint within the meaning of Article 6.3(c) of the SCM Agreement in that it is a separate like product that is identical or has characteristics similar to the upland cotton lint from the United States? (e.g. Brazil's further submission, para. 81) US**

27. For purposes of this dispute, the United States is not arguing that all US cotton is "unlike" Brazilian cotton. There are some grades of cotton that both produce. Such grades would have similar characteristics although, as noted by Mr. Ward at the second session of the first panel meeting, Brazilian lint has been sold in the past at a substantial discount to the New York futures price. That discount has been declining over time as Brazil, a relatively new supplier internationally, works to establish a reputation for quality and reliability.

**E. "SUBSIDIES"**

**127. The Panel notes that the US contests that export credit guarantees constitute "subsidies". The Panel recalls that the US agrees that Step 2 payments are "subsidies" and wishes to have confirmation that it is correct in understanding that the US does not disagree that the following are "subsidies" for the purposes of Article 1 of the SCM Agreement: marketing loan/loan deficiency payments, PFC, direct payments, market loss assistance and CCP payments, crop insurance payments, cottonseed payments, storage payments and interest subsidy (without prejudice to the Panel's rulings on the US requests for preliminary rulings on the latter two payments). US**

28. With respect to marketing loan payments, the United States agrees that these product-specific amber box payments that are made to producers of upland cotton for the production of upland cotton are subsidies within the meaning of Article 1 of the Subsidies Agreement.

29. With respect to crop insurance payments, through which the United States pays a portion of the crop insurance premium for producers, the United States agrees that these amber box payments are subsidies within the meaning of Article 1 of the Subsidies Agreement. We note, however, that these payments are not product-specific because they are not made to upland cotton producers for the production of upland cotton. Rather, they are non-product-specific support made to "producers in general" (that is, generally). Further, these crop insurance payments are not specific within the meaning of Article 2 of the Subsidies Agreement because they are available with respect to all

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base acreage numbers, the most Brazil can logically claim is that "*at least* 2.1 million [base acres] were not planted to upland cotton in MY2002". That is, if in 2002 new producers without base acres planted upland cotton or if some historical producers planted more than their base acres, then some portion of the 14.1 million planted acres in MY2002 were not planted "on" upland cotton base acres.

agricultural products for which policies are offered by private companies. Therefore, pursuant to Article 1.2, this "subsidy" is not subject to the provisions of Part III of the Subsidies Agreement.

30. With respect to cottonseed payments, we recall that these payments are not within the terms of reference of the Panel.[16] With respect to "other payments" for upland cotton notified by the United States to the WTO – that is, storage payments and interest subsidy – the United States also recalls that these payments are not within the Panel's terms of reference.[17] Without prejudice to the US request for preliminary rulings on these three types of payments, the United States considers that these product-specific amber box payments are subsidies within the meaning of Article 1.

31. With respect to green box production flexibility contract payments under the 1996 Act and direct payments under the 2002 Act, the United States does not consider that Brazil has demonstrated what is the amount of the subsidy attributable to upland cotton producers pursuant to Article 1. Article 1 requires that a financial contribution by a government or public body or income or price support confers a benefit. The subsidies Brazil challenges are subsidies to producers, users, and/or exporters of upland cotton. However, Brazil has not identified the portion of the production flexibility contract payments that is properly attributable to upland cotton producers as opposed to other recipients of this subsidy. In fact, Brazil concedes that the entire amount of these payments does not confer a benefit on upland cotton producers by reducing the amount of production flexibility contract payments and direct payments on upland cotton base acres by the proportion 14/16. However, Brazil has provided no evidence of the amount of these decoupled payments received by producers that currently produce cotton. Nor has Brazil demonstrated how much or to what extent US cotton exports are subsidized.

32. With respect to *ad hoc* market loss assistance and counter-cyclical payments under the 2002 Act, the United States also does not consider that Brazil has demonstrated what is the amount of the subsidy attributable to upland cotton producers pursuant to Article 1. Specifically, as with production flexibility contract payments and direct payments, Brazil has not identified the portion of the subsidy that is properly attributable to producers of upland cotton as opposed to other recipients of this subsidy. Brazil has not identified the benefit to upland cotton producers conferred by these payments. Rather, Brazil merely assumes that for every upland cotton harvested acre, upland cotton producers had a corresponding upland cotton base acre. However, Brazil has provided no evidence of the amount of these decoupled payments received by producers that currently produce cotton.

## F. PROHIBITED SUBSIDIES

**128. Could the US respond to Brazil's assertions relating to the meaning and effect of the introductory phrase of Article 3 ("Except as provided in the Agreement on Agriculture....")? Would the meaning/effect change if Article 13 of the Agreement on Agriculture did not exist? BRA, US**

33. It is not entirely clear to the United States to which assertions of Brazil the Panel refers in its question. Moreover, the United States does not believe Brazil has purported to ascribe a specific meaning to that particular phrase. Indeed, with respect to Article 3.1(b), Brazil's arguments would effectively delete the introductory phrase in its entirety.[18]

## G. SPECIFICITY / CROP INSURANCE

**129. In the event that the Panel does not consider that the alleged prohibited subsidies fall within the provisions of Article 3 and are therefore, pursuant to Article 2.3, "deemed to be**

[16] *See, e.g.*, US Further Submission, para. 8.
[17] *See* US Further Submission, paras. 6-7.
[18] See Answer of the United States to Panel Question 144, *infra*.

**specific", are there any other grounds on which Brazil would rely in order to support the view that such measures are "specific" within the meaning of Article 2 of the SCM Agreement (see, for example, fn 16 of Brazil's further submission)? BRA**

**130. Does Brazil agree that the US insurance premium subsidy is available in respect of all agricultural products? Please cite relevant portions of the record. BRA**

**131. How should the concept of specificity - and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the SCM Agreement apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the SCM Agreement: BRA, US**

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

34. The United States does not regard a domestic subsidy as being specific solely because the subsidy is limited to the agricultural sector. As previously noted, this proposition is codified in the US countervailing duty regulations, at 19 C.F.R. § 351.502(d). Thus, the United States is of the view that the agricultural sector is too broad and too diverse to constitute a single "enterprise or industry or group of enterprises or industries".

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

35. It is difficult to opine on this question in the abstract. However, this fact pattern does not apply to the US insurance premium subsidies, which are also available in respect of livestock.

**(c) is a subsidy in respect of certain identified agricultural products specific?**

36. It is difficult to opine on this question in the abstract. However, this fact pattern does not apply to the US insurance premium subsidies since the premium subsidy is a single subsidy programme available in respect of all products (while policies issued by private parties are in certain instances available in respect of certain identified products).

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

37. The United States assumes that this would require that the subsidy be limited to certain entities or the upland cotton industry and so would be specific. This fact pattern, however, does not apply to the US insurance premium subsidies since the premium subsidy is a single subsidy programme available with respect to all products (while policies issued by private parties are in certain instances available in respect of certain identified products).

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

38. In principle, a subsidy that is limited to a sufficiently small proportion of US commodities would be "limited", and, thus, "specific" within the meaning of Article 2.1(c). However, the Subsidies Agreement does not establish any quantitative standards for determining when a subsidy is so limited, and a proposal to establish such standards was rejected during the Uruguay Round. Therefore, the determination must be made on the basis of the facts of the particular case. This is the approach taken by the US Department of Commerce for purposes of the US countervailing duty law.

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

39. This question is not presented in this dispute, but the United States would note that "land" is neither an "enterprise" nor an "industry", and so the proportion of farmland as such would not be appear to be relevant to the analysis under Article 2 of the Subsidies Agreement. The issue also does not appear to fall within the scope of Article 2.2, which deals with regional specificity – that is, "total US farmland" does not correspond to a "designated geographical region".

**132. Please state the amount and percentage of upland cotton acreage covered by each crop insurance programme and/or policy under the ARP Act of 2000. US**

40. There is one crop insurance programme, through which the United States provides premium subsidies on crop insurance policies that are offered by private insurance companies under the authority of the Federal Crop Insurance Act. There is no specific crop insurance programme or policies for cotton authorized under the Agricultural Risk Protection Act of 2000. Within this crop insurance programme, there are different plans of insurance that offer different types of coverage, such as production plans of insurance or revenue plans of insurance. All such plans of insurance are reinsured by FCIC and a premium subsidy paid by the US Government, is available. The amount and percentage of upland cotton acreage covered by each plan of insurance is shown in Exhibit US-65.

**133. Concerning Brazil's arguments in its oral statement, para. 7, can the US indicate if any producers of livestock outside a pilot programme are covered by the crop insurance programme? US**

41. Yes, producers of livestock outside of pilot programmes are covered by the crop insurance programme. In addition, there are policies being developed pursuant to pilot programmes in order to expand the scope of insurance products offered by private insurers to livestock producers. Thus, US crop insurance payments on premiums are made to a broad range of agricultural producers across the agricultural sector, including many livestock producers.

42. Livestock producers are eligible for several forms of "crop insurance" benefits under the provisions of the same operational statute that provides for benefits for "crops". Under the Federal Crop Insurance Act (7 USC 1501-1524), the Federal Crop Insurance Corporation (FCIC), an entity within the US Department of Agriculture, can approve insurance products if there is "sufficient actuarial data" to justify it to producers of "agricultural commodities".[19] *See* 7 USC 1508(a). The Act defines "agricultural commodity" to include a lengthy list of commodities, including such non-plant commodities as "finfish" and "mollusks". The definition also includes any "other agricultural commodity", except stored grain (the crop that produced the grain would be eligible for coverage), as determined by the Board of Directors of FCIC.

43. Thus, FCIC has the authority to offer insurance for livestock under its regular insurance programmes. The FCIC has approved products providing income protection to producers with livestock on t heir farm as contemplated in the statute. In addition, with the enactment of the Agricultural Risk Protection Act of 2000 (ARPA) (Pub. Law 106-224), Congress specifically mandated that FCIC offer pilot programmes for livestock. See 7 USC 1523.

44. The Adjusted Gross Revenue (AGR) product provides protection against low revenue due to unavoidable natural disasters and market fluctuations that occur during the insurance year. Covered farm revenue consists of income from all agricultural commodities, including amounts of income from animals and animal products and aquaculture reared in a controlled environment. To be eligible to purchase an AGR policy, the producer can earn no more than 35 per cent of expected allowable income from animals and animal products. Because the amount of livestock is considered incidental,

[19] *See* 7 US Code § 1508.

the expenditures are not counted against the funding limitations for livestock contained in 7 USC 1523 (which have never been reached).

45. The 35 per cent limit does not apply in the so-called "AGR-lite" programme, which was developed by, and originally available only in, Pennsylvania , the state that developed the policy. However, beginning with the 2004 crop year, an "AGR-lite" product will be expanded to counties in Connecticut, Delaware, Maine, Vermont, Massachusetts, New Hampshire, New Jersey and Rhode Island, and selected counties in West Virginia, New York, and Maryland, as approved by RMA. In all, the AGR-lite programme will now cover about 300 counties. That expansion of AGR-Lite was announced in an 18 August 2003, press release, available on the RMA website.

46. There are at least four kinds of products specifically for livestock available to livestock producers, and they are described at the website of the Risk Management Agency (RMA) (www.rma.usda.gov). There are two different policies that are available for swine producers. The first is Livestock Risk Protect (LRP- Swine). Originally that product was available only in Iowa. RMA recently announced that the policy may be offered to swine producers in 10 additional states: Illinois, Indiana, Kansas, Minnesota, Nebraska, Nevada, Oklahoma, Texas, Utah and Wyoming. The other policy available to swine producers is Livestock Gross Margin (LGM), which is available in Iowa. For cattle, there are two specialized policies available. Livestock producers may purchase a LRP-Feeder Cattle policy in Colorado, Iowa, Kansas, Nebraska, Nevada, Oklahoma, South Dakota, Texas, Utah, and Wyoming. Finally, there are "LRP-Fed Cattle" policies in Illinois, Iowa and Nebraska.

**134. Please state the annual amount of premiums paid or contributions made by US upland cotton farmers relating to each of the crop insurance programmes and/or policies supported by the US Risk Management Agency and the Federal Crop Insurance Corporation in each year from 1992 through 2002. US**

47. Please see Exhibit US-66.

**135. Please state the annual amount of insurance indemnity payments made by the US government; or insurance companies participating in crop insurance programmes and/or policies under the ARP Act of 2000 to upland cotton farmers in each year from 1992 through 2002. US**

48. Please see Exhibit US-67.

**136. Is the US arguing that crop insurance subsidies corresponding to "over 90 per cent of insured cotton area" (US 7 October oral statement, para. 46) in MY1999 through 2002 are consistent with paragraph 8(a) of Annex 2 of the Agreement on Agriculture? Is it correct that in the past these subsidies were nonetheless notified to the Committee on Agriculture as non-product specific AMS (see, for example, G/AG/N/USA/43 in Exhibit BRA-47)? US**

49. The United States has notified crop insurance payments to the Committee on Agriculture as non-product specific support. This is consistent with the US position that crop insurance subsidies are generally available subsidies to the agricultural sector as a whole.[20] In the US oral statement of 7 October 2003, it is pointed out that over 90 per cent of the cotton area currently under the programme is insured at coverage levels of 70 per cent or less of expected yield (or revenue). Over all commodities, almost 70 per cent of total insured area is insured at 70 per cent or less of expected yield or revenue. Thus, associated subsidies would be consistent with paragraph 8(a) of Annex 2 of the Agreement on Agriculture – that is, payments for relief from natural disasters that Members have

[20] US Comments on Brazil's Rebuttal Submission, paras. 34-42; US Rebuttal Submission, paras. 93-98; US Further Submission of September 30, 2003, paras. 14-15.

agreed have no or at most minimal trade-distorting effects or effects on production. The point is made to stress that such subsidies that satisfy green box criteria are likely non-production distorting, contrary to the assertions made by Brazil.

## H. EXPORT CREDIT GUARANTEES

**137. Please elaborate the meaning of "net losses" as is used in paragraph 70 of Brazil's 7 October oral statement. BRA**

**138. Please comment on Brazil's views stated in paragraph 70 of its 7 October oral statement. US**

50. In specific response to Brazil's views stated in that paragraph, the United States invites the attention of the Panel to paragraphs 157-162 of the 22 August US Rebuttal Submission, the table accompanying paragraph 161 of that submission, and paragraphs 144-150 of 30 September Further Submission of the United States. Paragraph 70 of Brazil's 7 October oral statement is simply a recapitulation of arguments it had previously advanced.

51. As noted in paragraph 144 of the US Further Submission, current data for each of the cohorts for 1992, 1993, 1994, 1995, 1996, and 1999 indicates a profit.[21] As stated in OMB Circular No. A-11: "The subsidy cost is the estimated present value of the cash flows . . . resulting from a direct loan or loan guarantee . . . . A positive net present value means that the Government is extending a subsidy to borrowers; *a negative present value means that the credit programme generates a 'profit' (excluding administrative costs) to the Government."*[22]

**139. In the context of export credit guarantees, is the Panel correct in understanding that Brazil's claims of inconsistency with the Agriculture Agreement involve GSM 102, GSM 103 and SCGP, but that it limits its "serious prejudice" allegations in respect of export credit guarantee programmes to the GSM 102 programme, and does not challenge GSM 103 and SCGP in this respect? If so,**

**(a) could Brazil please explain why it did so, and confirm that all the data relied upon in its further submissions (e.g. in Table 13) relate to the GSM 102 programme rather than to GSM 102, GSM 103 and SCGP (and, if the data needs to be adjusted to take account of a narrower "serious prejudice" focus, supply GSM-102-relevant data)? BRA**

**(b) for the purposes of Article 13(c)(ii) of the Agreement on Agriculture, is it necessary for the Panel to examine only GSM 102 or should the Panel's examination include also GSM 103 and SCGP? Why or why not? BRA**

**140. Could Brazil explain how, if at all, it has treated export credit guarantees for the purpose of Table 1 of its further submission? BRA**

**141. The Panel notes the US argument, inter alia in its further submission, that the export credit guarantee programmes are "self-sustaining". Recalling that item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement refers to "premium rates", could the US expand upon how it takes into account the premium rates for the export credit guarantee programmes in its analysis. US**

[21] *See also* US Rebuttal Submission, para. 161 (chart of Subsidy Estimates and Reestimates by Cohort); US Further Submission, fns. 82 and 96.

[22] OMB Circular No. A-11, section 185.2, pp. 185-3 and 185-4 (italics added) (Exhibit Bra-116).

52. Item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement is concerned with whether premium rates are inadequate to cover the long-term operating costs and losses of the programmes. **A rate is applied against a transaction amount to generate revenue to cover any costs and losses. In the context of the export credit guarantee programmes, the premium rate is applied against the volume of a particular transaction to generate revenue. The mere rate as an abstract number cannot generate revenue. Consequently, premium rates as applied to the volume of transactions is necessarily the principal source of programme revenue. In addition, recoveries – whether direct or through rescheduling – are an additional source of revenue. Revenue from all these sources are applied against its operating costs (e.g., administrative expenses) and losses from its claims experience. Alternatively, such recoveries may be viewed not as revenue but as a reduction of loss arising from claims experience. For example, a full recovery of an amount already paid as a claim yields a net loss of zero. Arithmetically, this would yield the same result as treating the recovery as revenue, offsetting the equivalent amount of prior loss.**

53. As the United States noted in footnote 81 of its 30 September Further Submission, Brazil has erroneously argued that item (j) compels consideration only of premiums on the revenue side of the ledger for purposes of covering long-term operating costs and losses. In Brazil's Comment on the US answer to Panel question 77 (para. 94), Brazil states that "item (j) limits the revenue to be used to offset operating costs and losses to 'premium rates'". To the contrary, item (j) envisions an examination of whether premium rates are inadequate to cover long-term operating costs and losses. It does not say that all other revenue must be excluded from the calculation of whether a loss has occurred. Brazil would argue that if the United States paid a claim on day 1 and recouped in full on day 2 the amount it had paid, it could not include such recovery in a determination of whether the programme satisfied item (j). Such a draconian result is economically illogical and certainly not compelled by the text. As noted above, whether the recovery is viewed as revenue or as a subtraction from loss, the net result would be the same, but it must be included in any evaluation of whether premium rates cover long-term operating costs and losses.

54. As the United States further noted in its response to Panel question 77 (11 August Answers to Panel Questions, para. 145), item (j) applies to three different types of programmes: export credits, export credit guarantees, and insurance. In the case of export credit guarantees and insurance, the provider will occasionally incur claims. To the extent such claims or defaults exceed revenue from whatever source it may be derived, the net result would be a loss arising from operations. In an accounting sense such result would constitute an 'operating loss.'.

55. Revenues derived from fees paid in connection with the export credit guarantee programmes form an integral part of the estimate and re-estimate process that currently indicate profitability for each of the cohorts in 1992, 1993, 1994, 1995, 1996, and 1999.[23] The application of the rates in this regard to the analysis is properly extended to 1992, as this is the first fiscal year of applicability of government-wide accounting for federal credit programmes under the Credit Reform Act of 1990. This period also conforms with the period that Brazil recognizes as appropriate for analysis under item (j).[24] As a result of such profitability, the programmes are self-sustaining.

**142. The US has pointed out that there are many limitations on granting export credit guarantees and that there is no requirement to issue any particular guarantee (US further**

[23] *See* Answer of the United States to Panel Question 138, *supra*. *See also* US Rebuttal Submission, para. 161 (chart of subsidy estimates and reestimates by cohort); US Further Submission, fns. 82 and 96.

[24] See First Submission of Brazil (24 June 2003), para. 282: "[A] ten-year period . . . fulfils the criterion of being 'long-term' within the meaning of item (j)." In contrast, no such long-term analysis is possible with respect to the Supplier Credit Guarantee Programme, the regulations for which were first promulgated only on 1 July 1996, with transactions commencing during fiscal year 1997.

**submission, paras 153-156). Can the Commodity Credit Corporation decline to grant an export credit guarantee even in cases where the programme conditions are met? US**

56. A proper response to this question requires one to define by what is meant by "programme conditions". The arguments of Brazil would appear to create a tautological circularity: if one assumes that none of the various discretionary programmatic and budgetary bases that would permit the Commodity Credit Corporation not to issue a particular export credit guarantee are in effect, then can the CCC decline to grant that particular guarantee? Under those circumstances the question itself dictates that the answer must be "no". The United States submits, however, that assuming away all of the real-world bases that would permit CCC to decline issuance of a guarantee is not a proper basis for analysis.

57. The fact remains, as the United States has pointed out, that numerous bases exist for denial of a guarantee.[25] Brazil has argued, however, that "CCC does not enjoy the discretion to refuse to issue a guarantee to an eligible individual".[26] This is simply not true. Perhaps a practical example would further illustrate the point. As the United States mentioned during the first substantive meeting of the Panel, CCC internally maintains limits on the amount of its exposure to obligations of particular foreign banks.[27] Although a qualified applicant might apply for an export credit guarantee for an eligible good to an eligible destination (each of those elements themselves constituting potential bases for denying an application), notwithstanding the eligibility of the applicant, good, and destination, if the foreign-bank obligor envisioned in the transaction would exceed the applicable *internally established* exposure limit if it consummated the transaction, CCC could and would deny the application for the guarantee. Thus, while it is true that the CCC does not engage in any *arbitrary* or standard-less denials, the point is that no exporter seeking to engage in a particular export transaction can be certain of obtaining a credit because of CCC decisions relating to the conditions for issuance of export credit guarantees.

**143. Brazil agrees with National Cotton Council estimates of the effects of the GSM 102 programmes (Brazil's further submission, para. 190) but it also cites a different conclusion by Prof. Sumner (paragraph 192). Brazil cites other estimates by Prof. Sumner throughout its further submission. Does Brazil adopt Prof. Sumner's conclusions and estimates as part of its submission? BRA**

## I. STEP 2 PAYMENTS

**144. Is the Panel correct in understanding that the US does not dispute that Step 2 (domestic) payments are contingent upon import substitution, and that it argues that such measures are permitted due to the operation of the provisions of the Agreement on Agriculture? How is that relevant to a claim under Articles 5 and 6 of the SCM Agreement? US**

58. The United States acknowledges that to receive a payment under the Step 2 programme a domestic user must open a bale of domestically produced baled upland cotton. As the United States noted in its Further Submission of 30 September 2003[28], the introductory clause of Article 3.1 of the Subsidies Agreement, "Except as provided in the Agreement on Agriculture", applies to both Articles 3.1(a) and 3.1(b). Brazil's arguments would delete the application of the introductory clause to Article 3.1(b). As the exception's applicability to Article 3.1(b) must be given meaning, the United States has noted that the Agreement on Agriculture does permit domestic content subsidies in favour

[25] See, e.g., US Further Submission (30 September), paras. 153-156
[26] Second Oral Statement of Brazil (7 October), para. 67.
[27] See http://www.fsa.usda.gov/ccc/banks_foreign_rqts.htm.
[28] Paras. 165-176.

of agricultural producers, albeit paid to processors, if such subsidies are provided consistently with the Member's domestic support reduction commitments.[29] The European Communities concur.[30]

59. As the United States has previously indicated to the Panel[31], the United States reports all Step 2 payments as product-specific domestic support to cotton. As the United States is entitled to the protection of the Peace Clause under Article 13(b)(ii) of the Agreement on Agriculture, the United States is exempt from action under Articles 5 and 6 of the Subsidies Agreement. By their express terms, Articles 5 and 6 do "not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture".

60. The question of "import substitution" is otherwise irrelevant to Brazil's claims under Articles 5(c) and 6, which focus on the effect of the particular subsidy without regard to the origin requirements of the subsidy. In contrast, Article 3.1(b) focuses on whether a subsidy is contingent upon use of domestic over imported goods to determine whether a particular subsidy is a prohibited subsidy irrespective of its effect.

## J. ACTIONABLE SUBSIDIES

**145. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Articles 4.7 and 7.8 of the SCM Agreement. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy without delay, can the Panel:**

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? BRA, US**

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the SCM Agreement? BRA, US**

61. As a practical matter, there may be limited value in a particular dispute from making a finding that a particular subsidy is both a prohibited subsidy and causes adverse effects. If a subsidy is prohibited, then the remedy required to be recommended under Article 4.7 is to withdraw the subsidy without delay. A finding at the same time that a subsidy causes serious prejudice, if done cumulatively with an analysis of other subsidies, would mean that it would leave unclear the question of whether the other, non-prohibited subsidies cause adverse effects. That may diminish the value (in terms of resolving the dispute) of any finding concerning those other subsidies.

62. On the other hand, if the Panel were to make a separate "adverse effects" analysis for each of the non-prohibited subsidies, there would be no reason to so analyze any prohibited subsidy. First, an adverse effects analysis of a prohibited subsidy could not affect a panel's findings with respect to each non-prohibited subsidy. Second, since under Article 4 the panel would have recommended withdrawal of the prohibited subsidy, compliance with Article 4 would also comply with a recommendation under Article 7. Therefore, having made a recommendation under Article 4 with respect to a subsidy, there would be no utility to also making a recommendation under Article 7.

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[29] US Further Submission (September 30, 2003), para. 167; First Written Submission of the United States, paras. 146-150.

[30] Answers of the European Communities to Panel Question 40, paras. 72-78; First Oral Statement of the European Communities, paras. 31-37.

[31] See, e.g., First Written Submission of the United States, para. 129; G/AG/N/USA/43, at 20 (Supporting Table DS:6) (Exhibit Bra-47)

**146. Brazil acknowledges that there are some interaction effects that may increase or decrease the overall effects of the subsidies (Brazil's further submission, para. 225). How would your analysis under Articles 5(c) and 6.3 of the SCM Agreement and Article XVI of GATT 1994 differ if it excluded, for example, crop insurance subsidies, PFC and/or direct payments? BRA**

**147. Does the US agree that subsidies provided under the marketing loan programme, counter-cyclical payments and market loss assistance are or were more than minimally trade-distorting? If so, please elaborate on the type of effects which are more than minimally trade-distorting within the meaning of Annex 2 of the Agreement on Agriculture but less than adverse effects within the meaning of Article 5 of the SCM Agreement. US**

63. The issues of whether a measure is more than minimally trade-distorting and whether a measure has adverse effects require two different analyses. While it may be a necessary condition that a subsidy has trade- or production-distorting effects in order to find that it causes adverse effects, it is not a sufficient condition. The question under an adverse effects analysis is one of the effect on a particular Member's "interests" – for example, whether injury to the domestic industry of another Member, nullification or impairment, or serious prejudice to the interests of another Member. Therefore, the mere showing that a subsidy can distort trade or production does not necessarily mean it has, for example, seriously prejudiced a particular Member's interests.

64. Marketing loan payments, counter-cyclical payments, and market loss assistance payments provide different types of support that can be expected to have different effects. As noted in the US answer to Question 127, the United States notifies marketing loan payments as product-specific amber box support. These payments are linked to production of upland cotton in favour of the producers of upland cotton – a producer must have harvested cotton to receive the payment. Therefore, the United States considers that marketing loan payments could not satisfy the general and policy-specific criteria set out in Annex 2 of the Agreement on Agriculture and therefore could not be deemed to have met the fundamental requirement of that Annex.

65. That a particular support measure does not conform to the general and policy-specific criteria of Annex 2 is relevant to the type of support it is deemed to be, which has meaning for a Member's compliance with its reduction commitments. That a particular measure is not green box, however, would not suffice to demonstrate that a measure has "adverse effects" within the meaning of Articles 5 and 6 of the Subsidies Agreement. A finding that a subsidy has caused adverse effects is a fact-intensive analysis. In the case of a claim of serious prejudice, for example, one of the four effects set out in Article 6.3 must be demonstrated (such as significant price suppression or depression by the subsidized product in the same market as the non-subsidized product is found) and the effects caused by the subsidy must rise to the level of "serious prejudice." Such a fact-intensive analysis must take into account, *inter alia*, the nature and amount of the subsidy, market conditions, and other factors affecting production, consumption, and prices.

66. Therefore, a conclusion that a measure does not provide green box support and therefore would not be deemed to have no or at most minimal trade-distorting effects or effects on production cannot take the place of the fact-intensive examination required to show causation under the WTO Agreements. For example, marketing loan payments provide a revenue floor of 52 cents per pound for US upland cotton producers. The effect of this subsidy would depend in large part on the producer's expected market revenue at the time of planting – that is, whether this expected revenue was above or below 52 cents per pound. Thus, the effect of this subsidy would be quite different from a subsidy that merely provided an unchanging per unit payment (e.g., 10 cents per pound), even if as a result of prices that actually develop over the course of a marketing year the per-unit payments under these two measures turn out to be the same. As another example, a measure that provided, in the aggregate, $1 of support linked to production of upland cotton could not satisfy the general and

policy-specific criteria of Annex 2 of the Agreement on Agriculture[32], but it would be difficult to conceive that the effect of $1 in subsidies could be "significant price suppression [or] price depression" or "an increase in the world market share of the subsidizing Member" given the large number of market participants (including cotton producers worldwide), highly developed cotton markets, and volume and value of cotton trade.

67. With respect to counter-cyclical payments under the 2002 Act, the United States recalls that according to Brazil's interpretation of the first sentence of Annex 2 as a stand-alone requirement, if a measure has no more than minimal trade-distorting effects or effects on production, it follows that such a measure must be deemed green box. As the United States has demonstrated, the economic literature on decoupled payments (counter-cyclical payments are decoupled from production although linked to current prices) suggests that the effects on production of such income transfers are no more than minimal.[33] Therefore, although the United States would not contend that counter-cyclical payments conform fully to the policy-specific criteria in Annex 2, there is not only no evidence that such payments have more than minimal trade-distorting effects or effect on production, but the evidence suggests the contrary. In such a case, the effect of a payment that does not have more than minimal effects on production would not appear to be "significant price suppression [or] depression" or an "increase in the world market share of the subsidizing Member", much less "serious prejudice".

68. The expired market loss assistance payments were ad hoc payments made during the 1999, 2000, and 2001 marketing years to holders of base acreage. These payments were not linked to production – that is, a recipient need not have produced upland cotton or any crop at all in order to receive the payment.[34] However, because these payments were explicitly made in reaction to low commodity prices, the United States considered that these payments would not conform fully to the criteria in Annex 2 of the Agreement on Agriculture and therefore notified these payments as non-product-specific amber box support. As noted above with respect to the 2002 counter-cyclical payments, however, the economic literature on payments decoupled from production suggests that the effects on production of income transfers such as the market loss assistance payments are no more than minimal.[35] Therefore, the evidence suggests that the effect of such payments could not be "significant price suppression [or] depression" or an "increase in the world market share of the subsidizing Member" resulting in "serious prejudice".

**148. How should the significance of price suppression or depression be assessed under Article 6.3(c) of the SCM Agreement? In terms of a meaningful effect? Or another concept? BRA, US**

69. As the United States has previously noted[36], in Article 6.3(c) the term "significant" modifies the phrase "price suppression or depression", suggesting that it is the level of price suppression or depression itself that must be "important, notable" or "consequential".[37] As Brazil agrees[38], important

[32] For example, the measure would not qualify as decoupled income support because, by requiring that recipients have produced upland cotton, the amount of the payment would be "related to, or based on, the type or volume of production . . . undertaken by the producer in any year after the base period". *See* Agreement on Agriculture, Annex 2, para. 6(b).

[33] *See, e.g.*, US Rebuttal Submission, paras. 59-64.

[34] Supplemental legislation authorizing each of these payments was passed several months after planting for the crop year in question had occurred. Even if producers had some expectations of payment at planting time, they were eligible to receive such a payment regardless of what crop they planted. Indeed, they could choose not to plant and still be eligible for the payment. This would argue that market loss assistance payments, like production flexibility contract payments, direct payments, and counter-cyclical payments, are decoupled from planting decisions.

[35] *See, e.g.*, US Rebuttal Submission, paras. 59-64.

[36] US Opening Statement at the Second para. 58.

[37] US Further Submission, para. 83.

[38] *See* Brazil's Further Submission, para. 88 ("This interpretation of price suppression and price depression is consistent with the *relevant context of Article 6.3(c), which includes Article 15.2 of the SCM*

context for interpreting this phrase can be found in Article 15.2 of the Subsidies Agreement, which sets out for countervailing duty purposes the same effects found in Article 6.3.[39] This text confirms that the relevant analysis is whether the level of price suppression or depression itself is "significant":

> With regard to the effect of subsidized imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise *to depress prices to a significant degree or to prevent price increases*, which otherwise would have occurred, *to a significant degree*.[40]

Thus, Article 15.2 provides contextual support for reading the term "significant price suppression [or] depression" in Article 6.3(c) according to the ordinary meaning of its terms – that is, it is the degree of price suppression or depression itself that must be "significant".

70. As suggested by this analysis, it is not the effect on the producers of the complaining Member that must be "significant". In determining whether the alleged price suppression or depression is "important" or "notable", it will of course be relevant to look at that suppression or depression in the context of the prices that have been affected – that is, at the *degree* of suppression or depression. One absolute level of suppression or depression could be significant in the context of prices for one product but not for another and meaning must be given to the phrase "in the same market".

**149. What is the meaning of "may" in the chapeau of Article 6.3(c) in the context of Brazil's assertion that there is no need to conduct a distinct analysis of "serious prejudice" under Article 5(c) after having made a finding under 6.3(c) or (d)? (Brazil's further submission, paras 437 ff). How, if at all, are Articles 6.2 and 6.8 relevant in this context? What context should the Panel use for assessing serious prejudice under Article 5(c) of the SCM Agreement if the Panel takes the view that Article 6.3(c) and (d) are permissive conditions for a determination of serious prejudice? US**

71. The chapeau of Article 6.3 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or more of the following apply". The Article then goes on to detail four effects that "may" result in serious prejudice arising. Brazil's reading would re-write the chapeau of Article 6.3, changing the permissive "may" into the obligatory "shall". The ordinary meaning of "may" is "to express possibility, opportunity, or permission".[41] Therefore, the ordinary meaning of the chapeau of Article 6.3 would be that there is a "possibility" or "opportunity" for serious prejudice in the sense of Article 5(c) to arise where one or more of the effects listed in Article 6.3 is found.

72. Article 6.2 clarifies that a prerequisite for a finding of serious prejudice is that at least one of the four effects in Article 6.3 must be demonstrated. That is, Article 6.2 precludes a panel from finding serious prejudice ("serious prejudice shall not be found") if a subsidizing Member demonstrates that the subsidy has not had any of the effects listed in Article 6.3. This provided a subsidizing Member with a means to overcome the presumption created through the operation of

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*Agreement*. That provision discusses standards for the determination of injury in countervailing duty cases and provides that the investigating authorities should consider whether the effect of imports is 'to depress prices' or 'to prevent price increases, which otherwise would have occurred . . .'[.]") (emphasis added).

[39] Effects on prices form one part of a determination of injury for countervailing duty purposes. Pursuant to Article 15.1, such a determination of injury involves an objective examination of (a) the volume of subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products and (b) the consequent impact of these imports on the domestic producers of such products.

[40] Subsidies Agreement, Article 15.2 (italics added).

[41] *The Random House Dictionary of the English Language, Unabridged Edition* at 886 (1983).

Article 6.1 while that provision was still in effect. However, Article 6.1 demonstrates that Members knew how to create a presumption of serious prejudice: they did so by explicitly stating that, in certain cases, "[s]erious prejudice . . . *shall be deemed to exist*" (italics added). Article 6.2, while providing a means to rebut that presumption, does not by its terms establish that serious prejudice "shall be deemed to exist" if one of the effects in Article 6.3 exists.

73. Article 6.4 lends further contextual support to the interpretation that the use of the term "may" in the chapeau of Article 6.3 signifies that the effects listed in Article 6.3 are permissive conditions for a determination of serious prejudice. Article 6.4 states that "displacement or impeding of exports shall include any case in which, subject to the provisions of paragraph 7, it has been demonstrated that there has been a change in the relative shares of the market to the disadvantage of the non-subsidized like product". Thus, given certain situations further explained in Article 6.4, displacement or impeding of exports "shall" exist. However, Article 6.3 does not state that, given those situations, displacement or impeding of exports *resulting in serious prejudice* shall exist. That is, the situations in Article 6.4 which must result in a finding of displacement or impeding of export do not, by the terms of the Article, also result in a finding of serious prejudice.

74. Article 6.5 similarly defines a situation in which "price undercutting" under Article 6.3(c) "shall" be found but does not also mandate a finding of serious prejudice. Had Members intended (as Brazil contends) that a finding under Article 6.3 would necessarily suffice to demonstrate serious prejudice, one also would have expected Articles 6.4 and 6.5 to mandate a finding of serious prejudice where a finding of one of the effects under Article 6.3 is mandated.

75. Article 6.8 provides further contextual support for reading Article 6.3 as setting out certain permissive conditions that could result in a panel finding that serious prejudice to the interests of a Member exist. Article 6.8 states that, "in the absence of circumstances referred to in paragraph 7", which merely preclude a panel from finding displacement or impediment resulting in serious prejudice, "the existence of serious prejudice *should be* determined on the basis of the information submitted to or obtained by the panel" (italics added). Again, this provision does not mandate a finding of serious prejudice should one or more of the effects set out in Article 6.3 be demonstrated. Rather, it emphasizes that "the existence of serious prejudice" (rather than the existence of one of the effects in Article 6.3) "should be determined" by the panel based on the information before it. Thus, while a panel may be *precluded* from making a finding of serious prejudice (where, for example, a complaining party has only alleged displacement or impediment under Article 6.3, but one of the conditions in Article 6.7 exist), there is no currently effective provision under which a panel is *compelled* to find serious prejudice.

**150. Is the list in Article 6.3 of the SCM Agreement exhaustive, or could serious prejudice arise in circumstances other than those listed in paragraphs (a) through (d)? US**

76. Article 6.3 sets out four circumstances in which the effects of subsidies "may" give rise to a finding of serious prejudice. Article 6.2 establishes that "serious prejudice shall not be found" if a subsidizing Member demonstrates that a challenged subsidy has not resulted in any of those four effects. Therefore, Articles 6.3 and 6.2 indicate that serious prejudice may not be deemed to have arisen without at least one of the four effects listed in Article 6.3 having been demonstrated.

**151. Where in the text of Article 6.3(d) of the SCM Agreement is there a basis to take into account that 1998 may be a "misleading" year for the purposes of comparison? For example, unlike the text of Article XVI:3 of the GATT 1994, there does not seem to be a general reference to "special factors". US**

77. Article 6.3(d) requires that a complaining party demonstrate that the effect of a challenged subsidy is an increase in the world market share in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this

increase follows a consistent trend over a period when subsidies have been granted. Where the evidence offered by a complaining party relies in large part on abnormal production and trade data evidently caused by factors unrelated to the challenged subsidy (in the case of the United States in 1998, severe drought and record abandonment of planted acres), use of that data cannot satisfy the complaining party's burden of demonstrating causation – that is, the "effect of the subsidy".

78. Article 6.3(d) sets out a fairly mechanical two-part test: first, there must be an increase in world market share as compared to the average over the preceding period of three years. Thus, assuming *arguendo* that Brazil could challenge expired marketing year 2001 support measures, this test would compare the world market share of US upland cotton in that year to the average over the preceding three years. Brazil, however, has misinterpreted Article 6.3(d) and examined the US world *export* share.

79. The second part of the test is that any such increase over the average of the preceding three-year period "follows a consistent trend over a period when subsidies have been granted". The marketing year 2001 payments challenged by Brazil were first introduced for the 1996 marketing year by the 1996 Act. Thus, Brazil must demonstrate that the alleged increase in world market share follows a "consistent trend" between marketing years 1996-2001. In fact, there is no consistent trend showing an increasing US world market share over this period; that world market share has been inconsistent but showing a tendency to decline over that period. As demonstrated in Exhibit US-47, US world market share surpassed 20 per cent in both marketing years 1996 and 1997 but has not thereafter.

80. Finally, as the United States has noted in its further submission, Brazil has limited its claim under Article 6.3(d) to alleged effects in marketing year 2001.[42] Thus, there can be no finding that challenged US subsidies under the 2002 Act presently cause serious prejudice within the meaning of Article 6.3(d). As the United States has previously noted, moreover, payments with respect to marketing year 2001 expired with the granting of support in respect of the 2002 marketing year's production, which began on 1 August 2002 – that is, seven months before this Panel's terms of reference were established. The result is that Brazil is asking the Panel to make findings and a recommendation with respect to subsidies that had been replaced at the time of panel establishment and that no longer exist to be withdrawn even were a recommendation to be made.

**152. If the US is correct in asserting that the Article 13(b)(ii) Agreement on Agriculture analysis is a year-by-year analysis, how would this affect the Panel's examination of Brazil's claims of serious prejudice, including the three year period and the trend period in Article 6.3(d) of the SCM Agreement? US**

81. Article 13(b)(ii) exempts from action measures that, *inter alia*, conform fully to the provisions of Article 6 of the Agreement on Agriculture. Chief among those provisions is the obligation that a Member remain within its Annual and Final Bound Commitment Levels for its Aggregate Measurement of Support, a commitment that is expressed by year. Therefore, while a Member may breach the Peace Clause in a given year by exceeding its bound commitment level, that Member may in the following year not breach the Peace Clause if its domestic support measures once again do not exceed its commitment levels. Thus, to gauge whether domestic support measures have breached the Peace Clause requires a year-by-year analysis.[43]

[42] US Further Submission, para. 100.

[43] Brazil agrees that the Peace Clause requires a year-by-year comparison. Brazil insists, however, that once a Member has breached the Peace Clause once, that Member can never thereafter regain Peace Clause protection. There is nothing in the text of the Peace Clause that supports Brazil's view on this point – nor, as a result, has Brazil pointed to any supporting text.

82. The year-by-year analysis under the Peace Clause does not affect how the Panel would undertake a serious prejudice analysis; it affects only the Panel's analysis of which of the US measures that Brazil has challenged may be the subject of the serious prejudice analysis. In the event, Brazil has only claimed that the effect of US subsidies in marketing year 2001 was inconsistent with Article 6.3(d). Therefore, the Panel's task is first to analyze whether US domestic support measures in marketing year 2001 breached the Peace Clause. If so, then the Panel would be able to undertake a serious prejudice analysis – and that second analysis is distinct from the first one. The United States has demonstrated that US measures in marketing year 2001 do not grant product-specific support to upland cotton in excess of that decided during the 1992 marketing year, whether measured according to the level of support granted by those measures or a price-gap AMS calculation.

83. With respect to the two-part test of the three-year average and consistent trend over a period when subsidies have been granted, the Peace Clause would have no impact on these tests. That is, assuming *arguendo* that marketing year 2001 measures were not exempt from action, the fact that the Peace Clause exempts from action measures for other marketing years would not preclude the Panel from examining data and evidence from those years as part of its serious prejudice analysis of the 2001 measures. The payments made in those other marketing years (that is, the marketing year 1999 measures and the marketing year 2000 measures) would be exempt from action; evidence relating to those years would not be sheltered from examination by the Panel in its serious prejudice analysis of the 2001 measures.

**153. Would the conditions in Article 6.3(d) of the SCM Agreement be satisfied in respect of time periods other than the one specified? What relevance, if any, would this have for Brazil's claims? BRA**

**154. Does the US agree that upland cotton is a "primary product or commodity" within the meaning of Article 6.3(d) of the SCM Agreement? (ref. Brazil's further submission, para. 262) and within the meaning of Article XVI:3 of the GATT 1994? US**

84. Yes.

**155. Please respond to Brazil's identification of the seven-year period beginning with MY1996 (following the passage of the FAIR Act of 1996) as the "most representative period" for the purposes of Article 6.3(d)? (ref. Brazil further submission, para. 269) US**

85. Brazil has challenged only those US subsidies that allegedly had the effect of increasing US world market share in marketing year 2001 – that is, marketing year 2001 payments. The second part of the test under Article 6.3(d) is that any increase in world market share that is the effect of the challenged subsidy over the average of the preceding three-year period "follows a consistent trend over a period when subsidies have been granted". The marketing year 2001 payments were granted under the 1996 Act. Therefore, the "period when subsidies have been granted" for purposes of an analysis of the effect of marketing year 2001 support would be the marketing year 1996-2001 period.

86. The United States believes that marketing year 2001 support cannot cause present serious prejudice because these payments expired when marketing year 2002 payments began to be made. Nonetheless, if marketing year 2001 payments are the challenged measures for purposes of Brazil's Article 6.3(d) claim, there is no basis to include marketing year 2002 within the period when subsidies have been granted. (We also note that Brazil identifies a seven-year period beginning with marketing year 1996 but presents data only for the six-year period through marketing year 2001.)

**156. Does the US agree that "...footnote 17 [of the SCM Agreement] does not carve out upland cotton from the scope of Article 6.3(d) of the SCM Agreement"? (ref. Brazil further submission, para. 275). US**

87. The United States is not aware of any "other multilaterally agreed specific rules apply to the trade in the product or commodity in question" within the meaning of footnote 17 to Article 6.3(d) of the Subsidies Agreement.

**157. Does the reference to "trade" in footnote 17 of the SCM Agreement have any impact on the interpretation of "world market share" in Article 6.3(d)) If so, what is it? US**

88. The use of the term "trade" in footnote 17 provides useful context in interpreting the phrase "world market share" in Article 6.3(d). Specifically, Article 6.3(d) speaks of an increase in a Member's "world market share", not an increase in a Member's "world trade share". By using the term "market" and not "trade", Article 6.3(d) establishes that its scope is *not* limited to cross-border movements of a primary product or commodity. That is, the "world market" for a primary product or commodity encompasses all the markets in the entire "world", including the market of the allegedly subsidizing Member. Had Members desired instead to restrict the analysis under Article 6.3(d) to cross-border shipments, they could have used the phrase "world trade share" or, in Brazil's preferred formulation, "world export share", or even (as in GATT 1994 Article XVI:3) "world export trade". They did not. Finally, we note that, rather than elaborating on the test under Article 6.3(d), footnote 17 was intended to describe those products or commodities *not* covered by Article 6.3(d) and therefore could use the term "trade".

**158. Please respond to Brazil's assertion that "...the absence of any payment, production or expenditure limitations in the US marketing loan programme is analogous to the EC sugar regime that was challenged in EC - Sugar Exports II (Brazil) and EC - Sugar Exports I (Australia)." (ref. Brazil further submission, para. 317) US**

89. The EC sugar export regime challenged by Australia and Brazil under the GATT 1947 was manifestly different than the US marketing loan programme, primarily in that the challenged programme was an export subsidy providing export refunds on exportable surpluses of sugar. The *Sugar Exports* panel concluded that in the particular market situation prevailing in 1978 and 1979, the EC system had caused serious prejudice to Brazil's interests because it had been applied in a manner which contributed to depress sugar prices. The panel also concluded that the lack of "pre-established effective limitations" on those export refunds and the application of that refund system "constituted a permanent source of uncertainty in world sugar markets and therefore constituted a threat of serious prejudice. The panel's finding on serious prejudice was made carefully, circumscribed by "the particular market situation prevailing in 1978 and 1979". However, the panel's finding on threat of serious prejudice was made without any explanation and apparently without argument by the parties. Therefore, it is difficult to see how the Panel could draw useful guidance from this finding by that panel or draw conclusions on relevant types of payments.

**159. The EC, in its oral statement (paras 9 and 10), disagrees with the US interpretation of the terms "same market". Can the US comment on the EC's view? US**

90. The United States still has difficulty with the EC view. The United States cannot understand how the "world" can be one "market" for purposes of Article 6.3(c), which by its nature calls for a comparison of the prices of the goods of one Member when competing in a market with the goods of another Member. Goods are not sold to the "world" – they are sold in the market of a particular country.

91. The EC on the other hand evidently considers that it is at least possible that the world could function as one market and therefore constitute a "same market" for purposes of analyzing whether

the "effect of the subsidy" is "significant price suppression [or] depression" of the price of a non-subsidized product in the same market. For the reasons set forth in the US further submission, the United States considers that such an interpretation would render the "in the same market" language inutile because the subsidized and non-subsidized products could never be found in the same geographic market and still be considered to be in the same "world market". Furthermore, under the EC's approach, a Member could be selling at a price well above another Member's price in the same country, and yet be found to be depressing prices on the "world market" due to a comparison between sales prices of the Member in one country compared to sales prices of the other Member in a different country.

92. However, the EC itself concedes that a "world market" could only be deemed to exist if there were not significant barriers to trade in the product at issue, such as customs duties, technical barriers to trade, etc. The EC's own explanation suggests that such a "world market" is unlikely to exist because of significant barriers to trade somewhere in the world. Thus, even under the EC's approach, it is not the case that there is a "world market" for upland cotton.

**160. Without prejudice to the meaning of "world market share" as used in Article 6.3(d) of the SCM Agreement, can you confirm the world export share statistics provided in Exhibit BRA-206? US**

93. The table below reflects most recent updates for 2002-03 and 2003-04. We caution that, as noted in the footnotes in the table, the data are drawn from different sources and data sets. Also, we have corrected data in BRA-206 for 1997-98 for total world exports, world upland exports, and US export share.

**World cotton exports (million bales)**

| Year | US upland exports (1) | Total world exports (2) | ELS world exports (3) | World upland exports (4) | US Share of World Exports (5) |
|---|---|---|---|---|---|
| 1996-97 | 6.399 | 26.929 | 1.017 | 25.912 | 24.70% |
| 1997-98 | 7.06 | 26.838 | 1.106 | 25.732 | 27.44% |
| 1998-99 | 4.01 | 23.668 | 1.085 | 22.583 | 17.76% |
| 1999-00 | 6.303 | 27.326 | 1.193 | 26.133 | 24.12% |
| 2000-01 | 6.303 | 26.589 | 1.127 | 25.462 | 24.75% |
| 2001-02 | 10.603 | 29.052 | 1.325 | 27.727 | 38.24% |
| 2002-03 | 11.266 | 30.629 | 1.989 | 28.640 | 39.34% |
| Average: 98/99 - 00/01 | 5.539 | 25.861 | 1.135 | 24.726 | 22.40% |
| 99/00 - 01/02 | 7.736 | 27.656 | 1.215 | 26.441 | 29.26% |
| 00/01 - 02/03 | 9.391 | 28.757 | 1.480 | 27.276 | 34.43% |

*Source:*
*(1)* ***USDA,Fact Sheet Upland Cotton, 2003 p.5***
*(2) USDA, ERS. Cotton and Wool Yearbook, 2002, p. 31; Fact Sheet Upland Outlook, USDA, Oct 2003 table 2*
*(3)* ***ICAC, Cotton World Statistics, Sept. 2003, p. 7.***
*(4) Calculation: (2) - (3)*
*(5) Calculation: (1)*100/(4)*

**161. Would a finding of serious prejudice under Article 5(c) of the SCM Agreement be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the SCM Agreement in this context? BRA, US**

94. Article 5(c) establishes that one of the adverse effects that a subsidizing Member should not cause to the interests of other Members is "serious prejudice", and footnote 13 to that Article states that the term "'serious prejudice to the interests of another Member' is used in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994". Therefore, "serious prejudice" under Subsidies Agreement Article 5(c) and GATT 1994 Article XVI:1 must be read to have the same meaning. As Article 5(c), and Article 6 which explains it, are the more detailed provisions on "serious prejudice" and contain a more effective remedy than the consultation envisioned under GATT 1994 Article XVI:1, the Panel's analysis should begin with the Subsidies Agreement provisions. Were the Panel to agree that Brazil has not established that the effect of the challenged subsidy is "serious prejudice" within the meaning of the Subsidies Agreement, it would be difficult to see how the Panel could then determine that "serious prejudice" exists within the meaning of GATT 1994 Article XVI:1 since the term is used "in the same sense" in these provisions.

**162. Can the US confirm that marketing loan/LDP, step 2 and counter-cyclical payments are mandatory if the price conditions are fulfilled? US**

95. The statutory authority for marketing loan payments, step 2 payments, and counter-cyclical payments does not provide the Secretary with the authority to arbitrarily decline to make these payments to qualified recipients. However, certain conditions must be met before these payments will be made: price conditions must be met, the producer must meet all conditions for payment, including compliance with "sodbuster" and "swampbuster" provisions and any planting restrictions, the Commodity Credit Corporation (CCC) must not have exhausted its statutory borrowing authority, and Congress must not have cut back on the programme, by an appropriations bill or otherwise.

96. As the question notes, different price conditions apply to each of these payments. For example, in the case of marketing loan payments, the adjusted world price (as calculated by the Department of Agriculture) must be below 52 cents per pound. Recently, the adjusted world price has been above 52 cents per pound and thus no marketing loan payments have been made to qualified recipients.

97. There is no preset limit on the total amount of payments that can be made under each of these programmes although for counter-cyclical payments a maximum total outlay can be calculated using the base acres, base yields, and maximum payment rate for each commodity produced during the historical base period. In addition, for certain recipients, per-person payment limits may apply. We also note that under Section 1601(e) of the 2002 Act, the Secretary has the authority (so-called "circuit breaker" authority) to make adjustments to farm programmes because of WTO domestic support reduction commitments. Presumably, this authority could result in refusals to make certain payments.

98. Conditions for receiving counter-cyclical and marketing loan payments are numerous. The programme contract for counter-cyclical payments is required by section 1105 of the 2002 Act. That section provides explicitly that the producers must agree: (A) to comply with the requirements dealing with the highly erodible cropland conservation found at 16 USC 3811 *et seq*.; (B) comply with the wetland conservation requirements found at 16 USC 3821 *et seq*.; (C) comply with the planting flexibility requirement of Section 1106 of the 2002 Act; (D) use the land representing the base acres for an agricultural or conserving use but not for a non-agricultural, commercial, or industrial use, as determined by the Secretary; and (E) control noxious weeds and otherwise maintain the land in accordance with sound agricultural practices as determined by the Secretary of Agriculture, if the agricultural or conserving use involves the noncultivation of any portion of the land as permitted under the specification just set out in (D). For marketing loans, the loan agreement and loan

regulations, contained in 7 CFR part 1421, specify various conditions that must be met and followed by the producer. Under 16 USC 3811 *et seq*., the wetland and conservation provisions cited above are made applicable to all commodity benefits, including loans.

**163. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ? US, BRA**

99. The United States notes that even using cost data that reflects 1997 cost structures[44], US producers appear to have been able to cover variable costs through the sale of cotton at harvest time in every year but marketing years 2001 and (more narrowly) 2002. In this, US producers were no different than Brazil's farmer witness, Christopher Ward, who stated: "But even with these high yields and the excellent quality of our land, we were not able to fully recover all of our variable costs of production during the 2000/01 and 2001/02 seasons[,]" a position evidently shared by most producers in Mato Grosso, Brazil's leading cotton-producing state.[45]

100. Furthermore, even in years in which US producers may not have been able to cover fixed and variable costs, it does not follow that it is subsidies that covered these costs. Again, Mr. Ward explained that in marketing years 2000 and 2001, "Nor were we able to meet our total costs which include the additional fixed costs." Therefore, producers can cover costs from revenue sources other than subsidies. That harvest prices at times fall below costs does not necessarily mean that subsidies have had the effect of maintaining production.

**US upland cotton operating costs compared to harvest cotton price**

| Year | Cotton price at harvest ($/lb) | Average operating cost ($/lb) |
|---|---|---|
| 1998 | 0.64 | 0.481 |
| 1999 | 0.47 | 0.418 |
| 2000 | 0.57 | 0.473 |
| 2001 | 0.35 | 0.447 |
| 2002 | 0.42 | 0.453 |

*Source: USDA, Economic Research Service, Agricultural Resources Management Survey (www.ers.usda.gov/data/ costsandreturns/testpick.htm)*

## K. CAUSATION

**164. When the US points, in its oral statement of 7 October, to the alleged "bias" of Prof. Sumner's model, is it arguing that US subsidies are irrelevant to the movement in prices and production (acreage) of upland cotton? US**

101. The United States recognizes that subsidies can potentially affect production and prices of upland cotton. The question is one of the nature of the subsidy examined and the degree of any predicted effect, which could range from significant to negligible. The criticisms of Dr. Sumner's model outlined in the US oral statement of October 7, 2002 take issue with many of the underlying

[44] Recall that the Department of Agriculture conducted a survey of cotton farmers in 1997. For any cost data published by the Department since that time, the 1997 data has merely been updated by applying the producer price index to 'update' input costs. *See* US Closing Statement at the Second Session of the First Panel Meeting, paras. 10-11.

[45] Statement of Mr. Christopher Ward at the Second Session of the First Panel Meeting, para. 6 (emphasis added). Mr. Ward goes on to state: "Based on my discussions with many producers relating to Mato Grosso cotton production and revenue, *I know that most other producers in State of Mato Grosso were in the same situation as we were during the 1999-2000 period." (Id* (emphasis added)

assumptions in the model, particularly in regards to how decoupled payments were modelled and the choice of baselines used by Dr. Sumner, which have led to results that have exaggerated the impact of US subsidies on world cotton markets.

**165. Please comment (and submit substantiating evidence) on the US assertion that the FAPRI model has been designed and developed for prospective analysis, and is not suitable for retrospective counterfactual analysis. What is the reliability of past FAPRI-produced analyses when compared with actual data for the period covered by them? Is there any other instrument that can be used to try to identify the effect of subsidies already granted, or of their removal? BRA, US**

102. FAPRI uses its models for prospective analyses; that is, they analyze the future effects of proposed programme changes against a baseline that assumes current programmes are in place. Recent examples of FAPRI analyses include the effects of stricter payment limitations on US farmers[46], an analysis of the European Union's 2003 CAP Reform Agreement[47], and the effects on the US dairy industry of removing current Federal regulations.[48] These analyses are forward-looking examinations of the effects of policy changes.[49]

103. Econometric modelling systems similar to the ones maintained by FAPRI and USDA are designed for prospective analyses of alternative policy assumptions. The foundation for forward-looking analyses is the baseline projections, which are conditioned on specific assumptions for exogenous variables, i.e., those that are independent of the modelling system. The baseline model is also conditioned to incorporate the current structure of specific commodity markets through equation specifications, elasticity estimates, and structural shift and dummy variables. As a result, the baseline models will not be appropriately structured to analyze changes over a historical period. For example, models calibrated for the current structure of the US textile industry may not be appropriate to assess the structure present in the late 1990's due to the tremendous changes that have occurred. Another difficulty of using the system over a historical period is the degree of external shocks that impact the model. In prospective analysis, assessing the impacts of alternative policies occurs absent of extreme shocks from independent variables.

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[46] FAPRI. *FAPRI Analysis of Stricter Payment Limitations* FAPRI-UMC Report #05-03 17 June 2003. 15 pp. Available at: http://www.fapri.missouri.edu/FAPRI_Publications.htm.

[47] FAPRI. *Analysis of the 2003 CAP Reform Agreement.* FAPRI Staff Report #2-03, 9 September 2003. 16 pp. Available at: http://www.fapri.missouri.edu/FAPRI_Publications.htm

[48] FAPRI. *The Effects on the United States Dairy Industry of Removing Current Federal Regulations.* FAPRI-UMC Report #03-03. April 2003. 14 pp. Available at http://www.fapri.missouri.edu/ FAPRI_Publications.htm

[49] FAPRI recognizes the forward-looking nature of its analyses and the limitations of those baselines quite clearly:

> Each year, FAPRI prepares a set of baseline projections that provide information about the outlook for agricultural markets, farm programme spending, farm income, and a variety of other indicators. The baseline then serves as the point of comparison for analyses of alternative policy options....
>
> The baseline is not a forecast of what will happen, but rather a projection of what could happen under a particular set of assumptions. Current global policies are held in place, even when there is reason to suspect changes are likely....
>
> In reality, these assumptions are certain to be violated and actual market outcomes will differ from the deterministic baseline projections presented in the supply-demand tables....

FAPRI 2003 US Baseline Briefing Book, Foreward, page 1. FAPRI-UMC Technical Data Report 04-03 (March 2003) (www.fapri.missouri.edu).

104. As mentioned by Dr. Sumner in Annex I to Brazil's submission of 30 September, baseline models such as the one utilized by FAPRI or USDA are not forecasting models. They are used to analyse proposed policy changes.[50] The attached table shows the forecast accuracy for year ahead price forecasts by FAPRI.

**FAPRI farm price projections for upland cotton compared to actual prices, MY1999-2003 ($/lb)**

| FAPRI published baseline | Marketing year | FAPRI projected price | Actual price 1/ | Difference 2/ |
|---|---|---|---|---|
| January 1998 | 1999/00 | 0.689 | 0.45 | -0.239 |
| January 1999 | 2000/01 | 0.531 | 0.498 | -0.033 |
| January 2000 | 2001/02 | 0.479 | 0.298 | -0.181 |
| January 2001 | 2002/03 | 0.554 | 0.43 | -0.124 |
| January 2002 | 2003/04 | 0.385 | 0.463 3/ | 0.078 |

*Source: FAPRI, USDA World Agricultural Supply and Demand Estimates*
1/ Marketing year average farm price reported by USDA.
2/ Actual farm price minus forecast price
3/ Average cotton farm price for August 2003. USDA is prohibited from publishing cotton price forecasts.

105. One potential approach to using a baseline model to estimate the effects of subsidies during a historical period would be to use an *ex post* prospective analysis. Under an *ex post* analysis, instead of using the current baseline for measurement, one would use a past baseline to make year-ahead projections of the effects of subsidies on the cotton market. For example, to analyze the effects of subsidies on the 1998/99 marketing year, one could use the January 1998 FAPRI baseline model to project the effects of removing subsidies and compare them to baseline levels for the 1998/99 marketing year. To analyze the 1999/00 marketing year, one would update the baseline to the January 1999 baseline and so on, until the current baseline. This would provide baseline comparisons that would reflect the estimated effects of the programmes at the time of planting in each year.

**166. The US states that "futures prices demonstrate that market participants predict increasing upland prices over the course of the marketing year" (US 7 October oral statement, para. 62). Please elaborate on this argument including citing specific futures prices. US**

106. Exhibit US-68 shows average daily closing prices for the December 2003 cotton futures contract. Daily futures prices for December 2003 and May 2004 delivery have increased by as much as 35 per cent from January 2003 levels.

107. Futures prices reflect a price that a buyer is willing to pay to secure a supply at a given price and protect against the possibility of prices rising even higher. Thus, where futures contract prices are higher than current market prices, the futures prices suggest that cotton buyers are concerned about

[50] For example, the US Department of Agriculture explains:
The projections are a conditional scenario with no shocks and are based on specific assumptions regarding the macroeconomy, agricultural policy, the weather, and international developments. In particular, the baseline incorporates provisions of the Farm Security and Rural Investment Act of 2002 (2002 Farm Act) and assumes that current farm legislation remains in effect through the projections period. The projections are not intended to be a Departmental forecast of what the future will be, but instead a description of what would be expected to happen under a continuation of the 2002 Farm Act, with very specific external circumstances. Thus, the baseline provides a point of departure for discussion of alternative farm sector outcomes that could result under different domestic or international assumptions."
USDA Agricultural Baseline Projections to 2012. Office of the Chief Economist, US Department of Agriculture.

the possibility of cotton prices rising still higher and are willing to lock in a purchase price that carries a premium over current prices.

108. In fact, current futures prices reveal that market participants anticipate upland cotton prices rising over the current 2003 marketing year.

| New York Cotton Exchange, Closing Futures Prices MY03<br>Friday, 24 October 2003[51] | |
|---|---|
| December 2003 contract | 82.11 cents per pound |
| March 2004 contract | 84.34 cents per pound |
| May 2004 contract | 84.50 cents per pound |
| July 2004 contract | 84.64 cents per pound |

That is, a producer may sell cotton futures for December delivery at 82.11 cents per pound, but for deliver later in marketing year 2003 the price rises to greater than 84 cents per pound. To update the information provided by the United States to the Panel in its further submission[52], these futures prices indicate that the market expects cotton prices to remain well above their 20-year average of 67.86 cents per pound (1983-2002) within the current 2003 marketing year and well above what Brazil calculates as the 1980-98 A-index average (74 cents per pound) – that is, the average for the period *before* Brazil alleges serious prejudice through significant price suppression or depression.[53] Thus, given expected cotton prices reflected in futures contracts, Brazil has not demonstrated any clearly foreseen and imminent likelihood of serious prejudice. Quite the contrary: in marketing year 2003, upland cotton producers expect high and increasing prices.

**167. How does Brazil react to Exhibit US-44? BRA**

**168. Please confirm that the production figures cited in Exhibit US-47 are for upland cotton only and do not include textiles. US**

109. Yes, the production figures cited in Exhibit US-47 are for upland cotton production only. They do not include the raw cotton equivalent of textile production.

**169. Can the US confirm the accuracy of the facts and figures cited in the four bullet points in paragraph 12 of Brazil's 7 October oral statement? US**

110. From paragraph 12 of Brazil's 7 October oral statement:

> *Between MY 1999-2001, prices received by US upland cotton farmers fell by 34 per cent, yet US production increased by 20.3 per cent. . . . .*
>
> **Fact check**: We can confirm the price and production figures given and would note again Brazil's selective use of marketing year 2001 as the end-point for its comparison. As Brazil complains of effects over marketing years 1999-2002, it would appear that Brazil has simply chosen to use MY2001 figures to inflate the figures it presents.
>
> *Between MY 1999-2002, the average US upland cotton farmer would have lost 24.3 cents per pound for every pound of cotton produced if revenue were based only on market revenue. The US response to this huge gap between market prices and costs was to increase*

[51] Current futures contract prices are available at: http://www.nybot.com/cotton/ (click on "Futures").
[52] *See, e.g.*, US Further Submission, para. 118.
[53] Brazil's Further Submission, para. 114, figure 6.

*production leading to an increase of US exports by 78.7 per cent and to an increase in the US world market share from 24.1 per cent to 41.6 per cent. . . . .*

**Fact check**: Based on Economic Research Service (ERS) estimates provided in Exhibit US-69, the market value of upland cotton (including the value of cottonseed) averaged $325.06 per acre over MY 1999-2002. Operating costs averaged $261.35 per acre over MY 1999-2002. The value of upland cotton production less operating costs averaged $63.71 per acre. Based on an average upland cotton yield of 577 pounds per planted acre, upland cotton producers received 11.05 cents per pound above their operating costs.

We can confirm the export figure but note that the US share of "world exports" rose from 24.1 per cent in 1999/00 to 39.34 per cent in 2002/03. (See US response to Question 160). In addition, we note that US world market share over the marketing year 1999-2002 period fell from 18.6% in MY1999 to 16.9% in MY2000, rose to 19.8% in MY2001, and fell again to 19.6% in MY2002.[54]

*Between MY 1999-2001, the US dollar appreciated approximately 15 per cent against the currencies of other worldwide cotton producers. . . . US exports increased by 68 per cent. . . . .*

**Fact check**: ERS calculates a commodity-weighted exchange rate index for upland cotton based on the real exchange rates of importing countries, weighted by the share of US cotton exports.[55] Based on this index, the dollar appreciated by 6.2 per cent from 1999 to 2001. ERS also calculates a commodity weighted exchange rate index based on the currencies of other cotton producers and their share in world cotton trade. Based on this index, the dollar appreciated by 11 per cent from 1999 to 2001.

**Fact check**: We can confirm the US upland cotton export figure and again note Brazil's use of marketing year 2001 for its comparison.

*US costs of production are much higher than those of most other exporters of upland cotton, yet the US export market share increased from 24.1 per cent to 41.6 per cent between MY 1999-2002.*

**Fact check**: In paras. 284 and 285 of its Further Submission of 9 September 2003, Brazil uses data from the International Cotton Advisory Committee (ICAC) to compare costs of production across countries, which represents the most complete published comparisons of costs of cotton production for major cotton producing countries. Nevertheless, even when good survey data are available for one country, using cost of production data to draw valid economic conclusions is fraught with difficulties. In fact, the ICAC specifically discourages this kind of cross-country comparison: "***Because of a number of limitations, it is not advisable to compare the costs of production among several countries at the same time***".[56]

**Fact check**: Over the period 1999/00 to 2002/03, the US share of world exports rose from 24.1 per cent to 39.34 per cent. (See US response to Question 160).

**170. Brazil quotes a report that states that a 10% increase in soybean prices reduces upland cotton acreage by only 0.25% (Brazil's 7 October oral statement, para. 27). Could Brazil indicate if this analysis is done on a short-run basis or a long-run basis? BRA**

[54] *See* Exhibit US-47.
[55] *See* Exhibit US-69.
[56] Raffiq Chaudhry, International Cotton Advisory Committee, "Cost of Producing Raw Cotton" Presented at the III Brazilian Cotton Congress, Brazil, 31August 2001 (emphasis added).

**171. In paragraphs 22 and 23 of its further submission, we understand that the US is, in short, claiming that increased total supply (i.e. including polyester) drove prices down. On the other hand, we note that, according to the figures in the chart in paragraph 22 of the same submission, the world production of cotton during this period has basically been steady. Do all polyester fibres as represented by these figures compete directly with cotton? That is to say, do these figures for polyester fibres include, for example, those that are used for textiles that technically cannot be substituted by cotton? US**

111. The figures in the chart in paragraph 22 represent world polyester textile production. Polyester competes with cotton either directly in the fibre market or indirectly through apparel and other intermediate products.

**172. Please estimate the price effect, in cents per pound, of the growth in the US retail market which it is said has directly contributed to strengthening world cotton prices. US**

112. As was presented in the table in paragraph 27 of the Further Submission of the United States of 30 September 2003, US retail purchases of raw cotton fibre increased from 12.3 million bales in 1990 to 20.9 million bales in 2002, an increase of 8.6 million bales. This increase accounted for the entire increase in world retail purchases of raw cotton fibre over the same period and reflects an increase at the world level of 10 per cent. Based on the average demand elasticity of -0.25 used by Dr. Sumner in his analysis (see Annex 1 of Brazil's Further Submission to the Panel, para 23), an equivalent price decline of 40 per cent would be necessary to generate a 10 per cent increase in demand of cotton, all else held equal. Of course, this omits other factors such as supply response of world cotton producers and competition of manmade fibres. Nonetheless, it is clear that the growth in retail purchases of cotton fibres in the United States has strengthened world prices.

**173. The US asserts that "burgeoning US textile imports … shifted the disposition of US cotton production from domestic mills to export markets" (US further submission, para. 20). A similar description appears in paragraph 33, together with the explanation that "the share of world cotton consumption supplied by US cotton has been roughly the same since 1991/92". Why have sales of US cotton for export increased and sales of cotton imported into the US increased? US**

113. The role and impact of rapidly growing US textile and apparel imports is fundamental in explaining the shift in the use of US cotton production from domestic mills to foreign mills. As noted at paragraphs 20 and 33 of the US further submission, the US textile and apparel industry has suffered from declining competitiveness compared with off-shore producers for many years, reflecting many factors, including higher wage costs, a strong US dollar, etc. As domestic mills have shut down in the United States, and production has moved overseas, domestic demand for US cotton by domestic mills has declined sharply.

114. But US consumer demand for cotton products has not declined. That demand has increasingly been met by lower-priced imports of cotton textiles and apparel. As can be seen in the table following paragraph 34 of the US further submission, US imports of cotton textiles (in cotton equivalents) have more than tripled since 1990. It is important to note that the import, export, and consumption data in that table are expressed in bales of cotton-equivalent. In other words, the data are not "sales of cotton imports", but rather represent the amount of cotton imbedded in the particular products.[57]

[57] These estimates of the "cotton equivalent" of textile imports are done by USDA's Economic Research Service, based an a set of internationally-accepted conversion factors. See Cotton and Wool Situation and Outlook Yearbook. Market and Trade Economics Division, Economic Research Service. US Department of Agriculture, November 2002, CWS-2002.

115. US cotton is grown to be used to make cotton textiles and apparel. The point of the US submission is to explain how the location of where US cotton is manufactured into products has shifted. US and world consumers continue to purchase cotton products. But increasingly US consumers purchase those cotton products, made from exported US cotton, from overseas manufacturers as US manufacturers are less able to compete. That is the structural transformation that paras. 33-34 and the accompanying table seeks to present and explains at least in part some of the changes in US exports.

**174. How, if at all, did the Asian financial crisis affect the United States' world market share? Did it disproportionately affect the US as compared to other exporters? US**

116. The Asian financial crisis disrupted cotton consumption (spinning) in the major consuming countries of Thailand, Indonesia, and the Republic of Korea in 1997/98, reducing their mill use 9 per cent from the preceding year. In addition, the decline in world economic growth induced by the crisis reduced total world cotton consumption 3.4 per cent in 1998/99 from the pre-crisis level in 1996/97. Subsequently, however, the depreciation of currencies in these three countries boosted their cotton consumption due to expanding textile exports. World cotton consumption rose 11 per cent between 1996/97 and 2002/03, while consumption in Thailand, Indonesia, and Korea collectively rose 16 per cent. During this same period, US spinners lost market share to textile imports, due in large part to currency effects, and US domestic mill use fell 35 per cent.

117. US export share in these markets is influenced by total supply availability, qualities produced, and price. For example, US export share of the three countries' consumption fell by more than half in 1998/99, due to the drought-devastated US crop. Export share has since returned to the pre-crisis level of about 30 per cent and, with higher consumption, this added about 400,000 bales to US exports between 1996/97 and 2002/03. Since the combined total consumption increase for Thailand, Indonesia, and Korea was about 800,000 bales, this indicates that other exporters also increased exports by about 400,000 bales. As US mill use of cotton declined while exports increased, US world market share was left relatively unchanged (with a slight downward bent) by the Asian financial crisis.

**175. With reference to paragraphs 57-58 and the related table on page 21 of the US further submission, could you please clarify the arguments regarding the ratio of the soybean futures to the cotton futures prices since in the table the inverse ratio is used? US**

118. Attached is a corrected version of the table. The ratio of cotton futures price to soybean futures prices is positively correlated with movement in planted cotton area.

**Expected cotton and soybean prices and planted cotton acreage**

| Year | December cotton futures (cents/lb) | November soybean futures ($/bushel) | Ratio of cotton futures to soybean futures | Planted cotton acres (million acres) |
|---|---|---|---|---|
| 1996 | 78.58 | 7.23 | 10.87 | 14.4 |
| 1997 | 76.82 | 6.97 | 11.02 | 13.6 |
| 1998 | 72.13 | 6.64 | 10.86 | 13.1 |
| 1999 | 60.32 | 5.11 | 11.8 | 14.6 |
| 2000 | 61.31 | 5.32 | 11.52 | 15.3 |
| 2001 | 58.63 | 4.67 | 12.55 | 15.5 |
| 2002 | 42.18 | 4.50 | 9.37 | 13.7 |
| 2003 | 59.6 | 5.26 | 11.33 | 13.5 |

**176. With reference to Figure 4 of Brazil's Further Submission, how does Brazil explain the apparent decrease in prices in 2001 and the increase of the A-Index in recent months, despite the continued use of US subsidies on upland cotton? BRA**

**177. Could the United States further elaborate on paragraph 50 of its 7 October oral statement? US**

119. Lin et al. estimated that the own-price elasticity of cotton acreage under the FAIR Act was 0.466.[58] This is identical to the 2003 net-return elasticity reported by Dr. Sumner. However, it is incorrect to equate a price elasticity to net-return elasticity given the linear specification utilized by Dr. Sumner. The implied price elasticity from Dr. Sumner's model would be approximately 50 per cent larger than the net-return elasticity. Larger elasticities imply greater acreage shifts to change in policies or prices.

120. The relationship between the price elasticity and a net revenue elasticity can be shown as follows. Given a linear specification as described by Dr. Sumner, then cotton area (CA) can be expressed:

(1) $CA = a0 + a1*CNR + a2*Z,$
where CNR is Expected Cotton Net Returns and Z is a vector of other variables including returns from competing crops.

The elasticity with respect to CNR is found by differentiating the equation with respect to CNR. The derivative is the coefficient a1. The elasticity, eNR, is expressed as follows:

(2) $eNR = a1 * CNR / CA.$

With CNR a function of the cotton price P, the elasticity with respect to P can be determined by taking the derivative of the equation with respect to price P. Based on equation (1) from page 13 of Annex I, the derivative with respect to price P is a1*Y, where Y is expected yield.

It follows that the price elasticity is $eP = a1 * Y * P / CA$. One can then conclude that $eNR/eP = ENR / (Y*P)$.

The relationship between eNR and eP can be found by looking at the relationship between CNR and Y*P. Specifically, $eP = ((Y * P) / CNR) * eNR$.

In recent years, the ratio of $(Y * P) / CNR$ has been approximately 1.5, implying that $eP = 1.5 * eNR = 1.5 * 0.466 = 0.699$.

**178. The Panel notes Exhibit US-63. Could the US please provide a conceptually analogous graph concerning US export sales during the same period? US**

121. Exhibit US-70 shows in table and graph form the per cent change over the previous year for upland cotton exports by the United States and the rest of the world. In addition, the United States provides in Exhibit US-71 a table and graph demonstrating the absolute levels of US exports and domestic consumption. As the figures show, over the last seven years domestic consumption has declined by almost the same amount by which exports have increased, leaving US world market share largely unchanged.

[58] **Lin, W., P.C. Westcott, R. Skinner, S. Sanford, and D.G. De La Torre Ugarte. *Supply Response Under the 1996 Farm Act and Implications for the US Field Crops Sector.* US Department of Agriculture, Economic Research Service, Technical Bulletin No. 1888**, Appendix table 21.

**179. Could Brazil comment on the argument that decoupled payments and other subsidies to upland cotton are largely being capitalized into land values and that removing these subsidies would reduce the cost of production of upland cotton producers (US 7 October oral statement, para. 48). What would be the net effect of these adjustments? BRA**

**180. Please describe the precise formula as to how USDA determines the "adjusted world price" using the Liverpool A-Index, the NY futures price and any other relevant price indicators. Please submit substantiating evidence. BRA, US**

122. The Adjusted World Price (AWP) is equal to the Northern Europe (NE) price (the 5-day average of the 5 lowest-priced growths for Middling 1-3/32 inch cotton, cost, insurance and freight [CIF] northern Europe), adjusted to US base quality and average location. The AWP for individual qualities is determined using the schedule of loan premiums and discounts and location differentials. A "coarse count adjustment" (CCA) may be applicable for cotton with a staple length of 1-1/32 inches or shorter and for certain lower grades with a staple length of 1-1/16 inches and longer. The AWP and CCA are announced each Thursday.[59]

123. A Step 1 adjustment to the AWP may be made when the 5-day average of the lowest US growth quote for Middling 1-3/32 inch cotton, CIF United States-northern Europe (USNE) price, exceeds the NE price and the AWP is less than 115 per cent of the loan level. The Secretary of Agriculture may lower the AWP up to the difference between the USNE price and the NE price. A Step 1 adjustment has never been made, although the conditions have been met many times.

**181. Please provide a side-by-side chart of the weekly US adjusted world price, the Liverpool A-Index, the NY futures price, and spot market prices from 1996-present. What, if anything, does this reveal? BRA, US**

124. Exhibit Q181 sets out weekly price movements for the Adjusted World Price, the Liverpool A Index, the nearby New York cotton futures price and the spot market price from January 1996 to present.

**182. Please explain why the US can be taken to be price leaders, or price setters, (and not just takers) when US producers receive large subsidy payment to support the difference between world prices and their own costs? BRA**

## L. ARTICLE XVI OF GATT 1994

**183. Why does Brazil believe that the appropriate "previous representative period" is the term of the previous Farm Bill, MY1996-2002? (Brazil's further submission, para. 282) BRA**

**184. Why does Brazil believe that an "equitable share" is one which factors out all subsidies? To the extent that domestic support and export subsidies are permitted by the Agreement on Agriculture, why should they not be accepted as being normal conditions in analyzing an equitable market share? (See Brazil's further submission, paras 288-289) BRA**

**185. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the Agreement on Agriculture and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the SCM Agreement. BRA, US**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional**

[59] *See* Exhibit US-72.

**provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions of the Agreement on Agriculture, relevant?**

125. As indicated in the US opening statement at the recent panel meeting[60], GATT 1994 Article XVI:3 applies only to export subsidies. Paragraph 3 is found in Part B of Article XVI, entitled "Additional Provisions on Export Subsidies", as opposed to Part A, which is entitled "Subsidies in General". Paragraph 2 (also in Part B) states that "[c]ontracting parties recognize that the granting of a *subsidy on the export* of any product may have harmful effects for other contracting parties" (emphasis added). Paragraph 3 begins with the word "[a]ccordingly", the ordinary meaning of which is "[i]n accordance with the logical premises; correspondingly"[61], and follows with "contracting parties should seek to avoid the use of *subsidies on the export* of primary products" (emphasis added). That is, "in accordance with" the recognition in paragraph 2 that export subsidies may have harmful effects, paragraph 3 address the use of "subsidies on the export of primary products". The second sentence of paragraph 3 follows this hortatory statement with the obligation not to apply subsidies "which operate[] to increase the export of any primary product" in a manner that "results in a contracting party having more than an equitable share of world export trade in that product". Paragraph 4 "[f]urther" addresses export subsidies for "any product other than a primary product". Thus, the text and context of paragraph 3 indicate that this provision is addressed to export subsidies and not domestic support programmes.

126. The Peace Clause provides further context supporting this interpretation. Article 13(c)(ii) exempts export subsidies that conform fully with Part V of the Agreement on Agriculture from, *inter alia*, "actions based on Article XVI of GATT 1994" – that is, including Article XVI:3 on export subsidies. Article 13(b)(ii), on the other hand, exempts conforming domestic support measures from, *inter alia*, "actions based on paragraph 1 of Article XVI of GATT 1994" but does not mention Article XVI:3. Thus, Article 13 lends contextual support to the notion that Article XVI:3 applies to export subsidies on primary products or commodities but does *not* apply to domestic subsidies on such products.

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in US-FSC, para. 117 here?**

127. Article 6.3(d) of the Subsidies Agreement does not, by its terms, interpret or replace GATT 1994 Article XVI:3. In fact, the range of measures potentially actionable under Article 6.3 is broader than the export subsidies subject to GATT 1994 Article XVI:3. In addition, the analysis under these two provisions is different. Article 6.3(d) is concerned with whether the effect of a subsidy is to increase the world market share of the subsidizing Member; GATT 1994 Article XVI:3 is concerned with whether export subsidies result in a Member having "more than an equitable share in world export trade" in a particular product. However, an important similarity between these two provisions is the scope of products covered by their respective disciplines. GATT 1994 Article XVI:3 is concerned with export subsidies on primary products; Article 6.3(d) is concerned with any subsidy on "a particular subsidized primary product or commodity". This similar product coverage resulted because Members desired to provide more operationally effective subsidies disciplines with respect to these products but had found the "more than equitable share" language of GATT 1994 Article XVI:3 to be unworkable. For further discussion, please see the US response to Question 186 from the Panel.

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in**

[60] US Opening Statement at the Second Session of the First Panel Meeting, para. 60.
[61] *The New Shorter Oxford English Dictionary*, vol. 1, at 15 (1993 ed.) (third definition).

**Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?**

128. The United States notes the Appellate Body's discussion of relevant differences between the provisions of the Subsidies Agreement and those of GATT 1994 in *United States – FSC*.

**186. Could the United States please expand upon its statement that "[t]hese are the types of considerations that led to the negotiation of the Subsidies Agreement...." (US further submission, para. 109)? Is there any relevant material, including, for example, drafting history that might support this statement? US**

129. Dissatisfaction with the difficulties in applying the "more than equitable share" standard of GATT 1994 Article XVI:3 was an important motivation for the negotiation of stronger and more operational disciplines in the WTO Subsidies Agreement. In two separate challenges in 1979 and 1980 to the sugar export subsidy programme of the European Communities by Australia and Brazil, panels were unable to find that the export refunds provided by the Communities resulted in a "more than equitable share" of world export trade.[62] Similarly, in the 1983 US challenge to export subsidies on wheat flour by the European Communities (quoted in the US further submission), "[t]he [p]anel found that it was unable to conclude as to whether the increased [EC] share [of world exports of wheat flour] has resulted in the EEC 'having more than an equitable share' in terms of Article 10 [of the Subsidies Code], in light of the highly artificial levels and conditions of trade in wheat flour, the complexity of developments in the markets, including the interplay of a number of special factors, the relative importance of which it was impossible to assess, and, most importantly, the difficulties inherent in the concept of 'more than equitable share'".[63]

130. Significantly, the latter two of these panel reports explicitly considered the 1979 Tokyo Round Subsidies Code and its interpretive gloss on the "more than equitable share language". Article 10.2 of the 1979 Subsidies Code (of which both Brazil and the United States were signatories) stated, in pertinent part:

> For purposes of Article XVI:3 of the General Agreement and paragraph 1 above:
>
> (a) "more than an equitable share of world export trade" shall include any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets;
>
> (b) with regard to new markets traditional patterns of supply of the product concerned to the world market, region or country, in which the new market is situated shall be taken into account in determining 'equitable share of world export trade'[.]

That is, the 1979 Subsidies Code represented an effort to make operational the discipline provided in GATT 1994 Article XVI:3 by giving additional meaning to the phrase "more than an equitable share of world export trade". Despite that effort, however, the panel considering the Brazilian challenge to EC sugar export subsidies and the panel considering the US challenge to EC wheat flour export subsidies remained unable to find any inconsistency with GATT 1994 Article XVI:3 (in the words of

[62] *European Communities – Refunds on Exports of Sugar*, L/4833, 26S/290 (adopted 6 November 1979) (complaint by Australia); *European Communities – Refunds on Exports of Sugar*, L/5011, 27S/69 (adopted 10 November 1980).

[63] *European Economic Community – Subsidies on Export of Wheat Flour*, SCM/42, para. 5.3 (unadopted 21 March 1983).

the Wheat Flour panel) "in light of . . . , most importantly, the difficulties inherent in the concept of 'more than equitable share'".

131. Thus, there was a recognition in the Uruguay Round subsidies negotiations that the effort in the 1979 Subsidies Code to make GATT 1994 Article XVI:3 more operationally effective had not succeeded. For example, a reference paper on GATT subsidies rules and the existing status of discussion of these rules prepared by the GATT Secretariat for the Negotiating Group on Subsidies and Countervailing Measures states:

> The most pronounced difficulties have occurred in connection with the concept of "more than an equitable share" embodied in Article XVI:3 of the GATT. The Agreement on Subsidies and Countervailing Measures (Article 10) attempted to bring precision to Article XVI:3 but it has not always been found to give clear guidance on its interpretation. Consequently a number of disputes involving the concept of "more than an equitable share" have not found a satisfactory solution and in some cases have provoked retaliatory subsidization. The case-by-case application of this concept has revealed its imprecisions and the fact that it largely refers to notions which escape objective criteria. There is, for example, sufficient imprecision in this concept to allow countries using export subsidies to argue that these subsidies do not result in obtaining more than equitable share. On the other hand it is not always possible to provide causality between the subsidy and the increase share. Furthermore, it is impossible to derive a general line of case law from the decisions of panels, some of which have given divergent interpretations.[64]

132. A checklist of issues for the negotiations based on Contracting Parties' written submissions and oral statements prepared by the Secretariat demonstrates that Contracting Parties were well aware of these difficulties and the need to move away from the "more than an equitable share" concept:

> There is a need for review, with a view to improving GATT disciplines, of the provisions of Article XVI:2 and 3. Notably there is a need to build on the recognition embodied in Article XVI:2 and the exhortation in the first sentence of XVI:3 in the direction of improving the conditions of competition on world markets for primary products currently covered by the equitable share criterion in the second sentence of Article XVI:3.
>
> The review should examine the application of the "more than an equitable share" rule for primary products. This rule has serious conceptual flaws and in practice has failed to provide clear guidance as to the permissible scope of primary product subsidization. . . . .
>
> The Negotiating Group should consider negotiating a similar prohibition to that of Article 9 of the Code on the use of export subsidies for forest, fishery and farm products.
>
> The prohibition on export subsidies for products other than basic or primary products under Article XVI:4 and Article 9 of the Code should be extended to agricultural, forestry and fishery products, in other words to all basic or primary products.
>
> A major objective of these negotiations should be to extend the existing prohibition on export subsidies to cover all products, primary as well as non-primary.

[64] *Subsidies and Countervailing Measures: Note by the Secretariat*, MTN.GNG/NG10/W/4, at 79 (28 April 1987) (Section VI.3).

> There are serious deficiencies in Article XVI:3 of the GATT and in Article 10 of the Code, notably the fundamental problems connected with the 'more than equitable share' concept. However, these problems arise from the basic fact that current disciplines for primary products are significantly weaker than those which apply to manufactured goods. They cannot be resolved merely by making minor adjustments to rules which are intrinsically defective. The only genuine, long-term solution is an effective prohibition on all export subsidies. Accordingly at this stage of the negotiating process, there is little value in trying to improve the "more than equitable share" rule, which is only relevant so long as there is no general prohibition on export subsidies.[65]

133. Reflecting the desire of Members to move away from the "more than an equitable share" concept which had repeatedly been found by panels to be incapable of application, the WTO Subsidies Agreement does not provide any further definition or interpretation of GATT 1994 Article XVI:3. Instead, it contains the general prohibition on export subsidies in Article 3 and rules on adverse effects, including serious prejudice.

## M. THREAT CLAIMS

**187. Please provide USDA's projections of marketing loan/LDP payments, direct payments and counter-cyclical payments to be made during MY2003 through 2007 based on the most recent USDA baseline projection. US**

134. The following table shows projections for cotton marketing loan/LDP payments, direct payment and counter-cyclical payments for crop years 2003 through 2008, as published in the FY2004 Mid-Session Review on 15 July 2003. We note that projected outlays for marketing year 2003 are likely to be significantly overstated given the increase in prices and futures prices over the course of this marketing year. For example, no marketing loan payments are currently being made because the adjusted world price is above the marketing loan rate.

**Projected outlays (million dollars)**

| Item | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|
| Direct payments | 587 | 587 | 587 | 587 | 587 | 587 |
| Counter-cyclical payments | 929 | 602 | 521 | 521 | 521 | 521 |
| Loan deficiency payments | 420 | 298 | 193 | 137 | 137 | 82 |
| Marketing loan gains | 22 | 13 | 8 | 6 | 6 | 3 |
| Certificate gains 1/ | 196 | 114 | 75 | 55 | 52 | 29 |

1/ Includes value of non-cash marketing loan transactions.

**188. Can the United States comment on the FAPRI projections for cotton provided in Exhibit BRA-202? US**

135. The FAPRI projections presented by Brazil in Exhibit BRA-203 reflect the January 2003 FAPRI projections. These projections were published by Iowa State University in January 2003.[66] The same projections were published by FAPRI at the University of Missouri in March 2003 and were referenced by the United States in Exhibit US-52.

[65] *Checklist of Issues for Negotiations: Note by the Secretariat*, MTN.GNG/NG10/W/9/Rev.4, at 26-28 (12 December 1988).

[66] Food and Agricultural Policy Research Institute. *FAPRI 2003: US and World Agricultural Outlook.* Iowa State University Staff Report 1-03. January 2003.

136. Of significance is the difference between the January 2003 baseline and the preliminary baseline of November 2002 utilized by Dr. Sumner in his analysis. Under the January 2003 baseline, the Adjusted World Price (AWP) forecasts for 2002/03 to 2007/08 are considerably higher than the forecasts made in the preliminary November 2002 baseline. Because loan deficiency payments and marketing loan gains are calculated based on the difference between the loan rate and the AWP, this means that expected marketing loan subsidies under the November 2002 baseline are far higher than expected marketing loan subsidies under the January 2003 baseline. Thus, the effects of eliminating marketing loans would tend to be biased upwards using the preliminary November 2002 baseline.

**Differences in the Adjusted World Price forecast between the November 2002 and January 2003 FAPRI baseline ($/lb)**

| | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 | 2007/08 |
|---|---|---|---|---|---|---|
| November 2002 baseline 1/ | 0.3597 | 0.3722 | 0.3983 | 0.4194 | 0.436 | 0.4548 |
| January 2003 baseline 2/ | 0.448 | 0.454 | 0.46 | 0.46 | 0.467 | 0.48 |
| Difference | 0.0883 | 0.0818 | 0.0617 | 0.0406 | 0.031 | 0.0252 |

1/ As presented by Dr. Sumner in Annex I and oral statement of 7 October 2003.
2/ As reported in Exhibit BRA-203 and Exhibit US-52

## N. CLARIFICATIONS

**189. Please indicate whether the correct figure in paragraph 37 of Brazil's 7 October oral statement is 38.1% or 38.3%? BRA**

**190. Please confirm that the figure "17.5" in paragraph 43 of Brazil's 7 October oral statement, is "percentage point". BRA**

**191. Could Brazil clarify its statement in para. 12 of its 9 September further submission: "Alternatively crop insurance is not specific because the 2000 ARP Act denies benefits to commodities representing more than half of the value of US agriculture. Further US crops represent only 0.8 per cent of total US GDP." (emphasis added) BRA**

**List of Exhibits**

64 Lin, W., et al.. Supply Response Under the 1996 Farm Act and Implications for the US Field Crops Sector. US Department of Agriculture, Economic Research Service, Technical Bulletin No. 1888, Appendix table 21

65 Amount and percentage of upland cotton acreage coverage by crop insurance policy

66 Premiums paid by upland cotton producers

67 Insurance indemnity payments to upland cotton producers

68 New York Cotton Futures, Average Daily Closing Prices for December 2003 Contract (chart and data)

69 US Department of Agriculture, Economic Research Service, Cost of Production Estimates; Commodity-Weighted Exchange Rate Estimates

70 US and Rest of World Exports of Upland Cotton, Year-Over-Year Per cent Change, 1996-2002

71 US Exports and Domestic Consumption of Upland Cotton, 1996-2002

72 US Department of Agriculture, Press Release on Adjusted World Price (18 October 2003)

73 Weekly Price Movements: Adjusted World Price, Liverpool A-Index, New York cotton futures, spot market price, January 1996 to present

74 National Agricultural Statistics Service, Planted Acreage of Selected Crops by Region and State

# ANNEX I-7

## ANSWERS OF BRAZIL TO QUESTIONS POSED BY THE PANEL FOLLOWING THE SECOND SUBSTANTIVE MEETING OF THE PANEL

(22 December 2003)

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| *Korea – Beef* | GATT Panel Report, *Republic of Korea – Restrictions on Imports of Beef – Complaint by the United States*, BISD 36S/268, adopted on 7 November 1989. |
| *Japan – Alcoholic Beverages* | Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, adopted 1 November 1996. |
| *EC – Hormones* | Appellate Body Report, *European Communities - Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, adopted 13 February 1998. |
| *Brazil – Aircraft* | Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/R, adopted 20 August 1999. |
| *Indonesia – Automobiles* | Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, adopted 23 July 1998. |
| *Argentina – Textiles and Apparel* | Appellate Body Report, *Argentina – Measures affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/AB/R, adopted 22 April 1998. |
| *Guatemala – Cement (I)* | Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS69/AB/R, adopted 25 November 1998. |
| *Japan – Agricultural Products* | Panel Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/R, adopted 19 March 1999. |
| *India – Quantitative Restrictions* | Panel Report, *India – Quantitative Restrictions on Imports of Agricultural, Textiles and Industrial Products*, WT/DS90/R, adopted 22 September 1999. |
| *Canada – Dairy* | Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, adopted 27 October 1999. |
| *US – FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
| *Argentina – Footwear* | Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R, adopted 12 January 2000. |
| *Australia – Leather* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999. |
| *US – Certain EC Products* | Appellate Body Report, *United States –Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R, adopted 10 January 2001. |
| *US – Export Restraints* | Panel Report, *United States – Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001. |
| *Chile – Agricultural Products (Price Band)* | Appellate Body Report, *Chile- Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002. |
| *Canada – Aircraft II* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS222/R, adopted 19 February 2002. |
| *Argentina – Peach Safeguard* | Panel Report, *Argentina – Definitive Safeguard Measure on Imports of Preserved Peaches*, WT/DS238/R, adopted 15 April 2003. |
| *Japan – Apples* | Panel Report, *Japan – Measures affecting the Importation of Apples*, WT/DS245/R, adopted 10 December 2003. |
| *US – Steel Safeguards* | Appellate Body Report, *United States – Definitive Safeguard Measures on Imports of Certain Steel Products*, WT/DS248/AB/R, adopted 10 December 2003. |

## List of Exhibits

**UNITED STATES – SUBSIDIES ON UPLAND COTTON**

Questions from the Panel to the parties –
second substantive Panel meeting

## I. Terms of Reference

**192. Regarding the interest subsidies and storage payments listed by the United States in its response to the Panel's Question No. 67:**

**(a) Please provide a copy of the regulations under which they are currently provided and under which they were provided during the marketing years 1996-2002;**

**(b) Please indicate whether there are any such payments which are not provided to implement the repayment rate for upland cotton within the marketing loan programme. USA**

**193. Are interest subsidies and storage payments already included in the amounts shown in your submissions to date for payments under the marketing loan programme? Has there been any double-counting? BRA**

Brazil's Answer:

1. The answer to both questions is "no." Brazil reported interest subsidies and storage payments separately and thus did not double count them.[1] To the extent that the United States confirms that both of these payments are connected in some way to the storage of bales of cotton involved in the marketing loan programme, then they would appropriately be included within the overall marketing loan numbers. In that case, the Panel should increase the amount of payments attributable to marketing loan payments by including interest and storage payments related to bales of cotton in the marketing loan programme.

**194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? BRA, USA**

Brazil's Answer:

2. Brazil reserves its right to further comment on the US answer provides some initial thoughts.

3. Brazil reiterates its arguments that the Panel must examine data relating to payments made after the date of establishment.[2] In addition, the Panel is not prevented from examining payment data that originates after the date of the Panel's establishment because these payments are identified in Brazil's panel request and, therefore, are within the Panel's terms of reference.

4. The measures covered by Brazil's request for the establishment of the Panel are very broad and encompass, *inter alia*, any type of payment made under the 2002 FSRI Act and the 2000 ARP Act.[3] In addition, the panel request covers, *inter alia*, a time period of a "marketing year" for 2002 for

[1] *See e.g.* Brazil's 9 September Further Submission, Table 1.
[2] Brazil's 22 August Rebuttal Submission, paras. 88-96; Brazil's 22 July Oral Statement, paras. 40-44.
[3] WT/DS267/7, p. 2.

upland cotton for the period 1 August 2002 through 31 July 2003. The panel request further covers 2002 FSRI Act and 2000 ARP Act payments *to be made* during marketing years MY 2003-2007. In addition, the identified measures guarantee the right of eligible US producers, users and exporters to receive future payments.[4] Given the comprehensive scope and timing coverage of the request for the establishment of a Panel and the mandatory nature of the payments,[5] the Panel's terms of reference encompass all payments made under the 2002 FSRI Act for the period marketing year 2002.

5. As has been firmly established in WTO jurisprudence, any "measure" identified in the panel request pursuant to DSU Article 6.2, is within terms of reference of the panel.[6] As noted above, Brazil identified all relevant "measures" in its request for the establishment in the Panel. Further, in the *Chile – Agricultural Products (Price Band)* case, the Appellate Body held that a panel request which includes reference to "amendments" is sufficient to bring later enacted significant changes to legislation within the Panel's terms of reference.[7] While Brazil's panel request also included "amendments," this case does not even raise the *Chile – Agricultural Products (Price Band)* issues because Brazil's panel request identified the measures that have not changed or been amended since 18 March 2003. Further, to the extent that "payments" made since 18 March 2003 are evidence, the Appellate Body and panels have repeatedly found that evidence generated after the establishment of the panel can be used by panel's in their objective assessment of the facts under DSU Article 11.[8]

## II. Economic Data

**195. Does the United States wish to revise its response to the Panel's Question No. 67*bis*, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers"? Did the United States make enquiries of the FSA in the course of preparing its original answer? USA**

**196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. BRA, USA**

Brazil's Answer:

6. With its letter of 18 December 2003, the United States has finally confirmed – after asserting the contrary repeatedly to Brazil and then to the Panel – that it has collected complete planted acreage, contract base acreage, contract yields, and even payment data that would allow it to calculate with relative precision the amount of direct and counter-cyclical payments made to current producers of

[4] Brazil's 9 September Further Submission, para. 423.

[5] US 27 October Answers to Questions, paras. 95-97.

[6] Panel Report, *Japan – Agricultural Products*, WT/DS76/R, para. 8.4; Panel Report, *Indonesia – Automobiles*, WT/DS54/R, paras. 14.3-14.4.

[7] Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 135.

[8] Panel Report, *India – Quantitative Restrictions*, WT/DS90/R, para. 5.161-5.163 ("In this case the parties and the IMF have supplied information concerning the evolution of India's balance of payments and reserve situation until June 1998. To the extent that such information is relevant to our determination of the consistency of India's balance of payments measures with GATT rules as of the date of establishment of the Panel [18 November 1997], we take it into account."); Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, paras. 133-4 ("The deliberate disregard of, or refusal to consider, the evidence submitted to a panel is incompatible with the panel's duty to make an objective assessment of the facts. … A claim that a panel disregarded or distorted the evidence submitted to it is, in effect, a claim that the panel, to a greater or lesser degree, denied the party submitting the evidence fundamental fairness, or what in many jurisdictions is known as due process of law or natural justice."); Panel Report, *Japan – Apples*, WT/DS245/R, para. 8.49; GATT Panel Report, *Korea – Beef*, BISD 36S/268, paras. 122-123.

upland cotton in MY 2002. Therefore, Brazil looks forward to the United States answering this question in full on 22 December.

7. Unfortunately, Brazil cannot calculate direct payment and counter-cyclical payment figures because the United States refused to produce on 18 December the information requested by Brazil and the Panel. In particular, the United States refused to provide farm-specific identifying numbers, thus rendering any matching of farm-level information on contract payments with information on farm-specific plantings impossible. Only this unique farm number (or a substitute number protecting the alleged confidentiality of farmers) would allow any matching of planting and payment data critical for the calculation of the amount of contract payments that constitute support to upland cotton.[9] The United States asserts newfound "confidentiality" concerns even though it provided identical information on rice to a private US citizen making a simple FOIA request. But even these confidentiality concerns could not possibly apply to aggregate matched figures that the United States could easily calculate with the data the United States admits it has collected. On 12 January 2004, Brazil will provide a more detailed analysis of the US failure to cooperate in this proceeding by continuing to refuse to provide Brazil and the Panel with the requested information.

8. In view of the US failure to produce the requested information that would allow Brazil and the Panel to calculate easily the amount of direct and counter-cyclical payments (as well as PFC and market loss assistance payments for MY 1999-2001), Brazil must present below revised figures using its so-called "14/16$^{th}$" methodology.[10] The figures represent the best information available and are corroborated by circumstantial evidence. Moreover, in view of the US refusal to produce the actual information regarding direct payment and counter-cyclical payments, the Panel could reasonably infer that the *actual* amounts are greater than those estimated by Brazil.

[9] Brazil pointed this out more than a month ago when it stated in its 18 November Further Rebuttal Submission, that "CCC-509 *does* indicate the quantity of base acreage fir each programme crop on the farm. Since both CCC-509 and FSA-578 require identification of the *identical* 'farm' by a unique farm serial number, the base acreage from CCC-509 can be matched with the planted acreage in FSA-578. What the United States has failed to do is 'connect the dots,' *i.e.*, match the information in the two forms." (Brazil's 18 November Further Rebuttal Submission, para. 44, emphasis in original, footnotes omitted).

[10] In view of the new information provided by the United States in Exhibit US-95, Brazil has adjusted the total amount of contract payments by a ratio of 13.714 million acres of actual upland cotton plantings in MY 2002 to 18.858 million acres of total upland cotton base.

| PROGRAMME | PREVIOUS AMOUNT OF PAYMENTS[11] | NEW AMOUNT OF PAYMENTS |
|---|---|---|
| **MARKETING LOAN GAINS AND LDPS** | **$918 MILLION** | **$832.8 MILLION[12]** |
| **CROP INSURANCE** | **$194.1 MILLION** | **$194.1 MILLION[*]** **(+ $104.2 MILLION[13])** **($298.3 MILLION)** |
| **STEP 2** | **$217 MILLION** | **$217 MILLION[*]** |
| **DIRECT PAYMENTS** | **$485.1 MILLION** | **$454.5 MILLION[14]** |
| **COUNTER-CYCLICAL PAYMENTS** | **$998.6 MILLION** | **$935.6 MILLION[15]** |
| **COTTONSEED PAYMENTS** | **$50 MILLION** | **$50 MILLION[*]** |
| **OTHER PAYMENTS** | **$65 MILLION** | **$65 MILLION[*]** |
| TOTAL PAYMENTS | $2,927.8 MILLION | $2,749 MILLION ($2,853.2 MILLION) |

[*] Brazil has no new information on the amount of these payments

9. Concerning the export credit guarantee programmes, Brazil estimates the amount of payments using the "guaranteed loan subsidy" estimate FY 2003 (which largely overlaps with MY 2002) results in a subsidy amount of $17 million.[16] In sum, the latest data available to Brazil continues to demonstrate that US support to upland cotton in MY 2002 far exceeds the support decided in MY 1992.

**197. Please provide actual data for 2002/2003 for US exports, US consumption and per cent of world consumption to replace the projected data in Exhibit US-47. If available, please provide projected data for 2003/2004 to replace the forecast data. USA**

**198. Please comment on the respective merits of the price-gap calculations of MY1992 deficiency payments in US comments of 27 August, footnote 14 ($867 million), and Brazil's response to the Panel's Question No. 67 ($812 million). BRA, USA**

[11] Taken from Table 1 of Brazil's 9 September Further Rebuttal Submission.

[12] Exhibit Bra-373 (Loan Deficiency Payment and Price Support Activity as of 12/3/2003).

[13] Brazil notes that the United States also paid $104.2 million in fulfilment of its reinsurance obligations towards the insurance companies providing the insurance policies to upland cotton producers. These payments also constitute support to upland cotton, but Brazil had so far not included them in its calculation of the total support to upland cotton. This amount results from a MY 2002 loss ratio of 1.26, *i.e.*, the 26 per cent of the $400,666,618 in indemnity payments were not covered by the Federal Crop Insurance Corporation or producer premium payments. These $104.2 million were paid by the Federal Crop Insurance Corporation (*See* Exhibit Bra-374 ("Crop Year Statistics MY 2002" – Federal Crop Insurance Corporation).

[14] This calculation is based on total direct payments for upland cotton base of $625 million (US 27 August Comments, Table at para. 28 reporting PFC payments for MY 2002 of $452 million and additional direct payments of $173 million). This figure has been adjusted by the ratio of MY 2002 plantings (13.714 million acres) and MY 2002 direct payment base acreage (18.858 million acres) (*See* Exhibit US-95).

[15] Brazil has used the direct payment of $454.5 million and adjusted it by the ratio of the direct payment rate of 6.67 cent per pound basis and the CCP payment rate for MY 2002 of 13.76 cents per pound.

[16] Brazil refers the Panel to Exhibits Bra-333 (Cotton: World Markets and Trade, USDA, October 2003, Table 3) for the amount of cotton exports that were covered by export credit guarantees during the fiscal years that overlap with MY 2002 (FY 2002 and FY 2003). Since the overlap is largely with fiscal year 2003, Brazil has used the share of cotton export credit guarantees ($349.63 million) of the total guarantees made available ($5,953 million) under GSM 102 and GSM 103 in that year to calculated the amount of payments as estimated by the FCRA formula. The original subsidy estimate for FY 2003 (taken from the 2004 budget) is $294 million. The share attributable to cotton export credit guarantees would be $17 million.

Brazil's Answer:

10. Brazil has no reason to disagree with the US calculations which appear based on information exclusively within the control of the United States.

**199. What is the composition of the A-Index? We do note footnote 19 and, for example, Exhibit BRA-11, but please explain more in detail how this index is calculated. BRA**

Brazil's Answer:

11. Brazil refers the Panel to the statement made by Andrew Macdonald in Annex II of Brazil's 9 September Further Submission that provides considerable detail about the calculation and formation of the A-Index.[17] Further information is set forth in Exhibit Bra-375.[18] The A-Index, along with the B-Index, are two important indices that summarize the price developments of the physical market in various countries around the world. Both indices are published by Cotlook, Inc., a private company, and reflect an average price.[19] As an index, it is not a trading or negotiable price, but a composite of quotations from the major producing origins around the world, much like a poll.

12. The A-Index is published weekly by the Cotton Outlook and calculated daily based on daily cotton price quotes converted on the basis of delivery to Northern European ports. The A-Index is generated based on Cotlook receiving daily information as regards quotations for upland cotton referring to 16 different origins. The quotes are for an upland cotton described as quality Middling Grade with a 1 3/32" staple length. The 16 quoted prices that are eligible for inclusion in the A-Index include prices for Brazilian Middling 1 3/32" upland cotton as well as prices for US Memphis and California/Arizona Middling 1 3/32" upland cotton.[20] The A-Index value of the day represents the average of the five cheapest quotes out of the 16 quotes that are considered for the index calculation. The price quotes are derived from a variety of physical markets, merchants and trade information, which is gathered telephonically and analyzed for consistency and logic.[21]

13. Andrew Macdonald testified that growers, consumers and traders perceive the A- (and B-Index), along with the New York futures prices as reflecting the "world" market price for cotton.[22]

**200. Concerning the chart on page 37 of Brazil's further rebuttal submission, why did Brazil use a futures price at planting time? Is this a relevant measure for assessing acreage response? BRA**

Brazil's Answer:

14. Brazil presented the nearby futures chart in its 18 November Further Rebuttal Submission[23] to rebut US arguments that US producers allegedly respond to market price signals in making their

[17] Brazil's 9 September Further Submission, Annex II, paras. 22-25.
[18] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).
[19] Brazil's 9 September Further Submission, Annex II, paras. 22-25.
[20] The other quotes being Mexican Middling 1 3/32", Paraguayan Middling 1 3/32", Izmir/Ant St White 1 3/32", Syrian Middling 1 3/32", Greek Middling 1 3/32", Spanish Middling 1 3/32", Uzbekistan Middling 1 3/32", Pakistan Punjab SG 1503 1 3/32", Indian H-4/Meach-1 1 3/32", Chinese Type 329, Tanzanian AR Type 2, African "Franc Zone" Middling 1 3/32" and Australian Middling 1 3/32".
[21] Brazil's 9 September Further Submission, Annex II, para. 22.
[22] Brazil's 9 September Further Submission, Annex II, para. 22.
[23] Brazil's 18 November Further Rebuttal Submission, paras. 81-82.

planting decisions.[24] Because the United States' 18 November Further Rebuttal Submission focused on the December Futures price in February as the relevant contract month to gauge producer's revenue expectations, Brazil presented a similar chart in its 2 December Oral Statement based on average December futures prices in January-March planting period.[25] Using December futures prices (like the nearby futures chart) confirms USDA's economists – and the world's leading cotton trader's[26] – conclusions that US subsidies make cotton producers largely unresponsive to market price signals.[27]

**201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so, please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? BRA, USA**

Brazil's Answer:

15. Brazil has reviewed the questions very carefully and regrets that it does not have a clear understanding of the meanings of the terms used. Therefore, Brazil provides alternative answers depending on the possible intent of the questions/terms used. Brazil regrets if it has misinterpreted the terms in the questions and would welcome the opportunity to provide additional comments if the Panel should so desire.

16. The first question focuses on data relating to "cotton production sold under *futures contracts.*" The term "futures contracts" could have several meanings in the context of this dispute. First, if the phrase "production sold under futures contracts" means the amount of US production sold on a forward delivery basis, the answer is that Brazil has no access to any such data. However, Brazil notes that all US upland cotton that is exported is for "future delivery" because it takes time to actually ship cotton from the United States, and some contracts are more "future" than other contracts. Theoretically, it would be possible to take the volume of US upland cotton exported each week and assume that it was sold at the average A-Index price that week. However, this would only be an estimate and would not necessarily reflect the price received by the US producers, or the prices received by the exporter. Prices received by US producers are tabulated by USDA and are before the Panel.[28] Average A-Index prices are also evidence before the Panel and are found in Exhibit Bra-311. If this is the information sought by the Panel, Brazil would be pleased to provide an estimate.

17. If the phrase "production sold under futures contracts" means contracts for future delivery where the contract for sale contains a pricing clause pegged to the New York futures price at the time of delivery, then the answer to the first question is "no," *i.e.*, there is no data that would provide the amount of production sold through such contracts. The record contains evidence that Brazilian and Chad producers and purchasers of upland cotton use such clauses in their contracts.[29] Brazil has no access to information concerning the amount of US upland cotton sold through such contracts.

18. Finally, if the phrase "cotton production sold under futures contracts" means the amount of US upland cotton that is sold through the New York cotton futures exchange, the answer is "very

[24] Brazil's 7 October Oral Statement, paras. 13-15. Brazil's 27 October Answers to Questions, paras. 35-36.

[25] *See e.g.* Brazil's 2 December Oral Statement, para. 44.

[26] *See* Brazil's Answer to Question 247 *infra*.

[27] Brazil's 2 December Oral Statement, paras. 39-40.

[28] *See e.g.* Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5) and various issues of USDA's Cotton and Wool Outlook, Table 6.

[29] Brazil's 9 September Further Submission, Annex II, para. 16; Chad's 8 October Oral Statement, para. 9 (Statement by Ibrahim Malloum).

little." As Andrew Macdonald has indicated, the purpose of the futures market is not for the buying or selling of physical cotton.[30] Rather, it is used for hedging position for growers and the upland cotton industry while the speculators in the market provide the day-to-day liquidity.[31] Physical delivery is theoretically possible in order to give reality to the market, *i.e.*, it is always possible to take or give delivery of cotton at the expiration of the contract. This ensures that the futures truly reflect the market and vice versa. However, the volume normally delivered is very small compared to the total volume traded during the life of a contract. This is because traders with long (or buy) futures contracts and traders with short (or sell) futures contracts "close out" or "settle" the contracts by offsetting trades at the end of the contract period and, thus, no physical cotton is delivered.[32]

19. With respect to the final question of whether a "futures sale impacts the producer's entitlement to marketing loan programme payments," the answer is "no." A producer is entitled to receive a marketing loan payment independent from any futures price or selling price that the producer may receive. A producer receives a marketing loan benefit if – after having taken out a marketing loan – he sells the upland cotton, *i.e.*, loses the beneficial interest to the upland cotton, or foregoes the right to a marketing loan in favour of a LDP payment, which is paid upon ginning of the raw cotton.[33] The process of marketing and selling the upland cotton in the United States or for export through forward contracts to supply upland cotton in the future, or contracts which set the price based on future New York futures market prices does not impact in any way the amount the US producer receives in marketing loan payments. The amount of marketing loan payment solely depends on the difference between the loan rate and the adjusted world price. Whether the actual selling price is below or above the loan rate, or below or above the adjusted world price, has no impact on the amount of the marketing loan benefit. The fact that producers may sell at prices above the adjusted world price means that they generate a combined revenue from the market and the marketing loan programme that exceeds 52 cents per pound.

**202. Concerning paragraph 7 of the US oral statement, are the expected cash prices shown for February only? Can the US provide the prices for January and March of each year as well? USA**

**203. Please provide information concerning the organization, mandate, credentials and standing of FAPRI. BRA**

Brazil's Answer:

20. The Food and Agricultural Policy Research Institute (FAPRI) was established in 1984 by a grant of Congress and continues to be financed largely by the US Congress. FAPRI is a unique dual-university programme by the Center for Agricultural and Rural Development (CARD) at Iowa State University[34] and the Center for National Food and Agricultural Policy at the University of Missouri (Columbia),[35] with researchers at the University of Missouri focusing mainly on the domestic / US side of agriculture and researchers at Iowa State University focusing mainly on international agricultural issues. FAPRI uses comprehensive data and computer modeling systems to analyze the

[30] Brazil's 9 September Further Submission, Annex II, para. 17.
[31] Brazil's 9 September Further Submission, Annex II, paras. 14-15.
[32] The information in this paragraph was provided by Andrew Macdonald to counsel for Brazil during the week of 12 December.
[33] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 1-2).
[34] Exhibit Bra-376 ("About FAPRI," Center for Agricultural and Rural Development, Iowa State University).
[35] Exhibit Bra-377 ("About FAPRI," Food and Agricultural Policy Research Institute at the University of Missouri).

complex economic interrelationships of the food and agriculture industry.[36] FAPRI's mission is to provide objective qualitative and quantitative analyses of alternative US and international agricultural policies.

21. FAPRI is considered the leading US agricultural policy research institute and ever since the 1985 farm bill[37] has conducted analyses of alternative policies that have helped shape US farm legislation. In July 2002, FAPRI received the USDA Secretary's Honor Award, the highest award bestowed by the US Department of Agriculture, for its analysis of various farm bill proposals that led to the 2002 FSRI Act.[38] Professor Bruce Babcock described the award as follows:

> This award recognizes the outstanding research effort by FAPRI at [Iowa State University] and [the University of] Missouri in analyzing policy proposals during the 2002 farm bill debate. This group has dedicated itself to being the world's best at conducting agricultural policy analysis.[39]
>
> …
>
> World economic integration makes it increasingly vital that we understand the impacts of US policy decisions on US and world markets, producers and consumers. Increasing numbers of policy proposals and their complexity requires that we continually update our analytical capabilities and our market intelligence.[40]

22. FARPI is the leading research institution that fulfills this task in the United States. FAPRI prepares baseline projections each year for the US agricultural sector and international commodity markets. The multi-year projections are published as FAPRI Outlooks,[41] which provide a starting point for evaluating and comparing scenarios involving macroeconomic, policy, weather, and technology variables.[42] These projections are intended for use by farmers, government agencies and officials, agribusinesses, and others who do medium-range and long-term planning.[43]

23. FAPRI describes its objectives as follows:

- To prepare baseline projections for the US agricultural sector and international commodity markets. These multi-year projections are available in print and on the Web.
- To examine the major commodity markets and analyze alternative policies and external factors for implications on production, utilization, farm and retail prices, farm income, trade, and government costs.
- To help determine effective risk management tools for crop and livestock producers, and to analyze how government policy affects risk management strategies.

[36] Exhibit Bra-378 ("About FAPRI," Food and Agricultural Policy Research Institute).
[37] Exhibit Bra-379 (CARD Report, 40th Anniversary Commemorative Issue, Part 2, p. 1-2.)
[38] Exhibit Bra-380 ("Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002).
[39] Exhibit Bra-380 ("Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002).
[40] Exhibit Bra-380 ("Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002).
[41] *See* http://www.fapri.iastate.edu/outlook2003.
[42] *See* http://www.fapri.iastate.edu/publications for all of FAPRI's publications.
[43] Exhibit Bra-378 ("About FAPRI," Food and Agricultural Policy Research Institute).

- To brief staff members of the US Senate and House Agriculture Committees on projections for US and world agricultural markets.

- To disseminate research results through printed reports, staff presentations, and on the Web.[44]

24. In sum, FAPRI is the most influential organization in the United States analyzing farm policy and its effects on US and world commodity markets, *i.e.*, that has the highest reputation and experience in answering the kind of "but for" questions faced by this Panel. This is a fact implicitly recognized by Dr. Glauber who indicated on 2 December in responding to the Panel's oral questions that the United States was not contesting FAPRI's work or analysis but rather took issue with Professor's Sumner's modifications to and use of the FAPRI baseline.

**204. Which support to upland cotton is not captured in the EWG data referred to in Brazil's 18 November further rebuttal submission? BRA**

Brazil's Answer:

25. While Brazil believes that the EWG data is a useful indicator of the amount of support provided to producers of upland cotton, the EWG data undercounts the amount of support in several basic ways. First, the database *undercounts* the amount of marketing loan payments reflected in FSA's "LDP / Loan / Market Gain Activity" Summary Report by $572 million for MY 2000 through MY 2002.[45] The EWG database also undercounts the amount of contract payments by $61 million in MY 2000 and MY 2001.[46] This means that there are very likely additional farms and recipients of upland cotton contract payments that also received marketing loan payments, but that are not tracked by EWG data.

26. Second, as described more fully in Christopher Campbell's statement in Exhibit Bra-316, the database also undercounts the percentage of contract payments to farms growing upland cotton, because marketing loan certificates are often purchased by partnerships, with the partnership receiving the payment from USDA.[47] There can be multiple partners in these partnerships that eventually get a portion of the marketing loan certificate payment. These partners are not recorded in the EWG data as receiving marketing loan payment – thus as upland cotton producers – but they *are*, in fact, producers of upland cotton that will most likely receive contract payments.

27. Third, current producers of upland cotton also received contract payments from base acreage other than upland cotton. The EWG database does not readily permit the allocation of these payments without the application of a complex methodology requiring a number of assumptions. Only farm-specific data exclusively controlled by the United States, which it continues to refuse to provide to Brazil and the Panel, would permit such a calculation.

28. The EWG data, however, provides corroborating evidence that Brazil's "$14^{th}/16^{th}$" methodology is a reasonable approximation of the amount of contract payments that are support to upland cotton. In view of the continued refusal of the United States to provide the requested information on contract payments and acreage matched by farm, the Panel should infer that Brazil's methodology of calculating these payments undercounts the actual amount of contract payments that constitute support to upland cotton.

[44] Exhibit Bra-378 ("About FAPRI," Food and Agricultural Policy Research Institute).

[45] *See* Brazil 9 September Further Submission, Table 1 p. 4 and Exhibit Bra-316 (Statement of Christopher Campbell – Environmental Working Group).

[46] *Compare* Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6) with Exhibit Bra-317 (EWG Database: Tables of Results, Table 2).

[47] Exhibit Bra-316 (Statement of Christopher Campbell, para. 13).

**205. Does the United States accept or agree with the EWG data submitted by Brazil? If not, please explain your reasons. USA**

**206. Please explain how the graph in paragraph 40 of the US further rebuttal submission was derived. In so doing, please clarify whether the figures are on a cents per pound basis or some other basis. What averaging method was used? Can you prepare individual charts showing average US and Brazilian cotton prices for each of those third country markets? USA**

**207. Please indicate whether any of the measures challenged in this dispute *obliges* cotton farmers to harvest their crop in order to receive the benefit of the programme (subsidy). USA**

**208. Please provide data for the marketing years 1992 and 1999-2002 of the "quantity of production to receive the applied administered price" (*Agreement on Agriculture*, Annex 3, paragraph 8) for purposes of a price-gap calculation of support through the marketing loan programme. USA**

**209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs. BRA, USA**

Brazil's Answer:

29. The trend between those two graphs differs because they provide a different measure for US upland cotton acreage. The graph at paragraph 5 of the US 2 December Oral Statement shows *harvested* acreage, while the graph at paragraph 39 of Brazil's Oral Statement shows *planted* acreage. The figures differ because not all planted US upland cotton is harvested. The rate of abandonment that describes the difference between planted acres and harvested acres is significant in the United States. During MY 1996-2002 it varied between 3.6 per cent in MY 1997 and 20 per cent in MY 1998. The average for the period was 12.2 per cent.[48]

30. Brazil notes that US upland cotton farmers naturally reflect their planting decisions in planted – not harvested – acreage. To analyze whether the planting decisions of upland cotton farmers in the United Sates are "congruent" to farmers in other parts of the world, it would be best to compare planted acreage figures. Harvested acreage figures are a function of weather effects that may cause the abandonment of a significant portion of planted acreage. This is relatively common in the arid cotton producing areas of the US Southwest and less common in the irrigated regions of the US West or in the high rainfall regions of the South. Brazil also refers the Panel to its response to Question 210.

**210. Are worldwide planted acreage figures available? BRA, USA**

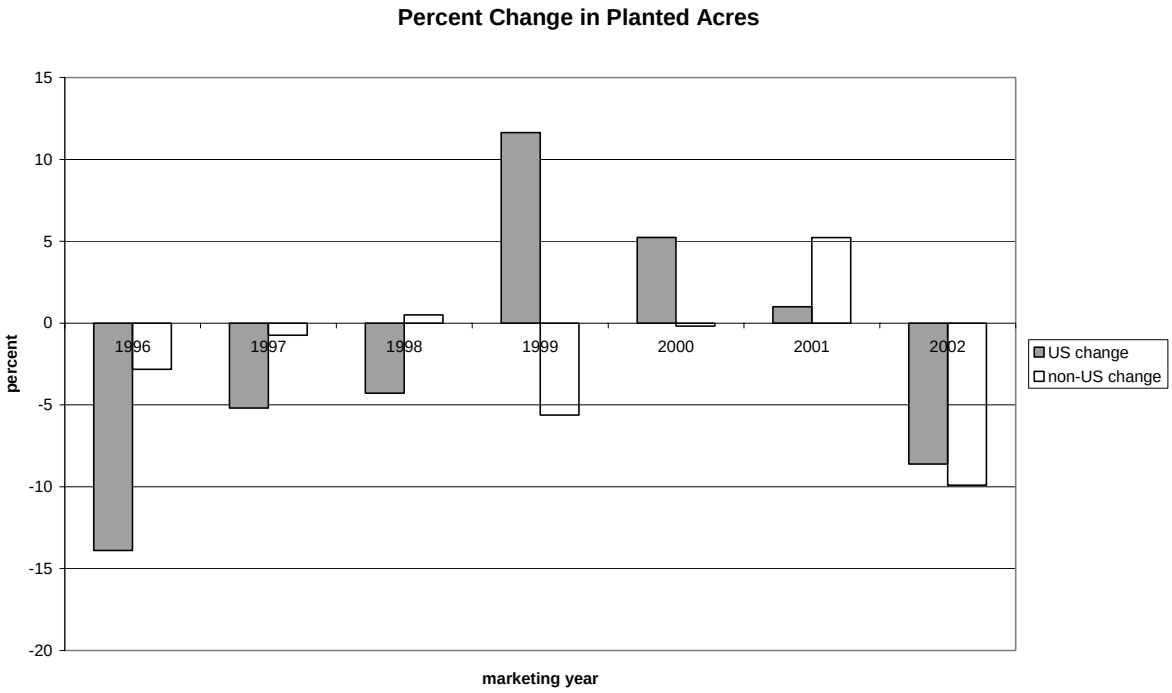
Brazil's Answer:

31. To the best of Brazil's knowledge, there are no planted acreage figures available on a worldwide basis. However, the fact that these figures do not or may not exist does not render the US harvested acreage graph valid for the purpose of evaluating the responsiveness of the US farmer to world prices.

[48] Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

32. Nonetheless, variations in harvested acreage could be a reasonable proxy for variations in planted acreage for the world outside the United States. The reason is that the relationship between planted acreage and harvested acreage on a worldwide basis can be assumed to be relatively stable, *i.e.*, weather-related problems likely lead to the abandonment of about the same percentage of planted acreage at the aggregate level each year. Upland cotton is grown in many regions and worse than normal weather conditions in one region will be offset by better than normal weather in other regions. But this is not the case when only an individual country such as the United States is analyzed because individual countries have more variable weather. This is particularly true for the United States with the considerable variance in abandonment in the Southwest. Thus, for the United States, planted acreage is the appropriate measure of production decisions. By contrast, on the worldwide level, high abandonment in one region would be compensated or balanced out by low abandonment in other regions. On average, these differing trends would cancels each other out and worldwide harvested acreage would remain relatively stable over from year to year.

33. The following graph shows percentage changes in US planted acreage and percentage changes in non-US (harvested) acreage:[49]




As expected, the graph demonstrates that the decision-making process of US producers is quite different than that of non-US producers. US planted acreage moved in *opposite* directions to world harvested acreage between MY 1998-2000. In MY 1996, 1997 and 2001, US planted acreage changes to a far greater extent than non-US planted acreage.[50] Given those significant differences, for any valid statistical analysis, this graph could not possibly be used to support a claim that planting decisions in the US were analogous to those made worldwide. In fact, taken together with the other evidence that US producers are not sensitive to market signals,[51] this graph confirms that US producers are insulated from market forces and act independently of competitors' behavior.

[49] The US planted acreage is taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4) and Non-US acreage is taken from Exhibit US-63.

[50] The non-US planted acreage is approximated by using non-US harvested acreage. As discussed above, with a stable rate of abandonment, changes in harvested acreage equal changes in planted acreage.

[51] Brazil's 18 November Further Rebuttal Submission, Section 3.4 with further references.

34. The United States relies on its "harvested acreage" chart to argue that "US producers have increased and decreased acreage commensurately with producers in the rest of the world" relying on data for MY 1996-2002.[52] But even using this inappropriate harvested acreage chart, the same disconnect between US producers and other world producers can be seen. Only in two out of seven years is there a similar movement in the harvested acreage of the US and the rest of the world. In the other five years, the movement either goes in the opposite direction or the magnitude of the acreage movement is much smaller or greater respectively.

35. These distinctly different reactions by US and non-US farmers are consistent with the fact that non-US farmers must actually deal with market signals. The significant production declines by Mato Grosso producers in MY 2000 and 2001 in the face of record low prices (even though they are among the world's highest yield and lowest cost producers) illustrate this point well.[53] In addition, the fact that US farmers' planted acreage did not significantly decline in MY 1999-2002 is totally inconsistent with the considerable exchange rate increases of the US dollar during the same period.

36. Finally, even in MY 2002 when US acreage movements were relatively consistent with the rest of the world, the effect of the US subsidies significantly dampened the decrease in US acreage. As Professor has demonstrated, the US planted acreage in MY 2002 would have been 7.5 million acres *without* US subsidies not the 13.7 million acres actually planted.[54] Thus, the effect of the US subsidies is better estimated by examining the amount (or level) of US planted acres, rather than percentage changes in which the graph moves. Were it not for the US subsidies, the US downward trend in MY 2002 would have been much sharper, as a large number of inefficient cotton producers would have chosen not to plant or would have switched crops.

**211. Brazil presents a graph in paragraph 59 of its further rebuttal submission indicating the increasing cumulative loss incurred by cotton producers. Please comment on the argument that US cotton producers could not continue operating without subsidies. In particular:**

**(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?**

**(b) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? USA**

**212. Brazil states in paragraph 37 of its oral statement that studies of Westcott and Price found that the effect of the programme on cotton is to add an additional 1 to 1.5 million acres during marketing years 1999-2001 and to suppress US prices by 5 cents per pound. Does the US reject these findings? Why or why not? USA**

**213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? BRA, USA**

[52] US 2 December Oral Statement, para. 5. This data is different from the one contained in the above graph, as it is based on US harvested acreage data rather then planted acreage.

[53] *See* Exhibit Bra-283 (Statement by Christopher Ward – 7 October 2003).

[54] Brazil has applied the percentage change as estimated by Professor Sumner in Brazil's 9 September Further Submission, Annex I, Table I.5a.

Brazil's Answer:[55]

37. Econometric simulation models of the sort used by Professor Sumner, USDA and other independent economic analysts have not used futures markets in their projections or counterfactual analysis. Instead, analysts have used either lagged prices and revenues or some variant of lagged or actual realized prices or revenues as the representation of grower expectations. Thus, there are no comparisons that one could make in this regard.

38. As previously noted, "it is impossible to know what precisely individual farmers expect"[56] because price expectations of farmers are "fundamentally unobservable."[57] It is important to note that USDA economists Westcott and Price, like Professor Sumner, have used and relied on the same retrospective analysis of the effects of marketing loans using so-called "lagged prices" – not futures prices. The United States notes that the use of a futures price analysis for MY 2002 is not possible for "multi-commodity modeling frameworks for extended time projection."[58] The United States accepts that FAPRI, USDA and the US Congressional Budget Office use lagged prices rather than futures prices as proxies for price expectations.[59] And Dr. Glauber indicated during the second Panel meeting on 3 December that the United States accepts the FAPRI modeling system as a valid means to analyze the questions faced by this Panel.

39. The statistical estimation literature in agricultural economics has used a variety of proxies for anticipated prices and revenue for the upcoming season. These include rational expectations in which many sources of information available to decision makers are combined and the expectations are consistent with the conditional forecasts of the model. Such models have strong theoretical grounding but have been impractical in most estimation situations.

40. No systematic survey has been undertaken of the very large statistical literature estimating supply functions to study how estimates differ based on assumed models of the formation of expectations.[60] In a recent study for rice, McDonald and Sumner[61] found that most published articles for rice (another US programme crop with complex government programmes) used a variant of lagged information to project prices and future revenue per acre. None of the rice estimates used futures markets.

41. Across a wide variety of commodities, no systematic differences are noticeable in estimated supply or acreage response depending on how expectations of prices and other revenue terms are represented in the model. That is, there is no evidence that the estimated acre response elasticity are systematically lower or higher using futures markets to represent the price that then enters the projected relative net revenue function used for estimation.

42. Finally, if the United States were right (which it is not) that futures prices are a better indicator of farmers' price expectations, then Professor Sumner's results are *not wrong*, but

[55] The information and analysis in this answer was provided by Professor Sumner.

[56] Brazil's 9 September Further Submission, Annex I, para. 18.

[57] Exhibit Bra-279 (Statement of Professor Sumner – 7 October 2003, para. 9). *See also* Exhibit Bra-361 (Cotton Pricing Guide, July 2001) containing guidance for farmers to take planting and marketing decisions.

[58] US 7 October Oral Statement, para. 34.

[59] US 7 October Oral Statement, para. 34.

[60] Exhibit Bra-306 (Lin, William, Paul C. Westcott, Robert Skinner, Scott Sanford, and Daniel G. De La Torre Ugarte. *Supply Response Under the 1996 Farm Act and Implications for the US Field Crops Sector*, TB-1888, US Department of Agriculture, Economic Research Service, July 2000) provides a survey of the literature and cites mostly studies that use a variant of lagged prices. Lin et al. use both lagged prices and futures markets to represent expectations.

[61] Exhibit Bra-381 (Jeffrey D. McDonald and Daniel A. Sumner. "The Influence of Commodity Programmes on Acreage Response to Market Price: With an Illustration concerning Rice Policy in the United States." *American Journal of Agricultural Economics*, (85) 4 (November 2003): 857-871).

*conservative*. This is, because, as a matter of statistical theory, the more precise the proxy for expected price or revenue, the larger the coefficient of supply response. For example, in regression estimations, when an explanatory variable is measured with error, the regression coefficient tends to be biased toward zero, thus undercounting the significance of the variable. When there is less error in measurement (*i.e.*, the imperfectly measured proxy variable becomes more accurate) the regression coefficient tends to be larger.[62] In the present context, this means that if futures market prices were better proxies for farmers' expectations, the estimated coefficient of the price or revenue effect on acreage (the acreage response elasticity) would be larger. It follows that the estimated acreage response elasticity would be too low in the FAPRI model. US acreage would respond stronger to changes in relative cotton revenue than estimated in the FAPRI models. In the context of the Professor Sumner's simulation analysis, that would mean larger US supply response to expected price and revenue changes, and thus higher supply and export response to government programme benefits. In sum, Professor Sumner's results, which are based on FAPRI elasticity estimates, would not be wrong, but would underestimate the amount of additional acreage, production and exports from US policy incentives.

## III. Domestic Support

**214. Please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? USA**

**215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA**

Brazil's Answer:

43. It is correct that the CCP payments cease when average US farm prices for the marketing year received by US farmers rise above 65.73 cents per pound. But this has only happened four times since the 1930s and the last time was seven years ago in MY 1996. In MY 2002, the average price received by US farmers was 40.50 cents per pound.[63] Through November 2003, MY 2003 average price received by US farmers was 58.5 cents per pound.[64] Indeed, the first CCP payment has been made for MY 2003.[65]

44. The impact of the direct payments has been analyzed and quantified by Professor Sumner who found, using the FAPRI November 2002 baseline, that in MY 2002 direct payments added 120,000 acres to US upland cotton production.[66]

45. Even in the highly unlikely event that expected US farm prices were to exceed the CCP target price of 72.4 cents per pound for MY 2004[67] (prices that have occurred only twice in the past 75 years), direct payments would still be made and US producers would still require direct payments

[62] *See e.g.* William H. Green, Econometric Analysis, 5th edition, 2002, Prentice Hall or any standard textbook on regression analysis.

[63] Exhibit Bra-202 (Agricultural Outlook Tables, USDA, August 2003, p. 5).

[64] Exhibit Bra-382 (Cotton and Wool Outlook, USDA, 12 December 2003, Table 6) for September to November 2003 and Exhibit Bra-328 (Cotton and Wool Outlook, USDA, 14 October 2003, Table 6) for August 2003.

[65] Exhibit Bra-340 ("USDA Announces First Partial 2003-Crop Counter-Cyclical Payments," USDA Press Release, 17 October 2003).

[66] Brazil's 9 September Further Submission, Annex I, Table I.5a.

[67] US farm prices have exceeded 72.4 cents per pound only twice in 75 years – in MY 1995 and in MY 1980. Exhibit Bra-4 ("Fact Sheet Upland Cotton," USDA, January 2003, p. 5).

to cover the total cost of current production. These payments, like the other payments in the package of cotton subsidies, are essential to maintain past, current, and future high levels of US upland cotton production.[68] Thus, they must be taken into account in assessing the production-distorting effects they caused in MY 2002 as well as today in MY 2003.

46. Brazil recalls that even if futures price were to indicate that US farm prices will be at or somewhat above the target price, the programme has a significant impact on planting decisions. At planting time, the producer still is unsure on whether or not the target price will be met during the following marketing year. Given the considerable price fluctuations and the low prices in the MY 1997-2002 period, there is a significant risk that actual prices will be lower than the futures market predicts. The direct and counter-cyclical payments remove the risks of lower prices. The evidence of a long-term lack of any significant US acreage response to higher or lower prices since MY 1996 demonstrates that US producers have and will continue to plant upland cotton because they face no downside revenue risk. Professor Sumner outlined this effect when he responded to a similar question by the Panel at the second meeting with the parties.[69] This reinforces the argument that the Panel cannot disregard these payments in the scenario described in the question.

**216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. BRA, USA**

Brazil's Answer:

47. Under the deficiency payment programme as provided by the 1985 and 1990 Farm Acts, farmers were offered the option to update the amount of acreage participating in the programme each year. To do this, they were required to opt *out* of the programme and receive no payments during the period in which they increased the amount of acreage planted to the programme crop. Relatively few upland cotton farmers took advantage of this programme feature because the costs of forgoing payments in the current year generally outweighed the present value of benefits of higher base acres and base yield in the future.

48. In the 1996 FAIR Act, farmers established their production flexibility base acreage by carrying over the would-be deficiency payment base acreage. For example, any producers of upland cotton during the period MY 1991-1995 were entitled to place such acreage into the PFC programme along with any acreage that had been in the conservation programme and was released from that programme in MY 1996.[70] Unlike the 1985 and 1990 Farm Acts, the 1996 FAIR Act did not authorize any acreage or yield updates by individual farmers during later years. In the 1996 FAIR Act, Congress essentially told farmers they should take advantage of planting flexibility and that planting alternative crops would not affect the amount of their payments. However, several years after 1996, as commodity prices began to decline, momentum for an update in the next farm act began to build. Many upland cotton farmers and others argued that their historical acreage and yields no longer reflected the reality of their current production and that they needed additional payments on their increased programme crop acreage. These upland cotton and other programme crop growers

[68] Brazil's 18 November Further Rebuttal Submission, para. 26 citing, *inter alia*, the National Cotton Council.

[69] Exhibit Bra-371 (Simple Example of the Calculations of Marketing Lon Benefits (Probability Distribution).

[70] Any such former deficiency payment base being released from the conservation programme could be added to the PFC base once the land left the conservation programme.

including wheat, feed grains, and rice pressured Congress to include updating of acreage and yield bases in the 2002 Farm Bill.[71]

49. The 2002 FSRI Act provided for the opportunity for all farmers to update their base acreage for purposes of the direct payment programme and to update their base acreage and base yields for purposes of the counter-cyclical payment programme. They could do this without having to temporarily opt out of the programmes, which they needed to do under the deficiency payments programme. The 2002 update and the individual deficiency payment updates during 1985-1995 established the principle that acreage and yield base updates are a part of the farm policy in the United States. Even though no updates are explicitly provided for during the lifespan of the 2002 FSRI Act, farmers may reasonably expect future updates, either as a part of ad hoc legislation or as a part of the regularly scheduled new law in 2007.

50. The pressure for updates will come especially from farmers who were not in a position to take advantage of the 2002 update having switched away from higher per-acre payment crops like upland cotton or rice. For example, farmers who had planted less than their full upland cotton base to upland cotton in the MY 1998 to 2001 period would likely have found the acreage update unattractive. But, since the yield update was only available to farmers who updated acreage, these farmers also missed the opportunities to update yields. These farmers expressed deep disappointment in 2002 that they had used planting flexibility, only to find that they were penalized by not being allowed to update payment yields. These farmers saw the update of 2002 by farmers who had stayed in upland cotton production during MY 1998-2001 as unfair and look to have this redressed in the next revision of the programmes. Many of those (non-updating) farmers are now planting their full upland cotton base (or more) and are maintaining high and expanding inputs to expand their yields in order to be in a position to take advantage of an anticipated base update at the next opportunity. These farmers will add to the political pressure to update base in 2007, if not before.

**217. What is the reason for reducing payments under the PFC and direct payments programmes for planting and harvesting fruit, vegetables and wild rice on certain base acreage? Please comment on the statements by the European Communities that "the reduction in payment for fruit and vegetables, if the EC understands correctly, is in fact designed to avoid unfair competition within the subsidising Member." (EC oral statement at first session, first substantive meeting, paragraph 29) and "To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition (…)" (EC response to Panel third party Question No. 5). USA**

**218. Please comment on the testimony of USDA Chief Economist Keith Collins cited in paragraph 36 of Brazil's oral statement regarding the trade-distorting and production-distorting nature of the marketing loan payments. USA**

## IV. Export Credit Guarantees

**219. Under the *Agreement on Agriculture* the general position is that the use of export subsidies, both those listed in Article 9.1 as well as those within the scope of Article 1(e) which are not so listed, may only be used within the limits of the product specific reduction commitments specified in Part IV of Members' Schedules. One might therefore have expected that Article 3.3 of the *Agreement on Agriculture* would have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, would have simply prohibited the use of any export subsidy. Instead, the Article 3.3 prohibition is limited in both cases to export**

[71] *See e.g.* Exhibit Bra-41 (Congressional Hearing, "The Future of Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, p. 4, and 24).

**subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:**

**(a) the fact that export performance-related tax incentives, which like subsidised export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held (for example, in *United States – Tax Treatment for Foreign Sales Corporations*, WT/DS108) to be subject to the anti-circumvention provisions of Article 10.1; and**

**(b) the treatment of international food aid and non-commercial transactions under Article 10? USA**

**220. What will be the relevance of Articles 9 and 10.1 of the *Agreement of Agriculture* to export credit guarantees when disciplines are internationally agreed? BRA**

Brazil's Answer:

51. The relevance of Articles 9 and 10.1 of the Agreement on Agriculture following the conclusion of the negotiations called for by Article 10.2 of the Agreement necessarily depends on the commitments that are negotiated. Brazil does not know what the outcome of the negotiations will be, or what commitments, if any, parties will undertake. Nor does Brazil know in what way those commitments would be brought into the WTO – automatically, *via* the cross-reference in Article 10.2, or instead *via* amendments to the Agreement on Agriculture or the SCM Agreement, or yet some other means. The nature of the disciplines negotiated and the way in which those disciplines are transposed into the WTO will dictate the effect they will have on Articles 9 and 10.1. With these important reservations about the purely hypothetical nature of this exercise, Brazil will explore a number of possible outcomes and the impact those outcomes would have on Articles 9 and 10.1.

52. One possible outcome is that negotiators will reach agreement on other types of export credits, but that export credit guarantees will not be included. In Brazil's view, this would mean that export credit guarantees would continue not to be among those *per se* export subsidies listed in Article 9.1, and would continue to be subject to Article 10.1, to the extent that they constitute export subsidies and circumvent (or threaten to circumvent) a Member's export subsidy commitments.

53. Another possible outcome is an amendment to Article 9.1 that would add export credit guarantees (or possibly those export credit guarantees issued or programmes maintained on particular terms or conditions) to the list of *per se* export subsidies. Article 10.1 would no longer be applicable, since export credit guarantees would no longer be "[e]xport subsidies not listed in paragraph 1 of Article 9 … ."

54. Yet another possible outcome is agreement to subject export credit guarantees to the same type of notification, consultation and information exchange disciplines agreed in the OECD Arrangement on Officially Supported Export Credits for industrial products ("OECD Arrangement").[72] For example, the OECD Arrangement includes provisions regarding: prior notification of derogations, permitted exceptions, matching of derogations, permitted exceptions, non-conforming non-notified terms, and terms granted by countries that are not parties to the OECD Arrangement. The United States now characterizes such disciplines as "pedestrian."[73] In *Canada – Aircraft II*, however, the United States characterized these provisions and the disciplines they

[72] *See* OECD Arrangement on Guidelines for Officially Supported Export Credits, Chapter IV (Sections 1-5) available at http://www.oecd.org/dataoecd/52/3/2763846.pdf.

[73] US 3 December Closing Statement, para. 3.

provided as central to the "entire logic" of the OECD Arrangement, and as a critical way to prevent "a subsidy 'race to the bottom.'"[74]

55. Under this outcome, export credit guarantees would continue not to be among those *per se* export subsidies listed in Article 9.1, and would continue to be subject to Article 10.1, to the extent that they constitute export subsidies and circumvent (or threaten to circumvent) a Member's export subsidy commitments. Under WTO jurisprudence, the provisions regarding notification, consultation and information exchange would be read cumulatively with Article 10.1, since the obligations imposed would not be mutually exclusive or mutually inconsistent.[75]

56. Another possible outcome would be agreement on alternative benchmarks against which to determine whether export credit guarantees and export credit guarantee programmes would constitute export subsidies. In determining what constitutes an "export subsidy" within the meaning of Article 10.1, the Appellate Body's decisions in *US – FSC*[76] and *Canada – Dairy*[77] currently direct the Panel to refer to contextual guidance included in Articles 1 and 3 of the SCM Agreement and in item (j).[78] Were agreement one day reached on alternative benchmarks following negotiations pursuant to Article 10.2, that agreement might provide relevant context for a panel to determine what constitutes an "export subsidy" for the purposes of Article 10.1. Alternatively, it might serve as "subsequent practice," pursuant to Article 31(3)(b) of the Vienna Convention on the Law of Treaties, indicating the interpretation of the term "export subsidy" that the Members intend for the purposes of Article 10.1.[79]

57. Under this outcome, export credit guarantees would continue not to be among those *per se* export subsidies listed in Article 9.1. Moreover, they would continue to be subject to Article 10.1, to the extent that they constitute export subsidies, and to the extent that they circumvent (or threaten to circumvent) a Member's export subsidy commitments. The difference would be that the interpretation of the term "export subsidy" might be based, among other things, on the context or evidence of "subsequent practice" offered by the newly-negotiated alternative benchmark.

**221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be $230,127,023 instead of the figure which originally appeared ($381,345,059).**

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[74] Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2, paras. 12-13 (Third Party Submission of the United States, 22 June 2001).

[75] *See e.g.* Appellate Body Report, *Guatemala –Cement*, WT/DS60/AB/R, paras. 66, 73-74; Panel Report, *Indonesia – Automobiles*, WT/DS54, para. 14.28.

[76] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 136-140.

[77] Appellate Body Report, *Canada – Dairy*, WT/DS103/AB/R and WT/DS113/AB/R, para. 87-90.

[78] *See* Brazil's 24 June First Submission, paras. 258-261.

[79] The extent to which alternative benchmarks agreed pursuant to negotiations under Article 10.2 qualify as relevant context for or as "subsequent practice" regarding the interpretation of the term "export subsidy" in Article 10.1 will depend, in part, on the form the agreement takes. If agreement is reached among only the 10 WTO Members that participated in OECD discussions on agricultural export credit disciplines, it will be difficult to argue that the agreement serves as relevant context for interpretation of Article 10.1, which is applicable to 146 Members. Nor would such an agreement constitute evidence of "subsequent practice." *See* Appellate Body Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/AB/R, para. 213 (defining "subsequent practice" as "a 'concordant, common and consistent' sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties [to a treaty] regarding its interpretation."). *See also* Appellate Body Report, *Japan – Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 12-17.

**(a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.**

**(b) Please clarify whether and how the Panel should treat the figures in Exhibit BRA-182 for the net lifetime re-estimates for each respective cohort.**

**(c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of $4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately $4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result.**

Brazil's Comment:

58. With respect to the $4 million of administrative expenses for the CCC guarantee programmes, Brazil draws the Panel's attention to Congressional testimony by the administrator of the programmes, General Sales Manager Christopher Goldthwait. This testimony is included on pages 20-21 of Exhibit Bra-87. Mr. Goldthwait's testimony clarifies that premiums charged by the CCC are sufficient to cover these administrative expenses, but not other costs and losses of the programmes.

59. A member of Congress posed the following question to Mr. Goldthwait and August Schumacher, USDA's Under Secretary for Farm and Foreign Agricultural Services:

> Is [the GSM] programme operated at essentially no net costs to the US Government? By that what I mean putting to one side the Iraq and the Poland experiences which you outlined earlier in your response to questions, do we charge fees that reflect the cost of administering the programme *and the risk that is involved, the default, things such as that*, or is this a programme which is subsidized at a fairly significant level by the Federal Government? (emphasis added)

Mr. Goldthwait's response was as follows:

> Yes. The programme is *from the administrative standpoint* at least pretty much self-financing. We do collect fees. The fee structure is relatively modest. We keep the fees low because the legislation has limited us to no more than 1 per cent. But, nonetheless, we collect several million dollars a year in fees, *and that enables us to say that effectively the administrative cost of running the programme are more than covered*. Now, that money does not come directly to us at the USDA, it goes to the general Treasury account, but the amount of the money is more than *enough to cover the administrative costs of the programme*. (emphasis added)

60. Thus, although the question asked whether fees covered "the cost of administering the programme *and* the risk that is involved, the default, things such as that," Mr. Goldthwait, the administrator of the CCC guarantee programmes, responded that fees "at least pretty much" covered only "the administrative cost of running the programme." Mr. Goldthwait could not state that the fees collected also cover "the risk that is involved, the default, things such as that," since, as Brazil has established, fees for the CCC guarantee programmes are not set to (see comment to question 223) and in fact do not cover those risks and defaults.

**(d) Please identify what is considered an "administrative expense" for this purpose.**

**(e) The Panel notes the US statement in paragraph 160 of its answers to Panel questions following the first meeting that all cohorts are still open although the 1994 and 1995 cohorts will close this year. Is this still an accurate statement? If not, please indicate whether any cohorts have since "closed" for the period 1992-2002.**

**(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily* reach a "profitable" result (for example, the 1994 cohort, which has almost closed still indicates an outstanding amount)? Do "re-estimates" reflect also expectations about a cohort's future performance?**

Brazil's Comment:

61. Brazil reserves the right to comment on the US response, but would like to provide a preliminary comment on the last part of the Panel's question. To a certain extent, reestimates do reflect expectations about a cohort's future performance. Agencies are to undertake two types of reestimates – interest rate and technical reestimates. The Office of Management and Budget ("OMB") defines these two types of reestimates in the following way:

> Two different types of reestimates are made:
>
> - Interest rate reestimates, for differences between interest rate assumptions at the time of formulation (the same assumption is used at the time of obligation or commitment) and the actual interest rate(s) for the year(s) of disbursement; and
>
> - Technical reestimates, for changes in technical assumptions.[80]

62. One purpose of technical reestimates is "to adjust the subsidy estimate for . . . new forecasts about future economic conditions, and other events and improvements in the methods used to estimate future cash flows."[81] The OMB also states that one purpose of technical reestimates is to record "changes in assumptions about future cash flows."[82]

**(g) Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?**

**(h) Why should the Panel "eliminate", in addition, the 2000 cohort, as also suggested in paragraph 198 of the US further rebuttal submission for which information is presumably more "complete"?**

**(i) Under the US approach, at what point in time could a Panel ever make an assessment of the programme, if it had to wait for each cohort to be completed before it could be "properly" assessed? Why is it inappropriate for the Panel to**

[80] Exhibit Bra-116 (OMB Circular A-11, p. 185-15).
[81] Exhibit Bra-116 (OMB Circular A-11, p. 185-16).
[82] Exhibit Bra-163 ("Introduction to Federal Credit Budgeting," OMB Annual Training, 24 June 2002, White House Conference Center, p. 32).

**include these "most recent years" in its evaluation, as the US suggests in paragraph 199 of its 18 November further rebuttal submission? USA**

**222. For GSM 102, 103 and SCGP, please provide year-by-year amounts from 1992 to 2003 with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes. Please indicate any allocation methodologies used to calculate administrative costs. USA**

**223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? USA**

Brazil's Comment:

63. Brazil reserves the right to comment on the US response, but would like to provide a preliminary comment on the first part of the Panel's question. First, Brazil notes that premium rates for the three CCC guarantee programmes are not subject to regular review. In audit reports of the CCC's fiscal year 2000 and 2001 financial statements, USDA's Office of the Inspector General confirmed that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed in 7 years and may not be reflecting current costs."[83] Two changes have been made, in the fee schedule for GSM 102, since November 1994: (i) for a 12-month guarantee with semi-annual repayment intervals, the fee was changed from $0.209 per $100 of coverage to $0.229 per $100 of coverage; and (ii) borrowers are now offered the additional option of 30- and 60-day guarantees, at the same fee charged for 90-day and 4-, 6- and 7-month guarantees.[84]

64. Moreover, the US General Accounting Office ("GAO") analyzed CCC's failure to charge guarantee fees that take account of country risk or the creditworthiness of individual borrowers. The GAO emphasized that CCC's failure to do so means that it lacks the flexibility to cover the costs and losses of the programmes:

> Although GSM-102 recipient countries vary significantly from one another in terms of their risk of defaulting on GSM-102 loans, CCC does not adjust the fee that it charges for credit guarantees to take account of country risk. CCC fees are based upon the length of the credit period and the number of principal payments to be made. For example, for a 3-year GSM-102 loan with semiannual principal payments, CCC charges a fee of 55.6 cents per $100, or 0.56 per cent of the covered amount. For 3-year loans with annual principal payments, the fee is 66.3 cents per $100.[ ] CCC fees that included a risk-based component might not cover all of the country risk, but they could help to offset the cost of loan defaults.[85]

[83] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31). *See also* Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programmes have not been changed for many years and may not be reflecting current costs.").

[84] Brazil's 11 August Answers to Questions, para. 167 (first bullet point).

[85] Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 135-136).

As noted above, CCC fees for GSM 102 have not changed materially since the GAO published its report in 1995.[86] Moreover, the United States confirmed in its 11 August Answer to Question 84 (at paragraph 180) that US law prohibits CCC from charging fees in excess of one per cent of the guaranteed dollar value of the transaction.

65. With respect to the second part of the Panel's question, Brazil has demonstrated that forfaits and export credit insurance are not similar financial instruments to CCC export credit guarantees, and therefore that the terms for forfaits and export credit insurance cannot serve as benchmarks against which to determine whether CCC export credit guarantees confer "benefits."[87] Moreover, Brazil has demonstrated that in any event, fees for forfaiting instruments are well above fees for CCC export credit guarantees.[88]

66. Although government support from the US Export-Import Bank does not constitute a market benchmark for the purposes of determining "benefit," Brazil has offered evidence that premiums for CCC guarantees are considerably lower that fees for Ex-Im Bank guarantees.[89] This demonstrates that the terms for CCC guarantees do not even meet *non-market* benchmarks. As noted by the GAO:

> The US Export-Import Bank, which provides credit guarantees to promote a variety of US exports, uses risk-based fees to defray the cost of defaults on its portfolio. Under its system, each borrower/guarantor is rated in one of eight country risk categories. Exposure fees vary based on both the level of assessed risk and the length of time provided for repayment. For example, in the case of repayment over 3 years, a country rated in the lowest risk category is charged a fee of 75 cents per $100, whereas a country in the highest risk category is charged a fee of $5.70 per $100 of coverage. Thus, the bank's fee structure includes a substantial added charge for high country risk. According to the bank, its system is designed to remain as competitive as possible with fees charged by official export credit agencies of other countries.
>
> Under section 211(b)(1)(b) of the 1990 Farm Bill, CCC is currently restricted from charging an origination fee for any GSM-102 credit guarantee in excess of an amount equal to 1 per cent of the amount of credit extended under the transaction.[90] This restriction was initially enacted in 1985 following proposed administration legislation to charge a 5-per cent user fee for exports backed with credit guarantees. Some Members of Congress were concerned that such a fee would adversely affect the competitiveness of GSM-102 exports. Under the 1-per cent restriction, CCC would be considerably limited in the size of the fee that it could charge to take account of country risk should it decide to do so. For example, as previously noted, CCC charges 0.56 per cent for a loan payable in 3 years and with principal payments due annually. The most it could increase the fee would be 0.44 per cent. In contrast, the Export-Import Bank currently charges fees as high as 5.7 per cent for 3-year loans.[91]

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[86] Brazil's 11 August Answer to Question 77 and 84, para. 167, 193-194.

[87] Brazil's 22 August Rebuttal Submission, paras. 103-105; Brazil's 27 August Comments on US Rebuttal Submission, paras. 68-70; Brazil's 7 October Oral Statement, para. 72; Brazil's 18 November Further Rebuttal Submission, paras. 233-241; Brazil's 2 December Oral Statement, para. 79.

[88] Brazil's 27 August Comments on US Rebuttal Submission, paras. 76-77 and Exhibit Bra-199 (Trade and Forfaiting Review, "Argentina Trade Finance to the Rescue," Volume 6, Issue 9 July/August 2003).

[89] Brazil's 27 August Comments on US Answers, para. 110.

[90] The United States confirmed in paragraphs 179-180 of its 11 August Answer that this remains the case.

[91] Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 135-136).

**224. Please indicate how the CCC's cost of borrowing was treated in the 2002 financial statement of the CCC, in Exhibit BRA 158. USA**

**225. Please indicate whether there was any instance where the CCC "wrote off" debt and, if so, please indicate the accounting regulation or principle used. If a "written off" debt is subsequently recovered, do the CCC's accounts reflect both the interest cost and interest received in relation to the debt during the time it was "written off"? USA**

**226. If a debt was "written off" more than ten years ago, does it still create a cost to the programme? If so, how is this reflected in the 2002 financial statement of the CCC, in Exhibit BRA 158 (or any other material)? USA**

**227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount – referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? USA**

Brazil's Comment:

67. On page 4 of the notes to the CCC 2002 financial statements, CCC defines the term "Credit Guarantee Liability" as follows:

> Credit guarantee liabilities represent the estimated net cash outflows (loss) of the guarantees on a net present value basis. To this effect, CCC records a liability and charges an expense to the extent, in management's estimate, CCC will be unable to recover claim payments under the post-Credit Reform Export Credit Guarantee programmes.[92]

Thus, Brazil stands by its characterization of the $411 million figure as a cumulative running tally of the losses for the programmes during the period 1992-2002, and as one way of demonstrating that the CCC guarantee programmes meet the elements of item (j).

**228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? BRA, USA**

Brazil's Answer:

68. Item (j), interpreted according to its ordinary meaning, in its context and according to the object and purpose of the SCM and Agriculture Agreements, does not require that the Panel use any particular accounting principles to assess long-term operating costs and losses. Similarly, under item (j), it is not *incumbent* on the Panel to conduct its analysis in accordance with US government accounting principles, whether or not those principles adhere to GAAP. (A Panel may, however, consider it particularly persuasive that the US government' own accounting principles lead to a conclusion that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes.) Nor is it necessary, at this stage of dispute settlement proceedings, for

[92] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 4)).

the Panel to arrive at a determination of the precise amount by which operating costs and losses incurred by the CCC guarantee programmes outpace premiums collected.

69. For these reasons, Brazil has offered a number of different methodologies and sets of evidence that the Panel can use to determine whether premium rates are adequate to meet the long-term operating costs and losses of the CCC guarantee programmes. Each of those methodologies or sets of evidence demonstrates that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes.

70. One methodology is the present value accounting endorsed by the US Congress and the President in the Federal Credit Reform Act ("FCRA"). The FCRA has been translated into accounting standards for US government loan guarantees by the Federal Accounting Standards Advisory Board ("FASAB"). Consistent with the FCRA, the FASAB accounting standards state that "[f]or guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability."[93] The FASAB standards (and the FCRA) state that "[t]he amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term applicable to the period during which the loans are disbursed."[94]

71. As one way to determine whether the long-term operating costs and losses of the programmes outpace premiums collected, Brazil has used the net subsidy expense (including reestimates) calculated using the FCRA and FASAB standards over the period 1992-2002.[95] The CCC has itself adopted this methodology in its 2002 financial statements, when it lists a net subsidy expense of $411 million for all post-1991 CCC guarantees.[96] Using present value accounting, CCC's 2002 financial statements also track enormous uncollectible amounts on pre-1992 and post-1991 guarantees that far outpace premiums collected for the programmes – by $2.3 billion on pre-1992 guarantees, and by $550 million on post-1991 guarantees.[97]

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[93] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, "Statement of Federal Financial Accounting Standards No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees" in STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 2, March 2001, p. 13 (para. 23)).

[94] Exhibit Bra-118 (Federal Accounting Standards Advisory Board, "Statement of Federal Financial Accounting Standards No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees" in STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 2, March 2001, pgs. 13-14 (para. 24)).

[95] Exhibit Bra-193.

[96] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 19).

[97] *See* Brazil's 11 August Answers to Questions, para. 167 (third and fourth bullet points); Brazil's 18 November Further Rebuttal Submission, para. 250; Notes to Financial Statements contained in Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2002, Audit Report No 06401-15-FM (December 2002), pg. 14). Contrary to the United States' assertion at paragraph 170 of its 22 August Rebuttal Submission, for post-1991 CCC guarantees, the amounts in the "subsidy allowance" column are actually the amounts of receivables associated with post-1991 CCC guarantees that CCC considers uncollectible. Under the FCRA – and as confirmed above in the quote from page 4 of the CCC 2002 financial statements – the subsidy allowance is recorded on a net present value basis, which means that it represents the cost CCC considers it will incur on a guarantee cohort *at the time that cohort is closed*. The amount listed in the "subsidy allowance" column in the receivables table of CCC's 2002 financial statements for post-1991 guarantees is therefore as uncollectible as the amount listed in the "uncollectible" column of the pre-1992 CCC guarantee receivables table.

72. The Panel asks whether, if US government regulations require costs to be treated differently than they would be under generally accepted accounting principles, the Panel must conduct its analysis in accordance with that treatment. As Brazil has already noted, nothing in item (j) would require the Panel to do so. However, Brazil notes that in its 2002 financial statements, the CCC, which relies on present value accounting, states that "[t]he accounting principles and standards applied in preparing the financial statements and described in this note are in accordance with Generally Accepted Accounting Principles (GAAP) for Federal entities."[98]

73. In this dispute, the United States objects to the use of present value accounting to determine the costs of the CCC guarantee programmes, because present value accounting entails the use of "estimates."[99] Apart from the fact that the FCRA does not in fact rely on "estimates" to the extent suggested by the United States,[100] Brazil also notes that in other contexts, the US government is comfortable with this inherent aspect of present value accounting for loan guarantees. Present value accounting has been endorsed by the US Congress and the President in the FCRA, as well as by the FASAB, the Office of Management and Budget,[101] and the General Accounting Office,[102] to name a few. Finally, Brazil notes that the United States is comfortable with the Panel relying on present value accounting and *some* estimated data, as long as the Panel limits itself to data suggesting that CCC guarantees issued in some, carefully-selected years did not lose money.[103] This is not an appropriate means of determining the performance of the "programmes," as is required by item (j).

74. Other methodologies and means of accounting for CCC's long-term operating costs and losses confirm the result reached using present value accounting. First, Brazil has constructed a methodology using actual data on income, costs and losses, which shows net losses for the CCC guarantee programmes of $1.1 billion.[104] Second, defaults of more than $4 billion on CCC guarantees for exports to Iraq and Poland alone similarly demonstrate costs and losses far in excess of total CCC premiums collected.[105] Third, a methodology adopted by the US General Accounting Office concluded that if GSM 102 and GSM 103 continued until 2007, costs would reach $7.6 billion, which exceeds maximum premiums collected by nearly $7.3 billion.[106]

75. In conclusion, item (j) does not require that the Panel use any particular accounting principles in assessing long-term operating costs and losses. Brazil has offered the Panel a number of different methodologies based on a variety of accounting principles. Each methodology confirms that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes.

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[98] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 1).

[99] US 11 August Answers to Questions, paras. 157-161, 162-163, 169-172, 173; US 22 August Rebuttal Submission, para. 162; US 18 November Further Rebuttal Submission, para. 196.

[100] Brazil's 22 August Rebuttal Submission, para. 113; Brazil's 11 August Answers to Questions, paras. 180-181.

[101] Exhibit Bra-116 (OMB Circular A-11) and Exhibit Bra-163 (Office of Management and Budget Annual Training, Introduction to Federal Credit Budgeting, 24 June 2002).

[102] Exhibit Bra-120 (GAO, Report to the Director, Office of Management and Budget, "Credit Reform: Review of OMB's Credit Subsidy Model," GAO/AIMD-97-145, August 1997, p. 3-5).

[103] US 18 November Further Rebuttal Submission, paras. 196-198.

[104] Brazil's 11 August Answers to Questions, paras. 158-166 (including chart at para. 165). Brazil's all-inclusive formula can be stated as follows: (Premiums collected + Recovered principal and interest (Line 88.40) + Interest revenue (Line 88.25)) – (Administrative expenses (Line 00.09) + Default claims (Line 00.01) + Interest expense (Line 00.02)).

[105] *See* Brazil's 11 August Answers to Questions, para. 167 (second bullet point and note 226); Brazil's 18 November Further Rebuttal Submission, para. 251.

[106] *See* calculation included at Brazil's 11 August Answers to Questions, para. 167.

## V. Serious Prejudice

**229. What is the meaning of the words "may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the *SCM Agreement*? Please comment on the possibility that these words indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice and that serious prejudice should be considered an additional or overriding criterion to the factors specified in the subparagraphs. BRA**

Brazil's Answer:

76. The phrase "*one or several*" must be interpreted in its ordinary meaning. This phrase means that the conditional clause "may arise" is satisfied when *one* of the following applies or when *more than one* of the following apply. The phrase "*one or several*" is equivalent to: "*at least one*." Such a trigger is not conditioned on any other clause. In fact, this is stressed by the words "in any case" just before the phrase *where one or several*. Therefore, serious prejudice may be shown *in any case* where *at least one* of the subparagraphs of Article 6.3 applies.

77. Brazil disagrees with the possibility that the words *one or several* indicate that one of the Article 6.3 subparagraphs may not be sufficient to establish serious prejudice. Had negotiators felt that this should be the case, they certainly would have found a way to say so. This was the case, for example, in Articles 3.2 and 3.4 of the Anti-Dumping Agreement, where after the enumeration of relevant factors, the text states that no "… one or several of these factors" can "give decisive guidance." Identical language is found in the SCM Agreement itself. Article 15.4 *in fine* reads "… nor can one or several of these factors necessarily give decisive guidance." In SCM Article 15.7 negotiators were even more explicit, affirming that "[n]o one of these factors by itself can necessarily give decisive guidance but the totality of the factors considered must lead to the conclusion that … ."

78. The provisions of the Anti-Dumping and SCM Agreement cited above relate to situations where a number of factors could lead to a determination of injury. Article 6.3 of the SCM Agreement is meant to address a similar situation: a list of factors could lead to a determination of serious injury. However, in stark contrast with Articles 3.2 and 3.4 of the Anti-Dumping Agreement and Articles 15.4 and 15.7 of the SCM Agreement, negotiators chose not to include reference to the possibility that, in Article 6.3, "the words *one or several* indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice." To find so, the Panel would need to read into Article 6.3 the words found in Articles 3.2 and 3.4 of the Anti-Dumping Agreement and Articles 15.4 and 15.7 of the SCM Agreement. The Appellate Body has made clear that panels must not read into a text words that are not there.

79. The phrase "may arise in any case where one or several of the following apply" recognizes that effects of subsidies constituting serious prejudice under one of the identified paragraphs of Article 6.3 may *also* constitute serious prejudice under another of the identified paragraphs of Article 6.3. This case is a good example. US cotton subsidies have both increased the US world market share under Article 6.3(d) as well as suppressed world market prices and prices in third country markets under Article 6.3(c). But the existence of "serious prejudice" in this or other cases does not depend upon whether the effects of the subsidies cause one or four different types of serious prejudice.

80. In its context within Article 6, the phrase "may arise in any case where one or several of the following apply" is necessary because while the facts may demonstrate that the effects of the subsidies *may* create the one, two, three or four enumerated types of serious prejudice, these effects may not be *actionable.* For example, under Article 6.3(d), there may be an increase in the world market share for a commodity product. But it "may" not be actionable because there are specific multilaterally agreed rules for that commodity, within the meaning of footnote 17. Further,

Article 6.7 of the SCM Agreement creates exemptions from serious prejudice findings even if the requirements of Article 6.3 would be fulfilled. These situations include export prohibitions by the complaining Member, *force majeure*, arrangements that limit exports, or the failure to conform to standards and regulatory requirements. Article 6.9 of the SCM Agreement covers another situation in which the "may" language would be applicable. It exempts serious prejudice that exists even where the requirements of Article 6.3 are fulfilled because the subsidies are exempt from action by virtue of the peace clause of Article 13 of the Agreement on Agriculture.

**230. Please comment on Brazil's views on Article 6.3 of the *SCM Agreement* as stated in paragraphs 92-94 of its further submission. USA**

**231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the *SCM Agreement* are relevant context for the Panel's interpretation of Article 6.3? USA**

**232. How, if at all, should the Panel take into account the effects of other factors in its analysis of the effects of US subsidies under Article 6.3? If the Panel should compare the effects of other factors to establish the relative significance of one compared to others, how would this be done? What would be relevant "factors" for this purpose? BRA**

Brazil's Answer:

81. Brazil divides its response to this question into two parts. First, Brazil will discuss Article 6.3(c), and, second, Brazil will discuss Article 6.3(d).

82. Concerning Article 6.3(c), the Panel can and should, to the extent it is relevant to do so, take into account the effects of non-subsidy related factors in its analysis of the price-suppressing effects of US subsidies. The only "other factors" identified by the United States include demand-related factors the United States claims contributed to lower cotton prices in MY 1999-2002 including weak cotton demand, flat retail consumption, falling world incomes, increasing US textile imports, and China's releasing of stocks.[107] The United States further claimed that US production-related factors accounted for increased US production including boll weevil eradication, higher yielding GMO cotton, and lower prices of alternative crops.[108]

83. Brazil addressed all of these "other" factors in earlier submissions and demonstrated that while some of the so-called other factors no doubt influenced prices, many of them either were factually incorrect (*i.e.*, not "other factors") or could not have had the effect claimed by the United States.[109] Brazil further demonstrated that Professor Sumner's analysis took account of all the "other" factors identified by the United States. Professor Sumner stated:

> The baseline is calibrated to reproduce the acreage, production, exports, prices and other variables that actually applied between the marketing years 1999-2001, the period over which data was available at the time the baseline was developed. *By calibrating the baseline to actual data for the recent past, the model incorporates all the factors that have determined the situation of the cotton market during this period.*
>
> The United States has highlighted some of these factors. In their Further Submission they discuss developments in the synthetic fiber market, such as prices of polyester; Chinese stock releases, exchange rate movements, global and US macroeconomic

[107] US 30 September Further Submission, paras. 22-44.
[108] US 30 September Further Submission, paras. 45-70.
[109] Brazil's 7 October Oral Statement, paras. 18-28; Exhibit Bra-279 (Statement of Professor Sumner – 7 October 2003, paras. 13-14); Brazil's 27October Answers to Question 176, paras. 157-160.

> conditions, and technical changes in cotton production that reduce costs, such as boll weevil eradication and release of genetically modified cotton varieties. Remember, my model is calibrated to reproduce actual cotton market data for the historical period. *Hence, my model incorporates all these historical factors into the baseline from which I analyze the impact of removing cotton subsidies.*[110]

84. The econometric evidence presented by Brazil – including the studies by USDA economists Westcott and Price, Professor Sumner, and Professor Ray of the University of Tennessee, among others – separate out the effects of the US subsidies from the effects of all other supply and demand factors that impact on the upland cotton market. In effect, these studies are designed precisely to answer the question posed by the Panel. The results of these studies sift through the "other factors" to isolate for the effects of the US subsidies. Professor Sumner has conservatively estimated that A-Index prices would on average be 12.6 per cent or 6.5 cents per pound higher without the US subsidizing upland cotton production, use and exports. The other econometric simulation models find that cotton prices are suppressed to a significant degree regardless of whether other factors push upland cotton prices up or down.

85. It bears repeating that Brazil has not claimed in this dispute that the entire decline in upland cotton prices during MY 1999-2002 was due to the effects of US subsidies. Brazil's argument has been all along that *but for* the US subsidies upland cotton prices would be higher by a significant degree, whether prices rise or fall. Thus, for example, the fact that Chinese release of stocks may have lowered world prices in MY 2000-2001 to a certain extent is entirely consistent with Brazil's evidence and its proof. Brazil demonstrated that actual market prices in MY 1999-2002 would have been higher to a significant degree but for the US subsidies.

86. Thus, the Panel can and should take "other factors" into account. But the record shows that there is no legitimate basis to conclude that "other" supply and demand factors collectively (a) accounted for *all* of the declines in prices during the period of investigation or (b) meant that prices went as high as they would have even if no US subsidies had been provided.

87. Brazil's claim under Article 6.3(d) concerns the development of actual world market share data. This world market share is the result of several key factors including US subsidies, weather effects in many countries, and exchange rate effects. However, Brazil has demonstrated that the US subsidies were a major contributing factor behind the increase in the US world market share, which occurred even when prices were falling and the US dollar increased in value. Professor Sumner has conservatively estimated that without the US subsidies, US exports would be on average 41.2 per cent lower during MY 1999-2002.[111] The US upland cotton farmers' long-term cost of production gap between market revenue and total costs of $872 per acre for over 14.38 million acres during MY 1997-2002 (or $12.5 billion) fully supports Professor Sumner's analysis.[112]

88. It follows that the US world market share would be much lower absent the US subsidies. As an example, based on Exhibit Bra-302, Brazil has calculated out the effects of a 41.2 per cent decline in US exports as estimated by Professor Sumner for MY 2002.[113] In this example, US world market shares for MY 1999-2001 remain unchanged.[114] The results are as follows:

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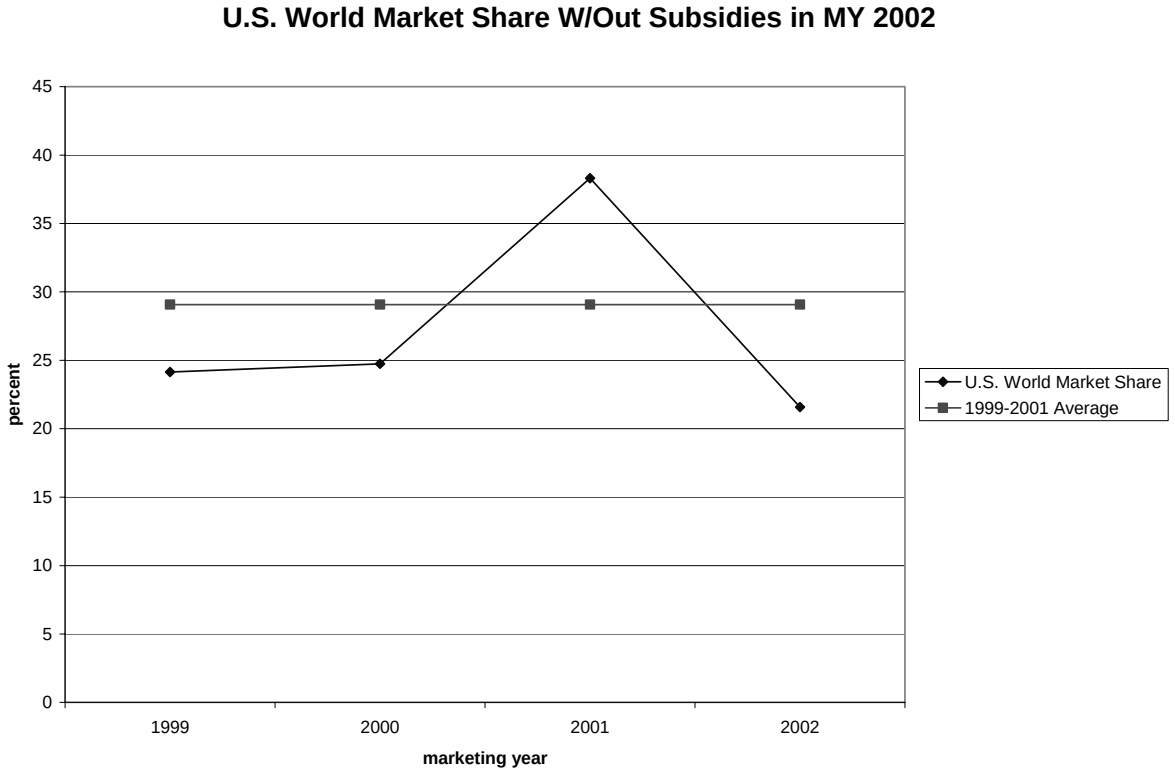
[110] Exhibit Bra-279 (Statement of Professor Sumner – 7 October 2003, paras. 13-14).

[111] Brazil's 9 September Further Submission, Annex I, Table I.5a.

[112] Brazil's 3 December Closing Statement, para. 13.

[113] This calculation assumes that total world trade would not be affected if US subsidies were not provided.

[114] Brazil emphasizes that also for these years there are strong export-enhancing effects of the US subsidies, but has assumed for this exercise that they had no effects on US world market share.




89. This graph shows that in MY 2002, US exports would have fallen and remained below their previous three-year average *without* the US subsidies for that year. In other words, *but for* the 2002 US subsidies, there would have been a reduction in US world market share, not an *increase.*[115] This analysis also demonstrates that while there may have been other factors at work stimulating US exports (such as reduced domestic US demand for upland cotton), these factors were not enough to cause an increase in US world market share over the previous 3 year period as required by Article 6.3(d).

**233. In Brazil's view, what is or are the "same market(s)" for the purposes of Article 6.3(c)? Does Brazil's view of "world market" imply that regardless of which domestic (or other) "market" is examined, price suppression will be identifiable? BRA**

Brazil's Answer:

90. The "same market(s)" for the purposes of Brazil's price suppression claims under Article 6.3(c) are (1) the world market for upland cotton, (2) the Brazilian market, (3) the US market, and (4) 40 third country markets[116] where Brazil exports its cotton. US and Brazilian "like" upland cotton is found in each of these markets.

[115] Brazil's 9 September Further Submission, Annex I, Table I.5a.

[116] Argentina, Belgium, Bangladesh, Bolivia, Cambodia, China, Chile, Colombia, Cuba, Ecuador, France, Germany, Greece, Hong Kong, Indonesia, India, Israel, Italy, Japan, South Korea, Malaysia, Morocco, Netherlands, Pakistan, Peru, Poland, Portugal, Philippines, Singapore, South Africa, Spain, Switzerland, Thailand, Tunisia, Turkey, Taiwan, United Kingdom, Ukraine, Venezuela, Vietnam.

91. The record establishes that there is a "world market" for upland cotton and that the prices for that market are reflected in the New York futures prices and in the A-Index prices.[117] Brazil established that there is a global price discovery mechanism that reflects the "world market price," which is heavily influenced by world market supply and demand factors, including the US subsidies.[118] These "world market prices," in turn, are transmitted to the US market, the Brazilian market, and to the 40 other markets where both Brazilian and US subsidized cottons are marketed as typical commodities.[119]

92. In response to the Panel's question whether the world market prices that Brazil claims are suppressed are also "identifiable" in the "domestic (or other) 'market,'" the answer is "yes." The evidence of the transmission of the global effects to these other markets includes (1) USDA's own data for the US prices received by US producers,[120] (2) USDA volume and value data for US exports to third countries,[121] (3) Brazilian Government volume and value data for Brazilian exports to 40 countries,[122] (4) Brazilian ESALQ Index data regarding internal Brazilian prices,[123] (5) data from various third countries reflecting upland cotton import prices,[124] and (6) data from several third countries reflecting their domestic prices for upland cotton.[125] In addition, Brazil has presented the evidence of Andrew Macdonald and Christopher Ward who testified concerning the importance of the A-Index. Brazil further includes the views of Gerald Estur, the ICAC's chief statistician, as set out below.[126]

93. A-Index world prices are a useful benchmark by which to judge whether prices for upland cotton traded internationally or even within domestic markets are influenced by global world market forces.[127] While the New York futures prices play a major role in influencing markets, the short term volatility of the futures market makes comparison with monthly or annual export prices more difficult. Andrew Macdonald indicated that "the price oscillations of the A and B-Index are much less pronounced than the futures market, but in the longer term they accompany the signs and trends coming from the futures market."[128] Moreover, the US Government uses the A-Index as a key basis for Step 2 and marketing loan payments. Professor Sumner's model adapted from the FAPRI model used actual A-Index prices for the period MY 1999-2001 and the "world price" simulation effects are estimated "A-Index" prices.[129]

94. Organized below is the evidence on pricing data supporting the link between A-Index prices that reflect the global supply and demand influences (including effects of the US subsidies) and prices in "other markets" as posed in the Panel's question. Brazil first presents evidence of US and Brazilian

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[117] Brazil's 2 December Oral Statement, paras. 14-16 (*citing* evidence set out in the record from earlier submissions to the Panel).

[118] Brazil's 2 December Oral Statement, paras. 14-16 (*citing* evidence set out in the record from earlier submissions to the Panel).

[119] Brazil's 2 December Oral Statement, paras. 14-16 (*citing* evidence set out in the record from earlier submissions to the Panel).

[120] Brazil's 9 September Further Submission, para. 113 (*citing* Exhibit Bra-4 and Exhibit Bra-202).

[121] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

[122] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

[123] Exhibit Bra-207 (Cotton lint: International Prices & Brazilian Prices); Brazil's 9 September Further Submission, para. 115 note 156.

[124] Exhibit Bra-384 (Import Prices from Various Countries).

[125] Exhibit Bra-385 (Domestic Prices from Various Countries).

[126] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

[127] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC)("The A-Index is a good proxy for prices of cotton traded internationally.").

[128] Brazil's 9 September Further Submission, Annex II (Statement of Andrew Macdonald, para. 23.).

[129] Brazil's 9 September Further Submission, Annex I (Sumner Analysis, para. 70 ("the model uses the Cotlook A-Index price to represent the world price . . . [and] the actual A-Index prices were used for the database for the model for marketing years 1999-2001.").

export prices to 40 different countries, based on official published US and Brazilian Government sources. It then provides (based on availability) information concerning the import prices of all imports from certain of the 40 countries where both Brazil and US upland cotton was exported during MY 1999-2002. Finally, Brazil presents information of internal domestic prices in the United States, Brazil, and China.

**Brazilian and US Export Prices**

95. In response to the Panel's question, Brazil first presents evidence of US and Brazilian export prices to 40 different markets where both Brazilian and US upland cotton was exported at some point during MY 1999-2002. The information and evidence below is based on a compilation from two sources. First, all information on US upland cotton export prices is based on the "US Trade Internet System," a web application run by USDA's Foreign Agricultural Service (FAS).[130] Second, information on Brazilian upland cotton export prices is taken from information published and maintained the Brazilian Ministry of Agriculture on its public web-site.[131] The export "prices" represent the declared contract value of the upland cotton at the US and Brazilian port of export – known as "Free Alongside Ship (FAS)" values.[132]

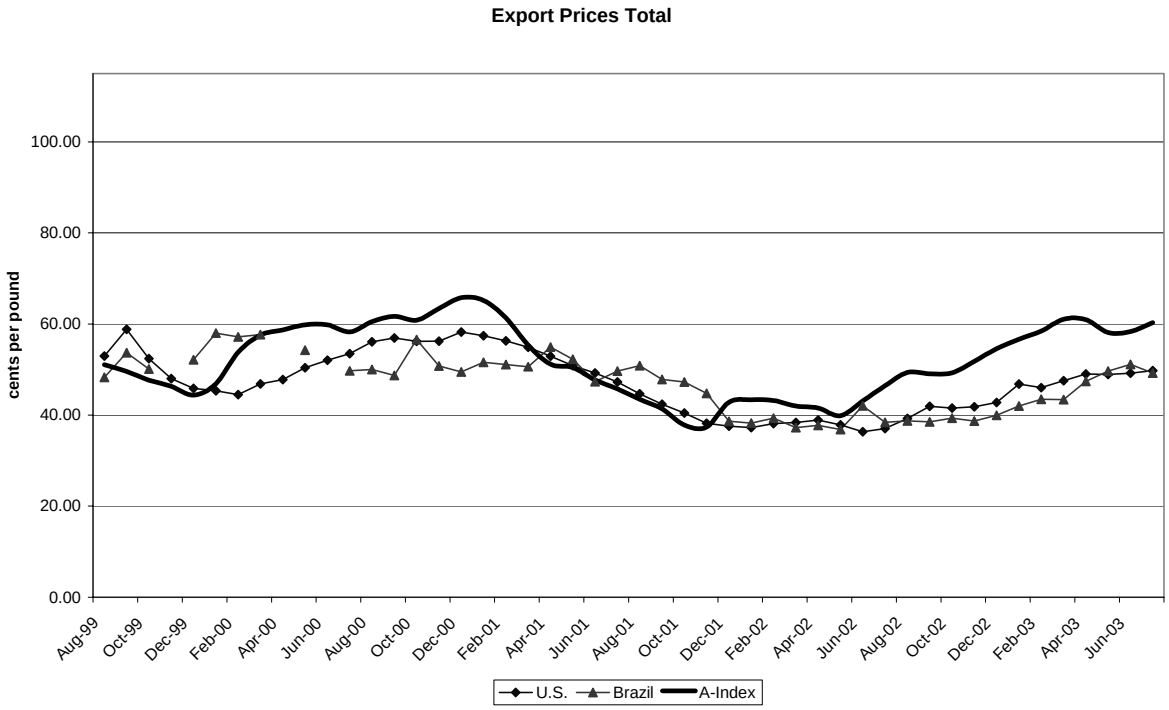
96. The first way to examine the available data is to view it collectively similar to what the United States did in Exhibit US-75. The first graph below examines the cumulative Brazilian and US export prices in MY 1999-2002 covering exports to the 40 markets where Brazil exports its upland cotton as well as US exports to Brazil.[133]

[130] *See* http://www.fas.usda.gov/ustrade/. The four upland cotton HS-10 codes used are 5201001010, 5201001020, 5201001025 and 5201001090. All data originally in tons and dollars, was converted into pounds and cents.

[131] *See* http://alicewebl.desenvolvimento.gov.br; www.mdic.gov.br/indicadores/balanca/balanca.html. See also Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country). All Brazilian data originally provided in kilograms and dollars was converted into pounds and cents.

[132] The FAS value includes all inland freight, insurance and other charges incurred in placing the merchandise alongside the carrier at shipping or insurance costs.

[133] Exhibit Bra-386 (Brazil and US Export Prices by Country). The data for all of the graphs in this subsection of Brazil's answer is contained in Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).

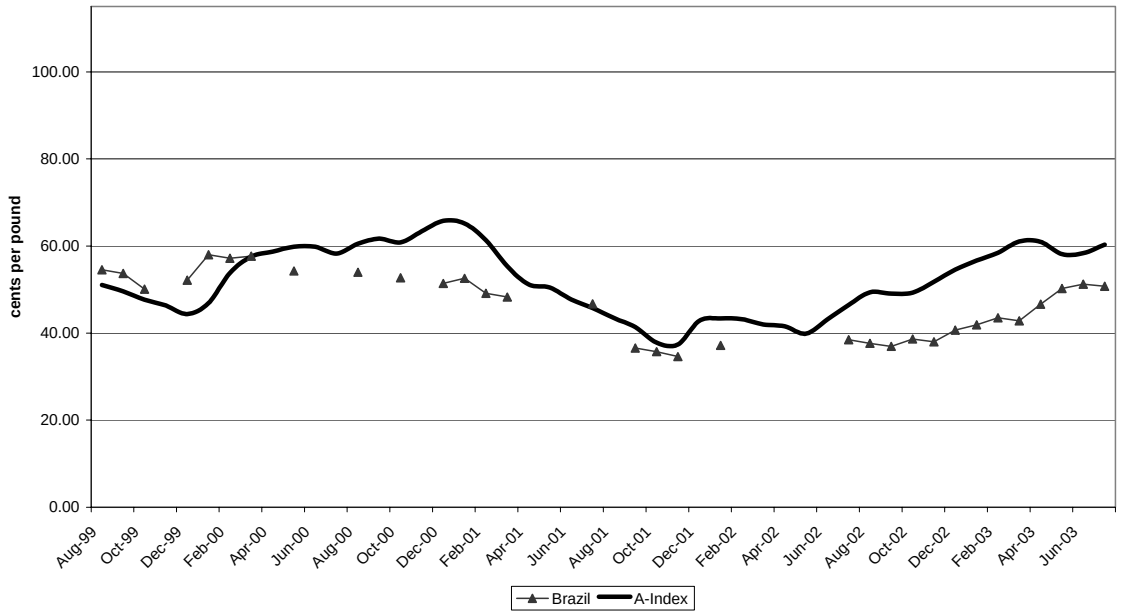



97. The A-Index on the graph is the solid black line. The Panel can see that over the four year period, US and Brazilian export prices closely follow the movements in the A-Index. In addition, as discussed in greater detail in the answer to Question 235, Brazilian prices are at times equal to, slightly greater than US prices or slightly lower than US prices.

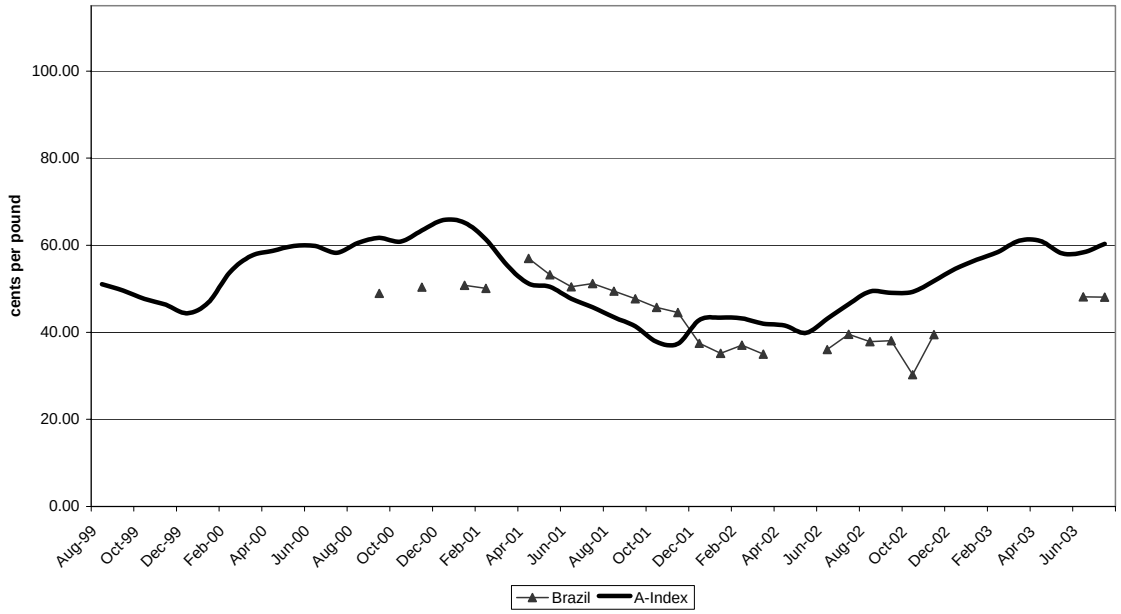
98. The Brazilian export data can be used as a proxy for third country market prices in a handful of countries where there were extensive Brazilian exports. This is illustrated in the cases of three of the larger markets for Brazilian exports – Argentina, India, and Portugal as set out in the graph below:[134]

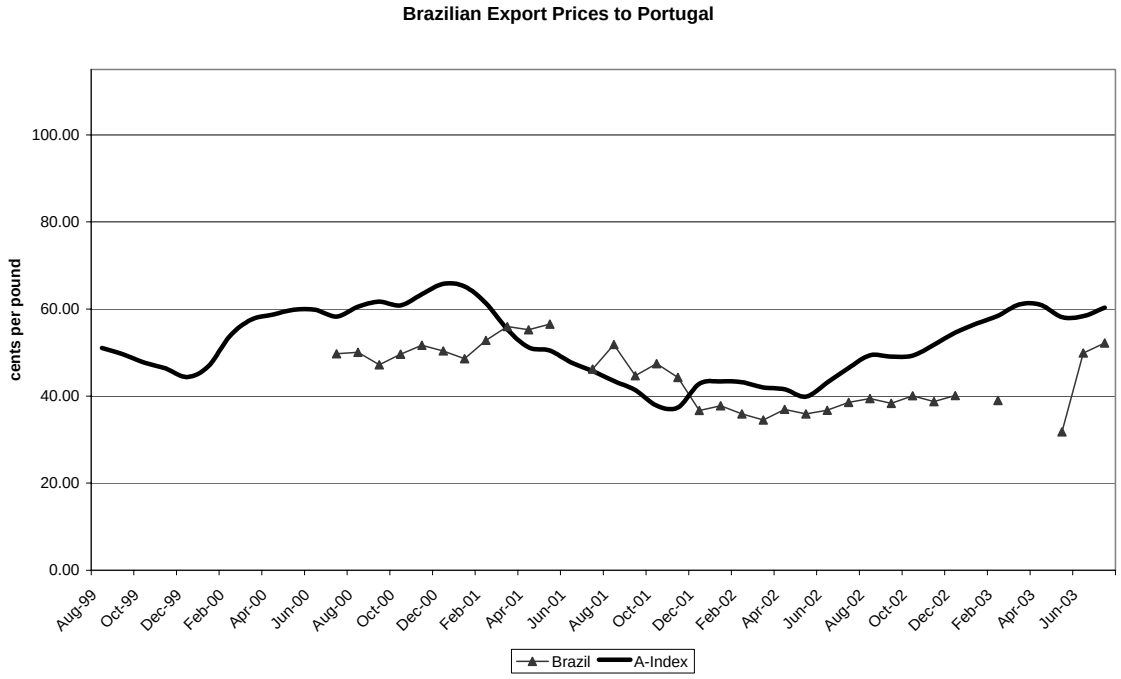
[134] The Panel will find a complete list of graphs showing A-Index prices plotted against Brazilian export prices to all countries to which Brazil exports in Exhibit Bra-387 (Brazil Export Prices v A-Index Prices by Country).

**Brazilian Export Prices to Argentina**




**Brazilian Export Prices to India**

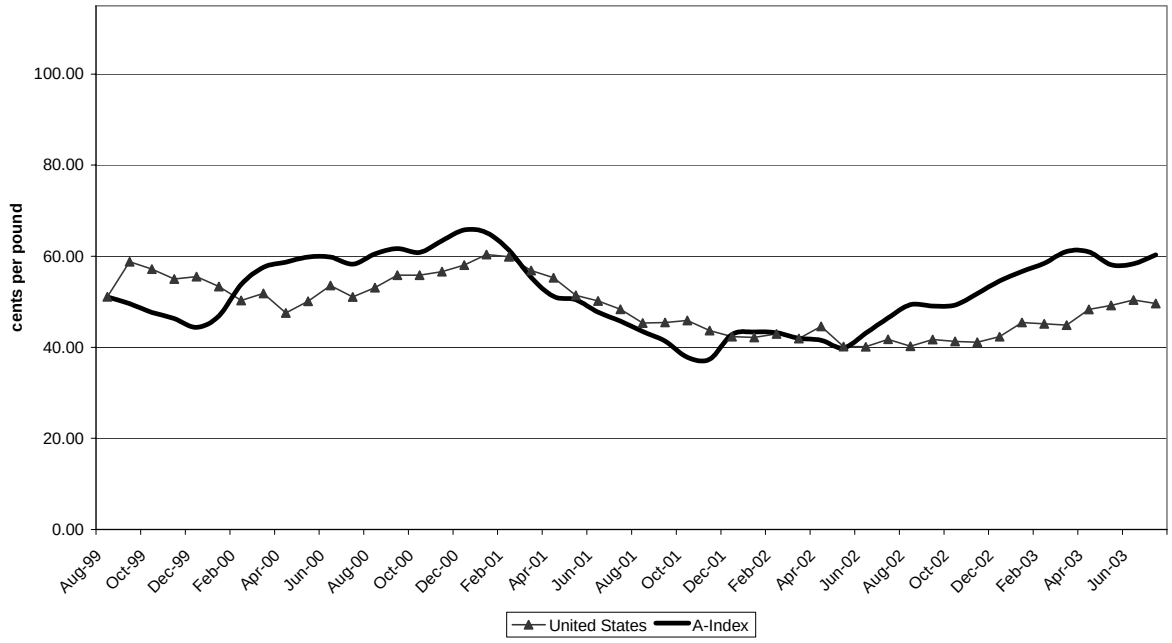




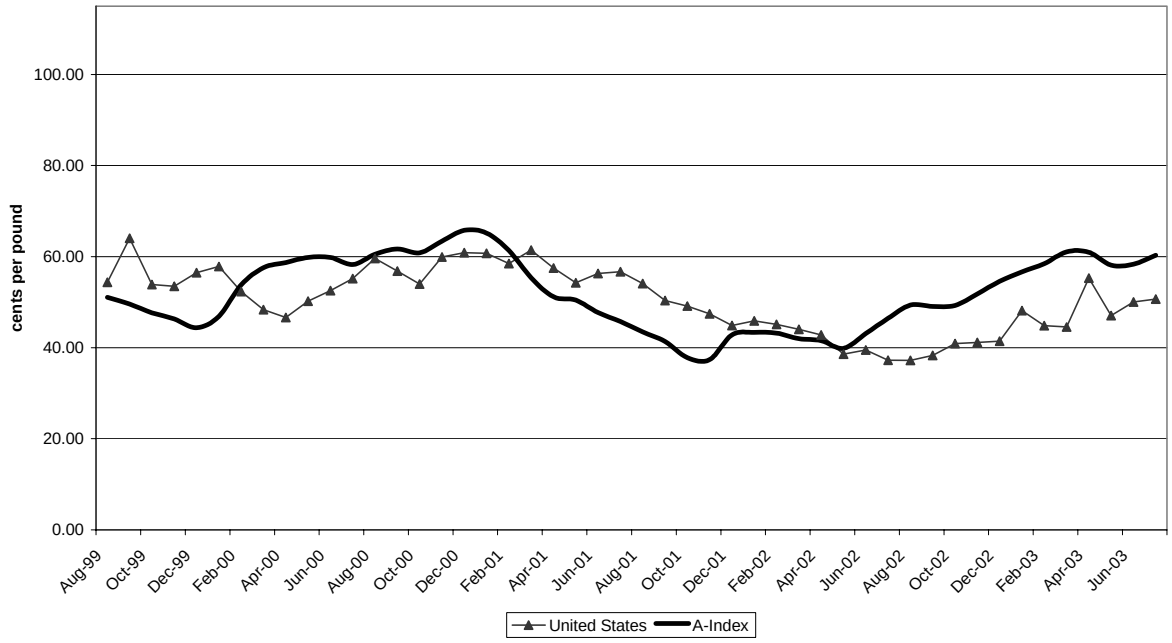

99. Because US exports were so much greater than Brazilian exports, a better way to examine the relationship between A-Index prices and prices in the 40 countries is to examine US export prices, particularly where there were large volumes of US exports. This is illustrated in the graphs below for China, Indonesia, South Korea and the Philippines (as well as other graphs in Exhibit Bra-388):[135]


[135] The Panel will find a complete list of graphs showing A-Index prices plotted against US export prices to all countries to which Brazil exports in Exhibit Bra-388 (US Export Prices v A-Index Prices by Country).

**US Export Prices to Indonesia**




**Export Prices to South Korea**




100. Brazil presents in Exhibit Bra-383 the underlying data on all 40 of the markets where Brazil and the United States export their upland cotton. This underlying data is presented in a variety of different graphs; one set compares Brazilian exports to the A-Index;[136] another compares US exports to the A-Index,[137] and a third combines Brazilian and US export prices.[138]

101. Many of the 40 markets show only very limited amounts of Brazilian exports. Compared to the volume of US exports, Brazilian exports during MY 1999-2002 were relatively small (representing approximately 1 per cent of total world market share).[139] Thus, when the monthly export data is examined on a country-by-country basis, there are very few third country markets where Brazil exported in each of the 48 months in MY 19999-2002, *i.e.*, where there is a complete set of 48 data points. Nevertheless, even the limited data points for each of the 40 countries shows that Brazilian export prices generally tracked A-Index prices.

102. Many of the graphs also reflect fairly widely ranging data point prices, particularly where the import volumes are not very great.[140] By contrast, country markets with very high volumes of imports[141] tend to have much more stable import prices that closely follow the A-Index. This is why the US high-volume import data graphs provide reliable evidence of pricing trends in some of the 40 country markets examined. There are various reasons that explain the widely ranging pricing data points. First, while US and Brazilian cottons may have the same staple length, their quality may differ significantly which, in turn, impacts their respective price.[142] For example, California A-Index cotton is consistently sold at a premium in world markets because its superior quality allows it to be

[136] Exhibit Bra-387 (Brazil Export Prices v A-Index by Country).
[137] Exhibit Bra-388 (US Export Prices v A-Index by Country).
[138] Exhibit Bra-386 (Brazil and US Export Prices by Country).
[139] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 4 and 76).
[140] *See* Exhibit Bra-387 (Brazil Export Prices v A-Index by Country). Examples are Belgium, Pakistan, South Africa.
[141] *See* Exhibit Bra-387 (Brazil Export Prices v A-Index by Country). Examples are Argentina, China, India, Italy, Portugal, Philippines, Thailand.
[142] Brazil's 9 September Further Submission, Annex II (Statement of Andrew Macdonald, paras 9-10).

used in production of finer cotton fabric.[143] During certain period between MY 1999-2002, both Brazil and the United States exported cotton with a high staple length or a particularly good quality to a third country market, resulting in higher prices. This no doubt accounts for much higher US prices compared to Brazilian cotton in some markets such as France, Germany, and Portugal.

103. Second, smaller monthly export sales to a third country market with relatively few imports may result in much higher prices than large volume sales to large importers. Larger consuming countries (with larger consumers) can demand volume price premiums and sellers can export at higher volumes and lower prices based on economies of scale. The country data of the world's largest importers such as China, Hong Kong, Taiwan, and Indonesia, for example, closely match A-Index price trends.[144] But even larger importing countries data reflects an occasional month where prices diverge from the overall trend. This may be due to the fact that smaller shipments were purchased quickly on a spot basis at higher prices.

104. Third, some exports or forward contracts for export sales are fixed-price contracts, which may be executed months before export takes place.[145] For example, a yarn spinner or textile producer in Brazil may contract to purchase 100 tons of US cotton on 1 January 2002 at an import price fixed at 40 cents per pound at that date, but when the cotton is actually exported on 1 June 2002 the A-Index price may be 50 cents. This type of contract with terms fixed at execution rather than on delivery may explain a number of country market graphs where there is a delayed reaction of the country price to declines or increases in the A-Index prices. However, even where there is a delay in response, the longer-term trends in most markets thereafter track the downward or upward climb of A-Index prices.

105. But even with the limitations in the monthly data for individual country markets, the data on the whole strongly supports the conclusion that world prices do influence local export market prices. Any anomalies in smaller importing country markets are notably eliminated by using the weighted average analysis of monthly data from all 40 markets where Brazil and US cotton exports are found. With the vast bulk of US – and most of Brazilian cotton – being exported to large volume markets, the combined analysis shows the close relationship between A-Index prices and both Brazilian and US prices. Indeed, the Chief Statistician of the ICAC, who has extensive experience with individual country and world market pricing data, came to the following conclusions:

> For all importing non-producing countries, domestic prices follow the Cotlook A Index, taking into account appropriate location and quality differentials and the quality differential for the particular type of cotton needed by the spinning industry.
>
> Prices of imported cotton in producing countries also follow the Cotlook A Index, with appropriate location and quality differentials. The international market for raw cotton is relatively open, with rather low imports taxes (averaging less than 5 per cent. The US having one of the highest).

[143] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC)(California/Arizona cottons "is usually about 2 cents more expensive than Memphis"). *See also* Brazil's 9 September Further Submission, para. 241, figure 17 (showing California A-Index quotes at higher prices than Brazil A-Index cotton which is comparable to Memphis).

[144] *See* Exhibit Bra-387 (Brazil Export Prices v A-Index by Country), Exhibit Bra-388 (US Export Prices v A-Index by Country) and Exhibit Bra-384 (Import Prices from Various Countries).

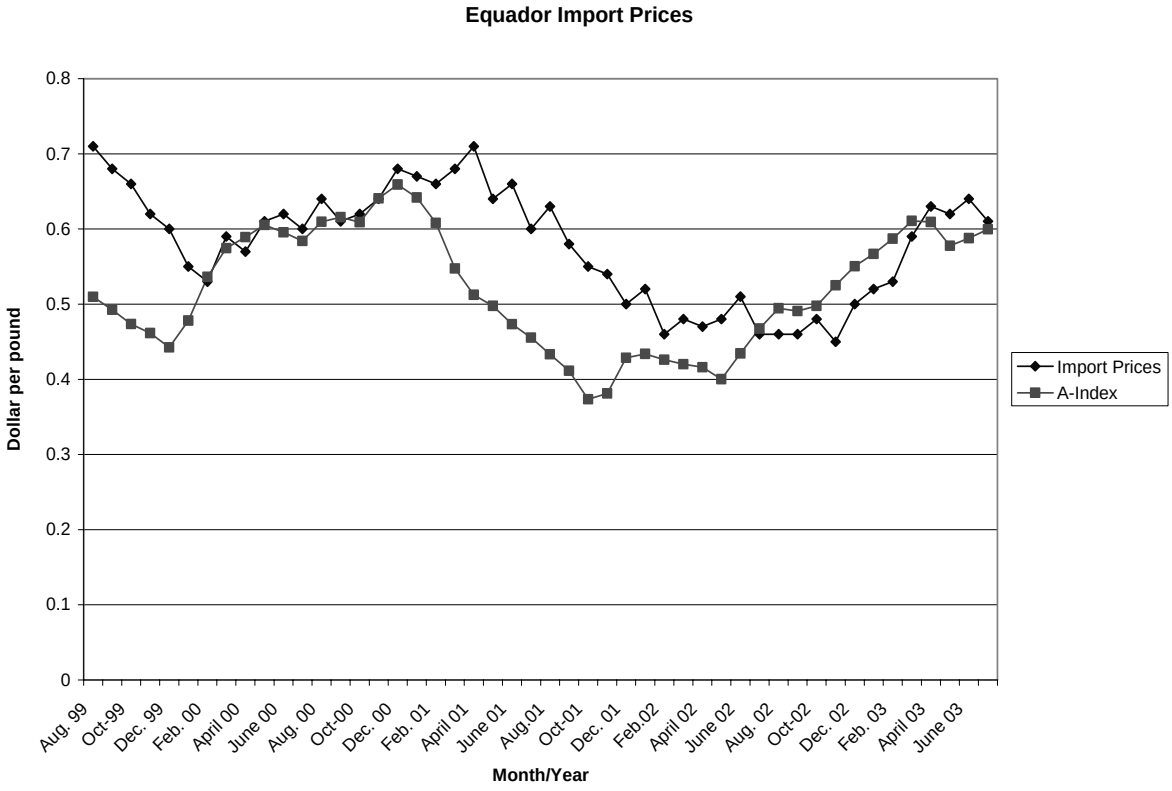
[145] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC)("Actual prices of imported cotton, in non-producing as well as in producing countries, are based on the A Index or on New York Futures . . . on the day of the contract (concluded prior to shipment, and cotton can be sold more than one year forward). As a result, the average price of imports (value divided by quantity) for a specific period is not directly related to prevailing market prices.").

> Domestic prices of cotton produced and consumed locally are influenced by the supply and demand situation in the country but are not disconnected from international prices.[146]

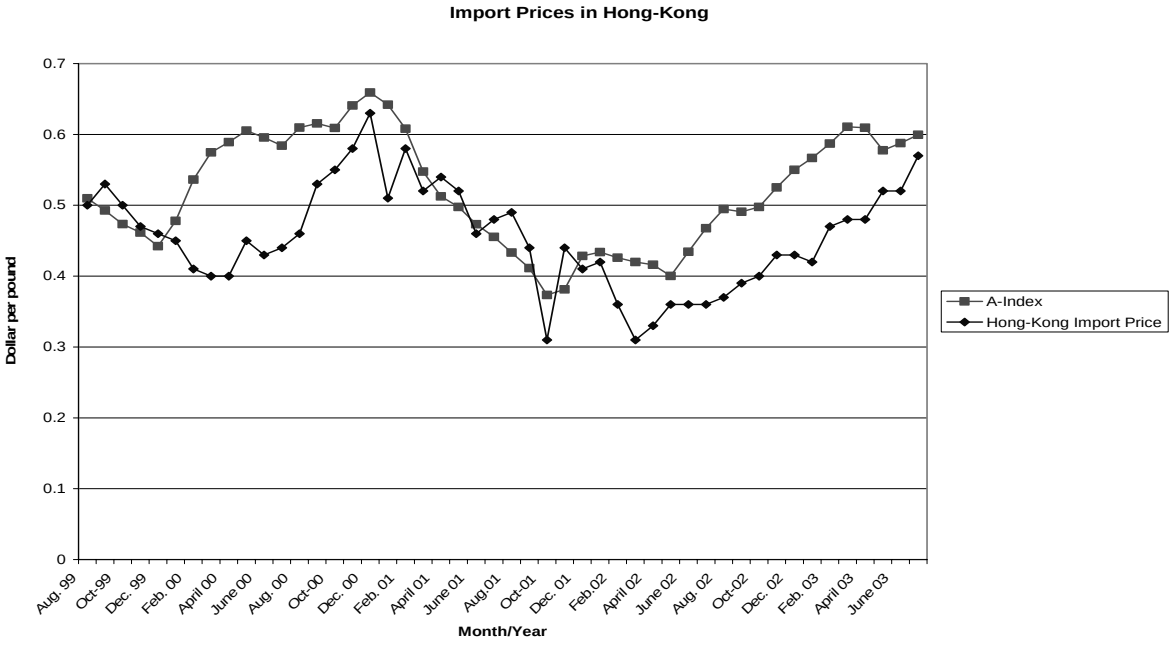
**Individual Country Market Import Price Data**

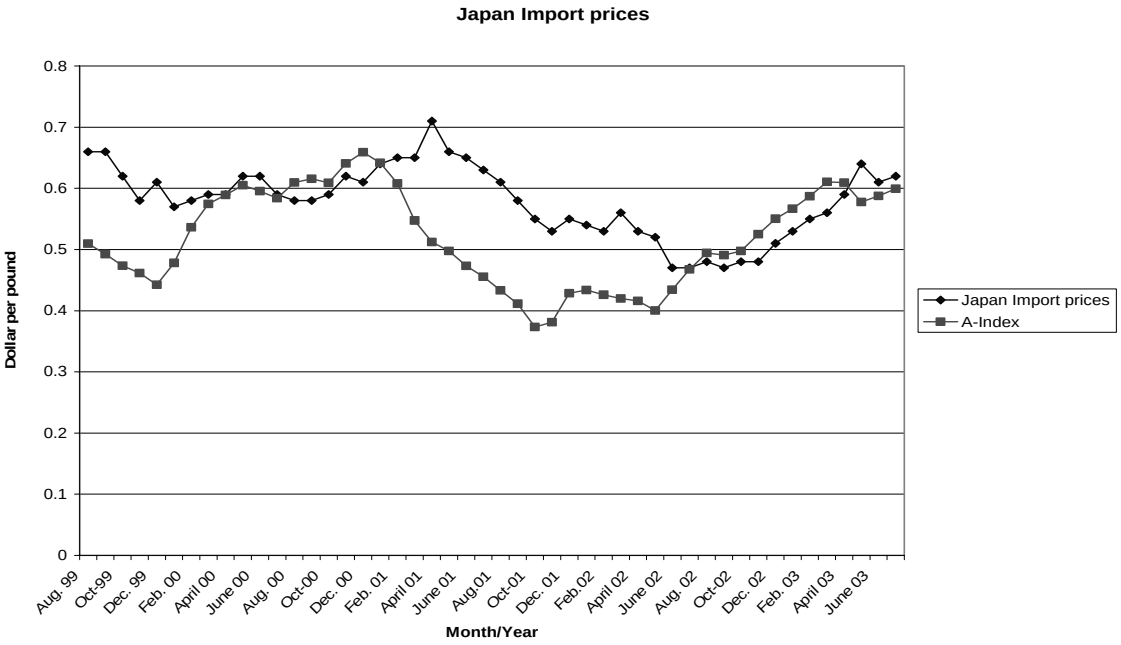
106. Additional evidence responsive to the Panel's question is found in various third country market *import* pricing data that was collected since 9 December 2003 by Brazilian embassies around the world. The data and the graphs are set out in Exhibit Bra-384. This data is available in two forms: (1) *monthly* import data from all sources, and (2) *annual* import data from all sources. While this information is not available to Brazil for many of the 40 export market countries, the available evidence confirms the other third country market data discussed above.

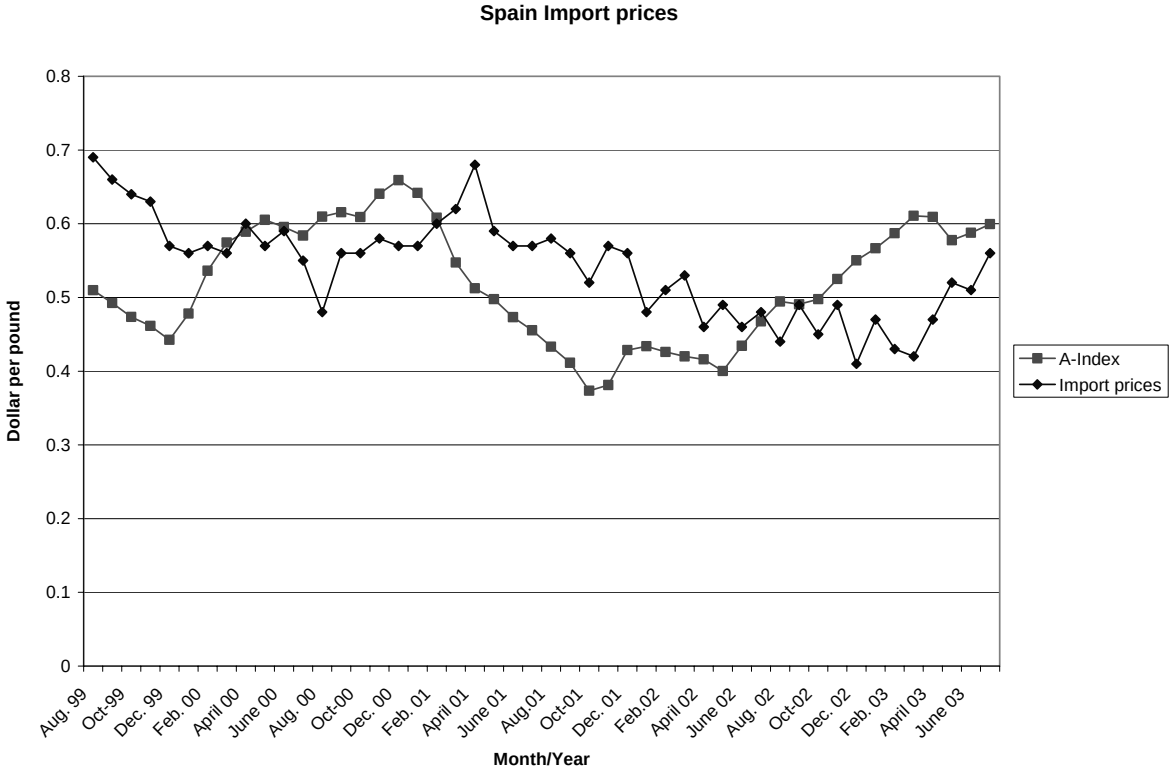
107. Monthly import data is available from Argentina, Ecuador, Hong Kong, Japan, Spain, Thailand, and the Ukraine. The data generally shows a close relationship between the movement of import prices and the movement of the A-Index. For example, set out below are graphs representing the data from Ecuador, Hong Kong, Japan and Spain:




[146] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

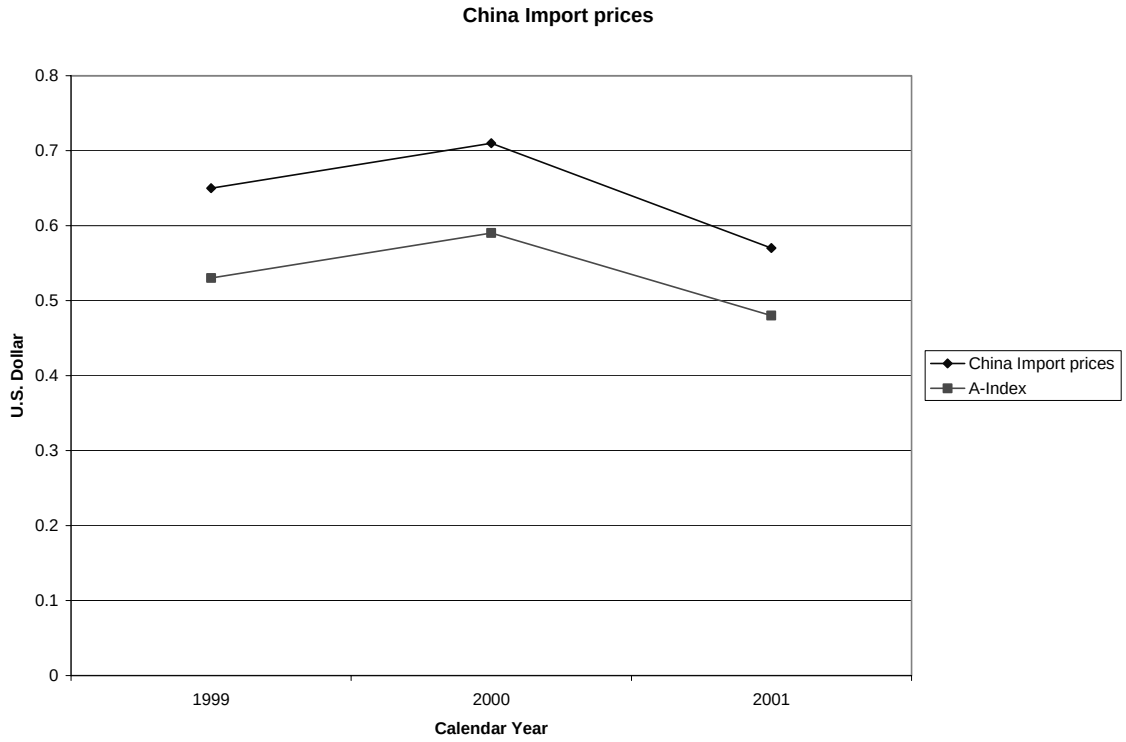




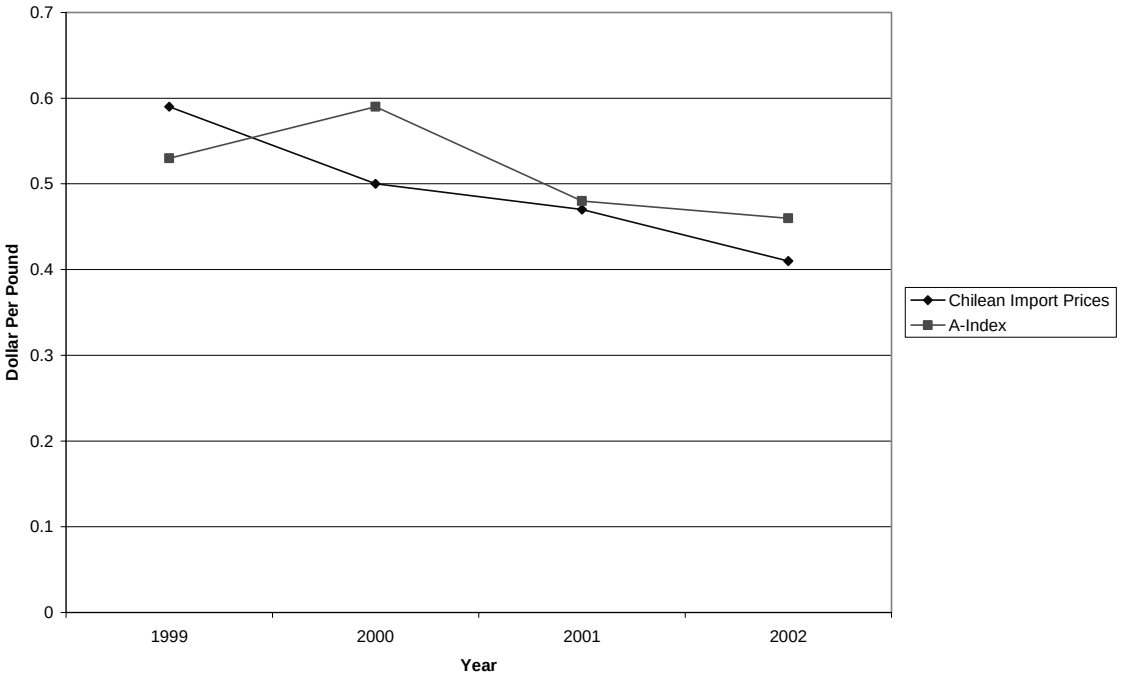

The monthly data for these countries reflects fairly high-volume imports from all worldwide sources. The higher volumes guarantee a more accurate reflection of the bulk of prices within these countries. The link between A-Index and import prices is also confirmed by the data for Argentina, Thailand and the Ukraine in Exhibit Bra-384.

108. There is also *annual* import data available from a few countries. While annual data does not provide as detailed information concerning price movements within a year, it also supports a link between the A-Index and import prices. These import prices, in turn, serve as a proxy for prices in the third country market generally. For example, the available import data from China, Chile, and the United Kingdom is set forth below:[147]

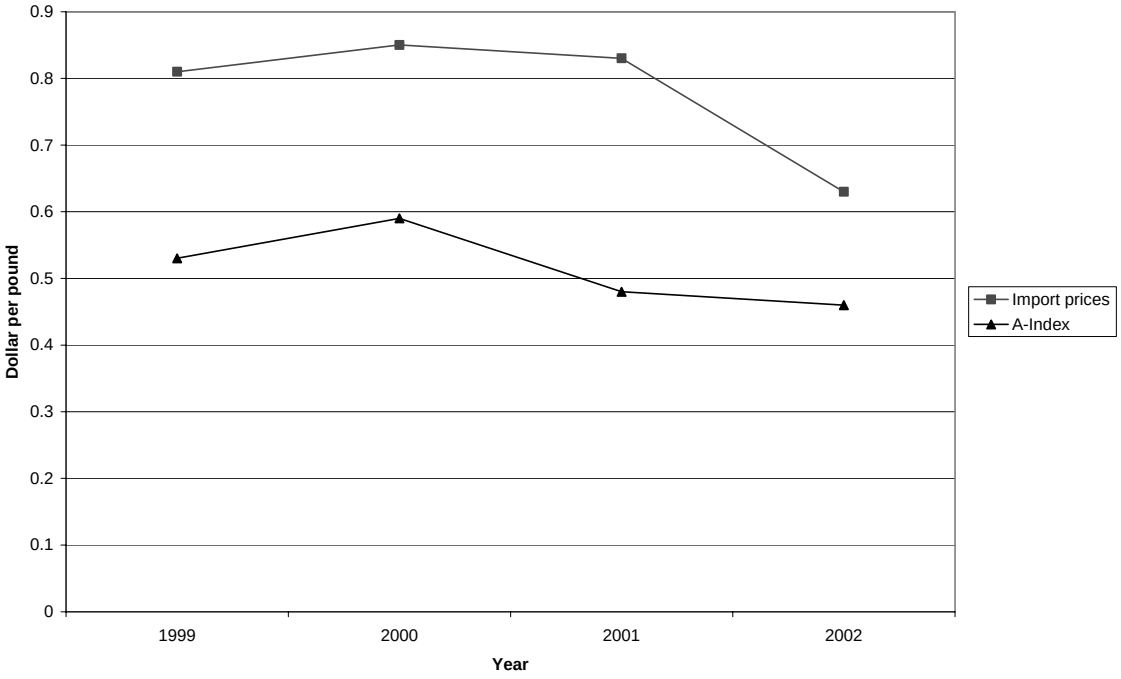



[147] Exhibit Bra-384 (Import Prices from Various Countries).

**Chilean Import prices**



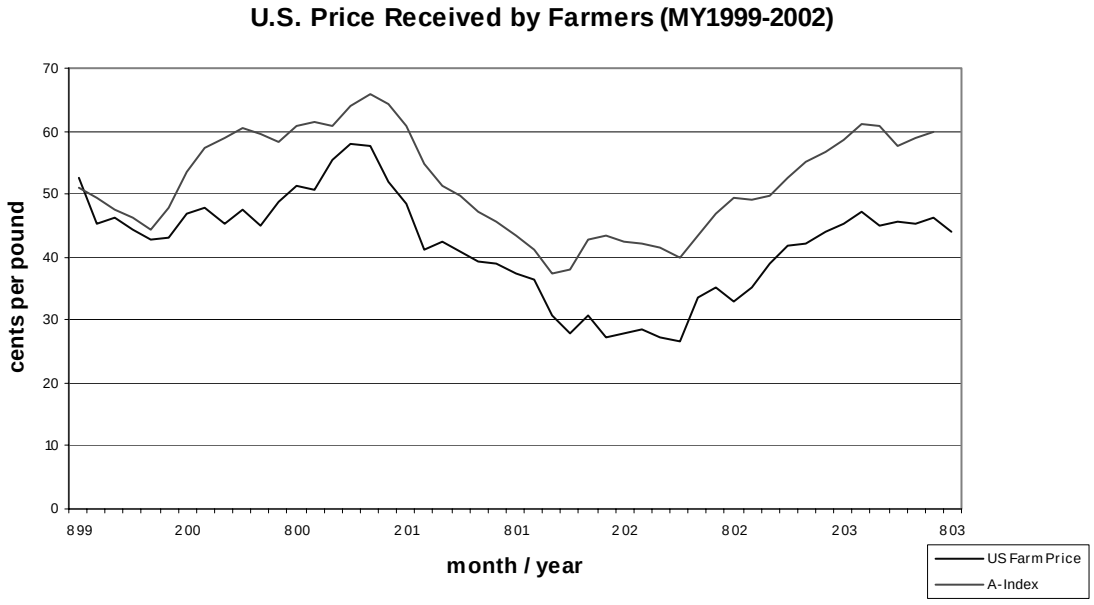

**United Kingdom Import prices**



**Individual Country Domestic Prices**

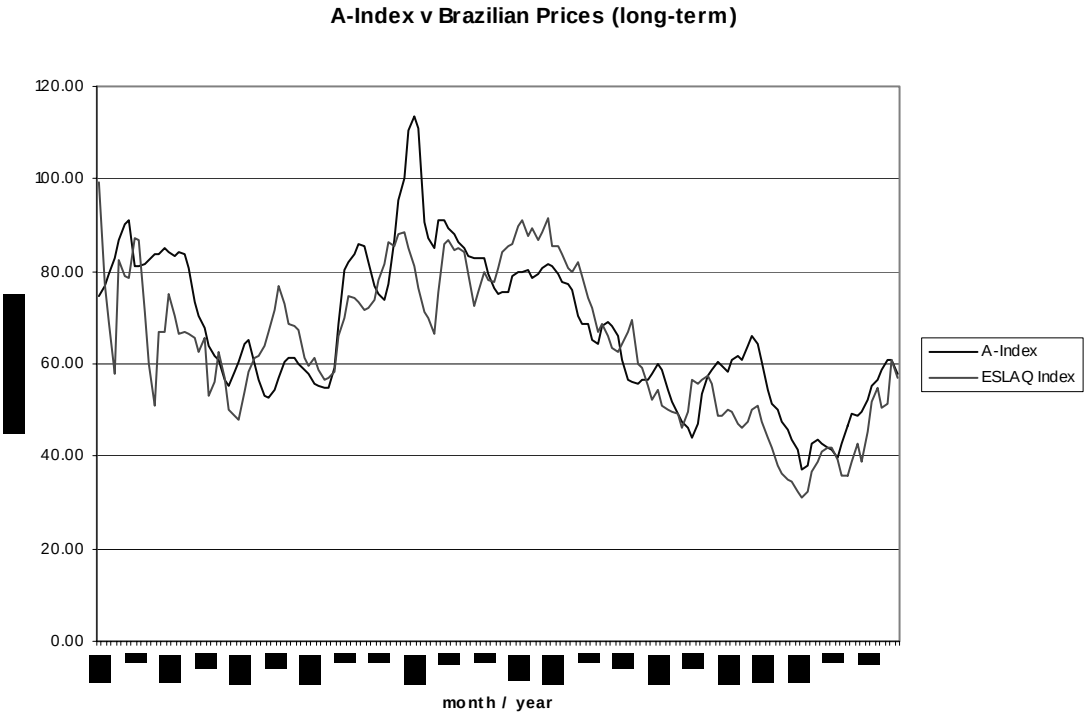
109. Finally, Brazil presents a series of graphs showing domestic prices in those countries for which domestic prices were available. Andrew Macdonald has indicated that most countries do not collect or maintain accessible data on domestic upland cotton prices. This was confirmed by the requests for such data by Brazilian embassies around the world. Therefore, Brazil can only offer information on domestic prices from a limited number of countries. These countries, however, constitute key markets, including the United States, China, Brazil and Pakistan.

110. The record shows that domestic prices within several key producing countries including the United States, Brazil, China and Pakistan also reflect and generally move with the overall trends of A-Index prices. This is shown in the graphs below:[148]



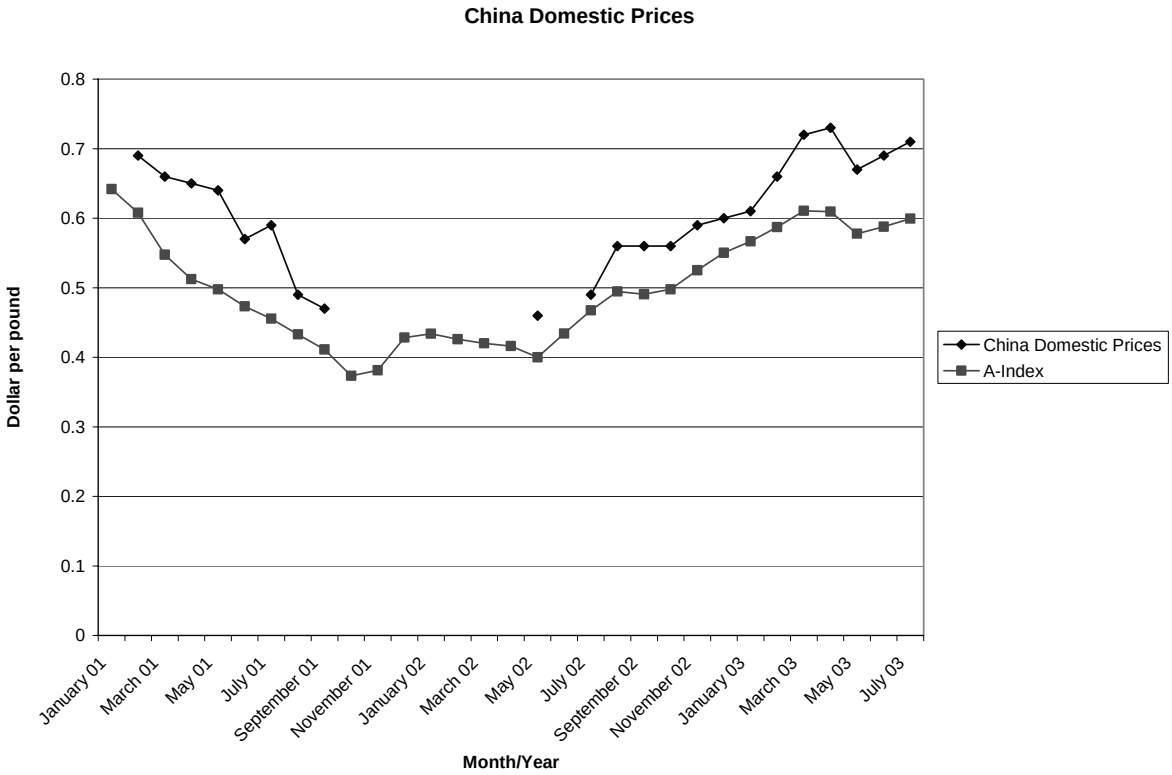

111. This data provides further confirmation of the close link between US domestic prices and the A-Index prices. As set forth below, this close link also exists for the domestic Brazilian market where most of Brazilian production is marketed:[149]

[148] This graph is reproduced from Figure 5 of Brazil's 9 September Further Submission.
[149] This graph is reproduced from Figure 7 of Brazil's 9 September Further Submission.

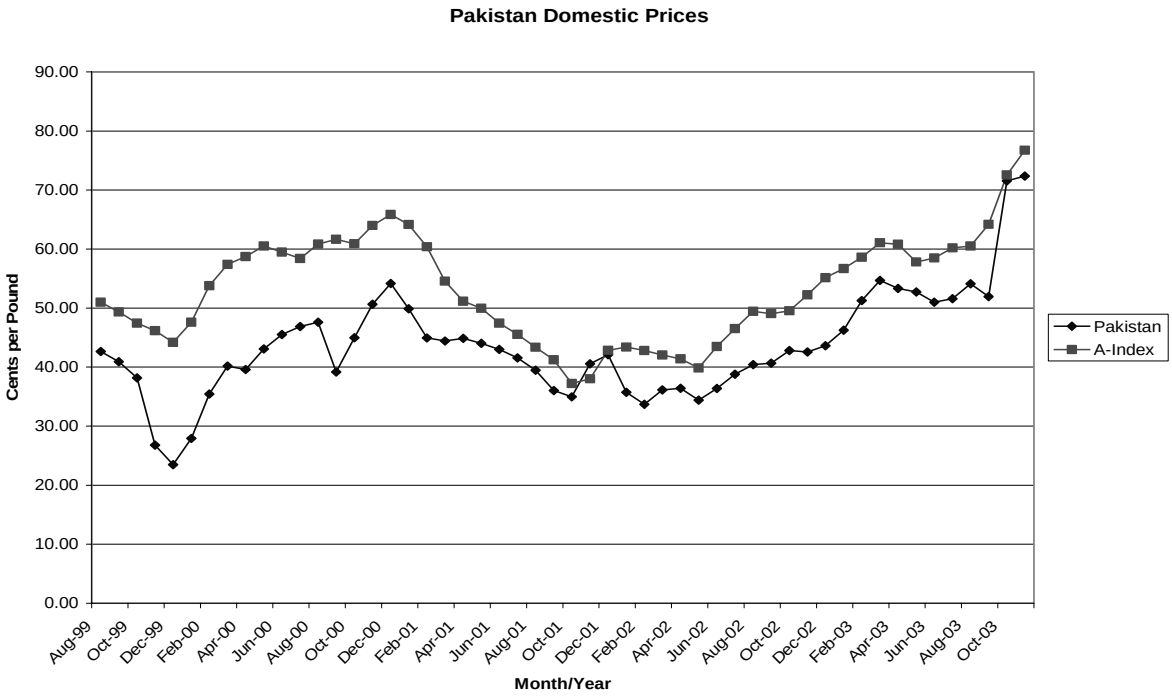



112. Finally, the domestic prices of the world's largest producer and consumer of upland cotton is the Chinese market. Because China is one of the world's largest importers of upland cotton, it is not surprising that its domestic market prices also track the A-Index prices as seen in the graph below:[150]

[150] Exhibit Bra-385 (Domestic Prices from Various Countries).




A similar pattern also evolves for domestic prices in another major producers and user of upland cotton: Pakistan.[151]




[151] Exhibit Bra-385 (Domestic Prices from Various Countries).

**Conclusion**

113. The evidence outlined above and in Brazil's earlier submissions shows that world market prices were transmitted to other markets during MY 1999-2002, and that this continues today. Whether the data is viewed collectively or individually, the data generally shows that Brazilian, US and other exporters' prices to these 42 countries are consistent with movements and trends in the A-Index price. While there are some (particularly low volume) graphs that show monthly differences from A-Index trends or movements, Brazil has set forth the quality, contract, and timing factors accounting for such anomalies. The collective statistical evidence supports the conclusion of the ICAC's chief statistician that "[a]ctual prices of imported cotton, in non-producing as well as in producing countries, are based on the Cotlook A Index or on the New York futures" and "the prices of the major types of cotton … are affected by the supply and demand situation facing the market as a whole."[152] All of this evidence is consistent with the conclusion that these third country market prices are heavily influenced by A-Index and New York futures prices. Professor Sumner analysis and the studies by USDA economists undeniably show that the US subsidies have suppressed A-Index and New York futures prices. Since these indices are the benchmarks for prices in those "same markets" where US and Brazilian upland cotton were exported, it is indisputable that the US subsidies have suppressed the prices in each of the "markets" cited in the introductory paragraph of Brazil's answer to this question.

**234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"? USA, BRA**

Brazil's Answer:

114. In response to both questions, Brazil, New Zealand, and Argentina have argued previously that whether price suppression is "significant" cannot be judged solely by reference to a non-textually based "objective" amount of price suppression.[153] Rather, the "significance" of price suppression must be assessed with reference to the quality of the impacts of *whatever* level of price suppression exists on the producers of the like product. For example, a panel could find that even large amounts of price suppression are not "significant" where the complaining party producers had *de minimis* production, or no exports, and/or that the total value of lost revenue from suppressed prices was minimal. On the other hand, very large producers of a commodity product like upland cotton would suffer serious prejudice from even smaller "objective" levels of price suppression in terms of the amount of lost revenue.

115. The Panel's question really comes down to whether Article 6.3 of the SCM Agreement requires a two step process – first, an objective finding of an amount of price suppression that is "significant," and second, whether the complaining party Member suffers serious prejudice from such "significant" levels of price suppression. Brazil does not believe the text requires such a two-step process for the reasons outlined above and in previous submissions. However, the facts of this case show that even if such a test were required, the amount of price suppression caused by the US subsidies is significant and far from *de minimis*. Brazil has also submitted undisputed evidence that its producers have suffered considerable losses in revenue from suppressed prices that could have

[152] Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

[153] Brazil's 9 September Further Submission, paras. 251-259; Brazil's 7 October Oral Statement, para. 30; Brazil's 27 October Answers to Questions, paras. 119-122. New Zealand's 3 October Further Submission, paras. 2.21-2.27; New Zealand's 8 October Oral Statement, para. 8; Argentina's 3 October Oral Statement, para. 36; Argentina's 8 October Oral Statement, para. 38.

been used for further investment in high-yielding lower cost production.[154] By any measure, this evidence establishes both "significance" of the price suppression and "serious prejudice" to the interests of Brazil.

**235. Please comment on paragraphs 8, 9 and 10 of the US 2 December oral statement, in particular, why the average Brazilian price is shown as lower than the average US price. BRA**

Brazil's Answer:

116. Brazil previously has set forth its reasoning why evidence of lower Brazilian prices in some markets is irrelevant to the issue of whether or not all the prices in those markets were suppressed by the global effects of US subsidies.[155] This global price transferral mechanism is and remains the relevant analysis of Brazil's Article 6.3(c) price suppression claim as Brazil has outlined in its Answer to Question 233. Brazil sets forth its comments and rebuttal to paragraphs 8, 9 and 10 of the US 2 December Oral Statement and Exhibit US-75 below.

**Cumulative Analysis of 8 Country Export Prices**

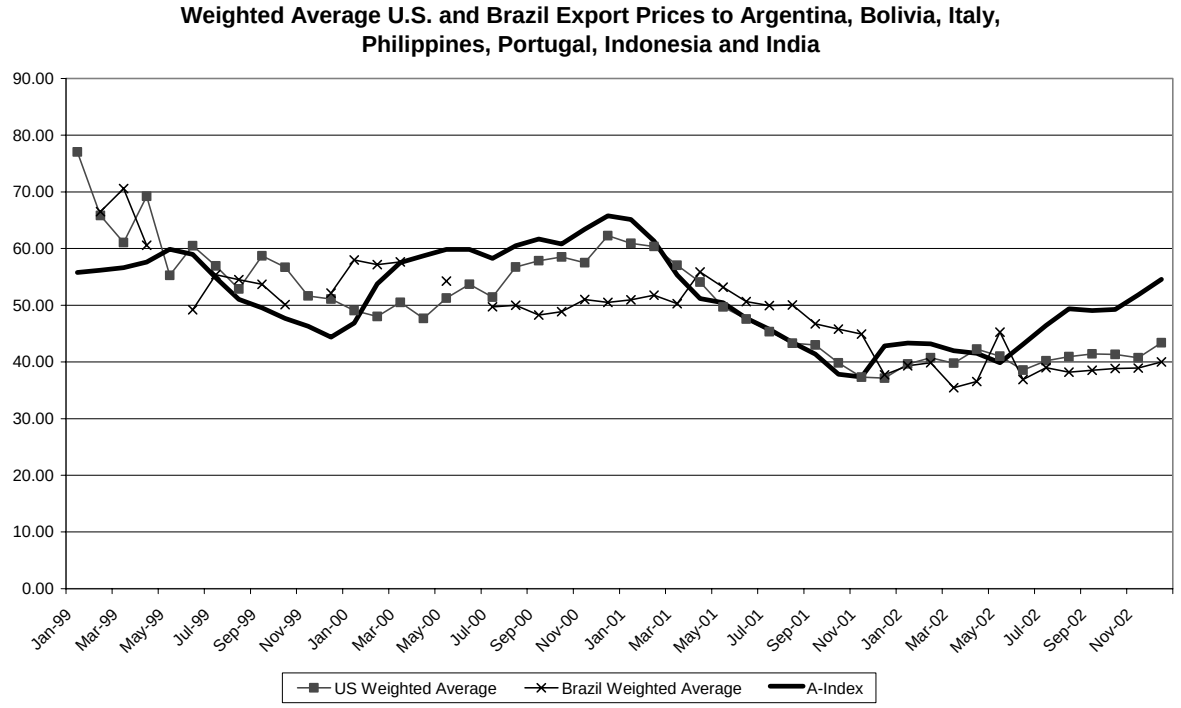
117. With respect to the US "price undercutting" argument, and in particular the US chart set out in Exhibit US-75, the factual assertion that cumulative US prices in the 8 countries examined are consistently much higher than Brazilian prices is simply wrong. One fundamental error with Exhibit US-75 is that the United States did not "weight-average" the data regarding export prices for Argentina, Bolivia, Italy, Philippines, Portugal, Indonesia, Paraguay and India. Rather, Exhibit US-75 is based on a simple average, not taking into account whether Brazilian shipments on a monthly basis were 2 tons or US shipments the same month were 100,000 tons. In addition, the US chart (and accompanying data) in Exhibit US-75 provides no volumes on monthly shipments, provides no published backup material, uses a non-public source of information, and inexplicably does not use official USDA Foreign Agricultural Service (FAS) published data on export prices.

118. Using the proper monthly weighted average methodology and FAS's own official export pricing data together with the Brazilian Government's official export pricing data,[156] the collective situation in the eight countries examined in Exhibit US-75 looks completely different than the US chart in that exhibit:

[154] Brazil's 9 September Further Submission, Section 6 and Annex III. *See* also Exhibit Bra-283 (Statement by Christopher Ward – 7 October 2003).

[155] Brazil's 2 December Oral Statement, paras. 14-19 (providing evidence and references to other evidence supporting Brazil's clams); Brazil's 9 September Further Submission, Section 3.3.4.9.

[156] This data was discussed in some detail in Brazil's Answer to Question 233 and is contained in Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).



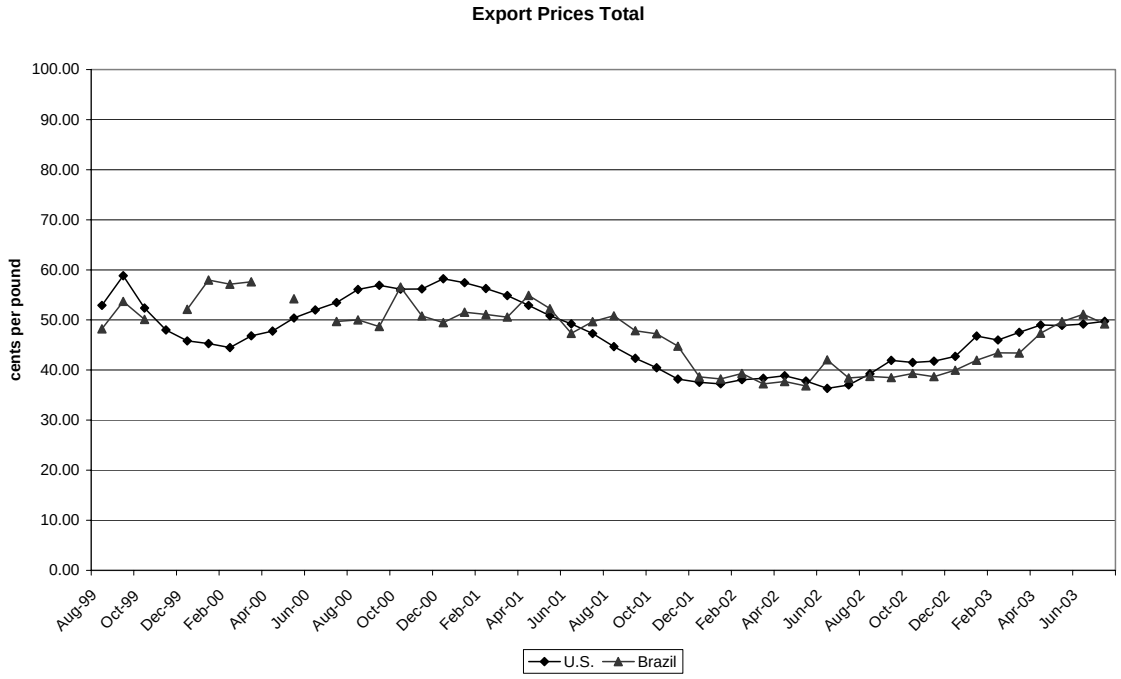

119. The graph shows that US and Brazilian prices fluctuate with Brazilian prices at times higher than US prices and US prices higher than Brazilian prices at other times. The chart shows that beginning in November 2000, US prices plunged along with the A-Index prices and that Brazilian prices quickly followed, with both US and Brazilian prices remaining at record lows until near the end of 2002 when both started rising again. Finally, the chart shows that US prices generally followed the movements or trends in A-Index prices (the solid line in the graph). As discussed in Brazil's Answer to Question 233, this is what is relevant for a price suppression claim under Article 6.3(c) as opposed to any alleged "undercutting" by Brazilian cotton in individual markets as the US claims.

**Cumulative Analysis of US and Brazilian Prices in 40 Third-Country Markets**

120. Moving beyond the 8 countries in Exhibit US-75 to all 41 countries (including Brazil) where Brazil and the US both sold at least some upland cotton between MY 1999-2002 further demonstrates the absence of so-called "price undercutting" by Brazilian products as alleged by the United States. For the period MY 1999-2002, the weighted average price covering a total of 10.5 billion pounds of US upland cotton exported to these same 41 countries (including Brazil) is 45.33 cents per pound.[157] By contrast, the average weighted price of 709 million pounds of exported Brazilian upland cotton to 40 export markets is 44.65 cents per pound.[158] This is a difference of 0.68 cents per pound. For marketing year 2001 – the year when prices plunged to record lows – the weighted average price of US upland cotton in all markets where Brazilian cotton was also exported was 38.83 cents per pound while Brazilian weighted average prices to the same markets was significantly higher at 44.05 cents per pound.[159] Brazilian prices were lower than US prices during MY 2000 and 2002, but were higher than US prices in MY 1999.[160] This is hardly evidence of "price undercutting" by Brazilian upland cotton.

[157] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
[158] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
[159] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
[160] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

121. These very close relationships – as well as movements – of Brazilian and US cumulative prices in the 41 countries are reflected in cumulative weighted average monthly prices in the graph below:[161]




122. This graph illustrates the absolute closeness of prices between Brazilian and US prices, particularly after mid-2001. But it also shows very similar *movements* in prices between Brazilian and US exports. And, as discussed in Brazil's Answer to Question 233, these similar movements are further evidence of the influence of the global pricing mechanisms on prices received by US and Brazilian exporters in third country markets.

**Individual Third-Country Analysis of Brazilian and US Export Prices**

123. When US and Brazilian prices in the 40 individual markets are examined, the evidence does not support the United States' broad assertion that Brazilian prices are consistently lower than US prices. In some of the key textile producing countries where US exporters ship large quantities of US upland cotton – Hong Kong, Taiwan, India, Pakistan, and Vietnam – US prices during MY 1999-2002 were *lower* than Brazilian prices.[162]

124. In other large consuming (textile producing) countries, while US prices were somewhat higher than Brazilian prices, the volume of US exports vastly exceeded the volume of Brazilian exports, including China (120 times greater), Bangladesh (26 times greater), Colombia (9 times greater), Indonesia (17 times greater), Japan (35 times greater), Korea (3384 times greater), and Peru (631 times greater).[163] Huge volumes of US exports in these 7 markets compared to the volumes of Brazilian exports suggest that US exports, not Brazilian exports, play a dominating role in the conditions of competition in those markets.

[161] Exhibit Bra-386 (Brazil and US Export Price by Country).

[162] A complete set of graphs for each of the 40 countries country markets and the underlying data are set forth in Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country) and Exhibit Bra-386 (Brazil and US Export Prices by Country).

[163] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

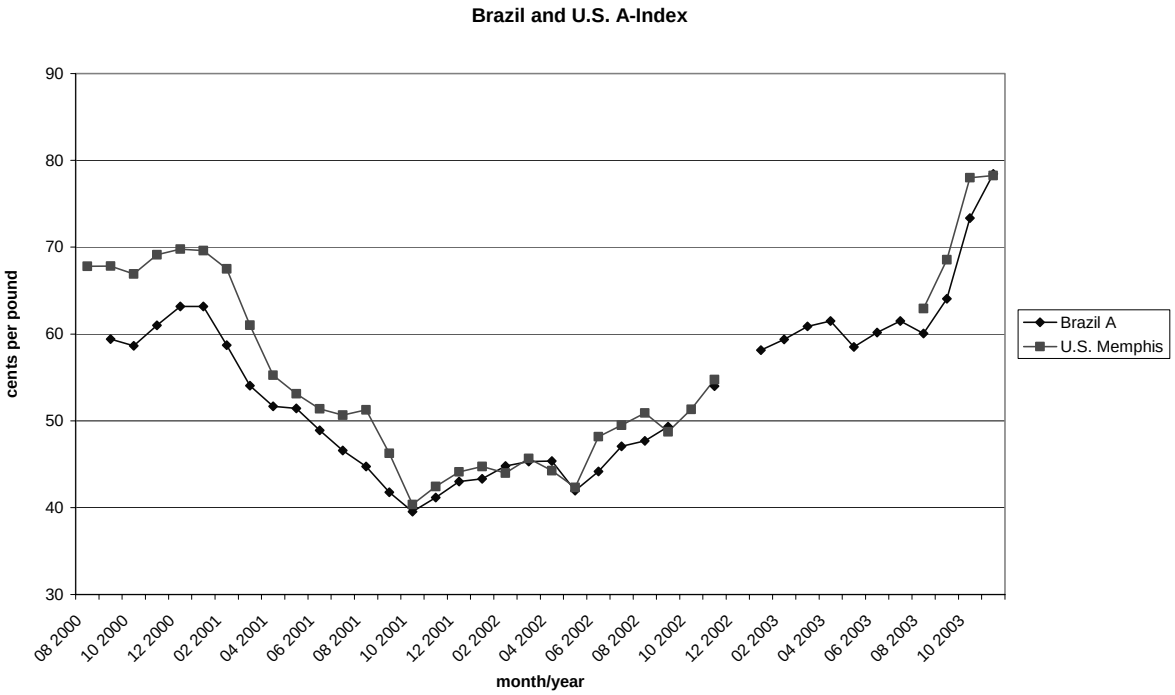
125. Indeed, overall, the cumulative volume of US exports to the 40 countries where Brazilian exports were shipped was *15 times* greater than the volume of Brazilian exports.[164] For Brazilian exports to secure any sales, let alone increase market share in competition with heavily subsidized US exports in these markets, it would not be surprising that textile consumers of upland cotton would expect Brazilian exporters to discount their prices. Andrew Macdonald confirmed that such discount pricing was necessary for non-Brazilian cottons to compete with US cotton.[165] This is particularly true in Argentina, Bolivia, Chile, Colombia, Ecuador, Indonesia, Peru, South Korea, Turkey and Venezuela where US exporters received the benefit of US export credit guarantees.[166] No exporter of non-US cotton could hope to compete with those export credits without discounting its upland cotton prices.[167]

126. But even where the volume of Brazilian exports was greater than US exports, the evidence does not suggest the absence of overall price suppression from the effects of US subsidies.[168] Brazilian exports were greater than US exports in only 10 of the 40 countries (Argentina, Bolivia, Cuba, Poland, France, Germany, Greece, Portugal, South Africa, and Spain) over the MY 1999-2002 period. These 10 countries represented a tiny fraction – 0.49 per cent – of total US exports during MY 1999-2002 to the 41 countries, and only 37.5 per cent of Brazilian exports.[169] Yet, even without significant US exports to these countries, the domestic prices of these countries still largely followed A-Index prices, as discussed in Brazil's Answer to Question 233.

127. Further, in the 10 countries where the volume of Brazilian exports was larger than the United States, Brazilian prices were higher than US prices in 3 of the 10 countries – Poland, Greece, and South Africa.[170] Further, US prices in 4 of the 10 countries – France, Germany, Spain, and Portugal – were much higher than Brazilian prices.[171] The very low volume of US exports to these same four countries suggests that far higher quality US cotton was sold in these countries which produce low-volume specialized cotton textile products.[172] Finally, US and Brazilian prices were very close in remaining 3 countries – Argentina, Bolivia, and Cuba.[173] Thus, contrary to the US arguments, this evidence does not suggest that Brazilian prices are suppressing US prices, even in those markets where there are larger volumes of Brazilian imports.

128. Similarly, the unqualified US assertion that "the Brazilian A-Index quote is consistently *below* the US A-Index quote"[174] is both untrue as well as irrelevant to the question of whether US production subsidies caused suppression of world and third country market prices. Comparing US Memphis A-Index prices with Brazil A-Index prices shows the following graph:[175]

[164] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).
[165] Brazil's 9 September Further Submission, Annex II, para. 50.
[166] Exhibit Bra-73 (Summary of Export Credit Guarantee Programmes, FY 1999-2003) and Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Activity," USDA, Covering GSM 102, GSM 103 and SCGP).
[167] Brazil's 9 September Further Submission, Annex II, paras. 49-53.
[168] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[169] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[170] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[171] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[172] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[173] Exhibit Bra-383 (Brazil and US Export Data on Quantities and Values by Country).
[174] US 2 December Oral Statement, para. 10.
[175] Based on Exhibit Bra-242 (A and B-Index Quotes from Major Producers), extended to November 2003 using Cotton Outlook quotes.




129. As the Panel can see from the graph, since October of 2001, the US Memphis A-Index price has been slightly higher or slightly lower than the Brazilian A-Index price.[176] But throughout the entire period, the *movements* of both US Memphis and Brazilian A-Index prices track each other very closely.[177] This is the key fact illustrating the transmission of global price-suppressing effects as discussed in Answer to Question 233 *supra.*

**Domestic Prices for Brazil, US and China**

130. Nor does the record support the US claim that Brazilian prices undercut US export prices to the Brazilian market. Indeed, the evidence suggests the opposite. More than 90 per cent of Brazilian production of upland cotton was sold in Brazil during MY 1999-2002.[178] Imports represented approximately 20 per cent of Brazilian consumption during MY 1999-2002.[179] US exports to Brazil represented 21 per cent of Brazilian imports with a total of 306 million pounds of US upland cotton exported to Brazil[180] in MY 1999-2002.[181] US annual weighted average export prices to Brazil were lower in every year except MY 2000 when US exports volumes fell to very low levels.[182] Significantly, in MY 1999, when US export volumes to Brazil represented 17.6 per cent of very large Brazilian imports of upland cotton, the US weighted average prices were 10.27 cents *below* Brazilian domestic prices.[183] Similarly, in MY 2002, when US exports represented 50 per cent of total Brazilian imports, US export prices were 4.57 cents per pound *lower* than Brazilian domestic

[176] The US comparison between the Brazilian quote and the California/Arizona quote is misleading given the much higher quality of the latter cotton, as discussed above.

[177] The absence of data in MY 2002 for Memphis cotton was due to weather-related quality problems according to Gerald Estur of the ICAC. *See* Exhibit Bra-375 (Information Provided by Gerald Estur, ICAC).

[178] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 76).

[179] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 76).

[180] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

[181] Exhibit Bra-208 ("Cotton: World Statistics," ICAC, September 2003, p. 76).

[182] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

[183] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country).

prices.[184] This evidence confirms the testimony of Andrew Macdonald that Brazilian textile purchases of cotton used, *inter alia,* US imports – or the threat of US imports – to negotiate lower Brazilian domestic prices during MY 1999-2002.[185] It may also be an effect of US GSM 102 export credit guarantees. And this evidence further confirms the price suppressing effects of US subsidies in the Brazilian market.

**Conclusion**

131. The evidence set out above refutes the inappropriate non-weighted average analysis in Exhibit US-75, and confirms the effects of the US subsidies in each market where Brazil and the US upland cotton were found in MY 1999-2002. Any "competition" between US and Brazilian cottons took place against the background of subsidy-distorted marketplaces. In the final analysis, the fact that selected US prices are higher[186] or lower in the A-Index or in individual third country markets is largely irrelevant to the question whether US subsidies are causing significant price suppression "in the same market" where US and Brazilian cotton is marketed. Rather, as Brazil has established, it is the impact of the US subsidies on the global supply and demand factors that suppresses prices in the world market as well as in the third countries where upland cotton is marketed. This means that the prices in each of those 40 third country markets – as well as the Brazilian and US markets – were already suppressed before any cotton was shipped by US or Brazilian exporters.

132. Finally, the generalized price-suppression effect manifests itself in all 42 individual country markets[187] in which Brazilian upland cotton is consumed. Professor Sumner estimates that over 40 per cent of US upland cotton exports during MY 1999-2002 would not have been made *but for* the US subsidies.[188] Forty per cent fewer US exports necessarily means lower, or even non-existent, US exports in many of the 40 markets where Brazil exported its upland cotton. Had significant volumes of US upland cotton not received Step 2 export payments, US exports and, thus, the amount of US upland cotton competing with Brazilian cottons would have been lower. Similarly, far fewer bids of US upland cotton financed by the GSM 102 programme may well have meant higher prices for Brazilian exporters and/or an expanded market share in each of these markets.

**236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share". USA**

**237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? BRA, USA**

[184] Exhibit Bra-383 (Brazil and US Export Data on Export Quantities and Values by Country); Exhibit Bra-389 (Brazilian Domestic Price Data) *updating* Exhibit Bra-240 (International, US and Brazilian Prices).

[185] Brazil's 9 September Further Submission, Annex II, para. 47 ("local purchasers of Brazilian cotton will frequently threaten to import foreign cotton if they consider the price of local cotton to be too high.").

[186] *See* Brazil's 9 September Further Submission, Figure 17 (US California A-Index prices were higher than Brazilian prices).

[187] 40 export markets plus the United States and Brazil.

[188] Brazil's 9 September Further Submission, Annex I, Table 5a. This conclusion is conservative in view of the huge $12.5 billion loss that would have been suffered by US producers with no US subsidies between MY 1997-2002.

Brazil's Answer:

133. In responding to this question, Brazil starts from the ordinary meaning of the term "consistent trend." A "trend" means "a general course, tendency or drift."[189] "Consistent" means "congruous, compatible with, not contradictory, marked by uniformity or regularity."[190] A consistent trend within the meaning of Article 6.3(d) therefore means a non-contradictory tendency marked by regularity.

134. Generally, a phenomenon that remains at approximately the same level could be considered a consistent trend. However, read in the context of Article 6.3(d), which speaks of an "increase that follows a consistent trend over a period when subsidies have been granted," the consistent trend must reflect the increase in the world market share of a Member over its previous three-year average. Thus, for a given period of time, the world market share of a Member could remain at approximately the same level and be compatible with a finding of a consistent trend. Yet, there will not be a consistent trend, within the meaning of Article 6.3(d), if during the final year there is no increase of a Member's world market share over its previous three-year average. It follows that over the period when subsidies have been granted there must be a regular tendency of an increase in the world market share of a Member – although no increase in each and every year is required for the conditions of Article 6.3(d) to be fulfilled.

135. This interpretation is confirmed by the scope of Article 6.3(d), which applies to primary products or commodities. The parties agree that this includes agricultural products that necessarily will be affected by favourable or adverse weather conditions. The United States, for example, repeatedly asserts that the weather-related problems of MY 1998 mean that data for that year should be disregarded. These weather-related effects alone could cause in particular years the world market share of a Member to increase or decrease. This may well be the reasoning behind requiring examination of a longer trend in Article 6.3(d). But to require a constant increase in the world market share during each year "when subsidies have been granted" would render the disciplines of Article 6.3(d) largely inutile for agricultural products faced with weather-related production fluctuations.

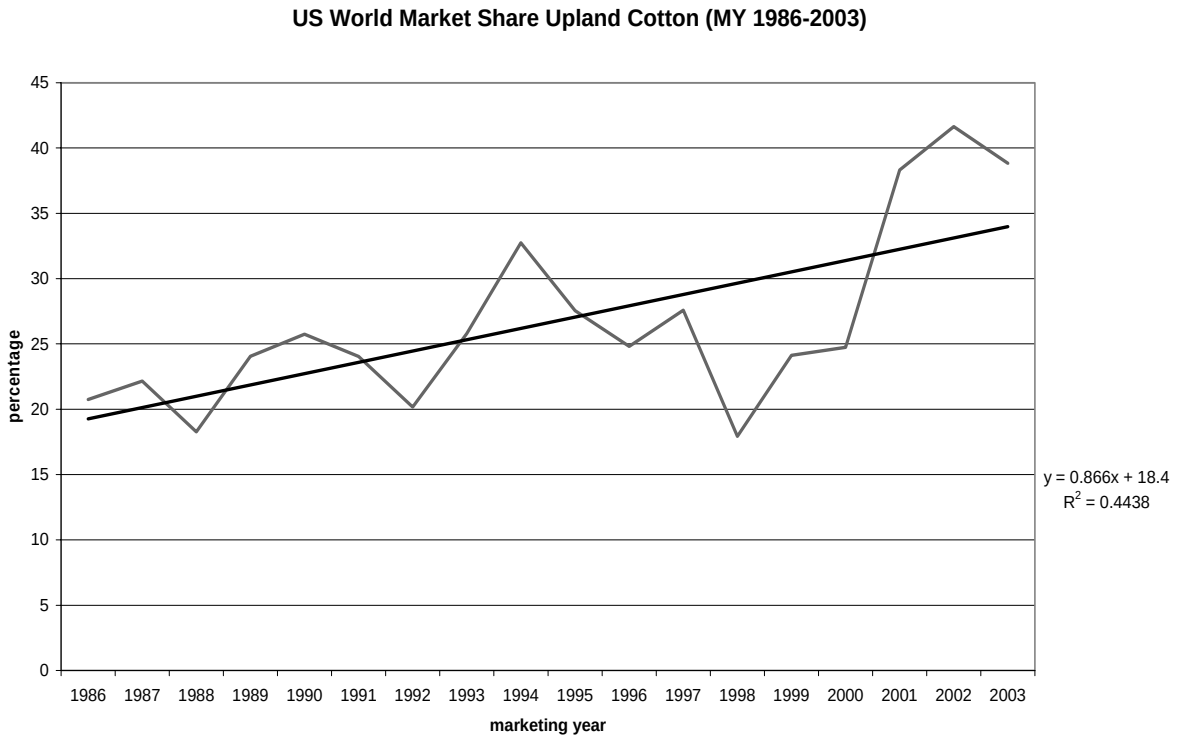
136. Brazil has offered data on the US world market share over the period since MY 1996 as well as since MY 1986.[191] The data shows that the trendline for the US world market share increases whether based on MY 1996 or MY 1986 as the starting point. The Panel's question asks for guidance on the conditions for a finding whether this trend is consistent.

137. Brazil cautious that statistical methods may not be helpful in analyzing the consistency of a trend within the meaning of Article 6.3(d) for two reasons: first, Article 6.3(d) is concerned with yearly data over a relatively short period. That means that only very few data points will be available, which will affect the statistical significance of any results. Second, as discussed above, it is the nature of world market shares in agricultural products to fluctuate due to weather-related effects. This phenomenon tends to further weaken any statistical significance of methods analyzing the consistency of a trend.

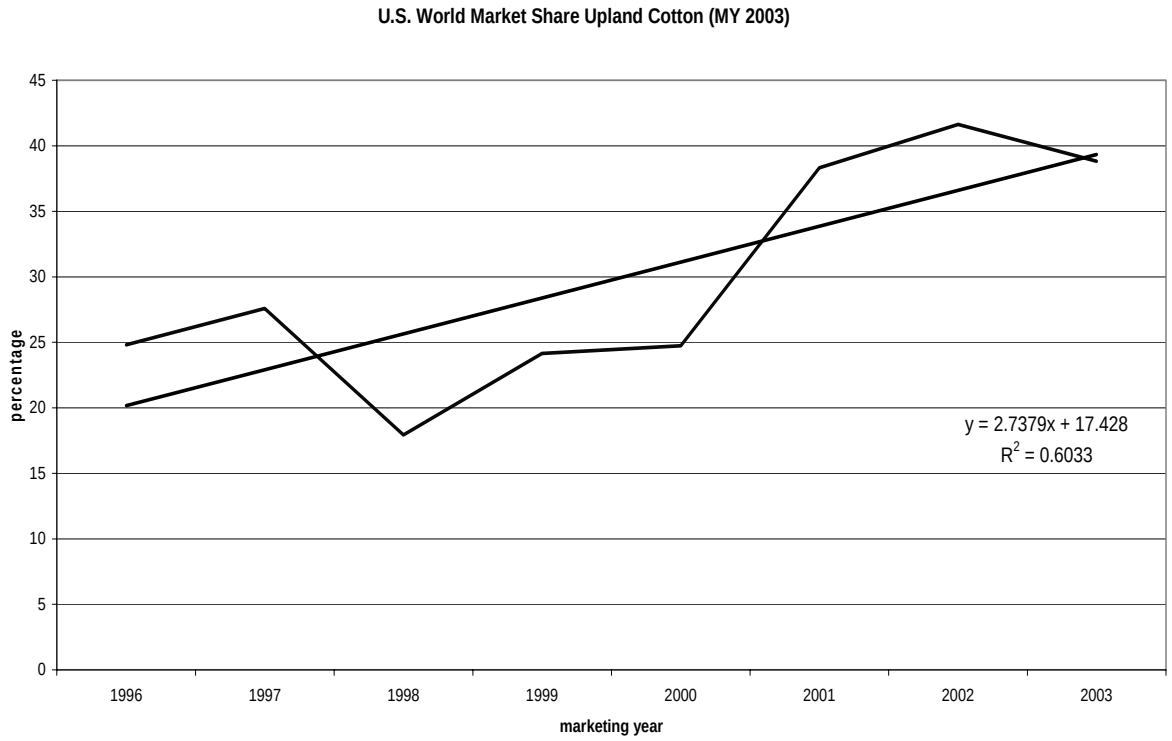
138. With these considerations in mind, Brazil suggests that the Panel analyze the trendlines offered by Brazil[192] and decide whether on their face they demonstrate – as Brazil has argued – a trend consistent with a finding that the effect of the subsidies is an increase in the US world market share for upland cotton. Brazil believes they do, particularly if the severe MY 1998 decline is disregarded.

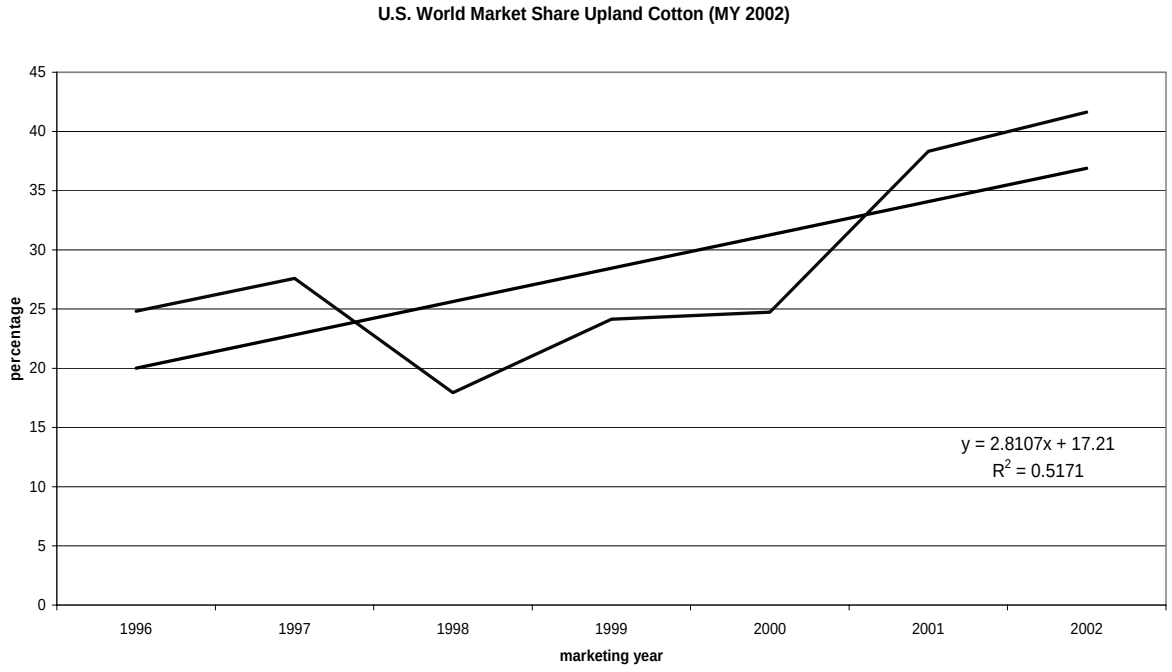
[189] The New Short Oxford English Dictionary 1993 edition, p. 3384.
[190] The New Shorter Oxford English Dictionary, 1993 edition, p. 486.
[191] Brazil's 27 October Answers to Questions, paras. 123-129 and Brazil's 9 September Further Submission, Sections 3.4 and 4.12.2.
[192] Brazil's 27 October Answers to Questions, paras. 123-129 and Brazil's 9 September Further Submission, Sections 3.4 and 4.12.2.

139. However, Brazil has also run a regression analysis for the trends over the period MY 1986-2003, MY 1996-2003 and MY 1996-2002, with the results being reproduced in the graphs below.[193]




[193] The results are based on data as reported in Exhibit Bra-302 (Revised and Extended Data on Article 6.3(d) Claim).




The $R^2$ – the measure for the fit of a regression analysis – varies between 0.44 for MY 1986-2003 and 0.60 for MY 1996-2003. The $R^2$ demonstrate that there is a positive relationship between the US world market share and its increase over time. In view of the limited number of observations and the nature of the commodity market in question, this is a very high number.

**238. According to the US interpretation of the term "world market share":**

**(a) should the domestic consumption of closed markets be added into the denominator?**

**(b) if US production and consumption increased by the same percentage, whilst the rest of the world's production and consumption remained steady, would this imply an increase in the US "world market share" by a different percentage?**

**(c) does Saudi Arabia have a small world market share for oil? USA**

**239. How does the US respond to Brazil's assertions that, under the US interpretation of the term "world market share":**

**(a) there would be no WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports? (see paragraph 64 of Brazil's 2 December oral statement);**

**(b) a Member's exports would have to be disregarded in calculating their "world market share" in terms of "world consumption"? (see e.g. paragraph 65 of Brazil's 2 December oral statement) USA**

**240. Does Article XVI:3 of GATT 1994 provide context in interpreting Article 6.3(d) of the *SCM Agreement*? Do these provisions apply separately? If not, could it indicate that "world market share" is intended to mean the same as "share of world export trade"? USA**

**241. How does the US reconcile its data on consumption for 2002 in US Exhibit 40, Table 1 with the "consumption" data it refers to in its 30 September submission, paragraph 34, Exhibit US-47 or US-71? USA**

**242. How much of the benefits of PFC, MLA, CCP and Direct Payments go to land owners? If not all of the benefits go to land owners, what proportion goes to producers? USA**

**243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? USA**

**244. What proportion of the 2000 cottonseed payments benefited *producers of upland cotton*, given that payments were made to *first handlers*, who were only obliged to share them with the producer to the extent that the revenue from sale of the cottonseed was shared with the producer? (see 7 CFR §1427.1104(c) in Exhibit US-15). BRA**

Brazil's Answer:

140. Brazil does not know "what proportion of the 2000 cottonseed payments" were paid *directly* to producers of upland cotton by first handlers. Any such information would be within the exclusive control of USDA. Therefore, Brazil looks forward to the United States providing this information in its 19 January comments.

141. However, there is evidence that the MY 2000 cottonseed payments – together with the MY 1999 and MY 2002 payments – benefited upland cotton producers either directly or indirectly. First, producers who ginned their own cotton received payments directly as "first handlers." But even producers who did not gin their own cotton received indirect benefits because the purpose and effect of the subsidy was to prevent producers from having to pay *more* for ginning because of low

cottonseed prices. This was made clear by the official USDA announcement of the USDA Secretary Glickman in announcing the MY 2000 cottonseed payments:

> Agriculture Secretary Dan Glickman announced today that USDA will propose to pay cotton farmers and ginners about $74 million to help offset losses from low 1999-crop cottonseed prices.
>
> Because of those low prices, many gins were unable to meet operating expenses normally covered by cottonseed revenues and some cotton farmers had to pay higher ginning costs," Glickman said. "This discretionary programme will help farmers make up this lost income."
>
> The proposed payments would be made to cotton gins based on seed tonnage produced from the 1999 crops of upland and Extra Long Staple cotton. USDA plans to propose that *gins share cottonseed programme payments with cotton farmers commensurate with any increased 1999-crop ginning charges as a condition of accepting programme payments.*[194]

142. This analysis makes it clear that upland cotton producers in MY 1999-2000 were required to pay more for ginning when cottonseed prices fell because ginning companies accept as part of the payment for ginning the cottonseed produced from the ginning process of raw cotton. The benefits of the cottonseed programme to producers explains why the NCC strongly supported the "the establishment of a permanent programme for cottonseed" during the debate for the 2002 FSRI Act.[195] In testimony before Congress, the Chairman of the NCC stated as follows:

> *Cottonseed is a critical component of total farm revenue* generated from cotton production. From 1994-1998, cottonseed accounted for approximately 13 per cent of the total value of cotton production, averaging $58 per acre. Unfortunately cottonseed prices weakened significantly in 1999 as a result of weak crushing demand ads well as low oilseed prices. Cottonseed values remain well below those of previous years. The special cottonseed payment authorized by Congress for the 1999 and 2000 marketing years were *vitally important on boosting producer income* and helping to maintain the industry's ginning infrastructure.[196]

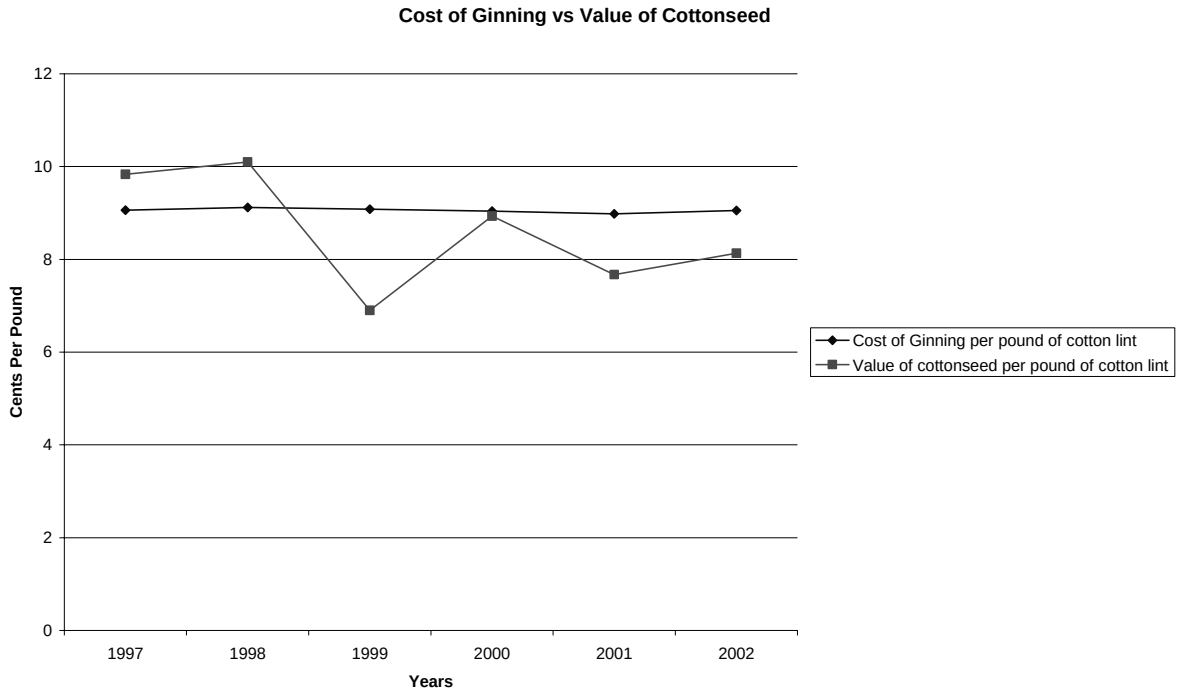
143. Finally, the importance of cottonseed payments to producers is further demonstrated by comparing the costs of ginning to the value of cottonseed. This is illustrated in the graph below:[197]

[194] Exhibit Bra-390 ("Glickman Proposes Cottonseed Payment Programme," USDA News Release, 29 February 2000) (emphasis and underlining added).

[195] Exhibit Bra-41 (Congressional Hearing, "The Future of Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, p. 5).

[196] Exhibit Bra-188 (Testimony of James Echols, Chairman of the National Cotton Council before the Committee of Agriculture, Nutrition and Forestry of the US Senate, 17 July 2001, p. 9).

[197] This graph is based on per pound figures for the value of cottonseed and the cost of ginning per pound of cotton lint produced as calculated from Exhibit Bra-323 (Costs and Returns of US Upland Cotton Farmers, MY 1997-2002). They calculated figures are reproduced in Exhibit Bra-391 (Cost of Ginning and Value of Cottonseed per Pound of Cotton Lint).




144. This graph shows that producers were the primary beneficiaries of the cottonseed programme. When cottonseed prices declined in MY 1999, ginning costs exceeded cottonseed prices by 2.18 cents per pound of cotton lint.[198] This gap between ginning costs and cottonseed prices totalled $170.5 million.[199] Congress authorized $185 million in cottonseed payments in MY 2000[200], which covered much of the MY 1999 losses. As noted, it was upland cotton *producers* – not ginners – who were required to pay the $170.5 million difference in MY 1999 between the costs of ginning and the value of the cottonseed. When cottonseed prices again plunged in MY 2001 and MY 2002, Congress provided relief to producers with the 2002 cottonseed payments. For example, the $50 million in cottonseed payments in MY 2002 covered part of a gap of $73 million between the ginning cost and the value of the cottonseed.[201] Thus, this evidence suggests not only that cottonseed payments were support to upland cotton within the meaning of Article 13(b)(ii) of the Agreement on Agriculture, but that these payments, while relatively small in comparison to the billions of dollars paid to US producers, nevertheless, provided yet further subsidies supporting large quantities of US upland cotton production.

**245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? BRA, USA**

[198] Exhibit Bra-391 (Cost of Ginning and Value of Cottonseed per Pound of Cotton Lint).

[199] This figure has been calculated based on the price gap of 2.18 cents per pound multiplied by the MY 1999 production of 16.294 million 480-pound bales (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4).

[200] Brazil's 9 September Further Submission, Table 1.

[201] This figure has been calculated based on the price gap of 0.92 cents per pound multiplied by the MY 2002 production of 16.531 million 480-pound bales (Exhibit Bra-391 (Cotton and Wool Outlook, USDA, 12 December 2003, Table 1).

Brazil's Answer:

145. The Panel is well aware of Brazil's view that all of the US subsidies are non-green box. But if the Panel were to find that certain of the subsidies are green-box subsidies, then under the specific circumstances of this dispute, Article 13(a)(ii) of the Agreement on Agriculture prohibits – during the implementation period – the effects of these subsidies being included along with other effects of non-green box subsidies in assessing Brazil's actionable subsidy claims. Professor Sumner's analysis in Annex I of Brazil's 9 September Further Submission permits the Panel to examine both the individual as well as collective effects of the various US subsidies. In response to Question 146, Professor Sumner analyzed the production, export and price effects of all of the subsidies except PFC subsidies.[202] This analysis would also permit the Panel to ensure that effects caused by, for example, PFC payments, were not attributed to the effects caused by the other non-green box subsidies.

146. After the 9-year implementation period of the Agreement on Agriculture, there is nothing in that Agreement that exempts the effects of green box subsidies from being considered by panels in actions based on Articles 5 and 6 of the SCM Agreement. Subsidies that conform to Annex 2 of the Agreement on Agriculture are exempt from the reduction commitments established under Article 6, but there is nothing in Articles 5 or 6 of the SCM Agreement that provides for any type of exemption, beginning in 2004. On the contrary, Article 5 of the SCM Agreement clearly states the Members should not cause, "… through the use of *any* subsidy … adverse effects to the interests of other Members." The only exception provided therein refers to the temporary exception of Article 13 of the Agreement on Agriculture.

**246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? BRA, USA**

Brazil's Answer:

147. Yes, the Panel is required to take into account *all* non-green box subsidies, including prohibited subsidies in assessing Brazil's Article 5 and 6 claims under the SCM Agreement.[203] Even if the Panel were to conclude that the effects of prohibited subsidies, such as Step 2 and export credit guarantees, should not be assessed for the purposes of Brazil's Article 5 and 6 claims, Professor Sumner's analysis permits the Panel to analyze such claims for those non-green box and non-prohibited subsidies (marketing loan payments, crop insurance subsidies and contract payments).

**247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? BRA, USA**

Brazil's Answer:

148. Yes. Nothing prevents the Panel from considering – in assessing Brazil's threat of serious prejudice claims – the volatility of the upland cotton market and current and likely futures price developments after the date of establishment of the Panel. Brazil has proposed that the Panel follow the guidance of the GATT *EC – Sugar Exports* panels and the Appellate Body in *US – FSC* and analyze whether there is any mechanism that stems, or otherwise controls, the flow of US upland

[202] Brazil's 27 October Answers to Questions, paras. 114-118 and Exhibit Bra-301 (Additional Results from Professor Sumner's Model, Table "Impact of removal of all domestic support except PFC/direct payments and crop insurance).

[203] *See* Brazil's 27 October Answer to Question 145(b).

cotton subsidies and whether these mandated and unlimited subsidies constitute a permanent source of uncertainty in the upland cotton market.[204]

149. The Panel's question raises both legal and factual issues. First, as a legal matter, Brazil has previously argued that it is appropriate for the Panel to consider pricing, export, production, acreage and other evidence occurring after the date of establishment of the Panel.[205] The Panel's terms of reference in this case involve both *present* and *threat* of serious prejudice claims (*i.e.*, matters) with each of these types of claims overlapping during the period of MY 2002. Thus, the "matter" before the Panel has not changed (and cannot) since the establishment of the Panel.

150. In "making an objective assessment of the matter," the Panel must make "an objective assessment of the facts of the case" pursuant to DSU Article 11. Nothing in the text of DSU Article 11 suggests that this objective assessment of "facts" cannot include collecting and analyzing facts occurring after the establishment of a Panel. Indeed, there are a number of precedents in which panel's have considered evidence that came into existence *after* the date of the establishment of a panel.[206] As with investigating authorities in trade remedy investigations, a "period of investigation" for a WTO Panel in an Article 5 and 6 claim is useful for assessing whether present or threatened effects presently exist. There is nothing in the text of Part III of the SCM Agreement or the DSU that suggests that the time period for the collection of evidence or data to investigate must stop with the establishment of the Panel.

151. The second question raised by the Panel's question is a factual one, *i.e.*, what weight should the Panel give to the most recent evidence of volatility in the cotton futures and spot markets? It is fact that upland cotton prices have risen – and fallen – significantly since the Panel was established in March 2003. For example, futures prices for the nearby March 2004 contract rose from 55.80 cents on 6 March 2003 to a high of 86 cents on 30 October before falling to 72.32 cents on 19 December 2003.[207] But the record shows that such volatile futures price increases – and decreases – also occurred between MY 1999-2002.[208] And they will no doubt exist during MY 2003-2007.

152. In assessing whether there is a threat of serious prejudice, the Panel should be cautious about relying too heavily on only 3-4 months worth of the most recent data. Indeed, the Appellate Body has cautioned that "competent authorities are required to examine the trends in [data] over the entire period of investigation," because the "analysis could be easily manipulated to lead to different results, depending on the choice of end points."[209] Similarly, in *Argentina – Footwear* the Appellate Body held that "competent authorities are required to consider the trends in imports over the period of investigation (rather than just comparing the end points)."[210] The panel in *Argentina – Peach Safeguards* stated that "[t]the most recent past should not be considered separately from the overall

[204] *See* Brazil's 18 November Further Rebuttal Submission, Section 4.

[205] Brazil repeatedly in its many submission to the Panel refers to data that originates after the establishment of the Panel, including in these answers to the Panel's questions.

[206] Panel Report, *India – Quantitative Restrictions*, WT/DS90/R, para. 5.161-5.163 ("In this case the parties and the IMF have supplied information concerning the evolution of India's balance of payments and reserve situation until June 1998. To the extent that such information is relevant to our determination of the consistency of India's balance of payments measures with GATT rules as of the date of establishment of the Panel [18 November 1997], we take it into account."); Panel Report, *Japan – Apples*, WT/DS245/R, para. 8.49; GATT Panel Report, *Korea – Beef*, BISD 36S/268, paras. 122-123.

[207] Exhibit Bra-393 (Futures Prices as of 19 December 2003).

[208] *See* Exhibit Bra-311 (Side-By-Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average Spot Market Price and Prices Received by US Producers from January 1996 to the Present).

[209] Appellate Body Report, *US – Steel Safeguards*, WT/DS248/AB/R, paras 353-356.

[210] Appellate Body Report, *Argentina – Footwear*, WT/DS121/AB/R, para. 129.

trends during the period of analysis," as otherwise the resulting picture may be "quite misleading."[211] The Panel in this case performs a task similar to a domestic competent authority in a trade remedy case.

153. The Panel has before it two different methodologies to judge the present price levels and threat of serious prejudice. The first methodology before the Panel is the use of baseline projections such as the USDA's and FAPRI's baseline projections to assess the effects of mandated US subsidies in the year ahead. Professor Sumner's analysis based on the January 2003 FAPRI baseline, shows that the US subsidies continue to maintain large amounts of US production whether prices are high or low. Professor Sumner found that during MY 2003-2007 annual US production would be 19.4 per cent lower leading to a reduction in projected US exports by 32.4 per cent annually and world prices that would be 8.3 per cent higher absent the US subsidies.[212] Similarly, Professor Ray of the University of Tennessee also found significant production, export, and price suppressing effects from the US subsidies from MY 2003-2007.[213] These findings by two of the leading US economists cannot be ignored by the Panel.

154. A second far less valid methodology would be to use the US "futures methodology." This methodology would examine the December futures price at the time of planting (January-March 2004). What is significant about current futures prices (in December 2003) is that the "futures market" is predicting that prices will fall in MY 2004. The December 2003 price of the December 2004 futures contract is 65.85 cents per pound as of 19 December 2003, while the March 2004 futures contract is 72.32 cents per pound.[214] Assuming that the current 65.85 cents per pound December 2004 futures contract price will continue during the planting decision marking time between January-March 2004, the expected adjusted world price will be 52.48 cents per pound[215] and the expected average MY 2004 price received by US producers would be 59.73 cents per pound.[216] This means that US producers "expect" to receive a considerable CCP payment of 6 cents per pound in MY 2004 (65.73 cents minus 59.73 cents).

155. As discussed by Professor Sumner on 3 December, given the probability distribution of the expected adjusted world price,[217] producers would also expect to receive some marketing loan payments because producers expect with a certain probability that the adjusted world price would be below the marketing loan rate triggering marketing loan payments.

156. As with the period MY 1999-2002, the existing (December 2003) price levels in the upland cotton world and US markets mean that US producers will be planting in 2004 for government support during MY 2004, not for the market. This constant theme was recently emphasized by the world's largest cotton trader, William Dunavant:

> The [US] farm programme can return more when prices are low rather than when prices are high . . . [and] [t]he loan deficiency payment created by the farm programme is the name of the game – not necessarily the futures price or the cash price . . .

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[211] Panel Report, *Argentina – Peach Safeguards*, WT/DS238/R, para. 7.64-7.65 citing para. 138 of the Appellate Body Report in *US – Lamb*.

[212] Exhibit Bra-326 (Results of Professor Sumner's Modified Model, Table B).

[213] *See* Brazil's 9 September Further Submission, paras. 204-205.

[214] Exhibit Bra-393 (Futures Prices as of 19 December 2003).

[215] Exhibit Bra-370 (The Difference between the Average World Price and the Nearby December Futures Contract Price).

[216] The spread of 6.12 cents has been calculated based on the data in Exhibit Bra-370 (The Difference between the Average World Price and the Nearby December Futures Contract Price) and the average farm price in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 5).

[217] *See* Exhibit Bra-371 (Simple Example of the Calculations of Marketing Lon Benefits (Probability Distribution)).

> It's interesting that we project nearly an 8 per cent increase in world production [in MY 2003], but US production is forecast to rise only slightly. *This tells me the world is certainly more price sensitive and responsive than the US cotton producer*. I think the nature of our farm programme definitely creates this situation. *Cotton futures prices need to rise to nearly 70 cents a pound to make cash prices better than the farm programme protection.*[218]

In addition, Mr. Dunavant emphasized that US producers "must have" the GSM-102 programme "if we are to export the quantities needed to support our level of cotton production in this country [*i.e.*, the United States]."[219] These statements by the world's leading cotton trader confirm the significant effects that have existed and will continue to exist at current price levels because of the mandatory nature of the subsidy programmes.

157. Finally, nothing about the price levels that have increased since 18 March 2003 has changed in any way the mandatory nature of the US subsidies. At current price levels, producers would receive benefits from crop insurance subsidies, direct payments, and indirectly from Step 2 payments and export credit guarantees. Whether prices are at 70 cents per pound or 30 cents per pound, US producers know and expect that they will be protected by the wide range of US subsidies. When US prices decline, as they inevitable will, US producers will be provided direct production incentives to continue producing at any price level. Historical data convincingly demonstrates that this downside risk protection guarantees high levels of production. Brazil proved that US planted acreage remains high within relatively narrow ranges whether market prices increase or decrease. This lack of US producers' production response to huge costs overruns of $12.5 billion over six years or to record low prices, or even to increasing prices, is at the heart of Brazil's threat case. While the cumulative price-suppressing and export-enhancing effects of the US subsidies may be smaller now than they were on 18 March 2003, they are, and will remain significant for MY 2003 and for MY 2004 based on current prices.

158. In sum, Brazil reiterates its arguments that taking all available data into account, the US subsidies pose a threat of serious prejudice to the interests of Brazil, in violation of Articles 5(c) and 6.3 of the SCM Agreement and GATT Articles XVI:1 and XVI:3.[220]

## VI. Step 2

**248. In respect of the level of Step 2 payments in certain time periods, the Panel notes, *inter alia*, footnote 129 in the US first written submission; footnote 33 in the US 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? BRA, USA**

Brazil's Answer:

159. Under the 2002 FSRI Act (with the elimination of the 1.25 cent per pound threshold), Step 2 payments will be zero when the lowest US A-Index quote is equal or below the average A-Index.[221] Thus, for Step 2 payments to expire, the lowest US quote will have to be one of the cheapest of the

[218] Exhibit Bra-392 ("William Dunavant Says: Overproduction Thwarts Cotton Price Upturn," Western Farm Press).
[219] Exhibit Bra-392 ("William Dunavant Says: Overproduction Thwarts Cotton Price Upturn," Western Farm Press).
[220] *See* Section 4 of Brazil's 18 November Further Rebuttal Submission.
[221] Exhibit Bra-29 (Section 1207 (a) of the FSRI Act).

only five quotes making up the given A-Index. During MY 2002, there were zero Step 2 payments during five weeks: 20 September, 27 September, 4 October, 11 October and 18 October 2002.[222]

160. By contrast, during MY 2001, Step 2 payments were zero during 15 weeks: 14 December, 21 December, 28 December, 4 January, 11 January, 18 January, 25 January, 1 February, 8 February, 15 February, 22 February, 1 March, 8 March, 15 March, and 22 March.[223]

161. The elimination of the 1.25 cent per pound threshold under the 2002 FSRI Act has reduced the likelihood of zero payments under the Step 2 programme because the lowest US quote must now be even lower relative to the A-Index for Step 2 payments to expire. It also means that the US government will pay the entire difference between the cheapest US price quote for the A-Index and the A-Index itself.

**249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":**

**(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer?[224] How, if at all, would this be relevant for an analysis of the issue of export contingency under the *Agreement on Agriculture* or the *SCM Agreement*? BRA**

Brazil's Answer:

162. As set out in Brazil's Answer to Question 125, Step 2 payments generally are not received by US producers but rather by eligible exporters and domestic users.[225] Of course, it is theoretically possible for a producer to receive directly Step 2 payments when the producer meets the definition of an exporter "regularly engaged in selling eligible upland cotton for *exportation* from the United States."[226] However, the fact that most US producers do not *directly* receive Step 2 payments does not mean that they do not benefit *indirectly* from Step 2 payments. Quite the contrary. Step 2 payments support significant quantities of planted upland cotton acreage, production and exports by stimulating the demand for high-cost and high-priced US cotton.[227] Brazil has provided considerable evidence of these effects in its earlier submissions that has never been rebutted by the United States.[228]

163. The answer to the second question is "not at all." Exporters are only eligible to receive Step 2 export payments if they produce evidence to CCC that they have exported an amount of US upland cotton. Thus, payments are conditional upon proof of export. Exporters will not receive any Step 2 export payments if they have not produced evidence of the export of US upland cotton. In sum, the fact that producers – in their capacity as exporters – may benefit from Step 2 export payments does not impact the export contingency of these payments.

[222] Exhibit Bra-350 (Weekly Step 2 Certificate Values).
[223] Exhibit Bra-350 (Weekly Step 2 Certificate Values).
[224] For example, Brazil's response to Panel Question 125, paragraph 14.
[225] Brazil's 27 August Answers to Question, para. 14.
[226] Exhibit Bra-37 (7 CFR 1427.104(a)(2)).
[227] *See* Brazil's 9 September Further Submission, Annex I, table I.5f.
[228] Sections 2.6.7, 2.6.8, 4.1, 5.1 and 5.2 of Brazil's 24 June First Submission; Section 3 of Brazil's 22 July Oral Statement; Brazil's 24 July Closing Statement, paras. 21-22; Section 4 of Brazil's 22 August Rebuttal Submission; Section 3.3.4.7.5 of Brazil's 9 September Further Submission; Section 3.7.3 of Brazil's 18 November Further Rebuttal Submission.

**(b) How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do *not* go directly to the producer? USA**

**(c) What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. USA**

## VII. Remedies

**250. Does Brazil seek relief under Article XVI of *GATT 1994* in respect of expired measures? What type of recommendation would the Panel be authorized to make? (Brazil further submission, paragraph 471 (iii)) BRA**

Brazil's Answer:

164. Brazil does not seek relief under GATT Article XVI of GATT 1994 in respect of expired measures, which Brazil understands the Panel to mean only the legal instruments consisting of the 1996 US Farm Bill providing, *inter alia,* for production flexibility contract payments, as well as the various emergency appropriation Acts in 1998-2001 providing, *inter alia,* for market loss assistance payments.[229]

165. With respect to the second question, the Appellate Body held in *US – Certain EC Products,* that a panel may *not* make a recommendation to the DSB that a Member bring a measure into conformity with its WTO obligations if that measure no longer exists.[230] Therefore, as detailed in paragraph 471(x) of Brazil's 9 September Further Submission, Brazil requests the Panel to recommend that the United States bring its existing measures providing or facilitating the payment of subsidies to producers, users and exporters of upland cotton into conformity with GATT Article XVI.

**251. In light, *inter alia,* of Article 7.8 of the *SCM Agreement,* if the Panel were to find that any subsidies have resulted in adverse effects to the interests of another Member within the meaning of Article 5 of the *SCM Agreement,* should it make any recommendation other than the one set out in the first sentence of Article 19.1 of the DSU? BRA**

Brazil's Answer:

166. Yes. If the Panel agrees with Brazil that the US subsidies to upland cotton cause and threaten to cause serious prejudice to the interests of Brazil, in violation of Article 5 of the SCM Agreement, the Panel should recommend pursuant to Article 7.8 of the SCM Agreement that the United States remove these adverse effects or withdraw the subsidies.[231]

**252. Without prejudice to any findings by the Panel, if the Panel were to find that any of the challenged measures constitute prohibited subsidies within the meaning of Article 3 of the *SCM Agreement,* what are the considerations that should guide the Panel in making a recommendation under Article 4.7 of the *SCM Agreement* relating to the time period "within which the measure must be withdrawn"? What should that time period be? BRA**

[229] Brazil's claims under Articles 5(a) and 6(c) of the SCM Agreement do include the continuing adverse effects today and in the future of subsidies provided under these expired legal provisions. *See* Brazil's 24 July Closing Statement, paras 4-7.

[230] Appellate Body Report, *US – Certain EC Products*, WT/DS165/AB/R, para. 81

[231] *See* Brazil's 9 September Further Submission, paras. 471(viii) and 471(ix).

Brazil's Answer:

167. Brazil suggests that the Panel follow the precedent of all previous WTO panels[232] that made findings of prohibited subsidies and specify that the measure must be withdrawn within 90 days.[233]

## VIII. Miscellaneous

**253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):**

**(a) Does it relate to export credit guarantees, crop insurance and cottonseed payments?**

**(b) Does it relate only to compliance with AMS commitments?**

**(c) Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?**

**(d) How would the Secretary exercise her authority to prevent serious prejudice to the interests of another Member? How would she exercise her authority to prevent a threat of serious prejudice to the interests of another Member? At what time and on the basis of what type of information would she exercise her authority?**

**(e) What does "to the maximum extent practicable" mean? In what circumstances would it not be practicable for the Secretary to exercise her adjustment authority? USA**

**254. Would payments made after the date of panel establishment be *mandatory* under the marketing loan, direct payments, counter-cyclical payments and user marketing certificate (step 2) programmes, but for the circuit-breaker provision? USA**

**255. How does Brazil respond to US assertions concerning the circuit-breaker provision? (see US 2 December oral statement, paragraph 82). Does this mean that US subsidies cannot be "mandatory" for the purposes of WTO dispute settlement? BRA**

Brazil's Answer:

168. The United States has admitted what the text of the "circuit breaker" provision in Section 1601(e)(1) of the 2002 FSRI Act already makes clear, *i.e.* that it only applies to "total allowable domestic support levels under the Uruguay Round Agreements," *i.e.*, "total AMS."[234] The United States further acknowledges that this provision "is not specifically addressed to forestalling

[232] Panel Report, *Brazil – Aircraft*, WT/DS46/R, para. 8.5; Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 10.4; Panel Report, *Australia – Leather*, WT/DS126/R, paras. 10.6-10.7, Panel Report, WT/DS139/R and WT/DS142/R, paras. 11.6-11.7 and Panel Report, *Canada – Aircraft II*, WT/DS222/R, para. 8.4.

[233] Brazil notes that the panel in *US – FSC* took account of the fact that the US tax system could only be changed from the beginning of the next fiscal year and therefore set the 1 October 2001 as the deadline for withdrawing the FSC subsidies "without delay."

[234] US 2 December Oral Statement, para. 82

serious prejudice."[235] Indeed, no provision in US law is designed to forestall serious prejudice to US trading partners caused by US agricultural subsidies *specifically in support of upland cotton*.

169. The current US "total AMS" is $19.1 billion. As long as the United States stays below this level, there is no legal provision in the 2002 FSRI Act granting the Secretary of Agriculture any authority to stem, or otherwise control, the amount of upland cotton subsidies. Indeed, the numerous mandatory provisions of the 2002 FSRI Act text cited in Brazil's earlier submissions[236] *requires* the Secretary to make the payments to which eligible producers, users and exporters have a legal entitlement. No exceptions for upland cotton are provided for. Thus, these provisions continue to be mandatory in all circumstances where the US total AMS is below $19.1 billion. The Appellate Body and WTO panels have held that measures are mandatory where they cannot be applied in a WTO consistent manner in certain circumstances.[237]

170. And even were the US total AMS to exceed $19.1 billion, the text of Section 1601(e)(1) does not mandate any reductions if it is not "practicable" to do so. Nor does the text mandate an even, across the board, cut for *all* programme crops. For example, the Secretary appears to have the discretion to cut corn or wheat subsidies but retain the full amount of upland cotton subsidies. Brazil will provide further comments on the "circuit breaker" provision on 19 January in response to the US Answers to Questions 253-254.

**256. The United States submits that the Panel cannot make rulings without allocating precise amounts of payments to upland cotton production. However, to the extent that such precise data is not on the Panel record, to what extent can the Panel rely on less precise data, and on reasonable assumptions, in fulfilling its duty under Article 11 of the *DSU* in this case? USA**

[235] US 2 December Oral Statement, para. 82.

[236] Brazil's 9 September Further Submission, para. 423 (summarizing the evidence and the specific statutory provisions of the 2002 FSRI Act and the 2000 ARP Act mandating payments by USDA).

[237] Appellate Body Report, *Argentina – Textiles and Apparel*, WT/DS56/AB/R, paras. 48-54, 62; Panel Report, *US – Export Restraints*, WT/DS194/R, para. 877.

# ANNEX I-8

## ANSWERS OF THE UNITED STATES TO QUESTIONS POSED BY THE PANEL FOLLOWING THE SECOND SUBSTANTIVE MEETING OF THE PANEL

(22 December 2003)

### A. TERMS OF REFERENCE

**192. Regarding the interest subsidies and storage payments listed by the United States in its response to the Panel's Question No. 67:**

**(a) Please provide a copy of the regulations under which they are currently and under which they were provided during the marketing years 1996-2002;**

1. For interest subsidies and storage payments under the 1996 Act (marketing years 1996-2002), the relevant regulations are found at 7 CFR 1427.13 and 1427.19 (2000 ed.) (first published at 61 FR 37601, 18 July 1996).[1] Under the 2002 Act, those rules are found at 7 CFR 1427.13 and 1427.19 (2003 ed.) (first published at 67 FR 64459, 18 October 2002).[2] We describe and discuss these provisions below in response to part "(b)" of this question.

**(b) Please indicate whether there are any such payments which are not provided to implement the repayment rate for upland cotton within the marketing loan programme. USA**

2. Interest subsidies and storage payments are support provided in connection with the marketing loan programme. On a forfeit of warehouse-stored upland cotton under loan, the Commodity Credit Corporation (CCC) pays warehouse charges for the loan period (even though the farmer had title during that period) and forgives interest. 7 CFR 1427.13 (2000 ed. and 2003 ed.). As for redemption of cotton under loan, repayment rates depend on the world market price. If the repayment amount set on that price is low enough, CCC may have to forgive interest and pay storage charges because the repayment amount will not be enough to satisfy the loan amount and those charges. *See* 1427.19(e) (2000 and 2002). By contrast, if the repayment rate set on the world market price is high enough, the producer pays both. *Id.* In general, if the loan is repaid, there is not an interest subsidy at all; rather, in 7 CFR Part 1405, it is provided that CCC will charge the sum of (1) the rate that CCC pays the Treasury and (2) another 1 per cent per annum. We are not aware of any other payments that would be responsive to the panel's question.

[1] *See* Exhibit US-117 (7 CFR 1427.13 and 1427.19 (2000 ed.)).
[2] *See* Exhibit US-118 (7 CFR 1427.13 and 1427.19 (2003 ed.)).

**194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? BRA, USA**

3. In response to the Panel's Question 67, which asked the parties "to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002," the United States stated, in the context of its calculation of the AMS for marketing year 2002, that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment, on which the Panel's terms of reference were set. Measures taken after the Panel was established cannot be within the Panel's terms of reference."[3] The United States continues to believe that this statement is accurate. Past panels have frequently been confronted with the issue of the date as of which measures should be examined. Panels have generally determined to examine those measures as of the date of panel establishment as a matter both of terms of reference as well as for practical reasons (for example, so as to allow findings to be made with respect to a measure withdrawn after the panel was established but before panel proceedings were completed).

4. The Panel's terms of reference were set by the DSB at its meeting on 18 March 2003, namely, "[t]o examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."[4] In that panel request, Brazil identifies the measures at issue as "prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton."[5] In Brazil's answer to question 19 from the Panel, Brazil clarified: "Brazil's Request for Establishment of a Panel ('Panel Request') challenges two types of domestic support 'measures' provided to upland cotton and various different types of export subsidy measures. *The first type of domestic support "measure" is the payment of subsidies* for the production and use of upland cotton. These payments were and continue to be made between MY 1999 to the present (and will be made through MY 2007) through the various statutory and regulatory instruments listed on pages 2-3 of Brazil's Panel Request. Brazil referred to these payments at pages 2-3 of the Panel Request as 'subsidies and domestic support provided under' or 'mandated to be provided' under the various listed statutory and regulatory instruments. Brazil has tabulated the *different types of payments (i.e., the measures)* made under these legal instruments in paragraphs 146-149 of its First Submission."[6] That is, to the extent that "payments" are at issue (as opposed to Brazil's challenge of certain legal instruments "as such")[7], the "measure" is "the payment of subsidies for the production and use of upland cotton." Only those payments made through the date of panel establishment could be "measures at issue" within the meaning of DSU Article 6.2 (as opposed to measures not yet taken, such as the Agricultural Assistance Act of 2003, which had not been enacted at the time of Brazil's panel request).

5. Thus, for purposes of the Panel's Peace Clause analysis or the evaluation of the "effect of the subsidy" for purposes of the Panel's actionable subsidies analysis, Brazil's choice to obtain establishment of this Panel several months into the 2002 marketing year but well before that marketing year was completed necessarily impacts the payments ("measure") that the Panel may examine. The payment of subsidies *after* panel establishment cannot alter the measures within the Panel's terms of reference and properly before the Panel, just as the cessation of payments after panel establishment would not prevent the Panel from making findings as to those payments that had been made as of the date of establishment.

[3] US Answer to Question 67 from the Panel, para. 134 (11 August 2003).
[4] WT/DSB/M/145, para. 35.
[5] WT/DS267/7, at 1.
[6] Brazil's Answer to Question 19 from the Panel, para 15 (emphasis added).
[7] Brazil's Answer to Question 19 from the Panel, para. 16.

## B. ECONOMIC DATA

**195. Does the United States wish to revise its response to the Panel's Question No. 67bis, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers"? Did the United States make enquiries of the FSA in the course of preparing its original answer?**

6. Question No. 67*bis* inquired about annual amounts granted to upland cotton producers per pound and in total expenditures under each of the decoupled payment programmes. The United States of course conferred with US Department of Agriculture personnel, including FSA personnel, concerning this question and reported to the Panel that USDA "does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers."[8] That response remains accurate today: because those payments are decoupled from current production, expenditures under such programmes are not tracked by whether the recipient produces upland cotton. In fact, the United States does not collect production data based on actual harvesting figures reported by farmers; we do not understand Brazil to have asserted the contrary.[9]

7. Brazil has also not asserted that the United States maintains information on the receipt of decoupled payments for upland cotton base acres by upland cotton producers. Rather, it has presented a novel methodology developed by the Environmental Working Group (EWG) to compare disparate data separately collected by the United States to attempt to infer that information. [10]EWG compared the farm numbers of recipients of decoupled payments for upland cotton base acres with the farm numbers of recipients of marketing loan payments in marketing years 2000-2002. It bears emphasis that the latter database is not a production database based on actual harvesting figures reported by farmers; the marketing loan database merely records the quantities of cotton on which a recipient has received payments. By comparing the matches by farm number between the two databases, EWG calculated that the share of decoupled payments for upland cotton base acres paid to upland cotton "producers" (that is, recipients of marketing loan payments) was 71.3 per cent in marketing year 2000, 76.9 per cent in marketing year 2001, and 73.6 per cent in marketing year 2002.

8. As we have previously mentioned[11], using the marketing loan payments database to identify "producers" would be contingent on marketing year prices; only if prices are sufficiently low would a high proportion of production of a crop receive marketing loan payments. This appears to have been the case for upland cotton in some recent marketing years but will not always be so (for example, no marketing loan payments are being made in the 2003 marketing year) and was not the case for other commodities (in marketing year 2002, *total* marketing loan payments of only $16.3 million for soybeans, $16.3 million for corn, and $16.1 million for wheat were made).[12]

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[8] US Comments and Answer to Additional Question, para. 20.

[9] We do note that the record reflects the extensive evidence the United States has presented on the programmes and crop in question, from the actual data of amounts paid under the programmes to the amounts of cotton that have been planted from year to year. Further, in response to a Brazilian request for certain information that was presented for the first time at the second panel meeting, the United States generated, through significant expenditures of time and resources, aggregate and farm-by-farm records for both the "PFC" and "DCP" period for every "cotton farm" in the United States, including the planting records for all such farms. These data were transmitted on 18 and 19 December 2003.

[10] *See* Brazil's Further Rebuttal Submission, para. 31 ("If USDA was able to provide comprehensive payment data for all (or most) payments in an electronic format, it is also able to *generate information* on subsidy payments made to farms.") (emphasis added).

[11] US Opening Oral Statement at Second Panel Meeting, para. 29.

[12] Exhibit US-93. For this reason, it is fallacious for Brazil to argue that the specialization of cotton farms on cotton is show by the alleged fact that "[i]n MY 2002, 92.45 per cent of marketing loan payments for all crops made to farms producing upland cotton were made with respect to upland cotton." Brazil's Further

9. We note that Brazil has not made any adjustment in the outlay figures it has presented to the Panel for purposes of both Peace Clause and its actionable subsidy claims to reflect the fact that the EWG percentages are substantially lower than the 87 per cent revision made by Brazil to correct its initial Peace Clause analysis. The adjustment resulting from the EWG data in the total decoupled payments for upland cotton base acres made to upland cotton "producers" is also substantial. Since Brazil presents the EWG percentages as Brazil's own data, Brazil has effectively conceded that its own figures should be corrected at least as follows:

| Decoupled payments for upland cotton base acres to upland cotton "producers" ($ millions) | | | |
|---|---|---|---|
| | Brazil initial amount[13] | Brazil corrected amount[14] | EWG amount[15] |
| 1999 PFC | 616 | 547.8 | no data presented |
| 1999 MLA | 613 | 545.1 | no data presented |
| 2000 PFC | 575 | 541.3 | 373.4 |
| 2000 MLA | 612 | 576.2 | 436.7 |
| 2001 PFC | 474 | 453 | 364.3 |
| 2001 MLA | 654 | 625.7 | 402.8 |
| 2002 Direct | 523 | 485.1 | 451.4 |
| 2002 CC | 1077 | 998.6 | 893.5 |

The Panel can see a rather striking decline in the decoupled payments at issue that have not been reflected in Brazil's argumentation to the Panel.

10. We note further, however, that the EWG figures do not end the story. These figures represent only the first step in a proper calculation of the decoupled payments received by upland cotton producers that benefit upland cotton. For example, as detailed in the US answer to question 242 from the Panel, the literature on decoupled payments indicates that these payments benefit the owners of the base acres on which payments are made; payments made on rented acres will be captured by landowners through increased rent or other arrangements. Brazil itself has conceded that as of marketing year 1997 – that is, only the first year after introduction of the production flexibility contracts – already *34-41 cents per dollar* of production flexibility contract payment were capitalized into land rents.[16] Thus, *based on its own evidence*, Brazil should have adjusted the EWG figures *downwards by 22 to 27 per cent* to reflect the capture by landowners (who are not producers) through increased rent of 34-41 per cent of decoupled payments on the 65 per cent of cotton acres that are rented.[17] Furthermore, this study as of marketing year 1997 is consistent with the evidence presented by the United States that as rental contracts come up for renewal the full value of the decoupled

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Rebuttal Submission, para. 26. If prices were above the respective loan rates for other crops produced by a farm also producing upland cotton, then logically the share of marketing loan payments for upland cotton will be high, given that upland cotton prices were so low in marketing year 2002. The fallacy of Brazil's argument is further demonstrated by reviewing the data submitted by the United States on 19 December 2003. In the aggregated data file "Dcpsum.xls", for marketing year 2002 upland cotton planted area represented only 30.7 per cent of total cropland for "cotton farms" (13.541 million acres out of total cropland of 44.036 million acres).

[13] Brazil's First Written Submission, paras. 148-49.

[14] Brazil's Answer to Question 67 from the Panel, para. 130 (adjusted amount of decoupled payments for upland cotton base acres estimated as "support for upland cotton").

[15] Brazil's Further Rebuttal Submission, para. 23 (EWG data on amount of decoupled payments for upland cotton base acres received by upland cotton "producers")

[16] Brazil's Answer to Question 179 from the Panel, para. 165; Brazil's Opening Oral Statement at the Second Panel Meeting, para. 57.

[17] *See* Exhibit US-69 (cost of production data published by the Economic Research Service, based on the 1997 ARMS survey, showing cotton producers owning 35 per cent of land they operate).

payments on rented acres will be captured by landowners and capitalized into land values.[18] Thus, to reflect the benefit to upland cotton producers, the EWG data should be adjusted *downwards by 65 per cent* to reflect the fact that "[n]ot all operators [producers] can therefore be considered as true beneficiaries of the [PFC] programme, since competitive cropland rental markets work to pass through payments from PFC recipients who are tenants to the owners of base acres."[19] Only those upland cotton producers who are owners of upland cotton base acres will receive the benefit of those decoupled payments.

11. Finally, to answer the Panel's question on the total payments for upland cotton base acres that benefit upland cotton producers would require information relating to the total value of each recipient's production. The EWG figures, adjusted to account for the capture of 65 per cent of those payments by owners of base acreage who are not cotton producers, would need to be allocated across the total value of production in order to calculate the subsidy benefit to upland cotton. Brazil has not brought forward information to permit that allocation; in fact, as discussed in more detail in the US answer to question 256 from the Panel, Brazil has not even claimed that such an allocation is necessary. Accordingly, it does not appear possible to calculate the total payments to upland cotton producers that benefit upland cotton nor any per pound measurement.

**196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. BRA, USA**

12. Data for marketing loan and user marketing certificate programmes are for upland cotton only and are current as of 12 December 2003.[20]

- Marketing loan programme (includes loan deficiency payments, marketing loan gains, and certificate gains): $832,836,963
- Step 2 payments (data are on a October 2002 - September 2003 fiscal year basis): $415,379,000

13. Data for direct payments and counter-cyclical payments are presented for upland cotton base acres only and are current as of 12 December 2003.[21]

- Direct payments: $181,811,374 million. (Because the 2002 marketing year was a transition year between the 1996 and 2002 farm bills, $436,805,000 in Production Flexibility Contract payments were made in 2002.)
- Counter-cyclical payments: $1,309,471,167

14. Data for export credit guarantee programmes are only available on a fiscal year basis (October 2002 - September 2003) and apply to all cotton. No breakout is available for upland cotton. The value of registration guarantees is $234,423,344. This figure represents the coverage applied for by exporters, not actual exports. An exporter may apply for a guarantee but not actually ship the goods.[22] Outstanding claims are $280,898, less than one-tenth of one per cent of the value of

[18] *See* US Further Rebuttal Submission, paras. 75-77.

[19] Burfisher, M. and J. Hopkins. "Farm Payments: Decoupled Payments Increase Households' Well-Being, Not Production." *Amber Waves*, Vol. 1, Issue 1, (February 2003): 38-45, at 44 (Exhibit US-78)

[20] Source: Official data base of the Commodity Credit Corporation, maintained by the Farm Service Agency, USDA; latest data are unpublished and may differ from published FSA data.

[21] Source: Official data base of the Commodity Credit Corporation, maintained by the Farm Service Agency, USDA; latest data are unpublished and may differ from published FSA data.

[22] Published data on guarantee values can be found in *Export Assistance, Food Aid, and Market Development Programmes, FY 2003 Summary* at http://www.fas.usda.gov/excredits/quarterly/archive.html. Data for FY 2003 found in this report are current as of 9/30/03 and differ slightly from these figures, which reflect exporter activity through mid-December, including cancellations and reserve activity. Data for FY 2003

registrations (further evidence, specific to cotton export credit guarantees in particular, that premiums are more than sufficient to cover operating costs and losses).

**197. Please provide actual data for 2002/2003 for US exports, US consumption and per cent of world consumption to replace the projected data in Exhibit US-47. If available, please provide projected data for 2003/2004 to replace the forecast data. USA**

15. The 11 December 2003 *World Agricultural Supply and Demand Estimates* report, published by USDA's Office of the Chief Economist, the Department's official commodity estimates, provide the latest data available. Note that 2002/03 is still considered an estimate and 2003/04 is considered a projection.[23]

**US and World Cotton Consumption** (1,000 480-lb bales)

| | 2002/03 (e) | 2003/04 (p) |
|---|---|---|
| US exports | 11,900 | 13,200 |
| US mill use | 7,270 | 6,200 |
| Total US consumption[24] | 19,170 | 19,400 |
| World consumption | 97,930 | 97,690 |
| US as a per cent of world | 19.6% | 19.9% |

The updated data show that the US world market share is basically unchanged from Exhibit US-47; in fact, US world market share using the 11 December 2003 data is the same (19.6 per cent) as reported in the exhibit.[25] Viewed in conjunction with the data in Exhibit US-47, the data further confirm that there has been no increase in US world market share following a consistent trend over a period when subsidies to upland cotton have been granted.

**198. Please comment on the respective merits of the price-gap calculations of MY1992 deficiency payments in US comments of 27 August, footnote 14 ($867 million), and Brazil's response to the Panel's Question No. 67 ($812 million).**

16. The two calculations use similar methodologies to measure MY 1992 deficiency payments. Both measures calculate deficiency payments as the deficiency payment rate times eligible production. Both the US and Brazil measures use the same deficiency payment rate for MY 1992 of 15 cents per pound. The difference between the two measures can thus be attributed to how each calculated the amount of production eligible for deficiency payments.

17. In their response to the Panel's Question No. 67, Brazil provides a simplistic calculation of payment production by multiplying the upland cotton programme yield times the amount of area eligible for deficiency payments. But as the United States previously indicated[26], the average programme yield for deficiency payment recipients in MY 1992 was 601 pounds per acre and the average programme yield for 50/92 recipients was 628 pounds per acre. By contrast, Brazil

found in this report are current as of 9/30/03 and differ slightly from these figures, which reflect exporter activity through mid-December, including cancellations and reserve activity.

[23] USDA Office of the Chief Economist, *World Agricultural Supply and Demand Estimates*, 11 December 2003 (Exhibit US-119).

[24] The US consumption figure includes imports. However, US cotton imports are often zero and, even when positive, have accounted for less than one per cent of consumption over the past decade. *See* USDA, Economic Research Service, Fibers Yearbook, Appendix Table 2, Upland Cotton Supply and Use (Exhibit US-120).

[25] *See also* US Opening Oral Statement at the Second Panel Meeting, para. 13.

[26] US Comments and Answer to Additional Question, para. 8 fn. 14.

incorrectly estimates programme yields to be 531 pounds per acre. This underestimates deficiency payments for MY 1992.

18. The US calculation uses the methodology set out in paragraphs 10 and 11 of Annex 3. Consistent with the 1995 US WTO notification, payment production is the sum of production eligible for basic deficiency payments and production eligible for 50/92 payments. Eligible production for basic deficiency payments in 1992 was equal to 5,544 million pounds (9.226 million acres times the average programme yield of 601 pounds per acre). Multiplying the price gap times eligible production gives basic deficiency payments equal to $832 million. The same formula is used to calculate deficiency payments under the 50/92 programme. For 1992, the price gap is the same as that calculated for the basic deficiency payments (15 cents per pound). Eligible production under the 50/92 programme was 254 million pounds (404 thousand acres times the average programme yield of 50/92 participants of 628 pounds per acre). Deficiency payments under the 50/92 programme were thus equal to $35 million (0.92 times 254 million times $0.15). Total deficiency payments under the price gap methodology were thus equal to $867 million ($832 million plus $35 million).

19. We also note that this calculation is conservative in that it uses the actual payment acreage (that is, acres planted for harvest or participating in the 50/92 programme on which payment was received) rather than eligible acreage to calculate the "quantity of production eligible to receive the applied administered price."[27] Using instead the base acreage minus the 10 per cent acreage reduction figure and the 15 per cent normal flex acres (14.9 million effective base acres[28] *x* 0.75 = 11.175 million acres) and multiplying by the programme yield (602 pounds per acre), the "quantity of production eligible to receive the administered price" is 6,727 million pounds, yielding a price gap deficiency payment calculation of $1,009 million.

**201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so, please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? BRA, USA**

20. In April 1999, the US General Accounting Office published a report on farmers' use of risk management strategies.[29] Based on survey data from the 1996 USDA Agricultural Resource Management Study, the study showed that between 35 and 57 per cent of cotton farmers used a hedging instrument in 1996. (The ranges reflect a 95 per cent confidence interval.) In addition, an estimated 63 to 89 per cent of cotton farms used cash forward contracts in 1996.[30] These survey results suggest that even seven years ago a large proportion of cotton farmers either directly or indirectly priced their cotton off of organized futures and options markets.

21. For 18 December 2003, total open interest for all cotton futures contracts on the New York Board of Trade was 79,283 contracts[31] while open interest for all cotton options contracts on the

[27] Agreement on Agriculture, Annex 3, para. 10.

[28] *See* Exhibit Bra-105, Annex 2 (1st source document: US Department of Agriculture, *Provisions of the Federal Agricultural Improvement and Reform Act of 1996*, at 142) (giving 1992 effective base acreage of 14.9 million acres); *id.*, Annex 2 (2nd source document: Daniel A. Sumner, *Farm Programmes and Related Policy in the United States*, at 4) (same).

[29] US General Accounting Office. *Agriculture in Transition: Farmers' Use of Risk Management Strategies*. GAO/RCED-99-90. April 1999. See page 9, table 4 (Exhibit US-121)

[30] A forward contract is defined as a cash market transaction in which two parties agree to buy or sell a commodity or asset under agreed-upon conditions. For example, a farmer agrees sell, and a ginner or warehouse agrees to buy, cotton at a specific future time for an agreed-upon price or on the basis of an agreed on pricing mechanism (such as a futures or options market). See Exhibit US-121, page 22.

[31] *See*, Exhibit US-122.

NYBOT totalled 320,657 contracts.[32] Based on a contract size of 50,000 pounds, total open interest on futures and options contracts represent 41.7 million bales. While a bale of cotton may be hedged several times throughout the marketing chain, we note that 41 million bales is approximately 2.3 times the total size of the US upland cotton crop. A futures or options contract transaction has no effect on a producer's entitlement to marketing loan programme payments.

**202. Concerning paragraph 7 of the US oral statement, are the expected cash prices shown for February only? Can the US provide the prices for January and March of each year as well? USA**

22. The following tables show the average daily closing futures price for the December contract for January, February and March, as well as the average for the three months. As the United States previously noted[33], the differences between months is small. As outlined in paragraph 162 of the US further rebuttal submission, the expected cash price is calculated as the futures prices minus a 5-cent basis.

**Average Daily December Futures Closing Prices ($/lb)**

| Month | Contract Month | | | | |
|---|---|---|---|---|---|
| | DEC 1999 | DEC 2000 | DEC 2001 | DEC 2002 | DEC 2003 |
| January | 0.6335 | 0.5912 | 0.6188 | 0.4295 | 0.5808 |
| February | 0.6027 | 0.6131 | 0.5863 | 0.4218 | 0.5960 |
| March | 0.5980 | 0.6233 | 0.5321 | 0.4292 | 0.5975 |
| Average January – March | 0.6114 | 0.6092 | 0.5791 | 0.4268 | 0.5914 |

Source: New York Board of Trade (Exhibit US-124)

**Expected Cash Price ($/lb)**

| Month | MY 1999 | MY 2000 | MY 2001 | MY 2002 | MY 2003 |
|---|---|---|---|---|---|
| January | 0.5835 | 0.5412 | 0.5688 | 0.3795 | 0.5308 |
| February | 0.5527 | 0.5631 | 0.5363 | 0.3718 | 0.5460 |
| March | 0.5480 | 0.5733 | 0.4821 | 0.3792 | 0.5475 |
| Average January – March | 0.5614 | 0.5592 | 0.5291 | 0.3768 | 0.5414 |

Source: Futures Price minus 5-cent cash basis.

**205. Does the United States accept or agree with the EWG data submitted by Brazil? If not, please explain your reasons. USA**

23. USDA provided the EWG with payment data under a Freedom of Information Act Request. Although the United States can confirm the data transmitted to EWG was correct, we do not know if the data has changed after EWG further processed the information. Taking that data at face value, the United States would note the following.

[32] *See*, Exhibit US-123.

[33] US Further Rebuttal Submission, para. 162 fn. 124 ("The United States notes that the January-March average futures price for December delivery does not differ significantly from the February average presented in the text.").

24. As was reported in the US Answer to Panel Question 125(5) and the US oral statement of 2 December, a preliminary review of data from the Farm Service Agency shows that approximately 47 per cent of upland cotton farms eligible for decoupled income support payments planted no cotton in marketing year 2002. This number is consistent with the Environmental Working Group data presented by Brazil in its further rebuttal submission that showed the per cent of farms receiving only contract payments in 2000, 2001, and 2002 (46, 45, and 45 per cent, respectively).[34] Thus, the EWG data support the US position that decoupled income support is, in fact, decoupled from production decisions since nearly half of historic upland cotton farms no longer plant even a single acre of cotton.[35]

25. The EWG data also show that Brazil's 14/16 adjustment to decoupled payments, even on Brazil's faulty allocation theory, is too small an adjustment. Brazil has asserted that 87 per cent of decoupled payments for upland cotton base acres are received by upland cotton producers and support to upland cotton. However, the EWG data suggest that in marketing years 2000, 2001, and 2002 only 71, 77, and 74 per cent, respectively of upland cotton base acreage payments went to farms that planted upland cotton. Thus, the EWG data support the US position that Brazil has overestimated and failed to properly calculate the subsidy benefit to upland cotton provided by these payments. For further detail, please see the US answer to question 195.

26. We also note a serious misuse of the EWG data when Brazil claims that, because approximately 92 per cent of total marketing loan payments received in MY 2002 by farms planting upland cotton were upland cotton payments, therefore such farms must predominantly produce cotton. In fact, marketing loan payments crucially depend on whether prices are above or below the loan rate for the crop at issue. Soybeans and corn saw high prices in MY 2002, meaning few marketing loan payments were made in MY2002.[36] Furthermore, the data collected by the United States in response to Brazil's request for certain information demonstrate that for MY 2002 upland cotton planted acres accounted for only 29.4 per cent of total cropland of those farms receiving production flexibility contract payments for upland cotton base acreage. Thus, the EWG data on marketing loan payments does *not* support an inference that farms producing upland cotton are so "specialized in upland cotton"[37] that it would be "reasonable" to attribute decoupled payments for upland cotton base acres almost entirely (87 per cent) to upland cotton.

> **206. Please explain how the graph in paragraph 40 of the US further rebuttal submission was derived. In so doing, please clarify whether the figures are on a cents per pound basis or some other basis. What averaging method was used? Can you prepare individual charts showing average US and Brazilian cotton prices for each of those third country markets? USA**

27. The data were based on official export data reported by the United States and Brazil, as obtained and published in the "World Trade Atlas". The World Trade Atlas is a service that monthly provides world-wide trade information for a fee.

28. The United States reports its export values to the World Trade Atlas as F.A.S. and Brazil reports its values as F.O.B.

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[34] Brazil's Further Rebuttal Submission, para 23.

[35] Indeed, even Brazil states that "the evidence still suggests that there are a *large number of very small farms* (with base acreage resulting from production dating back as far as MY 1981-85) *that no longer produce upland cotton*," Brazil's Further Rebuttal Submission, para. 27 (emphasis added), which would seem to support the US view that contract payments are decoupled from production decisions.

[36] *See* US Opening Oral Statement at the Second Panel Meeting, para. 29.

[37] *See* Brazil's Further Rebuttal Submission, para. 26.

> **Free Along Ship Export Value (F.A.S.) –** The value of exports at the seaport, airport, or border, port of export, based on the transaction price, including inland freight, insurance, and other charges incurred in placing the merchandise alongside the carrier at the port of exportation. The value, as defined, excludes the cost of loading the merchandise aboard the exporting carrier and also excludes freight, insurance, and any charges or transportation costs beyond the port of exportation**.**
>
> **Free On Board (F.O.B.)** – A standard reference to the price of merchandise on the border or at a national port. In F.O.B. contracts, the seller is obliged to have the goods packaged and ready for shipment at the place agreed upon, and purchaser agrees to cover all ground transport costs and to assure all risks in the exporting country, together with subsequent transport costs and expenses incurred in loading the goods onto the chosen means of transport.

FOB is greater than FAS except when the vessel is not changed at the port of export, in which case the values are equal.

29. The World Trade Atlas publishes an average unit price for exports. The average unit price is calculated by dividing the value of the exports by the quantity for selected HS codes. Average unit prices are expressed in dollars per kilogram. This value was converted to dollars per pound for the graphs.

30. The graph in paragraph 40 of the US further rebuttal submission is a comparison of simple average unit prices of cotton exports from the United States and Brazil to Argentina, Bolivia, Italy, Philippines, Portugal, Indonesia, Paraguay, and India. The data for each third country market is provided in the following table.

## Unit Export Values to Selected Countries

US

| Country | 3Q/99 | 4Q/99 | 1Q/00 | 2Q/00 | 3Q/00 | 4Q/00 | 1Q/01 | 2Q/01 | 3Q/01 | 4Q/01 | 1Q/02 | 2Q/02 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Argentina | 0.71 | 0.71 | 0.42 | 0.49 | na | na | na | na | na | na | na | na |
| Bolivia | na | 1.15 | 1.15 | na | na | na | na | 0.76 | na | na | na | na |
| India | 0.96 | 0.46 | 0.51 | 0.55 | 0.64 | 1.04 | 0.74 | 0.50 | 0.43 | 0.36 | 0.38 | 0.42 |
| Indonesia | 0.61 | 0.59 | 0.56 | 0.57 | 0.59 | 0.65 | 0.65 | 0.57 | 0.49 | 0.50 | 0.50 | 0.45 |
| Italy | 0.90 | 0.81 | 0.80 | 0.98 | 0.73 | 0.93 | 0.90 | 0.92 | 0.92 | 0.67 | 0.76 | 0.70 |
| Paraguay | na | na | na | na | na | na | na | na | na | na | na | na |
| Philippines | 0.50 | 0.42 | 0.41 | 0.41 | 0.53 | 0.54 | 0.52 | 0.44 | 0.42 | 0.41 | 0.41 | 0.38 |
| Portugal | 0.97 | 0.93 | 0.92 | 0.92 | 0.98 | 0.75 | 1.17 | 1.14 | 0.92 | 0.57 | 1.03 | 0.94 |
| Average | 0.78 | 0.72 | 0.68 | 0.65 | 0.70 | 0.78 | 0.79 | 0.72 | 0.64 | 0.50 | 0.61 | 0.58 |

Brazil

| Country | 3Q/99 | 4Q/99 | 1Q/00 | 2Q/00 | 3Q/00 | 4Q/00 | 1Q/01 | 2Q/01 | 3Q/01 | 4Q/01 | 1Q/02 | 2Q/02 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Argentina | 0.54 | 0.51 | 0.58 | 0.54 | 0.54 | 0.52 | 0.50 | na | 0.38 | 0.35 | 0.37 | na |
| Bolivia | na | na | na | na | 0.47 | 0.48 | 0.47 | na | na | na | na | na |
| India | na | na | na | na | 0.49 | 0.50 | 0.50 | 0.53 | 0.49 | 0.43 | 0.36 | 0.36 |
| Indonesia | na | na | na | na | 0.49 | 0.49 | 0.48 | 0.47 | 0.50 | 0.47 | 0.47 | 0.45 |
| Italy | na | na | na | na | 0.48 | 0.51 | 0.54 | 0.56 | 0.46 | 0.44 | 0.39 | 0.37 |
| Paraguay | na | na | 0.50 | na | na | 0.55 | na | na | 0.50 | na | na | na |
| Philippines | na | na | na | na | na | 0.59 | 0.52 | 0.53 | 0.52 | 0.49 | 0.36 | na |
| Portugal | na | na | na | na | 0.49 | 0.51 | 0.54 | 0.56 | 0.47 | 0.42 | 0.35 | 0.37 |
| Average | 0.54 | 0.51 | 0.54 | 0.54 | 0.49 | 0.52 | 0.51 | 0.53 | 0.47 | 0.43 | 0.38 | 0.39 |

Source: *World Trade Atlas*

**207. Please indicate whether any of the measures challenged in this dispute obliges cotton farmers to harvest their crop in order to receive the benefit of the programme (subsidy).**

31. One programme at issue in this dispute requires that a cotton farmer harvest upland cotton in order to receive payment: the marketing loan programme. In addition, the user marketing certificate programme (Step 2) requires that upland cotton have been harvested and marketed although payment is made to upland cotton users and not to farmers directly.

**208. Please provide data for the marketing years 1992 and 1999-2002 of the "quantity of production to receive the applied administered price" (Agreement on Agriculture, Annex 3, paragraph 8) for purposes of a price-gap calculation of support through the marketing loan programme.**

32. The marketing loan programme is a direct payment to support producer income that is "dependent on a price gap," namely, the difference between the loan rate and the Adjusted World Price. Thus, the price-gap calculation of support would be calculated under paragraphs 10 and 11 of Annex 3 of the Agreement on Agriculture on "non-exempt direct payments," not paragraph 8 on "market price support." That said, the calculations to quantify the support under these provisions are similar. Under paragraph 10, "non-exempt direct payments which are dependent on a price gap shall be calculated either using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, or using budgetary outlays."

33. Under the 1990 Act, only production produced on cotton base acres or other programme crop base acres was eligible for marketing loans. Based on the 1992 *Compliance Report* (Exhibit US-39), 11,164,726 acres programme acres were planted to upland cotton. Based on an average crop yield of 694 pounds per acre[38], 7,748,319,844 pounds or 16,142,333 480-lb bales, would have been eligible for marketing loans in 1992.

34. Under provisions of the 1996 farm bill, upland cotton planted on farms with any programme crop base were eligible for marketing loans. While production data are not collected by the Farm Service Agency, the following quantities of upland cotton were put under loan or collected a loan deficiency payment in 1999, 2000, 2001 and 2002.

**Upland cotton loan activity (pounds)**

| | Quantity receiving loan deficiency payment | Quantity placed under loan | Total |
|---|---|---|---|
| 1999 | 3,393,678,940 | 4,290,958,570 | 7,684,637,510 |
| 2000 | 3,499,431,430 | 4,349,621,850 | 7,849,053,280 |
| 2001 | 2,618,109,300 | 6,718,513,500 | 9,336,622,800 |
| 2002 | 1,603,527,850 | 6,292,102,810 | 7,895,630,660 |

Source: USDA, Farm Service Agency, *Loan Deficiency Payment and Price Support Cumulative Activity as of 10 December 2003.* Available at: http://www.fsa.usda.gov/dafp/psd

35. Thus, compared to MY1992, the quantity of cotton placed under marketing loans or receiving loan deficiency payments in MYs 1999, 2000, and 2002 were similar. In MY 2001, as a result of exceptional weather conditions and yields, a much larger quantity of cotton was eligible.

36. As noted above, the price gap calculation involves comparing a fixed reference price to an applied administered price. Under paragraph 11 of Annex 3, the fixed reference price "shall be based

[38] *See* Upland Cotton Fact Sheet at 4 (Exhibit BRA-4).

on the years 1986 to 1988 and shall generally be the actual price used for determining payment rates." The applied administered price for marketing loan payments is the marketing loan rate. The fixed reference price is the average over 1986 to 1988 of the Adjusted World Price (the "actual price used for determining payment rate").

37. The average Adjusted World Price for 1986-88 was 53.65 cents per pound – that is, higher than the loan rate in marketing years 1992 (52.35 cents per pound), 1999-2001 (51.92 cents per pound), and 2002 (52 cents per pound). The result is that the gap between the fixed reference price and the applied administered price is always negative as would be the AMS calculation. When these price gap calculations for marketing loan payments are utilized, negative numbers result, reflecting the decrease in support from the 1986-88 level. Similarly, if the applied administered price for marketing years 1999-2002 were compared to the 1992 applied administered price, the resulting negative numbers would again show the decrease in the level of support from MY 1992. Thus, the large budgetary expenditures for marketing loan payments in recent years obscures the fact that the level of support decided by the United States had declined; the price gap calculation, on the other hand, reflects this reduction in support. As the United States demonstrated in its rebuttal submission, by calculating both deficiency payments and marketing loan payments using a price gap methodology, the upland cotton AMS reveals that in no year have the challenged US measures granted support in excess of that decided during the 1992 marketing year.[39]

**209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs. BRA, USA**

38. The planted and harvested area differ because of abandonment. Over the period 1965 to 2003, the rate of abandonment (abandoned acres divided by total acres) for US upland cotton averaged 8.3 per cent, but the rate will vary from year to year primarily because of weather, primarily in the Southwest. In 1997, for example, weather in the Southwest was generally good and the abandonment rate for that year was only 3.6 per cent. By contrast, dry weather in Texas, Oklahoma and parts of the Southeast in 1998 led many farmers to abandon their cotton crop because of poor yields, resulting in an abandonment rate of 20 per cent.

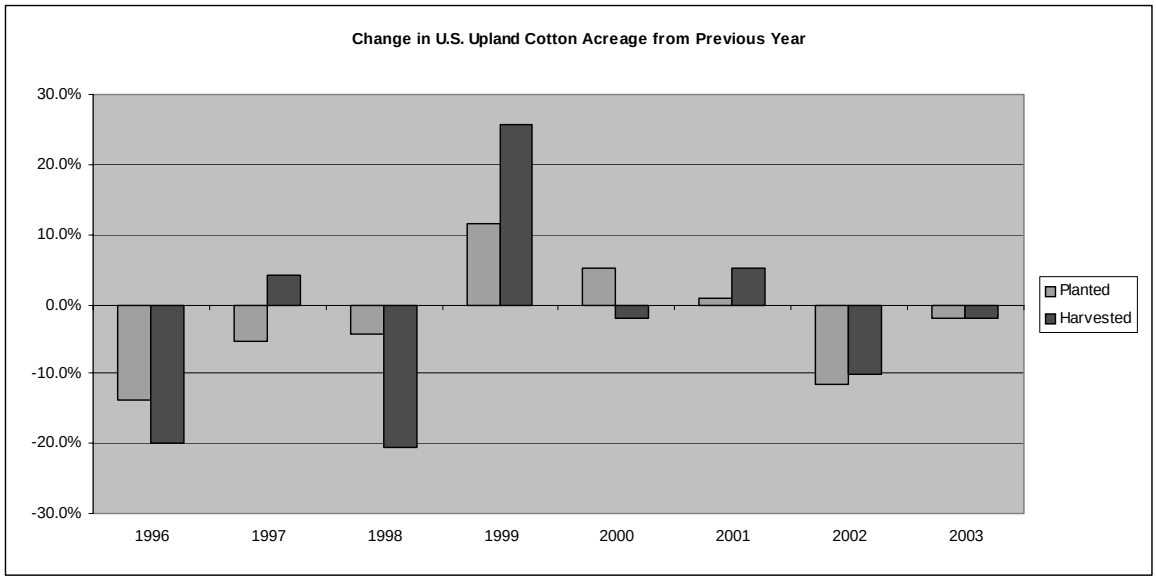
**Planted and Harvested Upland Cotton Acres** (1,000 acres)

| Crop year | Planted acres | Harvested acres | Abandoned acres | Rate of abandonment |
|---|---|---|---|---|
| 1995 | 16,717 | 15,796 | 921 | 5.5% |
| 1996 | 14,395 | 12,632 | 1,763 | 12.2% |
| 1997 | 13,648 | 13,157 | 491 | 3.6% |
| 1998 | 13,064 | 10,449 | 2,615 | 20.0% |
| 1999 | 14,584 | 13,138 | 1,446 | 9.9% |
| 2000 | 15,347 | 12,884 | 2,463 | 16.0% |
| 2001 | 15,499 | 13,560 | 1,939 | 12.5% |
| 2002 | 13,714 | 12,184 | 1,530 | 11.2% |

[39] *See* US Rebuttal Submission, paras. 115. In that calculation, the United States conservatively assigned a value of zero to marketing loan payments that in every instance were negative under the price gap methodology. Had the United States used the actual negative values resulting from the calculation, the AMS would have been even smaller for those years with a lower loan rate (marketing years 1999-2001) and larger eligible production (marketing year 2001). The end result would have been the same, however: in no year would upland cotton support (as measured by an upland cotton AMS) have exceeded the 1992 marketing year level.

| Crop year | Planted acres | Harvested acres | Abandoned acres | Rate of abandonment |
|---|---|---|---|---|
| 2003 | 13,451 | 11,939 | 1,512 | 11.2% |

Source: USDA, National Agricultural Statistics Service, *Acreage*, various issues.




39. Comparing the per cent change from the prior year of planted and harvested US upland cotton acreage shows that movements in acreage figures are fairly similar, as one would expect.

**210. Are worldwide planted acreage figures available? BRA, USA**

40. To our knowledge, planted acreage figures are not available on a consistent basis across countries. No other sources (including ICAC) carry worldwide-planted area. Harvested area is the standard, but in reality many countries do not have a sophisticated system for data collection. To provide a comparative analysis of US acreage changes to the rest of the world, the United States has therefore used harvested acreage, the most reliable acreage measure available.

**211. Brazil presents a graph in paragraph 59 of its further rebuttal submission indicating the increasing cumulative loss incurred by cotton producers. Please comment on the argument that US cotton producers could not continue operating without subsidies. In particular:**

**(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?**

41. Brazil's cost of production argument is based on erroneous facts and arguments. Brazil points to dated *average total cost* of production data over a randomly selected period, compares this to market revenue, and proclaims that any "gap" must be covered by subsidies. The United States has identified several fatal conceptual and factual flaws in Brazil's analysis.[40] For example, Brazil ignores the evidence on record that a significant number (approximately 47 per cent) of traditional (and likely high-cost) upland cotton producers no longer plant upland cotton. This structural shift in

[40] US Further Rebuttal Submission, paras. 105-51.

the industry is not reflected in cost of production data. In addition, Brazil treats the only sources of farm income as cotton market prices and government payments, ignoring crop diversification and off-farm sources of income. By ignoring alternative revenue sources, Brazil invalidates its claim that *only* government payments could serve to cover any alleged cost-revenue gap.

42. But most importantly, Brazil has no legal basis for its argument. Brazil argues that the Appellate Body in *Canada - Dairy (21.5)* has stated that total costs are the relevant measure, but that reasoning is inapt here. The only question in that dispute was whether a practice involved an export subsidy within the meaning of Article 9.1(c) of the Agriculture Agreement. Solely because the question was to determine whether certain milk provided to processors constituted a payment for purposes of Article 9.1(c) did the Appellate Body opt to use the average cost of production.[41] However, the Appellate Body explicitly recognized that "a producer may well decide to sell goods or services if the sales price covers its marginal costs." The Appellate Body also noted that cost of production can be measured "in at least two ways": (1) per unit average total cost of production and (2) marginal cost of production.[42] Here, the issue for which Brazil seeks to use total costs is not whether a subsidy exists but to evaluate the effect of the subsidy, an altogether different analysis. Thus, *Canada - Dairy (21.5)* provides no support Brazil's average total cost argument.

**(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?**

43. As described in detail in previous US submissions[43], the combination of, among other things, the boll weevil eradication programme and the extraordinary adoption rates of biotech cotton have combined to lower producers' costs and enhance net revenues. Despite the difficulty in providing precise figures on the extent of cost savings and net revenue increases for the cotton sector that have occurred since the 1997 USDA ARMS cost and returns survey, the rapid adoption of biotech cotton (over 90 per cent of area in key producing States) suggests farmers are reaping significant benefits in terms of net returns. These cost savings have been analyzed and documented in a wide range of studies.

44. In June 2002, the National Center for Food and Agricultural Policy (NCFAP) compiled 40 case studies of 27 crops to document the benefits of biotechnology.[44] These case studies were done by various universities. Among other findings, one study found that adoption of insect resistant biotech cotton in states in the Southeast and Southwest experiencing high infestations of budworm resulted in a $20 per acre increase in net income. Another study that examined the use of herbicide-resistant cotton in several Mid-South states estimated producers saved $133 million annually in weed control costs.

45. The post-1997 updates of the cost of production data assume the same technological coefficients as the 1997 survey – for example, pounds of seed per acre, the number of pesticide applications per acre, etc. Brazil correctly notes that the ERS/USDA updated COP data from 1997 show increased seed costs, which reflects the use of higher-cost biotech seed.[45] To the extent those inputs become more costly (for example, as biotech seed replaces conventional), cost increases are captured by the updating process through input price indexes. What is not captured is the *cost savings* from technological changes that alter the mix of production activities and inputs. New survey data

[41] The specific issue addressed was limited to whether the supply of certain milk to processors constituted a "payment" on the export of milk "financed by virtue of governmental action."

[42] *Canada-Dairy: First Recourse to 21.5*, AB-2001-6, para. 94.

[43] US Further Submission, paras. 46-54; US Further Rebuttal Submission, paras. 123 -132.

[44] *Plant Biotechnology: Current and Potential Impact For Improving Pest Management in US Agriculture: An Analysis of 40 Case Studies.* Leonard P. Gianessi, Cressida S. Silvers, Sujatha Sankula and Janet Carpenter. NCFAP, June 2002. The full report can be found at http://www.ncfap.org/40CaseStudies.htm.

[45] Further Rebuttal Submission of Brazil, 18 November, para. 72.

will incorporate new technological coefficients as well as changes in such practices as direct pesticide costs, changes in tillage, application and cultivation trips, and handweeding. Many of the cost-saving aspects of biotechnology or other new practices (no-till farming) cannot be accurately captured by simply updating old cost data by price indices. Thus, relying on such updated cost data that reflects an outdated technological mix is in error.

**(b) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? USA**

46. As explained in some detail in the US Further Rebuttal Submission of 18 November, the agricultural economics profession is clear that short-run production decisions are made based on the ability of a producer to cover his variable or operating costs.[46] All economic models that attempt to capture supply response (producer planting behaviour) use variable costs in the equations, not total costs. Examples include the FAPRI baseline projections model (a variation of which was used by Dr. Sumner), the ERS baseline projections model, and the Economic Research Service's FAPSIM model, the results of which are cited by Brazil.[47] No economic model of which we are aware looks to total costs as the relevant costs for producer planting decisions.

47. One can do the same exercise as done by Brazil in paragraph 59 of its further rebuttal submission, but using the economically correct variable costs instead of total costs.[48] Even using the technologically- and structurally-dated cost-of-production data based off the 1997 ARMS survey, in all years except the extraordinary year of 2001, average market returns more than covered variable costs, allowing producers to earn a sufficient margin to pay off other fixed costs, a conventional agricultural business practice, as noted by Christopher Ward.[49] Instead of a cumulative loss of $332.79 per acre over the 6-year period as claimed by Brazil, producers had a cumulative net margin of $592.65 per acre. Clearly, if all years were like 2001, US cotton farmers would go out of business.[50] But because most US cotton farmers regularly cover their variable costs – and then some – they can survive a year like 2001.

**Cumulative net returns ($ per acre)**

| Item | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|
| Variable costs | 271.46 | 230.87 | 244.26 | 296.38 | 284.24 | 278 |
| Market revenue | 545.55 | 356.1 | 314.8 | 375.18 | 271.4 | 307.83 |
| Net return | 274.09 | 125.23 | 70.54 | 105.8 | -12.84 | 29.83 |
| Cumulative net return | 274.09 | 399.32 | 469.86 | 575.66 | 562.82 | 592.65 |

Source: USDA, Economic Research Service, www.ers.usda.gov/data/costsandreturns

[46] US Further Rebuttal Submission, 18 November 2003, para. 117. Brazil continues to inappropriately make all its cost-revenue arguments using total costs. Brazil cites the Appellate Body decision in Canada – Dairy 21.5 III as support for using a total cost of production figure but that decision was unique to those circumstances and involved export subsidies. That decision does not refute accepted wisdom and long-standing economic theory, as well as farmers' usual business practices.

[47] Exhibit Bra-222.

[48] See http:/www.ers.usda.gov/data/costsandreturns/.

[49] Further Rebuttal Submission of Brazil, 18 November 2003, para. 58.

[50] Even Mr. Christopher Ward was unable to cover his variable costs in 2001. Statement of Mr. Christopher Ward at the Second Session of the First Panel Meeting, para. 6.

**212. Brazil states in paragraph 37 of its oral statement that studies of Westcott and Price found that the effect of the programme on cotton is to add an additional 1 to 1.5 million acres during marketing years 1999-2001 and to suppress US prices by 5 cents per pound. Does the US reject these findings? Why or why not?**

48. While an interesting "academic" analysis of the impacts of the US marketing loan programme, the Westcott and Price study *Analysis of the US Commodity Loan Programme With Loan Provisions* (Exhibit BRA-222) is not relevant for the Panel's assessment of the matter before it. In this study acreage decisions are based on an expected net returns which includes as the expected price term as the higher of the lagged market price or the loan rate plus additional marketing loan facilitated revenue. Since the period of analysis for the study is 1998 through 2005, rather than actual data, the authors used USDA's 2000 baseline. This baseline incorporates actual data for years prior to marketing year 1998 and partial marketing year 1999 to make projections about prices and other factors for marketing year 1999 forward. Thus the study is based on projections except for MY1998.[51]

49. A panel, however, cannot base its findings on hypothetical market conditions instead of actual conditions. That is, Brazil must show that US domestic support has actually caused serious prejudice in a given year based on actual market conditions and not that under some assumed conditions US domestic support programmes have impacted prices. Since the study is based on projected prices, the analysis is not useful for the Panel in determining whether US support programmes have caused serious prejudice to Brazil.

50. Putting aside the issue that the study is based on projections and not actual market conditions for the 1999-2001 period, the United States believes the study results overstate the impacts of the US marketing loan programme for two reasons: (1) the expectation of prices used and (2) the overstated additional marketing loan facilitated revenue.

51. As previously discussed, the authors used USDA's 2000 baseline as the input into the USDA FAPSIM model. To represent farmers' price expectations, the simulation uses lagged prices from the projections in the USDA's 2000 baseline. The model uses the higher of lagged market prices or the loan rate plus additional marketing loan facilitated revenue (fixed at 14 cents per pound for cotton). Using the price projections in the USDA 2000 baseline, farmers would expect the marketing loan programme to kick in for the period 1999-2001. The problem here is that the price expectations used by the model are not consistent with the price expectations the farmers *actually held* at the time of planting for prices at harvest. As the United States provided in its opening statement at the Second Meeting of the Panel with the Parties, the futures prices at the time of planting indicated that prices would be above the marketing loan rate during this period.

| **Harvest Futures Prices at Planting Time Compared to USDA Baseline Expected Prices (cents per pound)** | | | |
|---|---|---|---|
| | MY1999 | MY2000 | MY2001 |
| Futures Price 1/ | 60.27 | 61.31 | 58.63 |
| Expected Cash Price 2/ | 55.27 | 56.31 | 53.63 |
| 1/ February New York futures price for December delivery.<br>2/ Futures price minus 5 cent cash basis. | | | |

[51] In fact, the study found marketing loans to have negligible impacts in 1998. *See* Exhibit BRA-222, p. 16.

As the futures prices demonstrate, market expectations at the time of planting for marketing years 1999-2001 was that prices would be above the marketing loan rate and hence no marketing loan benefits. Therefore, the marketing loan programme would not have had the impact this study found.

52. In addition to having the wrong expectations about price levels and the marketing loan programme being tripped, the study has overstated the potential additional market loan facilitated revenue that can be achieved. The authors used a fixed rate of 14 cents to represent this additional revenue above the loan rate when the marketing loan programme kicks in. Their justification for this figure is that this was their calculation for 1998. The authors do not provide any discussion as to why conditions in 1998 were indicative of conditions to continue for the near future that would keep this margin at 14 cents. This margin is based on the fact that farmers can pick the date to make the claim for the marketing loan gain/deficiency payment and then sell the cotton at a later date. The premise is that a farmer is able to sell when prices have increased relative to the date they made their claim. However, in reality, there is no such guarantee. It is just as possible that prices will fall below the price when the claim was made. In fact, the additional revenue has not been as large as in MY1998.[52] In MY1999, the annual average was 6.1 cents, MY2000 was 5.8 cents, and MY2001 was 1.3 cents. As Exhibit US-126 demonstrates, the margin fluctuates from month to month, with the value in several months even negative, implying that a farmer that did not sell his crop at the time he received the marketing loan payment earned *less than* the marketing loan rate. Using a much lower value for this additional revenue above the loan rate when the marketing loan rate kicks in would have reduced the impact of the study's result.

53. By request of the Payment Limitations Commission, Westcott and Price updated this analysis using actual prices for MY2001. As the United States has discussed at the panel meetings and in its further rebuttal submission, this will overstate the impact of the marketing loan programme because it assumes that farmers had perfect foresight. That is, the model is calibrated to the actual values that occurred in that year while, in fact, producers could not have anticipated such events when planting decisions occurred. This overstates the effects of the programme because the model assumes outcomes that were unanticipated by producers when they made their planting decisions.

54. This overstatement is similar to the other third party studies that used actual outlays for marketing loans when calculating the price wedge. As the United States argued when critiquing those models, a more appropriate method to determine the impact is to look at expectations based on futures prices relative to the marketing loan rate. If the futures prices are above the loan rate, the programme will have a negligible impact on planting decisions since farmers are not expecting benefits from the programme.

55. For these reasons, the United States finds the results from these studies not relevant for the Panel in making its assessment of the effect of the marketing loan programme.

**213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? BRA, USA**

56. In this dispute two approaches have been advocated in determining farmers' expectations about prices. Brazil and its economic consultant have used lagged prices as the mechanism to gauge farmers' expectations about prices. Dr. Sumner wrote:

> Of course, it is impossible to know precisely what individual growers expect. I have adopted the long-standing approach of FAPRI, and other models[,] to approximate

[52] See Exhibit US-126 for calculations using the authors' formulation of the additional marketing loan facilitated revenue realized per unit for MY 1998-2003 (partial year), using actual data.

> these expectations by using the current year final realized market prices as the expectation for the following season's price.[53]

The lagged prices used by Brazil and its economic consultant can at best, be an approximation of farmers' price expectations. That is because the lagged prices used in Brazil's analysis incorporate pricing information that occurs *after US farmers make their planting decision* (that is, prices from April through July of a given marketing year when planting decisions are taken in the January to March period). Therefore, by necessity, farmers cannot be looking at a lagged price that incorporates prices that do not yet exist.

57. The United States, on the other hand, has advocated the use of futures prices, a market determined expectation of prices. As Mr. MacDonald, Brazil's own witness, has explained, the New York futures price is a key mechanism used by cotton growers, traders and consumers in determining current market values as well as the contract prices for forward deliveries, in the domestic US and non-US markets.[54]

58. The use of futures by market participants is supported by a US government study. In April 1999, the US General Accounting Office published a report on farmers' use of risk management strategies.[55] Based on survey data from the 1996 USDA Agricultural Resource Management Study, the study showed that between 35 and 57 per cent of cotton farmers used a hedging instrument in 1996. (The ranges reflect a 95 per cent confidence interval.) In addition, an estimated 63 to 89 per cent of cotton farms used cash forward contracts in 1996.[56] These survey results suggest that a large proportion of cotton farmers either directly or indirectly price their cotton off of organized futures and options markets.

59. Furthermore, economic literature supports the United States' approach. For example, in his classic paper on rational price expectations, Muth (Exhibit US-48) argued that there is little evidence that expectations based on past prices are economically meaningful. Additionally, in a 1976 paper Gardner (Exhibit US-49) contended that the future price for next year's crop is the best proxy for expected price.

60. Unfortunately, the use of futures prices in a multi-commodity modelling framework for extended time projection is cumbersome. First, equations must be developed that can predict values for futures contracts in simulation analysis. Second, many commodities lack an organized futures exchange (e.g., grain sorghum). For these reasons, large-scale models like those used by FAPRI, USDA and the US Congressional Budget Office typically use lagged prices rather than futures prices as proxies for price expectations.

61. Nonetheless, the use of lagged prices may result in biased results. Over the long term, where there is reasonable stability in markets, lagged prices function adequately as a proxy for price expectations. However, in those years, as in the period under investigation here, when unexpected exogenous shocks such as China dumping stocks and unexpected yields worldwide due to good weather conditions, lagged prices are poor predictors of expected prices. Future prices, by contrast, are more efficient because they are based on more current information.

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[53] Brazil's Further Submission, Annex I, para 18.

[54] Exhibit BRA-281, para 13 (statement by Andrew MacDonald)

[55] US General Accounting Office. *Agriculture in Transition: Farmers' Use of Risk Management Strategies*. GAO/RCED-99-90. April 1999. See page 9, table 4 (Exhibit US-125).

[56] A forward contract is defined as a cash market transaction in which two parties agree to buy or sell a commodity or asset under agreed-upon conditions. For example, a farmer agrees to sell, and a ginner or warehouse agrees to buy, cotton at a specific future time for an agreed-upon price or on the basis of an agreed on pricing mechanism (such as a futures or options market). See Exhibit US-125, page 22.

62. For example, during marketing years 2000, 2001, 2002, and 2003, lagged prices significantly understate the harvest season prices expected by producers as seen in the futures prices at the time of planting. The use of lagged prices thereby inflate the effect of the marketing loan rate. In fact, those lagged prices would have to be increased by 8-25 per cent, depending on the year, to equal the harvest season price actually expected by producers as indicated by the futures price.[57] For the period MY 1999-2003, only MY 2002 exhibits expected prices below the marketing loan rate when using futures prices. However, over that same period, when lagged prices are used as expected prices, the loan rate is higher than the expected price *in every year over this period* except MY1999. Thus, it is a significant error for Brazil and Dr. Sumner to use lagged prices instead of the futures prices Brazil's own expert explained to be the more accurate gauge of farmers' price expectations.

| **Harvest Futures Prices at Planting Time Compared to "Lagged Prices"(cents per pound)** | | | | | |
|---|---|---|---|---|---|
| | MY1999 | MY2000 | MY2001 | MY2002 | MY2003 |
| Futures Price 1/ | 60.27 | 61.31 | 58.63 | 42.18 | 59.6 |
| Expected Cash Price 2/ | 55.27 | 56.31 | 53.63 | 37.18 | 54.6 |
| Lagged Prices 3/ | 60.2 | 45 | 49.8 | 29.8 | 44.5 |
| Difference | -4.93 | 11.31 | 3.83 | 7.38 | 10.1 |

1/ February New York futures price for December delivery.
2/ Futures price minus 5 cent cash basis.
3/ Prior crop year average farm price, weighted by monthly marketings.[58]

63. Looking more specifically at Dr. Sumner's analysis in Annex I provides further evidence of the bias of lagged prices relative to future prices. Consider the 2002 crop year. In the Sumner analysis, area response to the removal of the cotton loan programme results in a 36 per cent reduction in US planted area – the largest single effect for any of the years considered in his analysis. Based on lagged prices, price expectations for 2002 were 29.8 cents per pound, a 40 per cent reduction from 2001 levels. Yet, the futures market data suggests a far smaller reduction in expected price. December futures prices taken as the average daily closing values in February 2002 averaged 42.18 cents per pound, a 28 per cent drop from year earlier levels. Based on Dr. Sumner's range of supply response elasticities of 0.36 to 0.47, a decline of this magnitude would suggest a drop in acreage of 10 to 13 per cent from the preceding year. In fact, actual US cotton acreage dropped 12 per cent (from 15.5 million acres in 2001 to 13.7 million acres in 2002) suggesting acreage levels entirely consistent with world market conditions and price expectations. Thus, in marketing year 2002, lagged prices would significantly overestimate the decline in plantings in the absence of a marketing loan rate.

64. While the United States would agree with Brazil that it is impossible to know precisely what individual farmers' price expectations are, the United States argues that futures prices provide the most current expectations of market participants. The United States disagrees with the approach used by Brazil in its analysis to rely solely on lagged prices and ignore information provided by futures prices. While it may be impractical to include futures prices in some models, modelling convenience is no justification to ignore these objective, market-based price expectations, and the biased results from using lagged prices do not assist the Panel in making an objective assessment of what is the effect of the US marketing loan programme.

[57] US Further Rebuttal Submission, paras. 164-65.
[58] Exhibit US-90.

## C. DOMESTIC SUPPORT

**214. Please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? USA**

65. Please see US Exhibits 117 and 118. In these document, the Department of Agriculture set the level of support for the 1993 marketing year. For example, the Department announced a marketing loan rate of 52.35 cents per pound. In addition, the Secretary did not exercise his discretion to alter the effective price, which by statute was to be "not less than" 72.9 cents per pound.[59] We also note that the March 24 notice lowered the acreage reduction percentage (the share of base acreage on which deficiency payments could not be obtained) from 10 to 7.5 per cent.

**215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA**

66. Direct payments are made to producers regardless of the price level; no production of upland cotton or any other crop is required to receive payment, and the recipient may additionally leave the land in conserving use. In contrast, the counter-cyclical payment is contingent on farm prices falling below the target price of 72.4 cents per pound less the direct payment rate of 6.67 cents per pound. Thus, at farm prices near to or over the 65.73 cents threshold, the counter-cyclical payment will be reduced or eliminated.

**216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. BRA, USA**

67. Under the 1990 Act, base acreage for purposes of deficiency payments was calculated as the average, minus the high and low year, of the previous five years plantings. There was no updating of base acres by upland cotton producers since the base period was always a rolling average of the previous five years. In effect, to increase acreage base, a producer had to overplant his or her current acreage base. The 1990 Act penalized producers who overplanted their base by declaring them ineligible for farm programme payments in the year they overplanted their base. For this reason, participation in the programme was quite high.

68. The 1996 Act eliminated deficiency payments in favour of decoupled production flexibility contract payments. The Act also did away with the rolling five-year average approach for base acreage. Instead, crop base acreage was based on the amount of base acreage that would have been in effect under the 1990 farm bill for the 1996 crop year. Producers maintained the same acreage base over the 1996 through 2001 crop years, without current plantings affecting their base acreage.

69. The 2002 Act allowed producers either to retain base acreage as under the production flexibility contracts or to update their base area equal to the average acreage planted and prevented in 1998-2001. The latter option allowed decoupled payments to be made with respect to soybeans and other oilseeds, which did not have base acreage under the 1990 Act. This new crop acreage base cannot be updated as it extends for the life of the 2002 Act (that is, through the 2006 crop year).

70. We note that the likelihood of further base updating would appear small. Currently, there is no authority for future base updating. Any changes would have to originate in Congress where there

[59] 7 USC 1444-2 (Exhibit US-5).

would likely be an associated budgetary cost. Given the current US fiscal situation, increases in the agricultural budget are seen as unlikely.

**217. What is the reason for reducing payments under the PFC and direct payments programmes for planting and harvesting fruit, vegetables and wild rice on certain base acreage? Please comment on the statements by the European Communities that "the reduction in payment for fruit and vegetables, if the EC understands correctly, is in fact designed to avoid unfair competition within the subsidising Member." (EC oral statement at first session, first substantive meeting, paragraph 29) and "To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition (…)" (EC response to Panel third party Question No. 5).**

71. The limitation only applies to base amounts of acreage, and to that end it is worthy of note that the US December 18-19 filings indicate that cotton farms plant less than one-third of their total cropland to cotton. Of note, too, is that fruit and vegetable prohibition came into play before 1996 in connection with the "flex acre" concept of the 1990 farm bill as reflected in the provisions of 7 USC 1464 (1988 ed. Supp. III) as enacted at that time. It continues to be the case under the 1996 and 2002 Farm Bill, as with the 1990 Bill, that the restrictions on plantings is only limited to the base acres amount of the farmer's cropland.

72.

73. Paragraph 6 prohibits basing payments on production requirements, not basing payments on not producing. As the United States earlier pointed out, consider a situation in which a recipient of direct payments produces fruits and vegetables and sees the direct payment reduced. How could that recipient receive the entire payment to which he or she is entitled? The marginal amount of decoupled payment is not "related to, or based on, the type or volume of production" undertaken by the producer since the recipient need not produce anything at all. Rather, to receive the marginal payment, the recipient need merely refrain from producing fruit, vegetables, or wild rice. Thus, the extra amount of payment is not "related to, or based on" production; if anything, it is "related to, or based on" non-production (of certain crops).

**218. Please comment on the testimony of USDA Chief Economist Keith Collins cited in paragraph 36 of Brazil's oral statement regarding the trade-distorting and production-distorting nature of the marketing loan payments.**

74. We agree with the statement of Dr. Collins that marketing loan payments are potentially production- and trade-distorting. The United States has consistently notified upland cotton marketing loan payments as cotton-specific amber box payments in its WTO Domestic Support notifications. The issue in this dispute is not whether marketing loan payments are potentially production- and trade-distorting, but the degree to which they have actually distorted production and trade in a particular year, given market prices and other relevant factors.

75. The degree of distortion caused by the marketing loan programme depends on the relationship of the expected harvest price to the loan rate at the time of planting. If the expected price is below the loan rate, the loan rate may provide an incentive to plant cotton because farmers will receive a

government payment for the difference between the loan rate and the adjusted world price. For this reason, we believe that the marketing loan programme was more distorting in 2002 when expected cash prices were below loan rates at planting than in 2001, when expected cash prices were higher than loan rates at the time of planting. However, as explained previously, the observed decline in upland cotton planted acreage in marketing year 2002 was commensurate with the decline in futures prices over the year before.

## D. EXPORT CREDIT GUARANTEES

**219. Under the *Agreement on Agriculture* the general position is that the use of export subsidies, both those listed in Article 9.1 as well as those within the scope of Article 1(e) which are not so listed, may only be used within the limits of the product specific reduction commitments specified in Part IV of Members' Schedules. One might therefore have expected that Article 3.3 of the *Agreement on Agriculture* would have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, would have simply prohibited the use of any export subsidy. Instead, the Article 3.3 prohibition is limited in both cases to export subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:**

**(a) the fact that export performance-related tax incentives, which like subsidised export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held (for example, in *United States - Tax Treatment for Foreign Sales Corporations*, WT/DS108) to be subject to the anti-circumvention provisions of Article 10.1; and**

**(b) the treatment of international food aid and non-commercial transactions under Article 10? USA**

76. The United States has previously noted the unremarkable fact that Article 9.1 of the Agreement on Agriculture sets forth a list of six very specific practices known to the drafters and deemed to constitute export subsidies under that Agreement.[60] The specific identification and description of these export subsidy practices, well-known and notorious in the agricultural trade sector, served at least three purposes in the text. First, under Article 3.3, these particular practices were unambiguously subject to the export subsidy reduction commitments of each member.

77. However, certain limited exceptions to this rule constitute the second and third purposes of the specific list of export subsidies in Article 9.1: Article 3.3 is by its terms "subject to the provisions of paragraphs 2(b) and 4 of Article 9." Article 9.2(b) has since lapsed, but while in effect permitted a Member to provide export subsidies listed in Article 9.1 in a given year in excess of the corresponding annual commitment levels in the Member' s schedule, subject to the cumulation limits of Articles 9.2(b)(i)-(iv). Under Article 9.4, during the implementation period, developing country Members were not required to undertake export subsidy commitments with respect to export subsidies listed in Articles 9.1(d) and 9.1(e), except not to apply them in a manner that would circumvent their reduction commitments.

78. Unlike export performance-related tax incentives, which are not expressly mentioned in the Agreement on Agriculture, export credit guarantees were subject to an altogether separate treatment and commitment: exclusion from the export subsidy disciplines altogether until agreement on

[60] US First Written Submission (11 July 2003), para. 161.

internationally agreed disciplines. Under Article 10.2, Members were (and continue to be) obligated to work toward the development of such disciplines, and once agreed, adhere to them.

79. Question 219 suggests one might have expected Article 3.3 to have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, to have simply prohibited the use of any export subsidy. Article 8, however, serves this specific role. It imposes the obligation not to provide export subsidies otherwise than in conformity with the Agreement on Agriculture and with the commitments specified in the respective Members' schedules.

80. The anti-circumvention provisions of Article 10.1 further highlight the separate treatment of export credit guarantees. That article explicitly recognizes that "non-commercial transactions" shall not be used to circumvent export subsidy commitments. This phraseology is distinctly similar to that of item (h) in Addendum 10, entitled "Export Competition: Export Subsidies to be subject to the terms of the Final Agreement," dated August 2, 1991, among the series of addenda to the Note on Options circulated by Chairman Dunkel.[61] That item(h) addressed: "Export credits provided by governments or their agencies on less than fully commercial terms."

81. However, instead of making any connection between "non-commercial transactions" and export credits, the Members agreed in the very next section - Article 10.2 as ultimately adopted - to provide wholly distinct treatment to export credits, export credit guarantees and insurance. The reference to circumvention for non-commercial transactions in the current Article 10.1 would have been the obvious place to draw the distinction that New Zealand and Brazil claim the Members allegedly made between "commercial" and "non-commercial" export credits.[62] But the text simply does not support this fictional argument.

82. Article 10.4 provides further support that export credits are part of a work programme to develop disciplines for them and consequently are not currently subject to the other disciplines of Article 10. Article 10.4 of the Agreement on Agriculture ties the discipline on food aid to terms negotiated elsewhere: the Food Aid Convention and the United Nations' Food and Agriculture Organization (FAO). This specific set of disciplines applicable to food aid demonstrate the situation that will apply once the negotiations mandated under Article 10.2 are completed. They also illustrate an approach comparable to the negotiations that subsequently occurred in the OECD and as contemplated in paragraph 5 of Attachment 5 of the Harbinson Text.[63] Once internationally agreed disciplines are achieved, then it will be possible for a given export credit practice to circumvent export subsidy disciplines as a result of failure to comply with the export credit disciplines.[64]

> **221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be $230,127,023 instead of the figure which originally appeared ($381,345,059).**
>
> **(a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.**

[61] MTN.GNG/AG/W/1/Add. 10 (2 August 1991) (Exhibit US-27)

[62] See, New Zealand Answers to Question 35 of Panel to Third Parties, Brazil Answer to Panel Question 71(a); US Rebuttal Submission (22 August 2003), para. 144-145

[63] Exhibit US-9

[64] See US First Written Submission (11 July 2003), fn. 150.

| GSM 102/GSM-103/SCGP<br>Subsidy Estimates and Reestimates By Cohort | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Original Subsidy Cohort** | **Cohort Reestimates by Fiscal Year Estimate** | **FY93-00** | **FY01** | **FY02** | **FY 03** | **Total Reestimates** | **Subsidy Estimate Net of Reestimate** |
| 1992 | 267,426,000 | 166,136,256 | -599,604,000 | 27,030,201 | 14,823,708 | -391,613,835 | -124,187,835 |
| 1993 | 171,786,000 | -10,556,906 | -257,206,000 | 23,017,631 | 16,571,778 | -228,173,497 | -56,387,497 |
| 1994 | 122,921,000 | -82,345,960 | -77,135,000 | 2,228,985 | 41,521,000 | -115,730,975 | 7,190,025 |
| 1995 | 113,000,000 | -40,555,149 | -105,216,000 | 2,823,516 | -6,351,460 | -149,299,093 | -36,299,093 |
| 1996 | 328,000,000 | 896,907 | -386,916,000 | 7,611,330 | 44,934,327 | -333,473,436 | -5,473,436 |
| 1997 | 289,000,000 | 0 | -237,316,000 | 19,845,279 | 50,733,713 | -166,737,008 | 122,262,992 |
| 1998 | 301,000,000 | 0 | -237,271,000 | 14,661,079 | - 15,693,431 | -238,303,352 | 62,696,648 |
| 1999 | 158,000,000 | 0 | -68,758,000 | 51,146,455 | -144,434,351 | -162,045,896 | -4,045,896 |
| 2000 | 195,000,000 | 0 | | -91987247 | -61,534,936 | -153,522,183 | 41,477,817 |
| 2001 | 103,000,000 | | | -33497152 | 16,381,864 | -17,115,288 | 85,884,712 |
| 2002 | 97,000,000 | | | | 40008586 | 40,008,586 | 137,008,586 |
| **Total for all Cohorts** | **2,146,133,000** | **33,575,148** | **-1,969,422,000** | **22,880,077** | **-3,039,202** | **-1916005977** | **230127023** |

Source: FSA Budget Division Reestimate Documentation and Apportionment Documents.
There were no reestimates apportioned during FY 1998 through FY 2000.

**(b) Please clarify whether and how the Panel should treat the figures in Exhibit BRA-182 for the net lifetime re-estimates for each respective cohort.**

83. The United States has no objection to use of the figures in the column entitled "Net lifetime reestimate amount" in Exhibit Bra-182 in lieu of the column entitled "Reestimates" in the table that accompanied paragraph 161 of the US Rebuttal Submission (22 August 2003) and reproduced in the response to question 221(a) immediately above. The figures are intended to represent the same thing.

84. The Panel will first note that with respect to the figures corresponding to cohorts 1997-2002, Exhibit Bra-182 and the table previously submitted by the United States match.

85. Differences appear with respect to cohorts 1992-1996. The United States attempted to explain the disparity in footnote 96 of its Further Submission of 30 September 2003. These differences would appear to be related to the cumulative re-estimates applied to these cohorts within the calculations of the budgets in fiscal years 1993-2000. The United States noted that it was searching for internal documentation to corroborate the figures included in the table previously submitted to the Panel. In the absence of such documentation and unable to explain the relatively minor disparity in figures, the United States necessarily accepts Exhibit Bra-182.

86. In fact, the United States' initial figures were more conservative than these official figures which show profitability in every year during the period 1992-1996. The following table illustrates this result:

| Cohort | Estimate | Re-estimates (Bra-182) | Net of Re-estimates |
|---|---|---|---|
| 1992 | 267426000 | -370963000 | -103537000 |
| 1993 | 171786000 | -239160000 | -67374000 |
| 1994 | 122921000 | -133746000 | -10825000 |
| 1995 | 113000000 | -159564000 | -46564000 |
| 1996 | 328000000 | -333407000 | -5407000 |
| 1997 | 289000000 | -166737000 | 122263000 |
| 1998 | 301000000 | -238304000 | 62696000 |
| 1999 | 158000000 | -162046000 | -4046000 |
| 2000 | 195000000 | -153522000 | 41478000 |
| 2001 | 103000000 | -17115000 | 85885000 |
| 2002 | 97000000 | 40009000 | 137009000 |

These figures show that all of the first five cohorts (1992-1996), including 1994, are profitable. The figures for these years, unlike the more recent cohorts, reflect much more complete data for actual operating experience (although 1999 is already showing profitability).

**(c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of $4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately $4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result**.

87. The figures in the table in paragraph 161 do not include administrative expenses. Imputed administrative costs are not subject to the re-estimation process but are reflected separately in the budget.[65] The United States has previously acknowledged that it would be appropriate to apply an administrative expense as an operating cost of the programme.[66] Consequently, it would be appropriate to add the administrative expense applicable to a particular cohort as an operating cost.

**(d) Please identify what is considered an "administrative expense" for this purpose.**

88. The Commodity Credit Corporation (CCC) has no physical presence. It also has no employees. The "administrative expense" in the budget is simply a reasonable approximation for budgetary purposes of the value of services supplied by US Department of Agriculture agencies and personnel in the administration of this particular programme subsumed within the CCC.

89. The relevant provision from the applicable appropriations legislation for fiscal year 2003 reads as follows:

> COMMODITY CREDIT CORPORATION EXPORT LOANS PROGRAMME ACCOUNT (INCLUDING TRANSFERS OF FUNDS)
>
> For administrative expenses to carry out the Commodity Credit Corporation's export guarantee programme, GSM 102 and GSM 103, $4,058,000; to cover common overhead expenses as permitted by section 11 of the Commodity Credit Corporation Charter Act and in conformity with the Federal Credit Reform Act of 1990, of which $3,224,000 may be

[65] See US First Written Submission (11 July 2003), para. 175 and fn. 160.
[66] US Answers to Panel Question 77 (11 August 2003), para. 146.

> transferred to and merged with the appropriation for "Foreign Agricultural Services, Salaries and Expenses", and of which $834,000 may be transferred to and merged with the appropriation for "Farm Service Agency, Salaries and Expenses."

Also, paragraph 38 of Statement of Federal Financial Accounting Standard No. 2[67], originally issued 23 August 1993[68], provides:

> Costs for administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of direct loans and loan guarantees.

**(e) The Panel notes the US statement in paragraph 160 of its answers to Panel questions following the first meeting that all cohorts are still open although the 1994 and 1995 cohorts will close this year. Is this still an accurate statement? If not, please indicate whether any cohorts have since "closed" for the period 1992-2002.**

90. Although the United States has not completed the formal administrative steps to close cohorts 1994 and 1995, all financial transactions necessary to do so are complete. Consistent with figures reflected in the 2004 Budget Federal Credit Supplement Table 8 (Exhibit Bra-182), the net of reestimate figure for each of cohorts 1994 and 1995 will be negative, indicating profitability.

**(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily* reach a "profitable" result (for example, the 1994 cohort, which has almost closed still indicates an outstanding amount)? Do "re-estimates" reflect also expectations about a cohort's future performance?**

91. Until a "closing reestimate" occurs with respect to a particular cohort, which is made "once all the loans in the cohort have been repaid or written off,"[69] each reestimate does necessarily reflect certain expectations about a cohort's future performance. "Reestimates mean revisions of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and/or estimated changes in future cash flows of the cohort."[70] Generally, reestimates must be made immediately after end of each fiscal year.

92. With the passage of time, of course, each reestimate necessarily more closely reflects actual results. In the case of the GSM-102 export credit guarantee programme, for example, after three fiscal years have elapsed both the actual amount of guarantees and the actual amount of defaults are known.

93. With respect to the 1994 cohort alone, as noted in the response to Panel Question 221(b) above, the numbers from Table 8 of the Federal Credit Supplement (Exhibit Bra-182), indicate profitability. As noted in the immediately preceding response, although the United States has not

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[67] See Answer to Question 228, *infra*, regarding the Federal Accounting Standards Advisory Board

[68] Statement of Federal Financial Accounting Standards No. 2: Accounting for Direct Loans and Loan Guarantees, issued 23 August 1993, pp. 187-267. (Exhibit US-127)

[69] See OMB Circular A-11 (Exhibit Bra- 116), section 185.6, page 185-15. See also, US Rebuttal Submission (22 August 2003), paras. 155-156 and fn. 189; US Answers to Panel Question 81(d) (11 August 2003), paras. 162-163.

[70] OMB Circular A-11 (Exhibit Bra- 116), Section 185.3(x), p. 185-12

completed the formal administrative steps to close cohorts 1994 and 1995, all financial transactions necessary to do so are complete. Consistent with figures reflected in the 2004 Budget Federal Credit Supplement Table 8 (Exhibit Bra-182), the net of reestimate figure for each of cohorts 1994 and 1995 will be negative, indicating profitability.

94. With respect to 1997 and 1998, the United States of course cannot with absolute certainty predict the future**.** A principal issue with respect to the 1997 cohort concerns Pakistani and Ecuadorean defaults. All of this debt has been rescheduled and is now fully performing. These rescheduled amounts currently involve approximately $209 million of outstanding principal alone. Consequently, the United States has every reason to believe that 1997 cohort will ultimately reflect profitability.

95. With respect to the 1998 cohort over $30 million of Ecuadorean and Russian (private sector) outstanding principal are in performing reschedulings.

**(g) Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?**

96. The United States has previously noted that the original subsidy estimate in the US budget begins with an historically overly optimistic projection of the actual use of the programme and then the use of government-wide estimation rules is required, including mandated risk assessment country grades without regard to the actual experience specific to the CCC export credit guarantee programmes.[71] The original subsidy estimate for these cohorts, like the original subsidy estimate for all cohorts, necessarily reflects no actual operating experience with respect to that cohort.

97. Subsequent downward reestimates (i.e., good performance) are calculated not from the original subsidy estimate but from the actual figure corresponding to amounts of guarantees actually issued.[72] Although this budgetary convention exaggerates the apparent negative performance in all years, this exaggeration is particularly acute in the nearer term. As reflected in the table entitled "CCC Export Credit Guarantee Programme Levels - Annual President's Budgets and Actual Sales Registrations - FYs 1992-2004" accompanying paragraph 148 of the US Further Submission (30 September 2003), actual sales registrations are only reflected in budgetary figures two fiscal years following the fiscal year of the particular cohort. For the 2002 cohort, therefore, the actual sales registrations of $3,388 million contrasts with the estimated programme level of $3,926 million in the immediately preceding budget. Similarly, for the 2001 cohort, the actual figure of $3,227 million is also more than one-half billion dollars less than the anticipated programme level of $3,792 million reflected in the preceding budgets. For this reason, the tables set forth in response to questions 221(a) and 221(b) commence with an "estimate" figure corresponding to the actual level of sales registrations.

98. More significant in direct response to the question, as reflected in the tables above in response to questions 221(a) and 221(b), is the trend of negative reestimates (i.e., better than expected performance). They are uniformly large for all cohorts for 1999-2000. This trend has also commenced with respect to the 2001 cohort. It is reasonable to expect that in the fullness of time the data will similarly reflect further negative reestimates for cohorts 2001 and 2002. This is likely to become more pronounced as the terms of the guarantees issued during this time expire.

99. For the foregoing reasons, the United States submits that the current budgetary subsidy estimate figures do not accurately reflect the proper relationship of premia to long-term operating costs and losses (if any) with respect to cohorts 2001 and 2002. Although over the long-term the

[71] US Further Submission (30 September 2003), paras. 147-148.
[72] See US Further Submission (30 September 2003), paras. 148-149.

subsidy estimate / re-estimate process will incorporate information relating to actual operating experience, the original subsidy estimate figures in the budget do not reflect any operating experience for the respective cohort. Thus, those subsidy estimates cannot properly be used as part of an analysis of whether the export credit guarantee programmes conform to Item (j) of the Illustrative List (i.e, the sufficiency of premia to cover long-term *operating* costs or losses (if any)).

**(h) Why should the Panel "eliminate", in addition, the 2000 cohort, as also suggested in paragraph 198 of the US further rebuttal submission for which information is presumably more "complete"?**

100. The Panel is of course correct to note that the data for the 2000 cohort is necessarily more complete than with respect to the subsequent cohorts. And, as the United States would have anticipated, the large negative reestimates have commenced for the 2000 cohort. As we are now in the third month of fiscal year 2004, all outstanding GSM-102 and SCGP guarantees will have expired, and the next budget cycle reestimate process will necessarily reflect that fact.

101. The same points made in the immediately preceding response to question 221(g) apply to the 2000 cohort. Of particular note with respect to this cohort, however, is the very large difference between the original projected level of use reflected in the 2000 budget ($4,506 million) and the actual level of sales registrations reflected in the 2002 budget for that cohort ($3,082 million). This difference, approaching $1.5 billion of initially overestimated utilization, has a profound effect on the budgetary depiction of programme performance and required estimates (although the tables set forth above eliminate this distortion in the US budget by starting from the estimate figure corresponding to actual sales registrations).

**(i) Under the US approach, at what point in time could a Panel ever make an assessment of the programme, if it had to wait for each cohort to be completed before it could be "properly" assessed? Why is it inappropriate for the Panel to include these "most recent years" in its evaluation, as the US suggests in paragraph 199 of its 18 November further rebuttal submission? USA**

102. Fortunately, neither the Panel nor the United States has to answer this question entirely in the abstract. First, Brazil and the United States agree that an examination beyond 10 years is inappropriate.[73] Indeed, as the United States has noted, to subject the programme to the analytical yoke of the unique circumstances of the Polish and Iraqi defaults over 10 years ago would effectively require elimination of the programme altogether.[74] Item(j) analysis requires a certain retrospection to make the requisite comparison between premia and net operating results of the programme. The question therefore becomes at what point does the financial data yield a sufficiently accurate picture to render this judgment.

103. The United States has noted that the budgetary figures inherently tend to exaggerate negative performance of the programme. This is more pronounced in the "most recent years" for the reasons noted above. As noted in the immediately preceding sub-question(h), in the case of fiscal year 2001 and 2002 cohorts, the original budgetary subsidy estimates do not reflect any operating results of those cohorts. In contrast, cohorts 1992-1999, taken as a whole, currently reflect a net negative reestimate (i.e., profitable performance). Although it is theoretically conceivable that status could change, every indication in the trends related to the programme, including most specifically the uniform performance of reschedulings, indicate that the negative reestimates will grow, not diminish, in time.

[73] The most recent manifestation is Brazil's statement in paragraph 81 of its 2 December 2003, Oral Statement: "Item(j) requires the Panel to determine whether the 'programmes,' . . . charge premium rates that meet operating costs and losses over a period that the United States and Brazil agree should be 10 years."

[74] US Rebuttal Submission (August 22, 2003), paras. 172-174

104. Consequently, the United States believes the Panel has sufficient data to determine that premium rates are adequate to cover long-term operating costs and losses of the programmes.

> **222. For GSM 102, 103 and SCGP, please provide year-by-year amounts from 1992 to 2003 with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes. Please indicate any allocation methodologies used to calculate administrative costs. USA**

105. The chart constituting Exhibit US-128 sets forth the information requested. This data is current through November 30, 2003. As the Panel will note, claims outstanding plus interest and administrative expenses are now well below premia plus interest otherwise collected or earned. This current data clearly reflects that premia are adequate to cover long-term operating costs and losses.

106. For each of cohorts 1992-1996, $3 million of administrative costs are allocated. For each subsequent cohort, $4 million of such costs are allocated. These are the figures reflected in the table accompanying paragraph 132 of Brazil' s Oral Statement of July 22, 2003, and the corresponding references to the US budget cited therein. As Exhibit US-128 breaks out activity for each of GSM-102, GSM-103, and SCGP, these respective administrative costs have then been allocated based on the relative registration values of these programmes. Interest costs and revenue (see response to question 224 and table therein) have similarly been allocated based on registration value.

> **223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? USA**

107. Premium rates applicable to GSM-102, GSM-103, and SCGP are reviewed annually. The premia rates vary by programme, length of coverage, and repayment interval. For GSM-102, the premium ranges from 15.3 cents per $100 of coverage to about 66 cents per $100 of coverage. Under SCGP, a two-tier fee schedule exists. For up to 90 days, the fee is 45 cents per $100 of coverage. For 91 to 180 days, the fee is 90 cents per $100 of coverage. A higher fee structure for longer term is viewed as an incentive to exporters to opt for a shorter term and correspondingly reduce the likelihood of claims, and therefore potential operating losses, associated with the programmes. Premia for both GSM-102 and SCGP are currently subject to a statutory cap of one per cent.[75]

108. Private commercial quotes for export credit insurance are simply not available to the United States. As the United States has previously noted, however[76], commercial insurers do offer export credit insurance covering agricultural commodities. According to a background paper on export credits prepared by the WTO Secretariat: "While guarantees could be unconditional, they usually have conditions attached to them, so that in practice there is little distinction between credits which are guaranteed and credits which are subject to insurance."[77]

109. With respect to forfaiting, the United States similarly does not have access to specific implicit rates available in the marketplace. The United States notes, however, that an importer does not necessarily realize any benefit from a CCC export credit guarantee. CCC has no role in the arrangements between the foreign bank issuing the letter of credit and the importer, which is typically

[75] See US Answer to Panel Question 85 (11 August 2003), paras. 181-183.
[76] US Answer to Panel Question 76 (11 August 2003), para. 144
[77] *Export Credits and Related Facilities*, G/AG/NG/S/13 (26 June 2000)

the account party under the letter of credit. Consequently, the importer may have to pay its bank in full upon disbursement under the documentary letter of credit. The existence of an export credit guarantee transaction also has no necessary effect on the pricing of financing or letter of credit fees that the importer's bank may charge. In this respect, the export credit guarantee transaction is less favourable to the importer than a forfaiting transaction.[78] As the United States has previously observed, forfaiting and export credit guarantee transactions compete as a method for trade financing over comparable tenors in similar markets, but it is difficult to make direct comparisons of implicit rates even among forfaiting transactions themselves.[79]

**224. Please indicate how the CCC's cost of borrowing was treated in the 2002 financial statement of the CCC, in Exhibit BRA 158.**

110. In the 2002 financial statements of the CCC, the cost of borrowing is treated as interest expense. It is included as part of the Net Cost of Operations set forth in Exhibit US-129, entitled "Commodity Credit Corporation Consolidated Statement of Net Cost (Note 13) for the Fiscal Year Ended 30 September 2002)." A separate column is presented for Foreign Programmes, of which the Export Credit Guarantee programmes are a part. Borrowing costs are subsumed within "Intragovernmental Gross Costs". CCC also earns interest on monies held by Treasury. These interest collections become a component of "intragovernmental earned revenue." The net result is the difference between these two figures in a given year.

111. With respect to the export credit guarantee programmes specifically, this "interest on debt to Treasury" and "interest on uninvested funds" are reflected in the financing account portion of each budget. As interest expense and revenue are necessarily homogenized numbers, they are not readily allocated to cohorts. Actual interest expense and revenue figures for a particular fiscal year are set forth in line 00.02 and 88.25 of the financing account provisions of each budget. The following table sets out these figures, which are also reflected in the table responding to question 222 above.

[78] See, generally, US Further Submission (30 September 2003), paras. 157-162
[79] US Rebuttal Submission (22 August 2003), para. 189-191

**CCC Export Credit Guarantee Programme -- Financing Account**
**Payments of Interest on Borrowings from Treasury (00.02) and**
**Interest Earned on Uninvested Funds (88.25)**
**Programming Years 1992 – 2002**
($ Millions)

| **Annual President's Budgets** | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Programme Year** | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| 1992 Actuals | | | | | | | | | | | |
| Interest on Borrowings | $0 | | | | | | | | | | |
| Interest Earned | (1) | | | | | | | | | | |
| 1993 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | $0 | | | | | | | | | |
| Interest Earned | | (16) | | | | | | | | | |
| 1994 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | $0 | | | | | | | | |
| Interest Earned | | | (0) | | | | | | | | |
| 1995 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | $10 | | | | | | | |
| Interest Earned | | | | (0) | | | | | | | |
| 1996 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | $61 | | | | | | |
| Interest Earned | | | | | (26) | | | | | | |
| 1997 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | $62 | | | | | |
| Interest Earned | | | | | | (26) | | | | | |
| 1998 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | | $62 | | | | |
| Interest Earned | | | | | | | (54) | | | | |
| 1999 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | | | $62 | | | |
| Interest Earned | | | | | | | | (0) | | | |
| 2000 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | | | | $62 | | |
| Interest Earned | | | | | | | | | (99) | | |

| **Annual President's Budgets** | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Programme Year** | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| 2001 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | | | | | $104 | |
| Interest Earned | | | | | | | | | | (125) | |
| 2002 Actuals | | | | | | | | | | | |
| Interest on Borrowings | | | | | | | | | | | $93 |
| Interest Earned | | | | | | | | | | | -61 |

**225. Please indicate whether there was any instance where the CCC "wrote off" debt and, if so, please indicate the accounting regulation or principle used. If a "written off" debt is subsequently recovered, do the CCC's accounts reflect both the interest cost and interest received in relation to the debt during the time it was "written off"? USA**

112. A complete response to this question requires a vocabulary distinction between "write off" for purposes of CCC accounting and debt forgiveness. A "write off" conventionally is used to describe debt that CCC itself independently determines to be uncollectible. This determination is made by the Controller of CCC.

113. Debt forgiveness, on the other hand, refers to multilaterally agreed debt forgiveness, usually through the Paris Club, that is subsequently implemented by the United States and CCC through legislation or other internal mechanisms to eliminate the outstanding debt. As a result, in the more common parlance, that debt too is written off.

114. Historically, debt forgiveness is far larger than independent "write off." CCC has independently written off as uncollectible only approximately $190,000 of private sector debt with respect to the export credit guarantee programmes as follows:

| Cohort | Fiscal Year of Write Off | Country | Amount |
|---|---|---|---|
| Pre-1992 | 1995 | Nigeria | $129,000 |
| Pre-1992 | 1999 | Argentina | 48,000 |
| 1992 | 1999 | Russia and Former Soviet Union | 13,000 |

Debt forgiveness:

| Cohort | Fiscal Year of forgiveness | Country | Amount |
|---|---|---|---|
| Pre-1992 | 1991, 1994 | Poland | $1,406,000,000[80] |
| Pre-1992 | 1997 | Yemen | 1,686,000 |
| Pre-1992 | 1999 | Honduras | 5,951,000 |
| Pre-1992 | 2002 | Former Yugoslavia | 3,343,000 |
| Pre-1992 | 2002 | Tanzania | 8,806,000 |

None of the foregoing debt in either table has been recovered.

**226. If a debt was "written off" more than ten years ago, does it still create a cost to the programme? If so, how is this reflected in the 2002 financial statement of the CCC, in Exhibit BRA 158 (or any other material)?**

115. The provisions of the Federal Credit Reform Act first took effect with fiscal year 1992, which commenced on 1 October 1991. Write-offs before 1 October 1991 would have no continuing effect in the current financial statements of CCC, as such write-offs would have been reflected as part of the operating loss of the corporation, which in turn was replenished through the annual appropriations process in the year following such write-off.

[80] This amount is approximate as it requires allocation of write off related to debt arising from various programmes.

116. Write-offs after 1 October 1991 also would not independently create an expense. Upon payment of a claim on an export credit guarantee, CCC receives a fully subrogated position to collect from the defaulting obligor. As a result, this debt is then reflected as a loan receivable for both budgetary and financial statement purposes. In accordance with paragraph 61 of Statement of Federal Financial Accounting Standard No. 2,[81]:

> When post-1991 direct loans are written off, the unpaid principal of the loans is removed from the gross amount of loans receivable. Concurrently, the same amount is charged to the allowance for subsidy costs. Prior to the write-off, the uncollectible amounts should have been fully provided for in the subsidy cost allowance through the subsidy cost estimate or reestimates. Therefore, the write-off would have no effect on expenses.

> **227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount - referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? USA**

117. Brazil wrongly describes this amount as "record losses . . . for its guarantee programmes over the period 1992-2002."[82] This figure does *not* represent a loss. It is a *prospective* estimate at a particular moment in time of anticipated experience under the programme. It is, like the budget figures, an estimate.

118. The $411 million figure is simply another manifestation of the estimate and re-estimate process required under the Credit Reform Act of 1990 and reflected in the budget figures of the United States. As a result, it is another depiction, albeit in a different format, of the results of the estimate and re-estimate process.

119. Just as the estimate figures in the budget proceed in a downward direction (i.e., good performance), one would expect this corresponding estimate figure in the CCC Financial Statements to do the same. And it does. On the corresponding page of the Notes to Financial Statements 30 September 2003 and 2002[83], the $411 million figure has declined to $22 million.

120. As reflected on page 19[84] of Exhibit Bra-158 and on its 2003 analog, the $411 million figure and the more recent $22 million figure are the result net of "interest rate reestimate" and "technical/default reestimate". The figure, net of such total subsidy reestimates, is then brought forward to the subsequent year (as is manifest on page 19 from 2001 to 2002 and in turn from 2002 to 2003). Prior years' figures similarly brought forward are also figures net of "total subsidy reestimates".

121. Furthermore, Appendix E of the Statements of Federal Financial Accounting Concepts and Standards of the Financial Accounting Standards Advisory Board is a consolidated glossary of terms

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[81] Exhibit US-127.

[82] The most recent example of this repeated assertion is in paragraph 84 of the 2 December 2003, Statement of Brazil.

[83] Audit Report, Commodity Credit Corporation, Financial Statements for Fiscal Years 2003 and 2002, Note 5, page 19. (Exhibit US-129).

[84] The information and format of this page are required by Statement of Federal Financial Accounting Standards No. 18: Amendments To Accounting Standards for Direct Loans and Loan Guarantees In Statement of Federal Financial Accounting Standards No. 2, Appendix B: Schedule B, entitled "Schedule for Reconciling Loan Guarantee Liability Balances." Exhibit US-125 , p. 990 (Exhibit US-125: http://www.fasab.gov/pdf/cod4.pdf pages 967-993).

applicable to GAAP for federal entities. That glossary defines "liability" as: "For Federal accounting purposes, a probable future outflow or other sacrifice of resources as a result of past transactions or events." Loss, on the other hand, is: "Any expense or irrecoverable cost, often referred to as a form of nonrecurring charge, an expenditure from which no present or future benefit may be expected."[85] The $411 million figure in the 2002 Financial Statements and the $22 million figure in the 2003 Financial Statements describe "credit guarantee liability," not loss.

**228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? BRA, USA**

122. Financial statements of the Commodity Credit Corporation are prepared in accordance with generally accepted accounting principles (GAAP), based on accounting standards promulgated by the Federal Accounting Standards Advisory Board (FASAB).[86] In October, 1999, this board was designated by the American Institute of Certified Public Accountants (AICPA) as the standards-setting body for financial statements of federal government entities, with respect to the establishment of generally accepted accounting principles. On October 19, 1999, AICPA adopted an amendment to its Code of Professional Ethics to recognize accounting standards published by the FASAB as GAAP for federal financial reporting entities. The amendment recognized FASAB as the source of GAAP for federal entities. Consequently, no incompatibility of accounting principles exists.

## E. SERIOUS PREJUDICE

**230. Please comment on Brazil's views on Article 6.3 of the SCM Agreement as stated in paragraphs 92-94 of its further submission. USA**

123. Brazil's arguments fail to convince. First, Brazil complains that "[t]here is no valid basis for the US interpretation that the word "may" in the chapeau of Article 6.3 of the SCM Agreement [to] mean[] that a complainant - in addition to demonstrating the existence of one of the effects listed in the subparagraphs, e.g., significant price suppression - must also make a separate showing of 'serious' prejudice."[87] Brazil may choose to believe there is no "valid" basis, but there is a clear textual basis for the US interpretation: the ordinary meaning of the word "may."

124. The ordinary meaning of "may" is "have ability or power to; can."[88] Therefore, the chapeau of Article 6.3 permits but does not require a finding that serious prejudice exists when one of the situations in Article 6.3 is demonstrated.

125. Second, Brazil argues that the use of "may" in Article 6.3 is merely intended to reflect that there are "situations in which the four enumerated types of serious prejudice exist but are not actionable." For example, Brazil points to Article 6.7, which delineates certain circumstances in which displacement or impeding of exports shall not arise, and Article 6.9, which states that Article 6 does not apply to measures that conform to the Peace Clause. Brazil's argument is badly flawed. The ordinary meaning of the chapeau to Article 6.3 does not suggest that serious prejudice must arise if one of the situations in Article 6.3 exists. If the drafters had intended merely to suggest that exceptions to Article 6.3 exist, they succeeded instead in creating a provision that does not compel

[85] Statement of Federal Financial Accounting Concepts and Standards (May 2002), Appendix E, pages 1140-1141 (Exhibit US-130).
[86] The website for the FASAB is www.fasab.gov.
[87] Brazil's Further Rebuttal Submission, para. 92.
[88] *New Shorter Oxford English Dictionary*, vol.1, at 1721.

any finding of serious prejudice in a circumstance in which one of the criteria under Article 6.3 is met, even when the circumstances in Articles 6.7 and 6.9 are met.

126. Indeed, the text of Article 6 does reflect Members' decision to create in Articles 6.1 and 6.2 exactly the sort of mandatory presumption / exception structure that Brazil attempts to read into Article 6.3. Article 6.1 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 *shall be deemed to exist* in [certain] case[s]" (emphasis added). Article 6.2 states that, "*[n]otwithstanding* the provisions of paragraph 1, serious prejudice *shall not be found* if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3" (emphasis added). By way of contrast, Articles 6.3 and 6.7 do *not* use mandatory language (for example, "shall be deemed to exist" / "shall not be found") to establish a presumption / exception relationship. Rather, the language of Article 6.3 is permissive, and Article 6.7 is not expressed as an exception to a mandatory finding under Article 6.3.

127. Brazil's reference to Article 6.9 is inapt. We note that Article 6.9 does not limit its application to situations under Article 6.3. Rather, it states: "This *Article* does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture" (emphasis added). The language of Article 6.9 indicates that it applies to *all* of the provisions under "[t]his Article." Thus, according to Brazil's logic, every affirmative use of the word "shall" in Article 6 (for example, Article 6.1: "Serious prejudice shall be deemed to exist . . . ."; Article 6.4: "[D]isplacement or impeding of exports shall include . . . ."; Article 6.5: "[P]rice undercutting shall include . . . .") should have been written "may" to reflect the fact that "even where the requirements of [that provision] are fulfilled," the "subsidies are exempt from action by virtue of the peace clause of Article 13 of the Agreement on Agriculture." Those other provisions *do* use the term "shall," however, suggesting that the term "may" in Article 6.3 was used deliberately and according to its ordinary meaning.

128. Finally, Brazil asserts that "Article 6 is silent on the nature of the alleged additional requirements for a finding of 'serious' prejudice."[89] This is not wholly accurate. For example, as Question 229 from the Panel to Brazil notes, the chapeau to Article 6.3 indicates that "[s]erious prejudice . . . may arise in any case *where one or several of the following apply*" (emphasis added). Therefore, the Panel could conclude that where more than one prong of Article 6.3 is satisfied, the likelihood that the result is "serious prejudice" increases. Furthermore, Brazil points to additional details provided in Article 6.4 on displacement or impedance and in Article 6.5 on price undercutting as suggesting that a finding of "serious prejudice" must result if one prong of Article 6.3 is satisfied. However, Brazil draws no consequence from the lack of" detailed definitions" capable of application for Articles 6.3(a), 6.3(c) (significant prices suppression, price depression, or lost sales), or 6.3(d).

129. Finally, Brazil claims that the United States did not assert and the panel in *Indonesia - Automobiles* did not find any separate "serious prejudice" requirement in Article 6.3. As the United States notes in its answer to Question 234, the permissive ("may") language of the chapeau to Article 6.3 would not preclude the Panel from concluding that a finding under one prong of Article 6.3 suffices to establish serious prejudice. As Article 6.8 suggests, "the existence of serious prejudice should be determined on the basis of the information submitted to or obtained by the panel" – that is, on a case-by-case basis. Thus, the Panel will be called upon to exercise its judgment on the quality of the evidence on causation and on the extent of any alleged effects. To reiterate one hypothetical example suggested at the second panel meeting, were a complaining party to make a *prima facie* case that *one unit* of its exports had been displaced from the market of the subsidizing Member, the situation in Article 6.3(a) would technically have been demonstrated. Such a situation, however, would lend itself to the exercise of the Panel's discretion not to find serious prejudice. This is the type of flexibility that the chapeau to Article 6.3 gives the Panel and which Brazil 's interpretation would read out of the Subsidies Agreement.

[89] Brazil's Further Rebuttal Submission, para. 94.

**231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the SCM Agreement are relevant context for the Panel's interpretation of Article 6.3? USA**

130. The United States believes that both Article 6.1 and Annex IV of the Subsidies Agreement provide relevant context for interpreting "serious prejudice" within the meaning of Article 5(c) and Article 6.3. As the Panel's question notes, Article 6.1 has expired pursuant to Article 31, which established that Article 6.1 would "apply for a period of five years, beginning with the date of entry into force of the WTO Agreement," unless the Committee on Subsidies and Countervailing Measures determined to extend its application. Annex IV is entitled, "Calculation of the Total Ad Valorem Subsidization (Paragraph 1(a) of Article 6)," and by its terms establishes a methodology to calculate "the amount of a subsidy for the purpose of paragraph 1(a) of Article 6." Thus, since the provision it is meant to implement is no longer in effect, Annex IV as well is no longer directly applicable.

131. The context provided by these provisions, of course, must be judged in light of the fact that Members did *not* agree to extend Article 6.1(a). That is, it is highly relevant that the provision establishing a rebuttable presumption of serious prejudice upon a showing of a 5 per cent *ad valorem* subsidization rate was allowed by Members to lapse. On the other hand, no decision on whether to extend Annex IV was contemplated or taken pursuant to Article 31. In addition, we note that in *United States – Countervailing Measures (EC)*, the Appellate Body relied on Annex IV as context in interpreting another provision of the Subsidies Agreement.[90] Thus, although the underlying provision attaching a consequence to a certain subsidization rate lapsed, it is appropriate to examine how Members agreed in Annex IV a subsidy not tied to the production or sale of a given product would be allocated across the total value of the recipient's production.

132. The Panel must utilize some methodology to determine the benefit to upland cotton from a subsidy not tied to production of upland cotton. For example, Part V does not expressly set out an allocation methodology, but the same methodology of allocating an untied subsidy across the total value of the recipient's production is applied by several Members (for example, the European Communities and the United States) for purposes of their countervailing duty law. Indeed, Brazil itself has proposed in the Negotiating Group on Rules that Members adopt a "guideline" on calculating the amount of the subsidy for countervailing duty purposes precisely setting out the methodology contained in Annex IV.[91] The Panel should consider whether Brazil's refusal to countenance any allocation of the decoupled payments it has challenged is credible given the fact that Brazil in its Rules proposal and Annex IV as agreed by Members both express the same approach to allocating non-tied subsidies across production. Thus, the United States believes that Annex IV continues to provide useful context for the necessary task of identifying the products that benefit from a subsidy not tied to the production or sale of a given product.

**234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"?**

133. "Significant" price suppression under Article 6.3(c) does not necessarily amount to "serious prejudice" within the meaning of Article 5(c). This conclusion flows from the ordinary meaning of

[90] WT/DS212/AB/R, para. 112. Similarly, in *United States – FSC: Article 22.6*, Arbitrator cited the expired Articles 8 and 9 as "helpful . . . in understanding the overall architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address." WT/DS108/ARB, note 56.

[91] Paper by Brazil, Countervailing Measures: Illustrative Major Issues, TN/RL/W/19, at 6 (7 October 2002) ("If the benefit of a subsidy is limited to a particular product, the denominator should reflect only sales [production/exports] of that product. If this is not the case, the denominator should be the recipient's total sales.").

the text of Article 6.3(c): "Serious prejudice in the sense of paragraph (c) of Article 5 *may* arise in any case where one or several of the following apply." The ordinary meaning of "may" is "have ability or power to; can." Therefore, the existence of one of the situations in Article 6.3 is a necessary condition for a finding of serious prejudice but may not be sufficient.

134. Brazil argues that the use of "may" in Article 6.3 is merely intended to reflect that Article 6.7 delineates certain circumstances in which displacement or impeding of exports shall not arise. However, the ordinary meaning of the chapeau to Article 6.3 does not suggest that serious prejudice must arise if one of the situations in Article 6.3 exists. Further, the text of Article 6 reflects Members' decision to create just such a mandatory presumption / exception structure in Article 6.1 and 6.2. Article 6.1 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 *shall be deemed to exist* in [certain] case[s]" (emphasis added). Article 6.2 states that, "[n]otwithstanding the provisions of paragraph 1, serious prejudice *shall not be found* if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3" (emphasis added). Article 6.3 and 6.7 do *not* use mandatory language ("shall be deemed to exist" / "shall not be found") to establish a presumption / exception relationship. Rather, the language of Article 6.3 is permissive, and Article 6.7 is not expressed as an exception to a mandatory finding under Article 6.3.

135. At the same time, the United States does not believe the text of the chapeau to Article 6.3 *precludes* a finding of serious prejudice where only "significant price suppression" by the subsidized product "in the same market" as a like product and no other situation in Article 6.3 has been demonstrated. Thus, it is conceivable that the effect of a subsidy could be price suppression so significant that it alone rises to the level of serious prejudice to the interests of another Member.

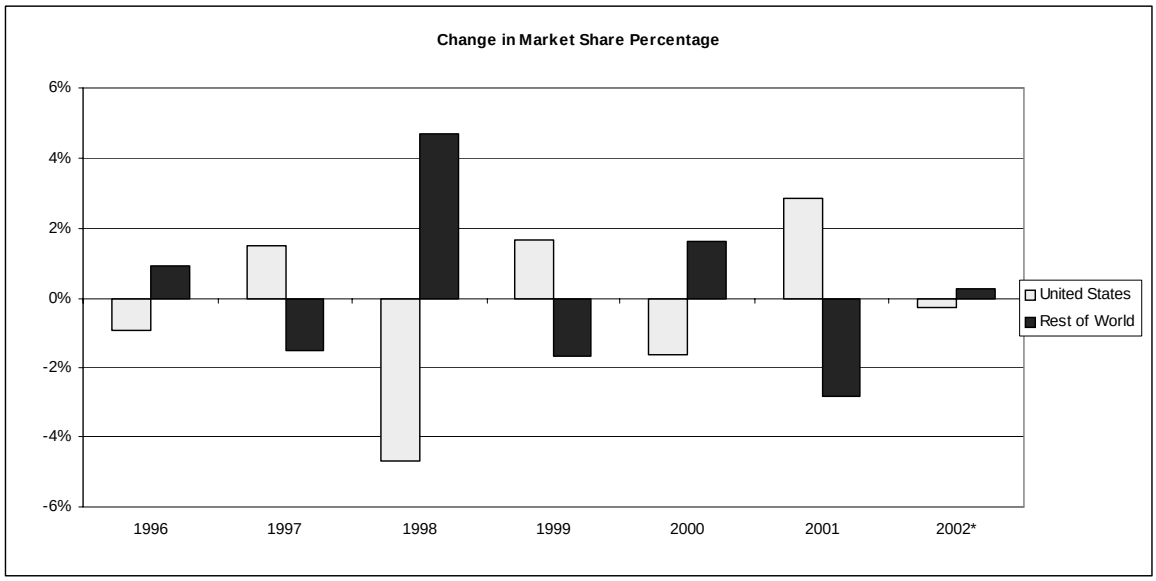
136. We recall that Brazil's interpretation is that price suppression would be "significant" even at a level of 1 cent per pound because this could still "meaningfully affect" its producers.[92] The use of the term "significant," however, would seem to be intended to prevent insignificant price effects from rising to the level of serious prejudice. For example, were the term "significant" omitted from Article 6.3(c), *any* production subsidy (for example, a per-unit payment of 0.0001 cents per pound of production) would be deemed to satisfy Article 6.3(c) because *any* increase in production resulting from the subsidy would *theoretically* result in some price effect. Coupled with Brazil's reading of "may arise" in the chapeau of Article 6.3, this would result in any production subsidy running afoul of Articles 5 and 6, effectively undermining the separation of Part III of the Subsidies Agreement on "Actionable Subsidies" from Part II on "Prohibited Subsidies."

> **236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share".**

137. The graph shows the year-over-year percentage change in the world market share over 1996-2002. US world market share is defined as in Exhibit US-47 as the quantity of consumption of US cotton (domestic mill use + exports) relative to world cotton consumption.

138. The annual change in the US market share is relatively slight with the exception of 1998 when severe drought, primarily in Texas, caused US production to fall significantly.

[92] *See* Brazil's Further Submission, para. 256.




**237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? BRA, USA**

139. It would not appear that a phenomenon (world market share) that remains at approximately the same level over a given period of time could be considered a "consistent trend" within the meaning of Article 6.3(d). This follows from the text of Article 6.3(d) itself because the "effect of the subsidy" must be an *increase* in world market share (as compared to the preceding three-year period), and "this increase [must] follow[] a consistent trend over a period when subsidies have been granted." Thus, if world market share remains at approximately the same level over a given period of time, the trend would not be an "increase" in world market share; hence, the trend would not be a "consistent trend" within the meaning of Article 6.3(d). And, in fact, the data do not demonstrate that US world market share has increased following a consistent trend over a period when subsidies have been granted.[93]

**238. According to the US interpretation of the term "world market share":**

**(a) should the domestic consumption of closed markets be added into the denominator?**

140. It is not clear from the Panel's question what is meant by "closed markets," but the US reading of Article 6.3(d) is that "world market share . . . in a particular subsidized primary product or commodity" means just that: a Member's share of the world market in, for example, upland cotton. There is nothing in the text of Article 6.3(d) that supports excluding any portion of the "world" from the analysis. For this reason, Brazil's reading of this provision as solely relating to world export trade necessarily excludes any portions of the "world market" for upland cotton that do not import, no

[93] *See, e.g.*, US Opening Statement at the Second Panel Meeting, paras. 12-13 ("That is, the facts demonstrate that since marketing year 1996, US world market share has increased and then decreased in alternating years, and US world market share in marketing year 2002 (19.6 per cent) is lower than in marketing years 1996 and 1997 (20.4 and 21.6 per cent, respectively).").

matter the size of that market. Such a result runs contrary to the ordinary meaning of the terms of the provision.

141. We note that excluding consumption from "closed markets" in the world market share calculation would increase the overall market share of the United States (and other suppliers) because the total world consumption figure would be lower. However, the variation in market share across years would not change appreciably assuming that the level of consumption in closed markets was relatively constant.

**(b) if US production and consumption increased by the same percentage, whilst the rest of the world's production and consumption remained steady, would this imply an increase in the US "world market share" by a different percentage?**

142. The United States interprets this question as asking whether the US market share would increase if an increase in US cotton consumption was completely supplied by increased US production without any changes to the consumption and supply patterns of the rest of the world. Under the US approach to "world market share," US world market share would increase.[94] The amount of increase in the US world market share would depend largely on the size of US consumption relative to world consumption.

143. Under Brazil's approach to Article 6.3(d), however, an increase in a Member's cotton consumption that was completely supplied by increased production by that Member would result in no change in that Member's world market share since there was no change in the Member's exports. Brazil's approach, therefore, would allow a larger or even dominant cotton consumer to provide huge per-unit production subsidies that increased the share of its own domestic consumption that its producers supplied without any discipline under Article 6.3(d), regardless of the impact on other Members who could potentially supply that increasing domestic consumption. Such a result runs contrary to the ordinary meaning of "world market share" in Article 6.3(d) since the term "world market" would captures impacts both in the market of the subsidizing Member (as in Article 6.3(a)) and in third-country markets (Articles 6.3(b) and 6.3(c)).

**(c) does Saudi Arabia have a small world market share for oil?**

144. The relevance of this question is not entirely clear since Article 6.3(d) does not speak of "large" or "small" world market shares. That is, it is only a certain *increase* in world market share, from whatever level, that follows a consistent trend over a period when subsidies have been granted that is relevant to the 6.3(d) analysis.

145. Nonetheless, we note that Saudi Arabia exports crude oil but also refines petroleum into products that it consumes and refines as well. Based on 2000 world petroleum supply and disposition data for 2000, Saudi crude oil exports account for about 16 per cent of total world exports. Using an analogous measure for consumption (exports plus domestic consumption–i.e., refining–divided by total world consumption) gives a market share of 12 per cent.

**239. How does the US respond to Brazil's assertions that, under the US interpretation of the term "world market share":**

**(a) there would be no WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports? (see paragraph 64 of Brazil's 2 December oral statement);**

[94] US world market share = (US domestic use of US cotton + US exports)/world consumption of cotton

**(b) a Member's exports would have to be disregarded in calculating their "world market share" in terms of "world consumption"? (see e.g. paragraph 65 of Brazil's 2 December oral statement)**

146. (a) We note that Brazil must repeatedly insert the term "export" into the phrase "world market share of export" or "world export share" in order to convey a meaning restricting the term "market share" to exports. That is because the ordinary meaning of "world market share" would be all those markets in which cotton is consumed. Further, Brazil's argument is overstated. There would be disciplines on production-enhancing subsidies, even those that increase a Member's world market share *of exports* (even though that is not an WTO obligation in and of itself). Under Article 6.3(d), for example, a Member's world market share is determined by its domestic consumption plus exports of the product it produces. If a subsidy increased the Member's exports, and domestic consumption and world consumption remained the same, the increase in the Member's exports alone would increase that Member's world market share.

147. Further, production-enhancing subsidies with export effects could be inconsistent with Article 5(a) (injury), Article 6.3(b) (displace or impede exports to third country markets), Article 6.3(c) (lost sales), or GATT 1994 XVI:1 (serious prejudice).

148. (b) It is interesting that Brazil, which roundly rejects the use of any concepts from Part V or Annex IV of the Subsidies Agreement or from the Safeguards or Anti-Dumping Agreements when these are inconvenient for it, here tries to introduce "the ordinary meaning in a trade remedy context of 'domestic consumption'." The Panel's task is not to interpret the term "domestic consumption" but rather the "world market share of the subsidizing Member in a particular subsidized primary product or commodity". The United States has proposed that the US share of the world market for upland cotton must be measured by that portion of world consumption of upland cotton satisfied by US upland cotton. That necessarily must include US domestic consumption satisfied by US upland cotton. Again, we note that a relevant "market" for serious prejudice purposes is the market of the subsidizing Member under Article 6.3(a). There is no basis in the text or context of 6.3(d) to exclude that market from the "world market" identified in 6.3(d).

**240. Does Article XVI:3 of GATT 1994 provide context in interpreting Article 6.3(d) of the SCM Agreement? Do these provisions apply separately? If not, could it indicate that "world market share" is intended to mean the same as "share of world export trade"?**

149. GATT 1994 Article XVI:3 provides some context to reading Article 6.3(d). Both provisions are addressed to subsidies that have effects on primary products. However, the context they provide also consists of the *differences* in their respective texts. GATT 1994 Article XVI:3 is limited to export subsidies, as Brazil acknowledged and agreed in the Tokyo Round Subsidies Code. (Brazil does not, because it cannot, deny that in the Tokyo Round it expressed its understanding that GATT 1994 Article XVI:3 applies only to export subsidies. The Panel can judge how credible it finds Brazil's change of opinion in this dispute.) GATT 1994 Article XVI:3 relies on an "equitable share" concept that panels and Members found incapable of definition or application. Moreover, Brazil has not provided any objective definition in this dispute of the "equitable share" concept but to argue that anything other than a non-subsidized level of exports is inequitable, a reading that would convert Article XVI:3 into a prohibition on domestic subsidies with production effects.

150. Article 6.3(d) of the Subsidies Agreement, on the other hand, applies to all subsidies and has objective criteria that are capable of application. This provision sets forward a mechanical test: a Member's share of the world market for a product must be greater than preceding 3-year average, and the increase must follow a consistent trend over a period when subsidies have been granted. Therefore, there is no "inequitable share" concept to deal with, and the consistency of a Member with its obligations is a straightforward matter to determine.

151. The United States does not see any basis to say that "world market share" was intended to mean the same as the "share of world export trade". The key difference is the use of the term "market" instead of "export". The term "market" can, of course, mean a domestic market; its meaning is not limited to markets in international trade. "Export" refers to cross-border transactions; therefore, a more limited set of transactions would be of interest. As a result, the term "world market share" requires that one look at all places where upland cotton is consumed and determine what portion of world consumption of is satisfied with US upland cotton.

**241. How does the US reconcile its data on consumption for 2002 in US Exhibit 40, Table 1 with the "consumption" data it refers to in its 30 September submission, paragraph 34, Exhibit US-47 or US-71? USA**

152. In paragraph 34 of the 30 September submission and in the accompanying table, "consumption" is used to capture both the domestic use of raw cotton production (that is, the "mill use" figure), plus the raw cotton equivalent of textile imports (that is, how much raw cotton is incorporated into manufactured cotton textile imports). This point is crucial to understanding how the growth in cotton textile imports has contributed to the decline in consumption of US domestically produced raw cotton for domestic manufacturing, which has resulted in more US domestic cotton finding a home in off-shore markets. That is, much US domestic cotton that is exported returns to the United States in the form of textiles and apparel.[95]

153. In Exhibits 40, 47, and 71, the data on consumption correspond to the "mill use" data described above. The only difference is that these data are on a crop year basis (August - July). Therefore, the mill use figure in paragraph 34 of the US further submission will differ slightly from the consumption figure in the other exhibits. They are the same data, adjusted for different periods. The most recent domestic consumption (that is, mill use) figure is given in the response to Question 197.

**242. How much of the benefits of PFC, MLA, CCP and Direct Payments go to land owners? If not all of the benefits go to land owners, what proportion goes to producers? USA**

154. As noted in the US further rebuttal submission, the literature on direct payments suggest that a large portion of direct payments get capitalized into land values. As Burfisher and Hopkins (2003) note: "Not all operators can . . . be considered as true beneficiaries of the [PFC] programme, since competitive cropland rental markets work to pass through payments from PFC recipients who are tenants to the owners of base acres."[96] Thus, the effects of increased wealth largely accrue to non-operators, and any theoretical production effects are further minimized.

155. In well-functioning markets, asset prices reflect expectations about the future returns from their ownership. The PFC programme covered a fixed number of base cropland acres, established in 1996 when farmers enrolled in the programme, and benefits did not require current production. The direct link between base acres and the known programme benefits allowed the future stream of payments to be efficiently capitalized into land values:

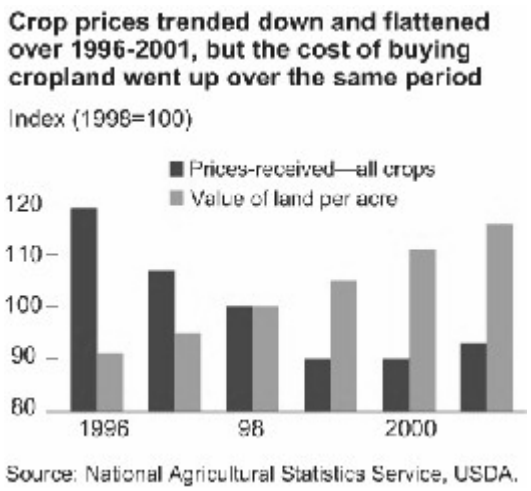
> Decoupled payments clearly increase the well-being of the operators who receive them, but only when they are owners of base acres. Otherwise, land markets allow a pass-through of payments from operators to landowners, via modified rental

[95] The data in the table in paragraph 34 are on a calendar year basis in order to match them with the import data from the US Bureau of the Census.

[96] Burfisher, M. and J. Hopkins. "Farm Payments: Decoupled Payments Increase Households' Well-Being, Not Production." *Amber Waves*, Vol. 1, Issue 1, (February 2003): 38-45, at 44 (Exhibit US-78)

arrangements. Despite uncertainty over future policy, land values already reflect the market's expectations about future programme benefits.[97]

156. Land values set by sales and rental markets can be examined to see whether they track commodity price trends. If these values diverge from prices, it suggests that land markets have additionally capitalized the present and expected future value of government payments. As the figure from Burfisher and Hopkins (2003) below demonstrates, commodity prices have fallen since 1996 due to a number of factors while land values have trended upward, consistent with land capitalization of payments. Land rent data, although more fragmented, follow the same trend as land values.




157. In its 27 October answer to Question 179 and in paragraph 57 of its oral presentation of 2 December, Brazil attempts to minimize the effects of direct payments on land by citing a recent study that showed that 34-41 cents per dollar of PFC payment were capitalized into land rents in MY 1997. However, in citing this study, Brazil effectively concedes the US analysis. The study cited by Brazil analyzes cash rent data in only *the first year* following implementation of the 1996 Act and the decoupled production flexibility contract payments. As the authors of the study acknowledge, cash rents may be "sticky" and adjust over the long run.[98] For example, not all rental contracts would be year-to-year; as additional multi-year rental contracts expire, landowners would be expected to adjust rents to capture the value of the decoupled payments made with respect to the base acreage on the land.

158. In the long run, only those upland cotton producers who are owners of upland cotton base acres will receive the benefit of those decoupled payments. Based on 1997 cost of production data, about 35 per cent of cotton production is grown by owner-operators. Therefore, only 35 per cent of the value of decoupled payments would benefit upland cotton producers, and this subsidy benefit would then have to be attributed across the total value of the recipient's production in order to determine the benefit to upland cotton.

**243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? USA**

[97] Burfisher, M. and J. Hopkins. "Farm Payments: Decoupled Payments Increase Households' Well-Being, Not Production." *Amber Waves*, Vol. 1, Issue 1, (February 2003): 38-45, at 45 (Exhibit US-78)

[98] *See* Roberts *et al.*, at 769 (Exhibit Bra-310).

159. If the United States has understood the Panel's question, the answer would appear to be no. To explain this answer, we distinguish between three types of subsidies: (1) a subsidy tied to production of upland cotton, (2) a subsidy tied to production of another commodity, and (3) a subsidy not tied to the production of any commodity. In the first case, a subsidy tied to production of upland cotton (for example, marketing loan payments) would be support to upland cotton exclusively, even if the upland cotton producer also produces other commodities. In the language of Annex IV, a subsidy that "is tied to the production or sale of a given product" is deemed to subsidize "the recipient firm's sales of that product."[99] Similarly, in the second case, a subsidy tied to the production of another commodity (for example, marketing loan payments for soybeans) are deemed to benefit that commodity exclusively. Thus, such payments – which depend upon production of a commodity other than upland cotton – would not be deemed to benefit upland cotton.

160. In the third case, a subsidy not tied to the production or sale of a given product (for example, decoupled income payments) would be deemed to subsidize any product sold by the recipient. Annex IV establishes that the value of the subsidized product for such a payment is "the total value of the recipient firm's sales."[100] Logically, a subsidy not tied to a particular product provides a benefit to the recipient in the form of increased income. Since money is fungible, the benefit can be deemed to inure to all of the products the recipient produces; a neutral way of attributing the subsidy to particular products is according to their proportion of the firm's sales. Thus, for purposes of Subsidies Agreement analysis, such a non-tied payment would be deemed to benefit upland cotton and any other commodity the recipient produces.

161. It is worthwhile to compare these Subsidies Agreement concepts of payments tied to productions or sale and payments not tied to production or sale to Agriculture Agreement concepts of product-specific and non-product-specific. The two sets of concepts are not identical. Recall that Article 1(a) of the Agreement on Agriculture establishes that product-specific support is "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product" while non-product-specific support is a residual category of "support provided in favour of agricultural producers in general." Thus, product-specific support is "tied to the production or sale of a given product" within the meaning of the Subsidies Agreement (Annex IV, para. 3) because it must be "provided for *an* agricultural product" and must be "in favour of *the producers of the* basic agricultural product."

162. Non-product-specific support is not tied to the production or sale of a particular product since it is provided to producers in general – for example, decoupled payments for which the recipient need not produce any particular commodity or any commodity at all. However, as noted above, such a non-tied payment will be allocated over the total value of the recipient's production. Hence, it could be possible to derive the benefit to upland cotton for purposes of the Subsidies Agreement from non-product-specific support.

163. Brazil would take these different concepts and suggest that any support that is not tied to production must be allocated to a particular crop; such support would be "support to a specific commodity" within the meaning of the Peace Clause. However, Brazil's approach eliminates the concept of non-product-specific support for purposes of Peace Clause since a non-tied payment may always be allocated according to the recipient's production (and, in Brazil's approach, then be deemed "support to a specific commodity"). It would appear anomalous to import into Article 13 of the Agreement on Agriculture a concept from the Subsidies Agreement (that itself is only reflected in Annex IV, which Brazil does not believe is relevant to actionable subsidies claims) that renders inutile such a key concept from the Agreement on Agriculture. Such an interpretation, moreover, runs contrary to the ordinary meaning of the phrase "support to a specific commodity." As the EC pointed out, support cannot at the same time be "support to a specific commodity" and "support to multiple

[99] *See* Subsidies Agreement, Annex IV, para. 3.
[100] *See* Subsidies Agreement, Annex IV, para. 2.

commodities." And yet, allocating a non-tied payment across the total value of the recipient's production necessarily means that the payment is support *not* to a specific commodity but rather to multiple commodities (in fact, any commodities the recipient happens to produce).

164. Thus, it is important to distinguish Agreement on Agriculture concepts for purposes of Peace Clause from Subsidies Agreement concepts for purposes of identifying the amount of subsidy benefit and subsidized products. While decoupled payments – properly allocated – may provide support to upland cotton within the meaning of the Subsidies Agreement, they do not provide support to a specific commodity within the meaning of the Peace Clause. In fact, such decoupled payments provide support to any commodities the recipient happens to produce.[101]

**245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the SCM Agreement? BRA, USA**

165. A subsidy that is green box – that is, conforms fully to the provisions of Annex 2 to the Agreement on Agriculture – is "exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement" pursuant to Article 13(a)(ii) of the Agreement on Agriculture. Therefore, green box subsidies may not be taken into account when considering whether a Member has caused serious prejudice to the interests of another Member through the use of any other subsidy for purposes of Article 5 nor when considering the "effect of" any other subsidy for purposes of Article 6.

**246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the SCM Agreement? BRA, USA**

166. The United States has previously indicated that it takes no position on whether prohibited subsidies may be taken into account in considering "the effect of the subsidy" under Article 6 or whether the use of any subsidy has caused adverse effects. We note, however, that there may be limited utility in making a finding that a subsidy is prohibited and then finding that that subsidy contributes to "adverse effects" or "serious prejudice." Once the DSB adopts findings that a subsidy is prohibited, the responding Member is required to withdraw the subsidy without delay under Article 4. If the same measure were to form part of findings that a Member had caused adverse effects in the form of serious prejudice, for example, the responding Member would presumably be free to argue that the withdrawal of the prohibited subsidy was sufficient to remove the adverse effects. Thus, as the Panel is charged with making findings to promote a prompt settlement of disputes, the Panel should not include any subsidy it deems to be prohibited as part off its actionable subsidy analysis.

**247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? BRA, USA**

167. Under its terms of reference, the Panel is called upon "[t]o examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document."[102] Past panels have concluded that it is appropriate to look at the measures at issue in a dispute as of panel establishment. By that time, it was already

[101] As the United States has noted, finding that non-tied payments, once allocated, could be "support to a specific commodity" would rob Members of the ability to design their measures to be consistent with the Peace Clause. For example, if every recipient of decoupled income support, or any other non-tied payment, decided to produce upland cotton, a Member could be deemed to have granted support in excess of that decided during the 1992 marketing year, solely as a function of producer choices, not that of the Member.

[102] WT/DSB/M/145, para. 35.

evident that the challenged US measures would not pose a threat of serious prejudice. For example, the 2003 harvest season futures price at planting time – 59.60 cents per pound, or a 54.60 expected cash price – suggested that the marketing loan rate (52.00 cents per pound) would have no or minimal effect on planting decisions.[103] The evidence already indicated that US acreage movements corresponded to acreage changes in the (largely unsubsidized) rest of the world.[104] The evidence already indicated that direct and counter-cyclical payments have no more than minimal impacts on production and trade. Thus, by the time of panel establishment the evidence did not support a clearly demonstrated and imminent likelihood of future serious prejudice.

168. The Panel is not precluded from examining evidence subsequent to panel establishment. In fact, both Brazil and the United States have presented such evidence (of course, which cannot alter the Panel's terms of reference). For example, actual market prices and future prices for the 2003 marketing year confirm that producers are receiving higher prices for their 2003 crop and expect to continue doing so for the remainder of the marketing year. Thus, that evidence arising after panel establishment serves to confirm what prior evidence suggested: the evidence does not support a clearly demonstrated and imminent likelihood of future serious prejudice.

## F. STEP 2

**248. In respect of the level of Step 2 payments in certain time periods, the Panel notes, inter alia, footnote 129 in the US first written submission; footnote 33 in the US 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? BRA, USA**

169. Step 2 payments have been zero since the elimination of the 1.25 cents per pound threshold in the 2002 farm bill. This occurred in 5 consecutive weeks beginning 19 September 2002.

170. A Step 2 payment could be zero when the AWP exceeds 134 per cent of the base loan rate (52 cents) or the US/North Europe price is less than the Northern Europe price. If either occurs, the rate will be zero for at least 4 consecutive weeks.

171. Elimination of the 1.25 cent per pound threshold increases the range of price differences in which a step 2 payment could be triggered and raises the resulting payment by 1.25 cents. To some degree, as compared with prior years, the 1.25 cent threshold elimination may correct for some long term changes in the valuation of currencies. Further, at certain price levels where the market price used to determine countercyclical payments is above the loan rate but below 65.73 cents per pound, the additional impact that the Step 2 payment can have on the market price for US cotton can reduce the amount of countercyclical payments received by US producers.

**249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":**

**(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer? How, if at all, would this be relevant for an analysis of the issue of export contingency under the Agreement on Agriculture or the SCM Agreement? BRA**

[103] The futures price in the text is the average daily February closing price for the December contract. As noted in the US further rebuttal submission, para. 162 fn. 124., the January through March average daily closing price (59.10 cents per pound) is not markedly different.

[104] *See, e.g.*, US Opening Statement at the Second Panel Meeting, paras. 5-6.

**(b) How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do not go directly to the producer? USA**

172. By referring to "producers" in this context, the US has referred to producers acting in their capacity as producers of cotton, that is as persons with a risk of loss in cotton that they have planted and harvested. It could be that some large producers of cotton in that sense could also be persons who are manufacturers of cotton or exporters who marketed their cotton directly overseas. In that sense, they could receive payments just as any other manufacturer or exporter could do, but they would be receiving the payment not as a producer of raw cotton but in their other capacity.

173. In short, the regulations are drafted simply to reflect that there may be many ways in which the public may organize itself, but we are assured that the same bundle of cotton will only produce one payment and the breaking of the bundle would only come in connection with the manufacturing process. Officials know of no instance in which a payment was made other than for a legitimate export or for some sort of legitimate manufacturing effort. Again, these payments are received by such persons in their other capacities and not as producers of raw cotton. Such payments simply reflect the universal application of the programme to all cotton uses without a market-interfering government restriction on who may be a manufacturer or exporter of cotton.

**(c) What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. USA**

174. As of the present writing, the United States does not have any data or information on how many producer/manufacturers there are, or how many producer/exporters there are. We do not think that there are many but we continue to search for additional information that might be relevant in this regard.

## H. MISCELLANEOUS

**253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):**

**(a) Does it relate to export credit guarantees, crop insurance and cottonseed payments?**

175. The adjustment authority would not reach export credit guarantees, crop insurance premium payments, or the 2003 cottonseed payment. Section 1601(e) of the 2002 Act, codified at 7 USC 7991(e), states that if the Secretary determines that expenditures under subtitles A through E of Title I of the Farm Bill (which cover the "programme crops") subject to the total allowable domestic support levels under the Uruguay Round Agreements (as defined in section 2 of the Uruguay Round Agreements Act as in effect on the date of enactment of this Act) "will exceed such allowable levels for any applicable reporting period, the Secretary shall, to the maximum extent practicable, make adjustments in the amount of such expenditures during that period to ensure that such expenditures do not exceed such allowable levels." Further the statute provides as to procedure that before making any adjustment under that authority, "the Secretary shall submit to the Committee on Agriculture, Nutrition, and Forestry of the Senate and the Committee on Agriculture of the House of Representatives a report describing the determination made under that paragraph and the extent of the adjustment to be made."

176. It should be noted that interpretation of this language should take into account that, as we have noted throughout, the government cannot predict how much actual expenditures for programme crops will be since those expenditures are sensitive to factors outside the control of the government.

What is clear is that the Congress thought that the problems with total dollar commitments, the AMS, were the only problem likely to arise given that Congress did discipline itself to stay within the support levels of the Peace Clause. The continuation of decoupled payment programmes was anticipated to protect producer income without causing distortions that could increase the level of US world share or could result in price suppression or depression in particular markets. To the contrary, because the Congress anticipated that US prices would still be higher than those elsewhere, the 2002 Act reauthorizes Step 2 payments. There was no contemplation that the mere fact of support, because of the size of the United States, would ipso fact result in a WTO violation, as Brazil would have the Panel make it through its threat of serious prejudice and *per se* claims. This point is made clear in the conference report on the 2002 Act, in which the Congress says:

> *The Conference has made it a priority to craft a programme that provides assistance to producers in a way that is consistent with our obligations under the Uruguay Round Agreement on Agriculture.*[105]

177. That said, the circuit breaker provision by its terms applies only to the cited subtitles of the 2002 Farm Bill and as such does not address expenditures under the export credit guarantees programme, crop insurance, or cottonseed programme, provided for elsewhere. Rather, the circuit breaker provision addresses only expenditures under the programme crop programmes that are covered in the cited subtitles – namely, the direct and countercyclical payments, the marketing loan payment, and Step 2, for all of the programme addressed in Title I. Those programmes would include, in addition to other crops that are the more traditional "programme crops," payments related to sugar, wool, mohair, and peanuts, and various oilseeds.

**(b) Does it relate only to compliance with AMS commitments?**

178. By reference to 19 USC 3501, the reference in Section 1601 is to the entirety of the Uruguay Round Agreements, which is identified in 19 USC 3501 and described there. Consequently, the provision would arguably recognize any total limits provided for in that agreement; thus, section 1601(e) applies to the Aggregate Measurement of Support commitments under the Uruguay Round Agreement on Agriculture. To this point, there has been no specific test to determine the precise nature of its limits. Again, however, it must be presumed in light of the history outlined above that the Congress contemplated that if there was to be a problem it would be with the AMS limit. Thus, if there is an AMS problem, the Secretary could limit the expenditures for upland cotton; in that sense, those expenditures are not "without limit."

**(c) Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?**

179. The authority is not discretionary, but rather requires that the Secretary take action as the statute provides that "the Secretary *shall*, to the maximum extent practicable, make adjustments" (emphasis added). In adopting this language, the Senate and House conference members rejected "circuit breaker" provisions proposed in the original House version of the farm bill (HR 2646) and original Senate version (Senate amendment to HR2646) which would have made the adjustment discretionary.[106] However, it should be noted that the statute does contain a Congressional referral

[105] Report 107-424, page 469 (printed at 148 Cong. Rec.H1916, May 1, 2002).

[106] Under the original House version: "[T]he Secretary *may* make adjustments in the amount of such expenditures during that period to ensure that such expenditures don not exceed, but in no case are less than, such allowable levels" (emphasis added). Under the original Senate version: "Amends Section 161 of the FAIR Act *to allow* the Secretary to adjust the amount of domestic support to assure compliance with Uruguay Round obligations." *See* Farm Security and Rural Investment Act of 2002, Conference Report to Accompany HR 2646. House of Representatives, Report 107-424, 1 May 2002, page 468.

provision, which presumably would allow the Congress to intervene in the event that the Secretary felt it necessary to implement the authority contained in 1601.

**(d) How would the Secretary exercise her authority to prevent serious prejudice to the interests of another Member? How would she exercise her authority to prevent a threat of serious prejudice to the interests of another Member? At what time and on the basis of what type of information would she exercise her authority?**

180. To the extent mandated by the statute, the Secretary would, subject to the foregoing concerns about the breadth of the statute, adjust the programme provisions to provide for reduced expenditures. But, as indicated, the statute does not appear to contemplate any such finding of serious prejudice, but rather is seemingly focussed more particularly on the overall level of expenditures as that was the only restriction agreed to in this instance by the United States and the United States believes its programme designs to be in compliance with its WTO commitments. The United States continues to maintain its compliance with the AMS levels as agreed to and with all other aspect of its obligations under the agreement, as we have shown. As noted, Congress understood and believed that it was acting within traditional levels and with the allowed levels of the agreement.

**(e) What does "to the maximum extent practicable" mean? In what circumstances would it not be practicable for the Secretary to exercise her adjustment authority? USA**

181. We believe that this provision of the 2002 Act is directed, in the first instance at least, more at domestic complainants in the event that the correction by the Secretary, because of the difficulties of predicting how much an effect a change could have, could prove more than needed. If so, this could lead, to potential legal claims by US farmers that they had been unduly denied benefits that there were entitled to receive. However, this provision could also contemplate that in some cases the results of an adjustment might well be unknown or that certain programmes or procedures would be too far along in a crop year to allow corrections to be made in any real or fair way, leading to results that otherwise might be objectionable.

**254. Would payments made after the date of panel establishment be mandatory under the marketing loan, direct payments, counter-cyclical payments and user marketing certificate (step 2) programmes, but for the circuit-breaker provision? USA**

182. Not in the sense at least that there are many conditions that a person must meet in order to qualify for payments, and in the sense that the payments are of course dependent upon the availability of funds from the Commodity Credit Corporation (CCC). The CCC has a large, however limited, borrowing authority which must be replenished from time to time. Rarely has CCC run out of funds, but it has happened for brief periods of time -- and of course, Congress can change the programme at any time.

**256. The United States submits that the Panel cannot make rulings without allocating precise amounts of payments to upland cotton production. However, to the extent that such precise data is not on the Panel record, to what extent can the Panel rely on less precise data, and on reasonable assumptions, in fulfilling its duty under Article 11 of the DSU in this case? USA**

183. Under DSU Article 11, the Panel is called upon to make an objective assessment of the matter before it, which consists of the measures challenged by Brazil and the claims Brazil has advanced. This assessment must include an objective assessment of the facts of the case. It is well-established, however, that a Panel is not to make claims for a party, nor to develop evidence for a party. As the Appellate Body explained in *Japan – Varietal Testing*, it is for the complaining party to bring forward

sufficient evidence and arguments to carry its burden of establishing a *prima facie* case. Thus, although a panel may be able to draw reasonable inferences from evidence on the record as part of its objective assessment of the facts of the case, such inferences cannot take the place of evidence necessary for a complaining party to establish its *prima facie* case.

184. The difficulty in this dispute arises because Brazil has chosen to challenge decoupled income support measures – namely, direct payments and counter-cyclical payments – that are not tied to production or sale of upland cotton. For payments that *are* tied to production of upland cotton – for example, marketing loan payments – there is no difficulty because the subsidy is solely attributed to upland cotton.[107] As set out in previous US submissions and oral statements, however, decoupled payments must be allocated across the value of each recipient's production in order to determine what is the benefit to upland cotton within the meaning of Article 1 of the Subsidies Agreement. A failure to allocate the decoupled payment either would result in arbitrarily assigning subsidy benefits to one product over another or would result in double-counting of a subsidy as providing a greater benefit than the value of the payment.

185. Brazil has not identified evidence that would allow for the challenged decoupled payments to be allocated across their recipients' production (that is, attributed to upland cotton and any other commodities produced by those recipients). Thus, Brazil has not established facts necessary for the Panel to identify the amount of the challenged subsidy nor evaluate its effects. Even if there were evidence on the record from which "reasonable assumptions" (in the words of the question) could be drawn, the Panel could not make those assumptions because Brazil has not claimed that allocating the value of these decoupled payments across the total value of each recipient's production is necessary. That is, while Brazil has improperly sought to expand the scope of this dispute by allocating decoupled payments received for non-upland cotton base acres to upland cotton producers, Brazil has *not* claimed that all such payments must be allocated across the value of the recipient's production. To the contrary, Brazil has argued that such payments would *exclusively* be support to upland cotton.[108]

186. As a result, this dispute presents a situation analogous to that in the *Japan – Varietals* dispute. Were the Panel to agree that to determine the subsidy benefit to upland cotton decoupled payments not tied to upland cotton production must be allocated across the total value of the recipient's production, the Panel could not then seek evidence or make "reasonable assumptions" relating to such an allocation because to do so would be to make a claim that Brazil has not advanced. Brazil has chosen *solely* to argue that decoupled payments for base acreage up to the amount of upland cotton planted on the farm are support to upland cotton, ignoring the production of any other crops on the

[107] In the language of Annex IV, "the value of the [subsidized] product shall be calculated as the total value of the recipient firm's sales *of that product*." Subsidies Agreement, Annex IV, para. 3 (italics added).

[108] See Brazil's Further Rebuttal Submission, para. 24 ("This EWG data also provides the amount of upland cotton contract payments attributable to upland cotton producers, broken down by PFC, market loss assistance, direct and counter-cyclical payments. These figures are also set out in the table above. However, because some upland cotton was produced on non-upland cotton contract base, it would be necessary to calculate an amount of non-upland cotton contract payments, based on the EWG data, that also constitutes support to upland cotton received by producers of upland cotton.").

farm. (For example, with respect to plantings and not production, the data provided to the Panel and Brazil on December 18 and 19, 2003, demonstrate that, in the aggregate for farms planting upland cotton in marketing year 2002, upland cotton planted acres represented only 48 per cent of total cropland on those farms. One could surmise that Brazil refuses to recognize that decoupled payments must be allocated because to do so would invalidate both Brazil's Peace Clause analysis, which merely took the value of decoupled payments for upland cotton base acres and factored such payments by approximately 14/16, and Brazil's serious prejudice analysis by eliminating a substantial portion of the "$12.9 billion" in payments alleged to have been made to upland cotton. Nonetheless, Brazil has chosen what arguments and evidence to advance to support its claims – as is its prerogative. The Panel must judge whether those arguments and evidence amount to a *prima facie* case. Where Brazil has refused to adopt the proper approach to allocation of decoupled payments and has identified no evidence to allow a proper allocation, the Panel may not step into the breach and make any "reasonable assumptions" to support Brazil' s claims.

# ANNEX I-9

## COMMENTS OF THE UNITED STATES CONCERNING BRAZIL'S ECONOMETRIC MODEL

22 December 2003

## I. THE SUMNER MODEL PRESENTED BY BRAZIL DOES NOT PROVIDE ACCEPTABLE ECONOMIC SUPPORT FOR BRAZIL'S CLAIM OF SERIOUS PREJUDICE

### A. INTRODUCTION

1. Our review of Brazil's economic model analysis as submitted by Brazil and independently by Dr. Bruce Babcock of Iowa State University shows a clear and consistent manipulation of well-known econometric tools and mischaracterization of the US cotton programme in order to exaggerate acreage and ultimate price impacts. In particular:

- The Sumner approach forces changes onto the FAPRI system, and misleadingly claims the result as a FAPRI-type analysis;
- Using flawed and often unsubstantiated economic assumptions, Brazil transformed the FAPRI model for its own purposes;
- Every economic result ascribed to a FAPRI-type analysis by Brazil contains the same flawed assumptions originally introduced by Dr. Sumner;
- Brazil did not use the correct models or assumptions according to FAPRI/CARD analysts and appears to have even changed the underlying FAPRI baseline in order to exaggerate acreage and price impacts of programme removal.

2. This critique is directed primarily at Dr. Sumner's model, the results of which were first presented to the Panel in Annex I.[1] Brazil continues to cite Annex I as a part of its fundamental economic findings. The United States notes that Brazil has introduced different analytical tools since the United States and the Panel requested to see the model used to produce the Annex I results.[2] In no instance has Brazil appeared to retreat from its impacts cited in Annex I.

3. Dr. Sumner's supply-side adaptations or modifications to the FAPRI model with respect to various components of the US cotton programme, such as direct payments or export credit guarantees, continue to be the key reason his model displayed the results presented in Annex I and are carried

[1] In evaluating Dr. Sumner's impacts (and this critique of them), the Panel should take into consideration that Annex I results have not been, and apparently cannot be, confirmed. The models used and outputs obtained were, by their own admission, not retained by Dr. Sumner nor Dr. Babcock. *See*, Letter dated 31 October 2003 from Dr. Bruce Babcock to Dr. Dan Sumner, submitted to Panel by Brazil on 5 November 2003. The record remains incomplete with respect to Dr. Sumner's adaptations. The United States has attempted in this critique to note where it has been forced to make assumptions due to missing data.

[2] The United States has based its critique on three Excel spreadsheets that have been provided by Brazil and/or Dr. Bruce Babcock. These include the CARD international cotton model, delivered by Brazil on 13 November, the cotton-only US model provided by Brazil on 18 November; and the US crops model provided by Dr. Babcock on November 26. A graphical representation of the scope and disclosure of Brazil's modelling system is provided in Exhibit US-113.

forward into all subsequent econometric demonstrations using subsequent FAPRI baselines. In many respects, Brazil's Annex I (and subsequent) results are caused directly by introduced changes to the FAPRI model.

4. Brazil offers Dr. Sumner's model results as evidence that but for the US cotton programme, US cotton acreage would have declined and world prices would have increased. While the US has in its submissions and oral statements demonstrated the fatal flaws in Brazil's arguments on subsidy identification, causation, and its actionable subsidies claims, it is clear to the United States that but for the significant manipulation and adaptation of the FAPRI model carried out by Brazil and Dr. Sumner, acreage impacts attributed to the US cotton programme by that economic model would be far less than reported in Annex I. As a result, Dr. Sumner's economic analysis cannot serve as a basis for any findings on the effect of challenged US subsidies.

## II. BRAZIL MODEL IS NOT FAPRI/CARD ANALYSIS

5. The adaptations and modifications made to the FAPRI model by Brazil have so changed the model that Brazil cannot rely on FAPRI's reputation to confirm the results.

- Dr. Babcock, Dr. Sumner's "collaborator" on the project, states that a FAPRI analysis would have used different models and applied different assumptions;

- Thus, Dr. Babcock has stated that the Sumner analysis is "in no way" an official FAPRI analysis.

6. In a recent letter, Dr. Babcock, an economist at the CARD located at Iowa State University and the "technician" that carried out much of Dr. Sumner's economic analysis[3], cleared up some of the confusion regarding the models used in Brazil's analysis. In Dr. Babcock's opinion, a true FAPRI analysis would have used different models and applied different assumptions to those models to arrive at the type of estimate presented by Brazil in its Annex I. In his letter Dr. Babcock states that the analysis carried out by Dr. Sumner and used by Brazil was

> "in no way an official FAPRI analysis and if FAPRI had done the analysis, FAPRI would have come up with different estimates of the effects of US cotton subsidies on world prices."[4]

7. Dr. Babcock also stresses the differences between FAPRI and Dr. Sumner's assumptions used to estimate the effects of various components of US cotton policy. Many of these different assumptions are described in Bra-313 and will be discussed in detail.

8. Dr. Babcock indicates a FAPRI analysis would have used different models. He states that FAPRI would have used different models entirely.

> "The domestic model used was not based on the models used for the FAPRI 2003 baseline. … the model that FAPRI uses to conduct domestic and international US policy analysis is the US stochastic model and the FAPRI international models. The

[3] Opening Statement of Dr. Sumner, 2 Dec. 2003, "I have specified equations and parameters which adapt the systems to apply to the specific questions of interest in this dispute and I have worked closely with skilled and experienced technicians who have operated the details of the system. This is the same procedure that economists routinely use in performing simulation modelling in academic research and that they use in performing complex econometric statistical analysis. I rely on the technician to operate the "machinery" of the models just as a medical doctor would rely on an X-ray or Magnetic Resonance Imaging technician to operate those systems and generate results for analysis and interpretation."

[4] Letter from Dr. Bruce Babcock, Exhibit US-114.

> international cotton model used in Dan's analysis was a stand-alone cotton model developed to better understand the role that China plays in international cotton markets."
>
> "... FAPRI would have used different models ..."[5]

9. Dr. Babcock's letter confirms that the concerns of the United States have been well-founded. While cloaking itself in the FAPRI model's reputation, Brazil and Dr. Sumner's analysis is, in fact, something quite different. The differences between FAPRI and the Brazil analysis reflected in Annex I involve much more than small, "conservative" changes. As the United States will demonstrate, Brazil's Annex I analysis relies too heavily on adaptations, modifications and adjustments to suggest acceptance based upon FAPRI's reputation. Brazil's estimates, to a very great extent, distort the FAPRI system for the express purpose of achieving pre-conceived results.

10. The United States, after completing as complete a critique of Annex I results as possible in this proceeding, respectfully submits that the results indicated in Annex I are significantly exaggerated, due either to economic errors or to Dr. Sumner's introduced biases (most of which are discussed in Bra-313 and in Annex I, and many of which contain errors). Brazil's results set out in Annex I and subsequent submissions have no explanatory power.

11. The United States submits that the results in Annex I provide very little guidance to the Panel in terms of overall impacts of the US cotton programme. The United States has stated that the FAPRI model as used by Dr. Sumner was an inappropriate tool for the intended job. This opinion has now been confirmed by Dr. Sumner's chief "technician" on this project[6], who has directly stated that FAPRI would not have used the models used by Dr. Sumner and would not have made the adaptations to that model that he discusses in Annex I and in Bra 313 if it had been requested as an organization to conduct this analysis.

## A. BRAZIL MODEL NOT COMPARABLE TO FAPRI SYSTEM

12. The differences between Dr. Sumner's analysis and the FAPRI framework are significant. Those differences arise primarily as a result of Brazil's disagreement with FAPRI and many other agricultural economists over the impact of payment programmes that are not directly linked to production decisions. There are other important differences. Most notably, FAPRI does not include crop insurance as a production-distorting programme. The FAPRI model also does not contain components designed to estimate production effects from the export credit guarantee programme, a seemingly appropriate choice since Brazil itself has stated that it cannot quantify the alleged benefit to upland cotton provided by the export credit guarantee programmes.[7]

13. Whenever the FAPRI modeling system did not tend to show acreage impacts high enough to satisfy Brazil in this case, Dr. Sumner simply made modifications to encourage it to do so. The United States disagrees with these modifications, but still cannot confirm all of these changes or the specific components of each of them. Second, whenever the FAPRI modeling system did not include a programme component challenged by Brazil, Dr. Sumner simply forced acreage impacts of that programme onto the system - showing little or no economic foundation for the introduced variables.[8]

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[5] *Id*.

[6] "…FAPRI would have used different models". Letter from Dr. Babcock, Exhibit US-114.

[7] Paragraph 82 of Answers of Brazil to Questions from the Panel, 27 October 2003.

[8] For example, Brazil cites export impacts ascribed to the export credit guarantee programme by the National Cotton Council of America and uses those impacts without further foundation. The National Cotton Council of America's economic analysis in this instance has no foundation and no demonstrated methodology.

14. All of these effects, displayed in Annex I, were introduced into the FAPRI system by Dr. Sumner. Dr. Sumner discusses some of his modifications in Bra-313, but not all of them. Dr. Sumner has never provided the United States with an electronic, verifiable version of his modifications. Efforts by the United States to replicate the Sumner formula using a FAPRI model have been unsuccessful, leading to the conclusion that other modifications, adaptations or calibrations are involved.

## B. ADAPTATIONS TO AND MODIFICATIONS OF FAPRI MODEL RESULTED IN EXAGGERATED RESULTS

15. Dr. Sumner's treatment of decoupled payments, crop insurance, and export credits are significant deviations from the FAPRI modelling framework. These changes are forced onto the FAPRI system resulting acreage effects that are much greater than would ever be anticipated by a true FAPRI analysis. Again, as Dr. Babcock has now candidly stated:

> "In addition, the modeling assumptions that Dan used to estimate the effects of the various US domestic programme components of US policy are different than FAPRI would use if asked to answer the same questions."[9]

### 1. Dr. Sumner exaggerates the impact of decoupled payments as compared to FAPRI's modelling of those payments

16. FAPRI analysis of the impacts of decoupled programmes (like Production Flexibility Contract payments (PFC), Direct Payments (DP), Market Loss Assistance payments (MLA) and Counter-cyclical Payments (CCP) was discarded by Dr. Sumner and replaced with an approach not supported by FAPRI, nor supported by the bulk of economic literature on the subject.

17. Dr. Sumner's decoupled effects are different than those normally used by FAPRI and were supposedly justified by Dr. Sumner's own estimation of producers' "anticipation" of future programme changes and on his, now proven incorrect, contrived assumptions about actual planting patterns in the United States.[10]

18. The FAPRI baseline reflects their "most-likely" outcome for acreage, production, consumption and prices under a defined set of assumptions. Acreage projections for each of the crops reflect assumptions and outcomes for market indicators and government policy. According to the US crops model (Excel file US CROPS MODEL 2002.xls) sent by Dr. Babcock on 26 November, upland cotton acreage in each region is determined by the following equation:

$$CTPLT_i = a_o + a_o * CTENR_i/PD + A*(\text{Vector of Competing Crop Returns}_i)/PD + \text{Decoupled Payment Impacts}_i + \text{CRP}[11]\ \text{Impacts}_i + \epsilon_i$$

where

CTPLT = upland cotton planted acreage in region i
CTENR = expected cotton net returns from the market and the marketing loan in region i
PD = general price deflator
A = vector of parameter estimates for competing crops.

[9] For example, Brazil cites export impacts ascribed to the export credit guarantee programme by the National Cotton Council of America and uses those impacts without further foundation. The National Cotton Council of America's economic analysis in this instance has no foundation and no demonstrated methodology.

[10] Paragraphs 39-44 of US Opening Statement at the Second Session of the First Panel Meeting, 7 October 2003.

[11] CRP = Conservation Reserve Programme.

19. Although the US does not agree that decoupled payments impact planting decisions, it is useful to compare FAPRI's view of the impacts with that of Dr. Sumner.

20. Looking further into the FAPRI model, one finds that the decoupled payments are not included on a crop-specific basis as done by Dr. Sumner in his adaptations. Instead, FAPRI allocates total decoupled payments across all crops in a region. First, the total money is put on a per-acre basis by dividing the payments by acres planted to the major crops. Second, FAPRI then determines a total acreage impact for the region based on the responsiveness of the total land to the infusion of money. Third, the total acreage impact is allocated to the individual crops in each region based on the crop's share of recent plantings.

- Dr. Sumner discarded this FAPRI approach to decoupled payments and inserted his own "coupling" factor.

- Cotton acreage impacts for US decoupled programmes as would likely be presented by FAPRI are about 0.3%, consistent with the estimates in the economic literature previously presented by the United States (e.g., Westcott et al.).[12]

- Dr. Sumner's cotton acreage impacts, by contrast, are as high as 15.9% - that is, more than 50 times larger than what the FAPRI model would indicate.

21. The following table provides a comparison of acreage impacts included in the FAPRI model to those calculated by Dr. Sumner. In the FAPRI model, the acreage contribution of all decoupled payments across all major programme crops ranges between 1.4 and 2.6 million acres. Decoupled payments to all crops contribute between 69 and 123 thousand acres to upland cotton. If we isolate the impact of decoupled payments for upland cotton base acres, the FAPRI model indicates that the shift in total cotton plantings ranges between 23 and 45 thousand acres, or less than three-tenths of one percent of upland cotton area. Impacts of this magnitude would not have appreciable impact on production and prices.

22. In stark contrast to the FAPRI model are the contrived impacts calculated by Dr. Sumner. In order to present a complete picture to the Panel, the United States presents Dr. Sumner's impacts in two ways. In Dr. Sumner's analysis of decoupled payments, equations (5) and (6) of Exhibit Bra-313 document his formulas for determining "the amount of cotton acreage that was held in cotton by these programme payments". This acreage is subtracted from the error term of the equation or the impact can also be thought of as a shift in the supply curve. This impact will be termed the "gross impact" on cotton acreage of the programme in question. Values for these "gross impacts" have been taken from the file FINAL US2003CropsModel WORKOUT.xls (received by the United States on 18 November). Dr. Sumner's "gross impacts" of cotton decoupled payments on cotton plantings range from a low of 352 thousand acres to a high of 2.2 million acres. In contrast, the FAPRI model shows a gross impact of 23 to 45 thousand acres. Dr. Sumner's impacts are almost 50 times larger than those included in the FAPRI model.

23. To avoid any confusion by the Panel, the gross impacts of the programmes are not the same values as the impacts shown in Annex I and Exhibit Bra-325. The results of Dr. Sumner's scenarios reflect his estimate of the net impact of removing various aspects of the cotton programme. Net impacts will reflect the fact that producers have responded to the higher cotton prices under the scenario and increased plantings to partially offset the initial loss in acreage.

24. The following table also provides a comparison of Dr. Sumner's net acreage impacts of removing decoupled payments. These impacts correspond to the results presented in Annex I. It is

[12] Westcott, P., Young, C. E., and Price, M., USDA, ERS, The 2002 Farm Act, Provisions and Implications for Commodity markets, Economic Research Service, November 2002. (See Exhibit Bra-42)

worthwhile to note that Dr. Sumner's net impacts are still 25 times larger than the gross impacts derived from the FAPRI model. Simply put, FAPRI's model would not show the kind of acreage impacts assumed by Dr. Sumner.

**Acreage Impacts of Decoupled Payments (Million Acres)**

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 99-02 Avg | 03-07 Avg |
|---|---|---|---|---|---|---|---|---|---|---|---|
| FAPRI Model Gross Total Area Impact of all Decoupled Pymts Across All Crops (1) | 1.379 | 1.838 | 1.912 | 2.091 | 1.534 | 2.180 | 2.566 | 2.379 | 2.101 | 1.805 | 2.152 |
| % of Plantings of All Crops | 0.5% | 0.7% | 0.8% | 0.8% | 0.6% | 0.9% | 1.0% | 0.9% | 0.8% | 0.8% | 0.8% |
| FAPRI Model Gross Impact of All Decoupled Pymts on Cotton Acreage (2) | 0.069 | 0.090 | 0.092 | 0.101 | 0.075 | 0.105 | 0.123 | 0.115 | 0.101 | 0.088 | 0.104 |
| % of Upland Cotton Area | 0.5% | 0.6% | 0.6% | 0.7% | 0.5% | 0.7% | 0.8% | 0.8% | 0.7% | 0.6% | 0.7% |
| FAPRI Model Gross Impact of Cotton Decoupled Pymts on Cotton Acreage (3) | 0.023 | 0.030 | 0.031 | 0.029 | 0.037 | 0.042 | 0.045 | 0.043 | 0.040 | 0.028 | 0.041 |
| % of Upland Cotton Area | 0.2% | 0.2% | 0.2% | 0.2% | 0.3% | 0.3% | 0.3% | 0.3% | 0.3% | 0.2% | 0.3% |
| Sumner's Gross Impact of Cotton Decoupled Pymts on Cotton Acreage (4) | 0.352 | 0.437 | 0.670 | 0.538 | 2.185 | 2.114 | 2.200 | 2.038 | 2.029 | 0.500 | 2.113 |
| % of Upland Cotton Area | 2.4% | 2.8% | 4.3% | 3.8% | 15.9% | 14.2% | 14.9% | 13.9% | 14.2% | 3.4% | 14.6% |
| Sumner's Net Impact of Cotton Decoupled Payments on Cotton Acreage (5) | 0.350 | 0.320 | 0.510 | 0.300 | 1.710 | 1.190 | 0.790 | 0.860 | 0.850 | 0.370 | 1.080 |
| % of Upland Cotton Area | 2.4% | 2.1% | 3.3% | 2.1% | 12.4% | 8.0% | 5.3% | 5.9% | 6.0% | 2.5% | 7.5% |
| FAPRI Model Gross Impact of Cotton AMTA/DP Pymts on Cotton Acreage (6) | 0.018 | 0.017 | 0.013 | 0.014 | 0.014 | 0.014 | 0.014 | 0.013 | 0.013 | 0.016 | 0.014 |
| % of Upland Cotton Area | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% |
| Sumner's Gross Impact of Cotton AMTA/DP Payments on Cotton Acreage (7) | 0.191 | 0.164 | 0.240 | 0.202 | 0.575 | 0.567 | 0.593 | 0.544 | 0.544 | 0.199 | 0.565 |
| % of Upland Cotton Area | 1.3% | 1.1% | 1.5% | 1.4% | 4.2% | 3.8% | 4.0% | 3.7% | 3.8% | 1.3% | 3.9% |
| Sumner's Net Impact of Cotton AMTA/DP Payments on Cotton Acreage (8) | 0.190 | 0.100 | 0.170 | 0.120 | 0.420 | 0.310 | 0.200 | 0.220 | 0.220 | 0.145 | 0.274 |
| % of Upland Cotton Area | 1.3% | 0.7% | 1.1% | 0.9% | 3.0% | 2.1% | 1.4% | 1.5% | 1.5% | 1.0% | 1.9% |
| FAPRI Model Gross Impact of Cotton MLA/CCP Pymts on Cotton Acreage (9) | 0.005 | 0.014 | 0.017 | 0.015 | 0.023 | 0.028 | 0.031 | 0.029 | 0.027 | 0.013 | 0.028 |
| % of Upland Cotton Area | 0.0% | 0.1% | 0.1% | 0.1% | 0.2% | 0.2% | 0.2% | 0.2% | 0.2% | 0.1% | 0.2% |
| Sumner's Gross Impact of Cotton MLA/CCP Payments on Cotton Acreage (10) | 0.161 | 0.273 | 0.431 | 0.336 | 1.610 | 1.546 | 1.607 | 1.494 | 1.484 | 0.300 | 1.548 |
| % of Upland Cotton Area | 1.1% | 1.8% | 2.8% | 2.4% | 11.7% | 10.4% | 10.9% | 10.2% | 10.4% | 2.0% | 10.7% |
| Sumner's Net Impact of Cotton MLA/CCP Payments on Cotton Acreage (11) | 0.160 | 0.220 | 0.340 | 0.180 | 1.290 | 0.880 | 0.590 | 0.640 | 0.630 | 0.225 | 0.806 |
| % of Upland Cotton Area | 1.1% | 1.4% | 2.2% | 1.3% | 9.4% | 5.9% | 4.0% | 4.4% | 4.4% | 1.5% | 5.6% |

(1) Source: File US CROPS MODEL 2002.xls, Model sheet, Row 4484.
(2) Source: File US CROPS MODEL 2002.xls, Model sheet, Row 4475.
(3) Source: Calculated in file *US CROPS MODEL 2002 NO Decoupled.xls* by setting cotton decoupled payments to zero.
(4) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, sum of Rows 728 and 740.
(5) Source: Sum of Sumner's Net Impacts of AMTA/DP Payments and MLA/CCP Payments.
(6) Source: Calculated by subtracting acreage impacts of NO MLA/CCP from acreage impacts of NO Decoupled payments.
(7) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, Row 728.
(8) Source: Table I.5b of Annex I.
(9) Source: Calculated in file *US CROPS MODEL 2002 NO MLA CCP.xls* by setting cotton MLA/CCP payments to zero.
(10) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, sum of Row 740.
(11) Source: Table I.5c of Annex I.

## 2. Dr. Sumner Assigns Production Effects to Crop Insurance that FAPRI Does Not

25. Dr. Sumner's arbitrary introduction of crop insurance into his acreage system is a direct departure from the FAPRI model. Dr. Sumner provides no statistical basis to support his incorporation of crop insurance. He simply derives a per-acre value, forces those impacts into the acreage system, and treats the results as valid analysis. There is absolutely no empirical validation associated with his results.

26. FAPRI does not explicitly attribute any acreage response to the availability of crop insurance. Dr. Sumner's gross impacts range as high as 1.05 million acres, and net impacts reach 590 thousand acres.

27. The exclusion of crop insurance from the FAPRI model is warranted. As the United States has previously suggested[13], if one were to consider the coverage levels obtained by cotton farmers, over 90 per cent of insured cotton area would be subject to coverage levels agreed by Members to have no or minimal trade-distorting effects.

28. The United States has also demonstrated that the economic literature examining acreage effects of crop insurance is clearly mixed, but have never gone so far as to attribute production impacts as great as those asserted by Brazil.[14] The literature in general reflects that by its very nature the impact of crop insurance on production may be significantly different than its impact on acreage.

29. It seems intuitive to the United States that a dollar provided in the way of an insurance premium subsidy (provided to reduce the cost of an insurance product that pays when the crop is not produced) would have different impacts on producer decisions than a dollar provided to the producer when the value of a harvested crop falls short of some defined level (such as a marketing loan payment). Dr. Sumner's analysis treats them the same. FAPRI does not.

30. Thus, it is significant that the FAPRI model does not attribute acreage response to the availability of crop insurance. Dr. Sumner deviates from that model without any empirical foundation in the economic literature.

**Acreage Impacts of Crop Insurance (Million Acres)**

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 99-02 Avg | 03-07 Avg |
|---|---|---|---|---|---|---|---|---|---|---|---|
| FAPRI Model Impact of Cotton Crop Insurance Program on Cotton Acreage (1) | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| % of Upland Cotton Area | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Sumner's Gross Impact of Cotton Crop Insurance Program on Cotton Acreage (2) | 0.584 | 0.541 | 0.798 | 0.808 | 1.040 | 1.018 | 1.056 | 0.979 | 0.974 | 0.683 | 1.013 |
| % of Upland Cotton Area | 4.0% | 3.5% | 5.1% | 5.7% | 7.5% | 6.8% | 7.1% | 6.7% | 6.8% | 4.6% | 7.0% |
| Sumner's Net Impact of Cotton Crop Insurance Program on Cotton Acreage (3) | 0.580 | 0.360 | 0.600 | 0.540 | 0.590 | 0.550 | 0.420 | 0.440 | 0.430 | 0.520 | 0.486 |
| % of Upland Cotton Area | 4.0% | 2.3% | 3.9% | 3.8% | 4.3% | 3.7% | 2.8% | 3.0% | 3.0% | 3.5% | 3.4% |

(1) Source: No impact included in file US CROPS MODEL 2002.xls.
(2) Source: File FINAL US2003CropsModel WORKOUT.xls, Equations sheet, Row 752.
(3) Source: Table I.5d of Annex I.

[13] US Opening Statement at the Second Session of the First Panel Meeting, 7 Oct. 2003, paras. 45-47.
[14] See Exhibits US-57 through US-60.

### 3. Dr. Sumner Assigns a Production Effect to Export Credits that FAPRI Does Not

31. In a further departure from the modelling approach used by FAPRI, Dr. Sumner introduces a 500 thousand-bale impact for export credit programmes. US exports are reduced by introducing this shift in the US export equation.[15] The resulting effect is to lower the US price while increasing the world price. However, as with Dr. Sumner's other modifications, there is no statistical basis for these changes.

32. Brazil provides no statistical or other economic foundation for this level of impact from the export credit guarantee programme. Dr. Sumner's stated source for the 500,000 bale impact is testimony delivered by the National Cotton Council of America in 2001, a US trade association that operates on behalf of the US cotton industry.[16] Brazil presents no evidence of how that estimate was calculated and presents no analysis of its own.[17]

33. With respect to any actual effects on world prices caused by the application of the US export credit guarantee programme to US cotton exports, Brazil has cited no subsidy component estimates and demonstrated no economic analysis.

34. Dr. Sumner's model passes off his 500,000-bale export shift as economic analysis and forces it upon the FAPRI model. Does the Sumner model show acreage impacts from the removal of the export credit guarantee programme? Of course it does since Dr. Sumner forced it to show those impacts. Brazil, cannot, however, base its estimates on FAPRI or on any demonstrated analytical approach.

[15] Exhibit Bra-313, page 5, "For the export credit, as explained in the Annex I, I base the estimated shift in export demand conservatively on the information provided by the US Cotton Council. The FAPRI baseline, which assumes continuation of the export credit programme, implicitly includes 500,000 bales of cotton attributable to the export credit programme. So eliminating the programme is implemented by simply subtracting 500,000 bales from the intercept of equation 7 in each year."

[16] See Exhibit Bra-41. The National Cotton Council is a trade association that lobbies the US government on behalf of the US cotton industry.

[17] In the 9 September Brazil Submission before the Second Session of the First Panel Meeting, paras 192-194, Brazil carried out another economic sleight of hand by implying that Dr. Sumner's export estimates with respect to the export credit guarantee program were more conservative than the unsubstantiated estimate it cites from the National Cotton Council. Paragraph 194 of that submission acts as if the NCC estimate of a possible 3 cent per pound US price impact and Dr. Sumner's estimate of a .57 cent per pound world price impact are somehow independent analyses - and demonstrate Dr. Sumner's conservative approach. However, as demonstrated in Bra-313, all Dr. Sumner did was force a reduction in US export estimates of 500,000 bales (using the NCC testimony as his sole economic foundation), which correspondingly reduced prices in the US, which correspondingly both reduced US acreage and slightly increased exports - cutting into the initially imposed 500,000 bale shift. Further, the "different" price estimates were, in fact, estimates of two different set of prices - US and world. Brazil inappropriately characterized Dr. Sumner's results as being conservative relative to the NCC estimate. (Paragraph 192, Brazil's Further Submission to the Panel, 9 September 2003) Later when the Panel raised a question about the results, Dr. Sumner somehow forced a full 500,000 bale decline in US exports, ignoring the impacts of price response. (See, for example, Bra-325, last category of tables - export credit guarantee with fixed 500,000 bale impact) In that response, Brazil also maintained the stance that these two "analyses," neither demonstrating economic foundation, were somehow independent, while fairly clearly demonstrating that Dr. Sumner merely took the NCC testimony and imposed a 500,000 bale demand shift.

**Export Shifts due to Export Credits (Million Bales)**

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 99-02 Avg | 03-07 Avg |
|---|---|---|---|---|---|---|---|---|---|---|---|
| FAPRI Model Impact of Export Credits on Cotton Exports (1) | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| Sumner's Gross Impact of Export Credits on Cotton Exports (2) | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 | 0.500 |
| Sumner's Net Impact of Export Credits on Cotton Exports (3) | 0.300 | 0.290 | 0.330 | 0.300 | 0.300 | 0.300 | 0.300 | 0.310 | 0.310 | 0.305 | 0.304 |

(1) Source: No impact included in file US CROPS MODEL 2002.xls.
(2) Source: Paragraph 59 of Annex I.
(3) Source: Table I.5g of Annex I.

## III. ANNEX I RESULTS USED VARIABLES LOWER THAN CITED NOVEMBER 2002 FAPRI BASELINE

35. The United States has previously indicated to the Panel its concern that acreage impacts in Annex I were based off of the FAPRI preliminary November '02 baseline instead of the more recent and readily available final January 2003 FAPRI baseline. The United States believes this choice of baseline biased the results shown in Annex I.[18] A closer review of the Annex I results, however, show they were not exactly based off the November 2002 baseline either.

### A. USE OF VARIABLES LOWER THAN NOVEMBER 2002 BASELINE INCREASED ACREAGE IMPACTS

- By using prices and other variables that were even lower than the FAPRI November '02 baseline, Brazil managed to further increase acreage impacts it attributed to the US cotton programme.

36. Contrary to the assertions contained in Annex I, it appears that the baseline that is presented there is not the FAPRI November 2002 baseline. The following table provides a comparison of the "A" Index from the baseline presented in Annex I with the FAPRI November 2002 baseline as provided by Dr. Babcock on 26 November.

[18] US Opening Statement at the Second Session of the First Panel Meeting, 7 Oct. 2003, para. 36.

**Comparison of Annex I Baseline with FAPRI November '02 Baseline**

| | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| "A" Index (Cents/Lb) | | | | | |
| Annex I | 50.69 | 53.44 | 55.75 | 57.56 | 59.60 |
| FAPRI Nov '02 Baseline | 52.35 | 54.74 | 56.77 | 58.69 | 60.52 |
| Change from FAPRI | -1.66 | -1.30 | -1.02 | -1.13 | -0.92 |
| Upland Cotton Farm Price (Cents/Lb) | | | | | |
| Annex I | 44.96 | 47.74 | 50.30 | 51.20 | 53.89 |
| FAPRI Nov '02 Baseline | 45.66 | 48.83 | 51.18 | 52.04 | 54.67 |
| Change from FAPRI | -0.70 | -1.09 | -0.88 | -0.84 | -0.78 |
| Upland Cotton Planted Area (Million Acres) | | | | | |
| Annex I | 13.780 | 14.880 | 14.770 | 14.650 | 14.270 |
| FAPRI Nov '02 Baseline | 13.782 | 14.720 | 14.772 | 14.658 | 14.252 |
| Change from FAPRI | -0.002 | 0.160 | -0.002 | -0.008 | 0.018 |
| Upland Cotton Production (Million Bales) | | | | | |
| Annex I | 16.050 | 17.420 | 17.400 | 17.370 | 17.010 |
| FAPRI Nov '02 Baseline | 16.052 | 17.215 | 17.397 | 17.377 | 16.982 |
| Change from FAPRI | -0.002 | 0.205 | 0.003 | -0.007 | 0.028 |

Source: FAPRI Nov '02 Baseline numbers from file *US CROPS MODEL 2002.xls*

37. The baseline used by the Annex I model appears to contain slightly lower cotton planted acreage, different upland cotton production, lower upland cotton farm prices and lower "A" index cotton prices than were shown in the FAPRI preliminary November 2002 baseline.[19]

### B. BASELINE USED IN ANNEX I EXAGGERATED PROGRAMME EFFECTS BEYOND THAT PREVIOUSLY ASSUMED BY UNITED STATES

38. The baseline used in Annex I exaggerated programme effects even more than previously assumed by the United States. The baseline used in Annex I contained lower cotton prices than those included in the FAPRI November 2002 baseline. It also contains several other variables that are different from the November 2002 baseline. There is no basis for this discrepancy, if Dr. Sumner actually used the November 2002 FAPRI baseline and, as stated in Bra-313, "none of the other equations in the FAPRI specification are modified to explicitly analyze the removal of US cotton programmes".[20]

## IV. BRAZIL'S MODEL HAS NO EXPLANATORY POWER

39. It would be anticipated that a model proposed to demonstrate effects of removing programme components of the US cotton programme and the impact of that removal on planting decisions would also demonstrate the ability to correctly predict planted acreage of upland cotton, given prices and other factors.

40. The Sumner-modified model presented in Annex I does not explain cotton planting decisions.

[19] Brazil's later submissions refer to the November 2002 baseline, paragraph 114 of Brazil's Further Rebuttal Submission of 18 Nov 2003.

[20] Bra-313, page 5.

41. In fact, the simple ratio of cotton to soybeans expected harvest season futures prices at the time of planting, discussed by the United States[21], does a much better job of explaining the movement in US cotton acreage than what is found in Dr. Sumner's formulation.

42. Even an analysis of planting decisions based on lagged prices, while not as correlated as the ratio of expected futures prices, also does a better job of explaining producer planting decisions than does Dr. Sumner's net returns formulation.

43. In fact, the formulation presented in Annex I actually contains a negative correlation between expected net revenue and planting decisions in most cotton regions of the United States.

44. In other words, the Annex I model tends to predict that cotton producers will plant less cotton in response to higher returns.

45. In Annex I, Dr. Sumner reports the functional form of expected net revenue used in determining planted acreage of upland cotton (equation 1 on page 13). Empirical results indicate that Dr. Sumner's contrived formulation of expected net revenue does not explain the movement in US plantings of upland cotton.[22] The following table presents correlation coefficients between the explanatory variables in Dr. Sumner's acreage equations and actual acreage levels for each region and for the United States over the 1996-2002 period.

46. Cotton expected net revenue, in nominal terms, calculated according to equation (1) of Annex I has a negative correlation with planted acreage in 4 of the 6 cotton-producing regions modelled by Dr. Sumner. Over the 1996-2002 period, those 4 regions accounted for 93% of US acreage. Dr. Sumner's equations for planted acreage are not solely based on nominal net revenue of cotton. They also take into account competing crops in each region, and returns are converted to real dollars by dividing by a general price deflator.

47. The lack of predictive ability of Dr. Sumner's acreage equations is best illustrated by the correlation between acreage and the Weighted Expected Net Returns for all Crops in real terms. This aggregate net return is calculated by multiplying each parameter estimate by the respective real net returns for that crop calculated according to equation (1) of Annex I and then summing the resulting values. This calculation incorporates all explanatory variables that are included in Dr. Sumner's acreage equations with the appropriate elasticity.

48. The correlation results indicate that Dr. Sumner's equations are not accurate predictors of the movements in cotton acreage. The correlation in 3 regions is negative, and in two other regions, the correlation is weakly positive. Only in the smallest production region in the US is there a positive correlation that is statistically significant.

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[21] Paragraphs 152-167 of US Further Rebuttal Submission, 18 November 2003.

[22] The calculation of expected net revenue follows the general form indicated by equation (1) of Annex I. Data for expected market and marketing loan benefits are taken directly from the file FINAL US2003CropsModel WORKOUT.xls, which is a cotton-only US model supplied by Brazil. Exact calculations of per-acre PFC, DP, MLA and CCP payments, as well as crop insurance were not included in the file. Nor has this exact documentation been provided by Brazil. In the absence of a complete explanation regarding these calculations, the US has adopted the following formulas for expected per-acre payments for each region i:

PFCi = 0.85 * (PFC Payment Rate) * (Programme Yield)i,
MLAi = 0.85 * (MLA Payment Rate) * (Programme Yield)i,
DPi = 0.85 * (Direct Payment Rate) * (Programme Yield)i,
CCPi = 0.85 * max(0, Target Price – max)(Loan Rate, Farm Price)) (Programme Yield)I,

The variables for decoupled payments and crop insurance have been calculated for each crop and region and included in expected net revenue for the determination of correlation coefficients and explanatory power.

49. In fact, the explanatory power and reliability of Dr. Sumner's acreage model is far less than one explanation of recent movements in cotton acreage provided by the United States, the ratio of cotton to soybeans expected harvest season futures prices at time of planting. Because soybeans is a major competing crop of cotton in many cotton-producing regions, this ratio expresses the relative attractiveness of planting cotton from expected market returns.[23] Simply put, the ratio of expected futures prices does a much better job of explaining the movement in US cotton acreage than what is found in Dr. Sumner's arbitrary formulation.

**Correlation of Selected Explanatory Variables with Upland Cotton Planted Area, 1996-2002 Period (1)**

| | Corn Belt | Central Plains | Delta States | Far West | Southeast | Southern Plains | **US** |
|---|---|---|---|---|---|---|---|
| Sumner's Cotton Expected Net Returns (Nominal $) | -0.27 | 0.11 | -0.29 | 0.29 | -0.53 | -0.09 | **-0.28** |
| Sumner's Cotton Expected Net Returns (Real $) | -0.29 | -0.08 | -0.32 | 0.38 | -0.58 | -0.14 | **-0.30** |
| Sumner's Weighted Expected Net Returns for all Crops (Real $) | -0.21 | 0.40 | -0.25 | 0.17 | -0.35 | 0.16 | **-0.14** |
| Ratio of Cotton and Soybean Futures Prices | 0.55 | -0.37 | 0.66 | 0.23 | 0.33 | 0.63 | **0.69** |
| Ratio of Lagged Cotton and Soybean Farm Prices | 0.14 | -0.64 | 0.37 | 0.40 | -0.06 | 0.46 | **0.40** |

(1) Source: File FINAL US2003CropsModel Correl 1.xls

50. The statistics are very clear. Dr. Sumner's methodology of modelling producer expectations and planting decisions has no explanatory power, and analysis based on these equations is not reliable. His proposed formulation of net returns is not consistent with producers' expectations and acreage decisions. The equations are not reliable for assessing the removal of US programmes, and this applies to not only decoupled payments and crop insurance, but also marketing loans.

51. Recent historical data clearly indicate that producers are making their decisions on their expectations of market prices for cotton and primary competing crops.[24] Furthermore, those price expectations are not captured by the naïve approach of simply using last year's price to determine this year's acreage decision. As Brazil's expert, Mr. MacDonald explained at the second session of the first panel meeting, futures markets embody the best available information about expected prices. The data indicate that cotton farmers' planting decisions are made accordingly.

[23] Paragraphs 5-9 of Answers of the United States of America to the Questions from the Panel to the Parties following the Second Session of the First Substantive Panel Meeting, 27 October 2003.

PFCi = 0.85 * (PFC Payment Rate) * (Programme Yield)i,
MLAi = 0.85 * (MLA Payment Rate) * (Programme Yield)i,
DPi = 0.85 * (Direct Payment Rate) * (Programme Yield)i,
CCPi = 0.85 * max(0, Target Price – max)(Loan Rate, Farm Price)) (Programme Yield)I,

The variables for decoupled payments and crop insurance have been calculated for each crop and region and included in expected net revenue for the determination of correlation coefficients and explanatory power.

[24] Paragraphs 152-167 of US Further Rebuttal Submission, 18 November 2003.

52. The formulations discussed in Annex I do not reflect the expectations of producers and do not explain the movement in US cotton acreage. This is particularly troublesome as those formulations are a critical link in Brazil's attempt to ascribe significant acreage impacts to the US cotton programme. There is no credible statistical evidence that supports this linkage, and the Annex I formulations that form a part of this analytical linkage fail to accurately explain movement in acreage.

## V. DR. SUMNER'S METHODOLOGY DEVIATES FROM FAPRI'S LINEAR ACREAGE SYSTEM

53. FAPRI's linear acreage system would tend to ensure that impacts from a static change in returns should be the same across several years. However, contrary to the normal FAPRI system, the Sumner analysis shows impacts that grow substantially over several years.

54. According to the US crops model (Excel file US CROPS MODEL 2002.xls) sent by Dr. Babcock on 26 November, upland cotton acreage in each region is determined by the following equation:

$CTPLT_i = a_o + a_o * CTENR_i/PD + A*(\text{Vector of Competing Crop Returns}_i)/PD$
$+ \text{Decoupled Payment Impacts}_i + \text{CRP Impacts}_i + \epsilon_i$

where

CTPLT = upland cotton planted acreage in region i
CTENR = expected cotton net returns from the market and the marketing loan in region i
PD = general price deflator
A = vector of parameter estimates for competing crops.

Expected net returns for each crop are defined as
(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs.

55. As documented in equation (1) of Annex I, Dr. Sumner modifies expected net returns to include his calculations of decoupled payments and crop insurance benefits. The new equations for expected net returns are transformed as follows:

(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs + $b_{pfc}$ * PFC + $b_{dp}$ * DP + $b_{mla}$ * MLA + $b_{ccp}$ * CCP + CIS,
where

PFC = per-acre PFC payments
DP = per-acre direct payments
MLA = per-acre MLA payments
CCP = per-acre counter-cyclical payments
CIS = crop insurance variable
$b_{pfc}$ , $b_{dp}$ , $b_{mla}$ , $b_{ccp}$ = scaling factors.

56. An important aspect of the linear acreage equations as modified by Dr. Sumner concerns the response to changes in net returns. If net returns for cotton change by a given amount, then the impact or shift in cotton acreage is determined as $a_i$*(Change in returns)/PD. If the change in returns is the same across years, then the only difference in terms of the acreage impact is due to the value of the price deflator PD.

### A. ACREAGE IMPACTS FOR 2003-07 APPEAR INCONSISTENT WITH 1999-2002 PERIOD

57. Dr. Sumner's acreage impacts attributed to decoupled payments and crop insurance show tremendous variations over the 1999-2007 period. Specifically, acreage shifts for the 2003-07 period are much larger than those reported for the 1999-02 period. The larger impacts are not consistent with

the relative programme values assumed by Dr. Sumner. In the case of decoupled payments, incorporating Dr. Sumner's "coupling" factors does not fully explain the differences in impacts.

58. The following table provides a comparison of the average acreage impacts reported in rows 720-771 of the file FINAL US2003CropsModel WORKOUT.xls. The averages reflect the two periods of the analysis covered by the different farm bills. The US cannot verify Dr. Sumner's calculations due to insufficient information. However, some basic calculations cast serious doubt on the validity of Dr. Sumner's analysis.

59. The acreage impacts reported for DP payments over the 2003-07 period are much larger than those indicated for PFC payments during 1999-2002 even though direct payment rates under the current farm bill are actually smaller than PFC payment rates under the FAIR Act. Surprisingly, this difference cannot be adequately explained by Dr. Sumner's decision to provide much stronger acreage impacts for Direct Payments than he attributed to PFC payments. Even when the United States attempted to incorporate Dr. Sumner's "coupling" factor, the acreage impacts appear much larger than the increased (1.5 times) "coupling" factor would seem to indicate.

60. The same concern holds true for MLA and CCP payments. The acreage impact associated with CCP increases by a factor of five while the effective payment under the 2002 Act is 3.4 times larger than the MLA payment. In the Central Plains, the impact is more than 147 times larger over the 03-07 period than over 99-02. The Southeast shows an acreage impact due to CCP that is almost 8 times the size of that implied for MLA by Dr. Sumner under the 1996 Act.

B. CROP INSURANCE IMPACTS OVER 2003-2007 PERIOD VARY FROM IMPACTS OVER 1999-2002

61. In paragraphs 52 through 56 of Annex I, Dr. Sumner addresses his contrived methodology for incorporating crop insurance. He states that the per-acre crop insurance effect on net revenue is the same in all years of the analysis, and at the national level, it equals $19 per acre. He does not indicate if the value changes for each region in his acreage system. That notwithstanding, we do know that the impact on net revenue is the same in all years of the analysis. If that is the case, then the linear specification presented in equation (1) of Annex I would generate roughly the same acreage shift in each year of the analysis, with the exception of the impact of the change in the general price deflator. Since the price deflator, which is a measure of general price inflation, generally increases over time, then the actual impact on acreage should get modestly smaller over time. Instead, Dr. Sumner's acreage shifts due to crop insurance increase dramatically over the analysis period. In the early years, the impact of $19 in net revenue amounts to fewer than 600 thousand acres, while it grows to more than 1 million acres in 2003.

62. Despite the fact that the perceived benefit did not change, Dr. Sumner's methodology produced an acreage impact over the 2003-07 period that is roughly 1.5 times larger than over the 1999-2002 period. Furthermore, in the case of the Corn Belt, Dr. Sumner's analysis actually indicates that the presence of the crop insurance programme has removed acres from cotton production - a result that is implausible.

**Comparison of Calculated Payment Rates with Acreage Shifts Reported in FINAL US2003CropsModel WORKOUT.xls**

| | 99-02 Average | 03-07 Average | Ratio |
|---|---|---|---|
| AMTA/DP Effective Average Payment Rate (Cents/Lb) * | 1.10 (= 7.34 * 0.15) | 1.67 (= 6.67 * 0.25) | 1.52 |
| AMTA/DP Acreage Impacts (Mil Acres) | | | |
| Corn Belt | 0.0015 | 0.0047 | 3.03 |
| Central Plains | 0.0025 | 0.0053 | 2.11 |
| Delta States | 0.0390 | 0.1425 | 3.65 |
| Far West | 0.0004 | 0.0012 | 2.84 |
| Southeast | 0.0764 | 0.2734 | 3.58 |
| Southern Plains | 0.0794 | 0.1380 | 1.74 |
| Total U.S. | 0.1993 | 0.5650 | 2.84 |
| MLA/CCP Effective Average Payment Rate (Cents/Lb) * | 1.61 (= 6.42 * 0.25) | 5.49 (= 13.73 * 0.40) | 3.41 |
| MLA/CCP Acreage Impacts (Mil Acres) | | | |
| Corn Belt | 0.0023 | 0.0137 | 5.96 |
| Central Plains | 0.0001 | 0.0151 | 147.22 |
| Delta States | 0.0872 | 0.3867 | 4.43 |
| Far West | 0.0022 | 0.0037 | 1.67 |
| Southeast | 0.0927 | 0.7307 | 7.88 |
| Southern Plains | 0.1157 | 0.3983 | 3.44 |
| Total U.S. | 0.3002 | 1.5482 | 5.16 |
| Crop Insurance Average Benefit (Dollars/Ac) | $19 | $19 | 1.00 |
| Crop Insurance Acreage Impacts (Mil Acres) | | | |
| Corn Belt | -0.0002 | -0.0003 | 1.52 |
| Central Plains | 0.0120 | 0.0219 | 1.83 |
| Delta States | 0.0596 | 0.1018 | 1.71 |
| Far West | 0.0012 | 0.0013 | 1.06 |
| Southeast | 0.2372 | 0.4609 | 1.94 |
| Southern Plains | 0.3728 | 0.4279 | 1.15 |
| Total U.S. | 0.6826 | 1.0135 | 1.48 |

* Effective Rates Calculated by Multiplying Average Rates by Dr. Sumner's "Coupling" Factor.

C. SUMNER MODEL ADOPTS NON-LINEAR RESPONSES CONTRARY TO FAPRI

63. In Exhibit Bra-313, Dr. Sumner provides further documentation regarding the analysis of decoupled payments and crop insurance. The new documentation suggests an entirely different methodology than presented in Annex I.

64. The documentation provided in Annex I suggests that cotton area is determined by the equation:

$CTPLT_i = a_o + a_o*CTENR_i/PD + A*(\text{Vector of Competing Crop Returns}_i)/PD + \epsilon_i$

where cotton expected net returns CTENR are determined as
(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs + $b_{pfc}$ * PFC + $b_{dp}$ * DP + $b_{mla}$ * MLA + $b_{ccp}$ * CCP + CIS.

65. Based on this documentation, analyzing the impacts of no decoupled payments would be done by simply setting the decoupled payments to zero. However, in Exhibit Bra-313, equations (4)-(6) suggest a very different methodology for deriving impacts. Dr. Sumner reports to use the following approach:

Percentage difference in acreage due to programme
= (Expected programme payments/(Expected programme payments + (cotton market & market loan net revenue))) * Acreage elasticity.

Acreage impacts would be derived by multiplying the percentage difference in acreage by the baseline level of acreage.

66. The new methodology yields acreage impacts that vary depending on the level of returns from the market and marketing loan. This methodology explains how Dr. Sumner is able to derive varying impacts in a scenario where the change introduced into the system is constant, such as the crop insurance scenario.

## D. SUMNER FORMULATION IGNORES PRESENCE OF OTHER PROGRAMMES AND THEREFORE EXAGGERATES IMPACTS

67. Dr. Sumner's formulation for isolating the impacts of each individual programme produces exaggerated results. It is logical to assume that Dr. Sumner's baseline acreage represents his most likely view based on the presence of all US cotton programmes. As such, determining the acreage impact of each individual programme should be done by comparing returns from the programme in question with total returns, where total returns are defined as

(Lagged Farm Price + max(0, Loan Rate – Lagged Loan Repayment Price)) * Expected Yield – Variable Costs + $b_{pfc}$ * PFC + $b_{dp}$ * DP + $b_{mla}$ * MLA + $b_{ccp}$ * CCP + CIS.

68. Dr. Sumner's approach of comparing returns for the programme in question to returns from the market and marketing loan ignores the presence of other programmes. Since returns from the market and marketing loan are less than total returns, then the acreage impacts for a given programme based on Dr. Sumner's formulation will be larger. The following table uses data for the Southern Plains in 2005 to illustrate the differences. Following Dr. Sumner's documentation of Exhibit Bra-313, the acreage impacts of decoupled payments and crop insurance total 671 thousand acres. If the methodology was based on total revenue, then the estimated acreage impact is 543 thousand acres. Full details of the calculations are presented in the file FINAL US2003CropsModel Correl 1 (Exhibit US-115).

## E. UNITED STATES HAS DIFFICULTY REPLICATING SUMNER RESULTS - EVEN AFTER ADOPTING SUMNER METHODOLOGY

69. The estimates prepared by the US are substantially smaller than those reported by Dr. Sumner in the file FINAL US2003CropsModel WORKOUT.xls (submitted on 18 November). The discrepancies are particularly large over the 2003-07 period. Dr. Sumner reports an average acreage

impact due to decoupled payments and crop insurance of 3.1 million acres over the 2003-07 period. Estimates by the US using Dr. Sumner's formulas find an impact of only 1.2 million acres. The inability to even remotely replicate Dr. Sumner's estimates casts serious doubts about the validity of his results. Dr. Sumner's calculations appear to be as arbitrary as his economic logic.

70. Brazil may cite the fact that the elasticity with respect to net returns is lower than the estimates published in Table I.3 of Annex I. While the United States is not able to verify the discrepancy, the elasticities used in the US calculations are based on data provided in the file FINAL US2003CropsModel WORKOUT.xls. Specifically, the elasticity in each year is determined by the formula ($a_i$ / Value of price deflator)*(Value of net returns / Value of cotton acres), where a1 is the coefficient on cotton net returns in the regional cotton acreage equation. The value of net returns and cotton acres are based on regional numbers in each year. This formulation is consistent with Dr. Sumner's documentation presented in Exhibit Bra-313.

**Example of Southern Plains Acreage Impacts, 2005**

| Program | (1) Market Revenue | (2) Program Revenue | (3) = (2)/((1) + (2)) % of Market + Program Revenue | (4) Elasticity | (5) Planted | (6) = (3)*(4)*(5) Estimated Impact | (7) Sumner Impact |
|---|---|---|---|---|---|---|---|
| Direct Payments | $109.04 | $6.08 | 5.28% | 0.28 | 6.046 | 0.090 | 0.145 |
| CCP's | $109.04 | $20.02 | 15.51% | 0.28 | 6.046 | 0.265 | 0.416 |
| Crop Insurance | $109.04 | $24.67 | 18.45% | 0.28 | 6.046 | 0.316 | 0.446 |
| **Total Area Impact** | | | | | | **0.671** | **1.007** |

**Example of Southern Plains Acreage Impacts, 2005**

| Program | (1) Total Revenue | (2) Program Revenue | (3) = (2)/(1) % of Total Revenue | (4) Elasticity | (5) Planted | (6) = (3)*(4)*(5) Estimated Impact | (7) Sumner Impact |
|---|---|---|---|---|---|---|---|
| Direct Payments | $159.81 | $6.08 | 3.80% | 0.28 | 6.046 | 0.065 | 0.145 |
| CCP's | $159.81 | $20.02 | 12.53% | 0.28 | 6.046 | 0.214 | 0.416 |
| Crop Insurance | $159.81 | $24.67 | 15.44% | 0.28 | 6.046 | 0.264 | 0.446 |
| **Total Area Impact** | | | | | | **0.543** | **1.007** |

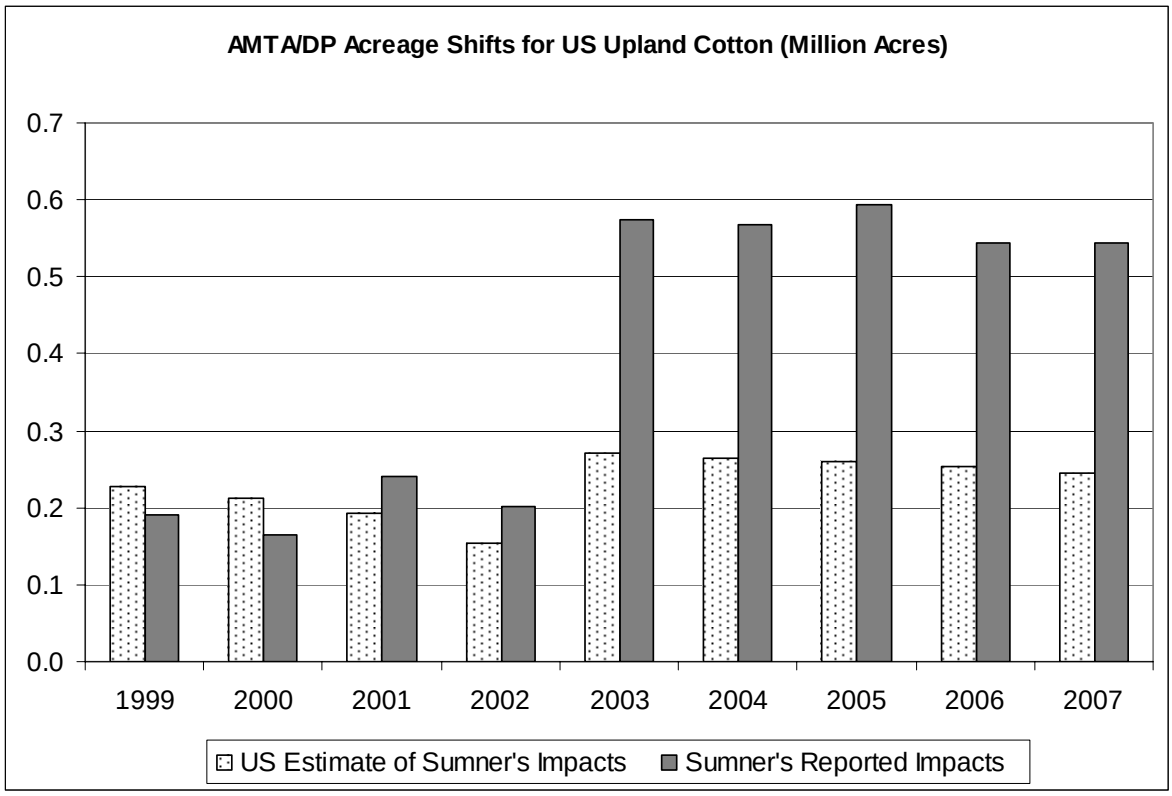
| | 1999-2002 Average Acreage Impact (Million Acres) | | | |
|---|---|---|---|---|
| | **AMTA/DP** | **MLA/CCP** | **Crop Insurance** | **Total** |
| Sumner Reported Impact | 0.199 | 0.300 | 0.683 | 1.182 |
| Estimate of Sumner Approach Using Market Returns | 0.197 | 0.286 | 0.636 | 1.119 |
| Estimate of Sumner Approach Using Total Returns | 0.166 | 0.243 | 0.587 | 0.996 |

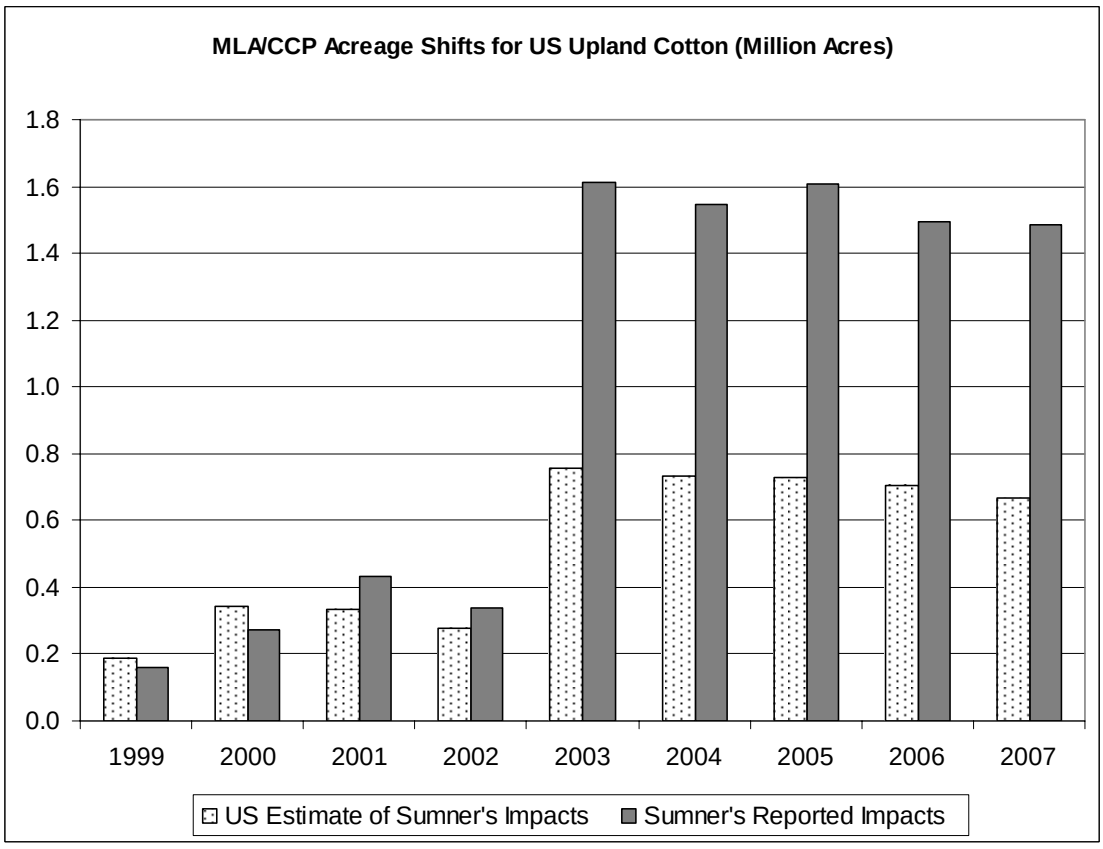
| | 2003-2007 Average Acreage Impact (Million Acres) | | | |
|---|---|---|---|---|
| | **AMTA/DP** | **MLA/CCP** | **Crop Insurance** | **Total** |
| Sumner Reported Impact | 0.565 | 1.548 | 1.013 | 3.127 |
| Estimate of Sumner Approach Using Market Returns | 0.258 | 0.718 | 0.553 | 1.529 |
| Estimate of Sumner Approach Using Total Returns | 0.179 | 0.591 | 0.432 | 1.202 |

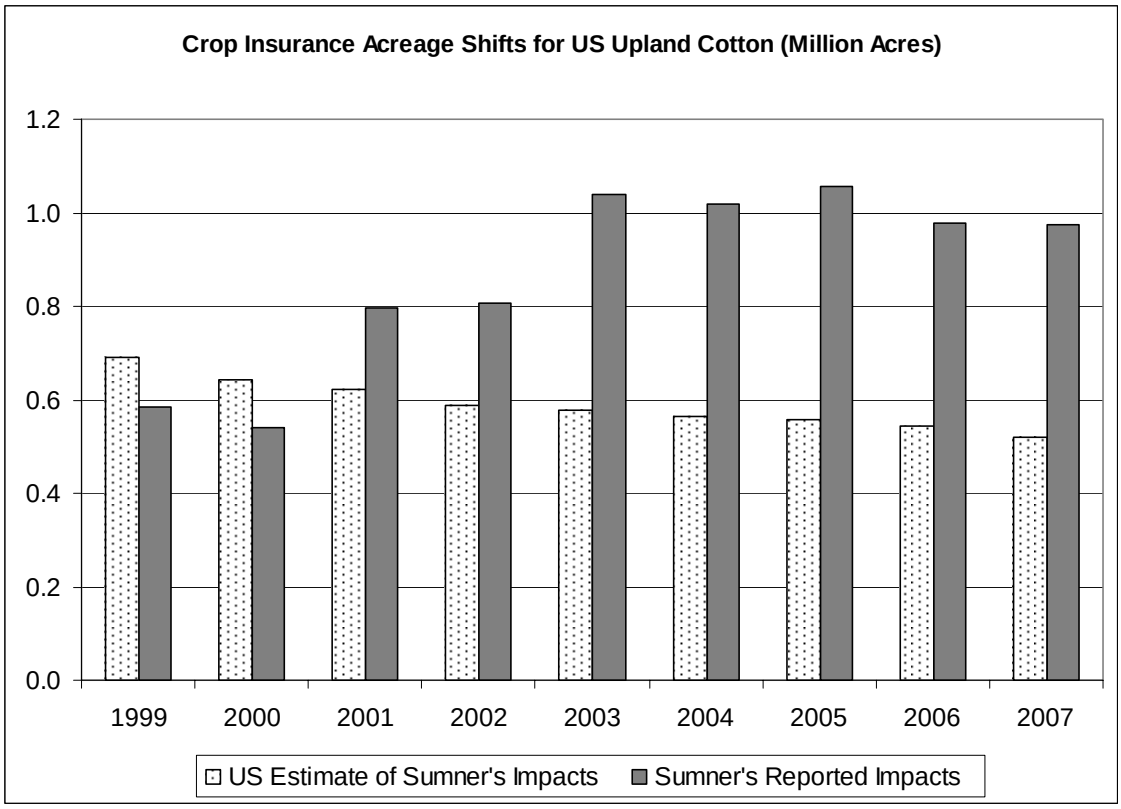
71. The following charts provide a year-by-year comparison between Dr. Sumner's reported impacts and estimates prepared by the United States. The formulas use to generate these estimates follow the documentation provided by Dr. Sumner. In cases where the information was incomplete, reasonable assumptions were made to facilitate the calculations. Complete details are provided in the file FINAL US2003CropsModel Correl 1[25].

72. Estimates by the United States for the 1999-2002 period are reasonably close to those offered by Dr. Sumner. However, there are large discrepancies over the 2003-07 period. It is inexplicable how the impact between the two periods can be so different. The differences cannot be explained by Dr. Sumner's method of incorporating alternative "coupling" factors.

[25] Exhibit US-115.






## VI. SUMNER MODIFICATIONS TO FAPRI MODEL DESCRIBED IN BRA-313 CONTAIN ERRORS

73. In Exhibit Bra-313, equation (2) on page 2 states that real net revenue for crop i in year (t-1) is a function of the price in (t-1) and the loan rate in (t-1), and other variables. It is this specification for real net revenue that determines acreage in year t, as described in equation (1). The combination of these two equations indicates that the loan rate in t-1 helps determine acreage in period t. In other words, Dr. Sumner's equation seems to assert it is last year's loan rate, and not the one in effect for this year's crop, that determines this year's plantings. Not only is this completely illogical, but it is in direct conflict with acreage equations previously developed by both FAPRI and USDA. The United States cannot determine if this equation reflects a lack of knowledge of the model, a broader deficiency in economics, or some previously unknown modification of the FAPRI or CARD models.

74. Dr. Sumner's documentation presented in equation (2) is inconsistent with equations contained in the files US CROPS MODEL 2002.xls (provided by Dr. Bruce Babcock on 26 November) and FINAL US2003CropsModel WORKOUT.xls (provided by Brazil on 18 November). Equation (2) defines real net revenue for crop i by taking the higher of the lagged farm price and the lagged loan rate, then multiplying by trend yield and subtracting variable costs. He further explains that this formulation applies to all crops except cotton and rice, where the marketing loan benefit depends on the difference between the loan rate and the AWP. However, in the two electronic versions of the crops model, which have been provided by Dr. Sumner and Dr. Babcock[26], the formulation of expected net revenue is not consistent with Dr. Sumner's documentation. According to the electronic versions, all crops incorporate the marketing loan benefit by taking the difference between the loan rate and the loan repayment price. The United States and the Panel are left to wonder why there is a discrepancy between Dr. Sumner's documentation and the models that have been provided.

[26] File US CROPS MODEL 2002.xls (provided by Dr. Bruce Babcock on 26 November) (Exhibit US-116) and FINAL US2003CropsModel WORKOUT.xls (provided by Brazil on 18 November) (Exhibit US-115).

75. Exhibit Bra-313 and Annex I provide different and conflicting methodologies for incorporating the impacts of crop insurance and decoupled payments. According to equation (1) of Annex I, the formula for determining expected net revenue has been modified to include per-acre decoupled payments and crop insurance benefits. These net returns then determine cotton planted acreage. However, in equation (1a) of Bra-313, Dr. Sumner indicates that net revenue only considers returns from the market and the marketing loan. He then incorporates the impacts of decoupled payments and crop insurance by adding some arbitrary acreage impacts into the equation. As explained earlier[27], the approach presented in Exhibit Bra-313 only serves to exaggerate his acreage impacts.

76. In equation (7), Dr. Sumner documents the equation specification for US cotton exports. His documentation indicates that exports in year t are a function of production in t-1, and other variables. Dr. Sumner's model suggests that last year's production directly determines this year's exports. This is both illogical and a departure from the specification included in the FAPRI framework.

## VII. OVERALL PRICE RESPONSIVENESS OF THE ANNEX I MODEL

77. The overall price impacts generated by a model are determined by the underlying supply and demand elasticities within the system. If overall supply and demand are more elastic, or more responsive, then an external shock to the system will generate a smaller change in price than a system that is more inelastic.

78. In the case of the scenarios examined by Dr. Sumner, the external shocks to the model are the elimination of various aspects of the US cotton programme. According to Dr. Sumner's analysis, the removal of the US cotton programme leads to a reduction in planted area, production, and subsequently exports onto the world market. The reduced supplies into the world market generate an increase in world price, with the magnitude of the price increase determined by the overall elasticities embodied within the models for foreign production and consumption.

79. The following table provides a comparison of aggregate supply and demand elasticities for foreign area and mill use. Based on individual country elasticities, the response of aggregate foreign area and consumption can be calculated based on weights derived from recent historical data. The elasticities reported in Table I.3 of Annex I are used to derive the aggregate elasticities of the Sumner-CARD international cotton[28] model provided by Brazil on 13 November. These are compared to published research from Dr. Seth Meyer at FAPRI-University of Missouri, which reports more responsiveness in both area and consumption.[29]

| Comparison of Model Elasticities | | | | |
|---|---|---|---|---|
| | Meyer – FAPRI | | Sumner – CARD | |
| | Short Run | Long Run | Short Run | Long Run |
| Foreign Area | 0.45 | 0.78 | 0.24 | N/A |
| Foreign Mill Use | -0.37 | -0.49 | -0.25 | N/A |

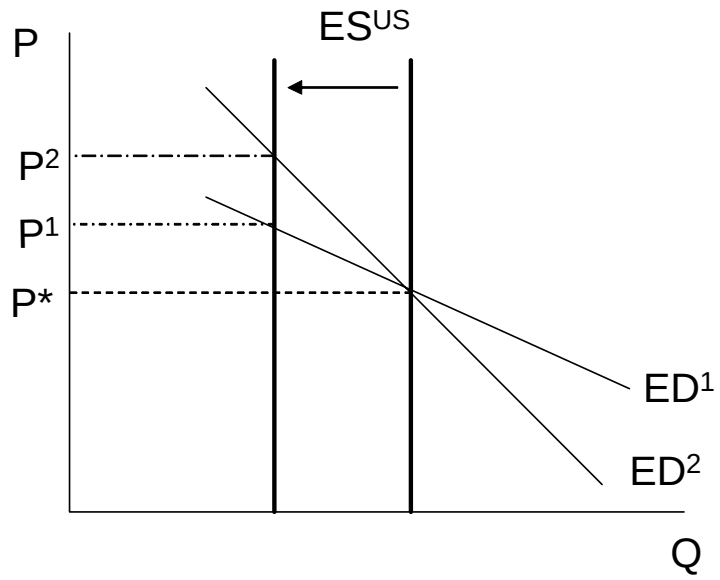
80. The net trade position of countries outside of the US is one of a net importer. Since their consumption exceeds their production, their excess demand (ED) is defined as demand (D) – supply (S). The responsiveness of their excess demand (ED) is approximated by the elasticity of the

[27] Section V.c of this document.

[28] File WDCT2002 Meltdown WORKOUT.xls, provided by Brazil on 13 November 2003. (Exhibit US-115.)

[29] Seth D. Meyer, *A Model of Textile Fiber Supply and Inter-Fiber Competition with Emphasis on the United States of America*, Food & Agricultural Policy Research Institute, University of Missouri, 2002.

domestic demand less the elasticity of their domestic supply. In the case of the Meyer model, the elasticity of excess demand is -0.37 – 0.45 = -0.82. For the Sumner model, the elasticity of excess demand is -0.25 – 0.24 = -0.49. This fundamental difference has a direct impact on the price impacts generated by the model, as evidenced by the following chart. The line ED1 represents an excess demand curve with more price responsiveness, while ED2 is an excess demand curve with less elasticity. The intersection of excess demand outside of the United States with excess supply (ESUS) from the United States generates an equilibrium price. When there is a reduction in the excess supply from the United States, the elasticity of excess demand, which is reflected by the slope of the line has a direst impact on the change in price. Dr. Sumner's choice of international supply and demand elasticities leads to exaggerated price impacts.




## VIII. CONCLUSION

81. The Sumner models, as presented by Brazil, are so laden with faulty theory on programme impacts and so deviate from the FAPRI standards that they cannot provide any foundation for the Panel's analysis of the effect of challenged United States programmes with respect to upland cotton. Not only does the Sumner model contain major differences from previous FAPRI work, it also appears to be internally inconsistent as the United States has noted changes in described methodology from the original Annex I submission to later submissions, such as Exhibit Bra-313 and subsequent documentation.

82. Virtually all of the concerns of the United States cited in this critique are directed toward Brazil economic manipulation that exaggerates acreage impacts of the United States upland cotton programme.

- Brazil's impacts attributed to decoupled programmes deviate from traditional FAPRI analysis.
- Brazil's impacts attributed to crop insurance programme are not supported by FAPRI analysis.
- Brazil's impacts attributed to the export credit guarantee programme have no demonstrated economic foundation.
- Brazil's Annex I results used baselines that were inexplicably lower than even FAPRI's preliminary November 2002 baseline.
- Brazil's non-linear approach to results deviated from the traditional FAPRI methodology.

- Many of Dr. Sumner's adaptations contain errors.

83. In the final analysis, Brazil does not rely on the FAPRI model to prove its case, it relies on its manipulation of that model to ensure it obtains the desired results.

# ANNEX I-10

## BRAZIL'S ANSWERS TO ADDITIONAL QUESTIONS FROM THE PANEL

20 January 2004

### TABLE OF CASES

| | |
|---|---|
| *EC – Sugar Exports I (Australia)* | GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Australia*, L4833 - 26S/290, adopted 6 November 1979 |
| *EC – Sugar Exports II (Brazil)* | GATT Panel Report, *European Communities – Refunds on Exports of Sugar (Complaint by Brazil)*, L/5011 – 27S/69, adopted 10 November, 1980. |
| *US – FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
| *US – 1916 Act* | Appellate Body Report, *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, adopted 26 September 2000. |
| *US – Corrosion-Resistant Steel* | Appellate Body Report, *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan*, WT/DS244/AB/R, adopted 9 January 2004. |

### List of Exhibits

| | |
|---|---|
| Agricultural Outlook Tables, USDA, November 2003, Table 19 | Exhibit Bra- 394 |
| "Trade Issues Facing the US Cotton Industry," Speech by Dr. Mark Lange, President and CEO, National Cotton Council, 6 January 2004. | Exhibit Bra- 395 |
| "Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, 2 September 2003. | Exhibit Bra- 396 |
| "Report of the Commission on the Application of Payment Limitations for Agriculture," August 2003. | Exhibit Bra- 397 |
| Western Farm Press, 7 January 2003 | Exhibit Bra- 398 |
| Acreage Discrepancies.xls | Exhibit Bra- 399 |
| List of Publications of Professors Babcock and Beghin | Exhibit Bra- 400 |

**257. The Panel takes note of the Appellate Body Report in United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.**

**(a) In that report, the Appellate Body cautioned against the "mechanistic" application of the so-called "mandatory/discretionary distinction" and stated that the import of this distinction may vary from case to case (para. 93). For the Appellate Body, the question of whether a measure is mandatory or not is relevant "if at all" only as part of the assessment of whether the measure is, as such, inconsistent with particular obligations. How, if at all, are these statements and the related findings concerning the mandatory/discretionary distinction in that Appellate Body Report relevant to:**

**(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the Agreement on Agriculture and Articles 3.1(a) and (b) of the SCM Agreement, concerning: BRA**

**- Step 2 payments (see, e.g. paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and**

**- export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, e.g., para. 90 Brazil's oral statement at second Panel meeting).**

**(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"? BRA**

**(iii) the legal standard and elements Brazil sets out to establish its "per se" "serious prejudice" claims (e.g. Brazil's 9 September further submission, para. 417 ff; US oral statement at second Panel meeting, para. 86 ff.)? BRA**

***The Appellate Body's Decision***

1. Prior to answering the Panel's specific questions, Brazil makes the following introductory comments. Generally speaking, with respect to the Panel's Questions 257(a) – (c), Brazil does not believe that the Appellate Body Report in *US – Corrosion-Resistant Steel* has a significant impact on the legal standards or the elements of Brazil's "*per se*" or threat of serious prejudice claims. This is because, unlike the USDOC Policy Bulletin in *US – Corrosion-Resistant Steel*, the measures at issue in this dispute, on their face, require the payment of subsidies to eligible producers, users, and exporters. The record in this dispute shows that US government officials enjoy no flexibility to apply the US subsidy programmes in a WTO-consistent manner.

2. The *US – Corrosion-Resistant Steel* decision does make the important conclusion that panels cannot reject on a jurisdictional basis "*per se*" claims against measures that on their face are not mandatory.[1] This Panel therefore need not examine whether the subsidy measures that Brazil has challenged are mandatory as a preliminary jurisdictional matter. However, this does not mean that the mandatory nature of measure is not important in deciding the merits of a "*per se*" (or threat of serious prejudice) claim. Indeed, the Appellate Body's analysis of the merits of Japan's "*per se*" claims in *US – Corrosion-Resistant Steel* appeared to turn largely on whether the measure was "mandatory", i.e., whether it required USDOC officials to analyze sunset reviews in a WTO-inconsistent manner.

[1] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 88.

3. The Appellate Body held that "[w]hen a measure is challenged 'as such,' the starting point for an analysis must be the measure on its face. If the meaning and content of the measure are clear on its face, then the consistency of the measure as such can be assessed on that basis alone".[2] The Appellate Body in *US – Corrosion-Resistant Steel* found that the "as such" challenge "hinges upon whether [the Sunset Policy Bulletin] instruct[s] USDOC to treat dumping margins and/or import volumes as determinative or conclusive, on the one hand, or merely indicative or probative, on the other hand, of the likelihood of future dumping".[3] Finding ambiguity in the text of the Bulletin (the use of the word "normally" and "good cause"), the Appellate Body held that the panel should have examined the history of the application of the Bulletin and individual decisions thereunder.[4] Since the panel had failed to make the necessary factual findings, the Appellate Body was unable to complete the analysis and to rule on Japan's claim.[5]

4. Nevertheless, the Appellate Body's decision appears to stand for the proposition that "*per se*" challenges require demonstration that either the text or the operation of a measure creates requirements for government officials to act in a WTO-inconsistent manner. Where the text is not completely clear, the Appellate Body found that panels must determine whether the measure creates "normative" requirements, i.e., whether the measures are treated as binding by government officials, are interpreted as binding on executive branch officials by courts, or are consistently applied in a manner suggesting that the measures are considered to be mandates for action.[6]

5. Further, the *US – Corrosion-Resistant Steel* decision highlights the importance of challenges to legal/regulatory measures as a way to avoid repeated WTO dispute settlement challenges in "as applied" claims. In describing what is a "measure," the Appellate Body recalled:

> [I]n GATT and WTO dispute settlement practice, panels have frequently examined measures consisting not only of particular acts applied only to a specific situation, but also of acts setting forth rules or norms that are intended to have general and prospective application. In other words, instruments of a Member containing rules or norms could constitute a "measure", irrespective of how or whether those rules or norms are applied in a particular instance. This is so because *the disciplines of the GATT and the WTO, as well as the dispute settlement system, are intended to protect not only existing trade but also the security and predictability needed to conduct future trade*. This objective would be frustrated if instruments setting out rules or norms inconsistent with a Member's obligations could not be brought before a panel once they have been adopted and irrespective of any particular instance of application of such rules or norms. *It would also lead to a multiplicity of litigation if instruments embodying rules or norms could not be challenged as such, but only in the instances of their application. Thus, allowing claims against measures, as such, serves the purpose of preventing future disputes by allowing the root of WTO-inconsistent behaviour to be eliminated*.[7]

6. Consistent with the language quoted above, Brazil's various challenges to US legal/regulatory instruments "*per se*" are intended to protect the security and predictability that Brazil's upland cotton producers need to conduct future trade. In addition, resolution of Brazil's separate threat of serious

[2] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 168.
[3] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 178.
[4] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, paras. 182-184, 187-189.
[5] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, paras. 189-190.
[6] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, paras. 99, 168.
[7] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 83 (emphasis added; references in original omitted).

prejudice claim under the *EC – Sugar Exports and US – FSC* rationales will prevent future disputes by addressing the root cause of the United States' WTO-inconsistent behaviour – the absence of any legal or regulatory limitations on subsidy payments, which creates a structural and permanent source of uncertainty in upland cotton markets.[8] Brazil has demonstrated that the mandatory US subsidy measures function to guarantee a high level of US upland cotton production and exports, and by definition, act to suppress world prices because of the increased supply by US producers of a fungible commodity.[9] Brazil further demonstrated that Brazilian producers are reluctant to engage in significant investments in leasing or purchasing land for upland cotton production because of the uncertainty caused by locked-in US production.[10] Brazil also recalls its position that requiring an "imminent threat" standard, as proposed by the United States, would in effect require Members such as Brazil to litigate claim after claim on the *application* of these measures, which threaten to cause serious prejudice to its interests.

7. Finally, Brazil notes that the Appellate Body's conclusions in *US – Corrosion-Resistant Steel* regarding the mandatory/discretionary distinction, although based on provisions of the Anti-Dumping Agreement, are equally relevant to claims under any of the covered agreements, including Brazil's claims under the SCM Agreement, the Agreement on Agriculture, and Article XVI of GATT 1994.[11]

**(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the Agreement on Agriculture and Articles 3.1(a) and (b) of the SCM Agreement, concerning: BRA**

- **Step 2 payments (see, e.g. paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and**

Brazil's Answer

8. Application of the *US – Corrosion-Resistant Steel* criteria requires a complainant bringing a per se claim to demonstrate that a measure does not provide relevant government officials with the flexibility to apply the measure in a WTO-consistent manner. As Brazil has argued[12], US government officials are not provided with any flexibility to make Step 2 subsidies under Section 1207(a) of the 2002 FSRI Act in a WTO-consistent manner. Thus, the Act violates Articles 3.3 and 8 of the Agreement on Agriculture, and Articles 3.1(a) and 3.1(b) of the SCM Agreement. The United States has conceded that "subject to the availability of funds (that is, the availability of CCC borrowing authority), Step 2 payments must be made to all those who meet the conditions for eligibility".[13] The

[8] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 203-216; Brazil's 9 September 2003 Further Submission, paras. 413-436.

[9] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 200-202.

[10] *See* Annex III of Brazil's 9 September 2003 Further Submission; Brazil's 9 September 2003 Further Submission, Section 6.3; Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003); Brazil's 18 November 2003 Further Rebuttal Submission, para. 203.

[11] The Appellate Body noted with respect to Article 17.3, the consultation clause of the Anti-Dumping Agreement, that there is "no threshold requirement, in Article 17.3, that the measure in question be of a certain type". Moreover, it has drawn the conclusion from the phrasing of Article 18.4 of the Anti-Dumping Agreement that "the entire body of generally applicable rules, norms and standards adopted by Members in connection with the conduct of anti-dumping proceedings" should be potentially subject to dispute settlement.[11] The provisions of Article 17.3 of the Anti-Dumping Agreement are closely modeled on those of GATT Article XXIII:1 which are cross-referenced in Article 30 of the SCM Agreement and Article 19 of the Agreement on Agriculture, and the provisions of Article 18.4 are virtually identical to Article XVI:3 of the Marrakesh Agreement Establishing the WTO.

[12] Brazil's 24 June 2003 First Submission, paras. 93-96, 244-45 and 250; Brazil's 22 August 2003 Comments to the US 11 August 2003 Answers to Questions 92-93, 96, 99 and 107.

[13] US 11 August 2003 Answer to Question 109.

United States admits that "the CCC has a large" borrowing authority and "*rarely has CCC run out of funds* but it has happened for brief periods of time".[14] Indeed, while the 1996 FAIR Act imposed a $701 million budgetary limit on the Step 2 programme during MY 1996-2001, this limit was reached by 1999. At the urging of the NCC, Congress eliminated the spending cap in 2000.[15] Unlimited funding has existed ever since, including $415 million in expenditures in MY 2002 alone.[16]

9. The Secretary of the USDA must make payments pursuant to the plain text of Section 1207(a)(1), (2), and (4) of the 2002 FSRI Act (as set out in paragraph 245 of Brazil's 24 June First Submission). Consistent with the *US – Corrosion-Resistant Steel* decision, the evidence of mandatory payments demonstrates the absence of any flexibility for US officials to apply the programme in a WTO-consistent manner. Even if US authorities, acting in the best of faith, recognize that Step 2 payments are inconsistent with the US export subsidy obligations as well as with the prohibition on local content subsidies, *Congress has not given them the discretion to stop the payments*. Indeed, Congress has created a legal right for eligible recipients to demand and receive payments.

- **export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, e.g., para. 90 Brazil's oral statement at second Panel meeting).**

Brazil's Answer

10. The Appellate Body Report in *US – Corrosion-Resistant Steel* does not affect the legal standard and elements set out by Brazil to establish its claims against the GSM 102, GSM 103 and SCGP programmes under Articles 10.1 and 8 of the Agreement on Agriculture, and under Article 3.1(a) of the SCM Agreement. In fact, the mandatory/discretionary distinction is not relevant to Brazil's claims against the CCC export credit guarantee programmes under Article 10.1 of the Agreement on Agriculture.

11. Article 10.1 prohibits circumvention, and the threat of circumvention, of export subsidy reduction commitments. Brazil has demonstrated actual circumvention, by establishing that with respect to both unscheduled products[17] and at least one scheduled product[18], the United States has in fact circumvented its export subsidy reduction commitments. This is somewhat akin to an "as applied" claim, and it is therefore not relevant to this claim whether the CCC programmes are mandatory or discretionary.

12. Brazil has also demonstrated threat of circumvention. With respect to unscheduled products, the Appellate Body has held that it constitutes threat of circumvention to provide *any* export subsidies for unscheduled products.[19] Having proven that CCC guarantees are export subsidies (under Articles 1.1 and 3.1(a) of the SCM Agreement, as well as item (j)), and having proven that those guarantees are available for unscheduled products[20], Brazil demonstrated threat of circumvention, and a violation of Article 10.1. This is the standard set out by the Appellate Body in *US – FSC*; it does not appear to be relevant to this claim whether the CCC programmes are mandatory or discretionary.

13. With respect to scheduled products, the test under Article 10.1 is not whether the CCC programmes are "mandatory" as opposed to "discretionary". Rather, to determine whether CCC export credit guarantees for scheduled products threaten to lead to circumvention of the US export

[14] US 22 December 2003 Answers to Question 254.
[15] Brazil's 24 June 2003 First Submission, para. 95.
[16] US 22 December 203 Answer to Question 196, para. 12 (based on October 2002-September 2003 fiscal year data).
[17] *See* Brazil's 2 December 2003 Oral Statement, para. 87.
[18] *See* Brazil's 2 December 2003 Oral Statement, para. 89 (and note 179).
[19] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 150.
[20] *See* Brazil's 18 November 2003 Further Rebuttal Submission, para. 256 (and note 414).

subsidy reduction commitments, Brazil has noted that the test set out by the Appellate Body in *US – FSC* is whether the CCC can "stem[], or otherwise control[], the flow of" CCC export credit guarantees. Brazil has demonstrated that CCC cannot do so.[21] One fact Brazil has noted is that the CCC programmes are "mandatory," as that term is defined in US law.[22] (In Brazil's view, the CCC programmes are also "mandatory," within the meaning of WTO/GATT law).

14. Brazil also claims that the CCC export credit guarantee programmes constitute prohibited export subsidies under Articles 1.1 and 3.1(a) of the SCM Agreement. Brazil has demonstrated that the CCC programmes confer "benefits" per se, within the meaning of Article 1.1(b) of the SCM Agreement (as well as that they are financial contributions and are *de jure* contingent on export). Brazil has relied on three types of evidence and argument to make this *per se* showing, as summarized in paragraphs 231-241 of its 18 November 2003 Further Rebuttal Submission. These three types of evidence and argument demonstrate that every time a CCC guarantee is issued, a benefit is conferred *per se*. This is effectively the equivalent of saying that the CCC programmes "mandate" a violation.

15. Finally, Brazil also claims that the CCC export credit guarantee programmes constitute prohibited export subsidies under item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement. Brazil does not consider that, to the extent the traditional mandatory/discretionary principle was modified by the Appellate Body in *US Corrosion-Resistant Steel*, those modifications have any impact on Brazil's claim.

16. Moreover, Brazil does not consider that it is particularly useful to determine whether Brazil's claim is "as applied" or "as such", thus necessitating a determination whether the CCC programmes are "mandatory" or "discretionary". Indeed, the Appellate Body in *US Corrosion-Resistant Steel* stressed that the "import of the 'mandatory/discretionary distinction' may vary from case to case", cautioning "against the application of this distinction in a mechanistic fashion".[23] Item (j) imposes a *sui generis* standard – it calls for an evaluation whether the CCC programmes are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programmes. Brazil has established these elements in two ways. First, using a number of methodologies, Brazil has looked at historical data concerning premiums collected and costs and losses incurred, to establish that costs and losses incurred exceeded premiums collected over a 10-year period.[24] Second, Brazil used statements by USDA's Office of the Inspector General and the US General Accounting Office to establish that premium rates for the CCC programmes, and not just premiums collected, do not and will continue not to meet costs because they do not, and are not adjusted to, offset credit risks, and are, further, capped at one per cent.[25] Given the forward-looking nature of this analysis, Brazil does not agree with the United States that item (j) necessarily "requires a certain retrospection".[26]

**(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"**

[21] *See* Brazil's 2 December 2003 Oral Statement, paras. 90-91; Brazil's November 2003 Further Rebuttal Submission, paras. 258-262.

[22] Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Programme classified as "Mandatory" in Table 2, and in the "Introduction", the Office of Management and Budget states that Table 2 provides "the programme's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory").

[23] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 93.

[24] *See* Brazil's 18 November 2003 Further Rebuttal Submission, paras. 243, 245-253 and the references cited therein.

[25] *See* Brazil's 18 November 2003 Further Rebuttal Submission, para. 252 (and all citations). Given the forward-looking nature of this analysis, Brazil does not agree with the United States that item (j) necessarily "requires a certain retrospection". (US 22 December 2003 Answers to Questions, para. 103).

[26] US 22 December 2003 Answers to Questions, para. 103.

Brazil's Answer

17. The *US – Corrosion-Resistant Steel* decision does not significantly change Brazil's analysis of its serious prejudice or threat of serious prejudice claims. There has never been an issue whether the statutes and regulations providing for the five US subsidies referred to in the Panel's question are "mandatory" – this has been clear from the face of the statutory and regulatory provisions, as set out in Brazil's earlier submissions and even acknowledged by the United States.27 The record establishes that marketing loan, crop insurance, direct and counter-cyclical payments, and Step 2 payments are "mandatory" provisions – payments and expenditures are required to be made by US Government officials to eligible producers, users or exporters.[28]

18. The mandatory nature of the US subsidies is relevant to (a) Brazil's "per se" claims as well as (b) Brazil's threat of serious prejudice claims that do not involve claims regarding the "*per se*" validity of the statutes. The evidence of mandatory (or "normative") measures is a required element for Brazil's "*per se*" claims. And a threat of serious prejudice under Article 6.3 and 5(c) will be more likely to exist if the subsidies are mandatory, i.e., that the subsidies must be paid to eligible producers, exporters, and users. The record demonstrates that there are no provisions in US law limiting the payments, and, thus, limiting the threat of serious prejudice (i.e., significant price suppression, increased world market share for US exports, or inequitable share of world trade). The so-called "circuit-breaker" in the 2002 FSRI Act is not applicable to individual commodities, but instead only to total US AMS.[29] The United States has admitted that there is no provision in US law that stops subsidy payments when serious prejudice is caused to other WTO Members.[30] In particular, there was no flexibility provided to US government officials to limit upland cotton payments at any time during MY 1999-2002. When prices plunged to record lows in MY 2001 and MY 2002, USDA poured funds into sustaining high levels of US upland cotton production and exports. The participants in the world market know this will happen again when prices fall. And world producers, such as those from Brazil, as well as traders discovering prices in the New York futures markets, know that this means that US production and exports will remain high for the remainder of the 2002 FSRI Act.[31]

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[27] *See* Brazil's 9 September 2003 Further Submission, Sections 4.2.1-4.2.5 (summarized in paragraph 423); US 27 October 2003 Answer to Question 162, para 95 ("The statutory authority for marketing loan payments, step 2 payments, and counter-cyclical payments does not provide the Secretary with the authority to arbitrarily decline to make these payments to qualified recipients."); para. 97 ("there is no present limit on the total amount of payments that can be made under each of these programmes although for counter-cyclical payments a maximum total outlay can be calculated using the base acres, base yields, and maximum payment rate for each commodity produced during the historical base period".).

[28] *See* also Brazil's Answer to Question 257(b) below.

[29] US 2 December 2003 Oral Statement para 82. US 22 December 2003 Answer to Question 253, para. 180.

[30] US 22 December 2003 Answer to Question 253, para. 180 (the circuit-breaker provision "does not appear to contemplate any such finding of serious prejudice, but rather is seemingly focused more particularly on the overall level of expenditures as that was the only restriction agreed to in this instance by the United States … ".).

[31] The absence of any "circuit breaker" for upland cotton is significant given the fact that producers of upland cotton received far more per unit and *ad valorem* subsidies than any other US commodity during MY 1999-2002 (Brazil's 9 September 2003 Further Submission, para. 4). No other US crop has a "competitiveness" subsidy such as Step 2, which paid $415 million to US users and exporters of upland cotton in MY 2002. No other US crop had counter-cyclical payments of over $1 billion in MY 2002. No other US crop had such large per unit marketing loan payments during MY 1999-2002. These huge guaranteed payments, along with the *unlimited* amount of upland cotton that can receive benefits from marketing loan, Step 2, and crop insurance subsidies, together with the very high per-acre direct and counter-cyclical payments (compared to other programme crops), together constitutes strong evidence that these measures have not, are not, and will not be applied in the future in a WTO-consistent manner.

19. This permanent threat of serious prejudice is similar to "threat of circumvention" of export subsidy reduction commitments, under Article 10.1 of the Agreement on Agriculture. In US – FSC, the Appellate Body held that the absence of any legal mechanism that can "stem[], or otherwise control[], the flow of"[32] subsidies creates a *threat* of circumvention. Again, as in this dispute, in *US – FSC* and *EC – Sugar Exports*, there was no legal mechanism to limit the amount of potential subsidies that could be paid. The threat was and is tangible

20. The price-trigger mechanism contained in certain of the programmes does not minimize the threat of serious prejudice. In fact, the very existence of the mandatory marketing loan, Step 2 and counter-cyclical payment programme alone impacts farmers' planting decisions. Even when farmers expect market price levels that would not trigger these payments, farmers know that there is a certain likelihood that their expectations will turn out to be wrong and prices will turn out much lower than anticipated. However, history has taught US upland cotton producers to know with certainty that they will not suffer any economic harm from their misperception of prices for the upcoming marketing year. Any downside market revenue risk is covered by the combined effects of the marketing loan and counter-cyclical payment programmes, as well as by the effects of certain crop insurance policies such as revenue insurance. In short, the mandatory US subsidies mean that high US production and exports are guaranteed.

21. Further, these programmes have effects on production decisions of US farmers *via* a second mechanism, as Brazil and Professor Sumner have detailed at the second meeting of the Panel.[33] Even if farmers expect upland cotton prices (cash prices as well as the adjusted world price) to be above the trigger prices for marketing loan, counter-cyclical and Step 2 payments, farmers will expect with a certain likelihood that prices might nevertheless turn out to be below these trigger prices, i.e., farmers have a probability distribution for expected prices. Given this probability distribution, Professor Sumner explained at the second meeting of the Panel that farmers would still expect some payments from these programmes.[34] Thus, these programmes impact farmers planting decisions, increasing and locking in a high US supply of upland cotton that causes adverse effects.

22. Finally, Brazil has demonstrated that the "chilling effect" of guaranteed US subsidies leads to reduced investment of Brazilian farmers in upland cotton production.[35] Indeed, USDA itself acknowledges – with respect to soybeans, but equally applicable to upland cotton – that low international prices have had negative impacts on additional investments and increases in production in Brazil.[36] This "chilling effect" is the result of Brazilian and other countries' farmers' perception of the threat of serious prejudice from the US upland cotton subsidies.

**(iii) the legal standard and elements Brazil sets out to establish its "per se" "serious prejudice" claims (e.g. Brazil's 9 September further submission, para. 417 ff; US oral statement at second Panel meeting, para. 86 ff.)?**

[32] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

[33] *See* Brazil's 2 December 2003 Oral Statement, para. 48 and Exhibit Bra-371 (Simple Example of the Calculation of Expected Marketing Loan Benefit); Brazil's 22 December 2003 Answers to Questions, para. 155.

[34] Exhibit Bra-371 (Simple Example of the Calculation of Expected Marketing Loan Benefit).

[35] Brazil's 9 September 2003 Further Submission, Section 6.3 and Annex III; Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003); Brazil's 18 November 2003 Further Rebuttal Submission, para. 203.

[36] Brazil's 9 September 2003 Further Submission, para. 455 and Exhibit Bra-263 ("Argentina & Brazil Sharpen Their Competitive Edge," USDA, Agricultural Outlook, September 2001, p. 32).

Brazil's Answer

23. As detailed in Brazil's answer to Question 257(a)(ii) and (b), marketing loan, Step 2, crop insurance, direct and counter-cyclical payment subsidies are mandatory within the traditional mandatory/discretionary distinction. Thus, the Appellate Body decision in *US – Corrosion-Resistant Steel* does not affect the legal standard and elements for Brazil's *per se* claims against those subsidy programmes.[37]

**(b) How and to what extent are the legal and regulatory provisions cited in paras. 415 and 423 of Brazil's 9 September further submission "normative" in nature and treated as binding within the US legal system (see, e.g., para. 99 of the Appellate Body Report)? Does your response differ depending on whether the payments are dependent upon market price conditions? BRA**

Brazil's Answer

24. Brazil understands the ordinary meaning of "normative" to be "establishing a norm or standard of; deriving from or implying a standard or norm; prescriptive".[38] In the sense of the term used by the Appellate Body in *US – Corrosion-Resistant Steel*, the US statutes and regulations summarized in paragraphs 415 and 423 of Brazil's 9 September Further Submission[39] are "normative" because they establish (a) obligations for US officials to make payments, and (b) legal rights for eligible producers, users, and exporters to receive the payments. As used by the Appellate Body, the term "normative" includes as a subcategory the group of measures that are mandatory, within the meaning of the traditional mandatory/discretionary distinction.

25. The United States has acknowledged that the "statutory authority for marketing loan payments, step 2 payments, and counter-cyclical payments does not provide the Secretary with the authority to arbitrarily decline to make these payments to qualified recipients".[40] In addition, the direct payment provisions of the 2002 FSRI Act similarly provide that "payment [is] required" and the "Secretary shall make direct payments to producers on farms for which payment yields and base acres are established".[41] Finally, the crop insurance payment provisions of the 2000 ARP Act also create "norms" in the form of mandated payments of subsidies for "catastrophic risk protection" and "alternative catastrophic coverage" that "shall" be provided to all eligible producers.[42] Thus, the statutory and regulatory provisions mandating payments for each of these five types of subsidies are, by any reasonable definition, "normative" measures.

26. The Panel asks further whether Brazil's response differs depending on whether the payments are dependent upon market price conditions. The answer is "no".

27. As Brazil has argued before, the fact that marketing loan, counter-cyclical and Step 2 payments may not be made due to higher prices does not mean that these subsidy programmes are not mandatory.[43] The focus for deciding whether a measure is mandatory or discretionary is on whether it

[37] While a *per se* claims against non-mandatory measures under Article 5(c) and footnote 13 of the SCM Agreement seems possible, the Panel is not faced with such a situation in this case, as all the measures challenged by Brazil are, in fact, of a mandatory nature.

[38] New Shorter Oxford Dictionary, 1993 edition, p. 1941.

[39] Each of these statutory and regulatory provisions were discussed in more detail in paragraphs 312-341 of Brazil's 9 September 2003 Further Submission.

[40] US 27 October 2003 Answer to Question 162, para 95.

[41] Brazil's 9 September 2003 Further Submission, para. 333 citing Section 1103(a) of the 2002 FSRI Act.

[42] Brazil's 9 September 2003 Further Submission, para. 319 citing Section 508(b)(1), (2), and 508(c)(1)(A) of the 2000 ARP Act.

[43] Brazil's 7 October 2003 Oral Statement, paras. 50-51.

provides government officials with the discretion to implement the measure in a WTO-consistent manner.[44] But the terms of the statutes/regulations provide no discretion or flexibility to any US Government official when low prices trigger the required marketing loan and counter-cyclical payments or when high prices lead payments to phase out temporarily. Rather, price levels are an eligibility condition for payment, similar to conditioning eligibility of a producer for contract payments on his not growing fruits and vegetables.

28. Objective conditions, such as market price movements, or objective eligibility criteria are not appropriately considered in determining whether a measure gives an implementing official "discretion" to act in a WTO-consistent fashion. For example, the FSC measure payments were only available where the income concerned was of foreign origin. Despite the fact that non-foreign sourced income would thus be excluded from FSC benefits, the measure was still found to threaten the circumvention of export subsidy requirements. Similarly, Step 2 payments are only available if an exporter is regularly engaged in the business of exporting upland cotton. The fact that a USDA official cannot legally make a Step 2 payment to a non-eligible exporter does not make the Step 2 programme "discretionary". And the fact that no marketing loan payments are available for upland cotton when the adjusted world price exceeds 52 cents per pound does not mean that the billions of dollars of payments made during MY 1999-2002, when prices were below that level, were "discretionary".

29. The United States argues that measures are "discretionary" if there are any conditions attached to payments – regardless of whether the executive official is permitted to exercise any discretion in refusing to make the payment. Such an interpretation would read out any meaning to the "mandatory/discretionary" distinction. Of course, at some level of abstraction, it is possible to create scenarios under which subsidies might not be paid. For example, the US Congress could decide to impose actual limits on CCC funding or change the 2002 FSRI Act to include a cotton "circuit-breaker" provision to limit cotton payments. But these theoretical possibilities do not make the existing mandatory text of the 2002 FSRI and 2000 ARP Act discretionary.

30. However, even if these existing texts were not mandatory on their face (which they are), the *US – Corrosion-Resistant Steel* decision teaches that the Panel must give weight to the long-term application of the measure to determine its normative character. The fact that billions of dollars in marketing loan, Step 2, counter-cyclical and direct payment were paid to US upland cotton producers, users and exporters of upland cotton over the past four years is highly relevant evidence for that determination. So is the fact that billions more will be paid before the 2002 FSRI ends in MY 2007. The provisions of these programmes have never been applied in a "discretionary" manner. Not a single eligible upland cotton farmer, user or exporter has been denied payment under these programmes by USDA officials. This is because there is simply no discretion vested in any US official to decide, independent of any objective market conditions or eligibility criteria, not to make these payments. Therefore, they are mandatory within the meaning WTO/GATT precedent, including the *US – Corrosion-Resistant Steel* decision.

**(c) Does Brazil challenge as "mandatory" the "subsidies" themselves, the subsidy programmes or the legal/regulatory provisions for the grant or maintenance of those subsidies, or something else? BRA**

Brazil's Answer

31. With respect to the Panel's question, Brazil does not believe that there is any difference between the "subsidy programmes" and the "legal/regulatory provisions" for the grant or maintenance of the subsidies.

[44] Appellate Body Report, *US – 1916 Act*, WT/DS132/AB/R, para. 100.

32. With respect to Brazil's "*per se*" claim, it challenges as "mandatory" the legal/regulatory provisions for the grant or maintenance of the subsidies.[45]

33. Brazil's "threat of serious prejudice" claim also challenges as "mandatory" the legal/regulatory provisions for the grant or maintenance of the subsidies. However, in this claim Brazil is not challenging the text of these provisions in the traditional "*per se*" sense, but rather under the rationale of the *EC – Sugar Exports* precedent. Under this claim, the mandatory nature of the largely unlimited subsidies required to be provided in MY 2003-2007 under the 2002 FSRI Act and the 2000 ARP Act (and implementing regulations) is key evidence demonstrating an ongoing, significant threat of significant price suppression and increased and inequitable US world market shares in the period MY 2003-2007.

34. In Brazil's view, a "threat of serious prejudice" claim is, in the Panel's word, "something else" – a *sui generis* claim. Brazil considers that the Appellate Body was advising against slavish adherence to the "*per se*" and "as applied" labels – intimately related to the traditional mandatory/discretionary distinction – when it cautioned in *US – Corrosion Resistant Steel* "against the application of this distinction in a mechanistic fashion".[46] If a claimant proves the elements of a threat claim, as set out in *EC – Sugar Exports* and *US – FSC*, it succeeds on the merits, regardless whether the claim is labelled "*per se*" or "as applied" – terms which are not themselves found in Part III of the SCM Agreement.

35. In the case of a "threat" claim, this note of caution is particularly apt. In proving its threat of serious prejudice claim, Brazil has followed the rationale in *EC – Sugar Exports* and *US – FSC*, demonstrating the "mandatory" nature of the legal/regulatory instruments by which the subsidies are paid, together with the unlimited amount of products that may receive the subsidies, and the extent to which those legal/regulatory instruments fail to stem or control the flow of the subsidies.[47] Brazil has backed up this evidence with historical data regarding the unlimited way in which the legal/regulatory instruments have been applied to grant payments to US upland cotton farmers during the period MY 1999-2002.

36. This data gives context to the nature and extent of the threat posed by the mandatory legal/regulatory instruments at hand. The data is critical, because it demonstrates that even if the measures are not mandatory (which they are), the US authorities have always applied the measures in a way that would cause serious prejudice. Since payments have never been withheld, the data demonstrates, at the very least, that the US authorities treat the measures as "normative", as that term was used by the Appellate Body in *US – Corrosion Resistant Steel*.[48]

37. Brazil turns now to its claims regarding the three CCC export credit guarantee programmes. As discussed in Brazil's response to question 257(a)(i), Article 10.1 prohibits circumvention, and the threat of circumvention, of export subsidy reduction commitments. As discussed above, Brazil has demonstrated actual circumvention with respect to both unscheduled products and at least one scheduled product. This is somewhat akin to an "as applied" claim against guarantees issued under the CCC programmes. It is therefore not relevant to this claim whether the CCC programmes are mandatory or discretionary.

38. Brazil has also demonstrated that the three CCC programmes pose a threat of circumvention. Brazil's threat of circumvention claims are against the programmes as such. With respect to unscheduled products, it constitutes threat of circumvention to provide *any* export subsidies for

[45] Brazil's 9 September 2003 Further Submission, paras. 422-423.
[46] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 93.
[47] Brazil refers the Panel to the additional discussion regarding the mandatory nature of the US measures and Brazil's threat of serious prejudice claim in its Answer to Question 257(a)(ii) *supra*.
[48] Appellate Body Report, *US – Corrosion-Resistant Steel*, WT/DS244/AB/R, para. 93.

unscheduled products. Under *US – FSC*, it does not appear to be relevant to this claim whether the CCC programmes are mandatory or discretionary. With respect to unscheduled products, the test under Article 10.1 is whether export subsidies are made available to those products. With respect to scheduled products, the test under Article 10.1 is also not whether the CCC programmes are "mandatory" as opposed to "discretionary". Rather, the question set out in *US – FSC* is whether the CCC can "stem[], or otherwise control[], the flow of" CCC export credit guarantees. Brazil has demonstrated that CCC cannot do so.

39. Brazil turns now to its claims under Articles 1.1 and 3.1(a) of the SCM Agreement, which are against the CCC programmes themselves. Brazil has demonstrated that the CCC programmes confer "benefits" *per se*, within the meaning of Article 1.1(b) of the SCM Agreement (as well as that they are financial contributions and are *de jure* contingent on export). Brazil has demonstrated that every time a CCC guarantee is issued, a benefit is conferred *per se*. This is effectively the equivalent of saying that the CCC programmes themselves "mandate" a violation, under the traditional meaning of the mandatory/discretionary principle.

40. Finally, Brazil's claims under item (j) of the Illustrative List of Export Subsidies are both against guarantees granted under the three CCC programmes, and against the CCC programmes themselves. First, Brazil has demonstrated that, retrospectively, costs and losses incurred by the programmes exceeded premiums collected over a 10-year period. This is somewhat akin to an "as applied" claim against guarantees issued under the CCC programmes. It is therefore not relevant to this claim whether the CCC programmes are mandatory or discretionary. Second, Brazil has demonstrated that, looking forward, premium rates for the CCC programmes, and not just premiums collected, do not and will continue not to meet costs because they do not, and are not adjusted to, offset credit risks, and are, further, capped at one percent.[49] As statements by USDA's Office of the Inspector General and the US General Accounting Office demonstrate, the CCC programmes do not have the flexibility under US law to offset credit risks and meet costs. This is effectively the equivalent of saying that the CCC programmes themselves "mandate" a violation, under the traditional meaning of the mandatory/discretionary principle.

**(d) Does the "requirement" upon the CCC to make available "not less than" $5.5 billion annually in guarantees have a normative character and operation? (see, e.g. Brazil's response to Panel Question 142; Exhibit BRA-297, 7 USC 5641(b)(1); 7 USC 5622(a) & (b); paragraph 201 of US 18 November further rebuttal submissions). Is this requirement "mandatory"? If so, how does the CCC have "discretion" not to make this amount of guarantees available in a given year? USA**

Brazil's Comment

41. Brazil offered the evidence mentioned by the Panel (as well as evidence regarding CCC's obligation to make available an additional annual amount of at least $1 billion in direct credits or guarantees for exports to "emerging markets"[50]) to demonstrate, with respect to scheduled products, its threat of circumvention claim under Article 10.1 of the Agreement on Agriculture. Brazil has already noted that the test under Article 10.1 is not whether the CCC programmes are "mandatory" as opposed to "discretionary". Rather, to determine whether CCC export credit guarantees for scheduled

[49] For this reason, Brazil does not agree with the United States that an item (j) analysis necessarily "requires a certain retrospection" (US 22 December 2003 Answers to Questions, para. 102).

[50] *See* Exhibit Bra-366 (7 U.S.C. § 5622 note, "Promotion of Agricultural Exports to Emerging Markets, para. (a) ("The Commodity Credit Corporation shall make available for fiscal years 1996 through 2002 not less than $1,000,000,000 of direct credits or export credit guarantees for exports to emerging markets under section 201 or 202 of the Agricultural Trade Act of 1978 (7 U.S.C. 5621 and 5622), in addition to the amounts acquired or authorized under section 211 of the Act (7 U.S.C. 5641) for the programme.")). *See also* Exhibit Bra-367 (Section 3203 of the 2002 FSRI Act (extending mandate to 2007)).

products threaten to lead to circumvention of the US export subsidy reduction commitments, the test set out by the Appellate Body in *US – FSC* is whether the CCC can "stem[], or otherwise control[], the flow of" CCC export credit guarantees. Brazil has demonstrated that CCC cannot do so.

**(e) Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (e.g. Exhibit BRA-117 (2 USC 661(c)(2))? USA**

Brazil's Comment

42. As noted in Brazil's response to question 257(a)(i), Brazil has provided evidence that the CCC programmes are "mandatory," within the meaning of that term under US law (although that is not to say that the CCC programmes are not also mandatory, within the meaning of WTO/GATT law).

**258. Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks. BRA**

Brazil's Answer

43. Brazil appreciates the opportunity to describe to the Panel the methodology that it will apply to the data, should the United States produce it on 20 January 2004. As the Panel noted in its 12 January Communication, the United States failed on 18/19 December 2003 to comply with its obligation to provide the requested data in a non-"scrambled" form. Therefore, Brazil is not in a position to apply the methodology discussed below and to present its results to the Panel today. If the United States does not produce non-scrambled and otherwise complete data responsive to the Panel's request, on 28 January 2004, Brazil will provide further comments and make requests as appropriate.

44. Generally, Brazil's methodology will calculate the amount of expenditures that support upland cotton production by examining farm-specific contract and planted acreage data. For each of these farms, Brazil would calculate the amount of contract payments for each crop for which the upland cotton farm has base acreage.[51] To that end, for each crop, the amount of contract payment units (as provided by the United States[52]) would be multiplied by the payment rate for the subsidy programme (PFC, market loss assistance, direct and counter-cyclical payments) in the marketing year in question.[53] Brazil will allocate crop contract payments to the respective crop for which they are made for each farm, up to the amount of acreage actually planted to that crop. For example, any contract payment for an upland cotton base acre that is actually planted to upland cotton is deemed

[51] These crops include all crops that constitute programme crops for purposes of the PFC, market loss assistance, direct and counter-cyclical payment programmes.

[52] In case the United States does not provide the payments units with its 20 January 2004 data, they can be easily calculated by multiplying the contract acreage for a crop with the payment yield for that crop. The payments units are calculated as 85 percent of that figure.

[53] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19 provides payment rates for PFC, direct and counter-cyclical payments in a column called "income support rates" for marketing years 1999-2002. However, rice payments for MY 2002 appear to be reported in error, since no rice counter-cyclical payments were made. In fact, the full rice counter-cyclical payment was made in MY 2002 (*see* Exhibit Bra-173 (Revised Estimate of Support Granted by Commodity via Counter-Cyclical Payments)). The full rice CCP is $1.65 (*see* Exhibit Bra-27 ("Side by Side Comparison of the 1996 and 2002 Farm Act, p. 2-5) report the rice target price as $10.50 per cwt, the direct payment rate as $2.35 per cwt and the loan rate as $6.50 per cwt, resulting in a full CCP payment of $1.65 per cwt or $0.00748 per pound).

support to upland cotton. If non-upland cotton base acres on a farm are planted to upland cotton, payments made for these base acres would also be deemed to constitute support to upland cotton.

45. Application of Brazil's methodology would require the writing of a simple computer programme that calculates the contract payments that constitute support to upland cotton for any farm in the United States that receives contract payments and plants upland cotton. The individual farm data would then be tabulated to calculate a total amount of expenditures provided in support of the production of upland cotton.

46. Brazil provides below additional details concerning its methodology. The data that has been withheld by the United States will show farms with many different combinations of base acreage and upland cotton plantings. There may be farms with more upland cotton base acres than planted acres, or with less base acres than planted acres. There may be farms that plant only upland cotton, or farms that have other programme crops as well. Finally, farms may have more or less crop base acreage than they plant to programme crops. Brazil systematically presents below a number of sample farms and illustrates how its allocation methodology will be applied to the actual data for each type of farms.

47. In a first step, Brazil considers three general categories of upland cotton farms: (1) those with fewer planted upland cotton acres than upland cotton base acres, (2) those with more planted upland cotton acres than upland cotton base acres, and (3) those planting cotton without any upland cotton base acres.[54] The table below illustrates this for the three categories of farms:

| Sample Farm No. | Farm 1 | Farm 2 | Farm 3 |
|---|---|---|---|
| Type of Cotton Farm | Farm With Cotton Plantings Below Cotton Base | Farm With Cotton Plantings Exceeding Cotton Base | Farm With Cotton Plantings But No Cotton Base |
| Cotton Base | 100 acres | 100 acres | 0 acres |
| Cotton Plantings | 50 acres | 150 acres | 100 acres |
| Payments Allocated In A First Step | Payments for 50 Cotton Base Acres | Payments for 100 Cotton Base Acres | No Payments for Cotton Base Acres |

Sample Farm 1 plants 50 acres of its 100 upland cotton base acres to upland cotton. Thus, any payments for these 50 upland cotton base acres constitute support to upland cotton.[55] Since contract payments for all acres planted to upland cotton are allocated therewith, the calculation ends for this farm (and any farm in a similar position). Any payments associated with the other 50 upland cotton base acres are not considered, as they do not constitute support to upland cotton. Sample Farm 2 plants 150 acres of upland cotton, but has only 100 acres of upland cotton base. The entire upland cotton base payments, therefore, constitute support to upland cotton. Sample Farm 3 plants 100 acres of upland cotton, but has no upland cotton base. No upland cotton base payments can be allocated in this case. Thus, in this overly simple methodology, support to upland cotton would be calculated only by adding up the amount of upland cotton payments received on land that currently produces upland cotton. However, Brazil believes the Panel should also include as support to upland cotton contract payments on non-upland cotton base acreage that is currently planted to upland cotton. For example, for Sample Farms 2 and 3 above, for which payments for less upland cotton acres than actually planted were allocated in this first step, additional contract payments made for other contract crop base could be allocated as support to upland cotton in a second step, provided they are available on

[54] In later steps, Brazil will discuss what happens when the farms have other crop contract payment base and how this may be allocated.

[55] The amount payments results from multiplying the payment rate for the contract crop, including for upland cotton, by the amount of base acres involved. The respective contract payment amounts to 85 per cent of this figure. Payment rates are published by USDA, *see* Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

the farm. These additionally allocated contract payments stem from contract payments made for other crops and not allocated to these other crops.

48. However, as with upland cotton contract payments, any contract payments for other crop base would be primarily assigned as support to the production of those crops. As with upland cotton contract payments, any other programme crop base payments are treated as support to those crops up to the amount of base acreage that is actually planted to the respective programme crop. Payments on any further base acreage for those programme crops are allocated to the crops for which planted acres exceed base acres. The following table illustrates this for Sample Farm 4:

| Sample Farm 4 | | | |
|---|---|---|---|
| Crop | Cotton | Rice | Corn |
| Crop Base | 100 acres | 100 acres | 100 acres |
| Crop Plantings | 160 acres | 40 acres | 100 acres |
| Crop Base Allocated as Support for the Crop in Question | 100 acres | 40 acres | 100 acres |
| Remaining Crop Base Available for Allocation | 0 acres | 60 acres | 0 acres |
| Crop Plantings To Which Additional Payments Will Be Allocated | 60 rice acres | 0 acres | 0 acres |

Sample Farm 4 plants three crops (upland cotton, rice and corn) having 100 base acres for each crop. All 100 corn base acres are planted to corn and, thus, any corn contract payments made for the corn base constitute support to corn. However, only 40 of the 100 rice base acres are planted to rice and, consequently, only payments for those 40 rice base acres constitute support to rice. Sample Farm 4 plants 160 acres of upland cotton, but has only 100 upland cotton base acres. Thus, all payments on the entire 100 upland cotton base acres represent support to cotton. In addition, payments for the 60 rice base acres not planted to rice but to upland cotton also represent support to upland cotton.

49. Sample Farm 4 was a farm for which the total base acreage and the total acreage planted to programme crops were equal. However, there may be instances in which farms plant more (or less) acreage to programme crops than they used to do in the past establishing their base acreage.

50. The following two tables explain how Brazil's methodology addresses the issue of farms that plant more acreage to programme crops than they have base acreage (Sample Farm 5) and farms that plant less acreage to programme crops than they have base acreage (Sample Farm 6).[56] In Brazil's methodology, payments available for allocation – i.e., not allocated to the programme crop itself – are pooled and allocated proportionally to the remaining programme crop acreage.[57] Brazil's approach of pooling payments from additional base acres not planted to the respective programme crop and allocating these payments proportionally as support to crops, for which plantings exceeds base acreage, ensures that a single dollar is not allocated to two different crops, resulting in double

[56] Brazil exemplifies the principle for farms with less upland cotton base than upland cotton plantings, but the same principle applies to farms without any upland cotton base.

[57] Since the United States has not provided the data necessary to do this allocation, Brazil has no information on how often such situations actually occur. However, the record strongly suggests that not many farms would be able to plant more program crops than they have base acreage. In particular for upland cotton, Brazil has demonstrated that it is not economically possible to produce this crop without contract payments. *See inter alia* Brazil's 2 December 2003 Oral Statement, paras. 26-27 and Exhibit Bra-353 (Cumulative Loss From Upland Cotton Production MY 1997-2002 Without Contract Payments).

counting.[58] It also ensures that each contract payment dollar is allocated to a programme crop, as exemplified by the calculations for Sample Farms 5 and 6 below.

51. The first table shows the allocation of contract payments on Sample Farm 5, a farm with fewer planted (370 acres) than base acres (400 acres).

| Sample Farm 5 | | | | |
|---|---|---|---|---|
| Crop | Cotton | Corn | Wheat | Rice |
| Crop Base | 100 acres | 100 acres | 100 acres | 100 acres |
| Crop Plantings | 140 acres | 120 acres | 40 acres | 70 acres |
| Crop Base Allocated as Support for the Crop in Question | 100 acres | 100 acres | 40 acres | 70 acres |
| Remaining Crop Base Available for Allocation | 0 acres | 0 acres | 60 acres | 30 acres |
| Crop Plantings To Which Additional Payments Will Be Allocated | 40 acres | 20 acres | 0 acres | 0 acres |
| Pooled Available Crop Base | 60 Wheat Base Acres and 30 Rice Base Acres | | | |
| Allocated Share of Payments on Pooled Crop Base | 40/60th or 2/3rd | 20/60th or 1/3rd | 0 | 0 |
| Allocation | 100 Cotton Base Acres and 2/3rd of 60 Wheat and 30 Rice Base Acres (40 and 20) | 100 Corn Base Acres and 1/3rd of 60 Wheat and 30 Rice Base Acres (20 and 10) | 70 Wheat Base Acres | 30 $rice Base Acres |

52. The second table shows the allocation of contract payments on Sample Farm 6, a farm with more planted (410 acres) than base acres (400 acres).

[58] The United States alleges that Brazil's 14/16th methodology would allocate the same contract payments to two different crops resulting in double counting (*see e.g.* US 2 December 2003 Oral Statement, para. 27). The US claim about double counting by Brazil originates in an entirely erroneous understanding of Brazil's 14/16th methodology. As explained many times, Brazil used this methodology only as a proxy, since the United States refused to provide the very data that would allow the calculation of the exact amount of support to upland cotton from contract payments. It makes the assumption that for any acre planted to upland cotton an average contract payment in the amount of an upland cotton contract payment is received.

| Sample Farm 6 | | | | |
|---|---|---|---|---|
| Crop | Cotton | Corn | Wheat | Rice |
| Crop Base | 100 acres | 100 acres | 100 acres | 100 acres |
| Crop Plantingq | 125 acres | 125 acres | 80 acres | 80 acres |
| Crop Base Allocated as Support for the Crop in Question | 100 acres | 100 acres | 80 acres | 80 acres |
| Remaining Crop Base Available for Allocation | 0 acres | 0 acres | 20 acres | 20 acres |
| Crop Plantings To Which Additional Payments Will Be Allocated | 25 acres | 25 acres | 0 acres | 0 acres |
| Pooled Available Crop Base | 20 Wheat Base Acres and 20 Rice Base Acres | | | |
| Allocation | 100 Cotton Base Acres and 1/2 of 20 Wheat and 20 Rice Base Acres (10 and 10) | 100 Corn Base Acres and 1/2 of 20 Wheat and 20 Rice Base Acres (10 and 10) | 80 Wheat Base Acres | 30 Rice Base Acres |

53. In both cases, the contract payments on wheat and rice base acres that are not allocated to production of these crops (as current plantings are below the base acreage) are pooled. The resulting amount of contract payments is distributed as support to upland cotton and corn with the share of both crops corresponding to the ratio of plantings to which additional payments are allocated.[59]

54. This same principle would be applied for farms that have *no upland cotton base acreage*. For these farms, contract payments would be allocated to upland cotton solely from the pool of payments made on crop base not planted to the respective programme crop. This is illustrated in the table below (Sample Farm 7).

| Sample Farm 7 | | | |
|---|---|---|---|
| Crop | Cotton | Rice | Corn |
| Crop Base | 0 acres | 100 acres | 100 acres |
| Crop Plantings | 100 acres | 50 acres | 50 acres |
| Crop Base Allocated as Support for the Crop in Question | 0 acres | 50 acres | 50 acres |
| Remaining Crop Base Available for Allocation | 0 acres | 50 acres | 50 acres |
| Pooled Available Crop Base | 50 Rice Base Acres and 50 Corn Base Acres | | |
| Crop Plantings To Which Additional Payments Will Be Allocated | 50 Rice Base Acres and 50 Corn Base Acre | 0 acres | 0 acres |

[59] Additional payments will only be allocated to planted crop acres exceeding the amount of base acreage.

55. For Sample Farm 7 with no upland cotton base but 100 acres of upland cotton plantings, contract payments would be allocated from the rice and corn base not allocated to these crops. In this case payments on 50 rice and 50 corn base acres are allocated to upland cotton. On average, the per-acre payment from those crop base acres is similar to the amount of upland cotton base acre payments.

# ANNEX I-11

## ANSWERS OF THE UNITED STATES TO FURTHER QUESTIONS FROM THE PANEL TO THE PARTIES FOLLOWING THE SECOND PANEL MEETING

20 January 2004

**257. The Panel takes note of the Appellate Body Report in United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.**

**(d) Does the "requirement" upon the CCC to make available "not less than" $5.5 billion annually in guarantees have a normative character and operation? (see, e.g. Brazil's response to Panel Question 142; Exhibit BRA-297, 7 USC 5641(b)(1); 7 USC 5622(a) & (b); paragraph 201 of US 18 November further rebuttal submissions). Is this requirement "mandatory"? If so, how does the CCC have "discretion" not to make this amount of guarantees available in a given year? USA**

1. With respect to the Panel's first question, the United States notes that the Appellate Body's discussion of the "normative character and operation" of an instrument came in the context of its explanation of how to determine whether an instrument is a "measure" subject to challenge in dispute settlement and that the Appellate Body distinguished this question from the separate question of whether the instrument, if a measure, mandates a breach of a WTO obligation under a "mandatory/discretionary" analysis.[1] The Appellate Body explicitly noted that it was not undertaking a comprehensive examination of the relevance or significance of that analysis and, indeed, simply applied it.[2] An analysis of the normative character and operation of this "requirement" to make available not less than $5.5 billion in guarantees is not necessary because the parties do not dispute whether the "requirement" is a "measure."

2. Under a "mandatory/discretionary" analysis, the relevant question would be not whether the requirement to make available $5.5 billion in guarantees per year is as such inconsistent with a provision of the WTO agreements (since Brazil has not claimed that it is), but rather whether the provisions establishing the export credit guarantee programmes mandate a breach of any WTO obligation. As we have explained, they do not. As an initial matter, the requirement that the CCC "make available . . . not less than $5,500,000,000 in credit guarantees" does not mandate that the CCC actually issue any particular level of credit guarantees.[3] This law merely requires that CCC "make available" certain guarantees; the actual issuance of guarantees, however, is within the discretion of the Commodity Credit Corporation, which "may guarantee the repayment of credit made available to

[1] Appellate Body report, *United States - Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan ("US -Sunset Review)*, WT/DS244/AB/R, adopted 9 January 2004, paras. 78, 81-82, 89, and 93.

[2] *US Sunset Review*, paras. 93, 156, and 172-174.

[3] As the United States has previously noted, except for programme year 1992, CCC has *never* issued $5.5 billion in guarantees in any year during the period 1992 to the present. Sales registrations have been as low as $2.876 billion for programme year 1997 and have generally hovered in the range of $3.0 billion - $3.2 billion. Further Rebuttal Submission of the United States (18 November 2003), para. 201; US Further Submission (30 September 2003), para. 148 and accompanying table entitled CCC Export Credit Guarantee Program Levels, Annual President's Budgets and Actual Sales Registrations, Fiscal Years 1992-2004.

finance commercial export sales of agricultural commodities".[4] The statute makes clear that "[e]xport credit guarantees issued pursuant to this section shall contain such terms and conditions as the Commodity Credit Corporation determines to be necessary".[5]

3. The United States has elsewhere noted the various discretionary elements in the operation of the programme that tamp down the actual issuance of guarantees. These include the regulatory authorities permitting non-issuance of guarantees with respect to any individual application for an export credit guarantee or to suspend the issuance of export credit guarantees under any particular allocation; limitations on commodities with respect to which guarantees may be made available, total guarantee value for individual commodities, destination, time within which export must occur, and internally established exposure limits applicable to individual bank obligors.[6]

4. Furthermore, and more importantly, Brazil's own approach would require a showing that the programmes mandate that the premium rates will be insufficient to cover long-term operating costs and losses of the programmes. Brazil has not made such a showing, for the simple reason that the programmes do not so mandate. The Commodity Credit Corporation ("CCC") has discretion concerning numerous aspects of any guarantees it may issue, such as the destinations, types of commodities, and length of term of the guarantee. All of these aspects could affect the question of the long-term operating costs and losses of the programmes. For example, the credit risk involved in some destinations may be less than for others. Similarly, the risk associated with a guarantee of credit extended for one year may be less than for credit extended for three years.

5. Thus, while the provisions establishing the export credit guarantee programmes are measures, they do not mandate an inconsistency with any WTO obligation. Putting aside the US argument that export credit guarantees are not subject to export subsidy disciplines by virtue of Article 10.2 of the Agreement on Agriculture until Members conclude their ongoing negotiations and agree on such disciplines, there is no basis to presume, on the basis of the law itself, that the export credit guarantee programmes provide export subsidies and threaten to lead to circumvention of US export subsidy reduction commitments.[7] Because the CCC retains the discretion to issue particular guarantees and attach terms and conditions as set out above, the statute alone does not allow a presumption that premium rates will be insufficient to cover long-term operating costs and losses of the programmes. Thus, Brazil's argument that the CCC is mandated to "make available" $5.5 billion in export credit guarantees cannot alter the fact that the CCC has discretion to control the guarantees actually provided and the terms of those guarantees; as a result, no WTO inconsistency is mandated.

**(e) Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (e.g. Exhibit BRA-117 (2 USC 661(c)(2))? USA**

6. The Budget Enforcement Act of 1990 ("BEA") divides spending into two types: "discretionary" spending and "direct" spending.[8] "Discretionary" spending means budget authority

[4] 7 U.S.C. 5622(a)(1), (b); *see also id.* 5622(k) (imposing requirement that certain percentages "of the total amount of credit guarantees *issued* for a fiscal year [be] *issued*," not merely made available, with respect to certain products) (italics added).

[5] 7 U.S.C. 5622(g).

[6] US First Written Submission (11 July 2003), fn. 134; 7 C.F.R. Sections 1493.10(d), 1493.40(b) (Exhibit US-6); US Answer to Panel Question 5 (11 August 2003), para. 12 (Exhibit US-12); US Rebuttal Submission (22 August 2003), paras. 180-182; US Further Submission (30 September 2003), paras. 153-156; US Answer to Panel Question 142 (27 October 2003), paras. 56-57.

[7] *See* Brazil's Answer to Question 142 from the Panel, para. 88 (27 October 2003).

[8] *See* OMB Circular A-11 (2003), Section 15: Basic Budget Laws (available at: http://www.whitehouse.gov/ omb/circulars/a11/current_year/s15.pdf).

controlled by annual appropriations acts and the outlays that result from that budget authority. "Direct" spending (commonly referred to as "mandatory" spending)[9] means budget authority and outlays resulting from permanent laws as well as "entitlement authority".[10] That is, whether spending is "mandatory" for purposes of the BEA is an accounting classification issue and does not control whether a measure is "mandatory" for a mandatory / discretionary analysis for WTO purposes.

7. The Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" because the "budget authority is provided by law other than appropriation Acts".[11] As a result, although the export credit guarantee programmes are exempt from the ordinary requirement that budget authority be provided in advance through annual appropriations acts, they remain subject to the continuing availability of budget authority in law other than annual appropriations legislation. Of note, the Office of Management and Budget has also recognized: "While mandatory and discretionary classifications are used for measuring compliance with the BEA, *they do not determine whether a programme provides legal entitlement to a payment or benefit*"[12] (italics added). Thus, the classification of these programmes as "mandatory" for purposes of the BEA merely means that the budget authority is not "discretionary", that is, "provided in appropriation Acts".[13] This accounting classification does not alter CCC's considerable discretion in operating the programmes, as explained in more detail in the US answer to Question 257(d), and does not make the programmes "mandatory" for purposes of a mandatory/discretionary analysis.

[9] See OMB Circular A-11 (2003), Section 20: Terms and Concepts (available at: http://www.whitehouse.gov/omb/circulars/a11/current_year/s20.pdf).

[10] This distinction between discretionary spending, mandatory direct spending and mandatory entitlement spending is reflected in the applicable statutory definitions. 2 U.S.C. Section 900(7) and 900(8) provide:

"(7) The term 'discretionary appropriations' means budgetary resources (except to fund direct-spending programmes) provided in appropriation Acts.

"(8) The term 'direct spending' means—
(A) budget authority provided by law other than appropriation Acts;
(B) entitlement authority; and
(C) the food stamp programme

[11] 2 U.S.C. 900(8).

[12] OMB Circular A-11 (2003), Section 20.9 (emphasis added).

[13] 2 U.S.C. 900(7).

# ANNEX I-12

## BRAZIL'S COMMENTS ON THE 22 DECEMBER US COMMENTS CONCERNING BRAZIL'S ECONOMETRIC MODEL

20 January 2004

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## I. BRAZIL'S INTRODUCTORY COMMENTS

1. Brazil's response to the US 22 December 2003 Comments Concerning Brazil's Econometric Model ("US Critique") is divided into two parts. First, Brazil provides some introductory comments setting the US Critique into perspective. And, second, Brazil offers Professor Sumner's detailed response to the US critique.

2. The United States Critique initially focuses on proving a point that has never been contested by Brazil, i.e., that the Sumner model is not exactly like the FAPRI model. As Professor Sumner points out, he never claimed that his model was identical to the FAPRI model. The United States points to no contradictions between what Professor Babcock has stated and what Professor Sumner stated in Annex I or his other statements concerning the links between his model and the FAPRI model. Nevertheless, while there are differences between the Sumner model and the FAPRI model, the record is undisputed that the core elements of the FAPRI model – the hundreds of demand and supply equations – are identical. The differences in Professor Sumner's model are primarily the result of his use of the CARD international cotton model and additions to the FAPRI model made by Professor Sumner. The additions were necessary to enable the FAPRI/CARD modelling framework to respond to the questions before this Panel.

3. The United States Critique asserts that Professor Sumner's choice of baselines has prejudiced the outcome to such an extent that his results are not usable.[1] But the record shows that the significant acreage, production, export and price effects found in Professor Sumner's Annex I results using the CARD international cotton model and the amended FAPRI US crops model based off the (recalibrated) FAPRI preliminary November 2002 baseline are essentially the same even when used against other baselines.[2] The United States first argued that Professor Sumner should have used the FAPRI 2003 baseline.[3] Professor Sumner responded by running his model on that later baseline.[4] There were no significant changes between Annex I and those results for either the period from MY 1999-2002 or in the period from MY 2003-2007.[5] The United States Critique raises a new argument that Professor Sumner manipulated the FAPRI preliminary November 2002 baseline.[6] This allegation is wrong. Any differences are the result of a necessary recalibration of the model following the use of the CARD international cotton model rather than the FAPRI international crops models and some update incorporating more recent macroeconomic data.[7] As Professor Sumner demonstrates below, there are no significant differences with his Annex I result by using this slightly modified baseline.[8] Indeed, the fact that Professor Sumner's simulation model generates nearly identical results regardless of the baselines used demonstrates the robustness of the Sumner model.

4. In criticizing Professor Sumner's modelling of the four different types of contract payments, the United States repeats its baseless arguments that the contract payments have absolutely no effect on production decisions for upland cotton. The notion that an estimated[9] $4.7 billion[10] of amber box

[1] US 22 December 2003 Comments on Brazil's Econometric Model, paras. 35-38, especially para. 38.

[2] These other baselines include the original FAPRI preliminary November 2002 baseline and the official FAPRI January 2003 baseline.

[3] US 7 October 2003 Oral Statement, paras. 36-39.

[4] Exhibit Bra-325 (Results of Professor Sumner's Modified Model Based on the January 2003 FAPRI baseline); Exhibit Bra-326 (Results of Professor Sumner's Modified Model) and Exhibit Bra-331 (Description of Methodology Comparing the Analysis of US Upland Cotton Subsidies Under the January 2003 Baseline to Analysis under the November 2002 Baseline, Daniel A. Sumner, November 2003).

[5] *See* Exhibit Bra-326 (Results of Professor Sumner's Modified Model).

[6] US 22 December 2003 Comments on Brazil's Econometric Model, para. 36.

[7] *See* Professor Sumner's discussions below, Response to Section III.

[8] *See* Professor Sumner's discussions below, Response to Section III.

[9] Brazil is still waiting the United States to provide the data that would permit the calculation of the exact amount of support to upland cotton from the contract payments. Brazil hopes that the United States will produce the data on 20 January 2004.

(presumptively trade- and production-distorting) subsidies paid to current producers of upland cotton and allocated as support to upland cotton had no effect on upland cotton production has been, and remains today, incredible. The United States has never explained why upland cotton base acreage payments are so much higher than other programme crops (except rice). The obvious reason is that Congress and the NCC expected the bulk of acreage historically planted to upland cotton to continue to be planted to upland cotton, a high-cost crop. Nor has the United States been able to explain how there could be no production effects when US upland cotton producers would have lost $332.79 per acre over a six-year period if they had received no contract payments.[11] NCC representatives stated that these payments were "critically needed"[12] to "make ends meet"[13], i.e., to cover their cost of production.

5. In fact, Professor Sumner has been, in the view of Brazil, probably overly conservative in his estimation of the effects of these contract payments on US upland cotton production. Brazil notes that the nature of Professor Sumner's modelling does not permit an assessment of the cumulative losses such as the $332.79 per acre over a six-year period. Even Professor Sumner acknowledges that his use of only $0.25 of each direct payment dollar as having production effects is probably low in light of the obvious impact of this subsidy in supporting the continued survival of many US producers.[14] Similarly, Professor Sumner's use of only $0.40 of each counter-cyclical payment dollar as having production effects[15] is also low in light of the fact that $1 billion in payments in MY 2002 were crucial to the economic survival of many upland cotton producers. In light of the evidence produced by Brazil, the US Critique that Professor Sumner's analysis is fundamentally wrong for not concluding that these huge subsidies, filling almost half of the cost-revenue gap, have no effects is completely unjustified.

6. The United States Critique also expresses amazement that Professor Sumner could attempt to model the effects of export credit guarantees. The fact that FAPRI has not yet modelled this subsidy is completely irrelevant. Nor is Professor Sumner blazing new economic ground by modelling export credit guarantees. The NCC has a team of economists working with the United States on this dispute, headed by Gary Adams, a former FAPRI economist who worked on the FAPRI upland cotton model.[16] NCC economists concluded in 2001 that major changes to the GSM 102 programme would result in 500,000 fewer bales being exported from the United States and result in a 3 cent per pound increase in prices.[17] It is curious that the United States, assisted by NCC economists, now seeks to contradict the conclusions of the beneficiaries of this GSM 102 programme by asserting that there were no production, export or price effects from this subsidy. The NCC's 2001 findings, which Professor Sumner used conservatively to estimate the production, export and price effects of the export credit guarantee programmes, was supported by the fact that $1.6 billion in US upland cotton exports between MY 1998-2002 were covered by GSM 102 export credit guarantees.[18] Further support for the NCC's 2001 estimate comes from the US Congressional Research Service that concluded that guarantees have "mainly benefited exports of wheat, wheat flour, oilseeds, feed grains

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[10] This figure is based on Brazil's estimates at paragraph 8 of its 9 September 2003 Further Submission as updated by the table at paragraph 8 of its 22 December 2003 Answers to Questions.

[11] Brazil's 2 December 2003 Oral Statement, para. 27.

[12] Brazil's 22 July 2003 Oral Statement, paras. 52-54 and 58-60 and exhibits cited therein.

[13] Exhibit Bra-324 (NCC Chairman's Report by Kenneth Hood, 24 July 2002, p. 2).

[14] Brazil's 9 September 2003 Further Submission, Annex I (paras 48-51 setting out high and low estimates of production effects for the four contract payments).

[15] Brazil's 9 September 2003 Further Submission, Annex I (paras 48-51 setting out high and low estimates of production effects for the four contract payments).

[16] *See* Exhibit Bra-395 ("Trade Issues Facing the US Cotton Industry," Speech by Dr. Mark Lange, President and CEO, National Cotton Council, San Antonio, 6 January 2004), Lange noted that Gary Adams had spent "countless hours" working with USTR on the Brazil upland cotton dispute.

[17] Exhibit Bra-41 ("The Future of Federal Farm Commodity Programmes (Cotton)," Hearings before the House of Representatives Committee on Agriculture, 15 February 2001, p. 12).

[18] Brazil's 9 September 2003 Further Submission, para. 188.

and cotton".[19] Andrew Macdonald has also testified to the export-enhancing effects of the US GSM 102 programme.[20] In its evaluation of the US Critique's claim that Professor Sumner – and the 2001 NCC economists – incorrectly estimated the effects of removing the GSM 102 subsidies, the Panel must consider this uncontested evidence.

7. The United States Critique also challenges Professor Sumner's modelling of the effects of removing crop insurance subsidies. The US Critique focuses primarily on the fact that FAPRI has not yet modelled these subsidies.[21] But this is irrelevant. What is relevant are the facts which show that $788 million in crop insurance subsidies were provided to upland cotton producers between MY 1999-2002.[22] And it is relevant that USDA's own economists found that lower pre-2000 ARP Act crop insurance subsidies had significant production and price effects for upland cotton (as opposed to other programme crops).[23] Current higher crop insurance benefits under the 2000 ARP Act would certainly have higher effects. Professor Sumner's crop insurance modelling is also consistent with USDA's own economists' conclusion that the "availability of subsidized crop insurance affects farmers' current crop production decisions by creating a direct incentive to expand production".[24] It is uncontested that the amount of crop insurance subsidies received by upland cotton producers is directly related to the amount of upland cotton they plant.[25] Given this evidence, it was reasonable for Professor Sumner to conclude that each dollar of crop insurance subsidies had direct effects on US production.

8. With respect to Professor Sumner's modelling of marketing loan payments, the US Critique is essentially silent.[26] This silence is no doubt due to the fact that Professor Sumner's model uses exactly the same elasticities and estimates of effects as the FAPRI model, for which the United States has indicated it has no objection.[27] Further, Professor Sumner's findings regarding the effects of marketing loan payments between MY 1999-2002 are very much consistent with those of Westcott/Price who found that in MY 2001 that marketing loan payments caused 3 million additional acres to be planted to upland cotton with an implied price decline of 10 cents per pound (or 33 percent of the MY 2001 price).[28] Brazil has already addressed the various US critiques of the use of so-called "lagged prices" by noting that USDA, FAPRI, Professor Sumner and a host of other economists have used these prices in countless models and that any use of futures market prices in large-scale simulation models is impossible.[29] Further, the faulty and primitive US futures methodology for estimating the production effects of marketing loan programmes is no substitute for the comprehensive models used by USDA, FAPRI and Professor Sumner.[30] Most pointedly, the US futures methodology suffers from the fatal flaw that it does not even focus on the price that does get

[19] Brazil's 9 September 2003 Further Submission, para. 189.

[20] Brazil's 9 September 2003 Further Submission, Annex II (Statement of Andrew Macdonald, paras 49-50).

[21] US 22 December 2003 Comments on Brazil's Econometric Model, paras 25-30.

[22] Brazil's 9 September 2003 Further Submission, Table 1, para. 8.

[23] Brazil's 22 August 2003 Rebuttal Submission, paras. 62-66.

[24] Exhibit Bra-63 (C.Edwin Young, Randall D. Schnepf, Jerry R. Skees and William W. Lin: "Production and Price Impacts of US Crop Insurance Subsidies: Some Preliminary Results, p. 4).

[25] Brazil's 22 August 2003 Rebuttal Submission, para. 53.

[26] The United States points out a typo (US 22 December 2003 Comments on Brazil's Econometric Model, paras. 73-74) that did not affect the actual analysis undertaken by Professor Sumner (*see* below, Comments on Section VI).

[27] *See* below, Comments on Section VI.

[28] Brazil's 7 October 2003 Oral Statement, paras. 31-33 and the references contained therein.

[29] *See* Professor Sumner's 9 October 2003 Closing Statement attached as Annex II to Brazil's 9 October 2003 Closing Statement, his 2 December 2003 Oral Statement (Exhibit Bra-342, paras. 24-28), Exhibit Bra-345 (paras. 6-14) as well as Brazil's 22 December 2003 Answers to Questions, paras. 37-42).

[30] *See* Brazil's 2 December 2003 Oral Statement, paras. 42-55.

the attention of US producers who depend on marketing loan payments – the adjusted world price (AWP).[31]

9. Nor does the US Critique find any fault with Professor Sumner's analysis of the Step 2 subsidies.[32] Brazil notes that Professor Sumner models the effects of Step 2 domestic and export subsidies in exactly the same manner as FAPRI. Professor Sumner's Step 2 analysis is also completely consistent with the overwhelming evidence that Step 2 export and domestic subsidies have significant production, export, and world price effects. As with the GSM 102 subsidies, the NCC has been quite vocal in praising the production and export effects of the Step 2 subsidies.[33] There would simply be no basis for the United States to contradict these testimonies from the users and beneficiaries of the Step 2 programme.

10. The Panel must also assess the validity of the US critique in view of the overwhelming non-econometric evidence that the US subsidies had significant production, export and price effects.[34] For example, the Panel must ask whether it is reasonable to conclude, as the United States argues, that $12.9 billion dollars in amber box, presumed trade-distorting subsidies had no effect on US production, US exports, and world prices. It is further uncontested that USDA's own data shows that the average US upland cotton farm would have lost $872 per acre during MY 1997-2002 – but had a "profit" of $106 per acre when subsidies are included in their revenue.

11. Further, the Panel must also examine the US Critique of Professor Sumner's analysis in light of the evidence of other econometric studies examining the effects of removing US upland cotton subsidies. The United States has argued that all these studies – including USDA's studies – were wrong in finding significant production, export, and price effects. Would the United States also argue that all of these other economists analyzed the US upland cotton subsidies and their effects on the (world) upland cotton market "for the express purpose of achieving pre-conceived results"?[35] Brazil submits that a common sense analysis of these other studies, including USDA's own studies, shows that Professor Sumner's results are both valid as well as conservative. They are certainly within the ranges of the other econometric studies in the record and consistent with what would be expected given the non-econometric evidence in the record.

12. Finally, Brazil notes US suggestions that Professor Sumner made modelling choices "for the express purpose of achieving pre-conceived results"[36] and "in order to exaggerate acreage and ultimately price impacts".[37] These are offensive and inappropriate charges directed at one of the world's leading agricultural economists. Members of the NCC admitted that "Dr. Sumner is a brilliant economist" who is "well-respected" and a "widely recognized UC [University of California] economist" who is a "confidant to the administration on trade and other issues".[38] Personal attacks by the United States against Professor Sumner's integrity are ironic given the fact that only seven months ago he was one of only two private US economists to be asked by the Chairman of the US

[31] *See* Brazil's 2 December 2003 Oral Statement, paras. 42-55.

[32] The United States points out a typo (US 22 December 2003 Comments on Brazil's Econometric Model, paras. 76) that did not affect the actual analysis undertaken by Professor Sumner (*see* below, Comments on Section VI).

[33] For an example of the extensive evidence supporting this fact, *see* Brazil's Further Submission, paras. 141, 178-180.

[34] *See inter alia* Brazil's 9 September 2003 Further Submission, Sections 3.3.4.1-3.3.4.6; Brazil's 7 October 2003 Oral Statement, Section 2; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 3.1-3.4, 3.7; Brazil's 2 December 2003 Oral Statement, Section 5.

[35] US 22 December 2003 Comments on Brazil's Econometric Model, para. 9.

[36] US 22 December 2003 Comments on Brazil's Econometric Model, para. 9.

[37] US 22 December 2003 Comments on Brazil's Econometric Model, para. 1. *See* also para. 38.

[38] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, September 2, 2003)(quoting Earl Williams, President of California Cotton Ginners and Growers Association).

Commission on the Application of Payment Limitations for Agriculture, Chief USDA Economist Keith Collins, to testify before that Commission. In evaluating the effects of additional payment limitations, the Report of the Commission relies, inter alia, on the testimony and advice provided by Professor Sumner.[39]

13. While the US Government has attacked Professor Sumner's professional integrity, the leaders and members of the US National Cotton Council have gone further during this long dispute. They have met with and pressured Professor Sumner to discontinue his work before the Panel.[40] Moreover, NCC members have and continue to seek to cut off research and scholarship funds for the University of California at Davis, in protest of Professor's Sumner's work in this dispute.[41] One NCC member representative even went so far as to be quoted as saying that "if this had been a military issue, what Dr. Sumner did would be called treason".[42] Recently, the President of the NCC threatened both Professors Sumner and Babcock with unspecified action following the end of the WTO proceedings, stating "[i]n another time and venue there will be a full examination of the actions taken by these 2 economists".[43] This threat was elaborated in a recent analysis in a leading Agricultural Newspaper, the Western Farm Press:

> In the trade issue with Brazil, NCC President and CEO Mark Lange remains incensed at [Brazil's] WTO action. More specifically, he is angry because two US economists hired on to Brazil's payroll and prepared testimony against the United States in the WTO action. University of California economist Dan Sumner, former assistant secretary of agriculture, was hired to assist in the case. Lange added that Sumner 'appears to have hired' Professor Bruce Babcock, an agricultural economist at Iowa State University and director of the Center for Agricultural and Rural Development to attempt to modify the Food and Agricultural Policy Research Institute baseline projections for use by the Brazilians. "This action was taken without the knowledge of FAPRI," said Lange of the University of Missouri-based facility. Lange said Babcock receives federal funds for the CARD programme and he pledged "a full examination of the actions of these two guys" once the WTO issue is settled. California cotton industry leaders and others have protested Sumner's actions to the dean of U.C. Davis school of agriculture and have lobbied for private research and scholarship funds to be withdrawn from the University in protest of Sumner's actions.[44]

14. Over the past six months, NCC members have been instrumental in coordinating efforts to attempt to force officials of the University of California at Davis to require Professor Sumner to stop

[39] Exhibit Bra-397 ( "Report of the Commission on the Application of Payment Limitations for Agriculture," August 2003).

[40] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute", Western Farm Press, 2 September 2003)("group of representatives from cotton, wheat and rice met with Professor Sumner in mid-August to express their displeasure over his testimony before the Panel").

[41] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute", Western Farm Press, 2 September 2003)(Earl Williams, President of the California Cotton Ginners and Growers Associations was quoted as stating "And we are going to bring pressure to bear on the university that would allow someone from a public, taxpayer supported institution to have such latitude that can reap such harm on the supporters of the University".).

[42] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute", Western Farm Press, 2 September 2003) quoting Earl Williams.

[43] Exhibit Bra-395 ("Trade Issues Facing the US Cotton Industry," Speech by Dr. Mark Lange, President and CEO, National Cotton Council, San Antonio, January 6 )(underlining added); *See* also Exhibit Bra- 398 (Western Farm Press, 7 January 2004 , p. 3).

[44] Exhibit Bra-398 (Western Farm Press, 7 January 2004, p. 2).

his work in this dispute.[45] To their credit, these U.C. Davis officials have refused to bend to the pressure.

15. As Dr. Lange's statements quoted above indicates, the NCC now has focused on Professor Babcock for his very limited role in working with Professor Sumner in the application of parts of the FAPRI and CARD models. Professor Babcock's letter[46] is addressed to leading House and Senate staff members who have "relied on FAPRI and CARD to provide objective and high quality quantitative and qualitative assessment of US farm policy alternatives". Professor Babcock's letter states he is "prepared to do whatever it takes to mend this relationship, including disassociating myself from future official FAPRI analyses if so desired". The letter provides the Panel with insights into the type of pressure imposed by the NCC on the economists providing the Panel with assistance in this dispute.

16. These efforts by the representatives of the US upland cotton producers who are heavily dependent upon US subsidies and US Congressional support for their economic survival is perhaps understandable, but nonetheless deplorable. Professor Sumner has demonstrated considerable courage and fortitude in continuing his work to assist the Panel and ultimately all WTO Members in this dispute. Brazil has no doubts that the United States is also appalled at the prospect that either of these two distinguished economists would suffer any adverse professional consequences from their assistance to the Panel and the Parties in this dispute. Given the obligation of all WTO Members to cooperate and assist the Panel in making an objective assessment of the facts of a dispute, Brazil is certain the United States will unequivocally condemn any such threats, including those now being made by the US National Cotton Council.

17. With these introductory remarks in mind, Brazil presents below Professor Sumner's response to the US 22 December 2003 Comments Concerning Brazil's Econometric Model.

[45] Exhibit Bra-396 ("Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, 2 September 2003).

[46] Exhibit US-114.

## II. PROFESSOR SUMNER'S COMMENTS CONCERNING THE US CRITIQUE OF HIS MODEL

Response to "Comments from the United States of America
Concerning Brazil's Econometric Model" dated December 22, 2003

Daniel A. Sumner

20 January 2004

18. This response to the US critique of the modelling work on US cotton subsidies conducted by myself and my colleagues addresses each of the US comments in the order in which they appear in the US critique submitted on 22 December 2003. However, let me start with some general comments I feel are in order.

19. Much of the US critique repeats the description of my adaptations to the FAPRI model, as provided in Annex I and subsequent documents.[47] The model I developed was based on the core domestic crops model of FAPRI with several additions and modifications to fit the questions before this Panel. I stated in detail where my model made those additions and modifications.[48] Thus, these US comments add nothing by reasserting that my model was not identical to the FAPRI model. Since I never claimed that my model was the FAPRI model, I frankly do not understand the point of these repeated assertions that are written as though they were exposing some revelation.

20. Second, the United States at least three times asserts claims about my motivations for modelling choices. Twice in the very first paragraph the United States asserts that my modelling choices were made "in order to exaggerate" acreage and price impacts. Then in paragraph 9, the United States asserts that my modelling choices were made, "for the express purpose of achieving pre-conceived results". I am puzzled how the United States would claim to have any evidence about my motivation. But more important, these statements suggest seriously immoral and unprofessional behaviour on my part. This is a very serious charge that I do not take lightly. I submit that besides being simply wrong, such attacks have no place in these proceedings.[49]

21. Most of the substantive issues raised in the US critique are simply re-statements of assertions that the United States disagrees with the modelling choices made in Annex I.[50] My arguments for why I modelled the policies as I did have been provided to the Panel on several previous occasions and there is no reason to repeat those arguments in this document. I will refer to those arguments as necessary in footnotes.

[47] *See* my Closing Statement on 9 October 2003, attached as Annex II to Brazil's 9 October 2003 Closing Statement, and my statements in Exhibits Bra-313 to 315, my 2 December 2003 Statement to the Panel in Exhibit Bra-342, as well as the detailed reactions to US criticism of my model in Exhibits Bra-343-345.

[48] *See* Annex I to Brazil's 9 September 2003 Further Submission and Exhibit Bra-313.

[49] Some of the economic material presented by the United States in this case has been authored directly by Dr. Glauber. I note that the 22 December 2003 "Comments" are not attributed to anyone by name, therefore I am unable to respond directly to any individual person with respect to these personal charges.

[50] However, the United States does not propose other methods for modelling the subsidy programmes in case they disagree with my model choices. They simply state that these programmes should not cause any effects – a position that is clearly untenable given the other economic evidence about the effects of the programs, including statements by the users and beneficiaries of the programmes.

**Section II**

22. Paragraphs 5 to 11 of the US critique are devoted to reasserting what I stressed in Annex I that was submitted many months ago, namely that I made adaptations to the FAPRI modelling framework. As I have explained, the FAPRI framework alone was not appropriate for the analysis of the questions before this Panel and therefore I modified and supplemented the framework. However, let us put these modifications and additions in perspective. Of the hundreds of equations used to compute the results, almost all are directly taken from the FAPRI domestic crops model. The basic behavioural supply and demand equations are taken directly from the FAPRI model as are the elasticities used to quantify those equations. In Annex I, and in subsequent documentation[51], I tried to avoid taking credit for work that was not mine. At the same time, I tried to be clear about the distinctions between my work and that of FAPRI and CARD.

23. Professor Bruce Babcock from CARD – with whom I worked together in his private capacity – provided a letter to Congressional staff economists[52] who are familiar with "official" FAPRI analysis of US policy questions, but who have not followed these proceeding closely. In that letter, Professor Babcock explained to them what he and I have always been clear about and had already stated to this Panel. My analysis used part of the FAPRI modelling system, but was not conducted by the full FAPRI team and was not "official" FAPRI analysis. These Congressional staff members had not had access to Annex I or other material submitted to this Panel and Professor Babcock felt a need to clarify these facts. There was no new information in the letter that he sent these staff members that was not already included in Annex I and in the subsequent material provided to the Panel.

24. For example, Professor Babcock points out that the baseline was the November 2002 preliminary FAPRI baseline not the official 2003 FAPRI baseline that became available after I undertook my analysis. He also points out that I used the CARD international cotton model rather than the FAPRI full international model in my analysis.[53] This is not new to those of us who have participated in this Panel proceeding, but Professor Babcock decided to make these clarifications to the Congressional staff members.[54]

25. One point made in the Babcock letter – and emphasized in the US critique – is the obvious fact that if a different team of analysts with a different model had conducted the analysis the results would have been different. That is always true. Different analysts to whom the same question is posed would come up with at least a somewhat different model. Obviously a FAPRI team conducting an official "FAPRI" analysis would have developed a model that is at least somewhat different from my adaptations. In part this occurs because, with complex issues involved, the questions themselves may be interpreted slightly differently, and because, in many cases, there are a range of equally acceptable approaches to an economic modelling choice. It is much less clear how the direction of the results would have changed if different teams with different models conducted analyses. As the review of the independent literature and the independent models in this case suggests, most analyses of US cotton subsidies have found larger impacts than I found in my research.[55] It is not clear whether an "official" FAPRI analysis would have found larger or smaller impacts if FAPRI would have been posed the same questions as those posed in Annex I, and if the FAPRI team analyzing these questions had considered all the evidence presented to this Panel.

[51] *See* in particular Exhibit Bra-313.

[52] Exhibit US-114.

[53] I will discuss the latter issue in greater detail in my comment on Section VII.

[54] The letter responds a perception of concern among some in the United States about the participation of US economists and US based models providing evidence on behalf of Brazil. In particular, Professor Babcock clarified that his FAPRI colleagues at the University of Missouri had not participated in the analysis and that this work was done in a private capacity not at a part of an "official" FAPRI project.

[55] *See* for example the review of independent studies in Exhibit Bra-344.

**Section II. A.**

26. The heading of this section is oddly contradicted by its content. The heading says the "Brazil Model Not Comparable to the FAPRI System", yet the next three paragraphs proceed to compare these two models. Several incorrect assertions are included here, but these are repeated in more detail in later sections and so are dealt with below. However, one clarification is important to make both here and below. Whereas the FAPRI system does not include separate explicit provisions for crop insurance and export credit guarantee programmes, this does not imply that the FAPRI system assumes that there are zero supply impacts of these programmes. Rather, effects of these programmes are imbedded in the baseline of the FAPRI framework.

27. If the FAPRI system had been posed questions about the impacts of crop insurance or export credit guarantee programmes, the natural approach would be to proceed as described in Annex I and in subsequent submissions: to ask how a new scenario with these programmes removed would differ from the baseline that includes these programmes. This procedure was precisely what FAPRI analysts did when they analyzed payment limit rules for the Commission on Payment Limitation in analysis presented in June 2003.[56] The FAPRI framework also does not contain any explicit provisions on payment limitations. These were added to the system for the analysis of the effect of payment limitations, much as I added equations on crop insurance and export credit guarantees for purposes of my Annex I analysis.

28. It is simply wrong to assert that, because a programme is not identified separately in the FAPRI framework, its effects must be assumed to be zero. Furthermore, as discussed further below, in some cases the best evidence on the impact of a programme is from the users of that programme. This was my judgment about the impacts of the export credit guarantee programmes. It certainly makes no sense whatsoever to assume that a programme has zero effect, simply because its impacts, which are known to be positive, are difficult to quantify precisely.

**Section II.B.1**

29. I explained in great detail the basis for my approach to PFC, DP, MLA and CCP payment programmes.[57] Clearly I disagree with the assertion made in paragraph 16 and 17. There is no new content here and there is no reason to repeat my argument and evidence. I note, however, that no "official" FAPRI analysis of these payment programmes has asked the question how acreage would respond if cotton programmes were removed while the payments for the other programme crops remained in place. The FAPRI analysis is concerned with the very different question of what would be the impact for all crops if the payment programmes were removed for all crops simultaneously. Therefore, I had to make some adjustments to the treatment of these programmes, as the question that faces this Panel could not be answered by the traditional FAPRI framework. In addition, as footnote

[56] *See* for example, FAPRI analysis FAPRI-UMC Report #05-03 and #06-03 to be found at http://www.fapri.missouri.edu/FAPRI_Publications.htm and partly reproduced in Exhibit Bra-228.

[57] Annex I, paras. 37-51; and my oral statements on 22 July (Exhibit Bra-105, paras 20-33), 2 December (Exhibit Bra-342, paras 31-37) and my closing statement on 9 October (Part 4); Exhibits Bra-280, Bra-313, and Bra-345 (paras 18-34). Some of the key arguments I made can be summarized as follows:

- none of the studies in the literature analyzes the amount of payments made in connection with a specific crop that are received by current producers of that crop,
- none of the studies in the literature focuses on the specific effects of these payments for cotton due to
    - the high per-acre payments for cotton reflecting higher costs of production,
    - the restrictions on planting fruits and vegetables affect particularly cotton production,
- direct and counter-cyclical payments give farmers an incentive to produce the crop for which they have base acreage,
- future updates of base induce farmers to plant their base acreage to the programme crop or even expand the area planted to the programme crop.

57 highlights, my judgment is that the programmes all have some commodity-specific acreage impact for cotton.

30. The table referred to in paragraphs 21 through 24 simply shows that when the planting impact of these payment programmes for cotton are assumed to have no specific impact on cotton acreage, but only a broad and diffuse effect on all programme crops, then the resulting acreage impact will indeed be nearly zero.

**Section II.B.2**

31. Annex I as well as subsequent submissions and oral discussions with the Panel have explained in detail my approach to the production impacts of crop insurance and why my approach, for example by leaving out risk reduction impacts, is conservative.[58] The approach is straightforward. The crop insurance subsidy lowers costs to cotton growers and the acreage impact of lower costs in percentage terms may be calculated by multiplying the lower per acre costs by the elasticity of supply. The FAPRI framework has not been used to assess the production impacts of crop insurance. But the impacts of crop insurance subsidies are implicit in the FAPRI baseline.[59] My approach made the impacts explicit so that I could assess the acreage effects of removing the subsidy. This is discussed in somewhat more detail below.

32. Paragraphs 25 through 30 and the table referred to there simply repeat the US claim that hundreds of millions of dollars of crop insurance subsidies for cotton producers has had zero effect on farmers' choices to grow cotton. I disagree and my model has quantified these impacts using FAPRI elasticities and other features of the FAPRI US crops model.

33. Not withstanding the "intuition" of the United States, the analysis that underlies paragraph 29 of the US critique is evidence of faulty economic reasoning. Furthermore, the US claim about how the FAPRI model treats crop insurance subsidies is misleading at best.[60] As noted above, the FAPRI framework includes the value of crop insurance subsidies implicitly and has not previously been used to analyze the impact of eliminating crop insurance for cotton. Crop insurance for cotton is a service purchased by farmers on a per-acre basis in their business of producing cotton. The subsidy provided by the US government lowers the cost of this service. It is a principle of basic economics that a subsidy that lowers marginal costs results in the same impact as a direct price subsidy on output. Following this principle, I first calculate the regional cotton crop insurance subsidy rate per acre of cotton as a percentage of net revenue and then multiply those subsidy ratios times the elasticity of cotton acreage response applicable to that region. The United States is right that there are more complex ways to model the impact of crop insurance, for example, by noting that crop insurance has an additional acreage impact due to risk reduction. But, the methodology I apply is straightforward, conservative and based on intuitive economic logic and basic principles.

**Section II.B.3**

34. Paragraphs 31 through 34 and the table to which they refer again simply repeat the US assertion that billions of dollars of subsidized export credit guarantees for cotton exports have zero effect on US production and exports. I find this implausible on its face and based my quantification of the impact on estimates provided by representative of users of the programme. This seems to me to be a reasonable approximation. My use of that estimate was conservative relative to the National

[58] *See* also Exhibit Bra-313.

[59] While there is no specific equation modelling the effects of crop insurance, its effects are part of the baseline that projects a level of planted acreage against the background of the continuation of the crop insurance programme.

[60] Paragraph 29 of the US Critique.

Cotton Councils estimates, as explained in detail in response to questions from the Panel[61], and as the US acknowledges in footnote 17 to paragraph 32 of its critique. The National Cotton Council testified that the impact on export was 500,000 bales and the impact that I estimate is considerably smaller. I use my model, based significantly on FAPRI elasticities and other parameters to calculate the price, acreage and other impacts of the initial shift of 500,000 bales. This resulted in much lower net impacts on price and export quantities than estimated by the National Cotton Council.[62]

**Section III**

35. In paragraphs 35 through 38 of the US critique, the United States points out that the baseline prices reported in Annex I are not the same as baseline prices provided to the United States by Professor Babcock on November 26 as part of the model documentation.[63] The United States implies that I have manipulated the baseline to generate higher effects.[64] This allegation has no basis whatsoever.

36. The documentation delivered by Professor Babcock[65] was the FAPRI US crops model that was calibrated with the system of FAPRI international crops models to reproduce the FAPRI November 2002 preliminary baseline projections. The Annex I analysis began with these FAPRI November 2002 preliminary baseline projections. However, the Annex I results were developed by linking the FAPRI US crops model with the CARD international cotton model that was developed by researchers at Iowa State University. Unfortunately, the description of the baseline in Annex I and subsequent submissions was imprecise by not making this distinction explicit. Instead, I labelled the baseline as an (unpublished) FAPRI November 2002 preliminary baseline rather than a slight modification thereof. This slight modification was required for internal consistency reasons, as explained below.

37. The table below provides a full comparison of the differences in the baseline reported in Annex I and the FAPRI November of 2002 preliminary baseline. As can be seen, they are different but those differences are very small overall.

38. There are two reasons for the small differences between the baseline projections used in the Annex I analysis and reported in Annex I and the November 2002 FAPRI preliminary baseline projections. The first was caused by the need to calibrate the CARD cotton model rather than the FAPRI international model with the US crops model. Consistency with the CARD international cotton model implied very small changes in the baseline. The second source of difference was that new macroeconomic projections became available in late November, 2002. These new macroeconomic projections were incorporated into the CARD international cotton model. I stress that the equations of the FAPRI US crops model were not changed in any way. Again, the slight changes between the baseline projections are solely a result of the calibration of the model, once with the FAPRI international crops models (FAPRI preliminary November 2002 baseline) and once with the CARD international cotton model (Annex I model), as well as the updated macroeconomic data used.

39. To put this baseline issue in perspective, Brazil has provided the Panel with several sets of results from similar models on several alternative baselines, including the official FAPRI 2003

[61] Brazil's 27 October Answers to Questions, paras. 104-107.

[62] In table 5.Ig of Annex I, I report an average export effect of 300,000 bales and an average US price effect of about 0.5 cents per pound, as opposed to the NCC estimate of 500,000 bales and 3 cents per pound.

[63] *See* Exhibit Bra-346.

[64] Paragraph 38 of the US critique.

[65] Exhibit Bra-343, para. 11 and Exhibit Bra-346.

baseline.[66] The bottom line is that these results are extremely robust to those alternative baselines and slight modifications to modelling specifics.

40. The same robustness applies to the results using the FAPRI November 2002 preliminary baseline and the modification applied. The United States assertion that the Annex I baseline meaningfully affects ("exaggerate[s]"[67]) the effects of removing US cotton subsidies is, therefore, unfounded.

41. To analyze the validity of the US assertion, we have recalibrated the CARD international cotton model (used to generate the Annex I results) to replicate exactly the FAPRI November 2002 preliminary baseline. We also used the macroeconomic projections used by FAPRI in November 2002.[68] Rerunning the model of Annex I yields results that are nearly identical to those reported in Annex I. Removal of US cotton subsidies would decrease US production by an average of 24.9 per cent from 2003 to 2007.[69] Mill use would decrease by 6.4 per cent.[70] US exports would decrease by 41.5 per cent.[71] The US Season average price would increase by 15.1 per cent.[72] Importantly, the A index price would increase by 10.6 per cent. In Annex I, I reported a change in the A index price of 10.8 per cent relative to the baseline.[73] This difference of less than 0.2 percentage points is simply not material.

42. In sum, it is unfortunate that this confusion occurred in the labeling of the baseline used in Annex I. The important point, however, is that it has not affected the results of my analysis. Indeed, having run the Annex I model off the non-modified version of the FAPRI November 2002 preliminary baseline projections provides one more indication of the robustness of those results.

[66] This includes my Annex I model based off the FAPRI preliminary November 2002 baseline, my cotton-focussed model based off the FAPRI preliminary November 2002 baseline and the FAPRI January 2003 baseline, as well as a number of independent third party studies (Exhibit Bra-344).

[67] Paragraph 38 of the US critique.

[68] Both of these modifications result in an Annex I modelling system that is calibrated to exactly generate the FAPRI preliminary November 2002 baseline. It no longer contains any modifications that the United States criticizes as generating overstated resulting effects (paragraphs 36-37 of the US critique).

[69] The Annex I result was 26.3 percent (paragraph 65).

[70] The Annex I result was equally 6.4 percent (Table I.5a).

[71] The Annex I result was 44 percent (paragraph 68).

[72] The Annex I result was 15.3 percent (paragraph 69).

[73] The Annex I result was 10.8 percent (paragraph 70).

Comparison between baseline projections

| | 2003 | 2004 | 2005 | 2006 | 2008 |
|---|---|---|---|---|---|
| | Planted Area (million acres) | | | | |
| Annex I baseline | 13.7802 | 14.8798 | 14.7722 | 14.6525 | 14.2744 |
| FAPRI baseline | 13.7820 | 14.7205 | 14.7716 | 14.6584 | 14.2519 |
| | Harvested Area (million acres) | | | | |
| Annex I baseline | 12.0444 | 13.0666 | 12.9761 | 12.8739 | 12.5282 |
| FAPRI baseline | 12.0462 | 12.9164 | 12.9751 | 12.8791 | 12.5068 |
| | Yield (bales per acre) | | | | |
| Annex I baseline | 1.3325 | 1.3328 | 1.3410 | 1.3494 | 1.3579 |
| FAPRI baseline | 1.3325 | 1.3328 | 1.3408 | 1.3492 | 1.3578 |
| | Production (million bales) | | | | |
| Annex I baseline | 16.0497 | 17.4157 | 17.4010 | 17.3715 | 17.0121 |
| FAPRI baseline | 16.0519 | 17.2152 | 17.3974 | 17.3769 | 16.9818 |
| | Free Stocks (million bales) | | | | |
| Annex I baseline | 4.9155 | 4.6527 | 4.3863 | 4.3458 | 4.0330 |
| FAPRI baseline | 4.8188 | 4.4349 | 4.2145 | 4.1920 | 3.8837 |
| | Imports (millions bales) | | | | |
| Annex I baseline | 0.0050 | 0.0050 | 0.0050 | 0.0050 | 0.0050 |
| FAPRI baseline | 0.0050 | 0.0050 | 0.0050 | 0.0050 | 0.0050 |
| | Mill Use (million bales) | | | | |
| Annex I baseline | 7.7825 | 7.7018 | 7.6339 | 7.5896 | 7.5245 |
| FAPRI baseline | 7.7429 | 7.6547 | 7.5968 | 7.5532 | 7.4927 |
| | Exports (Million bales) | | | | |
| Annex I baseline | 9.7667 | 9.9817 | 10.0384 | 9.8275 | 9.8054 |
| FAPRI baseline | 9.9042 | 9.9495 | 10.0260 | 9.8513 | 9.8024 |
| | Season Average Price ($/lb) | | | | |
| Annex I baseline | 0.450 | 0.477 | 0.503 | 0.512 | 0.539 |
| FAPRI baseline | 0.457 | 0.488 | 0.512 | 0.520 | 0.547 |
| | A Index Price ($/lb) | | | | |
| Annex I baseline | 0.507 | 0.534 | 0.558 | 0.576 | 0.596 |
| FAPRI baseline | 0.524 | 0.547 | 0.568 | 0.587 | 0.605 |
| | Adjusted World Price ($/lb) | | | | |
| Annex I baseline | 0.372 | 0.398 | 0.419 | 0.436 | 0.455 |
| FAPRI baseline | 0.387 | 0.410 | 0.428 | 0.446 | 0.463 |
| | Step 2 Payments ($/lb) | | | | |
| Annex I baseline | 0.057 | 0.060 | 0.063 | 0.047 | 0.052 |
| FAPRI baseline | 0.054 | 0.060 | 0.063 | 0.047 | 0.052 |

**Section IV**

43. In section IV of the US critique, the United States claims that my model does not forecast future or explain historical outcomes of cotton plantings and that variables, such as the ratio of soybean to cotton futures prices, are more highly correlated to acreage variations in the seven years from 1996 to 2002.[74] The United States claims that this has some relevance for the validity of my model and its simulation results. These claims are seriously flawed.

44. Section IV of the US critique demonstrates a complete lack of understanding of the role of policy simulation models. A policy simulation model is not designed to and does not have the capability of forecasting. Policy simulation models are designed to ask "but for" counterfactual questions not to attempt to replicate a specific history or forecast the future. Specific statistical tools

[74] *See inter alia* paragraphs 39-42 of the US critique. This is the entire theme of section IV.

apply to forecasting economic time series – generally based on some variant of regression analysis – to forecast/predict future or explain historic outcomes of, for instance, cotton plantings. Contrary to the assertion of paragraph 39 of the US critique, no professional economist would ever propose a simulation model designed to consider the impacts of policy alternatives as the appropriate tool for forecasting the future or for explaining historical data for an industry. I certainly would never propose the use of a policy simulation model for forecasting purposes.[75]

45. I begin my response to the US critique in section IV by noting that – as I understand it – the questions before the Panel relate to the analysis of the effects of the US cotton subsidies, not to predict cotton plantings for future marketing years.[76] The simulation model that I have presented in Annex I and in later submissions to the Panel addresses exactly that first question before the Panel. Given the baseline that covers historical data for marketing years 1999-2001 and projections for marketing years 2002-2007, my simulation model asks what would have been or what would be the effects of removing the US subsidies on US acreage, use and exports of cotton as well as on cotton prices and other variables.

46. The United States is wrong when it implicitly claims that the ability of a policy simulation model to forecast or account for variations in a time series provides any useful guide to its reliability in terms of the simulation results that it generates – for example in assessing what may happen if policy variables were to change.

47. Forecasting models are typically based on multivariate time series regression analysis that accounts for short-run and long-run trends, serial correlation of times series and exogenous factors. In agriculture, projecting acreage choices would likely involve projecting climate variations, pest trends, and many other variables. (Any standard econometrics textbook provides the basics for forecasting economic time series.[77])

48. Neither my Annex I model nor the FAPRI policy model (nor the USDA policy models) provides an appropriate framework for statistical analysis explaining historical variations in acreage or for forecasting future acreage.[78] The purpose of simulation models is to isolate the effects of, for instance, subsidy programmes as they occur against the baseline results. Policy simulation models do not claim to be useful for forecasting purposes and they are not. But this is irrelevant to their stated purpose as "but for" (counterfactual) policy analysis tools.

49. My simulation model assumes "average" trends for many variables that change in real world situations, but are set at averages in the baseline (or at historical outcomes). For example, my model assumed average weather conditions for marketing years 2002-2007. However, no doubt, there will be years with weather better than the average and years with weather worse than the average. The model cannot predict this, and, therefore, any deviations in the real world that impact on, for instance, planting decisions, would result in "projections" by the model to be necessarily wrong – to the extent that important outcomes of variables, such as weather, deviate from the baseline.

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[75] I note that the claims made by the United States about the "Sumner model" apply with equal (lack of) force to the FAPRI models themselves. No one uses these models to forecast, nor should they. The models are used and useful to ask "but for" questions, which forecasting models are not in a position to do.

[76] Thus, any assertions of the United States that my model cannot predict future or explain past outcomes of cotton planting is not a relevant factual statement that helps this Panel determine the effects of the US cotton subsidies.

[77] See for example, William H. Greene, *Econometric Analysis* Prentice Hall; 5th edition (2002) (cited in Brazil's 22 December Answers to Questions, para. 42) A classic and still useful reference is Charles R. Nelson, *Applied Time Series Analysis for Managerial Forecasting*, Holden Day, San Francisco. (1973).

[78] Running the same correlation calculations that the United States applied to my model off the FAPRI or USDA's FAPSIM model would very likely not reveal significantly higher correlations as these simulations models are – like my adaptation of the FAPRI model – not designed for that purpose.

50. A simple illustration may clarify the point that statistical regression models and policy simulation models serve different purposes. Consider a period in which a large direct production subsidy was in force, but the parameters of the programme did not change. Given changes in climate, agronomic factors or other economic incentives, planted acreage would change over the period, but none of the changes in acreage would be due to changes in the subsidy, because there were none. The result of any time-series regression analysis of a limited number of data points is incapable of isolating the effects of variables, such as subsidy programmes, that do not change considerably during the period under analysis. Other variables would explain the variation in acreage over the period and would be better predictors of future acreage shifts so long as the large subsidy programme remained unchanged.

51. But does this mean that the large direct production subsidy is irrelevant to planted acreage? No, of course not. Does this mean that a model to consider the amount of acreage that would be planted, but for the subsidy, should assume the subsidy was irrelevant? No, of course not. Therefore, a statistical regression (or correlation) model applied to analyze the effects of such "constant variables" would fail to capture their importance. In sum, only a policy simulation model, of the general sort that I have provided in Annex I will adequately isolate the effects from the cotton subsidy programme hidden in the regression analysis.

52. Similarly, policy simulation models are not usually very good at forecasting future or explaining past events, as explained above. Does this mean that the simulation analyzed the effects of the subsidy programmes incorrect?[79] No, of course not, if they are properly designed.

53. The United States further claims that there are small positive or negative correlations between the expected net revenue and planting decisions, as a result of my model.[80] The table referred to in paragraphs 43 though 52 of the US critique and the discussion in those paragraphs also illustrate the misunderstanding that the United States evidently has about model evaluation and the meaning of the statistics they produce. The table at paragraph 49 reports simple correlations coefficients based on seven observations for a few variables. First, I note that the sample size for these variables is simply too small for any meaningful statistical analysis. Second, simple (univariate) correlation coefficients are not measures of explanatory power as the United States implies, for example, in paragraph 42 of its critique.[81] Simple correlation coefficients tell us nothing of interest when many variables affect an outcome.[82] This again highlights the difference between forecasting or explanatory models and policy simulations models that ask "but for" counterfactual questions. Nothing in this section of the US critique relates in any way to the usefulness of models for policy analysis.

54. Correlation coefficients measure linear statistical relationships between two variables in isolation from all other influences. They do not indicate causation and they do not even indicate a statistical relationship between variables that takes place in the real-world situation when there are many simultaneous statistical and causal relationships in place. It follows that the figures presented in the table at paragraph 49 are not indicative of causation or even of the contribution to statistical explanatory power in the current case where many variable are interrelated. Whether the figures are

[79] The United States implies this in paragraphs 40-50 of its critique.

[80] Paragraphs 43-46 and table at paragraph 49 of the US critique

[81] Paragraphs 41-42 and 45-49.

[82] The case of cotton plantings is a good example. Planting decisions are a function of expected revenue itself determined by expected market revenue and expected government payments. It is further a function of expected revenue for other crops, of weather conditions at planting time, of expected demand for the crop, expected weather during the growing season and so forth. Simple univariate correlation measures linear statistical relationships, not causation or even statistical relationships if there are many factors that potentially affect the outcome of a variable. This explains that there may be a negative correlation where one intuitively expects a positive correlation as a result of ignoring the effects of all other factors on the variable to be explained.

positive or negative, large or small, they have no statistical significance and provide no meaningful information.

55. In sum, the US statement at paragraph 50 of its critique has no basis whatsoever. As with all policy simulation models, including the FAPRI and USDA simulation models, any single factors or set of variables in my model are not necessarily expected to "explain" the time series data. The model was not designed to explain historic events or predict future outcomes. Instead my model is designed to simulate what would be expected to happen if US subsidies were removed. A test of the model would be to observe responses if subsidies were removed and other factors were held constant. Presenting a set of simple correlation coefficients on seven years of historical data over which subsidies remained in place provides no evidence of any relevance.

56. Finally, I refer the Panel to the many instances in which I have addressed the question of lagged prices used to model farmers' price expectations at planting time.[83] I will not repeat these arguments here to respond to the US criticism that I should have used futures market prices.[84] I would note that Brazil's submissions have thoroughly addressed the US arguments that US farmers planting decisions are made in accordance with futures market prices.[85]

**Section V**

57. This section of the US critique repeats again that my model differs from the FAPRI US crops model. It also asserts that the United States had difficulties in replicating results of my analysis from the electronic files. This section also reveals that the United States made several mistaken "assumptions" about how certain variables entered the model. As indicated before, given the complexities of working with these models, both Professor Babcock and I have repeatedly offered to work with the United States to replicate my results.[86] US government or other economists working on the US critique of my model could have contacted either Professor Babcock or myself requesting any needed information or assistance with any problems they have had. If they would have done so, we could have clarified any ambiguities and the United States could have avoided the evident errors made in applying my model. However, they did not contact either of us. As a result they made inappropriate assumptions and have failed to apply the model correctly.

58. Let me begin by addressing the US statements about the differences between the Annex I model and the FAPRI model.[87] The essence of those differences was explained in Annex I while the operational details were specified more precisely in Exhibit Bra-313. Annex I attempted to provide a relatively simple heuristic discussion of the modelling approach. Exhibit Bra-313 provided the operational equations. These operational specification are made explicit in equations (4), (5) and (6) in Exhibit Bra-313. As explained in Exhibit Bra-313, my approach to the PFC, MLA, DP and CCP payment programmes and for crop insurance was to use a constant regional acreage elasticity (taken from the FAPRI crops model publications).[88] These elasticities were the averages of the time-varying elasticities used over previous periods, as reported by the FAPRI US crops model that I adapted. I

[83] *See* my 9 October Closing Statement attached as Annex II to Brazil's 9 October Closing Statement, my 2 December Oral Statement (Exhibit Bra-342, paras. 24-28), Exhibit Bra-345 (paras.6-14) as well as Brazil's answers to question 213 from the Panel on which I have provided input (Brazil's 22 December Answers to Questions, paras. 37-42).

[84] *See* paragraphs 51-52 of the US critique.

[85] Brazil's 2 December Oral Statement, Section 5.2 and the accompanying exhibits, as well as my oral explanations on 3 December, including Exhibit Bra-371.

[86] *See* my oral statement on 2 December (Exhibit Bra-342, para. 5 and 8), Exhibit Bra-331 (para. 10), letter of Professor Bruce Babcock attached to Brazil's 5 November letter to the Panel

[87] *See* section V

[88] The regional supply elasticities used for the constant elasticity calculations to determine the PFC, DP, MLA and CCP effects and the crop insurance effects are as follows: Corn Belt, 0.219; Central Plains, 0.942; Delta, 0.544; Far West, 0.041; South East, 0.615; and Southern Plains, 0.362.

then apply this constant elasticity to the percentage effects of the subsidy on net revenue. This constant elasticity modelling is well established in the literature.[89] Paragraphs 53-56 of the US critique misstate the operational model I used and ignore the information in Exhibit Bra-313 that explains how the heuristic explanation in Annex I was operationalized.

**Sections V.A to V.C**

59. In sections V.A and V.B, the Unites States fails to acknowledge that, because the level of net returns vary from year to year, the constant elasticity specification explained in Exhibit Bra-313 means that the impacts of the PFC, MLA, DP, CCP and crop insurance programmes will vary as well. When one recognizes this commonly applied feature of my specification, there is no inconsistency whatsoever between the acreage impacts in the periods 1999 through 2002 and 2003 through 2007.

60. In fact, the United States acknowledges its understanding of the operational specifications explained in Exhibit Bra-313 in paragraphs 63 through 66 of section V.C. And they acknowledge that with constant percentage effect, the number of acres shifted will depend on the percentage impacts of the subsidies on net revenue, not the absolute dollar impacts. The US observations about the programme effects in section V.A (paragraphs 57-60), section V.B (paragraphs 61-62) and in the table that follows paragraph 62 of the US critique are explained by my explicit description of the operational specifications of the Annex I model in equations (4) through (6) in Exhibit Bra-313. It is therefore puzzling why the United States included Section V.A and V.B in the document at all, since they provide no new information. The United States first simply mischaracterizes my approach as linear, and then states that the results are not in line with that linear characterization. As I explained in Exhibit Bra-313 (equations (4) through (6)) and as repeated by the United States in section V.C, my model uses a constant elasticity, constant percentage effect for these impacts.[90]

61. Let me clarify this a little further. The FAPRI US crops model applies a constant linear response to any added revenue. My Annex I model takes the same approach for all variables that are included from the standard FAPRI US crops model. This refers to all variables for which no modifications are reported in Exhibit Bra-313. The FAPRI linear system means that a $100 increase in subsidy has the same effect on acreage whether the base revenue is $200 or $1,000. My alternative approach is used for PFC, MLA, DP and CCP payments as well as crop insurance. It implies that a subsidy that is a constant 10 percent of net revenue has a constant percentage effect on acreage. Hence, a $100 increase in subsidy has a bigger percentage effect on acreage if base revenue were $200 (a 50 per cent increase) than if base revenue were $1,000 (a 10 per cent increase). Constant percentage impacts and constant elasticity models are far more common in the economics literature than are strictly linear models. Constant percentage effects do not imply larger impacts in general. In effect, a constant percentage effect says that subsidies have a bigger acreage effect when they are a bigger share of net revenue than when they are a smaller share of net revenue.

62. Section V.B on crop insurance contains some additional US mistakes in applying my model. The United States seems to apply a constant per-acre crop insurance benefit for all regions. This is inconsistent with my approach and with reality. As explained in paragraphs 54 and 55 of Annex I, crop insurance subsidy rates differ substantially by region and my model incorporates those differences. When the constant percentage effects are incorporated and when one applies the different regional subsidy rates, there is absolutely no inconsistency between the results in the period from 1999 through 2002 and the period 2003 through 2007.[91]

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[89] *See* Sumner, Daniel A., and Michael Wohlgenant, "Effects of an Increase in the Federal Excise Tax on Cigarettes," American Journal of Agricultural Economics, 1985, vol. 67, 235-242.

[90] I note that contrary to the US assertion in paragraph 66, my methodology has not changed between Annex I and Exhibit Bra-313.

[91] The United States claims in paragraph 62 that the existence of crop insurance had a negative impact in the acreage in the Corn Belt and that this would be an implausible result (paragraph 62 of the US Critique and

**Section V.D.**

63. The point of paragraphs 67 and 68 and the table to which they refer, which follows paragraph 70 ("Example of Southern Plains Acreage Impact"), are not at all clear. Most importantly, the United States is simply incorrect that I used only market revenue plus marketing loan gains as the basis for the percentage calculation.[92] The full net revenue including all programme payments are included in the model specification. It is not clear why the United States made this mistaken assumption.

64. In addition, the labelling of the table itself is not clear. For example, neither Annex I nor my other submissions include regional acreage effects of subsidy programmes. This is because the focus of this case is on national and international impacts. It appears that it was the United States which calculated the figures reported in the table following paragraph 70 ("Example of Southern Plains Acreage Impact"). I note that the marketing year 2005 planting effect of crop insurance in the Southern Plains that the United States labels "Sumner Impact" exceeds the effect I report in Annex I for the entire United States.[93] This reason for this seems to be that the United States presents first round effects, i.e., effects before any feedback effects (second-round effects) from both the US crops model itself as well as before any feedback from the CARD international cotton model. To be clear, these US figures are not the equilibrium figures that I reported in Annex I. They are also not the first-round effects that were intermediate for the results reported in Annex I because of mistaken US assumptions, as discussed below.

65. Further, the column (2) of the US table at paragraph 70 ("Example of Southern Plains Acreage Impact") is labelled "Programme Revenue," yet includes crop insurance. I assume this refers to the total subsidy per acre, not programme revenue. Also, the "programme revenue" only includes revenue from DP and CCP payments as well as crop insurance. No revenue from the marketing loan programme (10.06 cents per pound in MY 2005 pursuant to an AWP of 41.94 cents per pound reported in the baseline)[94] is included in the calculations. By not including marketing loan payments in its calculations, the United States does not follow its own proposition of what the right approach is.[95] Rather, it has excluded marketing loan revenue entirely from its calculations in the table at paragraph 70 of its critique ("Example of Southern Plains Acreage Impact"), leading to distorted elasticity calculations.

66. There are a number of further problems in the examples the United States provides in the tables at paragraph 70 of the US critique ("Example of Southern Plains Acreage Impact") that seem to account for the differences they have created by misapplying my model. Let us use the crop insurance calculations as an example. I calculate that the Southern Plains crop insurance subsidy is $26.14 per acre, not $24.67 per acre[96], as the United States enters into its table in the "programme revenue" column. Furthermore the acreage elasticity that I use is not 0.28, but rather 0.362. These

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the accompanying table). This is, however, not true. Net crop insurance subsidies in the Corn Belt were negative over time, with indemnity payments being below premium payments. Therefore, the program provided farmers with a net negative return causing negative acreage impacts. This is an entirely plausible result. *See* below the discussion on the amount of crop insurance subsidy payments (at paragraph 66, note 96 below). I also note that cotton is not an important crop in the Corn Belt and that crop insurance benefits in the more important regions in the Southern Plains and in the Southeast are much higher.

[92] *See* paragraph 68 of the US Critique.

[93] *Compare* the 0.446 million acres reported by the United States without offering any source with the results I have reported in Annex I, Table I.5d, which is 0.420 million acres.

[94] *See* Annex I, Table I.5a.

[95] *See* paragraph 68 of the US Critique.

[96] The regional crop insurance subsidy rates that I use are as follows: Corn Belt: -$0.70; Central Plains: $28.24; Delta: $7.37; Far West: $13.62; Southeast: 15.71; Southern Plains: 26.14.

two further obvious errors in the US application of my model account for the bulk of the differences that the United States seems to imply (incorrectly) were errors on my part.

67. Besides this, the table following paragraph 70 of the US critique ("Example of Southern Plains Acreage Impact") not only contain numbers that are not my reported impacts, they also make the serious conceptual error of simply adding the impact of each programme across the columns to get a "total" effect. This is an error because the effects of the programmes are not independent. In order to estimate the impacts of removing these three sets of programmes together, one must simulate that scenario explicitly. The resulting impacts will be smaller than the sum of the impacts of removing each programme one at a time. For example, if one removed the crop insurance programme for cotton, supply would fall and the market price of cotton in the United States would rise. This would imply that the CCP programme would have a smaller subsidy element and its effect would be smaller. The fact that the United States reported the simple sum of impacts across programmes and represented that as the impact due to the three sets of programmes together seems to demonstrate either an inadvertent error or a basic lack of understanding of how the programme and the model operates.

**Section V.E**

68. There are several problems and inconsistencies in the discussion and tables included in this section. These problems also apply to the calculations in section V.D.[97] The United States improperly applied my model and, therefore, it is not surprising that they found different results. I note that the United States in paragraphs 71 of its critique states that "reasonable assumptions were made to facilitate the calculations". I repeat again that Professor Babcock and myself offered the United States our assistance in replicating the results. Any request for assistance would have avoided these problems and the need for the United States to make "reasonable assumptions … to facilitate the calculations".

69. One important problem that vitiates any claims in this section is that the numbers that are labeled "Sumner's Reported Impacts" in the three charts that follow paragraph 72 are not what I reported in Annex I Tables I.5.b, I.5.c and I.5.d.98 The United States compares two sets of numbers that were evidently generated by the United States, neither of which is the result that I actually reported to this Panel.

70. As noted above, it seems that the United States provides direct acreage effects (so-called first-round effects) that do not take into account feedback effects from either the US crops model or the CARD international cotton model. These feedback adjustments are very large and the US figures do not represent the new, much smaller, equilibrium effects.

71. With this in mind, I will address the US arguments in section V.E. The United States claims that my approach to estimating the acreage impacts of removing PFC/DP, CCP/MLA, and crop insurance subsidies is deeply flawed because their attempted replication of the my methodology showed sharply lower impacts in 2002 – 2007 than what they claim were my estimated impacts.[99] As I will demonstrate, the difference between the two sets of estimates of the United States is primarily due to differences in the magnitude of elasticities of supply the United States used, as compared to the elasticities that I actually used. The United States applied time-varying, linear elasticities[100] because this is what is suggested by the FAPRI linear modelling framework. My Annex I results of the effects

[97] I have combined the discussion of these points to avoid any repetition in an already lengthy and technical document.

[98] Nor are these the figures that I have reported using the FAPRI January 2003 baseline (Exhibit Bra-325)

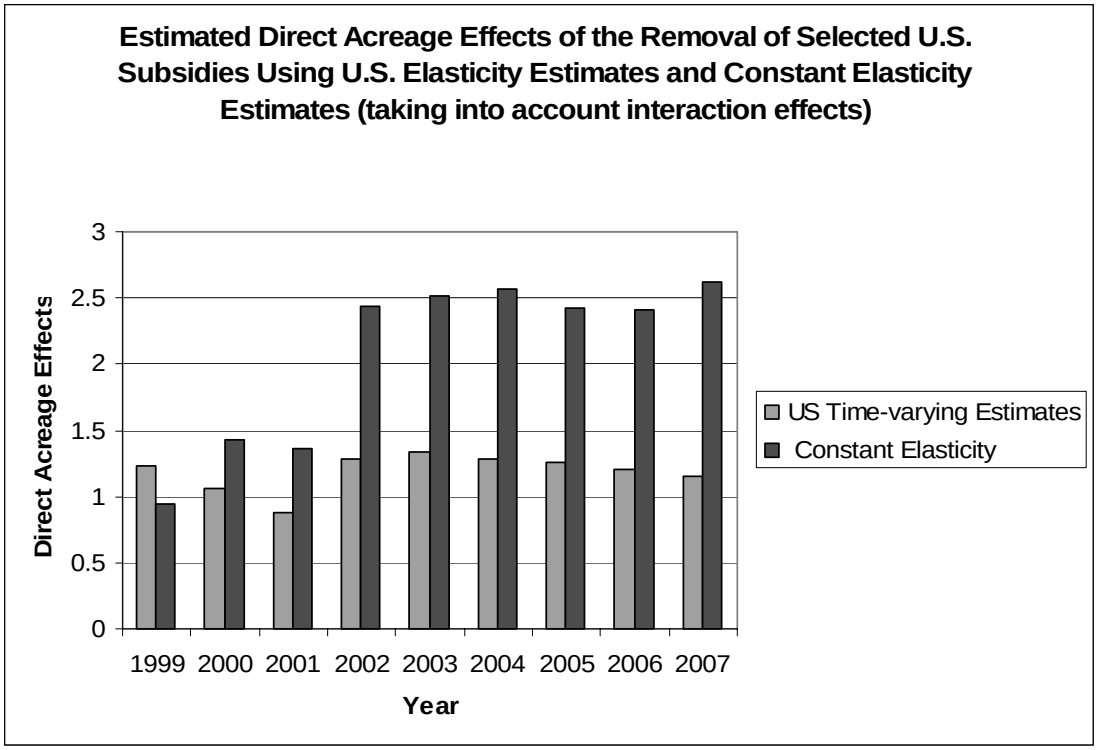
[99] Paragraph 69 of the US Critique and second set of tables following paragraph 70 of the US Critique, as well as the three charts following paragraph 72 of the US Critique.

[100] I have explained that in my comments on section V.A-V.C.

of these listed programmes are, however, based on a constant elasticity structure. As I will show, the US implementation of the United States' method using time-varying, linear elasticities is deeply flawed and leads to a dramatic underestimation of the effects. To clarify this step by step, I take as a starting point the US implementation of my Annex I methodology.[101]

72. The United States calculates time-varying, linear elasticities by multiplying the slope coefficient in the FAPRI US crops model by real net revenue (net revenue divided by a GNP deflator) and dividing the result by base acreage.[102] Net revenue used in this calculation is expected market revenue plus marketing loan gains. Contrary to the US approach and as discussed above, I use a set of elasticities that does not vary with time. The first chart below shows how the different elasticity estimates change the estimated acreage effects of removing PFC/DP, CCP/MLA, and crop insurance subsidies.[103]

Chart 1




73. I note again that these acreage effects are "first-round" effects that represent an intermediate calculation step towards estimating the new equilibrium results. Therefore, these figures are conceptually different from the equilibrium acreage effects reported in Annex I.[104]

74. These effects are also not the same as the first-round acreage effects that I have estimated using the Annex I model because of differing subsidy levels, as explained below.

[101] All calculations are presented in Exhibit Bra-399 ('AcreageDiscrepancies.xls') attached to the electronic version of this document.

[102] Base acres are the acreage planted under the baseline scenario.

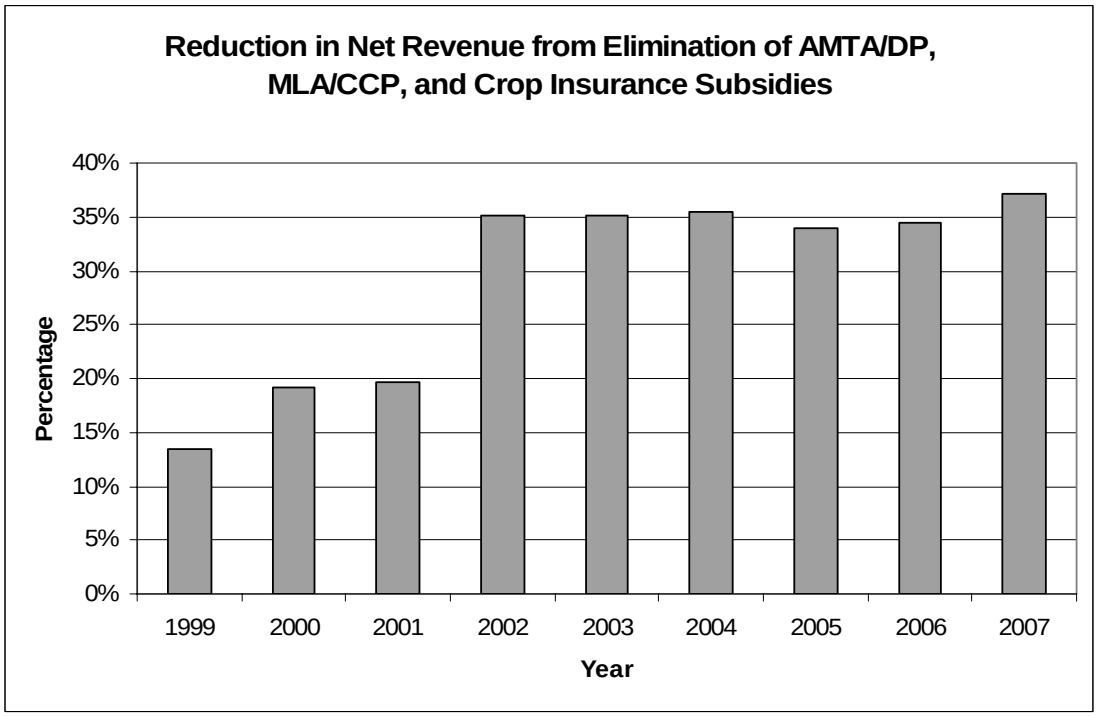
[103] The chart presents total effects from all three subsidy programs (PFC/DP, MLA/CCP and crop insurance) and controls for interaction effects.

[104] The Annex I effects take into account second round effects on price and quantities resulting from the first round effects and also the feedback from the CARD international cotton model leading to an equilibrium effect.

75. I note that the effects reported in chart 1 are quite similar to the pattern of effects presented by the United States, as reported in the charts following paragraph 72 of the US critique.[105] I have included the aggregate effects from these three programmes, controlling for interaction effects between them, which accounts for the differences between my figures and the sum of the figures presented by the United States.

76. I also note that, in chart 2, the pattern of acreage effects estimated by my use of a constant elasticity model specification[106] is consistent with the pattern of the importance of these subsidies, i.e., the share of the total net revenue presented by these subsidies.

Chart 2




77. The results in chart 1 would suggest that most of the discrepancy between the first-round effects that lead to my Annex I results and those first-round effects calculated by the United States is due to different assumptions regarding elasticities.

78. However, it is not true that the difference in the assumptions regarding the elasticities does primarily account for the difference. First, there is much less difference between the results from the two assumptions regarding the elasticities once an error in the United States' method for calculating its time-varying, linear elasticities is corrected.[107] As documented in the Final USCROPS2003.xls file[108], the United States calculates the supply elasticity by multiplying the slope parameter by real net revenue and then dividing it by base acreage. Net revenue in this calculation includes marketing loan

[105] They are not identical, as the United States used the FAPRI January 2003 baseline provided with my cotton-focused model for these calculations. The similarity of the figures demonstrates again the robustness of the model if different baselines are used.

[106] I have discussed this feature of a constant elasticity model in my comments on section V.A-V.C above.

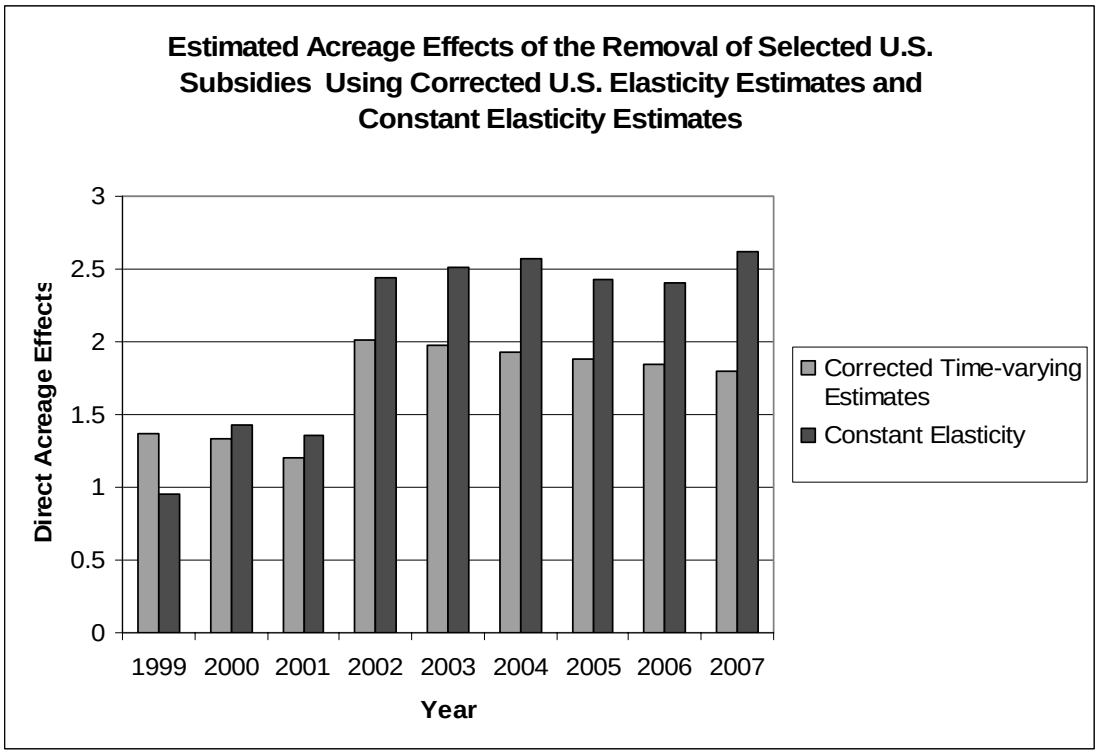
[107] As discussed below, the United States also uses compares results from two different baselines.

[108] Exhibit US-115.

gains and expected market revenue, but it does not include crop insurance subsidies and the other government subsidies that are to be removed in this simulation.[109] As the United States correctly points out when they question whether I included these subsidies for the calculation of the percentage change in net revenue from subsidy removal[110], these subsidies should also be counted towards net revenue when calculating the elasticity of supply.[111] The mistaken assumption by the United States that I have not done so seems to have let the United States to also leave these revenue components out of their calculation, thereby generating misleading results.

79. The following chart 3 shows that when the time-varying, linear elasticities are correctly calculated, then the choice of time-varying, linear elasticities or constant elasticities makes much less difference to the estimated impacts of subsidy removal than suggested by the United States in the three charts following paragraph 72 of the US critique.

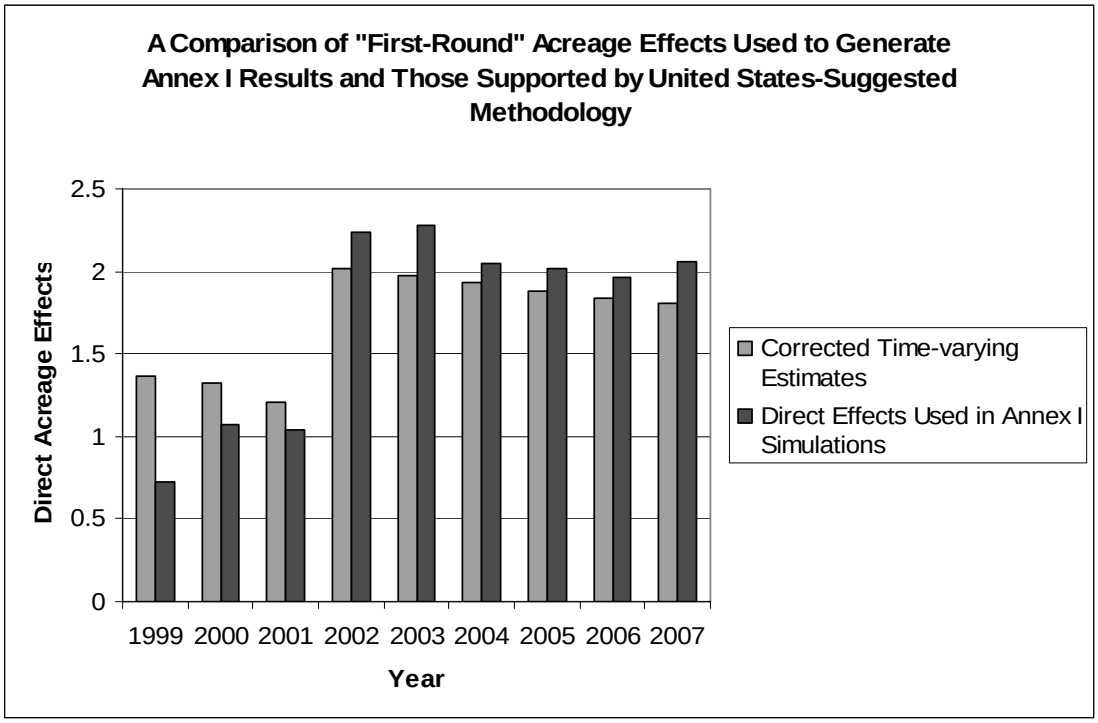
Chart 3




80. Finally, one last source of difference is that the United States uses the model calibrated to the FAPRI 2003 baseline[112] rather than the baseline used to estimate the effects reported in Annex I. The next chart (4) compares the actual direct acreage effects (first round effects) from removal of PFC/DP, CCP/MLA, and crop insurance subsidies based off the baseline used to generate the Annex I results to those that would have resulted from using the correct US time-varying, linear elasticity approach, the correct net revenue estimates and the same baseline. As shown below, adopting the corrected United States procedure compared to my constant elasticities approach would have resulted in a dramatic increase in the estimated impacts of removing these subsidies in 1999, somewhat higher estimates in 2000 and 2001, and a bit lower estimates in 2003 to 2007.

[109] I note that I also made this point in my comments on section V.D above.
[110] *See* paragraph 68 of the US Critique.
[111] I note that I correctly included these subsidies.
[112] Provided by Brazil as an attachment to its 18 November 2003 Further Rebuttal Submission.

Chart 4




81. In sum, the bottom line of these calculations is that, if the United States had followed the approach that they and I agree would be correct for calculating total net revenue and resulting time-varying, linear elasticities, the resulting effects would not be significantly different whether simulated using constant elasticities or time-varying, linear elasticities. I used the constant elasticity method because it makes the common sense assumption that equal percentage changes in net revenue should give rise to similar changes in acreage.[113] As noted above, this is also a standard approach in economic literature.

82. Finally, I would like to stress that any remaining differences from using different elasticity approaches are still on the level of "first round" effects, not equilibrium effects. The resulting equilibrium effects would show results that are even less different based on the choice of time-varying, linear versus constant elasticities. In short, this choice does not meaningfully affect my Annex I results.

**Section VI.**

83. In paragraphs 73-74 of the US critique, the United States calls into questions my modelling approach for the marketing loan programme by describing it as revealing a "lack of knowledge of the programme, a broader deficiency in economics or some previously unknown modification of the FAPRI or CARD models". These allegations are baseless. Indeed, the United States simply identified a typo in the transcription of equation 2 in Exhibit Bra-313. This transcription typo was not made in the electronic model and, therefore, does not affect the results of my Annex I model. In the Annex I model, as in the FAPRI US crops model, the acreage in year 't' is affected by the loan rate in year 't' (not the loan rate in 't-1' as erroneously reported in Exhibit Bra-313). I regret the inconvenience if this typo caused some confusion.

[113] I have discussed this above providing the example of a $100 payments and base revenues of $200 and $1000.

84. It turns out that, contrary to what the United States implies in paragraph 74 of its critique, this typo introduced no ambiguity at all and would not have affected the results in any significant way. The fact is that the loan rate for cotton is essentially constant over the full period of analysis and, thus, the loan rate in period 't' is equal to the loan rate in period 't-1'.[114] Despite the tone of the paragraph, the model was clear, and the subscript 't' or 't-1' make no difference at all in this case. Yet, I stress again that this typo only occurred in the transcript of equation (2) in Exhibit Bra-313, and not in the electronic versions of the Annex I model itself.

85. In paragraph 74 the United States makes a major issue of what amounts to their own semantic confusion. The model that I use for the marketing loan benefits for cotton is as specified in equation (2) (noting the typo discussed above). As noted by the United States, the electronic versions of the models show that the marketing loan effect is based on the difference between the loan rate and what is labeled as the loan repayment rate. For crops other than rice and cotton the loan repayment rate is the US market price of the crop (a local market price). For cotton and rice the loan repayment rate is an international price and, for cotton specifically, it is the adjusted world price (AWP). Thus, there is no discrepancy between Exhibit Bra-313 and the electronic documentation provided. The formulation that I use for the marketing loan impacts is the same as the FAPRI US crops model.

86. Paragraph 75 of the US critique simply repeats their discussion from the section V.C., which I have addressed above.

87. Finally, in paragraph 76 of its critique, the United States alleges that I have taken an "illogical" approach on specifying the export effect of Step 2 payments that constitutes "a departure from the specifications in the FAPRI framework." Similar to my response to the US critique at paragraph 73, I regret that I made another typo in the subscript in Exhibit Bra-313 that was not included in the electronic version of the model and, therefore, does not affect my results. Of course exports in period 't' market the crop produced in that period. The US marketing years are calibrated so that this is generally true. The United States is correct that, with the typo, equation (7) obviously makes no sense. The subscript should have referred to production in period 't' rather than 't-1', which, of course, is the equation contained in my model as well as in the FAPRI US crops model. Despite the US tone in paragraph 76, I expect the United States is aware that the specification of equations (7) and (8) follow the FAPRI model, as provided in the electronic verification of both the FAPRI US crops model as well as my cotton-focused model. Removal of the export step-2 and domestic step-2 subsidies increase effective demand for US cotton by lowering the effective net price paid by buyers.

**Section VII**

88. In paragraphs 77 through 80 of the US critique, the United States notes that the CARD international cotton model used different supply and demand elasticities than found in a paper by FAPRI-Missouri economist Seth D. Meyer. In fact there are several sets of such elasticities in the literature.

89. I relied on the CARD model and the CARD elasticities for four simple reasons. First, the authors of the published studies that underlie the CARD international cotton model include Professors Babcock and Beghin, who are two of the most widely-published and respected agricultural economists in the field. The scholarly credibility of their work and that of their CARD colleagues has been reinforced by scores of professionally-refereed academic articles to their credit as well as awards and other accolades.[115] In terms of quality objective research in agricultural commodity market economics and related areas, the CARD team has a long distinguished track record and a top notch

[114] I note that the loan rate was 51.92 cents per pound in marketing years 1999-2001 and 52 cents per pound in all later marketing years, so there is a tiny difference between 2001 and 2002.

[115] Exhibit Bra-400 (List of Publications of Professors Babcock and Beghin).

professional reputation. By contrast, I do not know the professional work of Seth D. Meyer, and have not been able to locate any of his work in professionally-refereed publications.

90. Second, the CARD international cotton model was the model that had been used by CARD in its respected work on other international commodity analysis. I would note that the various CARD international commodity models developed by Professors Babcock and Beghin and their colleagues have been used and relied upon in a number of different studies and been published in professionally referred publications.[116]

91. Third, the elasticity parameters incorporated in the CARD model are well within the range of estimates found and applied for many agricultural commodities. Finally, the United States provides no evidence to support a suggestion that the Meyer estimates are in any way more appropriate for the questions posed by this Panel than the estimates imbedded in the CARD model. Therefore, United States assertion that use of the CARD model somehow "exaggerates" impacts is simply unfounded.[117]

**Conclusion**

92. The Annex I model adapted from the FAPRI US crops model and the CARD international cotton model is an appropriate tool for both forward- and backward-looking "but for" counterfactual US agricultural policy analysis questions, such as those facing this Panel. The conservative results from my Annex I model are well within any plausible range and supported by other economic and econometric evidence.

93. Over the past months of this lengthy proceeding, I have responded to each criticism raised by the United States at various occasions[118] and have explained why none affects the validity of my model or its results.

94. Professor Babcock and I have been fully transparent about the manner in which the effects of the US subsidies have been simulated and I have rebutted any US allegations that I made my modelling choices to achieve pre-conceived results. To that end, I have explained each of my

[116] Refereed articles using CARD international models:

Fuller F., J. Beghin, J. Fabiosa, C. Fang, H. Matthey, and S. De Cara. "China's Accession to the WTO. What Is at Stakes for Agricultural Markets?" *Review of Agricultural Economics* 25(2) (2003): 399-414.

Beghin J., B. El Osta, J. Cherlow, and S. Mohanty. "The Cost of the US Sugar Program Revisited," *Contemporary Economic Policy* 21 (1) (2003): 106-116. Reprinted in *International Sugar Journal* 105 (2003): 293-303.

Fuller F., J. Beghin, S. Mohanty, J. Fabiosa, C. Fang, and P. Kaus. " Accession of the Czech Republic, Hungary, and Poland to the European Union: Impacts on Agricultural Markets," *The World Economy* 25(3) (2002): 407-428.

Fang C., and J. Beghin. "Urban Demand for Edible Oils and Fats in China. Evidence from Household Survey Data," *Journal of Comparative Economics*, 30 (4) (2002): 732-753.

Fabiosa, J.F., D.J. Hayes and H.H. Jensen. 2002. "Technology Choices and the Economic Effect of a Ban in the Use of Over-the-Counter antibiotics in US Swine Rations." *Food Control* 13(2), 97-101.

Hayes, D.J., H.H. Jensen, L. Backstrom, and J.F. Fabiosa. 2001. "Economic Impact of a Ban on the Use of Over-the-Counter Antibiotics in US Swine Rations." *International Food and Agribusiness Management Review* Vol 4., p 81-97.

Fuller F., J. Beghin, S. Mohanty, J. Fabiosa, C. Fang, and P. Kaus. " The Impact of the Berlin Accord and European Enlargement on Dairy Markets," *Canadian Journal of Agricultural Economics*, 47 (5) (1999 – appeared in 2000): 117-130.

[117] It is also useful to remind ourselves that larger elasticies may mean smaller price impact, but also imply larger impacts on quantities and in particular larger acreage elasticities mean more acreage in the non-subsidized countries that is driven out of cotton by the US cotton subsidy programmes.

[118] *See inter alia* US 7 October 2003 Oral Statement, paras. 26-50 and US 22 December 2003 Comments on Brazil's Econometric Model.

modelling steps and offered my assistance to the Panel and the United States to facilitate the understanding of this complicated econometric model and its results.

95. The United States has criticized my choice of baseline and I have provided analysis under various other baselines, demonstrating the robustness of my results. The United States has also criticized my modelling choices for PFC, MLA, DP and CCP payments, crop insurance and export credit guarantees. I have provided evidence that these choices were reasonable and, in fact, conservative. Concerning the largest US subsidy, the marketing loan programme, I note that the United States has not criticized its modelling. I have explained that the use of lagged prices for a large-scale policy simulation analysis is standard and does not generate biased or exaggerated results – in fact, no futures prices could or have been used in such models.

96. In sum, I stand by my conclusions in Annex I "that very large subsidies provided to US producers and users of upland cotton have had and will continue to have large impacts on quantities of US cotton produced, used and traded and on both US and world prices of cotton".

# ANNEX I-13

## COMMENTS ON US ANSWERS TO QUESTIONS POSED BY THE PANEL FOLLOWING THE SECOND SUBSTANTIVE MEETING OF THE PANEL

28 January 2004

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| *EC – Sugar Exports II (Brazil)* | GATT Panel Report, *European Communities – Refunds on Exports of Sugar Complaint by Brazil*, L/5011 – 27S/69, adopted 10 November, 1980. |
| *US – Gasoline* | Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996. |
| *EC – Hormones* | Appellate Body Report, *European Communities - Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, adopted 13 February 1998. |
| *Australia – Salmon* | Panel Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/R, adopted 6 November 1998. |
| *EC – Bananas* | Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS27/ARB, adopted 9 April 1999. |
| *Brazil – Aircraft* | Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW, adopted 28 August 2000. |
| *Indonesia – Automobiles* | Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, adopted 23 July 1998.- |
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| *Korea – Dairy Safeguards* | Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000. |
| *Canada – Dairy* | Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, adopted 27 October 1999. |
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| *US – FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
| *Australia – Leather* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999. |
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| *US – Wheat Gluten* | Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted 19 January 2001. |
| *US – Wheat Gluten* | Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted 19 January 2001. |
| *Chile – Agricultural Products (Price Band)* | Appellate Body Report, *Chile- Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002. |
| *US – CVD's on EC Products* | Appellate Body Report, *United States – Countervailing Duties on EC Products*, WT/DS212/AB/R, adopted 8 January 2003. |
| *Canada – Aircraft II* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS222/R, adopted 19 February 2002. |
| *EC – Sardines* | Appellate Body Report, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002. |
| *EC – Sardines* | Panel Report, *European Communities – Trade Description of Sardines*, WT/DS231/R, adopted 23 October 2002. |
| *Japan – Apples* | Appellate Body Report, *Japan – Measures affecting the Importation of Apples*, WT/DS245/AB/R, adopted 10 December 2003. |

## List of Exhibits

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| Second Declaration of Andrew Macdonald, 27 January 2004. | Exhibit Bra- 401 |
| "Genetically Engineered Cotton Suffering from Production Problems", Organic Consumers Organization, 11 January 2002. | Exhibit Bra- 402 |
| "NCC will Intensify Emphasis for Quality, Yield Answers", Western Farm Press, 3 March 2001. | Exhibit Bra- 403 |
| "Benefits - BT Cotton", Monsanto Imagine. | Exhibit Bra- 404 |
| "Sample Costs to Produce Cotton Transgenic Herbicide- Resistant Acala Variety", San Joaquin Valley, University of California Cooperative Extension, 2003. | Exhibit Bra- 405 |
| "Cotton Cost-Return Budget in Southwest Kansas", Kansas State University Agricultural Experiment Station and Cooperative Extensive Service, October 2003. | Exhibit Bra- 406 |
| Documents on Cost of Production Insurance Plan for Cotton. | Exhibit Bra- 407 |
| Export – Import Bank of the United States, Standard Repayment Terms. | Exhibit Bra- 408 |
| Ex-Im Bank Fee Schedule. | Exhibit Bra- 409 |
| Export Insurance Services. | Exhibit Bra- 410 |
| "The Federal Scoop: US Government Financing for Service Exports", Export America, May 2003. | Exhibit Bra- 411 |
| Cotton and Wool Situation Outlook and Outlook Yearbook, USDA, November 2003, Table 16. | Exhibit Bra- 412 |
| "Agricultural Cash Rents", USDA, NASS, July 1999. | Exhibit Bra- 413 |
| "Agricultural Land Values and Cash Rents," USDA, NASS, August 2003. | Exhibit Bra- 414 |
| "Agricultural Land Values", USDA, NASS, April 1999. | Exhibit Bra- 415 |
| "What is a Farm Bill?", Congressional Research Service, Report for Congress, 5 May 2001. | Exhibit Bra- 416 |
| "Commodity Program Entitlements: Deficiency Payments", USDA, May 1993. | Exhibit Bra- 417 |
| Washington Post v. United States Department of Agriculture, 943 F. Supp. 31 (D.D.C. 1996). | Exhibit Bra- 418 |
| Allocation Calculations Based on Brazil's Methodology and US Summary Data. | Exhibit Bra- 419 |

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| Agricultural Outlook Tables, November 2003, Table 17. | Exhibit Bra- 420 |
| ERS Briefing Room: Farm Income and Costs: US Farm Sector Cash Receipts from Sales of Agricultural Commodities, USDA. | Exhibit Bra- 421 |
| Fruits and Tree Nuts Yearbook, USDA, October 2003, Table A-2. | Exhibit Bra- 422 |
| Vegetables and Melons Yearbook, USDA, July 2003, Table 3. | Exhibit Bra- 423 |
| Allocation Calculations Based on US Methodology and US Summary Data. | Exhibit Bra- 424 |

Questions from the Panel to the parties –
second substantive Panel meeting

## I. TERMS OF REFERENCE

**192. Regarding the interest subsidies and storage payments listed by the United States in its response to the Panel's Question No. 67:**

**(a) Please provide a copy of the regulations under which they are currently provided and under which they were provided during the marketing years 1996-2002;**

**(b) Please indicate whether there are any such payments which are not provided to implement the repayment rate for upland cotton within the marketing loan programme. USA**

**Brazil's Comment:**

1. The United States finally confirms that the "other payments" (*i.e.*, interest and storage payments) are not separate subsidies but rather a component of the marketing loan programme.[1] The US acknowledgement eliminates any question whether such payments are within the Panel's terms of reference.[2] Brazil's request for the establishment of a panel clearly includes "subsidies and domestic support … relating to marketing loans … providing direct or indirect support to the US upland cotton industry".[3] Based on the US answer, Brazil amends the table at paragraph 8 of its 22 December 2003 Answers to Question 196 to add $65 million "other payments" to the $832.8 million for marketing loans, for a grand total of $887.8 million in marketing loans for MY 2002. Brazil also makes similar changes for MY 1999-2001 that combine "other payments" and marketing loan payments in Table 1 of Brazil's 9 September 2003 Further Rebuttal Submission.

**193. Are interest subsidies and storage payments already included in the amounts shown in your submissions to date for payments under the marketing loan programme? Has there been any double-counting? BRA**

**194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? BRA, USA**

**Brazil's Comment:**

2. Brazil's 22 December 2003 response to this question, particularly its reference to the request for the establishment of the panel and existing jurisprudence, provides a comprehensive response to the points raised by the United States.[4] Brazil would offer the following additional comments to the US Answer.

3. Contrary to the suggestion at paragraphs 3-4 of the US 22 December 2003 response, Brazil's 11 August 2003 response to Question 19 did not change in any way the scope of Brazil's request for the establishment of a panel ("Panel Request"). Question 19 asked Brazil to clarify the measures in respect of which Brazil sought relief. Brazil's answer referred to one set of measures relating to

[1] US 22 December 2003 Answers to Questions, para. 2.
[2] US 30 September 2003 Further Submission, paras. 6-7; US 7 October 2003 Oral Statement, para. 2.
[3] WT/DS267/7, p. 2 (paragraphs relating to both the 2002 FSRI and the 1996 FAIR Act).
[4] Brazil's 22 December 2003 Answers to Questions, paras. 3-5.

Brazil's serious prejudice claims as those involving domestic support and export subsidy payments that had been made and were required to be made by the terms of the various statutory instruments identified in the Panel Request from MY 1999 through MY 2007. Some of these payments are relevant to Brazil's present serious prejudice claims for the period MY 1999-2002, and some of the payments are relevant to Brazil's threat of serious prejudice claims for the period MY 2002-2007. But as Brazil indicated in its 22 December 2003 Answer to Question 195, the text of the Panel Request (as well as Brazil's 11 August 2003 Answer to Question 19) in no way limits the type or scope of the payments made under those statutory and regulatory instruments up to 18 March 2003.

4. It is curious that the United States in its 22 December 2003 response takes an opposite position in this dispute than the one it took as the complaining party in the only other WTO serious prejudice dispute.[5] In *Indonesia – Automobiles*,,[6] the measures at issue provided for past, present, and future subsidy payments. Indonesia argued, similar to the US arguments here, that the effects of expired measures could no longer be examined for the purposes of current serious prejudice under Articles 5 and 6 of the SCM Agreement. Rejecting such a restrictive interpretation of Articles 5 and 6, the panel noted that:

> If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were "expired measures" while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice. Thus, we decline to proceed on the course suggested by Indonesia.[7]

At no time did the panel find, as Indonesia argued, that only non-expired subsidies paid under the measures at issue up until the date of establishment of the panel should have been considered for the purposes of assessing serious prejudice. Indeed, the US position in this dispute is practically the same as what Indonesia argued – and the US argued against[8] – in *Indonesia – Automobiles*. Brazil recalls the consistent US positions that (a) so-called "recurring" subsidies for MY 1999-2001 cannot be the basis for any serious prejudice claims[9], combined with (b) its claim that only *current* 2002 subsidies up to 18 March 2003 (*i.e.*, eight months of subsidies for MY 2002) can be the basis for any serious prejudice claims.[10] Given these two arguments, in the words of the *Indonesia – Automobiles* panel, "it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice".

5. As in *Indonesia – Automobiles*, the legal statutes and regulations set out in the Panel Request that mandate the payment of subsidies did not change between 18 March 2003 and 20 January 2004. Indeed, the 2002 FSRI Act and its implementing regulations will remain identical (unless amended by the US Congress) until the end of MY 2007. Nor has the 2000 ARP changed since 18 March 2003. The mandated subsidies from these statutes and regulations were flowing before 18 March 2003 and they will continue to flow thereafter. This case does not present the situation where a new legal instrument providing subsidies is enacted after the panel request was established. Nor is it even a situation as in *Chile – Agricultural Products (Price Band*,[11], in which a significant amendment to the legal instrument covered in the panel request was made long after the panel was established. The rationale of the Appellate Body in *Chile – Agricultural Products (Price Band)* and of the panel in *Indonesia – Automobiles* is to allow the Panel to conduct the required objective assessment under

[5] US 22 December 2003 Answers to Questions, paras. 3-5.
[6] Panel Report, *Indonesia – Automobiles*, WT/DS54/R.
[7] Panel Report, *Indonesia – Automobiles*, WT/DS54/R, para. 14.206.
[8] Panel Report, *Indonesia – Automobiles*, WT/DS54/R, paras. 4.44-4.50.
[9] US 30 September 2003 Further Submission, para. 94.
[10] US 11 August 2003 Answers to Questions, para. 134; US 22 December 2003 Answers to Questions, paras. 3-5.
[11] Panel Report, *Chile – Agricultural Products (Price Band)*, WT/DS207/R, paras. 7.3-7.8.

DSU Article 11 based on all the relevant facts. These decisions are also grounded in the need for the "prompt settlement" of disputes under DSU Article 3.4 – and are structures to avoid the endless filing of precision-timed annual disputes and the litigation gaming strategy envisioned by the US argument.

## II. ECONOMIC DATA

**195. Does the United States wish to revise its response to the Panel's Question No. 67*bis*, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers"? Did the United States make enquiries of the FSA in the course of preparing its original answer? USA**

**Brazil's Comment:**

6. Brazil notes that the US answer is largely unresponsive to the Panel's question.

7. The Panel's question whether the United States "maintains information" is straight-forward. A correct answer would have been "yes". The ordinary meaning of the word "maintain" is "practice habitually", "observe", "cause to continue (a state of affairs, a condition, an activity)".[12] The United States consistently misled Brazil and the Panel by stating that USDA never collected, organized and maintained information regarding the amount of contract payments paid to current producers of upland cotton.[13] There is no doubt that these statements were false and misleading. It is significant that the United States has made no attempt to refute the evidence produced by Brazil in its 18 November 2003 Further Rebuttal Submission regarding the FSA forms completed by practically every US farm receiving contract or marketing loan payments.[14] Nor can the United States dispute that all of the information collected from the contract and acreage forms is (and was) maintained in a centralized database in USDA's Kansas City facility. The rapid response of USDA's Kansas City office to the rice FOIA request provides compelling evidence of the habitual practice of the US government in "maintaining" both contract and planted acreage information.[15] Indeed, the strongest proof of the United States' misleading conduct is the fact that USDA produced within three weeks the rice data in response to a FOIA request, and that the United States effectively admitted in its 18 and 19 December 2003 and 20 January 2004 Letters to the Panel that it maintains this information.

8. In fact, the United States continues to mislead the Panel in its 22 December 2003 Answer to Question 195. It states that "because those payments are decoupled from current production, expenditures under such programmes are not tracked by whether the recipient produces upland cotton".[16] Neither Brazil nor the Panel ever asked the United States how the programmes are "tracked". Rather, the Panel asked whether the United States "maintains information" that would permit the calculation of the amount of such payments. As Brazil has demonstrated in using the rice FOIA request[17], in discussing its proposed methodology, and in using the incomplete summary data provided by the United States on 18/19 December 2003, this is a simple exercise.[18]

[12] New Shorter Oxford Dictionary, 1993 edition, p. 1669.

[13] US 27 August 2003 Comments on Brazil's Rebuttal Submission and Answers to Additional Question, paras. 20, 21, 27; US 11 August 2003 Answer to Question 60; The United States made similar statements during the consultations held between November 2002 and January 2003.

[14] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.2.

[15] Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003).

[16] US 22 December 2003 Answers to Questions, para. 6.

[17] Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003).

[18] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55; Brazil's 28 January Comments and Requests Regarding US Data, Section 9.

9. The United States also asserts that "Brazil has also not asserted that the United States maintains information on the receipt of decoupled payments for upland cotton base acres by upland cotton producers".[19] Once again, the United States misleads and misrepresents. What Brazil asserted was that the United States maintains information in a centralized database on the amount of contract acreage, contract yields, and upland cotton plantings on contract acreage that would permit the ready calculation of the exact amount of contract payments received by current producers of upland cotton.[20] The fact that the United States claims not to have performed the simple calculation from this data does not mean the United States does not maintain the information requested by Brazil and the Panel.

**196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. BRA, USA**

## Brazil's Comment:

10. Brazil notes the new and increased figures ($415 million) that the US 22 December response presented for Step 2 payments during MY 2002. This figure should replace Brazil's figure presented at paragraph 8 of its 22 December 2003 Answers to Questions.[21]

**197. Please provide actual data for 2002/2003 for US exports, US consumption and per cent of world consumption to replace the projected data in Exhibit US-47. If available, please provide projected data for 2003/2004 to replace the forecast data. USA**

**Brazil's Comment:**

11. The US 22 December 2003 response admits at note 24 to the table at paragraph 15 that the US "consumption" standard for "world market share", within the meaning of Article 6.3(d) of the SCM Agreement, includes tabulating US exports and US imports and US domestic consumption of US origin upland cotton.[22] This acknowledgement that imports are also included highlights the fact that the United States is double counting exports as part of the world market share of the exporting country and part of the world market share of the *importing* country.[23] Since internationally-traded upland cotton is not similarly included twice in the total "world consumption," summing up the individual world market shares of all countries generates a total world market share vastly exceeding 100 per cent – a manifestly absurd result.[24] As Brazil has stated before, the Panel should not rely on the US interpretation of world market share as share of world consumption – the proper interpretation of the term refers to the share of world exports.[25]

12. Further, Brazil notes the new information presented by the United States concerning US upland cotton exports in MY 2002 and 2003. These figures (11.9 million bales and 13.2 million bales respectively) would replace Brazil's latest information, as contained in Exhibit Bra-302 (11.3 million bales and 11.2 million bales respectively). These new facts support Brazil's threat of serious prejudice claim under Article 6.3(d) and footnote 13 of the SCM Agreement. For both marketing

[19] US 22 December 2003 Answers to Questions, para. 7.

[20] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.2.

[21] *See* Brazil's comment on US 22 December 2003 Answer to Question 192(b) above concerning the treatment of "other payments." US 22 December 2003 Answers to Questions, para. 2. This US statement eliminates any doubt that "other payments" are within the Panel's terms of reference.

[22] US 22 December 2003 Answers to Questions, para. 15 (note 24).

[23] *See* Brazil's 2 December 2003 Oral Statement, para. 66. *See* also Brazil's comment on Question 136, below.

[24] *See* Brazil's comment on Question 136, below.

[25] *See* Brazil's 7 October 2003, Oral Statement, paras. 38-41; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 170-173; Brazil's 2 December 2003 Oral Statement, para. 66.

years, the US world market share, *i.e.*, the US share of world exports, is or will be even above its previous three-year average, strengthening the consistent trend of increasing world market shares since MY 1996 (as well as since MY 1986).[26]

**198. Please comment on the respective merits of the price-gap calculations of MY1992 deficiency payments in US comments of 27 August, footnote 14 ($867 million), and Brazil's response to the Panel's Question No. 67 ($812 million). BRA, USA**

**Brazil's Comment:**

13. As indicated in Brazil's 22 Decembers Answers to Questions, Brazil agrees with the US methodology of calculating MY 1992 deficiency payments[27] for purposes of an AMS approach, as developed by the United States in its 27 August 2003 Comments on Brazil's 22 August 2003 Rebuttal Submission.[28]

14. However, Brazil strongly disagrees with the US proposition that the US AMS calculation of deficiency payments is "conservative".[29] The US calculation is the only appropriate one under paragraphs 10 and 11 of Annex 3 of the Agreement on Agriculture. The United States suggests that it should have used "eligible" acreage rather than "actual" acreage for the calculation.[30] However, paragraph 10 of Annex 3 does not refer to eligible acreage; it refers to "the quantity of *production* eligible to receive the applied administered price".[31] Production eligible to receive the applied administered price under the deficiency payment programme is calculated based on the eligible, participating acreage and the applicable programme yield (not the actual yield). Any production exceeding the programme yields and any production on acreage that did not participate in the deficiency payment programme necessarily was not eligible production. Thus, the fact that theoretically more acreage could have participated in the upland cotton deficiency payment programme (*i.e.*, those farms opted to not participate) cannot artificially inflate the upland cotton AMS figure resulting from this programme. Thus, any production that takes place on a farm not participating in the deficiency payment programme is not, in fact, eligible to receive the applied administered price and, therefore, cannot be part of the AMS calculation under paragraphs 10 and 11 of Annex 3.

**199. What is the composition of the A-Index? We do note footnote 19 and, for example, Exhibit BRA-11, but please explain more in detail how this index is calculated. BRA**

**200. Concerning the chart on page 37 of Brazil's further rebuttal submission, why did Brazil use a futures price at planting time? Is this a relevant measure for assessing acreage response? BRA**

**201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so, please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? BRA, USA**

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[26] *See* Brazil's 27 October 2003 Answers to Questions, paras. 123-129. *See* also Brazil's 22 December 2003 Answers to Questions, paras. 133-139, concerning Brazil's arguments regarding a "consistent trend."

[27] Brazil emphasizes that it does not agree with to applying any price-gap calculation method for the calculation of marketing loan payments for AMS purposes. *See inter alia* Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 10-16.

[28] Brazil's 22 December 2003 Answers to Questions, para. 10.

[29] US 22 December 2003 Answers to Questions, para. 19.

[30] US 22 December 2003 Answers to Questions, para. 19.

[31] Emphasis added.

**Brazil's Comment:**

15. Brazil notes that the study cited by the United States[32] on upland cotton farmers' use of hedging instruments is relatively dated (from 1996) and analyzes a time period during which prices were high. Therefore, it may not reflect farmers' use of hedging instruments during the period of investigation.

16. In addition, Brazil notes that the futures market is not only used as a hedging instrument by US farmers, but also by farmers in other parts of the world, including Brazilian farmers.[33] It is also used by speculators.[34] It follows that the number of open contracts does not bear any relationship to the amount of the US upland cotton crop hedged by futures contracts at the New York futures market.[35]

**202. Concerning paragraph 7 of the US oral statement, are the expected cash prices shown for February only? Can the US provide the prices for January and March of each year as well? USA**

**Brazil's Comment:**

17. Brazil notes that the expected cash price is not the relevant price for purposes of analyzing the effects of the marketing loan programme. Since any marketing loan benefits are calculated as the difference between the loan rate and the adjusted world price, it would be necessary to look at the expected adjusted world price to draw any conclusions.[36] This point is admitted by the United States in paragraph 75 of its 22 December 2003 Answers to Questions: "… because farmers will receive a government payment for the difference between the loan rate and the adjusted world price".[37]

18. Brazil also notes that the figures presented by the United States differ to a minor degree from the ones presented by Brazil.[38] Brazil does not know the reason for these minor differences and does not consider them to be material.

**203. Please provide information concerning the organization, mandate, credentials and standing of FAPRI. BRA**

**204. Which support to upland cotton is not captured in the EWG data referred to in Brazil's 18 November further rebuttal submission? BRA**

**205. Does the United States accept or agree with the EWG data submitted by Brazil? If not, please explain your reasons. USA**

[32] US 22 December 2003 Answers to Questions, para. 20.

[33] Exhibit Bra-281 (Statement of Andrew Macdonald – 7 October 2003, para. 13).

[34] Exhibit Bra-281 (Statement of Andrew Macdonald – 7 October 2003, para. 13).

[35] The United States appears to suggest this relationship in paragraph 21 of its 22 December 2003 Answers to Questions.

[36] *See* Brazil's 2 December 2003 Oral Statement, Section 5.2 for further details on this point.

[37] Brazil addresses this point in greater detail in its comment on Question 212 and 213 below.

[38] *Compare* US figures at paragraph 22 of the US 22 December 2003 Answers to Questions with Brazil's figures as reported in Exhibit Bra-356 (January – March Quotes of the December Futures Contract, Expected and Actual AWP and Cash Price) and at paragraph 44 of Brazil's 2 December 2003 Oral Statement.

**Brazil's Comment:**

19. As a preliminary comment, the United States answer does not rebut evidence from EWG's expert analyst that the EWG data undercounts the amount of contract payment and marketing loan payment subsidies.[39] While it undercounts the data, the EWG data and the estimates generated by Brazil's 14/16th methodology for MY 2002 are very close. Brazil estimates the MY 2002 direct payments to current cotton producers at $454.5 million[40], while the EWG data shows MY 2002 direct payments to current cotton producers of $451.4 million.[41] Similarly, Brazil's estimates that the MY 2002 CCP payments to current cotton producers were $935.6 million[42], while the EWG data shows $893 million.[43] Thus, as Brazil has argued, the EWG data could certainly be used by the Panel as evidence *supporting* Brazil's 14/16th methodology, as explained previously and elaborated further below.

20. The US 22 December 2003 response asserts, at paragraph 25, that Brazil has overestimated the support to upland cotton from contract payments. However, the summary US data produced on 18 and 19 December 2003 seems to show that only between 10-20 per cent of US upland cotton producers planted upland cotton on non-cotton base acreage.[44] The EWG data showed that, in MY 2002, 15 per cent of the contract payments received by current producers of upland cotton were from other contract acreage crops.[45] The United States refused to produce any information regarding current upland cotton production on non-upland cotton base acreage.[46] However, the EWG database – although understating the amounts – supports a finding that farms producing upland cotton received a significant amount of non-upland cotton contract payments. The EWG database therefore also supports an adverse inference by the Panel that the actual data withheld by the United States would show even higher payments to current upland cotton producers than the EWG data or the Brazilian estimates. It also demonstrates that the EWG data is not a comparable substitute for the information requested by the Panel on 8 December 2003 and 12 January 2004.[47] The EWG data contains no information about acreage planted and, thus, does not allow for any farm-specific allocation. It is also incomplete in terms of actual payments made.

21. The US statement in paragraph 24 of its 22 December 2003 response focuses on the large number of farms not receiving direct payments. What the United States largely ignores is the predominance of very small non-cotton producing farms that receive very small upland cotton base payments. In fact, according to the US summary data, the 45 per cent of farms that received upland cotton contract payments (but did not produce upland cotton) received only between 15 and 25 per cent of the upland cotton contract payments.[48] It is undisputed that the bulk of upland cotton is

[39] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 29-30; Exhibit Bra-316 (Statement of Christopher Campbell, paras. 12-15); Brazil's 22 December 2003 Answer to Question 204, paras. 25-26.

[40] Brazil's 18 November 2003 Further Rebuttal Submission, para. 8.

[41] Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 2).

[42] Brazil's 18 November 2003 Further Rebuttal Submission, para. 8.

[43] Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 2).

[44] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively, data for upland cotton production on farms without upland cotton base. Brazil notes that this does not mean that these farms have no contract base acreage whatsoever. Instead, the United States has withheld that data (Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 2).

[45] Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 5 (MY 2002)).

[46] US 18 and 19 December 2003 Letters to the Panel and US 20 January 2004 Letter to the Panel. *See* also Brazil's 28 January 2004 Comments and Requests Regarding US Data, Sections 2-3.

[47] *See* Brazil's 28 January 2004 Comments and Requests Regarding US Data which details the information that could have been adduced with the information withheld by the United States.

[48] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. The upland cotton contract acreage on farms not producing upland cotton represents between 15 and 25 per cent of total upland cotton contract acreage. Brazil has used contract acreage

produced in very large operations[49], and the EWG data confirms this.[50] The EWG data shows that 5 per cent of farms receiving the highest amounts of upland cotton payments account for 41-45 per cent of marketing loan payments, *i.e.*, 41-45 per cent of production. The top 10 per cent of farms account for 55-58 per cent of production, and the top 20 per cent of farms account for 70-72 per cent of production.[51]

22. The United States makes the assertion in paragraph 25 of its 22 December 2003 response that in MY 2000-2002, "only 71, 77, and 74 per cent respectively of upland cotton base acreage payments went to farms that planted upland cotton". The United States claims this EWG data shows that Brazil's 14/16$^{th}$ methodology overestimates the amount of contract payments to upland cotton. This is incorrect. First, even the incomplete EWG data shows a very high percentage of upland cotton contract payments directly connected with the current production of upland cotton. Second, the EWG data cannot be used to calculate the amount of non-upland cotton base payments attributable to current producers of upland cotton.[52] Because the EWG data cannot match contract acreage and planted acreage of the same farm – it is payment data, not acreage data. Given the fact that 10-20 per cent of US upland cotton is planted on farms without upland cotton base (but some other base acreage)[53], non-upland cotton contract payments would make up for the shortfall alleged by the United States.[54] This further highlights the need for the withheld US data. The United States obviously knows what the data shows and can easily calculate the amount of non-cotton base payments allocable to upland cotton production. The US decision not to release even "non-confidential" data that would show the amount of allocated payments is strong evidence that it knows that the actual data is larger than the EWG and Brazilian estimates.

23. Finally, the United States in paragraph 26 argues that summary data it produced on 18/19 December 2003 shows that in MY 2002, 29.4 per cent of total cropland on farms receiving upland cotton contract acreage payments was planted to upland cotton. This figure is highly misleading, because it includes all of the acreage from farms with upland cotton base acreage that do not plant upland cotton. When only farms that currently produce upland cotton are included, then about 50 per cent of the cropland acreage on these farms that actually produce upland cotton was planted to upland cotton. Indeed, the United States acknowledges this fact in paragraph 186 of its 22 December 2003 Answers to Questions.

24. Further, because of the US refusal to provide the information requested by the Panel on 8 December 2003 and 12 January 2004, it is impossible to determine from the US incomplete summary data the diversity of the cropland for upland cotton producers accounting for the majority of upland cotton production. Indeed, strong evidence that upland cotton producers concentrate in upland cotton production is found in the EWG data, which shows that 85 per cent of the contract payments

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as a proxy for payments, which is a conservative proxy, as presumably the less productive farms (*i.e.* those with lower yields and thus fewer payment units per payments acre and fewer payments per acre) stopped producing upland cotton.

[49] Brazil's 27 October 2003 Answer to Questions, paras 7-8.

[50] Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 3).

[51] Exhibit Bra-317 (Environmental Working Group Database: Table of Results, Table 3).

[52] Without the farm-specific data the United States has refused to produce, it is impossible to know for certain what non-upland cotton contract payments received by current upland cotton producers are properly allocated to upland cotton production.

[53] Even for those farms that mainly plant on upland cotton base, additional non-upland cotton contract payments would need to be allocated. *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. *See* also Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55 and Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 9.

[54] *See* Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 9.

received by upland cotton producers were *upland cotton* payments.[55] This supports USDA's own reports on cotton specialization, which indicate that the considerable bulk of cotton is produced in farms that specialize largely in upland cotton production.[56]

**206. Please explain how the graph in paragraph 40 of the US further rebuttal submission was derived. In so doing, please clarify whether the figures are on a cents per pound basis or some other basis. What averaging method was used? Can you prepare individual charts showing average US and Brazilian cotton prices for each of those third country markets? USA**

**Brazil's Comment:**

25. The United States asserts in paragraph 28 of its 22 December 2003 response that "FOB is greater than FAS except where the vessel is not changed at the port of export, in which case the values are equal". As set forth in the Second Declaration of Andrew Macdonald, "in practice there is in fact no difference in cost between FAS and FOB, since the ship loads and unloads the cargo, and thus, the difference in selling price between cotton which is sold FAS and cotton which is sold FOB is negligible".[57] Further, Mr. Macdonald agreed with the US statement quoted above, but noted that "vessels are rarely 'changed' in the port," and even if they were, "there would be an insignificant interest loss and thus, no difference between FAS and FOB values".[58] Brazil directs the Panel to Mr. Macdonald's Second Declaration, in which he provides additional details supporting his expert opinion.[59]

26. Brazil notes that the United States does not appear to have any difficulty with comparing Brazilian FOB prices with US FAS prices since it makes this comparison in the graph in paragraph 30 of its 22 December 2003 Answers to Questions. Because of the negligible difference between these two types of prices based on export value, Brazil agrees that there is no difficulty in comparing such FOB and FAS prices. This would include the various pricing comparisons between US and Brazilian prices set out in Brazil's 22 December 2003 Answers to Questions 233 and 235.

27. Finally, Brazil notes the US acknowledgement that the United States used only a "simple average unit price" comparison between US and Brazilian prices in paragraph 30 of its 22 December 2003 response. As Brazil has indicated, from a statistical point of view this is a totally inappropriate way to compare prices because of the enormous distortions it creates.[60] The United States should have used "weighted average" unit value pricing comparisons.

**207. Please indicate whether any of the measures challenged in this dispute *obliges* cotton farmers to harvest their crop in order to receive the benefit of the programme (subsidy). USA**

**Brazil's Comment:**

28. The United States confirms that the marketing loan programme requires farmers to harvest their upland cotton to receive marketing loan payments.[61] In addition, the Step 2 programme requires

[55] Exhibit Bra-317 (EWG Database: Table of Results, Table 5, MY 2002, top line, far right side under "percentage of total contract payments", 85.07 per cent).
[56] Brazil's 27 October 2003 Answer to Question 125(a), paras. 7-10.
[57] Exhibit Bra-401 (Second Declaration of Andrew Macdonald, 27 January 2004, p. 2).
[58] Exhibit Bra-401 (Second Declaration of Andrew Macdonald, 27 January 2004, p. 2).
[59] Exhibit Bra-401 (Second Declaration of Andrew Macdonald, 27 January 2004).
[60] *See* following webpages which discuss, in a variety of contexts, the significant distortions that can occur with statistics by using simple averages as opposed to weighted averages: http://www.statcan.ca/english/edu/power/ch13/estimation/estimation.htm; http://www.grantedc.com/publications/Grant%20Co%20Washington%20W&FB%20Report%202003.pdf
[61] US 22 December 2003 Answers to Questions, para. 31.

the use or export of upland cotton to trigger payments.[62] Brazil notes that the crop insurance programme requires farmers to *plant* upland cotton to receive premium subsidies. No harvest is required from farmers to receive indemnity payments, which in turn may trigger additional reinsurance payments to the private insurance companies running the crop insurance programme.[63]

**208. Please provide data for the marketing years 1992 and 1999-2002 of the "quantity of production to receive the applied administered price" (*Agreement on Agriculture*, Annex 3, paragraph 8) for purposes of a price-gap calculation of support through the marketing loan programme. USA**

**Brazil's Comment:**

29. Brazil notes that this question directly implicates earlier evidence and arguments demonstrating that the United States has never used a "price-gap" methodology for calculating its marketing loan portion of AMS, *inter alia*, for upland cotton.[64] Rather, the United States has always used and notified a *budgetary* methodology in accounting for marketing loan payments (marketing loans, loan deficiency, certificate payments, and interest & storage payments).[65] In particular, when it agreed with other WTO Members on what the US "base level" would be for purposes of Total AMS, the United States chose to calculate marketing loan payments using a budgetary approach.

30. This is easily seen by first examining Exhibit Bra-191[66], which is a document in which the United States notified "supporting material related to commitments on agricultural products contained in Schedule XX - United States". Marketing loan payments for upland cotton are listed on page 20 of the document. The document lists the US loan deficiency payments for upland cotton for MY 1986 as $126.860 million, for MY 1987 as $0.364 million, and for MY 1998 as $42.038 million. Comparing these figures with the actual budgetary outlays for loan deficiency payments in MY 1986-88, as set out in Exhibit Bra-4, show the same figures (rounded out). Similar *budgetary* outlays are used for marketing loan gains and interest and storage payments that are also related to "marketing loan payments". In addition, Exhibit Bra-191[67] contains an Annex which is the "Supporting Table for Cotton: Deficiency Payment Calculation for GATT AMS." This table is there because the United States used the "price-gap" formula of Annex 3, paragraph 10 of the Agreement on Agriculture to calculate the AMS for deficiency payments. But no such supporting table exists for marketing loan payments, because a *budgetary* approach was used. In short, there is no doubt that the United States Total AMS Commitments were based, *inter alia*, on the US decision to use *budgetary* outlays for calculating its marketing loan payments for upland cotton.

31. The US decision under Annex 3, paragraph 10 to use budgetary outlays instead of the price-gap formula in calculating upland cotton AMS for marketing loan payments is legally binding on the United States. Annex 3, paragraph 5 states that "[t]he AMS calculated as outlined *below* [*i.e.*, paragraphs 6-13 of Annex 3] shall constitute the *base level* for the implementation of the reduction commitments on domestic support." The marketing loan budgetary decision reflected in G/AG/AGST/USA was incorporated into the US schedules and set the US "base level" of total AMS. The title of the G/AG/AGST/USA suggests its legally binding character – "Supporting Tables Relating to Commitments on Agricultural Products in Part IV of the Schedules." These "supporting

[62] US 22 December 2003 Answers to Questions, para. 31.
[63] Brazil's 24 June 2003 First Submission, paras. 80-83.
[64] *See* Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 10-16.
[65] *See, e.g.*, Exhibit Bra-191 (G/AG/AGST/USA, p. 20); Exhibit Bra-47 (G/AG/N/USA/43, p. 20); Exhibit Bra-150 (G/AG/N/USA/10, p. 18).
[66] G/AG/AGST/USA, p. 20.
[67] G/AG/AGST/USA, p. 21-22.

tables" were the basis upon which the "final bound commitment level specified in Part IV" of the US schedule was determined.

32. Annex 3, paragraph 5 of the Agreement on Agriculture indicates that the United States is bound by its initial decision to calculate AMS using a budgetary approach (as permitted in Annex 3, paragraph 10 of the Agreement on Agriculture). This conclusion follows from the text of Article 6.3 of the Agreement on Agriculture:

> A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS *does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule.*

33. Further, Article 3.2 provides that "[s]ubject to the provisions of Article 6, a Member shall not provide support in favour of domestic producers in excess of commitment levels specified in Section I of Part IV of its Schedule". The United States' "final bound commitment level specified in Section I of Part IV" of the US Schedule is currently $19.1 billion. Nothing in Article 6 or any other provision of the Agreement on Agriculture permits a Member such as the United States to change its Annex 3, paragraph 10 choice of budgetary or price gap calculations for the purposes of calculating *current* AMS.

34. Brazil has previously detailed the reasons why permitting Members to reverse the Annex 3, paragraph 10 choice to calculate *current* AMS for a product would make the disciplines of Article 3.2 and 6.3 of the Agreement on Agriculture inutile.[68] The United States never denied it has always notified marketing loan payments using a budgetary approach, and has never rebutted Brazil's arguments that permitting a Member to change its election under Annex 3, paragraph 10 to calculate *current* AMS would lead to the nullification of a Member's obligations under Articles 3.2 and 6.3. Indeed, the US Answer to Question 208 provides the best example of such a nullification, when the United States admits that "if the applied administered price for marketing years 1999-2002 were compared to the 1992 applied administered price, the resulting negative numbers . . . show the decrease in the level of support from MY 1992."[69] Translated, this means that the huge increase in marketing loan payments to $2.5 billion in marketing loan payments in MY 2001 would not be counted towards US total AMS for MY 2001.

35. Brazil emphasizes again that while the United States makes what are theoretical arguments in this dispute, its WTO partners properly rely on the past and most recent US notifications.[70] And these notifications consistently demonstrate that the United States properly treats the *budgetary outlays* for marketing loan payments for cotton as well as other programme crops as part of its total current AMS. These notifications further demonstrate that US budgeted outlays for marketing loans have significantly increased in MY 1999-2002 over the level of such loans in MY 1992.[71]

36. In light of the arguments and evidence set out above, there is little need for Brazil to comment on the calculations provided by the US 22 December 2003 response. Brazil notes that the US applies a contradictory approach to the quantity of eligible production for MY 1992 and MY 1999-2002. For example, the United States uses actual production figures calculated from *harvested* acreage for MY 1999-2002, while it calculates eligible production for MY 1992 as *planted* eligible acreage multiplied

[68] Brazil's 27 August 2003 Comments on US 22 August 2003 Rebuttal Submission, paras. 10-16.
[69] US 22 December 2003 Answer to Question 208, para. 37.
[70] *See, e.g.,* Exhibit Bra-191 (G/AG/AGST/USA, p. 20); Exhibit Bra-47 (G/AG/N/USA/43, p. 20); Exhibit Bra-150 (G/AG/N/USA/10, p. 18).
[71] Brazil's 9 September 2003 Further Submission, Table 1.

by the *yield on harvested* acreage.[72] This grossly overstates the eligible production. In fact, the US "eligible production" figures even overstate *actual* production in MY 1992 by 432,333 bales.[73] The actual eligible production for MY 1992 was 6.485 billion pounds[74], not the 7.748 billion calculated by the United States.[75] When compared to the actual production eligible for marketing loans in MY 1999-2002, the Panel can see that significantly greater US upland cotton production was provided marketing loan benefits in each of those later years compared to MY 1992.

**209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs. BRA, USA**

**Brazil's Comment:**

37. Brazil reemphasizes its position that only planted acres constitute a reliable measure for planting decisions in a single country, such as the United States.[76] This is highlighted by the fact that changes in planted and harvested acreage for the United States during MY 1996-2003 do not move in parallel. Contrary to the US assertion that the "movements in acreage figures are *fairly similar*"[77], in fact, the US planted and harvested acreage changes are in entirely opposite directions in 3 out of 8 marketing years[78], vary by great magnitudes in a further 3 out of 8 marketing years[79], and are "fairly similar" only in 2 out of 8 marketing years.[80] This overall picture can hardly be called "fairly similar" movements. Brazil refers the Panel to its 22 December 2003 Answer to Question 210[81], demonstrating that in fact US planted acreage and a proxy for worldwide planted acreage move in quite opposite directions, demonstrating that US producers of upland cotton do not take their planting decisions based on the same market-based price factors as other producers worldwide.[82]

**210. Are worldwide planted acreage figures available? BRA, USA**

**Brazil's Comment:**

38. Brazil agrees that no data on harvested acres is available on a worldwide basis. However, Brazil strongly disagrees that the only possible comparison between US and worldwide upland cotton acreage needs to be done on the basis of harvested acreage.[83] As discussed before, the only valid measure of farmers planting decisions is planted acres, as harvested acres figures are distorted by variations over time in the abandonment rate.[84] Therefore, it is critical to use planted acreage for the

[72] US 22 December 2003 Answer to Question 208, paras 33-35.

[73] *Compare* US figure at paragraph 33 of its 22 December 2003 Answers to Questions (16,142,333 bales) with the actual production in MY 1992 of 15,710,000 bales, as reported in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 4).

[74] 11,164,726 planted eligible acres times 0.837 (share of planted acres that was harvested (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4 (Abandonment Rate))) times 694 pounds per harvested acre (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4 (Yield))).

[75] US 22 December 2003 Answers to Questions, para. 33.

[76] Brazil's 27 October 2003 Answers to Questions, paras. 27-28; Brazil's 18 November 2003 Further Rebuttal Submission, para. 87; Brazil's 22 December 2003 Answers to Questions, paras. 30-32.

[77] US 22 December 2003 Answers to Questions, para. 39.

[78] MY 1997, 1999, 2000.

[79] MY 1996, 1998, 2001.

[80] MY 2002, 2003.

[81] Brazil's 22 December 2003 Answers to Questions, para. 31-36.

[82] Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.4 (containing further references).

[83] US 22 December 2003 Answers to Questions, para. 40.

[84] Brazil's 27 October 2003 Answers to Questions, paras. 27-28; Brazil's 18 November 2003 Further Rebuttal Submission, para. 87; Brazil's 22 December 2003 Answers to Questions, paras. 30-32.

United States in any analysis of congruence in planting decisions between the United States and the rest of the world. However, harvested acres may serve as a proxy for planted acreage on a worldwide basis.[85] On this basis, no congruence exists between the planting decisions of US upland cotton farmers and upland cotton farmers worldwide.[86] But, even if one were to look at harvested acres for both US and worldwide planting decisions, there is no congruence in the movements.[87]

**211. Brazil presents a graph in paragraph 59 of its further rebuttal submission indicating the increasing cumulative loss incurred by cotton producers. Please comment on the argument that US cotton producers could not continue operating without subsidies. In particular:**

**(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?**

**Brazil's Comment:**

39. Brazil reads the Panel's question as requesting the United States to provide an estimate of how much the updated 2003 USDA ARMS 1997 survey overstates the $872 per acre deficit between total costs and market revenue for the period MY 1997-2002. The United States' 22 December 2003 response declines to provide any dollar per acre estimate. Indeed, the US response appears to raise more questions than it provides answers.

40. The United States has claimed that the 2003 USDA cost data used by Brazil in calculating the $872 per acre deficit[88] cannot be relied on by the Panel.[89] Because this is a fact asserted by the United States, it has the burden of establishing it.[90] The Panel should expect the United States, which employees the USDA personnel who created the 2003 cotton update of the 1997 ARMS study, to have provided statements or other evidence from these cost experts explaining why the 2003 update is unreliable and cannot be used by the Panel. No such statements were provided. Brazil has examined the websites of USDA and the US National Cotton Council carefully and cannot find any warnings that the 2003 upland cotton costs and revenue are unreliable. Indeed, the current NCC website provides a direct link to the ERS-USDA costs and returns website for each major US region.[91] Presumably, the NCC intended its Members to rely on such data or they would not have included the link. Further, the United States neglected to inform the Panel that the 2003 upland cotton cost and revenue data has benefited from a "new costs of production estimation methodology" implementing the American Agricultural Economics Association (AAEA) Recommendations.[92] It is reasonable for the Panel to find that the 2003 cotton updates to the 1997 ARMS study using this new AAEA-recommended methodology results in a more accurate estimate of cotton costs and revenues – not a less accurate estimate.

41. What the United States attempts to prove in its 22 December 2003 Answer to Question 211(a) is that the use of biotechnology cotton ("BT cotton") has lowered costs, and that somehow these lower costs were not reflected in the annual updated USDA costs and returns surveys. It is noteworthy that the United States now admits that the USDA personnel updating the 1997 ARMS study *properly*

[85] Brazil's 22 December 2003 Answers to Questions, para. 32.
[86] Brazil's 22 December 2003 Answers to Questions, para. 33.
[87] Brazil's 22 December 2003 Answers to Questions, para. 34.
[88] Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.1.
[89] *See e.g.* US 22 December 2003 Answers to Questions, para. 43.
[90] *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").
[91] htt://risk.cotton.org/CotBudgets/cotbudget.htm, visited 20 January 2004.
[92] *See* www.ers.usda.gov/briefing/FarmIncome/Glossary/compare.htm visited 28 January 2004. A link to this ERS page is provided on the NCC Webpage.

updated the cost of production data to show increased upland cotton seed costs.[93] But, without citing any proof, the United States asserts that these same personnel that *properly* updated the cotton cost data (to reflect *increased* (BT-cotton and overall) seed costs) improperly failed to "capture the *cost savings* from technological changes that alter the mix of production activities and inputs."[94]

42. The credibility of this assertion is difficult to accept given the fact that the US government during the period of investigation touted the productivity benefits of using, *inter alia*, BT-cotton.[95] Indeed, an Economic Research Service-USDA Report updated through 27 October 1999 analyzed ARMS data concerning the use of BT cotton.[96] The ERS report identified increased yields and lower use (and hence costs) of pesticides as indicated below:

> Comparison of mean yields shows that in most cases (4 of 7 region/year cases for which data were sufficient) adopters of Bt cotton appear to obtain statistically significant higher yields than nonadopters. Although less prevalent, similar results (2 of 5 cases) were observed for Bt corn. For the case of herbicide-tolerant crops, the results are mixed: only for a few regions and in some years are yields higher for adopters. Most of the time (4 of 5 for corn, 9 of 13 for soybeans, 3 of 5 for cotton), differences in yields are statistically insignificant.
>
> Comparison of mean pesticide acre-treatments for 1997 shows that in most cases (2 of 3) the adoption of Bt cotton reduces treatments of insecticides normally used on the pests targeted by Bt. In 1 of 3 cases, total treatments for all other cotton pests are higher for adopters than nonadopters. Insecticide treatments for Bt-targeted pests on corn are significantly lower for Bt users than for nonusers. Adoption of herbicide-tolerant varieties accompanied statistically significant reductions in herbicide treatments in 4 of 8 cases across all crops, mostly for soybeans.

It is difficult to imagine how USDA ERS personnel working with ARMS survey data could arrive at the conclusions of (a) higher yields for BT cotton and (b) lower use of pesticides and chemicals in 1999 as detailed above, but the USDA personnel updating the cotton cost data in 1999-2002 could *not.* This evidence suggests that because information on the cost savings for using BT cotton were widely available for farmers and the ERS, then they would also be known to those updating the cotton cost survey. Thus, the Panel can conclude that the published USDA cost survey properly identified both cost increases and cost savings.

43. Finally, to attempt to answer the Panel's question concerning the graph at paragraph 59 of Brazil's 18 November 2003 Further Rebuttal Submission, Brazil analyzed the extent to which any alleged overstating of costs could impact on the huge $872 per acre cost-revenue gap. The answer, as outlined below, is very little.

44. To conduct this analysis, Brazil first assumed, contrary to the evidence outlined above, that the USDA employees updating the cost savings data[97] "got it wrong". Brazil then determined that the largest published estimate of the possible cost savings for using BT-cotton was $20 per acre.[98] The

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[93] US 22 December 2003 Answer to Question 211(a), para. 45.

[94] US 22 December 2003 Answer to Question 211(a), para. 45.

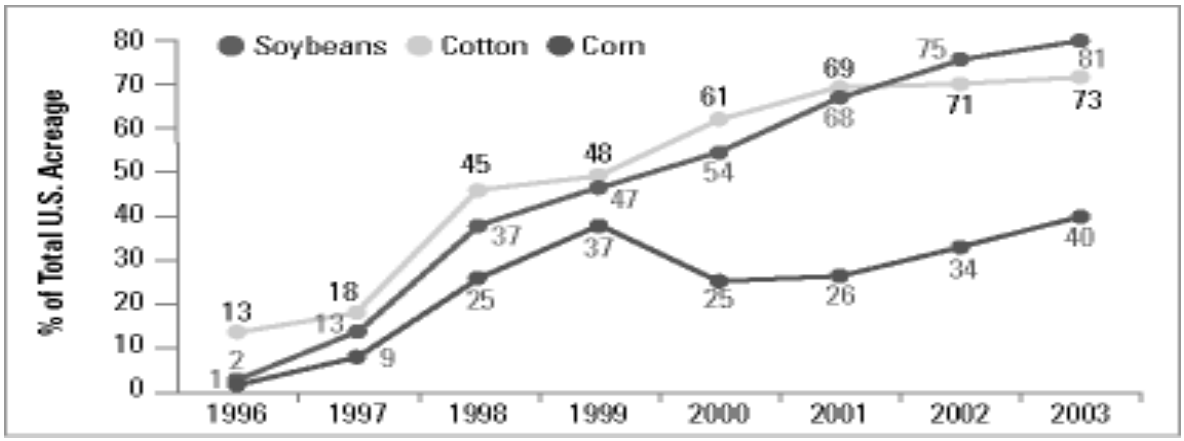
[95] See http://www.ers.usda.gov/publications/tb1906/tb1906b.pdf visited 28 January 2004; US 22 December 2003 Answers to Questions, para. 44 (note 44).

[96] http://www.pestlaw.com/x/guide/1999/USDA-19990625A.html visited 28 January 2004.

[97] Brazil's 27 October 2003 Answers to Questions, p. 56 (setting out USDA data).

[98] Exhibit Bra-404 (Monsanto Imagine, "Benefits – BT Cotton" downloaded from www.monsanto.co/monsanto/layout/our_pledge/bnefits/bt_cotton.asp visited 28 January 2004). The document concludes that the average US cotton farmer using BT –cotton has "average net incomes . . . increased by $50 per hectare in the United States" The Monsanto assertion of $50 per hectare translates into $20.2 per acre because one hectare constitutes 2.47 acres.

next step was to determine that between 1997-2002 an average of 58 per cent of cotton acreage was planted to BT-cotton between MY 1998-2002. This is reflected in the graph below:[99]




45. With 58 per cent of US acreage between 1998-2002 was planted to BT-cotton, this meant that the average per acre national cotton cost savings was $12 between 1997-2002 (0.58 x $20). But recall that the United States answer claims that the USDA 1998-2002 cost data reflects the cost increases for BT-cotton seed, but not the cost savings from use of fewer chemicals. Therefore, to reflect the *net* cost savings, Brazil further deducted the difference in between increased cotton-seed in 1997 and between 1998-2002 ($12.8 per acre).[100] Thus, in the best-case US scenario, the total amount of average cost savings allegedly *not* reflected in published USDA data was $24.8 per acre.

46. Brazil recalls that the total six-year *deficit* between total costs and total revenue from USDA's 2003 revenue and costs estimates (*i.e.*, the updated 1997 ARMS Study) is $872 per acre.[101] Brazil then assumed (1) the accuracy of the $12 per acre net cost reduction from using BT-cotton, (2) that the $12 per acre net cost savings existed for the entire 1998-2002 period, and (3) that USDA cost experts updating the 1997 ARMS Study in 1998-2002 were not aware of such cost reductions or improperly failed to include them in the latest USDA update of cotton revenue and costs, then the 1997-2002 deficit between USDA's total reported costs and total market revenue would still be $748 per acre.[102]

47. In sum, while Brazil believes that at least some of the assumptions listed above are highly questionable, the "best case" that the United States could have put forward (but did not) shows continued huge long-term deficits of $748 per acre between US producers' total costs and their market revenue. In short, the United States has not met its burden of proving that its own USDA data was hopelessly flawed. Brazil and the Panel can properly rely on the 2003 cotton cost and revenue data showing either $872 or $748 average per acre deficits between costs and market revenue during MY 1997-2002. Both figures reflect huge gaps between market revenue and total costs of production. As Brazil has argued, this evidence strongly supports the significant impact of the US subsidies on US production, exports and on world prices.

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[99] http://www.whybiotech.com/index.asp?id= visited 28 January 2004.

[100] This was done by subtracting the amount of increased seed costs in Exhibit Bra-323 (Costs and Returns of US Upland Cotton Farmers, MY 1997-2002) from MY 1997 – this was 0 in 1998, $1 in 1999, $13 in 2000, $20 in 2001, and $30 in 2002.

[101] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 59-62.

[102] This figure has been calculated by applying the $12 per acre time five years (which is conservative, because in earlier years less Bt-cotton was planted) and also deducting the yearly increases in seed costs (compared to the 1997 basis), since the $12 represented a net cost saving, *i.e.*, net of cost increases to due higher seed costs.

*(ii) Comment on US Argument concerning Canada Dairy*

48. Finally, Brazil notes the US attempt to distinguish the Appellate Body's decision in *Canada – Dairy* in paragraph 42 of the US 22 December 2003 Answer to Question 211. In assessing the credibility of these new US arguments, it is instructive to review what the United States argued before the Appellate Body in *Canada – Dairy*. First, on the issue of whether average cost of production data should be used, the United States made the following arguments in *Canada – Dairy*:

> [T]he Panel correctly recognized that an individual producer cost of production benchmark was unworkable. The Panel noted that governments rarely have the sort of detailed, producer-specific information that such a test would require. Indeed, as discussed below, Canada itself was unable to supply the necessary data regarding individual producer participation in the CEM market to support its claim that no payments were being made. … In sum, the Panel's reliance on the CDC's average total cost of production data as a 'sufficient, albeit conservative, approximation of the average total cost of production of the Canadian dairy industry' is consistent with the Appellate Body's instruction to sue an average total cost of production benchmark in this case.

49. The Panel will recall that the United States in this dispute has argued that using an average total cost of production was not appropriate.[103] Yet, as in *Canada – Dairy*, the issue in this dispute is not whether there are *certain* producers that may sell cotton (or milk) below their total cost of production. Of course, there will be some efficient producers who will be able to do so, even with few or no subsidies. Rather, the issue generally in both cases is whether, on *average*, the producers' total costs of production are above the prices received by the producers in the relevant markets. Thus, as in *Canada – Dairy*, the average total cost of production generated by USDA and used by Brazil is more than a "useful approximation".

50. The United States' arguments in this dispute that fixed costs should *not* be considered by the Panel mirrored arguments made by Canada in *Canada – Dairy*. Consider the following arguments made by the United States (which were accepted by the Appellate Body) in *Canada – Dairy* and which are practically identical to arguments made by Brazil in this dispute:

> With respect to imputed costs, the Panel correctly recognized that these are "real costs" that a producer must recoup in order to stay in business over time. In economic terms, these costs represent opportunity costs or the costs associated with opportunities that are foregone by not putting the producers' resources to their best use. The producers' resources include family labour, its managerial services, and its capital. There is a cost associated with using all of these resources. For example, if a farmer foregoes the opportunity to earn cash wages off the farm in order to contribute his labour to the farm's production, the value of his labour is properly counted as an economic cost to the farm even though the farmer does not pay cash wages to himself. Likewise, it makes no sense to suggest, as Canada does, that the farm which hires labour and management services is incurring a cost, while the farm that uses family labour and management is making a profit.[104]
>
> Likewise, the Panel correctly concluded that there was no basis to exclude the marketing, transportation, and administrative costs included in the CDC cost of production data. … [T]he panel properly concluded that these are also 'real costs'

[103] US 18 November 2003 Further Rebuttal Submission, Section IV.F.3(1) – (4).

[104] Appellee Submission of the United States, *Canada – Dairy (21.5)(II)*, para. 40 (*see* http://www.ustr.gov/enforcement/briefs.shtml).

> that producers must recoup if they are to remain in business over time. … The costs incurred by the farmer that must be recouped to avoid going out of business do not stop at the 'farm gate'.[105]

Brazil agrees with the United States that all of the costs identified above (which the Appellate Body accepted in its decision) are "real costs" that a producer must recoup "in order to stay in business over time". This is precisely Brazil's point in this case.

51. The United States argues that *Canada – Dairy* is inapposite because "the issue for which Brazil seeks to use total costs is not whether a subsidy exists but to evaluate the effect of the subsidy, an altogether different analysis".[106] First, this is incorrect as a factual matter. One use of the total cost of production data by Brazil has been as circumstantial evidence to demonstrate that contract payments are support to upland cotton and that such payments provide a benefit to US upland cotton producers.[107] This is directly analogous to the issue of whether the subsidy existed in Article 9.1(c) of the Agreement on Agriculture in *Canada – Dairy*.

52. Second, the evidence of the total cost of production was used in both cases to demonstrate that both dairy and cotton producers were selling their products into a market well below their total costs of production. In *Canada – Dairy*, Canadian producers were selling C-milk into the export market well below their total cost of production. In cotton, the US producers were selling into all identifiable markets at well below their total costs of production.[108] And in both cases, the subsidies provided by the Canadian and US governments permitted these producers to continue to produce without regard for the gap between market revenue and total costs of production. In sum, without both the *Canada – Dairy* panel and this Panel examining *total* costs of production, it would be difficult to determine whether all the alleged subsidies existed, and second, to determine the role that subsidies played in maintaining production.

**(a) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? USA**

**Brazil's Comment:**

53. Brazil generally agrees that covering operating costs are important to producers who are making planting decisions "in the short term – that is, the market price for one year".[109] And it is true that during a one-year "short term" period, a producer may be able to afford to receive revenue that only meets its operating costs and at least some of the fixed costs.[110] But the US 22 December 2003 Answer to Question 211(b) appears to suggest[111] that even over a long-term period of time – between 5-10 years – producers can continue to plant upland cotton oblivious to whether they meet their total costs of production. This is, of course, economic nonsense for agriculture or any other economic sector.

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[105] Appellee Submission of the United States, *Canada – Dairy (21.5)(II)*, para. 42 (*see* http://www.ustr.gov/enforcement/briefs.shtml).

[106] US 22 December 2003 Answer to Question 211, para. 42.

[107] Brazil's 22 August 2003 Rebuttal Submission, paras. 30-41; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 59-72; Brazil's 2 December 2003 Oral Statement, paras. 25-33.

[108] *Compare* the prices set out in Brazil's 22 December 2003 Answers to Questions 233 and 235, and in Exhibits Bra-383 – Bra-388, *with* US total cost of production data in Exhibit Bra-323 (Costs and Returns of US upland cotton Farmers MY 1997-2002).

[109] US 9 October 2003 Closing Statement, para. 12 (The full context of the quote is as follows: "Total costs are relevant over the long-term, but Brazil uses this (inaccurate) number to compare to revenue in the short term – that is, the market price for one year.").

[110] *See* Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, paras. 7-10).

[111] *See* in particular the graph at paragraph 47 of the US 22 December 2003 Answer to Question 211(b).

54. Basic economics holds that no business can continue to operate unless its total costs of production are met over the long term. The United States recognizes this when it states, in its 18 November 2003 Further Rebuttal Submission, that "in the long run, producers will have to cover these asset and overhead (i.e., economic) costs".[112] USDA's ERS suggests that the long term is a period between 5-10 years[113], and Christopher Ward testified that the normal recovery period for cotton equipment investments is 5-7 years.[114] In light of this evidence, Brazil focused on *total costs* for a six-year period of time between MY 1997-2002 in analyzing the long-term cost/revenue gap.[115] By contrast, the US graph at paragraph 47 of its 22 December 2003 Answer to Question 211(b) improperly focuses on only operating costs. Neither the US graph nor the US response provides any hint as to how US cotton producers could survive for six years without market revenue covering their fixed costs, *i.e.*, covering lease or mortgage payments, paying labor, recovering equipment costs, and paying taxes and insurance.[116] In fact, the land-specific costs must be paid every year simply to be able to continue farming on leased land or to avoid foreclosure in the case of owner-operators.[117]

55. The US arguments that economists are only concerned with examining operating costs, and not total costs, are simply not correct. For example, the University of California Cooperative Extension economists conduct a large number of studies regarding costs of production for different types of, *inter alia*, upland cotton farms in California. Every one of these studies, which are relied on throughout the agricultural industry in California and other states, contains a detailed examination of all types of costs.[118] Other economic studies of the cost of production similarly provide for total costs, including the land charge and rents.[119]

56. Additional evidence that total costs are relevant to planting decisions even in the short term of one year is found in several documents on an intended but not introduced "Cost of Production Insurance Plan for Cotton". The entire intent of this project to develop new a insurance programme was to provide comprehensive insurance covering *total costs* – not just operating costs.[120] If upland cotton producers were solely concerned with covering only their operating costs each year, then the project would not also have sought to provide cotton producers with protection from increased fixed

[112] US 18 November 2003 Further Rebuttal Submission, para. 122.

[113] Exhibit US-84 (Production Costs Critical To Farming Decisions, William D. McBride, ERS, p. 40 (quoted in US 18 November 2003 Further Rebuttal Submission, para. 118).

[114] Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, para. 10).

[115] This was not, therefore, a "randomly selected period," as the United States alleges in paragraph 41 of its 22 December 2003 Answer to Question 211(a).

[116] *See* Brazil's 18 November 2003 Further Rebuttal Submission, paras. 64-69 (setting forth composition of fixed costs. This evidence has never been rebutted by the United States).

[117] *See* Brazil's 18 November 2003 Further Rebuttal Submission, paras. 64-69 (setting forth composition of fixed costs. This evidence has never been rebutted by the United States).

[118] Exhibit Bra-405 (Sample Cost to Produce Cotton – Transgenic Herbicide-Resistant Alacla Variety, San Joaquin Valley, University of California Cooperative Extension, 2003). A large number of cost of production studies by the University of California Cooperative Extension for cotton, as well as for many other crops, can be found at www.ucanr.org/CES.CEA.shtml.

[119] Exhibit Bra-406 (Cotton Cost-Return Budget in Southwest Kansas, Kansas State University Agricultural Experiment Station and Cooperative Extensive Service, October 2003).

[120] Exhibit Bra-407 (Documents on Cost of Production Insurance Plan for Cotton)("Review of the FCIC Cost of Production Insurance Plan for Cotton," Sparks Companies, Inc., 15 September 2003, p. 11, 12 and 16. (COP insurance policy is based on the *farmer's total cost*.")); "Underwriting Review of FCIC Cost of Production Insurance Plan for Cotton," Jeffrey T. LaFrance, Ph.D, 13 September 2003, p. 5 ("… the basis for the guarantee is not a farmer-chosen percentage of expected or predicted revenue; rather it is a percentage of an estimate of the *total cost of production*."); "Review of Poposed 'Cost of Production Insurance Plan for Cotton,' Jerry R. Skees, Dr. Barry J. Barnett, Dr. J. Roy Black, and James Long, 15 September 2003, p.32 ("Purchasers will be required to provide estimates of variable expenses per acre, *fixed expenses per acre, and land expenses per acre* in addition to the acreage and historical yield information required for existing cotton insurance products.") emphasis added

costs such as leasing land, employing workers, and annual financing costs for replacement equipment. Yet, the "Cost of Production Insurance Plan for Cotton" programme focused on *annual* protection that would include all types of costs, because that is what the sponsors perceived farmers needed.

57. Finally, the Panel should recognize that the most efficient low-cost US producers will be able to withstand lower market prices without the need for significant subsidies for a year or two. But higher-cost producers will not. The ERS study on production costs cited by the United States highlighted the ability of higher-cost producers to survive in the shorter term only through government payments:

> Low-cost producers are generally better able to survive periods of low prices and thrive when prices improve, while high-cost producers are often the first to exit farming when prices are low.[121]
>
> ** ** ** **
>
> Also, this cost-price squeeze has put an emphasis on enhancing revenues through a variety of sources, such as government programmes, and on controlling or cutting costs. Government programme support has likely helped many producers remain in business and may explain why structural adjustments in these industries have been gradual.[122]

Many US upland cotton producers are "high-cost" producers, according to USDA's latest comprehensive cost of production survey.[123] Brazil notes that Professor Sumner found that roughly 70 per cent of US planted acreage would continue to be planted to upland cotton even without the US subsidies.[124] This finding that 30 per cent of the US cotton acreage would not remain planted to cotton is consistent with the conclusion that it is the category of high-cost cotton producers that would not be able to survive without US subsidies – even in the short term.

**212. Brazil states in paragraph 37 of its oral statement that studies of Westcott and Price found that the effect of the programme on cotton is to add an additional 1 to 1.5 million acres during marketing years 1999-2001 and to suppress US prices by 5 cents per pound. Does the US reject these findings? Why or why not? USA**

**Brazil's Comment:**

58. At the outset, Brazil notes that USDA economists Westcott and Price are among the most experienced and well-respected USDA analysts, who both have long records of publication of US government reports and other research studies. They have an in-depth knowledge of the marketing loan programme. Further, they received comments and suggestions for their study from leading US agricultural economists such as Professor Bruce Gardner.[125] Westcott and Price's study was their best estimate of the effects of the marketing loan programme. It bears repeating that they developed their study independently of this dispute in 2000.

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[121] Exhibit US-84 (Production Costs Critical To Farming Decisions, William D. McBride, ERS, p. 40). This study includes a graph regarding wheat farmers on page 41 which illustrates that low-cost producers can survive much lower prices while higher-cost wheat farmers require much higher prices even to meet their operating costs. The same dynamic exists for US cotton farmers.

[122] Exhibit US-84 (Production Costs Critical To Farming Decisions, William D. McBride, ERS, p. 41).

[123] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms", USDA, October 2001).

[124] Brazil's 9 September 2003 Further Submission, Annex I, Table 5a.

[125] Exhibit Bra-222 ("Analysis of the US Commodity Loan Program with Marketing Loan Provisions," USDA, AER 801, cover page).

59. The Westcott/Price study is an approved USDA paper published by USDA's Economic Research Service.[126] It is only during this dispute that the United States' government began to characterize this study as an "interesting 'academic' exercise"[127], whereas, outside this dispute, its results represent USDA's official view on the effects of the marketing loan programme.

60. Brazil recalls that the US Payment Limitations Commission, chaired by USDA's Chief Economist, requested Westcott and Price to update their study and analyze the effects of the marketing loan programme in MY 2001.[128] This official US Commission never criticized the approach chosen by Westcott and Price; rather, the Payment Limitations Commission relied on it. It is not clear to Brazil why the United States considers this study to be appropriate for analyzing effects of current agricultural policies and for considering policy reform proposals such as more effective payment limitations in a domestic political context, but, when US upland cotton subsidy programmes undergo multilateral scrutiny in a WTO context, the United States considers the very same study to be fatally flawed and unreliable.

61. Indeed, the United States goes so far as to characterize the Westcott/Price study as irrelevant for the analysis of this Panel.[129] The United States claims that using baseline projections for the period MY 1999-2001 will not suffice for the Panel's analysis, as the Panel needs to assess "actual conditions".[130] Brazil notes that the 2000 USDA baseline actually projected much higher prices than occurred during the period MY 1999-2001, thus the 5-cent per pound price suppression found by Westcott and Price understate the effects of "actual conditions".[131] This is confirmed by the fact that, when Westcott and Price used actual data to update their study for the Payment Limitations Commission, their results showed much stronger effects of the marketing loan programme.[132] Brazil notes that Professor Sumner has analyzed the effects of the marketing loan programme using actual MY 1999-2001 data.[133] Not surprisingly, the overall results of both Westcott/Price studies are in line with Professor Sumner's results.[134]

62. The United States also rejects the Westcott/Price study because its lagged price analysis based on the 2000 USDA baseline allegedly would not reflect farmers' actual price expectations.[135] Brazil and Professor Sumner have addressed the issues of the inappropriateness of using futures prices in complex modeling systems before.[136] The undisputed evidence is that – as the United States itself admits[137] – futures market prices cannot be used for such modeling systems.[138]

63. Brazil also notes that Westcott and Price in their updated MY 2001 analysis used actual MY 2001 prices as farmers' price expectations. This credits farmers with accurate information about

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[126] Exhibit Bra-222 ("Analysis of the US Commodity Loan Programme with Marketing Loan Provisions", USDA, AER 801).

[127] US 22 December 2003 Answers to Questions, para. 48.

[128] Brazil's 7 October 2003 Oral Statement, paras. 31-34.

[129] US 22 December 2003 Answers to Questions, para. 48.

[130] US 22 December 2003 Answers to Questions, para. 49. Brazil notes that the United States understands "actual conditions" to refer to actual price expectations held by US upland cotton producers. These are, however, as Brazil and the United States agree, "fundamentally unobservable".

[131] Brazil also notes that the 2000 USDA baseline contained actual data for MY 1998, *i.e.*, the Westcott/Price study used USDA's FAPSIM model for retrospective analysis.

[132] *See* Brazil's 7 October 2003 Oral Statement, paras. 31-34.

[133] *See* Annex I of Brazil's 9 September 2003 Further Submission, para. 4, Table I.5e (regarding the data used, baseline and resulting effects of the marketing loan programme).

[134] *See inter alia* Brazil's 7 October 2003 Oral Statement, paras. 9, 34.

[135] US 22 December 2003 Answers to Questions, paras. 50-51.

[136] *See* Brazil's 20 January 2004 Comments on US Model Critique, para. 56 (for further references).

[137] US7 October 2003 Oral Statement, para. 34.

[138] Brazil offers additional rebuttal arguments in its comment on the US 22 December 2003 Answer to Question 213, below.

upcoming prices and represents a third approach to modeling price expectations – the others being of course lagged prices and futures market prices.

64. In the context of its critique of the Westcott/Price study, the United States repeats its contention that futures market prices are the appropriate indicator for upland cotton farmers' price expectations, and that the effect of the marketing loan programme can be judged by looking at farmers' expectations about the US seasonal average cash price in the upcoming marketing year.[139] *This approach is simply factually wrong. There is no question that marketing loan payments are based off the adjusted world price – not a cash price.* Both Brazil and Professor Sumner explained this fact in detail on 2 and 3 December 2003.[140] Indeed, the United States acknowledges this fact elsewhere in its 22 December 2003 Answers to Questions.[141] Thus, the effects of the marketing loan programme would depend on upland cotton farmers' expectations about the adjusted world price. All of the repeated US arguments that there are no effects of the marketing loan programme for upland cotton in MY 1999-2001 because the expected US cash price was above the loan rate are simply meaningless.[142]

65. The US argument that the marketing loan programme has no effects if the expected US cash price is above the loan rate is, however, also wrong on its merits. (The same would be true had the United States relied on the correct price – the adjusted world price.) Brazil demonstrated that the spread between the January to March quotes of the December futures contract and the adjusted world price is (i) 18.5 cents[143] (if measured against the average AWP for the following marketing year) or (ii) 12.22 cents[144] (if measured against the December AWPs).[145] Subtracting this spread from the average of the January to March quotes of the December futures contract provides the expected adjusted world price (i) for the upcoming marketing year and (ii) for the upcoming December. As Professor Sumner has explained, it is also not at all clear which futures prices to use for any such calculations.[146] Taking the quotes of just one month for a single futures contract, as the United States does, is an overly simplistic approach.[147] But whether one assumes that farmers look at the average AWP for the upcoming marking year or at some particular AWP for a specific month such as

[139] US 22 December 2003 Answers to Questions, para. 51. *See* also US 18 November 2003 Further Rebuttal Submission, Section IV.G (for earlier US arguments using this fatally flawed approach).

[140] *See* Brazil's 2 December 2003 Oral Statement, Section 5.2 and Exhibits Bra-370 – Bra-371. *See* also Brazil's 22 December 2003 Answers to Questions, para. 155; Brazil's 20 January 2004 Answers to Additional Questions, para. 21.

[141] US 22 December 2003 Answers to Questions, para. 75. Also Exhibit US-126 calculates the marketing loan benefit correctly as the difference between the loan rate and the adjusted world price, rather than – as implied by the United States in its other arguments – as the difference between the loan rate and the cash price.

[142] US 22 December 2003 Answers to Questions, para. 51. Brazil is puzzled to learn that the United States continues to ignore these basic facts about the operation of the marketing loan program for upland cotton and continues to rely on this seriously flawed argument. Brazil recalls again that the United States is fully aware of its error, as demonstrated by its statements in paragraph 75 of its 22 December 2003 Answers to Questions and by Exhibit US-126, both of which rely on the adjusted world price as the basis for calculating marketing loan benefits.

[143] Exhibit Bra-356 (January – March Quotes of the December Futures Contract, Expected and Actual AWP and Cash Price).

[144] Exhibit Bra-370 (The Difference Between the Adjusted World Price and the December Futures Contract), presented by Professor Sumner on 3 December 2003.

[145] Concerning the problems inherent in the choice of the exact spread, *see* Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 13).

[146] Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 11-12).

[147] Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 12).

December, the fact is that the expected world price has always been well below the loan rate during MY 1999-2002.[148]

66. Moreover, even if the expected adjusted world price would not have been below the loan rate, that does not mean that there are no effects from the marketing loan programme. As Professor Sumner explained on 3 December 2003, this is because farmers have a probability distribution for the expected adjusted world price. That means they will expect with a certain likelihood that the adjusted world price will be below (or above) the mean of the expectation.[149] It follows that even if farmers expect the mean of the probability distribution for the AWP to be above the loan rate, they will nevertheless expect some marketing loan payments to be made.[150]

67. In sum, Brazil emphasizes that the Westcott/Price studies are important evidence of the effects of the upland cotton marketing loan programme that corroborate the effects found by Professor Sumner and the effects that are implied by all the non-econometric evidence for the effects of the US upland cotton subsidies presented by Brazil.

68. Finally, Brazil notes a new US argument that undercuts the US arguments regarding the peace clause. The United States argues for the first time in its 22 December 2003 Answers to Questions that the marketing loan programme *does not guarantee* US upland cotton producers 52 cents per pound in income.[151] Rather, there is additional revenue generated by the marketing loan programme that increases the effective support level – so-called "marketing loan facilitated revenue".[152] This revenue results from several sources. First, US farmers receive a domestic farm price when selling their crop. This price is consistently above the adjusted world price, off which the marketing loan payments are based.[153] It follows that US farmers receive additional revenue, as the US farm price plus the difference between the loan rate (52 cents) and the adjusted world price (below the US farm price) will exceed 52 cents.[154] Second, by cleverly marketing their upland cotton crop, US farmers can maximize this additional marketing loan facilitated revenue, which Westcott and Price assumed to be *14 cents*.[155]

69. In Exhibit US-126, the United States provides monthly data on the amount of additional marketing loan facilitated revenue. This actual data demonstrates considerable additional positive revenue "facilitated" by the marketing loan programme. Thus, using an adjusted world price as the loan repayment rate for upland cotton (as opposed to a local posted county price used for other crops

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[148] *See* Brazil's 2 December 2003 Oral Statement, paras. 43-47, and Professor Sumner's oral explanation on 3 December 2003.

[149] *See* Exhibit Bra-371 (Simple Example of the Calculation of Expected Marketing Loan Benefit).

[150] Professor Sumner's oral explanations on 3 December 2003; Brazil's 2 December 2003 Oral Statement, para. 48; Brazil's 22 December 2003 Answers to Questions, para. 155.

[151] In passing, Brazil notes that the use of 14 cents as marketing loan facilitated revenue was taken from the assumptions in USDA's own FAPSIM policy simulation model (Exhibit Bra-222 ("Analysis of the US Commodity Loan Program with Marketing Loan Provisions," USDA, AER 801, p. 11)). In addition, Westcott and Price demonstrate that the additional marketing loan facilitated revenue for MY 1999 is 12.7 cents – very close to the authors' assumption (Exhibit Bra-222 ("Analysis of the US Commodity Loan Programme with Marketing Loan Provisions," USDA, AER 801, p. 8)). Finally, Exhibit US-126 does not contradict the appropriateness of using 14 cents, as Exhibit US-126 does not provide the entire marketing loan facilitated revenue received by farmers (*see* Brazil's arguments in the main body of its comment).

[152] US 22 December 2003 Answers to Questions, paras. 50-52. Brazil notes that this additional revenue in rare circumstances can also turn out to be negative.

[153] *See* Brazil's 27 October 2003 Answers to Questions, chart at paragraph 172 and Exhibit Bra-311 (Side by Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average US Spot Market Price and Prices Received by US Producers from 1996 to the present).

[154] US 22 December 2003 Answers to Questions, paras. 50-52. Brazil notes that this additional revenue may also turn out to be negative, as shown by Exhibit US-126.

[155] US 22 December 2003 Answers to Questions, para. 52.

except rice) increases the revenue guarantee beyond the official loan rate, as shown by the data in Exhibit US-126. This data, however, understates the real effect for two basic reasons. First, it calculates the additional revenue based on an average national cash price that may be quite different from the price an actual upland cotton farmer receives for its crop. Second, and more importantly, it omits the second source of "marketing loan facilitated revenue" – the timing decisions of farmers in marketing their crop and taking out marketing loan benefits.

70. The existence of additional marketing loan programme facilitates revenue further highlights the importance of the upland cotton marketing loan programme in assisting upland cotton producers to close the gap between costs and market returns. It also invalidates further the US argument during the peace clause phase of this dispute that a rate of support should be used for purposes of the "peace clause" analysis, as the rate of support is the only measure that the United States controls.[156] The United States now admits that it does not control the rate of support either, as the rate of support may be above (or even below) 52 cents, depending on market conditions[157], and farmers' timing decisions for the marketing of their crop. Nor does the United States control the flow of marketing loan payments, as there is no mechanism in the upland cotton marketing loan programme to stem or control the flow of upland cotton marketing loan payments. This is precisely one of the reasons that Brazil has challenged this mandatory programme as causing a threat of serious prejudice.

**213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? BRA, USA**

## Brazil's Comment:

71. The United States focuses its response entirely on Professor Sumner's model. In fact, it does not provide an answer to the question posed by the Panel. Brazil recalls that this question asks for differences in results that can be observed from models *in the literature* that use lagged prices and futures prices. In its 22 December 2003 response to this question, Brazil detailed that there are no comparable models that use futures prices, but that all models discussed in the context of this proceeding – as well as all other large-scale multi-commodity models – use some variant of lagged prices.[158]

72. At the outset, Brazil notes that the United States *has presented no econometric model* in this dispute. The United States has not taken advantage of the economic and econometric expertise of USDA's Economic Research Service to substantiate econometrically its argument that $12.9 billion in upland cotton subsidies have had no effect on production and exports of US upland cotton and have had no effects on US or world prices.

73. Instead, the United States has criticized various aspects of Professor Sumner's model.[159] In particular, it has focused its critique on Professor Sumner's approach to modeling farmers' price expectations. However, Professor Sumner and Brazil have effectively rebutted all of these criticisms.[160]

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[156] *See inter alia* US 11 July 2003 First Submission, para. 94; US 22 July 2003 Oral Statement, paras. 12-13.

[157] These market conditions are in particular reflected in the spread between the adjusted world price and the cash price received by US upland cotton producers.

[158] Brazil's 22 December 2003 Answers to Questions, paras. 37-42.

[159] US 7 October 2003 Oral Statement, paras. 26-50; US 22 December 2003 Comments on Brazil's Econometric Model.

[160] *See* Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effects of US Cotton Subsidies – Professor Daniel Sumner, 2 December 2003, paras. 6-14, with further references).

74. The United States cites Andrew Macdonald in support of its propositions that futures prices are the better price indicators.[161] However, once again, the United States takes a quote out of context. What Mr. Macdonald actually said in the cited paragraph is that New York futures prices are an indicator of the direction in which prices will move in the future, *i.e.*, price trends, not an indicator of actual price in the future.[162]

75. The United States further cites a US government study that allegedly demonstrates that a certain percentage of US upland cotton producers rely on the New York futures market to *price* their crop for actual sales.[163] While Brazil cautions against the use of the specific results of the study (as it is somewhat dated)[164], Brazil agrees that at least some farmers *price* their crop with reference to the New York futures price. However, what this study *does not demonstrate* is that US upland cotton producers rely on the futures market in *making their planting decisions* many months before marketing.

76. The basic question that arises from the US criticism is the following: is Professor Sumner's approach to model farmers' price expectations biased towards generating stronger effects? The United States correctly notes that "[t]he lagged prices used by Brazil and [Professor Sumner] can[,] at best, be an approximation of farmers' price expectations".[165] This is an obvious fact; the actual price expectations of thousands of farmers are "fundamentally unobservable".[166]

77. There are three basic approaches to modeling farmers' price expectations: (1) using lagged prices, (2) using futures market prices if available, and (3) using rational expectations in various forms, including crediting farmers with complete information (*i.e.*, using the actual price as the expected price[167]).

78. It is not clear that any of these approaches lead to *a priori* biased results. However, it is standard practice among economists to use lagged prices in a large-scale, multi-commodity econometric policy simulation framework. FAPRI, USDA and the US Congressional Budget Office ("CBO") use lagged prices in their models. Indeed the United States admits that using futures prices for these models is not feasible and has never been done.[168] Had Brazil attempted to use this unconventional and untested approach for its model, the United States could have raised legitimate concerns as to the reliability of the model results. Any such results would have been purely speculative.[169]

79. Indeed, Brazil would have had to develop equations to predict futures prices for those commodities for which a functioning futures market exists. It also would have had to use an altogether different modeling approach for price expectations for crops for which there is no futures market. Again, this would have been purely speculative.[170]

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[161] US 22 December 2003 Answers to Questions, para. 57

[162] Exhibit Bra-281 (Statement by Andrew Macdonald – 7 October 2003, para. 13, even clearer paras. 17, 28, 31).

[163] US 22 December 2003 Answers to Questions, para. 58.

[164] *See* Brazil's comment on Question 201, above.

[165] US 22 December 2003 Answers to Questions, para. 56, *see* also para. 64.

[166] Brazil's 9 September 2003 Further Submission, Annex I, para. 18.

[167] Westcott/Price have chosen this approach for the update of their study for purposes of the Payment Limitations Commission.

[168] US 7 October 2003 Oral Statement, para. 34.

[169] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 9-14).

[170] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 9-14).

80. The approach favoured by the United States is not itself free of problems.[171] So far, futures market prices have only been used in statistical estimation using aggregate time-series data and not in econometric policy simulations.[172] Using it for modeling purposes raises further questions about the choice of futures contracts, the time period over which quotations are used, and calculations of appropriate spreads, among others.[173]

81. In sum, there are good reasons that FAPRI, USDA and the CBO use lagged prices in their policy simulation models. The Panel will recall that the FAPRI model (using lagged prices) was influential in the policy-making process leading to the 2002 FSRI Act, and that FAPRI, USDA and CBO models (all of which are based on lagged prices) are used regularly in US policy evaluation and formulation. Professor Sumner's approach uses a simple and commonly used proxy for the fundamentally unobservable price expectations of farmers.[174] Brazil is puzzled that the United States now views the very approach that every credible econometric policy simulation model takes as a significant error once this approach is used by Brazil in this dispute.

82. The United States further argues that in years with strong exogenous shocks lagged price models are poor proxies for price expectations.[175] The United States criticizes Professor Sumner's MY 2002 results as grossly overstated.[176] Brazil notes that it is has never relied on Professor Sumner's results of individual years. Instead, Brazil has used averages of the effects of the US programmes in MY 1999-2002 and MY 2003-2007. Using these averages mitigates any problems that may have existed from the use of lagged prices in any individual year.

83. Finally, Brazil notes that the United States relies on elasticities supplied by Professor Sumner in Annex I to calculate acreage responses from the expected lower cash prices in MY 2002.[177] However, these US calculations the United States are meaningless for several reasons. First, the futures prices used by the United States are problematic. Using only a single month's quotes for a single contract does not appropriately model the complexities of farmers' planting and marketing timings.[178] Second, it is unclear from the US response whether the United States used an appropriate spread for the calculation of price expectations held by farmers.[179] Third, it is therefore unclear whether the United States has calculated the appropriate change in price expectations between MY 2001 and 2002. Finally, even assuming that all of these problems did not exist, the results calculated by the United States using Professor Sumner's elasticities fail to provide meaningful results. These elasticities were applied in Professor Sumner's model to obtain direct effects, *i.e.*, effects before any feedback from the FAPRI US crops model and the CARD international cotton model.[180] Thus, the results are nowhere near the results that one would have obtained using Professor Sumner's full Annex I model. For all these reasons, Brazil strongly disagrees with the conclusion that the marketing loan programme did not have any effect in MY 2002. Brazil also recalls its arguments

[171] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 9-14).

[172] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 9).

[173] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, paras. 11-13).

[174]Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 14).

[175] US 22 December 2003 Answers to Questions, para. 61.

[176] US 22 December 2003 Answers to Questions, para. 63.

[177] US 22 December 2003 Answers to Questions, para. 63.

[178] Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 12).

[179] Brazil's 2 December 2003 Oral Statement, para. 44; Exhibit Bra-345 (Response to Further US Criticism of the Annex I Model of the Effect of US Cotton Subsidies – Daniel Sumner, 2 December 2003, para. 13).

[180] *See* Brazil's 20 January 2004 Comments on US Model Critique, paras. 64, 70.

and evidence regarding the serious flaws in the US application of its futures price methodology using expected cash prices rather than expected adjusted world prices.[181]

## III. DOMESTIC SUPPORT

**214. Please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? USA**

**215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA**

**216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. BRA, USA**

**Brazil's Comment:**

84. In addition to its own answer[182], Brazil offers two comments to the US response to this question. First, the United States makes a factual mistake in describing the calculation of base acreage under the deficiency payment programme.[183] While the United States' description of the calculation of deficiency payment crop base as the rolling five-year average minus the high and low year would be correct for other deficiency payment crops, upland cotton (and rice) had a special provision.[184] 7 CFR 1413.7(c) mandates the calculation of upland cotton base as "the average of the acreages planted and considered planted to such crop for harvest on the farm in each of the 3 crop years preceding such crop year.[185] For farms participating in the programme, all current base acreage was "considered planted".[186] Therefore, for the base to change, farmers had to opt out of the programme.[187]

85. Second, Brazil does not consider credible or relevant a statement by the United States that "[g]iven the current US fiscal situation,"[188] any further base update four years from now seems "unlikely". The Panel must determine whether the 2002 FSRI Act update of the direct and counter-cyclical payment base is a violation of paragraphs 6(a) and (b) of Annex 2 of the Agreement on Agriculture.

**217. What is the reason for reducing payments under the PFC and direct payments programmes for planting and harvesting fruit, vegetables and wild rice on certain base acreage? Please comment on the statements by the European Communities that "the reduction in payment for fruit and vegetables, if the EC understands correctly, is in fact designed to avoid unfair competition within the subsidising Member." (EC oral statement at first session, first substantive meeting, paragraph 29) and "To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition (…)" (EC response to Panel third party Question No. 5). USA**

[181] *See* Brazil's comment on Question 212, above.
[182] Brazil's 22 December 2003 Answers to Questions, paras. 47-50.
[183] US 22 December 2003 Answers to Questions, paras. 67-68.
[184] Exhibit Bra-26 (7 CFR 1413, Deficiency Payment Program, 1993 edition).
[185] Exhibit Bra-26 (7 CFR 1413.7(c)).
[186] Exhibit Bra-26 (7 CFR 1413.3, "Considered planted acreage").
[187] Brazil's 22 December 2003 Answers to Questions, para. 47.
[188] US 22 December 2003 Answers to Questions, para. 70.

**Brazil's Comment:**

86. The United States does not answer the Panel's first question as to "what is the reason" that PFC and direct payments are reduced for planting and harvesting fruits, vegetables, and wild rice. No reason is provided in the US 22 December 2003 response.

87. Nor does the United States take advantage of the Panel's second question to comment on the statement made by the European Communities that "the reduction in payment for fruit and vegetables, is in fact designed to avoid unfair competition within the subsidizing Member".[189] No US comment is provided. The EC argument involves considerable speculation about the "design" of the US measures. With the United States deciding not to provide any such reasons, the Panel is left without a factual basis to know whether the US reduction of payment based on growing fruits and vegetables is intended to "minimize any distortion which may be caused by any decoupled payments in markets which were historically undistorted by subsidies".[190]

88. The EC argument appears to attempt to impose a "trade distortion" test to the criteria of Annex 2, paragraph 6. However, Brazil notes that the EC argued that a decoupled domestic support measure need *not* be tested with regard to the "fundamental requirement" in Annex 2, paragraph 1 to determine whether it has "trade distorting effects".[191] Nor do any of the specific criteria in paragraph 6(b) of Annex 2 refer to "trade distorting effects".[192] Annex 2, paragraph 5 requires the specific criteria of Annex 2, paragraph 6 to be met for a direct payment measure to be included within the green box.

89. But even if Annex 2, paragraph 6(b) included a "trade distorting effects" test, the EC is simply wrong that the elimination or reduction of PFC and direct payments when fruits and vegetables and wild rice are grown does not "distort" trade. The EC argument ignores the distortion in trade in the products on which payments are focused, *i.e.*, upland cotton and the other programme crops rather than fruits, vegetables, and wild rice. Limiting or prohibiting payments for types of products representing 60 per cent of the value of production in a region such as California, Florida, or Arizona has the effect of maintaining production in the 40 per cent of the value of crops for which programme payments are received.[193] This "distorts" the trade in the agricultural crops receiving the payment by *maintaining or increasing their production.* The practical effect of the PFC and direct payment restriction is that the resources are targeted towards certain "types" of crops only. Negotiators intended that measures that were so linked to current production were not properly part of the green box.

90. In light of this evidence, the EC's argument boils down to asserting that trade distortions for products that traditionally have been subsidized should be permitted in order to prevent trade distortion in markets for non-subsidized products. Thus, the EC's argument is not one that would avoid distortions; it is one of *maintaining* existing distortions, contrary to the object and purpose of the Agreement on Agriculture.[194]

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[189] EC 23 July 2003 Oral Statement, para. 29.

[190] EC 11 August 2003 Answer to Third Party Question 11, para. 30.

[191] EC 11 August 2003 Answer to Third Party Questions 6 and 9, paras. 17, 23-25.

[192] Indeed, the United States has acknowledged that such effects can be presumed if the specific criteria in paragraph 6 of Annex 2 are not complied with. *See* US 11 August Answer to Question 31, para. 65 ("if a new measure does not conform to the basic and applicable policy-specific criteria in Annex 2, it will not have the benefit of the presumption that it meets the fundamental requirement of the first sentence.").

[193] Exhibit Bra-105 ("Statement of Professor Daniel Sumner at the First Meeting," para. 24); Oral Statement of Brazil, paras. 65-66.

[194] *See* Brazil's 22 August 2003 Rebuttal Submission, paras. 8-9, note 15.

91. The only thing the US 22 December 2003 response does is to repeat earlier faulty arguments attempting to defend the fruits, vegetables, and wild rice payment limitation.[195] The US response is useful because it finally clarifies that the US argument boils down to the assertion that if a direct payment measure does not *require* production, then it cannot violate Annex 2, paragraph 6. The US 22 December 2003 response states, at paragraph 73, that "paragraph 6 [no subsection listed] prohibits basing payments on production requirements … ".[196] It further states that the reduced PFC and direct payments "are not 'related to, or based on, the type or volume of production' *since the recipient need not produce anything at all*".[197] But there has never been an issue whether PFC and direct payments require production. All this means is that they comply with Annex 2, paragraph 6(e), in that "no production shall be required in order to receive such payments". But what about Annex 2, paragraph 6(b), which must be interpreted to have a separate meaning apart from paragraph 6(e)?

92. Paragraph 6(b) focuses on the amount of payments related to the type of production. In other words, if a farmer decides to produce something (recognizing that he or she need not under Annex 2, paragraph 6(e)), does the direct payment provision condition the amount of payment on the type of production undertaken? The answer with respect to the 1996 FAIR and the 2002 FSRI Act for PFC and direct payments is a clear "yes". The amount of the PFC or direct payments falls when prohibited crops are grown – and increases when the prohibited crops cease to be grown. These legal provisions send a fairly compelling message to the farmer – channel your current production into *certain* crops to continue receiving the full amount of direct payments today. This re-couples payments to current production.

93. The United States claims, at paragraph 73 of its 22 December 2003 response, that all a producer need do to receive the full payment is to "*merely* refrain from producing fruit, vegetables, or wild rice".[198] This is an interesting dismissal given that the practical effect of this provision is to direct production away from crops that represent up to 60 per cent of the value of available options for cotton farmers in states such as Florida, California, and Arizona.

94. Moreover, the logic of the US argument leads to an evisceration of any disciplines in Annex 2, paragraph 6, and is therefore contrary to the object and purpose of that provision. Consider the following hypothetical: a measure provides for a direct payment that was reduced by 75 per cent if a farmer produced any of 99 per cent of the available crop options; as a practical matter, farmers could only plant one or two crops (or no crops) and still receive the full payment. Under the US argument, because the farmer had no obligation to grow any crops, it could "merely refrain" from producing 99 per cent of available crops. Like the fruits, vegetables and wild rice exception, this argument would emasculate the green box requirement of Annex 2, paragraph 6(b).

**218. Please comment on the testimony of USDA Chief Economist Keith Collins cited in paragraph 36 of Brazil's oral statement regarding the trade-distorting and production-distorting nature of the marketing loan payments. USA**

**Brazil's Comment:**

95. The United States states in its response to this question "that marketing loan payments are *potentially* production- and trade-distorting".[199] Yet, Keith Collins' statement did not say "potentially" production- and trade-distorting. Dr. Collins stated that marketing loan payments "are

[195] US 22 December 2003 Answers to Questions, para. 73.
[196] US 22 December 2003 Answers to Questions, para. 73.
[197] US 22 December 2003 Answers to Questions, para. 73.
[198] Emphasis added.
[199] US 22 December 2003, Answers to Questions, para. 74 (emphasis added).

*unambiguously* trade-distorting and production-distorting".[200] This is quite a different statement than the one the United States appears to "agree" to. Coming from the Chief Economist of the USDA, who is one of the most-widely respected agricultural economists, it is positive evidence that marketing loan payments are not only "potentially" production- and trade-distorting, but that these payments have, in fact, "unambiguously" distorted US production and exports of upland cotton. But Dr. Collin's statement also confirms what other evidence in the record already demonstrates: the effect of the marketing loan programme is to sustain economically unviable US production of upland cotton, that in turn increases US exports and suppresses world prices.[201]

96. In a further response to this question, the United States itself provides the reason why its arguments about the expected cash price as a meaningful measure of the effects of the marketing loan programme are seriously flawed. The United States confirms that marketing loan benefits are not paid off the cash price (so that any expectations about future cash prices would matter), but that "farmers will receive a government payment for the difference between the loan rate and *the adjusted world price*".[202] Thus, what potentially matters in evaluating the effects of the marketing loan programme is the expected adjusted world price, and not the expected cash price.[203] Looking at the expected adjusted world price, it is below the loan rate in all marketing years during the period of investigation and, therefore, the marketing loan programme is expected to have a significant effect on US farmers' upland cotton planting decisions.[204] This fact confirms all the other evidence presented by Brazil to demonstrate the trade- and production-distorting effects of the marketing loan programme.[205]

## IV. EXPORT CREDIT GUARANTEES

**219. Under the *Agreement on Agriculture* the general position is that the use of export subsidies, both those listed in Article 9.1 as well as those within the scope of Article 1(e) which are not so listed, may only be used within the limits of the product specific reduction commitments specified in Part IV of Members' Schedules. One might therefore have expected that Article 3.3 of the *Agreement on Agriculture* would have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, would have simply prohibited the use of any export subsidy. Instead, the Article 3.3 prohibition is limited in both cases to export subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:**

**(a) the fact that export performance-related tax incentives, which like subsidized export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held**

[200] Brazil's 2 December 2003 Oral Statement, para. 36 and Exhibit Bra-211 ("The Current State of the Farm Economy and the Economic Impact of Federal Policy," Hearings before the Committee on Agriculture, US House of Representatives, p. 43)(emphasis added).

[201] Brazil's 9 September 2003 Further Submission, Section 3.3.4.7.1; Brazil 7 October 2003 Oral Statement, paras. 31-33; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 3.1, 3.2, 3.4 and 3.7.1; Brazil's 2 December 2003 Oral Statement, Section 5.2.

[202] US 22 December 2003 Answers to Questions, para. 75 (emphasis added).

[203] Brazil's 2 December 2003 Oral Statement, Section 5.2. Brazil notes that the United States, in Exhibit US-126, appears to acknowledge this fact, as it calculates the marketing loan benefit as the difference between the loan rate and the adjusted world price, rather than the cash price, as the United States implies in its other arguments.

[204] Brazil's 2 December 2003 Oral Statement, Section 5.2, in particular paras. 44-50 (including Exhibits Bra-356-359) and Professor Sumner's oral explanations on 3 December 2003 (including Exhibit Bra-370-371).

[205] Brazil's 9 September 2003 Further Submission, Section 3.3.4.7.1; Brazil 7 October 2003 Oral Statement, paras. 31-33; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 3.1, 3.2, 3.4 and 3.7.1; Brazil's 2 December 2003 Oral Statement, Section 5.2.

**(for example, in *United States – Tax Treatment for Foreign Sales Corporations*, WT/DS108) to be subject to the anti-circumvention provisions of Article 10.1; and**

**(b) the treatment of international food aid and non-commercial transactions under Article 10? USA**

**Brazil's Comment:**

97. Brazil agrees with the United States that Article 8 of the Agreement on Agriculture assumes the role the Panel suggests one might have expected Article 3.3 to play.[206] Article 8 prohibits the use of both those export subsidies listed in Article 9.1 and those not listed in Article 9.1 other than in conformity with the Agreement on Agriculture and the commitments specified by a Member in its Schedule.

98. However, Brazil does not consider that this fact provides illuminating context for the interpretation of Article 10, including Articles 10.1 and 10.2. The question is whether Article 10.2 of the Agreement on Agriculture exempts or carves-out export credits from the disciplines included in Article 10.1. The Appellate Body has concluded that to exempt or carve-out particular categories of measures from general obligations such as the export subsidy obligations in the Agreement on Agriculture, the exemption or carve-out must be *explicit* in the text of an agreement.[207] Article 10.2 includes no such explicit exemption or carve-out.[208] The negotiators knew how to make such an exemption or carve-out explicit, as evidenced by, for example, Article 13 of the Agreement on Agriculture, footnote 15 to Article 6.1(a) of the SCM Agreement, and the second paragraph of item (k) of the Illustrative List of Export Subsidies.[209] The United States has not rebutted these arguments.

99. Instead, the United States appeals to what it considers to be "similarity" between the treatment of export credit instruments and international food aid in Articles 10.2 and 10.4.[210] These two provisions are fundamentally different, however. Article 10.2 announces Members' intent to work toward negotiations on specific disciplines for export credits, and calls on Members to adhere to those disciplines once they are adopted. As Brazil noted in its 22 December 2003 Answers to Questions, the nature of the disciplines negotiated and the way in which they are transposed into the WTO will dictate the effect they will have on claims against export credits under Article 10.1.[211] At least for the time being, however, Article 10.2 does not meet the standard for carve-outs or exemptions set by the Appellate Body in *EC – Sardines* and *EC – Hormones*, and export credits are subject to the disciplines of Article 10.1.[212]

100. Article 10.4 similarly does not meet the standard for exemptions or carve-outs set by the Appellate Body in *EC – Sardines* and *EC – Hormones*. However, it does provide specific disciplines for international food aid through reference to FAO and Food Aid Convention provisions. In Brazil's

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[206] *See* US 22 December 2003 Answers to Questions, para. 79.

[207] Appellate Body Report, *EC – Sardines*, WT/DS231/AB/R, para. 201-208; Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 128.

[208] *See* Brazil's 22 July 2003 Oral Statement, paras. 100-115; Brazil's 22 August 2003 Rebuttal Submission, paras. 99-100; Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 33-52; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 219-220; Brazil's 2 December 2003 Oral Statement, paras. 73-76; Brazil's 22 December 2003 Answers to Questions, paras. 51-57.

[209] *See, e.g,*. Brazil's 2 December 2003 Oral Statement, para. 75.

[210] US 22 December 2003 Answers to Questions, paras. 80-82.

[211] Brazil's 22 December 2003 Answers to Questions, paras. 51-57.

[212] *See* Brazil's 22 July 2003 Oral Statement, paras. 100-115; Brazil's 22 August 2003 Rebuttal Submission, paras. 99-100; Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 33-52; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 219-220; Brazil's 2 December 2003 Oral Statement, paras. 73-76; Brazil's 22 December 2003 Answers to Questions, paras. 51-57.

view, Article 10.4 could be considered an example of the situation envisioned in paragraph 56 of Brazil's 22 December 2003 Answers to Questions.[213] Article 10.4 sets out a benchmark against which to determine whether particular international food aid measures constitute "export subsidies", within the meaning of Article 10.1. Thus far, the Appellate Body's decisions (in *US – FSC*[214] and *Canada – Dairy*[215]) have directed panels to contextual guidance included in the SCM Agreement for this determination. In a case against international food aid measures, however, a panel could look to the alternative benchmarks set out in Article 10.4 as context for its determination whether those measures constitute "export subsidies" for the purposes of Article 10.1. (A panel could also look to a Member's notifications to the Committee on Agriculture. The United States, for example, notifies international food aid – or some portion of the international food aid provided by it – as export subsidies to be counted towards its reduction commitments.[216])

**220. What will be the relevance of Articles 9 and 10.1 of the *Agreement of Agriculture* to export credit guarantees when disciplines are internationally agreed? BRA**

**221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be $230,127,023 instead of the figure which originally appeared ($381,345,059).**

**(a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.**

**Brazil's Comment:**

101. The data provided by the United States in the chart accompanying its response demonstrates that using the net present value methodology imposed by the US Federal Credit Reform Act ("FCRA"), premiums for the CCC guarantee programmes over the period 1992-2002 were inadequate to cover the operating costs and losses of the programmes, in the amount of $230 million.[217] For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[218]

102. Brazil addresses further the US chart in its comments on other US answers, below.

**(b) Please clarify whether and how the Panel should treat the figures in Exhibit BRA-182 for the net lifetime re-estimates for each respective cohort.**

[213] Brazil's 22 December 2003 Answers to Questions, para. 56.
[214] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 136-140.
[215] Appellate Body Report, *Canada – Dairy*, WT/DS103/AB/R and WT/DS113/AB/R, paras. 87-90.
[216] *See, e.g.*, Exhibit Bra-99 (G/AG/N/USA/39, p. 2).
[217] US 22 December 2003 Answers to Questions, chart included in response to Question 221(a).
[218] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

**Brazil's Comment:**

103. The United States' response is inaccurate. In stating that "all of the first five cohorts (1992-1996), including 1994, are profitable",[219] the United States oddly neglects to account for the most recent reestimate data, which it has included in its own chart, provided with its response to question 221(a). That chart shows massive upward reestimates in 2003 for the 1992, 1993, 1994, 1996, 1997 and 2001 cohorts. Accounting for those reestimates, the 1994 cohort, which the United States asserts is nearly closed[220], does *not* show profitability. Nor do the 1997, 1998, 2000, 2001 or 2002 cohorts.

104. The United States is implying that over time, cohorts will turn out to be positive. The data does not support this implication. Upward reestimates continue, even on "older" cohorts, and net results do not suggest profitability with anywhere near the uniformity suggested by the United States.

105. Finally, Brazil emphasizes that showing gains or losses for particular *cohorts* is not relevant for the purposes of item (j), which calls for the assessment of a "*programme*" across its entire portfolio.[221]

**(c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of $4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately $4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result.**

**Brazil's Comment:**

106. Brazil agrees that for a complete assessment under item (j), administrative expenses in the amount of approximately $39 million[222] should be added to the $230 million of losses recorded in the chart accompanying the US response to question 221(a), or to $211 million of losses recorded in the Brazilian chart included as Exhibit Bra-193.

**(d) Please identify what is considered an "administrative expense" for this purpose.**

**(e) The Panel notes the US statement in paragraph 160 of its answers to Panel questions following the first meeting that all cohorts are still open although the 1994 and 1995 cohorts will close this year. Is this still an accurate statement? If not, please indicate whether any cohorts have since "closed" for the period 1992-2002.**

**Brazil's Comment:**

107. The United States' response is inaccurate. Using the most recent data available, provided by the United States with its response to question 221(a), the subsidy figure net of reestimates for the 1994 cohort will in fact be positive, indicating losses. Based on this same data, the same thing can be said for other "older" cohorts, such as 1997 and 1998. Moreover, the United States' data demonstrates that 2002 and 2003 reestimates for "older" cohorts 1992, 1993, 1994, 1996 and 1997 are all *upward*, indicating adjustments for even greater losses than previously anticipated.

[219] US 22 December 2003 Answers to Questions, para. 86.
[220] US 22 December 2003 Answers to Questions, para. 93.
[221] *See* Brazil's 2 December 2003 Oral Statement, para. 81; Brazil's 18 November 2003 Further Rebuttal Submission, para. 248; Brazil's 27 August 2003 Comments on US Rebuttal Submission, para. 61.
[222] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

108. Brazil emphasizes, however, that showing gains or losses for particular *cohorts* is not relevant for the purposes of item (j), which calls for the assessment of a "*programme*" across its entire portfolio.

**(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily* reach a "profitable" result (for example, the 1994 cohort, which has almost closed still indicates an outstanding amount)? Do "re-estimates" reflect also expectations about a cohort's future performance?**

**Brazil's Comment:**

109. Once again, the United States' response is inaccurate. The United States asserts that data for the 1994 cohort indicate profitability.[223] Using the most recent data available, however, provided by the United States with its 22 December 2003 response to question 221(a), the subsidy figure net of reestimates for the 1994 cohort will in fact be positive, indicating losses. Based on this same data, the same thing can be said for other "older" cohorts, such as 1997 and 1998. Moreover, the United States' data demonstrates that 2002 and 2003 reestimates for "older" cohorts 1992, 1993, 1994, 1996, 1997 are all *upward*, indicating adjustments for even greater losses than previously anticipated.

110. The United States shows *no evidence* to support its assertion that Pakistani and Ecuadorean defaults account for an important part of the poor performance of the 1997 cohort.[224] Nor does it offer any evidence to show that those defaults were rescheduled, or that they are performing. Additionally, the United States' assertion that it expects the 1998 cohort to show profitability is not supported by the data included with its response to question 221(a).[225] As recently as 2002, upward reestimates were made to the 1998 cohort, indicating that there is no discernible trend of profitability.

111. In any event, Brazil notes that showing gains or losses for a particular *cohort* is not relevant for the purposes of item (j), which calls for the assessment of a "*programme*" across its entire portfolio.[226]

**(g) Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?**

**Brazil's Comment:**

112. The United States confuses two issues in paragraphs 96-97 of its response.[227] First, it notes that reestimates need to be applied to the subsidy estimate included in the prior, actual year column of the US budget, since the original subsidy estimate included in the budget year column of the US budget includes subsidy figures for some guarantees that are budgeted but not in fact granted. In other words, fewer guarantees are granted than were budgeted to be granted. Brazil recognized this in Exhibit Bra-193, as does the United States in the chart included with the US response to question 221(a). Nonetheless, both Brazil and the United States reach the same conclusion – over the 10-year period, operating costs and losses outpace premiums collected for the CCC programmes (even before administrative expenses are included in the calculation). The United States tracks losses of $230

[223] US 22 December 2003 Answers to Questions, para. 93.
[224] US 22 December 2003 Answers to Questions, para. 94.
[225] US 22 December 2003 Answers to Questions, para. 94.
[226] *See* Brazil's 2 December 2003 Oral Statement, para. 81; Brazil's 18 November 2003 Further Rebuttal Submission, para. 248; Brazil's 27 August 2003 Comments on US Rebuttal Submission, para. 61.
[227] US 22 December 2003 Answers to Questions, paras. 96-97.

million in the chart accompanying its response to Question 221(a), and Brazil tracks losses of $211 million in Exhibit Bra-193.

113. The second point the United States makes is that the data it has presented in its response to question 221(a) includes no "operating experience" with the 2001 and 2002 cohorts.[228] This is wholly inaccurate. Estimates of costs and losses are based, first and foremost, on historical experience with borrowers.[229] Moreover, the chart included in the US response to question 221(a) shows that reestimates – which are in part made to reflect operating results – have already been made for both the 2001 and 2002 cohorts.

114. Finally, the United States' assertion that there is a "trend of negative reestimates"[230] is not borne out by the data provided by the United States itself, in its response to question 221(a). In 2002, upward reestimates were made for the 1992, 1993, 1994, 1995, 1996, 1997 and 1999 cohorts. Similarly, in 2003, upward reestimates were made for the 1992, 1993, 1994, 1996, 1997, 2001 and 2002 cohorts. It is not at all "reasonable to expect that in the fullness of time the data will … reflect further negative reestimates for cohorts 2001 and 2002",[231] as the United States asserts, for the simple reason that recent data provided by the United States shows significant upward reestimates *across all cohorts*, including "older" cohorts that are presumably closer to closing.

115. For all of these reasons, the US suggestion that the 2001 and 2002 cohorts should be disregarded by the Panel in its item (j) analysis should be rejected.

**(h) Why should the Panel "eliminate", in addition, the 2000 cohort, as also suggested in paragraph 198 of the US further rebuttal submission for which information is presumably more "complete"?**

**Brazil's Comment:**

116. The United States notes that the original subsidy estimate for the 2000 cohort was reduced to reflect the fact that fewer guarantees were granted than were budgeted to be granted.[232] This is wholly irrelevant, and does not even remotely imply *profitability* for those guarantees that were actually issued in fiscal year 2000. As the data provided by the United States in its response to question 221(a) demonstrates, there is still a large positive subsidy estimate, indicating losses, for the 2000 cohort.

117. Moreover, the data provided by the United States in its response to question 221(a) shows that, as cohorts age, downward reestimates can not be assumed. In 2002, upward reestimates were made for the 1992, 1993, 1994, 1995, 1996, 1997 and 1999 cohorts. Similarly, in 2003, upward reestimates were made for the 1992, 1993, 1994, 1996, 1997, 2001 and 2002 cohorts. Brazil also notes that cohorts that are "older" than the 2000 cohort – such as the 1994, 1997 and 1998 cohorts, continue to show positive subsidy estimates, or losses.

[228] US 22 December 2003 Answers to Questions, paras. 96, 99.

[229] *See e.g.* Brazil's 22 August Rebuttal Submission, para. 113 (including notes 234-235), Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36) ("Actual historical experience of the performance of a risk category is a *primary factor* upon which an estimation of default cost is based.")).

[230] US 22 December 2003 Answers to Questions, para. 98.

[231] US 22 December 2003 Answers to Questions, para. 98.

[232] US 22 December 2003 Answers to Questions, para. 101.

118. For these reasons, the US suggestion that the 2000 cohort should be disregarded by the Panel in its item (j) analysis should be rejected.

**(i) Under the US approach, at what point in time could a Panel ever make an assessment of the programme, if it had to wait for each cohort to be completed before it could be "properly" assessed? Why is it inappropriate for the Panel to include these "most recent years" in its evaluation, as the US suggests in paragraph 199 of its 18 November further rebuttal submission? USA**

**Brazil's Comment:**

119. Brazil notes that the United States has not answered the Panel's question. In the United States' view, it is only appropriate to make an assessment of a programme under item (j) using a net present value accounting methodology once all cohorts in a period are closed. The United States specifically argues as follows:

> Not until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government.[233]

120. According to the United States, no cohort in the period 1992-2002 has yet closed. Therefore, in the United States' view, were the Panel to undertake a 10-year assessment of the CCC programmes under item (j) using a net present value accounting methodology, it could only do so for the period 1982-1991. Of course, since net present value accounting for the CCC programmes only began in 1992, following passage of the FCRA in 1990, subsidy estimate and reestimate figures would be unavailable for this period.

121. In insisting that it is necessary to wait until cohorts are closed to be used for the purposes of item (j), the United States is effectively saying that net present value accounting is not an appropriate way to assess a programme under item (j). As the United States is well aware, the whole point of net present value accounting, endorsed by the US Congress and the President of the United States in the FCRA, is to assess the costs of contingent liabilities, like guarantees, when they are issued, rather than when they are paid (on a default of the underlying loan). Brazil notes that there are important retrospective elements to the net present value accounting methodology imposed by the FCRA – initial estimates of costs and losses are based, first and foremost, on historical experience with borrowers[234], and reestimates are calculated annually to adjust initial estimates as dictated by actual results. In any 10-year period, of course, the most recent years will have been subject to fewer reestimates than the earlier years. This is not, as the United States suggests, a <u>flaw</u> in the methodology. It <u>is</u> the methodology. The methodology records what the US Congress, the US President and US government accountants agree is a more actuarially appropriate means of assessing the costs and losses of contingent liabilities like guarantees.[235]

122. The United States' rejection of net present value accounting as an accurate way to make an assessment under item (j) is particularly odd given the United States' conclusion that it would be

[233] *See e.g.* US 11 August 2003 Answers to Questions, para. 159.

[234] *See e.g.* Brazil's 22 August 2003 Rebuttal Submission, para. 113 (including notes 234-235), Exhibit Bra-118 (Federal Accounting Standards Advisory Board, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NO. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* (March 2001), p. 16 (para. 36) ("Actual historical experience of the performance of a risk category is a *primary factor* upon which an estimation of default cost is based.")).

[235] Brazil's 22 July 2003 Oral Statement, para. 128.

inappropriate "to subject the [CCC programmes] to the analytical yoke of the unique circumstances of the Polish and Iraqi defaults over 10 years ago . . ".[236]

123. The United States had previously made this assertion, albeit only with respect to Iraq.[237] The United States has offered no support whatsoever for this assertion[238], which is inaccurate in at least two respects. As Brazil has noted, these defaults were not "over 10 years ago". The US General Accounting Office reports that the losses in Iraq occurred over the period 1990-1997.[239] Nor are these defaults "unique," as the United States argues. As discussed below in Brazil's comments on the US response to question 225, the evidence regarding write-offs by the CCC (not even mentioning defaults that are not written off) demonstrates that the Iraqi and Polish defaults are not at all "unique".

124. Setting factual inaccuracies aside, if the United States wants to put post-1991 defaults on pre-1992 guarantees behind it, it should *embrace*, rather than *reject*, the net present value accounting methodology adopted in the FCRA. Using net present value accounting and the FCRA formula to make an assessment of the CCC programmes under item (j), the United States is not held accountable (in these proceedings, at least) for post-1991 defaults on pre-1992 cohorts. Post-1991 activity on pre-1992 CCC guarantees is treated separately[240], and is not in any way included in the data provided by the United States in its response to question 221(a), or by Brazil in Exhibit Bra-193. Even without the effect of the Iraqi and Polish defaults, both the United States and Brazil conclude that the CCC programmes have lost money over the period 1992-2002 (the United States puts those losses at over $230 million; Brazil at $211 million). (For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[241])

125. Rejecting the use of net present value accounting to assess the CCC programmes under item (j) does not keep the United States from cherry picking the results of the FCRA formula to make its case. According to the United States, using data for *some* cohorts that have not yet closed is acceptable, but using data for other cohorts that have not yet closed is not acceptable. Several points are clear regarding the United States' approach.

126. First, it is factually inaccurate for the United States to assert, in paragraph 103 of its response, that "trends" suggest that annual downward reestimates on older cohorts will continue and will grow. The chart included with the US response to question 221(a) indicates *upward* reestimates in 2002 *for every cohort* during the period 1992-1999. Similarly, that same chart shows *upward* reestimates in 2003 for the 1992, 1993, 1994, 1996, 1997 and 2001 cohorts. Moreover, that same chart shows "trends" of positive net subsidy estimates after adjusting for cumulative reestimates, even for cohorts that the United States considers are close to closing – 1994, 1997 and 1998. In other words, *these aging cohorts are losing money*. Thus, it is not at all factually accurate to conclude that reestimates are generally downward as a cohort ages and approaches closure, or that as a cohort approaches closure, the data suggests that it will have made money.

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[236] US 22 December 2003 Answers to Questions, para. 102.

[237] US 22 August 2003 Rebuttal Submission, para. 172.

[238] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[239] Brazil's 27 August 2003 Comments, para. 65 (and document cited at note 81).

[240] *See e.g.* Exhibit Bra-116 (Office of Management and Budget, Circular No. A-11, Section 185, p. 185-4); Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 15).

[241] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

127. Second, even if one accepts the US argument that the 2001 and 2002 cohorts should be left out of the calculation because there are not yet any "operating results" for those years (a point that is itself factually inaccurate, as addressed by Brazil above)[242], this does not explain the United States' decision to eliminate the 2000 cohort – for which it acknowledges there are "operating results" – when it concludes that "cohorts 1992-1999, taken as a whole, currently reflect a net negative reestimate (i.e., profitable performance)".[243] When the 2000 cohort is included, the data provided by the United States in the chart accompanying its response to question 221(a) show losses. This is a gross example of the cherry-picking exercise in which the United States would have the Panel engage to gerrymander a result in the United States' favour. Consistent with the Panel's duty to make an objective assessment of the facts, it should not accept this approach.

128. Third, the US approach does not tell the Panel anything about how the CCC *programmes* fare when assessed under item (j). Item (j) calls for an assessment of the entire portfolios of the *programmes* themselves.[244] In contrast, the US approach only offers some indication of how particular, carefully-selected *cohorts* are performing (and as discussed in the previous two paragraphs, the results do not even reflect profitability for those cohorts). The data provided by the United States itself demonstrates that using the net present value methodology imposed by the FCRA, premiums for the CCC guarantee *programmes* over the period 1992-2002 were inadequate to cover the operating costs and losses of the programmes, in the amount of $230 million.[245] For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[246]

129. If the Panel does not consider that net present value accounting is an appropriate way of assessing the CCC programmes under item (j), Brazil has also demonstrated that the long-term operating costs and losses of the programmes outpace premiums collected, using a *cash-basis accounting* methodology. The chart included at paragraph 165 of Brazil's 11 August 2003 Answers, reproduced below, tracks this result:

[242] US 22 December 2003 Answers to Questions, para. 99.
[243] US 22 December 2003 Answers to Questions, para. 103.
[244] *See* Brazil's 2 December 2003 Oral Statement, para. 81; Brazil's 18 November 2003 Further Rebuttal Submission, para. 248; Brazil's 27 August 2003 Comments on US Rebuttal Submission, para. 61.
[245] US 22 December 2003 Answers to Questions, chart included in response to Question 221(a). *See also* Exhibit Bra-193.
[246] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

| Fiscal year | Premiums collected (88.40) + Recovered principal and interest (88.40) + Interest revenue (88.25) | Admin. expenses (00.09) + Default claims (00.01) + Interest expense (00.02) |
|---|---|---|
| 1993 | $27,608,000 + $12,793,000 + $15,672,000[247] = $56,073,000 | $3.320,000[248] + $570,000,000[249]+ $0[250] = $573,320,000 |
| 1994 | $20,893,000 + $458,954,000 + $0[251] = $479,847,000 | $3,381,000[252] + $422,363,000[253] + $0[254] = $425,744,000 |
| 1995 | $18,000,000 + $62,000,000 + $0[255] = $80,000,000 | $3,000,000 + $551,000,000 + $10,000,000[256] = $564,000,000 |
| 1996 | $20,000,000 + $68,000,000 + $26,000,000[257] = $114,000,000 | $3,000,000[258] + $202,000,000[259] + $61,000,000[260] = $266,000,000 |
| 1997 | $14,000,000 + $104,000,000 + $26,000,000[261] = $144,000,000 | $4,000,000[262] + $11,000,000[263] + $62,000,000[264] = $77,000,000 |
| 1998 | $17,000,000 + $81,000,000 + $54,000,000[265] = $152,000,000 | $4,000,000[266] + $72,000,000[267] + $62,000,000[268] = $138,000,000 |
| 1999 | $14,000,000 + $58,000,000 + $0[269] = $72,000,000 | $4,000,000[270] + $244,000,000 + $62,000,000[271] = $310,000,000 |
| 2000 | $16,000,000 + $100,000,000 + $99,000,000[272] = $215,000,000 | $4,000,000[273] + $208,000,000[274] + $62,000,000[275] = $274,000,000 |
| 2001 | $18,000,000 + $149,000,000 + $125,000,000[276] = $292,000,000 | $4,000,000[277] + $52,000,000[278] + $104,000,000[279] = $160,000,000 |

[247] Exhibit Bra-126 (US budget for FY 1995, p. 156).
[248] Exhibit Bra-126 (US budget for FY 1995, p. 156).
[249] Exhibit Bra-126 (US budget for FY 1995, p. 156).
[250] No budget line, Exhibit Bra-126 (US budget for FY 1995, p. 156).
[251] Exhibit Bra-95 (US budget for FY 1996, p. 162).
[252] Exhibit Bra-95 (US budget for FY 1996, p. 161).
[253] Exhibit Bra-95 (US budget for FY 1996, p. 162).
[254] Exhibit Bra-95 (US budget for FY 1996, p. 162).
[255] Exhibit Bra-94 (US budget for FY 1997, p. 176).
[256] Exhibit Bra-94 (US budget for FY 1997, p. 175).
[257] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[258] Exhibit Bra-93 (US budget for FY 1998, p. 174).
[259] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[260] Exhibit Bra-93 (US budget for FY 1998, p. 175).
[261] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[262] Exhibit Bra-92 (US budget for FY 1999, p. 105).
[263] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[264] Exhibit Bra-92 (US budget for FY 1999, p. 106).
[265] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[266] Exhibit Bra-91 (US budget for FY 2000, p. 111).
[267] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[268] Exhibit Bra-91 (US budget for FY 2000, p. 112).
[269] Exhibit Bra-90 (US budget for FY 2001, p. 112).
[270] Exhibit Bra-90 (US budget for FY 2001, p. 110).
[271] Exhibit Bra-90 (US budget for FY 2001, p. 111).
[272] Exhibit Bra-89 (US budget for FY 2002, p. 118).
[273] Exhibit Bra-89 (US budget for FY 2002, p. 116).
[274] Exhibit Bra-89 (US budget for FY 2002, p. 117).
[275] Exhibit Bra-89 (US budget for FY 2002, p. 117).
[276] Exhibit Bra-88 (US budget for FY 2003, p. 120).

| | | |
|---|---|---|
| 2002 | $21,000,000 + $155,000,000 + $61,000,000[280] = $237,000,000 | $4,000,000[281] + $40,000,000[282] + $93,000,000[283] = $137,000,000 |
| Total | $1,841,920,000 | $2,925,064,000 |
| **Long-term Net Cost** | **$1,083,144,000** | |

130. In Exhibit US-128, the United States has also provided data to be used for an assessment of the CCC programmes under item (j) using cash-basis accounting. As discussed further in Brazil's comment to the US response to question 222, the data offered by the United States in Exhibit US-128 leads to the same conclusion, when adjusted to account properly for the impact of rescheduling on defaults.[284]

131. Finally, an even more fundamental approach demonstrates the incredibility of the United States' assertion that "trends" suggest that the CCC programmes are making and will continue to make profits. Congressional testimony by USDA officials and reports by the US General Accounting Office demonstrate that 1990-1997 defaults on Iraqi and Polish CCC guarantees amounted to approximately $4 billion.[285] The US General Accounting Office also noted in 1995 that defaults on Russian and Former Soviet Union GSM 102 guarantees similarly reached $2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid.[286] These defaults were not, therefore, all "over 10 years ago", as the United States suggests at paragraph 102 of its 22 December 2003 response. Nor are they "unique", as the United States also suggests at paragraph 102. In addition to this $6 billion in defaults, the United States' response to question 225 cites to further "written-off" or "forgiven" defaults of $20 million. This does not, of course, account for other defaults that have not yet been written-off or forgiven.

132. *Even if premiums collected over the entire lifetime of the CCC guarantee programmes are considered, these defaults, in the amount of over $6 billion, would mean net losses in the amount of*

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[277] Exhibit Bra-88 (US budget for FY 2003, p. 118).
[278] Exhibit Bra-88 (US budget for FY 2003, p. 119).
[279] Exhibit Bra-88 (US budget for FY 2003, p. 120).
[280] Exhibit Bra-127 (US budget for FY 2004, p. 109).
[281] Exhibit Bra-127 (US budget for FY 2004, p. 107).
[282] Exhibit Bra-127 (US budget for FY 2004, p. 108).
[283] Exhibit Bra-127 (US budget for FY 2004, p. 108).
[284] At paragraph 103 of its 22 December 2003 response, the United States refers to "the uniform performance of reschedulings". The United States has offered no proof that its reschedulings are performing. Yet as the party asserting this fact, the United States bears the burden of proving it. *See, e.g.*, Appellate Body Report, *Japan – Apples*, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof."). In fact, according to the US General Accounting Office, rescheduling of GSM defaults has not historically been "performing," and has rather been in arrears. *See* Brazil's 22 August 2003 Comments, para. 99 (and note 94).
[285] *See* Brazil's 11 August 2003 Answers to Questions, para. 167 (second bullet point), *citing* Exhibit Bra-87 ("Testimony of August Schumacher Jr., Under Secretary, Farm and Foreign Agricultural Service, USDA, before the Subcommittee on General Farm Commodities, Hearing on the Asian Financial Crisis, 4 February 1998," p. 10-11) and Exhibit Bra-157 (US General Accounting Office, REPORT TO THE CHAIRMAN, TASK FORCE ON URGENT FISCAL ISSUES, COMMITTEE ON THE BUDGET, HOUSE OF REPRESENTATIVES, *International Trade: Iraq's Participation in US Agricultural Export Programs*, GAO/NSIAD-91-76 (November 1990), p. 27 (Table IV.2)). *See also* Brazil's 18 November 2003 Further Submission, para. 251.
[286] *See* Brazil's 22 August 2003 Rebuttal Submission, para. 109 (note 226), *citing* Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6). *See also* Brazil's 18 November 2003 Further Submission, para. 251.

*over $5.5 billion*.[287] Brazil emphasizes that this is just taking account of the defaults about which Brazil is aware. Brazil also notes that while the United States emphasizes the role of rescheduling in the recovery of defaults (which Brazil disputes in its comments on the US answer to question 222 below), the more than $6 billion in defaults discussed here *have not been rescheduled*, or at least where they have been (in the case of Russian and Former Soviet Union), they are in arrears.[288] This demonstrates that long-term operating un-recovered and non-recoverable costs and losses for the CCC programmes have outpaced premiums collected by a considerable amount.

133. Item (j) does not require the Panel to adopt or to reject any particular methodology to assess the CCC guarantee programmes.[289] Nor do the *facts* require the Panel to endorse any one methodology to determine that the CCC guarantee programmes constitute export subsidies under item (j). Brazil has demonstrated that under *any* methodology, properly applied, premiums for the CCC guarantee programmes over the period 1992-2002 were inadequate to cover the operating costs and losses of the programmes.

**222. For GSM 102, 103 and SCGP, please provide year-by-year amounts from 1992 to 2003 with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes. Please indicate any allocation methodologies used to calculate administrative costs. USA**

**Brazil's Comment:**

134. Exhibit US-128, provided by the United States in response to this question, allegedly demonstrates that using a cash basis accounting methodology, the CCC export credit guarantee programmes generate money. In fact, the United States claims that revenue collected outpaces total expenses for the three programmes by $666 million. Brazil has offered a similar chart at paragraph 165 of its 11 August 2003 Answers. Brazil's chart demonstrates that the CCC programmes lost $1.048 billion over the period of FY 1993-2002. The total difference between the US result and Brazil's result is $1.75 billion.

135. This figure closely corresponds to the total "Claims Rescheduled" figure reported by the United States in Exhibit US-128.[290] Indeed, the difference between the chart provided by the United States in Exhibit US-128 and Brazil's chart in paragraph 165 of its 11 August 2003 Answers lies in the treatment of rescheduled debt.[291] The United States treats defaulted guarantees that have

[287] Brazil has calculated that the highest amount of premiums that could have been generated would amount to approximately $450 million. *See* Brazil's 11 August 2003 Answers to Questions, para. 167 (second bullet point). Data included in Exhibit US-128 suggests that Brazil is over-estimating the amounts of premia collected.

[288] The US General Accounting Office noted that defaults on Russian and Former Soviet Union guarantees reached $2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid. Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6). Brazil raised this point in its 22 August 2003 Rebuttal Submission (at para. 109, note 226) and its 18 November 2003 Further Submission (para. 251). It remains unrebutted by the United States.

[289] *See* Brazil's 22 December 2003 Answers to Questions, paras. 68-75.

[290] The fact that both figures do not match exactly is explained by the fact that the United States analyses data covering FY 1992-2003 on a cohort-specific basis, while the data available to Brazil covers FY 1993-2002 and represents actual performance of the CCC programs during a given fiscal year.

[291] If the Panel were to compare all other totals, it would readily see that the totals correspond, taking into account that the US data covers FY 1992-2003 and is on the basis of cohorts, while Brazil's data covers only FY 1993-2002 and represents the actual performance of the programs in a fiscal year. Brazil does not have

been rescheduled as 100 per cent recovered on the day the terms of the rescheduling are agreed.[292] Brazil, on the other hand, has treated rescheduled claims as receivables, until they have been actually recovered.[293] Only once CCC actually collects incremental amounts on a rescheduled claim is the corresponding incremental amount of the default considered "recovered" and no longer a loss to CCC.[294] Under Brazil's approach, whatever portion of rescheduled claims is collected in a particular year is treated as a recovery, whereas under the United States' approach, the *entirety* of the rescheduled claims is treated as a recovery at the moment the terms of the rescheduling are agreed.

136. Brazil's approach is the more actuarially appropriate of the two, and is consistent with the cash-basis accounting preferred by the United States in this dispute. Under cash-basis accounting, when financial commitments are rescheduled, they would normally be re-amortized on a new, longer payment schedule that reduces the amount of each periodic payment due from the borrower. Rescheduling does not mean that a creditor *collects* on an outstanding claim – it just means that the creditor *hopes* to do so in the future by reducing the amount the borrower has to pay each month.[295] CCC, in fact, acknowledges that all it possesses following a rescheduling is a receivable, and that not all receivables are collectable.[296] (And in fact, CCC rescheduling has historically been in arrears.[297]) The US approach, therefore, overstates the effect rescheduled guarantees have on claims paid, by automatically treating rescheduled guarantees, in every instance, as actual recoveries of claims paid, at the moment the terms of the rescheduling are agreed. (Indeed, the CCC's Financial Statement for FY 2002 and 2003 confirm that rescheduling of export credit guarantee receivables covered both principle and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled.)[298]

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access to FY 2003 data, as the actual figures for that year will only be published in connection with the FY 2005 budget.

[292] *See* Exhibit US-128. The United States defines "Claims Outstanding" (G) as "Claim Payments" (D) minus "Claims Recovered" (E) minus "Claims Rescheduled" (F). It follows that a rescheduled claim no longer constitutes an outstanding claim at the moment the terms of the rescheduling are agreed. Instead, for accounting purposes, the rescheduling is simply treated as 100 percent recovered.

[293] This is the reason that Brazil treats recovered principle as a revenue inflow for accounting purposes. The principle recovered is netted against the claims paid by CCC (*see* Brazil's 11 August 2003 Answers to Questions, para. 163).

[294] Contrary to this approach, the United States nets defaults paid against the sum of recovered and rescheduled defaults (*see* Exhibit US-128). However, it only *hopes* to eventually recover rescheduled debt; the rescheduling alone does not mean it will do so.

[295] *See* Exhibit Bra-115 (US General Accounting Office ("GAO"), Report to the Chairman, Subcommittee on Criminal Justice, US House of Representatives Committee on the Judiciary, "Loan Guarantees: Export Credit Guarantee Programs' Long-Run Costs Are High," GAO/NSIAD-91-180, 19 April 1991, p. 3 (Table 1, Note *a*) ("GAO/NSIAD-91-180") (accounts receivable for the GSM programmes "[i]ncludes delinquent payments and *rescheduled debt not yet due*.") (emphasis added).

[296] Brazil's 27 August 2003 Comments on US Rebuttal Submission, para. 64.

[297] Brazil's 22 August 2003 Comments, para. 99. *See also* Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6 (noting that in 1995 defaults on Russian and Former Soviet Union guarantees reached $2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid.); Exhibit Bra-152 (GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National Security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, *Status Report on GAO's Reviews of the Targeted Export Assistance Programme, the Export Enhancement Programme, and the GSM-102/103 Export Credit Guarantee Programmes*, GAO/T-NSIAD-90-53, 28 June 1990, p. 14 (noting that historically, the majority of GSM support that is rescheduled is "in arrears.").

[298] Exhibit US-129 (CCC Financial Statements for FY 2002 and 2003 – Audit Report, USDA, Office of the Inspector General, Report No. 06401-16-FM, November 2003, Note 5, p. 22).

137. Brazil maintains its position that it is not appropriate to treat as "recovered" those losses (resulting from defaults) that were actually incurred by the CCC export credit guarantee programmes and that are rescheduled, until such a point in time when the money *actually has been recovered.* Therefore, Brazil maintains that its cash-basis formula is the appropriate one. It follows that the CCC export credit guarantee programmes suffered losses of $1.1 billion between fiscal years 1993-2002, resulting in a finding that the CCC programmes operate at premium rates inadequate to cover the long-term operating costs and losses of the programmes, within the meaning of item (j).

**223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? USA**

**Brazil's Comment:**

138. Although the United States asserts that premium rates for the GSM-102, GSM-103 and SCGP programmes are "reviewed annually"[299], it offers no evidence to support this assertion.[300] As Brazil has already noted, both USDA's Inspector General and the US General Accounting Office have noted the CCC's failure to change its premium rates or to reflect credit risk in those rates – and its inability to do so given the one-per cent fee cap included in US law – as evidence of a failure to cover costs and losses.[301]

139. The CCC guarantee programmes are unique financing instruments that are not available on the market.[302] Brazil has demonstrated that forfaits and CCC export credit guarantees are not similar financial instruments, and therefore that the terms for forfaits cannot serve as benchmarks against which to determine whether CCC export credit guarantees confer "benefits".[303] The United States has offered no evidence that the two instruments "compete as a method for trade financing over comparable tenors in similar markets …."[304] Further, the regulations for the CCC programmes belie the United States' assertion that "an importer does not necessarily realize any benefit from a CCC export credit guarantee".[305] The regulations state that the programmes operate in cases where banks "would be unwilling to provide financing without CCC's guarantee".[306] To summarize the differences between the two instruments, the essential function of a CCC guarantee is to make possible an export sale that would otherwise be impossible. A forfait, by contrast, does not make an impossible sale possible, but instead merely allows an exporter to collect its receivable without waiting for that receivable to come due.[307] This opportunity, offered by the forfait, only arises if the CCC guarantee has made the sale happen in the first place.

[299] US 22 December 2003 Answers to Questions, para. 107.

[300] As the party asserting this fact, the United States bears the burden of proving it. *See* Appellate Body Report, *Japan – Apples*, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[301] Brazil's 22 December 2003 Answers to Questions, paras. 63-64.

[302] *See* Exhibit Bra-190 (Affidavit of Marcelo Franco, Seguradora Brasileira de Crédito à Exportação).

[303] Brazil's 22 August 2003 Rebuttal Submission, paras. 103-105; Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 68-70; Brazil's 7 October 2003 Oral Statement, para. 72; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 233-241; Brazil's 2 December 2003 Oral Statement, para. 79; Brazil's 22 December 2003 Answers to Questions, paras. 65-66.

[304] US 22 December 2003 Answers to Questions, para. 109.

[305] US 22 December 2003 Answers to Questions, para. 109.

[306] Exhibit Bra-38 (7 CFR 1493.10(a)(2) (GSM 102 and GSM 103 regulations)). *See also* Exhibit Bra-38 ((7 CFR 1493.400(a)(2) (SCGP regulations)).

[307] *See, e.g.*, Brazil's 18 November 2003 Further Rebuttal Submission, para. 237.

140. Even if the two instruments were similar, the United States has not met its burden to establish (under either Article 10.3 of the Agreement of Agriculture, or as the party asserting the fact) that CCC guarantees are provided on terms no better than those offered for forfaiting instruments on the market. Although the United States curiously repeats its argument that it "does not have access to specific implicit rates available in the marketplace"[308], Brazil presented evidence regarding forfaiting fees five months ago, with its 27 August 2003 submission. That evidence demonstrates that forfaiting fees are well above fees for CCC export credit guarantees.[309] It also demonstrates that unlike CCC guarantee fees, which vary on the basis of only one factor – the length of the underlying credit – forfaiting fees additionally vary according to the risks involved in the transaction[310], as one would expect of any market-based financial instrument.

141. Similarly, export credit insurance and CCC export credit guarantees are not similar financial instruments, and therefore the terms for export credit insurance cannot serve as benchmarks against which to determine whether CCC export credit guarantees confer "benefits". The United States has acknowledged the differences between CCC guarantees and export credit insurance.[311] One critical difference, noted by the WTO Secretariat in the WTO document quoted by the United States in paragraph 108 of its 22 December 2003 response, is that premia for insurance vary according to the credit rating or risk status of both the importer and the importing country.[312] In contrast, neither importer risk nor country risk have *any* impact on the premiums payable for GSM 102, GSM 103 or SCGP guarantees.[313] Moreover, Brazil notes that while export credit insurance is indeed available for agricultural commodities, export credit insurance for agricultural commodities is limited to 360 days, or the expected/useful life of the commodity in question.[314] In contrast, CCC guarantees are available for terms of up to 10 years.[315]

142. Even if the two instruments were similar, the United States has not met its burden to establish (under either Article 10.3 of the Agreement of Agriculture, or as the party asserting the fact) that CCC guarantees are provided on terms no better than those offered for export credit insurance obtained on the market. The United States argues that "[p]rivate commercial quotes for export credit insurance are simply not available to the United States".[316] Brazil attaches two premium fee schedules: first, a fee schedule published by Export Insurance Services, Inc., a private broker for export credit insurance for small businesses offered by the US Export-Import Bank ("Ex-Im Bank") (Exhibit Bra-410); and second, a fee schedule published by Ex-Im Bank itself for export credit insurance for small businesses (Exhibit Bra-409).

143. The Panel will note that the rates in Ex-Im Bank's own fee schedule, which do not even include administrative fees that would be added by a private broker such as Export Insurance Services, exceed those offered for CCC guarantees by considerable margins.[317] When administrative

[308] US 22 December 2003 Answers to Questions, para. 109.

[309] Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 76-77 and Exhibit Bra-199 (Trade and Forfaiting Review, Volume 6, Issue 9 July/August 2003).

[310] Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 75-76.

[311] US 11 August 2003 Answers to Questions, para. 179. The United States has correctly observed that "[i]f the commercial market does not offer a particular borrower the exact terms offered by a government, then the government is providing a benefit to the recipient . . ." Panel Report, *Canada – Aircraft II*, WT/DS222/R, Annex C-2 (para. 7) (emphasis added).

[312] G/AG/NG/S/13, para. 9.

[313] *See* US 11 August 2003 Answers to Questions, para. 184; Brazil's 11 August 2003 Answers to Questions, paras. 192, 195.

[314] Exhibit Bra-408 (Export-Import Bank, Standard Repayment Terms), p. 3 (Chart II, no. 2), 4 (second bullet point). Brazil made a similar point with respect to forfaits. *See* Brazil's 27 August 2003 Comments, para. 78.

[315] Brazil's 24 June 2003 First Submission, para. 101.

[316] US 22 December 2003 Answers to Questions, para. 109.

[317] *Compare* Ex-Im Bank schedule in Exhibit Bra-409 *with* CCC fee schedule in Exhibit Bra-155.

fees levied by a market-based institution are accounted for, the differences become even more pronounced.[318]

144. This comparison likely understates the extent to which CCC rates are below-market, for two reasons. First, government support from Ex-Im Bank does not constitute a market benchmark for the purposes of Article 1.1(b) of the SCM Agreement.[319] Nonetheless, this comparison demonstrates that the CCC guarantee programmes do not even meet *non-market* benchmarks.[320] Second, the comparison involves export credit insurance for small businesses. As noted by the US International Trade Administration's Foreign Commercial Service, export credit insurance for small businesses is offered at reduced premium rates.[321]

145. Finally, because the provisions address somewhat different disciplines and could require different means of implementation, Brazil reiterates its earlier request that the Panel find that the CCC programmes constitute export subsidies by virtue of *both* Articles 1 and 3.1(a) of the SCM Agreement *and* item (j).[322]

**224. Please indicate how the CCC's cost of borrowing was treated in the 2002 financial statement of the CCC, in Exhibit BRA 158. USA**

**Brazil's Comment:**

146. Brazil notes that it has accounted for CCC's interest expense and revenue figures (lines 00.02 and 88.25 of the US budget) in its cash-basis accounting methodology.[323]

**225. Please indicate whether there was any instance where the CCC "wrote off" debt and, if so, please indicate the accounting regulation or principle used. If a "written off" debt is subsequently recovered, do the CCC's accounts reflect both the interest cost and interest received in relation to the debt during the time it was "written off"? USA**

**Brazil's Comment:**

147. As noted in Brazil's comment on the US response to question 221(i), if the Panel uses a net present value accounting methodology to assess the CCC programmes under item (j), the United States would not be held accountable (in these proceedings, at least) for write-offs on pre-1992 cohorts. Activity on CCC guarantees issued before 1992 is not in any way included in the net present

[318] *Compare* Export Insurance Services, Inc. fee schedule in Exhibit Bra-410 (p. 6-7) *with* CCC fee schedule in Exhibit Bra-155.

[319] *See* Appellate Body Report, *United States – Countervailing Duties on EC Products*, WT/DS212/AB/R, para. 124 (Appellate Body questions whether a "fair market price" is reached when a government "shapes" the market, stating that "[t]he Panel's absolute rule of 'no benefit' may be defensible in the context of transactions between two private parties taking place in reasonably competitive markets; however, it overlooks the ability of governments to obtain certain results from markets by shaping the circumstances and conditions in which markets operate."). *See also* Arbitrator's Decision, *Brazil Aircraft*, WT/DS46/RW, para. 6.95 (One reason the Panel offered for rejecting a proposed benchmark was that the benchmark was "the direct result of a *government* guarantee," rather than an indication of the "commercial or market rate of interest."). *See also id.*, paras. 6.90-6.92, 6.104.

[320] The Panel will recall that Brazil made a similar comparison between Ex-Im Bank export guarantee fees and CCC export guarantee fees, and reached the same result. *See* Brazil's 22 August 2003 Comments, para. 110.

[321] Exhibit Bra-411 (*The Federal Scoop: US Government Financing for Service Exports*, EXPORT AMERICA (May 2000), p. 33).

[322] Brazil's 18 November 2003 Further Rebuttal Submission, para. 228.

[323] *See* Brazil's 11 August 2003 Answers to Questions, para. 165. *See also* Brazil's comments on Question 221(i), above.

value data provided by the United States in its response to question 221(a), or by Brazil in Exhibit Bra-193.[324] Even without the effect of the write-offs detailed in paragraph 114 of the US 22 December 2003 response – all of which relate to pre-1992 cohorts – both the United States and Brazil conclude that the CCC programmes have lost money over the period 1992-2002 (the United States puts those losses at over $230 million; Brazil at $211 million).[325] (For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[326])

148. Under a cash-basis accounting methodology of assessing the CCC programmes under item (j), the United States should be held accountable for write-offs and "debt forgiveness" (as defined in paragraph 113 of the US response) that occurred during the period 1992-2002, even if it relates to guarantees that were issued before 1992. Although this is not clear from the US 22 December 2003 response, to the extent that the write-offs catalogued in paragraph 114 of the US 22 December 2003 response are related to *defaults* that occurred in the period 1992-2002, Brazil presumes that the defaults themselves would be included in the line item (00.01) for default claims, which are tracked in the chart included at paragraph 165 of Brazil's 11 August 2003 Answers to Questions, and reproduced in Brazil's comments on the US response to question 221(i), *supra*. Applying a cash-basis accounting methodology, Brazil demonstrated that long-term operating costs and losses outpace premiums collected over the period 1992-2002 for the CCC programmes, by $1.083 billion.

**226. If a debt was "written off" more than ten years ago, does it still create a cost to the programme? If so, how is this reflected in the 2002 financial statement of the CCC, in Exhibit BRA 158 (or any other material)? USA**

**Brazil's Comment:**

149. As discussed in Brazil's comment on the US response to question 225, if the Panel uses a net present value accounting methodology to assess the CCC programmes under item (j), the United States would not be held accountable (in these proceedings, at least) for write-offs that occurred more than 10 years ago. The reason is that those write-offs would relate to guarantees issued prior to 1992. Activity on CCC guarantees issued before 1992 is not in any way included in the net present value data provided by the United States in its response to question 221(a), or by Brazil in Exhibit Bra-193.[327]

150. Under a cash-basis accounting methodology of assessing the CCC programmes under item (j), the United States would not be held accountable for write-offs and "debt forgiveness" that occurred more than 10 years ago (at least in this proceeding), assuming that the period of review is 1993-2002. This is because the underlying defaults would also have occurred more than 10 years ago, even before the write-offs or forgiveness.

151. However, Brazil would like to correct the United States' mischaracterization of Brazil's position about the 10-year period of review for an assessment under item (j). Brazil does not agree, as the United States asserts, that an examination beyond 10 years is "inappropriate".[328] Rather, Brazil

[324] As Brazil notes in its comment on Question 221(g), however, estimates of costs and losses made in the context of the FCRA formula are based, first and foremost, on historical experience with borrowers. Thus, prior defaults would tend to lead to positive subsidy estimates on new guarantees.

[325] *See* US 22 December 2003 Answers to Questions, response to Question 221(a); Brazil's Exhibit Bra-193.

[326] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

[327] As Brazil notes in its comment on the US response to Question 221(g), however, estimates of costs and losses made in the context of the FCRA formula are based, first and foremost, on historical experience with borrowers. Thus, prior defaults would tend to lead to positive subsidy estimates on new guarantees.

[328] US 22 December 2003 Answers to Questions, para. 102.

considers that a 10-year period is *adequate* in this case to get a picture of the performance of the CCC programmes' portfolio. If the Panel wishes to look beyond that 10-year period, Brazil does not believe that doing so would be "inappropriate". Brazil has noted that should the Panel wish to corroborate evidence showing that over the period 1992-2002, the long-term operating costs and losses for the CCC programmes outpace premiums collected, it could look to CCC's 2003 financial statements, which state that uncollectible amounts on pre-1992 CCC guarantees outpace premiums collected during the period 1981-1991 by nearly $2 billion.[329]

**227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount – referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? USA**

**Brazil's Comment:**

152. In paragraphs 117-118 of its 22 December 2003 response, the United States again rejects use of the FCRA formula as an appropriate methodology to make an assessment of the CCC programmes under item (j), since it is based on "estimates". As noted above, the United States' view is that it is only appropriate to use a net present value accounting methodology once all cohorts in a period are closed.[330] In paragraphs 117 and 121 of its 22 December 2003 response, the United States argues that the "credit guarantee liability" figure included in the CCC financial statements, which is calculated using a net present value accounting methodology, does not reflect "losses", within the meaning of item (j), but instead only estimated losses.

153. This does not stop the United States from appealing to the FCRA formula when it believes it suits its purposes to do so. In paragraph 119, the United States cites with approval the $22 million credit guarantee liability figure used in CCC's 2003 financial statements as evidence of "good performance" by the CCC guarantee programmes. Brazil notes, however, that at page 4 of the notes to its 2003 financial statements, CCC defines the term "credit guarantee liability" as "the estimated net cash outflows (loss) of the guarantees on a net present value basis".[331] Thus, the $22 million figure still represents a "loss", as does the $230 million cumulative figure listed in the chart included with the US response to question 221(a). For a complete assessment under item (j), administrative expenses in the amount of approximately $39 million should be added.[332]

154. Finally, Brazil directs the Panel's attention to the massive increase from 2002 to 2003 in the losses CCC considers it will incur at the time all post-1991 guarantee cohorts are closed. At page 15 of the notes to its 2003 financial statements, CCC estimates that when all post-1991 cohorts close, it

[329] Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 15). Brazil notes that unlike the CCC 2002 financial statements included in Exhibit Bra-158, the CCC 2003 financial statements included in Exhibit US-129 are not publicly available on the USDA website. *See* http://www.usda.gov/oig/rptsauditsccc.htm.

[330] *See e.g.* US 11 August 2003 Answers to Questions, para. 159 ("Not until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal Government.").

[331] Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 4).

[332] Exhibit Bra-133 (Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programmes GSM 102, GSM 103 and SCGP).

will have lost $1.16 billion (as opposed to the $770 million it reported in its 2002 financial statements).[333]

**228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? BRA, USA**

## V. SERIOUS PREJUDICE

**229. What is the meaning of the words "may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the *SCM Agreement*? Please comment on the possibility that these words indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice and that serious prejudice should be considered an additional or overriding criterion to the factors specified in the subparagraphs. BRA**

**230. Please comment on Brazil's views on Article 6.3 of the *SCM Agreement* as stated in paragraphs 92-94 of its further submission. USA**

**231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the *SCM Agreement* are relevant context for the Panel's interpretation of Article 6.3? USA**

**Brazil's Comment:**

155. For the reasons Brazil has previously articulated, Brazil disagrees that Article 6.1 and Annex IV of the SCM Agreement are relevant context for interpreting the present text of Part III of the SCM Agreement.[334]

156. The US 22 December 2003 response to Question 243 confirms the fundamental role that Annex IV plays in its analysis of actionable subsidies in Part III of the SCM Agreement. The United States treats Annex IV as if the title of the Annex were "Calculation of the Total Ad Valorem Subsidization for Subsidies Subject to Part III of the Agreement". But all participants know and agree that Annex IV is dead. If it were not, then Brazil's submissions would certainly have been far more concise, as the total *ad valorem* subsidization for the US subsidies is 95 per cent over the four-year period of investigation.

157. The US reference in paragraph 131 of its 22 December 2003 Answer to Question 231 to the Appellate Body report in *US – CVD's on EC Products* is inapposite. That case involved countervailing duty measures, not actionable subsidy measures and claims under Part III of the SCM Agreement. The Appellate Body's citation to Annex IV was in the context of citing to a long list of SCM provisions that refer to the "recipient" of a "benefit" in the SCM Agreement. The Appellate Body did not, as the United States seeks to do in this case, use Article IV as the sole legal basis for the wholesale inclusion of countervailing duty methodologies into Part III of the SCM Agreement.

158. In paragraph 132 of its 22 December 2003 Answer, the United States continues to make the assumption that contract payments are "not tied to the production of upland cotton". As a factual

[333] Notes to Financial Statements contained in Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002, Audit Report N° 06401-16-FM (November 2003) p. 15). The United States reports that premiums of $246 million were collected on CCC guarantees over the period 1992-2003. *See* Exhibit US-128.

[334] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 96-107; Brazil's 2 December 2003 Oral Statement, paras. 4-6.

matter, Brazil has demonstrated that contract payments *are* tied to the production of upland cotton.[335] The evidence of much higher upland cotton per-acre payments, among many other facts, demonstrates that the *de jure* "flexibility" is, in practice, not exercised by upland cotton producers[336], and that the bulk of the upland cotton contract payments are paid to current upland cotton producers.[337]

159. More importantly, while the United States repeats its calls for Brazil to implement various allocation methodologies in paragraph 132 of its 22 December 2003 Answers to Questions, it refuses to provide the information that would allow Brazil or the Panel to even perform a calculation using the flawed US methodology based on Annex IV. And the United States is just plain wrong to suggest in paragraph 132 of its 22 December 2003 response that Brazil has "refus[ed] to countenance any allocation of the decoupled payments it has challenged … ". Brazil's 20 January 2004 Answer to Question 258 explained in greater detail in Brazil's methodology for allocating the payments.[338] Brazil even demonstrated that applying the US allocation methodology with the flawed and incomplete US 18/19 December 2003 data resulted in levels of support to upland cotton that were consistent with Brazil's 14/16$^{th}$ Methodology.[339]

**232. How, if at all, should the Panel take into account the effects of other factors in its analysis of the effects of US subsidies under Article 6.3? If the Panel should compare the effects of other factors to establish the relative significance of one compared to others, how would this be done? What would be relevant "factors" for this purpose? BRA**

**233. In Brazil's view, what is or are the "same market(s)" for the purposes of Article 6.3(c)? Does Brazil's view of "world market" imply that regardless of which domestic (or other) "market" is examined, price suppression will be identifiable? BRA**

**234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"? USA, BRA**

[335] *See* Brazil's 22 August 2003 Rebuttal Submission, Section 2.2 and references included therein. *See* also Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

[336] *See* Brazil's 22 August 2003 Rebuttal Submission, Section 2.2 and references included therein. *See* also Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

[337] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.1; Brazil's 28 January 2004 Comments and Request Regarding US Data, Section 9. *See* also Brazil's comment on Question 205, above.

[338] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[339] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 10.

**Brazil's Comment:**

160. The US 22 December 2003 response again ignores the determination of the panel in *Indonesia – Automobiles*, which found that the term "significant" in Article 6.3(c) required examination of a link between the size of the margins of undercutting and whether those margins could "meaningfully affect suppliers of the imported product".[340] Under this "meaningfully affect" standard, the focus, at least for the purposes of Article 6.3(c)[341], is on producers of the non-subsidized like product. Have their revenue, investments, or crop choices been "meaningfully affected" by the level of price suppression experienced? These are the types of questions that provide guidance as to whether a particular level of price suppression is significant or not. The notion of "meaningfully affect" and "serious prejudice" are, in essence, equivalent for the purpose of Article 6.3(c).

161. The US 22 December 2003 response to Question 234, at paragraph 136, states that "[t]he use of the term 'significant' however, would seem to be intended to prevent insignificant price effects from rising to the level of serious prejudice." But this statement presumes some sort of an objective standard exists by which to judge what are "insignificant price effects". The United States provides no suggestions how this Panel or future panels are to make such an abstract determination. The United States' position implies that the "Panel will know them when they see them". But the Article 6.3(c) test, at least, requires the Panel to make an assessment of the relationship between the price effects and serious prejudice. And this link is to be judged by whether the price effects are "significant".

162. The Panel should firmly reject the two-step process suggested by the US interpretation. The first step would require a finding, using some unknown, non-textual standard, of whether a particular price level of suppression is "significant". Evidence that Brazilian producers would have lost $71.5 million during MY 1999-2002 from only one cent per pound of price suppression[342] would be totally irrelevant for the first step.[343] Only if a panel makes this "significant" finding, divorced from any impact on producers, would it move to the second step, *i.e.*, whether that level of now-significant price effects caused serious prejudice. But such an interpretation, like many proposed by the United States in this dispute, would leave Members who lost millions of dollars due to the effects of subsidies without a remedy. There is no textual basis for such a result, which would be contrary to the object and purpose of the SCM Agreement. In sum, the Panel should adopt the *Indonesia – Automobiles* standard of judging significance in light of whether the particular level of price suppression "meaningfully affects" non-subsidized suppliers of the like product.[344]

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[340] "Although the term "significant" is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that *margins of undercutting so small that they could not meaningfully affect suppliers of the imported product* whose price was being undercut are not considered to give rise to serious prejudice…" (emphasis added). Panel Report, *Indonesia – Automobiles*, WT/DS54/R, para. 14.254.

[341] Brazil notes that Articles 6.3(a), (b) and (d) do not contain similar qualitative or quantitative qualifiers.

[342] Brazil's 9 September 2003 Further Submission, para. 258 (citing a $143 million loss from a 2 cents per pound level of price suppression).

[343] A good example of evidence that would be irrelevant under the first part of the US test is found in the testimony of Christopher Ward. He indicated that a 10 percent increase in prices for Mato Grosso producers in MY 2000 and MY 2001 would have permitted them to cover their variable costs for MY 2001 and come close to covering variable costs in MY 2000. However, because of the losses they suffered without such revenue increases, many Mato Grosso producers reduced production or were forced out of cotton production. Mato Grosso production fell by 34 per cent between MY 2000 -2001. Exhibit Bra-283 (Statement of Christopher Ward – 7 October 2003, paras. 8-10 and accompanying graph).

[344] The US example of a per-unit payment of 0.0001 cents per pound in paragraph 136 is irrelevant, because under its hypothetical, this particular level of price suppression could never "meaningfully affect" any suppliers of the like product.

163. But even if the Panel decides to adopt some sort of numerical standard not reflected in the text of Article 6.3(c), Brazil has also set forth evidence showing that the levels of price suppression found by a number of different economists are "significant".[345] In assessing whether the various levels of price suppression found by USDA and other economists are "significant," the Panel should take into account the fact that upland cotton is a primary commodity traded in huge volumes and produced and consumed in a large number of countries. Under these circumstances, any measurable and identifiable effect on the *world* price from the subsidies provided by a single Member is important. In this case, the Panel is faced with particularly compelling facts – during MY 1999-2002 (and even during MY 1997-1998) the record shows that the absolute numerical levels of price suppression caused by some or all of the US subsidies were significant, ranging from 4 to 26.3 per cent of the world price, and 10 to 33.6 per cent of the US price.[346]

164. Finally, the United States argues in paragraph 136 that the effect of Brazil's interpretation is that any production subsidy would run afoul of Part III of the SCM Agreement, thus turning it into a prohibited subsidies provision. There is no basis for this argument. First, it is difficult to see how extremely low levels of production subsidies (0.0001 cents per pound price effects in the US example) could "materially affect" any competing producers of the non-subsidized Member. Only production subsidies that generate price suppression significant enough to "materially affect" competitors would be subject to the disciplines of Part III. This is far from an insignificant threshold, and gives meaning to the word "significant".

165. Second, this US argument is similar to other arguments it has made to the effect that any limitations on the amount of subsidies would change "actionable" subsidies to "prohibited" subsidies.[347] The United States loses sight of the basic fact that an actionable subsidy that creates adverse effects is a violation of WTO rules. No Member has the right to provide unlimited production subsidies *if* they cause serious prejudice. Members deciding to impose discretionary or mandatory limits on the amount of production subsidies may significantly diminish the possibility that such subsidies create significant price suppression or an ongoing threat of serious prejudice. But it is wrong for the United States to argue that because the only practical way to impose limitations on production subsidies may be some sort of a cap on such subsidies necessarily an actionable subsidy is turned into a "prohibited subsidy".[348]

**235. Please comment on paragraphs 8, 9 and 10 of the US 2 December oral statement, in particular, why the average Brazilian price is shown as lower than the average US price. BRA**

**236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share". USA**

**Brazil's Comment:**

166. Brazil considers it telling that the United States does not provide the percentage figures underlying the chart at paragraph 138 of its 22 December 2003 response. This is because the percentage figures reveal that the US methodology suffers from a fatal flaw. The sum of the US world market share, as defined by the United States[349], and the "rest of the world" market share, as

[345] Brazil's 9 September 2003 Further Submission, Table 22; Brazil's 7 October Oral Statement, paras. 30-34.

[346] See Brazil's 9 September 2003 Further Submission, paras. 148-161, 190, 200-232, 254, 379-384 and Table 23.

[347] US 2 December 2003 Oral Statement, paras 83-84.

[348] US 2 December 2003 Oral Statement, paras 83-84.

[349] "(Domestic Mill Use + Exports)" / Total World Consumption; *see* US 22 December 2003 Answers to Questions, para. 137.

defined by the United States[350], far exceeds 100 per cent. To clarify this point, Brazil presents the following table, based on the data provided by the United States in Exhibit US-47 and in response to question 197.[351]

| | US Domestic Consumption | US Exports | World Consump-tion | Non-US[352] Domestic Consumption | Non-US Exports | US Share[353] | Non-US Share | Total Share |
|---|---|---|---|---|---|---|---|---|
| | | | million bales | | | | per cent | |
| 1995 | 10.647 | 7.675 | 86.040 | 75.393 | 19.900 | **21.29** | **110.75** | **132.05** |
| 1996 | 11.126 | 6.865 | 88.031 | 76.905 | 20.100 | **20.44** | **110.19** | **130.63** |
| 1997 | 11.349 | 7.500 | 87.138 | 75.789 | 19.300 | **21.63** | **109.12** | **130.76** |
| 1998 | 10.401 | 4.298 | 84.640 | 74.239 | 19.400 | **17.37** | **110.63** | **128.00** |
| 1999 | 10.194 | 6.750 | 90.957 | 80.763 | 20.600 | **18.63** | **111.44** | **130.07** |
| 2000 | 8.862 | 6.740 | 92.172 | 83.310 | 19.800 | **16.93** | **111.87** | **128.79** |
| 2001 | 7.696 | 11.000 | 94.381 | 86.685 | 18.100 | **19.81** | **111.02** | **130.83** |
| 2002 | 7.270 | 11.900 | 97.930 | 90.660 | 18.700 | **19.58** | **111.67** | **131.25** |
| 2003 | 6.200 | 13.200 | 97.690 | 91.490 | 19.100 | **19.86** | **113.20** | **133.06** |

167. Indeed, as the Panel can readily see, the "rest of the world" "world market share", as defined by the United States, exceeds 100 per cent – a result that defies any logic.

168. For the ease of the Panel's reference, Brazil presents an excerpt from its own figures originally presented in Exhibit Bra-302,[354] showing that, under Brazil's and USDA's definition of the "world market share," the total world market share equals 100 per cent.

[350] "(Non-US Domestic Mill Use (*i.e.* consumption) + Non-US Exports) / Total World Consumption.

[351] US 22 December 2003 Answers to Question, para. 15 and Exhibit US-120. Since the United States did not provide any data on "Non-US Exports," Brazil has used USDA published figures on "Foreign Cotton Exports" from USDA's Cotton and Wool Yearbook (Exhibit Bra-412 (Cotton and Wool Situation and Outlook Yearbook, USDA, November 2003, Table 16).

[352] "World Consumption minus US Domestic Consumption."

[353] The 2003 figure differs a little from what would seem to be the 2003 figure in the US table at paragraph 138 of the US 22 December 2003 Answers to Questions. It appears that the reason is the United States use of its non-updated figures from Exhibit US-47, rather than the updated MY 2002 and 2003 figures from its 22 December 2003 response to Question 197, para. 15.

[354] *See* also Brazil's 27 October 2003 Answers to Questions, paras. 123-129.

| | US upland cotton exports | Non-US upland cotton exports | World upland cotton exports | US Share | Non-US Share | Total Share |
|---|---|---|---|---|---|---|
| | | million bales | | | per cent | |
| 1995 | 7.375 | 19.394 | 26.769 | 27.55 | 72.45 | 100.00 |
| 1996 | 6.399 | 19.384 | 25.783 | 24.82 | 75.18 | 100.00 |
| 1997 | 7.060 | 18.534 | 25.594 | 27.58 | 72.42 | 100.00 |
| 1998 | 4.056 | 18.559 | 22.615 | 17.94 | 82.06 | 100.00 |
| 1999 | 6.303 | 19.805 | 26.108 | 24.14 | 75.86 | 100.00 |
| 2000 | 6.303 | 19.170 | 25.473 | 24.74 | 75.26 | 100.00 |
| 2001 | 10.603 | 17.072 | 27.675 | 38.31 | 61.69 | 100.00 |
| 2002 | 11.266 | 15.796 | 27.062 | 41.63 | 58.37 | 100.00 |
| 2003 | 11.225 | 17.690 | 28.915 | 38.82 | 61.18 | 100.00 |

169. Brazil will address the US arguments that the world market share means share of world consumption in detail in its comments on the following questions.

**237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? BRA, USA**

**Brazil's Comment:**

170. As noted in its 22 December 2003 response to this question, Brazil agrees that a phenomenon that remains at approximately the same level over a given period cannot be considered a consistent trend.[355] However, as detailed in that answer, this is not the situation facing this Panel. The data clearly establishes that, in MY 2001, 2002 and 2003, there is an increase in the US world market share over the previous three-year average, and that this increase follows a consistent trend since MY 1996 (and MY 1986).[356] In response to this question, the United States again relies on an utterly wrong interpretation of the term "world market share" in Article 6.3(d) of the SCM Agreement. The term

[355] Brazil's 22 December 2003 Answers to Questions, para. 134.

[356] Brazil's 22 December 2003 Answers to Questions, paras. 133-139; Brazil's 27 October 2003 Answers to Questions, paras 123-129. Brazil further notes the new information presented by the United States concerning US upland cotton exports in MY 2002 and 2003. These figures (11.9 million bales and 13.2 million bales respectively) would replace Brazil's latest information, as contained in Exhibit Bra-302 (11.3 million bales and 11.2 million bales respectively). These new facts strengthen Brazil's threat of serious prejudice claim under Article 6.3(d) and footnote 13 of the SCM Agreement. *See* US 22 December 2003 Answers to Questions, para. 15 and Brazil's comment to US 22 December 2003 Answer to Question 197, above.

does not mean "world consumption share", but world market share of exports, as detailed by Brazil many times, including in these comments.

**238. According to the US interpretation of the term "world market share":**

**(a) should the domestic consumption of closed markets be added into the denominator?**

**Brazil's Comment:**

171. Brazil understands that the Panel's question referred to the distinction between "competitive markets," where world upland cotton producers/exporters compete for available share of world exports, and "closed markets", where no competition for export market share can take place because of subsidies like the domestic Step 2 programme, tariffs, or non-tariff barriers.[357] The US 22 December 2003 response, at paragraph 140, affirms that the United States would greatly increase and distort the Article 6.3(d) denominator by including, *inter alia*, all sales of US upland cotton in the US market. Yet, there is little "international trade" in the US domestic upland cotton market, because there were only marginal imports during MY 1999-2002.[358] The effect of the US argument is to obscure and hide the huge volume and market share increase in US exports in "competitive" markets during MY 1998-2003. As Brazil has argued, the US focus on "consumption" as opposed to "trade" is contrary to the text, context, and object and purpose of Article 6.3(d).[359] Article 6.3(d) focuses on "trade", not domestic consumption, and thus involves competitive world markets where exports and trade take place.[360]

172. It is noteworthy that the US answer ignores un-rebutted evidence that USDA's top economists and analysts repeatedly use the phrase "world market share" to describe and analyze how US agricultural exporters are performing in competitive world markets for exports.[361] The United States never provided a single instance in which USDA economists – or any other Member's economists – included domestic US consumption in their analysis of the US "world market share". This is because the unique US notion of "consumption" (which combines exports, domestic use, and imports as part of "consumption") simply does not exist (in the literature or trade statistics) outside of the US arguments in this case.

**(b) if US production and consumption increased by the same percentage, whilst the rest of the world's production and consumption remained steady, would this imply an increase in the US "world market share" by a different percentage?**

**Brazil's Comment:**

173. The US 22 December 2003 response in effect acknowledges, at paragraph 142, that the US subsidies could be subject to a challenge under Article 6.3(d) even though those subsidies did not cause any increase in US exports. Under the US theory, even though none of the non-subsidized producer/exporters of upland cotton would have lost any world export market share, these producers could initiate a claim against the United States under Article 6.3(d), in addition to Article 6.3(a), because the US domestic production and domestic consumption increased. This US response

[357] Brazil detailed its arguments concerning the focus of Article 6.3(d) on competitive markets and where "trade" takes place in its 7 October 2003 Oral Statement, paras. 38-41.

[358] For example, between MY 1999-2001, US imports represented only 0.2 percent of total US mill use of upland cotton. *See* Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4-5).

[359] Brazil's 7 October 2003 Oral Statement, paras 38-41; Brazil's 27 October 2003 Answers to Question, paraa. 202-206; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 170-172; Brazil's 2 December 2003 Oral Statement, paras. 62-65.

[360] Brazil's 7 October 2003 Oral Statement, para. 39.

[361] Brazil's 7 October 2003 Oral Statement, note 78.

highlights the disconnect between its theory and the reality of what Article 6.3(d) really is about – the impact of subsidies on trade in the product in question in competitive international markets.

174. Of course, the Part III of the SCM Agreement discipline addressing the Panel's hypothetical factual situation is Article 6.3(a). The United States argues in paragraph 143 that "Brazil's approach … would allow a larger or even dominant upland cotton consumer to provide huge per-unit production subsidies that increased the share of its own domestic consumption that its production supplied *without any disciplines under Article 6.3(d)*, regardless of the impact on other Members who could potentially supply that increasing domestic consumption" (emphasis added). But what the US-posited hypothetical outlines is a classic "displacement or impedence" case under Article 6.3(a). "But for" the "huge per-unit production subsidies", the non-subsidized Member exporters would have increased or maintained their export market share in the market of the subsidizing Member. Thus, interpreting Article 6.3(d) to mean the "world market share of exports" does not leave non-subsidized Member producers who are squeezed out of the subsidizing Member's market without a remedy. And the fact that Article 6.3(d) does not *also* discipline the situation covered by Article 6.3(a) is hardly surprising, since negotiators presumably intended different provisions to cover different situations.

175. Indeed, the US argument in paragraph 143 highlights the fallacy of its interpretation. It argues that "the ordinary meaning of 'world market share' in Article 6.3(d) … would capture impacts both on the market of the subsidizing Member (as in Article 6.3(a)) and in third-country markets (Articles 6.3(b) and 6.3(c))".[362] But if that were true, then there would be no need for Articles 6.3(a) and 6.3(b).[363] The US interpretation would render one of the sets of disciplines a nullity, in violation of the customary rules of treaty interpretation as codified in the *Vienna Convention*.

176. Finally, rather than capturing all the possible instances where subsidies can cause serious prejudice in world markets, the US "consumption" interpretation of "world market share" leaves a gaping hole in the serious prejudice remedies. The facts of this case show how the US interpretation would completely hide the huge US increase in world market share of exports – from 25 per cent in MY 1999 to 41.6 per cent in MY 2002. Where a Member uses subsidies to capture export market share in the competitive world market, it causes serious prejudice by limiting the opportunities for non-subsidized Members to increase their exports.[364] The record shows that African upland cotton producers, with among the lowest world production costs, actually *lost* world market share to the United States between MY 1998-2002.[365] Yet, the US interpretation of Article 6.3(d) would deny them, as well as Brazil, any remedy to challenge such an increase in the US world market share of exports.

[362] US 22 December 2003 Answers to Questions, para. 143.

[363] Article 6.3(a) disciplines the situation described in the Panel's question: a Member using subsidies to increase the share of domestic consumption satisfied by domestic supply (*i.e.*, displacing or impeding imports into the market of the subsidizing Member). Article 6.3(b) disciplines such effects of a Member's subsidies (displacing or impeding exports) in a third country market. Article 6.3(c) disciplines significant price effects of a Member's subsidies in all markets. Brazil's 2 December 2003 Oral Statement, para. 63.

[364] *See* Brazil's 9 September Further Submission, paras. 451-456; paras 444-453 (facts supporting the interconnected relationship between the serious prejudiced due to price suppression and the serious prejudice due to increased world market share); Annex III Statements by Brazilian producers Christopher Ward, Jaime Naito, Aloysio Lerner and Ronaldo Spirlandelli de Oliveria, among others.

[365] Brazil's 9 September 2003 Further Rebuttal Submission, Section 7.1 and Figure 26 following para. 282.

**(c) does Saudi Arabia have a small world market share for oil? USA**

**Brazil's Comment:**

177. Contrary to the US 22 December 2003 response, Brazil has no difficulty appreciating the relevance of the Panel's question. Even accepting the US figures, which include Saudi Arabian consumption of crude oil to produce refined products that are then exported, the US response highlights the significant (25 per cent) difference between their "consumption" methodology and a world market share of exports methodology.[366]

**239. How does the US respond to Brazil's assertions that, under the US interpretation of the term "world market share":**

**(a) there would be no WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports? (see paragraph 64 of Brazil's 2 December oral statement);**

**Brazil's Comment:**

178. The US 22 December 2003 response confirms Brazil's arguments that the US interpretation leaves no direct remedy for a Member who either loses or is not able to increase its world market share of exports as a result of another Member's subsidies.[367] The United States asserts in paragraph 147 of its answer, that Article 6.3(b) provides such a remedy. But that provision only addresses a non-subsidizing Member's right to contest the effects of subsidies in, *inter alia*, increasing a subsidizing Member's export market share in an *individual* third country market. The *EC – Sugar Exports I (Australia)* and *EC- Sugar Exports II (Brazil)*[368] disputes demonstrated how difficult it can be for a non-subsidizing Member to demonstrate displacement or impedence in an individual third country market. Article 6.3(d) helped to address this legal vacuum by providing clear, objective guidelines for subsidizing Members to know when their increase in world market share of exports would be subject to disciplines, and to provide an objective basis for the injured non-subsidized exporting Member to evaluate and protect its rights.

179. The United States further argues, in paragraph 147 of its response, that Article 5(a) of the SCM Agreement would provide a remedy for a non-subsidized Member who lost world market share in exports. But while that provision relates to "injury to the domestic industry of another Member", footnote 11 of the SCM Agreement qualifies that the "injury" "is used in the same sense as it is used in Part V". "Injury" is defined in Article 15.1 *et seq.* of the SCM Agreement as that caused by (a) the volume of the subsidized *imports* and the effect of the subsidized imports on prices in the domestic market for like products, and (b) the consequent impact of these imports on the domestic producers of such products. In the context of this dispute, this remedy would appear to apply only to US subsidized exports to the Brazilian market (*i.e.*, the "domestic" market). Contrary to the US argument, Article 5(a) would not address the situation covered by Article 6.3(d), where Brazilian exporters suffer serious prejudice by an increase in the US world market share of exports.

180. Finally, the United States claims, at paragraph 147 of its response, that Article XVI:1 of GATT 1994 would provide Brazil with the right to challenge the US world market share for exports. Brazil agrees that GATT Article XVI:1, as read in conjunction with GATT Article XVI:3, provides for a very analogous recourse as that provided for in Article 6.3(d), *i.e.*, any subsidies that increase exports and lead to an inequitable share of world export trade. But the United States contradicts itself

[366] US 22 December 2003 Answers to Questions, para. 145.
[367] *See e.g.* Brazil's 2 December 2003 Oral Statement, para. 64.
[368] GATT Panel Report, *EC – Sugar Exports I (Australia)*, L/4833 – 26S/290, para. 4.26-4.27*;* GATT Panel Report, *EC – Sugar Exports II (Brazil)*, L/5011-27S/69, para. 414.

in offering up an Article XVI:1 remedy (which is inexorably linked to Article XVI:3, second sentence) in paragraph 147, while arguing elsewhere that this provision is no longer applicable and has been replaced by Article 6.3.[369]

181. In sum, the Panel is left with the US interpretations that (a) there is no longer any disciplines for a Member suffering from a decrease in its world market share for exports under Article XVI:3, second sentence on the one hand[370], and (b) Article XVI:3's presumed successor, Article 6.3(d), does not apply to the world market share of exports. In effect, Members are left without any explicit protection for their loss of world market share of exports due to massive subsidization. Such a result defies the text, context, and object and purpose of Article 6.3(d), as Brazil has repeatedly argued.

182. In any event, whether there may be – outside Article 6.3(d) of the SCM Agreement – indirect disciplines that may provide some relief to non-subsidizing Members whose rights have been nullified and impaired by a subsidizing Member's increase in world market share of exports does not free the Panel from its obligation to interpret the term "world market share" in Article 6.3(d) in accordance with its "ordinary meaning, in their context and in light of the treaty's object and purpose". Brazil demonstrated that under a *Vienna Convention* analysis, the term "world market share" means world market share of exports – not consumption.[371]

**(b) a Member's exports would have to be disregarded in calculating their "world market share" in terms of "world consumption"? (see e.g. paragraph 65 of Brazil's 2 December oral statement) USA**

**Brazil's Comment:**

183. In paragraph 148 of its 22 December 2003 response, the United States does not address the substance of the Panel's question or Brazil's earlier arguments. That is, the United States does not respond to the fact that its methodology double counts exports as part of the world market share of the exporting country *and* the importing country.[372] In effect, the United States requires this Panel to ignore this illogical conceptual error in its interpretation of the term "world market share". Instead, the United States insists that it is not incumbent upon the Panel "to interpret the term 'domestic consumption'".[373] Brazil agrees, but that is because the term "domestic consumption" is nowhere to be found in the text or context of Article 6.3(d) of the SCM Agreement. Nor is it consistent with the object and purpose of Article 6.3(d). But since the United States would read "consumption" into that text, then the Panel must closely examine its meaning, using appropriate context to do so. And it should reject the use of that term if it leads to an interpretation that is illogical, leads to absurd results, and otherwise fails to live up to the standards on the interpretation of international treaties, as set out in the *Vienna Convention*.

**240. Does Article XVI:3 of GATT 1994 provide context in interpreting Article 6.3(d) of the *SCM Agreement*? Do these provisions apply separately? If not, could it indicate that "world market share" is intended to mean the same as "share of world export trade"? USA**

[369] US 22 December 2003 Answers to Questions, para. 149.
[370] US 22 December 2003 Answers to Questions, para. 146.
[371] Brazil's 7 October 2003 Oral Statement, paras. 38-41; Brazil's 27 October 2003 Answers to Question, para. 202-206; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 170-172; Brazil's 2 December 2003 Oral Statement, parass 62-65.
[372] The United States admits that its methodology counts imports as part of domestic consumption. *See* US 22 December 2003 Answers to Questions, Table at para. 15 and note 24.
[373] US 22 December 2003 Answers to Questions, para. 148.

**Brazil's Comment:**

184. Regarding the first question, Brazil has previously detailed the basis for its arguments that Article XVI:3, second sentence of GATT 1994 provides very important context for interpreting Article 6.3(d).[374] In response to the Panel's second question, Brazil has demonstrated that these provisions do apply separately, for the reasons Brazil has earlier stated.[375] With respect to the third question, the phrase "world market share" in the text of Article 6.3(d) is intended to mean the same thing as "share of world export trade".[376]

185. The United States points out several differences between Article XVI:3 and Article 6.3(d), one of which is its faulty interpretation that Article XVI:3, second sentence only deals with "export" subsidies. Brazil has earlier demonstrated that the pool of subsidies that could cause serious prejudice is the same for Article 6.3(d) and Article XVI:3, second sentence.[377]

186. The United States further argues that Brazil agreed in the Tokyo Round Subsidies Code that GATT 1994 Article XVI:3 is limited to export subsidies.[378] This is not correct, as demonstrated by the text of the Tokyo Round Code.[379] It uses the language "shall include" and "export subsidy" in connection with the notion of a more than equitable share of world trade.[380] Thus, an inequitable share of world trade may result from export subsidies, but it is not limited to that source. Moreover, whatever the interpretation of these terms may have been in the now extinct plurilateral Tokyo Round Subsidies Code, the only text that continues to exist is the ordinary meaning of the words used in Article XVI:3, second sentence, which must be interpreted according to its ordinary meaning in its context, and in light of the object and purpose of the GATT. Yet, the United States argues that even that provision is "incapable of definition or application".[381]

187. The United States argues in paragraph 151 that the use of the term "market" provides the fundamental key to its interpretation. The US argument would include *all* markets where upland cotton is produced, consumed, or used when it states that Article 6.3(d) is *not* limited to "markets in international trade". But this argument ignores the fundamental focus of Article 6.3 (as well as Part III of the SCM Agreement itself) on *international* trade and the impact of subsidies on *competition* between subsidized and non-subsidized producers and their products. For example, Article 6.3(a) involves situation, in which exporters are impeded or displaced from the market of the subsidizing Member. Articles 6.3(b) and 6.4 involve the situation, in which the export share of a subsidizing Member squeezes out or limits the export share of the non-subsidizing Member in a third

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[374] Brazil's 18 November 2003 Further Rebuttal Submission, para. 172.

[375] Brazil's 27 October 2003 Answer to Question 161, para. 130 and Question 196(b), paras. 202-206.

[376] Brazil's 18 November 2003 Further Rebuttal Submission, paras 170-172; Brazil's 7 October Oral Statement, paras. 38-41.

[377] Brazil's 27 October 2003 Answer to Question 185, paras. 194-201; Brazil's 18 November 2003 Further Rebuttal Submission, paras 178-179.

[378] US 22 December 2003 Answers to Questions, para. 149.

[379] US 27 October 2003 Answers to Questions, para. 130. For purposes of Article XVI:3 of the General Agreement and paragraph 1 above:

> (a) "more than an equitable share of world export trade" shall include any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets;
>
> (b) with regard to new markets traditional patterns of supply of the product concerned to the world market, region or country, in which the new market is situated shall be taken into account in determining 'equitable share of world export trade'[.]

[380] *See* US 27 October 2003 Answers to Questions, para. 130.

[381] US 22 December 2003 Answers to Questions, para. 149; US 27 October 2003 Answers to Questions, paras. 131-132.

country market. And the United States has argued that Article 6.3(c) only involves situations, in which prices are suppressed in markets where competition between the subsidized products and the non-subsidized like products take place.[382] In essence, the key to initiating a claim under all three of these provisions is demonstrating that "trade" and "competition" have been affected through the use of subsidies.

188. The Panel must ask how is it possible that Articles 6.3(a) – (c) only apply to situations where international trade and competition actually take place (or are impeded from taking place), while Article 6.3(d) is totally different – it is to be read without any reference to competition and trade *at all*? The United States asserts that the "world" in "world market share" means the "entire world," without regard to whether there is trade or competition between subsidizing Member products and those of non-subsidizing Members.[383] But this slavishly literal reading goes too far. Brazil submits that read in this context, along with the other contextual provisions such as "trade" in footnote 17 of the SCM Agreement, and Article XVI:3, second sentence, that the US interpretation is simply wrong.

189. The United States further argues, at paragraph 149 of its response, that "Brazil has not offered any objective definition" of "equitable share". This is incorrect.[384] Further, the fact that certain GATT and WTO provisions express disciplines in broad terms, such as "equitable" or "reasonable" or "serious" or "significant," does not mean that a treaty interpreter can simply throw up his or her hands and find, as the United States urges, that a provision is incapable of interpretation. Article 31 of the *Vienna Convention* provides that "the words of a treaty are to be given their ordinary meaning, in their context and in light of the treaty's object and purpose".[385] Further, the Appellate Body held in *US – Gasoline* that "an interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility".[386] Thus, the Panel should reject this US attempt to condemn Article XVI:3.

190. However, should the Panel decide that GATT Article XVI:3, second sentence is, indeed, inapplicable, then this certainly strengthens the basis for the Panel to interpret the phrase "world market share" in Article 6.3(d) as meaning the "share of world export trade". It is inconceivable that negotiators – who certainly did not expressly terminate the application of Article XVI:3, second sentence – would also intend, without making it explicit, that there would be no disciplines for subsidies that allowed Members to seize world market share of exports in competitive markets.

**241. How does the US reconcile its data on consumption for 2002 in US Exhibit 40, Table 1 with the "consumption" data it refers to in its 30 September submission, paragraph 34, Exhibit US-47 or US-71? USA**

**Brazil's Comment:**

191. The US 22 December 2003 response appears to have clarified that the graph in paragraph 34 of its 30 September 2003 Further Submission relates to US finished cotton fibre consumption, while the "consumption" referred to in Exhibits US-40, US-47 and US-71 relates to upland cotton lint consumption by US textile mills. Brazil has demonstrated the irrationality of the US world market share of upland cotton consumption data in terms of Article 6.3(d). Brazil has also demonstrated the irrelevance of the US arguments concerning the US consumption of finished textile products.[387]

[382] US 18 November 2003 Further Rebuttal Submission, paras. 37-40.
[383] US 22 December 2003 Answer to Questions, para. 151.
[384] Brazil refers the Panel and the United States to its oral answers to the Chairman's questions during the October 2003 meeting of the Panel, paragraphs 17-18 of Brazil's 9 October 2003 Closing Statement, and paragraphs 189-193 of Brazil's 27 October 2003 Answers to Questions.
[385] Appellate Body Report, *US. – Gasoline,* WT/DS2/AB/R, p. 17.
[386] Appellate Body Report, *US – Gasoline*, WT/DS2/AB/R, p. 23.
[387] Brazil's 7 October 2003 Oral Statement, para.25.

**242. How much of the benefits of PFC, MLA, CCP and Direct Payments go to land owners? If not all of the benefits go to land owners, what proportion goes to producers? USA**

**Brazil's Comment:**

192. The Panel's question is set out in a section entitled "Serious Prejudice" and uses the word "benefit" relating to contract payments. Brazil will address its comments to the US 22 December 2003 response in two senses of the word "benefit". First, Brazil will address its comment with respect to the definition of the term "benefit" as it is used in Article 1.1(b) of the SCM Agreement. Second, the question also appears to address "benefit" in a more generic sense, as it relates to the effects of contract payments on US production, exports, and the world price of upland cotton. Brazil believes it is this second sense of the term "benefit" to which the Panel's question was directed. However, the United States' answer concludes by asserting that "35 per cent of the value of decoupled payments would benefit upland cotton producers"[388], suggesting that it interpreted the Panel's question as directed at the term "benefit" in the sense of Article 1.1(b) of the SCM Agreement. The United States also suggests that the remaining 65 per cent of the US contract payments do not constitute a benefit within the meaning of Article 1.1(b) of the SCM Agreement.

"*Benefit" under Article 1.1(b) of the SCM Agreement*

193. As set forth below, for the purposes of Article 1 of the SCM Agreement, the record shows that 100 per cent of contract payments are paid to the bank accounts of current upland cotton producers on terms that constitute "benefits".

194. Under the 2002 FSRI Act, direct and counter-cyclical payments are *only* paid to "producers on farms for which payment yields and base acres are established".[389] "Producers" are defined in the Act as "an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop and is entitled to share in the crop availability for marketing from the farm, or would have shared had the crop been produced". A similar definition of "producer" existed for the 1996 FAIR Act.[390] As implemented, USDA acknowledges that contract payments "are paid only to farm operators rather than farmland owners, with payment benefits split between the operator and owners in the case of crop-share rental arrangements".[391] Thus, the only "landlords" or "owners" who directly receive contract payments are those who are producers of upland cotton, *i.e.*, those that share in the risk of producing an upland cotton crop.[392] The USDA study further states that "[t]he operators' receipt of the PFC payments compensates for higher land costs that may result from the effects of the PFC programme".[393]

195. Brazil has proved that without the receipt of the PFC, market loss assistance, direct and counter-cyclical payments in their bank accounts, US upland cotton producers could not meet their costs – including their lease and land-related costs. Even if these current producers may subsequently write checks to their landlords who do not share in the risk of producing a crop, that does not mean that the subsidies that the producers are legally entitled to receive from USDA do not provide them with a "benefit", within the meaning of Article 1.1(b) of the SCM Agreement, as the United States appears to argue. Rather, the full amount of the payment is made to the current producers.

[388] US 22 December 2003 Answers to Questions, para. 158.
[389] Exhibit Bra-29 (Sections 1103 and 1104 of the 2002 FSRI Act).
[390] Exhibit Bra-28 (Section 111(b) of the 1996 FAIR Act).
[391] Exhibit US–78, p. 44.
[392] *See* Brazil's 22 July 2003 Oral Statement, para. 57; Brazil's 22 August 2003 Rebuttal Submission, paras. 19, 24.
[393] Exhibit US–78, p. 44.

196. The Appellate Body has held that a "benefit" exists if a financial contribution is received by a "recipient" or a "producer" of the subsidized good on terms more favourable than those available to the recipient in the market.[394] Producers of US crops who have contract base acreage receive these payments from USDA. In *Canada – Aircraft*, the Appellate Body established that "a benefit does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient", noting that "the term benefit, therefore, implies that there must be a recipient".[395] The Appellate Body in *US – CVD's on EC Products* held that "the focus of any analysis of whether a 'benefit' exists should be on 'legal or natural persons' instead of on productive operations".[396] Contrary to the US arguments, it is legally irrelevant for purposes of determining the existence of a "benefit" under the SCM Agreement whether a benefit received by a "recipient" is subsequently transferred to other non-recipients.

197. The United States' 22 December 2003 response continues its efforts to transform this dispute into a countervailing duty investigation based on now-defunct Annex IV of the SCM Agreement. The United States alleges in paragraph 158 of its 22 December 2003 response that only 35 per cent of PFC, market loss, CCP and direct payments "would benefit upland cotton producers". If the United States is using the word "benefit" in the sense of Article 1.1(b) of the SCM Agreement, then the statement is legally as well as factually wrong. As Brazil has demonstrated above, 100 per cent of the four types of contract payments are paid to the bank accounts of current upland cotton producers. Thus, there is no doubt that each of the four contract payment subsidies confers a "benefit" to upland cotton producers.

198. Finally, even if this case was a countervailing duty investigation, under existing CVD procedures, 100 per cent of the contract payments – not 35 per cent – would be allocated across the production value of the producers. This is, again, because, first, the total amount of benefits to the company producing the subsidized goods would be calculated. No deductions are made depending on how the subsidy is used by the recipients (*i.e.*, to pay rents). 100 per cent of the subsidy is countervailable. Only in case the subsidy is not *de facto* tied to the production of the subsidized product, is there in a second step an allocation of the benefit (100 per cent) over the total value of the company's production.

*Use of "benefit" to assess the amount of subsidies that could cause serious prejudice*

199. The more likely use of the term "benefit" in the Panel's question is the extent to which contract payments contributed to and will contribute to the serious prejudice suffered by Brazil. In other words, to what extent do contract payments enhance and support the production and exports of US upland cotton, and to what extent do they suppress world prices? Brazil has produced evidence, *inter alia*, through Professor Sumner's analysis, that the contract payments have various effects on production, exports and world prices. The isolated effects of these contract payments are less than those created by the marketing loan programme. Brazil acknowledged that one reason why the serious prejudice effects of PFC payments are relatively small is because a certain percentage of the payments were capitalized into land values and subsequently into land rents.[397] Brazil noted that this

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[394] In *Canada – Aircraft*, the Appellate Body found that:

> …the word "benefit", as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, *the marketplace provides an appropriate basis for comparison* in determining whether a "benefit" has been "conferred" because the trade distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market."(emphasis in original and underlining added)

Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 157; The same language is included in Appellate Body Report, *US – CVD's on EC Products*, WT/DS212/AB/R, para. 106.

[395] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 154.

[396] Appellate Body Report, *US – CVD's on EC Products*, WT/DS212/AB/R, para. 110.

[397] Brazil's 27 October 2003 Answer to Question 179, paras. 164-167.

evidence is supported by Professor Sumner's conclusions because significant amounts of the PFC payments (approximately two thirds) were available to generate production effects.[398] Finally, Brazil also demonstrated that the total USDA-estimated increase in land values from PFC payments translated into less than one per cent of an upland cotton producers' total costs.[399]

200. The United States 22 December 2003 response now claims for the first time that only 35 per cent of the value of decoupled payments benefited upland cotton production during the period of investigation.[400] Having asserted this fact, the United States bears the burden of proving it.[401] But even a cursory look at the evidence proffered by the United States shows that this assertion is simply not true.

201. The US assumption is that every dollar of every contract payment placed into the bank accounts of producers *leasing* land (approximately 65 per cent of upland cotton land is "leased" or "rented") is immediately required to be paid to non-producer landlords.[402] The United States produced no evidence that 100 per cent of even PFC payments (let alone market loss assistance, direct or counter-cyclical payments) to cash rent cotton producers were consumed by increased rents during the period of investigation or since contract payments began in 1996.[403] Further, the United States produces no evidence that 65 per cent of the upland cotton land is cash-rented. In fact, only 25 per cent of the US upland cotton land is cash-rented, whereas 40 per cent is share-rented.[404] As established above, share-rent lease agreements mean that the landlord is considered a producer of upland cotton. Therefore, even under the flawed US theory, much more than just 35 per cent, in fact at least 75 per cent, should be considered benefits to upland cotton producers.

202. But do the facts even support the US allegation that rents increased because of the contract payments? Indeed, the most recent USDA cotton cost of production data shows that the opportunity cost of land decreased from $58.33 per acre in MY 1997 to $46.76 per acre in MY 2002.[405] This data was reinforced by testimony in 2001 by the NCC President, who disagreed with the suggestion that "the payments that we are receiving are increasing land values or holding them up".[406] Instead of PFC payments, the NCC President stated his belief that the "strong economy outside of agriculture … has supported land values … ".[407] This cotton-specific cost data and testimony by the recipients of PFC payments contradicts the US "35 per cent" assumption.

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[398] Brazil's 27 October 2003 Answer to Question 179, para. 167.

[399] Brazil's 27 October 2003 Answer to Question 179, para. 167.

[400] US 22 December 2003 Answers to Questions, para. 157.

[401] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[402] US 22 December 2003 Answers to Questions, para. 158.

[403] Furthermore, even cash-rent landlords also make decisions that affect production such as land levelling, irrigation installation and related investments. Therefore benefits to landlord have significant effects on yields and acreage planted to cotton.

[404] Exhibit Bra-16 (Characteristics and Production Costs of US Cotton Farms, USDA, October 2001, p. 23).

[405] Exhibit Bra-323 (Costs and Returns of US Upland Cotton Farmers, MY 1997-2002, USDA).

[406] Exhibit Bra-41 (Congressional Hearing, "The Future of the Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, Testimony of Robert McLendon, p. 21). Mr. McLendon responded to a question by Congressman Dooley who stated: "I am concerned that a significant portion of that is going to be capitalized in rents, land values – and, you know, I hope we find ways in which we can structure our program so … we can actually see asset valuations that are more commensurate with actual market conditions … ."

[407] Mr. McLendon was accompanied at the Congressional Hearing by now-President of the NCC, Mark Lange (then Chief NCC Economist), who said nothing to contradict Mr. McLendon's sworn testimony. *See* Exhibit Bra-41 (Congressional Hearing, "The Future of the Federal Farm Commodity Programs (Cotton)," House of Representatives, 15 February 2001, p. 6).

203. It is also possible to test the US "35 per cent" assumption by examining non-cotton-specific cash rent and land value data. If the US assumption were correct, then cash land rents for cropland in states where upland cotton is produced should have increased significantly since the guaranteed PFC payments started in MY 1996. Further, it would be presumed, if the United States is correct, that 65 per cent of all the PFC upland cotton-related payments (as well as the other three contract payments) were captured by increased cash rents for cropland during MY 1996-2002. But this is simply not the case, as demonstrated below.

204. USDA carefully tracks cropland cash rents in all US states. In almost all of the 16 states where cotton is produced, land rents for cropland increased only slightly between MY 1996 and MY 2003.[408] This is in contrast to the value of cropland which increased to a far greater extent.[409] The United States seeks to have the Panel assume that both cropland values and cash rents increased significantly by stating, in paragraph 156 of its 22 December 2003 response, that "land rent data … follows the same trend" as land values. This is a misleading statement because, while cash rents increased, they did so at a much lower rate. For example, in Texas, cash rents for land increased 13.5 per cent ($18.50 to $21.00 per acre) during 1996-2003 while the value of an acre of cropland increased 28 per cent, from $674 in 1997 to $937 in 2003.[410] The increase in cash rents in Texas is less than the inflation rate (17 per cent) for the seven-year period.[411]

205. Cash rents in other US states producing upland cotton increased by similar amounts:[412]

| US State[413] | Cash Rent 1996 | Cash Rent 2002 | Difference | Percentage Change |
|---|---|---|---|---|
| Texas | $18.50 | $21.00 | $2.50 | 13.5 per cent |
| Oklahoma | $25.60 | $27.00 | $1.40 | 5.5 per cent |
| Arkansas | $48.80 | $53.00 | $4.20 | 8.6 per cent |
| Louisiana | $53.00 | $57.00 | $4.00 | 7.5 per cent |
| Mississippi | $45.00 | $54.00 | $9.00 | 20.0 per cent |
| Alabama | $39.00 | $36.00 | - $3.00 | -7.7 per cent |
| Florida | $30.00 | $32.00 | $2.00 | 6.7 per cent |
| Georgia | $36.40 | $39.00 | $2.60 | 7.1 per cent |
| South Carolina | $23.80 | $28.50 | $4.70 | 19.7 per cent |

[408] Exhibit Bra-413 (USDA, NASS "Agricultural Cash Rents, July 1999, p. 2-3); Exhibit Bra-414 (USDA, NASS "Agricultural Land Values and Cash Rents," August 2003, p. 12-13.)(examining cropland cash rent values).

[409] Exhibit Bra-415 (USDA, NASS, "Agricultural Land Values", April 1999, p. 4); Exhibit Bra-414 (USDA, NASS, "Agricultural Land Values and Cash Rents," August 2003, p. 12-13).

[410] Exhibit Bra-413 (USDA, NASS "Agricultural Cash Rents, July 1999, p. 2-3); Exhibit Bra-414 (USDA, NASS "Agricultural Land Values and Cash Rents", August 2003, p. 12-13.)(examining cropland cash rent values).

[411] http://woodrow.mpls.frb.fed.us/research/data/us/calc/ ($1.00 in 1996 is worth $1.17 in 2003).

[412] Exhibit Bra-413 (USDA, NASS "Agricultural Cash Rents, July 1999, p. 2-3); Exhibit Bra-414 (USDA, NASS "Agricultural Land Values and Cash Rents", August 2003, p. 12-13.)(examining cropland cash rent values).

[413] Data for several other states is distorted by the fact that cash rents for irrigated land, which is not used for upland cotton production, are shown.

206. As the figures demonstrate, the increase in cash rents is below the inflation rate of 17 per cent in most of the states. The highest numerical increase between 1996 and 2002 is $9 in Mississippi. Being extremely conservative, Brazil has assumed that this Mississippi increase represents the increase in cash rents for all US upland cotton cropland. It follows that for MY 2002 (with 13.8 million acres planted to upland cotton) and with about 25 per cent of upland cotton land cash-rented, these $9 mean that $31 million of the total of $454.5 million[414] in direct payments found their way into increased cash rents for upland cotton land.[415] Thus, USDA's own data shows that only 6.8 per cent of the MY 2002 direct payments could have been attributable to increased cash rents – not 65 per cent as the United States asserts.

207. It should be noted that none of this analysis includes CCP payments. If CCP payments were included with direct payments, the percentage share would be even lower. Generally, the United States agrees that cash rents also reflect long-term expectations about crop prices and programme benefits. While direct payments are paid regardless of prices, CCP payments vary with prices. Therefore, one can expect that the payments will be discounted by a margin reflecting the uncertainty about the availability of CCP payments in future years for which cash rents are fixed.

208. The United States claims that cash rents are "sticky" and do not respond quickly to the increased net revenue from the use of the land.[416] The United States further suggests that the estimated 34-41 per cent of PFC payments captured for MY 1997 as set out in an August 2003 ERS study will be higher for later years.[417] But the evidence outlined above suggests that cash rents for cropland did not increase significantly between MY 1996-2002, and thus do appear to reflect to any considerable extent the effects of PFC or other contract acreage payments. The US assertion amounts to speculation, as the authors of the August 2003 study properly acknowledge.[418] Cash rents may be just as easily, if not more, affected by expected low prices for upland cotton, as suggested by the NCC President[419], or other factors such as interest rates. The absence of evidence of significant cash rent increases more than seven years after enactment of the 1996 FAIR Act suggests that whatever production effects from direct payments and CCP payments exist presently will continue to exist in the future – supporting Brazil's threat of serious prejudice claims.

209. The above discussion has focused on PFC payments, since that is the only type of contract payment for which the United States presented evidence. However, the United States "35 per cent" assumption also was made regarding CCP payments and market loss assistance payments.[420] The Panel will look in vain for any evidence produced by the United States that only 35 per cent of MY 2002 CCP payments benefited upland cotton producers who cash rent upland cotton cropland. Because CCP payments are triggered on a year-by-year basis depending on low prices for upland cotton, a non-producing landlord cannot know in what amount CCP payments will be made. Further, as Brazil has demonstrated repeatedly, given the high non-land-related production costs involved in producing cotton, most US producers simply could not profitably produce cotton without CCP

[414] Brazil's 22 December 2003 Answer to Question 196, para. 8.
[415] 13.8 million acres times 0.25 times $9 equals $31,050,000.
[416] US 22 December 2003 Answer to Question 242, para. 157.
[417] US 22 December 2003 Answer to Question 242, para. 157.
[418] Exhibit Bra-310 ("The Incidence of Government Program Payments on Agricultural land Rents: The Challenges of Identification," Roberts, Kirwan, Hopkins, p. 769) ("It could be … [and] [m]ore research is needed to verify these incidence estimates to ascertain the time it takes for rents to reflect changes in associated government payments and to measure how incidence is ultimately capitalized into land values.").
[419] Exhibit Bra-41 (Testimony of Roberto McLendon, p. 7)("I think people that are professional farm managers have been concerned for the last 2 or 3 years that we are going to have a decrease in land values because they saw it in the 1980's. We had low prices and a bad situation. Again, in my opinion, we have had such a strong economy outside of agriculture it has supported land values, but that support won't last forever … .")
[420] US 22 December 2003Answer to Question 242, para. 158.

payments. Therefore, there is little, if any, basis for a non-producing landlord to demand increased rents to capture CCP payments.

210. The evidence that is before the Panel indicates that every eligible upland cotton producer planting on upland cotton base acreage (approximately 75 per cent of such producers), received a CCP check in MY 2002.[421] The record shows that the high costs of these producers meant that they had to use this money to cover their production costs, including the costs related to the cash rents they were required to pay. Thus, in an immediate "cover your annual costs" sense, 100 per cent of the payments each year of the period of investigation "benefited" the producers of upland cotton.[422]

211. Similarly, the United States provides no evidence concerning how much of the market loss assistance payments during MY 1998-2001 did not benefit upland cotton farmers. Brazil demonstrated that all producers (not non-producing landlords) planting on upland cotton or other base acreage were entitled to receive market loss assistance payments. The producers had the legal right to receive these payments. Thus, the United States did not meet its burden of showing that only 35 per cent of the market loss payments "benefited" upland cotton production.

212. Finally, the United States provides no evidence to support its argument that only "35 per cent" of the amount of direct payments under the 2002 FSRI Act "benefit" producers of upland cotton. As Brazil demonstrated, in MY 2002, US cotton producers needed all of the direct payment subsidies to cover their production costs and to re-coup losses from MY 2001.

213. Brazil recalls its showing that even under the US approach, the percentage should be 75 per cent rather than 35 per cent, *i.e.*, including land that is owned or share rented by producers. However, also for producers that cash rent their upland cotton land, not all of their contract payments are capitalized in land values and translated into higher cash rents. Thus, by far the greatest portion of contract payments is available to cause production effects along the lines discussed in the literature and by Professor Sumner[423], as well as by Brazil.[424]

214. In conclusion, 100 per cent of the contract payments paid to, received, and deposited in the accounts of current "producers" of upland cotton (applying Brazil's allocation methodology) in MY 1999-2002 constituted a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement.[425] The relevant issue regarding "benefit" to production is not, as the United States argues, the amount of the funds paid; this dispute does not involve a countervailing duty investigation. Rather, the focus of any generic "benefit" analysis is on the *effects* of the subsidies. The record shows that the various types of contract payments stimulated US production of upland cotton to different extents, ranging from 15 per cent for PFC payments to 40 per cent for CCP payments, as estimated by Professor Sumner.[426]

**243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? USA**

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[421] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.1, para. 23; Brazil's 9 September 2003 Further Submission, paras. 59-331; Brazil's 22 August 2003 Rebuttal Submission, para. 50 *citing* Exhibit Bra-173 (Revised Estimate of Support Granted by Commodity via Counter-Cyclical Payments).

[422] Brazil's 27 October 2003 Answers to Question 125(c), paras. 15-25.

[423] Brazil's 9 September 2003 Further Submission, Annex I, paras. 37-42 and Exhibits Bra-280 and Bra-345 (paras. 18-34).

[424] Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

[425] Similarly, 100 per cent of the contract payments, as allocated by Brazil, were "support to" upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.

[426] Brazil's 9 September 2003 Further Submission, Annex I, paras. 43-51.

**Brazil's Comment:**

215. Contrary to the assumption permeating the US 22 December 2003 response, Brazil reiterates that there is no legal requirement for a claimant under Part III of the SCM Agreement to quantify on an *ad valorem* basis the amount of the challenged US subsidies.[427] Annex IV – which the US response shows is the *only* legal basis for its arguments – is dead. Even when alive, it only applied to Article 6.1(a), not Article 6.3 of the SCM Agreement. The Panel's obligation under Part III of the SCM Agreement is to conduct an objective assessment of the evidence regarding the "effects" of the challenged subsidies. This means it must first examine the evidence regarding whether each of the supports is a "financial contribution," confers a "benefit," and is "specific".

216. Detailing the precise amount of the financial contribution ending up in the bank accounts of US upland cotton producers is not a legal pre-requisite to Brazil's actionable subsidy claims. If the Panel finds that Brazil is legally required to examine the exact *amount* of the subsidies in order to assess their "effects," then it need only ask why the United States has refused to produce the evidence to determine such an amount.[428] In the absence of the most accurate evidence, withheld by the United States, Brazil refers the Panel to evidence and the allocation of the amount of "support to upland cotton" it has presented in the peace clause portion of its various submissions.[429] This evidence is part of the record pursuant to Brazil's alternative arguments and is offered as evidence of the amount of such subsidy payments.

217. With the above-referenced qualifications, Brazil would answer the Panel's question with a qualified "yes". First, Brazil agrees with the United States' assumption, in paragraph 159 of its 22 December 2003 response, that the full amount of marketing loan payments for upland cotton production "benefits" US producers even if they also produce other crops. The logic of the US assumption means that the full amount of crop insurance and Step 2 payments, which are also *de jure* linked to production, sale or export of upland cotton, would "benefit" upland cotton production. With respect to contract payments, Brazil's allocation methodology first considers every acre of upland cotton grown on an acre of upland cotton contract base to "benefit" (or constitute "support to") upland cotton.[430] In other words, Brazil's allocation methodology does assume that all such cotton to cotton matches do "benefit" upland cotton, regardless of the other agricultural production of the farm.[431] Brazil notes that the cotton to cotton matches accounts for most of the contract payments to current upland cotton producers.[432] However, for those cotton producers growing cotton on non-upland cotton base acres, Brazil does *not* ignore other agricultural production of the particular farm. Rather, it allocates the payments attributable to upland cotton based on the overall composition of programme crops for that particular farm.[433] Of course, Brazil's methodology could not be fully applied because of the refusal of the United States to produce the necessary farm-specific information.[434]

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[427] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 96-107; Brazil's 2 December 2003 Oral Statement, paras. 4-6. *See* also Brazil's comment on Question 231, above.

[428] US 18 and 19 2003 December Letters to the Panel; US 20 January 2004 Letter to the Panel; *See* also Brazil's 28 January 2004 Comments and Requests Regarding US Data.

[429] These facts are summarized in Annex 1 to Brazil's 9 October 2003 Closing Statement, but are also contained in a number of Brazil's earlier submissions to the Panel beginning with its 24 June 2003 First Submission; S*ee* also Brazil's 18 November 2003 Further Rebuttal Submission, Sections 2.1 and 2.4; Brazil's 2 December 2003 Oral Statement, Sections 5.1 and 5.3.

[430] Brazil's 20 January 2004 Answers to Additional Questions, para. 47.

[431] Brazil's 20 January 2004 Answers to Additional Questions, paras. 44-48.

[432] *See* Electronic PFC and DCP Summary Files provided on 18 and 19 December 2003 respectively. *See* also Brazil's 18 November 2003 Further Rebuttal Submission, paras. 22-24.

[433] Brazil's 20 January 2004 Answers to Additional Questions, paras. 48-55. Thus, contrary to the US assertions in the last sentence of paragraph 163, Brazil does not advocate allocating a non-tied payment across the total value of the recipients production.

[434] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Sections 4, 8 and 9.

218. The US 22 December 2003 response highlights the differences between the parties on how to allocate the "benefit" for payments made under the four types of contract payments. Further, the US response reflects the parties' differences over whether the quantification exercise is relevant for the peace clause "support to cotton," or whether it is instead relevant for assessing Brazil's claims under Part III of the SCM Agreement.

219. Brazil's position is that the allocation[435] of contract payments is required in the peace clause portion of the proceeding. Brazil has set forth in considerable detail the factual evidence supporting the *de facto* link between the contract payments and the production of upland cotton.[436] Brazil further provided considerable detail concerning its allocation methodology and the application of that methodology.[437] Brazil even attempted to apply the US "across the value of the farm" methodology, based on the incomplete and scrambled US data.[438] Brazil presented extensive legal arguments supporting the requirement under Article 13(b)(ii) to collect and tabulate any and all support for a specific commodity such as upland cotton.[439] For example, Brazil's 22 August 2003 Rebuttal Submission stated:

> [T]he phrase "support to a specific commodity" … read in its context, requires the Panel to tabulate any non-green box domestic support payments that are linked in some manner to the production of upland cotton. Contrary to the US arguments,[440] there is nothing in the text of Article 13(b)(ii) limiting the support to only that provided to a single commodity. Nor does the text limit support to only that *requiring* a recipient to produce or to produce a specific commodity as the United States alleges.[441] Rather, it requires examining whether a specific commodity receives support from a domestic support measure identified in the chapeau of Article 13(b) and whether there is some sort of link between the support at issue and the specific commodity.[442] Thus, the question of "support to a specific commodity" is fundamentally a factual question requiring an examination of different types of support set out in the *chapeau* of Article 13(b).[443]

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[435] Brazil's 11 August 2003 Answer to Question 40 provided detailed analysis regarding the application of its 14/16th methodology. Brazil explained in its Rebuttal Submission that: "Necessarily, this process requires allocation of support that may be provided to producers of more than one type of agricultural product, but which is not provided to producers *in general*." *See* Brazil's 11 August Answer to Question 40. An allocation process is also required with respect to Annex 3 paragraph 7 support to processors of agricultural products," 'to the extent that such measures benefit the producers of the basic agricultural product." Brazil's 22 August 2003 Rebuttal Submission, note 33.

[436] The United States has refused to produce the most relevant information – the precise amount of contract payments received by current US upland cotton producers. Brazil summarized much of the available evidence, demonstrating that the contract payments are, *de facto*, tied to the production of upland cotton, in its 9 October 2003 Closing Statement, Annex I.

[437] Brazil's 11 August 2003 Answer to Question 40. Brazil's 22 December 2003 Answer to Question 258, paras. 43-55; Brazil's 28 January 2004 Comments and Requests Regarding US Data, Sections 9 and 10. *See* also Brazil's 11 August 2003 Answer to Question 40. An allocation process is also required with respect to Annex 3 paragraph 7 support to processors of agricultural products," 'to the extent that such measures benefit the producers of the basic agricultural product." Brazil's 22 August 2003 Rebuttal Submission, note 33.

[438] Brazil's 28 January 2004 Comments on Data Provided by United States, Section 10.

[439] *See* Brazil's 22 August Rebuttal Submission, paras. 13-22; Brazil's 22 August 2003 Comments on US Answers, paras. 48-53, 58, 61; Brazil's 11 August 2003 Answers to Questions, paras. 54-55, 57-58, 61-64, 66-72, 129-132; Brazil's 24 July 2003 Closing Statement, para. 8; Brazil's 22 July 2003 Oral Statement, paras. 13-26; Brazil's 24 June 2003 First Submission, paras 130-134.

[440] US 11 August Answer 2003 to Question 38, para. 81.

[441] US 11 August 2003 Answer to Question 38, para. 81.

[442] *Compare* Brazil's 11 August 2003 Answer to Question 41, paras. 57-58.

[443] Brazil's 22 August 2003 Rebuttal Submission, para. 14.

220. The US 22 December 2003 response reiterates, in paragraphs 161-163, the US peace clause arguments that the absence of any *requirement* to produce upland cotton in the statutory provisions of the 1996 and 2002 Farm Acts for direct and counter-cyclical payments (as well as PFC and market loss assistance payments) completely insulates these subsidies from any actionable subsidy challenge during the implementation period. Brazil demonstrated how this extremely narrow US "production requirement" test is contrary to the *chapeau* of Article 13(b)(ii), contrary to the context of Annex 2, paragraph 6(e), contrary to the context of Annex 3, paragraphs 10, 12, and 13, and contrary to the context of the AMS definition in Article 1(a) (referring to "in general").[444] Brazil also demonstrated that the US "production requirement" test is contrary to the object and purpose of the Agreement on Agriculture, because it carves out huge amounts of amber box subsides from any discipline of the SCM Agreement during the implementation period.[445]

221. The United States argues, at paragraph 163 of its 22 December 2003 response, that Brazil's allocation methodology "eliminates the concept of non-product specific support for purposes of the peace clause since a non-tied payment may always be allocated according to the recipient's production". Brazil notes again its fundamental disagreement with the US assumption that $935.6 million in CCP payments and $454.5 million in direct payments paid in MY 2002 to current producers of upland cotton are "untied" subsidies.[446] The overwhelming evidence in the record shows they are *de facto* "tied" to upland cotton production.[447] Further, the United States incorrectly assumes that "non-product specific support" is the language set out in Article 13(b)(ii). The actual text is "support to a specific commodity", which requires the tabulation – and allocation if necessary – of any and all support provided to producers, users, or exporters of a particular product. The test is not whether the domestic support *requires* production, but rather whether the domestic support provides support for the production of a particular commodity.[448]

222. Further, as Brazil noted in its 11 August 2003 response, all of the domestic support measures challenged by Brazil have an "upland cotton specific link in terms of historic, updated, or present upland cotton acreage, present upland cotton production or prices, or upland cotton groups of insurance policies or other specific upland cotton provisions"[449] The ordinary meaning of the terms "non-product specific" support that is provided "in general" is support to producers of all or almost all commodities or agricultural products, such as irrigation, state credit programmes, and other infrastructure subsidies such as farm roads. Thus, even if the peace clause test were "product-specific support," Brazil's interpretation does not read out any meaning to "non-product specific support".

223. In sum, Brazil's methodology for allocating the various subsidy payments that "benefit" or "support" upland cotton is reasonable and based on an extensive factual record demonstrating the link between such payments and current upland cotton production. If the United States disagreed, it was required to do more than simply assert the *de jure* form of the legal instruments of the contract payments. Rather, it must produce the farm-specific evidence that would permit a detailed assessment of the "other agricultural production" (and the value) of each producer of upland cotton. It has refused to do so. Therefore, the US 22 December 2003 response to Question 243, besides being

[444] *See*, in particular, Brazil's 22 August 2003 Rebuttal Submission, paras. 15-22 (legal arguments), as well as factual evidence regarding each direct payment subsidy, in paras. 24-52. Since August, Brazil has presented considerable additional evidence establishing the *de facto* link between each type of contract payment and the production of US upland cotton. *See* Annex 1 of Brazil's 9 October 2003 Closing Statement; Brazil's 27 October 2003 Answers to Questions, paras. 7-26, 37-40; Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5; Brazil's 2 December 2003 Oral Statement, Section 5.3.

[445] Brazil's 22 July 2003 Oral Statement, paras. 21-25.

[446] Brazil's 22 December 2003 Answers to Question 196, para 8.

[447] *See e.g.* Brazil's 9 October 2003 Closing Statement, Annex I; Brazil's 27 October 2003 Answers to Question 125(2)(a), paras. 7-25; Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.7.5.

[448] Brazil's 22 August 2003 Rebuttal Submission, paras. 15-22.

[449] Brazil's 11 August 2003 Answer to Question 41, paras. 57-58.

largely legally and factually wrong, is an astounding display of hubris in light of the US refusal to produce the very evidence that would permit the application of the methodology it advocates.

**244. What proportion of the 2000 cottonseed payments benefited *producers of upland cotton,* given that payments were made to *first handlers,* who were only obliged to share them with the producer to the extent that the revenue from sale of the cottonseed was shared with the producer? (see 7 CFR §1427.1104(c) in Exhibit US-15). BRA**

**245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? BRA, USA**

**246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? BRA, USA**

**Brazil's Comment:**

224. The Panel is well aware that Brazil considers Article 5 and its reference to "any" subsidy to require the Panel to take prohibited subsidies into account for a serious prejudice claim.[450] There is no contradiction between the implementing obligations of a Member under Articles 4.7 and 7.8 of the SCM Agreement. Thus, the Panel must take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the SCM Agreement.

**247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? BRA, USA**

**Brazil's Comment:**

225. Brazil's 22 December 2003 response to this question covers most of the points raised in the US 22 December 2003 response. In response to the US argument at paragraph 149 that the Panel's terms of reference as well as Brazil's threat claims are limited to subsidy payments up to, but not after, 18 March 2003, Brazil refers the Panel to its Comments to Question 194 above, and to its 20 January 2004 Answer to Questions 257(ii), at paragraphs 17-22. Brazil has, further, responded to improper use of futures prices at the time of planting, instead of the adjusted world price, in its Comments to Questions 212 and 213, above.

**VI. STEP 2**

**248. In respect of the level of Step 2 payments in certain time periods, the Panel notes, *inter alia,* footnote 129 in the US first written submission; footnote 33 in the US 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? BRA, USA**

**Brazil's Comment:**

226. Brazil notes the US admission that one of the reasons for the elimination of the 1.25 cent threshold is to "correct for some long term changes in the valuation of currencies".[451] Thus, the United States effectively admits that Step 2 payments cause US exports to increase despite the

[450] Brazil's 22 December 2003 Answers to Questions, para. 147; Brazil's 27 October 2003 Answers to Questions, paras. 108-110.

[451] US 22 December 2003 Answers to Questions, para. 171.

appreciation of the US dollar. In fact, the United States has never rebutted the considerable evidence that one of the main effects of the US upland cotton subsidies is to cause US exports of upland cotton to increase even when the US dollar is appreciating rapidly.[452]

**249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":**

**(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer?[453] How, if at all, would this be relevant for an analysis of the issue of export contingency under the *Agreement on Agriculture* or the *SCM Agreement*? BRA**

**(b) How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do *not* go directly to the producer? USA**

**(c) What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. USA**

**VII. REMEDIES**

**250. Does Brazil seek relief under Article XVI of *GATT 1994* in respect of expired measures? What type of recommendation would the Panel be authorized to make? (Brazil further submission, paragraph 471 (iii)) BRA**

**251. In light, *inter alia*, of Article 7.8 of the *SCM Agreement*, if the Panel were to find that any subsidies have resulted in adverse effects to the interests of another Member within the meaning of Article 5 of the *SCM Agreement*, should it make any recommendation other than the one set out in the first sentence of Article 19.1 of the DSU? BRA**

**252. Without prejudice to any findings by the Panel, if the Panel were to find that any of the challenged measures constitute prohibited subsidies within the meaning of Article 3 of the *SCM Agreement*, what are the considerations that should guide the Panel in making a recommendation under Article 4.7 of the *SCM Agreement* relating to the time period "within which the measure must be withdrawn"? What should that time period be? BRA**

**VIII. MISCELLANEOUS**

**253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):**

**(a) Does it relate to export credit guarantees, crop insurance and cottonseed payments?**

**(b) Does it relate only to compliance with AMS commitments?**

**(c) Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?**

**(d) How would the Secretary exercise her authority to prevent serious prejudice to the interests of another Member? How would she exercise her authority to prevent a threat**

[452] Brazil's 9 September 2003 Further Submission, paras. 124-128 and the Exhibits cited therein; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 78-80.

[453] For example, Brazil's response to Panel Question 125, paragraph 14.

**of serious prejudice to the interests of another Member? At what time and on the basis of what type of information would she exercise her authority?**

**(e) What does "to the maximum extent practicable" mean? In what circumstances would it not be practicable for the Secretary to exercise her adjustment authority? USA**

**Brazil's Comment:**

227. In its arguments at paragraphs 176, 178 and 180 of its 22 December 2003 response, the United States speculates about the "thoughts," "anticipations," "contemplations," "understandings", and "belief" of the US Congress. Yet it provides no citation to the extensive Congressional debates on the 2002 FSRI Act. Speculation about legislative (or negotiators') intentions not backed up by reference to the record of the debates is not positive evidence. Further, if any Member could successfully plead compliance with WTO rules by simply inserting language asserting the provision "provides assistance to producers in a way that is consistent with [its] obligations under the Uruguay Round Agreement on Agriculture"[454], then there would be little role for any WTO panel. The only "evidence" of US legislators' intent before the Panel is the text of the 2002 FSRI Act.

228. In sum, the record now shows that both Brazil and the United States agree that (1) Section 1601(e) applies only to Total AMS[455], (2) Section 1601(e) does not apply to serious prejudice caused to US trading partners by US subsidies to upland cotton covered by the 2002 FSRI Act[456], and, (3) the 2002 FSRI Act does not provide any discretion for the USDA Secretary specifically to limit the amount of *upland cotton* marketing loan, Step 2, direct or counter-cyclical payments.[457]

**254. Would payments made after the date of panel establishment be *mandatory* under the marketing loan, direct payments, counter-cyclical payments and user marketing certificate (step 2) programmes, but for the circuit-breaker provision? USA**

**Brazil's Comment:**

229. Brazil established that marketing loan, Step 2, direct and counter-cyclical payments are mandatory, within the traditional mandatory/discretionary distinction under GATT/WTO law.[458] In its 20 January 2004 Answers to Additional Questions, Brazil has responded to US arguments that conditions attached to the payment of subsidies would make these subsidies non-mandatory.[459]

230. Brazil notes further that the listed programmes are not only mandatory within the meaning of WTO law, but are also mandatory under US budget law. They create a legal entitlement to the payment.[460] While the United States now argues that payments depend on the availability of funds[461],

[454] US 22 December 2003 Answer to Question 253(a), para. 176.
[455] US 22 December 2003 Answer to Question 253(b), para. 178.
[456] US 22 December 2003 Answer to Question 253(d), para. 180.
[457] US 27 October 2003 Answer to Question 162, para 95 ("The statutory authority for marketing loan payments, step 2 payments, and counter-cyclical payments does not provide the Secretary with the authority to arbitrarily decline to make these payments to qualified recipients."), para. 97 ("there is no present limit on the total amount of payments that can be made under each of these programs although for counter-cyclical payments a maximum total outlay can be calculated using the base acres, base yields, and maximum payment rate for each commodity produced during the historical base period.").
[458] *See* Brazil's 20 January 2004 Answers to Additional Questions, paras. 17 (with further references), 24-30.
[459] Brazil's 20 January 2004 Answers to Additional Questions, paras. 27-30.
[460] Exhibit Bra-416 ("What Is A Farm Bill," Congressional Research Service, Report for Congress, 5 May 2001) ("Commodity programmes are entitlements. Expenditures are based upon programme rules and commodity market conditions. Eligible farmers are guaranteed legislatively-specified support based on these rules and conditions."). USDA noted with respect to an earlier commodity program – the deficiency payment

the legal entitlement nature of these programmes means that payments must be made – if necessary after CCC funds have been replenished.

231. Finally, Brazil recalls that the United States argued in the peace clause portion of this dispute that is has no control over the flow of the upland cotton subsidies.[462] In fact, there is no legal mechanism to stem, or otherwise control, the flow of these upland cotton subsidies, which cause a permanent source of uncertainty in the world upland cotton market.[463] Thus, the US subsidies cause a threat of serious prejudice, in violation of Articles 5(c), 6.3(c) and 6.3(d) as well as footnote 13 of the SCM Agreement, and GATT Articles XVI:1 and 3.

**255. How does Brazil respond to US assertions concerning the circuit-breaker provision? (see US 2 December oral statement, paragraph 82). Does this mean that US subsidies cannot be "mandatory" for the purposes of WTO dispute settlement? BRA**

**256. The United States submits that the Panel cannot make rulings without allocating precise amounts of payments to upland cotton production. However, to the extent that such precise data is not on the Panel record, to what extent can the Panel rely on less precise data, and on reasonable assumptions, in fulfilling its duty under Article 11 of the *DSU* in this case? USA**

**Brazil's Comment:**

232. Because the United States has refused to cooperate in producing the most precise data concerning the amounts of contract payments to upland cotton producers, the Panel should (1) first draw adverse inferences from the US refusal to cooperate, and (2) use the best information available in making its determination.[464] Brazil presents the factual and legal basis permitting the Panel to make findings based on reasonable assumptions in its separate 28 January Comments and Requests Regarding US Data. These separate comments address most of the points raised in the extensive – and largely unresponsive – US answer to Question 256.[465] Additional points are set out below.

233. First, there is relevant WTO jurisprudence that provides a legal basis for the Panel to draw inferences from the best information available in the record in order to comply with the requirements of Article 11 of the DSU.[466] For example, in the *US – Wheat Gluten* case, the panel requested that the United States supply it with certain information that had been redacted from the public version of a USITC Report, but despite several requests, the United States refused to submit the information.[467] The panel decided that while having access to all the requested information from the United States would have furnished a more extensive basis for its examination and have facilitated an objective assessment of the facts, there were other facts of record that the panel was required to include in its "objective assessment".[468] Ultimately, the panel determined that the United States violated provisions of the Agreement on Safeguards on the basis of the available factual record.[469] When the

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program – that "[d]eficiency payments are entitlements; that is, spending is determined by rules that define eligibility and govern benefit levels rather than by the annual appropriations process. USDA and Congress have no control over deficiency payment outlays." (Exhibit Bra-417 ("Commodity Program Entitlements: Deficiency Payments", USDA, May 1993).

[461] US 22 December 2003 Answers to Questions, para. 182.

[462] In the context of the peace clause arguments, the United States argued that it could not control the amount of budgetary outlays under the programmes.

[463] Brazil's 20 January 2004 Answers to Additional Questions, paras. 18-22 (with further references).

[464] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 6.

[465] *See* also Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 11.

[466] Brazil's 9 October 2003 Closing Statement, paras. 2, 9 (*citing* Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.39).

[467] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 168.

[468] Panel Report, *US – Wheat Gluten*, WT/DS166/R, para. 8.12.

[469] Panel Report, *US – Wheat Gluten*, WT/DS166/R, para. 8.12.

United States appealed this decision, the Appellate Body affirmed the panel, stating that "where a party refuses to provide information requested by a panel, that refusal will be one of the relevant facts of record, and indeed, an important fact, to be taken into account in determining the appropriate inference to be drawn".[470] The Appellate Body further indicated that it "deplored the conduct of the United States" in refusing to cooperate and provide information that was within its exclusive control.[471]

234. Another example of a panel using the best information available when a Member refused to provide documents within its exclusive control is the *Argentina – Textiles and Apparel* case. In that case, the United States requested Argentina to produce complete original customs documents of all footwear imports to demonstrate that Argentina was imposing and requiring payment of specific duties in excess of its bound duty rates of 35 per cent *ad valorem*.[472] Argentina refused to provide the complete (or any) documents.[473] The United States then provided examples of customs documents, which Argentina contested on a variety of authenticity and relevance grounds.[474] The panel rejected these Argentine arguments and found that "the United States has provided *sufficient evidence*".[475] In so holding, the panel noted that "[i]n situations where direct evidence is not available, relying on inferences drawn from relevant facts of each case facilitates the duty of international tribunals in determining whether or not the burden of proof has been met".[476] The panel further held that there is a requirement for collaboration of the parties in the presentation of the facts and evidence to the panel, and emphasized especially the role of the respondent in that process.[477]

235. Applying these concepts to the allocation issues involved in the peace clause portion of this dispute indicates that the Panel has more than sufficient evidence in the record to support a reasonable estimate of the amount of contract payment support provided to upland cotton in MY 1999-2002.[478] Brazil detailed its views concerning the appropriate allocation methodology for purposes of the peace clause.[479] Faced with the US refusal to provide the data necessary to calculate the precise amount of support to upland cotton from the US contract payments using Brazil's (and the US) allocation methodology, Brazil offered extensive circumstantial evidence in support of its alternative so-called "14/16$^{th}$ methodology".[480] The Panel may properly draw adverse inferences that the United States data would, if produced, have shown that Brazil's 14/16$^{th}$ methodology undercounted the amount of support to upland cotton.[481] Such an adverse inference supports the other extensive evidence that the 14/16$^{th}$ methodology provides a reasonable estimate.[482]

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[470] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 174.
[471] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 171.
[472] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.54.
[473] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.56.
[474] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.33.
[475] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.65 (emphasis added).
[476] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.39.
[477] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.40.
[478] Brazil recalls that the United States has invoked the peace clause of Article 13 of the Agreement on Agriculture. As demonstrated by Brazil, the peace clause is in the nature of an affirmative defense. And even if the Panel were to disagree, Brazil established a *prima facie* case of inconsistency of the US measures with Article 13(b)(ii) of the Agreement on Agriculture. Neither the claim nor the measures to which it relates are outside the Panel's terms of reference, within the meaning of the Appellate Body decision in *Japan – Agricultural Products*, paras. 129-130.
[479] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.
[480] These facts are summarized in Annex 1 to Brazil's 9 October 2003 Closing Statement, but are also contained in a number of Brazil's earlier submissions to the Panel, beginning with its 24 June 2003 First Submission. *See* also Brazil's 18 November 2003 Further Rebuttal Submission, Sections 2.1 and 2.4; Brazil's 2 December 2003 Oral Statement, Sections 5.1 and 5.3.
[481] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 6.
[482] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 6.

236. Turning to its claims of serious prejudice and threat thereof, Brazil remains of the firm view that neither Part III of the SCM Agreement nor GATT Article XVI requires an exact determination of the amount of subsidies involved.[483] Rather, Brazil must demonstrate their *effects*.[484] Nevertheless, and as an alternative legal argument, Brazil presented extensive evidence concerning the *amounts as well as the effects* of each challenged subsidy. This is the same evidence Brazil used to demonstrate the amount of support to upland cotton.

237. The United States asserts that Brazil has to allocate all contract payments received by an upland cotton producing farm over the total value of that farm's sales.[485] However, even though the United States alone is in exclusive control of the information that would permit such an allocation, it has refused to produce that information. Even if it would be Brazil's burden to establish this fact, the United States has done everything to frustrate Brazil's ability to do so. In particular, the United States first wrongly asserted that data on plantings of farms was not available to it and – after Brazil demonstrated that this was incorrect[486] – refused to produce the evidence.[487]

238. Indeed, even if the Panel were of the view that the US allocation methodology would provide the best means of evaluating the amount of support to upland cotton, the refusal of the United States to produce the requested data prevents the Panel from applying that methodology. In the face of this lack of cooperation, the Panel is required to apply some other methodology to estimate the amount of contract payment support, *i.e.*, Brazil's 14/16$^{th}$ methodology, or some variant thereof. To hold otherwise would obviously penalize Brazil, who sought the information, *inter alia*, for the purpose of demonstrating that the US methodology would reveal amounts of support similar to those estimated by Brazil's own 14/16$^{th}$ methodology.

239. It is ironic that among the evidence that supports Brazil's 14/16$^{th}$ methodology is the incomplete summary data provided by the United States. Brazil attempted to use that data to perform a simplified version of the (improper) US allocation methodology.[488] Brazil does not believe, as the Panel's question suggests, that it can make reasonable assumptions using this methodology based on the fragmented summary data provided by the United States. Nevertheless, although Brazil cautions against the use of its results, and although this methodology is not relevant for purposes of the peace clause, Brazil notes that these results are only marginally smaller than the results of Brazil's own 14/16$^{th}$ methodology.[489]

240. Thus, contrary to the US 22 December 2003 arguments[490], there is evidence provided by Brazil in the record on which the Panel can rely in making an objective assessment of the facts and in deciding on Brazil's claims under Part III of the SCM Agreement and GATT Article XVI (as well as under Article 13(b)(ii) of the Agreement on Agriculture). Brazil has also met its burden of proof in establishing a *prima facie* case concerning its claims of inconsistency of the US measures with these provisions.

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[483] *See* Brazil's comment on Question 243, above.

[484] *See inter alia* Brazil's 2 December 2003 Oral Statement, paras. 4-6 (and the references cited therein).

[485] *See* US 22 December 2003 Answers to Questions, paras. 185-186, 10-11, 160-164.

[486] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.2; Exhibits Bra-368 – Bra-369.

[487] *See* generally Brazil's 28 January 2004 Comments and Requests Regarding US Data.

[488] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 10.

[489] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 10.

[490] US. 22 December 2003 Answers to Questions, paras. 185-186.

## IX. ADDITIONAL QUESTIONS POSED ON 23 DECEMBER 2003 AND 12 JANUARY 2004

**257. The Panel takes note of the Appellate Body Report in *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan* (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.**

**(a) In tht report, the Appellate Body cautioned against the "mechanistic" application of the so-called "mandatory/discretionary distinction" and stated that the import of this distinction may vary from case to case (para. 93). For the Appellate Body, the question of whether a measure is mandatory or not is relevant "if at all" only as part of the assessment of whether the measure is, as such, inconsistent with particular obligations. How, if at all, are these statements and the related findings concerning the mandatory/discretionary distinction in that Appellate Body Report relevant to:**

**(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the *Agreement on Agriculture* and Articles 3.1(a) and (b) of the *SCM Agreement,* concerning: BRA**

- **Step 2 payments (see, *e.g.* paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and**

- **export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, *e.g.*, para. 90 Brazil's oral statement at second Panel meeting).**

**(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"? BRA**

**(iii) the legal standard and elements Brazil sets out to establish its "*per se*" "serious prejudice" claims (*e.g.* Brazil's 9 September further submission, para. 417 *ff*; US oral statement at second Panel meeting, para. 86 *ff.*)? BRA**

**(b) How and to what extent are the legal and regulatory provisions cited in paras. 415 and 423 of Brazil's 9 September further submission "normative" in nature and treated as binding within the US legal system (see, *e.g.*, para. 99 of the Appellate Body Report)? Does your response differ depending on whether the payments are dependent upon market price conditions? BRA**

**(c) Does Brazil challenge as "mandatory" the "subsidies" themselves, the subsidy programmes or the legal/regulatory provisions for the grant or maintenance of those subsidies, or something else? BRA**

**(d) Does the "requirement" upon the CCC to make available "not less than" $5.5 billion annually in guarantees have a normative character and operation? (see, e.g. Brazil's response to Panel Question 142; Exhibit BRA-297, 7 USC 5641(b)(1); 7 USC 5622(a) & (b); paragraph 201 of US 18 November further rebuttal submissions). Is this requirement "mandatory"? If so, how does the CCC have "discretion" not to make this amount of guarantees available in a given year? USA**

**(e) Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programmes as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (*e.g.* Exhibit BRA-117 (2 USC 661(c)(2))? USA**

**Brazil's Comment:**

241. Brazil makes several observations with respect to the United States' 20 January 2004 responses to Questions 257(d) and 257(e).

242. First, the evidence discussed in the Panel's questions and the US responses is only relevant to a determination whether the United States is in compliance with Article 10.1 of the Agreement on Agriculture with respect to scheduled products. For unscheduled products, the Appellate Body held that it is inconsistent with Article 10.1 to provide *any* export subsidies.[491] Brazil has demonstrated that CCC guarantees were extended for unscheduled products during the period 1992-2003. Having also demonstrated that the CCC programmes constitute export subsidies (under Articles 1.1 and 3.1(a) of the SCM Agreement, and under item (j)), Brazil has therefore established that the United States has circumvented its export subsidy commitments with respect to unscheduled products, in violation of Article 10.1. Brazil has also demonstrated that CCC guarantees continue to be available for unscheduled products.[492] Since it is inconsistent with Article 10.1 to provide *any* export subsidies, the availability of CCC guarantees leads to a threat of circumvention of the US export subsidy commitments.

243. Second, the test to determine whether the United States is threatening to circumvent its export subsidy commitments with respect to scheduled products is not whether the CCC guarantee programmes are "mandatory" as opposed to "discretionary."[493] Rather, to determine whether export subsidies result in, or threaten to lead to, circumvention of the United States' export subsidy commitments, the test set out by the Appellate Body in *US – FSC* is whether there is a "mechanism in the measure" for CCC to "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[494]

244. Under this test, the threat of circumvention is not abated simply because, as the United States notes, the CCC is not actually required to issue the "not less than $5,500,000,000 in credit guarantees" that it must, as a matter of law, make available every year.[495] The threat arises because, year-on-year, the CCC announces its plans to extend over $6 billion in guarantees, as it did for fiscal year 2004.[496]

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[491] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 150.

[492] Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Program Activity," USDA, covering GSM-102, GSM-103 and SCGP). For 1999-2002, s*ee also* Exhibit Bra-73 ("Summary of Export Credit Guarantee Program Activity," USDA, covering GSM 102, GSM 103 and SCGP for US fiscal years 1999-2003). For 1992-1998, *see* Exhibit US-41.

[493] The Panel will recall that in addition to its threat of circumvention claims with respect to scheduled products, Brazil has also demonstrated that the United States has used the CCC guarantee programs to circumvent its export subsidy commitments with respect to rice (a scheduled product). *See* Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP). The United States has not rebutted this evidence.

[494] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149. Brazil's 27 October 2003 Answers to Questions, para. 88; Brazil's 18 November 2003 Further Rebuttal Submission, para. 257; Brazil's 2 December 2003 Oral Statement, paras. 90-91; Brazil's 20 January 2004 Answers to Additional Questions, para. 13.

[495] Brazil is aware of no other provision of US law that provides a floor, and not a corresponding ceiling, for support to US industry.

[496] Exhibit Bra-296 ("USDA Announces $2.8 Billion in Export Credit Guarantees," FAS Press Release, 30 September 2003).

It is required to do so by law.[497] It is, moreover, altogether exempt from any ceiling on the amount of guarantees it extends, and from the normal requirement that it receive new budget authority before undertaking new guarantee commitments (the programmes' "mandatory" status under US law "does not effectively constrain credit activity").[498] The CCC uses that exemption liberally, increasing allocations throughout the fiscal year to meet the needs of US exporters.[499]

245. Even if the CCC does not reach its goal of issuing over $6 billion in guarantees by year end, the fact that US law tells it that it must make available at least this amount, the fact that it sets its sights on and actually announces this amount, and the fact that nothing in US law sets any upward bound on the amount of guarantees it can issue, communicates a threat that it will circumvent its export subsidy commitments. Even if the CCC does not reach its goal of issuing $6 billion in export credit guarantees, foreign competitors of US farmers see that it has announced its intent to do so, that it has the authority to do that and an unlimited amount more, and that there is no "mechanism in the measure" for CCC to "stem[], or otherwise control[], the flow of" CCC export credit guarantees.[500]

246. Moreover, foreign competitors of US farmers have seen how, as an historical matter, the United States has applied the CCC guarantee programmes to surpass its quantitative export subsidy reduction commitments – even when falling short of its announced intent to issue $6 billion in guarantees. Brazil has demonstrated how this threat materialized for one product – rice – in fiscal years 2001, 2002 and 2003 (despite the fact that the CCC did not reach its announced intent of handing out $6 billion in guarantees in any of those years).[501] Foreign producers' fears that the threat will materialize in other years for other products are legitimate, and the threat is therefore tangible (regardless whether or not the CCC meets its goal of handing out $6 billion in guarantees in any given year).

247. Merely having what the United States claims is the unwritten, administrative discretion to "tamp down the actual issuance of guarantees" would not be enough under this test.[502] The reason the Appellate Body in *US – FSC* looked for an affirmative "mechanism in the measure" subject to an Article 10.1 claim that would stem or control the flow of subsidies, rather than merely accepting as sufficient the unwritten administrative discretion to do so, is that only when such a mechanism exists, will foreign competitors of US farmers know with a degree of assurance that the threat of

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[497] Brazil's 18 November 2003 Further Rebuttal Submission, para. 261, *citing* Exhibit Bra-297 (7 U.S.C. § 5641(b)(1); 7 U.S.C. § 5622(a), (b)). *See also* Brazil's 2 December 2003 Oral Statement, para. 91, *citing* Exhibit Bra-366 (7 U.S.C. § 5622 note, "Promotion of Agricultural Exports to Emerging Markets, para. (a) ("The Commodity Credit Corporation shall make available for fiscal years 1996 through 2002 not less than $1,000,000,000 of direct credits or export credit guarantees for exports to emerging markets under section 201 or 202 of the Agricultural Trade Act of 1978 (7 U.S.C. 5621 and 5622), in addition to the amounts acquired or authorized under section 211 of the Act (7 U.S.C. 5641) for the program.")). *See also* Exhibit Bra-367 (Section 3203 of the 2002 FSRI Act (extending mandate to 2007)).

[498] Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Programme classified as "Mandatory" in Table 2, and in the "Introduction," the Office of Management and Budget states that Table 2 provides "the program's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory"); Exhibit Bra-117 (2 U.S.C. § 661(c)(2)) (exempting CCC programmes from appropriations requirement); Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform," April 1991, p. 7 (for quote provided in text above)).

[499] Brazil's 27 October 2003 Answers to Questions, para. 95, *citing* the archived list of USDA press releases announcing supplemental allocations extended throughout fiscal year 2003 (http://www.fas.usda.gov/excredits/exp-cred-guar.asp).

[500] Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 149.

[501] Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP). The United States has never rebutted Brazil's showing. The CCC announced guarantee allocations of $5.762 billion in 2001, $6.158 billion in 2002, and $6.247 billion in 2003, while granting guarantees in the amount of $3.227 billion in 2001, $3.388 billion in 2002, and $3.223 billion in 2003. *See* Exhibit US-41.

[502] US 20 January 2004 Answers to Questions, para. 3.

circumvention is not real. The purpose of the mechanism, in other words, is to diminish the threat. (Had this not been the Appellate Body's intent, it would simply have stuck to the traditional mandatory/discretionary formula it has used elsewhere and that the United States asserts applies in the analysis of an Article 10.1 claim.)

248. In any event, the "discretionary elements" that the United States asserts[503] abate the threat posed by its annual announcement that it will issue over $6 billion in CCC export credit guarantees are an illusion, for at least two reasons.[504]

249. First, the United States has offered no evidence that the CCC may reject "any individual application"[505] (much less that there is a "mechanism" to do so in order to avoid circumvention of US export subsidy commitments). As Brazil has previously noted, the CCC guarantee programmes are classified as "mandatory" under US law.[506] The Congressional Budget Office ("CBO") and the Congressional Research Service ("CRS") (legislative branch agencies charged with servicing the US Congress) have both noted the inability of executive branch agencies charged with implementing mandatory programmes to deny support to eligible borrowers.[507] The United States cites a non-programme specific document for a generic principle that mandatory and discretionary classifications under the Budget and Enforcement Act "'do not determine whether a programme provides legal entitlement to a payment or benefit'".[508] Speaking specifically with respect to USDA mandatory programmes, however, the CRS states that "'[e]ligibility for mandatory programmes is written into law, and any individual or entity that meets the eligibility requirements is entitled to a payment as authorized by the law'".[509]

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[503] US 20 January 2004 Answers to Additional Questions, para. 3.

[504] Brazil has elsewhere explained the CCC's authority to undertake an inquiry into whether particular countries are creditworthy, and the possibility that this inquiry could end up reducing the amount of CCC guarantees, does not prevent a conclusion that nothing "stem[s], or otherwise control[s], the flow of" CCC guarantees. Brazil's 27 October 2003 Answers to Questions, para. 92. Under the United States' FSC measure, US authorities were permitted to undertake a factual inquiry into, among other things, whether the foreign-source income of the foreign corporation was "effectively connected with the conduct of a trade or business within the United States." Appellate Body Report, *US – FSC*, WT/DS108/AB/R, para. 16. This authority, and the possibility that the factual inquiry could limit the amount of income that would qualify for the FSC exemption, did not prevent the Appellate Body from concluding that nothing in the FSC measure "stem[ed], or otherwise control[led], the flow of" FSC benefits, leading to a threat of circumvention of the United States' export subsidy reduction commitments.

[505] US 20 January 2004 Answers to Additional Questions, para. 3. The United States has not offered any support for its assertion that CCC has the authority "to suspend the issuance of expert credit guarantees under any particular allocation". In any event, Brazil demonstrates *infra* that the allocation process does not remotely abate the threat that the United States will circumvent its *quantitative* export subsidy reduction commitments.

[506] Exhibit Bra-295 (2004 US Budget, Federal Credit Supplement, Introduction and Table 2 (CCC Export Loan Guarantee Program classified as "Mandatory" in Table 2, and in the "Introduction", the Office of Management and Budget states that Table 2 provides "the programme's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory").

[507] *See* Exhibit Bra-117 (2 U.S.C. § 661(c)(2)); Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform," April 1991, p. 7 and Table 2); Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget," IB95031 (16 February 1996), p. 3).

[508] US 20 January 2004 Answers to Additional Questions, para. 7.

[509] Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget," IB95031 (16 February 1996), p. 3). The United States made a similar error in its 30 September 2003 Further Submission, at paragraph 156, when it cited the very same generic, non-agency-specific document (Circular A-11) for the principle that "the ability of CCC to issue guarantees is constrained by the apportionment process . . ." As Brazil has demonstrated, the CCC programs are exempt from the requirement that to receive new Congressional budget authority before undertaking new guarantee commitments. *See* Exhibit Bra-117 (2 U.S.C. § 661(c)(2)).

250. Second, the "discretionary elements" cited by the United States do not in any way abate the threat that the United States will circumvent its export subsidy commitments for scheduled products:

- The existence of eligibility criteria does not abate the threat. The focus for deciding whether a measure is discretionary is on whether it provides government officials with the discretion to implement the measure in a WTO-consistent manner.[510] Objective conditions, such as objective eligibility criteria, are not appropriately considered in determining whether a measure gives an implementing official "discretion" to act in a WTO-consistent fashion. For example, the FSC measure payments were only available where the income concerned was of foreign origin. Despite the fact that non-foreign sourced income would thus be excluded from FSC benefits, the measure was still found to threaten the circumvention of export subsidy commitments. Similarly, CCC guarantees are only available if an exporter meets the eligibility criteria set out in 7 C.F.R. § 1493.30.[511] The fact that a CCC official cannot legally issue a CCC guarantee to a non-eligible exporter does not make the CCC programmes "discretionary".

- The authority to limit guarantees given for exports to particular "destination[s]" and the authority to employ "exposure limits applicable to individual bank obligors"[512], like the authority to determine that particular destination countries are uncreditworthy and are ineligible for guarantees[513], do not reduce the threat of circumvention. The United States' export subsidy commitments are undertaken on a quantitative basis, and not on a destination or individual bank basis. Removing particular destination countries or banks from the list of those countries or banks eligible for CCC guarantees is utterly irrelevant to the CCC programmes' absolute activity levels – CCC can simply shift those guarantees to other countries and banks.

- Nor does the authority to limit the "time within which export must occur"[514] reduce the threat of circumvention. A requirement that the export that is the subject of a guarantee occur within a certain period of time following issuance of the guarantee only matters if the guarantee is issued in the first place; the requirement does nothing to control the flow of those guarantees or to abate the threat that they will circumvent the US export subsidy commitments.

- Nor does the allegedly commodity-specific allocation process that the United States cites[515] reduce the threat of circumvention. More than 95 per cent of allocations are made on a country-specific basis only, with less than 5 per cent of 2003 allocations made on a scheduled product-specific basis.[516] And the press release announcing initial allocations for 2004 contains no product-specific allocations.[517] More importantly, the allocations are made on a *monetary* basis, which provides virtually no assurance that the United States will not surpass

[510] Appellate Body Report, *US – 1916 Act*, WT/DS136/AB/R, para. 100.
[511] Exhibit US-6.
[512] US 20 January 2004 Answers to Additional Questions, para. 3.
[513] *See* US 30 September 2003 Further Submission, para. 154.
[514] US 20 January 2004 Answers to Additional Questions, para. 3.
[515] US 20 January 2004 Answers to Additional Questions, para. 3. *See also* US 30 September 2003 Further Submission, para. 155.
[516] *See* Brazil's 27 October Answers to Questions, para. 99, note 136 and Exhibit Bra-299 ("Summary of FY 2003 Export Credit Guarantee Programme Activity," USDA, covering GSM-102, GSM-103 and SCGP (Total GSM 102, GSM 103 and SCGP allocations for fiscal year 2003 are listed as $6.025 billion, with product-specific allocations for scheduled products as follows: $200 million for wheat to Korea; $85 million for wheat to Pakistan; and, $10 million for vegetable oils for Tunisia.). *See also* Brazil's 18 November 2003 Further Rebuttal Submission, para. 261 (second bullet point).
[517] Exhibit Bra-296 ("USDA Announces $2.8 Billion in Export Credit Guarantees," FAS Press Release, 30 September 2003).

its *quantitative* export subsidy reduction commitments.[518] Brazil has demonstrated how this threat materialized for one product (rice)[519]; the threat that it might happen in some years for other products is therefore tangible.

251. Thus the "discretionary elements" cited by the United States do not abate the threat of circumvention of its export subsidy commitments. The United States erroneously states that "Brazil's own approach would require a showing that the programmes mandate that the premium rates will be insufficient to cover long-term operating costs and losses of the programmes".[520] The Panel will recall Brazil's demonstration that the United States has exported quantities of scheduled products in excess of US quantitative reduction commitments.[521] Thus, under Article 10.3 of the Agreement on Agriculture, the burden falls on the United States to prove that those excess quantities of scheduled products did not receive "export subsidies," within the meaning of Article 10.1. The burden is on the United States to show, in its own words, that the CCC programmes mandate that premium rates will be sufficient to cover long-term operating costs and losses of the programmes, within the meaning of item (j), and that CCC guarantees do not constitute financial contributions that confer benefits and are contingent on export, with the meaning of Articles 1.1 and 3.1(a) of the SCM Agreement.

252. But whomever bears the burden, Brazil has shown that the CCC does not have the discretion to charge fees that will enable it to meet its long-term operating costs and losses. Both USDA's Inspector General and the US General Accounting Office have noted the CCC's failure to change its premium rates or to reflect credit risk in those rates – *and in particular the maximum one-per cent premium rate imposed by US law*[522] – as evidence of a failure and inability to cover costs and losses.[523] There is no affirmative "mechanism" in place to stop the CCC programmes from constituting export subsidies under item (j), and in fact the fee ceiling imposed by US law is a mechanism that ensures that the programmes will operate as export subsidies.

253. Moreover, Brazil has demonstrated that the CCC export credit guarantee programmes confer "benefits" *per se*, within the meaning of Article 1.1(b) of the SCM Agreement (as well as that they are financial contributions and are contingent on export), and therefore that they constitute *per se* export subsidies for the purposes of Article 10.1.[524] Among other reasons (*e.g.*, the regulations for the CCC programmes, and a comparison to non-market benchmarks established by the US Export-Import Bank)[525], Brazil has made this *per se* showing by demonstrating that CCC export credit guarantees are unique financing instruments for agricultural commodity transactions that are not available on the commercial market for terms longer than the marketing cycles of the eligible commodities.[526] Far from an affirmative "mechanism" to prevent CCC guarantees from constituting export subsidies, guarantees under the CCC programmes constitute export subsidies *per se*.

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[518] Brazil's 27 October 2003 Answers to Questions, para. 100.

[519] Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP).

[520] US 20 January 2004 Answers to Additional Questions, para. 4.

[521] Brazil's 2 December 2003 Oral Statement, para. 78; Brazil's 24 June 2003 First Submission, para. 265.

[522] US 11 August 2003 Answers to Questions, para. 180. *See also* Exhibit Bra-297 (7 U.S.C. § 5641(b)(2)).

[523] Brazil's 22 December 2003 Answers to Questions, paras. 63-64.

[524] *See, e.g.*, Brazil's 18 November 2003 Further Rebuttal Submission, paras. 233-241.

[525] This evidence is summarized at paragraphs 231-241 of Brazil's 18 November 2003 Further Rebuttal Submission.

[526] *See* Brazil's 24 June 2003 First Submission, paras. 289-292; Brazil's 22 July 2003 Oral Statement, para. 116; Brazil's 11 August 2003 Answers to Questions, paras. 139-140, 152-157, 183-187; Brazil's 22 August 2003 Rebuttal Submission, paras. 103-105; Brazil's 22 August 2003 Comments, paras. 92-93, 109-113; Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 68-80; Brazil's 7 October 2003 Oral Statement, para. 72; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 230-242; Brazil's 2 December 2003 Oral Statement, para. 79.

254. Everything about the CCC programmes aggravates and legitimizes the fear foreign competitors of US farmers have that the programmes will be used to circumvent the United States' export subsidy commitments. Brazil has demonstrated that under Articles 1.1 and 3.1(a) of the SCM Agreement, and item (j), guarantees under the programmes constitute *per se* export subsidies. The CCC issues these export subsidies free from the normal budgetary constraints placed on federal spending. The only constraint placed on the programmes is one that in fact encourages fear of circumvention – the obligation the US Congress has placed on the CCC to make available *a minimum* of $6.5 billion of CCC guarantees every year.[527] While the United States considers CCC's failure to actually grant $6.5 billion in guarantees in a given year as significant to its defense, it misunderstands the obligation included in Article 10.1. Article 10.1 prohibits the threat of circumvention. Foreign competitors of US farmers see and fear the unchecked authority US farmers and the CCC have to circumvent US export subsidy commitments. Their fear is legitimate, since that unchecked authority has been used in the past to circumvent those commitments.[528]

255. There is no affirmative "mechanism in the measure" that will stem or control the flow of CCC guarantees in a way that will abate the threat of circumvention of the US export subsidy commitments with respect to scheduled products. To abate the fear that makes the threat real, foreign competitors need to see a mechanism in place that will keep the United States from using the CCC programmes to provide export subsidies that surpass the US reduction commitments. The nature of the obligation in Article 10.1 – the prohibition of a threat – is such that it cannot be met with a showing that there is mere discretion to avoid surpassing those commitments. That the Appellate Body failed to apply the traditional mandatory/discretionary distinction in interpreting the standard required by Article 10.1 demonstrates its understanding that to prevent a measure from posing a threat of circumvention, there needs to be some affirmative mechanism in place to reduce the legitimate fear of circumvention.

**258. Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks. BRA**

[527] For citations, *see* Brazil's 2 December 2003 Oral Statement, para. 91.
[528] Exhibit Bra-300 (Calculation on US Rice Exports Benefiting from GSM 102, GSM 103 and SCGP).

# ANNEX I-14

## COMMENTS OF THE UNITED STATES ON THE ANSWERS OF BRAZIL TO FURTHER QUESTIONS FROM THE PANEL TO THE PARTIES FOLLOWING THE SECOND PANEL MEETING

(28 January 2004)

### A. Terms of Reference

**194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? BRA, USA**

1. Brazil's answer conflates two issues: the measures a Panel is to examine and the evidence a Panel may examine. As stated in the US response, Brazil has challenged certain statutory measures "as such"; Brazil has also challenged certain "payments" as measures. With respect to payments, it is only those payments made through panel establishment that can be "specific measures at issue" between the parties. Payments made after panel establishment necessarily had not been made as of the time of establishment; therefore, those "measures" did not exist and cannot have been within the Panel's terms of reference as set out by the DSB.

2. The situation here is different from that in *Chile – Price Bands*[1] where the question was whether an amendment made to a measure that both parties agreed were within the panel's terms of reference had altered the "essence" of the measure such that it was no longer a measure within the panel's terms of reference. Here, the question concerns measures (payments) that it is without dispute did not exist at the time of panel establishment. Accordingly, the request for a panel could not have "identified" non-existent measures, nor could Brazil have consulted on measures "affecting" (present tense) the operation of a covered agreement. To find these measures to be within the Panel's terms of reference would therefore be in contravention of Articles 4 and 6 of the DSU. It was Brazil's choice to request establishment of the Panel part way through marketing year 2002; thus, Brazil's timing sets the parameters for what payments are properly before the Panel.[2] In this connection, we note that Brazil has finally conceded the correctness of the US view that this Panel's terms of reference cannot expand beyond their scope of the date of panel establishment. In its answer to the Panel's Question 247 (paragraph 149), Brazil states: "Thus, the 'matter' before the Panel has not changed (*and cannot*) since the establishment of the Panel" (emphasis added). Brazil should of course also have acknowledged that, despite this statement, it has in fact attempted to change the matter before the Panel.

3. This is not to say that a Panel may not examine evidence that is developed after panel establishment.[3] In fact, the United States would largely agree with Brazil's statement that "to the extent that 'payments' made since 18 March 2003 are evidence, the Appellate Body and panels have

[1] WT/DS207/AB/R.

[2] Past panels have examined measures subject to a dispute as they exist on the date of panel establishment. *See, e.g.*, *Panel Report, India -- Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WT/DS90/R, adopted 22 September 1999, paras. 5.159-5.163.

[3] *See, e.g.*, *Japan – Measures Affecting the Importation of Apples*, WT/DS245/R, para. 4.15 (15 July 2003) (rejecting Japan's preliminary ruling request to strike certain affirmative evidence developed and submitted after the date of panel establishment but no later than during the first panel meeting).

repeatedly found that evidence generated after the establishment of the panel can be used by [panels] in their objective assessment of the facts under DSU Article 11."[4] The Panel should carefully consider the import of this statement by Brazil, given the existence of three telling pieces of evidence that Brazil has sought to minimize or neglected:

- First, Brazil largely ignores the undisputed fact that no marketing loan payments have been made since 19 September 2003; thus, given expected prices, US outlays will be dramatically lower in marketing year 2003.

- Second, Brazil seeks to minimize the fact that futures prices indicate that the market expects cotton prices to remain high through marketing years 2003 and 2004.

- Third, and perhaps most disconcerting, Brazil has neglected to inform the Panel that, with respect to its preferred baseline approach, FAPRI has produced a (preliminary) November 2003 baseline that revises projected prices significantly upwards as compared to the outdated baseline on which Mr. Sumner's economic analysis relies.

4. The first piece of evidence demonstrates not only that marketing loan payments will be sharply lower in marketing year 2003 than in previous years, but fatally undercuts Brazil's economic analysis. The Panel will recall that in Brazil's economic analysis, the marketing loan programme alone accounted for almost 43 per cent of the effect of removal of all challenged US subsidies. Given that no marketing loan payments are being made and that futures prices and the November 2003 FAPRI baseline suggest that no marketing loan payments will be made over the remainder of marketing year 2003, the evidence does not support Brazil's argument that US marketing loans for upland cotton create a threat of serious prejudice.

5. The second piece of evidence is that futures prices indicate that the market expects cotton prices to remain high through marketing years 2003 and 2004. The table below shows settlement prices on 27 January 2004, for contracts through marketing year 2004.

| **New York Cotton Exchange, Cotton No. 2, 27 January 2000**[5] | |
|---|---|
| **Contract** | **Settlement (cents per pound)** |
| March 2004 | 73.76 |
| May 2004 | 75.06 |
| July 2004 | 75.90 |
| October 2004 | 68.25 |
| December 2004 | 69.05 |
| March 2005 | 71.05 |
| May 2005 | 71.70 |
| July 2005 | 72.40 |

6. The following table of futures prices for December 2004 upland cotton contracts further demonstrates that price expectations have risen over time, and market participants expect cotton prices to remain high through December 2004.

[4] Brazil's Answer to Question 194, para. 5.
[5] Exhibit US-142.

**Futures Prices for December 2004 Cotton**

| Month ending | Open for the Month | High for the Month | Low for the Month | Close for the Month | Average Close for the Month |
|---|---|---|---|---|---|
| 12/31/2002 | 60.63 | 62.20 | 60.49 | 60.50 | 61.34 |
| 1/31/2003 | 61.25 | 62.50 | 60.50 | 62.70 | 61.69 |
| 2/28/2003 | 62.90 | 63.00 | 61.30 | 62.87 | 62.53 |
| 3/31/2003 | 62.90 | 63.25 | 61.70 | 62.45 | 62.57 |
| 4/30/2003 | 62.40 | 64.00 | 62.00 | 62.45 | 62.69 |
| 5/31/2003 | 62.50 | 64.00 | 60.58 | 60.75 | 62.60 |
| 6/30/2003 | 60.50 | 64.60 | 59.00 | 65.25 | 62.55 |
| 7/31/2003 | 66.90 | 66.90 | 63.32 | 62.85 | 65.29 |
| 8/31/2003 | 62.90 | 63.25 | 60.70 | 63.68 | 61.95 |
| 9/30/2003 | 63.95 | 66.95 | 62.20 | 66.25 | 64.99 |
| 10/31/2003 | 65.75 | 71.00 | 64.80 | 68.85 | 67.72 |
| 11/30/2003 | 68.85 | 70.00 | 62.50 | 65.65 | 67.54 |
| 12/31/2003 | 67.50 | 68.45 | 63.25 | 68.28 | 65.60 |
| 1/22/2004 | 68.40 | 69.70 | 67.62 | 69.62 | 68.78 |

Source: New York Board of Trade, NY Cotton Exchange

7. Third, Brazil has not provided the Panel with any information relating to the most recent FAPRI November 2003 baseline. This preliminary baseline further undermines Brazil's economic analysis, which was predicated on projections of continued low cotton prices. As noted with respect to the cessation of marketing loan payments and high futures prices, that low-cotton-price projection on which Mr. Sumner relies has proven to be dramatically off-base. The November 2003 baseline now recognizes that fact.

- For example, the FAPRI November 2002 baseline used by Mr. Sumner projected an A-index of 50.7 cents per pound for marketing year 2003.

- The actual A-index in 2004 (through 22 January) has varied between a low of 75.45 cents per pound on 2 January to a high of 76.95 cents per pound on 22 January 2004 – that is, *roughly 50 per cent higher* than the FAPRI November 2002 projection.

8. The price outlook for cotton has improved considerably since publication of the November 2002 FAPRI baseline used by Dr. Sumner to estimate the effects of subsidies on US cotton production. The table below shows that projections for the Adjusted World Price are as much as *54.1 per cent higher*, or 20 cents per pound, for marketing year 2003 in the November 2003 baseline as under the November 2002 baseline.

**FAPRI's Upwards Revisions to Adjusted World Price Baseline Projections**

| Year | Adjusted World Price (cents/lb) | | | |
|---|---|---|---|---|
| | Nov 2002 (Sumner) | Jan 2003 | Nov 2003 1/ | Increase from Sumner Nov02 baseline to Nov03 |
| 2003/04 | 37.22 | 44.8 | 57.36 | 54.1 % |
| 2004/05 | 39.83 | 45.4 | 50.96 | 27.9 % |
| 2005/06 | 41.94 | 46 | 50.82 | 21.2 % |
| 2006/07 | 43.6 | 46.7 | 50.35 | 15.5 % |
| 2007/08 | 45.48 | 48 | 49.24 | 8.3 % |
| Average | 41.61 | 46.18 | 51.75 | 24.4 % |

1/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

The chart below sets out the same data graphically, showing how much FAPRI's projections have been revised upwards since the November 2002 baseline on which Mr. Sumner's analysis relies.

9. As a result of this large upwards revision in FAPRI's projected adjusted world price, FAPRI's estimated marketing loan gains have been reduced considerably.

- Under the November 2003 baseline, *the estimated marketing loan gain for marketing year 2003 is now zero*, compared to almost 15 cents per pound under the November 2002 baseline used by Dr. Sumner.

- For marketing year 2004, the estimated marketing loan gain under the November 2003 baseline is 1.04 cents per pound, *a reduction of 91.5 per cent* from the 12.17 cents per pound estimated marketing loan gain in the November 2002 baseline used by Dr. Sumner.

- In fact, over the five-year period from marketing year 2003 to marketing year 2007, the average marketing loan gain is estimated in the November 2003 baseline as 1.32 cents per pound, *87.3 per cent lower* than the 10.39 cents per pound average using the November 2002 baseline on which Dr. Sumner relied.

**FAPRI's Downwards Revisions to Its Marketing Loan Gain Baseline Projections**

| Year | Estimated marketing loan gain1/ (cents/lb) | | | |
|---|---|---|---|---|
| | Nov 2002 (Sumner) | Jan 2003 | Nov 2003 2/ | Decrease from Sumner Nov02 baseline to Nov03 |
| 2003/04 | 14.78 | 7.2 | 0 | 100.0 % |
| 2004/05 | 12.17 | 6.6 | 1.04 | 91.5 % |
| 2005/06 | 10.06 | 6 | 1.18 | 88.3 % |
| 2006/07 | 8.4 | 5.3 | 1.65 | 80.4 % |
| 2007/08 | 6.52 | 4 | 2.76 | 57.7 % |
| Average | 10.39 | 5.82 | 1.32 | 87.3 % |

1/ The estimated marketing loan gain is the difference, if positive, between the loan rate (52 cents per lb) and the Adjusted World Price.

2/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

10. Recall that the marketing loan programme accounted for more than 42 per cent of the estimated effects of removing all US subsidies over MY 1999-2007 on production under the model

developed by Dr. Sumner.[6] Thus, updating the model to the November 2003 baseline would virtually eliminate the estimated effect of the marketing loan programme and significantly reducing the overall estimated effect on production. Any remaining effects would largely be attributed to direct payments under Dr. Sumner's flawed model, with which we strongly disagree.

11. In addition, the FAPRI baseline from November 2002 projected 50.7 cents per pound for the A-Index for marketing year 2003 and the January 2003 baseline projected 58.4 cents per pound for the A-index for marketing year 2003. The FAPRI November 2003 projection for the MY2003 A-Index is 70.9 cents per pound, *40 per cent higher* than the FAPRI November 2002 projections used by Dr. Sumner. Even this revision could be low as the actual A-index for January 2004 (through 22 January) has varied between a low of 75.45 cents per pound on January 2 to a high of 76.95 cents per pound on 22 January 2004. We also note that FAPRI's November 2002 projections that Dr. Sumner employed did not show, through marketing year 2012, the A-Index *ever* rising as high as current prices.

**FAPRI Baseline Projections for A-Index** *(cents per pound)*

| A-Index | Nov 2002 (Sumner) | Jan 2003 | Nov 2003 1/ | Increase from Sumner Nov02 baseline to Nov03 |
|---|---|---|---|---|
| 2003/04 | 50.7 | 58.4 | 70.9 | 39.8% |
| 2004/05 | 53.4 | 58.8 | 64.5 | 18.9% |
| 2005/06 | 55.8 | 59.4 | 64.3 | 15.2% |
| 2006/07 | 57.6 | 60.1 | 63.8 | 10.8% |
| 2007/08 | 59.6 | 61.5 | 62.7 | 5.2% |

1/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

12. The current high cotton prices and market expectations of continued high prices are crucially relevant because, as mentioned, marketing loan payments will not be made if cotton prices are above the loan rate of 52 cents per pound and, further, counter-cyclical payments will not be made if the season average farm price is above 65.73 cents per pound (the target price of 72.5 cents minus the direct payment rate of 6.67 cents). The weighted average farm price for August-November was 62.4 cents per pound, as reported by USDA on 11 January 2004.[7]

13. Without even referencing the US critique of the modelling used by Brazil with respect to the challenged US measures, this evidence relating to prices indicates that Brazil's economic analysis is founded on price projections that are almost 40 per cent below actual prices; thus, the economic analysis put forward by Brazil does not support a finding of threat of serious prejudice. Furthermore, we recall that Brazil has argued that the 2002 Act increased the support provided to upland cotton producers, threatening continued high levels of production, exports, and price suppression. And yet, US acreage declined in both MY2002 and MY2003, and prices have steadily recovered from their MY2001-2002 trough to five-year highs. Market participants expect those high prices to continue. Thus, the evidence does not support the view that the effects of challenged US subsidies are significant price suppression.

[6] *See* Brazil's Further Submission, Annex I, table 1.4.
[7] *World Agricultural Supply and Demand Estimates*, USDA, WAOB, WASDE-406, 11 January 2004.

## B. ECONOMIC DATA

**196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. BRA, USA**

14. In its reply, Brazil makes several unfounded accusations and misrepresentations of fact. In this comment, the United States attempts to disentangle fact from fiction for the Panel.

15. Brazil asserts that through its December 18, 2003 letter, "the United States has finally confirmed – after asserting the contrary repeatedly to Brazil and then to the Panel – that it has collected complete planted acreage, contract base acreage, contract yields, and even payment data that would allow it to calculate with relative precision the amount of direct and counter-cyclical payments made to current producers of upland cotton in MY 2002." There are several errors in this passage. First, the United States recalls that it was the United States itself at the second session of the first panel meeting that brought to the Panel's and Brazil's attention the planting reporting requirement that was introduced by Section 1105 of the 2002 Act (7 USC 7915). Thus, the United States did not "finally confirm[]" the maintenance of planting data on 18 December.

16. Second, the United States never asserted that it did not have contract base acreage and contract yield information. The United States explained that it did not track decoupled payments by recipients' production and thus did not maintain information on the payments made for upland cotton base acres to upland cotton producers. That statement remains true today. In fact, while Brazil's statement asserts that "planted acreage, contract base acreage, contract yields, and . . . payment data" can be used to calculate the amount of decoupled payments "made to current producers of upland cotton," this information would allow the calculation of decoupled payments made to farms that reported *planting* upland cotton. As stated, the United States does not collect information relating to whether a farm *produces* upland cotton. Therefore, the data referenced by Brazil would allow calculation of payments made to upland cotton "planters," and in fact the United States has provided the contract data to perform this calculation on 18 and 19 December 2003.

17. Brazil claims that it "cannot calculate direct payment and counter-cyclical payment figures" because it was not provided (ignoring that Brazil bears the burden of proof in this dispute) "farm-specific identifying numbers, thus rendering any matching of farm-level information on contract payments with information on farm-specific plantings impossible." This statement was indecipherable to the United States until the Panel insisted that Brazil explain its proposed methodology for calculating those payments in Question 258. The United States comments on this proposed methodology, which lacks any basis in the Subsidies Agreement, any WTO agreement, or in economic logic, in its comment on Brazil's answer to Question 258.

18. It is, of course, ironic to read Brazil' s suggestion that only the "unique farm number (or a substitute number protecting the alleged confidentiality of farmers) would allow any matching" since *the United States expressly asked Brazil at the second panel meeting whether it could act to protect the privacy interests of US cotton producers*, perhaps by obscuring farm numbers. The Panel Chairman also inquired of Brazil whether obscuring the farm numbers would be acceptable, *but Brazil refused to agree to any such step, insisting that all of the information, including farm numbers, be provided as set out in Exhibit BRA-369.* Thus, it is Brazil that refused to allow "a substitute number protecting the . . . confidentiality of farmers" – or any other step to maintain farmer confidentiality – to be used. The United States again notes Brazil's reference to "a private US citizen making a simple FOIA request," who was in fact a member of Brazil's delegation, and reminds Brazil for the third time of the US request for assistance in curing the breach of privacy that resulted from providing that planting information.

19. We also note that in Brazil's response, Brazil references several payments that were not included in the Panel's question, namely, crop insurance payments, cottonseed payments, and "other payments." Brazil does not state for what year these payments apply.

20. With regards to crop insurance payments[8], we note that the data provided by Brazil for crop insurance net indemnities with respect to upland cotton in 2002 is incorrect.[9] However, the only crop insurance payments within the scope of Brazil's panel request are payments to "upland cotton producers, users, and exporters."[10] Thus, Brazil is once again attempting to broaden the scope of this dispute to measures beyond its panel request, and the Panel should reject that effort.

21. With respect to cottonseed payments, the United States recalls the panel's communication of 8 December 2003 in which it stated that "[t]he Panel intends to rule that cottonseed payments made under the Agricultural Assistance Act of 2003 are not within its terms of reference." Thus, Brazil's citation to the amount of cottonseed payments made under this Act are not only outside the scope of the question but also outside the scope of this dispute. With respect to "other payments," the United States recalls its preliminary ruling request that these payments are not with the Panel's terms of reference.[11]

22. With respect to direct and counter-cyclical payments, Brazil continues to put forward erroneous figures before the Panel. Brazil fails to make any adjustment in the amount of payment to reflect the proportion of cotton planted acreage that is rented or owned. However, those "subsidies" to cotton producers that are the subject of Brazil's panel request must "benefit" producers.[12] Brazil itself has conceded that land rental rates as of marketing year 1997 – that is, one year after introduction of the decoupled production flexibility contract payments – reflect the capture of more than one-third of the subsidy by landowners. Finally, Brazil has not allocated these decoupled payments that are not tied to the production, use, or sale of any product across the total value of the recipient's production, the only allocation methodology set out in the Subsidies Agreement and, in fact, applied by Brazil itself for countervailing duty purposes.[13]

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[8] We also note that Brazil has insisted that crop insurance premium payments are "specific" subsidies within the meaning of Article 2 of the Subsidies Agreement because the crop insurance statute precludes coverage of livestock. *See, e.g.*, Brazil's Further Rebuttal Submission, para. 163. At one time there was such an exclusion, but as we have previously pointed out, it was removed. In fact, Brazil simply and repeatedly misquotes its own exhibit, which does not contain the "excluding livestock" language of the old statute. *See* Exhibit BRA-30, at 1-44 to 1-45 (extending coverage to enumerated products and "any other agricultural commodity, excluding stored grain, determined by the Board, or any one or more of such commodities, as the context may indicate").

[9] Total indemnity payments paid to upland cotton producers in 2002 was $400,686,555. Total upland cotton premiums were $317,610,012 of which the government provided premium subsidies of $194,111,641 and $123,498,371 was paid by producers. Thus, net indemnities (that is, indemnities minus producer-paid premiums) paid to upland cotton producers in 2002 was $277,188,184 ($400,686,555 minus $123,498,371), not $298.3 million as reported by Brazil.

[10] *See* WT/DS267/7, at 1 ("The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton.").

[11] US Further Written Submission, Section II. The United States also recalls its point above, namely Brazil has conceded the correctness of the US view that this Panel's terms of reference cannot expand beyond their scope of the date of panel establishment. In its answer to the Panel's Question 247, Brazil states: "Thus, the 'matter' before the Panel has not changed (*and cannot*) since the establishment of the Panel." Brazil should also have acknowledged that, despite this assurance, it has in fact attempted to change the matter before the Panel.

[12] *See* Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, adopted 7 June 2000, paras. 6.65 and 6.66 (quoting and agreeing with *Canada – Aircraft* panel: "'A "benefit" does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a "benefit" can be said to arise only if a person . . . has in fact received something.'").

[13] *See* US Comment on Brazil's Answer to Question 258 from the Panel.

23. With respect to the export credit guarantee programmes, Brazil "estimates the amount of payments using the 'guaranteed loan subsidy' estimate FY 2003."[14] This figure is of course not a payment at all, but merely a prospective budgetary *estimate* calculated under the Federal Credit Reform Act of 1990. As the United States noted in its answer, for all cotton for fiscal year 2003 (October 2002 - September 2003), outstanding claims are $280,898, less than one-tenth of one per cent of the value of registrations – further evidence, specific to cotton export credit guarantees in particular, that premiums are more than sufficient to cover operating costs and losses.

**199. What is the composition of the A-Index? We do note footnote 19 and, for example, Exhibit BRA-11, but please explain more in detail how this index is calculated. BRA**

24. With respect to the explanations of Brazil of the A-Index, we note that the A-Index is not a price for a "world market" for purposes of Article 6.3(c). As Brazil's answer puts it, the A-Index is an "average price," a "composite of quotations from the major producing regions around the world, much like a poll" (para. 11). The A-Index is also not a "price" in a "world market"; it is a Northern Europe-delivered price quote. We note the statement in paragraph 16 of Brazil's answer that "the average A-index price" in the week of export "would only be an estimate and would not necessarily reflect the price received by the US producers, or the prices received by the exporters." Finally, we note that there are 16 different quotes, and the A-Index consists of the average of the lowest 5. The fact that the prices differ also indicates that there is not one "world market" price. There is also a B-Index composed of upland cotton price quotes of lower quality growths, again suggesting that the A-Index is not a "world market price."

**200. Concerning the chart on page 37 of Brazil's further rebuttal submission, why did Brazil use a futures price at planting time? Is this a relevant measure for assessing acreage response? BRA**

25. Brazil asserts that US producers are largely unresponsive to market price movements and cites a chart provided in their oral statement of December 2 that showed cotton future prices and planted cotton acreage. However, using a simple cotton price is inappropriate to measure price responsiveness. Prices for cottons alternatives also fell from 1999 to 2002. A farmer cannot just consider cotton prices but must instead consider the opportunity cost at the time of planting. Operating costs being covered (as the United States has already shown the farmer expected to do in each year), he must decide which crop to plant, and this requires looking at the cotton price relative to alternatives. In fact, this is the approach taken by FAPRI and Dr. Sumner in considering net returns of cotton versus other crops.[15]

26. When one considers movements of cotton futures versus the price of a substitute like soybeans, a far different picture emerges than the one promoted by Brazil in its response to question 200. The graph below uses the same planted area numbers and time period as Brazil. It shows planted area is price responsive when judged against the more appropriate ratio of cotton to soybeans harvest season futures prices at the time of planting.[16]

27. In the US *Comments Concerning Brazil's Econometric Model*, we point out that the correlation between planted acreage and the ratio of cotton futures to soybean futures is 0.69 over the 1996 to 2002 period. This compares to a correlation of 0.40 for lagged prices to planted acreage, and a *negative correlation* using Dr. Sumner's expected net return calculation and planted acreage. Thus,

[14] Brazil's Answer to Question 196 from the Panel, para. 9.

[15] Indeed, our objections to their approach focuses on the use of lagged prices rather than futures prices as a proxy for producer price expectations.

[16] The cotton-soybeans futures price ratio is drawn from the US answer to question 175 from the Panel, paragraph 118.

in contrast to statements by Brazil that futures prices are poor predictors of planted acreage, the correlation data suggest that the futures price ratios are better predictors of planted acreage than the arbitrary net return calculations as constructed by Dr. Sumner.

28. In conclusion, the United States has demonstrated that because the harvest season cotton futures price at planting was above the marketing loan rate (in MY99-01), farmers were planting for the market, not the loan rate. But it is simplistic for Brazil to put compare cotton plantings to futures and judge US farmers not to be price responsive. The United States has never claimed (nor would it) that cotton futures are the only variable that matters for purposes of planting decisions. The correlation data on cotton planted acres to the cotton / soybeans futures ratio shows that competing crops must be factored into any planted acreage analysis. Thus, if Brazil had been interested in presenting an accurate analysis to the Panel, it could have presented such data, or even incorporated alternative crops besides soy from each relevant growing region. Brazil preferred to put forward an analysis that could only serve to obscure the issue.

**201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so, please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? BRA, USA**

29. As was pointed out in the US response to question 201, cotton producers' use of futures and option markets is high relative to other crops. Based on survey data from the 1996 USDA Agricultural Resource Management Study, it is estimated that between 35 and 57 per cent of cotton farmers used a hedging instrument in 1996. (The ranges reflect a 95 per cent confidence interval.) In addition, an estimated 63 to 89 per cent of cotton farms used cash forward contracts in 1996.[17] These survey results suggest that even seven years ago a large proportion of cotton farmers either directly or indirectly priced their cotton off of organized futures and options markets.

30. Moreover, futures markets provide producers information regarding the future price outlook even if they do not hedge directly on the exchange. For example, the 16 January 2004 newsletter by cotton market analyst O.A.. Cleveland states:

> With December [futures contract price] exhibiting signals of breaking away from old crop prices, *hedging of new crop has increased*. Now above 69 cents, *December will need to move higher to prevent acreage loss to both soybeans and corn. A soybean/cotton ratio of 9.5 to 1 is enough to begin moving some land from cotton to soybeans (November soybeans to December cotton). A 10 to 1 ratio accelerates the switch.* A September corn ratio of 4 to 1 over December cotton takes more cotton acreage. With both management and capital risk greatly reduced for both of these crops, relative to cotton, significant cotton acreage can be loss if cotton becomes less favourable. With world cotton carryover at a decade low, the new crop December must maintain its tie to the grain/oilseed complex instead of the old crop cotton contracts.[18]

Note that Dr. Cleveland refers not just to cotton futures but to the cotton to soybean ratio and the ratio between cotton futures and corn futures. He confirms not just the importance of cotton futures prices in guiding cotton planted acreage decisions but, more significantly, the relationship of cotton futures prices to the futures prices of competing crops like soybeans and corn.

[17] A forward contract is defined as a cash market transaction in which two parties agree to buy or sell a commodity or asset under agreed-upon conditions. For example, a farmer agrees sell, and a ginner or warehouse agrees to buy, cotton at a specific future time for an agreed-upon price or on the basis of an agreed on pricing mechanism (such as a futures or options market). See Exhibit US-121, page 22.

[18] O.A. Cleveland Newsletter, January 16, 2004. Exhibit US-133.

31. Brazil has presented no evidence that any farmer ever planted based on "lagged prices" (or its "estimated adjusted world price"). Despite Brazil's criticisms of looking at December futures prices to gauge producer price expectations, farm publications are full of references (like that by O.A. Cleveland, above) to the use of December futures for upland cotton planting and hedging purposes. Consider USDA's "Weekly Cotton Market Review" of 9 January 2004.[19] It reported:

- "Most producers [in southeastern markets] have turned their focus to marketing the remainder of their 2003 crop and to *making initial preparations for planting the 2004 crop. Some producers inquired about forward contracts on 2004-crop cotton*. These inquiries were preliminary and no cotton was booked. Merchants offered contracts in Georgia at *350 to 400 points off NY December futures*" (emphasis added).

Two weeks later, the most recent "Weekly Cotton Market Review" reported:[20]

- "Producers in Georgia booked a very light volume of 2004-crop cotton at 275 to 300 basis points off NY December futures."

- "Merchants continued to offer contracts in Georgia at 300 to 375 points off NY December futures."

- "Contracts in North Carolina were offered at 450 to 475 points off NY December futures."

- "Merchants offered forward contracts at 350 points off NY December futures [in south central markets]."

That is, as the United States has explained, producers are beginning to make planting decisions for MY2004 and are using the December futures price as a guide to their expected returns from planting cotton. A farmer in Georgia can currently lock in a price for the 2004 crop of approximately 65-66 cents per pound (27 Jan. 2004 December futures price of 69.05 cents per pound less 300 to 375 points), and farmers have begun to do just that. Thus, Brazil asserts that the US methodology of looking to the December futures price to gauge producer price expectations is far less valid than using the (outdated November 2002) FAPRI baseline, but cotton producers disagree. In the final analysis, it is producer decisions – and not FAPRI's nor Dr. Sumner's decision to use "lagged prices" – that must drive the Panel's analysis of the effect of removal of marketing loan payments.[21]

**203. Please provide information concerning the organization, mandate, credentials and standing of FAPRI. BRA**

32. The United States agrees with Brazil's general characterization of FAPRI as a preeminent research institution focused on providing comprehensive analysis of the food and agricultural system. As noted by Brazil in its answer, the United States takes issue with the modifications of the FAPRI model by Dr. Sumner. These differences are outlined in detail in the *US Comments Concerning*

[19] USDA, Weekly Cotton Market Review at 1-2 (January 9, 2004) (Exhibit US-139)

[20] USDA, Weekly Cotton Market Review at 1-2 (Jan. 23, 2004) (Exhibit US-140).

[21] We also note an argument by Brazil in paragraph 19 that farmers generate a combined revenue from the market and the marketing loan program that exceeds 52 cents per pound. Brazil's analysis is once again partial. The premise is that a farmer is able to sell when prices have *increased* relative to the price on the date they claimed the marketing loan gain. However, in reality, there is no guarantee that prices will have increased. It is equally possible that prices will fall *below* the price on the date when the claim was made. As Exhibit US-126 demonstrates, the margin fluctuates from month to month, with the value in several months even negative, implying that a farmer that did not sell his crop at the time he received the marketing loan payment earned *less than* the marketing loan rate.

*Brazil's Econometric Model* of 22 December 2003. Chief among these differences is that manner in which Dr. Sumner modelled the effects direct and counter-cyclical payments. FAPRI allows for modest effects of direct payments on all crop acreage. Their result is consistent with the literature on decoupled payments, showing no or minimal effects on production.[22] By contrast, Dr. Sumner has included an arbitrary and completely *ad hoc* formulation that exaggerates the effects of these payments on acreage decisions. As compared to FAPRI's modelling, Dr. Sumner assumes and then finds effects some 50 times larger.[23]

33. The differences between the FAPRI baseline and Dr. Sumner's model were highlighted as well by Dr. Bruce Babcock, the economist who assisted Dr. Sumner in preparing the Annex I results. In a letter to Dr. Glauber, Dr. Babcock states, that the analysis of Dr. Sumner was "in no way an official FAPRI analysis and if FAPRI had done the analysis, FAPRI would have come up with different estimates of the effects of US cotton subsidies on world prices." Thus, to cloak Dr. Sumner's analysis in the reputation of "the award-winning FAPRI model" is grossly misleading. The differences between FAPRI and the Brazil analysis reflected in Annex I are substantial and, as detailed in the US Comments of 22 December, lead to the biased results presented by Brazil.

**204. Which support to upland cotton is not captured in the EWG data referred to in Brazil's 18 November further rebuttal submission? BRA**

34. In this answer on "support to upland cotton," Brazil makes reference to "contract payments from base acreage other than upland cotton" and the "allocation of these payments".[24] This answer makes clear that Brazil proposes that such payments with respect to non-upland cotton base acres can be "support to upland cotton." The United States comments on the methodology proposed by Brazil for allocating such payments, which lacks any basis in the Subsidies Agreement, any WTO agreement, or in economic logic, in its comment on Brazil's answer to Question 258. Here, we take issue with Brazil's attempt to amend this Panel's terms of reference to include such payments, and to do so at such a late stage in this proceeding.[25]

35. Nowhere in Brazil's consultation request or request for the establishment of this Panel does Brazil reference these payments under programmes unrelated to upland cotton. Accordingly these payments are not within this Panel's terms of reference. Moreover, Brazil's attempt to raise these payments at the very end of this proceeding deprives the United States of fundamental rights of due process. The United States, as well as all WTO Members, had a right, as of the date of Brazil's request for the establishment of this Panel, to know the "*specific*" measures at issue in this dispute.[26] Brazil cannot make vague allegations of "support" and then change at will the measures that it is challenging as its own position changes and to suit its convenience.

36. Brazil's own submissions to this Panel demonstrate that Brazil did not consider these payments to be measures within the Panel's terms of reference. In particular, the measures Brazil has alleged are "support to upland cotton" govern both Brazil's serious prejudice claims as well as its Peace Clause analysis. That is, the same measures that are "support for upland cotton" under Brazil's subsidies claims must be the measures that Brazil claims are "support to a specific commodity" for purposes of the analysis under Article 13(b)(ii) of the support that current measures grant versus the support decided during the 1992 marketing year. However, by seeking to allocate to upland cotton

[22] *See* US Further Rebuttal Submission, paras. 81-82 (reviewing literature, which finds less than one per cent effect on production, even making unrealistic assumptions on wealth effects).

[23] *See* US Comments on Brazil's Economic Model, para. 20.

[24] Brazil's Answer to Question 204, para. 27.

[25] As previously noted, Brazil's answers to the Panel's questions contain an important concession: in its answer to the Panel's Question 247, Brazil states: "Thus, the 'matter' before the Panel has not changed (and cannot) since the establishment of the Panel."

[26] *See* DSU, Article 6.2.

"contract payments from base acreage other than upland cotton," Brazil directly contradicts the arguments it set forth in the Peace Clause phase of this dispute. For example, in response to Question 41 from the Panel, Brazil wrote:

> The *only US domestic support measures that Brazil is aware of that would meet the test of being 'support to upland cotton' are those that it listed for purposes of calculating the level of Peace Clause support* in its First Written Submission. In the view of Brazil, these non-green box domestic support measures are the measures that constitute "support to" upland cotton for the purpose of Article 13(b).[27]

The footnote to the first quoted sentence cited paragraphs 144, 148, and 149 of Brazil's first written submission. These paragraphs, in turn, contain the tables in which calculated that budgetary outlays it alleged were support to upland cotton; crucially, these tables list production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments *for upland cotton base acres only.*[28]

37. Similarly, in response to Question 19, in which the Panel asked Brazil to identify "the measures . . . in respect of which Brazil seeks relief," Brazil wrote:

> The first type of domestic support "measure" is the payment of subsidies for the production and use of upland cotton. . . . . Brazil has tabulated the different types of payments (i.e., the measures) made under these legal instruments in paragraphs 146-149 of its First Submission.[29]

Again, the referenced paragraphs list production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments *for upland cotton base acres only.*[30]

38. Further, in explaining to the Panel why it did not allocate any portion of other payments notified by the United States to the WTO as non-product-specific, "some of which" (in the Panel's words) "presumably deliver support to upland cotton (e.g. state credit programmes, irrigation subsidies etc)," Brazil explained:

> None[] of these other measures notified by the United States as non-product specific had *any upland cotton specific link* in terms of historic, updated, or present upland cotton acreage, present upland cotton production or prices, or upland cotton groups of insurance policies or *any other specific upland cotton provisions.*[31]

Of course, the same analysis applies to decoupled income support payments made with respect to base acres for wheat, corn, soy, oats, sorghum, barley, flax, sunflower, safflower, rice, rapeseed, mustard, canola, crambe, and sesame. *None* of these payments has any "upland cotton specific" link in terms of upland cotton acreage, production, prices, or "any other specific upland cotton provisions." Indeed, these other payments are related to acreage historically planted to these other crops and may be (in the case of counter-cyclical payments) related to current prices of these other crops, *not upland cotton*. It is for that reason, presumably, that Brazil did not identify any of these payments among the measures it challenged.

39. Indeed, an important element in Brazil's argument that the decoupled income support measures it challenged were *not* non-product-specific – and thus constitute "support to a specific

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[27] Brazil's Answer to Question 41 from the Panel, para. 58 (footnote omitted) (italics added).
[28] *See* Brazil's First Written Submission, paras. 144, 148, 149.
[29] Brazil's Answer to Question 19 from the Panel, para. 15.
[30] *See* Brazil's First Written Submission, paras. 146-49.
[31] Brazil's Answer to Question 41 from the Panel, para. 57 (italics added).

commodity" – was that the challenged measures contained upland cotton-specific parameters. For example, with respect to counter-cyclical payments, Brazil wrote:

> For the purpose of calculating AMS, counter-cyclical payments (CCP) are 'product-specific' support for two main reasons: (i) they are not "support provided in favour of agricultural producers in general," and (ii) they are directly linked to *upland cotton-specific parameters* (current prices and historical acreage and yield).[32]

Brazil similarly argued that other decoupled income support measures were product-specific support in favour of upland cotton because they allegedly contain upland cotton-specific parameters.[33]

40. We also note that Brazil's request to the Panel to make rulings and recommendations does not reference any decoupled payments made with respect to non-upland cotton base acres. In fact, Brazil specifically stated that its "as such" challenge to "Sections of the 2002 FSRI Act and the referenced regulations thereto," including provisions relating to counter-cyclical payments and direct payments, were only made "to the extent that they relate to upland cotton."[34]

41. In sum, Brazil's arguments on the Peace Clause explicitly limited its claims with respect to decoupled income support measures to payments made with respect to upland cotton base acres. In fact, Brazil relied on the notion that such measures contained "upland cotton-specific" parameters to support its argument that those measures were "support to upland cotton" rather than non-product-specific support.

42. Under its serious prejudice claims, however, Brazil now seeks to expand the challenged measures to include decoupled income support measures with respect to non-upland cotton base acres[35], despite repeatedly arguing that the challenged US subsidies provided $12.9 billion in support over marketing years 1999-2002, a figure based on payments made under specific programmes, *including decoupled income support with respect to upland cotton base acres only*.[36] Decoupled payments made with respect to non-upland cotton base acres would not be within the terms of reference of this dispute; Brazil as complaining party cannot unilaterally expand the terms of reference at the conclusion of a dispute and claim that additional programmes, other than those at issue throughout the dispute, are now also challenged measures providing "subsidies to upland cotton."[37]

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[32] Brazil's Answer to Question 44 from the Panel, para. 61 (italics added).

[33] *See, e.g.*, Brazil's First Written Submission, para. 60 ("Between MY 1998-2001, upland cotton producers thereby received an additional amount of money, which was calculated based on their respective share of total upland cotton base times the amount of budgetary outlays allocated for upland cotton.").

[34] Brazil's Further Submission, para. 471(vii).

[35] The United States notes that Brazil does not appear to seriously believe that these measures are within the Panel's terms of reference since Brazil has not presented the 1992 levels of support that would include these additional payments, which Brazil would have had to do to make the Peace Clause comparison.

[36] We note that Brazil seeks to have it both ways. That is, it now argues that decoupled payments made with respect to non-upland cotton base acres can be allocated to, and become support to, upland cotton, yet at the same time, when it suits its purposes, it continues to argue that decoupled payments are support to upland cotton because of their alleged upland cotton-specific parameters. *See, e.g.*, Brazil 's Opening Statement at Second Panel Meeting, para. 60 ("[T]he 72.4 cent target price triggers CCP payments when *cotton* prices are lower – not corn, or soybeans prices – but *cotton*.").

[37] Indeed, although Brazil attempted to argue at the second panel meeting that it sought information on payments made with respect to *non-upland cotton base acres* through the Annex V procedure that the DSB did not agree to initiate, Brazil itself stated in its first written submission that its Annex V request was *limited to upland cotton base acres*: "Brazil requested the United States during the Annex V procedure to provide information on the amount of the *total upland cotton base acreage and yield under the CCP (and DP) program*." Brazil's First Written Submission, para. 68 (italics added). If so, this would be consistent with

**209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs**. **BRA, USA**

43. We note that Brazil acknowledges that a comparison of "planted to planted" area would be best. Harvested area can only be used as a proxy for planted area, and as indicated by the US data in the US Opening Statement of 2 December 2003, the two measures can diverge significantly. This divergence is especially important to note in light of Brazil's answer to Panel Question 210.

**210. Are worldwide planted acreage figures available? BRA, USA**

44. After noting in its response that consistent world-wide planting data for upland cotton are not available, Brazil continues to insist that world-wide harvested area data are a good proxy for planted area. Brazil offers a theoretical justification for using harvested area as a proxy for planted area (annual abandonment will average out over all cotton producing countries and be relatively stable over time). But Brazil has no empirical evidence to support the theory and continues to mix "apples and oranges" in its charts. For example, we note the chart at paragraph 33 of Brazil's answers is misleading: it is not a chart of "Per cent Change in Planted Acres" as labelled. Rather, it compares changes in US *planted* area for upland cotton with changes in non-US *harvested* area. This comparison is not appropriate.

45. As noted in the US answers to Question 209 from the Panel, US planted and harvested area generally move in the same direction but occasionally move in opposite directions. We note that, once again, Brazil has relied on a period that begins with marketing year 1998 to present a biased analysis. The period 1998 - 2000 that Brazil focuses on in para. 33 was an unusual period for US cotton because of weather. As noted in the US Opening Statement of December 2 (para. 6), abandonment was especially high in 1998 and area rebounded sharply in 1999. The year 2000 was a year when US planted and harvested area moved in opposite directions.

**US Planted and Harvested Upland Cotton Acres** (1,000 acres)

| Crop year | Planted acres | Harvested acres |
|---|---|---|
| 1998 | 13,064 | 10,449 |
| 1999 | 14,584 | 13,138 |
| 2000 | 15,347 | 12,884 |

Source: USDA, National Agricultural Statistics Service, *Acreage*, various issues, as submitted in the US Opening Statement of December 2 (para. 6).

46. Because foreign planted area data are not available, it is not possible to observe whether foreign planted and harvested area similarly diverged in these years. Therefore, using US planted area and foreign harvested area is a misleading comparison. Brazil uses its mislabelled chart to simplistically conclude that whenever US planted area moves in a divergent direction from foreign harvested area, the only reason must be because US subsidies insulate US upland cotton producers. That conclusion ignores any other possible factors that may affect area planted – for example, weather or competing crop prices – and is not supported by the data.

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Brazil 's Peace Clause argumentation in this dispute that only payments on upland cotton base acres could be product-specific support for upland cotton.

47. In para. 34, Brazil again complains that the US chart in the US Opening Statement of 2 Dec. (para. 6) is inappropriate. Brazil has it completely backwards. The US chart is the only appropriate comparison. We agree that a comparison of planted area data would be the best method, but the data are not available. Therefore, Brazil's conclusions based on a "planted versus harvested" comparison are not valid.

48. We again present a comparison of changes in US harvested area for upland cotton with changes in harvested area for the rest of the world. (These data are found in Exhibit US-63, but 2002 data are updated and estimated data for 2003-04 are included.) We note again the anomalous years of 1998 and 1999 for the US, where harvested area was sharply below planted area in 1998 because of severe adverse weather but then planted (and harvested) area increased sharply in 1999 in reaction both to the previous year's high abandonment and to favourable prices relative to competing crops. For the years 2000 - 2002 harvested area in the US and the rest of the world moved in tandem – declining in 2000, rising in 2001, and declining again in 2002. Brazil's claim of "distinctly different reactions"[38] are not supported by the data.

49. Brazil further claims that US area should have declined during the period 1999 - 2002. In fact, it is hard to discern any trend in US (or foreign) harvested area during this period. But since 1999, an admitted high year because of unique weather factors and favourable cotton prices relative to competing crops, US upland cotton area has generally declined. The new data provided for 2003 reinforce this conclusion: US area declined while the rest of the world, including Brazil, increased.

**Harvested Area for Upland Cotton** *(1,000 hectares and per cent change from previous year)*

| Crop year | 1998 | 1999 | 2000 | 2001 | 2002 | 2003(p) |
|---|---|---|---|---|---|---|
| | | | | | | |
| US area | 4,324 | 5,433 | 5,282 | 5,596 | 5,030 | 4,881 |
| Foreign area | 28,559 | 26,955 | 26,904 | 28,308 | 25,470 | 28,090 |
| Brazil area | 685 | 752 | 853 | 748 | 735 | 940 |
| | | | | | | |
| US (% change) | -20.3 | 25.6 | -2.8 | 5.9 | -10.1 | -3.0 |
| Foreign (% change) | 0.5 | -5.6 | -0.2 | 5.2 | -9.9 | 10.3 |
| Brazil (% change) | -10.5 | 9.8 | 13.4 | -12.3 | -1.7 | 27.9 |

Sources: USDA, Foreign Agricultural Service, Production, Supply, and Distribution Database; World Agricultural Supply and Demand Estimates, World Agricultural Outlook Board, USDA, 11 January 2004. Exhibit US-63, with 2003 added.

50. The data show that US harvested cotton area moves consistently with the rest of the world, when there are not abnormal weather events. Brazil conceded as much (in para. 36) that US acreage movements were relatively consistent with the rest of the world. How could that be if US producers are insulated from price movements because of subsidies? In marketing year 2003, US cotton area declined 3 per cent while the rest of the world rose 10 per cent. These divergent results again suggest that cotton area around the world is affected by different factors and these need to be accounted for carefully. But a *decline* in US harvested acreage in marketing year 2003, following a decline in marketing year 2002, is certainly not consistent with Brazil's theory that the United States increased support in the 2002 Act and that these "higher" payments will result in US overproduction of cotton, threatening to cause serious prejudice.

[38] Brazil's Answer to Question 210 from the Panel, para. 35.

51. In discussing how producers react to price signals, we would note recent trends in Brazil's cotton area. In MY2002, Brazil's harvested area declined about 2 per cent while the US and foreign cotton area dropped 10 per cent. In MY2003, Brazil's cotton area is estimated to have increased *28 per cent* while US cotton area fell 3 per cent. In fact, since the collapse in Brazil's cotton area in 1996, Brazil's cotton area has shown a much more consistent upward trend than US or foreign cotton area. We also note that in marketing years 1998, 1999, 2000 and 2001, Brazil's harvested area moved in the *opposite direction* from non-US cotton area. Those different responses, in absolute values, ranged from 11 per cent in MY1998 to 17.5 per cent in MY2001. In MY2002, Brazil's harvested area declined much less than the (non-US) rest of the world (1.7 per cent versus 9.9 per cent), and in MY2003 Brazil's harvested area is forecast to expand by far more than the (non-US) rest of the world (27.9 per cent versus 10.3 per cent). Thus, it would appear that, in terms of changes in harvested acres, Brazil deviates far more from the non-US rest of the world than does the United States.

52. Finally, in paragraph 35, even when Brazil' s misleading data do show a consistent decline between US planted and non-US harvested area, Brazil does not accept that US cotton producers were responding to market signals. Brazil simply claims that US cotton area should have declined more than it did.[39]

53. Brazil has tried to explain away similarities in acreage movements by asserting that Dr. Sumner's analysis suggests that US cotton acreage should have even been lower. Not only do we disagree with that analysis, but we note that it fails to explain why US and non-US harvested acreage moves commensurately from 1997-2002. If US producers were insulated from price movements, as Brazil claims, one would not expect US acreage to be highly correlated with acreage movements in the rest of the world. In fact, the data suggests the opposite; i.e., that US producers respond in similar fashion with cotton producers around the world.

**213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? BRA, USA**

54. Brazil points out that the statistical estimation literature in agricultural economics has used a variety of proxies for anticipated prices and revenue for the upcoming season. These include rational expectations in which many sources of information available to decision makers are combined and the expectations are consistent with the conditional forecasts of the model. Such models have strong theoretical grounding but have been impractical in most estimation situations.

55. Models such as used by FAPRI, USDA and the Congressional Budget Office has been developed not for retrospective analysis but for *prospective* analysis. If one wants to project out over a period for which futures prices are not available, it makes sense to rely on lagged prices since the models will produce prices for a given year that can then be used as the price expectation for the following year.

[39] In paragraph 35, Brazil again tries to buttress its claims by arguing that US exports increased during a period when the US dollar was appreciating in value. The exchange rate analysis put forward by Brazil is incomplete and inadequate. Brazil has ignored the fact that cotton is a raw material for apparel and textile products. The increase in foreign demand for raw cotton drove an increase in US exports. For example, with a strong US dollar, imported cotton textile and apparel became relatively cheaper, thereby increasing demand for such products. Increased textile and apparel demand in the United States from the higher dollar resulted in increased demand for raw cotton by foreign textile and apparel manufacturers. Foreign use of cotton increased from 80.8 million bales in MY 1999 to 91 million bales in MY 2002. Foreign production, however, remained basically the same, 70.5 million bales in MY 1999 to 70.8 million bales in MY2002. Therefore, US exports were responding to demand that was not met by foreign production. Source: Cotton and Wool Situation and Outlook Yearbook, Economic Research Service, USDA, November 2003, pg. 32.

56. Nonetheless, the use of lagged prices may result in biased results. Over the long term, where there is reasonable stability in markets, lagged prices function adequately as a proxy for price expectations. However, in those years, as in the period Brazil has pointed to here, when unexpected exogenous shocks such as China dumping stocks (late 1990s) and unexpected yields worldwide due to good weather conditions such as 2001, lagged prices are poor predictors of expected prices. Future prices, by contrast, are more efficient because they are based on more current information. Moreover, as we have argued elsewhere (see comments to question 200 and 201 above), producers base acreage decisions on futures markets. Where futures prices diverge from lagged prices, there is reason to believe that planted acreage decisions will diverge from forecast acreage from models based on lagged prices.

57. For example, during marketing years 2000, 2001, 2002, and 2003, lagged prices significantly understate the harvest season prices expected by producers as seen in the futures prices at the time of planting. The use of lagged prices thereby inflate the effect of the marketing loan rate. In fact, those lagged prices would have to be increased by 8-25 per cent, depending on the year, to equal the harvest season price actually expected by producers as indicated by the futures price.[40]

- For the period MY 1999-2003, when futures prices are used to gauge producer price expectations, only in MY 2002 were expected cash prices below the marketing loan rate.

- However, over that same period, when lagged prices are used as expected prices, the loan rate is higher than the expected price *in every year over this period* except MY1999.

Thus, it is a significant error for Brazil and Dr. Sumner to use lagged prices instead of the futures prices Brazil's own expert explained to be the more accurate gauge of farmers' price expectations. In fact, despite the hundreds of exhibits it has filed, Brazil has provided not one single piece of evidence that any farmers use or have ever used lagged prices to make planting decisions.

58. While the United States would agree with Brazil that it is impossible to know precisely what individual farmers' price expectations are, the United States (and Brazil's expert, Mr. McDonald) believe that futures prices provide the most current expectations of market participants. As such, futures prices incorporate the views of numerous market participants, including producers, regarding expectations of future market conditions. The United States disagrees with the approach used by Brazil in its analysis to rely solely on lagged prices and ignore information provided by futures prices. While it may be impractical to include futures prices in some models, modelling convenience is no justification to ignore these objective, market-based price expectations. The Panel cannot rely on Brazil's economic analysis that uses a proxy for expected prices that would have to be increased by up to 25 per cent to accurately reflect futures prices, the only objective data on the record reflecting actual price expectations of market participants. The biased results from using lagged prices do not assist the Panel in making an objective assessment of what is the effect of the US marketing loan programme.

59. Brazil ignores the fact that expected cash prices based on futures prices were above the loan rate from MY1999-2001, whereas the lagged price was below the loan rate for 2000-2002. That is, withdrawal of the marketing loan would not have greater acreage impacts because producers are planting for market prices, not loan rate.

**215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? BRA, USA**

[40] US Further Rebuttal Submission, paras. 164-65.

60. In the US response to question 211 (b), we demonstrate that market returns have exceeded variable costs for cotton producers in every year but one (2001) over the period of investigation. Brazil continues to argue that producers require direct payments to cover total costs of production, but this ignores the evidence that significant acreage is planted to cotton by cotton producers who have no cotton base acreage and hence are ineligible for cotton direct payments.

61. Brazil claims US producers will continue to plant upland cotton because they face no revenue risk, but this argument ignores the substantial evidence on record of huge acreage shifts, both on state level and within three categories of farms (i.e., those who plant cotton with cotton base; those who do not plant cotton but have cotton base; those farms who planted cotton but have no cotton base). Moreover, Brazil ignores the decline in plantings over last two years as other commodities have become more attractive and expected cotton prices less so. Finally, the claim that direct and counter cyclical payments remove risk of revenue loss runs contrary to theory on decoupled payments. Farmers will plant the crop that maximizes their expected revenue since the decoupled payment will be made whether they plant or not.

62. Brazil's argument that direct payments have significant effects on production runs counter to the empirical literature as well as running counter to the estimated effects from the FAPRI model that they purport to use. As pointed out in Dr. Glauber's literature review[41] and in the US discussion of direct payments in the US further submission and further rebuttal submission, empirical studies suggest that direct payments have only minimal effects on production. Indeed, as pointed out in the US Comments Concerning Brazil's Econometric Model of 22 December, the FAPRI baseline model (that is, the original FAPRI model as distinct from the model modified by Dr. Sumner) suggests that the effect of direct payments on cotton acreage is less than one per cent.

63. It is only when Dr. Sumner explicitly modifies the FAPRI model to *include* an *ad hoc* production specification for direct payments that Brazil obtains the tautological result that direct payments have a significant effect on cotton production.

**216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. BRA, USA**

64. In this answer the matter addressed has to do with base issues and whether farmers could or could not update their bases in the period that followed 1985. In our 22 December response we gave a full answer on that topic. We would note that in the US answer it is indicated that under the 1990 Act the running base provisions for cotton called for a five-year running average. This was an error. The running base period was a five-year period for other programme crops, but cotton and rice used a three-year period.

65. Brazil's contention that the United States has a base building policy is belied by Brazil's own recitation that there has been only one chance to add base cost-free (that is, without loss of benefits); that was in the 2002 Act, in which new crops were added to the programme mix, necessitating a recalculation. There is no guarantee nor any reason to believe that this will ever happen again. Brazil is simply speculating on the likelihood that updating could occur. What could happen in some cases is programme termination, such as that which occurred with the elimination of peanut quotas in the 2002 Act.

66. Brazil further speculates that some farmers could be upset by the new programme because they did not plant as much as they could have over 1998-2001 and that such farmers will now plant more than they would otherwise have. Brazil's speculation is devoid of any facts. In fact, the United States has pointed to planting data (for example, that submitted on December 18 and 19, 2003) that

[41] Exhibit US-23.

demonstrates just the opposite – that is, cotton plantings are declining. Further, Brazil's own scenario suggests that there was no such understood policy of base building – otherwise, why would any farmer be surprised? Farmers will always speculate on the shape of the future, but these speculations (for which Brazil has presented no evidence) cannot drive determinations of consistency or inconsistency of measures with WTO obligations.

67. Finally, to the extent that Members would wish to limit the ability of Members to choose a new "defined and fixed base period" for purposes of paragraph 6(a) of Annex 2 to the Agreement on Agriculture, they may do so as a result of the current Doha negotiations. However, no such limitation currently appears in the text, and Brazil is acting in contravention of Article 3.2 of the DSU in seeking to have a panel "add to or diminish" the rights and obligations of Members through dispute settlement. The United States would also note that Brazil's response to this question appears to assume that Members will not accept the US proposal for significant reductions in domestic support under the Doha negotiations. The overall AMS reduction commitment would be relevant for the amount of support, including base acres, that a Member would provide.

## D. EXPORT CREDIT GUARANTEES

**220. What will be the relevance of Articles 9 and 10.1 of the Agreement of Agriculture to export credit guarantees when disciplines are internationally agreed? BRA**

68. Brazil's response to this question demonstrates that Brazil continues to ignore the text of Article 10.2 itself. Article 10.2 is clear that once disciplines are internationally agreed, then Members undertake "to provide export credits, export credit guarantees or insurance programmes only in conformity therewith." No "amendment" to Articles 9 or 10 would be needed. Article 10.2 has already specified the obligations once the negotiations are completed. In this sense, Article 10.2 goes further than, for example, Articles XIII:2 and XV:1 of the GATS, which also call for negotiations to develop additional disciplines but do not on their face already commit Members to abide by the results of those negotiations.

69. Brazil mischaracterizes the views of the United States with respect to the role of the OECD and the interpretation of Article 10.2 of the *Agreement on Agriculture.* Brazil stated that "some participants [in the Uruguay Round negotiations] may have been seeking additional obligations regarding notification, consultation and information exchange, like those included in the OECD Arrangement on Officially Supported Export Credits for industrial products".[42] Brazil alluded to no other potential disciplines available under the OECD Arrangement. In its Closing Statement of 3 December 2003, the United States responded that Brazil minimizes the significance of Article 10.2 as reflecting:

> merely a banal compromise to accommodate potential 'additional obligations regarding notification, consultation, and information exchange.' Brazil implausibly asserts that the obvious transition between the language of the Draft Final Act that would have imposed significant substantive disciplines on export credit guarantees and the absence of such language in the Article 10.2 ultimately adopted can be fully explained as reflecting merely an agreement to work on such pedestrian disciplines as information exchange".[43]

70. Brazil, however, mischaracterizes the US statement as a dismissal of other disciplines that Brazil itself never mentioned: "permitted exceptions, matching of derogations, non-conforming non-notified items, and terms granted by countries that are not parties to the OECD Arrangement."[44]

[42] Opening Statement of Brazil, 2 December 2003, para. 74
[43] Closing Statement of the United States, 3 December 2003, para. 3.
[44] Answers of Brazil (22 December 2003), Question 220, para. 54.

71. Ironically, the United States – not Brazil – has emphasized the significance of the OECD in the interpretation of Article 10.2. During the Uruguay Round, WTO Members did not agree on disciplines to be applicable to export credit guarantee programmes and therefore opted "to work toward the development of internationally agreed disciplines," as contemplated by the text of Article 10.2, in the appropriate forum of the OECD to achieve such disciplines. As the United States has pointed out, the OECD was the logical forum for such negotiations because of the institutional experience of that organization in the development of disciplines on officially supported export credits in the industrial sector.[45] Six years of negotiations continued there until 2001.

**221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be $230,127,023 instead of the figure which originally appeared ($381,345,059).**

> **(c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of $4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately $4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result**.

72. Brazil quotes selective excerpts of 1998 testimony of then- General Sales Manager Christopher Goldthwait but misconstrues them to draw the absurd proposition that export credit premia cover only administrative expenses of the programme. These excerpts on their face not only do not say what Brazil claims - they contradict Brazil's claim. Both Brazil and the United States have noted that administrative expenses of the programme are between $3 and 4 million per year.[46] Premia collected, of course, consistently far exceed that amount.[47]

73. Moreover, Mr. Goldthwait's testimony does not state that premia cover *only* administrative expenses (even in the excerpt quoted by Brazil he twice says that the money collected is "more" than the amount of administrative expenses), and the actual figures for premia reveal the inaccuracy of Brazil's claim.

74. The testimony in Exhibit Bra-87 in fact supports the argument of the United States that it exercises considerable discretion in the administration of the programme and that contrary to Brazil's repeated mischaracterizations, CCC can "stem[], or otherwise control, the flow of" CCC export credit guarantees.[48]

75. Then Undersecretary August Schumacher stated:

> "On GSM we are continually revising the changing creditworthiness of these overseas buyers. We are extremely prudent in the use. We follow this very, very

[45] US First Written Submission (11 July 2003), paras. 155-160
[46] See, e.g., Oral Statement of Brazil (22 July 2003), para. 132.
[47] Exhibit US-128.
[48] The most recent invocation of Brazil's misapplied mantra appears in Brazil's Answer to Additional Question 257(c) (20 January 2004), para. 38

carefully. Without the [International Monetary Fund], we would be very reluctant to operate and allocate these GSM programmes as required by the Agricultural Trade Act of 1978.

"Actual credit packages are subject to interagency review. Overall, we will continue to achieve balance between our twin objectives of promoting US agricultural exports and operating Federal programmes such as the GSM with fiduciary responsibility to the taxpayers and to you in Congress."[49]

76. Further testimony not quoted by Brazil included the following:

Congressman Minge:

"I would like to ask if you could explain to us why you feel that this programme is one that will not expose the American taxpayer or the US Treasury to a loss, particularly if private sector lenders are competing with the Federal Government for repayment of their loans and these countries in Southeast Asia find their financial condition further deteriorates? Is this a risk that we are creating for the US Treasurer, or is this something you feel we are adequately protected on?"

Mr. Goldthwait:

"We developed our programme allocations by beginning with a country risk analysis. It is very much the same sort of analysis that a private bank will do in setting its . . . confirmation line for transactions with a particular foreign country.

"We . . . evaluate very carefully the financial situation of the country and the banks involved and the letters of credit that we will eventually guarantee in determining exactly how far further we can go and still remain prudent with the taxpayers' money."

Congressman Minge: "So you do not expect any greater exposure to loss here than you have had historically in the operation of the programme?"

Mr. Goldthwait: "We do not".[50]

**223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? USA**

77. Brazil asserts that "premium rates for the three CCC guarantee programmes are not subject to regular review".[51] This is incorrect. As the United States noted in its response to this question, premium rates are reviewed annually. They may or may not increase in any given year as a result of such annual review.

78. To avoid any potential misunderstanding the United States would also point out that the statutory cap on premia of one per cent applies only to GSM-102. Brazil correctly notes this in

[49] Exhibit Bra-87, page 10.
[50] *Id.*, page. 12.
[51] Answers of Brazil to Question 223 of the Panel (22 December 2003), para. 63.

paragraph 66 of its December 22 answers, but paragraph 64 could be interpreted to imply that the cap similarly applies to GSM-103, which it does not.

**227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount - referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? USA**

79. In addition to its own response to this question from the Panel, the United States would reiterate that the $411 million figure is an *estimate* and the "results of the reestimate process".[52] In addition, the $770 million in the 'subsidy allowance' is not an uncollectible amount. It is merely a loan loss *allowance* based on annual re-estimates reflected in the budget. It is obviously not an amount deemed uncollectible, because from 2001 to 2002, as reflected in the very next line of the financial statement, the number itself *declined* from $1.043 billion to $770 million.[53] Similarly, the figure applicable to pre-1992 credit guarantees in the column "allowance for uncollectible accounts" is itself only a prospective *allowance*, which may or may not ultimately correspond to actual uncollectability. As with the subsidy allowance noted above, in this case, too, the allowance declined from 2002 to 2003 by $389 million.[54]

80. Office of Management and Budget Circular A-11 defines "allowance" as follows:

> "Allowance means a lump-sum included in the budget to represent certain transactions that are expected to increase or decrease budget authority, outlays, or receipts but that are not, for various reasons, reflected in the programme details. For example, the budget might include an allowance to show the effect on the budget totals of a proposal that would affect many accounts by relatively small amounts, in order to avoid unnecessary detail in the presentations for the individual accounts. The President doesn't propose that Congress enact an allowance as such, but rather that it modify specific legislative measures as necessary to produce the increases or decreases represented by the allowance."[55]

**228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? BRA, USA**

81. Brazil incorrectly asserts that "US government's own accounting principles lead to a conclusion that premium rates are inadequate to meet the long-term operating costs and losses of the CCC guarantee programmes".[56] To the contrary, under current GAAP for Federal Entities, including the application of such principles related to the Federal Credit Reform Act of 1990, the programme reflects profitability for all of the first five cohorts (1992-1996). In addition, the cohort for 1999 is already showing profitability.[57] Exhibit US-128 also reflects the long-term profitability of the programmes.

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[52] Rebuttal Submission of Brazil (22 August 2003), para. 109; US Further Submission (30 September 2003), fn. 94; See Exhibit Bra-158, Notes to Financial Statement, page 19.

[53] See Exhibit Bra-158, Notes to Financial Statement, p. 14.

[54] See Exhibit US-129, Notes to 2003 Financial Statement, p. 15.

[55] OMB Circular A-11 (2003), Section 20.3, p. 20-2.
http://www.whitehouse.gov/omb/circulars/a11/current_year/s20.pdf

[56] Answers of Brazil to Panel Question 228 (22 December 2003), para. 68.

[57] See Exhibit Bra-182 and US Answers to Panel Question 221(b) (22 December 2003, paras. 83-86.

82. The United States has every reason to believe this trend will continue with respect to more recent cohorts. Contrary to the assertions of Brazil, the United States is not "carefully selecting" or "cherry-picking" years that "did not lose money".[58] For the reasons set forth in US answers to Panel Questions 221(f), (g), (h), and (i)[59], chronologically more recent – not "carefully selected" – years are reflected unnecessarily negatively in the US budget.

## E. SERIOUS PREJUDICE

**229. What is the meaning of the words "may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the SCM Agreement? Please comment on the possibility that these words indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice and that serious prejudice should be considered an additional or overriding criterion to the factors specified in the subparagraphs. BRA**

83. Brazil states that "[t]he phrase 'one or several' must be read according to its ordinary meaning" and reads this phrase to mean "at least one." Brazil then states that it "disagrees with the possibility that the words *one or several* indicate that one of the Article 6.3 paragraphs may not be sufficient to establish serious prejudice".[60] However, Brazil's answer simply neglects to read *all* of "the words" quoted in the Panel's question (drawn from the chapeau of Article 6.3) according to their ordinary meaning: "What is the meaning of the words 'may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the *SCM Agreement*?" Crucially, Brazil simply neglects to read the words "may arise" according to their ordinary meaning.[61] The ordinary meaning of "may" is "have ability or power to; can"[62] and "to express possibility, opportunity, or permission".[63] Therefore, the ordinary meaning of the chapeau to Article 6.3 (that is, including the phrase "may arise" as well as "one or several") would be that there is a "possibility" or "opportunity" for serious prejudice in the sense of Article 5(c) to "arise" where one or more of the effects listed in Article 6.3 is found.[64]

84. Thus, when Brazil "disagrees with the possibility that the words *one or several* indicate that one of the Article 6.3 paragraphs may not be sufficient to establish serious prejudice," Brazil is not reading the chapeau of Article 6.3 according to the ordinary meaning of all of the words in the provision. Such a selective approach fails to read the treaty text according to the customary rules of interpretation of public international law. Indeed, if Article 6.3 had been intended to mean that any one of the subparagraphs would *necessarily* suffice to show serious prejudice, the text would have used obligatory language in favour of a finding of serious prejudice (such as, "serious prejudice . . . shall arise in any case where at least one of the following apply").[65]

85. Brazil's discussion of various provisions of the Antidumping Agreement and Subsidies Agreement that contain language that no one factor can necessarily "give decisive guidance" towards a pertinent finding is inapt. That is, simply because the "may arise" language in the chapeau of Article 6.3 does not necessarily *preclude* a finding of serious prejudice where the effect in only one subparagraph has been demonstrated does not convert the "possibility" or "opportunity" that serious

[58] See, e.g., Answer of Brazil to Panel Question 228 (22 December 2003), para. 73.

[59] US Answers to Panel Questions (22 December 2003), paras. 91-104.

[60] Brazil's Answer to Question 229 from the Panel, paras. 76-77.

[61] *See* Brazil 's Answer to Question 229 from the Panel, paras. 79-80 (setting forth no interpretation of "may arise" according to its ordinary meaning).

[62] *The New Shorter Oxford English Dictionary*, vol. 1, at 1721 (1993 ed.).

[63] *The Random House Dictionary of the English Language, Unabridged Edition* at 886 (1983).

[64] *See* US Answer to Question 149 from the Panel, paras. 71-75.

[65] Indeed, Article 6.1 demonstrates that Members knew how to create a presumption of serious prejudice: they did so by explicitly stating that, in certain cases, "[s]erious prejudice . . . *shall* be deemed to exist" (italics added). Article 6.2, while providing a means to rebut that presumption, does not by its terms establish that serious prejudice "shall be deemed to exist" if one of the effects in Article 6.3 exists.

prejudice arise into an *obligation* to find serious prejudice. Rather, serious prejudice "may arise" or it may not, for example, where a panel concludes that one or more subparagraphs is technically met but the effect is not sufficient to cause serious prejudice.

86. Finally, we note Brazil's new argument that the "may arise" language "is necessary because while the facts may demonstrate that the effects of the subsidies *may* create the one, two, or three enumerated types of serious prejudice, these effects may not be actionable".[66] Brazil' s argument misunderstands the nature of the serious prejudice analysis. As stated above, the plain language of Article 6.3 establishes that demonstrating one or several of the effects of the subparagraphs does not *necessarily* suffice to demonstrate serious prejudice. Thus, it is not the case that "serious prejudice" will arise where one of the effects is demonstrated but an "exemption" (in Brazil's words) in Article 6 applies; rather, the "exemptions" cited by Brazil preclude the very finding of "serious prejudice."

- For example, Brazil argues that the effect in Article 6.3(d) (an increase in world market share) may be demonstrated but may "not be actionable" because multilaterally agreed rules exist within the meaning of footnote 17. But the effect of footnote 17 is to remove certain primary products or commodities subject to such rules from the 6.3(d) analysis altogether.[67] Thus, no finding of "serious prejudice" for such a product would be possible.

- Neither does Article 6.7 support the conclusion that serious prejudice "may arise" but may not be actionable. Rather, that provision establishes that "[d]isplacement or impediment resulting in serious prejudice shall not arise under paragraph 3 where any one of the following circumstances exist"; that is, even where the effect of displacement or impediment is demonstrated under Article 6.3, a finding of serious prejudice is precluded ("shall not arise").

- Finally, Brazil points to Article 6.9 and claims that this provision "exempts serious prejudice that exists even where the requirements of Article 6.3 are fulfilled because the subsidies are exempt from action by virtue of the peace clause." Article 6.9 does not "exempt[] serious prejudice that exists," however. The text reads: "*This Article does not apply* to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture" (emphasis added). Because the entire "Article does not apply," no finding of "serious prejudice" is possible.[68]

87. Finally, we note that Brazil's argument that the "may arise" language is "necessary" because certain circumstances may exist in which a finding of serious prejudice is precluded would suggest that whenever an exception exists to a "shall" obligation, that obligation should be expressed using "may". For example, because there is an exception to the prohibition on export subsidies in Article 3.1 of the Subsidies Agreement, presumably Brazil would consider that the provision should have been written: "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, [may] be prohibited." The use of "may" in place of "shall," however,

[66] Brazil's Answer to Question 229, para. 80.

[67] Footnote 17 to Article 6.3(d) follows the words "the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity" and reads: "Unless other multilaterally agreed specific rules apply to the trade in the product or commodity in question."

[68] Brazil's argument echoes its erroneous interpretation of the "exempt from actions" language of the Peace Clause. Indeed, as the United States has pointed out, Brazil has never explained how it is that the Panel, if it ultimately determines that US measures are "exempt from actions" based on Articles 5 and 6 of the Subsidies Agreement, could nonetheless make findings on those claims without resulting in the DSB making rulings and recommendations with respect to those claims and measures. Given the automaticity in adoption of panel and Appellate Body reports, the only means by which Peace Clause-compliant US measures may be "exempt from actions" is for the Panel to decline to reach Brazil's claims based on those provisions specified in the Peace Clause.

changes the meaning of that provision from mandatory to permissive. Similarly, the use of "may" instead of "shall" in Article 6.3 means that there is a "possibility" or "opportunity" for serious prejudice to arise where one or more of the effects listed in Article 6.3 is found, rather than a certainty or necessity that serious prejudice have arisen.

**232. How, if at all, should the Panel take into account the effects of other factors in its analysis of the effects of US subsidies under Article 6.3? If the Panel should compare the effects of other factors to establish the relative significance of one compared to others, how would this be done? What would be relevant "factors" for this purpose? BRA**

88. Causation is a key issue in this dispute, and Brazil continues to gloss over this issue. The United States is interested to see Brazil argue that an econometric analysis by definition satisfies the causation requirements under the WTO.[69] Brazil's position in this dispute is at odds with its position in other disputes, such as *Steel*. Brazil appears to change its view on the correct approach to causation depending on whether it bears the burden or not. For example, Brazil now argues in its response to this question: "But the record shows that there is no legitimate basis to conclude that "other" supply and demand factors collectively (a) accounted for all of the declines in prices during the period of investigation or (b) meant that prices went as high as they would have even if no US subsidies had been provided." In other words, Brazil appears to claim that it is entitled to a finding in its favour on causation unless someone else (not Brazil) shows that other factors accounted for all the effects, rather than that Brazil must show that it is not attributing to the US measures at issue effects that are due to other factors. This is in error.

89. Brazil must establish that effect of the challenged subsidies was "significant price suppression" or an increase in world market share. Brazil has not established that it has accounted for "the effect of" other factors at play, even though it concedes that "[t]his world market share is the result of several key factors *including US subsidies*, weather effects in many countries, and exchange rate effects" (italics added). How then can Brazil claim that the effect of the subsidies is "significant"? That is, if Brazil itself argues that US subsidies were only one of "several key factors," its analysis must allow the Panel to distinguish the effects of these other factors. Brazil has not even attempted to explain what those effects were, nor did Brazil demonstrate that its economic model accounted for these factors.

90. Brazil did not answer the Panel's question about what relevant factors should be taken into account nor did it respond to the question about how this should be done. Brazil simply claims, through Dr. Sumner 's analysis, that it has taken various other factors into account. Until forced to respond to the US Further Submission of 30 Sept., Brazil had not acknowledged that any factor besides US subsidies had any effect on world cotton markets.

91. In paragraph 82, we find it curious that Brazil refers to the material on other factors presented by the United States[70] as covering "only" weak cotton demand, flat retail consumption, falling world incomes, increasing US textile imports, and China's releasing of stocks. Brazil also errs in referring to these as all "demand-related". For example, China's release of stocks affects the supply of cotton. (The US Further Submission also included an analysis of the effects of the strong US dollar on cotton prices.) These six factors were the "only" ones presented because they, in fact, provide a compelling explanation of the factors driving down world cotton prices at that time and encouraging the shift in US cotton use from domestic processing to export markets.

92. The Panel asks how it should take into account the effect of other factors. In paragraph 85, Brazil argues that *but for* the effect of US subsidies, world cotton prices would have been significantly higher. One could just as easily analyze and claim *but for* the effect of China's releasing 11.6 million

[69] Brazil's approach would certainly simplify the causation discussion in numerous other disputes.
[70] US Further Submission, paras. 22 - 44.

bales of subsidized cotton onto world markets between 1999-2001 world prices would have been significantly higher. In other words, Dr. Sumner can claim his analysis accounts for various factors because he calibrated his model to actual data for the recent past, but Brazil' s analysis has not provided an explanation of the various events and actions at play that would allow the Panel to form a reasoned conclusion that the effects of US subsidies are not in fact the effects of these other factors.

93. Finally, in paragraph 87, Brazil's repeats oft-stated arguments about the presumed revenue-cost gap faced by US cotton producers using total costs of production. Brazil has not replied to US counter arguments that using *total average costs* is misleading and inappropriate. We refer the panel to the US further rebuttal submission, paras. 116-41, and the US answer to Question 211(b). As for Brazil's exchange rate argument, we refer the panel to the US answer to Question 210 above.

**233. In Brazil's view, what is or are the "same market(s)" for the purposes of Article 6.3(c)? Does Brazil's view of "world market" imply that regardless of which domestic (or other) "market" is examined, price suppression will be identifiable? BRA**

94. In this answer, Brazil continues to make serious interpretive errors with respect to Article 6.3(c). In addition, the evidence and arguments made by Brazil with respect to each of the "markets" it identifies do not satisfy the requirements of Article 6.3(c). The United States treats each of these issues in turn.

**Brazil Misinterprets Article 6.3(c) and Fails to Bring Forward Evidence and Arguments to Establish Its Claims**

95. The United States is gratified that in this answer Brazil finally appears to recognize that the "in the same market" language of Article 6.3(c) requires that Brazil make claims with respect to markets in which both Brazilian and US upland cotton are found.[71] This follows from the use of the words "same" and "market." "Market" means "[a] place or group with a demand for a commodity or service".[72] "Same" means "[i]dentical with what has been indicated in the preceding context" and "previously alluded to, just mentioned, aforesaid".[73] In the context of Article 6.3(c), the market that is "[i]dentical with what has been indicated in the preceding context" would be that market in which there is "significant price undercutting by the subsidized product as compared with the price of a like product of another Member" (the phrase immediately preceding the phrase on significant price suppression, depression, or lost sales). Thus, Brazil may only advance claims with respect to those markets in which US upland cotton and Brazilian cotton are both found .

96. Brazil continues to argue that there is a "world market" for upland cotton in which it may demonstrate significant price suppression, depression, or lost sales. However, the text and context of Article 6.3(c) do not support the view that Brazil may assert a generalized "world" price effect. First, the significant price suppression, depression, or lost sales must be "in the same market." As explained above, this "same market" would be the market in which both Brazilian and US cotton are found and there is significant price undercutting. In asserting that a "world" market can be this "same" market, Brazil renders the "same market" phrase inutile since the products of both the complaining and responding parties will always be in the "world." Consider that one of the effects under Article 6.3(c) is "lost sales in the same market." Brazil's interpretation would mean that a complaining party could advance a claim with respect to a lost sale anywhere in the "world," even if the responding party did not export to the market in which the lost sale occurred. Again, such a result would render the "in the same market" language meaningless.

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[71] *See, e.g.*, Brazil's Answer to Question 233 from the Panel, para. 113 ("[T]hese indices are benchmarks for prices *in those 'same markets' where US and Brazilian cotton were exported* . . . .") (emphasis added).

[72] *The New Shorter Oxford English Dictionary*, vol. 1, at 1699 (1993 ed.).

[73] *The New Shorter Oxford English Dictionary*, vol. 2, at 2678 (1993 ed.).

97. Brazil's interpretation also does not make sense of important context for Article 6.3(c). Article 6.6 states that "[e]ach Member *in the market of which* serious prejudice is alleged to have arisen shall . . . make available . . . all relevant information . . . as to the changes in market shares of the parties to the dispute as well as concerning *prices of the products involved*" (emphasis added). If the "world" could be a "market" for purposes of Article 6.3, which WTO Members should provide market data? Read literally, Article 6.6 would seemingly oblige *every* WTO Member to provide data on market share and prices since every Member would be a "Member in the market of which serious prejudice is alleged to have arisen." Annex V similarly suggests that the "same market" must be an actual market, be it that of the subsidizing Member or a third-country. For example, where Article 7.4 has been invoked "any third-country Member concerned" – for example, any Member in whose market significant price suppression is alleged to have occurred – "shall notify to the DSB" the organization responsible for responding to information requests and the procedures to be used to comply.[74] Furthermore, the information gathered during the information-gathering process "should include, *inter alia*, data concerning the amount of the subsidy in question (and, where appropriate, the value of total sales of the subsidized firms), *prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers to the market*, changes in the supply of the subsidized product *to the market in question* and changes in market shares".[75] Again, these provisions suggest (as does Article 6.6) that Article 6.3(c) is directed at particular markets where competition exists between Brazilian and US upland cotton.

98. Because Brazil must demonstrate price suppression by US imports of Brazilian imports in the same market, Brazil must bring forward evidence and arguments on import volumes and prices. In numerous instances, Brazil has simply failed to present prices for Brazilian cotton and US cotton in an identified market, much less import volumes relating to the parties or other suppliers. This failure to present, *inter alia*, prices for each market sufficient to demonstrate price suppression is fatal to Brazil's claim with respect to each such market. The necessity of presenting price information for each market is suggested by the fact that each "same market" in which significant price suppression is alleged to occur is a market in which there is significant price undercutting. Article 6.6 refers to each Member "in the market of which serious prejudice is alleged to have arisen" providing the "prices of the products involved," also suggesting that prices for both Brazilian and US cotton must be examined. Further, Annex V, paragraph 5, states that a panel should examine "prices of the subsidized product, prices of the non-subsidized product, [and] prices of other suppliers *to the market*."

**There is No "World Market Price" for Upland Cotton that Can Be Significantly Suppressed**

99. The preceding legal interpretation that the "same market" means a particular market in which competition between Brazilian and US cotton imports occurs is confirmed when one considers that nature of the "world price" that Brazil claims is significantly suppressed. This "world market price" turns out not to be a price at all but several "benchmarks" or indicia of prices. As Brazil states: "The record establishes that there is a "world market" for upland cotton and that the prices for that market are *reflected* in the *New York futures prices* and in the *A-index prices"*.[76] That is, this alleged "market" does *not* have or set any price for US and Brazilian upland cotton; rather, this "price" is "reflected" in not one, but two price indices, the NY futures price and A-index price.

100. Brazil must argue that the "world market price" is "reflected" in the NY futures and A-index because *neither* of these relates to an abstract "world market."

[74] Subsidies Agreement, Annex V, para. 1.
[75] Subsidies Agreement, Annex V, para. 5.
[76] Brazil's Answer to Question 233 from the Panel, para. 91.

- Rather, the NY futures price relates to a New York-based exchange trading in contracts for future delivery with various physical delivery points in the United States: Galveston, Houston, New Orleans, Memphis, or Greenville/Spartenburg (South Carolina).[77]

Indeed, Brazil concedes that "[w]hile the New York futures prices play a major role in *influencing markets*, the short term volatility of the futures market makes comparison with monthly or annual export prices more difficult".[78]

- The A-index "price" reflects delivery to Northern Europe of upland cotton with certain quality specifications (Middling,1-1/32 inch staple length). Further, the A-index is not a "price" but an average of the five lowest *price quotes* obtained by Cotlook, a private organization based in London, from various merchants of 15 cotton growths.

101. Thus, the A-index reflects price offers but does not reflect actual prices in Northern Europe of either Brazilian or US (or any other) upland cotton. The A-index relates to the Northern European market, not to the "world" market. In fact, the A-index, with its disparate price quotes from around the world, demonstrates that prices differ around the world, not that there is a uniform, harmonious "world" market price. The fact that Brazil points to *two* disparate price indices, which deviate significantly.[79] also demonstrates that there is not a "world market price" for upland cotton. Thus, neither the NY futures price nor the A-index are a "world market price" for upland cotton.

**Brazil Cannot Demonstrate Significant Price Suppression in the United States Because There Were No Brazilian Imports**

102. Brazil also identifies the US market as a "same market." However, Brazil does not advance any arguments nor evidence establishing that there were *any* Brazilian imports into the United States in marketing years 1999-2002. In fact, our information is that there have not been any imports of Brazilian cotton to the United States since marketing year 1996.[80] Neither (and perhaps for that reason) does Brazil present any arguments or evidence on Brazilian cotton prices in the United States. Thus, Brazil has failed to establish that the United States is a "same market" for purposes of Article 6.3(c).

**Brazil's Effort to Expand the Scope of Its Claims and Arguments to 40 Third-Country Markets is Untimely**

103. Brazil belatedly attempts to argue that it is alleging "significant price suppression" in 40 third-country markets; for only seven of these had Brazil previously even attempted to make argument. Brazil has not attempted to justify presenting this new affirmative evidence at this late stage in the proceeding, contrary to the Panel's working procedures. To do so prejudices the United States, which has necessarily participated in this dispute on the basis of the claims and arguments Brazil has previously set out, and would circumvent the notification obligations of the complaining party. For example, we note that in its request to the DSB to initiate the Annex V information-gathering process, which the DSB was not able to agree to in light of the Peace Clause issue, Brazil did not notify these 40 WTO Members that they were markets in which serious prejudice was alleged to have occurred. By not naming these markets at the outset of the dispute, but seeking to

[77] *See* www.nybot.com (search No. 2 Cotton Futures Contract Specifications).

[78] Brazil's Answer to Question 233 from the Panel, para. 93 (italics added).

[79] *See* Brazil 's Answer to Question 233 from the Panel, para. 93 ("[P]rice oscillations of the A and B-index are much less pronounced than the futures market, but in the longer term they accompany the signs and trends coming from the futures market.").

[80] *See* US Department of Agriculture trade statistics at www.fas.usda.gov/ustrade (search on Imports/HS-4 for Brazil).

name them now, Brazil would preclude these Members from fulfilling their notification obligations under paragraph 1 of Annex V.

104. We also note that none of these 40 markets are listed in Brazil's request for rulings and recommendations from the Panel. That request, in pertinent part, reads: "The US subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interest of Brazil *by suppressing upland cotton prices in the US, world and Brazilian markets* for upland cotton in violation of Articles 5(c) and 6.3(c) of the SCM Agreement".[81] The United States is entitled to rely on Brazil's representations with respect to the scope of its claims and arguments.

105. Even in the markets that Brazil has raised in a timely manner, there are other suppliers into that market, and Brazil has failed to explain why any price suppression should be attributed to US sales rather than to sales from other countries. One cannot presume that US sales are the only factor that could cause any price suppression. Thus, with respect to these markets, Brazil has failed to establish a *prima facie* case on its claims.

**Brazil Incorrectly Argues that Significant Price Suppression in All Markets Can Be Shown Through Suppression of "World Market Prices"**

106. The foregoing considerations are dispositive of Brazil's claims with respect to significant price suppression in the same market. In this portion of its comment, the United States further examines the evidence and arguments Brazil has brought forward and points out that they do not establish the elements necessary to demonstrate a claim under Article 6.3(c).

107. Brazil argues that the US suppression of "world market prices" is transmitted to all markets as evidenced by the fact that price movements in individual markets are similar to the general trends of the A-index. Brazil alleges that the proof of the US suppression of the A-index is the results of Dr. Sumner's analysis and studies by USDA economists. The United States has already explained in great detail to the Panel the conceptual flaws of Dr. Sumner's analysis and will not repeat those here. Additionally, the USDA studies provided by Brazil to the Panel did not address impacts on the A-index or futures prices, but the impact of US programmes on US prices. While interesting academic exercises, moreover, those studies do not analyze the question before the Panel.[82]

108. As a factual matter, the United States has provided evidence that disproves Brazil's allegation that the United States suppresses the A-index. Exhibit US-46 demonstrates that the low US quote (either Memphis or California) for the A-Index has rarely been one of the 5 low bids. If both US quotes are always above (but for one month) the 5 lowest quotes used in the A-Index, the United States cannot be suppressing the A-Index. Nevertheless, even if one were to follow the Brazilian approach, the data provided by Brazil does not provide evidence of price suppression by the United States.

109. As set out above, a generalized claim of price suppression is not contemplated by Article 6.3(c), which requires price suppression "in the same market" – that is, that market in which there is "significant price undercutting by the subsidized product as compared to the price of a like product of another Member." Thus, we proceed here to examine Brazil 's evidence with respect to those "same markets" identified in its answer.

**Comparison based on Export Unit Values**

110. Brazil begins its analysis by comparing US and Brazilian export unit values in various markets to the A-index. It should be noted that the proper analysis would be US and Brazilian market

[81] Brazil's Further Submission, para. 471(i).
[82] *See* US Answer to Question 212 from the Panel, paras. 48-55.

*prices* in the market in question. The export price does not represent the final selling price in the market in question. Given the short time the United States had to review all of this new data, the discussion here will focus on those countries included in the main text of the Brazilian response. To the extent that Brazil has provided data in its exhibits on various markets that it does not examine or explain, we do not consider that Brazil has advanced arguments with respect to such markets sufficient to carry its burden of establishing a *prima facie* case, and we ask the Panel to so find.

111. The fact that US or Brazil export prices to the seven markets, Argentina, China, India, Indonesia, Philippines, Portugal, and South Korea generally may have had movements similar to the A-Index does not demonstrate price suppression by the United States. In fact, Brazil does not in its main text show comparisons of US and Brazilian export unit values in each market (this is only provided in Exhibit BRA-386), much less other relevant market information, such as import prices from other suppliers or import volumes. This absence of relevant argument alone demonstrates that Brazil has not met its burden of establishing its price suppression claims. However, the United States has updated the Brazilian export unit value graphs to include data through November 2003 in order to set out a cursory analysis of each "same market" for the Panel.[83] On the whole, we find that it is the Brazilian price that undercuts the US price to these markets.

112. Brazil alleges price suppression in the Argentine market due to the United States. The data, however, does not support such a claim. As can be seen in the graph, the United States is an infrequent supplier to the Argentine market. For those time periods when no US imports were found in Argentina, there could be no price suppression by the US subsidized product of the prices of Brazilian cotton "in the same market." Of the 15 periods that both are in the market, the United States' export price was greater than Brazil's export price 8 times, below Brazil 6 times, and the same once.

113. Comparing US and Brazilian export unit values to China does not demonstrate price suppression by the United States. Brazil is not a frequent participant in the China market. For those time periods when no Brazilian imports were found in China, there could be no price suppression by the US subsidized product of the prices of Brazilian cotton "in the same market." From August 1999 to June 2003, Brazil only shipped to China in 13 months. Of these 13 months, Brazil's export unit value was below the US export unit value 8 times, above the US price 4 times, and the same once. Evidence of Brazilian price undercutting the US price is inconsistent with the argument that the United States suppresses Brazilian prices to the China market.

114. India was one of the few markets Brazil discussed in which there were a good number of months in which both parties supplied cotton. Of the 25 months in which both provided cotton, the US price was narrowly below the Brazil price in 12 months, was above Brazil in 12 months, and at the same level in 1 months. The time during which the US price was below the Brazil price was during the period April 2001 to December 2001, in which the high yields of MY2001 influenced. However, during August 2000 to January 2001 period, US unit values were high and were consistently undercut by Brazil by a large margin. This Brazilian undercutting led to a plunge in US unit values. We also note that US unit values appear to increase when Brazilian cotton is not in the market. Brazilian unit values, on the other hand, show very little change; this lack of price movement is not consistent with price suppression since the Brazilian price is unresponsive. As the graph shows, there is no systemic relationship between the US and Brazilian unit values to indicate that the United States is suppressing Brazilian prices to this market.

115. Indonesia also was another country in which both the United States and Brazil were active participants, and each had the low price about an equal number of times. However, the majority of times the US had a lower price occurred during MY2001, a period in which the United States had higher than expected yields which reduced US unit values while Brazil had lower than normal yields,

[83] Exhibit US-134.

driving up the price for Brazilian cotton. In MY2002, Brazil returned to general undercutting of US unit values, failing to follow US price increases in early 2003. There does not seem to be any support for price suppression in this market as the movements between the US and Brazilian export unit values are not the same. For example, during the period October 2000 to January 2001, US export unit values increased, whereas Brazil's export unit values declined. Again in the period December 2001 to June 2002, the wide swings in the Brazil price relative to the steady US movements demonstrate that US prices are not suppressing Brazil's.

116. Philippines is a market in which Brazil had sporadic shipments over the period. For those time periods when no Brazilian imports were found in Philippines, there could be no price suppression by the US subsidized product of the prices of Brazilian cotton "in the same market." There were 19 months in which both parties supplied the Philippines. Part of the difference in price is probably due to the shipment sizes. As Exhibit BRA-383 reports, the quantities shipped are quite different between Brazil and the United States. Smaller shipments typically have higher per unit costs. Many of the months in which Brazil exhibited higher export unit values to the Philippines was during MY 2001, a year in which the US had higher than expected yields, driving down its price while Brazil had lower than expected yields, increasing its price.

117. Brazil and the United States overlapped in the Portuguese market in 27 months, a good number of samples. In all instances except for November 2003, the US unit value was greater than the Brazilian unit value, generally by a large margin. The fact the US unit value was greater than the Brazilian unit value is not consistent with price suppression by the United States. Even if there was a quality difference between the two, the spread between the two should be relatively constant. However, the movements of unit values do differ. When the US had big swings in the late 2000 and late 2001 early 2002, Brazil saw only modest changes in unit values. Since MY2003, US prices first increased and have slightly declined whereas Brazilian prices first declined and have been increasing slightly. The fact that the price movements are not consistent would weaken arguments that the United States is causing or threatens to cause price suppression to Brazil.

118. The final country market discussed directly in Brazil's response was South Korea. As the graph depicts, Brazil only supplied cotton to this market in one month. Since no Brazilian imports were found in South Korea over the complained of period, during those times there could be no price suppression by the US subsidized product of the prices of Brazilian cotton "in the same market."

**Comparing Import Values ("Import Prices") to A-Index**

119. Brazil continues its analysis by comparing average import prices to specific markets with the A-Index. As with the "export prices" these import prices are not the prices at which the product were sold but its value at the border of the importing country. Again a proper analysis would not use border valuation of the product but the actual market prices the product was sold. Also it is not clear how averaging import prices from the different sources would provide evidence that the United States has caused price suppression. In fact the various graphs provided by Brazil put in doubt their theory of world price transmission.

120. The yearly import price data in paragraphs 106-108 is too general to be of any assistance. Looking at the various graphs of monthly individual country import prices against the A-Index (paragraphs 106-107) also shows discrepancies between markets. For example, looking at the graph of Japan's prices against the A-Index, it is notable that their import prices never fell below 48 cents even though the A-Index fell to as low as 38 cents and that the gap between import prices and the A-Index were quite large when prices were falling but minimal when prices were rising. A similar pattern seems to have been present in Ecuador. On the face of it, these graphs would seem to imply that some mechanism was at work to impede the transmission of declining "world market prices." This undermines Brazil' s assertion that price suppression can be shown in all third-country markets through alleged effects on a "world market price." The Hong Kong graph is exactly opposite in these

respects from the Japanese and Ecuador graphs. This could mean that Hong Kong is less protected from world prices, but the great deal of inconsistency both within and between all of these graphs indicates the uncertainty surrounding Brazil's claims that "all these third country markets are heavily influenced by the A-Index and New York futures prices".

**Comparison of Domestic Prices and the A-Index**

121. Brazil then compares for a few countries in which it could get domestic prices, those domestic prices to the A-index. Again their analysis concludes that the A-index influences domestic prices in these markets and therefore, the United States is guilty of price suppression. We have explained that a claim of significant price suppression requires that US and Brazilian cotton be found "in the same market." In addition, there are problems with the connection between the A-Index and domestic prices as presented by Brazil. To demonstrate the problems with Brazil's analysis, the United States will look at the analysis on China.

122. We agree that China's domestic prices have always been significantly above the A-index and tracked it rather well. Indeed we include a full series below including all the data currently available to us. This starts September, 1999 and runs through April 2003 (Southern China prices as reported by East-West Inc. a Beijing agricultural consulting group) . It is consistent with Brazil's data although Brazil's only starts in January 2001. These data reveal that China's domestic prices are not consistent with China's export and import prices.

123. China's export prices, as can be seen in Exhibit US-141, are well below the A-index during most of the time China exported heavily (MY 1999 through the first half of MY 20001, and the last quarter of MY 2001 through the third quarter of MY 2002). Contrary to Brazil's assertion in paragraph 113 that export prices from all suppliers move with the A-Index, more often than not China's export price did not, staying relatively flat during the periods from August 1999 to January 2001 and from February 2002 to July 2003. What is more, as can be seen from the China Prices graph in Exhibit US-141, China's export prices were significantly lower than the Chinese domestic price when China was exporting heavily.

124. The imports are different but still problematic. During those times when China has imported heavily, from the beginning of MY 2002 until the present, prices have tracked A-Index prices fairly well.

125. These data, not presented or explained by Brazil, show that Chinese domestic prices have some connection to the A-index but hardly the "heavily influenced" and "consistent" relationship Brazil asserts. As noted in the US further submission, the Chinese Government during this time had the goal of reducing their massive, undisclosed cotton stocks in a way that would insulate there cotton producers and processors from changes in prices. The aim was to maximize cotton prices received by Chinese farmers while still insuring their cotton textile exports were competitive in world export markets. China sold as much as it could on the world market as long as the A-Index stayed at or above a trigger price around 50 cents a pound – hence the flat export price line until the stock situation was finally resolved in late MY 2002.

**Conclusion**

126. Brazil has not done a proper analysis to support its price suppression claims. To demonstrate significant price suppression that leads to serious prejudice, Brazil must provide evidence showing that US prices in a given market are suppressing Brazilian prices in that market. Brazil has not presented and explained evidence on actual market prices of US and Brazilian cotton in third-country markets. Thus, Brazil has not established a *prima facie* case with respect to its price suppression claims. In fact, the market-by-market data presented above does not support a finding of significant price suppression by US cotton.

**234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"? USA, BRA**

127. Brazil's interpretation that whether price suppression is "significant" can only "be assessed with reference to the quality of the impacts of *whatever* level of price suppression exists on the producers of the like product" raises concerns. Brazil provides the example that even where "large amounts of price suppression" have been demonstrated, this might not be "significant" if the producers of the complaining party "had *de minimis* production, or no exports, and/or that the total value of lost revenue from suppressed prices was minimal".[84] The United States believes that the conditions of the producers of the complaining party would not enter into an analysis of whether a given level of price suppression is "significant." Brazil's interpretation would create, out of one legal standard ("significant price suppression"), different thresholds that would apply to different Members depending on their financial well-being. For example, a Member with a strong position in a given third-country market might not be able to utilize Article 6.3(c) (for significant price undercutting or significant price suppression or depression") simply on the basis that "the total value of lost revenue from suppressed prices was minimal" even if the level of price suppression was large. Conversely, a Member with a nascent exporting industry might not be able to utilize Article 6.3(c) if it "had *de minimis* production, or no exports," despite a desire to increase both production and exports. Neither scenario appears to fit with the text of Article 6.3(c).

128. In addition, Brazil fails to explain how the two different terms in the text of Article 6 ("serious prejudice" and "significant price suppression") result in there being only one and the same test for both terms. This would appear to render one of the terms superfluous, contrary to customary rules of treaty interpretation.

129. Finally, we note Brazil's reference to the impacts on "complaining party producers" of the like product. We take this to mean that, contrary to its earlier position, Brazil has now conceded that "adverse effects" to other Members are irrelevant for Brazil's claims. This follows from the text of the Subsidies Agreement. Under Article 5(c), no Member is to cause "serious prejudice *to the interests of another Member*," and a request for consultations under Article 7.2 "shall include a statement of available evidence with regard to . . . serious prejudice *caused to the interests of the Member requesting consultations*."

**235. Please comment on paragraphs 8, 9 and 10 of the US 2 December oral statement, in particular, why the average Brazilian price is shown as lower than the average US price. BRA**

130. Brazil's answer to Question 235 does not refute the US evidence that Brazilian cotton prices undercut US prices from 1999-2002. Brazil does not go so far as to claim the United States undercut Brazil's prices – except in the Brazilian market, an argument that is based on prices that are not directly comparable, as will be discussed later. Instead Brazil argues that US and Brazilian prices exhibited an "absolute closeness" with Brazil's export prices sometimes higher and sometimes lower than US prices.

131. Except for their own market, Brazil does not provide data or analysis on country markets. Instead they examine aggregate data for forty markets that both the United States and Brazil exported to in MY1999 to MY 2002. As the United States explained in our comments on Question 233, this aggregate approach is not the proper method of analysis for price suppression claims under Article 6.3(c). However, even if we accept the Brazil approach, close analysis of the aggregated data presented in Brazil's response further supports the US claim of Brazilian undercutting by showing

[84] Brazil's Answer to Question 234 from the Panel, para. 114.

that consistently and on average Brazilian [unit values] prices were lower than those of the United States, even though there were periods when factors not related to subsidies led to lower US unit values.

**Average Unit Value Comparison**

132. First, Brazil in the graph following paragraph 121 compares the average unit values of Brazilian and US exports. It is this graph that Brazil uses to support its claim of "absolute closeness" between the two countries ' export prices and the absence of Brazil undercutting, but it simply does not do this. Of the 45 months when both the US and Brazil were exporting, Brazil prices were lower 25 months as opposed to the United States' 20. Further eight of the United States low-price months were in MY 2001, when good weather allowed the United States to realize record yields as opposed to sub-par yields for Brazil. The US yield of 790 kgs./hectare was 6 per cent above the five year average for MY 1999 to 2003.[85] Brazil's 1073/kgs/hectare for MY 2001 was 5 per cent below its 1999-2001 average.[86] Also Brazil planting half a year later than the United States saw a much different price signal as cotton prices dropped sharply and soybean prices, the main alternative crop for both countries, rose slightly from February to August 2001.[87] The United States increased planted area by 6 per cent but Brazil reduced planted area by 12 per cent. US production consequently rose 18 per cent to 20.3 million bales in MY 2001, whereas Brazil's dropped to 18 per cent to 3.5 million bales. This naturally drove US export prices down compared to Brazil's. Brazilian prices followed the US prices down in the last half of MY 2001 and have stayed equal to or below US prices ever since.

133. Setting aside MY1999 and MY 2001 for the moment, two years that are not representative of normal conditions, Brazil prices undercut US prices in 18 of the 24 months for MY 2000 and MY 2002.[88] This is consistent with Brazilian production changes in the two years. In MY 2000 Brazil production increased 34 per cent while US barely 1 per cent from the year earlier. In MY 2002, Brazil production fell 2 per cent while US production fell 15 per cent.[89] So, even using Brazil's own methods we can see that Brazil undercut the United States in 2 of the 3 relevant marketing years and in that third year lower US prices are clearly related to yield and normal market price signals

134. The same conclusions are apparent when looking at the graph following paragraph 118 where Brazil looks at the aggregated weighted average of the 8 countries originally analyzed by the United States. Looking at the data available in this graph for MY 1999-2002, in 16 of 37 months when both countries exported to these countries, the United States price was higher 21 times as opposed to only 16 for Brazil. Six of the 16 periods when Brazil was higher came in MY 2001, consistent with the analysis above, and 6 came in MY 1999 when results were distorted because the volume of total Brazil exports was extremely small.

**Looking at All US and Brazil Exports**

135. To better look at the issue of Brazil's undercutting of US prices, it is appropriate to expand Brazil's analysis. Although Brazil emphasizes the closely interconnected world market, as noted before, their analysis looks only at data from countries to which Brazil and the United States both

[85] Exhibit US-135.
[86] Exhibit US-135.
[87] The relevant futures prices ratio of cotton to soybean for Brazil in August 2001 was the May 2002 cotton and May 2002 soy which was 8.63. The relevant ratio for US farmers in February 2001 was the Dec 2001 cotton to Nov 2001 soybean which was 12.55. (New York Board of Trade and Chicago Board of Trade).
[88] In MY 1999, Brazil only exported 12,000 bales of cotton compared to an average of 438,000 bales in MY 2000, MY 2001, and MY 2002. (See Exhibit US-135) As discussed in the preceding paragraph, MY 2001 was a year of atypical yields for both Brazil and the United States.
[89] Exhibit US-135 (Production data )

exported. The graph below looks at unit values for the entirety of US and Brazilian exports during this period, which Brazil would argue is appropriate if in fact there is a "world price" that is transmitted with little interference to all cotton markets. The graph presents data obtained directly from the Foreign Agricultural Service/USDA web site[90] and Brazilian customs data provided through the World Trade Atlas, a for-fee service that collects and enters in an easily accessible database official data from Brazil and numerous other countries ( produced by Global Trade Information Service Inc.) showing value, quantity and unit values.[91] It also expands Brazil's data by incorporating data through November 2003.

136. This graph reenforces what was discussed above regarding Brazil's 40-same-markets data. In this case though, Brazil export unit values are lower than the United States in all but one of the 24 months in MY 2000 and MY2002. Although very similar to Brazil's graph, it is even clearer here that Brazil's export prices were consistently and often significantly lower than those of the United States. As the graph depicts, Brazil undercuts the United States during MY 2000, resulting in a decline in US unit values. In MY2001, both continued to decline because of record yields and slack demand. But at the beginning of MY2002, US export values rebound whereas Brazil's remain low, undercutting the US export values. In the start of MY 2003, US prices begin a sharp increase, but Brazilian prices decline slightly before making a slight increase resulting in an increased spread between the United States and Brazil.

**Cumulative Average Values Using all the Data**

137. Going further and looking at the cumulative weighted price as Brazil did in paragraph 120, but again using the entirety of US and Brazilian exports, the average US price for MY 1999-2002 was 47.59 cents per pound for the United States as compared to an average for Brazil of 44.70 (Brazil calculation was almost exactly the same at 44.65). This means the United States average export value during the period was 2.89 cents per pound (6 per cent) higher than that of Brazil. Looking at just the 40 markets, Brazil still found US prices were higher but by only 0.68 cents. This is an important point in itself when addressing the question of Brazil's price undercutting. This means the increased spread between average US and Brazilian prices when looking at all exports – as compared to just the 40 countries identified by Brazil – was due almost entirely to United States exporters being able to charge higher prices in markets where Brazil was not competing. This is clearly consistent with Brazil undercutting.

138. Looking at the cumulative averages for the atypical MY 2001 when there were weather-related reasons for low US prices, Brazil's method showed a cumulative US average export price lower than Brazil's by 5.22 cents (44.05 for Brazil and 38.83 for the United States). Looking at the entirety of exports, the difference was only 3.65 cents (44.14 for Brazil and 40.49 for the United States). In addition, a distortion in Brazil's cumulative analysis magnifies the importance of MY2001. Nearly 45 per cent of Brazil's exports during this 4-year period came in MY 2001.[92] By contrast, the United States only exported 30 per cent of its 4-year total in MY 2001.[93] This means the difference between the unit average values is even further skewed. Looking at the difference in average unit values for years other than MY2001 (that is, in MY1999, MY2000 and MY2002 combined), the average unit value for the United States is 50.83. In Brazil it is 45.15. *US prices are higher by 5.68 per cent or almost 12 per cent.*

[90] Exhibit US-136 (FAS US trade data)
[91] Exhibit US-137 (WTA Brazilian trade data)
[92] Exhibit US-135.
[93] Exhibit US-135.

**Prices in the Brazil Market**

139. It is also misleading for Brazil to claim as they do in paragraph 130 that US cotton imported into Brazil undercuts domestic Brazilian cotton. This claim is based on comparing US FOB export prices to Brazil domestic prices. That is, it ignores Brazil's tariff on cotton imports as well as transportation and other costs incurred shipping cotton to Brazil, which would raise the US price significantly. The Brazilian tariff was 8 per cent in 1999 and 2000, 8.5 per cent in 2001, 10 per cent in 2002 and 9.5 per cent in 2003.[94] In all years except 1999, the difference between Brazil domestic and US export prices fell well short of even covering the tariff. In 1999 the difference of 10.27 per cent only exceeded the tariff by 2.27 per cent. Recent trader price quotes for transportation to Brazil exceed 10 cents a pound, more than offsetting the difference. In sum, Brazil's use of non-comparable prices cannot support a finding of price suppression, much less significant price suppression.

**Price Suppression**

140. Even using Brazil's method of looking at the average unit value of exports, rather than actual third-country domestic prices, strong evidence of Brazilian price undercutting exists – contrary to Brazil's arguments. Brazil's second line of argument is that price undercutting is irrelevant, arguing that it is not a question of undercutting but price suppression and that the global marketplace instantaneously translates subsidy-induced lower prices in the United States into lower prices world-wide. Brazil further contends that "prices in each of those 40 third country markets as well as the Brazilian and US market were already suppressed before any cotton was shipped by US or Brazilian exporters" (paragraph 131).

141. The price mechanism in cotton is relatively sophisticated, but Brazil's explanation is unrealistic. It says essentially that everyone in the market has perfect knowledge of the market and can adjust instantly. If over the period when US subsidies increased, they had a significant suppressing effect on world markets, this would have been manifested in the United States continually lowering prices to take more market share with other suppliers being forced to follow. It is implausible to assume that this would have occurred without some time lag between US and Brazilian prices that would have been evident in monthly export data – and yet, no such dynamic can be seen in the price data.[95]

142. The fact that, other than in MY2001, US prices generally stayed above Brazilian prices indicates that is was not US subsidies, but other factors that drove down prices. The textile market was extremely competitive during this period. China's industry, operating in a tightly controlled market with access to cheap government stocks was pushing down prices. Also a sluggish world economy kept consumption growth in the same 1.5 to 1.75 per cent annual growth range it had been in the previous 4 years despite markedly lower cotton prices. Processors of raw cotton, other than those in China, demanded lower prices from suppliers in order to remain competitive with the Chinese. At the same time, the US textile and apparel industry was faced with increasing textile and apparel imports, domestic raw cotton use fell sharply, and US cotton growers and merchants had to turn to exports. The fact that US stocks grew significantly during this time also indicates that US

[94] Source: Various USDA/FAS Attache Reports (available at: www.fas.usda.gov (search on Attache Reports, Brazil, Cotton, 1999-2003)).

[95] Prices take time to adjust. Suppliers are hesitant to lower prices particularly when they have not seen a reduction in their own costs and cannot be sure the prices will stay lower. They will be willing to allow stocks to build until the need to drop prices is inevitable. Similarly, customers will not immediately switch since changing to a new unfamiliar supplier has costs particularly if the new lower prices do not continue. Additionally, as put forth by Brazil in its response to question 233 (para. 104), even if Brazilian suppliers and their customers had through the global pricing system perfect knowledge of US prices and their future direction, they would still have contractual commitments at higher prices that must be met and thus would delay the transmission of declines in price movements. Brazil, however, in its discussion ignored that this delayed transmission due to contracts also could bound a supplier to a lower price although spot prices are increasing.

suppliers were the price takers and not the price setters in this market.[96] Further, the shift in raw cotton consumption from the United States to other countries (much of which is shipped back to the United States in the form of cotton apparel) explains why US cotton exports increased as the US world market share was unchanged.

143. The point is reinforced by looking at the A-Index and the corresponding quotes for the United States and Brazil. Again one would expect that a US cotton industry with subsidized excess production to dispose of on export markets would have been consistently pricing below the average represented by the A-Index (the 5 lowest price quotes obtained by Cotlook CIF Northern Europe). But this is not the case as can be seen in the graph below of the A-Index and the US Memphis and California / Arizona A-Index quotes.

- At no point during MY1999-2003 to date was the California / Arizona quote below the A-Index.

- Only once during MY1999-2003 to date, September 2002, was the Memphis quote below the A-Index.

144. Consistent with what was discussed before, a tightening of the gap between the A-Index and US quotes is apparent in MY 2001. However, Brazil aside, a number of countries had good weather and significantly increased area in that year so that US prices were still above the average as measured by the A-Index.

145. A parallel analysis can be made by comparing the US and Brazilian A-Index quotes (data from Brazil Exhibit 242). This graph is the same as that used by Brazil in paragraph 128 (although the last 3 data points are not in the exhibit). Again, US price quotes are well above Brazil quotes in marketing years 1999, 2000, 2002, and 2003 to date. In MY 2001 quotes grew closer, and for a few months the Memphis quote fell below the Brazilian.

- At all other times, the evidence demonstrates that Brazilian exporters were offering cotton at prices well below the US A-index quote.

146. Indeed, looking at the graph below comparing the A-Index to the Brazilian A-index quote, there are considerable periods, particularly in MY 2000, when Brazil was consistently quoting below the A-Index. This evidence of low price quotes by Brazilian exporters is consistent with the view that Brazilian price undercutting exerted downward pressure on prices.

**237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? BRA, USA**

147. Although not entirely clear from Brazil's answer, Brazil appears to assert that as long as there is an increase in a Member's world market share over the preceding three-year average, the fact that the Member's world market share remains at approximately the same level could be compatible with a finding of an "increase" following a "consistent trend" within the meaning of Article 6.3(d). We would disagree. A flat world market share over a three-year period followed by a one-year increase would not demonstrate that the last year's "increase follows a consistent trend over a period when subsidies have been granted" (in the words of Article 6.3(d)). A flat "consistent trend" would not suffice since an "increase" could not "follow[] a [flat] consistent trend." In that situation, the "increase" would be deviating from, not following, the flat "consistent trend."

[96] Exhibit US-135.

148. From a statistical standpoint, we would agree with Brazil's comment in paragraph 137 that due to the limited number of observations it is difficult to calculate a trend that is statistically significant. However, the United States strongly disagrees with the analysis presented by Brazil in the graphs accompanying paragraph 139. Note that if the trend line were calculated between 1986 and 2000 or 1996 to 2000, the trend line would be flat or slightly negative. As we have argued in the Second Submission to the Panel, the change in export share is due primarily to the decline in the US textile industry which resulted in almost two-thirds of US cotton being exported in 2002 compared to almost two-thirds milled domestically in 1998.

149. Indeed, if we observe the trend in the US market share as presented in our Second Submission to the Panel and in the Concluding statements to the panel of 8 October, the share of the world market for upland cotton supplied by US cotton has been flat over the period from marketing year 1999-2002. And of course Article 6.3(d) is talking about "the effect of the subsidy" which requires that it be the same subsidy at issue for each year of the "consistent trend".

**244. What proportion of the 2000 cottonseed payments benefited producers of upland cotton, given that payments were made to first handlers, who were only obliged to share them with the producer to the extent that the revenue from sale of the cottonseed was shared with the producer? (see 7 CFR §1427.1104(c) in Exhibit US-15). BRA**

150. USDA did not require handlers of cottonseed to report their payments to producer, rather the payments went to first handlers. Handlers were allowed to settle up with their producers as they saw fit. The programme, however, *ipso facto*, did give the producers a basis for possible complaint against handlers who had effectively moved low seed prices back to their producers. If so, the remedy was lay in whatever civil remedies might be available in a particular jurisdiction.

151. It would appear that to the extent that the cost of low cottonseed prices were charged against the producer so as to create a duty for the handler to pass on the payment to the producer, the recovery by the producer would have been simply for higher ginning costs paid by the producer. That is, the producer would have suffered the loss to the extent the ginner charged more for ginning because the return to the ginner from the seed was too low.

152. Payments here are disaster-like in that the cost that was suffered and passed through to producers, to the extent that it was passed through, was after the fact. The season was long over and thus payments could not have induced the planting of the crop. In short, if there was a pass through, it was a wash to reflect higher ginning costs. Those costs were not associated with the marketing of upland cotton, but of cottonseed.

**245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the SCM Agreement? BRA, USA**

153. Brazil and the United States agree that green box subsidies may not be taken into account in considering the effects of non-green box subsidies in an action based on Articles 5 and 6 of the Subsidies Agreement. Article 13(a)(ii) of the Agreement on Agriculture states that green box measures are "exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement." We recall that previously in this dispute Brazil asserted that the phrase "exempt from actions" did not preclude the Panel from considering Brazil's serious prejudice claims but only from imposing remedies.[97] Nonetheless, in its answer, Brazil appears to have read this "exempt from

[97] Brazil's Brief on Preliminary Issue Regarding the "Peace Clause" of the Agreement on Agriculture, para. 2 (5 June 2003) (interpreting "exempt from actions" to mean that "a complaining Member cannot receive authorization from the DSB *to obtain a remedy* against another Member's domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the Agreement on Subsidies and Countervailing Measures . . . or Article XVI of GATT 1994") (emphasis added).

actions" phrase to "*prohibit* . . . the effects of these subsidies being included along with other effects of non-green box subsidies *in assessing Brazil's actionable subsidies claims"*.[98] Thus, Brazil here appears to read this phrase according to its ordinary meaning – that is, "not exposed or subject to" a "legal process or suit" or the "taking of legal steps *to establish a claim* or obtain a remedy".[99] This is the definition that the United States has advanced in this dispute, and the Panel should consider Brazil's answer to this question an endorsement of that definition.

**246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the SCM Agreement? BRA, USA**

154. Brazil errs when it claims in its response to this question that "the Panel is required to take into account all non-green box subsidies, including prohibited subsidies in assessing Brazil's Article 5 and 6 claims under the SCM Agreement." The Panel has discretion in assessing Brazil's claims. The United States would note, for example, that Article 6.3(c) and (d) each refer to the "effect of the subsidy," which clearly permits the Panel to examine the effect of each subsidy individually.

**247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? BRA, USA**

155. The United States does not disagree that facts arising after the date of panel establishment may be taken into account, for example, in analyzing Brazil's threat of serious prejudice claim. As we have explained, as market prices have recovered strongly over marketing year 2003 (continuing their upwards trend since the trough reached in marketing year 2001), Brazil has jettisoned its proposed legal standard that the Panel examine whether there is a clearly foreseen and imminent likelihood of future serious prejudice. One could speculate that it has done so because the facts are no longer favourable – that is, high cotton prices will result in significantly lower budgetary outlays for two price-based measures (marketing loan payments and counter-cyclical payments) in marketing year 2003 than seen in previous years.

156. Brazil describes the task for the Panel "in an Article 5 and 6 claim" is to "assess[] whether present or threatened effects presently exist".[100] We would agree but note that Brazil has provided no basis to conclude that past subsidies, such as payments made for the 1999-2001 marketing years, that were fully expensed in past years could have "present . . . effects [that] presently exist." To the contrary, to the extent that these subsidies are *not* allocated to future production – and the Panel will recall that Brazil itself has both expensed these payments for purposes of its Peace Clause calculation as well as recognized that these recurring subsidies payments would be expensed for countervailing duty purposes – no lingering effects can exist because the subsidies themselves are deemed to have been used up. Thus, the question before the Panel is whether present subsidies – that is, those made for marketing year 2002 through the date of panel establishment – were causing certain adverse effects to presently exist and whether the US laws and regulations in existence as of the date of establishment of the Panel threaten serious prejudice. Any payments not in existence as of the date of establishment are not measures within the Panel' s terms of reference.[101]

157. We also note that Brazil cites two reports in support of its arguments: *Argentina Footwear* and *Argentina Peaches*. Those citations are misplaced for several reasons. First, Brazil entirely ignores that both reports interpreted the *Agreement on Safeguards*, not the Subsidies Agreement, and

[98] Brazil's Answer to Question 245 from the Panel, para. 145.

[99] *See, e.g.*, Comments of the United States of America on the Comments by Brazil and the Third Parties on the Question Posed by the Panel, paras. 8-10 (June 13, 2003).

[100] Brazil's Answer to Question 247 from the Panel, para. 150.

[101] We recall once again that Brazil now admits that the matter before the Panel cannot change after establishment. Answer to Panel Question 247.

that the two agreements have different texts. Brazil compounds the problem by failing to mention that the paragraphs it quotes in both reports dealt not with the issue of threat of injury, but with the issue of whether imports had "increased" (within the meaning of the Safeguards Agreement). Finally, while Brazil does acknowledge the existence of the Appellate Body report in *US Lamb*, it fails to point out that, in the context of a discussion of threat of serious injury under the Safeguards Agreement, in that report the Appellate Body made a finding that undercuts Brazil's position dramatically:

> Like the Panel, we note that the *Agreement on Safeguards* provides no particular methodology to be followed in making determinations of serious injury or threat thereof. However, whatever methodology is chosen, we believe that data relating to the most recent past will provide competent authorities with an essential, and, usually, the most reliable, basis for a determination of a threat of serious injury. The likely state of the domestic industry in the very near future can best be gauged from data from the most recent past. Thus, we agree with the Panel that, in principle, within the period of investigation as a whole, evidence from the most recent past will provide the strongest indication of the likely future state of the domestic industry.[102]

158. The strong recovery in market prices and futures prices demonstrate that there is no clearly foreseen and imminent likelihood of future serious prejudice. As we have previously seen with respect to the December 2004 future contract, price recovery has been sustained and steady; the contract average monthly close was 61.34 cents per pound in December 2002, and the current (as of 22 January 2004) monthly average close is 68.78 cents per pound. As a result of higher prices, US outlays are markedly down, with no marketing loan payments being made. In addition, the expectation of continuing high prices embodied in current future price suggests that no further marketing loan payments will be made this marketing year and that counter-cyclical payments will be dramatically lower.

159. In assessing the credibility of Brazil's argument that the baseline projections of FAPRI are more probative than futures prices, the Panel should recall the "testimony" of Brazil's own economic expert, Mr. MacDonald. Brazil has presented no evidence or analysis to suggest that FAPRI's baselines are more accurate price projections than what the NY futures indicates; in fact, the United States has put before the Panel evidence showing that FAPRI's baseline projections have been far off the mark.

160. For corroboration, the Panel need only consider the marketing year 2003-2008 baseline projections made by FAPRI in November 2002, January 2003, and November 2003. The price outlook for cotton has improved considerably since publication of the November 2002 FAPRI baseline used by Dr. Sumner in his Annex I estimate of the effects of US subsidies on US cotton production.

- The table below shows that FAPRI's projections for the MY2003 Adjusted World Price (used for calculating the marketing loan payments) are as much as *20 cents per pound, or 54 per cent, higher* in the November 2003 baseline as under the November 2002 baseline.

- Even so, FAPRI's November 2003 projected Adjusted World Price is still almost 6 cents per pound lower than the current Adjusted World Price.[103]

161. As a result of these revisions, FAPRI's estimated marketing loan gains (the difference between the marketing loan rate and the estimated Adjusted World Price) are reduced considerably.

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[102] Appellate Body Report, *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, WT/DS177/AB/R, WT/DS178/AB/R, adopted 16 May 2001, para. 137 (footnote omitted).

[103] The Adjusted World Price for January 23-29, 2004, is 63.25 cents per pound.

- Under the November 2003 baseline, the estimated marketing loan gain for 2003/04 is *zero*, compared to *almost 15 cents per pound* under the November 2002 baseline used by Dr. Sumner.

- Over the five-year period 2003/04 to 2007/08, the average marketing loan gain under the November 2003 baseline is estimated to be only *1.32 cents per pound*. This is compared to *10.39 cents per pound* using the November 2002 baseline used by Dr. Sumner.

**FAPRI's Revised Price and Marketing Loan Gain Baseline Projections**

| Year | Adjusted World Price (cents/lb) | | | Est. marketing loan gain 1/ (cents/lb) | | |
|---|---|---|---|---|---|---|
| | Nov 2002 | Jan 2003 | Nov 2003 2/ | Nov 2002 | Jan 2003 | Nov 2003 2/ |
| 2003/04 | 37.22 | 44.8 | 57.36 | 14.78 | 7.2 | 0 |
| 2004/05 | 39.83 | 45.4 | 50.96 | 12.17 | 6.6 | 1.04 |
| 2005/06 | 41.94 | 46 | 50.82 | 10.06 | 6 | 1.18 |
| 2006/07 | 43.6 | 46.7 | 50.35 | 8.4 | 5.3 | 1.65 |
| 2007/08 | 45.48 | 48 | 49.24 | 6.52 | 4 | 2.76 |
| Average | 41.61 | 46.18 | 51.75 | 10.39 | 5.82 | 1.32 |

1/ The estimated marketing loan gain is the difference, if positive, between the loan rate (52 cents per lb) and the Adjusted World Price.

2/ Source: FAPRI Baseline, November 2003 (Exhibit US-132)

162. We also note the New York Cotton Exchange closing prices for 23 January 2004, showed the March 2004 contract at 75.94 cents, the May 2004 contract at 77.02 cents, and the July 2004 contract at 77.90 cents. Based on these futures prices, the latest (although preliminary) FAPRI baseline still appears to have projected near-term future cotton prices too low.

163. The marketing loan programme contributes to over 42 per cent of the estimated effects of removing subsidies on production under the model developed by Dr. Sumner.[104] As the November 2002 baseline projected significant marketing loan payments through 2008 whereas the November 2003 baseline projects no or minimal marketing loan payments, updating Dr. Sumner's model to the November 2003 baseline would significantly reduce the overall estimated effect of US payments on production. Any remaining effects would largely be those incorrectly attributed to decoupled income support payments under Dr. Sumner's flawed model.

164. Finally, in paragraph 154 of its answer, Brazil again tries to muddy the waters by referencing the wholly arbitrary "expected adjusted world price first mentioned in its opening statement at the second substantive meeting of the Panel with the parties. There, Brazil attempted to provide an alternative to the US futures analysis. Brazil's alternative was that farmers look to an "expected adjusted world price" when making planting decisions since the marketing loan programme benefits are ultimately determined by the Adjusted World Price. Whereas the United States has provided references to numerous sources that demonstrate farmers look to the futures prices in making planting decisions.[105] Brazil has not provided any evidence to support its assertion that farmers look to an "expected adjusted world price" in making planting decisions.

[104] *See* Brazil's Further Submission, Annex I, table 1.4.
[105] *See* US Answers to Questions 200 and 201.

165. Without any sources to back up its assertion, Brazil implied that farmers could readily calculate an "expected adjusted world price" in making planting decisions.[106] According to Brazil, a farmer at planting time for MY 1999 would take the December 1999 futures price and subtract 18.5 cents to get the "expected adjusted world price" (which would then be compared to the marketing loan rate). Why 18.5 cents? For each of MY 1996-MY2002, Brazil calculated the difference between the December futures price and the average adjusted world price for that marketing year. Brazil then calculated the average of the differences for these 7 years as 18.5 cents.

166. As with Brazil's lagged price calculation, however, this formula has never been, nor could it ever be, applied by a farmer in real-life. First, calculating the "average adjusted world price" for a given year – say, MY 1999 – requires knowledge of the adjusted world prices that actually result in that year. Thus, a farmer making a planting decision for MY 1999 (that is, in January-March 1999) has no way of calculating the "average adjusted world price" for marketing year 1999 (1 August 1999 – 31 July 2000). Moreover, the same farmer making a planting decision for MY 1999 could not possibly know the December futures prices for MY2000 - MY2002; nor could that farmer know the "average adjusted world price" for MY2000 - MY2002. Thus, that farmer could not have calculated the 18.5 cents per pound average for the "average adjusted world price," nor could he have calculated the "expected adjusted world price"[107] as set out by Brazil.[108] Thus, Brazil's critique of the US futures price approach to planting decisions is not only incorrect but grossly misleading.

167. Brazil's assertions relating to "lagged prices," "average adjusted world prices," and "expected adjusted world prices" are utterly irrelevant to an analysis of the effect of the marketing loan programme because they are simply not knowable by the farmer at the time of planting. In fact, the *only* parts of Brazil's spurious methodology that are objectively knowable at the time of planting – and undisputed facts on the record of this dispute – are (1) the December futures price at the time of planting and (2) the marketing loan rate. These are precisely the elements that make up the US analysis of the effect of the marketing loan programme.

**249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":**

> **(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer? How, if at all, would this be relevant for an analysis of the issue of export contingency under the Agreement on Agriculture or the SCM Agreement? BRA**

168. In response to Brazil's statement that Step 2 "payments are conditional upon proof of export,"[109] the United States would simply remind the Panel that such payments are made to users of upland cotton upon demonstration of the use of cotton. Such use can be manifest either by opening the bale of cotton or by export. The programme is indifferent to whether recipients of the benefit of this subsidy are exporters or parties that open bales for the manufacture of raw cotton into cotton products. Indeed, to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the payment upon submission of the requisite documentation. This subsidy is therefore not contingent on export performance and is not an export subsidy.[110] The situation here is analogous to that in the Ad Note to Article III of the GATT 1994 which makes clear

[106] The methodology is set out in Brazil's opening statement at the second panel meeting and in Exhibits BRA-356 and BRA-357.

[107] December futures - 7-year average of "average adjusted world price".

[108] *See* Brazil's Opening Statement at the Second Panel Meeting, paras. 44-47; Exhibit BRA-356, -357, -358; Brazil's Answer to Question 247, para. 154.

[109] Answers of Brazil to Question 249(a) (22 December 2003), para. 163.

[110] See, e.g., US First Written Submission (11 July 2003), paras. 127-135.

that just because a measure that covers all products evenly is applied in the case of imports (here exports) at the border, does not change it to a border measure.

169. As was pointed out in the *Opening Statement of the United States of America at the Second Session of the First Meeting of the Panel with the Parties*, Brazil's analysis of Step 2 payments exaggerates the effect of Step 2 payments on world prices. Because demand for cotton is more price responsive than supply, the incidence of processor subsidies like Step 2 accrue to supply rather than demand. That is, producers gain through higher prices paid to producers while world prices are relatively unaffected. This is consistent with a previous analysis of Step 2 by FAPRI in 1999 (Exhibit US-61). In that study, FAPRI estimated an average Step 2 payment of 5.3 cents per pound. (By way of contrast, the Step 2 payment rate in effect for January 23 - 29, 2004, is 1.62 cents per pound.) These payments resulted in an increase of the spot price of US cotton by 4 cents and a fall in the world cotton price of less than 0.5 cents.

170. While it is true as Brazil points out that the margin of difference that is required between the relevant delivered US price and the A index has been adjusted slightly by the 2002 farm bill, the Brazil answer shortchanges several aspects of the continued limitations on Step 2 payments. The statute continues to allow payments only when the delivered US price in Northern Europe is higher than the going local Northern European price, and only when that difference has existed for four weeks straight, and only when the prevailing local Northern European price (adjusted for price and location) is not more than 134 per cent of the US loan rate of 52 cents per pound. That figure, 134 per cent of the loan rate, would be about 69.6 cents, and the current adjustment for location and quality is about 13 cents per pound. This means that where the prevailing local N.E. price was more than about 82 cents, there would be no Step 2 payments irrespective of the amount of difference in the two prices that are otherwise compared to determine whether Step 2 payments are made. Also missing in the Brazil answer is a reference to reflect that the relief from the additional 1.25 cent differential is temporary as under current law that 1.25 cents will return on 1 August 2006.[111]

## G. REMEDIES

**250. Does Brazil seek relief under Article XVI of GATT 1994 in respect of expired measures? What type of recommendation would the Panel be authorized to make? (Brazil further submission, paragraph 471 (iii)) BRA**

171. In Brazil's answer, it states that it does not seek relief "under . . . Article XVI of GATT 1994" in respect of "the legal instruments consisting of the 1996 US Farm Bill providing, *inter alia*, for production flexibility contract payments, as well as various emergency appropriation Acts in 1998-2001 providing, *inter alia*, for market loss assistance payments." However, Brazil also clarifies that "Brazil's claims under Articles 5(a) and 6(c) of the SCM Agreement do include the adverse effects today and in the future of subsidies *provided* under these expired legal provisions".[112] Brazil's answer points out the difficulty in its approach to actionable subsidies.

172. As Brazil acknowledges, "a panel may *not* make a recommendation to the DSB that a Member bring a measure into conformity with its WTO obligations if that measure no longer exists."

[111] We have sought additional information on whether producers in the capacity of manufacturers or exporters ever receive Step 2 payments. As we indicated, this would only occur with very large producers, if at all. We have examined recent Step 2 payment lists, and they indicate that at the very best any such payments would be highly isolated. Cooperatives would not, in this sense, be considered "producers" since a cooperative does not, as such, have a risk in the crop during the growing season. Step 2 payments are never paid more than once for the same cotton and absent export are only paid in connection with the manufacturing process for breaking open bundles. A producer who simply bundled cotton just to break the bundle would not be eligible for the payment.

[112] Brazil's Answer to Question 250 from the Panel, para. 164 (emphasis added).

Simply put, if a measure does not exist at the time of panel establishment, then that "measure" is not part of the "matter" referred to the panel and cannot be within the panel's terms of reference. Furthermore, there is nothing to be brought into conformity. In this dispute, recurring subsidies "provided" (in Brazil's words) with respect to past years and fully expensed to those years no longer exist once a new marketing year, for which new recurring subsidies are paid, commences. Thus, not only did these measures (subsidies) for past marketing years (1999-2001) not exist at the time Brazil's panel request was filed and the panel established (during marketing year 2002), they do not exist today (half way through marketing year 2003) and cannot be the subject of any recommendation to be brought into conformity.[113]

173. For this reason, Brazil's insistence that its serious prejudice "claims . . . do include the continuing adverse effects today and in the future of subsidies provided under these expired legal provisions" is troubling. Were the Panel to consider that expired subsidies have some continuing effect (and we note that Brazil has never explained how long those effects could be deemed to last nor how they would be distinguished from the present effects of current subsidies), "include" them as part of its analysis of Brazil's serious prejudice claims, and render a finding of present serious prejudice, the Panel could not recommend that these expired measures be brought into conformity. On the other hand, a recommendation that the adverse effects be removed would be of questionable use since those "effects" would have included the effects of expired measures. Thus, Brazil's claims of present serious prejudice should be limited to those measures that currently existed at the time of Brazil's panel request and panel establishment.

**251. In light, inter alia, of Article 7.8 of the SCM Agreement, if the Panel were to find that any subsidies have resulted in adverse effects to the interests of another Member within the meaning of Article 5 of the SCM Agreement, should it make any recommendation other than the one set out in the first sentence of Article 19.1 of the DSU? BRA**

174. The United States disagrees with Brazil's answer. There is no recommendation made "pursuant to Article 7.8 of the SCM Agreement." Rather, there is an obligation under Article 7.8 on a Member granting or maintaining a subsidy inconsistently with Article 5 to "remove the adverse effects or . . . withdraw the subsidy" *after adoption* of the relevant reports "in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member." Article 19.1 of the DSU addresses the entirely separate question of what recommendations should be *in the report.*[114]1 We also note the contrast between Subsidies Agreement Articles 4.7 and 7.8 in that the text of Article 4.7 specifically authorizes the Panel to take an action ("shall recommend that the subsidizing Member withdraw the subsidy without delay") while Article 7.8 does not.

**252. Without prejudice to any findings by the Panel, if the Panel were to find that any of the challenged measures constitute prohibited subsidies within the meaning of Article 3 of the SCM Agreement, what are the considerations that should guide the Panel in making a recommendation under Article 4.7 of the SCM Agreement relating to the time period "within which the measure must be withdrawn"? What should that time period be? BRA**

175. In its answer, Brazil sets forth no considerations that could guide the Panel in making a recommendation under Article 4.7 relating to the relevant period of time, other than to say that the period should be 90 days. The United States understands that different time periods have been set by panels that have made findings of prohibited subsidies given the nature of the measure in question.

[113] This is so for all the reasons we have given earlier in this dispute, as well as for the reason that Brazil gives: the matter before a Panel "cannot" change after establishment. Brazil's Answers to Panel Question 247.

[114] DSU Article 19.1 ("Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, *it shall recommend that the Member concerned bring the measures into conformity with that agreement*.") (emphasis added; footnote omitted).

For example, in several disputes in which it appears that solely administrative action would be necessary to withdraw the measure, it appears that panels have set 90-day periods. In the *United States – FSC* dispute, the panel found that withdrawal of the measure would require legislative action and provided an appropriate period of time. The time for appeal and adoption would also be a relevant consideration. The United States has explained on several occasions the intricacies of the US legislative process and the time needed to enact legislation, including in submissions to arbitrators acting under Article 21.3(c) of the DSU. No such arbitrator has ever concluded that a period as short as 90 days is a reasonable period of time for the United States to complete implementation of the DSB's recommendations and rulings where legislative action is needed.[115]

176. Brazil has challenged Step 2 payments, the export credit guarantee programmes, and FSC benefits to upland cotton as prohibited subsidies. Brazil has also asserted that these measures are "mandatory," such that officials have no discretion to implement the measures in a WTO-consistent fashion. While the United States does not accept Brazil's assertion, the United States would suggest that the 90-day period given with respect to measures requiring only administrative fixes would not be appropriate.

177. With respect to the FSC legislation, should the Panel find this to be inconsistent with US obligations under Article 3.2 of the SCM Agreement, it is not a practical possibility that the United States could withdraw the subsidy within 90 days, given that legislative action would be required. However, the United States notes that there already are bills before both houses of Congress that would repeal the FSC and that have been reported out of their respective committees. In the event of a prohibited subsidy finding, the United States should be given until the end of this year to complete the legislative process and enact this legislation into law.

## H. MISCELLANEOUS

**255. How does Brazil respond to US assertions concerning the circuit-breaker provision? (see US 2 December oral statement, paragraph 82). Does this mean that US subsidies cannot be "mandatory" for the purposes of WTO dispute settlement? BRA**

178. The United States provides comments on the mandatory / discretionary analysis in its comments on Brazil's answer to question 257.

**257. The Panel takes note of the Appellate Body Report in *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan* (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.**

**(a) In that report, the Appellate Body cautioned against the "mechanistic" application of the so-called "mandatory/discretionary distinction" and stated that the import of this distinction may vary from case to case (para. 93). For the Appellate Body, the question of whether a measure is mandatory or not is relevant "if at all" only as part of the assessment of whether the measure is, as such, inconsistent with particular obligations. How, if at all, are these statements and the related findings concerning the mandatory/discretionary distinction in that Appellate Body Report relevant to:**

[115] The Panel may wish to refer, *inter alia*, to the 21.3(c) arbitrations conducted in the dispute *United States – Continued Dumping and Subsidy Offset Act of 2000* (WT/DS217/14, WT/DS234/22, award circulated 13 June 2003), to which Brazil was a party. Other such arbitrations include *United States - Anti-Dumping Measures on Certain Hot-Rolled Steel Products From Japan* and *United States - Antidumping Act of 1916*.

179. Brazil's response to question 257 begins with a general discussion of the Appellate Body report in *United States – Sunset Review*.[116] As reflected in the US answer to the same question, the United States agrees with the view expressed in paragraphs one and two of Brazil's response that the *United States – Sunset Review* report has no significant impact on this dispute and that the Appellate Body in *United States – Sunset Review* in fact undertook an analysis of whether the measure at issue in that dispute was mandatory based on a traditional "mandatory / discretionary" analysis. The language cited in the Panel's question was drawn from a separate section of the *United States – Sunset Review* report addressing the preliminary jurisdictional issue of what is a measure, and that question is not present here.

180. While the United States agrees that the *US–Sunset* report is not relevant to the analysis in this dispute, the United States nevertheless disagrees with Brazil's further characterizations of that report.

181. For example, in paragraph three of Brazil' s answer, Brazil addresses the Appellate Body discussion on the interpretation of a Member's domestic law. In its statement at the 9 January 2004, meeting of the DSB at which the report was adopted (attached as Exhibit US-138), the United States placed the Appellate Body statement which Brazil cites in its proper context, which is that the meaning of a domestic law must be determined based on applicable *domestic* legal principles of interpretation. It is simple error to conclude that a measure mandates behaviour by government officials of a Member if, under the domestic law of that Member, the behaviour is not mandated. Thus, Brazil's speculations in paragraph four of its answer that it is permissible to examine whether "the operation of a measure" creates requirements for government officials to act in a WTO-inconsistent manner is both groundless and meaningless. US officials are required to do what US laws require, and there is no principle of US law indicating that a law's "operation" requires anything.

182. Brazil elaborates on its discussion of the "operation of a measure" with a reference to the Appellate Body's discussion of "normative" requirements. However, the United States notes, as it did in its answer to Question 257(d), that the Appellate Body's discussion of an instrument's "normative" character came in the context of its analysis of whether an instrument can be a measure, and not the separate question of whether a measure mandates a breach of any WTO obligation. It is only this latter question that is before this Panel.

183. Likewise, the Appellate Body statement on protecting future trade which Brazil cites in paragraph five of its answer and analyzes in paragraph six came in the context of the Appellate Body's discussion of why certain instruments should be considered measures, and not in the Appellate Body's separate analysis of whether that measure mandates a WTO breach. Again, it is not disputed that the measures at issue in this case *are* "measures." Thus, as Brazil itself notes, the Panel "need not examine whether the subsidy measures that Brazil has challenged are mandatory as a preliminary jurisdictional matter," but should do so only in the context of determining whether the measures breach US obligations.[117]

**(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the Agreement on Agriculture and Articles 3.1(a) and (b) of the SCM Agreement, concerning: BRA**

**- Step 2 payments (see, e.g. paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and**

[116] Appellate Body Report, *United States – Sunset Review of Anti-Dumping Duties on Corrosion Resistant Carbon Steel Flat Products from Japan*, WT/DS244/AB/R (adopted 9 January 2004) ("*United States – Sunset Review*").

[117] *See* Brazil's Answer to Question 257 from the Panel, para. 2.

184. Brazil has challenged Section 1207(a) of the 2002 Act providing for Step 2 payments as both a prohibited export subsidy under Subsidies Agreement Article 3.1(a) and an import-substitution subsidy under Subsidies Agreement Article 3.1(b).[118] Brazil argues that the statute mandates payments inconsistent with WTO obligations and therefore is *per se* WTO inconsistent.[119]

185. The *United States – Sunset Review* Appellate Body report did not analyze or alter the mandatory/discretionary analysis that has been used in past WTO disputes. Thus, for purposes of Brazil's *per se* challenge to Section 1207(a) of the 2002 Act, the relevant issue is whether that measure mandates a violation of the WTO Agreement.[120] It does not, and therefore Brazil's *per se* claim must fail.

186. The United States has explained that "subject to the availability of funds (that is, the availability of CCC borrowing authority), Step 2 payments must be made to all those who meet the conditions for eligibility."[121] That is, the United States may not arbitrarily deny payment to eligible recipients when the price conditions for payment have been met. However, the absence of discretion given these conditions does not mean the measure mandate a violation of Articles 3.1(a), 3.1(b), and 3.2 of the Subsidies Agreement.

187. Brazil states that "US government officials are not provided with any flexibility under Section 1207(a) of the 2002 FSRI Act" and therefore "the Act violates Articles 3.3 and 8 of the Agreement on Agriculture, and Articles 3.1(a) and 3.1(b) of the SCM Agreement".[122] Whether or not US government officials have flexibility with regard to administration of the Step 2 programme, Step 2 subsidies can violate Articles 3.3 and 8 of the Agreement on Agriculture only if they constitute export subsidies. For the reasons summarized in the US Comment to Brazil Answer to Panel Question 249, Step 2 subsidies are not export subsidies.

188. The Step 2 subsidy payments are included in the Total Aggregate Measurement of Support reported by the United States. The United States has also remained within its domestic support reduction commitments as set forth in Part IV of its Schedule. Pursuant to Article 6.3 of the Agreement on Agriculture and Paragraph 7 of Annex 3 of that Agreement, the United States therefore "shall be considered to be in compliance with its domestic support reduction commitments." Under Article 6.3 a Member may choose to provide "amber box" support in any direct or indirect manner so long as that Member's "Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule." Furthermore, the first words of Article 3 of the SCM Agreement render that article subject to the terms of the Agreement on Agriculture. The terms of Articles 3.1(a) and 3.1(b) of the SCM Agreement apply "except as provided in the Agreement on Agriculture".[123] Therefore, without regard to flexibility in operation of

[118] Brazil's First Written Submission, para. 235 ("The measure Brazil challenges as a *per se* violation of the Agreement on Agriculture and the SCM Agreement is the Step 2 export payment program as set forth in Section 1207(a) of the 2002 FSRI Act."); *id.*, para. 331("The measure Brazil challenges is therefore Section 1207(a) of the 2002 FSRI Act, which mandates the payment of Step 2 domestic payments.").

[119] Brazil's First Written Submission, para. 250 ("Section 1207(a) of the 2002 FSRI Act mandates Step 2 export payments that are prohibited export subsidies within the meaning of SCM Agreement Article 3.1(a)."); *id.*, para. 341 ("The programme also constitutes a per se violation of ASCM Articles 3.1(b) and 3.2, because payments are mandatory under US law. Section 1207(a) of the 2002 FSRI Act gives no discretion to the US Secretary of Agriculture to apply the measure in a WTO consistent manner.").

[120] Appellate Body Report, *US – Anti-Dumping Act of 1916*, WT/DS136/AB/R, para. 88 (adopted 26 September 2000).

[121] US Answer to Question 109 from the Panel.

[122] Brazil's Answers to Question 257(a)(i) (20 January 2004), para. 8.

[123] See US First Written Submission (11 July 2003), paras. 138-145. See also, Answers of the United States to Panel questions 111-116 (22 August 2003), paras. 222-226; US Further Submission (30 September 2003), paras. 165-176.

the Step 2 programme, to the extent the United States has not exceeded its domestic support reduction commitments, the Step 2 programme and its authorizing legislation do not constitute a *per se* violation of Article 3.1(a) or 3.1(b) of the Subsidies Agreement.[124]

- **export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, e.g., para. 90 Brazil's oral statement at second Panel meeting).**

189. With respect to export credit guarantee programmes, the United States will not reiterate its myriad points regarding the carve-out conferred by Article 10.2 of the Agreement on Agriculture and the data indicating that, in any event, premia are sufficient to cover long-term operating costs and losses.[125] We do note that, as Brazil recognizes, the programmes are currently below the 1 per cent cap on premiums. Because the United States has discretion to raise the fees to the cap, which along with other elements of discretion over provision of actual guarantees, creates a "discretionary" aspect to the programme that does not "mandate" WTO inconsistent measures.

190. However, the United States notes the disingenuous response of Brazil, in paragraph 16 of its response to Question 257(a)(i). On the one hand Brazil claims to have "looked at historical data concerning premiums collected and costs and losses incurred" to allegedly make its case under item(j), but in the very same paragraph it states that "Brazil does not agree with the United States that item(j) necessarily 'requires a certain retrospection.'" Brazil literally uses retrospection in an effort to make its case on this very point: "Brazil has demonstrated that, *retrospectively* [italics added], costs and losses incurred by the programmes exceeded premiums collected over a 10-year period".[126] The United States of course disagrees with the factual premise of the statement, but Brazil cannot credibly disagree that "a certain retrospection" is necessary for a proper analysis under item(j).

**(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"? BRA**

191. Brazil's answer does not explain the significance of assigning the "mandatory" label to challenged measures for purposes of its serious prejudice claim. Brazil has challenged certain statutory and regulatory provisions as *per se* inconsistent with Articles 5(c) and 6.3(c) and (d) of the Subsidies Agreement and Article XVI:1 and :3 of GATT 1994.[127] Brazil's challenge to these measures is "as such".[128] As explained above with respect to Section 1207(a) of the 2002 Act, under Brazil's *per se* challenge, the relevant issue is whether the challenged measures mandate a violation of the WTO Agreement.[129] They do not.

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[124] Step 2 payments are available to all users of domestic upland cotton within the United States, be they domestic users or exporters. Thus, payment is not contingent upon export performance, and Section 1207(a) does not mandate the grant or maintenance of a prohibited export subsidy within the meaning of Article 3.1(a).

[125] In the view of the United States, the relevant analysis under the Subsidies Agreement whether export credit guarantees are export subsidies could only be the cost-to-government approach set out in item (j) of the Illustrative List of export subsidies.

[126] Brazil's Answer to Question 257(c) (20 January 2004), para. 40.

[127] Brazil's Further Submission, para 413 ("Brazil challenges as *per se* violations of Articles 5(c), 6.3(c), and 6.3(d) of the SCM Agreement, and Article XVI:1 and 3 of GATT 1994 selected mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act, as they cause a threat of serious prejudice within the meaning of those provisions.").

[128] Brazil's Further Submission, para. 471(vii) ("The following Sections of the 2002 FSRI Act and the referenced regulations thereto violate, as such, Articles 5(c), 6.3(c), 6.3(d) of the SCM Agreement and Articles XVI: 1 and 3 of GATT 1994 to the extent that they relate to upland cotton.").

[129] Appellate Body Report, *US – Anti-Dumping Act of 1916*, WT/DS136/AB/R, para. 88 (adopted 26 September 2000).

192. Both Brazil and the United States agree that, given certain conditions such as price levels, these challenged measures would be "mandatory" in the sense that the United States could not arbitrarily decline to provide them. However, for purposes of a mandatory / discretionary analysis, no WTO-inconsistency is mandated by those measures because serious prejudice does not necessarily result, even where there is no discretion not to provide payment.

- For example, a finding of serious prejudice based on Article 6.3(d) requires that there be an increase in the world market share of the subsidizing Member in a subsidized primary product and the increase follow a consistent trend over a period when subsidies have been granted. This finding cannot be made in the abstract but depends upon real-world conditions, such as the current and recent shares of the world market for upland cotton held by the United States.

- Similarly, a finding of serious prejudice based on Article 6.3(c) requires that there be "significant price suppression" in the "same market" where imports of both the complaining and responding party are found. This finding also cannot be made in the abstract but requires an examination of actual prices, import levels, and an analysis of the effects of challenged subsidies.

Thus, that certain US measures "mandate" payments given certain conditions (such as price levels) does not establish that these measures mandate a WTO-inconsistency under a mandatory / discretionary analysis of Brazil's *per se* serious prejudice claim.

193. With respect to Brazil's threat of serious prejudice claims "that do not involve claims regarding the '*per se*' validity of the statutes," Brazil colloquially describes the 5 US subsidies in the Panel's question as "mandatory," but the mandatory / discretionary analysis is inapplicable to this threat claim. In this context, it is significant that certain of the challenged payments are not mandated if price conditions are not met. Thus, in evaluating the threat of serious prejudice resulting from these measures, the *likelihood* that price conditions will be satisfied must be taken into account. (For example, the price conditions have not been met for marketing loan payments since September 2003, and none are currently being made. Furthermore, farm prices have risen to the point that the counter-cyclical payment for marketing year 2003 is projected at one-third or less of its statutory maximum.)

194. Brazil argues that "a threat of serious prejudice under Articles 6.3 and 5(c) will be more likely to exist if the subsidies are mandatory" and that "there are no provisions in US law limiting the payments, and, thus, limiting the threat of prejudice." Putting aside the fact that the "circuit breaker" provision could serve to "limit[] the payments,"[130] Brazil's argument rests on the flawed notion that the absence of a "legal mechanism to limit the amount of potential subsidies that could be paid" necessarily creates a threat of serious prejudice. This proposed standard does not withstand scrutiny.

195. As the United States has noted[131], Brazil looks to the Appellate Body report in *United States – FSC*, but that report involved the "threat of circumvention" of export subsidies standard of Article 10.1 of the Agreement on Agriculture. Because agricultural export subsidies *are* subject to volume and value limits, it may be appropriate in that particular circumstance to conclude that the absence of a mechanism to control the flow of subsidies could threaten circumvention of those absolute commitment levels. However, the commitment in the case of Articles 5(c) and 6.3 is not to

[130] Although the trigger for the circuit breaker provision is compliance with the United States' AMS commitments, the Secretary would appear to have discretion over what "adjustments in the amount of such expenditures" would be made. That is, the Secretary could determine to make adjustments in expenditures for one product or multiple products or decoupled income supports.

[131] *See, e.g.*, US Opening Statement at the Second Panel Meeting, paras. 83-85.

threaten serious prejudice – that is, not threaten a particular form of adverse *effect*. Whether a particular type and level of subsidy could threaten that effect necessarily depends upon a fact-intensive examination of, *inter alia*, the subsidy, the relevant market or markets, supply and demand factors, etc. Thus, the *FSC* standard for claims of "threat of circumvention" of export subsidy commitments is not relevant in this context.

196. Brazil's continued reliance on *EC – Sugar Export Subsidies* is misplaced. In that dispute, the panel found that as there was no legal mechanism to control the EC's sugar export subsidies, the subsidy constituted a permanent threat of instability. That panel, however, provided no basis for selecting that standard, which is not reflected in the text of the Subsidies Agreement or GATT 1994 Article XVI:1.[132] We further note that Brazil itself, when it first presented this report to the Panel, commented that "[t]he panel's conclusion was based on several key factual findings".[133] Thus, even that GATT panel report's finding of threat was based on the particular factual circumstances it reviewed, and that report would not support an abstract standard that the lack of a legal mechanism to control the flow of subsidies suffices to create a threat of serious prejudice.

**(iii) the legal standard and elements Brazil sets out to establish its "per se" "serious prejudice" claims (e.g. Brazil's 9 September further submission, para. 417 ff; US oral statement at second Panel meeting, para. 86 ff.)? BRA**

197. Given the way in which Brazil structured its answer, the United States directs the Panel's attention to its comment on Brazil's answer to question 257(a)(ii). We do note, however, that Brazil has not commented on or rebutted that portion of the US oral statement referred to in the Panel's question. There, we pointed out that Brazil had asserted that in either of two price circumstances, the United States is required to act in a manner inconsistent with US WTO obligations. The first price circumstance is that "both USDA's and FAPRI's baseline expect marketing loan and counter-cyclical payments to be made during the lifespan of the 2002 FSRI Act, i.e., through MY 2007. Thus, the circumstances that will exist during the lifespan of the 2002 FSRI Act are such that all of the five mandatory subsidies will be paid until MY 2007 and that they will threaten to cause serious prejudice".[134] Brazil avoids discussing the fact that market price developments during marketing year 2003 have already superseded this analysis by Brazil.

198. The second price circumstance Brazil posits is when prices are sufficiently high that only direct payments and crop insurance payments are made. Brazil has provided no analysis of the estimated effects of direct payments and crop insurance payments at such high market price levels – that is, its economic analysis is made using baseline prices that are *not* sufficiently high that only direct payments and crop insurance payments are made. Neither has Brazil responded to this criticism.

**(b) How and to what extent are the legal and regulatory provisions cited in paras. 415 and 423 of Brazil's 9 September further submission "normative" in nature and treated as binding within the US legal system (see, e.g., para. 99 of the Appellate Body Report)? Does your response differ depending on whether the payments are dependent upon market price conditions? BRA**

[132] Indeed, the GATT panel's conclusion that "the Community system and its application constituted a permanent source of uncertainty in world sugar markets and therefore constituted a threat of serious prejudice in terms of Article XVI:1" does not clarify any standard to distinguish subsidies that threaten serious prejudice from those that do not since any subsidy that has some production effect could be deemed to "constitute[] a permanent source of uncertainty." *See* GATT Panel Report, *EC – Sugar Exports II(Brazil)*, L/5011, 27S/69, part V(g).

[133] Brazil's Further Submission, paras. 296-97.

[134] Brazil's Further Submission, para. 430.

199. As explained in the US answer to question 257(d), the Appellate Body's discussion of the "normative character and operation" of an instrument came in the context of its explanation of how to determine whether an instrument is a "measure" subject to challenge in dispute settlement. The Appellate Body distinguished this question from the separate question of whether the instrument, if a measure, mandates a breach of a WTO obligation under a "mandatory/discretionary" analysis. Since there is no dispute that the cited legal and regulatory provisions are "measures," the "normative" character of those measures is not at issue. Indeed, Brazil recognizes this in stating that, "[a]s used by the Appellate Body, the term 'normative' includes as a subcategory the group of measures that are mandatory, within the meaning of the traditional mandatory/discretionary distinction".[135] In other words, "normative" measures may or may not mandate a WTO-breach, as analyzed based on the "traditional mandatory / discretionary distinction."

200. Brazil further notes correctly that "[t]he focus for deciding whether a measure is mandatory or discretionary is on whether it provides government officials with the discretion to implement the measure in a WTO-consistent manner".[136] However, discretion is only one reason why a measure may not be found to mandate a breach of a WTO obligation. Here, Brazil's challenge is fact-dependent. There is no basis for presuming the existence of a particular set of facts, and hence no basis for presuming that measures mandate a breach of WTO obligations. Brazil erroneously denies the relevance of the conditions attached to payments.[137] For example, if, when those conditions are met, only *some* of the elements which establish a breach have been shown to exist, then there is no breach.

201. The United States has explained that, given the existence of certain conditions (for example, in the case of marketing loan payments, an adjusted world price less than 52 cents per pound), the five sets of measures Brazil challenges on a *per se* basis would mandate that payments be made. However, as set out in the US comment on Brazil 's answer to question 257(a)(ii), these measures do not mandate any inconsistency with the obligation not to cause serious prejudice because payment alone is not sufficient to establish a breach of the obligation. Even if all the conditions mandating payment have been met, one cannot simply presume that serious prejudice will result; it must also be demonstrated that the effect of the subsidy is one or more of the effects listed in Article 6.3 of the Subsidies Agreement and that serious prejudice results from such effect(s). Moreover, it cannot be disregarded that when those conditions have not been met, those payments will *not* be made and therefore cannot cause serious prejudice.

**(c) Does Brazil challenge as "mandatory" the "subsidies" themselves, the subsidy programmes or the legal/regulatory provisions for the grant or maintenance of those subsidies, or something else? BRA**

202. With respect to Brazil's arguments relating to its threat of serious prejudice claims, the United States refers the Panel to its comment on Brazil's answer to question 257(a)(ii). We do find it revealing that, as in its further rebuttal submission and its statements at the second panel meeting, Brazil makes no reference to the "clearly foreseen and imminent" standard it set forth in its further submission.[138] The absence is even more striking when one considers Brazil's argument that, "[h]aving established the existence of present serious prejudice from the actionable subsidies,

[135] Brazil's Answer to Question 257(b), para. 24.
[136] Brazil's Answer to Question 257(b), para. 27.
[137] Brazil's Answer to Question 257(b), para. 29.
[138] *See, e.g.*, Brazil's Further Submission, para. 292 ("Prior to addressing the specifics of these three claims, Brazil sets forth two legal standards that could be used to analyze the threat of serious prejudice. The first is the standard established by the GATT Panels in *EC – Sugar Exports I (Australia)* and *EC – Sugar Exports II (Brazil)* of a "permanent source of uncertainty" requiring a demonstration that guaranteed subsidies by a large exporter have no effective production or export limitations. The second standard includes the same elements necessary to demonstrate present serious prejudice focusing on the likely effects of the subsidies in suppressing world prices and in increasing and maintaining a high level of world export market share.").

demonstrating that such prejudice is 'clearly foreseen and imminent' from the effects of the same and even larger subsidies is not difficult".[139]

203. We would suggest that to argue that "such prejudice is 'clearly foreseen and imminent'" became much more difficult for Brazil as upland cotton prices recovered over the course of marketing year 2003. That is, the increase in prices had the simultaneous effect of reducing current outlays (for example, no marketing loan payments have been made since September and projected counter-cyclical payments have been reduced by two-thirds) and invalidating Brazil's (flawed) economic analysis for marketing years 2003-2007, which was based on an outdated FAPRI baseline projection that understates the MY2003 AWP by 54 per cent and overstates the estimated marketing loan gain by nearly 15 cents per pound (or 100 per cent). The 5-year high prices reached in marketing year 2003, and the high futures prices for the remainder of marketing years 2003 and for the marketing year 2004 crop, also severely undercut Brazil's rhetorical linking of the large amount of outlays in past marketing years with the extremely low prices experienced.

- That is, if US subsidies caused "significant price suppression" in marketing years 1999-2001, and Brazil claims that support under the 2002 Act has "*significantly increased*" from those levels[140], then how can prices have rebounded to 5-year highs?

Thus, Brazil has good reason not to focus the Panel's attention on actual market developments[141], which demonstrate that there is no "clearly foreseen and imminent" likelihood of future serious prejudice. To the contrary, there is a clearly foreseen and imminent likelihood of record cotton plantings in Brazil[142] and of continued high cotton prices in marketing year 2004.

204. With respect to Brazil's arguments relating to the export credit guarantee programmes, the United States refers the Panel to its comment on Brazil's answer to question 257(a)(i). In additions to those observations, the United States further notes that Brazil has not explained why premium rates at any particular level, let alone if they were significantly increased to the one per cent rate of GSM-102, will *necessarily* not be sufficient to cover long-term operating costs and losses. The United States has numerous mechanisms, such as evaluation of creditworthiness of particular countries and the establishment of individual bank limits, to insulate itself from "credit risks and meet costs".[143] Brazil does not suggest a "magic bullet" rate that would under *all* circumstances necessarily cover long-term operating costs and losses because it cannot, nor does it explain why the flexibility inherent in the operation of the export credit guarantee programme is necessarily less effective than some unknown rate.

205. With respect to Brazil's threat of circumvention claim against the CCC programmes "as such," this claim cannot stand. Assuming *arguendo* that Article 10.2 of the Agreement on Agriculture contrary to its terms did not obligate Members to work towards internationally agreed disciplines on export credit guarantees and thereafter provide export credits only in conformity with such disciplines, then the only way to judge whether the export credit guarantee programmes provide an

[139] Brazil's Further Submission, para. 308.

[140] *See* Brazil' s Further Submission, para. 309 ("The 2002 FSRI Act, along with the 2000 ARP Act, create a legal structure guaranteeing and mandating the payment of *significantly increased levels of spending* for the production, use and export of US upland cotton beyond the 1996 FAIR Act and special appropriation bills in 1998-2001.") (emphasis added).

[141] *See* Brazil's Further Submission, para. 308 ("The evidence presented by Brazil below is based on facts regarding the mandated and unlimited nature of the US subsidies, as well as on actual market conditions demonstrating the present and likely future effects of the US subsidies."). As the Panel will have noted, subsequent to Brazil's further submission, Brazil focused on the first half of this passage and sought to minimize the latter half.

[142] Exhibit US-131 ("Brazil's Mato Grosso to triple winter cotton area," Reuters, 2004-01-20 ("Increased winter cotton planting will result in a record overall area.")).

[143] Brazil's Answer to Question 257(c) (20 January 2004), para. 40.

export subsidy – and hence either circumvent US export subsidy reduction commitments or threaten to – is to look to item (j) of the Illustrative List. Under item (j), the relevant inquiry examines whether premiums are sufficient to cover long-term *operating* costs and losses. That is, it is the operating experience of the programmes that would matter. Thus, the programmes "as such" could not threaten circumvention.

206. Brazil argues in paragraph 39 that the export credit guarantee programmes themselves "confer 'benefits' *per se*." The United States has previously noted Article 10.2 provides the appropriate analysis for claims against export credit guarantee programmes for agricultural products. Were the Subsidies Agreement relevant to such programmes, the relevant test would be that of item(j) of the Illustrative List of Export Subsidies; the United States has shown that the export credit guarantee programmes meet that test. Further, we would note that Brazil has not demonstrated that any benefit is conferred by these programmes; in fact, Brazil has conceded that it "is not in a position to quantify the benefit to the recipients that has arisen from the application of the GSM 102 export credit guarantee programme to exports of US upland cotton between MY 1999-2002.[144] Neither has Brazil attempted to quantify any alleged benefit to recipients of export credit guarantees for any other agricultural products. Thus, Brazil may not obtain findings under Articles 1.1 and 3.1(a) of the Subsidies Agreement by virtue of Articles 10.2 and 21.2 of the Agreement on Agriculture, nor has Brazil established any *per se* inconsistency with Article 1.1 and 3.1(a).

**258. Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks. BRA**

207. The Panel's question highlights Brazil's failure to provide its methodology prior to this late stage of the proceedings. The United States is gratified that the Panel's question has finally compelled Brazil to come forward and explain its methodology for allocating decoupled income support payments. Brazil states that it "appreciates the opportunity to describe to the Panel" this methodology, but Brazil needed no invitation to do so. In fact, as the complaining party alleging that certain decoupled income support payments are support to upland cotton for purposes of Article 13(b)(ii) of the Agreement on Agriculture and actionable subsidies for purposes of Articles 1, 5(c), 6.3, and 7 of the Subsidies Agreement, it has always been Brazil' s burden to make claims and arguments with respect to these measures. Rather, Brazil's answer demonstrates that Brazil's proposed methodology lacks any basis in the Subsidies Agreement, any WTO agreement, or in economic logic. Thus, the Panel should find that Brazil has not made a *prima facie* case of WTO inconsistency with respect to these measures.

208. Furthermore, Brazil's response demonstrates that it is attempting to add new measures to its claims in this proceeding, an attempt that is inconsistent with the Panel's terms of reference. Payments for programmes other than upland cotton are not within the terms of reference and are to be excluded from Brazil's claims. Brazil cannot now alter the terms of reference to add programmes for base acreage for other crops. As Brazil itself has admitted (in its response to question 247): "Thus, the 'matter' before the Panel has not changed (*and cannot*) since the establishment of the Panel" (emphasis added).

**Brazil's Proposed Methodology is not Based on Any Text, Nor Does It Adequately Deal with Fundamental Subsidies Issues**

209. By way of introduction, we recall the proper approach to attributing a non-tied (or decoupled) subsidy to particular products. The United States has explained that a complaining party in a serious prejudice dispute must demonstrate which product or products benefit from the challenged subsidy.[145]

[144] Brazil's Answer to Question 140, para. 82.
[145] *See, e.g.*, US Further Rebuttal Submission, paras. 6-17.

This requirement flows from several sources. First, Article 6.3 and provisions explaining it specifically identify certain effects – for example, displacement or impediment, significant price undercutting, suppression, or depression, and increase in world market share) – caused through a "subsidized product".[146] Thus, to determine whether "the effect of the subsidy" is one of those listed in Article 6.3 requires a finding that upland cotton is a "subsidized product" with respect to that subsidy.

210. Second, a "subsidy" does not exist within the meaning of Article 1 of the Subsidies Agreement if a "benefit" is not conferred.[147] As Brazil is asserting the existence of serious prejudice with respect to upland cotton, the challenged subsidy must actually "benefit" cotton and not any other crop.

211. With respect to decoupled income support, a recipient need not produce upland cotton in order to receive payment. In fact, the recipient need not produce anything at all – hence, the support is "decoupled" from production requirements. Since decoupled income support payments do not, on their face, provide a "benefit" to upland cotton, the question of what products benefit from the subsidy arises.

212. Brazil now answers this question by inventing a methodology by which "excess" base acres – that is, base acres of a crop historically grown on the farm in excess of the planted acres of that crop in a given year – are allocated to other crops with "excess" planted acres (but only if they are "programme crops") – that is, planted acres in excess of the base acres of that crop historically grown on the farm. It is ironic to recall that Brazil criticized the US approach to this issue by writing that the "alleged requirement" to allocate untied subsidies across the total value of production on a recipient's farm "lacks any textual basis".[148]

- In fact, the Panel will search Brazil's answer to question 258 in vain for a *single citation* to a WTO provision that sets out or even indirectly supports its proposed allocation methodology.

213. The methodology explained by the United States, on the other hand, is rooted in the text and context of the Subsidies Agreement. As set out above, to establish that the effect of a subsidy is serious prejudice with respect to upland cotton, Brazil must identify the subsidized products – that is, the products that benefit from the payment and the portion of those payments that benefit upland cotton. Annex IV provides useful context in its methodology for calculating an *ad valorem* subsidization rate. An *ad valorem* subsidy rate is the quotient of a numerator (subsidy amount) and a denominator (value of the subsidized product). Thus, to perform the calculation, one must know what the subsidized product is.

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[146] For example, for purposes of a claim under Article 6.3(c) of the Subsidies Agreement, the "effect of the subsidy" must be "significant price undercutting" or "significant price suppression, price depression, or lost sales" caused by "*the subsidized product*." Article 6.5 confirms that price undercutting includes "any case in which such price undercutting has been demonstrated through a comparison of prices of the *subsidized product* with prices of a non-subsidized like product supplied to the same market." Similarly, under Article 6.3(d) "the effect of the subsidy" must be an increase in world market share "in a particular *subsidized primary product or commodity*." Finally, under Articles 6.4 and 6.3(b), pursuant to which Brazil is not claiming serious prejudice, the "change in relevant market shares" involves an examination of the "relative shares of the market" of the non-subsidized like product and "*the subsidized product*."

[147] *See* Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, adopted 7 June 2000, paras. 6.65 and 6.66 (quoting and agreeing with *Canada – Aircraft* panel: "'A "benefit" does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a "benefit" can be said to arise only if a person . . . has in fact received something.'").

[148] Brazil's Further Rebuttal Submission, para. 103.

- Paragraph 2 of Annex IV provides that "*the value of the product* shall be calculated as the *total value of the recipient firm's sales* in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted" (footnotes omitted & italics added).

- Paragraph 3 of Annex IV modifies the general principle of paragraph 2, providing that "[w]here the subsidy is *tied to the production or sale of a given product*, the value of the product shall be calculated as the *total value of the recipient firm's sales of that product* in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted" (italics added).

Thus, "[w]here the subsidy is [not] tied to the production or sale of a given product," the general methodology of paragraph 2 applies. Because the "value of the [subsidized] product" is the "total value of the recipient firm's sales," it follows that the subsidized product is the entirety of what the recipient sells. To determine the share of the subsidy that is attributable to upland cotton, one would multiply the value of the payment by the share of the total value of production accounted for by upland cotton. Brazil does not deny that both the EC and Brazil apply this very methodology for purposes of their domestic countervailing duty procedures[149], nor that Brazil has proposed that Members adopt this very methodology as a "guideline" on calculating the amount of the subsidy.[150]

214. Brazil can only assert that the allocation methodology set out in Annex IV of the Subsidies Agreement and applied by Brazil itself and the EC for purposes of their countervailing duty procedures "are irrelevant to Article 6.3 claims".[151] And yet, *some* allocation methodology for purposes of Article 6.3 is necessary to deal with non-tied (decoupled) payments – to assert otherwise is to deny the relevance of the "subsidy" definition of Article 1 as well as those provisions of Article 6 contingent on the existence of a "subsidized product". However, Brazil's proposed methodology is not even based on a Subsidies Agreement text, nor based on *its own* procedures for determining the subsidized product that benefits from a non-tied (decoupled) payment. One could reasonably ask how Brazil's own countervailing duty procedures could deal with non-tied subsidies in one way while Brazil proposes a contradictory approach for purposes of its serious prejudice claims, given that both situations are faced with the same issues of whether a subsidy benefits a particular product.

215. In judging the credibility of Brazil's proposed methodology in comparison to the methodology explained by the United States, the Panel may wish to compare the sources that Brazil and the United States, respectively, have drawn upon:

| **Comparison of Allocation Methodologies for Non-Tied (Decoupled) Payments** | | |
|---|---|---|
| **Party** | **Methodology** | **Interpretive and Other Sources** |
| Brazil | Payments for base acres for historically grown crop are attributed to current plantings of that crop, if any; payments for base acres in excess of plantings are attributed to all crops planted in excess of base acres for that historically grown crop by the proportion of a crop's excess planted acres to total excess planted acres | None[152] |

[149] *See* Brazil's Opening Oral Statement at the Second Panel Meeting, para. 4.

[150] Paper by Brazil, Countervailing Measures: Illustrative Major Issues, TN/RL/W/19, at 6 (7 October 2002) ("If the benefit of a subsidy is limited to a particular product, the denominator should reflect only sales [production/exports] of that product. If this is not the case, the denominator should be the recipient's total sales.").

[151] Brazil's Opening Statement at the Second Panel Meeting, para. 4.

[152] *See* Brazil' s Answer to Question 258, paras. 43-55.

| Comparison of Allocation Methodologies for Non-Tied (Decoupled) Payments | | |
|---|---|---|
| **Party** | **Methodology** | **Interpretive and Other Sources** |
| United States | Payments that are not tied to the production or sale of a given product are attributed to all the products the recipient produces; the subsidy benefits a particular product by its share of the total value of production | SCM Agreement, Article 1.1(a); Articles 6.3, 6.4, 6.5; Annex IV, paras. 2-3<br><br>CVD practice, Brazil and EC<br><br>Brazilian CVD proposal[153] |

Simply put, Brazil has pointed to nothing in the WTO agreements that would support its approach to the allocation of non-tied (decoupled) payments.

216. Finally, Brazil's argument that the Annex IV methodology *cannot* apply to claims of serious prejudice does not withstand scrutiny. Although the provision to which Annex IV relates – Article 6.1(a) – is no longer in effect, it may still be relevant for purposes of interpreting the Subsidies Agreement. For example, in *United States – Countervailing Measures (EC)*, the Appellate Body relied on Annex IV as context in interpreting another provision of the Subsidies Agreement.[154] Similarly, in *United States – FSC: Article 22.6*, Arbitrator cited the *expired* Articles 8 and 9 as "helpful . . . in understanding the overall architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address".[155]

217. There is a difference between looking to the expired provisions of Article 6.1 for a legal obligation (for example, the presumption created by a 5 per cent *ad valorem* subsidization rate) and looking to the provisions of Annex IV for a methodology, or logical approach to identifying the subsidized product. In the former case, it is precisely the expiry of the provision that indicates that the presumption created by that rule no longer has effect. In the latter case, unless there is some basis to draw a negative implication from the expiry of the rule in Article 6.1, the methodology can be examined for its underlying logic. If the methodology fits with pertinent subsidies concepts, it may provide useful guidance in determining the product that benefits from the subsidy. In this regard, we note Brazil's statement that the Annex IV methodology existed only because "[n]egotiators wanted to be certain that if such a presumption [of serious prejudice] was created [by virtue of Article 6.1(a)], the precise *level* of subsidization was carefully calculated".[156] To the extent that the Panel agrees that it must "be certain" that the non-tied subsidies at issue benefit upland cotton and that "the precise level of subsidization [must be] carefully calculated," we suggest that Annex IV provides the appropriate methodology.

**Brazil's Allocation Methodology Does Not Make Economic Sense**

218. The foregoing discussion suffices to show that Brazil's allocation methodology has no basis in the Subsidies Agreement. As Brazil has not demonstrated, for each challenged decoupled payment (production flexibility contract, market loss assistance, direct, and counter-cyclical payments), what is the subsidized product nor what is the benefit to upland cotton, Brazil cannot and has not made a *prima facie* case with respect to these payments. That is, Brazil cannot begin to demonstrate "the effect of the subsidy" if it has not shown the subsidy benefit and the subsidized product.

219. It may be of interest to the Panel, however, that Brazil's allocation methodology does not make economic sense. In essence, Brazil's approach arbitrarily assigns payments for base acreage to particular planted acres, as if the current crop was "planted on" base acreage, even though "base

[153] US Further Rebuttal Submission, paras. 9-13.
[154] WT/DS212/AB/R, para. 112.
[155] WT/DS108/ARB, note 56.
[156] Brazil's Further Rebuttal Submission, para. 103.

acres" do not correspond to any physical acres on a farm; they are a mere accounting concept. At the same time, however, any "excess" base acres are assigned to crops that have "excess" planted acres. This methodology leads to situations in which a particular crop could be subsidized at different rates, depending on whether it is planted on "excess" acreage or base acreage. It leads to situations in which a particular crop could receive a greater subsidy than another crop that accounts for more acreage on the farm. It also allocates payments only to certain "programme" crops, ignoring the fact that the subsidy recipient may grow crops for which no base acreage exists and may engage in other types of production. Neither situation makes sense from an economic perspective, and neither results from the correct (Annex IV) methodology explained above.

220. The first situation is one in which a particular crop, such as upland cotton, could be subsidized at different rates, depending on what type of acreage it is "planted on." For example, consider a farm with 200 base acres, 100 of cotton and 100 of soybeans, and 200 planted acres, 150 of cotton and 50 of soybeans. According to Brazil's proposed methodology, 100 base acres of cotton are allocated to 100 acres of planted cotton, leaving 50 planted acres of cotton; similarly, the 50 of the 100 base acres of soybeans are allocated to the 50 base acres of soybeans, leaving 50 "excess" soy base acres that can be allocated to the 50 "excess" cotton planted acres. However, this allocation methodology results in two different rates of subsidization for cotton acreage. The 100 cotton acres deemed to be "planted on" cotton base acreage is subsidized at the rate corresponding to decoupled payments for upland cotton base acres while the 50 cotton acres deemed to be "planted on" soy base acreage is subsidized at the rate corresponding to decoupled payments for soy base acres.[157] There is no rationale for deeming one acre of cotton to receive one subsidy and deeming the next acre of cotton to receive an entirely different subsidy. These decoupled payments are not tied to production of a particular commodity; in fact, the "upland cotton" base acreage could now be "planted to" soybeans or nothing at all. In economic terms, money is fungible, and payments received through decoupled payments are deemed to subsidize whatever the recipient chooses to produce. As all of the recipient's production is the "subsidized product," the subsidy should be neutrally allocated to all of those products.

221. The second situation is one in which a particular crop that is with "excess" plantings could receive a greater subsidy than another crop that accounts for more acreage on the farm. For example, consider a farm with 200 base acres of soybeans and none of cotton and with 75 planted acres of cotton and 50 planted acres of soybeans. Seventy-five base acres of soybeans are attributed to the 75 planted acres of soybeans, and "[p]ayments on any further base acreage for [that] programme crop[ is] allocated to the crops for which planted acres exceed base acres".[158] Since cotton is the only crop "for which planted acres exceed base acres, payments for 125 base acres of soybeans are allocated the 50 acres of cotton.[159] This produces the anomalous result that the lesser planted crop (upland cotton, with 50 planted acres) would be deemed to receive a greater subsidy than the crop with greater planted acreage (soybeans, with 75 planted acres). If the same farm decided to plant 75 acres of soybeans and only *one* acre of cotton, again, all of the "excess" base acres would be allocated to the one acre of cotton. Again, this result makes no economic sense since the farm "allocated" its plantings 75 to 1, soy over cotton. The allocation of payments not tied to production of a particular commodity should reflect the recipient's decisions on what production to undertake.

[157] *See, e.g.*, Brazil's Answer to Question 258, para. 48 (Sample Farm 4: 160 planted acres of cotton are allocated 100 base acres of cotton and 60 base acres of rice).

[158] Brazil's Answer to Question 258, para. 48.

[159] *See, e.g.*, Brazil's Answer to Question 258, para. 51 (Sample Farm 5: 140 planted acres of cotton are allocated payments for 160 base acres (100 cotton, 40 wheat, 20 rice).

222. Brazil's erroneous methodology also allocates payments only to certain "programme" crops, for which base acreage exists.[160] This ignores the fact that the subsidy recipient may grow crops for which no base acreage exists and may engage in other types of production. A farmer's activities and plantings are not restricted to "programme" crops. In the production flexibility contract era, farmers who planted cotton did not just plant wheat, oats, rice, corn, sorghum, and barley. They also planted other crops, like peanuts, sugar, soybeans, and perhaps tobacco. They may have also planted fruits and vegetables on any acreage exceeding their base acreage. They may have produced hay or had livestock operations on the farm. The possibilities are numerous. Given the myriad production activities that a payment recipient could (and did) choose to undertake, there is no basis to allocate non-tied (decoupled) payments solely to programme crops and not to the entirety of a farm's production.

223. In sum, these illogical results follow from a methodology in which payments on "excess" base acreage are allocated only to those crops for which plantings "exceed" their base. If Brazil believes a decoupled payment is capable of allocation when base acreage "exceeds" planted acreage, Brazil must concede that the payment is not tied to production, use, or sale of particular commodity. However, the same consideration must apply to those payments with respect to base acreage for which there is an equal amount of planted acres – that is, those legally indistinguishable payments on "non-excess" base acres are not tied to production, use, or sale of a particular commodity either. Thus, one, consistent allocation methodology must apply to the entire amount of a recipient's decoupled payments. Brazil's erroneous allocation methodology does not provide that. The methodology set out in Annex IV and also applied by Brazil for purposes of its countervailing duty procedures under Part V of the Subsidies Agreement does.

**Implications of Brazil's Erroneous Methodology for Subsidies Claims and Peace Clause**

224. As Brazil's answer makes perfectly clear, and as it had previously stated[161], Brazil rejects the allocation methodology for non-tied (decoupled) payments suggested, *inter alia*, by Annex IV to the Subsidies Agreement. That is, Brazil has refused to acknowledge that such payments must be allocated across the total value of the recipient's production. Therefore, as the United States suggested in its answer to question 256, Brazil has not advanced claims and arguments that would allow the Panel to determine the subsidy benefit to upland cotton. It follows that Brazil has failed to make a *prima facie* case that decoupled income support payments cause or threaten to cause serious prejudice.

225. Brazil's refusal to adopt a proper methodology for determining the subsidy benefit and subsidized product also has important implications for its Peace Clause arguments. The Panel will recall that Brazil argued that "support to a specific commodity" in the Peace Clause proviso could only be gauged by using budgetary outlays. However, calculating the subsidy benefit to upland cotton is indispensable – on Brazil's approach – to determining the "support to" upland cotton. To the extent that Brazil has not utilized the correct methodology, its Peace Clause calculation of the support to upland cotton from decoupled payments is erroneous.

226. In addition, the fact that Brazil seeks to attribute upland cotton decoupled payments made for "excess" base acres is an important point. Brazil acknowledges that these decoupled payments are not tied to production, and therefore can be attributed across production. Our difficulty with Brazil's approach, is that it claims the attribution is only made to crops with "excess" acreage. As explained above, there is no basis for attributing part of a payment to only some crops planted on the farm,

[160] *See, e.g.*, Brazil's Answer to Question 258, para. 50 ("In Brazil's methodology, payments available for allocation – *i.e.*, not allocated to the program crop itself – are pooled and allocated proportionally to the remaining program crop acreage.").

[161] Brazil's Further Rebuttal Submission, paras. 103-05; Brazil's Opening Statement at the Second Panel Meeting, para. 4.

rather than attributing the entire value of such payments across all production. Thus, Brazil has not established that US domestic support measures breach the Peace Clause, and the US domestic support measures are entitled to Peace Clause protection.

227. Brazil's answer also highlights that decoupled income support payments do not grant "support to a specific commodity" within the meaning of Article 13(b)(ii). Brazil has asserted that such support can be any support that benefits upland cotton. Thus, Brazil would seek to allocate decoupled payments to the products on the farm as set out in its methodology. However, Brazil's approach is incompatible with important Agreement on Agriculture concepts. As is clear from Brazil's answer, a payment made with respect to base acreage historically planted to one crop can be support to that crop *and* support to any other "programme" crop at the same time. Such a result is inconsistent on its face with the ordinary meaning of "support to a specific commodity" since such a payment would in fact be 'support to multiple commodities.'

228. In addition, Brazil's approach would render nugatory non-product-specific support for purposes of the Peace Clause. Brazil has argued that the decoupled income support payments it challenges are not non-product-specific support because they are not support to producers "in general." And yet, the recipients of decoupled payments *are* producers "in general" because they are free, with limited exceptions, to plant any commodity and are free, without exception, to undertake other agricultural activities. Thus, they are producers generally of whatever products they choose to produce. By asserting that the allocation of such non-product-specific support to the commodities a recipient produces renders such payments "support to a specific commodity," Brazil reads non-product-specific support out of the scope of the Peace Clause. If non-product-specific support could simply be allocated to a recipient's production and thereby become support to each specific commodity produced, there would simply be no reason to have a category of non-product-specific support in the Agreement on Agriculture.

229. In fact, the Agreement on Agriculture does not permit an interpretation that would allocate all non-product-specific support to specific commodities. First, the precise definition of product-specific support in Article 1(f) ensures that support that is *not* "provided for an agricultural product in favour of the producers of the basic agricultural product" must be categorized as non-product-specific ("support provided in favour of agricultural producers in general"). Second, paragraph 1 of Annex 3 establishes that non-product-specific support must be kept separate from product-specific support for purposes of AMS calculation.[162] Brazil has stated that "support to a specific commodity" under the Peace Clause may be measured either using budgetary outlays or an "AMS-like methodology using rules in Annex 3".[163] Therefore, since Annex 3 specifically provides that non-product-specific support must be kept separate from product-specific support, non-product-specific support must also be kept separate from "support to a specific commodity" for purposes of the Peace Clause analysis. Brazil may not allocate non-product-specific decoupled payments to certain products for Subsidies Agreement purposes and then, on that basis, assert that such allocated payments are "support to a specific commodity" for Peace Clause purposes. The product-specific / non-product-specific categories in the Agreement on Agriculture are *sui generis* and may not be rendered inutile by the application of Subsidies Agreement concepts (subsidy, benefit, subsidized product) not used in nor directly applicable to the Peace Clause.

[162] Agreement on Agriculture, Annex 3, para. 1 ("Support which is non-product-specific shall be totalled into one non-product-specific AMS in total monetary terms.").
[163] Brazil's Rebuttal Submission, para. 87.

**List of Exhibits**

| | |
|---|---|
| US131 | Brazil's Mato Grosso to triple winter cotton area 2004-01-20 20:10:01 GMT (Reuters), By Inae Riveras |
| US132 | Chart, US Crops Cotton supply and utilization, and Baseline |
| US133 | Statement By O A Cleveland 1/16/04 |
| US134 | Charts of US and Brazilian Export Unit Values to 7 Destinations |
| US135 | Production, Yield, Trade, and Stocks Data, MY99-02 |
| US136 | USDA/FAS US trade data, MY99-03 |
| US137 | World Trade Atlas official Brazilian trade data, MY99-03 |
| US138 | Statement of the United States at the DSB (9 January 2004) on adoption of the reports in *United States- Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products for Japan* |
| US139 | USDA Weekly Cotton Market Review 1/9/04 |
| US140 | USDA Weekly Cotton Market Review 1/23/04 |
| US141 | Charts of Chinese (Domestic, Import, Export) Prices vs. A-Index |
| US142 | NY Board of Trade, NY Cotton Exchange, 27 January 2004 futures data |

# ANNEX I-15

## BRAZIL'S COMMENTS AND REQUESTS REGARDING DATA PROVIDED BY THE UNITED STATES ON 18/19 DECEMBER 2003 AND THE US REFUSAL TO PROVIDE NON-SCRAMBLED DATA ON 20 JANUARY 2004

(28 January 2004)

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| *EC – Sugar Exports I (Australia)* | GATT Panel Report, *European Communities – Refunds on Exports of Sugar Complaint by Australia*, L/4833 – 26S/290, adopted 6 November, 1979. |
| *EC – Sugar Exports II (Brazil)* | GATT Panel Report, *European Communities – Refunds on Exports of Sugar Complaint by Brazil*, L/5011 – 27S/69, adopted 10 November 1980. |
| *US – Gasoline* | Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996. |
| *EC – Hormones* | Appellate Body Report, *European Communities - Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, adopted 13 February 1998. |
| *Australia – Salmon* | Panel Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/R, adopted 6 November 1998. |
| *EC – Bananas* | Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS27/ARB, adopted 9 April 1999. |
| *Brazil – Aircraft* | Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW, adopted 28 August 2000. |
| *Indonesia – Automobiles* | Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, adopted 23 July 1998.- |
| *Argentina – Textiles and Apparel* | Panel Report, *Argentina – Measures affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/R, adopted 22 April 1998. |
| *Canada – Aircraft* | Panel Report, *Canada – Measures affecting the Exports of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999. |
| *Canada – Aircraft* | Appellate Body Report, *Canada – Measures affecting the Exports of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999. |
| *Japan – Agricultural Products* | Appellate Body Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/AB/R, adopted 19 March 1999. |
| *Korea – Dairy Safeguards* | Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000. |
| *Canada – Dairy* | Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, adopted 27 October 1999. |
| *Canada – Dairy (21.5) (II)* | Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/RW, adopted 17 January 2003. |
| *US – FSC* | Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000. |
| *Australia – Leather* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999. |
| *Australia – Leather (21.5)* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/RW, adopted 11 February 2000. |
| *US – 1916 Act* | Appellate Body Report, *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, adopted 26 September 2000. |
| *US – Wheat Gluten* | Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted 19 January 2001. |

| Short Title | Full Case and Citation |
|---|---|
| *US – Wheat Gluten* | Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted 19 January 2001. |
| *Chile – Agricultural Products (Price Band)* | Appellate Body Report, *Chile- Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted 23 October 2002. |
| *US – CVD's on EC Products* | Appellate Body Report, *United States – Countervailing Duties on EC Products*, WT/DS212/AB/R, adopted 8 January 2003. |
| *Canada – Aircraft II* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS222/R, adopted 19 February 2002. |
| *EC – Sardines* | Appellate Body Report, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002. |
| *EC – Sardines* | Panel Report, *European Communities – Trade Description of Sardines*, WT/DS231/R, adopted 23 October 2002. |
| *Japan – Apples* | Appellate Body Report, *Japan – Measures affecting the Importation of Apples*, WT/DS245/AB/R, adopted 10 December 2003. |

## 1. Introduction and Summary

1. Brazil and the Panel have repeatedly requested information from the United States regarding the amount of four different types of contract payments to upland cotton producers. The Panel requested this information *five* months ago, in August 2003, and again in October 2003, in December 2003 and, finally, in January 2004. Brazil first requested this information in November 2002. This information is relevant to the "peace clause" portion of the dispute. It would have permitted the Panel to determine with considerable accuracy the amount of support provided to upland cotton from PFC, market loss assistance, direct and counter-cyclical payment subsidies. After repeatedly denying for over *thirteen* months that it even collected or maintained the payment information, the United States finally acknowledged in its 18/19 December 2003 and 20 January 2004 Letters to the Panel that USDA collected, compiled, and organized all data that would permit an allocation of the amount of contract payments received by producers of upland cotton for MY 1999-2002. Regrettably, even after admitting it has this highly relevant information, the United States refuses to produce the data. Accordingly, Brazil has no choice but to request the Panel to draw adverse inferences from the refusal of the United States to produce this data.

2. In this document, Brazil first describes in Section 2 the factual background and the purposes behind its various requests for contract payment information. In Section 3, Brazil details exactly what the United States produced (and did not produce) on 18/19 December 2003 when it "scrambled" farm-specific data and refused to produce other types of data. Brazil then addresses in Section 4 the *post hoc* and invalid US arguments that the farm-specific information is "confidential" under US law. In Section 5, Brazil sets forth the relevant WTO jurisprudence interpreting Article 13.1 of the DSU, which requires Members to produce even confidential information when so requested by panels. In Sections 6-8, Brazil then makes its request for the Panel to draw adverse inferences that the withheld information would show contract payments higher than those estimated in Brazil's 14/16$^{th}$ methodology, and that, therefore, the Panel should find that the United States has no peace clause protection. In Sections 9 and 10, Brazil attempts to use the summary information provided by the United States on 18/19 December 2003, together with a number of assumptions, to apply Brazil's methodology for calculating the amount of the contract payments, as well as to perform the methodology advanced by the United States. The results of this analysis each support the amount of allocated payments, as calculated using Brazil's 14/16$^{th}$ methodology. Finally, in Section 11, Brazil demonstrates that the *Japan – Agricultural Products* decision relied on by the United States is inapplicable.

## 2. Brazil's Request for Information as Posed by the Panel on 8 December 2003 and 12 January 2004

3. Brazil's request for information is set out in Exhibit Bra-369. Brazil requested "farm-specific data to determine the amount of cotton planted on contract base acreage during marketing year 1999-2002." The purpose of Brazil's request for contract acreage and planted acreage data for each farm producing upland cotton was to obtain actual data to permit as exact an allocation as possible of contract payments (from both upland cotton as well as other programme crop base acreage) to current producers of upland cotton. This farm-specific base and planting information (together with requested yield base information) would have permitted the calculation of the amount of support to upland cotton from contract payments by combining two different components of support: (a) *upland cotton* contract payments to current producers of upland cotton, and (b) *other crop* contract payments to current producers of upland cotton. These payments would then be allocated to the current plantings of upland cotton on the farm and, finally, aggregated.[1] This would help the Panel in determining the amount of contract payments that constitute "support to" upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture, and to decide on the peace clause. Finally, to a large extent, the requested information would have also permitted the Panel to apply the

[1] *See* Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

(incorrect) US-proposed methodology for calculating the amount of "benefit" from these subsidies to current upland cotton producers.

4. Brazil first requested this information in November 2002.[2] The Panel requested it in August, October, and December 2003, as well as in January 2004.[3] Faced with repeated US denials that it "maintained" such information, Brazil offered its so-called "14/16$^{th}$" methodology during the peace clause phase of this dispute.[4] Because Brazil conclusively learned in late November 2003 (*inter alia via* the rice FOIA request[5]) that the United States had falsely stated that it did not maintain contract and planted acreage information for each farm, it sought the information detailed in Exhibit Bra-369 to confirm further its 14/16$^{th}$ methodology, which was already supported by a large amount of circumstantial evidence. In effect, Brazil sought to *replace* the 14/16$^{th}$ methodology with a methodology using actual farm-specific data that would provide precise information that the Panel could rely on in making its determination of the amount of support to upland cotton.[6] There is no question that the information withheld by the United States would have been the best information for allocating contract payments that constitute support to upland cotton.

5. Based on its experience working with the data produced in the rice FOIA request, Brazil knew how easy it is to use the computerized farm-specific data to perform the necessary calculations and present the evidence in a summary form. As the Panel could see from the computerized rice data displayed during the meeting on 3 December 2003, this farm-specific data permits the ready calculation of the amount of contract payment support provided to upland cotton producers. Brazil had an entire team ready on 18 December 2003 (and on 20 January 2004) to perform these operations quickly. Brazil had intended to present the evidence in a *summary* form (obviously not in a farm-specific form) for its Answers to Questions on 22 December 2003. But as described below, unlike USDA's response to the rice FOIA request, the United States intentionally "scrambled" the farm-specific information to make it useless for purposes of the comparison sought by the Panel and Brazil, i.e., for calculating the allocated contract payment figures (which the Panel had requested the United States to provide, *inter alia*, in response to Question 67*bis* on 27 August 2003).

6. On 12 January 2004, the Panel again requested the United States to produce the data, and offered the United States the option to (1) produce the data using "substitute farm numbers which still

[2] Exhibit Bra-101 (Questions for the Purpose of Consultations, Questions 3.4, 3.5, 3.13, 3.14 and 11.2). Brazil has made a similar request during the Annex V procedure, during which the United States refused to participate (Exhibit Bra-49 (Brazil's Questions for the Purpose of the Annex V Procedure, Questions 3.8 – 3.10)). Brazil reiterated its request in note 411 of its 24 June 2003 First Submission.

[3] 25 August 2003 Communication from the Panel, Question 67*bis*; 13 October 2003 Communication from the Panel, Question 125(9); 8 December 2003 Communication from the Panel, second bulled point; 12 January 2004 Communication from the Panel, p. 1.

[4] Brazil's 11 August 2003 Answers to Questions 60 and 67.

[5] Brazil's request in Exhibit Bra-369 was modeled on a very similar request regarding rice made by a private US citizen who received rice farm-specific information as set out in Exhibit Bra-368. The rice FOIA request resulted in the production of farm-specific acreage information showing (a) the amount of rice contract acreage and (b) the amount of planted rice acreage for the entirety of rice farms between MY 1996-2002. (As noted in Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, para. 6), more than 99.5 per cent of rice acreage planted is accounted for in the data provided in response to this FOIA request. The data on rice base acreage is naturally complete.) This farm-specific information allowed the easy tabulation of precise aggregate amounts of payments received by current rice producers between MY 1999-2002. Brazil presented the non-confidential *aggregate* rice information to the Panel in Exhibit Bra-368. This aggregated data demonstrates the absurdity of the US claim that the rice (or cotton) *aggregate* data is somehow "confidential."

[6] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55. Brazil also sought the information to rebut the US argument that under its "value" allocation methodology that the amount of support to upland cotton would be much smaller.

permit data-matching," and (2) to arrange for special confidentiality procedures.[7] In its 20 January 2004 Letter to the Panel, the United States refused again to provide the information.[8]

### 3. The United States 18/19 December 2003 and 20 January 2004 Responses to the Panel's and Brazil's Request for Information[9]

7. The first and fundamental conclusion from the US 18 December 2003 Letter and the accompanying data is that the United States admits, for the first time, that it collects, maintains, and can readily analyze whether every farm planting upland cotton is doing so on contract base acreage. It admits that it knows how many farms planted upland cotton in MY 1999-2002.[10] It admits that it knows the amount of acreage for each farm that planted upland cotton.[11] It admits that it knows the number of upland cotton contract acres planted to upland cotton.[12] It admits that it knows the amount of non-upland cotton contract acreage planted to upland cotton.[13] And it admits that it knows the yield information for each farm with contract acreage.[14] Indeed, it admits that it knows the amount of contract payments received by each current producer of upland cotton.[15]

8. In other words, the United States *knows* today, and it knew on 18 December 2003 and on 20 January 2004, exactly how many dollars of contract payments were paid to producers of upland cotton during MY 1999-2002. Moreover, the United States, at a minimum, had the information necessary to make all payment calculations for MY 1999-2001 in November 2002 when Brazil first requested it.[16] And the United States had this information for MY 1999-2002 in August 2003, in October 2003, in December 2003, and in January 2004 when the Panel requested its production.[17]

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[7] *See* 12 January 2004 Communication from the Panel.

[8] *See* US 20 January 2004 Letter to the Panel, p. 3.

[9] Brazil notes that the United States provided the MY 2002 data on 19 December (one day after the deadline set by the Panel). When Brazil refers to the 18 December data, any such reference includes the MY 2002 data provided on 19 December.

[10] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. These files contain summarized data based on farm-specific data that is grouped in three categories: (1) farms producing upland cotton and holding upland cotton base, (2) farms not producing upland cotton but holding upland cotton base, and (3) farms producing upland cotton but not holding upland cotton base. Categories (1) and (2) would be relevant in this respect.

[11] *See* Electronic Planted Acreage Files for MY 1999-2001 and MY 2002 provided by the United States on 18 and 19 December 2003 respectively offering farm-specific information but no farm-identifying information. *See* also Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December respectively offering summary information.

[12] This information would result from matching the farm-specific information on contract acreage and planted acreage. The United States withheld the farm identification number for the acreage information so that Brazil and the Panel are unable to match the information provided and to generate this information. However, the United States performed this exercise as can be seen from the electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. Had the United States not matched the information, it would have been impossible to group the farms into the three categories for which summary information is provided: (1) farms planting upland cotton and holding upland cotton contract base acreage, (2) farms not planting upland cotton but holding upland cotton contract base acreage, and (3) farms planting upland cotton and not holding upland cotton contract base acreage.

[13] This results from the information discussed in the previous note. It is the residual category of the amount of upland cotton planted in any marketing year minus the amount planted on upland cotton base.

[14] *See* Electronic PFC and DCP Files including yield information. The United States used the farm-specific yield information to provide summaries of payment units for each crop in each of the three categories for the contained in the PFC and DCP Summary Files provided on 18 and 19 December 2003 respectively.

[15] This would be the result of multiplying the farm-specific payment units for each programme crop on each farm that plants upland cotton by the respective payment rate for the programme crop in that marketing year.

[16] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 36-40.

[17] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 36-41.

9. The Panel can readily see from the US three-page description of the data it presented on 18 December 2003 that the data provided prevents any farm-specific analysis that would permit the calculation under either of the allocation methodologies advanced by the parties in this dispute. On page 2, the United States states that it is producing "second, a farm-by-farm file (with particular farm identification information) with all the requested data (plus additional data regarding payment quantities) *but not including planted acres and cropland*."[18] Further, the United States states that it is producing "[t]hird, farm-by-farm files for planted acres . . . *with the order of the farms scrambled in order to prevent any matching of farms.*"[19] In short, the United States admits that it does not "provide planted acreage information associated with an individual farm."[20] Translated, this means that neither the Panel nor Brazil can use the provided information to calculate the amount of contract payments made to *all* farms producing upland cotton and allocate the support to upland cotton. Brazil has explained this briefly in its 22 December 2003 Answers to Questions.[21]

10. While the United States provided a considerable amount of farm-specific data, the fact that it scrambled the data on plantings made any matching of contract base and current planting data impossible, and renders all data useless for purposes of producing any conclusive figures under any legitimate allocation methodology. Admitting this, the United States then provides aggregate data for three groups of farms: (1) those planting upland cotton and having at least some upland cotton base acreage, (2) those not planting upland cotton but having at least some upland cotton base acreage, and (3) those planting upland cotton and not holding upland cotton base.[22] The United States appears to consider that this summary data could serve as a substitute for the farm-specific information.[23] This is fundamentally wrong.

11. The United States states as follows in its 20 January 2004 Letter to the Panel:

> [T]he information relevant to the Panel's assessment *would not be farm-specific data* but rather some *aggregation* of data to permit this "assessment of . . . total expenditures." As noted above, the United States has provided both farm-specific and aggregated contract data that would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton.[24]
>
> Further, the United States has provided both farm-specific and aggregated contract data that would permit the Panel to make the assessment it identifies, that is, an

[18] US 18 December 2003 Letter to the Panel, p. 2 (emphasis and underlining added).
[19] US 18 December 2003 Letter to the Panel, p. 2 (emphasis and underlining added).
[20] US 18 December 2003 Letter to the Panel, p. 2.
[21] Brazil's 22 December 2003 Answers to Questions, para. 7.
[22] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively.
[23] US 20 January 2004 Letter to the Panel, p. 2. ("the United States notes that it has previously provided data that permits calculation of "total expenditures" for all decoupled payments made to farms planting upland cotton with respect to historical base acres (whether upland cotton base acres or otherwise). In particular, for the production flexibility contract payment era, we provided a farm-by-farm file ("Pfcby.txt") with base acreage and yield data for all programme crops for all "cotton farms" as defined in BRA-369 and data file ("Pfcsum.xls") that aggregated this data for ease of use. The "programme payment units" field allows for easy calculation of "total expenditures" to farms planting upland cotton in any given year by multiplying payment units by the applicable payment rate. Similarly, for the direct and counter-cyclical payment era, the United States provided a farm-by-farm file ("Dcpby.txt") with base acreage and yield data and an aggregate data file ("Dcpsum.xls"). Again, the "programme payment units" field allows for easy calculation of total expenditures by multiplying payment units by the applicable payment rate. Thus, the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton.") (notes omitted).
[24] US 20 January 2004 Letter to the Panel, p. 3-4 (emphasis added).

> assessment of total expenditures of decoupled payments to farms planting upland cotton. [25]

12. Both the Panel's 12 January 2004 Communication and Exhibit Bra-369 are clear that the United States was required to produce farm-specific information, on the basis of which the allocation of contract payments as support to upland cotton could be performed. The Panel's 12 January 2004 Communication states:

> [T]he Panel requests the United States to provide the *same data* that it agreed to provide in its letters dated 18 and 22 December 2003 but in a format which permits matching of *farm-specific* information on contract payments with *farm-specific* information on plantings. The Panel considers it both necessary and appropriate to seek this information in a suitable format in order to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements.[26]

13. There is a fundamental reason why the US summary (non-farm specific) data does *not* allow for an allocation of support to upland cotton in any given marketing year. To obtain undistorted results, any allocation calculation has to be done on the basis of *individual farms*. Aggregating farm-specific data does not generate the correct amount of contract payments to be allocated to upland cotton. On the contrary, using the aggregate data provided by the United States to allocate payments will inevitably trigger distortions of the results due to an aggregation problem. This problem is illustrated by considering two cotton farms with the following combination of upland cotton base and current upland cotton plantings.

| | **Farm 1** | **Farm 2** |
|---|---|---|
| Cotton Base | 99 acres | 1 acre |
| Cotton Plantings | 1 acre | 99 acres |
| Aggregate Cotton Base | 100 acres | |
| Aggregate Cotton Plantings | 100 acres | |
| Suggested Aggregate Cotton Plantings on Cotton Base | 100 acres | |
| Actual Cotton Plantings On Cotton Base | 1 acre | 1 acre |
| Real Aggregate Cotton Plantings on Cotton Base Acreage | 2 acres | |

Farm 1 plants 99 acres of upland cotton and has 1 upland cotton base acre. Farm 2 plants 1 acre of upland cotton and has 99 upland cotton base acres. In the aggregate, there are 100 acres of upland cotton planted and 100 upland cotton base acreage – a perfect match suggesting that 100 per cent of the upland cotton is planted on upland cotton base. The underlying farm-specific data reveals, however, that this is not the case. Both farms only plant 1 upland cotton acre on upland cotton base. Thus, the real aggregate upland cotton planting on upland cotton base is only 2 acres – not 100 acres. The remaining upland cotton acreage may be planted on some other crop base acreage – as the information requested by the Panel and Brazil would have established.

14. This example demonstrates that using aggregate data to allocate contract payments distorts the results, possibly to a considerable extent. Without non-scrambled farm-specific data (exclusively controlled by the United States), it is impossible to assess how severe this problem is. More importantly, the same aggregation problem arises when other crop plantings and crop base acreages

[25] US 20 January 2004 Letter to the Panel, p. 4.
[26] 12 January 2004 Communication from the Panel, p. 1 (emphasis added).

are considered. This increases the possible distortion that stems from the analysis of aggregate data and makes any judgement as to the direction of the distortion (over- or under-stating the results) impossible.

15. It follows from the discussions above that it is also necessary to have farm-specific data for any allocation exercise. It is only these farm-specific data that allow for farm-specific payment allocations, which, in turn, can be aggregated to "total expenditures."[27] Contrary to the US assertions,[28] aggregate data will not suffice. In sum, despite its numerous assertions on 18 December 2003 and 20 January 2004 to the contrary, the United States failed to provide the requested data.

16. In addition to not providing usable farm-specific planted acreage data, the United States also refused to provide other information requested by the Panel and Brazil.

17. First, the Panel and Brazil also requested the United States to produce farm-specific data on the amount of other contract crop base acreage on farms producing upland cotton with *no* upland cotton base acreage. But the United States refused to provide this information – even in summary form.[29] Although the United States claims otherwise in its 20 January 2004 Letter,[30] the summary files, in fact, do *not* contain data on contract payments to farms that plant upland cotton but do not have upland cotton base.[31] The fact that farms do not have any contract base for upland cotton cannot mean that no such farms have any base acreage whatsoever, which the US-produced data appears to suggest. To the contrary, at least some of these farms are likely to have contract base for other crops, such as rice, corn, and wheat, among others. Because the United States withheld that information, Brazil and the Panel would need to make assumptions on the amount of contract payments received by farms in this third category. Any such assumptions necessarily distort the resulting allocation of contract payments that constitute support to upland cotton.

18. It appears that the reason for the US refusal to provide even summary data on non-upland cotton contract base acreage for these farms stems from the erroneous US argument that Brazil has only challenged upland cotton contract payments made to current producers of upland cotton.[32] The United States concludes, therefore, that it is inappropriate for Brazil to allocate contract payments made to producers of upland cotton producing on other types of base acreage.[33] This refusal is based on an entirely flawed legal argument. In fact, the Panel's terms of reference include the following broad references to contract payments:

> Subsidies and domestic support provided under [the 2002 FSRI Act] … related to … direct payments, counter-cyclical payments … that provide direct or indirect support to the US upland cotton industry.[34]
>
> Subsidies and domestic support provided under [the 1996 FAIR Act] … relating to … production flexibility contract payments … providing direct or indirect support to the US upland cotton industry.[35]

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[27] 12 January 2004 Communication from the Panel, p. 1.
[28] US 20 January 2004 Letter to the Panel, p. 2-4.
[29] *See* Electronic PFC and CCP Summary Files provided by the United States on 18 and 19 December 2003 respectively (Information on contract base of farms in the third category).
[30] US 20 December Letter to the Panel, p. 2.
[31] *See* Electronic PFC and CCP Summary Files provided by the United States on 18 and 19 December 2003 respectively (Information on contract base of farms in the third category).
[32] US 2 December 2003 Oral Statement, para. 31.
[33] US 2 December 2003 Oral Statement, para. 31.
[34] WT/DS267/7, p. 2.
[35] WT/DS267/7, p. 2.

> Subsidies provided under the [1998-2001 Appropriation Acts, i.e., market loss assistance subsidies][36]

19. These terms of reference in Brazil's request for the establishment of a panel are not limited in any way to contract payments made on upland cotton base acres. Brazil listed *contract payments* (unqualified) providing support to the US upland cotton industry, *not upland cotton contract payments* providing support to the US upland cotton industry. Indeed, the reference to "indirect" subsidies is more than broad enough to encompass any type of payment, including payments made from non-upland cotton base acreage. In addition, Brazil's allocation methodology always has included payments made to producers of upland cotton on non-upland cotton base acreage.[37] In short, the US argument ignores the Panel's terms of reference, evidences a misunderstanding of Brazil's allocation methodology, and a misunderstanding of the Panel's and Brazil's requests for information.[38] (As with the other data the United States refuses to produce, Brazil discusses, in Section 5 below, how this constitutes a violation of the US obligations under Article 13.1 of the DSU to cooperate in a panel proceeding.[39])

20. Second, the United States has not provided the requested data for *market loss assistance payments* received by the farms listed for MY 1999-2001. Therefore, the Panel and Brazil would have to make assumptions about the amount of market loss assistance payments that constitute support to upland cotton, based on the information about PFC payments that constitute support to upland cotton. This might distort the results. Further, since market loss assistance payments were also made for soybean base (that otherwise was not eligible to receive PFC payments), this allocation methodology may significantly underestimate the amount of market loss assistance payments that constitute support to upland cotton.[40] In its 20 January 2004 Letter, the United States appears to recognize that market loss assistance payments were within the scope of the Panel's request.[41] It also implies that it has provided the information – at the very least on an aggregate basis.[42] The fact, however, remains that it has not done so.[43]

21. Third, Brazil notes that the 19 December 2003 US data concerning MY 2002 does not contain any information regarding the amount of direct and counter-cyclical payments made on peanut base.[44] As with the missing information on market loss assistance payments (specifically the soybean

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[36] WT/DS267/7, p. 2.

[37] Brazil's 22 August 2003 Rebuttal Submission, Section 2.2 and particularly paras. 32, 38, 42; Brazil's 27 October 2003 Answers to Questions, para. 40; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 2, 17, 50.

[38] Exhibit Bra-369 (Brazil's Request to the United States for Farm-Specific Planting and Base Acreage Data).

[39] *See* Section 5.

[40] The Electronic DCP Summary File demonstrates that farms growing upland cotton in MY 2002 (categories I and III) also grow a significant amount of soybeans, this would have been eligible for a considerable amount of market loss assistance payments in MY 1999-2001 (for which no such data is available).

[41] US 20 January 2004 Letter to the Panel, p. 2.

[42] US 20 January 2004 Letter to the Panel, p. 2 ("In particular, for the production flexibility contract payment era, we provided a farm-by-farm file ("Pfcby.txt") with base acreage and yield data for all programme crops for all "cotton farms" as defined in BRA-369 and data file ("Pfcsum.xls") that aggregated this data for ease of use.[42] The "programme payment units" field allows for easy calculation of "total expenditures" to farms planting upland cotton in any given year by multiplying payment units by the applicable payment rate. Similarly, for the direct and counter-cyclical payment era, the United States provided a farm-by-farm file ("Dcpby.txt") with base acreage and yield data and an aggregate data file ("Dcpsum.xls").[42] Again, the "programme payment units" field allows for easy calculation of total expenditures by multiplying payment units by the applicable payment rate.").

[43] *See* Electronic PFC Summary File, which contains no information on soybean base for market loss assistance payments and no information on possible discrepancies between PFC base and market loss assistance base for the other PFC crops.

[44] Exhibit US-112.

payment information), the missing data on peanut contract payments for MY 2002 would cause lower aggregate payments allocated as support to upland cotton.[45] It follows that any such figures would lead to understating the real support to upland cotton by an amount unknown to Brazil.

22. The United States asserts that the summary data it provided allows for the "easy calculation" of "total expenditures of decoupled payments to farms planting upland cotton."[46] This is simply not true. The table below presents Brazil's calculations of total contract payments to farms that actually produce upland cotton in as far as they were "easy" to perform.[47] The table also reflects the holes in the US summary data described above. These holes prevent any "easy," or even "difficult," calculation of the amount of contract payments to upland cotton farms. Only by making a number of assumptions, as detailed in Sections 9 and 10 below, can the incomplete summary data be used.

| **Subsidy Programme** | **Farms Planting Cotton and Holding Cotton Base** | **Farms Planting Cotton and Not Holding Cotton Base[1]** | **Total Payments** |
|---|---|---|---|
| Marketing Year 1999 | | | |
| PFC Payments | $695,912,510[48] | ? | ? |
| MLA Payments[2] | ? | ? | ? |
| Marketing Year 2000 | | | |
| PFC Payments | $650,579,667[49] | ? | ? |
| MLA Payments[2] | ? | ? | ? |
| Marketing Year 2001 | | | |
| PFC Payments | $520,230,908[50] | ? | ? |
| MLA Payments[2] | ? | ? | ? |
| Marketing Year 2002 | | | |
| Direct Payments[3] | $619,049,305[51] | ? | ? |
| CCP Payments[3] | $1,062,580,729[52] | ? | ? |

[1] The United States has not provided any information on contract payments to farms that plant upland cotton, but do not hold any upland cotton base in its summary files.

[45] The President of the National Cotton Council testified to Congress in 2001 that he grew primarily cotton and peanuts. Exhibit Bra-41 (Congressional Hearing, "The Future of the Federal Farm Commodity Programmes (Cotton)," House of Representatives, 15 February 2001, p. 2). Peanuts are generally grown in the Southern states of the United States, where also cotton is grown. Therefore, it is likely that many cotton farms have also peanut base, which is a high per-acre payment base.

[46] US 20 January 2004 Letter to the Panel, p. 3-4.

[47] Brazil has omitted the third category of farms, for which the United States has presented data (farms not planting upland cotton but holding upland cotton base), as those farms do not produce upland cotton. Therefore, any contract payments received by these farms cannot be "support to" upland cotton.

[48] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[49] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[50] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[51] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[52] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[2] The United States has not provided specific information on market loss assistance payments. In particular, any information on soybean payments to upland cotton farms is missing.

[3] Brazil recalls that the United States withheld information on peanut base payment, thus, these figures are in all likelihood understated.

23. As the Panel can readily see, the only "easy to calculate" payment figures are the PFC, DP and CCP payments figures to farms planting upland cotton and holding upland cotton base (with the DP and CCP payment figures being understated due to the peanut base issue). The other payment figures relating to all market loss assistance payments, and to farms that plant upland cotton but hold only non-upland cotton base cannot be calculated, because the United States produced no data.

24. These calculations are, however, only one step to allocating the amount of contract payments that are actually support to "upland cotton." As Brazil has detailed above, any allocation of "support to" upland cotton has to be performed on a farm-specific basis, to avoid aggregation problems. Any calculation using the US summary data will further distort the results by due to its incompleteness, as demonstrated by the table above.

25. In sum, the fundamental shortcomings in the scrambled and incomplete data provided by the United States on 18 and 19 December 2003 render it unusable for purposes of Brazil's allocation methodology, discussed below,[53] and, for that matter, any allocation methodology.

26. While the United States argued in its 20 January 2004 Letter that the summary data it provided was useful for calculating the amount of contract acreage that constitutes support to upland cotton[54], the Panel must realize that this is – at best – "second-best" evidence, which, due to all the shortcomings just discussed, only allows for distorted calculation results, heavily depending on assumptions.

27. Nevertheless, because the redacted, scrambled and incomplete US data is what was produced, Brazil has attempted to use it.[55] In particular, in Section 9, Brazil has attempted to use the summary data provided by the United States on 18 and 19 December 2003 to allocate contract payments that constitute support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.[56] Due to the limitations of the data discussed above, Brazil was required to make a number of critical assumptions. None of Brazil's assumptions would have been necessary had the

[53] *See* Section 3 below.

[54] US 20 January 2004 Letter to the Panel, p. 2.

[55] Brazil notes that the data provided by the United States appears to be complete, as shown by the following table:

| MY | Contract Acres (US Data) | Contract Acres (USDA) | Percentage | Planted Acres (US Data) | Planted Acres (USDA) | Percentage |
|---|---|---|---|---|---|---|
| 1999 | 16,416,399.4 | 16.4 million | 100 % | 14,572,963.5 | 14.584 million | 99.92 % |
| 2000 | 16,306,696.2 | 16.3 million | 100 % | 15,388,002.9 | 15.347 million | 100.26 % |
| 2001 | 16,245,896.4 | 16.2 million | 100 % | 15,463,934.5 | 15.499 million | 99.77 % |
| 2002 | 18,558,304.2 | not yet reported | - | 13,541,505.9 | 13.714 million | 98.74 % |

Sources:

Contract Acres (USDA): Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19.

Planted Acres (USDA): MY 1999-2001: Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4); MY 2002: Exhibit US-95. Contract Acres (US Data) and Planted Acres (US Data) are taken from the Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December respectively.

[56] *See* Section 9 below. Brazil has applied publicly available information on the payment rates for the contract crops in the marketing yeas concerned (*see* Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

United States produced the requested complete farm-specific information within its exclusive control. Therefore, Brazil cautions against the use of these results. However, Brazil offers these calculations as further circumstantial evidence that its 14/16th methodology is reasonable.

28. In Section 10, Brazil has also attempted to use the US data to perform the US-proposed methodology of allocating contract payments over the total value of the crops produced on the farms producing upland cotton.[57] Brazil strongly disagrees with the US position that such an allocation is required under Part III of the SCM Agreement and GATT Article XVI.[58] Similarly, although Brazil cautions against relying on Brazil's results from applying the US-proposed methodology[59] due to the limitations of the data and the resulting assumptions it had to make, the results would indicate that Brazil's 14/16th methodology generates fairly similar results.

**4. The US Assertions of Confidentiality Are Baseless**

29. The United States attempts to justify its "scrambling" of the acreage data on the grounds that it is "confidential" data barred by the US Privacy Act.[60] A close examination of the facts, including the federal court precedent that binds USDA's administrative actions, shows that the farm-specific acreage data requested by the Panel and Brazil are not confidential.[61]

30. The primary basis for the US confidentiality assertion is an 11 April 2002 USDA FOIA decision concerning *FOOS Farm* (Exhibit US-104). This non-appealed USDA decision stands for the fairly narrow proposition that a FOIA request for a single farm's planting records is an invasion of privacy rights of that farm's operator. In that decision, USDA found that the "release of the number of acres farmed by FOOS Farms would not contribute significantly to public understanding of the operations and activities of FSA."[62]

31. As the USDA *FOOS Farm* decision in Exhibit US-104 demonstrates, there is clearly a difference between a FOIA request for a single farm's acreage data and an across-the-board request for all acreage information – such as that set out in Brazil's 3 December request, and in the rice FOIA request. USDA – and USTR – are bound by US federal court decisions that made exactly this distinction. The leading case is US district court decision in *Washington Post v. United States Department of Agriculture,* 943 F.Supp. 31 (D.D.C. 1996).[63] In that case, the federal court rejected USDA's arguments that the Privacy Act prevented it from producing information on the US cotton programme, including over $1 billion in marketing loan payments, Step 2 payments, and deficiency payments, among others, to US cotton farmers. The court found that there were no violations of privacy rights of US cotton farmers from the "disclosure of names, addresses, and payments that commodity programme recipients received."[64] A close reading of the decision highlights the illegitimacy of the *post hoc* US assertions of confidentiality raised in this dispute. Consider the following passages from the decision:

> The nature of the list [names, addresses, amount of subsidies] sought by plaintiff in this case does not create the same sort of personal privacy concerns or invite the kind of unwarranted intrusion that would justify nondisclosure. The only individualized

[57] *See* Section 10 below.

[58] *See* Brazil's 18 November 2003 Further Rebuttal Submission, Section 3.5 and Brazil's 2 December 2003 Oral Statement, Section 3.

[59] *See* Section 10 below.

[60] US 18 December 2003 Letter to the Panel, p. 1-2.

[61] *See* also 12 January 2004 Communication from the Panel, p. 1.

[62] Exhibit US-104, p. 2.

[63] Cited in Exhibit US-104, p. 2.

[64] Exhibit Bra-418 (Washington Post v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996, p. 5).

> information that would be ascertainable from the release of the list is that a particular individual grows cotton, the address of the farm where the cotton is grown and where the subsidy is received, and how much of a subsidy that cotton farmer received in 1993. *It might also be deduced from the amount of the subsidy how much cotton the producer grew in 1993.* The Court is unable to discern, nor have defendants persuasively explained, how any of this relatively generic information about thousands of similarly situated business people could constitute clearly unwarranted invasions of their personal privacy. *Indeed, it is precisely because the list is so large and the information so generic that the impact on privacy interests are so small*.[65]

32. The court went on to note that there was a strong public interest in the disclosure of the information, rejecting USDA's arguments that the data "pertaining to the cotton programme recipients would not shed any light on the workings of the agency and that therefore there is no public interest in its disclosure." [66] The court found (in language that is particularly applicable to this WTO dispute) that "a significant public interest lies in shedding light on the workings of the Department of Agriculture and the administration of this massive subsidy programme, and plaintiffs have persuasively demonstrated how the release of the recipients names, addresses and subsidy amounts could illuminate the USDA's actions."[67] Thus, despite the Privacy Act of 1974, the court ordered USDA to turn over the farm-specific information.

33. A 1999 US federal court decision in *Hill v. United States Department of Agriculture* found there was a privacy interest in instances where the FOIA request sought information on loans made to an individual borrower. Citing the *Washington Post* case, the court reasoned that because the information related to the finances of one closely-held family corporation and not to "tens of thousands of otherwise indistinguishable business people," it found the corporation had a significant privacy interest.[68]

34. In light of this precedent, it is not surprising that USDA's FOIA office in Kansas City (which is USDA's only FOIA office for such data) agreed on 14 November 2003 to provide complete contract base and acreage data in relation to rice. This is because that request covered *all* rice planted acreage and all rice contract acreage. Pursuant to the reasoning in the *Washington Post* case, USDA's FOIA representatives necessarily must have determined that because the request did not focus on an individual producer's farm, the interests of the public in understanding and evaluating the operation of the contract payment schemes outweighed any privacy interests. Otherwise, the rice data would never have been released. The *post-hoc* attempt by the United States on 18 December 2003 and 20 January 2004 to argue that this information was provided by "mistake" is simply not credible.

35. Brazil notes, further, that the United States provided no evidence that any mandatory provisions of US law or regulations prevent the production of acreage information. The United States incorrectly argues that the Privacy Act of 1974 prohibits the release of planted acreage information for individual farms.[69] But nothing in the text of the Privacy Act cited by the United States requires this. Indeed, the fact the federal court in *Washington Post* ordered the production of farm-specific payment data shows the fallacy of this US arguments. The *Washington Post* decision teaches that the Privacy

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[65] Exhibit Bra-418 (Washington Post v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996, p. 3)(emphasis added). None of the information at issue this case is stigmatizing, embarrassing, or dangerous; it does not expose these cotton farmers to creditors and nothing about the success or failure of the farm or the wealth or poverty of the recipient.

[66] Exhibit Bra-418 (Washington Post v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996, p. 3).

[67] Exhibit Bra-418 (Washington Post v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996, p. 4).

[68] Exhibit US-104 *citing Hills v USDA* decision.

[69] US 18 December 2003 Letter to the Panel, p.2.

Act of 1974 does not function as an inviolate shield to protect individual crop planting data with no exception other than the written permission of each US farmer, as the United States incorrectly asserts.

36. In fact, the only reference to acreage reports is in what the United States incorrectly characterizes as a "long-standing policy" set out in FSA's FOIA Handbook.[70] But this FOIA "policy" does not constitute a US law mandating confidentiality of planted acreage information. It is only guidance to FOIA officers that obviously can be disregarded by the USDA Secretary or other implementing officials in individual cases. The release of the rice information by USDA's FOIA office on 14 November 2003 demonstrates that this policy guidance is not mandatory. In fact, the statutory FOIA requirements, as interpreted by the US federal courts (as in the *Washington Post* decision) clearly take priority over any internal USDA policy guidance documents. The United States is not barred by any provision of US law, either on its face or as interpreted by US courts, from providing the information requested by the Panel.

37. The evidence cited by the United States in support of its refusal to provide the requested data does not, therefore, support its conclusion that the data cannot be released.[71] In effect, the US government has attempted to create, *post-hoc*, a new mandatory policy for the purposes of this dispute. This blatant attempt to prevent the Panel and Brazil from gaining access to information that was readily supplied to a private US citizen in the case of rice was rejected by the Panel in its 12 January 2004 Communication. Unfortunately, the United States' 20 January 2004 Letter continues this approach.

38. Finally, Brazil notes that even if the USDA FOIA policy "guidance" were set out in a mandatory US statute, the United States could still provide the information requested by the Panel and Brazil without "scrambling" it. As the Panel has noted in its 12 January 2004 Communication, there would have been various options available to the United States to produce the information in a manner that would have protected the confidentiality rights of US farmers. Brazil made it clear in its 22 December 2004 Answers to Questions that a substitute number protecting the alleged confidentiality rights of farmers would be acceptable.[72] Since neither Brazil nor the Panel has any interest in an individual farm's identity, providing the requested information in such a manner would have provided Brazil and the Panel with the payment information that they have long sought.

39. In its 20 January 2004 Letter, the United States now asserts that no farm-specific data was actually requested, as the Panel has only sought to determine the total amount of contract payments to farms producing upland cotton.[73] However, both the Panel's 12 January 2004 Communication and Exhibit Bra-369 are clear that the United States was required to produce farm-specific information, on the basis of which the allocation of contract payments as support to upland cotton could be performed. And as Brazil has demonstrated above,[74] the initial allocations have to be performed on a farm-specific level to avoid any aggregation problems.

40. The United States did not even provide a complete summary of the data resulting from the farm-specific comparison between planted and contract acreage on an *aggregate* basis.[75] Such

[70] Exhibit US-106.
[71] *Similarly* 12 January Communication from the Panel, p. 1.
[72] Brazil's 22 December 2003 Answers to Questions, para. 7.
[73] US 20 January 2004 Letter to the Panel, p. 3.
[74] *See* Section 3.
[75] Of course, since the United States fails to provide other requested data, even the summary data of the farm-specific data has huge gaps. For example, the United States does not provide data on contract base on farms that have no upland cotton base but may have other crop contract base. Further, the United States does not provide any MY 2002 data on peanut base on whichever type of farm, thus triggering an understatement of the actual support to upland cotton from contract payments, calculated under any allocation methodology.

summary aggregate information is, of course, not confidential, since it could never reveal the names of any producers, their farms, or the location of the farms. Of course, such a summary document is not a perfect substitute for the complete farm-specific data requested by the Panel. But the US failure to present this obviously non-confidential data highlights its continuing non-justifiable concealment of key information from the Panel and Brazil.

41. Had the United States been willing to cooperate on this issue, it could have either provided the data, as the Panel's 12 January 2004 Communication and Brazil's 22 December Answers to Questions[76] suggested, using a dummy farm number or a consolidated single file for contract and planted acreage (with no farm number),[77] or clarified with Brazil whether there could be a way to address the US confidentiality concern, including throught special procedures for confidential information, as foreseen by Articles 13 and 18 of the DSU.[78] Instead, the United States has simply chosen to refuse to produce the information.

42. Lastly, the United States' 18 December 2003 Letter dramatically calls for Brazil to "return" the rice FOIA request data that was requested and received by a private US citizen.[79] Yet, US federal courts have held that "once records are released, nothing in FOIA prevents the requester from disclosing the information to anyone else."[80] Thus, under US law, the rice data is in the public domain. However, in the spirit of cooperation, Brazil notes that it understands that neither it, nor any person in or formerly in its delegation, or which provided statements to the Panel, currently retains any of this now-public data released by USDA pursuant to its FOIA authority. Moreover, the only information from the rice request used by Brazil in this dispute is set out in Exhibit Bra-368, which reflects *aggregated* data gleaned from the farm-specific comparisons of rice contract acreage with rice planted acreage. Brazil assumes that even the United States would agree that this aggregated data is not confidential.

### 5. There Is No Basis under WTO Rules for the United States to Withhold Planted Acreage Information on The Basis of Confidentiality

43. As described in Section 4 above, the effect of the "scrambling" of planted acreage and contract acreage data by the United States amounts to withholding information specifically requested by the Panel. Further, the failure of the United States to provide any non-cotton base acreage for the third category of farms,[81] and the failure of the United States to produce any information on market loss assistance payments and peanut direct and counter-cyclical payments, also amounts to withholding the information requested by the Panel.

44. In its 20 January 2004 Letter, the United States now makes the additional argument that it can no longer provide the requested information in an anonymous format,[82] using either a dummy farm number, or providing a consolidated file that would contain both contract acreage and planted acreage, but no farm serial number.[83] According to the United States, this is because it has already provided contract acreage with farm serial numbers, and that, with the additional information

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Finally, the United States does not provide information on market loss assistance payments during MY 1999-2001.

[76] Brazil's 22 December 2003 Answers to Questions, para. 7.

[77] The United States was aware that neither Brazil nor presumably the Panel was interested in the farm serial number *per se*.

[78] The Panel has suggested that in its 12 January 2004 Communication as well.

[79] The United States reiterates its request in its 20 January 2004 Letter to the Panel, p. 3.

[80] *Swan v. SEC*, 96 F.3d 498, No. 95-5376, slip. Op. at 4 *cited in Washington Post*, Exhibit Bra-418, p. 2.

[81] Those that produce upland cotton, but do not have upland cotton contract acreage.

[82] This was suggested by the Panel in its 12 January 2004 Communication.

[83] As suggested by Brazil in its 22 December 2004 Answers to Questions, para. 7.

requested by the Panel, Brazil would be able to deconstruct the "confidential" farm serial number.[84] This argument is irrelevant, because the United States has an obligation to produce the information, even if it is "confidential."

45. The United States asserts that, pursuant to the US Privacy Act, it cannot release so-called "confidential" farm-specific planted acreage information associated with a particular farm.[85] Nevertheless, despite the alleged bar of the US Privacy Act, the United States produced farm-specific information concerning the contract acreage designating it as "confidential due to its sensitive nature."[86] The United States never explained how it could produce *contract payment information* on a farm-specific basis, which would be protected by WTO confidentiality procedures, but not *farm-specific acreage information*. If the WTO confidentiality procedures are good enough for one set of confidential data, then they must be good enough for another set of "confidential" data.

46. But even accepting, *arguendo*, that the US acreage data is confidential under US law, there is no basis for the United States to argue or assert that the confidentiality of this information would not be protected in these WTO proceedings. Paragraph 3 of the Panel's working procedures states that "Members shall treat as confidential information submitted by another Member to the Panel which that Member has designated as confidential." These working procedures, like DSU Articles 13.1 and 18.1, require information designated as confidential by the United States to be protected as such by both the Panel and Brazil. Nothing in the Panel's working procedures or any other DSU rule suggests that the United States should be concerned that its information would not be protected. Certainly, nothing suggests that the United States may unilaterally withhold or redact requested information on confidentiality grounds. Indeed, the Panel notes in its 12 January 2004 Communication that this information "can be protected under the DSU and our working procedures."[87] Brazil fully agrees.

47. Brazil notes that the US 18 December 2004 Letter also did not request the adoption of any special confidentiality procedures. Nor did the United States attempt to contact Brazil prior to 18 December 2003 to discuss whether Brazil would agree to special procedures for the protection of the allegedly confidential information – procedures that Brazil has agreed to repeatedly in past disputes involving business confidential information.[88] The United States has similarly participated in many earlier WTO disputes in which it has agreed to such procedures.[89] Nor has the United States presented evidence or argument suggesting that existing WTO confidentiality provisions would not fully protect the confidentiality of planted acreage information. It goes without saying that Brazil would have treated such information in a confidential manner, consistent with its obligations under the Panel's working procedures, and Articles 13.1 and 18.1 of the DSU.

48. There is no legal basis under WTO rules for the United States to withhold this information following the Panel's August 2003, October 2003, 3 December 2003 and 12 January 2004 requests that it produce this information. These requests to the United States to produce the information requested by Brazil in Exhibit Bra-369 were made pursuant to the Panel's authority under DSU Article 13.1.

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[84] US 20 January 2004 Letter to the Panel, p. 3.
[85] US 18 December 2003 Letter to the Panel, p. 2.
[86] US 18 December 2003 Letter to the Panel, p. 3.
[87] 12 January 2004 Communication from the Panel.
[88] Panel Report**,** *Brazil – Aircraft***,** WT/DS46/R, para. 1.10; Panel Report, *Canada – Aircraft*, WT/DS70/R, paras. 9.57 – 59.
[89] Panel Report, *EC – Bananas (22.6) (US)*, WT/DS27/ARB, para. 2.5 (as requested specially by the United States); Panel Report, *Australia – Leather*, WT/DS126/R, para. 4.1; Panel Report, *Australia – Leather (21.5)*,WT/DS126/RW, para. 3.2; Panel Report, *US – Wheat Gluten*, WT/DS166/R, para. 3.1; Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.54-56.

49. The Appellate Body and panels have held that a Member is *required* to provide information – including confidential business information – upon a request made under DSU Article 13.1. The Appellate Body in *Canada – Aircraft* found that WTO Members "are … under a duty and an obligation to 'respond promptly and fully' to requests made by panels for information under Article 13.1 of the DSU."[90] The obligation in DSU Article 13.1 is not limited to only non-confidential information. Indeed, Article 13.1 explicitly anticipates the production of confidential information, providing that "confidential information which is provided shall not be revealed without formal authorization from the individual, body, or authorities of the Member providing the information." As the Appellate Body stated in *Canada – Aircraft*:

> [t]o hold that a Member party to a dispute is not legally bound to comply with a panel's request for information relating to that dispute, is, in effect, to declare that Member legally free to preclude a panel from carrying out its mandate and responsibility under the DSU. So to rule would be to *reduce to an illusion and a vanity the fundamental right of Members to have disputes arising between them resolved through the system and proceedings for which they bargained in concluding the DSU*.[91]

50. The "refusal by a Member to provide information requested of it" has been found by the Appellate Body to "undermine seriously the ability of a panel to make an objective assessment of the facts and the matter, as required by Article 11 of the DSU."[92] The obligation to provide information has been deemed a "requirement for collaboration of the parties in the presentation of the facts and evidence to the panel."[93] Panels have found that "the most important result of the rule of collaboration appears to be that the adversary is obligated to provide the tribunal with relevant documents which are in its sole possession."[94]

51. In *US – Wheat Gluten*, the Appellate Body reaffirmed this "obligation" and "duty" under DSU Article 13.1 to produce all information requested, including information designated as "business confidential." In that case, the United States only agreed to produce to the panel, but not to the EC, information redacted from the public version of a USITC report in a safeguard investigation. The panel in that case proposed three different special procedures for business confidential information, but the United States still refused to make the information available to the EC. The panel indicated that the information withheld "would have facilitated our objective assessment of the facts in this case, and of the matter before us."[95] On appeal, the Appellate Body reaffirmed the "obligation" and "duty" of Members to produce all information, including business confidential information, to panels when requested under DSU Article 13.1. In affirming the panel's ruling, the Appellate Body stated that it "deplore[d] the conduct of the United States" in refusing to produce business confidential information.[96]

52. The panel in *Canada – Aircraft* similarly emphasized the obligation of a Member under DSU Article 13.1 to provide "highly sensitive business confidential information,"[97] as well as information that Canada claimed was governed by a "Cabinet privilege."[98] Similar to what the United States did in "scrambling" the key information in this case, Canada argued that while it could not provide the confidential "Cabinet privilege" documents, it could provide a summary of the criteria the

[90] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 187 (emphasis added).
[91] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 189 (emphasis added).
[92] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 189.
[93] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.40.
[94] Panel Report, *Argentina – Textiles and Apparel*, WT/DS56/R, para. 6.40.
[95] Panel Report, *US – Wheat Gluten*, WT/DS166/R, para. 8.12.
[96] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 171.
[97] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.293 (Canada's description).
[98] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.294.

Government used to award one particular contribution.[99] However, the panel rejected the utility of this proffered information, finding that the information provided by Canada was not sufficient to rebut Brazil's *prima facie* case that Canada had provided export subsidies.[100] In addition, as with the "scrambled" information provided by the United States, the panel noted the uselessness of business confidential information "redacted" by Canada. The panel found it had been so heavily redacted that it was "simply of no value to the panel."[101]

53. As in *Canada – Aircraft*, the US "scrambling" of contract and acreage data effectively "redacted" the information requested by the Panel to such an extent that it cannot be relied on. In addition, the United States' offer to provide "summary" data tabulating the incomplete "scrambled" acreage data on the one hand, and the contract acreage on the other hand, should be rejected by the Panel. As in *Canada – Aircraft*, a party refusing to cooperate under Article 13.1 should not be permitted to selectively present evidence while withholding evidence within its exclusive control that is far more directly relevant. As the panel found in *Canada – Aircraft*, "Canada has outright refused (on the basis of Cabinet privilege) to provide what in the Panel's view are the most relevant of the documentation that it requested regarding the five contributions identified by Brazil."[102] Data permitting the linking of contract and acreage data is similarly the most relevant of the documentation requested by the Panel.

54. The US refusal to provide *certain* allegedly confidential information in this dispute without even seeking special confidentiality provisions[103] (while providing other information it designates as confidential) is completely inconsistent with its arguments before the Appellate Body in *Canada – Aircraft*. In that appeal, the United States argued that "the need for additional procedures for protecting business confidential information is extremely important, because it goes to the viability of WTO dispute settlement as a vehicle for preserving the rights and obligations of Members."[104] Moreover, the United States argued that the application of procedures for protecting business confidential information promotes important objectives, because Members' rights and obligations under the covered agreements can only be preserved if due process is accorded to both the complaining party and the responding party.[105] The United States maintained that "the demands of due process are not satisfied, however, if the absence of such procedures precludes a Member from properly making its case."[106]

55. Finally, while it argues in this case that the 1974 Privacy Act allegedly prevents it from providing the acreage information *in any form*, the United States maintained in *Canada - Aircraft* that "a Member's national laws do not provide a basis for depriving another Member of its rights under the WTO Agreement."[107] In that case, the EC – as a third party – argued that requiring its officials to sign a non-disclosure form as part of special confidentiality procedures set up by the *Canada – Aircraft* panel would violate their duties of disclosure under EC law. In response, the United States argued

[99] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.294.
[100] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.345.
[101] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.345.
[102] Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 9.345.
[103] In addition to DSU Article 13.1, DSU Article 18.2 provides procedures concerning the protection of confidential information. In addition, Article 12.1 of the DSU permits panels to adopt working procedures in addition to those established in the DSU. This would provide private business interests with adequate protection for their business information, if it is considered of sensitive nature. If the US concern was indeed confidentiality, it could have requested the Panel to arrange for the proper procedures to deal with the information the US claims has such a high confidential status, that it cannot be provided to the Panel or Brazil under normal business confidential information procedures. Therefore, such procedures could have addressed the US concerns about the confidential nature of the information withheld. The United States has not done so.
[104] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 137.
[105] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 139.
[106] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 139.
[107] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 140.

that the EC's claim that "its officials would be unable, under their staff regulations, to accept the undertaking proposed 'should not be allowed.'"[108]

56. In conclusion, there is no justification under WTO rules for the United States to refuse to produce all of the information sought by the Panel in August 2003, October 2003, and on 3 December 2003 and 12 January 2004. The continuing refusal to provide this highly-relevant information is clear evidence of non-cooperation.

**6. The Panel Should Draw Adverse Inferences from the US Failure to Cooperate**

57. In light of the US failure, in response to the Panel's four requests for information on the amount of contract payments provided to *current* producers of upland cotton, to provide information within its exclusive control, Brazil requests the Panel to draw the following adverse inferences:

- That the application of Brazil's methodology[109] for allocating PFC, MLA, CCP, and DP payments to current producer of upland cotton in each of the marketing years 1999-2002 using data exclusively within the control of the United States would have resulted in payments that were higher than those estimated by Brazil's 14/16th methodology.

- That the application of the US methodology for allocating PFC, MLA, CCP, and DP payments to current producer of upland cotton in each of the marketing years 1999-2002 using data exclusively within the control of the United States would have resulted in payments that were as high or higher than those estimated by Brazil's 14/16th methodology.

- That the information withheld by the United States would have been detrimental to its arguments that PFC, MLA, DP, and CCP payments are not support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture, or alternatively, "non-product-specific" support.

58. The legal basis for the Panel's drawing *adverse* inferences is found in the Appellate Body's decision in *Canada – Aircraft*, where it found that "the authority to draw adverse inferences from a Member's refusal to provide information belongs *a fortiori* also to panels examining claims of prohibited export subsidies. Indeed, that authority seems to us an ordinary aspect of the task of all panels to determine the relevant facts of any dispute involving any covered agreement: a view supported by the general practice usage of international tribunals."[110] The Appellate Body in *Canada – Aircraft* stated that "if we had been deciding the issue that confronted the panel [when referring to the drawing of adverse inferences] we might have concluded that the facts of the record did warrant the inference that the information Canada withheld included information prejudicial to Canada."[111] The Appellate Body based its "adverse inferences" holding on an interpretation of the DSU and the SCM Agreement, as well as on support from the following international law jurisprudence:

- In *The Corfu Channel Case*, where the International Court of Justice stated that "… the victim of a breach of international law is often unable to furnish direct proof of facts giving rise to responsibility. Such a State should be allowed a more liberal recourse to

[108] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, paras 135, 140.
[109] *See* Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.
[110] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 202; *See* also "Evidence Before International Tribunals," D.V. Sandifer, Revised Edition, University Press of Virginia 1975, p.153.
[111] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 205.

inferences of fact and circumstantial evidence. This indirect evidence is admitted in all systems of law, and its use is recognized by international decisions."[112]

- *Case Concerning Military and Paramilitary Activities In and Against Nicaragua*, where on the basis of the facts before it, the International Court of Justice found that it could reasonably infer that certain aid had been provided from Nicaraguan territory.[113]

- *Case Concerning the Barcelona Traction, Light and Power Company Limited*, where Judge Jessup, in his separate opinion, opined that "… if a party fails to produce on demand a relevant document which is in its possession, there may be an inference that the document if brought, would have exposed facts unfavourable to the party… ."[114]

- In *William A. Parker (USA) v. United Mexican States*, the Mexican-United States General Claims Commissions stated that "in any case where evidence which would probably influence its decisions is peculiarly within the knowledge of the claimant or of the respondent Government, the failure to produce it, unexplained, may be taken into account by the Commission in reaching a decision."[115]

59. In *US – Wheat Gluten*, the Appellate Body provided additional guidance on the drawing of adverse inferences, noting that the complaining party must identify which facts support a particular inference and what inferences the Panel should have drawn from those facts.[116]

60. In view of these legal standards, Brazil sets forth and references the facts which support the drawing of these three adverse inferences it has requested.

61. First, at the time it refused to produce the requested information on 20 January 2004, the United States was aware of the following key facts: (1) it knew Brazil's latest estimates using the 14/16$^{th}$ methodology,[117] (2) it knew the results of the EWG database tabulations,[118] and (3) it had access to all farm-specific contract, yield, payment and planted acreage data in a centralized database that would have permitted a calculation of the total amount of support under a variety of methodologies, including that advocated by the United States. These facts support the drawing of the first two (adverse) inferences requested by Brazil.

62. Second, the United States was fully capable of calculating the amount of payments allocable to current US producers of upland cotton. As an initial matter, the data would allow for an exact payment total of the amount of *upland cotton* contract payments received by *upland cotton* farmers. Thus, without using any allocation methodology for non-upland cotton payments, the United States knows the exact amount of all these cotton-specific payments. Further, the United States was fully instructed on how Brazil calculated the support attributable to rice in Exhibit Bra-368, Tables 2-3 and accompanying data. Further, throughout the briefings on the different allocation methodologies, the United States left no doubt that it was fully aware of how to calculate the amount of payments using a

[112] The Corfu Channel Case, 1949, ICJ, 4, p.18, *cited* in Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R; note 128.

[113] Case Concerning Military and Paramilitary Activities, 1986 ICJ 14, p. 82-86, paras. 152, 154-156, *cited* in Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R; note 128.

[114] Case Concerning the Barcelona Traction, Light and Power Company Limited, 1970 ICJ 3, p. 215, para. 97, *cited* in Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R; note 128.

[115] Reports of International Arbitral Awards, Vol. IV, 35, p.39, *cited* in Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R; note 128.

[116] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 176.

[117] Set out in Brazil's 22 December 2003 Answers to Question, para. 8.

[118] Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.1. *See* also Brazil's 28 January 2004 Comments on US Answers, paras. 20-22.

number of different methodologies, including Brazil's 14/16th methodology, as well as the methodology advocated by the United States itself.[119] Given this knowledge, opportunity, and capability, the Panel may infer that the United States knew the amount of payments resulting from the application of both the Brazilian as well as their own allocation methodologies. These facts support the drawing of the first two (adverse) inferences.

63. Third, the consistently misleading information provided by the United States concerning its possession of data regarding acreage and payment information for contract payments is another fact supporting the drawing of all three adverse inferences. Brazil first requested this information in November 2002, and then repeatedly through December 2003. The Panel made similar requests. It is uncontested that the United States government, through USDA's Kansas City Administrative Office and its database, collected, organized and maintained in a centralized database all of the data that would be responsive to Brazil's and the Panel's requests. The United States now argues it did not "maintain" information on the amount of contract payments paid to current producers of upland cotton.[120] The ordinary meaning of the word "maintain" is "practice habitually," "observe," "cause to continue (a state of affairs, a condition, an activity)."[121] The rapid response of USDA's Kansas City office to the rice FOIA request provides compelling evidence of habitual practice of the US government in "maintaining" both contract and planted acreage information.[122] In sum, the pattern of misrepresentations supports the finding that the United States sought to hide this information and to mislead Brazil and the Panel, because it knew that the requested information would be harmful to its defence.

64. Fourth, a major issue in this dispute has been whether the US contract payments are support to upland cotton, or alternatively, as the United States argued, whether they are "non-product-specific support." As the United States knew on 20 January 2004, a key element of Brazil's proof of support to upland cotton is demonstrating the extent to which the allegedly "decoupled" contract payments are actually paid to current producers of upland cotton. Brazil has provided extensive circumstantial evidence demonstrating this link.[123] The refusal of the United States to provide the information provides the basis for the Panel to infer that the United States knew this information would be detrimental to its argument that these payments were not linked to current cotton production.

65. In deciding whether to draw any adverse inferences, the Panel may wish to consider the precedential impact of the US refusal to cooperate. If a Member can easily block a panel's request for information without any consequences, it will provide a clear roadmap for avoiding subsidy and other WTO disciplines in the future. It will also encourage parties to a future dispute to obfuscate and refuse to provide requested evidence. The WTO dispute settlement system will simply cease to function over the long run unless there are consequences that follow from a Member's non-cooperation. In short, the US lack of cooperation, in the words of the Appellate Body in *US – Wheat Gluten*, is to be "deplored," rather than rewarded.[124]

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[119] US 18 November 2003 Further Submission, paras. 11-17; US 2 December 2003 Oral Statement, paras. 23-24, 26-28.

[120] US 22 December 2003 Answers to Questions, paras. 6-11.

[121] New Shorter Oxford Dictionary, 1993 edition, p. 1669.

[122] The current WTO rules do not permit Brazil to recover the enormous costs it has incurred in this dispute to prove circumstantially what the United States had in its possession for the past 15 months. The Panel should consider that, if the misrepresentations made by the United States in this proceeding had been made in US Federal Courts, they would have resulted in the award of significant attorney's fees and costs in a US Federal Court. *See e.g.*, Federal Rule of Civil Procedure 26(g)(2)(A), (3) (sanctions include reasonable expenses including attorney's fees due to misleading certification of accuracy of discovery responses).

[123] *See e.g.* Brazil's 9 October Closing Statement, Annex I, although later submissions provided considerable additional information such as Brazil's 18 November Further Rebuttal Submission, Sections 2.1, 3.1 and 3.7.5.

[124] Appellate Body Report, *US – Wheat Gluten*, WT/DS166/AB/R, para. 171.

66. Finally, any adverse inferences drawn by the Panel become part of the evidence on the basis of which the Panel must make an objective assessment of the facts under DSU Article 11. Among the best available "facts" are the adverse inferences themselves. The Appellate Body in *Canada – Aircraft* held that "a panel must draw inferences on the basis of all of the facts of record relevant to the particular determination to be made,"[125] and that "[w]here a party refuses to provide information requested by a panel, that refusal will be one of the relevant facts on record, and indeed an important fact, to be taken into account in determining the appropriate inference to be drawn."[126]

### 7. The US Refusal to Provide the Information Requested Renders Brazil's 14/16th Methodology the Most Accurate Information on Record Concerning the Amount of Support to Upland Cotton from Contract Payments

67. Since the United States has not provided the data, the best available information before the Panel is Brazil's so-called "14/16th" methodology. This information is the most accurate proxy for the amount of contract payments that constitute support to upland cotton. By this methodology, Brazil has made the assumption that all upland cotton is planted on upland cotton base. Or, put differently, for each acre planted to upland cotton an average contract payment in the amount of an upland cotton contract payment is received. Accordingly, Brazil has adjusted the amount of upland cotton contract payments made in any marketing year by the ratio of the acreage actually planted to upland cotton and the upland cotton contract payment base acreage in that marketing year.[127] For MY 2002, the original ratio was about 14/16th,[128] therefore the name of the methodology. In fact, Brazil has used a different adjustment factor for each marketing year.[129]

68. Brazil has demonstrated with circumstantial evidence that current upland cotton producers need contract payments to generate sufficient returns to remain economically viable.[130] Brazil has also demonstrated that current producers of upland cotton need high per-acre contract payments (such as those provided for upland cotton, rice, peanut or corn base) to cover the cost of upland cotton production.[131] Thus, in the absence of the withheld data, it is fair to assume that some upland cotton was planted on base acreage with higher payments than upland cotton base (*e.g.*, rice[132]), and some was planted on base acreage yielding lower contract payments than upland cotton base (*e.g.*, corn). These phenomena would, on average, cancel each other out, so that one can reasonably assume that the average planted upland cotton acre received a contract payment in the amount of an upland cotton contract payment.[133]

69. In addition, the incomplete EWG data supports the conclusion that most US upland cotton is planted on upland cotton base.[134] Three quarters of all upland cotton base payments are paid to

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[125] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 204.

[126] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, para. 204.

[127] Since planted acreage in all marketing years is below the base acreage, this amounts to a downward adjustment of the total payments made in relation to upland cotton base acreage.

[128] The final planted acreage figure provided by the United States in a later stage of this dispute required a slight adjustment to the figure: *see* Brazil's 22 December 2003 Answers to Questions, para. 8.

[129] *See* Brazil's 11 August 2003 Answers to Questions, Notes to Table at paras. 97 and 130.

[130] These facts are summarized in Annex 1 to Brazil's 9 October 2003 Closing Statement but are contained in a number of Brazil's earlier submissions to the Panel beginning on 24 June 2003. *See* also Brazil's 18 November Further Rebuttal Submission, Sections 3.1 and 3.7.5.

[131] Brazil's 22 August 2003 Rebuttal Submission, paras. 30-34 and 39-44; Brazil's 27 October 2003 Answers to Questions, paras. 14-24 and Brazil's 2 December 2003 Oral Statement, paras 26-27.

[132] Brazil notes that the data provided by the United States does not contain any information on peanut base payments, which would also be a high per-acre payment crop.

[133] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 50-51.

[134] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 22-28. *See* also Brazil's 28 January 2004 Comments on US Answers, paras. 20-22.

producers of upland cotton.[135] The EWG data further demonstrates that the great majority of both contract payments and marketing loan payments received by upland cotton producers are for upland cotton.[136] Thus, while part of the contract payment support to upland cotton comes from non-upland cotton contract payments, any over- or under-counting resulting from Brazil's "14/16th" methodology would be minimal.

70. Finally, in making this factual finding, the Panel should also take into account, as a fact of record, the adverse inferences outlined in Section 6 above, which fully support a finding that Brazil's 14/16th methodology is correct. In addition, the Panel should take into account the adverse inference that the US allocation methodology would have resulted in contract payments at least as high as those in Brazil's 14/16th methodology. However, in making its objective assessment of the facts, the Panel should reject the partial information proffered by the United States in its 18 and 19 December 2003 Letter and reflected in various submissions.[137] As in *Canada – Aircraft*, this heavily redacted information, which excludes the most relevant information requested, should be ignored.

## 8. Brazil's Intended Methodology For Allocating Contract Payments as Support to Upland Cotton

71. Brazil intended to use the data requested from the United States to calculate the amount of contract payments that constitute "support to" upland cotton,[138] within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.[139] In its 20 January 2004 Answers to Additional Questions, Brazil provided more detailed information concerning its allocation methodology.[140] Brazil emphasizes that it intended to apply this methodology since early on in this dispute, but was prevented from doing so due to (1) the US denial that the data existed and (2) the US refusal to provide the data requested by the Panel and Brazil.[141] Only because of the US argument that it did not have the information requested and – after demonstrating the incorrectness of that argument – because of the US refusal to provide the information, Brazil suggested to apply its so-called "14/16th" methodology as a proxy.

[135] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 23-24.

[136] Brazil's 18 November 2003 Further Rebuttal Submission, para. 26.

[137] *E.g.*, in note 12 of the 22 December 2003 US Answers to Questions the United States asserts that only 30.7 per cent of cropland on US upland cotton farms was planted to upland cotton in MY 2002. This figure is however misleading, as the United States has classified as "upland cotton farm" not only farms that currently grow upland cotton, but also farms that historically grew upland cotton (and, therefore, have upland cotton base) yet have stopped to do so. This is an inappropriate categorization. By contrast, in paragraph 186 of its 22 December 2003 Answers to Questions, the United States provides the correct figure of 48 per cent of cropland on farms actually producing upland cotton is planted to upland cotton. The Panel should not allow the United States to selectively use its data (which cannot be checked), but not allow the Panel or Brazil to receive the data needed to calculate the amount of support to upland cotton from the contract payments.

[138] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 3, 17-19, 47-49; Brazil's 2 December 2003 Oral Statement, para. 2 and Exhibit Bra-369 (Brazil's Request to the United States for Farm-Specific Planting and Base Acreage Data).

[139] Brazil notes that it is its position that the peace clause is an affirmative defence and that it is the burden of the United States to demonstrate that its current support to upland cotton does not exceed the support decided during 1992 (*see inter alia* Brazil's 22 July 2003 Oral Statement, paras. 5-11). The United States has not lived up to its burden of proof and has repeatedly failed to provide the data that would allow the Panel and Brazil to calculate the exact amount of support to upland cotton.

[140] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[141] *See inter alia* Brazil's 9 October 2003 Closing Statement, paras. 2-9, in particular para. 2, 6 and 9; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 2-3, 17, 32 and 47-51.

## 9. Using the Problematic and Incomplete US 18 / 19 December 2003 Aggregate Data for Allocating Contract Payments as Support to Upland Cotton Does Not Contradict Brazil's 14/16th Methodology

72. In this Section, Brazil presents its results from applying a simplified version of its methodology applied to the US summary data. Brazil incorporates all of its reservations it has expressed regarding this data.[142] Brazil further recalls its various arguments why contract payments constitute support to specific commodities.[143] Therefore, contract payments are principally allocated to the programme crops covered, as suggested by Brazil's methodology presented in its 20 January 2004 Answers to Additional Questions.[144]

73. As the record demonstrates, none of four types of contract payments[145] is truly "decoupled," given the production of programme crops by the farms holding contract payment base. To the contrary, they are intended to and, in fact, do provide support for the production of programme crops. This is particularly true in the case of high per-acre payment crops, such as upland cotton and rice.[146] Therefore, Brazil allocates contract payments to the programme crops covered. This approach is reasonable, since contract payments are eliminated, for instance, if fruits and vegetables are grown. In sum, Brazil maintains its position – supported by all third parties[147] – that the support from contract payments that can be allocated to upland cotton is product-specific support within the meaning of the Agreement on Agriculture.[148]

74. Although Brazil could not use the data provided by the United States for its intended purpose, Brazil has attempted to apply a similar but less complex allocation methodology[149] to the aggregate data provided by the United States.[150] The summary data provided by the United States groups farms in three different categories and provides aggregate data for these categories: (1) those farms planting upland cotton and holding upland cotton contract base acreage, (2) those farms not planting upland cotton but holding upland cotton contract base acreage, and (3) those farms planting upland cotton and not holding upland cotton contract base acreage.[151] For purposes of this analysis, only the aggregate data concerning farms in category (1) and (3) are of interest, as only those farms actually plant upland cotton. Brazil discusses below how it has calculated the contract payment support to upland cotton for each of these categories.

75. Due to the summary nature of this data, Brazil had to make several critical assumptions that would not have been necessary had the United States provided usable non-scrambled farm-specific data rather than summary data and "scrambled" farm-specific data. These assumptions are set out below.

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[142] *See* Section 3.

[143] *See inter alia* Brazil's 9 October 2003 Closing Statement, Annex 1.

[144] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[145] PFC, market loss assistance, direct and counter-cyclical payments.

[146] *See inter alia* Brazil's 9 October 2003 Closing Statement, Annex I for a summary of these arguments.

[147] *See* Brazil's 22 August 2003 Rebuttal Submission, para. 13 for further references.

[148] *See e.g.* Brazil's 22 August 2003 Rebuttal Submission, paras. 13-23 and 24-52 for evidence and arguments concerning the four contract payments.

[149] Due to the limitations of the data provided by the United States, Brazil had to simplify its suggested methodology (Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55) so as to enable its application to aggregate rather than farm-specific data.

[150] Brazil notes that as explained above, the farm-specific data provided by the United States does not allow for matching the contract payment data with the data on current plantings of contract programme crops. Therefore, Brazil could only use the summary data for this allocation exercise.

[151] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively.

76. First, Brazil had to assume that no "aggregation problem" exists with the US summary data. Brazil's example in Section 3 above demonstrates that basing calculations on aggregate rather than farm-specific data can distort the results to a considerable extent. Without usable non-scrambled farm-specific data, it is impossible to avoid this problem – although Brazil does not know how severe the problem is in the case of upland cotton contract payments. Using the US aggregate base acreage data and aggregate planting data to allocate contract payments will most likely trigger distortions of the results due to the allocation problem.

77. It bears repeating that a proper allocation calculation has to be done on the basis of individual farms to obtain undistorted results. Only aggregating farm-specific allocations of contract payments as support to upland cotton generates the correct total amount of contract payments to be allocated to upland cotton.

78. Further critical assumptions are discussed in the course of the description of the allocation methodology used, as set out below.

79. *First, Brazil has considered the data for upland cotton planted on farms that also have upland cotton base*. As indicated in Brazil's allocation approach,[152] as a first step in these calculations, Brazil has assigned all aggregate upland cotton base payments received by farms producing upland cotton and holding upland cotton base as support to upland cotton – yet only up to the share of upland cotton base acreage that was actually planted to upland cotton.[153] The monetary value of contract payments to these farms was calculated by multiplying the payment units for a crop base (as provided by the United States) by the payment rate for that crop in the marketing year in question.[154] For MY 1999-2001, all upland cotton PFC payments to farms producing upland cotton and holding upland cotton base were allocated as support to upland cotton, because the aggregate acreage planted to upland cotton by that group of farms exceeded their aggregate upland cotton base acreage.[155] For MY 2002, only a percentage of total upland cotton direct and counter-cyclical payments was allocated as support to upland cotton, because upland cotton acres planted by farms holding upland cotton base were below their updated upland cotton base for that marketing year.[156] The percentage of payments allocated corresponds to the ratio of aggregated upland cotton planted acreage to aggregated upland cotton base acreage for the group of farms producing upland cotton and holding upland cotton base.[157] It follows that in MY 2002 for this group of farms no further direct or counter-cyclical payments from other crops were allocated.

80. Since for MY 1999-2001 upland cotton acreage planted by farms that also had upland cotton base exceeded that base, additional PFC payments paid on other crop base were allocated as support to upland cotton. As discussed in Brazil's methodology,[158] PFC payments for other crops were primarily allocated as support for these crops – up to the share of contract acreage planted to the respective crop – in a manner identical to the above described first step for upland cotton. Any further payments stemming from contract acreage not planted to the respective base crop were pooled and

[152] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55, in particular para. 47 discussion of Sample Farms 1-3.

[153] Brazil's 20 January 2004 Answers to Additional Questions, paras. 44-48.

[154] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

[155] *See* Exhibit Bra-419 (Allocation Calculations Based on Brazil's Methodology and US Summary Data). (Also provided electronically as 'allocation calculations.xls').

[156] *See* Exhibit Bra-419 (Allocation Calculations Based on Brazil's Methodology and US Summary Data). (Also provided electronically as 'allocation calculations.xls').

[157] *See* Exhibit Bra-419 (Allocation Calculations Based on Brazil's Methodology and US Summary Data). (Also provided electronically as 'allocation calculations.xls').

[158] Brazil's 20 January 2004 Answers to Additional Questions, para. 48 discussing Sample Farm 4.

allocated as additional support to those contract crops whose aggregate planting exceeded their aggregated base acreage.[159]

81. Second, Brazil has analyzed the US summary data concerning *upland cotton that has been planted on farms without upland cotton base*. Unfortunately, the United States did not provide the requested information (even in summary form) regarding the amount of contract acreage that existed on those farms.[160] The second critical assumption Brazil, therefore, must make is that, for each upland cotton acre planted on a farm without upland cotton base, contract payments were received in an amount identical to the average per-acre payment allocated to upland cotton planted by the first group of farms. This assumption triggers further uncertainty about the reliability of the results, because it assumes that this group of farms receives contract payments in an equal manner as compared to group planting upland cotton and holding upland cotton base.[161]

82. Third, since the United States has not provided any information on the amount of market loss assistance payments received by any farm producing upland cotton – the United States did not even provide aggregate information – Brazil has assumed[162] that any allocation of market loss assistance payment as support to upland cotton would have to be made in the same manner as the allocation of PFC payments in the marketing year in question.[163]

83. Combining the resulting PFC, market loss assistance, direct and counter-cyclical payments from these calculations yields the following amount of contract payments that would be considered support to upland cotton.

[159] *See* Brazil's 20 January 2004 Answers to Additional Questions, paras. 49-55 discussing Sample Farms 5-7. For MY 1999 and 2000, only upland cotton plantings exceeded the crop base acreage, thus, all additional payments were allocated to upland cotton. For MY 2001, also oats and sorghum were planted on more acreage than their respective contract base ("overplanted"), thus, triggering additional payments being allocated pursuant to the crop's share of the total acreage being "overplanted." *See* Exhibit Bra-419 (Allocation Calculations Based on Brazil's Methodology and US Summary Data). (Also provided electronically as 'allocation calculations.xls').

[160] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively. Considering the fact that US upland cotton producers needed contract payments to produce upland cotton in an economically viable manner, it is simply not realistic to assume that there were farms without any kind of contract acreage planting upland cotton. *See* Sections 4 and 5 rejecting the US reasoning for not providing the data.

[161] Brazil also recalls that the US data for MY 2002 does not contain any information concerning the amount of direct and counter-cyclical payments made on peanut base (Exhibit US-112). Thus, the missing peanut contract payments for MY 2002 are also missing in the calculation of the amount of direct and counter-cyclical payments that constitute support to upland cotton. It follows that these figures are understated by an amount unknown to Brazil.

[162] Brazil recalls that market loss assistance payments are made on the same basis as PFC payments – with the exception that market loss assistance payments were also made for soybeans.

[163] *See* note to the summary table below. This assumption leads to an understatement of the resulting payments, since market loss assistance payments also covered soybean production in additional to any PFC payment base. Thus, just relying on PFC payments as a proxy leaves out a potential significant amount of money that may have supported upland cotton.

| MY | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | $619,336,990.11 | $564,607,044.52 | $456,554,286.78 | - |
| MLA Payments[164] | $616,320,738.53 | $601,042,809.61 | $630,594,516.48 | - |
| DP Payments | - | - | - | $464,596,092.01 |
| CCP Payments | - | - | - | $1,025,653,053.34 |

84. For purposes of comparison, Brazil presents below its results based on the "14/16th" methodology:[165]

| MY | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | $547,800,000 | $541,300,000 | $453,000,000 | - |
| MLA Payments | $545,100,000 | $576,200,000 | $625,700,000 | - |
| DP Payments | - | - | - | $454,500,000 |
| CCP Payments | - | - | - | $935,600,000 |

As the Panel can see, Brazil's figures based on the 14/16th methodology are consistently *below* the results using the US summary data provided on 18 and 19 December 2003. It follows that the results of this methodology using the flawed US summary data, at the very least, do not contradict Brazil's 14/16th methodology. Judging from these results, it appears that, even having in mind all the limitations of the US data as discussed above,[166] Brazil's methodology is rather conservative compared to an allocation based on the US summary data, which the United States seems to endorse as a valid base for calculating support to upland cotton.[167]

### 10. Application of The US-Proposed Allocation Methodology to The US Summary Data

85. Brazil recalls that its allocation methodologies offered so far and their results are provided in the context of the peace clause analysis under Article 13(b)(ii) of the Agreement on Agriculture.[168] The United States has criticized Brazil's 14/16th methodology and asserts that, for purposes of Brazil's claims under Articles 5(c) and 6.3 of the SCM Agreement, Brazil has to allocate contract payments to farms producing upland cotton over the entire sales of those farms.[169] (On the other hand, the United States maintains that any such allocation is not warranted for purposes of the peace clause[170] –

[164] The amount of market loss assistance payments has been calculated by applying the ratio of allocated PFC payments (as calculated) to upland cotton PFC payments as provided in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6) to the amount of upland cotton market loss assistance payments as provided by the same source.

[165] The figures in this table are reproduced from Brazil's 9 September 2003 Further Submission, Table 1. MY 2002 data is taken from the updated figures presented by Brazil in its 22 December 2003 Answers, para. 8.

[166] Brazil notes that some of the limitations result in distortions in different directions. The omission of peanut base information tends to lower the amount of payments allocated. The missing information on market loss assistance payments has an unknown effect and so does the aggregation problem. The missing information on base acreage of farms that produce upland cotton but have no upland cotton base could slightly overstate results – however, Brazil cautions that this effect may not be too strong, as the mount of upland cotton planted on such farms is very limited.

[167] US 20 January 2004 Letter to the Panel, p. 2.

[168] Brazil maintains that no allocation methodology is warranted under Part III of the SCM Agreement. Rather, it is the effect of the subsidies that is the subject of scrutiny.

[169] *See e.g.* US 7 October 2003 Oral Statement, para. 17; US 18 November 2003 Further Rebuttal Submission, paras. 11-17; US 2 December 2003 Oral Statement, para. 24; US 22 December 2003 Answers to Questions, paras. 11, 159-164, 184.

[170] US 22 December 2003 Answers to Questions, paras. 159-164.

an entirely untenable position, as Brazil explains in its 28 January 2004 Comments on the US 22 December 2003 Answers to Questions.[171])

86. Despite its serious misgivings about the proposed US methodology, Brazil sets forth below its analysis of the US methodology. Since the United States provided on 18/19 December 2003 some limited summary data on the production composition of upland cotton farms, Brazil has attempted to offer an estimate using the US allocation methodology. As described below, Brazil has been required to make several assumptions, given the shortcomings in the data and due to the US refusal to provide data in support of its own methodology.

87. Brazil notes that for MY 2002, the United States collected and has access to information on *all acreage planted to any crops*, including non-programme crops, produced by farmers receiving contract payments and marketing loan payments.[172] The United States has never produced this information to the Panel or Brazil in any form (either as summary or farm-specific data). Thus, while the United States asserts that the Panel should apply a particular methodology, it refuses to provide the information that would permit the Panel to calculate the payments under the US methodology.

88. But the information requested by Brazil on all different types of contract crop plantings during MY 1999-2002 would go a long way towards permitting the calculation of the value of all crop production, as well as the calculation of the value of upland cotton produced in relation to other crops produced. This is because most cotton farms producing upland cotton specialize in the production of upland cotton as opposed to other crops, and only produce a limited amount of other crops and almost no livestock.[173]

89. Brazil notes that among the selected information provided by the United States is the amount of total cropland on farms producing upland cotton.[174] The following table shows the percentage of total cropland and the percentage of total programme cropland that is planted to upland cotton (and other programme crops) on upland cotton producing farms, i.e., farms in category (1) and (3).[175]

[171] *See* Brazil's 28 January 2004 Comment on US Answer to Question 243. *See* also Brazil's 2 December 2003 Oral Statement, paras. 4-6. Brazil strongly disagrees that this is a required or appropriate methodology under Part III of the SCM Agreement or under GATT Article XVI (or even under Article 13(b)(ii) of the Agreement on Agriculture). The US arguments in that respect are not supported by any Vienna Convention interpretation of these provisions.

[172] Brazil's 18 November 2003 Further Rebuttal Submission, para. 41.

[173] Brazil's 27 October 2003 Answers to Questions, paras. 7-13. While the exclusion of tiny livestock production on upland cotton farms from the allocation of contract payments might slightly understate the resulting contract payments allocated to upland cotton, any such over counting would be outweighed by the missing data on peanut contract payments made to farms that results in an undercounting of the contract payments allocated to upland cotton.

[174] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively.

[175] Farms planting upland cotton and holding upland cotton base and farms planting upland cotton without holding upland cotton base. Farms not planting upland cotton are excluded from these calculations, as they are entirely irrelevant for purposes of this dispute. They are simply not upland cotton farms, they only have been in the past.

| | **MY 1999** | **MY 2000** | **MY 2001** | **MY 2002**[176] |
|---|---|---|---|---|
| | Total Cropland 30,628,557.4 acres | Total Cropland 31,090,742.9 acres | Total Cropland 30,635,774.0 acres | Total Cropland 28,141,085.2 acres |
| | Total Programme Cropland 21,388,415.0 acres | Total Programme Cropland 22,552,704.4 | Total Programme Cropland 22,793,179.7 acres | Total Programme Cropland 22,753,369.8 acres |
| Programme Crop | Percentage of Total Cropland on the Farm Planted to That Crop | | | |
| | Percentage of Total Programme Cropland on the Farm Planted to That Crop | | | |
| Planted to Upland Cotton | 47.58 per cent | 49.49 per cent | 50.48 per cent | 48.12 per cent |
| | 68.13 per cent | 68.23 per cent | 67.84 per cent | 59.51 per cent |
| Planted to Wheat | 8.95 per cent | 10.60 per cent | 8.58 per cent | 10.36 per cent |
| | 12.82 per cent | 14.61 per cent | 11.54 per cent | 12.82 per cent |
| Planted to Oats | 0.28 per cent | 0.32 per cent | 0.61 per cent | 0.56 per cent |
| | 0.40 per cent | 0.44 per cent | 0.82 per cent | 0.69 per cent |
| Planted to Rice | 1.72 per cent | 1.35 per cent | 1.77 per cent | 1.50 per cent |
| | 2.46 per cent | 1.86 per cent | 2.38 per cent | 1.86 per cent |
| Planted to Corn | 4.94 per cent | 5.37 per cent | 4.90 per cent | 6.35 per cent |
| | 7.07 per cent | 7.41 per cent | 6.59 per cent | 7.86 per cent |
| Planted to Sorghum | 6.17 per cent | 5.21 per cent | 7.87 per cent | 6.13 per cent |
| | 8.83 per cent | 7.19 per cent | 10.58 per cent | 7.58 per cent |
| Planted to Barley | 0.20 per cent | 0.19 per cent | 0.18 per cent | 0.18 per cent |
| | 0.29 per cent | 0.26 per cent | 0.25 per cent | 0.22 per cent |
| Planted to Soybeans | no information, as no PFC programme crop | no information, as no PFC programme crop | no information, as no PFC programme crop | 7.48 per cent |
| | | | | 9.26 per cent |
| Total Programme Farmland as a Percentage of Total Cropland | 69.83 per cent | 72.54 per cent | 74.40 per cent | 80.85 per cent |

90. As demonstrated by this table, US farms planting upland cotton are specialized in that crop. Upland cotton plantings account for 50 per cent of their cropland and for between 60 and 70 per cent of the land devoted to programme crops. Important alternative crops planted by upland cotton farms are wheat, corn, sorghum, soybeans and rice. About 20 per cent of the cropland on farms producing upland cotton is devoted to non-programme crops or to no crops.[177] As detailed below, Brazil has conservatively assumed that the value of the crops produced on this 20 per cent of farmland is the average per-acre value of production of non-programme crops in that marketing year in the entire United States, as reported by USDA.[178]

91. Performing the US-invented allocation methodology, Brazil starts again by considering the group of farms that produce upland cotton and have upland cotton base acreage. As a first step, Brazil has calculated the total amount of contract payments received by these farms by multiplying the

[176] Brazil has not indicated the percentages for other oilseeds, as the figures were so small.

[177] The lower figures for MY 1999-2001 are explained by the fact that soybeans were not a contract programme crop.

[178] This most certainly overstates their value for the farms under scrutiny, as it includes uses for the production of tobacco, greenhouse crops and other high value crops not likely produced on cotton farms. The result is an allocation of contract payments to upland cotton that is too low.

contract payment units provided in the US summary files by the payment rates applicable to the crop in any given marketing year.[179] The resulting payments have been summed up.

92. As a second step, Brazil has calculated the value of the programme crop production on farms producing upland cotton and holding upland cotton base. To estimate the value of the programme crop production on these farms,[180] Brazil has multiplied the acreage planted to a crop by its average yield in the United States and the average price received by US farmers for that crop in any given marketing year.[181] As the United States has not provided any specific information on what upland cotton farms plant on the remainder of the cropland not devoted to the programme crops, Brazil had to make several assumptions. First, Brazil assumed that the per-acre value of these non-contract programme crops equals the average per-acre value of total US non- contract programme crop production, excluding fruits and vegetables.[182] Brazil has, therefore, calculated the total value of non-contract payment crops as the total value of US crops minus the value of programme crops and fruits and vegetables for each marketing year between MY 1999-2002.[183] The resulting figure has been divided by the total US cropland[184] (minus cropland devoted to fruits[185] and vegetables[186] and programme crops[187]).[188] The per-acre value thereby generated has been multiplied by the acreage not planted to programme crops on category (1) farms,[189] resulting in a figure for the total value of non-contract programme crops produced on the group of farms that produce upland cotton and hold upland cotton base.[190]

93. Following these preparatory steps, it is now possible to allocate contract payments that constitute support to upland cotton. Summing up the value of all crops produced on the farm provides the total value of the production on farms that produce upland cotton and hold upland cotton base. Dividing the value of the upland cotton crop by the value of all crops provides the adjustment factor to be applied to the total contract payments received by that group of farms.[191] This concludes the allocation for all group (1) farms.

94. Turning to farms in group (3), the Panel will recall that these farms plant upland cotton, but do not hold upland cotton base. The Panel will further recall that the United States has not provided

[179] Payment rates are published by USDA, *see* Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

[180] Brazil recalls that the United States has only provided information on programme crop production on upland cotton farms.

[181] MY 1999-2002 yields and farm prices for programme crops are published by USDA, *see* Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17).

[182] Brazil considers this exclusion justified due to the elimination of contract payments if fruits and vegetables are planted.

[183] Exhibit Bra-421 (ERS Briefing Room: Farm Income and Costs: US Farm Sector Cash Receipts from Sales of Agricultural Commodities, USDA).

[184] Exhibit Bra-106 ("United States State Fact Sheet," ERS, USDA, 15 July 2003, p. 2). The figure represents the total amount of US cropland pursuant to the 1997 census. This is the latest figure available to Brazil. However, since the total of US cropland can be presumed to not vary too greatly, this may be a reasonable assumption.

[185] Exhibit Bra-422 (Fruits and Tree Nuts Yearbook, USDA, October 2003, Table A-2).

[186] Exhibit Bra-423 (Vegetables and Melons Yearbook, USDA, July 2003, Table 3).

[187] Exhibit Bra-420 (Agricultural Outlook Tables, USDA, November 2003, Table 17).

[188] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[189] Farms that produce upland cotton and hold upland cotton base.

[190] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[191] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

any information concerning contract payments for this group of upland cotton farms.[192] This US refusal renders any precise calculations for the third group of farms impossible. Therefore, Brazil has assumed that farms producing upland cotton but not holding upland cotton base receive per acre of upland cotton the same amount of allocated contract payments as farms producing upland cotton and holding upland cotton base.[193]

95. Since the United States has not provided any information on the amount of market loss assistance payments received by any farm producing upland cotton – the United States did not even provide aggregate information[194] – Brazil has assumed that any allocation of market loss assistance payment as support to upland cotton would have to be made in the same manner as the allocation of PFC payments in the marketing year in question.[195]

96. Contract payments allocated in both groups of upland cotton farms are aggregated. The results of this calculation are reported in the table below:

| **MY** | **1999** | **2000** | **2001** | **2002**[196] |
|---|---|---|---|---|
| PFC Payments | $477,692,236.06 | $473,744,959.03 | $333,295,919.25 | - |
| MLA Payments[197] | $475,365,812.83 | $504,317,124.58 | $460,349,590.68 | - |
| DP Payments | - | - | - | $416,216,862.44 |
| CCP Payments | - | - | - | $714,424,543.18 |

97. For purposes of comparison, Brazil presents below its results based on the "14/16th" methodology:[198]

[192] *See* Electronic PFC and DCP Summary Files provided by the United States on 18 and 19 December 2003 respectively.

[193] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data) for the details of the calculation. (Also provided electronically as 'allocation calculations.xls').

[194] *See* Section 3.

[195] *See* note to the summary table below. Brazil recalls that market loss assistance payments were made for soybeans in addition to the PFC crops. This increases the total amount of market loss assistance payments that would be allocated to upland cotton. Solely using the PFC payments as a basis, undercounts Brazil's results by an unknown amount. Brazil also recalls that the US data for MY 2002 does not contain any information concerning the amount of direct and counter-cyclical payments made on peanut base (Exhibit US-112). Thus, the missing peanut contract payments for MY 2002 are also missing in the calculation of the amount of direct and counter-cyclical payments that constitute support to upland cotton. It follows that these figures are understated by an amount unknown to Brazil.

[196] Brazil also recalls that the US data for MY 2002 does not contain any information concerning the amount of direct and counter-cyclical payments made on peanut base (Exhibit US-112). Thus, the missing peanut contract payments for MY 2002 are also missing in the calculation of the amount of direct and counter-cyclical payments that constitute support to upland cotton. It follows that these figures are understated by an amount unknown to Brazil.

[197] The amount of market loss assistance payments has been calculated by applying the ratio of allocated PFC payments (as calculated) to upland cotton PFC payments as provided in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6) to the amount of upland cotton market loss assistance payments as provided by the same source.

[198] The figures in this table are reproduced from Brazil's 9 September 2003 Further Submission, Table 1. MY 2002 data is taken from the updated figures presented by Brazil in its 22 December 2003 Answers, para. 8.

| MY | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | $547,800,000 | $541,300,000 | $453,000,000 | - |
| MLA Payments | $545,100,000 | $576,200,000 | $625,700,000 | - |
| DP Payments | - | - | - | $454,500,000 |
| CCP Payments | - | - | - | $935,600,000 |

98. As the Panel can readily see, even using the methodology proposed by the United States as relevant under Part III of the SCM Agreement results in amounts of support to upland cotton from contract payments that, accounting for the shortcomings of the US data, are roughly equivalent to the figures produced by Brazil's 14/16th methodology. Brazil cautions against the direct use of these results, as they may be tainted by the assumptions Brazil had to make due to the refusal of the United States to provide data that would render possible performing the allocation that the United States asserts is called for under Part III of the SCM Agreement.[199] In particular, the data withheld on MY 2002 peanut contract payments to farms producing upland cotton would have increased the amount of contract payments allocated to upland cotton. Other shortcomings of the data are discussed above.

### 11. The *Japan – Agricultural Products* Decision is Inapposite

99. The United States claims that the Appellate Body's decision in *Japan – Measures Affecting Agricultural Products* would have prevented the Panel from using the information the United States refused to provide to calculate the amount of contract payments across the "total value of the recipient's production."[200] However, this Appellate Body decision is inapposite.[201]

100. In *Japan – Agricultural Products*, the complaining party (the United States) did not "claim" in its request for establishment of a panel that there was an alternative SPS testing "measure" (determination of sorption levels) that was less trade restrictive.[202] Rather, the request for establishment "claimed" that testing by product (not variety) was sufficient to achieve Japan's appropriate level of protection. The panel, based on expert testimony and *not* on any arguments or evidence presented by the United States, found a violation of SPS Article 5.6 based on the alternative (sorption levels) testing "measure." This decision was taken despite a US argument to the panel that "it is not within the scope of the Panel's terms of reference to make findings with respect to the comparative efficacy of alternative treatments proposed by technical experts."[203]

101. On appeal, the Appellate Body reversed the panel's finding. Noting that a panel has authority under DSU Article 13.1 to request information, it found that "this authority cannot be used by a panel to rule in favour of a complaining party which has not established a *prima facie* case of inconsistency based on specific legal claims asserted by it." The Appellate Body found the panel had erred in relying on expert information and advice as the basis for a finding of inconsistency with SPS Article 5.6, "since the United States did not establish a *prima facie* case of inconsistency with Article 5.6 based on claims relating to the 'determination of sorption levels.'"[204]

[199] Again, Brazil notes that this allocation is not required under Part III of the SCM Agreement and GATT Article XVI:3. Both provisions deal with the effect of subsidies, and not their amount or subsidization rate.

[200] US 20 January 2004 Letter to the Panel, p.4.

[201] *See* also Brazil's 28 January 2004 Comments on Question 256.

[202] WT/DS76/2.

[203] Appellate Body Report, *Japan-Agricultural Products*, WT/DS76/AB/R, note 79.

[204] Appellate Body Report, *Japan-Agricultural Products*, WT/DS76/AB/R, para. 130.

102. The factual situation in this dispute is entirely different from that in *Japan –Agricultural Products*. Brazil's "claim" in relation to the withheld data is, first, that the United States does not enjoy peace clause protection because, *inter alia*, the non-green box contract payments provide support to upland cotton in excess of the level of support decided by the United States in MY 1992.[205] The "measures" impacted by the withheld data are PFC, market loss assistance, direct and counter-cyclical payment subsidies provided under the 1996 FAIR Act and the 2002 FSRI Act,[206] which fall squarely within the Panel's terms of reference. The withheld data is also relevant to Brazil's actionable subsidy "claims" to establish the volumes of subsidies provided for US upland cotton production.[207] Further, the withheld data is relevant to support Brazil's arguments that the contract payments are "support to upland cotton," because most of the upland cotton base payments are paid to current producers of upland cotton. Finally, the withheld data is relevant to provide the factual basis for Brazil to rebut US arguments that the US preferred "value" methodology for allocating payments results in much lower benefits to upland cotton.[208] Brazil notes that the Panel's 12 January 2004 request falls squarely within these various Brazilian claims and arguments when it states that "[d]isclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years."[209]

103. The implication in the US citation to the *Japan – Agricultural Products* decision is that the Panel's 8 December 2003 and 12 January 2004 request may be designed to establish a "claim" never advanced by Brazil. This suggestion is obviously contrary to the factual record outlined above. Moreover, it reveals a profound misunderstanding of the difference between a "claim" and an "argument." The Appellate Body in *EC –Hormones* held that there is a distinction between legal claims reflected in a panel's terms of reference, and arguments used by a complainant to sustain its legal claims. The Appellate Body ruled that "nothing in the DSU limits the faculty of a panel freely to use arguments submitted by any of the parties – *or to develop its own legal reasoning* – to support its own findings and conclusions of the matter under its consideration."[210] Numerous panel reports have narrowly interpreted "claims" to involve only legal claims and have freely permitted complaining parties to advance arguments not expressly reflected in a panel request.[211] A close reading of the Appellate Body's decision in *Japan – Agricultural Products* shows that it was based on the fact that the United States had not advanced legal "claims" relating to an alternative SPS "measure." The fact that the United States had also not made legal "arguments" on its non-claim only reinforced the underlying reasoning.[212]

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[205] This is a claim in the alternative because, as Brazil has argued, it is the United States burden of proof to establish that it enjoys peace clause protection. *See e.g.* Brazil's 24 June 2003 First Submission, paras. 110-121; Brazil's 22 July 2003 Oral Statement, paras. 5-11; Brazil's 11 August 2003 Answers to Questions, paras. 48-51; Brazil's 22 August 2003 Comments, paras 42-45.

[206] The market loss assistance payments were based on various appropriations bills.

[207] Brazil has argued that the exact amounts of the subsidies are not legally relevant (contrary to the US arguments) but rather that the "effects" of the subsidies are what is at issue in claims under Article 6.3 of the SCM Agreement.

[208] *See* Section 10 above.

[209] 12 January 2004 Communication from the Panel, p. 1.

[210] Appellate Body Report, *EC – Hormones*, WT/DS26/AB/R, para. 156 (emphasis added).

[211] Panel Report, *EC – Sardines*, WT/DS231/R, paras. 7.142-145 ( "…Peru's requests for findings were actually just summations of its arguments and not claims."); Appellate Body Report, *Korea – Dairy Safeguards*, WT/DS98/AB/R, paras. 139-140 ("…EC reliance on the OAI report during the rebuttal stage of the panel proceeding to be a new argument rather than a new claim, and therefore, did not exclude it."); Panel Report, *Australia – Salmon*, WT/DS18/R, paras. 8.24-8.25 (Panel considered that "this 'new claim' to be a new argument, not a new claim.").

[212] Appellate Body Report, *Japan-Agricultural Products*, WT/DS76/AB/R, para 130 (Appellate Body, after ruling the Panel erred noted that "The United States did not even *argue* that the 'determination of sorption levels' is an alternative measure which meets the three elements under Article 5.6").

104. This United States suggestion that the Panel's request of 8 December 2003 and 12 January 2004 would improperly make the case for Brazil is totally baseless. In the *Japan – Agricultural Products* case, the United States did not seek the expert information to support a "claim" or "measure" within the Panel's terms of reference. By contrast, Brazil *repeatedly* sought the information withheld by the United States for fourteen months. Further, the Panel's 8 December 2003 and 12 January 2004 requests incorporated Brazil's request of 3 December 2003, as set out in Exhibit Bra-369. Brazil, as a litigating party, has no independent right to request information from the United States; that must be conducted through the Panel's authority under DSU Article 13.1. Thus, the US assertion that somehow the Panel (and not also Brazil) is seeking evidence to support a "measure," "claim" or even "argument" never advanced by Brazil is fallacious.

105. Indeed, the United States cautions that the Panel "must take care not to use the information gathered under [the] authority [of DSU Article 13.1] to relieve a complaining party from its burdens of establishing a *prima facie* case." [213] This is a curious argument given the fact that the United States has refused to produce information the Panel found was "necessary and appropriate … in order to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements."[214] Brazil must ask how the Panel is to even evaluate the evidence to "take care not to use" the information, if it does not even have it?

106. Finally, Brazil notes that this is the first dispute involving interpretations of the peace clause, as well as many provisions in Part III of the SCM Agreement. Brazil obviously does not know how the Panel will resolve many interpretative issues. A good example is the issue of the relevant allocation methodology under the peace clause, or whether subsidies challenged under Part III of the SCM Agreement are required to be allocated at all, and if so, by what methodology. Brazil believes strongly that the US methodology is not supported by any textual or legitimate contextual basis. But in order to "cover all the bases," and conscious of the absence of any remand procedures, Brazil has presented – or has attempted to present in the case of the withheld US data – considerable evidence to provide the Panel with the basis to make the factual determinations supporting any possible legal interpretation of these not previously interpreted WTO provisions. As demonstrated by Brazil's analysis in Section 3, above, the information withheld by the United States has deprived the Panel and Brazil of the opportunity to use the most accurate and complete information possible – even to apply the inappropriate US methodology for allocating contract payments.[215]

## 12. Conclusion

107. In sum, the United States has refused to provide the information concerning the amount of contract payments made to current producers of upland cotton. There are no legitimate confidentiality concerns that would prevent the United States from producing the data. And even if there were, confidentiality procedures under Article 13.1 of the DSU and/or the Panel's working procedures could have addressed these concerns.

108. Therefore, Brazil asks the Panel to draw adverse inferences (listed in Section 6) and conclude that the withheld information would have been adverse to the US defence in this case. Furthermore, Brazil asks the Panel to use the best information available, including the adverse inferences, to find that the figures Brazil has estimated under its so-called 14/16$^{th}$ methodology are supported by the

[213] US 20 January 2004 Letter to the Panel, p. 4.
[214] 12 January 2004 Communication from the Panel, p. 1.
[215] *See* Brazil's 28 January comment on Question 256.

evidence in the record. Brazil also notes that its attempts to apply the flawed and incomplete US summary data to both a simplified version of its own and the US approach yields results that further confirm the results of Brazil's 14/16$^{th}$ methodology.

# ANNEX I-16

## COMMENTS OF THE UNITED STATES ON COMMENTS BY BRAZIL ON US COMMENTS CONCERNING BRAZIL'S ECONOMETRIC MODEL

(28 January 2004)

### I. Introduction

1. The United States wishes to rebut Brazil's response to the US 22 December 2003 Comments Concerning Brazil's Econometric Model. Our aim is to make clear the fundamental flaws in Brazil's analysis that invalidate its claims. In the following section, we lay out the erroneous approach Dr. Sumner took in modelling the effects of cotton payments. We believe that our rebuttal provides convincing evidence why the Panel should reject this model as supporting a finding of serious prejudice. Moreover, Dr. Sumner's rebuttal fails to allay our concerns regarding technical issues and lack of transparency with the model. These concerns are laid out in Section III.

### II. US Concerns with the Sumner Model

2. The United States reiterates the following concerns it has with Brazil's approach to its economic analysis in this dispute:

(c) Dr. Sumner continues to imply that his model is essentially the FAPRI model. It is not. Dr. Sumner has made significant modifications to the FAPRI model. The fact that Dr. Sumner's model is "in no way a FAPRI model" is acknowledged by Dr. Babcock in his letter to staff members of the Senate and House of Representatives (Exhibit US-114).

(d) The ways in which Dr. Sumner has modelled decoupled payments (including Production Flexibility Contract payments, Market Loss Assistance payments, Direct payments and Counter cyclical payments), crop insurance payments, and export credit guarantees differ sharply from the FAPRI model and are not based on empirical studies. These *ad hoc* modifications contribute to the large effects on production and other variables obtained by Dr. Sumner when he simulates the removal of cotton subsidies. We argue that the effects are thus largely tautological with no empirical grounding.

(e) In particular, Dr. Sumner's results differ sharply from the economics literature on the effects of decoupled payments on production. As we have argued in numerous submissions, Dr. Sumner's treatment of decoupled payments (particularly from Annex I on pages 16-21) is neither a "standard" feature of other models, nor is it as "consistent" with USDA work in the area as repeated citations of that work might suggest. There has been considerable work done by the USDA and other researchers on such programmes, both theoretical and empirical, which acknowledges the programmes may have some minimal impact on production. However, the research concludes that the impact appears negligible (less than 1 per cent of acreage). As we pointed out in our *Comments Concerning Brazil's Econometric Model of 22 December 2003*, similar results are obtained by FAPRI (less than 0.3 per cent impact on cotton acreage). In contrast, Dr. Sumner's model produces results

suggesting cotton acreage impacts as high as 15.9% - that is, more than 50 times larger than what the FAPRI model would indicate.

(f) Likewise, we disagree with Dr. Sumner's modelling of the crop insurance programme. We take issue with how the subsidies were calculated and how they affect production. In particular, we have argued that most cotton production has been insured at coverage levels less than 70 per cent and thus it is likely that any production effects are minimal. Moreover, we have noted that Dr. Sumner has failed to take into account the potential effects of moral hazard on input use and crop yields that potentially offset any impacts on area.

(g) We also take issue with how Dr. Sumner modelled export credit guarantees. In our previous comments, we have argued that Dr. Sumner's formulation is entirely *ad hoc*. He has essentially assumed an effect.

(h) As for marketing loans and deficiency payments, we would agree that such programmes are potentially production distorting when expected market prices fall below loan rates. However, we have argued that the use of lagged prices, while a modelling convenience for large scale models such as FAPRI and the model used by Dr. Sumner, nonetheless introduce potential biases that can overstate effects when futures market prices differ substantially from lagged prices, as they did in 2001 and 2002.

(i) Lastly, as we point out in our *Comments on Answers of Brazil to Questions from the Parties following the Second Panel Meeting,* calibrating Dr. Sumner's model to the November 2002 FAPRI baseline exaggerates the effects of price-based programmes such as marketing loans, counter-cyclical payments and Step 2 payments. The price outlook for cotton has improved considerably since publication of the November 2002 FAPRI baseline used by Dr. Sumner to estimate the effects of subsidies on US cotton production. Improving price forecasts suggest minimal marketing loan outlays over 2003-12.

3. We will briefly summarize our points below.

**Dr. Sumner's treatment of decoupled programmes is unconventional and not based on theory or empirical evidence**

4. Dr. Sumner's treatment of decoupled payments (particularly from Annex I on pages 16-21) is neither a "standard" feature of other models, nor is it as "consistent" with USDA work in the area as repeated citations of that work might suggest. There has been considerable work done by the USDA and other researchers on such programmes, both theoretical and empirical, which acknowledges the programmes may have some impact on production, and that those impacts depend in part on farmers' expectations (Westcott et al., 2002).[1] However, the research concludes that the impact appears negligible.

5. Dr. Sumner, on the other hand, uses a stylized logic to come up with the estimates for the impact of production flexibility contract (PFC) payments that have neither empirical nor theoretical grounding. He cites, then ignores, recent USDA empirical work showing that decoupled payments have only a small impact (ERS 2003).[2] He justifies this, in part, by saying that the analysis looked at

[1] Westcott, P., Young, C.E., and Price, M., USDA, ERS, The 2002 Farm Act, Provisions and Implications for Commodity Markets, Economic Research Service, November 2002. (*See* Exhibit BRA-42)

[2] USDA, ERS, Decoupled Payments: Household Income Transfers in Contemporary US Agriculture, M.E. Burfisher and J. Hopkins, Eds. USDA ERS AER Number 822. February 2003. (*See* Exhibit US-53)

all programmes, while he is looking only at cotton. However, in both their inception and administration, these programmes must be considered as a whole. Treating part of the overall programmes as though they were a "cotton programme" distorts the programmes. It is widely accepted that these programmes have whole farm impacts rather than crop specific impacts—the payments received do not have crop-specific impacts. Furthermore, the impact is much smaller than Dr. Sumner has estimated; the whole farm impact is, at its upper estimate, perhaps one-quarter to one-fifth the impact he cites for cotton alone. He thus vastly overstates the impact of these payments on cotton production.[3]

6. Dr. Sumner argues that market loss assistance (MLA) payments have a larger effect on area than do PFC payments despite the fact that MLA payments were paid on the identical payment base as the PFC payments. Moreover, MLA payments were authorized by Congress on a *post hoc* basis as emergency supplemental payments. Supplemental legislation authorizing each of these payments was passed several months after planting for the crop year in question had occurred. Dr. Sumner included these payments in his acreage equations and asserts that producers had expectations that they would receive market loss assistance payments at the time of planting. If producers had expectations of payment, then they also knew that they would be eligible to receive such a payment regardless of what crop they planted. Indeed, they could choose not to plant and still be eligible for the payment. This would argue that market loss assistance payments, like production flexibility contract payments, direct payments, and counter-cyclical payments, are decoupled from planting decisions and should not be included in an acreage response equation.[4]

7. Like other direct payments, counter-cyclical payments are based on historical production rather than actual production. The fact that the payment rate is tied to current prices does not mean that payments are less decoupled from current production. Indeed, as economists have shown, producers can hedge counter-cyclical payment rates using options markets, thus converting a counter-cyclical payment into a fixed direct payment.[5]

8. Lastly, empirical evidence supports the decoupled nature of these payments. As reported in the US Answer to Panel Question 125(5), a preliminary review of data from the Farm Service Agency shows that 47 per cent of upland cotton farms eligible for decoupled income support payments planted no cotton in marketing year 2002. This number is consistent with the Environmental Working Group data presented by Brazil in its further rebuttal submission that showed the per cent of farms receiving only contract payments in 2000, 2001, and 2002.[6] Thus, Brazil and the United States would agree that the data support the notion that decoupled income support is, in fact, decoupled from production decisions since nearly half of historic upland cotton farms no longer plant even a single acre of cotton.

9. As was shown in Exhibit US-95, enrolled upland cotton base acreage exceeded planted acreage by over 5.1 million acres. Thus, planted acres accounted for less than 73 per cent of total base acres in 2002,[7] supporting the decoupled-from-production nature of direct and counter-cyclical

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[3] As we pointed out in our *Comments Concerning Brazil's Econometric Model of 22 December 2003*, similar results are obtained by FAPRI (less than 0.3 per cent impact on cotton acreage). In contrast, Dr. Sumner's model produces results suggesting cotton acreage impacts as high as 15.9% - that is, more than 50 times larger than what the FAPRI model would indicate.

[4] Dr. Sumner has argued that base updating provisions of the 2002 Farm Bill effectively relink direct payments to production, but as we have shown in Dr. Glauber's presentation at the Second Panel Meeting in December 2004, the economics argue the opposite and the empirical evidence suggests that concerns that producers are planting cotton in expectation of future base updating are unfounded.

[5] Anderson, C.G. "Consider "Hedging" Strategies to Enhance Income Beyond Farm Programme Payments" Texas A&M University, Extension Economics, October 2002 (*See* Exhibit US-54)

[6] Brazil's Further Rebuttal Submission, para. 23.

[7] We note that these numbers are similar to the Environmental Working Group data that show that 73.6 per cent of total contract payments in marketing year 2002 were on farms that also received marketing loan payments.

payments. The ratio of planted acreage to base acreage varies considerably by region, ranging from about 40 per cent of eligible base in the West to almost 93 per cent of eligible base in the Southeast. The data also support the notion that rather than being required to base planting decisions on acreage base allocations, producers were able to exercise their planting flexibility, clearly choosing to plant other crops instead of cotton.

**Dr. Sumner's analysis of the US crop insurance programme ignores effects of moral hazard on yields**

10. As we have documented in our previous submissions, crop insurance subsidies are generally available for most crop producers and hence do not give a specific advantage to one crop over another. Thus, their effects are not commodity specific, and have no or minimal impacts on cotton markets.

11. Moreover, crop insurance purchases by cotton growers have generally been at lower coverage levels than for other row crops. This was particularly the case before 2002 when less than 5 per cent of insured cotton acres were insured at coverage levels greater than 70 per cent. Over 2002-03, roughly 90 per cent of cotton acreage insured was at coverage levels of 70 per cent or less. This supports the notion that crop insurance has had minimal effects on production.

12. Lastly, the economic literature on the effects of crop insurance on production is clearly mixed. While many studies like the ones cited by Brazil have suggested crop insurance subsidies may have a slight effect on acreage, the effects on production are less clear. If crop insurance encourages moral hazard problems like those cited by Brazil, crop yields will be adversely affected as producers attempt to increase crop insurance indemnities. If moral hazard and adverse selection problems are severe, they could potentially have a negative effect on production.[8]

**Impacts attributed to the export credit guarantee programme are unsubstantiated**

13. Neither Brazil nor Dr. Sumner has offered empirical analysis as to how much or whether the export credit guarantee programme actually affects exports. As demonstrated in Bra-313, Dr. Sumner imposed an *ad hoc* reduction in US export estimates of 500,000 bales (using the National Cotton Council testimony as his sole economic foundation), which correspondingly reduced US prices, which correspondingly both reduced US acreage and slightly increased exports - cutting into the initially imposed 500,000 bale shift.

**The effects of marketing loans depend on underlying assumptions regarding price expectations**

14. As we have argued elsewhere, we agree with the statement of Dr. Collins that marketing loan payments are *potentially* production- and trade-distorting.[9] The United States has consistently notified upland cotton marketing loan payments as cotton-specific amber box payments in its WTO Domestic Support notifications. The issue in this dispute is not whether marketing loan payments are

[8] The Economic Research Service study cited by Dr. Sumner (Young et al. 2001) only examines the effects of crop insurance subsidies on acreage. The authors assume that yields are unaffected when they simulate production effects. Recent studies by Smith and Goodwin (1996), Babcock and Hennessy (1996) and Goodwin and Smith (2003) suggest that farms with more insurance tend to use less inputs like fertilizer and pesticides and vice versa. This demonstrates a potential moral hazard problem with crop insurance that suggests that crop insurance participation may have a negative effect on yields. Lower yields may well offset the marginal effects on crop area.

[9] *See* US Answers to Questions of the Panel to the Parties following the Second Meeting of the Panel, 22 December 2004, para. 74.

potentially production- and trade-distorting, but the degree to which they have actually distorted production and trade in a particular year, given market prices and other relevant factors.

15. The degree of distortion caused by the marketing loan programme depends on the relationship of the expected harvest price to the loan rate at the time of planting. If the expected price is below the loan rate, the loan rate may provide an incentive to plant cotton because farmers will receive a government payment for the difference between the loan rate and the adjusted world price. For this reason, we believe that the marketing loan programme was more distorting in 2002 when expected cash prices were below loan rates at planting than in 2001, when expected cash prices were higher than loan rates at the time of planting. However, as explained previously, the observed decline in upland cotton planted acreage in marketing year 2002 was commensurate with the decline in futures prices over the previous year.

16. In this dispute two approaches have been advocated in determining farmers' expectations about prices. Brazil and its economic consultant have used lagged prices as the mechanism to gauge farmers' expectations about prices. Dr. Sumner wrote:

> Of course, it is impossible to know precisely what individual growers expect. I have adopted the long-standing approach of FAPRI, and other models[,] to approximate these expectations by using the current year final realized market prices as the expectation for the following season's price.[10]

The lagged prices used by Brazil and its economic consultant can, at best, be an approximation of farmers' price expectations. That is because the lagged prices used in Brazil's analysis incorporate pricing information that occurs *after US farmers make their planting decision* (that is, prices from April through July of a given marketing year, when planting decisions are taken in the January to March period). Therefore, by necessity, farmers cannot be looking at a lagged price that incorporates prices that do not yet exist.

17. The United States, on the other hand, has advocated the use of futures prices, a market-determined expectation of prices. It is evident from the use of futures and options markets by cotton producers[11] and from numerous market reports available to producers that producers look to futures markets rather than lagged prices for information regarding future cash prices.

18. Furthermore, economic literature supports this view. For example, in his classic paper on rational price expectations, Muth (Exhibit US-48) argued that there is little evidence that expectations based on past prices are economically meaningful. Additionally, in a 1976 paper Gardner (Exhibit US-49) contended that the future price for next year's crop is the best proxy for expected price.

19. As we have repeatedly argued, the use of lagged prices may result in biased results. Over the long term, where there is reasonable stability in markets, lagged prices function adequately as a proxy for price expectations. However, in those years, as in the period under investigation here, when unexpected exogenous shocks such as China dumping stocks and unexpected yields worldwide due to good weather conditions, lagged prices are poor predictors of expected prices. Future prices, by contrast, are more efficient because they are based on more current information.

20. For example, during marketing years 2000, 2001, 2002, and 2003, lagged prices significantly understate the harvest season prices expected by producers as seen in the futures prices at the time of planting. The use of lagged prices thereby inflate the effect of the marketing loan rate. In fact, those lagged prices would have to be increased by 8-25 per cent, depending on the year, to equal the harvest

[10] Brazil's Further Submission, Annex I, para. 18.

[11] *See* US Answers to Questions of the Panel to the Parties following the Second Meeting of the Panel, 22 December 2004, para. 58.

season price actually expected by producers as indicated by the futures price.[12] For the period MY 1999-2003, only MY 2002 exhibits expected prices below the marketing loan rate when using futures prices. However, over that same period, when lagged prices are used as expected prices, the loan rate is higher than the expected price *in every year over this period* except MY1999. Thus, it is a significant error for Brazil and Dr. Sumner to use lagged prices instead of the futures prices Brazil's own expert, Mr. MacDonald, explained to be the more accurate gauge of farmers' price expectations.

| **Harvest Futures Prices at Planting Time Compared to "Lagged Prices"(cents per pound)** | | | | | |
|---|---|---|---|---|---|
| | MY1999 | MY2000 | MY2001 | MY2002 | MY2003 |
| Futures Price[1] | 60.27 | 61.31 | 58.63 | 42.18 | 59.6 |
| Expected Cash Price[2] | 55.27 | 56.31 | 53.63 | 37.18 | 54.6 |
| Lagged Prices[3] | 60.2 | 45 | 49.8 | 29.8 | 44.5 |
| Difference | -4.93 | 11.31 | 3.83 | 7.38 | 10.1 |

[1] February New York futures price for December delivery.
[2] Futures price minus 5 cent cash basis.
[3] Prior crop year average farm price, weighted by monthly marketings.[13]

21. Looking more specifically at Dr. Sumner's analysis in Annex I provides further evidence of the bias of lagged prices relative to future prices. Consider the 2002 crop year. In the Sumner analysis, area response to the removal of the cotton loan programme results in a 36 per cent reduction in US planted area – the largest single effect for any of the years considered in his analysis. Based on lagged prices, price expectations for 2002 were 29.8 cents per pound, a 40 per cent reduction from 2001 levels. Yet, the futures market data suggests a far smaller reduction in expected price. December futures prices taken as the average daily closing values in February 2002 averaged 42.18 cents per pound, a 28 per cent drop from year earlier levels. Based on Dr. Sumner's range of supply response elasticities of 0.36 to 0.47, a decline of this magnitude would suggest a drop in acreage of 10 to 13 per cent from the preceding year. In fact, actual US cotton acreage dropped 12 per cent (from 15.5 million acres in 2001 to 13.7 million acres in 2002), suggesting acreage levels entirely consistent with world market conditions and price expectations. Thus, in marketing year 2002, lagged prices would significantly overestimate the decline in plantings in the absence of a marketing loan rate.

22. While the United States would agree with Brazil that it is impossible to know precisely what individual farmers' price expectations are, the United States argues that futures prices provide the most current expectations of market participants. The United States disagrees with the approach used by Brazil in its analysis to rely solely on lagged prices and ignore information provided by futures prices. While it may be impractical to include futures prices in some models, modelling convenience is no justification for ignoring these objective, market-based price expectations, and the biased results from using lagged prices do not assist the Panel in making an objective assessment of what is the effect of the US marketing loan programme.

**Use of the November 2002 baseline exaggerates the effects of the removal of subsidies**

23. The price outlook for cotton has improved considerably since publication of the November 2002 FAPRI baseline used by Dr. Sumner to estimate the effects of subsidies on US cotton production. As we show in the *US Response to Brazil's Answers to the Questions of the Panel of the Parties Following the Second Meeting of the Panel*, FAPRI projections for the Adjusted World Price are as much as 20 cents per pound higher in the November 2003 baseline as under the November 2002 baseline.

[12] US Further Rebuttal Submission, paras. 164-65.
[13] Exhibit US-90.

24. As a result, estimated marketing loan gains are reduced considerably. Under the November 2003 baseline, the estimated marketing loan gain for 2003/04 is zero, compared to almost 15 cents per pound under the November 2002 baseline. Over the five year period 2003/04 to 2007/08, the average marketing loan gain is estimated to be 1.32 cents per pound. This is compared to 10.39 cents per pound utilizing the November 2002 baseline used by Dr. Sumner in his estimates.

25. Under Dr. Sumner's model, the marketing loan programme contributes to over 42 per cent of the estimated effects of removing subsidies on production (*see* Annex 1, table 1.4). Thus, updating the model to the November 2003 baseline would significantly reduce the estimated effect on production, with the remaining effects largely attributed to direct payments under Dr. Sumner's flawed model, with which we strongly disagree.

26. In addition, the FAPRI baseline from November 2002 projected 50.7 cents per pound for the A-Index for marketing year 2003 and the January 2003 baseline projected 58.4 cents per pound for the A-index for marketing year 2003. FAPRI's November 2003 preliminary baseline projection for the A-Index is 70.9 cents per pound, 40 per cent higher than the FAPRI projections used by Dr. Sumner.[14] The actual A-index was 76.1 cents per pound on January 15, 2004. In fact, FAPRI's November 2002 projections (through 2012/13) did not show the A-Index ever rising as high as current prices. The current high cotton prices and market expectations of continued high prices are crucially relevant because, as mentioned, marketing loan payments will not be made if cotton prices are above the loan rate of 52 cents per pound and, further, counter-cyclical payments will not be made if the season average farm price is above 65.73 cents per pound (the target price of 72.5 cents minus the direct payment rate of 6.67 cents). The weighted average farm price for August-November was 62.4 cents per pound, as reported by USDA on 11 January 2004.[15]

**Conclusions**

27. Brazil's estimates of the impact of US subsidies on world cotton markets have rested largely on the basis of Dr. Sumner's flawed model. As we pointed out in our *Comments on Brazil's Econometric Model*, Dr. Sumner's model is not the FAPRI model. The modifications he has made are *ad hoc*; rather than being based on empirical research as is claimed, they are, in fact, at odds with the empirical literature.

**III. Technical Comments on Brazil's Rebuttal**

28. Brazil's explanations of exactly what was done to the FAPRI/CARD model have been stated and restated by Brazil at least three times to this point.

29. With each new statement, different clarifications are made, different variables used. In Annex I, Brazil submitted its economic analysis of the impacts of the US cotton programme. In Bra-313, Brazil provided more detail about its original economic analysis, in light of its seeming inability to provide the Panel with the actual model used. Finally, in its submission of 20 January 2004, Brazil informs the Panel that its Annex I discussion was a "simple heuristic discussion"[16] with Bra-313 explaining how the "heuristic explanation in Annex I was operationalized" and rationalizes the fact it did not use the baseline it stated it did in Annex I as "necessary recalibration."[17] These *post hoc*

[14] *Cotton: World Markets and Trade*, Foreign Agricultural Service, USDA. January 2004, Table 8, pg. 20.
[15] *World Agricultural Supply and Demand Estimates*, USDA, WAOB, WASDE-406, 11 January 2004.
[16] *See* para. 58, Brazil's Comments on US Model Critique, 20 January 2004.
[17] *See* para. 3, Brazil's Comments on US Model Critique, 20 January 2004.

rationalizations of Annex I differ dramatically from oral statements delivered to the Panel on 7 October 2003.[18]

**Brazil further confuses the impact of its elasticity modifications**

30. Brazil clings to its repeated representations that its model uses "*exactly the same elasticities of supply and demand that are also used in the FAPRI model*,"[19] yet, in its latest iteration of what is really included in its analysis, Brazil seems to be saying something different:

> ***As I will demonstrate, the differences between the two sets of estimates of the United States is primarily due to differences in the magnitude of elasticities of supply the United States used, as compared to the elasticities that I actually used. The United States applied time-varying, linear elasticities because this is what is suggested by the FAPRI linear modelling framework. My Annex I results of the effects of these listed programmes are, however, based on a constant elasticity structure." [20] [emphasis supplied]***

31. This current claim contradicts documentation in Annex I, oral statements made before the Panel, and Bra Exhibit-313. Table I.1 of Annex I clearly presents time-varying elasticities. This time-varying approach is again reported in equation (4) – (6) of Exhibit-313. Dr. Sumner's equations clearly indicate that the supply elasticity changes depending on the year *t*.

32. The United States remains convinced that neither it nor the Panel can be fully sure of whether the elasticities used by Brazil were "exactly the same" as those used in the FAPRI model as Brazil stated on 7 October, or whether those elasticities were based on a different structure entirely, as Brazil states in its 20 January 2004 submission. Brazil has never submitted a simple table showing a comparison of the elasiticities.

33. Finally, the United States does not agree with Dr. Sumner that the time-varying, linear elasticities, which would be consistent with the FAPRI modelling framework, lead to a dramatic underestimation of the effects. The United States stands firm by its belief that FAPRI has it right and that Dr. Sumner's approach leads to a dramatic overestimation of the impacts.

**Calibration vs. manipulation vs. mislabelling[21]**

34. The United States pointed out that Brazil stated that its analysis in Annex I was based on the FAPRI November 1 baseline, when it, in fact, was not. Now, Brazil confirms that those baseline numbers were, in fact, "necessarily recalibrated" by Dr. Sumner in order to conform to his use of the CARD International model -- a use that is not consistent with FAPRI's modelling and a use that decidedly was not made clear to the Panel in Annex I,[22] contrary to Brazil's assertions in paragraph 24

[18] "For more detail on these equations and the discussion of the incentives provided, please refer to my written description of the model in Annex I. My Annex I statement discusses in detail the analysis of the production enhancing impacts of the US supply side subsidies." Oral Statement of Dr. Sumner, 7 October 2003, paragraph 11. The United States read these and other statements, and the failure of Brazil to deliver its Annex I analysis, as indication that Brazil meant what it said in Annex I. The US was unaware that the document in which Dr. Sumner "discusses in detail the analysis" was, in fact, a "simple heuristic discussion." That revelation is no doubt a surprise to the Panel, as well.

[19] Oral Statement of Dr. Sumner, 7 October 2003, paragraph 20. A similar comment was made at least twice in Annex I.

[20] *See p*ara. 71, Brazil's Comments on US Model Critique, 20 January 2004.

[21] *See* para. 24 and subsequent paragraphs in Brazil's 20 January submission.

[22] In paragraph 3 of Annex I, Dr. Sumner states that he used "the international model and parameters used in two recent publications from [CARD]…." He goes on to state that the "approach used here is standard and has been applied by the USDA Economic Research Service in their analysis of the FSRI Act of 2002….,"

of its recent submission. Ultimately, Brazil passes off this significant discrepancy as "confusion" in the "labelling of the baseline used in Annex I."[23] This continues a pattern of carelessness in modelling and analysis that has added significantly to the burden in discerning underlying data and model constructs in order to appropriately evaluate the validity of Brazil's proffered results.[24]

**Crop Insurance programme results**

35. The United States continues to disagree with Dr. Sumner's characterization of the crop insurance programme presented in paragraphs 31-33. The United States does not accept Dr. Sumner's logic that $1 from the crop insurance programme that is paid in the event of a crop failure would have the same production impact as $1 of benefit that is tied directly to the production decision. While the United States does not accept Dr. Sumner's logic, we are puzzled by his operational implementation of the acreage impacts. Dr. Sumner argues that FAPRI's net returns specification includes the value of the crop insurance programme by reducing variable costs of production. Based on this first step of reasoning, it is unclear to the United States why Dr. Sumner did not implement his scenario by simply increasing the costs of production in the FAPRI baseline by the amount of the per-acre benefit that he calculates. Such an approach would have produced smaller acreage impacts.

**Replicating history and predicting the future**

36. In paragraphs 43-56, Dr. Sumner develops a lengthy discussion regarding his view of the use of simulation models. Dr. Sumner dismisses a US concern that Dr. Sumner's analysis does a very poor job of explaining the movement in cotton acreage in the United States. Dr. Sumner appears to assert that policy simulation models do not attempt to "forecast the future." From a layman's point of view, it seems surprising that a model that changes the past and then estimates how that change would have resulted in a different future can be said to not be an attempt to forecast the future.

37. From an economic point of view, the analysis doesn't really change. Economists who develop structural models employ a number of techniques for validating the accuracy and reliability of a model. One of those techniques is testing the ability of the model to simulate actual historical outcomes. In such an historical simulation, the model is solved for each year of a historical period and predicted values for the exogenous variables are compared to the actual data. Not only is the model evaluated based on its ability to approximate historical values, but also on its ability to capture the turning points in the observed values, i.e. determine if the model's predicted values for a variable move in the same direction as the actual values from one year to the next.

38. The process of model validation involves testing the performance of the model over the historical period that corresponds to the timeframe used for the statistical estimation of parameter values, i.e. the in-sample period. In addition, the model will also be tested over a historical period outside of the estimation period. This is referred to as out-of-sample validation. If a model does not

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citing the Westcott study. However, one of the two studies referenced in footnote 4 did not use the CARD International Cotton Model; it used FAPRI's full international model. Similarly, the study referenced in footnote 5 also used FAPRI's full international model. It is clear by reviewing paragraphs 3-11 of Annex I (particularly footnote 10) and Dr. Sumner's Oral Statement of 7 October 2003, that Brazil's documents manifestly led the Panel to believe it was using a broad, multi-commodity international model in its analysis. Only later did Brazil clearly admit it did not use such a model and that all competing crops were not included in its international analysis.

[23] *See* para. 42, Brazil's Comments on US Model Critique, 20 January 2004.

[24] The United States notes also that with each discovered discrepancy, Brazil has supposedly rerun its analysis to demonstrate that none of its misstatements has had any appreciable affect on the Sumner model results and asserts this demonstrates the "robustness" of the Sumner model. As noted in the introductory statements to this submission, every economic result ascribed to a FAPRI-type analysis by Brazil contains the same flawed assumptions originally introduced by Dr. Sumner, apart from the few corrections Brazil has made. It is no surprise that each rerun of the same basic construct would reveal the same basic results.

perform well under these validation methods, then particular components or equations within the system are evaluated and re-specified.

39. It does not appear that Dr. Sumner employed any of these standard techniques for validating the robustness of his model. It is doubtful that his model, with its modified acreage equations, would pass this common test. However, despite the lack of documented validation of the model, Dr. Sumner nevertheless proceeds to use the model and treats the results as credible.

40. Dr. Sumner's "simple illustration" provided in paragraph 50 does not address the true issue and is not relevant to the example of US cotton. The United States has repeatedly shown that the overriding economic signals that have affected cotton acreage have been the expected prices of cotton and relevant competing crops.

41. To conclude our response to Dr. Sumner's arguments in paragraphs 43-56, it is abundantly clear that Dr. Sumner can produce no meaningful empirical validation for his approach. His results are based on forced outcomes that are the results of his *ad hoc* modelling specifications.

**Inconsistent descriptions of "full net revenue"**

42. In paragraph 63, Dr. Sumner states that "full net revenue including all programme payments" form the basis for his model specification. He states that he does not understand how the United States made such a mistaken assumption. Dr. Sumner's current claim is in direct contradiction to his documentation in Exhibit Bra-313.

43. On page 2, in equation (2) and the subsequent paragraph of Exhibit Bra-313, Dr. Sumner clearly states that his net revenue includes only the farm price and the marketing loan and not the full programme payments. Then, in equations (4) - (6), the net revenue, which presumably is the same as specified in equation (2), is again denoted as being a portion of the denominator in his determination of the impacts of the programme in question. The United States maintains its assertion that the full programme payments should have been in the denominator of the function. Neither the United States nor the Panel can be certain of Dr. Sumner's exact approach because his explanation changes with each submission.

**Incorrect assertions**

44. Dr. Sumner's criticisms in paragraph 65 of the calculations provided by the United States are unfounded.

45. The claim in paragraph 65 that the Southern Plains revenue of $109.04 does not include marketing loan benefits is patently incorrect. The Panel and Dr. Sumner need only to look in cell AO236 of the Equations sheet of the file FINAL US2003CropsModel WORKOUT.xls and they will find that the value of net revenue from the market and the marketing loan is $109.04. All subsequent critiques on this issue put forth by Dr. Sumner are obviously incorrect because of his error reading the spreadsheets submitted by Brazil.

46. Dr. Sumner attempts to invalidate the US criticisms in paragraph 69-70 by claiming that the numbers are not the ones reported in Annex I. He indicates that the numbers were generated by the United States, but that is incorrect. The United States properly references the source of the acreage impacts as being the file FINAL US2003CropsModel WORKOUT.xls. More specifically, the data come from rows 721-771 of the Equations sheet and are the first-round impacts reported in the model. These are appropriately compared to first-round impacts calculated in the US critique.

**Marketing loan and step 2 impacts**

47. Given Brazil's efforts to misstate the US position on marketing loan and step 2 impacts in paragraphs 8 and 9, the United States refers the Panel to its earlier discussion included in section G (paragraphs 152, et seq.) in the US Further Rebuttal Submission, 18 November 2003 where the United States stresses the need for the Panel to investigate the actual decisions facing producers making their planting decisions. The United States has also not altered its position regarding the step 2 programme. The US submission of 22 December 2003 was directed at its critique of Dr. Sumner's economic modelling. While the US has indicated to the Panel its belief that the FAPRI model is not the best measure of impacts of the marketing loan or step 2 programmes, it did not specifically criticize Brazil's analytical method in this regard as Brazil apparently did not make significant changes to the FAPRI model on these points - as it did in virtually every other aspect of its analysis.

**Annex I results have never been independently confirmed**

48. The models used and outputs obtained by Brazil and submitted to the Panel were not retained by Brazil's employed experts.[25] The record remains incomplete with respect to Dr. Sumner's adaptations.

49. The United States has found that the current submission by Dr. Sumner is fraught with many of the same types of errors contained in his previous submissions. He disputes numbers that are taken directly from files that either he or Dr. Babcock has provided to the Panel. He continues to provide contradictory explanations and documentation of his methodology. Furthermore, detailed electronic verification of his calculations used in Annex I have never been provided to the United States or the Panel. Dr. Sumner has repeatedly claimed that he has provided all information to the Panel. That is obviously not the case, since new information, such as the regional crop insurance numbers, were just provided in this most recent submission.

**Impacts attributed to the export credit guarantee programme are unsubstantiated**

50. The United States is surprised that, despite repeated opportunities to offer some degree of economic support to the 500,000 bale impact Brazil attributes to the US export credit guarantee programme, Brazil has still not done so.[26] Worse, Brazil still refers to its estimates of the impact of this programme as "conservative." As the United States indicated in its critique of the Sumner model, the figures bandied about regarding acreage impacts of the export credit guarantee programme on cotton are anything but conservative.

51. In the September 9 Brazil Submission before the Second Session of the First Panel Meeting, (paragraphs 192-194), Brazil implied that Dr. Sumner's export estimates with respect to the export credit guarantee programme were more conservative than the unsubstantiated estimate it cites from the National Cotton Council (the "NCC"). Paragraph 194 of that submission acts as if the NCC estimate of a possible 3 cent per pound US price impact and Dr. Sumner's estimate of a .57 cent per pound world price impact are somehow independent analyses - and demonstrate Dr. Sumner's conservative approach. However, as demonstrated in Bra-313, all Dr. Sumner did was force a reduction in the US export estimates of 500,000 bales (using the NCC testimony as his sole economic foundation), which correspondingly reduced prices in the US, which correspondingly both reduced US acreage and slightly increased exports - cutting into the initially imposed 500,000 bale shift.

[25] *See* Letter dated October 31, 2003 from Dr. Bruce Babcock to Dr. Dan Sumner, submitted to the Panel by Brazil on 5 November 2003.

[26] Other than citing congressional testimony offered by the National Cotton Council, a US trade association that operates on behalf of the US cotton industry.

52. The "different" price estimates were, in fact, estimates of two different sets of prices - US and world. Brazil inappropriately characterized Dr. Sumner's results as being conservative relative to the NCC estimate. (*see* para. 192, Brazil's Further Submission to the Panel, 9 September 2003) Later when the Panel raised a question about the results, Dr. Sumner somehow forced a full 500,000 bale decline in US exports, ignoring the impacts of price response. (*See, e.g.*, Bra-325, last category of tables - export credit guarantee with fixed 500,000 bale impact.) In that response, Brazil also maintained the stance that these two "analyses," neither demonstrating economic foundation, were somehow independent, while fairly clearly demonstrating that Dr. Sumner merely took the NCC testimony and imposed a 500,000 bale demand shift.

53. Neither Brazil nor Dr. Sumner have ever offered any analysis at all as to how much or whether the export credit guarantee programme actually affects exports. They took someone else's word for it, with no demonstrated economic foundation - much the same approach Brazil has asked the Panel to take with respect to important aspects of the Annex I model.

**Conclusions**

54. Dr. Sumner's economic analysis should not be relied upon by the Panel as credible support for any findings on the effect of challenged US cotton subsidies. Brazil offers Dr. Sumner's model results as evidence that *but for* the US cotton programmes, US cotton acreage would have declined and world prices would have increased. In order to support this claim, Brazil and Dr. Sumner had to make significant modifications to a previously well-respected econometric system. The United States has demonstrated the weakness inherent in those modifications and the failure of Brazil to independently validate those modifications. Throughout its submissions, Brazil has claimed that nebulous factors such as a producer's "anticipation of policy change" are legitimate pillars on which to base Dr. Sumner's modifications to the FAPRI model. Brazil has pushed this questionable logic despite the fact that FAPRI itself has refused to ascribe the type of impacts forced on its model by Brazil. When confronted by the United States and pointedly questioned about the particulars of its approach, Brazil has been unable to advance convincing, supportable or even consistent explanations of its analysis.

55. As stated previously, while the US has demonstrated fatal flaws in Brazil's arguments on subsidy identification, causation, and its actionable subsidies claims, it is clear to the United States that *but for* the significant modification and adaptation of the FAPRI model carried out by Brazil and Dr. Sumner, acreage impacts attributed to the US cotton programme by that economic model would be far less than reported in Annex I. Brazil has offered nothing in its critique to change the US view of the failure of Brazil's evidence to prove this aspect of its claim.

# ANNEX I-17

## BRAZIL'S RESPONSE TO THE PANEL'S QUESTIONS

11 February 2004

### TABLE OF CASES

| Short Title | Full Case and Citation |
|---|---|
| *EC – Hormones* | Arbitrator Report, *EC – Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/15, WT/DS48/13, circulated 29 May 1998. |
| *Brazil – Aircraft* | Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/R, adopted 20 August 1999. |
| *Canada – Aircraft* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS/70, adopted 20 August 1999. |
| *Korea – Alcoholic Beverages* | Arbitrator Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/16 and WT/DS84/14, circulated, 4 June 1999. |
| *US – FSC* | Panel Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/R, adopted 20 March 2000. |
| *Australia – Leather* | Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999. |
| *US – 1916 Act* | Arbitrator Report, *US – Anti-Dumping Act of 1916*, WT/DS136/11 and WT/DS162/14, circulated 28 February 2001. |
| *Canada – Automotive Industry* | Panel Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R and WT/DS/142/R, adopted 19 June 2000. |
| *US – Section 110* | Arbitrator Report, *United States – Section 110(5) of the US Copyright Act*, WT/DS160/12, circulated 15 January 2001. |
| *US – Hot-Rolled Steel* | Arbitrator Report, *US – Hot-Rolled Steel from Japan*, WT/DS184/13, circulated 19 February 2002. |
| *US – Byrd Amendment* | Arbitrator Report, *US – Continued Dumping and Subsidy Offset Act*, WT/DS217/14 and WT/DS234/22, circulated 13 June 2003. |
| *Canada – Aircraft II* | Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS222/R, adopted 19 February 2002. |

**276. The Panel notes the parties' responses and comments relating to Question No. 252 concerning the time period within which any prohibited measure must be withdrawn within the meaning of Article 4.7 of the *SCM Agreement*. Please supplement your original response, taking into account the particular nature of each alleged prohibited subsidy measure (i.e. "Step 2" payments under Section 1207(a) of the 2002 FSRI Act, export credit guarantee programmes and the ETI Act) and the functioning of the US legal and regulatory system in respect of these measures.**

**Brazil's Answer:**

1. Brazil thanks the Panel for the opportunity to supplement its 22 December 2003 response to Question 252.[1] As Brazil has previously noted, the three prohibited subsidies at issue in this dispute (Step 2 payments, CCC export credit guarantees and ETI Act subsidies) all involve mandatory measures requiring changes to the statutes that provide for these prohibited subsidies.

2. The ordinary meaning of the phrase "without delay" in Article 4.7 of the SCM Agreement is "as quickly as possible." While the text does not state "immediately," neither does it use a qualifier such as "reasonable delay." The term implies a certain sense of urgency. And it suggests that implementing governments must move more quickly to implement prohibited subsidies measures than other types of measures. In particular, the phrase "without delay" requires a faster implementation than the "reasonable period of time" provisions of Article 21.3 of the DSU. Article 21.3 provides that if it is "*impracticable* to comply immediately with the recommendations and rulings, the Member shall have a *reasonable* period of time in which to do so" (emphasis added). The use of terms "impracticable" and "reasonable" suggest a less urgent approach to implementation in DSU Article 21.3 than in Article 4.7 of the SCM Agreement. This is exactly how the provisions of DSU Article 21.3 have been interpreted by a number of arbitrators, as discussed below.

3. The context of Article 4.7 of the SCM Agreement strongly supports a more rapid implementation for prohibited subsidy measures than for other measures. First, there are special expedited dispute settlement procedures in Articles 4.4-4.6 of the SCM Agreement for prohibited subsidy disputes. Why would the drafters have cut the time for litigating prohibited subsidy cases in half, if they had expected "business as usual" in the implementation phase by using the same "reasonable period" implementation provisions of DSU Article 21.3? The "special rule and procedure" status of Article 4.7 of the SCM Agreement in DSU Annex 2 is also significant. This special status must be given meaning by the Panel. To simply treat implementation according to the "reasonable period of time" standard of DSU Article 21.3, as the United States argument suggests[2],would effectively denude the "without delay" standard in Article 4.7 of any "special" status.

4. The "prohibited" status of subsidies covered by Articles 3 and 4 of the SCM Agreement suggests that the object and purpose of prohibited subsidy disciplines is to create significant disincentives for Members to continue providing such subsidies. These provisions demonstrate that negotiators determined that special dispute settlement and implementation procedures were required for prohibited subsidies because of their particularly trade-distorting nature. The object and purpose of Articles 3 and 4 would be frustrated if the phrase "without delay" were interpreted to permit a Member to take as long as normally required to implement any legislative changes. Each day that a prohibited subsidy, such as Step 2 payments, continues to be provided is a day in which trade is distorted. This is particularly true given the recent fall in cotton futures prices.[3]

[1] *See* Brazil's 22 December 2003 Answers to Questions, para. 167.

[2] *See* US 28 January 2004 Comments, paras. 175-177.

[3] http://www.nybot.com (click on cotton and then futures). As of 10 February 2004, the futures price for the March 2004 contract had fallen to 64.96 cents from a high of 86 cents in October 2003.

5. There is only one precedent applying the Article 4.7 "without delay" provision to prohibited subsidy measures requiring legislative changes. In the *US – FSC* dispute, the Panel found 1 October 000 (15 months after the interim report was issued) to be the appropriate "without delay" period.[4] However, the facts of *US – FSC* highlight the reason for such a long period of implementation. In that case, the Panel found that legislation repealing a *tax* break had to be enacted *before* the start of the next US fiscal (*i.e.*, tax) year. The Panel found that in view of the likely appeal of its report and the timing of the fiscal year, 1 October 2000 would be the earliest possible implementation date and, thus, a period of time constituting "without delay".[5]

6. Unlike the FSC measure, the export credit guarantee and Step 2 subsidies at issue in this dispute are not tax breaks determined (retrospectively) on the basis of annual income and in force for a fiscal year. Step 2 payments and export credit guarantees are also not paid on the basis of marketing years or any other time period. Instead, the beneficiaries of these two types of prohibited subsidies receive financial contributions that confer benefits on a *transaction-by-transaction* basis. Therefore, the United States cannot claim that there is a need to wait to enact legislation before a "fiscal year", as was required in the *US – FSC* dispute.[6]

7. Although the DSU Article 21.3 standard requires a less rapid legislative response than Article 4.7 of the SCM Agreement, the decisions of various arbitrators provide a useful reference point for the Panel's interpretation of Article 4.7. The now standard language in almost all arbitrators' reports under DSU Article 21.3 is that implementation must occur in the shortest period possible within the *normal* legal system of a Member.[7] DSU Article 21.3(c) implementation need not employ "extraordinary legislative procedures".[8] In other words, under DSU Article 21.3, an implementing Member's legislative process need not move faster than it would *normally* operate in moving legislation through its legal system.[9]

8. But the Panel's role is to interpret the meaning of Article 4.7 of the SCM Agreement and to give meaning to the term "without delay" as a special provision *apart* from DSU Article 21.3. This does not require the Panel to find that there is a conflict between the provisions. Rather, the Panel must prevent Article 4.7 from being totally absorbed within the meaning of DSU Article 21.3, as that latter provision has been interpreted by numerous arbitrators. Any interpretation of Article 4.7 that would not give it special and independent meaning by instead adopting a "business as usual" approach to implementation for prohibited subsidy measures would render that provision inutile.

9. In determining what "without delay" means for the United States' implementation obligations in this case, Brazil notes that various arbitrators have emphasized that the US Congress has considerable flexibility to enact legislation quickly.[10] The United States has confirmed this fact.[11] Indeed, the United States enacted the FSC replacement measure in less than eight months after the adoption of the panel report in *US – FSC*.[12] Arbitrators applying DSU Article 21.3(c) have found that the United States must be given the right to use "normal" legislative procedures, and therefore granted

[4] Panel Report, *US – FSC*, WT/DS108/R, para. 8.8.
[5] Panel Report, *US – FSC*, WT/DS108/R, para. 8.8.
[6] Panel Report, *US – FSC*, WT/DS108/R, para. 8.8.
[7] Arbitrator Report, *EC – Hormones*, WT/DS26/15, para. 26. *See* also Arbitrator Report, *US – Section 110*, WT/DS160/12, para. 31.
[8] Arbitrator Report, *US – Section 110*, WT/DS160/12, para. 32; Arbitrator Report, *Korea – Alcoholic Beverages*, WT/DS75/16, para. 42.
[9] Arbitrator Report, *US – Section 110*, WT/DS160/12, para. 32.
[10] Arbitrator Report, *US – Section 110*, WT/DS160/12, para. 38; Arbitrator Report, *US – 1916 Act*, WT/DS136/11, para. 43; Arbitrator Report, *US – Byrd Amendment*, WT/DS217/14, para. 32.
[11] Arbitrator Report, *US – Section 110*, WT/DS160/12, para. 38.
[12] Arbitrator Report, *US – 1916 Act*, WT/DS136/11, para. 43.

the United States between 10[13] and 15[14] months for implementation requiring legislative changes. But Article 4.7 of the SCM Agreement is not a "normal" procedure – it is a special one. And it requires special efforts of implementing legislators to act more quickly than may be "normal".

10. The record shows that Step 2 payments are prohibited subsidies that are paid upon proof of export shipments or domestic use by US textile mills. Eliminating this prohibited subsidy requires no complex word play or textual wrangling. Rather, it simply involves the repeal of Section 1207(a) of the 2002 FSRI Act. Therefore, Brazil considers that 90 days after the adoption of the Panel Report by the DSB should be considered to be "without delay".[15]

11. With respect to the CCC export credit guarantee programmes, the Panel should specify that within six months after the adoption of the Panel Report, the prohibited subsidies must be withdrawn by enacting the necessary changes to the statutes and regulations providing for GSM 102, GSM 103 and SCGP. These changes would have to result in CCC guarantees being provided on market terms and at premium rates that are adequate to cover the long-term operating costs and losses of the programmes. Due to the more complex nature of the implementation with respect to the CCC export credit guarantee programmes, Brazil considers a period of time of six months to be consistent with the "without delay" obligation.

12. With respect to the ETI Act, the United States has repeatedly indicated that implementation is underway and that "bills are before both houses of Congress that would repeal the FSC and that have been reported out of their respective committees."[16] In view of the implementation process, which has already begun, and the text of Article 4.7 of the SCM Agreement requiring the withdrawal of the prohibited subsidies "without delay", the Panel should specify that, with respect to the ETI Act, "without delay" means a period of 90 days. This represents an appropriate period of time that would be consistent with the "without delay" obligation to withdraw the ETI Act.

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[13] Arbitrator Report, *US – 1916 Act*, WT/DS136/11, para. 45.

[14] Arbitrator Report, *US – Hot-Rolled Steel*, WT/184/13, para. 40. Brazil notes that this case also involved changes to the regulations that could only be adopted after the underlying statute had been changed by Congress. Therefore, the arbitrator considered a period of more than 10 months to be "reasonable."

[15] The period of 90 days is also consistent with the specification of earlier panels that "without delay" generally means 90 days. *See* Brazil's 22 December 2003 Answers to Questions, para. 167. *See* Panel Report, *Brazil – Aircraft*, WT/DS46/R, para. 8.5; Panel Report, *Canada – Aircraft*, WT/DS70/R, para. 10.4; Panel Report, *US – FSC*, WT/DS108/R, paras. 8.7-8.8; Panel Report, *Australia – Leather*, WT/DS126/R, paras. 10.6-10.7, Panel Report, *Canada – Automotive Industry*, WT/DS139/R and WT/DS142/R, paras. 11.6-11.7, and Panel Report, *Canada – Aircraft II*, WT/DS222/R, para. 8.4.

[16] *See* most recently: US 28 January 2004 Comments, para. 177. *See* also US 11 July 2003 First Submission, para. 189 and US 11 August Answers to Questions, paras. 229-230.

# ANNEX I-18

## UNITED STATES' RESPONSE TO THE PANEL'S QUESTIONS

11 February 2004

**259. With respect to the Privacy Act of 1974, 5 U.S.C. 552a:**

**(a) Whose interests are protected under section 552a(b) in light of the definition of "individual" in section 552a(a)(2)? Do all payment recipients, including corporations and organizations, have Privacy Act rights? If not, is the United States prevented by its domestic law from releasing such of the information requested on 12 January 2004 as relates to payment recipients without Privacy Act rights? Please explain with references to case law.**

1. We appreciate the Panel's interest in the Privacy Act interests that the United States Department of Agriculture is obligated, under US domestic law, to protect. Farm-specific planting data is one such protected interest[1], and was one since long before the inception of this dispute. We discuss this point further in response to question 259(c) below.

2. Under the Privacy Act of 1974, generally, "[n]o agency shall disclose any record which is contained in a system of records by any means of communication to any person . . . ". 5 U.S.C. 552a(b). The statute provides a criminal penalty for any agency employee who willfully discloses protected records knowing that disclosure is prohibited. 5 U.S.C. 552(a)(I)(1). A "record" is defined as "any item, collection, or grouping of information about an individual that is maintained by an agency" (5 U.S.C. 552a(a)(4)), and an "individual" is defined as "a citizen of the United States or an alien lawfully admitted for permanent residence" (5 U.S.C. 552a(a)(2)). Therefore, courts have held that the rights of the Privacy Act of 1974 do not extend to corporations or organizations. *See*, *e.g.*, Dresser Industries v. United States, 596 F.2d 1231 (5th Cir. 1979). While corporations do not have a personal privacy interest, closely held corporations are an exception in that the release of information about the corporation is tantamount to a release of information on the individuals involved.

3. With respect to planting information of non-closely held corporations, courts have held that information voluntarily received from a corporation is to be withheld under exemption (4) of the Freedom of Information Act (FOIA), 5 U.S.C. 552 (5 USC (b)(4)), if it is not the type of information that would customarily released by the corporation to the public. See also, Center for Auto Safety v. National Highway Traffic Safety Administration, 244 F.3d 144, 147 (DC Cir. 2001). This is the case with respect to plantings. Furthermore, the Trade Secrets Act, 18 U.S.C. 1905, prohibits the release of any information that falls within the exemption from disclosure provided by 5 U.S.C. (b)(4) unless otherwise permitted by law. CNA Financial Corp. v. Donovan, 830 F.2d 1132, 1151-1152 (D.C. Cir. 1987).

4. The 1999-2001 plantings information of non-closely held corporations was voluntarily submitted. For 2002 and beyond the reports are required by statute. Thus, such data could presumably be released for non-closely held corporations (it would still be protected under the Privacy Act for individuals and closely-held corporations). However, determining which farms are

[1] We discuss below an exception to this principle for farms owned by corporations other than closely held corporations.

non-closely corporations would require examining, on a case by case basis, the circumstances of each operation. That would require the consideration in county offices across the cotton-growing country of some 200,000 files.

5. As explained in the US letter of 20 January 2004, Brazil's insistence on receipt of contract payment and planting data identified by farm number is unnecessary to resolution of the issues in this dispute. Instead, to the extent any of this information is relevant to this dispute, given Brazil's arguments, aggregation of payment data would provide information in the appropriate format, and aggregation would moreover be consistent with US law. The Panel has now requested aggregated data, and as explained elsewhere in today's submissions the United States is working to provide that.

**(b) The Panel notes that data concerning the four relevant programmes, in particular, payment amounts, identified by specific farms, is freely available on the internet. Please explain why that data can be disclosed but the requested planted acreage data cannot. Do individual recipients have Privacy Act rights with respect to their entrepreneurial activity? Please explain with references to case law.**

6. The Panel is correct to distinguish between information on government activity and government payments, and individual activity, in particular individual entrepreneurial activity. Indeed, there are long-standing and well-recognized distinctions in the United States between, on the one hand, government-generated information and conclusions formed by the government itself (such as payment amounts, bases, and yields), and, on the other hand, the private reportings of farmers (such as plantings) which do not generate any payments and which are submitted for compliance purposes only. Filings of the latter kind have long been recognized in US agricultural law as being private in nature. *See, e.g.,* 7 USC 1373 and 7 USC 1502(c) (protecting such filings under the terms of the Agricultural Act of 1938 and in the crop insurance context).[2]

7. The interrelationship between the Privacy Act of 1974 and the FOIA requires an analysis balancing the privacy interest of the individual with the "core purpose" of FOIA which is to "shed light on an agency's performance of its statutory duties". United States Department of Justice v. Reporters Committee for Freedom of the Press, 489 US 749 (1989). Information that does not directly disclose government operations cannot be factored into the balance. Reporters Committee, 489 US at 775.

8. Information concerning planted acreage does not demonstrate anything regarding the government's operation – it only demonstrates what a producer is doing. Accordingly it is protected from disclosure. By contrast, information regarding payment amounts relate to the government's implementation of farm programmes, and this outweighs any privacy interest on the part of the producer.[3]

9. With respect to the final part of the Panel's question, while there is a split of authority in US courts as to whether individuals have Privacy Act rights with respect to their entrepreneurial activities, the Department of Agriculture has determined that an individual acting in an entrepreneurial capacity is protected by the Privacy Act of 1974. *See* Metadure Corporation v. United States, 490 F. Supp. 1368 (S.D.N.Y. 1980); Campaign for Family Farms v. Glickman, 200 F.3d 1180 (8th Cir. 2000).

[2] It would be odd, to say the least, to say that such planted acreage information would be protected for crop insurance purposes but then releaseable by some other avenue.

[3] This sort of weighing process was the basis of the decision in Washington Post Company v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996). There, the court found some privacy interest in payment information, but found that interest to be both minimal and outweighed by a "substantial" public interest in identifying "fraud and conflict of interest". 943 F. Supp. at 37.

**(c) Please provide any further available evidence of the USDA's long-standing policy that planted acreage information will not be released.**

10. Exhibit US-144 is a notice dated December 1, 1998, from the Acting Administrator of the Farm Service Agency ("FSA") to all FSA employees setting out "FSA's policy on information that can be released" to the public and "exclusions to FSA's policy on releasing lists of names and addresses. Page 2 of the notice states that "[a]creage, production data, and other producer-related information, without any personal identifiers attached, may be released when grouped . . . unless the request would be able to identify an individual producer from the information provided".

11. Exhibit US-143 is a 18 September 1998, memorandum from the Director of the Legislative Liaison Staff for FSA, to State Offices. In this document, the author seeks to correct any misunderstandings that may have arisen after the Washington Post district court decision regarding what information may be releaseable under the Freedom of Information Act. The memorandum makes clear that, unlike the payment data at issue in that case, planted acreage information is not releaseable information under FOIA.

12. The Panel will see from these document that the positions taken by the Department of Agriculture here predate this dispute by several years.

**260. On 27 August 2003, in its response to Question No. 67 bis, the United States indicated that "it does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers". On 12 January 2004, the Panel requested the United States to provide information "to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years". On 20 January 2004, the United States informed the Panel that "the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton". Is the latest statement responsive to the Panel's request? If so, how can it be reconciled with the first statement?**

13. It is important to distinguish between information on plantings and information on production. The United States maintains some information on plantings, but does not maintain information on individual farm production. The 27 August 2003 statement concerned production, while the 20 January 2004 statement concerned plantings. Brazil has all of the payment data and, for every "cotton farm" (as defined in Exhibit BRA-369), all of the yield data and all of the base data. In addition, the summary files that the United States prepared also present total cropland data for these "cotton farms". However, the United States does not maintain information on whether farms that planted cotton produced (i.e., harvested) that cotton or abandoned it. For cotton, abandonment rates can be significant.

**261. Please confirm that each record in the actual planting database relates to a specific farm (Filenames: rPFCplac and rDCPplac in Exhibits US-111 and US-112). For example, in the data from rDCPplac:**

> **First line:**
> **Field9;Field16;Field22;Field28;Field34;Field40;Field46;Field52;Field58;Field64;Field70 Field76;Field82;Field88;Field94;Field100**
>
> **Second line:**
> **237.10;23059.80;5566.20;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00**
>
> **Does the second line represent data on plantings by the same farm?**

14. Yes, we can confirm that the panel's understanding of the files is correct. That is, for the detailed farm-by-farm text files, each farm was given its own line, with fields separated by semi-colons. The last field would not be followed by any mark; rather, after the last field for a given farm, a new line was started, indicating a new farm entry.

**262. The Panel has noted the two CD-ROMs delivered by the US in the evening of 23 December 2003. They are marked "US-111" and "US-112" respectively, but the contents actually do not correspond to the indication. The Panel also takes note of the US letter dated 28 January 2004 and the CD-ROM delivered together with it. For the record, please clarify the correct CD-ROMs and provide corresponding descriptions of their contents with exhibit numbers.**

15. The United States originally prepared and submitted six data files. The files designated "PFCby.txt" (the base acreage and yield file for the PFC payment era)[4] and "DCPby.txt" (the base acreage and yield file for the DCP payment era)[5] set out all base acres for each "programme crop" on every identified farm and the associated programme yield. For the Panel's and Brazil's convenience, the United States also calculated the payment units (bushels or pounds) for each "programme crop".

16. The United States also provided farm-by-farm planted acreage information, with farm-identifying information removed, in the files "PFCplac.txt" (planted acreage for the PFC payment era)[6] and "DCPplac.txt" (planted acreage for the DCP payment era).[7] The United States has explained that, under US law, it could not provide the farm-by-farm planted acreage information in a format that would permit identification of a specific farm.[8]

17. Finally, to assist the Panel and Brazil in interpreting the voluminous data provided, the United States prepared and submitted summary files setting out aggregate cropland, base acreage, base yield, payment units, and planted acreage. These summaries were labeled "PFCsum.xls" (for the PFC payment era) and "DCPsum.xls" (for the DCP payment era).

18. On 28 January 2004, the United States submitted revised data files to the Panel that corrected for certain programming errors that inevitably resulted in the rush to provide nearly 220 megabytes of data within the limited time available to reply to Brazil's request for data. As set out in the US letter of 28 January, the file names are identical to those previously submitted but with an "r" preceding the original file name. Thus, the files are now titled "rDcpsum.xls" (aggregate data file), "rDcpby.txt' (farm-by-farm base and yield data file), "rDcpplac.txt" (planted acres file), "rPfcsum.xls" (aggregate data file), "rPfcby.txt" (base and yield data file), and "rPfcplac.txt" (planted acres file).

19. In Exhibit US-145 that is being submitted today, the United States sets out the contents of the four revised farm-by-farm ".txt" files (that is, not the summary files) that were submitted to the Panel on 28 January 2004, on CD-ROM. (We note that, in each of the four ".txt" files, the fields are separated by colons and field labels are set out within the file, with each farm having its own line, just

[4] A description of the file contents for the "PFCby.txt" file was submitted as Exhibit US-109.

[5] We note that Exhibit US-111 set out a description of the file contents (by field number and heading) for the "DCPby.txt" file. Any marking of a CD-ROM delivered on 23 December 2003, as "Exhibit US-111" was therefore in error.

[6] A description of the file contents for the "PFCplac.txt" file was submitted as Exhibit US-110.

[7] We note that Exhibit US-112 set out a description of the file contents for the "DCPplac.txt" file. Therefore, any marking of a CD-ROM delivered on 23 December 2003, as "Exhibit US-112" was in error. We apologize for any confusion that may have been caused.

[8] *See* US Letter to Panel of 18 December 2003; US Letter to Panel of 20 January 2004; US Answers to Questions 259(a), (b), (c) from the Panel (11 February 2004).

as in the corresponding ".txt" files submitted on 18 and 19 December 2003.) These four revised files follow the same fields and formats as the files originally submitted on 18 and 19 December 2003. As explained on 28 January, those revised electronic files were prepared and submitted after the United States became aware of certain errors in the original data files submitted.

**263. The Panel has noted that the United States' response to Question No. 214 refers to Exhibits US-117 and US-118. Are these the correct documents to which the United States intended to refer in that response? If not, please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993.**

20. The exhibits submitted in response to Question 214 were in error. A copy of the 24 March 1993, Federal Register notice is attached as Exhibit US-263. The United States regrets any inconvenience its error may have caused.

**264. The Panel asks the United States to clarify certain aspects of Exhibit US-128:**

**(a) Is the Panel correct in understanding that -- as Brazil asserts in footnotes 290 and 291 of Brazil's 28 January 2004 comments on US responses to questions -- Exhibit US-128, all data are presented on a cohort-specific basis? If so, please also present the information originally requested by the Panel in another chart containing programme (as opposed to cohort-specific) activity by fiscal year.**

21. The data presented in Exhibit US-128 is presented on a cohort-specific basis. However, a cohort by definition reflects activity related to guarantees issued within a specific fiscal year. Exhibit US-128 also presents such data with respect to each of the individual programmes (GSM-102, GSM-103, and SCGP), as well as their cumulative totals. This data reflects actual performance of the programmes, unlike the data in the US budget to which Brazil alludes in its footnote 290, which, as the United States has repeatedly explained, are based on estimates and re-estimates required under the Federal Credit Reform Act of 1990.

22. Although the data in Exhibit US-128 is already presented by programme (as well as cumulatively), the United States infers from the Panel's question that it nevertheless would like to see a different presentation of the same data. Accordingly, Exhibit US-147 presents the same data, except Columns D (Claim Payments), E (Claims Recovered), F (Claims Rescheduled), G (Claims Outstanding), L (interest collected on claims recovered), and M (interest collected on reschedulings) are presented on a chronological basis (i.e., instead of applying the particular activity back to the cohort of the guarantee related to such activity, the cash-flows are set out in the fiscal year in which they occurred).

**(b) Does the US agree with the statement in paragraph 135 of Brazil's 28 January 2004 comments on US responses to questions that the difference between the $1,148 billion in the chart at para. 165 of Brazil's 11 August answers to questions and the $666 million amount in Exhibit US-128 ($1.75 billion) closely corresponds to the total "Claims rescheduled" figure reported by the US in Exhibit US-128 (column F)?**

23. The United States is examining the cited figures and expects to be able to provide an answer within the same period as its response to the Panel's supplemental request for information.

**(c) Does the US agree that from the formula in column G (that is: (Column (D) minus (E) minus (F)), it follows that a rescheduled claim no longer constitutes an outstanding claim at the moment the terms of the re-scheduling are agreed and that a rescheduling is**

**treated as 100 per cent recovered, as Brazil states in footnote 292 of Brazil's 28 January 2004 comments on US responses to questions?**

24. The Panel's understanding is correct. However, other than interest collected on reschedulings, Exhibit US-128 does not reflect the receipt of payments under the reschedulings. Consequently, no principal payments received under reschedulings are reflected in Exhibit US-128. As the principal amounts rescheduled are set forth in Column F and subtracted from Claims Outstanding in Column G, to include such principal payments as received would constitute double-counting.

**(d) Is the Panel correct in understanding that the amount of $888,984,792.04 in column F in Exhibit US-128 under "ALL" for 1992 represents the total continuing amount of unrecovered claims for the 1992 cohort, and that the amount of 387,692,219.39 represents the total continuing amount of unrecovered claims for the 1993 cohort, etc? Please indicate and substantiate how much principal and/or interest has actually been paid/recovered/rescheduled annually 1992-2003 in respect of each of the amounts shown in Columns D, E & F in the table.**

25. The Panel's understanding is not correct. The figures in column F to which the question refers do *not* reflect a continuing amount of unrecovered claims. As reflected in the response to question 264(c) these figures do not in any way reflect payment performance under the reschedulings themselves and therefore do not reflect a "continuing amount of unrecovered claims". Although Column M of Exhibit US-128 reflects interest collected on reschedulings, neither payment of original principal nor payments of capitalized interest are reflected in Exhibit US-128. Column M reflects only payments of interest on such original principal or on such capitalized interest.

26. Exhibit US-148 reflects, with respect to the same data as originally included in Exhibit US-128, principal and interest "paid/recovered/rescheduled" annually for 1992-2003, on a chronological cash basis.

**265. In connection with the US response to Question No. 225, please also provide amounts actually "written off" and "forgiven" annually for each post-1992 cohort, with annual details of country and amount (principal/interest).**

27. The response to Question 225 was intended to be comprehensive. CCC financial records indicate that no amounts have been "written off" or "forgiven" with respect to any post-1992 cohort.

**266. What are the precise terms, conditions and duration of each rescheduling reflected in column F in Exhibit US-128?**

28. Exhibit US-153 summarizes the principal terms, conditions, and duration of each rescheduling reflected in column F in Exhibit US-128. In each instance in which a Paris Club Agreed Minute is noted, the terms of the US rescheduling adhere to the multilateral terms agreed within the Paris Club. In no instance does the debt owed the United States and rescheduled in accordance with Paris Club terms pertain exclusively to debt arising from CCC export credit guarantee transactions.

**267. Is the Panel correct in understanding that "interest collected on reschedulings" in Column M in Exhibit US-128 refers not to amounts that have been actually collected by the CCC but rather to interest capitalized in conjunction with the rescheduling? If so, what are the terms, conditions and duration of the arrangements pertaining to these amounts?**

29. The Panel's understanding is *not* correct. As noted in the response to Question 264(d), Column M of Exhibit US-128 reflects only interest collected on reschedulings. It does not reflect

either payment of original principal nor payments of capitalized interest. At the inception of a rescheduling some outstanding interest may be capitalized or interest may be capitalized during the term of the rescheduling. Such capitalized interest is not itself reflected in any way in Exhibit US-128. Column M reflects only payments of interest on original principal or on such capitalized interest.

**268. Concerning Column N in Exhibit US-128, please elaborate upon "Interest earned from US Treasury on uninvested funds". What is the source and authority for these funds and for the interest thereon to be part of the CCC total revenues? What are the terms, conditions and duration of the arrangements pertaining to these amounts?**

30. Section 505(c) of the Federal Credit Reform Act (2 USC Section 661d(c)) applies to "Treasury transactions with financing accounts". In relevant part, it provides:

> The Secretary of the Treasury shall borrow from, receive from, lend to, or pay to the financing accounts such amounts as may be appropriate. The Secretary of the Treasury may prescribe forms and denominations, maturities, and terms and conditions for the transactions described above, except that the rate of interest charged by the Secretary on lending to financing accounts [...] and the rate of interest paid to financing accounts on uninvested balances in financing accounts shall be the same as the rate determined pursuant to [2 USC section 655(b)] [.....] This subsection shall apply to transactions related to direct loan obligations or loan guarantee commitments made on or after October 1, 1991 [...] Cash balances of the financing accounts in excess of current requirements shall be maintained in a form of uninvested funds and the Secretary of the Treasury shall pay interest on these funds.

31. Such section 655(b) provides: "In estimating net present values, the discount rate shall be the average interest rate on marketable Treasury securities of similar maturity to the cash flows of the direct loan or loan guarantee for which the estimate is being made."

32. Exhibit US-149 is Treasury Financial Manual I TFM 2-4600 (December 2003). This document, promulgated by the US Department of Treasury, prescribes Treasury reporting instructions for Federal credit programme agencies in accordance with Federal credit reform legislation. Section 4640 of that document addresses "Interest on Uninvested Funds". That section provides, in part: "Uninvested funds in the financing account consist of fund balances with Treasury from borrowings and/or offsetting collections that have not been disbursed. This balance earns interest from Treasury as determined by the disbursement-weighted average interest rate or single effective rate for each cohort in the financing account."

33. Agencies must report interest revenue and expense separately. Interest income becomes part of the cash balance in the financing account and is available to fund future disbursements.

**269. The Panel notes the table submitted by the US in its answer to Question No. 224 (CCC Financing Account Payments of Interest on Borrowings from Treasury and Interest Earned on Uninvested Funds). Is the Panel correct in understanding that the figures in this table correspond to the "ALL" figures in Columns I and N of Exhibit US-128?**

34. Yes. Column I of Exhibit US-128 corresponds to "Interest on Borrowings" found in the table associated with the response to Question 224, and Column N corresponds to "Interest Earned" in that same table.

**270. With respect to Column I in Exhibit US-128, ("Interest paid on borrowing from US Treasury") and Note 8, p. 25 of Exhibit US-129:**

**(i) please provide the total annual amounts (interest bearing and non-interest bearing) borrowed by the CCC from the US Treasury (annually since 1992), as well as the terms, conditions, interest rate (where applicable) and duration of such borrowing. Please provide details of any other amount borrowed by the CCC from the US Treasury during this period that may not have formed part of the regular annual borrowings.**

35. The Panel's Question 270 in its various sub-parts suggests that the Panel may have a misunderstanding regarding the scope of Note 8, p. 25 of Exhibit US-129. As the Panel is aware, CCC has extensive domestic and foreign operations. Note 8 reflects Debt to the Treasury with respect to myriad activities of CCC, the preponderance of which is associated with borrowings from Treasury to carry out programmes other than the export credit guarantee programmes.

36. Column I of Exhibit US-128 sets forth the total annual amount of interest paid on borrowing from the US Treasury with respect to GSM-102, GSM-103, and SCGP for the periods described. All references to "non-interest bearing" debt or repayments in Note 8, p. 25 of Exhibit US-129 are unrelated to the export credit guarantee programmes.

**(ii) Please explain the nature of "CCC's permanent indefinite borrowing authority from Treasury" referred to in Note 8, p. 25 of Exhibit US-129.**

37. This borrowing authority does not apply to the export credit guarantee programmes. Similar to "non-interesting bearing" debt or repayments noted in the preceding response, "CCC's permanent indefinite borrowing authority from Treasury" is not available with respect to export credit guarantee programmes and activities and has not been available since the advent of the Federal Credit Reform Act of 1990. It has therefore not been available with respect to any cohorts from 1992 to the present.

38. The permanent indefinite borrowing authority to which the question and Note 8, p. 125 of Exhibit US-129 refer is available to finance and carry out many (but not all) activities of the CCC, including, for example, certain domestic commodity and conservation programmes, but not including the export credit guarantee programmes. CCC may incur realized losses in the course of carrying out such other activities, and such net realized losses are restored through the annual Federal appropriations process.

**(iii) What determines the level of CCC export credit guarantee borrowing (interest-bearing and non-interest-bearing)? Is the interest-free borrowing up to the amount of unreimbursed realized losses?**

39. As noted in the preceding responses no "non-interest bearing" or "interest-free" borrowing is available with respect to the export credit guarantee programmes.

40. Generally speaking, the principal determinant of the level of CCC export credit guarantee financing will be the estimated programme activity in a particular fiscal year. Budget authority is based on estimates of all anticipated programme activity such as dollar value of guarantees projected to be issued, premia to be collected, payments to be received, and claims to be paid. Infrequently, borrowing from Treasury is also used if CCC has insufficient cash on hand to pay claims.

**(iv) Why are repayments applied to non-interest bearing notes first, as indicated at Note 8, p. 25 of Exhibit US-129?**

41. As noted in the previous responses, activity with respect to non-interest bearing notes is wholly unrelated to the export credit guarantee programmes.

**271. Note 8, p. 25 of Exhibit US-129 states that "In fiscal year 2003, CCC was fully reimbursed for its prior year net realized losses." Please indicate the amounts of prior year net realized losses (annually, since 1992) for which the CCC has been fully reimbursed.**

42. As indicated in the responses to Questions 226 (22 December 2003) and 272 below, such reimbursement is unrelated and inapplicable to the CCC export credit guarantee programmes since the inception of the Federal Credit Reform Act of 1990, which corresponds to fiscal year 1992. The table comprising Exhibit US-152 displays CCC net realized losses and all appropriations to restore those losses for fiscal years 1992 through 2003, but the United States hastens to reiterate that these figures have no relation to the export credit guarantee programmes. Such reimbursements for net realized losses do not include any portion attributable or allocable to the export credit guarantee programmes.

**272. With respect to the US response to Question No. 226, is the Panel correct in understanding that the reflection of write-offs as part of the operating loss of the CCC which in turn was replenished through the annual appropriations process ended with the entry into force of the FCRA in fiscal year 1992? If not, what amounts have been replenished through this process annually since fiscal year 1992?**

43. The Panel's understanding is correct.

**273. With respect to the US response to Question No. 225, what criteria does the CCC apply to "independently determine" that a debt is uncollectible? For post-1992 cohorts, what are these uncollectible amounts (annually) and how, if at all, are such "uncollectible amounts" shown in Exhibit US-128?**

44. With respect to post-1992 cohorts, no amounts have been determined uncollectible and therefore none are reflected in Exhibit US-128.

45. The determinations of uncollectability reflected in the response to Question No. 225, were based on the following facts. In the Argentine case, two private sector banks entered Argentine insolvency proceedings and were subsequently liquidated. CCC, after collecting a portion of the outstanding debt, received advice from the US Embassy that CCC would never receive further collection. Accordingly, the outstanding debt was written off. In the case of the Russian debt, certain debt of a private sector bank was not included in Paris Club rescheduling of debt of the former Soviet Union. The Russian Federation was therefore not liable for this debt. CCC received payments from the private sector bank but made an internal error in properly accounting for these payments. Certain late interest was not paid as a result, and CCC opted to deem such amount uncollectible. CCC has so far been unable to locate records pertaining to the Nigerian write-off.

**274. The Panel notes the US statement in the US response to Question No. 81 that "All rescheduled claims are currently performing " and that "all payments due up to this point under [rescheduling] agreements have been received". However, the Panel also notes Exhibit US-129 (in particular, Note 5 on p. 22) and Brazil's reference thereto in Brazil's 28 January comments on the US response to Question No. 222. In this connection:**

**(a) How does the US respond to Brazil's statement in Brazil's 28 January comments that Exhibit US-129 confirms that rescheduling of export credit guarantee receivables cover both principal and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled?**

46. The United States would first point out that the references to reschedulings in Note 5, p. 22, of Exhibit US-129 are not limited to reschedulings associated with the export credit guarantee

programmes, nor to post-1991 transactions. The substantial majority of the amounts rescheduled by CCC pertain to activities related to the P.L. 480 foreign food assistance programme.

47. Brazil misinterprets Exhibit US-129, Note 5, p. 22. Citing that reference, Brazil states: "Indeed, the CCC's Financial Statement for FY 2002 and 2003 confirm that rescheduling of export credit guarantee receivables covered both principle [*sic*] and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled."[9] Brazil is presumably referring to the second full paragraph of that page 22, particularly its second sentence. The full paragraph reads as follows:

> Direct credit and credit guarantee principal receivables under rescheduling agreements as of 30 September 2003 and 2002, were $7,532 million and $7,494 million, respectively. During fiscal years 2003 and 2002, CCC entered into agreements with debtor countries to reschedule their delinquent debt owed to CCC. These reschedulings totalled $591 million in delinquent principal and $196 million in delinquent interest during fiscal year 2003, and $152 million in delinquent principal and $55 million in delinquent interest during fiscal year 2002.

48. The second sentence refers primarily to delinquent debt under original obligations, not under outstanding reschedulings. All rescheduled export credit guarantee debt is currently performing.

**(b) In Note 5 on p. 22 of Exhibit US-129, what is the definition of "non-performing"? What is the meaning of "delinquent"? What is the current principal balance and amount of interest of the three CCC export credit guarantee programme "receivables" in a non-performing status (individually and together, for GSM 102, GSM 103 and SCGP))? What is the amount of interest on non-reporting "receivables"?**

49. Page 4 of Note 1 (Significant Accounting Policies) of Exhibit US-129 provides in relevant part under the paragraph entitled "Interest Income on Direct Credits and Credit Guarantees": "A non-performing direct credit or credit guarantee receivable is defined as a repayment schedule under a credit agreement, with an installment payment in arrears more than 90 days." "Delinquent" would apply to anything past due.

50. With respect to post-1991 cohorts, the principal balance of non-performing credit guarantee receivables as of 30 September 2003 is as follows:

| | |
|---|---|
| GSM-102: | $181 million |
| GSM-103: | - 0 - |
| SCGP: | 21 million |
| Total: | $202 million |

With respect to pre-1992 cohorts:

| | |
|---|---|
| GSM-102: | $2,237 million |
| GSM-103: | 11 |
| SCGP: | -not applicable- |
| Total: | $2,248 million |

[9] Brazil's Comments on US 22 December Answers (28 January 2004), para. 135.

51. With respect to the last question, the United States assumes that the Panel intended to refer to "non-performing 'receivables', rather than "non-reporting 'receivables'". The interest receivable on "non-performing 'receivables' is $146 million and is entirely related to pre-1992 GSM-102 principal.

**(c) The Panel notes the US reference to the "Paris Club" in US response to Question No. 225. What is the P.L. 480 programme referred to in Note 5 on p. 22 of Exhibit US-129 (including the Paris Club debt reduction process and the HIPC Initiative) ? To what extent is the P.L. 480 programme and Paris Club process relevant to the export credit guarantee programmes at issue in this dispute? Please identify and give the amounts of all CCC export credit guarantee debt subject to the P.L. 480 debt reduction (or other similar) process since 1992.**

52. The P.L. 480 programme is a foreign food-aid programme, under which assistance can be provided on either a grant or concessional financing basis. That programme is wholly distinct from the export credit programmes at issue in this dispute. Consequently, no CCC export credit guarantee debt overlaps with debt subject to P.L. 480 debt reduction. As the United States has noted in its prior submissions, virtually all of the rescheduling of debt in connection with the CCC export credit guarantee programmes is done in concert with a multilateral Paris Club debt rescheduling process. In addition, some debt has also been forgiven under the HIPC initiative. With reference to the United States' response to Question 225, all of the debt in the table reflecting "debt forgiveness" in paragraph 114 was associated with the Paris Club (Poland, Former Yugoslavia) or HIPC (Honduras, Tanzania, Yemen).

**(d) Can the US explain the process referred to in the second column of Note 5 on p. 22 ("CCC is awaiting an apportionment from the Office of Management and Budget before the transaction can be completed. Until such time, however, there is a 100% subsidy allowance established against the relevant debt as of 30 September 2003.") Please provide details of all such "apportionments" relating to the three export credit guarantee programmes in fiscal years 1992-2003.**

53. The transaction to which the cited reference applies involves an agreement between the United States and Pakistan to reduce debt incurred under the P.L. 480 programme, which is not within the scope of this dispute. It involves only P.L. 480 direct credits and does not involve any of the export credit guarantee programmes. It therefore does not involve transactions under federal credit reform provisions applicable to the export credit guarantee programmes. The cited reference is intended to note that although a debt reduction agreement had been signed, the requisite documentation from the Office of Management and Budget authorizing such reduction on the books of CCC had not yet been received as of the statement date.

54. The procedure in the above P.L. 480 instance is distinct from that which would apply in the case of export credit guarantee apportionments. The response of the United States to Panel Question 225 indicated three cases of debt "write-off" and five cases of debt forgiveness. Seven of those eight cases involved pre-1992 debt. Under the Federal Credit Reform Act of 1990, an apportionment is ordinarily not necessary with respect to pre-1992 transactions. In fact, only one such apportionment has ever occurred, and that was in fiscal year 1992 to establish the particular budgetary account (the "liquidating account") under which the budgetary accounting occurs for all activity associated with pre-1992 transactions. That apportionment did not reflect any debt reduction or write off.

55. The only other instance was the write-off of $13,000 owed from the Former Soviet Union/Russia. This particular write-off did not involve a sufficiently large amount to require an apportionment. The Office of Management and Budget database rounds to the nearest million dollars,

and therefore the write-off of $13,000 would not alter the relevant entries in the database for the particular budgetary account (the "financing account") applicable to post-1991 cohort transactions.

**275. Please provide evidence (or cite relevant portions of the record) that the premium rates for the export credit guarantee programmes are "reviewed annually" as stated in US 28 January comments on response to Question No. 223 (see also US 22 December response to Question No. 107; Brazil's 28 January 2004 comments on responses to Question No. 223.).**

56. Exhibit US-150 is comprised of the two most recent internal USDA documents entitled "Annual Review of Fees for USDA Credit Programmes," dated 25 March 2003, and 8 April 2002, respectively. In addition, Exhibit US-151 are Sections I and II of US Office of Management and Budget Circular No. A-129, dated November 2000, entitled "Policies for Federal Credit Programmes and Non-Tax Receivables". Section II.2.b mandates such annual review.

**List of Exhibits**

64 Memorandum from Larry Mitchell, USDA Farm Services Agency, to Various FSA Offices, Administrators, and Divisions on Release of Restricted Information under the Freedom of Information Act (18 September 1998)

65 USDA Farm Services Agency, Notice INFO-16: Releasing Lists of Names and Addresses in Response to Requests Under FOIA (1 December 1998)

66 Contents of 4 corrected data files submitted on 28 January 2004

67 USDA, Commodity Credit Corporation, 58 Federal Register 15755-15756 (24 March 1993).

68 Data in response to Panel Question 264(a): Exhibit US-128 on a Fiscal Year/ Cash Basis

69 Data in response to Panel Question 264(d): Claim Payments/ Recoveries/ Reschedulings on a Fiscal Year/ Cash Basis

70 United States Department of the Treasury Financial Manual I TFM 2-4600 (December 2003)

71 "Annual Review of Fees for USDA Credit Programmes", 25 March 2003 and 8 April 2002.

72 United States Office of Management and Budget Circular No. A-129 (November 2000), Table of Contents, General Information, Appendix A, Sections I and II.

73 Commodity Credit Corporation Realized Losses and Appropriations to Restore Such Losses for Fiscal Years 1992-2003

74 Summary of Principal Terms, Conditions, and Duration of Each Rescheduling Reflected in Column F of Exhibit US-128

Partially Corrected Calculations Allocating Decoupled Payments for Upland Cotton Base Acres to Upland Cotton Using Incomplete Annex IV Methodology

# ANNEX I-19

## COMMENTS OF THE UNITED STATES ON COMMENTS OF BRAZIL

11 February 2004

### I. Introduction

1. The United States thanks the Panel for providing a new deadline for comments on Brazil's comments on the data submitted by the United States on 18 and 19 December 2003.[1] The 48-page document filed by Brazil on 28 January 2004, goes far beyond a comment on that data or even its application to Brazil's invented allocation methodology for determining "support to" upland cotton. Instead, those "comments" on the US data present an attack on the good faith of the United States in responding to Brazil's requests for data, a lengthy attempt to re-write the history of this dispute, an inaccurate explanation of US domestic law regarding privacy interests in planting data, a request for the Panel to draw "adverse inferences" despite the fact that Brazil could have requested aggregated data that would not have implicated privacy interests, a rather circumspect application of its invented allocation methodology to the US data, and an inadequate application of the Annex IV allocation methodology[2] to the US data. Because Brazil has seen fit to raise and argue so many issues in its comments, the United States will necessarily address those in these comments. In these comments, we proceed as follows.

2. First, we put the issue of the use of the US data in its proper context. Brazil has asserted that decoupled income support payments must be allocated to upland cotton only for purposes of the Peace Clause and not for purposes of its serious prejudice claims. However, the allocation of a subsidy benefit is only mentioned in the Subsidies Agreement. The Agreement on Agriculture not only does not contain any allocation methodology, it also defines a category of support ("non-product-specific support") that consists of unallocated payments "to producers in general". Thus, Brazil gets it completely backwards: the text and context of the Peace Clause demonstrate that support is *not* to be allocated for purposes of the Peace Clause test while the text and context of Articles 5 and 6 of the Subsidies Agreement demonstrate that subsidies not tied to production of a given product (such as decoupled income support) *are* to be allocated to all of the products the recipient sells for purposes of serious prejudice claims.

3. Second, we explain the implications of Brazil's erroneous analysis and arguments, and in particular its express disavowal of any allocation methodology for purposes of its serious prejudice claims on decoupled income support payments. Brazil has failed to make a *prima facie* case on these claims; therefore, no serious prejudice findings may be made with respect to these measures, and these payments may not be included in an analysis of whether the effect of the challenged US subsidies has been serious prejudice to Brazil's interests.

4. Third, although the foregoing points should end the analysis, we nonetheless examine Brazil's application of its invented methodology to the US-supplied data. We recall that this Brazilian methodology has no basis in the text or context of the WTO agreements. Neither does Brazil's

[1] Brazil's Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled Data on 20 January 2004 (28 January 2004) ("Brazil's Data Comments").

[2] *Agreement on Subsidies and Countervailing Measures*, Annex IV, paras. 2-3 ("Subsidies Agreement").

methodology make economic sense. It does, however, allow Brazil to allocate decoupled payments exclusively or nearly exclusively to upland cotton. Thus, Brazil's invented allocation methodology can be described as an attempt to inflate the support to be allocated to upland cotton.

5. Fourth, the United States examines Brazil's cursory attempted application of the Annex IV methodology to the US-supplied data. We recall that Brazil expressly disavowed the applicability of that methodology. Brazil neither sought nor presented data to permit the Annex IV methodology to be applied. In fact, Brazil requested data relevant solely to its invented methodology, meaning there is no data before the Panel that would permit the Annex IV methodology to be applied. Finally, the calculations presented by Brazil reflect a misunderstanding of the plain meaning of that methodology and contain a number of erroneous assumptions that bias Brazil's results upwards.

6. Fifth, we correct Brazil's serious misrepresentations with respect to the data it requested and point out that the United States responded to that request as drafted and to the fullest extent permissible under US law. Thus, there is no basis to draw an inference, adverse or otherwise, from the inability to provide certain information that is not relevant to an analysis of Brazil's legal claims.

## II. Brazil Misunderstands the Relevant Analyses for the Peace Clause and for its Serious Prejudice Claims

### A. Brazil's Allocation Methodology is Inconsistent with the Definition of Product-Specific Support in the Agreement on Agriculture and, Therefore, Cannot be Used for Peace Clause Analysis

7. As has been evident since the parties' first submissions, Brazil and the United States have offered fundamentally differing interpretations of Article 13(b)(ii) of the Agreement on Agriculture and in particular the Peace Clause proviso which reads: "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year." The differences between the parties' approaches can be seen in the way they interpret the phrase "product-specific support" and apply that interpretation to decoupled income support payments.

8. Brazil argues that decoupled income support payments are not "truly 'decoupled'" since some recipients do produce programme crops, that "the support from contract payments that can be allocated to upland cotton is product-specific support within the meaning of the Agreement on Agriculture," and that Brazil's approach – "to allocate contract payments to the programme crops covered" – is "reasonable".[3] However, as the United States demonstrated in its comment on Brazil's answer to question 258, Brazil points to *no text* in the Peace Clause, the Agreement on Agriculture, nor any WTO agreement that supports its allocation methodology[4], nor does that methodology make economic sense.[5] Brazil may consider its approach to be "reasonable", but that does not make it based on any WTO provision.

9. As just one example, Brazil apparently would require that "decoupled support" *discourage* recipients from producing certain crops in order to be "decoupled" while at the same time Brazil

[3] Brazil's Data Comments, para. 73. Brazil also argues: "As the record demonstrates, none of four types of contract payments is truly 'decoupled,' given the production of programme crops by the farms holding contract payment base. To the contrary, they are *intended to* and, in fact, do provide support for the production of programme crops." *Id.* Brazil has in fact provided no evidence of such "intent" nor could it since the opposite is true. These programmes are intended to be decoupled. Moreover, under the Peace Clause, the "intent" of a payment is irrelevant; it is also irrelevant what a recipient decides to do with a payment. Rather, the issue is whether the payment as "decided" is "support to a specific commodity" or "support provided in favour of agricultural producers in general".

[4] US Comments on Brazil's Answers to Panel Questions Following the Second Panel Meeting, paras. 209-217 (28 January 2004) ("US January 28 Comments").

[5] US 28 January Comments, paras. 218-23.

complains that the payment restriction for planting fruits and vegetables means that the support is *not* "decoupled". Brazil cannot have it both ways. If support is decoupled, then there is no requirement to produce any particular commodity. If producers choose to exercise their flexibility and plant particular crops, that is perfectly consistent with the concept of decoupled support.

10. The lack of grounding of Brazil's methodology in the WTO agreements stems from its erroneous interpretation of "support to a specific commodity". Brazil has argued that any support that is not made "to producers in general" – which Brazil takes to mean "all" or "nearly all" – is not non-product-specific and therefore must be "product-specific". As the United States has pointed out before, not only does this reading of "in general" rely on an obsolete meaning[6], which therefore cannot be the ordinary meaning of the terms, but Brazil has consistently failed to read together the definitions of product-specific support and non-product-specific support in Article 1(a) of the Agreement on Agriculture. Read in conjunction with one another, non-product-specific support ("support provided in favour of agricultural producers in general") is a residual category of support that is not product-specific ("support . . . provided for an agricultural product in favour of the producers of the basic agricultural product").

11. Brazil's statement in its 28 January comments that "the support from contract payments that can be allocated to upland cotton is product-specific support within the meaning of the Agreement on Agriculture"[7] is significant because *it confirms that both parties interpret "support to a specific commodity" in the Peace Clause as meaning "product-specific support"*. Thus, the question for the Panel is whether decoupled income support measures provide product-specific support or non-product-specific support. The definitions from Article 1(a) quoted above establish that support that is *not* "provided for a basic agricultural product in favour of the producers of the basic agricultural product" cannot be product-specific support.

> The very fact that Brazil must apply an *allocation* methodology to these decoupled income support payments to attempt to determine the "support to upland cotton" demonstrates that they are not product-specific support. Rather, they are support to whatever *products* (if any) the recipients produce, rather than "support for *a* basic agricultural product." In addition, the recipients are "producers in general" because they are not required to be "producers of *the* basic agricultural product" the support is "provided for".

12. While Brazil appears to be arguing that its allocation methodology conforms to the concepts of product-specific and non-product-specific support in the Agreement on Agriculture, in fact that methodology is flatly inconsistent with those concepts.[8] There is nothing in the Agreement that suggests that support may, at one and the same time, be both product-specific and non-product-specific. For example:

> In Article 1(a), these two terms are defined disjunctively (that is, product-specific support "or" non-product-specific support).
>
> In Article 6.4(a), *de minimis* levels of support not required to be included in a Member's Current Total AMS are separately given for "product-specific domestic support" and "non-product-specific domestic support."
>
> Under Annex 3, paragraph 1, "an Aggregate Measurement of Support (AMS) shall be calculated on a product-specific basis for each basic agricultural product", and,

[6] US Comments on Brazil's Rebuttal Submission, para. 23 (noting that definition of "in general" as "in a body; universally; without exception" was marked "obsolete" in *New Shorter Oxford English Dictionary*).

[7] Brazil's Data Comments, para. 73.

[8] *See* US 28 January Comments, paras. 225-29.

> separately, "[s]upport which is non-product specific shall be totalled into one non-product-specific AMS in total monetary terms".

Despite the fact that product-specific and non-product-specific support are kept distinct in the Agreement on Agriculture, Brazil's allocation methodology necessarily collapses the two concepts.

13. For example, under Brazil's methodology decoupled income support "payments for other crops were primarily allocated as support for these crops – up to the share of contract acreage planted to the respective crop", but "[a]ny further payments stemming from contract acreage not planted to the respective base crop were pooled and allocated as additional support to those contract crops whose aggregate planting exceeded their aggregated base acreage".[9] Brazil states that in marketing year 2001, cotton, "oats and sorghum were planted on more acreage than their respective contract base ('overplanted'), thus[] triggering additional payments being allocated pursuant to the crop's share of total acreage being 'overplanted'".[10]

> That is, decoupled income support payments for base acreage with respect to other programme crops (other than upland cotton, oats, and sorghum) would, under Brazil's approach in this dispute, first be "product-specific support" to each of those programme crops to the extent of planted acreage.
>
> Then, the payments on "excess" base acreage would be "product-specific" support simultaneously to upland cotton, oats, and sorghum.

Logically, then, such payments would be support to "four different commodities" (whichever happen to be 'underplanted'), not "support to a *specific* commodity". Further, payments allegedly supporting four different commodities would not be "provided for *a* basic agricultural *product* in favour of the producers of *the* basic agricultural *product*".

14. Thus, decoupled income support payments are support to "agricultural producers in general" – that is, support to recipients who may decide (as Brazil has confirmed) to produce any of multiple commodities in general. Because such payments are non-product-specific, they may not at the same time be deemed to be product-specific. Brazil's methodology for purposes of the Peace Clause would result in non-product-specific support being allocated to the specific products the recipients produce, contrary to the separation of these concepts in the Agreement on Agriculture. As Brazil concedes that "support to a specific commodity" refers to "product-specific support within the meaning of the Agreement on Agriculture"[11], it follows that decoupled income support payments must be deemed to be non-product-specific within the meaning of Article 1(a) of the Agreement on Agriculture and therefore not part of the Peace Clause test under Article 13(b)(ii).

### B. Challenged US Measures do not Grant Support to a Specific Commodity in Excess of that Decided during the 1992 Marketing Year

15. As Brazil has conceded that the Peace Clause proviso refers to "product-specific support", the question for the Panel becomes: do challenged US measures grant product-specific support in excess of that decided during the 1992 marketing year? The United States has previously demonstrated in exhaustive detail that, removing non-product-specific support(that is, decoupled income support measures and crop insurance payments) from the Peace Clause comparison, US measures do not. We will not repeat the extensive arguments on this point, for example, relating to how the United States "decided" its support.

[9] Brazil's Data Comments, para. 80.
[10] Brazil's Data Comments, para. 80 fn. 159.
[11] Brazil's Data Comments, para. 73.

16. We do recall, however, that as the United States by design shifted the support it provided to its agricultural sector from product-specific amber box support (in the form of deficiency payments) to green box support (production flexibility contract payments and direct payments) and non-product-specific support (market loss assistance payments and counter-cyclical payments), the result was that the product-specific support to upland cotton declined substantially. The only way Brazil can overcome this fact is to argue that the only way to gauge "support to a specific commodity" is through budgetary outlays[12], which in the case of marketing loan payments will reflect through high outlays the record low cotton prices in marketing years 2001 and 2002 that the United States did not decide and could not control – as Brazil has conceded.[13]

17. As the United States has shown,[14] *any* measurement of the product-specific support for upland cotton that eliminates the effect of market prices and instead gauges the support "decided" by the United States demonstrates that upland cotton product-specific support was higher in marketing year 1992 than in any marketing year from 1999-2002. That is, whether the analysis is (as the United States believes is compelled by the Peace Clause text) the rate of support as decided in US measures,[15] or the upland cotton AMS measured through a price-gap methodology[16], or the "expected rate of per unit support" calculated by Brazil's expert[17], the result is the same: challenged US measures are not in breach of the Peace Clause.

### C. Under the Subsidies Agreement, Allocation of a Non-Tied Subsidy is Necessary to Identify the Amount of Subsidy and the Subsidized Product

18. Brazil seeks to allocate support not tied to the production of a specific commodity for purposes of the Peace Clause, despite the fact that the Agreement on Agriculture explicitly distinguishes and keeps separate product-specific and non-product-specific support. There is no mention of an allocation methodology in that Agreement because there is no need to allocate support – in fact, allocation is contrary to the very structure of the agreement. Ironically, Brazil then seeks *not* to allocate such a non-tied payment for purposes of its serious prejudice claims when there *is* an allocation methodology set out in Annex IV and when there *is* a need to identify the subsidized product as well as the subsidy amount. Brazil's approach ignores the text and context of Articles 5 and 6 of the Subsidies Agreement.[18]

19. Brazil has argued that it "strongly disagrees that this [Annex IV methodology for allocating non-tied payments] is a required or appropriate methodology under Part III of the SCM Agreement or

[12] In making this argument, Brazil ignores the fact that "support" does not mean "budgetary outlays". In fact, Annex 3 recognizes that an "Aggregate Measurement of Support" for price-based support either shall or can be calculated using a price-gap methodology, which does not rely on budgetary outlays. *See, e.g.*, Agreement on Agriculture, Annex 3, paragraph 8 ("Budgetary outlays made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS."); *id.*, para. 10.

[13] *See* Brazil's Comments on US Answers, para. 66 fn. 49 (August 22, 2003) ("Brazil acknowledges that the United States could not possibl[y] determine its expenditures as they would depend to a certain extent on market prices that were also influenced by factors outside the control of the US Government.").

[14] *See, e.g.*, US Rebuttal Submission, paras. 110-30.

[15] In marketing year 1992, 72.9 cents per pound; in marketing years 1999-2001, 51.92 cents per pound; in marketing year 2002: 52 cents per pound. US Rebuttal Submission, paras. 110-13.

[16] In marketing year 1992, $1,079 million; in 1999, $717 million; in 2000, $484 million; in 2001, $264 million; and in marketing year 2002 (as of the date of panel establishment, March 18, 2003), $205 million. US Rebuttal Submission, paras. 114-17.

[17] In marketing year 1992, 60.05 cents per pound; in marketing year 1999, 53.79 cents per pound; in marketing year 2000, 55.09 cents per pound; in marketing year 2001, 52.82 cents per pound; and in marketing year 2002, 56.32 cents per pound. US Rebuttal Submission, paras. 120-22. Removing the 1999 and 2002 marketing year cottonseed payments the Panel has determined to be not within its terms of reference results in support of 52.82 cents per pound in marketing year 1999 and 55.71 cents per pound in marketing year 2002.

[18] US Comment to Brazil's Answer to Question 258, paras. 209-17.

under GATT Article XVI (or even under Article 13(b)(ii) of the Agreement on Agriculture)".[19] However, Brazil has not provided any basis to conclude that the term "subsidy" can mean one thing in the context of Articles 5 and 6 and another in Article 1.1 (subsidy requires a "benefit" to recipient), Article 14 ("calculation of the amount of a subsidy in terms of the benefit to the recipient") and Article 15.5 (causal link necessary between injury and the subsidized imports "through the effects of subsidies"), all of which suggest that an evaluation of "the effect of the subsidy" requires an identification of the "benefit" the subsidy is alleged to provide. Further, Brazil has not provided any basis to conclude that a "subsidized product" for purposes of Articles 6.3(c), 6.3(d), 6.4, and 6.5 can be read in isolation from the methodology for determining the "subsidization" of a "product" set out in Annex IV. Therefore, the Subsidies Agreement – and Part III in particular – calls for an "allocation methodology" to determine the products that benefit from a subsidy that is not tied to production or sale of a given product.

20. Brazil denies the applicability to the Peace Clause analysis of the Annex IV methodology for allocating non-tied payments across the value of the recipients' production. However, even had Brazil suggested that the Annex IV methodology could be used for Peace Clause analysis, its interpretation would be plainly wrong. First, the phrase "support to a specific commodity" means "product-specific support" – as Brazil has conceded – and thus must be interpreted in light of the terms product-specific support and non-product-specific support in the Agreement on Agriculture (as set out above). Second, the terms "support to a specific commodity" and "product-specific support" are not found in Part III of the Subsidies Agreement, nor in Article 1 or Annex IV.[20] Neither are the terms "subsidy," "benefit," or "subsidized product" from the Subsidies Agreement found in the Peace Clause proviso or any supporting text. Thus, the plain language of the Peace Clause and Articles 5 and 6 indicate that these provisions refer to wholly different approaches and suggest that the methodology for allocating non-tied (decoupled) payments under the Subsidies Agreement may not be relevant under the Agreement on Agriculture. The definitions of product-specific support and non-product-specific support in Article 1(a) of the Agreement on Agriculture confirm that the Annex IV allocation methodology does not apply for purposes of the Peace Clause.

21. Thus, allocating a non-tied payment across the value of the recipient's production is not pertinent for Peace Clause purposes but is necessary for the Panel to be able to attempt to gauge "the effect of the subsidy" for purposes of Brazil's serious prejudice claims. We discuss Brazil's failure to bring forward evidence and arguments relating to this issue in the next section.

## III. Because Brazil Expressly Disavows Any Allocation Methodology for Purposes of its Serious Prejudice Claims on Decoupled Income Support Payments, Brazil Has Failed to Make a *Prima Facie* Case on these Claims

### A Brazil Has Presented No Evidence or Arguments Supporting the Annex IV Methodology to Allocate Decoupled Income Support Payments for Purposes of its Serious Prejudice Claims

22. As we have noted, because Brazil has chosen to include subsidies that are not tied to the production or sale of a given product within its serious prejudice claims, the Annex IV methodology is necessary to determine the subsidized product and the amount of the challenged non-tied subsidy that benefits upland cotton. Brazil recognizes that *some* allocation methodology is necessary to identify the decoupled income support payments within the scope of its panel request ("subsidies to producers, users, and/or exporters of upland cotton")[21] but relies on its wholly invented methodology (allocating decoupled payments for crop base in "excess" of planted acreage of the respective crop

[19] Brazil's Data Comments, para. 85 n. 171.

[20] The term "support" appears in Article 1.1(a)(2) of the Subsidies Agreement, which gives one definition of "subsidy" as "any form of income or price support in the sense of Article XVI of GATT 1994."

[21] WT/DS267/7, at 1.

solely to those programme crops planted on less acreage that their respective base acreage). That methodology finds no support in the text or context of the Subsidies Agreement or any other WTO agreement.

23. The result is that Brazil has not provided the Panel with evidence or arguments sufficient to establish a *prima facie* case that the effect of such decoupled payments is to cause serious prejudice to the interests of Brazil. Brazil has never sought or presented evidence and made arguments that would allow the Panel to evaluate properly "the effect of the subsidy" (decoupled income support payments) – for example, to identify the "subsidized product" through the Annex IV methodology and the "subsidy" in terms of the "benefit" to those recipients named in Brazil's panel request. Logically, if Brazil has not even identified the subsidized product with respect to such payments or the amount of the challenged subsidy, the Panel cannot evaluate "the effects".

24. Indeed, Brazil expressly disavows any allocation or even identification of the size of the subsidy for purposes of its serious prejudice claims:

> "Brazil maintains that no allocation methodology is warranted under Part III of the SCM Agreement. Rather, it is the effect of the subsidies that is the subject of scrutiny."[22]
>
> "Brazil strongly disagrees that this is a required or appropriate methodology under Part III of the SCM Agreement or under GATT Article XVI (or even under Article 13(b)(ii) of the Agreement on Agriculture."[23]
>
> "Again, Brazil notes that this allocation is not required under Part III of the SCM Agreement and GATT Article XVI:3. Both provisions deal with the effect of subsidies, and not their amount or subsidization rate."[24]

25. Further, Brazil has never sought nor presented information relating to the total value of the recipients' sales as would be necessary to apply the Annex IV methodology to decoupled income support payments.[25] Brazil has only sought base and planted acreage information to support its own invented methodology (and only for Peace Clause purposes).[26]

26. In this dispute, then, Brazil cannot have made its *prima facie* case with respect to the effect of decoupled income support payments. To find otherwise would mean a complaining party in a serious prejudice case could satisfy its burden merely by asserting that some unidentified amount of payments are received by producers of the relevant product.

### B. The *Japan – Agricultural Products* Appellate Body Report Confirms that in Such a Situation a Panel May not "Make the Case for a Complaining Party"

27. Brazil includes a discussion of the Appellate Body report in *Japan – Agricultural Products*, suggesting that the report is "inapposite" and that Brazil has advanced relevant claims and arguments such that the Panel could in no event relieve Brazil of its burden of establishing a *prima facie* case of inconsistency with WTO obligations. However, a careful reading of both Brazil's arguments as well as that report reveals that, were the Panel to seek and obtain data to apply, for purposes of its serious

[22] Brazil's Data Comments, para. 85 n. 168.
[23] Brazil's Data Comments, para. 85 n. 171.
[24] Brazil's Data Comments, para. 98 n. 199.
[25] Subsidies Agreement, Annex IV, paras. 2-3 (for a subsidy not tied to the production or sale of a given product, the subsidized product is "the total value of the recipient firm's sales").
[26] *See* Exhibit Bra-369; Brazil's Data Comments, para. 3 ("The purpose of Brazil's request for *contract acreage and planted acreage* for each farm producing upland cotton was . . . .") (italics added).

prejudice analysis, the allocation methodology set out in Annex IV of the Subsidies Agreement to the challenged decoupled income support payments, the Panel would be making Brazil's case for it.

28. We begin by examining Brazil's artfully drafted arguments. Brazil alleges that the US argument is that the *Japan – Agricultural Products* report "would have prevented the Panel from using the information the United States refused to provide to calculate the amount of contract payments across the 'total value of the recipient's production.'"[27] Brazil's assertion is wrong. First, the US argument is that the Panel may not seek and apply information to use the Annex IV methodology for decoupled income support payments because (as set out in the bulleted quotes above) Brazil has *expressly disavowed* any allocation or even identification of the size of the subsidy for purposes of its serious prejudice claims. As Brazil has brought forward no evidence or arguments to support findings on decoupled payments, it has not made its *prima facie* case.

29. Second, the United States has not "refused to provide" information to allocate decoupled payments according to the Annex IV methodology for the simple reason that *Brazil never sought this information*. Brazil merely asked for planted acreage and base acreage (and yield) information.[28] With respect to the farm-by-farm planted acreage data that the United States was unable under US law to provide in a format allowing matching with farm-specific base acreage data, that data is simply irrelevant for purposes of the Annex IV methodology. Thus, while the Panel has the authority under DSU Article 13 to seek information "as the panel considers necessary and appropriate", the inability of the United States to provide that data in the farm-by-farm format requested on 12 January 2004 is ultimately of no moment in this dispute since Brazil's allocation methodology using planted and base acreage data finds no support in any WTO text. The situation is quite different with respect to the Annex IV methodology that is found in the WTO agreements but that has been disavowed by Brazil.

30. Thus, it is Brazil that errs when it suggests that the Panel could seek and apply any information at all without making Brazil's case for it since Brazil has advanced relevant claims and arguments.[29] With respect to the allocation of non-tied (decoupled) payments across the total value of the recipients' sales for purposes of identifying the amount of the subsidy and the subsidized product, Brazil has not sought such information, has not made arguments to support use of that methodology, and has in fact argued that no allocation or identification of the subsidy amount is warranted under Part III of the Subsidies Agreement. Thus, the Panel would in fact be making Brazil's case for it were it to seek to apply the Annex IV methodology.

31. Appellate Body report. There, the Appellate Body reversed a panel finding of inconsistency with Article 5.6 of the *Agreement on the Application of Sanitary and Phytosanitary Measures* ("SPS Agreement") "because this finding was reached in a manner inconsistent with the rules on burden of proof".[30] Specifically, the Appellate Body found that "it was for the United States to establish a *prima facie* case . . . of inconsistency with Article 5.6. Since the United States did not even claim before the Panel that the 'determination of sorption levels' is an alternative measure which meets the three elements under Article 5.6, we are of the opinion that the United States did not establish a *prima facie* case that the 'determination of sorption levels' is an alternative measure within the meaning of Article 5.6".[31]

32. Brazil argues that this reversal was based on the fact that "the complaining party (the United States) did not 'claim' in its request for establishment of a panel that there was an alternative measure (determination of sorption levels) that was less trade restrictive".[32] However, in making this

[27] Brazil's Data Comments, para. 99.
[28] *See* Exhibit BRA-369.
[29] *See* Brazil's Data Comments, para. 103-04.
[30] WT/DS76/AB/R, para. 130.
[31] WT/DS76/AB/R, para. 126.
[32] Brazil's Data Comments, para. 100.

argument, Brazil itself (as it later asserts of the United States) "reveals a profound misunderstanding of the difference between a 'claim' and an 'argument'".[33] The United States agrees with Brazil (and the Appellate Body report in *EC – Hormones*) that "there is a distinction between legal claims reflected in a panel's terms of reference, and arguments used by a complainant to sustain its legal claims". There is no question, however, that the United States advanced a legal *claim* that Japan's varietal testing measure was inconsistent with Article 5.6 of the SPS Agreement.[34] The issue was whether the United States had presented evidence and arguments relating to an alternative measure that satisfied its burden of making a *prima facie* case with respect to its Article 5.6 claim.[35] Thus, the Appellate Body concluded that "the Panel was correct to seek information and advice from experts to help it to understand and evaluate the evidence submitted and arguments made by the United States and Japan with regard to the alleged violation of Article 5.6" but the panel erred "when it used that expert information and advice for a finding of inconsistency with Article 5.6 since the United States did not establish a *prima facie* case of inconsistency with Article 5.6 based on claims relating to the 'determination of sorption levels'".[36]

33. A similar situation would occur here were the Panel to seek and apply information to apply the Annex IV methodology to decoupled income support payments.[37] Brazil has neither sought nor presented any evidence relating to the total value of the recipient firms' sales. Brazil has also not only *not* argued that the Annex IV methodology is necessary to identify the subsidized product and the subsidy benefit, Brazil has also continually argued against use of the Annex IV methodology since, in its view, no allocation of the payment or quantification of the benefit is warranted under Part III of the Subsidies Agreement. Thus, it would appear that Brazil has resisted making the necessary legal arguments and refused to submit any evidence relating a proper analysis of its claims.

34. With respect to Brazil's refusal to recognize the relevance of the Annex IV methodology for purposes of its serious prejudice claims, and its resulting refusal to present evidence and arguments with respect to the application of that methodology to its claims, the findings of the Appellate Body in *Japan – Agricultural Products* remain highly relevant:

> "Article 13 of the DSU . . . suggest that panels have a significant investigative authority. However, this authority cannot be used by a panel to rule in favour of a complaining party which has not established a prima facie case of inconsistency based on specific legal claims asserted by it. A panel is entitled to seek information and advice from experts and from any other relevant source it chooses, pursuant to Article 13 of the DSU . . . *to help it understand and evaluate the evidence submitted and the arguments made by the parties, but not to make the case for a complaining party*."[38]

In this case, Brazil has not submitted evidence and made arguments sufficient to make its case that the effect of decoupled income support payments is to cause serious prejudice to Brazil's interests. In fact, Brazil's arguments have seemingly been designed to prevent the Panel from ascertaining even what is the amount of the subsidy being challenged. In such a circumstance, Brazil has not

[33] Brazil's Data Comments, para. 103.

[34] *See, e.g.*, WT/DS76/AB/R, para. 123 ("In this dispute, the United States claimed that the varietal testing requirement is more trade restrictive than required to achieve Japan's appropriate level of protection and is, therefore, inconsistent with Article 5.6."); Panel Report, *Japan – Agricultural Products*, WT/DS76/R, paras. 1.2, 4.178, 8.64.

[35] WT/DS76/AB/R, para. 124 ("As noted above, the United States argued that 'testing by product' is an alternative measure which meets the three cumulative elements under Article 5.6."); *id.*, para. 125 ("We note that the Panel explicitly stated that the United States, as complaining party, did *not specifically argue* that the 'determination of sorption levels' met any of the three elements under Article 5.6".).

[36] WT/DS76/AB/R, para. 130.

[37] *See* US Answer to Question 256 from the Panel, paras. 183-86 (22 December 2003).

[38] WT/DS76/AB/R, para. 129 (italics added).

established a *prima facie* case of inconsistency with Articles 5 and 6 of the Subsidies Agreement with respect to these payments, and the Panel cannot make findings of serious prejudice.

## IV. Brazil's Invented Methodology Has No Basis in the WTO Agreements and Represents an Effort to Maximize the Payments Allocated to Upland Cotton

35. The foregoing analysis suffices to demonstrate that Brazil has not made a *prima facie* case under its serious prejudice claims with respect to decoupled income support measures. Simply put, based on the evidence and arguments brought forward by Brazil, the Panel cannot make findings on those measures under Articles 5 and 6 of the Subsidies Agreement (as well as GATT 1994 Article XVI) without making Brazil's case for it. In this section of these comments, we nonetheless examine Brazil's application of its invented methodology to the US-supplied data.

36. The United States has previously explained, both in these comments and in its comments to Brazil's answer to Question 258, that the Brazilian allocation methodology has no basis in the text or context of the WTO agreements.[39] We do not repeat that detailed critique of Brazil's invented methodology here, other than to note that Brazil seeks to *apply* an allocation methodology for purposes of Peace Clause – despite the fact that the definitions of product-specific support and non-product-specific support (and their application in the Agreement on Agriculture) do not permit any such allocation – while at the same time Brazil seeks to *deny* any allocation methodology for purposes of serious prejudice – despite the fact that an allocation methodology is set forth explicitly in Annex IV reflecting core Subsidies Agreement concepts relating to subsidy benefits and the subsidized product. Thus, Brazil invites the Panel to adopt a legally erroneous approach that does violence to the existing texts of the Agreement on Agriculture and the Subsidies Agreement.

37. We have also previously explained that Brazil's invented allocation methodology does not make economic sense. Decoupled payments by their nature provide income support not tied to the production or sale of any given commodity[40], therefore, there is no more reason to attribute $1 in income support to upland cotton production on a farm than there is to attribute that $1 in income support to production of any other product (soybeans, corn, etc.). Brazil's approach, however, makes just such an arbitrary attribution, producing illogical results:

> The same crop (for example, upland cotton) produced on a farm could be deemed to be subsidized at different rates. For example, planted acres of upland cotton up to the amount of upland cotton base acres will be deemed to be subsidized at a rate corresponding to decoupled payments for upland cotton base acres. Planted acres of upland cotton in excess of the amount of upland cotton base acres will be deemed to be subsidized at a different rate – perhaps higher if sufficient payments corresponding to base acres for other crops are available, perhaps lower or even zero if few or no payments for "excess" base acres are available. From an economic perspective, there is no basis to say that some income support dollars are going to a certain portion of the crop but not others.[41]
>
> In addition, because payments on all the "excess" base acreage are allocated to whatever programme crop has planted acres in excess of base acreage, the subsidization of the "excess" planted acreage can be far higher than for other acres of that crop or for acreage of other crops that may be more heavily planted. (For example, if a farm has 100 base acres of soy, 10 planted acres of soy, and 1 planted

[39] *See, e.g.*, US Comments to Brazil's Answer to Question 258 from the Panel, paras. 207-29 (28 January 2004).

[40] *See, e.g.*, Brazil's First Written Submission, para. 51 (under direct payment program, the "amount of payment is not dependent upon current production" of any particular commodity).

[41] *See* US Comment on Brazil's Answer to Question 258, para. 221.

> acre of cotton, the 90 "excess" base acres of soy will be allocated to the 1 acre of cotton, resulting in a cotton subsidy and subsidization rate far higher than that for soy, despite the fact that soy plantings outstrip cotton plantings 10 to 1.)[42]
>
> Brazil's approach simply ignores the existence of crops other than "programme crops", much less other farming or non-farm economic activities the subsidy recipient may undertake. Again, there is no economic reason to attribute income support payments to some (programme) crops but not others and some (crop production) economic activities but not others.[43]

38. Fundamentally, Brazil's approach is in error because it assumes that there is a tie between the decoupled payments and current plantings. Brazil attributes payments for base acres to currently planted crops by describing the current crop as "planted on" base acres. The reality is that there are no physical "base acres" on a farm; crop base is an accounting concept that is limited by the farm's cropland. (For example, the farm may have 100 base acres of upland cotton, but if it currently plants 100 acres of cotton, that cotton may physically be "planted on" any land on the farm.) But Brazil does not carry through its own concept of crops "planted on" base acres.

> For example, in the example given above of a farm with 100 base acres of soy and current plantings of 10 acres of soy and 1 acre of cotton, under Brazil's approach, payments on the 90 "excess" base acres of soy are allocated to the 1 acre of upland cotton. But 1 acre of upland cotton could only be "planted on" 1 base acre of soy.
>
> Thus, for planted acreage *up to* the crop's base acreage, Brazil uses the concept of a crop "planted on" base acreage. But for planted acreage *beyond* the crop's base acreage, Brazil would allocate more than (or less than) one base acre per planted acre. In the preceding example, the one acre of upland cotton could not be deemed to be "planted on" 90 acres of soy.

Brazil's allocation methodology thus is not even internally consistent.

39. Given that Brazil's invention allocation methodology has no basis in the text or context of the Peace Clause, much less in the Subsidies Agreement or any other WTO agreement, given that its methodology does not make economic sense, and given that its methodology is internally inconsistent, one is left to wonder how Brazil arrived at its methodology. One answer may be that Brazil developed this methodology because it allows Brazil to allocate certain decoupled payments exclusively or nearly exclusively to upland cotton. That is, Brazil's invented allocation methodology can be described as an attempt to maximize the payments to be allocated to upland cotton, regardless of the legal or commonsense objections.

40. Consider the information set out in footnote 159 to paragraph 80 of Brazil's Data Comments. Brazil notes that "[f]or MY 1999 and 2000, *only upland cotton plantings exceeded the crop base acreage*; thus, *all additional payments were allocated to upland cotton* [italics added]. For MY 2001, also oats and sorghum were planted on more acreage than their respective contract base ('overplanted'); thus, triggering additional payments being allocated pursuant to the crop's share of the total acreage being 'overplanted'". Restated, in marketing year 2001, all "excess" contract payments were allocated to upland cotton, oats, and sorghum, but the latter two crops accounted for only a small share of plantings on farms that planted upland cotton.[44]

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[42] *See* US Comment on Brazil's Answer to Question 258, para. 221.

[43] *See* US Comment on Brazil's Answer to Question 258, para. 222.

[44] *See* US Letter to Panel (January 28, 2004) (file rPFCsum.xls: for farms planting upland cotton in MY2001 upland cotton planted acreage was 15.5 million acres, oats planted acreage was 0.19 million acres, and sorghum planted acreage was 2.4 million acres).

> Thus, for cotton plantings up to the amount of cotton base, Brazil would allocate payments on upland cotton base acres to cotton.
>
> For cotton plantings in excess of the amount of cotton base, Brazil's allocation methodology results in all "excess" contract payments for programme crops being allocated to upland cotton in marketing years 1999-2000 and almost all "excess" contract payments being allocated to upland cotton in marketing year 2001.

In this way, Brazil seeks to maximize the payments being allocated to upland cotton, regardless of the illogic of its approach. The Panel should reject Brazil's legally erroneous and economically unsound approach to allocation issues.

41. Brazil attempts to apply its unsound methodology to the summary data provided by the United States on 18 and 19 December 2003. (We note that Brazil did not request the summary data in Exhibit BRA-369. The United States generated this summary in order to assist the Panel and Brazil in viewing the aggregated results.) Brazil asserts that "Using the US aggregate base acreage data and aggregate planting data to allocate contract payments will most likely trigger distortions of the results due to the allocation problem".[45] However, we note that Brazil does not explain to the Panel that the results using the aggregated data will likely be biased upwards, overstating the decoupled payments allocated to upland cotton.

42. In Brazil's allocation methodology, a farm that plants less acreage of upland cotton than its cotton base acreage must always produce a drop in support because some payments on upland cotton base acres will not be allocated to cotton. A farm that plants more cotton acreage than its cotton base acreage, on the other hand, may still enjoy support for the "excess" planted acres but only if there are also "excess" non-upland cotton base acres on the farm. However, when all of the base acreage and planted acreage data are aggregated, Farm A's cotton planted acreage in excess of upland cotton base acres may effectively be allocated support from Farm B's "excess base acreage" in another programme crop (or more than one). Thus, while Brazil is correct that applying its methodology to the summary data will not necessarily produce the same results as a farm-by-farm calculation, Brazil fails to recognize that the results presented by Brazil in paragraph 83 of its data comments applying its invented allocation methodology to the summary data are biased upwards.

43. In sum, the United States has shown that Brazil's allocation methodology is not based on any WTO agreement text, does not make economic sense, and is not internally consistent. Based on the categorical US rejection of Brazil's methodology, the Panel should take Brazil's statement that "Brazil's methodology is rather conservative compared to an allocation based on the US summary data, *which the United States seems to endorse as a valid base for calculating support to upland cotton*"[46] as another gross distortion by Brazil. Unlike Brazil, the United States has taken a consistent position in this dispute that "support to a specific commodity" means "product-specific support" and that such support must be gauged by looking at the support "decided" by a Member through its measures.

## V. Brazil's Application of the Annex IV Methodology to the US Data Is Inadequate and Flawed

44. In this section, the United States examines Brazil's cursory application of the Annex IV methodology to the US-supplied data.[47] We note that Brazil's analysis is patently insufficient to carry Brazil's burden with respect to decoupled income support payments. First, Brazil has neither sought

[45] Brazil's Data Comments, para. 76.
[46] Brazil's Data Comments, para. 84 (italics added).
[47] *See* Brazil's Data Comments, § 10.

nor presented relevant data. Brazil requested data relevant only to its invented methodology, and there is no data before the Panel that would permit the Annex IV methodology to be applied. Brazil's complaint that the United States has "refuse[d] to provide" the information that would permit the Panel to calculate the payments under the US methodology[48] – while erroneous[49] – is also misplaced. It is not the United States' responsibility to make Brazil's *prima facie* case, and Brazil's argument reflects an impermissible effort to shift the burden onto the responding party.

45. Brazil has also not presented arguments sufficient to carry its burden. Brazil has repeatedly and expressly disavowed the applicability of the Annex IV methodology for purposes of identifying the subsidized product or quantifying the subsidy benefit for non-tied (decoupled) payments. Perhaps for that reason, the calculations presented by Brazil reflect a misunderstanding of the plain meaning of the Annex IV methodology and contain a number of erroneous assumptions that bias Brazil's results upwards.

46. Under the Annex IV methodology, a subsidy not tied to a particular product is allocated to all of the recipients' sales. That is, since money is fungible, the subsidy benefit is deemed to inure to all of the products the recipient produces; a neutral way of attributing the subsidy to particular products is according to their proportion of the firm's sales. Thus, allocating to upland cotton those Production Flexibility Contract (PFC) payments, Market Loss Assistance (MLA) payments, Direct Payments (DP) and Counter-Cyclical Payments (CCP) for upland cotton base acres would be done as follows:

> PFC payments for upland cotton base * (cotton gross sales/total sales)
> MLA payments for upland cotton base * (cotton gross sales/total sales)
> DP payments for upland cotton base * (cotton gross sales/total sales)
> CCP payments for upland cotton base * (cotton gross sales/total sales)[50]

The "total value of the recipient firm's sales" (Annex IV, para. 2) would include all economic activities by the firm (e.g., other farm and non-farm related activities). Thus, Brazil errs in limiting the denominator in its calculations to the estimated value of crops produced by the payment recipients.[51] Further, Brazil has presented no evidence relating to the total value of the recipient firm's sales that would permit the Annex IV methodology to be applied.

47. In its calculated apportionment, Brazil makes several errors that result in an overestimate of the payment value allocated to cotton. First, Brazil allocates decoupled payments for all crop base (e.g., wheat PFC payments, corn MLA payments) to upland cotton. As the United States has explained[52], Brazil impermissibly seeks to bring within the scope of this dispute payments that Brazil did not identify and that have not been at issue throughout this dispute.

48. In this regard, Brazil's argument that these programmes are within the Panel's terms of reference by virtue of the reference in Brazil's panel request to "payments . . . providing direct or indirect support to the US upland cotton industry"[53] is not sustainable. Article 6.2 of the DSU requires that the panel request "identify the specific measures at issue". Brazil's statement fails to meet this requirement; indeed, Brazil affirmatively emphasizes that its list of payments is

[48] Brazil's Data Comments, para. 87.

[49] For example, the United States has collected no information on "the recipient firm's sales" for marketing years 1999-2002.

[50] Arguably, one could include all economic activities by the firm (e.g., other farm and non-farm related activities.)

[51] Brazil's Data Comments, paras. 85-98.

[52] *See* US Comment on Brazil's Answer to Question 204 from the Panel, paras. 34-42 (28 January 2004).

[53] Para. 18.

"unqualified", and that it "is more than broad enough to encompass any type of payment".[54] In other words, Brazil by its own admission has provided virtually no information that would allow identification of the specific measures at issue.

49. Moreover, to the extent that Brazil in any way qualifies this list, it does so based on *legal* conclusions. Rather than identifying the payment measures by describing their characteristics or by citing any specific provision of US law[55], Brazil seeks to draw into the scope of this dispute an uncircumscribed and unidentified list of measures limited only by whether the *legal* conclusion may be drawn that the measure provides "direct or indirect support to the US upland cotton industry". Brazil might just as well have stated that it was challenging, "any US law that is inconsistent with US WTO obligations." In neither case would the description allow an identification of which measure is subject to the case, and in neither case would it be possible to determine whether a measure is within the scope of the case until the legal issues in the dispute are fully adjudicated. Indeed, the Appellate Body has criticized a panel for blurring the distinction between legal claims and measures when it read the term "measures" as synonymous with alleged violations, and thereby failed to require identification of the specific measure at issue.[56]

50. The DSU requirement to allow identification of the measures at issue is not a hollow one, and panels have not hesitated to conclude that measures fall outside the scope of a dispute because they are not adequately described.[57] Brazil's "unqualified" panel request does not bring non-cotton contract payments into the scope of this dispute.

51. While decoupled payments for upland cotton base account for the majority of decoupled income support payments to farms that planted cotton, including total decoupled payments in the allocation overstates the value of decoupled payments to be allocated.

| Decoupled payments: | 1999[1] | 2000[1] | 2001[1] | 2002 |
|---|---|---|---|---|
| Payments on cotton base | 515,280,580 | 482,302,565 | 387,870,741 | 1,520,701,136 |
| Total payments | 695,912,510 | 650,579,667 | 520,230,908 | 1,681,630,034 |
| Cotton as per cent of total | 74.0% | 74.1% | 74.6% | 90.4% |

1 Does not include Market Loss Assistance payments.

Source: Exhibit Bra-424; also provided electronically as "allocation calculations.xls"

52. Second, in calculating crop values for purposes of the total value of the recipient firm's sales[58], Brazil calculates crop values based on planted, not harvested, acreage. For cotton, abandonment rates can be significant. In the US response to Question 209 from the Panel, the United States demonstrated that harvested acreage differed significantly from planted acreage over the

[54] Para. 19.

[55] Brazil's reference to payment programs provided under the 2002 FSRI Act, the 1996 FAIR Act, and the 1998 -2001 Appropriations Acts in no way provides the required specificity. These laws provided for a myriad of payment programmes, and it is impossible through these references to determine the payment programmes Brazil now seeks to include within the dispute.

[56] Report of the Appellate Body, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted 25 November 1998, para. 69.

[57] *See, e.g.*, Preliminary Ruling by the Panel, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain*, WT/DS276/12, circulated 21 July 2003, paras. 28, 32.

[58] *See* Subsidies Agreement, Annex IV, para. 2.

period 1999-2002. The use of the smaller harvested acreage figure would lower the total value of cotton by as much as 16 per cent from what Brazil calculated.[59]

**Planted and Harvested Upland Cotton Acres** (1,000 acres)

| Crop year | Planted acres | Harvested acres | Abandoned acres | Rate of abandonment |
|---|---|---|---|---|
| 1999 | 14,584 | 13,138 | 1,446 | 9.9% |
| 2000 | 15,347 | 12,884 | 2,463 | 16.0% |
| 2001 | 15,499 | 13,560 | 1,939 | 12.5% |
| 2002 | 13,714 | 12,184 | 1,530 | 11.2% |

Source: USDA, National Agricultural Statistics Service, *Acreage*, various issues.

53. Third, Brazil underestimates the value of crop sales on cotton farms. To calculate the value of programme crops, Brazil multiplies acres planted to that crop (as provided electronically by the United States on December 18 and 19) times average crop yield times average farm price. For cropland not planted to programme crops, Brazil "assumed that the value of the crops produced on this 20 per cent of farmland is the average per-acre value of production of non-programme crops in that marketing year in the entire United States, as reported by USDA"[60]. Brazil has claimed repeatedly that upland cotton production is "concentrated" in several US States[61], but now that the issue matters, Brazil ignores its long-standing position. Under Brazil's approach to the Annex IV methodology, it is the per-acre value of production in cotton-producing states that would be relevant (rather than including, say, the per acre value of production of crops grown in Alaska in its average).

54. To calculate the average per-acre value of non-programme crops, moreover, Brazil also excludes the value of all fruits, tree crops, vegetables and melons, arguing that their exclusion is justified on the basis that, if fruits or vegetables are grown, "contract payments are eliminated".[62] However, this argument ignores the fact that producers may grow such crops on any cropland on the farm in excess of the farm's base acreage without any effect on payments.[63] As previously noted by Brazil, non-programme base accounts for 20 per cent of total cropland on farms that planted cotton over the period or about 6 million acres. Ignoring fruits and vegetables thus underestimates the value of non-programme crops and, as a consequence, overestimates the per cent of total crop value accounted for by cotton.[64]

55. Fifth, as Brazil concedes,[65] in estimating the total value of crop sales, Brazil excluded sales of (high value) livestock and livestock products. We would also note that Brazil excluded any other farm-related income. Brazil has put no data on the record that would allow for these sales to be included in the Annex IV allocation.

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[59] Brazil inadvertently uses the all cotton crop yield in their calculations rather than the yield for upland cotton only.

[60] Brazil's Data Comments, para. 90.

[61] *See, e.g.*, Brazil's Answer to Question 125(2)(a) from the Panel, para. 13 (27 October 2003).

[62] *See* Brazil's Data Comments, paras. 73, 92.

[63] *See, e.g.*, Brazil's First Written Submission, para. 45 (PFC payments are reduced or eliminated if fruits or vegetables are grown "on 'base acreage'" but not on total cropland).

[64] Brazil also appears to have inadvertently copied the incorrect acreage numbers for cotton planted on farms with no cotton base for 2000 and 2001. (The 1999 figure was copied to 2000 and 2001. From the spreadsheet "Raw Data 1999-2001" the correct numbers are:

1999 1,033,617.7
2000 1,222,180.1
2001 1,347,140.2

[65] Brazil's Data Comments, fn. 173.

56. Finally, Brazil fails to make any adjustment in the amount of payment to reflect the proportion of cotton planted acreage that is rented or owned.[66] However, those "subsidies" to cotton producers that are the subject of Brazil's panel request must "benefit" producers.[67] Brazil itself has conceded that land rental rates as of marketing year 1997 – that is, one year after introduction of the decoupled production flexibility contract payments – reflect the capture of more than one-third of the subsidy by landowners.[68] Thus, only those cotton producers who are also landowners of base acreage for which decoupled payments are made would benefit from those payments.[69]

57. The cumulative effect of these omissions and erroneous assumptions is to bias upwards Brazil's allocation of decoupled payments to upland cotton. In the following table, we have recalculated an estimated value of cotton production compared to the value of all crops produced on farms using corrected values for harvested acres, upland cotton yields, and per-acre value of non-programme crops.[70] Because Brazil has not put relevant data on the record, we have not been able to correct its calculations by including the value of all economic activities by the firm, for example, livestock and livestock products, other farm-related activities, and non-farm economic activities in the denominator. However, even without those necessary adjustments, the incomplete (undervalued) data show that cotton accounted for only about half of the total value of crop production on recipient farms planting upland cotton over the period.

**Value of Upland Cotton as Per cent of All Crops on Farms Planting Upland Cotton**

| | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| Upland cotton | $3,056,169,795 | $3,707,427,799 | $2,554,264,280 | $3,351,712,385 |
| All crops | $5,940,836,757 | $6,543,259,828 | $5,277,060,069 | $6,280,154,911 |
| Per cent | 51.4% | 56.7% | 48.4% | 53.4% |

58. In the table that follows, we present recalculated figures for decoupled payments on upland cotton base using the corrected value of upland cotton sales and per-acre value for non-programme crops in calculating the total value of crop sales to use in the denominator of the formula: decoupled payments received by recipient firms * (upland cotton gross sales / total crop sales). Again, contrary to Annex IV, paragraph 2, this calculation does not include in the denominator the value of *all* economic activities by the recipient firms. Nor have we adjusted the value of the decoupled payments for upland cotton base acres downwards to reflect the fact that two-thirds of cotton acreage is rented, not owned, and that landowners will capture the benefit of those payments for base acres on farms worked by tenants.

[66] *See* US Answer to Question 195 from the Panel, paras. 6-11 (22 December 2003).

[67] *See* Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, adopted 7 June 2000, paras. 6.65 and 6.66 (quoting and agreeing with *Canada – Aircraft* panel: "'A "benefit" does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a "benefit" can be said to arise only if a person . . . has in fact received something.'").

[68] *See, e.g.*, Brazil's Further Rebuttal Submission, para. 154 ("[S]ome portion of the contract payments do find their way into increased rent and cost of land") (footnote omitted).

[69] Indeed, the 2002 Act implicitly recognized that decoupled income support payments ultimately benefit landowners by giving to the landowner the authority to choose whether to update his or her base acres on the farm. *See* 2002 Act, § 1101(a)(1) ("For the purpose of making direct payments and counter-cyclical payments with respect to a farm, the Secretary shall give an owner of the farm an opportunity to elect 1 of the following as the method by which the base acres of all covered commodities on the farm are to be determined."); *see also id.*, § 1101(b), 1101(c), 1101(e)(1), (3), (5) (Exhibit US-1).

[70] Further calculations are presented in Exhibit US-154..

59. Nonetheless, the table shows that the "14/16" methodology proposed by Brazil, as well as the estimates purporting to apply the Annex IV methodology provided in section 10 of Brazil's data comments (reproduced below), are grossly inflated.

**Partially Corrected Results of Calculations Allocating Decoupled Payments for Upland Cotton Base Acres to Upland Cotton Using Incomplete Annex IV Methodology**

| | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | 265,077,970 | 273,273,870 | 187,741,729 | na |
| MLA Payments | 263,787,006 | 290,909,042 | 259,309,589 | na |
| DP Payments | na | na | na | 253,021,210 |
| CCP Payments | na | na | na | 558,575,463 |
| Total | 528,864,975 | 564,182,912 | 447,051,318 | 811,596,673 |

**Brazil's Erroneous Calculations Allocating Decoupled Payments for all Contract Base to Upland Cotton Using Incomplete Annex IV Methodology** (Brazil's Data Comments, para. 96.)

| | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | $477,692,236 | $473,744,959 | $333,295,919 | na |
| MLA Payments | $475,365,813 | $504,317,125 | $460,349,591 | na |
| DP Payments | na | na | na | $416,216,862 |
| CCP Payments | na | na | na | $714,424,543 |
| Total | $953,058,049 | $978,062,084 | $793,645,510 | $1,130,641,406 |
| **Minimum Per cent Overstated** | **80.2** | **73.4** | **77.5** | **39.3** |

**Brazil's Allocation of Decoupled Payments for all Contract Base to Upland Cotton Using Its Erroneous 14/16 Methodology** (Brazil's Data Comments, para. 97)

| | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| PFC Payments | $547,800,000 | $541,300,000 | $453,000,000 | na |
| MLA Payments | $545,100,000 | $576,200,000 | $625,700,000 | na |
| DP Payments | na | na | na | $454,500,000 |
| CCP Payments | na | na | na | $935,600,000 |
| Total | $1,092,900,000 | $1,117,500,000 | $1,078,700,000 | $1,390,100,000 |
| **Minimum Per cent Overstated** | **106.7** | **98.1** | **141.3** | **71.3** |

That is, when the results of Brazil's calculations are compared to the results obtained by the United States correcting for certain but not all of Brazil's errors and omissions, it appears that *Brazil dramatically overstates the decoupled payments that would be allocated to upland cotton* by 39.3 to 80.2 per cent for its incomplete Annex IV calculations and by 71.3 to 141.3 per cent for its erroneous 14/16 calculations.

60. Had Brazil put other data on the record necessary to apply the Annex IV methodology, for example, the value of any livestock and livestock products, other farm-related activities, and non-farm economic activities of recipient firms, moreover, *the decoupled payments allocated to upland cotton would be reduced even further*. Had Brazil further adjusted the value of the decoupled payments for upland cotton base acres downwards to reflect the capture of two-thirds of the benefit of those payments by landowners who are not cotton producers, *the decoupled payments allocated to upland cotton would be reduced even further*. Rather than confront the fact that the Annex IV methodology and Subsidies Agreement concepts would dramatically reduce the value of decoupled payments deemed to benefit upland cotton (and hence, would dramatically reduce the supposed "$12.9 billion" in support provided to upland cotton between marketing years 1999-2002), Brazil chose to argue that *no* allocation of non-tied payments is necessary and that *no* quantification of the subsidy benefit to upland cotton is necessary. Brazil also chose *not* to seek or put on the record information relevant to this determination. Thus, as explained earlier, Brazil has deliberately chosen a course of action that results in its failure to make a *prima facie* case on its serious prejudice claims with respect to decoupled payments.

## VI. Brazil Misrepresents Both the Scope of Its Own Requests for Data as well as the US Response

61. Finally, in this portion of its comments, the United States responds to inaccurate assertions by Brazil relating to what information it sought and what information the United States provided. The United States also responds to Brazil's arguments that certain "adverse inferences" should be drawn from its inaccurate portrayal of what was requested and provided. The United States notes that these issues are of relatively minor importance given that Brazil's allocation methodology, for which it sought farm-by-farm planted and base acreage data:

> (1) may not be applied for purposes of determining the product-specific support to upland cotton for purposes of the Peace Clause analysis because the methodology inappropriately conflates product-specific and non-product-specific support and

(2) may not be applied for purposes of determining the subsidized product or the subsidy benefit for decoupled income support payments because that methodology has no basis in the WTO agreements and Brazil expressly disavows its use for purposes of its serious prejudice claims.

Nonetheless, we undertake this review of Brazil's assertions because Brazil grossly distorts the record of the dispute in an effort to make the United States appear uncooperative (at best). The truth is that the United States has expended an unprecedented amount of time and resources in responding to the fullest extent under US law to the requests for information made of it. Given our experience in WTO dispute settlement to date, we question whether other Members would have responded so fully and promptly to similarly burdensome requests.

### A. Brazil Grossly Distorts the Record of This Dispute by Suggesting that the United States Has Failed to Cooperate

62. Brazil make a number of spurious accusations regarding US participation in this dispute and simple misstatements of the record. Although we regret the imposition on the Panel's time and attention, we do feel it necessary to set the record straight.

63. Brazil First Asked for this Data in December 2003, Not November 2002: First, Brazil asserts that it "first requested this information in November 2002".[71] "This information" refers to the request for information "set out in Exhibit BRA-369" for "contract acreage and planted acreage for each farm producing upland cotton".[72] Brazil's claim is false. There is no request in Exhibit BRA-101 (Brazil's consultation questions) for "contract acreage and planted acreage for each farm producing upland cotton". Further, there is no reference in Brazil's consultation questions to decoupled income support payments for non-upland cotton base acres. For example, Consultation Question 3.6 (not referenced by Brazil in footnote 2 of its data comments) was expressly directed at payments made "in connection with upland cotton for each of the marketing years 1992 through 2002". When the United States answered those questions by referring (where appropriate) to payments made with respect to upland cotton base acres, Brazil at no point asserted that it sought information with respect to "other crop contract payments".

64. Brazil Misrepresents the Panel's Request for Information: Second, Brazil asserts that the "Panel requested [this data] in August, October, and December 2003, as well as in January 2004." The Panel well knows what it has requested, but the United States notes that the Panel's questions too did not request contract and planted acreage information. Question 67 *bis* in August 2003 requested information about annual amounts granted to upland cotton producers per pound and in total expenditures under each of the decoupled payment programmes, not information on planted or base acreage. As previously explained, the United States accurately answered that it does not maintain information on expenditures to upland cotton producers because the United States collects no farm-specific production (harvesting) data.[73] Question 125(9) in October 2003 requested, *inter alia*, information on any adjustments to make for decoupled payments for upland cotton base acreage, not for information on planted and base acreage. In its 8 December 2003, communication, the Panel did not request planted and base acreage information from the United States; rather, it stated that "the United States will be given until **18 December** to respond to *Brazil's request* made in Exhibit BRA-369".[74] Finally, the 12 January 2004, communication from the Panel *did* request the planted

[71] Brazil's Data Comments, para. 4 (footnote referencing BRA-101 omitted).
[72] Brazil's Data Comments, para. 3.
[73] *See, e.g.*, US Answer to Question 195 from the Panel, paras. 6-11 (22 December 2003).
[74] The United States notes but does not understand the reference in fn.3 to paragraph 4 of Brazil's data comments to the "second bulleted point" in the Panel's December 8 communication; that bullet point referred to "a communication from the Panel concerning the FAPRI model".

acreage and base acreage information as set out in Exhibit BRA-369, and the United States explained that it was not able to provide this information farm-by-farm under the US Privacy Act. Thus, Brazil misrepresents the facts when it asserts that the Panel has requested "this data" four times.

65. Brazil Falsely Alleges that the United States Denied Having Certain Data: Brazil then accuses the United States of "falsely stat[ing] that it did not maintain contract and planted acreage information for each farm".[75] As just explained, the United States did not "falsely state" that it did not maintain that information because it was not asked for that information until the Panel on 8 December 2003, invited it to respond to Brazil's request made in Exhibit BRA-369. In its 18 and 19 December 2003, replies to that request, the United States explained that under US law it could not provide (as Brazil specifically requested and insisted upon) planted acreage information together with base acreage and yield information and FSA farm numbers.

66. We also recall, as explained in the US comments on Brazil's answers[76], that it was the United States itself at the second session of the first panel meeting (that is, before "late November 2003" and the presentation of Exhibit BRA-369 at the second panel meeting) that brought to the Panel's and Brazil's attention the acreage reporting requirement that was introduced by Section 1105 of the 2002 Act (7 USC 7915). We trust that the fact that the United States *offered* this information to Brazil and the Panel will lay to rest the unwarranted suggestion that the United States sought to obscure it instead.

67. contract base acreage and yield information. The focus of the Panel's question 67 *bis* and Brazil's argumentation has naturally been on the amount of decoupled income support payments to upland cotton producers. The United States has explained that it does not track decoupled payments by recipients' production and thus does not maintain information on the payments made for upland cotton base acres (or any other base acres) to upland cotton *producers*. The farm-by-farm planted acreage and base acreage and yield data sought by Brazil in Exhibit BRA-369 and by the Panel in its request of 12 January 2004, does not provide information on the payments made to upland cotton *producers*. Rather, putting aside issues of the appropriate methodology to identify the amount of the subsidy, this planted and base information would allow the calculation of the amount of decoupled payments made to farms that reported *planting* upland cotton.

68. Brazil Incorrectly Accuses the United States of Refusing to Provide Data on Non-Upland Cotton Base: Brazil also argues that the United States "refused to provide" farm-specific data on the amount of other contract base acreage on farms producing upland cotton with no upland cotton base acreage.[77] The omission of non-upland cotton base acreage from the data submitted by the United States in December 2003 was inadvertent and the result of programming errors, as explained in the US letter of 28 January 2004 transmitting revised data files. Thus, Brazil's extensive protestations that the United States "withheld that information" are misplaced.

69. We do note, however, that the United States continues to believe that such decoupled payments for non-upland cotton base acreage are not within the Panel's terms of reference and that Brazil's effort to include these payments at the end of this proceeding would deprive the United States of fundamental rights of due process.[78] That such payments for non-upland cotton base acreage was not even considered by Brazil earlier in this proceeding is nowhere more clear than in Brazil's own words:

[75] Brazil's Data Comments, para. 4.
[76] US Comment on Brazil's Answer to Question 196 from the Panel, paras. 15-18 (28 January 2004).
[77] Brazil's Data Comments, para. 17.
[78] *See* US Comments on Brazil's Answer to Question 204 from the Panel, paras. 34-42 (28 January 2004).

> "Brazil requested the United States during the Annex V procedure to provide information on the total amount of *upland cotton base acreage and yield* under the CCP (and DP) program."[79]

Indeed, the accuracy of Brazil's own description of its questions is amply supported by the text of those questions relating to "Deficiency Payments/Production Flexibility Contract Payments/Direct Payments":[80]

> "Please state the number of US upland cotton farms updating their *upland cotton base acreage* for the purposes of calculating Direct Payments under the 2002 FSRI Act. Please also provide the percentage of all US farmers producing upland cotton that updated *their upland cotton base acreage*." (Question 3.1 (italics added))
>
> "Please state the annual amount of Deficiency Payments made by the US Government in connection with *upland cotton base* for each of the marketing years 1992 through 1996." (Question 3.4 (italics added))
>
> "Please state the annual amount of Production Flexibility Contract Payments made by the US Government in connection with *upland cotton base* for each of the marketing years 1996 through 2002." (Question 3.6 (italics added))
>
> "Please state the total amount of Direct Payments made by the US Government in connection with *upland cotton base* in marketing year 2002." (Question 3.7 (italics added))
>
> "Please state the amount of *upland cotton base acreage* and the *average upland cotton base yield* applicable on this acreage under the Deficiency Payment Program during each of the marketing years 1992 through 1996." (Question 3.8 (italics added))
>
> "Please state the amount of *upland cotton base acreage* and the *average upland cotton base yield* applicable on this acreage under the Production Flexibility Contract Payment Program." (Question 3.9 (italics added))· "Please state the amount of *upland cotton base acreage* and the *average upland cotton base yield* applicable on this acreage for the Direct Payment Program." (Question 3.10 (italics added))

Thus, Brazil's assertion that it has argued all along that decoupled payments for non-upland cotton base acres are challenged measures is flatly contradicted by its own questions set out above. Brazil sent these questions on 1 April 2003, a mere 14 days after the DSB established the panel to consider this matter. If Brazil had considered that payments for non-upland cotton base acreage were within the scope of this dispute, surely it would have requested information with respect to those payments as well. The sheer number of references to upland cotton base acreage and yields demonstrates Brazil's view, at the time of panel establishment, of the scope of the decoupled payments it challenged.[81]

70. Market Loss Assistance Data Was Not Requested But Was Provided: Brazil argues that the United States "has not provided the requested data for market loss assistance payments received by

[79] Brazil's First Written Submission, para. 68 (emphasis added). We note in passing that the DSB did not initiate the Annex V procedures and that Brazil's statement that it asked the United States questions "during the Annex V procedure" is therefore incorrect.

[80] *See* Exhibit BRA-49 (Brazil's questions for purposes of the Annex V procedure).

[81] The United States has previously set out further evidence that decoupled payments for non-upland cotton base acres are not within the Panel's terms of reference and that Brazil did not consider these payments to be measures within the Panel's terms of reference. *See* US Comments to Brazil's Answer to Question 204 from the Panel, paras. 32-42 (28 January 2004).

the farms listed for MY 1999-2001". Brazil's argument is confused. Exhibit BRA-369 requested planted acreage and base acreage (and yield) for marketing years 1999-2002, and the United States provided that, farm-by-farm. The base acreage did not differ for production flexibility contract payments and market loss assistance payments so there was no need to set out base data for market loss assistance payments separately.

71. It is ironic that Brazil would accuse the United States of failing to provide certain "data for market loss assistance payments" since Exhibit BRA-369 *did not even identify market loss assistance payments by name*. Instead, it defined "programme crop" as "any crop that was assigned base acreage and payment yields under the Production Flexibility Contract (MY 1999-2001). Brazil inserts a question mark for MLA payments in its table at paragraph 22 of its comments, arguing that "[t]he United States has not provided any specific information on market loss assistance payments," but again Brazil ignores its own data request. Nowhere in Exhibit BRA-369 did Brazil request actual *payment* amounts for any of the decoupled income support programmes, and in any event Brazil well knows that market loss assistance payments were calculated in the same proportion as the production flexibility contract payments.[82]

72. Soybeans Were Not Within Brazil's Data Request: Next, Brazil argues that "since market loss assistance payments were also made for soybean base (that otherwise was not eligible to receive PFC payments), this allocation methodology [based on PFC payments] may significantly underestimate the amount of market loss assistance payments that constitute support to upland cotton".[83] The existence of soybeans market loss assistance payments is simply irrelevant to the data Brazil requested from the United States. Exhibit BRA-369 requested planted acreage and base acreage (and yield) information for "programme crops." Soybeans, however, were not a programme crop (or "contract commodity") under the 1996 Act[84], and no soybean base acreage was assigned to farms before marketing year 2002. In fact, in the very statutes that provided sections that provided for payments designated as marketing loss assistance, there were separate provisions for payments for soybeans in marketing years 1999 and 2000; these payments were not designated as market loss assistance and were provided for current soybeans producers (and oilseed producers of all types).[85] Contrary to market loss assistance payments, soybeans producers received payments not based on the farm history, but their own production history (as explained in the 8 June 2000 rule), no matter where they planted the soybeans. Thus, no soybeans data was included in the US response to Exhibit BRA-369 because no soybeans data was requested. Indeed, Brazil later implicitly concedes that soybeans data could *not* have been included in its request since soybeans were not a programme crop.[86]

73. Peanuts Were Not Within Brazil's Data Request: Finally, Brazil argues that "the 19 December 2003 US data concerning MY 2002 does not contain any information regarding the amount of direct and counter-cyclical payments made on peanut base". Brazil asserts that "the missing data on peanut contract payments for MY 2002 would cause lower aggregate payments

[82] *See* Brazil's First Written Submission, para. 60 ("Between MY1998-2001, upland cotton producers thereby received an additional amount of money, which was calculated based on their respective share of total upland cotton base times the amount of budgetary outlays allocated for upland cotton.").

[83] Brazil's Data Comments, para. 20.

[84] *See* 1996 FAIR Act, § 102(5) (Exhibit BRA-28).

[85] The 1999 crop soybean program was provided for by a statute, PL 106-78, enacted 22 October 1999. In fact, the USDA's programme rules were not issued until 8 June 2000, at 65 FR 36550. The amount provided in that statute was $475 million for all oilseeds, not just soybeans. As for the 2000 crop, the soybean payments were allowed by PL 106-224, in the amount of $500 million for all oilseeds, with rules that did not issue until 65 F.R. 5709 in November 2000. The amount paid was amplified for the 2000 crop by the addition of monies, long after, in PL 107-25, enacted in August of 2001. It is worth noting that all of these payments occurred well after plantings, again contradicting the contention of Brazil that non-upland cotton payments cause farmers to plant cotton.

[86] *See* Brazil's Data Comments, para. 90 fn. 177 ("The lower figures for MY 1999-2001 are explained by the fact that soybeans were not a contract programme crop.").

allocated as support to upland cotton".[87] Again, Brazil makes assertions that do not follow from its own data request. The marketing year 2002 data contains no peanut information because no farm had peanut base in marketing year 2002; it follows that there were no payments made on any farm base. No peanut base existed for farms in marketing year 2002 because decoupled payments for peanut base acreage was brand new, and the base was not assigned by Section 1302 of the Farm Bill to a farm but to "historical peanuts producers". The statute did not require an assignment of the base acreage to a farm until the 2003 crop. In fact, the United States expressly noted in Exhibits US-111 (describing contents of farm-by-farm DCP base and yield file) and US-112 (describing contents of farm-by-farm DCP planted acres file) that "[p]eanut figures were not run as peanut bases were not farm-specific in 2002". Thus, the United States could not have provided farm-specific planted acreage and base acreage information with respect to peanuts because there was no peanuts base acreage for farms in marketing year 2002. Again, Brazil's complaints are without merit.

74. Conclusion: Brazil's Accusations Are Spurious and Complicate the Panel's Task Needlessly: In conclusion, the United States notes that not only has Brazil sought to put the United States in a difficult position through its overbroad data request and unreasonable approach to privacy issues under US law, but the lack of clarity in Brazil's approach has added considerable confusion to this proceeding. For example, Brazil at one and the same time faults the United States for not providing the farm-specific information as requested in Exhibit BRA-369 but then also faults it for not producing the information using "a substitute number protecting the alleged confidentiality rights of farmers."[88] Despite refusing to consider any deviation from BRA-369 at the second panel meeting, Brazil now asserts that the United States should have noticed a newfound flexibility in a passing reference within a Brazilian answer and on that basis produced an entirely new set of data. It was entirely reasonable for the United States to consider Exhibit BRA-369 as Brazil's request since Brazil's refusal to consider alternatives compelled the United States to make tremendous efforts to produce that requested information while simultaneously preparing answers to more than 50 panel questions and comments on Brazil's econometric evidence. (Further, as the United States explained in its 20 January 2004, letter to the Panel, the sheer number of fields involved in Brazil's request would make possible identification of specific farms based on a unique combination of planted and base acreage, even with substitute farm numbers.)

75. As another example, Brazil's request was so broad that (as set out above) Brazil itself appears not to have understood the precise scope of the information it requested. This continual overbroad argumentation wastes the time and resources of the United States and the Panel that would be better spent on issues actually pertinent to this dispute. In addition, Brazil faults the United States for "misunderstanding [] Brazil's allocation methodology," when that methodology was not set out until Brazil filed its answer to Question 258 on 20 January 2004 – that is, more than one month after the United States provided the data requested in Exhibit BRA-369 (to the extent permissible under US law) and more than eight months into this proceeding. In this regard, Brazil's litigation tactics have impacted the ability of the United States to address Brazil's claims, arguments, and evidence and have complicated this Panel's task immensely and needlessly.[89]

[87] Brazil's Data Comments, para. 21.

[88] *See* Brazil's Data Comments, paras. 38-39 (referencing Brazil's December 22 Answers to Questions, para. 7).

[89] Indeed, the United States has cooperated in good faith in this dispute and expended extraordinary resources to do so, but Brazil put the United States in the position of violating US law or providing requested data. Brazil now seeks to have the Panel draw adverse inferences when its own request for information was over-broad in that Brazil could simply have asked the United States to apply its methodology (which, as of 3 December 2003, it had not yet disclosed, and would not until forced to do so by the Panel on 20 January 2004). The Panel should consider that it was Brazil at the second panel meeting that refused to cooperate and consider alternative means to request information that could have protected US farmers' privacy interests. If there is an "adverse inference" to be drawn, it may be that Brazil withheld its methodology until the end of the proceeding because it knew it could not withstand a full analysis and review and because Brazil

## B. US Law Prohibits Disclosing Planted Acreage Information Without the Prior Consent of the Farmer

76. The United States has explained in its letters dated 18 December 2003, 19 December 2003, and 20 January 2004, that under US law it may not disclose planting information in which a farmer has a privacy interest. This has been consistent US Department of Agriculture policy and is not contradicted by the *Washington Post* district court decision referenced by Brazil (which dealt with disclosure of payment information – similarly, the United States has provided contract data on a farm-by-farm basis). The United States also explains these matters in more detail in its answer to Questions 259(a), (b), and (c).

77. Brazil's views on how US law operates in the FOIA context are not relevant to the US Department of Agriculture's statutory responsibility to respect the privacy interests of US farmers in the planted acreage data. However, Brazil's discussion of Washington Post v. United States Department of Agriculture, 943 F.Supp. 31 (D.D.C. 1996), does not support Brazil's arguments that the United States need not protect this data.

78. The US position on the privacy interests in plantings is not *post hoc* since, as we showed in the attachments to the US letter of 18 December 2003, the position on planted acres has been the same since at least 1997 – that is, after the Washington Post decision. Brazil neglects to mention that all that was at issue in the Washington Post case was crop *payments*, not farmer plantings. Hence, that case fit within the FOIA precept of disclosure of the activities of the government, which was what was of concern to the court. 943 F. Supp. at 33, 36. Plantings are quite a different matter, involving a farmer's activities, not that of the government. Moreover, such producer-supplied information, not government-generated, has long been recognized as having special privacy concerns. *See, e.g.*, 7 USC 1373 and 7 USC 1502. Thus, under specific provision of the 1938 Act and provisions of the Crop Insurance Act, the US government has long considered plantings separate matters not subject to disclosure. A similar outcome results from an analysis under the Privacy Act and to some degree the Trade Secrets Act.

79. Regarding the rice matter, Brazil argues that "USDA's FOIA representatives necessarily must have determined that because the request did not focus on an individual producer's farm, the interests of the public in understanding and evaluating the operation of the contract payment schemes outweighed any privacy interests". However, the rice matter involved one office, and that disclosure was contrary to clearly established national policy. We have explained fully what the problem was and what FSA policy is. The concerns here are much greater than in the Hill decision, moreover, because the privacy interests of 200,000 farmers are involved.

## C. There Is No Basis to Draw Any Inference, Much Less an "Adverse Inference"

80. Brazil has asked the Panel to draw certain adverse inferences from the alleged failure of the United States to cooperate fully and provide requested data. As noted in the US letter of 20 January and explained above, the United States did not have the authority to provide the farm-specific planting information in the format requested by the Panel's 12 January 2004. However, the United States did provide both farm-specific and aggregated contract data that would permit the Panel and Brazil to assess the total expenditures of decoupled payments to farms planting upland cotton.[90] Brazil itself admits that "the data provided by the United States appears to be complete" with respect to both

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sought to distract from Brazil's failure to provide evidence and data necessary to support its arguments based on its methodology.

[90] The United States notes that it had no basis to provide any other aggregation of the data than that which it provided since it was not aware of Brazil's allocation methodology until Brazil filed its answer to Question 258 on 20 January 2004.

contract acres and planted acres[91] – therefore, the willingness of the United States to provide information within the limits set by US law cannot be questioned. Further, the Panel on 3 February requested certain additional aggregated information, which therefore does not implicate privacy interests of farmers and which the United States is endeavouring to provide.

81. The situation here is thus very different from the one in *Canada - Aircraft* where the Appellate Body first opined that "a panel should be willing expressly to remind parties – during the course of dispute settlement proceedings – that a refusal to provide information requested by the panel may lead to inferences[92] being drawn about the inculpatory character of the information withheld."[93] There is no basis for an "inference" of any kind, adverse or otherwise.

82. This is particularly so in this dispute as the farm-specific planted and base acreage information was sought for purposes of Brazil's allocation methodology, which is without any textual basis in the WTO agreements. For purposes of Peace Clause, Brazil's methodology is inapplicable because Brazil concedes that "support to a specific commodity" means "product-specific support" – and yet, Brazil's allocation methodology would contradict the meaning of product-specific support and non-product-specific support set out in the Agreement on Agriculture. Further, Brazil's methodology is inapplicable for purposes of its serious prejudice claims because Brazil argues that no allocation of decoupled payments or identification of subsidy benefits or the subsidized product is necessary under Part III of the Subsidies Agreement. Further, the only allocation methodology set out in the Subsidies Agreement is that of Annex IV, for which the farm-specific planted and base acreage information would be irrelevant. Thus, there is no need to draw an inference of any sort in this dispute.

83. Brazil's proposed "adverse influences" also do not follow logically from the data before the Panel. Brazil first suggests that farm-by-farm data would have resulted in payments higher than Brazil's 14/16 methodology. However, Brazil cannot escape the fact that it has not brought forward evidence and arguments to support findings under the Annex IV methodology.

84. Second, Brazil suggests that the Annex IV methodology would have produced higher payments than Brazil's 14/16 methodology. The United States is not in exclusive possession of relevant information with respect to an Annex IV methodology, but the incomplete data and calculations above demonstrate that in fact the Annex IV methodology would produce a far *lower* subsidy amount than Brazil's 14/16 methodology.

85. Third, Brazil suggests that "the information withheld" by the United States "would have been detrimental" to US arguments that decoupled payments are non-product-specific support. As set out previously, the farm-by-farm planted acreage data that the United States could not provide under US law is simply irrelevant to the issue whether decoupled payments are "product-specific support". Brazil appears to overreach, moreover, in suggesting that a "detrimental" inference be drawn since the *Canada – Aircraft* report found that the inferences to be drawn were not punitive but factual in nature.

[91] Brazil's Data Comments, para. 27 fn. 55.

[92] The United States notes that in the same report the Appellate Body was careful to distinguish "adverse" inferences from other "inferences", remarking that: "We note, preliminarily, that the 'adverse inference' that Brazil believes the Panel should have drawn is not appropriately regarded as a punitive inference in the sense of a 'punishment' or 'penalty' for Canada's withholding of information. It is merely an inference which in certain circumstances could be logically or reasonably derived by a panel from the facts before it." *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 200 ("*Canada – Aircraft*").

[93] *Canada – Aircraft*, WT/DS70/AB/R, para. 204.

## VII. Conclusion

86. Brazil has asserted that decoupled income support payments must be allocated to upland cotton only for purposes of the Peace Clause and not for purposes of its serious prejudice claims. However, Brazil's analysis is completely backwards: the text and context of the Peace Clause demonstrate that support is *not* to be allocated for purposes of the Peace Clause test while the text and context of Articles 5 and 6 of the Subsidies Agreement demonstrate that subsidies not tied to production of a given product (such as decoupled income support) *are* to be allocated to all of the products the recipient sells for purposes of serious prejudice claims.

87. The implication of Brazil's erroneous analysis and arguments, and in particular its express disavowal of any allocation methodology for purposes of its serious prejudice claims on decoupled income support payments, is that Brazil has failed to make a *prima facie* case on these claims. As a result, no findings may be made with respect to these measures, and these payments may not be included in an analysis of whether the effect of the challenged US subsidies has been serious prejudice to Brazil's interests

**List of Exhibits**

143 Memorandum from Larry Mitchell, USDA Farm Services Agency, to Various FSA Offices, Administrators, and Divisions on Release of Restricted Information under the Freedom of Information Act (18 September 1998)

144 USDA Farm Services Agency, Notice INFO-16: Releasing Lists of Names and Addresses in Response to Requests Under FOIA (1 December 1998)

145 Contents of 4 corrected data files submitted on 28 January 2004

146 USDA, Commodity Credit Corporation, 58 Federal Register 15755-15756 (24 March 1993).

147 Data in response to Panel Question 264(a): Exhibit US-128 on a Fiscal Year/ Cash Basis

148 Data in response to Panel Question 264(d): Claim Payments/ Recoveries/ Reschedulings on a Fiscal Year/ Cash Basis

149 United States Department of the Treasury Financial Manual I TFM 2-4600 (December 2003)

150 "Annual Review of Fees for USDA Credit Programs," 25 March 2003 and 8 April 2002.

151 United States Office of Management and Budget Circular No. A-129 (November 2000), Table of Contents, General Information, Appendix A, Sections I and II.

152 Commodity Credit Corporation Realized Losses and Appropriations to Restore Such Losses for Fiscal Years 1992-2003

153 Summary of Principal Terms, Conditions, and Duration of Each Rescheduling Reflected in Column F of Exhibit US-128

154 Partially Corrected Calculations Allocating Decoupled Payments for Upland Cotton Base Acres to Upland Cotton Using Incomplete Annex IV Methodology

# ANNEX I-20

## BRAZIL'S COMMENTS ON UNITED STATES 11 FEBRUARY 2004 ANSWERS TO ADDITIONAL QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL WITH THE PARTIES

18 February 2004

### Table of Cases Cited

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| *Japan – Apples* | Appellate Body Report, *Japan – Measures affecting the Importation of Apples*, WT/DS245/AB/R, adopted 10 December 2003. |

### List of Exhibits

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| Dresser Industries v United States, 596 F.2d 1231 (5th Cir. 1979) | Exhibit Bra-425 |
| Center for Auto Safety v National Highway Traffic Safety Administration, 244 F.3d 144 (DC Cir 2001) | Exhibit Bra-426 |
| CNA Financial Corporation v Donovan, 830 F.2d 1132 (DC Cir 1987) | Exhibit Bra-427 |
| United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989) | Exhibit Bra-428 |
| Metadure Croporation v United States, 490 F. Supp. 1368 (S.D.N.Y. 1990) | Exhibit Bra-429 |
| Campaign for Family Farms v Glickman, 200 F.3d 1180 (8th Cir. 2000) | Exhibit Bra-430 |
| Comparison of US and Brazil's Cash-Basis Accounting Methodologies for Purposes of the Item (j) Analysis | Exhibit Bra-431 |
| Congressional Budget Office, Fact Sheet, row titled "Export Credit Guarantee Programme, Subsidy Account" | Exhibit Bra-432 |

**259. With respect to the Privacy Act of 1974, 5 U.S.C. 552a:**

**(a) Whose interests are protected under section 552a(b) in light of the definition of "individual" in section 552a(a)(2)? Do all payment recipients, including corporations and organizations, have Privacy Act rights? If not, is the United States prevented by its domestic law from releasing such of the information requested on 12 January 2004 as relates to payment recipients without Privacy Act rights? Please explain with references to case law.**

**Brazil's Comment:**

1. In its 11 February 2004 response, the United States repeats its assertion that (many of) US upland cotton farms' planting reports are protected by the US Privacy Act and cannot be produced to the Panel and Brazil, even under confidentiality arrangements.[1] As explained below, the United States is wrong. But more fundamentally, as the United States has argued before other WTO panels, a WTO Member's domestic laws do not provide a basis for not complying with its obligation to cooperate in a WTO dispute settlement proceeding and to provide, if requested by a panel under DSU Article 13, any information – if necessary using special confidentiality procedures.[2] In sum, as Brazil established in its 28 January 2004 Comments and Requests Regarding US Data, there is no basis for the United States, citing confidentiality concerns, to withhold data from the Panel.[3]

2. The US 11 February 2004 response to this question confuses two fundamental questions. First, are there any Privacy Act rights of US upland cotton farms that would cover information about planted acreage that is gathered by the US government *via* mandatory or voluntary planting reports? And second, do these privacy rights prevail under the US Freedom of Information Act ("FIOA")) over the interest of the public in understanding the operations or activities of the US government. While the United States partly (yet falsely) addresses the first question, it ignores the second question.

3. The starting point for addressing these issues is the relationship of the Privacy Act and the FOIA. The Privacy Act, codified as 5 U.S.C. § 552a[4], protects "records maintained on individuals" by the US government, and prevents disclosure "to any person, or to another agency", with certain exceptions.[5] One of the exceptions listed reads: "unless disclosure would be … (2) required under section 552 of this title".[6] 5 U.S.C. § 552 is the place where the FOIA is codified. It follows that the prohibition of disclosure of information on individuals provided for by the Privacy Act is subject to the requirements of the FOIA.

4. Returning to the first step, the United States admits that corporations are not covered by the Privacy Act.[7] This is confirmed by the case law cited by the United States (*Dresser Industries v United States*).[8] Yet, neither this case law, nor any other reference provided by United States, supports the United States' distinction between "normal" corporations and "closely held corporations."[9] Even if "closely held corporations" were covered by the Privacy Act – an assertion

[1] US 11 February 2004 Answers to Additional Questions, paras. 1-5.
[2] *See* Brazil's 28 January 2004 Comments and Requests Regarding US Data, para. 55.
[3] *See* Section 5 of Brazil's 28 January 2004 Comments and Requests Regarding US Data.
[4] Exhibit US-107.
[5] Exhibit US-107 (5 U.S.C. § 552a(b)).
[6] Exhibit US-107 (5 U.S.C. § 552a(b)(2).
[7] US 11 February 2004 Answers to Additional Questions, para. 2.
[8] Exhibit Bra-425 (Dresser Industries v United States, 596 F.2d 1231 (5th Cir. 1979), p. 7 [**16]).
[9] US 11 February 2004 Answers to Additional Questions, para. 8. As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant

for which the United States does not offer any proof – they would have the same status as private individuals, which are discussed below in Brazil's comment on the US 11 February 2004 response to Question 259(b).

5. The United States further refers to the District of Columbia Court of Appeals decision in *Center for Auto Safety v National Highway Traffic Safety Administration*[10] for the proposition that information voluntarily submitted to the US government by corporations may not be released if that information would not customarily be released by the corporation to the public.[11] However, the United States misquotes this decision. In fact, the decision states that the information was

> exempt from disclosure because the information was voluntarily submitted *and constituted confidential commercial information that was not customarily disclosed*. The … information at issue had been disclosed in the past only when necessary, and always with a confidentiality agreement or protective order.[12]

Thus, the restriction only applies to confidential commercial information. While the United States asserts that "[t]his is the case with respect to plantings", the United States provides no evidence for this assertion.[13] The United States' assertion is simply wrong.

6. Planting information is always in the public domain – anyone can look at a field to determine to what crop it is planted. Most US farmland is connected by paved roads and is easily accessible to the public. Further, the Aerial Photography Field Office of USDA's Farm Services Agency exists to provide detailed aerial photographs of cropland.[14] The Office maintains aerial photographs of every square kilometre of cropland in the United States and updates the photographs on a regular basis.[15] Any person can order any aerial photograph by including a legal description of the area of interest in township, range, and section number or latitude and longitude coordinates.[16] The Aerial Photography Field Office indicated that scaled enlargements of photographs are made using specialized rectifying enlargers which maintains an accuracy greater than 99 per cent for most cropland in the United States.[17] The final rectified aerial photograph is, in effect, a photographic map accurately representing ground features. In fact, USDA's local FSA offices use the aerial photographs in verifying planting reports (FSA-578 forms) required under various US farm programmes.[18] No Privacy Act warnings are shown on the order form or on the web-site where these photographs can be purchased.

7. By its very nature, planting information cannot be confidential commercial information that could always be protected by confidentiality arrangements. In that sense, planting information is very

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must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[10] Exhibit Bra-426 (Center for Auto Safety v National Highway Traffic Safety Administration, 244 F.3d 144 (DC Cir 2001)).

[11] US 11 February 2004 Answers to Additional Questions, para. 3.

[12] Exhibit Bra-426 (Center for Auto Safety v National Highway Traffic Safety Administration, 244 F.3d 144 (DC Cir 2001), p. 4 [*147]) (emphasis added).

[13] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[14] The Web-page of the Office is found at http://www.apfo.usda.gov.

[15] *See* http://www.apfo.usda.gov.

[16] *See* http://www.apfo.usda.gov.

[17] *See* http://www.apfo.usda.gov.

[18] *See* Brazil's 18 November 2003 Further Rebuttal Submission, para. 36.

different from technical information about airbags used in cars, which was at issue in *Center for Auto Safety v National Highway Traffic Safety Administration*.[19]

8. This conclusion is supported by another appellate court decision in *CNA Financial Corporation v Donovan*, also cited by the United States.[20] Referring to the Trade Secrets Act, the court defined the scope of the exception in 5 U.S.C. § 552(b)(4) as only prohibiting the disclosure of commercial or financial information if disclosure "is likely to … cause substantial harm to the competitive position of the person from whom the information was obtained", requiring "both a showing of actual competition and a likelihood of substantial competitive harm".[21] The United States has made no such showing with respect to planting information on upland cotton farms. Furthermore, the court held that "[t]o the extent that any data requested under FOIA is in the public domain, a submitter is unable to make any claim of confidentiality – a *sine qua non* of [5 U.S.C. § 552(b)(4)]".[22] None of the information requested by the Panel poses a significant threat to "cause substantial harm to the competitive position of the person from whom the information was obtained", in particular because, as demonstrated above, the information is, in fact, by its very nature not information that can remain confidential, but is in the public domain, and, indeed, offered for sale by USDA.[23] It follows that (non-closely held) upland cotton farms cannot invoke the Trade Secrets Act to prevent disclosure of planting information.

9. Since the United States characterizes information submitted to the US Government under mandatory terms to be releasable (*i.e.*, MY 2002 planting information),[24] and MY 1999-2001 planting information is not protected under the above rebutted US theory, there is nothing in the Privacy Act that would prevent the United States from producing farm-specific planting information for corporate farms using farm serial numbers or "dummy" numbers. At best, there is some ambiguity in the US law that should be resolved by the United States in favour of releasing the information, as required by its obligations under the DSU.

10. Second, even for the "individuals" covered by the protection of the Privacy Act, there is no legal basis to preclude the release of planting information. As noted above, the protection of the Privacy Act is conditional on the FOIA disclosure rules, which necessitate a weighing process between the privacy interest of the group of individuals and the public interest in the operations of the US Government. Under the applicable case law, this weighing process would be resolved in favour of disclosing the information, as discussed in Brazil's comment on the US 11 February 2004 response to Question 259(b), below.

11. In sum, none of the US Privacy Act arguments holds up to scrutiny. And none is relevant in the first place, since the United States is under an obligation to provide – possibly subject to special confidentiality procedures – information requested by the Panel under DSU Article 13, even if that information is confidential.

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[19] Exhibit Bra-426 (Center for Auto Safety v National Highway Traffic Safety Administration, 244 F.3d 144 (DC Cir 2001), p. 3-4 [*146-*147]).

[20] Exhibit Bra-427 (CNA Financial Corporation v Donovan, 830 F.2d 1132 (DC Cir 1987)).

[21] Exhibit Bra-427 (CNA Financial Corporation v Donovan, 830 F.2d 1132 (DC Cir 1987), p. 23 [*1152]).

[22] Exhibit Bra-427 (CNA Financial Corporation v Donovan, 830 F.2d 1132 (DC Cir 1987), p. 25 [*1154]).

[23] The United States neither presents the legal provisions of the Trade Secrets Act nor explains any other pertinent information with respect to that Act. (*See* U.S. 11 February 2004 Answers to Additional Questions, para. 3.) Yet, as the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[24] US 11 February 2004 Answers to Additional Questions, para. 4.

**(b) The Panel notes that data concerning the four relevant programmes, in particular, payment amounts, identified by specific farms, is freely available on the internet. Please explain why that data can be disclosed but the requested planted acreage data cannot. Do individual recipients have Privacy Act rights with respect to their entrepreneurial activity? Please explain with references to case law.**

**Brazil's Comment:**

12. In its 11 February 2004 response, the United States asserts that "[i]nformation concerning planted acreage does not demonstrate anything regarding the government's operation – it only demonstrates what a producer is doing".[25] Brazil strongly disagrees. Information about plantings of farms receiving contract payments provides important information about the extent to which the US contract payments provide support to specific commodities. US taxpayers, as in the *Washington Post* case, have a strong public interest in knowing how their tax dollars are being spent. In particular, such information would shed light on the question of how much upland cotton is planted on upland cotton base acreage – information that is important for the US public to assess whether the United States is in compliance with its obligations under the Agreement on Agriculture. As the aggregate information provided by the United States suggests, in MY 2002, 96 per cent of US upland cotton plantings took place on upland cotton base.[26]

13. If follows that the US citation to a US Supreme Court decision in paragraph 7 of the US 11 February 2004 response misses the point. Since planting information is a vital component for assessing the "the government's operation", it has to be part of the balance between "the privacy interest of the individual with the 'core purpose' of FOIA".[27] And the US district court decision in *Washington Post v. United States Department of Agriculture* confirms that in cases, where "the information is so generic that the impact on privacy interests are so small"[28], the information has to be disclosed. This interpretation is, in fact, confirmed, rather then contradicted, by the US Supreme Court Decision in *United States Department of Justice v Reporters Committee For Freedom of the Press* ("Reporters Committee").[29]

14. The *Reporters Committee* decision concerns an individual person's FBI "rap sheet" that was requested under the FOIA. The Supreme Court rejected this request as outside the purpose of the FOIA, since it did not "contribut[e] significantly to the understanding *of the operation or activities of the government*" (emphasis in original).[30] By contrast, planting information of farms clearly contributes to the understanding of the operation of the US contract payments programmes. Providing this information would, thus, not only enhance the Panel's ability to make an objective assessment of the matter before it, but would also conform to "the basic purpose of the [FOIA,] to open agency action to the light of public scrutiny".[31]

[25] US 11 February 2004 Answers to Additional Questions, para. 8.
[26] *See* Brazil's 18 February Comments on US Comments, Annex A, para. 11.
[27] US 11 February 2004 Answers to Additional Questions, para. 7.
[28] Exhibit Bra-418 (Washington Post v United States Department of Agriculture, 943 Supp. 31 (D.D.C.) 1996, p. 3). *See* Brazil's 28 January Comments and Requests Regarding U.S. Data, paras. 31-34.
[29] Exhibit Bra-428 (United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989)).
[30] Exhibit Bra-428 (United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989), p. 15 [*775]).
[31] Exhibit Bra-428 (United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989), p. 15 [*774]).

15. The US Supreme Court decision in *Reporters Committee* states that "Congress exempted nine categories of documents from the FOIA's broad disclosure requirements".[32] These exemptions are codified at 5 U.S.C. § 552(b).[33] In this case, disclosure of the information is neither prevented by other laws (5 U.S.C. § 552(b)(3)), *i.e.*, the Trade Secrets Act (because the information does not constitute trade secrets as defined by US courts[34]), or the Privacy Act (which applies subject to the FOIA Act), nor by the separate exemption (5 U.S.C. § 552(b)(4) for trade secrets and commercial or financial information). Once again, since planting information could be collected from the public domain – or rather observed by any member of the public or, indeed, purchased from USDA – it cannot be deemed confidential. In fact, as the appeals court in *CNA Financial Corporation v Donovan* held, "[t]o the extent that any data requested under FOIA is in the public domain, a submitter is unable to make any claim of confidentiality – a *sine qua non* of [5 U.S.C. § 552(b)(4)]".[35]

16. Moreover, 5 U.S.C. § 552(b)(7)(C) exempts information "compiled for law enforcement purposes, but only to the extent that the production of such … information would … (C) … constitute an unwarranted invasion of personal privacy."[36] While acreage reports are partly mandatory to enforce the requirements of various US domestic support programmes[37], disclosure of planting information does not constitute an unwarranted invasion of personal privacy. In fact, the information could be gathered by simply checking the fields of a farm or by purchasing aerial photographs from the Aerial Photography Field Office of USDA's Farm Services Agency, as discussed above.[38] It is not difficult to determine the type of crop or the amount of acreage being planted to that crop from using high resolution colour aerial photographs. If a farmer growing crops can purchase from USDA high resolution and detailed aerial photographs of his next-door neighbour's farm to calculate that information, how can it be that this same farmer can claim a Privacy Act violation for his own planted acreage data? This evidence provides the common sense answer to the question whether acreage reports are, in fact, subject to the Privacy Act.

17. Thus, from the perspective of its "public domain" character, acreage information is even less confidential than payment information, which the district court in *Washington Post* decided must be released under FOIA.[39] Since acreage information sheds light on the performance of USDA and its adherence to the WTO obligations of the United States, any weighing of the limited privacy interests in planting information and the interest of the public in evaluating the work of USDA must be resolved in favour of the latter.

18. Finally, with respect to the "split of authority in US courts as to whether individuals have Privacy Rights with respect to their entrepreneurial activities"[40], it is clear that even if a privacy interest protected under the Privacy Act should exist with respect to the entrepreneurial activity in question, the FOIA takes precedence over that interest, as explained in Brazil's comment to the US 11 February 2004 response to Question 259(a), and in the *Washington Post* and *Reporters Committee* precedent. Concerning planted acreage information at issue between the parties, it is clear that the public interest in USDA's performance, including USDA adherence to the US obligations under the WTO Agreement, takes precedence over the privacy interests of US farmers in information that is potentially always in the public domain. Even assuming, *arguendo*, that there were some ambiguity

[32] Exhibit Bra-428 (United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989), p. 6 [*755]).
[33] Exhibit US-103.
[34] *See* above.
[35] Exhibit Bra-427 (CNA Financial Corporation v Donovan, 830 F.2d 1132, p. 25 [*1154]).
[36] Exhibit US-103.
[37] *See* Brazil's 18 November 2003 Further Rebuttal Submission, Section 2.2.
[38] *See* also http://www.apfo.usda.gov.
[39] *See* Brazil's 28 January 2004 Comments and Requests Regarding US Data, paras. 31-33.
[40] US 11 February 2004 Answers to Additional Questions, para. 9. The cases cited by the United States are reproduced as Exhibits Bra-429 (Metadure Croporation v United States, 490 F. Supp. 1368 (S.D.N.Y. 1990)) and Bra-430 (Campaign for Family Farms v Glickman, 200 F.3d 1180 (8th Cir. 2000)).

in the meaning of the US domestic law applicable to the question of confidentiality and the release of planted acreage information, the United States should resolve the ambiguity in favour of releasing the information, as required by its obligations under the DSU.

**(c) Please provide any further available evidence of the USDA's long-standing policy that planted acreage information will not be released.**

**Brazil's Comment:**

19. Brazil notes that it is not USDA's place to provide an authoritative interpretation of US law, including the Freedom of Information Act. Any "internal policy memorandum" cannot change the meaning of US law. Interpreting US laws is left to the US courts, which have issued rulings that would compel release of the planting, payment and contract payment base information.

20. Further, both Exhibits US-134 and US-144 refer to individual acreage information *in connection with names that cannot be released*. Brazil recalls that the Panel has requested farm-specific information with farm serial numbers (rather than names)[41], or, alternatively, farm-specific information using "dummy" farm numbers.[42] And Exhibit US-144 clarifies that "[a]creage, production data, and other producer-related information, without any personal identifier attached may be released". This language would certainly cover farm-specific information using "dummy" farm numbers.

21. Finally, whether there is a long-standing practice by USDA of not releasing farm-specific acreage data to the public is irrelevant to a WTO dispute. First, under DSU Article 13, the United States is required to provide even confidential information.[43] Second, any such information is not released to the public, and can – under WTO procedures – be protected as confidential information and be returned to the United States once this panel proceeding ends. Confidentiality procedures either under DSU Articles 13.1 and 18.1 or special confidentiality procedures under the Panel's working procedures can address any US concern that Brazil could match data provided by the United States with data publicly available to unveil the names of specific farmers and their plantings. In addition, any such concern would not exist had the United States provided a single file containing both base acreage and yields as well as planting information. Under these circumstances, no identification number, whether farm serial number or "dummy" number, would be necessary.

**260. On 27 August 2003, in its response to Question No. 67 *bis*, the United States indicated that "it does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers". On 12 January 2004, the Panel requested the United States to provide information "to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years". On 20 January 2004, the United States informed the Panel that "the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton." Is the latest statement responsive to the Panel's request? If so, how can it be reconciled with the first statement?**

**Brazil's Comment:**

22. The US 11 February 2004 response to the Panel's Question continues a pattern of misrepresentation that has tainted the US statements on this issue during this entire dispute.[44] In its

[41] 8 December 2003 Communication from the Panel.
[42] 12 January 2004 Communication from the Panel.
[43] *See* Section 5 of Brazil's 28 January 2004 Comments and Requests Regarding US Data.
[44] US 11 February 2004 Answers to Additional Questions, para. 13.

response, the United States draws the distinction between farms that plant upland cotton, for which the United States admits it has information, and farms that produce upland cotton, *i.e.*, farms that harvest the planted upland cotton, for which the United States asserts it does not have information.[45] Allegedly, this distinction between "planters" and "producers" of upland cotton explains the discrepancy between the two US statements referred to in the Panel's question. It does not.

23. In fact, the United States in its 11 February 2004 response engages in a play with words that hides its non-cooperation in this panel proceeding. Contract payments made to "planters" of upland cotton support the production of upland cotton and are, thus, "support to" upland cotton. This is true even if the planted upland cotton is in the end abandoned and not harvested. Indeed, the 2002 FSRI Act defines a "producer" as someone who "*shares in the risk of producing a crop* and is entitled to share in the crop available for marketing from the farm *or would have shared had the crop been produced*".[46] Thus, a person remains a "producer" even if the chances were against him or her in a given year and a planted crop failed.

24. In sum, the terms "producer" and "planter" of a crop are synonyms for purposes of defining "support to" a specific commodity. Any contract payments paid to producers/planters of upland cotton must be considered in allocating the "support to" upland cotton from contract payments – whether the crop planted on that farm was harvested or not.

25. It follows that the two US statements referred to in the Panel's question are *irreconcilable*.[47] Unfortunately, Brazil has to note that the United States continues its approach of trying to mislead the Panel and Brazil on the question of the amount of contract payments that constitute support to upland cotton. In its 11 February 2004 Comments on Brazil's 28 January 2004 Data Comments, the United States engages in a self-serving revisionist history.[48] What is left after the US rhetoric is one clear fact: that the United States has engaged in a highly successful effort over sixteen months to deny Brazil and the Panel information giving a definitive amount of the four contract payments paid to and received by producers of upland cotton during MY 1999-2002. Brazil and the Panel are still waiting for data that would allow a precise calculation of this support, either in a farm-specific manner, as requested by the Panel on 8 December 2003 and 12 January 2004, or in the aggregate manner as requested by the Panel on 3 February 2004. Brazil notes that the Panel has granted the United States an extension until 3 March 2004 to provide this information.[49]

26. Brazil believes the Panel is well aware of the US refusal to provide payment information in the numerous forms in which that information has been requested.[50] In an effort to assist the Panel with making factual findings in its report regarding this issue, Brazil sets forth a chronology of the facts relating to these various requests. These facts need little, if any, commentary or argument from Brazil, as they speak for themselves:

- **22 November 2002**: Brazil files its First Set of Questions and Request for Production of Documents to the United States.[51] Question 3.6 stated: "*What was the annual amount of . . . (ii) production flexibility contract payments and (iii) direct payments (as relevant given the particular time period) made by the US Government in connection with upland cotton for each of the marketing years 1992 through 2002*." Question 11.1 stated: "*Please state the total*

[45] US 11 February 2004 Answers to Additional Questions, para. 13. *See* also US 11 February 2004 Comments para. 67 and US 28 January 2004 Comments, para. 16 making the same argument.

[46] Exhibit Bra-29 (Section 1000(12) of the 2002 FSRI Act)(emphasis added).

[47] *See* also Brazil's 28 January 2004 Comments on Question 195, para. 6-9.

[48] US 11 February 2004 Comments, paras. 62-75.

[49] 16 February 2004 Communication from the Panel.

[50] The US 11 February 2004 Comments, para. 69 incorrectly assert that "this information" refers to contract acreage

[51] Exhibit Bra-101 (Questions for Purposes of the Consultations).

*amount of market loss assistance payments made to the US upland cotton industry in marketing years 1998 through 2001*."[52]

- **3 December 2002:** During the consultations, the United States responded orally to Question 3.6 by referring Brazil to the "Fact Sheet: Upland Cotton" (Exhibit Bra-4) and to www.fsa.usda.gov/dam/bud/bud1.htm. In response to Question 11.1, the United States similarly referred Brazil to www.fsa.usda.gov/dam/bud/bud1.htm. The data in these documents represented the total amount of payment data provided to holders of upland cotton base but did not provide any information about contract payments made to the US "upland cotton industry", which Brazil defined in its consultation and panel requests as "US producers, users and/or exporters of upland cotton". Brazil used the data included in Exhibit Bra-4 and the above-referenced web-site as the basis for its tabulation of the contract payment amount included in Table 1 of its 24 June 2003 First Submission.

- **1 April 2003:** Brazil filed a questionnaire with the United States in the Annex V procedures.[53] Question 11.1 states: "*Please state the total amount of Market Loss Assistance payments made to the US upland cotton industry in marketing years 1998 through 2002.*" Question 13.1 states: "*Please state the total amount of Counter-Cyclical Payments made by the United States to US upland cotton farmers in marketing year 2002.*" The United States provided no information in response to these questions.

- **24 June 2003:** Brazil's 24 June 2003 First Submission states, at paragraph 214, that "*[i]n the absence of the requested information from the United States on actual DP and CCP payments related to the production of upland cotton* or to farms holding upland cotton base, Brazil has used conservative methodologies to estimate the amount of 2002 DP and CCP payments received by upland cotton producers". In addition, Brazil stated that it "reiterates its requests to the United States to provide it and the Panel with actual upland cotton base acreage for the DP and CCP programmes and will revise its estimates and levels of support for MY 2002 based on updated data".[54]

- **22 July 2003:** Brazil states in its 22 July 2003 Oral Statement at the first meeting with the Panel that "Brazil notes that it has presented the best available information that it has access to and that is not exclusively within the control of the United States."[55] Brazil further stated that "the United States never provided any answers to Brazil's Annex V questions [and] [a]ccordingly, Brazil requests the Panel to rule on questions of fact based on the best information available as submitted by Brazil".[56]

- **11 August 2003**: Brazil provides an estimate of the total budgetary outlays of contract payment using its 14/16$^{th}$ methodology in its 11 August 2003 response to Question 60, as explained in paragraph 97 and notes 2-5 to the table accompanying paragraph 97. Brazil further states in response to Question 83 that "The list of Annex V questions provided to the United States by Brazil is included in Exhibit Bra-49. … [G]iven the United States' failure to cooperate in the Annex V information gathering process, Brazil has and will present its case regarding peace clause issues and serious prejudice claims based on evidence available to it. If there are gaps in the evidence provided to the Panel by Brazil in support of its *prima facie* case, and those gaps are due to the United States' failure to cooperate with and participate in

[52] Brazil defined "upland cotton industry" as "producers, users and/or exporters of upland cotton".
[53] Exhibit Bra-49 (Questions for Purposes of the Annex V Procedure).
[54] Brazil's 24 June 2003 First Submission, note 415.
[55] Brazil's 22 July 2003 Oral Statement, para. 4.
[56] Brazil's 22 July 2003 Oral Statement, para. 4.

the Annex V process, Annex V, paragraph 6 provides that 'the panel may complete the record as necessary relying on the best information otherwise available.'"[57]

- **25 August 2003**: The Panel requests the United States in Question *67bis* to provide "the annual amount granted by the US Government in each of the 1999, 2000, 2001, and 2002 marketing years (as applicable) to US upland cotton producers . . . in total expenditures, under each of the following programmes: production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments."[58]

- **27 August 2003**: The United States provides a response to Question 67*bis* which states, *inter alia*, that the United States "does not maintain and cannot calculate this information"[59] and that it "does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers".[60] The United States stated in paragraph 21 of its 27 August 2003 response that "Thus, the United States did not track total expenditures with respect to base acres of [1996 FAIR Act covered commodities] under the expired production flexibility contract payments and market loss assistance payments and does not track total expenditure with respect to base acres of [contract commodities] under the direct payments and counter-cyclical payments." Further, the United States stated in paragraph 28 of its 27 August 2003 response that "we are unable to provide to the Panel the total outlays under the cited programmes with respect to upland cotton base acreage."

- **7 October 2003**: The United States alleges that "Brazil has presented no evidence that the recipients of these decoupled payments on upland cotton base acres are, in fact, upland cotton producers".[61] And the United States alleges that Brazil's methodology is "merely a guess because Brazil has failed to demonstrate that the acres currently being used for upland cotton production are, in fact, upland cotton base acres. That is, Brazil has presented no evidence that the recipients of these decoupled payments on upland cotton base acres are, in fact, upland cotton producers".[62] The United States further alleges that Brazil has not substantiated the amount of contract payments to US upland cotton producers ("[I]t is for Brazil to establish who are the recipients of the subsidies and that the subsidies are properly attributed to upland cotton."[63] "Nor has [Brazil] demonstrated how much of the subsidy … should be allocated to other products produced by the recipient, such as corn or soybeans."[64]).

- **8 October 2003:** The Panel orally asks the United States whether it collects or maintains information concerning the amount of contract payments received by upland cotton producers. The United States answered orally that it neither collected nor retained this information.

- **9 October 2003:** Brazil stated in its closing statement that it had "requested this information [*i.e.*, information concerning the amount of contract payments to upland cotton producers] more than a year ago in the consultation phase of this dispute but never received any information".[65] The United States, following its closing statement, informed the Panel and Brazil that the 2002 FSRI Act contained a reporting requirement for the United States to

[57] Brazil's 11 August 2003 Answers to Questions, para. 190.
[58] 25 August 2003 Communication from the Panel.
[59] US 27 August 2003 Comments and Answers to Additional Question, para. 20.
[60] US 27 August 2003 Comments and Answers to Additional Question, para. 20.
[61] US 7 October 2003 Oral Statement, para. 14.
[62] US 7 October 2003 Oral Statement, para. 6.
[63] US 7 October 2003 Oral Statement, para. 10.
[64] US 7 October 2003 Oral Statement, para. 19.
[65] Brazil's 9 October 2003 Closing Statement, para. 2.

collect information on planted acreage, as a condition for recipients receiving direct payments and CCP payments.

- **13 October 2003:** The Panel asks the United States in Question 125(9) how to calculate upland cotton contract payments made to cotton producers and how to account for non-upland cotton contract payments made to producers of upland cotton.[66]

- **27 October 2003:** The United States responds to Question 125(9) by stating that it is for Brazil to prove the amount of contract payments (which the United States does not limit to upland cotton contract payments) that need to be allocated to upland cotton.[67] While referring to Annex IV, the United States declines to provide any data.[68]

- **18 November 2003:** Brazil requested the Panel to request the United States to produce information that would permit the calculation of a very precise amount of contract payment support to current producers of upland cotton.[69] Brazil further set forth evidence that USDA collects and maintains in a centralized database base acreage data and planted acreage data for all farms for MY 2002 and for almost all farms for the period MY 1999-2001.[70]

- **21 November 2003:** USDA's Kansas City FOIA office delivered to a private US citizen a completed analysis of farm-specific contract acreage data and planted acreage data for MY 1996-2002 regarding rice. The FOIA documentation indicates that the request was received on 30 October 2003, and that work was completed on 14 November 2003. The rice data showed that between 99.52 and 99.90 per cent of the farms producing rice in MY 1999-2002 completed planted acreage reports. The rice data provided by USDA permitted the calculation of the exact amount of rice contract acreage that was planted to rice during MY 1996-2002.[71]

- **2 December 2003:** Brazil requests the United States to provide farm-specific information as set out in Exhibit Bra-369.

- **3 December 2003:** Brazil presented the results of the rice FOIA request to the Panel and provided a copy of the rice data to the Panel and the United States.[72]

- **8 December 2003:** The Panel requests the United States to provide the farm-specific information set out in Exhibit Bra-369. In Question 195, the Panel asked whether "the United States wish to revise its response to the Panel's Question No. 67*bis*, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers?"[73]

- **18 December 2003:** The United States produced scrambled farm-specific information for MY 1999-2001, contrary to Brazil's and the Panel's requested set out in Exhibit Bra-369.

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[66] 13 October 2003 Communication from the Panel.
[67] US 27 October 2003 Answers to Questions, para. 23.
[68] US 27 October 2003 Answers to Questions, para. 24.
[69] Brazil's 18 November 2003 Further Rebuttal Submission, para. 48.
[70] Brazil's 18 November 2003 Further Rebuttal Submission, paras. 33-48.
[71] Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003) and Exhibit Bra-369 as amended on 3 December 2003 (Brazil's Request to the United States for Farm – Specific Planting and Base Acreage Data, 3 December 2003).
[72] *See* Exhibit Bra-368 (Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003) and Exhibit Bra-369 as amended on 3 December 2003 (Brazil's Request to the United States for Farm – Specific Planting and Base Acreage Data, 3 December 2003).
[73] 8 December 2003 Communication from the Panel.

- **19 December 2003:** The United States produced scrambled farm-specific information for MY 2002, contrary to Brazil's and the Panel's requested set out in Exhibit Bra-369.

- **22 December 2003:** The United States responds to Question 195 but does not "state the annual amount granted by the US government in each of the 1999, 2000, 2001 and 2002 marketing years to upland cotton producers … in total expenditures under the [four contract payment programmes]", as requested by the Panel on 25 August 2003 in Question 67*bis*. The United States reasoned that it "does not collect production data based on actual harvesting figures reported by farmers".[74] The United States response did not offer any information regarding the amount of contract payments received by upland cotton farmers who planted upland cotton. Brazil indicated in its Answer to Question 196 that the scrambled information provided by the United States prevented it from calculating the amount of payments received by US upland cotton producers planting upland cotton on contract base acreage.[75]

- **12 January 2004:** The Panel requested farm-specific information from the United States indicating that "it considers it both necessary and appropriate to seek this information in a suitable format in order to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements".[76] The Panel further stated that "disclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP, and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years". The Panel requested the United States to produce the information by 20 January 2004.

- **20 January 2004:** The United States filed a letter with the Panel stating it would not produce non-scrambled farm-specific data requested by the Panel on 12 January 2004.[77] The United States did not provide total expenditure information for the four contract payments originally requested in Question 67*bis* and did not otherwise provide information that would "permit an assessment of the total expenditures" that constitute "support to" upland cotton under the four contract payments, as requested by the Panel on 12 January 2004. Brazil files a detailed description of its methodology allocating upland cotton and non-upland cotton contract payments as support to upland cotton.[78]

- **28 January 2004:** Brazil filed a request that the Panel draw adverse inferences from the United States refusal during the period November 2002 through January 2004 to produce information relating to the amount of contract payments received by upland cotton producers who planted upland cotton.[79] The United States provided revised scrambled farm-specific data.[80]

- **3 February 2004:** The Panel requested aggregated farm-specific information from the United States in a format similar to the rice FOIA request set out Exhibit Bra-369, and further requested that the United States produce planted information on crops on cropland covered by the acreage reports. The Panel gave the United States until 11 February 2004 to provide the requested data.[81] This aggregate data would allow a precise calculation of the amount of support to upland cotton from the US contract payments, whereas the US summary data

[74] US 22 December 2003 Answers to Questions, para. 6.
[75] Brazil's 22 December 2003 Answer to Question 196.
[76] 12 January 2004 Communication from the Panel.
[77] US 20 January 2004 Letter to the Panel.
[78] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.
[79] Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 6.
[80] US 28 January 2004 Letter to the Panel.
[81] 3 February 2004 Communication from the Panel.

produced on 18/19 December 2003 and the revised US summary data produced on 28 January 2004 does not.[82] The Panel also asked the United States (Question 260) how it reconciled its 27 August 2003 response (that it did not maintain data on contract payments to upland cotton producers) with its 20 January 2004 Letter to the Panel stating that it had provided such information.[83]

- **11 February 2004:** The United States indicated it was not in a position to respond to the Panel's 3 February 2004 request and stated that it needed an additional four weeks to provide the aggregated data.[84]

- **13 February 2004:** Brazil requested the Panel to deny the United States any additional time to respond to the Panel's 3 February 2004 request, noting that this request represented the fifth time that the Panel had requested the United States to provide total expenditure information regarding the amount of contract payments made to upland cotton producers.[85]

- **16 February 2004:** The Panel extended the deadline for the United States to provide the data requested on 3 February 2004 and clarified its request.[86]

- **3 March 2004:** The deadline for the United States to produce the data requested by the Panel on 3 February 2004.[87]

27. Brazil hopes that the United States will finally live up to its obligation under the DSU and provide data that would permit the calculation of the support to upland cotton from the US contract payments. In one form or another, these figures have been at issue in all stages of this dispute – from the first round of consultations until the latest submissions to the Panel 16 months later. During all this time, it has been clear to the United States that what Brazil and the Panel sought was information that would enable a determination of the amount of contract payments that actually benefit upland cotton production. To be clear, that means support that benefits farms that plant upland cotton and support that can be allocated to this upland cotton planting/production.

28. In case the United States should fail to produce the information by 3 March 2004, Brazil maintains its 28 January 2004 request to the Panel to draw adverse inferences from this failure of cooperation. Drawing adverse inferences is clearly warranted given the history of his dispute settlement proceeding.

**261. Please confirm that each record in the actual planting database relates to a specific farm (Filenames: rPFCplac and rDCPplac in Exhibits US-111 and US-112). For example, in the data from rDCPplac:**

***First line*:**
**Field9;Field16;Field22;Field28;Field34;Field40;Field46;Field52;Field58;Field64;Field70;Field76;Field82;Field88;Field94;Field100**

***Second line*:**
**237.10;23059.80;5566.20;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00**

[82] Brazil's 13 February 2004 Letter to the Panel. *See* also Brazil's 18 February 2004 Comments on US 11 February 2004 Comments on Brazil's 28 January 2004 Comments and Requests Regarding U.S. Data.
[83] 3 February 2004 Communication from the Panel.
[84] Cover Letter to US 11 February 2004 Answers to Additional Questions.
[85] Brazil's 13 February 2004 Letter to the Panel.
[86] 16 February 2004 Communication from the Panel.
[87] 16 February 2004 Communication from the Panel.

**Does the second line represent data on plantings by the same farm?**

**262. The Panel has noted the two CD-ROMs delivered by the US in the evening of 23 December 2003. They are marked "US-111" and "US-112" respectively, but the contents actually do not correspond to the indication. The Panel also takes note of the US letter dated 28 January 2004 and the CD-ROM delivered together with it. For the record, please clarify the correct CD-ROMs and provide corresponding descriptions of their contents with exhibit numbers.**

**263. The Panel has noted that the United States' response to Question No. 214 refers to Exhibits US-117 and US-118. Are these the correct documents to which the United States intended to refer in that response? If not, please provide a copy of regulations regarding the marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993.**

**264. The Panel asks the United States to clarify certain aspects of Exhibit US-128:**

**(a) Is the Panel correct in understanding that -- as Brazil asserts in footnotes 290 and 291 of Brazil's 28 January 2004 comments on US responses to questions -- Exhibit US-128, all data are presented on a cohort-specific basis? If so, please also present the information originally requested by the Panel in another chart containing *programme* (as opposed to cohort-specific) activity by fiscal year.**

**Brazil's Comment:**

29. In paragraph 21 of its 11 February 2004 response, the United States suggests that Brazil's cash-basis accounting methodology for making an assessment under item (j), because it uses data included in the US budget, is "based on estimates and re-estimates" under the Federal Credit Reform Act ("FCRA"). This response is untruthful in the extreme.

30. None – absolutely none – of the data used for Brazil's cash-basis accounting methodology for making an assessment under item (j) is "based on estimates and re-estimates" generated for the purposes of the FCRA. As is evident from the chart included in paragraph 165 of Brazil's 11 August 2003 Answers (reproduced in paragraph 129 of its 28 January 2004 comments), Brazil's cash-basis accounting methodology relies on data from the "actual", prior year column of the US budget. Moreover, the data input into Brazil's cash-basis accounting methodology is drawn from the "financing account" for the CCC programmes.[88] The US budget makes the following statement about the financing account:

> As required by the Federal Credit Reform Act of 1990, this non-budgetary account records all cash flows to and from the Government resulting from loan guarantees committed in 1992 and beyond. The amounts in this account are a means of financing and are not included in the budget totals.[89]

31. Whether presented on a cohort-specific (Exhibit US-128) or a fiscal year (Exhibit US-147) basis, Brazil notes that none – absolutely none – of the data provided by the United States is

[88] The only exception is administrative expenses, which Brazil takes from the "programme account" included in the U.S. Budget. *See, e.g.*, Exhibit Bra-127 (2004 US Budget, p. 107 (line 00.09)). The US budget notes, however, that "administrative expenses are estimated on a cash basis", rather than a present value basis. *See, e.g.*, Exhibit Bra-127 (2004 US Budget, p. 108). *See also* Brazil's 22 July 2003 Oral Statement, para. 130 (and citations included at footnote 168). In any event, the United States and Brazil use virtually identical figures for the administrative costs of the CCC programs. *See* Exhibit Bra-431 (Columns 5(a) and 5(b)).

[89] *See, e.g.*, Exhibit Bra-127 (2004 U.S. Budget, p. 109 (emphasis added)).

verifiable. The United States has provided no documentation (or even citations to documentation that could be independently collected and reviewed by the Panel) to back up its data. The Panel asked the United States for this supporting documentation in July 2003, in Question 78 to the United States. The United States has never provided the supporting documentation requested by the Panel. In contrast, Brazil has provided US government documents to back up each and every figure input into its cash-basis accounting methodology for making an assessment under item (j).[90]

**(b) Does the US agree with the statement in paragraph 135 of Brazil's 28 January 2004 comments on US responses to questions that the difference between the $1,148 billion in the chart at para. 165 of Brazil's 11 August answers to questions and the $666 million amount in Exhibit US-128 ($1.75 billion) closely corresponds to the total "Claims rescheduled" figure reported by the US in Exhibit US-128 (column F)?**

**Brazil's Comment:**

32. The United States has failed to answer the Panel's question, stating that it will instead do so on a timeline of its own choosing.[91] The United States did not request additional time from the Panel, either in its 11 February 2004 response or in the cover letter to that response, but simply asserted in paragraph 23 of its response that it will take whatever additional time it needs.[92] In its letter to the Panel dated 13 February 2004, Brazil noted that the United States had more than adequate time (8 days) to undertake the review necessary to answer the Panel's question. After receiving the fiscal-year cash-basis accounting data included in Exhibit US-147, it took Brazil one hour to prepare a spreadsheet – included as Exhibit Bra-431 – that zeroes in on and identifies the reason that Brazil's cash-basis accounting methodology concludes that the operating costs and losses for the CCC export credit guarantee programmes have exceeded income over the period 1993-2002 by $1.083 billion, while the United States' cash-basis accounting methodology concludes that income for the CCC export credit guarantee programmes has exceeded operating costs and losses over the period 1993-2002 by $536 million.

33. In its 16 February 2004 ruling, the Panel did not respond to Brazil's request that it deny the United States' efforts to decide at what pace it wishes to offer responses to the Panel's questions. Brazil requests that if the United States, whenever it deems it convenient, eventually offers a response to Question 264(b), the Panel reject that response as not timely filed. If the Panel accepts the United States' response, Brazil reserves the right to comment.

34. In any event, the spreadsheet included as Exhibit Bra-431 confirms the assertion Brazil made in paragraph 135 of its 28 January 2004 Comments, which is that the difference between the results arrived at using the Brazilian versus the US cash-basis methodology (a difference of $1.6 billion) is largely due to the United States' treatment of rescheduled claims (listed by the United States as $1.58 billion). As confirmed by the United States in paragraph 24 of its 11 February 2004 response to Question 264(c), the United States' methodology treats defaulted guarantees that have been rescheduled as 100 per cent recovered at the moment the terms of the rescheduling are agreed.

35. Brazil, in contrast, treats rescheduled claims as receivables. Under Brazil's methodology, receivables resulting from rescheduling are treated just like any other receivable – receivables resulting from rescheduling are only treated as recovered incrementally, to the extent, in a given year, some increment of the rescheduled debt is actually collected (in column 2(a) of Exhibit Bra-431).

[90] *See* exhibits cited in Brazil's 11 August 2003 Answers, para. 165 and Brazil's 28 January 2004 Comments, para. 129.

[91] US 11 February 2004 Answers, para. 23.

[92] In a letter to the Panel dated 16 February 2004, the United States similarly declares that it "will provide any other data in response to Question 264(b) within the time indicated (and sooner if the data can be collected and examined in less time)."

This fundamental difference in approach is the reason that the "claims outstanding" recorded by the United States (in column 4(b) of Exhibit Bra-431) and Brazil (in column 4(a) of Exhibit Bra-431) differ by $1.6 billion – the only significant difference revealed in the comparison included in Exhibit Bra-431.

36. As Brazil has previously demonstrated, it is not actuarially appropriate to treat defaulted guarantees that have been rescheduled as 100 per cent recovered at the moment the terms of the rescheduling are agreed.[93] Brazil and the United States agree that a default that has been rescheduled is properly treated as a receivable[94], but as the CCC itself has acknowledged in its financial statements, not all receivables are considered collectible, let alone actually collected.[95]

37. The United States' methodology itself recognizes that defaulted guarantees that have been rescheduled are only collected over time (if at all). While the United States treats the principal amounts of rescheduled debt as an immediate, 100 per cent recovery that is passed through as a dollar-on-dollar reduction of the amount of claims outstanding in the year the terms of the rescheduling are agreed, it also tracks massive (and ever increasing) amounts of interest collected on reschedulings (column M in Exhibit US-147). Interest is collected on the rescheduled debt because significant amounts of principal remain outstanding on that rescheduled debt. It is not legitimate, therefore, for the United States to treat that rescheduled debt as recovered at the moment it is rescheduled, since it is not actually recovered at that moment.

38. In fact, no evidence suggests that CCC will collect the rescheduled principal that remains outstanding. In column F of Exhibit US-147, the United States states that $1.64 billion of defaulted CCC guarantees have been rescheduled over the period 1992-2003. Yet as of 30 November 2003, the United States reports in Exhibit US-153 that the principal outstanding on these reschedulings amounts to $1.58 billion. This means that over the period 1992-2003, the CCC has only collected $60 million, or 3.6 per cent, of the $1.64 billion in defaulted CCC guarantees that have been rescheduled. Over 96 per cent of defaulted CCC guarantees that have been rescheduled over the period 1992-2003 remain outstanding.

39. This demonstrates precisely why it is not legitimate for the United States to treat rescheduled debt as recovered at the moment it is rescheduled. The record does not suggest that the CCC will collect this rescheduled debt – in fact, the record shows that the CCC hardly collects any of the principal on its rescheduled debt. Rescheduled debt is nothing more than a receivable, and should be treated as recovered only incrementally, as portions of that debt are, in fact, recovered. This is how Brazil has treated rescheduled debt in its own cash-basis accounting methodology for making an assessment under item (j) (column 2(a) of Exhibit Bra-431).

40. Even if rescheduled debt could, as an actuarial matter, be considered 100 per cent recovered at the very moment the terms of the rescheduling are concluded but before the rescheduled debt is in actual fact collected, the United States appears to have triple-counted portions of the CCC reschedulings. The Panel will recall that under the United States' cash-basis accounting methodology for making an assessment under item (j), the entire amount of the approximately $1.6 billion in

[93] *See* Brazil's 28 January 2004 Comments, paras. 135-137; Brazil's 27 August 2003 Comments, para. 64; Brazil's 22 August 2003 Comments, para. 99; Brazil's 11 August 2003 Answers, para. 162; Brazil's 22 July 2003 Oral Statement, para. 122.

[94] *See* US 11 August 2003 Answers, para. 155.

[95] Exhibit Bra-158 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002*, Audit Report No. 06401-15-FM (December 2002), Notes to the Financial Statements, p. 14); Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002*, Audit Report No. 06401-16-FM (November 2003), Notes to the Financial Statements, p. 15).

rescheduled debt (in column 3(b) of Exhibit Bra-431) is subtracted from the amount of claims outstanding (in column 4(b) of Exhibit Bra-431) in the year the terms of the rescheduling are agreed. Over $636 million of the approximately $1.6 billion in reschedulings listed in Exhibit US-153 and column 3(b) of Exhibit Bra-431, however, appears to have been "[p]reviously [r]escheduled" (*see* the last two entries in Exhibit US-153, concerning CCC guarantees to Russia). It already is not legitimate for the United States to treat rescheduled debt as recovered at the moment it is rescheduled, since the record shows that the CCC has only collected 3.6 per cent of that rescheduled debt. But to allow the United States to reduce claims outstanding multiple times for successive reschedulings of the very same underlying defaults is unacceptable.

**(c) Does the US agree that from the formula in column G (that is: (Column (D) minus (E) minus (F)), it follows that a rescheduled claim no longer constitutes an outstanding claim at the moment the terms of the re-scheduling are agreed and that a rescheduling is treated as 100 per cent recovered, as Brazil states in footnote 292 of Brazil's 28 January 2004 comments on US responses to questions?**

**Brazil's Comment:**

41. Brazil notes the United States acknowledgment, in paragraph 24 of its response, that under the US cash-basis accounting methodology for making an assessment under item (j), a rescheduled claim no longer constitutes an outstanding claim as of the moment the terms of the rescheduling are agreed. Please see Brazil's comment on the United States' response to Question 264(b), which demonstrates that it is not legitimate for the United States to treat rescheduled debt as recovered at the moment it is rescheduled, since the record shows that the CCC has only collected 3.6 per cent of that rescheduled debt.

42. Additionally, Brazil notes the United States' statement, at paragraph 24 of its 11 February 2004 response, that "no principal payments received under reschedulings are reflected in Exhibit US-128". It is hardly surprising that the United States does not treat principal payments on rescheduled debt as recovered principal (under column 2(b) of Exhibit Bra-431), incrementally and year-on-year as they are actually recovered, since the United States already subtracts 100 per cent of rescheduled debt from claims outstanding (column 4(b) of Exhibit Bra-431) immediately, in the year the terms of the rescheduling are agreed.

**(d) Is the Panel correct in understanding that the amount of $888,984,792.04 in column F in Exhibit US-128 under "ALL" for 1992 represents the total continuing amount of unrecovered claims for the 1992 cohort, and that the amount of 387,692,219.39 represents the total continuing amount of unrecovered claims for the 1993 cohort, etc? Please indicate and substantiate how much principal and/or interest has actually been paid/recovered/rescheduled *annually* 1992-2003 in respect of each of the amounts shown in Columns D, E & F in the table.**

**Brazil's Comment:**

43. Please see Brazil's comment on the United States' response to Question 264(b), which demonstrates that it is not legitimate for the United States to treat rescheduled debt as recovered at the moment it is rescheduled, since the record shows that the CCC has only collected 3.6 per cent of that rescheduled debt.

44. As noted in Brazil's comment on the US response to Question 264(c), it is evident that the US methodology does not "reflect payment performance under the reschedulings themselves"[96] (under column 2(b) of Exhibit Bra-431), since the United States already subtracts 100 per cent of rescheduled

[96] US 11 February 2004 Answers, para. 25.

debt from claims outstanding (column 4(b) of Exhibit Bra-431) immediately, in the year the terms of the rescheduling are agreed.

**265. In connection with the US response to Question No. 225, please also provide amounts actually "written off" and "forgiven" annually for each *post*-1992 cohort, with annual details of country and amount (principal/interest).**

**Brazil's Comment:**

45. The United States notes, in paragraph 27 of its response, that "CCC financial records indicate that no amounts have been 'written off' or 'forgiven' with respect to any post-1992 cohort." Brazil makes two observations.

46. First, Brazil notes that the Federal Credit Reform Act took effect for the 1992 cohort. Thus, the Panel's question was likely meant to refer to "each post-1991 cohort". Brazil hopes that the United States understood the Panel's question to include the 1992 cohort.

47. Second, Brazil makes the obvious point that defaults need not be "written off" or "forgiven" to constitute an operating cost or loss for the purposes of item (j). Defaults (or other operating costs and losses) that remain on the books are just as relevant to an assessment under item (j) as they would be if they were "written off" or "forgiven".

**266. What are the precise terms, conditions and duration of each rescheduling reflected in column F in Exhibit US-128?**

**Brazil's Comment:**

48. While the Panel asked for the "precise terms, conditions and duration of each rescheduling", the United States has provided "summarized" data[97], without any documentary evidence as support.

**267. Is the Panel correct in understanding that "interest collected on reschedulings" in Column M in Exhibit US-128 refers not to amounts that have been actually collected by the CCC but rather to interest capitalized in conjunction with the rescheduling? If so, what are the terms, conditions and duration of the arrangements pertaining to these amounts?**

**Brazil's Comment:**

49. Please see Brazil's comment on the United States' response to Question 264(b), which demonstrates that it is not legitimate for the United States to treat rescheduled debt as recovered at the moment it is rescheduled, since the record shows that the CCC has only collected 3.6 per cent of that rescheduled debt.

50. As noted in Brazil's comment on the US responses to Questions 264(c) and 264(d), it is hardly surprising that the US methodology does not "reflect … payment of original principal"[98] (under column 2(b) of Exhibit Bra-431), since the United States already subtracts 100 per cent of rescheduled debt from claims outstanding (column 4(b) of Exhibit Bra-431) immediately, in the year the terms of the rescheduling are agreed.

**268. Concerning Column N in Exhibit US-128, please elaborate upon "Interest earned from US Treasury on uninvested funds". What is the source and authority for these funds and for**

[97] US 11 February 2004 Answers, para. 28.
[98] US 11 February 2004 Answers, para. 29.

**the interest thereon to be part of the CCC total revenues? What are the terms, conditions and duration of the arrangements pertaining to these amounts?**

**269. The Panel notes the table submitted by the US in its answer to Question No. 224 (CCC Financing Account Payments of Interest on Borrowings from Treasury and Interest Earned on Uninvested Funds). Is the Panel correct in understanding that the figures in this table correspond to the "ALL" figures in Columns I and N of Exhibit US-128?**

**270. With respect to Column I in Exhibit US-128, ("Interest paid on borrowing from US Treasury") and Note 8, p. 25 of Exhibit US-129:**

**(i) please provide the total annual amounts (interest bearing and non-interest bearing) borrowed by the CCC from the US Treasury (annually since 1992), as well as the terms, conditions, interest rate (where applicable) and duration of such borrowing. Please provide details of any other amount borrowed by the CCC from the US Treasury during this period that may not have formed part of the regular annual borrowings.**

**Brazil's Comment:**

51. The United States has not answered the Panel's question, which requested "the terms, conditions, interest rate (where applicable) and duration" of CCC borrowings from the US Treasury.

**(ii) Please explain the nature of "CCC's permanent indefinite borrowing authority from Treasury" referred to in Note 8, p. 25 of Exhibit US-129.**

**Brazil's Comment:**

52. The United States' response inaccurately implies that CCC's authority to extend export credit guarantees is somehow limited by the budget appropriations process. As Brazil has frequently noted, US law expressly provides that the CCC export credit guarantee programmes are exempt from the requirement that they receive new Congressional budget authority before undertaking new guarantee commitments.[99] Moreover, any "subsidy" losses the programmes incur are funded "through a permanent, indefinite appropriation and not by annual appropriation".[100]

**(iii) What determines the level of CCC export credit guarantee borrowing (interest-bearing and non-interest-bearing)? Is the interest-free borrowing up to the amount of unreimbursed realized losses?**

**(iv) Why are repayments applied to non-interest bearing notes first, as indicated at Note 8, p. 25 of Exhibit US-129?**

**271. Note 8, p. 25 of Exhibit US-129 states that "In fiscal year 2003, CCC was fully reimbursed for its prior year net realized losses." Please indicate the amounts of prior year net realized losses (annually, since 1992) for which the CCC has been fully reimbursed.**

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[99] *See* Exhibit Bra-117 (2 U.S.C. § 661(c)(2)); Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform," April 1991, p. 7 and Table 2); Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget," IB95031 (16 February 1996), p. 3).

[100] US House of Representatives, Report 105-178, Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Bill, 1998, p. 90, available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=105_cong_reports&docid=f:hr178.105.pdf.

**Brazil's Comment:**

53. The United States' response inaccurately implies that CCC's authority to extend export credit guarantees is somehow limited by the budget appropriations process. As Brazil has frequently noted, US law expressly provides that the CCC export credit guarantee programmes are exempt from the requirement that they receive new Congressional budget authority before undertaking new guarantee commitments.[101] Moreover, any "subsidy" losses the programmes incur are funded "through a permanent, indefinite appropriation and not by annual appropriation".[102]

**272. With respect to the US response to Question No. 226, is the Panel correct in understanding that the reflection of write-offs as part of the operating loss of the CCC which in turn was replenished through the annual appropriations process ended with the entry into force of the FCRA in fiscal year 1992? If not, what amounts have been replenished through this process annually since fiscal year 1992?**

**Brazil's Comment:**

54. Brazil notes that under US law, any "subsidy" losses the CCC export credit guarantee programmes incur are funded "through a permanent, indefinite appropriation and not by annual appropriation".[103]

**273. With respect to the US response to Question No. 225, what criteria does the CCC apply to "independently determine" that a debt is uncollectible? For post-1992 cohorts, what are these uncollectible amounts (annually) and how, if at all, are such "uncollectible amounts" shown in Exhibit US-128?**

**Brazil's Comment:**

55. The United States notes, in paragraph 44 of its response, that "[w]ith respect to post-1992 cohorts, no amounts have been determined uncollectible . . ." Brazil makes two observations.

56. First, Brazil notes that the Federal Credit Reform Act took effect for the 1992 cohort. Thus, the Panel's question was likely meant to refer to "each post-1991 cohort". Brazil hopes that the United States understood the Panel's question to include the 1992 cohort.

57. Second, Brazil notes that CCC's financial statements record a $1.16 billion "subsidy allowance" for all post-1991 cohorts.[104] Under the FCRA, the subsidy allowance is recorded on a net present value basis, which means that it represents the cost CCC considers it will incur on post-1991 guarantee cohorts at the time those cohorts are closed. In other words, at the time all outstanding

[101] *See* Exhibit Bra-117 (2 U.S.C. § 661(c)(2)); Exhibit Bra-185 (Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform," April 1991, p. 7 and Table 2); Exhibit Bra-186 (Congressional Research Service Issue Brief for Congress, "Agriculture and the Budget," IB95031 (16 February 1996), p. 3).

[102] US House of Representatives, Report 105-178, Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Bill, 1998, p. 90, available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=105_cong_reports&docid=f:hr178.105.pdf.

[103] US House of Representatives, Report 105-178, Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Bill, 1998, p. 90, available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=105_cong_reports&docid=f:hr178.105.pdf.

[104] Exhibit US-129 (US Department of Agriculture, Office of Inspector General, Financial and IT Operations, Audit Report, *Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002*, Audit Report No. 06401-16-FM (November 2003), Notes to the Financial Statements, p. 15).

post-1991 cohorts close, the CCC considers that it will face $1.16 billion in uncollectible guarantees.[105]

**274. The Panel notes the US statement in the US response to Question No. 81 that "All rescheduled claims are currently performing " and that "all payments due up to this point under [rescheduling] agreements have been received". However, the Panel also notes Exhibit US-129 (in particular, Note 5 on p. 22) and Brazil's reference thereto in Brazil's 28 January comments on the US response to Question No. 222. In this connection:**

**(a) How does the US respond to Brazil's statement in Brazil's 28 January comments that Exhibit US-129 confirms that rescheduling of export credit guarantee receivables cover both principal and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled?**

**Brazil's Comment:**

58. The United States has offered no documentary support for its assertion that the "substantial majority" of the reschedulings referred to in Note 5, p. 22 of Exhibit US-129 "pertain to activities related to the P.L. 480 foreign food assistance programme".[106]

59. Moreover, the United States has never offered any support for its repeated assertion that "[a]ll rescheduled export credit guarantee debt is currently performing."[107] In fact, in its comment on the US response to Question 264(b), Brazil demonstrated that CCC is not collecting over 96 per cent of the rescheduled principal that remains outstanding.[108] In column F of Exhibit US-147, the United States states that $1.64 billion of defaulted CCC guarantees have been rescheduled over the period 1992-2003. Yet as of 30 November 2003, the United States reports in Exhibit US-153 that the principal outstanding on these reschedulings amounts to $1.58 billion. This means that over the period 1992-2003, the CCC has only collected $60 million, or 3.6 per cent, of the $1.64 billion in

[105] The Congressional Budget Office agrees, projecting positive subsidy estimates for every cohort during the period 2002-2013. Exhibit Bra-432 (Congressional Budget Office, Fact Sheet, row titled "Export Credit Guarantee Program, Subsidy Account," available at http://www.cbo.gov/factsheets/CCC&FCIC.pdf).

[106] US 11 February 2004 Answers, para. 46. As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[107] US 11 February 2004 Answers, para. 48. *See also* U.S. 11 August 2003 Answers, para. 155. As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[108] Moreover, the United States has never responded to reports by the U.S. General Accounting Office and testimony by GAO officials, submitted by Brazil, demonstrating that CCC rescheduling has historically been in arrears. *See* Brazil's 28 January 2004 Comments, para. 136; Brazil's 22 August 2003 Comments, para. 99. *See also* Exhibit Bra-181 (US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60 (February 1995), p. 50-52 and Table 2.6 (noting that in 1995 defaults on Russian and Former Soviet Union guarantees reached $2 billion by the end of 1993, and that despite repeated rescheduling agreements, those debts were not being repaid.); Exhibit Bra-152 (GAO, Statement of Allan I. Mendelowitz, Director, Trade, Energy and Finance Issues, National Security and International Affairs Division, before the Task Force on Urgent Fiscal Issues of the Committee on Budget of the US House of Representatives, *Status Report on GAO's Reviews of the Targeted Export Assistance Programme, the Export Enhancement Program, and the GSM-102/103 Export Credit Guarantee Programs*, GAO/T-NSIAD-90-53, 28 June 1990, p. 14 (noting that historically, the majority of GSM support that is rescheduled is "in arrears.").

defaulted CCC guarantees that have been rescheduled. Over 96 per cent of defaulted CCC guarantees that have been rescheduled over the period 1992-2003 remains outstanding.

**(b) In Note 5 on p. 22 of Exhibit US-129, what is the definition of "non-performing"? What is the meaning of "delinquent"? What is the current principal balance and amount of interest of the three CCC export credit guarantee programme "receivables" in a non-performing status (individually and together, for GSM 102, GSM 103 and SCGP))? What is the amount of interest on non-reporting "receivables"?**

**(c) The Panel notes the US reference to the "Paris Club" in US response to Question No. 225. What is the P.L. 480 programme referred to in Note 5 on p. 22 of Exhibit US-129 (including the Paris Club debt reduction process and the HIPC Initiative) ? To what extent is the P.L. 480 programme and Paris Club process relevant to the export credit guarantee programmes at issue in this dispute? Please identify and give the amounts of all CCC export credit guarantee debt subject to the P.L. 480 debt reduction (or other similar) process since 1992.**

**(d) Can the US explain the process referred to in the second column of Note 5 on p. 22 ("CCC is awaiting an apportionment from the Office of Management and Budget before the transaction can be completed. Until such time, however, there is a 100% subsidy allowance established against the relevant debt as of September 30, 2003.") Please provide details of all such "apportionments" relating to the three export credit guarantee programmes in fiscal years 1992-2003.**

**Brazil's Comment:**

60. Although the United States asserts that the reference in the Panel's question is to a single transaction related to the P.L. 480 food aid programme[109], and further asserts that the "apportionment" procedure cited in the Panel's question does not apply to the CCC export credit guarantee programmes[110], the United States offers no support for these assertions.[111]

61. In any event, Brazil makes the obvious point that defaults need not be "written off" to constitute an operating cost or loss for the purposes of item (j). Defaults (or other operating costs and losses) that remain on the books are just as relevant to an assessment under item (j) as they would be if they were "written off".

**275. Please provide evidence (or cite relevant portions of the record) that the premium rates for the export credit guarantee programmes are "reviewed annually" as stated in US 28 January comments on response to Question No. 223 (see also US 22 December response to Question No. 107; Brazil's 28 January 2004 comments on responses to Question No. 223.).**

**Brazil's Comment:**

62. Even if the CCC does undertake the annual premium rate review asserted by the United States, the US Department of Agriculture's Inspector General noted in 2000 and 2001 that "the fees CCC charges for its GSM-102 and GSM-103 export credit guarantee programmes have not been

[109] US 11 February 2004 Answers, para. 53.
[110] US 11 February 2004 Answers, para. 54.
[111] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

changed in 7 years and may not be reflecting current costs".[112] Brazil has demonstrated that since 1993, only two changes have in fact been made to the GSM 102 fee schedule.[113]

63. Brazil makes several observations regarding Exhibit US-150, which purports to include memoranda concerning the 2003 and 2002 annual reviews of fees for the CCC export credit guarantee programmes.

64. First, page 2 of the 2003 memorandum shows that "offsetting fees" for GSM 102, GSM 103 and SCGP, both "historical[ly]" and for FY 2004, do not cover the "subsidy", within the meaning of the FCRA. As the Panel will recall, under the net present value accounting methodology endorsed by the US Congress and the President in the FCRA, a positive subsidy indicates a judgment that when the cohorts close, the CCC programmes will "lose money."[114] At page 3 of the memorandum, a major heading reinforces the point that the programmes are losing money, reading as follows: "JUSTIFICATION FOR NOT COVERING THE SUBSIDY COST OF THE PROGRAMME."

65. Second, Exhibit US-150 reinforces Brazil's claim that the CCC programmes confer "benefits" *per se*, within the meaning of Article 1.1(b) of the SCM Agreement, and therefore that they constitute *per se* export subsidies for the purposes of Article 10.1.[115] With other evidence (*e.g.*, the regulations for the CCC programmes, and a comparison to non-market benchmarks established by the US Export-Import Bank)[116], Brazil has made this *per se* showing by demonstrating that CCC export credit guarantees are unique financing instruments for agricultural commodity transactions that are not available on the commercial market for terms longer than the marketing cycles of the eligible commodities.[117] Pages 3-4 of the 2003 memorandum included in Exhibit US-150 reinforce Brazil's claim, by stating that fees for the CCC programmes are set not according to market benchmarks, but are instead set according to policy considerations. According to page 3 of the memorandum, "[s]etting prices is a policy matter, sometimes governed by statutory provisions and regulations, and other times by managerial or public policies". While it is fundamental that pricing for market-based financial instruments takes account of the risks involved in a transaction, the memorandum notes, at page 4, that "current fees for GSM-102, GSM-103, and SCGP are not risk-based", and that "[i]f the fees were changed to a risk-based system, this would most likely exceed [the statutory fee cap of] 1 per cent . . ."[118]

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[112] Exhibit Bra-153 (US Department of Agriculture Office of Inspector General Financial and IT Operations Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2000, Audit Report No. 06401-14-FM (June 2001), p. 31). *See also* Exhibit Bra-154 (US Department of Agriculture Office of Inspector General Great Plains Region Audit Report of the Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC (February 2002), p. 49 ("[T]he fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programs have not been changed for many years and may not be reflecting current costs.").

[113] *See* Brazil's 11 August 2003 Answers, para. 167 (second bullet point).

[114] Exhibit Bra-121 (US General Accounting Office ("GAO"), Report to Congressional Committees, "Credit Reform: US Needs Better Method for Estimating Cost of Foreign Loans and Guarantees," GAO/NSIAD/GGD-95-31, December 1994, p. 20) ("GAO/NSIAD/GGD-95-31")).

[115] *See*, *e.g.*, Brazil's 28 January 2004 Comments, para. 253; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 233-241.

[116] This evidence is summarized at paragraphs 231-241 of Brazil's 18 November 2003 Further Rebuttal Submission.

[117] *See* Brazil's 24 June 2003 First Submission, paras. 289-292; Brazil's 22 July 2003 Oral Statement, para. 116; Brazil's 11 August 2003 Answers to Questions, paras. 139-140, 152-157, 183-187; Brazil's 22 August 2003 Rebuttal Submission, paras. 103-105; Brazil's 22 August 2003 Comments, paras. 92-93, 109-113; Brazil's 27 August 2003 Comments on US Rebuttal Submission, paras. 68-80; Brazil's 7 October 2003 Oral Statement, para. 72; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 230-242; Brazil's 2 December 2003 Oral Statement, para. 79.

[118] Regarding the statutory one-per cent fee cap, *see* US 11 August 2003 Answers, para. 180. *See also* Exhibit US-150 (Annual Review of Fees for USDA Credit Programmes, March 25, 2003, p. 4 ("Section

**276. The Panel notes the parties' responses and comments relating to Question No. 252 concerning the time period within which any prohibited measure must be withdrawn within the meaning of Article 4.7 of the *SCM Agreement*. Please supplement your original response, taking into account the particular nature of each alleged prohibited subsidy measure (i.e. "Step 2" payments under Section 1207(a) of the 2002 FSRI Act, export credit guarantee programmes and the ETI Act) and the functioning of the US legal and regulatory system in respect of these measures.**

211(b)(2) of the Agricultural Trade Act of 1978, as amended, caps the current fees at 1 per cent for . . . GSM-102 and SCGP.")).

# ANNEX I-21

## COMMENTS OF THE UNITED STATES TO THE 11 FEBRUARY 2004 ANSWERS OF BRAZIL TO PANEL QUESTION 276

18 February 2004

**Question 276. "The Panel notes the parties' responses and comments relating to Question No. 252 concerning the time period within which any prohibited measure must be withdrawn within the meaning of Article 4.7 of the SCM Agreement. Please supplement your original response, taking into account the particular nature of each alleged prohibited subsidy measure (i.e. "Step 2" payments under Section 1207(a) of the 2002 FSRI Act, export credit guarantee programmes and the ETI Act) and the functioning of the US legal and regulatory system in respect of these measures."**

1. The United States appreciates this opportunity to comment on the response of Brazil to Panel question 276, posed on 3 February 2004. As an initial matter, the United States notes that the question poses a hypothetical situation: that any of the measures at issue in this dispute might be found to be a prohibited subsidy. The United States of course has explained that Brazil has not shown that any of the measures at issue is a prohibited subsidy. That being said, the United States offers the following comments on Brazil's response.

2. Of note, in its response Brazil has recognized that its previous answer to Question 252 from the Panel was inadequate. In full, that answer provided: "Brazil suggests that the Panel follow the precedent of all previous WTO panels that made findings of prohibited subsidies and specify that the measure must be withdrawn within 90 days."[1] Brazil has now revised – from 90 days to six months – its recommendation to the Panel of the time period that would constitute withdrawing "without delay" subsidies allegedly provided by the export credit guarantee programmes. However, Brazil's response sets out a faulty analysis of the meaning of "without delay" in Article 4.7 as applied in previous reports and therefore identifies what would be inappropriately short time periods for withdrawal of the measures at issue if they were prohibited subsidies, which they are not.

3. Article 4.7 of the *Agreement on Subsidies and Countervailing Measures* ("Subsidies Agreement") establishes that "[i]f the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn". The Agreement does not further define "without delay", although Brazil concedes that the "text [of Article 4.7] does not state 'immediately'".[2]

4. Past panels have dealt with the meaning of the term "without delay," and have concluded that this involves an examination of the nature of the changes to be effected and the domestic legal process involved. For example, in *Canada – Certain Measures Affecting the Automotive Industry*, the panel found that "in examining what time-period would represent withdrawal 'without delay' in a particular case, we consider that we may take into account the nature of the steps necessary to withdraw the prohibited subsidy".[3] Similarly, in *Australia – Subsidies Provided to Producers and Exporters of*

[1] Brazil's Answer to Question 252 from the Panel, para. 167 (22 December 2003) (footnotes omitted).
[2] Brazil's Answer to Question 276 from the Panel, para. 2.
[3] WT/DS139/R, WT/DS142/R, paras. 11.6-11.7 (adopted as modified 19 June 2000) (italics added).

*Automotive Leather*[4], the panel found that "the nature of the measures and issues regarding implementation might be relevant" to the time period for withdrawal of the subsidies".[5]

5. The analysis by these panels is similar to that undertaken by arbitrators under Article 21.3 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") in considering the period of time for a Member to implement DSB recommendations and rulings. There, arbitrators have also considered that Article 21.3 calls for an analysis of the nature of the changes to be effected and "the shortest period possible within the legal system of the Member to implement the recommendations and rulings of the DSB".[6] Thus, in practical terms, the "reasonable period of time" standard of DSU Article 21.3 has been interpreted to mean something akin to without "delay" ("procrastination; lingering; putting off"[7]).

6. DSU Article 21.3 is part of the context of Article 4.7. Brazil attempts to distinguish Article 4.7 of the Subsidies Agreement from Article 21.3 of the DSU.[8] However, Brazil argues that a key difference is that Article 21.3 uses the term "reasonable". Brazil thus appears to argue that under Article 4.7 any time period specified should not be reasonable. The United States agrees that there are differences between Article 4.7 of the Subsidies Agreement and Article 21.3 of the DSU. But those differences do not amount to a requirement that panels require unreasonable actions. Rather, one key difference is that DSU Article 21.3(c) provides arbitrators with a "guideline" that the "reasonable period of time" to implement panel or Appellate Body recommendations "should not exceed 15 months from the date of adoption of a panel or Appellate Body report" whereas Article 4.7 does not.[9]

7. In the current dispute, the measures at issue all involve legislation and any change would require legislative action. Brazil has proposed that withdrawal "without delay" should be considered to mean withdrawal within 90 days for allegedly prohibited subsidies under the Step 2 programme and the ETI Act and withdrawal within 6 months for alleged export subsidies under the export credit guarantee programmes. However, Brazil's proposed time periods are not supported by considerations relating to the nature of the measures at issue nor the US legislative process that would be necessary to effect changes to those measures.

8. Specifically, Brazil concedes that statutory changes would be necessary to withdraw the allegedly prohibited subsidies at issue in this dispute.[10] However, the panel reports Brazil cites as

[4] WT/DS126/R, paras. 10.4-10.7 (adopted 16 June 1999).

[5] *See also* the panel reports in the *Aircraft* disputes between Canada and Brazil, in which the panels took into account the nature of the measures and the procedures which may be required to implement the panels' recommendations.

[6] Report of the Arbitrator, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/14, WT/DS234/22, para. 42 (13 June 2003) (quotation marks and footnote omitted) (citing 3 previous reports of arbitrators).

[7] *The New Shorter Oxford English Dictionary*, vol. 1, at 623 (1993 ed.).

[8] Brazil's response to Question 276, para. 2.

[9] In the earliest arbitrations under Article 21.3(c), arbitrators viewed the guideline as meaning that each party bore the burden of proof that the reasonable period of time should depart from the 15 months period, which would be a significant difference from Article 4.7. That approach has now evolved into the practice described above of the shortest possible period of time within the legal system of the Member to implement the recommendations and rulings of the DSB.

[10] Brazil's Answer to Question 276 from the Panel, para. 10 (11 February 2004) (eliminating Step 2 "simply requires the repeal of Section 1207(a) of the 2002 FSRI Act); *id.*, para. 11 (for export credit guarantee programmes, "the prohibited subsidies must be withdrawn by enacting the necessary changes to the statutes and regulations providing for GSM102, GSM 103, and SCGP"); *id.*, para. 12 (90 days "represents an appropriate period of time . . . to withdraw the ETI Act").

support for the proposition that "without delay" generally means 90 days dealt with subsidies that required *only executive or administrative action* to withdraw:[11]

> In Canada – Certain Measures Affecting the Automotive Industry, the panel found: "we note that the [challenged measures] are both Orders-in-Council, and as such are acts of the executive, and not the legislative branch of government. The amendment of an act of the executive branch can normally be effectuated more quickly than would be the case if legislative action were required."[12] The report further notes that "in those disputes involving a prohibited subsidy in which legislative action was not required, panels have specified a time-period of 90 days".[13]
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> In Australia – Subsidies Provided to Producers and Exporters of Automotive Leather,[14] taking into account that the dispute involved payments made under a grant contract between the Australian Government and a private company, the panel recommended that the measures be withdrawn within 90 days.
>
> In Canada – Export Credits and Loan Guarantees for Regional Aircraft,[15] involving executive action concerning financing provided by Canada for particular transactions, the panel found that "Canada should withdraw the export subsidies within 90 days ("without delay").
>
> In Brazil – Export Financing Programme for Aircraft, with respect to payments under the interest rate equalization component of PROEX,[16] the panel report found that, "taking into account the nature of the measures and the procedures which may be required to implement our recommendation," Brazil should withdraw the measures within 90 days.[17]
>
> In Canada – Measures Affecting the Export of Civilian Aircraft,[18] with respect to certain executive action concerning financing and funds provided to the Canadian civil aircraft industry, the panel report found that, "[t]aking into account the procedures that may be required to implement our recommendation", Canada should withdraw the measures within 90 days.

Thus, in every panel report in which the "without delay" time period has been set as 90 days, only executive action (and not statutory amendment) has been necessary. Thus, these reports offer little guidance to the Panel, other than to indicate that 90 days would *not* be an adequate time period, given that Brazil recognizes that legislation would be required to modify the measures in dispute.

9. Brazil notes, almost in passing, that "[t]here is only one precedent applying the Article 4.7 'without delay' provision to prohibited subsidy measures requiring legislative changes"[19]: the panel

[11] Brazil's Answer to Question 276 from the Panel, para. 10 n.15.
[12] WT/DS139/R, WT/DS142/R, paras. 11.6-11.7 (adopted as modified 19 June 2000) (italics added).
[13] *Id.*, para. 11.7 n. 910 (citing panel reports in *Australia – Leather*, *Brazil – Aircraft*, and *Canada – Aircraft*).
[14] WT/DS126/R, paras. 10.4-10.7 (adopted 16 June 1999).
[15] WT/DS222/R, paras. 8.1-8.4 (adopted 19 February 2002).
[16] PROEX was being maintained by provisional measures issued by the Brazilian Government on an monthly basis, and the financing terms for which interest rate equalization payments were made were set by Ministerial Decrees. WT/DS46/R, paras. 2.1, 2.3 (adopted 20 August 1999).
[17] *Id.*, paras. 8.2-8.5.
[18] WT/DS70/R, paras. 10.3-10.4 (adopted as modified 20 August 1999).
[19] Brazil's Answer to Question 276 from the Panel, para. 5 (11 February 2004).

report in *United States – FSC*.[20] However, Brazil fails to quote or discuss that panel report's discussion of the "without delay" language, which would seem to be particularly relevant given that Brazil has challenged the ETI Act – the successor to the FSC programme – in this dispute. Brazil erroneously cites this report as supporting the proposition that "without delay" generally means withdrawal within 90 days[21], but there is no discussion of a 90-day period in the report.

10. Upon finding that the FSC scheme provided export subsidies inconsistent with Article 3.1(a) of the Subsidies Agreement, the *FSC* panel first recommended, "pursuant to Article 4.7 of that Agreement, that the DSB request the United States to withdraw the FSC subsidies without delay".[22] The panel examined what should be its recommendation with respect to the time-period within which the measure must be withdrawn. The panel noted that the time period specified "must be consistent with the requirement that the subsidy be withdrawn 'without delay'". The panel then went on to find, and recommend:

> Given that the implementation of the Panel's recommendation will require legislative action (a fact recognized by the European Communities), that the United States fiscal year 2000 starts on 1 October 1999, and that this report is not scheduled for circulation to Members until September 1999 (and, if appealed, might not be adopted until as late as early spring 2000), it is not in our view a practical possibility that the United States could be in a position to take the necessary legislative action by 1 October 1999. That being so, and acting in good faith, there is no way that this could be described as a 'delay.' However, this objective timing constraint would not be present with effect from the following fiscal year (2001), which commences on 1 October 2000. As this would be the first practicable date by which the United States could implement our recommendation, it satisfies the 'without delay' standard found in Article 4.7. Accordingly, we specify that FSC subsidies must be withdrawn at the latest with effect from 1 October 2000.[23]

Brazil recognizes that statutory changes would be necessary to modify the measures at issue in this dispute. However, Brazil fails to discuss the various considerations identified by the *FSC* panel report, such as the potential date of circulation of the Panel's report and the effect of appeal on the timing of adoption. Neither does Brazil discuss whether there would be a "practical possibility" of legislative action within its suggested time periods.

11. With respect to the potential date of circulation, the Panel's current schedule provides for the final report to be issued to the parties on 19 May. Circulation to all Members would be upon translation into the official WTO languages. Conservatively assuming one month for completion of translation of what may be a very lengthy panel report, the report would be circulated in mid-June. Panel reports may not be considered for adoption until 20 days after they have been circulated to all Members[24] – approximately early July. If the Panel report is appealed, the Appellate Body report will likely be issued 90 days from the notice of appeal[25] – approximately early October. The Appellate Body report would be adopted (unless the DSB decides by consensus not to adopt it) within 30 days of circulation[26] – approximately early November.

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[20] Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/R (adopted 20 March 2000) ("*United States – FSC*").

[21] Brazil's Answer to Question 276 from the Panel, para. 10 n.15 (11 February 2004).

[22] *United States – FSC*, WT/DS108/R, para. 8.3.

[23] *United States – FSC*, WT/DS108/R, para. 8.8.

[24] DSU Article 16.1.

[25] See *Statistical Information on Recourse to WTO Dispute Settlement Procedures: Background Note by the Secretariat*, Job(03)/225, circulated 11 December 2003, Section IV.B and Table 8.

[26] DSU Article 17.14.

12. The current US Congress is scheduled to adjourn on 1 October 2004. Accordingly, no legislative action would be possible until after the new Congress convenes in 2005 and organizes itself. The United States has previously stated that, in the event of a prohibited subsidy finding, it should be given until the end of "this year" to complete the legislative process. However, given the probable time line for this dispute noted above, that is not a possibility.

13. Once the new Congress convenes and organizes (a process that we would not expect to be completed before mid-February), any legislation would then need to proceed through the legislative process. In the United States, this involves the following.[27]

**The US Legislative Process**

14. Under the United States system of constitutional government, any changes to a federal statute must be enacted by the US Congress, which sets its own procedures and timetable. The Executive branch of the US Government has no control over these procedures and timetable. Securing the enactment of legislation in the US Congress is a complex and lengthy process. Moreover, only a small fraction of the thousands of bills introduced in each Congress ever become law. This indicates that the process of obtaining the votes necessary to enact legislation is difficult and time-consuming. Viewed in this light, there is no "practical possibility" that this process will take, as Brazil suggests, 3 months for the Step 2 programme and ETI Act and 6 months (including time for administrative action) for the export credit guarantee programmes.

15. The power to legislate is vested in the United States Congress, which has two chambers, the House of Representatives and the Senate. Both chambers must approve all legislation in identical form, before it is sent to the President of the United States for signature or other action. Only after presidential approval does proposed legislation become law. Proposed legislation that will become public law usually takes the form of a "bill". From the time that a bill is introduced in Congress to the time that it is approved by both chambers, it will have passed through at least ten steps. These ten steps include: (1) the bill is introduced in the House of Representatives or the Senate by a member of Congress; (2) the bill is referred to a standing committee or committees having jurisdiction over the subject matter of the bills, which may also refer the proposed legislation to various subcommittees; (3) the merits of the bill are considered by a subcommittee, which may include public hearings; (4) when hearings are completed, the subcommittee meets to "mark-up" the bill (make changes and amendments) prior to deciding whether to recommend (or "report") the bill to the full committee; (5) the full committee (considering the subcommittee's report) may conduct further study and hearings and then votes whether to report the bill, either as originally introduced without amendment, or as revised, to the full House; (6) the House considers the bill on its merits and, after voting on amendments, the House immediately votes on the bill itself with any adopted amendments; (7) if the bill is passed, the bill must be referred to the Senate, which, following its own legislative process and consideration, may approve the bill as received, reject it, ignore it, or change it; (8) if the Senate amends the bill or passes its own similar but not identical legislation, a conference committee is organized to reconcile differences between the House and Senate versions; (9) if the committee reaches agreement on a single bill, a "conference report" must be approved by both chambers, in identical form, or the revised legislation dies; and (10) after the bill proposed by the conference committee is approved by both chambers, it is sent to the President for approval. Most bills that are introduced do not survive this process to become law, and those that do are likely to have been significantly amended along the way.

[27] A more detailed description of the US legislative process may be found in paragraphs 21-35 of the Submission of the United States in the Arbitration under Article 21.3(c) of the DSU in the dispute *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217 & 234 (13 April 2003) (available at http://www.ustr.gov/enforcement/briefs.shtml).

16. In addition, Brazil has recognized that a finding that the programmes are prohibited export subsidies would necessarily require "changes to the statutes and regulations" providing for the programmes.[28] The regulatory changes could not be made until after the legislative changes are finalized. Thus, the time period that would constitute withdrawal "without delay" would have to allow for both legislative and regulatory changes.

17. No panel report considering Article 4.7 has ever awarded a period of less than three months. Moreover, panels have found that "[t]he amendment of an act of the executive branch can normally be effectuated more quickly than would be the case if legislative action were required".[29]

18. Indeed, in a recent arbitration under DSU Article 21.3(c) in a dispute where compliance by the United States involved both legislative and regulatory action, the arbitrator concluded that 15 months was the reasonable period of time for implementation.[30]

19. In light of the foregoing considerations, under the hypothetical situation that any of the measures at issue would be a prohibited subsidy, the United States suggests that a panel recommendation that the measure be withdrawn 15 months after adoption of the DSB recommendations and rulings would be "without delay" in the circumstances of this dispute.

[28] Brazil's Answer to Question 276 from the Panel, para. 11.

[29] *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R, paras. 11.6-11.7.

[30] Award of the Arbitrator, *United States – Anti-Dumping Measures on Certain Hot-rolled Steel Products from Japan: Arbitration under Article 21.3(c) of the DSU*, WT/DS184/13, circulated 19 February 2002.

# ANNEX I-22

## BRAZIL'S COMMENTS ON UNITED STATES 11 FEBRUARY COMMENTS ON BRAZIL'S 28 JANUARY "COMMENTS AND REQUESTS REGARDING DATA PROVIDED BY THE UNITED STATES ON 18/19 DECEMBER 2003 AND THE US REFUSAL TO PROVIDE NON-SCRAMBLED DATA ON 20 JANUARY 2004"

18 February 2004

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## 1. Introduction

1. Brazil sets forth its response to the US 11 February 2004 Comments on Brazil's 28 January Comments and Requests regarding the US Data ("US 11 February 2004 Comments"). Brazil demonstrates in Sections 2 and 3 that the US critique of any methodology for tabulating "support to a specific commodity" is based on (1) a faulty legal interpretation that only subsidies tied to the production of a specific commodity can be counted for the purposes of Article 13(b)(ii) of the Agreement on Agriculture, and (2) a faulty factual assumption that the non-green box US contract payments did not provide support to maintain US production of upland cotton between MY 1999-2002. In Section 5, Brazil responds to the US 11 February 2004 Comments by demonstrating that applying Brazil's and the US methodologies (along with two slight variations thereof) to the incomplete and inadequate US summary data (including the most recent 28 January 2004 data) demonstrates that the US budgetary expenditures in MY 1999-2002 exceed the level of support decided in MY 1992. Finally, Brazil responds to a number of other points raised by the US 11 February 2004 Comments in Sections 4, and 6-10.

## 2. The US Critique of Brazil's Methodology Is Based on the Flawed US Interpretation of "Support to a Specific Commodity" and, Alternatively, "Non-Product Specific Support"

2. The United States' 11 February 2004 Comments challenging Brazil's methodology for counting contract payments are premised on a faulty interpretation of Article 13(b)(ii) of the Agreement on Agriculture. The US comments continue the US interpretation that the Panel can only count as "support" in MY 2002 those non-green box subsidies that *require* the production of upland cotton.[1] But this leaves behind a number of subsidies that significantly and directly support production of upland cotton. As Brazil has previously argued, the Panel is required to count under Article 13(b)(ii) as "support to upland cotton" for MY 1999-2002 *all* identifiable non-green box support to upland cotton that supports, either directly or indirectly, the production or sale of upland cotton.[2]

### 2.1 US 11 February 2004 Comments Improperly Interpret the Phrase "Support to a Specific Commodity"

3. The United States argues that no allocation methodology can be applied by the Panel under Article 13(b)(ii) of the Agreement on Agriculture. This US argument is based on the US 11 February 2004 Comments that "support to" means support "tied to" the production of a specific commodity.[3] In evaluating this argument the Panel should examine the ordinary meaning of the phrase "support to a specific commodity" in Article 13(b)(ii). The word "support" is defined as "the action of preventing a person from giving way or of backing-up a person or group; assistance, backing".[4] "Support" does not mean or require, as the US comments suggest, an "incentive" or "encouragement" to produce. The SCM Agreement Annex IV, paragraph 3 phrase "tied to the production or sale of a [specific commodity]" is not found in Article 13(b)(ii). Rather, the word "support" has a more general sense of "backing up" a group of agricultural farmers producing a specific commodity. For example, subsidies that cover costs of production when a farmer chooses to grow a crop, "back up" or "support" that farmer. While some non-green box subsidies at issue in this dispute may create a greater *incentive* to produce (*i.e.*, marketing loan, counter-cyclical payments, or crop insurance subsidies) than other subsidies (PFC or direct payments), all of these subsidies at issue in this dispute "support" production of upland cotton because they cover (or contribute to) the costs of production of a crop.

[1] *See* US 11 August 2003 Answer to Question 38, para 81.
[2] Brazil's 22 August 2003 Rebuttal Submission, para. 14-16.
[3] Brazil's 11 February 2004 Comments, paras. 7-9.
[4] New Shorter Oxford Dictionary, Volume II, p. 3152 (first definition).

4. The distinction between "support for production" and "incentive for" (or "tied to") production becomes relevant only when examining the *effects* these subsidies have in causing serious prejudice, within the meaning of Part III of the SCM Agreement. Brazil and the United States agree that the contract payments, which do not *require* production, create less direct *incentives* to produce than, *e.g.*, marketing loan payments, Step 2 payments and crop insurance subsidies. But it is improper to impose an "incentive to" or "tied to" production test when counting up the non-green box "support" to a specific commodity under Article 13(b)(ii) of the Agreement on Agriculture. As noted above, the meaning of the phrase "support to" is a far broader concept. Indeed, the *chapeau* of Article 13(b)(ii) confirms this broader meaning of "support," because it includes all types of non-green box measures, without regard to whether they create direct production incentives.

5. The United States' comments continue to repeat the flawed mantra that "support to a specific commodity" means exactly the same thing as "product-specific support".[5] Negotiators presumably knew what they intended when they used the very particular term "product-specific support". They used the term repeatedly in the Agreement on Agriculture, and even defined "non-product-specific support" in Article 1(a) – yet they declined to use "product-specific support" in Article 13(b)(ii). Accepting *arguendo* the US narrow interpretation of "product-specific"[6], one reason may be that the "support to a specific commodity" phrase was *not* intended to mean *only* support that is tied to *one product*, but rather is intended to include *all* support that is *provided*, either directly or indirectly, to *a product*. The term "specific" clarifies that Article 13(b)(ii) focuses on any support to an individual commodity, not a *group* of commodities such as "grains"[7] or even all commodities. In fact, the notion of a "specific commodity" is very analogous to the "like product" in, *inter alia*, Articles 5 and 6 of the SCM Agreement and Article XVI of GATT 1994 – provisions that are expressly referenced in Article 13(b)(ii) of the Agreement on Agriculture.

6. The United States argues that the Panel is prohibited from even including as "support to" upland cotton, let alone applying *any* allocation methodology to, any non-green box domestic support measure.[8] This would be true even where a measure may provide billions of dollars of support to producers of a "specific commodity". This, of course, is based on the US view that only support directly tied to the production of a specific product is covered by Article 13(b)(ii).[9] But because Article 13(b)(ii) captures *all* non-green box domestic subsidies that support a commodity, it may require the application of an allocation methodology for many trade- and production-distorting domestic support measures that may provide support to more than one commodity. The issue under Article 13(b)(ii) is whether a particular commodity receives "backing" or "support" from a domestic support measure. But the sole fact that multiple commodities are supported by a single type of (trade- and production-distorting) measure does not mean that the "support" or backing suddenly disappears when tabulating the amounts of support for the purpose of Article 13(b)(ii).

7. Applying a methodology such as that proposed by Brazil is consistent with the object and purpose of Article 13(b)(ii) – to capture all identifiable non-green box trade distorting subsides that "support" upland cotton production. To allow huge amounts of trade- and production-distorting support – such as the almost $1 billion in counter-cyclical payments received by almost every upland cotton farmer in MY 2002 – to remain uncounted renders any disciplines during the implementation period inutile. Were this the intention of negotiators, as the United States argues, then it would certainly have been stated explicitly – with language such as "exempt from actions … provided that measures *which are paid upon the production of* a specific commodity do not grant support to a specific commodity in excess of that decided during the 1992 marketing year". Or with language

[5] US 11 February 2004 Comments, paras. 11-14.

[6] Brazil disagrees with the US interpretation, as set out in Section 2.2, *infra*.

[7] Brazil's 11 August 2003 Answer to Question 42, paras. 59-60.

[8] US 11 February 2004 Comments, para 36 (arguing that "support to a specific commodity" really means "product-specific support").

[9] US 11 August 2003 Answers to Question 38, para. 81.

such as "exempt from actions … provided that *measures are directed only at a specific commodity* do not grant support … ." It would have been simple to include these explicit phrases limiting support measures to only subsidies tied to production. But no such limitations were made in the *sui generis* provisions of Article 13(b)(ii).

8. In rejecting the narrow US "required production" test for "support to" in Article 13(b)(ii), the Panel must also reject the US criticisms of Brazil's methodology for calculating support to upland cotton. This is because the US challenge to Brazil's methodology is premised on incorporating into Article 13(b)(ii) the test that the only trade and production distorting support that can be counted is support that is *de jure* "tied to the production or sale of a given product". Yet, this "tied to the production" language is found only in Annex IV, paragraph 3 of the SCM Agreement – not Article 13(b)(ii) of the Agreement on Agriculture.

### 2.2 The US 11 February 2004 Comments Improperly Interpret the Phrase "Product-Specific"

9. Brazil has argued, *in the alternative*, that the contract payments would also be considered to be "product-specific" support if the term "product-specific" had actually been used in the text of Article 13(b)(ii).[10] Brazil argued that the meaning of "product-specific" AMS must be governed by the only term providing some guidance to what it means – the definition of "non-product-specific support" in Article 1(a) of the Agreement on Agriculture.[11] Because the United States raised this issue in its 11 February 2004 Comments,[12] Brazil addresses it below, referencing Brazil's earlier arguments.

10. As a preliminary matter, however, Brazil must correct an error in the US 11 February 2004 Comments. The United States falsely asserts that Brazil has "conceded that 'support to a specific commodity' refers to 'product-specific support'".[13] The alleged "concession" by Brazil[14] becomes the foundation for the US arguments in paragraphs 11-17 of the US 11 February 2004 Comments.

11. As the Panel knows, Brazil argued extensively – and correctly – in the peace clause phase of this dispute that the phrase "support to a specific commodity" is *not* the same as "product-specific support".[15] Brazil's earlier arguments noted that under the facts of this case, all of the non-green box support payments challenged by Brazil as "support to a specific commodity" would also be considered "product-specific support", within the meaning of Article 1(a) of the Agreement on Agriculture.[16] However, this argument was only made in the alternative, to demonstrate that, even under the incorrect US theory, the amount of "product-specific" support for upland cotton in MY 1999-2002 exceeded the level of "product-specific" support for upland cotton decided in MY 1992.

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[10] Brazil's 11 August 2003 Answers to Questions 40-41; Brazil's 11 August 2003 Rebuttal Submission, paras. 24-52.

[11] Brazil's 11 August 2003 Answers to Questions 40-41; Brazil's 22 August 2003 Rebuttal Submission, para. 19.

[12] US 11 February 2004 Comments, paras. 11-14.

[13] US 11 February 2004 Comments, paras. 11, 14.

[14] The text of the alleged "concession" made by Brazil is "In sum, Brazil maintains its position – supported by all third parties – that the support from contract payments that can be allocated to upland cotton is product-specific support within the meaning of the Agreement on Agriculture." What the United State neglects to note in its "concession" assertion is that Brazil then cited to its 22 August 2003 Rebuttal Submission, paras. 3-23 and 24-52, where Brazil argued exactly the same position it has set forth in these comments. Therefore, there was no "concession" or otherwise by Brazil.

[15] Brazil's 22 August 2003 Rebuttal Submission, paras. 13-22. Brazil's 22 July 2003 Oral Statement, paras. 13-26. Brazil's 24 July 2003 Closing Statement, para. 8.

[16] Brazil's 22 August 2003 Rebuttal Submission, paras. 13-52. Brazil's 22 August 2003 Comments on US Answers to Questions 38-39, paras. 48-53, Question 43, para. 58.

12. The US 11 February 2004 Comments now go so far as to argue that *any* allocation methodology under Article 13(b)(ii) – which it argues means "product-specific" support – is prohibited by the Agreement on Agriculture.[17] One interpretative guide to determine whether support is "product-specific" is found in the definition of "non-product-specific support" in Article 1(a) of the Agreement on Agriculture. Brazil demonstrated that only non-product specific support is actually defined and that it includes "support provided in favour of agricultural producers *in general*".[18] The United States asserts that Brazil's definition of "general" is obsolete and that "general" means any support provided to more than one commodity.[19] But this is a tortured reading of the term "in general". "Non-obsolete" definitions of "general" include "relating to a whole class of objects" and "*not* partial, local or sectional".[20] As with the so-called "obsolete" definition criticized by the United States, these definitions fully support the ordinary meaning of "non-product-specific" support as support provided to a broad range of producers covering a wide variety of agricultural products, not simply more than one, as the United States argues.

13. Further context for the existence of some sort of an allocation methodology in the Agreement on Agriculture is Annex 3, paragraph 7, which provides that "[m]easures directed at agricultural processors shall be included *to the extent that such measures benefit* the producers of the basic agricultural products". This use of the term "benefit" is very similar to the notion of "support" as used in Article 13(b)(ii). The assessment of the extent to which measures directed at agricultural processors benefit producers of a particular product necessitates a delineation of support that actually benefit upstream agricultural producers. This requires an allocation methodology.

14. Further, the narrow US interpretation is contradicted by Annex 3, paragraphs 7, 8, 12 and 13 of the Agreement on Agriculture, which include as "product-specific" many types of domestic support not tied to the production of a particular commodity.[21] Nor do the Agreement on Agriculture citations in paragraph 12 of the US 11 February 2004 Comments provide guidance as to where to draw the line for "non-product specific support".

15. While future negotiators may decide to clarify exactly what "product-specific" means in future revisions of the Agreement on Agriculture, the present text does not provide the "hard and fast" "production-requirement" subsidy rules advanced by the United States in this dispute. Indeed, Brazil notes that all commenting third parties in this dispute have stated their belief that the US counter-cyclical payments and crop insurance subsidies were "product-specific".[22] This suggests that the United States' trading partners do not agree that there is a "production-requirement" test for "product-specific support". Consistent with these third party views, there is nothing in the text of the Agreement on Agriculture to support a finding that "product-specific" is determined solely by the *de jure* form of the payment or by whether the payment is tied to the production of the crop. Nor does the Agreement on Agriculture support the US hard and fast "tied to production" test. Absent such guidance, the determination of whether agricultural support is specific or "general" is a *factual* issue that must be decided on a case-by-case basis.

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[17] US 11 February 2004 Comments, paras 11 and 36 ("the definitions of product-specific support and non-product specific support (and their application in the Agreement on Agriculture) do not permit any such allocation … ".).

[18] Brazil's 11 August 2003 Answers to Questions 40-41.

[19] US 11 February 2004 Comments, para. 10.

[20] New Shorter Oxford Dictionary, Volume I, p. 1073 (definitions 1, 3, 4).

[21] Brazil's 22 August 2003 Rebuttal Submission, paras. 17-18 (illustrating that many non-green box measures considered as "product-specific" support do not contain "tied-to" production requirements). The United States never rebutted this argument.

[22] *See* New Zealand's 11 August 2003 Answer to Third Party Question 15; Argentina's 11 August 2003 Answer to Third Party Question 15 and 23 July 2003 Oral Statement, para. 8; EC's 11 August 2003 Answer to Third Party Question 15 *See* also Exhibit Bra-144 (G/AG/R/31, paras. 29-32).

16. The US 11 February 2004 Comments further state that "product-specific" and "non-product-specific" are disjunctive, and that Article 6.4 of the Agreement on Agriculture requires *de minimis* levels of support to be categorized into "product-specific" and "non-product-specific".[23] This is true, but begs the question of how and when to draw the line between product-specific and non-product-specific support. For example, the United States has argued that MY 2002 counter-cyclical payments for upland cotton are non-product specific.[24] But in MY 2002, upland cotton counter-cyclical payments of almost $1 billion were received by producers holding only 1.7 per cent of US farmland.[25] Brazil agrees with the EC, New Zealand, and Argentina that such payments are "partial, local or sectional" to particular US producers.[26] They are not provided "in general" to a broad group of US producers. Thus, they should be allocated as "product-specific support," including for purposes of an Article 6.4 *de minimis* analysis.

17. The United States argues that a single type of domestic support measure cannot be both "product-specific" and "non-product-specific" support.[27] Once again, the answer to this question would depend on the facts of the case. For example, if 95 per cent of the expenditures of a so-called decoupled payment ended up in the pockets of farmers producing a single commodity (such as upland cotton counter-cyclical payments), these facts would support the finding of product-specific support for that commodity. Whether the other nine commodities eligible to receive a similar type of payment were also receiving product-specific support would have to be decided on a case-by-case basis. Similarly, if a decoupled payment programme gave farmers the flexibility to grow four different crops, but these crops represented only 10 per cent of total commodity production in that Member, then the support for each of these crops might be considered to be "product-specific".

18. In sum, the use of the term "in general" in Article 1(b) of the Agreement on Agriculture implies that this is a question of fact, the answer to which depends on a host of factors, not a simplistic and non-textually based "tied to production" rule, as advanced by the United States. Any other interpretation would write text into the Agreement on Agriculture that is not there and was not agreed to by Members. As the comments of the EC, New Zealand and Argentina in this dispute vividly illustrate, there is not an universal understanding that product-specific support means only domestic support that is *de jure* tied to production. By defining "non-product-specific support" using the "in general" language, Members provided flexibility to examine, on an case-by-case basis, whether the domestic support was so linked to a handful of products that it could not be considered "non-product specific support".

19. Finally, Brazil does not believe that the Panel, in this dispute settlement proceeding, is required to interpret "product-specific" support to resolve the now-expired peace clause provisions of Article 13(b)(ii). The concept of "product-specific" continues to be a significant issue with respect to ongoing negotiations and in future interpretations of Members' obligations to comply with their "total AMS" requirements. Brazil's claims in this dispute do not challenge the "total AMS" of the United States. Brazil has never claimed that "AMS" must be interpreted in this dispute. The interpretative issues relating to the peace clause can and should be resolved by interpreting the terms actually used in that provision – "support to a specific commodity" – not by interpreting the term "product-specific" that the United States now seeks to substitute in place of a carefully negotiated text.

[23] US 11 February 2004 Comments, para. 12.
[24] US 22 August 2003 Rebuttal Submission, paras. 86-88.
[25] Brazil's 11 August 2003 Answers to Question 44, paragraph 62 (first and next to last bullets).
[26] *See* New Zealand's 11 August 2003 Answer to Third Party Question 15; Argentina's 11 August 2003 Answer to Third Party Question 15 and 23 July 2003 Oral Statement, para. 8; EC's 11 August 2003 Answer to Third Party Question 15 *See* also Exhibit Bra-144 (G/AG/R/31, paras. 29-32).
[27] US 11 February 2004 Comments, paras. 13-14.

### 3. Brazil's Methodology is Supported by Undisputed Evidence that the Contract Payments were Essential to Maintain Upland Cotton Production Between MY 1999-2002, and, thus, are Support to Upland Cotton

20. The US critique of Brazil's methodology rests not only on an incorrect legal interpretation of "support to a specific commodity," but more fundamentally on its false assumption that contract payments do not support the production of upland cotton. This factual assumption permeates *all* of the 32 pages of the US 11 February 2004 Comments. It is articulated by asserting that the contract payments are "decoupled" or "not tied to" the production of upland cotton. Ultimately, the combination of these flawed legal interpretations and factual assumptions result in the equally flawed US assertion that its Annex IV methodology is the only way to allocate contract payments (albeit only for purposes of Part III of the SCM Agreement).

21. In evaluating which methodology to use to count contract payment as "support to cotton", the starting point is the necessary fact that all the contract payments at issue are non-green box support.[28] For example, direct payments and counter-cyclical payments are not properly considered "decoupled income support", within the *chapeau* of paragraph 6 of Annex 2 of the Agreement on Agriculture.[29] This means that each of the contract payments is linked (or coupled), to some extent, to the production of one or more agricultural commodities. In addition, prior to applying the methodology, it must have been determined that the non-green box measures are "support to a specific commodity".

22. Having demonstrated these first two steps, the next question is the "amount of the support" to a specific commodity. This is a factual question and requires assessing *to what extent* a particular non-green box subsidy supports or maintains the production of a specific commodity or commodities. This initially requires an examination of the legal structure of the support mechanism. But more importantly, it requires an examination of the record evidence concerning the extent to which the payments *de facto* support or maintain the production of a specific commodity. Applied to this case, it means that the stronger the requirement for the contract payments to maintain (*i.e.*, cover the costs of) production of upland cotton, the more appropriate it is to use a methodology that treats each dollar of payments received directly by producers of upland cotton as "support to" upland cotton.

23. The US "Annex IV" methodology assumes that all four contract payments are not tied in any significant way to the production of upland cotton. The primary evidence relied on by the United States are the legal provisions of the 1996 FAIR Act and the 2002 FSRI Act, which permit "producers" to grow other crops (except fruits, vegetables and wild rice) and still receive the contract payments. The United States argued that the legally permitted "decoupled" form of the support requires the payment to be spread out over the entire value of a farm's production.[30] It is this assumption that underpins the US Annex IV methodology.

24. Calculating the amount of contract payments that is "support" to upland cotton by allocating the benefit of those payments across total production of farms receiving the payments might make sense *if* the four contract payments had, *in fact*, no significant role in maintaining the production of upland cotton. But the US methodology runs headlong into the overwhelming weight of the evidence showing a direct and significant link between "producers" receiving upland cotton contract payments and "producers" planting upland cotton. Brazil produced extensive evidence showing the link

[28] The Panel would not be able to count these programmes for purposes of Article 13(b)(ii) unless they are out of the green box, and thus, "non-green box" support.

[29] *See e.g.* Brazil's 24 June 2003 First Submission, Section 3.2.7 and 3.2.8; Brazil's 22 August 2003 Rebuttal Submission, Section 2.1.

[30] *See* US 11 February 2004 Comments, para. 37-38.

between these contract payments and the maintenance of upland cotton production.[31] Consider the following key uncontested facts:

- 96 per cent of MY 2002 upland cotton acreage was planted on farms that hold upland cotton base.[32] This demonstrates that the overwhelming majority of current US upland cotton production is planted on upland cotton base and shows that, in fact, direct and counter-cyclical payments are directly linked to current production.

- US upland cotton producers would have lost $332.79 per acre between MY 1997-2002 if they had not received upland cotton contract payments.[33] This demonstrates the critical role contract payments play in sustaining *production* of upland cotton during MY 1999-2002.

- Without direct and counter-cyclical payments in MY 2002, the average US cotton farmer would have lost 14.36 cents per pound. With these two payments, they earned a "profit" of 4.2 cents per pound with the cotton DP and CCP payments.[34]

- Producers growing crops on upland cotton acreage receive much higher per acre payments than all other "covered commodities", except rice. The higher per acre payments are directly related to the higher costs to produce cotton compared to other crops.[35] This fact highlights the *expectation* that former producers would continue to be present producers.[36] This is an expectation that is a reality, since 96 per cent of upland cotton farmers do plant upland cotton on high per-acre payment upland cotton base acreage.

- Upland cotton producers in MY 2002 received $446.8 million in upland cotton direct payments, representing a subsidization rate of 13.1 per cent.[37]

- Upland cotton producers in MY 2002 received $986.4 million in upland cotton counter-cyclical payments, representing a subsidization rate of 28.9 per cent.[38]

- The amount of US planted cotton acreage has shown only relatively small shifts over the past ten years regardless of market price movements, confirming the influence of the contract

[31] Brazil's 9 October 2003 Closing Statement, Annex I (Summary of Evidence Demonstrating that Upland Cotton Producers in MY 1999-2002 Produced Upland Cotton on Upland Cotton, Rice, or Peanut Base Acreage); *see also* Brazil's 27 October 2003 Answers to Question 125(a), paras. 7-25; Brazil's 18 November 2003 Further Rebuttal Submission, Sections 2.1 and 3.1; Brazil's 2 December 2003 Oral Statement, paras. 25-27.

[32] *See* Annex A, Section 1, para. 16. This figure might be slightly overstated by possible aggregation problems. However, Brazil notes that the total amount of upland cotton base on farms planting upland cotton and holding upland cotton base exceeds MY 2002 plantings by 800,000 (13.8 million acres v 13 million acres), suggesting that any aggregation problem for MY 2002 is not significant.

[33] Brazil's 2 December 2003 Oral Statement, paras 25-27 *and* Exhibit Bra-353.

[34] Brazil's 22 August 2003 Rebuttal Submission, paras. 39-41.

[35] Brazil's 18 November 2003 Further Rebuttal Submission, para. 70 and Exhibit Bra-324 (NCC Chairman's Report by Kenneth Hood, 24 July 2002, p. 2)..

[36] *See* Brazil's 9 September 2003 Further Submission, para. 344 and Exhibit Bra-109 (Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, before the House Agriculture Committee, National Cotton Council, p. 5-7) arguing for higher upland cotton loan rates and "decoupled commodity payment rate[s]."

[37] *See* Annex A, Section 1, Table 1.5. *See* Table 3.8 for the total value of the upland cotton crop on all farms producing upland cotton.

[38] *See* Annex A, Section 1, Table 1.5. *See* Table 3.8 for the total value of the upland cotton crop on all farms producing upland cotton.

payments in maintaining large volumes of production.[39] This evidence is consistent with NCC testimony and USDA data showing that most upland cotton farmers do not shift out of specializing in upland cotton production towards the production of other crops to any great extent.[40]

- NCC officials repeatedly stated that their cotton farmer members cannot produce upland cotton without contract payments, and they have always treated contract payments as an integral part of an overall subsidy package of support for upland cotton production.[41]

25. In addition to the above, the provisions of the 2002 FSRI Act are evidence that upland cotton contract payments were intended to support the production of upland cotton. First, Section 1104(c)(1)(F) of the 2002 FSRI Act sets a "target price" for upland cotton of 72.4 cents per pound, which guarantees high revenues in much the same way that deficiency payments worked before MY 1996. This upland cotton-specific "target price" was requested by the NCC in 2001 and exists to support upland cotton – not the production of other crops. The cotton target price results in much higher per acre counter-cyclical payments for upland cotton than other crops (except rice). Second, Sections 1103(a) and 1104(a) require payments to current producers growing on covered crop base acreage. In other words, Congress intended that only farmers actually planting crops (or sharing the risk of planting a crop if one would have been produced) would directly receive the payments. Third, Section 1103(b) of the 2002 FSRI Act establishes very high direct payment rates for upland cotton base relative to other "covered commodities"[42]

26. The facts set out above are crucial for understanding why the US "Annex IV" methodology rests on a completely false assumption. That assumption is that US producers of upland cotton do not need or rely on the full amount of upland cotton payments to cover their long-term losses from the production of *upland cotton*. The United States implements this assumption by proposing that the *only* methodology that can be used is one that would spread the entire amount of the contract payments across the total value of an upland cotton farmer's production. But the record shows conclusively that most upland cotton farmers simply could not produce upland cotton profitably in MY 1999-2002 without using all contract payments they demanded and received for their upland cotton production.

27. The US 11 February 2004 Comments argue that Brazil's methodology for counting support to upland cotton makes "no economic sense".[43] But it is the US Annex IV methodology, as applied to contract payments to US upland cotton producers, that makes no economic sense. For example, if upland cotton farmers were, in fact, using these payments to support unprofitable dairy, livestock, or fish farming operations, then they would have lost money on their upland cotton production. The fact that US producers were able to grow any upland cotton at all in MY 2002 after four straight years of huge "losses" (totalling $872 per acre by MY 2002,[44] comparing production costs and market revenue) demonstrates conclusively the production-sustaining effects of these subsidies.[45] Indeed, the

[39] *See* Brazil's 27 October 2003 Answers to Questions, paras. 35-36; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 81-88.

[40] Brazil's 9 October 2003 Closing Statement, Annex I (Summary of Evidence Demonstrating that Upland Cotton Producers in MY 1999-2002 Produced Upland Cotton on Upland Cotton, Rice, or Peanut Base Acreage, paras. 9-12.

[41] Exhibits Bra-3, 108, 109, 111 and 252. Brazil's 9 October 2003 Closing Statement, Annex I (Summary of Evidence Demonstrating that Upland Cotton Producers in MY 1999-2002 Produced Upland Cotton on Upland Cotton, Rice, or Peanut Base Acreage, paras. 14-19.

[42] *See* Exhibit Bra-29 (2002 FSRI Act).

[43] US 11 February 2004 Comments, para. 37.

[44] Brazil's 27 October 2003 Answers to Questions, paras. 35-36

[45] Without contract payments, US producers would have lost $332.79 per acre over the 6-year period. Brazil's 2 December 2003 Oral Statement, paras. 25-27 *and* Exhibit Bra-353.

continued high levels of plantings in MY 2002 despite these losses are strong evidence that upland cotton producers did in fact (a) receive, and (b) use upland cotton contract payments to sustain their upland cotton production during MY 1999-2002. If not, US upland production would have been far lower, as farmers simply could not have survived economically. Thus, the US assumption in its "Annex IV" methodology that producers did not need or use upland cotton payments to sustain high-cost upland cotton production is simply wrong.

28. By contrast, Brazil's methodology properly reflects the economic reality of the key role these payments played in sustaining US upland cotton production in MY 1999-2002. Brazil, like the NCC, believes that the contract payments were necessary for the maintenance and the survival of US upland cotton production during MY 1999-2002.[46] In keeping with the key role that upland cotton contract payments played in sustaining upland cotton production, the principal element of Brazil's methodology focuses only on upland cotton contract payments made to producers of upland cotton. Such "cotton to cotton" payments represent the vast bulk of contract payments received by upland cotton producers. For example, under Brazil's methodology, 99.1 per cent of the MY 2002 direct payments received by upland cotton producers were upland cotton payments.[47] Similarly, under Brazil's methodology, 99.8 per cent of the MY 2002 counter-cyclical payments received by upland cotton producers were upland cotton payments.[48] Treating all of these "cotton to cotton" payments as support to upland cotton is fully supported by the essential role these cotton payments play in sustaining US upland cotton production.

29. The second (and relatively minor) part of Brazil's methodology is to account for the non-upland cotton contract payments received by current upland cotton producers. These non-upland cotton base payments represented a tiny 0.9 per cent in MY 2002 of the total direct payments allocated to upland cotton under Brazil's methodology, and 0.2 per cent in MY 2002 of the counter-cyclical payments allocated to upland cotton under Brazil's methodology. This small part of Brazil's methodology first pools any contract payments received for base acres not planted to their respective base crop and then distributes them as support to these contract payment crops according to their share of total "overplanted" base acreage on the farm.

30. The facts show that it is appropriate for Brazil to allocate these payments over the plantings of the other "covered commodities" produced by an upland cotton producer. Brazil demonstrated that, for each of the marketing years from 2000-2002, an upland cotton producer growing upland cotton on *non*-contract acreage would have suffered considerable losses.[49] Even growing on non-upland cotton (except rice) base acreage would have resulted in losses during most of the period of investigation.[50] Therefore, the relatively few upland cotton producers planting on some other type of base acreage needed and relied on the non-upland cotton payments to come close to making a profit. Without such payments, the average producer would have not been able to sustain upland cotton production.

31. In addition, the allocation across all contract crops (as opposed to all farm products produced) is justified by the evidence of the "specific" nature of the "covered commodity" payments. The United States never contested Brazil's evidence or argument that the contract payments are "specific" subsidies within the meaning of the SCM Agreement. For example, the United States never rebutted evidence that the 2002 FSRI Act "covered commodities" represented only 24 per cent of the value of US farm receipts (and 30 per cent of US farm acreage) in MY 2002, and that the 1996 FAIR Act "programme crops" represented less than 14 per cent of the value of US crops (and 22 per cent of the

[46] Brazil's 24 June 2003 First Submission, para. 1.
[47] *See* Annex A.2, Tables 2.9, 2.21 and 2.21.
[48] *See* Annex A.2, Tables 2.9, 2.20 and 2.21.
[49] Brazil's 27 October 2003 Answers to Question 125(c), paras. 15-25; Brazil's 22 August 2003 Rebuttal Submission, paras. 39-44, and 30-31.
[50] Brazil's 27 October 2003 Answers to Question 125(c), paras. 15-25; Brazil's 22 August 2003 Rebuttal Submission, paras. 39-44, and 30-31.

acreage) during MY 1999-2001.[51] Nor did the United States ever rebut any of the numerous statements of the users and recipients of the contract payments – the NCC – that they needed and received contract payments to survive.[52]

32. In sum, the proper allocation methodology under Article 13(b)(ii) of the Agreement on Agriculture must be consistent with the extent to which the domestic support payments directly maintain the production of a specific commodity. Brazil's methodology reflects the crucial role that each of the four contract payments plays in maintaining the production of US upland cotton. By contrast, the US "Annex IV" methodology assumes incorrectly that these payments do not support upland cotton any more than they support catfish farming or other production activities on an upland cotton farm. For the above reasons, Brazil requests that the Panel reject the US arguments, and adopt Brazil's methodology for allocating the contract payments.

### 4. A Methodology to Count Contract Payments Is Appropriate Based on the Text of Article 13(b)(ii) of the Agreement on Agriculture

33. The United States criticizes Brazil's methodology (and presumably any other methodology) because it is not based in the "text" of the peace clause or the Agreement on Agriculture.[53] Instead, the United States argues that the Panel should use Annex IV of the SCM Agreement as the basis for its calculation of the amount of the contract payments.[54]

34. Article 13(b)(ii) of the Agreement on Agriculture does not provide explicit guidance on how to count up the amount of support for contract or any other type of payments.[55] But that does not mean that no counting methodology can be used. The absence of explicit guidance on implementing more general provisions has not stopped WTO panels or parties from proposing and using methodologies to tabulate the amount of subsidies, costs, and volumes of trade impacted.

35. The Panel only need to look as far as the export credit guarantee arguments in this dispute as an example. Item (j) establishes that export credit guarantee programmes constitute export subsidies if they are operated at premium rates that are inadequate to cover the long-term operating costs and losses of the programmes.[56] There is no explicit methodology provided in the text of item (j) that would define how to apply this provision. Yet, the United States has repeatedly argued for the application of a cash-basis accounting methodology to tabulate the amount of costs and losses.

36. Similarly, DSU Article 22.7 requires any suspension of concessions to be "equivalent to the level of nullification or impairment". As with Article 13(b)(ii) of the Agreement on Agriculture, this requires the tabulation of amounts – in the case of Article 22.7, the amounts of trade impacted through the non-implementation of WTO-inconsistent measures. Again, there is no methodology provided in Article 22.7 to assess the level of nullification or impairment. Nevertheless, arbitrators, at the urging, *inter alia*, of the United States, have applied DSU Article 22.7 using a variety of methodologies developed on a case-by-case basis to assess the level of nullification or impairment.[57]

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[51] Brazil's 22 August 2003 Rebuttal Submission, paras. 24-25; Brazil's 9 September Further Submission, paras. 46, 55.

[52] *See e.g.* Brazil's 22 July 2003 Oral Statement, paras 52-53, 58-60; Brazil's 24 June 2003 First Submission, para. 1; Brazil's 18 November 2003 Further Rebuttal Submission, para. 25, 70, 102.

[53] US 11 February 2004 Comments, para. 8.

[54] The United States argues that its methodology can only be used in connection with Part III of the SCM Agreement, not the Agreement on Agriculture. (*See e.g.* US 11 February 2004 Comments, paras. 2, 86).

[55] Nor does Annex IV, as discussed in Section 4 below.

[56] Brazil also claims that the export credit guarantee programmes constitute export subsidies under the terms of Articles 1.1. and 3.1(a) of the SCM Agreement.

[57] Arbitrator Report, *EC – Bananas (US)*, WT/DS27/ARB; Arbitrator Report, *EC – Bananas (Ecuador)*, WT/DS27/ARB; Arbitrator Report, *EC – Hormones (US, Canada)*, WT/DS26/ARB and

37. Finally, other provisions of the WTO Agreement similarly require WTO Members, as a practical matter, to implement general obligations by applying different valuation and allocation methodologies under general Anti-Dumping Agreement and the SCM Agreement rules.[58]

38. The United States argues that only Annex IV of the SCM Agreement offers any useful context. While it derides Brazil's methodology as being "invented", a close look at the text of Article IV reveals that it is ill-equipped to address the tabulation of support issue before the Panel. Annex IV, which is entitled "Calculation of the Total *Ad Valorem* Subsidization (Paragraph 1(a) of Article 6)" deals – as the title indicates – with the calculation of subsidization rates, within the meaning of Article 6.1(a) of the SCM Agreement. However, the "support to cotton" question before this Panel is *not* establishing an *ad valorem* subsidization rate, but rather the calculation of the *amount of support* to upland cotton, within the meaning of Article 13(b)(ii) of the SCM Agreement.

39. But setting aside the problem that Annex IV deals with calculation of a subsidization rate, the US contract payments at issue in this dispute are *de facto* tied to upland cotton production. Thus, Annex IV paragraph 3 would be implicated, *i.e.*, the subsidization rate is determined by *dividing the total amount of the tied contract payment* subsidies by the total value of upland cotton sales. But this presupposes that the amount of the payments subsidies is known. Thus, Annex IV does not answer the crucial question how to determine the amount of the *de facto* tied contract payments that constitute support to upland cotton. Instead, it only offers a methodology to calculate the *subsidization rate* for known amounts of subsidies.

40. Indeed, Annex IV itself recognizes that there are holes in its provisions, stipulating in footnote 62 to Annex IV that "[a]n understanding among Members should be developed, as necessary, on matters which are not specified in this Annex or which need further clarification for purposes of paragraph 1(a) of Article 6". One such matter could have been the scope of the meaning of "tied to the production or sale of a given product". Must the "tie to production" be *de jure* as the United States argues, or *de facto* as Brazil asserts? But no understanding or clarification of this, or any other issue relating to Annex IV, was agreed to by Members prior to the expiration of Annex IV in 2000.

41. Thus, Annex IV does not assist the Panel in determining the amount of support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture. Contrary to the US arguments, paragraph 2 of Annex IV is inapplicable because the subsidies at issue are *de facto* tied to upland cotton production. Further, paragraph 3 of Annex IV does not provide any guidance on how to calculate the amount of the subsidy which is the goal of the Article 13(b)(ii) exercise.

42. In conclusion, it is incorrect to assert that the absence of any specific methodology precludes the Panel from applying one for the purposes of Article 13(b)(ii). It is also incorrect to claim that Annex IV provides definitive guidance, because it could only be useful for establishing a rate of subsidization, and not for calculating the amount of the subsidy. Thus, as with its item (j) analysis, the Panel needs to adopt a reasonable methodology to be applied for purposes of the peace clause in assessing the amount of support to upland cotton from the four contract payment programmes. This methodology must reflect the facts in the record and be consistent with the text, context and object

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WT/DS48/ARB; Arbitrator Report, *Brazil – Aircraft*, WT/DS46/ARB; Arbitrator Report, *US – FSC*, WT/DS108/ARB; Arbitrator Report, *Canada – Aircraft II*, WT/DS222/ARB.

[58] *See e.g.* Appellate Body Report, *US – Lumber CVDs Final*, WT/DS257/AB/R, paras. 155-166 (Appellate Body affirmed panel's finding that a "pass-through" methodology analysis must be performed by investigating authorities to determine the amount of subsidies benefiting down-stream purchases of subsidized products; this was despite the fact that no specific methodology for pass through was explicitly set out in Articles 10 and 32.1 of the SCM Agreement); Panel Report, *US – Sheet/Plate from Korea*, WT /DS179/R, paras. 6.135-36 (finding USDOC methodology applying multiple averaging periods during the investigation appropriate to implement "fair comparison" standard of Article 2.4 of the Anti-Dumping Agreement).

and purpose of Article 13(b)(ii). As Brazil has argued, its methodology – or some variant of its methodology such as the cotton-to-cotton methodology – is reasonable given the key role that contract payments played in the maintenance of upland cotton production during MY 1999-2002.[59]

### 5. The Evidence in the Record Supports a Finding, under any Methodology, that the United States' Level of Support Provided in MY 1999-2002 Exceeded the amount of Support Decided in MY 1992

43. Brazil responds in this section to the US 11 February 2004 Comments asserting that Brazil has not established that the amount of "support to upland cotton" in MY 1999-2002 is greater than the support decided in MY 1992.[60] Brazil's basic response to these arguments is that even if the United States does not produce the farm-specific information by 3 March 2004, the Panel has before it sufficient evidence, including the evidence of any adverse inferences, to establish the amount of four contract payments for MY 1999-2002. The less-than-ideal data analyzed below confirms, in the first instance, Brazil's 14/16$^{th}$ methodology. Moreover, even if the Panel were to rely directly on the figures generated below from the application of Brazil's methodology, the US Annex IV methodology and a variation of each of those methodologies to the incomplete US data,[61] these figures support a finding that the US support to upland cotton in MY 1999-2002 exceeded the level decided in MY 1992.

44. Brazil's analysis of the data below is necessary because Brazil's 28 January 2004 original analysis of the incomplete US data submitted on 18/19 December 2003 did not include additional data the United States recognized[62] it failed to produce on 18/19 December 2003, and subsequently produced on 28 January 2004. Brazil has made certain adjustments to respond to criticisms of the United States. Further, to assist the Panel, Brazil presents the calculations from a minor variation of Brazil's methodology and of the US Annex IV methodology. In the final analysis, these various methodologies are "tools" (not "claims") that assist the Panel in making an objective assessment of the US data and other evidence before it for purposes of making a peace clause finding (and, if the Panel deems this necessary, the amount of subsidization for Brazil's serious prejudice claims).

45. Below, Brazil presents its updated results of the two methodologies applied in Sections 9 and 10 of its 28 January 2004 Comments and Requests Regarding US Data. This update is based on the revised US data provided by the United States on 28 January 2004.[63] For detailed calculations, Brazil refers the Panel to Annex A to this submission.

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[59] *See* Section 3, *supra*. The fact that the great majority of upland cotton is planted on upland cotton base (86.34 per cent in MY 1999, 82.05 per cent in MY 2000, 80.10 percent in MY 2001 and 96.17 per cent in MY 2002) lends considerable support for this conclusion. These amounts are calculated as the share of upland cotton production planted on farms holding upland cotton base (up to the amount of upland cotton base) of total upland cotton plantings. MY 1999-2001 data are taken from category "1" farms and total upland cotton planting from the rPFCsum.xls file provided by the United States on 28 January 2004. Data for MY 2002 is taken from "Enrolled in Cotton PFC and planted cotton" farms and total upland cotton plantings from the rDCPsum.xls file provided by the United States on 28 January 2004.

[60] *See* US 11 February 2004 Comments, paras. 15-17. This section also responds to the US comments that Brazil has not established a *prima facie* case of the amount of the contract payment subsidies for the purpose of its serious prejudice claims.

[61] Brazil recalls that even the revised US summary data produced on 28 January 2004 suffers from aggregation problems and falls short of enabling the Panel and Brazil to account for soybean market loss assistance and peanut direct and counter-cyclical payments in its allocations. *See* Section 3 of Brazil's 28 January 2004 Comments and Requests Regarding US Data.

[62] US 28 January 2004 Letter to the Panel and accompanying CD-Rom.

[63] *See* US 28 January Letter to the Panel.

*Cotton-to-Cotton Methodology*

46. Brazil first presents the results of using a slight variation of Brazil's methodology. Brazil notes the US arguments that only upland cotton contract payments could be included in any "support to" upland cotton. Counting only upland cotton payments would undercount the amount of contract support, as Brazil argues in Section 9, *infra*. [64] But even though it undercounts the amount of support, a methodology that examines only "cotton-to-cotton" payments is supported by the evidence in the record described in Section 3 *supra*, including the fact that in MY 2002 96 per cent of upland cotton was planted on upland cotton base acreage.[65]

47. Brazil sets out the results of examining only the upland cotton contract payments received by producers planting upland cotton for MY 1999-2002 in Table 1.5 below:[66]

Annex A Table 1.5

| **Cotton-to-Cotton Methodology** [67] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $515,310,673.4 | $512,801,043.5 | - | - |
| 2000 | $482,422,346.0 | $513,554,489.0 | - | - |
| 2001 | $387,916,892.8 | $535,792,287.0 | - | - |
| 2002 | - | - | $446,796,377.9 | $986,357,993.8 |

48. As Brazil described in its 28 January 2004 Comments, the results of this analysis may be distorted somewhat because the revised US summary data does not control for aggregation problems.[68] However, given the fact that the United States can be deemed to know the amount of payments from a cotton-to-cotton match, any continued refusal of the United States to produce the data should permit the Panel to infer that the data outlined above is accurate.

*Brazil's Methodology*

49. Brazil also presents the results of applying its proposed methodology. However, given the absence of farm-specific information, Brazil can present only a modified version of its proposed methodology, as discussed in more detail in its 20 January 2004 Answers to Additional Questions[69] and applied in its 28 January 2004 Comments and Requests Regarding US Data.[70] The data presented below updates Brazil's earlier calculations by using the 28 January 2004 revised US summary data

[64] US 11 February 2004 Comments, paras. 47-51. *See* also US 28 January 2004 Comments, paras. 34-52, 208.

[65] Calculated as the share of upland cotton production planted on farms holding upland cotton base (up to the amount of upland cotton base) of total upland cotton plantings. MY 1999-2001 data are taken from category "1" farms and total upland cotton planting from the rPFCsum.xls file provided by the United States on 28 January 2004. Data for MY 2002 is taken from "Enrolled in Cotton PFC and planted cotton" farms and total upland cotton plantings from the rDCPsum.xls file provided by the United States on 28 January 2004.

[66] This is because only in MY 2002 was less acreage planted to upland cotton than the total amount of upland cotton base acreage held by farms producing upland cotton and holding upland cotton base. In MY 1999-2001, the amount of upland cotton acreage slightly exceeded the amount of upland cotton base. This phenomenon is the effect of the base update allowed for under the 2002 FSRI Act.

[67] For details of the calculations, see Annex A.1.

[68] Brazil notes that the US summary data requested by the Panel on 3 February 2004 (part (b) of the Panel's Request for Information under DSU Article 13) would not result in aggregation problems tainting the results, nor would farm-specific data withheld by the United States and requested by Brazil on 3 December 2003 and by the Panel on 8 December 2003, 12 January 2004 and 3 February 2004 (part (a) of the Panel's Request for Information under DSU Article 13).

[69] *See* Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[70] *See* Section 9 of Brazil's 28 January 2004 Comments and Requests Regarding US Data.

that includes information on contract payments to farms not holding upland cotton base but producing upland cotton.[71] The following table shows the results of applying Brazil's allocation methodology to the revised US summary data.[72]

Table 2.21

| **Brazil's Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $574,488,456.1 | $571,690,622.7 | - | - |
| 2000 | $538,079,545.3 | $572,803,412.3 | - | - |
| 2001 | $428,007,676.4 | $591,165,829.7 | - | - |
| 2002 | - | - | $450,924,339.1 | $988,252,054.4 |

*Modified US Annex IV methodology*

50. Brazil also applied the revised US summary data to a modified "Annex IV" methodology allocating total contract payments to farms producing upland cotton over the value of *contract payment* crops produced on these farms. This methodology is based on two assumptions: first, contract payments are support only to contract payment crops; and second, contract payments are allocated pursuant to the value of these contract crops' production on upland cotton producing farms.

51. Brazil believes that this methodology is not appropriate because it improperly undercounts the amount of support provided to maintain the production of upland cotton. Nevertheless, the analysis of this methodology permits the Panel to assess the impact of different assumptions on the amount of contract payments allocated. Further, because the "cotton-to-cotton" and "Brazil's" methodologies are supported by the strong link between contract payments and maintaining upland cotton production, the same evidence would more than support the modified Annex IV methodology. The following table shows the results of this allocation methodology. Brazil notes these figures are understated due to the fact that the United States did not provide any data concerning soybean market loss assistance payments and peanut direct and counter-cyclical payments.[73]

Annex A Table 3.10

| **Modified Annex IV Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $576,544,351.0 | $573,736,505.1 | - | - |
| 2000 | $546,052,507.2 | $581,290,893.0 | - | - |
| 2001 | $399,648,260.3 | $551,995,696.4 | - | - |
| 2002 | - | - | $431,923,303.9 | $722,082,667.7 |

*US Annex IV Methodology*

52. Finally, Brazil has applied the revised US summary data to the US-proposed methodology – updating the calculations presented in Section 10 of Brazil's 28 January 2004 Comments and Requests Regarding US Data. The data presented here updates Brazil's earlier calculations by using the 28 January 2004 revised US summary data that includes information on contract payments to

[71] Calculations based on this data continue to suffer from aggregation problems and the missing information on soybean contract payments and peanut direct and counter-cyclical payments to farms producing upland cotton. (*See* Section 3 of Brazil's 28 January 2004 Comments and Requests Regarding US Data).

[72] For details of the calculations, see Annex A.2.

[73] For details of the calculations, see Annex A.3.

farms not holding upland cotton base but producing upland cotton.[74] The following table shows the results of applying the US-proposed allocation methodology to the revised US summary data.[75]

Annex A Table 4.8

| **US Annex IV Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $440,061,035.8 | $437,917,881.4 | - | - |
| 2000 | $432,996,788.7 | $460,939,354.1 | - | - |
| 2001 | $304,243,319.2 | $420,222,029.1 | - | - |
| 2002 | - | - | $383,057,256.1 | $640,389,168.2 |

53. For purposes of comparison, Brazil reproduces the results of its "14/16$^{th}$" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September 2003 Further Submission.

| **Results of Brazil's 14/16$^{th}$ Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

54. Brazil notes that the results from each of the four methodologies applied to the revised US summary data suffer from shortcomings due to the incomplete and non-farm-specific data. Brazil would have to re-calculate all of these numbers if the United States produces the actual data on 3 March 2004. As it stands, the data currently available undercounts the support under each of the methodologies (except the cotton-to-cotton), because no information on soybean market loss assistance payments and peanut direct and counter-cyclical payments to farms producing upland cotton was provided by the United States. Further, due to the manner in which the US data is provided, distortions from the aggregation of farm-specific data possibly over- or under-state the results, as discussed in Section 6 below. Therefore, Brazil remains of the view that in the absence of complete farm-specific aggregated data, the Panel should rely on Brazil's 14/16$^{th}$ methodology.

55. While Brazil does not believe that the Panel should rely on either the two Annex IV-type methodologies, or even the "cotton-to-cotton" methodology, it is noteworthy that all four of the methodologies show that the United States does not enjoy peace clause protection.[76] The table below shows the results of the comparison of US support to upland cotton decided in MY 1992 with US support to upland cotton provided in MY 2002. Under any methodology, the US support to upland cotton in MY 2002 exceeds the support decided in MY 1992 considerably – by at least $464 million.

[74] Calculations based on this data continue to suffer from aggregation problems and the missing information on soybean contract payments and peanut direct and counter-cyclical payments to farms producing upland cotton. (*See* Section 3 of Brazil's 28 January 2004 Comments and Requests Regarding US Data).

[75] For details of the calculations, see Annex A.4.

[76] Only under methodology (4) in MY 2000 is the support provided in that marketing year below the support decided in MY 1992.

Budgetary Outlays For Upland Cotton MY 1992, 2002[77]

| Year | 1992 | 2002 (1) | 2002 (2) | 2002 (3) | 2002 (4) | 2002 (5) |
|---|---|---|---|---|---|---|
| Programme | ----- $ million ----- | | | | | |
| Deficiency Payments | 1017.4 | None | none | none | none | none |
| Direct Payments | none | 466.8 | 450.9 | 432.9 | 383.1 | 454.5 |
| CCP Payments | none | 986.4 | 988.3 | 722.1 | 640.4 | 935.6 |
| Marketing Loan Gains and LDP Payments[78] | 866 | 898 | 898 | 898 | 898 | 898 |
| Step 2 Payment | 207 | 415 | 415 | 415 | 415 | 415 |
| Crop Insurance | 26.6 | 194.1 | 194.1 | 194.1 | 194.1 | 194.1 |
| Cottonseed Payments | none | 50 | 50 | 50 | 50 | 50 |
| **Total** | **2,117.0** | **2,990.3** | **2,996.3** | **2,711.1** | **2,580.6** | **2,947.2** |

(1) Cotton-to-Cotton Methodology
(2) Brazil's Methodology
(3) Modified Annex IV Methodology
(4) US Annex IV Methodology
(5) Brazil's 14/16$^{th}$ Methodology

56. Brazil presents the tabulations for MY 1999-2001 in Annex B. These data show that the United States also exceeds the MY 1992 limits under each of the four methodologies (except for methodology (4) in MY 2000) and under Brazil's 14/16$^{th}$ methodology.[79]

## 6. The US Critique of Brazil's Allocation Methodology Is Baseless

57. Brazil recalls that its methodology allocates support paid for upland cotton base that is "planted to" upland cotton. It further allocates proportionally any other contract crop base payments that are not allocated to plantings of the respective contract payments crop.[80] Brazil's methodology, as well as the "cotton-to-cotton" methodology, generates results that are very close to Brazil's 14/16$^{th}$ methodology. This is not surprising since the 14/16$^{th}$ methodology is based on the assumption of very high percentages of upland cotton "planted on" upland cotton base acreage. All three of these methodologies reflect the economic reality in MY 1999-2002 that each allocated contract dollar received by upland cotton producers over a four-year period was needed to cover the costs of producing upland cotton. The fact that the vast majority of upland cotton was actually planted on upland cotton base is further confirmation of the reasonableness of these three methodologies.

58. Much of the US criticism of Brazil's methodology is tainted by the wrong assumption that contract payments provide "decoupled income support".[81] For example, the United States states, at paragraph 38 of its 11 February 2004 Comments, that "fundamentally, Brazil's approach is in error

[77] The table below reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission as updated by paragraph 8 of Brazil's 22 December 2003 Answers to Questions and paragraphs 12-14 of the US 22 December 2004 Answers to Questions. Step 2 and marketing loan payments have been updated in light of the US answer to Question 196. *See* US 22 December 2004 Answers to Questions, para. 12.

[78] "Other Payments" have been included in the marketing loan figures.

[79] Besides conclusively demonstrating that the US non-green box domestic support measures are not exempt from action by virtue of Article 13(b)(ii) of the Agreement on Agriculture, the table above, as well as the tables in Annex B, indicate the amount of subsidization of upland cotton by contract payments. Thus, should the Panel consider that an allocation methodology is warranted under Part III of the SCM Agreement, the record provides the factual basis for a finding that Brazil has met its burden of proof and established a *prima facie* case of the amount of subsidization.

[80] Brazil's 20 January 2004 Answers to Additional Questions, para. 43-55 and Brazil's 28 January 2004 Comments and Requests Regarding US Data, Section 9.

[81] *See inter alia* US 11 February 2004 Comments, paras. 37. *See* also US 28 January 2004 Comments, paras. 217, 219, 222-223.

because it assumes that there is a tie between the decoupled payments and current production". The United States is correct – Brazil's methodologies do make that assumption, for the very good reason that that assumption reflects the economic cost realities and the cotton-to-cotton planting on the ground, discussed in Section 3 *supra.* Similarly, the United States claims, at paragraph 37 of its comments, that "decoupled payments by their nature provide income support not tied to the production or sale of any given commodity". But this ignores the vast weight of the evidence, which demonstrates the link between upland cotton production and upland cotton base acre payments (and other payments) in MY 1999-2002.

59. The United States raises a number of hypothetical "problems" with Brazil's methodology.[82] But the extent of any such problems, if any, can only be assessed by examining the actual farm-specific data. It is not credible for the United States to refuse to produce key farm-specific data and then speculate about potential problems for individual farms. Upon receipt of the US response to the Panel's request, Brazil looks forward to providing the Panel with such an analysis.

60. A principle complaint of the United States is that Brazil's allocation of *non-upland cotton contract payments* results in differential subsidization rates on different acres planted to upland cotton.[83] Similarly, the United States criticizes Brazil for potentially allocating more than one *non-upland cotton* base acre payments to one planted acre of upland cotton.[84] Both of these alleged problems with the allocation of non-upland cotton contract payments do not exist for MY 2002. This is because Brazil's methodology allocates for each planted acres of upland cotton only one upland cotton base acre payment.[85] In MY 2002, the vast majority of contract payments allocated as support to upland cotton are upland cotton contract payments. In MY 2002, 99.1 per cent of direct payments[86] and 99.8 per cent of the counter-cyclical payments[87] received by upland cotton producers were upland cotton contract payments. This is because the vast majority of upland cotton is grown on farms holding upland cotton base, which in MY 2002 exceeds acreage planted to upland cotton. Farms growing upland cotton but not holding upland cotton base accounted for only 0.9 and 0.2 per cent of total allocated direct and counter-cyclical payments respectively. Since the two main US criticisms affect only the allocation of non-upland cotton contract payments, they affect, at most, 0.9 per cent of the payments at issue for MY 2002.[88]

61. Brazil notes that the "cotton-to-cotton" methodology, discussed in Section 5, does not allocate any non-upland cotton base payments. Therefore, none of the US criticisms, at paragraphs 37-42 of its 11 February 2004 Comments, affects the "cotton-to-cotton" results for MY 1999-2002. Thus, these results reflect the worst case scenario of any alleged over-counting in Brazil's methodology. Comparing the results of both methodologies, reproduced in Section 5 and Annex B demonstrates that even under the "cotton-to-cotton" methodology the Unites States surpasses its peace clause limits. The tables below reproduce the results of both methodologies:

[82] US 11 February 2004 Comments, paras. 37-42.
[83] US 11 February 2004 Comments, para. 37.
[84] US 11 February 2004 Comments, para. 38-42.
[85] The United States has not criticized Brazil's allocation of one payments on one contract payment base acres to one planted acre of cotton and the other contract payment crops. In other word, the United States accepts that the one-to-one allocation between planted and base acres.
[86] *See* Annex A.2, Tables 2.9, 2.21 and 2.21.
[87] *See* Annex A.2, Tables 2.9, 2.20 and 2.21.
[88] The United States has not criticized Brazil's allocation of one payments on one contract payment base acres to one planted acre of cotton and the other contract payment crops. In other word, the United States accepts that the one-to-one allocation between planted and base acres.

**Cotton-to-Cotton Methodology (Table 1.5 of Annex A.1)**

| MY | PFC Payments | MLA Payments[89] | Direct Payments | CCP Payments |
|---|---|---|---|---|
| 1999 | $515,310,673.4 | $512,801,043.5 | - | - |
| 2000 | $482,422,346.0 | $513,554,489.0 | - | - |
| 2001 | $387,916,892.8 | $535,792,287.0 | - | - |
| 2002 | - | - | $446,796,377.9 | $986,357,993.8 |

**Brazil's Methodology (Table 2.21 of Annex A.2)**

| MY | PFC Payments | MLA Payments[90] | Direct Payments | CCP Payments |
|---|---|---|---|---|
| 1999 | $574,488,456.1 | $571,690,622.7 | - | - |
| 2000 | $538,079,545.3 | $572,803,412.3 | - | - |
| 2001 | $428,007,676.4 | $591,165,829.7 | - | - |
| 2002 | - | - | $450,924,339.1 | $988,252,054.4 |

62. As the Panel can readily see, the differences in the results of both methodologies are minor (with $118 million in MY 1999, $114 million in MY 2000, $95.5 million in MY 2001, and $5.7 million in MY 2002).

63. In addressing the specific US criticism affecting MY 1999-2001, Brazil notes that its methodology involves analysing the planting patterns and base acres of individual farms. Each farm is unique. Some farms will have greater base acres than planted acres and *vice versa*. Some farms will plant different crops than they used to establish their base acres, and, as in the case of most upland cotton farms, they will continue to plant upland cotton holding upland cotton base acres. Brazil's methodology accounts for all contract payments as support to contract crops planted on farms holding base. This means that some farms will have "extra" base acres payments that will need to be allocated over fewer planted acres of contract payments crops or *vice versa*. This reflects economic realities for farms that have many different combinations of base and planted acres.

64. The US comments, at paragraph 37 of its 11 February 2004 Comments, raise theoretical "arbitrary" attribution problems relating to "excess cotton acreage" or "excess" base acreage situations for a hypothetical farm. But the purpose of any methodology is not to determine the "subsidization" rate of a particular farm, but rather to assess, in the aggregate, the amount of payments. Of course, different farms will have different crop subsidization rates given the inherently unique base acreage and planting combinations. Therefore, Brazil's methodology, which is based on examining individual farm data, may result, in certain cases, in different crop subsidization rates for different farms. But this is neither remarkable nor illogical, as the United States claims, but rather reflects economic reality.

[89] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

[90] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

65. The United States further complains that Brazil allocates all "excess" contract payments in MY 1999-2000 and almost all "excess" contract payments in MY 2001 to upland cotton.[91] However, the data shows that in those three marketing years, all contract payment crops (except upland cotton) were planted to a degree that fell *short* of the base acreage for these crops. Thus, the simple fact that upland cotton farms during MY 1999-2001 increased their amount of upland cotton plantings at the expense of other contract payment crops suggests that some of the payments for these non-upland cotton base acres were devoted to supporting upland cotton production. This is reflected in Brazil's 28 January 2004 calculations (as well as in its updated calculations in Annex A.2). Brazil's calculations, therefore, reflect the reality of upland cotton production in those marketing years – production on upland cotton farms shifted to upland cotton and away from other contract payment crops. Brazil notes that no such "excess" upland cotton production exists in MY 2002. This appears to be – at the very least in part – a direct consequence of the base update aligning contract payments base with production trends during MY 1998-2001.[92] The re-linkage of production meant that more current upland cotton production takes place on base acreage than during MY 1999-2001.

66. Finally, the United States asserts that the aggregation problems inherent in the US summary data will necessarily *increase* the amount of payments allocated to upland cotton.[93] This criticism is again an ironic assertion by a party that has refused to provide the very data that would answer this criticism. Whether the aggregation problem leads to an upward or downward error in estimating the amount of support to upland cotton is a factual question that cannot be answered in the abstract, as suggested by the United States.[94] Indeed, the effect of the aggregation problem is that upland cotton contract payments on farms that have "excess" upland cotton base are treated as upland cotton payments to farms that have "excess" upland cotton plantings.[95] Whether such a treatment leads to over- or under-counting depends entirely on what the amount of support allocated to the "excess" planted upland cotton acres would be, which can only be derived with using farm-specific data. Only if it is lower then the support for an upland cotton base acre (allocated due to the aggregation effect) would the aggregation problem lead to over-counting. And this is a factual, not a theoretical question. The amount of support allocated to the "excess" acres planted to upland cotton could rank from zero (no contract payments available for allocation on that farm) to an amount that exceeds the upland cotton per-acre payment rate (for instance, rice base or payments for more than one base acre). Again, it bears repeating, that there will be no "aggregation problems" if the United States produces complete farm-specific data on 3 March 2004.

67. In sum, Brazil maintains that, in view of the *de facto* tied nature of the US contract payments at issue, Brazil's methodology is a reasonable means of calculating the support to upland cotton. As for some of the US criticisms that might affect the results (except for MY 2002), Brazil will control for these effects once the United States provides aggregate data in the manner requested by the Panel. Yet, Brazil is of the firm view that none of the US criticisms will meaningfully affect its results.

## 7. The US Critique of Brazil's Application of the Improper Annex IV Methodology is Baseless

68. Brazil has earlier demonstrated, in Section 4 above, the inability of Annex IV of the SCM Agreement to provide useful guidance regarding the calculation of the amount of the contract payments that constitute support to upland cotton. Brazil further demonstrated that the entire premise behind the US attempt to use an Annex IV-like methodology is wrong, since contract payments during MY 1999-2002 were *de facto* tied to the production of upland cotton.

[91] US 11 January 2004 Comments, paras. 40.
[92] Brazil notes that part of the phenomenon also results from reduced upland cotton plantings.
[93] US 11 January 2004 Comments, para. 42.
[94] US 11 January 2004 Comments, para. 42.
[95] *See* Brazil's 28 January 2004 Comments and Requests Regarding US Data, para. 13-15.

69. Nevertheless, as an alternative argument, Brazil attempted in its 28 January 2004 Comments to apply the Annex IV paragraph 2 non-tied subsidy allocation methodology to the US summary data. As a preliminary matter, Brazil notes that the United States has never presented any data in support of its methodology.[96] Instead, the United States has repeatedly argued that it is not its "burden" to establish the amount of contract payments under its own methodology. The United States has gone even further and refused, to date, to provide the data that would permit the calculation of its "across the value of total production on the farm" methodology. As a result, Brazil had to make a number of assumptions to fill the data gaps. The United States has reserved its energy regarding its methodology for a spirited critique of Brazil's attempt to apply the US methodology. Brazil responds to these to these arguments, and the incorrect US calculations, below.

70. First, the United States challenges, in paragraph 51 of its 11 February 2004 Comments, the use of non-upland cotton base acreage payments. This criticism is incorrect, since the Panel must make an objective assessment of the amount of "support to" upland cotton under Article 13(b)(ii), including support provided from non-upland cotton base payments. Therefore, Brazil's inclusion of all contract payments in its calculation was proper. Brazil sets out its arguments in Section 9 *infra*.[97] Consequently, all of the US calculations at paragraphs 59-60 of the US 11 February 2004 Comments are incorrect, because they exclude all non-upland cotton payments.[98]

71. Second, the United States criticizes Brazil for not having included all farm and non-farm income of a farm into its calculations.[99] There is no legitimate basis to include social security and stock market investment income in any payment calculation.[100] Brazil has earlier responded to similar US arguments in cost of production discussions.[101] The focus of Article 13(b)(ii) is on tabulating the amount of *agricultural* domestic support to a specific commodity.

72. Third, the United States claims that Brazil should have included the value of livestock raised by upland cotton farmers. The United States has provided no data to support its own methodology or its implied assertion that livestock production is a major component of upland cotton farms' production. However, the record supports Brazil's decision not to include any livestock value. A USDA 1997 ARMS study on costs of production on cotton farms showed that only between 0-6 per cent (depending on the category and location) of US upland cotton farms specialize in livestock production.[102] Since no significant amount of livestock production is found on upland cotton farms, distortions in Brazil's results, if any, would be very minor.

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[96] As the party asserting this fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[97] *See* also US 11 January 2004 Comments, paras. 46-50.

[98] Otherwise, all figures seem to reflect Brazil's calculations.

[99] US 11 January 2004 Comments, paras. 46, 55 and note 50.

[100] Brazil has addressed the US argument that off-farm income may be responsible for closing the gap between upland cotton market revenue and production costs in paragraph 28 of its 2 December 2003 Oral Statement.

[101] US 18 November 2003 Further Rebuttal Submission, paras. 111, 137. Brazil is further puzzled by the fact that the United States argues for inclusion of off-farm income over which contract payments have to be allocated. In its 18 November 2003 Further Rebuttal Submission, the United States argued that off-farm income (such as social security benefits) could be support to upland cotton (para. 111). It follows that the United States would argue that social security benefits support the production of upland cotton, while contract payments support social security benefits.

[102] Exhibit Bra-16 ("Characteristics and Production Costs of US Cotton Farms", USDA, October 2001, Appendix Tables 1-4 p. 23-26).

73. The United States also raises several issues with respect to Brazil's calculation methodology. The United States correctly points out that Brazil should have used yields on planted acreage, rather than applying yields on harvested acreage to all acreage planted.[103] Brazil has corrected for this in its updated analysis, set out in Annex A.4 – albeit only for its calculation of the value of upland cotton production.[104] Since yield information on planted acreage for other crops is not available to Brazil – assuming that the US allegation is correct and the yield data in Exhibit Bra-420 is, indeed, based on harvested acres – Brazil continues to apply this data with respect to planted acreage for other crops. Any bias caused by this inaccuracy will naturally *overstate* the value of the non-upland cotton crop production on upland cotton farms[105] and, thus, undervalue the amount of contract payments constituting support to upland cotton.[106]

74. The United States also criticizes Brazil's exclusion of fruits and vegetables from the calculation of the value of non-contract payment crop plantings.[107] However, the contract payment programmes themselves exclude fruits and vegetables as possible beneficiaries of that support, by prohibiting the growing of these crops on base acres. There is no legitimate reason to assume that these payments could be support to fruits and vegetables.[108] In any event, Brazil notes that the United States required reporting of fruits, vegetables and wild rice acreage on all farms receiving contract payments from MY 1999-2002 and that the Panel has requested this information.[109] Thus, the extent of any distortions, if any, can only be assessed when the actual data is reviewed.

75. Finally, the United States repeats its flawed arguments that contract payments have to be reduced by about two-thirds to reflect the fact that only upland cotton farms that own their land in fact benefit from contract payments.[110] Brazil refers the Panel to its 28 January 2004 Comments for its arguments on this issue.[111]

76. In sum, none of the US criticisms summarized at paragraphs 57 and 60 of its 11 February 2004 Comments withstand close scrutiny. Brazil's calculations under the US Annex IV methodology, based on the incomplete non-farm-specific data, are not biased.[112] By contrast, all of

[103] US 11 February 2004 Comments, para. 52 note 59.

[104] US 11 February 2004 Comments, para. 52 and accompanying table.

[105] This is because the upland cotton value is correct, whereas all the values of all other crops are overstated, reducing the share of the upland cotton value of total crop production on the farm.

[106] The United States also asserts, at paragraph 53 of its 11 February 2004 Comments, that Brazil should have used state-by-state data in the determination of the value of sales from non-contract payment crops. Brazil is puzzled by this US argument, as it was the United States that withheld the farm-specific data, including data that would have enabled Brazil to use state-by-state figures on non-contract payment crop plantings for the calculation of the value of non-contract payment crop plantings. The US summary data simply does not allow for a proper weighting of any state-by-state values of non-contract payments crop plantings, if such data were indeed available. Similarly, the US reference to farming in Alaska is irrelevant. Any value of production in that state would not meaningful affect aggregates for the United States. In fact, it would be the US burden to produce data that would allow for the application of its proposed methodology. As the party asserting a fact, the United States bears the burden of proving it. *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof.").

[107] US 11 January 2004 Comments, para. 54.

[108] *See* Section 6 above. *See* also Brazil's 28 January 2004 Comments and Requests Regarding US Data, paras. 92. Brazil's 20 January 2004 Answers to Questions, para. 73.

[109] 3 February 2004 Communication from the Panel.

[110] US 11 February 2004 Comments, paras. 56, 60; *See* also US 28 January 2004 Comments, para. 22.

[111] Brazil's 28 January 2004 Comments, paras. 192-214.

[112] For instance, Brazil has used yields on harvested acres for all non-upland cotton planted acres, thereby significantly overstating the value of the non-upland cotton production and understating the amount of support allocated to upland cotton. In fact, Brazil's calculations are conservative.

the calculations presented by the United States in its 11 February 2004 Comments were improperly based on upland cotton contract payments only.[113]

### 8. Brazil Has Established, in the Alternative, the Amount of Contract Payments for Purposes of its SCM Serious Prejudice Claims

77. The United States 11 February 2004 Comments continue the US argument that there is an explicit allocation requirement in Part III of the SCM Agreement "for determining the 'subsidization' of a product set out in Annex IV."[114] The US Comments also argue that "Brazil has expressly disavowed any allocation methodology for purposes of its serious prejudice claims on decoupled income support payments [and has] failed to make a *prima facie* case on these claims."[115] Both assertions are incorrect.

78. Brazil has argued that Part III of the SCM Agreement does not require detailing the precise amount of the subsidies or a subsidization rate.[116] But it has presented evidence and argument, in the alternative, regarding the size and subsidization rate of the subsidies it has challenged.[117] For the four contract payments, the subsidy quantities are those amounts generated for the purposes of the "peace clause" analysis. The amount of a subsidy for purposes of establishing "support to a specific commodity" for purposes of Article 13(b)(ii) is the same amount for Brazil's serious prejudice claims. This conclusion is supported by the fact that the phrase "domestic support" in the Agreement on Agriculture is the same as "subsidy" in the SCM Agreement (assuming the elements of a subsidy for the "support" have been established). Thus, Brazil has offered the contract payment quantities (as well as the other subsidies) established in the peace clause phase of the proceedings as the "amount of subsidization," to the extent this is required, in the serious prejudice phase of the proceedings.

### 9. The United States Improperly Seeks to Limit the Scope of the Non-Green Box Support Measures to be Examined for Determining the Amount of Support for Purposes of the Peace Clause

79. The United States' 11 February 2004 Comments argue that the Panel cannot examine any evidence of payments received by upland cotton producers growing upland cotton on non-upland cotton base acreage, because Brazil's request for the establishment of a panel ("Brazil's panel request") violates DSU Article 6.2.[118] There is no factual or legal merit to these arguments.

80. First, the Panel's obligation is to conduct an objective assessment of the facts and arguments before it. The issue of the *amount* of contract payments is a key issue that is part of the broader question of the *amount* of support to upland cotton under Article 13(b)(ii) of the Agreement on Agriculture. This broader issue is ultimately the key legal question and it is clearly within the Panel's terms of reference. Determining the amount of support requires an objective assessment by the Panel as to the amount of non-green box support to producers and users of upland cotton in MY 1992 and MY 1999-2002. It requires the Panel to include all support to upland cotton from the evidence before it – regardless of whether Brazil's panel request is broad enough to encompass all of the same subsidies for the purpose of its serious prejudice claims. For example, the fact that the Panel has ruled

[113] US 11 February 2004 Comments, paras. 58-59.
[114] US 11 February 2004 Comments, paras. 20.
[115] US 11 February 2004 Comments, paras. 22-24.
[116] *See e.g.*, Brazil's 11 February 2004 Comments on US Answers to Questions Posed by the Panel Following the Second Substantive Meeting of the Panel, paras. 196-197, 216; Brazil's 18 November 2003 Further Rebuttal Submission, paras. 97-107; Brazil's 2 December 2003 Oral Statement, paras 3-5.
[117] *See e.g.*, Brazil's 11 February 2004 Comments on US Answers to Questions Posed by the Panel Following the Second Substantive Meeting of the Panel, para.216; Brazil's 2 December 2003 Oral Statement , para. 5; Brazil's 9 September 2003 Further Submission, Table 1 (setting out the amount and rate of subsidization of each of the four contract payment subsidies based on the 14/16th Methodology).
[118] US 11 February 2004 Data Comments, paras. 47-50.

that certain cottonseed payments are not within its terms of reference for purposes of Brazil's serious prejudice claims does not mean that these same subsidies cannot be counted as "support to upland cotton" for the purposes of the peace clause. The amount of these payments is within the Panel's terms of reference in order to resolve the peace clause issues, because they are "support to" upland cotton. Indeed, identical payments made in MY 1999 have been notified by the United States as "product-specific" upland cotton support.[119]

81. Second, with respect to the new US Article 6.2 assertion, Brazil notes that the US comments acknowledge that Brazil's panel request is broad enough to cover the contract payments received by upland cotton producers.[120] But the United States now claims the request is *too* broad claiming it "provides virtually no information that would allow identification of the specific measure at issue".[121] This argument is both untimely[122] and contradicted by Brazil's request.

82. Brazil's request complied fully with DSU Article 6.2 by identifying the specific measures at issue. Brazil's request (1) identified by name the specific laws providing for contract payments, *i.e.*, the 1996 FAIR Act, the 2002 FSRI Act, and the 1998-2001 appropriation acts for market loss assistance payments, (2) identified by name the specific payments, *i.e.*, PFC, market loss assistance, direct and counter-cyclical payments, which were required to be paid from those laws, (3) identified by name the specific recipients of those payments, *i.e.*, upland cotton producers, and (4) identified the specific time period when those payments were made, *i.e.*, MY 1999-2007. Yet, the United States would read into DSU Article 6.2 a requirement to go to a further level of detail and identify the *sub*-category (*i.e.*, payments on non-upland cotton and on upland cotton base acreage) of the specific measures that were identified (contract payments to upland cotton producers). This would impose an unprecedented and unjustified level of detail in a panel request that is not required by DSU Article 6.2.

83. In sum, it is undisputed that Brazil's panel request covered all types of contract payments to upland cotton producers, not just those based on upland cotton base acreage. Thus all types of contract payment provided to upland cotton producers, as properly allocated, are support to upland cotton that are well-within the Panel's terms of reference.

84. Finally, the United States now claims that its due process rights were somehow violated because Brazil did not present its methodology for allocating contract payments when it filed its first submission on 24 June 2004.[123] This is simply not credible. Brazil did not realize until early November 2003 that the United States had inaccurately denied for almost one year that it did not have specific information that would allow the computation of the amount of contract payments received by upland cotton producers planting upland cotton.[124] Without farm-specific data, there is no basis to develop, let alone apply, Brazil's methodology. Brazil could only develop a methodology to apply to actual data when it received the EWG data in mid-November, and when it then sought farm-specific

[119] *See* Exhibit Bra-47 (G/AG/N/USA/43, p. 20).

[120] US 11 February 2004 Comments, para. 48.

[121] US 11 February 2004 Comments, para. 48.

[122] Brazil notes that the United States did not make this assertion even at the Panel meeting of 2-3 December 2004 even though Brazil's 18 November 2003 Further Rebuttal Submission unequivocally stated that non-upland cotton contract payments were included when calculating the amount of contract support payments. *For example*, in Brazil's 18 November 2003 Further Rebuttal Submission, Brazil stated in paragraph 16 in presenting the EWG data that "the best evidence that would permit the Panel to calculate the most precise amount of support to upland cotton from these contract payments is (sic) amount of upland cotton (*and other*) contract acreage that is planted to upland cotton". The footnote to this statement indicated that "*these payments include all contract payments for upland cotton base acreage and payments for other crop base acreage that are received by US producers of upland cotton*." (emphasis added).

[123] *See* US 16 February 2004 Letter to the Panel.

[124] *See* Brazil's 18 February 2004 Comments on US Answers to Questions, para. 26 (setting out the chronology of Brazil's and the Panel's requests for information).

data from the United States.[125] This methodology then would be applied to *actual* data, and replace Brazil's 14/16th methodology. Thus, it is disingenuous in the extreme for the United States to claim now[126] that Brazil should have presented its methodology on 24 June 2003. Any delay in the United States receiving notice of Brazil's methodology is due directly to the regrettable pattern of US misrepresentations in this dispute beginning in December 2002.[127] In any event, the United States' due process rights have hardly been violated, since they have had more than sufficient opportunity to comment on Brazil's methodology.[128] Unfortunately, Brazil cannot say the same, since it has not been able to apply its methodology because the United States has not produced farm specific data requested by the Panel on several occasions.

### 10. The United States Arguments Concerning Various Issues Related to the Amount of Support "Decided" in MY 1992 Compared to the Amount Supported in MY 1999-2002 are without Merit

85. Brazil briefly responds to several arguments that the US level of support decided in MY 1999-2002 was less than that decided in MY 1992. The United States first argues that because it could not know in MY 1992 what its exact expenditures would be, it is inappropriate to use a budgetary outlay methodology for calculating the amount of support to upland cotton.[129] Brazil will not repeat all of its arguments concerning the meaning of "decided" and "support provided".[130] However, the United States cannot deny that when it passed the implementing Uruguay Round legislation and Congress approved the SAA in late 1994, it was well aware of all, or the vast majority of, the budgetary support for upland cotton provided in MY 1992. Had the United States been concerned about the certainty of its peace clause "protection", it would not have been difficult for Congress, in the 1996 FAIR Act or even the 2002 FSRI Act, to include a "circuit breaker" provision directing the USDA Secretary to stop funding of any upland cotton budgetary outlays in excess of the 1992 levels. Such a provision would have allowed the United States to ensure that it remained protected by the peace clause throughout the implementation period.[131]

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[125] *See* Brazil's 18 November 2003 Further Rebuttal Submission, para 16.

[126] The United States points to questions raised by Brazil in the Annex V procedures – questions the United States refused to answer. US 11 February 2004 Data Comments, para. 69. While Brazil focused some of its questions on upland cotton base acreage, it also focused on total market loss assistance and CCP payments to the US upland cotton industry and US upland cotton farmers in Questions 11.1 and 13.1. Exhibit Bra-49 (Questions for Purpose of Annex V Procedure). Similarly, Brazil's questions 3.6 in the consultations focused on total amount of PFC and DP to "upland cotton" for marketing years 1992-2002, and question 11.1 asked for the "total amount of market loss assistance payments made to US upland cotton industry in marketing years 1998 through 2001". Exhibit Bra-101 (Questions for Purposes of the Consultations). Obviously, Brazil is not precluded from seeking information or arguing that "support to upland cotton" also included payments to upland cotton producers on non-cotton base acreage. No party is required to cast in stone its arguments concerning a never-before interpreted WTO Agreement in responding to hundreds of questions, exhibits, and more than a thousand pages of arguments. Given the 10 months of briefing in this extraordinary panel proceeding – and the US refusal to provide requested information – it is disingenuous for the United States to claim that Brazil is prevented from further elaborating on its methodologies for allocating contract payments.

[127] Given the refusal of the United States for the past sixteen months to produce information regarding contract payments, it is incredible for the United States to argue that Brazil "has provided virtually no information that would allow identification of the specific measures at issue". US 11 February 2004 Comments, para. 48.

[128] *See* US 11 February 2004 Comments, paras 35-43.

[129] US 11 February 2004 Comments, para. 16.

[130] Brazil's 22 August 2003 Rebuttal Submission, paras. 68-87; Brazil's 22 July 2003 Oral Statement, paras. 27-36.

[131] Of course, the United States was not required to enact such a measure, because the "peace clause" does not create an obligation on Members to bring their laws into conformity, since it is in the nature of an affirmative defence.

86. Furthermore, the United States asserts that under any methodology of calculating "support to upland cotton", it provided support in MY 1999-2002 below the level of support decided in MY ^1992.[132] The United States performs this legal magic by (1) making $4.7 billion in contract payments[133], including a billion dollars of CCP upland cotton payments in MY 2002 alone, simply disappear, (2) assuming that $5.5 billion[134] in marketing loan payments were never made by applying a price-gap support methodology it never actually used or notified,[135] and (3) imposing its "statute of limitations" calculation to end MY 2002 payments on 18 March 2002.[136] Brazil has addressed all of these creative attempts to cover-up billions of dollars in support payments and will not repeat them here.

## 11. The United States Comments Regarding the Appellate Body's *Japan – Agricultural Products* Decision Are Misplaced

87. Brazil has studied the US comments regarding *Japan – Agricultural Products*[137] carefully and believes Brazil's initial analysis of the decision largely addresses the points raised in the US comments.[138] The United States continues to incorrectly interpret *Japan – Agricultural Products* by confusing "claims" with "arguments". The United States argues in paragraph 33 of its 11 February 2004 Comments that because Brazil allegedly has not *argued* that Annex IV is the proper methodology, the Panel cannot request information from the United States relevant to the application of that methodology.[139] But *Japan – Agricultural Products* stands for the proposition that a Panel cannot make a "claim" for a party, *i.e., a legal claim* that would be required to be set out in a request for the establishment of a panel. It does not stand for the proposition that a panel is prevented from requesting information from a party that would be relevant to determine the merits of *arguments* made by that same party.

88. Further, the United States' entire premise in relying on *Japan – Agricultural Products* is wrong. In its 28 January 2004 Comments and Requests Regarding US Data, Brazil has made an

[132] US 11 February 2004 Comments, para. 17 and accompanying notes.

[133] This figure is based on Brazil's 14/16th methodology, but all other methodologies performed in Annex A generate very similar amounts of support to upland cotton from the four contract payment programmes.

[134] *See* Brazil's 2 December 2003 Oral Statement, Section 5.2.

[135] *See* US 22 August 2003 Rebuttal Submission, paras. 114-119. *See* Brazil's response in its 27 August 2003 Comments, paras. 10-16 and Brazil's 28 January 2004 Comments, paras. 29-36.

[136] US 11 August 2003 Answer to Questions, para. 69, 133-134; US 22 August 2003 Rebuttal Submission, para. 115 note 145. *See* Brazil's response in its 22 August 2003 Rebuttal Submission, paras. 88-96; 22 August 2003 Comments, para. 33; Brazil's 2 December 2003 Oral Statement, paras. 7-10.

[137] US 11 February 2004 Comments, paras 27-34.

[138] Brazil's 28 January 2004 Comments and Requests Regarding US Data, paras. 99-106.

[139] US 11 February 2004 Comments, para. 33.

"argument," *in the alternative*, regarding a methodology proposed by the United States. The Panel's 3 February 2004 request for information on non-contract acreage crops grown by upland cotton producers was entirely consistent with the United States' suggestion of the US Annex IV methodology and with Brazil's attempt in its 28 January 2004 comments to apply the US Annex IV methodology. The United States responded to Brazil's argument on 11 February 2004. There is no doubt that receipt of the non-contract acreage crops grown on cotton farms would allow a more precise tabulation of the amount of payments using the Annex IV methodology. Thus, the Panel's various requests are fully consistent with the holding by the Appellate Body in *Japan – Agricultural Products* that a "panel is entitled to seek information … to help it understand and evaluate the evidence submitted and the arguments made by the parties."[140]

[140] WT/DS76/AB/R, para. 129.

# Annexes A: Calculations of the "Support To" Upland Cotton Using Various Methodologies

# and

# Annex B: Peace Clause Comparisons

## Annex A

## Calculation of Contract Payment Support to Upland Cotton

1. In this Annex, Brazil sets forth the details of its calculation of contract payments that constitute support to upland cotton, within the meaning of Article 13 of the Agreement on Agriculture. All of Brazil's calculations are based on the revised US summary files produced on 28 January 2004 and other USDA documents provided as exhibits to the Panel. Brazil explains its calculations either in the narrative of this annex or in the footnotes accompanying the tables.

### 1. Upland Cotton Contract Payments Only

2. The calculations in this section are based on the presumption that only upland cotton contract payments would be relevant for calculating support to upland cotton. As Brazil has explained in the main text of these comments, Brazil strongly opposes the US arguments that all non-upland cotton contract payments have to be excluded from the calculation of support to upland cotton. All contract payments, including those made on non-upland cotton base acreage, are properly within the Panel's terms of reference. Further, the Panel needs to include all contract payments, including those made on non-upland cotton base acreage, in its objective evaluation of the applicability of the peace clause exemption. Nevertheless, Brazil provides below the necessary calculations for allocating only upland cotton contract payments as "support to" upland cotton.

3. These calculations are performed in two different manners: First, the total amount of upland cotton contract payments to farms actually producing upland cotton is calculated. Second, the amount of upland cotton contract payments to farms actually producing upland cotton is adjusted pursuant to the amount of upland cotton actually produced by farms holding upland cotton base. Under this approach, only upland cotton payments for upland cotton base acres that are actually planted to upland cotton would be considered support to upland cotton. Since plantings of upland cotton on farms also holding upland cotton base exceed the upland cotton base acreage in MY 1999-2001,[1] the adjustment only affects MY 2002 figures.[2]

4. The first step is performed by multiplying the amount of upland cotton payments units on farms producing upland cotton and holding upland cotton base[3] (as reported by the United States in its 28 January 2004 summary files) by the applicable payment rate for upland cotton in each of the marketing years 1999-2002.

[1] *See* rPFCsum.xls and rDPCsum.xls files provided by the United States on 28 January 2004.

[2] Both approaches exclude any non-upland cotton contract payments received by farms that produce upland cotton and (1) hold upland cotton base, or (2) do not hold upland cotton base (but possible other base).

[3] These farms are called "1" in the rPFCsum.xls file and "Enrolled in Cotton PFC and planted cotton" in the rDCPsum.xls file. Presumably the latter should be called "Enrolled in Cotton DCP and planted cotton."

Table 1.1

| Upland Cotton Contract Payments to Farms Producing Upland Cotton and Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| MY | Programme | Payment Units[4] | Payment Rate[5] (cents per pound) | Subsidy Amount[6] |
| 1999 | PFC Payments | 6,539,475,550.8 | 7.88 | $515,310,673.4 |
| 2000 | PFC Payments | 6,581,478,117.7 | 7.33 | $482,422,346.0 |
| 2001 | PFC Payments | 6,476,075,004.9 | 5.99 | $387,916,892.8 |
| 2002 | Direct Payments | 7,107,791,953.5 | 6.67 | $474,089,723.3 |
| | CCP Payments | 7,622,807,085.5 | 13.73 | $1,046,611,412.8 |

5. The table below summarizes the total amount of upland cotton contract payments received by farms producing upland cotton and holding upland cotton base.

Table 1.2

| Total Upland Cotton Contract Payment Amounts on Farms Producing Upland Cotton and Holding Upland Cotton Base[7] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[8] | Direct Payments | CCP Payments |
| 1999 | $515,310,673.4 | $512,801,043.5 | - | - |
| 2000 | $482,422,346.0 | $513,554,489.0 | - | - |
| 2001 | $387,916,892.8 | $535,792,287.0 | - | - |
| 2002 | - | - | $474,089,723.3 | $1,046,611,412.8 |

6. For purposes of comparison, Brazil reproduces the results of its "14/16$^{th}$" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September Further Submission.

Table 1.3

| Results of Brazil's 14/16$^{th}$ Methodology | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

7. As the Panel can see, the results of this methodology are not considerably different from the results of Brazil's 14/16$^{th}$ methodology.

[4] Payment Units for MY 1999-2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004. Payment Units for MY 2002 are taken from the rDCPsum.xls file provided by the United States on 28 January 2004.

[5] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19).

[6] Subsidy Amount = Payment Units * Payment Rate.

[7] *See* Table 1.1 for the underlying calculations.

[8] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

8. In a second step, Brazil adjusts the above calculated subsidy amount pursuant to the amount of upland cotton actually planted on farms holding upland cotton base. These calculations are possible distorted due to the aggregation problems discussed in Brazil's 20 January 2004 Comments and Requests Regarding US Data.[9] The adjustment factor is calculated as the ratio of upland cotton planted acreage to upland cotton base acreage (capped a 1).

Table 1.4

| **Adjustment Factor to Be Applied to Upland Cotton Contract Payments to Farms Producing Upland Cotton and Holding Upland Cotton Base** | | | | |
|---|---|---|---|---|
| MY | Upland Cotton Planted Acreage[10] | Upland Cotton Base Acreage[11] | Ratio[12] | Adjustment Factor[13] |
| 1999 | 13,540,382.7 | 12,581,724.8 | 1.07619 | 1 |
| 2000 | 14,170,477.5 | 12,625,168.7 | 1.12239 | 1 |
| 2001 | 14,118,952.4 | 12,386,499.4 | 1.02176 | 1 |
| 2002 | 13,022,668.9 | 13,818,215.2 | 0.94243 | 0.94243 |

9. The table below includes the amount of contract payments that would constitute "support to" upland cotton, if only payments for upland cotton base acreage that is actually planted to upland cotton were considered.

Table 1.5

| **Cotton-to-Cotton Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[14] | Direct Payments | CCP Payments |
| 1999 | $515,310,673.4 | $512,801,043.5 | - | - |
| 2000 | $482,422,346.0 | $513,554,489.0 | - | - |
| 2001 | $387,916,892.8 | $535,792,287.0 | - | - |
| 2002 | - | - | $446,796,377.9 | $986,357,993.8 |

10. For purposes of comparison, Brazil reproduces the results of its "14/16$^{th}$" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September Further Submission.

[9] *See inter alia* Brazil's 28 January 2004 Comments and Requests Regarding US Data, paras. 13-15.

[10] Upland Cotton Planted Acreage for MY 1999-2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004. Upland Cotton Planted Acreage for MY 2002 is taken from "Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[11] Upland Cotton Base Acreage for MY 1999-2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004. Upland Cotton Base Acreage for MY 2002 is taken from "Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[12] Ratio = Upland Cotton Planted Acreage / Upland Cotton Base Acreage.

[13] The Adjustment Factor equals the Ratio of Upland Cotton Planted Acreage to Upland Cotton Base Acreage capped at 1. This means all upland cotton contract payments are deemed to be support to upland cotton if more (or equal) upland cotton is planted than there is upland cotton base. If upland cotton plantings are short of upland cotton base, only the respective ratio is considered to be support to upland cotton.

[14] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

Table 1.6

| Results of Brazil's 14/16th Methodology | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

11. The results of this methodology are only marginally below the results of Brazil's 14/16th methodology, although this methodology would assume that upland cotton produced on farms that do not hold upland cotton base would not receive any contract payments at all, and that upland cotton contract payments on farms that produce upland cotton and hold base would only allocated up to the share of contract acreage that is actually planted to upland cotton. The reason for the close similarity between the 14/16th methodology and the cotton-to-cotton methodology results is that the overwhelming majority of upland cotton is planted on upland cotton base (86.34 per cent in MY 1999, 82.05 per cent in MY 2000, 80.10 per cent in MY 2001 and 96.17 per cent in MY 2002).[15]

### 2. Brazil's (Simplified) Allocation Methodology

12. In this section of Annex A, Brazil provides an update of its calculations in Section 9 of its 28 January 2004 Comments and Requests Regarding US Data taking into account the revised summary data produced by the United States on 28 January 2004. Brazil has discussed its methodology in considerable detail in its 20 January 2004 response to Question 258[16] and has applied it in Section 9 of its 28 January 2004 Comments and Requests Regarding US Data. Brazil recalls that its methodology considers as support to a particular crop all crop contract payments for that crop that are made for base acres actually planted to that crop. All remaining support is pooled and allocated as support to contract crops according to their share of total "overplanted" contract crop acreage on a farm.

13. While the revised US summary data provided on 28 January 2004 neither addresses the aggregation problems resulting from the particular manner in which the United States produced its summary data,[17] nor the shortcomings in terms of soybean market loss assistance payments and peanut direct and counter-cyclical payments, the United States provides information on contract base of farms that plant upland cotton, but do not hold upland cotton base. To reflect this additional information, Brazil has updated its earlier calculations.[18]

14. In a first step, Brazil analyses farms that plant upland cotton and hold upland cotton base. By marketing year, the following four tables provide, first, by crop the total amount of contract payments received by farms that produce upland cotton and hold upland cotton base.

[15] Calculated as the share of upland cotton production planted on farms holding upland cotton base (up to the amount of upland cotton base) of total upland cotton plantings. MY 1999-2001 data are taken from category "1" farms and total upland cotton planting from the rPFCsum.xls file provided by the United States on 28 January 2004. Data for MY 2002 is taken from "Enrolled in Cotton PFC and planted cotton" farms and total upland cotton plantings from the rDCPsum.xls file provided by the United States on 28 January 2004.

[16] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[17] No such aggregation problem exists with respect to the summary data as requested by the Panel on 3 February 2004.

[18] Since there are also minor changes to the summary data on farms that plant upland cotton and hold upland cotton base, Brazil has recalculated all of the figures presented in Section 9 of its 28 January 2004 Comments and Requests Regarding US Data following the very same calculation methodology.

Table 2.1

| MY 1999 PFC Payments by Crop for Farms Producing Upland Cotton And Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[19] | Payment Rate[20] (US$ per unit) | Subsidy Amount[21] |
| Upland Cotton | PFC Payments | 6,539,475,550.8 | 0.0788 | $515,310,673.4 |
| Wheat | PFC Payments | 95,664,040.0 | 0.6370 | $60,937,993.5 |
| Oats | PFC Payments | 4,237,510.4 | 0.0300 | $127,125.3 |
| Rice | PFC Payments | 1,737,257,447.2 | 0.0128 | $22,236,895.3 |
| Corn | PFC Payments | 161,779,123.3 | 0.3630 | $58,725,821.8 |
| Sorghum | PFC Payments | 85,161,081.8 | 0.4350 | $37,045,070.6 |
| Barley | PFC Payments | 6,144,577.9 | 0.2710 | $1,665,180.6 |

Table 2.2

| MY 2000 PFC Payments by Crop for Farms Producing Upland Cotton And Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[22] | Payment Rate[23] (US$ per unit) | Subsidy Amount[24] |
| Upland Cotton | PFC Payments | 6,581,478,117.7 | 0.0733 | $482,422,346.0 |
| Wheat | PFC Payments | 97,234,507.3 | 0.5880 | $57,173,890.3 |
| Oats | PFC Payments | 4,307,676.7 | 0.0280 | $120,614.9 |
| Rice | PFC Payments | 1,835,587,326.3 | 0.0118 | $21,659,930.5 |
| Corn | PFC Payments | 160,180,015.1 | 0.3340 | $53,500,125.0 |
| Sorghum | PFC Payments | 85,770,731.7 | 0.4000 | $34,308,292.7 |
| Barley | PFC Payments | 6,408,296.1 | 0.2510 | $1,608,482.3 |

[19] Payment Units for MY 1999 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[20] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[21] Subsidy Amount = Payment Units * Payment Rate.

[22] Payment Units for MY 2000 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[23] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[24] Subsidy Amount = Payment Units * Payment Rate.

Table 2.3

| MY 2001 PFC Payments by Crop for Farms Producing Upland Cotton And Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[25] | Payment Rate[26] (US$ per unit) | Subsidy Amount[27] |
| Upland Cotton | PFC Payments | 6,476,075,004.9 | 0.0599 | $387,916,892.8 |
| Wheat | PFC Payments | 92,731,181.0 | 0.4740 | $43,954,579.8 |
| Oats | PFC Payments | 4,096,334.8 | 0.0220 | $90,119.4 |
| Rice | PFC Payments | 1,963,467,470.7 | 0.0095 | $18,652,941.0 |
| Corn | PFC Payments | 154,693,661.2 | 0.2690 | $41,612,594.9 |
| Sorghum | PFC Payments | 82,952,147.8 | 0.3240 | $26,876,495.9 |
| Barley | PFC Payments | 5,564,922.0 | 0.2060 | $1,146,373.9 |

Table 2.4

| MY 2002 Direct and Counter-Cyclical Payments by Crop for Farms Producing Upland Cotton And Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop[28] | Programme | Payment Units[29] | Payment Rate[30] (US$ per unit) | Subsidy Amount[31] |
| Upland Cotton | DP Payments | 7,107,791,953.5 | 0.0667 | $474,089,723.3 |
| | CCP Payments | 7,622,807,085.5 | 0.1373 | $1,046,611,412.8 |
| Wheat | DP Payments | 68,412,316.3 | 0.5200 | $35,574,404.5 |
| | CCP Payments | 70,209,721.9 | 0.0000 | $0 |
| Oats | DP Payments | 3,202,016.5 | 0.0200 | $64,040.3 |
| | CCP Payments | 3,227,085.9 | 0.0000 | $0 |
| Rice | DP Payments | 1,972,478,301.5 | 0.0107 | $21,105,517.8 |
| | CCP Payments | 2,133,694,144.3 | 0.0075 | $16,002,706.1 |
| Corn | DP Payments | 118,220,781.7 | 0.2800 | $33,101,818.9 |
| | CCP Payments | 132,055,130.0 | 0.0000 | $0 |
| Sorghum | DP Payments | 63,545,759.2 | 0.6300 | $40,033,828.3 |
| | CCP Payments | 64,258,624.9 | 0.0000 | $0 |
| Barley | DP Payments | 4,494,711.7 | 0.2400 | $1,078,730.8 |
| | CCP Payments | 4,663,526.3 | 0.0000 | $0 |
| Soybeans | DP Payments | 32,002,425.3 | 0.4400 | $14,081,067.1 |
| | CCP Payments | 35,163,355.6 | 0.0000 | $0 |

[25] Payment Units for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[26] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[27] Subsidy Amount = Payment Units * Payment Rate.

[28] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[29] Payment Units for MY 2002 are taken from category "Enrolled in Cotton PFC and planed cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[30] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[31] Subsidy Amount = Payment Units * Payment Rate.

15. The next four sets of calculations indicate the amount of base and planted acreage for each crop and the amount of crop contract payments allocated to each crop as well as the amount of contract payments available for allocation to other crops. They finally also indicate the amount of contract payments that constitute support to upland cotton on farms that plant upland cotton and hold upland cotton base.[32]

Table 2.5

| **MY 1999 Farms Producing Upland Cotton And Holding Upland Cotton Base (PFC Payment Allocation)** | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[33] | Planted Acres[34] | Subsidy Allocated[35] | Subsidy Available for Allocation[36] |
| Upland Cotton | 12,581,724.8 | 13,540,382.7 | **$515,310,673.4** | $0.0 |
| Wheat | 3,071,118.0 | 2,363,687.3 | $46,900,953.1 | $14,037,040.4 |
| Oats | 110,232.9 | 72,349.1 | $83,436.1 | $43,689.2 |
| Rice | 466,080.3 | 451,264.0 | $21,530,003.1 | $706,892.2 |
| Corn | 2,214,514.8 | 1,306,755.6 | $34,653,322.9 | $24,072,498.9 |
| Sorghum | 1,809,835.7 | 1,747,475.2 | $35,768,629.3 | $1,276,441.4 |
| Barley | 119,385.9 | 59,080.0 | $824,040.9 | $841,139.7 |

16. Since planted acreage exceeds base acreage only for upland cotton, the entire amount of 1999 PFC payments available for allocation (**$40,977,701.8**) is allocated to upland cotton. Therefore the amount of PFC payments that constitute support to upland cotton on farms planting upland cotton and holding upland cotton base in MY 1999 is **$556,288,375.2**.[37]

[32] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton but do not hold upland cotton base, as discussed below.

[33] Contract Acres for MY 1999 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[34] Planted Acres for MY 1999 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[35] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.1 for the calculation of the total MY 1999 PFC payment by crop).

[36] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[37] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton but do not hold upland cotton base, as discussed below.

Table 2.6

| **MY 2000 Farms Producing Upland Cotton And Holding Upland Cotton Base (PFC Payment Allocation)** | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[38] | Planted Acres[39] | Subsidy Allocated[40] | Subsidy Available for Allocation[41] |
| Upland Cotton | 12,625,168.7 | 14,170,477.5 | **$482,422,346.0** | $0.0 |
| Wheat | 3,127,581.2 | 2,866,488.2 | $52,400,967.8 | $4,772,922.5 |
| Oats | 112,722.9 | 80,100.4 | $85,708.4 | $34,906.5 |
| Rice | 491,929.7 | 350,319.2 | $15,424,743.7 | $6,235,186.8 |
| Corn | 2,201,781.0 | 1,439,083.7 | $34,967,672.9 | $18,532,452.1 |
| Sorghum | 1,833,506.9 | 1,458,672.4 | $27,294,448.5 | $7,013,844.2 |
| Barley | 124,232.0 | 55,138.4 | $713,899.3 | $894,583.0 |

17. Since planted acreage exceeds base acreage only for upland cotton, the entire amount of 2000 PFC payments available for allocation (**$37,483,895.1**) is allocated to upland cotton. Therefore the amount of PFC payments that constitute support to upland cotton on farms planting upland cotton and holding upland cotton base in MY 2000 is **$519,906,241.1**.[42]

[38] Contract Acres for MY 2000 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[39] Planted Acres for MY 2000 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[40] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.2 for the calculation of the total MY 2000 PFC payment by crop).

[41] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[42] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton but do not hold upland cotton base, as discussed below.

Table 2.7

| MY 2001 Farms Producing Upland Cotton And Holding Upland Cotton Base (PFC Payment Allocation I) | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[43] | Planted Acres[44] | Subsidy Allocated[45] | Subsidy Available for Allocation[46] |
| Upland Cotton | 12,386,499.4 | 14,118,952.4 | **$387,916,892.8** | $0.0 |
| Wheat | 2,948,042.9 | 2,235,873.5 | $33,336,312.8 | $10,618,267.0 |
| Oats | 105,068.0 | 155,272.1 | $90,119.4 | $0.0 |
| Rice | 530,490.2 | 437,596.1 | $15,386,625.9 | $3,266,315.1 |
| Corn | 2,149,751.1 | 1,272,872.9 | $24,638,919.5 | $16,973,675.4 |
| Sorghum | 1,785,775.2 | 2,228,624.6 | $26,876,495.9 | $0.0 |
| Barley | 106,907.6 | 53,286.2 | $571,389.8 | $574,984.1 |

18. The total amount of PFC payment that is available for allocation over crops whose planted acreage exceeds their base acreage is allocated as detailed in the following table:

Table 2.8

| MY 2001 Farms Producing Upland Cotton And Holding Upland Cotton Base (PFC Payment Allocation II) | | | | |
|---|---|---|---|---|
| Crop | (Contract Acres[47]) – (Planted Acres[48]) | Share of Total Overplanted Base[49] | Total Subsidy Available for Allocation[50] | Additional Subsidy Allocated[51] |
| Upland Cotton | 1,732,453.0 | 77.85 per cent | $31,433,241.7 | **$24,469,312.4** |
| Oats | 50,204.1 | 2.26 per cent | $31,433,241.7 | $709,086.9 |
| Sorghum | 442,849.4 | 19.89 per cent | $31,433,241.7 | $6,254,842.3 |
| Total | 2,225,506.5 | 100 per cent | $31,433,241.7 | $31,433,241.7 |

19. The amount of PFC payments that constitute support to upland cotton on farms planting upland cotton and holding upland cotton base in MY 2001 is **$412,386,205.2**.[52,53]

[43] Contract Acres for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[44] Planted Acres for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[45] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.3 for the calculation of the total MY 2001 PFC payment by crop).

[46] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[47] Contract Acres for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[48] Planted Acres for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[49] *See* "Total" in the preceding column.

[50] The figures in this column represent the total of the amount of MY 2001 PFC payments available for allocation as calculation in the "Subsidy Available for Allocation" column of Table 2.7.

[51] Additional Subsidy Allocated = Share of Total Overplanted Base * Total Subsidy Available for Allocation.

[52] Calculated as the sum of the two bolded figures in Tables 2.7 and 2.8.

20. Since in MY 2002, the amount of upland cotton acreage (13,022,668.9 acres[54]) on farms that planted upland cotton and held upland cotton base was below the amount of upland cotton base (13,818,215.2[55]), no additional contract payments would be allocated. Instead, the amount of support to upland cotton is calculated by multiplying the amount of upland cotton direct and counter-cyclical payments on these farms by 0.94243.[56] The table below shows the amount of payments allocated as support to upland cotton.

Table 2.9

| **MY 2002 Allocated Upland Cotton Direct and Counter-Cyclical Payments** | | | |
|---|---|---|---|
| | Total Payments[57] | Share To Be Allocated[58] | Payments Allocated[59] |
| Direct Payments | $474,089,723.3 | 94.243 per cent | **$446,796,377.9** |
| CCP Payments | $1,046,611,412.8 | 94.243 per cent | **$986,357,993,8** |

21. In a second step, Brazil analyses farms that plant upland cotton but do not hold upland cotton base. By marketing year, the following four tables provide, first, by crop the total amount of contract payments received by farms that produce upland cotton and hold upland cotton base.

Table 2.10

| **MY 1999 PFC Payments by Crop for Farms Producing Upland Cotton But Not Holding Upland Cotton Base** | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[60] | Payment Rate[61] (US$ per unit) | Subsidy Amount[62] |
| Upland Cotton | PFC Payments | 0 | 0.0788 | $0 |
| Wheat | PFC Payments | 20,027,129.9 | 0.6370 | $12,757,281.7 |
| Oats | PFC Payments | 801,406.4 | 0.0300 | $24,042.2 |
| Rice | PFC Payments | 579,443,200.3 | 0.0128 | $7,416,873.0 |
| Corn | PFC Payments | 34,650,665.6 | 0.3630 | $12,578,191.6 |
| Sorghum | PFC Payments | 12,138,759.1 | 0.4350 | $5,280,360.2 |
| Barley | PFC Payments | 551,544.3 | 0.2710 | $149,468.5 |

[53] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton but do not hold upland cotton base, as discussed below.

[54] Taken from category "Enrolled in Cotton PFC and planted cotton" farms from in rDCPsum.xls provided by the United States on 28 January 2004.

[55] Taken from category "Enrolled in Cotton PFC and planted cotton" farms from in rDCPsum.xls provided by the United States on 28 January 2004.

[56] This figure represents the share that upland cotton planted acreage constitutes of upland cotton base acreage.

[57] *See* Table 2.4 for the calculation of the total upland cotton MY 2002 direct and counter-cyclical payments.

[58] This figure represents the share that upland cotton planted acreage constitutes of upland cotton base acreage – calculated based on data taken from "Enrolled in Cotton PFC and planted cotton" farms column from in rDCPsum.xls provided by the United States on 28 January 2004.

[59] Payments Allocated = Total Payments * Share To Be Allocated.

[60] Payment Units for MY 1999are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[61] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[62] Subsidy Amount = Payment Units * Payment Rate.

Table 2.11

| MY 2000 PFC Payments by Crop for Farms Producing Upland Cotton But Not Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[63] | Payment Rate[64] (US$ per unit) | Subsidy Amount[65] |
| Upland Cotton | PFC Payments | 0 | 0.0733 | $0 |
| Wheat | PFC Payments | 22,244,808.9 | 0.5880 | $13,079,947.6 |
| Oats | PFC Payments | 952,045.1 | 0.0280 | $26,657.3 |
| Rice | PFC Payments | 633,534,085.0 | 0.0118 | $7,475,702.2 |
| Corn | PFC Payments | 36,445,141.6 | 0.3340 | $12,172,677.3 |
| Sorghum | PFC Payments | 12,928,302.9 | 0.4000 | $5,171,321.2 |
| Barley | PFC Payments | 558,190.5 | 0.2510 | $140,105.8 |

Table 2.12

| MY 2001 PFC Payments by Crop for Farms Producing Upland Cotton But Not Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| Crop | Programme | Payment Units[66] | Payment Rate[67] (US$ per unit) | Subsidy Amount[68] |
| Upland Cotton | PFC Payments | 0 | 0.0599 | $0 |
| Wheat | PFC Payments | 22,428,260.7 | 0.4740 | $10,630,995.6 |
| Oats | PFC Payments | 942,768.1 | 0.0220 | $20,740.9 |
| Rice | PFC Payments | 777,335,099.0 | 0.0095 | $7,384,683.4 |
| Corn | PFC Payments | 38,743,300.2 | 0.2690 | $10,421,947.8 |
| Sorghum | PFC Payments | 13,988,512.5 | 0.3240 | $4,532,278.1 |
| Barley | PFC Payments | 583,440.6 | 0.2060 | $120,188.8 |

[63] Payment Units for MY 2000 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[64] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[65] Subsidy Amount = Payment Units * Payment Rate.

[66] Payment Units for MY 2001 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[67] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[68] Subsidy Amount = Payment Units * Payment Rate.

Table 2.13

| **MY 2002 Direct and Counter-Cyclical Payments by Crop for Farms Producing Upland Cotton But Not Holding Upland Cotton Base** | | | | |
|---|---|---|---|---|
| Crop[69] | Programme | Payment Units[70] | Payment Rate[71] (US$ per unit) | Subsidy Amount[72] |
| Upland Cotton | DP Payments | 0 | 0.0667 | $0 |
| | CCP Payments | 0 | 0.1373 | $0 |
| Wheat | DP Payments | 8,301,576.6 | 0.5200 | $4,316,819.8 |
| | CCP Payments | 8,541,723.9 | 0.0000 | $0.0 |
| Oats | DP Payments | 161,464.9 | 0.0200 | $3,229.3 |
| | CCP Payments | 164,737.2 | 0.0000 | $0.0 |
| Rice | DP Payments | 495,586,654.0 | 0.0107 | $5,302,777.2 |
| | CCP Payments | 498,858,849.4 | 0.0075 | $3,741,441.4 |
| Corn | DP Payments | 16,302,167.4 | 0.2800 | $4,564,606.9 |
| | CCP Payments | 18,440,044.0 | 0.0000 | $0.0 |
| Sorghum | DP Payments | 5,944,728.1 | 0.6300 | $3,745,178.7 |
| | CCP Payments | 5,882,846.2 | 0.0000 | $0.0 |
| Barley | DP Payments | 127,254.2 | 0.2400 | $30,541.0 |
| | CCP Payments | 129,400.5 | 0.0000 | $0.0 |
| Soybeans | DP Payments | 1,732,743.1 | 0.4400 | $762,407.0 |
| | CCP Payments | 1,855,963.7 | 0.0000 | $0.0 |

22. The next four sets of calculations indicate the amount of base and planted acreage for each crop and the amount of crop contract payments allocated to each crop as well as the amount of contract payments available for further allocation to other crops. They finally also indicate the amount of contract payments that constitute support to upland cotton on farms that plant upland cotton but do not hold upland cotton base.[73]

[69] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[70] Payment Units for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planed cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[71] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 19). Rice payment units are expressed in US$ per pound rather than in US$ per hundredweight as reported in that exhibit (*i.e.*, divided by 220.46).

[72] Subsidy Amount = Payment Units * Payment Rate.

[73] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

Table 2.14

| **MY 1999 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (PFC Payments)** | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[74] | Planted Acres[75] | Subsidy Allocated[76] | Subsidy Available for Allocation[77] |
| Upland Cotton | 0 | 1,032,580.8 | **$0** | $0 |
| Wheat | 664,033.9 | 377,929.2 | $7,260,697.5 | $5,496,584.2 |
| Oats | 20,442.4 | 12,284.9 | $14,448.2 | $9,594.0 |
| Rice | 133,161.8 | 74,642.6 | $4,157,458.7 | $3,259,414.3 |
| Corn | 495,800.2 | 205,429.0 | $5,211,626.2 | $7,366,565.4 |
| Sorghum | 224,604.4 | 141,533.7 | $3,327,401.1 | $1,952,959.1 |
| Barley | 13,086.9 | 3,021.1 | $34,504.7 | $114,963.8 |

23. Since for none of the non-upland cotton crops planted acreage exceeds base acreage, the entire amount of 1999 PFC payments available for allocation (**$18,200,080.9**[78]) is allocated to upland cotton.[79]

[74] Contract Acres for MY 1999 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[75] Planted Acres for MY 1999 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[76] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.10 for the calculation of the total MY 1999 PFC payment by crop).

[77] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[78] Sum of "Subsidy Available for Allocation" in Table 2.14.

[79] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

Table 2.15

| **MY 2000 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (PFC Payments)** | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[80] | Planted Acres[81] | Subsidy Allocated[82] | Subsidy Available for Allocation[83] |
| Upland Cotton | 0 | 1,217,550.3 | **$0** | $0 |
| Wheat | 749,812.2 | 429,019.3 | $7,483,940.6 | $5,596,007.0 |
| Oats | 25,096.0 | 19,731.5 | $20,959.1 | $5,698.2 |
| Rice | 147,118.7 | 70,088.3 | $3,561,472.9 | $3,914,229.3 |
| Corn | 523,505.2 | 231,096.1 | $5,373,505.8 | $6,799,171.5 |
| Sorghum | 244,894.8 | 162,155.4 | $3,424,154.6 | $1,747,166.6 |
| Barley | 13,533.9 | 2,808.5 | $29,074.2 | $111,031.6 |

24. Since for none of the non-upland cotton crops planted acreage exceeds base acreage, the entire amount of 2000 PFC payments available for allocation (**$18,173,304.2**[84]) is allocated to upland cotton.[85]

[80] Contract Acres for MY 2000 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[81] Planted Acres for MY 2000 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[82] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.11 for the calculation of the total MY 2000 PFC payment by crop).

[83] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[84] Sum of "Subsidy Available for Allocation" in Table 2.15.

[85] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

Table 2.16

| **MY 2001 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (PFC Payments)** | | | | |
|---|---|---|---|---|
| Crop | Contract Acres[86] | Planted Acres[87] | Subsidy Allocated[88] | Subsidy Available for Allocation[89] |
| Upland Cotton | 0 | 1,344,982.1 | **$0** | $0 |
| Wheat | 716,566.2 | 393,648.9 | $5,840,185.8 | $4,790,809.8 |
| Oats | 23,851.4 | 32,464.5 | $28,230.8 | -$7,489.9 |
| Rice | 182,597.4 | 105,932.1 | $4,284,152.0 | $3,100,531.4 |
| Corn | 569,027.1 | 228,127.0 | $4,178,232.8 | $6,243,715.0 |
| Sorghum | 264,349.3 | 182,763.6 | $3,133,488.4 | $1,398,789.7 |
| Barley | 13,343.0 | 2,783.6 | $25,073.6 | $95,115.2 |

25. Since for none of the non-upland cotton crops planted acreage exceeds base acreage, the entire amount of 2001 PFC payments available for allocation (**$15,621,471.2**[90]) is allocated to upland cotton.[91]

[86] Contract Acres for MY 2001 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[87] Planted Acres for MY 2001 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[88] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.13 for the calculation of the total MY 2001 PFC payment by crop).

[89] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[90] Sum of "Subsidy Available for Allocation" in Table 2.16.

[91] Additional PFC payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

Table 2.17

| **MY 2002 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (Direct Payments)** | | | | |
|---|---|---|---|---|
| Crop[92] | Contract Acres[93] | Planted Acres[94] | Subsidy Allocated[95] | Subsidy Available for Allocation[96] |
| Upland Cotton | 0 | 518,837.0 | **$0** | $0 |
| Wheat | 243,967.7 | 231,183.7 | $4,090,616.8 | $226,203.0 |
| Oats | 4,049.8 | 11,842.4 | $3,229.3 | $0.0 |
| Rice | 111,611.5 | 49,723.9 | $2,362,433.6 | $2,940,343.6 |
| Corn | 197,312.6 | 145,345.6 | $3,362,408.3 | $1,202,198.6 |
| Sorghum | 108,062.4 | 104,094.2 | $3,607,650.6 | $137,528.1 |
| Barley | 3,368.5 | 1,697.3 | $15,388.8 | $15,152.2 |
| Soybeans | 98,409.5 | 140,070.8 | $762,407.0 | $0.0 |

26. The total amount of MY 2002 direct payments that is available for allocation over crops whose planted acreage exceeds their base acreage is allocated as detailed in the following table:

Table 2.18

| **MY 2002 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (Direct Payments)** | | | | |
|---|---|---|---|---|
| Crop | (Contract Acres[97]) – (Planted Acres[98]) | Share of Total Overplanted Base[99] | Total Subsidy Available for Allocation[100] | Additional Subsidy Allocated[101] |
| Upland Cotton | 518,837.0 | 91.298 per cent | $4,521,425.4 | **$4,127,961.2** |
| Oats | 7,792.60 | 1.371 per cent | $4,521,425.4 | $61,999.3 |
| Soybeans | 41,661.30 | 7,331 per cent | $4,521,425.4 | $331,464.9 |
| Total | 568,290.90 | 100 per cent | $4,521,425.4 | $4,521,425.4 |

[92] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[93] Planted Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[94] Contract Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[95] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.14 for the calculation of the total MY 2002 direct payment by crop).

[96] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

[97] Contract Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[98] Planted Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[99] *See* Total in the preceding column

[100] The figures in this column represent the total of the amount of MY 2002 direct payments available for allocation as calculated in the "Subsidy Available for Allocation" column in Table 2.17.

[101] Additional Subsidy Allocated = Share of Total Overplanted Base * Total Subsidy Available for Allocation.

27. The total amount of 2002 direct payments that constitute support to upland cotton on farms that produce upland cotton but do not hold upland cotton base is therefore **$4,127,961.2**.[102]

Table 2.19

| **MY 2002 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (CCP Payments)** | | | | |
|---|---|---|---|---|
| Crop[103] | Contract Acres[104] | Planted Acres[105] | Subsidy Allocated[106] | Subsidy Available for Allocation[107] |
| Upland Cotton | 0 | 518,837.0 | **$0** | $0 |
| Wheat | 243,967.7 | 231,183.7 | $0 | $0 |
| Oats | 4,049.8 | 11,842.4 | $0 | $0 |
| Rice | 111,611.5 | 49,723.9 | $1,666,844.9 | $2,074,596.5 |
| Corn | 197,312.6 | 145,345.6 | $0 | $0 |
| Sorghum | 108,062.4 | 104,094.2 | $0 | $0 |
| Barley | 3,368.5 | 1,697.3 | $0 | $0 |
| Soybeans | 98,409.5 | 140,070.8 | $0 | $0 |

28. The total amount of MY 2002 counter-cyclical payments that is available for allocation over crops whose planted acreage exceeds their base acreage is allocated as detailed in the following table:

[102] Additional direct payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

[103] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[104] Contract Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" from the rDCPsum.xls file provided by the United States on 28 January 2004.

[105] Planted Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" from the rDCPsum.xls file provided by the United States on 28 January 2004.

[106] The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage. (*see* Table 2.14 for the calculation of the total MY 2002 counter-cyclical payment by crop).

[107] The amount of subsidy available for allocation to other contract payment crops is the residuum of crop contract payments that has not been allocated to the respective crop because planted acreage was below base acreage.

Table 2.20

| MY 2002 Farms Producing Upland Cotton But Not Holding Upland Cotton Base (CCP Payments) | | | | |
|---|---|---|---|---|
| Crop | (Contract Acres[108]) – (Planted Acres[109]) | Share of Total Overplanted Base[110] | Total Subsidy Available for Allocation[111] | Additional Subsidy Allocated[112] |
| Upland Cotton | 518,837.0 | 91.298 per cent | $2,074,596.5 | **$1,894,060.6** |
| Oats | 7,792.60 | 1.371 per cent | $2,074,596.5 | $28,447.6 |
| Soybeans | 41,661.30 | 7,331 per cent | $2,074,596.5 | $152,088.3 |
| Total | 568,290.90 | 100 per cent | $2,074,596.5 | $2,074,596.5 |

29. The amount of 2002 counter-cyclical payments that constitute support to upland cotton on farms that produce upland cotton but do not hold upland cotton base is therefore **$1,894,060.6**.[113]

30. In a third step, Brazil presents the total amount of contract payments received by farms that produce upland cotton that constitute support to upland cotton, whether or not these farms actually hold upland cotton base.[114]

Table 2.21

| Total Contract Payment Support to Upland Cotton on Farms Producing Upland Cotton and Holding Upland Cotton Base | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[115] | Direct Payments | CCP Payments |
| 1999 | $574,488,456.1 | $571,690,622.7 | - | - |
| 2000 | $538,079,545.3 | $572,803,412.3 | - | - |
| 2001 | $428,007,676.4 | $591,165,829.7 | - | - |
| 2002 | - | - | $450,924,339.1 | $988,252,054.4 |

[108] Contract Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[109] Planted Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[110] *See* Total in the preceding column

[111] The figures in this column represent the total of the amount of MY 2002 direct payments available for allocation as calculated in the "Subsidy Available for Allocation" column in Table 2.17.

[112] Additional Subsidy Allocated = Share of Total Overplanted Base * Total Subsidy Available for Allocation.

[113] Additional counter-cyclical payments will be allocated as support to upland cotton on farms that produce upland cotton and hold upland cotton base, as discussed above.

[114] These figures have been calculated as the sum of the contract payments allocated as support to upland cotton on farms that either hold or do not hold upland cotton base and produce upland cotton.

[115] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

31. For purposes of comparison, Brazil reproduces the results of its "14/16th" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September Further Submission.

Table 2.22

| **Results of Brazil's 14/16th Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

32. As the Panel can readily see, both methodologies produce quite similar results.

### 3. Annex IV-Type Methodology Over Contract Crop Values Only

33. The calculations in this section apply an Annex IV-type allocation methodology to all contract payments received by farms that produce upland cotton, whether or not those farms hold upland cotton base. The approach is the same as in Section 10 of Brazil's 28 January Comments and Requests Regarding US Data. – with the sole exception that the allocation is performed only over the value of programme crops produced on the farm, rather than over the entire value of the upland cotton farms (crop) production.[116]

34. As a first step, Brazil tabulates the total amount of contract payments received by farms that produce upland cotton, as calculated in Section 2 above. The following four tables show the results of this calculation indicating the amount of contract payments by contract payment crop.

Table 3.1

| **Total Amount of MY 1999 PFC Payments** | | | |
|---|---|---|---|
| Crop | Farms Holding Upland Cotton Base[117] | Farms Not Holding Upland Cotton Base[118] | Total PFC Payment[119] |
| Upland Cotton | $515,310,673.4 | $0.0 | $515,310,673.4 |
| Wheat | $60,937,993.5 | $12,757,281.7 | $73,695,275.2 |
| Oats | $127,125.3 | $24,042.2 | $151,167.5 |
| Rice | $22,236,895.3 | $7,416,873.0 | $29,653,768.3 |
| Corn | $58,725,821.8 | $12,578,191.6 | $71,304,013.4 |
| Sorghum | $37,045,070.6 | $5,280,360.2 | $42,325,430.8 |
| Barley | $1,665,180.6 | $149,468.5 | $1,814,649.1 |
| **Total** | $696,048,760.5 | $38,206,217.2 | **$734,254,977.7** |

[116] This calculation based on the revised 28 January 2004 US data is replicated in Section 4 below.
[117] *See* Table 2.1 for the calculations resulting in these subsidy figures.
[118] *See* Table 2.10 for the calculations resulting in these subsidy figures.
[119] Sum of the two preceding columns

Table 3.2

| **Total Amount of MY 2000 PFC Payments** | | | |
|---|---|---|---|
| Crop | Farms Holding Upland Cotton Base[120] | Farms Not Holding Upland Cotton Base[121] | Total PFC Payment[122] |
| Upland Cotton | $482,422,346.0 | $0.0 | $482,422,346.0 |
| Wheat | $57,173,890.3 | $13,079,947.6 | $70,253,837.9 |
| Oats | $120,614.9 | $26,657.3 | $147,272.2 |
| Rice | $21,659,930.5 | $7,475,702.2 | $29,135,632.7 |
| Corn | $53,500,125.0 | $12,172,677.3 | $65,672,802.3 |
| Sorghum | $34,308,292.7 | $5,171,321.2 | $39,479,613.9 |
| Barley | $1,608,482.3 | $140,105.8 | $1,748,588.1 |
| **Total** | $650,793,681.7 | $38,066,411.4 | **$688,860,093.1** |

Table 3.3

| **Total Amount of MY 2001 PFC Payments** | | | |
|---|---|---|---|
| Crop | Farms Holding Upland Cotton Base[123] | Farms Not Holding Upland Cotton Base[124] | Total PFC Payment[125] |
| Upland Cotton | $387,916,892.8 | $0.0 | $387,916,892.8 |
| Wheat | $43,954,579.8 | $10,630,995.6 | $54,585,575.4 |
| Oats | $90,119.4 | $20,740.9 | $110,860.3 |
| Rice | $18,652,941.0 | $7,384,683.4 | $26,037,624.4 |
| Corn | $41,612,594.9 | $10,421,947.8 | $52,034,542.7 |
| Sorghum | $26,876,495.9 | $4,532,278.1 | $31,408,774.0 |
| Barley | $1,146,373.9 | $120,188.8 | $1,266,562.7 |
| **Total** | $520,249,997.7 | $33,110,834.6 | **$553,360,832.3** |

[120] *See* Table 2.2 for the calculations resulting in these subsidy figures.
[121] *See* Table 2.11 for the calculations resulting in these subsidy figures.
[122] Sum of the two preceding columns
[123] *See* Table 2.3 for the calculations resulting in these subsidy figures.
[124] *See* Table 2.12 for the calculations resulting in these subsidy figures.
[125] Sum of the two preceding columns

Table 3.4

| Total Amount of MY 2002 Direct and Counter-Cyclical Payments | | | | |
|---|---|---|---|---|
| Crop[126] | Programme | Farms Holding Upland Cotton Base[127] | Farms Not Holding Upland Cotton Base[128] | Total DP and CCP Payments[129] |
| Upland Cotton | DP Payments | $474,089,723.3 | $0.0 | $474,089,723.3 |
| | CCP Payments | $1,046,611,412.8 | $0.0 | $1,046,611,412.8 |
| Wheat | DP Payments | $35,574,404.5 | $4,316,819.8 | $39,891,224.3 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| Oats | DP Payments | $64,040.3 | $3,229.3 | $67,269.6 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| Rice | DP Payments | $21,105,517.8 | $5,302,777.2 | $26,408,295.0 |
| | CCP Payments | $16,002,706.1 | $3,741,441.4 | $19,744,147.5 |
| Corn | DP Payments | $33,101,818.9 | $4,564,606.9 | $37,666,425.8 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| Sorghum | DP Payments | $40,033,828.3 | $3,745,178.7 | $43,779,007.0 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| Barley | DP Payments | $1,078,730.8 | $30,541.0 | $1,109,271.8 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| Soybeans | DP Payments | $14,081,067.1 | $762,407.0 | $14,843,474.1 |
| | CCP Payments | $0.0 | $0.0 | $0.0 |
| **Total** | DP Payments | $619,129,131.0 | $18,725,559.9 | **$637,854,690.9** |
| | CCP Payments | $1,062,614,118.9 | $3,741,441.4 | **$1,066,355,560.3** |

35. In a second step the value of all contract payment crops produced on farms that also produce upland cotton is determined. Therefore, the total amount of acreage planted to each of the contract payment crops is multiplied by the average yield and the average farm price for the crop. This is shown in the following four tables.

[126] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[127] *See* Table 2.4 for the calculations resulting in these subsidy figures.

[128] *See* Table 2.13 for the calculations resulting in these subsidy figures.

[129] Sum of the two preceding columns

Table 3.5

| MY 1999 Value of Programme Crop Production on Upland Cotton Farms | | | | | |
|---|---|---|---|---|---|
| Crop | Crop Plantings on Farms Holding Upland Cotton Base[130] | Crop Plantings on Farms Not Holding Upland Cotton Base[131] | Average Yield[132] | Farm Price per unit[133] | Total Value[134] |
| Upland Cotton | 13,540,382.7 | 1,032,580.8 | 536.095 | $0.45 | $3,515,621,790.4 |
| Wheat | 2,363,687.3 | 377,929.2 | 42.7 | $2.48 | $290,326,220.9 |
| Oats | 72,349.1 | 12,284.9 | 59.6 | $1.12 | $5,649,488.8 |
| Rice | 451,264.0 | 74,642.6 | 5,866 | $0.027 | $82,912,712.7 |
| Corn | 1,306,755.6 | 205,429.0 | 133.8 | $1.82 | $368,241,145.1 |
| Sorghum | 1,747,475.2 | 141,533.7 | 69.7 | $1.57 | $206,712,354.9 |
| Barley | 59,080.0 | 3,021.1 | 59.2 | $2.13 | $7,830,700.3 |
| **Total** | 19,540,993.90 | 1,847,421.30 | - | - | $4,477,294,413.0 |

[130] Planted Acres for MY 1999 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[131] Planted Acres for MY 1999 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[132] Upland cotton yields per planted acre (adjusted for abandonment) are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4). All other yields are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17). If these yields should constitute yields on harvested acres (the USDA document relied on by Brazil does not provide this information), then the use of these figures would bias the results leading to lower allocations for upland cotton. No other yield figures are available to Brazil.

[133] Average farm prices are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17).

[134] Total Value = (Crop Plantings on Farms Holding Upland Cotton Base + Crop Plantings on Farms Not Holding Upland Cotton Base) * Average Yield * Farm Price per Unit.

Table 3.6

| MY 2000 Value of Programme Crop Production on Upland Cotton Farms | | | | | |
|---|---|---|---|---|---|
| Crop | Crop Plantings on Farms Holding Upland Cotton Base[135] | Crop Plantings on Farms Not Holding Upland Cotton Base[136] | Average Yield[137] | Farm Price per unit[138] | Total Value[139] |
| Upland Cotton | 14,170,477.5 | 1,217,550.3 | 525.84 | $0.498 | $4,029,636,988.1 |
| Wheat | 2,866,488.2 | 429,019.3 | 42.0 | $2.62 | $362,637,645.3 |
| Oats | 80,100.4 | 19,731.5 | 64.2 | $1.10 | $7,050,128.8 |
| Rice | 350,319.2 | 70,088.3 | 6,281 | $0.025 | $67,139,462.6 |
| Corn | 1,439,083.7 | 231,096.1 | 136.9 | $1.85 | $422,998,087.0 |
| Sorghum | 1,458,672.4 | 162,155.4 | 60.9 | $1.89 | $186,558,900.6 |
| Barley | 55,138.4 | 2,808.5 | 61.1 | $2.11 | $7,470,572.3 |
| **Total** | 20,420,279.80 | 2,132,449.40 | - | - | $5,083,491,784.8 |

[135] Planted Acres for MY 200 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[136] Planted Acres for MY 2000 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[137] Upland cotton yields per planted acre (adjusted for abandonment) are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4). All other yields are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17). If these yields should constitute yields on harvested acres (the USDA document relied on by Brazil does not provide this information), then the use of these figures would bias the results leading to lower allocations for upland cotton. No other yield figures are available to Brazil.

[138] Average farm prices are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17).

[139] Total Value = (Crop Plantings on Farms Holding Upland Cotton Base + Crop Plantings on Farms Not Holding Upland Cotton Base) * Average Yield * Farm Price per Unit.

Table 3.7

| MY 2001 Value of Programme Crop Production on Upland Cotton Farms | | | | | |
|---|---|---|---|---|---|
| Crop | Crop Plantings on Farms Holding Upland Cotton Base[140] | Crop Plantings on Farms Not Holding Upland Cotton Base[141] | Average Yield[142] | Farm Price per unit[143] | Total Value[144] |
| Upland Cotton | 14,118,952.4 | 1,344,982.1 | 607.25 | $0.298 | $2,798,361,319.1 |
| Wheat | 2,235,873.5 | 393,648.9 | 40.2 | $2.78 | $293,864,905.3 |
| Oats | 155,272.1 | 32,464.5 | 61.4 | $1.59 | $18,327,973.3 |
| Rice | 437,596.1 | 105,932.1 | 6,496 | $0.019 | $68,010,000.7 |
| Corn | 1,272,872.9 | 228,127.0 | 138.2 | $1.97 | $408,653,226.8 |
| Sorghum | 2,228,624.6 | 182,763.6 | 59.9 | $1.94 | $280,217,777.2 |
| Barley | 53,286.2 | 2,783.6 | 58.2 | $2.22 | $7,244,442.4 |
| **Total** | 20,502,477.80 | 2,290,701.80 | - | - | $3,874,679,644.8 |

[140] Planted Acres for MY 2001 are taken from category "1" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[141] Planted Acres for MY 2001 are taken from category "3" farms from the rPFCsum.xls file provided by the United States on 28 January 2004.

[142] Upland cotton yields per planted acre (adjusted for abandonment) are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4). All other yields are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17). If these yields should constitute yields on harvested acres (the USDA document relied on by Brazil does not provide this information), then the use of these figures would bias the results leading to lower allocations for upland cotton. No other yield figures are available to Brazil.

[143] Average farm prices are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17).

[144] Total Value = (Crop Plantings on Farms Holding Upland Cotton Base + Crop Plantings on Farms Not Holding Upland Cotton Base) * Average Yield * Farm Price per Unit.

Table 3.8

| MY 2002 Value of Programme Crop Production on Upland Cotton Farms | | | | | |
|---|---|---|---|---|---|
| Crop[145] | Crop Plantings on Farms Holding Upland Cotton Base[146] | Crop Plantings on Farms Not Holding Upland Cotton Base[147] | Average Yield[148] | Farm Price per unit[149] | Total Value[150] |
| Upland Cotton | 13,022,668.9 | 518,837.0 | 566.676 | $0.445 | $3,414,772,646.8 |
| Wheat | 2,685,236.6 | 231,183.7 | 35.3 | $3.56 | $366,500,706.3 |
| Oats | 145,601.7 | 11,842.4 | 56.7 | $1.81 | $16,158,015.7 |
| Rice | 373,548.5 | 49,723.9 | 6,578 | $0.019 | $53,252,747.8 |
| Corn | 1,641,968.8 | 145,345.6 | 130.0 | $2.32 | $539,054,023.0 |
| Sorghum | 1,621,276.2 | 104,094.2 | 50.7 | $2.32 | $202,944,967.9 |
| Barley | 49,167.3 | 1,697.3 | 54.9 | $2.72 | $7,595,509.0 |
| Soybeans | 1,966,061.6 | 140,070.8 | 38.0 | $5.53 | $442,582,662.5 |
| **Total** | 21,505,529.60 | 1,202,794.90 | - | - | $5,042,861,279.0 |

36. The following table shows the share that the upland cotton value represents of the total value of contract payments crops produced on farms that also produce upland cotton.

Table 3.9

| Percentage of Upland Cotton Value of Total Programme Crop Value[151] | | | |
|---|---|---|---|
| MY 1999 | MY 2000 | MY 2001 | MY 2002 |
| 78.521 per cent | 79.269 per cent | 72.222 per cent | 67.715 per cent |

37. Finally, Brazil applies these percentages (the share of upland cotton value of total contract payment crop value) to the total amount of contract payments, as calculated in the first step. The resulting figures represent the total amount of contract payments that constitute support to upland cotton under this methodology. The following table shows the amount of support to upland cotton if an Annex IV-type methodology is applied to allocate the value of contract payments over the total value of contract crops produced on farms that also produce upland cotton.

[145] Brazil has not calculated the amounts of payments for other minor oilseeds, as the figures were so small and payment rates were not available to Brazil. Any distortion resulting from this omission would only reduce the amount of contract payments that are considered support to upland cotton.

[146] Planted Acres for MY 2002 are taken from category "Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[147] Planted Acres for MY 2002 are taken from category "Not Enrolled in Cotton PFC and planted cotton" farms from the rDCPsum.xls file provided by the United States on 28 January 2004.

[148] Upland cotton yields per planted acre (adjusted for abandonment) are taken from Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 4). All other yields are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17). If these yields should constitute yields on harvested acres (the USDA document relied on by Brazil does not provide this information), then the use of these figures would bias the results leading to lower allocations for upland cotton. No other yield figures are available to Brazil.

[149] Average farm prices are taken from Exhibit Bra-420 (Agricultural Outlook Tables, November 2003, Table 17).

[150] Total Value = (Crop Plantings on Farms Holding Upland Cotton Base + Crop Plantings on Farms Not Holding Upland Cotton Base) * Average Yield * Farm Price per Unit.

[151] These figures have been calculated as "Total Value" of upland cotton divided by "Total Value" of all crops reported in Tables 3.5-3.8.

Table 3.10

| Total Contract Payments Allocated as Support to Upland Cotton[152] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[153] | Direct Payments | CCP Payments |
| 1999 | $576,544,351.0 | $573,736,505.1 | - | - |
| 2000 | $546,052,507.2 | $581,290,893.0 | - | - |
| 2001 | $399,648,260.3 | $551,995,696.4 | - | - |
| 2002 | - | - | $431,923,303.9 | $722,082,667.7 |

38. For purposes of comparison, Brazil reproduces the results of its "14/16$^{th}$" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September Further Submission.

able 3.11

| Results of Brazil's 14/16$^{th}$ Methodology | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

### 4. US-Proposed Annex IV Methodology

39. In this section, Brazil provides updated calculations for allocating contract payments over the entire sales of crops produced on farms producing upland cotton.[154] In Section 3 of this annex, Brazil calculated the total amounts of contract payments received by farms producing upland cotton (Tables 3.1-3.4). Brazil also calculated the value of the contract programme crop production on farms producing upland cotton (Tables 3.5-3.8). To avoid repetition, Brazil refers to Panel to these calculations.

40. While the revised US summary data provided on 28 January 2004 neither addresses the aggregation problems resulting from the particular manner in which the United States produced its summary data,[155] nor the shortcomings in terms of soybean market loss assistance payments and peanut direct and counter-cyclical payments, the United States provides information on contract base of farms that plant upland cotton, but do not hold upland cotton base. To reflect this additional information, Brazil has updated its earlier calculations.[156]

[152] These figures have been calculated by multiplying the percentage amount in Table 3.9 by the total amount of PFC, direct and counter-cyclical payments in Tables 3.1-3.4.

[153] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

[154] Brazil's original calculations are contained in Section 10 of its 28 January 2004 Comments and Requests Regarding US Data.

[155] No such aggregation problem exists with respect to the summary data as requested by the Panel on 3 February 2004.

[156] Since there are also minor changes to the summary data on farms that plant upland cotton and hold upland cotton base, Brazil has recalculated all of the figures presented in Section 10 of its 28 January 2004 Comments and Requests Regarding US Data following the very same calculation methodology.

41. Allocating the total amount of contract payments over the entire sales of crops produced on farms that also produce upland cotton requires determining the value of the non-programme crop production on these farms. In a first step, Brazil calculates the amount of acreage planted to non-programme crops on farms that produce upland cotton.

Table 4.1

| **MY 1999 Non-Contract Payment Crop Acres on Upland Cotton Farms** | |
|---|---|
| Total Acreage on Farms Holding Upland Cotton Base[157] | 27,912,407.1 acres |
| Total Acreage on Farms Not Holding Upland Cotton Base[158] | 2,716,150.3 acres |
| **Total Acreage on Upland Cotton Farms[159]** | 30,628,557.4 acres |
| Total Contract Crop Acreage on Farms Holding Upland Cotton Base[160] | 19,540,993.9 acres |
| Total Contract Acreage on Farms Not Holding Upland Cotton Base[161] | 1,847,421.3 acres |
| **Total Contract Crop Acreage on Upland Cotton Farms[162]** | 21,388,415.2 acres |
| **Total Non-Contract Crop Acreage on Upland Cotton Farms[163]** | **9,240,142.2 acres** |

[157] Data taken from category "1" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.

[158] Data taken from category "3" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.

[159] Sum of the two above figures.

[160] Sum of figures reported in Table 2.5.

[161] Sum of figures reported in Table 2.14.

[162] Sum of the two above figures.

[163] Difference between "Total Acreage on Upland Cotton Farms" and "Total Contract Crop Acreage on Upland Cotton Farms."

Table 4.2

| **MY 2000 Non-Contract Payment Crop Acres on Upland Cotton Farms** | |
|---|---|
| Total Acreage on Farms Holding Upland Cotton Base[164] | 28,104,322.2 acres |
| Total Acreage on Farms Not Holding Upland Cotton Base[165] | 2,986,458.7 acres |
| **Total Acreage on Upland Cotton Farms[166]** | 31,090,780.9 acres |
| Total Contract Crop Acreage on Farms Holding Upland Cotton Base[167] | 20,420,279.8 acres |
| Total Contract Acreage on Farms Not Holding Upland Cotton Base[168] | 2,132,449.4 acres |
| **Total Contract Crop Acreage on Upland Cotton Farms[169]** | 22,552,729.2 acres |
| **Total Non-Contract Crop Acreage on Upland Cotton Farms[170]** | **8,538,051.7 acres** |

Table 4.3

| **MY 2001 Non-Contract Payment Crop Acres on Upland Cotton Farms** | |
|---|---|
| Total Acreage on Farms Holding Upland Cotton Base[171] | 27,412,998.5 acres |
| Total Acreage on Farms Not Holding Upland Cotton Base[172] | 3,222,775.5 acres |
| **Total Acreage on Upland Cotton Farms[173]** | 30,635,774.0 acres |
| Total Contract Crop Acreage on Farms Holding Upland Cotton Base[174] | 20,502,477.8 acres |
| Total Contract Acreage on Farms Not Holding Upland Cotton Base[175] | 2,290,701.8 acres |
| **Total Contract Crop Acreage on Upland Cotton Farms[176]** | 22,793,179.6 acres |
| **Total Non-Contract Crop Acreage on Upland Cotton Farms[177]** | **7,842,594.4 acres** |

[164] Data taken from category "1" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.
[165] Data taken from category "3" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.
[166] Sum of the two above figures.
[167] Sum of figures reported in Table 2.6.
[168] Sum of figures reported in Table 2.15.
[169] Sum of the two above figures.
[170] Difference between "Total Acreage on Upland Cotton Farms" and "Total Contract Crop Acreage on Upland Cotton Farms."
[171] Data taken from category "1" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.
[172] Data taken from category "3" farms column in rPFCsum.xls file provided by the United States on 28 January 2004.
[173] Sum of the two above figures.
[174] Sum of figures reported in Table 2.7.
[175] Sum of figures reported in Table 2.16.
[176] Sum of the two above figures.
[177] Difference between "Total Acreage on Upland Cotton Farms" and "Total Contract Crop Acreage on Upland Cotton Farms."

Table 4.4

| **MY 2002 Non-Contract Payment Crop Acres on Upland Cotton Farms** | |
|---|---|
| Total Acreage on Farms Holding Upland Cotton Base[178] | 26,576,970.2 acres |
| Total Acreage on Farms Not Holding Upland Cotton Base[179] | 1,564,115.0 acres |
| **Total Acreage on Upland Cotton Farms[180]** | 28,141,085.2 acres |
| Total Contract Crop Acreage on Farms Holding Upland Cotton Base[181] | 21,505,529.6 acres |
| Total Contract Acreage on Farms Not Holding Upland Cotton Base[182] | 1,202,794.9 acres |
| **Total Contract Crop Acreage on Upland Cotton Farms[183]** | 22,708,324.5 acres |
| **Total Non-Contract Crop Acreage on Upland Cotton Farms[184]** | **5,432,760.7 acres** |

42. Brazil notes that the calculation of the average value of the production from a non-contract crop acre in the United States is unaffected by the new summary data provided by the United States on 28 January 2004. For ease of reference, Brazil reproduces the average values in the table below.

Table 4.5

| **Average Per-Acre Value from Production of Non-Contract Programme Crops in the United States[185]** | | | |
|---|---|---|---|
| MY 1999 | MY 2000 | MY 2001 | MY 2002 |
| $150.28 | $155.58 | $154.92 | $118.42 |

43. Multiplying the per acre value of non-contract crop production by the amount of acreage planted to non-programme crops provides the total value of this production, as shown in the table below.

[178] Data taken from category "Enrolled in Cotton PFC and planted cotton" farms column in rDCPsum.xls file provided by the United States on 28 January 2004.

[179] Data taken from category "Not Enrolled in Cotton PFC and planted cotton" farms column in rDCPsum.xls file provided by the United States on 28 January 2004.

[180] Sum of the two above figures.

[181] Sum of planted acre figures on category "Enrolled in Cotton PFC and planted cotton" farms from rDCPsum.xls provided by the United States on 28 January 2004.

[182] Sum of figures reported in Tables 2.17 and 2.18.

[183] Sum of the two above figures.

[184] Difference between "Total Acreage on Upland Cotton Farms" and "Total Contract Crop Acreage on Upland Cotton Farms."

[185] *See* Exhibit Bra-424 (Allocation Calculations Based on US Methodology and US Summary Data). Brazil has provided this file also electronically as 'allocation calculations.xls' on 28 January 2004.

Table 4.6

| **Total Value of Non-Contract Programme Crops Production on Upland Cotton Farms[186]** | | | |
|---|---|---|---|
| MY 1999 | MY 2000 | MY 2001 | MY 2002 |
| $1,388,608,569.8 | $1,328,350,083.5 | $1,214,974,724.4 | $643,347,522.1 |

44. These figures are added to the value of contract programme crops determined in Section 3 and presented below.

Table 4.7

| **Total Value of Crop Production on Upland Cotton Farms** | | | | |
|---|---|---|---|---|
| | MY 1999 | MY 2000 | MY 2001 | MY 2002 |
| Value of Contract Programme Crops[187] | $4,477,294,413.0 | $5,083,491,784.8 | $3,874,679,644.8 | $5,042,861,279.0 |
| Value of Non-Contract Payment Crops[188] | $1,388,608,569.8 | $1,328,350,083.5 | $1,214,974,724.4 | $643,347,522.1 |
| Total Value[189] | $5,865,902,982.8 | $6,411,841,868.3 | $5,089,654,369.2 | $5,686,208,801.1 |
| Upland Cotton Value[190] | $3,515,621,790.4 | $4,029,636,988.1 | $2,798,361,319.1 | $3,414,772,646.8 |
| Upland Cotton Value as a Percentage of Total Value[191] | 59.933 per cent | 62.857 per cent | 54.981 per cent | 60.054 per cent |

45. Applying this percentage rate to the total amount of contract payments received by farms producing upland cotton generates the amount of contract payments that constitute support to upland cotton under this methodology. The figures are shown in the table below.

[186] Total Value = "Average Per-Acre Value of Non-Contract Payment Crop Production in the United States" (as reported in Table 4.5) * "Total Non-Contract Crop Acreage on Upland Cotton Farms" (as reported in Tables 4.1-4.4).

[187] *See* Tables 3.5-3.8.

[188] *See* Table 4.6.

[189] Sum of the two preceding figures.

[190] *See* Tables 3.5-3.8.

[191] Calculated by dividing "Upland Cotton Value" by "Total Value."

Table 4.8

| **Total Contract Payments Allocated as Support to Upland Cotton[192]** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[193] | Direct Payments | CCP Payments |
| 1999 | $440,061,035.8 | $437,917,881.4 | - | - |
| 2000 | $432,996,788.7 | $460,939,354.1 | - | - |
| 2001 | $304,243,319.2 | $420,222,029.1 | - | - |
| 2002 | - | - | $383,057,256.1 | $640,389,168.2 |

46. For purposes of comparison, Brazil reproduces the results of its "14/16$^{th}$" methodology, as presented to the Panel at paragraphs 8 of Brazil's 22 December 2003 Answers to Questions and Brazil's 9 September Further Submission.

Table 4.9

| **Results of Brazil's 14/16$^{th}$ Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $547,800,000 | $545,100,000 | - | - |
| 2000 | $541,300,000 | $576,200,000 | - | - |
| 2001 | $453,000,000 | $625,700,000 | - | - |
| 2002 | - | - | $454,500,000 | $935,600,000 |

[192] Calculated by applying the "Upland Cotton Value as a Percentage of Total Value" (reported in Table 4.7) to the total amount of contract payments reported in Tables 3.1-3.4.

[193] Market Loss Assistance Payments are calculated as PFC payments multiplied by the ratio of upland cotton market loss assistance payments to upland cotton PFC payments, as contained in Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). Since payment rates are not available directly, this ratio provides the information because both subsidies are paid based off the same payment units. Brazil notes that the market loss assistance payment amounts are understated by the non-allocated amount of soybean market loss assistance payments for which the United States has not produced any information.

## Annex B

## Peace Clause Comparisons MY 1999-2001 Under Various Allocation Methodologies

**Budgetary Outlays For Upland Cotton MY 1992, 1999[1]**

| Year / Programme | 1992 | 1999 (1) | 1999 (2) | 1999 (3) | 1999 (4) | 1999 (5) |
|---|---|---|---|---|---|---|
| | ----- $ million ----- | | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none | none |
| PFC Payments | none | 515.3 | 574.5 | 576.5 | 440.1 | 547.8 |
| MLA Payments | none | 512.8 | 571.7 | 573.7 | 437.9 | 545.1 |
| Marketing Loan Gains and LDP Payments[2] | 866 | 1,761 | 1,761 | 1,761 | 1,761 | 1,761 |
| Step 2 Payment | 207 | 422 | 422 | 422 | 422 | 422 |
| Crop Insurance | 26.6 | 169.6 | 169.6 | 169.6 | 169.6 | 169.6 |
| Cottonseed Payments | none | 79 | 79 | 79 | 79 | 79 |
| **Total** | **2,117.0** | **3,459.7** | **3,577.8** | **3,581.8** | **3,309.6** | **3,524.5** |

(1) Adjusted Total Upland Cotton Contract Payments to Farms Producing Upland Cotton and Holding Upland Cotton Base; (Under The Non-Adjusted Methodology, The Amount Would Be Identical)
(2) Brazil's Allocation Methodology
(3) Annex IV-Type Allocation Over Value of Contract Payment Crops Only
(4) US-proposed Methodology
(5) Brazil's 14/16th Methodology

**Budgetary Outlays For Upland Cotton MY 1992, 2000[3]**

| Year / Programme | 1992 | 2000 (1) | 2000 (2) | 2000 (3) | 2000 (4) | 2000 (5) |
|---|---|---|---|---|---|---|
| | ----- $ million ----- | | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none | none |
| PFC Payments | none | 482.4 | 538.1 | 546.1 | 433.0 | 541.3 |
| MLA Payments | none | 513.6 | 572.8 | 581.3 | 460.9 | 576.2 |
| Marketing Loan Gains and LDP Payments[4] | 866 | 636 | 636 | 636 | 636 | 636 |
| Step 2 Payment | 207 | 236 | 236 | 236 | 236 | 236 |
| Crop Insurance | 26.6 | 161.7 | 161.7 | 161.7 | 161.7 | 161.7 |
| Cottonseed Payments | none | 185 | 185 | 185 | 185 | 185 |
| **Total** | **2,117.0** | **2,214.7** | **2,329.6** | **2,346.1** | **2,112.6** | **2,336.2** |

(1) Adjusted Total Upland Cotton Contract Payments to Farms Producing Upland Cotton and Holding Upland Cotton Base; (Under The Non-Adjusted Methodology, The Amount Would Be Identical)
(2) Brazil's Allocation Methodology
(3) Annex IV-Type Allocation Over Value of Contract Payment Crops Only
(4) US-proposed Methodology
(5) Brazil's 14/16th Methodology

[1] The table below reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission.
[2] "Other Payments" have been included in the marketing loan figures.
[3] The table below reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission.
[4] "Other Payments" have been included in the marketing loan figures.

**Budgetary Outlays For Upland Cotton MY 1992, 2001**[5]

| Year / Programme | 1992 | 2001 (1) | 2001 (2) | 2001 (3) | 2001 (4) | 2001 (5) |
|---|---|---|---|---|---|---|
| | ----- $ million ----- | | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none | none |
| PFC Payments | none | 387.9 | 428.0 | 399.6 | 304.2 | 453.0 |
| MLA Payments | none | 535.8 | 597.2 | 552.0 | 420.2 | 625.7 |
| Marketing Loan Gains and LDP Payments[6] | 866 | 2,609 | 2,609 | 2,609 | 2,609 | 2,609 |
| Step 2 Payment | 207 | 196 | 196 | 196 | 196 | 196 |
| Crop Insurance | 26.6 | 262.9 | 262.9 | 262.9 | 262.9 | 262.9 |
| Cottonseed Payments | none | none | none | none | none | none |
| **Total** | **2,117.0** | **3,991.6** | **4,093.1** | **4,019.5** | **3,792.3** | **4,146.6** |

(1) Adjusted Total Upland Cotton Contract Payments to Farms Producing Upland Cotton and Holding Upland Cotton Base; (Under The Non-Adjusted Methodology, The Amount Would Be Identical)
(2) Brazil's Allocation Methodology
(3) Annex IV-Type Allocation Over Value of Contract Payment Crops Only
(4) US-proposed Methodology
(5) Brazil's 14/16th Methodology

[5] The table below reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission.

[6] "Other Payments" have been included in the marketing loan figures.

# ANNEX I-23

## COMMENTS OF THE UNITED STATES TO THE 18 FEBRUARY 2004 COMMENTS OF BRAZIL

3 March 2004

**Introduction**

1. The United States thanks the Panel for this opportunity to provide comments on the 18 February comments filed by Brazil relating to the data submitted by the United States on 18 And 19 December 2003. As an initial matter, the United States finds it odd that Brazil's 18 February comments advance a number of new arguments concerning the applicability of the Peace Clause at this late stage in the proceedings, long after the time when the Peace Clause portion of the dispute was supposed to have been concluded. This only demonstrates the shifting nature of Brazil's arguments and approach to the legal provisions at issue.

2. In these comments, we proceed as follows:

- First, the United States sets forth how Brazil's arguments on the use of the December data are mistaken because of Brazil's erroneous interpretation of the Peace Clause phrase "support to a specific commodity."

- Second, we rebut Brazil's argument that support to a specific commodity may be determined by an analysis of whether the payment in question "cover[s] (or contribute[s] to) the costs of production of a crop." Brazil's "costs of production" principle finds no support in the text of the Peace Clause or of any WTO agreement and in fact collapses when applied to its logical conclusion.

- Third, we demonstrate that Brazil's argument that decoupled income support payments are *de facto* tied to production is in error.

- Fourth, we explain that Brazil has not made a *prima facie* case under its subsidies claims with respect to decoupled payments because it has failed to advance evidence and arguments to allow for identification of the challenged subsidy and subsidized product.

- Fifth, we demonstrate that Brazil's various allocation methodologies, in addition to being irrelevant for Peace Clause Purposes and inapplicable for serious prejudice claims, are internally inconsistent and illogical and that its so-called "Annex IV" methodologies are in fact unrelated to the text of Annex IV.

- Finally, we conclude by noting that Brazil's interpretation of the Peace Clause and application of the December data would upset the balance of rights and obligations of members in the WTO agreements.

**Brazil Misinterprets the Peace Clause[1] Phrase, "Support to a Specific Commodity"**

3. We begin by noting that the entirety of section 2, and many other parts, of Brazil's comments are based on an argument that Brazil invents and falsely ascribes to the United States. Brazil seeks to paint the US interpretation of the Peace Clause proviso as "based on" an understanding that "'support to' means 'tied to' the production of a specific commodity" – that is, that "support to" in Article 13(b)(ii) of the Agreement on Agriculture means something like "tied to the production or sale of a given product" in paragraph 3 of Annex IV of the Subsidies Agreement.[2] Brazil's argument, however, is not based on any submission of the United States since the United States has never linked the Peace Clause to Annex IV. Indeed, in the US February 11 comments, we specifically noted that:

> [T]he terms "support to a specific commodity" and "product-specific support" are not found in Part III of the Subsidies Agreement, nor in Article 1 or Annex IV. Neither are the terms "subsidy," "benefit," or "subsidized product" from the Subsidies Agreement found in the Peace Clause proviso or any supporting text. Thus, the plain language of the Peace Clause and [Subsidies Agreement] Articles 5 and 6 indicate that these provisions refer to wholly different approaches and suggest that the methodology for allocating non-tied (decoupled) payments under the Subsidies Agreement may not be relevant under the Agreement on Agriculture. The definitions of product-specific support and non-product-specific support in Article 1(a) of the Agreement on Agriculture confirm that the Annex IV allocation methodology does not apply for purposes of the Peace Clause.[3]

Thus, contrary to Brazil's assertions, the United States is plainly *not* inappropriately attempting to interpret the phrase "support to" in the Peace Clause in light of the phrase "tied to" in Annex IV.[4] Having laid down a patently incorrect understanding of the US argument, Brazil proceeds never to address the true bases for the US interpretation of the Peace Clause phrase "support to a specific commodity".

4. Although Brazil correctly suggests that the Panel should look to the ordinary meaning of the phrase "support to a specific commodity," it *only* provides a dictionary definition for one term in the phrase, "support" ("assistance, backing").[5] Brazil's reliance on "support" is misplaced. When Brazil states: "The issue under Article 13(b)(ii) is whether a particular commodity receives 'backing' or support' from a domestic support measure," Brazil fundamentally misunderstands the issue.[6] "Non-product-specific support" is also "support" to various agricultural commodities. The simple fact that it supports those commodities (on a non-specific basis) does not thereby convert that support into

[1] In paragraph 19 of Brazil's 18 February comments, Brazil in passing characterizes the Peace Clause as "now-expired". As the United States has explained earlier in this proceeding, the issue of the date of expiration of the Peace Clause is not at issue in this proceeding. Brazil accepts that the Peace Clause was in effect when the Panel was established. However, the United States has also explained that the Peace Clause has not yet expired for the United States or other Members whose relevant "year" began later in 1995, so Brazil's characterization is inaccurate as well.

[2] Brazil's 18 February Comments, para. 3.

[3] US February 11 Comments, para. 20 (footnote omitted).

[4] Similarly, we are puzzled by Brazil's lengthy argument in section 4 of its comments that it is the US position that "only Annex IV of the SCM Agreement offers any useful context" to finding some methodology to apply to decoupled payments for purposes of the Peace Clause analysis. Brazil's 18 February Comments, paras. 38-41. As set out above, the Peace Clause determination is made on the basis of its text in its context; the United States does not rely on Annex IV as context or otherwise for interpretation of the Peace Clause; and no methodology to allocate non-product-specific support to a specific commodity can be found in the Agreement on Agriculture.

[5] Brazil's 18 February Comments, para. 3.

[6] Brazil's 18 February Comments, para. 6.

support to a "specific commodity" for purposes of Article 13(b)(ii). In addition, by solely defining "support," Brazil avoids the ordinary meaning of the phrase as a whole – that is, "assistance" or "backing" "specially . . . pertaining to a particular" "agricultural crop"[7] – a meaning which runs directly contrary to Brazil's approach under which support to multiple commodities is at the same time support to particular commodities. Brazil not only fails to look to the ordinary meaning of *all* of the terms in this phrase[8], it also fails to read the phrase "support to a specific commodity" in light of any other provision of the Agreement on Agriculture (the most immediate context for the Peace Clause) that contains any of the terms "support," "specific," or "commodity".[9]

5. For example, the phrase "support to a specific commodity" contains elements found in the phrases product-specific and non-product-specific support – but Brazil denies that those concepts have any relevance to the Peace Clause.[10] Brazil also fails to discuss (and therefore presumably believes irrelevant) the similarities between the phrase "*support to a specific commodity*" and the phrases "*support* . . . provided *for an agricultural product* in favour of the producers of the basic agricultural product" (Article 1(a)) and "*support for basic agricultural products*" (Article 1(h)), which, respectively, define and refer to product-specific support (without using those exact words). Brazil's interpretation of the Peace Clause phrase "support to a specific commodity", in addition to ignoring the ordinary meaning of the phrase as a whole, ignores relevant context as well – that is, those phrases in the Agreement on Agriculture that, because of their close similarities, must inform a valid interpretation.

6. As we have previously noted, "support to a specific commodity" must be read not only according to the ordinary meaning of the terms, but also in light of the structure of the Agreement on Agriculture. Brazil asserts that Members would have used the exact phrase "product-specific support" instead of "support to a specific commodity" if they had meant the two to be read as having the same meaning,[11] but Brazil sets up a false dichotomy. The Agreement elsewhere defines (Article 1(a)) and refers to (Article 1(h)) this concept without using that exact phrase. Indeed, the Agreement on Agriculture *nowhere* uses the exact phrase "product-specific support". A close approximation is the phrase "product-specific domestic support" in Article 6.4(a)(i); in Annex 3, paragraph 1, the term "product-specific" is used in the context of describing the AMS to be calculated for each basic agricultural product.[12] Despite the absence in the text of the exact phrase "product-specific support", even Brazil has no difficulty recognizing that such a concept exists in the Agreement on Agriculture; thus, that the exact phrase "product-specific support" was not used in the

[7] *See* US First Written Submission, para. 77 (July 11, 2003) (citing dictionary definitions of each term).

[8] According to the customary rules of interpretation of public international law, the Agreement is to "be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." *See* Vienna Convention on the Law of Treaties, Article 31 (General rule of interpretation).

[9] *See, e.g.*, Agreement on Agriculture, Articles 1(a), 1(d), 1(f), 6.4, and Annex 3 (paragraphs 1 and 7).

[10] Instead, Brazil claims that all of its arguments relating to product-specific support and non-product-specific support have been arguments "*in the alternative.*" Brazil also faults the United States for "falsely assert[ing] that Brazil has 'conceded that 'support to a specific commodity' refers to 'product-specific support.'" Brazil's 18 February Comments, paras. 9-10. The United States notes that the Brazilian statement previously referred to by the United States (that is, "the support from contract payments that can be allocated to upland cotton is product-specific support within the meaning of the Agreement on Agriculture", Brazil's 28 January Comments, para. 73) did *not* contain any indication that it was made "in the alternative". Nonetheless, in these comments, the United States proceeds as if Brazil's 18 February comments are its final position.

[11] Brazil's February 18 Comments, para. 5 ("Negotiators presumably knew what they intended when they used the very particular term 'product-specific support'. They used the term repeatedly in the Agreement on Agriculture, and even defined 'non-product-specific support in Article 1(a) – yet they declined to use 'product-specific support' in Article 13(b)(ii)".).

[12] *See* Agreement on Agriculture, Annex 3, para. 1 ("Subject to the provisions of Article 6, an Aggregate Measurement of Support (AMS) shall be calculated on a product-specific basis for each basic agricultural product receiving market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment ('other non-exempt policies').").

Peace Clause is no bar to finding that this is the correct interpretation of "support to a specific commodity".[13]

7. In addition, Brazil's suggestion that "support to a specific commodity" was intended to clarify that the Peace Clause test involves only "support to an individual commodity, not a *group* of commodities such as grains or even all commodities"[14], does not withstand scrutiny.

- First, the phrase "support to a commodity," without the use of the word "specific", conveys the same meaning as "support to an individual commodity" (Brazil's proffered interpretation); thus, Brazil's interpretation renders the use of the term "specific" inutile.

- Second, under Brazil's interpretation of the Peace Clause, support to "a group of commodities" or "even all commodities" could be support to a specific commodity because the payments may be allocated to an individual commodity depending on what the recipient produces. Thus, Brazil's own Peace Clause interpretation contradicts this distinction between "support to an individual commodity" and support "to a group of commodities".

In addition, Brazil's suggestion that "the *chapeau* of Article 13(b)(ii) confirms this broader meaning of 'support,' because it includes all types of non-green box measures"[15], simply begs the question. "Domestic support measures that conform fully to the provisions of Article 6" (the language in the chapeau) may be either product-specific or non-product-specific, and even Brazil would agree that non-product-specific support is not "support to a specific commodity". Thus, just because a measure falls within the Article 13(b)(ii) chapeau does not assist in determining whether that measure provides "support to a specific commodity".

8. What may be most striking about the Brazilian critique of the US reading of the Peace Clause is that it nowhere presents nor rebuts the basis for the US interpretation. The basis for the US interpretation is set out plainly in the US February 11 comments:

> The lack of grounding of Brazil's methodology in the WTO agreements stems from its erroneous interpretation of "support to a specific commodity." . . . . *Brazil has consistently failed to read together the definitions of product-specific support and non-product-specific support in Article 1(a) of the Agreement on Agriculture.* Read in conjunction with one another, non-product-specific support ("support provided in favour of agricultural producers in general") is a residual category of support that is not product-specific ("support . . . provided for an agricultural product in favour of the producers of the basic agricultural product").[16]

Brazil nowhere addresses the US argument relating to the definition of product-specific support in Article 1(a) of the Agreement on Agriculture. In fact, whereas in Brazil's Peace Clause submissions it serially misquoted the definition of product-specific support in Article 1(a), dropping key words,[17] in its 18 February comments Brazil avoids that inconvenient definition *by simply never mentioning it*.[18] At the same time, however, Brazil relies heavily on the definition of non-product-specific support

[13] For convenience sake, the United States will use the term "product-specific support" as a shorthand for the concept of support to a specific commodity, in contrast to "non-product-specific support".

[14] Brazil's 18 February Comments, para. 5.

[15] Brazil's 18 February Comments, para. 4.

[16] US 11 February Comments, para. 10 (emphasis added).

[17] *See* US Rebuttal Submission, para. 82 (22 August 2003); US Comments on Brazil's Rebuttal Submission, para. 23 n.30 (27 August 2003).

[18] *See, e.g.*, Brazil's February 18 Comments, para. 9 ("Brazil has argued that the meaning of 'product-specific' AMS must be governed by the only term providing some guidance as to what it means – the definition of 'non-product-specific support' in Article 1(a) of the Agreement on Agriculture".).

in Article 1(a).[19] Thus, once again, Brazil invites the Panel to commit legal error in interpreting the phrase "non-product-specific support provided in favour of agricultural producers in general" devoid of the context provided by the immediately preceding definition of product-specific support.

9. That Brazil's position is untenable is demonstrated by comparing Annex 3, entitled "Calculation of Aggregate Measurement of Support," with Article 1(a), which defines "Aggregate Measurement of Support" or "AMS". Paragraph 1 of Annex 3 specifies that two different types of AMS shall be calculated:

- First, "an Aggregate Measurement of Support (AMS) shall be calculated *on a product-specific basis* for each basic agricultural product." Second, "[s]upport *which is non-product specific* shall be totalled into one non-product-specific AMS in total monetary terms".

Thus, Annex 3 distinguishes and calls for the separate calculation of non-product-specific support and product-specific support, which together comprise the AMS. Article 1(a), defining AMS, contains the identical distinction. While only non-product-specific support is identified by name, the structure of the AMS definition – which parallels Annex 3, paragraph 1 – demonstrates that product-specific and non-product-specific support together comprise the AMS:

- "'Aggregate Measurement of Support' and 'AMS' mean the annual level of support, expressed in monetary terms, [1] provided for an agricultural product in favour of the producers of the basic agricultural product <u>*or*</u> [2] non-product-specific support provided in favour of agricultural producers in general . . . [bold and italics added]."[20]

That is, just as the calculation of AMS (which uses the term "product-specific") distinguishes product-specific from non-product-specific support, logically, so too does the definition of AMS (which does not use that term).[21] Thus, it is simply not credible for Brazil to refer to the definition of "non-product-specific support" in Article 1(a) but to ignore the immediately preceding definition of product-specific support.[22]

10. her, Brazil's discussion of the meaning of the term "in general" in the definition of non-product-specific support is disappointing because Brazil mischaracterizes the US position and presents the Panel with an interpretation that is not the ordinary meaning of the term. In so doing, Brazil renews a faulty argument advanced in its Peace Clause submissions. In case there were any confusion, the United States clarifies the issue here.

- Brazil has, in fact, never used a dictionary definition of "in general," the exact phrase in the definition of non-product-specific support. Rather, Brazil has attempted to define "in general" by providing definitions of the word "*general*" as "relating to a whole class of

[19] *See, e.g.*, Brazil's 18 February Comments, paras. 9, 12, and 18.

[20] Agreement on Agriculture, Article 1(a).

[21] *See also* Agreement on Agriculture, Article 6.4(a) (for purposes of *de minimis* support, distinguishing "product-specific domestic support" from "non-product-specific domestic support").

[22] *See, e.g.*, Brazil's 18 February Comments, para. 12 ("One interpretive guide to determine whether support is 'product-specific' is found in the definition of 'non-product-specific support' in Article 1(a) of the Agreement on Agriculture. Brazil demonstrated that *only non-product-specific support is actually defined . . .* .") (emphasis added).

objects" and "*not* partial, local or sectional".[23] However, in the same dictionary from which Brazil quotes, there is a definition of "in general," which Brazil continues to avoid.[24]

- The definition of "in general" that comes closest to Brazil's use (for example, "including, involving, or affecting all or nearly all the parts of a (specified or implied) whole") is "in a body; universally; without exception." *However, that definition of "in general" is marked "obsolete" in Brazil's own dictionary.*[25]

- Thus, Brazil errs when it argues that the United States has asserted "that Brazil's definition of 'general' is obsolete". Rather, the United States has asserted that Brazil has advanced a reading of the phrase "*in general*" that employs an obsolete meaning.[26]

- In contrast, the non-obsolete definition of "in general" is "in general terms, generally".[27]

Thus, the ordinary meaning of "non-product-specific support provided in favour of agricultural producers in general" in Article 1(a) would be support *not* "specially . . . pertaining to a particular"[28] product provided in favour of agricultural producers "generally".

11. Brazil uses its faulty definition of non-product-specific support to conclude that US decoupled payments are not non-product-specific. However, Brazil recognizes that decoupled income support payments do not require any production[29], a recipient may produce nothing at all or may produce any of numerous commodities. Thus, decoupled income support payments are non-product-specific because they do not "specially . . . pertain[] to a particular" product and are support "generally" to producers of whatever commodities they choose to produce (if any).

12. We also pause to note that Brazil argues that the EC, New Zealand, and Argentina believe that decoupled income support in the form of counter-cyclical payments are product-specific.[30] However, Brazil points to nothing in the arguments of these third parties that differs from its own flawed interpretation, which the United States has thoroughly rebutted. Moreover, Brazil now explicitly argues that the Peace Clause "may require the application of an allocation methodology for . . . domestic support measures that may provide support to more than one commodity".[31]

- However, in the Peace Clause phase of this dispute, Brazil had asserted that "[t]he use of the word 'specific' [in "support to a specific commodity"] makes clear that AoA [Agreement on Agriculture] Article 13(b)(ii) addresses actionable subsidy challenges made on a

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[23] Brazil's 18 February Comments, para. 12 (footnote omitted); Brazil's Answer to Question 40 from the Panel (para. 54) (defining "general" as "'including, involving, or affecting all or nearly all the parts of a (specified or implied) whole'").

[24] *See* US Rebuttal Submission, para. 83 (22 August 2003).

[25] US Comments on Brazil's Rebuttal Submission, para. 23 (noting that the definition of "in general" as "in a body; universally; without exception" was marked "obsolete" in *The New Shorter Oxford English Dictionary*).

[26] US 11 February Comments, para. 10 ("As the United States has pointed out before, *not only does this reading of 'in general' rely on an obsolete meaning, which therefore cannot be the ordinary meaning of the terms*, but Brazil has consistently failed to read together the definitions of product-specific and non-product-specific support in Article 1(a) of the Agreement on Agriculture.") (emphasis added; footnote omitted).

[27] "In general" means "in general terms, generally" and "as a rule, usually." *The New Shorter Oxford English Dictionary*, vol. 1, at 1073 (1993 ed.).

[28] *The New Shorter Oxford English Dictionary*, vol. 2, at 2972 ("specific": second definition); *see also id.* (fifth definition: "Clearly or explicitly defined; precise, exact, definite.").

[29] Brazil's 18 February Comments, para. 4 ("Brazil and the United States agree that the contract payments, which do not *require* production . . . .").

[30] Brazil's 18 February Comments, para. 15 & n.22, para. 16 & n. 26.

[31] Brazil's 18 February Comments, para. 6.

product-by-product basis, *as opposed to* challenges regarding *support for multiple commodities*".[32]

- Further, we recall that the European Communities argued that "support which is provided to a number of crops cannot at the same time be considered 'support to a specific commodity'. Such support is 'support to several commodities' or 'support to more than one commodity'".[33]

Thus, the European Communities has set out an understanding of "support to a specific commodity" in the Peace Clause that *directly contradicts* Brazil's current allocation methodology. Had Brazil revealed (or conceived of) its allocation methodology during the Peace Clause phase of the dispute, the third parties would have been in a better position to provide their informed opinions as to Brazil's Peace Clause interpretation and characterization of particular measures.

13. We also note that the context to which Brazil cites in support of its allocation methodology for Peace Clause purposes lends no support to its interpretation. First, Brazil argues that "[f]urther context for the existence of some sort of an allocation methodology in the Agreement on Agriculture is Annex 3, paragraph 7".[34] However, even if this provision were to suggest "*some sort of* an allocation methodology" in the Agreement on Agriculture, it only applies to calculate AMS with respect to measures directed at processors and does not suggest any methodology that would allocate non-product-specific support as "support to a specific commodity." Brazil also suggests that paragraphs 7, 8, 12, and 13 of Annex 3 "include as 'product-specific' many types of domestic support not tied to the production of a particular commodity."[35] The United States has noted that it is Brazil that has put forward this "tied to the production" definition; the US position is that product-specific support means what Article 1(a) says it does: "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product." That said, none of the paragraphs cited by Brazil speak to an allocation of non-product-specific support as product-specific support. That is, whether measures referred to in those provisions are product-specific or non-product-specific must be determined on the basis of the definition found in Article 1(a).[36]

14. Finally, Brazil argues that "Article 13(b)(ii) of the Agreement on Agriculture does not provide explicit guidance on how to count up the amount of support for contract or any other types of payments. But this does not mean that no counting methodology can be used. The absence of explicit guidance on implementing more general provisions has not stopped WTO panels or parties from proposing and using methodologies to tabulate the amount of subsidies, costs, and volumes of trade impacted."[37] We disagree with Brazil's diagnosis and remedy.

- First, the Peace Clause is not a "general provision[]" lacking "explicit guidance on how to count up the amount of support." In fact, the Peace Clause provides "explicit guidance" through the phrase "support to a specific commodity". Read according to its ordinary meaning and in its context, this phrase refers to product-specific support as defined in

[32] Brazil's First Submission, para. 136 (24 June 2003) (emphasis added).

[33] Oral Statement by the EC at the First Panel Meeting, para. 21. The same logic would apply to crop insurance payments: support is provided to multiple commodities through premium payments for approved insurance products. *See, e.g.*, US Rebuttal Submission, paras. 93-98 (22 August 2003).

[34] Brazil's 18 February Comments, para. 13.

[35] Brazil's 18 February Comments, para. 14.

[36] For example, Brazil cites to paragraph 8 of Annex 3 on the calculation of "market price support". This provision refers to "the quantity of *production* eligible to receive the applied administered price"; assuming that "the applied administered price" relates to production of one product, such a measure would be product-specific. Paragraph 12 of Annex 3 refers to "[n]on-exempt direct payments which are based on factors other than price" being measured using budgetary outlays; paragraph 13 refers to the measurement of the value of other non-exempt direct payments; neither provision speaks to the distinction between non-product-specific support and product-specific support nor to the allocation of the former to the latter.

[37] Brazil's 18 February Comments, para. 34.

Article 1(a) of the Agreement on Agriculture. The definitions in Article 1(a) establish a methodology by which product-specific support is included in "count[ing] up the amount of support" for Peace Clause purposes while non-product-specific is not.

- Second, given the balance struck in concluding the Uruguay Round between the need to achieve binding reduction commitments on agricultural support and the need of Members to be able to design measures to conform to those commitments – a point to which we return later – it is difficult to imagine that Members would have left the issue of how to calculate the "support to a specific commodity" for Peace Clause purposes undefined, putting the Panel in the difficult position of "proposing and using [a] methodolog[y]" on such a crucial issue. In fact, the Peace Clause provides a methodology for calculating that support. The *measures* to be included in the calculation are identified by the phrase "support to a specific commodity," as explained in the preceding bullet. The *unit of measure* to be used in the Peace Clause comparison is identified by the way in which the Member "decided" support during the 1992 marketing year.[38]

Thus, Members did not put the Panel in the untenable position of "adopt[ing] a reasonable methodology" with respect to its Peace Clause findings. Rather, they agreed to language that provides an explicit methodology both for the Panel's purposes as well as for the purposes of Members who wished to ensure their measures would conform to the Peace Clause. Neither Brazil's allocation "methodology [n]or some variant of its methodology" – however "reasonable" Brazil may believe those to be – can serve those purposes or find any basis in the Peace Clause and the Agreement on Agriculture.

15. Thus, we end where we began: the interpretation of the Peace Clause phrase "support to a specific commodity" we have provided is based on its ordinary meaning and in light of the context provided by relevant provisions of the Agreement on Agriculture,[39] in particular, the definition of product-specific support in Article 1(a). Brazil, on the other hand, does not read this phrase according to the ordinary meaning of all of its terms, ignores the context provided by those provisions of the Agreement on Agriculture that use the terms "support", "specific," and "commodity," ignores the definition of product-specific support in Article 1(a), and instead points to provisions that do not provide any relevant context.

16. The Panel may ask itself: can a methodology that (as Brazil's tortured allocation methodology would have it) results in a payment sometimes being considered as support to *no* commodity (if the recipient produces nothing), sometimes as support to *one* commodity (if the recipient has planted a number of acres of a crop at least equal to the number of recipient's base acres of that crop), or sometimes as support to *multiple* commodities (if the recipient plants fewer acres of any crop for which the recipient has base acres) provide any meaningful interpretation of the phrase "support to a specific commodity"? The United States believes that the answer is no. Brazil has, at best, appreciated the *reality* of the payments in question: they are paid to producers in any of the situations it has described. Such support is not "support to a specific commodity" under the ordinary meaning of the terms (assistance or backing specially pertaining to a particular agricultural crop) or the Article 1(a) definition (support provided for an agricultural product in favour of the producers of the basic agricultural products). Rather, it is non-product specific support (support not specially pertaining to a particular product provided in favour of agricultural producers generally).

[38] Thus, in the case of the United States, the support "decided during the 1992 marketing year" was a rate of support provided by the target price for deficiency payments of 72.9 cents per pound and the marketing loan rate of 52.35 cents per pound. *See* US February 11 Comments, paras. 15-17.

[39] *See, e.g.*, Agreement on Agriculture, Articles 1(a), 1(d), 1(f), 6.4, and Annex 3 (paragraphs 1 and 7).

**Brazil's Costs of Production Approach to Determine Whether Payments are "Support to a Specific Commodity" Does Not Withstand Scrutiny**

17. In the foregoing section, the United States set out the textual and contextual basis for reading the Peace Clause phrase "support to a specific commodity" according to the definition of product-specific support in Article 1(a). We also pointed out that it is not the United States that has attempted to apply Subsidies Agreement concepts to the Peace Clause analysis as Brazil incorrectly asserted. Rather, it is Brazil that has attempted to apply an (incorrect) allocation methodology as might be relevant for purposes of actionable subsidies claims under the Subsidies Agreement to the Peace Clause analysis. In so doing, Brazil has asserted a principle for determining whether a subsidy provides support to a commodity – that is, whether "they cover (or contribute to) the costs of production of a crop"[40] – that is unworkable and illogical.

18. First, we note that Brazil defines "support" as relating to the recipient, but later elides this into support for a crop. For example, Brazil writes: "[T]he word 'support' has a more general sense of 'backing up' *a group of agricultural farmers* producing a specific commodity. For example, subsidies that cover costs of production when a farmer chooses to grow a crop, 'back up' or 'support' *that farmer*".[41] However, the Peace Clause text is "support to a *specific commodity*" not support to *farmers* producing a specific commodity. This distinction is also found in the Article 1(a) definition of product-specific support: "support . . . provided *for an agricultural product* in favour of the producers of the basic agricultural product". The difference is that income support provided to farmers is not "support to a specific commodity" because the support is not "provided for an agricultural product" over any other; the farmer can (in Brazil's words), "choose[] to grow a crop", choose to grow no crop, or choose to grow multiple crops. Even if all recipients of a decoupled payment chose to produce one crop in particular, the payment would still not be support "for an agricultural product"; the support is "for" no specific product but rather is support not "specially . . . pertaining to a particular" product that supports producers generally. It is those producers, in turn, who may choose to produce one crop in particular.

19. Brazil then, without further explanation, links the notion that support has a "sense" of backing up a farmer who "chooses to grow a crop" to the notion that such support is "support to a specific commodity" by asserting that "all of these subsidies at issue in this dispute 'support' production of upland cotton because they cover (or contribute to) the costs of production of a crop".[42] Brazil nowhere provides any basis in the text of the Peace Clause or the Agreement on Agriculture for this test. Neither does Brazil explain the necessary implications of its approach.

20. For example, if a decoupled payment is "support to a specific commodity" if it "cover[s] (or contribute[s] to) the costs of production of a crop" then the same payment will be product-specific for some producers but not others. Brazil has pointed to survey data from 1997 – that the United States has explained is technologically and structurally out-of date[43] – for the notion that average total costs of production for US producers are $0.73 per pound. On this basis, Brazil has (incorrectly) claimed that decoupled payments were necessary to cover the gap between market revenue and costs. Putting aside the extensive US critique of Brazil's argument (such as its reliance on total costs instead of operating costs)[44], however, the out-of-date per pound total average cost on which Brazil relies is just

[40] Brazil's 18 February Comments, para. 3.
[41] Brazil's 18 February Comments, para. 3 (italics added).
[42] Brazil's 18 February Comments, para. 3.
[43] US Further Rebuttal Submission, paras. 123-33.
[44] The United States has presented a detailed critique of Brazil's alleged costs of production vs. total revenue "gap" in paragraphs 105-41 of its further rebuttal submission of 18 November 2003. As further confirmation that Brazil's "average total costs of production" argument is wrong, we note that Brazil silently has de-emphasized its assertion that, to cover their high costs of production, upland cotton producers *must* have planted upland cotton "on" upland cotton, rice, or peanut base acreage to reap decoupled payments for these

that, an average. In claiming that all decoupled payments received by upland cotton producers (satisfying its complicated allocation methodology) are support to upland cotton, Brazil takes no account of the distribution of costs across farms. That is, some farms produce at costs below the average and some produce at costs above the average.[45] Brazil attempts no analysis of whether decoupled payments received by producers who produce cotton at costs below the average "cover (or contribute to) the costs of production of" upland cotton.

- However, *under Brazil's own rationale*, if the decoupled payments do *not* "cover (or contribute to) the costs of production of a crop", then those payments do not support production of that crop and *are not support to a specific commodity*.

Thus, those payments could not form part of Brazil's Peace Clause analysis, but Brazil has not accounted for this.

21. Consider further Brazil's argument that "[w]ithout direct and counter-cyclical payments in MY 2002, the average US cotton farmer would have lost 14.36 cents per pound. With these two payments, they earned a 'profit' of 4.2 cents per pound with the cotton DP and CCP payments".[46] But Brazil has asserted that payments are "support to a specific commodity" only if they "cover (or contribute to) the costs of production of a crop".

- Thus, *under Brazil's own rationale*, the 4.2 cents per pound of "profit" – that is, returns above and beyond total costs of production – that Brazil attributes to decoupled payments cannot be "support to" upland cotton.

Brazil, of course, fails to carry through its rationale to this extent because this would reduce the decoupled payments it has calculated as support to upland cotton under its own (incorrect) approach.

22. In addition, Brazil's argument that payments are "support to a specific commodity" only if they "cover (or contribute to) the costs of production of a crop" carried through to its logical end would not only run contrary to the definitions of product-specific support and non-product-specific support in Article 1(a) of the Agreement on Agriculture but would produce illogical results. Consider the situation of marketing loan payments for soybeans:

- In the US view, there is no question that these payments are "support to a specific commodity" within the meaning of the Peace Clause because they are "support . . . provided for an agricultural product in favour of the producers of the basic agricultural product" (Article 1(a)).

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base acres. *See, e.g.*, Brazil's Closing Statement at the Second Session of the First Panel Meeting, Annex I (summary of evidence demonstrating that upland cotton producers in MY 1999-2002 produced upland cotton on upland cotton, rice, or peanut base acreage) (October 9, 2003). In fact, without having repudiated its earlier argument, Brazil's 28 January calculations demonstrate that Brazil's allocation methodology results in payments for many other programme crops being allocated to cotton. For example, for farms producing cotton and having cotton base, in marketing year 1999, payments for *wheat, oats, rice, corn, and sorghum* are allocated to cotton; in marketing year 2000, payments for *wheat, rice, corn, sorghum, and barley* are allocated to cotton; and in marketing year 2001, payments for *wheat, rice, corn, and barley* are allocated to cotton, oats, and sorghum. Brazil's 18 February Comments, Annex A, paras. 15-19 (Tables 2.5-2.8). That is, under Brazil's 20 January allocation methodology, upland cotton is allegedly "planted on" base acres for each of the programme crops just listed, not the cotton, rice, or peanut acres in Brazil's costs argument. Brazil has never explained the contradiction in its two arguments.

[45] For example, the 1997 study shows that in that year the 25 per cent of US cotton farms with the lowest cost (accounting for 36 per cent of cotton production) had average operating costs of $0.31 cents per pound and average total costs of $0.55 cents per pound. Exhibit BRA-16, at tbl. 2.

[46] Brazil's 18 February Comments, para. 24 (third bullet) (footnote omitted).

- Under Brazil's rationale, however, marketing loan payments for soybeans might *not* be "support to" soybeans because they might not "cover (or contribute to) the costs of production of [that] crop".

- To determine whether, under Brazil's theory, those marketing loan payments for soybeans are "support to" soybeans or "support to" some other commodity (such as upland cotton) "requires an examination of the record evidence concerning the extent to which the payments *de facto* support or maintain the production of a specific commodity".[47]

- Under some combination of facts, then, marketing loan payments for soybeans could be deemed, under Brazil's theory, to be support to upland cotton (or some other commodity).

This cannot be the right result since, if the marketing loan payments provide any incentive to production (which will depend on the expected harvest season prices at planting), they provide an incentive to plant soybeans, not upland cotton (and if payments are made, they are made to producers of soybeans, not upland cotton). A correct reading of the Peace Clause does produce the right result since such payments are "support to a specific commodity," soybeans[48], regardless of "the record evidence concerning the extent to which the payments *de facto* support or maintain the production of a specific commodity".

23. Finally, as a factual matter, we would note that Brazil has not addressed the most telling data that contradicts its assertion that decoupled payments "directly maintain the production of" upland cotton. This is the significant amount of upland cotton acreage planted by farms without any upland cotton base acres.

- Under the 1996 Act, farms without any upland cotton base acres planted 1.0 million acres of upland cotton in marketing year 1999, 1.2 million acres of upland cotton in marketing year 2000, 1.3 million acres in marketing year 2001, and 1.5 million acres in marketing year 2002.[49]

- After new base acreages were established in the 2002 Act (for purposes of direct and counter-cyclical payments), farms without any upland cotton base acres planted 0.5 million acres of upland cotton in marketing year 2002.

Under Brazil's theory, none of these acres should have been planted since without decoupled payments for upland cotton base acres, these producers "would have lost $332.79 per acre between MY 1997-2002" and "would have lost 14.36 cents per pound" in marketing year 2002.[50] The fact that such large numbers of acres *were* planted without decoupled payments for upland cotton base acres demonstrates that, as a factual matter, US upland cotton producers can and do plant upland cotton without the allegedly indispensable decoupled payments for upland cotton base acres.[51]

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[47] Brazil's 18 February Comments, para. 22; *see also id.*, para. 32 ("In sum, the proper allocation methodology under Article 13(b)(ii) of the Agreement on Agriculture must be consistent with the extent to which the domestic support payments directly maintain the production of a specific commodity.").

[48] Under Article 1(a), marketing loan payments for soybeans are "support . . . provided for an agricultural product [soybeans] in favour of the producers of the basic agricultural product". Under the ordinary meaning of the terms "support to a specific commodity," marketing loan payments for soybeans are "assistance" or "backing" "specially . . . pertaining to a particular" "agricultural product": soybeans.

[49] US Letter to Panel (28 January 2004) (file "rPFCsum.xls": category 3 under column "cotton planted acres").

[50] Brazil's 18 February Comments, para. 24 (second and third bullets).

[51] The data submitted in response to the Panel's supplementary request for information further proves the point. In marketing year 2002, for example, the 52,504 farms in category B planted 7.0 million acres of

24. Thus, the principle Brazil advances to determine whether and to what extent decoupled payments are support to a specific commodity – that is, whether they "cover (or contribute to) the costs of production of a crop" – must fail. This principle is not applied by Brazil to its logical ends because to do so would reduce the amount of support to upland cotton Brazil has calculated to upland cotton. Most importantly, Brazil's costs of production principle finds no support in the text of the Peace Clause or any WTO agreement (such as the definition of product-specific support in Article 1(a)). Thus, the Panel should reject Brazil's erroneous approach.

**Brazil's Argument that Decoupled Income Support Payments Are *De Facto* Tied to Production Is Wrong**

25. Brazil argues that the decoupled income support measures at issue in this dispute cannot be allocated across "the total value of the recipient firm's sales" under paragraph 2 of Subsidies Agreement Annex IV because the payments are "*de facto* tied to upland cotton production".[52] Brazil also argues that the amount of subsidies that support upland cotton cannot be determined under Annex IV, paragraph 3, and therefore "Annex IV does not assist the Panel in determining the amount of support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture".[53] On this latter point, we are in agreement with Brazil: as set out above, the Peace Clause establishes the relevant support through the ordinary meaning of the phrase "support to a specific commodity" in its context, not by way of Annex IV. Under a correct reading of the phrase "support to a specific commodity", *no* allocation methodology may be applied to allocate non-product-specific support as "support to a specific commodity". Here, however, we note that Brazil's argument relating to the alleged *de facto* tie of payments to production does not hold.

26. In fact, the evidence does not support Brazil's argument that decoupled income support payments are "tied to the production or sale of a given product".[54] These payments are received by recipients that may choose to produce no, one, or many different products. The evidence presented by the United States – fully consistent with the Environmental Working Group data presented by Brazil[55] – is that approximately 47 per cent of upland cotton farms eligible for decoupled income support payments planted no cotton in marketing year 2002.[56] Thus, payments are not "tied to the production or sale of a given product" since nearly half of the recipients do not plant even a single acre of cotton.

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upland cotton and had, in the aggregate, 5.4 million base acres of upland cotton; the 7,420 farms in category C planted 0.5 million acres of upland cotton and had 0 base acres of upland cotton. In marketing year 2001, the 61,854 farms in category B planted 10.0 million acres of upland cotton and had 6.4 million base acres of upland cotton; the 20,322 farms in category C planted 1.3 million acres of upland cotton and had no upland cotton base acres. In marketing year 2000, the 62,557 farms in category B planted 9.8 million acres of upland cotton and had 6.4 million base acres of upland cotton; the 18,001 farms in category C planted 1.2 million acres of upland cotton and had no upland cotton base acres. In marketing year 1999, the 59,793 farms in category B planted 9.0 million acres of upland cotton and had 6.0 million base acres of upland cotton; the 15,812 farms in category C planted 1.0 million acres of upland cotton and had no upland cotton base acres. *Under Brazil's theory, none of the tens of thousands of category B farms should have planted more upland cotton acres than their respective quantities of upland cotton base acres, and none of the tens of thousands of category C farms should have planted upland cotton at all.*

[52] Brazil's 18 February Comments, para. 39.

[53] Brazil's 18 February Comments, para. 41.

[54] Subsidies Agreement, Annex IV, para. 3.

[55] Brazil's Further Rebuttal Submission, para 23 (EWG data showed that 46, 45, and 45 per cent of farms receiving upland cotton contract payments received no marketing loan payments in 2000, 2001, and 2002, respectively).

[56] US Oral statement at Second Panel Meeting, para. 56 (2 December 2003); US Answer to Panel Question 125(9).

27. Brazil points to evidence that it asserts demonstrates the "crucial role that each of the four contract payments plays in maintaining the production of US upland cotton".[57] That is, Brazil argues that without the decoupled income support payments, many US producers would not have been able to continue producing cotton. However, Brazil's argument is not, as in Annex IV, that "the subsidy is tied to the production or sale of a given product", but rather that the production or sale of a given product is tied to the subsidy. The two statements are not equivalent. That an upland cotton farmer could not produce upland cotton without a subsidy payment (an argument which the United States has rebutted) does not mean that the payment is "tied to the production or sale of a given product" if recipients may produce or sell other than a given product. This is precisely the case with respect to decoupled income support payments: there is no "tie" to the production or sale of upland cotton because payment recipients can choose not to produce upland cotton (or any other crop).

28. Thus, Brazil has not established that the decoupled income support payments are "*de facto* tied to upland cotton production"; rather, the facts that demonstrate that nearly half of the payment recipients choose not to plant upland cotton at all *de facto* contradict Brazil's argument.

**Brazil Has Not Made a *Prima Facie* Case under its Subsidies Claims with respect to Decoupled Payments**

29. The United States has previously explained that Brazil has not properly interpreted the Peace Clause proviso and has not demonstrated that the challenged US measures are in breach of the Peace Clause. This ends the analysis with respect to Brazil's subsidies claims under Subsidies Agreement Articles 5 and 6 and GATT 1994 Article XVI:1. However, even if the Panel were to look beyond the Peace Clause to Brazil's subsidies claims, Brazil has not established a *prima facie* case with respect to decoupled payments.[58]

30. Brazil now argues that, while "Part III of the Subsidies Agreement does not require detailing the precise amount of the subsidies", Brazil "has presented evidence and argument, in the alternative, regarding the size and subsidization rate of the subsidies challenged."[59] Brazil further claims that it "has offered the contract payment quantities (as well as the other subsidies) established in the peace clause phase of the proceedings as the 'amount of subsidization', to the extent this is required, in the serious prejudice phase". In light of Brazil's repeated disavowals of any need to identify the amount of the subsidy for purposes of its subsidies claims,[60] the United States does not believe that this and two other comments referenced by Brazil demonstrate that Brazil has argued and advanced evidence relating to identification of the challenged subsidy.[61]

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[57] Brazil's 18 February Comments, para. 32.

[58] The United States has elsewhere explained that Brazil has not demonstrated serious prejudice, or threat thereof, from upland cotton marketing loan payments or any other challenged US measures. *See, e.g.*, US Further Rebuttal Submission, paras. 1-177; US Further Submission, paras. 16-133.

[59] Brazil's 18 February Comments, para. 78. The United States continues to be surprised by Brazil's denial of the significance of the amount of the subsidy for purposes of determining "the effect of the subsidy' under its serious prejudice claims. For example, had the DSB initiated the Annex V information-gathering process, that process would have been concerned, in part, with establishing "the amount of subsidization," Subsidies Agreement, Annex V, para. 2, and "the amount of the subsidy in question," *id.*, Annex V, para. 7. Brazil's position that "the effect of the subsidy" may be evaluated without identifying the amount of the subsidy is akin to saying that one can determine "the effect of eating" without knowing how much is being eaten.

[60] *See, e.g.*, US 11 February comments, para. 24.

[61] *See* Brazil's Comment on US Answer to Question 214 from the Panel, para. 216 (28 January 2003) ("Detailing the precise amount of the financial contribution ending up in the bank accounts of US upland cotton producers is not a legal pre-requisite to Brazil's actionable subsidy claims. If the Panel finds that Brazil is legally required to examine the exact *amount* of the subsidies in order to assess their 'effects,' . . . Brazil refers the Panel to evidence and the allocation of the amount of 'support to upland cotton' it has presented in the peace clause portion of its various submissions. This evidence is part of the record pursuant to Brazil's alternative arguments and is offered as evidence of the amount of such subsidy payments."); Brazil's Opening Statement at

31. Nonetheless, even if the Panel were to find that Brazil's comments dated 28 January 2004, and 11 February 2004 – that is, more than eight months into this dispute and after scheduled panel meetings and written submissions have been concluded[62] – advanced an argument in the alternative, Brazil still would not have made a *prima facie* case with respect to decoupled payments. As set out in the US 11 February comments[63], Brazil has never presented evidence nor made arguments that would allow the Panel to evaluate "the effect of the subsidy [decoupled income support payments]". In particular, Brazil has never presented information relating to the total value of the recipients' sales as would be necessary to determine the amount of these subsidies benefiting upland cotton that are not tied to the production or sale of a given product. The reason for this omission is simple: Brazil has never believed, nor does it today, that the Annex IV methodology is necessary or even relevant to identify the subsidy benefit and subsidized product.[64] Because Brazil believes Annex IV is irrelevant for the Peace Clause but has offered its Peace Clause calculations (again, in the alternative) "as evidence of the amount of such subsidy payments"[65], logically, Brazil must believe that Annex IV "does not assist the Panel in determining the amount of [the subsidy]".[66]

32. We do note that Brazil has argued that, "as an alternative argument, Brazil attempted in its 28 January 2004 Comments to apply the Annex IV paragraph 2 non-tied subsidy allocation methodology to the US summary data".[67] We later set out in more detail the infirmities in Brazil's calculations. Here, we note that, Brazil evidently believes that by liberally assigning the "in the alternative" label, it will be able to assert that it has advanced evidence and arguments relating to whatever methodology the Panel adopts. Such an approach speaks volumes to Brazil's confidence in its approach to its serious prejudice claims, but it is also not enough to meet its *prima facie* case. A party may not make an argument, even if "in the alternative", for the first time nine months into briefing in a dispute, in its 18 February "Comments on US 11 February Comments on Brazil's 28 January 'Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled Data on 20 January 2004", in order to later claim to have carried its burden of making a *prima facie* case should the Panel decide to rely on this new argument. (The Panel will appreciate the irony that the party that has been complaining incessantly about delay in the proceedings has now been reduced to improperly trying to take advantage of that delay.) To allow this would deny the United States due process – as the entire dispute has been argued on other grounds and enormous amounts of time and resources have been

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the Second Panel Meeting, para. 5 ("In any event, Brazil has demonstrated a collective subsidization rate averaging 95 per cent and subsidies in the amount of $12.9 billion.").

[62] Article 12 and Appendix 3 of the DSU contemplates a process which all WTO dispute settlement proceedings must follow in order to ensure due process for the parties involved. Such a process requires that the parties "present the facts of the case, their arguments and their counter-arguments" before the first substantive meeting of the panel (*see* para. 4 of the Working Procedures of the Panel), present their case at the first substantive meeting of the panel (*see* para. 5 of the Working Procedures of the Panel), and then present their formal rebuttals by the second substantive meeting of the panel (*see* para. 6 of the Working Procedures of the Panel). In this regard, for Brazil to present new arguments for the first time now, or to use recently submitted US data to try to meet Brazil's initial burden of proof now, outside of the confines of the established panel process and without allowing the United States to provide counter-arguments or rebuttals, would appear contrary to the due process safeguards provided by the DSU and the Working Procedures of the Panel.

[63] US 11 February Comments, paras. 22-34.

[64] *See, e.g.*, Brazil's 18 February Comments, para. 38 ("[A] close look at the text of Annex IV reveals that it is ill-equipped to address the tabulation of support issue before the Panel."); *id.*, para. 41 ("Thus, Annex IV does not assist the Panel in determining the amount of support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.").

[65] *See* Brazil's Comment on US Answer to Question 214 from the Panel, para. 216.

[66] Brazil's 18 February 18 Comments, para. 41 ("Thus, Annex IV does not assist the Panel in determining the amount of support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture.").

[67] Brazil's 18 February Comments, para. 69.

devoted to defending against the arguments Brazil *did* make – and deprive the Panel of the opportunity to receive fully considered briefing with respect to those issues.

33. Finally, through its belated and patently inadequate arguments and evidence relating to Annex IV, Brazil has put the Panel in the inappropriate position of "mak[ing] the case for the complaining party" were it to base any serious prejudice findings on decoupled payment subsidies allocated using the Annex IV methodology. As we stated in the February 11 comments:

- "Brazil has neither sought nor presented any evidence relating to the total value of the recipient firms' sales. Brazil has also not only *not* argued that the Annex IV methodology is necessary to identify the subsidized product and the subsidy benefit, Brazil has also continually argued against use of the Annex IV methodology since, in its view, no allocation of the payment or quantification of the benefit is warranted under Part III of the Subsidies Agreement. Thus, it would appear that Brazil has resisted making the necessary legal arguments and refused to submit any evidence relating a proper analysis of its claims."[68]

Brazil chose to challenge decoupled income support payments not tied to production or sale of a given product but also chose not to seek, develop, and present evidence relating to the total value of the recipients' sales. In fact, Brazil has not presented evidence that would allow that methodology to be applied.[69] Therefore, due to its own litigation choices, Brazil has not established the amount of the challenged subsidies and therefore has not established a *prima facie* case that the effect of decoupled income support payments is to cause serious prejudice to Brazil's interests. The United States respectfully requests the Panel to so find.

34. The United States has reviewed Brazil's new comments regarding the *Japan – Agricultural Products* Appellate Body report and believes that Brazil continues to misread that report. In fact, Brazil does not address any of the facts relating to the "claims" and "arguments" made by the United States in that dispute, instead relying on generalizations as to "the proposition" that that report "stands for".[70] The United States refers the Panel to its previous comments on this report for a more complete analysis.[71]

35. The United States does note that Brazil argues that any evidence sought by the Panel that would allow an Annex IV calculation to be made "was entirely consistent" with the US proposal of that methodology and Brazil's in the alternative argument. We have already shown that Brazil's "in the alternative" evidence and arguments are patently insufficient, and this was done without the need for additional information or the need to run any Annex IV calculations. Further, it requires no information to understand and evaluate the US rebuttal that Brazil had not brought forward evidence and arguments relating to the Annex IV methodology necessary for Brazil to identify the subsidy benefit and subsidized product. In other words, Brazil cannot use a US defence as rationale to insist that the Panel seek information and make all the Annex IV calculations necessary to make Brazil's *prima facie* case for Brazil.

**Brazil's Various Allocation Methodologies, In Addition to Being Irrelevant for Peace Clause Purposes and Inapplicable for Serious Prejudice Claims, Are Internally Inconsistent and Illogical**

36. The United States here addresses Brazil's revised, and in some cases new, allocation methodologies. Brazil advances all of these allocation calculations for purposes of the Peace Clause (and, in the alternative, to identify the amount of the challenged subsidies). For purposes of the Peace

[68] US 11 February Comments, para. 33.
[69] *See* US 11 February Comments, paras. 44-60.
[70] Brazil's 18 February Comments, para. 88.
[71] US 11 February Comments, paras. 31-34.

Clause, as set out above, the United States believes that no allocation methodology may be employed since the only relevant support is product-specific. For purposes of Brazil's serious prejudice claims, we have already explained that the Annex IV methodology would be necessary to identify the subsidy benefit and subsidized product for each of the challenged decoupled income support measures – and Brazil has not brought forward evidence and arguments to allow the Annex IV methodology to be used. Nonetheless, here we present certain additional comments on Brazil's allocation methodologies.

**Brazil's Allocation Methodology Is Internally Inconsistent and Not Applied Consistently**

37. In its February 18 comments, Brazil reaffirms that "its methodology allocates support paid for upland cotton base that is 'planted to' upland cotton. It further allocates proportionally any other contract crop base payments that are not allocated to plantings of the respective contract payments crop".[72] We note that Brazil inserted quotation marks around "planted to" in the phrase "upland cotton base that is 'planted to' upland cotton". The reason for this is, as the United States has explained, there are no physical "base acres" on a farm. Crop base acres are an accounting fiction that do not represent any particular acres on the farm.[73] Thus, base acres cannot be physically "planted to" any crop; this expression merely means that a quantity of acres has been planted that corresponds to (are equal to or less than) a farm's quantity of base acres. Thus, at the outset, there is no physical basis to say that decoupled payments for base acres of a crop must be "support to" that crop to the extent that the quantity of planted acres is less than or equal to the quantity of base acres – but that is exactly the first step in Brazil's flawed methodology.[74]

38. There is also no economic basis to conclude that (in Brazil's words) payments for base acres of a crop "planted to" that crop are support to that planted crop. Because a recipient of a decoupled income support payment is free to plant no crop, plant one crop, plant multiple crops, or engage in other economic activities, that payment is a subsidy to all of the recipient's economic activities (if any). Brazil's "planted to" approach does not take into account the fungible nature of money: if the payment recipient chooses to produce only upland cotton, that would be the sole "subsidized product", but if the recipient chooses to produce upland cotton and other products, all of those products are the "subsidized product" since the payment could have been applied to any of those activities. (In fact, recipients of decoupled payments *do* engage in a myriad of other activities; for example, in marketing year 2002, the 137,160 cotton farms falling in Category A as defined by the Panel (that is, that planted fewer cotton acres than their quantities of upland cotton base acres) planted over 1 million acres of fruits and vegetables and nearly 7 million acres of "other crops" as compared to nearly 6 million acres of upland cotton.)[75]

39. Further, we note that Brazil's reason for treating decoupled income support payments for upland cotton base acres as "support to" upland cotton was allegedly based on the *de facto* tie between such payments and upland cotton production. That is, Brazil argued that such payments were necessary to support or maintain upland cotton production.[76] But Brazil does not apply that analysis throughout its methodology.

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[72] Brazil's 18 February Comments, para. 57.

[73] US 11 February Comments, para. 38.

[74] Applied to decoupled payments for upland cotton base acres, this first step in Brazil's methodology is the "cotton-to-cotton" alternative methodology set out by Brazil. *See, e.g.*, Brazil's 18 February Comments, Annex A, para. 3 ("Under this approach, only upland cotton payments for upland cotton base acres that are *actually planted to* upland cotton would be considered support to upland cotton.") (italics added). As set out in the text above, base acres are not "actually planted to" anything; thus, in addition to not accounting for the fungible nature of money, the cotton-to-cotton methodology is not based on any physical reality.

[75] *See* file "DCP02-2W.xls" (Category A farms, "Total" row).

[76] *See, e.g.*, Brazil's 18 February Comments, paras. 22-28.

- Brazil also allocates decoupled income support payments for non-upland cotton base acres *first* to the respective programme crops.[77]

- However, Brazil has made *no analysis* of whether such decoupled payments for *non*-upland cotton base acres support or maintain the production of the respective programme crop to which they are allocated by Brazil.

Therefore, *even under its own Peace Clause analysis*, Brazil has provided no basis to a key step in its allocation methodology – that is, the allocation of payments for non-upland cotton base acres first to the respective programme crops.

40. Brazil's current Peace Clause allocation methodology also directly contradicts its position earlier in this dispute. First, Brazil argued that all payments for upland cotton base acres were support to upland cotton. Then, Brazil amended its argument and asserted that, in order to cover their total costs, upland cotton producers must have planted upland cotton "on" upland cotton base acres. Subsequently, Brazil changed that argument to upland cotton must be "planted on" base acres for upland cotton, rice, or peanuts.[78] Thus, the latter two of these arguments were predicated on the notion that each planted acre of upland cotton corresponded to one base acre. Now, however, Brazil's allocation methodology could assign payments from multiple base acres to a single planted acre of upland cotton.[79]

41. Tellingly, Brazil has no response to this critique of its methodology, other than to assert that "they affect, at most, 0.9 per cent of the payments at issue for MY 2002"[80] and a vague statement that "[a]s for some of the US criticisms that might affect the results (except for MY2002), Brazil will control for these effects once the United States provides aggregate data in the manner requested by the Panel".[81]

- That is, Brazil has *no logical explanation* for the internal inconsistency in its methodology, that one upland cotton base acre should be allocated to one upland cotton planted acre while multiple non-upland cotton base acres could be allocated to one upland cotton planted acre.

This internal inconsistency suggests that Brazil's methodology is an effort to assign the maximum amount of payments to upland cotton, regardless of whether it provides any economically neutral method to allocate decoupled payments (as Annex IV, paragraph 2, does).

42. As the United States has previously pointed out, moreover, there is no economic reason to attribute decoupled income support payments to some crops (programme crops) but not others and some economic activities (programme crop production) but not others.[82] Brazil's 18 February calculations demonstrate the point. For farms with *no* upland cotton base acres, Brazil treats all upland cotton planted acres as "overplanted base" (that is, planted acres in excess of base acres)

[77] *See, e.g.*, Brazil's February 18 Comments, Annex A, Tables 2.5-2.7; *id.*, Annex A, para. 15 n. 175 ("The subsidy allocated is the entire amount of contract payments for that crop if planted acreage exceeds or equals base acreage. The subsidy allocated is [the] amount of contract payments for that crop adjusted by the ratio of planted acreage to base acreage if planted acreage is below base acreage.").

[78] *See, e.g.*, Brazil's Closing Statement at the Second Session of the First Panel Meeting, Annex I (summary of evidence demonstrating that upland cotton producers in MY 1999-2002 produced upland cotton on upland cotton, rice, or peanut base acreage) (9 October 2003).

[79] *See* US 11 February Comments, para. 38 (providing example of farm with 100 base acres of soy, 10 planted acres of soy, and 1 planted acre of cotton; under Brazil's methodology, the 1 acre of cotton would be "planted on" (receive payments related to) 90 base acres of soy).

[80] Brazil's 18 February Comments, para. 60.

[81] Brazil's 18 February Comments, para. 67.

[82] *See* US 11 February Comments, para. 37.

eligible for an allocation of the total subsidies available from "excess" base acres for other programme crops.[83]

- However, non-programme crops are in the *identical position* to upland cotton: that is, all non-programme crops also have base acreage equal to zero.[84]

- Even on Brazil's methodology, there is no reason (other than Brazil's assertion that it is so) to treat decoupled payments for non-upland cotton base acres as subsidizing upland cotton when a farm has overplanted its (zero) upland cotton base but *not* to non-programme crops that also (necessarily) have "overplanted" their base.

43. Finally, we note that, had Brazil desired to make its invented allocation methodology consistent with other arguments in its 18 February comments, it should have allocated "excess" base acres *not* to programme crops with "overplanted base" but rather to any crop (programme or not) produced by a payment recipient for which such payments "cover (or contribute to) the costs of production".[85] Where payments "cover (or contribute to) the costs of production," according to Brazil, payments *must* be "support to [that] specific commodity."[86] Further, if Brazil has *not* analyzed whether the challenged payments "cover (or contribute to) the costs of production" of other products produced by payment recipients, Brazil cannot assert that any payments must be "support to" one commodity over another since the payment might be necessary to "cover (or contribute to) the costs of production" of more than one product. That Brazil was unwilling to apply its "costs of production" principle throughout its allocation methodology suggests that Brazil's approach to Peace Clause interpretation has been a *post hoc* exercise in rationalization.

44. In sum, Brazil's allocation methodology is irrelevant to the Peace Clause because the only relevant support is product-specific. Unlike the Annex IV methodology, moreover, it is not a neutral and economically rational methodology for allocating a non-tied subsidy (such as decoupled payments) in order to identify the subsidized product and the amount of the subsidy. Finally, it is internally inconsistent and even contradicts other arguments Brazil has put forward in this dispute, for example, its argument that a payment is "support to a specific commodity" if it "cover[s] (or contribute[s] to) the costs of production" of that commodity.

**Brazil's "Annex IV" Methodologies Are Nothing Like the Methodology Set Out in Annex IV**

45. Brazil presents two other methodologies, a "modified Annex IV" calculation and a "US Annex IV calculation". Neither of these methodologies could serve as a basis to identify the amount of subsidy and subsidized product for purposes of Brazil's serious prejudice claims. The correct methodology is neither a "modified" nor a "US" methodology; rather, it is the methodology set out in the text of Annex IV. That text establishes that, if a payment is not "tied to the production or sale of a given product," the subsidized product is all of the recipient firm's sales, and the subsidy for any one product is that product's share of "the total value of the recipient firm's sales".[87] Brazil does not use

[83] *See, e.g.*, Brazil's 18 February Comments, Tables 2.17 & 2.18 (upland cotton base acres: 0; upland cotton planted acres: 518,837.0; planted acres over which "excess" subsidy allocated: 518,837.0).

[84] The data submitted in response to the Panel's supplementary request for information reveals that in marketing year 2002 (after base acres were established under the 2002 Act) farms planting upland cotton and having no upland cotton base acres planted substantial amounts of non-programme crop acreage, for example, 64,917 acres of fruits and vegetables, 9,664 acres of tobacco, and 169,480 acres of other crops. *See* "DCP02-2W.xls" file, Category C farms, "Total" row.

[85] Brazil's 18 February Comments, para. 3.

[86] Recall that it is for purposes of the Peace Clause that Brazil asserts its allocation methodology; in the alternative, Brazil argues that its Peace Clause methodology would also calculate the amount of the subsidy for its serious prejudice claims.

[87] Subsidies Agreement, Annex IV, paras. 2-3.

"the total value of the recipient firm's sales" in its "Annex IV calculations" and does not even attempt to calculate total sales of upland cotton producers. Thus, neither of these methodologies can fairly be called an "Annex IV" calculation.

46. With respect to Brazil's "modified Annex IV" methodology, we note that Brazil allocated total contract payments to farms producing upland cotton "over the value of *contract payment* crops produced on the farms" based on the assumption that "contract payments are support only to contract payment crops".[88] This approach is fundamentally inconsistent with Annex IV, paragraph 2, under which the subsidy is allocated over "the total value of the recipient firm's sales." Further, the United States has set out above a rebuttal of Brazil's assertion that decoupled income support payments could be considered "support only to contract payment crops". For example, such an approach ignores the fungible nature of money and contradicts Brazil's argument that payments are support to those crops whose costs are covered by the payments.

47. With respect to Brazil's "US Annex IV methodology," the United States has explained above that Brazil has not made a *prima facie* case with respect to decoupled payments because it has not presented evidence and arguments sufficient to allow an Annex IV calculation to be made. Brazil also has not corrected for errors in its calculations that the United States previously pointed out in its 11 February comments.

48. For example, Brazil's "US Annex IV methodology" errs in omitting the value of fruits and vegetables in calculating the total value of non-programme crop production. Brazil justifies this stance by asserting that fruits and vegetables could not possibly be "beneficiaries" of decoupled payments because they may not be grown on base acres. Again, this argument by Brazil ignores Annex IV, paragraph 2, under which the subsidy is allocated over "the total value of the recipient firm's sales" and ignores the non-tied (decoupled) nature of these payments. The aggregate data submitted today demonstrates that, in marketing year 2002 alone, 1.2 million acres were planted to fruits and vegetables on farms that reported cotton base acreage.[89] As pointed out in the US comments of 11 February[90], excluding fruits and vegetables biases significantly downward the value of non-programme crop acreage. For example, the per-acre value of non-programme crops including fruits and vegetables was estimated at $281[91] for 2002 – that is, 138 per cent higher than the $118 per acre Brazil calculated when fruits and vegetables are excluded.[92]

49. Including fruits and vegetables in the total value of crop production gives a more accurate reflection of the share of upland cotton as a per cent of the total value of crop production on farms that planted upland cotton. As noted previously,[93] had Brazil included fruits and vegetables in the value of non-programme crop cropland, upland cotton would have accounted for approximately 48.4 per cent to 56.7 per cent of the total value of crop production on farms that planted cotton in 1999-2002.

50. Moreover, Brazil has not taken any account of the value of on-farm production other than crops, and has presented no data that would allow that calculation to be made. Again, Brazil's approach is inconsistent with Annex IV, paragraph 2, pursuant to which the subsidy is allocated over "the total value of the recipient firm's sales." Brazil asserts that its "decision not to include any livestock value" is supported by the 1997 ARMS cotton costs of production survey, but that survey only shows that a small number of cotton farms in the survey year "specialized" in livestock production. Brazil does not define what "specialization" in livestock production would entail, but it would seem that a farm may have sales of a product without "specializing" in that product. The

[88] Brazil's 18 February Comments, para. 50.
[89] *See* file "DCP02-2W.xls" ("Grand Total (Farms A - C)" row).
[90] *See* US 11 February Comments, para. 54.
[91] See Exhibit US-154.
[92] Brazil's 18 February Comments, Annex A, Table 4.5.
[93] *See* US 11 February Comments, para. 57.

evidence suggests that, had Brazil taken into account the value of non-crop on-farm production, the share of cotton as a per cent of total farm sales would be lower still. For example, in the 1997 ARMS cotton costs of production survey, the US Department of Agriculture found that, for 1997 when the value of cotton was high, cotton accounted for only 44.5 per cent of the total value of agricultural production on cotton farms.[94]

51. Brazil also fails to include off-farm economic activity, which can be substantial, in its calculation. Annex IV, paragraph 2, establishes that the non-tied subsidy is allocated over "the total value of the recipient firm's sales"; there is no basis in that provision to limit the sales over which the subsidy is allocated to *farm* sales. Brazil's refusal to apply the Annex IV methodology in full introduces yet another serious distortion in its calculation as cotton operations earn almost 30 per cent of income from off-farm sources.[95]

52. Finally, Brazil contests the notion that, in calculating the amount of subsidy benefiting upland cotton, it must take account of the fact that decoupled payments for base acres are capitalized into higher land values and cash rents, thus benefiting land owners, not necessarily those farming the land, referring the Panel to its 28 January comments.[96] There, Brazil asserts that it is for the United States to demonstrate that payments on rented acres are capitalized into rents, thus impermissibly seeking to shift its burden of establishing the amount of challenged subsidies to the United States as responding party. Brazil also cites aggregate state-level data on cash rents to show that average cash rents in some cotton-producing states increased by less than the rate of inflation over the 1996-2002 period.[97] Such analysis, however, ignores the aggregation bias introduced by averaging (1) cash rents from farmland *with* programme base with (2) cash rents from farmland *without* programme base.

53. We recall that Brazil has previously conceded that, as of marketing year 1997, 34 to 41 cents per dollar of production flexibility contract payments were capitalized into land rent.[98] Brazil now argues that there is no evidence that further (increased) shares of production flexibility contract payments were capitalized in subsequent years. The Commission on the Application of Payment Limitations for Agriculture, to which Dr. Sumner presented testimony, reached conclusions on this very issue, however, and Brazil submitted this report as Exhibit BRA-276. The United States was therefore disappointed to see that Brazil's exhibit was missing pages 89-122, which precisely includes the portion of Chapter 5 of the Report entitled "Effects of Further Payment Limitations on Farmland Values." We attach as Exhibit US-155 the missing pages from the report.

54. The analysis of the *Report of the Commission on the Application of Payment Limitations for Agriculture* directly contradicts Brazil's conclusion that cash rent data "do [not] appear to reflect to any considerable extent the effects of PFC or other contract acreage payments".[99] To the contrary, the Commission's Report explained:

> In early 1997, professional farm managers indicated that in areas where competition for rental land was intense, *PFC payments were almost immediately captured by landowners and reflected in rental rates and land values*. Given the intense competition for leased land in many areas, tenants operating on cash leases found their lease rates being bid up until the landowner had captured most of the tenant's share of PFC payments. Producers with share leases reported that some landowners reduced their share of expenses, retained a larger crop share, or converted from share

[94] See Exhibit BRA-16, table 3.
[95] *See* US Further Rebuttal Submission, para. 137.
[96] Brazil's 18 February Comments, para. 75.
[97] *See* Brazil's Comments on US Answer to Panel Question 242, paras. 204-206 (28 January 2003).
[98] Brazil's Answer to Question 179 from the Panel, para. 165 (27 October 2003); Brazil's Opening Statement at the Second Panel Meeting, para. 57.
[99] Brazil's Comments on US Answer to Panel Question 242, para. 208 (28 January 2004).

> leases to cash leases. However, in areas where competition for rental land was less intense, tenants retained much of their PFC payments (Ryan et al). *Goodwin and Mishra estimate that each additional dollar per acre of PFC payments increased US average rents by $0.81 to $0.83 per acre during 1998-2000.*[100]

Thus, the missing pages from Brazil's own exhibit reports that, during 1998-2000, an estimated average of 81 to 83 per cent of production flexibility contract payments were captured by landowners through increased rent.[101] This conclusion is consistent with the US position that land owners capture the benefit of decoupled payments for base acres made to producers on rented land.[102] The Report also extends its conclusions to market loss assistance payments, direct payments, and counter-cyclical payments.[103]

55. We also note Brazil's argument that counter-cyclical payments could not be captured by landowners through increased rent because the payments are "triggered on a year-by-year basis depending on low prices for upland cotton", and a landowner "cannot know in what amount CCP payments will be made".[104] As noted, the Commission's Report does not support Brazil's position on counter-cyclical payments. However, Brazil does not draw the logical conclusion from its assertion: if that statement is true, then counter-cyclical payments cannot have effects on cotton farmers' planting decisions and production because farmers (and therefore landowners) cannot anticipate receiving those payments. On the other hand, to suggest that counter-cyclical payments *do* have production effects, Brazil has also argued that farmers *do* anticipate counter-cyclical payments being made.[105] If that is true, then Brazil's own evidence demonstrates that those payments will be capitalized. Brazil cannot have it both ways.

56. In sum, Brazil's two "Annex IV" methodologies are wholly inadequate because Brazil does not even attempt to apply the methodology actually set out in Annex IV: that is, to allocate the value of a non-tied subsidy across "the total value of the recipient firm's sales". Brazil has never sought nor

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[100] Exhibit US-155, at 106 (italics added).

[101] We also note that this information directly contradicts Brazil's previous argument that "contrary to the premise of the Panel's question [179], th[e] evidence suggests that PFC payments are somewhat, but not 'largely capitalized' into land rents". Brazil's Answer to Question 179 from the Panel, para. 165 (27 October 2003).

[102] Brazil also attempts to draw a distinction between land that is cash-rented versus share-rented. However, the Commission's Report describes a "non-operator landlord" as including those who "receiv[e] rent in the form of the crop produced on the land." Exhibit US-155, at 104. Thus, the Report's conclusions that the benefits of government payments largely accrue to non-operator landlords would appear to apply to owners who share-rent their land as well.

[103] *See, e.g.*, Exhibit US-155, at 106 ("Barnard et al. (2001) estimated that $62 billion or 20 per cent of the value of land producing the 8 major programme crops . . . was due to PFC payments, market loss assistance, disaster payments, and marketing loan benefits."); *id.* at 106 ("The effects of farm commodity payments on cropland values vary geographically, reflecting differences in . . . payments for crops eligible for direct and counter-cyclical payments and marketing loan benefits . . . ."); *id.* at 111 ("Government payments in the form of direct payments, counter-cyclical payments, and marketing loan benefits affect the value of farmland and land rents. Several studies indicate that government payments in recent years have increased farmland values nationally by 15-25 per cent.")

[104] Brazil's Comments on US 22 December 2003 Answers, para. 209 (28 January 2003). Brazil goes on to say: "Further, as Brazil has demonstrated repeatedly, given the high non-land-related production costs involved in producing cotton, most US producers simply could not profitably produce cotton without CCP payments. Therefore, there is little, if any, basis for a non-producing landlord to demand increased rents to capture CCP payments". *Id.* The United States is puzzled by this assertion. It would appear that Brazil is saying that landlords would not charge higher rental rates because producers "could not profitably produce cotton without CCP payments". This is not our understanding of how landlords choose to set rental rates.

[105] For example, in Dr. Sumner's model, acreage is a function of the net return to planting cotton, which includes prospective counter-cyclical payments. *See* Brazil's Further Submission, Annex I, para. 28 (equation (1)).

presented the value of *total sales* of the recipients (upland cotton producers) of the challenged decoupled income support payments. Brazil's inadequate calculations cannot meet its burden of establishing a *prima facie* case on decoupled income support payments for purposes of its serious prejudice claims.

**Conclusion: Brazil's Interpretation of the Peace Clause Would Upset the Balance of Rights and Obligations of Members in the WTO Agreements**

57. Throughout this dispute, we have noted that Brazil's Peace Clause interpretation is without foundation in the text and context of that provision and would upset the balance of rights and obligations set out in the Agreement on Agriculture. Brazil asserts that "[h]ad the United States been concerned about the certainty of its peace clause 'protection,' it would not have been difficult for Congress, in the 1996 FAIR Act or even the 2002 FSRI Act, to include a 'circuit breaker' provision directing the USDA Secretary to stop funding any upland cotton budgetary outlays in excess of the 1992 levels".[106] Of course, the United States has disciplined itself to grant support not in excess of that decided during the 1992 marketing year by shifting away from the product-specific deficiency payments with high target prices under the 1990 Act and instead to provide a mix of decoupled income supports that are green box (direct payments) or non-product-specific (counter-cyclical payments) and product-specific marketing loan payments. But Brazil's assertion raises a number of questions:

- How could the United States have known how to cap the budgetary outlays under the decoupled income support measures to stay within the 1992 levels?

- How could the United States have known what payments would be considered "support to upland cotton" under Brazil's methodology, which only appeared on 20 January 2004?

- Which of Brazil's five in-the-alternative methodologies – the "cotton-to-cotton methodology", "Brazil's methodology", the "modified Annex IV methodology", the "US Annex IV methodology", or "Brazil's 14/16th methodology"[107] – should the United States have been applying to ensure that budgetary outlays did not exceed the 1992 level?

Indeed, Brazil has ended this dispute taking the position that "the Panel needs to adopt a *reasonable* methodology to be applied for purposes of the peace clause in assessing the amount of support to upland cotton from the four contract payment programmes".[108] It is difficult to imagine how that standard could have been incorporated into the design of the challenged decoupled income support measures to ensure Peace Clause compliance.

58. The United States submits that the Peace Clause must be interpreted in a way that permits Members to comply in good faith – that is, Members must be able to tell if they will breach the Peace Clause or not. Putting legal interpretive issues aside, Brazil's budgetary outlays approach does not do that since, with price-based support such as marketing loan payments, the United States cannot "decide" market prices.[109] Brazil's allocation methodology also does not do that because the

[106] Brazil's 18 February Comments, para. 85.

[107] *See, e.g.*, Brazil's 18 February Comments, para. 55. We note that the range of budgetary outlays Brazil calculates under these five in-the-alternative methodologies range from, for 2002 direct payments, $383.1 million to $466.8 million, and for 2002 counter-cyclical payments, from $640.4 million to $988.3 million.

[108] Brazil's 18 February Comments, para. 42 (italics added).

[109] We have previously noted that "support" does not mean "budgetary outlays". US 11 February Comments, para. 16 n.12. In addition, it is ironic that Brazil criticizes the US interpretation on the grounds that the Peace Clause does not read "product-specific support" when the Peace Clause also does not read "budgetary

United States does not "decide" what a decoupled income support recipient chooses to produce (or not to produce).[110] Brazil's approach to Peace Clause issues would rob Members of the ability to design price-based and income support measures to conform to the Peace Clause and mean that Members could not know if they had complied with the Peace Clause until it was too late to do anything about it.

59. The United States has demonstrated that using any measurement that reflects the support "decided" by the United States – rather than factors (such as market prices) beyond the United States' control – US support to upland cotton in marketing years 1999-2002 has not exceeded the 1992 marketing year level.[111] The question then is whether the Panel will find that the United States has breached the Peace Clause simply because market prices were lower in some recent years than they were in 1992. We have demonstrated that the United States has disciplined itself to grant support not in excess of that decided during the 1992 marketing year.[112] Therefore, we are entitled to the protection of the Peace Clause and respectfully request the Panel to so find.

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outlays"; however, the latter *is* a defined term in Article 1(b) of the Agreement on Agriculture while the former is not, suggesting that Members' decision not to use "budgetary outlays" in the Peace Clause was deliberate.

[110] As set out above, no allocation methodology can be applied to the Peace Clause as the only support that is relevant to that determination is support to a specific commodity, read according to its ordinary meaning and in context.

[111] *See, e.g.*, US 11 February Comments, paras. 15-17.

[112] Recognizing, as the United States believes is required by the Peace Clause text, that "decided" and "grant" cover only those parameters over which Members exercise control would also be consistent with this approach of allowing "good faith" compliance since it would permit Members to control whether their measures conformed to their obligations.

# ANNEX I-24

## RESPONSE OF THE UNITED STATES TO THE PANEL'S 3 FEBRUARY 2004 DATA REQUEST, AS CLARIFIED ON 16 FEBRUARY 2004

3 March 2004

**Introduction**

1. The United States is submitting today 8 data files, as requested by the Panel in its 3 February 2004, supplementary request for information, as clarified by the Panel's communication of 16 February 2004. The files are in an EXCEL format.

2. The data has been prepared in response to those letters, and has been prepared as well as possible in the time allotted, involving much time and effort. We first address how the files were derived and issues involved in their preparation, such as the handling of 1999 and 2000 crop soybeans and 2002 peanuts. Because of the peanut and soybean issues, there were in essence two runs of data, and both sets of data are presented.

3. In the first run, the United States ran the figures for 1999 and 2000 treating soybeans as a non-base crop, and thus one which would not effect any categorizations based on comparing plantings of total programme crops to total programme crop bases (such as those necessary to sort farms into B1, B2, and B3 categories). In the second run, soybeans were treated as a full programme crop for the Market Loss Assistance payments for those years in which oilseed payments were made (1999 and 2000) with an assigned base of zero for each farm as there were no farm bases for the soybean crops for 1999 and 2000.

4. Likewise, for peanuts, there were separate runs for 2002. In the first run, the peanut crops for Direct payments and Counter-cyclical payments were treated as a non-programme crop for categorization purposes. In the second run, peanuts were treated as a programme crop with a base of zero for each farm.

5. These two runs took into account the directive of the Panel of 16 February. There, the Panel instructed us to treat soybeans for Market Loss Assistance (MLA) as a programme crop and peanuts as a Direct and Counter-cyclical Payment (DCP) crop. As indicated, this did raise a question, one which is colored somewhat by a broader issue on the MLA payments themselves. There is no separate base acreage or yields for MLA purposes. And, the oilseed programmes for 1999 and 2000 were not farm based programmes. No farm had a soybean base for those years. Likewise, with peanuts, there was no farm base for 2002, the first year that peanuts became a programme crop. Bases were not assigned for peanuts until 2003 and could not be effective until that year. For 2002, the peanut programme was a producer-based programme. The same was true for soybeans in 1999 and 2000.

6. Finally, we also present the results of our efforts to identify any farms that would not have protectable privacy interests under the Privacy Act of 1974, as requested in item (a) of the Panel's 3 February supplementary request for information.

7. We then indicate how the files were put together and identify the files.

**There were no Separate Market Loss Assistance Bases; Rather the Payments Were Made Proportionately to the Production Flexibility Contract (PFC) Payments**

8. The market loss assistance payments (MLAs) were after the fact and simply supplemented payments that were made to a person under a PFC contract. There were no new contracts, bases, or yields. There were four MLA programmes. The first was for the 1998 crop. MLA programmes followed for the 1999, 2000 and 2001 crops, each under separate legislation, each after the fact – that is after the crop was planted and in supplement of payments already made under the PFC contracts.

9. To respond to the Panel's data request of 3 February 2004, the United States was called upon to give information for the PFCs and the MLAs. The data request was for base acreage with respect to farms that were in the programme. There were no bases as such for MLAs. The payments were proportional to what has been received in the PFC. The only slight difference was that for 2000, where Congress simply prescribed a rate, drawing from the previous statute for the previous crop. Thus, we have treated the request for MLA data (as explained below, soybeans aside) to be a request for the PFC data for the PFC year for which the PFC payment was supplemented by a particular MLA payment.

**There Was No Soybean Farm Base for the 1999 and 2000 Market Loss Assistance Programme As There Were No Market Loss Assistance Programmes for Soybeans, and Oilseed Payments in those Years were Producer-Based, Not Farm-Based**

10. Soybeans complicate the analysis. The United States reads the Panel's 16 February letter to indicate that for purposes of the data request, soybeans should be treated as an MLA crop. This presents an analytical problem because no farm had a soybean base. We note that the data files do contain for every category the soybean plantings for 1999 and 2000. (We note that there was no oilseed programme, and therefore no payments for soybeans, for 2001.)

11. As an initial matter, soybean payments for 1999 and 2000 were part of an overall oilseeds programme. There was no oilseed programme for the 2001 crop; therefore, there was no soybean payment of any kind for that year. There was never, even for 1999 and 2000, a base or yield for a farm for oilseeds in the PFC era.

12. For the PFC programme crops like cotton, the "farm" had a base. The "farm" had a yield. "Producers" on the farm received the payment even if they were not the same person who had produced the crops that produced the historic base or yield or had even been on the farm when the base or yield were created. If the producer had an interest in several farms with base under the PFC programmes, the producer received several checks. The base acreage and yield derived from historical plantings on the farm.

13. In the oilseeds programme, it was completely different. The producer had a base. The producer had a yield. The farm had no base. The farm had no yield. For the 1999 programme, if the producer was on Farm X in 1999 and planted soybeans there, the producer could receive a payment based on plantings that the producer may have had on Farms A, B, C, and D in the historical period. Current producers on Farms A, B, C, and D, by contrast, would have no "base." In short, there was no base for soybeans for any farm for oilseeds payments for 1999 or 2000.

14. Thus, this is the problem in terms of the data request for the Panel: the request considers soybeans as a covered commodity for MLAs and seeks information for base acreage on "farms," but soybean base for 1999 and 2000 oilseed payments was producer-based, not farm-based. In order to be as responsive as possible, we have run the data two ways. First, for 1999 and 2000, we treat soybeans as a non-programme crop for purposes of categorizing the farms into subcategories (as explained in more detail below), but show the actual soybean plantings for all farms. In the second run, we treat

soybeans as a programme crop and, for categorization purposes, treat all farms as having a soybean base of zero.

15. We respectfully refer the Panel to its 3 February 2004, letter. Category B farms are those with cotton "overplantings" – that is with more cotton plantings than cotton base. Category B2 farms are defined are those where, for all covered crops added together, the farm underplanted the total aggregated base. B3 is the mirror image of B2. It is where there was an aggregated overplanting for all programme crops taken together.

16. Assume the following plantings on Farm A:

| | | |
|---|---|---|
| Cotton | Base 10 | Plantings 12 |
| Rice | Base 5 | Plantings 0 |
| Soybeans | -- | Plantings 5 |

If soybean plantings do not matter for categorization, then this farm is a B2 farm since the plantings for rice and cotton would be 12 and the total base would be 15. But if soybeans are counted and treated as having a zero base, then this farm is a B3 farm because the countable base would still be 15, but the plantings would now be 17. This would only be the case for MLA. Since soybeans, under the Panel's February 16 letter, would only be counted for MLAs, the farm would still be a B2 farm for purposes of the PFC calculations for the same year.

17. As we have indicated and set out further below, we have it covered both ways. We provide a file in which soybeans are treated as a covered commodity (for MLA purposes) with a farm base of zero. We also present a file in which soybeans are not considered a programme crop, in which the PFC and MLA figures are the same.

**Farms Had No Peanut Base in 2002 Because the 2002 Peanut Programme was Producer-Based, Not Farm-Based**

18. The Peanut programme presents the same problem for the 2002 Direct and Counter-cyclical Programme (DCP) as do soybeans for the 1999 and 2000 programmes, since it too was a producer-based, not a farm-based programme. There were no peanut bases for 2002 for any farm. The base was assigned to a producer for 2002. That producer had to be a "historical peanut producer" – someone who had produced peanuts in the base period. For the 2002 crop year, the producer received one check for all of the producer's base, calculated as the payment rate times the "payment acres of the historic cotton producer" times the "average peanut yield . . . for the historic cotton producer."[1] However, starting in 2003, the base and yield had to be assigned by the historical producer to a farm of that producer's choice. The designated farm did not have to be a farm in which the producer had an interest, or one on which the producer had ever produced peanuts, or, for that matter, one on which anyone had ever produced peanuts or would ever produce peanuts in the future.

19. The distinction is perhaps best demonstrated by example. Assume that a farmer had in 1998-2001 produced peanuts on rented Farms A, B, and C. Assume that for 2002 the farmer decided to get out of farming altogether, and was living in retirement in Denver, Colorado, far outside the peanut belt and with no interest in any farm or any farm production anywhere. Under the terms of the 2002 Farm Bill, that historical producer would receive a payment based on that producer's base and that producer's yield. If that farmer happened to be a producer in 2002 on Farm D, that farmer would nonetheless receive payment based on his or her production on Farms A, B, and C in the base period.

[1] 2002 Farm Bill, § 1303(c) (direct payments) (Exhibit US-1); *see id.* § 1304(e) (counter-cyclical payments).

Producers in 2002 on Farms A, B, and C would receive nothing (unless they of course had their own producer base).

20. For 2003, however, the farmer living in Denver would have to pick a farm on which to place his base.

21. In short, there were no bases for any peanut farm in 2002, and the problem is the same as for soybeans. As for soybeans, the data was run both ways – that is, treating peanuts as a covered commodity for 2002 with a farm base of zero and not treating peanuts as a covered commodity.

**How the Data was Compiled**

22. The United States now explains the source of the data. We have previously mentioned the limitations of crop reports, which is from where all the planting data in the aggregations presented here are derived. Crop reports were not generally required until 2002, at which point they were required for persons seeking benefits for crops other than peanuts in the form of direct payments, counter-cyclical payments, or marketing loans. As for peanuts, similar reporting requirements apply where the payments are in connection with farms for which a base is assigned. Hence, the peanut reporting provision only begins to apply with the 2003 crop.

23. We note that the total number of acres accounted for in 2002 may exceed the total cropland numbers set out in the 18-19 December 2003 data, as corrected on 28 January 2004. Differences may result because: (1) farmers may have reported plantings of grass on noncropland; (2) there can be double-cropping in some areas; and (3) CRP acres may not have been reported and counted as available cropland.

**The Categories of Farms for the Aggregated Data Files Responsive to Part "(b)" of the Panel's Request**

24. We have sorted and aggregated the relevant farms into those categories set out in the 3 February supplementary request from the Panel. Category A farms are those for which the farms underplanted their cotton base. The panel also asked for farms that did not plant any other covered commodities and we have classified those as "A1" farms.

25. Category B farms are farms that overplanted their base. Subcategory B1 farms are farms that, in total for all base crops, planted exactly their covered commodity base, while B2 farms under-planted and B3 farms over-planted those total bases.

26. Category C farms planted cotton but had no base.

**Data on Farms Without Privacy Interests Under the Privacy Act of 1974 As Set Out in Item (a) of the Panel's Request**

27. We now address what was item (a) of the Panel's 3 February supplementary request for information. The Panel asked for information relating to those farms that do not have a privacy interest and thus who could potentially be subject to a detailed release of planted and base acreage information. This information appears to be of little interest to Brazil at this point as Brazil indicated in its 13 February letter that "because the United States apparently intends only to provide farm-specific information for far less than the total amount of farms (i.e., those that are not held by 'individuals') this information will be useless for calculating the exact amount of total contract payments."[2] By way of contrast, Brazil commented that, "[i]f the United States provides the complete information requested in part (b) of the 3 February 2004 Request, then most of Brazil's 28 January

[2] Brazil's 13 February 2004, Letter to the Panel, at 2.

Data Comments would be rendered moot," and "[w]ith the actual and complete data, the Panel would be in a position to apply any methodology it deems acceptable."[3]

28. For non-closely held corporations, information *voluntarily* received from a corporation is to be withheld if it is not the type of information customarily released by the corporation to the public. *See* Center for Auto Safety v. National Highway Traffic Safety Administration, 244 F.3d 144 (D.C. Cir. 2001).

29. Such is the case with respect to plantings prior to 2002. It would therefore, be necessary to examine, on a case by case basis, the circumstances of each "corporate" farming operation to determine if it is a closely held corporation which might enjoy a privacy interest and if the information was voluntarily submitted and not the type of information customarily released by the corporation to the public.

30. Given the time available, we used the year 2002 when in all cases, crop reports were mandatory with the limits indicated above. The United States conducted an electronic sort of cotton farms to narrow the number of files to a manageable number, which we then examined on a farm-by-farm basis to see if they were closely-held corporations. The data file containing farm-by-farm base, yield, and planted acreage information for these farms is described below.

**The Data Files**

31. The United States is providing the following data files via CD-ROM. This information is sensitive, and we do not consent to the release of this information to the public domain. Therefore, as with the data submitted on 18 and 19 December 2003, as corrected on 28 January 2004, pursuant to paragraph 3 of the Panel's working procedures, we designate this information as confidential.

32. File Name: PFC1999W.xls: This file is the first 1999 PFC and MLA file treating soybeans as a non-base crop and showing soybeans plantings.

33. File Name: PFC99-2W.xls: This file is the second 1999 PFC and MLA file. Soybeans is treated as a crop with a zero base on all farms.

34. File Name: PFC2000W.xls: This file is the 2000 PFC and MLA files with soybeans treated as a non-base crop and showing soybeans plantings.

35. File Name: PFC00-2W.xls: This file is the 2000 PFC and MLA files treating soybeans as a crop with a zero base on all farms.

36. File Name: PFC2001W.xls: This file is the 2001 PFC and MLA file.

37. File Name: DCP2002W.xls: This file is the 2002 Direct and Counter-cyclical file with peanuts treated as a non-base crop and showing peanuts plantings.

[3] Brazil's 13 February 2004, Letter to the Panel, at 5. Brazil further commented that "by producing the complete aggregated information, there would no longer be a need to draw adverse inferences." *Id.* In light of the filing today of a complete response to item (b) of the Panel's supplementary request, the United States welcomes Brazil's withdrawal of its request that the Panel draw adverse inferences in this dispute.

38. File Name: DCP02-2W.xls: This file is the 2002 Direct and Counter-cyclical file with peanuts treated as a crop with a zero base on all farms.

39. File Name: notclose.xls: This is the result of the search for not closely held farms as described above. (Each line corresponds to one farm. The base, yield, and planting fields are set out in the file and are the same as those in the base/yield and planted acres data files provided on 28 January 2004 (as set out in Exhibit US-145).)

# ANNEX I-25

## UNITED STATES' RESPONSE TO QUESTION 264(B) DATED 3 FEBRUARY 2004 FROM THE PANEL TO THE PARTIES FOLLOWING THE SECOND MEETING OF THE PANEL

3 March 2004

**264. The Panel asks the United States to clarify certain aspects of Exhibit US-128:**

**(b) Does the US agree with the statement in paragraph 135 of Brazil's 28 January 2004 comments on US responses to questions that the difference between the $1,148 billion in the chart at para. 165 of Brazil's 11 August answers to questions and the $666 million amount in Exhibit US-128 ($1.75 billion) closely corresponds to the total "Claims rescheduled" figure reported by the US in Exhibit US-128 (column F)?**

1. The United States first notes that Exhibit US-128 portrays data on a cohort basis. The figures in Brazil's chart are on a fiscal-year basis, which do not necessarily correspond to figures on a cohort-basis. In addition, data reflected in Exhibit US-128 commence with the 1992 cohort and end with the 2003 cohort. In contrast, Brazil's chart commences with fiscal year 1993 and ends with fiscal year 2002.

2. Also, as indicated in response to question 264(c)[1], Exhibit US-128 does not reflect the receipt of principal payments under the reschedulings. Exhibit US-148 (column F) reflects approximately $205 million of principal collected on the reschedulings. As a theoretical matter, such "recovered principal" should be reflected in the budget line 88.40 that Brazil cites in its chart. Accounting research within the US Government suggests, however, that a significant portion of this amount has not in fact been reflected in that budget line.

3. Although the $1.75 billion number cited in the question and the $1.637 billion number pertaining to "claims rescheduled" are numerically of the same order of magnitude, for the reasons noted above, a direct comparison between Exhibit US-128 and Brazil's chart is not as appropriate or facile as Brazil would suggest. Nevertheless, as a general matter, the United States acknowledges that the most significant difference between the data reflected in Exhibit US-128 and the data in the Brazilian chart arises as a function of the standard accounting treatment of reschedulings by the Commodity Credit Corporation as no longer constituting an outstanding claim, but in fact a new direct

[1] US Answers to Further Panel Questions Following Second Panel Meeting (11 February 2004), para. 24

loan.[2] This is consistent with standard commercial practice in accounting for refinancings and reschedulings.[3] Such treatment is reflected in column F of Exhibit US-128.

[2] Under FASAB: Original Pronouncements, Version 3 (01/2004), a "direct loan" is defined as "a disbursement of funds by the government to a nonfederal borrower under a contract that requires the repayment of such funds within a certain time with or without interest. The term includes the purchase of, or participation in, a loan made by another lender. (Adapted from OMB Circular A-11)." http://www.fasab.gov/pdffiles/vol1v3.pdf, p. 1290. Section 185.3 of OMB Circular A-11 defines "direct loan": "a disbursement of funds by the Government to a non-Federal borrower under a contract that requires repayment of such funds with or without interest. The term includes: [. . .] Financing arrangements that defer payment for more than 90 days [. . .]." Exhibit BRA-116 (section 185.3, page 185-6).

[3] In a routine case, a lender upon rescheduling or refinancing a loan would extinguish the prior loan because payments are no longer due on the original schedule. The lender simultaneously would book the new rescheduled loan as the asset (receivable) pursuant to the terms of which payments would be received. Perhaps the most familiar illustration of this type of transaction is a home mortgage refinancing where the applicable interest rate and maturity are changed from the prior mortgage loan. Upon consummation of the refinancing, the original note and mortgage are deemed paid, and the new loan and its terms are booked as the new loan receivable.

# ANNEX I-26

## BRAZIL'S COMMENTS ON US 3 MARCH 2004 DATA

10 March 2004

**Table of Contents**

**List of Exhibits**

| | |
|---|---|
| 'Calculations Acreage Based Methodologies.xls' provided in electronic format | Exhibit Bra-433 |
| 'Calculations Value Based Methodologies.xls' provided in electronic format | Exhibit Bra-434 |

## I. INTRODUCTION

1. Brazil thanks the Panel for the opportunity to comment on the US data produced on 3 March 2004. Section II of this submission provides Brazil's comments on the completeness and usability of the 3 March 2004 US data. In Section III, Brazil presents the results of its calculations applying the same allocation methodologies as used in Brazil's 18 February 2004 Data Comments. In Section IV, Brazil offers four tables comparing MY 1992 support to upland cotton with MY 1999-2002 support to upland cotton as determined under the four allocation methodologies.

2. Brazil's results – whether based off the 3 March 2004 US summary data or the earlier US 18/19 December 2003 or 28 January 2004 summary data – remain unchanged. Under any reasonable methodology for allocating contract payment support to upland cotton, the US support to upland cotton in MY 1999-2002 exceeds the support decided in MY 1992, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture. Thus, the US domestic support measures challenged by Brazil in this dispute are not "exempt from actions" under the SCM Agreement and GATT Article XVI.

## II. THE US 3 MARCH 2004 DATA REGARDING PART B OF THE PANEL'S 3 FEBRUARY 2004 REQUEST IS GENERALLY USABLE AND SHOULD BE RELIED ON BY THE PANEL

3. Given the US refusal to provide farm-specific data, the aggregated data provided by the United States on 3 March 2004 in response to part (b) of the Panel's 3 February 2004 Request is the best information available before the Panel. While certain problems with the US 3 March 2004 data remain (which particularly affect any value-based Annex IV-type allocation methodology), the Panel can and should rely on this data in making its peace clause determination. Thus, Brazil notes that it no longer considers that relying on its "14/16th" methodology would be appropriate.

4. With respect to part (b) of the Panel's 3 February 2004 Request, the United States appears to have provided complete summary base and complete summary planted acreage data covering all crops for which data was requested by the Panel and all farms covered by the Panel's request.

5. However, the United States has engaged in a completely incorrect reading of the Panel's request for data on Category A farms. The Panel defined Category A farms as "farms [that] had fewer *upland cotton planted acres* than upland cotton base acres".[1] Unfortunately, the United States read this request as covering all farms that had upland cotton base and planted less than their full upland cotton base to upland cotton or that planted no upland cotton at all.[2] There is no basis for any such interpretation. Farms with no planted acres do not have "fewer upland cotton planted acres" – which refers to a positive amount – they have none. Indeed, from the context of the Panel's 3 February 2004 Request is becomes clear that the entire purpose of the Panel's request was to facilitate the calculation of support to upland cotton, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture. Neither Brazil, nor the United States, has ever argued that farms, which do not even plant upland cotton, receive any "support to upland cotton". Including these farms in the calculations would inevitably lead to major distortions, as the calculations are impacted by base and planted acreage on farms that are of no relevance to a determination of the "support to upland cotton".[3] Had the United States interpreted the Panel's request according to its ordinary meaning, or, alternatively,

[1] 3 February 2004 Communication from the Panel, p. 1 (emphasis added).

[2] This is apparent from the fact that the sum of all upland cotton base acres from Category A, B and C farms in the US 3 March 2004 summary data equals the amount of total upland cotton base in the United States. Logically, farms that gave up producing upland cotton must have been included in one of the categories and could only have been included in Category A. Indeed, this inclusion explains that large amount of upland cotton base relative to the upland cotton planted acreage on these farms.

[3] Brazil notes that this problem does not affect the Cotton-To-Cotton Methodology, as discussed below.

provided the farm-specific information requested by the Panel on 8 December 2003, 12 January 2004 and 3 February 2004 (as part (a) of the Panel's Request[4]), this would not have been a problem.

6. Nevertheless, Brazil has been able to use the 28 January 2004 US summary data to largely correct for this erroneous inclusion of additional non-upland cotton producing farms in Category A. The 28 January 2004 US summary data contains a separate category for farms that hold upland cotton base but do not produce upland cotton. Brazil has used this aggregate information to subtract out of Category A data any base and planted acreage on farms that do not produce upland cotton.[5] However, this approach was not feasible for the US Annex IV Methodology, since the 28 January 2004 US summary data does not contain all the data items contained in the 3 March 2004 US summary data. In particular, specific data on planted acreage for non-contract payment crops is missing from the 28 January 2004 US summary data, limiting Brazil's ability to correct all Category A farm data items for the purposes of applying the data to the US Annex IV Methodology. Similarly, a correction was not feasible for soybean planted acreage during MY 1999-2001 and for peanut planted acreage in MY 2002, as discussed below. Thus, any remaining distortions that might result from the necessary exclusion of soybeans and peanuts of Brazil's calculations under Brazil's Methodology and under the Modified Annex IV Methodology are directly a result of the US erroneous inclusion of non-upland cotton producing farms in Category A (and its continued refusal to produce farm-specific data).

7. In addition, and again in contrast with the 28 January 2004 US summary data, the United States' 3 March 2004 response does not provide contract payment yields or payments units that would allow for a precise calculation of the total amounts of contract payments received by a category of farms. While Brazil recognizes that the Panel's 3 February 2004 Request does not ask for this information, the United States should have produced in good faith the information on payment units in order to avoid potential distortions (as it did when providing its 18/19 December 2003 and 28 January 2004 summary data). Brazil has been required, therefore, to use the contract payment yield information set out in the 28 January 2004 US summary data. Brazil believes this contract payment yield information to be a useful proxy and the potential distortions that might result from the use of this data to be relatively minor.[6]

8. The United States' 3 March 2004 summary data is furthermore inadequate because it does not permit the calculation of support from soybean market loss assistance payments and peanut direct and counter-cyclical payments. The United States notes that MY 1999-2000 soybean market loss assistance payments and MY 2002 peanut direct and counter-cyclical payments were not "farm-based" but "producer-based".[7] Therefore, payments were received by (historic) producers, rather than farms (or their owners). While the United States produced data on soybean and peanut planted acreage on upland cotton farms[8], the United States did not produce any information that would allow

[4] Brazil notes that it is of the firm view that none of the farm-specific planting data requested by the Panel would be covered by the US Privacy Act.

[5] Brazil has subtracted from the Category A summary data provided on 3 March 2004 the amount of planted and base acreage per covered commodity as reported in the 28 January 2004 US summary data for farms that hold upland cotton base but do not plant upland cotton. This calculation corrects for any erroneous inclusion of additional farms in Category A. Since the 28 January 2004 US summary data does not contain data on MY 1999-2001 soybean plantings or base and MY 2002 peanut plantings or base by farms holding upland cotton base but not producing upland cotton, no correction is possible that would cover these crops. Therefore, both soybeans (for MY 1999-2001) and peanuts (for MY 2002) needed to be excluded from the calculations under Brazil's Methodology or the value-based allocation calculations under the Modified Annex IV Methodology, as discussed below. In addition, no update of the US-Proposed Annex IV Methodology using the US 3 March 2004 summary data was possible.

[6] The United States obviously has no basis to complain about Brazil's use of this yield proxy given its failure to provide yield information on 3 March 2004 or to provide the farm-specific data.

[7] US 3 March 2004 Response to the 3 February 2004 Request by the Panel, paras. 10-21.

[8] The United States produced for MY 1999, 2000 and 2002 two sets of data, one treating soybeans and peanuts as a contract payment crop and categorizing farms accordingly and one treating the soybeans and

the calculation of "producer-based" soybean market loss assistance and peanut direct and counter-cyclical payments received by producers operating upland cotton farms.[9] Yet, these payments should be considered under any allocation exercise (except the "Cotton-To-Cotton" Methodology). The absence of this information prevents Brazil from including these payments in its allocation calculations and, thus, biases Brazil's calculations downward, as discussed below. Any distortions resulting from this shortcoming of the 3 March 2004 us summary data are a consequence of the US failure to produce data on these soybean and peanut payments.

9. With respect to part (a) of the Panel's 3 February 2004 Request pursuant to DSU Article 13, the US 3 March 2004 response provided – after four weeks of what the United States characterizes as an analysis "involving much time and effort"[10] – a file ("NotClose.xls") containing farm-specific data on 28 farms for MY 2002 that would not be covered by the US Privacy Act. At the same time, the United States indicated that, in MY 2002, 197,084 farms produced upland cotton and/or received upland cotton direct and counter-cyclical payments. It is obvious that the farm-specific data covering these 28 farms cannot provide information relevant to this dispute.[11]

10. Brazil reiterates that it does not consider farm-specific planting information to be covered by the US Privacy Act.[12] (Certainly, Brazil's summary calculations in Sections III and IV below, based on the 3 March 2004 US summary data, could not possibly be considered confidential.) But even if the farm-specific planting information were confidential under US law, DSU Article 13 would oblige the United States to produce the information for the Panel and Brazil.[13] Brazil also emphasizes that it remains of the view that farm-specific data would permit the most precise calculation of the amount of contract payments that constitute support to upland cotton, under whichever allocation methodology the Panel deems appropriate.[14]

## III. CALCULATION OF SUPPORT TO UPLAND COTTON UNDER VARIOUS ALLOCATION METHODOLOGIES

11. In this Section, Brazil presents the results of applying the four allocation methodologies discussed in Section 5 of Brazil's 18 February 2004 Data Comments. That is, Brazil has applied two acreage-based allocation methodologies ("'Cotton-To-Cotton' Methodology" and "Brazil's Methodology") and two value-based methodologies ("Modified Annex IV Methodology" and "US Annex IV Methodology") to the 3 March 2004 US summary data.[15] The results under Brazil's

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peanuts as a non-contract payment crop and categorizing farms accordingly. (*See* US 3 March 2004 Response to the 3 February 2004 Request by the Panel, paras. 17, 21, 31-38).

[9] As discussed above, no payment units are provided with the US 3 March 2004 summary data.

[10] US 3 March 2004 Response to the Panel's 3 February 2004 Request.

[11] *See* Brazil's 13 February 2004 Letter to the Panel, p. 2.

[12] Brazil's 18 February 2004 Comments, comments regarding answers 259(a)-(c), paras. 1-21. *See* also Brazil's 28 January 2004 Data Comments, Section 4.

[13] *See* Brazil's 28 January 2004 Data Comments, Section 5.

[14] While Brazil stated at page 5 of its 13 February 2004 Letter to the Panel that "by producing the complete aggregated information, there would no longer be a need to draw adverse inferences", Brazil notes that the data produced by the United States is not complete, as discussed above. Should the United States argue or the Panel believe that Brazil ought to have provided more accurate data on contract payments that constitute support to upland cotton, Brazil requests the Panel to rely nevertheless on the calculations provided by Brazil in this submission. Any shortcoming in these results stems from the refusal of the United States to produce the farm-specific data requested numerous times by the Panel and Brazil. Further, the United States' refusal (1) to produce the farm-specific data or (2) to produce proper data on Category A farms by excluding all farms that do not produce upland cotton, as well as complete contract payment yield or payment unit information would permit the Panel to draw the adverse inferences that this information – if produced – would have shown even higher payments being allocated to upland cotton (*see* Brazil's 28 January 2004 Data Comments, Section 6).

[15] While Brazil uses these results for purposes of the comparison required under Article 13(b)(ii) of the Agreement on Agriculture, the Panel could also use these results to determine the amount of subsidies provided

Methodology replace the estimated amount of support to upland cotton under Brazil's so-called "14/16th" methodology.

*Cotton-To-Cotton Methodology*[16]

12. First, Brazil has applied the "Cotton-To-Cotton" Methodology to the 3 March 2004 US summary data.[17] This methodology is not affected by the Category A "over-inclusiveness" problem.[18] The "Cotton-To-Cotton" Methodology allocates for each planted acre of upland cotton payments associated with one upland cotton base acre – if available for that category of farms. For Category A farms this means that for each acre planted to upland cotton, payments associated with one upland cotton base acre are allocated.[19] For Category B1 to B3 farms this means that for each acre planted to upland cotton, payments associated with one upland cotton base acre are allocated – up to the amount of upland cotton base acres held by these farms.[20] For category C farms this means that no allocations are made.[21]

13. Since the 3 March 2004 US summary data did not include information on contract payment yields or payment units by farm category, Brazil used the contract payment yield figures provided or implied in the 28 January 2004 US summary data to calculate payment amounts.[22] After correcting for and eliminating the non-upland cotton producing farms in Category A, Categories A, B1, B2 and B3 consist of farms that previously were included in Category 1 under the US 18/19 December 2003 and 28 January 2004 summary data, as farms planting upland cotton and holding upland cotton base.[23]

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to upland cotton for purposes of Brazil's actionable subsidy claims, should the Panel deem a finding on the amount of subsidies necessary.

[16] *See* Brazil's 18 February 2004 Data Comments, paras. 46-48 and Annex A.1.

[17] For the reasons discussed below in the context of "Brazil's Methodology," Brazil has relied on the categorization treating soybeans in MY 1999-2000 and peanuts in MY 2002 as a non-contract payment crop. That is, Brazil has used the following files: 'PFC1999W.xls', 'PFC2000W.xls', 'PFC 2001W.xls' and 'DCP2002W.xls' as provided by the United States on 3 March 2004. While the "Category A" problem does not affect this methodology, to ensure comparability between the payment allocations for each category of farms, Brazil has used the same categorization as for the calculations under Brazil's Methodology.

[18] Since Category A consists of farms that have more upland cotton base acres than upland cotton planted acres, for each planted acre of upland cotton payments associated with one upland cotton base acre are allocated. All remaining upland cotton and other crop base payments are ignored.

[19] Brazil recalls that these farms are defined as farms that plant less acres of upland cotton than they hold base acres.

[20] Brazil recalls that these farms are defined as farms that plant more acres of upland cotton than they hold base acres. Thus, there are not enough upland cotton base acres to allocate payments associated with one upland cotton base acre to each acre planted to upland cotton. No additional allocations are applied under this methodology and, therefore, some upland cotton planted acres are not allocated contract payments at all.

[21] Brazil recalls that these farms are defied as farms that plant upland cotton but do not hold upland cotton base acres. Therefore, no upland cotton contract payments are available for allocation and no non-upland cotton contract payments are allocated under this methodology.

[22] The file 'rPFCsum.xls' contains payment units and base acres per category of farms (1, 2, and 3 referring to farms that (1) hold upland cotton base and plant upland cotton, (2) hold upland cotton base and do not plant upland cotton, and (3) do not hold upland cotton base but plant upland cotton). Since payment units are defined as 85 per cent of the product of base acres and contract yields, payment units and base acres can be used to calculate the required contract yield (payment units / (base acres * 0.85)). The file 'rDCPsum.xls' contains contract yields for all three categories of farms (see above).

[23] To avoid any confusion, Brazil presents the following table detailing the nomenclature of the farm categories in the various US summary data submissions:

| **Farm Definitions** | **3 March 2004 Data** | **18/19 December 2003 28 January 2004** |
|---|---|---|
| Farms Planting Less Cotton Than Their Cotton Base | Category A (erroneously also includes farms that produce no cotton – all formerly Category 2 farms) | Included in Category 1 |

Accordingly, Brazil applied the contract payment yield for Category 1 farms from the 28 January 2004 US summary data to these four categories of farms in the 3 March 2004 US summary data.[24] The contract payment yield for Category C farms under the 3 March 2004 US summary data corresponds to that of Category 3 farms under the 28 January 2004 US categorization.

14. Next, Brazil calculated the payment units by category of farms[25] and multiplied them by the payment rate.[26] The details of Brazil's calculations are presented (by farm category) in electronic form as Exhibit Bra-433 ('Calculations Acreage Based Methodologies.xls').

15. The following table shows the amount of contract payments allocated as support to upland cotton under the "Cotton-To-Cotton" Methodology.

| **Cotton-to-Cotton Methodology**[27] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[28] | Direct Payments | CCP Payments |
| 1999 | 434,945,069 | $432,826,830 | - | - |
| 2000 | 411,776,128 | $438,349,261 | - | - |
| 2001 | 329,593,231 | $452,369,304 | - | - |
| 2002 | - | - | $391,846,198 | $864,980,104 |

*Brazil's Methodology*[29]

16. In applying Brazil's Methodology to the new 3 March 2004 US summary data, Brazil again corrected for the over-inclusiveness of farms in Category A[30] and applied the contract yields, as

| | | |
|---|---|---|
| Farms Planting Cotton And Holding Cotton Base (contract payment crop planting equals crop base) | Category B1 | Included in Category 1 |
| Farms Planting Cotton And Holding Cotton Base (contract payment crop planting falls short of crop base) | Category B2 | Included in Category 1 |
| Farms Planting Cotton And Holding Cotton Base (contract payment crop planting exceeds crop base) | Category B3 | Included in Category 1 |
| Farms Planting Cotton But Not Holding Cotton Base | Category C | Category 3 |
| Farms Not Planting Cotton But Holding Cotton Base | not requested, but erroneously included in Category A | Category 2 |

[24] Any possible distortion stemming from slightly higher or lower contract yields in Categories A, B1, B2 and B3 than the average contract yield that was reported for category 1 farms in the 28 January 2004 summary data is due to the failure of the United States to provide more specific information.

[25] 85 per cent of the product of base acres and contract yields (using the applicable contract yields).

[26] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 17).

[27] For details of the calculations, see Exhibit Bra-433 ('Calculations Acreage Based Methodologies.xls').

[28] As in previous calculations (*see* Brazil's 28 January 2004 Data Comments, Section 9 and 10; Brazil's 18 February 2004 Data Comments, Annex A), market loss assistance payments have been calculated by adjusting the PFC payment according to the ratio of total upland cotton market loss assistance payments to total upland cotton PFC payments (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). The United States has never criticized this approach and, in fact, confirmed its accuracy in paragraphs 8-9 of its 3 March 2004 response to the 3 February 2004 Request by the Panel.

[29] *See* Brazil's 20 January 2004 Answers to Questions, paras. 43-55; Brazil's 28 January 2004 Data Comments, Section 9 and Brazil's 18 February 2004 Data Comments, paras. 50-51, Section 6 and Annex A.2.

[30] For instance, Brazil has deducted the amount of upland cotton base held by farms that hold upland cotton base but do not produce upland cotton (as provided by the United States on 28 January 2004) from the amount of upland cotton base held by Category A farms (as provided by the United States in 3 March 2004). A similar deduction has been applied to base and planted acres for each crop for which such data was available in the 28 January 2004 US summary data.

provided by the 28 January 2004 summary data[31], and the payment rates[32] to calculate the amount of contract payments by category of farms.[33] Brazil recalls that its methodology allocates for each acre planted to a contract payment crop payments associated with one base acre of that crop – as available. All further contract payments not allocated to their respective contract payment crop are pooled and allocated proportionally to the planted acres of contract payment crops to which no contract payments have been assigned under the first step.[34]

17. For the purposes of Brazil's methodology, Brazil treats soybeans as a non-contract payment crop for purposes of MY 1999 and 2000 market loss assistance payments[35] and peanuts as a non-contract payment crop for purposes of MY 2002 direct and counter-cyclical payments. This treatment follows from Brazil's inability to correct the Category A data concerning soybean and peanut plantings, discussed above.[36] In addition and as discussed above, Brazil has not been able to allocate any MY 1999-2000 soybean market loss assistance payments or MY 2002 peanut direct and counter-cyclical payments because no data on these payments has been provided. Accordingly, soybeans and peanuts neither receive contract payment allocations, nor are soybean and peanut contract payments allocated for the relevant marketing years.

18. The details of Brazil's calculations are presented (by farm category) in electronic form as Exhibit Bra-433 ('Calculations Acreage Based Methodologies.xls'). Brazil applied the very same calculation methodology as in its 28 January 2004 Data Comments and in its 18 February 2004 Data Comments.[37] This methodology is not entirely identical to Brazil's 20 January 2004 discussion of its methodology, which anticipated the use of farm-specific data that was never produced by the United States.[38] Thus, certain adjustments, documented in Brazil's 28 January 2004 Data Comments, were necessary.[39]

19. The table below shows the results of Brazil's calculations.

| **Brazil's Methodology**[40] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[41] | Direct Payments | CCP Payments |
| 1999 | $501,450,663 | $499,008,534 | - | - |
| 2000 | $478,926,663 | $509,833,219 | - | - |
| 2001 | $385,723,950 | $529,409,157 | - | - |
| 2002 | - | - | $421,367,874 | $869,470,827 |

[31] *See* above discussion in the context of the "Cotton-To-Cotton" Methodology and Section II.

[32] Exhibit Bra-394 (Agricultural Outlook Tables, USDA, November 2003, Table 17).

[33] Brazil has used the following files: 'PFC1999W.xls', 'PFC2000W.xls', 'PFC 2001W.xls' and 'DCP2002W.xls' as provided by the United States on 3 March 2004.

[34] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[35] Brazil recalls that the United States has informed Brazil and the Panel that there were no such soybean payments in MY 2001. *See* US 3 March 2004 Response to the 3 February 2004 Request by the Panel, para. 10.

[36] *See* also the more detailed discussed in the context of the Modified Annex IV Methodology, below.

[37] Brazil's 28 January 2004 Data Comments, Section 9 and Brazil's 18 February 2004 Data Comments, paras. 50-51, Section 6 and Annex A.2.

[38] Brazil's 20 January 2004 Answers to Additional Questions, paras. 43-55.

[39] *See* Brazil's 28 January 2004 Data Comments, Section 9.

[40] For details of the calculations, see Exhibit Bra-433 ('Calculations Acreage Based Methodologies.xls').

[41] As in previous calculations (*see* Brazil's 28 January 2004 Data Comments, Section 9 and 10; Brazil's 18 February 2004 Data Comments, Annex A), market loss assistance payments have been calculated by adjusting the PFC payment according to the ratio of total upland cotton market loss assistance payments to total upland cotton PFC payments (Exhibit Bra-4 ("Fact Sheet: Upland Cotton", USDA, January 2003, p. 6). The United States has never criticized this approach and, in fact, confirmed its accuracy in paragraphs 8-9 of its 3 March 2004 response to the 3 February 2004 Request by the Panel.

20. The differences between results of the "Cotton-To-Cotton" Methodology and Brazil's Methodology result from the fact that under Brazil's Methodology a limited amount of non-upland cotton contract payments is allocated as "support to upland cotton." However, the great majority of upland cotton is planted on farms holding upland cotton base acres and their amount of upland cotton base acres closely tracks their amount of upland cotton planted acres. Thus, upland cotton contract payments account for the great majority of contract payments allocated even under Brazil's methodology. The following table presents, by marketing year, the amount of upland cotton planted acres for which there exists a corresponding upland cotton base acre farm category.

| Ma**rketing Year**[42] **Category**[43] | **MY 1999** | **MY 2000** | **MY 2001** | **MY 2002** |
|---|---|---|---|---|
| | ---- acres ---- | | | |
| A | 4,548,886 | 4,386,073 | 4,146,352 | 5,997,438 |
| B1 | 87,034 | 94,377 | 78,075 | 166,619 |
| B2 | 2,412,580 | 2,389,053 | 2,173,819 | 2,035,335 |
| B3 | 3,570,724 | 3,906,688 | 4,125,899 | 3,220,762 |
| C | 0 | 0 | 0 | 0 |
| Total | 10,619,224 | 10,776,191 | 10,524,145 | 11,420,154 |
| Total Planted Acres | 14,572,963 | 15,388,028 | 15,463,934 | 13,541,506 |
| Percentage | 72.87 per cent | 70.03 per cent | 68.06 per cent | 84.33 per cent |

*Modified US Annex IV Methodology*[44]

21. In applying the first value-based methodology, the Modified Annex IV Methodology, to the new 3 March 2004 US summary data, Brazil again corrected for the over-inclusiveness of Category A and applied contract payment yields, as provided by the 28 January 2004 summary data, and the contract payment rates to calculate the total amount of contract payments by category of farms.[45]

22. Brazil was required to exclude soybeans[46] and peanuts from the allocation calculations under this methodology[47] (as well as under Brazil's Methodology) for the following reasons: First, since the United States did not provide data on soybean and peanut plantings with its 28 January 2004 summary data, Brazil is unable to correct these data items in the US 3 March 2004 Category A summary data.[48] There were three theoretical options available to Brazil to address this problem. First, Brazil could have left in Category A all farms which were included by the United States, but which do not produce upland cotton. This approach would have resulted in distortions because considerable amounts of extra contract payments received by farms not producing upland cotton as well as unknown amounts of extra contract payment crop value generated by these non-upland cotton producing farms would be included in the calculations. Or, second, Brazil could have corrected the over-inclusiveness of

[42] Brazil has used the following files: 'PFC1999W.xls', 'PFC2000W.xls', 'PFC 2001W.xls' and 'DCP2002W.xls' as provided by the United States on 3 March 2004.

[43] For Category A farms, Brazil has used the amount of upland cotton planted acres, since on those farms upland cotton base acres exceed upland cotton base acres. For the three Categories B1, B2 and B3, Brazil has used upland cotton base acres since for those farms upland cotton planted acres exceed upland cotton base acres. Finally, for Category C farms, Brazil has used "0," since those farms have no upland cotton base acres.

[44] Brazil has discussed this methodology in paragraphs 50-51 and in Annex A.3 of its 18 February 2004 Data Comments.

[45] *See* above discussion in the context of the "Cotton-To-Cotton" Methodology and in Section II.

[46] This exclusion of soybeans does not apply to MY 2002, for which complete summary data is available.

[47] Consequently, Brazil has used to following files as the basis for its calculations: 'PFC1999W.xls', 'PFC2000W.xls', 'PFC 2001W.xls' and 'DCP2002W.xls' as provided by the United States on 3 March 2004.

[48] This correction of course concerns the amount of soybean and peanut acreage planted by farms that do not produce upland cotton.

Category A for all data items that it could correct leaving the additional soybean and peanut acreage from non-upland cotton producing farms in the pool. This approach would have resulted in distortions because unknown amounts of extra value of soybean and peanut production from non-upland cotton producing farms would be included in the calculations. To avoid these distortions, Brazil has selected the third option – to exclude soybeans and peanuts from the allocation. This choice enables Brazil to correct the Category A data for the inclusion of farms not producing upland cotton, in the manner described above[49], and to proceed with its calculations.

23. Second, Brazil notes that the United States distinguishes the soybean market loss assistance and peanut direct and counter-cyclical payments in MY 1999, 2000 and 2002 as being producer-based rather than farm-based payments. But, the United States never provided information on the amount of these payments. However, payments received by producers of these crops that also owned upland cotton producing farms (to which all other contract payments were made) would need to be considered for any allocations methodology (except the "Cotton-To-Cotton" Methodology).

24. No doubt Brazil's choice not to include soybean and peanut planted acreage and soybean market loss assistance and peanut direct and counter-cyclical payments leads to distortions. These are unavoidable given the incorrect US reading of the definition of Category A farms. However, Brazil believes that these distortions are relatively minor. Brazil has excluded payments stemming from soybean market loss assistance and peanut direct and counter-cyclical payments[50] as well as the crop value of soybean (for MY 1999-2001) and peanut (for MY 2002) production.[51] Thus, soybeans and peanuts do not contribute contract payments to the pool of payments allocated over the value of the entire contract payment crop production of upland cotton producing farms. But, there are also no contract payments being allocated to soybeans and peanuts for these years. This minimizes distortions by roughly cancelling out over and under-counting effects from their exclusion from the calculation. Brazil notes that, for other crops, the amount of crop plantings and crop payment base is fairly proportionate.[52] Soybeans and peanuts in all likelihood follow a similar pattern. In excluding these crops entirely from the calculations, Brazil minimizes the distortions resulting from the shortcomings of the 3 March 2004 US summary data, based on the assumption that these crops would contribute an equal (or very similar) amount of contract payments to the pool, as they would be allocated based on their share of the total value of contract payment crop production.

25. As in its 18 February 2004 calculations, Brazil calculated, by category of farm, the value of each contract payment crop produced on farms that make up the category. Brazil multiplied the amount of planted acreage times the yield[53] and times the per unit price of the particular crop.[54] Total contract payments for each category of farm were then allocated to upland cotton according to the share of the upland cotton crop value of the total value of contract payment crop production on the farms of that category. The details of Brazil's calculations are presented (by farm category) in electronic form as Exhibit Bra-434 ('Calculations Value Based Methodologies.xls').

26. The table below shows the resulting support to upland cotton under this methodology.

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[49] *See* Section II above.

[50] For which the United States has not provided any payment information.

[51] For which Brazil is not able to correct the Category A data given the respective data items missing in the 28 January 2004 US summary data.

[52] Compare crop base and crop plantings as reported by the US 3 March 2004 summary data ('PFC1999W.xls', 'PFC2000W.xls', 'PFC 2001W.xls' and 'DCP2002W.xls').

[53] Brazil notes that similar to its 18 February 2004 calculations it has used yields on planted acres for upland cotton and yields on harvested acres for all other contract payment crops, thereby overstating the latter's value and leading to understated allocations of contract payments to upland cotton. *See* Brazil's 18 February 2004 Data Comments, para. 73 and Annex A.3, notes to Tables 3.5-3.8 for further explanation and references to the data.

[54] Exhibit Bra-420 (Agricultural Outlook Tables, USDA, November 2003, Table 17). Brazil notes that the cover page of this exhibit appears to be wrong. The table is, however, correct.

| Modified Annex IV Methodology[55] | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments[56] | Direct Payments | CCP Payments |
| 1999 | $562,922,665 | $560,181,159 | - | - |
| 2000 | $540,877,974 | $575,782,432 | - | - |
| 2001 | $394,791,930 | $541,855,031 | - | - |
| 2002 | - | - | $462,037,836 | $771,636,204 |

Brazil notes that these allocations are conservative. Absent data on yields per planted acre for any non-upland cotton crop, Brazil applied yields on harvested acres to calculate the amount of crop produced from all planted acres, thereby ignoring abandonment. This calculation leads to overstating the value of non-upland cotton crop production by overstating the amount of such production. By contrast, the value of the upland cotton crop has been calculated by using yields on planted acres, providing an accurate estimate.[57] Thus, Brazil's calculations overstate the value of non-upland cotton contract payment crops produced in each of the farm categories, resulting in lower allocations to upland cotton.

*US Annex IV Methodology*

27. Brazil could not perform any updated calculations under this methodology based on the 3 March 2004 US summary data. The reason is that Brazil could not exclude from Category A data those farms that do not produce upland cotton.[58] The US Annex IV Methodology would necessitate adjusting Category A data, *inter alia*, concerning planted soybeans acreage in MY 1999-2001 and peanut acreage in MY 2002. However, no such planted acreage data is available in the 28 January 2004 US summary data and, therefore, no such adjustment to Category A can be performed.

28. Further, for MY 2002, the 3 March 2004 US summary data provides more specific data items, including acreage data for fruits and vegetables, ELS cotton, tobacco and peanuts for all categories of farms. However, because these data items were also not provided in the 28 January 2004 US summary data, Brazil cannot correct the over-inclusiveness of Category A for these data items. In addition, the United States appears to have included more acreage in its "All Other Use Acres" than simply cropland. The sum of all non-contract payment crop acres in the 3 March 2004 US summary data exceeds the additional cropland as reported in the 28 January 2004 US summary data. This again

[55] For details of the calculations, see Exhibit Bra-434 ('Calculations Value Based Methodologies.xls').

[56] As in previous calculations (*see* Brazil's 28 January 2004 Data Comments, Section 9 and 10; Brazil's 18 February 2004 Data Comments, Annex A), market loss assistance payments have been calculated by adjusting the PFC payment according to the ratio of total upland cotton market loss assistance payments to total upland cotton PFC payments (Exhibit Bra-4 ("Fact Sheet: Upland Cotton," USDA, January 2003, p. 6). The United States has never criticized this approach and, in fact, confirmed its accuracy in paragraphs 8-9 of its 3 March 2004 response to the 3 February 2004 Request by the Panel.

[57] *See* Brazil's 18 February 2004 Data Comments, para. 73 and Annex A.3, notes to Tables 3.5-3.8 for further explanation and references to the data.

[58] As long as only data concerning contract payment crops was relevant (excluding soybeans and peanuts under the Modified Annex IV Methodology), such an exclusion could be performed based on the 28 January 2004 US summary data, that provided congruous base and planted acreage summary information for these contract payment crops on farms that are now erroneously included in Category A. This allowed for deducting the base and planted acreage summary data for contract payment crops on farms that hold upland cotton base but do not produce upland cotton from the identical summary data items in Category A of the 3 March 2004 US summary data. For instance, Brazil has deducted the amount of upland cotton base held by farms that hold upland cotton base but do not produce upland cotton (as provided by the United States on 28 January 2004) from the amount of upland cotton base held by Category A farms (as provided by the United States in 3 March 2004). A similar deduction has been applied to base and planted acres for each crop for which such data was available in the 28 January 2004 US summary data.

precludes an adjustment of this data item in Category A for its over-inclusiveness, since the 28 January 2004 and the 3 March 2004 sets of summary data do not appear to be congruous.

29. Once more, the inability to exclude the non-upland cotton producing farms from Category A is important, because including a large number of farms that do not produce upland cotton in the allocation calculations would add a large potential for distortions given the significant amounts of plantings and contract payment crop base by these farms.

30. Further, while the 28 January 2004 US summary data provided information on the amount of non-contract payment crop acreage for MY 1999-2001, the 3 March 2004 US summary data fails to do so. Thus, for those marketing years and for purposes of the US Annex IV Methodology, Brazil could not rely on the 3 March 2004 US summary data and categorization of upland cotton farms at all, since the 3 March 2004 US summary data does not contain any information on the plantings of non-contract payment crops on these farms. For purposes of the US Annex IV Methodology, Brazil, however, needs to rely on planting data for non-contract payment crops to estimate the value of their production on upland cotton producing farms – data such as that provided by the United States in its 18/19 December 2003 and 28 January 2004 data submissions. Thus, Brazil's 18 February 2004 US Annex IV Methodology results based on the 28 January 2004 US summary data are more accurate than any calculations that could be performed based on the 3 March 2004 US summary data or some adjusted version thereof. Therefore, Brazil reproduces below its 18 February 2004 results applying the US Annex IV methodology to the 28 January 2004 US summary data.

Annex A.4 Table 4.8[59]

| **US Annex IV Methodology** | | | | |
|---|---|---|---|---|
| MY | PFC Payments | MLA Payments | Direct Payments | CCP Payments |
| 1999 | $440,061,035.8 | $437,917,881.4 | - | - |
| 2000 | $432,996,788.7 | $460,939,354.1 | - | - |
| 2001 | $304,243,319.2 | $420,222,029.1 | - | - |
| 2002 | - | - | $383,057,256.1 | $640,389,168.2 |

Brazil notes that these allocations are conservative for two reasons: (1) the calculations overstate the value of non-upland cotton contract payment crops, as discussed in the context of the Modified Annex V Methodology; and (2) the calculations do not account for soybean market loss assistance payments in MY 1999-2000 and peanut direct and counter-cyclical payments in MY 2002.[60]

## IV. THE UNITED STATES MY 1999-2002 SUPPORT TO UPLAND COTTON EXCEEDS THE MY 1992 SUPPORT TO UPLAND COTTON UNDER ANY METHODOLOGY

31. In the previous Section, Brazil has updated its 18 February 2004 calculations of the support to upland cotton applying various acreage- and value-based allocation methodologies. In this Section, Brazil combines its results with data on the amount of support to upland cotton from the other support programmes, and provides the Panel with summary tables for each of the 1999-2002 marketing years comparing the support to upland cotton in those marketing years with the MY 1992 level of support to upland cotton.

[59] *See* Annex A.4 of Brazil's 18 February 2004 Data Comments.

[60] Brazil's 18 February 2004 Data Comments, para. 52 and note 75 thereto as well as Annex A.4, para. 40. While the missing soybean and peanut contract payments could be corrected for by excluding these crops from any allocations under the previous three methodologies, soybeans and peanuts are a firm part of the allocation calculations under the US Annex IV Methodology because they are part of the overall farm's revenue. They were included in Brazil's 18 February 2004 calculations based on the US 28 January 2004 summary data. Thus, it is only the payment data that remains missing from these calculations resulting in understating the amount of contract payments allocated to upland cotton.

32. As Brazil discussed in its 18 February 2004 Data Comments, Article 13(b)(ii) of the Agreement on Agriculture endorses no particular methodology. Thus, the Panel needs to choose a reasonable methodology for allocating contract payments as support to upland cotton.[61] Brazil favours its methodology, based on an allocation pursuant to the acreage planted to contract payment crops, but also provides results under the Cotton-To-Cotton Methodology (similarly based on an acreage comparison), as well as two value-based methodologies.

33. However, Brazil strongly urges the Panel to apply an acreage-based methodology – preferably Brazil's Methodology. A particular flaw in a value-based methodology is that allocating counter-cyclical payments over the value of crop production means that allocations for a crop will decrease if prices for that crop fall.[62] Thus, at the time when counter-cyclical payments are "critically needed"[63] to offset low prices for a crop, a value-based methodology would allocate these counter-cyclical payments increasingly as support to other crops, whose prices have not fallen. Using a value-based allocation methodology shifts the share of counter-cyclical payments that are allocated to the crop with falling prices away from that crop and to crops with increasing or constant prices. By contrast, allocating contract payments over the acreage planted to contract payment crops – as done by the "Cotton-To-Cotton" Methodology and by Brazil's Methodology – provides an allocation approach that reflects the economic reality and intention behind the counter-cyclical payment support.

34. But Brazil emphasizes that, on the facts of this case, and using whichever methodology the Panel may ultimately choose, the US MY 1999-2002 support to upland cotton exceeds the MY 1992 level in each year and under each methodology (with the exception of the "Cotton-To-Cotton" and the US Annex IV Methodology in MY 2000).[64]

35. The following four tables present the peace clause comparisons for MY 1999-2002. The table below presents Brazil's peace clause comparison for MY 2002.

[61] Brazil's 18 February 2004 Data Comments, paras. 33-42.

[62] Suppose that a farm produces in two consecutive years the same amount of upland cotton and rice. The value of both crops is 50 in the first year leading to an allocation of half of the contract payments received by that farm. In the second year, prices for upland cotton fall to half their pervious level, while rice prices remain the same. Thus, the same amount of upland cotton is only worth 25 in the second year with the value of the rice crop remaining at 50. It follows that upland cotton receives a third of the contract payments allocations (its value is 25 out of a total crop value of 75) and rice receives two thirds of the contract payment allocations. The same principle would apply if rice prices had fallen by half with upland cotton remaining constant. In this case rice would receive an allocation of a third of the contract payments while upland cotton would receive two thirds of the contract payments allocations. In both cases the crop whose price is falling receives a smaller share of the support, contrary to the counter-cyclical (not pro-cyclical) approach of the payments involved.

[63] Exhibit Bra 111, ("The Six Year World Outlook for Cotton and Peanuts: Implications for Production and Prices," Bob McLendon, National Cotton Council, p.1).

[64] Brazil recalls that given the manner in which the United States presented its 3 March 2004 summary data, Brazil was prevented to provide an updated US Annex IV Methodology calculation based on the 3 March 2004 US summary data. *See* Section III, above. Further, neither of the two methodologies captures all support to upland cotton with the "Cotton-To-Cotton" Methodology not capturing any non-upland cotton contract payments that constitute support to upland cotton and the US-Proposed Annex IV Methodology suffering from various data problems, including the non-availability of data on soybean market loss assistance payments for that year.

Budgetary Outlays For Upland Cotton MY 1992 and MY 2002[65]

| Year | 1992 | 2002 (1) | 2002 (2) | 2002 (3) | 2002 (4) |
|---|---|---|---|---|---|
| Programme | ----- $ million ----- | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none |
| Direct Payments | none | 391.8 | 421.4 | 462.0 | 383.1 |
| CCP Payments | none | 865.0 | 869.5 | 771.6 | 640.4 |
| Marketing Loan Gains and LDP Payments[66] | 866 | 898 | 898 | 898 | 898 |
| Step 2 Payment | 207 | 415 | 415 | 415 | 415 |
| Crop Insurance | 26.6 | 194.1 | 194.1 | 194.1 | 194.1 |
| Cottonseed Payments | none | 50 | 50 | 50 | 50 |
| Total | 2,117.0 | 2,813.9 | 2,848.0 | 2,790.7 | 2,580.6 |

(1) Cotton-To-Cotton Methodology
(2) Brazil's Methodology
(3) Modified Annex IV Methodology
(4) US Annex IV Methodology (based on 28 January 2004 US summary data)

36. The table below presents Brazil's peace clause comparison for MY 2001.

Budgetary Outlays For Upland Cotton MY 1992 and MY 2001[67]

| Year | 1992 | 2001 (1) | 2001 (2) | 2001 (3) | 2001 (4) |
|---|---|---|---|---|---|
| Programme | ----- $ million ----- | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none |
| PFC Payments | none | 329.6 | 385.7 | 394.8 | 304.2 |
| MLA Payments | none | 425.4 | 529.4 | 541.9 | 420.2 |
| Marketing Loan Gains and LDP Payments[68] | 866 | 2,609 | 2,609 | 2,609 | 2,609 |
| Step 2 Payment | 207 | 196 | 196 | 196 | 196 |
| Crop Insurance | 26.6 | 262.9 | 262.9 | 262.9 | 262.9 |
| Cottonseed Payments | none | none | none | none | none |
| Total | 2,117.0 | 3,849.9 | 3,983.0 | 4,004.6 | 3,792.3 |

(1) Cotton-To-Cotton Methodology
(2) Brazil's Methodology
(3) Modified Annex IV Methodology
(4) US Annex IV Methodology (based on 28 January 2004 US summary data)[69]

[65] The table below includes the updated contract payment allocations to upland cotton and otherwise reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission as updated by paragraph 8 of Brazil's 22 December 2003 Answers to Questions and paragraphs 12-14 of the US 22 December 2004 Answers to Questions. Step 2 and marketing loan payments have been updated in light of the US answer to Question 196. *See* US 22 December 2004 Answers to Questions, para. 12.

[66] "Other Payments" have been included in the marketing loan figures.

[67] The table below includes the updated contract payment allocations to upland cotton and otherwise reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission.

[68] "Other Payments" have been included in the marketing loan figures.

[69] *See* Brazil's 18 February 2004 Data Comments, Annex A.4 Table

37. The table below presents Brazil's peace clause comparison for MY 2000.

Budgetary Outlays For Upland Cotton MY 1992 and MY 2000[70]

| Year | 1992 | 2000 (1) | 2000 (2) | 2000 (3) | 2000 (4) |
|---|---|---|---|---|---|
| Programme | ----- $ million ----- | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none |
| PFC Payments | none | 411.8 | 478.9 | 540.9 | 433.0 |
| MLA Payments | none | 438.3 | 509.8 | 575.8 | 460.9 |
| Marketing Loan Gains and LDP Payments[71] | 866 | 636 | 636 | 636 | 636 |
| Step 2 Payment | 207 | 236 | 236 | 236 | 236 |
| Crop Insurance | 26.6 | 161.7 | 161.7 | 161.7 | 161.7 |
| Cottonseed Payments | none | 185 | 185 | 185 | 185 |
| Total | 2,117.0 | 2,068.8 | 2,207.4 | 2,335.4 | 2,112.6 |

(1) Cotton-To-Cotton Methodology
(2) Brazil's Methodology
(3) Modified Annex IV Methodology
(4) US Annex IV Methodology (based on 28 January 2004 US summary data)

38. The table below presents Brazil's peace clause comparison for MY 1999.

Budgetary Outlays For Upland Cotton MY 1992 and MY 1999[72]

| Year | 1992 | 1999 (1) | 1999 (2) | 1999 (3) | 1999 (4) |
|---|---|---|---|---|---|
| Programme | ----- $ million ----- | | | | |
| Deficiency Payments | 1017.4 | none | none | none | none |
| PFC Payments | none | 434.9 | 501.5 | 562.9 | 440.1 |
| MLA Payments | none | 432.8 | 499.0 | 560.2 | 437.9 |
| Marketing Loan Gains and LDP Payments[73] | 866 | 1,761 | 1,761 | 1,761 | 1,761 |
| Step 2 Payment | 207 | 422 | 422 | 422 | 422 |
| Crop Insurance | 26.6 | 169.6 | 169.6 | 169.6 | 169.6 |
| Cottonseed Payments | none | 79 | 79 | 79 | 79 |
| Total | 2,117.0 | 3,299.3 | 3,432.1 | 3,554.7 | 3,309.6 |

(1) Cotton-To-Cotton Methodology
(2) Brazil's Methodology
(3) Modified Annex IV Methodology
(4) US Annex IV Methodology (based on 28 January 2004 US summary data)

[70] The table below includes the updated contract payment allocations to upland cotton and otherwise reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal.

[71] "Other Payments" have been included in the marketing loan figures.

[72] The table below includes the updated contract payment allocations to upland cotton and otherwise reproduces the table at paragraph 73 of Brazil's 22 August 2003 Rebuttal Submission.

[73] "Other Payments" have been included in the marketing loan figures.

39. In sum, the contract payment data provided by the United States on 3 March 2004 (as well as the data provided on 28 January 2004) demonstrates that the United States' support to upland cotton in MY 1999-2002 exceeds the support to upland cotton decided by the United States in MY 1992, within the meaning of Article 13(b)(ii) of the Agreement on Agriculture. The results using any allocation methodology applying any set of US summary data[74] demonstrates their robustness.

[74] *See* Brazil's results in its 28 January 2004 and 18 February 2004 Data Comments.

# ANNEX I-27

## BRAZIL'S COMMENTS ON US 3 MARCH 2004 ANSWER TO QUESTION 264(B)

10 March 2004

**264. (b) Does the US agree with the statement in paragraph 135 of Brazil's 28 January 2004 comments on US responses to questions that the difference between the $1,148 billion in the chart at para. 165 of Brazil's 11 August answers to questions and the $666 million amount in Exhibit US-128 ($1.75 billion) closely corresponds to the total "Claims rescheduled" figure reported by the US in Exhibit US-128 (column F)?**

**Brazil's Comment:**

1. The United States acknowledges, in paragraph 3 of its 3 March 2004 response, that the difference referred to in the Panel's question arises because the United States treats the principal amounts of rescheduled defaults as an immediate, 100 per cent recovery that is passed through as a dollar-on-dollar reduction from the amount of claims outstanding in the year the terms of the rescheduling are agreed.[1]

2. In paragraph 1 of its response, the United States argues that the Brazilian conclusion included in the Panel's question results from Brazil's comparison of *fiscal year* data provided by Brazil with *cohort-specific* data provided by the United States. In fact, as explained at paragraph 34 of Brazil's 18 February 2004 Comments and illustrated in Exhibit Bra-431, Brazil reaches the same conclusion with a comparison of 1993-2002 *fiscal year* data provided by Brazil with 1993-2002 *fiscal year* data provided by the United States.[2]

3. In paragraph 2 of its response, the United States asserts, citing undocumented "[a]ccounting research within the US Government," that "a significant portion" of principal collected on reschedulings "has not been reflected" in US budget line 88.40, tracked in column 2(a) of Exhibit Bra-431, despite the United States' acknowledgement that "[a]s a theoretical matter such 'recovered principal' should be reflected in budget line 88.40". As the party asserting this fact, the United States bears the burden of proving it (particularly here, where it is addressing a line item from its own budget).[3]

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[1] For Brazil's views on this aspect of the US cash-basis accounting methodology for making an assessment under item (j), s*ee* Brazil's 18 February 2004 Comments, paras. 34-40; Brazil's 28 January 2004 Comments, paras. 134-137; Brazil's 11 August 2003 Answers, para. 162; Brazil's 22 July 2003 Oral Statement, para. 122.

[2] Exhibit US-147 also lists (undocumented) data for fiscal years 1992, 2003 and 2004. Including the additional revenue and expense figures for these years does not change the fact that revenue for the CCC export credit guarantee programmes fails to cover the costs and losses of the programs. Exhibit US-147 alleges additional revenue of $38.5 million for 1992, $185.6 million for 2003, and $35.4 million for 2004; and additional costs and losses of $3 million for 1992, $130.1 million for 2003, and $22.8 million for 2004. Accounting for this data (($38.5 + $185.6 + $35.4) – ($3 + $130.1 + $22.8) = $103.6 million) would bring the total net costs and losses down from $1.083 billion, arrived at in Exhibit Bra-431, to $979.4 million.

[3] *See e.g.* Appellate Body Report, *Japan – Apples*, WT/DS245/AB/R, para. 157 ("It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof."). Moreover, Brazil again notes that the United States

4. Each and every figure used in Brazil's cash-basis accounting methodology for making an assessment under item (j) represents actual (as opposed to estimated) data from official US documents that Brazil has provided to the Panel.[4] The United States has not even *cited* to any documentary support for the figures it has provided in Exhibit US-147 or US-148, let alone *provided* those documents for the Panel's review.

5. Thus, it is impossible for Brazil or the Panel to verify, for example, whether the CCC has, as the United States asserts at paragraph 2, recovered $205 million of the principal on its reschedulings. Moreover, this figure conflicts with other data provided by the United States. In column F of Exhibit US-147, the United States asserts that $1.64 billion of defaulted CCC guarantees have been rescheduled over the period 1992-2003; in Exhibit US-153, the United States asserts that the principal outstanding on these reschedulings amounts to $1.58 billion. Rather than recovering $205 million of the principal on its reschedulings, this data shows that the CCC has recovered only $60 million.

6. In any event, even if the Panel accepts the United States' unsupported assertion that the CCC has recovered $205 million of the principal on its reschedulings, this would not mean that premiums collected for the CCC export credit guarantee programmes meet the operating costs and losses of the programmes. Even if the entire $205 million figure is added to the "claims recovered" column of Brazil's cash-basis accounting calculation (column 2(a) of Exhibit Bra-341) – which by its own admission would be over-crediting the United States for recoveries of the principle on its reschedulings[5] – the result is still that long-term operating costs and losses for the CCC export credit guarantee programmes outpace revenue (not just premiums collected, but all revenue) by $878 million.[6]

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bears the burden, under Article 10.3 of the Agreement on Agriculture, of proving that quantities exported in excess of its reduction commitments have not benefited from export subsidies.

[4] *See* chart included in paragraph 165 of Brazil's 11 August 2003 Answers (reproduced in paragraph 129 of Brazil's 28 January 2004 Comments).

[5] In paragraph 2 of its response, the United States asserts that "a significant portion of" the principal recovered on its reschedulings is not included in line item 88.40 and column 2(a) of Exhibit Bra-341 – not that *none* of the principal recovered is included in that column.

[6] Exhibit Bra-431 shows that the operating costs and losses outpace revenue by $1.083 billion. Deducting the $205 million cited by the United States yields a loss of $878 million by the CCC export credit guarantee programmes.

# ANNEX I-28

## COMMENTS OF THE UNITED STATES ON THE 10 MARCH 2004 COMMENTS OF BRAZIL ON THE US DATA SUBMITTED ON 3 MARCH 2004

(15 March 2004)

**Introduction**

1. The United States thanks the Panel for this opportunity to respond to the 10 March comments filed by Brazil[1] relating to the data submitted by the United States on 3 March 2004, in response to the Panel's supplemental request for information. Brazil's 10 March comments consist primarily of a series of calculations using the US 3 March data in each of the methodologies previously explained by Brazil in its 18 February comments. The United States has previously explained, in filings on 11 February[2] and 3 March[3], that none of these methodologies is pertinent for purposes of the Peace Clause.[4] Therefore, we will not repeat much of that analysis in these comments but rather will refer the Panel, as appropriate, to those previous comments by the United States.

2. Brazil states that, because the US 3 March data "is the best information available before the Panel," Brazil "no longer considers that relying on its '14/16th methodology would be appropriate.'"[5] This means that, by Brazil's own statement, the only methodology that Brazil had brought forward from August 2003 until January 2004 to allegedly demonstrate a breach of the Peace Clause is irrelevant to this dispute. Moreover, it is difficult to reconcile Brazil's concession with its view that the Panel need only apply a "reasonable" methodology to calculate the support to upland cotton since Brazil alleges that the 14/16th methodology produces results that are similar to those under its other (flawed) methodologies.

3. Brazil's disavowal of its 14/16th methodology, however, does highlight the shifting nature of Brazil's Peace Clause arguments on decoupled payments. It may be of use to set out just how and how many times Brazil's theories have changed in this dispute.

4. First, Brazil argued that all payments for upland cotton base acres were "support to upland cotton." For example, in response to Question 41 from the Panel following the first session of the first substantive meeting, Brazil wrote:

> "The only US domestic support measures that Brazil is aware of that would meet the test of being 'support to upland cotton' are *those that it listed* for purposes of calculating the level of support in its First Written Submission. *In the view of Brazil,*

[1] Brazil's Comments on US 3 March 2004 Data (10 March 2004) ("Brazil's 10 March Comments").
[2] Comments of the United States of America on the Comments of Brazil to US Data Submitted on 18 and 19 December 2003 (11 February 2004) ("US 11 February Comments").
[3] Comments of the United States of America on the 18 February 2004, Comments of Brazil (3 March 2004) ("US 3 March Comments").
[4] *Agreement on Agriculture*, Article 13 ("Agreement on Agriculture").
[5] Brazil's 10 March Comments, paras. 2-3.

> *these non-green box domestic support measures are the measures that constitute 'support to' upland cotton* for the purpose of Article 13(b)."[6]

The decoupled measures listed in Brazil's first written submission (paragraphs 144, 148, and 149) were all production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments *for upland cotton base acres only*. Thus, "in the view of Brazil" as of the first session of the first substantive meeting, only these payments were within the Panel's terms of reference.[7]

5. Second, in response to US criticisms, Brazil realized that, on its own terms, the theory that all payments for upland cotton base acres were "support to upland cotton" was not tenable. Brazil's theory ignored the fact that there were fewer acres planted to upland cotton than there were upland cotton base acres, suggesting that payment recipients utilized planting flexibility to plant other crops or nothing at all.

> Thus, following the first session of the first panel meeting, Brazil introduced the so-called 14/16th methodology, which adjusted total expenditures for upland cotton base acres "by the ratio of upland cotton base acres actually planted." In Brazil's words, "only the portion of upland cotton [base] payments that actually benefits acres planted to upland cotton can be considered support to upland cotton."[8]

That is, Brazil amended its theory, arguing that all upland cotton was planted "on" upland cotton base acres.

6. Third, under Brazil's fallacious argument that receipt of decoupled payments was necessary for upland cotton producers to cover their costs, Brazil acknowledged that it was not "necessary" that upland cotton be planted on upland cotton base acres – that is, rice and peanuts base acreage also received payments that would allow these alleged costs to be covered. However, Brazil argued that the facts did not support the notion that upland cotton was "planted on" rice or peanuts base acreage.[9] Rather, through the second session of the Panel's first substantive meeting (that is, after the Peace Clause phase of the dispute had concluded), Brazil continued to insist that "at a minimum a significant majority of upland cotton farmers in MY 2002 were farming on upland cotton base acres."[10]

7. Fourth, however, even Brazil's own evidence indicated that not all upland cotton was planted "on" upland cotton base acres. For example, as a result of pest eradication and adoption of biotechnology, significant acres in the US Southeast previously planted to peanuts, corn, and other crops were newly being planted to upland cotton.[11] Thus, Brazil altered its theory again and argued that "Brazil's methodology assumes that US producers of upland cotton grew upland cotton on upland cotton base acreage," which is "a reasonable proxy, because there will be some upland cotton that is grown on rice (and peanut) base receiving higher payments, and some upland cotton that is grown on, *e.g.*, corn base receiving somewhat lower payments. On average, Brazil's approach would roughly cancel out the over-counting of rice and peanut payments and the under-counting of corn and any other lower-paying programme crop payments."[12]

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[6] Brazil's Answer to Question 41 from the Panel, para. 58 (footnote omitted; italics added).

[7] *See* US Comment on Brazil's Answer to Question 204 from the Panel, paras. 36-39 (providing additional citations) (28 January 2004).

[8] Brazil's Answer to Question 67 from the Panel, para. 130 (table fn. 2-5) (11 August 2003).

[9] *See, e.g.*, Brazil's Rebuttal Submission, para. 32, 38 (22 August 2003).

[10] Brazil's Further Submission, para. 335; *see also id.*, para. 331.

[11] *See* Brazil's Answer to Question 125(7), para. 38 (27 October 2003) ("Testimony from NCC representatives indicated that a number of producers in the south-eastern part of the United States grew upland cotton on corn base acreage during MY1999-2001.") (footnote omitted).

[12] Brazil's Answer to Question 125(8), para. 40 (27 October 2003).

8. Fifth, Brazil suggested in its further rebuttal submission of 18 November 2003, that "the United States has refused to generate information regarding how much and which of the contract payment base acreage was planted to upland cotton."[13] However, Brazil nowhere explained how such an analysis of "how much and which of the contract payment base acreage was planted to upland cotton" could be done. In fact, Brazil suggested that the Panel should request the United States to produce information and that "Brazil would be pleased *to provide the Panel with a precise list of parameters and questions that should be answered* in any such analysis."[14]

9. Brazil, however, did not provide any such "precise list of parameters and questions" until the second panel meeting in December 2003. While Brazil requested certain information through its request in Exhibit BRA-369, Brazil did *not* explain to the Panel or the United States how it proposed to determine the amount of upland cotton acreage "planted on" base acreage for any particular commodity. Indeed, the Panel was compelled on 12 January 2004, to ask Brazil to "submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks."[15]

10. Sixth, Brazil put forward on 20 January 2004, *for the first time* its allocation methodology – that is, after further rebuttal submissions had been filed and as the "serious prejudice" phase (and indeed the dispute settlement proceeding) was concluding. Here, Brazil set out its notion of under- and over-planting of programme crop base acreage, which the United States has criticized and rebutted in a series of filings over the last month.

11. Seventh, however, Brazil did not stop there. On 28 January 2004, in its comments on the US 18 and 19 December 2003, data (the comments that were to have been filed on 20 January), Brazil set forth yet another in-the-alternative methodology, a purported application of that December data to the Subsidies Agreement Annex IV methodology.[16]

12. Eighth, Brazil put forward on 18 February 2004 – that is, in its last substantive filing in this dispute – *two more* in-the-alternative methodologies to calculate the alleged support to upland cotton from decoupled payments. First, it explained a cotton-to-cotton methodology[17] under which only decoupled payments for upland cotton base acres would be deemed support to upland cotton. Second, it introduced a "modified (programme crop only) annex IV methodology"[18] under which decoupled payments would be allocated only to programme crops in the proportions to which they contributed to the value of programme crop production on a farm.

13. Given this never-ending stream of theories of how and to what extent decoupled income support payments could be support to upland cotton, it would appear that Brazil has made any argument that suited its immediate needs to maximize the purported support to upland cotton. There can be no question that Brazil's incessant in-the-alternative argumentation has prejudiced the United States by significantly increasing the burden in evaluating and responding to Brazil's theories.

14. Brazil has argued that "[w]ithout farm-specific data, there [was] no basis to develop, let alone apply, Brazil's methodology. Brazil could only develop a methodology to apply to actual data when

[13] Brazil's Further Rebuttal Submission, para. 50.
[14] Brazil's Further Rebuttal Submission, para. 48 (italics added).
[15] Panel Communication of January 12, 2004 (Question 258).
[16] The United States has elsewhere explained that Brazil has not brought forward evidence and arguments to allow the Annex IV methodology to be applied for purposes of its subsidies claims. *See, e.g.*, US 3 March Comments, paras. 29-35, 45-56.
[17] Brazil's 18 February Comments, para. 46 ("Brazil first presents the results of using a slight variation of Brazil's methodology.").
[18] Brazil's 18 February Comments, para. 50 ("Brazil also applied the revised US summary data to a modified 'Annex IV' methodology allocating total contract payments to farms producing upland cotton over the value of *contract payment* crops produced on these farms.").

it received the EWG data in mid-November, and when it then sought farm-specific data from the United States."[19] In this statement, however, Brazil concedes that it had not developed – because, allegedly, "there [was] no basis to develop" – its methodology until, at the earliest, mid-November 2003.

- It is simply incredible to read that a complaining party should have chosen to challenge payments which, on their face, are not product-specific support to upland cotton, yet not have developed a methodology to determine the amount of the payments it would consider "support to [that] specific commodity" until at least 6 months into the dispute.

- That is, it is rather startling that Brazil, as the complaining party, began this dispute without the evidence, *or even the legal theory*, necessary to sustain its assertions.

Further, we note that, even if Brazil *had* developed its methodology in mid-November, it did not choose to put this methodology forward until 20 January 2004 (eight months into this dispute), in response to the Panel's Question 258.

15. It is precisely this long delay in developing its Peace Clause arguments that led Brazil first to focus solely on payments for upland cotton base acres, and then only six months or more into the dispute to seek to bring in payments for non-upland cotton base acres. As the United States has argued, Brazil did not identify these payments that are not within the Panel's terms of reference[20] and which, if included in this dispute, would prejudice US rights of defence.[21] Furthermore, that Brazil had not crafted its methodology for Peace Clause purposes until six or eight months into this dispute undermines Brazil's Peace Clause interpretation: that is, Brazil has cast and recast its Peace Clause theories in order to find a theory that would result in US support exceeding the 1992 level. As the United States has demonstrated, however, non-product-specific support (whether green box or not) cannot be allocated as "support to a specific commodity" within the ordinary meaning of that phrase and as defined in Article 1(a) of the Agreement on Agriculture.[22] Thus, there is no basis to allocated decoupled income support payments to upland cotton for purposes of Peace Clause. Brazil various theories also rely on a "budgetary outlays" approach, which, for all the reasons the United States has explained previously, is not found in the Peace Clause text and is the wrong approach for Peace Clause purposes.

**Brazil's Attempt to Resurrect a Basis for the Use of Adverse Inferences Is Unsustainable**

16. After stating that the US 3 March data "is the best information available before the Panel" and that "the United States appears to have provided *complete summary base and complete summary planted data covering all crops for which data was requested by the Panel and all farms covered by the Panel's request*,"[23] Brazil nonetheless faults the United States for "certain problems" with the data and argues, in the alternative, that the alleged US "refusal" to provide certain data "would permit the Panel to draw the adverse inferences that this data – if produced – would have shown even higher payments being allocated to upland cotton."[24] Brazil's effort to resuscitate its request for "adverse inferences" to be drawn is misguided. First, in its 13 February letter, Brazil stated that "by producing the complete aggregated information, there would no longer be a need to draw adverse inferences."[25] As noted, Brazil has in its 10 March comments stated that the United States has produced "complete

[19] Brazil's 18 February Comments, para. 84.
[20] US 11 February Comments, paras. 47-50.
[21] *See* US Comments on Brazil's Answer to Question 204 from the Panel, paras. 34-42 (28 January 2004).
[22] *See, e.g.*, US 3 March Comments, paras. 3-16.
[23] Brazil's 10 March Comments, paras. 3-4 (italics added).
[24] Brazil's 10 March Comments, para. 10 fn. 14.
[25] Brazil 13 February 2004, Letter to the Panel, at 5.

summary base and complete summary planted data covering all crops for which data was requested by the Panel and all farms covered by the Panel's request." Therefore, Brazil has implicitly conceded that there is no basis to draw adverse inferences, and its suggestion otherwise is yet another in-the-alternative argument that only serves to add needlessly to the complexity of this dispute.

17. This conclusion is confirmed by examining the data that the United States allegedly "refused" to provide. First, Brazil faults the United States for providing data with respect to farms that had upland cotton base acres but planted no upland cotton within Category A.[26] We note that the Panel's supplementary request for information asked for information on farms with "fewer upland cotton planted acres than upland cotton base acres, or equal numbers of each,"[27] which does not exclude farms with no planted acres from its ambit. Indeed, as Brazil points out, on 28 January 2004, and on 19 December 2003, the United States had provided planted and base acreage information relating to (1) farms that both planted upland cotton and had upland cotton base acres and (2) farms that did not plant upland cotton and had upland cotton base acres.[28] It is not apparent from the text of item (b) of the Panel's supplementary request for information that the Panel was seeking the same information that had previously been provided. Because the United States provided the information requested under item (b) with respect to Category A farms, there is no basis for any adverse inference to be drawn.

18. Second, Brazil argues that the US 3 March data "does not provide contract payment yield or payment[] units." However, Brazil itself immediately concedes that "the Panel's 3 February 2004 Request does not ask for this information."[29] Thus, as the payment yield information was not requested by the Panel, the United States could not have refused to provide it, and there is no basis for any adverse inference to be drawn.[30]

19. Third, Brazil states that "the United States did not produce any information that would allow the calculation of 'producer-based' soybean market loss assistance [that is, "oilseed payments" for soybean producers[31]] and peanut direct and counter-cyclical payments received by producers operating upland cotton farms."[32] However, Brazil does not contest that these payments were made to producers and that there were no base acres for these payments on any farms for the relevant years (soybeans in 1999 and 2000, peanuts in 2002). The United States recalls that the Panel's supplementary request for information related to "farms" with upland cotton base acres and/or upland cotton planted acres.[33] Thus, the Panel's request did not ask for "payments received by producers

[26] Given Brazil's repeated complaints in this dispute, it is ironic that Brazil now, in effect, complains that the United States has provided too much information.

[27] Panel's Supplementary Request for Information, item (b) (3 February 2004).

[28] Brazil's 10 March Comments, para. 6 & fn. 5.

[29] Brazil's 10 March Comments, para. 7.

[30] Brazil's comment that the United States should have provided information on payment units in "good faith" as it did in its data submissions of 18 and 19 December 2004, and 28 January 2004, fails to mention that Brazil's request for data specifically asked for contract yields to be provided. Exhibit BRA-369 (second paragraph, fourth bullet: requesting "payment yield for each programme crop") (3 December 2003). The United States has responded to all requests for data in this dispute in "good faith" by providing all the data (within the limits of US law) requested.

[31] *See, e.g.*, Response of the United States of America to the Panel's 3 February 2004, Data Request, As Clarified on 16 February 2004, paras. 10-13.

[32] Brazil's 10 March Comments, para. 8.

[33] *See* Panel's Supplementary Request for Information, item (b) (first solid bullet: "How many farms had fewer upland cotton planted acres than upland cotton base acres, or equal numbers of each? We refer to these as 'Category A' farms."; second solid bullet: "How many farms had more upland cotton planted acres than upland cotton base acres? We refer to these as 'Category B' farms."; third solid bullet: "How many farms had upland cotton planted acres but no upland cotton base acres? We refer to these as 'Category C' farms.") (3 February 2004).

operating upland cotton farms," and there is no basis to draw an adverse inference from an alleged "failure" to provide information not requested.

20. In sum, Brazil's in-the-alternative renewed request concerning adverse inferences has no basis in fact; either the Panel's supplementary request for information did not request the information or the United States properly responded to the request as drafted. Furthermore, to the extent that Brazil argues that the contract payment yield data or soybeans or peanuts payments received by producers operating upland cotton farms were "necessary" for its Peace Clause analysis, this would demonstrate not that any adverse inference should be drawn but rather that Brazil, as the complaining party bearing the burden of proof, has failed to bring forth evidence to make a *prima facie* case.

**Brazil's Allocation Methodologies Are Irrelevant for Peace Clause Purposes and, in any event, Continue to Suffer from Conceptual and Methodological Flaws**

21. The United States has set forth in other comments the reasons that no allocation methodology may be employed for purposes of a Peace Clause analysis since the only relevant support is "support to a specific commodity" – that is, "assistance" or "backing" "specially pertaining to a particular" "agricultural crop" (in the ordinary meaning of the terms) or "support . . . provided for a basic agricultural product in favour of the producers of the basic agricultural product" (read in the context of the definition of product-specific support in Article 1(a) of the Agreement on Agriculture).[34]

22. Further, we have explained that for purposes of Brazil's serious prejudice claims, the Annex IV methodology[35] would be necessary to identify the subsidy benefit and subsidized product for each of the challenged decoupled income support measures – and Brazil has not brought forward evidence and arguments to allow the Annex IV methodology to be used.[36]

23. Finally, we have previously presented comments on each of Brazil's allocation methodologies.[37] As the calculations in Brazil's 10 March Comments are substantially similar to those it set out earlier, our comments on Brazil's new calculations are limited but also substantially similar to those we have previously provided. In particular, we note that Brazil has simply ignored the US criticisms of its pseudo-"Annex IV" methodology and excluded any sales from fruits and vegetables production, non-crop on-farm activities, and all other off-farm economic activity.

**Cotton-to-Cotton Methodology**

24. The United States has previously set out its criticism of this methodology, under which decoupled payments for upland cotton base acres on a farm that are equal to or less than the number of upland cotton planted acres are deemed to be support to upland cotton. Indeed, Brazil has never responded to the US explanation that "there are no physical 'base acres' on a farm. Crop base acres are an accounting fiction that do not represent any particular acres on a farm."[38] Thus, the very notion that base acres are "planted to" any particular crop (or, conversely, that a crop is "planted on" any particular base acre) is illusory.

25. We do note that the application of this erroneous methodology to the 3 March data does result in significant downwards revisions in the calculations Brazil previously presented, ranging from $58 million (MY2001 PFC) to $122 million (MY2002 CCP).[39]

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[34] *See* US 3 March Comments, paras. 3-16; US 11 February Comments, paras. 7-14.

[35] *Agreement on Subsidies and Countervailing Measures*, Annex IV, paras. 2-3 ("Subsidies Agreement").

[36] *See, e.g.*, US 3 March Comments, paras. 29-35; US 11 February Comments, paras. 18-21.

[37] *See, e.g.*, US 3 March Comments, paras. 36-56; US 11 February Comments, paras. 35-60.

[38] *See, e.g.*, US 3 March Comments, paras. 37-38.

[39] *Compare* Brazil's 10 March Comments, para. 15 *with* Brazil's 18 February Comments, para. 47.

**Brazil's Methodology**

26. Again, the United States has previously set out at length its criticisms of Brazil's methodology. The inconsistencies and logical flaws in this methodology are striking and demonstrate the *post hoc* nature of Brazil's attempt to force an allocation methodology onto decoupled payments. For example:

- There is no physical or economic basis to consider that decoupled payments for base acres of a crop are support to current production of that crop or to other (underplanted) programme crops. Base acres are not physical acres and are not "planted to" anything. A decoupled income support recipient may produce no, one, or multiple products; since money is fungible, those payments in economic terms (but not for purposes of Peace Clause) may be attributed to all (if any) of the recipient's sales.

- Brazil has never examined whether decoupled payments for non-upland cotton base acres "support or maintain" the production of those non-upland cotton programme crops – and thus has demonstrated no basis (on its own theory) for allocating such payments to those crops first.

- Brazil argues that base acres are "planted to" a particular commodity, one-for-one, but has no explanation for how an upland cotton planted acre can also be deemed to be "planted on" multiple base acres at once, as occurs when "underplanted" base acres are totalled and allocated proportionally to all "excess" planted acres (including cotton).[40]

- Brazil has never provided any logical explanation for why decoupled income support payments would be attributed to programme crops but not to other crops or other on-farm or off-farm economic activities (as economics and the Annex IV methodology would suggest is necessary).

- Neither has Brazil attempted to apply its own rationale that decoupled payments are "support to a specific commodity" when such payments "cover (or contribute to) the costs of production" of that commodity[41] to any other product produced by payment recipients, thus invalidating its own methodology, under which payments for base acreage is first support to the crop to which the acreage corresponds and then to other programme crops. Using Brazil's own "cost of production" principle, there is no basis to assert that order of analysis since Brazil has presented no evidence that such payments "cover (or contribute to) the costs of production" of those commodities but not others.

The United States has explored at some length these and other logical inconsistencies in Brazil's purported methodology for allocating decoupled payments to particular commodities. Although there is no basis in the Peace Clause to allocate non-product-specific support as support to a specific

[40] For example, in Exhibit BRA-433, Brazil presents calculations for allocating payments under its methodology for the different categories of farms set out in the Panel's supplementary request for information. For marketing year 2002, Category B2 farms planted 2,703,663 acres of cotton and had 2,035,335 base acres of cotton. Thus, Brazil calculates that there were 668,329 overplanted cotton acres eligible for allocated payments. Base acreage for other programme crops for Category B2 farms exceeded planted acreage for those crops by 1,197,785 acres, and no other programme crop was planted in excess of its base acreage. Thus, Brazil allocated the total payments "free to be allocated" ($21,290,090) from the non-upland cotton base acreage entirely to upland cotton. This means that the 668,329 overplanted cotton acres were "planted on" 1,197,785 "excess" base acres for other programme crops, or each "excess" acre of cotton was "planted on" 1.79 non-upland cotton base acres.

[41] Brazil's 18 February Comments, para. 3.

commodity, we nonetheless invite the Panel to consider these reasons why Brazil's methodology cannot serve as a neutral means to allocate decoupled payments.[42]

27. We also pause to recall that one of Brazil's primary responses to the US criticism that its methodology would result in different subsidization rates for upland cotton on a single farm and would result in the allocation of multiple non-upland cotton base acres per cotton planted acre was that "both of these alleged problems . . . do not exist from MY 2002. This is because Brazil's methodology allocates for each planted acre[] of upland cotton only one upland cotton base acre." Brazil then went on to suggest that because in MY 2002 greater than 99 per cent of direct and counter-cyclical payments received by upland cotton producers were for upland cotton base acres and because upland cotton base exceeded upland cotton planted acreage, "the two main US criticisms affect . . . at most, 0.9 per cent of the payments at issue for MY 2002."[43]

28. However, Brazil's 10 March comments tell quite a different story. There, Brazil calculates "the amount of upland cotton planted acres for which there exists a corresponding upland cotton base acre [by] farm category."[44] The percentage of upland cotton planted acreage for which an upland cotton base acre exists is 72.87 per cent in marketing year 1999, 70.03 per cent in marketing year 2000, 68.06 per cent in marketing year 2001, and 84.33 per cent in marketing year 2002.

- That is, in any given year, approximately 15 to 22 per cent of upland cotton planted acres – between 2.1 million and 4.9 million acres – were allocated payments for non-upland cotton base acres and would be subject to the US criticisms dismissed by Brazil as *de minimis*. Brazil simply ignores this issue in its 10 March comments.

Furthermore, we recall that Brazil stated that "[a]s for some of the US criticisms that might affect the results (except for MY2002), Brazil will control for these effects once the United States provides aggregate data in the manner requested by the Panel."[45] The United States is not aware of any explicit recognition by Brazil of "US criticisms that might affect the results" nor any effort by Brazil in its 10 March comments to "control for these effects."

29. Finally, we note that the application of Brazil's erroneous methodology to the 3 March data again results in significant downwards revisions in the calculations Brazil previously presented, ranging from approximately $43 million (MY2001 PFC) to $120 million (MY2002 CCP).[46]

**Modified US Annex IV methodology**

30. Brazil presents largely unchanged "modified Annex IV" calculations, for example, excluding both soybeans (marketing years 1999 and 2000) and peanuts (marketing year 2002) as a programme crop.[47] Under this "modified Annex IV" methodology, Brazil allocated total contract payments to

[42] *See* US 3 March Comments, paras. 37-44; US 11 February Comments, paras. 35-43; US Comments to Brazil's Answer to Question 258 from the Panel, paras. 207-29 (28 January 2004).

[43] Brazil's 18 February Comments, para. 60.

[44] Brazil's 10 March Comments, para. 20.

[45] Brazil's 18 February Comments, para. 67.

[46] *Compare* Brazil's 10 March Comments, para. 19 *with* Brazil's 18 February Comments, para. 49.

[47] We note that the rice prices used by Brazil in its calculations in Exhibit BRA-434 are incorrect. Brazil has mistakenly divided the average rice farm price, reported in dollars per hundredweight (i.e., 100 pounds), by 220.46 instead of by 100 to obtain a price expressed in dollars per pound.

upland cotton "according to the share of upland cotton crop value of the total value of contract payment crop production."[48] Thus, the US view of this "modified" methodology remains unchanged: Brazil's approach is fundamentally inconsistent with Annex IV, paragraph 2, under which the subsidy is allocated over "the total value of the recipient firm's sales." Furthermore, there is no plausible basis to maintain that decoupled income support payments are support only to contract payment crops. Brazil also improperly includes the total value of contract payments in its calculation when only payments for upland cotton base acres are within the scope of this dispute.

**"US Annex IV Methodology"**

31. Brazil offers no new analysis in its 10 March comments but just repeats the calculations presented in its 18 February filing. Thus, Brazil's "US Annex IV methodology" does not reflect the "US" interpretation of Annex IV, which is based on the text of Annex IV. That text establishes that, if a payment is not "tied to the production or sale of a given product," the subsidized product is all of the recipient firm's sales, and the subsidy for any one product is that product's share of "the total value of the recipient firm's sales."[49] Brazil does not use "the total value of the recipient firm's sales" in its "US Annex IV calculation" and does not even attempt to calculate total sales of upland cotton producers.

32. Because Brazil reiterates its 18 February calculations, Brazil's 10 March calculations are similarly flawed. First, Brazil errs by omitting the value of fruits and vegetables in calculating the total value of non-programme crop production. As the US 3 3 March data shows, in marketing year 2002 alone, 1.2 million acres were planted to fruits and vegetables on farms that reported cotton base acreage.[50] As pointed out in the US comments of 11 February,[51] excluding fruits and vegetables biases significantly downward the value of non-programme crop acreage. For example, the United States estimated the per-acre value of non-programme crops *including* fruits and vegetables was estimated at $281[52] for 2002 – that is, 138 per cent higher than the $118 per acre Brazil calculated when fruits and vegetables are excluded.[53]

33. Brazil suggests that it was not able to make any adjustment to its calculations because of its inability to separate those farms with no planted acres of cotton from Category A. However, Brazil does not explain why it was unable to use the actual planted acreage data, including that for fruits and vegetables, for Category B farms.[54] Nor does Brazil explain why it was unable to use the state-by-state information on plantings to make any adjustment to its use of "the average per-acre value of production of non-programme crops in that marketing year *in the entire United States*."[55]

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| | Brazil 1/ | WASDE 2/ |
|---|---|---|
| MY1999 | $0.027 | $0.0593 |
| MY2000 | $0.025 | $0.0561 |
| MY2001 | $0.019 | $0.0425 |
| MY2002 | $0.019 | $0.0449 |

1/ Exhibit BRA-434
2/ *World Agricultural Supply and Demand Estimates*, available at: http://www.usda.gov/agency/oce/waob/wasde/wasde.htm.

[48] Brazil's 10 March Comments, para. 24.
[49] Subsidies Agreement, Annex IV, paras. 2-3.
[50] *See* file "DCP02-2W.xls" ("Grand Total (Farms A - C)" row).
[51] *See* US 11 February Comments, para. 54.
[52] See Exhibit US-154.
[53] Brazil's 18 February Comments, Annex A, Table 4.5.
[54] Category C farms had no upland cotton base acres and thus received no decoupled payments within the scope of this dispute. To the extent Brazil disagrees, however, the same criticism of Brazil's failure to use the actual planted acreage data applies.
[55] Brazil's 28 January Data Comments, para. 90 (italics added).

34. Further, Brazil has not taken any account of the value of on-farm production other than crops, and has presented no data that would allow that calculation to be made. Again, the 1997 ARMS cotton costs of production survey suggested that, had Brazil taken into account the value of non-crop on-farm production, the share of cotton as a per cent of total farm sales would be lower still. For 1997, when the value of cotton was high, the 1997 ARMS cotton costs of production survey reported that cotton accounted for only 44.5 per cent of the total value of agricultural production on cotton farms.[56]

35. Brazil also fails to include off-farm economic activity, which can be substantial, in its calculation. Annex IV, paragraph 2, establishes that the non-tied subsidy is allocated over "the *total value* of the recipient firm's sales," not merely its *farm* sales. As we have previously noted, cotton operations earn almost 30 per cent of income from off-farm sources.[57]

36. Finally, Brazil continues not to make any adjustment for the fact that landowners capture the subsidy benefit of payments on rented acres. As the United States has noted, Brazil has previously conceded that, as of marketing year 1997, 34 to 41 cents per dollar of production flexibility contract payments were capitalized into land rent.[58] Furthermore, certain missing pages from Exhibit BRA-276 report that, during 1998-2000, the capture by landowners through increased rent of production flexibility contract payments increased to an estimated average of 81 to 83 per cent.[59] Thus, Brazil's own evidence does not support its decision not to adjust the subsidy benefit to upland cotton producers downwards to reflect the two-thirds of cotton acres that are rented by producers, not owned.

**Conclusion: Brazil Can Only Prevail on the Peace Clause Under an Incorrect Interpretation of the Peace Clause**

37. The United States has demonstrated that Brazil's reading of the Peace Clause is not tenable; instead, Brazil invents the concept that non-product-specific support must be allocated to specific commodities. This concept runs directly contrary to the ordinary meaning of the Peace Clause text and directly contrary to its context, including the fundamental separation of product-specific and non-product-specific support in the Agreement on Agriculture.

38. The United States has also demonstrated that Brazil's approach to its "serious prejudice" claims is misguided. As mentioned previously, Brazil's notion that "the effect of the subsidy" may be analyzed without knowing the amount of the challenged subsidy is akin to saying that "the effect of eating" may be determined without knowing how much is being eaten.[60] Of course, to determine "the effect of eating" one must also determine "what" is being eaten (in addition to "how much"); similarly, "the effect of the subsidy" will depend on the nature of the challenged subsidy.[61] Thus, the United States believes that Brazil has failed to make a *prima facie* case with respect to decoupled income support payments (direct and counter-cyclical payments)[62] under its serious prejudice claims because it has not identified either the subsidy benefit or the subsidized product(s) using the Annex IV

[56] US 3 March Comments, para. 50; US 11 February Comments, para. 55.

[57] *See* US 3 March Comments, para. 51.

[58] Brazil's Answer to Question 179 from the Panel, para. 165 (27 October 2003); Brazil's Opening Statement at the Second Panel Meeting, para. 57.

[59] US 3 March Comments, paras. 52-54; Exhibit US-155, at 106.

[60] US 3 March Comments, para. 30 fn. 59.

[61] *See* Subsidies Agreement, Article 7.2 (request for consultations under Article 7.1 "shall include a statement of available evidence with regard to (a) the existence *and nature* of the subsidy in question") (italics added).

[62] Only direct and counter-cyclical payments were measures in existence at the time the Panel was established during marketing year 2002. Both production flexibility contract payments and market loss assistance payments were recurring subsidies paid with respect to past production that had terminated by the time of the panel request and panel establishment.

methodology. In addition, Brazil has failed to establish that the *effect* of these challenged payments is "serious prejudice"; to the contrary, the United States has demonstrated that the effect of these decoupled measures is no more than minimal.[63]

39. Finally, the United States has demonstrated that using any measurement that reflects the support "decided" by the United States – rather than factors (such as market prices) beyond the United States' control – US support to upland cotton in marketing years 1999-2002 has not exceeded the 1992 marketing year level.[64] Brazil's proposed approach suffers from the key flaws (among others) that it relies on the argument that:

(1) budgetary outlays must be used, despite the fact that the United States never "decided" an expenditure level (a point confirmed by Brazil's own reliance on the marketing loan rate and counter-cyclical target price for purposes of its *per se* and threat of serious prejudice claims[65]); and

(2) decoupled income support measures – the green box direct payments and the non-product-specific counter-cyclical payments[66] – can and must be allocated as "support to a specific commodity," despite the ordinary meaning of those terms in their context in the Agreement on Agriculture.

40. That both of these conditions must be met is evident if one examines the four tables setting out Brazil's Peace Clause comparisons.[67]

- For example, even using budgetary outlays, if decoupled income support payments are removed from Brazil's Peace Clause comparisons, *US measures did not breach the Peace Clause in marketing years 2002 and 2000*. The 1992 support would be $2,117.0 million, and the 2002 and 2000 levels would be $1,557.1 million and $1,218.7 million, respectively.[68]

- On the other hand, even if decoupled income support measures were allocated according to any of Brazil's four erroneous methodologies, *US measures did not breach the Peace Clause in marketing year 2001* if a price-gap calculation is used in place of outlays for marketing loan payments. A price-gap calculation eliminates the effect of market prices on the support

[63] *See, e.g.*, US Comments on Brazil's Comments on US Comments Concerning Brazil's Econometric Model, paras. 4-9 (28 January 2004).

[64] *See, e.g.*, US 11 February Comments, paras. 15-17.

[65] *See* Brazil's Further Submission, para. 432 ("The existence of the 72.4 cents per pound support price under the 2002 FSRI Act alone causes production-enhancing and price-suppressing effects. The single fact that these programmes exist ensures a guaranteed revenue amount from the production of upland cotton. This revenue floor is a guaranteed entitlement. That guaranteed revenue floor has the effect of removing any uncertainty and risk about the revenue farmers will receive for the crop. It means that regardless of the actual price development during the marketing year, a farmer knows that he or she will receive at the very least the loan rate for their product, plus price-triggered revenue support granted by the CCP programme.").

[66] Were the Panel to examine the terminated payments prior to the 2002 Farm Act, production flexibility contract payments would be green box, and the market loss assistance payments would be non-product-specific, as notified to the WTO.

[67] Brazil's 10 March Comments, paras. 35-38.

[68] *See* Brazil's 10 March Comments, paras. 35, 37. This calculation ignores the inappropriate inclusion of crop insurance payments (non-product-specific), cottonseed payments (not in existence at time of panel establishment), and "other payments" (not identified in Panel request). We also note that the marketing year 1999 budgetary outlay level would be $2,431.6 million if decoupled support is excluded. Brazil has alleged that some portion of Step 2 payments are prohibited export subsidies, rather than domestic support, and the United States has argued that "other payments" are not within the Panel's terms of reference. The Panel's view of these issues could result in the 1999 budgetary outlay level too being below the 1992 level.

provided.[69] US measures conform to the Peace Clause in marketing year 2001 under two different Brazilian allocation methodologies if a price-gap calculation is used.[70]

- Indeed, even without making any changes to Brazil's data, under two of its current "reasonable" methodologies, US measures did not breach the Peace Clause in 2000, the year with the highest market prices and therefore the lowest marketing loan payments.[71]

41. The United States believes that a proper interpretation and application of the Peace Clause must reflect the way in which the United States "decided" support in marketing years 1992 and 2002[72] – and, in the case of US measures, the support to upland cotton as "decided" was a rate of support. However, the United States has demonstrated that even an AMS calculation that reflects the support decided by the United States rather than market prices beyond our control would also demonstrate that US measures conform to the Peace Clause. Brazil's revised budgetary outlay calculations also support this view.

- If neither condition set out above is met – that is, decoupled income support measures are properly excluded from the Peace Clause analysis and price-based marketing loan payments are calculated using a price-gap methodology – *US measures did not breach the Peace Clause in any marketing year between 1999 and 2002.*

- Support in marketing year 1992 would be $1,384 million,[73] well above the revised support levels are $659.1 million for marketing year 2002, $458.9 million for marketing year 2001, $582.7 million for marketing year 2000, and $670.6 million for marketing year 1999.[74]

- Again, these lower levels of support "decided" in recent years reflects the United States' decision after the Uruguay Round to move away from the product-specific deficiency payments with high target prices and instead to supplement producer income with a mix of decoupled income supports that are green box (direct payments) or non-product-specific (counter-cyclical payments).

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[69] *See* US Rebuttal Submission, paras. 114-17. By holding the external reference price fixed, support measured using a price-gap calculation shows the effect of changes in the level of support (the applied administered price) decided by the United States, rather than changes in outlays that may result from forces beyond our control, such as market prices.

[70] For marketing year 2001, support measured using a price-gap calculation for price-based measures and budgetary expenditures for other payments results in $1,251 million. For methodologies (1) ("cotton-to-cotton") and (4) ("US Annex IV methodology"), support was $1,240.9 million and $1,183.8 million. Again, these calculations do not remove crop insurance payments (non-product-specific), any portion of "Step 2" payments, or "other payments" (not within the scope of the dispute).

[71] Brazil's 10 March Comments, para. 37 (1992 budgetary outlays were $2,117.0 million; 2000 outlays under the cotton-to-cotton methodology were $2,068.8 million; 2000 outlays under the "US Annex IV Methodology" were $2,112.6 million).

[72] The measures (subsidies) provided with respect to marketing years 1999-2001 were no longer in existence at the time of Brazil's panel request and panel establishment. To the extent the Panel were to examine these measures, however, the same analysis would apply.

[73] This figure uses the same $1,017.4 expenditure amount that Brazil used for deficiency payments. This figure is not markedly different from the $1,009 price-gap figure calculated by the United States using eligible acreage, but even if actual payment acreage were used, the price-gap payment total would be $867 million. US Comments on New Material in Brazil's Rebuttal Filings, para. 8 (27 August 2003). Thus, the 1992 level of support would still be higher than in marketing years 1999-2002.

[74] These revised figures exclude decoupled payments and use the price-gap calculation for marketing loan payments, which results in a zero level of support since the marketing loan rate was below the fixed reference price. *See* US Rebuttal Submission, para. 117 & fn. 148 (22 August 2003). However, these revised figures do not even remove crop insurance payments (non-product-specific), any portion of "Step 2" payments (which Brazil alleges are, in part, prohibited export subsidies), or "other payments" (not within the scope of the dispute).

42. Were the Panel to reach the question of serious prejudice or threat thereof, the United States has demonstrated that Brazil has not made a *prima facie* case that the challenged US measures have had that effect. However, the Panel should not even reach that question as the facts demonstrate that the United States has disciplined itself to grant support not in excess of that decided during the 1992 marketing year. Brazil must argue that non-product-specific support can be allocated as support to a specific commodity and must argue that support "decided" means budgetary outlays because without those conditions, it cannot demonstrate a Peace Clause breach. The United States has demonstrated, however, that Brazil's approach is legally unsound and internally inconsistent. It would, moreover, provide no certainty for Members who seek to conform to their WTO obligations. Brazil's constantly shifting methodologies reflect its desire to find an approach to maximize the dollars it could argue are support to upland cotton but do not reflect the legal texts, structure, and concepts found in the Agreement on Agriculture and the Subsidies Agreement.

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**WORLD TRADE ORGANIZATION**

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# UNITED STATES – SUBSIDIES ON UPLAND COTTON

## *Report of the Panel*

Addendum

This addendum contains the Annexes J-O to the Report of the Panel to be found in document WT/DS267/R. Annexes A-H can be found in Add.1 and Annex I can be found in Add.2.

# ANNEX J

## ANSWERS OF THIRD PARTIES TO THE QUESTIONS FROM THE PANEL AND FROM OTHER THIRD PARTIES', AND COMMENTS THERETO

# ANNEX J-1

## REPLIES BY ARGENTINA TO QUESTIONS POSED BY THE PANEL TO THE THIRD PARTIES FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING OF THE PANEL

11 August 2003

**Article 13 of the *Agreement on Agriculture***

**1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions in Article 13 are a "prerequisite" to the availability of a right or privilege? Australia Would other third parties have any comments on Australia's assertion?** 3rd parties, in particular Argentina, Benin, China, Chinese Taipei

Argentina agrees with Australia that Article 13 of the Agreement on Agriculture is an affirmative defence and that in these proceedings the United States therefore carries the burden of proof on the question of whether its subsidies conform with the terms of Article 13.

According to the Appellate Body in *US-Shirts and Blouses*:

> *" … the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption".*[1]

As stated by Brazil in Paragraph 112 of its first written submission, in the case of claims of violation of the positive obligations of the WTO Agreement, it is the complaining party that has the burden of providing a prima facie case of violation. However, in the case of affirmative defences, such as Articles XX and XI:2(c)(i), the Appellate Body itself established that it is only reasonable that the burden of establishing such a defence should rest upon the party asserting it.[2]

According to the standards established by the Appellate Body,[3] Article 13 of the Agreement on Agriculture is a provision in the nature of an affirmative defence. As such, it does not create new obligations for Members, but limits the scope of certain provisions of the SCM Agreement and the GATT 1994 subject to certain conditions. Nor does it alter the legal nature of Members' measures, but simply permits Members to maintain those measures exempt from actions, if the measures meet the conditions specified in Article 13(a), (b) or (c). As Argentina stated in its Third Party Initial Brief:[4]

> *"Argentina considers that the provisions contained in Article 13 of the AoA have an exceptional nature. This would imply that the Member who alleges to be protected by the Peace Clause has the burden of proving the fulfilment of its legal requirements. As long as*

[1] Appellate Body Report, *US – Shirts and Blouses*, WT/DS33/AB/R, p. 14, text at note 16.
[2] *Id.*, p. 16, text preceding note 23.
[3] See paragraphs 113 to 116 of Brazil's First Written Submission.
[4] Argentina's Third Party Initial Brief, paragraph 14.

*the US does not demonstrate prima facie that it fulfils all the conditions that would allow a protection against a claim by virtue of Article 13 of the AoA, the Panel should consider as appropriate the claims under Article XVI of GATT 1994 or Articles 3, 5 and 6 of the SCM Agreement".*

The exceptional nature of Article 13 of the Agreement on Agriculture (AoA) cannot change merely because the conditions justifying it include conformity with rules that create positive obligations for Members (e.g. Article 6 of the AoA). This legal nature comes out clearly in the chapeau of Article 13 of the AoA which begins with the words "*Notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures …*", providing guidance to the effect that the purpose of the entire Article 13 is to create exceptions, subject to certain conditions, to the provisions of the GATT 1994 and the SCM Agreement.

For example the party claiming defence under Article 13 of the AoA clearly must prove, inter alia, that the domestic support measures which it claims should be exempt from actions based on Articles 5 and 6 of the SCM Agreement and Article XVI of the GATT 1994 do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

If Article 13 of the AoA did not exist, any domestic support measure would unquestionably be subject to actions based on Articles 5 and 6 of the SCM Agreement and Article XVI of the GATT 1994. The temporary defence accorded by Article 13 is an exception to that situation, and it is therefore up to the claimant to demonstrate that the conditions permitting such defence have been fulfilled.

Mere reference, as one of the conditions justifying the measure, to conformity with a positive obligation of the AoA, cannot alter the exceptional nature that informs all of Article 13.

**Article 13(b) of the *Agreement on Agriculture*: Domestic Support Measures**

**2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*.** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

Argentina considers that while the term "defined" refers to the need for the base period to be clearly determined in the order authorising the payments, the term "fixed" refers to the need for the base period to be identified in terms which prevent it from being shifted or modified *a posteriori*. The term "fixed" indicates that the payments made in accordance with the criteria stipulated in paragraph 6(a) must always rely on the same base period, and no change is possible.

**3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3.** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

The purpose of the term "a" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture is to establish the obligation for Members to identify a single period, which may cover two, three or more years depending on the Member. For example the base periods established by the EU, the United States and Argentina are different with respect to the payments referred to in paragraph 6(a) of Annex 2. However, although different for each Member – the identification of the period is up to the Members in that it is not specified in the text of the Agreement *per se* – the period must be identified by the Member concerned and must remain constant. Otherwise, the choice of the word "a" in this provision would be difficult to explain. If the negotiators of the AoA had not wanted the period to maintain an identity over time, they would have so indicated by using a different preposition, for example, "some" period, indicating that the period could be subject to a certain mobility.

In the case at issue, the United States identified, for the purposes of paragraph 6(a) of Annex 2, the period running from 1986 to 1988, as shown in document G/AG/AGST/USA on pages 1-7, referred to in Part IV of the United States' Schedule of Commitments – Schedule XX.

In paragraph 6(b), (c) and (d), Argentina understands the term "the base period" to refer to the base period 1986-1988, the only base period identified in the AoA for domestic support (Annex 3).

"The" base period refers to the base period 1986-1988, since there is no other period for domestic support. Indeed, Article 1(a)(i) also refers to "the" base period, which is none other than the period specified in Annex 3 of the AoA. Article 1(d)(i) and Article 1(h)(i) also mention "the" base period.

In other words, "a" base period is different from "the" base period. Moreover, the second sentence of paragraph 5 of Annex 2 of the AoA requires the adoption of "the" base period established in paragraphs 6(b), (c) and (d), clearly reflecting this difference with paragraph 6(a).

In the case of payments by the United States under paragraph 6 of Annex 2 of the AoA, this distinction is irrelevant since "a" base period in the context of paragraph 6(a) and "the" base period of paragraphs 6(b), (c) and (e) are the same - 1986-1988 - having been so defined by the United States in its Schedule of Commitments.

**4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

It is Argentina's understanding that under paragraph 6 of Annex 2 of the Agreement on Agriculture, for each programme a Member may only define and establish a base period once. Otherwise, the term "fixed" would lose all of its relevance.

**5. Do you agree that a payment penalty based on crops produced is "related to type of production"?** EC

**6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the *Agreement on Agriculture* have on the meaning of the preceding sentence?** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

The word "criteria" in Article 6.1 and 7.1 signifies the parameters, rules or precepts which serve to distinguish the domestic support measures that are not subject to reduction.

In relation to the preceding sentence, the use of the word "accordingly" in paragraph 1 of Annex 2 of the Agreement on Agriculture indicates that the basic criteria listed thereafter are a corollary to the "fundamental principle" set forth in the preceding sentence. However, this does not imply that the preceding sentence does not contain "stand-alone" obligations.

On the contrary, the domestic support measures for which exemption from the reduction commitments is sought must conform to the two basic criteria (set forth in paragraph 1(a) and (b)), plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2, in addition to which they must meet "the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production". A measure which meets the two criteria set forth in paragraph 1(a) and (b) plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2 may also violate the general principle. Any other interpretation would deprive

of any meaning the first sentence of paragraph 1 of Annex 2, which the text itself qualifies as a "fundamental requirement".

**7. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the *Agreement on Agriculture*.** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

In Argentina's view, the words "the fundamental requirement" as used in paragraph 1 of Annex 2 signify the establishment of a general mandatory condition governing the establishment and application of any measure whose inclusion in the "Green Box" is claimed.

**8. In your oral statement, you emphasize the use of the word "criteria" in other parts of the *Agreement on Agriculture*, as distinct from the reference to "fundamental requirement" in the first sentence of paragraph 1 of Annex 2. Is it the case that sub-paragraphs (a) and (b) of paragraph 1 of Annex 2 are also "criteria"?** EC

**9. If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation, does this allow effects-based claims of non-compliance with Annex 2? If so, how does this affect the purpose of Article 13(b)?** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

The first sentence of paragraph 1 of Annex 2 of the AoA contains a stand-alone obligation.

Since the first sentence of paragraph 1 of Annex 2 imposes an obligation by requiring that the measures for which exemption from a reduction commitment is claimed must, as a primary or essential condition, be such that they do not artificially alter trade or production, it permits claims of non-compliance with Annex 2 based on the effects of the domestic support measures, regardless of whether they meet the basic criteria set out in the second sentence of paragraph 1 and with the policy-specific criteria and conditions set out in the rest of Annex 2.

Otherwise, we would be exempting from the reduction commitments measures that might be complying with the two basic criteria set forth in paragraph 1(a) and (b) of Annex 2 plus the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2 while at the same time violating the general principle of meeting "the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production."

It might then be possible to evade conformity with the provisions of Article 6 of the AoA or with the level of support to a specific commodity decided during the 1992 marketing year.

The result could be to undermine the purpose of Article 13(b) of exempting from countervailing duties or actions based on Article XVI.I or Articles 5 and 6 of the SCM Agreement only those measures which comply with the conditions set forth therein.

**10. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box?** 3rd parties, in particular Australia, Argentina, Canada. EC, NZ

Yes. Argentina considers that non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 must be excluded from the Green Box. In other words, the measures which satisfy the fundamental requirement of having no, or at most minimal, trade-distorting effects or effects on production, but which do not meet the criteria established in paragraph 1(a) and (b) of Annex 2 and the policy-specific criteria and conditions set out in the subsequent paragraphs of Annex 2, cannot be exempted from reduction commitments.

**11. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2.** 3rd parties, in particular, Australia, Argentina, Canada, EC, NZ

Argentina considers that there is a clear hierarchy between the two provisions, in which the principal obligation for Members is to ensure that their support programmes, even if they could qualify as decoupled support programmes under paragraph 6 of Annex 2, do not have trade-distorting effects or effects on production, as stipulated in paragraph 1 of the same Annex.

Consequently, even if the Direct Payments programme complies with the requirements of the second sentence of paragraph 1 of Annex 2, if it does not comply with the fundamental requirement laid down in the first sentence, it cannot be considered a Green Box programme.

Argentina agrees with Brazil's statement in paragraphs 183-191 of its first written submission with respect to the strong production and trade-distorting effects of the Direct Payments programme.

**12. Where does Article 13(b) require a year-on-year comparison?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

As stated in paragraph 21 of its oral submission, Argentina maintains that the domestic support measures granted during any one of the marketing years of the period covered between the entry into force of the AoA in 1995 and the expiry of Article 13 on 31 December 2003 are relevant for the purpose of determining conformity with Article 13(b), the text of which does not explicitly establish the requirement of a year-on-year comparison.

Thus, the excess support granted during any one of the years of the period of implementation suffices to cancel the protection provided by the Peace Clause.

Nor can a year-on-year comparison be inferred from Article 13 or from its context. Otherwise, at the beginning of each marketing year the Member that had exceeded the level of support in the previous year would be covered by the Peace Clause once again and exempt from any claims.

In practical terms, this interpretation would turn Article 13 protection into an absolute defence, given the difficulty of challenging the level of support granted during the current marketing year at the time of the complaint. If it were only possible to challenge the support granted during a past marketing year independently of the support granted during the current year, what would be the use of any successful claim under Articles 5 and 6 of the SCM Agreement? How would it be possible, in that case, to eliminate the adverse effects of a subsidy already granted?

**13. Does a failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

In Argentina's view, the failure by a Member to comply in a given year with either the *chapeau* of Article 13(b) or the proviso in sub paragraph (ii) of Article 13(b) results in the loss of the protection granted by the Peace Clause.

Regarding the "*chapeau*" of Article 13(b): domestic support that does not conform to the provisions of Article 6.1, for example distorting support in excess of the reduction commitment in violation of Article 3.2 of the AoA, is outside the scope of Article 13(b). Indeed, that Article refers to "domestic support measures that conform fully to the provisions of Article 6 … ". Consequently, domestic support of the kind referred to in Article 13(b) that does not conform to Article 6 does not

bear any relation to Article 13(b)(ii). Such support is prohibited and does not enjoy the protection of the Peace Clause.

Regarding failure to comply with the proviso in Article 13(b)(ii): any failure to comply in whatever year implies exclusion from the scope of Article 13(b) for all of the distorting domestic support measures concerning the specific commodity in question.

**14. Does a failure of a Member to comply with Article 13(b) in respect of a *specific commodity* impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

In Argentina's view, failure by a Member to comply with Article 13(b)(i) and (ii) in respect of a specific commodity does not impact its entitlement to benefit in respect of other agricultural products from the exemption action provided by Article 13(b).

However, failure to comply with the conditions laid down in the *chapeau* of Article 13(b) i.e. failure of the domestic support to conform with the provisions of Article 6 of the AoA, could result in exclusion from the protection offered by Article 13(b) in respect of domestic support granted to all products, for example, if the domestic support measure exceeds the level of the commitment in the schedule of the Member concerned.

**15. Is there any basis on which counter-cyclical payments could be considered product-specific?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

As stated in paragraph 8 of its Oral Submission, Argentina considers that "*support to a specific commodity*" in Article 13(b)(ii) includes any domestic support measure that is not a Green Box measure and that provides any identifiable support to a commodity in particular, regardless of whether the measure may provide support to a greater number of commodities.[5] In this respect, counter-cyclical payments explicitly provide support to cotton (upland) as can be seen in the text of the United States Farm Act of 2002 (2002 Farm Security and Rural Investment Act, Title I, Subtitle A, Exhibit US-1).

**16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph?** 3rd parties, in particular Australia, Argentina, Benin, Canada, China, EC, NZ

The word "specific" is an adjective qualifying the noun "commodity". The adjective "specific" does not qualify the support (the calculation of which may or may not be product-specific, as stated in paragraph 1 of Annex 3 of the AoA).

If the word "specific" qualifying the noun "commodity" were not there, the text would no longer have the precision that it currently has, although this does not mean that even then it could not be interpreted as referring to any type of domestic support (regardless of whether it is categorized as product-specific or non-specific under Annex 3 of the AoA).

**17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to a "product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) *Agreement on Agriculture*?** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

[5] In this respect, Argentina agrees with New Zealand: *" … New Zealand sees no basis on which to suggest that support to a specific commodity should be excluded simply because other commodities may receive similar support".* Third Party Submission of New Zealand, 15 July 2003, paragraph 2.23.

In Argentina's view the concept of specificity in Article 2 of the SCM Agreement is not linked to the term "specific commodity" in Article 13(b)(ii) of the AoA. In Article 2 of the SCM Agreement, the specificity is a characteristic of the subsidies (prohibited or actionable) covered by the current SCM Agreement, while the specificity referred to in the phrase "specific commodity" is characteristic of the commodity and not of the subsidy granted. The phrase "support to a specific commodity" cannot be identified with "specific support to a commodity".

The concept of "specificity" in Article 2 of the SCM Agreement is what indicates whether a subsidy is subject to the provisions of Part II or to the provisions of Parts III or V of that Agreement.

**18. Benin's oral statement considers the phrase "support to a specific commodity" in Article 13(b)(ii) of the *Agreement on Agriculture*. How does Benin believe that phrase is best interpreted? Please substantiate your response, commenting on other submissions by parties and third parties as you believe appropriate.** Benin

**19. Where does Article 13(b)(ii) require a year-on-year comparison?** 3rd parties, in particular Australia, Argentina, Canada, EC, NZ

Argentina submits that the domestic support measures granted in any of the marketing years of the period covered between 1995 and 2003 are relevant for the purposes of determining conformity with Article 13(b)(ii), which does not explicitly require a year-on-year comparison.

**20. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?**

In Argentina's view Article 13(b)(ii) requires a comparison of support granted with support decided. Such a comparison is possible by making a calculation in terms of budgetary outlays in each one of the periods in question (support granted in the implementation period as compared to support decided during the 1992 marketing year).

**21. Please comment on Brazil's assertion that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term?** 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ

According to the text of Article 13(b)(ii) the word "*decided*" signifies the decision to provide payments for a specific commodity (including the revenue foregone under Article 1(c) of the AoA), whether those payments are classified as product-specific or non-specific, as well as other forms of domestic support in monetary terms as set forth in Annex 3 of the AoA.

The phrase "*support decided during the 1992 marketing year*" is necessarily linked to the phrase "grant support" - indeed, there would be no basis for comparison if in one case the support was granted, while in the other case, the support was only planned. In other words, as indicated in the reply to the preceding question, the Article 13(b)(ii) requirement necessarily involves a comparison of domestic support measured in the same manner in each one of the periods in question, i.e. a "comparison of the comparable".

In principle, the comparison must be made between the support granted in any year of the implementation period and the support "decided" during 1992. The support "decided during the 1992 marketing year" refers to a legislative or administrative decision by a Member during the 1992 marketing year on the domestic support to be granted during the implementation period in terms of budgetary outlays.

Where no "decision" has been taken in terms of budgetary outlays during 1992, Argentina understands that the only support that can be considered as "decided" during that marketing year is the support granted during that year.

**22. What is the meaning of "support" in *Agreement on Agriculture* 13(b)(ii)? Why would it be used differently from Annexe 3, where it refers to total outlays?** 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ

The "support granted" in each marketing year of the implementation period must necessarily be linked to the budgetary outlays for those years.

The term "support" used in Article 13(b)(ii) of the AoA refers to budgetary outlays for any kind of support that is not Green Box. For example, the term "support" could include assistance granted by the State by foregoing tax revenue or writing off producers' debts.

**23. Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both?** 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ

Support should be compared under Article 13(b)(ii) in total monetary terms. In paragraph 16 of its oral submission, Argentina submits that the term "decided" in Article 13(b)(ii) should not be interpreted as meaning that the rate per unit of production is the factor to be considered in determining the amount of support granted. If the argument put forward by the United States were accepted, this would enable an unlimited amount of domestic support to be granted for each product provided the total AMS is not exceeded, since it would be covered by Article 13. Thus, the amount of the AMS could be granted to one or several products, provided its maximum bound level is not exceeded.

The comparison must be made in terms of total value of support for a specific product, comparing the levels for each marketing year subsequent to 1992 and up to 31 December 2003 with the levels of support decided during the 1992 marketing year.

**24. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) of the *Agreement on Agriculture* and, in particular, why the words "grant" and "decided" were used.** EC

**25. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during".** 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ

The term "decided during" in Article 13(b)(ii) refers to a decision made by the Member granting the support during the 1992 marketing year with respect to the budgetary outlays that would be made for domestic support, excluding Green Box.

If there was no decision during the 1992 marketing year, the budgetary outlays effectively made during that marketing year must be considered to constitute the support "decided during" the 1992 marketing year (i.e. if there is no express decision in this respect, we must fall back on what was effectively disbursed which also, implicitly, represents a "decision").

**26. Under Article 13(b)(ii), a comparison is required between support at different times. One of the issues which is contested between the parties is whether the only later period that the Panel can consider is the present one (i.e. the period underway at the time of the request for establishment of the Panel). This argument is based on the present tense of the words "do not grant" in the English text. The Panel asks whether there is any difference in the verb tense as**

**used in the Spanish-language text, or any other difference which might aid the Panel in interpreting these words?** Argentina, EC, Paraguay, Venezuela

While it is true that in the English version of the Agreement on Agriculture, the verb tense used in Article 13(b)(ii) is the present tense, as stated by the United States in paragraph 90 of its first written submission ( … the proviso is written in the present tense …), it should be stressed that in the Spanish text, the present tense is clearly used in the subjunctive mode ("*a condición de que* ***no otorguen*** *ayuda* … ")

The expression "*a condición de que*" uses the subjunctive mode to indicate the conditional or possible nature and expresses syntactic subordination.

The use of the subjunctive mode in Article 13(b)(ii) is important, because in Spanish it is used to express and form sentences in which the action remains in doubt, as opposed to the indicative mode where the tenses always indicate that the action, concretely, is taking place, has taken place, or will be taking place.

The Spanish text coincides with the verbal tense used in the French version ("*à condition que ces mesures n'accordent pas*"), in which the present subjunctive is also used.

Consequently, Argentina does not agree with the United States' contention that the present tense criterion in Article 13(b)(ii) implies that the only support the Panel may consider is current support.

**27. If the 1992 "decision" led to or was the funding source for the money provided in 1992 and later years, is it the full amount of all that funding that constitutes the "support" decided in 1992? If the answer to this question is that it is the full amount of all the support provided pursuant to the "decision" that must be taken into account, must this be compared with the total amount of support that will or might flow from the decision made in the more recent period for the purposes of the comparison required under Article 13(b)(ii)? If a Member did not make a "decision" (however that may be interpreted) in 1992 about "support", is it the case that the Member has a zero base for the purposes of the comparison required under Article 13(b)(ii)?** EC

**28. In paragraph 13 of Australia's oral statement, you state that a "question" is: "could conditions of price competition for the purposes of a non-violation or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole." Could you please clarify this statement (indicating other elements which would complete the "whole" and explain its relevance for the purposes of our consideration of Article 13 of the *Agreement on Agriculture*?)** Australia, EC

**Export Credit Guarantee Programme**

**29 (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*? Why or why not?** 3rd parties, in particular, Argentina, Canada, EC, NZ

An export credit guarantee is a "financial contribution" in the form of a "potential direct transfer of funds or liabilities" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement when it involves the granting of a financial credit in conditions more favourable than those that can normally be found on the market. Those conditions may contain all or some of the following

elements: lower interest rates, longer repayment terms for loans, lower down-payment requirement, reduced frequency of payments per year and/or total or partial exemption from any fee or premium to provide the US Government with adequate protection against potential flaws in its export credit guarantee portfolio. This is confirmed in practice by the fact that no company on the market is prepared to provide coverage equivalent to the coverage accorded with the credit guarantees of the Commodity Credit Corporation of the United States.

Moreover, items (j) and (k) of the Illustrative List in (Annex 1) of the SCM Agreement set out the circumstances in which this type of operation should be considered an export subsidy.

**29. (b) How, if at all, would this be relevant to the claims of Brazil?** 3rd parties, in particular, Argentina, Canada, EC, NZ

It is relevant to the claims of Brazil in that the fact of being a "financial contribution" is the first element of a prohibited export subsidy claim.

**30. The Panel could arguably take the view that Articles 1 and 3 of the *SCM Agreement* were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an *a contrario* interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission).** 3rd parties, in particular, Argentina, Canada, EC, NZ

As stated by the Appellate Body in *US - FSC* and in *Canada - Dairy Products*, the AoA does not contain its own definition of a subsidy, and hence we must turn to the SCM Agreement for the context. The Appellate Body has also established (FSC case) that export subsidies under Article 3.1(a) of the SCM Agreement constitute export subsidies under the AoA.

The relevance of Articles 1 and 3 of the SCM Agreement is therefore unquestionable when it comes to evaluating the consistency of the export credit guarantees with WTO rules.

Moreover, Annex I of the *SCM Agreement* identifies export subsidies by providing an illustrative list thereof. In other words, a measure which constitutes an export subsidy classified in the Illustrative List is *per se* a prohibited subsidy under Article 3.1(a) of the *SCM Agreement*. Obviously, the "Illustrative" List in no way covers all measures that could qualify as an export subsidy under Article 3.1(a) of the SCM Agreement. As its name indicates, it is only an "illustrative" list and not an exhaustive one.

Now, footnote 5 in Article 3.1(a) of the SCM Agreement states that "measures referred to" in Annex I as not constituting export subsidies shall not be prohibited.

There are two paragraphs in this Annex that refer to credit, guarantee or insurance programmes: (j) and (k). There is a fundamental difference between the two. Item (k) explicitly recognises that a measure, in the circumstances set forth in its second paragraph, shall not be considered an export subsidy (see the last sentence of the second paragraph), fulfilling the requirement set forth in footnote 5 to the SCM Agreement:

> (k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

> Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement. (Emphasis added)

Argentina does not agree with the *a contrario* interpretation provided by the United States in paragraphs 180 to 183 of its submission, either with respect to the first paragraph of item (k) or with respect to item (j) of Annex I to the *SCM Agreement*, because unlike the final sentence of the second paragraph of item (k), the text does not explicitly recognize that the measure will not be an export subsidy, and an *a contrario* interpretation that circumvents the test of Article of 3.1(a) of the *SCM Agreement* is not possible.

That is to say, even if a given credit, guarantee or insurance programme includes:

- either, in relation to item (j), premium rates which are adequate to cover the long-term operating costs and losses of the programmes;

- or, in relation to the first paragraph of item (k), interest rates below the cost of funds that are not used to secure a material advantage in the field of export credit terms,$

none of this in any way enables us to infer that because they display either or both of these characteristics, they should not be considered to be export subsidies if they meet the conditions set forth in Articles 1 and 3.1(a) of the *SCM Agreement*.

For the situation put forward by the United States to be possible, there would have to be a text similar to the final sentence of the second paragraph of item (k) which explicitly states that a given measure is not considered to be an export subsidy. Only then would footnote 5 of the *SCM Agreement* become operational.

Now, even if the appropriate language had been included in item (j) and the first paragraph of the item (k) of Annex I of the SCM Agreement and footnote 5 were operational, an *a contrario* interpretation would still be unacceptable because, in addition to the test of Article 3.1(a) of the *SCM Agreement*, Members using such programmes must also comply with the AoA obligations, in particular Articles 8, 10.1 and 10.3, without prejudice to the application of Article 3 of the *SCM Agreement* to agricultural subsidies after the expiry of the Peace Clause in Article 13 of the AoA. In other words, the absence in Article 1(e) of the AoA of a footnote such as footnote 5 of the SCM Agreement precludes any *a contrario* interpretation in favour of users of export credits for agricultural products. Furthermore, Article 10.3 of the SCM Agreement itself places on the user Member the entire burden of proof that such programmes are not export subsidies.

**31. If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance in the interpretation of the terms in Article 10 *Agreement on Agriculture*, should the Panel refer to item (j) or Articles 1 and 3 of the *SCM Agreement* or both?** 3rd parties, in particular, Argentina, Canada, EC, NZ

If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance, as established by the Appellate Body, in the interpretation of the terms of Article 10 of the *Agreement on Agriculture* (Prevention of Circumvention of Export Subsidy Commitments), the Panel should refer to both: first of all to item (j) of Annex I (*Illustrative List of Export Subsidies*) of the *SCM Agreement*, and subsidiarily to Articles 1 and 3 of the *SCM Agreement*. Naturally, if the Panel should conclude

that the challenged credit guarantees come under indent (j) of Annex I, it would have to conclude that they violate Articles 1 and 3.1(a) of the *SCM Agreement per se*.

**32. The Panel's attention has been drawn to Article 14(c) of the *SCM Agreement* (see third party submission of Canada) and to the panel report in DS 222 *Canada - Export Credits and Loan Guarantees*. How and to what extent are Article 14(c) of the *SCM Agreement,* and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material.** 3rd parties, in particular, Argentina, Canada, EC, NZ

Argentina agrees with Canada's interpretation in paragraphs 41 to 48 of its written submission to the effect that Article 14(c) of the SCM Agreement and the Panel and Appellate Body reports in WT/DS70, as well as the Panel report in WT/DS222, are relevant to the issue of whether the export credit guarantee programmes of the United States confer a "benefit". The standard established therein for the determination of the existence of a "benefit" constitutes the appropriate legal framework for the interpretation of the facts in the present case.

According to the last part of paragraph 157 of the report of the Appellate Body in WT/DS70, *" … the marketplace provides an appropriate basis for comparison in determining whether a 'benefit' has been 'conferred', because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market."*

**33. What is the relevance (if any) of Brazil's statement that: " … export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders"**. 3rd parties, in particular, Argentina, Canada, EC, NZ

The relevance of Brazil's statement lies in the fact that if the marketplace is unable to provide export credit guarantees for agricultural products, the mere granting of such guarantees by the Government of the United States would constitute an export subsidy. It would demonstrate that the market was unable to equal the conditions offered by the challenged programmes.

**34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"?** 3rd parties, in particular, Argentina, Canada, EC, NZ

**35. Did the drafters of the *Agreement on Agriculture* include export credit guarantees in Article 9.1 of the *Agreement on Agriculture*? Why or why not?** 3rd parties, in particular, Argentina, Canada, EC, NZ

Article 9.1 of the Agreement on Agriculture is a list of export subsidies that are subject to reduction commitments. As such, it does not include export credit guarantees. However, there are other export subsidies, as emerges the actual text of Article 10.1, which are also subject to disciplines.

In this respect, Argentina agrees with Canada's statement in paragraph 32 of its Written Submission that:

> *"Article 9 of the Agriculture Agreement lists and describes certain export subsidies that are subject to reduction commitments. All other export subsidies fall within the scope of Article 10.1 … "*

**36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38).** 3rd parties, in particular, Argentina, Canada, EC, NZ

**(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where U.S. financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

The fact that the programmes operate in cases where credit is necessary to increase or maintain exports and where US private financial institutions would be unwilling to provide financing without the CCC's guarantee is relevant to Brazil's claims about the GSM 102 and GSM 103 programmes in that it implies a recognition of the impact and trade-distorting effect of the export credit guarantees.

**(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

This is another recognition of the fact that without such measures, there would be no exports, or there would be fewer exports from the United States.

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

The fact that in providing this credit guarantee facility, the CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities once again reinforces the negative impact and distortion caused by the export credit guarantees to world trade.

**37. The United States seems to argue that, at present, by virtue of Article 10.2 of the *Agreement on Agriculture*, there are no disciplines on agricultural export credit guarantees under the *Agreement on Agriculture* (or the SCM Agreement).**

**(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the *Agreement on Agriculture*? Please cite any relevant material, including any past WTO dispute settlement cases.** 3rd parties, in particular, Argentina, Canada, EC, NZ

It is wrong to state that there are no disciplines on export credits and export credit guarantees. Article 10.2 must be analysed together with Article 10.1, in that when the export guarantee and credit programmes contain a subsidy component and are therefore genuine export subsidies, they must automatically comply with the requirement of not circumventing export subsidy commitments.

The export credits and export credit guarantees granted by the United States constitute export subsidies for the reasons set forth in the replies to questions 29 and 36 above. They do not comply with Articles 3, 8 and 10.1 of the AoA.

Regarding the first question of the Panel in (a) above, the answer is no. The granting of export credit guarantees under conditions in which no consideration is required, in this case a premium charged by the granting institution, is tantamount to the transfer of funds to the beneficiary. The beneficiary, in the absence of an adequate premium, transfers all of the credit and commercial risk of the operation to the institution granting the guarantee without any cost to itself. In other words, we are speaking of a subsidy.

**(b) If, as the United States argues, there are no disciplines on export credit guarantees in the *Agreement on Agriculture*, how could export credit guarantees "conform fully to the provisions of Part V" of the *Agreement on Agriculture* within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)?** 3rd parties, in particular, Argentina, Canada, EC, NZ

In Argentina's view, the United States' interpretation of Article 10.2 is entirely at odds with the context of the provision and the object and purpose of Article 10 of the AoA, since it would contribute to the circumvention of export subsidy commitments by excluding an entire category of export subsidies from the general disciplines in that area.

Article 1(e) of the AoA clearly defines export subsidies without excluding those that are not listed in Article 9.1 of the Agreement.

At the same time, Article 13(c) of the AoA stipulates that in order to be exempted, export subsides must conform fully to the provisions of Part V of the AoA, and not to a particular article. Article 10, which forms part of Part V of the AoA, stipulates in paragraph 1 that: *" … export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments … ".*

Thus, the lack of disciplines specifically developed for export credit guarantees does not necessarily imply the absence or shortage of criteria that would make it possible to establish objectively whether these instruments *"conform fully to the provisions of Part V of this Agreement"* as stipulated in the chapeau of Article 13(c).

STEP 2 PAYMENTS

**38. Please comment on the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in Canada-Dairy and the findings of the Appellate Body in US-FSC (21.5)[6], do any other dispute settlement reports offer guidance on this issue? For example, how,**

[6] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances. Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

**if at all is the Appellate Body's report in Canada-Aircraft relevant here?**[7] 3rd parties, in particular, Australia, Argentina, NZ, Paraguay

As stated by Argentina in paragraphs 80-85 of its written submission, both the corresponding section of the 2002 SFRI Act and the provisions of the Section 1427.100ff. of the Code of Federal Regulations clearly establish that the Commodity Credit Corporation (CCC) must issue marketing certificates or cash payments to exporters and/or users of US (upland) cotton.

Given that the purpose of the programme is to provide a direct incentive for US cotton exports and consists of a direct payment to exporters based on the difference between the US domestic cotton price and the world market price, there can be no doubt that whenever the former is higher than the latter, an export subsidy is present inasmuch as the existence of these payments enables the US product to compete artificially with the lower-cost products of more efficient producers.

It should be noted that the programme known as *Step 2* establishes the right of exporters to receive a subsidy for shipments made in connection with foreign sale operations, while establishing an obligation upon the CCC to grant that subsidy once the particular requirements are satisfied.

We stress that the payment is the difference between the domestic market and the international market because that would be the most relevant evidence that the subsidy seeks to ensure that the product can be exported at prices lower than the domestic price.

**39. Please comment on the United States assertions at paragraph 129 of its first written submission, that "[t]he program is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States."** 3rd parties, in particular, Australia, Argentina, NZ, Paraguay

The fact that the Step 2 programme is indifferent to whether the recipients are exporters or users of cotton in the United States does not alter its inconsistency, since the United States has not specified upland cotton in its schedule of commitments and this type of subsidy under the Step 2 programme is granted for cotton. Consequently, any provision in the legal texts with respect to the granting of such a subsidy makes it inconsistent per se with Articles 3.3 and 8 of the AoA, while for the same reason any sum distributed, budgeted or provided for under the programme constitutes a prohibited subsidy within the meaning of Article 3 of the SCM Agreement.

**40. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the AoA? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the *SCM Agreement* and Article III:4 of the GATT 1994.** 3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay

Are subsidies contingent on the use of domestic goods, because they are prohibited under Article 3.1(b) of the SCM Agreement, also prohibited under the AoA given that there is no specific provision in the AoA that is explicitly mentioned in the introductory sentence of Article 3 of the

[7] There, the Appellate Body stated that,

> "the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".[7]

SCM Agreement? Indeed, Article 3 of the SCM Agreement reads "except as provided in the Agreement on Agriculture … ". The AoA does not contain any provision which explicitly permits such subsidies.

"Except as provided in the Agreement on Agriculture …" also means that Article 3 of the SCM Agreement applies to agricultural subsidies to the extent that they are not in conflict with the AoA. In this connection, no provision can be found in the AoA that is in conflict with Article 3.1(b) of the SCM Agreement, permitting the granting of "subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." Consequently, Argentina considers that subsidies contingent upon the use of domestic over imported goods are prohibited under the AoA.

Regarding the EC's argument in which it tries to distinguish between the terms "to" and "in favour" with respect to support for agricultural producers, this difference does not tally with the Spanish text, and "in favour", "to" and "benefit" are synonyms.

| Article from the Agreement on Agriculture | Spanish | English |
|---|---|---|
| 1.a | a | in favour |
| 1.d | a | to |
| 1.h | a | in favour |
| 3.2. | a | in favour |
| 6.1. | en favor | in favour |
| 6.2. | a | to |
| 6.3. | a | in favour |
| 7.1. | en favor | in favour |
| 7.2.a | en favor | in favour |
| 7.2.b | a | to |
| 9.1.a | a | to |
| Annex 2 | a | to (in different paragraphs throughout the annex) |
| Annex 3.7 | beneficio a | benefit |
| Annex 4.4 | beneficio a | benefit |

In other words, the text does not contain the difference that the EC is attempting to expose, nor can a phrase such as "in favour" be interpreted as the waiver of a prohibition under Article 3.1(b) of the SCM Agreement, since such a waiver does not appear in the text.

Regarding the second sentence of paragraph 7 of Annex 3 of the AoA concerning "measures directed at agricultural processors", it makes no reference whatsoever to the "subsidies contingent … upon the use of domestic over imported goods" mentioned in Article 3.1(b) of the SCM Agreement. Obviously, these are two different matters. Moreover, paragraph 7 of Annex 3 contains no mention of the SCM Agreement. If the intention had been to exempt these measures from the prohibition contained in Article 3.1(b) of the SCM Agreement, this would have been expressly stated, specifically mentioning the provision of the SCM Agreement, i.e. Article 3.1(b).

As regards the second question, for the reasons provided above, the phrase "provide support in favour of domestic producers" neither refers to the subsidies in Article 3.1(b) of the SCM Agreement, nor permits them.

With respect to the third question, Article III:4 of the GATT 1994 prohibits discrimination against imported products, so that this article is also applicable, as well as Article 2.1 of the Agreement on Trade-Related Investment Measures. Moreover, the TRIMs Agreement does not make the slightest reference to the Agreement on Agriculture.

**ETI Act**

**41. Concerning its claims on the ETI Act, Brazil relies on the US – FSC case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here?** Argentina, China, EC, NZ

**42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant.** Argentina, China, EC, NZ

# ANNEX J-2

## ANSWERS BY AUSTRALIA TO THE QUESTIONS FROM THE PANEL

11 August 2003

ARTICLE 13 OF THE *AGREEMENT ON AGRICULTURE*

**1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions in Article 13 are a "prerequisite" to the availability of a right or privilege? Australia Would other third parties have any comments on Australia's assertion? 3RD parties, in particular Argentina, Benin, China, Chinese Taipei**

Reply

Australia does not see any inconsistency in its views. In Australia's view, the potential availability of an affirmative defence in the general sense is in the nature of a right or privilege. Australia wishes to clarify, however, that it considers Article 13 in the specific sense to be a right available when the conditions prescribed therein are met, rather than a privilege.

ARTICLE 13(B) OF THE *AGREEMENT ON AGRICULTURE*: DOMESTIC SUPPORT MEASURES

**2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

In Australia's view, having regard to their ordinary meanings in their context of the object and purpose of the *Agreement on Agriculture*, the words "defined" and "fixed" have distinct meanings.[1] The word "defined" refers to the period of time stipulated for the purposes of determining initial eligibility for a particular decoupled income support payment. The word "fixed" establishes that once it has been "defined", that period of time is unchangeable for that payment.

**3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

[1] *The New Shorter Oxford English Dictionary*, Ed. Lesley Brown, Clarendon Press, Oxford, Volume 1 provides the following potentially relevant definitions of the words:

"defined": "having a definite or specified outline or form; clearly marked, definite" (page 618);

"fixed": "**1** Definitely and permanently placed or assigned; stationary or unchanging in relative position; definite, permanent, lasting. **2a** Directed steadily or intently towards an object. **b** … **3** Placed or attached firmly; made firm or stable in position. …

Reply

In Australia's view, "a" is used in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 to the *Agreement on Agriculture* as an indefinite article, and is defined as meaning "one, some, any"[2]. Thus, having regard to the ordinary meaning of the words in their context and in the light of the object and purpose of the Agreement on Agriculture, "a defined and fixed base period" is the base period selected by an individual WTO Member for the purposes of determining initial eligibility for a particular decoupled income support payment. Once that base period is selected, it is fixed, that is, it is unchangeable.

"The" is defined as "designating one or more … things already mentioned or known, particularized by context or circumstances, inherently unique, familiar, or otherwise sufficiently identified".[3] Thus, the use of "the" as a definite article in the phrase "after the base period" in paragraphs 6(b), (c) and (d) of Annex 2 establishes a relationship to the base period already identified, that is, to the base period selected by an individual WTO Member for the purposes of determining initial eligibility for a particular decoupled income support payment in accordance with paragraph 6(a) and which, once fixed, is unchangeable.

Australia does not consider that there is any relationship between any base period defined and fixed for a support programme for the purposes of paragraph 6 of Annex 2 and the use of the years 1986-88 as a base period under Annex 3, nor was there intended to be. Annex 3 relates to the calculation of a Member's AMS for the purposes of implementing its reduction commitments in relation to production and trade-distorting domestic support measures, consistent with the object and purpose of the Agreement on Agriculture. By definition in the first sentence of paragraph 1, Annex 2 domestic support measures may not, or may only minimally, distort production and trade. Thus, there is no logical or other basis for there to be any relationship.

Australia notes too that Article 7.2(a) of the *Agreement on Agriculture* specifically envisages the introduction of domestic support measures after entry into force of the *WTO Agreement* by providing for "any [domestic support] measure that is subsequently introduced that cannot be shown to satisfy the criteria in Annex 2 to this Agreement". Australia considers that, had the negotiators intended that the 1986-88 period be required to be used as the base period for the purposes of making decoupled income support payments – or indeed for any other purpose envisaged in Annex 2 – paragraph 6(a) would have expressly provided for this rather than for "a defined and fixed base period".

**4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture? 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

In Australia's view, and consistent with the use of the word "a" in the phrase "a defined and fixed base period", a Member may only define and fix a base period once for the purposes of a particular decoupled income support payment. Once that base period is defined and fixed, it is unchangeable.

**5. Do you agree that a payment penalty based on crops produced is "related to type of production"? EC**

[2] *The New Shorter Oxford English Dictionary*, Volume 1, page 1.
[3] *The New Shorter Oxford English Dictionary*, Volume 2, page 3269.

**6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the Agreement on Agriculture have on the meaning of the preceding sentence? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

The ordinary meaning of "criteria", as the plural of "criterion", is "principle[s], standard[s], or test[s] by which a thing is judged, assessed, or identified"[4]. Thus, the "criteria" in Articles 6.1 and 7.1 as these relate to Annex 2 of the *Agreement on Agriculture* encompasses all of the relevant principles, standards or tests established in Annex 2 against which domestic support measures for which exemption from reduction commitments is claimed are to be judged, assessed and/or identified.

As Australia said in its Oral Statement,[5] the word "accordingly" has several, equally valid meanings that are potentially applicable in the context: "harmoniously", "agreeably", "in accordance with the logical premises" and "correspondingly"[6]. A further definition is "in conformity with a given set of circumstances".[7]

In Australia's view, having regard to its ordinary meanings in its context and in light of the object and purpose of the A*greement on Agriculture*, including to "[correct] and [prevent] … distortions in world agricultural markets",[8] the word "accordingly" can and should properly be interpreted in the sense of "consistent with" or "in conformity with" the fundamental requirement established in the first sentence. Consistent with that interpretation, the obligation that "green box" measures "meet the fundamental requirement …" is cumulative with the additional basic criteria established in paragraph 1 and the policy specific criteria established in paragraphs 2-13 of Annex 2. To interpret the word "accordingly" otherwise would be to negate the plain and unambiguous obligation established in the first sentence of paragraph 1 of Annex 2 that "[d]omestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production".

**7. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the Agreement on Agriculture. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

The word "fundamental" has a number of meanings[9] which can be summarised as "primary" or "essential". The word "requirement" too has a number of meanings[10] which can be summarised as a "condition". Thus, a "fundamental requirement" is a primary or essential condition. [11] It is an

[4] *The New Shorter Oxford English Dictionary*, Volume 1, page 551.
[5] Oral Statement by Australia, paragraphs 35-36.
[6] *The New Shorter Oxford English Dictionary*, Volume 1, page 15.
[7] *Webster's Third New International Dictionary*, Ed. Philip Babcock Gove, Merriam-Webster Inc, Springfield, Massachusetts, 1993, page 12.
[8] Third preambular paragraph of the *Agreement on Agriculture*.
[9] *The New Shorter Oxford English Dictionary*, Volume 1, page 1042, provides relevant definitions of "fundamental" as "**1** Of or pertaining to the basis or groundwork; going to the root of the matter. **2** Serving as the base or foundation; essential or indispensable. Also, primary, original; from which others are derived."
[10] *The New Shorter Oxford English Dictionary*, Volume 1, page 2557, provides definitions of "requirement" as "**1** The action of requiring something; a request. **2** A thing required or needed, a want, a need. Also the action or an instance of needing or wanting something. **3** Something called for or demanded; a condition which must be complied with."
[11] Third Party Submission of Australia, paragraph 31, and Oral Statement by Australia, paragraph 33.

overarching, freestanding obligation that applies to all "green box" measures cumulatively with the additional basic criteria established in paragraph 1 and the policy specific criteria established in paragraphs 2-13 of Annex 2. To interpret a "fundamental requirement" otherwise than as a primary or essential condition would not give the words their ordinary meaning in their context and in light of the object and purpose of the *Agreement on Agriculture*.

**8. In your oral statement, you emphasize the use of the word "criteria" in other parts of the Agreement on Agriculture, as distinct from the reference to "fundamental requirement" in the first sentence of paragraph 1 of Annex 2. Is it the case that sub-paragraphs (a) and (b) of paragraph 1 of Annex 2 are also "criteria"? EC**

**9. If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation, does this allow effects-based claims of non-compliance with Annex 2? If so, how does this affect the purpose of Article 13(b)? 3rd parties' in particular Australia, Argentina, Canada, EC, NZ**

Reply

It is not clear to Australia what is meant by "effects-based claims" in the context of this question. In Australia's view, a claim of non-compliance with the first sentence of paragraph 1 of Annex 2 would require an assessment of whether a domestic support measure meets the primary or essential condition that such measures have no, or at most minimal, trade-distorting effects or effects on production, that is, that such measures not, or only negligibly, bias or unnaturally alter trade or production.

**10. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

Yes.

**11. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. 3rd parties, in particular, Australia, Argentina, Canada, EC, NZ**

Reply

Australia assumes that the "direct payments programme" referred to in this question is the Direct Payments programme of the United States at issue in this dispute.

Even if the first sentence of paragraph 1 of Annex 2 were to express only a general principle which informs the interpretation of the other criteria in Annex 2, the US Direct Payments programme would still be non-compliant with paragraph 6(b) of Annex 2 because it:

- penalises producers based on the type of production undertaken after the base period, and
- because it allowed producers to update their base acreage and base yield(s) after the base period,

contrary to the express requirement of paragraph 6(b) that the amount of decoupled income support payments not be related to, or based on the type and/or volume of production undertaken by the producer in any year after the base period.

**12. Where does Article 13(b) require a year-on-year comparison? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

In Australia's view, a requirement for a temporal comparison of measures granting support to a specific commodity is an implicit and integral component of the requirement in Article 13(b)(ii) that such measures not be "in excess of" that decided during the 1992 marketing year. "In excess of" is defined as "more than"[12] and "to an amount or degree beyond"[13].

See question 28 below.

**13. Does a failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

It is Australia's view that there is no obligation with which a Member is required to comply in either the chapeau of Article 13(b), or the proviso of Article 13(b)(ii).

See question 28 below.

**14. Does a failure of a Member to comply with Article 13(b) in respect of a specific commodity impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Yes. In Australia's view, there is no requirement that the application of the proviso be considered only in relation to a specific commodity at issue in a dispute. The failure of a Member to comply with Article 13(b)(ii) and (iii) in respect of one specific commodity affects its right to exemption from actions under Article 13(b)(ii) and (iii) in respect of all commodities.

Australia notes that the basic text of both Article 13(b)(ii) and (iii) reads as follows:

> During the implementation period, … domestic support measures that conform fully to the provisions of Article 6 … shall be … exempt from actions based on [*the specified provisions*], provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

The phrase "such measures" in the proviso refers to "domestic support measures that conform fully to the provisions of Article 6 …". Thus, the proviso states "provided that [*domestic support measures that conform fully to the provisions of Article 6*] do not grant support to a specific commodity in excess of that decided during the 1992 marketing year".

[12] *The New Shorter Oxford English Dictionary*, Volume 1, page 873.
[13] *Webster's Third New International Dictionary*, page 792.

Similarly to its use in the context of question 3 above, "a" is used in the phrase "support to a specific commodity" as an indefinite article, and is defined as meaning "one, some, any"[14]. Having regard to the ordinary meaning of the word in its context and in light of the object and purpose of the *Agreement on Agriculture*, "support to a specific commodity" means support to any one commodity.

Further, Australia considers that this interpretation is consistent with the object and purpose of the *Agreement on Agriculture*, including as expressed in the preambular clauses to that Agreement, for example, "to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets". The *Agreement on Agriculture* resulted from lengthy and complex negotiations and provided a finely balanced set of rights and obligations aimed at reducing the unnatural distortions of global agricultural production and trade. During an agreed transition period, so long as a Member adheres to its obligations intended to achieve that objective and does not introduce domestic support measures which result in new or additional distortions in trade and production, it would enjoy, as a right, protection for actions that would otherwise be WTO-inconsistent. On the other hand, if a Member did not observe the obligations that form part of the negotiated outcome, it would lose its generic right to the protection that constituted an essential element of that outcome. See also question 28 below.

**15. Is there any basis on which counter-cyclical payments could be considered product-specific? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

In this question, Australia understands that the panel uses the term "product-specific" in the sense of "product-specific" support as argued by the United States in its First Written Submission.[15]

Australia notes that counter-cyclical payments (CCPs) are expressly differentiated by product.[16] Even though the CCP programme applies to more than one commodity and there is no requirement for a producer to grow any of those commodities, actual payments are made by product. Further, notwithstanding that there is no requirement for a producer to grow upland cotton to receive the CCP for upland cotton, it is not possible for a producer to receive the CCP for upland cotton if that producer has never actually produced upland cotton. Similarly, a producer could not receive the CCP for another eligible commodity under the program, e.g., corn, if that producer has never grown corn. Thus, CCPs for eligible commodities, in this case upland cotton, are effectively product-specific.

Australia notes too that CCPs for upland cotton are product-specific if there is a correlation between enrolled acreage for the purposes of the CCP (and Direct Payments) programme and the acreage actually used to grow upland cotton. However, there is insufficient current information available to Australia to assess whether CCPs can be considered to be product-specific on this basis.

That said, Australia re-iterates its strong view that "support to a specific commodity" within the meaning of subparagraph (ii) (and (iii)) of Article 13(b) does not equate to product-specific support and that "support to a specific commodity" includes that portion of non-product specific support that benefits the commodity at issue, in this case upland cotton.[17] Had the authors of Article 13 intended that "support to a specific commodity" not include non-product specific support, Australia believes that they would have said so, consistent with the usage of such terminology elsewhere in the *Agreement on Agriculture*, for example, in Articles 1(a), 4(a) and paragraph 1 of Annex 3.

[14] *The New Shorter Oxford English Dictionary*, Volume 1, page 1.
[15] First Written Submission of the United States, paragraphs 77-81.
[16] Section 1104, 2002 Farm Security and Rural Investment Act, Exhibit Bra-29.
[17] Oral Statement by Australia, paragraphs 20-25.

Further, "such measures" in the proviso of Article 13(b)(ii) and (iii) refers to "domestic support measures that conform fully to the provisions of Article 6" in the chapeau of Article 13(b), which include non-product specific support measures other than "green box" support measures. In Australia's view, to exclude non-product specific domestic support measures from the assessment of "support [*granted by such measures*] to a specific commodity" would be contrary to the express meaning of the text.

See also question 28 below.

**16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? 3RD parties, in particular Australia, Argentina, Benin Canada, China, EC, NZ**

Reply

No. See also questions 14 and 28.

**17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Australia does not consider that the concept of "specificity" in SCM Article 2, or references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement*, have any express textual relationship to the meaning of "support to a specific commodity" in Article 13(b)(ii).

However, Australia notes that a subsidy does not need to be enterprise or industry-specific to be "specific" within the meaning of SCM Article 2. SCM Article 2.1(c) expressly provides that a subsidy can be specific notwithstanding an appearance of non-specificity if a subsidy programme is in fact directed at certain enterprises or industries. SCM Article 2 could therefore be considered to provide broad contextual support for Australia's view that CCPs for upland cotton are product-specific .

**18. Benin's oral statement considers the phrase "support to a specific commodity" in Article 13(b)(ii) of the Agreement on Agriculture. How does Benin believe that phrase is best interpreted. Please substantiate your response, commenting on other submissions by parties and third parties as you believe appropriate. Benin**

**19. Where does Article 13(b)(ii) require a year-on-year comparison? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

See questions 12 above and 28 below.

**20. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?**

Reply

See question 28 below.

**21. Please comment on Brazil's assertion that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

See question 28 below.

**22. What is the meaning of "support" in Agreement on Agriculture 13(b)(ii) ? Why would it be used differently from Annex 3, where it refers to total outlays? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

Australia believes it is significant that the proviso of Article 13(b)(ii) and (iii) uses "support" rather than "AMS" , "support as calculated in Annex 3", or a similar term and that it bears out Australia's view that the use of the term "support" in the proviso was not intended to have the same meaning.

See question 28 below.

**23. Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

See question 28 below.

**24. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) of the Agreement on Agriculture and, in particular, why the words "grant" and "decided" were used. EC**

**25. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Australia is concerned that use of the phrase "authorised during" may be considered to imply a relationship with budgetary approval and expenditure processes and that this would not necessarily be a correct interpretation. As an alternative, Australia suggests "committed to during" could be an appropriate interpretation of the phrase "decided during". See question 28 below.

**26. Under Article 13(b)(ii), a comparison is required between support at different times. One of the issues which is contested between the parties is whether the only later period that the Panel can consider is the present one (i.e. the period underway at the time of the request for establishment of the Panel). This argument is based on the present tense of the words "do not grant" in the English text. The Panel asks whether there is any difference in the verb tense as**

**used in the Spanish-language text, or any other difference which might aid the Panel in interpreting these words? Argentina, EC, Paraguay, Venezuela**

**27. If the 1992 "decision" led to or was the funding source for the money provided in 1992 and later years, is it the full amount of all that funding that constitutes the "support" decided in 1992? If the answer to this question is that it is the full amount of all the support provided pursuant to the "decision" that must be taken into account, must this be compared with the total amount of support that will or might flow from the decision made in the more recent period for the purposes of the comparison required under Article 13(b)(ii)? If a Member did not make a "decision" (however that may be interpreted) in 1992 about "support", is it the case that the Member has a zero base for the purposes of the comparison required under Article 13(b)(ii)? EC**

**28. In paragraph 13 of Australia's oral statement, you state that a "question" is: "could conditions of price competition for the purposes of a non-violation or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole." Could you please clarify this statement (indicating other elements which would complete the "whole" and explain its relevance for the purposes of our consideration of Article 13 of the Agreement on Agriculture? Australia, EC**

Reply

The proviso "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" appears in both subparagraphs (ii) and (iii) of Article 13(b). In both cases, the basic textual provision is the same:

> During the implementation period … domestic support measures that conform fully to the provisions of Article 6 … shall be … exempt from actions based on [*the specified provisions*], provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.

Yet Article 13(b)(ii) deals with situations of violation nullification or impairment complaints in relation to actionable subsidies, and Article 13(b)(iii) deals with situations of non-violation nullification or impairment complaints in relation to tariff concessions. It does not seem to Australia to be feasible that the authors of the text of Article 13 of the *Agreement on Agriculture* would have intended exactly the same language within the same Article to have distinct meanings. Indeed, Australia believes it must be assumed that, had the authors intended that the proviso be interpreted and applied differently in the context of violation and non-violation complaints, they would have used different texts, consistent with the normal rules of treaty interpretation. In Australia's view, therefore, it must be assumed that the authors of Article 13 intended that the proviso have the same meaning in the context of both violation and non-violation complaints, and the proviso must be interpreted in such a way as to be capable of being applied in relation to both situations. To this end, it would be a proper exercise of the Panel's discretionary powers to consider also the nature of a non-violation complaint to determine the proviso's meaning.

Australia recalls that the text of the proviso, as well as the draft text of what became Article 13 of the *Agreement on Agriculture* first appeared in the "Blair House Accord" and that the

Accord also included provisions concerning the *EEC – Oilseeds* dispute.[18] In Australia's view, that dispute is crucially relevant to the proper interpretation of Article 13(b)(ii) and (iii).[19]

The panel in *EEC – Oilseeds* described the purpose of GATT Article XXIII:1(b) in the following terms:

> … The Panel noted that these provisions, as conceived by the drafters and applied by the contracting parties, serve mainly to protect the value of tariff concessions.[…] The idea underlying them is that the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. …[20]

The *EEC – Oilseeds* panel went on to say:

> The Panel carefully analysed the price mechanism established in the framework of the Community's market organization for oilseeds and found that the production subsidy schemes of the Community protect Community producers completely from the movement of prices for imports and hence prevent the lowering of import duties from having any impact on the competitive relationship between domestic and imported oilseeds. …[21]

The *EEC – Oilseeds* panel also said:

> … The Panel considered that the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset. … The Panel does not share the view of the Community that the recognition of the legitimacy of such expectations would amount to a re-writing of the rules of the General Agreement. … The recognition of the legitimacy of an expectation relating to the use of production subsidies therefore in no way prevents a contracting party from using production subsidies consistently with the General Agreement; it merely delineates the scope of the protection of a negotiated balance of concessions. For these reasons the Panel found that the United States may be assumed not to have anticipated the introduction of subsidies which protect Community producers completely from the movement of prices for imports and thereby prevent tariff concessions from having any impact on the competitive relationship between domestic and imported oilseeds, and which have as one consequence that all domestically-produced oilseeds are disposed of in the internal market notwithstanding the availability of imports.[22]

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[18] *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins ("EEC – Oilseeds")*, Report of the Panel, adopted 25 January 1990, BISD 37S/86.

[19] Australia notes that the report of the *EEC – Oilseeds* panel has been cited with approval in subsequent WTO jurisprudence, for example, *Japan – Measures Affecting Consumer Photographic Film and Paper*, Report of the Panel, WT/DS44/R, paragraph 10.35, and *EC – Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, WT/DS135/AB/R, paragraph 185.

[20] *EEC – Oilseeds*, paragraph 144.

[21] *EEC – Oilseeds*, paragraph 147.

[22] *EEC – Oilseeds*, paragraph 148.

In summary, the *EEC – Oilseeds* panel considered that the basis for assessing whether the benefits of tariff concessions are being nullified or impaired in a non-violation complaint is the legitimate expectations of the "conditions of price competition" for a product. In assessing those conditions, matters to be considered included market prices and the applicable tariff concession(s) as well as any other relevant measures, including measures that were not inconsistent with GATT 1947. Further, that assessment involved a temporal comparison between the "conditions of price competition" that could legitimately have been expected at the time a tariff concession was negotiated and the conditions that actually prevailed at a later point of time.

Accordingly, to enable its application in a situation of non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member, the proviso of Article 13(b)(iii) must be interpreted in a manner capable of:

- establishing other Members' legitimate expectations of the "conditions of price competition";
- taking account of factors such as the applicable tariff concession(s), market prices and domestic support measures that conform fully to the provisions of Article 6 of the *Agreement on Agriculture*; and
- allowing a comparison between two different points in time.

In Australia's view, interpreting the phrase "grant support" in a manner that limits the factors to be considered to domestic support measures that conform fully to the provisions of Article 6 as measured by budgetary outlays, as argued by Brazil, or the rate of payment, as argued by the United States, could not lead to a proper application of the proviso of Article 13(b)(iii) in the context of a non-violation dispute. Such an interpretation cannot establish other Members' legitimate expectations of "conditions of price competition" as these have been understood in GATT and WTO jurisprudence, as it cannot capture issues relating to tariff concessions and market prices that are integral to a non-violation complaint of nullification or impairment of the benefits of tariff concessions accruing to another Member. The only essential element that such an interpretation is capable of capturing is the basic point in time for the purposes of comparison: instead of being the time at which a tariff concession was negotiated, it is the 1992 marketing year.

It would not be possible for the interpretations of the proviso offered by Brazil and the United States to apply in the context of a non-violation dispute. Thus, Australia believes it is incumbent upon the Panel to consider whether it is possible to apply in the context of an actionable subsidy complaint the proviso in the sense of legitimate expectations of the "conditions of price competition" as this applies to a non-violation nullification or impairment complaint. That application would need to take account as appropriate of tariff concessions, market prices and domestic support measures that conform fully to the provisions of Article 6.

Australia considers that such a "conditions of price competition" test is capable of being applied in the context of a violation complaint covered by Article 13(b)(ii) and was in fact intended by the authors of the text of Article 13. In Australia's view, a "conditions of price competition" test as this was interpreted and applied in *EEC – Oilseeds*, allowing as appropriate tariff concessions, market prices and domestic support measures that conform fully to the provisions of Article 6, forms "the whole".

Further, such an interpretation overcomes the many interpretive questions raised by the arguments put forward by the parties to the dispute. Notwithstanding that legitimate expectations of "conditions of price competition" are not normally applicable in the context of a violation complaint, Australia cannot identify any provision of the *Agreement on Agriculture*, or indeed any other of the covered agreements, that would preclude the application of such a test in the context of Article 13(b)(ii).

The use of such a test would explain why the phrase "grant support" was used without further elaboration, such as "support as measured by AMS", "support as calculated in Annex 3" or similar wording. "Support" in the context of subparagraphs (ii) and (iii) of Article 13(b) was purposefully intended to mean all non-"green box" domestic support measures, whether specific or not, which benefit a specific commodity in the sense of a "conditions of price competition" test. In this context, Australia notes that paragraph 8 of Annex 3 expressly excludes from the calculation of AMS some forms of "support" within the meaning of subparagraphs (ii) and (iii) of Article 13(b).

The proviso establishes "support … decided during the 1992 marketing year" as the basis for comparison. In other words, the basis for comparison is the legitimate expectations of other Members of the "conditions of price competition" having regard to the applicable tariff measures and non-"green box" domestic support measures as these were committed to by a Member during the 1992 marketing year, vis-à-vis market prices. It requires a comparison of the legitimate expectations of other Members of the "conditions of price competition" to apply in future on the basis of decisions made by a Member during the 1992 marketing year with the actual "conditions of price competition" at a future point in time. Thus, question concerning whether a year-on-year comparison is required or whether a failure by a Member to comply in a given year affects that Member's entitlement to invoke Article 13(b) in other years become moot. So long as a Member's non-"green box" domestic support measures that conform fully to the provisions of Article 6 "grant support to a specific commodity" in the sense of a "conditions of price competition" test "in excess of that decided during the 1992 marketing year", Article 13(b)(ii) and (iii) does not provide an exemption from actions based on the specified provisions. Conversely, once a Member's non-"green box" domestic support measures no longer grant support in excess of that decided during the 1992 marketing year, the Member re-acquires the right to invoke Article 13(b)(ii) and (iii).

In Australia's view, interpreting the proviso of Article 13(b)(ii) as requiring the application of a "conditions of price competition" test is consistent with the ordinary meaning of the words in their context:

> provided that [*domestic support measures that conform fully to the provisions of Article 6*] do not grant [agree to, bestow or confer][23] support [*assistance or backing*][24] to a specific commodity in excess of [*more than*][25] that decided [*determined or resolved,*[26]*, i.e., committed to*] during the 1992 marketing year.

Moreover, interpreted in the sense of legitimate expectations of "conditions of price competition" in respect of both Article 13(b)(ii) and (iii), the proviso is consistent with the object and purpose of the *Agreement on Agriculture*, including as expressed in the preamble of the Agreement "to establish a fair and market-oriented agricultural trading system and that a reform process should be initiated through the negotiation of commitments on support and protection and through the establishment of strengthened and more operationally effective … rules and disciplines" and "to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets". The provisos of Article 13(b)(ii) and (iii) establish the outer limits within which the market distorting support that continues to be permitted under the *Agreement on Agriculture* must remain during the implementation period if a Member is to benefit from the protection against actionable subsidy claims offered by Article 13(b) during that time. In other words, a Member's domestic support measures may not create a more market distorting situation in respect of any one commodity than could reasonably have been anticipated on the basis of that Member's decisions made known during the 1992 marketing year for that product.

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[23] *The New Shorter Oxford English Dictionary*, Volume 1, page 1131.
[24] *The New Shorter Oxford English Dictionary*, Volume 2, pages 3152-3153.
[25] *The New Shorter Oxford English Dictionary*, Volume 1, page 873.
[26] *The New Shorter Oxford English Dictionary*, Volume 1, 607.

However, should the Panel consider that another interpretation of the proviso of Article 13(b)(ii) was intended by the authors of the text of Article 13, Australia believes it incumbent upon the Panel to test its interpretation in the context of a non-violation complaint covered by Article 13(b)(iii).

EXPORT CREDIT GUARANTEE PROGRAMMES

**29. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

**(b) How, if at all, would this be relevant to the claims of Brazil? 3rd parties, in particular, Argentina, Canada, EC, NZ**

**30. The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an a contrario interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission). 3rd parties, in particular, Argentina, Canada, EC, NZ**

**31. If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both? 3rd parties, in particular, Argentina, Canada, EC, NZ**

**32. The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see third party submission of Canada) and to the panel report in DS 222 Canada- Export Credits and Loan Guarantees. How and to what extent are Article 14(c) of the SCM Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material. 3rd parties, in particular, Argentina, Canada, EC, NZ**

**33. What is the relevance (if any) of Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders". 3rd parties, in particular, Argentina, Canada, EC, NZ**

**34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"? 3rd parties, in particular, Argentina, Canada, EC, NZ**

**35. Did the drafters of the Agreement on Agriculture include export credit guarantees in Article 9.1 of the Agreement on Agriculture? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

**36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38) 3rd parties, in particular, Argentina, Canada, EC, NZ**

**(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

**(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

**37. The United States seems to argue that, at present, by virtue of Article 10.2 of the Agreement on Agriculture, there are no disciplines on agricultural export credit guarantees under the Agreement on Agriculture (or the SCM Agreement).**

**(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the Agreement on Agriculture? Please cite any relevant material, including any past WTO dispute settlement cases. 3rd parties, in particular, Argentina, Canada, EC, NZ**

**(b) If, as the United States argues, there are no disciplines on export credit guarantees in the Agreement on Agriculture, how could export credit guarantees "conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)? 3rd parties, in particular, Argentina, Canada, EC, NZ**

STEP 2 PAYMENTS

**38. Please comment on the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in Canada-Dairy and the findings of the Appellate Body in US-FSC (21.5)[27], do any other dispute settlement reports offer guidance on this issue? For example, how,**

[27] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.[27] Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a

**if at all is the Appellate Body's report in Canada-Aircraft relevant here?[28] 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

**39. Please comment on the United States assertions at paragraph 129 of its first written submission, that "[t]he programme is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States". 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

Reply

This comment responds to both questions 38 and 39.

Australia provided detailed comment on the "Step 2" payment programme having regard to the Appellate Body's findings in *US – FSC (21.5)* at paragraphs 49-69 of its Third Party Submission. Australia does not dispute that "Step 2" payments may be made on either export or domestic use of a bale of cotton, or that the "intent" with which a buyer purchased a bale of cotton has no effect on an entitlement to a "Step 2" payment in respect of that particular bale. However, these arguments by the United States are not determinative of the issue.

To qualify for a "Step 2" payment, a bale of cotton must be either exported or consumed by a domestic user. These are the two distinct factual situations covered by the "Step 2" payment programme: by definition, a particular bale of cotton cannot be both exported and consumed by a domestic user.

The Appellate Body's findings in *Canada – Aircraft*[29] provide further support for the view that "Step 2" payments are export or local content subsidies. In each of the distinct factual situations of export or domestic use, "Step 2" payments are contingent upon export performance or contingent upon the use of domestic over imported goods respectively.

**40. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the AoA? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the SCM Agreement and Article III:4 of the GATT 1994. 3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay**

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United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

1. [28] There, the Appellate Body stated that,

> "the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".[28]

[29] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, paragraph 179.

Reply

Australia does not consider that the phrase "provide support in favour of domestic producers" in Article 3.2 of the *Agreement on Agriculture* permits subsidies contingent upon the use of domestic goods.

In Australia's view, the legal issue in question relates to the condition attached to the grant of a subsidy, not the grant of a subsidy *per se* or who might benefit from the subsidy. The fact that a measure may benefit an agricultural producer ("support in favour of domestic producers") does not serve to override measures otherwise prohibited.

Article 21.1 of the *Agreement on Agriculture* provides that "[t]he provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement". Article 3.1 of the *SCM Agreement* applies "[e]xcept as provided in the Agreement on Agriculture". The General Interpretive Note to Annex 1A of the *Marrakesh Agreement Establishing the World Trade Organization* also provides contextual guidance. Pursuant to that Note, the *Agreement on Agriculture* would prevail to the extent of any conflict with GATT 1994.

However, in the case of subsidies contingent upon the use of domestic goods, there is no conflict between either the *Agreement on Agriculture*, which inter alia disciplines the amounts of domestic support in favour of domestic producers which distorts trade and production, and the *SCM Agreement* or GATT 1994, which discipline or prohibit certain conditions attached to subsidies, including subsidies in favour of agricultural producers (subject only to the provisions of Article III:8(b) of GATT 1994). There is no provision in the *Agreement on Agriculture* which provides for an exception to, or cover for, local content conditions attached to the grant of a subsidy.

Australia has already noted[30] that Article 13(b)(ii) does not exempt non-"green box" domestic support measures from actions based on Article 3 of the *SCM Agreement*. Neither does Article 13 anywhere refer to GATT Article III:4. Nor with regard to these Articles is there any provision comparable to Articles 5 and 12 of the *Agreement on Agriculture*. As stated in the preambular clauses of the *Agreement on Agriculture*, the "long-term objective is to provide for substantial progressive reductions in agricultural support and protection": it is not intended to provide for a weakening of disciplines, particularly when such disciplines are not specifically mentioned.

Australia also notes that the domestic support provisions of the *Agreement on Agriculture* provide for a strengthening and elaboration of the provisions of Article XVI of GATT 1994. They are not directed towards a diminution of basic GATT obligations. National treatment is central to the multilateral trading system. It is inconceivable to Australia that the negotiators of the Agreement on Agriculture would, as part of a reform programme designed to strengthen disciplines, agree to weaken national treatment disciplines.

However, in the event the Panel were to consider that the phrase "provide support in favour of domestic producers" refers to and/or permits subsidies contingent upon the use of domestic goods, Australia notes that such support could be permitted only to the extent that the support was actually passed through to the producers of the basic agricultural product.

[30] Oral Statement by Australia, paragraphs 29-30.

ETI ACT

**41. Concerning its claims on the ETI Act, Brazil relies on the US – FSC case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the Agreement on Agriculture. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Argentina, China, EC, NZ**

**42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to that dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. Argentina, China, EC, NZ**

# ANNEX J-3

## ANSWERS OF BENIN TO THE PANEL'S QUESTIONS OF 25 JULY 2003

11 August 2003

Benin offers the following responses to the 25 July questions of the Panel, as they pertain to the scope of Benin's Third Party Submission or Oral Statement:

**1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions of Article 13 are a "prerequisite" to the availability of a right or privilege? Australia. Would other third parties have any comments on Australia's assertion? 3rd parties, in particular Argentina, Benin, China, Chinese Taipei**

Reply

Benin agrees with the basic assertion of Australia that Article 13 of the *Agreement on Agriculture* is an affirmative defence.

In Benin's view, the notion of Article 13 as an affirmative defence is easily reconciled with the view that the conditions set out in Article 13 are a prerequisite to its availability. As Benin argued in its Third Party submission, the language used in Article 13 shows the clear intent of its drafters that the Member seeking to invoke the peace clause defence must bear the burden of demonstrating full compliance with all of the preconditions set out in this provision. As noted by Benin, this intent is demonstrated, *inter alia*, by the use of the proviso "provided that." In the *Quantitative Restrictions* case, also referred to in Benin's Third Party submission, the Appellate Body considered similar language in GATT Article XVIII:11, and found that the burden lay on the Member seeking to invoke the proviso.

While Benin and Australia thus share the same view on the nature of Article 13, Benin would not find it necessary to refer to the invocation of Article 13 as a "privilege." In Benin's view, a Member that has met the burden of demonstrating full compliance with all of the preconditions set out in Article 13 could invoke this defence as a right. However, the United States has clearly not met this burden in the present case.

**16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? 3rd parties, in particular Australia, Argentina, Benin, Canada, China, EC, NZ**

Reply

Please see Benin's answer to Question 18, which also addresses the issue raised in Question 16.

**18. Benin's oral statement considers the phrase "support to a specific commodity" in Article 13(b)(ii) of the *Agreement on Agriculture*. How does Benin believe that phrase is best interpreted? Please substantiate your response, commenting on other submissions by parties and third parties you believe appropriate. Benin**

Reply

In Benin's view, the phrase "support to a specific commodity" in Article 13(b)(ii) means any support, other than green box support, provided to a particular, identifiable agricultural commodity. Such support can be provided through either a product-specific or non product-specific programme.

The United States argues that "the phrase 'support to a specific commodity' should be understood to mean 'product-specific support'". This position is supported by the European Communities, which suggests that the word "specific" was inserted in Article 13 as "a qualifier to the word 'support'".

As noted by Benin in its oral statement of July 24, if the drafters of the Agreement on Agriculture had wanted to use the term "product-specific support" in Article 13(b)(ii), they obviously could have done so, as they did elsewhere in Agreement, such as in Article 6(4), or in Annex 3.

The interpretation proposed by the United States and the European Communities is contrary to the language actually used in Article 13(b)(ii), which refers to support to a "specific commodity" and not "specific support" to a commodity, or "product-specific support." The treaty interpreter must give meaning to the words actually used by the drafters of this provision.

As noted by New Zealand in its Third Party submission, the use of the term "specific commodity" in Article 13(b)(ii) was used to distinguish the "peace clause" from general domestic support commitments, which are determined on the basis of total "Aggregate Measure of Support". As stated by New Zealand, without such wording, "peace clause" protection could be lost for any agricultural product if total AMS increased, even if support to a specific product had not increased.

Moreover, to re-iterate another point raised by Benin in its oral statement, acceptance of the US interpretation would clearly elevate form over substance. Benin agrees with Brazil that the US interpretation "would carve out a category of non-'green box' subsidies simply because the measures distort trade in *multiple* commodities…This interpretation would permit Members to insulate their trade-distorting non-'green box' measures from challenge by manipulating the *form* of the support so that it does not mandate the production of a specific commodity in order to receive the subsidy, or by providing such support through a non-'product-specific' measure."

Benin also notes that the Appellate Body has made clear that the WTO-consistency of subsidies must be determined by their substance, and not by their form.[1]

Therefore, support provided to any specific or identifiable commodity, regardless of the nature of that support, must be included in the analysis required by Article 13(b)(ii). In Benin's view, this interpretation would remain the same if the word "specific" were deleted from Article 13(b)(ii),

[1] In Benin's view, it is useful to recall how the Appellate Body interpreted the export subsidy commitments of the *Agreement on Agriculture* in the *Canada Dairy* dispute, where the tribunal emphatically rejected an interpretation that would have elevated form over substance. The Appellate Body refused to read the word "payments" in Article 9.1(c) narrowly, i.e. to mean monetary payments only, but not payments-in-kind:

> "…if a restrictive reading of the words "payments" were adopted, such that "payments" under Article 9.1(c) had to be monetary, no account could be taken, under Article 9.1(c), of "revenue foregone". This would, we believe, prevent a proper assessment of the commitments made by WTO Members under Article 9.2, as envisaged by Article 1(c) of the *Agreement on Agriculture*. We, therefore, prefer a reading of Article 9.1(c) that allows full account to be taken of "revenue foregone". The contrary view would, in our opinion, elevate form over substance and permit Members to circumvent the subsidy disciplines set forth in Article 9 of the *Agreement on Agriculture*." [emphasis added]

Appellate Body Report, Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products, WT/DS103/AB/R, WT/DS113/AB/R, paragraph 110.

an issue raised in Question 16. Such a deletion, in Benin's view, would reinforce the view that support provided to "a commodity", regardless of the form of that support, would come under this provision.

In any event, whether the drafters chose the term "support to a specific commodity" or "support to a commodity", the result would be the same. The most important point is that the drafters of the Agreement could have used "product-specific support", a term of art found elsewhere in the Agreement, but did not.

In addition, Benin would offer the following views on the ETI Act:

**41. Concerning its claims on the ETI Act, Brazil relies on the *US – FSC* case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Argentina, China, EC, NZ**

Reply

Brazil has asked the Panel to find that "the ETI Act constitutes an export subsidy violating AoA Articles 10.1 and 8 and ASCM Article 3.1(a)." [Paragraph 330 of Brazil's First Submission.] As is well-known, the Appellate Body has found that the ETI measure is inconsistent, *inter alia*, with the same provisions cited by Brazil: Articles 10.1 and 8 of the *Agreement on Agriculture*, and Article 3.1(a) of the SCM Agreement.[2] The Appellate Body report was adopted by the DSB on January 29, 2002, and the ETI has remained unamended since that time.

Before responding directly to Question 41, Benin would offer some preliminary observations on the relevance of earlier Panel and Appellate Body reports.

In Benin's view, prior adopted Panel or Appellate Body reports are not technically binding on subsequent Panels. As the Appellate Body stated in *Japan Alcohol*, adopted panel reports "are not binding, except with respect to resolving the particular dispute between the parties to that dispute." [3] Thus, the adopted Appellate Body decision in the FSC/ETI dispute is binding only on the parties to that dispute, the United States and the EC.

However, the Appellate Body in *Japan Alcohol* also made clear that prior panel decisions "create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute."[4]

A similar approach was taken by the Panel in the *India – Patent Protection* case. The Panel, established at the request of the EC, had to determine what weight to give to the adopted Panel and Appellate Body reports on the same subject matter in an earlier case brought by the United States. The Panel stated that:

[2] Appellate Body report, *United States – Tax Treatment for 'Foreign Sales Corporations': Recourse to Article 21.5 of the DSU by the European Communities.* WT/DS108/AB/RW.

[3] Appellate Body report, *Japan - Taxes on Alcoholic Beverages*. WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R. Page 14.

[4] Appellate Body report, *Japan - Taxes on Alcoholic Beverages. Ibid*, page 14. In the *Shrimp-Turtle* compliance panel appeal, the Appellate Body added that: "This reasoning applies to adopted Appellate Body Reports as well." Appellate Body report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products: Recourse to Article 21.5 of the DSU by Malaysia*. WT/DS58/AB/RW, paragraph 109.

> "It can thus be concluded that panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same. In examining dispute WT/DS79 [the EC complaint] we are not legally bound by the conclusions of the Panel in dispute WT/DS50 [the prior US complaint] as modified by the Appellate Body report. However, in the course of "normal dispute settlement procedures" required under Article 10.4 of the DSU, we will take into account the conclusions and reasoning in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we should give significant weight to both Article 3.2 of the DSU, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, and to the need to avoid inconsistent rulings (which concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the DSU."[5] [original emphasis]

It is also highly instructive to recall the position taken by the United States as a third party to the EC complaint, since there are direct parallels to the current situation in *Cotton*. The US position, as summarized by the Panel, included the following:

> "The United States argued in its third party submission that the precise measures and provisions of the WTO Agreement at issue in this dispute had been the subject of a previous WTO dispute settlement proceeding….[T]he Appellate Body had thoroughly analyzed the legal issues in the case and it was neither necessary nor appropriate for the Panel to repeat that work. The Panel should consider the arguments of the parties, but be guided by the Appellate Body's recent interpretation of the obligations at issue….
>
> The United States supported the view of the EC that it was not necessary or appropriate to repeat all of the legal arguments made in the earlier dispute (WT/DS50) in the context of the present proceedings….India appeared to seek an entirely redundant proceeding. Despite India's obligation under Article 17.14 of the DSU to accept the Appellate Body's report in the earlier case unconditionally, India's submission gratuitously disparaged the work of the Appellate Body….
>
> The United States added that, moreover, India did not argue that it had modified its patent regime since the Appellate Body's ruling and that, in that situation, the Panel should be guided by the Appellate Body's decision, not by allegedly new arguments about the same patent regime.
>
> India should not be permitted to reopen legal issues that had been conclusively determined by a panel and the Appellate Body. Such a result would invite repetitive litigation….The drafters had wanted to avoid giving complainants or defendants an incentive to re-litigate disputes to see if different panels would produce different results. If such "panel shopping" did produce different results, the effect on the dispute settlement system would be profoundly destabilizing.
>
> The WTO dispute settlement system could not function effectively without consistent panel judgments….Without consistent judgments, WTO Members would find little guidance in the legal interpretations developed by dispute settlement panels and the Appellate Body. The role of the dispute settlement system [would be] greatly

[5] Panel report, India - Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS79/R, paragraph 7.30.

> diminished and the system could not fulfill its purpose: to serve as a "central element in providing security and *predictability* to the multilateral trading system." [emphasis added]

The parallels between *India – Patent Protection* and *Cotton* are striking, and the US submission in the former case provide clear guidance as to how the *Cotton* panel should examine Brazil's current ETI claims.

As was the case in *Patent Protection*, the Appellate Body has "thoroughly analyzed the legal issues in the [FSC/ETI] case" and it is "neither necessary nor appropriate" for the *Cotton* Panel to "repeat that work." The *Cotton* Panel should consider the arguments of the parties, but "be guided by the Appellate Body's recent interpretation of the obligations at issue." The United States should not be permitted to "reopen legal issues [related to the ETI] that had been conclusively determined by a panel and the Appellate Body." Benin shares the US concern that "such a result would invite repetitive litigation", would promote "panel shopping", and that different results could be "profoundly destabilizing."

Thus, in Benin's view, the *Cotton* panel should be guided by the Appellate Body's interpretation of the US ETI measure.

Turning to the specific question raised by the Panel: as noted above, Benin agrees with the position advanced by the United States in *Patent Protection* that a responding party in a subsequent case dealing with the same measure should not be permitted to reopen issues "that had been conclusively determined by a panel and the Appellate Body." However, in *Cotton*, the United States would have the right to advance specific new defences that were not considered by the Panel or the Appellate Body in the FSC/ETI dispute (e.g. that the United States is entitled to the protection of Article 13 because its export subsidies for cotton "conform fully" to the provisions of Part V of the *Agreement on Agriculture*).

Thus, as a procedural matter, the *Cotton* Panel could consider such US arguments. However, as a substantive matter, Benin would note that the relevant obligations in Part V of the *Agreement on Agriculture* are Articles 8 and 10.1. As stated above, the Appellate Body has already determined that the ETI involves export subsidies inconsistent with US obligations under both these provisions. Therefore, in Benin's view, US export subsidies for cotton do not "conform fully to the provisions of Part V." Accordingly, the ETI is not exempt from action by virtue of the Peace Clause.

**42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the *DSU*, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the *DSU*, and please cite any other provisions you consider relevant. Argentina, China, EC, NZ**

Reply

As noted in the footnote to paragraph 43 of the EC statement, the reference to adopted Appellate Body reports providing "a final resolution to the dispute" was taken from the decision of the Appellate Body in the *Shrimp-Turtle* compliance panel appeal.[6] However, the context of that case was slightly different from the present dispute. The Appellate Body decision in the Article 21.5 proceeding in *Shrimp Turtle* involved the same dispute as had been litigated earlier between Malaysia

[6] Appellate Body report, United States – Import Prohibition of Certain Shrimp and Shrimp Products: Recourse to Article 21.5 of the DSU by Malaysia. Op. Cit.

and the United States, although it had by then moved to the compliance panel stage.[7] By contrast, *Cotton* is a new dispute, albeit one that includes the same measure that had been found to be WTO-inconsistent in the earlier EC-US *FSC* dispute.

Thus, in the present context, the reference to "the dispute" in DSU Article 17.14 would refer to the EC-US dispute in FSC/ETI, since that is the "dispute" which has resulted in an adopted Appellate Body report. The "dispute" referred to in Article 12 and Appendix 3 would be the *Cotton* dispute, as these proceedings are now underway. Article 9.3 provides that if more than one panel is established to examine the complaints related to the same matter, to the greatest extent possible, the same persons shall serve as panelists on each of the separate panels, and the timetables shall be harmonized. While this provision might have had some potential relevance if the *Cotton* and *FSC* cases had been running concurrently, given the partial overlap of claims, it seems of little relevance now to the Panel as it assesses the weight to ascribe to prior rulings on the FSC/ETI.

In any event, Benin would strongly re-iterate its position, as set out above, that the *Cotton* panel should be guided by the Appellate Body's interpretation of the ETI, particularly since the measure has not been amended since the DSB adopted the Appellate Body's report.

[7] Similar kinds of issues are raised in European Communities – Antidumping Duties on Imports of Cotton-Type Bed Linen from India: Recourse to Article 21.5 of the DSU by India. Report of the Appellate Body. WT/DS141/AB/RW.

# ANNEX J-4

## CANADA'S RESPONSES TO PANEL QUESTIONS TO THIRD PARTIES AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES (FIRST SESSION)

11 August 2003

Canada sets out responses to the questions of the Panel in which Canada has a systemic interest:

**2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*.**

Reply

1. The meaning of the term "defined" is "having a definite or specified outline or form; clearly marked, definite".[1] The term "fixed" is defined as "definitely and permanently placed or assigned; stationary or unchanging in relative position; definite, permanent, lasting".[2] Based on the ordinary meaning of these terms, the base period for US direct payments must be clearly set out and remain unchanged. Because the structure of direct payment programme and the parameters for direct payments are essentially the same as those regarding PFC payments, the Panel should find that the applicable base period for direct payments is the base period for PFC payments. By allowing base acreage for direct payments to be updated, the United States acts inconsistently with paragraph 6(a) of Annex 2 because the base period is not "fixed". Canada refers the Panel to paragraphs 4-6 of its third party oral statement.

**3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3.**

Reply

2. Paragraph 6(a) of Annex 2 of the *Agriculture Agreement* requires eligibility for decoupled income support payments to be determined by "clearly-defined criteria such as… production level in a defined and fixed based period". Use of the indefinite article "a" in this provision means that no base period is specified. To the contrary, paragraph 11 of Annex 3 specifies a base period.

3. Use of the definite article "the" in paragraphs 6(b), (c) and (d) of Annex 2 creates a reference to the base period established pursuant to paragraph 6(a).

**4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*?**

[1] *New Shorter Oxford English Dictionary*, p. 618 ("defined") [Exhibit CDA-4].
[2] *New Shorter Oxford English Dictionary*, p. 962 ("fixed") [Exhibit CDA-5].

Reply

4. A Member may define and fix a base period only once for any given type of decoupled income support payment.

**16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph?**

Reply

5. The Appellate Body explained in *United States – Reformulated Gasoline* that "[o]ne of the corollaries of the 'general rule of interpretation' in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of a treaty".[3] The term "specific commodity" means a commodity that is clearly and explicitly defined.[4] Deletion of the word "specific" would imply an examination of support benefiting a potentially broader product class, a result that is not supported by the text of Article 13(b)(ii) of the *Agriculture Agreement*.

**17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement* to the meaning of "support to a specific commodity" in Article 13(b)(ii) *Agreement on Agriculture*?**

Reply

6. Article 2 of the *SCM Agreement* sets out principles that apply to determine whether a subsidy "is specific to [certain enterprises]". In the context of Article 2, the phrase "is specific to" means that a government restricts the availability of a subsidy to certain enterprises.[5] In the context of Article 13(b)(ii) of the *Agriculture Agreement*, the term "specific commodity" means a commodity that is clearly and explicitly defined.[6] Article 13(b)(ii) requires an examination of all support that is not exempt under Annex 2 and that benefits a "precise", "exact", or "defined" commodity. Such support may be provided either through product-specific or non-product-specific support programmes.

**29. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement* ? Why or why not?**

Reply

7. Yes, an export credit guarantee is a potential direct transfer of funds under Article 1.1(a)(1)(i) of the *SCM Agreement*. The GSM programmes "underwrite credit extended by the private banking sector in the United States (or, less commonly, by the US exporter) to approved foreign banks using dollar-denominated, irrevocable letters of credit to pay for food and agricultural products sold to foreign buyers."[7] Under the SCGP, "CCC guarantees a portion of payments due from importers under short-term financing (up to 180 days) that exporters have extended directly to the importers for the

[3] *United States – Standards for Reformulated and Conventional Gasoline*, Report of the Appellate Body, WT/DS2/AB/R, adopted 20 May 1996, p. 23.

[4] US First Written Submission, para. 77, fn 66. ("Clearly or explicitly defined; precise, exact, definite.")

[5] US First Written Submission, para. 77. ("'Specific' means '[s]pecially or peculiarly pertaining to a particular thing or person, or a class of these; peculiar (to)'.")

[6] US First Written Submission, para. 77, fn 66. ("Clearly or explicitly defined; precise, exact, definite.")

[7] See Exhibit BRA-71 ( "Fact Sheet: CCC Export Credit Guarantee Programmes (GSM-102/103)").

purchase of US agricultural products."[8] Where a foreign bank or foreign importer defaults under the terms of the credit/financing that has been extended, the CCC will transfer funds to the US bank or US exporter directly.

**(b) How, if at all, would this be relevant to the claims of Brazil?**

Reply

8. Where the guarantees provided under the US programmes confer a "benefit", a "subsidy" exists within the meaning of Article 1.1 of the *SCM Agreement*. Whether a "subsidy" exists under Article 1.1 of the *SCM Agreement* is relevant to determining whether the US programmes grant export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement*. Panels and the Appellate Body have relied upon the definition of a "subsidy" in Article 1.1 of the *SCM Agreement* as context to determining whether an "export subsidy" exists under Article 1(e) of the *Agriculture Agreement*. This Panel should do the same.

9. Were the Panel to find that these programmes provide export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement* (a likely result in this case), then it would also find that the United States has violated Articles 8 and 10.1 at the very least in respect of exports of upland cotton because it is an unscheduled product and the US quantitative export subsidy reduction commitment level for that commodity is therefore zero.

**30. The Panel could arguably take the view that Articles 1 and 3 of the *SCM Agreement* were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an *a contrario* interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission).**

Reply

10. Whether an export subsidy exists under Articles 1 and 3 of the *SCM Agreement* is relevant to determining whether the US programmes grant export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement*. Item (j) of the Illustrative List may not be interpreted *a contrario* to deem US export credit guarantee practices as not providing export subsidies under Article 10.1 of the *Agriculture Agreement*. Where US programmes may not be deemed to provide export subsidies because they do not meet the requirements of item (j), Articles 10.1 and 10.3 of the *Agriculture Agreement* nevertheless require the United States to demonstrate that it has not granted export subsidies within the meaning of Articles 1 and 3 of the *SCM Agreement* in respect of the relevant quantity of exports. Canada refers the Panel to paragraphs 49-50 of its written third party submission and paragraphs 12-14 of its third party oral statement.

**31. If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance in the interpretation of the terms in Article 10 *Agreement on Agriculture*, should the Panel refer to item (j) or Articles 1 and 3 of the *SCM Agreement* or both?**

[8] See Exhibit BRA-72 ("Fact Sheet: CCC Supplier Credit Guarantee Programme").

Reply

11. The Panel should refer to both. Item (j) of the Illustrative List in Annex I of the *SCM Agreement* allows the Panel to determine whether the United States provides "export credit guarantee… programmes" such that guaranteed export credit transactions guaranteed under those programmes are subsidized *per se*. Articles 1 and 3 of the *SCM Agreement* allow the Panel to determine, on a transaction-by-transaction basis, whether given quantities of US exports are subsidized.

**32. The Panel's attention has been drawn to Article 14(c) of the *SCM Agreement* (see third party submission of Canada) and to the panel report in DS 222 *Canada - Export Credits and Loan Guarantees*. How and to what extent are Article 14(c) of the *SCM Agreement*, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material.**

Reply

12. Canada refers the Panel to paragraphs 41-48 of its written third party submission with respect to how and to what extent Article 14(c) of the *SCM Agreement* and the cited panel report are relevant.

13. Whether a benefit is conferred under Article 1.1(b) of the *SCM Agreement* is a question of fact, to be assessed in the light of all the relevant financial considerations of a given export credit transaction. The Panel's findings in this respect will depend on an examination of: 1) the terms of credit transactions that are guaranteed by the CCC, including the length of the repayment period and any fees charged for the guarantee, and 2) credit transactions with similar terms that are occurring in the market without a CCC guarantee.

**33. What is the relevance (if any) of Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders."**

Reply

14. Were the Panel to find that support for exports of agricultural products such as export credit guarantees are not available on the marketplace from commercial lenders, this would suggest that a benefit under Article 1.1(b) of the *SCM Agreement* exists because the provision of such support in the market would otherwise require uneconomical terms and conditions (based on factors such as a lack of security provided by the product and a lack of lender confidence in sales of the product).

**34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"?**

Reply

15. The term "costs" must be distinct in meaning from the term "losses", otherwise the coordinating conjunction "and" is rendered meaningless. This is confirmed by the French version of the phrase ("*les frais et les pertes*"). In Canada's view, any "claims paid" may yield "losses" when they are added to any other "operating costs" incurred under the programme. Such losses would be required to be covered over the long term by the premiums charged to avoid a finding that transactions guaranteed under the programme are subsidized *per se*.

**35. Did the drafters of the *Agreement on Agriculture* include export credit guarantees in Article 9.1 of the *Agreement on Agriculture*? Why or why not?**

Reply

16. Export credit guarantees were not included in Article 9.1 of the *Agreement on Agriculture* because Members could not agree on specific language. Article 10.1 therefore covers any export subsidies granted by such guarantees.

**36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38)**

**(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

17. This statement suggests that similar credit transactions that are not guaranteed by the CCC would involve uneconomical terms and conditions. Therefore, it suggests that a "benefit" exists within the meaning of Article 1 of the *SCM Agreement*. The statement also confirms that the US programmes are contingent upon export performance within the meaning of Article 1(e) of the *Agriculture Agreement*.

**(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

18. This statement also suggests that a "benefit" exists within the meaning of Article 1 of the *SCM Agreement*, and confirms that the US programmes are contingent upon export performance within the meaning of Article 1(e) of the *Agriculture Agreement*.

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

19. This statement confirms that the US programmes are contingent upon export performance within the meaning of Article 1(e) of the *Agriculture Agreement*.

**37. The United States seems to argue that, at present, by virtue of Article 10.2 of the *Agreement on Agriculture*, there are no disciplines on agricultural export credit guarantees under the *Agreement on Agriculture* (or the *SCM Agreement*).**

**(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an**

**indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the *Agreement on Agriculture* ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the *Agreement on Agriculture*? Please cite any relevant material, including any past WTO dispute settlement cases.**

Reply

20. Were the Panel to find that US export credit guarantee programmes provide export subsidies within the meaning of Article 1(e) of the *Agriculture Agreement*, then it would also find that the United States has violated its export subsidy commitments under the *Agriculture Agreement* at the very least in respect of exports of upland cotton. In this respect, Canada refers the Panel to paragraphs 51-54 of its written third party submission, paragraphs 15-16 of its third party oral statement, and paragraphs 133-153 of the Appellate Body's original report in *US – FSC*.[9]

**(b) If, as the United States argues, there are no disciplines on export credit guarantees in the *Agreement on Agriculture*, how could export credit guarantees "conform fully to the provisions of Part V" of the *Agreement on Agriculture* within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)?**

Reply

21. For export credit guarantees to be exempt from the obligations set out in the *Agriculture Agreement*, the Agreement would have to expressly provide for the exemption. No provision of the *Agriculture Agreement* exempts export credit guarantees from any obligation under the Agreement. The US guarantees will therefore "conform fully to the provision of Part V" only if they do not confer export subsidies within the meaning of Articles 1(e) of the *Agriculture Agreement* "in a manner which results in, or which threatens to lead to, circumvention of [US] export subsidy commitments" under Article 10.1.

[9] *United States – Tax Treatment for "Foreign Sales Corporations"*, Report of the Appellate Body, WT/DS108/AB/R, adopted March 20, 2000.

# ANNEX J-5

## RESPONSE BY CHINA TO THE PANEL'S QUESTIONS TO THIRD PARTIES

11 August 2003

1. China appreciates this opportunity to present its views to the Panel in relation to the Panel's questions posed to third parties on July 28, 2003. While it was specifically asked to address Questions 1, 4, 12, 13, 14, 15, 16, 17, 21, 22, 23, 25, 41 and 42, China notes the Panel in the fax cover page granted freedom to third parties "to respond to or comment on questions posed to the other third parties". Given the short period within which third parties are required to submit their views, China therefore responds to and comments on the following underlined questions.

ARTICLE 13 OF THE *AGREEMENT ON AGRICULTURE*

2. **Question 1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you [Australia] reconcile this with your [Australian] view that the conditions in Article 13 are a "pre-requisite" to the availability of a right or privilege? Would other third parties have any comments on Australia's assertion?**

Reply

3. China agrees with the interpretation of Article 13 of the *Agreement on Agriculture* (the "Peace Clause") put forward by Australia. As explained in its written submission, China believes that the Peace Clause does not impose positive obligations; it only stands to provide limited exemptions from actions to measures that may otherwise be subject to actions based on GATT 1994 and the Agreement on Subsidies and Countervailing Measures (the "*Subsidies Agreement*"). As wording of the Peace Clause indicates, such exemptions are not automatically available or granted upon a simple allegation by a Member that it is protected; certain conditions built into the Peace Clause must be met before such a Member can enjoy entitlement to Peace Clause exemption.

4. The United States alleged that if conditions do have to be met for availability of Peace Clause protection, it is upon the complaining party to prove that the US measures do not meet such conditions, and hence do not enjoy Peace Clause protection. In support of its reasoning, it asserts that the Peace Clause imposes positive obligations by its built-in reference to Annex 2 to and Article 6 of the *Agreement on Agriculture*[1]. China disagrees on that point. In its written submission, China stated that when Annex 2 and Article 6 are brought under the Peace Clause as conditions, they lose any positive obligation nature, if any, in their original places; they have come to form conditions precedent for entitlement to Peace Clause exemption. Since the Peace Clause contains limited exemptions from actions based on GATT and the *Subsidies Agreement*, it is affirmative defence in nature, and the party claiming its entitlement bears the burden of proving that it is so entitled.

5. China sees no need to "reconcile" the affirmative defence nature with the conditions that must be met to enjoy that defence. The latter is simply required to happen prior to availability of affirmative defence. The two elements, i.e. conditions to be met and availability of exemptions, form an organic whole of the Peace Clause. To China's understanding, parties to this dispute share greater

[1] Para. 43, US First Written Submission, United States – Subsidies on Upland Cotton, WT/DS267, 11 July 2003.

disagreement on who should bear the burden of proof under the Peace Clause than whether conditions under the Peace Clause are pre-requisites to availability of Peace Clause exemption.

ARTICLE 13(B) OF THE AGREEMENT ON AGRICULTURE: DOMESTIC SUPPORT MEASURES

**6. Question 4, How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*?**

Reply

7. In relation to US direct payments under the 2002 FRSI Act, the European Communities ("EC") in its oral statement took a unique stance different from those of all other parties. Noting the United States argument that updating of base periods was necessary in order to bring support for oilseeds production under the direct payment scheme, the EC argued that "it must be possible to have different reference periods while eligibility is based on previous eligibility for production distorting subsidies" "to ensure the progressive movement of production distorting subsidies to decoupled subsidies"; on the other hand, the EC also expressed concern that "continued updating of reference periods in respect of the same already decoupled support, creating an expectation that production of certain crops will be rewarded with a greater entitlement to supposedly decoupled payments, tends to undermine the decoupled nature of such payments"[2]. Such a line of reasoning may have given rise to the question raised by the Panel.

8. While sharing the same concern with the EC, China does not see eye to eye with the EC on the proposed allowance for an initial jump of the reference period over the transition from production distorting subsidies to "decoupled subsidies", even if the latter are found to be decoupled. In China's opinion, the issue is not about frequency of reference period updating; the issue is whether Para. 6 of Annex 2 to the *Agreement on Agriculture* allows updating of the reference period at all.

9. Specifically, the Panel in this case is faced with a direct payment programme that was initiated by a Member several years prior to the coming into effect of the *Agreement on Agriculture*, but was over the years, maintained in the Member country by successor legislations with slight variations. While Para. 6 of Annex 2 to the *Agreement on Agriculture* does not specify when "a fixed and defined base period" falls, it certainly does not provide a window of opportunity for an existing production distorting support measure to transform into a kind of payment with an increased production factor (acreage) in a new up-to-date period. Such an interpretation would grant a bonus not intended by the drafters. The requirement by Para. 6 for a "base" period reflects the drafters' intention to freeze any "Green Box" programme at its initial support level, as opposed to a period selected by a Member. If a Member wishes to carry out a transformation, it should certainly follow the spirit of Para. 6 and use the base period that is already fixed and defined by the predecessor legislation.

10. Therefore, with respect to the interpretation Para. 6 of Annex 2 to the *Agreement on Agriculture* as applied to a direct payment programme that is a direct descendent of predecessor programmes, China is of the view that no updating shall be allowed at all.

**11. Question 12. Where does Article 13(b) require a year-on-year comparison?**

[2] Para. 30, Oral Statement by the European Communities, United States – Subsidies on Upland Cotton, WT/DS267, 24 July 2003.

Reply

12. Main elements of Article 13(b)(ii) and (iii) read: "domestic support measures that fully conform to … shall be exempt from actions … , provided that such measures do not grant support to a specific commodity *in excess of that* decided *during the 1992 marketing year*" (emphasis added). The full conformity chapeau and the proviso are two conditions to the availability of exemption granted by this Article.

13. The Panel's question relates to interpretation of the proviso. Key to the interpretation are the words "that", "during the 1992 marketing year" and "in excess of". The word "that" is inserted in the second portion of the proviso to refer back to what was described in the previous portion, i.e. "support to a specific commodity". The phrase "in excess of" requires a comparison. The phrase "during the 1992 marketing year" indicates a requisite element of comparison, a common denominator in time frame without which a comparison is impossible. The combination of these three elements requires a comparison of support levels between a given year at issue and 1992 marketing year, i.e. a year-on-year comparison.

14. Obviously, the proviso does not contemplate the comparison of the sum of support levels for more than one year with that of 1992 marketing year. Such a comparison would be one between two grossly unequal numbers, resulting in no statistical significance and would destroy the purpose of the proviso being a condition precedent to the availability of a protection.

15. In addition, the proviso, properly interpreted, cannot be limited to a comparison only of measures currently in effect against those during the 1992 marketing year, as the US argues. The US based its argument on the present tense of the proviso, arguing that such a tense only calls for determination of the support that challenged measures currently grant. With respect, China disagrees. While it is indeed written in the present tense, the sentence is led by the key word "provided" in a strong limitation and demand style. As such, the present tense serves the purpose. The intention of such tense is to ensure that support levels beyond those in 1992 are not to be protected by the Peace Clause. Further, the US argument fails to recognize that the present tense is "present" only in respect of 1995, when the *Agreement on Agriculture* came into effect. It seeks to govern then "future" measures. Using the time of panel dispute resolution as the vantage point, as the United States argues, seriously limits the proviso's scope to examining only measures current as of the time of dispute. Thirdly, the US interpretation that a comparison is only limited to the measures currently in effect drives a significant loophole into the treaty language, and seeks to remove the proviso requirement for measures that are not current during the year of dispute resolution. Such an interpretation would also be tantamount to placing a period of limitation within which a complaining member must seek dispute settlement against dispute-current measures only. Neither the loophole nor the period of limitation can be intended by the drafters. It follows therefore, while Article 13(b) requires a year-on-year comparison, that comparison is not limited to measure currently in effect. The issue of what measures are before this Panel are set out in the terms reference for this Panel.

**16. Question 13. Does a failure by a Member to comply in a given *year* with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)?**

Reply

17. China proposes to address this question in two parts: one, does a failure by a Member to comply in a given year with the chapeau of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? Two, does a failure by a Member to comply in a given year with the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by

Article 13(b)? In this respect, it is again useful to turn back to the elements in Article 13(b)(ii) and (iii), which read: "domestic support measures that fully conform to … shall be exempt from actions … , provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year". As discussed in China's answers to Question 12, both the chapeau and the proviso are two co-existing conditions, and breach of either will lead to loss of the exemption granted by these Articles.

18. For the first part, a failure by a Member to comply in a given year with the chapeau of Article 13(b) will not impact its entitlement to benefit in an earlier or a later year from the exemption from action. The chapeau requires that domestic support measures conform fully to provisions of Article 6. Articles 6.1 and 6.3 in turn provide that all non-green box domestic support measures of a Member are considered to be in compliance with Article 6 if the Member's "C*urrent Total AMS* does not *exceed* the *corresponding annual* or final bound commitment level specified in Part IV of the Member's Schedule" (emphasis added). The word "exceed" requires a comparison. The words "current", "corresponding" and "annual" indicate that the comparison is to be made on an annual basis between the level of support actually provided in a given year and annual bound commitment level in the same year as indicated in the Member's Schedule. A Member's actual level of support varies from year to year, so does a Member's annual bound commitment level. Therefore a factual comparison between the two in a given year shall not have any bearing on a comparison of different support levels in an earlier or later year.

19. In respect of the second part of the question, China would like to reiterate its answer to Question 12 that Article 13 (b) requires a year-on-year comparison between the annual level of support at issue and the level of support in 1992 marketing year. Whether domestic support measures in a given marketing year exceeds same in 1992 marketing year is a matter of fact. The level of support in each given year challenged shall be compared separately to same in the 1992 marketing year. A factual conclusion on the "excess" issue for measures in one year certainly shall not preclude an examination of a different set of facts in another year.

**20. Question 14. Does a failure of a Member to comply with Article 13(b) in respect of a *specific commodity* impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)?**

Reply

21. The chapeau of Article 13(b) requires compliance with Article 6 for the purpose of determining whether Peace Clause protection is available. As discussed in China's answers to Question 13, Article 6 provides that a Member's Current Total AMS in any year shall not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule. In other words, in considering the "exceed" issue, Current Total AMS, being the monetary sum value of all measures provided by a Member in a given year shall be compared against the corresponding annual bound commitment committed by the Member in its Schedule. Such a comparison disregards the issue of support to a specific commodity. Furthermore, the phrase "support to a specific commodity" only appears in the proviso of Article 13(b), but not in the chapeau. Therefore support to a specific commodity is not an issue under consideration by the chapeau of Article 13(b).

22. In respect of the proviso of Article 13(b), China believes a failure of a Member to comply thereof in respect of *a specific commodity* does not impact its entitlement to benefit in respect of other agriculture products from the exemption from action provided by Article 13(b).

23. For the purpose of this discussion, support measures can be classified into two categories: support measures provided exclusively to one specified product or those generally available to a number of specified products.

24. Where a programme is designed to provide support exclusively to one product, e.g. upland cotton for the purpose of this case, other products are not brought under its coverage. Failure by the Member's upland cotton-specific programme (if there is any in this case) to comply with Article 13(b)'s proviso would only take the exclusively cotton support programme at issue out of the protection of exemption by Article 13(b). Whether that Member's other support programmes are protected under Article 13(b)'s protection against actions is a matter not related to the cotton support measures at issue.

25. Where support measures are generally available to a number of products including upland cotton, the term "specific commodity" requires break up and attribution of the general budgetary outlay to each specific product for comparison under the proviso. For the purpose of this case, only the portion of outlay that was used for upland cotton is relevant for that comparison. Outlays broken up for other products covered by the same programme is not at issue before this Panel. In addition, terms of reference governing this Panel procedure does not require the Panel to review measures involving other products.

**26. Question 16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph?**

Reply

27. China believes that a hypothetical deletion suggested would not change the fundamental meaning of Article 13(b)(ii).

28. China understands that the word "specific" is inserted to avoid a lump-sum treatment of measures generally applicable to a number of commodities. It is to emphasize that when calculating the amount of support granted to one commodity, the portion that is delivered to that specific commodity at issue shall be singled out and counted as part of the amount of all support granted to that specific commodity. Doing the comparison otherwise would render the requisite comparison as part of the proviso meaningless.

29. If the word "specific" were to be deleted, the proviso would read:

> …, provided that such measures do not grant support to *a* commodity in excess of that decided during the 1992 marketing year. (emphasis added)

With "specific" deleted, while the emphasis effect may be diminished, the word "a" remains and the fundamental meaning of this proviso will not change. A comparison is still required for the support levels that are directly applicable and those attributable to upland cotton.

30. The above interpretation accords with the views of New Zealand and Australia that the term "support to a specific commodity" is not synonymous with the term "product-specific support"[3]. The term "product-specific support" focuses on "product-specific", pointing to a support programme designed for and provided exclusively to a specified product. On the other hand, the term "support to a specific commodity" is used to incorporate a level of support delivered to a *specific commodity*, combining both product specific support and the attributed portion of a much larger programme generally available to a number of products including upland cotton.

[3] Paras. 23 – 24, Oral Statement by Australia, *United States – Subsidies on Upland Cotton*, WT/DS267, 24 July 2003; Para. 9, New Zealand's Oral Statement, *United States – Subsidies on Upland Cotton*, WT/DS267, 24 July 2003.

**31. Question 17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement* to the meaning of "support to a specific commodity" in Article 13(b)(ii) *Agreement on Agriculture*?**

32. China believes that the concept of "specificity" in Article 2 of the *Subsidies Agreement* is used in a sense and for purposes different from that used in the proviso of Article 13(b)(ii) of the *Agreement on Agriculture*. References to "a product" or "subsidized product" in certain provisions of the *Subsidies Agreement* is not relevant at all to the meaning of "support to a specific commodity".

33. Pursuant to Article 1.2 of the *Subsidies Agreement*, a subsidy shall be subject to WTO disciplines only if its availability is restricted to specified recipients, i.e. to a *specific enterprise or industry or a group of enterprises or industries*. (emphasis added) The word defines what falls under WTO discipline over subsidies. In contrast, the word "specific" used in the phrase "support to a specific commodity" of the Peace Clause proviso, as China explains in its answers to Question 16, is an emphasis for calculating year on year support levels on a product basis. The latter is only an indicator for a method of calculation and comparison. The same word in the two different places carry with them separate meanings and purposes.

**34. Question 21. Please comment on Brazil's assertion that "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term?**

35. Debate among the parties revolves around the word "decided" in the proviso of Article 13(b)(ii). The United States argued that its domestic support measures "did not decide on an outlay or expenditure amount in favor of upland cotton"; rather, it argued that "US measures 'determined'" a per pound rate of support during 1992 marketing year while actual outlays or expenditures were known or completed after the marketing year's end. As the actual outlay would come to its knowledge upon final accounting of the world prices, no amount of outlay was "decided" during the 1992 marketing year[4].

36. In China's opinion, the above US interpretation does not lend any utility to interpreting the proviso in Article 13(b)(ii). The proviso, of which "decided" is an element, serves, together with the chapeau, as a qualifier to the entitlement to exemption from actions. Were the US interpretation to prevail, no measure involving year end accounting for the calculation of expenditure would exceed "that decided during the 1992 marketing year", as the former is not capable of measuring up to the 1992 level.

37. In support of the US reading, EC argued that Brazil's the use of "decided" as opposed to "granted" is indication that use of budgetary outlays shall be ruled out; that "decided" implies one-off determination, not involving "deciding" countless applications for support under a particular programme; and that use of the word "during" in the same sentence means that "decided" may also cover future periods.[5] However, the EC in its arguments fails to point out expressly what should constitute the 1992 benchmark[6].

38. Interpretation of the word "decided" shall be carried out "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose"[7]. Drafters of this Article must be understood to have used the word to carry out the Article's object and purpose, being a 1992 benchmark against which to measure whether certain supports are

[4] Para. 94, *First Written Submission of the US*, 11 July 2003.
[5] Paras. 14 - 17, *Oral Statement by the European Communities*, 24 July 2003.
[6] Para. 19, Ibid.
[7] Article 31.1, *Vienna Convention on the Law of Treaties*.

entitled to exemption. Measures involving agricultural support above that benchmark must risk challenges on the basis of Article XVI:1 of the GATT and Articles 5 and 6 of the *Subsidies Agreement*. As such, the 1992 benchmark must be established for the purpose of comparison.

39. Preference of the word "decided" over "granted" by drafters of the Article may be a result of numerous possibilities. Choosing "decided" to imply a "fixed determination" can be reflective of an intention to exclude expenditures that cannot be precisely allocated to a specific marketing year; certain support payments may be granted by an administration, but may not have reached its beneficiaries in 1992; it may well be an indication of the drafters' intention to cover the exact scenario described by the US, i.e. granted in 1992 but decided in 1993. However, such choice of the word shall not push aside the core intention, which is to choose the year 1992 for establishing that benchmark support level.

40. Again, the issue of burden of proof comes up. If a subsidizing Member wishes to avail itself of the protection of Article 13(b)(ii), it is obligated to prove that the measures being challenged do not exceed the 1992 benchmark. Subsequent to the coming effect of GATT 1994, there exists a reasonable expectation that all subsidizing Members should have notified the WTO Committee on Agriculture their respective level of support in 1992 to allow a workable comparison. In the absence of such notice, evidence of a 1992 benchmark level can only be established by the complaining party, in the form of actual budgetary outlays by the subsidizing Member. Such is the best information available for a proper comparison.

**41. Question 22, What is the meaning of "support" in *Agreement on Agriculture* 13(b)(ii)? Why would it be used differently from Annex 3, where it refers to total outlays? Question 23, Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both?**

42. Annex 3 of the *Agreement on Agriculture* is an aid to calculating AMS, which is required not to exceed the corresponding annual or final bound commitment level specified in a Member's domestic support reduction commitments in the Member's schedule under Article 6 of the *Agreement on Agriculture*. In other words, the support calculated on the basis of outlays is part of the concept of replacing commitments to reduce domestic support on a product by product basis with a commitment to reduce overall support to the agricultural sector, a breakthrough in the Agreement's negotiations effected by the Blair House accord.

43. Insertion of the Peace Clause into the *Agreement on Agriculture* is again a part of the Blair House accord. Budgetary outlay, as exemplified by the calculation method in Annex 3, is the approach adopted to ensure that levels of support to upland cotton, whether generally available to a number of products including the product at issue, or product specific, do not overstep the 1992 marketing year level if it is to be protected by the Peace Clause exemption.

44. The United States argued that the comparison required should be between the "per pound rates" of product specific supports[8]. With respect, such an approach fails to recognize the thrust of the Blair House accord. In addition, while domestic support programmes may have specific designs, e.g. paid on per unit basis, such designs shall not guide how Article 13(b)(ii) should be interpreted. The Article has no reference at all to per unit calculation for the purpose of comparison.

45. If unit of production is to be accepted as an method for comparison in addition to absolution support level comparison, under Article 13(b)(ii), four possibilities exists. A decision as to whether a Member asserting affirmative defence is entitled to Peace Clause protection is possible only when both the absolute support level and the per unit support level are higher or lower than those during the

[8] Paras. 82 – 87, US First Written Submission, *United States – Subsidies on Upland Cotton*, WT/DS267, 11 July 2003.

1992 marketing year. A decision on whether Peace Clause shields the measures at issue may have to be made taking into account extraneous factors if one method yields a plus and another minus. Those factors are, however, nowhere to be found under Article 13(b)(ii) and thus the inclusion of product unit comparison is certainly not contemplated by the drafters.

ETI ACT

**46. Question 41. Concerning its claims on the ETI Act, Brazil relies on the *US – FSC* case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here?**

47. China believes that it is not necessary for the Panel to consider the issue of the Peace Clause or Article 6 of the *Agreement on Agriculture* regarding Brazil's claims on the ETI Act.

48. The issue is dealt with by Article 7.2 of the *DSU*, which provides:

> Panels shall address the relevant provisions in any covered agreement or agreements *cited by the parties* to the dispute." (emphasis added)

In effect, under this article, a Panel is required to consider and address relevant provisions *cited by the parties* only. Since the US in this case has not claimed defence for its ETI Act, there is no need for this Panel to consider same.

**49. Question 42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the *DSU*, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the *DSU*, and please cite any other provisions you consider relevant.**

50. The phrase "a final resolution to that dispute" cited by the EC in its third party oral statement comes from the Appellate Body Report in *US-Shrimp (21.5)* case, in which the Appellate Body stated,

> [I]t must also be kept in mind that Article 17.14 of the DSU provides not only that Reports of the Appellate Body 'shall be' adopted by the DSB, by consensus, but also that such Reports 'shall be unconditionally accepted by the parties to the dispute.' Thus, Appellate Body Reports that are adopted by the DSB are, as Article 17.14 provides, 'unconditionally accepted by the parties to the dispute', and, therefore, *must be treated by the parties to a particular dispute as a final resolution to that dispute.* In this regard, we recall, too, that Article 3.3 of the DSU states that the 'prompt settlement' of disputes 'is essential to the effective functioning of the WTO'. (emphasis added)

51. The word "that" appears to limit the binding force of Appellate Body report only to the parties in the case on which the Appellate Body's report is made. Panels in other cases are not bound by any precedential effect of an earlier Appellate Body report, because the facts, parties and other circumstances of claim may be entirely different. Generally speaking, such an interpretation is widely accepted by commentators[9].

[9] John H. Jackson, "The Legal Meaning of a GATT Dispute Settlement Report: Some Reflections", Towards More Effective Supervision by International Organization: Essays in Honour of Henry G. Schermers (Martinus Nijhoff Publishers, Dordrecht, Boston and London, 1994).

52. Be that as it may, the ETI Act in this current case is the very same one challenged by the EC, and found to violate the *Agreement on Agriculture* and the *Subsidies Agreement* by both the panel[10] and the Appellate Body[11] in *US – FSC (21.5)*, whose reports were adopted on 29 January 2002 by the DSB. While in *that* case, the complaint was the EC, and in *this* case, the complaint was Brazil, the measures being challenged were the same, and the Member whose measures were challenged were the same. Countermeasures against the same measures were authorized by the DSB. While both the panel and the Appellate Body reports must be treated by EC and the US as final resolution to that dispute, the US is the party whose measures were found to be non-WTO compliant, and the same measures, since not having been withdrawn, is brought to this dispute. Brazil, as a Member of the WTO system, indeed with other Members of the WTO, has reasonable expectations for the US to withdraw the measures after the DSB authorization. In respect of ETI Act, there is no difference between *that* case, being *US – FSC (21.5)* and *this* case, *US – Subsidies to Upland Cotton*. Under the circumstances, there is no reason why "final resolution to that dispute" as reflected in *US – FSC (21.5)* should not be considered and taken by this Panel.

53. In respect of the term "disputes" under Article 12 and Appendix 3 of the *DSU*, it is simply used in the general context of limiting participation to only parties to a dispute for the purpose of assisting panels in organizing their respective working procedures. Meaning and interpretation of the term "dispute" lends no support to interpretation of the Appellate Body's exclamation in *US-Shrimp (21.5)* that its report in a specific case "must be treated by the parties to a particular dispute as a final resolution to that dispute". Therefore, China believes that the term "dispute(s)" used in Article 12 and Appendix 3 of the *DSU* is not helpful for interpretation of the Appellate Body's statement.

54. Article 9.3 of the *DSU*, on the other hand, is part of *DSU* Article 9 which deals with procedures for multiple complainants. It is an attempt to consolidate panel proceedings while the matter at issue has been challenged by more than one Member. Specifically, Article 9.3 reads:

> If more than one panel is established to examine the complaints related to the same matter, to the greatest extent possible the same persons shall serve as panelists on each of the separate panels and the timetable for the panel process in such disputes shall be harmonized.

The Article seeks, to the extent possible, uniformity and consistency in panel reasoning and conclusions, in the event that more than one panel is established, by having the same jurists sitting on separate panels. The requirement for having the same panelists and harmonization of panel processes, on the other hand, is only capable of being carried out if the first panel's proceedings were on-going.

55. For the current case, direct application of Article 9.3 is practically impossible. While complaints raised by Brazil in this case do cover the same ETI Act of the United States which was the subject matter of *US – FSC (21.5)*, the panel in the latter case completed its proceedings as early as 29 January 2002. In addition, the complaint by Brazil involves a whole plethora of US measures, of which the US ETI Act was only one. The majority of the measures challenged by Brazil were not dealt with by the panel in *US – FSC (21.5)*.

56. Having said that, China believes that the spirit of Article 9.3 is still of guidance value. Since the ETI Act challenged by Brazil in this case is exactly the same challenged by the EU in *US – FSC*

[10] Panel Report, *US - FSC (21.5)*, WT/DS108/RW, adopted on 29 January, 2002.

[11] Appellate Body Report in *US - FSC (21.5)*, AB-2002-1, WT/DS108/AB/RW,adopted on 29 January 2002.

*(21.5)*, and that the panel proceedings have long progressed beyond the panelist selection stage, the only way to ensure uniformity and consistency in panel reasoning and conclusions is to have this Panel consider and adopt the reasoning and conclusion of the panel and the Appellate Body *US – FSC (21.5)* in respect of the US ETI Act.

57. China thanks this Panel for granting this opportunity to present its views on issues related to this proceeding, and hopes that this Panel will finds the above points helpful.

# ANNEX J-6

## RESPONSES TO THE PANEL'S QUESTIONS AND THE QUESTIONS OF CERTAIN THIRD PARTIES SUBMITTED BY THE EUROPEAN COMMUNITIES

11 August 2003

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## I. ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE

**Q1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions in Article 13 are a "prerequisite" to the availability of a right or privilege? Australia Would other third parties have any comments on Australia's assertion? 3RD parties, in particular Argentina, Benin, China, Chinese Taipei**

Answer

1. Australia's views cannot be reconciled. Australia is correct in noting that the conditions in Article 13 can be considered a prerequisite for taking action under the *SCM Agreement*.[1] In using the term "prerequisite", Australia essentially recognises that, in respect of measures covered by Article 13, a complainant can only invoke the relevant provisions of the *SCM Agreement* if it proves that the threshold requirements or prerequisites referred to in Article 13 have been satisfied. As the European Communities has pointed out, such a situation is very different from the situation where, in the event of a violation of a WTO Agreement, a WTO Member pleads a defence which potentially exculpates it from this violation (e.g. Article XX GATT) in respect of which it bears the burden of proof.

2. Comparing Article 13 with Article 3.3 of the *SPS Agreement* shows that Australia's views are irreconcilable. This provision permits WTO Members not to base SPS measures on international standards but to impose higher standards where there is a scientific justification or an appropriate risk assessment has been carried out. This provision has some similarities with Article 13 of the *Agreement on Agriculture* since it sets a threshold which must be met before a Member can act. However, Article 3.3 may be seen as going further than Article 13 since it provides a derogation from the central discipline of the *SPS Agreement* ; the obligation to base SPS measures on international standards. On the other hand, Article 13 is simply one element regulating the interface between the *Agreement on Agriculture* and the other Annex I Agreements and cannot be seen as a derogation therefrom. Despite the extent to which Article 3.3 could be thought of as a derogation from the *SPS Agreement*, the Appellate Body ruled in *EC Hormones* that it could not be considered an affirmative defence, and that the burden of proof did not, therefore lie with the defendant.[2] In particular, the Appellate Body noted that the situation in Article 3.3 of the SPS Agreement is "qualitatively different" from the relationship between for instance, Article 1 and XX GATT.[3]

3. Consequently, Australia is correct to consider that Article 13 is a prerequisite or a threshold condition before the other Annex I Agreements may become applicable but is incorrect to consider that Article 13 can be considered an affirmative defence.

## II. ARTICLE 13(B) OF THE *AGREEMENT ON AGRICULTURE*: DOMESTIC SUPPORT MEASURES

**Q2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

[1] Australia's Oral Statement, para. 18.

[2] Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 109.

[3] Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 105.

Answer

4. The two words have slightly different meanings, as is suggested by the use of the conjunctive "and". "Defined" means "having a definite or specified outline, or form; clearly marked, definite"[4] and thus implies, in terms of interpretation of paragraph 6, that the base period for any measure which is claimed to be green box must be set down in the measure itself. "Fixed" is defined as "definitely and permanently placed or assigned, stationary or unchanged in relative position, definite, permanent lasting"[5] and suggests that the base period for a particular measure cannot be changed at a later date. In other words, a Member may define a base period by means of a formula whereas a fixed base period implies that the years chosen for the base period do not change.

5. Decoupled support within a WTO Member need not take the form of a single measure, but may involve several measures. The first sentence of Paragraph 1 of Annex 2 refers to "domestic support measures". Different measures may have different base periods, and a single measure may have several different base periods.[6] Each measure will, or course, have to be judged against the basic and policy specific criteria set down in Annex 2. However, it would defeat the objective of Annex 2 paragraph 6 if a Member could adopt repeated, practically identical measures, in respect of which farmers are aware that they may update the base period. If a farmer knows that a base period is going to be updated, and knows the type of production that will qualify for payments, a WTO Member inevitably encourages the growth of a particular crop, cannot be considered to have decoupled support from production and inevitably creates trade or production distorting effects.

6. The European Communities also refers the Panel to its response to question 11.

**Q3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

7. In the view of the European Communities, the word "a" indicates that it is for the Member concerned to choose a base period, rather than the base period be fixed for all WTO Members.

8. "The" in paragraphs 6(b),(c) and (d) refers to the base period or periods established for eligibility for payments in paragraph 6(a).

9. There are notable differences between these phrases and the phrase "based on the years 1986 to 1988" in Annex 3. First, Annex 3 refers to an already defined and fixed period. Second, the reference period 1986-1988 refers to all measures taken by all Members, and not to specific measures which are intended to conform to Annex 2 taken by specific Members.

**Q4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*? 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

[4] The New Shorter Oxford English Dictionary, 1993.
[5] The New Shorter Oxford English Dictionary, 1993.
[6] For instance, in the experience of the European Communities, where decoupled payments are based on past payments of production aids, and not all production aids are brought under a decoupled scheme, it must be envisioned that new products could be brought into the decoupled payment scheme, with the possibility that such payments are based on a different base period.

Answer

10. As explained in question 2 above, a Member may provide decoupled support through several measures which may have different base periods. However, a Member may not renew a measure, with essentially the same characteristics as previous measures, where, as a matter of fact, farmers are aware that they will have the possibility to update their base periods and thus have an interest in producing certain crops.

11. We also refer the Panel to our response to question 11.

**Q5. Do you agree that a payment penalty based on crops produced is "related to type of production"? EC**

Answer

12. The European Communities believes that an examination of the conformity of a decoupled scheme with the criteria set out in Annex 2 must involve an examination of the scheme as a whole. In that light, the European Communities is not convinced that where, as part of a scheme where no production is required to receive payments, and that the production of any type of crop is permitted, reducing payments where certain crops are produced can be such as to make the scheme, when taken as a whole, related to a type of production. Consequently, the reduction of payment linked to the production of fruit and vegetables must be seen as part of a scheme which permits a farmer to grow any type of crop, or even not to produce at all. Such a scheme, it is submitted, taken as a whole, meets the criteria that payments are not related to a type of production. To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition, in an historical perspective, and avoid those farmers receiving decoupled payments from enjoying both the decoupled payments and a privileged position vis-à-vis farmers who are not entitled to such payments. Moreover, as the European Communities has explained, such a finding would require a Member to increase its subsidy programmes in order to prevent internal distortions of competition, running directly contrary to the process of reform instituted by the *Agreement on Agriculture*.

13. We also refer the Panel to our response to question 11.

**Q6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the *Agreement on Agriculture* have on the meaning of the preceding sentence? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

14. Both Article 6.1 and 7.1 refer to the "criteria set out in [..] Annex 2". When one considers Annex 2, there are two sets of "criteria". The first is the "basic criteria" set out in subparagraphs (a) and (b) of paragraph 1, and the second is the "policy-specific criteria" set out in paragraphs 2 to 13. This understanding is confirmed by the text of paragraph 5 of Annex 2, which refers to the "basic criteria" and the "specific criteria". Thus, Articles 6.1 and 7.1 of the *Agreement on Agriculture* refer to the basic and policy specific criteria set out in Annex 2.

15. The European Communities has already set out its understanding of the term "accordingly" in its Third Party Written Submission.[7] In the European Communities view, the term "accordingly" is

[7] First Third Party Submission of the European Communities, 15 July 2003, para. 20. The European Communities recall, in this context, the opinion of Professor Desta set out in footnote 19 to para. 20.

intended to link the purposive language of the first sentence, with the "basic criteria" set out in the second sentence. In its Third Party Submission the EC offered a dictionary definition, "in accordance with the logical premises" which showed that the word "accordingly" operates as a linkage between the premise or understanding set out in the first sentence and the operative language in the second sentence. Australia offers the Panel another definition: "harmoniously" or "agreeably", but fails to note that that the Oxford English Dictionary considers this usage of the word "accordingly" obsolete.[8]

16. The European Communities would point out that both the French and Spanish text support the view that the use of the word "accordingly" links the general statement in the first sentence with the specific obligations of the second sentence. The French text uses the term "en conséquence" and the Spanish the term "por consiguiente". Both of these terms show that the criteria in the second sentence are intended to express the principle set out in the first sentence. Moreover, had the negotiators intended that the first sentence be a self-standing obligation, rather than use the term "accordingly" they would have used the term "additionally" or "in addition", or a synonymous term.

17. Further support for this view can be found in the frequent use of the term "accordingly" in the WTO Agreement. A survey of the term's use suggests that it links a general statement, often recognising that a particular situation causes specific effects, with a right or obligation to take some type of action set out in an ancillary sentence.[9] These general statements are not such as to impose specific obligations. The Appellate Body had occasion to consider the relationship between such provisions in the *Turkey-Textiles* dispute (Articles XXIV.4 and XXIV.5 GATT). It concluded:

> The chapeau of paragraph 5 of Article XXIV begins with the word "accordingly", which can only be read to refer to paragraph 4 of Article XXIV, which immediately precedes the chapeau.
>
> [..]
>
> 57. According to paragraph 4, the purpose of a customs union is "to facilitate trade" between the constituent members and "not to raise barriers to the trade" with third countries. This objective demands that a balance be struck by the constituent members of a customs union. A customs union should facilitate trade within the customs union, but it should *not* do so in a way that raises barriers to trade with third countries. [..] Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV. Thus, the purpose set forth in paragraph 4 informs the other relevant paragraphs of Article XXIV, including the chapeau of paragraph 5. For this reason, the chapeau of paragraph 5, and the conditions set forth therein for establishing the availability of a defence under Article XXIV, must be interpreted in the light of the purpose of customs unions set forth in

[8] Australia's Oral Statement, para 35. Oxford English Dictionary, p. 15. Australia refers to the first sense of the word "accordingly" which is preceded by the symbol "=" which indicates that a particular usage is obsolete (see Abbreviations and Symbols, page xxvi).

[9] See Articles II.6(a), III.9, XII.3(d), XVI.3, XVIIII.5, XXIV.5 GATT 1994, together with Ad Article III and Ad Article XXVIII.4 to GATT 1994, Articles 2.1 and 11 of the Dispute Settlement Understanding, Article A(i) of the Trade Policy Review Mechanism, Article 12.8 of the Agreement on Technical Barriers to Trade, Article 1 of the GATS Annex on Telecommunications and Article 5.1 of the Agreement on Textiles and Clothes.

> paragraph 4. The chapeau cannot be interpreted correctly without constant reference to this purpose.[10] (emphasis added)

18. The Appellate Body has, consequently, recognised the linking function of the word "accordingly", and the fact that provisions which may be linked to later provisions through the use of the word "accordingly" may not impose separate obligations.

19. The European Communities would also point out that the Appellate Body has found that other provisions (e.g. Article III.1 GATT) which contain general principles are set up as "a guide to understanding and interpreting the specific obligations contained" in other provisions (e.g. Article III.2 and the other paragraphs of Article III).[11] Such provisions do not, however, impose additional obligations supplemental to the specific obligations, unless expressly stated.[12]

20. The Panel may find it useful to refer to the European Communities' response to a question posed by Australia (see question no. 44 in this document). In its response, the European Communities deals with Australia's unfounded assertion that the European Communities' reading of the first sentence of paragraph 1 would render that provision ineffective.

**Q7 Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the *Agreement on Agriculture*. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

21. The phrase "the fundamental requirement" signals the negotiators intent to treat differently measures which are less or not at all distortive to trade or production and sets forth the general purpose of Annex 2; a purpose which permeates the rest of Annex 2. Considering the term in the abstract does not answer the question whether a panel must examine the effects of measures for which green box status is claimed in addition to examining whether such measures respect the basic and policy-specific criteria set out in Annex 2, or whether respecting the basic and policy-specific criteria is such that a measure is deemed not to have the effects mentioned in the first sentence. As the European Communities has explained, there are compelling textual and purpose based arguments which support the latter interpretation.

**Q8. In your oral statement, you emphasize the use of the word "criteria" in other parts of the *Agreement on Agriculture*, as distinct from the reference to "fundamental requirement" in the first sentence of paragraph 1 of Annex 2. Is it the case that sub-paragraphs (a) and (b) of paragraph 1 of Annex 2 are also "criteria"? EC**

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[10] Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products ("Turkey – Textiles")*, WT/DS34/AB/R, adopted 19 November 1999, paras. 56 and 57 (emphasis added). Note that the Panel also found that Article XXIV.4 was "not expressed as an obligation" (Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products ("Turkey – Textiles")*, WT/DS34/R, adopted 19 November 1999, as modified by the Appellate Body Report, WT/DS34/AB/R, para. 9.126).

[11] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages")*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 17.

[12] See Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas ("European Communities – Bananas")*, WT/DS27/AB/R, adopted 25 September 1997, paras. 214-216 holding that the absence of a specific reference to Article III.1 GATT in Article III.4 GATT meant that an examination of the consistency of a measure with Article III.4 GATT did not require, in addition, an examination of the consistency of the measure with Article III.1 GATT.

Answer

22. Yes. The second sentence of paragraph 1 refers to sub-paragraphs (a) and (b) as "basic criteria". Paragraph 5 refers to the same "basic criteria". The European Communities considers that the "criteria" referred to in Articles 6.1 and 7.1 of the *Agreement on Agriculture* (mentioned in question 6 above) refer to both the basic criteria set out in the second sentence of paragraph 1 and the policy-specific criteria set out in paragraphs 2 to 13 of Annex 2.

**Q9. If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation, does this allow effects-based claims of non-compliance with Annex 2? If so, how does this affect the purpose of Article 13(b)? 3rd parties' in particular Australia, Argentina, Canada, EC, NZ**

Answer

23. The implication of finding that the first sentence of paragraph 1 is a stand-alone obligation is that an effects test would become applicable to assessing compliance with Annex 2. The result of such an interpretation is two fold. First, as the Panel implies, another WTO Member could bring a WTO dispute alleging that because of its effects a measure does not comply with Annex 2. Second, WTO Members, when designing measures intended to conform to Annex 2, will be required to attempt to identify the effects of such measures. Such a task is often only feasible on an *ex post facto* basis. The correct classification of measures is a vital element for a Member to ensure that it respects it domestic support ceilings. Requiring a Member to measure effects diminishes the ability of a Member to ensure correct classification. Such an interpretation should, therefore, be avoided.[13]

24. It is rather remarkable, had the drafters intended that the first sentence of paragraph 1 be a self-standing obligation, that no indication of how such effects are to be measured was included in the *Agreement on Agriculture*. It is far from obvious how the effects of a measure on production and/or trade is to be measured. Nor is it clear how it can be decided that a particular effect can be considered as going beyond "minimal". This can be contrasted with Article 6.3 of the *SCM Agreement* where the negotiators set out with some precision certain criteria deemed to cause serious prejudice to the interests of another Member. This leads to the inevitable conclusion that the criteria by which a Member or a panel is required to determine whether a measure has more than minimal trade or production distorting effects are the basic and policy specific criteria set out in Annex 2.

25. Article 13(b) is one element of a complex series of arrangements intended to provide legal security and certainty to Members who have embarked on a process of agricultural reform. It is designed to ensure that a Member may design its domestic support measures in such a way as to ensure that they do not provide support in excess of that decided in 1992 in order that it be exempted from the actions listed in Article 13(b). This requires a Member to be able to classify its measures as green box, other exempt policies, or as amber box. Only by being sure of its classification can a Member ensure that it maintains the protection provided by Article 13(b). This is one reason why the criteria for treatment as green box, or as another exempt measure, are so precisely defined. (Other exempt measures are precisely defined in Articles 6.4 and 6.4 of the *Agreement on Agriculture*). Consequently, bringing an effects test into an analysis of green box compatibility would make it very difficult for a Member to be sure that it remains within the level of support decided in 1992 and would therefore render nugatory the security and predictability necessary to permit the process of agricultural reform initiated by the Agreement on Agriculture.

**Q10. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in**

[13] See, in this sense, First Third Party Submission of the European Communities, para. 24.

**Annex 2 be classified as non-Green Box? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

26. The European Communities is not convinced that "non- or minimally trade-distorting measures" might exist which would not be covered by Annex 2. Annex 2 has at least two paragraphs which are designed as "catch–all" provisions. Paragraph 2 of Annex 2 acts as a "catch-all" for general service programmes not involving direct payments to producers or processors.[14] Paragraph 5 acts as a "catch-all" for all direct payments.[15] Moreover, Annex 2 is designed to cover all domestic support measures which are deemed to have no or at least minimal trade-distorting effects. Consequently, it would seem surprising if a non- or minimally trade-distortive measure would not meet the criteria of Annex 2.

27. In the hypothesis that a measure which had no or minimal trade-distorting effects did not conform to the criteria in Annex 2 the European Communities would conclude that it could not be considered as Green Box support. As the European Communities explained in its Third Party Submission, rather than defining those domestic support measures which were to be subject to reduction commitments, the negotiators of the *Agreement on Agriculture* chose to define all those measures which were not to be subject to reduction commitments – hence Annex 2.[16] Such a result does not run counter to the objectives of the *Agreement on Agriculture* since it ensures the security and predictability of the reform process.

**Q11 If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. 3rd parties, in particular, Australia, Argentina, Canada, EC, NZ**

Answer

28. The European Communities considers that the first sentence of paragraph 1 of Annex 2 sets out the general purpose of Annex 2 and therefore informs the interpretation of the criteria in Annex 2. It is relevant to the interpretation of paragraph 6 in that it should be considered to be part of the context of paragraph 6. Nevertheless, while the first paragraph informs the interpretation of paragraph 6 it cannot detract from the words actually used in paragraph 6.[17] As the Panel considers its interpretation of the words used in paragraph 6, it can take account of the purposive language of the first sentence of paragraph 1.

29. There are two issues which the Panel must resolve with respect to direct payments – the reduction of payments where certain crops are grown and the updating of base periods.

[14] The third sentence of paragraph 2 reads "[S]uch programmes, which include but are not restricted to the following list, shall meet the general criteria in paragraph 1 above and policy-specific conditions where set out below [..]".

[15] The second sentence of paragraph 5 reads "[w]here exemption from reduction is claimed for any existing or new type of direct payment other than those specified in paragraphs 6 through 13, it shall conform to criteria (b) through (e) in paragraph 6, in addition to the general criteria set out in paragraph 1."

[16] First Third party Submission, paras. 19 & 20. Obviously, some other exempted support measures are defined in Article 6 of the *Agreement on Agriculture*.

[17] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages")*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p.17.

30. With respect to the former, the European Communities has already explained why it considers that reducing payments upon growing certain crops cannot be considered to base payments on a type of production (see also the EC's response to Panel question 5 above). The European Communities position is supported not only by the text of paragraph 6(b) but also by an interpretation informed by the first sentence of paragraph 1. Permitting such a reduction of payments does not distort trade – it minimises any distortion which may be caused by any decoupled payments in markets which were historically undistorted by subsidies. It ensures that the equilibrium established by the market in the relevant product is maintained. To the extent decoupled support can be seen as having an effect on trade or production by providing support to farmers who produce some crops, the reduction in payment prevents subsidised farmers from potentially upsetting the market equilibrium, and thus serves to prevent effects on trade or production in the market for crops for which payment is reduced. Seen the other way, not ensuring such a reduction would allow subsidised farmers to grow the relevant crops and thus upset the historical market equilibrium with potential effects on trade and production. In the light of the first sentence of paragraph 1, the only possible application of Article 6(b) to payment reductions imposed where certain crops are grown is to find that such reductions are not such as to make the payment based on a type of production.

31. The situation is rather different with respect to the updating of base periods. The European Communities considers that where farmers know that base periods will be updated, and that the production of certain crops will give them a greater entitlement to support in a later period, there will be a production distorting effect. Such updating is clearly inconsistent with notions set out in the first sentence of paragraph 1 since knowledge of such updating will incite farmers to produce more of certain crops which qualify for support and thus will have effects on production.

**Q12. Where does Article 13(b) require a year-on-year comparison? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

32. The European Communities does not consider that Article 13(b) requires a year-on-year comparison. It permits such a year-on-year comparison and given that support is generally expressed in annual amounts, appears a reasonable basis for making such a comparison. In considering this issue, the Panel must compare two elements. The first is the domestic support measure challenged. The second is, at least for Article 13(b)(ii), support "decided" in an earlier period.

33. We examine first the domestic support measure challenged. In order to benefit from the protection of Article 13 a measure must conform to the provisions of Article 6 and must "not grant support" in excess of that decided in during the 1992 marketing year. The European Communities interprets the present tense of "not grant support" as requiring the Panel to determine the support at the time the measure is challenged when Panel is asked to determine whether Article 13 is applicable. Inevitably, such a determination requires that the Panel consider a specific period, which is comparable with an earlier period. The European Communities considers that the Panel has some discretion in choosing a specific period, although it is clear it must be as close as possible to the time of the dispute. However, since the Panel must consider the support granted it must choose a period for which data is complete. Given Article 1(i) of the *Agreement on Agriculture*, the period chosen may well be based on the calendar, financial or marketing year of the Member complained against.

34. In respect of support "decided", the Panel must consider the nature of the support decided during the 1992 marketing year. As the European Communities has explained at length elsewhere, the relevant element for comparison is not the support actually granted for the 1992 marketing year – rather it is the support decided. Consequently, in each case, the element for comparison must depend on the decision made during the 1992 marketing year. As a function of that decision, the Panel will

have to choose a period which is comparable with the most recent period. This may well be a marketing year, but need not be so.

**Q13. Does a failure by a Member to comply in a given *year* with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

35. Failure to comply with Article 6 of the *Agreement on Agriculture* or granting support in excess of that decided in 1992 in a given year does not impact a Member's entitlement to benefit from the protection of Article 13(b) in a later (or earlier) year, provided that the Member concerned complies with Article 6 of the *Agreement on Agriculture* and does not grant support at present in excess of that decided during marketing year 1992. This is clear from the present tense of "do not grant support" which makes it clear that the comparison must be with the support granted in the most recent period.

**Q14. Does a failure of a Member to comply with Article 13(b) in respect of a *specific commodity* impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

36. No. A failure to maintain support granted within the level decided during marketing year 1992 in respect of a specific commodity would not affect the availability of Article 13(b) in respect of other commodities, provided that support granted to that specific commodity was not in excess of that decided during 1992.

**Q15. Is there any basis on which counter-cyclical payments could be considered product-specific? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

37. The European Communities considers that, since counter-cyclical payments are paid as a function of fluctuations in the price of different commodities with respect to target prices also specified by commodity, they should be considered product specific.

**Q16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? 3RD parties, in particular Australia, Argentina, Benin Canada, China, EC, NZ**

Answer

38. Yes. Article 13(b)(ii) refers to product specific support. It does not refer to all support which may be attributed to a product. The use of the word "specific" has meaning, because it makes it clear that the support in question is that granted or decided in respect of a specific product, rather than that granted or decided in respect of all products and which could arguably be attributed to a product.

**Q17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement* to the meaning of "support to a specific commodity" in Article 13(b)(ii)**

***Agreement on Agriculture*? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

39. The European Communities is not convinced that the drafters of the *Agreement on Agriculture* had Article 2 of the *SCM Agreement* in mind when drafting Article 13(b) of the *Agreement on Agriculture*. It may comment further depending on the views of the other third parties on this issue.

40. The European Communities has already referred to the relevance of the references to " a product" and a "subsidised product" in its Oral Statement.[18]

**Q18. Benin's oral statement considers the phrase "support to a specific commodity" in Article 13(b)(ii) of the *Agreement on Agriculture*. How does Benin believe that phrase is best interpreted. Please substantiate your response, commenting on other submissions by parties and third parties as you believe appropriate. Benin**

Answer

41. The European Communities may comment, as necessary, on Benin's response.

**Q19. Where does Article 13(b)(ii) require a year-on-year comparison? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

42. See the answer to question 12 above.

**Q20. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?**

**Answer**

43. Yes. See the answer to question 22 below.

**Q21. Please comment on Brazil's assertion that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Answer

44. As the European Communities has explained elsewhere, the use of the term "decided" is crucial to an understanding of Article 13(b). It is now established that a panel is obliged to use the normal rules of interpretation of international law as codified in the Vienna Convention on the Law of Treaties. This requires it to look, in the first place, to the ordinary meaning of the words. "Granted" does not mean the same as "decided".

45. Granted is the past tense of the verb "grant" which means "to give or confer, (a possession, a right etc) formally; transfer (property) legally".[19] "Decided" is the past tense of the verb "decide"

[18] EC Oral Statement, 24 July 2003, para. 23.
[19] The New Shorter Oxford English Dictionary, 1993, p. 1131.

which means "come to a determination or resolution *that, to do, whether*".[20] Thus, in this context, "granted" refers to support which has been provided, to which a farmer (or all eligible farmers in a Member) has obtained a right. "Decided" implies that a political authority (be it a legislature or a government department or agency) has determined that a particular crop is to be entitled to a particular type of assistance.

46. The European Communities believes that the use of the term "decided", as opposed to "granted" and "provided" (which are used elsewhere in the *Agreement on Agriculture*) is very deliberate. Article 13(b) is designed to protect support which was "decided" during 1992. It was negotiated in November 1992 as part of the first Blair House Agreement and later multilateralised.[21] In November 1992, the negotiators could not have known the support granted for the marketing year 1992, which was of course running during that period. They did not, therefore, intend to refer to the support granted when using the term "decided". Rather, they were referring to decisions taken during 1992 in respect of support which WTO Members intended to grant – not that actually granted.

**Q22. What is the meaning of "support" in *Agreement on Agriculture* 13(b)(ii) ? Why would it be used differently from Annex 3, where it refers to total outlays? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Answer

47. With respect, the European Communities does not consider that support is equated in Annex 3 to total outlays. Annex 3 provides methodologies for calculating the Aggregate Measure of Support (AMS). Article 1(a) defines the AMS as "the annual level of support, expressed in monetary terms […]". However, AMS is not necessarily calculated in terms of budgetary outlays. For instance, market price support is calculated "using the gap between a fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price. Budgetary payments made to maintain this gap […] shall not be included in the AMS." (Annex 3, para. 8) Similarly, non-exempt payments dependent on a price gap are to be calculated "either using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, or using budgetary outlays" (Annex 3, para. 10). This makes it clear that AMS need not be calculated in terms of total outlays.

48. The European Communities considers the term "support" in Article 13(b)(ii) must be considered from several perspectives. First, it is clear that the word "support" refers to the support granted in a recent period. Second, and at the same time, the word "that" used in the phrase "that decided" is also a reference to the word "support". However, as already noted, there is crucial distinction in this comparison between the "support decided" and the "support granted". The support decided does not equal the support actually granted during marketing year 1992. For the later period, there is no reason that the support granted should not be calculated on the basis of the AMS methodology set out in Annex 3. Indeed, Article 1(a) of the *Agreement on Agriculture* refers to AMS as "the annual level of support" (emphasis added).

49. For the support decided AMS-like criteria should be used. This would take into account the reference to AMS as the annual level of support, but would also recognise that Article 13(b)(ii) refers to the support "decided" rather than granted. Crucially, the support decided must be considered as that which it was decided to provide during the 1992 marketing year. This must be determined on a case-by-case basis. It should be determined on the basis of the information available to the decision

[20] The New Shorter Oxford English Dictionary, 1993, p. 607. Italics in the original.

[21] The main change made in the second Blair House Agreement, in respect of Article 13(b) was the extension of the implementation period for the purposes of the Article 13(b).

makers. It may be that only a certain amount of production would be eligible,[22] or that the decision makers had production estimates at their disposal, and thus knew the extent of the support that was being decided. Alternatively, the amount of support decided could also be determined from budgetary acts, preparing expenditure for future years, in which the decision making authorities would have knowledge of the support they wished to grant, and the quantity of production which would likely enjoy such support. Using such a basis, it would be possible to use AMS-like criteria. AMS-like criteria can be used because it will often be possible to establish, for certain measures, a gap between the applied administered price and the internal or external fixed reference price[23] and establish, on the basis of information available to the decision makers, the amount of production which was eligible, or which was estimated. For other measures, it may also be possible to use appropriation or budgetary decisions.

**Q23. Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Answer

50. The European Communities considers that the Panel should use AMS for the most recent period, and an AMS - like calculation for calculating the support decided during the 1992 marketing year, as explained in our response to question 22.

**Q24. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) of the *Agreement on Agriculture* and, in particular, why the words "grant" and "decided" were used. EC**

Answer

51. As the European Communities has noted above, the current text of Article 13(b)(ii) formed part of the first Blair House Agreement of November 1992. We have annexed the text which resulted from these negotiations[24], together with the relevant sections of the "Dunkel Draft", which were replaced by Article 13(b)(ii).[25]

52. The European Communities also considers that it may assist the Panel to have a copy of some of the key decisions reforming the EC's Common Agricultural Policy adopted during 1992. Thus, we have annexed Council Regulation (EC) No. 1766/92 on the common organisation of the market in cereals and Council Regulation (EC) No. 1765/92 establishing a system of compensatory payments.[26]

**Q25. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Answer

53. The European Communities finds some merit in such an interpretation. It would be consistent with the careful choice of the negotiators to use the word "decided" rather than the term "granted" or

[22] For instance, because of quotas on eligible production or definitive budgetary ceilings.
[23] See para. 9 & 11 of Annex 3.
[24] Exhibit EC-1.
[25] Exhibit EC-2.
[26] Council Regulation (EC) No. 1766/92 on the common organisation of the market in cereals (Exhibit EC-3) and Council Regulation (EC) No. 1765/92 (Exhibit EC-4).

"provided". The European Communities is concerned, however, that the term "authorised" is more restrictive than the term "decided". For that reason, while the European Communities sees support for the interpretation that "decided during" is synonymous with "authorised during", it is not clear to the European Communities that "authorised" has exactly the same meaning as "decided".

**Q26. Under Article 13(b)(ii), a comparison is required between support at different times. One of the issues which is contested between the parties is whether the only later period that the Panel can consider is the present one (i.e. the period underway at the time of the request for establishment of the Panel). This argument is based on the present tense of the words "do not grant" in the English text. The Panel asks whether there is any difference in the verb tense as used in the Spanish-language text, or any other difference which might aid the Panel in interpreting these words? Argentina, EC, Paraguay, Venezuela**

Answer

54. The European Communities notes that both the French and Spanish text also use the present tense.

**Q27. If the 1992 "decision" led to or was the funding source for the money provided in 1992 and later years, is it the full amount of all that funding that constitutes the "support" decided in 1992? If the answer to this question is that it is the full amount of all the support provided pursuant to the "decision" that must be taken into account, must this be compared with the total amount of support that will or might flow from the decision made in the more recent period for the purposes of the comparison required under Article 13(b)(ii)? If a Member did not make a "decision" (however that may be interpreted) in 1992 about "support", is it the case that the Member has a zero base for the purposes of the comparison required under Article 13(b)(ii)? EC**

Answer

55. The European Communities does not consider that it is the full amount of support decided in 1992 for later years that should be taken into account. Such an approach might not be feasible where the decision taken in 1992 was an open-ended one. This approach also sits uneasily with the practice in the *Agreement on Agriculture* of expressing support on an annual basis. Since the regulation of agricultural production takes place on a yearly basis, it seems unlikely that a decision would be taken setting a maximum amount for a number of years without regulating how such support would be allocated between specific years.

56. The European Communities considers that the Panel should use a level of support readily comparable with the support currently granted. This may well be the support decided for a particular marketing year. If a decision was made in 1992 for future years, it would be to ignore the drafters intent to rule out the possibility that the support decided for later years is the relevant support.

57. The European Communities does not consider that it will ever be the case that a Member which provides subsidies can be said never to have made a decision in 1992 which would qualify under Article 13(b). At the very least, a Member would have decided, on the basis of its subsidy programmes, and the amount of eligible production and/or estimated production, to set aside a specific amount of budgetary appropriations for future years. If, however, a Member decided not to provide support to a specific commodity, the level of support for purposes of the comparison would be zero.

**Q28. In paragraph 13 of Australia's oral statement, you state that a "question" is: "could conditions of price competition for the purposes of a non-violation or impairment claim be**

**assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole." Could you please clarify this statement (indicating other elements which would complete the "whole" and explain its relevance for the purposes of our consideration of Article 13 of the *Agreement on Agriculture*? Australia, EC**

Answer

58. The European Communities would prefer to let Australia clarify its statement. The European Communities will comment upon Australia's clarification in its comments on the responses of the other third parties.

## III. EXPORT CREDIT GUARANTEE PROGRAMMES

**Q29. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

59. Export credits may involve the provision of "loans". Export credit guarantees, like other types of guarantees, normally involve an obligation to cover losses resulting from defaults on guaranteed loans. If provided by a government, they may involve a "financial contribution" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*.

**(b) How, if at all, would this be relevant to the claims of Brazil? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

60. Whether or not export credit guarantees are "financial contributions" is directly relevant to Brazil's claim that GSM 102, GSM 103 and SCGP constitute "export subsidies" within the meaning of Article 3.1 (a) of the *SCM Agreement*.

61. It is also relevant, by way of context, for Brazil's claim that those programmes are "export subsidies" for the purposes of Article 10.1 of the *Agreement on Agriculture*.

**Q30. The Panel could arguably take the view that Articles 1 and 3 of the *SCM Agreement* were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an *a contrario* interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission). 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

62. The relationship between the Illustrative List and Article 3.1(a) is addressed specifically by footnote 5, which provides that

> Measures referred to in Annex I as not constituting export subsides shall not be prohibited under this or any other provision of the Agreement.

63. In this regard, the European Communities recalls the reasoning followed by the panels in *Brazil –Aircraft (21.5) I* and *II*[27], which concluded that the first paragraph of item (k) of the Illustrative List does not provide *a contrario* an "affirmative defence".

64. As noted by the panel in *Brazil –Aircraft (21.5) – II*, the Appellate Body's statement relied upon by the United States "does not form part of the legal basis for its disposition of the appeal, nor did the Appellate Body explain its statement".[28]

65. Item (j) of the illustrative list describes circumstances in which, *inter alia*, export credit guarantee programmes may constitute export subsidies. In certain circumstances (e.g. where the Government is the only provider), it may be that the requirement set out in item (j) – that export credit guarantees must not be provided at premium rates which are inadequate to cover the long-term operating costs and losses of the programme – represents the appropriate benchmark for determining that an export subsidy does not exist.

**Q31. If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance in the interpretation of the terms in Article 10 *Agreement on Agriculture*, should the Panel refer to item (j) or Articles 1 and 3 of the *SCM Agreement* or both? . 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

66. Both.

**Q32. The Panel's attention has been drawn to Article 14(c) of the *SCM Agreement* (see third party submission of Canada) and to the panel report in DS 222 *Canada- Export Credits and Loan Guarantees*. How and to what extent are Article 14(c) of the *SCM Agreement,* and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material. . 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

67. The European Communities agrees that Article 14(c) may be relevant context for the interpretation of Article 1.1(b) of the *SCM Agreement*, where the subsidy consists of a loan guarantee. However, Article 14(c) may not be applicable if the government is the only supplier of a certain type of service and no comparable type is provided by other suppliers. In that case it may be necessary to resort to alternative benchmarks, such as the one set out in item (j) of the Illustrative List. This would depend on the particular circumstances of the case.

**Q33 What is the relevance (if any) of Brazil's statement that : "...export credit guarantees for exports of agricultural exports [*sic*] are not available on the marketplace by commercial lenders." . 3rd parties, in particular, Argentina, Canada, EC, NZ**

[27] Panel report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS64/RW, ("Brazil – Aircraft (21.5) – I"), paras. 6.24-6.67; Panel report, *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW/2, (Brazil – Aircraft (21.5) - II, paras5.269-5.275.

[28] Panel report, *Brazil –Aircraft (21.5) – II*, footnote 214.

Answer

68. The European Communities does not agree with the proposition that the provision by a government of finance not available from other suppliers confers *per se* a benefit. The European Communities recalls that the Panel in *Canada – Export Credits and Loan Guarantees* left open this issue.[29]

**Q34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

69. The European Communities does not express an opinion on this question at this time.

**Q35. Did the drafters of the *Agreement on Agriculture* include export credit guarantees in Article 9.1 of the *Agreement on Agriculture*? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

70. Export credit guarantees are not included in Article 9.1. Article 9.1 represents a list of export subsidies which were permitted to be maintained, but which were made subject to reduction commitments. Article 9.1 is a list of permitted export subsidies negotiated by the drafters of the *Agreement on Agriculture*. All other export subsides are regulated by Article 10.1.

**Q36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38) 3rd parties, in particular, Argentina, Canada, EC, NZ**

**(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

**(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

**(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

[29] Panel report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, para. 7.341.

Answer

71. At this stage, the European Communities does not comment on the factual aspects of this claim.

**Q37. The United States seems to argue that, at present, by virtue of Article 10.2 of the *Agreement on Agriculture*, there are *no* disciplines on agricultural export credit guarantees under the *Agreement on Agriculture* (or the *SCM Agreement)*.**

**(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the *Agreement on Agriculture* ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the *Agreement on Agriculture*? Please cite any relevant material, including any past WTO dispute settlement cases. 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

72. The European Communities considers that it is only the operation of export credit guarantees as export subsidies which is regulated by the *Agreement on Agriculture*. Other elements of the provision of export credit guarantees are not regulated by the *Agreement on Agriculture*. To the extent that the scenario developed by the Panel would lead to the provision of export subsidies which circumvent, or which threaten to circumvent, a Member's export subsidy commitments the European Communities considers that it cannot be reconciled with Article 10.1 of the *Agreement on Agriculture*.

**(b) If, as the United States argues, there are no disciplines on export credit guarantees in the *Agreement on Agriculture*, how could export credit guarantees "conform fully to the provisions of Part V" of the *Agreement on Agriculture* within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Answer

73. The European Communities disagrees with the US argument that there are no disciplines on export credit guarantees. The discipline applying to export credit guarantees, where they operate as export subsidies, is that they should not be provided in a manner inconsistent with Article 10.1. If they are provided inconsistently with Article 10.1 then they are not protected by Article 13

## IV. STEP 2 PAYMENTS

**Q38. Please comment on the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in *Canada-Dairy* and the findings of the Appellate Body in *US-FSC***

***(21.5)*[30], do any other dispute settlement reports offer guidance on this issue? For example, how, if at all is the Appellate Body's report in *Canada-Aircraft* relevant here?[31] . 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

Answer

74. This is a question of fact on which the European Communities takes no position. It will comment, as necessary, on the replies of the other third parties.

**Q39. Please comment on the United States assertions at paragraph 129 of its first written submission, that "[t]he programme is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States." . 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

Answer

75. This is a statement of fact on which the European Communities offers no comment at present. The European Communities will comment further depending on the replies of other third parties.

**Q40. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the *AoA*? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the *SCM Agreement* and Article III:4 of the GATT 1994.. 3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay**

Answer

76. The Panel's question involves two elements. First, is a Member entitled to provide domestic content subsidies under the *Agreement on Agriculture*? Second, if such subsidies are permitted, what is the relevance of such a rule to Brazil's claims under Article 3 of the *SCM Agreement* and

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[30] [Original footnote to question] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.[30] Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

[31] There, the Appellate Body stated that,

> "the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies contingent ... in fact … upon export performance".[31]

Article III.4 GATT. The European Communities has already provided elements of a response in its oral statement.[32] These are expanded upon below.

77. First, a Member is entitled to provide domestic content subsidies under the *Agreement on Agriculture* provided such subsidies are provided consistently with the Member's domestic support commitment levels. This conclusion flows from a number of factors. First, the *Agreement on Agriculture* disciplines domestic support. Article 6.1 refers to "domestic support reduction commitments". Article 3.1 refers to "domestic support [..] commitments […] constitut[ing] commitments limiting subsidization" and Article 3.2 obliges Members "not [to] provide support in favour of domestic producers in excess of the [domestic] support commitment levels". Despite these clear rules on domestic support, the *Agreement on Agriculture* does not define "domestic support".

78. AMS is the measurement of domestic support. AMS is defined as "the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general, other than [that exempted etc]." This is very general – it covers all support in favour of agricultural producers. This broad scope of domestic support measures which can be maintained consistently with the *Agreement on Agriculture* is confirmed by Article 6.1 which states that the domestic support reduction commitments "shall apply to all of its [i.e. the Member's] domestic support measures in favour of agricultural producers […]". Paragraph 1 of Annex 3 on the calculation of the AMS refers to AMS being calculated "on a product specific-basis for each basic agricultural product receiving market prices support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment". (emphasis added)

79. Consequently, the range of domestic support measures which a Member may maintain (consistent with reduction commitments) is very broad and is only limited by the condition that such support must be in favour of agricultural producers. As the European Communities has noted, paragraph 7 of Annex 3 explicitly states that "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products".[33] The European Communities considers that the term "benefit" used here must be regarded as being synonymous with "favour" in the sense of "in favour of agricultural producers". Moreover, it is clear that by "measures directed at agricultural processors" the negotiators intended subsidies which were paid to processors, where the benefit went to the agricultural producer. Consequently, in light of the broad definition of "domestic support" and the specific reference to domestic content subsidies in paragraph 7 of Annex 3, the European Communities considers that a Member is entitled to maintain domestic content subsidies consistently with the *Agreement on Agriculture*.

80. Second, in response to the Panel's question, the effect of finding that domestic content subsidies are provided consistently with the *Agreement on Agriculture* would be that they cannot be found inconsistent with either Article 3.1(b) of the *SCM Agreement* or Article III.4 GATT 1994. Article 21.1 of the *Agreement on Agriculture* states that "the provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the

[32] Paras. 34 to 38 of the EC's Oral Statement (as delivered). The Panel's reference to para. 32 corresponds to the text provided at the third party session.

[33] In terms of negotiating background, it may be useful to the Panel to note that paragraph 7 of Annex 3 was subject to negotiation during the period in which a Panel had ruled that the EC's payments to oilseed processors was not covered by Article III.8(b) GATT 1947 and were consequently inconsistent with Article III.4 GATT 1947 (*European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* Report of the Panel (L/6627 BISD 37S/86) adopted on 25 January 1990. That the negotiators retained this text must therefore be considered as a clear sign that they intended to permit Members to maintain such subsidies, subject to reduction commitments, in the *Agreement on Agriculture*.

provisions of this Agreement." As the European Communities pointed out in its oral statement, this means that provisions of the other Annex 1A Agreements are "subordinated" to the *Agreement on Agriculture*.[34]

81. To find that such subsidies were inconsistent with either Article 3.1(b) of the *SCM Agreement* or Article III.4 GATT would be to subordinate the right to provide such domestic content subsidies under the *Agreement on Agriculture* to the *SCM Agreement* or GATT 1994. Such an interpretation directly contradicts Article 21.1 of the *Agreement on Agriculture*.

82. Indeed, it can be pointed out that applying Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT to domestic content subsidies provided consistently with the *Agreement on Agriculture* would lead to stricter disciplines being applied to domestic subsidies for agriculture than are applicable to domestic subsidies for industrial goods. If Article 3.1(b) and Article III.4 were to apply, domestic subsidies for agricultural products would be subject to reduction commitments and Article 3.1(b) *SCM Agreement* and Article III.4 GATT. However, domestic subsidies for industrial products are not subject to reduction commitments. Since the *Agreement on Agriculture* establishes "a basis for initiating a process of reform of trade in agriculture", it would seem contradictory to find that domestic support for agriculture is in fact subject to stricter obligations than domestic support for other industries. This explains the "subject to" language of Article 21.1 of the *Agreement on Agriculture*. Article 21.1 and the *Agreement on Agriculture* more generally can also be compared with the other sectoral agreement included in Annex 1A of the WTO Agreement. The *Agreement on Textiles and Clothing* explicitly provides, in its Article 9, that the textiles and clothing sector is to be fully integrated into the GATT 1994. The *Agreement on Agriculture* has no such language, and Article 21.1 runs directly counter to this notion. It cannot be lightly assumed that the negotiators, while providing for the possibility to maintain domestic content subsidies, intended that such subsidies also be subject to rules which effectively makes it impossible to maintain such subsidies.[35]

83. The Panel should therefore reject Brazil's arguments that domestic content subsidies granted in favour of agricultural producers can be found to be inconsistent with Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT 1994.

## V. ETI ACT

**Q41. Concerning its claims on the ETI Act, Brazil relies on the *US – FSC* case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Argentina, China, EC, NZ**

Answer

84. The European Communities does not consider that either the Peace Clause or Article 6 of the *Agreement on Agriculture* is relevant. The ETI Act provides export subsidies.[36] Article 6 of the *Agreement on Agriculture* does not apply to export subsidies, and therefore the US would not have been in a position to invoke it.

[34] Oral Statement, para. 38.

[35] See, in a similar sense, Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 165.

[36] The Appellate Body confirmed the panel's findings of a violation of Article 3.1(a) of the SCM Agreement see Article 231.5 Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"* ("United States – FSC (21.5)"), WT/DS108/AB/RW, adopted 29 January 2002, para. 120.

85. The Peace Clause will only apply in respect of export subsidies which "conform fully to the provisions of Part V" of the *Agreement on Agriculture* (Article 13(c)). The Appellate Body upheld the panel's findings that the ETI Act provided export subsidies in violation of Article 10.1 of the *Agreement on Agriculture*.[37] Consequently, the US could not have legitimately maintained that it was entitled to peace clause protection.

**Q42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the *DSU*, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the *DSU*, and please cite any other provisions you consider relevant. Argentina, China, EC, NZ**

Answer

86. Article 17.14 DSU states that an Appellate Body Report shall be "adopted by the DSB and unconditionally accepted by the parties to the dispute". The reference in the EC's oral statement to the phrase "a final resolution to *that* dispute" (emphasis from the Panel) is from the Appellate Body in *United States – Shrimp (21.5)*.[38]

87. In the present case the Panel must decide a preliminary question. It must determine whether the claims brought by Brazil against the ETI Act are in any way different from those which the panel and Appellate Body upheld against the ETI Act in the EC's Recourse to Article 21.5. If Brazil's claims are identical to those upheld against the ETI Act, the European Communities considers that the United States must be considered to have unconditionally accepted the Appellate Body's findings as adopted by the DSB.

88. The Panel may find some assistance in the Appellate Body's findings in *United States – Shrimp (21.5).* In that recourse to Article 21.5, Malaysia attempted to challenge certain aspects of the revised US measure at issue which were identical in the measure which was subject to the original challenge.[39] These aspects had been found by the panel and the Appellate Body to be consistent with the United States' WTO obligations. The Appellate Body found that there was no need for the panel, having determined that this aspect of the measure had not changed, to re-examine the consistency of the measure with the US' WTO obligations.[40]

89. The situation before the Panel is the inverse. Here, the US measure was found to be inconsistent with US' WTO obligations. The European Communities understands that the measure before the Panel in this case and before the panel and the Appellate Body in *United States – FSC (21.5)* is identical. On the assumption that the claims are identical, applying Article 17.14 DSU and the Appellate Body's findings in *United States – Shrimp (21.5)* the United States must be assumed to have unconditionally accepted the findings against the ETI Act.

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[37] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"* ("United States – FSC (21.5)"), WT/DS108/AB/RW, adopted 29 January 2002, para. 196.

[38] Para. 97, Article 21.5 Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.-5 of the DSU by Malaysia* ("United States – Shrimp (21.5)"), WT/DS58/AB/RW, adopted 21 November 2001.

[39] United States – Shrimp (21.5), para. 96.

[40] The Appellate Body made a similar finding with respect to a claim not pursued before a panel. See, Report of the Appellate Body in *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by* India, WT/DS141/AB/RW, adopted on 24 April 2003.

90. The European Communities does not consider it material that the present case concerns a party (Brazil) which was not party to the FSC dispute. Article 17.14 states that a "party to the dispute" must unconditionally accept the findings of the Appellate Body adopted by the DSB. Of the parties before the Panel, the United States is a party to the FSC dispute, and must, therefore, unconditionally accept the Appellate Body's findings in that dispute. This is further reinforced by Articles 3.2 and 3.3 DSU which state that the dispute settlement system must provide security and predictability and promote prompt settlement of disputes. Consequently, given the United States is required to unconditionally accept the findings in the Article 21.5 procedure, the European Communities believes that Brazil, by adopting the EC' claims and the Appellate Body's findings in the FSC dispute, would make a sufficient case to compel the Panel to find that the ETI Act is inconsistent with the US' WTO obligations in this dispute.

## VI. QUESTIONS FROM OTHER THIRD PARTIES ADDRESSED TO THE EUROPEAN COMMUNITIES

### Questions from Australia to the European Communities

**Q43. Would the European Communities please explain why, in its view, the ordinary meaning of the phrase "shall meet the fundamental requirement" as it appears in the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* does not give meaning and effect to all provisions of that agreement.[41]**

Answer

91. The European Communities did not state that the phrase "shall meet the fundamental requirement" does not give meaning and effect to all provisions of that agreement. The question appears to be based on an erroneous characterisation of the EC's position. In paragraph 17 of its First Written Submission the European Communities stated that the first sentence of Annex 2 did not create a free-standing obligation. This view is compelling when an interpreter considers the ordinary meaning of the terms, in their context, and in light of the object and purpose of the provision. The European Communities has explained this in some detail in its answers to the Panel's questions 6-11 and in its previous submissions to the Panel.

**Q44. The European Communities argues that, under the "accepted canons of interpretation of international law", "context and objective" require that the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* be considered to set out an objective.[42] Would the European Communities please explain the legal authorities for its argument, having regard to relevant statements by the Appellate Body, particularly those in *Japan – Alcohol Taxes*.[43]**

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[41] [Original footnote to question] First Third Party Submission by the European Communities, paragraph 17.

[42] [Original footnote to question] Oral Statement by the European Communities, paragraph 25.

[43] [Original footnote to question] In *Japan – Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, pages 11-12, the Appellate Body said:

> Article 31 of the *Vienna Convention* provides that the words of the treaty form the foundation for the interpretive process: "interpretation must be based above all upon the text of the treaty".[…] The provisions of the treaty are to be given their ordinary meaning in their context. […] The object and purpose of the treaty are also to be taken into account in determining the meaning of its provisions.[20] A fundamental tenet of treaty interpretation flowing from the general rule of interpretation set out in Article 31 is the principle of effectiveness …[…] In *[US – Gasoline]*, we noted that "[o]ne of the corollaries of the 'general rule of interpretation' in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility". […]

Answer

92. European Communities understands from Australia's question that Australia considers that the European Communities' interpretation of the first sentence of Paragraph 1 of Annex 2 would deprive the first sentence of effect.

93. Australia's implication is quite erroneous, and built upon an incomplete, examination of the Appellate Body's rulings. The European Communities interpretation does not deprive the first sentence of effect. Stating that the first sentence does not impose a self-standing obligation is not the same as stating that it is deprived of effect. Indeed, the Appellate Body has arrived at exactly the same conclusion with respect to other provisions containing purposive language, similar to that contained in the first sentence of paragraph 1. In *Japan – Alcoholic Beverages* the Appellate Body found:

> Article III:1 articulates a general principle that internal measures should not be applied so as to afford protection to domestic production. This general principle informs the rest of Article III. The purpose of Article III:1 is to establish this general principle as a guide to understanding and interpreting the specific obligations contained in Article III:2 and in the other paragraphs of Article III, while respecting, and not diminishing in any way, the meaning of the words actually used in the texts of those other paragraphs. In short, Article III:1 constitutes part of the context of Article III:2, in the same way that it constitutes part of the context of each of the other paragraphs in Article III. Any other reading of Article III would have the effect of rendering the words of Article III:1 meaningless, thereby violating the fundamental principle of effectiveness in treaty interpretation. Consistent with this principle of effectiveness, and with the textual differences in the two sentences, we believe that Article III:1 informs the first sentence and the second sentence of Article III:2 in different ways.[44] (emphasis added)

94. Moreover, the Appellate Body has also found that Article XXIV.4 GATT , which the Appellate Body qualified as "purposive language", was relevant for the interpretation of Article XXIV.5.[45] Clearly this gave a provision which had no operational effects, an effect, within the meaning of the Appellate Body's statements in *United States – Gasoline*.[46] Similarly, the European Communities has argued that while the first sentence of paragraph 1 does not impose a self standing obligation, it does set out the purpose of Annex 2 which informs the interpretation of other elements of Annex 2. (See the European Communities response to question 11 from the Panel).

**Q45. The European Communities argues that the omission of a reference to the "fundamental requirement" as set out in the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* in paragraphs 5, 6 and 7 of that Annex provides "contextual support" to its argument that the first sentence sets out an objective.[47] Would the European Communities**

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*Footnote 20:* That is, the treaty's "object and purpose" is to be referred to in determining the meaning of the "terms of the treaty" and not as an independent basis for interpretation: …

[44] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages")*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, page 18.

[45] Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products* ("Turkey – Textiles"), WT/DS34/AB/R, adopted 19 November 1999, para. 57.

[46] Appellate Body Report, *United States - Standards for Reformulated and Conventional Gasoline* ("United States – Gasoline"), WT/DS2/AB/R, adopted 20 May 1996, page 23.

[47] [Original footnote to question] First Third Party Submission by the European Communities, paragraph 21.

**please explain the legal authorities for its argument, having regard to its arguments and the Appellate Body's findings in *Argentina – Footwear Safeguard*.[48]**

Answer

95. We refer Australia in part to the European Communities' answer to the previous question where the European Communities has explained that its interpretation of the first sentence of Paragraph 1 does not deprive the provision of effect. Second, the issue in *Argentina – Footwear Safeguards* was whether the panel had given any effect to Article XIX GATT.[49] The panel in that case erroneously concluded that because of the omission of a reference to unforeseen developments in the *Agreement on Safeguards* it need not give effect to this requirement set out in Article XIX GATT. As the European Communities has explained, by interpreting the first sentence of paragraph 1 as setting an objective informing the rest of Annex 2, the Panel would be giving effect to the first sentence.

**Questions from Argentina to the European Communities**

**Q46. In paragraph 18 of its Oral Statement, the European Communities state that Article 13 (b)(ii) and (iii) of the Agreement on Agriculture are clearly "not intended to set up a comparison between domestic support granted in 1992 and domestic support granted in a more recent period" and request the Panel to reject the equation of the term "decided" with the term "granted".**

**What would be, in the opinion of the EC, the appropriate benchmark in a hypothetical case in which a subsidizing Member has taken no decision on internal support during 1992 ?**

Answer

96. We refer Argentina to the European Communities' response to question 27.

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[48] [Original footnote to question] In *Argentina – Safeguard Measures on Imports of Footwear*, Report of the Appellate Body, WT/DS121/AB/R, the European Communities argued (paragraphs 38-44) on appeal, and the Appellate Body found (paragraph 88), that the Panel erred by:

> fail[ing] to give meaning and legal effect to *all* the relevant terms of the *WTO Agreement*, contrary to the principle of effectiveness … in the interpretations of treaties. [...] The Panel states that the '*express omission* of the criterion of unforeseen developments' in Article XIX:1(a) from the *Agreement on Safeguards* 'must, in our view, have meaning'. [...] On the contrary, in our view, if they had intended to *expressly omit* this clause, the Uruguay Round negotiations would and could have said so in the *Agreement on Safeguards*. They did not.

[49] Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear* ("Argentina – Footwear Safeguards"), WT/DS121/AB/R, adopted 12 January 2000.

# ANNEX J-7

## NEW ZEALAND ANSWERS TO QUESTIONS FROM THE PANEL TO THIRD PARTIES

11 August 2003[1]

Article 13(b) of the *Agreement on Agriculture*: Domestic support measures

**Q2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

"Defined" and "fixed" mean two different things and impose two distinct and different requirements for a base period under paragraph 6(a) of Annex 2. "Defined" means "having a definite or specified outline or form".[2] "Fixed" means "definitely and permanently placed or assigned; stationary or unchanging in relative position; definite, permanent, lasting".[3] Accordingly a base period must have a definite and specified form that is permanent.

**Q3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the Agreement on Agriculture, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

"A" in the context of paragraph 6(a) refers to one single defined and fixed base period. "The" in "the base period" in the context of subsequent sub-paragraphs refers to the single base period required under paragraph 6(a). Paragraph 6(a), however, does not specify a particular base period – only that once it is determined it is fixed. On the other hand, Annex 3 specifies that the "fixed" base period in that instance must be the 1986-88 period.

**Q4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the Agreement on Agriculture? 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Once, when a programme is first established. Thereafter, so long as the programme retains fundamentally the same elements, it should be considered to be the same programme and apply the same base periods.

**Q6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the Agreement on**

[1] New Zealand has not responded to questions not directed specifically to New Zealand.
[2] *The New Shorter Oxford English Dictionary*, Vol 1, Clarendon Press, Oxford (1993), page 618.
[3] *Ibid*, page 962.

**Agriculture have on the meaning of the preceding sentence? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

"Criteria" are the standards by which a thing is assessed. In this case they are the standards by which domestic support measures must be assessed in order to qualify for exemption from reduction commitments. These criteria are set out in Article 6 and Annex 2 of the *Agreement on Agriculture*, and include: the "fundamental requirement" in Annex 2 paragraph 1 that measures have at most minimal trade-distorting effects; the "basic criteria" in paragraph 1(a) and (b); and the "policy-specific criteria and conditions" set out elsewhere in Annex 2. The use of the word "accordingly" signifies that the intention of the drafters was to indicate that in order to meet the first criterion – the "fundamental requirement" that they be at most minimally trade-distorting – measures would at the very least have to meet the subsequent basic and policy-specific criteria.

**Q7. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the Agreement on Agriculture. 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

"The fundamental requirement" as used in paragraph 1 of Annex 2 refers to a characteristic which, if not present, excludes a measure from a claim of exemption from reduction commitments. In this case that characteristic is that the measure has "no, or at most minimal, trade-distorting effects or effects on production." Paragraph 1 specifies that measures for which exemption is claimed "shall meet" this fundamental requirement. Had the drafters intended to make only a general statement of principle they would not have referred to a "requirement" that "shall be met". The use of the term "fundamental" only serves to underline the importance placed on all measures meeting this requirement in order to be exempt.

**Q9. If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation, does this allow effects-based claims of non-compliance with Annex 2? If so, how does this affect the purpose of Article 13(b)? 3rd parties' in particular Australia, Argentina, Canada, EC, NZ**

Reply

If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation it would allow effects-based claims of non-compliance with Annex 2. This is consistent with Article 13(b) because it means that the measures excluded from Annex 2 have a more than minimal distorting effect on trade or production, and as such they could potentially give rise to the kind of adverse effects to the interests of other Members that the *GATT 1994* and the *SCM Agreement* establish a right to address. As such those measures should not be exempt from reduction commitments and should be required to meet the requirements of Article 13(b) in order to be exempt from actions under the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*") and *General Agreement on Tariffs and Trade 1994* (the "*GATT 1994*").

**Q10. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Reply

Yes.

**Q11. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. 3rd parties, in particular, Australia, Argentina, Canada, EC, NZ**

Reply

If the first sentence of paragraph 1 of Annex 2 expresses a general principle then the criteria in paragraph 6 of Annex 2 must be strictly applied to ensure that only genuinely decoupled income support that had at most minimal impacts on trade and/or production qualified for exemption from reduction commitments.

Irrespective of whether the first sentence of paragraph 1 of Annex 2 is to be considered a general principle or a stand-alone obligation, the requirement that there be only one defined and fixed base period in paragraph 6 is unambiguous. In New Zealand's view the updating of base acreage under the Direct Payments programme alone is sufficient to exclude it from the scope of permitted green box measures set out in paragraph 6 of Annex 2, as outlined in paragraph 2.29 of New Zealand's Third Party Submission.[4]

**Q12. Where does Article 13(b) require a year-on-year comparison? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Article 13(b)(ii) and 13(b)(iii) require a comparison with 1992 of any year in which injury, nullification or impairment or serious prejudice is alleged to have occurred.

**Q13. Does a failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

The nature of the non-compliance at issue may be such that it does impact on a Member's entitlement to benefit in an earlier or later year from the exemption from action provided by Article 13(b). Whether or not that is so must be assessed on a case-by-case basis.

**Q14. Does a failure of a Member to comply with Article 13(b) in respect of a specific commodity impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

[4] Third Party Submission of New Zealand, 15 July 2003.

Reply

No. The language of Article 13(b) makes it clear that the exemption from action applies to a "specific commodity", which means that the eligibility for such exemption must be assessed on a product-by-product basis.

**Q15. Is there any basis on which counter-cyclical payments could be considered product-specific? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

Yes. The basis upon which counter-cyclical payments should be considered product-specific have been outlined in the First Written Submission of Brazil,[5] and highlighted in New Zealand's Third Party Submission.[6]

**Q16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? 3RD parties, in particular Australia, Argentina, Benin Canada, China, EC, NZ**

Reply

Not necessarily. The application of the rules of treaty interpretation to the provision, taking into account its object and purpose, would still support a conclusion that the relevant support was that granted to an individual commodity. The use of the word "specific" simply reinforces that interpretation.

**Q17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the SCM Agreement and references to "a product" or "subsidized product" in certain provisions of the SCM Agreement to the meaning of "support to a specific commodity" in Article 13(b)(ii) Agreement on Agriculture? 3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

The *SCM Agreement* provisions cited would seem to shed little light on the meaning of "support to a specific commodity" in Article 13(b)(ii). Article 2 of the *SCM Agreement* sets out principles for determining whether a subsidy is specific to an enterprise or industry or group of enterprises or industries. Article 13(b)(ii) of the *Agreement on Agriculture* is concerned with the support granted to a specific commodity. The two assessments are unrelated. In relation to the second part of the question, the references to "a product" or "subsidised product" seem fully consistent with interpreting "support to a specific commodity" referred to in Article 13(b)(ii) as meaning support to a particular product.

**Q19. Where does Article 13(b)(ii) require a year-on-year comparison? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

[5] Brazil's First Submission to the Panel Regarding the "Peace Clause" and Non-"Peace Clause" Related Claims, 24 June 2003 ("First Written Submission of Brazil"), paragraphs 199-202 and 207-213.
[6] Paragraphs 2.17-2.13.

Reply

See New Zealand's answer to question 12 above.

**Q20. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?**

Reply

Such a comparison could be made by interpreting these terms logically as requiring a comparison between the total volume of support to a specific commodity in 1992 and in any other year in respect of which claims under the *SCM Agreement* and *GATT 1994* are made.

**Q21. Please comment on Brazil's assertion that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

Article 13(b)(ii) would be devoid of meaning if it were to be interpreted as requiring a comparison between two things that were not like ie if "support granted" was somehow different from "support decided". Therefore the issue is not the difference in wording used, but substantively, what comparison meets the object and purpose of the provision. In New Zealand's view that is a comparison between the total volume of support to a specific commodity in 1992 and in any other year in respect of which claims under the *SCM Agreement* and *GATT 1994* are made.

**Q22. What is the meaning of "support" in Agreement on Agriculture 13(b)(ii) ? Why would it be used differently from Annex 3, where it refers to total outlays? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

Annex 3 refers to budgetary outlays as a component of the Aggregate Measurement of Support ("AMS") calculation. There is nothing to suggest that budgetary outlays should not also be a component of the calculation of "support" in the context of Article 13(b)(ii).

**Q23. Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both? 3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

Reply

The rationale behind the comparison required by Article 13(b)(ii) is to create an upper limit to the level of trade and production distortion resulting from Members' domestic support programmes. Therefore the appropriate comparison is with the total volume of support because that provides the truest indication of the real effects of the support programmes on trade and production. Support in terms of unit of production may well be a relevant factor in that calculation but it will not be the only one.

**Q25. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". 3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

Reply

New Zealand is not sure what "authorised" in such a context would mean. Presumably it requires evidence of some kind of formal "authorisation". What support was formally authorised, by legislation or regulation, might provide some insight into what level of support was received for specific commodities, but it cannot provide the full picture. It therefore makes no sense to interpret "decided" in such a limited way.

Export credit guarantee programmes

**Q29. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

An export credit guarantee is a "financial contribution" under Article 1.1(a)(1) because it is a "loan guarantee".

**Q29. (b) How, if at all, would this be relevant to the claims of Brazil? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

It is relevant because a financial contribution is a necessary element of a "subsidy" under Article 1.1(a)(1)(i) of the *SCM Agreement*. Brazil has presented arguments to support a finding that the US export credit guarantee programmes are subsidies as defined in Article 1.1(a)(1)(i), that are contingent upon export according to the terms of Article 3.1(a). The *SCM Agreement* has been found to provide useful context for determining what constitutes an export subsidy for the purposes of Article 10.1 of the *Agreement on Agriculture*. Brazil has demonstrated that, in the terms of Article 10.1, the United States export credit guarantee programmes are applied so as to result in, or threaten to lead to, circumvention of the United States export subsidy commitments.

Brazil has therefore demonstrated that the United States export credit guarantee programmes do not conform fully to the provisions of Part V of the *Agreement on Agriculture* and therefore cannot be exempt from actions based on Article XVI of *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement* by the terms of Article 13(c)(ii) of the *Agreement on Agriculture*.

**Q30. The Panel could arguably take the view that Articles 1 and 3 of the SCM Agreement were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an a contrario interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission). 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

New Zealand notes that the Illustrative List simply lists measures that constitute export subsidies under Article 3.1(a) of the *SCM Agreement*. As stated by the Panel in Canada – Export Credits, "item (j) sets out the circumstances in which the grant of loan guarantees is *per se* deemed to

be an export subsidy (i.e. when the "premium rates … are inadequate to cover the long-term operating costs and losses" of the loan guarantee)."[7]

**Q31. If the Panel decides to refer to provisions of the SCM Agreement for contextual guidance in the interpretation of the terms in Article 10 Agreement on Agriculture, should the Panel refer to item (j) or Articles 1 and 3 of the SCM Agreement or both? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

The Panel should refer to both. The *SCM Agreement* provides both a general definition of an "export subsidy" (specifically the definition of a "subsidy" in the terms of Article 1 and the requirement of contingency upon export in the terms of Article 3) and an Illustrative List containing specific examples of export subsidies. Therefore Articles 1 and 3 and item (j) of the Illustrative List provide contextual guidance for the interpretation of the terms in Article 10.

**Q32. The Panel's attention has been drawn to Article 14(c) of the SCM Agreement (see third party submission of Canada) and to the panel report in DS 222 Canada- Export Credits and Loan Guarantees. How and to what extent are Article 14(c) of the SCM Agreement, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material. . 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

The Panel in Canada – Export Credits and Loan Guarantees[8] considered that Article 14(c) of the *SCM Agreement* provided contextual guidance for interpreting 'benefit' in relation to loan guarantees. In that case it was determined that the relevant benchmark for determining whether a loan guarantee conferred a "benefit" was whether there was "a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed … and the amount that the firm would pay on a comparable commercial loan absent the … guarantee." This confirms that the appropriate point of reference for determining whether a "benefit" has been conferred is the marketplace, in this case the extent to which the premium rates charged on current export credit guarantees are lower than the corresponding financing rates that a commercial bank would normally require given a similar level of risk.

**Q33. What is the relevance (if any) of Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders." . 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

Brazil's statement goes toward a conclusion that a "benefit" is conferred in the terms of Article 1.1(b) of the *SCM Agreement*. It is significant because it indicates that either commercial lenders are not prepared to accept the risks associated with such guarantees or that the United States export credit programme is so big that it has forced any competition from commercial programmes out of the marketplace. For whatever reason, the United States export credit guarantee programmes

[7] Report of the Panel, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS/222, paragraph 7.395.

[8] *Ibid*, paragraph 7.397.

provide the recipient with export credit guarantees not available in, and therefore on terms more favourable than, the marketplace, and thus confers a "benefit" in the terms of Article 1.1(b).

**Q34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

"Claims paid" is one element of the calculation of the costs and losses of an export credit guarantee programme. Other elements to be taken into account would include, for example, costs and losses associated with reinsurance costs, administration costs and the costs of refinancing (i.e. the rescheduling (not the full amount, but the net present value of the losses)).

**Q35. Did the drafters of the Agreement on Agriculture include export credit guarantees in Article 9.1 of the Agreement on Agriculture? Why or why not? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

The drafters of the *Agreement on Agriculture* did not include export credit guarantees in Article 9.1 of the *Agreement* because export credit guarantees are not, *per se*, export subsidies. They may involve export subsidies, but this depends on whether they provide a benefit in relation to the marketplace.

**Q36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38) 3rd parties, in particular, Argentina, Canada, EC, NZ**

**"The programs operate in cases where credit is necessary to increase or maintain U.S. exports to a foreign market and where U.S. financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

See New Zealand's answer to Question 33 above.

**"The programs are operated in a manner intended not to interfere with markets for cash sales. The programs are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

This statement simply supports Brazil's analysis in relation to the "benefit" and "export contingency" elements of the export credit guarantee programme.

**"In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for U.S. agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)**

Reply

This statement reinforces the obvious export contingency of the export credit guarantee programme and through the reference to expand[ing] opportunities and assist[ing] long-term market development makes it clear that the intention of the programme is to provide a benefit to US exporters.

Reply

**Q37. The United States seems to argue that, at present, by virtue of Article 10.2 of the Agreement on Agriculture, there are no disciplines on agricultural export credit guarantees under the Agreement on Agriculture (or the SCM Agreement).**

**(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the Agreement on Agriculture ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the Agreement on Agriculture? Please cite any relevant material, including any past WTO dispute settlement cases. 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

The proposition is not reconcilable with the title of Article 10 of the *Agreement on Agriculture* as such an export credit guarantee would clearly provide an export subsidy and thus potentially circumvent export subsidy commitments. It also ignores the findings of the Panel in US-FSC Article 21.5[9], affirmed by the Appellate Body,[10] that the threat of circumvention of export subsidy reduction commitments in the terms of Article 10.1 exists in relation to both unscheduled and scheduled agricultural products when the amount of a subsidy is unqualified or unlimited, as implied in the proposition above.

**(b) If, as the United States argues, there are no disciplines on export credit guarantees in the Agreement on Agriculture, how could export credit guarantees "conform fully to the provisions of Part V" of the Agreement on Agriculture within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)? 3rd parties, in particular, Argentina, Canada, EC, NZ**

Reply

The United States interpretation would render the phrase "conforming fully to the provisions of Part V" meaningless in respect of export credit guarantees and it therefore cannot be sustained.

Step 2 payments

**Q38. Please comment on the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale,**

[9] Report of the Panel, *United States – Tax Treatment for "Foreign Sales Corporations", Recourse to Article 21.5 of the DSU by the European Communities* (WT/DS108/RW), paragraphs 8.118 and 8.119.

[10] Report of the Appellate Body, *United States – Tax Treatment for "Foreign Sales Corporations", Recourse to Article 21.5 of the DSU by the European Communities* (WT/DS108AB/RW).

**then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in Canada-Dairy and the findings of the Appellate Body in US-FSC (21.5), do any other dispute settlement reports offer guidance on this issue? For example, how, if at all is the Appellate Body's report in Canada-Aircraft relevant here? 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

Reply

The two distinct factual situations involved are 1) where cotton is exported, and 2) where cotton is used domestically. The notional consumer referred to by the United States cannot be both an exporter and domestic user of the same bale of cotton.

Even if the Panel were to find that there are not two distinct factual situations involved, ie that there was only one 'Step 2 payment' programme as alleged by the United States, the findings of the Appellate Body in Canada-Aircraft[11] referred to in the question above make it clear that the fact that some of the payments made under that programme are *not* contingent upon export performance, does not necessarily mean that the same is true for all of the payments under the programme. To paraphrase the Appellate Body, it is enough to show that one or some of the Step 2 payments do constitute subsidies "contingent … in fact … upon export performance." Those payments made upon production of proof of export clearly meet the export contingency requirement.

**Q39. Please comment on the United States assertions at paragraph 129 of its first written submission, that "[t]he program is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States." . 3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

Reply

The fact that an applicant is required to identify themselves as either an exporter or domestic user and an exporter is required to provide proof of export in order to receive the payment would seem to suggest that the programme is not, in fact, so 'indifferent'.

**Q40. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the AoA? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the SCM Agreement and Article III:4 of the GATT 1994.. 3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay**

Reply

New Zealand does not agree that a right to provide subsidies contingent upon the use of domestic products contrary to Article 3 of the *SCM Agreement* can be found in the requirement that subsidies "directed at agricultural producers … to the extent that they benefit producers of the basic agricultural product" be included in the calculation of AMS. There is no basis for reading such a right into the *Agreement on Agriculture*. To do so would allow the possibility for exemption from action under the *SCM Agreement* to exist other than by virtue of the peace clause. The peace clause explicitly does not provide such exemption from action under Article 3 of the *SCM Agreement* when

[11] Report of the Appellate Body, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R , paragraph 179.

it quite clearly could have done so. In New Zealand's view that indicates that there was no intention on the part of the drafters that domestic support measures, whether they conform with Article 6 of the *Agreement on Agriculture* or not, should be so exempt. The same is true in respect of *GATT 1994* Article III:4 claims.

ETI Act

**Q41. Concerning its claims on the ETI Act, Brazil relies on the US – FSC case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the Agreement on Agriculture. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Argentina, China, EC, NZ**

Reply

While it is open to the United States to claim exemption from action for such measures under the peace clause, the United States has no reduction commitments in respect of upland cotton and it cannot therefore provide export subsidies to upland cotton in a WTO-consistent manner.

**Q42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to that dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. Argentina, China, EC, NZ**

Reply

References to "disputes" in the Dispute Settlement Understanding must be interpreted in context. Article 17.14 requires that parties to a dispute unconditionally accept the report of the Appellate Body once adopted by the Dispute Settlement Body ("DSB"). That acceptance is in the context of that particular dispute between those particular parties. However that does not preclude a Panel from finding that a *prima facie* case of WTO-inconsistency has been made out where a Member makes a complaint in relation to a measure that has previously been ruled to be WTO-inconsistent where that ruling has been adopted by the DSB and where the measure remains unchanged.

# ANNEX J-8

## PARAGUAY'S REPLY AS THIRD PARTY TO THE FOLLOWING QUESTION

11 August 2003

ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE

**26. Under Article 13(b)(ii), a comparison is required between support at different times. One of the issues which is contested between the parties is whether the only later period that the Panel can consider is the present one (i.e. the period underway at the time of the request for establishment of the Panel). This argument is based on the present tense of the words "do not grant" in the English text.**

**The Panel asks whether there is any difference in the verb tense as used in the Spanish-language text, or any other difference which might aid the Panel in interpreting these words?**

Reply

In its analysis of the question raised by the Panel as to the period to be considered and the verb tense used, Paraguay is expressing a view based on both versions:

> *"(ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, **provided** that such measures **do not grant support** to a specific commodity in excess of that decided during the 1992 marketing year; and …."*
>
> *"ii) estarán exentas de medidas basadas en el párrafo 1 del artículo XVI del GATT de 1994 o en los artículos 5 y 6 del Acuerdo sobre Subvenciones, **a condición de que no otorguen** ayuda a un producto básico específico por encima de la decidida durante la campaña de comercialización de 1992; y …"*

As regards the verb tense used, the English version clearly calls for a present tense interpretation, as the Panel rightly points out.

It clearly reads "**provided** that such measures do not grant support". If we take the word "provided" as indicating the occurrence of an event (**"in the event"**), we must bear in mind that this would introduce conditionality.

The Spanish text expresses the conditionality in even clearer terms through the words **"a condición de que no otorguen"**, a conditionality which introduces a notion of facts.

In Spanish, the verb is used in the present **subjunctive mode**, which according to the ***Larousse Dictionary***, *is the mode used to express possibility, as opposed to the indicative mode, which is the reality mode.*

Although we consider that both versions indicate the present, it appears to us that the Spanish version of the sentence stresses conditionality, which must be given considerable weight in order to arrive at a correct interpretation.

In the case at issue, *the condition under which the measures shall be exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement* is that support should not be granted to a specific commodity in excess of that decided during the 1992 marketing year.

The 1992 marketing year provides the standard needed to carry out a proper comparison between support at different times, so that in our view, we should be considering the entire spectrum and taking a comprehensive view of the background information.

Paraguay concludes that it is the Panel's task to consider the period it deems suitable for determining the effects of this type of measure on world trade.

# ANNEX J-9

## COMMENTS BY ARGENTINA ON THE REPLY BY THE EUROPEAN COMMUNITIES TO QUESTION 40 FROM THE PANEL

22 August 2003

Argentina would like to make the following comments on the reply by the European Communities to question 40 from the Panel.

Argentina does not share the EC's assertion that Members are entitled to provide domestic content subsidies under the Agreement on Agriculture (AoA) provided such subsidies are provided consistently with the Member's domestic support commitment levels.

It is our view that the rules of the AoA, on the one hand, and of the GATT 1994 and the Agreement on Subsidies and Countervailing Measures (ASCM), on the other, contain disciplines that apply independently unless there is a "conflict" between the provisions, in which case the rules of the AoA apply as a result of Article 21.1 of this Agreement.

Article 21.1 of the AoA states that *"The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to* ("a reserva de" in the Spanish text) *the provisions of this Agreement*."

The words "subject to" or "a reserva de" indicate dependency or a condition[1]. Such dependency or condition does not, however, mean that all the disciplines in the GATT 1994 and the Agreements in Annex 1A automatically cease to apply in the case of the AoA. On the contrary, these disciplines "shall apply" unless there is a discrepancy or conflict between a rule in the AoA and the rules in the GATT 1994 or the Agreements in Annex 1A. This conclusion also receives contextual support in the General interpretative note to Annex 1A.

The conditions for the existence for a conflict between two rules was clarified by the Appellate Body in the *Guatemala – Cement case*[2], where it is determined that there is a conflict between two provisions if adherence to one provision leads to a violation of the other. In the case before us, in order to determine whether a rule in the GATT 1994 or in an Agreement in Annex 1A (Article 3.1(b) of the ASCM in this particular case) does not apply, it must first be determined whether there is an inconsistency or discrepancy with a provision of the AoA. In other words, these rules must be applied together.

In this connection, Argentina considers that compliance with the obligations laid down in Articles 6.1 and 3.2 of the AoA, and with paragraph 7 of Annex 3, does not allow any inconsistency with Article 3.1(b) of the ASCM to be detected.

Regarding Articles 6.1 and 3.2 of the AoA, nothing in these provisions indicates that it is not possible to apply them together with the prohibition on granting subsidies contingent on the use of domestic rather than imported products. The fact that the term "domestic support" is not defined in

[1] The New Oxford Dictionary of English: "subject to: … 2 dependent or conditionally upon".
[2] WT/DS60/AB/R, paragraph 65.

the AoA or that the AMS is broadly defined, as indicated by the EC[3], does not imply that the prohibition laid down in Article 3.1(b) of the ASCM is not valid in relation to the AoA. In this connection, the AoA does not contain any reference to possible exclusion.

Regarding paragraph 7 of Annex 3, the statement that "Measures directed at agricultural processors shall be excluded to the extent that such measures benefit the producers of the basic agricultural products" does not mean that such benefits cover measures made subject to the use of national rather than imported products. Producers of the basic agricultural products are allowed the benefits without making the measure contingent on the use of domestic products.

Lastly, with regard to the EC's reference to the preamble to the AoA ("*Having decided* to establish a basis for initiating a process of reform of trade in agriculture …"), it should be noted that this process could very well envisage stricter obligations concerning certain types of measure that particularly distort international agricultural trade. On the contrary, it appears contradictory to assume that an agricultural trade reform process envisages the weakening of disciplines that could be applied in another way.

For the foregoing reasons, Argentina considers that subsidies that are granted to agricultural producers contingent on the use of domestic rather than imported products, either as a sole requirement or as one of several requirements, are inconsistent with Article 3.1(b) of the ASCM and Article III.4 of the GATT 1994.

[3] Replies by the EC to question 40, paragraph 77.

# ANNEX J-10

## COMMENTS BY AUSTRALIA ON THE RESPONSES OF THE EUROPEAN COMMUNITIES TO QUESTIONS FROM THE PANEL AFTER THE FIRST SESSION OF THE FIRST SUBSTANTIVE PANEL MEETING

22 August 2003

These comments by Australia are offered in response to some of the answers submitted by the EC to the questions from the Panel after the first session of the first substantive Panel meeting. It is not Australia's intention to comment on all of the answers submitted by the EC, as most issues have already been addressed in Australia's written Third Party Submission, Australia's Oral Statement and Australia's responses to questions from the Panel after the first session of the first substantive Panel meeting.

Panel question no. 6 and Australian question no. 2

The EC refers to the findings of the Appellate Body in the *Turkey – Textiles* dispute concerning the interpretation of the word "accordingly" at the beginning of Article XXIV:5 of GATT 1994 to support its view that the first sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* does not establish a freestanding obligation. However, as EC recognises, the Appellate Body expressly found in that dispute that the text of GATT Article XXIV:4 does not contain any operative language, that is, that GATT Article XXIV:4 "does not set forth a separate obligation itself". Nor do any of the other provisions cited by the EC in its footnote 9 contain operative language in the sense of setting forth a separate obligation.

The words "shall meet the fundamental requirement" establish a clear and unambiguous obligation that Annex 2 measures must conform to or satisfy the primary or essential condition that such measures have no, or at most minimal, trade-distorting effects or effects on production. "Shall", when used in the present tense as an auxiliary verb followed by an infinitive as in the first sentence of paragraph 1 of Annex 2, is defined as: "must according to a command or instruction".[1] "Meet" has a number of meanings, including "come into conformity with (a person, a person's wishes or opinion)" and "satisfy (a demand or need); satisfy the requirements of (a particular case); be able or sufficient to discharge (a financial obligation)". The words "shall meet" in context mean that Annex 2 measures must conform to or satisfy an express stipulation. Australia has previously explained that a "fundamental requirement" is a primary or essential condition.[2] When used as a definite article as in the clause "shall meet the fundamental requirement", the word "the" establishes the "fundamental requirement" as the express stipulation that Annex 2 measures must conform to or satisfy.[3]

In Australia's view, the normal rules of treaty interpretation do not permit the word "accordingly" to be interpreted so as to obviate a clear and unambiguous obligation. Australia agrees that the Appellate Body found in the *Turkey – Textiles* dispute, in the particular circumstances of GATT Article XXIV, that the word "accordingly" linked the purposive language of Article XXIV:4 to operative language in the specific obligations found elsewhere in Article XXIV. However, the first

[1] *The New Shorter Oxford English Dictionary*, Volume 2, page 2808.
[2] Australian response to Question no. 7 from the Panel.
[3] Australia addressed the meaning of "the" in more detail in its response to question 3 from the Panel.

sentence of paragraph 1 of Annex 2 to the *Agreement on Agriculture* cannot be characterised as purposive. The Appellate Body's finding in the *Turkey – Textiles* dispute is not, and cannot be, a valid interpretative basis to say that because the word "accordingly" has a particular meaning in the context of GATT Article XXIV, that same meaning must apply wherever else the word "accordingly" appears.[4]

Panel question no. 9

It remains unclear to Australia what is meant by "effects-based claims" in the context of the Panel's question.

However, Australia notes that under the EC's interpretation there would be no limits to the amounts that a WTO Member could provide as Annex 2 support, even if such support had profound trade-distorting effects or effects on production. For example, the EC's interpretation would allow a Member to pay "decoupled income support" of such a magnitude that the support would provide the means for that Member's domestic producers to switch from dryland to irrigation production with resulting substantial increases in production and trade-distorting effects. Thus, even if the first sentence of paragraph 1 of Annex 2 of the *Agreement on Agriculture* were considered to express an objective, such an outcome would nevertheless be directly contrary to that objective. At the very least, the magnitude of Annex 2 payments must be able to be a factor in assessing whether Annex 2 domestic support measures "meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production".

Further, the EC's argument that identifying the effects of such measures is often only feasible on an *ex post facto* basis is not convincing. First, even the EC argument concedes that in many, if not most, cases, it is feasible to identify the effects of such measures in advance. Secondly, even if the precise effects of such measures cannot be identified in advance, policy makers could draw on past experience and econometric analyses to determine whether certain types of payments would likely be distorting.

Finally, Australia considers that the "problems" pointed to by the EC that would be engendered by interpreting the first sentence of paragraph 1 as a freestanding obligation are no different to other situations, including under the *Agreement on Agriculture*. If another Member were to argue successfully in a dispute that a measure at issue was indeed an export subsidy, the responding Member could well be required to show "after the fact" that it is in compliance with its export subsidy reduction commitments under the *Agreement on Agriculture*.[5]

[4] Australia considers that the Appellate Body's discussion of the meaning of "like products" in *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* , WTO DS135/AB/R, paragraphs 87-100, confirms this view.

[5] See, for example, *United States – Tax Treatment of "Foreign Sales Corporations"*, WT/DS108.

# ANNEX J-11

## COMMENTS BY THE EUROPEAN COMMUNITIES ON RESPONSES TO THE QUESTIONS OF THE PANEL SUBMITTED BY OTHER THIRD PARTIES

22 August 2003

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## I. INTRODUCTION

1. The European Communities has sought to comment on some of the responses to the Panel's questions submitted by other third parties. It has not been possible to do this in an exhaustive manner. Rather, the European Communities has made comments on certain responses which in its view merited further discussion. Evidently, where the European Communities has not commented on a particular argument, this does not imply that we support it.

2. For the Panel's ease of reference, we have retained in this document the Panel's original questions and the responses of the European Communities. Where the European Communities has decided to comment on a particular argument of another third party, we have inserted *verbatim* the text of the other party's arguments. We have deleted all questions which we have decided not to make comments on.

## II. ARTICLE 13 OF THE AGREEMENT ON AGRICULTURE

**Question**

**1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions in Article 13 are a "prerequisite" to the availability of a right or privilege? Australia Would other third parties have any comments on Australia's assertion? 3rd parties, in particular Argentina, Benin, China, Chinese Taipei**

Answer

3. Australia's views cannot be reconciled. Australia is correct in noting that the conditions in Article 13 can be considered a prerequisite for taking action under the *SCM Agreement*.[1] In using the term "prerequisite", Australia essentially recognises that, in respect of measures covered by Article 13, a complainant can only invoke the relevant provisions of the *SCM Agreement* if it proves that the threshold requirements or prerequisites referred to in Article 13 have been satisfied. As the European Communities has pointed out, such a situation is very different from the situation where, in the event of a violation of a WTO Agreement, a WTO Member pleads a defence which potentially exculpates it from this violation (e.g. Article XX GATT) in respect of which it bears the burden of proof.

4. Comparing Article 13 with Article 3.3 of the *SPS Agreement* shows that Australia's views are irreconcilable. This provision permits WTO Members not to base SPS measures on international standards but to impose higher standards where there is a scientific justification or an appropriate risk assessment has been carried out. This provision has some similarities with Article 13 of the *Agreement on Agriculture* since it sets a threshold which must be met before a Member can act. However, Article 3.3 may be seen as going further than Article 13 since it provides a derogation from the central discipline of the *SPS Agreement* ; the obligation to base SPS measures on international standards. On the other hand, Article 13 is simply one element regulating the interface between the *Agreement on Agriculture* and the other Annex I Agreements and cannot be seen as a derogation therefrom. Despite the extent to which Article 3.3 could be thought of as a derogation from the *SPS Agreement*, the Appellate Body ruled in *EC Hormones* that it could not be considered an affirmative defence, and that the burden of proof did not, therefore lie with the defendant.[2] In particular, the Appellate Body noted that the situation in Article 3.3 of the SPS Agreement is "qualitatively different" from the relationship between for instance, Article 1 and XX GATT.[3]

5. Consequently, Australia is correct to consider that Article 13 is a prerequisite or a threshold condition before the other Annex I Agreements may become applicable but is incorrect to consider that Article 13 can be considered an affirmative defence.

**Response of Australia**

> Australia does not see any inconsistency in its views. In Australia's view, the potential availability of an affirmative defence in the general sense is in the nature of a right or privilege. Australia wishes to clarify, however, that it considers Article 13 in the specific sense to be a right available when the conditions prescribed therein are met, rather than a privilege.

**EC Comment**

6. The European Communities fails to see how Australia can reasonably assert that there is no "inconsistency in its views". If Article 13 *Agreement on Agriculture* is a "prerequisite" for a complainant to bring an action under the *SCM Agreement* it cannot be at the same time a defence. A defence applies when a breach of a WTO Agreement arises, and the defending Member relies on another provision of a WTO Agreement in order to exculpate itself. Article XX GATT is the best example. In such a case, the burden of proof shifts to the Member invoking a defence. A prerequisite

[1] Australia's Oral Statement, para. 18.

[2] Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 109.

[3] Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 105.

is entirely different. It implies that before a Member can undertake a particular action, it must take another action. In this context, a complaining Member must prove that Article 13 *Agreement on Agriculture* does not apply, before proving that the relevant provisions of the *SCM Agreement* apply.

7. Australia's bald assertion, glossing over its previous use of the word "prerequisite", does not adequately explain how its views can be reconciled.

## III. ARTICLE 13(B) OF THE *AGREEMENT ON AGRICULTURE*: DOMESTIC SUPPORT MEASURES

### Questions 2 - 5

8. The European Communities would only note that the changes presented by Australia to questions 2 and 3 on 15 August 2003 as "corrigenda" altered substantively the meaning of Australia's original response. The change from "program" to "payment" is a substantial change, and not a mere typographical error.

### Question

**6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the *Agreement on Agriculture* have on the meaning of the preceding sentence? 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

9. Both Article 6.1 and 7.1 refer to the "criteria set out in [..] Annex 2". When one considers Annex 2, there are two sets of "criteria". The first is the "basic criteria" set out in subparagraphs (a) and (b) of paragraph 1, and the second is the "policy-specific criteria" set out in paragraphs 2 to 13. This understanding is confirmed by the text of paragraph 5 of Annex 2, which refers to the "basic criteria" and the "specific criteria". Thus, Articles 6.1 and 7.1 of the *Agreement on Agriculture* refer to the basic and policy specific criteria set out in Annex 2.

10. The European Communities has already set out its understanding of the term "accordingly" in its Third Party Written Submission.[4] In the European Communities view, the term "accordingly" is intended to link the purposive language of the first sentence, with the "basic criteria" set out in the second sentence. In its Third Party Submission the EC offered a dictionary definition, "in accordance with the logical premises" which showed that the word "accordingly" operates as a linkage between the premise or understanding set out in the first sentence and the operative language in the second sentence. Australia offers the Panel another definition: "harmoniously" or "agreeably", but fails to note that that the Oxford English Dictionary considers this usage of the word "accordingly" obsolete.[5]

11. The European Communities would point out that both the French and Spanish text support the view that the use of the word "accordingly" links the general statement in the first sentence with the specific obligations of the second sentence. The French text uses the term "en conséquence" and the Spanish the term "por consiguiente". Both of these terms show that the criteria in the second sentence

[4] First Third Party Submission of the European Communities, 15 July 2003, para. 20. The European Communities recall, in this context, the opinion of Professor Desta set out in footnote 19 to para. 20.

[5] Australia's Oral Statement, para 35. Oxford English Dictionary, p. 15. Australia refers to the first sense of the word "accordingly" which is preceded by the symbol "=" which indicates that a particular usage is obsolete (see Abbreviations and Symbols, page xxvi).

are intended to express the principle set out in the first sentence. Moreover, had the negotiators intended that the first sentence be a self-standing obligation, rather than use the term "accordingly" they would have used the term "additionally" or "in addition", or a synonymous term.

12. Further support for this view can be found in the frequent use of the term "accordingly" in the WTO Agreement. A survey of the term's use suggests that it links a general statement, often recognising that a particular situation causes specific effects, with a right or obligation to take some type of action set out in an ancillary sentence.[6] These general statements are not such as to impose specific obligations. The Appellate Body had occasion to consider the relationship between such provisions in the *Turkey-Textiles* dispute (Articles XXIV.4 and XXIV.5 GATT). It concluded:

> The chapeau of paragraph 5 of Article XXIV begins with the word "accordingly", which can only be read to refer to paragraph 4 of Article XXIV, which immediately precedes the chapeau.
>
> [..]
>
> 57. According to paragraph 4, the purpose of a customs union is "to facilitate trade" between the constituent members and "not to raise barriers to the trade" with third countries. This objective demands that a balance be struck by the constituent members of a customs union. A customs union should facilitate trade within the customs union, but it should *not* do so in a way that raises barriers to trade with third countries. [..] Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV. Thus, the purpose set forth in paragraph 4 informs the other relevant paragraphs of Article XXIV, including the chapeau of paragraph 5. For this reason, the chapeau of paragraph 5, and the conditions set forth therein for establishing the availability of a defence under Article XXIV, must be interpreted in the light of the purpose of customs unions set forth in paragraph 4. The chapeau cannot be interpreted correctly without constant reference to this purpose.[7] (emphasis added)

13. The Appellate Body has, consequently, recognised the linking function of the word "accordingly", and the fact that provisions which may be linked to later provisions through the use of the word "accordingly" may not impose separate obligations.

14. The European Communities would also point out that the Appellate Body has found that other provisions (e.g. Article III.1 GATT) which contain general principles are set up as "a guide to understanding and interpreting the specific obligations contained" in other provisions (e.g.

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[6] See Articles II.6(a), III.9, XII.3(d), XVI.3, XVIIII.5, XXIV.5 GATT 1994, together with Ad Article III and Ad Article XXVIII.4 to GATT 1994, Articles 2.1 and 11 of the Dispute Settlement Understanding, Article A(i) of the Trade Policy Review Mechanism, Article 12.8 of the Agreement on Technical Barriers to Trade, Article 1 of the GATS Annex on Telecommunications and Article 5.1 of the Agreement on Textiles and Clothes.

[7] Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products ("Turkey – Textiles")*, WT/DS34/AB/R, adopted 19 November 1999, paras. 56 and 57 (emphasis added). Note that the Panel also found that Article XXIV.4 was "not expressed as an obligation" (Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products ("Turkey – Textiles")*, WT/DS34/R, adopted 19 November 1999, as modified by the Appellate Body Report, WT/DS34/AB/R, para. 9.126).

Article III.2 and the other paragraphs of Article III).[8] Such provisions do not, however, impose additional obligations supplemental to the specific obligations, unless expressly stated.[9]

15. The Panel may find it useful to refer to the European Communities' response to a question posed by Australia (see question no. 44 in this document). In its response, the European Communities deals with Australia's unfounded assertion that the European Communities' reading of the first sentence of paragraph 1 would render that provision ineffective.

**Response of Australia**

> The ordinary meaning of "criteria", as the plural of "criterion", is "principle[s], standard[s], or test[s] by which a thing is judged, assessed, or identified"[10]. Thus, the "criteria" in Articles 6.1 and 7.1 as these relate to Annex 2 of the *Agreement on Agriculture* encompasses <u>all</u> of the relevant principles, standards or tests established in Annex 2 against which domestic support measures for which exemption from reduction commitments is claimed are to be judged, assessed and/or identified.
>
> As Australia said in its Oral Statement[11], the word "accordingly" has several, equally valid meanings that are potentially applicable in the context: "harmoniously", "agreeably", "in accordance with the logical premises" and "correspondingly".[12] A further definition is "in conformity with a given set of circumstances".[13]
>
> In Australia's view, having regard to its ordinary meanings in its context and in light of the object and purpose of the *Agreement on Agriculture*, including to "[correct] and [prevent] … distortions in world agricultural markets",[14] the word "accordingly" can and should properly be interpreted in the sense of "consistent with" or "in conformity with" the fundamental requirement established in the first sentence. Consistent with that interpretation, the obligation that "green box" measures "meet the fundamental requirement …" is cumulative with the additional basic criteria established in paragraph 1 and the policy specific criteria established in paragraphs 2-13 of Annex 2. To interpret the word "accordingly" otherwise would be to negate the plain and unambiguous obligation established in the first sentence of paragraph 1 of Annex 2 that "[d]omestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production".

**Response of New Zealand**

> "Criteria" are the standards by which a thing is assessed. In this case they are the standards by which domestic support measures must be assessed in order to qualify for exemption from reduction commitments. These criteria are set out in Article 6 and Annex 2 of the *Agreement*

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[8] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages")*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 17.

[9] See Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas ("European Communities – Bananas")*, WT/DS27/AB/R, adopted 25 September 1997, paras. 214-216 holding that the absence of a specific reference to Article III.1 GATT in Article III.4 GATT meant that an examination of the consistency of a measure with Article III.4 GATT did not require, in addition, an examination of the consistency of the measure with Article III.1 GATT.

[10] *The New Shorter Oxford English Dictionary*, Volume 1, page 551.

[11] Oral Statement by Australia, paragraphs 35-36.

[12] *The New Shorter Oxford English Dictionary*, Volume 1, page 15.

[13] *Webster's Third New International Dictionary*, Ed. Philip Babcock Gove, Merriam-Webster Inc, Springfield, Massachusetts, 1993, page 12.

[14] Third preambular paragraph of the *Agreement on Agriculture*.

> *on Agriculture*, and include: the "fundamental requirement" in Annex 2 paragraph 1 that measures have at most minimal trade-distorting effects; the "basic criteria" in paragraph 1(a) and (b); and the "policy-specific criteria and conditions" set out elsewhere in Annex 2. The use of the word "accordingly" signifies that the intention of the drafters was to indicate that in order to meet the first criterion – the "fundamental requirement" that they be at most minimally trade-distorting – measures would at the very least have to meet the subsequent basic and policy-specific criteria.

**EC Comment**

16. Neither Australia nor New Zealand examine the use of the word "criteria" in Annex 2 where it means something different from the fundamental requirement. The second sentence of the first paragraph of Annex 2 clearly distinguishes the "fundamental requirement" from the general and policy-specific "criteria". Paragraph 5 of Annex 2 is even more explicit in this regard. It would seem odd that Article 6.1 and 7.1 would use criteria to mean both the basic and policy specific criteria and the requirement, while Annex 2 itself operates a distinction between the criteria and the requirement. Thus, while it is the case that the dictionary definition of "criteria" could arguably, in the abstract, cover a "fundamental requirement" in this particular case there are compelling arguments that the use of the word "criteria" in Articles 6.1 and 7.1 does not.

17. The European Communities has already explained why Australia's interpretation of "accordingly" is incorrect. It is quite clear that "accordingly" establishes a relationship between the purposive language of the first sentence of para. 1 of Annex 2 and the operational language of the other parts of Annex 2. Synonyms of "accordingly" include "as a result, consequently, ergo, thus, therefore".[15] To read the term as meaning that the first sentence and the rest of the paragraph applied as cumulative and separate conditions (as suggested by Australia) would deprive the word "accordingly" of effect. Reading the first sentence of paragraph 1 as relevant to the interpretation of the rest of Annex 2, but not as a separate condition would, contrary to Australia's assertion, give the first sentence meaning.

18. New Zealand points out that:

> "the use of the word "accordingly" signifies that the intention of the drafters was to indicate that in order to meet the first criterion – the "fundamental requirement" […]measures would at the very least have to meet the subsequent basic and policy-specific criteria"

19. New Zealand does not explain how the first sentence can set a self-standing criterion if respecting that so-called criterion depends on satisfying other criteria. What then is the content of the separate "criterion" in the first sentence, if it is already defined in the second sentence of the first paragraph and the rest of Annex 2 ? Moreover, how, given the alleged existence of two sets of self-standing criteria, can it be sufficient to satisfy only one set of criteria and at the same time satisfy the other set (or "at the very least" satisfy the other set) as the final sentence of New Zealand's response implies. Even on its own terms, New Zealand's position that the first sentence of paragraph 1 is a self standing obligation, but that it can be satisfied by meeting the criteria set out in the rest of Annex 2, is internally inconsistent. This illustrates very well the European Communities' point that the proposition that the first sentence imposes a self-standing obligation cannot be squared with any reasonable interpretation of "accordingly".

[15] Chamber's Thesaurus, 1986.

**Question**

**7. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the *Agreement on Agriculture.* 3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

Answer

20. The phrase "the fundamental requirement" signals the negotiators intent to treat differently measures which are less or not at all distortive to trade or production and sets forth the general purpose of Annex 2; a purpose which permeates the rest of Annex 2. Considering the term in the abstract does not answer the question whether a panel must examine the effects of measures for which green box status is claimed in addition to examining whether such measures respect the basic and policy-specific criteria set out in Annex 2, or whether respecting the basic and policy-specific criteria is such that a measure is deemed not to have the effects mentioned in the first sentence. As the European Communities has explained, there are compelling textual and purpose based arguments which support the latter interpretation.

**Response of Australia**

> The word "fundamental" has a number of meanings[16] which can be summarised as "primary" or "essential". The word "requirement" too has a number of meanings[17] which can be summarised as a "condition". Thus, a "fundamental requirement" is a primary or essential condition. [18] It is an overarching, freestanding obligation that applies to all "green box" measures cumulatively with the additional basic criteria established in paragraph 1 and the policy specific criteria established in paragraphs 2-13 of Annex 2. To interpret a "fundamental requirement" otherwise than as a primary or essential condition would not give the words their ordinary meaning in their context and in light of the object and purpose of the *Agreement on Agriculture*.

**EC Response**

21. Australia executes a logical leap in the fourth sentence of its response. It arrives at the conclusion that the "fundamental requirement" is a "freestanding obligation" that applies "cumulatively" with the other criteria. However, this assertion is without foundation, and is directly contradicted by the use of the word "accordingly" at the beginning of the next sentence.

**Question**

**2. In paragraph 13 of Australia's oral statement, you state that a "question" is: "could conditions of price competition for the purposes of a non-violation or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the**

[16] *The New Shorter Oxford English Dictionary*, Volume 1, page 1042, provides relevant definitions of "fundamental" as "**1** Of or pertaining to the basis or groundwork; going to the root of the matter. **2** Serving as the base or foundation; essential or indispensable. Also, primary, original; from which others are derived."

[17] *The New Shorter Oxford English Dictionary*, Volume 1, page 2557, provides definitions of "requirement" as "**1** The action of requiring something; a request. **2** A thing required or needed, a want, a need. Also the action or an instance of needing or wanting something. **3** Something called for or demanded; a condition which must be complied with."

[18] Third Party Submission of Australia, paragraph 31, and Oral Statement by Australia, paragraph 33.

**whole." Could you please clarify this statement (indicating other elements which would complete the "whole" and explain its relevance for the purposes of our consideration of Article 13 of the *Agreement on Agriculture*? Australia, EC**

Answer

22. The European Communities would prefer to let Australia clarify its statement. The European Communities will comment upon Australia's clarification in its comments on the responses of the other third parties.

**Australia's Response**

> Given the length of Australia's response, the European Communities has not reproduced it here.

**EC Comment**

23. The European Communities is unconvinced of Australia's argument. There is nothing in the text of Article 13 to suggest that in order to determine "support" under Article 13 it is necessary to consider all the factors which are relevant to examining a non-violation case. Moreover, the European Communities notes that Article 13(b)(ii) provides that Articles 5 and 6 of the *SCM Agreement* may be applicable under certain conditions. However, an assessment of whether a measure is inconsistent with Articles 5 and 6 of the *SCM Agreement* is not based on the same criteria as would be applicable in assessing a non-violation complaint. Indeed, such criteria may have nothing to do with the domestic market of the Member which is providing a subsidy. Australia does not explain why the type of criteria relevant to non-violation complaints would also be relevant in assessing a complaint under Articles 5 and 6 of the *SCM Agreement*. Nor does it explain why it is necessary to import notions from the assessment of non-violation complaints, but not notions from Articles 5 and 6 *SCM Agreement* into an assessment of support for the purposes of Article 13 *Agreement on Agriculture*.

24. In short, the European Communities sees no foundation for Australia's assertions.

## IV. STEP 2 PAYMENTS

**Question**

**40 With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the *AoA*? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the *SCM Agreement* and Article III:4 of the GATT 1994.. 3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay**

Answer

25. The Panel's question involves two elements. First, is a Member entitled to provide domestic content subsidies under the *Agreement on Agriculture*? Second, if such subsidies are permitted, what is the relevance of such a rule to Brazil's claims under Article 3 of the *SCM Agreement* and

Article III.4 GATT. The European Communities has already provided elements of a response in its oral statement.[19] These are expanded upon below.

26. First, a Member is entitled to provide domestic content subsidies under the *Agreement on Agriculture* provided such subsidies are provided consistently with the Member's domestic support commitment levels. This conclusion flows from a number of factors. First, the *Agreement on Agriculture* disciplines domestic support. Article 6.1 refers to "domestic support reduction commitments". Article 3.1 refers to "domestic support [..] commitments […] constitut[ing] commitments limiting subsidization" and Article 3.2 obliges Members "not [to] provide support in favour of domestic producers in excess of the [domestic] support commitment levels". Despite these clear rules on domestic support, the *Agreement on Agriculture* does not define "domestic support".

27. AMS is the measurement of domestic support. AMS is defined as "the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general, other than [that exempted etc]." This is very general – it covers all support in favour of agricultural producers. This broad scope of domestic support measures which can be maintained consistently with the *Agreement on Agriculture* is confirmed by Article 6.1 which states that the domestic support reduction commitments "shall apply to all of its [i.e. the Member's] domestic support measures in favour of agricultural producers […]". Paragraph 1 of Annex 3 on the calculation of the AMS refers to AMS being calculated "on a product specific-basis for each basic agricultural product receiving market prices support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment". (emphasis added)

28. Consequently, the range of domestic support measures which a Member may maintain (consistent with reduction commitments) is very broad and is only limited by the condition that such support must be in favour of agricultural producers. As the European Communities has noted, paragraph 7 of Annex 3 explicitly states that "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products".[20] The European Communities considers that the term "benefit" used here must be regarded as being synonymous with "favour" in the sense of "in favour of agricultural producers". Moreover, it is clear that by "measures directed at agricultural processors" the negotiators intended subsidies which were paid to processors, where the benefit went to the agricultural producer. Consequently, in light of the broad definition of "domestic support" and the specific reference to domestic content subsidies in paragraph 7 of Annex 3, the European Communities considers that a Member is entitled to maintain domestic content subsidies consistently with the *Agreement on Agriculture*.

29. Second, in response to the Panel's question, the effect of finding that domestic content subsidies are provided consistently with the *Agreement on Agriculture* would be that they cannot be found inconsistent with either Article 3.1(b) of the *SCM Agreement* or Article III.4 GATT 1994. Article 21.1 of the *Agreement on Agriculture* states that "the provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the

[19] Paras. 34 to 38 of the EC's Oral Statement (as delivered). The Panel's reference to para. 32 corresponds to the text provided at the third party session.

[20] In terms of negotiating background, it may be useful to the Panel to note that paragraph 7 of Annex 3 was subject to negotiation during the period in which a Panel had ruled that the EC's payments to oilseed processors was not covered by Article III.8(b) GATT 1947 and were consequently inconsistent with Article III.4 GATT 1947 (*European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* Report of the Panel (L/6627 BISD 37S/86) adopted on 25 January 1990. That the negotiators retained this text must therefore be considered as a clear sign that they intended to permit Members to maintain such subsidies, subject to reduction commitments, in the *Agreement on Agriculture*.

provisions of this Agreement." As the European Communities pointed out in its oral statement, this means that provisions of the other Annex 1A Agreements are "subordinated" to the *Agreement on Agriculture*.[21]

30. To find that such subsidies were inconsistent with either Article 3.1(b) of the *SCM Agreement* or Article III.4 GATT would be to subordinate the right to provide such domestic content subsidies under the *Agreement on Agriculture* to the *SCM Agreement* or GATT 1994. Such an interpretation directly contradicts Article 21.1 of the *Agreement on Agriculture*.

31. Indeed, it can be pointed out that applying Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT to domestic content subsidies provided consistently with the *Agreement on Agriculture* would lead to stricter disciplines being applied to domestic subsidies for agriculture than are applicable to domestic subsidies for industrial goods. If Article 3.1(b) and Article III.4 were to apply, domestic subsidies for agricultural products would be subject to reduction commitments and Article 3.1(b) *SCM Agreement* and Article III.4 GATT. However, domestic subsidies for industrial products are not subject to reduction commitments. Since the *Agreement on Agriculture* establishes "a basis for initiating a process of reform of trade in agriculture", it would seem contradictory to find that domestic support for agriculture is in fact subject to stricter obligations than domestic support for other industries. This explains the "subject to" language of Article 21.1 of the *Agreement on Agriculture*. Article 21.1 and the *Agreement on Agriculture* more generally can also be compared with the other sectoral agreement included in Annex 1A of the WTO Agreement. The *Agreement on Textiles and Clothing* explicitly provides, in its Article 9, that the textiles and clothing sector is to be fully integrated into the GATT 1994. The *Agreement on Agriculture* has no such language, and Article 21.1 runs directly counter to this notion. It cannot be lightly assumed that the negotiators, while providing for the possibility to maintain domestic content subsidies, intended that such subsidies also be subject to rules which effectively makes it impossible to maintain such subsidies.[22]

32. The Panel should therefore reject Brazil's arguments that domestic content subsidies granted in favour of agricultural producers can be found to be inconsistent with Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT 1994.

**Australia's response**

> Australia does not consider that the phrase "provide support in favour of domestic producers" in Article 3.2 of the *Agreement on Agriculture* permits subsidies contingent upon the use of domestic goods.
>
> In Australia's view, the legal issue in question relates to the condition attached to the grant of a subsidy, not the grant of a subsidy *per se* or who might benefit from the subsidy. The fact that a measure may benefit an agricultural producer ("support in favour of domestic producers") does not serve to override measures otherwise prohibited.
>
> Article 21.1 of the *Agreement on Agriculture* provides that "[t]he provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement". Article 3.1 of the *SCM Agreement* applies "[e]xcept as provided in the Agreement on Agriculture". The General Interpretive Note to Annex 1A of the *Marrakesh Agreement Establishing the World Trade Organization* also

[21] Oral Statement, para. 38.

[22] See, in a similar sense, Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones")*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 165.

provides contextual guidance. Pursuant to that Note, the *Agreement on Agriculture* would prevail to the extent of any conflict with GATT 1994.

However, in the case of subsidies contingent upon the use of domestic goods, there is no conflict between either the *Agreement on Agriculture*, which *inter alia* disciplines the amounts of domestic support in favour of domestic producers which distorts trade and production, and the *SCM Agreement* or GATT 1994, which discipline or prohibit certain conditions attached to subsidies, including subsidies in favour of agricultural producers (subject only to the provisions of Article III:8(b) of GATT 1994). There is no provision in the *Agreement on Agriculture* which provides for an exception to, or cover for, local content conditions attached to the grant of a subsidy.

Australia has already noted[23] that Article 13(b)(ii) does not exempt non-"green box" domestic support measures from actions based on Article 3 of the *SCM Agreement*. Neither does Article 13 anywhere refer to GATT Article III:4. Nor with regard to these Articles is there any provision comparable to Articles 5 and 12 of the *Agreement on Agriculture*. As stated in the preambular clauses of the *Agreement on Agriculture*, the "long-term objective is to provide for substantial progressive reductions in agricultural support and protection": it is not intended to provide for a weakening of disciplines, particularly when such disciplines are not specifically mentioned.

Australia also notes that the domestic support provisions of the *Agreement on Agriculture* provide for a strengthening and elaboration of the provisions of Article XVI of GATT 1994. They are not directed towards a diminution of basic GATT obligations. National treatment is central to the multilateral trading system. It is inconceivable to Australia that the negotiators of the *Agreement on Agriculture* would, as part of a reform program designed to strengthen disciplines, agree to weaken national treatment disciplines.

However, in the event the Panel were to consider that the phrase "provide support in favour of domestic producers" refers to and/or permits subsidies contingent upon the use of domestic goods, Australia notes that such support could be permitted only to the extent that the support was actually passed through to the producers of the basic agricultural product.

**New Zealand's Response**

New Zealand does not agree that a right to provide subsidies contingent upon the use of domestic products contrary to Article 3 of the *SCM Agreement* can be found in the requirement that subsidies "directed at agricultural producers … to the extent that they benefit producers of the basic agricultural product" be included in the calculation of AMS. There is no basis for reading such a right into the *Agreement on Agriculture*. To do so would allow the possibility for exemption from action under the *SCM Agreement* to exist other than by virtue of the peace clause. The peace clause explicitly does not provide such exemption from action under Article 3 of the *SCM Agreement* when it quite clearly could have done so. In New Zealand's view that indicates that there was no intention on the part of the drafters that domestic support measures, whether they conform with Article 6 of the *Agreement on Agriculture* or not, should be so exempt. The same is true in respect of *GATT 1994* Article III:4 claims.

[23] Oral Statement by Australia, paragraphs 29-30.

**EC Comments**

33. Australia confuses legal issues. Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT concern *inter alia* the conditions under which subsidies may be granted. The *Agreement on Agriculture* provides a right, up to a specified limit, to provide support to domestic producers, irrespective of the manner in which such support is provided. That is, a Member is entitled to provide support up to the limits and to do so in any form. Paragraph 3.7 of Annex 3 makes it clear that a Member is entitled to include in its support subsidies granted to processors which benefit agricultural producers. A Member thus has a right to provide support in the form of payments to its agricultural producers. This right conflicts with the prohibition in Article 3.1(b) of the *SCM Agreement* and Article III.4 GATT.

34. The European Communities fails to see the relevance of Article XVI GATT to this issue. Moreover, it is inaccurate of Australia to suggest that interpreting the *Agreement on Agriculture* in this manner would result in a weakening of obligations. Australia conveniently ignores that, in placing absolute limits on the amount of domestic support which a Member may provide, WTO Members agreed to impose stricter disciplines on domestic support for agriculture than that applicable to domestic subsidies for industrial products.

35. New Zealand's argument rests on the conception that it is only Article 13 (the peace clause) which regulates the interface between the *Agreement on Agriculture* and the other Annex 1A Agreements. As Australia points out, Article 21.1 *Agreement on Agriculture* is clearly relevant, as is the General Interpretative Note to Annex 1A. New Zealand's unsubstantiated argument does not stand.

# ANNEX J-12

## REPLIES FROM ARGENTINA TO PANEL'S QUESTIONS

27 October 2003

A. QUESTIONS TO INDIVIDUAL THIRD PARTIES

**Q43. Please elaborate, citing figures, on your statement that polyester fibre prices actually follow cotton prices. Argentina**

1. Argentina submits that the explosion in the production of synthetic fibres played no part in the fall in international cotton prices; in fact, the contrary appears to have occurred.[1]

2. The "Fibre Prices" table in paragraph 23 of the Further Submission of the United States shows that polyester prices have always been lower than cotton prices (see the columns "US mill" and "US spot" as compared to "Asia poly") and, moreover, they appear to follow cotton prices. Thus, for example, in 1995, when cotton prices reached their record level for the series, polyester prices happened to follow the same trend, precisely at a time when the price of oil was practically at its lowest for the period under consideration.

3. Another example is the period from 2000 to 2002: while the price of oil was at its highest, the price of polyester reached its low point for the period under consideration, having "accompanied" the very low cotton prices.

4. Attached hereto as Annex ARG-1 is a graph comparing the evolution of cotton prices (US mill and US spot) with that of polyester fibre prices (Asian poly)[2] and with the price of oil per barrel (West Texas)[3], clearly reflecting a very close correlation between cotton and polyester prices.

5. On the other hand, the last few years do not show any correlation between the price per barrel of oil and the price of polyester fibres, which shows that polyester has had to adapt to cotton prices in order to remain competitive, and not the reverse as the United States claims.

B. QUESTIONS TO ALL THIRD PARTIES

**Q49. What is the meaning and effect of the introductory phrase of Article 3 of the SCM Agreement ("Except as provided in the *Agreement on Agriculture* ...")?**

6. The introductory phrase of Article 3 of the SCM Agreement ("*Except as provided in the Agreement on Agriculture* ...") means that the provisions of that Article apply to agricultural subsidies to the extent that they do not conflict with the Agreement on Agriculture (AoA). The phrase "*except as provided* ..." does not necessarily imply that there is a conflict between the two Agreements.

7. In this connection, Argentina replied to question 40 of the Panel to the third parties, stating that no provision could be found in the AoA that conflicted with Article 3.1(b) of the SCM Agreement. Indeed, the AoA does not contain any provision which explicitly permits the granting of

[1] Second oral third party submission by Argentina, 8 October 2003, paragraphs 15-17.
[2] Source: Further submission of the United States, "Fibre Prices" table, paragraph 23.
[3] Source: Argentine Oil and Gas Institute (IAPG).

"subsidies contingent, whether solely or as one of several other conditions, on the use of domestic over imported products."

8. It is therefore Argentina's understanding that since they are prohibited under Article 3.1(b) of the SCM Agreement, and since there is no specific provision in the AoA that is explicitly mentioned in the introductory phrase of Article 3 of the SCM Agreement, subsidies contingent on the use of domestic over imported goods are also prohibited under the AoA.

9. Likewise, Argentina pointed out in its comments on the reply by the European Communities to question 40 from the Panel that the rules of the AoA, on the one hand, and of the GATT 1994 and the SCM Agreement, on the other, contained disciplines that were applied together, unless there was a discrepancy or "conflict" between the different provisions.[4]

**Q50. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*?**

10. The impact will depend on the Panel's finding on the preliminary issue raised with respect to the Peace Clause. If the Panel finds, as Argentina maintains, that the United States does not qualify for protection under Article 13 of the AoA, the expiry date of the Peace Clause will be entirely irrelevant.

11. If after 31 December 2003 the Panel should decide not to rule on the substantive claims, this would affect Brazil's right to due process by depriving it, on the basis of rules which are no longer in force, of the right to a finding that would settle of the dispute as to whether or not the subsidies were consistent. Thus, Brazil would be deprived of a positive settlement of the dispute.

**Q51. How should the concept of specificity - and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" - in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions citing the principles in Article 2 of the *SCM Agreement*:**

**(a) Is a subsidy in respect of all agricultural, but not other, products specific?**

12. Yes.

**(b) Is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

13. Yes.

**(c) Is a subsidy in respect of certain identified agricultural products specific?**

14. Yes.

[4] As already stated, "[t]he conditions for the existence for a conflict between two rules was clarified by the Appellate Body in the *Guatemala – Cement case* (WT/DS60/AB/R, paragraph 65), where it is determined that there is a conflict between two provisions if adherence to one provision leads to a violation of the other. In the case before us, in order to determine whether a rule in the GATT 1994 or in an Agreement in Annex 1A (Article 3.1(b) of the ASCM in this particular case) does not apply, it must first be determined whether there is an inconsistency or discrepancy with a provision of the AoA. In other words, these rules must be applied together." (Comments by Argentina on the reply by the European Communities to question 40 from the Panel to the third parties).

**(d) Is a subsidy in respect of upland cotton, but not other products, specific?**

15. Yes.

**(e) Is a subsidy in respect of certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

16. Yes.

**(f) Is a subsidy in respect of certain proportion of total US farmland specific?**

17. Yes.

18. Argentina stresses that the concept of "specificity" in Article 2 of the SCM Agreement is very broad, since it refers to the subsidies for an enterprise or an industry or group of enterprises or industries.

19. From the standpoint of the SCM Agreement, agricultural subsidies are specific within the meaning of Article 2, since they are not available for all products. The mere fact that they are "agricultural" precludes any interpretation that they are not specific.

20. As regards the principle of Article 2.1, agricultural subsidies comply with the requirements of each one of its indents:

- Indent (a), because not all of the enterprises of a Member have access to subsidies under the AoA;
- indent (b), because there is no automatic eligibility for the subsidies under the AoA, nor are they based on objective criteria such as those listed in footnote 2 to Article 2, since they benefit the producers of certain products – in the case in point, those included in Annex I of the AoA;
- indent (c), because a subsidy for an agricultural product complies with all of the requirements of the first sentence thereof. As regards the second sentence of indent (c), there is no evidence for including an agricultural subsidy under any of these factors.

As to the specific case of export subsidies, Article 2.3 reaffirms their specificity. Having already pointed out that specificity is established under Article 2.1 and 2.3, there is no need to address the principle in Article 2.2.

21. Generally speaking, it should be borne in mind that in addition to the principles laid down in indents (a) and (b) of Article 2.1 for determining whether a subsidy is specific, indent (c) stipulates that in case of doubt as to the specificity of a subsidy, a number of other factors should be considered. In Argentina's view, this implies that the intention of the drafters of the Agreement was that the concept of "specificity" should be as comprehensive as possible.

**Q52. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the *SCM Agreement*. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the *SCM Agreement* to withdraw the subsidy without delay, can the Panel:**

**(a) Also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel?**

22. In Argentina's view, if the Panel were to conclude that a subsidy was prohibited and to make a recommendation – under Article 4.7 of the SCM Agreement – to withdraw the subsidy without delay, it could nevertheless also conclude that the same subsidy had resulted in adverse effects to the interests of another Member and make the same recommendation to withdraw the subsidy under Article 7.8 of the SCM Agreement.

23. Indeed, bearing in mind that we are speaking of two different claims, the value of such a conclusion would be to have made *"an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and ... such other findings as will assist the DSB in making recommendations or in giving the rulings provided for in the covered agreements"*, in conformity with Article 11 of the DSU.

24. For the reasons set forth above and as stated throughout these proceedings, Argentina requests the Panel to issue the findings and recommendations requested by Brazil, including those related to the Step 2 and GSM 102 programmes which, under Article 4.7 of the SCM Agreement, must be withdrawn without delay. Likewise, the Panel should also make a recommendation that the United States take appropriate steps to remove the adverse effect of those programmes under Article 7.8 of the SCM Agreement.

**(b) Take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the *SCM Agreement*?**

25. In Argentina's view, if the Panel concludes that there were prohibited subsidies, it should recommended – under Article 4.7 of the SCM Agreement – that they be withdrawn without delay, without prejudice to taking into account the effects of the interaction of those prohibited subsidies with other actionable subsidies.

26. Taking into account the effects of the said interaction is extremely important to determining causation under Article 5 of the SCM Agreement. Indeed, as already stated[5], Argentina considers that it is the collective impact of all the US subsidies that has effects on the cultivated area, production, exports and prices, notwithstanding the fact that the mere elimination of a prohibited subsidy would not necessarily put an end to the adverse effects of the other actionable subsidies.

**Q53. Would a finding of serious prejudice under Article 5(c) of the *SCM Agreement* be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the *SCM Agreement* in this context?**

27. A finding of serious prejudice under Article 5(c) of the SCM Agreement is determinative for a finding under Article XVI:1 of the GATT 1994, since that Article orders the contracting party granting the subsidy to consider the possibility of limiting it *"*[*i*]*n any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by such subsidization …"*. In other words, if it is determined that a subsidy causes or threatens to cause serious prejudice under Article 5(c) of the SCM Agreement, it necessarily calls for a finding of violation of Article XVI:1 of the GATT 1994.

[5] Second oral third party submission by Argentina, 8 October 2003, paragraph 33.

28. In this connection, footnote 13 of the SCM Agreement, which states that *"the term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice"*, clearly establishes the link between the two provisions.

**Q54. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims?**

29. Argentina has no evidence that US cotton producers are unable to cover their fixed and variable costs without subsidies.

30. What Argentina has repeatedly stated – referring to the evidence submitted by Brazil during these proceedings – is that the US cotton producers cannot bridge the gap between total production costs (i.e. the sum of fixed and variable costs) and market prices for cotton without subsidies.

31. Argentina has pointed out that cotton production costs in the United States are among the highest in the world.[6] According to an ICAC study[7], the cost of production in the United States was US$0.81 per pound of cotton in the marketing year 1999[8], while US producers' market prices fell from US$0.60 to US$0.30 per pound.

32. Argentina also stated that the only possible explanation how the United States bridged this widening gap between production costs and market prices is subsidies, since without them many US producers would have been compelled to cease production (in spite of the fact that they would eventually have been able to cover their fixed and variable costs).

33. This fact, that without subsidies US cotton producers could not have bridged the gap between their total production costs and market prices, is entirely relevant to Brazil's claims, since it shows that as a result of the subsidies, less efficient US producers are immune to changes in market prices. In other words, without the US subsidies which generate a world market surplus, international cotton prices would have been higher or would not have fallen as much.

34. This confirms both the actual serious prejudice and the threat of serious prejudice caused by the subsidies, in that future subsidies will be as necessary as the current ones for US producers to bridge the gap between market prices and their total production costs.[9] This will enable them to continue competing with more efficient third-country producers, especially considering that the USDA itself forecasts an increase in total production costs.[10]

**Q55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) (*"another Member"*) for the purposes of these proceedings?**

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[6] Third party submission by Argentina, 15 July 2003, paragraphs 17 and 18.

[7] Cotton: World Statistics, Bulletin of the International Cotton Advisory Committee, September 2002 (Annex BRA-9).

[8] As stated by Brazil in its first submission to the Panel of 24 June 2003, paragraph 32, according to the ICAC study the cost of production in Argentina averaged 59 cents per pound of cotton (See Annex BRA-9).

[9] Second written third party submission by Argentina, 3 October 2003, paragraph 49.

[10] See Annexes BRA-7 (ERS Data: Commodity Costs and Returns); BRA-257 ("Cost of Farm Production Up in 2003", USDA, 6 May 2003) and BRA-82 ("USDA Agricultural Baseline Projections until 2012", USDA, February 2003, p.48).

35. The concept of "another Member" within the meaning of Article 6.3(c) covers Argentina, which indeed submitted claims relating to the price effect of US subsidies.

36. Notwithstanding, Argentina is aware that in these proceedings, it is Brazil that brought the case and requested consultations and the establishment of this Panel. At the same time, Argentina – which has also suffered serious prejudice – felt that it was appropriate to ask to be joined in the consultations, participated actively in them and raised a number of issues, as well as asking to join as a third party and presenting, in its submissions, arguments relating to price effect.

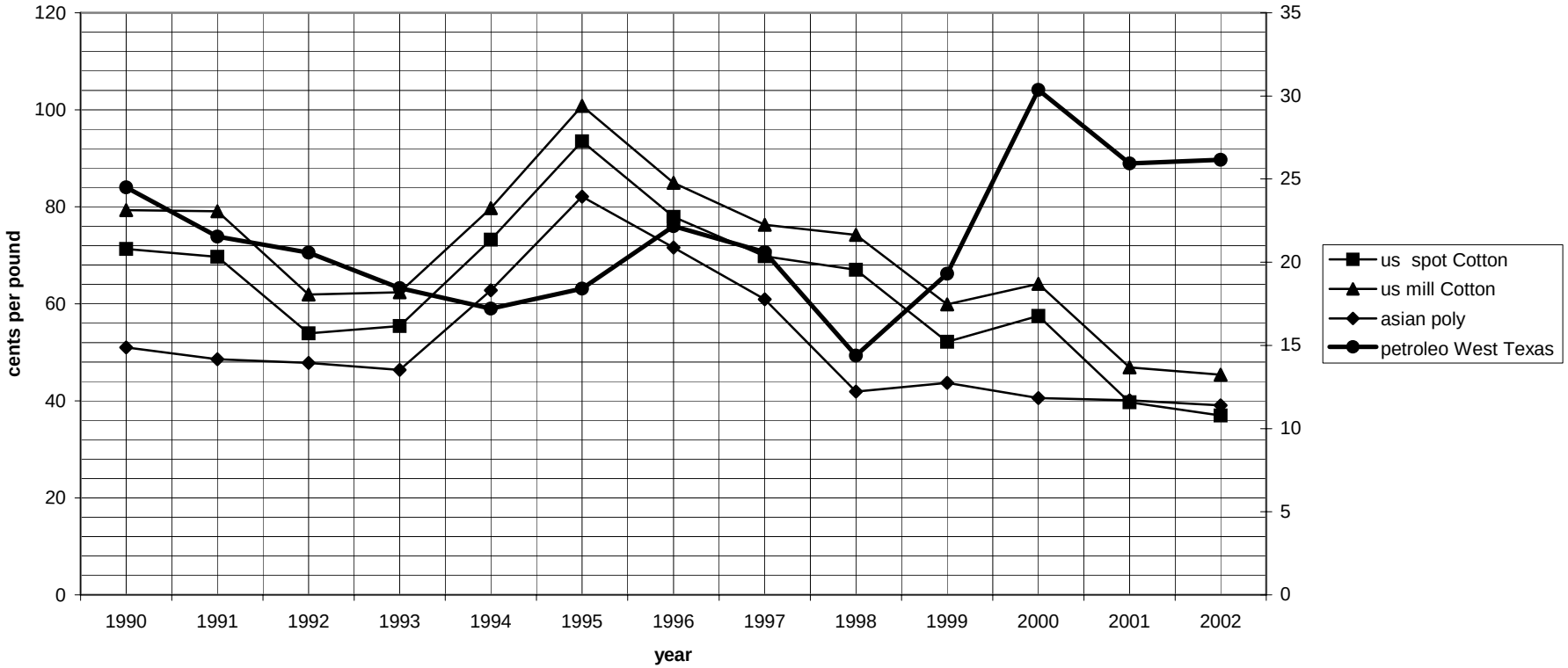
37. As stated throughout these proceedings, it is in Argentina's interest that the Panel should issue the findings and recommendations requested by Brazil, since this would mean that, in conformity with Article 7.8 of the SCM Agreement, the United States would have to *"take appropriate steps to remove the adverse effects or … withdraw the subsidy"*.

38. This interest on the part of Argentina is based on the conviction that if the Panel were to issue such findings and recommendations, the elimination of the adverse effects or the withdrawal of the subsidies would have a favourable impact on the international price of cotton – indeed, without the US subsidies which generate a world market surplus, international cotton prices could be higher or could fall less. Similarly, if its share in the world market were not increased as a result of the subsidies, the international price of cotton would be higher or would not be so low, and as a result, third party producers, including Argentina, would not suffer as much prejudice as a result of artificially depressed prices.[11]

39. As already stated, an increase in the world cotton price would be significant – even if as a result of the subsidies the suppression or depression of international prices amounted to only 1 cent per pound – since it would enable countries like Argentina to recover their competitive position in the world cotton market.[12]

[11] Second oral third party submission by Argentina, 8 October 2003, paragraph 10.

[12] Second written third party submission by Argentina, 3 October 2003, paragraphs 34 to 36, and second oral third party submission by Argentina, 8 October 2003, paragraph 38.



# ANNEX J-13

## RESPONSES BY AUSTRALIA

27 October 2003

A. QUESTIONS TO INDIVIDUAL THIRD PARTIES

43. …

44. …

45. …

46. …

47. …

48. …

B. QUESTIONS TO ALL THIRD PARTIES

**Q49. What is the meaning and effect of the introductory phrase of Article 3 of the SCM Agreement ("Except as provided in the Agreement on Agriculture …")?**

Reply

In Australia's view, with regard to subsidies for agricultural products, unless the *Agreement on Agriculture* makes express provision to the contrary, Article 3 of the *SCM Agreement* continues to apply to such subsidies. The simultaneous application of both Agreements to agricultural products is confirmed by Article 21.1 of the *Agreement on Agriculture.*

Australia noted previously in its response to the Panel's earlier question 40 that the legal issue in question concerning the relationship between the *Agreement on Agriculture* and Article 3.1(b) of the *SCM Agreement* derives from the condition attached to the grant of a subsidy, not the grant of a subsidy *per se* or who might benefit from the subsidy. The *Agreement on Agriculture* does not include any provisions concerning the conditionality of domestic support in the sense of SCM Article 3.1(b).

Moreover, the *Agreement on Agriculture* does not confer a right to grant subsidies. Rather, that Agreement establishes disciplines for the use of certain subsidies in relation to agricultural products should a Member choose to provide subsidies for such products. Arguments that the *Agreement on Agriculture* allows local content subsidies based on the phrase "support in favour of domestic producers" and similar phrasing and the provisions of paragraph 7 of Annex 3 of that Agreement are not sustainable. The word "support" is used throughout the *Agreement on Agriculture* in the sense of generic measures providing a calculable financial advantage to agricultural producers, whether price support, direct subsidy payments or any other means not exempted from a Member's commitment to reduce domestic support. Indeed, Annex 3 is headed "Domestic Support: Calculation of Aggregate Measurement of Support".

It is inconceivable to Australia that any intended exemption from the very significant and unambiguous local content subsidy disciplines of Article 3.1(b) of the *SCM Agreement* would not have been expressly set out in the *Agreement on Agriculture*. The inclusion of express provisions concerning export subsidies in the *Agreement on Agriculture* indicates that the negotiators of that Agreement were well aware of the need to include express provisions if additional or alternative disciplines concerning subsidies for agricultural products were intended vis-à-vis the disciplines established pursuant to the *SCM Agreement*.

The situation is analogous to that examined by the Panel and the Appellate Body in *EC – Bananas* wherein the Appellate Body upheld the Panel's conclusion that the *Agreement on Agriculture* did not permit the EC to act inconsistently with Article XIII of GATT 1994 in the absence of any provisions dealing specifically with the allocation of tariff quotas on agricultural products.[1] In the absence of provisions dealing specifically with local content subsidies in the *Agreement on Agriculture*, that Agreement does not allow a Member to act inconsistently with the *SCM Agreement*. The fact that the phrase "[e]xcept as provided in the Agreement on Agriculture" in the chapeau of SCM Article 3.1 also applies to paragraph (b) of that Article cannot of itself compel the interpretation that there are provision(s) of the *Agreement on Agriculture* which necessarily apply.

The Panel may not interpret the provisions of the *SCM Agreement* and the *Agreement on Agriculture* so as to diminish or override fundamental WTO obligations in the absence of express provisions to that effect. To do so would constitute, in Australia's view, a misapplication of the customary rules of interpretation of public international law.

**Q50. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture?**

Reply

In Australia's view, whether the date the Panel's report will be issued to the parties to the dispute will have any impact on any "exempt[ion] from actions" under Article 13(b)(ii) of the *Agreement on Agriculture* will depend on whether the Panel finds that the United States is granting, through domestic support measures that conform fully to the provisions of Article 6 of that Agreement, support to a specific commodity in excess of that decided during the 1992 marketing year. If the Panel finds that the United States is granting support to a specific commodity in excess of that decided during the 1992 marketing year, the United States will have no "exempt[ion] from actions" pursuant to Article 13(b)(ii), irrespective of when the Panel's report is issued. If the Panel finds that the United States is not granting such support to a specific commodity in excess of that decided during the 1992 marketing year, the United States may be "exempt from actions" pursuant to Article 13(b)(ii) until Article 13 expires.

**Q51. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" – in Article 2 of the SCM Agreement apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the SCM Agreement:**

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

[1] *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R, paragraphs 153-158.

**(c) is a subsidy in respect of certain identified agricultural products specific?**

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

Reply

Australia does not wish to comment on this issue.

**Q52. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the SCM Agreement. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy without delay, can the Panel:**

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel?**

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the SCM Agreement?**

Reply

If the Panel were to conclude that a subsidy was prohibited and to make a recommendation under Article 4.7 of the *SCM Agreement* to "withdraw the subsidy without delay", and having regard to the presumption of adverse effects implicit in a finding that a subsidy is prohibited and to the observations of the Appellate Body on the meaning of "withdraw" in SCM Article 4.7[2]:

(a) the Panel could conclude that the same subsidy had also resulted in adverse effects to the interests of another Member under SCM Article 5, particularly if that other Member were a third party to the dispute in light of the provisions of Article 10.1 of the DSU;

(b) the Panel could also consider the interaction of that prohibited subsidy with other, allegedly actionable subsidies. However, the prohibited subsidy would be required to be withdrawn without delay and thus any causative contribution its interaction with other allegedly actionable subsidies may make to the adverse effects of those other actionable subsidies will be removed as a consequence of the withdrawal of the prohibited subsidy.

**Q53. Would a finding of serious prejudice under Article 5(c) of the SCM Agreement be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the SCM Agreement in this context?**

Reply

Australia does not wish to comment on this issue.

[2] *Brazil – Export Financing Programme for Aircraft*, Recourse by Canada to Article 21.5 of the DSU, Report of the Appellate Body, WT/DS46/AB/RW, paragraph 45.

**Q54. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims?**

Reply

Australia does not wish to comment on the facts of US costs of production in relation to upland cotton, but notes the statements of the Appellate Body in relation to the calculation of costs of production in the *Canada – Dairy* dispute.[3]

**Q55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("another Member") for the purposes of these proceedings?**

Reply

Australia does not wish to comment on this issue.

**Q56. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the Agreement on Agriculture and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the SCM Agreement.**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on export subsidies" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions, of the Agreement on Agriculture, relevant?**

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in US – FSC, para. 117 here?**

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 were negotiated?**

Reply

In Australia's view, it is unambiguous that agricultural domestic support programmes are challengeable under Article XVI:3 of GATT 1994.

It is useful to recall to begin with that GATT 1947 did not provide a definition of a "subsidy" or of an "export subsidy" and that the only disciplines on subsidies of any type were the general subsidy disciplines of paragraph 1 of GATT Article XVI. The provisions of Section B of GATT Article XVI, comprising paragraphs 2-5 and headed "Additional Provisions on Export Subsidies", were added at the 1954-55 Review Session and constituted the earliest disciplines directed at "the use

[3] *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, Recourse to Article 21.5 of the DSU by New Zealand and the United States, WT/DS103/AB/RW – WT/DS113/AB/RW, paragraphs 94-96, and Second Recourse to Article 21.5 of the DSU by New Zealand and the United States, WT/DS103/AB/RW2 – WT/DS113/AB/RW2, paragraphs 91-120.

of subsidies on the export of primary products". The plurilateral 1979 Tokyo Round Subsidies Code[4] represented a further stage in the elaboration of disciplines on export subsidies and subsidies generally, in particular, Articles 8-11and the Annex. This background is helpful in understanding the evolution of the use of terminology originally found in GATT Article XVI and the relationship between provisions of the covered agreements as they exist today.

In relation to the use of subsidies on the export of primary products, the substantive discipline established by Article XVI:3 of GATT 1994 was that:

> "[i]f a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product".

Thus, the key discipline established by Article XVI:3 of GATT 1994 is that a subsidy that has the effect of increasing a Member's exports of a primary product must not be applied so as to result in that Member having more than an equitable, that is, a "just" or "fair",[5] share of world export trade in that primary product. GATT Article XVI:3 was elaborated by Article 10.1 and 10.2 of the later plurilateral Tokyo Round Subsidies Code, but these provisions were not carried forward to, and incorporated as such, in the *SCM Agreement*.

Notwithstanding the heading of Section B of GATT Article XVI, that discipline is distinct from the export subsidy disciplines later incorporated in Article 3.1(a) of the *SCM Agreement*. In particular, GATT Article XVI:3 is concerned with the effects rather than the conditions of a subsidy's grant.

Moreover, the discipline established by Article XVI:3 of GATT 1994 is distinct from the discipline established by Article 6.3(d) of the *SCM Agreement*, which relates to whether the effect of a subsidy is to increase a Member's world market share compared to the previous three-year average share. At the same time, there may be substantial commonality of facts in demonstrating non-compliance with either provision. Further, both GATT Article XVI:3 and SCM Article 6.3(d) must be applied within the same contextual framework of "serious prejudice" established by GATT Article XVI:1, and SCM Article 5(c) and its footnote.

The GATT Article XVI:3 discipline is also distinct from the disciplines established by other provisions of the covered agreements.

The Appellate Body has previously noted that the *WTO Agreement* was accepted by WTO Members as a "single undertaking".[6] The Appellate Body has also said:

> The relationship between the GATT 1994 and the other goods agreements in Annex 1A is complex and must be examined on a case-by-case basis. Although the provisions of the GATT 1947 were incorporated into, and became a part of the GATT

[4] *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade*, BISD 26S/56.

[5] *The New Shorter Oxford English Dictionary*, Ed. Lesley Brown, Clarendon Press, Oxford, 1993, Volume 1, 843.

[6] For example, *Brazil – Measures Affecting Desiccated Coconut*, Report of the Appellate Body, WT/DS22/AB/R, page 13.

> 1994, they are not the sum total of the rights and obligations of WTO Members concerning a particular matter. For example, with respect to subsidies on agricultural products, Articles II, VI and XVI of the GATT 1994 alone do not represent the total rights and obligations of WTO Members. The *Agreement on Agriculture* and the *SCM Agreement* reflect the latest statement of WTO Members as to their rights and obligations concerning agricultural subsidies. The general interpretative note to Annex 1A was added to reflect that the other goods agreements in Annex 1A, in many ways, represent a substantial elaboration of the provisions of the GATT 1994, and to the extent that the provisions of the other goods agreements conflict with the provisions of the GATT 1994, the provisions of the other goods agreements prevail. This does not mean, however, that the other goods agreements in Annex 1A, such as the *SCM Agreement*, supersede the GATT 1994. …"[7] (emphasis added)

In the absence of a conflict between the provisions of Article XVI:3 of GATT 1994 and Article 6.3(d) of the *SCM Agreement* or any other provisions of the covered agreements such that the General Interpretative Note to Annex 1A of the *WTO Agreement* becomes operative, GATT Article XVI:3 continues to apply. In Australia's view, the Appellate Body report in *US – FSC*, paragraph 117, does not affect the interpretation of the relationship between these provisions other than in the sense of confirming that the relationship must be determined on the basis of the texts of the relevant provisions as a whole.

The continued applicability of Article XVI:3 of GATT 1994 is confirmed by Article 13 of the *Agreement on Agriculture*. The exemption from action pursuant to AA Article 13(b)(ii) is only applicable in respect of paragraph 1 of GATT Article XVI, whereas the exemption from action pursuant to AA Article 13(c)(ii) is applicable to the whole of GATT Article XVI. Had the negotiators of the *WTO Agreement* believed that GATT Article XVI:3 had become redundant, they would not have expressly distinguished between the paragraphs of GATT Article XVI in AA Article 13 as they did. Moreover, Australia believes its view is fully consistent with the provisions of Article 21.1 of the *Agreement on Agriculture* and with the nature of the *WTO Agreement* as a whole as a "single undertaking".

Further, the distinction between the provisions of Article XVI of GATT 1994 in Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture* is entirely consistent with the object and purpose of the *Agreement on Agriculture*, including as expressed in the third preambular paragraph that the "long-term objective is to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets". It would be directly contrary to that objective if WTO Members were able, albeit otherwise consistently with the domestic support provisions of the *Agreement on Agriculture*, nonetheless to arrange their domestic support payments so as to achieve an inequitable share of the world export market in a particular primary product.

[7] *Brazil – Desiccated Coconut*, Report of the Appellate Body, pages 14-15.

# ANNEX J-14

## RESPONSES OF BENIN AND CHAD TO THE PANEL'S QUESTIONS

27 October 2003

Benin and Chad would offer the following responses to those Panel questions that pertain to the scope of their Third Party Submissions:

**"44. Please explain how Articles 5 and 6 of the *SCM Agreement* and Article XVI of the GATT 1994 would permit or require the Panel to take account of any effects of the subsidies in question on the interests of Members other than the complaining party. Benin and Chad."**

Brazil is the sole complaining party in this dispute, and ultimately only Brazil would have the right to any remedy provided by the SCM Agreement. However, Benin and Chad submit that the Panel is nevertheless required to take account of the effects of the US subsidies on the interest of Members other than the complaining Member, for the following reasons.

First, the chapeau of Article 5 states that "[n]o Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members". The drafters of Article 5 referred to "Members" in the plural, connoting an obligation on behalf of the subsidizing Member not to cause adverse effects to the interests of all WTO Members – not just the complaining Member.

Second, when the drafters of the SCM Agreement intended to refer only to the "complaining Member", they used this term specifically, such as in Article 6.7, or in paragraph 2 of Annex V. They could similarly have used the term "complaining Member" elsewhere in Articles 5 and 6, but they did not. Therefore, the term "other Members" cannot be interpreted as synonymous with "complaining Members", just as the term "another Member" cannot be read as limited only to the "complaining Member". The treaty interpreter must give meaning to the terms actually used in the text.[1]

Third, this interpretation is consistent with Article 3.8 of the DSU, which provides as follows:

> In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge. [emphasis added]

Article 3.8 refers to the "adverse impact" on "other Members" in the plural, referring to all WTO Members. Although the SCM Agreement provides special and additional rules for dispute settlement, these special rules have not ousted the application of DSU Article 3.8. Benin and Chad are "parties to [the] covered agreement", the SCM Agreement, and it can therefore be presumed that

[1] The textual analysis set out above applies equally to Article XVI:1 of the GATT 1994, which refers to the "other contracting party." (By virtue of paragraph 2(a) of the *Explanatory Notes to GATT 1994*, the references to "contracting party" are deemed to read "Member.") Article XVI:1 thus refers to the "other Member" and not the "complaining Member."

the breach of the SCM Agreement by the United States has an adverse impact on these two African countries.

In any event, the Panel need not rely exclusively on the presumption set out DSU Article 3.8, since Benin and Chad have already provided to the Panel detailed evidence about the adverse effects of US subsides on West and Central Africa. Benin and Chad also note the similarities in language between the SCM Agreement ("adverse effects") and DSU Article 3.8 ("adverse impact"). This reinforces the relevance and applicability of the latter provision.

Fourth, DSU Article 10.1, which deals with Third Parties, provides additional support for the position that the Panel should take into account the adverse effects on parties other than just the complaining party:

> The interests of the parties to a dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process.

DSU Article 10.1 is not limited simply to allowing Third Parties to present their views. That is dealt with elsewhere, including in DSU Article 10.2, which grants to Third Parties the right "to be heard by the Panel". By contrast, DSU Article 10.1 is not limited to providing Third Parties with the right to present views. Instead, it mandates that the "interests" of the third parties shall be "fully taken into account".

Fifth, DSU Article 24.1 provides that "[a]t all stages… of dispute settlement procedures involving a least-developed country Member, particular consideration shall be given to the special situation of least-developed country Members". Benin and Chad are both least-developed countries. The "particular consideration" that must be extended to them goes beyond simply ensuring that their views are heard – as noted above, such procedural protections are provided for elsewhere in the DSU. Instead, Panels must give "particular consideration" to their "special situation". In the context of the present case, the "special situation" of Benin and Chad has been presented in some detail to the panel. Massive US cotton subsidies have had, and continue to have, a devastating impact on the fragile economies of West Africa, pushing hundreds of thousands of people from subsistence farming into absolute poverty. If DSU Article 24.1 has any meaning, this "special situation" of Benin and Chad must be given full, substantive consideration by the Panel.

Finally, Benin and Chad note that the serious prejudice caused to their economies has also been specifically raised before the Panel by one of the disputing parties, Brazil. As the Panel will recall, Part 7 of Brazil's Further Submission of 9 September 2003 is on "Serious Prejudice to the Interests of African Countries by Reason of the US Subsidies on Upland Cotton". This provides addition support for the position that the serious prejudice to Benin and Chad needs to examined by the Panel in assessing the WTO-consistency of the US subsidies.

**"55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("another Member") for the purposes of these proceedings? All third parties."**

As noted, the drafters of the SCM Agreement used the term "complaining Member" in other provisions of the Agreement. In Article 6.3(c), they chose the term "other Member" rather than "complaining Member." For the reasons set out above, Benin and Chad are of the view that Article 6.3(c) encompasses both the complainant, Brazil, as well as other WTO Members.

The Panel has before it substantial evidence about the effects of the US subsidies, including the significant price undercutting by US cotton compared with the price of the like products of Brazil,

Benin and Chad in world markets, as well as significant price suppression and price depression in world cotton markets. In assessing the WTO-consistency of the US subsidies, the Panel is required by the SCM Agreement to take this evidence into account.

# ANNEX J-15

## CANADA'S RESPONSES TO PANEL QUESTIONS TO THIRD PARTIES FIRST SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES (RESUMED FIRST SESSION)

27 October 2003

Canada sets out responses to the questions of the Panel in which Canada has a systemic interest:

**49. What is the meaning and effect of the introductory phrase of Article 3 of the *SCM Agreement* ("Except as provided in the *Agreement on Agriculture*...")?**

Reply

The meaning and effect of this phrase is that Article 3 of the *SCM Agreement* applies *subject to* the export subsidy disciplines of the *Agreement on Agriculture*, which permit, in some instances and within certain limits, the granting or maintaining of subsidies that would otherwise be prohibited under the *SCM Agreement*.

**51. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" – in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*:**

Reply

Canada's answers assume that the phrase "in respect of" has the same meaning as the standard "is specific to" in Article 2.1 of the *SCM Agreement*. Based on the ordinary meaning of the phrase "is specific to", read in context and in light of the object and purpose of Article 2 and of the *SCM Agreement*, the specificity test is concerned with the actual availability of a programme. Analysis on availability may include an assessment of the manner in which a programme is used in the circumstances of a given case. The panel in *US – Softwood Lumber III* recently confirmed: "In our view, Article 2 SCM Agreement is concerned with the distortion created by a subsidy which either in law or in fact is not broadly available."[1] Moreover, a programme may be found either *de jure* or *de facto* specific, and either determination depends on the nature of the evidence relied upon.[2]

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

[1] *United States – Final Countervailing Duty Determination with respect to Certain Softwood Lumber from Canada*, Report of the Panel, WT/DS257/R, circulated 29 August 2003, para. 7.116.

[2] In this respect, a determination under Article 2 is similar to a determination under Article 3. The legal standard expressed by the phrase "is specific to" is the same for both *de jure* or *de facto* determinations; the only difference is the nature of the evidence relied upon. See *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999, para. 167 ("In our view, the legal standard expressed by the word 'contingent' is the same for both *de jure* or *de facto* contingency. There is a difference, however, in what evidence may be employed to prove that a subsidy is export contingent.")

Reply

No. Canada shares the view of the United States in *United States – Continued Dumping and Subsidy Offset Act of 2000*, that, as a general matter, "all agriculture" is too broad to qualify as a "group of enterprises or industries" for specificity purposes.[3]

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

Reply

The answer will depend on the facts of a given case. A panel would have to consider, among other things, the number of enterprises or industries (based on standard industrial classification) within the jurisdiction of the granting authority that are actually eligible to receive the subsidy, and the level of diversification of the "all agricultural crops" universe. Furthermore, the answer would also depend on the nature of the measure in question and whether it excludes enterprises or industries that might otherwise be reasonably or practically included. For example, weather that may cause extensive damage to crops (e.g. hail, frost, excessive moisture, drought) may not cause any damage to livestock. Therefore, it may not be reasonable or practical to include livestock under a crop insurance programme. On the other hand, an income stabilization programme could reasonably or practically include both crops and livestock.

**(c) is a subsidy in respect of certain identified agricultural products specific?**

Reply

The answer will depend on the facts of a given case, including whether the eligible products involve only "an enterprise or industry or group of enterprises or industries" (based on standard industrial classification) under Article 2.1.

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

Reply

Yes.

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

Reply

Where a programme appears *de jure* non-specific under Articles 2.1(a) and (b), predominant use of a programme by "certain enterprises" (a defined term in Article 2.1) would indicate, in the absence of any other reasonable explanation, that the availability of the subsidy is limited in fact to such enterprises or industries under Article 2.1(c) and 2.4. Likewise, where a programme appears *de jure* non-specific under Articles 2.1(a) and (b), the granting of disproportionately large amounts of subsidy to certain enterprises would indicate, in the absence of any other reasonable explanation, that the availability of the subsidy is limited in fact to such enterprises or industries under Article 2.1(c) and 2.4. In both cases, any predominance or disproportionality should be measured over an

[3] *United States – Continued Dumping and Subsidy Offset Act of 2000*, Report of the Panel, WT/DS217/R, WT/DS234/R, adopted 27 January 2003, at para 4.1146.

appropriate period of time and in relation to the value of production in question as compared to the total value of all agricultural production.

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

Reply

The answer will depend on the facts of a given case, including the proportion of total US farmland involved, whether that proportion involves "an enterprise or industry or group of enterprises or industries", and whether the programme "is specific to" (i.e., available only to) those enterprises or industries.

# ANNEX J-16

## RESPONSE BY CHINA TO THE PANEL'S QUESTIONS TO THIRD PARTIES

27 October 2003

1. China appreciates this opportunity to present its views again to the Panel in relation to the Panel's questions posed to third parties on October 13, 2003. Given the short period within which third parties are required to submit their views, China responds to and comments on the following underlined questions.

**2. Question 49. What is the meaning and effect of the introductory phrase of Article 3 of the *SCM Agreement* ("Except as provided in the *Agreement on Agriculture*…")? All third parties**

3. To answer this Panel's question, it is helpful to first look to the relationship between the *Agreement on Agriculture* and the *SCM Agreement*. Art. 21.1 of the *Agreement on Agriculture* provides:

> The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement [on Agriculture].

4. The Appellate Body, in *EC – Bananas III,* further clarified this article by stating that

> the provisions of GATT 1994, [and indeed 'other Multilateral Trade Agreements including the *SCM Agreement*, note added pursuant to Art. 21 of the *Agreement on Agriculture*], …, apply …, except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter".[1]

In other words, Art. 21.1 of the A*greement on Agriculture*, as interpreted by the Appellate Body, requires that in connection with a specific matter, the A*greement on Agriculture* prevails over the *SCM Agreement* to the extent that it has more specific provisions over the same matter covered by the *SCM Agreement*.

5. The introductory phrase of Art. 3 of the *SCM Agreement* again, in the matter of prohibited subsidies, grants deference to the *Agreement on Agriculture*. It reads:

> [E]xcept as provided in the *Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited.

Given that the *SCM Agreement* contains disciplines over all types of subsidies, including agricultural, and the *Agreement on Agriculture* imposes more specific disciplines over subsidies granted to agricultural commodities only, where such specificity of discipline can be established, the *Agreement on Agriculture* shall prevail pursuant to Article 3.1 of the *SCM Agreement*.

[1] Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, DSR 1997:II, Para. 155.

6. Therefore, in line with Art. 21.1 of the *Agreement on Agriculture* past Appellate Body interpretation above and Art. 3.1 of the *SCM Agreement*, the *Agreement on Agriculture*, where it is more specific, shall *prevail* over provisions of the *SCM Agreement*.

**7. Question 50. According to its revised timetable, the Panel will issue its report to the parties after the end of 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*? All third parties**

8. China believes Article 13 continues to be applicable to the current case even after it ceases to be in effect.

9. Art. 13 of the *Agreement on Agriculture* protects subsidy measures otherwise prohibited or actionable under the *SCM Agreement* during the nine-year implementation period commencing in 1995. Unless agreed otherwise amongst Members, Article 13 will expire in 2004.

10. Art. 70 of the *Vienna Convention on the Law of Treaties*, in dealing with the consequences of the termination of a treaty, provides to the effect that the termination of a treaty does not affect any right, obligation or legal situation of the parties created through the execution of the treaty prior to its termination. Applied to Art. 13 of the *Agreement on Agriculture*, if a Member's subsidy measures were granted and implemented prior to expiry of the Peace Clause, such Member's possible right to be protected thereunder is not removed by the expiry; neither are obligations on other Members to exercise due restraint. Such rights, obligations and legal situations created through implementation of the Peace Clause for the purpose of these proceedings are allowed by the *Vienna Convention on the Law of Treaties* to be live issues as between parties to a dispute. Even if the Panel were to make its report after the expiry, the rights and obligations and their past interaction are heavily controversial issues the interpretation and resolution of which by this Panel will have bearings on the merits of the case not only between the parties to this dispute, but also to the general WTO membership. Therefore, this Panel, even if it chooses to issue its report after the expiry date of the Peace Clause, is obligated to rule on such rights and obligations during implementation of the Peace Clause.

11. In addition, considering the likelihood of the Peace Clause being extended as reportedly suggested by some Members, however remote, an interpretation of the "exempt from action" requirement and its practical application is of extraordinary value to Members having interests in such an extension proposal; such Members, aided with the Panel's interpretation of the key components of this clause, will have a better basis to form their negotiating policy and stance, not only in terms of the Peace Clause, but also with regard to WTO discipline on agriculture.

**12. Question 51. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*: All third parties**

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

**(c) is a subsidy in respect of certain identified agricultural products specific?**

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

13. "Commodity" includes agricultural crops such as upland cotton.[2] While the *Agreement on Agriculture* identifies agricultural products by reference to their respective HS codes[3], in certain places it uses the terms "commodity" and "agricultural product" interchangeably.[4] Hence, in China's opinion, "agricultural commodity" can be understood as equivalent to "agricultural product" under the *Agreement on Agriculture*. Such equivalence is particularly relevant with regard to upland cotton, which being an agricultural product and crop, unquestionably meets the definition of a commodity.

14. On the other hand, "industry" used in the context of Art. 2 of the *SCM Agreement* normally refers to "a particular form or branch of productive labour; a trade, a manufacture"[5], while in the context of trade and commercial policy, "agriculture" means "the science and practice of cultivating the soil and rearing animals; farming".[6] Cultivate, in turn, means "prepare and use soil for crops"[7], i.e. the use of productive labour for soil preparation and use. Hence, agriculture, being the science and practice of using productive labour, meets the definition of "industry". Further, the *Agreement on Agriculture* also treats "agriculture" as an "industry" by extensively using "agricultural producers" and "agricultural production" to refer to the targets of domestic support measures.[8]

15. Art. 2 of the *SCM Agreement* provides that a subsidy is specific if it is provided to an enterprise or industry or group of enterprises or industries. Based on the analysis in Paras. 12 and 13 above, China believes that any subsidy to agricultural commodities shall be considered as specific for the purpose of Art. 2 of the *SCM Agreement.* By the same token, China believes that:

(a) a subsidy in respect of all agricultural, but not other, product is specific, since agriculture producing all agricultural products is an industry and consists of "group of enterprises" by definition.

(b) Similarly, subsidies in respect of "all agricultural crops (i.e. but not to other agricultural commodities, such as livestock)", "certain identified agricultural products" and "upland cotton, but not other products" should all be deemed as specific since "group of enterprises" producing crops (certain products, upland cotton) are targeted in all the cases.

(c) The use of "a certain proportion of the value of total US commodities" or "a certain proportion of US farmland" will necessarily be equivalent to "an enterprise or industry or group of enterprises or industries" because the "proportion" has to be generated by adding up those data from specific "enterprise or industry or group of enterprises or industries".

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[2] Commodity means "a thing of *use* or value; specially a thing that is an object of trade, especially a raw material or agriculture crop", Lesley Brown (ed.), *The Shorter Oxford English Dictionary*, 5th ed. (Oxford University Press, 2002), p.461.

[3] Art. 2, *Agreement on Agriculture*.

[4] e.g. under Art. 6, the terms "*product*-specific domestic support" and "*basic agricultural product*" are used in the context of quantifying domestic support commitments, while under Art. 13(b), domestic support measures under Art. 6 that do not grant support to *a specific commodity* in excess of that decided during the 1992 marketing year are required to be exempt from actions as specified therein.

[5] *The Shorter Oxford English Dictionary*, p.1363.

[6] Ibid, p. 44.

[7] Ibid, p. 575.

[8] e.g. Art. 6, *Agreement on Agriculture.*

**16. Question 52, The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the *SCM Agreement*. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the *SCM Agreement* to withdraw the subsidy without delay, can the Panel:**

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? All third parties**

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the *SCM Agreement*? All third parties**

17. China believes that if this Panel were to find that a subsidy was prohibited and were to recommend under Article 4.7 of the *SCM Agreement* an immediate withdraw the subsidy, there would be no need for this Panel to dwell on the issue of whether adverse effects have been generated by the same subsidy.

18. The *SCM Agreement* has a primary distinction between prohibited subsidies under Article 3 where effects are presumed and actionable subsidies under Article 5 where the complaining party must demonstrate adverse effects. Amongst differences between prohibited and actionable subsidies, such as degree of proof, dispute settlement procedures, are different remedies under Arts. 4.7 and 7.8.

19. While no panel has dealt squarely with the issued raised by this Panel, the panel on *Australia – Automotive Leather II (Article 21.5 – US)* did touch upon the relationship between Arts. 4.7 and 7.8 briefly.[9]

> As regards the context of Article 4.7, we note that the term "withdraw the subsidy" appears elsewhere in the SCM Agreement. We consider these references to "withdrawal" of subsidies to be relevant for our understanding of the term. In the case of "actionable" subsidies, Members whose trade interests are adversely affected may, under Part III of the SCM Agreement, pursue multilateral dispute settlement in order to establish whether the subsidy in question has resulted in adverse effects to the interests of the complaining Member. If such a finding is made, the subsidizing Member "shall take appropriate steps to remove the adverse effects **or shall withdraw the subsidy**".[10] Alternatively, a Member whose domestic industry is injured by subsidized imports may impose a countervailing measure under Part V of the SCM Agreement, "**unless the subsidy or subsidies are withdrawn**".[11] In both cases, withdrawal of the subsidy is an alternative, available to the subsidizing Member, to some other action. Repayment of the subsidy would certainly effectuate withdrawal of the subsidy by a subsidizing Member so as to allow it to avoid action by the complaining Member.[12]

[9] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW and Corr.1, adopted 1 February 2000.

[10] Original note, "*SCM Agreement Article 7.8* (emphasis added)".

[11] Original note, "*SCM Agreement Article 19.1* (emphasis added)".

[12] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW and Corr.1, adopted 1 February 2000, Para. 6.28.

20. The panel in that case went *on* to elaborate in light of Art. 4.7's object and purpose:

> Turning to the object and purpose of Article 4.7 of the SCM Agreement, we observe that the SCM Agreement as a whole establishes disciplines on subsidies. The SCM Agreement categorizes subsidies as non-actionable, actionable, or prohibited.[13] In the case of non-actionable and actionable subsidies, Members are only allowed to take certain prescribed steps in the event that their trade interests are harmed by another Member's subsidies. Part II of the SCM Agreement, however, establishes an absolute prohibition on certain types of subsidies: Members are obligated, under Article 3.2 of the SCM Agreement, to "neither grant nor maintain" such subsidies. **While the trade effects of prohibited subsidies may be countered under Parts III and V of the SCM Agreement, Part II of the SCM Agreement establishes special and additional rules for rapid dispute settlement in cases involving such subsidies. Article 4.7 of the SCM Agreement establishes a specific remedy to be recommended in the case of a violation - withdrawal of the subsidy**. (Original emphasis added)

21. Indeed, the panel considered the Art. 4.7 prescription of withdrawal for subsidies found to be prohibited under to be so "special" that it is "specific remedy" designed to "not merely counteract *adverse* trade effects, but is intended to enforce the absolute prohibition on the grant or maintenance of such subsidies".[14]

22. In other words, such a specific remedy under Art. 4.7 grants the subsidizing Member far less options than Art. 7.8, which allows the subsidizing Member the options of either to "remove the adverse effects" or "withdraw the subsidy".

23. The above interpretation is further supported by the difference in terminology for countermeasures allowed to be taken by a complaining Member in the event that recommendations adopted by the DSB are not followed. The Arbitrators in their Decision on *Brazil – Aircraft (Article 22.6 – Brazil)*[15], stated:

> We also note that, when the negotiators have intended to limit countermeasures to the effect caused by the subsidy on a Member's trade, they have used different terms than 'appropriate countermeasures'. Article 7.9 and 10, which is the provision equivalent for actionable subsidies to Article 4.9 and 10 for prohibited subsidies, uses the terms 'commensurate with the degree and nature of the adverse effects determined to exist'.[16]

while Art. 4.10 only used the term "appropriate countermeasures", without the qualification of commensuration with the degree and nature of adverse effects as required under Arts. 7.9 and 7.10 for actionable subsidies. In deed, the Arbitrators ruled in the arbitration that

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[13] Original note, "[w]e note *that*, pursuant to Article 31 of the SCM Agreement, the provisions of Articles 6.1 (presumption of serious prejudice), and 8 and 9 (non-actionable subsidies) shall apply for five years from the date of entry into force of the WTO Agreement unless extended for a further period."

[14] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW and Corr.1, adopted 1 February 2000, Para. 6.34.

[15] Decision by the Arbitrators, *Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS46/ARB, 28 August 2000.

[16] *Ibid*, Para. 3.49.

when dealing with a prohibited export subsidy, an amount of countermeasures which corresponds to the total amount of the subsidy is "appropriate"[17] against the Brazilian argument that such an interpretation would be punitive.[18]

24. Hence, past panels and arbitrators have determined that Art. 4.7 remedies are special, specific, and additional to those under Art. 7.8, that when recommended by a panel, they more than counteract adverse trade effects. In light of such reasoning, the need for this Panel, after it having established prohibited subsidies, to go an extra step to find adverse effects is superfluous.

25. With respect to this Panel's question as to whether the Panel can "take into account the effects of interaction of those prohibited subsidies with other, allegedly, actionable subsidies" if it were to find prohibited subsidy, China believes the answer is not straight forward.

26. Art. 5 of the *SCM Agreement* makes no express distinction between prohibited and actionable subsidies when discussing adverse effects to the interests of other Members. It simply requires that no Member shall cause adverse effects through the use of any subsidy referred to in Paras. 1 and 2 of Article 1 of the *SCM Agreement*, which covers all types of subsidies that meets the specificity test, i.e. prohibited and actionable.

27. Having said that, the structure of the *SCM Agreement* is such that it sets out highly compartmentalized sections on prohibited, actionable and non-actionable subsides. Analyses of adverse effects are specifically placed under Part III that deals with actionable subsidies only. As discussed above, establishment of a prohibited subsidy does not require any finding of adverse effect, but is contingent upon a finding of a mere existence. In that sense, when this Panel accounts and analyzes adverse effects caused by actionable subsidies, inclusion of adverse effects generated by prohibited subsidies would tend to enlarge adverse effects caused by actionable subsidies, if the former only adds to the latter. In other words, the highly compartmentalized nature of the *SCM Agreement* requires this Panel to form a precise opinion, where partition is possible, on the degree and nature of adverse effects caused by actionable subsidies alone, and such precision is vital for the subsidizing Member to "remove the adverse effects" under Art. 7.8 and for the complaining Member to take commensurate countermeasures under Arts. 7.9 and 7.10. Such a partitioning method is very much relevant to the issue of causation, as in cases where partition is possible, there should be no causal link between prohibited subsidies and adverse effects caused by actionable subsidies.

28. If, however, this Panel finds that a simple partition is not possible to exclude adverse effects generated by prohibited subsidies, due to the fact that such adverse effects compounds or amplifies adverse effects caused by actionable subsidies, the issue is more difficult. Prohibited subsidies may indeed have played a role in causing a compounding or amplification of adverse effects, caused by actionable subsidies in the first place. Such circumstances would necessitate a consideration of the totality of evidence before this Panel and a finding that best reflects a possible attribution of adverse effects to those only caused by actionable subsidies found. Such a finding, China submits, may have to be weighed against the crucial need to discourage the use of multiple types of subsidies that are not WTO compliant to create compounded adverse effects.

**29. Question 53. Would a finding of serious prejudice under Article 5(c) of the *SCM Agreement* be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the *SCM Agreement* in this context? All third parties**

[17] *Ibid*, Para. 3.60.
[18] *Ibid*, Para. 3.55.

30. China believes that a finding of serious prejudice under Article 5(c) of the *SCM Agreement* would be determinative for a finding under Article XVI:1 of the GATT 1994.

31. Art. 5(c) of the *SCM Agreement* prohibits any Member against using any subsidy to cause serious prejudice to the interests of another Member. Instances of deemed existence and possible occurrence of serious prejudice are further enumerated under Art. 6 of the same agreement. Art. XVI:1 of GATT 1994, on the other hand, requires a subsidizing Member, to discuss, upon request, with the other contracting party or parties concerned, or with the Contracting Parties, the possibility of limiting the subsidization, in the event that its granting of subsidies causes or threatens to cause serious prejudice to the interests of any other contracting party while stopping short of listing those under Art. 6 of the *SCM Agreement*.

32. China believes possible difference, if any, between serious prejudice found under Art. 5(c) of the *SCM Agreement* and serious prejudice found under GATT Art. XVI:1, is effectively removed by footnote 13 of the *SCM Agreement*, which specifically provides:

> The term "serious prejudice to the interests of another Member" is used in this [SCM] Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice.

To interpret otherwise would clearly be contrary to the intent of the drafters of this footnote.

**33. Question 55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("another Member") for the purposes of these proceedings? All third parties**

34. China believes that any Member, the prices of whose like product (upland cotton for these proceedings), as supplied in the same market, at the same level of trade and at comparable times, are capable of being compared to the prices of the subsidized product for the purpose of determining whether significant price undercutting exists under Art. 6.3(c), is *another Member* for the purpose of Art. 6.3(c) of the *SCM Agreement*..

35. First, 6.3(c) of the *SCM Agreement* reads,

> Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply: …
>
> (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market.

36. Article 6.5 subsequently explains that

> For the purpose of paragraph 3(c), price undercutting shall include any case in which such price undercutting has been demonstrated through a comparison of prices of the subsidized product with prices of a non-subsidized like product supplied to the same market. The comparison shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability. However, if such a direct comparison is not possible, the existence of price undercutting may be demonstrated on the basis of export unit values.

37. Essentially, Art. 6.5 requires a comparison between prices of the subsidized product and prices of a *non-subsidized like product supplied to the same market* for the purpose of determining whether significant price undercutting exists under Art. 6.3(c). To ensure fairness and statistical meaningfulness of such a comparison, Art. 6.5 requires it to be made at the same level of trade and at comparable times, as well as any other factor affecting price comparability. No where does Art. 6.5 limit non-subsidized like product to only those from one country, e.g. the complaining party.

38. Second, specific references to the "complaining Member" is made in other paragraphs of this very Article 6. For instance, Article 6.7, reads

> Displacement or impediment resulting in serious prejudice shall not arise under paragraph 3 where any of the following circumstances exist during the relevant period:
>
> (a) prohibition or restriction on exports of the like product from *the complaining Member* (emphasis added) or on imports from the *complaining Member* (emphasis added) into the third country market concerned;…".

39. The same word "complaining Member" is specifically used from Para. (a) through to Para. (e) under Article 6.7. The above reference clearly suggests that for the purpose of these paragraphs, the drafters explicitly distinguished the like product from "the complaining Member" from the like product from other Members. Should the drafters have the same intent to make such a distinction under Article 6.3, they would have done so.

40. Based on the above interpretations, China believes that *another Member* under Art. 6.3 of the *SCM Agreement* shall include any Member, the prices of whose like product, upland cotton for these proceedings, as supplied in the same market, at the same level of trade and at comparable times, is capable of being compared to the prices of the subsidized product for the purpose of determining whether significant price undercutting exists under Art. 6.3(c).

**41. Question 56. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the *Agreement on Agriculture* and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the *SCM Agreement*. All third parties**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions, of the *Agreement on Agriculture,* relevant?**

42. In China's opinion, agricultural domestic support programmes are not challengeable under Article XVI:3 of GATT 1994.

43. Negotiating history of the current WTO agreements, being codification of the GATT Uruguay Round, as reported by scholars, indicates that the original Art. XVI of GATT 1947 contained only the first paragraph. Section B of Art. XVI and the interpretive note thereto were added by the *1955 Protocol Amending the Preamble and Part I and II of the Agreement* with an intent to outlaw export subsidies that results in subsidizing Member "having more than equitable share of the world export trade in that product"[19] only.[20] While the added article adopted such vague wordings as "any form of

[19] Article XVI:3, GATT 1994.

[20] Terence P. Stewart (ed.), *the GATT Uruguay Round: a Negotiating History* (Kluwer Law and Taxation Publishers, 1993), p. 134.

subsidy which operates to increase the export of any product", no where can any express effort to discipline domestic support be found.

44. The addition of Art. 11, entitled "Subsidies other than export subsidies" by the *1979 Agreement on Interpretation and Application of Article VI, XVI and XXIII of the General Agreement* (the "*Subsidies Code*")[21] is further proof that Art. XVI did not contemplate any discipline on domestic support. While not all Contracting Parties of GATT signed the *Subsidies Code*, it does represent the efforts of some GATT Contracting Parties

> [t]o apply fully and to interpret the provisions of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade only with respect to subsidies and countervailing measures and to elaborate rules for their application in order to provide greater uniformity and certainty in their implementation.[22]

45. On the issue of subsidies, the *Subsidies Code* is structured to distinguish between export subsidies on certain primary (Art. 10, for the purpose of Art. XVI:3, GATT) and non-primary subsidies (Art. 9 and illustrative Annex) on the one hand, and "[s]ubsidies other than export subsidies" (Art. 11) on the other. Such a distinction represents consensus, at least amongst some GATT Contracting Parties, that GATT Art. XVI:3 only disciplines export subsidies *per se*.

46. In addition, in attempting to develop the "unlawfulness" of these "non-export subsidies", Art. 11(2) of the *Subsidies Code* only specified possible "injury to a domestic industry of another signatory", "serious prejudice to the interests of another signatory", nullification and impairment of "benefits accruing to another signatory under the General Agreement [of Tariffs and Trade] as well as adverse effect on "the conditions of normal competition", to the express exclusion of a GATT Art. XVI:3 action for "more than equitable share of world export trade". The ostensible omission of a GATT XVI:3 challenge against non-export subsides is again indication that GATT XVI:3 did not contemplate a challenge against non-export subsidies, which should include domestic support measures.

47. The *Agreement on Agriculture* of the WTO, while setting out object and quantitative disciplines on agricultural domestic supports, does not engage in a comprehensive and express definition of the term domestic support, except that it is granted in favour of domestic agricultural producers. Yet the agreement does treat domestic support and export subsidies in different sections. Art. 13, in addition, makes a symmetrical reference to the two concepts on equal footing. The polarized treatment lends support to a conclusion that the multilateral trade regime at the Uruguay Round sees a need to discipline agricultural domestic support measures. Given the progression of discipline development for agricultural domestic support and the loss of inequitable world export trade challenge in the *Agreement on Agriculture*, it appears to be a stretching of terms to interpret that Art. XVI:3 of GATT 1947 should contemplate a challenge against agricultural domestic support measures.

48. Language of Article 21.1 of the *Agreement on Agriculture* again supports the above opinion of China. The article governs the relationship of the provisions of GATT 1994 and the Agreement on Agriculture.[23] The Appellate Body, in its *EC – Bananas III* report, stated to the effect that the provisions of GATT 1994 apply to a matter except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter.[24]

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[21] 26S/56.

[22] Preamble, the S*ubsidies Code*.

[23] Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Appellate Body Report, WT/DS27/AB/R, DSR 1997:II, Paras. 155-156.

[24] See *Supra*, Para. 3.

49. Coming back to the text of GATT Art. XVI:3, as well as the general progression of multilateral trade regime on agricultural domestic support measures, specificity on domestic support discipline as provided under the *Agreement on Agriculture* clearly stands out and pales any possible equation of GATT Article XVI:3 to a discipline on agricultural domestic support.

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the *SCM Agreement*, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in *US-FSC*, para. 117[25] here?**

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the *SCM Agreement* and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?**

50. Art. 6(3)(d), on the other hand, is a natural prolongation of the inequitable world export trade challenge made available by GATT Art. XVI:3 and further developed by the *Subsidies Code*. China believes that requirements of Art. XVI:3 of the GATT 1994 are reflected in and developed by requirements in Article 6.3(d) of the *SCM Agreement*.

51. GATT Art. XVI:3 is the first attempt by the multilateral trade system to seek avoidance of the clinching of "more than equitable share of world export trade in a primary product" by a Member granting "directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory". The article, led by the word "[a]ccordingly", grants Members the inequitable world export trade challenge to address concerns over possible "harmful effects", "undue

[25] Original quote from the Appellate Body Report, WT/DS108/AB/R, Para. 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market". In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* must clearly take precedence over the *exemption* of primary products from export subsidy disciplines in Article XVI.4 of the GATT 1994."

disturbance" and hindrance to "the achievement of the objectives" of GATT cause by subsidies to primary products, as enumerated under the preceding article of XVI:2.

52. The *Subsidies Code* further defined "more than an equitable share of world export trade" as including

> any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets.[26]

In addition to attempting to discipline subsidies to primary products, signatories to the *Subsidies Code* also agreed to a number of general provisions on subsidies, not necessarily limited to primary products. Adverse effects caused by subsidies, exemplified by injury to the domestic industry of another signatory, nullification or impairments to the benefits of another Member and serious prejudice to the interests of another Members, were first introduced under Art. 8 of the *Subsidies Code* as indication of the "unlawfulness" of such subsidies. The very same standards were to be later adopted by Art. 5 of the *SCM Agreement* on actionable subsidies.

53. The concept of inequitable world export share caused by subsidies to primary products, on the other hand, was retained under Art. 6.3(d) of the SCM Agreement, with such changes as "world market share" to replace "share of world export trade" and the addition of a three year period to constitute "representative period" benchmark.

54. While China agrees that the requirements of GATT Art. XVI:3 are reflected in and developed by requirements in Article 6.3(d) of the *SCM Agreement*, prior Appellate Body reports have indicated that to the extent a specific WTO agreement conflict with the provisions of GATT 1994, the former shall prevail. In that respect, it is important to quote the Appellate Body in *Brazil – Desiccated Coconut*:

> The relationship between the GATT 1994 and the other goods agreements in Annex 1A is complex and must be examined on a case-by-case basis. Although the provisions of the GATT 1947 were incorporated into, and became a part of the GATT 1994, they are not the sum total of the rights and obligations of WTO Members concerning a particular matter. For example, with respect to subsidies on agricultural products, Articles II, VI and XVI of the GATT 1994 alone do not represent the total rights and obligations of WTO Members. The *Agreement on Agriculture* and the *SCM Agreement* reflect the latest statement of WTO Members as to their rights and obligations concerning agricultural subsidies. The general interpretative note to Annex 1A was added to reflect that the other goods agreements in Annex 1A, in many ways, represent a substantial elaboration of the provisions of the GATT 1994, and to the extent that the provisions of the other goods agreements conflict with the provisions of the GATT 1994, the provisions of the other goods agreements prevail. This does not mean, however, that the other goods agreements in Annex 1A, such as the *SCM Agreement*, supersede the GATT 1994. As the Panel has said:
>
> > ... the question for consideration is not whether the SCM Agreement supersedes Article VI of GATT 1994. Rather, it is whether Article VI creates rules which are separate and distinct from those of the SCM Agreement, and which can be applied without reference to that Agreement, or whether Article VI of GATT 1994 and the SCM

[26] Para. 10:2(a), the *Subsidies Code*.

> Agreement represent an inseparable package of rights and disciplines that must be considered in conjunction.[27]

55. The Appellate Body noted further that "[t]he relationship between the *SCM Agreement* and Article VI of GATT 1994 is set out in Articles 10 and 32.1 of the *SCM Agreement*."[28] Apart from the integrated structure of the *WTO Agreement* and the annexed agreements, the Appellate Body therefore focused on these two provisions of the *SCM Agreement*. The Appellate Body then explicitly agreed with the Panel's statement that:

> Article VI of GATT 1994 and the SCM Agreement represent a new and different package of rights and obligations, as among WTO Members, regarding the use of countervailing duties. Thus, Article VI and the respective SCM Agreements impose obligations on a potential user of countervailing duties, in the form of conditions that have to be fulfilled in order to impose a duty, but they also confer the right to impose a countervailing duty when those conditions are satisfied. The SCM Agreements do not merely impose additional substantive and procedural obligations on a potential user of countervailing measures. Rather, the SCM Agreements and Article VI together define, clarify and in some cases modify the whole package of rights and obligations of a potential user of countervailing measures.[29]

56. The Appellate Body then proceeded to find that:

> [C]ountervailing duties may only be imposed in accordance with Article VI of the GATT 1994 and the *SCM Agreement*. A countervailing duty being a specific action against a subsidy of another WTO Member, pursuant to Article 32.1, it can only be imposed "in accordance with the provisions of GATT 1994, as interpreted by this Agreement". The ordinary meaning of these provisions taken in their context leads us to the conclusion that the negotiators of the *SCM Agreement* clearly intended that, under the integrated *WTO Agreement*, countervailing duties may only be imposed in accordance with the provisions of Part V of the *SCM Agreement* and Article VI of the GATT 1994, taken together. If there is a conflict between the provisions of the *SCM Agreement* and Article VI of the GATT 1994, furthermore, the provisions of the *SCM Agreement* would prevail as a result of the general interpretative note to Annex 1A.
>
> …
>
> The fact that Article VI of the GATT 1947 could be invoked independently of the *Tokyo Round SCM Code* under the previous GATT system does not mean that Article VI of GATT 1994 can be applied independently of the *SCM Agreement* in the context of the WTO. The authors of the new WTO regime intended to put an end to the fragmentation that had characterized the previous system.[30]

57. China takes the above Appellate body statement to mean that Art. 32.1 of the *SCM Agreement*, being the linkage between Art. XVI:3 of GATT 1994 and Art. 6.3(d) of *SCM Agreement*

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[27] Original Appellate Body quote, Panel Report on *Brazil – Desiccated Coconut, Brazil – Measures Affecting Desiccated coconut*, WT/DS22/R, adopted 20 March 1997, Para. 227; Appellate Body Report, *Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/AB/R, DSR 1997:I, p. 15.

[28] Appellate Body Report on *Brazil – Desiccated Coconut*, p. 16.

[29] Panel Report, *Brazil - -Desiccated Coconut, Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/R, adopted 20 March 1997, Para. 246, as upheld by the Appellate Body Report; Appellate Body Report on *Brazil – Desiccated Coconut*, p. 17.

[30] Appellate Body Report on *Brazil – Desiccated Coconut*, pages 16 and 18.

in connection with the inequitable share of world market challenge, requires that the Art. 6.3(d) prevail over GATT Art. XVI:3. In other words, if this Panel were to find that the GATT provision in conflict with the Art. 6.3(d), a claim against agricultural export subsidies cannot be brought under GATT XVI:3, but should be brought as actionable subsidies under Art. 6.3(d) of the *SCM Agreement*; however, if this Panel does not find any conflict, agricultural export subsidies actionable under Art. 6.3(d) of the *SCM Agreement* shall not be precluded from being actionable under GATT XVI:3, which can only be logical interpretation of note 56 to the *SCM Agreement* as it applies to the relationship.

58. Conflicts or differences were obviously found by the Appellate Body in *US-FSC*. It found that Article XVI:4 of GATT 1994

> differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on* Agriculture.

Hence, "[u]nquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the Agreement on Agriculture must clearly take precedence over … the GATT 1994".

59. Such an interpretation is further supported the general interpretative note to Annex 1A, which provides to the effect that in the event of a conflict between a provision of the GATT 1994 and a provision of another agreement in Annex 1A, the latter shall prevail to the extent of the conflict.

60. This Panel's Question 56(c) is in fact answered by the quoted passage from the Appellate Body in *US-FSC*. When GATT 1947 was negotiated and codified, there was nothing in it that expressly defines the term "subsidy", or the term "export subsidy". Such definitions only came into WTO wording in the Uruguay Round in addition to the new and more comprehensive discipline on "prohibited subsidies" under the *SCM Agreement* and "domestic [agricultural] support" under the *Agreement on Agriculture*. The more explicit disciplines under the *SCM Agreement* and the *Agreement on Agriculture*, as noted by the Appellate Body in the quoted passage, being "the latest statement of WTO Members as to their rights and obligations concerning agricultural subsidies", clearly take precedence over any GATT 1994 provisions to the extent of direct conflict.

61. China thanks this Panel for granting this opportunity to present its views on issues related to this proceeding, and hopes that this Panel will finds the above points helpful.

# ANNEX J-17

## REPLIES OF THE EUROPEAN COMMUNITIES TO THE QUESTIONS FROM THE PANEL

27 October 2003

### QUESTIONS TO THE EC

Question 45

**In relation to the term "same market" in Article 6.3 (c)of the SCM Agreement states in paragraph 10 of its oral statement that a "world market" cannot exist if there are significant trade barriers between Members. On the other hand, the Panel notes that in relation to cotton, the EC takes the position in paragraph 14 of its further submission that the term "same market" in Article 6.3(c) should be read to include the domestic market of the subsidising Member. In light of the fact that many domestic cotton markets, possibly including that of China, have significant trade barriers, how can the EC reconcile these two positions?**

Reply

1. The question does not state correctly the views expressed by the EC. Contrary to what is said in the question, the EC did not state at paragraph 14 of its further submission that "the term '**same market**' in Article 6.3 **(c)** should be read to include the domestic market of the subsidising Member". Rather, the EC said in paragraphs 14-16 of its further submission that the term "**world market share"** in Article 6.3 **(d)** includes also the share of the domestic market of the subsidising Member. This reading of Article 6.3(d) is compatible with the view that the term "same market" in Article 6.3(c) may include the world market, where there is such a world market. On the other hand, there is no reason why Article 6.3(d) should apply only in those cases where it can be established that there is a world market. Rather the term "world market share" should be understood to mean, in that context, the aggregate of the shares in each of the relevant geographical markets.

2. Contrary also to what is stated in the question, the EC has taken no position on the issue of whether, "in relation to cotton", there is a world market for the purposes of Article 6.3 (c). It might well be that, as suggested in the question, there is no world market for cotton, with the consequence that the price effects mentioned in Article 6.3(c) would have to be observed separately within each distinct national or regional market and/or in the residual "rest-of-the world" market. This is a factual matter on which the EC does not wish to express any views.

Question 46

**Should the Panel prefer a concept of allocation of the benefit of subsidies to later years, to a concept of fully expensing subsidies to the year in which the benefit was provided?**

Reply

3. Whether a subsidy should be "allocated" or "expensed" depends on the nature of the subsidy concerned, having regard to relevant criteria, such as those outlined at paragraph 11 of the EC's further submission.

4. The EC is not expressing any views on the largely factual question of whether the subsidies at issue should be "allocated" or "expensed". The point made by the EC was simply that Brazil cannot have it both ways. If the subsidies are fully expensed to the marketing year where they are granted, as Brazil appears to have done, it is contradictory to claim at the same time that they continue to provide benefits beyond that marketing year.

Question 47

**In the EC further submission, it is said that significantly different conditions of competition in regional markets may prevent the Panel from arriving at the conclusion that there is a world market. Is the payment of a subsidy a "condition of competition" and, if so, how should that impact upon the Panel's analysis?**

Reply

5. To be precise, the EC's position is that there is no world market for the purposes of Article 6.3 (c) where the existence of trade barriers has the consequence that the conditions of competition, and in particular the price levels prevailing in one geographical area are significantly different from those prevailing in another geographical area.

6. Unlike, for example, import duties, quotas or transport costs, subsidies do not, of themselves, insulate the prices in one geographical area from those in other areas and, therefore, do not lead to existence of separate geographical markets.

**QUESTIONS TO ALL THIRD PARTIES**

Question 49

**What is the meaning and effect of the introductory phrase of Article 3 of the SCM Agreement ("Except as provided in the Agreement on Agriculture...")?**

Reply

7. The introductory phrase of Article 3 makes it clear that subsidies which would be inconsistent with Article 3.1, but which are provided consistently with the export competition provisions of the *Agreement on Agriculture* are not prohibited.

Question 50

**According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture?**

Reply

8. No.

9. In the first place, and contrary to the Panel's implicit suggestion, it is still an open question, in view of the definition of the terms "implementation period" and "year" in Article 1 (f) and (i), respectively, of the *Agreement on Agriculture*, whether the provisions cited in the question will cease to apply by the end of the 2003 calendar year or at a subsequent date during 2004.

10. In any event, the Panel would be precluded by its terms of reference from taking into account the consequences of the expiry of those provisions. The "matter" before the Panel was defined at the time where the DSB agreed to the establishment of the panel and cannot be modified in the course of the proceedings.[1] In accordance with its terms of reference, the Panel must consider the measures in dispute as they existed when the matter was referred to the DSB, on the basis of the facts existing at that moment and in the light of the WTO provisions that were relevant at that time.

11. Brazil's claim is that the measures at issue were WTO inconsistent at the time when the matter was referred to the DSB. The Panel would go beyond its terms of reference if it were to decide that the measures are WTO inconsistent at a subsequent moment, as a result of the expiry of the peace clause. If, on the other hand, the Panel were to apply WTO provisions that will become relevant only after the expiry of the peace clause to measures and facts as they existed at the time when the matter was referred to the DSB, it would be making an impermissible retroactive application of such provisions.

Question 51

**How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the SCM Agreement apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the SCM Agreement:**

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

**(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?**

**(c) is a subsidy in respect of certain identified agricultural products specific?**

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

**(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?**

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

Reply

A subsidy granted to an economic operator which does not require any production of agricultural products, and in which the subsidy may be used for any purpose, does not appear, to the EC, to be specific in the sense of Article 2.1(a)

Question 52

**The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the SCM Agreement. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy without delay, can the Panel:**

[1] See e.g. Panel report on *India – Measures Affecting the Automotive Sector*, WT/DS1465/R, WT/DS175/R, at para. 7.26.

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel?**

Reply

12. Yes. There is nothing in the *SCM Agreement* which prevents a complaining party from claiming that a subsidy is prohibited under Part II and, in addition, causes "adverse effects" under Part III.

13. A finding that a prohibited subsidy causes "serious prejudice" may still be relevant in so far as at it may be possible for the subsidising Member to withdraw the export or local content condition attached to the subsidy, which causes its prohibition, while maintaining the subsidy and its adverse effects.

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the SCM Agreement?**

14. In a situation where the complaining party has made no claim that a prohibited subsidy causes adverse effects under Part III, it would be necessary to establish the causal link between the actionable subsidies and the adverse effects. However, the EC understands that this situation does not arise in the present dispute, because Brazil claims that all the allegedly prohibited subsidies cause adverse effects.

Question 53

**Would a finding of serious prejudice under Article 5(c) of the SCM Agreement be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the SCM Agreement in this context?**

Reply

15. Footnote 13 states that the term "serious prejudice" is used in the *SCM Agreement* in the same sense as in Article XVI:1 of the GATT. Therefore, it seems that a finding that a subsidy causes "serious prejudice" under Article 5(c) of the *SCM Agreement* would have the necessary implication that the same subsidy causes also "serious prejudice" in the sense of Article XVI:1 of the GATT, in so far as that provision can be applied on its own.

Question 54

**Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ?**

Reply

16. The EC has not taken any position on the factual issue raised in the question.

17. In principle, whether or not a producer is able to cover all its costs without subsidies is not, as such, directly relevant, let alone determinative of whether the subsidies cause adverse effects.

Question 55

**In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("another Member") for the purposes of these proceedings?**

Reply

18. The EC agrees with the United States that, for the purposes of Article 6.3(c), only the price effects on the "products" of Brazil are relevant. (See US Further Submission, para. 86 and the case law cited therein)

Question 56

**Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the Agreement on Agriculture and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the SCM Agreement.**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on export subsidies" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions, of the Agreement on Agriculture, relevant?**

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in US-FSC, para. 117[2] here?**

[2] WT/DS108/AB/R, para 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market." In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?**

Reply

19. Article XVI:3 of the GATT has been elaborated in Article 6.3(d) of the *SCM Agreement*, with the consequence that it cannot be applied independently from Part III of the SCM Agreement, just like Article VI of the GATT cannot be applied independently from Part V of the *SCM Agreement*.[3] Indeed, if Article XVI:3 could be applied on its own, the additional requirements provided for in Article 6.3(d) and related provisions, such as Article 6.7, would be rendered largely redundant.

20. By its own terms, Article XVI:3 is concerned exclusively with "export subsidies". However, as noted by the Appellate Body in the passage of the *FSC* report mentioned in the question, the scope of the notion of export subsidy in Article XVI differs from the scope of the same term in the *SCM Agreement* and in the *Agreement on Agriculture*. It is conceivable, therefore, that one and the same measure may be at the same time an "export subsidy" in the sense of Article XVI:3 and "domestic support" within the meaning of the *Agreement on Agriculture*. This is not saying that the *Agreement on Agriculture* and Article XVI:3 can apply simultaneously to the same measure. Where a measure is subject to the rules on domestic support of the *Agreement on Agriculture*, those rules excludes the application of Article XVI:3 to the same measure, in accordance with Article 21.1 of the *Agreement on Agriculture* (irrespective of whether Article XVI:3 can be applied independently from the *SCM Agreement*.)

21. This interpretation is confirmed by Article 13 of the *Agreement on Agriculture*. It would be odd if the peace clause exempted export subsidies from action under Article XVI:3, but not domestic support, which is assumed to have less pernicious trade effects. Clearly, if the drafters of the peace clause did not deem necessary to exempt domestic support from action under Article XVI:3 it is because they considered that this provision did not apply to domestic support pursuant to Article 21.1 of the *Agreement on Agriculture*.

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> is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* must clearly take precedence over the *exemption* of primary products from export subsidy disciplines in Article XVI:4 of the GATT 1994."

[3] Cf. Panel and Appellate Body reports, *Brazil – Measures Affecting Desiccated Coconuts*, WT/DS22/R and WT/DS22/AB/R.

# ANNEX J-18

## ANSWER TO PANEL QUESTION TO INDIA

27 October 2003

**Question 48**

**In the further submission of India, it is stated that "there is "no obligation under the *SCM Agreement* to demonstrate serious prejudice separately after establishing that one of the effects of a subsidy listed under Article 6.3 applies, as the effects listed in Article 6.3 themselves equate to serious prejudice". How does this view relate to Article 6.3(d), which appears to contain no element of degree? India**

Reply

India presumes that by 'element of degree' the Panel means the 'intensity or amount' of the effects of the subsidy as enumerated in Article 6.3 of the SCM Agreement. India notes that for serious prejudice to arise, in respect of only one out of the four effects of the subsidy in Article 6.3, has the intensity of the effect been specified. This is in respect of the effect of the subsidy in Article 6.3 (c) wherein the 'intensity or amount' of price undercutting, price suppression or price depression has been qualified by 'significant'. Thus, for serious prejudice to arise in case of price undercutting, price suppression or price depression, such effects should be significant. What can constitute 'significant' would vary from case to case. India is of the view that the other cases of effect of the subsidy specified in paragraphs 3 (a), 3(b) and 3 (d) of Article 6 contain no element of degree.

India fails to see how the absence of any element of degree in paragraphs 3 (a), 3(b) and 3 (d) of Article 6 results in the complaining Member being separately required to prove that the prejudice is indeed serious even after having established that one of these effects exists. If the drafters had intended that the complaining Member should separately establish that the prejudice caused by the effects of the subsidy was serious they would have defined the requirements for this purpose. The SCM Agreement contains no such requirement. India is, therefore, of the view that there is no obligation under the *SCM Agreement* to demonstrate serious prejudice separately after establishing that one of the effects of a subsidy listed under Article 6.3 applies.

# ANNEX J-19

## RESUMED FIRST SESSION OF THE FIRST SUBSTANTIVE MEETING OF THE PANEL

## NEW ZEALAND ANSWERS TO QUESTIONS FROM THE PANEL TO THIRD PARTIES

14 October 2003

**Q49. What is the meaning and effect of the introductory phrase of Article 3 of the SCM Agreement ("Except as provided in the Agreement on Agriculture …")? All third parties**

This phrase refers to provisions in the *Agreement on Agriculture* that provide specific exception from Article 3 of the *SCM Agreement*. New Zealand does not agree that any such exception exists in the *Agreement on Agriculture* that would authorise use of local content subsidies contrary to Article 3.1(b) of the *SCM Agreement*, as argued by the United States.[1] There is no basis upon which to claim that the *Agreement on Agriculture* gives Members a right to use whatever domestic support they wish with complete impunity from action under other WTO Agreements.

**Q50. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exemp[tion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the Agreement on Agriculture? All third parties**

No. Brazil has not claimed that the implementation period in Article 13 has expired. It has claimed that the provision of Articles 13(b) and (c) have not been respected.

**Q51. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" – in Article 2 of the SCM Agreement apply to subsidies in respect of agricultural commodities ? Please answer the following questions, citing the principles in Article 2 of the SCM Agreement. All third parties**

New Zealand agrees with Brazil that the ordinary meaning, context and object and purpose of Article 2.1(a) of the *SCM Agreement* confirm that subsidies that are available to discrete segments of an economy or to only particular industries are specific. New Zealand considers that Brazil has demonstrated that each of the subsidies provided by the United States to upland cotton are specific within the meaning of Article 2.

Whether or not a subsidy is specific within the terms of Article 2, with the exception of prohibited subsidies which are deemed specific by Article 2.3, requires examination of the particular features of the subsidy at issue, including factual information about the actual usage of the subsidy and not simply its availability. Thus in relation to the general scenarios outlined below only general responses are possible.

[1] *United States – Subsidies on Upland Cotton*, Further Submission of the United States, 30 September 2003, para 167.

**(a) is a subsidy in respect of all agricultural, but not other, products specific?**

New Zealand does not consider that this question is relevant to this dispute as none of the subsidies at issue are provided on the same terms to all agricultural products.

**(b) is a subsidy in respect of all agricultural crops (ie but not to other agricultural commodities, such as livestock) specific?**

Yes such a subsidy would be specific, because access to the subsidy is explicitly limited to certain enterprises within the meaning of Article 2.1(a), specifically to producers of agricultural crops.

**(c) is a subsidy in respect of certain identified agricultural products specific?**

Yes, because it is specific to producers of certain agricultural products and is thus explicitly limited to certain enterprises within the meaning of Article 2.1(a).

**(d) is a subsidy in respect of upland cotton, but not other products, specific?**

Yes, because it is specific to producers of one product and is thus explicitly limited to certain enterprises within the meaning of Article 2.1(a).

**(e) is a subsidy in respect of a certain proportion of the value of the total US commodities (or total US agricultural commodities) specific?**

It is not clear from the question what kind of subsidy is being referred to, and, as noted in New Zealand's general comments on this question, whether or not a subsidy is specific within the terms of Article 2 of the *SCM Agreement* requires examination of the particular features of the subsidy at issue. To the extent that the subsidy referred to in the question is limited to certain enterprises (as suggested by the fact that the subsidy is provided only in respect of a certain proportion of the total value of United States commodities or agricultural commodities) it would be specific within the meaning of Article 2.1(a).

**(f) is a subsidy in respect of a certain proportion of total US farmland specific?**

See New Zealand's answer to (e) above.

**Q52. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the SCM Agreement. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy without delay, can the Panel:**

**(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? All third parties**

A Panel may conclude that a prohibited subsidy had resulted in adverse effects to the interests of another Member. The chapeau of Article 5 of the *SCM Agreement* refers to "any subsidy referred to in paragraphs 1 and 2 of Article 1". Reference is made in paragraph 2 of Article 1 to subsidies being subject to the provisions of Part III only if they are specific in accordance with Article 2. Article 2.3 deems any subsidy falling under the provisions of Article 3, ie prohibited subsidies, to be "specific". Thus a prohibited subsidy may also be subject to the provisions of Part III of the *SCM Agreement*. It is therefore open to a Panel to conclude that a prohibited subsidy resulted in adverse effects to the interests of another Member.

The value of such conclusion in terms of the settlement of the matter before the Panel is to clarify the adverse effects that must be removed by the subsidising Member, albeit that a subsidising Member does not have the option of removing the adverse effects attributable to prohibited subsidies other than by withdrawing the subsidy without delay.

**(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the SCM Agreement? All third parties**

A Panel may take into account the effects of the interaction of those prohibited subsidies with other actionable subsidies. For example, actionable subsidies could operate to neutralise the effect of removal of the prohibited subsidy, as would likely be the case in respect of removal of the Step 2 export payments. Removal of this prohibited export subsidy would be likely to lead to a decline in United States exports and thus lower the United States domestic price for upland cotton. However lower prices for upland cotton producers would trigger increased marketing loan deficiency payments that could in turn boost exports and thus maintain the adverse effect of the United States subsidies.

It is therefore important to consider the interaction of the various types of subsidies at issue and look at their collective effect. However no attribution of the effects to either prohibited or actionable subsidies is needed, because there is no conflict between the remedies for prohibited subsidies and actionable subsidies. To the extent that the subsidies causing serious prejudice to the interests of other Members include prohibited subsidies, the subsidising Member must withdraw them without delay, as they do not have the option available in respect of actionable subsidies of maintaining the subsidy so long as the adverse effect is removed.

**Q53. Would a finding of serious prejudice under Article 5(c) of the SCM Agreement be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the SCM Agreement in this context? All third parties**

A finding of serious prejudice under Article 5(c) of the *SCM Agreement* would be determinative for a finding under Article XVI:1 of the GATT 1994 because serious prejudice is used in the same sense in Article 5(c) as it is in Article XVI:1. Footnote 13 explicitly clarifies this.

**Q54. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevant is this, if any, to Brazil's actionable subsidy claims? All third parties**

Without subsidies United States cotton producers would not be covering their full costs of production and so would be making losses over the longer term. Evidence for this has been provided by Brazil in Exhibits Bra-7 and Bra-205. For example in 1999, 2000 and 2001 the USDA estimated that United States cotton producers total costs exceed the value of production by 173, 142 and 259 dollars per planted acre respectively, as shown in "US cotton production costs and returns 1997-2001".[2]

Accordingly the subsidies mean that United States production is higher than it otherwise would be. As Professor Sumner's econometric work shows, without subsidies US production over 1999-2002 would have been an average of 28.7 per cent lower than actual US production[3] and as a consequence United States exports would have declined on average by 41.2 per cent between MY

[2] Exhibit BRA 7.

[3] *United States – Subsidies on Upland Cotton*, Brazil's Further Submission to the Panel, 9 September 2003, para 105.

1999-2002[4] and world prices would have been an average of 12.6 per cent higher. This evidence thus supports Brazil's claim that the United States subsidies have caused serious prejudice to Brazil's interests and threaten to cause serious prejudice to Brazil's interests in the future.

**Q55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("another Member") for the purposes of these proceedings? All third parties**

Brazil is the "other party" in the context of Article 5(c). But that does not mean that other Members too cannot be suffering the serious prejudice through the use of the subsidies at issue by the United States. Indeed the Oral Statement of Benin to the Panel[5] makes it clear that this is the case.

**Q56. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the Agreement on Agriculture and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5 and 6.3 (d) of the SCM Agreement. All third parties.**

**(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on export subsidies" (emphasis added) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions, of the Agreement on Agriculture relevant?**

Agricultural domestic support programmes are challengeable under GATT 1994 Article XVI:3 to the extent that they meet the requirements of that Article, including, for example, that they must provide a subsidy that "operates to increase the export of any primary product from its territory".

The title of Section B is relevant in that it reflects the narrower scope of Section B vis-à-vis Section A. Section B addresses "Additional Provisions on Export Subsidies", whereas Section A is broader and addresses "Subsidies in General" – it includes subsidies that operate to reduce imports of any product into the territory of the subsidising Member. The term "export subsidies" in the particular context of GATT Article XVI is not defined, but can be given meaning by the scope of paragraph 3 which applies to "any form of subsidy which operates to increase the export of any primary product" and is thus a broader definition than "contingent … upon export" found in the *SCM Agreement*.

Article 21.1 of the *Agreement on Agriculture*, which provides that GATT 1994 must be applied subject to the *Agreement*, is relevant in so far as it clarifies that in the event of legal conflict the provisions of the *Agreement on Agriculture* apply. During the implementation period Article 13 of the *Agreement on Agriculture* provides exemption from actions based on specific GATT 1994 provisions, subject to certain criteria being met. Article 13 exempts domestic support measures from action based on Article XVI:1 only if such measures do not grant support in excess of that decided during the 1992 marketing year.

Brazil has brought forward evidence to demonstrate that the subsidies at issue operate to increase United States exports of upland cotton and that they have been applied by the US in a manner that has resulted in the United States having a "more than equitable share of the world export trade" within the meaning of Article XVI:3 and therefore cause serious prejudice within the meaning of Article XVI:1.

[4] *Ibid*.
[5] Oral Statement of Benin, 8 October 2003.

**(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in US-FSC, para 117 here?**

Article 6.3(d) of the *SCM Agreement* elaborates on one specific aspect of the disciplines on subsidies in GATT Article XVI:3, and that is in relation to the situation where a subsidy, as defined in the *SCM Agreement*, results in an increase in the world market share of the subsidising Member in the particular subsidised product. However GATT Article XVI:3 addresses a broader situation – where the result of the application of the subsidies is that the subsidising Member has a "more than equitable share" of the world export trade in the product.

A Member challenging a subsidy need not demonstrate that the subsidising Member's share of the world market has necessarily increased. For example, a Member may apply a subsidy that increases its exports of a product in order to simply maintain its market share. "But for" that subsidy, relevant economic factors might have meant that a Member's exports should in fact have declined. Therefore Article 6.3(d) of the *SCM Agreement* covers one specific aspect of how a "more than equitable share" of the world market might manifest itself but not all such situations.

As such the situation is distinguishable from *US-FSC*[6] in relation to GATT Article XVI:4 where the Appellate Body found that the narrow prohibition in Article XVI:4 had been entirely subsumed by Article 3.1(a) of the *SCM Agreement*.

**(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?**

See New Zealand's answer to Questions (a) and (b) above.

[6] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporation"*, WT/DS108/AB/R, adopted 20 March 2000

# ANNEX J-20

## RESPONSES TO QUESTIONS FROM THE PANEL FOR THIRD PARTIES

## THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU

27 October 2003

**Q49. About the meaning and effect of the introductory phrase of Article 3 of the SCM Agreement.**

A: The introductory phrase of Article 3 of the SCM Agreement "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited" has the meaning that if there is different provision in the Agreement on Agriculture (AoA) with regard to the subsidies listed in Article 3 of the SCM Agreement, the AoA provision shall prevail. In other words, even if a subsidy is specific within the meaning of Article 1 of the SCM Agreement, and even if it is a subsidy contigent upon export performance or a subsidy contigent upon the use of domestic over imported goods, it is still not within the scope of prohibition under Article 3 of the SCM Agreement. The effect of such agricultural subsidy shall be decided by the AoA.

The critical point here is whether it is "provided in the Agreement on Agriculture". In this regard, Article 8 of the AoA is relevant. Article 8 provides that: "Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule." The AoA, at this current stage, only requires reduction of such subsidy, not the elimination of such subsidy. In other words, suppose the subsidy is in conformity with the AoA and with the commitments as specified in the Members' Schedule, it should be allowed by the AoA and thus would not be prohibited under the SCM Agreement according to the introductory phrase of Article 3 of the SCM Agreement.

**Q50. About the impact of the revised timetable to issue the Panel report after the end of the 2003 calendar year on the "exempt[ion] from actions" under Articles 13(b)(ii) and 13(c)(ii) of the AoA.**

A: We have no comments on this question.

**Q51. About the concept of specificity in Article 2 of the SCM Agreement applying to subsidies in respect of agricultural commodities.**

A: Article 2.1 of the SCM Agreement provides that "In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as 'certain enterprises') within the jurisdiction of the granting authority, the following principles shall apply:…" Thus, when considering the answers below, the principles set forth in Article 2.1 must also be borne in mind.

Also, the basic reason for excluding "non-specific subsidies" from being prohibited should be that the subsidies are generally available and no competitive advantage is provided to a particular sector or some specific sectors. If there is competitive advantage provided to one or more sectors

with the effect of excluding other sectors from receiving the advantages, it should be considered as specific.

Our view is that the concept if specificity applies to the agriculture sector as follows:

(a) All agricultural products: not specific. The competitive advantage is provided to all agricultural products. No agricultural products are excluded.

(b) All agricultural crops: specific. Although the coverage is broad, some agricultural products are excluded.

(c) Certain identified agricultural products: specific. Apparently it excludes a large portion of products.

(d) Upland cotton: specific. It excludes all other products and only gives advantage to one product.

(e) Certain proportion of the value of total US commodities or total US agricultural commodities: not specific. No commodities or agricultural commodities are excluded.

(f) Certain proportion of total US farmland: not specific, as long as farmland is not restricted to that producing certain commodities.

**Q52. About different remedies available in respect of prohibited and actionable subsidies.**

A(a) The SCM Agreement explicitly divides subsidies into three categories, and Part II and Part III are designed to deal with different categories of subsidies. If a subsidy falls within "Part II Prohibited Subsidies", it would not be falling within "Part III Actionable Subsidies". Thus, it is unthinkable that if the Panel were to conclude, for example, that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the SCM Agreement, it would also have to decide whether the same subsidy had resulted in adverse effects to the interest of another Member.

(b) For the same reason, the Panel should not take into account the interactive effects of those prohibited subsidies with other subsidies.

**Q53. About the determinativeness of a finding under the SCM Agreement for a finding under GATT 1994**

A: Footnote 13 of the SCM Agreement explains that "The term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice." Although there is no same provision in Article XVI of the GATT 1994, the real intent of the WTO Members should be to harmonize the meaning and concept of the same phrase where it appears in different agreements. It would also be reasonable to interpret the same phrase in the same manner, unless there is strong reason for not doing so. Our view, therefore, would be that if there is a finding of serious prejudice under Article 5(c) of the SCM Agreement, it should be *de facto* determinative for a finding under Article XVI:1 of the GATT 1994.

**Q54. About the evidence of US cotton producers to cover or not to cover the fixed and variable costs without subsidies.**

A: We do not have information available on this.

**Q55. About "another Member" of Article 6.3(c).**

A: We do not claim that we are "another Member" in the sense of Article 6.3(c) of the SCM Agreement.

**Q56. About the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the AoA and the disciplines on prohibited export subsidies and actionable subsidies in Article 3, 5(c) and 6.3(d) of the SCM Agreement.**

A(a) Agricultural domestic support should not be challengeable under Article XVI:3 of the GATT 1994. Although the second sentence "grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory" seems to be broad enough to include domestic subsidies, this second sentence still comes after the introductory sentence, which requires Members to avoid the use of subsidies on the export of primary products. Also paragraph 3 of Article XVI of the GATT 1994 is under the title "Section B - Additional Provisions on Export Subsidies". There is no reason why the provisions in paragraph 3 should not be limited to export subsidies. Otherwise, the title would become meaningless and redundant.

(b) Paragraph 117 of the Appellate Body Report in *US-FSC* is an appropriate interpretation of the relationship between the definition of subsidies and export subsidies in Articles 1.1(a)(1) and 3.1(a) of the SCM Agreement on the one hand and export subsidies in Article XVI:4 of the GATT 1994 on the other. However, it does not have relevancy in deciding the relationship between domestic subsidies and export subsidies. The requirements of Article XVI:3 of the GATT 1994 are imposed on export subsidies, as explained above, while Article 6.3(d) of the SCM Agreement is about non-export subsidies. Thus, the requirements of Article XVI:3 of the GATT 1994 are neither reflected in, nor developed by or subsumed by the requirements in Article 6.3(d) of the SCM Agreement.

(c) Under the principle set forth by the above-mentioned Paragraph 117 of the Appellate Body Report in *US-FSC*, if there is conflict between Article XVI of the GATT 1994 and the AoA, the AoA must take precedence over the GATT 1994. Based on the same principle, the SCM Agreement should take precedence over the GATT 1994 to the extent that there is conflict. However, with regard to the definition of subsidy in Article 1 of the SCM Agreement and the prohibition on subsidies contingent upon export in Article 3.1(a), there is no conflict provision in Article XVI of the GATT 1994. Thus, there is no issue here of whether one agreement would take preference over the other. Nevertheless, Article XVI of the GATT 1994 and the SCM Agreement are still the rules under the WTO dealing with the same set of matters. The definition of certain terms in one agreement could serve as a very important source in helping to define the same terms in another agreement. Therefore, unless there is a sound basis for having a different interpretation, we do not see any reason for different meanings of subsidies and export subsidies in Article XVI of the GATT 1994 from those in the SCM Agreement.

# ANNEX K

## COMMUNICATIONS FROM PARTIES AND THIRD PARTIES

# ANNEX K-1

## LETTER FROM THE UNITED STATES

21 May 2003

The Panel in this dispute will soon meet with the parties to discuss the Panel's timetable and working procedures. In this regard, we draw to the Panel's attention Brazil's decision to raise claims under the *Agreement on Subsidies and Countervailing Measures* ("Subsidies Agreement") prior to the expiration of the Peace Clause (Article 13 of the *Agreement on Agriculture*) together with its desire to have recourse to the Annex V procedures of the Subsidies Agreement from the outset of this dispute.

Brazil's claims raise procedural and substantive questions that have not previously been faced by a dispute settlement panel. The most fundamental of these is whether Brazil may proceed with claims under the Subsidies Agreement against US support measures, notwithstanding that these claims are barred by the Peace Clause. The United States clearly maintains that Brazil may not.[1] The United States is submitting this letter in advance of the organizational meeting in order to propose a process to resolve these novel issues in an orderly and logical fashion.

Brazil has not contested that, if US support measures conform to the Peace Clause, they are protected from action based on claims of adverse effects or serious prejudice. In fact, Brazil implicitly recognizes that the Peace Clause bars its claims unless Brazil can demonstrate that the US measures are in breach of the Peace Clause – in both its panel request (WT/DS267/7, at 3) and its consultation request (WT/DS267/1, at 3), Brazil asserts that the Peace Clause does not exempt the challenged US measures from action. Thus, Brazil may not maintain this action based on its claims of adverse effects and serious prejudice under the Subsidies Agreement and GATT 1994 Article XVI unless the Panel has found that US support measures for upland cotton do not conform to the Peace Clause.

Accordingly, the United States proposes that the Panel organize its procedures to deal with the threshold Peace Clause issue at the outset of this dispute. We would suggest that the Panel first receive written submissions from both parties on the applicability of the Peace Clause, to be followed by a meeting of the Panel with the parties on this issue, and then rebuttal submissions. The Panel would then make findings on whether any US measure is in breach of the Peace Clause. If the Panel agrees that Brazil has failed to establish that the US measures are inconsistent with the Peace Clause,

[1] In this dispute, Brazil is claiming that US support measures for upland cotton have caused adverse effects (including serious prejudice) to Brazil's interests, within the meaning of Articles 5 and 6 of the Subsidies Agreement and GATT 1994 Article XVI. Both the Agriculture Agreement and the Subsidies Agreement make clear that such claims are precluded as long as the measures conform to the Peace Clause. The Peace Clause states that domestic support measures that conform fully to the criteria in Annex 2 of the Agriculture Agreement ("green box" support) "shall be . . . exempt from actions based on," *inter alia*, claims of adverse effects, including serious prejudice. Similarly, the Peace Clause states that domestic support measures that conform fully to the criteria in Article 6 of the Agriculture Agreement (for example, "amber box" support) "shall be . . . exempt from actions based on," *inter alia*, claims of ad verse effects, including serious prejudice, "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year." The final sentences of both Article 5 (on adverse effects) and Article 6 (further explaining serious prejudice) of the Subsidies Agreement use identical language to recognize the protection afforded by the Peace Clause: "This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture." Thus, domestic support measures that conform to the criteria specified in the Peace Clause are protected against actions claiming adverse effects and serious prejudice.

then that would dispose of those claims. If the Panel finds that the US measures are inconsistent with the Peace Clause, then Brazil could have recourse to the Annex V procedures with respect to its Subsidies Agreement claims on these measures. In either event, briefing and meetings of the Panel with the parties could then proceed on any claims not disposed of by the Peace Clause findings.

This procedure would satisfy the legal requirement that certain claims not be maintained while the Peace Clause is applicable and provide the Panel with a fair and orderly means of addressing the issues in this dispute. The United States notes that the Panel has broad discretion to determine its working procedures under Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), and, under DSU Article 12.2, the Panel is charged with establishing panel procedures with "sufficient flexibility so as to ensure high-quality panel reports." Because in this dispute Brazil has made claims under 17 different provisions of the WTO Multilateral Agreements with respect to numerous US programmes under at least 12 US statutes, we believe the Panel's consideration of the critical Peace Clause issue would be aided by briefing and argumentation focused on this threshold issue. Dispute settlement panels have made use of three panel meetings to allow adequate consideration of particular issues. For example, the panel in *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain* (DS276) has recently organized its proposed timetable and procedures to provide for the possibility of a panel meeting prior to the first substantive meeting in order to consider any preliminary issues. We also note that three panel meetings have been scheduled in each of the disputes under the *Agreement on the Application of Sanitary and Phytosanitary Measures* to allow a separate meeting of the panel with scientific/technical experts. Similarly, in this dispute, a meeting focused on the Peace Clause issue would assist in considering the complex matter in dispute.

We look forward to discussing this proposal with you in more detail at the organizational meeting. The United States is providing a copy of this letter directly to Brazil.

# ANNEX K-2

## LETTER FROM BRAZIL

23 May 2003

The Government of Brazil is in receipt of a letter dated 21 May 2003 from the US Mission, proposing that the Panel's working procedures provide for a special advance proceeding to deal with issues relating to Article 13 of the Agreement on Agriculture (AoA), commonly known as the "peace clause". The United States proposes two rounds of submissions by the parties, a meeting of the Panel with the parties, a special "discovery" proceeding and Panel issuance of a separate ruling on these issues. All other work in this dispute would be suspended until after the Panel has issued findings and a preliminary panel report. Brazil opposes these unprecedented and unnecessary procedures, which would impose significant financial and human resource burdens on Brazil and significantly delay this proceeding. Brazil asks that the Panel proceed expeditiously with this case using normal dispute settlement procedures and timeframes, for the reasons set forth below.

Brazil urges the Panel to take full account of Article 3.3 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), which provides: "The *prompt settlement* of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and to the maintenance of a proper balance between the rights and obligations of Members." DSU Article 12.9 contemplates that panel proceedings will be completed within six months. DSU Article 12.2 provides that "panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, *while not unduly delaying the panel process*". The US suggested procedure would unduly delay the panel process to the detriment of Brazil's rights.

The United States has singled out AoA Article 13 as a "special" provision which allegedly requires special and unprecedented procedural treatment. Yet DSU Appendix 2, the closed list of "special and additional" rules and procedures that trump the normal rules of dispute settlement, does not include Article 13 or any other AoA provision, nor does it include the cross-references to the AoA in Articles 3.1 and 7.1 of the Agreement on Subsidies and Countervailing Measures (ASCM). There is no support in the DSU, in the Agreement on Agriculture, or elsewhere in the WTO Agreement for the proposition that a separate "mini-trial" on peace clause issues is required before any claim can be made against subsidies under the Agreement on Agriculture. Acceptance of this proposition would invent a substantial new obstacle to future claims by any government against agricultural subsidy programs, altering the rights of Brazil and many other Members, in contradiction to Article 3.2 of the DSU.

The US notion that two rounds of submissions and a special meeting are required before the parties perform any further work on the case is unprecedented. As the Panel is aware, the concept of preliminary objections is not new. There are many WTO cases in which a defending party has made preliminary objections that a claim or a panel request has not met the requirements of DSU Article 6.2, and has requested an early ruling. Sometimes panels make an early ruling,[1] and sometimes

[1] US – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany, WT/DS213/R, fn. 224.

they do not.[2] The decision on how to handle such preliminary objections procedurally is a matter of panel discretion. Where preliminary objections have been resolved in advance of other claims, normally they have been resolved in the panel's first meeting, on the basis of the first round of submissions and oral statements.

The threshold issues posed by AoA Article 13 are no more or less significant than other threshold issues in many WTO Agreements. There are "peace clause"-type provisions in Articles 27.2(b), 27.3, and 27.4 of the ASCM Agreement precluding prohibited subsidy claims against developing country export subsidies under certain conditions. When this provision was invoked by developing countries in prior cases, no special procedures were created by panels and these threshold issues were decided as part of the final panel report.[3] Similarly, no claim may be brought against a measure under the General Agreement on Trade in Services unless the measure falls within the scope of the GATS as defined in GATS Article I. No claim may be brought under Article 2 of the Agreement on Technical Barriers to Trade except in respect of a measure that is a "technical regulation" as defined by that agreement. Claims under the Agreement on Government Procurement may only be brought concerning procurement of an entity covered by Annex I of that agreement. Many more examples exist.

Following the US proposal, panels would be *required* in any case involving such threshold issues to provide for special submissions, special meetings and preliminary panel decisions on admissibility of claims before reaching the substance, adding a month or two to each panel proceeding. The same procedure would be required whenever a defending party makes a preliminary objection under DSU Article 6.2. Resolving such issues, the United States would presumably argue, would be necessary to avoid wasteful litigation of unnecessary claims. But like the Agreement on Agriculture, none of these agreements contain any special procedural provisions for resolution of these threshold issues, and there is no reference to such procedures in Appendix 2 of the DSU. Negotiators could have provided for the type of bifurcated dispute settlement process suggested by the United States for these types of issues. But they did not.

The United States notes that special meetings have been held with experts in cases involving the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS). However, these meetings were held pursuant to Article 11.2 of the SPS Agreement that gives the panel the authority to "seek advice from experts chosen by the panel in consultation with the parties to the dispute." With such authority comes an implied need for the Panel to *meet* with the experts. It also creates an expectation of additional delay from the normal panel schedule to accommodate obtaining such advice. Nothing in the AoA contains any similar authority to address peace clause issues.

The peace clause issues in this dispute are not just technical procedural issues (as the US implies in its letter) that can be quickly disposed of without extensive briefing or the presentation of considerable factual evidence and expert econometric testimony. They require careful deliberation by the Panel on the basis of the entire body of evidence submitted by the parties. The peace clause issues are also intertwined with the substance of Brazil's claims regarding prohibited and actionable subsidies under the Agreement on Subsidies and Countervailing Measures. For example:

> Among the issues presented by the peace clause are whether three of the six actionable US domestic support subsidies (Production Flexibility Payment Contract Payments, Direct Payments, and Counter-Cyclical payments) are properly in the "green" or "amber/blue" box of the AoA. To resolve these issues involves, *inter alia*,

[2] US – Anti-Dumping Measures on Certain Hot Rolled Steel Products from Japan, WT/DS184/R, fn. 16 to para. 7.1.

[3] Brazil – Export Financing Program for Aircraft, WT/DS46/R (20 August 1999), paras. 7.56-57; Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R (23 July 1998), para. 14.52

the presentation of econometric analysis of the trade distorting or production enhancing effects of each of these subsidies to determine whether or not they are properly green box subsidies within Annex 2 AoA. If they are not, then these three subsidies are included in the amount of support in marketing years 1999-2002 for the purpose of comparing against the level of support decided by the United States for marketing year 1992 under Article 13(b)(ii) AoA. However, Brazil's econometric and other extensive documentary evidence regarding the production enhancing effects of such subsidies for the purposes of the peace clause is *exactly* the same evidence Brazil presents for these three referenced subsidies to demonstrate its serious prejudice claims under ASCM Articles 5(c), 6.3(b), 6.3(c), 6.3(d), and Article XVI of GATT 1994.

Brazil has made claims under the AoA and the ASCM regarding prohibited export subsidies under the US Step-2 programme and US export credit guarantee programmes. Brazil will demonstrate in its first submission that these two export subsidies do not "conform fully to the provisions of Part V of this Agreement" in the sense of AoA Article 13(c); obviously, Brazil's evidence and argument regarding the lack of conformity of these two measures with Part V of the AoA largely overlaps with the evidence and argument necessary to demonstrate a violation of ASCM Articles 3.1(a) and (b).

The close relationship between these "threshold" issues and the merits of Brazil's case can be seen by considering the possible outcome of the Panel's preliminary rulings. For instance, if the Panel rules that Brazil may bring its export subsidy claims because the US export subsidies are inconsistent with AoA Part V, it will have decided up front a key issue regarding the merits. But would the United States accept such a ruling and not attempt to re-litigate the same issues raised in the context of the ASCM Agreement? The answer is obvious. It highlights that a preliminary mini-trial of the sort sought by the United States will not save time, expense, and trouble for the Panel or for the parties, and will simply serve to increase the length and expense of this panel proceeding.

The Panel must also consider the position of the 13 interested third parties in this dispute. Many of these third parties may wish to provide their views on the interpretation and application of AoA Article 13 given the implications of any decision for future disputes. If the panel were to decide to request submissions and/or hold a hearing in advance of its first meeting with the parties, third parties will probably claim that they must be accorded the same opportunities for participation as in normal panel proceedings. These opportunities are particularly important since the "mini-trial" called for by the United States would decide key substantive issues relating to the facts and merits of Brazil's complaint.

Brazil would also be prejudiced because the United States proposal would require it to use limited resources to bring its Brazilian counsel and its US econometric experts to Geneva for the proposed special meeting. Further, Brazil would be required to prepare essentially four additional written submissions (a first and rebuttal written submissions, an oral statement submission, and written answers to the Panel's questions) for the proposed special briefing and meeting. The acceptance of the US proposal will create travel, hotel, legal, and human resource expenditures that are particularly burdensome for a developing country with limited financial and human resources such as Brazil. In sum, the US proposal would impair Brazil's rights under WTO rules.

Finally, the United States proposes even more delay in this proceeding with its suggestion in the letter that "Brazil could have recourse to the Annex V procedures with respect to its Subsidies Agreement claims" after the determination by the Panel pursuant to the special procedures. Brazil initiated Annex V procedures on 18 March as the DSB established the panel pursuant to Brazil's request for the establishment of a panel that invoked ASCM Article 7.4. Brazil sought information

from third countries and the United States on 1 April 2003 under the provisions of Annex V, paragraphs 2 and 3. Brazil has collected information from a number of third parties pursuant to these requests. The United States on 19 March in WT/DS267/8 informed the DSB that *"any requests for information pursuant to the Annex V procedures may be provided in writing to the US Mission to the World Trade Organization. The United States will gather the information to respond to any such requests and provide the responses through the US Mission"*. Unfortunately, the United States refused to answer Brazil's questions dated 1 April 2003 during the 60-day period of the procedures that ended on 17 May 2003.

Brazil rejects any suggestion by the United States that a new Annex V procedure be conducted during the panel stage of the process to impose even further delays in this proceeding. Instead, Brazil will use the best information available to it when it files its first submission. If appropriate, Brazil will request that the Panel draw adverse inferences from any failure of the United States to provide information requested during the consultation and Annex V process.

In light of the above, Brazil strongly urges the Panel to reject the United States' unprecedented and wasteful procedural proposal. As noted above, much of the evidence involved in demonstrating the absence of peace clause protection *also* is related to Brazil's substantive claims. Given this overlap, the Panel should structure its work so that the peace clause issues and Brazil's claims regarding prohibited subsidies and serious prejudice are dealt with at the same time and in the same two meetings between the Panel and the parties. Use of the normal two meetings and briefing schedule will permit the Panel to have sufficient time to consider the views of Brazil, the United States, and the 13 third parties involved in this dispute. Use of the existing procedures and timeframes will avoid significant prejudice to Brazil by avoiding it having to use its limited resources to litigate the same issues at three, not two meetings. Use of existing procedures will avoid duplication of effort by the Panel and the third parties, and avoid significant delays in the issuance of a final report regarding the subsidies Brazil challenges in this dispute.

Brazil would be pleased to provide the Panel with additional information at the organizational meeting regarding this and any other procedural issues.

# ANNEX K-3

## LETTER FROM BRAZIL

14 July 2003

Brazil would like to bring to the attention of the Panel in *United States – Subsidies on Upland Cotton* (DS267) the following matter.

The "Working Procedures for the Panel" establish in paragraph 17(b) that,

"*the parties and third parties should provide their submissions to the Secretariat by 5:30 pm on the deadline established by the Panel, unless a different time is set by the Panel"*

and in paragraph 17(d) that,

*"the parties and third parties shall provide electronic copies of all submissions to the Secretariat at the time they provide their submissions [...]".*

The electronic version of the US first submission, which was due on Friday, 11 July, 5:30 pm, was delivered after 11 pm, almost 6 hours after the deadline. Brazil had access to the hard copy only on Saturday morning. Because it was a Friday, the failure of the United States to meet the established deadline led to delays in the transmittal and reception of the submission to different Government officials in Brazil and to Brazil's legal advisors. In addition, the delay no doubt caused third parties to have less time to react to the US submission – a not insignificant delay given the fact that third parties had only two working days to respond to the US submission before filing on 15 July. The result was that Brazilian officials were unable to review the submission until Monday, 14 July.

Brazil notes that this delay is not the first in the present case. The US Comments on the initial brief by Brazil, due on 13 July, 5:30 pm, were sent electronically after 8 pm.

Brazil has been faced with extremely short deadlines in this case, including the filing on 24 June its First Submission which required extensive changes to respond to the Panel's determination of 20 June. Nevertheless, Brazil met the deadline and filed the submission prior to 5:30 pm on 24 June. Brazil expects that the United States will, like Brazil, meet its own deadlines in a timely fashion.

Brazil would like the Panel to take note of this delay and to encourage the US to respect the deadlines, with a view to ensuring procedural fairness in these proceedings.

# ANNEX K-4

## LETTER FROM THE UNITED STATES REQUEST FOR EXTENSION OF DEADLINE FOR RESPONSES TO PANEL QUESTIONS

29 July 2003

In view of the number and the complexity of the questions addressed by the Panel to the United States and Brazil (not counting subparts, it appears that the Panel has asked the United States approximately 95 questions), the United States would like to request an extension of the deadline for the parties' responses until Friday, 15 August 2003. In particular, a number of the questions address new issues and request extensive additional information. Given the issues and volume of information involved, as well as the travel schedules of key members of the US delegation, an extension of the deadline originally proposed by the Panel would assist the parties in providing thorough responses.

While extending the deadline for answers would necessarily shorten the period for commenting on those answers, the parties would still have one week to prepare those comments. The United States considers that both the initial answers and subsequent comments would benefit if proportionately more time were allocated to ensuring that the initial answers are as complete and clear as possible.

# ANNEX K-5

## LETTER FROM BRAZIL

29 July 2003

Brazil received a letter dated today from the United States requesting until Friday 15 August to provide answers to the Panel's questions. Brazil cannot agree to this request.

Brazil has been working diligently every day since 25 July to comply with the Panel's deadline and is prepared to provide its answers to the Panel's questions by 4 August. A delay until 15 August will prejudice Brazil by not providing it with sufficient time to comment on the US answers or to prepare its Rebuttal Submission.

Brazil also notes that the Panel's questions do not raise new issues. Instead, they address issues either raised to a large extent in the First Written Submissions or that have been dealt with extensively during the first substantive meeting with the parties.

However, in the spirit of cooperation and in recognition of the fact that the Panel did request more questions of the United States than Brazil, Brazil would have no objection if the Panel were to extend the deadline to 7 August for the Parties and the Third Parties to answer the Panel's and each other's questions.

# ANNEX K-6

## LETTER FROM THE EUROPEAN COMMISSION

31 July 2003

The European Communities would like to thank the Panel for the questions it has posed to the third parties, and for extending the deadlines for responses. In light of the detailed nature of the questions asked and the importance of the issues concerned, the European Communities respectfully makes two requests to the Panel.

First, it would greatly assist the European Communities (and we assume other third parties) in preparing our responses to the Panel's questions to have sight of the oral statements of the main parties to the dispute at the first substantive meeting. So doing would permit third parties to respond to arguments made by the main parties where such a response would be of relevance in answering the Panel's questions. Since the Panel has requested the third parties to answer detailed questions, the European Communities considers that allowing the third parties access to the oral statements would allow the third parties to participate in a "full and meaningful fashion" in the stages of the proceeding where the panel has requested their input.[1] Moreover, the European Communities considers that this would benefit the Panel since the third parties will be able to provide more complete responses to the Panel's questions.

Second, the European Communities welcomes the Panel's decision to allow the third parties to comment on the response of the other third parties. However, it is not clear to the European Communities whether the third parties will also be able to comment upon the responses of the main parties to the Panel's questions, or questions the main parties have asked of each other. Once more, the European Communities considers that the third parties comments will be more full and meaningful, and consequently more beneficial to the Panel, if it is also possible to comment on the responses of the main parties in addition to commenting upon the other third parties responses.

Accordingly, the European Communities requests the Panel to ask the main parties to provide the third parties with copies of their oral statements and copies of their responses to the Panel's questions, when lodged. The European Communities also requests the Panel to invite the third parties to comment upon the responses of the main parties to the Panel's questions, and those posed by the other party.

Finally, the European Communities would also respectfully ask you to clarify the treatment of the Panel's expression of views on Article 13 of the *Agreement on Agriculture* and associated issues, scheduled for 5 September 2003. Given that the Panel's findings on this issue may be considered similar to a preliminary ruling, and that the third parties will be asked to provide the Panel with further comments on 29 September 2003, the European Communities considers that, in order to protect third parties' due process rights, the Panel's expression of views should be available to the third parties. The European Communities would be obliged if you could confirm this understanding.

[1] Para. 249, Article 21.5 Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"* ("United States – FSC (21.5)"), WT/DS108/AB/RW, adopted 29 January 2002.

A copy of this letter has been provided to the delegations of Brazil and the United States, and to the other third parties.

May I take this opportunity to thank you in advance for your consideration of these issues.

# ANNEX K-7

## LETTER FROM THE UNITED STATES

1 August 2003

The United States is in receipt of the letter dated 31 July 2003, from the European Communities (EC) relating to third parties' participation in the present dispute. The United States would consent to the Panel's release of its further views on the Peace Clause issue to the third parties as a sensible way forward in this dispute (although we would not necessarily endorse all of the reasoning expressed in the EC letter). Further, the United States has no objection to either party choosing to make its submissions or oral statements public – as the United States and, we understand, Brazil have decided to do. However, we see no basis in the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (DSU) for the additional procedural requirements that the EC is proposing – namely, that the Panel require the parties to make available to the third parties copies of their oral statements and responses to the Panel's questions, and that the third parties comment on the parties' responses to the Panel's questions. The EC proposal appears to erase the distinction between parties and third parties for purposes of dispute settlement.

The United States recalls that in the context of a panel proceeding a third party is welcome to express its interests under any covered agreement at issue in the dispute. Thus, the DSU ensures that third parties may express those interests by providing "an opportunity to be heard by the panel and to make written submissions" (DSU Article 10.2) and the right to "receive the submissions of the parties to the dispute to the first meeting of the panel" (DSU Article 10.3). These requirements have been met in every prior dispute by providing third parties the opportunity to receive the first submissions of the parties, to make one written submission, and to present statements at a third-party session of the first meeting of the panel.

We are aware of no dispute in which third parties have been granted the additional rights now sought by the EC. It would represent a fundamental change in the role of third parties in dispute settlement. Changes of this nature are being discussed in the context of the ongoing negotiations on clarifications and improvements to the DSU, and that is the proper forum for Members to consider these changes.

In addition, on a practical note, if the parties have to deal with the additional work of responding to comments by potentially more than a dozen third parties on (1) each others' answers to the Panel's third-party questions as well as (2) the parties' answers to more than 100 questions from the Panel, the already ambitious timetable established by the Panel will become totally untenable.

Finally, the United States recalls that, like all WTO Members and the public, the EC already has access to US submissions and oral statements on our website. (Indeed, we have already provided a copy of our oral statement directly to the EC at their request.) We also understand that Brazil is making its submissions public within two weeks of filing as contemplated by the parties' agreement and reflected in the Panel's Working Procedures. We would welcome Brazil's making its submissions public upon filing but do not see a basis in the DSU for requiring disclosure of those submissions to the third parties.

The United States is providing a copy of this letter directly to Brazil and the third parties.

# ANNEX K-8

## LETTER FROM BRAZIL

1 August 2003

Brazil received a letter dated 31 July 2003 from the European Communities requesting the Panel:

(i) to ask the parties to the dispute to provide third parties with copies of their oral statements and copies of their responses to the Panel's questions;
(ii) to invite the third parties to comment upon the responses of the parties to the dispute to the Panel's questions, and those posed by the other party;
(iii) to make the "Panel's expression of views on Article 13 of the *Agreement on Agriculture* and associated issues", scheduled for 5 September 2003, available to the third parties.

2. With respect to the EC's requests, Brazil would like to make the following comments.

3. In light of the Timetable for Panel Proceedings, the Working Procedures for the Panel, and DSU Articles 10.2 and 10.3, Brazil considers that the third parties to the present dispute are entitled to be provided with copies of the parties' First Written Submission and parties' Further Submission only. In Brazil's view, these are the only documents that constitute "submissions of the parties to the dispute to the first meeting of the panel" in accordance with DSU Article 10.3.

4. Brazil further notes that the parties to the dispute did not make any oral statements during the session of the substantive meeting of the Panel set aside for the third parties to present their views (24 July 2003). Thus, there are no oral statements of which the third parties should receive written versions. As a matter of fact, the oral (opening and closing) statements made by Brazil and the US were delivered exclusively at the closed session of the substantive meeting of the Panel which the third parties did not have access to. Again, there would be no reason for providing third parties with copies of those oral statements.

5. As is the case for the oral statements, Brazil submits that third parties need not be given copies of the parties' responses to the Panel's questions. The Panel's questions were put to Brazil and the US in the context of the closed session of the first substantive meeting with the parties, as were the preliminary responses given by both parties to the dispute. Moreover, such responses do not constitute "submissions" within the meaning of DSU Article 10.3.

6. Finally, with regard to the "Panel's views on certain issues", Brazil agrees with the EC that the document should be available also to third parties.

# ANNEX K-9

## LETTER FROM THE EUROPEAN COMMISSION

4 August 2003

The European Communities refers to its letter to the Panel of 31 July 2003, and the responses of the United States and Brazil of 1 August 2003.

The European Communities would like first to welcome the agreement of both the United States and Brazil that the Panel's views on the Peace Clause and related issues should be communicated to the third parties.

However, in the view of the European Communities, both the United States and Brazil misunderstand the thrust of the EC's letter of 31 July. Both parties enter into a discussion of whether the third parties are entitled to be given access to, and the chance to comment upon, the responses to the Panel's questions of the main parties. Both argue that the documents which the third parties have received are the only documents which the third parties are entitled to. However, these arguments miss the point of the European Communities request.

The European Communities central point was that, given the detailed questions which the third parties have received from the Panel, and given the Panel's decision to permit third parties to comment upon the responses of the other third parties, it would be a reasonable exercise of the Panel's discretion to organise its procedures so as to allow the third parties also to comment upon the responses of the main parties. The European Communities considers that this would be beneficial to the Panel, and would allow the third parties to participate completely, given the extent to which the Panel has already invited the third parties to participate.

The European Communities does not consider that this would set an unfavourable precedent because a panel would always have the discretion, in the light of its own procedures and the dispute before it, to decide whether to grant third parties such possibilities. Moreover, the European Communities sees no possible impairment of the due process rights of the main parties, and indeed neither the United States not Brazil have alleged any such impairment would result from the Panel acceding to the request of the European Communities.

The European Communities is aware of the practical concerns raised by the United States. However, the European Communities notes that a party always has a choice whether to comment upon responses, and that these practical concerns weigh equally on both parties.

Finally, the European Communities is, of course, aware that the United States makes it oral statements public (and is grateful that the US officials involved in this dispute have provided a copy directly to the EC delegation). We also note that the Panel's procedures provide for the submission of non-confidential summaries within 14 days of filing which could be made public.[1] However, the European Communities is not aware, first, whether such summaries shall also be provided to the third parties, and second, whether such summaries can be considered equivalent to the oral statements as

[1] Para. 3 – Panel's Working Procedures.

delivered. In that light, the European Communities recalls its arguments in favour of provision of the statements as delivered, set out in its letter of 31 July 2003.

A copy of this letter has been provided to the delegations of Brazil and the United States, and to the other third parties.

Thank you in advance for your consideration of these issues.

# ANNEX K-10

## LETTER FROM BRAZIL

14 August 2003

Once more, Brazil is faced with the need to detract from its substantive work relating to the dispute *United States – Subsidies on Upland Cotton* (DS267) to bring to the attention of the Panel a new US failure to abide by the "Working Procedures for the Panel" concerning the timing for delivery of documents required by the Panel.

As it had already done on two previous occasions[1], the US did not deliver its answers to the Panel's questions following the first substantive meeting with the parties by the time established in paragraphs 17(b) and (d) of the "Working Procedures".[2] Brazil recalls that the deadline for submitting the parties' answers to the Panel was expressly confirmed by the Panel on its communication dated 30 July 2003 informing about the extension of the deadline for the submission of the parties' responses[3].

As a matter of fact, the electronic version of the US answers, which was due on 11 August, 5:30 pm, was delivered around 11:30 pm, more than 6 hours after the deadline, more than 6 hours after Brazil delivered both its electronic version and hard copies to the Secretariat and the US. Brazil further notes that no hard copy of the US answers was made available either to the Secretariat or to Brazil by the deadline.

Brazil regrets that the US has decided to adopt such a strategy. In this particular case, the US behavior is even more egregious because the deadline – at request of the US and with the good faith and cooperation of Brazil – had been extended by 7 days by the Panel (from 4 August to 11 August).

As stated, the failure of the US to meet the established deadline provided US officials an opportunity to examine Brazil's answers before submitting their own responses more than 6 hours later. Moreover, the US failure led to delays in the transmittal and reception of the US answers to different Government officials in Brazil and to Brazil's legal advisors, diminishing an already short period for Brazil to comment upon the US responses. Due to the 5 hour time zone difference between Brasilia and Geneva, the US delay prevented work by Brazilian officials on the 11th of August. US official, however, had no such impairment since the USTR representatives in Geneva had the Brazilian answers to the Panel by 11:30 a.m. Washington D.C. time on that same date.

Needless to repeat that Brazil – a developing country with serious budgetary and human resources constraints – has been faced with extremely short deadlines in this case, including the filing on 24 June of its First Submission which required extensive changes to respond to the Panel's

[1] Also the US Comments on the initial brief by Brazil, due on 13 June 2003, and the US First Written Submission, due on 11 July 2003, were delivered after the deadline (see Brazil's letter to the Panel on 14 July 2003).

[2] WP, paragraph 17(b): "*the parties and third parties should provide their submissions to the Secretariat by 5:30 pm on the deadlines established by the Panel, unless a different time is set by the Panel.*" WP, paragraph 17(d): "*the parties and third parties shall provide electronic copies of all submissions to the Secretariat at the time they provide their submissions* [...]".

[3] "*The Panel reminds the parties that paragraph 17(b) of the Panel's working procedures indicates that the responses should be submitted by 17:30 (Geneva time).*"

determination of 20 June. However, Brazil has been meeting the deadlines established, and will continue to do so. Although the facts do not recommend Brazil to be very optimistic, Brazil continues to expect that the US will, like Brazil, meet its own deadlines in a timely fashion from now on.

Brazil respectfully asks the Panel to take note of this new delay and to encourage, again, the US to respect the deadlines, with a view to ensuring procedural fairness in these proceedings.

In addition, Brazil would like to bring to the Panel's attention an issue regarding certain of the United States' Answers to the Panel's Questions. In certain answers, the United States has indicated it will provide responsive arguments and information in its rebuttal submission. In other answers, it made allegations without providing any documentary support that would permit Brazil to challenge the accuracy and credibility of allegations. The answers in question are the following:

> Answer to Questions 14 and 26: no detailed information or arguments were provided in the US answers regarding either production flexibility contracts or market loss assistance payments. The last sentence of paragraph 57 of the U.S. answers indicates US will discuss production flexibility contract payments only in the rebuttal submission.
>
> Answer to questions 60 and 66(a): The United States provided no responsive information or calculations to respond to the Panel's questions.
>
> Answer to Questions 66(d): In paragraph 121, the United States indicates that "it will provide a detailed critique of Mr. Sumner's analysis in our rebuttal submission." In paragraph 124 it states: "We will discuss other conceptual errors in Sumner's approach in our rebuttal submission."
>
> Answer to Question 73: Other than an undocumented allegation in US answer to Question 76, the United States provided no information or argument concerning Articles 1 and 3 of the SCM Agreement. Instead, the United States stated in paragraph 140 that it would "review Brazil's submissions, including its responses to these questions, and provide any further response in the US submission".
>
> Answers to Questions 12, 71-88: The United States provided only two exhibits (US-12 and US-20) and no other documentation in support of arguments or allegations.

Brazil recalls that the purpose of scheduling the filing of the answers to the Panel's questions 11 days before the submission of the rebuttal submission was to permit the parties to review each other's answers and supporting documentation and then to comment on those answers in the rebuttal submissions. Brazil cooperated in this process by providing complete and comprehensive answers to all of the Panel's questions together with extensive documentation. As demonstrated above, for certain questions, the United States did not provide complete answers or documentation that would have allowed Brazil the opportunity to comment and rebut in its rebuttal submission.

Brazil will be prejudiced if it does not have the opportunity to comment on information, arguments, and documents the United States makes or provides for the first time in their rebuttal submission that *would have been* responsive to those Panel questions listed above. Accordingly, Brazil requests the right, only with respect to the questions above, to comment on any new information, arguments, or documents presented for the first time in the U.S. rebuttal submission.

Providing Brazil with this right is consistent with basic notions of due process. Otherwise, Brazil will not have another opportunity prior to the Panel's 5 September decision on peace clause issues, to comment on any new information, documents, or arguments presented by the United States.

The inability or unwillingness of the United States to provide complete answers should not prejudice Brazil. The United States now has the benefit of Brazil's complete answers together with extensive additional documentation to comment on in its rebuttal submission. This is particularly true with respect to issues related to export credit guarantees and issues related to Professor Sumner's analysis. Brazil is entitled the same right.

Brazil requests that it be provided until 28 August to file any such comments. In light of the fact that Brazil provided complete answers to the Panel's questions, there is no basis for the Panel to provide the United States with any corresponding right. Its due process rights have not been adversely impacted.

# ANNEX K-11

## LETTER FROM THE UNITED STATES

20 August 2003

The United States has received a copy of the letter to the Panel from Brazil of 14 August 2003. We have also received your communication of yesterday, responding to Brazil's requests for additional time to submit its rebuttal. The United States does wish to record its views on Brazil's letter, and my authorities have therefore instructed me to convey their surprise that Brazil would send such a letter and their regret over any burden that it may have placed on the Panel in what is already a very difficult and complicated dispute.

The United States would first like to thank the Panel for agreeing to extend the deadline for the responses to the Panel's questions. The United States appreciates the depth and level of understanding of the issues represented by the Panel's extensive and broad-ranging questions. Without an extension of the deadline, it would have been completely impossible for the United States to have provided responses in a timely manner. Even with the extension, the drafting, compiling, consulting internally with the various relevant officials, and finalizing the responses all required supreme effort and personal sacrifice on the part of the entire US delegation. The United States did provide responses by the August 11 deadline, although it was not possible to accommodate the 5:30 pm filing guideline despite the best efforts of the United States to do so.[1]

The same burden was not placed on Brazil and the outside legal counsel that Brazil has employed for this dispute. As a result, it is not surprising that Brazil found the deadline to be less demanding and resource-intensive. We would note that, if one only counts the main questions and not any of the subquestions, there were 104 questions posed to the United States, but only 63 posed to Brazil.[2] With all respect, the United States has considerable difficulty with Brazil's complaints about the time within which the United States filed its response in light of the total amount of work required, and effort that the United States expended, to provide its answers to the Panel's questions.[3]

The United States also could not understand how Brazil could ask for an additional opportunity to respond to new material in the rebuttal submissions while at the same time asking that the Panel deny any such opportunity to the United States. (After all, one would expect that Brazil will

[1] On the one hand, the United States is flattered that Brazil credits the United States with the ability to finalize its own responses while simultaneously reviewing Brazil's responses filed earlier in the evening. On the other hand, the United States is, to say the least, taken aback that Brazil would suggest that the United States would do so. In any event, the press of finalizing the US responses completely consumed the US delegation and no one was able to spare time to look at Brazil's responses at any point that day, let alone before the US responses were filed.

[2] The difference in the number of questions for each party means that Brazil had nearly 6-1/2 hours to prepare its responses to each question posed to it, whereas the United States had less than four hours per question. (Counting the subquestions would increase the disparity since a preliminary check indicates that there were more subquestions for the United States than for Brazil.) As a result, Brazil had approximately 65 percent more time to prepare its responses. Had the United States taken the same amount of time as Brazil to prepare each response, its responses would have taken 28 days to file (they would have been finished on August 22).

[3] The United States also failed to understand the reference in Brazil's letter to Brazil's "good faith and cooperation" in extending the deadline by seven days. In fact, Brazil did not "cooperate" in the Panel's decision to grant a seven-day extension. Brazil instead objected to any extension beyond three days.

also provide new material in its rebuttal submission on topics covered in the Panel's questions, and not just repeat material it has already submitted.) Such a one-sided approach would not have achieved the "procedural fairness" that Brazil has said it seeks. In this connection, the United States considers that the approach taken by the Panel in its communication yesterday achieves a fair balance of the parties' interests.

In conclusion, the United States would like to thank the Panel for the approach it has taken on Brazil's request, as well as for its work to date on the many issues presented by this dispute. The United States is also providing a copy of this letter directly to Brazil.

# ANNEX K-12

## LETTER FROM BRAZIL

23 August 2003

The Government of Brazil is in receipt of the Communication from the Panel dated 19 August 2003. Brazil only received this morning the *Rebuttal Submission of the United States of America*, dated 22 August 2003 ("US Rebuttal Submission"). Brazil notes that consistent with all of its earlier written submissions, the United States filed its Rebuttal Submission 6 hours late. This delay has prejudiced Brazil and prevented it from providing comments responsive to the Panel's 19 August 2003 letter until today. Brazil notes that the United States received its copy of Brazil's Rebuttal Submission, along with Brazil's Comments to the US Answers, consistent with the 5:30 p.m. deadline established in the Panel's Working Procedures.

In accordance with your communication of 19 August 2003, Brazil has reviewed the US Rebuttal Submission to determine "whether there is any specific material on which it has not had an opportunity to comment", and which it would like to address in a 27 August submission. Brazil identifies below the specific US arguments, data and documents on which it would like to comment. Brazil also shows below good cause why it should be granted the opportunity to address each specific argument, data and document.

Brazil recalls that its original 14 August 2003 request to the Panel to afford it this opportunity was triggered by explicit indications by the United States, in its 11 August responses to Panel questions, that it was not providing full responses to the Panel's questions and would instead address a number of issues for the first time in its Rebuttal Submission. Brazil argued that it would be prejudiced by this conduct. The list below is consistent with the spirit of Brazil's 14 August request. Brazil's list only includes specific issues that should have been but were not addressed in the United States' 11 August responses, or specific issues related to new documents relied on by the United States for the first time in its Rebuttal Submission.

There are a number of new arguments or re-packaging of earlier arguments presented by the United States in its Rebuttal Submission. Most of these arguments do not require a further response, since Brazil's various earlier submissions and exhibits addressed or anticipated the new or re-packaged US arguments or issues raised by those arguments. In this regard, Brazil notes that the United States' Rebuttal Submission does not respond to a number of arguments made in earlier submissions by Brazil. Brazil would object to any opportunity given to the United States to provide such a response in its 27 August submission. Brazil is of the view that the purpose of this exercise is not to provide the Parties with a whole-scale opportunity to rebut every point raised in either the United States' or Brazil's Rebuttal Submissions. The Panel should limit the United States to comments on specific issues that should have been but were not addressed in Brazil's 11 August responses, or specific issues related to new documents relied on by Brazil for the first time in its Rebuttal Submission.

Should the Panel grant the United States an opportunity to comment on issues beyond this narrow scope, Brazil reserves its right to revisit the list of material it includes in the list below.

In accordance with the above understanding, Brazil requests leave to comment on the following specific material:

**Domestic Support Issues**

Para. 43

*Subject:* US argument regarding the growing of illegal crops, etc.

*Good cause*: This is a new argument that should have been but was not raised in the United States' 11 August response to questions 25 and 26 from the Panel.

Paras. 96-98

*Subject*: US argument regarding crop insurance notifications of other Members.

*Good cause*: This is a new argument referring to new WTO documents not raised in earlier submissions.

Paras. 114-117

*Subject*: US argument regarding a price gap methodology for marketing loans.

*Good cause:* This is a new argument that should have been but was not raised in the United States' 11 August response to question 67 from the Panel, and that is directly contradictory to information provided by the United States in paragraphs 128-134 of that response.

Paras. 123-127 and Exhibit US-24

*Subject*: US new challenge to Professor Dan Sumner's analysis.

*Good cause*: This is a new argument and exhibit that should have been but was not provided in the United States' 11 August response to question 61(d) from the Panel.

Export Credit Guarantee Issues

Paras. 135-146 and Exhibits US-25 through US-29

*Subject:* New US arguments concerning the negotiating history of Article 10.2 AoA.

*Good cause:* These arguments should have been but were not raised in the United States' 11 August response to questions 88(a) and 88(b) from the Panel.

Paras. 147-152

*Subject:* New US argument that had it intended to subject export credit guarantees to the AoA and the SCM Agreement, it would have included them in the calculation of its reduction commitments.

*Good cause:* This argument should have been but was not raised in the United States' 11 August response to questions 88(a) and 88(b) from the Panel.

Paras. 156-157, 160-162, and Exhibits US-31 and US-32

*Subject:* New US arguments and data concerning the FCRA formula and the reestimate process.

*Good cause:* These arguments and data should have been but were not raised in the United States' 11 August response to questions 81(d)-(g) from the Panel.

Para. 169 and Exhibit US-33

*Subject:* New US assertion that rescheduled debt is not in arrears.

*Good cause:* This argument and evidence should have been but was not raised in the United States' 11 August response to question 81(a) from the Panel.

Paras. 172, 174-175:

*Subject:* US argument that item (j) does not require recovery of long-term losses.

*Good cause:* This argument should have been but was not raised in response to the United States' 11 August responses to questions 74 and 77 from the Panel.

Paras. 186-191, and Exhibits US-34 through US-37

*Subject:* US argument that "forfaiting" is analogous to CCC export credit guarantee programs for agricultural commodities.

*Good cause:* This argument should have been but was not raised in the United States' 11 August response to question 76 from the Panel (as well as questions 71(a) and 73).

Brazil notes that the United States has for the first time addressed Brazil's "threat of circumvention" claims under Article 10.1 AoA (paras. 180-183). In particular, Brazil notes new US arguments contrasting CCC guarantee programs from FSC (and the panel and Appellate Body decisions concerning the *United States – FSC* dispute), asserting that there is no legal entitlement to CCC guarantees, and asserting (*via* new data) compliance with scheduled quantitative reduction commitments. Consistent with the purpose of this exercise – offering an opportunity to comment solely on arguments that should have been addressed in the United States' 11 August responses to questions and to new documents proffered by the United States for the first time in its Rebuttal Submission – Brazil is not asking for an opportunity to address the US "circumvention" arguments in its 27 August submission. Brazil would be pleased, however, to address any questions the Panel has concerning these new US arguments.

Brazil thanks the Panel and the Secretariat for its consideration of this request and for its continuing work on this dispute.

# ANNEX K-13

## LETTER FROM THE UNITED STATES

25 August 2003

In the Panel's fax dated 19 August 2003, the Panel noted the possibility that a party might lack sufficient opportunity to comment on information, argumentation and documents submitted by the other party in its rebuttal submission, and the Panel invited the parties to request the opportunity to comment on specific material after receiving each other's rebuttal submissions. My authorities have instructed me to submit this letter requesting such an opportunity.

Because of Brazil's tactical decision to defer presenting its entire case with respect to Peace Clause issues, the United States is once again put in the difficult position of attempting to respond to extensive, wholly new evidence and arguments in an extremely compressed time frame. Furthermore, we note the comment of Brazil in its rebuttal submission that it "provides *additional evidence* establishing that under *a variety of interpretations and methodologies* the US level of support granted to upland cotton in MY 1999-2002 was far greater than the support decided in MY 1992".[1]

Under paragraph 13 of the Panel's working procedures, all evidence was supposed to have been submitted no later than during the first substantive meeting, except evidence necessary for purposes of rebuttals or answers to questions. Brazil has not explained why it could not have presented this evidence by the first Panel meeting or why this evidence is necessary for purposes of rebuttal. A quick review of the "additional evidence" appears to indicate that this is all evidence that should have been presented no later than the meeting with the Panel. Accordingly, unless Brazil can show "good cause" for withholding this evidence from the Panel and the parties until now, the United States would respectfully request the Panel to disregard this evidence.

In light of the shortness of time, the United States requests the opportunity to comment with respect to a number of issues raised for the first time in Brazil's rebuttal submission and comments on answers to questions, as listed below. With respect to each such issue, the United States demonstrates that there is good cause to permit such comments. The United States is requesting the opportunity to comment (even though some of this evidence may be disregarded by the Panel in response to the US request) so as to avoid further delay, pending the Panel's finding in response to the request to disregard the evidence.

Rebuttal Submission:

Paras. 4-9: Brazil for the first time responds to the US argument, made in both its opening and closing oral statements at the first panel meeting, that Brazil's interpretation of paragraph 6(b) would create an inconsistency between that provision and the fundamental requirement of the first

[1] Rebuttal Submission of Brazil, para. 1 (22 August 2003) (emphasis added). We also note that Brazil had indicated in its answers to the Panel's questions that it was deferring presenting its case on several issues pending receipt of the answers to the questions by the United States and in at least one instance by the European Communities (see *e.g.*, paragraph 80 of Brazil's answers to the Panel questions). Brazil's rebuttal submission for the first time now presents this material.

sentence of Annex 2, paragraph 1. This is a new argument not previously made to the Panel, for example, in either of Brazil's oral statements or in its answers to questions from the Panel.[2]

Paras. 24-26: On the basis of a previously submitted exhibit, Brazil now advances for the first time the argument that production flexibility contract payments may be considered "support to upland cotton" on the basis that such payments were not made "in favour of agricultural producers in general" because payments were linked to acres that produced any of seven crops during a fixed and defined base period.[3] This argument could have been made in Brazil's first submission, either of Brazil's oral statements, or in Brazil's answers to questions from the Panel.[4]

Paras. 29-35: In these paragraphs, Brazil for the first time advances an argument for market loss assistance payments that parallels the argument made for the first time in paragraphs 24-26 with respect to production flexibility contract payments: that market loss assistance payments may be considered "support to upland cotton" on the basis that such payments were not made "in favour of agricultural producers in general" because payments were linked to acres that produced any of seven crops during a fixed and defined base period. In addition, Brazil introduces a raft of assertions, new data, and calculations, including some with respect to crops other than upland cotton, to assert that production flexibility contract payments and market loss assistance payments are support for upland cotton because of costs for upland cotton farmers.[5] Brazil could have presented these data, calculations, and arguments in its previous submissions and statements.

Paras. 36-46: As with production flexibility contract payments and market loss assistance payments, Brazil argues (again for the first time) that direct payments may be considered "support to upland cotton" on the basis that such payments were not made in favor of all agricultural producers, and Brazil introduces a raft of assertions, new data, and calculations, including some with respect to crops other than upland cotton, to assert that direct payments are support for upland cotton because of costs for upland cotton farmers.[6] Brazil could have presented these data, calculations, and arguments in its previous submissions and statements.

Paras. 48-50: Brazil makes a nearly identical argument for counter-cyclical payments as for those indicated above: that is, these payments may be considered "support to upland cotton" on the basis that such payments were not made "in favour of agricultural producers in general" and on the basis of the same or similar assertions, new data, and calculations with respect to costs and subsidies for upland cotton and other crops.[7] Brazil could have presented these data, calculations, and arguments in its previous submissions and statements.

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[2] *See, e.g.*, Brazil's Answer to Question 27 from the Panel (para. 39 failed to make any such argument in the course of the answer alleging that US decoupled income support has more than a minimal effect on production (and thus is inconsistent with the fundamental requirement of the first sentence of Annex 2, paragraph 1) because such support "limit[s] payments based on the type of production").

[3] Indeed, none of the citations provided by Brazil in these paragraphs discloses the argument Brazil now advances. *See* Brazil 's Rebuttal Submission, paras. 24-35 fn. 38-44.

[4] *See* Brazil's Answer to Question 23 from the Panel (paras. 25, 27: noting base acreage and addition of crops to base acreage under direct payments program but failing to argue that limitations on base acreage render measure product-specific).

[5] *See, e.g.*, Brazil's Rebuttal Submission, para. 31 fn. 68, 69 (both of these footnotes contain new evidence that should have been presented by the first Panel meeting); *id.*, para. 33 fn. 71 (disclosing new calculation).

[6] *See, e.g.*, Brazil's Rebuttal Submission, para. 39 fn. 84 (this footnote contains new evidence that should have been presented by the first Panel meeting), 85.

[7] *See, e.g.*, Brazil's Rebuttal Submission, para. 50 fn. 112, 113, 114 (all of this is new evidence that should have been presented by the first Panel meeting).

Paras. 55-59: With respect to crop insurance payments, Brazil introduces new evidence (for example, relating to availability of specific policies) and arguments to claim that these payments are product-specific support to cotton.[8] Brazil could have presented this evidence and argument in its previous submissions and statements.

Paras. 73, 75-77: Brazil introduces revised data and calculations relating to alleged budgetary expenditures for upland cotton and an AMS for upland cotton.[9]

Paras. 88, 90-94: Brazil misstates the US position with respect to the Peace Clause analysis for support provided in past marketing years. Brazil also asserts, erroneously, the US Peace Clause interpretation is inconsistent with the position taken by the United States in previous WTO dispute settlement proceedings. These arguments could have been presented by Brazil earlier -- for instance, during its first oral statement to the Panel[10] or in its answers to the Panel's questions.[11]

Brazil's Comments on U.S. Answers

Paras. 44-45: Brazil for the first time presents an argument claiming that the US interpretation of paragraph 6(b), made in both its opening and closing oral statements at the first panel meeting, would render paragraph 6(e) a nullity. These arguments could have been presented in Brazil's answers to the Panel's questions. (*See also* paragraphs 4-9 of Brazil's Rebuttal Submission, discussed above.)

Paras. 54-56: In the guise of a "general comment" to questions 47-69, Brazil asserts for the first time that the US argument relating to the level of support decided by US measures does not account for various forms of product-specific support. This erroneous assertion could have been presented as early as Brazil's oral statements at the first panel meeting or in its answers to the Panel's questions.

The United States thanks the Panel for its consideration of these requests. In addition, like Brazil, we would of course also welcome the opportunity to respond to any further questions the Panel may have. Moreover, should the Panel consider it useful to hear further argumentation from the Parties, we would of course be pleased to make additional submissions or appear before the Panel on this complicated and sensitive matter.

The United States is providing a copy of this letter directly to Brazil.

[8] *See, e.g.*, Brazil's Rebuttal Submission, para. 56 fn. 131, 132.
[9] *See, e.g.*, para. 73 fn. 172.
[10] *See, e.g.*, Brazil's Oral Statement at First Panel Meeting, paras. 40-43.
[11] *See, e.g.*, Brazil's Answer to Question 15 from the Panel.

# ANNEX K-14

## LETTER FROM BRAZIL

25 August 2003

The Government of Brazil is in receipt of a letter from the United States dated 25 August. Brazil received that letter at 6 p.m. today. Brazil requests the Panel to take the following action as set forth below.

*Rejection of US request as untimely:*

Brazil requests that the Panel disregard the United States' request to have the Panel grant it permission to offer rebuttal arguments to Brazil's 22 August rebuttal submission and comments on the US answers. This letter, like *all* prior US submissions to the Panel, was not timely filed. This latest request was made at least 60 hours too late. The Panel's Communication of 19 August 2003 stated:

> when each party receives the other party's rebuttal submission, it is invited, *without delay* to draw the Panel's attention to any specific material on which it has not had an opportunity to comment . . . ."

The Communication further stated that "the Panel is willing to grant such permission on Saturday, 23 August 2003, if necessary."

Brazil interpreted this Communication as requiring it to make the request on Friday evening, 22 August, immediately after reviewing the US Rebuttal Submission. Unfortunately, the US Rebuttal Submission was sent shortly before midnight on Friday, 22 August and could only be accessed by the Brazilian Mission in Geneva at 9:00 a.m. Geneva time on Saturday, 23 August. Brazil informed the Secretariat on Friday evening that it could not make its request that evening since it had not received the US Rebuttal Submission. Brazil further informed the Secretariat on Saturday morning that it would file a request by 2:00 p.m. on Saturday.

By contrast, the United States received Brazil's 22 August Rebuttal Submission and Brazil's 22 August Comments to the US Answers and Brazil's exhibits at 5:30 p.m. Geneva time on Friday, 22 August. Regardless, the United States waited more than 72 hours to file its request that the Panel strike certain information in Brazil's 22 August submissions, and its request for leave to file comments on those Brazilian submissions.

Brazil has endured repeated violations by the United States of the Panel's procedural deadlines over the past three months. If the Panel's procedures are to mean anything, they must be enforced. There is no doubt that this latest request by the United States is well out of time. It was not made "without delay". There is no basis offered by the United States for such delay. There is none. Accordingly, the Panel should reject the United States request as untimely.

*Reject US Request to Strike Brazil's Rebuttal Evidence and Argument*

The United States also requests the Panel to strike large amounts of Brazil's Rebuttal Submission and Brazil's documents with the argument that Brazil allegedly violated paragraph 13 of the Panel's working procedures. Brazil notes the irony of the United States invoking the Panel's

working procedures given their repeated violations of such procedures over the past three months. Nevertheless, the United States ignores the Panel's Determination of 20 June, in which it stated, in paragraph 20, last bullet:

> For the purposes of allowing the Panel to express its views on the exemption conditions of Article 13 of the *Agreement on Agriculture* by 1 September 2003, in relation to those measures which may be affected by Article 13, *full and complete submissions on factual and legal issues related to Article 13 in this dispute will need to be provided, at the latest, in the parties' rebuttal submissions (to be submitted on 22 August 2003).*

Brazil interpreted this ruling as permitting it to provide no later than 22 August all of its evidence and argument that had not already been provided in its earlier submissions. This is the manner in which it treated the new evidence and arguments presented by the United States in its Rebuttal Submissions. Therefore, Brazil did not, in its 23 August letter to the Panel, seek to "strike" new US evidence included in the US 22 August Rebuttal Submission, but simply asked to be provided with an opportunity to respond to that evidence.

Therefore, there is no basis for the US request.

*Response to US requests to comment on Brazil's 22 August Submissions*

The United States complains at several points in its letter that Brazil is presenting for the first time, in its 22 August Rebuttal Submission, responses to US arguments made in the US opening and closing oral statements at the first panel meeting. Unless particular questions from the Panel offered Brazil the opportunity to respond to arguments made by the United States in the US statements at the first panel meeting, however, Brazil's first opportunity to respond to the US arguments was in Brazil's 22 August Rebuttal Submission.

Brazil has listed below its comments to the requests by the United States:

Brazil's 22 August Rebuttal Submission

Paragraphs 4-9:

These arguments were made by Brazil in rebuttal of US and EC arguments advanced in their first submissions, oral statements and answers to questions, or reflect summaries of earlier arguments made by Brazil. The Panel should, therefore, reject the US request to comment on them.

Paragraphs 24-26:

This evidence and arguments are based on exhibits presented previously and rebut US arguments that PFC payments do not constitute support to upland cotton. Contrary to the US assertion, there is no question by the Panel to which this evidence and arguments would be responsive. Therefore, the US request should be rejected.

Paragraphs 29-35:

This evidence was presented by Brazil in rebuttal to US arguments that market loss assistance payments do not constitute support to upland cotton. The US does not assert that there would have been a question by the Panel to which this evidence and arguments would be responsive. Therefore, the US request should be rejected.

Paragraphs 36-46:

This evidence was presented by Brazil in rebuttal to US arguments that direct payments do not constitute support to upland cotton. The US does not assert that there would have been a question by the Panel to which this evidence and arguments would be responsive. Therefore, the US request should be rejected.

Paragraphs 48-50:

This evidence was presented by Brazil in rebuttal to US arguments that counter-cyclical payments do not constitute support to upland cotton. The US does not assert that there would have been a question by the Panel to which this evidence and arguments would be responsive. Therefore, the US request should be rejected.

Paragraphs 55-59:

This evidence was presented by Brazil in rebuttal to US arguments that crop insurance payments do not constitute support to upland cotton. The US does not assert that there would have been a question by the Panel to which this evidence and arguments would be responsive. Therefore, the US request should be rejected.

Brazil's 22 August Comments on US Answers

Paragraphs 44-45:

These arguments were made in rebuttal of US arguments that the restrictions on planting flexibility contained in the US PFC and direct payment programmes are consistent with Annex 2, paragraph 6. Therefore, the US request should be rejected.

Paragraphs 54-56:

These arguments are a direct reaction and comment to new information provided by the United States in response to Question 67. It is entirely appropriate to react to this information and include it in the peace clause calculation. Therefore, the US request should be rejected.

Brazil would like once more to thank the Panel for the consideration of these requests.

# ANNEX K-15

## LETTER FROM THE UNITED STATES

27 August 2003

Attached please find the US comments on new material in Brazil's rebuttal filings and answer to the additional question from the Panel in the dispute, *United States – Subsidies on Upland Cotton* (DS267). The United States wishes to take this opportunity to thank the Panel for its rapid consideration of, and response to, the US request to file these comments.

In Brazil's letter to the Panel of 14 August 2003, Brazil raises the concern that "basic notions of due process" require providing parties the opportunity to comment on new material. Brazil's concern and the exchanges with the Panel and the parties over the days since that letter have highlighted a particular aspect of the unique proceedings in this panel process. As a result, my authorities have instructed me to draw another matter to the Panel's attention. The United States notes that the Panel intends to express its views on the issue of the Peace Clause by 5 September 2003. No prior panel nor the Appellate Body has made findings on the Peace Clause. The submissions and material provided to the Panel to date have demonstrated that the issues involved in the Panel's findings on the Peace Clause are fact-intensive, complex and sensitive.

While prior panels have made preliminary rulings on procedural issues, no prior panel has been confronted with the situation presented in this dispute. Here, the Panel will be making substantive findings on key provisions of the covered agreements. In this connection, the United States takes note of the Panel's observation that the fairness of panel proceedings may require ensuring that the parties receive sufficient opportunity to comment on new material.[1] The United States also takes note of the provisions of paragraph 2 of Article 15 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* in which Members have agreed that parties should have an opportunity to comment on a panel's findings before they are final.

In this dispute, the Panel's findings on the Peace Clause are presumably intended to be dispositive of substantive claims and arguments of the parties for the remainder of the panel proceedings. Because of the substantive nature of those findings, the Panel's findings on 5 September will need to provide the factual basis and basic rationale underlying the findings. Both parties have a significant interest in those findings, in terms not just of the ultimate conclusion reached, but also in terms of the factual findings, rationale underlying those findings, and an understanding of the scope of those findings.[2] Accordingly, in keeping with Article 15.2 of the DSU, and in order to be fair to both parties, the United States respectfully requests that the Panel provide Brazil and the United States with the Panel's 5 September Peace Clause findings in an interim form and provide the parties an opportunity to comment on the Panel's findings.[3] The United States suggests that, in keeping with the

[1] In the Panel's letter of 19 August 2003.

[2] Recent experience in the DSU with panel preliminary rulings has demonstrated the significant effect they can have on the parties and the course of the panel proceedings.

[3] The United States assumes that the Panel will also include its findings on the Peace Clause in its interim report issued towards the end of the panel proceedings. However, at that point the findings would have already determined the course of the remainder of the panel proceedings and it would be too late for either party to provide comments in a timely manner that would help ensure the accuracy of the facts on which the findings were based or to facilitate a clear understanding of the legal basis for those findings. Accordingly, the opportunity to comment at that stage would be inadequate to preserve the rights of both parties and could

practice in other panel proceedings and this Panel's timetable for the interim review in this dispute, two weeks should be sufficient time to comment.

The United States would be happy to provide further elaboration or to respond to any questions the Panel may have with respect to this request.

The United States is providing a copy of this submission directly to Brazil.

instead prejudice those rights. For the same reason, it could be perceived as circumventing the provisions of Article 15.2 of the DSU to issue substantive findings on the claims made (and that have effect on the parties) without an opportunity for the parties to comment prior to the findings having an effect.

# ANNEX K-16

## LETTER FROM BRAZIL

28 August 2003

The Government of Brazil is in receipt of a letter from the United States dated 27 August. Brazil notes that the US Comments to Brazil's 22 August Rebuttal Submission were filed five hours *after* the deadline of 5:30 p.m. In the covering letter to those Comments, the United States requests that the Panel provide the Parties with an opportunity to comment on an interim form of the Panel's 5 September rulings regarding peace clause-related issues.

Brazil opposes this request for the reasons stated below.

The Panel's ruling of 20 June 2003 revising the timetable for this dispute did so in order to "organize [its] proceedings in an orderly, effective and efficient manner". This 20 June 2003 decision, in the view of Brazil, addressed the concerns of Brazil that the extra briefing and meeting proposed by the United States on peace clause issues would not result in an overly lengthy delay of the resolution of Brazil's serious prejudice claims. To that end, the Panel established the date of September 1 for the Panel's decision and September 4 for Brazil to file its "Further Submission." Those dates were later extended to September 5 and 9 respectively pursuant to a 30 July Panel decision to accommodate a request of the United States for additional time to answer the Panel's questions.

Brazil is ready to file its Further Submission no later than 5:30 p.m. on 9 September. Establishing an unprecedented "interim review" for the peace clause preliminary finding will unquestionably delay Brazil's filing of its Further Submission and the Second meeting of the Panel scheduled for 7-9 October. This request will upset the balance created by the Panel's 20 June proceeding and negatively impact Brazil's rights to a speedy resolution of this dispute pursuant to DSU Article 3.3. The Panel was established more than five months ago and Brazil has yet to file its first submission on many of its claims.

Brazil notes further that DSU Article 15.2 provides an opportunity for the parties to request the panel to review "precise aspects of the interim report prior to the circulation of the final report to the Members". This actual text is contrary to the US statement that Article 15.2 provides Members "an opportunity to comment on a panel's finding before they are final". The parties' rights under Article 15.2 are explicitly recognized and preserved by paragraph 16 of the Panel's Working Procedures.

The US letter argues that the Panel must set forth its complete and full reasoning and factual findings in its 5 September decision. Brazil notes that paragraph 20 of the Panel's 20 June Decision stated that it would "express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the Agreement on Agriculture" and would "express its views in the form of ruling...". Brazil does not and would not presume or suggest what form the Panel's "ruling" will or should take. However, it is within the Panel's discretion, as with many previous panels, to provide the basic rulings on the preliminary issue and then to further elaborate such rulings in the final determination.

As the United States recognizes, there will be an opportunity for the parties to comment on the interim report that the Panel will issue following the second meeting of the Panel with the Parties.

Brazil believes that its procedural rights will be fully protected by the existing procedural safeguards provided by the interim review process. The United States has provided no legitimate reasons why its rights would not also be protected. Both parties will have an equal opportunity to comment on any decision by the Panel regarding the peace clause at that time.

In sum, Brazil requests that the Panel reject the United States request to establish an interim review process to the Panel's 5 September ruling.

# ANNEX K-17

## LETTER FROM THE UNITED STATES

29 August 2003

By letter of 28 August 2003 Brazil objects to the US request in the dispute *United States – Subsidies on Upland Cotton* (DS267) that the Panel provide Brazil and the United States with the Panel's September 5 Peace Clause findings in an interim form and provide the parties an opportunity to comment on the Panel's findings. My authorities have instructed me to submit this response to Brazil's letter.

The United States has reviewed carefully the concerns raised by Brazil in its letter. Brazil's objection appears solely to be based on the concern that granting this request would mean that the parties would have time to review and provide comments to assist the Panel in finalizing the Panel's findings on this key element of the dispute. Brazil expresses concern that the time for comment may result in some shifting of the schedule for the remainder of the dispute.[1]

Brazil acknowledges that the parties have the right under the DSU to comment on the Panel's Peace Clause findings before they are made final. The only apparent concern for Brazil is when that right to comment can be exercised. For Brazil, the comments should only be provided when they are too late to be effective. According to Brazil's approach, while it is to be expected that the Panel could alter any part of its findings in response to a party's comments, that alteration would come after the Panel's proceedings had already taken place on the basis of the preliminary findings. Any alteration would be unable to affect the past proceedings. The United States is unable to understand how this could possibly mean, as Brazil asserts, that a party's "procedural rights will be fully protected by the existing procedural safeguards provided by the interim review process".

Brazil would compound the problem by suggesting that findings on key substantive claims may be made in just a basic form, with none of the underlying factual basis or legal reasoning. Brazil asserts that would be in keeping "with many previous panels". Brazil's assertion has no foundation. No previous panel has ever been in the current situation, nor has any previous panel made findings part-way through a dispute on the Peace Clause or on any substantive issue, let alone one as factually complex with so many legal questions of first impression. The Panel's situation is unprecedented, thus it is no surprise that there are no precedents on which to draw. However, there *is* the text of the DSU on which to draw. As the United States explained in its 27 August 2003, letter, Article 15.2 of the DSU provides the parties with a right to comment on findings in an interim form. Brazil argues for an approach that would render that right largely hollow.

The United States has difficulty perceiving the basis for Brazil's objections. As the United States has argued, Brazil is barred by virtue of the Peace Clause from pursuing most of its claims in this dispute. It is strange then that Brazil would not want an opportunity to comment on any finding as to whether the Panel should hear evidence and argument on Brazil's claims.

[1] However, granting the request would not appear necessarily to mean any change in the date of circulation of the Panel's final report.

Brazil has failed to present a basis for denying the parties a timely and effective opportunity to exercise their right to comment on the Panel's findings. Accordingly, the United States respectfully renews its request that the Panel provide Brazil and the United States with the Panel's September 5 Peace Clause findings in an interim form and provide the parties an opportunity to comment on the Panel's findings.

The United States is providing a copy of this submission directly to Brazil.

# ANNEX K-18

## LETTER FROM BRAZIL

29 August 2003

The Government of Brazil is in receipt of a letter from the United States dated 29 August responding to Brazil's letter of 28 August. Brazil regrets the US continuation of the debate over its unprecedented "interim review" proposal that distracts the Panel and Brazil from substantive work on this dispute. In response, Brazil refers to the arguments set forth in its letter of 28 August that provides the Panel with the basis to reject the US request for a special interim review procedure.

Brazil notes that the United States does not deny that the proposed new interim procedure would result in additional delay. This is apparently not a concern to the United States. But it is a concern to Brazil. The United States ignores the balance in the Panel's June 20 decision that struck the balance protecting Brazil's rights under Article 3.3 of the DSU.

Reviewing the Panel's decision in the Article 15.2 existing procedures will not, as the United States claims, render the parties rights "largely hollow." The practical purpose of the interim review exercise under Article 15.2 is for parties to point out any particular errors of fact or citations that the Panel may wish to correct in the final report. Thus, the "timely and effective right to comment on the Panel's finding" can be accomplished in this case -- as Brazil suggests -- through the use of the normal Article 15.2 procedures in the normal timeframe for making such comments.

# ANNEX K-19

## LETTER FROM BRAZIL
## COMMENTS RE REVISED TIMETABLE

9 September 2003

1. Brazil welcomes the invitation to comment on the draft further revised timetable, as attached to the Panel's communication of 5 September 2003. In this respect, Brazil recognizes that the Panel must be given all the time necessary to make the best and most objective examination of the matter before it in order to provide the Parties to the dispute with a report founded on a sound legal basis and an accurate scrutiny of the facts. Nonetheless, the proposed date for the second substantive meeting with the Parties poses a difficulty for Brazil given commitments previously scheduled by members of the legal team according to the earlier adopted timetables. Indeed, the Brazilian team would face serious difficulties to participate in meetings in Geneva from 12 to 19 November 2003.

2. Brazil would further recall that any adjustments to the draft further revised timetable should take into account the time limits established in DSU Articles 12.8 and 12.9.

3. That said, Brazil would kindly request the Panel to examine the possibility of modifying the date for the second substantive meeting with the Parties. The subsequent deadlines would be adjusted accordingly.

# ANNEX K-20

## LETTER FROM THE UNITED STATES
## COMMENTS RE REVISED TIMETABLE

9 September 2003

In the Panel's communication of 5 September 2003, the Panel invited the parties to comment on the draft further revised timetable attached to the communication. My authorities have instructed me to submit the following comments on the draft timetable and, in addition, to request that the further submission of the United States be due on 2 October rather than 23 September.

With respect to the draft timetable, the United States notes that the Panel provides separately for comments on answers to questions, due on 27 October, one week after the rebuttal submissions and answers to questions. The United States appreciates the value of an opportunity for the parties to comment on each others' answers to questions. However, in this case that opportunity comes at the cost of adequate time to prepare the rebuttal submissions and answers to questions themselves. Given the number and complexity of issues in this dispute, and the opportunity available at the second substantive meeting for parties to comment on each other's submissions[1] and responses, it would be best to dispense with the 27 October comments, and instead have 30 October – three weeks after 9 October – as the due date for rebuttal submissions and answers to questions. The first substantive meeting may finish as late as 9 October, leaving less than two weeks for rebuttals and answers to questions[2] if they are due on 22 October. The United States notes that DSU Appendix 3 provides as a guideline for 2-3 weeks between the first substantive meeting and rebuttal submissions. Given the scope and scale of argumentation that has prevailed to date, and that is likely to continue, the United States believes that at least the three week guideline provided for in Appendix 3 is necessary for the parties to have adequate time to prepare their rebuttal submissions and answers.

The United States also wishes to request that it have until 2 October to prepare its further submission. Brazil noted in its submission of 24 June 2003 that its submission due today would include "extensive evidence"[3], and we expect that it will also include extensive new argumentation. It is therefore likely to require significant effort and time for the preparation of a response. Brazil has had months to prepare this submission, which is a first written submission for purposes of this part of the proceedings. Appendix 3 provides for 2-3 weeks for a first submission of the party complained

[1] The United States notes as well that comments on rebuttal submissions could be of equal importance or value, and those will be presented at the Panel meeting.

[2] The United States assumes that the questions may be at least as comprehensive at this stage as they were in connection with the Peace Clause, and therefore require significant time and care to research, develop and consult on the answers to those questions.

[3] Brazil stated in paragraph 18 of its submission of 24 June 2003,

> **Consistent with the Panel's decision of 20 June decision, and because (1) Brazil's claim under GATT Article XVI:3 involves export subsidies conditionally exempt from action and (2) Brazil's actionable subsidy claims under ASCM Articles 5 and 6 involve domestic support and export subsidies conditionally exempt from action, Brazil will only present its extensive evidence in support of those claims in its "further submission".**

against[4], and the burdens imposed by this dispute clearly warrant at least a three-week response period.

Preparing the submission in three weeks would likely be extremely challenging under any circumstances. However, the timing for this submission involves unusual circumstances. Many of the US officials involved in this dispute are attending the Fifth Ministerial Conference in Cancun this week and are therefore unavailable to assist with preparation of the submission. At the same time, the head of the US litigation team in this dispute became a father three weeks ahead of schedule. As a result, he will have limited time over the next week (at least) to prepare the US response. For all of these reasons, the United States respectfully requests that its next submission be due no earlier than 2 October.[5]

[4] Indeed, in the DSU negotiations many Members have indicated that this is too short a period of time and that the timeframes suggested in Appendix 3 of the DSU for first submissions should be reversed between complaining parties and responding parties.

[5] The United States notes that the third party submissions could then be due on 6 October.

# ANNEX K-21

## LETTER FROM BRAZIL
## COMMENTS RE REVISED TIMETABLE

10 September 2003

Brazil is in receipt of a letter dated 9 September 2003 from the United States commenting on the proposed timetable and requesting to be able to file their Further Submission on 2 October.

Brazil opposes the US request that it be granted until 2 October to file its Further Submission for the reasons set out below:

First, the United States has been on notice of Brazil's claims and arguments on the adverse effects portion of this dispute for almost one year when Brazil filed its 27 September 2002 request for consultations (WT/DS 267/1). The Annex to this comprehensive consultation request set forth in detail arguments, facts, and evidence (mostly consisting of US Government documents) that were available to Brazil. The great majority of these arguments and evidence are now found in Brazil's Further Submission. If this information and the three sessions of the consultations discussing these issues were not enough, Brazil's First Submission at paragraphs 1-15 outlined in summary form many of the principle arguments (and evidence) supporting Brazil's adverse effects claims. All of these arguments are again repeated in Brazil's Further Submission. Paragraphs 26-106 of Brazil's First Submission also set out comprehensive facts upon which Brazil relies but not repeated in its Further Submission. Thus, in view of the transparency of Brazil's earlier submissions, the United States' claims concerning the alleged "complexity" of this dispute as justifying more time to prepare is somewhat disingenuous.

Second, Brazil and the Third Parties need sufficient time between the filing of the US Further Submission to prepare their oral statements for the second session of the First Meeting on 7-9 October. Providing the United States until 2 October to file its Further Submission will not provide the Panel, Brazil, or the third parties enough time to prepare for the hearing on 7-9 October. Given the previous practice of the United States to file its submissions six hours late (the equivalent of unilaterally granting itself an additional working day to file each submission, and of giving Brazil one less day to respond), the US request to file on 2 October probably means that Brazil will not be able to review the submission until 3 October.

Third, Brazil (and no doubt some of the third parties) has relied upon the long-standing date of 7-9 October for the resumed session of the First Meeting. Brazil notes that while the United States' letter does not ask to reschedule the date of the resumed Second Session of the First Substantive meeting, the effect of its request to file its Further Submission on 2 October does just that. Brazil strongly opposes any delay in the resumed session of the First Meeting. Brazil intends to present at least three witnesses at the resumed session - Professor Daniel Sumner, Andrew Macdonald, and an upland cotton producer from Brazil. Each of these individuals (as well as the Brazilian delegation travelling from Brasilia) have complicated schedules and they have for some time rearranged their schedules to attend the hearing on 7-9 October.

Fourth, the working procedures of the DSU provide for 2-3 weeks for the Party complained against to file its First Written Submission and 2-3 weeks for the Parties to file their Rebuttal submissions. The United States' request to file on 2 October is beyond that maximum amount of time.

However, in the spirit of compromise, and particularly in view of circumstances set out in the fourth sentence of the last full paragraph of the US letter, Brazil could agree to an extension of time *no later than* Thursday, 25 September 2003 at 5:30 p.m. *Geneva* time. In this regard, Brazil notes that both the United States and Brazil will have, under the revised timetable for Panel proceedings, numerous opportunities to brief the various issues in the adverse effects portion of this dispute and thus to fully articulate, expand, and clarify their arguments and supporting evidence.

The United States also requests that the parties be provided until 30 October to file their rebuttal submissions. Brazil has no objection to this request but believes it is important to keep the 22 October date for answering questions intact. Under Brazil's proposed procedure – which was used in the "peace clause" portion of the proceedings – the parties could use their Rebuttal Submissions as the vehicle for commenting on the Parties' answers to the questions.

# ANNEX K-22

## LETTER FROM THE UNITED STATES RE DRAFT REVISED TIMETABLE

11 September 2003

My authorities have instructed me to respond to Brazil's letter of 10 September 2003, objecting to the US request for an extension to file its Further Submission.

In this letter, Brazil suggests first that its request for consultations offered sufficient notice of Brazil's arguments that the United States does not now require sufficient time to respond to the Brazilian Further Submission – a submission so extensive that it had to be divided in two for electronic transmission, and which in addition included extensive economic annexes. According to Brazil, the consultation request and additional summaries of Brazil's arguments render the US reference to the complexity of the issues raised by Brazil "disingenuous."

Brazil appears to be making the implausible suggestions that it is possible to respond to arguments that have not yet been written, and that complex issues become less complex if summarized in advance. One need only note again the size of Brazil's submission to conclude that Brazil itself did not consider its previous summaries to adequately present its arguments; yet Brazil considers that those summaries should have provided a sufficient basis for the United States to prepare its response. It is a statement of the obvious that Brazil's 214-page Further Submission represents the first time Brazil has set forth its detailed arguments and evidence (including the lengthy economic analysis found in the annexes). It is this Brazilian submission, and not anticipatory summaries, to which the United States must have the ability to respond. Brazil's suggestion that the United States need not have adequate time to respond to Brazil's massive submission on the basis that Brazil's argumentation cannot, under the circumstances, be considered "complex," strains credulity.

Brazil also objects to the US extension request on the ground that Brazil and third parties need adequate time to prepare for the second session of the first panel meeting. As regards Brazil, this amounts to an argument that while one week is not enough time for it to prepare for the panel meeting, two weeks must be considered sufficient for the US to respond to Brazil's 214-page submission and economic annexes. Apparently, Brazil considers it fair that, after having had months to prepare its Further Submission, the amount of time for the US response (two weeks) should be no greater than that provided to Brazil to prepare for the first panel meeting. While the United States appreciates that the time for third-party submissions will be limited, this is frequently the case in disputes given party and panel schedules. Further, third parties are free to use the third-party session to elaborate on their written statements.

Brazil is correct when it notes that the United States has not asked the Panel to postpone the date of the first panel meeting. However, it errs when it says that the US request would require a change in the date of that meeting. To the contrary, the United States made its requests for modification of the timetable in consideration of the dates of the panel meetings and on the assumption that it might be difficult for the Panel to change that date in light of the panelists' differing schedules. Indeed, but for seeking to accommodate the panelists' schedules by retaining the meeting dates, the United States would have requested a longer response period appropriate to the argumentation and evidence Brazil has submitted.

At the same time, the United States notes that Brazil has asked the Panel to postpone the date of the second meeting. The United States has no objection in principle to this request, but would request that it be consulted on any new dates that might be possible in light of the panelists' schedules. Brazil is not the only one with "complicated schedules."

Brazil also notes that Appendix 3 provides *as a guideline* 2-3 weeks for a responding party's first submission, and states that the US request exceeds that period (by two days). Brazil ignores not only the fact that a panel is free to adjust these time frames, but that a panel is required to adjust these time frames. Article 12.4 of the DSU states that panels must "provide sufficient time for the parties to the dispute to prepare their submissions." Indeed, in the past several disputes in which the United States has been a *complaining* party, panels have on average provided five weeks for the *responding* party to prepare its first written submission, twice the average called for under the DSU.[1] Article 12.4 applies fully to this proceeding, and the time requested by the United States to prepare its submission is more than justified.

In light of the above, and now with confirmation that Brazil's Further Submission does in fact contain "extensive evidence" and "extensive new argumentation", as foreshadowed by the US letter of 9 September, 2003[2], the United States respectfully renews its request that the Panel provide it until 2 October 2003, to submit its Further Submission. We thank the Panel once again for its consideration of this and previous requests.

[1] Indeed, of the last 23 panels to which the United States has been a party, the single shortest time period for preparing a responding submission has been the 17 days provided in this proceeding, a marked contrast from the over 35 days provided to responding parties when the United States has been the complaining party.

[2] US letter of September 9, 2003, para. 3.

# ANNEX K-23

## LETTER FROM BRAZIL

16 September 2003

Brazil thanks the Panel for its "Proposed revision to timetable for Panel Proceedings" of 12 September 2003.

Brazil notices that the second hearing with the parties is scheduled for 2 and 3 December, receipt of answers to Panel's questions for 22 December and receipt of parties' comments on each other's answers for 19 January 2004. Brazil also appreciates that establishing the timetable with the parties, the panelists and the Secretariat requires considerable coordination.

In light of the several changes made to the original schedule and also of the length of time between the second hearing and the answers to questions from the Panel, Brazil would like to suggest that these answers be delivered on 15 December (instead of 22 December) and that the parties' comments on the answers be due on 22 December (instead of 19 January). This would allow for the completion of the parties' main substantive work still in 2003 (the next step would then be the comments on the descriptive part).

Furthermore, Brazil notices that Article 12.9 of the DSU establishes that "in no case should the period from the establishment of the panel to the circulation of the report to the Members exceed nine months". The new proposed timetable of the Panel foresees that circulation of the final report to the WTO Members will take place after 19 May, that is, more than 5 months in excess of the strict time limit set up in DSU Article 12.9. Therefore, Brazil would stress that any changes in the schedule should not postpone the conclusion of the proceedings.

# ANNEX K-24

## LETTER FROM THE UNITED STATES
## COMMENTS ON REVISED TIMETABLE

16 September 2003

The United States thanks the Panel for its invitation to comment on the draft further revised timetable attached to its communication of 12 September 2003. My authorities have instructed me to submit the following comments.

The new dates of December 2 and 3 for the second substantive meeting are acceptable to the United States. We note, however, that there is approximately one month between the receipt of the further rebuttals (currently due November 3) and the second substantive meeting. We believe that this one month would be better allocated for the parties to consider and draft responses to the Panel's questions and prepare their rebuttal submissions. Therefore, the United States proposes that the due date for receipt of answers to Panel's questions be changed to Friday, 31 October 2003, and that the due date for the rebuttal submissions be changed to Friday, 21 November 2003. This would leave approximately 10 days before the second Panel meeting (which would be within the DSU guideline of one to two weeks between rebuttal submissions and the second panel meeting).

There also remains some concern with the 3 p.m. deadline for filing the US further submission on 29 September. While we – as always – will try our best to accommodate this deadline, we note that the time difference between Geneva and Washington (opening of business time in Washington would be 3 p.m. Geneva time) may cause additional difficulties with respect to finalizing the US submission in capital. We nonetheless appreciate the Panel's understanding in this regard.

# ANNEX K-25

## LETTER FROM BRAZIL

17 September 2003

1. The Government of Brazil is in receipt of a letter from the United States dated 16 September commenting on the proposed further revised timetable attached to the Panel's communication of 12 September.

2. Brazil would like to express its opposition to the alterations suggested by the United States. In our view the dates proposed by the Panel on 12 September ensure the parties will have the appropriate amount of time to respond to the Panel's further questions and to elaborate their further rebuttal submissions. Brazil notes, in particular, that between the last day of the resumed second session of the first substantive meeting (9 October) and the deadline for delivering their further rebuttal submissions (3 November), parties will have almost 30 days to prepare such documents. This is more than the amount of time the United States requested on 9 September to elaborate its further submission (previously due on 22 September).

3. Therefore, Brazil submits that parties need not be granted any extension of deadlines as suggested by the United States. Nonetheless, were the Panel inclined to change the timetable to accommodate the US concerns, Brazil would reiterate that any modifications in the schedule should not result in further delays of the proceedings (whose current timetable already exceeds by more than five months the time limit set out in DSU Article 12.9).

# ANNEX K-26

## LETTER FROM THE UNITED STATES

17 September 2003

My authorities have instructed me to respond to Brazil's letter of 16 September 2003, suggesting that the parties' answers to the Panel's questions related to the second substantive meeting be due 15 December instead of 22 December, and that the comments on these answers be due 22 December instead of 19 January 2004. The United States opposes these suggestions.

As it currently stands, the issues in this dispute are both wide-ranging and complicated. Therefore, it is unrealistic to expect that the parties would need only 10 days to answer the Panel's questions, and only 7 days to comment on each other's answers. Moreover, Brazil's sole justification for its suggestion, *i.e.*, that this "would allow for the completion of the parties' main substantive work still in 2003," is a *non sequitur*, particularly in light of the fact that Brazil does not object to the rest of the Panel's further revised timetable.

# ANNEX K-27

## LETTER FROM THE UNITED STATES

23 September 2003

As the Panel may be aware, hurricane Isabel hit the mid-Atlantic region of the East Coast of the United States last Thursday and Friday, bringing with it significant flooding, property damage, and extended loss of electricity to hundreds of thousands of homes and businesses. The hurricane forced all US Government offices in the Washington, D.C., area to be closed on Thursday and Friday, 18 and 19 September 2003. Further, several members of the US delegation were without power through the weekend and were unable to access materials for this dispute. During this time the United States delegation was unable to work on the US further submission that is due on 29 September. As result, the United States has been significantly impeded in its preparation of that submission. At the same time, we are mindful of the October 7 through 9 dates for the next meeting with the Panel.

Accordingly, the United States would like to request a modification of the deadline for submitting its further submission so that it would be due on Thursday, 2 October. In order to provide additional time for the Panel and the parties to review the third party further submissions, currently scheduled to be submitted on Friday, October 3, the deadline for these submissions could be changed to the opening of business on Monday, 6 October 2003.

# ANNEX K-28

## LETTER FROM BRAZIL

23 September 2003

The Government of Brazil is in receipt of a letter from the United States dated 23 September asking for a further extension of time until 2 October 2003 to respond to Brazil's Further Submission. The most recent US request for an extension of time would mean that the Panel, Brazil, and the Third Parties would have only two working days – Friday 3 October and Monday 6 October -- to review and draft an oral statement in response to the US Further Submission. Brazil would have no working days to review the numerous third party submissions.

The Panel must balance out the rights of Brazil and the Third Parties with those of the United States. The United States has been in receipt of Brazil's Further Submission for over two weeks. The United States will have a number of opportunities, including in its 7 October Oral Statement and in answering questions posed by the Panel, to clarify and expand on its responses to issues raised in Brazil's Further Submission. Under these circumstances, Brazil requests that the Panel maintain the current schedule requiring the United States to provide its Further Submission on 29 September 2003.

# ANNEX K-29

## LETTER FROM BRAZIL

2 October 2003

As the Panel may be aware, for the sixth consecutive time in the present proceedings the United States failed to deliver a document by the time expressly determined by the Panel in the Working Procedures and constantly reiterated to the United States in specific communications of the Panel. Instead of abiding by the 5h30 p.m. (Geneva time) deadline, the United States delivered the electronic version of its Further Submission around 11h45 p.m. on 30 September 2003, again more than 6 hours after the deadline. No hard copy of the document, also due on the same day by 5h30 p.m., was available to Brazil before 1 October.

Brazil will not repeat here the whole set of arguments showing the prejudices and obstacles caused by the US tactic to the rights of Brazil. We note however that this sixth delay is particularly egregious given the fact that the Panel provided the United States with two separate extensions of time to prepare its Further Submission. Therefore, Brazil cannot at this time only ask the Panel to take note of the problem and to encourage the United States to respect the deadlines. After six consecutive and totally unjustifiable delays, a more compelling action by the Panel appears to be necessary.

The strict observance of the deadlines is a centerpiece of any procedurally fair proceedings in all legal systems where the due process principle is expected to apply. Consequently, disrespect of the deadlines constitutes a fundamental breach of due process requirements, undermining the procedural fairness in the conduct of the examination of the matter in dispute. In other words, deadlines cannot be taken lightly. This is reinforced by DSU Article 12.5, which states: "Panels should set precise deadlines for written submissions by the parties and the parties should respect those deadlines."

In WTO dispute settlement procedures a Panel, together with the Appellate Body, must act as the guardian of the procedural fairness and, in order to act in this capacity, it is accorded the authority and discretion to establish its own working procedures, in addition to those set out in DSU Appendix 3, as recognized by the Appellate Body.[1] The working procedures are, in effect, the means by which a Panel exercises its authority and discretion to ensure that due process is respected and parties to the dispute have equal opportunities of defense. Brazil is fully aware that the term "working procedures" has been interpreted differently by WTO Members, but it is undeniable that the setting out and enforcement of deadlines is within the boundaries of the Panel's authority to establish its own working procedures.

In view of the fact that Brazil's rights have been systematically impaired by the US contempt of the established rules, and taking into consideration the Panel's authority to set up procedural rules to guarantee the respect for due process requirements, Brazil requests the Panel to determine that in the next steps of the present proceedings any unjustified delay in document delivery by the US results in such document being disregarded by the Panel. In addition, Brazil requests that the Panel reflect

[1] See for instance *Australia – Measures Affecting Importation of Salmon* (DS18), Report of the Appellate Body, para. 272.

each of the violations of the working procedures by the United States in the factual section of its Final Report so that the record of misconduct may be available to the full WTO Membership.

# ANNEX K-30

## LETTER FROM THE UNITED STATES

6 October 2003

The United States received on Friday, 3 October 2003, a copy of the letter to the Panel from Brazil dated 2 October 2003, and my authorities have instructed me to submit this reply. The United States regrets that Brazil once again distracts the Panel and the United States from the work required to prepare for the second session of the first panel meeting.

The United States takes seriously the time lines established by the Panel and has expended considerable resources and dedicated tremendous personnel time and effort to accommodate each of them.[1] As a result, the United States has filed each of its submissions on the date specified by the Panel. At the same time, the Panel will appreciate that the issues are not only complicated and difficult, but that there are a very large number of them – and that the materials that Brazil has submitted are voluminous.

As the complaining party in this dispute, Brazil has had the advantage of months and months in preparing its case far in advance.[2] Brazil has, however, consistently sought to deny to the United States sufficient time to prepare its own submissions, and Brazil's letter of last week regrettably continues an approach it appears to have adopted at the beginning of this dispute: to employ procedural tactics in an attempt to reduce the material and arguments that the United States could submit to the Panel to respond to Brazil's arguments, to correct factual errors by Brazil, and to explain the legal inaccuracies and omissions committed by Brazil. Those procedural tactics include in particular seeking imbalances between itself and the United States in the time provided to prepare submissions. These imbalances have been manifest from early in this dispute, as Brazil has simultaneously been submitting extraordinarily lengthy and complicated submissions and been resisting every effort of the United States to ensure that, as provided by Article 12.4 of the DSU, "the panel ... provide sufficient time for the parties to the dispute to prepare their submissions."

The United States recalls the very first example of Brazil's approach. During the organizational meeting Brazil objected to the US request that the time for the first US submission be increased beyond the two weeks contemplated in the Panel's draft timetable of 27 May. In that same meeting, however, Brazil objected to the suggestion that it have less than two weeks after filing its first submission to submit the executive summary of that submission. As the United States commented at the time, it seemed implausible that the United States could prepare a *substantive response* to a submission in two weeks if Brazil was unable to prepare a *summary* of that submission in less than that time. Brazil's attempt to hold the United States to a two-week period to reply to the first Brazilian submission is particularly telling given that, during that organizational meeting, the Panel had not yet decided to bifurcate the parties' initial submissions. Brazil thus must have hoped to force a response in two weeks to the over 350 pages of material contained in both its first submission (24 June 2003) and in its further written submission (9 September 2003).

[1] The United States also wishes to note that it arranged with the Brazilian Mission in Geneva to transmit a copy of its Further Submission directly to Brasilia upon filing in order to enable the Brazilian authorities to begin reviewing the document as soon as possible. The United States wishes to take this opportunity to express once again its thanks to the Brazilian Mission for its courtesy and cooperation in this connection.

[2] The document "properties" of Brazil's further submission to the Panel suggest quite clearly that Brazil began preparing its submission in April of ***2002*** -- i.e., more than a year before filing it.

The exchange at the organizational meeting was only the first example of a Brazilian approach to this dispute that combines extremely lengthy material with procedural inflexibility. The most recent example was Brazil's unwillingness to contemplate an extension for the filing of the US Further Submission in response to the circumstances in Washington, D.C., brought about by Hurricane Isabel (letter of 23 September 2003).

As the United States noted in its letter of 11 September 2003, the timetable that the Panel has established in this dispute for the filing of the US submissions are much shorter than the amount of time that has been provided to other WTO Members.[3] The length and complexity of Brazil's submissions makes it increasingly difficult to consider that the United States has had sufficient time to prepare its submissions or that the United States does not suffer prejudice in this proceeding as a result.[4]

It is also difficult, in the circumstances of this dispute, to credit the Brazilian suggestion that it is *Brazil* that has suffered an "impairment" of its "rights" when the United States has filed each of its written submissions on the date specified by the Panel. Brazil's sole complaint is with the time, not the date, of filing. There is certainly no basis (and indeed Brazil has not suggested one) for Brazil's astonishing suggestion that the Panel should not consider the views of the United States in the future. Brazil's suggestion is particularly startling in light of the numerous occasions on which Brazil has made extra submissions to the Panel that were nowhere provided for in the Panel's working procedures. Brazil appears to believe that it may ignore the Panel's working procedures at its convenience.[5]

Brazil's suggestion that "the Panel reflect each of the violations of the working procedures by the United States in the factual section of its Final Report" continues Brazil's one-sided approach to presenting material in these proceedings. First, of course, there is no basis for Brazil's characterization of the proceedings to date nor is there any basis for Brazil to seek to use the Panel's report[6] for Brazil's own purposes. Second, the United States notes that Brazil carefully seeks to censor out any reference to Brazil's disregard for the Panel's working procedures. Third, Brazil also would appear to want to avoid any record of the US responses to Brazil's allegations, an approach which would seem to be in keeping with Brazil's attempts throughout this proceeding to limit any material that might refute Brazil's flawed claims.

In conclusion, the United States would like to thank the Panel for its work to date on the many issues presented by this dispute. We look forward to our discussions of the parties' further submissions this week.

The United States is providing a copy of this letter directly to Brazil.

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[3] The United States noted then that in the most recent 23 panel proceedings to which it had been a party, the single shortest time period for preparing a responding submission has been the 17 days provided in this proceeding -- roughly one-half the average time period that respondents had been given when the United States was the complaining party.

[4] The United States would also like to take this opportunity to thank the Panel for agreeing to extend the deadline for the rebuttal submissions; we would hope that this extended time will help in the completion of that submission.

[5] The United States has to date in this dispute deliberately refrained from requesting that the Panel disregard Brazil' s extra-procedural material.

[6] The purpose of the Panel's report is supposed to be to help resolve the dispute in accordance with the terms of reference for the Panel, and the content of the report is specified in Articles 12.7 and 19.1 of the DSU. Brazil neglects to refer to these provisions.

# ANNEX K-31

## LETTER FROM THE UNITED STATES

14 October 2003

As discussed during the second session of the first panel meeting, the United States is providing in the attachment a written description of materials relating to Dr. Sumner's model that Brazil has agreed to provide to the Panel and the United States. The United States looks forward to receiving these materials at Brazil's earliest opportunity, with a view to permitting the United States to undertake its review of these materials in a timely fashion and without delay.

The United States is also providing in the attachment, as agreed, the two remaining exhibits referred to in its opening statement at the second session of the first panel meeting.

**ATTACHMENT**

**Request from the United States to Brazil**

Please provide the following information relating to the model used by Dr. Sumner in his analysis presented in Annex I to Brazil's further submission:

(a) Electronic copies of the actual models used for the baseline and each of the seven scenarios described in Annex I.

(b) Printed copies of the exact equation specifications used for the baseline and for each of the seven scenarios described in Annex I, including all parameter estimates. (If no such printed copies currently exist, please develop and provide.)

(c) Documentation of all adaptations to the original FAPRI modelling system made or used by Dr. Sumner for his analysis presented in Annex I. (If no such documentation currently exists, please develop and provide.)

# ANNEX K-32

## LETTER FROM BRAZIL

5 November 2003

In a letter to the Panel dated 14 October 2003, the United States requested from Brazil electronic and documentary information concerning Professor Sumner's econometric model (items a, b and c of the Annex).

In order to collect and compile that information, Professor Sumner, at the request of Brazil, has been working diligently to provide the United States with the "printed copies" of the exact equation specifications in paragraph (b) of the Annex and the "documentation of all adaptations to the original FAPRI modelling system made or used by Dr. Sumner for his analysis" as requested in paragraph (c). This process is now about to be completed and Brazil expects to provide the United States and the Panel with this information early in the week of 10 November.

As regards the request in paragraph (a) of the Annex for electronic copies of the FAPRI/CARD model used by Professor Sumner, Professor Sumner has contacted Professor Bruce Babcock of the Centre for Agricultural and Rural Development at the Iowa State University, which "owns" the FAPRI model. You will realize by the attached exchange of correspondence between Professor Sumner and Professor Babcock, that "[they] are unable to respond to your request for a simple 'electronic copy' of the FAPRI model used for the baseline and each of the seven scenarios described in Annex I because they literally do not exist".

Brazil notes, however, the last paragraph of Professor Babcock's letter which provides as follows:

> "[W]e would be willing to run USTR-requested scenarios using the FAPRI/CARD modeling system along with the operational additions and adaptations that comprise [Professor Sumner's] model of cotton policy. Our researchers would have to be compensated for the time it would take to run the model and we would have to work out the timing and other logistics of running the model".
>
> It is thus our understanding that this paragraph means that the "electronic version" of the model used by Professor Sumner is presently available for use by the US Government upon coordination with FAPRI staff."

# ANNEX K-33

## LETTER FROM THE UNITED STATES

11 November 2003

The United States is in receipt of Brazil's letter of 5 November 2003, in which it indicates that it expects to submit during the week of November 10 certain evidence relating to the analysis of Dr. Sumner presented in Annex I to Brazil 's further submission. My authorities have instructed me to submit this response.

The United States is disappointed that Brazil claims not to be able to provide electronic copies of the actual model used in that analysis. In our experience, it is common for electronic copies of econometric models to be disclosed to substantiate claimed model results, even in the context of WTO dispute settlement. Brazil's failure to make electronic copies available will hinder the ability of the Panel and the United States to analyze Dr. Sumner's claimed results.[1]

Brazil states that it will be providing printed copies of the exact equation specifications and documentation of all adaptations to the original FAPRI modelling system. This evidence is expected to be substantial and complex. Brazil has previously stated that its economic model "is built upon hundreds of linear supply, demand and related equations for major commodities - and in particular upland cotton - in the United States" and that "[t]hese equations are linked to a system of equations covering the demand and supply of upland cotton internationally".[2] This substantial new evidence relates to the core of Brazil's case relating to price suppression, as evidenced by the frequent invocation of those results in Brazil's further submission, at the second session of the first panel meeting, and in Brazil's answers to the Panel's further questions.

We note that the Panel and the United States had asked for this evidence during the first panel meeting, nearly five weeks ago. The United States expected this evidence to be submitted by the conclusion of the first panel meeting, or, at the latest, shortly after the United States provided Brazil with a written version of the information requested. Brazil, however, has now indicated that it will submit some of this new evidence mere days before the parties' rebuttal submissions are due.

The United States notes that, pursuant to paragraph 13 of the Panel's working procedures, the United States must be provided sufficient time to respond in writing to any new evidence submitted by Brazil. This paragraph reflects the Panel's obligation under Article 12.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* to "provide sufficient time for the parties to the dispute to prepare their submissions." Had Brazil presented that new evidence relating to Dr. Sumner's analysis no later than during the first panel meeting on 7-9 October 2003, as

[1] The offer by FAPRI to run simulations at the United States request for a fee is not an acceptable substitute. It is unprecedented that a party to a dispute should put another party in the position of not being able to gain access to that party's evidence, and its only recourse is to pay a private entity in order to gain even partial access.

[2] *See* Brazil's Further Submission, para. 218 ("The econometric model is built upon *hundreds of linear supply, demand and related equations* for major commodities - and in particular upland cotton - in the United States, but also accounts for regionally varying supply and demand responses in the United States. *These equations are linked to a system of equations* covering the demand and supply of upland cotton internationally.") (emphasis added).

contemplated by the Panel's working procedures, under the current timetable the United States would have been afforded nearly 6 weeks to examine and respond to that evidence.[3]

Given the anticipated complexity of the information and the fact that it will not be provided in electronic form, the United States will need sufficient time to be able to analyze and respond to Brazil's complex and substantial new evidence. To this end, and on the assumption that Brazil meets its expectation of submitting that evidence early this week, the United States would request that the rebuttal submissions be due on 22 December 2003, the current date for answers to panel questions. Remaining items on the timetable set out by the Panel could then be rescheduled accordingly. Adjusting the timetable in light of Brazil's late submission of new evidence is necessary to preserve US rights of defence by providing sufficient opportunity to analyze and critique that new evidence as well as by allowing the United States to present its response to that evidence in its rebuttal submission and at the second panel meeting.[4]

[3] Had Brazil presented this evidence as part of Annex I to its further submission of 9 September 2003, moreover, the United States would have been afforded 10 weeks to review and respond to that evidence.

[4] *See* Working Procedures for the Panel, para. 7 ("Formal rebuttals shall be made at a second substantive meeting of the Panel. . . . . The parties shall submit, prior to that meeting, written rebuttals to the Panel.") (28 May 2003).

# ANNEX K-34

## LETTER FROM BRAZIL

12 November 2003

The Government of Brazil is in receipt of a letter from the United States dated 11 November requesting yet another lengthy delay in this panel proceeding. Brazil requests the Panel to reject this request and maintain the current schedule including the deadline for rebuttal submissions of 18 November and the second Panel meeting on 2-3 December for the reasons set forth below.

The United States' letter attempts to leave the impression that there will be a tremendous amount of new evidence that will be provided to them in *written* form in response to their request of 14 October. This is incorrect. The bulk of the requested information is in *electronic* form which has been available for the United States to examine, review, and use since 5 November. Attached to this letter are (1) Professor Sumner's *written* adaptations to the FAPRI model for each of the seven scenarios described in Annex I to Brazil's Further Submission (Exhibit Bra-313), and (2) Professor Sumner's summary description of the equations in the FAPRI domestic model and the CARD international cotton model (Exhibit Bra-314). As the Panel can see from Exhibit Bra-313, this document reflecting Professor Sumner's adaptations is not lengthy and does not contain hundreds of equations as the US letter suggests. The "hundreds of equations" referred to in the US letter are those of the *FAPRI/CARD* model used by Professor Sumner and summarized in Exhibit Bra-314. Brazil believes that the US econometric experts who deal with the FAPRI model on a regular basis will not have any difficulty understanding Exhibit Bra-313. Professor Sumner, of course, will be prepared to provide any additional follow-up information and clarifications, as necessary, at the Panel meeting on 2-3 December for which he has made arrangements in his schedule to attend.

Brazil has been informed by Professor Sumner that he is working as quickly and thoroughly as he can in completing this work in addition to his other many responsibilities as the Director of the Agricultural Issues Centre at the University of California at Davis. Professor Sumner indicates he expects to be able to provide the relevant equations for the CARD international cotton model by the close of business on 13 November. This will complete Brazil's response to the US request of 14 October. Because Professor Sumner made no adaptations to the CARD international cotton model, the information to be provided will simply be the equations for a model that is much-used and well-known to USDA economists.

Brazil notes that the United States waited until 14 October to file its request for this information from Brazil. Brazil's letter of 5 November provided the United States with an offer of complete access to the electronic version of the exact same model used by Professor Sumner. The United States then waited almost a week to reply to Brazil's 5 November letter with full knowledge that the date for the Further Rebuttal Submission was 18 November. It appears as if the United States has *not* used the week since 5 November to take advantage of its ability to review and analyze the complete electronic version of everything that Professor Sumner has done in his analysis. As the last paragraph of Professor Babcock's letter of 31 October stated, upon request, the United States will be provided full and immediate access to the FAPRI and CARD models and Professor Sumner's adaptations that are available in electronic form.

Contrary to the US unsupported assertion, Brazil has not "put the United States in the position of not being able to gain access to that party's evidence." Rather, Professor Babcock's offer provides

the United States with complete access to the electronic version of *all* of the equations and analysis performed by Professor Sumner and the United States had access to them since 5 November.

Brazil further notes that it was required to use the FAPRI/CARD model for a fee, that neither Brazil nor Professor Sumner owns or can copy this model, and as explained by Professor Babcock, that there is no "written version" of the FAPRI model. The United States can, however, make arrangements with FAPRI officials to use the model and it would certainly not be unprecedented for the United States Government (or other governments or private entities) to compensate FAPRI for the use of the FAPRI model.

Brazil notes that USDA economists and officials use the FAPRI model frequently and are well aware of its parameters (for which the USDA provided it with its highest honorary award in 2002). Therefore, it will not be difficult for the United States to quickly analyze Professor Sumner's limited adaptations to the standard FAPRI/CARD models with which they are familiar. Brazil also notes that the FAPRI project is financed in large part by the US Congress

With respect to the existing schedule, Brazil considers that there is no legal or due process basis for the Panel to again delay the proceedings. Indeed, the existing schedule has considerable flexibility to provide the United States with more than sufficient time to prepare any rebuttal of Professor Sumner's analysis. In order to avoid further delay, Brazil suggests that the United States and Brazil file their rebuttal submissions on 18 November and the Panel hold the second meeting of the Panel with the Parties on 2-3 December as originally scheduled.

If the United States determines that it does not have sufficient time to (a) use the exact same FAPRI/CARD electronic model as adapted by Professor Sumner (as offered by Professor Babcock) and (b) to analyze Professor's Sumner's written equations and explanations of adaptations to the FAPRI model by 18 November, then Brazil would have no objection to the United States providing its rebuttal to Professor Sumner's analysis by 28 November, a few days prior to the Panel meeting on 2-3 December. This rebuttal, however, would be in addition to the 18 November Rebuttal on the multitude of other issues in this proceeding that do not relate in any way to Professor Sumner's analysis.

Brazil notes that the current schedule is also flexible enough to allow for rebuttal and counter-rebuttal by the Parties of the US analysis of Professor Sumner's results, *i.e.*, until the 22 December and 19 January deadlines for answering and then commenting on the Answers to the Panel's Questions. Of course, if the Panel determines that the United States and Brazil need additional time to comment on the econometric models or other issues, then the Panel has the discretion to allow for this for periods after 19 January 2004.

Brazil believes that this proposal will protect the United States' and Brazil's due process rights without yet again delaying this proceeding. It will allow the Panel and the Parties to maintain their current travel and business schedules which have now been in place for some time. Brazil notes that its delegation has scheduled a number of meetings and travel with a view towards the 2-3 December meeting date.

Finally, Brazil stresses that any changes in the schedule must not further delay the date of issuance of the final report to the parties, since the time limits of DSU Articles 12.8 and 12.9 have already been breached.

# ANNEX K-35

## LETTER FROM THE UNITED STATES

13 November 2003

My authorities have instructed me to respond to Brazil's letter of 12 November 2003, in which Brazil objects to the US request for an extension of time for the filing of rebuttal submissions in this dispute. Brazil ignores the Panel 's working procedures and the arguments in our letter of 11 November 2003, in dismissing the possibility that the United States would be prejudiced if the briefing schedule were not adjusted to take into account Brazil's decision to submit new evidence relating to the analysis of Dr. Sumner nearly five weeks after the conclusion of the first panel meeting. Brazil's 12 November letter cannot change the fact that United States will be prejudiced if it is not given adequate time to analyze the materials Brazil is only now providing.

*First*, Brazil simply does not discuss either the requirements of DSU Article 12.4, which provides that "[i]n preparing the timetable for the panel process, the panel shall provide sufficient time for the parties to the dispute to prepare their submissions," or the provisions of paragraph 13 of the Panel's working procedures, pursuant to which the United States must be provided sufficient time to respond in writing to any new evidence submitted by Brazil.

*Second*, Brazil states that it "would have no objection to the United States providing its rebuttal to Professor Sumner's analysis by 28 November, a few days prior to the Panel meeting on 2-3 December" and that "the current schedule is also flexible enough to allow for rebuttal and counter-rebuttal by the Parties of the US analysis of Professor Sumner's results, i.e., until the 22 December and 19 January deadlines for answering and then commenting on the Answers to the Panel's Questions". The United States cannot agree to this proposal. Indeed, this suggestion by Brazil would make it appear that Dr. Sumner's analysis was an issue of secondary importance to Brazil's allegations, such that the US response is not important to the Panel's evaluation. The reality, of course, is that Brazil's main economic conclusions rest on Dr. Sumner's analysis. If not, there would have been no reason for Brazil to reference that analysis repeatedly in its further submission, to attach Dr. Sumner's analysis as a 52-page annex to that submission, to call upon Dr. Sumner to deliver a 16-page statement as part of its opening statement and a four-page statement as part of its closing statement at the second session of the first panel meeting, nor to continue referencing Dr. Sumner's analysis in its answer to the Panel's further questions. It is simply not credible for Brazil to suggest that no prejudice would result to the United States if it were compelled to prepare and file a rebuttal submission without having had sufficient opportunity to examine and critique Brazil's new evidence relating to the very model which allegedly underlies Dr. Sumner's analysis.

*Third*, Brazil has also indicated that it will file *even more* new evidence on 13 November relating to Dr. Sumner's analysis. In addition to the prejudice that would result from not being able to prepare our rebuttal submission and prepare for the second panel meeting with sufficient time to analyze this new evidence, the United States notes that it has already been prejudiced because preparation of the US rebuttal submission over the last several weeks has been based on the materials which we have had at hand, that is to say, neither the materials included with Brazil 's 12 November letter nor those it says will be forthcoming on 13 November. Elements of the US rebuttal could be superseded or confirmed on the basis of Brazil's new information. Thus, without an extension of time, the United States will be forced either to reply to Dr. Sumner 's analysis in the absence of complete information or to defer responding to the centrepiece of Brazil's case.

*Fourth*, Brazil is in error when it claims that "the United States waited until 14 October to file its request for this information from Brazil". In fact, both the United States and the Panel Chairman verbally requested access to Brazil' s model on 7 October 2003, at the conclusion of opening statements on the first day of the second session of the first panel meeting. Brazil has provided no explanation for why it should have delayed providing any information in response to that request for nearly five weeks, which merely related to the very model that Dr. Sumner asserts to have employed.

*Fifith*, Brazil also claims that "Brazil's letter of 5 November provided the United States with an offer of complete access to the electronic version of the exact same model used by Professor Sumner" and "Professor Babcock's offer provides the United States with complete access to the electronic version of all of the equations and analysis performed by Professor Sumner *and the United States had access to them since 5 November*" (italics added). Presumably, Brazil is referring to its suggestion that the United States pay to *run* the model employed by Brazil[1], since FAPRI did not offer to disclose – either to the United States or the Panel – the equations underlying that model, whether for pay or otherwise (and we assume Brazil was also offering to the Panel this opportunity to pay to obtain Brazil's evidence). As stated in the US letter of 11 November, Brazil's suggestion that the responding party (and presumably the Panel) must pay for evidence on which the complaining party so heavily relies is unprecedented.

*Sixth*, Brazil also claims that "it will not be difficult for the United States to quickly analyze Professor Sumner's limited adaptations to the standard FAPRI/CARD models with which they are familiar." If it is the case that Professor Sumner has made only "limited adaptations to the standard FAPRI/CARD models," a claim we are not in a position to confirm, then again the question arises why Brazil should have delayed five weeks in providing these new materials. Presumably, Professor Sumner knew of and had documented those adaptations prior to submitting his analysis to the Panel as part of Brazil' s further submission on 9 September.

The United States respectfully requests the Panel to defer the parties' rebuttal submissions as set out in its letter of 11 November 2003. The United States is providing a copy of this letter directly to Brazil.

[1] *See* Brazil's Letter of 5 November 2003, p. 2 (quoting FAPRI letter as saying that FAPRI "'would be willing to run USTR-requested scenarios using the FAPRI/CARD modeling system along with the operational additions and adaptations that comprise [Professor Sumner's] model of cotton policy. Our researchers would have to be compensated for the time it would take to run the model and we would have to work out the timing and other logistics of running the model.'").

# ANNEX K-36

## LETTER FROM BRAZIL

13 November 2003

Brazil is in receipt of a letter from the United States dated 13 November. Brazil reiterates its request that the Panel adhere to the existing schedule along with the suggested modifications proposed by Brazil in its letter of 12 November. Brazil responds to the numbered paragraphs of the US 13 November letter below using the same paragraph numbers.

*First*, Brazil notes that with respect to DSU Article 12.4, the normal amount of time for a rebuttal submission set out in Annex 3 of the DSU is 2-3 weeks from the date of the First Substantive meeting. The Panel in this case provided the parties with a period of six weeks to prepare rebuttal submissions. Based on Brazil's suggestion that the United States have until 28 November to prepare a rebuttal on a single aspect of Brazil's evidence, the United States will have had **23 days** (from 5 November or more than three weeks) to examine, use, and analyze the full electronic version of everything that Professor Sumner examined. In addition, the United States would have **16 days** from 12 November to examine Professor Sumner's written adaptations to the FAPRI/CARD model and **15 days** (from November 13) to examine the full CARD international cotton model. All of these time frames either exceed or are within the 2-3 week period for rebuttal submissions set out in Annex 3 to the DSU. Therefore, there is no basis for the United States to claim any violation of either its due process rights or of DSU Article 12.4.

*Second*, Professor Sumner's analysis is not the "centrepiece" of Brazil's adverse effects case that the United States claims. Brazil has placed an enormous amount of evidence before the Panel that exists independently of Professor Sumner's analysis. Brazil has repeatedly emphasized in this dispute that Professor Sumner's analysis confirms econometrically what common sense and the overwhelming body of other evidence already conclusively demonstrates. The Panel need only examine paragraph 105 of Brazil's Further Submission to appreciate this point. Even Professor Sumner's econometric analysis is only one of many such analyses of the impact of US upland cotton subsidies that is referenced in Brazil's submissions. Professor Sumner has functioned for Brazil in these proceedings as a dual expert – as one who is expert in US subsidy programs and the US agricultural system, as well as an expert in econometric analysis.

*Third*, Brazil attaches as Exhibit Bra-315 the documentation for the CARD international cotton model.[1] This model is well-known to USDA economists and has not been changed for Professor Sumner's analysis. Therefore, this information will not be "new" to the United States or is something that it could not otherwise have already anticipated in preparing their arguments.

*Fourth*, the United States did not provide in writing, exactly what evidence it wanted from Professor Sumner until 14 October. Brazil provided access to the complete electronic version of Professor Sumner's analysis – which *only* exists in electronic form – on 5 November. This was not five weeks after receipt of the US request as the US claims. The additional information provided on 12 and 13 November required Professor Sumner to expend considerable amount of time. His busy

[1]Brazil is also providing herewith an electronic version of the CARD international cotton model via email.

schedule at the University of California at Davis as well as previous speaking commitments posed additional difficulties in completing this assignment.

*Fifth*, the United States again demonstrates that it has made no efforts to take advantage of the offer to gain access to *everything* that Professor Sumner did and analyzed, which is contained in the electronic version at the University of Iowa in the care of Professor Babcock. It appears to Brazil that the United States' conduct suggests it may be more interested in delaying this proceeding than in gaining access to Professor Sumner's analysis.

*Sixth*, the United States claims that it has only a small amount of time to change their rebuttal submission. Brazil notes that on 24 June 2003, it filed a lengthy submission after only being given 4 days notice of what it was required to file. Brazil, at great effort, met that deadline. Further, the additional ten days proposed by Brazil (until 28 November) provide the United States with an opportunity to react to and respond to Professor Sumner's documents delivered on 12 and 13 November. The United States will have additional time to prepare further responses for their oral statement on 2 December. Finally, as Brazil's 12 November letter indicated, both Brazil and the United States will have until 22 December and 19 January to file additional answers to questions and comments relating, *inter alia*, to the econometric models at issue in this dispute.

*In conclusion*, the Panel has to balance the right of the United States to have sufficient time to prepare a rebuttal to Professor Sumner's analysis with Brazil's right to obtain a timely panel decision. Brazil believes that its suggestion to provide the United States with an additional 10 days to prepare its rebuttal – until 28 November – is an appropriate result which is fair and protects each of the parties' due process rights. However, the request by the United States for another five weeks to prepare their rebuttal and to delay this proceeding by at least as much time, if not more, is grossly out of proportion. Brazil requests the Panel to avoid yet another long delay in these proceedings.

# ANNEX K-37

## LETTER FROM THE UNITED STATES

18 December 2003

In a communication dated 8 December 2003, the Panel afforded to the United States the opportunity to respond by 18 December 2003, to the request that Brazil had made through the Panel for certain information in Exhibit BRA-369.[1] The United States has completed work on 3 electronic files containing approximately 135 megabytes of requested data related to the production flexibility contract payment era, which are being transmitted with this letter. Work on the data files relating to the direct and counter-cyclical payment era is continuing, and the United States is endeavouring to provide this data by close of business Friday, 19 December.

However, as the United States preliminarily advised Brazil and the Panel at the second panel meeting, the release of planted acreage information associated with a particular farm, county, and state number is confidential information that cannot be released under US domestic law, in particular the Privacy Act of 1974.[2] This is consistent with the position of the United States in Freedom of Information Act[3] appeals raising this issue. One such decision is attached as Exhibit US-104.[4] Although the United States cannot provide planted acreage information associated with an individual farm, in an effort to be as fully responsive as possible, we are providing, for all programme crops and for each marketing year: (1) planted acreage data aggregated for all cotton farms and (2) farm-level planted acreage data without any fields that could identify the particular farm.

The United States is providing all of the pieces of data requested by Brazil in data files organized as follows:[5]

> First, a file with aggregate data for yields, bases, cropland, and plantings for all "cotton farms" for all programme crops as defined in the data request, using three categories: (1) farms with "cotton base" but no cotton plantings; (2) farms with cotton plantings but no "cotton base," and (3) farms with cotton plantings and "cotton base."
>
> Second, a farm-by-farm file (with particular farm identification information) with all of the requested data (plus additional data regarding payment quantities) but not including planted acres and cropland.

[1] *See* Exhibit US-102.

[2] *See* 5 USC 552a(b) (Exhibit US-107).

[3] Exhibit US-103.

[4] We note that no final denial of a release may be made by the US Department of Agriculture without the concurrence of USDA's Office of General Counsel. *See* 7 CFR 1.14 (Exhibit US-105). The attached appeal determination is consistent with USDA's long-standing policy that planted acres will not be released. For example, the policy against release has been stated explicitly since 1997 in FSA's FOIA Handbook. (*See* Exhibit US- 106.)

[5] In addition to the data requested by Brazil, the United States has provided total cropland and programme payment units (base acreage x base yield x .85) to allow for more meaningful aggregation.

> Third, farm-by-farm files for planted acres only for all programme crops, but with no other data and with the order of the farms scrambled in order to prevent any matching of farms.

The three files have been copied to a CD. The base and yield data are a text file named "Pfcby.txt." A description of that file and its 118 fields is found at Exhibit US-109. Planted acres are in "Pfcplac.txt". A description of that file is found at Exhibit US-110. Finally, the aggregate data file is named "Pfcsum.xls". That file is an Excel file and the headings within the file should be self-explanatory.

The information that we are providing is also sensitive. We do not consent to release of this information to the public domain and expect that it will be used solely for purposes of this dispute settlement proceeding. Therefore, pursuant to paragraph 3 of the Panel's working procedures, we designate this information as confidential and must exceptionally insist that this information not be disclosed outside of the delegation of the Brazilian Government and the Panel.

During the Panel meeting, Brazil referred to information released by the United States in connection with rice. This release was an error. Apparently, the Kansas City office of the Farm Services Agency (FSA) believed at some point that the Washington FOIA office had approved the release of planted acres so long as names and addresses were left out. FSA Washington personnel were not aware of that misunderstanding. It has been corrected. The farm number is unique and can be linked back to the name and address of persons on the farm using the FSA-supplied Environmental Working Group (EWG) payment and name and address files.[6] The payment files will allow a match by farm number. This leads, by the same file, to the "customer number". That number leads, in the name and address file, to the name and address of the farm owner. At the second Panel meeting, Brazil indicated that the rice request was theirs. We ask accordingly that Brazil and its agents return all copies of the erroneous rice release.[7]

The United States also notes that responding to Brazil's request has not been a simple undertaking. Because of the extensive nature of the request, it was necessary to run through approximately 10 million files to extract the pertinent information. There are approximately 2 million farms involved. For the production flexibility contract ("PFC") payment era under the 1996 Act, there were 7 programme crops. In the direct payment and counter-cyclical ("DCP") payment era under the 2002 Act, there are 10 programme crops (counting "other oilseeds", such as rapeseed, canola, etc., as one "programme crop" only). The PFC file alone, if each field for each farm was considered a cell, contains 25 million cells of information. The task involved is a far bigger, far more complicated task than the erroneous rice release. More than 250,000 farms fit the "cotton farm" definition at work in this exercise. The United States has expended a significant amount of time and resources to respond to this data request.[8]

Per Brazil's request, the United States is providing a copy of this letter, associated exhibits, and three electronic data files relating to the production flexibility contract payment era directly to Brazil through the Brazilian Embassy in Washington, D.C. Because of their size, the electronic data files will be couriered to Geneva for transmission to the Panel.

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[6] *See* Exhibit US-108 (excerpt of BRA-316).

[7] Regarding that release, the United States notes, too, that no member of the US delegation at the second panel meeting in Geneva was aware of the rice release. On inquiry, no one at FSA in Washington was aware of it either. The rice data was sent to an address in Geneva identified by the requester, a member of the Brazilian delegation, who the Kansas City office was led to understand had "relatives" there.

[8] There may well be limitations in the data output since the output depends on the completeness and accuracy of input from the FSA county offices. Moreover, not all farms file crop reports and not all plantings are plantings of programme crops. These are merely some examples.

# ANNEX K-38

## LETTER FROM THE UNITED STATES

22 December 2003

Further to the letter of the United States to the Panel on 18 December 2003, attached please find a letter from the United States to the Embassy of Brazil in Washington, D.C., dated 19 December 2003, transmitting directly to Brazil the completed electronic data files relating to the direct and counter-cyclical payment era. Please also find attached Exhibits US-111 and US-112. This letter, the electronic data files, and the two exhibits were received by the Embassy of Brazil on 19 December. The electronic data files are presently en route to Geneva, and will be transmitted to the Brazilian Mission to the WTO and to the Panel shortly.

In a letter dated 18 December 2003, to the Chairman of the Panel in the WTO dispute settlement proceeding *United States – Subsidies on Upland Cotton* (DS267), the United States indicated that it would endeavour to provide additional information responding to the request of Brazil conveyed in Exhibit BRA-369 by Friday, 19 December. In particular, we indicated that preparation of certain direct and counter-cyclical payment era electronic files was continuing. Those files have now been completed and are being transmitted with this letter.

There are three direct and counter-cyclical payment era files, containing approximately 85 megabytes of requested data, on the enclosed CD. These three files correspond to the three production flexibility contract payment era files transmitted previously. First, there is a farm-by-farm base and yield data file ("Dcpby.txt"); a description of that file and its 99 fields is found at Exhibit US-111. Second, there is a planted acres file ("Dcpplac.txt"); a description of that file is found at Exhibit US-112. For the reasons set forth in the 18 December letter to the Chairman, we note that the order of the records in the planted acre file is not the same as in the base and yield file. Finally, there is an aggregate data file ("Dcpsum.xls"); that file is an Excel file, and the headings within the file should be self-explanatory.

As indicated in the 18 December letter to the Chairman, the information that we are providing is sensitive. We do not consent to release of this information to the public domain and expect that it will be used solely for purposes of this dispute settlement proceeding. Therefore, pursuant to paragraph 3 of the Panel's working procedures, we designate this information as confidential and must exceptionally insist that this information not be disclosed outside of the delegation of the Brazilian Government and the Panel.

The United States is providing a copy of this letter, associated exhibits, and three electronic data files relating to the direct and counter-cyclical payment era directly to the Panel.

# ANNEX K-39

## LETTER FROM BRAZIL

23 December 2003

As per its Communication of 8 December 2003, the Panel established 22 December as a deadline for the delivery by Brazil and the United States of the Answers to Questions from the Panel and also for the delivery of the US comments on Brazil's econometric model.

In its Communication of 13 October, the Panel established that "*In accordance with paragraph 17 (b) of the Panel's working procedures, the Panel sets the following time for the provision of submissions by the parties: 11.59 p.m., Geneva time on the dates concerned. This time refers to receipt of submissions by the other party and the Secretariat and not to commencement of transmission. For greater clarity, this time for receipt of submissions also refers to the time of completion of receipt of any Exhibits and service of any Exhibits (if necessary electronically) to the other party and to the Secretariat as envisaged in paragraphs 17 (a)-(d) of the Panel's working procedures. All other provisions of the Working Procedures remain unchanged*".

The "Working Procedures for the Panel" establish in paragraph 17 b that

> *"the parties and third parties should provide their submissions to the Secretariat by 5:30 pm on the deadlines established by the Panel, unless a different time is set by the Panel"*

and in paragraph 17 d that,

> *"the parties and third parties shall provide electronic copies of all submissions to the Secretariat at the time they provide their submissions [...]"*.

The US submissions were not delivered within the deadline of 11.59 p.m. provided by the Panel, which is already an exception to the generally observed deadline of 5:30pm. Neither the paper nor the electronic versions of the submissions were delivered on 22 December until 11.59 p.m.. As duly registered at the form provided by the Secretary to the Panel, the US submission had not been delivered until 0.35 a.m. and it was apparently delivered as late as 1.08 a.m.. The electronic version was sent at 0.47 a.m. and received by Brazil at 1.34 a.m.

Brazil notes that, apart of the impairment of Brazil's rights under the DSU, the delay by the US also involves significant administrative constraints for the Brazilian Delegation in Geneva, which maintains human resources active until such a time as the US delivers the documents

This is already the seventh time the United States fails to deliver a document by the time expressly determined by the Panel. This issue has also been addressed during the panel hearing on 7 to 9 October and the Panel has already explicitly requested the United States to respect the deadlines of the dispute – "in order to ensure due process and secure a balance between the two parties" (Panel's Communication of 13 October). In its letter of 2 October, Brazil had requested the Panel to "determine that in the next steps of the present proceedings any unjustified delay in document delivery by the US results in such document being disregarded by the Panel".

Brazil therefore hereby requests that the documents delivered today by the United States, in renewed disrespect of the established deadline, be disregarded by the Panel.

Please accept, Sir, the assurances of my highest consideration.

# ANNEX K-40

## LETTER FROM BRAZIL

23 December 2003

The Government of Brazil is in receipt of a letter from the Panel dated 23 December enclosing a number of new questions to Brazil (eight) and to the United States (five) with a deadline set for 12 January. These questions address new interpretations by the Appellate Body, are very comprehensive, and in the view of Brazil will require a significant allocation of resources to complete properly.

Brazil notes that in addition to answering these questions, it must also respond to an extensive US critique of Professor Sumner's analysis, as well as provide comments and analysis on the US 18 December 2003 data, by 12 January. Because Brazil was not aware that the Panel would be filing these new questions, its representatives made severely tight travel and professional commitments that try to accommodate the upcoming holidays bearing in mind the original two deadlines for 12 January (Sumner and 18 December rebuttals).

In consideration of the above, Brazil requests that the Panel push the schedule back by only one week. The original 12 January deadline would be moved to 19 January, and the 19 January deadline for comments on the answers to the Parties' questions would be moved to 26 January. Other aspects of the schedule would be adjusted accordingly by the Panel, but with no more than a one week delay for the issuance of the final report, if this should be deemed necessary by the Panel.

Please accept, Sir, the assurances of my highest consideration.

# ANNEX K-41

## LETTER FROM THE UNITED STATES

23 December 2003

At the Panel's invitation, my authorities have instructed me to provide the following comments on Brazil's letter of 23 December 2003, in which Brazil requests that the upcoming schedule of filings be delayed.

The United States is amenable to Brazil's extension request, with the alternations suggested below, because it is well aware of the burdens that the very tight time frame established in this dispute has imposed on the parties (and the Panel), particularly in light of the complexity of the matter before the Panel and the volume of materials necessary to examine that matter. In fact, the United States has in the past three business days alone:

- Filed via two letters dated 18 and 19 December 2003, approximately two hundred megabytes of data requested by Brazil. Attempting to collect, prepare, and file these data within the time set out by the Panel in its 8 December communication required enormous efforts on the part of the United States, necessarily affecting preparations of the US answers to the Panel's questions and the US comments on Brazil's econometric model.

- Filed answers to approximately 51 questions from the Panel, within the same time that Brazil had to answer approximately 32 questions. (Indeed, given Brazil's comment that the "eight" new questions directed to it "in the view of Brazil will require a significant allocation of resources to complete properly" and therefore justify an extension of time, Brazil should now understand – if it did not before – the significantly greater burdens placed on the United States in responding to approximately 20 more questions than Brazil was asked to respond to.)

- Filed comments on Brazil's econometric model. In making this filing, the United States was faced with examining, and preparing and filing comments on the FAPRI model transmitted to the United States by Dr. Bruce Babcock, per the Panel's communication dated 8 December 2003, within the time originally set out by the Panel only to address Brazil's exhibits and models.

Had the United States focused its energies only on the answers to the Panel's questions and the comments on Brazil's economic modelling, the filing of those documents would not have been delayed, but the United States chose to make best efforts to comply with all of the requests and time frames set by the Panel in this dispute. It is only due to tremendous efforts by US personnel in Washington, Kansas City, and Geneva that Brazil is even in a position to cite the need to respond to the data submitted by the United States as part of the reason a delay in the schedule is needed.

In light of the foregoing, the United States would be willing to agree to an extension of time. However, instead of Brazil 's proposal, the United States would ask that the schedule be altered as follows: First, we would ask that the filing of the parties' responses to the additional questions from the Panel (dated 23 December 2003), as well as Brazil's comments originally scheduled for 12 January 2004, be moved to 21 January (to take into account the fact that 19 January is a US Federal holiday). We would then request that the parties' comments on each other's answers be

moved to 2 February. The reason for this latter proposal is because, in addition to filing comments on Brazil's answers to the Panel's additional questions on that date, the United States will also be filing – per the Panel's communication of 8 December 2003 – comments on (1) Brazil's comments on the data provided by the United States on 18 and 19 December 2003, as well as (2) Brazil's comments on the US comments on Brazil's economic model. Given Brazil's confirmation in its letter that its submissions on these matters will require four weeks to prepare, the United States and the Panel can expect that those comments will be extensive. Thus, one week to respond to Brazil 's three submissions would understandably be insufficient; for due process reasons, the United States believes at least two weeks would be needed to respond to Brazil's four weeks worth of comments and answers.

In agreeing to Brazil's extension request, with the above caveats, the United States notes that it is simply seeking to advance the goal of WTO dispute settlement – that is, the effective resolution of disputes, rather than pursuing litigation tactics designed merely to disadvantage the other party procedurally. In this regard, we regret Brazil's second letter of 23 December, requesting that certain US documents "be disregarded by the Panel". The United States has in a communication earlier today expressed its regret for any inconvenience that may have resulted to the Panel and Brazil due to the delay in submitting the US comments and its answers to questions from the Panel, noting largely the same reasons Brazil is now relying on to support its extension request. Indeed, this delay resulted in large measure from the US determination to make best efforts to respond to Brazil's request for certain information while simultaneously preparing its comments and answers. In this connection, we find it interesting that Brazil is seeking to have the Panel "disregard[]" the US answers and comments, but not the extensive data requested by Brazil, which was provided on 19 December, one day after the date set out in the Panel's 8 December communication. The significant burdens on all parties to a WTO dispute, and this dispute in particular, are well-understood. The effective functioning of the dispute settlement system and the resolution of disputes are not served through one-sided approaches that only recognize the burdens place on one party but not the other.

# ANNEX K-42

## REPLIES OF THE UNITED STATES TO ARTICLE 13 REQUEST

20 January 2004

The United States is in receipt of a request for information from the Panel pursuant to Article 13 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* transmitted on 12 January 2004. In its request, the Panel "requests the United States to provide the same data that it agreed to provide in its letters dated 18 and 22 December 2003 but in a format which permits matching of farm-specific information on contract payments with farm-specific information on plantings".[1] The Panel's request states that "[d]isclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years" and invites the United States to "protect the identity of individual producers by, for example, using substitute farm numbers which still permit data-matching". My authorities have instructed me to submit this response.

With respect to the Panel's explanation that "disclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years", the United States notes that it has previously provided data that permits calculation of "total expenditures" for all decoupled payments made to farms planting upland cotton with respect to historical base acres (whether upland cotton base acres or otherwise). In particular, for the production flexibility contract payment era, we provided a farm-by-farm file ("Pfcby.txt") with base acreage and yield data for all programme crops for all "cotton farms" as defined in BRA-369 and data file ("Pfcsum.xls") that aggregated this data for ease of use.[2] The "programme payment units" field allows for easy calculation of "total expenditures" to farms planting upland cotton in any given year by multiplying payment units by the applicable payment rate. Similarly, for the direct and counter-cyclical payment era, the United States provided a farm-by-farm file ("Dcpby.txt") with base acreage and yield data and an aggregate data file ("Dcpsum.xls").[3] Again, the "programme payment units" field allows for easy calculation of total expenditures by multiplying payment units by the applicable payment rate. Thus, the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton.

The United States has studied the Panel's request for certain farm-specific data as well as its suggestions with respect to protecting US producers' privacy interests. The United States thanks the Panel for recognizing the important confidentiality concerns which arise from Brazil's request to receive, by farm number, contract payment and planting information. The Panel will recall that at the second panel meeting the US delegation expressly inquired of the Brazilian delegation whether the

[1] The Panel's request references US letters dated 18 and 22 December 2003, providing certain information from Brazil. The United States understands the latter reference to be to the 19 December letter to Brazil that was transmitted to the Panel and the Brazilian Mission to the WTO on 22 December 2003.

[2] These files were provided, per Brazil's request, to the Brazilian Embassy in Washington, D.C., on 18 December 2003 via CD-ROM. The US letter was filed with the Panel on 18 December, and the CD-ROM was delivered via courier to Geneva and filed with the Panel on 23 December 2003.

[3] These files were provided to the Brazilian Embassy in Washington, D.C., on 19 December 2003 via CD-ROM. The US letter was filed with the Panel on 22 December, and the CD-ROM was delivered via courier to Geneva and filed with the Panel on 23 December 2003.

United States could provide the requested data in some format that also protected the identity of individual producers. The Brazilian delegation refused to answer and insisted that the requested information be provided with farm numbers, as set out in Exhibit BRA-369. In response to Brazil's request, the United States therefore provided all of the data that it could without violating the privacy interests of US producers, as required under the Privacy Act of 1974.

The United States has studied the Panel's request and has concluded that it is not possible to "protect the identity of individual producers" while providing the requested data in a format that permits data-matching. This results because the United States has already provided, by farm number, farm-specific contract information, including base acreage, base yield, and payment units, for each programme crop for each requested year. For example, for each and every "cotton farm" (as defined in the Brazilian request) identified by its FSA farm number, the United States has provided 96 separate data fields relating to 2002 direct and counter-cyclical contract payments. These 96 fields of contract data form a unique combination, such that – even in the absence of farm numbers – disclosing the farm-specific plantings that correspond to each unique combination of contract data would allow each farm's plantings to be connected to the FSA farm numbers through the farm-by-farm files previously provided. Thus, as a result of Brazil's insistence on receiving data with the FSA farm numbers and refusal to consider any alternative that would respect the privacy interests of US producers, unfortunately there would not appear to be a way to provide the requested data and "protect the identity of individual producers" given the data already provided. Under the Privacy Act of 1974, the United States could not disclose this information without the consent of the submitter.[4] Thus, the existence of confidentiality procedures would still not permit the United States to release each farm's planting information associated with the farm's particular contract payment data (given the previous submission of contract data in association with farm, county, and state numbers).[5]

With respect to the Panel's reference to the release of certain farm-specific planting data by the Farm Services Agency to a member of the Brazilian delegation, the United States has explained in its December 18 letter to the Panel that this release was in error. We have requested that Brazil assist the United States in curing this breach of confidentiality by returning all copies of the erroneous release but have yet to receive a response.

The Panel makes reference to a weighing of "the public interest in disclosure" against a payment recipient's privacy interests. The question of whether the information could be released – and even whether the "public interest" is a relevant consideration – is a complicated issue under US domestic law. In the first instance, the US Department of Agriculture has determined that it is prohibited under US law from releasing this information without the consent of each submitter. In any event, we note that the Panel states that it requests these data "to permit an assessment of the *total expenditures* of PFC, MLA, CCP and direct payments . . . to upland cotton producers". Thus, the information relevant to the Panel's assessment would not be *farm-specific data* but rather some *aggregation* of data to permit this "assessment of . . . total expenditures". As noted above, the United States has provided both farm-specific and aggregated contract data that would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton.

[4] 5 U.S.C. 552a(b) ("No agency shall disclose any record which is contained in a system of records by any means of communication to any person, or to another agency, except pursuant to a written request by, or with the prior written consent of, the individual to whom the record pertains . . . .").

[5] Moreover, because contract data by farm number may be releasable information – as we have done here with respect to Brazil's specific request – a request to release contract data associated with a farm's planting information would raise the same privacy concerns because of the potential to link such data back to farm and recipient information that could be separately obtained.

The United States further notes the Panel's statement that "[a] refusal by the United States to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn". As explained, the United States does not have the authority to provide the farm-specific planting information in the format requested. Further, the United States has provided both farm-specific and aggregated contract data that would permit the Panel to make the assessment it identifies, that is, an assessment of total expenditures of decoupled payments to farms planting upland cotton. The situation here is thus very different from the one in Canada - Aircraft where the Appellate Body first opined that "a panel should be willing expressly to remind parties – during the course of dispute settlement proceedings – that a refusal to provide information requested by the panel may lead to inferences[6] being drawn about the inculpatory character of the information withheld".[7] There is no basis for an "inference" of any kind, adverse or otherwise.[8]

Finally, we of course recognize that the Panel has the right to seek information which it deems appropriate pursuant to Article 13.1 of the DSU. We wish to recall, however, that panels must take care not to use the information gathered under this authority to relieve a complaining party from its burden of establishing a *prima facie* case of WTO inconsistency based on specific legal claims asserted by it. In *Japan – Measures Affecting Agricultural Products*, the Appellate Body explained that it is for a complaining party to make arguments supporting its specific legal claims and that the panel had erred in using information it had obtained to make a finding of inconsistency on the basis of an argument and claim not explicitly advanced by the complaining party.[9] In this dispute, Brazil has not advanced legal claims and arguments that decoupled payments should attribute across the total value of the recipients' production, nor has Brazil advanced claims and arguments setting forth any methodology for calculating the total amount of payments it challenges, as reflected in Question 258 from the Panel to Brazil. The Panel may not relieve Brazil of its burden of advancing and establishing claims and arguments relating to the value of decoupled payments benefiting upland cotton, a crucial element in Brazil's *prima facie* case under Articles 5 and 6 of the *Agreement on Subsidies and Countervailing Measures*.

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[6] The United States notes that in the same report the Appellate Body was careful to distinguish "adverse" inferences from other "inferences", remarking that: "We note, preliminarily, that the 'adverse inference' that Brazil believes the Panel should have drawn is not appropriately regarded as a punitive inference in the sense of a 'punishment' or 'penalty' for Canada's withholding of information. It is merely an inference which in certain circumstances could be logically or reasonably derived by a panel from the facts before it." *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 200 ("*Canada – Aircraft*").

[7] *Canada – Aircraft*, WT/DS70/AB/R, para. 204.

[8] The United States also notes that it is even less appropriate to draw "adverse inferences" in this dispute than in *Canada - Aircraft* in that Annex V, which was referred to by the Appellate Body in *Canada - Aircraft*, was rendered inapplicable by the Peace Clause in this dispute.

[9] Appellate Body Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/AB/R, adopted 19 March 1999, paras. 129-30.

# ANNEX K-43

## LETTER FROM THE UNITED STATES

28 January 2004

Enclosed with this letter the United States is providing a CD containing revised versions of the 6 electronic data files relating to the production flexibility contract era and the direct and counter-cyclical payment era that were transmitted to Brazil on 18 and 19 December 2003, and to the Panel on 18 and 22 December 2003. The enclosed CD contains six revised data files. The file names are identical to those previously submitted but with an "r" preceding the original file name. Thus, the files are now titled "rDcpsum.xls" (aggregate data file), "rDcpby.txt' (farm-by-farm base and yield data file), "rDcpplac.txt" (planted acres file), "rPfcsum.xls" (aggregate data filed), "rPfcby.txt" (base and yield data file), and "rPfcplac.txt" (planted acres file). We have prepared these revised electronic files after becoming aware of certain errors in the original data files submitted.

In the limited time available to reply to Brazil's request for data, certain programming errors appear to have resulted. As indicated in our letter of 18 December to the Panel, responding to the Brazilian request involved extracting pertinent information from approximately 10 million data files; because that request sought information relating to up to 10 programme crops on nearly 250,000 farms, the information provided by the United States ultimately spanned nearly 220 megabytes of data. Because that data was not the product of any established procedure with a protocol for cross-checking and verification, it was perhaps inevitable that certain errors should have occurred.

In preparing comments on Brazil's answer to question 258 from the Panel, the United States became aware that certain fields in the aggregate data files ("Pfcsum.xls" and "Dcpsum.xls") that the United States had prepared to assist the Panel and Brazil in interpreting the voluminous data in the farm-by-farm files contained no data (indicated by a zero ("0") or a dash ("-")). For example, looking at the original summary file for the direct and counter-cyclical payment era ("Dcpsum.xls"), those farms that in marketing year 2002 had upland cotton base acreage (4.7 million acres) but planted no cotton at all (0 acres), are also listed as having planted no acres of wheat, oats, rice, corn, sorghum, barley, flax, sunflower, safflower, soybeans, rapeseed, mustard, canola, crambe, or sesame on 15.9 million acres of cropland.

The United States has now expended significant effort correcting for programming errors and re-running the pertinent search. These efforts revealed that, while the cotton data continues to be correct (that is, farms with 4.7 million base acres of upland cotton planted not a single acre of cotton in marketing year 2002), in fact these farms planted approximately 10.3 million acres of these other crops and not zero as originally reported.

The corrected programming and new search generally corrected for instances in which the original search apparently failed to capture relevant data. The most significant revisions relate to (1) additional planted acres for other crops for those farms with upland cotton base acres that planted no cotton and (2) additional base acres for other crops for those farms without any upland cotton base acres that did plant cotton.

# ANNEX K-44

## LETTER FROM THE UNITED STATES

30 January 2004

The United States is in receipt of a document filed by Brazil with the Panel on 28 January 2004, providing Brazil's comments regarding data provided by the United States on 18 and 19 December 2003, and related matters. Brazil's filing of these comments was made 8 days after the deadline set by the Panel in communications dated 8 December and 24 December 2003, and on the date that had been established by the Panel for the United States to comment on Brazil's materials. Accordingly, my authorities have instructed me to respectfully request the Panel to specify the new date for the United States to file comments. The United States further suggests that since the Panel had originally provided that the United States would have eight days to provide its comments, the US comments could now be due eight days from the date the Panel establishes the new deadline.

As you know, on 8 December 2003, the Panel communicated to the Parties a revised schedule following the second panel meeting. The second paragraph of that coverfax and timetable reads: "As stated by the Chairman on 3 December, the United States will be given until **18 December** to respond to Brazil's request made in Exhibit BRA-369. Brazil will be given until **12 January 2004**, to comment on the US response." The third paragraph reads: "The parties may submit any further comments on each other's comments by **19 January 2004**."

On 24 December 2003, the Panel amended the timetable, stating that "all submissions originally due 12 January 2004 would now be due **Tuesday, 20 January 2004**" and "all submissions originally due 19 January 2004 would now be due **Wednesday, 28 January 2004**." Thus, Brazil had until 20 January 2004, to file its comments on the US data, and the United States had until 28 January 2004, to file its comments on Brazil's comments.

Brazil did not file its comments on 20 January, nor did it seek an extension of time from the Panel. Instead, Brazil simply delayed filing its 48 pages of detailed comments (with accompanying exhibits) until 28 January.[1] Providing the United States eight days to comment from the date of the Panel's communication of the new deadline would preserve the procedural balance originally established by the Panel.

[1] The United States finds Brazil's eight-day delay in meeting the Panel's deadline particularly ironic in light of Brazil's letters, such as its letter of 23 December 2003, complaining about the time of US filings.

# ANNEX K-45

## LETTER FROM BRAZIL

2 February 2004

The Government of Brazil is in receipt of a letter from the United States dated 30 January 2004 requesting an additional eight days to respond to Brazil's 28 January 2004 *Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled Data on 20 January 2004* ("*Brazil's Comments*"). Brazil would comment on the US request as follows:

First, the US 30 January 2004 letter suggests that Brazil was late in filing *Brazil's Comments*. This is incorrect. The US letter ignores the fact and the effect of the Panel's 12 January 2004 Communication, in which the Panel requested the United States to produce complete and unscrambled data concerning contract payment base and current plantings of upland cotton farms. This Communication necessarily mooted, at least temporarily, any comments by Brazil on the 18/19 December 2003 US "scrambled" data. It would have made little sense for Brazil to comment on the data deficiencies (and the implications thereof) on 20 January 2004, since Brazil trusted that the United States would have lived up to the Panel's repeated request and produced the data by 20 January 2004, as required by DSU Article 13.1. Only after the United States failed to produce the requested data was Brazil able to properly comment on the US data – and it did so on 28 January 2004 (in a much shorter time - 8 days - than originally foreseen by the Panel's 12 January 2004 deadline).

Second, the United States requests the opportunity to comment on Brazil's Comments and requests eight days to do so. Brazil is of the view that eight days from 28 January would be acceptable, which would make the US submission due on 5 February 2004. The United States already has had access to Brazil's Comments for five days (since 28 January 2004). The US request for what would amount to essentially two weeks to respond would further delay these proceedings. It would also violate Brazil's due process rights if the United States were given more time to comment on these documents than Brazil had to comment on the failure of the United States to produce the information on 20 January 2004.

Third, in order to preserve Brazil's due process rights, the Panel should limit the scope of the US "Comments" to responding to arguments that the United States has not yet had an opportunity to respond. For example, Sections 4, 5, 11 of *Brazil's Comments* simply respond to arguments and facts already presented in US letters of 18 December 2003 and 20 January 2004 in which the United States sought to justify the refusal to produce farm-specific data. The United States should not be given yet another opportunity to comment on Brazil's comments.

Fourth, the Panel should reject any attempt by the United States to present positive evidence in any comments without also giving Brazil an opportunity to respond. For example, the United States never presented the Panel with *any* application of its own proposed methodology for calculating and allocating the amount of contract payments to current upland cotton farmers. It would be manifestly unfair for the United States to present, in its last submission, positive evidence based on incomplete (non-farm specific data) in support of its defence when it has refused to provide any calculation, or even an estimate, for thirteen months – let alone produced the requested data that would permit Brazil or the Panel to do so.

Fifth, Brazil notes that the U.S. letter of 28 January 2004 provides Brazil and the panel with "revised" data files to correct for "certain errors" in the original data submitted forty days earlier on 18 December 2003. None of these "corrections" provide any useable farm-specific contract payment base and current planting data. Thus, the United States continues to violate the Panel's 8 December 2003 and 12 January 2004 requests for such information. Further, the 28 January 2004 revised data continues to suffer from the various aggregation problems identified in paragraphs 8-15, 22, 76-81, 90-98, of *Brazil's Comments*. Nor does the corrected data include complete information on market loss assistance payments (as identified in paragraphs 20, 22, 43, 82 and 95 as well as notes 40, 43, 75, 163, 164, 166, 195 and 197 of *Brazil's Comments*), or information on MY 2002 peanut base payments (as identified in paragraphs 21-23, 43 and 98 as well as notes 75, 132, 161, 166, 195 and 196 of *Brazil's Comments*). Thus, Brazil does not believe that this "revised" data, arriving *after* the 11th hour, is either timely or useful. If, however, the Panel believes that it would be useful for Brazil to provide revised calculations (based on the revised US summary data) replacing those set out in paragraphs 83 and 96 of *Brazil's Comments*, or comment in any other way on the revised US "scrambled" data, Brazil will be pleased to do so. Brazil recalls, however, that it provided the figures in those two paragraphs based on the flawed US summary data to demonstrate the existence of further support for its "14/16th" methodology estimated figures.

# ANNEX K-46

## LETTER FROM THE UNITED STATES

3 February 2004

The United States is in receipt of a letter filed by Brazil on 2 February 2004, commenting on the US request for the Panel to establish a new deadline for the United States to file comments on Brazil's comments regarding data provided by the United States on 18 and 19 December 2003, and related matters.

My authorities have instructed me to inform the Panel that the United States welcomes Brazil's statement that it has no objection to the Panel establishing a new deadline for the United States to comment on Brazil's comments. Brazil, however, objects to the United States being given eight days from the Panel's communication establishing the new deadline, arguing that it would "violate Brazil's due process rights if the United States were given more time to comment on these documents than Brazil had to comment on the failure of the United States to provide the information on 20 January 2004". With respect, this fundamentally misstates the issue.

Brazil had access to the 18 and 19 December data for nearly *six weeks* before filing its comments, due on 20 January but submitted on 28 January, and evidently used that time in order to prepare quite lengthy and detailed comments (over 50 pages plus exhibits). Yet Brazil objects to the Panel providing the United States with notice that it has eight days to prepare its response. Brazil would have the Panel upset the balance of time set out in its communications for the preparation of the respective comments of Brazil and the United States.

We also note Brazil's argument that the Panel's 12 January letter "necessarily mooted, at least temporarily", the 20 January date for the filing of Brazil's comments. It is ironic, to say the least, that Brazil should have complained about delays (measured in minutes) in filing certain US documents and then unilaterally have decided that it was entitled to an additional *eight days* in filing its comments since, in Brazil's view, "[i]t would have made little sense" for Brazil to comply with the Panel's 20 January deadline. Brazil did not request the Panel to modify the deadlines as a result of the Panel's 12 January letter. Brazil simply decided not to abide by the deadlines established by the Panel. Indeed, Brazil should have filed its comments on the 18 and 19 December data on 20 January as scheduled and has provided no reason why it was unable to do so.

If Brazil wanted a further opportunity from the Panel to comment on any response to the Panel's 12 January letter, it could have so requested. Brazil did not do so. Instead it simply ignored the Panel's deadline and used a nearly six-week period to provide comments on the US data. Thus, Brazil's February 2 letter continues to evince its one-sided tactics on procedural issues, in which Brazil seeks (or simply provides to itself) substantial periods of time to prepare its filings but seeks to deny adequate time to the United States to prepare its responses.[1]

[1] For example, the United States recalls that at the panel organizational meeting, Brazil objected to the United States having more than two weeks to prepare its first submission while at the same arguing that Brazil would need a full two weeks to prepare the executive summary of its own first submission. (Brazil did not volunteer that it had already drafted a first submission that would ultimately turn out to be more than 135 pages in length, with over 100 exhibits.) As the United States noted at the time, it seemed implausible that the United States could prepare a *substantive response* to a submission in two weeks if Brazil was unable to prepare a *summary* of that submission in less than that time.

We note Brazil's request that the Panel *ex ante* "limit the scope of the US 'Comments' to arguments [to which] the United States has not yet had an opportunity to respond" and prevent the United States from "present[ing] positive evidence". However, the Panel had previously established that the United States "may submit any further comments on [Brazil's] comments" by 19 January, 2004[2], later revised to 28 January 2004.[3] Therefore, Brazil's request does not comport with the Panel's previous communication, would prejudge what comments the United States may provide (and perhaps preclude relevant comments on new information presented by Brazil), and would impose a limitation with respect to arguments and evidence on the United States that was not imposed on Brazil.

Finally, Brazil continues to mischaracterize the situation when it asserts that the United States should have breached US law regarding the protection of individual privacy in order to produce additional data relating to planting and contract payment information on a farm-by-farm basis. We have previously explained in our letters of 20 January 2004, and 18 December, 2003 why under US law we are unable to provide the data requested. In part, this results from Brazil's refusal at the second panel meeting to allow *any* deviation from the request set out in Exhibit BRA-369, which specifically requested that the data be provided by farm with its associated FSA farm number. The United States responded to that request to the maximum extent permissible under US law.

In sum, the Panel had intended for the United States to provide comments and have 8 days from the 20 January deadline for Brazil's comments to do so. However, Brazil seeks to impose limitations that were not applied to its own comments, and which would significantly impair the information available to the Panel in evaluating the material before it and US rights of defence. We request that the Panel reject Brazil's unbalanced suggestions and suggest that the US comments be due eight days from the Panel's confirmation of the new deadline for filing those comments.

[2] Panel Communication of 8 December 2003.
[3] Panel Communication of 24 December 2003.

# ANNEX K-47

## LETTER FROM THE UNITED STATES

11 February 2004

Attached please find answers of the United States to 29 additional questions from the Panel following the second substantive meeting in the dispute *United States – Subsidies on Upland Cotton* (DS267) and the comments of the United States on Brazil's 28 January 2004 comments and new arguments on the extensive data provided by the United States.

The United States wishes to inform the Panel that it continues to work on preparing information requested by the Panel in its supplementary request for information pursuant to Article 13 of the DSU as well as certain information requested under the Panel's additional questions. Unfortunately, the very extensive nature of those requests for information have rendered it impossible for the United States to prepare and provide that information within the eight days requested by the Panel.

- For example, the Panel has requested that the United States provide "such of the information requested on 12 January 2004 in the format requested, as regards payment recipients who do not have interests protected under the Privacy Act [of] 1974, if any".[1] More than 250,000 farms fell within the farm criteria set out in Brazil's request in Exhibit BRA-369[2], to which the Panel's January 12 request referred. While it would not be possible to examine singly the records relating to each of these 250,000 farms, the United States continues to seek some means by which the identities of payment recipients who may not have protectable privacy interests could be identified. Eight days has not been sufficient time to complete that effort.

- In addition, the Panel has asked for a very substantial amount of acreage information for "covered commodities" over four marketing years under four different programmes and for all commodities for which planting information is maintained in marketing year 2002. A significant amount of time was required to generate the data in response to the Panel's earlier requests. That effort and the programming errors encountered in that response demonstrate that the response to the supplemental request also requires more than eight days.

Thus, the United States continues to work on responses to item (a) and all the bulleted subparts of item (b) of the Panel's supplementary request for information, as well as to Question 264(b) of the Panel's additional questions. Based on the work completed to date, our current understanding of the scope of the Panel's requests, and our experience completing (and revising) a similar, but smaller, computerized search for electronic files in December, the United States estimates that it would be able to provide the requested information by four weeks from the date the Panel provides the clarifications requested below. Of course, should the United States complete its preparation of the requested information prior to that date, we would make that information available to the Panel and Brazil at that time.

[1] Panel's Supplementary Request for Information Pursuant to Article 13 of the DSU, item (a) (3 February 2004).

[2] *See* US Letter to the Panel at 3 (December 18, 2003).

With respect to item (b) of the Panel's supplementary request for information, the United States would seek clarification of that request. First, the United States would ask the Panel to specify which commodities are "covered commodities" as that term is used in several of the bullet points and subbullets. Second, the United States would seek confirmation that, with respect to the information sought for marketing year 2002 "with respect to all crops on cropland covered by the acreage reports", the relevant portions of the "above questions" are those that ask for planted acreage information for each Category of farm. Clarifications of these points will assist the United States greatly in preparing data responsive to the Panel's request.

Finally, the United States notes that the Panel's communication of 3 February invites the parties "to submit, by Wednesday 18 February 2004, any comments on material submitted on 11 February by the other party". The United States understands this procedure to mean that, with respect to Brazil's 28 January comments on the data submitted by the United States on 18 and 19 December 2003, Brazil would be permitted to file comments on the US comments filed today. If this is not the case, the United States would appreciate the Panel providing clarification to the parties at its earliest convenience.

However, to the extent that the Panel has given Brazil the opportunity to file a reply on 18 February to the US comments filed today, and Brazil chooses to do so, the United States would request an opportunity to respond to Brazil's comments. The procedure set out by the Panel in its communications of 8 and 24 December 2003, originally set out one opportunity for Brazil to comment on the US data (on 20 January 2004) and one opportunity for the United States to respond to Brazil's comments (on 28 January 2004). As the responding party, the United States believes that it is important that it have the opportunity to respond to Brazil's arguments, particularly in this dispute where Brazil's arguments and legal positions have changed from submission to submission. To the extent that Brazil as complaining party is now being provided two opportunities to comment on the US data, the United States would feel bound to request a similar second opportunity to comment. We suggest that the deadline for the US reply could be set for Wednesday, 25 February.

# ANNEX K-48

## LETTER FROM BRAZIL

13 February 2004

The Government of Brazil is in receipt of a letter from the United States dated 11 February 2004 in which it informs the Panel that it is not providing the requested information by the 11 February 2004 deadline. Further, the letter requests (1) four additional weeks to provide data, and (2) the opportunity to respond to Brazil's 18 February 2004 comments on the "US data". Brazil asks the Panel to reject both of these requests.

In putting these requests into perspective, Brazil recalls that the entire contract payment exercise is to provide the Panel with sufficient data to determine and calculate (using whichever methodology the Panel deems appropriate) the amount of "support to" upland cotton for MY 1999-2002. The best way for the Panel to do this is if it has the actual data to calculate the amount of contract payments received by producers that planted cotton in MY 1999-2002. As the Panel knows, it does not yet have this actual data. Any objective assessment of the record indicates that Brazil has sought this contract payment information since November 2002, and that the Panel has sought it since it posed Question 67 *bis* to the United States in August 2003.

The immediate focus of this lengthy exercise is the Panel's 3 February 2004 "Supplementary request for information pursuant to Article 13 of the DSU and additional questions." ("3 February 2004 Request"). In part (a) of that request, the Panel asked for "such information requested on 12 January 2004 in the format requested, as regards payment recipients who do not have interests protected under the Privacy Act of 1974, if any". In a completely separate request (not conditioned on the Privacy Act), the Panel asked in part (b) for summary *aggregated* information that required the United States to compare farm-specific contract acreage data with farm-specific planting data. Data provided in response to part (b) could not possibly include any confidential information since it is aggregated.

The United States letter of 11 February 2004 states that it needs four additional weeks to complete the part (a) analysis. Brazil notes that because the United States apparently intends only to provide farm-specific information for far less than the total amount of farms (*i.e.*, those that are not held by "individuals") this information will be useless for calculating the exact amount of *total* contract payments. Therefore, Brazil does not believe that the United States should be given any additional time to produce this information. In this regard, it is important to stress that even if part of the farm-specific information were confidential under US law (which Brazil believes is not the case), the United States would still be required to produce the information requested by the Panel on 8 December 2003 and 12 January 2004 subject to WTO confidentiality procedures.

With respect to part (b) of the Panel's 3 February 2004 Request, the United States also claims it needs four additional weeks to complete this analysis. And it asks the Panel to "clarify" its request regarding what are "covered commodities" and "with respect to all crops on cropland covered by the acreage reports". The Panel's 3 February 2004 Request provided a chart which listed the "covered commodities". If the United States had any questions despite the clarity of this chart, then why did it wait 8 days to raise these questions? Further, the request for "crops on cropland covered by the acreage reports *not simply commodities covered by the programmes*" could not be clearer. Again,

why did the United States wait 8 days to bring this to the Panel's attention if it was truly puzzled by this condition of the Panel's request?

With respect to the enormous amount of time the United States claims it will take to produce information in response to part (b) of the Panel's 3 February 2004 Request, Brazil notes that the format of the Panel's Request was very similar to the *rice* FOIA request that is set out in Exhibit Bra-368. The testimony of Mark Somers before the Panel on 3 December 2003 indicated that the rice FOIA documents showed that USDA took less than a week to process the data and respond to the rice FOIA request once USDA's statistical experts began work on the project (and the time from filing the request to issuance of the data was 15 days). Indeed, Brazil was easily able to calculate the aggregate rice farm-specific base and acreage information in just a few days as set forth in Christopher Campbell's statement in Exhibit Bra-368. With its access to a number of USDA statistical experts, not to mention the centralized database with all of the records already inputted, it is simply not credible for the United States to claim that it needs more than five weeks to respond to the Panel's request.

As the Panel knows from reviewing Exhibit Bra-368, the data delivered by USDA's Kansas City office permitted the ready tabulation of the exact number of rice farms holding contract acreage and the amount of their rice acreage. The Panel's request for contract and planted acreage information on farms planting cotton is not fundamentally different from the rice request in terms of the type of data files at issue. The raw data in the contract and planted acreage (for all planted commodities) files that the United States would use to respond to the Panel's 3 February 2003 request are the same raw data files that have been in the centralized Kansas City database throughout this dispute. If there were any doubt about this, the United States demonstrated that it examined all the farm-specific data in its 18/19 December 2003 responses (albeit producing them in a scrambled format). Thus, part (b) of the Panel's 3 February 2004 Request did not involve any new data files – simply the writing of a programme that would allow the production of the data in an aggregated, non-confidential summary form, as defined and requested by the Panel.

Brazil believes that the Panel should not provide the United States with any additional time to respond to part (b) of its 3 February 2004 Request. The United States stood by and waited while the deadline approached without making any effort to request additional time or to seek clarifications. Yet, the United States had no difficulty during the same 8-day period in making extensive comments on Brazil's 28 January 2004 Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled Data on 20 January 2004. ("Brazil's 28 January Data Comments"). The United States provides no legitimate explanation why it could not complete part (b) of the Panel's request within the Panel's deadline. Indeed, the United States – in a non-litigation context – demonstrated in the rice FOIA request just how easy and fast it is to provide this information.

The Panel is now only one month away from the one-year anniversary of its establishment, and almost two months *beyond* the nine-month deadline for completing its work set out in DSU Article 12.9. Brazil has not objected to the Panel's laudable attempts to coax the United States into producing the actual non-scrambled data that would permit calculation of the amount of support provided to upland cotton producers from the four different contract payments. Brazil was willing to go along with the delays that each of these requests necessitated because it, presumably like the Panel, wanted the Panel to make use of the most complete and accurate information available to decide these important issues. Starting with its Question 67 *bis*, the Panel has now asked for contract payment information data on *five* separate occasions (Question 125(9) and 8 December 2003, 12 January 2004 and 3 February 2004 Requests). The Panel now has before it a pattern of delay by the United States that is seriously impinging on Brazil's due process rights to receive a timely resolution of its claims in this dispute.

Therefore, Brazil strongly believes that the United States has been given more than sufficient time (seven months) and opportunities (five) to produce the requested contract payment information in one form or another. If the Panel believes, however, that the required balance between ensuring high-quality panel reports and not unduly delaying the panel process requires providing yet another opportunity to the United States to produce the data requested in part (b) of the Panel's 3 February 2004 Request, then Brazil has the following additional comments. If the United States provides the complete information requested in part (b) of the 3 February 2004 Request, then most of Brazil's 28 January Data Comments would be rendered moot. The purpose of those comments was to (a) demonstrate the inadequacy of the US data production, (b) request the drawing of adverse inferences, and (c) in the absence of the actual data, to apply the inadequate summary data. Because the US 11 February 2004 comments on Brazil's 28 January 2004 Data Comments are only relevant to these underlying Brazilian comments, the US 11 February 2004 Comments will also similarly be largely rendered moot *if* the United States provides the data requested in part (b). With the actual and complete data, the Panel would be in the position to apply any methodology it determines to be acceptable. Further, by producing the complete aggregated information, there would no longer be a need to draw adverse inferences. Nor, would there be any need for Brazil to comment on the US use of the incomplete and inadequate data in applying the US methodology.

Accordingly, if the Panel provides the United States with additional time to provide the data (which Brazil opposes), it should allow Brazil the opportunity to file comments, to the extent any are still relevant, to the United States 11 February 2004 Comments to Brazil's 28 January 2004 Data Comments until 8 days *after* the United States has provided the information responsive to part (b) of the Panel's 3 February 2004 Request. By using this modified procedure, Brazil hopes to alleviate some of the considerable legal costs it has incurred in this extraordinary process. It would deny Brazil's due process rights to incur such unnecessary expenses by filing a response which would not assist the Panel in resolving the relevant issues in this dispute, assuming the United States provides the complete data requested in part (b).

Brazil also opposes the unjustified attempt by the United States to further delay this proceeding by seeking yet another opportunity to comment on Brazil's 18 February 2004 Comments. Brazil notes that the United States 11 February 2004 Comments to Brazil's 28 January 2004 Data Comments go far beyond what are legitimate comments on Brazil's original 28 January 2004 Data Comments. In particularly, in a number of instances, the US 11 February 2004 Comments address issues raised in Brazil's 28 January 2004 Comments on US Answers to Questions Posed by the Panel Following the Second Substantive Meeting of the Panel.

Thus, the United States, having already abused the Panel's procedures, now seeks yet another opportunity to comment. The Panel's 3 February 2004 Communication made it clear that the deadline for the United States to comment would be 11 February 2004. The US request would only serve to further delay these proceedings, to the detriment of Brazil.

Finally, Brazil asks the Panel to reject the United States' unilateral decision to take additional time to respond to Question 264(b). There is absolutely no legitimate reason for the United States to have failed to respond to this question; nor has the United States indicated any such reasons. The Panel's question in no sense called for a complicated analysis, and a response could readily have been provided within the 8-day response period. After reviewing the US response, Brazil was able to set up a table comparing the US and Brazilian figures in less than an hour.

# ANNEX K-49

## LETTER FROM THE UNITED STATES

16 February 2004

The United States is in receipt of a letter from Brazil dated 13 February 2004, requesting the Panel not to afford the United States additional time to provide certain requested information and the opportunity to respond to Brazil's anticipated 18 February 2004, comments on certain data submitted by the United States. My authorities have instructed me to make the following reply to these issues.

The United States has communicated to the Panel that work continues in response to the Panel's supplemental request for information and that the United States expects to complete this work within four weeks from the date the Panel provides certain clarifications to its request. The United States provided this time estimate on the basis of its work completed to date and questions that arose with respect to the Panel's request (the subject of our request for clarifications).[1] We also noted that item (a) in the Panel's request presented the challenge of seeking some means by which to review the identities of payment recipients on approximately 250,000 farms within the scope of the request, a task which was impossible to complete within the eight days the Panel had requested. Finally, in producing this time estimate, United States reflected on its experience in producing data for this dispute in December 2003. That data was provided within 15 days of its request, and, on subsequent review, contained a number of inaccuracies that had to be cured by a subsequent filing.[2] In addition to explaining the reasons supporting our estimate, we also made clear that "should the United States complete its preparation of the requested information prior to that date, we would make that information available to the Panel and Brazil at that time".[3]

If anything, the data requested by the Panel on 3 February 2004, is more extensive than the information requested in December as it requests that additional data be sought and that different aggregations be provided. By way of example, for marketing year 2002, we understand that the Panel has requested planted acreage data for all "crops" for each Category of farm set out in the request.[4] The Panel will recall that in marketing year 2002, the "crops" for which crop insurance premium subsidies were available included:

> Almonds, apples, avocado, avocado trees, barley, blackberries, blueberries, burley tobacco, cabbage, canola, cherries, chile peppers, cigar binder tobacco, cigar filler

[1] With respect to the first point of clarification sought by the United States, Brazil points to a table in the Panel's supplemental request for information. We note that two of the headings in that table, "soybeans" and "other oilseeds", are marked with an asterisk, which denotes "[w]here applicable". *See* Panel's Supplemental Request for Information, at 2 (3 February 2004). The United States has requested clarification of the Panel's supplemental request because, even with that table, the precise scope of the term "covered commodity" and where soybeans and other oilseeds are "applicable" are not clear.

[2] *See* US Letter to Panel of 28 January 2003 (transmitting CD-ROM with revised data files).

[3] *See* US Letter to Panel of 11 February 2004, at 2.

[4] Whether the data sought was planted acreage only for farms falling within each Category of farm was the second point of clarification raised by the United States. *See* US Letter to Panel of 11 February 2004, at 2. The United States was not asking for a list of "crops" covered by that request, a point which Brazil evidently misunderstands. Brazil's Letter to the Panel of 13 February 2004, at 2 ("Further, the request for 'crops on cropland covered by the acreage reports *not simply commodities covered by the programmes'* could not be clearer.").

> tobacco, cigar wrapper tobacco, citrus (grapefruit, lemons, limes, mandarins, murcotts, navel orange dollar, oranges, tangelos, tangerines), citrus trees, corn, cotton, cotton extra long staple, crambe, cranberries, cultivated clams, cultivated wild rice, dark air tobacco, dry beans, dry peas, figs, fire-cured tobacco, flax, Florida fruit trees, carambola, flue-cured tobacco, forage production, forage seed, forage seeding, fresh apricots, fresh nectarines, fresh market beans, fresh market sweet corn, fresh market tomatoes, grain sorghum, grapes, green peas, hybrid corn seed, hybrid sorghum seed, macadamia nuts, macadamia trees, mango trees, Maryland tobacco, millet, mint, mustard, nursery, oats, onions, peaches, peanuts, pears, pecans, peppers, plums, popcorn, potatoes, processing apricots, processing beans, processing cucumbers, prunes, raisins, rangeland, rapeseed, raspberries, rice, rye, safflower, soybeans, stonefruit (processing apricots, processing cling peaches, processing freestone), strawberries, sugar beets, sugarcane, sunflowers, sweet corn, sweet potatoes, table grapes, tomatoes (canning and processing), walnuts, wheat, and winter squash.[5]

Thus, this one element of the Panel's supplemental request would seem to require the United States to gather and organize a substantial amount of information not previously provided.

We do note again that the Panel's request for aggregated acreage data does not involve privacy issues and thank the Panel for seeking the data in this format, which allows the United States both to provide data in a manner consistent with its domestic law and to do so in a way that may be of assistance to the Panel. Had Brazil requested data in a similar aggregated format or responded positively to the US request at the second panel meeting for alternatives that would allow farmer privacy interests to be protected, a brief delay would not be necessary while the United States seeks to provide the requested data. Brazil did not respond positively to that request, insisted on receiving the data in a format that would reveal farmer identities, and never requested the Panel to seek data from the United States in aggregated form – despite the fact that *only Brazil was aware of its invented methodology until it responded to the Panel's Question 258 on 20 January 2004*. Had Brazil included its methodology in its first submission on Peace Clause issues (on 24 June 2003), all the time now being devoted to these topics could quite likely have been saved. Brazil's complaint that the United States is responsible for any perceived delays in the Panel's schedule would thus appear to be sorely misdirected.

We note Brazil's suggestion that, should the Panel accept the data the United States is preparing in response to item (b) of the Panel's supplemental request for information, "then most of Brazil's 28 January Data comments would be rendered moot".[6] We are not exactly sure what that statement means or how it relates to Brazil's objection to the United States requiring additional time to provide a response to the information that the Panel has requested. However, Brazil further states that "by producing the complete aggregated information, there would no longer be a need to draw adverse inferences".[7] The United States welcomes this belated recognition by Brazil that disclosure of farm-specific information of contract acreage and planted acreage is *not* necessary under Brazil's invented allocation methodology.

Brazil also questions the United States' comment that it will require additional time to respond to Question 264(b), saying that "Brazil was able to set up a table comparing the US and Brazilian figures in less than an hour." It does not appear to the United States that the Panel's question simply called for "set[ting] up a table" to compare the data referenced in that question. For

[5] Exhibit Bra-62 (US Department of Agriculture, Crops Covered Under the 2002 Crop Insurance Programme) (www.rma.usda.gov/policies/02croplist.html).

[6] Brazil's Letter to Panel of 13 February 2004, at 5.

[7] *Id.*

example, Brazil asserted in paragraph 135 of its 28 January 2004, comments on US answers that "the difference between the chart provided by the United States in Exhibit US-128 and Brazil's chart in para. 165 of its 11 August Answers lies in the treatment of rescheduled debt". To provide a helpful answer would seem to require that the United States examine what goes into each of the figures that are represented in Brazil's chart. The United States was not able to complete that analysis within the eight days provided – but was able to generate and provide in its 11 February answers copious amounts of numbers and data in response to the 29 Panel questions. Rather than seek an extension with respect to *all* questions, we provided the data we could on 11 February and will provide any other data in response to Question 264(b) within the time indicated (and sooner if the data can be collected and examined in less time).

With respect to comments by the Parties on the materials that the United States is preparing, we would not object to the Panel granting Brazil an opportunity to comment on the data to be provided by the United States in response to item (b) of the Panel's supplemental request. However, we cannot understand nor accept Brazil's suggestion that the United States should not be afforded an opportunity to reply to Brazil's comments. Since Brazil is seeking another opportunity to comment (eight days after the United States has provided the information in response to item (b)), there would be no significant "further delay in these proceedings, to the detriment of Brazil" were the United States to file its reply to Brazil's comments within, say, one week of those comments. In this respect, we note that Brazil continues its one-sided approach to procedural issues by seeking to provide itself with an opportunity to comment but to deny the same to the United States. Since this would be the first time Brazil's comments on the item (b) data would be presented, the United States as responding party must be given an opportunity to respond.[8]

Finally, the United States regrets that Brazil has repeated its suggestion that the United States should provide data protected by the Privacy Act and that the United States should rely on WTO confidentiality provisions in doing so. Apart from the fact that the United States is not able under its domestic law simply to ignore US persons' Privacy Act interests on that basis, the growing number of press articles revealing non-public information about this dispute makes that suggestion even less tenable.[9]

[8] In this connection we would like to draw the Panel's attention to a previous proceeding in which Brazil's last-minute submission of evidence and legal argumentation raised difficulties for the other party involved. Report of the Arbitrator in *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Recourse to Arbitration by Canada, WT/DS222/ARB, paras. 2.14 and 2.16. We recall that in the present dispute, Brazil first failed to explain its invented allocation methodology until 20 January 2004 – eight months into this dispute – when compelled to do so by the Panel. Then, Brazil delayed submitting its comments on the US December data until 28 January 2004 – eight days after the deadline set by the Panel. Now, Brazil would seek to have an opportunity to comment on the item (b) data – despite the necessary "delay in the proceeding" that would entail – but simultaneously seeks to deprive the United States of its "right – as respondent – to speak last." In this dispute, it would be singularly inappropriate to allow Brazil the final chance to comment.

[9] The most recent example contains a reference to the statement in a Panel communication to the United States that a failure to provide certain requested information without adequate explanation could lead to adverse inferences being drawn. (Exhibit US-155.) As far as the United States is aware, any communication from the Panel to the parties are subject to the confidentiality rules of the proceeding.

# ANNEX K-50

## LETTER FROM THE UNITED STATES

23 February 2004

The United States thanks the Panel for its communication of 20 February 2004, in which the Panel extends to the United States the opportunity to respond to Brazil's 18 February submission relating to certain data provided by the United States on 18 and 19 December 2003. The United States would like to confirm that it does wish to comment on this Brazilian submission. The Panel has asked the United States to file any comments within five days, that is, by Wednesday, 25 February. In light of the extensive material submitted by Brazil and US efforts to respond simultaneously to the Panel's supplemental request for information, the United States would like to ask the Panel to extend the deadline to provide these comments, to Wednesday, 3 March, the same due date for the US response to the Panel's supplemental request for additional information.

This extension would greatly assist the United States in providing useful comments for the Panel on Brazil's lengthy 18 February comments, which totalled 79 pages. Of these 79 pages, 41 pages were devoted to setting forth results of numerous calculations. The personnel who would need to review these calculations are also involved in the ongoing US efforts to provide data in response to the Panel's supplemental request for additional information. The extension requested would permit these personnel to better advance US efforts to respond fully and accurately to the Panel's supplemental request while simultaneously reviewing and providing comments on Brazil's 18 February submission.

In addition, we note that the extension requested would not impact any other dates set by the Panel in this proceeding. Thus, the United States respectfully requests the Panel to extend the deadline to provide the US comments, to Wednesday, 3 March.

The United States is providing a copy of this letter directly to Brazil.

# ANNEX L

## COMMUNICATIONS FROM THE PANEL



[1] Communications included as L-1.4, -1.7, -1.11, -1.12, -1.13 and -1.14 were also sent to 3rd parties.

# ANNEX L-1.1

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

21 May 2003

I refer to the letter from the United States dated 21 May 2003and addressed to the Chair of the Panel. I understand this was also copied to your delegation. The Panel wishes to ask Brazil to communicate its views, if any, in writing in response to this letter.

The Panel would appreciate if Brazil's written response could be submitted before the close of business this Friday, 23 May 2003. This is in view of the fact that the Chairman of the Panel, Mr. Rosati, is proposing to convene an organizational meeting with the parties on Monday 26 May 2003 from 11:30 a.m. The venue will be communicated to you shortly.

# ANNEX L-1.2

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

27 May 2003

The Panel takes note of the United States' comments with respect to the Panel's timetable and working procedures, dated 21 May 2003, and Brazil's communication dated 23 May 2003.

Attached you will find the Panel's proposed **working procedures and timetable**. The Panel intends to hold an **organizational meeting with the parties at 8 a.m. on Wednesday, 28 May** 2003 at room C in order to hear the parties' views on these proposals.

As indicated in the attached proposed timetable, prior to the submission by the parties of their first written submissions, the Panel intends to request the parties to address, in their initial briefs to the Panel, the following:

- whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue.

As also indicated in the attached timetable, the Panel will invite the parties to submit any written comments on each other's comments on this issue. The Panel currently wishes to signal its intention to clarify to the parties its view on these issues prior to the parties' submission of their first written submissions.

In the event that the Panel were to rule that Article 13 precludes the Panel from considering certain claims raised by Brazil prior to a conclusion that certain conditions of Article 13 remain unfulfilled, we may decide to adjust the timetable to permit the parties to make further submission(s) after the second substantive meeting and to schedule further substantive meeting(s), as necessary, with the parties.

With respect to the participation of third parties in these Panel proceedings, the Panel is aware of the provisions of Article 10.3 of the *DSU*, which states that third parties shall receive the submissions of the parties to the dispute to the first meeting of the Panel. Given the significant systemic issues in this Panel proceeding, and in exercise of our discretion to manage these Panel proceedings, we believe that it would be appropriate in this case for the third parties to have access to the parties' initial written comments (and any written comments the parties may make on each others' comments) as well as to have the ability to submit any written comments they themselves may have on the issue that we have identified above. We therefore intend to invite the parties to serve also on the third parties their initial briefs and any responding comments. At the organizational meeting, we will invite any comments you may have on this proposed approach to third party participation.

[Attachment omitted]

# ANNEX L-1.3

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

28 May 2003

Attached you will find the timetable and working procedures adopted by the Panel for this dispute in accordance with Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*"). In adopting the timetable and working procedures, the Panel has carefully considered the parties' comments at this morning's organizational meeting.

As indicated in the attached timetable, prior to the submission by the parties of their first written submissions, the Panel requests the parties to address, in their initial briefs to the Panel (to be submitted on 5 June 2003), the following:

- whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article 13.

As also indicated in the attached timetable, the Panel will invite the parties to submit any written comments on each other's comments on this issue (i.e. on 13 June 2003). The Panel intends to rule on these issues on 20 June 2003, prior to the parties' submission of their first written submissions.

As has been indicated, the Panel recognizes that it may need to revisit certain aspects of its timetable and working procedures in light of developments during the course of the Panel procedures, including the nature of the Panel's ruling that is scheduled for 20 June 2003. In particular, in the event that the Panel were to rule that Article 13 precludes the Panel from considering certain claims raised by Brazil prior to a conclusion that certain conditions of Article 13 remain unfulfilled, we may decide to adjust the timetable to permit the parties to make further submission(s) after the second substantive meeting and to schedule further substantive meeting(s), as necessary, with the parties. Related amendments to the working procedures may also be made, if necessary.

With respect to the participation of third parties in these Panel proceedings, we have carefully considered the parties' comments at this morning's organizational meeting. In exercise of our discretion to manage these Panel proceedings, we continue to believe that it would be appropriate in this case for the third parties to have access to the parties' initial written comments (and any written comments the parties may make on each others' comments) as well as to have the ability to submit any written comments they themselves may have on the issue that we have identified above. The Panel considers that such third party participation in this initial stage of the Panel proceedings is appropriate for the following reasons.

The Panel is aware of the provisions of Article 10.3 of the *DSU*, which states that third parties shall receive the submissions of the parties to the dispute to the first meeting of the Panel. We would also observe that the factual circumstance that presents itself here is not itself specifically addressed by the *DSU*. In our view, the legal issue that the Panel has asked the parties to address in their initial briefs will necessarily have ramifications for the remainder of the Panel proceedings, including the scope of the first substantive meeting, at which third parties will participate.

We therefore invite the parties to serve also on the third parties their initial briefs and any responding comments. The Panel will also invite third parties to submit any written comments they might have concerning the initial phase of these proceedings. The deadline for any third party comments is 10 June 2003. The parties' comments to be submitted on 13 June may, of course, also address comments made by third parties.

[Attachment omitted]

# ANNEX L-1.4

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THIRD PARTIES

20 June 2003

1. In a communication to the Panel, dated 21 May 2003, prior to the Panel's adoption of its working procedures, the United States had "propose[d] that the Panel organize its procedures to deal with the threshold Peace Clause issue at the outset of this dispute". The United States asserted *inter alia* that "[b]ecause in this dispute Brazil has made claims under 17 different provisions of the WTO Multilateral Agreements with respect to numerous US programmes under at least 12 US statutes, we believe the Panel's consideration of the critical Peace Clause issue would be aided by briefing and argumentation focused on this threshold issue". Brazil submitted a communication in response, dated 23 May 2003, opposing the US proposal.

2. On 28 May 2003, after having heard the views of the parties, we adopted our timetable and working procedures in accordance with Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*").

3. At the same time, we indicated that we would consider giving a ruling on certain issues on 20 June 2003, prior to the submission by the parties of their first written submissions, in relation to the following question and we requested the parties and third parties to address us in relation to it:

> "whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article 13."

4. The parties submitted their initial briefs on this question on 5 June 2003. On 10 June, the following six third parties submitted briefs: Argentina; Australia; European Communities; India, New Zealand and Paraguay. The parties submitted further comments on 13 June 2003.

5. Article 13(a)(ii) of the *Agreement on Agriculture* states that domestic support measures that conform fully to the provisions of Annex 2 of the *Agreement on Agriculture* shall be exempt from actions based on Article XVI of *GATT 1994* and Part III of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*"). Article 13(b)(ii) of the *Agreement on Agriculture* states that domestic support measures that conform fully to certain conditions shall be "exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year." Articles 5 and 6 of the *SCM Agreement* are each qualified by the proviso that "[t]his Article does not apply to subsidies maintained on agricultural

products as provided in Article 13 of the Agreement on Agriculture". Article 13(c)(ii) of the *Agreement on Agriculture* provides that export subsidies that conform fully to the provisions of Part V of that Agreement, as reflected in each Member's Schedule, shall be "exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement". Article 3.1 of the *SCM Agreement*, which prohibits export subsidies, is qualified by the proviso: "Except as provided in the *Agreement on Agriculture*...". These provisions of Article 13 afford a conditional exemption from certain obligations relating to certain actionable and prohibited subsidies under the provisions of the *SCM Agreement* and Article XVI of the *GATT 1994*. This conditionality requires, *inter alia*, a comparison of facts with the applicable exemption requirements.

6. Briefly, Brazil asserts that the Panel can simultaneously consider all of the arguments and evidence on the substance of its claims under the *SCM* and *Agriculture Agreements*, while the United States asserts that the Panel is precluded from examining the SCM claims concerning prohibited and actionable subsidies in the absence of a prior ruling that the conditions of Article 13 of the *Agreement on Agriculture* are not satisfied, and, even if not, the Panel should exercise its discretion to order its proceedings in this way. All of the six third parties that made submissions support the view that the Panel is not precluded from simultaneously considering all of the arguments and evidence on the substance of Brazil's claims under the *SCM* and *Agriculture Agreements*, or, putting this another way, that conclusions on the applicability of the Article 13 exemptions do not have to be made before consideration of SCM claims in relation to the measures concerned.

7. We are faced with two questions:

- first, whether we are *required* to defer any examination of certain of Brazil's claims based on Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* until after making a ruling or expressing views on the issue of fulfilment of *Agreement on Agriculture* Article 13 conditions; and

- second, if not, then *how* we should exercise our discretion to best structure our examination of the matter before us.

8. These questions concern the manner in which we should or must treat the claims of Brazil based on Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* having regard to the provisions of Article 13 of the *Agreement on Agriculture*.

9. We therefore look first to the dispute settlement procedures governing disputes under the *SCM Agreement*. Article 30 of the *SCM Agreement* states: "The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding shall apply to consultations and the settlement of disputes under this Agreement, except as otherwise specifically provided herein."

10. We thus turn next to the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*") and to the terms of the *SCM Agreement* itself (in order to see whether or not there is anything otherwise specifically provided therein). Article 1.1 of the *DSU* is entitled "Coverage and Application". It states that "[t]he rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the "covered agreements")."

11. As the Appellate Body has observed, "[a]rticle 1.1 of the DSU establishes an integrated dispute settlement system which applies to all of the agreements listed in Appendix 1 to the *DSU* (the "covered agreements"). The DSU is a coherent system of rules and procedures for dispute settlement

which applies to "disputes brought pursuant to the consultation and dispute settlement provisions of" the covered agreements."[1] The *SCM Agreement* and the *GATT 1994* are Multilateral Agreements on Trade in Goods in Annex 1A of the *WTO Agreement* and are therefore "covered agreements" listed in Appendix 1 of the *DSU*. The general *DSU* rules and procedures do not set forth any specific distinct way to deal with claims under the *SCM Agreement* and the *GATT 1994* having regard to the provisions of Article 13 of the *Agreement on Agriculture*.

12. Article 1.2 of the *DSU* provides, in relevant part, that the rules and procedures of the *DSU* shall apply subject to such special or additional rules and procedures on dispute settlement contained in the covered agreements as are identified in Appendix 2 to the *DSU*.

13. We therefore examine whether Appendix 2 to the *DSU* identifies any special or additional dispute settlement rules or procedures relating to the *SCM Agreement* or to Article XVI of the *GATT 1994*.

14. Appendix 2 of the *DSU* does not identify Article XVI of the *GATT 1994* as a special or additional rule. It does identify Articles 4.2-4.12 and Articles 7.2-7.10 of the *SCM Agreement* as "special or additional rules and procedures". These provisions contain special procedures and remedies for disputes involving prohibited and actionable subsidies governed by the *SCM Agreement*. However, none of these provisions purports to confer any sort of precedence or priority for considering SCM remedies in a dispute involving claims under the *Agreement on Agriculture*. Furthermore, Article 7.1 of the *SCM Agreement*, which is not identified as a special or additional rule or procedure in Appendix 2 of the *DSU*, indicates that it applies: "Except as provided in Article 13 of the Agreement on Agriculture....". This clearly indicates to us that this provision must be read in the light of the provisions of Article 13 of the *Agreement on Agriculture*. Moreover, as noted in para. 5 above, the substantive provisions to which these remedial articles are linked – Articles 3, 5 and 6 – stipulate either that they apply "except as provided in the Agreement on Agriculture" (Article 3 relating to prohibited subsidies), or that they do "not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture" (Articles 5 and 6.9 of the *SCM Agreement*, entitled "Adverse Effects" and "Serious Prejudice", respectively).

15. The cited provisions of the *SCM Agreement* refer, as just indicated, to the *Agreement on Agriculture*, and some specify more precisely Article 13 of the *Agreement on Agriculture*. We therefore examine the rules applicable to dispute settlement under the *Agreement on Agriculture*, which is also a Multilateral Agreement on Trade in Goods in Annex 1A of the *WTO Agreement* and is, therefore, a "covered agreement" listed in Appendix 1 of the *DSU*. Article 19 of the *Agreement on Agriculture* is entitled "Consultation and Dispute Settlement". It states that the provisions of Articles XXII and XXIII of *GATT 1994*, as elaborated and applied by the *DSU*, shall apply to consultations and the settlement of disputes under that Agreement.

16. Appendix 2 to the *DSU* does not identify any special or additional dispute settlement rules or procedures relating to Article 13 of the *Agreement on Agriculture*.

17. Consequently, consistent with our consideration of the relevant provisions, there is no special dispute settlement requirement foreseen in the covered agreements in respect of a panel's consideration of the fulfilment of Article 13 conditions. The issue of fulfilment of the conditions of Article 13 of the *Agreement on Agriculture* is to be resolved using generally applicable *DSU* rules and procedures. The fact that certain very specific provisions are included in Appendix 2 of the *DSU* as special or additional rules indicates that, when the drafters intended to make a particular provision

[1] Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico* ("*Guatemala – Cement I*"), WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, 3767, para. 64.

applicable as a special or additional dispute settlement rule, they did so explicitly. Therefore, their failure to include a reference to any provision of the *Agreement on Agriculture* in the text of Appendix 2 demonstrates that they did not intend to make any provision of that Agreement a special or additional dispute settlement rule. It is not necessary for us to look for any further interpretive guidance on this issue.

18. We next turn to the issue of how we should structure our procedures to consider the matter before us. As we have concluded above, this issue is subject to the *DSU* but not otherwise affected by the covered agreements. In this regard, within the overall parameters set by the *DSU* of prompt and efficient dispute resolution[2], we must exercise our discretion as to how best to organize our procedures. Our discretion must be guided by the instructions given to us by the *DSU*. Pursuant to Article 12.1 of the *DSU*, "[p]anels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute". Moreover, Article 12.2 provides: "Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process."

19. Article 11 of the *DSU*, entitled "Function of Panels" provides that the function of panels is to assist the DSB in discharging its responsibilities under the *DSU* and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Article 11 contemplates that a panel must make an "objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements." It does not require that a panel must conduct its proceedings in any particular way, provided that its requirements are fulfilled. It is within our discretion to manage our procedures so as to best fulfil the requirements of Article 11.

20. Given the potential complexity of the claims before us, the conditional nature of certain of these claims and the volume of evidence which may be introduced by the parties in support of their claims and arguments, and in order to organize our proceedings in an orderly, effective and efficient manner which serves to facilitate an objective assessment of the matter before us, and optimizes use of our resources, we have adopted the following modifications to our procedures (as indicated in the attached timetable):

- The Panel intends to express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, to the extent that it is able to do so, by **1 September 2003**, and will defer its consideration of claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as those provisions are referred to in Article 13 of the *Agreement on Agriculture* until after it has expressed those views. The Panel's views may be expressed in the form of rulings which could affect the Panel's further consideration of this dispute.

- In order that third parties may participate effectively at the first meeting at which the claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as referred to in Article 13 of the *Agreement on Agriculture* are examined (as necessary), the Panel intends to divide its first meeting into two sessions, each of which will include a third party session.

[2] Article 3.3 of the *DSU* provides: "The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

- Accordingly, for the purposes of the first session of the first substantive meeting on 22-24 July 2003, the Panel does not require the parties to address claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as referred to in Article 13 of the *Agreement on Agriculture*. Having said this, the Panel notes that this does not preclude the parties from addressing such matters in their first submissions.

- All other claims of Brazil in relation to measures which Brazil maintains do not involve a consideration of Article 13 of the *Agreement on Agriculture* should also be addressed in first submissions, in order for the other party and third parties to have an opportunity to express their views on any such claims.

- For the purposes of allowing the Panel to express its views on the exemption conditions of Article 13 of the *Agreement on Agriculture* by 1 September 2003, in relation to those measures which may be affected by Article 13, full and complete submissions on factual and legal issues related to Article 13 in this dispute will need to be provided, at the latest, in the parties' rebuttal submissions (to be submitted on 22 August 2003).

21. We recognize that we may need to revisit certain aspects of our timetable and working procedures in light of developments during the course of the Panel procedures. Related amendments to the working procedures may also be made, if necessary. We have been mindful of due process considerations in revising our timetable and will continue to ensure that the parties have reasonable time to prepare for any subsequent stages of the dispute, as appropriate.

[Attachment omitted]

# ANNEX L-1.5

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

25 July 2003

Please find attached a communication from the Panel on the following issues:

1. The Panel's view on the preliminary ruling requested by the United States.
2. Questions from the Panel to the parties.
3. A copy of the Panel's questions to third parties (sent for your reference)

The Panel's questions are intended to facilitate the work of the Panel, and do not in any way prejudge the Panel's findings on the matter before it. Nor does the fact that the Panel has placed these questions under certain headings prejudge the Panel's findings on the matter before it. Each party is free to respond to or comment on questions posed to the other party or third parties.

Please be reminded that as stated by the Chairman of the Panel in the meeting, parties are requested to submit answers by the close of business of 4 August 2003. Subsequently, parties can submit comments to each other's responses by the close of business 22 August, the same deadline applicable to the rebuttal submissions

Panels' views on the preliminary ruling requested by the United States

1. The United States requests a preliminary ruling that:

(1) export credit guarantee measures relating to eligible US agricultural commodities other than upland cotton,

(2) production flexibility contract payments and market loss assistance payments, and

(3) the Agricultural Assistance Act of 2003

are not within the Panel's terms of reference.[1]

2. Brazil asserts that these items are properly within the Panel's terms of reference and asks the Panel to reject the United States' request.[2]

3. The Panel wishes to indicate to the parties how it intends to rule on items (1) and (2), in order to assist them in deciding what argumentation and evidence to submit in their answers to questions and rebuttals.

4. The DSB established the Panel at its meeting on 18 March 2003 with the following standard terms of reference:[3]

> "To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

5. With respect to item (1), the Panel intends to rule in its report that "export credit guarantees … to facilitate the export of US upland cotton, and other eligible agricultural commodities" as addressed in document WT/DS267/7, are within its terms of reference.

6. With respect to item (2), the Panel intends to rule in its report that production flexibility contract payments and market loss assistance payments as addressed in document WT/DS267/7 are within its terms of reference. This is without prejudice to the relevance, if any, of those payments under Article 13(b) of the *Agreement on Agriculture*, Articles 5, 6 and 7 of the *SCM Agreement* and Article XVI of *GATT 1994*.

7. The Panel has not yet decided upon its approach to item (3) and asks the parties not to exclude consideration of the Agricultural Assistance Act of 2003 in responding to the Panels' written questions and in rebuttal submissions.

[1] US First Written Submission, para. 218.
[2] Brazil's Oral Statement at the First Substantive Meeting, paragraphs 90, 144 and 145.
[3] WT/DSB/M/145 (paragraph 35)

Questions from the Panel to the parties –
First session of the first substantive Panel meeting

UPLAND COTTON

1. Please confirm that all information and data that you have provided to the Panel relating to "cotton" in fact relates to upland cotton only. **BRA, USA**

PRELIMINARY ISSUES

*Note to parties: As indicated in the cover note, the Panel has expressed its views in respect of the three United States requests for preliminary rulings. The Panel's questions reflected in this compilation relating to the requested preliminary rulings on which the Panel has expressed its views are those that were posed in the course of the first session of the first Panel meeting. This is to give an opportunity for the parties to transpose into writing their oral responses.*

**Product scope of Panel's terms of reference relating to Brazil's export credit guarantee claims**

2. Is Brazil's claim in relation to export credit guarantees against the measures said to constitute the GSM-102, GSM-103 and SCGP programmes in their entire application, or against the measures said to constitute the GSM-102, GSM-103 and SCGP programmes in their application to upland cotton, or both? **BRA**

3. If the request for consultations in this dispute omitted certain *products* in relation to export credit guarantees, on what basis is it argued that it failed to identify the *measures* at issue in accordance with Article 4.4 of the *DSU*? **USA**

4. Is it argued that the export credit guarantee programmes concerning upland cotton are each a separate or independent *measure*, in that they operate independently? **USA**

5. Is there a specification in any legislation or regulation (or any other official government document) which limit or restrict the export credit guarantee programmes at issue exclusively to upland cotton? **USA**

6. For the purposes of the Panel's examination of Brazil's claims relating to GSM-102, GSM-103 and SCGP under the *Agreement on Agriculture* and the *SCM Agreement*, is accurate data and information available with respect to these export credit guarantee programmes concerning upland cotton alone (e.g. with respect to "long-term operating costs and losses")? In this respect, the Panel also directs the parties' attention to the specific questions below relating to the programmes. **USA**

7. Are commitments with respect to export subsidies under the *Agreement on Agriculture* commodity-specific? How, if at all, is this relevant? **BRA, USA**

8. Does the United States confirm that the questions referred to by Brazil in paragraph 92 of Brazil's oral statement were posed to the United States in the consultations? **USA**

9. How does the United States respond to paragraph 94 of Brazil's oral statement? **USA**

10. What actual prejudice, if any, has the United States suffered as a result of the alleged omission of products other than upland cotton from the request for consultations? **USA**

11. Does the United States agree that Brazil's request for establishment of the Panel can be understood to indicate that Brazil's export credit guarantee claims relatesto products other than upland cotton? How, if at all, is this relevant? **USA**

12. Please address issues and submit evidence regarding the three export credit guarantee programmes concerned relating to upland cotton and other eligible agricultural commodities in your answers to questions and rebuttal submissions. **BRA, USA**

13. Please include any argumentation and evidence to support your statement during the Panel meeting that the inclusion of such other eligible agricultural commodities would create additional "work" for the Panel with respect to each of these commodities under Article 13 of the *Agreement on Agriculture*. **USA**

**Expired measures**

14. Please submit evidence regarding the programmes under the 1996 FAIR Act, in particular, production flexibility contract payments and market loss assistance payments, to the extent that they would be relevant to the Panel's determination under Article 13 of the *Agreement on Agriculture* in your answers to questions and rebuttal submission. **USA**

15. Do the parties agree that it is beyond a Panel's power to recommend a remedy for an expired measure? Could the Panel could be required to examine "expired measures" in order to conduct its assessment of the matter before it? How, if at all, is Article 7.8 of the *SCM Agreement* relevant to these matters? **BRA, USA**

**Agricultural Assistance Act of 2003**

16. What, if any, prejudice in terms of the presentation of its case does the United States allege, should the Panel proceed to consider the measures constituting the cottonseed payments under the Agricultural Assistance Act of 2003? **USA**

17. (a) What is the relationship of the Agricultural Assistance Act of 2003 to other legislation in the request for establishment of the Panel? **BRA, USA**

(b) Do the legal instruments follow directly one after another, or are there temporal gaps? Are payments authorized under a broad legislative authority or are they specific to each legal instrument? **BRA, USA**

(c) Please provide any implementing regulations. Do these implementing regulations resemble those relating to previous programmes or payments? Are payments made retrospectively? How if at all is this relevant? **BRA, USA**

18. If the Panel is correct in understanding that cottonseed payments are divided between processors and producers, how is this reflected in Brazil's calculations? **BRA**

**Measures at issue**

19. The Panel notes that Brazil's panel request refers, *inter alia*, to alleged "subsidies" and "domestic support" "provided" in various contexts. Please specify the measures, in particular, the legislative and regulatory provisions, by number and letter, in respect of which Brazil seeks relief and indicate where each is referred to in the panel request. **BRA**

ARTICLE 13(B): DOMESTIC SUPPORT MEASURES

**"exempt from actions"**

20. In paragraph 8 of its initial brief (dated 5 June, 2003), the United States argued that the word "actions" as used in the phrase "exempt from actions" in Article 13 of the *Agreement on Agriculture* includes the "bringing of a case" and consultations. In paragraph 36 of its first written submission (dated 11 July, 2003), the United States stated as follows:

> "[P]rior to this point in the process, the *DSU* rules did not afford the United States any opportunity to prevent the dispute from proceeding through consultations and panel establishment automatically, regardless of the U.S. insistence that its measures conform to the Peace Clause."

Is it the United States' understanding that the drafters used the phrase "exempt from actions" knowing that under the *DSU* it would not be possible fully to exempt "actions", as the United States interprets that term? **USA**

21. In *US - FSC* and *US - FSC (21.5)* the Appellate Body made findings under the *SCM Agreement* relating to export subsidies in respect of agricultural products without making a finding in respect of Article 13 of the *Agreement on Agriculture.* How is this relevant to the United States' interpretation of the phrase "exempt from actions" as used in Article 13? **USA**

**"such measures" and Annex 2 of the *Agreement on Agriculture***

22. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*. **BRA, USA**

23. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. **BRA, USA**

24. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*? **BRA, USA**

25. Does the United States consider that there is any ambiguity in the term "type of production" as used in paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*? **USA**

26. Can the United States confirm Brazil's assertions in paragraph 174 of its first written submission that the implementing regulations for direct payments prohibit or limit payments if base acreage is used for the production of certain crops? If so, can the United States clarify the statement in paragraph 56 of its first written submission that direct payments are made regardless of what is currently produced on those acres? Can the United States confirm the same point in relation to production flexibility contracts? **USA**

27. Does Brazil argue that any United States measure that does not comply with the fundamental requirement of paragraph 1 of Annex 2 of the *Agreement on Agriculture* is actionable independently of any failure of that measure to comply with the basic or policy-specific criteria in Annex 2? **BRA**

28. Please explain the meaning of the word "criteria" in Articles 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the *Agreement on Agriculture* have on the meaning of the preceding sentence? **BRA**

29. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the *Agreement on Agriculture.* **USA**

30. Do the parties consider that direct payments and production flexibility contract payments meet or met the basic criteria referred to in paragraph 1 of Annex 2 of the *Agreement on Agriculture*? **BRA, USA**

31. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? **BRA, USA**

32. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. **USA**

**"do not grant support to a specific commodity"**

33. According to the United States' interpretation of the word "grant", when can a Member claim that a measure is not exempt from action under Article 13(b)? What if the measure is enacted annually? Can the Member obtain a remedy in respect of that measure under the *DSU*? **USA**

34. Does Brazil interpret the word "grant" as used in Article 13(b)(ii) of the *Agreement on Agriculture* to mean payment made *in* a specific year or payment made *in respect of* a specific year? **BRA**

35. Does a failure by a Member to comply in a given *year* with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? **BRA, USA**

36. Does a failure by a Member to comply with Article 13(b) in respect of a *specific commodity* impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? **BRA, USA**

37. In the United States' view, why did the drafters not use the exact term "product-specific" in Article 13(b)(ii)? **USA**

38. Given the fact that subsidies available for more than one product could have various effects on production, how does the United States demarcate between product-specific support and non-product specific support ? **USA**

39. If "such measures" in Article 13(b)(ii) refers to all those in the chapeau of Article 13(b), why are they not all included in the potential comparisons with 1992? In what circumstances can measures which grant non-product specific support lose exemption from action under Articles 5 and 6 of the *SCM Agreement* and Article XVI of *GATT 1994*? **USA**

40. In relation to which other provisions in the *Agreement on Agriculture* is it relevant to disaggregate non-product specific support in terms of specific commodities? **BRA**

41. What is the position of Brazil with regard to certain other domestic support measures not cited by Brazil that were notified by the United States as non-product-specific (e.g. G/AG/N/USA/43), some of which presumably deliver support to upland cotton (e.g. state credit programmes, irrigation subsidies etc). Why have budgetary outlays for such measures related to upland cotton not been included in the comparison of support with 1992? **BRA**

42. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? **BRA**

43. What are the precise differences between deficiency payments and counter-cyclical payments that lead you to classify the former as product-specific and the latter as non-product specific? How do you classify market loss assistance payments? **USA**

44. Do you allege that counter-cyclical payments could be considered product-specific? **BRA**

45. If the Panel considered that Step 2 payments paid to exporters were an export subsidy, would the United States count them as domestic support measures for the purposes of Article 13(b)? Please verify Brazil's separate data for Step 2 export payments and Step 2 domestic payments in Exhibit BRA-69 or provide separate data. **BRA, USA**

46. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM* Agreement and references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement* to the meaning of "support to a specific commodity" in Article 13(b)(ii) *Agreement on Agriculture*? **BRA, USA**

**"in excess of that decided during the 1992 marketing year"**

47. Where does Article 13(b)(ii) require a year-on-year comparison? **BRA, USA**

48. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made? **BRA, USA**

49. Brazil claims that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? **BRA**

50. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) and, in particular, why both words "grant" and "decided" were used. **USA**

51. Could the United States please comment on the interpretation advanced by the EC, in paragraphs 16 and 18 of its oral statement, of the words "decided during the 1992 marketing year"? **USA**

52. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". **BRA, USA**

53. Assume, for arguments sake, that the only "decision" made in the United States in 1992 was the target price. How would Brazil make the comparison *vis-à-vis*, for example, the year 2001? **BRA**

54. Please identify all United States legal and regulatory and administrative instruments decided during the marketing year 1992, with the respective dates of decision, that decided support for upland cotton. **BRA, USA**

55. Please provide a copy of the instrument in which the rate of support for upland cotton during the marketing year 1992 was decided, indicating the date of the decision. **USA**

56. Could the United States please explain how support granted under legislation that dates back to 1990 can have been support "decided during the marketing year 1992"? **USA**

57. If the United States decided on a rate of support for MY1992, does that not mean that it decided on whatever budgetary outlay was required to meet that rate of support, even if the exact amount was not known at that time? **USA**

58. Please comment on the argument advanced by the EC, in paragraph 17 of its oral statement that: "Had WTO Members intended a limitation to the support provided or granted in 1992 the word 'for' would have been used in place of 'during'." **BRA**

59. Should the rate of support as indicated in Article 13(b)(ii) include the market price? If so, why is it appropriate to include it in the comparison under Article 13(b)(ii)? **BRA, USA**

60. Can you provide information on support decided in 1992 and the years with which you believe it should be compared, on a per support programme / per unit of production / per annum basis? If possible, please specify how, if at all, budget outlays may be transposed into units of production, and which units of production are best to use. **BRA, USA**

61. Does the United States consider that Article 13(b)(ii) permits a comparison on any basis other than a per pound basis? **USA**

62. According to Prof. Sumner's calculation, the per pound support increased by approximately 24% from 1992 to 2002. On the other hand, the Panel understands that the total budget outlay, according to Brazil, increased more than that. What, in Brazil's view, is the reason for this difference in the rate of increase? **BRA**

63. In relation to Prof. Sumner's presentation at the first session of the first substantive meeting, please elaborate on the reasons behind the increase in the figures (from 1992 to 2002) concerning Loan Support and Step 2 payments. **BRA**

64. Do the figures cited in Prof. Sumner's presentation at the first session of the first substantive meeting indicate amount available or amount spent? Can the Panel derive amount spent from these figures? If Article 13(b)(ii) requires a rate of support comparison, is the rate of support the "rate" of support available or the "rate" at which the support was spent? **BRA**

65. Does Brazil consider that adjustment for inflation is relevant in the context of the comparison under Article 13 (b)(ii) ? **BRA**

66. Could you please comment on the relative merits of each of the following calculation methods for the purposes of the comparison of support to upland cotton with 1992, irrespective of whether a particular measure should be included or excluded:

(a) Total budgetary outlays (Brazil's approach). **USA**

(b) Budgetary outlays per unit of upland cotton: Could you please calculate and provide an estimate for the marketing years 1992 and 1999-2002, respectively, and draw attention to any factors/qualifications that the Panel would need to be aware of. **BRA, USA**

(c) Per unit rate of support (United States approach): How should changes in acreage, eligibility and payment limitations per farm(s) (commodity certificate programs) be factored into this approach? **BRA**

(d) Per unit rate of support for upland cotton (Prof. Sumner's approach at the first session of the first substantive meeting ). **USA**

67. The Panel requests the parties to calculate and submit estimates of the AMS for upland cotton for marketing years 1992, 1999, 2000, 2001 and 2002. For this purpose the parties are each requested to submit AMS calculations for upland cotton (using the budgetary-outlay/non-price gap methodology employed by the United States in respect of cotton in its DS Notifications (e.g., G/AG/N/USA/43) and using the formats and supporting tables in document G/AG/2) on the same basis as would be the case in calculating a product specific AMS for the purposes of the calculation of the "Total Current AMS" in any year in accordance with the relevant provisions, including as appropriate Article 1(a), (b) and (h), Article 6 and Annex 3 to the Agreement. **BRA, USA**

68. Could you please clarify the result of the calculations of, and the meaning of the title, in Appendix Table 1 "Estimated per unit Subsidy Rates by Program and Year" in Annex 2 to Exhibit BRA-105, page 12. Why are the numbers calculated for marketing loans considered to be subsidies? Could the Panel, for example, read the "total level of support" (bottom line of the table) as the effective support *price* for upland cotton or the maximum rate of support for upland cotton? **BRA, USA**

69. Can the United States confirm that the "marketing year" for upland cotton is 1 August to 31 July ? Can the United States confirm the Panel's understanding that USDA data for the "crop year" corresponds to the "marketing year"? **USA**

EXPORT CREDIT GUARANTEE PROGRAMMES

70. How does Brazil respond to the United States' assertion that Brazil is trying to realize through litigation what it could not achieve in past negotiations ? **BRA**

71. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*? Why or why not? Does it confer a benefit within the meaning of Article 1.1(b)? Why or why not? If so, to whom? **USA**

(b) How, if at all, would these elements be relevant to the claims of Brazil, and the United States response thereto? **BRA, USA**

72. Could Brazil expand on why, as indicated in paragraph 118 of its oral statement, it does "not agree" with the United States arguments relating to the viability of an *a contrario* interpretation of item (j) of the Illustrative List of Export Subsidies in Annex 1 of the *SCM Agreement*? **BRA**

73. The Panel could arguably take the view that Articles 1 and 3 of the *SCM Agreement* were relevant in assessing the WTO-consistency of United States export credit guarantees. The United States has yet to submit any evidence or argumentation on this point, either as potential context for interpretation of the terms in Article 10 of the *Agreement on Agriculture* or in relation to Brazil's claims under the *SCM Agreement*. The Panel would therefore appreciate United States views in respect of this situation, and invites the United States to submit relevant argumentation and evidence. **USA**

74. If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance in the interpretation of the terms in Article 10 of the *Agreement on Agriculture*, should the Panel refer to item (j) or Articles 1 and 3 of the *SCM Agreement* or both? **BRA, USA**

75. The Panel's attention has been drawn to Article 14(c) of the *SCM Agreement* (see e.g. written third party submission of Canada) and to the panel report in DS 222 *Canada- Export Credits and Loan Guarantees*. How and to what extent are Article 14(c) of the *SCM Agreement*, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would be the appropriate market benchmark to use for any comparison? Please cite any other relevant material. **BRA, USA**

76. How does the United States respond to Brazil's statement that : "...export credit guarantees for exports of agricultural exports [*sic*] are not available on the marketplace by commercial lenders."? **USA**

77. How does the United States interpretation of "long term operating costs and losses" in item (j) as claims paid give meaning to *both* "costs" and "losses"? Do claims paid represent "losses" or "costs" or both? If claims paid is represented by "losses", what would go into the "cost" element of item (j)? Could the United States expand on why it disagrees with the items which Brazil identifies for inclusion in the examination to be conducted under item (j)? **USA**

78. Can the United States provide supporting documentation for data used relating to "costs and losses" in paragraph 173? Could the United States confirm that the figures cited in paragraph 173 of its first written submission relate to the SCGP? Why did the United States cite these figures after stating that it is not possible to make any assessment of the long-term operating costs and losses of this programme? **USA**

79. In respect of what time periods does Article 13(c) require an assessment of conformity with Part V of the *Agreement on Agriculture*? How does this affect, if at all, your interpretation of Article 13(b)? **BRA, USA**

80. In Brazil's view, why did the drafters of the *Agreement on Agriculture* not include export credit guarantees in Article 9.1? **BRA**

81. How does the United States respond to the following in Brazil's oral statement: **USA**

(a) paragraph 122 (rescheduled guarantees)
(b) paragraph 123 (interest on debt to Treasury)
(c) paragraphs 125 ff. (guaranteed loan subsidy)
(d) paragraphs 127-129 (re-estimates, etc.)
(e) Exhibits BRA-125-127
(f) the chart on page 53 of Brazil's oral statement at the first session of the first Panel meeting relating to "Guaranteed Loan Subsidy and Administrative Expenses of US Export Credit Guarantee Programs GSM-102 GSM 103 and SCGP"?
(g) In respect of (a)-(f) above, how and to what extent do the information and data presented for the export guarantee programmes concerning "program" and "financing", "summary of loan levels", "subsidy budget authority", "outlay levels", etc., in particular in Exhibits BRA-125-127, reflect "actual costs and losses" of the GSM-102, GSM-102 and SCGP export credit guarantee programmes(see e.g. Brazil's closing oral statement at the first session of the first substantive meeting, paragraph 24)? **USA**

82. Please explain each of the following statements and any possible significance it may have in respect of Brazil's claims about GSM-102 and GSM-103 (7 CFR 1493.10(a)(2), Exhibit BRA-38): **BRA, USA**

(a) "The programs operate in cases where credit is necessary to increase or maintain U.S. exports to a foreign market and where U.S. financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)

(b) "The programs are operated in a manner intended not to interfere with markets for cash sales. The programs are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)

(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)

83. Could Brazil explain how the procedure in Annex V of the *SCM Agreement* would be relevant to its claims concerning agricultural export subsidies, prohibited subsidies and agricultural domestic support? (e.g. note 301 in Brazil's first submission and paragraph 4 of Brazil's oral statement at the first session of the first substantive meeting). **BRA**

84. Is the Panel correct in understanding that, under the *GSM-102 and GSM-103 programmes*, the exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? **USA**

85. Is the Panel correct in understanding that, under the *SCGP*, the exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales? How and on what basis are the fee rates fixed? Do the fee rates ever change? If so, how and for what reason? Would it be necessary to amend the legislation and/or regulations in order to adjust the fee rates? Please explain any "risk" assessment involved in the programme. **USA**

86. Is there a risk categorization in relation to three export credit guarantee programmes (GSM-102, GSM-103 and SCGP)? Does this have any impact on premiums payable and the ability of the CCC to on-sell the guarantees ? **USA**

87. What proportion of CCC (export-related and total) long term operating costs and losses are represented by GSM-102, GSM-103 and SCGP programmes? **USA**

88. (a) Is the Panel correct in understanding that the United States' argument is that, at present, by virtue of Article 10.2 of the *Agreement on Agriculture*, there are ***no*** disciplines on agricultural export credit guarantees under the *Agreement on Agriculture* (or the *SCM Agreement)*? **USA**

(b) Does the United States agree with the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the *Agreement on Agriculture* ("Prevention of Circumvention on Export Subsidy Commitments"), and

with other commitments contained in the *Agreement on Agriculture*? Please cite any relevant material, including any past WTO dispute settlement cases. How would this reconcile with the United States' own statement, at paragraph 21 of its closing oral statement that "of course, the United States may not provide subsidies without any limit". **USA**

(c) If, as the United States argues, there are no disciplines on export credit guarantees in the *Agreement on Agriculture*, how could export credit guarantees "conform fully to the provisions of Part V" of the *Agreement on Agriculture* within the meaning of Article 13 (how can you assess "conformity" or non-conformity when there are allegedly no disciplines against which such an assessment could occur)? **USA**

(d) Is the United States advocating the view that its own export credit guarantee programmes, which pre-dated the Uruguay Round, are effectively "grandfathered" so as to benefit from some sort of exemption from the export subsidy disciplines of the *Agreement on Agriculture*? How, if at all, is it relevant that the SCGP did not, according to the United States, become relevant for upland cotton until the late 1990's (i.e. after the entry into force of the *WTO Agreement*)? **USA**

STEP 2 PAYMENTS

89. Does the United States confirm Brazil's statement in paragraph 331 of its first submission that "The conditions and requirements for Step 2 domestic payments remain unchanged with the passage of the 2002 FSRI Act"? What is the relevance of this, if any, to this dispute? **USA**

90. Does the United States confirm Brazil's statement in paragraph 235 of its first submission that the changes concerning Step 2 export payments from the 1996 FAIR Act to the 2002 FSRI Act are: increase in the amount of the subsidy by 1.25 cents per pound and the removal of any budgetary limits that applied under the 1996 FAIR Act? What is the relevance of this, if any, to this dispute? **USA**

91. What is the significance of the elimination of the 1.25 cent threshold payment in the 2002 FSRI Act pertaining to Step 2 payments? **USA**

92. Does the United States confirm that Exhibit BRA-65 represents a sample contract for exporters of eligible upland cotton to conclude with the CCC under the FSRI 2002, and that an application form (Exhibit BRA-66) needs to be filled out with data on weekly exports and submitted to the USDA FAS. Is Exhibit BRA-66 - Form CCC 1045-2 – also a valid example? If not, please identify any differences or distinctions. **USA**

93. Please elaborate why the United States deems that Step 2 payments upon submission of proof of export are not subsidies contingent upon export. Is it the US contention that, in order to be contingent on export, exportation must be the exclusive condition for receipt of the payment? **USA**

94. Is the Panel correct in understanding that Brazil alleges an inconsistency with Article 3.1(b) of the *SCM Agreement* only with respect to Step 2 *domestic* payments? **BRA**

95. Do the criteria in 7 CFR 1427.103(c)(2) (Exhibit BRA-37) that Step 2 "eligible upland cotton" must be "not imported cotton" apply to *both* domestic and export payments? **USA**

96. Is a domestic sale a "use" for the purposes of Step 2 payments? Is a sale for export, or export, considered a "use"? **USA**

97. How does the United States respond to Brazil's assertion, at paragraph 70 of Brazil's oral statement at the first session of the first substantive meeting, that "It is obvious that a single bale of cotton cannot be both exported and used domestically." Is this a relevant consideration? **USA**

98. How many Step 2 payments are received if a bale of upland cotton is exported, and then opened by a domestic user in the United States, or *vice versa*? **USA**

99. How does the United States respond to Brazil's arguments in paragraphs 71-75 of Brazil's oral statement at the first session of the first Panel meeting concerning the relevance of the Appellate Body Report in *US-FSC (21.5)*. **USA**

100. How does Brazil respond to the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in *Canada-Dairy* and the findings of the Appellate Body in *US-FSC (21.5)*[4], do any other dispute settlement reports offer guidance on this issue? For example, how, if at all is the Appellate Body's report in *Canada-Aircraft* relevant here?[5] **BRA**

101. How does Brazil respond to the United States' assertion at paragraph 22 of its oral statement that the programme involves "eligible users" who constitute the "entire universe" of potential purchasers of upland cotton? **BRA**

102. How does Brazil respond to the United States' assertion at paragraph 129 of its first written submission, that "[t]he program is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States." **BRA**

103. Is the Step 2 programme fund a unified fund that is available for either domestic users or exporters, without a specific amount earmarked for either domestic users or exporters? Please

[4] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances.[4] Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

2 [5] There, the Appellate Body stated that,

> "the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".[5]

substantiate your response, including by reference to any applicable statutory or regulatory provisions. **USA**

104. How does the United States respond to the data presented in Exhibit BRA-69? Is it accurate? Please substantiate. **USA**

105. Why is the Step 2 programme separated into "domestic users" and "exporters"? Apart from differentiating between exporters and domestic users, with consequential differentiation as to the forms that must be filled out and certain other conditions that must be fulfilled, are the eligibility criteria for Step 2 payments identical? Are the form and rate of payment, as well as the actual payment made, identical? **USA**

106. With respect to paragraph 139 of the United States' first written submission, are Step 2 *export* payments included in the annual reduction commitments of the United States? If so, why? **USA**

107. Please comment on any relevance, to Brazil's *de jure* claims of inconsistency with the provisions of the *Agreement on Agriculture*, of Exhibit BRA-69, which shows Step 2 payments made to (i) domestic users and (ii) exporters. This Exhibit shows that, from FY 91/92 through 02, the Step 2 payments for exporters exceeded those for domestic users in FY 94; FY 95; FY 96 (in fact there were no domestic payments in FY 96); and FY 02. In the other years, the domestic payments are greater than export payments. **BRA, USA**

108. At paragraph 135 of its first written submission, the United States states : "[T]he *subsidy* is not contingent upon export performance..." (emphasis added). Again, in the course of the first Panel meeting, the United States admitted that the Step 2 payments were "subsidies". Does the United States thus concede that Step 2 payments constitute a "subsidy" within the meaning of the *WTO Agreement*? **USA**

109. How does the United States respond to Brazil's arguments concerning a mandatory/discretionary distinction and the allegation that certain United States measures (including s.1207(a) of the 2002 FSRI Act) are mandatory? (This is referred to, for example, in paragraph 28 of Brazil's first written submission). Does the United States agree with the assertion that (subject to the availability of funds) the payment by the Secretary of Step 2 payments is mandatory under section 1207(a) FSRI upon fulfilment by a domestic user or exporter of the conditions set out in the legislation and regulations? If not, then why not? To what extent is this relevant here? What determines the "availability of funds"? Please cite any other relevant measures or provisions which you consider should guide the Panel in respect of this issue. **USA**

110. Section 1207(a) of the 2002 FSRI Act provides that during the period beginning on the date of the enactment of the FSRI Act through 31 July 2008, " .. the Secretary shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters for documented purchases by domestic users and sales for export by exporters...". The Panel notes that Brazil does not appear to distinguish between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists. The United States refers to "benefits" and "payments" and "programme" in asserting that Step 2 is not export contingent (paragraphs 127-135 of the United States' first written submission).

(a) Do the parties thus agree that there is no need to draw any distinction between the treatment of (i) cash payments and (ii) marketing certificates in terms of the issue of whether or not a "subsidy" exists for the purposes of the *Agreement on Agriculture*? **BRA, USA**

(b) Why would a domestic user or an exporter select to receive a marketing certificate over a cash payment? What is the proportion of cash payments vs. marketing certificates granted under the programme? **USA**

111. Does the United States maintain its argument that actions based on Article 3.1(b) of the *SCM Agreement* are conditionally "exempt from actions" due to the operation of Article 13 of the *Agreement on Agriculture*? **USA**

112. In the event that the Panel finds that Article 6.3 of the *Agreement on Agriculture* does not preclude an examination of Brazil's claims under Article 3.1 of the *SCM Agreement* and Article III:4 of *GATT 1994*, how does the United States respond to the merits of Brazil's claims relating to Step 2 payments under those provisions? **USA**

113. Is it necessary for measures directed at agricultural processors included in AMS to discriminate on the basis of the origin of goods? **USA**

114. With respect to the last sentence of paragraph 22 of Brazil's closing oral statement, could Brazil elaborate on the circumstances in which a local content subsidy would comply with Article 3.1(b) of the *SCM Agreement*? **BRA**

115. What is the meaning and relevance (if any) to Brazil's claims under Article 3 of the *SCM Agreement* and Article III:4 of *GATT 1994* of the phrase "measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products" in the *Agreement on Agriculture*? **BRA, USA**

116. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the *Agreement on Agriculture*? Does the phrase "provide support in favour of domestic producers" in Article 3.2 of the *Agreement on Agriculture* refer to, and/or permit such subsidies? **BRA, USA**

117. What is the relationship between Step 2 payments to exporters and the marketing loan payments, both of which appear to compensate for the price differences relative to the Liverpool A-Index? For example, is there double compensation? Or is one of the explanations that these export-related price compensatory payments are paid to different operators (namely, the producer, on the one hand under the marketing loan arrangements, and the processor/users (Step 2 programme) arrangements on the other? **USA**

118. Can the United States confirm that it does not rely on Article III:8 of *GATT 1994*? **USA**

ETI ACT

119. How does the United States respond to Brazil's reference to the panel report in *India - Patents (EC)* (at paragraph 138 of its oral statement at the first session of the first substantive meeting)?[6]

[6]That panel stated: "It can thus be concluded that panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same. In examining dispute WT/DS79 we are not legally bound by the conclusions of the Panel in dispute WT/DS50 as modified by the Appellate Body report. However, in the course of "normal dispute settlement procedures" required under Article 10.4 of the *DSU*, we will take into account the conclusions and reasoning in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we should give significant weight to both Article 3.2 of the *DSU*, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, and to the need to avoid inconsistent rulings

How, if at all, should the Panel take this report into account in considering the issues raised by Brazil's claims relating to the ETI Act? **USA**

120. Concerning its claims on the ETI Act, Brazil relies on the *US – FSC* case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the United States appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here? Could you direct the Panel to any relevant findings or conclusions by the panel or Appellate Body in that case? **BRA**

121. How do you respond to the reference in paragraph 43 of EC third party oral statement with respect to the relevance of Article 17.14 of the *DSU*, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the *DSU*, and please cite any other provisions you consider relevant. **USA, BRA**

[Attachment on questions to Third Parties omitted]

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(which concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the *DSU*." (footnote omitted)

# ANNEX L-1.6

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

30 July 2003

The Panel is in receipt of the communication from the United States, dated 29 July, requesting an extension of the deadline for the submission of the parties' responses to questions, as well as the response from Brazil, dated 30 July.

Taking these communications into account, the Panel has decided to extend the deadline for the submission of the parties' responses to questions from Monday 4 August to **Monday 11 August**. The Panel reminds the parties that paragraph 17(b) of the Panel's working procedures indicates that the responses should be submitted by **17:30** (Geneva time).

The Panel has also decided upon the following additional changes to its schedule:

| | |
|---|---|
| Panel's views on certain issues: | 5 September 2003 |
| Further submission of Brazil: | 9 September 2003 |
| Further submission of the US: | 23 September 2003 |
| Further submission of the third parties (as necessary): | 29 September 2003 |

For the time being, all other dates remain unchanged. This includes the deadline for the submission of the parties' comments on each other's responses, as well as the submission of the parties' rebuttal submissions (i.e. 22 August). It also includes the dates for the resumption of the first substantive meeting (as necessary) and the second substantive meeting (i.e. 7-9 October).

# ANNEX L-1.7

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THE THIRD PARTIES

5 August 2003

1. The Panel has received a letter from the European Commission, dated 31 July 2003, in which the European Communities ("EC"):

- seeks clarification of the Panel's procedures for its expression of views on 5 September 2003 in relation to Article 13 of the *Agreement on Agriculture*; and

- makes two requests for additional third party rights.

2. The Panel sought the views of the parties to the dispute on these requests, which it received in letters dated 1 August 2003. Neither party objects to the Panel communicating its views to the third parties on 5 September 2003, but neither party agrees that the Panel should accept the EC's requests for additional third party rights. The EC responded to the parties' letters in a further letter dated 4 August 2003.

### 1. Panel's procedures for its expression of views on 5 September 2003 in relation to Article 13 of the *Agreement on Agriculture*

3. The Panel confirms that, in accordance with its communication dated 20 June 2003, as amended on 30 July 2003, it intends to express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, to the extent that it is able to do so, by 5 September 2003. Those views will be communicated to third parties, as well as to the parties to the dispute, in order to enable them to participate, as necessary and appropriate, in any second session of the first substantive meeting in a full and meaningful fashion.

### 2. EC requests for additional third party rights

4. The EC requests the following additional third party rights: (a) access to the oral statements of the parties to the dispute at the first session of the first substantive meeting held on 22-24 July 2003, and (b) the opportunity to comment on their responses to the Panel's questions, or questions that they have posed to each other.[1]

5. Third parties have certain rights in panel proceedings under Article 10 of the DSU, which a panel may not deny. The grant of third party rights beyond those provided in the DSU lies within the discretion and authority of a panel. That discretion is limited by the requirements of due process. Article 10.1, 10.2 and 10.3 of the DSU provides as follows:

[1] The Panel notes that the parties to the dispute have not posed any written questions to each other, and therefore does not need to address the request to allow third parties to comment upon the responses to such questions.

*Third Parties*

> "1. The interests of the parties to a dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process.
>
> "2. Any Member having a substantial interest in a matter before a panel and having notified its interest to the DSB (referred to in this Understanding as a "third party") shall have an opportunity to be heard by the panel and to make written submissions to the panel. These submissions shall also be given to the parties to the dispute and shall be reflected in the panel report.
>
> "3. Third parties shall receive the submissions of the parties to the dispute to the first meeting of the panel."

6. In our view, written versions of the parties' oral statements and the parties' responses to the Panel's questions do not form part of "the submissions of the parties to the dispute to the first meeting of the Panel", as provided for in Article 10.3 of the DSU. Articles 10.2 and 12.6 and the working procedure in paragraph 3 of Appendix 3 use the terms "written submissions" and "submissions" interchangeably. Appendix 3 distinguishes between "written submissions" in paragraphs 3, 4 and 10 and "a written version of … oral statements" in paragraph 9. Under the standard panel working procedures set out in Appendix 3 of the DSU, third parties may only attend the third party session and are not present during the rest of the panel's meetings. The granting of access by the Panel to written versions of the parties' oral statements would run counter to the standard practice under the DSU of holding the sessions at which those statements are made in the absence of the third parties.

7. As the Panel indicated in its communication dated 20 June 2003, the first meeting in this dispute is to be held in two separate sessions two months apart, as necessary. The issues under consideration at each session are distinct, so that the written versions of oral statements at the first session cannot be considered submissions to the second session. The Panel's working procedures currently envisage that third parties will receive the parties' written submissions to any second session of the first meeting, and will have an opportunity to present their views at any such session. Thus, with respect to the issues that form the subject of each session of the first meeting, each third party will receive the rights provided for in Article 10.2 and 10.3 of the DSU.

8. Therefore, in our view, third parties have no entitlement under the DSU to the additional rights requested by the EC, and we also note that there is no agreement between the parties that such additional rights should be granted. In any case, the EC indicates in its letter dated 4 August 2003 that this was not the thrust of its requests but, rather, it would be a "reasonable exercise of the Panel's discretion" to allow the third parties also to comment on the responses of the parties to the dispute to the Panel's questions.

9. The Panel must consider whether it should grant such additional rights as part of its duty to ensure due process of law for third parties, or within its discretion to grant or refuse the rights requested as it believes appropriate, keeping firmly in mind the Panel's duty to ensure an objective assessment of the matter before it in accordance with Article 11 of the DSU, and the requirement that the interests of the parties to the dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process, in accordance with Article 10.1.

10. The EC has argued that access to oral statements would permit third parties to respond to arguments made by the parties to the dispute where such a response would be of relevance in answering the Panel's questions to third parties, and that this would benefit the Panel since the third

parties would be able to provide more complete responses to the Panel's questions. It also argues that the third parties' comments on each others' responses to questions will be more full and meaningful, and consequently more beneficial to the Panel, if it is also possible for them to comment on the responses of the parties to the dispute.

11. In addition to the issues raised by the EC, the Panel is keenly aware of the implications of this particular dispute for third parties, including the systemic importance of the interpretation of Article 13 of the *Agreement on Agriculture* and its trade policy impact.

12. In fact, the Panel has already taken into account, to a certain extent, the systemic implications of this dispute and the issues now raised by the EC. The Panel has posed a large number of questions to third parties, including 39 questions addressed specifically to the EC. Through the third parties' responses to these questions, the Panel hopes to receive their views on the merits and systemic considerations presently at issue in this dispute, which it will take into account in its assessment of the matter before it. The questions are detailed precisely to ensure that third parties' views are fully taken into account in what is a complex case. The Panel believes that, through the questions that it has posed to the parties to the dispute and to third parties, it has ensured that it will benefit from third parties' input and that nothing prevents them from participating in a full and meaningful fashion.

13. This is not the only opportunity for third parties to express their views in this dispute. The Panel specifically sought the views of third parties on the issue of whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the Agreement on Subsidies and Countervailing Measures in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. Six third parties, including the EC, made submissions to the Panel on that issue, which the Panel took into account.

14. Nothing precludes the Panel from posing further questions to the parties to the dispute or third parties as the Panel deems necessary or appropriate throughout the course of these proceedings. The Panel may also seek the views of third parties in further questions at any second session of the first meeting that may be held, by posing questions on the issues under consideration at that session.

15. The Panel notes that none of the third parties, including the EC, requested any additional rights prior to the first meeting, even after the Panel's communication of 20 June 2003, in which it announced that the first meeting would be held in two sessions, as necessary. The parties to the dispute therefore delivered their oral statements at that meeting in closed session without third parties present, as is the usual procedure under Article 12 and Appendix 3 of the DSU, on the basis that the confidentiality of those statements was within their own respective control. The Panel is therefore unwilling to direct the parties to grant access to written versions of those statements after the event.

16. The Panel notes that nothing in the DSU or the Panel's working procedures precludes a party to the dispute from disclosing statements of its own positions to the public, as foreseen in Article 18.2 and paragraph 3 of the working procedures, and that the United States has indicated that it makes its oral statements available on its website and has already provided a copy directly to the EC.

17. For the reasons set out above, the Panel denies both the EC's requests for additional third party rights. Nonetheless, in view of the phased nature of the first meeting, the Panel directs the parties to the dispute to make best efforts to ensure that their submissions to any second session of the first meeting are understandable either on their own or in conjunction with the submissions to the first session of the meeting. In particular, such submissions should not refer to any document to which the third parties do not have access without, at the very least, a summary, explanation or description of the contents of that document (or a citation indicating where that document may be found on the public record).

# ANNEX L-1.8

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

19 August 2003

The Panel has received a communication from Brazil dated 14 August 2003 in which Brazil draws attention to the timing and format of service of the United States' responses to the Panel's questions, in light of paragraphs 17(b) and (d) of our Working Procedures, and in which it raises issues of procedural fairness.

The Panel has taken note of the matters raised in the communication from Brazil and draws them to the United States' attention. The Panel recalls that, at its meeting with the parties on 22 July 2003, it also drew the attention of the United States to these issues as raised by Brazil in connection with the filing of the United States' first written submission and comments on Brazil's initial brief.

In its communication dated 14 August 2003, Brazil also requested the right to comment on any new information, arguments or documents presented for the first time in the United States' rebuttal submission with respect to specific questions posed by the Panel. It raised considerations of due process and requested that the Panel provide it until 28 August 2003 to file any such comments without granting the United States any corresponding right.

The Panel has a duty to ensure the fairness of its proceedings, which requires that the parties receive sufficient opportunity to comment on information, argumentation and documents submitted. Due to the phasing of the first meeting, a party might lack sufficient opportunity to comment on such material presented for the first time in a rebuttal submission before the Panel expresses its views on certain issues in dispute. However, this will depend on what the rebuttal submissions actually contain.

Accordingly, when each party receives the other party's rebuttal submission, it is invited, without delay, to draw the Panel's attention to any specific material on which it has not had an opportunity to comment and to show cause why it needs such an opportunity. Upon a showing of good cause, the Panel will permit that party to comment in writing by 27 August 2003. The Panel is willing to grant such permission on Saturday, 23 August 2003, if necessary.

# ANNEX L-1.9

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

23 August 2003

The Panel has received a communication from Brazil dated 23 August 2003 in which Brazil requests the opportunity to comment on specific paragraphs of the United States' rebuttal, and exhibits thereto, as the parties were invited to do by the Panel in its communication dated 19 August 2003.

The Panel considers that Brazil has not had sufficient opportunity to comment on new material specifically listed in its communication of 23 August 2003. The Panel notes that the argument raised in paragraph 123 of the United States' rebuttal is not new but was raised earlier in the United States' response to question 66(d) posed by the Panel and in section 2.3.2 of Brazil's rebuttal.

Accordingly, the Panel permits Brazil to comment in writing on such new material by 27 August 2003. The procedures regarding service of documents set out in paragraph 17 of the Panel's working procedures shall apply.

# ANNEX L-1.10

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

25 August 2003

The Panel has received a communication from the United States dated 25 August 2003 in which the United States requests the opportunity to comment on specific paragraphs of Brazil's rebuttal, and comments on responses to questions, as the parties were invited to do by the Panel in its communication dated 19 August 2003. The Panel has also received a response to that communication from Brazil, also dated 25 August 2003, in which Brazil submits that the United States' request should be rejected.

The Panel considers that the United States has not had sufficient opportunity to comment on new material specifically listed in its communication of 25 August 2003, other than the alleged misstatements in paragraphs 88, 90-94 of Brazil's rebuttal which the Panel can check against the cross-referenced United States' responses and Panel report, if necessary.

Accordingly, the Panel permits the United States to comment in writing on such new material by 27 August 2003. The procedures regarding service of documents set out in paragraph 17 of the Panel's working procedures shall apply.

The Panel notes that the United States welcomes the opportunity to respond to any further questions that the Panel may have. Therefore, the Panel poses the following additional question to the United States and seeks a response by 27 August 2003:

> 67*bis*. Please state the annual amount granted by the US government in each of the 1999, 2000, 2001 and 2002 marketing years (as applicable) to US upland cotton producers, per pound and in total expenditures, under each of the following programs: production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments.

# ANNEX L-1.11

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THIRD PARTIES

5 September 2003

1. On 20 June 2003, the Panel communicated to the parties and third parties that:

> "Given the potential complexity of the claims before us, the conditional nature of certain of these claims and the volume of evidence which may be introduced by the parties in support of their claims and arguments, and in order to organize our proceedings in an orderly, effective and efficient manner which serves to facilitate an objective assessment of the matter before us, and optimizes use of our resources, we have adopted the following modifications to our procedures …"

2. The first modification to our procedures was as follows:

> "The Panel intends to express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, to the extent that it is able to do so, by 1 September 2003, and will defer its consideration of claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as those provisions are referred to in Article 13 of the *Agreement on Agriculture* until after it has expressed those views. The Panel's views may be expressed in the form of rulings which could affect the Panel's further consideration of this dispute."

3. In a fax dated 30 July 2003, the Panel decided to modify the date for expression of its views to 5 September 2003.

4. The Panel takes note of the correspondence from the parties dated 27, 28 and 29 August 2003 and declines to make findings at this stage as to whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, for the reasons given in its communication dated 20 June 2003. The Panel's findings on that issue will be included in its interim report, on which the parties will have the right to comment in accordance with Article 15.2 of the *DSU*.

5. The Panel has now had the opportunity to consider the parties' and third parties' evidence and arguments to date. At this stage, the Panel cannot conclude its assessment of the matter before it on the basis that the measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*. The expression by the Panel of this view is without prejudice to the Panel's eventual findings, and is subject to paragraph 6 below. In this context, the Panel is of the view that consideration, as appropriate, of Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*, as those provisions are referred to in Article 13 of the *Agreement on Agriculture*, is warranted in order for the Panel properly to discharge its responsibilities under the *DSU* and the relevant covered agreements. Therefore, the Panel will consider those claims at a second session of the first substantive meeting.

6. The Panel also wishes to inform the parties that, on the basis of the evidence and arguments presented to date, it is unable to form any view on whether the ETI Act satisfies the relevant provisions of the *Agreement on Agriculture*.

7. Regarding the Panel's procedures:

(a) the Panel invites the parties to address in further submissions, due on 9 and 23 September respectively, the claims referred to in paragraph 5 above;

(b) the Panel also invites the parties to address further the issue whether the export credit guarantee programs at issue constitute export subsidies for the purposes of the *Agreement on Agriculture*;

(c) the Panel confirms that items (o), (p) and (q) of its timetable will be necessary, and confirms the following dates:

| | |
|---|---|
| Further submissions of the third parties: | 29 September 2003; |
| First substantive meeting with the parties (resumed second session) : | 7, 8 and (as necessary) 9 October 2003; |
| Third party session: | **8 October** 2003 [1]; |

(d) the Panel invites the third parties to address in their further submissions the claims referred to in paragraph 5 above;

(e) the Panel intends to postpone the second substantive meeting; and

(f) the Panel invites the parties to comment on the attached draft further revised timetable. Such comments should be submitted no later than close of business on Tuesday, 9 September 2003.

[Attachment omitted]

[1] The Panel wishes to inform parties and third parties that due to the availability of meeting rooms, the third party session, previously scheduled for 9 October, will now be held on Wednesday, 8 October. The Panel will continue its meeting with the parties after the third party session and also on 9 October, as necessary.

# ANNEX L-1.12

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THIRD PARTIES

12 September 2003

Having carefully considered the parties' comments received on 9, 10 and 11 September, the Panel intends to follow the revised timetable, as attached.

In this connection, the Panel would like to inform the United States that the deadline for its "further submission" is **15h00 (i.e. 3 pm) Geneva time** on Monday, 29 September.

The Panel also wishes to draw the attention of **third parties** that the **deadline for their further submissions** has been changed to **3 October**.

In light of the US request for an opportunity to comment on the new dates of the second meeting, now rescheduled to be 2 and 3 December 2003, the Panel invites the US and Brazil to submit comments, if any, on these dates. Such comments, which should focus on the date of the second substantive meeting and other dates directly affected by this date, should be submitted no later than close of business on **Tuesday, 16 September**.

[Attachment omitted]

# ANNEX L-1.13

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THIRD PARTIES

18 September 2003

The Panel has received letters from Brazil and the US dated 16 September and 17 September, in which they submit further comments on certain dates we indicated in our fax dated 12 September.

Having carefully considered the views of both parties, the Panel amends the dates indicated in the 12 September fax as follows:

- The deadline for the receipt of answers to Panel's questions (previously, 22 October) will be changed to **27 October**.

- The deadline for the receipt of further rebuttals of the parties (previously, 3 November) will be changed to **18 November.**

In respect of items (u) and (v), the Panel notes Brazil's preference for "the completion of the parties' main substantive work still in 2003". The Panel reminds the parties that, as indicated in the 12 September fax, items (u) and (v) are deadlines that would apply "as necessary". They may, therefore, depend upon various factors, including the number and nature of any questions the Panel may actually pose to one or both parties at that juncture. Therefore, at least for the time being, the Panel prefers to leave these dates as indicated (22 December and 19 January, respectively).

**All other dates indicated in the fax of 12 September remain unchanged, and are now confirmed.**

# ANNEX L-1.14

## COMMUNICATION TO BRAZIL AND THE UNITED STATES AND THIRD PARTIES

24 September 2003

The Panel has received a letter from the United States dated 23 September, in which it informs the Panel of delays in the preparation of its further submission caused by hurricane Isabel, as well as a response from Brazil, also dated 23 September. Having carefully considered the views of both parties, the Panel further amends the dates we indicated in our fax of 12 September as follows:

deadline for the US's further submission: **30 September, 2003 (by 17:30 Geneva time)**

**All other dates and deadlines** indicated in the fax of 12 September (and subsequently amended in the fax of 18 September) including the deadline for the "further submission from third parties" (3 October), **remain unchanged**.

The Panel notes that the time for the third parties to review the US's "further submission" before making their respective written submissions is limited. The Panel reminds third parties that they are free to present arguments in addition to those set out in their written submissions in their oral statements to be presented on 8 October.

# ANNEX L-1.15

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

13 October 2003

1. Please find attached the Panel's questions to the parties following the resumed session of the first substantive Panel meeting. Parties are reminded that responses are due by **27 October 2003**.

2. The Panel's questions are intended to facilitate the work of the Panel, and do not in any way prejudge the Panel's findings on the matter before it. Nor does the fact that the Panel has placed these questions under certain headings prejudge the Panel's findings on the matter before it. Each party is free to respond to or comment on questions posed to the other parties or third parties.

3. The Panel takes note of Brazil's request in its letter dated 2 October 2003 regarding the late receipt of submissions, and the US response in its letter dated 6 October 2003. In accordance with paragraph 17(b) of the Panel's working procedures, the Panel sets the following time for the provision of submissions by the parties: 11:59 pm, Geneva time on the dates concerned. This time refers to *receipt* of submissions by the other party and the Secretariat and not to commencement of transmission. For greater clarity, this time for receipt of submissions also refers to the time of completion of receipt of any Exhibits and service of all Exhibits (if necessary, electronically) to the other party and to the Secretariat as envisaged in paragraphs 17(a)-(d) of the Panel's working procedures. All other provisions of the Working Procedures remain unchanged. The Panel confirms the dates in the revised timetable, as revised in its communication of 18 September 2003.

4. The Panel has set this time in light of the repeated service of submissions by the United States after 5.30 p.m. and in order to ensure due process and secure a balance between the two parties. The Panel stresses its expectation that the parties will respect all of the rules and procedures set out in the *DSU* and in the working procedures, including the new time set by the Panel above for the dates in question.

5. The Panel takes note of the United States' request in section II of its further submission for three preliminary rulings, regarding interest subsidies and storage payments; cottonseed payments; and export credit guarantees for products other than upland cotton. The Panel is not currently in a position to rule on these issues. The Panel will make rulings as necessary and appropriate in the course of this proceeding and hopes to be in a position to express its views, or give a ruling, on these requests, as appropriate, by 3 November (that is, shortly after the date of receipt of written responses to questions). Meanwhile, the Panel requests the parties not to exclude consideration of these issues in their responses to questions.

Questions from the Panel to the Parties –
Resumed first session of the first substantive Panel meeting

A. REQUEST FOR PRELIMINARY RULINGS

122. Does Brazil allege that cottonseed payments, interest subsidies and storage payments are included in the subsidies that cause serious prejudice? Do they appear in the economic calculations? **BRA**

123. Does Brazil's request for the establishment of the Panel name the statute authorizing cottonseed payments for the 1999 crop? **BRA**

B. EXEMPTION FROM ACTIONS

124. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*? **BRA, US**

C. IDENTIFICATION OF THE SUBSIDIZED PRODUCT

125.

(1) In view of requirements in the FAIR Act of 1996 and the FSRI Act of 2002 that contract acreage remain in agricultural or conservation uses and which impose penalties if the producer grows fruits or vegetables, how likely is it that the producer with upland cotton base acreage will not use his or her land to produce programme crops or covered commodities? **US**

(2) Brazil has submitted that "The record suggests that *historic* producers are *current* producers." It points to factors including the specialization of upland cotton producers, the need to recoup expensive investments in cotton-specific equipment, and the geographic focus and climatic requirements of upland cotton production in the "cotton belt". (Brazil's rebuttal submission, footnote 98, on page 24)

(a) Regarding the specialization of upland cotton producers and the geographic focus of upland cotton production, how does Brazil take account of the fact that cotton is produced in 17 of the 50 states of the United States and that average cotton area is approximately 38% of a cotton farm's acres? (This information is taken from the US's response to question 67*bis*, footnote 35). **BRA**

(b) Regarding the geographic focus of upland cotton production, how many other crops can upland cotton producers viably grow in the cotton belt, other than fruits and vegetables? **US**

(c) Regarding the high cost of upland cotton production, can Brazil show that farms who planted upland cotton could only have covered their costs by receiving upland cotton, rice or peanut payments in every year from 1999 through 2002? **BRA**

(d) Regarding the need to recoup investments in cotton-specific equipment, is it important to planting decisions that upland cotton producers cannot run any other crop through their cotton-pickers? How does this affect the likelihood that they will grow other crops? **US**

(3) In calculating the amount of PFC, MLA, direct and counter-cyclical payments that went on upland cotton, Brazil made an adjustment for the ratio of current acreage to base acreage (see its

answer to question 67, footnotes 2, 3, 4 and 5). Is this an appropriate adjustment for the particular factors referred to above? Why or why not? **BRA, US**

(4) Dr. Glauber has alleged that there are statistical problems in comparing planted acres to programme acres because of abandonment of crops and also because planted acres are only survey estimates, not reported figures (See Exhibit US-24, the first full paragraph in P2). Would it be more appropriate to divide harvested acreage by base acreage? What margin of error is there between the survey estimates and reported figures? **BRA, US**

(5) Do the acreage reports under section 1105(c) of the FSRI Act of 2002 indicate or assist in determining the number or proportion of acres of upland cotton planted on upland cotton base acres? Was there an acreage reporting requirement for upland cotton during MY1996 through 2002? **BRA, US**

(6) Please prepare a chart showing upland cotton base acreage, planted acreage and harvested acreage for MY1996 through 2002. Does the planted acreage fluctuate within a broad band? If not, does this indicate any stability in decisions to plant the same acres to upland cotton? **BRA, US**

(7) Brazil states that one third of all US farms with eligible acreage decided to update their base acreage under the direct payments and counter-cyclical payments programmes using their MY1998-2001 acreage. What is the proportion of the current base acreage for upland cotton resulting from such updating? Is the observed updating of base acreage consistent with Brazil's argument that it is only profitable to grow upland cotton on base acreage (and peanut and rice base acreage)? **BRA**

(8) How could one take account of upland cotton producers who receive PFC, MLA, direct and counter-cyclical payments for other covered commodity base acreage? **BRA, US**

(9) Assuming that Brazil's payment figures were to amount to a *prima facie* case, please answer the following questions: **US**

(a) How would the United States calculate or estimate the proportion of upland cotton producers who receive subsidy payments for upland cotton base acreage?

(b) Should any adjustment estimates be made for any factors besides those listed by Brazil?

(c) What adjustment estimate would it be appropriate to make?

(d) How could one take account of upland cotton producers who receive decoupled payments for other programme crop base acreage?

(e) Could the US specifically indicate what, in its view, are the flaws in the approach summarized in paras. 6-7 of Brazil's closing oral statement[1] on 9 October (i.e. the use of the ration of 0.87 to adjust the amount of total upland cotton direct and CCPs for the MY to obtain the amount of subsidies received by upland cotton producers)? Can the US suggest an alternative approach that would yield reliable results in its view?

[1] All of the paragraph numbers in relation to oral statements (opening statement and closing statement) cited in this document corresponds to the numbering made in the version available to the Panel on the date of the statement.

D. "LIKE PRODUCT"

126. Does the US agree that the product at issue is upland cotton lint and that Brazilian upland cotton lint is "like" US upland cotton lint within the meaning of Article 6.3(c) of the *SCM Agreement* in that it is a separate like product that is identical or has characteristics similar to the upland cotton lint from the United States? (e.g. Brazil's further submission, para. 81) **US**

E. "SUBSIDIES"

127. The Panel notes that the US contests that export credit guarantees constitute "subsidies". The Panel recalls that the US agrees that Step 2 payments are "subsidies" and wishes to have confirmation that it is correct in understanding that the US does not disagree that the following are "subsidies" for the purposes of Article 1 of the *SCM Agreement*: marketing loan/loan deficiency payments, PFC, direct payments, market loss assistance and CCP payments, crop insurance payments, cottonseed payments, storage payments and interest subsidy (without prejudice to the Panel's rulings on the US requests for preliminary rulings on the latter two payments). **US**

F. PROHIBITED SUBSIDIES

128. Could the US respond to Brazil's assertions relating to the meaning and effect of the introductory phrase of Article 3 ("Except as provided in the *Agreement on Agriculture*....")? Would the meaning/effect change if Article 13 of the *Agreement on Agriculture* did not exist? **BRA, US**

G. SPECIFICITY / CROP INSURANCE

129. In the event that the Panel does not consider that the alleged prohibited subsidies fall within the provisions of Article 3 and are therefore, pursuant to Article 2.3, "deemed to be specific", are there any other grounds on which Brazil would rely in order to support the view that such measures are "specific" within the meaning of Article 2 of the *SCM Agreement* (see, for example, fn 16 of Brazil's further submission)? **BRA**

130. Does Brazil agree that the US insurance premium subsidy is available in respect of all agricultural products? Please cite relevant portions of the record. **BRA**

131. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*: **BRA, US**

(a) is a subsidy in respect of all agricultural, but not other, products specific?

(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?

(c) is a subsidy in respect of certain identified agricultural products specific?

(d) is a subsidy in respect of upland cotton, but not other products, specific?

(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?

(f) is a subsidy in respect of a certain proportion of total US farmland specific?

132. Please state the amount and percentage of upland cotton acreage covered by each crop insurance programme and/or policy under the ARP Act of 2000. **US**

133. Concerning Brazil's arguments in its oral statement, para. 7, can the US indicate if any producers of livestock outside a pilot programme are covered by the crop insurance programme? **US**

134. Please state the annual amount of premiums paid or contributions made by US upland cotton farmers relating to each of the crop insurance programmes and/or policies supported by the US Risk Management Agency and the Federal Crop Insurance Corporation in each year from 1992 through 2002. **US**

135. Please state the annual amount of insurance indemnity payments made by the US government; or insurance companies participating in crop insurance programmes and/or policies under the ARP Act of 2000 to upland cotton farmers in each year from 1992 through 2002. **US**

136. Is the US arguing that crop insurance subsidies corresponding to "over 90 per cent of insured cotton area" (US 7 October oral statement, para. 46) in MY1999 through 2002 are consistent with paragraph 8(a) of Annex 2 of the *Agreement on Agriculture*? Is it correct that in the past these subsidies were nonetheless notified to the Committee on Agriculture as non-product specific AMS (see, for example, G/AG/N/USA/43 in Exhibit BRA-47)? **US**

H. EXPORT CREDIT GUARANTEES

137. Please elaborate the meaning of "net losses" as is used in paragraph 70 of Brazil's 7 October oral statement. **BRA**

138. Please comment on Brazil's views stated in paragraph 70 of its 7 October oral statement. **US**

139. In the context of export credit guarantees, is the Panel correct in understanding that Brazil's claims of inconsistency with the *Agriculture Agreement* involve GSM 102, GSM 103 and SCGP, but that it limits its "serious prejudice" allegations in respect of export credit guarantee programmes to the GSM 102 programme, and does not challenge GSM 103 and SCGP in this respect? If so,

(a) could Brazil please explain why it did so, and confirm that all the data relied upon in its further submissions (e.g. in Table 13) relate to the GSM 102 programme rather than to GSM 102, GSM 103 and SCGP (and, if the data needs to be adjusted to take account of a narrower "serious prejudice" focus, supply GSM-102-relevant data)? **BRA**

(b) for the purposes of Article 13(c)(ii) of the *Agreement on Agriculture*, is it necessary for the Panel to examine only GSM 102 or should the Panel's examination include also GSM 103 and SCGP? Why or why not? **BRA**

140. Could Brazil explain how, if at all, it has treated export credit guarantees for the purpose of Table 1 of its further submission? **BRA**

141. The Panel notes the US argument, *inter alia* in its further submission, that the export credit guarantee programmes are "self-sustaining". Recalling that item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* refers to "premium rates", could the US expand upon how it takes into account the premium rates for the export credit guarantee programmes in its analysis. **US**

142. The US has pointed out that there are many limitations on granting export credit guarantees and that there is no requirement to issue any particular guarantee (US further submission, paras 153-

156). Can the Commodity Credit Corporation decline to grant an export credit guarantee even in cases where the programme conditions are met? **US**

143. Brazil agrees with National Cotton Council estimates of the effects of the GSM 102 programmes (Brazil's further submission, para. 190) but it also cites a different conclusion by Prof. Sumner (paragraph 192). Brazil cites other estimates by Prof. Sumner throughout its further submission. Does Brazil adopt Prof. Sumner's conclusions and estimates as part of its submission? **BRA**

I. STEP 2 PAYMENTS

144. Is the Panel correct in understanding that the US does not dispute that Step 2 (domestic) payments are contingent upon import substitution, and that it argues that such measures are permitted due to the operation of the provisions of the *Agreement on Agriculture*? How is that relevant to a claim under Articles 5 and 6 of the *SCM Agreement*? **US**

J. ACTIONABLE SUBSIDIES

145. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Articles 4.7 and 7.8 of the *SCM Agreement*. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the *SCM Agreement* to withdraw the subsidy without delay, can the Panel:

(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? **BRA, US**

(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the *SCM Agreement*? **BRA, US**

146. Brazil acknowledges that there are some interaction effects that may increase or decrease the overall effects of the subsidies (Brazil's further submission, para. 225). How would your analysis under Articles 5(c) and 6.3 of the *SCM Agreement* and Article XVI of *GATT 1994* differ if it excluded, for example, crop insurance subsidies, PFC and/or direct payments? **BRA**

147. Does the US agree that subsidies provided under the marketing loan programme, counter-cyclical payments and market loss assistance are or were more than minimally trade-distorting? If so, please elaborate on the type of effects which are more than minimally trade-distorting within the meaning of Annex 2 of the *Agreement on Agriculture* but less than adverse effects within the meaning of Article 5 of the *SCM Agreement*. **US**

148. How should the significance of price suppression or depression be assessed under Article 6.3(c) of the *SCM Agreement*? In terms of a meaningful effect? Or another concept? **BRA**, **US**

149. What is the meaning of "may" in the chapeau of Article 6.3(c) in the context of Brazil's assertion that there is no need to conduct a distinct analysis of "serious prejudice" under Article 5(c) after having made a finding under 6.3(c) or (d)? (Brazil's further submission, paras 437 ff). How, if at all, are Articles 6.2 and 6.8 relevant in this context? What context should the Panel use for assessing serious prejudice under Article 5(c) of the *SCM Agreement* if the Panel takes the view that Article 6.3(c) and (d) are permissive conditions for a determination of serious prejudice? **US**

150. Is the list in Article 6.3 of the *SCM Agreement* exhaustive, or could serious prejudice arise in circumstances other than those listed in paragraphs (a) through (d)? **US**

151. Where in the text of Article 6.3(d) of the *SCM Agreement* is there a basis to take into account that 1998 may be a "misleading" year for the purposes of comparison? For example, unlike the text of Article XVI:3 of the GATT 1994, there does not seem to be a general reference to "special factors". **US**

152. If the US is correct in asserting that the Article 13(b)(ii) *Agreement on Agriculture* analysis is a year-by-year analysis, how would this affect the Panel's examination of Brazil's claims of serious prejudice, including the three year period and the trend period in Article 6.3(d) of the *SCM Agreement*? **US**

153. Would the conditions in Article 6.3(d) of the *SCM Agreement* be satisfied in respect of time periods other than the one specified? What relevance, if any, would this have for Brazil's claims? **BRA**

154. Does the US agree that upland cotton is a "primary product or commodity" within the meaning of Article 6.3(d) of the *SCM Agreement*? (ref. Brazil's further submission, para. 262) and within the meaning of Article XVI:3 of the GATT 1994? **US**

155. Please respond to Brazil's identification of the seven-year period beginning with MY1996 (following the passage of the FAIR Act of 1996) as the "most representative period" for the purposes of Article 6.3(d)? (ref. Brazil further submission, para. 269) **US**

156. Does the US agree that "...footnote 17 [of the SCM Agreement] does not carve out upland cotton from the scope of Article 6.3(d) of the SCM Agreement"? (ref. Brazil further submission, para. 275). **US**

157. Does the reference to "trade" in footnote 17 of the *SCM Agreement* have any impact on the interpretation of "world market share" in Article 6.3(d)) If so, what is it? **US**

158. Please respond to Brazil's assertion that "...the absence of any payment, production or expenditure limitations in the US marketing loan programme is analogous to the EC sugar regime that was challenged in *EC – Sugar Exports II (Brazil)* and *EC – Sugar Exports I (Australia)*." (ref. Brazil further submission, para. 317) **US**

159. The EC, in its oral statement (paras 9 and 10), disagrees with the US interpretation of the terms "same market". Can the US comment on the EC's view? **US**

160. Without prejudice to the meaning of "world market share" as used in Article 6.3(d) of the *SCM Agreement*, can you confirm the world export share statistics provided in Exhibit BRA-206? **US**

161. Would a finding of serious prejudice under Article 5(c) of the *SCM Agreement* be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the *SCM Agreement* in this context? **BRA, US**

162. Can the US confirm that marketing loan/LDP, step 2 and counter-cyclical payments are mandatory if the price conditions are fulfilled? **US**

163. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ? **US, BRA**

K. CAUSATION

164. When the US points, in its oral statement of 7 October, to the alleged "bias" of Prof. Sumner's model, is it arguing that US subsidies are irrelevant to the movement in prices and production (acreage) of upland cotton? **US**

165. Please comment (and submit substantiating evidence) on the US assertion that the FAPRI model has been designed and developed for prospective analysis, and is not suitable for retrospective counterfactual analysis. What is the reliability of past FAPRI-produced analyses when compared with actual data for the period covered by them? Is there any other instrument that can be used to try to identify the effect of subsidies already granted, or of their removal? **BRA, US**

166. The US states that "futures prices demonstrate that market participants predict increasing upland prices over the course of the marketing year" (US 7 October oral statement, para. 62). Please elaborate on this argument including citing specific futures prices. **US**

167. How does Brazil react to Exhibit US-44? **BRA**

168. Please confirm that the production figures cited in Exhibit US-47 are for upland cotton only and do not include textiles. **US**

169. Can the US confirm the accuracy of the facts and figures cited in the four bullet points in paragraph 12 of Brazil's 7 October oral statement? **US**

170. Brazil quotes a report that states that a 10% increase in soybean prices reduces upland cotton acreage by only 0.25% (Brazil's 7 October oral statement, para. 27). Could Brazil indicate if this analysis is done on a short-run basis or a long-run basis? **BRA**

171. In paragraphs 22 and 23 of its further submission, we understand that the US is, in short, claiming that increased total supply (i.e. including polyester) drove prices down. On the other hand, we note that, according to the figures in the chart in paragraph 22 of the same submission, the world production of cotton during this period has basically been steady. Do all polyester fibres as represented by these figures compete directly with cotton? That is to say, do these figures for polyester fibres include, for example, those that are used for textiles that technically cannot be substituted by cotton? **US**

172. Please estimate the price effect, in cents per pound, of the growth in the US retail market which it is said has directly contributed to strengthening world cotton prices. **US**

173. The US asserts that "burgeoning US textile imports … shifted the disposition of US cotton production from domestic mills to export markets" (US further submission, para. 20). A similar description appears in paragraph 33, together with the explanation that "the share of world cotton consumption supplied by US cotton has been roughly the same since 1991/92". Why have sales of US cotton for export increased and sales of cotton imported into the US increased? **US**

174. How, if at all, did the Asian financial crisis affect the United States' world market share? Did it disproportionately affect the US as compared to other exporters? **US**

175. With reference to paragraphs 57-58 and the related table on page 21 of the US further submission, could you please clarify the arguments regarding the ratio of the soybean futures to the cotton futures prices since in the table the inverse ratio is used? **US**

176. With reference to Figure 4 of Brazil's Further Submission, how does Brazil explain the apparent decrease in prices in 2001 and the increase of the A-Index in recent months, despite the continued use of US subsidies on upland cotton? **BRA**

177. Could the United States further elaborate on paragraph 50 of its 7 October oral statement? **US**

178. The Panel notes Exhibit US-63. Could the US please provide a conceptually analogous graph concerning US export sales during the same period? **US**

179. Could Brazil comment on the argument that decoupled payments and other subsidies to upland cotton are largely being capitalized into land values and that removing these subsidies would reduce the cost of production of upland cotton producers (US 7 October oral statement, para. 48). What would be the net effect of these adjustments? **BRA**

180. Please describe the precise formula as to how USDA determines the "adjusted world price" using the Liverpool A-Index, the NY futures price and any other relevant price indicators. Please submit substantiating evidence. **BRA, US**

181. Please provide a side-by-side chart of the weekly US adjusted world price, the Liverpool A-Index, the NY futures price, and spot market prices from 1996-present. What, if anything, does this reveal? **BRA, US**

182. Please explain why the US can be taken to be price *leaders*, or price *setters*, (and not just takers) when US producers receive large subsidy payment to support the difference between *world prices* and their own costs? **BRA**

## L. ARTICLE XVI OF GATT 1994

183. Why does Brazil believe that the appropriate "previous representative period" is the term of the previous Farm Bill, MY1996-2002? (Brazil's further submission, para. 282) **BRA**

184. Why does Brazil believe that an "equitable share" is one which factors out all subsidies? To the extent that domestic support and export subsidies are permitted by the *Agreement on Agriculture*, why should they not be accepted as being normal conditions in analyzing an equitable market share? (See Brazil's further submission, paras 288-289) **BRA**

185. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the *Agreement on Agriculture* and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the *SCM Agreement*. **BRA, US**

(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions of the *Agreement on Agriculture*, relevant?

(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the *SCM Agreement*, or in any other

provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in *US-FSC*, para. 117[2] here?

(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the *SCM Agreement* and the prohibition on subsidies contingent upon export in Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?

186. Could the United States please expand upon its statement that "[t]hese are the types of considerations that led to the negotiation of the Subsidies Agreement...." (US further submission, para. 109)? Is there any relevant material, including, for example, drafting history that might support this statement? **US**

M. THREAT CLAIMS

187. Please provide USDA's projections of marketing loan/LDP payments, direct payments and counter-cyclical payments to be made during MY2003 through 2007 based on the most recent USDA baseline projection. **US**

[2] WT/DS108/AB/R, para 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market." In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* must clearly take precedence over the *exemption* of primary products from export subsidy disciplines in Article XVI:4 of the GATT 1994."

188. Can the United States comment on the FAPRI projections for cotton provided in Exhibit BRA-202? **US**

N. CLARIFICATIONS

189. Please indicate whether the correct figure in paragraph 37 of Brazil's 7 October oral statement is 38.1% or 38.3%? **BRA**

190. Please confirm that the figure "17.5" in paragraph 43 of Brazil's 7 October oral statement, is "percentage point". **BRA**

191. Brazil clarify its statement in para. 12 of its 9 September further submission: "Alternatively crop insurance is **not specific** because the 2000 ARP Act denies benefits to commodities representing more than half of the value of US agriculture. Further US crops represent only 0.8 per cent of total US GDP." (emphasis added) **BRA**

# ANNEX L-1.16

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

3 November 2003

1. The Panel recalls that paragraph 5 of its 13 October 2003 communication reads as follows:

> "The Panel takes note of the United States' request in section II of its further submission for three preliminary rulings, regarding interest subsidies and storage payments; cottonseed payments; and export credit guarantees for products other than upland cotton. The Panel is not currently in a position to rule on these issues. The Panel will make rulings as necessary and appropriate in the course of this proceeding and hopes to be in a position to express its views, or give a ruling, on these requests, as appropriate, by 3 November (that is, shortly after the date of receipt of written responses to questions). Meanwhile, the Panel requests the parties not to exclude consideration of these issues in their responses to questions."

2. Accordingly, please find attached a communication from the Panel.

Panel's views on the preliminary ruling requested by the United States
in its further written submission of 30 September 2003

1. In its further written submission of 30 September 2003, the United States requests a preliminary ruling that:

(1) Brazil may not advance claims under either Article 4 or Article 7 of the *SCM Agreement* with respect to export credit guarantee measures relating to eligible US agricultural commodities other than upland cotton, because it did not include a statement of available evidence with respect to these measures as required by Articles 4.2 and 7.2 of the *SCM Agreement*;

(2) cottonseed payments made for the 1999 and 2000 crops are not within the Panel's terms of reference; and

(3) storage payments and interest subsidies referred to as "other payments" for upland cotton are not within the Panel's terms of reference.[1]

2. Brazil asks the Panel to reject the United States' request. In respect of item (1), Brazil asserts that the US request is not new and is untimely, groundless and "mooted by" the Panel's 25 July communication indicating that the Panel intended to rule that export credit guarantees to facilitate the export of US upland cotton and other eligible agricultural commodities are within the Panel's terms of reference.[2] Brazil asserts that items (2) and (3) are properly within the Panel's terms of reference.[3]

3. The Panel wishes to indicate to the parties how it intends to rule on items (1) and (2), in order to assist them in deciding what argumentation and evidence to submit in their further rebuttal submissions.

4. With respect to item (1), assuming *arguendo* that the US request was timely,[4] the Panel intends to rule in its report that Brazil provided a statement of available evidence with respect to export credit guarantee measures relating to eligible US agricultural commodities other than upland cotton, as required by Articles 4.2 and 7.2 of the *SCM Agreement*. As previously indicated in the Panel's communication of 25 July 2003, the Panel also intends to rule that "export credit guarantees … to facilitate the export of US upland cotton, and other eligible agricultural commodities" as addressed in document WT/DS267/7, are within its terms of reference.

5. With respect to item (2), the Panel intends to rule that cottonseed payments made under Public Laws 106-224 and 107-25 (in respect of the 2000 crop) are within its terms of reference, but that cottonseed payments made under Public Law 106-113 (in respect of the 1999 crop) are not within its terms of reference. This is without prejudice to the relevance, if any, of the cottonseed payments in respect of the 1999 crop to the conditions set out in Article 13(b) of the *Agreement on Agriculture*.

[1] US Further Written Submission, Sections II and XIII.
[2] Brazil's Oral Statement at the Resumed First Substantive Meeting, paragraphs 73-78.
[3] Brazil's Oral Statement at the Resumed First Substantive Meeting, paragraphs 79-81.
[4] The Panel recalls paragraph 12 of its working procedures but, in light of its intended ruling, does not need to address the issue of timeliness here.

6. The Panel has not yet decided upon its approach to item (3) and asks the parties not to exclude consideration of these other payments in their further rebuttal submissions.

# ANNEX L-1.17

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

14 November 2003

1. The Panel takes note of the United States' written request of 14 October 2003 for certain information relating to the quantitative simulation model used by Dr. Sumner in his analysis presented in Annex I to Brazil's 9 September 2003 further written submission. The Panel also takes note of the parties' related communications dated 5, 11, 12 and 13 November 2003, and the submissions by Brazil on 12 and 13 November 2003.

2. The Panel confirms the dates in its existing timetable, subject to the following.

3. The Panel does not require the parties' 18 November further rebuttal submissions, nor their oral statements during the second Panel meeting, to address the methodology, equations or parameters underlying the quantitative modelling simulation in Annex I to Brazil's further written submission which are directly linked to the information requested by the United States on 14 October 2003 and the submissions by Brazil on 12-13 November 2003. Having said this, the parties are not precluded from doing so.

4. Mindful of the requirements of Article 12.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* and in keeping with its duty to conduct an objective assessment of the matter before it, the Panel invites the United States to submit, on 22 December, in conjunction with its responses to any questions following the second Panel meeting, any comments that it may have on Brazil's submissions of 12-13 November 2003. Brazil may submit any comments on any such US comments by 12 January 2004, and the United States may submit any further comments by 19 January 2004. If necessary, at the discretion of the Panel, a further Panel meeting with the parties may be held to address this specific material.

5. This decision is without prejudice to the relevance and significance which the Panel may ascribe to the quantitative simulation model and related evidence and argumentation in its report.

6. Finally, the Panel wishes to ask the United States to respond, by 22 December, to the following:

> Is the Panel correct in understanding that the US government (including the United States Department of Agriculture) does not have a license or any other form of permission (standing or otherwise; free of charge or otherwise) to run, electronically, the FAPRI/CARD model and/or Professor Sumner's adaptations thereto?

# ANNEX L-1.18

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

8 December 2003

1. Please find attached:

- a communication from the Panel concerning its views on one of the preliminary ruling requests from the United States.

- a communication from the Panel concerning the FAPRI model, the essence of which was communicated to the parties by the Chairman of the Panel on 3 December 2003. As indicated therein, any US comments are due by **22 December**. Brazil will be given until **12 January 2004**, to comment on the US comments.

- the questions from the Panel. As was indicated earlier, responses to these questions are to be submitted by **22 December**.

2. As stated by the Chairman on 3 December, the United States will be given until **18 December** to respond to Brazil's request made in Exhibit BRA-369. Brazil will be given until **12 January 2004**, to comment on the US response.

3. The parties may submit any further comments on each other's comments by **19 January 2004**.

Panels' views on the preliminary ruling requested by the United States regarding the Agricultural Assistance Act of 2003

7. The United States requests a preliminary ruling that any measure under the Agricultural Assistance Act of 2003, including a cottonseed payment under that Act, is not within the Panel's terms of reference.[1]

8. Brazil asserts that that Act is properly within the Panel's terms of reference and asks the Panel to reject the United States' request.[2]

9. The Panel wishes to indicate to the parties how it intends to rule on this item in order to assist them in deciding what argumentation and evidence to submit in their answers to questions.

10. The Panel intends to rule that cottonseed payments made under the Agricultural Assistance Act of 2003 are not within its terms of reference. This is without prejudice to the relevance, if any, of those cottonseed payments to the conditions set out in Article 13(b) of the *Agreement on Agriculture*.

11. The Panel notes that it has not expressed a view concerning the United States' request for a preliminary ruling that storage payments and interest subsidies referred to as "other payments" for upland cotton are not within the Panel's terms of reference.[3] The Panel has not yet decided upon its approach to this item and asks the parties to respond to its written questions relevant to these payments, and not to exclude consideration of these payments in their answers to other questions.

[1] US First Written Submission, paras 217, 218; US Further Submission, para. 8.

[2] Brazil's Oral Statement at the first session of the First Substantive Meeting, para. 145; Brazil's Response to Panel Question No. 17 and comments on US Response to Panel Question No. 17.

[3] US Further Written Submission, Sections II and XIII.

Panels' communication concerning the FAPRI model

1. The Panel has been advised by Brazil that, to the best of Brazil's knowledge and belief, all of the information used by FAPRI to generate the various results presented in Brazil's submissions concerning the effects of the subsidies, and their removal, has been provided to the US in an electronic format. Conceptually speaking, the information is in two parts: (a) the model used as the basis for generating the results ("the FAPRI model"), and (b) adaptations to the model and other specific pieces of information which effect the calculations made by the model ("the Brazil information"). FAPRI has possession of the FAPRI model and the Brazil information. Brazil only has possession of the Brazil information. Brazil instructed FAPRI as to the use of the Brazil information that FAPRI then used to generate the various results presented by Brazil to the Panel.

2. We say that the US has all of the information (ie both the FAPRI model and Brazil's information) "to the best of Brazil's knowledge and belief" because Brazil itself has never had access to all of the data comprising the FAPRI model, which is voluminous. FAPRI considers the model to be its own work product. At the request of Brazil, FAPRI has made all of the information available to the US. Why it has done this in the case of the US, but not Brazil, relates to the relationship (commercial or otherwise) between FAPRI (which receives US funding for its work) and the US Government. FAPRI has provided all of the information to the US on the express stipulation that the model not be provided to the Panel or Brazil ("the FAPRI stipulation").

3. At para 74 of its Opening Statement at the Second Panel Meeting, the US asks this of the Panel:

> "[W]hether it intends the United States to comment on this new model, documentation, and results by the original 22 December deadline to file comments on the methodology underlying the Annex I model."

4. During the Second Panel Meeting, Brazil advised the Panel that it had no objection, then, to the US looking at the information provided to it by FAPRI, notwithstanding the FAPRI stipulation. The Panel acknowledges this, but also notes that it would be open to Brazil to reconsider its position depending on anything that the US may wish to present to the Panel about the FAPRI model.

5. The Panel's view in these circumstances is that the US should comment on the FAPRI model, if it believes that it needs to do so in the interests of presenting its case to the Panel, by **22 December**. The FAPRI stipulation does not, in the Panel's view, affect the Panel's ability to make an objective assessment of the matter before it in the terms of Article 11 of the DSU. The Panel will assess the reliability and relevance of the FAPRI model on the basis of the evidence presented to it by the parties.

6. Brazil will be given until **12 January 2004**, to comment on the above US comments.

Questions from the Panel to the Parties –
second substantive Panel meeting

A. TERMS OF REFERENCE

192. Regarding the interest subsidies and storage payments listed by the United States in its response to the Panel's Question No. 67:

(a) Please provide a copy of the regulations under which they are currently provided and under which they were provided during the marketing years 1996-2002;

(b) Please indicate whether there are any such payments which are not provided to implement the repayment rate for upland cotton within the marketing loan programme. **USA**

193. Are interest subsidies and storage payments already included in the amounts shown in your submissions to date for payments under the marketing loan programme? Has there been any double-counting? **BRA**

194. Does the United States maintain its position stated in response to the Panel's Question No. 67 that "it would not be appropriate for the Panel to examine payments made after the date of panel establishment"? If so, please explain why. Can Brazil comment on this statement? **BRA, USA**

B. ECONOMIC DATA

195. Does the United States wish to revise its response to the Panel's Question No. 67*bis*, in particular, its statement that "the United States ... does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers"? Did the United States make enquiries of the FSA in the course of preparing its original answer? **USA**

196. Please provide the latest data for the 2002 marketing year on payments under the marketing loan, direct payments, counter-cyclical payments, user marketing certificate (step 2) programmes and export credit guarantee programmes. **BRA, USA**

197. Please provide actual data for 2002/2003 for US exports, US consumption and per cent of world consumption to replace the projected data in Exhibit US-47. If available, please provide projected data for 2003/2004 to replace the forecast data. **USA**

198. Please comment on the respective merits of the price-gap calculations of MY1992 deficiency payments in US comments of 27 August, footnote 14 ($867 million), and Brazil's response to the Panel's Question No. 67 ($812 million). **BRA, USA**

199. What is the composition of the A-Index? We do note footnote 19 and, for example, Exhibit BRA-11, but please explain more in detail how this index is calculated. **BRA**

200. Concerning the chart on page 37 of Brazil's further rebuttal submission, why did Brazil use a futures price at planting time? Is this a relevant measure for assessing acreage response? **BRA**

201. Is data available to show the proportion of US upland cotton production sold under futures contracts, and the prices under those contracts, at different times during the marketing year? If so,

please provide summarized versions to the Panel. How does a futures sale impact the producer's entitlement to marketing loan programme payments? **BRA, USA**

202. Concerning paragraph 7 of the US oral statement, are the expected cash prices shown for February only? Can the US provide the prices for January and March of each year as well? **USA**

203. Please provide information concerning the organization, mandate, credentials and standing of FAPRI. **BRA**

204. Which support to upland cotton is not captured in the EWG data referred to in Brazil's 18 November further rebuttal submission? **BRA**

205. Does the United States accept or agree with the EWG data submitted by Brazil? If not, please explain your reasons. **USA**

206. Please explain how the graph in paragraph 40 of the US further rebuttal submission was derived. In so doing, please clarify whether the figures are on a cents per pound basis or some other basis. What averaging method was used? Can you prepare individual charts showing average US and Brazilian cotton prices for each of those third country markets? **USA**

207. Please indicate whether any of the measures challenged in this dispute *obliges* cotton farmers to harvest their crop in order to receive the benefit of the programme (subsidy). **USA**

208. Please provide data for the marketing years 1992 and 1999-2002 of the "quantity of production to receive the applied administered price" (*Agreement on Agriculture*, Annex 3, paragraph 8) for purposes of a price-gap calculation of support through the marketing loan programme. **USA**

209. It is understood that the data in the graph in paragraph 5 of the US oral statement are as at harvest time, while the data in the graph in paragraph 39 of Brazil's oral statement are as at planting time. Please explain why the trend of US acreage increase/decrease differs between these two graphs. **BRA, USA**

210. Are worldwide planted acreage figures available? **BRA, USA**

211. Brazil presents a graph in paragraph 59 of its further rebuttal submission indicating the increasing cumulative loss incurred by cotton producers. Please comment on the argument that US cotton producers could not continue operating without subsidies. In particular:

(a) to what extent does the use of 1997 survey technological coefficients with annually updated values affect the results?

(b) to what extent do producers base planting decisions on their ability to cover operating costs but not whole farm costs? **USA**

212. Brazil states in paragraph 37 of its oral statement that studies of Westcott and Price found that the effect of the programme on cotton is to add an additional 1 to 1.5 million acres during marketing years 1999-2001 and to suppress US prices by 5 cents per pound. Does the US reject these findings? Why or why not? **USA**

213. What differences, if any, can be observed in the results of econometric models in the literature which use lagged prices and those which use futures prices to analyse the effect of prices on planting decisions? **BRA, USA**

C. DOMESTIC SUPPORT

214. Please provide a copy of regulations regarding the marketing loan programme and loan ..... deficiency payments published at 58 Federal Register 15755, dated 24 March 1993. What does this regulation indicate about the target price? **USA**

215. Please expand or comment on the statement at paragraph 91 of the US further rebuttal submission that the counter-cyclical target price ceases to be paid when the farm price rises above 65.73 cents per pound. In this scenario, should the Panel disregard Direct Payments? **BRA, USA**

216. How many times have upland cotton producers been able to update their base acres since 1984? How do upland cotton producers come to note the possibility of future updating? Please provide examples of relevant material. **BRA, USA**

217. What is the reason for reducing payments under the PFC and direct payments programmes for planting and harvesting fruit, vegetables and wild rice on certain base acreage? Please comment on the statements by the European Communities that "the reduction in payment for fruit and vegetables, if the EC understands correctly, is in fact designed to avoid unfair competition within the subsidising Member." (EC oral statement at first session, first substantive meeting, paragraph 29) and "To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition (…)" (EC response to Panel third party Question No. 5). **USA**

218. Please comment on the testimony of USDA Chief Economist Keith Collins cited in paragraph 36 of Brazil's oral statement regarding the trade-distorting and production-distorting nature of the marketing loan payments. **USA**

D. EXPORT CREDIT GUARANTEES

219. Under the *Agreement on Agriculture* the general position is that the use of export subsidies, both those listed in Article 9.1 as well as those within the scope of Article 1(e) which are not so listed, may only be used within the limits of the product specific reduction commitments specified in Part IV of Members' Schedules. One might therefore have expected that Article 3.3 of the *Agreement on Agriculture* would have prohibited the use of both listed and non-listed export subsidies in excess of reduction commitment levels in the case of scheduled products and, in the case of non-scheduled products, would have simply prohibited the use of any export subsidy. Instead, the Article 3.3 prohibition is limited in both cases to export subsidies listed in Article 9.1. What significance, if any, does this contextual aspect have for how Article 10.2 might be interpreted having regard, *inter alia*, to:

(a) the fact that export performance-related tax incentives, which like subsidised export credit facilities were considered as a possible candidate for listing as an Article 9.1 export subsidy in the pre-December 1991 Draft Final Act negotiations, have been held (for example, in *United States – Tax Treatment for Foreign Sales Corporations*, WT/DS108) to be subject to the anti-circumvention provisions of Article 10.1; and

(b) the treatment of international food aid and non-commercial transactions under Article 10? **USA**

220. What will be the relevance of Articles 9 and 10.1 of the *Agreement of Agriculture* to export credit guarantees when disciplines are internationally agreed? **BRA**

221. In respect of the table in paragraph 161 of the US August 22 rebuttal submission (concerning the cohort specific treatment of export credit guarantees), the Panel notes the subsequent US agreement (footnotes 82 and 96 in US further submission of 30 September 2003; footnote 160 in US 18 November further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August 2003 comments on US rebuttal submission) that the total figure net of re-estimates should be $230,127,023 instead of the figure which originally appeared ($381,345,059).

(a) Please submit a corrected table reflecting all of the necessary information to produce this result, to the extent this is possible for the reasons indicated in footnote 96 in US further submission of 30 September 2003.

(b) Please clarify whether and how the Panel should treat the figures in Exhibit BRA-182 for the net lifetime re-estimates for each respective cohort.

(c) The Panel notes that the CCC 2002 financial statement in Exhibit BRA-158 refers to annual "administrative" expenses of $4 million, and that the US has also referred to this figure in its submissions (e.g. US first written submission, paragraph 175). Please confirm whether the figures in the table in paragraph 161 of the US August 22 rebuttal submission (or a corrected version thereof) includes "administrative expenses", of approximately $4 million per year over the period 1992-2002, and explain why (or why not) this affects the substantive result.

(d) Please identify what is considered an "administrative expense" for this purpose.

(e) The Panel notes the US statement in paragraph 160 of its answers to Panel questions following the first meeting that all cohorts are still open although the 1994 and 1995 cohorts will close this year. Is this still an accurate statement? If not, please indicate whether any cohorts have since "closed" for the period 1992-2002.

(f) The Panel notes the current "high" figures for 1997 and 1998 indicated in the original US chart. Pending their confirmation and/or updating by the US, why does the US assert that a cohort will *necessarily* reach a "profitable" result (for example, the 1994 cohort, which has almost closed still indicates an outstanding amount)? Do "re-estimates" reflect also expectations about a cohort's future performance?

(g) Why should the Panel "eliminate" the 2001 and 2002 cohorts from its examination, as suggested in paragraph 198 of the US further rebuttal submission?

(h) Why should the Panel "eliminate", in addition, the 2000 cohort, as also suggested in paragraph 198 of the US further rebuttal submission for which information is presumably more "complete"?

(i) Under the US approach, at what point in time could a Panel ever make an assessment of the programme, if it had to wait for each cohort to be completed before it could be "properly" assessed? Why is it inappropriate for the Panel to include these "most recent years" in its evaluation, as the US suggests in paragraph 199 of its 18 November further rebuttal submission? **USA**

222. For GSM 102, 103 and SCGP, please provide year-by-year amounts from 1992 to 2003 with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes. Please indicate any allocation methodologies used to calculate administrative costs. **USA**

223. Are the premium rates applicable to GSM 102, 103 and SCGP subject to regular review as to their adequacy in enabling the operating costs and losses associated with these programmes? If so, what criteria or benchmarks are taken into consideration for this purpose? Secondly, how do the premium rates applied compare with the implicit cost of forfaiting transactions and with premiums for export credit insurance? **USA**

224. Please indicate how the CCC's cost of borrowing was treated in the 2002 financial statement of the CCC, in Exhibit BRA 158. **USA**

225. Please indicate whether there was any instance where the CCC "wrote off" debt and, if so, please indicate the accounting regulation or principle used. If a "written off" debt is subsequently recovered, do the CCC's accounts reflect both the interest cost and interest received in relation to the debt during the time it was "written off"? **USA**

226. If a debt was "written off" more than ten years ago, does it still create a cost to the programme? If so, how is this reflected in the 2002 financial statement of the CCC, in Exhibit BRA 158 (or any other material)? **USA**

227. The United States has indicated that Brazil continues to "mischaracterize" the amount of $411 million in the 2002 financial statement of the CCC, in Exhibit BRA 158, pp. 18 & 19. Can the United States please indicate how it believes this amount – referred to on p. 19 of the Exhibit as "Credit Guarantee Liability-End of Fiscal Year" - should be properly characterized? How, if at all, does it represent CCC operating costs or losses? **USA**

228. What accounting principles should the Panel use in assessing the long-term operating costs and losses of these three programmes? For example, if internal US Government regulations require costs to be treated differently to generally accepted accounting principles, is it incumbent on the Panel to conduct its analysis in accordance with that treatment? **BRA, USA**

E. SERIOUS PREJUDICE

229. What is the meaning of the words "may arise in any case where *one or several* of the following apply" (emphasis added) in Article 6.3 of the *SCM Agreement*? Please comment on the possibility that these words indicate that one of the Article 6 subparagraphs may not be sufficient to establish serious prejudice and that serious prejudice should be considered an additional or overriding criterion to the factors specified in the subparagraphs. **BRA**

230. Please comment on Brazil's views on Article 6.3 of the *SCM Agreement* as stated in paragraphs 92-94 of its further submission. **USA**

231. Do you believe that the now-expired Article 6.1 and/or Annex IV of the *SCM Agreement* are relevant context for the Panel's interpretation of Article 6.3? **USA**

232. How, if at all, should the Panel take into account the effects of other factors in its analysis of the effects of US subsidies under Article 6.3? If the Panel should compare the effects of other factors to establish the relative significance of one compared to others, how would this be done? What would be relevant “factors” for this purpose? **BRA**

233. In Brazil's view, what is or are the "same market(s)" for the purposes of Article 6.3(c)? Does Brazil's view of "world market" imply that regardless of which domestic (or other) "market" is examined, price suppression will be identifiable? **BRA**

234. Does "significant" price suppression under Article 6.3(c) necessarily amount to "serious" prejudice within the meaning of Article 5(c)? Could the level of "significance" of any price suppression under Article 6.3(c) determine whether any prejudice under Article 5(c) rises to the level of "serious prejudice"? **USA, BRA**

235. Please comment on paragraphs 8, 9 and 10 of the US 2 December oral statement, in particular, why the average Brazilian price is shown as lower than the average US price. **BRA**

236. The Panel notes Exhibit US-47 (and the chart in paragraph 13 of the US 2 December oral statement). Please provide a conceptually analogous chart to Exhibit US-63 with respect to data relating to the US interpretation of "world market share". **USA**

237. Could a phenomenon that remains at approximately the same level over a given period of time be considered a "consistent trend" within the meaning of Article 6.3(d)? Do parties have any suggestions as to how to determine a "consistent trend", statistically or otherwise? **BRA, USA**

238. According to the US interpretation of the term "world market share":

(a) should the domestic consumption of closed markets be added into the denominator?

(b) if US production and consumption increased by the same percentage, whilst the rest of the world's production and consumption remained steady, would this imply an increase in the US "world market share" by a different percentage?

(c) does Saudi Arabia have a small world market share for oil? **USA**

239. How does the US respond to Brazil's assertions that, under the US interpretation of the term "world market share":

(a) there would be no WTO disciplines on production-enhancing subsidies that increase a Member's world market share of exports? (see paragraph 64 of Brazil's 2 December oral statement);

(b) a Member's exports would have to be disregarded in calculating their "world market share" in terms of "world consumption"? (see e.g. paragraph 65 of Brazil's 2 December oral statement) **USA**

240. Does Article XVI:3 of GATT 1994 provide context in interpreting Article 6.3(d) of the *SCM Agreement*? Do these provisions apply separately? If not, could it indicate that "world market share" is intended to mean the same as "share of world export trade"? **USA**

241. How does the US reconcile its data on consumption for 2002 in US Exhibit 40, Table 1 with the "consumption" data it refers to in its 30 September submission, paragraph 34, Exhibit US-47 or US-71? **USA**

242. How much of the benefits of PFC, MLA, CCP and Direct Payments go to land owners? If not all of the benefits go to land owners, what proportion goes to producers? **USA**

243. Can the Panel assume that any support at all, even marketing loan programme payments, benefits upland cotton if an upland cotton producer has other agricultural production besides upland cotton? **USA**

244. What proportion of the 2000 cottonseed payments benefited *producers of upland cotton*, given that payments were made to *first handlers*, who were only obliged to share them with the producer to the extent that the revenue from sale of the cottonseed was shared with the producer? (see 7 CFR §1427.1104(c) in Exhibit US-15). **BRA**

245. Can a panel take Green Box subsidies into account in considering the effects of non-Green Box subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? **BRA, USA**

246. Can a panel take prohibited subsidies into account in considering the effects of subsidies in an action based on Articles 5 and 6 of the *SCM Agreement*? **BRA, USA**

247. Can the Panel take into account trends and volatility in market and futures prices of upland cotton after the date of establishment of the Panel? If so, how do they affect the analysis of Brazil's claim of a threat of serious prejudice? **BRA, USA**

F. STEP 2

248. In respect of the level of Step 2 payments in certain time periods, the Panel notes, *inter alia*, footnote 129 in the US first written submission; footnote 33 in the US 18 November further rebuttal submission; and Exhibit BRA-350. Have Step 2 payments ever been zero since the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002? In what circumstances could a Step 2 payment be zero? How does the elimination of the 1.25 cent per pound threshold in the FSRI Act of 2002 affect your response? **BRA, USA**

249. The Panel notes that the definition of eligible "exporter" in 7 CFR 1427.104(a)(2) includes "a producer":

(a) How does this reconcile with Brazil's argument that Step 2 "export payments" do not directly benefit the producer?[4] How, if at all, would this be relevant for an analysis of the issue of export contingency under the *Agreement on Agriculture* or the *SCM Agreement*? **BRA**

(b) How does this reconcile with Dr. Glauber's statement in Exhibit US-24, p. 3 (referring to "the 1990 Farm Bill and subsequent legislation") that Step 2 payments do *not* go directly to the producer? **USA**

(c) What proportion of Step 2 "export payments" go to producers? Please supply supporting evidence. **USA**

G. REMEDIES

250. Does Brazil seek relief under Article XVI of *GATT 1994* in respect of expired measures? What type of recommendation would the Panel be authorized to make? (Brazil further submission, paragraph 471 (iii)) **BRA**

251. In light, *inter alia*, of Article 7.8 of the *SCM Agreement*, if the Panel were to find that any subsidies have resulted in adverse effects to the interests of another Member within the meaning of Article 5 of the *SCM Agreement*, should it make any recommendation other than the one set out in the first sentence of Article 19.1 of the DSU? **BRA**

[4] For example, Brazil's response to Panel Question 125, paragraph 14.

252. Without prejudice to any findings by the Panel, if the Panel were to find that any of the challenged measures constitute prohibited subsidies within the meaning of Article 3 of the *SCM Agreement*, what are the considerations that should guide the Panel in making a recommendation under Article 4.7 of the *SCM Agreement* relating to the time period "within which the measure must be withdrawn"? What should that time period be? **BRA**

H. MISCELLANEOUS

253. Regarding the adjustment authority related to Uruguay Round compliance in s.1601(e) of the FSRI Act of 2002 (the so-called "circuit-breaker provision"):

(a) Does it relate to export credit guarantees, crop insurance and cottonseed payments?

(b) Does it relate only to compliance with AMS commitments?

(c) Is the authority discretionary? If so, can its exercise be limited by the legislative branch of government?

(d) How would the Secretary exercise her authority to prevent serious prejudice to the interests of another Member? How would she exercise her authority to prevent a threat of serious prejudice to the interests of another Member? At what time and on the basis of what type of information would she exercise her authority?

(e) What does "to the maximum extent practicable" mean? In what circumstances would it not be practicable for the Secretary to exercise her adjustment authority? **USA**

254. Would payments made after the date of panel establishment be *mandatory* under the marketing loan, direct payments, counter-cyclical payments and user marketing certificate (step 2) programmes, but for the circuit-breaker provision? **USA**

255. How does Brazil respond to US assertions concerning the circuit-breaker provision? (see US 2 December oral statement, paragraph 82). Does this mean that US subsidies cannot be "mandatory" for the purposes of WTO dispute settlement? **BRA**

256. The United States submits that the Panel cannot make rulings without allocating precise amounts of payments to upland cotton production. However, to the extent that such precise data is not on the Panel record, to what extent can the Panel rely on less precise data, and on reasonable assumptions, in fulfilling its duty under Article 11 of the *DSU* in this case? **USA**

# ANNEX L-1.19

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

23 December 2003

Please find attached additional questions from the Panel.

We would ask the parties to provide their responses by **12 January 2004.** The parties may submit any comments on each other's responses by **19 January 2004**.

Additional Questions from the Panel to the parties –
following the second substantive Panel meeting

257. The Panel takes note of the Appellate Body Report in *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan* (DS244), which was circulated to WTO Members on 15 December 2003. The Panel is aware that this report has yet to be adopted by the Dispute Settlement Body. Nevertheless, the Panel asks the parties to respond to the following related questions.

(a) In that report, the Appellate Body cautioned against the "mechanistic" application of the so-called "mandatory/discretionary distinction" and stated that the import of this distinction may vary from case to case (para. 93). For the Appellate Body, the question of whether a measure is mandatory or not is relevant "if at all" only as part of the assessment of whether the measure is, as such, inconsistent with particular obligations. How, if at all, are these statements and the related findings concerning the mandatory/discretionary distinction in that Appellate Body Report relevant to:

(i) the legal standard and elements Brazil sets out to establish its export and prohibited subsidy claims under the provisions of the *Agreement on Agriculture* and Articles 3.1(a) and (b) of the *SCM Agreement*, concerning: **BRA**

- Step 2 payments (see, *e.g.* paras. 244-245 & 250 Brazil's first written submission; Panel Question 109 and parties' responses/comments thereon); and

- export credit guarantee programmes: GSM-102, GSM-103 and SCGP (see, *e.g.*, para. 90 Brazil's oral statement at second Panel meeting).

(ii) the legal standard and elements Brazil sets out to establish its serious prejudice and "threat of serious prejudice" claims, and in particular, its designation of marketing loan; crop insurance; counter-cyclical payments; direct payments and Step 2 as "mandatory"? **BRA**

(iii) the legal standard and elements Brazil sets out to establish its "*per se*" "serious prejudice" claims (*e.g.* Brazil's 9 September further submission, para. 417 *ff*; US oral statement at second Panel meeting, para. 86 *ff.*)? **BRA**

(b) How and to what extent are the legal and regulatory provisions cited in paras. 415 and 423 of Brazil's 9 September further submission "normative" in nature and treated as binding within the US legal system (see, *e.g.*, para. 99 of the Appellate Body Report)? Does your response differ depending on whether the payments are dependent upon market price conditions? **BRA**

(c) Does Brazil challenge as "mandatory" the "subsidies" themselves, the subsidy programmes or the legal/regulatory provisions for the grant or maintenance of those subsidies, or something else? **BRA**

(d) Does the "requirement" upon the CCC to make available "not less than" $5.5 billion annually in guarantees have a normative character and operation? (see, e.g. Brazil's response to Panel Question 142; Exhibit BRA-297, 7 USC 5641(b)(1); 7 USC 5622(a) & (b); paragraph 201 of US 18 November further rebuttal submissions). Is this requirement "mandatory"? If so, how does the CCC have "discretion" not to make this amount of guarantees available in a given year? **USA**

(e) Does the US agree that, under the Budget Enforcement Act of 1990, the Office of Management and Budget classifies the export credit guarantee programs as "mandatory" (see Brazil's response to Panel Question 142, para. 89)? Does this exempt the programmes from the requirement to receive new Congressional budget authority before it undertakes new guarantee commitments (*e.g.* Exhibit BRA-117 (2 USC 661(c)(2))? **USA**

# ANNEX L-1.20

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

24 December 2003

The Panel has received a letter from Brazil dated 23 December (numbered 760), in which it requests extension of certain deadlines. The Panel has also received a response from the US, dated 23 December. Having carefully considered the views of both parties, the Panel notifies the parties that it would amend the four immediate deadlines and schedules as follows:

(1) all submissions originally due 12 January 2004 would now be due **Tuesday, 20 January 2004**

(2) all submissions originally due 19 January 2004 would now be due **Wednesday, 28 January 2004**.

(3) issuance of descriptive part of the report to parties (currently scheduled for 26 January) would be rescheduled to **Wednesday, 4 February 2004**.

(4) receipt of comments by parties on the descriptive part of the report (currently scheduled for 19 February) would be rescheduled to **Monday, 1 March 2004**.

All subsequent dates remain unchanged. However, please be reminded that such dates may be changed in light of further developments.

# ANNEX L-1.21

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

12 January 2004

The Panel takes note that, as stated in its letters dated 18 and 22 December 2003, the United States provided certain data requested by Brazil, but deleted from farm-level planted acreage data any fields that could identify individual farms. Brazil commented on this in its answer to Panel Question No. 196. The United States stated in its letter dated 18 December 2003 that "the release of planted acreage information associated with a particular farm, county and state number is confidential information that cannot be released under US domestic law, in particular the Privacy Act of 1974."

The Panel has reviewed the material submitted in support in Exhibits US-102 through 107, and makes the following observations:

- in the sample Freedom of Information Act ("FOIA") determination submitted to the Panel, the FSA appears to have relied on the fact that the acreage requested concerned a single producer only and that there was no public interest in disclosure of records which did not directly reveal the operations or activities of the US Federal Government;

- in that sample FOIA determination, the FSA applied the relevant US domestic law and expressly acknowledged that disclosure of individual data on commodity programme recipients can be released where the recipients' privacy interests in that information are outweighed by the public interest in disclosure;

- the information which the US asserts that it cannot disclose is relatively generic, concerning planted acreage, and does not relate to one individual but to tens of thousands of business people, and can be protected under the DSU and our working procedures;

- farm-specific information on contract payments is already available free of charge on the internet on the EWG database, having been disclosed under the FOIA; and

- comprehensive farm-specific information concerning rice, including planted acreage data associated with particular farm, county and state numbers, was provided on request under the FOIA to a member of the public who was assisting Professor Sumner in the presentation of Brazil's case to the Panel. A sample of this data is set out in Exhibit BRA-369.

Article 13.1 of the DSU relevantly provides as follows:

> "A Member should respond promptly and fully to any request by a panel for such information as the panel considers necessary and appropriate. Confidential information which is provided shall not be revealed without formal authorization from the individual, body, or authorities of the Member providing the information."

Pursuant to Article 13 of the DSU, the Panel requests the United States to provide the same data that it agreed to provide in its letters dated 18 and 22 December 2003 but in a format which permits matching of farm-specific information on contract payments with farm-specific information

on plantings. The Panel considers it both necessary and appropriate to seek this information in a suitable format in order to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements. Disclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years.

The United States may again designate the data as confidential in accordance with paragraph 3 of the Panel's working procedures. Disclosure can be limited to Brazil's delegation, the Panel and Secretariat staff assisting the Panel. The United States may also protect the identity of individual producers by, for example, using substitute farm numbers which still permit data-matching.

A refusal by the United States to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn.

The Panel reminds Brazil that it may not disclose the above information outside its delegation in this proceeding if it is designated by the United States as confidential.

The Panel also wishes to pose the following additional question to Brazil:

> 258. Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks.

The Panel asks the parties to provide the respective information requested by 20 January 2004.

# ANNEX L-1.22

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

3 February 2004

Please find attached the Panel's supplementary request to the United States for information pursuant to Article 13 of the DSU, as well as additional questions to both parties. The Panel would like to ask the parties to provide the information requested and responses to the additional questions by **Wednesday 11 February 2004**. The Parties are invited to submit, by **Wednesday 18 February 2004,** any comments on material submitted on 11 February by the other party.

In light of the above development, the Panel intends to postpone the issuance of the descriptive part until **Friday 20 February 2004**. The remainder of the Panel's schedule remains unchanged for the time being.

The Panel recalls that it indicated, in its communication dated 14 November, that "[i]f necessary, at the discretion of the Panel, a further Panel meeting with the parties may be held" to address the issue of econometric models. The Panel would like to indicate that, at this stage, it does not see the need to hold such a meeting.

The Panel has noted the US letter dated 30 January, Brazil's response dated 2 February, and a further letter from the US dated 3 February 2004. Keeping in mind the dictates of due process and relevant provisions of the covered agreements -- including Article 12.2 of the DSU which requires Panel procedures to provide sufficient flexibility so as to ensure high-quality panel reports while not unduly delaying the panel process -- the Panel is of the view that the above revisions to the timetable provide the United States and Brazil sufficient opportunity to comment on each other's comments. Accordingly, the US is free to submit its comments on Brazil's above mentioned submission by 11 February (**but no later**).

This is without prejudice to any definitive view of the Panel on the characterization of any of the above communications by the parties and, in particular, of the document submitted by Brazil entitled "Brazil's Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-scrambled Data on 20 January 2004".

# PANEL'S SUPPLEMENTARY REQUEST FOR INFORMATION PURSUANT TO ARTICLE 13 OF THE DSU AND ADDITIONAL QUESTIONS

The Panel has reviewed the United States' letters dated 18 December 2003 and 20 January 2004, and the material submitted in support in Exhibits US-102 through 107, and Brazil's response to Question No. 258.

Pursuant to Article 13 of the DSU, the Panel requests the United States to provide:

(a) such of the information requested on 12 January 2004 in the format requested, as regards payment recipients who do not have interests protected under the Privacy Act 1974, if any; and

(b) the following information for each of the PFC, MLA, CCP and direct payments programmes for each of the 1999, 2000, 2001 and 2002 marketing years, showing as many of the underlying calculations as possible:

- How many farms had fewer upland cotton planted acres than upland cotton base acres, or equal numbers of each? We refer to these as "Category A" farms. What was the total of their upland cotton base acreage? What was the total of their upland cotton planted acreage?
    - How many Category A farms did not plant any other covered commodities? What was the total of their upland cotton base acreage? What was the total of their upland cotton planted acreage?
- How many farms had more upland cotton planted acres than upland cotton base acres? We refer to these as "Category B" farms. What was the total of their base acreage for each covered commodity, including upland cotton? What was the total of their planted acreage for each covered commodity, including upland cotton? Please also provide the following information concerning these farms:
    - How many Category B farms had equal numbers of acres planted to all covered commodities and base acres for all covered commodities? We refer to these as "Category B-1" farms. What was the total of the base acreage of Category B-1 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-1 farms for each covered commodity, including upland cotton?
    - How many Category B farms had fewer acres planted to all covered commodities than base acres for all covered commodities? We refer to these as "Category B-2" farms. How much was the total acreage of Category B-2 farms planted to all covered commodities less than their base acreage for all covered commodities? What was the total of the base acreage of Category B-2 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-2 farms for each covered commodity, including upland cotton?
    - How many Category B farms had more acres planted to all covered commodities than base acres for all covered commodities? We refer to these as "Category B-3" farms.

How much did the total acreage of Category B-3 farms planted to all covered commodities exceed their base acreage for all covered commodities? What was the total of the base acreage of Category B-3 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-3 farms for each covered commodity, including upland cotton?

- How many farms had upland cotton planted acres but no upland cotton base acres? We refer to these as "Category C" farms. What was the total of the base acreage of Category C farms for each covered commodity? What was the total of the planted acreage of Category C farms for each covered commodity, including upland cotton?

- In addition, for the marketing year 2002, please reply to the above questions with respect to all crops on cropland covered by the acreage reports, not simply commodities covered by the programmes.

- In addition, please provide all of the above information on a state-by-state basis.

You may wish to present your responses regarding acreage for each covered commodity in a table as follows:

**TABLE**

**Programme:**
**Marketing year:**
**Category of Farm:**

| | Covered commodities | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Upland Cotton | Barley | Corn | Oats | Rice | Sorghum | Wheat | Soybeans* | Other Oilseeds* |
| Base acres | | | | | | | | | |
| Planted acres | | | | | | | | | |

* Where applicable.

The Panel considers it both necessary and appropriate to seek this information to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements. However, the Panel reserves its views as to the extent to which any methodology might be appropriate to determine support provided to upland cotton in the circumstances of this case.

A refusal by the United States to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn.

The Panel also wishes to pose the following additional questions to the United States (Nos. 259 – 275) and to Brazil (No. 276):

259. With respect to the Privacy Act of 1974, 5 U.S.C. 552a:

(a) Whose interests are protected under section 552a(b) in light of the definition of "individual" in section 552a(a)(2)? Do all payment recipients, including corporations and organizations, have Privacy Act rights? If not, is the United States prevented by its domestic law from releasing such of the information requested on 12 January 2004 as relates to payment recipients without Privacy Act rights? Please explain with references to case law.

(b) The Panel notes that data concerning the four relevant programmes, in particular, payment amounts, identified by specific farms, is freely available on the internet. Please explain why that data can be disclosed but the requested planted acreage data cannot. Do individual recipients have Privacy Act rights with respect to their entrepreneurial activity? Please explain with references to case law.

(c) Please provide any further available evidence of the USDA's long-standing policy that planted acreage information will not be released.

260. On 27 August 2003, in its response to Question No. 67 *bis*, the United States indicated that "it does not maintain information on the amount of expenditures made under the cited programmes to US upland cotton producers". On 12 January 2004, the Panel requested the United States to provide information "to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years". On 20 January 2004, the United States informed the Panel that "the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to farms planting upland cotton." Is the latest statement responsive to the Panel's request? If so, how can it be reconciled with the first statement?

261. Please confirm that each record in the actual planting database relates to a specific farm (Filenames: rPFCplac and rDCPplac in Exhibits US-111 and US-112). For example, in the data from rDCPplac:

*First line*:
Field9;Field16;Field22;Field28;Field34;Field40;Field46;Field52;Field58;Field64;Field70;Field76;Field82;Field88;Field94;Field100

*Second line*:
237.10;23059.80;5566.20;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00;0.00

Does the second line represent data on plantings by the same farm?

262. The Panel has noted the two CD-ROMs delivered by the US in the evening of 23 December 2003. They are marked "US-111" and "US-112" respectively, but the contents actually do not correspond to the indication. The Panel also takes note of the US letter dated 28 January 2004 and the CD-ROM delivered together with it. For the record, please clarify the correct CD-ROMs and provide corresponding descriptions of their contents with exhibit numbers.

263. The Panel has noted that the United States' response to Question No. 214 refers to Exhibits US-117 and US-118. Are these the correct documents to which the United States intended to refer in that response? If not, please provide a copy of regulations regarding the

marketing loan programme and loan deficiency payments published at 58 Federal Register 15755, dated 24 March 1993.

264. The Panel asks the United States to clarify certain aspects of Exhibit US-128:

(a) Is the Panel correct in understanding that -- as Brazil asserts in footnotes 290 and 291 of Brazil's 28 January 2004 comments on US responses to questions -- Exhibit US-128, all data are presented on a cohort-specific basis? If so, please also present the information originally requested by the Panel in another chart containing *programme* (as opposed to cohort-specific) activity by fiscal year.

(b) Does the US agree with the statement in paragraph 135 of Brazil's 28 January 2004 comments on US responses to questions that the difference between the $1,148 billion in the chart at para. 165 of Brazil's 11 August answers to questions and the $666 million amount in Exhibit US-128 ($1.75 billion) closely corresponds to the total "Claims rescheduled" figure reported by the US in Exhibit US-128 (column F)?

(c) Does the US agree that from the formula in column G (that is: (Column (D) minus (E) minus (F)), it follows that a rescheduled claim no longer constitutes an outstanding claim at the moment the terms of the re-scheduling are agreed and that a rescheduling is treated as 100 per cent recovered, as Brazil states in footnote 292 of Brazil's 28 January 2004 comments on US responses to questions?

(d) Is the Panel correct in understanding that the amount of $888,984,792.04 in column F in Exhibit US-128 under "ALL" for 1992 represents the total continuing amount of unrecovered claims for the 1992 cohort, and that the amount of 387,692,219.39 represents the total continuing amount of unrecovered claims for the 1993 cohort, etc? Please indicate and substantiate how much principal and/or interest has actually been paid/recovered/rescheduled *annually* 1992-2003 in respect of each of the amounts shown in Columns D, E & F in the table.

265. In connection with the US response to Question No. 225, please also provide amounts actually "written off" and "forgiven" annually for each *post*-1992 cohort, with annual details of country and amount (principal/interest).

266. What are the precise terms, conditions and duration of each rescheduling reflected in column F in Exhibit US-128?

267. Is the Panel correct in understanding that "interest collected on reschedulings" in Column M in Exhibit US-128 refers not to amounts that have been actually collected by the CCC but rather to interest capitalized in conjunction with the rescheduling? If so, what are the terms, conditions and duration of the arrangements pertaining to these amounts?

268. Concerning Column N in Exhibit US-128, please elaborate upon "Interest earned from US Treasury on uninvested funds". What is the source and authority for these funds and for the interest thereon to be part of the CCC total revenues? What are the terms, conditions and duration of the arrangements pertaining to these amounts?

269. The Panel notes the table submitted by the US in its answer to Question No. 224 (CCC Financing Account Payments of Interest on Borrowings from Treasury and Interest Earned on Uninvested Funds). Is the Panel correct in understanding that the figures in this table correspond to the "ALL" figures in Columns I and N of Exhibit US-128?

270. With respect to Column I in Exhibit US-128, ("Interest paid on borrowing from US Treasury") and Note 8, p. 25 of Exhibit US-129:

(i) please provide the total annual amounts (interest bearing and non-interest bearing) borrowed by the CCC from the US Treasury (annually since 1992), as well as the terms, conditions, interest rate (where applicable) and duration of such borrowing. Please provide details of any other amount borrowed by the CCC from the US Treasury during this period that may not have formed part of the regular annual borrowings.

(ii) Please explain the nature of "CCC's permanent indefinite borrowing authority from Treasury" referred to in Note 8, p. 25 of Exhibit US-129.

(iii) What determines the level of CCC export credit guarantee borrowing (interest-bearing and non-interest-bearing)? Is the interest-free borrowing up to the amount of unreimbursed realized losses?

(iv) Why are repayments applied to non-interest bearing notes first, as indicated at Note 8, p. 25 of Exhibit US-129?

271. Note 8, p. 25 of Exhibit US-129 states that "In fiscal year 2003, CCC was fully reimbursed for its prior year net realized losses." Please indicate the amounts of prior year net realized losses (annually, since 1992) for which the CCC has been fully reimbursed.

272. With respect to the US response to Question No. 226, is the Panel correct in understanding that the reflection of write-offs as part of the operating loss of the CCC which in turn was replenished through the annual appropriations process ended with the entry into force of the FCRA in fiscal year 1992? If not, what amounts have been replenished through this process annually since fiscal year 1992?

273. With respect to the US response to Question No. 225, what criteria does the CCC apply to "independently determine" that a debt is uncollectible? For post-1992 cohorts, what are these uncollectible amounts (annually) and how, if at all, are such "uncollectible amounts" shown in Exhibit US-128?

274. The Panel notes the US statement in the US response to Question No. 81 that "All rescheduled claims are currently performing " and that "all payments due up to this point under [rescheduling] agreements have been received". However, the Panel also notes Exhibit US-129 (in particular, Note 5 on p. 22) and Brazil's reference thereto in Brazil's 28 January comments on the US response to Question No. 222. In this connection:

(a) How does the US respond to Brazil's statement in Brazil's 28 January comments that Exhibit US-129 confirms that rescheduling of export credit guarantee receivables cover both principal and interest, thereby confirming that not all of the rescheduled debt performs and that additional interest charges were also rescheduled?

(b) In Note 5 on p. 22 of Exhibit US-129, what is the definition of "non-performing"? What is the meaning of "delinquent"? What is the current principal balance and amount of interest of the three CCC export credit guarantee programme "receivables" in a non-performing status (individually and together, for GSM 102, GSM 103 and SCGP))? What is the amount of interest on non-reporting "receivables"?

(c) The Panel notes the US reference to the "Paris Club" in US response to Question No. 225. What is the P.L. 480 programme referred to in Note 5 on p. 22 of Exhibit US-129 (including the Paris Club debt reduction process and the HIPC Initiative) ? To what extent is the P.L. 480 programme and Paris Club process relevant to the export credit guarantee programmes at issue in this dispute? Please identify and give the amounts of all CCC export credit guarantee debt subject to the P.L. 480 debt reduction (or other similar) process since 1992.

(d) Can the US explain the process referred to in the second column of Note 5 on p. 22 ("CCC is awaiting an apportionment from the Office of Management and Budget before the transaction can be completed. Until such time, however, there is a 100% subsidy allowance established against the relevant debt as of September 30, 2003.") Please provide details of all such "apportionments" relating to the three export credit guarantee programmes in fiscal years 1992-2003.

275. Please provide evidence (or cite relevant portions of the record) that the premium rates for the export credit guarantee programmes are "reviewed annually" as stated in US 28 January comments on response to Question No. 223 (see also US 22 December response to Question No. 107; Brazil's 28 January 2004 comments on responses to Question No. 223.).

The Panel wishes to pose the following additional question to Brazil:

276. The Panel notes the parties' responses and comments relating to Question No. 252 concerning the time period within which any prohibited measure must be withdrawn within the meaning of Article 4.7 of the *SCM Agreement*. Please supplement your original response, taking into account the particular nature of each alleged prohibited subsidy measure (i.e. "Step 2" payments under Section 1207(a) of the 2002 FSRI Act, export credit guarantee programmes and the ETI Act) and the functioning of the US legal and regulatory system in respect of these measures.

# ANNEX L-1.23

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

16 February 2004

1. The Panel is in receipt of the letter from the U.S. dated 11 February, the response from Brazil dated 13 February and another US letter dated 16 February.

2. On page 2 of the United States letter of 11 February, with respect to item (b) of the Panel's supplementary request for information, the United States asks the Panel to specify which commodities are "covered commodities". We would like to clarify that "covered commodities" and "commodities covered", as used in the bullet points and sub-bullets, refer to wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, "other oilseeds" as defined in Section 1001(9) of the FSRI Act of 2002, and peanuts, except that soybeans do not apply to PFC payments and "other oilseeds" and peanuts do not apply to PFC or MLA payments.

3. The Panel also confirms that the additional information sought for marketing year 2002 "with respect to all crops on cropland covered by the acreage reports" refers to the reports filed under Section 1105(c) of the FSRI Act of 2002. The relevant portions of the "above questions" are those that ask for planted acreage information for each Category of farms. All crops other than "covered commodities" as defined in Section 1001(4) of the FSRI Act of 2002 and peanuts may be aggregated as "other crops".

4. In relation to the third point the US raises in its letter dated 11 February, the Panel informs the parties as follows:

(a) Without prejudice to whether any further comments are necessary, we would consider the US request for another opportunity to comment if Brazil submits any such comments on the US submission entitled "Comments of the United States of America on the Comments of Brazil to US data Submitted on 18 and 19 December 2003" (submitted 11 February).

(b) The US would be granted until **Tuesday 3 March**, at the latest, to submit all remaining data that was requested by the Panel in its communication dated 3 February.

(c) The issuance of the descriptive part would be changed to **Friday 5 March**.

(d) The remainder of the Panel's schedule remains unchanged for the time being.

5. The Panel notes that the data submitted by the United States, as described in Exhibit US-145, does not include data on MLA and CCP payments. The Panel asks the United States to address these payments and include this information in its response to the supplementary request for information.

6. The Panel also notes that the US response to Panel Question No. 263 refers to Exhibit US-263. Could the United States please confirm that this should refer to Exhibit US-146.

7. The Panel further notes Brazil's request for an opportunity to comment after the United States has submitted the data referred to in paragraph 4(b) above. The Panel will consider this request after it has had the opportunity to review data submitted by the United States.

# ANNEX L-1.24

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

20 February 2004

1. The Panel refers to its communication dated 16 February. Item 4 (a) of this communication deals with the request made by the United States (in its letter dated 11 February) that it be provided another opportunity to comment on a certain submission from Brazil. The Panel has informed parties in the same 4 (a) that it would consider this request if Brazil submits any such comments. The Panel has received on 18 February a submission entitled "Brazil's Comments on United States 11 February Comments on Brazil's 28 January 'Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-scrambled Data on 20 January 2004'". The Panel understands that this submission corresponds to what the United States was requesting to be given another opportunity to comment on. The Panel would now allow the United States to submit, if it so wishes, comments on this specific submission from Brazil by **Wednesday 25 February**. The Panel informs parties that it does not see, at this time, the need to have further opportunities to comment on this submission (if any) from the United States.

2. The Panel also takes note of Brazil's observation in paragraph 33 of its 18 February "Comments on US 11 February 2004 Answers to Additional Questions from the Panel Following the Second Meeting of the Panel with the Parties" that "...the Panel did not respond to Brazil's request that it deny the United States' efforts to decide at what pace it wishes to offer responses to the Panel's questions". The Panel also recalls the United States' original statement in connection with Question 264(b) that it "expects to be able to provide an answer within the same time period as its response to the Panel's supplemental request for information." In this connection, we wish to draw the parties' attention to our statement in item 4(b) of the 16 February communication, and to clarify that that statement also pertains to the United States response to Question 264(b). Thus, the United States has until **3 March**, at the latest, to submit its response. We further note that Brazil states in the same paragraph 33 that it "reserves the right to comment" on the United States response to Question 264(b). In line with what we mentioned in paragraph 7 of our communication dated 16 February, we would decide whether it is appropriate to give Brazil the opportunity, *after* we have had the opportunity to review the response from the United States.

# ANNEX L-1.25

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

24 February 2004

The Panel is in receipt of the letter from the United States dated 23 February 2004.

After carefully considering the views of the United States, we now change the date by which the United States is expected to submit its comment from the date originally designated as 25 February in our communication dated 20 February, to **3 March 2004**.

All other statements in our communication dated 20 February remain unchanged.

# ANNEX L-1.26

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

4 March 2003

The Panel is in receipt of the submissions from the United States dated 3 March. The Panel reminds parties of our communications dated 16, 20 and 24 February 2004, especially in relation to our intention to consider whether or not to allow Brazil to comment on certain US submissions. After carefully examining yesterday's submission from the United States, the Panel informs parties of the following amendment to the current timetable.

1. Brazil is granted until **10 March 2004** to submit comments, if any, on (a) the data supplied by the United States, dated 3 March, in the form of a CD-ROM (i.e. 8 data files therein) and (b) the submission entitled "Answers of the United States of America to Questions 264(b) Dated 3 February 2004, from the Panel to the Parties following the Second Panel Meeting". The Panel does not see the need to grant Brazil the opportunity to comment on any other submission from the United States.

2. The United States is granted until **15 March 2004** to submit comments, if any, on the submission from Brazil to be received by 10 March 2004.

3. The descriptive part will be issued on **16 March 2004**.

4. Comments on the descriptive part is to be received by **30 March 2004**.

5. The rest of the timetable remains unchanged for now.

# ANNEX L-1.27

## COMMUNICATION TO BRAZIL AND THE UNITED STATES

7 April 2004

The Panel informs the parties of the following change in the timetable for this dispute. As indicated, the Panel now intends to issue the interim report to the parties on Monday 26 April 2004.

| | |
|---|---|
| Issuance of the interim report, including the findings and conclusions, to the parties: | 26 April 2004 |
| Deadline for parties to request review of part(s) of report: | 10 May 2004 |
| Interim review meeting with the parties, if requested. If interim review meeting not requested, the deadline for comments on each others' comment. | 3 June 2004<br>(if a review meeting is to be held, **4 June** as well as 3 June, as necessary.) |
| Issuance of final report to the parties: | 18 June 2004 |
| Circulation of the final report to Members: | [after translation] |

# ANNEX L-2.1

## COMMUNICATION TO THIRD PARTIES

28 May 2003

Your delegation has reserved its rights to participate as a third party in the Panel *United States - Subsidies on Upland Cotton (DS267)*- Complaint by Brazil - established by the DSB on 18 March 2003. The Panel has now started its work.

Attached you will find the timetable and working procedures adopted by the Panel for this dispute in accordance with Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*").

As indicated in the attached timetable, prior to the submission by the parties of their first written submissions in these proceedings, the Panel has requested the parties to address, in their initial briefs to the Panel (to be submitted on 5 June 2003), the following:

- whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words "exempt from actions" as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article 13.

As also indicated in the attached timetable, the Panel will invite the parties to submit any written comments on each other's comments on this issue (i.e. on 13 June 2003). The Panel intends to rule on these issues on 20 June 2003, prior to the parties' submission of their first written submissions.

We have invited the parties to serve also on the third parties their initial briefs and any responding comments. The Panel also invites third parties to submit any written comments they might have concerning the initial phase of these proceedings. **The deadline for any initial third party comments on the specific issue identified above is 10 June 2003.**

Moreover, as also indicated in the attached timetable, the Panel invites your delegation to present its views at a meeting with the parties to the dispute and other third parties, which is scheduled for 24 July 2003. The exact time and venue will be communicated to you in due time.

The Panel would appreciate it if your delegation could provide the Panel with your written submission by 5.30 p.m. on 15 July 2003. If you so wish, this written statement may take the place of an oral presentation to the Panel. The Panel would appreciate the submission being kept as short as possible. I would appreciate it if you would advise the Panel before 1 July 2003 through me as Secretary to the Panel (telephone 022/739 6419) whether your delegation will be represented at the meeting and whether your delegation will require interpretation services into and out of English.

[Attachment omitted]

# ANNEX L-2.2

## COMMUNICATION TO THIRD PARTIES

25 July 2003

Please find attached a communication from the Panel on the following issues:

1. The Panel's view on the preliminary ruling requested by the United States.

2. Panel's questions to third parties.

The Panel's questions are intended to facilitate the work of the Panel, and do not in any way prejudge the Panel's findings on the matter before it. Nor does the fact that the Panel has placed these questions under certain headings prejudge the Panel's findings on the matter before it. Each third party is free to respond to or comment on questions posed to the other third parties.

Please be reminded that you are requested to submit answers by the close of business of 4 August 2003. Subsequently, third parties can submit comments to other's responses by the close of business 22 August.

[1st attachment omitted]

Questions from the Panel to the third parties –
First session of the first substantive Panel meeting

ARTICLE 13 OF THE *AGREEMENT ON AGRICULTURE*

1. Australia has argued that Article 13 of the *Agreement on Agriculture* is an affirmative defence. How do you reconcile this with your view that the conditions in Article 13 are a "prerequisite" to the availability of a right or privilege? **Australia** Would other third parties have any comments on Australia's assertion? **3RD parties, in particular Argentina, Benin, China, Chinese Taipei**

ARTICLE 13(B) OF THE *AGREEMENT ON AGRICULTURE*: DOMESTIC SUPPORT MEASURES

2. Please explain the difference, if any, between the meaning of "defined" and the meaning of "fixed" in the phrase "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture* . **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

3. Please explain the meaning of "a" in "a defined and fixed base period" in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*, the meaning of "the" in "the base period" in paragraphs 6(b), (c) and (d), and the difference between these and the phrase "based on the years 1986-88" in Annex 3. **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

4. How often can a Member define and fix a base period in accordance with paragraph 6 of Annex 2 of the *Agreement on Agriculture*? **3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

5. Do you agree that a payment penalty based on crops produced is "related to type of production"? **EC**

6. Please explain the meaning of the word "criteria" in Article 6.1 and 7.1. What effect, if any, does the use of the word "Accordingly" in paragraph 1 of Annex 2 of the *Agreement on Agriculture* have on the meaning of the preceding sentence? **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

7. Please explain the meaning of the words "the fundamental requirement" as used in paragraph 1 of Annex 2 of the *Agreement on Agriculture*. **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

8. In your oral statement, you emphasize the use of the word "criteria" in other parts of the *Agreement on Agriculture*, as distinct from the reference to "fundamental requirement" in the first sentence of paragraph 1 of Annex 2. Is it the case that sub-paragraphs (a) and (b) of paragraph 1 of Annex 2 are also "criteria"? **EC**

9. If the first sentence of paragraph 1 of Annex 2 is a stand-alone obligation, does this allow effects-based claims of non-compliance with Annex 2? If so, how does this affect the purpose of Article 13(b)? **3rd parties' in particular Australia, Argentina, Canada, EC, NZ**

10. If the first sentence of paragraph 1 of Annex 2 is not a stand-alone obligation, then must new, non- or minimally trade-distorting measures that do not conform to the criteria listed in Annex 2 be classified as non-Green Box? **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

11. If the first sentence of paragraph 1 of Annex 2 expresses a general principle which informs the interpretation of the criteria in Annex 2, please explain how this affects the assessment of the direct payments programme's compliance with paragraph 6 of Annex 2. **3rd parties, in particular, Australia, Argentina, Canada, EC, NZ**

12. Where does Article 13(b) require a year-on-year comparison? **3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

13. Does a failure by a Member to comply in a given *year* with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) impact its entitlement to benefit in an earlier or a later year from the exemption from action provided by Article 13(b)? **3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

14. Does a failure of a Member to comply with Article 13(b) in respect of a *specific commodity* impact its entitlement to benefit in respect of other agricultural products from the exemption from action provided by Article 13(b)? **3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

15. Is there any basis on which counter-cyclical payments could be considered product-specific? **3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

16. If the word "specific" were deleted from Article 13(b)(ii), would this change the meaning of the subparagraph? **3RD parties, in particular Australia, Argentina, Benin Canada, China, EC, NZ**

17. What is the relevance, if any, of the concept of "specificity" in Article 2 of the *SCM Agreement* and references to "a product" or "subsidized product" in certain provisions of the *SCM Agreement* to the meaning of "support to a specific commodity" in Article 13(b)(ii) *Agreement on Agriculture*? **3RD parties, in particular Australia, Argentina, Canada, China, EC, NZ**

18. Benin's oral statement considers the phrase "support to a specific commodity" in Article 13(b)(ii) of the *Agreement on Agriculture*. How does Benin believe that phrase is best interpreted. Please substantiate your response, commenting on other submissions by parties and third parties as you believe appropriate. **Benin**

19. Where does Article 13(b)(ii) require a year-on-year comparison? **3rd parties, in particular Australia, Argentina, Canada, EC, NZ**

20. Does Article 13(b)(ii) require a comparison of support granted with support decided? How could such a comparison be made?

21. Please comment on Brazil's assertion that the terms "grant" and "decided" in Article 13(b)(ii) have broadly the same meaning. If so, why did the drafters not use the same term? **3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

22. What is the meaning of "support" in *Agreement on Agriculture* 13(b)(ii) ? Why would it be used differently from Annex 3, where it refers to total outlays? **3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

23. Should support be compared under Article 13(b)(ii) in terms of unit of production or total volume of support or both? **3rd parties, in particular, Australia, Argentina, Canada, China, EC, NZ**

24. Please provide any written drafting history which could shed light on why the proviso was added to what is now Article 13(b)(ii) of the *Agreement on Agriculture* and, in particular, why the words "grant" and "decided" were used. **EC**

25. Please comment on an interpretation of the words "decided during" in Article 13(b)(ii) that would read them as synonymous with the words "authorized during". **3rd parties, in particular Australia, Argentina, Canada, China, EC, NZ**

26. Under Article 13(b)(ii), a comparison is required between support at different times. One of the issues which is contested between the parties is whether the only later period that the Panel can consider is the present one (i.e. the period underway at the time of the request for establishment of the Panel). This argument is based on the present tense of the words "do not grant" in the English text. The Panel asks whether there is any difference in the verb tense as used in the Spanish-language text, or any other difference which might aid the Panel in interpreting these words? **Argentina, EC, Paraguay, Venezuela**

27. If the 1992 "decision" led to or was the funding source for the money provided in 1992 and later years, is it the full amount of all that funding that constitutes the "support" decided in 1992? If the answer to this question is that it is the full amount of all the support provided pursuant to the "decision" that must be taken into account, must this be compared with the total amount of support that will or might flow from the decision made in the more recent period for the purposes of the comparison required under Article 13(b)(ii)? If a Member did not make a "decision" (however that may be interpreted) in 1992 about "support", is it the case that the Member has a zero base for the purposes of the comparison required under Article 13(b)(ii)? **EC**

28. In paragraph 13 of Australia's oral statement, you state that a "question" is: "could conditions of price competition for the purposes of a non-violation or impairment claim be assessed solely on the basis of budgetary outlay figures, as argued by Brazil, or on the basis of a rate of payment, as argued by the United States? In Australia's view, both factors put forward by Brazil and the United States would properly form a part of that assessment, but not the whole." Could you please clarify this statement (indicating other elements which would complete the "whole" and explain its relevance for the purposes of our consideration of Article 13 of the *Agreement on Agriculture*? **Australia, EC**

EXPORT CREDIT GUARANTEE PROGRAMMES

29. (a) Is an export credit guarantee a financial contribution in the form of a "potential direct transfer of funds or liabilities (e.g. loan guarantee)" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*? Why or why not? **3rd parties, in particular, Argentina, Canada, EC, NZ**

(b) How, if at all, would this be relevant to the claims of Brazil? **3rd parties, in particular, Argentina, Canada, EC, NZ**

30. The Panel could arguably take the view that Articles 1 and 3 of the *SCM Agreement* were relevant in assessing the WTO-consistency of United States export credit guarantees. The Panel would therefore appreciate third party views on this situation, including with respect to the viability of an *a contrario* interpretation of item (j) of the Illustrative List (as addressed in paragraphs 180-183 of the United States' first written submission). **3rd parties, in particular, Argentina, Canada, EC, NZ**

31. If the Panel decides to refer to provisions of the *SCM Agreement* for contextual guidance in the interpretation of the terms in Article 10 *Agreement on Agriculture*, should the Panel refer to item (j) or Articles 1 and 3 of the *SCM Agreement* or both? . **3rd parties, in particular, Argentina, Canada, EC, NZ**

32. The Panel's attention has been drawn to Article 14(c) of the *SCM Agreement* (see third party submission of Canada) and to the panel report in DS 222 *Canada- Export Credits and Loan Guarantees*. How and to what extent are Article 14(c) of the *SCM Agreement*, and the cited panel report, relevant to the issue of whether or not the United States export credit guarantee programmes confer a "benefit"? What would the appropriate market benchmark be to use for any comparison? Please cite any other relevant material. . **3rd parties, in particular, Argentina, Canada, EC, NZ**

33. What is the relevance (if any) of Brazil's statement that : "...export credit guarantees for exports of agricultural exports [sic] are not available on the marketplace by commercial lenders." . **3rd parties, in particular, Argentina, Canada, EC, NZ**

34. Comment on the United States' view of the meaning of "long term operating costs and losses" in item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* as meaning "claims paid" under the export credit guarantee programmes. Does the United States' interpretation give meaning to both "costs" and "losses"? Do claims paid represent "losses"? **3rd parties, in particular, Argentina, Canada, EC, NZ**

35. Did the drafters of the *Agreement on Agriculture* include export credit guarantees in Article 9.1 of the *Agreement on Agriculture*? Why or why not? **3rd parties, in particular, Argentina, Canada, EC, NZ**

36. Please explain any possible significance the following statements may have in respect of Brazil's claims about GSM102 and 103 (7 CFR 1493.10(a)(2), Exhibit BRA-38) **3rd parties, in particular, Argentina, Canada, EC, NZ**

(a) "The programmes operate in cases where credit is necessary to increase or maintain US exports to a foreign market and where US financial institutions would be unwilling to provide financing without CCC's guarantee. (7 CFR 1493.10(a)(2) Exhibit BRA-38)

(b) "The programmes are operated in a manner intended not to interfere with markets for cash sales. The programmes are targeted toward those countries where the guarantee is necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments." (7 CFR 1493.10(a)(2) Exhibit BRA-38)

(c) "In providing this credit guarantee facility, CCC seeks to expand market opportunities for US agricultural exporters and assist long-term market development for US agricultural commodities." (7 CFR 1493.10(a)(2) Exhibit BRA-38)

37. The United States seems to argue that, at present, by virtue of Article 10.2 of the *Agreement on Agriculture*, there are **no** disciplines on agricultural export credit guarantees under the *Agreement on Agriculture* (or the *SCM Agreement*).

(a) Comment on the following proposition: a WTO Member may therefore extend agricultural export credit guarantees without charging a premium, and for an indefinite period, in addition to any other terms and conditions it may wish? How would this reconcile with the title of Article 10 of the *Agreement on Agriculture* ("Prevention of Circumvention on Export Subsidy Commitments"), and with other commitments contained in the *Agreement on Agriculture*? Please cite any relevant material, including any past WTO dispute settlement cases. **3rd parties, in particular, Argentina, Canada, EC, NZ**

(b) If, as the United States argues, there are no disciplines on export credit guarantees in the *Agreement on Agriculture*, how could export credit guarantees "conform fully to the provisions of Part V" of the *Agreement on Agriculture* within the meaning of Article 13 (how can you assess "conformity" or non-conformity with non- existent disciplines)? **3rd parties, in particular, Argentina, Canada, EC, NZ**

STEP 2 PAYMENTS

38. Please comment on the statement in note 119 of the United States' first written submission that "...to the extent a consumer that had intended to export instead opens the bale, then that consumer could still obtain the Step 2 payment upon submission of the requisite documentation". The Panel notes that Step 2 payments all involve upland cotton produced in the United States. What are the two distinct factual situations that Step 2 payments involve? Other than the panel report in *Canada-Dairy* and the findings of the Appellate Body in *US-FSC* (21.5)[1], do any other dispute settlement reports offer guidance on this issue? For example, how, if at all is the Appellate Body's report in *Canada-Aircraft* relevant here?[2] . **3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

39. Please comment on the United States assertions at paragraph 129 of its first written submission, that "[t]he programme is indifferent to whether recipients of the benefit of this programme are exporters or parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States." . **3rd parties, in particular, Australia, Argentina, NZ, Paraguay**

40. With respect to paragraph 32 of the oral statement of the EC, are subsidies contingent on the use of domestic goods consistent with the *AoA*? Does the phrase "provide support in favour of domestic producers" refer to, and/or permit such subsidies? What is the meaning and relevance of this (if any) to Brazil's claims under Article 3 of the *SCM Agreement* and Article III:4 of the GATT 1994.. **3rd parties, in particular, Australia, Argentina, EC, NZ, Paraguay**

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[1] "We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances. [1] Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."

3. [2] There, the Appellate Body stated that,

> "the fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact … upon export performance".[2]

ETI ACT

41. Concerning its claims on the ETI Act, Brazil relies on the *US – FSC* case. However, it appears that the United States did not raise the issue of the Peace Clause in that case, nor did the US appear to invoke Article 6 of the *Agreement on Agriculture*. If the Panel's understanding is correct, how, if at all, are these differences relevant here? **Argentina, China, EC, NZ**

42. How do you view the reference in paragraph 43 of the EC's third party oral statement with respect to the relevance of Article 17.14 of the DSU, and, in particular, the phrase "a final resolution to *that* dispute" (emphasis added)? Please explain the use, and relevance (if any) of the term "disputes" in Articles 9.3 and 12 and Appendix 3 of the DSU, and please cite any other provisions you consider relevant. **Argentina, China, EC, NZ**

# ANNEX L-2.3

## COMMUNICATION TO THIRD PARTIES

30 July 2003

Taking into account a 29 July 2003 communication received from the United States, and Brazil's 30 July response, the Panel has decided to extend the deadline for the submission of the parties' and third parties' responses to questions from Monday 4 August to **Monday 11 August** (**17h30** (Geneva time)).

The Panel has also decided upon the following additional changes to its schedule:

| | |
|---|---|
| Panel's views on certain issues: | 5 September 2003 |
| Further submission of Brazil: | 9 September 2003 |
| Further submission of the US: | 23 September 2003 |
| Further submission of the third parties (as necessary): | 29 September 2003 |

For the time being, all other dates remain unchanged. This includes the deadline for the submission of the parties' and third parties' comments on responses. It also includes the dates for the resumption of the first substantive meeting and the third party session (as necessary) and the second substantive meeting (i.e. 7-9 October).

# ANNEX L-2.4

## COMMUNICATION TO THIRD PARTIES

13 October 2003

Please find attached the Panel's questions to third parties following the resumed first session of the first substantive Panel meeting.

The Panel's questions are intended to facilitate the work of the Panel, and do not in any way prejudge the Panel's findings on the matter before it. Nor does the fact that the Panel has placed these questions under certain headings prejudge the Panel's findings on the matter before it. Each third party is free to respond to or comment on questions posed to the other third parties.

You are requested to submit answers by close of business on **27 October 2003**. All provisions of the existing working procedures, including the time specified in paragraph 17(b) of the Panel's existing working procedures for service of submissions by third parties, are confirmed.

Questions from the Panel to the third parties –
resumed first session of the first substantive Panel meeting

A. QUESTIONS TO INDIVIDUAL THIRD PARTIES

43. Please elaborate, citing figures, on your statement that polyester fibre prices actually follow cotton prices. Argentina

44. Please explain how Articles 5 and 6 of the *SCM Agreement* and Article XVI of the GATT 1994 would permit or require the Panel to take account of any effects of the subsidies in question on the interests of Members other than the complaining party. **Benin and Chad**

45. In relation to the term "same market" in Article 6.3(c) of the *SCM Agreement*, the EC states in paragraph 10 of its oral statement that a "world market" cannot exist if there are significant trade barriers between Members. On the other hand, the Panel notes that in relation to cotton, the EC takes the position in paragraph 14 of its further submission that the term "same market" in Article 6.3(c) should be read to include the domestic market of the subsidising Member. In light of the fact that many domestic cotton markets, possibly including that of China, have significant trade barriers, how can the EC reconcile these two positions? **EC**

46. Should the Panel prefer a concept of allocation of the benefit of subsidies to later years, to a concept of fully expensing subsidies to the year in which the benefit was provided? **EC**

47. In the EC further submission, it is said that significantly different conditions of competition in regional markets may prevent the Panel from arriving at the conclusion that there is a world market. Is the payment of a subsidy a “condition of competition” and, if so, how should that impact upon the Panel’s analysis? **EC**

48. In the further submission of India, it is stated that “there is “no obligation under the *SCM Agreement* to demonstrate serious prejudice separately after establishing that one of the effects of a subsidy listed under Article 6.3 applies, as the effects listed in Article 6.3 themselves equate to serious prejudice”. How does this view relate to Article 6.3(d), which appears to contain no element of degree? **India**

B. QUESTIONS TO ALL THIRD PARTIES

49. What is the meaning and effect of the introductory phrase of Article 3 of the *SCM Agreement* ("Except as provided in the *Agreement on Agriculture*...")? **All third parties**

50. According to its revised timetable, the Panel will issue its report to the parties after the end of the 2003 calendar year. Does this have any impact on "exempt[ion] from actions" under Article 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture*? **All third parties**

51. How should the concept of specificity – and, in particular, the concept of specificity to "an enterprise or industry or group of enterprises or industries" -- in Article 2 of the *SCM Agreement* apply to subsidies in respect of agricultural commodities? Please answer the following questions, citing the principles in Article 2 of the *SCM Agreement*: **All third parties**

(a) is a subsidy in respect of all agricultural, but not other, products specific?

(b) is a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, such as livestock) specific?

(c) is a subsidy in respect of certain identified agricultural products specific?

(d) is a subsidy in respect of upland cotton, but not other products, specific?

(e) is a subsidy in respect of a certain proportion of the value of total US commodities (or total US agricultural commodities) specific?

(f) is a subsidy in respect of a certain proportion of total US farmland specific?

52. The Panel notes that different remedies are available in respect of prohibited and actionable subsidies under Article 4.7 and 7.8 of the *SCM Agreement*. If the Panel were to conclude that a subsidy was prohibited and were to make a recommendation under Article 4.7 of the *SCM Agreement* to withdraw the subsidy without delay, can the Panel:

(a) also conclude that the same subsidy had resulted in adverse effects to the interests of another Member? If so, what would be the value of such a conclusion in terms of the settlement of the matter before the Panel? **All third parties**

(b) take into account the effects of the interaction of those prohibited subsidies with other, allegedly, actionable subsidies? If so, how is this relevant to the issue of causation under Article 5 of the *SCM Agreement*? **All third parties**

53. Would a finding of serious prejudice under Article 5(c) of the *SCM Agreement* be determinative for a finding under Article XVI:1 of the GATT 1994? Why or why not? What, if any, is the role of footnote 13 of the *SCM Agreement* in this context? **All third parties**

54. Are US cotton producers able to cover the fixed and variable costs without subsidies? Please provide substantiating evidence. Of what relevance is this, if any, to Brazil's actionable subsidy claims ? **All third parties**

55. In light of the fact that certain third parties have provided submissions about the price effect of claimed US subsidies, which Member or Members is, or are, the "other party" under Article 6.3(c) ("*another Member*") for the purposes of these proceedings? **All third parties**

56. Please respond to the following questions concerning the relationship between Article XVI:3 of the GATT 1994, the disciplines on export subsidies and domestic support in the *Agreement on Agriculture* and the disciplines on prohibited export subsidies and actionable subsidies in Articles 3, 5(c) and 6.3(d) of the *SCM Agreement*. **All third parties**

(a) Are agricultural domestic support programmes challengeable under Article XVI:3 of the GATT 1994? How, if at all, is the title of Section B of Article XVI ("Additional provisions on *export subsidies*" (emphasis added)) relevant? How, if at all, are Articles 13 and 21.1, or any other provisions, of the *Agreement on Agriculture*, relevant?

(b) Are the requirements of Article XVI:3 of the GATT 1994 reflected in, developed by or subsumed by the requirements in Article 6.3(d) of the *SCM Agreement*, or in any other provisions of the covered agreements? Of what relevance, if any, is the Appellate Body Report in *US-FSC*, para. 117[1] here?

(c) Of what relevance, if any, is the fact that the definition of "subsidy" in Article 1 of the *SCM Agreement* and the prohibition on subsidies contingent upon export in

[1] WT/DS108/AB/R, para 117:

> "… the provisions of the *SCM Agreement* do not provide explicit assistance as to the relationship between the export subsidy provisions of the *SCM Agreement* and Article XVI:4 of the GATT 1994. In the absence of any such specific textual guidance, we must determine the relationship between Articles 1.1(a)(1) and 3.1(a) of the *SCM Agreement* and Article XVI:4 of the GATT 1994 on the basis of the texts of the relevant provisions as a whole. It is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the *SCM Agreement*, and, in particular, from the export subsidy provisions of both the *SCM Agreement* and the *Agreement on Agriculture*. First of all, the *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". Next, Article XVI:4 prohibits export subsidies only when they result in the export sale of a product at a price lower than the "comparable price charged for the like product to buyers in the domestic market." In contrast, the *SCM Agreement* establishes a much broader prohibition against *any* subsidy which is "contingent upon export performance". To say the least, the rule contained in Article 3.1(a) of the *SCM Agreement* that all subsidies which are "contingent upon export performance" are prohibited is significantly different from a rule that prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market. Thus, whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement*. Also, and significantly, Article XVI:4 of the GATT 1994 does not apply to "primary products", which include agricultural products. Unquestionably, the explicit export subsidy disciplines, relating to agricultural products, contained in Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* must clearly take precedence over the *exemption* of primary products from export subsidy disciplines in Article XVI:4 of the GATT 1994."

Article 3.1(a) were introduced in the Uruguay Round, but did not exist at the time that the GATT 1947 was negotiated?

# ANNEX M

## WORKING PROCEDURES AND TIMETABLE OF THE PANEL

# ANNEX M-1

## WORKING PROCEDURES FOR THE PANEL

1. In its proceedings the Panel shall follow the relevant provisions of the Dispute Settlement Understanding (DSU). In addition, the following working procedures shall apply.

2. The Panel shall meet in closed session. The parties to the dispute, and interested third parties, shall be present at the meetings only when invited by the Panel to appear before it.

3. The deliberations of the Panel and the documents submitted to it shall be kept confidential. Nothing in the DSU shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the Panel which that Member has designated as confidential. Where a party to a dispute submits a confidential version of its written submissions to the Panel, it shall also, upon request of a Member, provide a non-confidential summary of the information contained in its submissions that could be disclosed to the public.[1]

4. Before the first substantive meeting of the Panel with the parties, the parties to the dispute shall transmit to the Panel written submissions in which they present the facts of the case, their arguments and their counter-arguments, respectively. Third parties may transmit to the Panel written submissions after the first written submissions of the parties have been submitted.

5. At its first substantive meeting with the parties, the Panel shall ask Brazil to present its case. Subsequently, and at the same meeting, the United States will be asked to present its point of view. Third parties will be asked to present their views thereafter at the separate session of the same meeting set aside for that purpose. The parties will then be allowed an opportunity for final statements, with Brazil presenting its statement first.

6. All third parties which have notified their interest in the dispute to the Dispute Settlement Body shall be invited in writing to present their views during a session of the substantive meeting of the Panel set aside for that purpose. All such third parties may be present during the entirety of this session.

7. Formal rebuttals shall be made at a second substantive meeting of the Panel. The United States shall have the right to take the floor first, to be followed by Brazil. The parties shall submit, prior to that meeting, written rebuttals to the Panel.

8. The Panel may at any time put questions to the parties and to the third parties and ask them for explanations either in the course of the substantive meeting or in writing. Answers to questions shall be submitted in writing by the date(s) specified by the Panel. Answers to questions after the first meeting shall be submitted in writing at the same time as the written rebuttals, unless the Panel specifies a different deadline.

9. The parties to the dispute and any third party invited to present its views shall make available to the Panel and the other party or parties a written version of their oral statements, preferably at the end of the meeting, and in any event not later than the day following the meeting. Parties and third parties are encouraged to provide the Panel and other participants in the meeting with a provisional written version of their oral statements at the time the oral statement is presented.

[1] The Panel notes that parties have agreed between themselves as to applicable deadlines for the submission of non-confidential summaries: 14 days after the submission of the confidential version.

10. In the interest of full transparency, the presentations, rebuttals and statements shall be made in the presence of the parties. Moreover, each party's written submissions, including responses to questions put by the Panel, shall be made available to the other party.

11. The parties shall provide the Secretariat with an executive summary of the claims and arguments contained in their written submissions, oral presentations, and, if necessary, answers to questions. These executive summaries will be used by the Secretariat only for the purpose of assisting the Secretariat in drafting a concise arguments section of the Panel report so as to facilitate timely translation and circulation of the Panel report to the Members. They shall not serve in any way as a substitute for the submissions of the parties. The summaries of the first written submission and rebuttal written submission shall be limited to ten (10) pages each, and the summaries of the oral statements at the meetings will be limited to five (5) pages each. The Panel will determine the page limit for executive summaries of parties' responses to questions, if necessary and as appropriate. Third parties are requested to provide the Panel with executive summaries of their written submissions and oral presentations, of no more than 5 pages each. The executive summaries shall be submitted to the Secretariat within ten days of the original submission, presentation or, if necessary, written replies, concerned. Paragraph 17 shall apply to the service of executive summaries.

12. A party shall submit any request for preliminary ruling not later than its first submission to the Panel. If the complaining party requests such a ruling, the respondent shall submit its response to the request in its first submission. If the respondent requests such a ruling, the complaining party shall submit its response to the request prior to the first substantive meeting of the Panel, at a time to be determined by the Panel in light of the request. Exceptions to this procedure will be granted upon a showing of good cause.

13. Parties shall submit all factual evidence to the Panel no later than during the first substantive meeting, except with respect to evidence necessary for purposes of rebuttals or answers to questions. Exceptions to this procedure will be granted upon a showing of good cause. The other party shall be accorded a period of time for comment, as appropriate, on any new factual evidence submitted after the first substantive meeting**.**

14. The parties to the dispute have the right to determine the composition of their own delegations. The parties shall have the responsibility for all members of their delegations and shall ensure that all members of the delegation act in accordance with the rules of the DSU and the Working Procedures of this Panel, particularly in regard to confidentiality of the proceedings. The parties as well as third parties shall provide a list of their delegation before each meeting to Mr. Hiromi Yano (office 3036 ; e-mail hiromi.yano@wto.org ).

15. To facilitate the maintenance of the record of the dispute, and to maximize the clarity of submissions, in particular the references to exhibits submitted by parties, parties shall sequentially number their exhibits throughout the course of the dispute. For example, exhibits submitted by Brazil could be numbered BRA-1, BRA-2, etc. If the last exhibit in connection with the first submission was numbered BRA-5, the first exhibit of the next submission thus would be numbered BRA-6.

16. Following issuance of the interim report, the parties shall have two weeks to submit written requests to review precise aspects of the interim report and to request a further meeting with the Panel. The right to request such a meeting must be exercised no later than at that time. Following receipt of any written requests for review, if no further meeting with the Panel is requested, the parties shall have the opportunity, within a time-period specified by the Panel, to submit written comments on the other party's written requests for review. Such comments shall be strictly limited to responding to the other party's written request for review.

17. The following procedures regarding service of documents shall apply:

(a) Each party and third party shall serve all of its written submissions, executive summaries and written versions of oral statements, directly on all other parties, and on third parties as appropriate, and confirm that it has done so at the time it provides those submissions to the Secretariat.

(b) The parties and third parties should provide their submissions to the Secretariat by 5:30 p.m. on the deadlines established by the Panel, unless a different time is set by the Panel.

(c) The parties and third parties shall provide the Secretariat with nine paper copies of each of their written submissions. Seven of these copies should be filed with Mr. Ferdinand Ferranco (Office 3154). Two copies should be filed with the Secretary to the Panel. The final written versions of the parties' and third parties' oral statements shall be provided not later than noon of the day following the date of the presentation.

(d) The parties and third parties shall provide electronic copies of all submissions to the Secretariat at the time they provide their submissions, if possible in a format compatible with that used by the Secretariat. If the electronic version is provided by e-mail, it should be addressed to DSRegistry@wto.org, and cc'd to susan.hainsworth@wto.org, matthew.kennedy@wto.org, paul.shanahan@wto.org, thomas.friedheim@wto.org and hiromi.yano@wto.org. If a diskette is provided, it should be delivered to Mr. Ferdinand Ferranco.

(e) The Panel will endeavour to provide the parties with an electronic version of the descriptive part, the interim report and the final report, as well as of other documents as appropriate. When the Panel transmits to the parties or third parties both paper and electronic versions of a document, the paper version shall constitute the official version for the purposes of the record of the dispute.

# ANNEX M-2

## TIMETABLE

### UNITED STATES – SUBSIDIES ON UPLAND COTTON (WT/DS267)

**Timetable for Panel Proceedings**[1]

| | | |
|---|---|---|
| 1. | Establishment of the Panel: | 18 March 2003 |
| 2. | Constitution of the Panel: | 19 May 2003 |
| 3. | The following dates apply: | |
| (a) | Organizational meeting: | 28 May 2003 |
| (b) | Parties' comments on certain issues as indicated in the cover letter | 5 June 2003 |
| (c) | Third parties' comments on certain issues | 10 June 2003 |
| (d) | Parties' comments on each others' and third parties' comments submitted | 13 June 2003 |
| (e) | Issuance of Panel ruling on certain issues | 20 June 2003 |
| (f) | First submission of Brazil (complaining party) | 24 June 2003 |
| (g) | First submission of the US (party complained against) | 11 July 2003 |
| (h) | Submissions from third parties: | 15 July 2003 |
| (i) | First substantive meeting with the parties [2]: | 22, 23 July 2003<br>24 July 2003 |

[1] As was presented to parties and third parties on 28 May 2003. Subsequent changes are indicated in footnotes. Original footnote omitted.

[2] In a communication delivered on 20 June 2003 in accordance with item (e) of the timetable above, the Panel changed this meeting (including the third party session) to the "**first session of the first substantive meeting**" . The same communication also established the following dates: (a) the **Panel's view on certain issues** (i.e. issues relating to the "Peace Clause") to be issued on 1 September 2003, (b) **second session of the first substantive meeting** to be held on 7- 9 October 2003 (third party session held on 8 October), and (c) deadlines to submit further submissions for this second session: 4 September (from Brazil), 18 September (from the US) and 22 September (from the third parties). These dates were further changed by the Panel's communication dated 30 July to : (a) the Panel's view on "certain issues" on 5 September and (b) deadline to submit further submissions from Brazil by 9 September, from the US by 23 September (changed further to 29 September by the Panel's communication dated 12 September and changed again to 30 September by the Panel's communication dated 24 September), and from third parties by 29 September (changed further to

| | | |
|---|---|---|
| (j) | Third party session: | |
| (k) | Receipt of written rebuttals of the parties: | 29 August 2003 [3] |
| (l) | Second substantive meeting with the parties: | 17,18 September 2003 [4] |
| (m) | Issuance of descriptive part of the report to the parties: | 1 October 2003 [5] |
| (n) | Receipt of comments by the parties on the descriptive part of the report: | 15 October 2003 |
| (o) | Issuance of the interim report, including the findings and conclusions, to the parties: | 4 November 2003 [6] |
| (p) | Deadline for parties to request review of part(s) of report: | 18 November 2003 |
| (q) | Interim review meeting with the parties, if requested. If interim review meeting not requested, the deadline for comments on each others' comment. | 24 November 2003 |

3 October by the Panel's communication dated 12 September). The 12 September communication from the Panel established a deadline for parties to submit, before the second session of the second substantive meeting, "**further rebuttals**" by 3 November 2003. This date was further changed to 18 November by the Panel's communication dated 18 September.

[3] Changed to 22 August 2003 by the Panel's communication dated 20 June.

[4] Changed to 7, 8 October 2003 by the Panel's communication dated 20 June. These dates were subsequently changed to 2, 3 December by the Panel's communication dated 12 September. Apart from responses to Panel's questions, the Panel has established several deadlines after the second substantive meeting for parties to submit various documents. (See Panel's communications dated 14 November 2003, 8 December 2003, 24 December 2003, 12 January 2004, 3 February 2004, 16 February 2004, 20 February 2004, 24 February 2004 and 4 March 2004.)

[5] The dates for items (m) and (n) were delayed several times and were ultimately set to be 16 March and 30 March 2004, respectively, by the Panel's communication of 4 March 2004.

[6] The dates for items (o) - (r) were delayed several times and were ultimately set to be as follows, respectively, by the Panel's communication of 7 April, 2004: 26 April, 10 May, 3 June and 18 June 2004.

| | | |
|---|---|---|
| (r) | Issuance of final report to the parties: | 10 December 2003 |
| (s) | Circulation of the final report to Members: | [after translation] |

# ANNEX N

## REQUEST FOR CONSULTATIONS AND REQUEST FOR THE ESTABLISHMENT OF A PANEL

## ANNEX N-1

# WORLD TRADE ORGANIZATION

**WT/DS267/1**
**G/L/571**
**G/SCM/D49/1**
**G/AG/GEN/54**
3 October 2002
(02-5314)

Original: English

### UNITED STATES – SUBSIDIES ON UPLAND COTTON

Request for Consultations by Brazil

The following communication, dated 27 September 2002, from the Permanent Mission of Brazil to the Permanent Mission of the United States and to the Chairman of the Dispute Settlement Body, is circulated in accordance with Article 4.4 of the DSU.

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Upon instruction from my authorities, the Government of Brazil hereby requests consultations with the Government of the United States pursuant to Articles 4.1, 7.1 and 30 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement), Article 19 of the Agreement on Agriculture, Article XXII of GATT 1994 and Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).

The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton[1], as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry"). The measures include the following:

– Domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2002;[2]

– Export subsidies provided to the US upland cotton industry during marketing years 1999-2002;[3]

[1] Except with respect to export credit guarantee programs as explained below.

[2] The "marketing" year for upland cotton runs from 1 August through 31 July. For example, marketing year 2001 started on 1 August 2001 and ended on 31 July 2002. Brazil, as does the United States in its official USDA documents, treats "marketing year" to mean the same thing as "crop year".

[3] The adverse effects and serious prejudice and threat thereof created by the measures in the marketing years 1999-2007 also exists for the corresponding (somewhat overlapping) US fiscal years 2000-2008. The US government fiscal year runs from 1 October to 30 September. For example, the fiscal year for 2001 started on 1 October 2000 and ended on 30 September 2001.

– Subsidies provided contingent upon the use of US upland cotton;

– Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans, loan deficiency payments (LDPs), commodity certificates, direct payments, counter-cyclical payments, conservation payments (to the extent they exceed the costs of complying with such programs), Step 2 certificate program payments, export credit guarantees, and any other provisions of FSRIA that provide direct or indirect support to the US upland cotton industry;

– Subsidies and domestic support provided under the Agricultural Risk Protection Act of 2000 and any other measures that provide subsidies relating to crop, disaster or other types of insurance to the US upland cotton industry;

– Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to marketing loans, loan deficiency payments, commodity certificates, production flexibility contract payments, conservation payments, Step 2 certificate program payments, export credit guarantees, and any other FAIR Act provisions providing direct or indirect support to the US upland cotton industry;

– Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;

– Subsidies provided to the US upland cotton industry under the Agricultural Act of 1949 as amended;

– Export subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ("ETI Act");

– Subsidies provided under the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2002 (November 2001), the Crop Year 2001 Agricultural Economic Assistance Act (August 2001), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001 (October 2000), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 (October 1999), and the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1999 (October 1998);

– All subsidies or support measures benefiting upland cotton that have trade-distorting effects or effects on production by the US upland cotton industry, or that have an effect of providing price support for upland cotton, or that are otherwise not exempt from the reduction commitments of the United States, as described in Annex 2 of the Agreement on Agriculture, because they do not meet the policy-specific criteria and conditions set out in paragraphs 2-13 of Annex II of the Agreement on Agriculture (*i.e.* they are not so-called green box subsidies);

– Export subsidies, domestic support, and other subsidies provided under regulations, administrative procedures, administrative practices and any other present measures, amendments thereto, or future measures implementing any of the measures listed above, that provide for or facilitate the payment of domestic support, export subsidies, and other subsidies for the production, use and/or export of US upland cotton and upland cotton products.

The Government of Brazil considers that these measures are inconsistent with the obligations of the United States under the following provisions:

1. Article 5(c) of the SCM Agreement;
2. Article 6.3(b), (c) and (d) of the SCM Agreement;
3. Article 3.1(a) of the SCM Agreement including item (j) of the Illustrative List of Export Subsidies in Annex I thereto;
4. Article 3.1(b) of the SCM Agreement;
5. Article 3.2 of the SCM Agreement;
6. Article 3.3 of the Agreement on Agriculture;
7. Article 7.1 of the Agreement on Agriculture;
8. Article 8 of the Agreement on Agriculture;
9. Article 9.1 of the Agreement on Agriculture;
10. Article 10.1 of the Agreement on Agriculture; and
11. Article III:4 of GATT 1994.

Brazil is of the view that the US statutes, regulations, and administrative procedures listed above are inconsistent with these provisions as such and as applied.

The United States has no basis to assert a defense under Article 13(b)(ii) of the Agreement on Agriculture that the domestic support measures listed above are exempt from action based on Articles 5 and 6 of the SCM Agreement, because these measures provide support to upland cotton in marketing years 1999-2002 in excess of the support decided by the United States in the 1992 marketing year. Similarly, the United States has no basis to assert a defense under Article 13(c)(ii) of the Agreement on Agriculture that the export subsidies listed above are exempt from action based on Article 3, 5 and 6 of the SCM Agreement, because these export subsidies do not conform fully to the provisions of Part V of the Agreement on Agriculture, as reflected in the Schedule of the United States.

The measures listed above are subsidies because in each instance there is a financial contribution by the US government, or an income or price support in the sense of Article XVI of GATT 1994, and a benefit is thereby conferred within the meaning of Article 1.1(a) and (b) of the SCM Agreement. Each of the listed subsidies is specific to US producers of primary agricultural products and/or to the upland cotton industry within the meaning of Articles 2.1 and 2.3 of the SCM Agreement.

The use of these measures causes adverse effects, *i.e.* serious prejudice to the interests of Brazil:

– The effect of the measures is significant price depression and price suppression in the markets for upland cotton in Brazil and elsewhere during marketing years 1999-2002 in violation of SCM Articles 5(c) and 6.3(c).

– The effect of the measures is to displace or impede exports of Brazilian upland cotton in third country markets during marketing years 1999-2002, in violation of Articles 5(c) and 6.3(b) of the SCM Agreement.

– The effect of the measures is to increase the world market share of the United States for upland cotton in marketing year 2001 as compared to the average share of the United States between marketing years between 1998-2000, and by increasing its world market share for the production of upland cotton in the period from marketing year 1985 (the first year in which LDP and marketing loan payments were made for upland cotton) to marketing year

2001 from 16.7 to 20.6 percent in violation of Articles 5(c) and 6.3(d) of the SCM Agreement.

The statutes, regulations, and administrative measures listed above and the subsidies they mandate threaten – as such and as applied – to cause serious prejudice to the interests of Brazil as follows:

– By mandating conditions that will result in continued depressed and suppressed upland cotton prices for marketing years 2002 through 2007 through the guaranteed payment of subsidies to the US upland cotton industry, which artificially increases and/or maintains high-cost US upland cotton production in violation of SCM Articles 5(c) and 6.3(c); and

– By mandating conditions that will result in over-production of high-cost US upland cotton, which will continue to displace and impede Brazil's export market share in the world market and specific national markets for upland cotton, in violation of SCM Articles 5(c) and 6.3(b).

With respect to the Step 2 program, Brazil believes that the program as such and as applied to provide payments to exporters of US upland cotton is inconsistent with Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture, and with Articles 3.1(a) and 3.2 of the SCM Agreement. Brazil further believes that the program, as such and as applied to provide payments to US domestic mill users of US upland cotton, are inconsistent with Article 3.1(b) of the SCM Agreement, and Article III:4 of GATT 1994. Step 2 payments are actionable subsidies for the purpose of Brazil's claims under Articles 5 and 6.3 of the SCM Agreement.

Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, Brazil is of the view that these programs, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement. Subsidies provided under these programs are also actionable subsidies for the purpose of Brazil's claims under Article 6.3 of the SCM Agreement.

Articles 4.2 and 7.2 of the SCM Agreement together require that this request for consultations include a statement of available evidence (1) with regard to the existence and nature of the subsidies in question and (2) the adverse effects and serious prejudice to the interests of Brazil. This letter identifies the existence and nature of the subsidies, and further evidence is provided in the annex to this letter.

The Government of Brazil reserves the right to request the United States to produce information and documents regarding the measures in question and thir effect on the interests of Brazil, during the consultation process. The Government of Brazil also reserves the right to address additional measures and claims under other WTO provisions during the course of the consultations.

My authorities look forward to receiving in due course a reply from the United States to this request. Brazil is ready to consider with the United States mutually convenient dates to hold consultations in Geneva.

# ANNEX

## Statement of Available Evidence With Regard to the Existence and Nature of the Subsidies in Question and the Serious Prejudice Caused to the Interest of Brazil

1. Brazil's request for consultations dated 27 September 2002 identifies the prohibited and actionable subsidies that are the subject of this request for consultations.

2. The evidence set out below is evidence available to Brazil at this time regarding the existence and nature of those subsidies, and the adverse effects caused by them to the interests of Brazil. It reflects the presently available evidence regarding the claims reflected in Brazil's request for consultations and is supported by documents that are described and set out in United States Department of Agriculture (USDA) and non-governmental internet locations set out in paragraph 4 below. Brazil reserves the right to supplement or alter this list in the future, as required.

3. The evidence presently available to Brazil includes the following:

– US producers of upland cotton received domestic support in excess of 100 percent of the US crop value in marketing year 2001;

– US domestic and export support subsidies to upland cotton in marketing year 2001 exceeded $4 billion – far greater than the value of total US production;

– Compared with marketing year 1992, US Government subsidies to US producers of upland cotton have increased significantly, particularly for the 1999 and 2001 marketing year;

– The provisions of the 2002 Farm Bill mandate the payment of subsidies considerably in excess of those provided in the 1996 FAIR Act, including a new counter-cyclical payment program providing for more than $1 billion for marketing year 2002 at current market prices for upland cotton. The 2002 Farm Bill provides similar (although increased) payments as the FAIR act in the form of a "direct payment" program (a successor to production flexibility payments) and continues largely unchanged the loan deficiency payments, marketing loans payments, crop insurance payments, and the Step 2 program and other export subsidy programs that provided support to the US upland cotton industry prior to passage of the 2002 Farm Bill;

– For a significant number of US producers of upland cotton, total cost of production in 2001 (and from 1991 through 2000) was well *above* the US market price of upland cotton;

– Thus, without the benefit of US domestic and export subsidies, many US producers would not be able to produce upland cotton without sustaining a significant loss; current price projections for marketing years 2003-2007 indicate that US upland cotton prices are expected to remain well below the US cost of production;

– With upland cotton prices declining over the 4-year period from 1998 through 2001, US production increased from 14 million tons in marketing year 1998 to a record 20.3 million metric tons in marketing year 2001;

– In marketing year 2001 the United States was the world's largest exporter of upland cotton, with a 38 percent share. It is expected that the United States will remain by far the world's largest exporter of upland cotton in marketing year 2002;

– The volume of US exports of US upland cotton increased significantly from 946.000 metric tons in marketing year 1998 to 1.829.000 metric tons in marketing year 2001, with 1.960.000 metric tons expected to be exported in marketing year 2002;

– The effect of the US subsidies over the period of marketing years 1999-2001 was an increase in production of US upland cotton, an increase in US exports, and a corresponding significant decrease in Brazilian, world, and US prices of upland cotton;

– US year-end surplus stocks of upland cotton in marketing year 2001 increased steadily between marketing years 1999-2001 with the additional surplus creating a depressing and suppressing effect on US and world prices;

– Brazilian upland cotton is like or has characteristics closely resembling US upland cotton, is used interchangeably by customers in third country markets with US upland cotton and competes in the same markets for the same customers. Thus, the overproduction of US upland cotton suppresses and depresses the price that Brazilian producers can obtain for their upland cotton on the world and Brazilian market;

– Prices for upland cotton in Brazil follow trends created in the US and Northern European markets and experienced significant declines between marketing years 1999-2002;

– Brazilian production of upland cotton decreased between marketing year 2000 and 2001 from 939.000 to 718.000 metric tons;

– Prices for upland cotton in the Brazilian, worldwide, and other regional and third country markets were significantly depressed and suppressed over the period of marketing years 1999-2002 as a result of the effect of US subsidies;

– Prices for upland cotton in the Brazilian, worldwide, and other regional and third country markets continue to be suppressed in marketing year 2002 as a result of US subsidies;

– The world market share of the United States for upland cotton in marketing year 2001 increased over the average share of the United States between marketing years 1998-2000. In addition, the United States increased its world market share for the production of upland cotton in the period from marketing year 1985 (the first year in which LDP and marketing loan payments were made for upland cotton) to marketing year 2001 from 16.7 to 20.6 percent;

– The United States' notifications of subsidies to the WTO Committee on Agriculture provide information indicating that the loan deficiency payments (LDP), marketing loan gains, crop insurance programs, marketing loss payments, and Step 2 certificate payments made in connection with upland cotton are not "green" box payments;

– USDA econometric analyses demonstrate the actual or potential production enhancing effects for particular crops in the United States of LDP, marketing loan payments, crop insurance subsidies, and even production flexibility payments. Certain of these studies demonstrate the production enhancing effects of such subsidies on US production of upland cotton;

– Econometric studies by the International Cotton Advisory Committee, the World Bank, and the International Monetary Fund demonstrate that many of the US subsidies at issue in the consultation request have a price suppressive and depressive effect on prices of upland cotton and other crops;

– The US Step 1 and Step 2 programs, since their origin and up to the present, enhance the export competitiveness of US-produced upland cotton -- an effect consistent with the expressed purpose of such programs;

– US export credit guarantee programs have caused serious prejudice to Brazilian upland cotton producers by providing below-market financing benefits for the export of competing US upland cotton;

– US export credit guarantee programs, since their origin in 1980 and up the present, provide premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses;

– The volume of production and export of lower-cost Brazilian upland cotton have been impeded by US subsidies that have built and maintained excess US production by higher-cost US producers;

– The estimated losses suffered by Brazil due to price suppressed or depressed by US subsidies to the US upland cotton industry are well in excess of $ 600 million for marketing year 2001 alone including lost revenue, lost production, losses of related services, lost federal and state revenue, higher unemployment and losses in Brazil's trade balance.

4. The statistics, data and analytic documents supporting the summary of evidence above can be found in the following documents published by among others the US Department of Agriculture, the International Cotton Advisory Committee and the Food and Agriculture Policy Research Institute, University of Missouri as well as others:

US Department of Agriculture, Economic Research Service:
http://www.ers.usda.gov

– Comparison and Summary of 1996 and 2002 farm bills http://www.ers.usda.gov/Features/farmbill/titles/titleIcommodities.htm#c
– Briefing on Cotton
http://www.ers.usda.gov/briefing/cotton/
– Cotton and Wool Outlook: Various Editions
http://www.ers.usda.gov/publications/so/view.asp?f=field/cws-bb/
– Factors Affecting the US Farm Price for Upland Cotton, Cotton and Wool Situation and Outlook, April 1998
– Cotton and Wool Outlook: Latest Statistical Information
http://www.ers.usda.gov/briefing/cotton/Data/data.htm
– Statistical Information of the Cotton and Wool Yearbook
http://www.ers.usda.gov/data/sdp/view.asp?f=crops/89004/
– 1996 FAIR Act Frames Farm Policy for 7 Years
http://www.ers.usda.gov/publications/agoutlook/aosupp.pdf
– US Farm Program Benefits: Links to Planting Decisions & Agricultural Markets
http://www.ers.usda.gov/publications/agoutlook/oct2000/ao275e.pdf
– Production and Price Impacts of US Crop Insurance Subsidies: Some Preliminary Results
http://www.ers.usda.gov/briefing/FarmPolicy/ffc_insurrance.pdf
– Commodity Cost and Returns
http://www.ers.usda.gov/data/costsandreturns/
– Characteristics and Production Costs of US Cotton Farms
http://www.ers.usda.gov/publications/sb974-2/
– Analysis of the US Commodity Loan Program with Marketing Loan Provisions
http://www.ers.usda.gov/publications/aer801/aer801fm.pdf

- Agricultural Outlook December 1999: Ag Policy: Marketing Loan Benefits Supplement Market Revenues for Farmers
  http://www.ers.usda.gov/publications/agoutlook/dec1999/ao267b.pdf
- Farm and Commodity Policy: 1996-2001 Program Provisions
  http://www.ers.usda.gov/briefing/FarmPolicy/1996malp.htm
- Farm and Commodity Policy: Questions and Answers
  http://www.ers.usda.gov/briefing/FarmPolicy/questions/index.htm
- Farm and Commodity Policy: Crop Insurance
  http://www.ers.usda.gov/briefing/FarmPolicy/cropInsurance.htm
- Cotton: Background Issues for Farm Legislation
  http://www.ers.usda.gov/publications/CWS-0601-01/
- Cotton Policy: Special Program Provisions for Upland Cotton
  http://www.ers.usda.gov/briefing/cotton/specialprovisions.htm
- List of Studies Analyzing Market Effects of US Agricultural Policy
  http://www.ers.usda.gov/publications/tb1888/tb1888ref.pdf
- Major Agricultural and Trade Legislation, 1933–1996
  http://www.ers.usda.gov/publications/aib729/aib729a3.pdf

US Department of Agriculture, Farm Service Agency:
http://www.fsa.usda.gov

- Statistics on Price Support Loans and Loan Deficiency Payments
  http://www.fsa.usda.gov/pscad/:
- FSA Fact Sheets:
  http://www.fsa.usda.gov/pas/publications/facts/pubfacts.htm
- Fact Sheet: Upland Cotton: Locking the Adjusted World Price (AWP) by Loan Deficiency Payments on Upland Seed Cotton
  http://www.fsa.usda.gov/pas/publications/facts/html/upcotlock00.htm
- Price Support Programs
  http://www.fsa.usda.gov/dafp/psd/default.htm
- Loan Deficiency Payment and Price Support Cumulative Activity
  http://www.fsa.usda.gov/pscad/answer82rnat.asp

Congressional Budget Office Current Budget Projection:
http://www.cbo.gov/showdoc.cfm?index=1944&sequence=0

Food and Agriculture Policy Research Institute, University of Missouri:
http://www.fapri.missouri.edu/FAPRI_Publications.htm

International Cotton Advisory Committee:
http://www.icac.org/icac/english.html

- Cotton: Review of the World Situation August 2002
  http://www.icac.org/icac/CottonInfo/Publications/Reviews/english.html
- Production and Trade Policies Affecting the Cotton Industry, November 2000
- Production and Trade Policies Affecting the Cotton Industry, September 2001
- Production and Trade Policies Affecting the Cotton Industry, July 2002
  http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20053593~menuPK:34463~pagePK:34370~piPK:34424~theSitePK:4607,00.html
- Cotton: World Statistics
  http://www.icac.org/icac/CottonInfo/Publications/Statistics/statsws/english.html
- Report from Brazil on Injury From Low Cotton Prices
- Survey of Cost of Production of Raw Cotton

World Trade Organization:
– US notification on Domestic Support for Marketing Year 1998 - G/AG/N/USA/36

International Monetary Fund:
– World Economic Outlook September 2002
http://www.imf.org/external/pubs/ft/weo/2002/02/pdf/chapter2.pdf

World Bank:
– Cotton Producers Face Losses Because of Rich Country Subsidies
http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20053593~menuPK:34463~pagePK:34370~piPK:34424~theSitePK:4607,00.html

## ANNEX N-2

# WORLD TRADE ORGANIZATION

**WT/DS267/7**
7 February 2003

(03-0838)

Original: English

### UNITED STATES – SUBSIDIES ON UPLAND COTTON

Request for the Establishment of a Panel by Brazil

The following communication, dated 6 February 2003, from the Permanent Mission of Brazil to the Chairman of the Dispute Settlement Body, is circulated pursuant to Article 6.2 of the DSU.

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On 27 September, the Government of Brazil requested consultations with the Government of the United States pursuant to Articles 4.1, 7.1 and 30 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement), Article 19 of the Agreement on Agriculture, Article XXII of GATT 1994 and Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). This request was circulated to the WTO Members on 3 October 2002 as document WT/DS267/1, "United States – Subsidies on Upland Cotton". Consultations were held on 3, 4 and 19 December 2002 and on 17 January 2003 with a view to reaching a mutually satisfactory solution. Unfortunately, these consultations failed to settle the dispute.

The Government of Brazil therefore hereby requests that a panel be established pursuant to Articles 6 of the DSU, Article XXIII:2 of GATT 1994, Article 19 of the Agreement on Agriculture, and Articles 4.4, 7.4 and 30 of the SCM Agreement (to the extent that Article 30 incorporates by reference Article XXIII of GATT 1994).

The Government of Brazil further requests that the DSB initiate the procedures provided in Annex V of the SCM Agreement pursuant to paragraph 2 of that Annex. The Government of Brazil intends to put forward suggestions as to the information that should be sought under this procedure once the panel is established.

The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton[1], as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies (including export credit guarantees), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry"). The measures include the following:

[1] The term "upland cotton" means raw upland cotton as well as the primary processed forms of such cotton including upland cotton lint and cottonseed. The focus of Brazil's claims relate to upland cotton with the exception of the US export credit guarantee programs as explained below.

Domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2001[2];

Domestic support subsidies that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;

Export subsidies provided to the US upland cotton industry during marketing years 1999-2001;

Export subsides that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;

Subsidies provided contingent upon the use of US over imported upland cotton in marketing years 1999-2001 and that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;

Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans, loan deficiency payments (LDPs), commodity certificates, direct payments, counter-cyclical payments, conservation payments (to the extent they exceed the costs of complying with such programs), Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other provisions of FSRIA that provide direct or indirect support to the US upland cotton industry;

Subsidies and domestic support provided under the Agricultural Risk Protection Act of 2000 and any other measures that provide subsidies relating to crop, disaster or other types of insurance to the US upland cotton industry;

Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to marketing loans, loan deficiency payments, commodity certificates, production flexibility contract payments, conservation payments, Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other FAIR Act provisions providing direct or indirect support to the US upland cotton industry;

Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton, and other eligible agricultural commodities as addressed herein, provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;

Subsidies provided to the US upland cotton industry under the Agricultural Act of 1949 as amended;

Export subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ("ETI Act");

Subsidies provided under the Agricultural Assistance Act of 2003; Subsidies provided under the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2002 (November 2001), the Crop Year 2001 Agricultural Economic

[2] The "marketing" year for upland cotton runs from 1 August through 31 July. For example, marketing year 2001 started on 1 August 2001 and ended on 31 July 2002. Brazil, as does the United States in its official USDA documents, treats "marketing year" to mean the same as "crop year."

Assistance Act (August 2001), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001 (October 2000), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 (October 1999), and the Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1999 (October 1998);

All subsidies or support measures benefiting upland cotton that have trade-distorting effects or effects on production by the US upland cotton industry, or that have an effect of providing price support for upland cotton, or that are otherwise not exempt from the reduction commitments of the United States, as described in Annex 2 of the Agreement on Agriculture, because they do not meet the policy-specific criteria and conditions set out in paragraphs 2-13 of Annex II of the Agreement on Agriculture (*i.e.* they are not so-called "green box" subsidies);

Export subsidies, domestic support, and other subsidies provided under regulations, administrative procedures, administrative practices and any other present measures or future measures implementing or amending any of the measures listed above, that provide for or facilitate the payment of domestic support, export subsidies, and other subsidies for the production, use and/or export of US upland cotton and upland cotton products.

The measures, and any amendments to these measures, are inconsistent with the obligations of the United States under the following provisions:

1. Article 5(a) of the SCM Agreement;
2. Article 5(c) of the SCM Agreement;
3. Article 6.3(b), (c) and (d) of the SCM Agreement;
4. Article 3.1(a) of the SCM Agreement including item (j) of the Illustrative List of Export Subsidies in Annex I thereto;
5. Article 3.1(b) of the SCM Agreement;
6. Article 3.2 of the SCM Agreement;
7. Article 3.3 of the Agreement on Agriculture;
8. Article 7.1 of the Agreement on Agriculture;
9. Article 8 of the Agreement on Agriculture;
10. Article 9.1 of the Agreement on Agriculture;
11. Article 10.1 of the Agreement on Agriculture; and
12. Article III:4 of GATT 1994
13. Article XVI.1 and Article XVI.3 of GATT 1994

The US statutes, regulations and administrative procedures and any amendments thereto listed above are inconsistent with these provisions as such and as applied.

The United States has no basis to assert a defense under Article 13(b)(ii) of the Agreement on Agriculture that the domestic support measures listed above are exempt from action based on Articles 5 and 6 of the SCM Agreement, because these measures provide support to upland cotton in marketing years 1999-2001 in excess of the support decided by the United States in the 1992 marketing year. Similarly, the United States has no basis to assert a defense under Article 13(c)(ii) of the Agreement on Agriculture that the export subsidies listed above are exempt from action based on Article 3, 5 and 6 of the SCM Agreement, because these export subsidies do not conform fully to the provisions of Part V of the Agreement on Agriculture, as reflected in the Schedule of the United States.

The measures listed above are subsidies because in each instance there is a financial contribution by the US government, or an income or price support in the sense of Article XVI of GATT 1994, and a benefit is thereby conferred within the meaning of Article 1.1(a) and (b) of the SCM Agreement. Each of the listed subsidies is specific to US producers of primary agricultural

products and/or to the upland cotton industry within the meaning of Articles 2.1 and 2.3 of the SCM Agreement.

The use of measures provided to the US upland cotton industry causes adverse effects including material injury to the Brazilian upland cotton industry under SCM Article 5(a), and serious prejudice to the interests of Brazil under SCM Article 5(c) including:[3]

> The effect of the measures is significant price depression and price suppression in the markets for upland cotton in Brazil, the United States, other third country markets, and the world market during marketing years 1999-2002 in violation of SCM Articles 5(c) and 6.3(c).
>
> The effect of the measures is to displace or impede exports of Brazilian upland cotton in third country markets during marketing years 1999-2002, in violation of Articles 5(c) and 6.3(b) of the SCM Agreement.
>
> The effect of the measures is to increase the world export market share of the United States for upland cotton in marketing year 2001 as compared to the average share of the United States between marketing years 1998-2000, and by increasing its world export market share for the production of upland cotton in the period beginning with the FAIR Act in marketing year 1996 from 24 percent to 37 percent in marketing year 2001 in violation of Articles 5(c) and 6.3(d) of the SCM Agreement.
>
> The effect of the measures during marketing years 1999-2002 is to increase and maintain high levels of exports of upland cotton from the United States and to provide the United States with an inequitable share of world export trade in upland cotton in violation of Article XVI.1 and 3 of GATT 1994.

The statutes, regulations, and administrative measures and any amendments thereto listed above and the actionable subsidies they mandate threaten, as such and as applied, to cause material injury to the Brazilian upland cotton industry, and serious prejudice to the interests of Brazil including:

> By mandating conditions that are having and will continue to result in significant suppression and depression of upland cotton prices for marketing years 2002 through 2007 through the guaranteed payment of amounts of subsidies to the US upland cotton industry, which artificially increases and/or maintains high-cost US upland cotton production in violation of SCM Articles 5(c) and 6.3(c); and
>
> By mandating conditions that will result in over-production of high-cost US upland cotton, which will continue to displace and impede Brazil's export market share in the third country markets for upland cotton, in violation of SCM Articles 5(c) and 6.3(b).
>
> By mandating conditions that will result in over-production of high-cost US upland cotton, which will increase or continue to maintain high levels of exports of upland cotton from the United States in violation of SCM Articles 5(c) and 6.3(d) and continue to result in the United States having an inequitable share of world upland cotton export trade in violation of Article XVI.1 and 3 of GATT 1994.

[3] The adverse effects and serious prejudice and threat thereof created by the measures in the marketing years 1999-2007 also exists for the corresponding (somewhat overlapping) US fiscal years 2000 - 2008. The US government fiscal year runs from 1 October to 30 September. For example, the fiscal year for 2001 started on 1 October 2000 and ended on 30 September 2001.

With respect to subsidies provided under the so-called "Step 2" programmes, one type of subsidy under the programme provides payments to exporters contingent upon the export of US upland cotton and is inconsistent with Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture, and with Articles 3.1(a) and 3.2 of the SCM Agreement. Another type of subsidy under the Step-2 programme provides payments to US domestic mill users contingent upon the use of US upland cotton and is inconsistent with Article 3.1(b) and 3.2 of the SCM Agreement, and Article III:4 of GATT 1994. Brazil challenges these two types of subsidies under the Step 2 programme as such and as applied. These two Step 2 subsidies are actionable for the purpose of Brazil's claims under Articles 5 and 6.3 of the SCM Agreement.

Regarding export credit guarantees and export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and export credit guarantee measures relating to eligible US agricultural commodities, such as the GSM-102, GSM-103, and SCGP programmes, these programs violate, as applied and as such, Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Articles 3.1(a), 3.2 and item (j) of the Illustrated List of Export Subsidies included as Annex I to the SCM Agreement. Subsidies provided under these programs are also actionable subsidies for the purpose of Brazil's claims under Articles 5 and 6.3 of the SCM Agreement.

Brazil requests that a Panel be established with standard terms of reference, in accordance with Article 7 of the DSU.

Brazil asks that this request for the establishment of a Panel be placed on the agenda for the next meeting of the Dispute Settlement Body, which is scheduled to take place on 19 February 2003.

# ANNEX O

## LIST OF EXHIBITS

# ANNEX O-1

## TABLE OF EXHIBITS OF BRAZIL

| | |
|---|---|
| Exhibit BRA-1 | Draft Understanding on Rules and Procedures Governing the Settlement of Disputes, 15 June 1992 |
| Exhibit BRA-2 | Draft Understanding on Rules and Procedures Governing the Settlement of Disputes, 15 November 1993 |
| Exhibit BRA-3 | Roger Thurow and Scott Kilman, "US Subsidies Create Cotton Glut That Hurts Foreign Cotton Farms", The Wall Street Journal, 26 June 2002 |
| Exhibit BRA-4 | "Fact Sheet: Upland Cotton", USDA, January 2003. |
| Exhibit BRA-5 | "Agricultural Policies in OECD Countries – Monitoring and Evaluation 2003," OECD, 2003 |
| Exhibit BRA-6 | CCC Marketing Loan Write – Offs (Gains) – FY 1994-2002 |
| Exhibit BRA-7 | ERS Data: Commodity Costs and Returns |
| Exhibit BRA-8 | Cotton and Wool Situation and Outlook Yearbook 2002, USDA, November 2002 |
| Exhibit BRA-9 | "Cotton: World Statistics", ICAC, September 2002. |
| Exhibit BRA-10 | Cotton and Wool Outlook, 12 June 2003 |
| Exhibit BRA-11 | Cotton Outlook, 30 November 2001 and 5 April 2002 |
| Exhibit BRA-12 | "Cotton: Background for 1995 Farm Legislation", USDA, April 1995 |
| Exhibit BRA-13 | ERS Briefing Room Cotton: Background |
| Exhibit BRA-14 | "Survey of Cost of Production", ICAC, September 2001 |
| Exhibit BRA-15 | "Cultivating Poverty: The Impact of US Cotton Subsidies on Africa", Oxfam Briefing Paper 30, 27 September 2002 |
| Exhibit BRA-16 | "Characteristics and Production Costs of US Cotton Farms", USDA, October 2001 |
| Exhibit BRA-17 | Yearly A – Index Prices |
| Exhibit BRA-18 | "Prospective Plantings", USDA, 31 March 2003 |
| Exhibit BRA-19 | "Cotton this Month", ICAC, 1 April 2003 |
| Exhibit BRA-20 | Cotton and Wool Outlook, USDA, 11 April 2003 |
| Exhibit BRA-21 | "Cotton: World Markets and Trade", USDA Foreign Agricultural Service, January 2003 Edition |

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| Exhibit BRA-22 | "Cotton Marketing Weekly" dated 25 April 2003 |
| Exhibit BRA-23 | "Cotton: Total Accumulated Exports of Cotton by Country", USDA |
| Exhibit BRA-24 | "Provisions of the Agricultural Improvement and Reform Act of 1996, Appendix III: Major Agricultural and Trade Legislation, 1933-96", USDA |
| Exhibit BRA-25 | "1996 FAIR Act Frames Policy For 7 Years", Agricultural Outlook Supplement, April 1996 |
| Exhibit BRA-26 | 7 CFR 1413, Deficiency Payment Program, 1993 Edition |
| Exhibit BRA-27 | Side by Side Comparison of the 1996 and 2002 Farm Act, USDA |
| Exhibit BRA-28 | 1996 Federal Agriculture Improvement and Reform Act |
| Exhibit BRA-29 | 2002 Farm Security and Rural Investment Act |
| Exhibit BRA-30 | Federal Crop Insurance Act |
| Exhibit BRA-31 | 7 CFR 1412: Production Flexibility Contracts for Wheat, Feed Grains, Rice, and Upland Cotton, 2002 Edition. |
| Exhibit BRA-32 | 7 CFR 1427.1100 at seq.: Cottonseed Payment Program, 2002 Edition |
| Exhibit BRA-33 | 7 CFR 1400: Payment Limitation and Payment Eligibility, 2003 Edition |
| Exhibit BRA-34 | 7 CFR 1401: Commodity Certificates, in Kind Payments, and Other Forms of Payment, 2003 Edition |
| Exhibit BRA-35 | 7 CFR 1412: Direct and Counter-Cyclical Program and Peanut Quota Buyout Program, 2003 Edition |
| Exhibit BRA-36 | 7 CFR 1427.1 at seq.: Nonrecourse Cotton Loans and Loan Deficiency Payments, 2003 Edition |
| Exhibit BRA-37 | 7 CFR 1427.100 at seq.: Upland Cotton User Marketing Certificates, 2003 Edition |
| Exhibit BRA-38 | 7 CFR 1493: CCC Export Credit Guarantee Programs, 2003 Edition |
| Exhibit BRA-39 | 7 CFR 400 Excerpts: Federal Crop Insurance Corporation, 2003 Edition |
| Exhibit BRA-40 | ERS Briefing Room Cotton: Policy |
| Exhibit BRA-41 | Congressional Hearing, "The Future of Federal Farm Commodity Programs (Cotton)", House of Representatives, 15 February 2001 |
| Exhibit BRA-42 | "The 2002 Farm Act, Provisions and Implications for Commodity Markets", USDA, November 2002 |

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| Exhibit BRA-43 | 67 Federal Register, N° 203, 21 October 2002 |
| Exhibit BRA-44 | "Direct Payment and CCP Enrolment Report", USDA, 19 June 2003 |
| Exhibit BRA-45 | "Fact Sheet: Upland Cotton", USDA, June 2001 |
| Exhibit BRA-46 | "Cotton: Background and Issues for Farm Legislation", USDA, July 2001 |
| Exhibit BRA-47 | G/AG/N/USA/43 |
| Exhibit BRA-48 | "Counter-Cyclical Payments under the 2002 Farm Bill", National Cotton Council, June 2003 |
| Exhibit BRA-49 | Brazil's Questions for the purposes of Annex V Procedure, March 2003 |
| Exhibit BRA-50 | "Farm Services Agency Background Information: Non-recourse Marketing Assistance Loans and Loan Deficiency Payments", USDA, March 1998 |
| Exhibit BRA-51 | Cotton Outlook, 1 February 2002: US Price Mechanism |
| Exhibit BRA-52 | "Fact Sheet: Commodity Certificates", USDA, July 2000 |
| Exhibit BRA-53 | "NCC Delegates Focus on Farm Program Specifics", National Cotton Council, 31 January 2001 |
| Exhibit BRA-54 | "Farm Subsidy Limit Loophole Cost taxpayer Billions in Payments to Biggest Farmers", Environmental Working Group, 1 May 2002 |
| Exhibit BRA-55 | Loan Deficiency Payment and Price Support Cumulative Activity as of 6/11/2003, USDA, 13 June 2003. |
| Exhibit BRA-56 | Bruce Gardner, "American Agriculture in the Twentieth Century", Cambridge: Harvard University Press, 2002 |
| Exhibit BRA-57 | "Crop Year Statistics", Federal Crop Insurance Corporation |
| Exhibit BRA-58 | "US Crop Insurance: Premiums, Subsidies & Participation", USDA, Agricultural Outlook, December 2001 |
| Exhibit BRA-59 | "Briefing Room: Farm and Commodity Policy: Crop Yield and Revenue Insurance", USDA |
| Exhibit BRA-60 | RMA Online, Crop Policies, 23 March 2003 |
| Exhibit BRA-61 | "NCC Summary of Key Provisions of Crop Insurance Reform Legislation", NCC. |
| Exhibit BRA-62 | RMA Online – Crops Covered under the 2002 Crop insurance Program |
| Exhibit BRA-63 | "Production and Price Impacts of US Crop insurance Subsidies: Some Preliminary Results" |

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| Exhibit BRA-64 | "Weak Demand Dampens Outlook for US Cotton", USDA Agricultural Outlook, November 1999 |
| Exhibit BRA-65 | Upland Cotton Domestic User/Exporter Agreement |
| Exhibit BRA-66 | Sample Format Weekly Consumption/Application For Payment Report |
| Exhibit BRA-67 | Cotton Outlook |
| Exhibit BRA-68 | "Weekly Step 2 Certificate Values". EconCentral, National Cotton Council of America, 13 June 2003 |
| Exhibit BRA-69 | Step 2 Domestic and Export payments by US Fiscal Year |
| Exhibit BRA-70 | "Export News and Opportunities", USDA Foreign Agricultural Service |
| Exhibit BRA-71 | "Fact Sheet: CCC Export Credit Guarantee Programs (GSM-102/103" |
| Exhibit BRA-72 | "Fact Sheet: CCC Supplier Credit Guarantee Program" |
| Exhibit BRA-73 | Summary of Export Credit Gurantee Programs, FY 1999-2003 |
| Exhibit BRA-74 | Farm Service Agency News Room, Release N° 1532.03, 25 April 2003 |
| Exhibit BRA-75 | Stewart, Terrence, The GATT Uruguay Round, A Negotiating History, Vol. IV, p. 24-25 |
| Exhibit BRA-76 | CCC Loan Deficiency Payments – FY 1994-2002 |
| Exhibit BRA-77 | "Fact Sheet: Agricultural Assistance Act of 2003", February 2003. |
| Exhibit BRA-78 | G/AG/N/USA/17 |
| Exhibit BRA-79 | "US Farm Program Benefits: Links to Planting Decisions & Agricultural Markets", Agricultural Outlook, October 2000 |
| Exhibit BRA-80 | "How Decoupled Is US Agricultural Support for Major Crop", American Journal of Agricultural Economy 82, August 2000 |
| Exhibit BRA-81 | Ivan Roberts and Frank Jotzo, "2002 US Farm Bill: An Australian Perspective on its Impact", ABARE, Australian Commodities, Vol. 9, N° 2 June Quarter 2002 |
| Exhibit BRA-82 | "USDA Baseline Projections", USDA, February 2003 |
| Exhibit BRA-83 | Schedule XX of the United States of America, part IV, Section II entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments |
| Exhibit BRA-84 | G/AG/W/56 |
| Exhibit BRA-85 | "FATUS Export Aggregations" |
| Exhibit BRA-86 | "FAS Agricultural Export Commodity Aggregations" |

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| Exhibit BRA-87 | Testimony of August Schumacher Jr., Under Secretary, Farm and Foreign Agricultural Service, USDA, before the Subcommitte on General Farm Commodities, Hearing on the Asian Financial Crisis, 4 88February 1998 |
| Exhibit BRA-88 | US Budget for Fiscal Year 2003 |
| Exhibit BRA-89 | US Budget for Fiscal Year 2002 |
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| Exhibit BRA-94 | US Budget for Fiscal Year 1997 |
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| Exhibit BRA-103 | "1993 Cotton Management Economic Notes", University of Arizona, 27 July 1993. |
| Exhibit BRA-104 | CV and Selected Publications of Professor Daniel Sumner |
| Exhibit BRA-105 | Statement by Professor Daniel Sumner at the First Meeting of the Panel. |
| Exhibit BRA-106 | "United States State Fact Sheet", ERS, USDA Data, 15 July 2003. |
| Exhibit BRA-107 | "US and State Farm Income Data, Farm Cash Receipts, 1924-2001," ERS, USDA, June 2003. |
| Exhibit BRA-108 | « United For Profits », National Cotton Council Organizational Chart and Membership. |

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| Exhibit BRA-109 | Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, Before the House Agricultural Committee. National Cotton Council (NCC) |
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| Exhibit BRA-145 | US and State Farm Income Data, (United States and States 1997-2001), USDA |
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| Exhibit BRA-169 | Market Revenue and US Government Payments to US Upland Cotton Producers |
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| Exhibit BRA-172 | Rice Outlook, USDA, 13 August 2003, Table 1 |
| Exhibit BRA-173 | Revised Estimate of Support Granted by Commodity via Countercyclical Payments. |

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| Exhibit BRA-190 | Affidavit of Marcelo Pinheiro Franco |
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| Exhibit BRA-192 | Reestimated Guaranteed Loan Subsidy based on Original Budget Year Estimate. |
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| Exhibit BRA-194 | US Department of Agriculture Office of Inspector General Great Plains Region Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report N° 06401-4-KC, February 2002 |
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| Exhibit BRA-202 | Agricultural Outlook Tables, USDA, August 2003 |
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| Exhibit BRA-204 | "USDA's Cotton Classification Overview" |
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| Exhibit BRA-209 | Yearly A-Index Prices |
| Exhibit BRA-210 | "Production and Trade Policies Affecting the Cotton Industry," ICAC, July 2002. |

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| Exhibit BRA-272 | Fact Sheet: Adjusted Gross Revenue, Risk Management Agency, USDA, February 2003 |
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| Exhibit BRA-279 | Statement by Professor Daniel Sumner |
| Exhibit BRA-280 | "Brief Review of Empirical Assessments of Production Impacts of US Upland Cotton Subsidies" by Professor Daniel Sumner. |
| Exhibit BRA-281 | Statement by Andrew Macdonald |
| Exhibit BRA-282 | "About the Liverpool Cotton Association," The Liverpool Cotton Association Ltd. |
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| Exhibit BRA-300 | Calculation on US Rice Exports Benefiting from GSM-102, GSM-103 and SCGP. |
| Exhibit BRA-301 | Additional Results from Professor Sumner's Model. |
| Exhibit BRA-302 | Revised and Extended Data on Article 6.3(d) Claim. |
| Exhibit BRA-303 | John C. Beghin and Holger Matthey. "Modelling World Peanut Product Markets: A Tool for Agricultural Trade Policy Analysis." Center for Agricultural and Rural Development (CARD), May 2003. |
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| Exhibit BRA-311 | Side by Side Chart of the Weekly US Adjusted World Price, the A-Index, the nearby New York Futures Price, the Average US Spot Market Price and Prices Received by US Producers from January 1996 to the present. |
| Exhibit BRA-312 | Cotton Outlook Reports dated 7 June 2002, 27 September 2002 and 4 October 2002. |
| Exhibit BRA-313 | Analysis of Counterfactual Retrospective Scenarios and Prospective Scenarios of Elimination of Upland Cotton Subsidies in the United States using an elaboration of the FAPRI/CARD Modeling Framework |
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| Exhibit BRA-316 | Statement of Christopher Campbell- Environmental Working Group. |
| Exhibit BRA-317 | EWG Database: Tables of Results |
| Exhibit BRA-318 | Discussions Held With FSA Contacts in County and State Offices. |
| Exhibit BRA-319 | FSA-578 Manual: Report of Acreage |
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| Exhibit BRA-323 | Costs and Returns of US Upland Cotton Farmers MY 1997-2002 |
| Exhibit BRA-324 | NCC Chairman's Report by Kenneth B. Hood, 24 July 2002 |
| Exhibit BRA-325 | Results of Professor Sumner's Modified Model Based on the January 2003 FAPRI Baseline |
| Exhibit BRA-326 | Results of Professor Sumner's Modified Model |
| Exhibit BRA-327 | Cotton Marketing Weekly, O.A. Cleveland, 7 November 2003 |
| Exhibit BRA-328 | Cotton and Wool Outlook, USDA, 14 October 2003 |
| Exhibit BRA-329 | Cotton and Wool Situation and Outlook Yearbook, Table 16, USDA, November 2002**.** |
| Exhibit BRA-330 | Agricultural Exchange Rate Data Set, ERS, USDA |

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| Exhibit BRA-342 | Statement of Professor Daniel Sumner – 2 December 2003 |
| Exhibit BRA-343 | Response to US Statements about Access to Background Information about my US Cotton Policy Simulation Results |
| Exhibit BRA-344 | Discussion of the US Critique of Third Party Studies of the Economic Effects of US Cotton Subsidies |
| Exhibit BRA-345 | Response to Further US Criticisms of the Annex I Model of the Effect of US Cotton Subsidies |
| Exhibit BRA-346 | Email Exchange between Professor Bruce Babcock and Dr. Joseph Glauber, 26 November 2003 |
| Exhibit BRA-347 | Brazilian Exports, MY 1999-2002 |
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| Exhibit BRA-349 | Comparison of US and Brazilian Exports, MY 1999-2002 |
| Exhibit BRA-350 | Weekly Step 2 Certificate Values, National Cotton Council, 28 November 2003 |

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| Exhibit BRA-351 | BICO Export Commodity Aggregations (Values), USDA, FSA dated 21 November 2003 |
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| Exhibit BRA-353 | Cumulative Loss from Upland Cotton Production MY 1997-2002 Without US Contract Payments |
| Exhibit BRA-354 | "Brazilian Soybeans – Can Iowa Farmers Compete?" Iowa State University, December 2000 |
| Exhibit BRA-355 | US Acreage Response to Futures Prices at Planting Time |
| Exhibit BRA-356 | January – March Quotes of the December Futures Contract, Expected and Actual AWP and Cash Price |
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| Exhibit BRA-359 | 30 October and 25 November Cotton Futures Quotes |
| Exhibit BRA-360 | Adjusted World Price v Nearby Futures Price (1996-present) |
| Exhibit BRA-361 | Cotton Pricing Guide, July 2001 |
| Exhibit BRA-362 | Suspension of Anti-Dumping Duty Investigation: Cold-Rolled Flat Rolled Carbon-Quality Steel Products from the Russian Federation, Department of Commerce, 4 February 2000 |
| Exhibit BRA-363 | Global Steel Trade, Chapter 7: Avoiding Future Crises, Department of Commerce |
| Exhibit BRA-364 | 2003 US Budget, Federal Credit Supplement, Table 8 |
| Exhibit BRA-365 | 2002 US Budget, Federal Credit Supplement, Table 8 |
| Exhibit BRA-366 | 7 U.S.C. § 5622 |
| Exhibit BRA-367 | Section 3203 of the 2002 FSRI Act |
| Exhibit BRA-368 | Second Statement of Christopher Campbell – Environmental Working Group, 1 December 2003 |
| Exhibit BRA-369 | Brazil's Request to the United States for Farm – Specific Planting and Base Acreage Data, 3 December 2003 |
| Exhibit BRA-370 | The Difference between the Average World Price and the Nearby December Futures Contract Price |
| Exhibit BRA-371 | Simple Example of the Calculations of Marketing Lon Benefits (Probability Distribution) |
| Exhibit BRA-372 | Negotiating History of Articles 6.3(c) and 6.5 of the SCM Agreement |

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| Exhibit BRA-373 | Loan Deficiency Payment and Price Support Activity as of 12/3/2003 |
| Exhibit BRA-374 | "Crop Year Statistics MY 2002" – Federal Crop Insurance Corporation |
| Exhibit BRA-375 | Information Provided by Gerald Estur, ICAC. |
| Exhibit BRA-376 | "About FAPRI," Center for Agricultural and Rural Development, Iowa State University |
| Exhibit BRA-377 | "About FAPRI," Food and Agricultural Policy Research Institute at the University of Missouri. |
| Exhibit BRA-378 | "About FAPRI," Food and Agricultural Policy Research Institute. |
| Exhibit BRA-379 | CARD Report, 40 Anniversary Commemorative Issue |
| Exhibit BRA-380 | "Food and Agriculture Policy Research Institute Receives USDA's Highest Honor," CARD Press Release, 9 July 2002. |
| Exhibit BRA-381 | Jeffrey D. McDonald and Daniel A. Sumner. "The Influence of Commodity Programs on Acreage Responses to Market Price: With and Illustration concerning Rice Policy in the United States." American Journal of Agricultural Economics, (85) 4 November 2003. |
| Exhibit BRA-382 | Cotton and Wool Outlook, USDA, 12 December 2003. |
| Exhibit BRA-383 | Brazil and US Export Data on Export Quantities and Values by Country |
| Exhibit BRA-384 | Import Prices from Various Countries |
| Exhibit BRA-385 | Domestic Prices from Various Countries |
| Exhibit BRA-386 | Brazil and US Export Prices by Country |
| Exhibit BRA-387 | Brazil Export Prices v A-Index Prices by Country |
| Exhibit BRA-388 | US Export Prices v A-Index Prices by Country |
| Exhibit BRA-389 | Brazilian Domestic Price Data |
| Exhibit BRA-390 | "Glickman Proposes Cottonseed Payment Program," USDA News Release, 29 February 2000. |
| Exhibit BRA-391 | Cost of Ginning and Value of Cottonseed per pound of Cotton Lint |
| Exhibit BRA-392 | "William Duvanant Says: Overproduction Thwarts Cotton price Upturn," Western Farm Press. |
| Exhibit BRA-393 | Futures Prices as of 19 December 2003 |

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| Exhibit BRA-394 | Agricultural Outlook Tables, USDA, November 2003, Table 19 |
| Exhibit BRA-395 | "Trade Issues Facing the US Cotton Industry," Speech by Dr. Mark Lange, President and CEO, National Cotton Council, 6 January 2004. |
| Exhibit BRA-396 | "Farm Groups Shocked at UC Economist's Testimony in WTO Dispute," Western Farm Press, 2 September 2003. |
| Exhibit BRA-397 | "Report of the Commission on the Application of Payment Limitations for Agriculture," August 2003. |
| Exhibit BRA-398 | Western Farm Press, 7 January 2003 |
| Exhibit BRA-399 | Acreage Discrepancies.xls |
| Exhibit BRA-400 | List of Publications of Professors Babcock and Beghin |
| Exhibit BRA-401 | Second Declaration of Andrew Macdonald, 27 January 2004. |
| Exhibit BRA-402 | "Genetically Engineered Cotton Suffering from Production Problems," Organic Consumers Organization, 11 January 2002. |
| Exhibit BRA-403 | "NCC will Intensify Emphasis for Quality, Yield Answers," Western Farm Press, 3 March 2001. |
| Exhibit BRA-404 | "Benefits - BT Cotton," Monsanto Imagine. |
| Exhibit BRA-405 | "Sample Costs to Produce Cotton Transgenic Herbicide- Resistant Acala Variety," San Joaquin Valley, University of California Cooperative Extension, 2003. |
| Exhibit BRA-406 | "Cotton Cost-Return Budget in Southwest Kansas," Kansas State University Agricultural Experiment Station and Cooperative Extensive Service, October 2003. |
| Exhibit BRA-407 | Documents on Cost of Production Insurance Plan for Cotton. |
| Exhibit BRA-408 | Export – Import Bank of the United States, Standard Repayment Terms. |
| Exhibit BRA-409 | Ex-Im Bank Fee Schedule. |
| Exhibit BRA-410 | Export Insurance Services. |
| Exhibit BRA-411 | "The Federal Scoop: US Government Financing for Service Exports," Export America, May 2003. |
| Exhibit BRA-412 | Cotton and Wool Situation Outlook and Outlook Yearbook, USDA, November 2003, Table 16. |
| Exhibit BRA-413 | "Agricultural Cash Rents," USDA, NASS, July 1999. |
| Exhibit BRA-414 | "Agricultural Land Values and Cash Rents," USDA, NASS, August 2003. |
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| Exhibit BRA-416 | "What is a Farm Bill?," Congressional Research Service, Report for Congress, 5 May 2001. |
| Exhibit BRA-417 | "Commodity Program Entitlements: Deficiency Payments," USDA, May 1993. |
| Exhibit BRA-418 | Washington Post v. United States Department of Agriculture, 943 F. Supp. 31 (D.D.C. 1996). |
| Exhibit BRA-419 | Allocation Calculations Based on Brazil's Methodology and US Summary Data. |
| Exhibit BRA-420 | Agricultural Outlook Tables, November 2003, Table 17. |
| Exhibit BRA-421 | ERS Briefing Room: Farm Income and Costs: US Farm Sector Cash Receipts from Sales of Agricultural Commodities, USDA. |
| Exhibit BRA-422 | Fruits and Tree Nuts Yearbook, USDA, October 2003, Table A-2. |
| Exhibit BRA-423 | Vegetables and Melons Yearbook, USDA, July 2003, Table 3. |
| Exhibit BRA-424 | Allocation Calculations Based on US Methodology and US Summary Data. |
| Exhibit BRA-425 | Dresser Industries v United States, 596 F.2d 1231 (5th Cir. 1979) |
| Exhibit BRA-426 | Center for Auto Safety v National Highway Traffic Safety Administration, 244 F.3d 144 (DC Cir 2001) |
| Exhibit BRA-427 | CNA Financial Corporation v Donovan, 830 F.2d 1132 (DC Cir 1987) |
| Exhibit BRA-428 | United States Department of Justice at al. v Reporters Committee for the Freedom of the Press et al., 489 US 749 (1989) |
| Exhibit BRA-429 | Metadure Croporation v United States, 490 F. Supp. 1368 (S.D.N.Y. 1990) |
| Exhibit BRA-430 | Campaign for Family Farms v Glickman, 200 F.3d 1180 (8th Cir. 2000) |
| Exhibit BRA-431 | Comparison of US and Brazil's Cash-Basis Accounting Methodologies for Purposes of the Item (j) Analysis |
| Exhibit BRA-432 | Congressional Budget Office, Fact Sheet, row titled "Export Credit Guarantee Program, Subsidy Account" |
| Exhibit BRA-433 | 'Calculations Acreage Based Methodologies.xls' provided in electronic format |
| Exhibit BRA-434 | 'Calculations Value Based Methodologies.xls' provided in electronic format |

# ANNEX O-2

## LIST OF EXHIBITS OF THE UNITED STATES

| | |
|---|---|
| US-1 | 2002 Farm Security and Rural Investment Act, Public Law 107-171, 116 Stat. 134 (13 May 2002) (Title I) |
| US-2 | 57 *Federal Register* 14,326 (20 April 1992) |
| US-3 | 7 C.F.R. Part 1413 (1 January 1993) |
| US-4 | 7 C.F.R. 1413.6 (1991 ed.) |
| US-5 | 7 U.S.C. § 1444-2 (1992 supp.) |
| US-6 | 7 C.F.R. Part 1493 (2003) (excerpts) |
| US-7 | Organization for Economic Co-operation and Development, *The Chairman's Revised Proposal for a Sector Understanding on Export Credits for Agricultural Products*, TD/CONSENSUS(2000)25/REV4 (9 July 2002) |
| US-8 | Cairns Group, *Negotiating Proposal on Export Competition*, JOB(02)/186 (20 November 2002) |
| US-9 | *Negotiations on Agriculture: First Draft of Modalities for the Further Commitments*, TN/AG/W/1/Rev.1 (18 March 2003) |
| US-10 | MERCOSUR *et al.*, *Export Credits for Agricultural Products*, G/AG/NG/W/139, G/AG/W/50 (21 March 2001) |
| US-11 | 2 U.S.C. §§ 661 *et seq.* (2003) |
| US-12 | Examples of export credit guarantee program announcements issued pursuant to applicable program regulations (7 C.F.R. §§ 1493.10(d), 1493.400(d)) |
| US-13 | Schedule XX – United States of America, Part IV, Section II: Export subsidy reduction commitments |
| US-14 | 2002 Crop Cottonseed Regulations, 68 *Federal Register* 20,331 (25 April 2003) |
| US-15 | Regulations to disburse the 2000 crop cottonseed payment, 65 *Federal Register* 65,718 (2 November 2000) |
| US-16 | 1999 Crop Cottonseed Program Regulations, 65 *Federal Register* 36,563 (8 June 2000) |
| US-17 | US Department of Agriculture, Upland Cotton Fact Sheet (September 1992) |
| US-18 | USDA budget data (MY1999 & MY2000 marketing loan payments) (www.fsa.usda.gov/dam/BUD/estimatesbook.htm) |

US-19 Marketing Year 2002 Loan Deficiency Payment and Price Support Cumulative Activity As of 3/12/2003

US-20 Schedule of current fees paid by an exporter participating in either the GSM-102 or GSM-103 program

US-21 Recently updated program documents for the Step 2 program

US-22 The Agricultural Market Transition Act, Title I of the Federal Agriculture Improvement Act of 1996, Public Law No. 104-127 (4 April 1996)

US-23 The Production Effects of Decoupled Payments, by Dr. Joseph W. Glauber, Deputy Chief Economist, US Department of Agriculture

US-24 Calculating the Per-Unit Rate of Support, by Dr. Joseph W. Glauber, Deputy Chief Economist, US Department of Agriculture (22 August 2003)

US-25 MTN.GNG/NG5/W/170 (11 July 1990)

US-26 MTN.GNG/AG/W/1 (24 June 1991)

US-27 MTN.GNG/AG/W/1/Add.1 to Add.11 (2 August 1991)

US-28 Uruguay Round Agriculture Negotiations, Discussion Paper, Draft Text on Agriculture (12 December 1991)

US-29 Agriculture text of the Draft Final Act, MTN.TNC/W/FA (20 December 1991)

US-30 Articles 1 - 3 and the Illustrative List of Export Subsidies within the Draft SCM Agreement of the Draft Final Act, MTN.TNC/W/FA

US-31 Budget Summary GSM-102, 103 and Supplier Credit; Subsidy Estimates and Reestimates by Fiscal Year; Fiscal Years 1992 through 2004

US-32 United States Department of Agriculture, Advice of Allotment, Allotment Numbers 01-CCC-47; 02-CCC-28; 02-CCC-27; 03-CCC-26

US-33 Status of Reschedulings for CCC Export Credit Guarantee Program activity for fiscal years 1992-2002

US-34 World Trade (December 1998)

US-35 "Financial Know-How Pays Off," Journal of Commerce (14 June 1995)

US-36 Financial Times (27 January 1994)

US-37 Latin Finance, 1 June 1999, "Brazil Bounces Back," pg. S16; Trade Finance, 1 October 2002. "Forfaiters Seek Eastern Promise," No. 8, vol. 5, pg. SS7

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US-41 Foreign Agricultural Service, US Department of Agriculture, Export Credits Sales Registration Data

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US-44 Marketing loan rate and A-Index prices, MY 1996-2002 (graph and data)

US-45 Harvest season futures prices at planting and US loan rate, MY1996-2002 (graph and data)

US-46 Low US Northern Europe quote and A-Index, 1999-2003 (graph and data)

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US-64 Lin, W., et al.. Supply Response Under the 1996 Farm Act and Implications for the US Field Crops Sector. US Department of Agriculture, Economic Research Service, Technical Bulletin No. 1888, Appendix table 21

US-65 Amount and percentage of upland cotton acreage coverage by crop insurance policy

US-66 Premiums paid by upland cotton producers

US-67 Insurance indemnity payments to upland cotton producers

US-68 New York Cotton Futures, Average Daily Closing Prices for December 2003 Contract (chart and data)

US-69 US Department of Agriculture, Economic Research Service, Cost of Production Estimates; Commodity-Weighted Exchange Rate Estimates

US-70 US and Rest of World Exports of Upland Cotton, Year-Over-Year Percent Change, 1996-2002

US-71 US Exports and Domestic Consumption of Upland Cotton, 1996-2002

US-72 US Department of Agriculture, Press Release on Adjusted World Price (18 October 2003)

US-73 Weekly Price Movements: Adjusted World Price, Liverpool A-Index, New York cotton futures, spot market price, January 1996 to present

US-74 National Agricultural Statistics Service, Planted Acreage of Selected Crops by Region and State

US-75 Chart and Table of US and Brazilian Unit Value Prices to Various Third-Country Markets

US-76 Dr. Joseph W. Glauber, US Department of Agriculture, Estimating Cotton Price Volatility

US-77 Hennessy, D. "The Production Effects of Agricultural Income Support Policies Under Uncertainty." American Journal of Agricultural Economics 80(1998):46-57.

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US-90 US Department of Agriculture, Agricultural Marketing Service: Cotton Price Statistics (October 2003):18 (table 13)

US-91 Detailed Critique of Third-Party Economic Studies

US-92 Year-to-date MY2003 A-index prices, daily

US-93 US Department of Agriculture, unofficial marketing year 2002 marketing loan payments for soybeans corn, and wheat

US-94 US Department of Agriculture, Farm Services Agency, summary of marketing year 2002 enrolled direct and counter-cyclical payment base acres, upland cotton farms

US-95 Comparison of MY2002 enrolled direct and counter-cyclical payment base acres for upland cotton to NASS upland cotton planted acres

US-96 Total US upland cotton planted acreage, MY2001-2003, by state

US-97 US MY2002 upland cotton exports to Argentina, Bolivia, and Paraguay

US-98 E-mail communication from S. Tokarick, International Monetary Fund

US-99 Preparatory Committee for the World Trade Organization, *Notification Requirements and Formats Under the WTO Agreement on Agriculture*, PC/IPL/12, circulated 2 December 1994

US-100 US Notification, G/AG/N/USA/47, circulated 6 June 2003

US-101 [This exhibit number was not used.]

US-102 Excerpts from Exhibit BRA-369

US-103 US Freedom of Information Act

US-104 US Department of Agriculture, Decision under FOIA (11 April 2002)

US-105 7 C.F.R. § 1.14

US- 106 US Department of Agriculture, Farm Services Agency, FOIA Handbook (excerpts)

US-107 5 U.S.C. § 552a(b)

US-108 Excerpt of BRA-316

US-109 Description of electronic file "Pfcby.txt."

US-110 Description of electronic file "Pfcplac.txt."

US-111 Description of electronic file "Dcpby.txt"

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| US-112 | Description of electronic file "Dcpplac.txt" |
| US-113 | Graphical representation of scope and disclosure of Brazil's modeling system |
| US-114 | Letter from Dr. Bruce Babcock (10 December 2003) |
| US-115 | Electronic version of spreadsheets referenced in US Comments Concerning Brazil's Econometric Model |
| US-116 | Electronic version of spreadsheet referenced in US Comments Concerning Brazil's Econometric Model |
| US-117 | 7 CFR §§ 1427.13 and 1427.19 (2000 ed.) |
| US-118 | 7 CFR §§ 1427.13 and 1427.19 (2003 ed.) |
| US-119 | USDA Office of the Chief Economist, *World Agricultural Supply and Demand Estimates* (11 December 2003) |
| US-120 | USDA, Economic Research Service, Fibers Yearbook, Appendix Table 2, Upland Cotton Supply and Use |
| US-121 | US General Accounting Office. *Agriculture in Transition: Farmers' Use of Risk Management Strategies*. GAO/RCED-99-90. April 1999. |
| US-122 | Total open interest for all cotton futures contracts on the New York Board of Trade for 18 December 2003 |
| US-123 | Total open interest for all cotton options contracts on the New York Board of Trade for 18 December 2003 |
| US-124 | Daily December Futures Closing Prices ($/lb) (New York Board of Trade) |
| US-125 | Statement of Federal Financial Accounting Standards No. 18: Amendments To Accounting Standards for Direct Loans and Loan Guarantees In Statement of Federal Financial Accounting Standards No. 2, Appendix B: Schedule B, entitled "Schedule for Reconciling Loan Guarantee Liability Balances." |
| US-126 | Calculations of "additional marketing loan facilitated revenue" realized per pound of cotton, MY 1998-2003 (partial year) |
| US-127 | Statement of Federal Financial Accounting Standards No. 2: Accounting for Direct Loans and Loan Guarantees, issued 23 August 1993, pp. 187-267 |
| US-128 | Chart of data from 1992 to 2003 (as of 30 November 2003) for GSM 102, 103 and SCGP with respect to: (i) cumulative outstanding guarantees; (ii) claims paid; (iii) recoveries made; (iv) revenue from premiums; (v) other current revenue, including interest earned; (vi) interest charges paid; and (vii) administrative costs of running the programmes |
| US-129 | Commodity Credit Corporation Consolidated Statement of Net Cost (Note 13) for the Fiscal Year Ended 30 September 2002 |

US-130 Statement of Federal Financial Accounting Concepts and Standards (May 2002), Appendix E, pages 1140-1141

US-131 Inae Riveras, Brazil's Mato Grosso to triple winter cotton area (Reuters 2004-01-20)

US-132 Chart, US Crops Cotton supply and utilization, and Baseline

US-133 O.A. Cleveland, Cotton Market Weekly, 1/16/04

US-134 Charts of US and Brazilian Export Unit Values to 7 Destinations

US-135 Production, Yield, Trade, and Stocks Data, MY99-02

US-136 USDA/FAS US trade data, MY99-03

US-137 World Trade Atlas official Brazilian trade data, MY99-03

US-138 Statement of the United States at the Dispute Settlement Body (9 January 2004) on adoption of the reports in *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products for Japan*

US-139 USDA Weekly Cotton Market Review 1/9/04

US-140 USDA Weekly Cotton Market Review 1/23/04

US-141 Charts of Chinese (Domestic, Import, Export) Prices vs. A-Index

US-142 NY Board of Trade, NY Cotton Exchange, 27 January 2004 futures data

US-143 Memorandum from Larry Mitchell, USDA Farm Services Agency, to Various FSA Offices, Administrators, and Divisions on Release of Restricted Information under the Freedom of Information Act (18 September 1998)

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US-146 USDA, Commodity Credit Corporation, 58 *Federal Register* 15755-15756 (24 March 1993).

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US-148 Data in response to Panel Question 264(d): Claim Payments/ Recoveries/ Reschedulings on a Fiscal Year/ Cash Basis

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| US-151 | United States Office of Management and Budget Circular No. A-129 (November 2000), Table of Contents, General Information, Appendix A, Sections I and II. |
| US-152 | Commodity Credit Corporation Realized Losses and Appropriations to Restore Such Losses for Fiscal Years 1992-2003 |
| US-153 | Summary of Principal Terms, Conditions, and Duration of Each Rescheduling Reflected in Column F of Exhibit US-128 |
| US-154 | Partially Corrected Calculations Allocating Decoupled Payments for Upland Cotton Base Acres to Upland Cotton Using Incomplete Annex IV Methodology |
| US-155 | *Report of the Commission on the Application of Payment Limitations for Agriculture*, Chapter 5 (2003) |

**WORLD TRADE ORGANIZATION**

**WT/DS267/R/Corr.1**[*]
8 September 2004

(04-3687)

Original: English

# UNITED STATES – SUBSIDIES ON UPLAND COTTON

## *Report of the Panel*

Corrigendum

The following corrections should be made to document WT/DS267/R:

paragraph 6.9
"paragraph 7.227" should read "paragraph 7.277".

paragraph 6.22
"paragraph 7.6314" should read "paragraph 7.634".

paragraph 6.52
"footnote 1374" should read "footnote 1432".

paragraph 7.294
"Brazil's taking of 'legal steps to establish a claim' " should read "Brazil's 'taking of legal steps to establish a claim' ".

paragraph 7.688
"Article 13(b)(ii) of the *SCM Agreement*" should read "Article 13(b)(ii) of the *Agreement on Agriculture*".

paragraph 7.691
"Article 1.1(a)2(ii)" should read "Article 1.1(a)(1)(ii)".

footnote 993
"Question No.229" should read "Question No.228".

footnote 1052
"para. 7.866" should read "para. 7.843".

paragraph 7.1131
The following changes should be made in the 4th sentence:
(i) The first pair of quotation marks should be deleted.
(ii) The first pair of double quotation marks should be deleted.
(iii) The term "certain identified agricultural products" as it first appears in the sentence should be deleted (together with the quotation mark).
(iv) A quotation mark should be put before the word "all" and after the close bracket.

[*] In English only.

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paragraph 7.1140
"enterprise" should read "enterprises".

footnote 1313
"*DSU*" should read "*SCM Agreement*".

paragraph 7.1207
"subsidized Member" should read "subsidizing Member".

footnote 1333
The words "subsidized product" and "like product" that appear in the second and third lines, respectively, should be in italics.

paragraph 7.1227
"adverse effects to the interests" should read "adverse *effects* to the interests", and "(c) the effect of the subsidy is" should read "(c) the *effect* of the subsidy is".

footnote 1358
"Article 16.4" should read "Article 16.2".

paragraph 7.1246
The word "cotton" that appears in the first line should be deleted.

footnote 1429
"(MTN/GNG/NG19/W/38/Rev.2)" should read "(MTN/GNG/NG10/W/38/Rev.2)".

footnote 1431
"to request a finding" should read "to make a finding".

paragraph 7.1401
"is capable of" should read "are capable of ".

paragraph 7.1430
"*WTO Agreement*" should read "*SCM Agreement*".